

## Chairman's Statement

### Summary of the economic situation

The South African economy enjoyed a continuation of growth in GDP of close to 5% in 2006, following a similar growth rate the previous year. Nonetheless, the economic growth performance has remained somewhat unbalanced, with growth in demand remaining more buoyant than growth in production. The lowest interest rates in a quarter of a century and the associated relatively low level of inflation rising out of sustained currency strength between 2003 and 2005 have encouraged the biggest consumption boom since the gold boom of the early 1980s. On the other hand, the relative strength of the Rand until mid-2006 has impaired the competitiveness of South African exports and made imports extremely attractive, at the expense of local production.

The impact of higher interest rates and slightly higher inflation of imported goods resulting from currency depreciation and rising oil and food prices, is bound to cause some slackening-off in the growth of consumer spending over the coming year. In addition, the wealth effect from rising equity and property prices is also likely to diminish. The growth in property prices has already fallen significantly compared with a couple of years ago and it seems unreasonable to expect the rising trend of equity prices to be maintained at the extraordinary levels of the past two years. It is expected that the focus of growth during the coming year and subsequent years is likely to be directed at fixed investment in electricity generation, roads, rail, ports, low-cost housing, water and sanitation. Growth in capital investment is additionally likely to boom as government and the private sector attempt to prepare for the 2010 Soccer World Cup. Besides, the psychological impetus provided by the build-up to the World Cup is likely to provide a significant boost to a variety of sectors of the economy going beyond just construction.

A key determinant of the extent to which the economy will grow over the coming year will be the extent to which global economic activity remains sufficiently buoyant to sustain the rising trend of commodity prices. The insatiable demand for commodities by China and to a growing extent from India, associated with their near-double-digit economic growth rates, which in turn is related to favourable conditions amongst Western nations who import goods and services from the world's two most populous countries, has helped to generate an environment in which risk aversion towards emerging markets, and especially commodity producing countries, has fallen to its lowest level. Under such circumstances, the appetite for investment and capital inflows into Africa and South Africa in particular, has increased substantially.

Such capital inflows have assisted South Africa to finance its burgeoning current account deficit associated with a high propensity to import goods associated with brisk economic growth. Moreover, since economic growth is likely to be driven largely by an acceleration in fixed investment and much of such investment will continue being imported, it follows that the country is likely to continue experiencing a large current account deficit, in excess of 5% of GDP. Therefore, the economy will continue to remain highly dependent on capital inflows in the absence of which the Rand could come under downward pressure. In the event that global economic growth were to slump, resulting in declining commodity prices and an increase in risk aversion towards investing in emerging markets, rapid Rand depreciation and declining commodity prices could result in an acceleration of domestic inflation and significantly higher interest rates, with detrimental effects on consumption expenditure and on many domestic asset prices.

The key factor in determining whether or not global economic activity slumps, is whether the US housing market collapses in the wake of the rise in US interest rates of the past two years. If this happens, the massive build-up of global liquidity, which has underpinned the surge in financial assets prices around the world, could implode. Consensus forecasts, however, suggest that even if global economic growth recedes, it is unlikely to do so to any material extent. As a consequence, the most probable scenario is for the South African economy to continue growing at between 4% and 5% during the next few years.

### Albaraka banking group

The Albaraka Banking Group (ABG), of which Albaraka Bank Limited in South Africa is a subsidiary, is the world's leading Islamic banking group and is based in Bahrain. During the second quarter of 2006, ABG listed the group's shares on the Bahrain Stock Exchange and Dubai International Financial Market, a move widely regarded as a major landmark in the Islamic banking industry.



## Chairman's Statement *(Continued)*

ABG has recently conducted and completed a comprehensive restructuring programme, enhancing its business alignment with international best practice. Further, the group, which offers retail, corporate and investment banking and treasury services, conducts its activities in strict accordance with the principles of Shari'ah.

The group has subsidiary banking units in 10 countries world-wide which, in turn, have in excess of 200 branches. Its international footprint has been strengthened still further through a strategic business alliance with the Emirates Islamic Bank. ABG is also currently exploring the feasibility of increased expansion into Sub-Saharan Africa.

### **Performance**

Having consolidated our business in recent years, the review period is characterised by exceptional growth. I was especially pleased that the bank excelled in working to meet challenging financial targets and business objectives - in line with ABG's international strategy - delivering growth of some 50% in net profit before taxation of R15,3 million in 2006.

Such results auger well for the continued growth and development of our bank as it continues to expand its market share in South Africa, as this country's only fully-fledged Islamic bank.

### **Corporate governance**

Our board willingly and actively embraces the best practice ideal and, in so doing, adheres to the principles contained in the King II Report. We, as a responsible financial institution, remain acutely aware of our accountability to all our stakeholders and set out to ensure integrity and transparency in all our business activities through the continuous strengthening of our governance policies and procedures.

