ANNUAL REPORT | 2003

بنك ظفار

BankDhofar S.A.O.G ش.م.ع.ع

معكم... نتقدم

Moving Forward...with You

HIS MAJESTY SULTAN QABOOS BIN SAID

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BOARD OF DIRECTORS' REPORT

Dear Shareholders,

On behalf of the Board of Directors of Bank Dhofar S.A.O.G., I am pleased to present to you the Bank's Financial Statements and the Auditor's Report for the financial year ended 31 December 2003.

Oman's Economy

In spite of the political difficulties affecting the region in 2003, the local economy continued its sustainable and remarkable growth. The preliminary indicators and estimates showed that Oman's economy was expected to grow by 6.2% in 2003, as the oil-sector would grow by 7.1% resulting from the increase in international oil prices. The non-oil sector was also expected to realize a growth of 5.9% due to the strong performance in the LNG industry, construction and financial mediation activities. On the other hand, local inflation remains firmly under control as the general price index was expected to decrease by 0.4% in 2003 despite the increase in the non-Dollar import bills as a result of the significant decline of the exchange rate of the U.S. currency against other major currencies.

Also, backed by the good performance of the national economy, the Muscat Securities Market (MSM) recorded a significant growth of 42% in 2003. The MSM index increased from 191.9 points at the end of 2002 to reach 272.7 at the end of 2003.

The Bank's Activities in 2003

Last year was an eventful year for your Bank with the Bank undertaking several initiatives of strategic importance. After obtaining all regulatory approvals, we have successfully integrated the assets and liabilities, operations and activities of the erstwhile Majan International Bank. Also during the second-quarter of 2003, an international consultancy firm concluded its review and study of the various organizational and managerial aspects of the Bank after the merger. The proposed recommendations and suggestions were discussed and approved by the Board of Directors and have been implemented.

Also, the Board of Directors retained a renowned consultancy firm to coordinate and supervise the Bank's five-year strategic plan. The strategic plan was presented to the Board, discussed and approved in the second half of 2003.

In the fourth quarter of 2003, subsequent to the shareholders' approval in the Extraordinary General Meeting held on September 30, 2003, the Bank has obtained all regulatory and administrative approvals for shortening the Bank's name to 'Bank Dhofar' and has changed the Bank's logo. In 2004 you will see Bank Dhofar in its new livery and 'Moving Forward ... With You' just as its new marketing slogan says.

Financial Performance in 2003

As stated above and despite the difficult conditions that prevailed in the region, our Bank continued its excellent achievements, as all financial indicators showed significant growth.

The total assets grew in 2003 by 37.8% and reached RO 474.1 million at the end of the year compared with RO 344.0 million at the end of 2002. The net customer loans portfolio increased from RO 266.0 million in 2002 to reach RO 367.2 million, a growth of 38.1%. Also, the customer deposits recorded a growth of 29.3% and increased from RO 277.2 million at the end of 2002 to RO 358.4 million at the end of 2003.

The shareholders' equity was RO 63.1 million on 31 December 2003 compared with RO 47.4 million at 31 December 2002. The share capital increased from RO 35.28 million at the end of 2002 to RO 41.96 million at the end of the current year due to the issuance of 6.68 million shares with par value of RO 1 each to the former shareholders of erstwhile Majan International Bank as part of the merger consideration. As a result of the increase in the shareholders' equity the net assets per share increased from RO 1.344 at the end of 2002 to RO 1.504 at the end of 2003.

Also, most profitability indicators recorded significant growth, as net interest income grew by 17.6% from RO 18.2 million for the year 2002 to RO 21.4 million for 2003. Other income increased by 23.8% and reached RO 5.04 million in 2003 compared with RO 4.07 million in the previous year. Albeit, the operating expenses have increased due to the additional expenses related to the merger of Majan International Bank activities, the Bank maintained an acceptable operating expenses to operating income ratio of 41.7% for the year 2003 compared with 39.7% for 2002. The net profit of the Bank, after making the required provisions for bad and doubtful debts, grew in 2003 by 22.4% and reached RO 10.16 million compared with RO 8.30 million in 2002. This remarkable growth in net profit improved the earning per share from RO 0.235 in 2002 to RO 0.252 in 2003.

Proposed Dividends

Your Board of Directors recommends RO 6.29 million cash dividends, that represents a 15% of the share capital of the Bank. In compliance with the Bank for International Settlements (BIS) guidelines on capital adequacy, we will retain RO 1.47 million to be transferred to subordinated bonds reserve, amounting to 20% of the subordinated bonds maturing within the next five years.

The basis of the Bank's policy on dividends distribution is on maintaining a fine balance between retaining and distributing the annual profit. The Bank retains part of the annual profit in the form of reserves and retained earnings to build a solid capital base, taking into consideration the future growth of the Bank, the possible economic and financial markets fluctuations and the requirements of the capital adequacy ratio.

Acknowledgment

On behalf of the Board, I would like to thank our valuable customers for their patronage and confidence they have reposed in the Bank. I thank the shareholders for your continuous support and the Bank's staff and management for the good performance in 2003.

The Board of Directors also wishes to thank the Central Bank of Oman for its valuable guidance to the Bank.

Finally, on the behalf of the Board of Directors, I would like to express our most sincere gratitude to His Majesty Sultan Qaboos Bin Said for his wise leadership and generous support to the private sector.

Eng. Abdul Hafidh Salim Rajab Al-Aujaili

Chairman

THE BOARD OF DIRECTORS

Eng. Abdul Hafidh Salim Rajab Al-Aujaili
Chairman

Sheikh Salem Mubarak Al Shanfari
Vice Chairman

Ahmed Abdullah Moqaibel
Member

Sayyed Salem Musallam Al Busaidi
Member

Abdul Aziz Ali Al Shanfari
Member

Sheikh Salem Oufait Al Shanfari
Member

Saleh Nasser Al Habsy
Member

Ali Ahmed Al Mashani
Member

Eng. Saeed Salim Al Shanfari
Member

Dhafer Sahmi Al Ahbabi
Member

Suhail Ahmed Al Mashani
Member

Mohammed Yousuf Alawi Al Ibrahim
Member

MISSION STATEMENT

To grow steadily into a leading financial institution with a sharp focus on customer needs and to continue its endeavour to develop its competent staff, enhance its unrivalled shareholder value and increase its contribution to the progress of the Sultanate of Oman.

Prospects & Aspirations

- Expand the network of branches and ATMs to an optimum level in order to cover all the regions within the Sultanate of Oman
- Maintain optimum capital adequacy and liquidity ratios
- Offer an array of services to suit various customer needs
- Boost its contribution to the progress of the Sultanate and the welfare of its people
- Integrate resources to take the lead in the local market
- Constantly upgrade and develop staff competencies and skills
- A cross-functional and decentralised management structure

THE MANAGEMENT TEAM

1. **Ahmed Bin Ali Al Shanfari**
   Chief Executive
2. **Salaam Said Al Shaksy**
   Dy. Chief Executive
3. **Abdullah Bin Jama Farah**
   General Manager (Support Services)
4. **Abdul Hakeem Omar Al Ojaili**
   Dy. General Manager (Retail Banking)
5. **Mohammed Redha Jawad**
   Dy. General Manager (Risk Management)
6. **Virendra K. Raina**
   Assistant General Manager (Corporate Banking)
7. **Emad Khalid Al Zubi**
   Financial Controller
8. **Max Jayamanna**
   Head of Internal Audit
9. **Syed Ziarat Ali**
   Head of Treasury & International Banking
10. **Ravi Khanna**
    Head of Information Technology
11. **Mervyn G. Fernando**
    Head - Midsector Corporates

REPORT ON CORPORATE GOVERNANCE

Part One

1 - Corporate Governance Philosophy:

Corporate Governance is a topic that invites a multi-disciplinary as well as super-disciplinary view. A corporation in modern times represents an amalgam of diverse social interests. The interests belong not only to the present generation, but also to the future one. It wields large economic and social powers. Those in control of the corporation, therefore, hold enormous responsibilities of multifarious dimensions - social, economic, ethical, scientific and technological.

The behavioural pattern of those who govern are embedded in the pressures and tensions of the modern day society. The mental frame of corporate decision makers is inextricably linked to the under-currents of social phenomena.

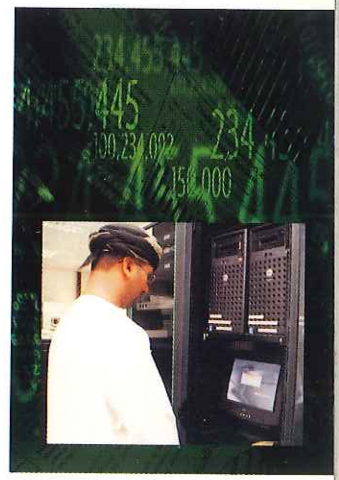
The values of accountability, social responsibility, long-term vision and ethical behaviour have thus, become important after the formal introduction of the code of corporate governance in the country.

The Board of the Bank bears the principal responsibility of fashioning the governance code as appropriate to the Bank within the broad framework enunciated by the Central Bank of Oman and the Capital Market Authority. It is also charged with the responsibility of subjecting the code to periodic review to keep it refurbished and contemporary.

Decision-making within the Bank has been broadly divided into two levels. The Board of Directors at the apex level, as trustees of the shareholders, bears the responsibility, of strategic supervision of the Bank, apart from fulfilling statutory obligations. Its composition has a balanced mix of experts and other directors. Some of the major responsibilities of the Board, namely audit, senior management succession, legal and regulatory compliance are discharged through two sub-committees, viz., the Audit Committee and the Executive Committee. These sub-committees which operate under Board approved charters have been meeting regularly and have contributed significantly to the effective functioning of the code of governance. The charters of these committees meets with all the requirements as laid down in the code of corporate governance enunciated by the Central Bank of Oman and the Capital Market Authority of Oman. In addition, the Board carries the responsibility of approving the strategic plans of the Bank. The executive management of the Bank comprises the Senior Managers headed by the Chief Executive.

Through this two-tiered inter-linked governance process, a wholesome balance has been created between the need for focus and executive freedom, and the need for supervision, control and checks and balances.

The formal code of governance prescribes the highest ethical standards in the conduct of the Bank's business. The Senior Members of the Bank are fully cognisant of their responsibilities in setting personal examples so that the code is internalised within the Bank and becomes part of its culture. In the ultimate analysis, there can be no substitute for the enlightened self-regulation that is expected of every member of the Bank.



2 - The Board of Directors

Functions of the Board

The responsibilities and functions of the Board include the following:

- Charting the overall strategic direction of the Bank and reviewing and approving the business and strategic plans.
- Monitoring the Bank's performance and evaluating whether the business is properly managed in accordance with the Bank's set plans.
- Approving the interim and annual financial statements.
- Forming various Board sub-committees, approving their charters and reviewing the functions of these committees.
- Reviewing all audit reports submitted by internal and external auditors and statutory agencies.
- Ensuring that the Bank conducts its operations in an ethical and transparent manner.
- Assessing and approving the proper delegation of authorities to executive management.
- Evaluating the functions and the performance of the CEO and the key employees.

Size and Terms

The Board consists of twelve (12) non-executive directors who are elected by the shareholders at the Annual General Meeting. The term of office of the Board of Directors is three years and each Director can be re-elected for similar period(s). The term of the current Board expires in April 2004 and the election of the new Board together with any re-nomination will be taken up at the Annual General Meeting to be held at the end of March 2004.

Composition and Selection

Members of the Board of Directors are elected from among the Bank's shareholders or non-shareholders provided that a shareholder candidate owns no less than 50,000 shares of the Bank. The majority of members of the Board of Directors shall be non-executive Directors.

A minimum of one-third of the Board members shall be independent Directors, none of their immediate relatives having held a senior position in the Bank for the last two years, who shall have no relation with the Bank that could result in financial transactions other than contracts and transactions entered through open tendering or done in the ordinary course of business.

The election process is through direct secret ballot whereby each shareholder shall have a number of votes equivalent to the number of shares he/she holds. Every shareholder shall have the right to vote for one candidate or more provided the total number of votes in the voting form is equivalent to the number of shares he/she holds.

Board Committees

The Board has the following two Board Committees, whose objectives, powers and procedures are governed by the terms and reference of respective Committees, as approved by the Board.

- Executive Committee
- Audit Committee

Additional committees may be established from time to time based on the business needs. Each committee has access to the information and resources it requires, including direct access to staff and consultants. The Board has selected the committee members based on their professional backgrounds, skills and other qualities they bring to the committees.

Part Two

1. Members of the Board of Directors

The Board of Directors of Bank Dhofar (SAOG) which met 8 times in the year 2003 consists of the following:

Sr. No.	Name of Director	Designation	No. of Meetings Attended	No. of other Directorships held
1	Eng. Abdul Hafidh Salim Rajab Al-Aujaili	Chairman	8	2
2	Sheikh Salem Mubarak Al Shanfari	Vice Chairman	7	3
3	Sayyed Salem Musallam Al Busaidi	Member (Executive Director)	8	-
4	Mr. Suhail Ahmed Al Mashani	Member (Executive Director)	7	2
5	Sheikh Salem Oufait Al Shanfari	Member	8	1
6	Mr. Dhafer Sahmi Al Ahbabi	Member	-	-
7	Mr. Abul Aziz Ali Al Shanfari	Member	8	2
8	Mr. Saleh Nasser Al Habsy	Member	8	-
9	Mr. Mohammed Yousuf Alawi Al Ibrahim	Member	6	1
10	Mr. Ali Ahmed Al Mashani	Member	8	3
11	Eng. Saeed Salim Al Shanfari	Member	8	2
12	Mr. Ahmed Abdullah Sulaiman Moqaibel	Member*	2	2

* Mr. Ahmed Abdullah Sulaiman Moqaibel was inducted as a Board Member in December 2003.

Board meetings were held on 16 February 2003, 8 April 2003, 14 April 2003, 25 May 2003, 2 June 2003, 9 June 2003, 6 December 2003 and 29 December 2003. There was a gap of more than 4 months between the meeting of 9 June 2003 and 6 December 2003, to contrary of the stipulation of Article 4 of Code of Corporate Governance for MSM-listed companies. The lapse however was more than compensated by the directors meeting 8 times during the year and the Executive Committee of 5 directors meeting 11 times as indicated below.

Although all Board members are Independent Directors as defined in the Code of Corporate Governance issued by the Capital Market Authority, they will be individually identified at the next election of the Board that will be held at the end of March 2004.

2. Executive Committee

The Committee consists of five members with proper experience, skills and initiative. The objective of the Executive Committee is to discharge responsibilities on behalf of the Board in deciding on specific policy matters demanding in-depth study and analysis, deliberation and interactive consideration and decisions on micro matters of business beyond the powers delegated to the management, but considered less important to receive the full Board's attention and time.

The Board members of the Executive Committee are:

Name of Director	Designation	No. of Meetings Attended
1. Eng. Abdul Hafidh Salim Rajab Al-Aujaili	Chairman of the Committee	9
2. Mr. Abdul Aziz Al Shanfari	Vice Chairman	10
3. Sayyid Salim Musallam Al Busaidi	Member	8
4. Mr. Saleh Nasser Al Habsy	Member	9
5. Mr. Ali Ahmed Al Mashani	Member	11

The Committee held 11 meetings during 2003.

