

Arcapita Bank B.S.C. (c)
INTERIM CONDENSED CONSOLIDATED
FINANCIAL STATEMENTS
31 DECEMBER 2010 (REVIEWED)

REPORT ON REVIEW OF INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS TO THE DIRECTORS OF ARCAPITA BANK B.S.C. (c)

Introduction

We have reviewed the accompanying interim condensed consolidated financial statements of Arcapita Bank B.S.C. (c) ('the Bank') and its subsidiaries ('the Group') as at 31 December 2010, comprising of the interim consolidated balance sheet as at 31 December 2010 and the related interim consolidated statements of income, changes in equity, cash flows and sources and uses of charity funds for the six month period then ended and explanatory notes. Management is responsible for the preparation and presentation of these interim condensed consolidated financial statements. Our responsibility is to express a conclusion on these interim condensed consolidated financial statements based on our review.

Scope of Review

We conducted our review in accordance with the International Standard on Review Engagements 2410, "Review of Interim Financial Information Performed by the Independent Auditor of the Entity". A review of interim financial information consists of making inquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures. A review is substantially less in scope than an audit conducted in accordance with International Standards on Auditing and consequently does not enable us to obtain assurance that we would become aware of all significant matters that might be identified in an audit. Accordingly, we do not express an audit opinion.

Conclusion

Based on our review, nothing has come to our attention that causes us to believe that the accompanying interim condensed consolidated financial statements are not prepared, in all material respects, in accordance with note 2.



14 February 2011
Manama, Kingdom of Bahrain

Arcapita Bank B.S.C. (c)

INTERIM CONSOLIDATED STATEMENT OF INCOME

For the six months ended 31 December 2010 (Reviewed)

	Note	Reviewed		Reviewed	
		Three month period from		Six month period from	
		1 October to 31 December	1 July to 31 December	2010	2009
		2010	2009	2010	2009
		US\$ '000	US\$ '000	US\$ '000	US\$ '000
TOTAL INCOME	4	117,903	(80,275)	265,322	(1,624)
Net Funding cost		(24,632)	(32,337)	(55,608)	(61,119)
NET OPERATING INCOME (LOSS)		93,271	(112,612)	209,714	(62,743)
OPERATING EXPENSES					
Staff compensation and benefits		(18,040)	(19,096)	(34,924)	(38,806)
General and administration expenses		(12,524)	(11,422)	(26,274)	(22,777)
Headquarter building expenses		(7,886)	(3,918)	(17,328)	(3,918)
		(38,450)	(34,436)	(78,526)	(65,501)
NET INCOME (LOSS) BEFORE ALLOWANCES		54,821	(147,048)	131,188	(128,244)
Allowance for doubtful receivables		(49,626)	(12,471)	(96,889)	(62,471)
NET INCOME (LOSS) FOR THE PERIOD		5,195	(159,519)	34,299	(190,715)

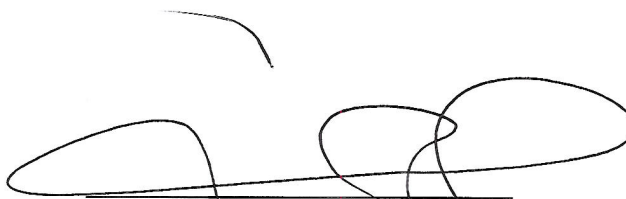
The attached notes 1 to 15 form part of these interim condensed consolidated financial statements.

Arcapita Bank B.S.C. (c)

INTERIM CONSOLIDATED BALANCE SHEET

At 31 December 2010 (Reviewed)

	<i>Note</i>	Reviewed 31 December 2010 US\$ '000	Audited 30 June 2010 US\$ '000
ASSETS			
Cash and short term funds		169,925	143,334
Receivables	5	1,153,484	1,073,959
Investments	6	2,126,603	2,074,420
Other assets		193,233	165,423
TOTAL ASSETS		3,643,245	3,457,136
LIABILITIES, UNRESTRICTED INVESTMENT ACCOUNTS AND EQUITY			
LIABILITIES			
Due to financial and other institutions		1,091,847	1,084,104
Medium-term financing facility		1,096,368	1,094,031
Other liabilities		41,165	36,372
Total liabilities excluding unrestricted investment accounts		2,229,380	2,214,507
Unrestricted investment accounts		291,457	182,469
Total liabilities including unrestricted investment accounts		2,520,837	2,396,976
EQUITY			
Share capital and premium		1,067,422	1,077,262
Reserves		15,705	(17,102)
Share subscription pending allotment		39,281	-
		1,122,408	1,060,160
TOTAL LIABILITIES, UNRESTRICTED INVESTMENT ACCOUNTS AND EQUITY		3,643,245	3,457,136



 Atif A. Abdulmalik
 Chief Executive Officer and Director

The attached notes 1 to 15 form part of these interim condensed consolidated financial statements.

