ANNUAL REPORT 2005

بنك مسقط
BankMuscat
www.bankmuscat.com

His Majesty Sultan Qaboos Bin Said

Mission Statement

Our mission is to be the best bank in the region by:

- Providing a high return to our shareholders
- Providing a high quality of service to our customers at an affordable cost by being innovative and introducing new products and channels of service
- Developing and motivating our employees who are the source of our strength
- Being a responsible Corporate Citizen

Quality Policy

Our Quality Policy is to achieve and sustain a reputation for quality in the national and international markets by offering products and services that exceed the requirements of our customers. We strive to remain the bank of choice in all our products and services.

Towards this policy, our objectives are:

- Establishing and maintaining a quality system based on the most recent ISO quality standards
- Continually reviewing our products and services, feedback from employees (internal customers) and our customers to ensure that there is continual improvement
- Offering our clients excellent service, innovative products and value-added banking while developing with them a mutually beneficial association
- Demonstrating vision, professionalism, transparency and integrity in the conduct of our business and service
- Achieving disciplined growth and reasonable profitability while operating on a sound financial base
- Creating value for our shareholders
- Encouraging, motivating and developing our human resources - our most valuable asset and the cornerstone of the bank
- Working towards the successful implementation of the Government objectives applicable to us
- Striving towards and maintaining a pre-eminent position in the banking community in the Sultanate of Oman

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Chairman's Report

Dear Shareholders,

Following a period of strong growth, the world economy slowed in late 2004 and in 2005. World GDP is estimated to have increased by 3.2% in 2005, down from 3.8% in 2004.

The economic slowdown was experienced throughout the industrialized world, with growth in Europe still underperforming potential. In contrast, despite having slowed, the economies of Japan and the United States of America are expanding at close to their maximum sustainable rate. Among large developing economies, GDP in 2005 continued to expand rapidly in China and India (in excess of 9% and about 7%, respectively), but slowed in Russia as growth in oil production slowed.

High oil prices and strong oil demand continue to be key drivers for the economies of the Middle East and North Africa, where GDP is estimated to have increased by 4.8% in 2005.

Looking ahead, the World Bank opines global growth will be stable in 2006, before strengthening in 2007.

Oman's Economy

Oman's economy continues to be carefully monitored and managed. The Government has once again recently announced a growth-oriented budget with a moderately conservative outlook.

The budget for 2006, the first of the 7th five year plan of the Sultanate, has excess of planned aggregate expenditure of RO 4,237 million over budgeted revenue receipts of RO 3,587 million and is thus estimated to leave a higher deficit of RO 650 million in 2006, as against a deficit of RO 540 million in the previous budget. Oil (RO 2.519 billion) and gas (RO 394 million) revenues for 2006 constitute 81% of total revenues, and current and capital revenues (RO 674 million) constitute the remaining 19%. Oil revenues have been calculated on the basis of USD 32 per barrel, with an average production of 746,000 barrels per day. The total expenditure of RO 4,237 million for the fiscal year 2006 is RO 557 million or 15% higher than the expenditure earmarked in last year's budget.

Focal areas of Government expenditure continue to be the oil sector, defense, education, healthcare and the development of human resources, all of which are critical to the sustained growth and development of the national economy.

Capital Markets

Under the able guidance of the Capital Markets Authority of the Sultanate of Oman, the Muscat Securities Market continued to register steady growth, reflecting the confidence of investors in the economy. The year 2005 has been very good for the market. The MSM 30 index started the year at 3,375 and concluded the year at 4,875 making a net gain of 44% during the year. The year also witnessed a number of IPOs entering the market, the most significant being the Omantel IPO, the largest ever IPO in Omani capital markets history, which received applications from over 160,000 investors and collected in excess of RO 700 million. Omantel has been a dominant stock since its listing. With the prospect of greater inter-connectivity between the regional bourses and the market itself in a buoyant mood, it is widely expected that 2006 will be a better year for the investing community in the Sultanate.

Financial Overview

On 01 January 2005, the Bank's Bahrain branch was disposed of to form a new bank by the name BankMuscat International (BMI), in which the Bank has a 49% stake. Investment in BMI is accounted as 'investment in associate' using the equity method. Accordingly, the results of the Bahrain operation are not consolidated line-by-line in the Bank's results of 2005 whereas the comparative figures of 2004 include the results of Bahrain branch.

The Bank achieved a net profit of RO 45.4 million for the year ended 31 December 2005, as against a net profit of RO 34.1 million for the year ended 31 December 2004, an increase of 33.1%. Net interest income increased by 3.9% from RO 75.2 million in 2004 to RO 78.1 million in 2005. However, net interest income increased by 9.1% when compared with Oman Operations of 2004. Non-interest income grew from RO 21.8 million in 2004 to RO 23.3 million in 2005, an increase of 6.5%. On a like-to-like basis, it increased by 23.1% in 2005. Operating profit of RO 57.3 million in 2005 is 3.6% higher than the RO 55.3 million achieved in 2004. Operating expenses of RO 44.0 million in 2005 are higher by 3% than RO 42.7 million incurred in 2004. The cost to income ratio for the year was at 43.4% as compared to 43.6% in 2004.

The return on average assets improved from 1.97% in 2004 to 2.33% in 2005. The return on average equity improved from 20.0% in 2004 to

20.2% in 2005. The basic earnings per share increased from RO 0.493 in 2004 to RO 0.642 in 2005.

The Bank enjoys a market share of 36.7% in terms of total assets, 36.6% in terms of total credit and 34.9% in terms of total customer deposits. The Bank's share of total savings deposits was 37.7% as at 30 November 2005.

The Bank's net loans and advances portfolio grew by RO 43 million to RO 1,372 million as at 31 December 2005 compared to RO 1,329 million as at 31 December 2004. However, net loans and advances portfolio of Oman Operations grew by RO 157 million, an increase of 12.9%. Customer deposits grew by RO 171 million to RO 1,333 million as at 31 December 2005 compared to RO 1,162 million as at 31 December 2004. Savings deposits increased by 17.7% from RO 287 million as at 31 December 2004 to RO 338 million as at 31 December 2005.

The Bank made loan loss provisions of RO 24.4 million during the year compared to RO 20.4 million made during the year ended 31 December 2004. Loan loss provision charge of RO 24.4 million for the year 2005 includes RO 13.2 million towards general loan loss provision as per the requirements of the Central Bank of Oman. As of 31 December 2005, the Bank has fully met the general loan loss provision requirements of the Central Bank of Oman though banks are allowed to comply by 2006. The Bank holds a general loan loss provision of RO 22.2 million as at 31 December 2005. During the year 2005, the Bank has recovered RO 15.9 million from provision for possible credit losses compared to RO 6.3 million in 2004. In addition, the Bank made a recovery of RO 1.9 million from provision for placements in 2005.

On disposal of its Bahrain branch, the Bank made a net profit of RO 2.8 million in 2005 representing the excess of sale consideration over net assets of Bahrain branch. The Bank's associates contributed RO 3.7 million as share of profits during the year 2005 as against a net loss RO 1.4 million of 2004. One of the Bank's associates had a dispute on certain trading transactions entered with a counter-party in 2005. Both the associate and the counter-party agreed to share the quantum of the trading loss and resolved the dispute. The Bank's share of this trading loss of RO 3.9 million (representing 49%) and was fully recognized in the income statement in 2005.

The Board of Directors is pleased to recommend a cash dividend of 35% and a stock dividend of 10% for the year 2005, subject to due approval by the shareholders and regulatory authorities, thus keeping up the practice of consistently providing good returns to shareholders.

The Year in Retrospect

The year 2005 has been significant in the history of the Bank in many ways. On one hand, it saw the Bank breaking new ground as it became the first bank from across the GCC region to be listed on the London Stock Exchange as a result of its maiden USD 163 million issue, which was oversubscribed many times over; on the other, it saw the Bank gearing up to enter new geographies as preparations to commence operations in the Kingdom of Saudi Arabia and the UAE are on in full swing.

The dawn of 2005 saw the Bank's operations in the Kingdom of Bahrain being converted into an independent bank - BankMuscat International (BMI) - in association with some of the most respected investors from across the region to capitalize on the growing opportunities from the greater integration of the GCC states. The Bank's investments in India also turned over a leaf as Centurion Bank successfully merged with the Bank of Punjab to become the Centurion Bank of Punjab with effect from October 2005, one of the largest private sector banks in the subcontinent, in which BankMuscat holds 25.34%. The quoted market value of the Bank's shareholding amounted to RO 59.74 million, which is not accounted in the Bank's balance sheet as this investment is accounted under equity method.

The last quarter saw the Bank gain permission from the Central Bank of Oman to explore the setting up of operations in Qatar and Kuwait, and also celebrate the 10th anniversary of its representative office in Dubai.

On the domestic front, the Bank in 2005 continued to grow upon the foundations that it has laid over the past few years. Recording progress quarter on quarter across each of its businesslines, the Bank has, in many ways, met with unprecedented success this year.

The Bank's corporate banking division continued to partner local enterprise and the public sector in its endeavour to help strengthen the domestic economy. During the year, it continued to play a key role in almost all projects of national importance. These include significant projects in the oil and gas sector, power, telecom, logistics, agriculture and tourism.

In recognition of the growing importance of the small and medium scale enterprise (SME) in the country, the Bank decided to launch Al Wathbah, its programme-lending services aimed for the SME sector during the last quarter of the year. Al Wathbah is expected to significantly help enterprising players in the SME sector forge ahead.

Continuing its successful association with significant mandates in the Sultanate, the Bank was also awarded mandates to advise the Government of Oman on the privatization of the country's first independent water project, the Sharqiyah Independent Water Project (IWP), the privatization and restructuring of Solid Waste management in the country, and the advisory and fund raising mandate for a leading petrochemical project in the Sultanate.

The Bank's retail banking division, led by its flagship product, the Al Mazyona savings scheme continued to fulfill a dual obligation of attempting to create a savings culture amongst people, even as it seeks to reward customers for their loyalty to the Bank. The scheme remains the most popular in the Sultanate despite increased competition from other local banks.

The cards department continued to help people across the Sultanate realize the greater convenience and security that plastic money affords.

Bancassurance continued to grow in popularity as customers have started to appreciate the power of a small saving plan, ably underwritten by a leading insurance partner.

The Bank's attempts to create even greater customer convenience continued to gather momentum as our e-banking network of ATMs, kiosks, cash deposit machines, internet banking facilities, mobile banking facilities and 24x7 call centre, continued to service the needs of customers across the length and breadth of the country.

Supporting the efforts of the Government in inducing people to share the success of leading public sector undertakings, the Bank's Investment Banking division continued to reach new milestones in the Initial Public Offering (IPO) market segment. Amongst the IPOs lead managed by the division during the year are those for AES Barka, Dhofar Power and Taageer Finance, all of which attracted substantial investor interest and oversubscribed several times. The most significant capital market offering of the year, the much-awaited RO 288 million Omantel issue – the biggest in the capital markets history of the Sultanate – was also lead managed by the Bank. The Omantel IPO saw an unprecedented number of people coming forward to invest in the issue, and went on to raise in excess of RO 700 million.

The Investment Banking division also launched two structured products during the year, which were marketed through the Bank's private banking division. Riding on these products and a basket of leading investment products from financial institutions and fund managers from across the globe, the private banking division continued to build stronger ties with its high net worth client base in the country and focus on further strengthening its Assets Under Management. The department also made considerable progress in its efforts at client acquisition, offering superior customer service and focused marketing during the year.

The Bank's asset management division also saw considerable activity during the year: the erstwhile Oryx JIA fund successfully rolled over into the new Oryx (2004) fund and appointed Aberdeen Asset Management (Asia) Limited to act as the investment advisors to the Fund. Worldwide, the Aberdeen Group manages over USD 45.6 billion in assets for a range of clients, through mutual and segregated funds.

The last quarter of the year also saw major changes being effected to the Muscat Index Fund (JIA), which has since rolled over into the Muscat Fund with the option to invest up to 20% of its funds outside the Index stocks with the objective to improve overall returns. The Fund would also change from its erstwhile closed-ended structure to an open-ended structure and offer a weekly subscription / redemption facility.

The Bank's efforts to provide the finest banking products and services to its customers was once again recognized by the global financial community, as the Bank was declared the 'Best Bank in Oman' by The Banker, FT, London, Global Finance and Euromoney again. The Bank was also awarded the Gulf Excellence Award last year. The Bank's employee-focussed efforts were recognized in the Bank being declared the 'Best Place to Work' in Oman by BusinessToday magazine and in its being awarded the 'People Development Award' at the Oman Awards for Excellence, for the second year in succession.

The Bank also adopted measures to re-focus its back-end operations to be in line with the requirements of the Real Time Gross Settlement System (RTGS) introduced by the Central Bank of Oman in September 2005. This RTGS system is expected to enable real-time movement and the settlement of funds between banks in the country, resulting in enhanced liquidity management in the banking system. It will also allow the Central Bank to monitor the account positions of banks online. With this, Oman has become the second country in the GCC, after the Kingdom of Saudi Arabia, to implement the RTGS system.

Risk Rating

During the year all key rating agencies reviewed and upwardly revised the Bank's long-term and short-term financial ratings.

Commenting on its decision to upgrade the Bank's credit ratings from BBB/Stable/A-3 to BBB/Stable/A-2, Standard & Poor's said:

"The upgrade reflects the Bank's enlarged capital base, sustained leading domestic market position, and improving financial performance. The ratings on the Bank continue to reflect controlling ownership of the Sultanate of Oman (foreign currency, BBB+/Stable/A-2; local currency, A/Stable/A-2) and expectations of strong support in times of difficulty…the leading bank in the limited financial sector of Oman, BankMuscat is ….strengthening its franchise and reducing reliance on its small home market through selective domestic and cross border acquisitions."

BankMuscat's ratings by the four international rating agencies, Fitch, Standard & Poor's, CI and Moody's are the highest to be awarded to any Omani bank.

Corporate Governance: From delight to ecstasy

The past year saw the Bank further strengthening its Corporate Governance best practices. Greater Board – Management harmony, resulted in faster growth, higher profitability and enhanced stakeholder welfare, thereby building on the foundations of profitability and stakeholder delight of 2004.

The Board and Management of the Bank have ensured a culture of respect for the laws and regulations of the Sultanate, and the countries in which the Bank operates. The Bank follows a fair dividend policy, offers remuneration commensurate with contribution and maintains high standards of disclosure and overall transparency. A robust and dynamic system of internal control, focused polices and the adoption of a participatory approach in decision making are other notable 'embedded' features of Corporate Governance in practice at the Bank.

We expect the coming year will see Corporate Governance practiced at the Bank set even higher standards and become increasingly part of the Bank's day-to-day operations.

A detailed Corporate Governance Report, duly audited by the External Auditors of the Bank, forms part of the Annual Report presented to you.

The Year Ahead

The year 2006 promises to be all the more exciting for three key developments that will impact the banking sector both directly and indirectly: the year will act as a watershed year between the WTO regulations coming into play at a national level and the Basel II regulations being implemented by the banking sector. It will also witness the signing of the Free Trade Agreement (FTA) between Oman and the United States of America.

While the Basel II norms are essentially an issue that will impact the banking sector alone, the WTO regulations and the FTA are another matter altogether; for one, they promise to help the country integrate much faster into the global economy in line with the vision of His Majesty; they are also expected to result in the emergence of substantial opportunities for local industry to extend their competencies overseas. They will also result in many more global organizations looking at the Sultanate and its burgeoning youth market as a potentially viable destination on the world map.

As the nation's largest bank, we are today well positioned to respond to the shifting conditions in the Omani economy. While interest income continues to form the primary revenue source for the sector, as for ourselves, there is an increasing realization that the future perhaps lies in also giving due importance to developing expertise in fee and commission based operations. This is expected to result in the growing importance of a diverse range of banking products, services and businesslines that are in the 'value-added' or 'knowledge space' and consequently, have the potential to earn substantial fee and commission income on a recurring basis. With the growing pace of economic, industrial and technological reform in the country, there will also be a need to develop a full range of banking services for both the retail and corporate banking markets, many of which are yet to realize their full potential.

What is also expected is increasing levels of competition in the banking sector with more and more regional and international banks trying to make their presence felt in the country and large Omani banks gearing up further to make their presence felt across the region. This can only augur well for the sector, which is already focused on providing greater value to the customer. Heightened competition will ensure greater attempts at consolidation, value-creation and higher efficiency levels. The consumer in particular, and the banking sector in general, has only to gain from such a move.

A Word of Thanks

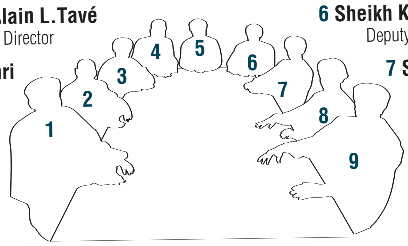
On behalf of the Board of Directors, I would like to take this opportunity to thank the banking community, both in Oman and overseas, for the confidence reposed in the Bank. I would also like to thank the Management Team and all our employees for their dedication, commitment and untiring efforts to make the Bank reach even higher levels of excellence.

The Board of Directors welcomes and supports the measures taken by the Central Bank of Oman and the Capital Markets Authority with a view to improving the financial markets in the Sultanate. The Bank's growth would not have been possible without the foresight and market-friendly policies adopted by His Majesty's Government.

The Board of Directors is also deeply thankful to His Majesty Sultan Qaboos bin Said for his vision and for ably steering the nation along its path of growth and prosperity.

AbdulMalik bin Abdullah Al-Khalili

Members of the Board



5 Sheikh AbdulMalik bin Abdullah Al Khalili
Chairman

4 Alain L.Tavé
Director

6 Sheikh Khalid bin Mustahail Al Mashani
Deputy Chairman

3 Brigadier Saif bin Ali Al Amri
Director

7 Sulaiman bin Mohamed bin Hamed Al Yahyai
Director

2 K.K.Abdul Razak
Director

8 Dr. Salem ben Nasser Al Ismaily
Director

1 Hamoud bin Ibrahim Soomar Al Zadjali
Director

9 Salim bin Taman Musallam Al Mashani
Director

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Report to the Shareholders of Bank Muscat SAOG ("the Bank") of Factual Findings in connection with the Corporate Governance Report of the Bank and application of the Corporate Governance practices in accordance with Capital Market Authority Code of Corporate Governance

We have performed the procedures prescribed in the Capital Market Authority ("CMA") Circular No. 16/2003 dated 29 December 2003 with respect to the Corporate Governance Report of the Bank ("the Report") and its application of the Corporate Governance practices in accordance with the CMA Code of Corporate Governance ("the Code") issued under Circular No. 11/2002 dated 3 June 2002, as amended. The Report is set out on pages 8 to 12.

Our engagement was undertaken in accordance with the International Standards on Auditing applicable to agreed-upon procedures engagements. The procedures were performed solely to assist you in evaluating the Report.

We found the Report reflects, in all material respects, the Bank's application of the provisions of the Code and is free from any material misrepresentation.

Because the above procedures do not constitute either an audit or a review made in accordance with International Standards on Auditing, we do not express any assurance on the Bank's Corporate Governance Report. Had we performed additional procedures or had we performed an audit or review of this Report in accordance with International Standards on Auditing, other matters might have come to our attention that would have been reported to you.

This report is solely for the purpose set forth in the second paragraph above, and for inclusion, with the Report, in the Bank's annual report, and is not to be used for any other purpose. This report relates only to the Report included in the Bank's annual report for the year ended 31 December 2005 and does not extend to the financial statements or any other report of Bank Muscat SAOG, taken as a whole.

1 March 2006

KPMG

New vistas

After instilling the best of corporate governance practices across the Bank, the focus has been on further developing the momentum that had been established in the last few years.

The four pillars of good governance were adopted and stakeholder welfare was taken to new heights. Corporate social responsibility, where corporate entities give back to the society they function in and earn from, in the form of social project funding and support was one of the key areas that the Bank focused on during the year. The Bank reiterated its support for sustainable development responsibilities through funding of projects related to water resources management, waste management and building environment friendly eco-tourism infrastructure.

Carrying forward the solidarity expressed by His Majesty Sultan Qaboos bin Said, with the United Nations' concern for road safety globally, the Bank sponsored several traffic and road safety awareness and educative campaigns during the year to inculcate road safety awareness across various groups in Oman such as students, young drivers etc, thereby reducing unnecessary loss of life.

To inculcate the banking habit and the spirit of savings and increase the awareness of banking products and services in a technology driven world, the Bank set up a full fledged branch in the Sultan Qaboos University to serve the students in their growing years and ensure a bright future. Culture, arts and crafts are encouraged by sponsorship of events such as the Muscat Festival.

Stakeholder welfare crossed another threshold with a rewarding dividend in 2004 and stakeholder awareness being built up by constant updates through the media and shareholder communication. A new Investor Relations sub-section on the Bank's website has been set up which is dedicated to constantly keeping investors informed about developments relating to the Bank.

Disclosure and transparency were key focus areas with a vigilant disclosure committee and the Board's continued interest in keeping the investing public informed. The financial statements have presented a true and fair picture of the finances of the Bank. The Board confirms that the Bank is in good financial health and is expected to grow in the coming years.

A fair and equitable **Dividend Policy**, which seeks to reward investors for their confidence and also build in prudential provisioning which is a pre-requisite for building up a strong banking institution has been set in place and is constantly evaluated to ensure that investors interests are sustained. Unclaimed dividends are transferred as required to the Investor's Trust Fund under the administration of the Capital Market Authority. The uncollected dividend/s for the year 2004, amounting to Rial Omani 82,969.000 was transferred to the CMA on 27 December 2005 as required under the regulations. Related party dealings are governed by a comprehensive **Related Party Policy** which details the transactions and their financial thresholds. All related party dealings are reported to the shareholders at the Annual General Meeting. The Articles of Association are constantly reviewed as required and amended after approval of the shareholders whenever there are changes in the legal and regulatory prescriptions. The Bank's compliance with Corporate Governance principles laid down in the Code of Corporate Governance are reviewed in detail by the Board throughout the year and at least once comprehensively on an annual basis. Enhancement of the principles is also constantly introduced by learning from the developments in the region as also

from international practices. Capital adequacy standards are met in good measure and the Bank strives to stay above the requirements at all times. Likely conflicts of interest situations are addressed by a set of principles which ensure fair decision making. The Board reviews the effectiveness of internal controls and their adequacy periodically and confirms that it has done so for the year 2005. The Board devotes considerable time to **reviewing the policies of the Bank**, the functioning of committees and the control measures in place. A well designed scheme of delegation of financial and administrative powers has been implemented within an optimal organizational structure. As required by the Capital Market Authority, the insurance needs of the Bank vis-a-vis insurable risks are reviewed periodically and adequate steps taken for risk mitigation.

The Board has set in place the principle of "lead by example", the foundation for which is laid by the Board adopting a stringent "Code of Conduct and Ethics" for the Board of Directors.

The Bank has complied in letter and spirit with the Capital Market Authority's Code of Corporate Governance.

The Board of Directors

The Bank has a nine member Board of Directors duly elected by the shareholders at the Annual General Meeting. The Board is elected for a three year term to ensure continuity of directorial leadership. All the nine members are non-executive directors. The members of the Board are all persons of stature in their respective professions, having contributed to administration, management, finance, strategy and governance.

Independence of directors

The members of the Board are independent within the definition laid down in the Code of Corporate Governance set in place by the Capital Market Authority.

The electoral process for the Board of Directors

The Board of Directors is elected for a three year term by the shareholders, at an Annual General Meeting convened, listing the election on the agenda. The best talent for directorial representation is ensured. Nominations are received from interested candidates. The election process has an observer from the Capital Market Authority, who ratifies the process. In keeping with stringent standards for bank directors the nominations are put through a sieving process based on fit and proper criteria prescribed under the regulations. After the election process is completed and the results announced, the Board is constituted and elects the chairman and deputy chairman. The membership of the Committees of the Board is also decided. The present Board was elected in 2004 and its term extends till 2007.

Working and contribution of the Board is accorded prime focus. An incisive process of identifying issues of importance, strategies to be adopted and charting the future expansion of the Bank, as also a keen and continued interest in the financial management of the Bank, characterizes the Board of Directors. **Board Management relations** are professional and the Board plays the role of mentor and supervisor as also a guide to give direction to the Bank. A comprehensive set of policies and strategy documents are set in place in line with the best banks worldwide. The Bank's organization chart ensures an optimal span of control and ensures efficiency. A matrix of effective controls and a full panel of management level committees address all issues of control and decision making in all the areas of functioning. Control systems are constantly reviewed and strengthened. Write-offs are carefully administered and are governed by a strict policy detailing the parameters for considering write-off proposals. Loans written off are reported to the regulatory authority promptly. Employee accountability in cases where loans go bad is examined minutely.

Likely conflict of interests and their resolution are handled by declaration of the interest and the distancing of the interested party from the decision making chain. Transparency in conflict situations is ensured and issues are handled to enable conflict being resolved with the interests of the Bank being protected.

Committees of the Board

The Board has two major committees namely the Board Credit Committee and the Audit Committee of the Board. With the increasing importance being accorded to risk management with the implementation of the Basel II norms, various measures have been taken to focus on risk management. A well laid down risk management policy is in operation.

Board Credit Committee

The Board Credit Committee consists of five members and serves to sanction loans as per the powers delegated to it by the full Board. The Committee has comprehensive terms of reference and all decisions are carefully documented.

Audit Committee

The Audit Committee consists of four members with at least one member having qualifications in finance and accounting and an in-depth understanding of financial management and accounting. The terms of reference of the Audit Committee, which is set in place by the Board, incorporates all the requirements of the Code of Corporate Governance and the essence of good audit committee functioning drawn from international bodies. The terms lay down the role and duties of the Audit Committee and ensure that it serves its objectives in good measure.