3. Audit Committee

The Audit Committee was formed in December 2001 by the Board of Directors with the following main objectives and responsibilities:

- To focus the attention of the Board and top management of the Bank on the importance of strong financial reporting and risk management.
- To monitor the adequacy of internal controls in the Bank and to take appropriate steps where required.
- To monitor the Bank's compliance with legal and regulatory provisions, its articles of association, charter, by-laws and rules established by the Board of Directors.
- To identify the risk areas of the Bank's operations to be covered in the scope of the internal and external audits during the year.
- To monitor the effectiveness of the internal audit function and approve the audit plan as well as the availability of adequate resources (personnel and tools).
- To recommend the appointment / change of the external auditors and determine and review their terms of engagement.
- To hear the views of the external auditors before forwarding the annual financial statements to the Board for approval.
- To report and bring to the attention of the Board any matters of concern with regard to the foregoing and any material accounting or auditing concerns identified as a result of the external or internal audits, or examination by supervisory authorities.

The Members of the Audit Committee are:

Name of Director	Designation	No. of Meetings Attended
1. Mr. Suhail Ahmed Al Mashani	Chairman of the Committee	5
2. Eng. Saeed Salim Al Shanfari	Member	5
3. Mr. Mohammed Yousuf Alawi Al Ibrahim	Member	5

The Committee held 5 meetings in 2003.

4. Directors' Remuneration and Executives Pay

As all members of the Board are non-executive directors, no fixed salary or performance-linked incentives are applicable. The non-executive directors are paid an annual remuneration and sitting fees for attending the Board / Committee meetings. Directors' remuneration and sitting fees paid during 2003 are as follows:

	Remuneration RO '000s	Sitting Fees RO '000s	**Total RO '000s**
Chairman of the Board	16.0	11.5	**27.5**
Board Members	162.4	70.0	**232.4**
Total	**178.4**	**81.5**	**259.9**

The Bank's top five executives, namely the Chief Executive, Deputy Chief Executive, General Manager-Support Services, Deputy General Manager- Retail Banking, and Deputy General Manager- Risk Management have received the following in 2003:

	Salaries	Performance Bonus	Other Allowances	**Total**
	RO '000s	RO '000s	RO '000s	**RO '000s**
Top five Executives	319.7	61.1	12.0	**392.8**

5. Compliance with Regulatory Requirements

The Bank adhered to and complied with all relevant regulatory requirements and there were no penalties or strictures imposed on the Bank in the last three years for non-compliance with any statutory or regulatory authority requirements.

Also, the Bank complied with all provisions of the Code of Corporate Governance issued by the Capital Market Authority, except with regard to the gap between two meetings of the Board of Directors as explained in Section 1 above.

6. Communication with Shareholders and Investors

The Bank publishes its quarterly interim financial statements and also hosts these and other relevant information at its website (www.bankdhofar.com). The quarterly results are published in two local newspapers in Arabic and English. These results can be obtained by shareholders either from the Bank or Muscat Securities Market (MSM).

The management provides regular updates to the market on the Bank's performance and new developments. The Management Discussion and Analysis Report forms part of this annual report.

7. Market Price Data

7.1. Share Price Movements

The high/low share price information of the Bank during the financial year ended 31 December 2003 compared with Muscat Securities Market Index is as follows:

2003	Bank Dhofar Share Price (RO)			MSM Index
Month	High	Low	Closing	Closing
January	2.250	2.170	2.200	195.62
February	2.250	2.200	2.250	194.06
March	2.250	2.250	2.250	201.50
April	2.600	2.270	2.600	217.65
May	2.680	2.600	2.650	227.88
June	2.750	2.650	2.710	238.31
July	2.950	2.730	2.950	248.22
August	2.950	2.900	2.940	250.74
September	3.000	2.950	3.000	257.54
October	3.010	3.000	3.000	265.46
November	3.020	3.000	3.010	270.45
December	3.050	3.000	3.000	272.67

7.2. Major Shareholders

The following are the major shareholders who own more than 5% of the outstanding shares as at 31 December 2003:

Shareholder	% of Ownership
Dhofar International Development and Investment Company (S.A.O.G.)	30.00%
Civil Service Pension Fund	10.00%
Public Authority for Social Insurance	8.34%
Qais Omani Establishment	6.46%
Malatan Trading and Contracting LLC	6.39%
Ministry of Defense Pension Fund	5.71%

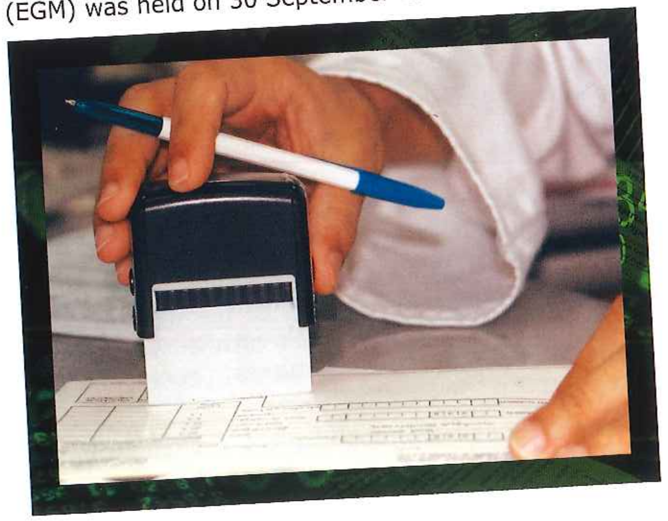
8. Profile of the Statutory Auditors

The Bank's statutory auditors are KPMG, an international accounting firm operating in 159 countries from 821 offices and having more than 100,000 staff. KPMG in Oman has over 70 employees including 3 partners and 12 managers. It trains the largest number of Omanis in the auditing and accounting profession.

Due to the mandatory requirement to rotate auditors every four years we are required to appoint new auditors for the year ending 31 December 2004. The Board of Directors would like to take this opportunity on behalf of the shareholders and the Bank, to express their thanks to KPMG for their services to our Bank over the previous years.

9. Other Matters

- In 2003 the Board of Directors, through the Audit Committee, reviewed and assessed the Bank's system of internal controls.
- The last Annual General Meeting (AGM) was held on 28 April 2003 and the last Extra General Meeting (EGM) was held on 30 September 2003.



KPMG

Audit & Accounting

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Report of the Auditors to the Shareholders of Bank Dhofar 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 9 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 materials respects, the Bank's application of the provisions of the Code and is free from any material misrepresentation. We draw attention to Page 10 of the Report that sets out that no Board of Directors' meeting was held for a period of more than 4 months between 9 June 2003 and 6 December 2003. This is not in accordance with Article 4 of the Capital Market Authority Code of Corporate Governance.

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 first 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 2003 and does not extend to the financial statements or any other reports of Bank Dhofar SAOG, taken as a whole.

6 March 2004

KPMG

KPMG, a branch office established under the law of Oman, is a member of KPMG International, a Swiss cooperative.

Chartered Accountants
C.R. No. : 6/30936/1

Ahmed Bin Ali Al Shanfari - Chief Executive

Oman's Economy and Outlook

Oman's economy fared well in 2003 as is evident from the available preliminary economic indicators. Based on estimates real Gross Domestic Product (GDP) grew by 6.2% in 2003. The consumer price index reduced by 0.4% in 2003, in line with the trend of the last few years of negative inflation. The Rial Omani interest rates continued to remain at low levels with the weighted average cost of total Rial Omani deposits in the banking sector at 1.2 % approx. At the back of the good corporate performance, the Muscat Securities Market general price index registered a significant growth of 42 % in 2003. Further testimony of the progress and development of Oman's economy came from the recently released report by the Fraser Institute that has ranked Sultanate of Oman as the 18th most liberal economy among the 123 nations covered in the study.

The Government is pressing ahead with the privatization in the telecommunication, power, water, ports and wastewater sectors. In its efforts to broaden the base of the economy, the Government has initiated a number of new projects of national importance. Some of the more prominent projects in the offing are the LNG and fertilizer plant in Qalhat, power plants at Barka, Al Kamil and Salalah, a third LNG train, a refinery, polypropylene and a methanol plant in Sohar, a tourism project at Bander Jissah, the Seeb seafront resort, an aluminum smelter plant and the Salalah Container Port and Free Zone area in Salalah.

The Government has been announcing a host of progressive regulations that are comparable to the best in the world to promote and attract investments in the country. In keeping with its open policy of encouraging investments to Oman, the Sultanate is expected to shortly announce laws permitting ownership of real estate by expatriates.

The budget for 2004 forecasts a deficit of RO 500 million with planned expenditure of RO 3.43 billion and anticipated revenues of RO 2.93 billion. The increase in expenditure is on account of additional investment expenditure, which would spur economic activity in the medium term. The budget is based on very cautious assumptions. The oil price has been conservatively assumed at USD 21 per barrel against an actual realization of USD 27.50 per barrel in 2003. Based on reports from various research houses and other multilateral agencies, the outlook in the short to medium term for the Oman's economy remains positive.

Industry Structure and Developments

The financial services industry comprises of commercial banks, specialized lending institutions and other financial intermediaries. At the end of 2003, there were fourteen commercial banks and three specialized banks operating in the Sultanate. The five local commercial banks accounted for the bulk of the market share, with competition remaining intense amongst the banks for new business. Further consolidation took place in the local banking industry in 2003 with Majan International Bank merging with Bank Dhofar. Also, a major local bank injected additional share capital to further strengthen its capital position.

The total assets of all the commercial banks in the Sultanate increased by 3.5 % year-on-year (y-o-y) to touch RO 4.5 billion as at the end of 2003. Total lending increased modestly by 1.2% (y-o-y) in 2003 as compared to 0.9% (y-o-y) in 2002. The total deposits including Government deposits increased by 2.7% (y-o-y) in 2003. Most of the local banks operating in the Sultanate have posted an increase in profits for the year ended December 31, 2003. The banks in Oman are well positioned to benefit from an upturn in global economic activity.

Opportunities and Threats

The opportunities to grow profitable corporate banking and trade finance business remain limited. With Oman's accession to the World Trade Organization regional and international banks may decide to enter the Omani market and create more competition for local banks. Also, proliferation of e-banking may offer customers the option to deal with non-local banks for certain financial services.

Falling oil production and volatility in oil prices could adversely affect the Government's revenues. Also increasing cost of capital for firms leading to reluctance on the part of the private sector to make significant new investments locally.

Merger of Erstwhile Majan International Bank

The first quarter of 2003 saw the culmination of the merger process of erstwhile Majan International Bank with Bank Dhofar SAOG. The merger between the two banks became effective March 31, 2003 with Majan International Bank ceasing to operate from that date. Plans were set and progress monitored against these plans to achieve a smooth and seamless integration with minimal disruption to customer service. Open communication, excellent teamwork, attention to detail and a shared purpose ensured that the various merger-related tasks were completed in a time bound manner. As a result of the merger, the accretion to the total assets of Bank Dhofar was RO 96.56 million, additional details of which are available in the notes accompanying the financial statements. The rationalization of functions and facilities subsequent to the merger, has ensured that synergies as anticipated are realized to enhance share value on a long-term basis.

An international consultancy firm was retained by the Bank to review and advise on the various organizational and managerial aspects of the Bank after the merger. Based on their study, the firm made recommendations and suggestions to the Board for implementation. After a careful consideration, of these recommendations, by the Board, the relevant changes were implemented in 2003.

Five Year Strategic Plan

The Bank retained a renowned consulting firm to assist in the development and preparation of a Strategic Plan for the Bank covering the next five years up to 2008. Ambitious growth plans have been drawn, keeping in perspective, the interests of the various stakeholders, paramount among them being our customers, shareholders and staff. The Board approved these plans towards the end of 2003.

New Corporate Identity

In the second half of 2003, we received shareholders' and regulatory approvals to shorten the name of the Bank to "Bank Dhofar". The new corporate identity has been formally launched in early 2004. The transition to the new corporate identity, in a phased manner, will entail changing signage, stationery, cheque books, Electron and credit cards, etc. The objective of launching the new corporate identity is to position the Bank as a significant and dominant player in the Omani banking sector.

بنك ظفار
BankDhofar

The new logo and identity are an affirmation of the Bank's unflinching commitment to our customers. The green dot on top of the new logo depicts this symbolically. The new logo is a phonetic connotation of the words Bank Dhofar. The Bank's vision, looking ahead, is aptly encapsulated in our new corporate slogan - **moving forward...with you.**

Review of Operations

Retail Banking and Marketing

The Retail Banking and Marketing Group (RBMG) posted a strong performance in 2003 with its continuing focus on delivering value-added innovative products and services to its customers. The RBMG adopts a market-oriented approach to develop and market financial products and services that fulfill the banking requirements of our Retail customers. Changing customer preferences are

The driving force...

identified through market research, customer surveys, opinion polls and an array of other tools so that innovative products and services are designed that meet the banking needs of customers in a particular segment. The customer is always at the forefront and center stage in all our product development, delivery and service initiatives.

In order to realize the strategic objectives and sharpen their focus, the RBMG was organized into five main units in the first half of 2003. These being: Branch Distribution, Direct Banking & Marketing, Product Management and Service Quality, Retail Credit and the Card Center. These divisions work in a cohesive manner to ensure that the strategic objectives set for the RBMG are achieved.

With the merger of erstwhile Majan International Bank SAOC with Bank Dhofar and the subsequent rationalization of our branch network, the total number of branches at the end of 2003 reached forty-five (45), a net increase of two (2) branches over the number as at December 31, 2002. The Bank is presently conducting feasibility studies to open new branches at suitable locations, thereby further augmenting the physical branch network of the Bank.

Complementing the branch network, the Bank is launching an array of electronic delivery channels for the added banking convenience of our customers. In the last quarter of 2003, Short Message Services (SMS) was launched under the 'Al Zajil' banner, making us the first bank in the Sultanate to offer such a service to its customers. The Bank offers a comprehensive range of banking services over SMS with a combination of 'pull' and 'push' services. Considerable investment in technology and people is being made to offer banking services through other

electronic channels, some of which will be available for the use of our customers in 2004. The Bank as at the end of 2003 had sixty-two (62) proprietary Automated Teller Machines (ATMs), which are linked to the OmanSwitch, allowing our customers to use a wide network of over 365 ATMs in Oman and other ATMs in some GCC countries to conduct banking transactions.

Last year, the consumer loan policy was enhanced to make the various consumer loan products more flexible and attractive. 'Al Heson' the prize savings scheme was redesigned and now has total annual prize money of RO 630,000. The new format of Al Heson savings scheme offers prizes on a monthly and weekly basis with special prizes for ladies and children. The launch of minors' accounts under the 'Mazeen and Mazoon' savings scheme has been well received as is evidenced by the keen interest in opening accounts under this scheme by young savers. The Bank recorded a significant growth in Visa Electron cards and credit cards issued during 2003. According to Visa International, the Bank has recorded the highest growth in Oman for both issuance and usage of Visa credit cards.

Various exciting initiatives are under way for rollout in 2004 which will ensure that our customers continue to benefit from top class products and services and the Bank retains its leadership position locally.

Corporate Banking

The Corporate Banking Division has been playing a pivotal role in the profitable growth of the business of the Bank. The division was organized into two distinct units in the first half of 2003, with one unit being exclusively responsible for medium-sized firms and the other unit managing the large corporate entities, syndications and project financing. The objective of this bifurcation, apart from improving focus on the customers belonging to the respective segments, is to ensure that we develop marketing strategies that are closely aligned to the requirements of our customers in each segment.

The Mid-Sector Corporate Division has been extending traditional credit products, in addition to offering tailor-made products especially designed for mid-sized entities in various sectors. We recognize this as a growing market segment having its own distinct financing requirements which is best served by dedicated staff who fully understand these unique banking needs.