Arcapita Bank B.S.C. (c)

INTERIM CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

For the six months ended 31 December 2010 (Reviewed)

	<i>Share Capital and Premium</i>			<i>Reserves*</i>	<i>Share subscription pending allotment</i>	<i>Total equity</i>	
	<i>Share capital</i>	<i>Share premium</i>	<i>Bank funded employee shares</i>				
	<i>US\$ '000</i>	<i>US\$ '000</i>	<i>US\$ '000</i>	<i>US\$ '000</i>	<i>US\$ '000</i>	<i>US\$ '000</i>	
Balance at 1 July 2010	311,323	954,175	(188,236)	1,077,262	(17,102)	-	1,060,160
Net income for the period	-	-	-	-	34,299	-	34,299
Total comprehensive income	-	-	-	-	34,299	-	34,299
Share subscription received	-	-	-	-	-	39,281	39,281
Repurchase of shares	(66)	(188)	-	(254)	-	-	(254)
Share-based compensation expense	-	-	-	-	(1,492)	-	(1,492)
Net movement in unallocated employee shares	-	-	(9,586)	(9,586)	-	-	(9,586)
	(66)	(188)	(9,586)	(9,840)	(1,492)	39,281	27,949
Balance at 31 December 2010	311,257	953,987	(197,822)	1,067,422	15,705	39,281	1,122,408
Balance at 1 July 2009	282,243	765,155	(168,221)	879,177	534,209	185,209	1,598,595
Net loss for the period	-	-	-	-	(190,715)	-	(190,715)
Total comprehensive loss	-	-	-	-	(190,715)	-	(190,715)
Share subscription received	-	-	-	-	-	32,891	32,891
Issue of shares	28,438	184,848	-	213,286	-	(213,286)	-
Share-based compensation expense	-	-	-	-	3,531	-	3,531
Net movement in unallocated employee shares	-	-	(15,034)	(15,034)	-	-	(15,034)
	28,438	184,848	(15,034)	198,252	3,531	(180,395)	21,388
Balance at 31 December 2009	310,681	950,003	(183,255)	1,077,429	347,025	4,814	1,429,268

* As at 31 December 2010 there were US\$344.3 million unrealized net gains (30 June 2010:nil) on investments which are not available for distribution in accordance with AAOIFI.

The attached notes 1 to 15 form part of these interim condensed consolidated financial statements.

Arcapita Bank B.S.C. (c)

INTERIM CONSOLIDATED STATEMENT OF CASH FLOWS

For the six months ended 31 December 2010 (Reviewed)

	<i>Reviewed Six month period from 1 July to 31 December 2010 US\$ '000</i>	<i>Reviewed Six month period from 1 July to 31 December 2009 US\$ '000</i>
OPERATING ACTIVITIES		
Net income (loss) for the period	34,299	(190,715)
Adjustments for non-cash items:		
Share-based compensation expense	(1,492)	3,531
Allowance for doubtful receivables	96,889	62,471
Changes in fair value of investments carried at fair value through statement of income	(81,867)	105,699
Operating income (loss) before changes in operating assets and liabilities	47,829	(19,014)
Changes in operating assets and liabilities:		
Receivables	(186,000)	195,521
Investments	29,684	(46,990)
Due to financial and other institutions	7,743	(141,852)
Other assets	(27,810)	(26,572)
Other liabilities	7,130	(24,545)
Net cash used in operating activities	(121,424)	(63,452)
FINANCING ACTIVITIES		
Share subscription received	39,281	32,891
Repurchase of shares	(254)	-
Movement in unrestricted investment accounts	108,988	(26,594)
Net cash from financing activities	148,015	6,297
NET MOVEMENT IN CASH AND CASH EQUIVALENTS	26,591	(57,155)
Cash and cash equivalents at beginning of the period	143,334	191,199
CASH AND CASH EQUIVALENTS AT END OF THE PERIOD	169,925	134,044
Cash and cash equivalents comprise:		
Cash and balances with banks	108,608	89,603
Transitory funds	-	44,365
Short term deposits	61,317	76
	169,925	134,044

The attached notes 1 to 15 form part of these interim condensed consolidated financial statements.

Arcapita Bank B.S.C. (c)

INTERIM CONSOLIDATED STATEMENT OF SOURCES AND USES OF
CHARITY FUNDS

For the six months ended 31 December 2010 (Reviewed)

	<i>Reviewed Six month period from 1 July to 31 December (Reviewed) 2010 US\$ '000</i>	<i>Reviewed Six month period from 1 July to 31 December (Reviewed) 2009 US\$ '000</i>
Undistributed charity funds at beginning of period	1,498	1,498
Funds utilized for charity	(1,498)	(247)
Undistributed charity funds at end of period	-	1,251

The attached notes 1 to 15 form part of these interim condensed consolidated financial statements.

NOTES TO THE INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

At 31 December 2010 (Reviewed)

1 INCORPORATION AND ACTIVITIES

a) Incorporation

Arcapita Bank B.S.C. (c) (the "Bank") was incorporated in November 1996 in the Kingdom of Bahrain, where its registered office is based, under commercial registration number 36403. The Bank operates under an Islamic wholesale banking license issued by the Central Bank of Bahrain ("CBB").

b) Activities

The activities of the Bank and its wholly-owned subsidiaries (together referred to as the "Group") include investing on own account and providing investment banking services in conformity with Islamic Shari'ah rules and principles.

2 ACCOUNTING POLICIES

These interim condensed consolidated financial statements have been prepared in conformity with International Accounting Standard 34 - "Interim Financial Reporting". The accounting policies used in the preparation of the interim condensed consolidated financial statements are consistent with those used in the preparation of the consolidated financial statements for the year ended 30 June 2010 (with the exception of new accounting Standards adopted after 30 June 2010), which were prepared in accordance with the Financial Accounting Standards issued by the Accounting and Auditing Organisation for Islamic Financial Institutions, International Financial Reporting Standards, the Shari'ah rules and principles as determined by the Shari'ah Supervisory Board of the Group. These interim condensed consolidated financial statements are presented in US dollars, which is the functional currency of the Group. All values are rounded to US dollar thousands unless otherwise indicated.

