

Directors' Report to the Shareholders

Dear Shareholders

On behalf of the Board, we are pleased to present the annual report of the Bank for the year ended December 31, 2006.

This year proved to be yet another hallmark year in which we achieved continued progress in our drive for sustained earnings growth by executing key administrative and operational strategies.

Economic Review

Pakistan has managed an appreciable economic turnaround during the last 5 years. From a tenuous position in 1999, the economy has transformed itself from one burdened by low economic growth, chronic fiscal deficits, increasing external debt into one characterized by vibrant growth, increased fiscal space and a stable external debt position. Real economic growth has averaged 7.6% in the last 3 years while exports have doubled in the last 6 years. Real investment, a lag for the initial part of the business cycle, is now starting to gain momentum. It grew by 9.26% in FY05 and 10.33% in FY06. The estimates of the population below the poverty line has fallen from 32% to 25%.

The most important drivers of the current year's economic growth are:

- Impetus to high growth in FY06 was principally from the performance of the services sector, as both the key commodity producing sectors, agriculture and industry saw growth fall well below the annual targets.
- Per capita income, increased from US\$500 in 2001-2002 to US\$847 in 2005-2006 owing to increase in real GDP, stable exchange rate and relatively lower increase in population compared to the previous years.
- Global economic growth reached to 5%.
- Massive credit flow of around PKR 345 billion to the private sector.
- Increase in total investment by 20% of GDP owing to rise in FDI.

Despite unexpectedly weak harvests of some key crops (cotton, sugarcane and wheat), the impact of the October 2005 earthquake, a tight monetary policy and an unprecedented rise in oil prices, real GDP growth remained strong at 6.6 percent during FY06.

The decline in the FY06 production of sugarcane and cotton, together with the modest growth in wheat was the principal reason for the 3.6 percent decline in the value addition by major crops, in sharp contrast to the 17.8 percent growth in the preceding year.

The provisional number for FY06 suggests that YoY industrial growth stood at 5.9 percent, substantially lower than the 11.4

percent YoY growth recorded during the preceding year. However, the industrial growth estimates based on full year data is expected to be a little higher than the provisional number. In particular, 9.0 percent growth in large scale manufacturing (LSM) could reach 10.7 percent during FY06, but this could still remain below the annual target (for the first time during the last four years) and also lower than the 15.6 percent growth recorded in FY05.

The services sector performed remarkably well, witnessing 8.8 percent growth during FY06, surpassing its annual target for the year as well as the 8.0 percent growth registered in FY05. This robust growth was mainly contributed by wholesale and retail trade, transport and communication and finance and insurance sub sectors which, although registered slower growth during FY06, was nonetheless well above the target for both sectors. On the other hand, transport, storage and communication sub sector has witnessed acceleration, with growth rising to 7.2 percent during FY06 against 3.6 percent in FY05, mainly on the back of improved performance of road transport and communication, which was supplemented by double digit growth in railway transport. Moreover, accelerated growth in community, social and personal services was witnessed and was probably a reflection of the increased social service activities in Pakistan's Northern areas in the aftermath of the October 2005 earthquake.

While Pakistan's economy suffered due to rising commodity prices, inflationary pressures eased somewhat in the domestic economy as headline Consumer Price Index (CPI) witnessed a deceleration from a peak of 9.3 percent (average annual inflation) in FY05 to 7.9 percent during FY06, mainly due to monetary tightening to soften demand pressures as well as administrative measures to counter supply shocks. FY06 deceleration is solely a result of ease in food inflation. Given high levels of CPI inflation and core inflation, resilience in non food inflation, which is still at high levels, acceleration in broader measures of inflation and a lower inflation target of 6.5 percent for the FY07, SBP has continued with its tight monetary policy in the period ahead. In this background, the current SBP forecast suggests that CPI inflation is likely to be in the range of 6.5–7.5 percent during FY07, a little above the annual target.

the Shareholders

This is the fifth successive year that the Debt to GDP ratio has improved. More significantly, this is the first time in more than two decades that this ratio has fallen below 60 percent. In fact, "The Fiscal Responsibility and Debt Limitation Act, 2005" envisaged a Debt to GDP ratio at 60 percent by FY13.