In the first half of 2003, Corporate Banking efforts were directed to ensure that the customer relationships remain unaffected due to the merger of erstwhile Majan International Bank with Bank Dhofar. It is noteworthy that the merged entity has been able to retain all the major clients. The client list which already includes most of the leading business houses in Oman was expanded further in 2003 to include new corporate relationships. The Corporate Banking Division was particularly active in the area of project financing and syndications in 2003. We participated in many high profile financial closures for a number of projects of national importance that are expected to benefit Oman's economy.

Treasury, Trade Finance and International

In order to reduce the volatility of the Bank's net income due to changes in the interest rates, which have continued to remain at historically low levels, concerted efforts have been made to increase the quantum of non-interest income. The strong growth in non-interest income is a clear indication that our efforts have started to yield good results with these three divisions being a significant contributor to the Bank's non-interest income in 2003.

Trade Finance continues to be a key focus area of the Bank and we are committed to upgrade our product range and service offerings in this area. Investment in technology and manpower will support the ambitious growth planned for the Trade Finance division in the coming years.

The International Division has successfully negotiated a fully underwritten syndicated loan facility for USD 50 million with a green shoe option of USD 25 million. The facility is led by major international banks and the response has been extremely encouraging with commitments from banks in Europe, Far East, Middle East and the USA exceeding the required amount. The participation of these banks in our syndicated borrowing program reflects the confidence of the international financial community to the country in general and to the Bank and its management, in particular.

Support Services

Key divisions in the Support Services Group are Information Technology, Human Resources and Central Operations.

Central Operations

In the second quarter of 2003, a Central Operations Division was established within the Bank. The objective of creating this division is to have a specialized unit, where various back office operations are carried out centrally in an efficient, economical and effective manner. Some of the key benefits that would accrue as a direct result of setting up this division include achieving economies of scale, application of specialized know-how, automation of workflows and an effective management of operational risks. It would also facilitate continuous improvement to our internal processes to provide top-quality service consistently to our valued customers. The centralization of the back office processes would provide our branch staff with quality time to delight and exceed customer expectations.

Some of the activities that are carried out by the Central Operations include processing of clearing, payments, payroll and support to the branches. The division aims to be a 'Centre of Excellence' and has embarked on value creation through:

- Effective processing of transactions
- Adopting "Total Care" approach in the services provided
- Developing "Business Smart Technical People"
- Establishing core "Areas of Excellence"
- Providing hands on training and experience-based learning for young Omani staff
- Providing technical "Check and Balance" to the organization
- Forging "Win-Win" modus operandi with the customers.

In 2004, the Central Operations Division will launch various new initiatives thereby moving up the value chain from being 'provider of services' to a 'service partner' whose strategies and objectives are firmly aligned with those of the service recipients and more importantly with those of the Bank.

Information Technology

The division ensures that the technology needs of the Bank are met in a cost effective manner by acquiring state-of-the-art solutions that are suitable for the activities and operations of the Bank. On merger of erstwhile Majan International Bank with Bank Dhofar, the division achieved a smooth and seamless integration of the computer system of erstwhile Majan International Bank with that of Bank Dhofar. It is indeed creditable that the data migration to the core banking system of Bank Dhofar was completed over a weekend, as planned, with minimal disruption to customer service.

MANAGEMENT DISCUSSION AND ANALYSIS REPORT (contd.)

The Bank continues to invest heavily in technology and upgrade its computer systems. In 2003, the Bank upgraded its core banking software. As mentioned earlier, the SMS banking service with a variety of pull and push services was successfully rolled out to the customers in the last quarter of 2003. Testing was successfully completed for upgradation of the front-end computer system being used by the branches with the actual implementation planned for 2004. We also migrated the SWIFT system from Fast-wire Logica to SWIFT Alliance Access in the second half of 2003.

The division is currently spearheading various new projects some of which would be implemented in 2004. These projects aim to enhance our electronic delivery channel capability, strengthen risk management systems, support new lines of business, reduce time to market to launch new products and services and automate more processes. The overall objective behind all these initiatives is to ensure that our customers are provided with superior financial products and world-class service.

Human Resources

The division successfully managed integration of new staff who have joined as a consequence of the merger. The total headcount as at December 31, 2003 was 562. The Bank is committed to developing and retaining top-notch Omani staff and has always placed special emphasis on quality Omanization at all levels. The Bank achieved an Omanization ratio of 92.7% as at the end of 2003, as compared to an Omanization level of 90 % set by the Central Bank of Oman.

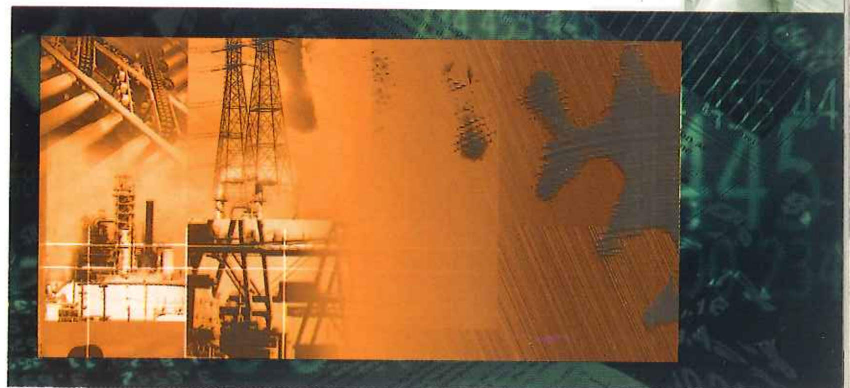
Over 150 training programs were arranged by the Bank in 2003 to impart necessary training to improve banking related knowledge and develop relevant skills of our staff. In all around 1,200 participants were covered in the various training programs conducted throughout the year on diverse topics like Bank Operations, Trade Finance, Lending, Management Development, Superior Customer Service and Marketing, Risk Management, Money Laundering and other relevant subjects. The Bank has also sponsored around 30 staff members at the Institute of Banking and Financial Studies to pursue Banking Diploma courses. The Bank has been sponsoring deserving senior staff for higher studies overseas. In 2003, the Bank sponsored two staff members each for MBA studies and a long duration course in Executive Business English in the UK.

A new Performance Management system has been introduced in the Bank. The redesigned system of performance appraisal is based on Management by Objectives. The new system will further reinforce that our reward system continues to be closely linked to the performance of the employees. We remain committed to make Bank Dhofar a learning organization and a preferred place for performing staff to work.

Risk Management

The Bank established an independent Risk Management Division, in the first half of 2003. The division is managed by a team of competent and experienced personnel. The primary function of this division is to ensure that an effective risk management framework exists within which the various divisions of the Bank operate. The division assists in defining appropriate risk tolerance levels for the respective business divisions. The risk management strategy of the Bank is based on a clear understanding of various risks, disciplined risk-assessment and measurement procedures and continuous monitoring. Risk management governance is provided through various Board and Management level oversight committees.

In 2003, the Central Bank of Oman formulated detailed guidelines on risk management for compliance of the banks operating in the Sultanate of Oman. A reputed external firm was retained by the Bank to review the existing risk management framework in the light of guidelines issued by the Central Bank of Oman. The review led to identification of areas where further improvement was possible in the area of risk management. Pursuant to this study, the Bank has drawn a time-bound plan to further strengthen its risk



management systems, based on best of breed technologies and latest techniques and methodologies in this area.

The Bank is at an advanced stage of implementing a best-in-class credit risk management software that will assist in an effective risk-based credit assessment, rating and benchmarking of our corporate borrowers. The corporate credit proposals are reviewed by Risk Management, whose observations form an important input to the decision making process.

The Treasury Division is responsible for the management of liquidity and interest rate risk under the guidance and supervision of the Asset and Liability Management Committee. The Risk Management Division is responsible for oversight of related guidelines set internally and by the regulators on this subject.

Operational risk is controlled through established and detailed internal controls with well-defined reporting lines and segregation of duties. Regular audit checks ensure that necessary controls exist to mitigate this risk.

The key elements of our risk management practices include independent checks and balances, formal authority limits for approval, well-defined policies and procedures, modelling and scenario testing, diversification, active portfolio management and experienced risk management personnel.

The important types of risks to which the Bank is exposed are credit risks, liquidity, market risk and operational risk. Note 28 accompanying the financial statements provides an overview of some of these risks along with details of the Bank's policies to measure, monitor and manage these risks.

Credit Risk

This refers to the risk that counter-parties may default where credit facilities have been provided to them. Credit risk is controlled and managed by dealing with customers of good credit standing, thorough credit assessment, obtaining collateral when appropriate and continuous monitoring. Additionally, group and single obligor limits, borrower rating, portfolio analysis, counter party limits and concentration of limits are some of the tools that are used by the Bank to effectively manage its credit risk.

The Bank employs experienced and competent staff in the area of Corporate Banking, providing them with regular training to upgrade and hone their credit skills. Detailed credit policies, procedures and guidelines, proper segregation of duties, elaborate matrix of authorities for credit approval and periodic audit and examinations by the internal and external auditors ensure that a rigorous environment of checks and balances exists within the Bank.

Liquidity Risk

Liquidity risk refers to the risk that a firm will encounter in raising funds to meet commitments associated with financial instruments. It includes both the risk of being unable to fund assets at appropriate maturities and rates and the risk of being unable to liquidate a financial asset at close to its fair value. The Treasury Division in conjunction with the other divisions manages the liquidity on a daily basis. The Asset Liability Committee (ALCO) sets the broad framework for the Treasury to operate so that the Bank is always in a position to meet its financial commitments. A high-level ALCO meeting is held on a monthly basis in addition to a weekly ALCO meeting to handle tactical issues. ALCO regularly reviews the liquidity policy, in addition to overseeing other matters with which it is entrusted.

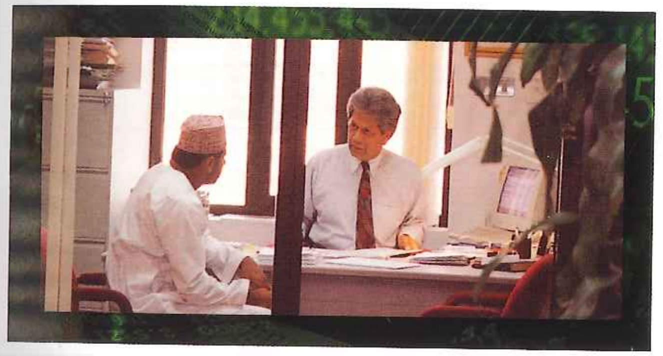
Diversification of depositor base, reducing dependence on large depositors and maintaining a suitable mix of deposits including low cost deposits are some of the measures that the Bank has regularly taken to maintain a stable deposit base. The Bank maintains a stock of high quality liquid assets, which can be liquidated at a short notice to raise cash if required. The Bank has in place arrangements with several international banks to raise funds, if required. The Bank has recently secured a medium term syndicated loan of USD 75 million from international banks, with the draw down expected in 2004. The Bank has also plans for augmenting its medium term deposits in Rial Omani to reduce the maturity mismatch.

Market Risk

Market risk is the risk of loss arising from unexpected changes in financial prices, including interest rate, exchange rates, bond, equity and commodity prices. Two prominent risks affecting the Bank are currency and interest rate risk.

The major foreign currency to which the Bank is exposed is the US Dollar. The established parity between US Dollar and Rial Omani substantially reduces this risk unless the parity between the two currencies is revised. It is unlikely that this parity will be changed in the near future. To control currency exposures, intra day and overnight limits have been set up in addition to currency-wise stop loss limits for the dealing room. The Central Bank of Oman has set prudential norms for the net open position to restrict the banks from taking undue currency risks.

The Bank manages the interest rate risk by matching the re-pricing of assets and liabilities through various means and operating within the set gap limits. Foreign currency loans are linked to the Libor rates and re-priced regularly to reduce the attendant interest rate risk.



Operational Risk

Operational risk is the risk of loss resulting from inadequate or defective internal processes and systems, technical failures or from external events. The Bank has detailed policies and procedures that are regularly updated to ensure that a sound internal control environment exists in the Bank. Trained and competent staff oversee the operational functions of the Bank. Tested Disaster Recovery plans exist to provide normal banking services in the eventuality of any disruption. The Bank is closely reviewing the various recommendations issued by the Basel Committee on "Sound practices for the management and supervision of operational risk" for implementation.

Financial Performance

The Bank posted strong growth in 2003 with the year-end total assets touching RO 474.1 million, an increase of 37.8% as compared with RO 344.0 million at the end of 2002. The net loans and advances to customers increased from RO 266.0 million at the end of 2002 to RO 367.2 million at the end of 2003, a creditable growth of 38.1%. An analysis of our loans and advances portfolio as at December 31, 2003 along with the comparative figures for the prior period is as follows:

	RO million	
	2003	2002
Overdrafts	50.8	39.5
Loans	326.1	228.7
Loans against trust receipts	18.4	4.9
Bills Discounted	2.6	1.5
Advance against credit cards	4.1	3.4
Others	2.8	6.4
Gross loans and advances to customers	404.8	284.4
Less: Allowance for impairment	(37.6)	(18.4)
Net Loans and Advances	**367.2**	**266.0**

Investments in securities increased in 2003 by RO 8.6 million mainly due to an increase in our holdings in the Government of Oman Development Bonds from RO 10.5 million in 2002 to RO17.3 million at the end of 2003. Also, the available for sale equity investments increased by RO 1.8 million in 2003.

Total deposits from customers reached RO 358.4 million at the end of 2003 compared with RO 277.2 million at the end of 2002, representing a growth of 29.3% over 2002 figures.

The composition of customer deposits at the end of 2003 along with the corresponding figures for the prior period is as follows:

	RO million	
	2003	2002
Current accounts	91.2	59.7
Saving accounts	45.5	39.7
Time deposits	209.0	176.9
Certificates of deposit	10.1	-
Margin accounts	2.6	0.9
Total customer accounts	**358.4**	**277.2**

The 3-years certificate of deposits (CDs) amounting to RO 10.1 million carries an interest rate of 6.75% per annum. The CDs will mature for payment in July 2004.

Following the merger of erstwhile Majan International Bank (MIB) with Bank Dhofar and in line with the merger terms, subordinated bonds amounting to RO 7.36 million were issued in 2003. These bonds having a face value of RO 1 each and tenor of 5 years and 1 day carry a coupon of 7% per annum with interest payable annually. The subordinated bonds were issued in accordance and in compliance with the guidelines on Reporting Capital Measurement and Capital Standards based on Basle Committee framework as defined by the Bank for International Settlements (BIS). These bonds are included in Tier II capital for the calculation of capital adequacy ratio and are listed on the Muscat Securities Market.

Shareholders' Equity

The shareholders' equity at the end of 2003 was RO 63.1 million compared with RO 47.4 million at the end of 2002. The increase in shareholders' equity is attributed mainly to an increase in share capital by RO 6.68 million and the recognition of RO 5.43 million as part of the share premium reserve. The increase in the share capital of RO 6.68 million is on account of issuance of 6.68 million shares of nominal value RO 1 each to the former shareholders of erstwhile Majan International Bank as part of the merger consideration.

We have transferred RO 1.02 million to the legal reserve being 10% of the net profits for 2003. Also, an amount of RO 1.47 million has been transferred to the subordinated bonds reserve representing 20% amortization of the total amount of outstanding subordinated bonds of RO 7.36 million. Retained earnings increased from RO 1.53 million at the end of 2002 to RO 2.65 million at the end of 2003.