The interim condensed consolidated financial statements do not contain all information and disclosures required for full financial statements prepared in accordance with International Financial Reporting Standards (IFRS) or Financial Accounting Standards issued by the Accounting and Auditing Organisation for Islamic Financial Institutions.

The following are relevant IFRS and IFRIC interpretations that have been adopted since the date of the last audited consolidated financial statements of 30 June 2010.

- IAS 32 - Amendment - classification of rights issue, 1 February 2010;
- IFRIC 19 – Extinguishing financial liabilities with equity instruments, 1 July 2010;
- IFRS 2 Amendment – Group cash settled share based payment transactions, 1 January 2010; and
- 2009 Annual Improvements to IFRS, 1 January 2010.

The directors do not anticipate that the adoption of these standards and interpretations will have a material impact on the consolidated financial statements in the period of initial application.

The interim condensed consolidated financial statements were approved on 14 February 2011.

3 CYCLICALITY OF OPERATIONS

Operations of the Group follow the investment cycle, commencing from investment sourcing to acquisition and ultimately exit. Reported results of the Group are affected by the cyclicity of its operations, and hence acquisition, placement and exit income, management fee and some of the staff benefits for the interim period is not indicative of the Group's financial performance for the whole of the financial period.

NOTES TO THE INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

At 31 December 2010 (Reviewed)

4 TOTAL INCOME

	<i>Reviewed Six month period from 1 July to 31 December 2010 US\$ '000</i>	<i>Reviewed Six month period from 1 July to 31 December 2009 US\$ '000</i>
Foreign exchange revaluation net gains	90,745	10,480
Fair Value Changes	81,867	(105,699)
Management fees	48,674	48,091
Income from investee companies	35,410	36,912
Yield from investments and others	19,672	15,108
Acquisition and placement fees	1,497	7,389
Capital loss on exit and distribution	(12,543)	(13,905)
	<u>265,322</u>	<u>(1,624)</u>

5 RECEIVABLES

	<i>Reviewed 31 December 2010 US\$ '000</i>	<i>Audited 30 June 2010 US\$ '000</i>
Receivables and prepayments (Note 5(a))	406,644	382,592
Notes receivable (Note 5(b))	219,592	227,037
Murabaha with investee companies (Note 5(c))	527,248	464,330
	<u>1,153,484</u>	<u>1,073,959</u>

a) Receivables and prepayments

	<i>Reviewed 31 December 2010 US\$ '000</i>	<i>Audited 30 June 2010 US\$ '000</i>
Yield and management fee receivable	183,181	158,432
Subscriptions receivable	42,974	69,727
Receivable from investee companies	85,962	80,219
Prepayments and other receivable	94,527	74,214
	<u>406,644</u>	<u>382,592</u>

b) Notes receivable

	<i>Reviewed 31 December 2010 US\$ '000</i>	<i>Audited 30 June 2010 US\$ '000</i>
Employee Stock Purchase Plan	163,350	158,868
Investment Participation Plan	56,242	68,169
	<u>219,592</u>	<u>227,037</u>

NOTES TO THE INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

At 31 December 2010 (Reviewed)

5 RECEIVABLES (continued)

c) Murabaha with investee companies

	<i>Reviewed</i> 31 December 2010 <i>US\$ '000</i>	<i>Audited</i> 30 June 2010 <i>US\$ '000</i>
Commodity Murabaha receivable	548,082	484,814
Deferred profits	(20,834)	(20,484)
	527,248	464,330

d) Allowance for doubtful receivables

	<i>Reviewed</i> 31 December 2010 <i>US\$ '000</i>	<i>Audited</i> 30 June 2010 <i>US\$ '000</i>
Balance as at 1 July 2010 / 1 July 2009	-	45,000
Allowance made during the period	96,888	68,230
Provision written off	(96,888)	(113,230)
Balance as at 31 December 2010 / 30 June 2010	-	-

6 INVESTMENTS

	<i>Reviewed</i> 31 December 2010 <i>US\$ '000</i>	<i>Audited</i> 30 June 2010 <i>US\$ '000</i>
Private equity investments	595,869	644,150
Real estate investments	1,064,500	955,682
Infrastructure investments	466,234	474,588
	2,126,603	2,074,420
Planned retention	1,271,352	1,130,766
Available for placement with investors	855,251	943,654
	2,126,603	2,074,420
Average investment exposure (daily average)	2,224,313	2,394,769

Investment commitments amounted to US\$ 83.6 million (30 June 2010: US\$ 95.7 million). Investment commitments represent contractual commitments to fund certain deals. These commitments may expire without being drawn upon and do not necessarily represent future cash requirements.

IFRS 7 - Financial Instruments: Disclosures, requires that the classification of financial instruments at fair value be determined by reference to the source of inputs used to derive the fair value. This classification uses the following three level hierarchy:

Level 1 - quoted prices (unadjusted) in active markets for identical assets or liabilities.

NOTES TO THE INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

At 31 December 2010 (Reviewed)

6 INVESTMENTS (continued)

Level 2 - inputs other than quoted prices included within level 1 that are observable for the asset or liability, either directly (i.e., as prices) or indirectly (i.e., derived from prices). (e.g. quoted prices in an inactive market).

Level 3 - inputs for the asset or liability that are not based on observable market data (unobservable inputs). (e.g. valuation methodology using EV/EBITDA multiples or discounted cash flows).

The following table categorizes the Group's investments using the hierarchy explained in the preceding paragraphs.