Details of the meetings, attendance at the meetings and details of the director's representation are contained in tables 1 and 2 at the end of this report.

Bank's share trade locations

The shares of the Bank are quoted on the Muscat Securities Market (MSM) and the Bahrain Stock Exchange (BSE). The Muscat Securities Market is linked to the Abu Dhabi Stock Exchange. The Global Depositary Receipts (GDRs) issued by the Bank are quoted on the London Stock Exchange.

Shareholding pattern of BankMuscat

The shares of the Bank are widely held and open to trade. The shareholding pattern of the Bank as at 31 December 2005 was as follows:

Royal Court Affairs 20.058% HSBC A/c. (Global Depository Receipts) 10.176% Société Générale 9.164% Ministry of Defence Pension Fund 7.601% Muscat Overseas Group LLC 6.071% National Equity Fund 3.471% Al Taman Trading Est. 3.345% Civil Service Pension Fund 3.292% H.E. Sheikh Mustahail Ahmed Al Mashani 2.780% Public Authority for Social Service 2.504% Others 31.538%

Issues of remuneration and fees paid

The Commercial Companies Law of Oman was amended during the year to comprehensively cover sitting fees and remuneration paid to directors of companies. The law and amendments apply to the Bank as a company. The law places a maximum limit of RO 200,000 per year for the entire Board, inclusive of sitting fees and remuneration. The Bank has complied with the law and has paid a total of RO 200,000 to the members of the Board by way of sitting fees and remuneration. The Bank has incurred expenses of RO 13,033 on deputing directors for conferences and seminars on directorial inputs.

The remuneration of the top five executives of the Bank of RO 1,931,878 is inclusive of the provision made for the performance related component of the remuneration.

Communication to the shareholders, investors and other financial institutions

The Bank has a dynamic website, www.bankmuscat.com, which is used to constantly communicate and disseminate information about the Bank to customers, shareholders, financial analysts, the banking community and financial institutions internationally. Major compliance statements such as Patriot Act compliance etc, are posted on the website. In addition to this, the Bank communicates by mailing annual reports, financial statements and other information statements to banks and financial institutions, including rating agencies and financial analysts.

As required under Article 16 of the Code of Corporate Governance, a detailed Management Discussion and Analysis Report (MD & A Report) has been included as part of the annual report to the shareholders.

Beneficial ownership

With the growing international practice of constant monitoring of beneficial ownership of financial institutions, the shareholding movements of the Bank's shares are constantly monitored.

Comparative share price data relating to the price of the Bank's shares vis-à-vis market indices

The following table presents a comparative picture of the movements of the Bank's share price on the Muscat Securities Market (MSM) vis-à-vis the MSM's index for the banking sector:

	BankMuscat			Banking Index		
	High	Low	Close	High	Low	Close
Jan-05	6.990	6.440	6.990	4819	4506	4795
Feb-05	7.000	6.750	7.000	4824	4703	4824
Mar-05	9.000	7.000	8.710	5941	4823	5745
Apr-05	9.110	7.600	8.850	6464	5712	6464
May-05	9.560	8.290	9.560	7095	5982	7095
Jun-05	12.110	9.360	10.920	8284	6924	7819
Jul-05	11.000	10.350	10.640	7885	7475	7622
Aug-05	10.620	9.810	9.810	7610	7230	7244
Sep-05	9.850	9.300	9.670	7267	6725	7065
Oct-05	10.110	9.200	9.310	7251	6868	6983
Nov-05	9.450	8.980	9.070	6946	6653	6724
Dec-05	9.180	8.800	8.920	6848	6604	6848

Corporate Governance

The Bank has not been subjected to any regulatory penalties during the last three years.

Convertible instruments affecting the equity

There were no convertible instruments outstanding as on 31 December 2005, which were likely to affect the equity structure of the Bank.

External Auditors of the Bank

KPMG Oman were appointed the external auditors of the Bank for a second year with the approval of the shareholders at the Annual General Meeting. The Code of Corporate Governance prescribes a system of rotation of audit firms with the maximum term set at 4 years.

KPMG Oman is a member of KPMG International. KPMG has member firms covering 148 countries world wide and has approximately 100,000 employees. KPMG provides audit, tax and advisory services through their network of committed professionals. KPMG Oman has about 70 employees.

The following tables give details of the meetings held by the Board and its committees during the year 2005 and the attendance of the Directors at the meetings. All the Directors attend the Annual General Meeting of the shareholders, unless they have compelling preoccupations in which case they seek leave of absence. Two Directors could not be present at the last Annual General Meeting held on 05 April, 2005 for urgent personal reasons and had sought leave of absence.

Table 1

Name of the Director and Representation		Board meetings attended	Other directorships	Committee meetings attended
Sheikh AbdulMalik bin Abdullah Al Khalili Royal Court Affairs	Chairman of the Board and Chairman of the Board Audit Committee	18	7	6
Sheikh Khalid bin Mustahail Al Mashani Individual capacity	Deputy Chairman and Chairman of the Board Credit Committee	16	4	9
Société Générale (Alain Tavé) Société Générale	Director and Member of the Board Credit Committee	18	Nil	9
Brigadier Saif bin Ali Al Amri Ministry of Defence Pension Fund	Director and Member of the Board Credit Committee	17	1	9
Hamoud bin Ibrahim Soomar Al Zadjali Royal Oman Police Pension Fund	Director and Member of the Board Audit Committee	18	4	9
Dr. Salem ben Nasser Al Ismaily Individual capacity	Director and Member of the Board Audit Committee	15	3	4
K. K. Abdul Razak Muscat Overseas Group	Director and Member of the Board Audit Committee	17	6	6
Salim bin Taman Musallam Al Mashani Individual capacity	Director and Member of the Board Credit Committee	16	1	9
Sulaiman bin Mohamed bin Hamed Al Yahyai Individual capacity	Director and Member of the Board Credit Committee	17	2	9

Table 2

Dates of Board meetings (Total meetings held : 18)

	Board meetings Total: 18 meetings	Audit Committee Total: 6 meetings	Board Credit Committee Total: 9 meetings
	Dates of meetings		
1	29.01.2005	27.01.2005	29.01.2005
2	15.02.2005	24.04.2005	28.02.2005
3	28.02.2005	06.06.2005	03.05.2005
4	07.03.2005	26.07.2005	29.05.2005
5	31.03.2005	25.10.2005	28.06.2005
6	05.04.2005	13.11.2005	24.08.2005
7	17.04.2005		24.09.2005
8	24.04.2005		25.10.2005
9	29.05.2005		01.12.2005
10	29.06.2005		
11	26.07.2005		
12	24.08.2005		
13	24.09.2005		
14	28.09.2005		
15	25.10.2005		
16	01.12.2005		
17	21.12.2005		
18	26.12.2005		

The Corporate Governance Report is part of the Bank's Annual Report as per the requirements of the Code of Corporate Governance.

Management Team

Front row (from left): Saad Al-Jenaibi - DGM, Retail Banking, **J. Sunder George** - Deputy Chief Executive, **AbdulRazak Ali Issa** - Chief Executive, **Ahmed Al-Abri** - General Manager, Banking, **T.V. Alaga Raja** - DGM, Banking Services & Operations

Middle row (from left): K. Gopakumar - AGM, Treasury & Investment Banking, **Said Al-Badai** - AGM, Branches, **Abdalla Al-Qasmi** - AGM, Private Banking, **Sulaiman Al-Harthy** - AGM, Trade Finance & Overseas Credit & SBU, **Wahid Panwala** - AGM, e-banking & Operations, **Abdul Kader Al-Balushi** - AGM, Credit Administration & Remedial Credit, **Salim Al-Kaabi** - AGM, Quality Management

Rear row (from left): Leen Kumar - Head, Risk Management, **Akshay Kumar Parija** - AGM, Corporate Credit & Marketing, **D. Venugopal** - Head, Information Technology, **Yasin Abdullatif** - AGM, Finance & Risk Management, **Ali Amin Ramadan** - AGM, Consumer Credit, **Said Al-Ismaily** - AGM, Human Resources, **Yousif Abbaker** - Chief Legal Advisor & Secretary to the Board of Directors, **Ganesh T** - Senior Manager, Finance, **Manas Das** - Head, Research & Development

Not in picture: Ganesan Sridhar - DGM, Corporate Banking, **Riad Al-Asfoor** - AGM, Government Business, **Suleiman Shahbal** - AGM, International Operations

Please note: The Management Team of the Bank has recently been refocused in line with the Bank's future strategy. This has resulted in a change of several key management portfolios and designations. Kindly check the Bank's website (www.bankmuscat.com) for updated details of the Bank's management team.

Economic Environment

The World Bank 'Global Economic Review and Projections' share that the slowdown that began in the second half of 2004 was experienced throughout the industrialized world as the year 2005, with growth in Europe still underperforming potential. The economies of Japan and the United States of America, in contrast, despite slowing down, are expanding at close to their maximum sustainable rate. The Chinese and Indian economies, on the other hand, continued to witness strong GDP growth (in excess of 9% and about 7%, respectively), but GDP growth slowed in Russia as growth in oil production slackened. High global energy prices and strong oil demand continued to be key drivers of growth in the Middle East and North African economies, where GDP is estimated to have increased by 4.8% in 2005, in comparison to world GDP figures, which are estimated to have increased by 3.2% in 2005 (down from 3.8% in 2004). The World Bank opines that global growth will be stable in 2006, before strengthening in 2007.

Oman's Economy

The beginning of the fiscal year 2006, not only marked a new budget, but also the unveiling of the nation's seventh five-year plan, that ends in 2010. The nation's five-year plans, instituted since 1976, aim to adopt a longer-term view of the developmental needs of the Sultanate. Each plan is intended to continue previous strategy, in addition to incorporating new developments and projects in recognition of the need for a dynamic approach toward the all round development of the national economy.

On the salient features of the seventh five-year plan, the Minister of National Economy and Deputy Chairman of the Financial Affairs and Energy Resources Council, HE Ahmed bin Abdulnabi Maki said:

"The Plan comes as a new phase in Oman's economic and social development. The key objectives of the plan are: Improvement of the standard of living of the citizens; maintenance of stability of prices; upgrading education and expanding the higher education opportunities; striving to provide employment opportunities for nationals; social welfare, human resource development; infrastructure development; enhancing water resources and provision of safe water; preserving the national heritage; strengthening the capabilities of the judicial system; development of tourism, fisheries, industry sectors and encouragement of export processes; and the encouragement of local and foreign private sector investments."

The Plan aims at achieving GDP growth at current prices, with an annual average growth rate of 3%. As the government continues to encourage local and foreign investments, it is expected that the average growth of investments will rise to about 24% of GDP during the plan period, as compared to about 16% in the previous development plan. Total investments are expected to touch RO 113,100 million during the Plan.

The Plan also aims at maintaining inflation levels at an average of 2% during the plan period. The government plans to adopt sustainable fiscal policies and appropriate monetary policies to achieve this.

The fiscal framework of the Plan, it is expected, will enhance the nation's capacity to achieve its economic and social objectives. The dimensions of the framework also involve: realizing sustainable expenditure levels through its rationalization; enhancing the financial reserves of the nation by transferring budget surpluses realized during the plan period; striving to enhance non-oil revenues and priority to sectors such as oil and gas.

The estimates for the Plan are based on an average daily production of oil of about 827,000 barrels and an average oil price of USD 30 per barrel. The total revenue during the Plan period is estimated at RO 18,636 million. Of this, oil revenue constitutes RO 12,884 million and non-oil revenue RO 5,752 million. The government expenditure for the Plan period has been estimated at RO 20,896 million. The overall budget deficit for the Plan period is estimated at RO 2,260 million, with an average annual deficit of RO 452 million. The deficit is therefore expected to be in the region of 12% and 3.9% of government expenditure and GDP respectively. The deficit will be financed through borrowings and withdrawal from reserves.

The budget for 2006, the first of the current five-year plan term, has excess of planned aggregate expenditure of RO 4,237 million over budgeted revenue receipts of RO 3,587 million and is thus estimated to leave a higher deficit of RO 650 million in 2006, as against a deficit of RO 540 million in the previous budget.

Describing the 2006 budget the Minister of National Economy and Deputy Chairman of the Financial Affairs and Energy Resources Council, HE Ahmed bin Abdulnabi Maki said:

"It is a budget that set's priorities. It is a budget that will help sustain economic growth and uphold pro-development policies. The thrust of the budget is to improve the standard of living of citizens, of course, to create more jobs for nationals."

Oil (RO 2,519 million) and gas (RO 394 million) revenues for 2006 constitute 81% of total revenues, and current and capital revenues (RO 674 million) constitute the remaining 19%. Oil revenues have been calculated on the basis of USD 32 per barrel, with an average production of 746,000 barrels per day.

The total expenditure of RO 4,237 million for the fiscal year 2006 is RO 557 million or 15% higher than the expenditure earmarked in the year 2005.

Focal areas of government expenditure continue to be the oil sector, defense, education, healthcare and the development of human resources, all of which are critical to the sustained growth and development of the national economy.

Considering the growing importance of social safety, the government has also allocated RO 29.8 million for social security for 2006, an increase of RO 5.2 million over the year 2005.

"In absolute terms, the (budget) deficit is high. However, this will contribute significantly to the country's gross domestic product. As economic activity get a boost, the deficit will indirectly spur further economic growth", His Excellency, the Minister added.

Oman's national budget for 2005 had estimated an oil price of USD 23 per barrel, but actual price realizations of USD 48.73 per barrel on the back of strong global energy prices led to a GDP growth of 21.7% during the year.

Financial Sector

The financial sector in Oman can be broadly classified as follows:

- Banking institutions: Comprising Central Bank of Oman (the apex banking institution in the Sultanate of Oman), commercial banks and specialized credit institutions
- Exchange houses: Dealing in the exchange of money and issue of drafts
- Non-banking credit institutions: Leasing companies, hire purchase and finance companies
- Non-monetary institutions without credit functions: Insurance companies, pension funds, mutual funds and investment companies
- Muscat Securities Market: Facilitates issue of securities to the public and trading in securities listed on the market

The number of licensed banks operating in Oman as of 31 December 2005 stood at sixteen of which, five were registered commercial local banks, eight were foreign banks' branches and three were specialized banks.

The Bank enjoys a market share of 36.7% in terms of total assets, 36.6% in terms of total credit and 34.9% in terms of total customer deposits, of which the share of total savings deposits is 37.7% , as at 30 November 2005.

Opportunities and threats

The year 2006 promises to be an extremely exciting year for the banking sector in Oman. Over the past thirty-five years, the Sultanate has changed from a land blessed with plenty to a nation that is amongst the most forward-looking of the GCC States thanks to the visionary leadership of His Majesty Sultan Qaboos bin Said and the progressive policies of His Majesty's government. The banking sector, under the able guidance of the Central Bank of Oman, has worked hand-in-hand with the government to facilitate this change.

With the regional economies continuing to show unprecedented growth on the back of strong global energy prices and increased geopolitical stability, and the GCC States moving closer together toward the creation of a common trading block and the formation of a common currency, the role of the sector is only expected to assume greater significance across the region during 2006.

The year promises to be all the more exciting for the Sultanate, as it will act as a watershed before the formal implementation of the WTO regulations. The nation will also start to witness the impact of the Free Trade Agreement signed between Oman and the United States of America and the advancement of talks between Oman and the European Union with regard to another Free Trade Agreement.

As the largest bank in the Sultanate, the Bank is also well poised to take full advantage of the rapid strides being taken by the Omani economy, even as the country moves toward greater integration with the global economy.

The Bank's international operations too are poised to throw up exciting possibilities with increased synergies expected between BankMuscat, BankMuscat International (Bahrain) and Centurion Bank of Punjab (India). Resources at the Bank's Dubai Representative Office have been strengthened and the Bank is poised to see the start of its operations in the Kingdom of Saudi Arabia during 2006. The start of operations of the Bank's proposed finance company in the UAE is also very much in the offing.

Threats could emerge from geopolitical factors adversely affecting the region, volatility in global oil prices, economic slowdown, further consolidation in the regional and local banking sector and increased levels of competition in Oman.

Segment-wise performance

The Bank achieved a net profit of RO 45.4 million in 2005, an increase of RO 11.3 million, or 33.1% over 2004.

The Bank's core business activities are split into the following key businesslines: Retail Banking, Corporate Banking, Treasury and Investment Banking, Asset Management, Private Banking and International Operations. The key support functions of the Bank include Information Technology, Human Resources, Finance and Risk Management.

Retail Banking Group

The year 2005 was another rewarding year for Retail Banking Group. By successfully leveraging our varied expertise, technology, and strong relationships with customers, the Bank's branch network was able to turn in another spectacular performance. Saving deposits grew by over RO 58 million during the year and touched RO 338 million, accounting for 37.7% of industry deposits, the highest ever achieved by the Bank. Consumer loans also showed an increase of RO 61 million during the year.

Growth was driven by a strategy focused on continuously enhancing our ability to understand and meet customer needs, following best practices and offering world-class products and services.

The savings and deposits mobilization thrust has been spearheaded by the Al Mazyona savings scheme, the trendsetter for such schemes since its inception. New dimensions have been added to the scheme by including more winners, increasing the frequency of Bumper Prizes and the introduction of special prizes for ladies.

In keeping with the Bank's overriding philosophy of attempting to use the power of technology to create a distinct customer experience and enhance growth, the promotion of electronic channels has continued to remain a key focal area. The Bank added two new cash deposit machines and ten new ATMs during the year in addition to launching its range of mobile banking services. The efforts of the Bank were recognized by Global Finance Inc, USA who declared the Bank the 'Best Consumer Internet Bank' in Oman for the second year running. Attempts to popularize the Bank's e-banking channels are expected to continue and gather momentum in the future.

The endeavour to further diversify revenue streams within the Group provided stability to the overall performance of the Retail Banking Group through the year.

Diversification of revenue streams:

The Bank's bancassurance unit, which launched six new products across the life and non-life segments during the year, started making contribution to the commission income of the Bank during 2005.

Non-Resident Indian (NRI) services, offered in association with Centurion Bank of Punjab, also offered a range of banking services – deposit accounts (NRE savings and fixed deposits) and investment products (mutual funds and life insurance schemes) - to members of the NRI community during the course of 2005 and contributed to the income of the Bank.

Commission income also resulted out of the Bank entering into a number of third party tie-ups during the year. Notable amongst these were:

- Bill collection services for the country's second telecom provider Nawras
- Bill collection services through the Bank's e-channels for public utilities company, OIFC
- Installment of recovery services for Al Omaniya Financial Services
- Payment collection partner of Air Arabia for their e-ticketing services

Product Development

Product development has continued to be a focal area of the Retail Banking Group. Notable amongst the products and schemes launched during the year are:

- 'Tharwa' - a long-term deposit product which offers customers a higher than usual rate of return
- 'Welcome kits' for the Bank's retail banking customers, which include cheque-books, ATM cards and telephone and internet banking passwords
- Refer and Win - a 'customer get customer' rewards scheme

Direct Sales Unit (DSU) and Call Centre

The DSU turned in an extremely creditable performance during the year with its productivity (in terms of opening new accounts) doubling alongside a sizeable reduction in related acquisition costs.

The facilities of the Bank's 24x7 Call Centre were also further enhanced during the year with the introduction of a new IVR platform.

Cards services

The Bank continues to be the frontrunners in credit card services across the Sultanate. The cards department increased its market share in the Point of Sale (POS) acquiring business to over 50% of industry volume during the year. The department was also successful in launching the nation's first smart card enabled rewards programme - the BasmaRewards programme - in association with Oman Oil Marketing Company, Lulu Hypermarkets and Oman Mobile.

The cards department has also been recently awarded the mandate to handle the complete acquiring services for the Royal Oman Police.

Customer service has been accorded the top most priority at the Bank. Ongoing communications have supported each of the initiatives within the Retail Banking Division to ensure customers are kept abreast of all developments at the Bank. Significant investments have also been made in human capital to ensure a more informed, pleasant and efficient customer experience across the Bank's branch network nationwide.

Corporate Banking Group

With Oman witnessing increased economic activity during 2005, the Bank's Corporate Banking Group has had an active and eventful year. The government's initiatives in the oil and gas sector, ably supported by its drive to boost tourism related, as well as petrochemical and industrial projects, have resulted in several large projects achieving financial closure during the year. Keeping abreast of these developments, the Bank significantly stepped up its presence in these sectors during the year.

In the oil and gas sector, the Bank has been closely associated with contract financing for PDO's Enhanced Oil Recovery (EOR) programme and its gas sector projects, including the substantial Harweel EOR project and the Kawther gas gathering project. The Bank is also the only Omani bank to have been involved with the financing of LNG tankers for the Oman Shipping Company, a company set up by the Government of Oman for the ownership, management and operations of LNG tankers. The aggregate size of projects that the Bank has been involved in, in the oil and gas sector is in excess of USD 2,500 million.

The Sohar region, one of the fastest growing industrial regions in the country today, has seen the Bank involved in a number of path-breaking projects. Notable amongst these are:

- The Sohar Independent Power and Water project (Mandated Lead Arrangers)
- Sohar Refinery project (Mandated Lead Arrangers)
- Sohar Aluminium project (amongst the Mandated Lead Arrangers)
- Aromatics Oman project (amongst the Mandated Lead Arrangers)

All these projects are integral to the growth of Sohar as a major industrial zone in the Middle East and the Bank looks forward to playing an important role in its development.

The Project Finance division enjoyed top-tier status in several other financial closures during the year including:

- Barr Al Jissah Resort Project Financing (Original Lender with a participation of USD 17.5 million in the USD 105 million debt facility and a Hedge provider)
- Oman Shipping Company (Co-Lender with a USD 5 million participation)
- Oman India Fertilizer Project (the Bank signed up a working capital facility for USD 20 million with OMIFCO. The Bank is the sole Working Capital Lender)
- Oman Qatari Telecommunications – Nawras (the Bank is an Arranger and Original Lender with a participation of USD 50 million in the USD 220 million commercial loan facility arranged by a four member bank group consisting of BankMuscat, GIB, Arab Bank and Qatar National Bank. The Bank is the Account Bank, Security Trustee and a collection bank for Nawras)
- The Bank was also mandated to be the main banker for the Electricity Holding Company SAOC and its nine subsidiaries during the year

Alongside involvement with such large-scale projects, the Bank took cognizance of the importance of a robust small and medium scale sector as a key driver in the economic development of Oman with its launch of the Al Wathbah range of programme lending solutions specially targeted at small and medium enterprises (SMEs). The Bank is looking forward to the rapid growth of these services with the opportunities thrown up by the growth and diversification of the industrial sector in particular and the economy in general.

As the leading corporate bank in Oman, strong customer relationships remain fundamental to the growth of corporate businesses with a strong focus on the quality of loan assets and building customer confidence. The credit delivery process, including the credit risk process, is robust at the Bank. This has resulted in an improvement of the overall asset quality at the Bank.

Close monitoring and timely implementation of preventive measures to avoid delinquency of loans supported by intensive follow-up on recovery of non-performing assets (NPAs) has resulted in the Corporate Banking Group being able to substantially reduce NPAs during the year. The revenue impact of this positive development is reflected in the write-back of provisions aggregating RO 15.9 million to the Bank's income.

Treasury and Investment Banking Group

As one of the key revenue earners for the Bank, the Treasury and Investment Banking Group contribution to the bottom line was significant.

Treasury

During the year 2005, the Bank's Treasury was actively involved in developing and offering new treasury-related structured products to both existing and new customers. The success of the structured products - namely hedging tools in foreign exchange, as well as interest rate swaps - have contributed handsomely to the Treasury's volume and revenue growth, which has grown significantly. The money market operations in capturing interest rate arbitrage between local and G7 interest rate has also added to the revenue stream of the division.

In addition to structuring complex interest rate swaps and sourcing Forex flows from corporations, Treasury was responsible for part-hedging interest rate exposures of one of the local banks. Treasury also manages the Bank's balance sheet through sourcing long-term deposits to meet gaps in the asset-liability mismatch and hedge the interest rate exposure on the Bank's balance sheet.

Committed to providing excellent service levels to the business community, the division continues to train and develop Omani employees in order to equip them with the skills and knowledge required to forge ahead. The Treasury team has also expanded this year to ensure that customers are served even better.

The achievements of the Treasury division were recognized by the international financial community as it was named as the 'Best Forex Bank and Provider' in Oman for the second year running by New York-based financial magazine, Global Finance.

Investment Banking

The Investment Banking division played a significant role in the Bank's maiden GDR issue, which took place in the second half of 2005. Following the completion of its USD 163 million Global Depository Receipt (GDR) issue, the Bank became the first bank from across the GCC region to be listed on the London Stock Exchange (LSE). The GDR issue consisted of 6,878,765 newly issued ordinary shares. Citigroup acted as the global coordinator and sole book runner of the issue. Bank of New York was appointed Depository Bank.

Brokerage

On the back of a vibrant stock market, the year was yet another good year for the Brokerage unit. Despite increasing competition and new brokerage companies entering the market, the unit further consolidated its position as market leader with a market share in excess of 14% in terms of volume. The introduction of differential brokerage rates for various classes of investors, in addition to higher employee productivity, have resulted in enhanced profitability.

For the first time in history, the retail client base of the unit crossed the 10,000 mark. This was aided by the Initial Public Offering (IPO) of the country's telecom giant, Omantel. The Brokerage team has recently expanded, in order to cater to and meet the needs and requirements of its broad retail client-base.

