

Ahli United Bank B.S.C.

CONSOLIDATED FINANCIAL STATEMENTS

31 DECEMBER 2017

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INDEPENDENT AUDITORS' REPORT TO THE SHAREHOLDERS OF AHLI UNITED BANK B.S.C.

Report on the Audit of the Consolidated Financial Statements

Opinion

We have audited the accompanying consolidated financial statements of Ahli United Bank B.S.C. ("the Bank") and its subsidiaries (together "the Group"), which comprise the consolidated balance sheet as at 31 December 2017, and the consolidated statements of income, comprehensive income, cash flows and changes in equity for the year then ended, and notes to the consolidated financial statements, including a summary of significant accounting policies.

In our opinion, the accompanying consolidated financial statements present fairly, in all material respects, the consolidated financial position of the Group as at 31 December 2017, and its consolidated financial performance and its consolidated cash flows for the year then ended in accordance with International Financial Reporting Standards (IFRSs).

Basis for Opinion

We conducted our audit in accordance with International Standards on Auditing (ISAs). Our responsibilities under those standards are further described in the *Auditor's Responsibilities for the Audit of the Consolidated Financial Statements* section of our report. We are independent of the Group in accordance with the International Ethics Standards Board for Accountants' *Code of Ethics for Professional Accountants* (IESBA Code), and we have fulfilled our other ethical responsibilities in accordance with the IESBA Code. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Key Audit Matters

Key audit matters are those matters that, in our professional judgment, were of most significance in our audit of the consolidated financial statements for the year ended 31 December 2017. These matters were addressed in the context of our audit of the consolidated financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters. For each matter below, our description of how our audit addressed the matter is provided in that context.

We have fulfilled the responsibilities described in the Auditor's responsibilities for the audit of the consolidated financial statements section of our report, including in relation to these matters. Accordingly, our audit included the performance of procedures designed to respond to our assessment of the risks of material misstatement of the consolidated financial statements. The results of our audit procedures, including the procedures performed to address the matters below, provide the basis for our audit opinion on the accompanying consolidated financial statements.

**INDEPENDENT AUDITORS' REPORT TO THE SHAREHOLDERS OF
AHLI UNITED BANK B.S.C. (continued)**

Report on the Audit of the Consolidated Financial Statements (continued)

Key Audit Matters (continued)

| 1. Impairment of carrying value of loans and advances | |
|---|---|
| Risk | How the key audit matter was addressed in the audit |
| <p>The Bank exercises significant judgment using subjective assumptions when determining both the timing and the amounts of the impairment provision for loans and advances. Because loans and advances form major portion of the Group's assets and due to the significance of judgment used in estimating both the specific and collective provisions for loans and advances, this audit area is considered a key audit risk. As at 31 December 2017, the gross loans and advances amounted to US\$ 20,087,770 thousand and related impairment provision amounted to US\$ 589,068 thousand. The basis of the impairment provision policy is presented in the accounting policies and further analysed in Note 8 to the Consolidated Financial Statements.</p> | <p>We have performed tests of controls over the monitoring process of loans and advances to assess the operating effectiveness of the key controls in place which identify the impaired loans and advances against which provisions are required. We also performed tests of controls over the rating system adopted by the Group.</p> <p>Where specific impairment provision was individually calculated, we tested a sample of loans and advances to assess whether an event of impairment has been identified through performing substantive audit procedures in connection with impairment provisions recognized. We also tested the assumptions and underlining data used by management in estimating the required provisions.</p> <p>For the collective impairment provision, we obtained an understanding of the methodology used by the Group to determine the collective provisions, assessed the reasonableness of underlying assumptions and sufficiency of the data used by management.</p> <p>We also assessed whether the financial statement disclosures appropriately reflect the requirements of IFRS.</p> <p>Refer to the critical accounting estimates and judgements, disclosures of loans and advances and credit risk management in note 3.3(g), Note 8 and Note 31 to the Consolidated Financial Statements.</p> |

INDEPENDENT AUDITORS' REPORT TO THE SHAREHOLDERS OF AHLI UNITED BANK B.S.C. (continued)

Report on the Audit of the Consolidated Financial Statements (continued)

Key Audit Matters (continued)

| 2. Impairment of goodwill | |
|--|--|
| Risk | How the key audit matter was addressed in the audit |
| Goodwill is allocated to cash generating units ('CGUs') for the purpose of impairment testing. Goodwill impairment testing of CGUs relies on estimates of value-in-use based on estimated future cash flows. Due to the subjectivity involved in forecasting and discounting of future cash flows and the significance of the Group's recognised goodwill (US\$ 431,299 thousand) as at 31 December 2017, this audit area is considered a key audit risk. Subjectivity is typically highest for those CGUs where headroom between value-in-use and carrying value is limited and where the value-in-use is most sensitive to the assumption used in the calculation of value-in-use. | <p>Our audit procedures included the assessment of reasonableness of key inputs, such as the discount rates and growth rates, by comparison to externally available industry, economic and financial data and the Group's own historical data and performance. With the assistance of our own specialists, we assessed the reasonableness of assumptions and methodologies used to calculate value-in-use for those CGUs where goodwill was found to be sensitive to changes in those assumptions.</p> <p>Additionally we considered whether the Group's disclosures of the application of judgement in estimating CGU cash flows and the sensitivity of the results of those estimates adequately reflect the risks associated with goodwill impairment.</p> <p>Refer to the critical accounting estimates and judgements and disclosures of goodwill in Note 14, and allocation of goodwill to CGUs in Note 30 to the Consolidated Financial Statements.</p> |

Other information included in the Group's 2017 Annual Report

Other information consists of the information included in the Group's 2017 Annual Report, other than the consolidated financial statements and our auditor's report thereon. The Board of Directors is responsible for the other information. Prior to the date of this auditors' report, we obtained the Board of Directors' report which forms part of the annual report, and the remaining sections of the annual report are expected to be made available to us after that date.

Our opinion on the consolidated financial statements does not cover the other information and we do not express any form of assurance conclusion thereon.

In connection with our audit of the consolidated financial statements, our responsibility is to read the other information identified above when it becomes available and, in doing so, consider whether the other information is materially inconsistent with the consolidated financial statements or our knowledge obtained in the audit, or otherwise appears to be materially misstated.

INDEPENDENT AUDITORS' REPORT TO THE SHAREHOLDERS OF AHLI UNITED BANK B.S.C. (continued)

Report on the Audit of the Consolidated Financial Statements (continued)

Other information included in the Group's 2017 Annual Report (continued)

If, based on the work we have performed on the other information obtained prior to the date of the auditor's report, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report in this regard.

Responsibilities of the Board of Directors for the Consolidated Financial Statements

The Board of Directors is responsible for the preparation and fair presentation of the consolidated financial statements in accordance with IFRSs and for such internal control as the Board of Directors determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the consolidated financial statements, the Board of Directors is responsible for assessing the Group's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless the Board of Directors either intends to liquidate the Group or to cease operations, or has no realistic alternative but to do so.

Auditor's Responsibilities for the Audit of the Consolidated Financial Statements

Our objectives are to obtain reasonable assurance about whether the consolidated financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these consolidated financial statements.

As part of an audit in accordance with ISAs, we exercise professional judgment and maintain professional skepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the consolidated financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Group's internal control.

INDEPENDENT AUDITORS' REPORT TO THE SHAREHOLDERS OF AHLI UNITED BANK B.S.C. (continued)

Report on the Audit of the Consolidated Financial Statements (continued)

Auditor's Responsibilities for the Audit of the Consolidated Financial Statements (continued)

- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the Board of Directors.
- Conclude on the appropriateness of the Board of Directors' use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Group's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the consolidated financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Group to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the consolidated financial statements, including the disclosures, and whether the consolidated financial statements represent the underlying transactions and events in a manner that achieves fair presentation.
- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Group to express an opinion on the consolidated financial statements. We are responsible for the direction, supervision and performance of the Group audit. We remain solely responsible for our audit opinion.

We communicate with the Board of Directors regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

We also provide the Board of Directors with a statement that we have complied with relevant ethical requirements regarding independence, and to communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, related safeguards.

INDEPENDENT AUDITORS' REPORT TO THE SHAREHOLDERS OF AHLI UNITED BANK B.S.C. (continued)

Report on the Audit of the Consolidated Financial Statements (continued)

Auditor's Responsibilities for the Audit of the Consolidated Financial Statements (continued)

From the matters communicated with the Board of Directors, we determine those matters that were of most significance in the audit of the consolidated financial statements of the current year and are therefore the key audit matters. We describe these matters in our auditor's report unless law or regulation precludes public disclosure about the matter or when, in extremely rare circumstances, we determine that a matter should not be communicated in our report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication.

Report on Other Legal and Regulatory Requirements

As required by the Bahrain Commercial Companies Law and (Volume 1) of the Central Bank of Bahrain (CBB) Rule Book, we report that:

- a) the Bank has maintained proper accounting records and the consolidated financial statements are in agreement therewith;
- b) the financial information contained in the Report of the Board of Directors is consistent with the consolidated financial statements;
- c) we are not aware of any violations of the Bahrain Commercial Companies Law, the Central Bank of Bahrain and Financial Institutions Law, the CBB Rule Book (Volume 1 and applicable provisions of Volume 6) and CBB directives, regulations and associated resolutions, rules and procedures of the Bahrain Bourse or the terms of the Bank's memorandum and articles of association during the year ended 31 December 2017 that might have had a material adverse effect on the business of the Bank or on its consolidated financial position; and
- d) satisfactory explanations and information have been provided to us by Management in response to all our requests.

The partner in charge of the audit resulting in this independent auditor's report is Mr. Ashwani Siotia.



Partner's registration no. 117
20 February 2018
Manama, Kingdom of Bahrain.

Ahli United Bank B.S.C.

CONSOLIDATED STATEMENT OF INCOME

For the year ended 31 December 2017

| | Note | 2017 US\$ '000 | 2016 US\$ '000 |
|--|------|-------------------|-------------------|
| Interest income | 4a | 1,379,174 | 1,319,798 |
| Interest expense | 4b | 502,704 | 491,566 |
| Net interest income | | 876,470 | 828,232 |
| Fees, commissions and others | 5 | 145,013 | 169,735 |
| Trading income | 6 | 35,239 | 48,288 |
| Investment income | | 39,399 | 72,605 |
| Share of profit from associates | | 23,251 | 26,626 |
| Fees and other income | | 242,902 | 317,254 |
| OPERATING INCOME | | 1,119,372 | 1,145,486 |
| Net provision for loan losses and others | 8f | 86,670 | 149,562 |
| Provision for investments | 9 | 2,280 | 9,279 |
| Total provisions | | 88,950 | 158,841 |
| NET OPERATING INCOME | | 1,030,422 | 986,645 |
| Staff costs | | 193,831 | 188,551 |
| Depreciation | | 20,824 | 22,242 |
| Other operating expenses | | 108,245 | 105,427 |
| OPERATING EXPENSES | | 322,900 | 316,220 |
| PROFIT BEFORE TAX | | 707,522 | 670,425 |
| Tax expense | 22 | 41,008 | 46,115 |
| NET PROFIT FOR THE YEAR | | 666,514 | 624,310 |
| Net profit attributable to non-controlling interest | | 47,799 | 53,670 |
| NET PROFIT ATTRIBUTABLE TO THE OWNERS OF THE BANK | | 618,715 | 570,640 |
| EARNINGS PER SHARE ATTRIBUTABLE TO THE OWNERS OF THE BANK FOR THE YEAR: | | | |
| Basic & diluted earnings per ordinary share (US cents) | 23 | 7.7 | 7.2 |



Hamad M. Al-Humaidhi
Chairman



Mohammad J. Al-Marzooq
Deputy Chairman



Adel A. El-Labban
Group Chief Executive Officer
& Managing Director

The attached notes 1 to 39 form part of these consolidated financial statements

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

For the year ended 31 December 2017

| | <u>2017</u> | <u>2016</u> |
|--|------------------|------------------|
| | <u>US\$ '000</u> | <u>US\$ '000</u> |
| Net profit for the year | 666,514 | 624,310 |
| Other comprehensive income (OCI) | | |
| Items that will not be reclassified to consolidated statement of income | | |
| Net change in fair value of financial assets measured at fair value through OCI | (2,289) | 2,683 |
| Net change in pension fund reserve | 2,410 | (15,492) |
| Net change in property revaluation reserve | (750) | 113 |
| Items that may be reclassified subsequently to consolidated statement of income | | |
| Foreign currency translation adjustments | 37,424 | (309,231) |
| Net change in fair value of cash flow hedges | (2,876) | 4,265 |
| Other comprehensive income for the year | 33,919 | (317,662) |
| Total comprehensive income for the year | 700,433 | 306,648 |
| Total comprehensive income attributable to non-controlling interest | 53,652 | 2,429 |
| Total comprehensive income attributable to owners of the Bank | 646,781 | 304,219 |

The attached notes 1 to 39 form part of these consolidated financial statements

Ahli United Bank B.S.C.

CONSOLIDATED BALANCE SHEET

At 31 December 2017

| | Note | 2017 US\$ '000 | 2016 US\$ '000 |
|--|------|-------------------|-------------------|
| ASSETS | | | |
| Cash and balances with central banks | 7a | 809,986 | 912,924 |
| Treasury bills and deposits with central banks | 7b | 2,576,352 | 2,464,846 |
| Deposits with banks | | 2,469,751 | 1,884,493 |
| Loans and advances | 8 | 19,498,702 | 18,606,883 |
| Non-trading investments | 9 | 6,002,410 | 5,570,447 |
| Investment in associates | 10 | 304,020 | 326,874 |
| Investment properties | 11 | 256,242 | 132,021 |
| Premises and equipment | 12 | 226,672 | 211,209 |
| Interest receivable and other assets | 13 | 616,920 | 738,155 |
| Goodwill and other intangible assets | 14 | 480,830 | 474,632 |
| TOTAL ASSETS | | 33,241,885 | 31,322,484 |
| LIABILITIES AND EQUITY | | | |
| LIABILITIES | | | |
| Deposits from banks | 15 | 3,943,233 | 3,279,038 |
| Borrowings under repurchase agreements | 16 | 1,272,758 | 698,228 |
| Customers' deposits | 17 | 22,009,857 | 21,703,358 |
| Interest payable and other liabilities | 18 | 912,679 | 865,376 |
| Subordinated liabilities | 19 | 215,204 | 236,982 |
| TOTAL LIABILITIES | | 28,353,731 | 26,782,982 |
| EQUITY | | | |
| Ordinary share capital | 20 | 1,889,213 | 1,711,322 |
| Treasury shares | | (11,661) | (11,497) |
| Reserves | | 1,938,070 | 1,801,002 |
| Equity attributable to the owners | | 3,815,622 | 3,500,827 |
| Perpetual Tier I Capital Securities | 20d | 600,000 | 600,000 |
| Non-controlling interest | | 472,532 | 438,675 |
| TOTAL EQUITY | | 4,888,154 | 4,539,502 |
| TOTAL LIABILITIES AND EQUITY | | 33,241,885 | 31,322,484 |



Hamad M. Al-Humaidhi
Chairman



Mohammad J. Al-Marzooq
Deputy Chairman



Adel A. El-Labban
Group Chief Executive Officer
& Managing Director

The attached notes 1 to 39 form part of these consolidated financial statements

CONSOLIDATED STATEMENT OF CASH FLOWS

For the year ended 31 December 2017

| | | <u>2017</u> | <u>2,016</u> |
|---|-------------|------------------|--------------------|
| | <i>Note</i> | <i>US\$ '000</i> | <i>US\$ '000</i> |
| OPERATING ACTIVITIES | | | |
| Profit before tax | | 707,522 | 670,425 |
| Adjustments for: | | | |
| Depreciation | | 20,824 | 22,242 |
| Investment income | | (39,399) | (72,605) |
| Net provision for loan losses and others | 8f | 86,670 | 149,562 |
| Provision for investments | 9 | 2,280 | 9,279 |
| Fair Value of ESPP charge | 21h | 3,921 | 5,224 |
| Share of profit from associates | 10 | (23,251) | (26,626) |
| Operating profit before changes in operating assets and liabilities | | 758,567 | 757,501 |
| Changes in: | | | |
| Mandatory reserve deposits with central banks | | (78,832) | 142,510 |
| Treasury bills and deposits with central banks | | (111,506) | (346,901) |
| Deposits with banks | | (183,879) | 696,363 |
| Loans and advances | | (978,489) | 596,736 |
| Interest receivable and other assets | | 121,235 | (147,326) |
| Deposits from banks | | 664,195 | (962,153) |
| Borrowings under repurchase agreements | | 574,530 | (102,770) |
| Customers' deposits | | 306,499 | (1,791,869) |
| Interest payables and other liabilities | | 66,038 | 17,080 |
| Cash from (used in) operations | | 1,138,358 | (1,140,829) |
| Income tax paid | | (30,997) | (25,581) |
| Net cash from (used in) operating activities | | 1,107,361 | (1,166,410) |
| INVESTING ACTIVITIES | | | |
| Purchase of non-trading investments | | (2,220,817) | (2,749,131) |
| Proceeds from sale or redemption of non-trading investments | | 1,817,326 | 2,562,141 |
| Net (increase) decrease in investment properties | | (124,221) | 51,145 |
| Net (increase) decrease in premises and equipment | | (36,732) | 5,476 |
| Dividends received from associates | | 12,955 | 12,955 |
| Net cash used in investing activities | | (551,489) | (117,414) |
| FINANCING ACTIVITIES | | | |
| Additional investment in subsidiary | 2 | (1,490) | - |
| Proceeds from issue of Perpetual Tier 1 Capital Securities | 20d | - | 200,000 |
| Payment of expenses related to Perpetual Tier 1 Capital Securities | | - | (1,351) |
| Distribution on Perpetual Tier 1 Capital Securities | 21j | (38,500) | (27,500) |
| Repayment of subordinated liabilities | | (21,778) | (24,612) |
| Dividends and other appropriations paid | | (302,647) | (287,226) |
| Dividends paid to non-controlling interest | | (15,414) | (5,892) |
| Capital increase from issuance of ESPP & MSP shares | 20c | 12,517 | 14,677 |
| Purchase of treasury shares | | (164) | (4,188) |
| Net cash used in financing activities | | (367,476) | (136,092) |
| Net foreign exchange difference | | 31,213 | (211,611) |
| INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS | | 219,609 | (1,631,527) |
| Cash and cash equivalents at 1 January | | 2,309,113 | 3,940,640 |
| CASH AND CASH EQUIVALENTS AT 31 DECEMBER | 24 | 2,528,722 | 2,309,113 |
| Additional cash flow information: | | | |
| Interest received | | 1,398,430 | 1,321,741 |
| Interest paid | | 518,651 | 452,133 |