	<i>Reviewed 31 December 2010 US\$ '000</i>	<i>Audited 30 June 2010 US\$ '000</i>
Level 1	6,570	12,500
Level 3	2,120,033	2,061,920
	2,126,603	2,074,420

The following table categorizes the movements within Level 3 investments from 1 July 2010 to 31 December 2010.

	<i>US\$ '000</i>
As at 1 July 2010	2,061,920
Net funding movements for investments	(107,991)
Net fair value adjustments	81,263
Foreign exchange movements	84,841
As at 31 December 2010	2,120,033

7 SHARE CAPITAL

	<i>Reviewed 31 December 2010 US\$ '000</i>	<i>Audited 30 June 2010 US\$ '000</i>
Authorized :		
800,000,000 (30 June 2010: 800,000,000) ordinary shares of US\$ 1 each	800,000	800,000
Issued and fully paid up :		
At beginning of the year :		
311,323,217 (30 June 2010: 282,243,170) ordinary shares of US\$ 1 each	311,323	282,243
Issued during the period :		
NIL (30 June 2010: 29,080,047) ordinary shares of US\$ 1 each	-	29,080
Less : treasury Shares		
66,666 (30 June 2010 : NIL) ordinary shares of US\$ 1 each	(66)	-
Issued and paid up Share Capital		
311,256,551 (30 June 2010: 311,323,217) ordinary shares of US\$ 1 each	311,257	311,323

At the extraordinary General Meeting held on 6 December 2010 the shareholders approved an issuance of 166,666,666 new shares (the 'Rights Shares') at nominal value of US\$1 each at a sale price of US\$3 per share to current shareholders. Rights Shares that are not taken up by existing shareholders may be offered and sold to third parties.

As of 31 December 2010 US\$39.2 millions has been received and classified as 'Share Subscription Pending Allotment' in the interim condensed consolidated financial statements.

NOTES TO THE INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

At 31 December 2010 (Reviewed)

8 UNRESTRICTED INVESTMENT ACCOUNTS

Unrestricted investment accounts ("URIA") are funds of investors held by the Bank which it can invest as it deems appropriate without restriction as to where, how and for what purposes the funds are invested. These funds are payable on demand and the account holder has the right to withdraw or transfer funds without penalty.

The Bank provides these accounts as an added service to investors who participate in the placement of investments and does not market these accounts as a product. Therefore, it is not the practice of the Bank to guarantee the preservation of capital or competitive rate of return through the creation of profit equalization reserves or investment risk reserves. As a result the Bank has minimal displaced commercial risk

URIA funds have been allocated in full to a pool of Murabaha and Mudaraba assets with financial institutions and investee companies. The funds are invested and managed in accordance with Shari'ah principles.

The allocation of the pool of assets by category of counterparty is as follows:

	<i>Reviewed 31 December 2010</i>	<i>Audited 30 June 2010</i>
Investee companies	79%	63%
Financial institutions	21%	37%

Profit paid to the URIA holder is based on the rate of return earned by the pool of profit-bearing assets in which the URIA funds have been allocated. The Bank does not charge management (Mudarib) fees or other expenses to URIA holders and the account holder participates in the profit earned in full. As a result the share of profits earned by the URIA holders is equal to the share of profits paid to them. The profits paid to URIA and the rate of return earned over the last five annual financial periods and for the six months ended 31 December 2010 are disclosed in the following table:

	<i>Profits earned and paid to URIA US\$'000</i>	<i>Rate of return %</i>
31 December 2005	4,938	4.45
30 June 2007	15,258	6.38
30 June 2008	14,088	4.53
30 June 2009	5,447	4.34
30 June 2010	3,604	1.53
Six months ended 31 December 2010 (annualized)	2,001	1.92

9 RELATED PARTY TRANSACTIONS

Related parties include the Group's major shareholders, directors and key management officers, their immediate families and entities controlled, jointly controlled or significantly influenced by them; and other related parties which comprises shareholders not included under 'Major Shareholders', the Shari'ah Supervisory Board, investee companies and companies that hold clients' investments.

The Group's transactions with related parties arise from the ordinary course of business and are on terms and conditions approved by the Group's management. Outstanding balances at period end are unsecured and settled in cash.

NOTES TO THE INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

At 31 December 2010 (Reviewed)

9 RELATED PARTY TRANSACTIONS (continued)

Income earned from related parties is as follows:

	<i>Reviewed Six month period from 1 July to 31 December 2010 US\$ '000</i>	<i>Reviewed Six month period from 1 July to 31 December 2009 US\$ '000</i>
Management fees	48,674	48,091
Income from investee companies	35,410	36,912
Yield from investments	19,701	15,095
Acquisition and placement income	3,814	5,761
	107,599	105,859

Acquisition and placement income was earned on the Group's transactions with such related parties.

Expenses pertaining to related parties are as follows:

	<i>Reviewed Six month period from 1 July to 31 December 2010 US\$ '000</i>	<i>Reviewed Six month period from 1 July to 31 December 2009 US\$ '000</i>
Net funding cost	22,652	25,176
Headquarter building expenses	17,328	3,918
	39,980	29,094

The related party balances included in these interim condensed consolidated financial statements are as follows:

	<u>31 December 2010 - Reviewed</u>				<i>Audited 30 June 2010 Total US\$ '000</i>
	<i>Major shareholders US\$ '000</i>	<i>Directors and key management US\$ '000</i>	<i>Others US\$ '000</i>	<i>Total US\$ '000</i>	
Assets					
Short-term funds	50,250	-	-	50,250	45,213
Receivables and other assets	15,805	3,561	1,164,139	1,183,505	1,032,808
Liabilities and unrestricted investment accounts					
Due to other institutions and other liabilities	61,793	-	588,653	650,446	729,026
Unrestricted investment accounts	71,676	1,736	96,687	170,099	156,696
Commitments					
Financial guarantee	-	-	228,975	228,975	209,357

Arcapita Bank B.S.C. (c)

NOTES TO THE INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

At 31 December 2010 (Reviewed)

10 SEGMENT INFORMATION

The following table presents revenue and segment results information regarding the Group's business segments for the six month period ended 31 December 2010 and 2009, respectively.