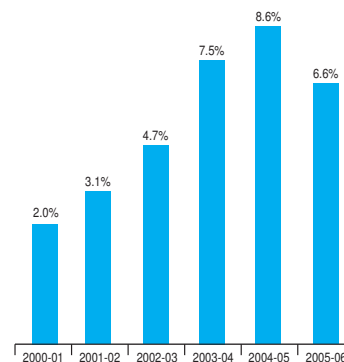
Pakistan once again accessed the global bond market to raise funding through the issuance of the Euro Bonds in FY06. Pakistan not only successfully generated inflows of US\$800 million from this issuance, but also established a long term sovereign benchmark that would help local corporates to access global markets. The FY06 issuance consists of 10 year bonds of US\$500 million, and US\$300 million in 30 year bonds. Also, in FY06 the private sector registered fresh loans of US\$522 million primarily on account of the long term loans to the communication sector and to Pakistan International Airline (PIA) for the purchase of aircrafts.

The External Account of Pakistan continued to remain under pressure during FY06 due to increase in aggregate demand, coupled with the rise in international oil and commodity prices. The country witnessed the highest ever current account deficit of US\$5.0 billion during FY06 as compared to deficit of US\$1.5 billion in the previous year. This rise in the current account deficit was mainly contributed by huge trade deficit of US\$8.4 billion as compared to the US\$4.5 billion in the preceding year. The expansion in the trade deficit was primarily due to a significant 31.3 percent YoY growth in imports that outpaced the 14 percent growth in exports.

The persistently rising international oil prices and the broad based increase in the aggregate demand led to a sharp rise in import bill to US\$24.9 billion during FY06. The exceptional import growth and accompanying rise in services account payments (principally for freight payments for imports), contributed to a sharp widening of the country's current account deficit, from a relatively manageable 1.4 percent of GDP in FY05 to a more threatening 4 percent of the GDP in FY06. However, the strong growth in remittances from Pakistanis and expatriates living abroad and gains from the lower net interest payment on external debt and liabilities partially offset the impact of the large trade gap.

The large current account deficit was however, easily financed through the improvement in the financial account. Specifically, financial account surplus increased substantially, from a meager US\$0.45 billion in FY05, to a sizeable US\$5.9 billion in FY06. The improvement in the financial account was quite broad based, contributed by higher FDI of US\$3.5 billion (including privatization proceeds of US\$1.54 billion); rise in portfolio investment on account of floatation of Euro bonds of US\$800 million and other

GDP - Growth



receipts. In addition to this, higher receipts of long term concessional loan from ADB and World Bank, and net inflow of supplier's credit also helped in swelling the financial account surplus. Hence, despite the unprecedented YoY deterioration in trade account in FY06, the overall balance recorded a surplus of US\$1.33 billion during the period.

The surplus in the overall external balance, that led to a net US\$520 million increase in the country's forex reserves (US\$13.137 billion by June 2006) during FY06 also helps explain, in part, the relative stability of the rupee during the year. The rupee traded within a narrow band of 74 paisa for most part of FY06, depreciating only 0.84 percent during the period, to close at Rs. 60.12 / US\$. However, due to comparatively higher domestic inflation in relation to trading partner countries and relative stability of the domestic currency, the rupee appreciated in real terms by around 1.9 percent.

National savings rose sharply by 16.5 percent during FY06 compared to the 7.5 percent growth in the preceding year, nonetheless this increase is lower than the rise in nominal GDP. As a result, the National Savings to GDP ratio dropped slightly (by 0.1 percentage) to 16.4 percent during FY06, the lowest level since FY01.

