

SME BANK LIMITED
Directors' Review on Operational Results for the Half Year
Ended June 30, 2010

We are pleased to present the operational results of SME Bank for the first half of 2010.

The Bank ended its operations as on June 30, 2010 with an Equity of Rs 1.712 billion after accounting for the losses as of June 30, 2010. The Paid up Capital of the Bank remained at Rs 2.392 billion and the Bank continued with less than required minimum capital on the basis of exemption granted by State Bank of Pakistan. The Minimum Capital Requirement set by the State Bank requires the banks to have Rs. 7.0 billion as paid up capital by the end of 2010.

The continuing depressed economic conditions and the ever increasing cost of doing business is taking a heavy toll of Small & Medium Enterprises, as it is seriously eroding their capacity to service their debts. Resultantly, the Non Performing Loans (NPL's) of SME's are rapidly rising. The NPL's of SME Bank have also recorded an increase from 13% in June 2009 to 27% in June 2010. In absolute term, NPL's have increased from Rs 316 million to Rs 671 million as on June 2010. This increase in amount

of NPL's pushed the operational results negative and bank posted an operating pre-tax loss of Rs 225 million on June 2010 as compared to pre-tax loss of Rs 97 million in June 2009.

Owing to the overall business environment, the SME and Consumers Sector have reduced their bank borrowings and asset mix of the Banking Sector slightly shifted towards investments. Under these circumstances and tight liquidity position, your Bank has been able to achieve disbursements level of Rs 991 million. The recoveries from Loans & Advances dropped from 453 million in June 2009 to Rs 270 million in June 2010. The recovery setback is mainly due to un-certainty with regard to the future corporate and operational status of the bank coupled with high staff turnover.

The mark up earned from SME lending operations after netting off the mark up income of Rs 40 million suspended due to increase in NPL's stands at Rs 157 million (2009: Rs 189 million). The income through recovery from old portfolio of defunct SBFC & RDFC has dropped from Rs 109 million in June

2009 to Rs 16 million in June 2010 due to closure of Recovery Function. However the cost of Rs 7.2 million per month on the employees rendered surplus due to closure of Recovery Function is adding towards the loss of the Bank.

Management has been striving hard to control the cost of funds and as a result the average cost of funds of the Bank has decreased from 11.92% in June 2009 to 9.85% in June 2010. Due to low credit rating, management has been facing great difficulties to attract large deposits from the public sector institutions because of policy of these institutions. The limited resources and branch network is also an impediment to deposit mobilization efforts.

The freezing of accounts of the Bank by the Taxation Authorities have further deterred the depositors and potential lenders of the funds from dealing with SME Bank.

Total income amounted to Rs 307 million (2009: Rs.420 million) of which treasury business generated Rs 137 million (2009: Rs.146 million) while performance of SME lending operations generated Rs.164 million (2009: Rs.198 million). An amount of Rs.6 million was generated through recoveries of portfolio

of defunct SBFC & RDFC (2009: Rs.76 million).

Administrative Expenses of the Bank has declined from Rs 270 million in June 2009 to Rs 261 million in June 2010. There is a cost savings of Rs 7.5 million per month due to release of 139 employees who opted VSS-2009.

Under the existing circumstances it has become imperative to increase the equity of the bank in order to continue the operations of the bank on self sustainable basis. The shareholders taking cognizance of the matter, in their meeting dated October 7, 2009 decided to recapitalize the bank by increasing its paid up capital. A letter in this context has been written to Ministry of Finance.

We would like to place on record, our thanks to State Bank of Pakistan and other regulatory authorities for their continued support and guidance and the Shareholders for the trust and confidence reposed in us.

For and on Behalf of
Board of Directors

Chairman

SME Bank Limited
Condensed Statement of Financial Position
As at June 30, 2010

	Note	(Un-audited) June 30, 2010	(Audited) December 31, 2009
(Rupees in '000')			
ASSETS			
Cash and balances with treasury banks		244,692	213,778
Balances with other banks		9,352	57,296
Lending to financial institutions		-	33,445
Investments	7	2,715,700	2,939,132
Advances	8	2,392,991	2,500,916
Other assets		211,521	446,244
Operating fixed assets		102,368	108,418
Deferred tax assets		-	-
		5,676,624	6,299,229
LIABILITIES			
Bills payable		29,162	54,542
Borrowings from financial institutions		1,051,898	1,371,750
Deposits and other accounts		2,178,206	2,203,152
Sub-ordinated loans		-	-
Liability against assets subject to finance lease		10,975	12,087
Other liabilities		693,864	436,957
Deferred tax liabilities		-	-
		3,964,105	4,078,488
NET ASSETS		1,712,519	2,220,741
REPRESENTED BY			
Share capital		2,392,507	2,392,507
Reserves		206,526	206,526
Unappropriated loss		(741,501)	(206,848)
		1,857,532	2,392,185
Deficit on revaluation of assets		(145,013)	(171,444)
		1,712,519	2,220,741

CONTINGENCIES AND COMMITMENTS

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The annexed notes 1 to 14 form an integral part of these financial statements.