	<i>Private Equity US\$ '000</i>	<i>Real Estate US\$ '000</i>	<i>Infrastructure US\$ '000</i>	<i>Total US\$ '000</i>
Six month period ended 31 December 2010 (Reviewed)				
Segmental revenue	(43,045)	197,910	19,942	174,807
Unallocated revenue				<u>90,515</u>
Total revenue				<u><u>265,322</u></u>
Segmental results	(96,802)	185,091	(38,224)	50,065
Unallocated expenses				<u>(15,766)</u>
Net income				<u><u>34,299</u></u>
Six month period ended 31 December 2009 (Reviewed)				
<i>Segmental revenue</i>	<i>(35,527)</i>	<i>(2,159)</i>	<i>24,442</i>	<i>(13,244)</i>
Unallocated revenue				<u>11,620</u>
Total revenue				<u><u>(1,624)</u></u>
<i>Segmental results</i>	<i>(109,543)</i>	<i>(11,781)</i>	<i>17,803</i>	<i>(103,521)</i>
Unallocated expenses				<u>(87,194)</u>
Net loss				<u><u>(190,715)</u></u>

The following table presents certain asset and liability information regarding the Group's business segments as at 31 December 2010 and as at the date of last audited financial statements (30 June 2010).

	<i>Private Equity US\$ '000</i>	<i>Real Estate US\$ '000</i>	<i>Infrastructure US\$ '000</i>	<i>Total US\$ '000</i>
As at 31 December 2010 (Reviewed)				
Segment assets	934,514	1,469,535	743,698	3,147,747
Unallocated assets				<u>495,498</u>
				<u><u>3,643,245</u></u>
Segment liabilities	70,363	125,029	84,170	279,562
Unallocated liabilities and URIA				<u>2,241,275</u>
				<u><u>2,520,837</u></u>

Arcapita Bank B.S.C. (c)

NOTES TO THE INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

At 31 December 2010 (Reviewed)

10 SEGMENT INFORMATION (continued)

	<i>Private Equity</i> <i>US\$ '000</i>	<i>Real Estate</i> <i>US\$ '000</i>	<i>Infrastructure</i> <i>US\$ '000</i>	<i>Total</i> <i>US\$ '000</i>
As at 30 June 2010 (Audited)				
Segment assets	995,460	1,358,409	789,159	3,143,028
Unallocated assets				314,108
				<u>3,457,136</u>
Segment liabilities	18,861	234,717	119,219	372,797
Unallocated liabilities and URIA				2,024,179
				<u>2,396,976</u>

11 FUNDING COVENANTS

The funding facilities categorized under 'due to financial and other institutions' and 'medium-term financing facility' have covenants relating principally to maintenance of minimum capital adequacy and leverage ratio, limitation on dividend and guarantees. For one of the facilities, a charge amounting to 5 percent of assets capped by the outstanding facility amount has been made over the planned retention component of the investment portfolio.

NOTES TO THE INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

At 31 December 2010 (Reviewed)

12 RISK MANAGEMENT

a) Liquidity risk

a) (i) Maturity analysis of assets and liabilities

The table below summarizes the maturity profile of the Group's assets and liabilities based on expected repayment arrangements.

The maturity profile of assets and liabilities as at **31 December 2010** (Reviewed) is as follows:

	<i>Up to 1 month US\$ '000</i>	<i>1 to 3 months US\$ '000</i>	<i>3 to 6 months US\$ '000</i>	<i>6 months to 1 year US\$ '000</i>	<i>Less than 1 year US\$ '000</i>	<i>1 to 3 years US\$ '000</i>	<i>Over 3 years US\$ '000</i>	<i>More than 1 year US\$ '000</i>	<i>Total US\$ '000</i>
ASSETS									
Cash and short term funds	169,925	-	-	-	169,925	-	-	-	169,925
Receivables	176,295	338,400	233,203	152,510	900,408	63,236	189,840	253,076	1,153,484
Investments	-	88,011	146,684	216,597	451,292	935,252	740,059	1,675,311	2,126,603
Other assets	-	16,343	-	-	16,343	-	176,890	176,890	193,233
Total assets	346,220	442,754	379,887	369,107	1,537,968	998,488	1,106,789	2,105,277	3,643,245
LIABILITIES AND UNRESTRICTED INVESTMENT ACCOUNTS									
Due to financial and other institutions	68,511	272,915	115,072	424,222	880,720	205,850	5,277	211,127	1,091,847
Medium-term financing	-	-	-	-	-	1,096,368	-	1,096,368	1,096,368
Other liabilities	-	36,977	-	-	36,977	4,188	-	4,188	41,165
Unrestricted investment accounts (URIA)	-	291,457	-	-	291,457	-	-	-	291,457
Total liabilities and URIA	68,511	601,349	115,072	424,222	1,209,154	1,306,406	5,277	1,311,683	2,520,837

NOTES TO THE INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

At 31 December 2010 (Reviewed)

12 RISK MANAGEMENT (continued)

a) Liquidity risk (continued)

a) (i) Maturity analysis of assets and liabilities (continued)

