Chairman's Statement

DATO' MOHD BAKKE SALLEH

بسم الله الرحمن الرحيم

In the Name of Allah, the Most Gracious, the Most Merciful

السلام عليكم ورحمة الله وبركاته

and " Salam Sejahtera"

Dear Shareholders,

Bank Islam Malaysia Berhad ("Bank Islam"), the pioneer of Islamic banking in Malaysia, turned 25 on 1 July 2008. It arrived at the quarter century mark in good style, turning in another record-breaking profit for the financial year ended 30 June 2008 ("FY2008"). This second consecutive profit record is all the more satisfying as it was only three years ago that the Bank was mired in hefty losses.

Contributing to the strong performance of the year under review were the combination of staying focused on growing new and existing businesses despite the volatilities in business demand and intensified competition; and the progressive implementation of the Turnaround Plan that had brought the Bank back on track.

On behalf of the Board of Directors, I am most delighted to present the annual report of Bank Islam and its subsidiaries ("the Group") for this exceptional FY2008.

A legacy that has stood the test of time

FINANCIAL HIGHLIGHTS

In FY2008, Group income rose 15.9% or RM 161.74 million to reach RM1.18 billion, while Group Profit before Zakat and Tax ("PBZT") rose by RM104.97 million or 49.5% to RM316.94 million.

At the Bank level, the PBZT increased by RM71.61 million to RM308.27 million. It contributed 97.3% to the Group profit. Bank Islam's wholly-owned subsidiary, BIMB Foreign Currency Clearing Agency Sdn Bhd ("BIFCA"), contributed RM20.35 million.

Based on the FY2008 financial performance, Bank Islam's Return On Equity ("ROE") improved to 26.5% from 23.3% in FY2007, versus the Banking Industry ROE of 19.7%. The Return On Asset ("ROA") improved to 1.5% from 1.4% (as compared to overall banking industry average of 1.5%). Other financial indicators also improved in tandem. The Risk-Weighted Capital Ratio ("RWCR") improved to 12.9% from 12.0% (This compares with BNM's minimum capital requirement of 8.0% and the industry ratio of 13.2%). Earnings Per Share improved to 22.26 sen compared to 16.10 sen the year before.

The Bank's total assets increased by 23.4% to RM23.56 billion from RM19.10 billion, while total customer deposits rose 17.9% to RM20.76 billion from RM17.62 billion, with a marked increase in Current Accounts and Savings Accounts ("CASA") deposits of 24.1% or RM1.6 billion.

During the year, the Bank completed an exercise to identify the adjustments required to match the total financing, advances and other balances to its financing system. The total impact arising from this adjustment was RM49.06 million, of which RM14.50 million was for FY2008, RM23.39 million for FY2007 and RM11.17 million for FY2006. These adjustments have been applied retrospectively.

Consequently, the PBZT of the Group and Bank for FY2007 have been restated as RM211.97 million and RM236.66 million from RM230.80 million and RM255.49 million respectively.

In FY2008, Group income rose 15.9% or RM 161.74million to reach RM1.18 billion, while Group Profit before Zakat and Tax ("PBZT") rose by RM104.97 million or 49.5% to RM316.94 million.

Operational Performance

The outstanding performance of the Group, in the face of ever-growing competition from Islamic "windows", newly established full-fledged Islamic banks and conventional banks, reflects the cumulative efforts of Bank Islam's operating divisions and its subsidiaries.

During the year, the Bank's six business divisions – Consumer Banking, Treasury, Corporate Banking, Commercial Banking, Corporate Investment Banking and Recovery – achieved significant success in securing new clients, new mandates, increased and improved asset quality and grew non-fund based revenue streams through enhancing value-adding services and product innovation. All business divisions posted substantial improvements in contributions.

The re-branding exercise which brought about a work culture change to match the needs of an increasingly sophisticated market, and our human resource ("HR") programme's investment in the training and development of our people's skills also supported the growth momentum.

All business divisions posted substantial improvements in contributions.

Consumer Banking continues to drive the earnings of the Bank. During the year, initiatives were taken to further enhance the features of core financing products to broaden the appeal and to reach out to the Bank's non-traditional non-Muslim customers. These included the innovative, first of its kind, "Payment Holiday Scheme" and the "No Payment During Construction Scheme" for home financing.

The **Corporate Investment Banking** division set up in November 2006 made history for the Bank when it acted as advisor for a mandatory general takeover offer for a public listed corporation. It is the first time a commercial bank, be it Islamic or conventional, had been given the mandate to advise such a transaction. In addition, the division also secured and completed mandates for several *sukuk* issues. The division's activities have increased awareness of Bank Islam's capabilities in providing a complete range of Shariah-based financial solutions.

Among the subsidiaries, BIFCA, which became a 100% owned subsidiary of Bank Islam last year, started to make meaningful contributions to Group earnings. Its PBZT of RM20.35 million was achieved by well executed foreign currency trade activities, much of these coming from its trade with financial institutions. In the case of loss-making subsidiaries, strategies have been drawn up to turn them around.

In addition, Bank Islam also entered several strategic partnerships aimed at enhancing its product offerings, increasing presence and awareness of its capabilities and tapping on synergies such as extending our ATM network to the millions of Tabung Haji depositors.

For Bank Islam, we will continue to embrace the competition as a catalyst for change and innovation, as we had in the last two years.

Outlook

Malaysia's Islamic banking and finance industry has undoubtedly expanded at a very rapid pace. From 1983 to 1999, Bank Islam was the only Islamic bank in the country. By the end of last year, there were a total of 16 licensed Islamic banks, while two locally incorporated foreign banks have established "windows" and seven investment banks are also offering Islamic banking services through the window structure.