During the year, the Brokerage sales team continued to conduct road shows across the GCC region to acquaint and enlighten clients on the investment opportunities available on the Muscat Securities Market (MSM). Locally, the unit continues to conduct two investor seminars every year to encourage transparency between listed companies and the investor community.

For the second year running, the MSM presented the Bank with the 'Best Brokerage Firm' (in terms of volume) award, in recognition of its efforts during the year.

Equity Research

The Bank's equity research team comprises qualified professionals who monitor and analyze the performance of the various companies and sectors listed on the equities market and publishes reports on them. The team covers 88% of the total analyzable universe. In terms of market capitalization, the published research coverage is RO 4,000 million. The following sectors were covered during the year: Telecom, Banking and Financial Services, Cement and Oil Marketing.

Equity Research unit also publishes the 'MSM Daily'; a daily update of the market's activities and the 'World Market Overview'; a daily snapshot of the global markets. The unit is also the Standard & Poor's data provider of information for the Oman indices.

Corporate Finance and Advisory

As a leading financial advisor to corporations, institutions and government agencies throughout the Sultanate and increasingly, in other geographies, the Corporate Finance and Advisory unit's wide range of advisory services, keen insight, execution skills and extensive distribution franchise make it the partner of choice amongst clients looking for innovative and customized corporate finance and project finance solutions.

The Corporate Finance and Advisory unit continued to leave imprints of success as the country witnessed the closure of the largest Initial Public Offer (IPO) in the history of the Capital Markets in Oman, this year. Partnering the government in its privatization drive, the Bank was Lead Manager to Oman Telecommunication's (Omantel) RO 288 million (USD 750 million) IPO. The issue, which was oversubscribed three times, attracted investors from across the Sultanate.

The unit dominated the IPO arena during the year, as it Lead Managed the three major IPOs that took place in the country in 2005. These included the RO 9.6 million (USD 25 million) issue of Dhofar Power IPO to which the Bank was the Lead Manager. The issue met with overwhelming response from investors and was oversubscribed seven times; and Taageer Finance's IPO worth RO 4.2 million (USD 11 million) which was floated and completed in the third quarter of the year. The unit also completed a USD 13 million capital raising exercise for a listed holding company in the country. The Bank was the financial advisor of the transactions.

However, the financial advisory services offered were not limited to the local market alone, as the Investment Banking division continued to develop its regional profile. The Bank acted as the Co-Manager to the USD 70 million GDR issue of Centurion Bank Limited (now Centurion Bank of Punjab), a private bank based in India, in which the Bank has a strategic investment.

On the advisory front, the Bank was awarded several key mandates by the Government of Oman. The Bank is currently acting as the Lead Financial Advisor to the Ministry of National Economy for the Sharqiya Independent Water Project, the country's first Independent Water Project. The project is worth RO 48.125 million (USD 125 million). The Bank is also the Financial Advisor to the Ministry of National Economy for a solid waste management restructuring project in the country.

At present, the Bank is acting as the Financial Advisor to a listed conglomerate for a liability side restructuring activity worth RO 8 million (USD 20 million) and as the Transaction Advisor to an Omani business house for a business sale transaction valued at about RO 8 million (USD 20 million). The Bank has also been entrusted with the role of the Financial Advisor for the Barka II Independent Water and Power Project (IWPP).

During the year, the Bank completed a RO 126 million (USD 327 million) LNG Tanker Financing project undertaken by the Oman Shipping Company. The Bank was a Joint Financial Advisor to the project. The Bank also completed an expansion feasibility and financial structuring project for an infrastructure company during the same period. The Bank's role was to offer financial advisory services to the company.

As for debt financing, the unit has been involved in several deals including a sub-loan placement for RO 3 million (USD 8 million) for the Al Kamil Power Company, a subordinated debt worth RO 11.55 million (USD 30 million) for a regional bank and a RO 39 million (USD 101 million) debt and equity raising exercise for a petrochemical project.

Financial Institutions

The year 2005 was a robust year for the Financial Institutions division, as they established new relationships and strengthened existing ones with correspondent banks from different countries across the globe.

The division was also responsible for identifying new markets for cross-border business (Bangladesh, Sri Lanka and Pakistan), sourcing international deals on the primary and secondary markets (the Bank was Mandated Lead Arranger to three major primary loan deals from Andhra Bank, Syndicate Bank and Indian Bank, participated in seventeen loan syndications and over fifty trade finance syndications during the year), obtaining competitive credit lines and arranging for new funding avenues. The division also assisted the Bank to maintain and further strengthen its relationships for nostro and vostro accounts, trade finance business and loan syndications, during the year.

In order to ensure controlled growth in cross-border assets, the Bank has streamlined and tightened its credit monitoring systems and procedures for cross-border exposures.

Private Banking

The Private Banking division has progressed well in 2005, gaining market share and achieving significant progress over the previous year. Private Banking provides high-net-worth clients in Oman with wealth management products and services. The team remains committed to offering customers innovative high-value-added products blended into customized solutions to offset commoditization.

The division has been successful in growing Assets Under Management (AUM) by increasing the wallet shares from existing customers and acquiring new customers to sustain long-term growth. Notable amongst the niche products that the division offered during the year are: the MENA India Fund, BM Capital Protected Note and several products that looked at investing in the Sultanate, regional and international markets.

The division plans to roll out white-labeled products in tune with market opportunities, sourced from leading financial institutions, at steady intervals, so to further build on its reputation of being the private banking partner of choice in the Sultanate.

Asset Management

The Bank's asset management division has also had a busy year. In the last quarter of 2005, the division successfully rolled over the Muscat Index Fund (MIF). The new structure of the Fund is similar to the MIF, with the added facility of an open-ended structure and the possibility to invest up to 20% of its assets in non-MSM30 index securities. The Muscat Fund is the largest mutual fund in the Sultanate and is focused on companies listed on Muscat Securities Market (MSM). The Fund is also the country's first fund offering weekly subscription and redemption facilities. With this the Bank has taken another step to provide better investment products to the investors. It provides domestic and international investors an attractive platform to participate in the growth opportunities in Oman.

The division also expanded its product portfolio during the year by offering products based on MENA and Indian markets and has further strengthened its presence in the portfolio management segment by adding on new local and regional customers to its existing customer base.

In an effort to broaden its revenue streams and explore cross-selling opportunities, the Asset Management division is actively building up relationships with players in the other emerging markets. The division has also established relationships with international asset management companies, thus strengthening its research resources and investment capabilities. The division's efforts to develop Fund Administration and Custody Services for local/regional/international clients as a separate revenue stream also received a good response with a number of clients deciding to avail these services.

International Operations

BankMuscat Representative Office – UAE

The Bank's Representative Office in the UAE celebrated its tenth successful year of operations in 2005. During the year, the resources available at the representative office have expanded to include experienced professionals from Financial Institutions Investment, Non-Banking Financial Companies Investments, Corporate Banking, Private Banking and Investment Banking to better serve customers in the UAE.

BankMuscat International – Bahrain

On 01 January 2005 BankMuscat (SAOG) converted its Bahrain branch operations into an independent bank – BankMuscat International (BMI), registered and regulated by the Bahrain Monetary Agency, in association with strong regional partners. BankMuscat continues to hold 49% stake in the new bank.

BMI's core business activities include: Corporate Banking, Retail Banking, Private Banking, Treasury and Islamic Financial Services. The response to the new entity from customers, correspondent banks, financial institutions and the market in general has been both positive and encouraging.

During the year, BMI increased its operations in Bahrain from a one-branch operation to a bank with three branches to cater to the growing needs of the Bahraini market. BMI faced a trading dispute with a correspondent bank during the year, which was resolved amicably.

Centurion Bank of Punjab – India

Centurion Bank of Punjab successfully issued a GDR for USD 70 million in March 2005 to support its future expansion and growth. The GDR is currently listed on the Luxembourg Stock Exchange.

In the quarter ending 30 September 2005 Centurion Bank successfully merged with the Bank of Punjab, forming the Centurion Bank of Punjab (CBoP). The net profit of CBoP grew by 358% to Rs 384.9 million (RO 3.3 million). The net advances of the CBoP grew 170% on a year on year basis to Rs 51,133.6 million (RO 433.3 million) from Rs 18,921.2 million (RO 160.3 million). CBoP's deposits have increased by 187% to Rs 80,713.1 million (RO 684.0 million) as on 30 September 2005.

Centurion Bank of Punjab plans to raise an additional Rs 8 billion (RO 67.8 million) in capital to support its future expansion and growth.

The Bank's shareholding in Centurion Bank of Punjab as on 31 December 2005 was 25.34% and the quoted market value of the Bank's shareholding amounted to RO 59.74 million which is not accounted in the Bank's balance sheet as this investment is accounted under equity method.

BankMuscat - KSA

Having obtained the relevant approvals to open a branch in the Kingdom of Saudi Arabia, the Bank has initiated the recruitment of the management team required to operate this branch. A suitable location has been identified on King Fahd Street, which is amongst the most prestigious locations in Riyadh. An in-principle approval from Ministry of Commerce and Industry is already in place. Full commercial registration is expected after the branch interiors are complete. The Bank is currently in the process of evaluating and finalizing an appropriate IT system. The branch is expected to be operational during the second half of 2006.

GCC Expansion

The Bank is currently exploring the ideal entry strategy for Kuwait and Qatar to further consolidate its GCC expansion plans.

Information Technology

The Bank is firm in its belief that use of the latest technology and providing technology-enabled services to its customers is the most effective way of keeping its growing customer base fully satisfied. The Bank continues to invest in new technology. Key technology initiatives launched by the Bank over the year include:

- Service Oriented Architecture (SOA): The Bank is the first bank in the region to conceptualize and implement Service Orientated Architecture. The Bank's SOA-based new internet banking system is under testing and is expected to be implemented during the first half of 2006
- Migration of the Bank's delivery channels to ISMP, an in-house developed J2EE based high-tech middleware
- Introduction of mobile banking services through which the customers can send and receive account information on their hand-held telephones

- Implementation of new call centre system, which leads to greater ease of use for customers. The new system also allows the Information Technology division to customize new services without being overtly dependent on an external vendor. This substantially reduces the 'time to market' of new features
- Creation of the Bank's Enterprise Intranet Portal, which is ready to be launched in the first quarter of 2006. The portal provides a single source for knowledge sharing by providing information on products, services, manuals, policies, training schedules and other valuable information to the Bank's employees
- Roll out of seven additional cash deposit machines, taking the total number of cash deposit machines to eleven
- Communication lines to twenty six branches have been upgraded to 128K from 64K; lines to other branches are to be upgraded by March 2006
- Several third-party payment services including bill payment services to Nawras Telecom and OIFC bills payments, and speed transfer services to Centurion Bank of Punjab have been automated
- The division has been re-organized and process management within the division standardized. This is towards the division achieving the ISO 20K standards
- The reorientation has also resulted in the creation of a Project Management Group (PMG) to exclusively concentrate on effectively managing the division's projects and a Service Management Group (SMG) to serve as the single point of contact for any division's issues/complaints
- The IT Security unit is on firm footing towards achieving BS7799 certification
- A quality management framework for the IT division has been developed

Moreover, to facilitate employee productivity, a centralized storage facility of electronic files/documents have been introduced and made available to all employees members through a Storage Area Network.

MS Exchange 2003 has also been implemented with a central mailbox. Through this the IT division intends to provide e-mail facilities to all employees of the Bank during the first half of 2006.

Human Resources

The Bank firmly believes that 'right people' are its assets and continuously endeavours to ensure the development of human resources for its various business and support departments. The key achievements of the Human Resources division during the year 2005 include:

- Launch of HRDirect: The Self-Service features of the Oracle HR system, named HRDirect was launched as a powerful tool for employees and managers to interact with the HR database further aiding in the decentralization of human resources activities and faster decision making on key HR issues. The Bank has published all its policies and processes online for use by employees
- The Bank recruited and deployed two hundred and eighty employees in various divisions of the Bank thereby increasing its Omanisation levels to 91.26% as at 31 December 2005
- The Bank has linked its competency framework to various HR processes, such as recruitment and performance management, during the year 2005 and is in the process of grooming business leaders as part of its career and succession plans that have been prepared and decided upon. The Bank has adopted a new performance management process that starts with goal setting, ongoing reviews and individual development plans
- The Bank received the 'People Development Award' for the second consecutive year from the Oman Awards of Excellence and was also rated the 'Best Place to Work in Oman' (Business Today). It has also been recognized as an 'Investor in People Organization' by iiP, United Kingdom
- Five thousand one hundred and thirty six training slots were provided to employees covering over four hundred courses during the year 2005; several courses were researched and developed in-house
- The Bank's training unit has created a mock branch and an e-learning suite covering products and services to train all new recruits before posting on the job
- The Bank has conducted diploma programmes and certification in various business areas such as Private Banking, Management, Human Resources, and Banking in association with reputed international organizations to cover over hundred employees in 2005. The Bank has also supported several employees under its Education Assistance Scheme to pursue post-graduate study programmes
- In keeping with its endeavour to assist students from financially weak backgrounds, the Bank sponsored ten students to pursue their banking diplomas in the College of Banking and Financial Services
- Hundred and sixty students were offered summer training internships as part of the Bank's partnership with leading educational institutes

Finance

The Finance division aids the Board and the Executive Management in the strategic planning and decision-making processes by providing vital information and critical in-depth analyses of the Bank's performance. The Bank uses state-of-the-art profitability systems for in-depth analyses of the profit contribution from business lines, products and customers. The profitability systems enable the Bank to make sound business decisions based on a thorough understanding of the Bank's profitability dynamics and focus on key business lines in a challenging and competitive environment. The division continues to enhance its information systems with the latest tools and techniques available to make the information more meaningful and ensure greater value addition.

The division also plays an active role in cost management initiatives with a view to maximizing the Bank's profits and deriving optimum benefits of synergies arising out of various mergers and acquisitions. The division uses different cost management techniques, including Activity Based Cost Management, in order to achieve optimum cost benefits. The Bank strongly believes in presenting financial statements, which are transparent and provide adequate and meaningful disclosures to the users of the financial statements. In line with this approach, the Bank follows the best practices in disclosure requirements of the International Financial Reporting Standards and regulatory authorities.

Risk Management

Risk Management is the process by which the Bank identifies key risks, obtains consistent, understandable risk measures, and chooses which risks to reduce and which to increase and by what means, and establishes procedures to monitor the resulting risk position. The Bank's risk function is independent of business line management and helps define appropriate risk levels for the various business divisions of the Bank through an enterprise-wide risk policy. The Bank's risk policy, approved by its Board of Directors analyses and sets risk limits for credit risk, liquidity risk, market risk and operational risk.

Compliance with the various parameters set in the risk policy is reviewed on a continuous basis and a risk policy compliance report highlighting variances from the limits set are reported to the Board and Management for remedial action. The risk policy is updated every year based on an analysis of the economic trends and the operating environment in the countries where the Bank operates.

Credit Risk Management

Credit risk is the potential loss resulting from the failure of a borrower or counter party to honour its financial or contractual obligations. The function of credit risk management is to maximize the Bank's risk-adjusted rate of return by maintaining credit risk exposure within acceptable parameters. The Bank has set for itself clear and well defined limits to address different types of credit risks.

Corporate lending accounts for approximately 59% of the total loan book of the Bank. While the day-to-day management of corporate credit and the asset quality is the responsibility of the business line management, all medium and large credit lines and their renewals are reviewed by the Risk Management division, whose recommendations form an important input to the decision making process. The review process is performed once in a year or more frequently if the situation so warrants. Using globally renowned risk rating software, the Bank does an objective risk rating of all its corporate borrowers based on their financial position as reflected in their latest audited financial statements and other relevant subjective matters, as evaluated by the concerned relationship managers.

Risk rating is centralized at Risk Management division to provide objectivity and ensure uniformity of the rating process. The decision on extending credit lines is made on the basis of the borrower's risk, transaction risk and pricing. The gross corporate loan book of Oman operations grew by 13.0 % during the year from RO 771.9 million in 2004 to RO 872.2 million in 2005. Non-performing corporate advances reduced by 12.2% from RO 82.3 million in 2004 to RO 72.3 million in 2005 and are adequately provided for.

During the year, Small Business Unit was moved to programme lending mode - branded 'Al Wathbah' - in order to improve the portfolio quality and quality of customer service. The migration to programme lending will result in standardization of the product offerings that will assist the Bank adopt a risk scoring model for small business lending.

Retail credit is reviewed by the Risk Management division on a portfolio basis. The risk of the retail credit portfolio is defined by the risk and retail credit policy. Retail credit forms 41% of the Bank's loan book. The gross retail loan book grew by 11.1% during the year from RO 548.8 million in 2004 to RO 609.6 million in the year. Non-performing retail advances stood at RO 24.3 million as at the end of the year.

The non-performing advances of the Bank stood at RO 96.7 million against which the Bank holds provisions of RO 109.9 million which comprises of specific loan loss provisions of RO 87.6 million and general loan loss provisions of RO 22.3 million.

Country risk limits are fixed based on the external ratings of the sovereign and other relevant risk factors. Exposures to banks are guided by bank risk limits that are based on the latest ratings assigned to the banks by external rating agencies. Where a bank is unrated, an independent assessment of the bank is carried out based on quantitative and qualitative analysis. Exposures against country and bank limits are monitored on a regular basis to ensure compliance to approved limits.

The risk policy ensures that the Bank's lending is targeted and distributed over various economic sectors. The sectoral exposures, which include both funded and non-funded, for the year were within prescribed limits. Detailed sector analysis is done every year and reports submitted to the management to help in the formulation of the Bank's lending strategy to individual sectors. Borrower risk ratings are back-tested to ensure robustness and reliability of the rating process. The risk rating grades are reviewed regularly and amendments, if necessary, carried out. The Bank uses estimated loss estimates based on probability of default, loss given default and exposure at default to improve lending, monitoring and pricing decisions.

The Bank has a strong credit administration process that ensures compliance with terms of approval and completion of documentation. It does a regular review to ensure that the quality of credit is maintained at targeted levels. The Bank has a specialist remedial credit unit to manage problem loans. This unit provides assistance and advice to customers to recover from problem situations and to aid recoveries. The Bank adopts a rigorous standard for identification, provisioning and monitoring of the non-performing loans towards an eventual recovery. Every problem account is reviewed to evaluate compliance with laid down lending norms, arrive at an appropriate grade commensurate with the risk and incorporate the lessons, if any, into banking lending guidelines. The Bank makes provision for bad and doubtful debts promptly when required in line with the conservative provisioning norms it has set for itself.

Liquidity Risk Management

Liquidity Risk is the potential inability of the Bank to meet its maturing obligations to a counter party. Liquidity risk management ensures that the Bank has ability under varying scenarios to fund increase in assets and meet maturing obligations as they arise. The Bank's treasury division is responsible for liquidity management under the guidance and supervision of Asset and Liability Management Committee (ALCO), comprising senior management of the Bank.

Liquidity risk management is done through liquidity measurement and contingency planning. Liquidity Measurement is done through Stock Approach & Cash Flow Approach. Stock approach measures liquidity in terms of various liquidity ratios to portray that sufficient liquidity is stored in the balance sheet. Cash flow approach measures currency-wise and bank-wide liquidity profile through maturity ladders and cumulative liquidity gaps. Contingency planning quantifies and measures alternative liquidity resorts available with the Bank to withstand stress situations.

The Bank's funding sources are well diversified across funding types and countries and include customer deposits, certificate of deposits, bonds, subordinated loans etc. During the year total customer deposits grew by 14.7% while the savings deposits grew by 17.7%. The sources and maturities of assets and liabilities are closely monitored to avoid any undue concentration and ensure a robust management of liquidity risks. The deposits have maintained a stable profile during the year and are within the limits prescribed by the risk policy to manage concentration of deposits.

Market Risk Management

Market Risk is the risk of losses due to movements in financial market variables. The variables include interest rates, foreign exchange rates, equities and commodities.

A. Interest Rate Risk

Interest Rate Risk is the risk that the Bank's profitability will be adversely affected by changes in interest rates and mismatches or gaps in the amount of assets and liabilities and off balance sheet items that mature or re-price in a given period. Interest rate risk poses a risk on the Bank's earnings and economic value of equity. The responsibility for interest rate risk management rests with the Bank's ALCO. ALCO takes an integrated view of the interest rate risk across products and business lines of the Bank.

The Bank uses a sophisticated Asset Liability Management System to manage interest rate risk through the use of re-pricing gap reports, simulation reports and fund transfer pricing system. Re-pricing gap is the difference between interest rate sensitive assets and liabilities spread over distinct maturity bands based on residual maturity or re-pricing dates. The Bank uses currency-wise and consolidated re-pricing gaps to quantify interest rate risk exposure over distinct maturities and analyze the magnitude of portfolio changes necessary to alter existing risk profile. The Bank uses simulation reports as an effective tool for understanding risk exposure under variety of interest rate scenario. The Bank's current on and off balance sheet exposures are evaluated under static environment to quantify potential effect of external interest rate shocks on the earnings and economic value of equity at risk, using assumptions about future course of interest rates and changes in Bank's business profile.

The Bank has implemented a robust fund transfer pricing system, which is used to transfer price across each and every class of deposits and loans. The fund transfer pricing mechanism is based on the matched maturity transfer method. The principle of the matched maturity transfer method is that the initial interest spread of the transaction is credited to the originating unit each month (over the life of the transaction) and thereby, the originating unit is insulated from any movements in interest rates. The transfer pricing rates are arrived at after taking into consideration the term, the re-pricing frequency, currency and other characteristics of the transaction.

B. Investment Price Risk

Investment price risk is the risk of a diminishment in the market value of the Bank's portfolio as a result of diminishment in the market value of individual investment. The responsibility for management of investment price risk rests with the Investment Banking division under supervision and guidance from the Investment Committee of the Bank.

The Bank's investments are governed by an investment policy approved by the Board of Directors and are subject to rigorous due diligence. Investments in debt instruments are based on guidelines as set forth in the Bank's risk policy. The Bank invests in bonds, which are rated 'Investment Grade' and within that, in companies with 'strong name-recall'. No investment is made on unrated instruments. The rating and price of the instruments are monitored on a daily basis and necessary actions are taken to reduce exposure if warranted.

Investment price risk management ensures that the Bank's investments are constantly monitored in terms of exposure and the issuer's profile. The Bank's investments are regularly revalued at market price to ensure that unrealized losses, if any, on account of diminishment in the market value of the investments over its cost remains within the acceptable parameters defined in the Bank's investment policy.

C. Foreign Exchange Risk

Foreign exchange risk is the risk that the foreign currency positions taken by the Bank may be adversely affected due to volatility in foreign exchange rates. The responsibility for management of foreign exchange risk rests with Treasury division of the Bank. The Bank's foreign exchange exposures are governed by the Treasury Policy approved by the Board of Directors. The Bank's Treasury front and back office units are well equipped with the latest technology and system gateways to conduct business activities in highly risk controlled environments. Foreign exchange risk management in the Bank is ensured through regular measurement and monitoring of open foreign exchange positions against approved limits.

Operational Risk Management

Operational risk is the risk of loss resulting from inadequate or failed internal processes, people, and systems or from external events and includes legal risk. Business units at the Bank have the primary responsibility for identifying, measuring and managing operational risks.

The risk policy provides the framework to identify, assess, monitor, control and report operational risks in a consistent and comprehensive manner across the Bank. A distinct function is in place to independently support business units in the management of operational risks. The risk policy and its requirements facilitate in:

- Maintaining strong risk controls, resulting in a distinctive risk management capability, enabling all business units to meet their performance and growth objectives
- Minimizing the impact of operational risks

Operational risk is controlled through a series of strong internal controls and audits, well-defined segregation of duties and reporting lines, detailed operational manuals and standards. Internal Audit independently reviews effectiveness of the Bank's internal control and its ability to minimize the impact of operational risks.

As a part of continuous improvement in the risk management processes, the Bank has developed its own Operational Risk Management Software. The software aids assessment of operational risks, as well as collection and analysis of operational losses.

The Bank collects operational loss data by business line and loss type and reports it to senior management periodically. Aggregate operational risk losses are recorded and details of incidents above a materiality threshold are reported to the Operational Risk Management Committee. The Committee reviews the operational losses and takes appropriate action where necessary to mitigate the loss and minimize and prevent its recurrence.

A total of one hundred and sixty two (2004: one hundred and sixty four) potential operational loss events were reported across the Bank during the year, representing a net potential loss of RO 0.14 million (2004: RO 0.22 million).

Business Continuity Management

Business Continuity Management is a key component of the operational risk management process at the Bank. Business Continuity Management is centrally coordinated and includes the following activities:

- A comprehensive business impact analyses on a periodic basis
- Developing, updating and maintaining business recovery plans
- A structured business recovery organization, consisting of Business Continuity Planning (BCP) and Crisis Management Teams
- Set-up of alternate facilities for disaster recovery
- Training and awareness programmes for employee
- Regular exercises and tests to ensure that plans for recovering business activities are practical and up-to-date

The Bank has set up a fully operational business recovery centre where operations will be swiftly moved, in the event of a disaster. Departments have completed BCP awareness, training, and testing programmes. Safety and security procedures are in place to protect people, facilities and information in case of untoward incidents. As part of the BCP process, the Bank has an 'alternate officers' plan in place to ensure that customer service is continuously provided through the assumption of responsibilities by substitute personnel.

Internal Control Systems and their Adequacy

The Management is fully aware of its responsibilities to the Bank's shareholders and depositors. A key factor in the fulfillment of these responsibilities is the strength of the Bank's operating procedures and associated internal control systems, which are designed to address several critical issues including the completeness, accuracy and reliability of the financial information that is used to monitor and manage the business and the need to provide a fast and efficient service to customers in a competitive market. The Bank addresses these issues by maintaining clearly defined operating procedures, which are updated as and when necessary to cope with the growth in the Bank's size and complexity.