The maturity profile of assets and liabilities as at 30 June 2010 (Audited) is as follows:

	<i>Up to 1 month US\$ '000</i>	<i>1 to 3 months US\$ '000</i>	<i>3 to 6 months US\$ '000</i>	<i>6 months to 1 year US\$ '000</i>	<i>Less than 1 year US\$ '000</i>	<i>1 to 3 years US\$ '000</i>	<i>Over 3 years US\$ '000</i>	<i>More than 1 year US\$ '000</i>	<i>Total US\$ '000</i>
ASSETS									
Cash and short term funds	96,735	46,599	-	-	143,334	-	-	-	143,334
Receivables	191,034	274,117	111,176	234,701	811,028	79,531	183,400	262,931	1,073,959
Investments	-	93,373	155,622	213,525	462,520	1,105,080	506,820	1,611,900	2,074,420
Other assets	-	5,559	-	-	5,559	-	159,864	159,864	165,423
Total assets	287,769	419,648	266,798	448,226	1,422,441	1,184,611	850,084	2,034,695	3,457,136
LIABILITIES AND UNRESTRICTED INVESTMENT ACCOUNTS									
Due to financial and other institutions	15,919	3,184	235,882	495,257	750,242	333,862	-	333,862	1,084,104
Medium-term financing	-	-	-	-	-	1,094,031	-	1,094,031	1,094,031
Other liabilities	-	32,038	-	-	32,038	4,334	-	4,334	36,372
Unrestricted investment accounts (URIA)	-	182,469	-	-	182,469	-	-	-	182,469
Total liabilities and URIA	15,919	217,691	235,882	495,257	964,749	1,432,227	-	1,432,227	2,396,976

NOTES TO THE INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

At 31 December 2010 (Reviewed)

12 RISK MANAGEMENT (continued)

a) Liquidity risk (continued)

a) (ii) Contractual undiscounted repayment obligations

The contractual undiscounted repayment obligations as at **31 December 2010 (Reviewed)**:

FINANCIAL LIABILITIES	<i>Up to 1 month US\$ '000</i>	<i>1 to 3 months US\$ '000</i>	<i>3 to 6 months US\$ '000</i>	<i>6 months to 1 year US\$ '000</i>	<i>Less than 1 year US\$ '000</i>	<i>1 to 3 years US\$ '000</i>	<i>Over 3 years US\$ '000</i>	<i>More than 1 year US\$ '000</i>	<i>Total US\$ '000</i>
Due to financial and other institutions	69,797	277,940	115,321	428,247	891,305	206,446	5,358	211,804	1,103,109
Medium-term financing	3,202	-	3,202	6,404	12,808	1,090,394	-	1,090,394	1,103,202
Other liabilities	41,165	-	-	-	41,165	-	-	-	41,165
Unrestricted investment accounts (URIA)	291,457	-	-	-	291,457	-	-	-	291,457
Total liabilities and URIA	405,621	277,940	118,523	434,651	1,236,735	1,296,840	5,358	1,302,198	2,538,933

The contractual undiscounted repayment obligations as at 30 June 2010 (Audited):

FINANCIAL LIABILITIES	<i>Up to 1 month US\$ '000</i>	<i>1 to 3 months US\$ '000</i>	<i>3 to 6 months US\$ '000</i>	<i>6 months to 1 year US\$ '000</i>	<i>Less than 1 year US\$ '000</i>	<i>1 to 3 years US\$ '000</i>	<i>Over 3 years US\$ '000</i>	<i>More than 1 year US\$ '000</i>	<i>Total US\$ '000</i>
Due to financial and other institutions	15,944	5,083	239,109	497,313	757,449	335,639	-	335,639	1,093,088
Medium-term financing	3,212	-	3,212	6,424	12,848	1,112,850	-	1,112,850	1,125,698
Other liabilities	36,372	-	-	-	36,372	-	-	-	36,372
Unrestricted investment accounts (URIA)	182,469	-	-	-	182,469	-	-	-	182,469
Total liabilities and URIA	237,997	5,083	242,321	503,737	989,138	1,448,489	-	1,448,489	2,437,627

NOTES TO THE INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

At 31 December 2010 (Reviewed)

12 RISK MANAGEMENT (continued)**b) Credit risk**

The Group does not engage in commercial or retail banking. Its exposure to credit risk arises largely from cash and short term funds and receivables.

b) (i) Maximum exposure to credit risk

The following table analyzes the maximum exposure to credit risk and the average balance outstanding. The average balance is calculated on a daily basis.

	<i>Reviewed</i> <i>31 December 2010</i>		<i>Audited</i> <i>30 June 2010</i>	
	<i>Outstanding</i> <i>US\$ '000</i>	<i>Average</i> <i>US\$ '000</i>	<i>Outstanding</i> <i>US\$ '000</i>	<i>Average</i> <i>US\$ '000</i>
Receivables (Note 5)	1,153,484	1,201,493	1,073,959	1,202,060
Cash and short term funds	169,925	202,702	143,334	44,395
Financial guarantees	228,975	219,166	209,357	192,823
Total credit risk exposure	<u>1,552,384</u>	<u>1,404,195</u>	<u>1,426,650</u>	<u>1,246,455</u>

b) (ii) Risk concentrations of the maximum exposure to credit risk.

Concentration of risk is managed by counterparty. The maximum credit exposure to any single counterparty as of 31 December 2010 was US\$ 115.2 million (30 June 2010: US\$ 105.1 million).

The following table analyzes the geographical and industrial sector concentrations of the Group's maximum exposure to credit risk.