The attached notes 1 to 39 form part of these consolidated financial statements

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

For the year ended 31 December 2017

| | Attributable to the owners | | | | | | | | | | |
|--|-------------------------------------|------------------------------|----------------------------|--------------------------------|--------------------------------|--------------------------------------|---|-----------------------------|--|---------------------------------------|-----------|
| | Reserves | | | | | | | | | | |
| | Ordinary share capital US\$ '000 | Treasury shares US\$ '000 | Share premium US\$ '000 | Statutory reserve US\$ '000 | Retained earnings US\$ '000 | Proposed appropriations US\$ '000 | Other reserves (Note 21(h)) US\$ '000 | Total reserves US\$ '000 | Tier 1 Capital Securities US\$ '000 | Non-controlling interest US\$ '000 | |
| Balance at 1 January 2017 | 1,711,322 | (11,497) | 747,583 | 454,856 | 791,395 | 310,144 | (502,976) | 1,801,002 | 600,000 | 438,675 | 4,539,502 |
| Distribution on Perpetual Tier 1 Capital Securities [note 21(j)] | - | - | - | - | (27,500) | - | - | (27,500) | - | - | (27,500) |
| Ordinary share dividend paid [note 21(i)] | - | - | - | - | 733 | (309,144) | - | (308,411) | - | - | (308,411) |
| Dividends of subsidiary | - | - | - | - | - | - | - | - | - | (15,414) | (15,414) |
| Donations paid | - | - | - | - | - | (1,000) | - | (1,000) | - | - | (1,000) |
| Bonus shares issued | 171,747 | - | - | - | (171,747) | - | - | (171,747) | - | - | - |
| Additional shares issued | 6,144 | - | 6,373 | - | - | - | - | 6,373 | - | - | 12,517 |
| Purchase of treasury shares | - | (164) | - | - | - | - | - | - | - | - | (164) |
| Distribution related to Perpetual Tier 1 Sukuk [note 21(j)] | - | - | - | - | (8,240) | - | - | (8,240) | - | (2,760) | (11,000) |
| Transfer of property revaluation reserve on sale of property | - | - | - | - | 243 | - | - | 243 | - | - | 243 |
| Fair value amortisation of share based transactions | - | - | - | - | 3,921 | - | - | 3,921 | - | - | 3,921 |
| Transfer from OCI reserve | - | - | - | - | (3,704) | - | - | (3,704) | - | - | (3,704) |
| Movement in subsidiaries | - | - | 352 | - | - | - | - | 352 | - | (1,621) | (1,269) |
| Total comprehensive income for the year | - | - | - | - | 618,715 | - | 28,066 | 646,781 | - | 53,652 | 700,433 |
| Transfer to statutory reserve [note 21(c)] | - | - | - | 61,872 | (61,872) | - | - | - | - | - | - |
| Proposed dividend on ordinary shares [note 21(i)] | - | - | - | - | (341,578) | 341,578 | - | - | - | - | - |
| Proposed donations | - | - | - | - | (1,000) | 1,000 | - | - | - | - | - |
| Balance at 31 December 2017 | 1,889,213 | (11,661) | 754,308 | 516,728 | 799,366 | 342,578 | (474,910) | 1,938,070 | 600,000 | 472,532 | 4,888,154 |

The attached notes 1 to 39 form part of these consolidated financial statements

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

For the year ended 31 December 2017

| | Attributable to the owners | | | | | | | |
|---|-------------------------------------|------------------------------|----------------------------|--------------------------------|--------------------------------|--------------------------------------|--|-----------------------------|
| | Reserves | | | | | | | |
| | Ordinary share capital US\$ '000 | Treasury shares US\$ '000 | Share premium US\$ '000 | Statutory reserve US\$ '000 | Retained earnings US\$ '000 | Proposed appropriations US\$ '000 | Other reserves (Note 21(h)) US\$ '000 | Total reserves US\$ '000 |
| Balance at 1 January 2016 | 1,623,030 | (7,309) | 739,781 | 397,792 | 694,312 | 294,099 | (223,968) | 1,902,016 |
| | | | | | | | | 400,000 |
| | | | | | | | | 442,477 |
| | | | | | | | | 4,360,214 |
| Distribution on Perpetual Tier 1 Capital Securities [note 21(i)] | - | - | - | - | (27,500) | - | - | (27,500) |
| Ordinary share dividend paid [note 21(i)] | - | - | - | - | 698 | (293,099) | - | (292,401) |
| Dividends of subsidiaries | - | - | - | - | - | - | - | - |
| Donations paid | - | - | - | - | - | (1,000) | - | (1,000) |
| Bonus shares issued | 81,417 | - | - | - | (81,417) | - | - | - |
| Additional shares issued | 6,875 | - | 7,802 | - | - | - | - | 7,802 |
| Purchase of treasury shares | - | (4,188) | - | - | - | - | - | - |
| Perpetual Tier 1 Sukuk issued by a subsidiary [note 20(d)] | - | - | - | - | - | - | - | - |
| Expenses related to Perpetual Tier 1 Sukuk issued by a subsidiary | - | - | - | - | (1,012) | - | - | (1,012) |
| Fair value amortisation of share based transactions | - | - | - | - | 17,811 | - | (12,587) | 5,224 |
| Transfer from OCI reserve | - | - | - | - | (14,929) | - | - | (14,929) |
| Total comprehensive income for the year | - | - | - | - | 570,640 | - | (266,421) | 304,219 |
| Transfer to statutory reserve [note 21(c)] | - | - | - | 57,064 | (57,064) | - | - | - |
| Proposed dividend on ordinary shares [note 21(i)] | - | - | - | - | (309,144) | 309,144 | - | - |
| Proposed donations | - | - | - | - | (1,000) | 1,000 | - | - |
| Balance at 31 December 2016 | 1,711,322 | (11,497) | 747,583 | 454,856 | 791,395 | 310,144 | (502,976) | 1,801,002 |
| | | | | | | | | 600,000 |
| | | | | | | | | 438,675 |
| | | | | | | | | 4,539,502 |

The attached notes 1 to 39 form part of these consolidated financial statements

1 CORPORATE INFORMATION

The parent company, Ahli United Bank B.S.C. ("AUB" or "the Bank") was incorporated in the Kingdom of Bahrain on 31 May 2000 originally as a closed company and changed on 12 July 2000 to a public shareholding company by Amiri Decree number 16/2000. The Bank and its subsidiaries as detailed in note 2 below (collectively known as "the Group") are engaged in retail, commercial, islamic and investment banking business, global fund management, private banking services and life insurance business through 109 branches, as at 31 December 2017, in the Kingdom of Bahrain (22 branches), the State of Kuwait (37 branches), the Arab Republic of Egypt (37 branches), Republic of Iraq (11 branches), Dubai International Financial Centre (Authorised Firm) and the United Kingdom (1 branch). During 2017, it also operated through its managed associates in the Sultanate of Oman (20 branches) and Libya (11 branches) with a total network of 31 branches as at 31 December 2017. The Bank operates under a retail banking license issued by the Central Bank of Bahrain. The Bank's registered office is located at Building 2495, Road 2832, Al Seef District 428, Kingdom of Bahrain.

The consolidated financial statements for the year ended 31 December 2017 were authorised for issue in accordance with a resolution of the directors dated 20 February 2018.

2 BASIS OF CONSOLIDATION

The consolidated financial statements comprise the financial statements of the Bank and its controlled subsidiaries as at and for the years ended 31 December 2017 and 2016. The results of subsidiaries are included in the consolidated financial statements from the date that control commences until the date that control ceases. Control is achieved where the Bank is exposed, or has rights, to variable returns from its involvement from its investee and has the ability to affect those returns through its power over the investee. The Bank re-assesses whether or not it controls an investee if facts and circumstances indicates that there are any change to elements of control. The financial statements of the subsidiaries are prepared for the same reporting year as the Bank, using consistent accounting policies. Adjustments are made to the consolidated financial statements to bring into line any dissimilar accounting policies that may exist.

All material intra-group balances, transactions, income and expenses and profits and losses resulting from intra-group transactions are eliminated on consolidation. The Group does not have significant restrictions on its ability to access or use its assets and settle its liabilities.

The following are the Bank's principal subsidiaries:

| <i>Name</i> | <i>Incorporation in</i> | <i>Group's nominal holding</i> | |
|---|-----------------------------|------------------------------------|-----------------------------|
| | | <i>31 December 2017</i> | <i>31 December 2016</i> |
| Ahli United Bank (U.K.) PLC (AUBUK) | United Kingdom | 100.0% | 100.0% |
| Ahli United Bank K.S.C.P. (AUBK)* | State of Kuwait | 67.3% | 67.3% |
| Ahli United Bank (Egypt) S.A.E. (AUBE) | Arab Republic of Egypt | 85.5% | 85.5% |
| Commercial Bank of Iraq P.S.C. (CBIQ) | Republic of Iraq | 75.0% | 74.3% |
| Al Hilal Life B.S.C. (c) (AHL) | Kingdom of Bahrain | 100.0% | 100.0% |
| Al Ahli Real Estate Company S.P.C. (AREC) | Kingdom of Bahrain | 100.0% | 100.0% |
| Ahli United Bank Limited (AUBL) | DIFC - United Arab Emirates | 100.0% | 100.0% |

During the year, AUBL's paid up capital was increased to USD 75 million from USD 50 million. Moreover, the Bank also increased its direct holding in the voting capital of CBIQ from 74.3% to 75.0%.

* Effective holding 74.9% (31 December 2016: 74.9%)

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

31 December 2017

2 BASIS OF CONSOLIDATION (continued)

Financial information of a subsidiary that has material non-controlling interest is provided below.

Proportion of equity interest held by non-controlling interests are provided below:

| <i>Name</i> | <i>Country of incorporation</i> | <i>31 December 2017</i> | <i>31 December 2016</i> |
|---|-------------------------------------|-----------------------------|-----------------------------|
| Ahli United Bank K.S.C.P. (AUBK) | State of Kuwait | 25.1% | 25.1% |
| Ahli United Bank (Egypt) S.A.E. (AUBE) | Arab Republic of Egypt | 14.5% | 14.5% |
| | | <i>US\$ '000</i> | <i>US\$ '000</i> |
| Accumulated non-controlling interest as at: | | | |
| Ahli United Bank K.S.C.P. (AUBK) | | 352,741 | 330,634 |
| Ahli United Bank (Egypt) S.A.E. (AUBE) | | 58,073 | 46,376 |
| Profit allocated to material non-controlling interest: | | | |
| Ahli United Bank K.S.C.P. (AUBK) | | 36,815 | 33,484 |
| Ahli United Bank (Egypt) S.A.E. (AUBE) | | 8,821 | 22,902 |

Summarised financial information of AUBK and AUBE is provided below. The information is based on amounts as reported in consolidated financial statements before inter-company eliminations and adjustments.

| | <i>31 December 2017</i> | <i>31 December 2016</i> |
|---|-----------------------------|-----------------------------|
| | <i>US\$ '000</i> | <i>US\$ '000</i> |
| Ahli United Bank K.S.C.P. (AUBK) | | |
| <i>Balance sheet related information of AUBK</i> | | |
| Loans and advances | 8,844,108 | 8,854,889 |
| Non- trading investments | 719,728 | 667,451 |
| Total assets | 12,131,348 | 12,081,679 |
| Customers' deposits | 9,793,292 | 10,024,287 |
| Total liabilities | 10,583,044 | 10,623,276 |
| <i>Income statement related information of AUBK</i> | | |
| Total operating income | 397,779 | 367,036 |
| Net profit attributable to shareholders | 146,602 | 133,352 |
| Total comprehensive income attributable to shareholders | 144,924 | 120,281 |
| Dividends paid to non-controlling interest | 15,414 | 5,892 |
| <i>Cash flow related information of AUBK</i> | | |
| Net cash from (used in) operating activities | 218,998 | (1,553,163) |
| Net cash used in investing activities | (111,487) | (194,327) |
| Net cash (used in) from financing activities | (72,716) | 175,621 |
| Ahli United Bank (Egypt) S.A.E. (AUBE) | | |
| <i>Balance sheet related information of AUBE</i> | | |
| Loans and advances | 1,233,727 | 1,060,784 |
| Non- trading investments | 474,229 | 221,429 |
| Total assets | 2,652,834 | 2,306,182 |
| Customers' deposits | 2,159,354 | 1,851,437 |
| Total liabilities | 2,285,489 | 2,022,001 |
| <i>Income statement related information of AUBE</i> | | |
| Total operating income | 133,707 | 248,783 |
| Net profit attributable to shareholders | 67,588 | 175,409 |
| <i>Cash flow related information of AUBE</i> | | |
| Net cash from operating activities | 182,750 | 44,306 |
| Net cash used in investing activities | (240,809) | (77,832) |
| Net cash used in financing activities | (4,575) | (3,499) |

3 ACCOUNTING POLICIES

3.1 Basis of preparation

The consolidated financial statements have been prepared on a historical cost basis as modified for the re-measurement at fair value of freehold land, certain financial instruments (as detailed below in note 3.3(c)) and all derivative financial instruments. In addition, as fully discussed below in note 3.3(h)(i), carrying values of recognised assets that are designated as hedged items in fair value hedges are adjusted to the extent of the fair value attributable to the risk being hedged. The consolidated financial statements are presented in US Dollars which is the Group's functional currency and all values are rounded to the nearest thousand (US Dollars thousand) except where otherwise indicated.

Statement of compliance

The consolidated financial statements of the Group have been prepared in accordance with International Financial Reporting Standards (IFRS) as issued by International Accounting Standards Board (IASB) and in conformity with the Bahrain Commercial Companies Law and the Central Bank of Bahrain and Financial Institutions Law.

New Standards and Interpretations issued but not yet effective

The following new Standards and amendments have been issued by the International Accounting Standards Board (IASB) but are not yet mandatory as of 31 December 2017:

- IFRS 9 – Financial Instruments (effective for annual periods beginning on or after 1 January 2018)

The IASB issued IFRS 9 'Financial Instruments' in its final form in July 2014 and is effective for annual periods beginning on or after 1 January 2018 with option to early adopt. IFRS 9 sets out the requirements for recognizing and measuring financial assets, financial liabilities and some contracts to buy or sell non- financial assets, impairment of financial assets and hedge accounting. This standard replaces IAS 39 Financial Instruments: Recognition and Measurement.

a. Classification and measurement

During 2012, the Group early adopted the phase 1 of IFRS 9 – "Classification and Measurement".

b. Hedge accounting

Hedge accounting model introduced under IFRS 9 are designed to better align hedge accounting with risk management activities. It also has provided using more broadly to a greater variety of hedging instruments and risks eligible for hedge accounting. Moreover, it has removed rule based thresholds for testing hedge effectiveness by bringing principle based criteria. Current accounting treatments of fair value, cashflow and net investment hedge accounting have been retained. IFRS 9 provides an accounting choice to continue to apply IAS 39 hedge accounting rules until the IASB finalizes its macro hedge accounting project.

The Group has determined that all existing hedge relationships that are currently designated in effective hedging relationships would continue to qualify for hedge accounting under IFRS 9 and accordingly will apply IFRS 9 hedge accounting effective 1 January 2018.

c. Impairment of financial assets

IFRS 9 will also fundamentally change the loan loss impairment methodology. The Standard will replace IAS 39's incurred loss approach with a forward-looking expected credit loss (ECL) approach. The Group will be required to record an allowance for ECL for all loans and other debt financial assets not held at fair value through profit or loss (FVTPL), together with loan commitments and financial guarantee contracts. The allowance is based on the expected credit losses associated with the probability of default in the next twelve months unless there has been a significant increase in credit risk since origination, in which case, the allowance is based on the probability of default over the life of the asset.

The Group has developed a framework to perform an assessment at the end of each reporting period of whether credit risk has increased significantly since initial recognition by considering the change in the risk of default occurring over the remaining life of the financial instrument.

- To calculate ECL, the Group will estimate the risk of a default occurring on the financial instrument during its expected life. ECLs are estimated based on the present value of all cash shortfalls over the remaining expected life of the financial asset, i.e., the difference between: the contractual cash flows that are due to the Group under the contract, and
- the cash flows that the Group expects to receive, discounted at the effective interest rate of the financial instrument.

3 ACCOUNTING POLICIES (continued)**3.1 Basis of preparation (continued)****Statement of compliance (continued)****New Standards and Interpretations issued but not yet effective (continued)**

The ECL model contains a three stage approach which is based on the change in credit quality of financial assets since initial recognition. Under Stage 1, where there has not been a significant increase in credit risk since initial recognition, an amount equal to 12 months ECL will be recorded. Under Stage 2, where there has been a significant increase in credit risk since initial recognition but the financial instruments are not considered credit impaired, an amount equal to the default probability weighted lifetime ECL will be recorded. Under the Stage 3, where there is objective evidence of impairment at the reporting date these financial instruments will be classified as credit impaired and an amount equal to the lifetime ECL will be recorded for the financial assets. In addition, in Stage 3 the Group recognises interest income on a receipt basis.

Transition adjustments

The adoption of the final form of IFRS 9 issued in July 2014 is expected to result in certain differences in the classification and measurement of financial assets.

Transition adjustments are summarised below:

| | Attributable to owners | | |
|--|---------------------------|---------------------------|---------------------------|
| | Retained earnings | Fair value reserves | Total equity |
| | <i>US \$ millions</i> | <i>US \$ millions</i> | <i>US \$ millions</i> |
| Balance at 31 December 2017 | 1,203.8 | (13.0) | 3,815.6 |
| Expected credit losses under IFRS 9 for all loans and other debt financial assets together with loan commitments and financial guarantee contracts | (249.8) | - | (249.8) |
| Impact of classification of debt instruments from amortised cost to fair value through other comprehensive income category | - | 54.9 | 54.9 |
| Net impact of adoption of IFRS 9 as at 1 January 2018 | (249.8) | 54.9 | (194.9) |
| Balance as at 1 January 2018 upon adoption of IFRS 9 | 954.0 | 41.9 | 3,620.7 |
| Impact of IFRS 9 adoption on equity attributable to the owners | | | 5.1% |

- IFRS 15 - Revenue from Contracts with Customers.

IFRS 15 was issued by IASB on 28 May 2014, effective for annual periods beginning on or after 1 January 2018. IFRS 15 supersedes IAS 11 Construction Contracts and IAS 18 Revenue along with related IFRIC 13, IFRIC 15, IFRIC 18 and SIC 31 from the effective date. This new Standard removes inconsistencies and weaknesses in previous revenue recognition requirements, provides a more robust framework for addressing revenue issues and improves comparability of revenue recognition practices across entities, industries, jurisdictions and capital markets.

- IFRS 16 Leases.

In January 2016, the IASB issued IFRS 16 'Leases' with an effective date of annual periods beginning on or after 1 January 2019. IFRS 16 results in lessees accounting for most leases within the scope of the Standard in a manner similar to the way in which finance leases are currently accounted for under IAS 17 'Leases'. Lessees will recognise a 'right of use' asset and a corresponding financial liability on the balance sheet. The asset will be amortised over the length of the lease and the financial liability measured at amortised cost.

The Group does not expect any significant impact on the Groups' financial position and results, resulting from the application of IFRS 15 & IFRS 16.

3 ACCOUNTING POLICIES (continued)

3.2 Significant accounting judgements and estimates

The preparation of the consolidated financial statements requires management to make judgements and estimates that affect the reported amounts of income, expenses, financial assets, liabilities, the accompanying disclosures and disclosure of contingent liabilities. Uncertainty about these assumptions and estimates could result in outcomes that require a material adjustment to the carrying amount of assets or liabilities affected in future periods.

Judgements

Judgements are made in the classification of financial instruments into 'fair value' and 'amortised cost' based on business model. Further goodwill and intangible assets with indefinite lives have been allocated to cash generating units for impairment testing. Judgements are also made in determination of the objective evidence that a financial asset is impaired.

Business model

In making an assessment of whether a business model's objective is to hold assets in order to collect contractual cash flows, the Group considers at which level of its business activities such assessment should be made. Generally, a business model is a matter of fact which can be evidenced by the way business is managed and the information provided to management.

In determining whether its business model for managing financial assets is to hold assets in order to collect contractual cash flows, the Group considers:

- Management's stated policies and objectives for the portfolio and the operation of those policies in practice;
- Management's evaluation of the performance of the portfolio;
- Management's strategy in terms of earning contractual interest revenues or generating capital gains.

Estimates

Pension plans

Estimates and assumptions are used in determining the Group's pension liabilities. The cost of the defined benefit pension plan and the present value of pension obligations are determined using actuarial valuations. An actuarial valuation involves making various assumptions that may differ from actual developments in the future. These include the determination of the discount rate, future salary increases, mortality rates and future pension increases.

Going concern

The management has made an assessment of its ability to continue as a going concern and is satisfied that it has the resources to continue in business for the foreseeable future. Furthermore, management is not aware of any material uncertainties that may cast significant doubt on the Group's ability to continue as a going concern. Therefore, the consolidated financial statements continue to be prepared on the going concern basis.