CFO & Company Secretary

President/Chief Executive

Director

Director

Director

SME Bank Limited
Condensed Profit and Loss Account (Un-audited)
For the half year ended June 30, 2010

	Note	June 30, 2010		June 30, 2009	
		For the quarter ended	For the Half Year ended	For the quarter ended	For the Half Year ended
------(Rupees in '000')-----					
Mark-up/return/interest earned		154,960	306,820	238,093	419,610
Mark-up/return/interest expensed		85,987	184,886	119,209	230,608
Net mark-up/interest income		68,973	121,934	118,884	189,002
Provision against non-performing advances		53,870	110,286	(15,577)	21,394
Provision/(reversal) for diminution/impairment in the value of investments		(43)	(12,814)	1,771	1,771
Bad debts written off directly		178	178	613	1,536
		54,005	97,650	(13,193)	24,701
Net mark-up/interest income after provisions		14,968	24,284	132,077	164,301
NON MARK-UP/INTEREST INCOME					
Fees, commission and brokerage income		3,648	6,827	4,307	5,608
Dividend income		1,364	2,417	1,209	1,209
Gain on sale of securities		-	415	-	-
Other income		855	1,565	639	2,382
Total non-markup/interest income		5,867	11,224	6,155	9,199
		20,835	35,508	138,232	173,500
NON MARK-UP/INTEREST EXPENSE					
Administrative expenses		138,767	252,336	135,179	269,808
Other provisions/write offs	10	2,163	4,035	-	-
Other charges		4,234	4,284	58	196
Total non-markup/interest expenses		145,164	260,655	135,237	270,004
(LOSS)/PROFIT BEFORE TAXATION		(124,329)	(225,147)	2,995	(96,504)
Taxation - Current		2,375	3,153	2,135	2,135
- Prior years	11	-	306,353	-	-
- Deferred		-	-	(9,252)	413
		2,375	309,506	(7,117)	2,548
(LOSS)/PROFIT AFTER TAXATION		(126,704)	(534,653)	10,112	(99,052)
Unappropriated loss brought forward		(614,797)	(206,848)	(344,694)	(235,530)
Loss available for appropriation		(741,501)	(741,501)	(334,582)	(334,582)
Earning per share (Rupees)		(0.53)	(2.23)	0.04	(0.41)

The annexed notes 1 to 14 form an integral part of these financial statements.

CFO & Company Secretary

President/Chief Executive

Director

Director

Director

SME Bank Limited
Condensed Statement of Comprehensive Income (Un-audited)
For the half year ended June 30, 2010

	June 30, 2010		June 30, 2009	
	For the quarter ended	For the Half Year ended	For the quarter ended	For the Half Year ended
	----- (Rupees in '000') -----			
Net (Loss)/Profit after taxation	(126,704)	(534,653)	10,112	(99,052)
Other comprehensive income for the period				
Surplus on remeasurement of investment available for sale to fair value	16,707	26,431	55,362	234,659
Total comprehensive (loss)/income for the period	<u>(109,997)</u>	<u>(508,222)</u>	<u>65,474</u>	<u>135,607</u>

The annexed notes 1 to 14 form an integral part of these financial statements.

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SME Bank Limited
Condensed Cash Flow Statement (Un-audited)
For the half year ended June 30, 2010