The board has, for a number of years, conducted a series of evaluations in accordance with the recommendations of the King Report, the purpose of which is to assist the board and the board committees to constantly improve upon their effectiveness. Detailed training programmes have been implemented in order to actively promote the concept of orientation for directors newly appointed to the board and to ensure that longer serving directors are kept abreast of new developments. Towards the latter part of last year, the Reserve Bank indicated that a training programme aimed specifically at meeting the needs of directors of banks had been developed by the Gordon Institute of Business Science. This programme will be considered by the bank in order to ensure that its directors receive ongoing training which will enhance their levels of effectiveness.

During the review period the national deadline for compliance with the Financial Intelligence Centre Act (FICA) expired. Importantly, efforts by the bank to ensure client compliance brought significant reward. For the bank's part, we have developed and implemented a comprehensive range of procedures to ensure compliance with legislation.

In addition and in line with the requirements of the Reserve Bank, we have made significant progress towards ensuring the bank's readiness to comply with Basel II by 1 January 2008. In this regard, pilot runs and other requirements as laid down by the Reserve Bank have been successfully met.

### **Shari'ah banking**

The phenomenal growth our bank has shown in the past year is clearly indicative of the rapidly expanding Islamic banking market in South Africa and increasing community acceptance of Albaraka Bank as this country's premier Shari'ah-compliant financial institution.

Just as ABG is a leading light internationally in the pioneering of banking in line with Islamic business principles, so too does our bank fully embrace and conform to Shari'ah standards in every aspect of our business. Indeed, we have taken steps to further strengthen the implementation of Shari'ah principles at every level of our banking activities. We have, during the past year, focused on Shari'ah audits to address Shari'ah issues and, as a member of the Bahraini-based Accounting and Auditing Organisation for Islamic Financial Institutions (AAOIFI), have invested significantly in staff training regarding adherence to the Shari'ah standards espoused by this respected institution.

### Capital adequacy

We continuously strive to improve the bank's capital resources so as to ensure our ability to maintain adequate levels at all times.

During the review period we received a share capital fillip which provides the ideal platform for unprecedented future growth, so allowing Albaraka Bank to better serve South Africa's growing Islamic banking market. The bank's shareholders injected R61 million, in the form of share capital, into our bank in a move which enabled us to increase Albaraka Bank's capital and reserves to in excess of R180 million. This, in turn, means that we are in a particularly strong position to grow the bank appreciably within South Africa's financial sector.

The 2006 capital injection saw Albaraka Bank become a subsidiary of ABG and thus an integral part of one of the leading Islamic banking groups in the world which, we believe, will have a distinctly beneficial effect on our business.

### Corporate social investment

Our bank has an active corporate social investment programme geared to empowering the needy. This programme complements the bank's ongoing commitment to the Financial Sector Charter, which is the framework in terms of which Black Economic Empowerment is to be implemented throughout the financial sector. It is our confirmed intention to intensify our social investment activities still further and to ensure that we increase our reach, impacting on all the regions of South Africa.

### Board appointments

I, on behalf of my fellow directors, executive management and staff of Albaraka Bank, take great pleasure in welcoming new directors Mr Farook Kassim and Mr Ahmed Lambat to our board.

Their appointments bring to our bank specialist knowledge and added professionalism - attributes we cherish and which will, I feel sure, stand the bank in good stead in the years ahead. We look forward to their counsel and strategic inputs as we steer the bank into the future.

### Future prospects

Looking ahead, there can be no doubt that the growth we have initiated will be sustained into the foreseeable future. We are projecting business growth as a result of the injection of share capital we received from ABG during the review period and the attendant expansion of the bank's offerings, coupled with continued improvement in overall performance and return on equity in line with our targets.

### Appreciation

Against the background of a most successful year, it would be remiss of me not to acknowledge the commitment and dedication of all those associated with Albaraka Bank whose combined efforts have brought about the business growth and development we sought. I thank my fellow directors for their leadership and wise counsel in giving Albaraka Bank its strategic direction. In addition, I am grateful to both executive management and our members of staff for their ongoing commitment in driving the business forward.

May Allah Ta'ala continue to shower us with His mercy and blessings.



**Adnan Ahmed Yousif**

Chairman  
16 March 2007  
Durban



## Chief Executive's Review

The 2006 financial year is best characterised as an exciting period of business growth, marked by the achievement of a number of critical milestones which combined to leverage the growth we have enjoyed.

### Financial performance

The bank realised net income before taxation of R15,3 million, against R10,2 million in the 2005 financial year. This 50,6% growth is a clear indication of both the bank's growing acceptance within the niche market we exist to serve and its ability to continue forging a growth path in a challenging business environment.

I am greatly encouraged by the growth experienced during the review period. The bank's total assets grew by 24,7% to R1,5 billion by the financial year end, while deposits strengthened by 24,9% to R1,3 billion. Advances showed growth of 28,8% over the previous year to R1,3 billion.

Our most pleasing financial performance may be attributed - at least in part - to the establishment of our first Corporate Division platform within our bank's network, located in Musgrave, Durban.