The organization structure and human resources policies of the Bank are designed to ensure that areas of the Bank's operations are managed and supervised effectively by competent and qualified employees. The operation of the internal control systems is also reviewed by the Bank's Internal Audit division, which reports directly to the Audit Committee of the Board of Directors.

The Management is confident that the Bank's internal control systems are adequate, but there is no complacency on this subject and the Bank will continue to monitor and refine the system as and when appropriate.

Capital Structure

The Bank is well capitalized and its equity shares are listed on the Muscat Securities Market (MSM), Bahrain Stock Exchange (BSE) and London Stock Exchange (LSE). The capital adequacy of the Bank is well supported by Tier I and Tier II capital base. The Bank was the first bank in the GCC region to have its Global Depository Receipts listed in LSE.

Outlook

The Bank remains committed to realizing its vision of becoming one of the foremost banks across the GCC region by the turn of the decade. It intends to do this by continuing to embrace the best of global technology and providing world-class products and services to its customers in Oman and across the countries in which it operates. The Bank will also retain its focus on diversifying its revenue base and geographical presence, adding on quality assets and further enhancing stakeholder value.

BankMuscat International, Bahrain

BankMuscat International B.S.C.(c) (BMI) is a natural extension of the spirit that has made BankMuscat (SAOG) one of the largest and fastest growing banks in the Sultanate of Oman. BMI will provide, consolidate and extend its local and regional branch network and range of products and services to become a truly GCC regional bank.

Financial Review 2005

On 01 January 2005, the Bank's Bahrain branch was disposed off to a newly formed bank by the name of BankMuscat International (BMI), in which the Bank acquired 49% stake. Investment in BMI is accounted as investment in associate using the equity method. Accordingly, the results of Bahrain operation are not consolidated line-by-line in the Bank's results for the year 2005 whereas the comparative figures of 2004 include the results of Bahrain branch. Hence, in the financial review, operating results are also compared with 2004 results of Oman operation.

Net Profit

The Bank reported a net profit of RO 45.4 million in 2005, an increase of RO 11.3 million, or 33.1% over 2004. Operating profit of RO 57.3 million was higher by RO 2.0 million or 3.6% over 2004.

Net interest income of RO 78.1 million was higher by RO 2.9 million or 3.9% higher than 2004. However, net interest income is higher by 9.1% as compared with Oman operations of 2004. Net interest income improved due to increase in assets volume and growth in low cost deposits even though interest rates moved up in 2005. Non-interest income actually increased by 23.1% to RO 23.3 million in 2005 on a like-to-like basis, though on the face of the income statement it reflects an increase of only 6.5%. Non-interest income has improved as a result of higher contribution from Investment Banking, Treasury, Trade Finance, and Retail segment during the year 2005.

Operating expenses were higher by RO 1.3 million, or 3.0%, at RO 44.0 million. The Bank's cost to income ratio has marginally improved from 43.6% in 2004 to 43.4% in 2005.

The net charge for possible credit losses was RO 8.5 million compared to RO 14.1 million in 2004. Included in the provisions established during the year is an amount of RO 13.2 million established on a general portfolio basis for similar assets.

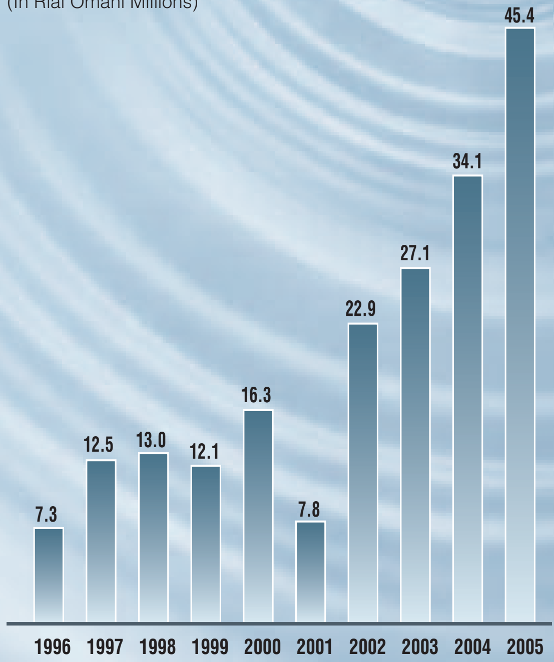
The basic earnings per share increased from RO 0.493 per share in 2004 to RO 0.642 in 2005 an increase of 30.2%.

Shareholders' Funds

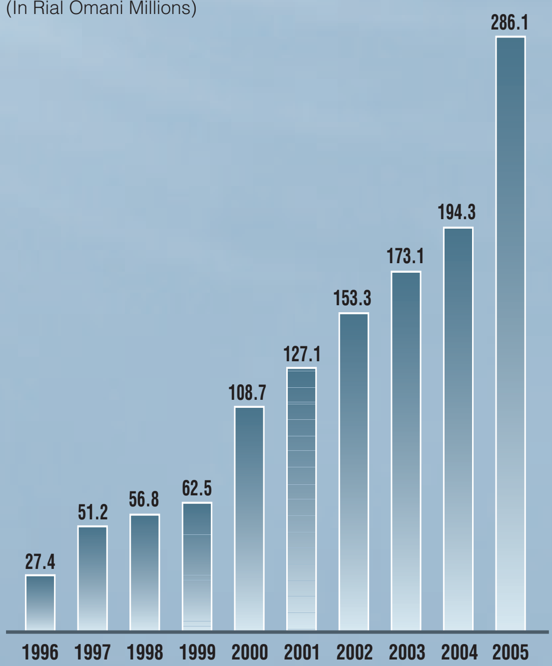
Shareholders' funds increased by RO 91.8 million, or 47.2%, to RO 286.1 million in 2005.

Shareholders' funds have increased mainly due to increase in share capital, share premium and retained profits. The Bank had its maiden Global Depository Issue of USD 163 million in 2005. This has resulted in an increase of RO. 6.9 million in share capital and RO. 53.4 million in share premium. After a dividend payout of RO 26.5 million, the Bank has retained RO 18.9 million or 41.6% of the profits generated in the year 2005. The return on average shareholders' funds was at 20.2% in 2005 as compared to 20.0% in 2004.

Net Profit
(In Rial Omani Millions)



Shareholders' Funds
(In Rial Omani Millions)



Kingdom of Saudi Arabia

BankMuscat has recently been granted approval to open offices in the Kingdom of Saudi Arabia by the Saudi Arabian Monetary Agency (SAMA). The Bank plans to open its first branch in Riyadh in early 2006 and then expand into other major cities, including Jeddah.

Financial Review 2005

The Board of Directors has proposed a cash dividend of 35% and a stock dividend of 10% for the year 2005 as against a combination of 25% cash dividend and 15% stock dividend for the year 2004. The cash dividend for 2005 would be covered 1.7 times by the net profit. The dividend pay out ratio works out to 58.4% of the current year profits.

Net Interest Income

Net interest income increased by RO 2.9 million, or 3.9%, to RO 78.1 million. However, the increase in net interest income was 9.1% when compared with Oman operations of 2004. The increase in net interest income was primarily due to higher volume of interest earning assets during the year 2005. In spite of raising interest rate trend, the Bank was able to manage its net interest spread by mobilizing low cost deposits and improving the yield on earning assets.

Average total assets increased by RO 201 million or 10% to RO 1,946 million. The growth in average assets was mainly due to increases in the loans and advances portfolio and placements with banks. The increase in placements was partly offset by a reduction in treasury bills holdings.

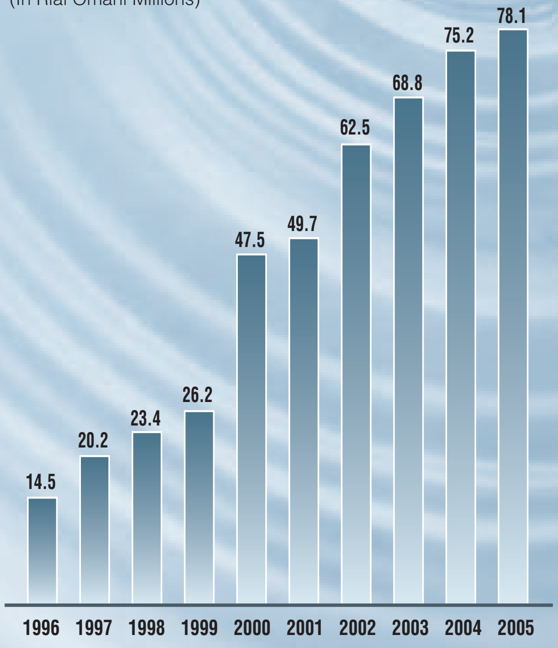
The return on average assets in 2005 increased to 2.3% as compared to 1.97% in 2004. The return on average assets was higher due to the increase in operating income and higher contribution from associates.

Other Operating Income

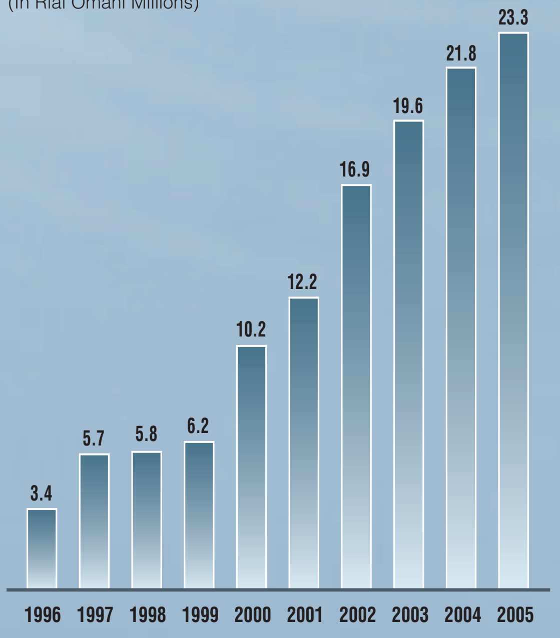
Other operating income increased by RO 1.43 million, or 6.5%, to RO 23.3 million. However, on a like-to-like comparison with Oman operation of 2004, the other operating income increased by 23.1% in 2005. Higher commission and fee income generated from trade finance activities, investment banking, broking activities, credit card business and other retail banking activities contributed for increase in other operating income. The Bank's focus is to significantly increase its fee based income.

Other operating income represents 22.9% of net operating income for the year 2005, compared to 22.3% for 2004.

Net Interest Income
(In Rial Omani Millions)



Other Operating Income
(In Rial Omani Millions)



GDR, London

On 05 October 2005, BankMuscat became the first organization from the Sultanate, and the first bank from across the GCC region, to have its Global Depository Receipts (GDRs) successfully listed on the London Stock Exchange (LSE).

Operating Expenses

Operating expenses have increased by RO 1.3 million or 3.0% to RO 44.0 million. Operating expenses increase was mainly due to increase in employee costs and other administrative costs. Employee costs increased as a result of increase in number of employees to cater to business expansion and other administrative costs increased due to new business and information technology initiatives.

The Bank's cost to income ratio has marginally improved from 43.6% in 2004 to 43.4% in 2005.

Provisions for Possible Credit Losses

The Bank made a net provision of RO 8.5 million for possible credit losses in 2005 compared to a net provision of RO 14.1 million the previous year. Net provision was lower in 2005 due to higher level of recoveries as compared to 2004. Included in the provisions established during the year is an amount of RO 13.2 million established as a general provision against loan losses. The Bank was able to effect recoveries of RO 15.9 million in 2005 as against recoveries of RO 6.3 million in 2004. The loan loss provision coverage has increased from 101.3% in 2004 to 113.7% in 2005.

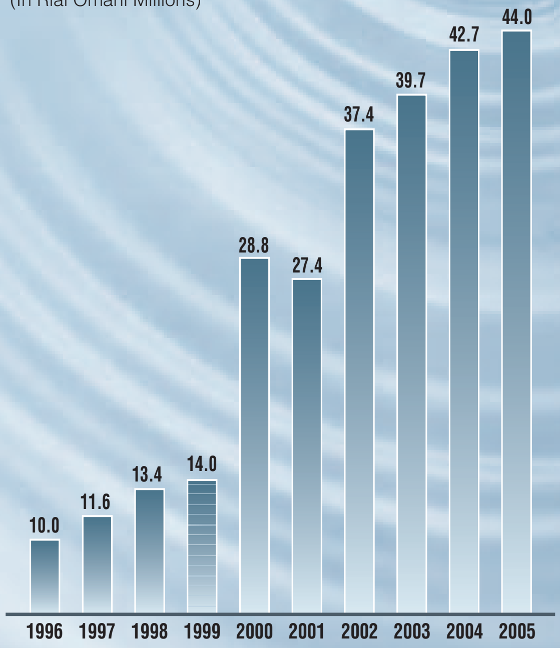
As at 31 December 2005, the total amount of provisions including reserved interest was RO 109.9 million. This represented 7.4% of gross lending to customers and 113.7% of non-performing advances. The total provisions and reserved interest as at 31 December 2004 represented 7.4% of gross lending and 101.3% of non-performing advances as at that date. The provisioning coverage has substantially increased during the year and the uncovered portion of the non-performing advances consists of operative accounts, which are adequately provided, and other accounts for which securities are held by the Bank and valued on a conservative basis. The provisions held are adequate as per the requirement of IAS 39.

Assets

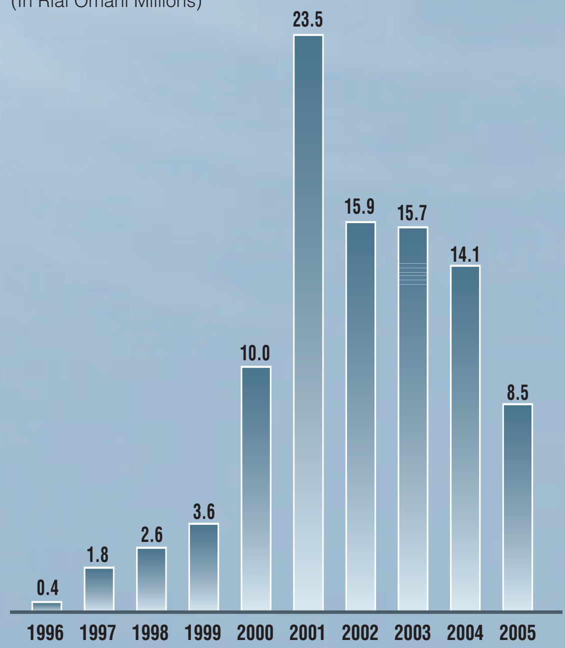
Total assets at 31 December 2005 increased by RO 93.5 million, or 4.9%, compared to 31 December 2004. However, total assets as compared to Oman Operation of 2004, increased by RO 268.6 million or 15.6%. The increase in total assets in 2005 was mainly in placements with banks, loans and advances and investments in associates.

Net loans and advances at 31 December 2005 increased by RO 42.6 million or 3.2% to RO 1,372 million. Net loans and advances as compared to Oman Operation of 2004, increased by RO 156.5 million or 12.9%. The Bank's non-performing advances decreased to 6.5% of gross loans and advances from 7.3% in the previous year.

Operating Expenses
(In Rial Omani Millions)



Annual Provision for Possible Credit Losses (Net)
(In Rial Omani Millions)



Centurion Bank of Punjab, India

BankMuscat's affiliate in India is Centurion Bank of Punjab, one of the fastest growing private sector banks in India today, in which BankMuscat currently holds a strategic stake of 25.34%.

Capital Adequacy

The Bank's capital adequacy ratio, calculated according to guidelines set by the Bank for International Settlements (BIS) was 17.8% as at 31 December 2005, compared to 15.3% as at 31 December 2004. While the international requirement as per BIS is 8%, the Central Bank of Oman's regulations stipulate that local banks maintain a BIS ratio of 12%.

Tier 1 capital increased by RO 70.9 million in 2005 due to issue of Global Depository Receipts and retained profits.

Tier 2 capital marginally increased by RO 4.1 million mainly due to increase in general loan loss provision. However, it was offset by reduction in net subordinated liabilities.

Liquidity Management

Liquidity policy is aimed at ensuring that the Bank can meet its financial obligations when they fall due. Sufficient volumes of high quality liquid instruments are held to meet bank deposit maturities and undrawn facilities, and to satisfy customer demands for deposit withdrawal.

The source and maturity of assets and liabilities are diversified to avoid any undue concentration of funding requirements at any one time or from any one source. A significant portion of deposits is made up of retail current and savings accounts, which although repayable on demand or at short notice, have traditionally formed a stable deposit base. Where possible, the Bank prefers to grow its balance sheet by increasing core retail deposits.

The liquidity situation in the banking industry continued to improve in 2005 too as a result of higher government revenues due to increased oil prices.

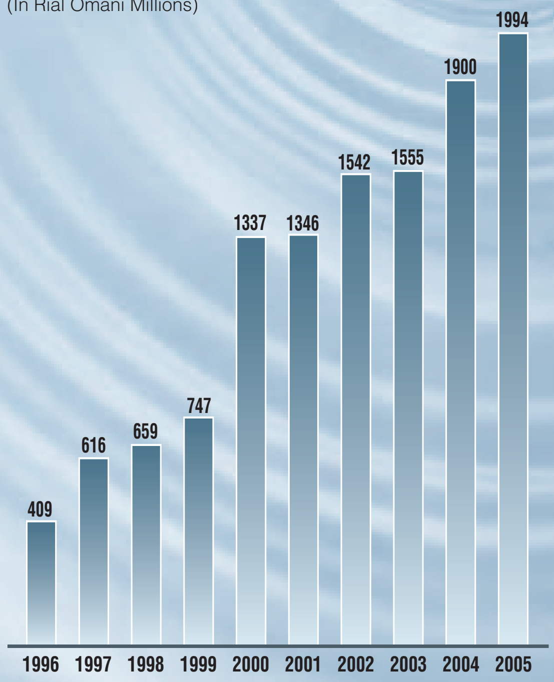
Cash and balances with Central Banks, treasury bills, government securities and placements with banks accounted for 23% of total assets and 33% of total deposits at 31 December 2005, compared with 24% and 33% respectively at 31 December 2004.

Interest Rate Risk Management

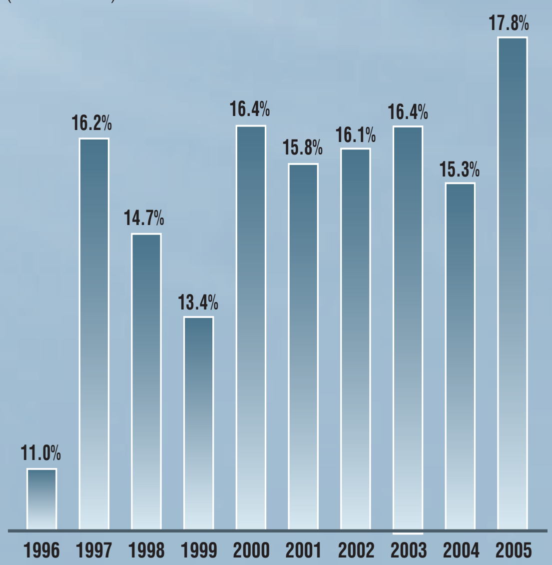
The Asset and Liability Management Committee (ALCO) manages the Bank's interest rate risk exposure. The major interest rate risk to the Bank originates from the short-term funding sources and the medium to long-term loans particularly on the fixed rate retail portfolio. The Bank manages this risk by broadening the maturity of its funding sources and by the use of medium term funding products.

In continuation with its efforts in long-term deposit raising, the Bank launched a term deposit product called "Tharwa" during the year 2005 to mobilize medium term customer deposits. The Bank focuses on long-term funding base and reduce its interest rate gaps. Since derivative products are not available in the local currency the Bank has limited options to use local currency hedging instruments.

Total Assets
(In Rial Omani Millions)



Capital Adequacy
(BIS Ratio %)



Qatar

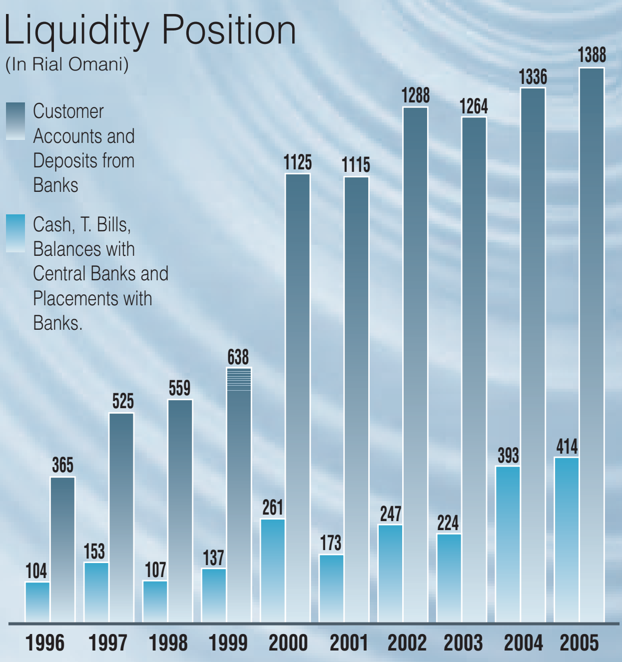
BankMuscat has drawn up ambitious plans to spread its wings by establishing a presence in all the Gulf countries. The Bank is currently exploring the possibility of setting up operations in Qatar.

Credit Rating

It is the Bank's philosophy to provide transparent and meaningful disclosures in its financial statements. The rating agencies and industry analysts appreciate the Bank's disclosures in its financial statements. The Bank values the comments and concerns of the rating agencies, and it is one of the Bank's objectives to maintain and enhance the credit ratings assigned by them.

Four leading international rating agencies, Standard and Poor's, Moody's, Fitch and Capital Intelligence rated the Bank during the year.

The ratings issued for the Bank by all the agencies are the highest assigned to any Omani bank.