	<i>Reviewed</i> <i>31 December</i> <i>2010</i> <i>US\$ '000</i>	<i>Audited</i> <i>30 June</i> <i>2010</i> <i>US\$ '000</i>
Geographic region:		
Middle East & Asia	614,232	424,193
North America	487,371	634,070
Europe	450,781	368,387
	<u>1,552,384</u>	<u>1,426,650</u>
Industry sector:		
Utilities and others	675,151	693,346
Real estate	436,514	317,744
Manufacturing	227,939	285,721
Banking and financial institutions	131,267	79,286
Services	48,969	34,279
Technology	32,544	16,274
	<u>1,552,384</u>	<u>1,426,650</u>

NOTES TO THE INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

At 31 December 2010 (Reviewed)

12 RISK MANAGEMENT (continued)

b) (iii) Analysis of exposure to credit risk by external credit ratings

The table below analyses the group's maximum credit exposure by the external credit ratings of counterparties. The CBB has recognized certain External Credit Risk Assessment Institutions ("ECAIs"). The Group considers the credit risk ratings that the counter party obtains from ECAIs recognized by the CBB. The Group follows the CBB mapping notation and equates all ratings to its equivalent Standard & Poor's rating for standardisation and comparison purposes.

The table below analyses the Group's maximum credit exposures which are neither past due or impaired by its equivalent Standard & Poors Rating. The majority of exposures which are not rated relate to receivables (Note 5).

	<i>Reviewed</i> 31 December <i>2010</i> US\$ '000	<i>Audited</i> 30 June <i>2010</i> US\$ '000
Standard & Poor's rating or equivalent		
AAA to AA-	50,411	20,611
A+ to A-	67,716	38,807
BBB+ to BBB-	1,465	11,185
BB+ to B-	-	5,001
Unrated	1,432,792	1,351,046
	1,552,384	1,426,650

c) Concentration risk

	<i>Reviewed</i> 31 December 2010		<i>Audited</i> 30 June 2010	
	<i>Assets</i> US\$ '000	<i>Liabilities and URIA</i> US\$ '000	<i>Assets</i> US\$ '000	<i>Liabilities and URIA</i> US\$ '000
Geographic region:				
Europe	1,268,278	1,290,535	1,134,483	750,846
Middle East & Asia	1,524,009	1,058,911	1,167,535	1,378,675
North America	850,958	171,391	1,155,118	267,455
	3,643,245	2,520,837	3,457,136	2,396,976
Industry sector:				
Utilities and others	1,342,194	707,234	1,390,674	568,068
Banking and financial institutions	139,839	1,554,637	79,339	1,552,522
Real estate	1,478,579	234,525	1,231,279	258,717
Manufacturing	293,782	3,855	360,878	5,544
Services	331,710	6,239	322,732	9,234
Technology	57,141	14,347	72,234	2,891
	3,643,245	2,520,837	3,457,136	2,396,976

NOTES TO THE INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

At 31 December 2010 (Reviewed)

12 RISK MANAGEMENT (continued)

d) Profit rate risk

The Group is not exposed to interest rate risk on its financial assets as no interest is charged. However, the fair value of financial instruments may be affected by current market forces including interest rates.

The following table indicates the effective profit rates on such financial instruments:

	<i>Profit rate</i>	
	Reviewed Six months ended 31 December 2010	<i>Reviewed</i> <i>Six months</i> <i>ended</i> <i>31 December</i> <i>2009</i>
Due from financial institutions	4.56%	0.30%
Due from investee companies	13.87%	13.77%
Due to financial and other institutions	10.06%	10.42%
Medium-term financing	1.81%	1.80%
Unrestricted investment accounts	1.92%	1.92%
<i>(Profit rates for six months have been annualized)</i>		

	<i>Reviewed</i>		<i>Reviewed</i>	
	Basis change in rates (+/-)	Sensitivity net funding costs (+/-) 31 December 2010 US\$ '000	Basis point change in rates (+/-)	Sensitivity of net funding costs (+/-) 31 December 2009 US\$ '000
<i>Currency:</i>				
USD	25	3,087	40	6,541
GBP	25	108	25	48
EURO	25	314	25	41
Others	25	534	5	34
On all profit bearing assets and liabilities	200	32,347	200	34,103

(Sensitivity to net funding costs have been calculated on an annual basis)

The Group currently does not hold fixed rate available for sale financial assets or associated hedges and swaps, whose value would be impacted by changes in profit rates. Therefore, changes in profit rates would not have any impact recognized directly in equity.

e) Currency risk

The majority of the Group's business is conducted in US dollars. However, certain investments and other financial assets and liabilities are in other currencies and give rise to foreign currency risk. In order to mitigate currency risk, liabilities in various relevant currencies are used to match asset exposure through the use of forward foreign exchange contracts. Depending on currency movements, the contracts may result in either a net asset or a net liability. As at 31 December 2010 there was a net asset of US\$8,519 thousand (30 June 2010: nil).

The Group has investments in foreign subsidiaries the majority of whom prepare financial statements in United States Dollars. The translation effect of those subsidiaries preparing their financial statements in currencies other than United States Dollars is negligible. Currency exposures resulting from its subsidiaries are managed on a consolidated basis as described above.