Impairment losses on loans and advances, non-trading investments and other assets

Estimates are made regarding the amount and timing of future cash flows when measuring the level of provisions required for non-performing loans, portfolios of performing loans with similar risk characteristics where the risk of default has increased, as well as provisions for non-trading investments and other assets. These are more fully described in note 3.3 (g).

Fair value of financial instruments

Estimates are also made in determining the fair values of financial assets and derivatives that are not quoted in an active market. Such estimates are necessarily based on assumptions about several factors involving varying degrees of uncertainty and actual results may differ resulting in future changes in such provisions.

Impairment of goodwill and intangible assets

The Group determines whether Goodwill and Intangibles with indefinite useful lives are impaired at least on an annual basis. Impairment exists when carrying value of an asset or cash generating unit (CGU) exceeds its recoverable amount, which is the higher of its fair value less costs of disposal and its value in use. The key assumptions and estimates used to determine the recoverable amount for the different CGUs, are disclosed and further explained in note 14.

The methodology and assumptions used for estimating future cash flows are reviewed regularly to reduce any differences between loss estimates and actual loss experience.

3.3 Summary of significant accounting policies

The principal accounting policies applied in the preparation of these consolidated financial statements, besides those detailed in note 3.1 are set out below. These policies have been consistently applied to all the years presented.

3 ACCOUNTING POLICIES (continued)

3.3 Summary of significant accounting policies (continued)

(a) Investments in associates

Associate companies are companies in which the Group exercises significant influence but does not control. Significant influence is the power to participate in the financial and operating policy decisions of the investee, but is not control or joint control over those policies. Investments in associate companies are accounted for using the equity method. After application of the equity method, the Group determines whether it is necessary to recognise an impairment loss on its investment in its associate. At each reporting date, the Group determines whether there is objective evidence that the investment in the associate is impaired. If there is such evidence, the Group calculates the amount of impairment as the difference between the recoverable amount of the associate and its carrying value, and then recognises the loss in the statement of income.

The reporting dates of the associates and the Group are identical and the associates' accounting policies materially conform to those used by the Group for like transactions and events in similar circumstances. Adjustments are made to the consolidated financial statements to bring into line any dissimilar accounting policies that may exist. The Group does not have significant restrictions on its ability to access or use its assets and settle its liabilities.

(b) Foreign currency translation

(i) Transactions and balances

Transactions in foreign currencies are initially recorded in the relevant functional currency at the rate of exchange prevailing on the date of the transaction.

Monetary assets and liabilities denominated in foreign currencies are translated into the functional currency at the rate of exchange ruling at the balance sheet date. Any resulting exchange differences are included in "trading income" in the consolidated statement of income.

Non-monetary assets and liabilities that are measured at historical cost in a foreign currency are translated using the exchange rates as at the dates of the initial transactions. Non-monetary investments classified as fair value through other comprehensive income (FVTOCI) measured at fair value in a foreign currency are translated using the exchange rates at the date when the fair value is determined and the differences are included in other comprehensive income as part of the fair value adjustment of the respective items, unless these items are designated as FVTPL or are part of an effective hedging strategy, in which case it is recorded in the consolidated statement of income.

(ii) Group companies

Assets and liabilities of foreign subsidiaries whose functional currency is not US Dollars are translated into US Dollars at the rates of exchange prevailing at the balance sheet date. Income and expense items are translated at average exchange rates prevailing for the reporting period. Any exchange differences arising on translation are included in "foreign exchange translation reserve" forming part of other comprehensive income except to the extent that the translation difference is allocated to the non-controlling interest. On disposal of foreign operations, exchange differences relating thereto and previously recognised in other comprehensive income are recognised in the consolidated statement of income.

(c) Financial instruments

The classification of financial instruments at initial recognition depends on the purpose for which the financial instruments were acquired and their characteristics. All financial instruments are initially recognised at the fair value plus, for an item not recorded at FVTPL, transaction costs that are directly attributable to its acquisition or issue. Premiums and discounts are amortised on a systematic basis to maturity using the effective interest rate method and taken to interest income or interest expense as appropriate.

3 ACCOUNTING POLICIES (continued)

3.3 Summary of significant accounting policies (continued)

(c) Financial instruments (continued)

(i) Date of recognition

All "regular way" purchases and sales of financial assets are recognised on the settlement date, i.e. the date that the Group receives or delivers the asset. Regular way purchases or sales are purchases or sales of financial assets that require delivery of assets within the timeframe generally established by regulation or convention in the market place.

(ii) Treasury bills and deposits with central banks

Treasury bills and deposits with central banks are initially recognised at cost. Premiums and discounts are amortised to their maturity using the effective interest rate method.

(iii) Deposits with banks and other financial institutions and loans and advances

Deposits with banks and other financial institutions and loans and advances are financial assets with fixed or determinable payments and fixed maturities that are not quoted in an active market. Loans with renegotiated terms are loans, the repayment plan of which have been revised as part of ongoing customer relationship to align with change in cash flows of the borrower, in some instances with improved security and with no other concessions. These assets are risk rated in accordance with the Group's policy on internal credit rating as explained in note 31 (c).

After initial recognition, these are subsequently measured at amortised cost using the effective interest rate method, adjusted for effective fair value hedges, less any amounts written off and provision for impairment. The losses arising from impairment of these assets are recognised in the consolidated statement of income in "net provision for loan losses and others" and in an impairment allowance account in the consolidated balance sheet. Amortised cost is calculated by taking into account any discount or premium on acquisition and fees that are an integral part of the effective interest rate. The amortisation is included in "interest income" in the consolidated statement of income.

(iv) Debt instruments

Debt instruments are measured at amortised cost using the effective interest rate method if:

- the assets are held within a business model whose objective is to hold assets in order to collect contractual cash flows; and
- the contractual terms of the financial assets give rise on specified dates to cash flows that are solely payments of principal and interest ("SPPI") on the principal amount outstanding.

For the purposes of this assessment, 'principal' is defined as the fair value of the financial asset on initial recognition. 'Interest' is defined as consideration for the time value of money and for the credit risk associated with the principal amount outstanding during a particular period of time and for other basic lending risks and costs, as well as profit margin. In assessing whether the contractual cash flows are SPPI, the Group considers the contractual terms of the instrument.

If either of these two criteria is not met, the financial assets are classified and measured at FVTPL. Additionally, even if the financial asset meets the amortised cost criteria the Group may choose at initial recognition to designate the financial asset at FVTPL based on the business model.

The Group accounts for any changes in the fair value in the consolidated statement of income for assets classified as "FVTPL". The change in value is not recognized for assets carried at cost or amortised cost.

(v) Equity investments

Investments in equity instruments are classified as FVTPL, unless the Group designates an equity investment that is not held for trading as FVTOCI on initial recognition. At initial recognition, the Group can make irrevocable election on an instrument by instrument basis to designate an equity instrument as FVTOCI. If an equity investment is designated as FVTOCI, all gains and losses, except for dividend income, are recognised in other comprehensive income and are not subsequently included in the consolidated statement of income.

3 ACCOUNTING POLICIES (continued)

3.3 Summary of significant accounting policies (continued)

(c) Financial instruments (continued)

(vi) Other financial instruments

A financial asset is classified as held for trading if:

- it has been acquired principally for the purpose of selling in the near term;
- on initial recognition it is part of a portfolio of identified financial instruments that are managed together and for which there is a recent actual pattern of short term profitability; or
- it is a derivative and not designated and effective as a hedging instrument or a financial guarantee.

(vii) Derivatives (other than hedging instruments)

Changes in fair values of the derivatives held for trading are included in the consolidated statement of income under "trading income".

Derivatives embedded in other financial instruments are not separated from the host contract and the entire contract is considered in order to determine its classification. These financial instruments are classified as FVTPL and the changes in fair value of the entire hybrid contract are recognised in the consolidated statement of income.

(viii) Deposits and subordinated liabilities

These financial liabilities are carried at amortised cost, less amounts repaid.

(d) Derecognition of financial assets and financial liabilities

A financial asset (or where applicable, a part of a financial asset or part of a group of similar financial assets) is derecognised where:

- the rights to receive cash flows from the asset have expired;
- the Group has transferred its rights to receive cash flows from the asset or has assumed an obligation to pay the received cash flows in full without material delay to a third party under a 'pass-through' arrangement; or
- the Group has transferred its rights to receive cash flows from the asset and either (i) has transferred substantially all the risks and rewards of the asset, or (ii) has neither transferred nor retained substantially all the risks and rewards of the asset, but has transferred control of the asset.

A financial liability is derecognised when the obligation under the liability is discharged, cancelled or expires.

(e) Repurchase agreements

Where investments are sold subject to a commitment to repurchase them at a predetermined price, they remain on the consolidated balance sheet and the consideration received is included in "Borrowings under repurchase agreements". The difference between the sale price and repurchase price is treated as interest expense and is accrued over the life of the agreement using the effective interest rate method.

(f) Determination of fair value

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The fair value measurement is based on the presumption that the transaction to sell an asset or transfer a liability takes place either in the principal market, or in the absence of a principal market, in the most advantageous market.

The fair value of financial instruments that are quoted in an active market is determined by reference to market bid prices respectively at the close of business on the balance sheet date.

The fair value of liabilities with a demand feature is the amount payable on demand.

3 ACCOUNTING POLICIES (continued)

3.3 Summary of significant accounting policies (continued)

(f) Determination of fair value (continued)

The fair value of interest-bearing financial assets and financial liabilities that are not quoted in an active market and are not payable on demand is determined by a discounted cash flow model using the current market interest rates for financial instruments with similar terms and risk characteristics.

For equity investments that are not quoted in an active market, a reasonable estimate of the fair value is determined by reference to the current market value of another instrument that is substantially similar, or is determined using net present valuation techniques. Equity securities and funds classified under level 3 are valued based on discounted cash flows and dividend discount models.

Investments in funds are stated at net asset values provided by the fund managers.

The fair value of unquoted derivatives is determined either by discounted cash flows or option-pricing models.

For the purpose of fair value disclosures, the Group has determined classes of assets and liabilities on the basis of the nature, characteristics and risks of the assets or liabilities.

For assets and liabilities that are recognised in the consolidated financial statements on a recurring basis, the Group determines whether transfers have occurred between Levels in the hierarchy by re-assessing categorisation (based on the lowest level input that is significant to the fair value measurement as a whole) at the end of each reporting period disclosed in note 34.

(g) Impairment of financial assets

An assessment is made at each balance sheet date to determine whether there is any objective evidence that a specific financial asset or a group of financial assets may be impaired. If such evidence exists, the estimated recoverable amount of that asset or a group of financial assets is determined and any impairment loss, based on the net present value of future anticipated cash flows, is recognised in the consolidated statement of income and credited to an allowance account.

Objective evidence that financial assets are impaired can include default or delinquency by a borrower, restructuring of a loan or advance by the Group on terms that the Group would not otherwise consider, indications that a borrower or issuer will enter bankruptcy, the disappearance of an active market for a security, or other observable data relating to a group of assets such as adverse changes in the payment status of borrowers or issuers in the group, or economic conditions that correlate with defaults in the Group.

The present value of the estimated future cash flows for loans and other interest bearing financial assets is discounted at the financial asset's original effective interest rate. If a loan has a variable interest rate, the discount rate for measuring any impairment loss is the current effective interest rate. The calculation of the present value of the estimated future cash flows of a collateralised financial asset reflects the cash flows that may result from foreclosure less costs for obtaining and selling the collateral, whether or not foreclosure is probable.

In addition to specific provisions against individually significant financial assets, the Group also makes collective impairment provisions on groups of financial assets, which although not identified as requiring a specific provision, have a greater risk of default than the risk at initial recognition. Financial assets are grouped on the basis of similar credit risk characteristics that are indicative of the debtors' ability to pay all amounts due according to the contractual terms and the collective impairment provision is estimated for any such group where credit risk characteristics of the group of financial assets has deteriorated. Factors such as any deterioration in country risk, industry, technological obsolescence as well as identified structural weaknesses or deterioration in cash flows are taken into consideration and the amount of the provision is based on the historical loss pattern within each group, adjusted to reflect current economic changes.

3 ACCOUNTING POLICIES (continued)**3.3 Summary of significant accounting policies (continued)****(g) Impairment of financial assets (continued)**

Loans together with the associated allowance are written off when there is no realistic prospect of future recovery and all collateral has been realised or has been transferred to the Group. If, in a subsequent year, the amount of the estimated impairment loss increases or decreases because of an event occurring after the impairment was recognised, the previously recognised impairment loss is increased or reduced by adjusting the allowance account. If a write-off is later recovered, the recovery is credited to the 'provision for loan losses and others' in the consolidated statement of income.

(h) Hedge accounting

The Group enters into derivative instruments including futures, forwards, swaps and options to manage exposures to interest rate and foreign currency risks, including exposures arising from forecast transactions. In order to manage particular risks, the Group applies hedge accounting for transactions which meet the specified criteria. Derivatives are stated at fair value. Derivatives with positive market values are included in "interest receivable and other assets" and derivatives with negative market values are included in "interest payable and other liabilities" in the consolidated balance sheet.

At inception of the hedge relationship, the Group formally designates and documents the relationship between the hedged item and the hedging instrument, including the nature of the risk, management objectives and strategy for undertaking the hedge. The methods that will be used to assess the effectiveness of the hedging relationship form part of the Group's documentation.

Also at the inception of the hedge relationship, a formal assessment is undertaken to ensure the hedging instrument is expected to be highly effective in offsetting the designated risk in the hedged item. Hedges are formally assessed at each reporting date. A hedge is regarded as highly effective if the changes in fair value or cash flows attributable to the hedged risk during the period for which the hedge is designated were offset in a range of 80% to 125%. For situations where the hedged item is a forecast transaction, the Group assesses whether the transaction is highly probable and presents an exposure to variations in cash flows that could ultimately affect the consolidated statement of income.

For the purposes of hedge accounting, hedges are classified into two categories: (i) fair value hedges which hedge the exposure to changes in the fair value of a recognised asset or liability; and (ii) cash flow hedges which hedge exposure to variability in cash flows that is attributable to a particular risk associated with a recognised asset or liability or a forecasted transaction.

(i) Fair value hedges

For fair value hedges which meet the conditions for hedge accounting, any gain or loss from remeasuring the hedging instrument at fair value is recognised immediately in the consolidated statement of income. The hedged item is adjusted for fair value changes relating to the risk being hedged and the difference is recognised in the consolidated statement of income.

If the hedging instrument expires or is sold, terminated or exercised, or where the hedge no longer meets the criteria for hedge accounting, the hedge relationship is terminated. For hedged items recorded at amortised cost, the difference between the carrying value of the hedged item on termination and the value at which it would have been carried without being hedged is amortised over the remaining term of the original hedge. If the hedged item is derecognised, the unamortised fair value adjustment is recognised immediately in the consolidated statement of income.

(ii) Cash flow hedges

For cash flow hedges which meet the conditions for hedge accounting, the portion of the gain or loss on the hedging instrument which is determined to be an effective hedge is recognised initially in OCI. The ineffective portion of the fair value of the derivative is recognised immediately in the consolidated statement of income as "trading income".

3 ACCOUNTING POLICIES (continued)

3.3 Summary of significant accounting policies (continued)

(h) Hedge accounting (continued)

(ii) Cash flow hedges (continued)

The gains or losses on effective cash flow hedges recognised initially in OCI are either transferred to the consolidated statement of income in the period in which the hedged transaction impacts the consolidated statement of income or included in the initial measurement of the related asset or liability.

For hedges which do not qualify for hedge accounting, any gains or losses arising from changes in the fair value of the hedging instrument are recognised in the consolidated statement of income for the year.

Hedge accounting is discontinued when the hedging instrument expires or is sold, terminated or exercised, or no longer qualifies for hedge accounting. In the case of cash flow hedges, the cumulative gain or loss on the hedging instrument recognised in OCI remains in OCI until the forecasted transaction occurs, unless the hedged transaction is no longer expected to occur, in which case the net cumulative gain or loss recognised in equity is transferred to the consolidated statement of income for the year.

(i) Offsetting financial instruments

Financial assets and financial liabilities are only offset and the net amount reported in the consolidated balance sheet when there is a currently enforceable legal right to offset the recognised amounts and the Group intends to settle on a net basis.

(j) Revenue recognition

Revenue is recognised to the extent that it is probable that the economic benefits will flow to the Group and the revenue can be reliably measured. The following specific recognition criteria must also be met before revenue is recognised:

(i) Interest income and expense

For all interest bearing financial instruments, interest income or expense is recorded using the effective interest rate, which is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument or a short period, where appropriate, to the net carrying amount of the financial assets or financial liability. Interest that is 90 days or more overdue is excluded from income. Interest on impaired loans and advances and other financial assets is not recognised in the consolidated statement of income.

(ii) Fees and commissions income

Credit origination fees are treated as an integral part of the effective interest rate of financial instruments and are recognised over their lives, except when the underlying risk is sold to a third party at which time it is recognised immediately. Other fees and commissions income are recognised when earned.

(iii) Dividend income

Dividend income is recognised when the right to receive payment is established.

(k) Business combinations, goodwill and other intangible assets

Business combinations are accounted for using the purchase method of accounting. Assets and liabilities acquired are recognised at the acquisition date fair values with any excess of the cost of acquisition over the net assets acquired being recognised as goodwill. Changes in parent's ownership interest in a subsidiary that do not result in loss of control are treated as transactions between equity holders and are reported in equity.

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3 ACCOUNTING POLICIES (continued)**3.3 Summary of significant accounting policies (continued)****(k) Business combinations, goodwill and other intangible assets (continued)**

Goodwill acquired in a business combination is initially measured at cost being the excess of the cost of the business combination over the Group's interest in the net fair value of the identifiable assets, liabilities and contingent liabilities acquired. Following initial recognition, goodwill is reviewed for impairment annually or more frequently if events or changes in circumstances indicate that the carrying value may be impaired. After initial recognition, goodwill is measured at cost less any accumulated impairment losses.

Intangible assets are measured on initial recognition at their fair values on the date of recognition. Following initial recognition, intangible assets are carried at originally recognised values less any accumulated impairment losses.

Impairment of goodwill and intangible assets with indefinite life is determined by assessing the recoverable amount of the cash-generating unit (or group of cash-generating units), to which the goodwill relates. Where the recoverable amount of the cash-generating unit (or group of cash-generating units) is less than the carrying amount, an impairment loss is recognised immediately in the consolidated statement of income.

For the purpose of impairment testing, goodwill and intangible assets with indefinite life acquired in a business combination is, from the acquisition date, allocated to each of the Group's cash-generating units, or groups of cash-generating units, that are expected to benefit from the synergies of the combination, irrespective of whether other assets or liabilities of the Group are assigned to those units or groups of units. Each unit or group of units to which the goodwill is allocated:

- represents the lowest level within the Group at which the goodwill is monitored for internal management purposes; and
- is not larger than a segment based on either the Group's primary or the Group's geographic segment reporting format determined in accordance with IFRS 8 Operating Segments.

(l) Premises and equipment

Freehold land is initially recognised at cost. After initial recognition, freehold land is carried at the revalued amount. The revaluation is carried out periodically by independent professional property valuers. Fair value is determined by reference to market-based evidence. The resultant revaluation surplus is recognised, as a separate component under equity. Revaluation deficit, if any, is recognised in the consolidated statement of income, except that a deficit directly offsetting a previously recognised surplus on the same asset is directly offset against the surplus in the revaluation reserve in equity.

Premises and equipment are stated at cost, less accumulated depreciation and impairment.

Depreciation on buildings and other premises and equipment is provided on a straight-line basis over their estimated useful lives.

The estimated useful lives of the assets for the calculation of depreciation are as follows:

- | | |
|--------------------------------|-----------------------|
| - Freehold buildings | 40 to 50 years |
| - Leasehold land and buildings | Over the lease period |
| - Other premises and equipment | Up to 10 years |

(m) Investment property

Land and buildings held for the purpose of capital appreciation or for long term rental yields and not occupied by the Group are classified as investment properties. Investment properties are remeasured at cost less accumulated depreciation (depreciation for buildings based on an estimated useful life of 40 years using the straight line method) and accumulated impairment. Any gains or losses on the retirement or disposal of an investment property are recognised in the consolidated statement of income in the period of retirement or when sale is completed.