The net assets per share reached RO 1.504 at the end of 2003 compared with RO 1.344 at the end of 2002. An analysis of shareholders' funds at the end of 2003 along with the corresponding figures for prior period is as follows:

	RO million	
	2003	2002
Share capital	41.96	35.28
Share premium	5.43	-
Legal reserve	5.32	4.30
Subordinated bonds reserve	1.47	-
Proposed distribution	6.29	6.29
Retained earning	2.65	1.53
Total Shareholders' Equity	**63.12**	**47.40**

Income Statement

Net interest income increased by 17.6% from RO 18.2 million for the year ended 2002 to RO 21.4 million for the year ended 2003. For the year ended 2003, interest income increased by 12.3%, while interest expense decreased by 2.2% as compared to that of 2002.

Other income recorded remarkable growth of 23.8% and reached RO 5.04 million in 2003 compared with RO 4.07 million in 2002 at the back of a robust increase in net fees and commission by 39%. A detailed analysis of other income for 2003 along with the corresponding figures for prior period is as follows:

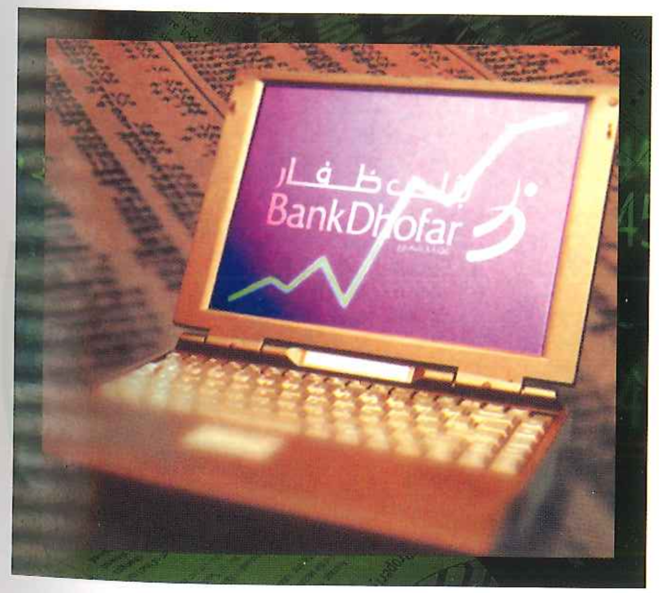
	RO million	
	2003	2002
Net fees and commission	1.45	1.04
Foreign exchange	0.40	0.27
Investment securities	1.70	1.20
Other income	1.49	1.56
Total Other Income	**5.04**	**4.07**

Total operating income grew by 18.6% and reached RO 26.44 million in 2003 compared with RO 22.29 million in 2002.

Total operating expenses increased from RO 8.85 million in 2002 to RO 11.02 million in 2003. Staff costs increased in 2003 by RO 1.30 million, while the administration costs increased by RO 0.86 million. The increase in operating expenses is mainly due to the additional operating expenses relating to the merger of the activities and operations of erstwhile Majan International Bank with Bank Dhofar. In spite of an increase in operating expenses, cost to income ratio has been maintained at an acceptable level of 41.7% in 2003 compared with 39.7% in 2002.

The Bank continued its prudent policy of making provisions as required for impaired assets. The amount of impairment provided in 2003 was RO 4.96 million compared with RO 4.84 million in 2002. A detailed analysis of impairment for 2003 along with the corresponding figures for the prior period is as follows:

	RO thousands	
	2003	2002
Impairment for:		
Investments	-	462
Loans & advances	4,878	4,248
Written-off	57	8
Property & Equipment	28	120
Provisions recovered	(960)	(735)
Impairment	**4,003**	**4,103**



Net profit increased in 2003 by 22.4% and reached RO 10.16 million for the year ended 2003 compared with RO 8.30 million in 2002. The earnings per share increased from RO 0.235 in 2002 to RO 0.252 in 2003.

The Board of Directors proposes to pay a 15% cash dividend amounting to RO 6.29 million, subject to the approval of the Bank's shareholders. The proposed profit appropriation for 2003 is as follows:

	RO thousands	
	2003	2002
Appropriation:-		
Proposed dividends	6,294	6,294
To legal reserve	1,016	830
To subordinated bonds reserve	1,472	-
Proposed directors remuneration	254	178
To retained earning	1,120	993
Net profit for the year	**10,156**	**8,295**

Future Prospects

Bank Dhofar is, today, the fourth largest bank in the Sultanate in terms of total assets and branch network. The Bank is ranked as the third most profitable bank in the Sultanate for 2003. The Bank has a strong capital position, state-of-the-art technology and a committed and competent work force. The Bank follows prudent provisioning policy and our provisions for non-performing accounts is in excess of 100% of the impaired amount. The Bank has been investing heavily in technology to upgrade systems and its people to offer a wide range of world-class financial services to our customers. The year 2004 should see us launching a number of key initiatives which will further cement our position as a dominant player in the local banking sector.

FINANCIAL HIGHLIGHTS OF LAST FIVE YEARS

(In RO'000)

For the year

	2003	2002	2001	2000	1999
NET INTEREST INCOME	21,402	18,224	15,390	10,873	10,438
NON INTEREST INCOME	5,040	4,068	3,282	3,049	3,114
OPERATING COSTS	11,016	8,854	7,948	6,129	6,016
OPERATING PROFIT (before impairment losses)	15,426	13,438	10,724	7,793	7,536
PROFIT FROM OPERATIONS	11,423	9,335	6,733	6,628	6,204
NET PROFIT FOR THE YEAR	10,156	8,295	6,133	5,528	5,463

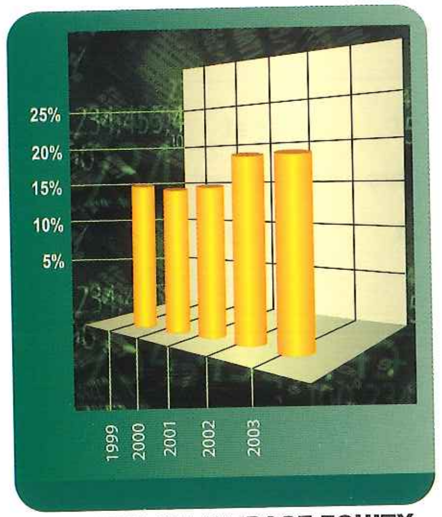
At year-end

	2003	2002	2001	2000	1999
TOTAL ASSETS	474,085	344,003	337,054	272,530	261,589
NET LOANS PORTFOLIO	367,185	266,006	257,676	212,761	197,304
CUSTOMER DEPOSITS	358,397	277,219	268,406	210,859	196,058
SHAREHOLDERS' EQUITY	63,127	47,408	42,651	39,839	39,195
SHARE CAPITAL	41,962	35,280	33,600	32,000	32,000
FULL SERVICE BRANCHES	45	43	43	27	23
ATMs	62	58	57	45	40
STAFF	562	431	443	348	341

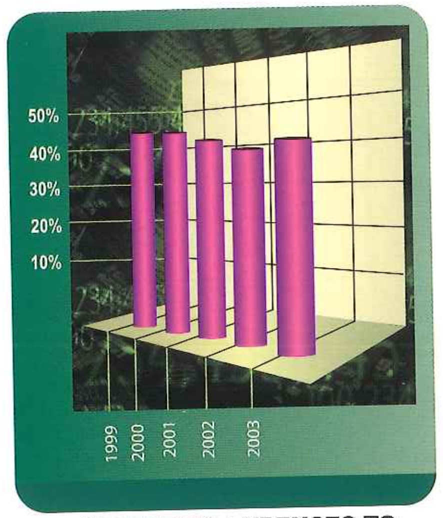
FINANCIAL RATIOS OF LAST FIVE YEARS

I-PROFITABILITY	As at 31st Dec 2003	As at 31st Dec 2002	As at 31st Dec 2001	As at 31st Dec 2000	As at 31st Dec 1999
Return on Average Equity	18.4%	18.4%	14.9%	14.0%	15.0%
Return on Average Capital	26.3%	24.1%	18.7%	17.3%	17.1%
Return on Average Assets	2.5%	2.4%	2.0%	2.1%	2.2%
Non Interest Income to Operating Income	19.1%	17.4%	17.6%	21.9%	23.0%
Operating Expenses to Operating Income	41.7%	39.7%	42.6%	44.0%	44.4%
II-LIQUIDITY					
Net Loans to Total Deposits	95.4%	93.6%	90.9%	95.2%	92.3%
Total Customer Deposits to Total Deposits	93.1%	97.6%	94.7%	94.3%	91.7%
III- ASSET QUALITY RATIOS					
Loan Loss Provisions to Total Loans	9.3%	6.5%	5.4%	5.3%	5.1%
Non Performing Loans to Total Loans	8.7%	5.3%	4.9%	4.4%	4.5%
Loan Loss Provisions to Total Non Performing Loans	106%	121.7%	110.3%	111.8%	114%
IV-CAPITAL ADEQUACY					
BIS Risk Assets Ratio	15.6%	14.3%	13.8%	15.7%	16.5%
BIS Risk Assets Ratio on Tier One Capital	12.8%	13.0%	12.7%	14.5%	15.2%
Shareholders' Equity / Total Assets	13.3%	13.8%	12.7%	14.6%	13.2%

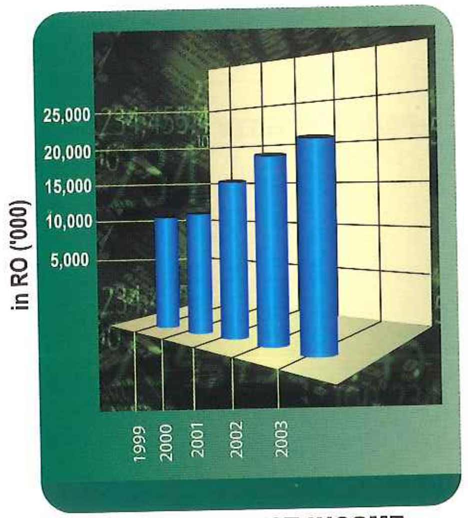
FINANCIAL HIGHLIGHTS OF LAST FIVE YEARS



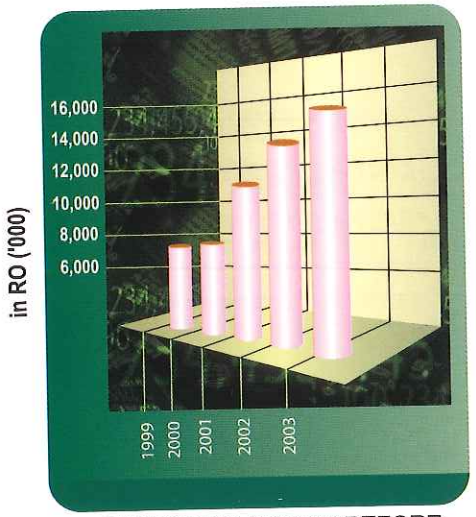
RETURN ON AVERAGE EQUITY



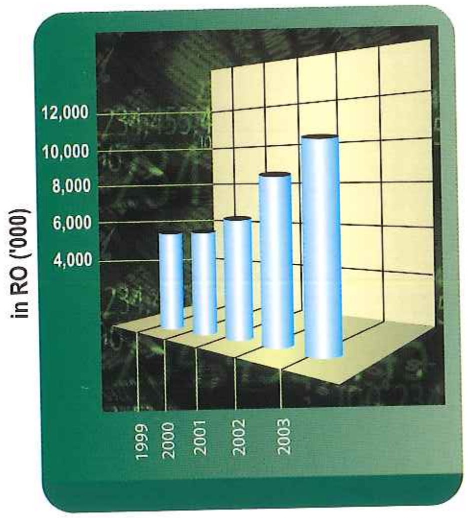
OPERATING EXPENSES TO OPERATING INCOME



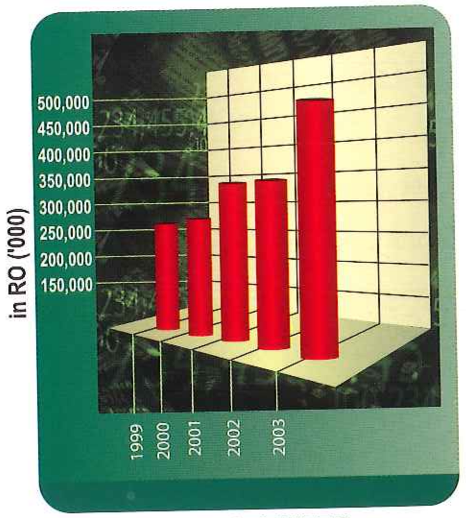
NET INTEREST INCOME



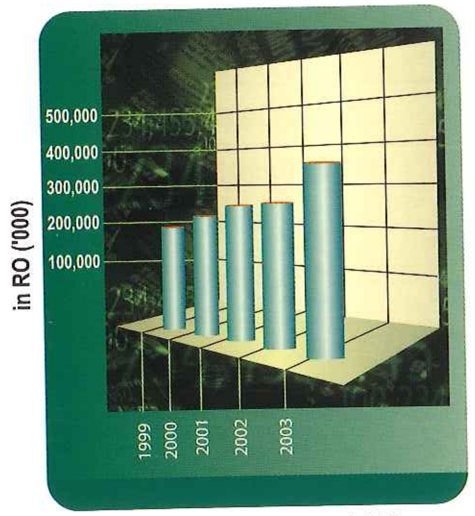
OPERATING PROFIT BEFORE IMPAIRMENT



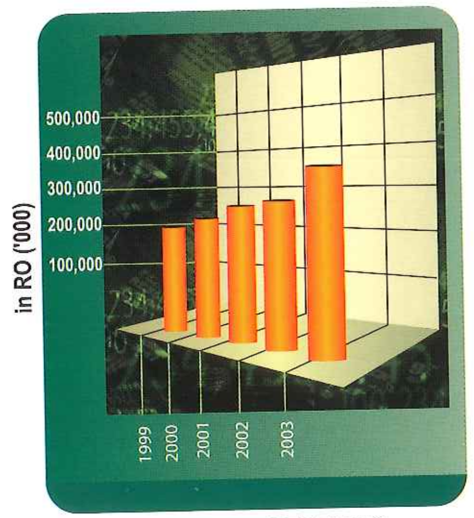
NET PROFIT FOR THE YEAR



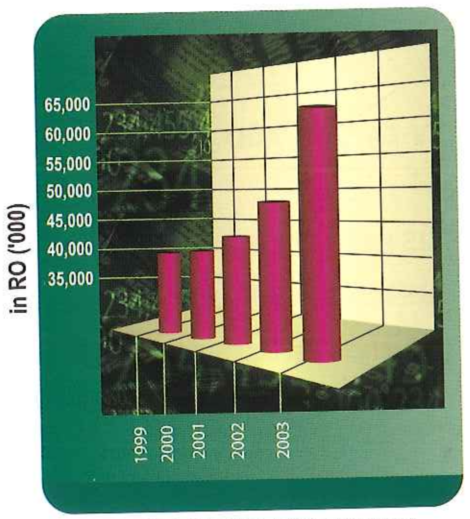
TOTAL ASSETS



NET LOAN PORTFOLIO



CUSTOMER DEPOSITS



SHAREHOLDERS' EQUITY

BANK DHOFAR NETWORK OF BRANCHES & ATMS

Branches

Branch	Telephone	Fax	Address
Muscat Governorate			
Muscat	736614/736606	739166	1613, PC 112, Ruwi
Chroniche Muttrah	712970/714452	713556	1441, PC 112, Ruwi
MBD	750516/790466	798621	2230, PC 112, Ruwi
Greater Muttrah	707959/706636	706103	1831, PC 112, Ruwi
Wadi Al Kabir	7714126/7714127	7714128	1507, PC 112, Ruwi
Ruwi	7731090/7735854	7731892	1442, PC 112, Ruwi
Amerat	576580/576120	575829	346, PC 112, Ruwi
Wattayah	566731	566732	1696, PC 112, Ruwi
Qurum	567671/567673	567679	108, PC 114
Madinat Sultan Qaboos	601256/604606	601245	326, PC 114
Al Khuwair	602374/602049	601623	1507, PC 112, Ruwi
Al Khuwair Centre	680008/684880	683366	2717, PC 112, Ruwi
Bausher Polyclinic	502606/596994	595323	184, PC130
Azaiba	595075/596811	595079	378, PC 133
Seeb Airport	510101/510102	510468	56, PC 111, Seeb
Al Khoud	536132/545026	545268	555, PC 121
Seeb Town	623373/625852	625627	347, PC 121, Seeb
AL Batinah Region			
Barka	884423/884428	884451	751, PC 320, Barka
Rustaq	875117/876039	875591	25, PC 318, Rustaq
Rustaq 2-Al Ghoshb	878737/875759	878797	216, PC 329
Muladdah	868544/868553	868549	106, PC 314, Muladdah
Suwaiq	862010/862001	862102	585, PC 315, Suwaiq
Khadra Al Burashid	814162/814164	814163	505, PC 315, Suwaiq
Khaboura	801028/801686	805130	423, PC 326
Hafeet	817991/817992	817993	596, PC 319, Saham
Saham	856699/854400	855277	92, PC 319, Saham
Sohar	840228/844358	841229	21, PC 311, Sohar