NOTES TO THE INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

At 31 December 2010 (Reviewed)

12 RISK MANAGEMENT (continued)

e) Currency risk (continued)

The Group had the following significant foreign currency exposures at the balance sheet date:

	<i>Reviewed</i> 31 December 2010			<i>Audited</i> 30 June 2010		
	<i>Assets</i> US\$ '000	<i>Liabilities and URIA</i> US\$ '000	<i>Net</i> US\$ '000	<i>Assets</i> US\$ '000	<i>Liabilities and URIA</i> US\$ '000	<i>Net</i> US\$ '000
Euro	761,248	(202,543)	558,705	912,818	(230,039)	682,779
Pounds sterling	314,416	(46,935)	267,481	262,502	(60,786)	201,716
Singapore Dollar	44,799	(162,338)	(117,539)	139,618	(20,229)	119,389
Other currencies	78,310	(98,844)	(20,534)	44,365	(5,202)	39,163
	1,198,773	(510,660)	688,113	1,359,303	(316,256)	1,043,047

The table below indicates the result of the VaR model, over a one day time horizon with a confidence level of 98.5 percent in relation to currency positions.

	<i>Reviewed</i> 31 December 2010 US\$ '000	<i>Audited</i> 30 June 2010 US\$ '000
Closing VaR	16,105	19,687
Average VaR	27,754	33,017
Highest VaR	42,432	42,432
Lowest VaR	15,494	18,592

f) Equity price risk

The table below indicates the result of the Investment VaR model in relation to the Group's investment portfolio. The model measures unexpected losses over a one year time horizon with a confidence level of 98.5 percent (30 June 2010: 98.5 percent).

	<i>Reviewed</i> 31 December 2010 US\$ '000	<i>Audited</i> 30 June 2010 US\$ '000
Closing VaR	914,304	836,057
Average VaR	881,278	998,009
Highest VaR	914,304	1,064,810
Lowest VaR	850,646	834,302

Arcapita Bank B.S.C. (c)

NOTES TO THE INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

At 31 December 2010 (Reviewed)

13 CAPITAL MANAGEMENT

	<i>Reviewed</i> 31 December 2010 <i>US\$ '000</i>	<i>Audited</i> 30 June 2010 <i>US\$ '000</i>
Tier I Capital (Note (a))	926,253	901,292
Tier II Capital (Note (b))	32,807	-
Total regulatory capital	959,060	901,292
Risk Weighted assets (Note (c))	7,110,452	7,105,363
Total capital ratio	13.5%	12.7%
Tier I capital ratio	13.0%	12.7%
Minimum regulatory capital ratio	12.0%	12.0%

a) Tier I Capital

	<i>Reviewed</i> 31 December 2010 <i>US\$ '000</i>	<i>Audited</i> 30 June 2010 <i>US\$ '000</i>
Share capital	311,257	311,323
Share premium	953,987	954,175
Share subscription pending allotment	39,281	-
Statutory reserves	98,492	98,492
Retained earnings	(115,592)	(115,594)
Bank funded shares	(361,172)	(347,104)
Tier I capital	926,253	901,292

b) Tier II Capital

Under current rules set by the CBB only unaudited retained earnings and unaudited unrealized gains on equity investments can form part of Tier II capital for the Bank. Any interim losses are categorized as part of Tier I capital.

Arcapita Bank B.S.C. (c)

NOTES TO THE INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

At 31 December 2010 (Reviewed)

13 CAPITAL MANAGEMENT (continued)

c) Risk weighted assets and allocated regulatory capital

	<i>Reviewed</i>		<i>Audited</i>	
	<i>31 December 2010</i>		<i>30 June 2010</i>	
	<i>Risk Weighted Assets</i>	<i>Allocated Regulatory Capital</i>	<i>Risk Weighted Assets</i>	<i>Allocated Regulatory Capital</i>
	<i>US\$ '000</i>	<i>US\$ '000</i>	<i>US\$ '000</i>	<i>US\$ '000</i>
Investment exposures	3,970,026	476,403	3,825,630	459,076
Receivables	988,969	118,676	1,031,022	123,723
Claims from Banks	29,710	3,565	18,487	2,218
Other assets	94,526	11,343	71,716	8,606
Attributable to self financed assets	5,083,231	609,987	4,946,855	593,623
Attributable to assets financed by URIA	84,790	10,175	49,664	5,960
Credit risk weighted assets	5,168,021	620,162	4,996,519	599,583
Operational risk weighted assets	1,065,519	127,862	1,065,519	127,862
Market risk weighted assets	876,912	105,229	1,043,325	125,199
Total	7,110,452	853,253	7,105,363	852,644

Credit risk-weighted assets

The Group uses the standardized approach, which requires banks to use external credit ratings to combine them into categories to which standardized risk weightings are applied. For regulatory purposes, credit risk-weighted assets include investments.

Assets financed by URIA are risk weighted in a similar way. The CBB requires that 30 percent of such risk-weighted assets should be allocated against the capital of the Bank.

Operational risk-weighted assets

In calculating operational risk-weighted assets, the Group uses the basic indicator approach which calculates operational risk-weighted assets as a proportion of the average of three years' revenues.

Market risk-weighted assets

The Group does not maintain a trading book and, as a result, market risk-weighted assets result from the net foreign currency positions of the Group. Market risk-weighted assets are calculated using the standardized method.

14 EARNINGS AND EXPENSES PROHIBITED BY SHARI'AH

The Bank receives interest from incidental deposits. These earnings are prohibited by Shari'ah, hence utilized exclusively for charitable purposes and amount to US\$ 277,942 for the six months ended 31 December 2010 (Six months ended 31 December 2009: US\$ 125,411).

15 COMPARATIVE FIGURES

Certain of the prior period's figures have been reclassified to conform to the presentation adopted in the current period. Such reclassification did not affect previously reported net income or shareholders' equity.