3 ACCOUNTING POLICIES (continued)

3.3 Summary of significant accounting policies (continued)

(n) Cash and cash equivalents

Cash and cash equivalents comprise cash and balances with central banks, excluding mandatory reserve deposits, together with those deposits with banks and other financial institutions and treasury bills having an original maturity of three months or less.

(o) Provisions

Provisions are recognised when the Group has a present obligation arising from a past event and the costs to settle the obligation are both probable and able to be reliably estimated.

(p) Employee benefits

Defined benefit pension plan

Pension costs are recognised on a systematic basis so that the costs of providing retirement benefits to employees are evenly matched, so far as possible, to the service lives of the employees concerned. Remeasurements of the net defined benefit liability, which comprise actuarial gains and losses, the return on plan assets and the effect of the asset ceiling (if any) both excluding interest are recognised immediately in OCI.

Defined contribution plans

The Group also operates a defined contribution plan, the costs of which are recognised in the period to which they relate.

(q) Taxes

There is no tax on corporate income in the Kingdom of Bahrain. Taxation on income from foreign entities is provided for in accordance with the fiscal regulations of the countries in which the respective Group entities operate.

Deferred taxation is provided for using the liability method on all temporary differences calculated at the rate at which it is expected to be payable. Deferred tax assets are only recognised if recovery is probable.

(r) Fiduciary assets

Assets held in trust or in a fiduciary capacity are not treated as assets of the Group and, accordingly, are not incorporated in the consolidated balance sheet.

(s) Non-controlling interests

Non-controlling interests represents the portion of profit or loss and net assets in the subsidiaries not attributable to the Bank's equity shareholders. Any change in Group's ownership interest in the subsidiary that does not result in a loss of control is accounted for as an equity transaction.

(t) Perpetual Tier 1 capital securities

Perpetual Tier 1 capital securities of the Group are recognised under equity in the consolidated balance sheet and the corresponding distribution on those securities are accounted as a debit to retained earnings.

(u) Dividends on ordinary shares

Dividends on ordinary shares are recognised as a liability and deducted from equity when they are approved by the Bank's shareholders.

Dividends for the period that are approved after the balance sheet date are shown as an appropriation and reported in the consolidated statement of changes in equity, as an event after the balance sheet date.

3 ACCOUNTING POLICIES (continued)

3.3 Summary of significant accounting policies (continued)

(v) Treasury shares

Own equity instruments that are acquired are recognised at cost and deducted from equity. Any surplus/deficit arising from the subsequent sale of treasury shares is included in capital reserve under equity.

(w) Employees' share purchase plan

The Group operates an employees' share purchase plan for certain eligible employees. The difference between the issue price and the fair value of the shares at the grant date is amortised over the vesting period in the consolidated statement of income with a corresponding effect to equity.

(x) Financial guarantees and loan commitments

In the ordinary course of business, the Group gives financial guarantees, consisting of letters of credit, guarantees and acceptances. Financial guarantees are contracts that require the Group to make specified payments to reimburse the holders for a loss that is incurred because a specified debtor fails to make payments when due in accordance with the terms of a debt instrument. Loan commitments are firm commitments to provide credit under pre-specified terms and conditions.

Financial guarantees are initially recognised in the consolidated financial statements at fair value, adjusted for transaction costs that are directly attributable to the issuance of the guarantee. Subsequent to initial recognition, the Group's liability under each guarantee is measured at the higher of the amortised commission and the best estimate of expenditure required to settle any financial obligation arising as a result of the guarantee.

(y) Repossessed assets

Repossessed assets are assets acquired in settlement of debt. These assets are carried at the lower of their repossessed value or their fair value and reported under "other assets".

(z) Islamic banking

The Islamic banking activities of the Group are conducted in accordance with Islamic Shari'a principles, as approved by the Shari'a Supervisory Board.

- Earnings prohibited by Sharia

The Islamic operation is committed to avoid recognising any income generated from non-Islamic sources. Accordingly, all non-Islamic income is credited to the charity account where the Islamic operation uses these funds for charitable purposes.

- Commingling of funds

The funds of Islamic operation are not commingled with the funds of the conventional operations of the Group.

(aa) Islamic products

Murabaha

An agreement whereby the Group sells to a customer commodities, real estate and certain other assets at cost plus an agreed profit mark up whereby the Group (seller) informs the purchaser of the price at which the asset had been purchased and also stipulates the amount of profit to be recognized.

Ijara

A lease agreement between the Group (lessor) and the customer (lessee), whereby the Group earns profit by charging rentals on assets leased to customers.

Tawarruq

A sales agreement whereby a customer buys commodities from the Group on a deferred payment basis and then immediately resells them for cash to a third party.

3 ACCOUNTING POLICIES (continued)

3.3 Summary of significant accounting policies (continued)

(aa) Islamic products (continued)

Mudaraba

An agreement between two parties; one of them provides the funds and is called Rab-UI-Mal and the other provides efforts and expertise and is called the Mudarib and is responsible for investing such funds in a specific enterprise or activity in return for a pre-agreed percentage of the Mudaraba income. In the case of normal loss, the Rab-UI-Mal would bear the loss of its funds while the Mudarib would bear the loss of its efforts. However, in the case of default, negligence or violation of any of the terms and conditions of the Mudaraba agreement, only the Mudarib would bear the losses. The Group acts as Mudarib when accepting funds from depositors and as Rab-UI-Mal when investing such funds on a Mudaraba basis.

Wakala

An agreement whereby the Group provides a certain sum of money to an agent who invests it according to specific conditions in return for a certain fee (a lump sum of money or a percentage of the amount invested). The agent is obliged to return the invested amount in the case of default, negligence or violation of any of the terms and conditions of the Wakala.

Istisna'a

Istisna'a is a sale contract between a contract owner and a contractor whereby the contractor based on an order from the contract owner undertakes to manufacture or otherwise acquire the subject matter of the contract according to specifications, and sells it to the contract owner for an agreed upon price and method of settlement whether that be in advance, by instalments or deferred to a specific future time.

Revenue recognition

Revenue is recognised on the above Islamic products as follows:

Income from Murabaha, Tawarruq and Istisna'a are recognised on an effective yield basis which is established on the initial recognition of the asset and is not revised subsequently.

Income from Ijara is recognized over the term of the Ijara agreement so as to yield a constant rate of return on the net investment outstanding.

Income (loss) on Mudaraba financing is based on expected results adjusted for actual experience as applicable, while similarly the losses are charged to income.

Estimated income from Wakala is recognised on an accrual basis over the period, adjusted by actual income when received. Losses are accounted for on the date of declaration by the agent.

(ab) Equity of unrestricted investment account holders' share of profit

The profit computed after taking into account all income and expenses at the end of a financial year is distributed between Equity of unrestricted investment account holders which include Mudaraba depositors and the Group's shareholders. The share of profit of the Equity of unrestricted investment account holders is calculated on the basis of their daily deposit balances over the year, after reducing the agreed and declared Mudaraba fee.

Equity of unrestricted investment account holders do not bear the expenses relating to non compliance with Shari'a regulations.

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4 NET INTEREST INCOME**(a) INTEREST INCOME**

| | <u>2017</u> | <u>2016</u> |
|-------------------------|------------------|------------------|
| | <u>US\$'000</u> | <u>US\$'000</u> |
| Treasury bills | 101,032 | 109,939 |
| Deposits with banks | 42,432 | 36,331 |
| Loans and advances | 998,161 | 946,358 |
| Non-trading investments | 237,549 | 227,170 |
| | <u>1,379,174</u> | <u>1,319,798</u> |

(b) INTEREST EXPENSE

| | <u>2017</u> | <u>2016</u> |
|-----------------------------------|-----------------------|-----------------------|
| | <u>US\$'000</u> | <u>US\$'000</u> |
| Deposits from banks | | |
| (including repurchase agreements) | 54,766 | 52,009 |
| Customers' deposits | 437,711 | 429,629 |
| Subordinated liabilities | 10,227 | 9,928 |
| | <u>502,704</u> | <u>491,566</u> |
| NET INTEREST INCOME | <u><u>876,470</u></u> | <u><u>828,232</u></u> |

5 FEES, COMMISSIONS AND OTHERS

| | <u>2017</u> | <u>2016</u> |
|--|-----------------|-----------------|
| | <u>US\$'000</u> | <u>US\$'000</u> |
| Fees and commission income | | |
| - Transaction banking services | 112,881 | 117,217 |
| - Management, performance and brokerage fees | 28,336 | 29,122 |
| Fees and commission expense | (9,450) | (8,568) |
| Others | 13,246 | 31,964 |
| | <u>145,013</u> | <u>169,735</u> |

Included in 'management, performance and brokerage fees' is US\$ 12.6 million (2016: US\$ 9.9 million) of fee income relating to trust and other fiduciary activities.

6 TRADING INCOME

| | <u>2017</u> | <u>2016</u> |
|--|-----------------|-----------------|
| | <u>US\$'000</u> | <u>US\$'000</u> |
| Foreign exchange - customer transactions | 29,198 | 41,383 |
| Proprietary trading | 6,041 | 6,905 |
| | <u>35,239</u> | <u>48,288</u> |

7 (a) CASH AND BALANCES WITH CENTRAL BANKS

| | <u>2017</u> | <u>2016</u> |
|--|-----------------|-----------------|
| | <u>US\$'000</u> | <u>US\$'000</u> |
| Cash and balances with central banks, excluding mandatory reserve deposits (note 24) | 484,124 | 665,894 |
| Mandatory reserve deposits with central banks | 325,862 | 247,030 |
| | <u>809,986</u> | <u>912,924</u> |

Mandatory reserve deposits are not available for use in day-to-day operations.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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7 (b) TREASURY BILLS AND DEPOSITS WITH CENTRAL BANKS

| | 2017 | 2016 |
|-------------------------|------------------|------------------|
| | US\$ '000 | US\$ '000 |
| Central Bank of Bahrain | 610,952 | 151,026 |
| Central Bank of Kuwait | 1,376,244 | 1,396,752 |
| Central Bank of Egypt | 407,909 | 716,386 |
| Central Bank of Iraq | 140,744 | 163,831 |
| Bank of England | 40,503 | 36,851 |
| | <u>2,576,352</u> | <u>2,464,846</u> |

The Deposits with Central Banks and Treasury bills are local currency denominated and are match funded by underlying respective local currencies.

8 LOANS AND ADVANCES

| | 2017 | | 2016 | |
|--|-------------------|-------|-------------------|-------|
| | US\$ '000 | % | US\$ '000 | % |
| a) By industry sector | | | | |
| Consumer/personal | 2,923,110 | 14.6 | 3,003,722 | 15.6 |
| Residential mortgage | 1,566,687 | 7.8 | 1,439,689 | 7.5 |
| Trading and manufacturing | 4,980,074 | 24.8 | 4,604,115 | 23.9 |
| Real estate | 5,192,200 | 25.8 | 5,188,090 | 26.9 |
| Banks and other financial institutions | 805,739 | 4.0 | 817,111 | 4.2 |
| Services | 4,130,810 | 20.6 | 3,709,224 | 19.2 |
| Government/public sector | 115,380 | 0.6 | 221,186 | 1.1 |
| Others | 373,770 | 1.8 | 320,917 | 1.6 |
| | <u>20,087,770</u> | 100.0 | 19,304,054 | 100.0 |
| Less: Specific impairment provision | (324,679) | | (380,239) | |
| Less: Collective impairment provision | (264,389) | | (316,932) | |
| | <u>19,498,702</u> | | <u>18,606,883</u> | |
| | | | | |
| b) By geographic region | | | | |
| Kingdom of Bahrain | 3,640,879 | 18.1 | 3,553,793 | 18.5 |
| State of Kuwait | 9,683,976 | 48.2 | 9,824,968 | 50.9 |
| Other GCC countries | 3,096,729 | 15.4 | 2,804,696 | 14.5 |
| United Kingdom | 1,558,328 | 7.8 | 1,300,502 | 6.7 |
| Arab Republic of Egypt | 1,601,126 | 8.0 | 1,431,118 | 7.4 |
| Europe (excluding United Kingdom) | 205,848 | 1.0 | 88,856 | 0.5 |
| Asia (excluding GCC countries) | 200,977 | 1.0 | 241,190 | 1.2 |
| Rest of the world | 99,907 | 0.5 | 58,931 | 0.3 |
| | <u>20,087,770</u> | 100.0 | 19,304,054 | 100.0 |
| Less: Specific impairment provision | (324,679) | | (380,239) | |
| Less: Collective impairment provision | (264,389) | | (316,932) | |
| | <u>19,498,702</u> | | <u>18,606,883</u> | |

Please refer note 31 (c) for disclosure of credit quality of loans and advances.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

31 December 2017

8 LOANS AND ADVANCES (continued)

c) Age analysis of past due but not impaired loans and advances

| | 2017 | | | |
|--------------------|----------------|---------------|---------------|----------------|
| | Up to 30 days | 31 to 60 days | 61 to 89 days | Total |
| | US\$ '000 | US\$ '000 | US\$ '000 | US\$ '000 |
| Loans and advances | | | | |
| Retail | 167,574 | 48,011 | 30,908 | 246,493 |
| Corporate | 83,416 | 22,025 | 32,893 | 138,334 |
| | 250,990 | 70,036 | 63,801 | 384,827 |
| | | | | |
| | 2016 | | | |
| | Up to 30 days | 31 to 60 days | 61 to 89 days | Total |
| | US\$ '000 | US\$ '000 | US\$ '000 | US\$ '000 |
| Loans and advances | | | | |
| Retail | 65,182 | 27,256 | 30,202 | 122,640 |
| Corporate | 19,087 | 8,714 | 61,182 | 88,983 |
| | 84,269 | 35,970 | 91,384 | 211,623 |

The past due loans and advances up to 30 days include those that are only past due by a few days. None of the above past due loans are considered to be impaired.

d) Individually impaired loans and advances

| | 2017 | | | 2016 | | |
|--------------------------------|---------------------|------------------------|--------------------|---------------------|------------------------|--------------------|
| | Retail US\$ '000 | Corporate US\$ '000 | Total US\$ '000 | Retail US\$ '000 | Corporate US\$ '000 | Total US\$ '000 |
| Gross impaired loans | 46,269 | 335,384 | 381,653 | 33,552 | 414,552 | 448,104 |
| Specific impairment provisions | (39,422) | (285,257) | (324,679) | (28,586) | (351,653) | (380,239) |
| | 6,847 | 50,127 | 56,974 | 4,966 | 62,899 | 67,865 |
| Impaired loan coverage | 85.2% | 85.1% | 85.1% | 85.2% | 84.8% | 84.9% |
| Gross loans | 3,942,033 | 16,145,737 | 20,087,770 | 3,781,435 | 15,522,619 | 19,304,054 |
| Impaired loan ratio | 1.2% | 2.1% | 1.9% | 0.9% | 2.7% | 2.3% |

The fair value of collateral that the Group holds relating to loans individually determined to be impaired at 31 December 2017 amounts to US\$ 357.7 million (31 December 2016: US\$ 443.9 million). The collateral consists of cash, securities and properties.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

31 December 2017

8 LOANS AND ADVANCES (continued)**e) Impairment allowance for loans and advances**

A reconciliation of the allowance for impairment losses for loans and advances by class is as follows:

| | <i>2017</i> | | | <i>2016</i> | | |
|-------------------------------------|------------------|------------------|------------------|------------------|------------------|------------------|
| | <i>Retail</i> | <i>Corporate</i> | <i>Total</i> | <i>Retail</i> | <i>Corporate</i> | <i>Total</i> |
| | <i>US\$ '000</i> | <i>US\$ '000</i> | <i>US\$ '000</i> | <i>US\$ '000</i> | <i>US\$ '000</i> | <i>US\$ '000</i> |
| At 1 January | 64,148 | 633,023 | 697,171 | 62,615 | 608,297 | 670,912 |
| Add/(Less): | | | | | | |
| Amounts written off during the year | (20,464) | (188,981) | (209,445) | (17,270) | (105,675) | (122,945) |
| Charge for the year | 20,790 | 116,408 | 137,198 | 23,416 | 136,801 | 160,217 |
| Recoveries during the year | (3,678) | (46,398) | (50,076) | (4,196) | (1,085) | (5,281) |
| Exchange rate and other adjustments | 1,823 | 12,397 | 14,220 | (417) | (5,315) | (5,732) |
| At 31 December | 62,619 | 526,449 | 589,068 | 64,148 | 633,023 | 697,171 |

f) Net provision for loan losses and others

The net charge for the year for provision for loan losses and others in the consolidated statement of income is determined as follows:

| | <i>2017</i> | <i>2016</i> |
|---|------------------|------------------|
| | <i>US\$ '000</i> | <i>US\$ '000</i> |
| Impairment charge for the year on loans and advances (note 8(e)) | 137,198 | 160,217 |
| Recoveries from loans and advances during the year (including from fully provided loans written off in previous years) | (76,481) | (21,629) |
| Net charge for others | 25,953 | 10,974 |
| Net provision for loan losses and others | 86,670 | 149,562 |

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

31 December 2017

9 NON-TRADING INVESTMENTS

| | 2017 | | |
|--|--|--|---------------------------|
| | <i>Held at amortised cost US\$'000</i> | <i>Held at Fair value US\$'000</i> | <i>Total US\$'000</i> |
| Quoted investments | | | |
| GCC government bonds and debt securities | 1,141,952 | - | 1,141,952 |
| Other government bonds and debt securities | 1,100,076 | - | 1,100,076 |
| GCC government entities' securities | 650,860 | - | 650,860 |
| Notes and certificates of deposit: | | | |
| - issued by banks and other financial institutions | 1,770,930 | - | 1,770,930 |
| - issued by corporate bodies | 1,194,231 | - | 1,194,231 |
| Equity | - | 37,362 | 37,362 |
| Funds at net asset value | - | 1,729 | 1,729 |
| | 5,858,049 | 39,091 | 5,897,140 |
| Unquoted investments | | | |
| Other government bonds and debt securities | | | |
| Notes and certificates of deposit: | | | |
| - issued by banks and other financial institutions | 57,788 | - | 57,788 |
| Equity | - | 33,519 | 33,519 |
| Funds at net asset value | - | 53,184 | 53,184 |
| | 57,788 | 86,703 | 144,491 |
| Total | 5,915,837 | 125,794 | 6,041,631 |
| Less: Allowance for impairment | | | (39,221) |
| | | | 6,002,410 |

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

31 December 2017

9 NON-TRADING INVESTMENTS (continued)

| | 2016 | | |
|--|---|---|----------------------------|
| | <i>Held at amortised cost US\$ '000</i> | <i>Held at Fair value US\$ '000</i> | <i>Total US\$ '000</i> |
| Quoted investments | | | |
| GCC government bonds and debt securities | 855,203 | - | 855,203 |
| Other government bonds and debt securities | 823,052 | - | 823,052 |
| GCC government entities' securities | 647,828 | - | 647,828 |
| Notes and certificates of deposit: | | | |
| - issued by banks and other financial institutions | 1,918,561 | - | 1,918,561 |
| - issued by corporate bodies | 1,088,916 | - | 1,088,916 |
| Equity | - | 37,592 | 37,592 |
| Funds at net asset value | - | 11,940 | 11,940 |
| | <u>5,333,560</u> | <u>49,532</u> | <u>5,383,092</u> |
| Unquoted investments | | | |
| Other government bonds and debt securities | 1,860 | - | 1,860 |
| Notes and certificates of deposit: | | | |
| - issued by banks and other financial institutions | 182,834 | - | 182,834 |
| - issued by corporate bodies | 1,558 | - | 1,558 |
| Equity | - | 33,025 | 33,025 |
| Funds at net asset value | - | 58,312 | 58,312 |
| | <u>186,252</u> | <u>91,337</u> | <u>277,589</u> |
| Total | <u>5,519,812</u> | <u>140,869</u> | <u>5,660,681</u> |
| Less: Allowance for impairment | | | <u>(90,234)</u> |
| | | | <u>5,570,447</u> |

The fair value of the non-trading investments held at amortised cost is US\$ 5,990.7 million as at 31 December 2017 (31 December 2016: US\$ 5,563.8 million) of which US\$ 5,932.9 million is classified under level 1 of fair value hierarchy (31 December 2016: US\$ 5,377.2 million) and US\$ 57.8 million is classified under level 2 of fair value hierarchy (31 December 2016: US\$ 186.6 million).