This is testimony that the Islamic banking system has emerged as a vibrant alternative financial system in Malaysia. According to Bank Negara Malaysia, Islamic banking assets including those held by development financial institutions ("DFIs") at the end of 2007, accounted for 15.4% of the total banking assets, compared with 11.5% in 2003.

For the Group, these statistics convey very clearly that the intense competition for a share of the business will only heighten. Our stand has always been that competition is good for both the industry and the consumer, and ultimately the economy.

Apart from increased competition at the domestic front, the global financial and economic turmoil that broke out in September 2008 is expected to slow down Malaysia's economic growth. While we do not foresee a possibility of recession, we expect Malaysia's 2008 Gross Domestic Product ("GDP") growth to drift about 5%, and subsequently decelerating to a growth of between 3% and 4% in 2009.

These developments pose significant challenges for the Bank and the Group in the current year. However, we will continue to embrace these challenges as catalysts for change and innovation, as we had in the last two years. In addition, we recognise that there is still a huge untapped potential as Islamic banking assets comprise only 15.4% of the total banking assets in the Malaysian financial system.

We believe the pioneering efforts of the last 25 years, despite the financial problems encountered in 2005 and 2006, have helped entrench Bank Islam as a leader in Shariah-based products and services in Malaysia and the region. The track record, the leadership position and the momentum of the last two years will enable us to compete not only locally but also regionally.

Acknowledgements

The Group's outstanding performance would not have been possible without the trust and confidence of our customers, especially in our capability to deliver competitive Shariah-based products and services. Dedication and commitment of our staff certainly play a pivotal role, in particular our long-serving employees who have journeyed with Bank Islam from day one, each executing a significant role in advancing the establishment of Islamic banking as a viable alternative to conventional banking.

On behalf of the Board, I would like to place on record Bank Islam's appreciation towards the significant contributions made by Yang Berbahagia Tan Sri Dato' Dr Abdullah Mohd Tahir, our former chairman, who retired on 1 April 2008. His dedication and valuable insight have helped Bank Islam move forward during its most difficult period.

Our appreciation also goes to the Board and members of the Shariah Supervisory Council for their relentless advice and to Bank Negara Malaysia for the unwavering support and guidance throughout the 25 years.

والسلام

Dato' Mohd Bakke Salleh
CHAIRMAN

Economic Review during the 1H2008

Defying all odds, the Malaysian economy started the year 2008 with a bang, with a Gross Domestic Product (GDP) growth of 7.4% year-on-year (YoY) in the first quarter of 2008, the fastest pace since the second quarter of 2004. Despite cooling off to 6.7% YoY in the second quarter of 2008, the economic expansion remained rock solid in the first half of 2008 (1H2008), to average at 7.1% YoY, even slightly faster compared to the 7.0% YoY pace in the previous 6-month period. Notwithstanding broad-based positive growth across all sectors, activities of the mining and quarrying as well as services sectors eased significantly in the 1H2008.

During the 1H2008, the 5.3% YoY increase in crude oil production to 699, 214 barrels was barely enough to offset the 4.0% YoY decline in natural gas output to 1,053,452 million standard cubic feet (mmscf), causing growth of the mining and quarrying sector to be more than halved to 1.6% YoY from 3.5% YoY in the second half of 2007 (2H2007).

Despite the apparent slowdown in output in the 1H2008 (+8.4% YoY vs. +9.9% YoY in the 2H2007), the services sector remained the "star performer", outperforming the broad economy and all other sectors. Major growth leaders among the services sub-sectors were the Wholesale & Retail Trade, Hotels & Restaurants (+11.7% YoY); Transport & Storage (+9.0% YoY); Finance & Insurance (+8.7% YoY) and Communication (+7.7% YoY) on the back of vigourous consumer spending and higher tourist arrivals; increased travel and trade-related activities; expansion in banking, insurance and capital market operations including Islamic finance and higher usage of cellular and broadband services.

The manufacturing sector reinforced its strength in the 1H2008 (+6.3% YoY compared to +4.4% YoY in the 2H2007) as export-oriented industries (+2.7% YoY) in particular machinery & equipment (+17.6% YoY) and electrical & electronics products (E&E) (+2.4% YoY) reversed the downtrend, in line with gains in global demand for Malaysian goods and services while domestic-oriented industries (+9.9% YoY) such as transport equipment (+27.1% YoY), construction-related products (+13.3% YoY) and food products (+10% YoY) gained further grounds.

The sharp rebound in crude palm oil output (+22.8% YoY) and increases in the production of livestock (+6.1% YoY), fishing (+1.5% YoY) and miscellaneous agriculture (+3.7% YoY) proved to be more than sufficient to take up the slack in output of cocoa (-21.6% YoY), rubber (-3.6% YoY) and forestry & logging (-4.6% YoY) in the 1H2008, catapulting the agriculture sector (+6.1% YoY) to expand at the fastest clip since the 2H2006.

In the 1H2008, the growth rate of the construction sector (+4.6% YoY) maintained above the 4% YoY-level for three consecutive half-yearly periods, largely spurred by increased building and civil engineering activities (+6.3% YoY) for the oil and gas sub-sector (of the mining sector) as well as in carrying out projects under the Ninth Malaysia Plan (9MP) and five growth corridors. Accelerated implementation of the Government's low-and-medium housing programs, liberalisation of the Foreign Investment Committee's ruling on foreign purchases of properties and promotion of Malaysia, My 2nd Home (MM2H) helped the residential sub-sector to advance by 3.5% YoY.