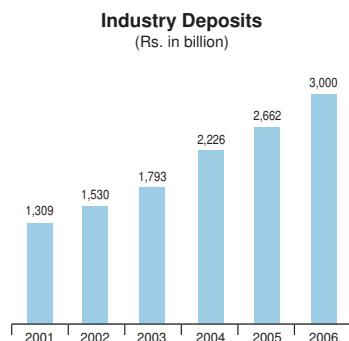
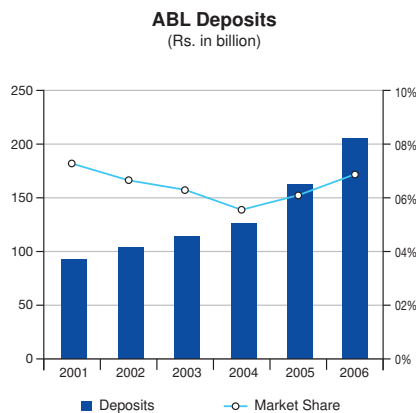
The total investment to GDP ratio rose to 20.0 percent during FY06 from 18.1 percent in the preceding year and an average of 17.1 percent in the last five years. Importantly, this is the highest level of the investment to GDP ratio in over a decade. The rise in the ratio is mainly attributed to improved confidence of local as well as foreign investors on the back of a good showing of the economy and a robust 22.3 percent growth in credit to private sector despite increasing interest rates.

Directors' Report to the Shareholders

Bank's Financial Review

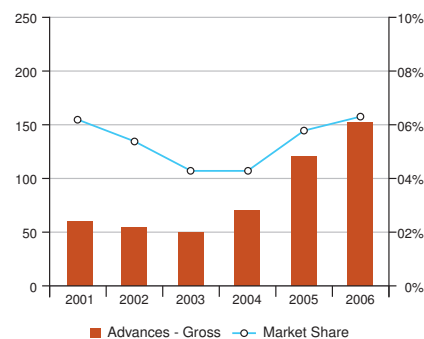
The Bank achieved another milestone by posting an after tax profit of Rs. 4,397 million, the highest ever earning in the Bank's history of over 60 years, depicting growth of 42% over FY05 profit of Rs. 3,090 million. During FY06, the operating profit before provisions and taxes surged by 37% to Rs. 7,574 million. The increase in gross advances by 27%, backed by significant improvement in yield resulted in higher mark up / return income of 74% from Rs. 9.9 billion in FY05 to Rs. 17.2 billion in FY06. Non mark up income witnessed a growth of 26% from Rs. 1.9 billion in FY05 to Rs. 2.4 billion in FY06. This was mainly driven by rise in core fee and commission income and gain on securities, which increased by 40% and 175% respectively over FY05. Despite such an increase in mark up / interest income, administrative expenses increased by only 24% .

Mark up / interest expense increased to Rs. 6.8 billion depicting an increase of 236% over FY05. This increase corresponds to the growth in deposits during FY06 coupled with increase in pricing of deposits. Despite this, the Bank has been able to maintain its cost of deposits below 3.5% during FY06, which eventually is reflected in the bottom line growth.

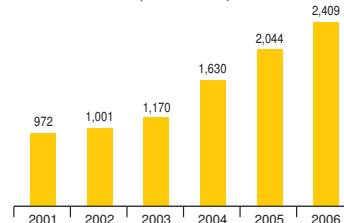


By the close of 2006, the advances portfolio of the Bank had increased by 27% to Rs. 151.7 billion from Rs. 119.9 billion at the close of last year, due to aggressive efforts towards growing private sector with concurrently continuing to exercise effective credit risk management and remaining watchful of the impact on capital adequacy. This has resulted in increase in market share of 50 basis points to 6.3%. The total deposits increased to Rs. 206.0 billion from last year's Rs. 161.4 billion, reflecting a growth of 28% with our market share increasing by 80 basis points to 6.9%. This milestone was achieved despite stiff competition for deposits mobilization during FY06. Total foreign trade handled by the Bank witnessed a growth of 15% as it increased from US\$1.63 billion in FY05 to US\$1.87 billion in FY06.