Agency	L/Term	S/Term	Individual	Support	Domestic/Fin. Strength/outlook
Standard & Poor's	BBB	A2	-	-	Stable
Moody's Investors Service	Baa1	Prime-2	-	-	D+
Fitch	BBB+	F2	C	2	Stable
Capital Intelligence	BBB+	A2	-	2	BBB+/Stable

Balance Sheet

At 31 December 2005

Ten Years' Summary of Results

	Amounts in RO '000									
	2005	**2004**	**2003**	**2002**	**2001**	**2000**	**1999**	**1998**	**1997**	**1996**
Assets										
Cash and balances with Central Banks	**32,936**	32,092	76,642	149,532	22,254	39,432	19,631	36,561	18,095	18,266
Treasury bills	**63,594**	89,711	55,347	31,863	57,038	76,464	40,898	36,325	12,948	23,000
Government Securities	**44,723**	52,446	37,825	28,303	39,410	40,150	12,379	7,850	5,487	5,277
Placements with banks	**316,735**	271,481	91,520	65,409	93,767	145,619	77,237	33,955	121,667	62,538
Loans and advances	**1,371,930**	1,329,378	1,243,810	1,225,830	1,098,067	996,650	582,146	530,404	445,504	291,087
Investment securities	**58,540**	33,053	15,923	14,015	11,967	8,503	6,552	5,705	4,939	2,355
Tangible fixed assets	**10,636**	11,902	12,029	9,757	7,507	7,941	5,164	5,450	5,175	4,774
Other assets	**94,723**	80,211	21,682	17,726	16,446	22,206	2,724	2,744	2,446	1,791
Total Assets	**1,993,817**	1,900,274	1,554,778	1,542,435	1,346,456	1,336,965	746,731	658,994	616,261	409,088
Liabilities and Shareholders' Funds										
Liabilities										
Deposits from banks	**55,169**	173,870	184,567	229,546	225,461	275,524	159,483	101,084	80,574	51,770
Customer deposits	**1,291,205**	1,110,603	1,005,624	963,322	816,303	809,178	478,149	457,699	444,300	313,676
Certificates of deposit	**41,745**	51,517	73,593	95,471	73,748	40,802	1,319	-	-	-
Unsecured bonds	**54,803**	54,803	25,000	-	-	-	-	-	-	-
Floating rate notes	**96,250**	96,250	-	-	-	-	-	-	-	-
Other liabilities	**116,126**	162,890	39,328	40,380	33,536	32,832	16,156	14,665	19,254	8,205
Taxation	**12,791**	10,376	7,933	6,353	3,366	3,045	1,833	-	-	-
Proposed dividends	**-**	-	-	-	-	-	6,000	7,500	5,000	5,000
Subordinated liabilities	**39,621**	45,621	45,621	54,010	66,910	66,910	21,290	21,290	15,900	3,000
	1,707,710	1,705,930	1,381,666	1,389,082	1,219,324	1,228,291	684,230	602,238	565,028	381,651
Shareholders' Funds										
Share capital	**75,666**	59,815	51,489	49,037	45,538	45,538	30,000	30,000	20,000	20,000
Share premium	**79,490**	26,104	4,482	4,482	177	-	-	-	-	-
Convertible bonds	**-**	-	27,100	27,100	27,098	-	-	-	-	-
Proposed increase in share capital	**-**	-	-	-	-	-	-	-	16,051	-
Proposed issue of bonus shares	**-**	-	2,848	2,452	-	-	-	-	5,000	-
General reserve	**24,612**	19,812	19,812	15,500	11,382	11,382	5,000	4,000	3,000	2,000
Non-distributable reserves	**58,133**	51,409	42,286	37,473	37,200	32,520	22,955	19,309	5,479	3,828
Proposed dividends	**-**	-	12,872	7,356	4,904	9,107	-	-	-	-
Cumulative changes in fair value	**1,233**	-	-	-	-	-	-	-	-	-
Retained profit	**46,973**	37,204	12,223	9,953	833	10,127	4,546	3,447	1,703	1,609
	286,107	194,344	173,112	153,353	127,132	108,674	62,501	56,756	51,233	27,437
Total Liabilities and Shareholders' Funds	**1,993,817**	1,900,274	1,554,778	1,542,435	1,346,456	1,336,965	746,731	658,994	616,261	409,088
Letters of credit, acceptances, guarantees and other obligations* on behalf of customers	**418,708**	338,411	329,809	325,703	344,168	327,818	153,888	131,405	108,535	96,819
Operating cost to income	**43.45%**	44.02%	44.84%	47.02%	44.25%	49.93%	42.96%	45.55%	44.72%	55.60%
Return on average assets	**2.33%**	1.97%	1.75%	1.59%	0.58%	1.56%	1.72%	2.04%	2.44%	1.96%
Return on average shareholders' funds	**20.18%**	20.04%	19.89%	20.25%	7.43%	19.01%	20.22%	24.14%	31.85%	27.90%
Basic Earnings Per Share (RO)	**0.642**	0.493	0.526	0.476	0.170	0.357	0.402	0.434	0.444	0.260
Share price (RO)	**8.920**	6.400	4.970	3.840	1.800	3.540	4.490	3.300	9.450	3.450
BIS capital adequacy	**17.82%**	15.31%	16.39%	16.05%	15.80%	16.39%	13.44%	14.65%	16.22%	11.01%

**Does not include acceptances from 2004 onwards. Refer note 2 to the financial statements.*

Statement of Income

Ten Years' Summary of Results

	Amounts in RO '000									
	2005	**2004**	**2003**	**2002**	**2001**	**2000**	**1999**	**1998**	**1997**	**1996**
Statement of Income										
Interest income	**116,017**	104,678	101,117	104,469	108,766	114,622	62,641	57,984	43,287	30,207
Interest expense	**(37,956)**	(29,440)	(32,296)	(41,925)	(59,075)	(67,075)	(36,402)	(34,552)	(23,063)	(15,674)
Net interest income	**78,061**	75,238	68,821	62,544	49,691	47,547	26,239	23,432	20,224	14,533
Other operating income	**23,271**	21,843	19,619	16,958	12,190	10,170	6,251	5,889	5,715	3,461
Net Operating Income	**101,332**	97,081	88,440	79,502	61,881	57,717	32,490	29,321	25,939	17,994
Operating Expenses										
Other operating expenses	**(40,778)**	(39,124)	(36,463)	(34,487)	(24,990)	(25,973)	(12,628)	(12,131)	(10,530)	(8,996)
Depreciation and amortisation/impairment	**(3,252)**	(3,613)	(3,190)	(2,893)	(2,390)	(2,846)	(1,331)	(1,224)	(1,069)	(1,009)
	(44,030)	(42,737)	(39,653)	(37,380)	(27,380)	(28,819)	(13,959)	(13,355)	(11,599)	(10,005)
Unrealised gain (loss) on investment securities	**-**	955	207	260	(318)	(1,563)	(1,090)	(300)	-	-
Release of (provision for) capital guarantee	**-**	-	-	303	(339)	(335)	-	-	-	-
Provision towards government assistance programme of brokerage companies	**-**	-	-	-	-	(1,993)	-	-	-	-
Provision for placements with banks	**-**	-	(2,310)	-	-	-	-	-	-	-
Provision for collateral pending sale	**(496)**	(102)	(175)	(144)	(1,129)	-	-	-	-	-
Provision for possible credit losses (net)	**(8,463)**	(14,120)	(15,693)	(15,919)	(23,536)	(10,047)	(3,553)	(2,634)	(1,812)	(422)
Share of profit (loss) from associates	**3,664**	(1,417)	-	-	-	-	-	-	-	-
Share of trading loss of an associate	**(3,945)**	-	-	-	-	-	-	-	-	-
Recoveries from provision for placements	**1,939**	-	-	-	-	-	-	-	-	-
Net gain on disposal of a foreign branch	**2,826**	-	-	-	-	-	-	-	-	-
	(48,505)	(57,421)	(57,624)	(52,880)	(52,702)	(42,757)	(18,602)	(16,289)	(13,411)	(10,427)
Profit Before Discontinuing Operations	**52,827**	39,660	30,816	26,622	9,179	14,960	13,888	13,032	12,528	7,567
Net (loss) gain from discontinuing operations	-	-	(56)	-	-	3,500	-	-	-	-
Net Profit Before Taxation	**52,827**	39,660	30,760	26,622	9,179	18,460	13,888	13,032	12,528	7,567
Taxation	**(7,383)**	(5,555)	(3,679)	(3,709)	(1,424)	(2,193)	(1,833)	-	-	(228)
Net Profit for the year	**45,444**	34,105	27,081	22,913	7,755	16,267	12,055	13,032	12,528	7,339

Balance Sheet

At 31 December 2005

Ten Years' Summary of Results

	Amounts in USD '000									
	2005	**2004**	**2003**	**2002**	**2001**	**2000**	**1999**	**1998**	**1997**	**1996**
Assets										
Cash and balances with Central Banks	**85,549**	83,357	199,069	388,395	57,803	102,421	50,990	94,964	47,000	47,444
Treasury bills	**165,179**	233,015	143,759	82,761	148,151	198,608	106,229	94,351	33,631	59,740
Government Securities	**116,163**	136,222	98,246	73,514	102,364	104,285	32,153	20,390	14,252	13,706
Placements with banks	**822,687**	705,145	237,715	169,895	243,551	378,232	200,616	88,195	316,018	162,437
Loans and advances	**3,563,455**	3,452,931	3,230,676	3,183,974	2,852,121	2,588,701	1,512,067	1,377,673	1,157,153	756,070
Investment securities	**152,051**	85,853	41,359	36,402	31,083	22,086	17,018	14,818	12,829	6,117
Tangible fixed assets	**27,626**	30,913	31,245	25,343	19,498	20,626	13,413	14,156	13,442	12,400
Other assets	**246,034**	208,340	56,316	46,042	42,718	57,678	7,075	7,127	6,353	4,652
Total Assets	**5,178,744**	4,935,776	4,038,385	4,006,326	3,497,289	3,472,637	1,939,561	1,711,674	1,600,678	1,062,566
Liabilities and Shareholders' Funds										
Liabilities										
Deposits from banks	**143,296**	451,611	479,394	596,223	585,614	715,647	414,242	262,556	209,283	134,467
Customer deposits	**3,353,779**	2,884,682	2,612,010	2,502,135	2,120,267	2,101,761	1,241,945	1,188,829	1,154,026	814,743
Certificates of deposit	**108,429**	133,810	191,150	247,977	191,552	105,979	3,426	-	-	-
Unsecured bonds	**142,345**	142,345	64,935	-	-	-	-	-	-	-
Floating rate notes	**250,000**	250,000	-	-	-	-	-	-	-	-
Other liabilities	**301,628**	423,091	102,152	104,883	87,105	85,278	41,964	38,091	50,010	21,312
Taxation	**33,223**	26,950	20,606	16,501	8,744	7,909	4,761	-	-	-
Proposed dividends	**-**	-	-	-	-	-	15,584	19,481	12,987	12,987
Subordinated liabilities	**102,911**	118,495	118,495	140,286	173,794	173,793	55,299	55,299	41,299	7,792
	4,435,611	4,430,984	3,588,742	3,608,005	3,167,076	3,190,367	1,777,221	1,564,256	1,467,605	991,301
Shareholders' Funds										
Share capital	**196,536**	155,365	133,739	127,369	118,279	118,279	77,922	77,922	51,948	51,948
Share premium	**206,469**	67,804	11,642	11,642	460	-	-	-	-	-
Convertible bonds	**-**	-	70,390	70,390	70,384	-	-	-	-	-
Proposed increase in share capital	**-**	-	-	-	-	-	-	-	41,691	-
Proposed issue of bonus shares	**-**	-	7,398	6,369	-	-	-	-	12,987	-
General reserve	**63,927**	51,460	51,459	40,260	29,564	29,564	12,987	10,390	7,792	5,195
Non-distributable reserves	**150,994**	133,530	109,833	97,332	96,624	84,466	59,623	50,153	14,232	9,943
Proposed dividends	**-**	-	33,434	19,106	12,738	23,656	-	-	-	-
Cumulative changes in fair value	**3,202**	-	-	-	-	-	-	-	-	-
Retained profit	**122,005**	96,633	31,748	25,853	2,164	26,305	11,808	8,953	4,423	4,179
	743,133	504,792	449,643	398,321	330,213	282,270	162,340	147,418	133,073	71,265
Total Liabilities and Shareholders' Funds	**5,178,744**	4,935,776	4,038,385	4,006,326	3,497,289	3,472,637	1,939,561	1,711,674	1,600,678	1,062,566
Letters of credit, acceptances, guarantees and other obligations* on behalf of customers	**1,087,553**	878,990	856,647	845,982	893,944	851,475	399,709	341,312	281,909	251,478
Operating cost to income	**43.45%**	44.02%	44.84%	47.02%	44.24%	49.93%	42.96%	45.55%	44.72%	55.60%
Return on average assets	**2.33%**	1.97%	1.75%	1.59%	0.58%	1.56%	1.72%	2.04%	2.44%	1.96%
Return on average shareholders' funds	**20.18%**	20.04%	19.89%	20.25%	7.43%	19.01%	20.22%	24.14%	31.85%	27.90%
Basic Earnings Per Share ($)	**1.67**	1.28	1.366	1.236	0.442	0.927	1.04	1.13	1.15	0.68
Share price ($)	**23.17**	16.62	12.91	9.97	4.68	9.19	11.66	8.57	24.55	8.96
BIS capital adequacy	**17.82%**	15.31%	16.39%	16.05%	15.80%	16.39%	13.44%	14.65%	16.22%	11.01%

**Does not include acceptances from 2004 onwards. Refer note 2 to the financial statements.*

Statement of Income

BankMuscat

Ten Years' Summary of Results

	Amounts in USD '000									
	2005	**2004**	**2003**	**2002**	**2001**	**2000**	**1999**	**1998**	**1997**	**1996**
Statement of Income										
Interest income	**301,343**	271,892	262,641	271,348	282,510	297,721	162,704	150,607	112,434	78,460
Interest expense	**(98,587)**	(76,469)	(83,885)	(108,896)	(153,441)	(174,222)	(94,551)	(89,745)	(59,904)	(40,712)
Net interest income	**202,756**	195,423	178,756	162,452	129,069	123,501	68,153	60,862	52,530	37,748
Other operating income	**60,446**	56,739	50,960	44,047	31,661	26,416	16,236	15,296	14,844	8,990
Net Operating Income	**263,202**	252,162	229,716	206,499	160,730	149,917	84,389	76,158	67,374	46,738
Operating Expenses										
Other operating expenses	**(105,917)**	(101,621)	(94,710)	(89,577)	(64,908)	(67,462)	(32,800)	(31,509)	(27,351)	(23,366)
Depreciation and amortisation/impairment	**(8,450)**	(9,387)	(8,284)	(7,514)	(6,207)	(7,392)	(3,457)	(3,179)	(2,777)	(2,621)
	(114,367)	(111,008)	(102,994)	(97,091)	(71,115)	(74,855)	(36,257)	(34,688)	(30,128)	(25,987)
Unrealised gain (loss) on investment securities	**-**	2,480	537	676	(826)	(4,060)	(2,831)	(779)	-	-
Release of (provision for) capital guarantee	**-**	-	-	787	(880)	(870)	-	-	-	-
Provision towards government assistance programme of brokerage companies	**-**	-	-	-	-	(5,178)	-	-	-	-
Provision for placements with banks	**-**	-	(6,000)	-	-	-	-	-	-	-
Provision for collateral pending sale	**(1,289)**	(264)	(456)	(374)	(2,932)	-	-	-	-	-
Provision for possible credit losses (net)	**(21,980)**	(36,676)	(40,761)	(41,348)	(61,134)	(26,096)	(9,228)	(6,841)	(4,706)	(1,096)
Share of profit (loss) from associates	**9,516**	(3,680)	-	-	-	-	-	-	-	-
Share of trading loss of an associate	**(10,245)**	-	-	-	-	-	-	-	-	-
Recoveries from provision for placements	**5,036**	-	-	-	-	-	-	-	-	-
Net gain on disposal of a foreign branch	**7,340**	-	-	-	-	-	-	-	-	-
	(125,989)	(149,148)	(149,674)	(137,350)	(136,887)	(111,058)	(48,316)	(42,308)	(34,834)	(27,083)
Profit Before Discontinuing Operations	**137,213**	103,014	80,042	69,148	23,843	38,859	36,073	33,850	32,540	19,655
Net (loss) gain from discontinuing operations	**-**	-	(145)	-	-	9,091	-	-	-	-
Net Profit Before Taxation	**137,213**	103,014	79,897	69,148	23,843	47,950	36,073	33,850	32,540	19,655
Taxation	**(19,178)**	(14,430)	(9,557)	(9,635)	(3,700)	(5,697)	(4,761)	-	-	(593)
Net Profit for the year	**118,035**	88,584	70,340	59,513	20,143	42,253	31,312	33,850	32,540	19,062

Kuwait

Focused on becoming one of the foremost banks across the region by 2010, the Bank is also considering setting up operations in Kuwait.

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REPORT OF THE AUDITORS TO THE SHAREHOLDERS OF BANK MUSCAT (SAOG)

We have audited the accompanying balance sheet of Bank Muscat (SAOG) ("the Bank") as of 31 December 2005, and the related statements of income, changes in equity and cash flows for the year then ended, set out on pages 43 to 82.

Respective responsibilities of the Bank's Board of Directors and Auditors

These financial statements are the responsibility of the Bank's Board of Directors. Our responsibility is to express an opinion on these financial statements based on our audit.

Basis of opinion

We conducted our audit in accordance with International Standards on Auditing as promulgated by the International Federation of Accountants. Those Standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by the Board of Directors as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

Opinion

In our opinion, the financial statement present fairly, in all material respects, the financial position of Bank Muscat SAOG as at 31 December 2005 and the results of its operations and its cash flows for the year then ended in accordance with International Financial Reporting Standards as promulgated by the International Accounting Standards Board and the disclosure requirements of the Capital Market Authority and comply, in all materials respects with the Commercial Companies Law of 1974, as amended.

14 February 2006

KPMG

Balance Sheet

At 31 December 2005

2004 USD '000	2005 USD '000		Notes	2005 RO '000	2004 RO '000
		ASSETS			
83,357	**85,549**	Cash and balances with Central Bank	4	**32,936**	32,092
705,145	**822,687**	Placements with banks	5	**316,735**	271,481
3,452,931	**3,563,455**	Loans and advances	6	**1,371,930**	1,329,378
436,051	**360,162**	Investments	7	**138,663**	167,879
12,887	**67,836**	Investment in associates	8	**26,117**	4,962
6,152	**5,395**	Goodwill	8	**2,077**	2,369
30,913	**27,626**	Property and equipment	9	**10,636**	11,902
208,340	**246,034**	Other assets	10	**94,723**	80,211
4,935,776	**5,178,744**			**1,993,817**	1,900,274
		LIABILITIES AND SHAREHOLDERS' FUNDS			
		LIABILITIES			
451,611	**143,296**	Deposits from banks	11	**55,169**	173,870
2,884,682	**3,353,779**	Customers' deposits	12	**1,291,205**	1,110,603
133,810	**108,429**	Certificates of deposit	13	**41,745**	51,517
142,345	**142,345**	Unsecured bonds	14	**54,803**	54,803
250,000	**250,000**	Floating rate notes	15	**96,250**	96,250
423,091	**301,628**	Other liabilities	16	**116,126**	162,890
26,950	**33,223**	Taxation	17	**12,791**	10,376
118,495	**102,911**	Subordinated liabilities	18	**39,621**	45,621
4,430,984	**4,435,611**			**1,707,710**	1,705,930
		SHAREHOLDERS' FUNDS			
155,365	**196,536**	Share capital	19	**75,666**	59,815
67,804	**206,469**	Share premium	19	**79,490**	26,104
51,460	**63,927**	General reserve	21	**24,612**	19,812
56,161	**65,511**	Legal reserve	21	**25,222**	21,622
3,155	**3,155**	Revaluation reserve	9	**1,215**	1,215
74,214	**82,328**	Subordinated loan reserve	22	**31,696**	28,572
-	**3,202**	Cumulative changes in fair value		**1,233**	-
96,633	**122,005**	Retained profit		**46,973**	37,204
504,792	**743,133**			**286,107**	194,344
4,935,776	**5,178,744**	**TOTAL LIABILITIES AND SHAREHOLDERS' FUNDS**		**1,993,817**	1,900,274
878,990	**1,087,553**	Commitments and contingent liabilities	24	**418,708**	338,411
8.43	**9.82**	Net assets per share (USD/RO)	25	**3.781**	3.249

The financial statements were approved and authorized for issue by the Board of Directors on 14 February 2006 and signed on their behalf by:

Chairman **Sheikh AbdulMalik bin Abdullah Al Khalili**
Deputy Chairman **Sheikh Khalid bin Mustahail Al Mashani**
Chief Executive **AbdulRazak bin Ali bin Issa**

The notes on pages 48 to 82 form an integral part of these financial statements.
The report of the auditors is set forth on page 42.

Income Statement

Year ended 31 December 2005

BankMuscat

2004 USD '000	2005 USD '000		Notes	2005 RO '000	2004 RO '000
271,892	**301,343**	Interest income		**116,017**	104,678
(64,654)	**(87,744)**	Interest expense		**(33,781)**	(24,892)
207,238	**213,599**			**82,236**	79,786
(11,815)	**(10,845)**	Interest expense on tier II capital		**(4,175)**	(4,548)
195,423	**202,754**	**Net interest income**		**78,061**	75,238
56,739	**60,446**	Other operating income	26	**23,271**	21,843
2,480	**-**	Unrealised gain on investments available for sale		**-**	955
254,642	**263,200**	**OPERATING INCOME**		**101,332**	98,036
		OPERATING EXPENSES			
(101,621)	**(105,919)**	Other operating expenses	27	**(40,778)**	(39,124)
(8,036)	**(7,849)**	Depreciation	9	**(3,022)**	(3,093)
(1,351)	**(597)**	Goodwill impairment	8	**(230)**	(520)
(111,008)	**(114,365)**			**(44,030)**	(42,737)
(264)	**(1,289)**	Provision for collateral pending sale and acquired assets		**(496)**	(102)
(52,995)	**(63,274)**	Impairment for credit losses	6	**(24,361)**	(20,403)
16,319	**41,294**	Recoveries from impairment for credit losses	6	**15,898**	6,283
(3,680)	**9,516**	Share of profit (loss) from associates	8	**3,664**	(1,417)
	(10,245)	Share of trading loss in an associate	41	**(3,945)**	-
-	**5,036**	Recoveries from provision for placements	5	**1,939**	-
-	**7,340**	Net gain on disposal of a foreign branch	3	**2,826**	-
(151,628)	**(125,987)**	**OPERATING EXPENSES**		**(48,505)**	(58,376)
103,014	**137,213**	**PROFIT BEFORE TAXATION**		**52,827**	39,660
(14,430)	**(19,178)**	Tax expense	17	**(7,383)**	(5,555)
88,584	**118,035**	**NET PROFIT FOR THE YEAR**		**45,444**	34,105
		Earnings per share:			
1.28	**1.67**	- Basic and Diluted (USD/RO)	28	**0.642**	0.493

The notes on pages 48 to 82 form an integral part of these financial statements.

The report of the auditors is set forth on page 42.

Statement of Changes in Equity

Year ended 31 December 2005

	Notes	Share capital RO '000	Share premium RO '000	Convertible bonds RO '000
2004				
Balance at 31 December 2003		51,489	4,482	27,100
Bonus shares issued		2,848	-	-
Net profit for the year		-	-	-
Dividends paid – 2003	23	-	-	-
Conversion of convertible bonds	20	5,478	21,622	(27,100)
Transfer to subordinoted loan reserve	22	-	-	-
Balance at 31 December 2004		59,815	26,104	-
Balance at 31 December 2004 (USD '000)		155,365	67,804	-

The notes on pages 48 to 82 form an integral part of these financial statements.

The report of the auditors is set forth on page 42.

	Notes	Share capital RO '000	Share premium RO '000
2005			
Balance at 31 December 2004		59,815	26,104
Bonus shares issued	19	8,972	-
Global Depository Receipts issued	19	6,879	53,386
Net profit for the year		-	-
Dividends paid – 2004	23	-	-
Transfer to subordinoted loan reserve	22	-	-
Transfer to general reserve	21&22	-	-
Transfer to legal reserve	21	-	-
Change in fair value of investments available for sale		-	-
Loss on translation of net investment in associates		-	-
Balance at 31 December 2005		**75,666**	**79,490**
Balance at 31 December 2005 (USD '000)		**196,536**	**206,469**

The notes on pages 48 to 82 form an integral part of these financial statements.
The report of the auditors is set forth on page 42.

Statement of Changes in Equity

Year ended 31 December 2005

General reserve RO '000	Legal reserve RO '000	Revaluation reserve RO '000	Subordinated loan reserve RO '000	Cumulative change in fair value RO '000	Retained profit RO '000	Total RO '000
19,812	21,622	1,215	19,448	-	27,944	173,112
-	-	-	-	-	(2,848)	-
-	-	-	-	-	34,105	34,105
-	-	-	-	-	(12,873)	(12,873)
-	-	-	-	-	-	-
-	-	-	9,124	-	(9,124)	-
19,812	21,622	1,215	28,572	-	37,204	194,344
51,460	56,161	3,155	74,214	-	96,633	504,792

General reserve RO '000	Legal reserve RO '000	Revaluation reserve RO '000	Subordinated loan reserve RO '000	Cumulative change in fair value RO '000	Retained profit RO '000	Total RO '000
19,812	21,622	1,215	28,572	-	37,204	194,344
-	-	-	-	-	(8,972)	-
-	-	-	-	-	-	60,265
-	-	-	-	-	45,444	45,444
-	-	-	-	-	(14,954)	(14,954)
-	-	-	7,924	-	(7,924)	-
4,800	-	-	(4,800)	-	-	-
-	3,600	-	-	-	(3,600)	-
-	-	-	-	1,233	-	1,233
-	-	-	-	-	(225)	(225)
24,612	**25,222**	**1,215**	**31,696**	**1,233**	**46,973**	**286,107**
63,927	**65,511**	**3,155**	**82,328**	**3,202**	**122,005**	**743,133**

Statement of Cash Flows

Year ended 31 December 2005

2004 USD '000	2005 USD '000		Notes	2005 RO '000	2004 RO '000
		OPERATING ACTIVITIES			
103,014	**137,213**	Profit for the year before taxation		**52,827**	39,660
		Adjustments for:			
3,681	**(9,516)**	Share of (gain) loss from associates		**(3,664)**	1,417
9,384	**8,447**	Depreciation and goodwill impairment		**3,252**	3,613
52,995	**63,274**	Provision for credit losses		**24,361**	20,403
(16,319)	**(41,294)**	Recoveries from provision for credit losses		**(15,898)**	(6,283)
(2,480)	**-**	Unrealised (gain) on investments available for sale		**-**	(955)
264	**1,288**	Provision for collateral pending sale and acquired assets		**496**	102
-	**(7,340)**	Profit on disposal of a branch		**(2,826)**	-
-	**(5,036)**	Recoveries from provision for placements		**(1,939)**	-
(54)	**(54)**	Profit on sale of property and equipment		**(21)**	(21)
(1,618)	**(2,135)**	Dividends received		**(822)**	(623)
148,867	**144,848**	Operating profit before working capital changes		**55,766**	57,313
(171,632)	**36,699**	Placements with banks		**14,129**	(66,078)
(258,933)	**(428,452)**	Loans and advances		**(164,954)**	(99,689)
(58,662)	**(58,217)**	Other assets		**(22,414)**	(22,585)
(6,192)	**(56,021)**	Deposits from banks		**(21,568)**	(2,384)
272,673	**789,470**	Customers' deposits		**303,946**	104,979
(57,340)	**(25,382)**	Certificates of deposit		**(9,772)**	(22,076)
77,410	**-**	Unsecured bonds		**-**	29,803
250,000	**-**	Floating rate notes		**-**	96,250
226,405	**(59,415)**	Other liabilities		**(22,875)**	87,166
422,596	**343,530**	Cash from operations		**132,258**	162,699
(8,086)	**(12,556)**	Income taxes paid		**(4,834)**	(3,113)
414,510	**330,974**	**Net cash from operating activities**		**127,424**	159,586
		INVESTING ACTIVITIES			
1,618	**2,135**	Dividends received		**822**	623
(60,952)	**(7,821)**	Net movement in non-trading investments		**(3,011)**	(23,466)
(16,567)	**(45,854)**	Investment in associates		**(17,654)**	(6,378)
(6,592)	**-**	Goodwill paid		**-**	(2,538)
(7,806)	**(6,517)**	Purchase of property and equipment		**(2,509)**	(3,005)
157	**99**	Proceeds from sale of property and equipment		**38**	60
-	**(57,839)**	Disposal of a foreign branch, net of sale consideration		**(22,268)**	-
(90,142)	**(115,797)**	**Net cash from investing activities**		**(44,582)**	(34,704)
		FINANCING ACTIVITIES			
(33,437)	**(38,842)**	Dividends paid		**(14,954)**	(12,873)
-	**156,532**	Net proceeds of Global Depository Receipts issue		**60,265**	-
-	**(15,585)**	Subordinated liabilities repaid		**(6,000)**	-
(33,437)	**102,105**	**Net cash from financing activities**		**39,311**	(12,873)
290,931	**317,282**	**NET CHANGE IN CASH AND CASH EQUIVALENTS**		**122,153**	112,009
161,320	**452,251**	Cash and cash equivalents at 1 January		**174,117**	62,108
452,251	**769,533**	**CASH AND CASH EQUIVALENTS AT 31 DECEMBER**	29	**296,270**	174,117

The notes on pages 48 to 82 form an integral part of these financial statements.
The report of the auditors is set forth on page 42.