Investment held at fair value include investments amounting to US\$ 1.2 million (2016: US\$ 1.0 million) which are designated as FVTPL.

Please refer note 31 (c) for disclosure of credit quality of non-trading investments.

The movements in provision for impairment on investments were as follows:

| | 2017 US\$ '000 | 2016 US\$ '000 |
|--|-------------------|-------------------|
| At 1 January | 90,234 | 184,099 |
| Add/(Less): | | |
| Charge for the year | 2,280 | 9,279 |
| Amounts written off during the year | (12,436) | (11,564) |
| Transfer to repossessed assets | - | (26,351) |
| Transfer to investment properties | - | (16,798) |
| Exchange rate and other reclassification / adjustments | (40,857) | (48,431) |
| At 31 December | <u>39,221</u> | <u>90,234</u> |

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10 INVESTMENTS IN ASSOCIATES

The principal associates of the Group are:

| Name | Country of incorporation | Nominal Holding | |
|---|--------------------------|-----------------|-------|
| | | 2017 | 2016 |
| Ahli Bank S.A.O.G. | Sultanate of Oman | 35.0% | 35.0% |
| United Bank for Commerce and Investment S.A.L. (UBCI) | Libya | 40.0% | 40.0% |
| Middle East Financial Investment Company (MEFIC) | Kingdom of Saudi Arabia | 40.0% | 40.0% |

The summarised financial information of the Group's associates was as follows:

| | 2017 | 2016 |
|--|-----------|-----------|
| | US\$ '000 | US\$ '000 |
| Assets | 5,937,476 | 5,524,151 |
| Liabilities | 4,967,284 | 4,715,872 |
| Net profit and comprehensive income for the year (Group's share) | 23,251 | 26,626 |

Financial information of Ahli Bank S.A.O.G. is provided below. The information is based on amounts as reported in financial statements of Ahli Bank S.A.O.G.

| | 31 December 2017 | 31 December 2016 |
|--|------------------|------------------|
| | US\$ '000 | US\$ '000 |
| Ahli Bank S.A.O.G. | | |
| <i>Balance sheet related information</i> | | |
| Loans and advances | 4,245,345 | 3,953,524 |
| Investment securities | 562,964 | 458,812 |
| Total assets | 5,232,680 | 4,934,168 |
| Customers' deposits | 3,768,444 | 3,301,367 |
| Total liabilities | 4,440,922 | 4,303,133 |
| <i>Income statement related information</i> | | |
| Total operating income | 142,751 | 139,148 |
| Net profit for the year | 69,266 | 76,760 |
| Total comprehensive income | 67,869 | 77,703 |
| Dividends received during the year | 12,955 | 12,955 |
| <i>Cash flow related information</i> | | |
| Net cash from (used in) operating activities | 130,967 | (73,857) |
| Net cash used in investing activities | (62,020) | (15,639) |
| Net cash from (used in) financing activities | 8,961 | (32,013) |

The market value of AUB's investment in Ahli Bank S.A.O.G. based on the price quoted in the Muscat Securities Market is US\$ 224.1 million (31 December 2016: US\$ 254.0 million).

11 INVESTMENT PROPERTIES

These represent properties acquired by the Group and are recognized at cost. As at 31 December 2017, the fair value of the investment properties is US\$ 291.3 million (31 December 2016: US\$ 159.3 million). Investment properties were valued by independent valuers using significant valuation inputs based on unobservable market data and are classified under level 3 of the fair value hierarchy.

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12 PREMISES AND EQUIPMENT

The net book values of the Group's premises and equipment are:

| | <i>2017</i> | <i>2016</i> |
|------------------------------|------------------|------------------|
| | <i>US\$ '000</i> | <i>US\$ '000</i> |
| Freehold land | 92,976 | 94,326 |
| Freehold buildings | 26,146 | 25,827 |
| Leasehold land and buildings | 37,350 | 30,098 |
| IT equipment and others | 49,715 | 38,000 |
| Capital work-in-progress | 20,485 | 22,958 |
| | 226,672 | 211,209 |

Freehold land was revalued by an independent valuer using significant valuation inputs based on unobservable market data and is classified under level 3 of the fair value hierarchy.

13 INTEREST RECEIVABLE AND OTHER ASSETS

| | <i>2017</i> | <i>2016</i> |
|-----------------------------|------------------|------------------|
| | <i>US\$ '000</i> | <i>US\$ '000</i> |
| Tax assets (note 22) | 3,748 | 4,735 |
| Interest receivable | 160,644 | 179,900 |
| Derivative assets (note 28) | 91,191 | 112,945 |
| Prepayments and others | 361,337 | 440,575 |
| | 616,920 | 738,155 |

Prepayments and others include repossessed assets amounting to US\$ 255.6 million (31 December 2016: US\$ 301.8 million).

14 GOODWILL AND OTHER INTANGIBLE ASSETS

| | <i>2017</i> | | | <i>2016</i> | | |
|-------------------------------------|-----------------|--------------------------|-----------------|-----------------|--------------------------|-----------------|
| | <i>Goodwill</i> | <i>Intangible assets</i> | <i>Total</i> | <i>Goodwill</i> | <i>Intangible assets</i> | <i>Total</i> |
| | <i>US\$'000</i> | <i>US\$'000</i> | <i>US\$'000</i> | <i>US\$'000</i> | <i>US\$'000</i> | <i>US\$'000</i> |
| At 1 January | 426,561 | 48,071 | 474,632 | 458,453 | 112,145 | 570,598 |
| Exchange rate and other adjustments | 4,738 | 1,460 | 6,198 | (31,892) | (64,074) | (95,966) |
| At 31 December | 431,299 | 49,531 | 480,830 | 426,561 | 48,071 | 474,632 |

Goodwill:

Goodwill acquired through business combinations has been allocated to the cash-generating units of the acquired entities for impairment testing purposes. The carrying amount of goodwill and intangible assets allocated to each of the cash-generating units is shown under note 30.

14 GOODWILL AND OTHER INTANGIBLE ASSETS (continued)**Key assumptions used in estimating recoverable amounts of cash-generating units**

The recoverable amount of each cash-generating unit's goodwill is based on value-in-use calculations using cash flow projections from financial budgets approved by the management, extrapolated for five year projections using nominal projected Gross Domestic Product growth rate in the respective countries in which they operate. The discount rate applied to cash flow projections represent the cost of capital adjusted for an appropriate risk premium for these business segments. The discount rate used in goodwill impairment testing was 8.8% to 17.3% (2016: 8.5% to 18.0%). The key assumptions used in estimating recoverable amounts of cash generating units were sensitised to test the resilience of value-in-use calculations. On this basis, management believes that reasonable changes in the key assumptions used to determine the recoverable amount of the Group's cash-generating units will not result in an impairment.

Intangible assets:

Intangible assets comprises primarily the subsidiaries' banking licenses which have indefinite lives. Based on an annual impairment assessment of the intangible assets, no indications of impairment were identified (2016: Nil). The fair values of a banking license are determined at the time of acquisition by discounting the future expected profits from their acquisition and their projected terminal value.

15 DEPOSITS FROM BANKS

| | 2017 US\$ '000 | 2016 US\$ '000 |
|-----------------|-------------------|-------------------|
| Demand and call | 1,146,635 | 775,224 |
| Time deposits | 2,796,598 | 2,503,814 |
| | <u>3,943,233</u> | <u>3,279,038</u> |

16 BORROWINGS UNDER REPURCHASE AGREEMENTS

The Group has collateralized borrowing lines of credit with various financial institutions through repurchase arrangements, under which it can borrow up to US\$ 5.6 billion (31 December 2016: US\$ 4.8 billion). Collateral is provided in the form of investment securities held within the non-trading investments portfolio.

As at 31 December 2017, the borrowings under these agreements were US\$ 1,272.8 million (31 December 2016: US\$ 698.2 million) and the fair value of investment securities that had been provided as collateral was US\$ 1,437.6 million (31 December 2016: US\$ 782.9 million).

17 CUSTOMERS' DEPOSITS

| | 2017 US\$ '000 | 2016 US\$ '000 |
|---------------------------|-------------------|-------------------|
| Current and call accounts | 3,999,944 | 4,354,547 |
| Saving accounts | 2,178,777 | 2,094,429 |
| Time deposits | 15,831,136 | 15,254,382 |
| | <u>22,009,857</u> | <u>21,703,358</u> |

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18 INTEREST PAYABLE AND OTHER LIABILITIES

| | <u>2017</u> | <u>2016</u> |
|------------------------------------|------------------|------------------|
| | <u>US\$ '000</u> | <u>US\$ '000</u> |
| Interest payable | 145,647 | 161,594 |
| Accrued charges and other payables | 148,612 | 127,040 |
| Derivative liabilities (note 28) | 143,145 | 142,547 |
| Other credit balances* | 425,238 | 413,494 |
| Tax liabilities (note 22) | 50,037 | 20,701 |
| | <u>912,679</u> | <u>865,376</u> |

* Other credit balances mainly includes insurance related technical provisions, unearned fees, dividend payables, pension fund, margin deposits and other creditors.

19 SUBORDINATED LIABILITIES

These borrowings are subordinated to the claims of all other creditors of the respective banks.

| | <u>2017</u> | <u>2016</u> |
|--|--------------------------|------------------|
| <i>Maturity</i> | <u>US\$ '000</u> | <u>US\$ '000</u> |
| International Finance Corporation (IFC): | | |
| - Repayable in two (31 December 2016: four) equal semi-annual installments and falling on each Interest Payment Date falling thereafter up to and including 15 December 2018. | 2018 | 22,222 |
| - Repayable in four equal semi-annual installments commencing on 15 April 2019 and falling on each Interest Payment Date falling thereafter up to and including 15 October 2020. | 2020 | 165,000 |
| | <u>187,222</u> | <u>209,444</u> |
| Others: | | |
| - 10 year subordinated debt repayable at maturity on 20 January 2020 | 2020 | 17,997 |
| - Repayable at maturity | 5 years & one day notice | 9,985 |
| | <u>27,982</u> | <u>27,538</u> |
| | <u>215,204</u> | <u>236,982</u> |

20 EQUITY

| Ordinary share capital : | | 2017 | 2016 |
|--|--|-----------------------------|------------------|
| | | US\$ '000 | US\$ '000 |
| (a) Authorised : | | | |
| Share capital | | | |
| 10,000 million shares (2016: 8,000 million shares) of US\$ 0.25 each | | 2,500,000 | 2,000,000 |
| Available for issuance of ordinary shares and various classes of preference shares | | | |
| (b) Issued and fully paid: | | | |
| | | 2017 | 2016 |
| | | US\$ '000 | US\$ '000 |
| Ordinary share capital (US\$ 0.25 each) | | 1,889,213 | 1,711,322 |
| Number of shares (millions) | | 7,556.9 | 6,845.3 |
| Number of treasury shares (millions) | | 18.2 | 16.3 |
| <u>Movement in ordinary shares</u> | | 2017 | 2016 |
| | | (number in millions) | |
| Opening balance as at 1 January | | 6,845.3 | 6,492.1 |
| Add: bonus share issue | | 687.0 | 325.7 |
| Add: issuance of additional shares (note 20 (c)) | | 24.6 | 27.5 |
| Closing balance as at 31 December | | 7,556.9 | 6,845.3 |

(c) Employee Share Purchase Plan and Mandatory Share Plan

The Employee Share Purchase Plan ("ESPP") was approved by the Board of Directors on 29 March 2005 and authorized by the shareholders at an EGM on 5 October 2004. An extension of the ESPP by authorizing the issuance of 100 million Ordinary Shares ("Shares") was approved by:

- (i) Board of Directors (on 5 November 2014)
- (ii) Ministry of Commerce (letter dated 9 March 2015).
- (iii) Capital Markets Supervision Directorate of CBB (letter dated 10 March 2015);
- (iv) Retail Banking Supervision Directorate of CBB (letters dated 22 February 2015 & 18 March 2015);
- (v) Shareholders at Annual General Meeting (on 31 March 2015)

As per the approved ESPP terms, 100 million shares were authorized for issuance to qualifying employees of the AUB Group, in five annual tranches (tranches 9-13) over a period from 2015 to 2019. The prices, timing and sizes of the tranches of the Shares are determined by the Board of Directors, within set parameters. The individual allocations of each tranche are made at the discretion of the Compensation Committee. In line with the earlier structure, the Shares are issued to the existing ESPP company, Al Mazaya Company B.S.C. (c) ["AMC"] a special purpose entity incorporated on 29 August 2005, to hold the Shares. AMC in turn issues to the ESPP Trustees, for the beneficial ownership of employees, a corresponding number of unsecured and unsubordinated equity linked notes ("Notes"), each Note representing the economic value of an Ordinary Share, as adjusted by any bonus share issues, dividends and/or rights issues. Notes issued under the scheme are subject to the vesting criteria and conditions, as set out in the ESPP Rules.

During 2016, the Bank issued 21,200,000 Ordinary Shares at a price of US\$ 0.52 per share under Tranche 10 and it was fully allocated to employees. During 2017, the Bank issued 18,368,831 Ordinary Shares at a price of US\$ 0.48 per share under Tranche 11 and it was fully allocated to employees. These Notes vest equally over three years from the grant date and as determined by the Compensation Committee.

Pursuant to the existing shareholders' approval, the Board of Directors has resolved to issue 26,333,496 Ordinary Shares at a price of US\$ 0.50 per share under Tranche 12 to be allocated to employees by the Compensation Committee after obtaining the necessary regulatory approvals.

20 EQUITY (continued)**(c) Employee Share Purchase Plan and Mandatory Share Plan (continued)**

The same bodies also approved the issuance of up to 50 million of Ordinary Shares for the approved Mandatory Share Plan ("MSP") to be initially issued as option rights exercisable into AUB ordinary shares, adjustable for any future bonus share distributions, rights issues or other issuances of share equivalents arising from any re-organization, re-classification, stock-split or consolidation of ordinary shares by the Bank. These options were authorised for issuance to employees of the Bank falling within the ambit of Module HC-5.4.2 of the CBB Rulebook, commencing 1 January 2015 to 1 January 2019 in five annual tranches, corresponding to the annual staff compensation cycle. Individual tranche sizes are determined by the Compensation Committee to address annual remuneration of defined employees, within the CBB regulations. The options can be exercised at the grant price of US\$ 0.25 per option over a three year service period in the ratio of 50%, 35%, 15% respectively and the options expire within 12 months from end of grant date month.

During 2016, the Bank issued 6,302,207 shares as part of the 2015 Performance Bonus Deferred Share Awards of which 1,960,471 options have been exercised till 31 December 2017. During 2017, the Bank issued 6,208,326 shares as part of the 2016 Performance Bonus Deferred Share Awards of which 32,087 options have been exercised till 31 December 2017.

Under the MSP scheme, the Board of Directors has resolved to issue 7,444,378 shares as part of the 2017 Performance Bonus Deferred Share Awards. These shares are entitled to be adjusted for any bonus share issues and dividend until the rights are exercised under the MSP.

(d) Perpetual Tier 1 Capital Securities

| | <u>2017</u> | <u>2016</u> |
|------------------------------------|------------------|------------------|
| | <u>US\$ '000</u> | <u>US\$ '000</u> |
| Issued by the Bank (20d(i)) | 400,000 | 400,000 |
| Issued by the subsidiary (20d(ii)) | 200,000 | 200,000 |
| | <u>600,000</u> | <u>600,000</u> |

- (i) Basel III compliant Additional Tier 1 Perpetual Capital Securities issued by the Bank during 2015 carries an initial distribution rate of 6.875 percent per annum payable semi annually with a reset after every 5 years. These securities are perpetual, subordinated and unsecured. The Capital Certificates are listed on the Irish Stock Exchange. The Bank can elect to make a distribution at its own discretion. The holders of these securities do not have a right to claim the same and such an event will not be considered an event of default. The securities carry no maturity date and have been classified under equity.
- (ii) During 2016, Ahli United Bank K.S.C.P, a subsidiary of the Bank, issued a US\$ 200 million Basel III compliant Additional Tier 1 Perpetual Capital Securities that bears a profit rate of 5.5%, which are eligible to be classified under equity. The Capital Certificates are subordinated, unsecured and will carry a Periodic Distribution Amount, payable semi-annually in arrears, until the first call date (25 October 2021). The Periodic Distribution Amounts in respect of the Capital Certificates may be cancelled (in whole or in part) at the sole discretion of the issuer on a non-cumulative basis. The Capital Certificates is listed on the Irish Stock Exchange and NASDAQ Dubai. These certificates have no maturity date and are callable (in whole but not in part) at par at the option of the issuer on the first call date and on every distribution payment date thereafter, subject to certain conditions.

21 RESERVES**a) Share premium**

The share premium arising on the issue of ordinary shares is not distributable except in such circumstances as stipulated in the Bahrain Commercial Companies Law.

b) Capital reserve

As required by the Bahrain Commercial Companies Law, any profit on the sale of treasury stock is transferred to a capital reserve. The reserve is not distributable except in such circumstances as stipulated in the Bahrain Commercial Companies Law.