Branch	Telephone	Fax	Address
Dhahirah Region			
Ibri	489341/489685	490341	28, PC 511, Ibri
Al Iraqi	495071/494126	495047	90, PC 515, Iraqi
Buraimi	651989/651696	651115	278, PC 512, Burami
Dakhliah Region			
Bidbid	369044/369033	369055	307, PC 613, Bid Bid
Sumail	351188/351283	350094	190, PC 620
Barkat Al Mauz	433460/433466	433462	97, PC 616, Barkat Al Mauz
Nizwa	410234/411370	411234	83, PC 611, Nizwa
Bahla	420292/420021	420387	661, PC 612, Bahla
Sharqiyah Region			
Sinaw	474367/474663	474823	296, PC 418, Sinaw
Ibra	471631/471632	470646	514, PC 413, Ibra
Al Mintirib	484049/483853	483510	154, PC 421
Jalan Bani Bu Ali	453440/453414	453446	10, PC 416, Jalan
Al Ees – Sur	444350/441912	443710	323, PC 411
Sur	441255/440256	440615	75, PC 411, Sur
Dhofar Governorate			
Salalah	292299/294863	295291	2334, PC 211, Salalah
Saada- Salalah	225409/225463	225179	2334, PC 211, Salalah
Al Wadi- Salalah	212185/212180	210085	2334, PC 211, Salalah
Awqadain- Salalah	211130/211226	211125	2334, PC 211, Salalah

ATM's

Muscat Governorate

Muscat Branch
Muttrah – Chroniche Branch
MBD Branch – 1
MBD Branch – 2
Greater Muttrah Branch
Al Wadi Al Kabir Branch
Ruwi Branch
Al Aamerat Branch
Wattayah Branch
Qurum Branch
Crowne Plaza Hotel
Madinat Sultan Qaboos Branch
Al Khuwair Branch
Al Khuwair Centre Branch
Al Sarooj Commercial Center
Al Khuwair 33 (Al Maha Filling Station)
Al Khuwair (Pic & Save)
Bausher Polyclinic Branch
Bausher (Zein Factory)
Al Gubrah(Al Shera'a Roundabout)
Azaiba Branch
Seeb Airport Branch
Seeb International Exhibition Center
Markaz Al Bahja
Al Khoud Branch
Al Khoud (Bp filling station- Book Roundabout)
Seeb Town Branch

Al Batinah Region

Barka Branch
Rustaq Branch
Rustaq 2 Branch – Gashob
Muladdah Branch
Suwaiq Branch
Khadhra Al Bu Rasheed Branch- Suwaiq
Khaboura Branch
Hafeet Branch- Saham
Saham Branch
Sohar Branch

Dhahirah Region

Ibri Branch
Iraqi Branch - Ibri
Buraimi Branch

Dakhliah Region

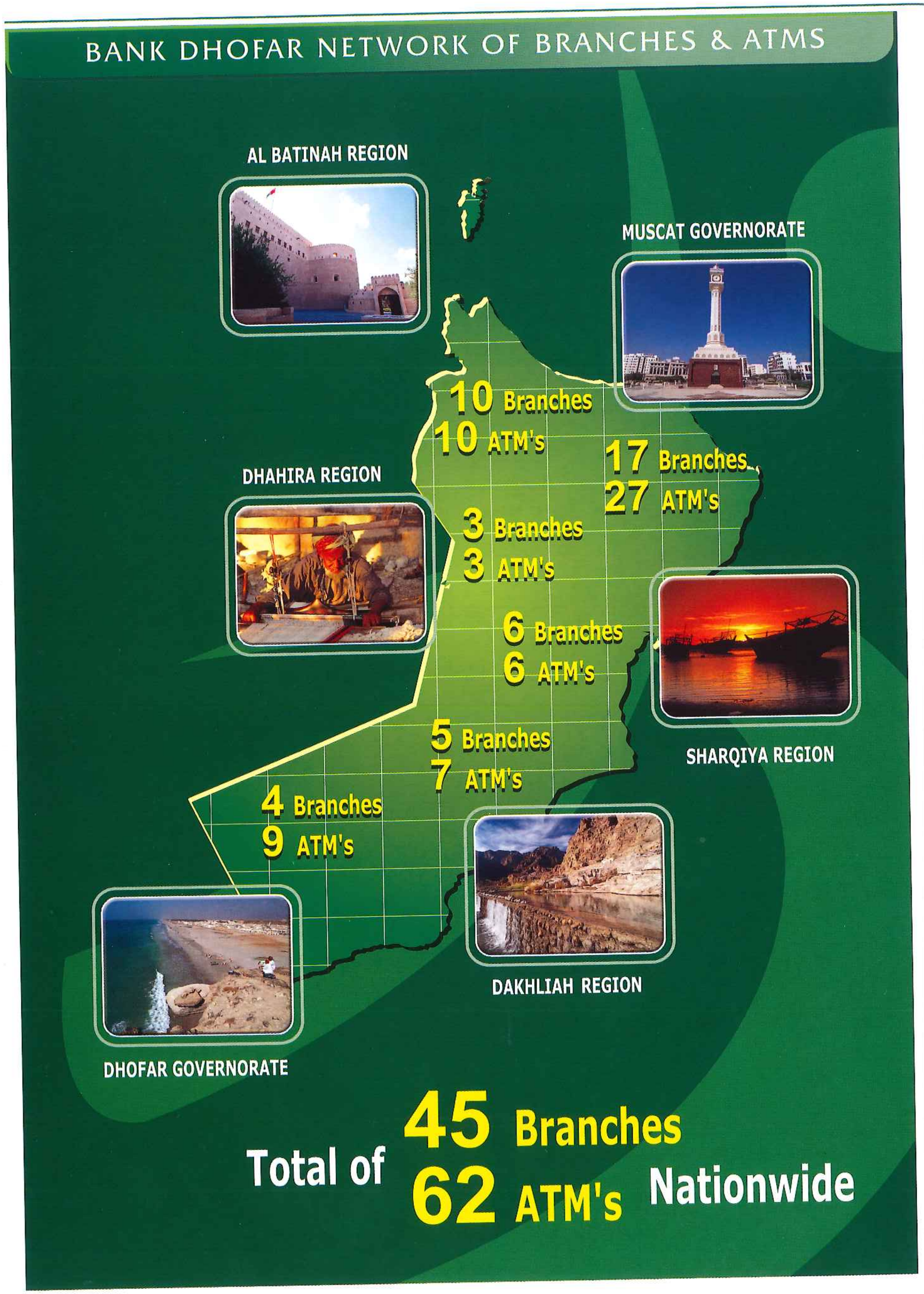
Bidbid Branch
Sumail Branch
Barkat Al Mauz Branch
Izki (Near Post Office)
Shafaa' (Shafaa' Military Camp- Izki)
Nizwa Branch
Bahla Branch

Sharqiyah Region

Sinaw Branch
Ibra Branch
Minitirib Branch-Bidiya
Jaalan Bani Bu Ali Branch
Al Ees Branch - Sur
Sur Branch

Dhofar Governorate

Salalah Branch
Salalah (Shell Filling Station-Sook Al Markazi)
New Salalah (Al Najah Street)
Salalah (Al Qoaf-Al Salaam Street)
Salalah (Haffa-Sultan Qaboos Street)
Al Sa'ada Branch-Salalah
Dahareez - Salalah
Al Wadi Branch - Salalah
Al Awqadain Branch-Salalah



KPMG

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REPORT OF THE AUDITORS TO THE SHAREHOLDERS OF BANK DHOFAR SAOG (Formerly Bank Dhofar Al-Omani Al-Fransi SAOG)

We have audited the balance sheet of Bank Dhofar SAOG ("the Bank") as of 31 December 2003 and the related statements of income, changes in equity and cash flows for the year then ended, set out on pages 30 to 64.

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 statements present fairly, in all material respects, the financial position of Bank Dhofar SAOG as at 31 December 2003 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 with the Commercial Companies Law of 1974, as amended.

27, January 2004

KPMG

Chartered Accountants
C.R. No. : 6/30936/1

KPMG, a branch office established under the law of Oman, is a member of KPMG International, a Swiss cooperative.

BALANCE SHEET

At 31 December 2003

2003 USD' 000	2002 USD' 000		Notes	2003 RO'000	2002 RO'000
		Assets			
36,320	26,940	Cash and cash equivalents	3	**13,983**	10,372
85,291	74,571	Treasury bills	26	**32,837**	28,710
59,377	36,951	Investment securities	4	**22,860**	14,226
52,652	32,683	Loans and advances to banks	5	**20,271**	12,583
953,727	690,925	Loans and advances to customers	6	**367,185**	266,006
8,927	12,221	Property and equipment	7	**3,437**	3,453
13,571	7,273	Intangible assets	8	**5,225**	2,800
21,524	11,951	Other assets	9	**8,287**	5,853
1,231,389	893,515	**Total assets**		**474,085**	344,003
		Liabilities			
69,026	18,016	Deposits from banks	10	**26,575**	6,936
930,901	720,049	Deposits from customers	11	**358,397**	277,219
48,374	32,311	Other liabilities	12	**18,624**	12,440
19,122	-	Subordinated bonds	13	**7,362**	-
1,067,423	770,376	**Total liabilities**		**410,958**	296,595
		Shareholders' equity			
108,992	91,637	Share capital	14	**41,962**	35,280
14,101	-	Share premium	14	**5,429**	-
13,813	11,174	Legal reserve	15	**5,318**	4,302
3,823	-	Subordinated bond reserve	15	**1,472**	-
16,348	16,348	Proposed distribution	14	**6,294**	6,294
6,889	3,980	Retained earnings		**2,652**	1,532
163,966	123,139	**Total shareholders' equity**		**63,127**	47,408
1,231,389	893,515	**Total liabilities and shareholders' equity**		**474,085**	344,003
169,709	124,062	**Contingent liabilities and commitments**	25	**65,338**	47,764
3.91	3.49	**Net assets per share (Rials Omani/USD)**		**1.504**	1.344

The notes on pages 34 to 64 form an integral part of these financial statements.

The financial statements were approved and authorised for issue by the Board of Directors on 27 January 2004 and signed on their behalf by:

Chairman

Chief Executive

The report of the auditors is set forth on page 29.

INCOME STATEMENT

For the year ended 31 December 2003

2003 USD' 000	2002 USD' 000		Notes	2003 RO'000	2002 RO'000
71,883	64,000	Interest income		**27,675**	24,640
(16,294)	(16,665)	Interest expense		**(6,273)**	(6,416)
55,589	47,335	**Net interest income**	18	**21,402**	18,224
13,091	10,566	Other income	19	**5,040**	4,068
68,680	57,901	**Operating income**		**26,442**	22,292
		Operating expenses			
(25,938)	(20,831)	Staff and administration costs	20	**(9,986)**	(8,020)
(2,675)	(2,166)	Depreciation	7	**(1,030)**	(834)
(28,613)	(22,997)	**Operating expenses**		**(11,016)**	(8,854)
40,067	34,904	**Profit from operations before impairment**		**15,426**	13,438
(10,397)	(10,657)	Impairment	21	**(4,003)**	(4,103)
29,670	24,247	**Profit from operations after impairment**		**11,423**	9,335
(3,291)	(2,701)	Income tax expense	22	**(1,267)**	(1,040)
26,379	21,547	**Net profit for the year**		**10,156**	8,295
0.66	0.61	**Earnings per share (Rials Omani/USD)**	16	**0.252**	0.235

The notes on pages 34 to 64 form an integral part of these financial statements.

The report of the auditors is set forth on page 29.

STATEMENT OF CHANGES IN EQUITY

For the year ended 31 December 2003

Share Capital USD' 000	Share Premium USD' 000	Legal reserve USD' 000	Sub-ordinated bond reserve USD' 000	Proposed distribution USD' 000	Retained earnings USD' 000	Total USD' 000		Note	Share Capital RO'000	Share premium RO'000	Legal reserve RO'000	Sub-ordinated bond reserve RO'000	Proposed distribution RO'000	Retained earnings RO'000	Total RO'000
87,273	-	9,018	-	13,091	1,401	110,783	1 January 2002		33,600	-	3,472	-	5,040	539	42,651
4,364	-	-	-	(4,364)	-	-	Issue of Bonus shares		1,680	-	-	-	(1,680)	-	-
-	-	-	-	-	21,545	21,545	Net profit for the year		-	-	-	-	-	8,295	8,295
-	-	-	-	(8,727)	-	(8,727)	Dividends paid		-	-	-	-	(3,360)	-	(3,360)
-	-	-	-	16,348	(16,348)	-	Proposed dividend	14	-	-	-	-	6,294	(6,294)	-
-	-	2,156	-	-	(2,156)	-	Transfer to legal reserve	15	-	-	830	-	-	(830)	-
-	-	-	-	-	(462)	(462)	Directors' remuneration		-	-	-	-	-	(178)	(178)
91,637	-	11,174	-	16,348	3,980	123,139	31 December 2002		35,280	-	4,302	-	6,294	1,532	47,408
17,355	-	-	-	-	-	**17,355**	**Shares issued**	14	**6,682**	-	-	-	-	-	**6,682**
-	**14,101**	-	-	-	-	**14,101**	**Share premium**	14	-	**5,429**	-	-	-	-	**5,429**
-	-	-	-	-	**26,379**	**26,379**	**Net profit for the year**		-	-	-	-	-	**10,156**	**10,156**
-	-	-	-	**(16,348)**	-	**(16,348)**	**Dividends paid**		-	-	-	-	**(6,294)**	-	**(6,294)**
-	-	-	-	**16,348**	**(16,348)**	-	**Proposed dividend**	14	-	-	-	-	**6,294**	**(6,294)**	-
-	-	**2,639**	-	-	**(2,639)**	-	**Transfer to legal reserve**	15	-	-	**1,016**	-	-	**(1,016)**	-
-	-	-	**3,823**	-	**(3,823)**	-	**Transfer to subordinated bond reserve**	15	-	-	-	**1,472**	-	**(1,472)**	-
-	-	-	-	-	**(660)**	**(660)**	**Directors' remuneration**		-	-	-	-	-	**(254)**	**(254)**
108,992	**14,101**	**13,813**	**3,823**	**16,348**	**6,889**	**163,966**	**31 December 2003**		**41,962**	**5,429**	**5,318**	**1,472**	**6,294**	**2,652**	**63,127**

The notes on pages 34 to 64 form an integral part of these financial statements the report of the auditors is set forth on page 29.