1 LEGAL STATUS AND PRINCIPAL ACTIVITIES

BankMuscat (SAOG) ("the Bank") is a joint stock company incorporated in the Sultanate of Oman and is engaged in commercial and investment banking activities through a network of ninety branches within the Sultanate of Oman. The Bank has a representative office in Dubai, United Arab Emirates. The registered address of the head office of the Bank is P. O. Box 134, Ruwi, Postal Code 112, Sultanate of Oman. The Bank operates in Oman under a banking licence issued by the Central Bank of Oman and is covered by its deposit insurance scheme.

The Bank operates in two countries (2004 - three countries) and employed 1,805 employees as of 31 December 2005 (2004 - 1,669).

2 SIGNIFICANT ACCOUNTING POLICIES

The significant accounting policies adopted in the preparation of the financial statements are as follows:

Statement of compliance

The financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS") and its interpretations adopted by the International Accounting Standards Board ("IASB"), the requirements of the Commercial Companies Law of 1974, as amended and disclosure requirements of the Capital Market Authority. In August 2005, IASB issued IFRS-7 "financial instruments: disclosures" which is effective for the periods beginning on or after 01 January 2007. Management believes that IFRS-7 will not affect the Bank's financial position or results of operation presented in future financial statements as IFRS-7 relates solely to the content and formats of the financial statements disclosures.

Adoption of revised IFRS

The accounting policies have been applied consistently by the Bank and are consistent with those used in the previous year, except for changes resulting from the amendments to IFRS. The comparative figures for 2004 have been adjusted or expanded to confirm to changes in presentation in the 2005 financial statements as required by the amended IFRS.

The Bank adopted the revised version of IAS - 32 - Financial Instruments: Disclosure and Presentation and IAS - 39 - Financial Instruments: Recognition and Measurements that were effective at 01 January 2005. The main effects of the adoption of IAS-32 and IAS-39 were as follows:

Investments securities

Certain investment securities previously classified as held for trading have been redesignated as "investments at fair value through income statement". Investments in a debt security where the bank provided funds directly to the issuer were previously classified as "originated by Bank" and stated at amortised cost, have been reclassified to held to maturity investments with effect from 01 January 2004 in accordance with the requirements of revised IAS-39. The impact of this was not considered material.

The Bank now classifies investment securities upon initial recognition into one of the following categories:

- Investment at fair value through income statement
- Held to maturity
- Available for sale

Acceptances

Under IAS-39 (revised) acceptances are disclosed on the balance sheet under other assets with corresponding liability disclosed under other liabilities. Therefore, there is no off-balance sheet commitment for acceptances.

Basis of preparation

The financial statements are prepared under the historical cost convention, modified to include the revaluation of freehold land and buildings and the measurement at fair value of derivative financial instruments and trading and available for sale investment securities.

2 SIGNIFICANT ACCOUNTING POLICIES (continued)

Basis of preparation (continued)

The preparation of financial statements in conformity with IFRS requires management to make judgements, estimates and assumptions that affect the application of policies and reported amounts of assets and liabilities, incomes and expenses. The estimates and associated assumptions are based on historical experience and various other factors that are believed to be reasonable under the circumstances, the results of which form the basis of making the judgements about carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates.

The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised if the revision affects only that period or in the period of the revision and future periods if the revision affects both current and future periods.

The accounting records are maintained in Rial Omani.

Cash and cash equivalents

Cash and cash equivalents consist of cash on hand, balances with banks, treasury bills and money market placements and deposits maturing within three months of the date of acquisition.

Placements with banks

These are stated at cost, less any amounts written off and provisions for impairment.

Loans and advances

Loans and advances originated by the Bank are classified as loans and receivables. Loans and advances are reported net of impairment allowance to reflect the estimated recoverable amounts.

Investments

All investments are initially recognised at cost, being the fair value of the consideration given including acquisition costs.

Premiums and discounts on non trading investments are amortised using the effective interest rate method and taken to interest income.

Held at fair value through profit and loss

These are initially recognised at cost and subsequently remeasured at fair value. All related realised and unrealised gains or losses are included in the income statement.

Available for sale

After initial recognition, investments which are classified “available for sale” are remeasured at fair value. Fair value changes are included in equity in the period in which they arise, except for changes in impairment losses. Impairment losses are included in the income statement when these investments are derecognised the cumulative gains or losses previously recognised directly in equity is recognised in the income statement.

Held to maturity

Investments which have fixed or determinable payments which are intended to be held to maturity, are carried at amortised cost, less provision for impairment in value.

Fair values

For investments traded in organised financial markets, fair value is determined by reference to Stock Exchange quoted market prices at the close of business on the balance sheet date.

The fair value of interest-bearing items is estimated based on discounted cash flows using interest rates for items with similar terms and risk characteristics.

For unquoted equity investments fair value is determined by reference to the market value of a similar investment, or is based on the expected discounted cash flows.

2 SIGNIFICANT ACCOUNTING POLICIES (continued)

Property and equipment

Property and equipment are recorded initially at cost.

Items of property and equipment are stated at cost less accumulated depreciation and impairment loss.

Revaluations of freehold land and buildings are carried out every five years on an open market value for existing use basis, by an independent valuer. Net surpluses arising on revaluation are credited to a revaluation reserve, except that a revaluation increase is recognised as income to the extent that it reverses a revaluation decrease of the same asset previously recognised as an expense. A decrease as a result of a revaluation is recognised as an expense, except that it is charged directly against any related revaluation surplus to the extent that the decrease does not exceed the amount held in the revaluation surplus in respect of that asset. On disposal, the related revaluation surplus is credited to the income statement.

Depreciation is calculated so as to write off the cost of property and equipment, other than freehold land and capital work-in-progress, by equal installments over their estimated economic useful lives from the date the asset is brought into use, as follows:

	Years
Freehold buildings	10 - 25
Furniture, fixtures and equipment	3 - 10
Motor vehicles	3 - 5

Gains and losses on disposal of property and equipment are determined by reference to their carrying amount and are taken into account in determining operating profit. Repairs and renewals are charged to the income statement when the expense is incurred. Subsequent expenditure is capitalised only when it increases the future economic benefits embodied in the item of property and equipment. All other expenditure is recognised in the income statement as an expense as incurred.

Investment in associates

Associates are those entities in which the Bank has significant influence, but not control, over the financial and operating policies. The financial statements include the Bank's share of the total recognised gains and losses of associates on an equity accounted basis, from the date that significant influence commences until the date that significant influence ceases. When the Bank's share of losses exceeds its interest in an associate, the Bank's carrying amount is reduced to nil and recognition of further losses is discontinued except to the extent that the Bank has incurred legal or constructive obligations or made payments on behalf of an associate.

Collateral pending sale

The Bank occasionally acquires real estate in settlement of certain loans and advances. Real estate is stated at the lower of the net realisable value of the related loans and advances and the current fair value of such assets. Gains or losses on disposal, and unrealised losses on revaluation, are recognised in the income statement.

Goodwill

Goodwill represents the difference between the cost of the acquisition and the fair value of the net identifiable assets acquired. Goodwill is stated at cost less any accumulated impairment losses and reviewed for impairment annually.

Impairment and uncollectability of financial assets

An assessment is made at each balance sheet date to determine whether there is objective evidence that a specific financial asset may be impaired. If such evidence exists, the estimated recoverable amount of that asset is determined and any impairment loss, based on the net present value of future anticipated cash flows including anticipated recoveries from guarantees and collateral, discounted at original effective interest rates, is recognised in the income statement.

In addition, a provision is made to cover potential impairment which, although not specifically identified, are deemed to be present in the Bank's portfolio of financial assets, based on historical experience.

2 SIGNIFICANT ACCOUNTING POLICIES (continued)

Deposits

All money market and customer deposits are carried at cost, less amounts repaid.

Income tax

Taxation is provided in accordance with Omani fiscal regulations.

Deferred income taxation is provided using the liability method on all temporary differences at the balance sheet date. Deferred income tax assets and liabilities are measured at the tax rates that are expected to apply to the period when the asset is realised or the liability is settled, based on laws that have been enacted at the balance sheet date.

The carrying amount of deferred income tax asset is reviewed at each balance sheet date and reduced to the extent that it is no longer probable that sufficient taxable profit will be available to allow all or part of the deferred income tax asset to be utilised.

Provisions

Provisions are recognised when the Bank has a present obligation (legal or constructive) arising from a past event and the costs to settle the obligation are both probable and able to be reliably measured.

Fiduciary assets

Assets held in trust or in a fiduciary capacity are not treated as assets of the Bank in the balance sheet.

Revenue recognition

Interest receivable and payable is recognised on a time proportion basis, taking account of the principal outstanding and the rate applicable. Interest which is doubtful of recovery is included in impairment allowance and excluded from income until it is received in cash. Other fees receivable or payable are recognised when due. Dividend income is recognised when the Bank's right to receive payment is established.

Foreign currencies

(i) Transactions denominated in foreign currencies are translated into Rial Omani and recorded at rates of exchange ruling at the value dates of the transactions.
(ii) Assets and liabilities denominated in foreign currencies are translated into Rial Omani at exchange rates ruling at the balance sheet date. Realised and unrealised gains and losses are included in the income statement.
(iii) The financial statements of overseas branches are translated into Rial Omani for aggregation purposes at the exchange rates ruling at the balance sheet date. Any translation differences arising from the application of exchange rates ruling at the balance sheet date to the opening net assets of overseas branches are taken directly to reserves.
(iv) Net investment in associates are translated into Rial Omani at the exchange rates ruling at the Balance Sheet date. Any translation differences arising from the application of exchange rates ruling at the Balance Sheet date are taken directly to equity.

Repurchase and resale agreements

Assets sold with a simultaneous commitment to repurchase at a specified future date (repos) are recognised in the balance sheet and are measured in accordance with accounting policies for such securities. The counterparty liability for amounts received under these agreements is classified as a liability. Assets purchased with a corresponding commitment to resell at a specified future date (reverse repos) are not recognised in the balance sheet and the amounts paid under these agreements are classified as an asset.

The difference between the related sale and repurchase prices is treated as interest expense or interest income arising from these transactions, respectively, and is accrued over the period of the agreement.

2 SIGNIFICANT ACCOUNTING POLICIES (continued)

Derivatives

Derivatives are used in the Bank's non-trading activities to reduce exposures to fluctuations in interest and exchange rates, including forward foreign exchange contracts and interest rate swaps. These derivatives are stated at fair value. The fair value of a derivative is the equivalent of the unrealised gain or loss from marking to market the derivative using prevailing market rates or internal pricing models. Unrealised gains or losses are included in the income statement.

Trade and settlement date accounting

All "regular way" purchases and sales of financial assets are recognised on the trade date, i.e. the date that the entity commits to purchase the asset. Regular way purchase or sales are purchases or sales of financial assets that require delivery of assets within the time frame generally established by regulation or convention in the market place.

Leases

Finance leases, which transfer to the Bank substantially all the risks and benefits incidental to ownership of the leased item, are capitalised at the inception of the lease at the fair value of the leased asset or, if lower, at the present value of the minimum lease payments. Lease payments are apportioned between the finance charges and reduction of the lease liability so as to achieve a constant rate of interest on the remaining balance of the liability. Finance charges are charged directly against income.

Capitalised leased assets are depreciated over the shorter of the estimated useful life of the asset or the lease term.

Leases where the lessor retains substantially all the risks and benefits of ownership of the asset are classified as operating leases. Operating lease payments are recognised as an expense in the income statement on a straight-line basis over the lease term.

Employee terminal benefits

Contributions to a defined contribution retirement plan, for Omani employees in accordance with the Oman Social Insurance Scheme, are recognised as expense in the income statement when accrued.

Provision for non-Omani employee terminal contributions, which is an unfunded defined benefit retirement plan, is recognized as expense in the income statement in accordance with Omani Labor Laws and is based on the liability that would arise if the employment of all employees were terminated at the balance sheet date.

Segment reporting

A segment is a distinguishable component of the Bank that is engaged either in providing products or services (business segment), or in providing products or services within a particular economic environment (geographical segment), which is subject to risks and rewards that are different from those of other segments.

Offsetting

Financial assets and financial liabilities are only offset and the net amount reported in the balance sheet when there is a legally enforceable right to set off the recognized amounts and the Bank intends to either settle on a net basis, or to realize the asset and settle the liability simultaneously.

3 DISPOSAL OF THE BANK'S BAHRAIN BRANCH AND ACQUISITION OF 49% STAKE IN A FOREIGN BANK

On 01 January 2005 ('effective date'), the net assets and operations of the Bahrain Branch ('the Branch') of the Bank has been acquired by a newly formed bank, BankMuscat International ("BMI"). BMI is registered in Bahrain and is engaged in commercial banking operations. The Branch had reported a net profit of RO 3.48 million for the year ended 31 December 2004 and at that date net assets were RO 15.678 million. The Branch was sold for a consideration of RO 18.693 million based on an independent valuation conducted by Ernst & Young, Bahrain. Legal and professional expenses incurred by the Bank in respect of the disposal were approximately RO 0.189 million. The Bank recorded a gain of RO 2.826 million on the disposal of the Branch.

In accordance with an arrangement entered with BMI, the Bank on 01 January 2005 has acquired 49% of the paid up share capital of BMI amounting to RO 10.013 million. The paid up share capital of BMI is RO 20.435 million. The Bank's investment in BMI is accounted as investment in associate using the equity method (refer note 8).

The Board of Directors of the Bank approved the transaction on 27 June 2004 and Central Bank of Oman approved the transaction on 05 September 2004.

An analysis of the fair value of identifiable net assets of the Branch as on 31 December 2004 is as follows:

USD '000		RO '000
	ASSETS	
7,296	Cash and balances with Bahrain monitoring agency	2,809
111,698	Due from banks and other financial institutions	43,004
295,946	Loans and advances	113,939
19,075	Non-trading investments	7,344
1,912	Property and equipment	736
18,883	Other assets	7,270
454,810		175,102
	LIABILITIES	
36,696	Due to banks and other institutions	14,128
305,792	Customers' deposits	117,730
14,582	Certificate of deposits	5,614
57,018	Other liabilities	21,952
414,088	Total liabilities	159,424
40,722	Net assets	15,678
48,553	Sale consideration	18,693
491	Legal and professional expenses	189
7,340	Net profit arising on disposal	2,826

The cash flows in respect of the disposal are as follows:

7,296	Cash and balances with Bahrain monitoring agency	2,809
98,608	Due from banks and other financial institutions	37,964
105,904	Cash and cash equivalents of Bahrain branch disposed	40,773

4 CASH AND BALANCES WITH CENTRAL BANKS

2004 USD '000	2005 USD '000		2005 RO '000	2004 RO '000
59,452	**79,166**	Cash	**30,479**	22,889
1,299	**1,299**	Capital deposit with Central Bank of Oman	**500**	500
4,231	**4,231**	Insurance deposit with Central Bank of Oman	**1,629**	1,629
18,375	**853**	Other balances with Central Bank of Oman	**328**	7,074
83,357	**85,549**		**32,936**	32,092

The capital deposit and insurance deposit with the Central Bank of Oman cannot be withdrawn without the approval of the Central Bank of Oman.

5 PLACEMENTS WITH BANKS

2004 USD '000	2005 USD '000		2005 RO '000	2004 RO '000
21,742	**31,654**	Nostro balances	**12,187**	8,371
689,403	**791,033**	Inter bank placements	**304,548**	265,420
711,145	**822,687**		**316,735**	273,791
(6,000)	**-**	Impairment	**-**	(2,310)
705,145	**822,687**		**316,735**	271,481

During the year, the Bank recovered an amount of approximately RO 1.9 million from a placement with a commercial bank. The recovery of this placement was in doubt and the amount was fully impaired in 2004.

6 LOANS AND ADVANCES

2004 USD '000	2005 USD '000		2005 RO '000	2004 RO '000
378,813	**332,358**	Overdrafts	**127,958**	145,842
2,999,349	**3,148,062**	Loans	**1,212,004**	1,154,749
138,612	**131,821**	Loans against trust receipts	**50,751**	53,366
143,424	**128,067**	Bills discounted	**49,306**	55,218
1,224	**22,102**	Bills under negotiation	**8,509**	471
67,300	**86,509**	Other advances	**33,305**	25,911
3,728,722	**3,848,919**		**1,481,833**	1,435,557
(275,791)	**(285,464)**	Impairment	**(109,903)**	(106,179)
3,452,931	**3,563,455**		**1,371,930**	1,329,378

The movement in impairment is analysed below:

Provision for loan losses

2004 USD '000	2005 USD '000		2005 RO '000	2004 RO '000
214,684	**204,944**	01 January	**78,903**	82,653
-	**(2,183)**	Disposal of a Branch	**(841)**	-
52,995	**63,274**	Provided during the year	**24,361**	20,403
(16,319)	**(40,065)**	Released during the year*	**(15,425)**	(6,283)
(46,395)	**(15,291)**	Written off during the year	**(5,887)**	(17,862)
(5,481)	**(1,013)**	Transfer during the year to acquired assets	**(390)**	(2,110)
5,460	**-**	Reallocation from reserve interest	**-**	2,102
204,944	**209,666**	31 December	**80,721**	78,903

* Recoveries of RO 15.898 million made during the year 2005 includes RO 0.473 million recovered from loans written off earlier.

Reserve interest (as per CBO requirements)

2004 USD '000	2005 USD '000		2005 RO '000	2004 RO '000
76,686	**70,847**	01 January	**27,276**	29,524
-	**(275)**	Disposal of a Branch	**(106)**	-
(17,247)	**(10,901)**	Written off during the year	**(4,197)**	(6,640)
(205)	**-**	Transfer during the year to acquired assets	**-**	(79)
(5,460)	**-**	Reallocation to loan loss provision	**-**	(2,102)
30,161	**30,615**	Interest reserved during the year	**11,787**	11,612
(13,088)	**(14,488)**	Reserved interest recovered	**(5,578)**	(5,039)
70,847	**75,798**	31 December	**29,182**	27,276
275,791	**285,464**	Total impairment	**109,903**	106,179

6 LOANS AND ADVANCES (continued)

All loans and advances require periodic payment of interest, some at fixed rates and others at rates that reprice prior to maturity (note 38). Interest is reserved by the Bank to comply with the rules, regulations and guidelines issued by CBO against loans and advances which are impaired. As of 31 December 2005, loans and advances on which interest is not being accrued or where interest has been reserved amounted to RO 96.681 million (2004 – RO 104.830 million).

Credit risk management

Credit risk is the risk that one party to a financial instrument will fail to discharge an obligation and will cause the other party to incur a financial loss. The Bank attempts to control credit risk by monitoring credit exposures, limiting transactions with specific counter parties and assessing continually the creditworthiness of counter parties. In addition, the Bank obtains security where appropriate, enters into collateral arrangements with counter parties, and limits the duration of exposure.

Concentrations of credit risk arise when a number of counter parties 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 affected similarly by changes in economic, political or other conditions. Concentrations of credit risk indicate the relative sensitivity of the Bank's performance to developments affecting a particular industry or geographic location.

The Bank seeks to manage its credit risk exposure through diversification of lending activities to avoid undue concentrations of risks with individuals or groups of customers in specific locations or businesses. It also obtains appropriate security.

The table below analyses the concentration of gross loans and advances by various sectors.

2004 USD '000	2005 USD '000		2005 RO '000	2004 RO '000
		Corporate and other loans		
18,138	**20,502**	Agriculture and allied activities	**7,893**	6,983
184,980	**176,780**	Construction	**68,060**	71,217
5,163	**10,189**	Export trade	**3,923**	1,988
173,740	**236,453**	Financial institutions	**91,034**	66,890
89,328	**44,408**	Government	**17,097**	34,391
410,515	**382,511**	Import trade	**147,267**	158,048
379,682	**329,024**	Manufacture	**126,674**	146,178
59,351	**60,564**	Mining and quarrying	**23,317**	22,850
58,791	**67,919**	Real estate	**26,149**	22,634
251,684	**279,892**	Services	**107,758**	96,899
48,707	**54,576**	Transport	**21,012**	18,752
143,447	**231,718**	Utilities	**89,212**	55,227
178,427	**110,950**	Wholesale and retail trade	**42,716**	68,695
199,248	**259,849**	Others	**100,041**	76,711
2,201,201	**2,265,335**		**872,153**	847,463
1,527,521	**1,583,584**	***Personal loans***	**609,680**	588,094
3,728,722	**3,848,919**		**1,481,833**	1,435,557

7 INVESTMENTS

	Available for sale RO '000	Held to maturity RO '000	2005 Total RO '000	2004 Total RO '000
Quoted investments	37,561	-	37,561	33,836
Unquoted investments				
Treasury bills	-	63,594	63,594	89,711
Government Bonds	-	32,516	32,516	38,727
Unquoted bonds/securities	4,992	-	4,992	5,605
	4,992	96,110	101,102	134,043
2005	**42,553**	**96,110**	**138,663**	167,879
2004	37,801	130,078	167,879	-

	Available for sale USD '000	Held to maturity USD '000	2005 Total USD '000	2004 Total USD '000
Quoted investments	97,561	-	97,561	87,886
Unquoted investments				
Treasury bills	-	165,178	165,178	233,015
Government Bonds	-	84,457	84,457	100,591
Unquoted bonds/securities	12,966	-	12,966	14,559
	12,966	249,635	262,601	348,165
2005	**110,527**	**249,635**	**360,162**	**436,051**
2004	98,184	337,867	436,051	-

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7 INVESTMENTS (continued)

An analysis of available for sale investments is set out below:

2004 USD '000	2005 USD '000		2005 RO '000	2004 RO '000
		Quoted investments		
11,524	**11,867**	Industrial sector	**4,569**	4,437
9,314	**12,133**	Financial services sector	**4,672**	3,585
8,354	**10,152**	Other services sector	**3,907**	3,216
15,878	**19,279**	Foreign securities	**7,422**	6,113
9,871	**16,999**	Corporate bonds	**6,545**	3,801
35,633	**31,706**	Government bonds	**12,207**	13,719
90,574	**102,136**	Total	**39,322**	34,871
(2,688)	**(4,575)**	Impairment losses	**(1,761)**	(1,035)
87,886	**97,561**		**37,561**	33,836
		Unquoted investments		
617	**2,651**	Unquoted local securities	**1,021**	238
7,419	**8,053**	Unquoted foreign securities	**3,101**	2,856
2,262	**2,262**	Investment fund units	**870**	871
10,298	**12,966**	Total	**4,992**	3,965
98,184	**110,527**	Total available for sale	**42,553**	37,801

8 INVESTMENTS IN ASSOCIATES AND GOODWILL

Investment in Centurion Bank of Punjab Limited

As at 31 December 2004, the Bank held 33.05% shareholding in Centurion Bank Limited ("CB"). In March 2005, CB issued Global Depository Receipts (GDRs) to the investors including the existing investors. The Bank acquired 4.135 million GDRs for a consideration of RO 7.6 million. These GDRs were allotted on 9 March 2005.

During the year 2005, CB entered into a Scheme of Amalgamation ("Scheme") with Bank of Punjab ("BoP"). As per the Scheme, effective 01 April 2005, the entire operations of BoP including assets and liabilities were transferred to and vest in CB. The Scheme is effective on 01 October 2005. The amalgamated entity is called Centurion Bank of Punjab Limited ("CBoP"). As at 31 December 2005, the Bank holds 25.34% of the paid up capital of CBoP. At 31 December 2005, the carrying value of the investment in CBoP was as follows:

USD '000		RO '000
23,163	Total consideration paid	8,918
(6,595)	Less: Goodwill recognized on acquisition	(2,539)
(3,681)	Less: Share of post acquisition loss	(1,417)
12,887	Carrying value of the investment at 31 December 2004	**4,962**
19,848	Add: Investment in GDR issue of CBL	**7,641**
4,194	Add: Share of profit for the year	**1,615**
(423)	Less: Translation foreign currency loss	**(163)**
36,506	Carrying value of the investment at 31 December 2005	**14,055**

The quoted market value of the Bank's shareholding in CBoP at 31 December 2005 was RO 59.74 million.

8 INVESTMENTS IN ASSOCIATE AND GOODWILL (continued)

Investment in Centurion Bank of Punjab Limited (continued)

The Bank's share of the total recognised gains and losses of associate are reflected on the basis of the audited financial statements of CBoP for the period from 01 January 2005 to 30 September 2005 and on the basis of unaudited published results of CBoP for the period 01 October 2005 to 31 December 2005.

The financial statements of CBoP are prepared as per the accounting standards, statutory provisions, and generally accepted practices prevailing within the banking industry in India (Indian GAAP). The Management of the Bank believes that it is not practicable to restate the financial statements of CBoP in order to reflect the position as per International Financial Reporting Standards.