ABL Advances - Gross
(Rs. in billion)

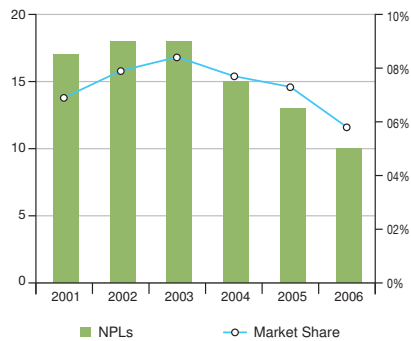


Industry Advances - Gross
(Rs. in billion)

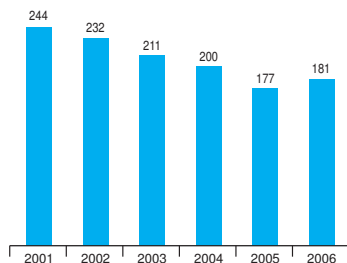


Non Performing Loans (NPLs) saw a noticeable net decline of 17% to reach at Rs. 10.5 billion from last year's Rs. 12.7 billion, when the industry NPLs augmented in the vicinity of 2.5% (based on September 06 position) over FY05.

ABL Non Performing Loans (NPLs)
(Rs. in billion)



Industry NPLs
(Rs. in billion)



Earnings Per Share

The Earnings per Share of the Bank for the year ended December 31, 2006 is Rs. 9.80 per share, which increased by 42% from last year's Rs. 6.88 per share.

Appropriations

The Board of Directors has recommended the following appropriations of the profit for the year ended December 31, 2006.

	Rs. in millions
Profit after tax for the year	4,397
Accumulated profits brought forward	2,732
Transfer from surplus on revaluation of fixed assets – net of tax	19
Profit available for appropriation	7,148
Final cash dividend for the year ended December 31, 2005 declared subsequent to the year end (Rs. 2.5 per share)	1,101
Transfer to Statutory Reserves	440
Accumulated profits carried forward	5,607

The Board of Directors has proposed a cash dividend of Rs. 2.5 per share and to issue bonus shares in the proportion of one share for every five shares held, i.e., 20%, for the financial year 2006. This will be put up for approval in the forthcoming annual general meeting.

Statement of Internal Control

The Board is pleased to endorse the statement made by the management relating to internal control to meet the requirements of the SBP's BSD Circular No. 7 of 2004 and the Code of Corporate Governance as issued by the Securities and Exchange Commission of Pakistan. The Management's Statement on Internal Control is included in the annual report.

Risk Management Framework

The Bank manages risk through a framework of sound risk principles which includes an optimum organizational structure, risk assessment and monitoring process that are closely aligned with our long term strategy. The Risk Management Group (RMG) is mandated to implement this framework as a function independent of commercial lines of business.

In addition, a Risk Management Committee comprising members of senior management discusses significant risk issues that arise, as well as recommends risk policies prepared by RMG to the Board Risk Management Committee for approval. This ensures that risk oversight and governance occur at the highest levels of management.

During 2006, RMG took several steps to further strengthen the Risk Management Framework, for example:

- Initiated the Basel II implementation project by engaging PricewaterhouseCoopers (PwC) in the later half of 2006 to conduct a Gap Analysis with respect to Credit, Market and Operational Risks. We expect completion of the Gap Analysis Reports and preparation of the Basel II implementation plan by PwC during the second quarter of 2007. This is an important step in the alignment of regulatory and economic capital requirements.
- Implemented a new Credit Application Package, which incorporates a formalized and structured approach for credit analysis, and directs the focus of evaluation towards a balanced assessment of credit risk with identification of proper mitigants. These risks include industry risk, business risk, financial risk, security risk and account performance risk.
- Strengthened financial analysis through launch of separate financial spreadsheet templates for manufacturing and trading concerns, banks, leasing and insurance companies. To make the risk estimation more accurate and forward looking, RMG on a pilot basis also developed in house Risk Rating Templates to rate the various asset classes. These rating templates are targeted for launch in 2007 after they have been tested with the assistance of an external consultant.

Directors' Report to the Shareholders

- Solicited proposals from various market risk consultants during the last quarter of 2006 to seek their assistance in establishment of a market risk management framework. A comparative evaluation is underway and a consultant will be appointed so that the Bank can efficiently manage liquidity and market risk.
- Evaluated various risk management software to meet the sophisticated data management and reporting requirements under Basel II. The Bank intends to procure appropriate software that would enable the Bank to meet the regulatory requirements as set out by the State Bank of Pakistan to achieve compliance with Basel II.