CASH FLOW STATEMENT

For the year ended 31 December 2003

2003 USD' 000	2002 USD' 000		2003 RO'000	2002 RO'000
		Operating activities		
82,319	70,452	Interest and commission receipts	31,693	27,124
(14,184)	(20,252)	Interest payments	(5,461)	(7,797)
(18,455)	(14,735)	Cash payments to suppliers and employees	(7,105)	(5,673)
49,680	35,465		19,127	13,654
		Increase in operating assets		
(65,333)	(31,192)	Loans and advances to customers	(25,153)	(12,009)
(17,932)	1,556	Loans and advances to banks	(6,904)	599
(153,000)	(109,730)	Purchase of treasury bills	(58,905)	(42,246)
144,790	119,870	Proceeds from sale of treasury bills	55,744	46,150
(91,475)	(19,496)		(35,218)	(7,506)
		Increase in operating liabilities		
59,405	22,891	Deposits from customers	22,871	8,813
48,400	(21,161)	Deposits from banks	18,634	(8,147)
107,805	1,730		41,505	666
66,010	17,699	**Net cash from operating activities**	25,414	6,814
(2,701)	(2,291)	Income tax paid	(1,040)	(882)
63,309	15,408	**Cash flow from operating activities**	24,374	5,932
		Investing activities		
1,855	2,345	Investment income	714	903
(2,605)	(2,252)	Purchase of investments	(1,003)	(867)
2,122	8,317	Proceeds from sale of investments	817	3,202
(1,769)	(1,699)	Purchase of property and equipment	(681)	(654)
203	96	Proceeds from sale of property and equipment	78	37
(34,720)	-	Acquisition of MIB	(13,367)	-
(34,914)	6,807	**Net cash from investing activities**	(13,442)	2,621
		Financing activities		
(16,348)	(8,727)	Dividend paid	(6,294)	(3,360)
(462)	(314)	Directors remuneration paid	(178)	(121)
(16,810)	(9,041)	**Net cash from financing activities**	(6,472)	(3,481)
11,585	13,174	**Net change in cash and cash equivalents**	4,460	5,072
28,535	15,361	**Cash and cash equivalents at 1 January**	10,986	5,914
40,120	28,535	**Cash and cash equivalents at 31 December**	15,446	10,986
36,320	26,940	Cash and cash equivalents	13,983	10,372
(894)	(875)	Capital deposit with Central Bank of Oman	(344)	(337)
5,060	3,005	Loans and advances to banks	1,948	1,157
(366)	(535)	Deposits from banks	(141)	(206)
40,120	28,535	**Cash and cash equivalents for the purpose of cash flow statement**	15,446	10,986

The notes on pages 34 to 64 form an integral part of these financial statements.
The report of the auditors is set forth on page 29.

Legal status and principal activities

Bank Dhofar SAOG ("the Bank") is incorporated in the Sultanate of Oman as a public joint stock company and is principally engaged in corporate and retail banking activities.

The Bank acquired Majan International Bank SAOC ("MIB"), an Omani closed joint stock company on 31 March 2003. In an Extra-ordinary General Meeting held on 30 September 2003, the shareholders of the Bank approved the change of name of the Bank from Bank Dhofar Al-Omani Al-Fransi SAOG to Bank Dhofar SAOG. The change of name was approved by the Ministry of Commerce and Industry on 17 January 2004.

Principal accounting policies

Basis of preparation

Statement of compliance

These financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS") issued by the International Accounting Standards Board ("IASB"), interpretations issued by the Standing Interpretations Committee of the IASB and the requirements of the Commercial Companies Law of 1974, as amended and disclosure requirements of the Capital Market Authority.

Basis of preparation

The financial statements are prepared on a fair value basis for derivative financial instruments, financial assets and liabilities held for trading, and available for sale assets, except those for which a reliable measure of fair value is not available. Other financial assets and liabilities and non-financial assets and liabilities are stated at amortised cost or historical cost.

The following accounting policies have been consistently applied in dealing with items that are considered material in relation to the Bank's financial statements.

Foreign currency transactions

Transactions in foreign currencies are translated into Rials Omani and recorded at the foreign exchange rate ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies, which are stated at historical cost, are translated into Rials Omani at the foreign exchange rate ruling at that date. Foreign exchange differences arising on translation are recognised in the income statement. Non-monetary assets and liabilities denominated in foreign currencies, which are stated at historical cost, are translated into Rials Omani at the foreign exchange rate ruling at the date of the transaction. Non-monetary assets and liabilities denominated in foreign currencies that are stated at fair value are translated into Rials Omani at the foreign exchange rates ruling at the dates that the values were determined.

2 Principal accounting policies (continued)

2.3 Financial instruments

2.3.1 Classification

Trading instruments are those that the Bank principally holds for the purpose of short-term profit taking and represent derivative contracts that are not designated and effective hedging instruments, and liabilities from short sales of financial instruments.

Originated loans and receivables are loans and receivables created by the Bank providing money to a debtor other than those created with the intention of short-term profit taking. Originated loans and receivables comprise loans and advances to banks and customers other than bonds purchased at original issuance.

Held-to-maturity assets are financial assets with fixed or determinable payments and fixed maturity that the Bank has the intent and ability to hold to maturity. These represent certain advances to banks and customers and certain debt investments.

Available-for-sale assets are financial assets that are not held for trading purposes, originated by the Bank, or held to maturity. Available-for-sale instruments include money market placements and certain debt and equity investments.

2.3.2 Recognition

The Bank recognises financial assets held for trading and available-for-sale assets on the date it commits to purchase the assets. From this date any gains and losses arising from changes in fair value of the assets are recognised.

Held-to-maturity loans and originated loans and receivables are recognised on the day they are transferred to the Bank.

2.3.3 Measurement

Financial instruments are measured initially at cost, including transaction costs.

Subsequent to initial recognition all trading instruments and all available-for-sale assets are measured at fair value, except that any instrument that does not have a quoted market price in an active market and whose fair value cannot be reliably measured is stated at cost, including transaction costs, less impairment losses.

All non-trading financial liabilities, originated loans and receivables and held-to-maturity assets are measured at amortised cost less impairment losses. Amortised cost is calculated on the effective interest rate method. Premiums and discounts, including initial transaction costs, are included in the carrying amount of the related instrument and amortised based on the effective interest rate of the instrument.

Principal accounting policies (continued)

Financial instruments (continued)

Fair value measurement principles

The fair value of financial instruments is based on their quoted market price at the balance sheet date without any deduction for transaction costs. If a quoted market price is not available, the fair value of the instrument 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 at the balance sheet date for an instrument with similar terms and conditions.

The fair value of derivatives that are not exchange-traded is estimated at the amount that the Bank would receive or pay to terminate the contract at the balance sheet date taking into account current market conditions and the current creditworthiness of the counter-parties.

Gains and losses on subsequent measurement

Gains and losses arising from a change in the fair value of available-for-sale assets and assets held for trading are recognised directly in income statement.

Cash and Cash equivalents

Cash and cash equivalents comprise cash on hand, cash deposited with Central Bank of Oman, and short-term highly liquid investments with maturities of three months or less when purchased, including treasury bills.

Treasury bills

Treasury bills issued for a term greater than three months are classified separately as assets available for sale.

Investments

Investments that the Bank holds for the purpose of short-term profit taking are classified as trading instruments. Debt investments that the Bank has the intent and ability to hold to maturity are classified as held-to-maturity assets. Other investments are classified as available-for-sale assets.

2 Principal accounting policies (continued)

2.7 Loans and advances

Loans and advances originated by the Bank are classified as originated loans and receivables. Loans and advances are reported net of allowances to reflect the estimated recoverable amounts (accounting policy 2.10).

2.8 De-recognition

A financial asset is derecognised when the Bank loses control over the contractual rights that comprise that asset. This occurs when the rights are realised, expire or are surrendered. A financial liability is derecognised when it is extinguished.

Available-for-sale assets and assets held for trading that are sold are derecognised and corresponding receivables from the buyer for the payment are recognised as of the date the Bank commits to sell the assets. The Bank uses the specific identification method to determine the gain or loss on de-recognition.

Held-to-maturity instruments and originated loans and receivables are derecognised on the day they are transferred by the Bank.

2.9 Offsetting

Financial assets and liabilities are offset and the net amount reported in the balance sheet when there is a legally enforceable right to set off the recognised amounts and there is an intention to settle on a net basis, or realise the asset and settle the liability simultaneously.

2.10 Impairment

Financial assets are reviewed at each balance sheet date to determine whether there is objective evidence of impairment. If any such indication exists, the asset's recoverable amount is estimated.

2.10.1 Originated loans and advances

The recoverable amount of originated loans and advances is calculated as the present value of the expected future cash flows, discounted at the instrument's original effective interest rate. Short-term balances are not discounted.

Principal accounting policies (continued)

Impairment (continued)

Originated loans and advances (continued)

Loans and advances are presented net of specific and general allowances for uncollectibility. Specific allowances are made against the carrying amount of loans and advances that are identified as being impaired based on regular reviews of outstanding balances to reduce these loans and advances to their recoverable amounts. General allowances are maintained to reduce the carrying amount of portfolios of similar loans and advances to their estimated recoverable amounts at the balance sheet date. The expected cash flows for portfolios of similar assets are estimated based on previous experience and considering the credit rating of the underlying customers and late payments of interest or penalties.

Increases in the allowance account are recognised in the income statement. When a loan is known to be uncollectible, all the necessary legal procedures have been completed, and the final loss has been determined, the loan is written off directly.

If in a subsequent period the amount of an impairment loss decreases and the decrease can be linked objectively to an event occurring after the write down, the write-down or allowance is reversed through the income statement.

Financial assets re-measured to fair value directly

The recoverable amount of an equity instrument is its fair value. The recoverable amount of debt instruments and purchased loans re-measured to fair value is calculated as the present value of expected future cash flows discounted at the current market rate of interest.

Where an asset re-measured to fair value directly through equity is impaired, and a write down of the asset was previously recognised directly in equity, the write down is transferred to the income statement and recognised as part of the impairment loss. Where an asset measured to fair value directly through equity is impaired, and an increase in the fair value of the assets was previously recognised in equity, the increase in fair value of the asset recognised in equity is reversed to the extent the asset is impaired. Any additional impairment loss is recognised in the income statement.

If in a subsequent period the amount of impairment loss decreases and the decrease can be linked objectively to an event occurring after the write-down, the write-down is reversed through the income statement.

2 Principal accounting policies (continued)

2.11 Property and equipment

Items of property and equipment are stated at cost less accumulated depreciation and impairment loss except for freehold land and capital work-in-progress which are stated at cost. 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 instalments over their estimated economic useful lives from the date the asset is brought into use, as follows:

	Years
Buildings	7-25
Furniture and fixtures	3-7
Motor vehicles	3-5
Computer equipment	4

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.

2.12 Intangible assets

Goodwill arising on an acquisition represents the excess of the cost of the acquisition over the fair value of the net identifiable assets acquired. Goodwill is stated at cost less accumulated amortisation and impairment losses. Goodwill is amortised over a period of 10 years from the date of initial recognition and is charged to the income statement on a straight line basis.

2.13 Investment property

Investment property is stated at fair value determined periodically by an independent registered valuer. Fair value is based on current prices in an active market of similar properties in same location and condition. Diminution in value below original cost will be charged to the income statement. Valuation increase will be credited to the income statement.

Investment property is included in other assets and is not depreciated.

2.14 Provisions

A provision is recognised in the balance sheet when the Bank has a legal or constructive obligation as a result of a past event, and it is probable that an outflow of economic benefits will be required to settle the obligation. If the effect is material, provisions are determined by discounting the expected future cash flow rate that reflects current market assessments of the time value of money and, where appropriate, the risks specific to the liability.

Principal accounting policies (continued)

Dividends

Dividends are recognised as a liability in the year in which they are declared.

Other payables

Other payables are stated at cost.

Interest income and expense

nterest income and expense is recognised in the income statement as it accrues, taking into account the effective yield of he asset or an applicable floating rate. Interest income and expense includes the amortisation of any discount or premium r other differences between the initial carrying amount of an interest bearing instrument and its amount at maturity alculated on an effective interest rate basis.

ee and commission income

e and commission income arises on financial services provided by the Bank. Fee and commission income is recognised nen the corresponding service is provided.

xation

ome tax on the profit or loss for the year comprises current and deferred tax. Income tax is recognised in the income tement except to the extent that it relates to items recognised directly to equity, in which case it is recognised in equity.

ent tax is the expected tax payable on the taxable income for the year, using tax rates enacted or substantially enacted e balance sheet date, and any adjustment to tax payable in respect of previous years.

rred tax is calculated using the balance sheet liability method, providing for temporary differences between the carrying nts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. The amount ferred tax provided is based on the expected manner of realisation or settlement of the carrying amount of assets and ties, using tax rates enacted or substantially enacted at the balance sheet date.

rred tax asset is recognised only to the extent that it is probable that future taxable profits will be available against the asset can be utilised. Deferred tax assets are reduced to the extent that it is no longer probable that the related nefit will be realised.

2 Principal accounting policies (continued)

2.20 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 as incurred.

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

2.21 Derivative financial instruments

The Bank uses forward exchange contracts to manage its exposure to foreign exchange risks arising from operational, financing and investment activities. The Bank does not hold or issue derivative financial instruments for trading purposes.

Derivative financial instruments are recognised at cost. Subsequent to initial recognition, derivative financial instruments are stated at fair value.

2.22 Directors' remuneration

In accordance with the Commercial Companies' Law of 1974, as amended, Directors' remuneration is shown as an appropriation of profit.

2.23 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. The Bank currently operates only in the Sultanate of Oman. The Bank's primary format for reporting segmental information is business segments, based upon Management and internal reporting structure. The Bank's main business segments are commercial and investment banking. During the years ended 31 December 2003 and 31 December 2002 the Investment Banking Segment is not considered by the management to be a reportable segment and accordingly, its assets, revenues and results have been combined, in these financial statements, within those of the Commercial Banking segment.

Cash and cash equivalents

	2003 RO'000	2002 RO'000
Cash on hand	**3,787**	3,930
Balances with Central Bank of Oman	**10,196**	6,442
	13,983	10,372

At 31 December 2003, cash and cash equivalents included balances with the Central Bank of Oman in the amount of approximately RO 344,000 (2002: RO 337,000) as minimum reserve requirements. These funds are not available for the Bank's daily business.