	Note	June 30, 2010	June 30, 2009
(Rupees in '000')			
CASH FLOW FROM OPERATING ACTIVITIES			
Loss before taxation		(225,147)	(96,504)
Dividend income		(2,417)	(1,209)
		<u>(227,564)</u>	<u>(97,713)</u>
Adjustments for non-cash/other items:			
Depreciation		6,997	11,135
Amortization		782	1,075
Provision against non-performing advances		110,286	21,394
Provision/(reversal) for impairment in value of investments		(12,814)	1,771
Other provisions/write offs		4,035	-
Bad debts written off directly		178	1,536
Net (profit)/loss on sale of operating fixed asset		113	(520)
Finance charges on leased assets		217	433
		<u>109,794</u>	<u>36,824</u>
		<u>(117,770)</u>	<u>(60,889)</u>
(Increase)/ decrease in operating assets			
Lendings to financial institutions		33,445	-
Advances		(2,539)	(75,012)
Other assets (excluding advance taxation)		230,688	(41,136)
		<u>261,594</u>	<u>(116,148)</u>
Increase/ (decrease) in operating liabilities			
Bills payable		(25,380)	1,934
Borrowings from financial institutions		(319,852)	(193,085)
Deposits		(24,946)	483,159
Other liabilities (excluding current taxation)		(51,284)	(15,276)
		<u>(421,462)</u>	<u>276,732</u>
		<u>(277,638)</u>	<u>99,695</u>
Income tax paid		(1,315)	(1,188)
Net cash flow from/(used in) operating activities		<u>(278,953)</u>	<u>98,507</u>
CASH FLOW FROM INVESTING ACTIVITIES			
Net (investments)/de-investment in available-for-sale securities		209,317	(23,652)
Net (investments)/de-investment in held-to-maturity securities		53,360	(77,332)
Dividend income		2,417	1,209
Investments in operating fixed assets		(2,125)	(4,942)
Sale proceeds of operating fixed assets disposed-off		283	1,061
Net cash flow (used in)/from investing activities		<u>263,252</u>	<u>(103,656)</u>
CASH FLOW FROM FINANCING ACTIVITIES			
Payments of lease obligations		(1,329)	(2,316)
Net cash flow used in financing activities		<u>(1,329)</u>	<u>(2,316)</u>
Decrease in cash and cash equivalents		(17,030)	(7,465)
Cash and cash equivalents at beginning of the period		271,074	349,863
Cash and cash equivalents at the end of period		<u>254,044</u>	<u>342,398</u>
Cash and balances with treasury banks		244,692	233,579
Balances with other banks		9,352	108,819
Call money lending		-	-
		<u>254,044</u>	<u>342,398</u>

The annexed notes 1 to 14 form an integral part of these financial statements.

CFO & Company Secretary

President/Chief Executive

Director

Director

Director

SME Bank Limited
Condensed Statement of Changes in Equity (Un-audited)
For the half year ended June 30, 2010

	Share Capital	Statutory reserve	Unappropriated loss	(Deficit)/ Surplus on revaluation of available for sale investment	Total
	(Rupees in '000')				
Balance as at January 1, 2009	2,392,507	199,356	(235,530)	(401,844)	1,954,489
Transfer to statutory reserve	-	-	-	-	-
Total comprehensive income for the period:					
Loss for the period after taxation	-	-	(99,052)	-	(99,052)
Other comprehensive income					
Surplus on remeasurement of investments available for sale to fair value	-	-	-	234,659	234,659
Total comprehensive income for the period	-	-	(99,052)	234,659	135,607
Balance as at June 30, 2009	2,392,507	199,356	(334,582)	(167,185)	2,090,096
Balance as at July 1, 2009	2,392,507	199,356	(334,582)	(167,185)	2,090,096
Transfer to statutory reserve	-	7,170	(7,170)	-	-
Total comprehensive loss for the period:					
Profit for the period after taxation	-	-	134,904	-	134,904
Other comprehensive income					
Deficit on remeasurement of investments available for sale to fair value	-	-	-	(4,259)	(4,259)
Total comprehensive income for the period	-	-	134,904	(4,259)	130,645
Balance as at December 31, 2009	2,392,507	206,526	(206,848)	(171,444)	2,220,741
Balance as at January 1, 2010	2,392,507	206,526	(206,848)	(171,444)	2,220,741
Transfer to statutory reserve	-	-	-	-	-
Total comprehensive loss for the period:					
Loss for the period after taxation	-	-	(534,653)	-	(534,653)
Other comprehensive income					
Deficit on remeasurement of investments available for sale to fair value	-	-	-	26,431	26,431
Total comprehensive loss for the period	-	-	(534,653)	26,431	(508,222)
Balance as at June 30, 2010	2,392,507	206,526	(741,501)	(145,013)	1,712,519

The annexed notes 1 to 14 form an integral part of these financial statements.