The Corporate Division proved to be an instant success and by financial year end this element of our business was already displaying tremendous growth. This was indicative of the aptness of our decision to implement this offering and has confirmed for us the need for this new and additional business focus within the community we serve.

### Compliance with Shari'ah

Importantly, our bank is - and always has been - fully Shari'ah-compliant and encouragingly there is now evidence of growing public awareness of this fact. As a member of the Accounting and Auditing Organisation for Islamic Financial Institutions (AAOIFI) and through our ongoing interaction with our Shari'ah Supervisory Board, we will continue strengthening and enhancing the implementation of Shari'ah principles throughout our business operations.

This is especially relevant because our bank's strategic direction is to reflect Islamic economic principles in all our operations and to comply with the Shari'ah in all our dealings with clients. During the year under review, our bank underwent regular Shari'ah audits to ensure ongoing compliance with these principles. In addition, we include in our Financial Statements a Shari'ah Report and AAOIFI Balance Sheets and Income Statements on pages 34, 66 and 67 respectively.

### Dividend payment

I am particularly pleased to report that during the 2006 financial year, Albaraka Bank declared a dividend of 20c per share to all shareholders recorded in the register as at 27 October 2006.

### Futuregrowth Albaraka Equity Fund

This partnered unit trust fund, which is Shari'ah-compliant, topped the R900 million mark by financial year end.

This fund, which has endured as one of South Africa's most consistent performers in the general equity sector, continues to prove a highly successful investment option and during our 2006 financial year has continued to attract major investment inflows from clients who recognise that this fund is highly competitive within the market and - in particular - is totally Shari'ah-compliant.

### Financial Sector Charter

The Financial Sector Charter constitutes a framework in terms of which Black Economic Empowerment is to be implemented and promoted throughout South Africa's financial sector.

During the 2006 financial year, our bank made substantial progress in addressing the requirements of the charter, including establishing a specific management committee to ensure compliance with the requirements of the charter. We also submitted our first report to the Financial Sector Charter Council during the period under review.

### Branch representation

The growing demand for Shari'ah-compliant banking products and services in South Africa, coupled with the phenomenal growth our bank has experienced in the past two years - growth which we are confident of being able to sustain - led to a decision in 2006 to expand our infrastructural network so as to better serve our national client base.

Having launched our new Corporate Division and relocated our Lenasia, Johannesburg, branch to larger premises during the 2006 financial year, we are set now to relocate our Head Office and Durban Branch to the Kingsmead Office Park in Durban.

Construction of the project is to be undertaken shortly, with occupation expected in the fourth quarter of 2008.

Our bank is currently also seriously evaluating the feasibility of expanding our six-branch national network in a concerted effort to bring our fully-fledged Islamic banking facilities closer to the communities, throughout South Africa, with whom we interact on a business level.





## Chief Executive's Review (Continued)

### The year ahead

Having enjoyed a sustained period of growth in recent years, I look to the future with great confidence.

I believe the coming year, in particular, will further strengthen our position within the important niche market we serve, providing the critical springboard for the further growth and development of the bank as we set out to accommodate a growing market and provide for the specific banking requirements of our community.

I also expect our bouquet of Shari'ah-compliant product offerings to be expanded in the year ahead, so enabling us to increasingly meet the evolving needs of our clients.

We are conscious of the fact that effective product provision goes hand-in-hand with service delivery. We regard service excellence as a way of life and instil in staff the need for total professionalism in their dealings with clients. We have identified a number of interventions designed to further enhance our service delivery capabilities and improve the customer experience at Albaraka Bank.

These include the establishment of a dedicated customer service centre telephone number, a facility which has already proved exceptionally beneficial since its inception in October 2006.

In addition, efforts are being made to upweight our available resources, a move which will be further supplemented by the introduction of internal workgroups, the active monitoring of client comments about service delivery and heightened public awareness of our company through strong branding and the introduction of a consistent corporate identity for the bank.

### Appreciation

In 2005 we gave effect to a period of growth within the bank, a trend which we both sustained and enhanced during the 2006 financial year, affording us the ideal platform to significantly develop the bank as a dynamic force within South Africa's Islamic financial sector.

Achieving and maintaining this encouraging growth trend was a major challenge; a challenge which required the total commitment of all those associated with our bank.

I was greatly encouraged by the fact that we were collectively able to both rise to the challenge and to overcome numerous hurdles, taking our bank to a new level within this country's financial environment.

Accordingly, I must express my grateful thanks to members of the board, executive management and staff for their collective dedication and individual commitment to the ongoing development of our bank for the benefit of all those we serve. In addition, I am pleased to acknowledge the support provided and active role played by the Albaraka Banking Group in facilitating our growth to the next level and for the confidence the group has shown in both our bank and the niche market in which we operate.

Lastly and above all else, I thank Almighty Allah, Most Gracious, and pray that He will continue to guide us to future success.

**Shabir Chohan**

Chief Executive  
16 March 2007  
Durban