Investment securities

	2003	2002
Debts and other fixed income instruments held to maturity		
Government Development Bonds (cost and market value)	**17,249**	10,449
Equity investments available for sale		
- Quoted	**3,254**	2,535
- Unquoted	**2,357**	1,242
	22,860	14,226

	Cost	Market value		Carrying value	
Quoted	RO'000	2003 RO'000	2002 RO'000	2003 RO'000	2002 RO'000
- at Muscat Securities Market					
Investments	485	974	619	974	486
Insurance	465	730	536	730	464
Services	782	973	863	973	738
Industrial	757	743	823	577	823
	2,489	3,420	2,841	3,254	2,511
- at foreign security markets	-	-	24	-	24
	2,489	3,420	2,865	3,254	2,535
Unquoted					
Unquoted Omani Company	1,618	-	-	1,368	740
Unquoted foreign equities	989	-	-	989	502
	2,607	-	-	2,357	1,242

t 31 December 2003, the investments are carried at their fair value. The market value in certain cases is higher than the arrying value, however the Board of Directors believe that due to the non-liquidity of certain shares, the market value of he quoted securities are not representative of the fair value and hence appropriate adjustments have been made to the arket value to reflect the fair values.

5 **Loans and advances to banks**

	2003 RO'000	2002 RO'000
Placement with other banks	**18,323**	11,426
Current clearing accounts	**1,948**	1,157
	20,271	12,583

At 31 December 2003, placements with one bank individually represents 20% or more of the Bank's placement (2002: one).

6 **Loans and advances to customers**

	2003	2002
Overdrafts	**50,805**	39,474
Loans	**326,139**	228,716
Loans against trust receipts	**18,345**	4,850
Bills discounted	**2,615**	1,510
Advance against credit cards	**4,042**	3,440
Others	**2,820**	6,412
Gross loans and advances	**404,766**	284,402
Less: Impairment allowance	**(37,581)**	(18,396)
Net loans and advances	**367,185**	266,006

The movement in the impairment allowance is analysed below:

a) Provision for loan losses

	2003	2002
1 January	**13,047**	10,049
Acquired from MIB	**11,051**	-
Allowance made during the year	**4,878**	4,248
Released to income statement during the year	**(960)**	(735)
Written off during the year	**(255)**	(515)
31 December	**27,761**	13,047

Loans and advances to customers (continued)

b) Reserved interest (CBO requirement)	**2003 RO'000**	2002 RO'000
1 January	**5,349**	4,668
Acquired from MIB	**2,536**	-
Reserved during the year	**2,361**	1,066
Released to income statement during the year	**(213)**	(102)
Written off during the year	**(213)**	(283)
31 December	**9,820**	5,349
Total impairment allowance	**37,581**	18,396

Interest is reserved by the Bank to comply with the rules, regulations and guidelines issued by the Central Bank of Oman against loans and advances which are impaired.

Under the Central Bank of Oman's guidelines for provision against classified loans and advances, at 31 December 2003, out of the total provisions of approximately RO 37,581,000 (2002: RO 18,396,000) provision made on a general portfolio basis for similar assets amounts to approximately RO 5,398,000 (2002: RO 5,042,000).

At 31 December 2003, loans and advances which are impaired on which interest has been reserved amount to approximately RO 30,292,000 (2002: RO 10,087,000) and loans and advances on which interest is not being accrued amount to approximately RO 5,120,000 (2002: RO 5,028,000).

7 **Property and equipment**

	Freehold land RO'000	Buildings RO'000	Furniture and fixtures RO'000	Motor vehicles RO'000	Computer equipment RO'000	Capital work-in-progress RO'000	Total RO'000
Cost							
1 January 2003	140	1,653	2,894	455	2,986	300	8,428
Acquired from MIB	-	-	498	151	915	-	1,564
Additions	-	-	277	115	517	-	909
Disposals/Transfer	-	-	(64)	(35)	(25)	(228)	(352)
Written-off	-	-	-	-	(114)	-	(114)
31 December 2003	**140**	**1,653**	**3,605**	**686**	**4,279**	**72**	**10,435**
Depreciation							
1 January 2003	-	375	1,988	290	2,322	-	4,975
Acquired from MIB	-	-	311	144	742	-	1,197
Charge for the year	-	69	433	91	437	-	1,030
Disposals / written-off	-	-	(49)	(34)	(121)	-	(204)
31 December 2003	-	**444**	**2,683**	**491**	**3,380**	**-**	**6,998**
Net book value							
31 December 2003	**140**	**1,209**	**922**	**195**	**899**	**72**	**3,437**
31 December 2002	140	1,278	906	165	664	300	3,453

During 2003, buildings classified as investment properties (note 9) in the amount of approximately RO 1.252 million (2002: RO 1.252 million) have been transferred to other assets.

8 **Intangible assets**

On 31 March 2003, the Bank acquired MIB. The net assets of MIB were acquired at a consideration of RO 26.82 million. The fair value of the identifiable net assets acquired amounted to RO 23.82 million. Accordingly, goodwill in the amount of approximately RO 3 million has been recognised, which is being amortised over a period of 10 years. Also during 2001, the Bank had acquired sixteen branches of Commercial Bank of Oman SAOG at a purchase price of approximately RO 15.48 million. This acquisition gave rise to goodwill of RO 3.5 million, which is also being amortised over a period of 10 years.

	2003 RO'000	2002 RO'000
Goodwill on acquisition	**6,500**	3,500
Accumulated amortisation	**(1,275)**	(700)
Goodwill at the end of the year	**5,225**	2,800
The movement in the goodwill account is as follows:		
Opening goodwill	**2,800**	3,150
Addition on acquisition (note 29)	**3,000**	-
Amortised during the year	**(575)**	(350)
Goodwill at the end of the year	**5,225**	2,800

The amortisation charges for the year are included in staff and administration costs.

Dther assets

	2003 RO'000	2002 RO'000
orward exchange contracts	4,139	1,989
nterest receivable	1,033	725
eceivable from Ministry of Finance	-	132
repaid expenses	526	465
eferred tax asset (note 22)	624	526
ther receivables	643	764
vestment property (note 7)	1,322	1,252
	8,287	5,853

ursuant to an agreement between the Bank and the Government of the Sultanate of Oman acting through the Ministry of nance ("MOF"), the MOF had agreed to make payments to the Bank in connection with the obligations of a customer. The lance receivable from MOF was fully paid in June 2003. Investment properties are not depreciated.

eposits from banks

rm deposits	26,434	6,730
yable on demand	141	206
	26,575	6,936

31 December 2003, borrowing from no bank individually represent 20% or more of the Bank's borrowings (2002: 2)

posits from customers

rent accounts	91,234	59,721
ings accounts	45,502	39,728
e deposits	209,007	176,898
ificate of Deposits	10,099	-
gin accounts	2,555	872
	358,397	277,219

ent accounts and time deposits include deposits from the Government of the Sultanate of Oman in the amount of oximately RO 71,090,000 (2002: RO 56,105,000).

12 Other liabilities

	2003 RO'000	2002 RO'000
Interest payable	2,241	1,429
Creditors and accruals	9,563	7,146
Staff terminal benefits	200	164
Forward exchange contracts	4,143	1,990
Income tax provision	2,230	1,566
Deferred income	247	145
	18,624	12,440

Staff terminal benefits

The Bank's net liability to unfunded defined benefit retirement plan and the movement during the year is as follows:

1 January	164	146
Expense recognised in the income statement	44	37
Cash paid to employees	(8)	(19)
31 December	200	164

13 Subordinated bonds

Pursuant to a 'merger agreement' between the Bank and MIB dated 28 December 2002, at 31 March 2003 the Bank has issued 7,361,767 subordinated bonds of RO 1 each for tenure of 5 years and 1 day to the erstwhile shareholders of MIB. These bonds carry a coupon rate of 7% per annum payable annually. The bonds are listed at Muscat Securities Market.

14 Share capital and share premium

The authorised share capital consists of 50,000,000 (2002: 50,000,000) shares of RO 1 each. At 31 December 2003, the issued and paid up share capital comprises 41,961,818 (2002: 35,280,000) shares of RO 1 each.

On 31 March 2003, pursuant to the 'merger agreement', the Bank has issued 6,681,818 shares of RO 1 each to erstwhile shareholders of MIB at a premium. Accordingly, total share premium RO 5,429,380 has been recognised and is not available for distribution.

During the year ended 31 December 2002, the Bank had issued 1,680,000 shares as bonus shares to shareholders. The bonus shares issued were funded from a transfer from retained earnings for the year ended 31 December 2001.

Share capital (continued)

Shareholders

The following shareholders of the Bank own 10% or more of the Bank's shares, in their name or through a nominee account:

	2003 Shares held	2003 (%)	2002 Shares held	2002 (%)
Dhofar International Development and Investment Company SAOG	**12,588,545**	**30.0**	12,115,575	34.3
Qais Omani Establishment	**2,709,603**	**6.5**	4,769,050	13.5
Civil Service Pension Fund	**4,196,181**	**10.0**	2,491,200	7.1

Proposed distribution

The Board of Directors in their meeting held on 27 January 2004 proposed a cash dividend of RO 6,294,000 for the year
ended 31 December 2003 (2002: RO 6,294,000).

eserves

egal reserve

	2003 RO'000	2002 RO'000
January	**4,302**	3,472
propriation for the year	**1,016**	830
December	**5,318**	4,302

accordance with Article 106 of the Commercial Companies Law of 1974, annual appropriations of 10% of profit are made
he legal reserve until the accumulated balance of the reserve is equal to one-third of the Bank's paid up share capital.
reserve is not available for distribution.

ordinated bond reserve

Bank transfers an amount equivalent to 20% of the subordinated bonds each year to a subordinated bond reserve till
onds mature.

16 Earning per share

The calculation of basic earnings per share is based on profit for the year attributable to ordinary shareholders as follows:

	2003	2002
Net profit for the year (RO)	**10,156,000**	8,295,000
Weighted average number of shares outstanding during the year	**40,291,363**	35,280,000
Earning per share	**0.252**	0.235

17 Capital adequacy

The ratio of equity to risk weighted assets as formulated by the Basle Committee for the year ended 31 December 2003 is 15.6% (2002: 14.3%).

18 Net interest income

	2003 RO'000	2002 RO'000
Loans and advances to customers	**26,902**	23,689
Debt investments	**299**	545
Money market placements	**449**	367
Cash and cash equivalents	**25**	39
Total interest income	**27,675**	24,640
Deposits from customers	**(6,061)**	(6,307)
Money market deposits	**(212)**	(109)
Total interest expense	**(6,273)**	(6,416)
Net interest income	**21,402**	18,224

Interest reserved during the year on impaired loans and advances in the amount of RO 2,361,000 (2002: 1,066,000) has not been included in the total interest income in accordance with CBO guidelines.

Had the Bank presented interest income in accordance with IFRS 39 - Financial Instruments: Recognition and Measurement, the interest income and impairment charge for the year would have increased by RO 2,361,000 (2002: RO 1,066,000). However, the presentation followed by the Bank does not have any impact on the net profit of the Bank.

Other income

	2003 RO'000	2002 RO'000
Fees and commissions (net)	**1,450**	1,039
Foreign exchange	**404**	273
Investment securities	**1,702**	1,197
Others	**1,484**	1,559
	5,040	4,068

The fees and commissions shown above are net of fees and commissions paid of RO 243,000 (2002: RO 191,000).

Staff and administration costs

Staff costs

	2003 RO'000	2002 RO'000
Salaries and allowances	**4,968**	3,820
Other personnel costs	**402**	296
Scheme costs	**198**	160
Non-Omani employee terminal benefit	**44**	37
	5,612	4,313

Administration costs

	2003 RO'000	2002 RO'000
Advertising and promotion	**1,053**	1,010
ccupancy costs	**844**	666
mortisation of intangible assets	**575**	350
ata processing	**505**	464
ees and subscription	**248**	202
orrespondent charges	**38**	27
ommunication costs	**222**	189
inting and stationery	**151**	136
ofessional charges	**144**	169
surance	**131**	89
hers	**463**	405
	9,986	8,020

31 December 2003, the Bank had employee strength of 562 (2002: 431).

an Social Insurance Scheme ("the Scheme")

Bank contributes to the Scheme for all Omani employees. The Scheme, which is a defined contributions retirement , is administered by the Government of Oman. The Bank and Omani employees are required to make monthly ributions to the Scheme based on fixed percentages of basic salaries.

NOTES

(forming part of the financial statements)

20 Staff and administration costs (continued)

Non-Omani employee terminal benefits

The provision for end of service benefits for non-Omani employees is made in accordance with the requirements of the Omani Labour Law of 1973. This is an unfunded defined benefits retirement plan. Employees are entitled to benefits based on length of service and final remuneration. Accrued staff terminal benefits are payable on termination of employment.

21 Impairment

	2003 RO'000	2002 RO'000
Investments	**-**	462
Loans and advances		
- allowance for impairment	**3,918**	3,513
- written-off	**57**	8
Property and equipment	**28**	120
	4,003	4,103

22 Income tax

(a) Income tax expense:

	2003 RO'000	2002 RO'000
Current tax expense	**1,365**	1,436
Deferred tax credit relating to the origination and reversal of temporary differences	**(98)**	(396)
Income tax	**1,267**	1,040

The Bank is liable to income tax for the year 2003 in accordance with the income tax laws of the Sultanate of Oman at the rate of 12% on taxable profits in excess of RO 30,000. The following is a reconciliation of income taxes calculated at the applicable tax rate with the income tax expense:

	2003 RO'000	2002 RO'000
Accounting profit for the year	**11,423**	9,335
Tax liability at the rates mentioned above	**1,367**	1,117
Tax effect of permanent differences	**(100)**	(36)
Tax effect of temporary differences not recognised as deferred tax	**-**	(41)
Tax expense	**1,267**	1,040

Income tax (continued)

Temporary differences which give rise to deferred tax assets are as follows:

	2003 RO'000	2002 RO'000
Depreciation	**(50)**	(65)
Provision for loan losses	**674**	591
Total deferred tax asset	**624**	526

Status of the tax assessments

The Bank's assessments for the tax years 1999 to 2002 have not yet been finalised with the Department of Taxation Affairs at the Ministry of Finance. The Board of Directors believe that additional taxes, if any, in respect of open tax assessments would not be material to the Bank's financial position.

Transactions with related parties and holders of 10% or more of the Bank's shares

In the ordinary course of business, the Bank conducts transactions with certain of its Directors/Shareholders and companies over which they are able to exert significant influence. Such transactions are considered by the Board of Directors to be on terms and conditions not significantly different to those that may be obtained from independent third parties. The aggregate amount of balances with such related parties are as follows:

	2003	2002
oans and advances		
Directors and shareholders holding less than 10% nterest in the Bank	**16,861**	5,699
irectors and shareholders holding 10% or more interest the Bank	**2,220**	6,896
	19,081	12,595
eposits and other accounts		
rectors and shareholders holding less than 10% erest in the Bank	**16,508**	23,663
ectors and shareholders holding 10% or more interest he Bank	**20,004**	2,287
	36,512	25,950

23 Transactions with related parties and holders of 10% or more of the Bank's shares (continued)

	2003 RO'000	2002 RO'000
Contingent liability and commitment		
Directors and shareholders holding less than 10% interest in the Bank	**1,552**	1,066
Directors and shareholders holding 10% or more interest in the Bank	**59**	3,223
	1,611	4,289
Remuneration paid to Directors		
Chairman – remuneration	**16**	11
– sitting fees	**12**	9
Board of Directors – remuneration	**162**	110
– sitting fees	**70**	56
	260	186
Other transactions		
Rental payment to a related party	**37**	18

Single borrower and senior members

Single borrower

	2003 RO'000	2002 RO'000
Total exposure:		
Direct	8,714	7,169
Indirect (off-balance sheet items)	855	7,674
Number of customers	1	2

Senior members

	2003 RO'000	2002 RO'000
Total exposure:		
Direct	19,513	12,595
Indirect	1,611	4,289
Number of Members	13	12

Excess over limits as specified by the Central Bank of Oman for Single Borrower and Senior Members, except for one single borrower, are secured by cash collaterals, pledge of Government Development Bonds or risk participation arrangements with other commercial banks.