The Bank devotes considerable resources in managing the risks to which it is exposed. The momentum attained thus far will be continued in the future through significant investments in technology and training.

Temenos T24 Core Banking Software

We have selected Temenos T24 Core Banking Software Solution for implementation across our branches countrywide. Temenos is a software company based in Geneva, Switzerland and its T24 core banking software is rated as the leading product in the world with over 500 installed sites worldwide. The T24 software is considered as the most technologically advanced integrated banking system available worldwide which integrates with all major technology platforms including Oracle, Windows, UNIX, Linux, etc.

T24 will replace the existing branch banking software to automate and network all the branches of the Bank. We have selected the full suite of T24 modules covering all business function areas of the Bank. It will enable the Bank to bring to market new products very quickly and scale upwards both in terms of transaction volumes and customer services.

Credit Rating

Acknowledging the significant improvement in your Bank's strength, JCR-VIS, in July 2006, upgraded the 'Outlook' one notch from last year's 'Stable' to 'Positive' while maintaining medium to long term entity rating at A+ (Single A Plus) and short term rating at A-1+ (Single A One Plus). We feel pleasure in apprising you of the fact that short term rating of A-1+ is the uppermost possible rating under this category. It represents highest certainty of timely payment with short term liquidity, including internal operating factors and / or access to alternative sources of funds, considered as outstanding and safety just below risk free Government of Pakistan's short term obligations. The long term credit rating assigned to the Bank represents good credit quality with adequate protection factors.

Term Finance Certificates (TFCs)

In order to strengthen Bank's Tier II capital, as required under SBP's BSD Circular No.12, dated August 25, 2004 and to create more room for assets' growth, the Bank has raised TFCs amounting to Rs.2.5 billion through Initial Public Offering and Private Placements during the later part of the current year. The TFCs are sub ordinate in nature and have been rated 'A' (Single A) by JCR-VIS Credit Rating Company. The Karachi Stock Exchange has granted its approval in January 2007, for listing of the TFCs.

Merger of First Allied Bank Modaraba (FABM) with and into ABL

During the current year, the Board of Directors, in their meeting held on April 28, 2006, decided to merge FABM with and into ABL, pursuant to Section 48 of the Banking Companies Ordinance, 1962 and approved the scheme of amalgamation to effect such transaction under Sections 284 to 288 read with Section 503(1)(C) of the Companies Ordinance, 1984. The effective date of the said amalgamation was fixed at January 01, 2006. The proposed scheme of amalgamation was adopted through special resolution in the Extraordinary General Meeting held on June 24, 2006. The scheme was approved by the State Bank of Pakistan on May 27, 2006 with subsequent sanctioning by the Lahore High Court on July 12, 2006 .

Liquidation of Allied Management Services (Private) Limited (AMSL)

The Board, in their meeting held on October 30, 2006, approved the liquidation of AMSL, a wholly owned subsidiary of the Bank, consequent to the merger of FABM (earlier managed by AMSL) into the Bank.

ATM Network

The Bank installed 190 ATMs during the current year, raising their number to 290 at the end of the year. This has led your Bank to achieve the distinction of having the largest ATM network in the country. Not only this, the ATM network was expanded to cover 95 cities, thereby, making it the widest geographical network for ATM based services amongst all the banks in Pakistan.

Awards and Recognitions

We are pleased to inform that your Bank has been declared the "BANK OF THE YEAR 2006" by "The Banker" published by Financial Times Business Limited, London. This is considered to be the most prestigious award in the world of finance. The award is given by the "The Banker" annually to one high performing



Bank in each country based on key performance indicators.

Your Bank has also been awarded “THE CORPORATE FINANCE HOUSE OF THE YEAR - BANK 2005-06” by CFA Association of Pakistan, during the year. This was given in recognition of the persistent endeavor to produce creative and technically challenging transactions with the intent to introduce to clients the different facets of investment banking.