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21 RESERVES (continued)**c) Statutory reserve**

As required by the Bahrain Commercial Companies Law and the Bank's Articles of Association, 10% of the net profit is transferred to a statutory reserve on an annual basis. The Bank may resolve to discontinue such transfers when the reserve totals 50% of the paid up capital. The reserve is not distributable except in such circumstances as stipulated in the Bahrain Commercial Companies Law.

d) Property revaluation reserve

The revaluation reserve arising on revaluation of freehold land is not distributable except in such circumstances as stipulated in the Bahrain Commercial Companies Law.

e) Foreign exchange translation reserve

It comprises of translation effects arising on consolidation of subsidiaries, non-monetary equity investments and investments in associates.

f) Other comprehensive income reserve (OCI Reserve)

This reserve represents changes in the fair values of equity investments that have been classified as fair value through other comprehensive income.

g) Cash flow hedge reserve

This reserve represents the effective portion of gain or loss on the Group's cash flow hedging instruments.

h) Movements in other reserves

| | <i>Capital reserve</i> | <i>Property revaluation reserve</i> | <i>Foreign exchange translation reserve</i> | <i>Cumulative changes</i> | | | <i>Pension fund reserve</i> | <i>Total other reserves</i> |
|---|----------------------------|---|---|---------------------------|--|-------------------------|-------------------------------------|-------------------------------------|
| | | | | <i>OCI reserve</i> | <i>Cash flow hedge reserve</i> | <i>ESPP reserve</i> | | |
| | <i>US\$ '000</i> | <i>US\$ '000</i> | <i>US\$ '000</i> | <i>US\$ '000</i> | <i>US\$ '000</i> | <i>US\$ '000</i> | <i>US\$ '000</i> | <i>US\$ '000</i> |
| Balance at 1 January 2017 | 8,480 | 36,256 | (455,168) | (11,019) | (23,783) | - | (57,742) | (502,976) |
| Currency translation adjustments | - | - | 31,182 | - | - | - | - | 31,182 |
| Transfers to consolidated statement of income | - | - | - | - | (1,570) | - | - | (1,570) |
| Net fair value movements | - | - | - | (5,666) | (1,306) | - | - | (6,972) |
| Transfers to retained earnings | - | (243) | - | 3,704 | - | (3,921) | - | (460) |
| Fair value movements and others | - | - | - | - | - | 3,921 | 2,410 | 6,331 |
| Revaluation of freehold land | - | (445) | - | - | - | - | - | (445) |
| Balance at 31 December 2017 | 8,480 | 35,568 | (423,986) | (12,981) | (26,659) | - | (55,332) | (474,910) |

21 RESERVES (continued)**h) Movements in other reserves (continued)**

| | | | Foreign | Cumulative changes | | | | |
|---|-----------|-------------|-------------|--------------------|-----------|-----------|-----------|-----------|
| | | Property | exchange | Cash flow | | | Pension | Total |
| | Capital | revaluation | translation | OCI | hedge | ESPP | fund | other |
| | reserve | reserve | reserve | reserve | reserve | reserve | reserve | reserves |
| | US\$ '000 | US\$ '000 | US\$ '000 | US\$ '000 | US\$ '000 | US\$ '000 | US\$ '000 | US\$ '000 |
| Balance at 1 January 2016 | 8,480 | 36,173 | (194,342) | (16,568) | (28,048) | 12,587 | (42,250) | (223,968) |
| Currency translation adjustments | - | - | (260,826) | - | - | - | - | (260,826) |
| Transfers to consolidated statement of income | - | - | - | - | (540) | - | - | (540) |
| Net fair value movements | - | - | - | (9,380) | 4,805 | - | - | (4,575) |
| Transfers to retained earnings | - | - | - | 14,929 | - | (17,811) | - | (2,882) |
| Fair value movements and others | - | - | - | - | - | 5,224 | (15,492) | (10,268) |
| Revaluation of freehold land | - | 83 | - | - | - | - | - | 83 |
| Balance at 31 December 2016 | 8,480 | 36,256 | (455,168) | (11,019) | (23,783) | - | (57,742) | (502,976) |

Foreign currency translation risk primarily arises from Group's investments in diverse countries. Assets and liabilities of these subsidiaries are translated into US Dollars at the rates of exchange prevailing at the balance sheet date. Income and expense items are translated at average exchange rates prevailing for the reporting periods. Any exchange differences arising on translation are included in "foreign exchange translation reserve" forming part of other comprehensive income prorated between non-controlling interests and equity owners.

The Group undertakes hedging of such net investment in foreign operation to mitigate any currency risk in a number of ways including borrowing in the underlying currency, structural hedging in the form of holding US Dollar long position to the extent possible and forward contracts.

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21 RESERVES (continued)**i) Dividends paid and proposed**

| | <u>2017</u> US\$'000 |
|---|-------------------------|
| Proposed for approval at the forthcoming Annual General Assembly of Shareholders Meeting | |
| Cash dividend on the Ordinary shares @ US cents 4.5 per share | 341,578 |
| Bonus share issue | 5% |
| | <u>2016</u> US\$'000 |
| Declared and paid during the year | |
| Cash dividend on the Ordinary shares @ US cents 4.5 per share (2016: US cents 4.5 per share) | 309,144 |
| Bonus share issue (2016: 5%) | 10% |

j) Distribution on Perpetual Tier 1 capital securities and Sukuk

| | <u>2017</u> US\$'000 | <u>2016</u> US\$'000 |
|---|-------------------------|-------------------------|
| Distribution @ 6.875 percent per annum on the Perpetual Tier 1 Capital Securities | 27,500 | 27,500 |
| Distribution @ 5.5 percent per annum on the Perpetual Tier 1 Sukuk | 11,000 | - |

22 TAXATION

| | <u>2017</u> US\$'000 | <u>2016</u> US\$'000 |
|---|-------------------------|-------------------------|
| Consolidated balance sheet (note 13 and note 18): | | |
| - Deferred tax asset | 3,748 | 4,735 |
| - Current tax liability | (26,737) | (19,410) |
| - Deferred tax liability | (23,300) | (1,291) |
| | <u>(50,037)</u> | <u>(20,701)</u> |
| Consolidated statement of income | | |
| - Current tax expense on foreign operations | 40,925 | 45,192 |
| - Deferred tax expense on foreign operations | 83 | 923 |
| | <u>41,008</u> | <u>46,115</u> |

The Group's tax expense includes all direct taxes that are accrued on taxable profits of entities to the authorities in the respective countries of incorporation, in accordance with the tax laws prevailing in those jurisdictions. Consequently, it is not practical to provide a reconciliation between the accounting and taxable profits together with the details of effective tax rates. Tax expense primarily relates to AUBUK and AUBE. Effective tax rate at AUBE is 22.5% (2016: 22.5%) and AUBUK is 19.25% (2016: 20.0%).

23 EARNINGS PER SHARE

Basic and diluted earnings per ordinary share are calculated by dividing the net profit for the year attributable to the Bank's ordinary equity shareholders less distribution on Perpetual Tier 1 Capital Securities, by the weighted average number of ordinary shares outstanding during the year.

The following reflects the income and share data used in basic and diluted earnings per ordinary share computations :

| | <u>2017</u> | <u>2016</u> |
|---|-------------------------|------------------|
| | <u>US\$ '000</u> | <u>US\$ '000</u> |
| Net profit for basic and diluted earnings per ordinary share computation | | |
| Net profit attributable to Bank's equity shareholders | 618,715 | 570,640 |
| (Less): Perpetual Tier 1 Capital Securities distribution | (35,740) | (27,500) |
| Adjusted net profit attributable to Bank's ordinary equity shareholders for basic and diluted earnings per ordinary share | <u>582,975</u> | <u>543,140</u> |
| Basic and diluted earnings per ordinary share (US cents) | <u>7.7</u> | <u>7.2</u> |
| | <i>Number of shares</i> | |
| | <i>(in millions)</i> | |
| | <u>2017</u> | <u>2016</u> |
| Weighted average ordinary shares outstanding during the year adjusted for bonus shares | <u>7,535</u> | <u>6,821</u> |
| Weighted average number of ordinary shares for diluted earnings per share | <u>7,535</u> | <u>6,821</u> |

24 CASH AND CASH EQUIVALENTS

Cash and cash equivalents included in the consolidated statement of cash flows include the following balance sheet amounts:

| | <u>2017</u> | <u>2016</u> |
|---|------------------|------------------|
| | <u>US\$ '000</u> | <u>US\$ '000</u> |
| Cash and balances with central banks, excluding mandatory reserve deposits (note 7(a)) | 484,124 | 665,894 |
| Deposits with Central banks, other banks and financial institutions - with an original maturity of three months or less | 2,044,598 | 1,643,219 |
| | <u>2,528,722</u> | <u>2,309,113</u> |

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25 RELATED PARTY TRANSACTIONS

The Group enters into transactions with major shareholders, associates, directors, senior management and companies which are controlled, jointly controlled or significantly influenced by such parties in the ordinary course of business at arm's length. All the loans and advances to related parties are performing and are free of any provision for possible loan losses.

The income, expense and the period end balances in respect of related parties included in the consolidated financial statements were as follows:

| 2017 | | | | | | |
|--|------------|----------------------------|--------------------------------------|--------|-------|-----------|
| US\$ '000 | | | | | | |
| Major shareholders | Associates | Non Executive Directors | Senior Management | | Total | |
| | | | Management Directors ² | Others | | |
| Interest income | 63 | 3,756 | 7,073 | 241 | 49 | 11,182 |
| Interest expense | 111,247 | 12 | 696 | 113 | 12 | 112,080 |
| Fees and commissions | 109 | 2,338 | 288 | 11 | 2 | 2,748 |
| Deposits with banks | - | 113,336 | - | - | - | 113,336 |
| Loans and advances | - | - | 167,615 | 7,310 | 1,767 | 176,692 |
| Deposits from banks | - | 6,686 | - | - | - | 6,686 |
| Customers' deposits ¹ | 5,966,668 | - | 46,248 | 7,035 | 1,916 | 6,021,867 |
| Subordinated liabilities | 197,207 | - | - | - | - | 197,207 |
| Derivatives liabilities | - | 622 | - | - | - | 622 |
| Commitments and contingent liabilities | - | 198,158 | 155,511 | - | - | 353,669 |
| Short term employee benefits | - | - | - | 11,437 | 3,781 | 15,218 |
| End of service benefits | - | - | - | 1,663 | 472 | 2,135 |
| Directors' fees and related expenses ³ | - | - | 2,226 | - | - | 2,226 |
| 2016 | | | | | | |
| US\$ '000 | | | | | | |
| Major shareholders | Associates | Non Executive Directors | Senior Management | | Total | |
| | | | Management Directors ² | Others | | |
| Interest income | 2,740 | 2,850 | 6,451 | 264 | 45 | 12,350 |
| Interest expense | 91,913 | 25 | 992 | 51 | - | 92,981 |
| Fees and commissions | 585 | 1,338 | 330 | 4 | - | 2,257 |
| Deposits with banks | - | 160,889 | - | - | - | 160,889 |
| Loans and advances | 110,500 | - | 151,604 | 13,055 | 2,282 | 277,441 |
| Deposits from banks | - | 5,692 | - | - | - | 5,692 |
| Customers' deposits ¹ | 6,193,804 | - | 63,352 | 6,609 | 32 | 6,263,797 |
| Subordinated liabilities | 218,985 | - | - | - | - | 218,985 |
| Commitments and contingent liabilities | - | 144,088 | 152,331 | - | - | 296,419 |
| Short term employee benefits | - | - | - | 11,859 | 3,174 | 15,033 |
| End of service benefits | - | - | - | 1,743 | 221 | 1,964 |
| Directors' fees and related expenses ³ | - | - | 2,181 | - | - | 2,181 |

25 RELATED PARTY TRANSACTIONS (continued)

¹Customers' deposits include deposits from GCC government-owned institutions amounting to US\$ 5,925 million (31 December 2016: US\$ 6,166 million).

²AUB Group Management Directors (Employees) who are appointed by the shareholders of AUB to the AUB Board to represent management or by AUB to the boards of any of its subsidiaries or affiliates or their related committees, are excluded from receiving any additional remuneration for their membership of or attendance at board or related committee meetings as per their contractual arrangements. Accordingly, the short term employee benefits and end of service benefits shown above reflect employment remuneration only.

³Directors fees and related expenses for 2016 were approved by the shareholders in the annual general meeting on 29 March 2017 and the same for 2017 will be presented for shareholders' approval at the ensuing annual general meeting in March 2018.

The consolidated income statement includes a fair value amortisation charge of US\$ 1.4 million (2016: US\$ 1.8 million) relating to share based transactions.

26 EMPLOYEE BENEFITS

The Group operates Defined Benefit and Defined Contribution retirement benefit schemes for its employees in accordance with the local laws and regulations in the countries in which it operates. The costs of providing retirement benefits including current contributions, are charged to the consolidated statement of income.

Defined benefit plans

The charge to the consolidated statement of income on account of end of service benefits for the year amounted to US\$ 17,451 thousand (2016: US\$ 7,249 thousand). There are no material differences between the carrying amount of the provision for end of service benefits at both 31 December 2017 and 2016 and the amount arising from an actuarial computation thereof.

AUBUK's defined benefit pension scheme was closed to future service accruals on 31 March 2010. In accordance with the amended IAS-19 Employee Benefits, the Group immediately recognizes the actuarial gains and losses relating to 'Defined Pension Benefit' scheme through consolidated statement of changes in equity.

Defined contribution plans

The Group contributed US\$ 7,726 thousand (2016: US\$ 8,034 thousand) during the year towards defined contribution plans. The Group's obligations are limited to the amounts contributed to various schemes.

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27 MANAGED FUNDS

Funds administrated on behalf of customers to which the Group does not have legal title are not included in the consolidated balance sheet. The total market value of all such funds at 31 December 2017 was US\$ 3,774.1 million (2016: US\$ 3,660.5 million).

28 DERIVATIVES

In the ordinary course of business the Group enters into various types of transactions that involve derivative financial instruments. A derivative financial instrument is a financial contract between two parties where payments are dependent upon movements in price in one or more underlying financial instruments, reference rates or indices.

Derivatives include financial options, futures and forwards, interest rate swaps and currency swaps, which create rights and obligations that have the effect of transferring between the parties of the instrument one or more of the financial risks inherent in an underlying primary financial instrument. On inception, a derivative financial instrument gives one party a contractual right to exchange financial assets or financial liabilities with another party under conditions that are potential favourable, or a contractual obligation to exchange financial assets or financial liabilities with another party under conditions that are potentially unfavourable. However, they generally do not result in a transfer of the underlying primary financial instrument on inception of the contract, nor does such a transfer necessarily take place on maturity of the contract. Some instruments embody both a right and an obligation to make an exchange. Because the terms of the exchange are determined on inception of the derivative instruments, as prices in financial markets change those terms may become either favourable or unfavourable.

The table below shows the net fair values of derivative financial instruments.

| | 2017 | | 2016 | |
|---|------------------------------|-----------------------------------|------------------------------|-----------------------------------|
| | <i>Derivative assets</i> | <i>Derivative liabilities</i> | <i>Derivative assets</i> | <i>Derivative liabilities</i> |
| | <i>US\$ '000</i> | <i>US\$ '000</i> | <i>US\$ '000</i> | <i>US\$ '000</i> |
| <i>Derivatives held for risk management:</i> | | | | |
| Interest rate swaps | 20,787 | 15,939 | 21,731 | 15,308 |
| Forward foreign exchange contracts | 36,446 | 25,279 | 50,787 | 38,959 |
| Options | 278 | 415 | 169 | 181 |
| Interest rate futures | 320 | 102 | - | - |
| <i>Derivatives held as fair value hedges:</i> | | | | |
| Interest rate swaps | 33,334 | 72,371 | 36,104 | 60,279 |
| <i>Derivatives held as cash flow hedges:</i> | | | | |
| Interest rate swaps | - | 27,982 | 2,287 | 27,666 |
| Forward foreign exchange contracts | 26 | 1,057 | 1,867 | 154 |
| | 91,191 | 143,145 | 112,945 | 142,547 |

Counterparties with whom the Group has entered into forward foreign exchange contracts have placed margin monies representing net fair values of contracts outstanding.

28 DERIVATIVES (continued)

In respect of derivative assets above, the Group has US\$ 25.2 million (2016: US\$ 31.0 million) of liabilities that can be offset through master netting arrangements. These master netting arrangements create a right of set-off that is enforceable only following an event of default, insolvency or bankruptcy of counterparties or following other predetermined events.

Cash flow hedges

The time periods in which the hedged cash flows are expected to occur and their impact on the consolidated statement of income is as follows:

| | <i>3 months or less</i> | <i>More than 3 months up to 1 year</i> | <i>More than 1 year up to 5 years</i> | <i>More than 5 years</i> | <i>Total</i> |
|--------------------------------|-----------------------------|--|---|------------------------------|-----------------|
| | <i>US\$'000</i> | <i>US\$'000</i> | <i>US\$'000</i> | <i>US\$'000</i> | <i>US\$'000</i> |
| At 31 December 2017 | | | | | |
| Cash outflows from liabilities | (345) | (3,211) | (9,205) | (13,898) | (26,659) |
| At 31 December 2016 | | | | | |
| Cash outflows from liabilities | 534 | (3,459) | (9,130) | (11,728) | (23,783) |

No significant hedge ineffectiveness on cash flow hedges was recognised in 2017 and 2016.

Fair value hedges

The net fair value of interest rate swap held as fair value hedges as at 31 December 2017 is negative US\$ 39.0 million (2016: Negative US\$ 24.2 million). Gain recognised on the hedged item at 31 December 2017, attributable to the hedged risk is US\$ 39.0 million (2016: US\$ 24.2 million). These gains and losses are included in "trading income" in the consolidated statement of income during 2017 and 2016 respectively.

Derivatives held for risk management purposes

Most of the Group's derivative trading activities relate to customer driven transactions as well as positioning and arbitrage. Positioning involves managing positions with the expectation of profiting from favourable movements in prices, rates or indices. Arbitrage involves identifying and profiting from price differentials between markets or products.

Derivatives held for hedging purposes

The Group has adopted a comprehensive system for the measurement and management of risk.

As part of its asset and liability management the Group uses derivatives for hedging purposes in order to reduce its exposure to currency and interest rate movements. This is achieved by hedging specific financial instruments and forecasted transactions, as well as strategic hedging against overall balance sheet exposures.

The Group uses options and currency swaps to hedge against specifically identified currency and equity risks. In addition, the Group uses interest rate swaps and forward rate agreements to hedge against the interest rate risk arising from specifically identified, or a portfolio of, fixed interest rate investments and loans. The Group also uses interest rate swaps to hedge against the cash flow risks arising on certain floating rate deposits. In all such cases the hedging relationship and objective, including details of the hedged item and hedging instrument, are formally documented and the transactions are accounted for as fair value hedges.

Hedging of interest rate risk is also carried out by monitoring the duration of assets and liabilities and entering into interest rate swaps to hedge net interest rate exposures. Since hedging of net positions does not qualify for special hedge accounting, related derivatives are accounted for the same way as trading instruments.

29 COMMITMENTS AND CONTINGENT LIABILITIES**Credit-related commitments**

Credit-related commitments include commitments to extend credit, standby letters of credit, guarantees and acceptances which are designed to meet the requirements of the Group's customers.

Commitments to extend credit represent contractual commitments to make loans and revolving credits available and generally have fixed expiration dates or other termination clauses. Since commitments may expire without being drawn upon, the total contract amounts do not necessarily represent future cash requirements.

Standby letters of credit, guarantees and acceptances (standby facilities) commit the Group to make payments on behalf of customers contingent upon their failure to perform under the terms of the contract. Standby facilities would have market risk if issued or extended at a fixed rate of interest. However, these contracts are primarily made at floating rates.

The Group has the following credit related commitments:

| | <u>2017</u> | <u>2016</u> |
|---|------------------|------------------|
| | <u>US\$ '000</u> | <u>US\$ '000</u> |
| Contingent liabilities | | |
| Guarantees | 2,629,554 | 2,443,017 |
| Acceptances | 187,852 | 132,119 |
| Letters of credit | 566,808 | 534,461 |
| | <u>3,384,214</u> | <u>3,109,597</u> |
| Maturity of contingent liabilities is as follows: | | |
| - Less than one year | 2,502,602 | 2,302,598 |
| - Over one year | 881,612 | 806,999 |
| | <u>3,384,214</u> | <u>3,109,597</u> |
| Irrevocable commitments: | | |
| Undrawn loan commitments | <u>1,077,266</u> | <u>1,130,419</u> |

Please also refer to note 35 for additional liquidity disclosures.

The Group's commitments in respect of non-cancellable operating leases were as follows:

| | <u>2017</u> | <u>2016</u> |
|---------------------------|------------------|------------------|
| | <u>US\$ '000</u> | <u>US\$ '000</u> |
| Within one year | 1,967 | 1,540 |
| Between one to five years | 4,718 | 5,219 |
| | <u>6,685</u> | <u>6,759</u> |

30 SEGMENT INFORMATION

For management purposes the Group is organised into four major business segments:

| | |
|------------------------|--|
| Retail banking | Principally handling individual customers' deposit and current accounts, providing consumer loans, residential mortgages, overdrafts, credit cards and fund transfer facilities. |
| Corporate banking | Principally handling loans and other credit facilities, and deposit and current accounts for corporate and institutional customers. |
| Treasury & investments | Principally providing money market, trading and treasury services, as well as management of the Group's investments and funding. |
| Private banking | Principally servicing high net worth clients through a range of investment products, funds, credit facilities, trusts and alternative investments. |

30 SEGMENT INFORMATION (continued)

These segments are the basis on which the Group reports its primary segment information. Transactions between segments are conducted at approximate market rates on an arm's length basis. Interest is charged/credited to business segments based on a pool rate which approximates the cost of funds.