Contingent liabilities and commitments

Credit related contingent items

etters of credit, guarantees and other commitments for which there are corresponding customer liabilities:

	2003 RO'000	2002 RO'000
etters of credit	15,828	12,830
cceptances	10,331	6,602
uarantees and performance bonds	17,474	12,823
lvance payment guarantees	7,047	6,162
yment guarantees	13,564	8,800
hers	1,094	547
	65,338	47,764

25 Contingent liabilities and commitments (continued)

(a) Credit related contingent items (continued)

The Bank guarantees the performance of customers by issuing standby letters of credit and guarantees to third parties. The risk involved is essentially the same as the credit risk involved in extending loan facilities to customers, therefore these transactions are subjected to the same credit organisation, portfolio maintenance and collateral requirements for customers applying for loans. While there is some credit risk associated with the remainder of commitments, the risk is viewed as modest, since it results from the possibility of unused portions of the facilities being drawn by the customers. As the facilities may expire without being drawn upon, the notional amounts do not necessarily reflect future cash requirements.

The credit risk of these facilities may be less than the notional amounts, but as it cannot be accurately determined, the credit risk has been taken to be the contract or notional amount. At 31 December 2003, letters of credit, guarantees and other commitments amounting to RO 11,752,000 (2002: RO 3,497,000) are counter guaranteed by other banks.

(b) Capital and investment commitments

	2003 RO'000	2002 RO'000
Contractual commitments for property and equipment	210	297

(c) Other contingent liabilities and commitments

At 31 December 2003, there are no significant contingencies or commitments which have crystallised after the balance sheet date nor are there any acknowledged material claims against the Bank.

Analysis of significant assets and liabilities

Interest Sensitivity Gap

Sensitivity to interest rates arises from mismatches in the period to repricing of assets and that of the corresponding liability funding. The Bank manages these mismatches by following policy guidelines and reduces risk by matching the repricing of assets and liabilities through various means including monitoring by the 'Asset–Liability' Committee. Significant changes in gap positions can be made to adjust the profile as market outlooks change.

	Effective Average Interest Rate	Due on demand and to 30 Days	Due within 1 to 6 months	Due within 7 to 12 months	Due within 1 to 5 years	Due after 5 years	Not bearing interest	Total
	%	RO'000	RO'000	RO'000	RO'000	RO'000	RO'000	RO'000
31 December 2003								
Cash & cash equivalent		6,000	-	-	-	-	7,983	13,983
reasury bills	1.1	18,337	9,000	5,500	-	-	-	32,837
oans and advances o banks	2.4	13,757	385	2,279	3,850	-	-	20,271
oans and advances customers	8.4	94,976	92,913	25,372	129,700	18,354	5,870	367,185
her assets	-	-	-	-	-	-	8,287	8,287
vestment securities	4.9	-	600	-	16,649	-	5,611	22,860
operty and equipment	-	-	-	-	-	-	3,437	3,437
angible assets	-	-	-	-	-	-	5,225	5,225
tal assets		**133,070**	**102,898**	**33,151**	**150,199**	**18,354**	**36,413**	**474,085**
posits from comers	1.8	52,001	78,094	91,142	56,423	42	80,695	358,397
osits from banks	1.3	24,512	-	1,925	138	-	-	26,575
er liabilities	-	-	-	-	-	-	18,624	18,624
ordinate bonds	7.0	-	-	-	7,362	-	-	7,362
eholders' equity	-	-	-	-	-	-	63,127	63,127
l liabilities & eholders' equity		**76,513**	**78,094**	**93,067**	**63,923**	**42**	**162,446**	**474,085**
lance sheet gap		56,557	24,804	(59,916)	86,276	18,312	(126,033)	-
ulative interest tivity gap		**56,557**	**81,361**	**21,445**	**107,721**	**126,033**	**-**	**-**

26 Analysis of significant assets and liabilities (continued)

(a) Interest Sensitivity Gap (continued)

	Effective Average Interest Rate	Due on demand and to 30 Days	Due within 1 to 6 months	Due within 7 to 12 months	Due within 1 to 5 years	Due after 5 years	Not bearing interest	Total
	%	RO'000	RO'000	RO'000	RO'000	RO'000	RO'000	RO'000
31 December 2002								
Cash & cash equivalent		-	-	-	-	-	10,372	10,372
Treasury bills	2.0	4,500	16,880	7,330	-	-	-	28,710
Loans and advances to banks	2.6	6,634	185	1,529	4,235	-	-	12,583
Loans and advances to customers	9.0	43,437	36,059	17,798	123,853	39,489	5,370	266,006
Other assets	-	-	1,989	-	-	-	3,864	5,853
Investment securities	6.6	-	250	-	10,199	-	3,777	14,226
Property and equipment	-	-	-	-	-	-	3,453	3,453
Intangible assets	-	-	-	-	-	-	2,800	2,800
Total assets		54,571	55,363	26,657	138,287	39,489	29,636	344,003
Deposits from customers	2.3	86,251	62,012	56,437	10,683	42	61,794	277,219
Deposits from banks	1.7	5,011	-	-	1,925	-	-	6,936
Other liabilities	-	-	1,990	-	-	-	10,450	12,440
Shareholders' equity	-	-	-	-	-	-	47,408	47,408
Total liabilities & Shareholders' equity		91,262	64,002	56,437	12,608	42	119,652	344,003
On-balance sheet gap		(36,691)	(8,639)	(29,780)	125,679	39,447	(90,016)	-
Cumulative interest sensitivity gap		(36,691)	(45,330)	(75,110)	50,569	90,016	-	-

Analysis of assets and liabilities (continued)

Treasury bills – available for sale

Represents treasury bills issued for a term of greater than three months:

	2003 RO'000	2002 RO'000
91 days to 120 days	21,337	15,380
121 days to 182 days	6,000	6,000
183 days and above	5,500	7,330
	32,837	28,710

Geographical concentrations

	Assets			Liabilities		
	Loans & advances to banks RO'000	Gross loans & advances RO'000	Investment securities RO'000	Deposits from customers RO'000	Deposit from banks RO'000	Contingent liabilities RO'000
31 December 2003						
Sultanate of Oman	7,850	404,766	21,871	358,397	1,678	36,767
Other GCC countries	4,159	-	-	-	9,336	5,822
Europe & N. America	8,262	-	989	-	15,561	12,349
frica and Asia	-	-	-	-	-	10,400
	20,271	404,766	22,860	358,397	26,575	65,338
. December 2002						
ltanate of Oman	-	284,402	13,700	277,219	-	28,948
her GCC countries	4,132	-	24	-	1,289	1,875
rope & N. America	8,397	-	502	-	5,647	6,768
ica and Asia	54	-	-	-	-	10,173
	12,583	284,402	14,226	277,219	6,936	47,764

26 Analysis of assets and liabilities (continued)

(d) Customer concentrations

	Assets			Liabilities		
	Loans & advances to banks RO'000	Gross loans & advances RO'000	Investment securities RO'000	Deposits from customers RO'000	Deposit from banks RO'000	Contingent liabilities RO'000
31 December 2003						
Personal	-	163,535	-	103,632	-	618
Corporate	20,271	227,521	5,611	183,675	26,575	64,142
Government	-	13,710	17,249	71,090	-	578
	20,271	404,766	22,860	358,397	26,575	65,338
31 December 2002						
Personal	-	120,212	-	82,911	-	210
Corporate	12,583	159,179	3,777	138,203	6,936	47,382
Government	-	5,011	10,449	56,105	-	172
	12,583	284,402	14,226	277,219	6,936	47,764

Analysis of assets and liabilities (continued)

Economic sector concentrations

	Assets	Liabilities	
	Gross loans and advances RO'000	Deposits from customers RO'000	Contingent liabilities RO'000
31 December 2003			
Personal	**163,535**	**103,632**	**618**
International trade	**52,012**	**12,582**	**14,499**
Construction	**25,316**	**3,408**	**12,723**
Manufacturing	**30,858**	**5,458**	**10,263**
Wholesale & retail trade	**16,301**	**1,199**	**4,377**
Communication and utilities	**6,717**	**1,013**	**1,463**
Financial services	**16,292**	**3,455**	**1,504**
Government	**13,710**	**71,090**	**578**
Other services	**29,200**	**64,810**	**6,830**
Others	**50,825**	**91,750**	**12,483**
	404,766	**358,397**	**65,338**
31 December 2002			
Personal	120,212	82,911	210
International trade	29,410	4,977	10,321
Construction	17,529	3,154	12,321
Manufacturing	15,245	3,471	8,787
Wholesale & retail trade	14,685	1,082	1,438
Communication and utilities	9,661	1,372	1,559
Financial services	14,873	4,066	1,624
Government	5,011	56,105	172
Other services	14,223	57,607	4,347
Others	43,553	62,474	6,985
	284,402	277,219	47,764

Foreign currency exposures

	2003 RO'000	2002 RO'000
Net assets denominated in US Dollars	**13,845**	12,767
Net assets denominated in other foreign currencies	**455**	270
	14,300	13,037

27 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 2003 are considered by the Management not to be materially different to 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.

8 **Risk Management**

The important types of financial risks to which the Bank is exposed are credit risks, liquidity and market risk. Market risk includes currency risk and interest rate risk. The Bank enters into derivative financial instruments like forward contracts for risk management purpose. Financial risks are actively managed by Management to ensure compliance with Bank's risk limits. The Bank risk limits are assessed regularly to ensure their appropriateness given the Bank's objectives, strategies and current market conditions.

Credit risk

The most important risk to which the Bank is exposed is credit risk. The Bank is subject to credit risk through its trading, lending and investing activities and in cases where it acts as an intermediary on behalf of customers or other third parties or issues guarantees. The risk that counter-parties to financial instruments might default on their obligations is monitored on an ongoing basis. To manage the level of credit risk, the Bank deals with counter-parties of good credit standing and when appropriate, obtains collateral.

The Bank's primary exposure to credit risk arises through its loans and advances. The amount of credit exposure in this regard is represented by the carrying amounts of the assets on the balance sheet. The Bank is exposed to credit risk on various other financial assets, the current credit exposure in respect of these instruments is equal to the carrying amount of these assets in the balance sheet.

The Bank guarantees the performance of customers by issuing standby letters of credit and guarantees to third parties. The risk involved is essentially the same as the credit risk involved in extending loan facilities to customers, therefore these transactions are subjected to the same credit organisation, portfolio maintenance and collateral requirements for customers applying for loans. While there is some credit risk associated with the remainder of commitments, the risk is viewed as modest, since it results from the possibility of unused portions of the facilities being drawn by the customers. As the facilities may expire without being drawn upon, the notional amounts do not necessarily reflect future cash requirements

The credit risk of these facilities may be less than the notional amounts, but as it cannot be accurately determined, the credit risk has been taken to be the contract or notional amount.

Concentrations of credit risk (whether on or off balance sheet) that arise from financial instruments exist for groups of counter-parties when they have similar economic characteristics that would cause their ability to meet contractual obligations to be similarly affected by changes in economic or other conditions.

The Bank's policy is to require suitable collateral to be provided by certain customers prior to the disbursement of approved loans. Guarantees and letters of credit are also subject to strict credit assessments before being provided. The agreements specify monetary limits to the Bank's obligations. Credit card commitments are unsecured. Periodic reviews of cardholders' creditworthiness are made and card limits are adjusted where necessary.

Collateral for loans, guarantees, and letters of credit is usually in the form of cash, inventory, listed investments, or other property.

28 **Risk Management (continued)**

Liquidity risk

Liquidity risk arises in the general funding of the Bank's activities and in the management of positions. It includes both the risk of being unable to fund assets at appropriate maturities and rates and the risk of being unable to liquidate an asset at a reasonable price and in an appropriate time frame.

The Bank has access to a diverse funding base. Funds are raised using a range of instruments including deposits, other liabilities and assigned capital. This enhances funding flexibility, limits dependence on any one source of funds and generally lowers the cost of funds. The Bank strives to maintain a balance between continuity of funding and flexibility through the use of liabilities with a range of maturities. The Bank continually assesses liquidity risk by identifying and monitoring changes in funding required to meet business goals and targets set in terms of the overall strategy. In addition the Bank holds certain liquid assets as part of its liquidity risk management strategy.

Market risk

Market risk includes currency risk and interest rate risk.

Currency risk

The Bank is exposed to currency risk through its transactions in foreign currencies. Major foreign currency to which the Bank is exposed to is US Dollar. As the currency in which the Bank presents its financial statements is Rial Omani, the Bank's financial statements are affected by movements in the exchange rates between these currencies and the Rial Omani. The Bank finances a significant portion of its financial assets in the same currencies as the relevant measurement currencies to mitigate its foreign currency risk.

The Bank's transactional exposures give rise to foreign currencies gains and losses that are recognised in the income statement. The Bank ensures that its net exposure is kept to an acceptable level by buying and selling foreign currencies at spot rates when considered appropriate.

Interest rate risk

The Bank's operations are subject to the risk of interest rate fluctuations to the extent that interest-earning assets and interest-bearing liabilities mature at different times or in different amounts. In case of floating interest rate assets and liabilities the Bank is also exposed to basis risk, which is the difference in repricing characteristics of the various floating rate indices, such as savings rate and different types of interest.

Risk management activities are aimed at optimising net interest income, given market interest rate levels consistent with the Bank's business strategies. The Bank manages these mismatches by following policy guidelines and reduces risk by matching the repricing of assets and liabilities through various means including monitoring by the 'Asset-Liability' Committee. Significant changes in gap positions can be made to adjust the profile as market outlooks change.

Merger with Majan International Bank SAOC

On 31 March 2003, the Bank acquired MIB, an Omani Closed Joint Stock Company incorporated in the Sultanate of Oman in October 1998. The transaction was approved by the shareholders on 3 December 2002, and has been accounted for using the 'purchase method' of accounting. Accordingly, the net assets of MIB are recorded at cost.

The fair value of assets and liabilities of MIB acquired by the Bank as 31 March 2003 were as follows:

	RO'000
Assets	
Cash and cash equivalents	4,242
Treasury bills	1,000
Investment securities	8,629
Loans and advances to banks	1,388
Loans and advances to customers - net	80,469
Property and equipment - net	367
Other assets	462
Total assets	96,557
Liabilities	
Deposits from banks	13,017
Deposits from customers	58,307
Other liabilities	1,409
Total liabilities	72,733
Net assets	23,824
Goodwill arising on acquisition	3,000
Purchase consideration	26,824

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

	RO'000
Cash and balances with CBO	509
Balances with Central Bank of Oman	3,603
Due from banks	2,888
Due to banks	(13,017)
Cash and cash equivalent for cash flow purposes acquired from MIB	(6,017)

The shareholders of MIB existing on 31 March 2003 have received the following consideration:

- 6,681,818 shares of RO 1 each of the Bank. These shares rank equally with the existing shares of the Bank;
- 7,361,767 subordinated bonds issued by the Bank with a nominal value of RO 1 each and a coupon rate of 7% per annum with interest being paid annually. The bonds are redeemable five years and one day after the date of the issue; and
- RO 7,350,000 in cash paid within one month after 31 March 2003.

Comparative figures

Certain comparative figures have been reclassified to conform to the presentation adopted in these financial statements.