Statement Under Code of Corporate Governance

The Board of Directors is aware of its responsibilities under Code of Corporate Governance and is pleased to report that:

- The financial statements, prepared by the management of the Bank, present fairly its state of affairs, the result of its operations, cash flows and changes in equity.
- Proper books of account of the Bank have been maintained.
- Appropriate accounting policies have been consistently applied in preparation of financial statements. Accounting estimates are based on reasonable and prudent judgment.
- International Accounting Standards, as applicable in Pakistan, have been followed in preparation of financial statements and any departure from them has been adequately disclosed.
- The system of internal control is sound in design and has been effectively implemented and monitored.
- There are no significant doubts upon the Bank's ability to continue as a going concern.
- ‘Management Discussion and Analysis’ gives a detailed overview of the operating results and significant variations.
- There has been no material departure from the best practices of corporate governance.
- A summary of key operating and financial data for last six years is included in this Annual Report.
- The book value of investment and accrued profit on investment of Pension Fund, Provident Fund, Benevolent Fund, Gratuity Fund and Welfare Fund is Rs. 4,659 million, Rs. 2,011 million, Rs. 483 million, Rs. 275 million, Rs. 417 million respectively as per audited accounts of the funds for the year ended December 31, 2005.

- Pattern of Shareholding is annexed.
- Statement of Compliance with Code of Corporate Governance is annexed.
- We have criteria for nomination of Bank's executives on the Boards of other companies where Allied Bank is an investor company. According to the criteria, an executive of cadre ‘Executive Vice President’ or above having related knowledge and expertise can be nominated on the Boards of other companies.
- Board of Directors has the following sub committees with clearly laid down Terms of Reference.
 1. Audit Committee
 2. Human Capital Committee
 3. Risk Management Committee
 4. e-Vision Committee
 5. Strategic Planning and Monitoring Committee

Meetings of The Board

Ten meetings of the Board were held during the year under review. The numbers of meetings attended by each Director for this period are as under:

Name	Designation	Attendance
Mohammad Naeem Mukhtar	Chairman	10
Sheikh Mukhtar Ahmed	Director	5
Mohammad Waseem Mukhtar	Director	8
Abdul Aziz Khan	Director	10
Sheikh Jalees Ahmad	Director	10
Farrakh Qayyum	Director	5
Nazrat Bashir	Director	4
Tasneem M. Noorani*	Director	4
Mubashir A. Akhtar*	Director	4
Kamal Monnoo*	Director	4
Khalid A. Sherwani	Director and President/CEO	10

* Elected on 17.08.2006, since then four (04) meetings of the Board were held.

Directors' Report to the Shareholders

Auditors

Messrs Ford Rhodes Sidat Hyder and Co., Chartered Accountants and Messrs M. Yousuf Adil Saleem and Co., Chartered Accountants being eligible have offered themselves for re appointment. Audit Committee has also recommended appointment thereof for the year 2007.

Year 2007 Prospects

The market scenario will be more challenging as banking industry in Pakistan is currently under a wave of Mergers and Acquisitions through local as well as foreign investors. One reason for the recent surge in bank mergers is Basel Accord II which is to be implemented from January 2008. Proactive asset liability management together with the Bank's ability to offer improved and innovative products will play a vital role in producing better results.

Tight monetary policy has started inducing banks to accelerate mobilization of time deposits and offering higher returns to depositors. Some of the banks have already started introducing schemes of higher return on saving accounts, which should improve real return on deposits going forward.

Your Bank aspires to continue with the strategy of products and geographical expansion during FY07. Expansion is planned in niche markets with potential for consumer, agricultural and SME finance. The management believes that these markets, if explored, with risk control measures in place, can spur growth of the Bank as well as the nation's economy as a whole.

Events After The Balance Sheet Date

There have not been any material events that occurred subsequent to the date of the Balance Sheet that require adjustments to the enclosed financial statements.

Acknowledgements

On the behalf of Board and management, we would like to express our sincere appreciation to our customers and shareholders for their patronage, State Bank of Pakistan and other regulatory bodies for their continuous guidance and support, and employees for all their continued dedication, enthusiasm and loyalty.

Khalid A. Sherwani
President

Mohammad Naeem Mukhtar
Chairman

Date: February 26, 2007
Place: Lahore



Allied Bank introduced
Internet Banking
Allied Direct
during 2006