Investment in BankMuscat International, Bahrain

On 01 January 2005, the Bank acquired 49% of the paid up capital of BMI (refer note 3). The carrying value of the investment in BMI as on 31 December 2005 was as follows:

	RO '000
Total consideration paid	10,013
Add: Share of profit from BMI	2,049
Carrying value of investment	**12,062**

Goodwill

At 01 January 2005, goodwill in the amount of RO 2,369,000 related to the acquisition of Al Ahlia Securities SAOG (RO 230,000) and Centurion Bank Limited (RO 2,139,000). On adoption of IFRS 3 and IAS 36 (revised), the Bank ceased annual goodwill amortization and commenced testing for impairment. Based on the annual impairment testing, the goodwill related to acquisition of Al Ahlia Securities is considered to be fully impaired and accordingly the carrying value of the goodwill has been adjusted to reflect the impairment. The carrying value of the goodwill in CBoP is as follows:

2004 USD '000	2005 USD '000		2005 RO '000	2004 RO '000
909	**6,152**	01 January 2004	**2,369**	350
6,594	**-**	Goodwill at the time of acquisition of CBoP	**-**	2,539
(1,351)	**-**	Amortisation during the year	**-**	(520)
-	**(597)**	Impairment during the year	**(230)**	-
-	**(160)**	Translation of foreign currency loss	**(62)**	-
6,152	**5,395**	31 December 2005	**2,077**	2,369

9 PROPERTY AND EQUIPMENT

	Freehold land and buildings RO '000	Furniture, fixtures and equipment RO '000	Motor vehicles RO '000	Total RO '000
Cost or valuation:				
At 01 January 2005	6,553	31,382	633	38,568
Additions during the year	-	2,410	99	2,509
Disposals	-	(40)	(180)	(220)
Transfers – Bahrain branch disposal	-	(2,265)	(62)	(2,327)
At 31 December 2005	6,553	31,487	490	38,530
Depreciation:				
At 01 January 2005	2,908	23,341	417	26,666
Charge for the year	267	2,671	84	3,022
Relating to disposals	-	(32)	(171)	(203)
Transfers – Bahrain branch disposal	-	(1,544)	(47)	(1,591)
At 31 December 2005	3,175	24,436	283	27,894
Net book value:				
At 31 December 2005	**3,378**	**7,051**	**207**	**10,636**
At 31 December 2005 (USD)	**8,774**	**18,315**	**537**	**27,626**
At 31 December 2004	3,645	8,044	213	11,902
At 31 December 2004 (USD)	9,467	20,893	553	30,913

The land and buildings owned by the Bank were revalued as of 31 December 2002 by independent professional valuers on an open market basis. The gross carrying amount of the land and buildings was restated so that the net carrying amount of the asset after its revaluation equals its revalued amount, surplus on revaluation was credited to revaluation reserve.

If freehold land and buildings had been carried at cost less depreciation, the carrying amount would have been RO 1,563,000 (2004 – RO 1,810,000).

The net book value of furniture, fixtures and equipment includes an amount of RO 227,000 (2004 – RO 364,000) in respect of assets held under finance leases.

10 OTHER ASSETS

(Restated) 2004 USD '000	2005 USD '000		2005 RO '000	(Restated) 2004 RO '000
10,707	**12,896**	Accrued interest	**4,965**	4,122
25,572	**12,806**	Other debtors and prepaid expenses	**4,931**	9,845
1,684	**1,337**	Deferred tax assets (note 17)	**515**	649
8,805	**87,678**	Positive fair value of derivatives (note 32)	**33,756**	3,390
33,019	**32,480**	Collateral pending sale (net of provisions)	**12,505**	12,712
124,380	**91,016**	Acceptances	**35,041**	47,886
4,173	**7,821**	Others	**3,010**	1,607
208,340	**246,034**		**94,723**	80,211

Collateral pending sale includes properties acquired from borrowers as part of settlement agreement of loans and advances. The properties have been registered in the name of the Bank.

11 DEPOSITS FROM BANKS

2004 USD '000	2005 USD '000		2005 RO '000	2004 RO '000
11,394	**20,853**	Vostro balances	**8,029**	4,387
315,217	**97,443**	Inter bank borrowings	**37,515**	121,358
125,000	**25,000**	Other money market deposits	**9,625**	48,125
451,611	**143,296**		**55,169**	173,870

12 CUSTOMERS' DEPOSITS

2004 USD '000	2005 USD '000		2005 RO '000	2004 RO '000
619,966	**777,368**	Current accounts	**299,287**	238,687
745,655	**878,751**	Savings accounts	**338,319**	287,077
170,032	**408,847**	Call accounts	**157,406**	65,463
1,341,297	**1,276,005**	Deposit accounts	**491,262**	516,399
7,732	**12,808**	Margin accounts	**4,931**	2,977
2,884,682	**3,353,779**		**1,291,205**	1,110,603

Deposits from the private sector constitute 79% of total customers' deposits (2004 - 76%). The remaining 21% of the total customer deposits (2004 - 24%) is received from Ministries and other Government organisations.

13 CERTIFICATES OF DEPOSIT

Certificates of deposit issued by the Bank are unsecured and are denominated in Rial Omani and US Dollars. The maturity profile and interest rate of certificates of deposit are disclosed in notes 36 and 38 respectively.

14 UNSECURED BONDS

Unsecured bonds are non-convertible, unsecured and listed on the Muscat Securities Market. The bonds have a maturity of 10 years. The maturity profile and interest rate of unsecured bonds are disclosed in notes 36 and 38 respectively.

15 FLOATING RATE NOTES

Floating rate notes are issued by the Bank under its Euro Medium Term Note Programme and are denominated in US Dollars. The notes carry a floating interest rate of Libor plus 70 basis points. These are non-convertible, unsecured and listed on the Luxembourg Stock Exchange. The maturity profile and interest rates of floating rate notes are disclosed in notes 36 and 38 respectively.

16 OTHER LIABILITIES

(Restated) 2004 USD '000	2005 USD '000		2005 RO '000	(Restated) 2004 RO '000
19,223	**31,969**	Accrued interest	**12,308**	7,401
5,078	**2,590**	Unearned discount and interest	**997**	1,955
8,962	**85,332**	Negative fair value of derivatives (note 32)	**32,853**	3,450
147,610	**-**	AES Barka IPO subscription	**-**	56,830
3,912	**4,278**	Employee terminal benefits	**1,647**	1,506
124,380	**91,016**	Acceptances	**35,041**	47,886
113,926	**86,443**	Other liabilities and accrued expenses	**33,280**	43,862
423,091	**301,628**		**116,126**	162,890

The charge for the year and amounts paid in respect of employee terminal benefits were RO 296,000 (2004 – RO 292,000) and RO 86,000 (2004 - RO 250,000), respectively.

17 TAXATION

2004 USD '000	2005 USD '000		2005 RO '000	2004 RO '000
		Current liability:		
14,556	**18,828**	Current year	**7,249**	5,604
12,394	**14,395**	Prior years	**5,542**	4,772
26,950	**33,223**		**12,791**	10,376
		Deferred asset:		
1,560	**1,686**	At 01 January	**649**	600
126	**(349)**	Movement for the period	**(134)**	49
1,686	**1,337**	At 31 December	**515**	649
		The deferred asset comprises the following temporary differences:		
1,795	**1,121**	Provisions	**432**	691
(109)	**216**	Net book value of property and equipment	**83**	(42)
1,686	**1,337**		**515**	649
		Income statement:		
14,556	**18,829**	Current year	**7,249**	5,604
(126)	**349**	Deferred tax asset relating to temporary differences	**134**	(49)
14,430	**19,178**	Tax expense	**7,383**	5,555

17 TAXATION (continued)

The tax rate applicable to the Bank is 12% (2004 - 12%). For the purpose of determining the tax expense for the year, the accounting profit has been adjusted for tax purposes. Adjustments for tax purposes include items relating to both income and expense. After giving effect to these adjustments, the average effective tax rate is estimated to be 13.72% (2004 – 14.13%).

The difference between the applicable tax rate 12% (2004 – 12%) and the effective tax rate of 13.72% (2004 – 14.13%) arises due to the tax effect of income not considered to be taxable and expenses that are not considered to be deductible. The adjustments are based on the current understanding of the existing tax laws, regulations and practices.

Deferred tax asset has been recognised at the effective tax rate of 12%.

The Bank's assessments have been completed by the tax authorities upto tax year 2000.

The Bank has filed an objection with the tax authorities contesting certain adjustments made by the tax department in its assessment for tax years 1999 and 2000. The decision on the objection is awaited.

The assessments of the former banks that have merged with the Bank are at different stages of completion.

The tax assessments in respect of the former Indian branch has been completed by the tax authorities up to the financial years ended 31 March 2003. The tax authorities had made certain adjustments in the assessments issued for the tax years 1999 to 2002, which were not acceptable to the Bank. The Bank has filed an appeal with the tax authorities for tax years 1999 to 2003. The management is confident that the Bank will receive a favorable decision on the issue contested. The tax assessment in respect of the financial year ended 31 March 2004 is yet to be completed by the tax authorities.

The Bank is responsible for any tax liability that may arise from the outstanding assessments of these former banks.

18 SUBORDINATED LIABILITIES

In accordance with the Central Bank of Oman's regulations, fixed rate Rial Omani subordinated loans is included in the calculation of tier 2 capital as defined by the Bank for International Settlements (BIS) for capital adequacy purposes.

Subordinated loan capital is repayable at par on maturity. The maturity profile and interest rate of subordinated liabilities are disclosed in notes 36 and 38 respectively.

19 SHARE CAPITAL

Share capital

The authorised share capital of the Bank is 125,000,000 (2004 - 75,000,000) shares of RO 1 each. At 31 December 2005, 75,666,424 shares (2004 – 59,815,355) of RO 1 each have been issued and fully paid.

Issue of bonus shares

The Board of Directors have proposed a bonus issue of 7,566,642 shares of RO 1 each, which is subject to the approval of shareholders at the Annual General Meeting.

A bonus issue of 8,972,303 shares at RO 1 each for the year ended 31 December 2004 was issued during the year after approval in the Annual General Meeting held on 05 April 2005.

Issue of Global Depository Receipts

In October 2005, the Bank issued 6,878,765 ordinary shares including the option exercised by the lead managers, in the form of Global Depository Receipts ("GDRs") at RO 9.143 per share (USD 23.75 per share). Each GDR represents the right to receive one share of common stock. The issue closed on 29 September 2005 and GDRs were allotted on 4 October 2005. The nominal value of each GDR is RO 1 and the share premium on each GDR is in the amount of RO 8.143 per GDR. The Bank received a total amount of RO 62.89 million from the issue of the GDR including a total premium of RO 56 million. After adjusting the issue expenses of RO 2.633 million, an amount of RO 53.386 million was the amount credited to share premium account.

19 SHARE CAPITAL (continued)

Significant shareholders

As of 31 December 2005, the following shareholders held 10% or more of the Bank's capital, either individually or together with their family members:

	Number of shares	% holding
Royal Court Affairs	**15,176,819**	**20.06**
Sheikh Mustahil Ahmed Al Mashani and Group Companies	**9,951,112**	**13.15**

20 CONVERTIBLE BONDS

Pursuant to a merger agreement as of 31 December 2001 with the shareholders of former Industrial Bank of Oman (IBO), the Bank issued 25,000,000 compulsorily convertible bonds of RO 1.084 each to the IBO shareholders. The bonds had a maturity of a minimum of two years and carry an annual rate of interest of 8.5%.

In accordance with the terms of the merger agreement the bonds were converted into 5,477,651 shares of the Bank at RO 4.947 each during 2004. The nominal value of each share is RO 1 and the balance amount of RO 3.947 per share was credited to share premium account amounting to RO 21,622,349.

21 LEGAL AND GENERAL RESERVE

i) In accordance with the Omani Commercial Companies Law of 1974 the Bank is required to transfer 10% of its profit for the year to legal reserve until the accumulated balance of the reserve equals one third of the Bank's paid up share capital. The Bank has transferred RO 3.6 million to legal reserves from the profits in 2005 in order to fully meet the legal reserve requirements subsequent to increase in share capital. The reserve is not available for distribution.

ii) The general reserve is established to support the operations and the capital structure of the Bank.

22 SUBORDINATED LOAN RESERVE

Consistent with the BIS guidelines on capital adequacy, the Bank transferred an amount of RO 7.9 million during the year 2005 (2004: RO 9.1 million) representing 20% amortisation of the subordinated loans maturing within the next five years.

During 2005, subordinated loans amounting to RO 6 million were fully repaid. As a result, an amount of RO 4.8 million has been released from subordinated loan reserve to general reserve.

23 PROPOSED DIVIDENDS

The Board of Directors have proposed a cash dividend of RO 0.350 per share aggregating to RO 26.5 million on Bank's existing share capital subject to formal approval of the Annual General Meeting of the shareholders. During 2005, dividends of RO 0.250 per ordinary share (aggregating to RO 14.9 million) were declared and paid following approval at the Annual General Meeting on 05 April 2005.

During 2004, dividends of RO 0.250 per ordinary share (aggregating RO 12.8 million) were declared and paid.

24 COMMITMENTS AND CONTINGENT LIABILITIES

Credit related commitments

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

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

Standby letters of credit and guarantees commit the Bank to make payments on behalf of customers contingent upon the failure of the customer to perform under the terms of the contract.

Other off-balance sheet financial instrument

Swaps are contractual agreement between two parties to exchange interest payments based on a specific notional amount. For interest rate swaps, counter party generally exchange fiscal and floating rate interest payments based on a notional value in a single currency.

a) As of the balance sheet date, commitments on behalf of customers for which there were corresponding customer liabilities consisted of the following:

2004 USD '000	2005 USD '000		2005 RO '000	2004 RO '000
288,942	**301,226**	Letters of credit	**115,972**	111,243
590,048	**786,327**	Guarantees	**302,736**	227,168
878,990	**1,087,553**		**418,708**	338,411

The table below analyses the concentration of contingent liabilities and commitments by economic sector:

2004 USD '000	2005 USD '000		2005 RO '000	2004 RO '000
120,239	**143,874**	Import trade	**55,390**	46,292
199,274	**217,914**	Construction	**83,897**	76,720
92,612	**93,713**	Manufacturing	**36,080**	35,656
67,812	**95,480**	Services	**36,760**	26,108
33,129	**27,286**	Wholesale and retail trade	**10,505**	12,755
53,890	**28,471**	Government	**10,961**	20,747
239,364	**281,860**	Financial institutions	**108,516**	92,155
2,019	**37,464**	Agriculture and allied activities	**14,424**	777
23,608	**80,173**	Mining and quarrying	**30,867**	9,089
15,090	**55,096**	Transport	**21,212**	5,810
483	**1,210**	Export trade	**466**	186
31,470	**25,012**	Others	**9,630**	12,116
878,990	**1,087,553**		**418,708**	338,411

24 COMMITMENTS AND CONTINGENT LIABILITIES (continued)

b) As of the balance sheet date, capital commitments were as follows:

2004 USD '000	2005 USD '000		2005 RO '000	2004 RO '000
1,357	**2,402**	Purchase of property and equipment	**925**	523

c) Irrevocable commitments to extend credit at the balance sheet date amounted to RO 100,624,000 (2004 – RO 131,395,554).

d) As of the balance sheet date, the Bank has not pledged any of its assets as security (2004 - no assets pledged).

25 NET ASSETS PER SHARE

The calculation of net assets per share is based on net assets as at 31 December 2005 attributable to ordinary shareholders of RO 286.107 million (2004 - RO 194.344 million), and on 75,666,424 ordinary shares (2004 - 59,815,355 ordinary shares) being the number of shares outstanding as at 31 December 2005.

26 OTHER OPERATING INCOME

2004 USD '000	2005 USD '000		2005 RO '000	2004 RO '000
7,177	**6,289**	Foreign exchange	**2,421**	2,762
41,478	**42,971**	Commission and fees (net)	**16,544**	15,969
1,618	**2,136**	Dividend income	**822**	623
912	**4,346**	Profit on sale of non trading investments	**1,673**	351
5,554	**4,704**	Other income	**1,811**	2,138
56,739	**60,446**		**23,271**	21,843

The commission and fee income shown above is net of commission and fees paid of RO 154,750 (2004 – RO 134,507).

27 OTHER OPERATING EXPENSES

2004 USD '000	2005 USD '000		2005 RO '000	2004 RO '000
37,070	**36,775**	Employees' salaries	**14,158**	14,272
759	**769**	Employees' end of service benefits (note 16)	**296**	292
25,718	**27,530**	Other staff costs	**10,599**	9,901
1,934	**1,918**	Contribution to Social Insurance schemes	**738**	745
1,558	**68**	Directors' remuneration (note 30)	**26**	600
6,655	**6,660**	Occupancy costs	**2,564**	2,562
27,927	**32,199**	Other administrative expenses	**12,397**	10,752
101,621	**105,919**		**40,778**	39,124

28 EARNINGS PER SHARE

Basic earnings per share is calculated by dividing the net profit for the year by the weighted average number of shares outstanding during the year.

	2005 RO '000	2004 RO '000
Net profit attributable to ordinary shareholders for basic earnings per share	**45,444**	34,105
Weighted average number of shares outstanding during the year	**70,795**	69,130
Basic earnings per share (RO)	**0.642**	0.493
Basic earnings per share (USD)	**1.67**	1.28

Diluted earnings per share is not different from basic earnings per share as the Bank has not issued any instrument, which would have an impact on earnings per share when exercised.

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29 CASH AND CASH EQUIVALENTS

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

2004 USD '000	2005 USD '000		2005 RO '000	2004 RO '000
77,827	**80,019**	Cash and balances with Central Banks	**30,807**	29,964
233,015	**165,177**	Treasury bills	**63,593**	89,711
462,791	**630,121**	Placements with banks	**242,597**	178,174
(321,382)	**(105,784)**	Deposits from banks	**(40,727)**	(123,732)
452,251	**769,533**		**296,270**	174,117

30 RELATED PARTY TRANSACTIONS

In the ordinary course of business the Bank conducts transactions with certain of its directors, shareholders, senior management and companies in which they have a significant interest. The terms of these transactions are approved by the Bank's management. The balances as of the balance sheet date and transactions with directors and their related concerns during the year were as follows:

2004 USD '000	2005 USD '000		2005 RO '000	2004 RO '000
		Loans and advances		
158,819	**122,369**	01 January	**47,112**	61,145
15,312	**22,953**	Disbursed during the year	**8,837**	5,895
(11,533)	**(7,179)**	Repaid during the year	**(2,764)**	(4,440)
(40,229)	**-**	Transferred during the year	**-**	(15,488)
122,369	**138,143**	31 December	**53,185**	47,112
		Current, deposit and other accounts		
84,952	**73,877**	01 January	**28,442**	32,706
33,384	**18,820**	Received during the year	**7,246**	12,853
(44,459)	**(23,938)**	Repaid during the year	**(9,216)**	(17,117)
73,877	**68,759**	31 December	**26,472**	28,442

30 RELATED PARTY TRANSACTIONS (continued)

Loans, advances, or receivables due from related parties or holders of 10% or more of the Bank's shares, or their family members, less all provisions and write-offs, can be further analysed as follows:

2004 USD '000	2005 USD '000		2005 RO '000	2004 RO '000
40,878	**43,948**	Royal Court Affairs	**16,920**	15,738
76,966	**90,636**	Sheikh Mustahil Ahmed Al Mashani and Group Companies	**34,895**	29,632
117,844	**134,584**		**51,815**	45,370

The income and expenses in respect of related parties included in the financial statements are as follows:

2004 USD '000	2005 USD '000		2005 RO '000	2004 RO '000
4,444	**5,736**	Interest income	**2,208**	1,711
2,854	**2,333**	Interest expense	**898**	1,099
101	**122**	Commission and other income	**47**	39
1,558	**68**	Directors' remuneration (note 27)	**26**	600
460	**451**	Directors' sitting fee	**174**	177

Interest expense incurred on deposits:

Items of expense which were paid to related parties or holders of 10% or more of the Bank's shares, or their family members, during the year can be further analysed as follows:

2004 USD '000	2005 USD '000		2005 RO '000	2004 RO '000
538	**144**	Royal Court Affairs	**55**	207
2,294	**2,172**	Sheikh Mustahil Ahmed Al Mashani and Group Companies	**836**	883
2,832	**2,316**		**891**	1,090

The total remuneration for the top five executives of the Bank was in the amount of RO 1.93 million (2004 - RO 1.79 million).

31 FIDUCIARY ACTIVITIES

The Bank's fiduciary activities consist of investment management activities conducted as trustee and manager for a number of investment funds and individuals. The aggregate amounts of funds managed, which are not included in the Bank's balance sheet, are as follows:

2004 USD '000	2005 USD '000		2005 RO '000	2004 RO '000
85,866	**75,559**	Funds under management	**29,090**	33,058

32 DERIVATIVES

In the ordinary course of business the Bank 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 instrument, reference rate or index. The Bank uses the following derivative financial instruments:

Derivative product types

Forwards and futures are contractual agreements to either buy or sell a specified currency, commodity or financial instrument at a specific price and date in the future. Forwards are customised contracts transacted in the over-the-counter market. Forward rate agreements are effectively tailor-made interest rate futures which fix a forward rate of interest on a notional loan, for an agreed period of time starting on a specified future date.

Interest rate swaps are contractual agreements between two parties to exchange interest differentials based on a specific notional amount. Counterparties generally exchange fixed and floating rate interest payments based on a notional value in a single currency.

Options are contractual agreements that convey the right, but not the obligation, to either buy or sell a specific amount of a commodity, foreign currency or financial instrument at a fixed price, either at a fixed future date or at any time within a specified period. The Bank transacts only in currency options for its customers. The Bank does not engage in the writing of options.

Derivatives held or issued for hedging purposes

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

The Bank uses forward foreign exchange contracts, currency options and currency swaps to hedge against specifically identified currency risks. In addition, the Bank uses interest rate swaps to hedge against the changes in the cash flow arising from certain fixed interest rate loans and deposits.

For interest rate risk strategic hedging is carried out by monitoring the repricing of financial assets and liabilities and entering into interest rate swaps to hedge a proportion of the interest rate exposure. As strategic hedging does not qualify for special hedge accounting, the related derivatives are accounted for as trading instruments.

32 DERIVATIVES *(continued)*

The table below shows the positive and negative fair values of derivative financial instruments, which are equivalent to the market values, together with the notional amounts analysed by the term to maturity. The notional amount is the amount of a derivative's underlying asset, reference rate or index and is the basis upon which changes in the value of derivatives are measured.

31 December 2005:

	Positive fair value RO '000 (note 10)	Negative fair value RO '000 (note 16)	Notional amount total RO '000	Notional amounts by term to maturity: Within 3 months RO '000	3 - 12 months RO '000	More than 1 year RO '000
Derivatives held for trading:						
Interest rate swaps	**31,381**	**31,389**	**120,485**	**21,078**	**1,200**	**98,207**
Forward rate agreement	**-**	**-**	**-**	**-**	**-**	**-**
Forward foreign exchange purchase contracts	**2,272**	**-**	**205,722**	**139,763**	**62,118**	**3,841**
Forward foreign exchange sales contracts	**-**	**1,361**	**205,268**	**139,343**	**62,084**	**3,841**
Interest CAP	**103**	**103**	**1,998**	**-**	**-**	**1,998**
Total	**33,756**	**32,853**				
Total USD	**87,678**	**85,332**				

31 December 2004:

	Positive fair value RO '000 (note 10)	Negative fair value RO '000 (note 16)	Notional amount total RO '000	Notional amounts by term to maturity: Within 3 months RO '000	3 - 12 months RO '000	More than 1 year RO '000
Derivatives held for trading:						
Interest rate swaps	1,974	2,381	52,178	21,186	12,320	18,672
Forward rate agreement	101	83	3,850	-	-	3,850
Forward foreign exchange purchase contracts	1,315	-	225,149	120,701	83,019	21,429
Forward foreign exchange sales contracts	-	986	224,944	121,303	83,102	20,539
Interest CAP	-	-	1,399	-	-	1,399
Total	3,390	3,450				
Total USD	8,805	8,962				

Options

As of the balance sheet date, there were outstanding currency options entered on behalf of customers, all maturing within one year as summarised below:

2004 USD '000	2005 USD '000		2005 RO '000	2004 RO '000
159,476	**67,995**	Sales	**26,178**	61,398
159,476	**67,995**	Purchases	**26,178**	61,398

The terms of the currency options entered on behalf of customers have been negotiated with the counter party banks to match the terms of commitments. The aggregate fair value of the respective rights and obligations in respect of the currency options at 31 December 2005 was not significant and has not been recorded in the financial statements (2004 – not significant and not recorded).

33 CURRENCY RISK

The Bank had the following significant net exposures denominated in foreign currencies as of 31 December:

2004 USD '000	2005 USD '000		2005 RO '000	2004 RO '000
149,073	**171,621**	US Dollar	**66,074**	57,393
1,558	**182**	UAE Dirhams	**70**	600
4,361	**2,548**	Others	**981**	1,679
154,992	**174,351**		**67,125**	59,672

34 REPURCHASE AGREEMENTS

The Bank did not have any repurchase transactions outstanding as of the balance sheet date (2004 - nil).

35 CAPITAL ADEQUACY

The international standard for measuring capital adequacy is the risk asset ratio, which relates capital to balance sheet assets and off balance sheet exposures weighted according to broad categories of risk.