Segmental information for the year was as follows:

| | <i>Retail banking</i> | <i>Corporate banking</i> | <i>Treasury & investments</i> | <i>Private banking</i> | <i>Total</i> |
|---|---------------------------|------------------------------|---------------------------------------|----------------------------|-------------------|
| | <i>US\$ '000</i> | <i>US\$ '000</i> | <i>US\$ '000</i> | <i>US\$ '000</i> | <i>US\$ '000</i> |
| Year ended 31 December 2017: | | | | | |
| Net interest income | 27,431 | 651,623 | 148,005 | 49,411 | 876,470 |
| Inter segment interest | 146,080 | (199,562) | 34,269 | 19,213 | - |
| Fees, commissions and others | 36,804 | 68,116 | 16,261 | 23,832 | 145,013 |
| Investment income and trading income | 3,215 | 19,918 | 74,603 | 153 | 97,889 |
| OPERATING INCOME | 213,530 | 540,095 | 273,138 | 92,609 | 1,119,372 |
| Net provision for loan losses and others | 8,264 | 80,179 | - | (1,773) | 86,670 |
| Provision for investments | - | - | 2,280 | - | 2,280 |
| NET OPERATING INCOME | 205,266 | 459,916 | 270,858 | 94,382 | 1,030,422 |
| Operating expenses | 111,932 | 75,768 | 103,191 | 32,009 | 322,900 |
| PROFIT BEFORE TAX | 93,334 | 384,148 | 167,667 | 62,373 | 707,522 |
| Tax expense | | | | | 41,008 |
| NET PROFIT FOR THE YEAR | | | | | 666,514 |
| Less : Attributable to non-controlling interest | | | | | 47,799 |
| NET PROFIT ATTRIBUTABLE TO THE OWNERS' OF THE BANK | | | | | 618,715 |
| Segment assets | 3,807,435 | 15,452,710 | 10,397,849 | 1,955,449 | 31,613,443 |
| Goodwill | 154,935 | 99,857 | 96,826 | 79,681 | 431,299 |
| Other intangible assets | 13,441 | 17,783 | 16,213 | 2,094 | 49,531 |
| Investment in associates | | | | | 304,020 |
| Unallocated assets | | | | | 843,592 |
| TOTAL ASSETS | | | | | 33,241,885 |
| Segment liabilities | 5,146,229 | 4,833,337 | 14,509,456 | 2,952,030 | 27,441,052 |
| Unallocated liabilities | | | | | 912,679 |
| TOTAL LIABILITIES | | | | | 28,353,731 |

30 SEGMENT INFORMATION (continued)

Segmental information for the year was as follows:

| | <i>Retail banking</i> | <i>Corporate banking</i> | <i>Treasury & investments</i> | <i>Private banking</i> | <i>Total</i> |
|---|---------------------------|------------------------------|---------------------------------------|----------------------------|-------------------|
| | <i>US\$ '000</i> | <i>US\$ '000</i> | <i>US\$ '000</i> | <i>US\$ '000</i> | <i>US\$ '000</i> |
| Year ended 31 December 2016: | | | | | |
| Net interest income | 20,683 | 586,964 | 169,452 | 51,133 | 828,232 |
| Inter segment interest | 169,960 | (189,471) | 9,175 | 10,336 | - |
| Fees, commissions and others | 41,447 | 93,415 | 10,069 | 24,804 | 169,735 |
| Investment income and trading income | 7,786 | 14,406 | 122,985 | 2,342 | 147,519 |
| OPERATING INCOME | 239,876 | 505,314 | 311,681 | 88,615 | 1,145,486 |
| Net provision for loan losses and others | 10,402 | 142,617 | - | (3,457) | 149,562 |
| Provision for investments | - | - | 9,279 | - | 9,279 |
| NET OPERATING INCOME | 229,474 | 362,697 | 302,402 | 92,072 | 986,645 |
| Operating expenses | 114,286 | 75,317 | 95,193 | 31,424 | 316,220 |
| PROFIT BEFORE TAX | 115,188 | 287,380 | 207,209 | 60,648 | 670,425 |
| Tax expense | | | | | 46,115 |
| NET PROFIT FOR THE YEAR | | | | | 624,310 |
| Less : Attributable to non-controlling interest | | | | | 53,670 |
| NET PROFIT ATTRIBUTABLE TO THE OWNERS' OF THE BANK | | | | | 570,640 |
| Segment assets | 3,761,034 | 14,181,899 | 9,806,124 | 1,822,557 | 29,571,614 |
| Goodwill | 153,381 | 98,599 | 95,802 | 78,779 | 426,561 |
| Other intangible assets | 13,043 | 17,258 | 15,735 | 2,035 | 48,071 |
| Investment in associates | | | | | 326,874 |
| Unallocated assets | | | | | 949,364 |
| TOTAL ASSETS | | | | | 31,322,484 |
| Segment liabilities | 4,823,033 | 4,982,953 | 13,348,790 | 2,762,830 | 25,917,606 |
| Unallocated liabilities | | | | | 865,376 |
| TOTAL LIABILITIES | | | | | 26,782,982 |

30 SEGMENT INFORMATION (continued)**Geographic segmentation**

Although the management of the Group is based primarily on business segments, the Group's geographic segmentation is based on the countries where the Bank and its subsidiaries are incorporated. Thus, the operating income generated by the Bank and its subsidiaries based in the GCC are grouped as "GCC Countries", while those generated by the Bank's subsidiaries located outside the GCC region is grouped under "Rest of the World". Similar segmentation is followed for the distribution of total assets. The following table shows the distribution of the Group's operating income and total assets by geographical segment:

| | <i>Operating income</i> | | <i>Total assets</i> | |
|-------------------|-------------------------|------------------|---------------------|------------------|
| | <i>2017</i> | <i>2016</i> | <i>2017</i> | <i>2016</i> |
| | <i>US\$ '000</i> | <i>US\$ '000</i> | <i>US\$ '000</i> | <i>US\$ '000</i> |
| GCC Countries | 783,536 | 705,715 | 22,977,029 | 22,205,097 |
| Rest of the World | 335,836 | 439,771 | 10,264,856 | 9,117,387 |
| Total | 1,119,372 | 1,145,486 | 33,241,885 | 31,322,484 |

Net profit from Bahrain onshore operations included above is US\$ 86.3 million (2016: US\$ 80.7 million) amounting to 13.9% (2016: 14.1%) of the Group's net profit attributable to owners of the Bank.

RISK MANAGEMENT**31 CREDIT RISK**

Credit risk is the risk that one party to a financial instrument will fail to discharge a financial obligation and cause the other party to incur a financial loss. In the case of derivatives this is limited to positive fair values. The Group attempts to control credit risk by monitoring credit exposures, limiting transactions with specific counterparties, and continually assessing the creditworthiness of counterparties.

a) Concentration risk

Concentrations of credit risk arise when a number of counterparties are engaged in similar business activities, or activities in the same geographic region, or have similar economic features that would cause their ability to meet contractual obligations to be similarly affected by changes in economic, political or other conditions.

Concentrations of credit risk indicate the relative sensitivity of the Group's performance to developments affecting a particular industry or geographic location.

The Group manages its credit risk exposure so as to avoid over concentration to a particular sector or geographic location. It also obtains security where appropriate. Guidelines are in place regarding the acceptability of types of collateral and valuation parameters.

The principal collateral types are as follows:

- In the personal sector – cash, mortgages over residential properties and assignments over salary income;
- In the commercial sector – cash, charges over business assets such as premises, inventories, receivables, debt securities and bank guarantees;
- In the commercial real estate sector – charges over the properties being financed; and
- In the financial sector – charges over financial instruments, such as debt securities and equities.

The Group monitors the market value of collateral and requests additional collateral when necessary in accordance with the underlying agreement.

Details of the concentration of the loans and advances by industry sector and geographic region are disclosed in note 8(a) and 8(b) respectively.

Details of the industry sector analysis and the geographical distribution of the assets, liabilities and commitments on behalf of customers are set out in note 32.

31 CREDIT RISK (continued)**b) Maximum exposure to credit risk without taking account of any collateral and other credit enhancements**

The table below shows the maximum exposure to credit risk for the components of the balance sheet. The maximum exposure is shown gross, before the effect of mitigation through the use of master netting and collateral agreements, but after provision for impairment, where applicable.

| | <i>Gross maximum exposure 2017</i> | <i>Gross maximum exposure 2016</i> |
|--|--|--|
| | <i>US\$ '000</i> | <i>US\$ '000</i> |
| Balances with central banks | 677,594 | 789,422 |
| Treasury bills and deposits with central banks | 2,576,352 | 2,464,846 |
| Deposits with banks | 2,469,751 | 1,884,493 |
| Loans and advances | 19,498,702 | 18,606,883 |
| Non-trading investments | 5,876,616 | 5,429,578 |
| Interest receivable and other assets | 308,942 | 385,700 |
| Total | 31,407,957 | 29,560,922 |
| Contingent liabilities | 3,384,214 | 3,109,597 |
| Undrawn loan commitments | 1,077,266 | 1,130,419 |
| Total credit related commitments | 4,461,480 | 4,240,016 |
| Total credit risk exposure | 35,869,437 | 33,800,938 |

Where financial instruments are recorded at fair value the amounts shown above represent the current credit risk exposure but not the maximum risk exposure that could arise in the future as a result of changes in values.

c) Credit quality per class of financial assets

The table below shows distribution of financial assets neither past due nor impaired.

| | <i>Neither past due nor impaired</i> | | |
|--|--------------------------------------|---------------------------|------------------|
| | <i>High standard grade</i> | <i>Standard grade</i> | <i>Total</i> |
| | <i>US\$ '000</i> | <i>US\$ '000</i> | <i>US\$ '000</i> |
| At 31 December 2017 | | | |
| Balances with central banks | 677,594 | - | 677,594 |
| Treasury bills and deposits with central banks | 2,037,712 | 538,640 | 2,576,352 |
| Deposits with banks | 2,309,631 | 160,120 | 2,469,751 |
| Loans and advances | | | |
| Retail | 2,844,665 | 804,606 | 3,649,271 |
| Corporate | 8,952,988 | 6,719,031 | 15,672,019 |
| Non-trading investments | 3,914,616 | 2,001,221 | 5,915,837 |
| Interest receivable and other assets | 147,382 | 70,369 | 217,751 |
| Other assets - derivatives | 91,191 | - | 91,191 |

31 CREDIT RISK (continued)**c) Credit quality per class of financial assets (continued)**

The table below shows distribution of financial assets neither past due nor impaired.

| | <i>Neither past due nor impaired</i> | | <i>Total</i> |
|--|--------------------------------------|------------------|------------------|
| | <i>High</i> | <i>Standard</i> | |
| | <i>standard</i> | <i>grade</i> | |
| | <i>grade</i> | <i>grade</i> | |
| | <i>US\$ '000</i> | <i>US\$ '000</i> | <i>US\$ '000</i> |
| At 31 December 2016 | | | |
| Balances with central banks | 789,422 | - | 789,422 |
| Treasury bills and deposits with central banks | 1,584,629 | 880,217 | 2,464,846 |
| Deposits with banks | 1,737,861 | 146,632 | 1,884,493 |
| Loans and advances | | | |
| Retail | 2,820,992 | 804,251 | 3,625,243 |
| Corporate | 9,035,773 | 5,983,311 | 15,019,084 |
| Non-trading investments | 3,893,853 | 1,625,958 | 5,519,811 |
| Interest receivable and other assets | 210,921 | 61,834 | 272,755 |
| Other assets - derivatives | 112,945 | - | 112,945 |

It is the Group's policy to maintain consistent internal risk ratings across the credit portfolio. The credit quality of the portfolio of loans and advances that were neither past due nor impaired can be assessed by reference to the Group's internal credit rating system. This facilitates focused portfolio management of the inherent level of risk across all lines of business. The credit quality ratings disclosed above can be equated to the following risk rating grades:

| Credit quality rating | Risk rating | Definition |
|------------------------------|--------------------|--|
| High standard | Risk rating 1 to 4 | Undoubted through to good credit risk |
| Standard | Risk rating 5 to 7 | Satisfactory through to adequate credit risk |

The risk rating system is supported by various financial analytics and qualitative market information for the measurement of counterparty risk.

There are no financial assets which are past due but not impaired as at 31 December 2017 and 2016 other than those disclosed under note 8(c).

32 CONCENTRATION ANALYSIS

The distribution of assets, liabilities and commitments on behalf of customers by geographic region and industry sector was as follows:

| | 2017 | | | 2016 | | |
|--|-------------------|--------------------|--|-------------------|--------------------|--|
| | <i>Assets</i> | <i>Liabilities</i> | <i>Contingent liabilities & commitments on behalf of customers</i> | <i>Assets</i> | <i>Liabilities</i> | <i>Contingent liabilities & commitments on behalf of customers</i> |
| | <i>US\$ '000</i> | <i>US\$ '000</i> | <i>US\$ '000</i> | <i>US\$ '000</i> | <i>US\$ '000</i> | <i>US\$ '000</i> |
| Geographic region: | | | | | | |
| Kingdom of Bahrain | 5,935,876 | 4,278,065 | 956,123 | 5,616,371 | 4,434,613 | 816,722 |
| State of Kuwait | 12,091,452 | 15,865,172 | 1,428,029 | 11,915,097 | 15,857,714 | 1,387,674 |
| Other GCC countries | 4,949,701 | 1,546,179 | 310,399 | 4,673,629 | 923,769 | 303,176 |
| United Kingdom (UK) | 2,402,182 | 705,559 | 37,976 | 2,206,461 | 705,767 | 12,373 |
| Arab Republic of Egypt | 2,749,095 | 2,573,010 | 386,634 | 2,563,112 | 2,227,158 | 376,328 |
| Europe (excluding UK) | 1,517,920 | 956,564 | 181,467 | 1,243,236 | 482,179 | 155,540 |
| Asia (excluding GCC) | 1,742,117 | 1,342,957 | 35,727 | 1,574,951 | 1,143,035 | 8,157 |
| United States of America | 723,072 | 199,670 | 4,803 | 633,953 | 230,878 | 5,025 |
| Rest of the World | 1,130,470 | 886,555 | 43,056 | 895,674 | 777,869 | 44,602 |
| | 33,241,885 | 28,353,731 | 3,384,214 | 31,322,484 | 26,782,982 | 3,109,597 |
| Industry sector: | | | | | | |
| Banks and other financial institutions | 10,045,621 | 13,265,548 | 489,975 | 9,860,992 | 12,229,616 | 456,688 |
| Consumer/personal | 2,843,340 | 5,492,545 | 21,939 | 2,906,297 | 5,146,647 | 8,241 |
| Residential mortgage | 1,540,526 | - | 215 | 1,423,193 | - | 214 |
| Trading and manufacturing | 5,771,772 | 1,459,145 | 1,309,406 | 5,163,317 | 1,371,348 | 1,181,986 |
| Real estate | 5,332,464 | 368,572 | 32,625 | 5,244,436 | 367,696 | 37,884 |
| Services | 4,111,806 | 2,537,221 | 1,247,853 | 3,676,082 | 2,420,122 | 1,212,843 |
| Government/public sector | 3,234,447 | 4,296,313 | 89,222 | 2,730,631 | 4,147,678 | 26,604 |
| Others | 361,909 | 934,387 | 192,979 | 317,536 | 1,099,875 | 185,137 |
| | 33,241,885 | 28,353,731 | 3,384,214 | 31,322,484 | 26,782,982 | 3,109,597 |

33 MARKET RISK

Market risk is the risk of potential financial loss that may arise from adverse changes in the value of a financial instrument or portfolio of financial instruments due to movements in interest rates, foreign exchange rates, equity prices, commodity prices and derivatives. This risk arises from asset - liability mismatches, changes that occur in the yield curve, foreign exchange rates and changes in volatilities/implied volatilities in the market value of derivatives. The Group classifies exposures to market risk into either trading or non-trading portfolios. Given the Group's low risk strategy, aggregate market risk levels are considered low. The Group utilises Value-at-Risk (VaR) models to assist in estimating potential losses that may arise from adverse market movements in addition to non-quantitative risk management techniques. The market risk for the trading portfolio is managed and monitored on a VaR methodology which reflects the inter-dependency between risk variables. Non-trading portfolios are managed and monitored using stop loss limits and other sensitivity analyses. The data given below is representative of the information during the year.

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33 MARKET RISK (continued)**a. Market risk-trading**

The Group calculates historical simulation VaR using a one day holding period at a confidence level of 99%, which takes into account the actual correlations observed historically between different markets and rates.

Since VaR is an integral part of the Group's market risk management, VaR limits have been established for all trading operations and exposures are reviewed daily against the limits by management. Actual outcomes are compared to the VaR model derived predictions on a regular basis as a means of validating the assumptions and parameters used in the VaR calculation.

The table below summarises the risk factor composition of the VaR including the correlative effects intrinsic to the trading book:

| | <i>Foreign exchange</i> | <i>Interest rate</i> | <i>Effects of correlation</i> | <i>Total</i> |
|-------------------------|-----------------------------|--------------------------|-----------------------------------|------------------|
| | <i>US\$ '000</i> | <i>US\$ '000</i> | <i>US\$ '000</i> | <i>US\$ '000</i> |
| 31 December 2017 | 1,032 | (139) | 1 | 894 |
| 31 December 2016 | 243 | 2 | 0 | 245 |

b. Market risk-non-trading**Interest rate risk**

Interest rate risk arises from the possibility that changes in interest rates will affect the value of financial instruments or the future profitability of the Group. The Group is exposed to interest rate risk as a result of mismatches or gaps in the amounts of assets and liabilities and off balance sheet instruments that mature or reprice in a given period. The Group measures and manages interest rate risk by establishing levels of interest rate risk by setting limits on the interest rate gaps for stipulated periods. Interest rate gaps on assets and liabilities are reviewed periodically and hedging strategies are used to reduce the interest rate gaps to within the limits established by the Bank's Board of Directors.

The following table demonstrates the sensitivity of the Group's net interest income for the next one year, to a change in interest rates, with all other variables held constant. The sensitivity is based on the floating rate financial assets and financial liabilities held at 31 December 2017 and 31 December 2016 including the effect of hedging instruments.

Sensitivity analysis - interest rate risk

| | <i>2017</i> | <i>2016</i> |
|--|-------------------|------------------|
| | <i>US\$ '000</i> | <i>US\$ '000</i> |
| at 10 bps - increase (+)/decrease (-) | +/- 4,669 | 3,713 |
| at 25 bps - increase (+)/decrease (-) | +/- 11,673 | 9,283 |

33 MARKET RISK (continued)**b. Market risk-non-trading (continued)****Currency risk**

Currency risk is the risk that the functional currency value of a financial instrument will fluctuate due to changes in foreign exchange rates.

The risk management process manages the Group's exposure to fluctuations in foreign exchange rates (currency risk) through the asset and liability management process. It is the Group's policy to reduce its exposure to currency fluctuations to acceptable levels as determined by the Board of Directors. The Board has established levels of currency risk by setting limits on currency position exposures. Positions are monitored periodically and hedging strategies used to ensure positions are maintained within established limits.

Sensitivity analysis - currency risk

All foreign currency exposures with the exception of investments in subsidiaries and associates are captured as part of the trading book. The risk of the exposures are subject to quantification via a daily VaR calculation, the results of which are disclosed in note 33 (a).

The effect of foreign currency translation on the Group's investments in subsidiaries and associates are reported under the "foreign exchange translation reserve" under the note 21(h).

Equity price risk

Equity price risk arises from fluctuations in equity indices and prices. The Board has set limits on the amount and type of investments that may be accepted. This is monitored on an ongoing basis by the Group Risk Committee. The non-trading equity price risk exposure arises from the Group's investment portfolio.

The effect on equity valuations (as a result of a change in the fair value of equity investments held as FVTOCI) due to a reasonably possible change in equity indices, with all other variables held constant is as follows:

| | | | <u>2017</u> | <u>2016</u> |
|-----------------------|---|-----|--|--|
| | <i>Change in equity indices %</i> | | <i>Effect on OCI US\$ '000</i> | <i>Effect on OCI US\$ '000</i> |
| Market indices | | | | |
| Kuwait Stock Exchange | +/- 10% | +/- | 25 | 602 |

34 FAIR VALUE MEASUREMENT

The fair value of financial assets and financial liabilities, other than those disclosed in the table below and in note 9, approximate their carrying values. Please refer note 9 for the fair value of non-trading investments carried at amortised cost.