The risk asset ratio calculated in accordance with the capital adequacy guidelines of the BIS was as follows:

2004 USD '000	2005 USD '000		2005 RO '000	2004 RO '000
		Capital		
482,595	**666,748**	Tier 1	**256,698**	185,799
63,771	**74,379**	Tier 2	**28,636**	24,552
546,366	**741,127**	Total capital base	**285,334**	210,351
		Risk weighted assets		
3,162,608	**3,562,927**	Balance sheet items	**1,371,727**	1,217,604
405,540	**596,717**	Off balance sheet items	**229,736**	156,133
3,568,148	**4,159,644**	Total risk weighted assets	**1,601,463**	1,373,737
		Risk asset ratios (%)		
15.31%	**17.82%**	Total capital	**17.82%**	15.31%
13.53%	**16.03%**	Tier 1 capital	**16.03%**	13.53%

Notes:

(a) Tier 1 capital comprises mainly shareholders' funds less goodwill and investment in associates.

(b) Shareholders funds include an amount of proposed dividends of RO 26.5 million (2004 - RO 14.9 million).

(c) Tier 2 capital comprises revaluation reserves, subordinated loan capital and general loan loss provision to the extent permitted by the BIS guidelines.

(d) Subordinated loans in excess of 50% of tier 1 capital have not been considered under tier 2 capital.

36 MATURITY PROFILE OF ASSETS AND LIABILITIES

The asset and liability maturity profile was as follows:

31 December 2005	On demand or within three months RO '000	Four months to 12 months RO '000	One to five years RO '000	More than five years RO '000	Total RO '000
Cash and balances with Central Banks	30,807	-	-	2,129	32,936
Placements with banks	242,597	37,741	33,350	3,047	316,735
Loans and advances	250,681	233,813	567,745	319,691	1,371,930
Investments	86,974	2,600	45,307	29,899	164,780
Goodwill, property & equipment and other assets	3,351	-	-	104,085	107,436
Total assets	614,410	274,154	646,402	458,851	1,993,817
Deposits from banks	40,727	2,810	9,625	2,007	55,169
Customers' deposits and certificates of deposit	457,023	294,100	366,046	215,781	1,332,950
Unsecured bonds and floating rate notes	-	-	96,250	54,803	151,053
Other liabilities and taxation	11,155	-	-	117,762	128,917
Subordinated liabilities	39,621	-	-	-	39,621
Shareholders' funds	-	-	-	286,107	286,107
Total liabilities and equity	548,526	296,910	471,921	676,460	1,993,817

31 December 2005	On demand or within three months USD '000	Four months to 12 months USD '000	One to five years USD '000	More than five years USD '000	Total USD '000
Cash and balances with Central Banks	80,019	-	-	5,530	85,549
Placements with banks	630,121	98,029	86,624	7,913	822,687
Loans and advances	651,117	607,306	1,474,662	830,370	3,563,455
Investments	225,905	6,753	117,681	77,659	427,998
Goodwill, property & equipment and other assets	8,704	-	-	270,351	279,055
Total assets	1,595,866	712,088	1,678,967	1,191,823	5,178,744
Deposits from banks	105,784	7,299	25,000	5,213	143,296
Customers' deposits and certificates of deposit	1,187,074	763,895	950,768	560,471	3,462,208
Unsecured bonds and floating rate notes	-	-	250,000	142,345	392,345
Other liabilities and taxation	28,976	-	-	305,875	334,851
Subordinated liabilities	102,911	-	-	-	102,911
Shareholders' funds	-	-	-	743,133	743,133
Total liabilities and equity	1,424,745	771,194	1,225,768	1,757,037	5,178,744

36 MATURITY PROFILE OF ASSETS AND LIABILITIES (continued)

31 December 2004	On demand or within three months RO '000	Four months to 12 months RO '000	One to five years RO '000	More than five years RO '000	Total RO '000
Cash and balances with Central Banks	29,963	-	-	2,129	32,092
Placements with banks	178,174	71,775	19,994	1,538	271,481
Loans and advances	197,940	313,665	522,043	295,730	1,329,378
Investments	120,369	20,610	15,988	15,874	172,841
Goodwill, property & equipment and other assets	-	-	-	94,482	94,482
Total assets	526,446	406,050	558,025	409,753	1,900,274
Deposits from banks	123,732	49,338	-	800	173,870
Customers' deposits and certificates of deposit	471,841	274,760	269,212	146,307	1,162,120
Unsecured bonds and floating rate notes	-	-	96,250	54,803	151,053
Other liabilities and taxation	80,336	-	-	92,930	173,266
Subordinated liabilities	-	6,000	39,621	-	45,621
Shareholders' funds	-	-	-	194,344	194,344
Total liabilities and equity	675,909	330,098	405,083	489,184	1,900,274

31 December 2004	On demand or within three months USD '000	Four months to 12 months USD '000	One to five years USD '000	More than five years USD '000	Total USD '000
Cash and balances with Central Banks	77,827	-	-	5,530	83,357
Placements with banks	462,791	186,428	51,933	3,993	705,145
Loans and advances	514,130	814,714	1,355,957	768,130	3,452,931
Investments	312,648	53,532	41,528	41,230	448,938
Goodwill, property & equipment and other assets	-	-	-	245,405	245,405
Total assets	1,367,396	1,054,674	1,449,418	1,064,288	4,935,776
Deposits from banks	321,382	128,151	-	2,078	451,611
Customers' deposits and certificates of deposit	1,225,560	713,663	699,250	380,019	3,018,492
Unsecured bonds and floating rate notes	-	-	250,000	142,345	392,345
Other liabilities and taxation	208,664	-	-	241,377	450,041
Subordinated liabilities	-	15,584	102,911	-	118,495
Shareholders' funds	-	-	-	504,792	504,792
Total liabilities and equity	1,755,606	857,398	1,052,161	1,270,611	4,935,776

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37 GEOGRAPHICAL DISTRIBUTION OF ASSETS AND LIABILITIES

The geographical distribution of assets and liabilities was as follows:

31 December 2005	Sultanate of Oman RO '000	Other GCC countries RO '000	Europe RO '000	United States of America RO '000	Others RO '000	Total RO '000
Cash and balances with Central Banks	32,936	-	-	-	-	32,936
Placements with banks	70,443	152,098	19,650	6,931	67,613	316,735
Loans and advances	1,346,410	15,080	2,412	-	8,028	1,371,930
Investments	70,423	12,538	2,472	63,004	16,343	164,780
Goodwill, property & equipment and other assets	107,436	-	-	-	-	107,436
Total assets	1,627,648	179,716	24,534	69,935	91,984	1,993,817
Deposits from banks	30,934	8,138	15,686	113	298	55,169
Customers' deposits and certificates of deposit	1,302,768	16,372	1,587	11,235	988	1,332,950
Unsecured bonds and floating rate notes	54,803	-	96,250	-	-	151,053
Other liabilities and taxation	128,917	-	-	-	-	128,917
Subordinated liabilities	39,621	-	-	-	-	39,621
Shareholders' funds	286,107	-	-	-	-	286,107
Total liabilities	1,843,150	24,510	113,523	11,348	1,286	1,993,817

31 December 2005	Sultanate of Oman USD '000	Other GCC countries USD '000	Europe USD '000	United States of America USD '000	Others USD '000	Total USD '000
Cash and balances with Central Banks	85,549	-	-	-	-	85,549
Placements with banks	182,966	395,059	51,040	18,003	175,619	822,687
Loans and advances	3,497,169	39,169	6,265	-	20,852	3,563,455
Investments	182,915	32,567	6,421	163,646	42,449	427,998
Goodwill, property & equipment and other assets	279,055	-	-	-	-	279,055
Total assets	4,227,654	466,795	63,726	181,649	238,920	5,178,744
Deposits from banks	80,345	21,138	40,744	294	775	143,296
Customers' deposits and certificates of deposit	3,383,812	42,525	4,123	29,182	2,566	3,462,208
Unsecured bonds and floating rate notes	142,345	-	250,000	-	-	392,345
Other liabilities and taxation	334,851	-	-	-	-	334,851
Subordinated liabilities	102,911	-	-	-	-	102,911
Shareholders' funds	743,133	-	-	-	-	743,133
Total liabilities	4,787,397	63,663	294,867	29,476	3,341	5,178,744

37 GEOGRAPHICAL DISTRIBUTION OF ASSETS AND LIABILITIES (continued)

31 December 2004	Sultanate of Oman RO '000	Other GCC countries RO '000	Europe RO '000	United States of America RO '000	Others RO '000	Total RO '000
Cash and balances with Central Banks	29,284	2,808	-	-	-	32,092
Placements with banks	19,208	131,094	20,544	1,329	99,306	271,481
Loans and advances	1,188,950	123,362	92	-	16,974	1,329,378
Investments	99,560	3,706	1,313	58,664	9,598	172,841
Goodwill, property & equipment and other assets	92,828	1,654	-	-	-	94,482
Total assets	1,429,830	262,624	21,949	59,993	125,878	1,900,274
Deposits from banks	5,315	79,805	74,458	9,632	4,660	173,870
Customers' deposits and certificates of deposit	1,013,724	71,618	62,569	11,998	2,211	1,162,120
Unsecured bonds and floating rate notes	54,803	-	96,250	-	-	151,053
Other liabilities and taxation	157,668	15,598	-	-	-	173,266
Subordinated liabilities	45,621	-	-	-	-	45,621
Shareholders' funds	194,344	-	-	-	-	194,344
Total liabilities	1,471,475	167,021	233,277	21,630	6,871	1,900,274

31 December 2004	Sultanate of Oman USD '000	Other GCC countries USD '000	Europe USD '000	United States of America USD '000	Others USD '000	Total USD '000
Cash and balances with Central Banks	76,061	7,296	-	-	-	83,357
Placements with banks	49,891	340,503	53,361	3,451	257,939	705,145
Loans and advances	3,088,181	320,421	240	-	44,089	3,452,931
Investments	258,597	9,627	3,411	152,375	24,928	448,938
Goodwill, property & equipment and other assets	241,111	4,294	-	-	-	245,405
Total assets	3,713,841	682,141	57,012	155,826	326,956	4,935,776
Deposits from banks	13,805	207,285	193,397	25,018	12,106	451,611
Customers' deposits and certificates of deposit	2,633,049	186,021	162,515	31,165	5,742	3,018,492
Unsecured bonds and floating rate notes	142,345	-	250,000	-	-	392,345
Other liabilities and taxation	409,527	40,514	-	-	-	450,041
Subordinated liabilities	118,495	-	-	-	-	118,495
Shareholders' funds	504,792	-	-	-	-	504,792
Total liabilities	3,822,013	433,820	605,912	56,183	17,848	4,935,776

38 INTEREST RATE RISK MANAGEMENT

Interest rate sensitivity position

Interest rate risk arises from the possibility of changes in interest rates and mismatches or gaps in the amounts of assets and liabilities and off balance sheet instruments that mature or reprice in a given period. The Bank manages this risk by matching the repricing of assets and liabilities, and through risk management strategies. The Bank's interest rate sensitivity position, based on the contractual repricing or maturity dates, whichever dates are earlier, is as follows:

31 December 2005	Effective annual interest rate %	Floating rate or within 3 months RO '000	Months 4 to 12 RO '000	Years 1 to 5 RO '000	Over 5 years RO '000	Non interest sensitive RO '000	Total RO '000
Cash and balances with Central Banks	None/2.00	-	-	-	2,129	30,807	32,936
Placements with banks	3.42	260,338	22,310	31,040	3,047	-	316,735
Loans and advances	7.95	396,437	275,707	456,225	243,561	-	1,371,930
Investments	4.6/2.25	86,974	2,600	45,307	29,899	-	164,780
Goodwill, property & equipment and other assets	None	-	-	-	-	107,436	107,436
Total assets		743,749	300,617	532,572	278,636	138,243	1,993,817
Deposits from banks	2.37	50,352	2,810	-	2,007	-	55,169
Customers' deposits and certificates of deposit	1.502	457,023	294,100	366,046	215,781	-	1,332,950
Unsecured bonds and floating rate notes	6.59/4.08	96,250	-	-	54,803	-	151,053
Other liabilities and taxation	None	-	-	-	-	128,917	128,917
Subordinated liabilities	8.32	39,621	-	-	-	-	39,621
Shareholders' funds	None	-	-	-	-	286,107	286,107
Total liabilities and Shareholders' funds		643,246	296,910	366,046	272,591	415,024	1,993,817
Total interest rate sensitivity gap		100,503	3,707	166,526	6,045	(276,781)	-
Cumulative interest rate sensitivity gap		100,503	104,210	270,736	276,781	-	-
In USD ('000)		261,047	270,675	703,210	718,912	-	-

38 INTEREST RATE RISK MANAGEMENT (continued)

31 December 2004	Effective annual interest rate %	Floating rate or within 3 months RO '000	Months 4 to 12 RO '000	Years 1 to 5 RO '000	Over 5 years RO '000	Non interest sensitive RO '000	Total RO '000
Cash and balances with Central Banks	None/2.00	-	-	-	2,129	29,963	32,092
Placements with banks	1.80	202,628	64,517	2,798	1,538	-	271,481
Loans and advances	7.99	363,994	342,789	385,456	237,097	42	1,329,378
Investments	4.65/0.82	100,095	20,610	15,988	10,904	25,244	172,841
Goodwill, property & equipment and other assets	None	-	-	-	-	94,482	94,482
Total assets		666,717	427,916	404,242	251,668	149,731	1,900,274
Deposits from banks	1.77	171,857	1,213	-	800	-	173,870
Customers' deposits and certificates of deposit	1.59	457,989	274,760	269,211	146,308	13,852	1,162,120
Unsecured bonds and floating rate notes	6.73/2.51	96,250	-	-	54,803	-	151,053
Other liabilities and taxation	None	-	-	-	-	173,266	173,266
Subordinated liabilities	9.77	-	6,000	39,621	-	-	45,621
Equity	None	-	-	-	-	194,344	194,344
Total liabilities and equity		726,096	281,973	308,832	201,911	381,462	1,900,274
Total interest rate sensitivity gap		(59,379)	145,943	95,410	49,757	(231,731)	-
Cumulative interest rate sensitivity gap		(59,379)	86,564	181,974	231,731	-	-
In USD ('000)		(154,231)	224,842	472,660	601,899	-	-

(i) The off-balance sheet gap represents the net notional amount of off-balance sheet financial instruments, including interest rate swap, which are used to manage interest rate risk.

(ii) The repricing profile is based on the remaining period to the next interest repricing date.

(iii) An asset (or positive) gap position exists when assets reprice more quickly or in greater proportion than liabilities during a given period and tends to benefit net interest income in a rising interest rate environment. A liability (or negative) gap position exists when liabilities reprice more quickly or in greater proportion than assets during a given period and tends to benefit net interest income in a declining interest rate environment.

39 SEGMENTAL INFORMATION

For management purposes the Bank reports its primary segment information of its operations by the following geographical locations:

For the year ended 31 December 2005.

(i) Oman (ii) International

Segment information in respect of geographical locations is as follows:

Total USD '000	International USD '000	Oman USD '000		Oman RO '000	International RO '000	Total RO '000
			Segment revenue			
301,343	-	301,343	Interest income	116,017	-	116,017
60,446	-	60,446	Operating income	23,271	-	23,271
(98,589)	-	(98,589)	Interest costs	(37,956)	-	(37,956)
263,200	-	263,200	Operating income	101,332	-	101,332
			Segment costs			
(105,919)	-	(105,919)	Other operating expenses	(40,778)	-	(40,778)
(8,446)	-	(8,446)	Depreciation and impairment	(3,252)	-	(3,252)
(1,289)	-	(1,289)	Provision for collateral pending sale and acquired assets	(496)	-	(496)
(63,274)	-	(63,274)	Impairment for credit losses	(24,361)	-	(24,361)
41,294	-	41,294	Recoveries from impairment for credit losses	15,898	-	15,898
9,516	9,516	-	Share of profit from associate	-	3,664	3,664
7,340	7,340	-	Gain on disposal of a branch	-	2,826	2,826
(10,245)	(10,245)	-	Share of trading loss of an associate	-	(3,945)	(3,945)
5,036	-	5,036	Recoveries from impaired placements	1,939	-	1,939
(19,178)	-	(19,178)	Tax expense	(7,383)	-	(7,383)
(145,165)	6,611	(151,776)	Total	(58,433)	2,545	(55,888)
118,035	6,611	111,424	Segment net profit for the year	42,899	2,545	45,444
			Other information			
5,178,744	67,834	5,110,910	Segment assets and liabilities	1,967,700	26,117	1,993,817
6,518	-	6,518	Segment capital expenses	2,509	-	2,509

39 SEGMENTAL INFORMATION (continued)

For the year ended 31 December 2004

Total USD '000	International USD '000	Oman USD '000		Oman RO '000	International RO '000	Total RO '000
			Segment revenue			
271,892	15,483	256,409	Interest income	98,718	5,960	104,678
56,739	7,651	49,088	Other operating income	18,899	2,944	21,843
2,480	(2)	2,482	Unrealised gain on investments available for sale	956	(1)	955
(76,469)	(6,669)	(69,800)	Interest expense	(26,873)	(2,567)	(29,440)
254,642	16,463	238,179	Operating income	91,700	6,336	98,036
			Segment costs			
(101,621)	(7,332)	(94,289)	Other operating expenses	(36,301)	(2,823)	(39,124)
(9,387)	(529)	(8,858)	Depreciation and amortisation	(3,409)	(204)	(3,613)
(264)	-	(264)	Provision for collateral pending sale	(102)	-	(102)
(52,995)	(450)	(52,545)	Impairment for credit losses	(20,230)	(173)	(20,403)
16,319	348	15,971	Recoveries from impairment for credit losses	6,149	134	6,283
(3,680)	(3,680)	-	Share of loss from associate	-	(1,417)	(1,417)
(14,430)	-	(14,430)	Tax expense	(5,555)	-	(5,555)
(166,058)	(11,643)	(154,415)	Total	(59,448)	(4,483)	(63,931)
88,584	4,820	83,764	Segment net profit for the year	32,252	1,853	34,105
			Other information			
4,935,776	438,306	4,497,470	Segment assets	1,731,526	168,748	1,900,274
7,805	617	7,188	Segment capital expenses	2,767	238	3,005

BankMuscat

39 SEGMENTAL INFORMATION *(continued)*

Although the primary reporting basis of the Bank is on geographical segments, the Bank reports its secondary segment information by the following business segments:

(i) Corporate banking
(ii) Retail banking
(iii) Treasury and investment banking
(iv) International

The following table shows the distribution of the Bank's net operating income and total assets by business segments:

For the year ended 31 December 2005

	Corporate	Retail	Treasury and Investment	International	Total
	RO '000	RO '000	RO '000	RO '000	RO '000
Operating income *	28,814	54,657	17,861	-	101,332
Segment assets	785,480	665,273	516,947	26,117	1,993,817
Operating income (USD '000) *	74,841	141,967	46,392	-	263,200
Segment assets (USD '000)	2,040,207	1,727,982	1,342,719	67,836	5,178,744

For the year ended 31 December 2004

	Corporate	Retail	Treasury and Investment	International	Total
	RO '000	RO '000	RO '000	RO '000	RO '000
Operating income	29,379	48,755	13,566	6,336	98,036
Segment assets	692,002	573,849	465,674	168,749	1,900,274
Operating income (USD '000)	76,310	126,637	35,238	16,457	254,642
Segment assets (USD '000)	1,797,407	1,490,518	1,209,543	438,308	4,935,776

* Share of profit from associates forming part of international operations amounting to RO 3.664 million (USD 9.516 million) does not form part of operating income.

40 FAIR VALUE INFORMATION

Based on the valuation methodology outlined below, the fair values of all on and off-balance sheet financial instruments at 31 December 2005 are considered by the Management not to be materially different from their book values:

Estimation of fair values

The following summarises the major methods and assumptions used in estimating the fair values of assets and liabilities.

Loans and advances

Fair value is calculated based on discounted expected future principal and interest cash flows. Loan repayments are assumed to occur at contractual repayment dates, where applicable. For loans that do not have fixed repayment dates or that are subject to prepayment risk, repayments are estimated based on experience in previous periods when interest rates were at levels similar to current levels, adjusted for any differences in interest rate outlook. Expected future cash flows are estimated considering credit risk and any indication of impairment. Expected future cash flows for homogeneous categories of loans are estimated on a portfolio basis and discounted at current rates offered for similar loans to new borrowers with similar credit profiles. The estimated fair values of loans reflect changes in credit status since the loans were made and changes in interest rates in the case of fixed rate loans.

Investments carried at cost and derivatives

Fair value is based on quoted market prices at the balance sheet date without any deduction for transaction costs. If a quoted market price is not available, fair value is estimated based on discounted cash flow and other valuation techniques.

Where discounted cash flow techniques are used, estimated future cash flows are based on management's best estimates and the discount rate is a market related rate for a similar instrument at the balance sheet date.

Bank and customer deposits

For demand deposits and deposits with no defined maturities, fair value is taken to be the amount payable on demand at the balance sheet date. The estimated fair value of fixed-maturity deposits, including certificates of deposit, is based on discounted cash flows using rates currently offered for deposits of similar remaining maturities. The value of long-term relationships with depositors is not taken into account in estimating fair values.

Other on-balance sheet financial instruments

The fair values of all on-balance sheet financial instruments are considered to approximate their book values.

Off-balance sheet financial instruments

No fair value adjustment is made with respect to credit-related off-balance sheet financial instruments, which include commitments to extend credit, standby letters of credit and guarantees, as the related future income streams materially reflect contractual fees and commissions actually charged at the balance sheet date for agreements of similar credit standing and maturity.

Foreign exchange contracts are valued based on market prices. The market value adjustments in respect of foreign exchange contracts are included in the book values of other assets and other liabilities.

41 SHARE OF TRADING LOSS IN AN ASSOCIATE

BankMuscat International (BMI) had a dispute regarding certain trading transactions entered into with a counter-party during 2005. The dispute was amicably resolved to the satisfaction of both the parties and both the parties had agreed to share the trading loss incurred in the transaction. BMI's share of the loss amounted to RO 8 million. It was resolved that the loss would be borne by the shareholders of BMI. Consequently, the Bank's share of the loss in the amount of RO 3.94 million was recognised in the financial statements for the year ended 31 December 2005.

42 TRANSLATION INTO US DOLLARS

The reporting currency of the Bank is Omani Rials. The US Dollar amounts, which are presented in these financial statements have been translated from the Omani Rial amounts at an exchange rate of USD 1 = RO 0.385.

43 COMPARATIVE FIGURES

The corresponding figures for 2004 included for comparative purposes have been reclassified to conform with the presentation in the current year. An amount of RO 35,041,000 in respect of acceptances (2004: RO 47,886,000), which was previously disclosed as an off-balance sheet item, have been included in other assets and other liabilities (refer note 2) in accordance with revised IAS-39.

DIFFERENCES BETWEEN INTERNATIONAL FINANCIAL REPORTING STANDARDS (IFRS) AND US GENERALLY ACCEPTED ACCOUNTING PRINCIPLES (US GAAP)

The financial statements of the Bank are prepared in accordance with the accounting principles as set out in the International Financial Reporting Standards (IFRS). Such principles differ in certain respects from US GAAP. The following is a summary of the significant differences with respect to the Bank's business:

Income statement

2004 USD '000	2005 USD '000		Notes	2005 RO '000	2004 RO '000
88,584	**118,035**	Profit for the year - IFRS		**45,444**	34,105
		Adjustments in respect of:			
46	**51**	Depreciation of property	a	**20**	18
		Net unrealised loss on			
(2,480)	**-**	Investment securities	c	**-**	(955)
(947)	**(833)**	Deferral of loan fees and costs	d	**(321)**	(364)
85,203	**117,253**	Net income - US GAAP		**45,143**	32,804

Shareholders' Funds

2004 USD '000	2005 USD '000		Note	2005 RO '000	2004 RO '000
504,792	**743,133**	Shareholders' funds - IFRS		**286,107**	194,344
452	**504**	Depreciation of property	a	**194**	174
(3,155)	**(3,155)**	Revaluation of property	b	**(1,215)**	(1,215)
(3,307)	**(4,141)**	Deferral of loan fees and costs	d	**(1,594)**	(1,273)
498,782	**736,341**	Shareholders' funds - US GAAP		**283,492**	192,030

a) Property depreciation

Depreciation is charged on the cost or revalued amounts of freehold and leasehold properties over their estimated useful economic lives. Under US GAAP freehold and leasehold property are depreciated based on historical cost.

b) Revaluation of property

Property is carried either at original cost or at subsequent valuation less related depreciation, calculated on the revalued amount where applicable. Revaluation surpluses are taken directly to shareholders' funds, while deficits below cost, less any related depreciation, are included in the income statement. Revaluation of properties is not permitted under US GAAP.

DIFFERENCES BETWEEN INTERNATIONAL FINANCIAL REPORTING STANDARDS (IFRS) AND US GENERALLY ACCEPTED ACCOUNTING PRINCIPLES (US GAAP) (continued)

c) Net unrealised gain and loss on investment securities

Under US GAAP, SFAS 115 requires that debt and certain marketable equity securities, which are intended for use on a continuing basis, be recorded at fair value with unrealised gains and losses recorded in shareholders' funds.

The Bank considers the Government securities as held to maturity securities and reports the value at cost. All other investment securities are classified as available for sale and are recorded at fair value through shareholders' funds subsequent to adoption of IAS 39 (revised) with effect from 01 January 2005.

d) Loan fees

Certain loan fees are recognised when received. Under US GAAP, all loan fees and certain direct costs are deferred and recognised as an adjustment to the yield on the related loan or facility.

Dubai Representative Office, UAE

Whilst functioning as a liaison office, the Representative Office in Dubai is the proactive marketing arm of the Bank in the UAE, sourcing business opportunities (funded and non-funded) in the field of corporate finance, financial institutions co-operation, syndications, investment banking and NRI business (INR, USD, GBP & Euro). The DRO completed its 10th anniversary in 2005.

Branch Network

At 31 December 2005

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