The Group's primary medium and long-term financial liabilities are the term debts and subordinated liabilities. The fair values of these financial liabilities are not materially different from their carrying values, since these liabilities are repriced at intervals of three or six months, depending on the terms and conditions of the instrument and the resultant applicable margins approximate the current spreads that would apply for borrowings with similar maturities.

The Group uses the following hierarchy for determining and disclosing the fair value of financial instruments by valuation technique:-

Level 1 : Quoted (unadjusted) prices in active markets for identical assets or liabilities;

Level 2: Other techniques for which all inputs which have a significant effect on the recorded fair value are observable, either directly or indirectly; and

Level 3 : techniques which use inputs which have a significant effect on the recorded fair value that are not based on observable market data.

| | <i>2017</i> | | | |
|--|------------------|------------------|------------------|------------------|
| | <i>Level 1</i> | <i>Level 2</i> | <i>Level 3</i> | <i>Total</i> |
| | <i>US\$ '000</i> | <i>US\$ '000</i> | <i>US\$ '000</i> | <i>US\$ '000</i> |
| Equity instruments and funds at fair value | 251 | 77,034 | 48,509 | 125,794 |
| Derivative assets | 320 | 90,871 | - | 91,191 |
| Derivative liabilities | 102 | 143,043 | - | 143,145 |

| | <i>2016</i> | | | |
|--|------------------|------------------|------------------|------------------|
| | <i>Level 1</i> | <i>Level 2</i> | <i>Level 3</i> | <i>Total</i> |
| | <i>US\$ '000</i> | <i>US\$ '000</i> | <i>US\$ '000</i> | <i>US\$ '000</i> |
| Equity instruments and funds at fair value | 465 | 92,174 | 48,230 | 140,869 |
| Derivative assets | - | 112,945 | - | 112,945 |
| Derivative liabilities | - | 142,547 | - | 142,547 |

During the year 2017 and 2016 there have been no transfers between Levels 1, 2 and 3.

For an explanation of valuation techniques used to value these financial instruments please refer to note 3.3 (f).

The significant inputs for valuation of equity securities classified under level 3 are annual growth rate of cash flows and discount rates and for funds it is the illiquidity discount. Lower growth rate and higher discount rate, illiquidity discount will result in a lower fair value. The impact on the consolidated statement of financial position or the consolidated statement of shareholders' equity would be immaterial if the relevant risk variables used to fair value the unquoted securities were altered by 5 per cent. There was no material changes in the valuation techniques used for the purpose of measuring fair value of investment securities as compared to the previous year.

35 LIQUIDITY RISK

Liquidity risk is the risk that the Group does not have sufficient financial resources to meet its obligations as they fall due, or will have to do so at an excessive cost. This risk arises from mismatches in the timing of cash flows. Funding risk arises when the necessary liquidity to fund illiquid asset positions cannot be obtained at the expected terms and when required.

The management of the Group's liquidity and funding is the responsibility of the Group Asset and Liability Committee (GALCO) under the chairmanship of the Deputy Group Chief Executive Officer Treasury and Investments supported by the Group Treasurer, and is responsible for ensuring that all foreseeable funding commitments, including deposit withdrawals, can be met when due, and that wholesale market access is coordinated

The Group maintains a stable funding base comprising core retail and corporate customer deposits and institutional balances, augmented by wholesale funding and portfolios of highly liquid assets which are diversified by currency and maturity, in order to enable the Group to respond quickly to any unforeseen liquidity requirements.

The Group subsidiaries and affiliates maintain a strong individual liquidity position and manage their liquidity profiles so that cash flows are balanced and funding obligations can be met when due.

Treasury limits are set by the GALCO and allocated as required across the various group entities. Specifically GALCO and the Group Treasurer are responsible for:

- projecting cash flows by major currency under various stress scenarios and considering the level of liquid assets necessary in relation thereto;
- monitoring balance sheet liquidity ratios against internal and regulatory requirements;
- maintaining a diverse range of funding sources with adequate back-up facilities;
- managing the concentration and profile of debt maturities;
- managing contingent liquidity commitment exposures within predetermined caps;
- monitoring depositor concentration in order to avoid undue reliance on large individual depositors and ensure a satisfactory overall funding mix; and
- maintaining liquidity and funding contingency plans. These plans must identify early indicators of stress conditions and describe actions to be taken in the event of difficulties arising from systemic or other crises while minimising adverse long-term implications for the business.

The maturity profile of the assets and liabilities at 31 December 2017 given below reflects management's best estimates of the maturities of assets and liabilities. These have been determined on the basis of the remaining period at the balance sheet date to the contractual or expected maturity date, where relevant. The liquidity profile of customer deposits has been determined on the basis of the effective maturities indicated by the Group's deposit retention history.

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35 LIQUIDITY RISK (continued)

| | US\$ '000 | | | | |
|--|--------------------------|--------------------------------------|---------------------|------------------|-------------------|
| | <i>Upto three months</i> | <i>Over three months to one year</i> | <i>Above 1 year</i> | <i>Undated</i> | <i>Total</i> |
| ASSETS | | | | | |
| Cash and balances with central banks | 809,986 | - | - | - | 809,986 |
| Treasury bills and deposits with central banks | 1,007,636 | 1,568,716 | - | - | 2,576,352 |
| Deposits with banks | 2,357,499 | 12,252 | 100,000 | - | 2,469,751 |
| Loans and advances | 7,802,632 | 1,940,791 | 9,755,279 | - | 19,498,702 |
| Non-trading investments | 538,448 | 575,149 | 4,888,813 | - | 6,002,410 |
| Investment in associates | - | - | - | 304,020 | 304,020 |
| Investment properties | - | - | - | 256,242 | 256,242 |
| Premises and equipment | - | - | - | 226,672 | 226,672 |
| Interest receivable and other assets | 119,909 | 335,230 | 161,781 | - | 616,920 |
| Goodwill and other intangible assets | - | - | - | 480,830 | 480,830 |
| Total | 12,636,110 | 4,432,138 | 14,905,873 | 1,267,764 | 33,241,885 |
| LIABILITIES | | | | | |
| Deposits from banks | 3,555,191 | 388,042 | - | - | 3,943,233 |
| Borrowings under repurchase agreements | 737,992 | 534,766 | - | - | 1,272,758 |
| Customers' deposits | 6,557,366 | 4,926,848 | 10,525,643 | - | 22,009,857 |
| Interest payable and other liabilities | 346,493 | 308,470 | 257,716 | - | 912,679 |
| Subordinated liabilities | - | 22,222 | 192,982 | - | 215,204 |
| Total | 11,197,042 | 6,180,348 | 10,976,341 | - | 28,353,731 |
| Net liquidity gap | 1,439,068 | (1,748,210) | 3,929,532 | 1,267,764 | 4,888,154 |

The Group has collateralized borrowing lines of credit with various financial institutions through repurchase arrangements. Please refer note 16 for further details.

35 LIQUIDITY RISK (continued)

The maturity profile of the assets and liabilities at 31 December 2016 was as follows:

| | US\$' 000 | | | | |
|---|------------------------------|--|-------------------------|------------------|-------------------|
| | <i>Upto three months</i> | <i>Over three months to one year</i> | <i>Above 1 year</i> | <i>Undated</i> | <i>Total</i> |
| ASSETS | | | | | |
| Cash and balances with central banks | 912,924 | - | - | - | 912,924 |
| Treasury bills and deposits with central banks | 1,318,342 | 1,146,504 | - | - | 2,464,846 |
| Deposits with banks | 1,749,447 | 84,126 | 50,920 | - | 1,884,493 |
| Loans and advances | 5,840,882 | 3,343,177 | 9,422,824 | - | 18,606,883 |
| Non-trading investments | 533,859 | 520,504 | 4,516,084 | - | 5,570,447 |
| Investment in associates | - | - | - | 326,874 | 326,874 |
| Investment properties | - | - | - | 132,021 | 132,021 |
| Premises and equipment | - | - | - | 211,209 | 211,209 |
| Interest receivable and other assets | 185,450 | 394,773 | 157,932 | - | 738,155 |
| Goodwill and other intangible assets | - | - | - | 474,632 | 474,632 |
| Total | 10,540,904 | 5,489,084 | 14,147,760 | 1,144,736 | 31,322,484 |
| LIABILITIES | | | | | |
| Deposits from banks | 3,065,663 | 213,375 | - | - | 3,279,038 |
| Borrowings under repurchase agreements | 322,819 | 375,409 | - | - | 698,228 |
| Customers' deposits | 6,271,169 | 4,743,379 | 10,688,810 | - | 21,703,358 |
| Interest payable and other liabilities | 397,475 | 275,337 | 192,564 | - | 865,376 |
| Subordinated liabilities | - | 22,222 | 214,760 | - | 236,982 |
| Total | 10,057,126 | 5,629,722 | 11,096,134 | - | 26,782,982 |
| Net liquidity gap | 483,778 | (140,638) | 3,051,626 | 1,144,736 | 4,539,502 |

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35 LIQUIDITY RISK (continued)

Analysis of financial liabilities by remaining contractual maturities

The table below summarises the maturity profile of the Group's financial liabilities (including interest) based on contractual undiscounted repayment obligations. However, the Group's expected cash flows on these instruments vary significantly from this analysis. In particular, customer deposits are expected to maintain stable or increased balances

| | US\$' 000 | | | | | |
|---|--------------------|---------------------------------|-------------------------------------|-----------------------------------|--------------------|------------|
| | Up to One month | One month to three months | Over three months to one year | Over one year to five years | Over five years | Total |
| As at 31 December 2017 | | | | | | |
| Deposits from banks | 2,105,425 | 1,455,037 | 391,105 | - | - | 3,951,567 |
| Borrowings under repurchase agreements | 231,808 | 507,800 | 539,973 | - | - | 1,279,581 |
| Customers' deposits | 10,506,062 | 3,917,929 | 6,604,986 | 1,140,625 | 11,241 | 22,180,843 |
| Subordinated liabilities | - | - | 22,856 | 203,885 | 12,264 | 239,005 |
| Total | 12,843,295 | 5,880,766 | 7,558,920 | 1,344,510 | 23,505 | 27,650,996 |
| Credit related commitments | 22,877 | 75,139 | 330,793 | 597,290 | 51,167 | 1,077,266 |
| Derivatives (net) | 205 | 9,183 | (2,142) | (7,946) | (51,335) | (52,035) |
| | | | | | | |
| | US\$' 000 | | | | | |
| | Up to One month | One month to three months | Over three months to one year | Over one year to five years | Over five years | Total |
| As at 31 December 2016 | | | | | | |
| Deposits from banks | 1,592,184 | 1,477,897 | 214,932 | - | - | 3,285,013 |
| Borrowings under repurchase agreements | 14,268 | 309,076 | 377,755 | - | - | 701,099 |
| Customers' deposits | 9,952,746 | 4,275,858 | 6,601,084 | 961,866 | 23,904 | 21,815,458 |
| Subordinated liabilities | - | - | 22,766 | 225,323 | 11,410 | 259,499 |
| Total | 11,559,198 | 6,062,831 | 7,216,537 | 1,187,189 | 35,314 | 26,061,069 |
| Credit related commitments | 18,653 | 131,414 | 211,137 | 671,940 | 97,275 | 1,130,419 |
| Derivatives (net) | 15,925 | 9,945 | (7,007) | (14,158) | (34,295) | (29,590) |

31 December 2017

36 CAPITAL ADEQUACY

The primary objectives of the Group's capital management policies are to ensure that the Group complies with externally imposed capital requirements and that the Group maintains strong credit ratings and healthy capital ratios in order to support its business and to maximise shareholders' value. Capital adequacy for each of the Group companies is also managed separately at individual company level. The Group does not have any significant restrictions on its ability to access or use its assets and settle its liabilities other than any restrictions that may result from the supervisory frameworks within which the banking subsidiaries operate.

In order to maintain or adjust the capital structure, the Group may adjust the amount of dividend payment to shareholders or issue capital securities. No changes were made in the objectives, policies and processes from the previous years.

The total capital ratio, calculated in accordance with the capital adequacy guidelines, under Basel III, issued by the Central Bank of Bahrain ("CBB"), for the Group, is disclosed under Pillar III Table 1, which is included in the Annual Report. The minimum capital adequacy ratio as per CBB is 12.5%. The Group's total capital ratio is 17.0% as of 31 December 2017 (31 December 2016: 17.1%).

37 DEPOSIT PROTECTION SCHEME

Certain customers' deposits of the Group are covered by deposit protection schemes established by the Central Bank of Bahrain (CBB) and the Financial Services Compensation Scheme, UK.

Bahrain: Customers' deposits held with the Bank in the Kingdom of Bahrain are covered by the Regulation Protecting Deposits issued by the Central Bank of Bahrain (CBB) in accordance with Resolution No.(34) of 2010. This scheme covers eligible 'natural persons' (individuals) up to a maximum of Bahraini Dinar 20,000 as set out by CBB requirements. A periodic contribution as mandated by the CBB is paid by the Bank under this scheme.

UK: Customers' deposits in AUBUK are covered under the Financial Services Compensation Scheme, up to a limit of GBP 85,000 per customer. No up-front contribution is currently mandated under this scheme and no liability is due unless any member bank of the scheme is unable to meet its depository obligations.

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38 ISLAMIC BANKING

The Group's Shari'a compliant Islamic banking activities are offered through its Islamic Banking subsidiary AUBK, Islamic banking associate UBCI and dedicated Islamic banking branches/windows at AUB Bahrain, AUBUK and through its associate Ahli Bank S.A.O.G. The results of its Islamic banking activities is presented below.

BALANCE SHEET AS AT 31 DECEMBER

| | <i>Note</i> | 2017 US\$ '000 | 2016 US\$ '000 |
|---|-------------|---------------------------------|---------------------------------|
| ASSETS | | | |
| Cash and balances with central banks | | 114,885 | 105,519 |
| Deposits with central banks | | 1,376,244 | 1,396,752 |
| Deposits with banks | (a) | 641,960 | 732,787 |
| Receivable balances from Islamic financing | (b) | 11,115,957 | 10,573,736 |
| Financial investments | | 819,008 | 778,615 |
| Investment in associates | | 42,738 | 40,880 |
| Investment properties | | 125,914 | 75,443 |
| Premises and equipment | | 110,616 | 103,058 |
| Profit receivable and other assets | | 57,291 | 82,094 |
| TOTAL ASSETS | | 14,404,613 | 13,888,884 |
| LIABILITIES | | | |
| Deposits from banks | (c) | 2,391,720 | 1,913,217 |
| Customers' deposits | (d) | 9,825,484 | 10,047,383 |
| Profit payable and other liabilities | | 240,499 | 230,161 |
| Restricted investment | | 31,964 | 2,773 |
| | | 12,489,667 | 12,193,534 |
| Equity of unrestricted investment account holders | | 125,219 | 55,199 |
| TOTAL LIABILITIES AND EQUITY OF UNRESTRICTED INVESTMENT ACCOUNTHOLDERS | | 12,614,886 | 12,248,733 |
| TOTAL EQUITY | | 1,789,727 | 1,640,151 |
| TOTAL LIABILITIES, EQUITY OF UNRESTRICTED INVESTMENT ACCOUNTHOLDERS AND EQUITY | | 14,404,613 | 13,888,884 |

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31 December 2017

38 ISLAMIC BANKING (continued)

| STATEMENT OF INCOME FOR THE YEAR ENDED 31 DECEMBER | Note | 2017 | 2016 |
|--|------|----------------|----------------|
| | | US\$ '000 | US\$ '000 |
| Net income from Islamic financing | (e) | 402,436 | 346,590 |
| | | 402,436 | 346,590 |
| Fees and commissions | | 41,609 | 39,814 |
| Other operating income | | 14,623 | 18,770 |
| Foreign exchange gains | | 11,447 | 13,239 |
| OPERATING INCOME | | 470,115 | 418,413 |
| Provision for financing receivables and others | | 117,462 | 113,285 |
| NET OPERATING INCOME | | 352,653 | 305,128 |
| Staff costs | | 81,680 | 69,148 |
| Depreciation | | 8,527 | 8,292 |
| Other operating expenses | | 45,029 | 40,196 |
| OPERATING EXPENSES | | 135,236 | 117,636 |
| PROFIT FOR THE YEAR BEFORE TAX | | 217,417 | 187,492 |
| Tax expense | | 7,085 | 6,685 |
| PROFIT FOR THE YEAR BEFORE THE SHARE OF PROFIT OF EQUITY OF UNRESTRICTED INVESTMENT ACCOUNT | | 210,332 | 180,807 |
| Less : Share of profit of equity of unrestricted investment account holders | | 611 | 270 |
| NET PROFIT FOR THE YEAR | | 209,721 | 180,537 |
| <i>Attributable to:</i> | | | |
| Owners of the Bank | | 172,906 | 151,472 |
| Non-controlling interest | | 36,815 | 29,065 |
| | | 209,721 | 180,537 |

| Notes | 2017 | 2016 |
|-----------------------------------|----------------|----------------|
| | US\$ '000 | US\$ '000 |
| (a) Deposits with banks | | |
| Murabaha finance with other banks | 514,929 | 622,221 |
| Wakala with banks | 99,917 | 70,103 |
| Current accounts and others | 27,114 | 40,463 |
| | 641,960 | 732,787 |

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38 ISLAMIC BANKING (continued)

Notes (continued)

| | 2017 US\$ '000 | 2016 US\$ '000 |
|---|-------------------|-------------------|
| (b) Receivable balances from Islamic financing | | |
| Tawarruq receivables | 6,539,897 | 6,544,634 |
| Murabaha receivables | 3,301,572 | 2,698,429 |
| Ijara receivables | 1,707,097 | 1,718,212 |
| Others | 28,861 | 11,184 |
| Less: Allowance for impairment | (461,470) | (398,723) |
| | <u>11,115,957</u> | <u>10,573,736</u> |
| | | |
| | 2017 US\$ '000 | 2016 US\$ '000 |
| (c) Deposits from banks | | |
| Murabaha | 1,855,346 | 1,616,778 |
| Wakala | 464,265 | 282,866 |
| Current accounts | 72,109 | 13,573 |
| | <u>2,391,720</u> | <u>1,913,217</u> |
| | | |
| | 2017 US\$ '000 | 2016 US\$ '000 |
| (d) Customers' deposits | | |
| Wakala | 5,899,772 | 5,863,449 |
| Murabaha | 1,997,722 | 2,364,822 |
| Mudaraba | 779,536 | 822,289 |
| Current accounts | 1,148,454 | 996,823 |
| | <u>9,825,484</u> | <u>10,047,383</u> |
| | | |
| | 2017 US\$ '000 | 2016 US\$ '000 |
| (e) Net income from Islamic financing | | |
| Income from Tawarruq | 292,040 | 252,218 |
| Income from Murabaha | 149,274 | 171,650 |
| Income from Ijara | 93,049 | 87,771 |
| Income from Financial Investments | 51,654 | 14,718 |
| Income from Islamic financing | <u>586,017</u> | <u>526,357</u> |
| | | |
| Profit expenses on Wakala | 91,536 | 106,078 |
| Profit expenses on Murabaha | 69,295 | 62,002 |
| Profit expenses on Mudaraba | 22,750 | 11,687 |
| Less: Distribution to depositors | <u>183,581</u> | <u>179,767</u> |
| Net income from Islamic financing | <u>402,436</u> | <u>346,590</u> |

39 COMPARATIVE INFORMATION

Certain corresponding figures for 2016 have been reclassified in order to conform to the presentation of financial statements for the current year. Such reclassifications do not affect previously reported net profit or shareholders' equity.