CFO & Company Secretary

President/Chief Executive

Director

Director

Director

SME Bank Limited

Notes to the Condensed Interim Financial Statements (Un-audited)

For the half year ended June 30, 2010

1. GENERAL INFORMATION

1.1 Status and Nature of Business

SME Bank Limited (the Bank) is a public limited company incorporated in Pakistan on October 30, 2001 under the Companies Ordinance, 1984 having its registered office at 40-Jang Building, A.K. Fazal ul Haq road, Blue area, Islamabad. The Bank obtained its business commencement certificate on April 16, 2005 which became effective from the date of its issue. The Bank is now a Scheduled Commercial Bank engaged in the business of banking with the primary objective to support and develop Small and Medium Enterprise (SME) sector in Pakistan by providing necessary financial assistance and business support services on a sustainable basis. The Bank is operating through a network of 13 Commercial banking branches. Based on the latest credit rating report dated June 29, 2010 issued by JCR-VIS Credit Rating Company Limited, credit rating of the Bank was BBB (triple B) in the long term and A-3 (A three) in the short term.

In terms of the provisions of the State Bank of Pakistan BSD circular No. 6 of 2005, the Bank was required to increase its paid up capital (net of losses) as at December 31, 2009 up to Rs.6 billion. The State Bank of Pakistan (SBP) has granted exemption from meeting the enhanced Minimum Capital Requirement and the Bank is allowed to operate with minimum paid up capital (net of losses) of Rs. 2 billion till privatisation of the bank.

1.2 Amalgamation of defunct RDFC and SBFC

The Federal Government promulgated the Regional Development Finance Corporation (RDFC) and Small Business Finance Corporation (SBFC) Amalgamation and Conversion Ordinance, 2001 (the Ordinance 2001) setting forth the mechanism of amalgamation of defunct RDFC and SBFC. Both these entities were Development Financial Institutions (DFIs). In pursuance of the Ordinance 2001, Finance Division, Ministry of Finance issued an Order (SRO (1) 2001) dated December 29, 2001 setting forth the scheme of amalgamation of RDFC and SBFC with the Bank effective January 1, 2002. Pursuant to this scheme entire assets and liabilities of defunct RDFC and SBFC as at December 31, 2001 were transferred to the Bank at fair value. These two institutions stand dissolved and ceased to exist effective January 1, 2002. The Bank allotted its shares to the share holders of defunct RDFC and SBFC in proportion to their shareholding therein based on the fair net assets value of defunct RDFC and SBFC on December 31, 2001.

Further, pursuant to clause 6 of the Ordinance 2001, notwithstanding anything contained in any other law for the time being in force, the Bank shall take and maintain existing deposits, continue lending and any other business which were being undertaken by defunct RDFC and SBFC, respectively, without prejudice to State Bank of Pakistan's permission for commencement of banking business.

2. BASIS OF PRESENTATION

In accordance with the directives of the Federal Government regarding the shifting of the banking system to Islamic modes, the State Bank of Pakistan (SBP) has issued various circulars from time to time. Permissible forms of trade-related modes of financing include purchase of goods by banks from their customers and immediate resale to them at appropriate mark-up in price on deferred payment basis. The purchases and sales arising under these arrangements are not reflected in these financial statements as such but are restricted to the amount of facility actually utilized and the appropriate portion of mark-up thereon.

3. STATEMENT OF COMPLIANCE

These financial statements have been prepared in accordance with approved accounting standards as applicable in Pakistan and the requirements of the Companies Ordinance, 1984, the Banking Companies Ordinance, 1962 and the directives issued by Securities and Exchange Commission of Pakistan (SECP) and State Bank of Pakistan (SBP). Approved accounting standards comprise of such International Accounting Standards as notified under the provisions of the Companies Ordinance, 1984. Wherever the requirements of the Companies Ordinance, 1984, the Banking Companies Ordinance, 1962 or directives issued by SECP and SBP differ with the requirements of these standards, the requirements of the Companies Ordinance, 1984, the Banking Companies Ordinance, 1962 or the requirements of the said directives take precedence.

SME Bank Limited

Notes to the Condensed Interim Financial Statements (Un-audited)

For the half year ended June 30, 2010

In terms of BSD circular letter No. 10 dated August 26, 2002, the State Bank of Pakistan has deferred the applicability of International Accounting Standard (IAS) 39, 'Financial Instruments: Recognition and Measurement' and International Accounting Standard (IAS) 40, 'Investment Property' for Banking Companies through BSD Circular Letter No. 11 dated September 11, 2002. Accordingly, the requirements of these standards have not been considered in the preparation of these condensed interim financial statements. However, investments have been classified and valued in accordance with the requirements prescribed by the State Bank of Pakistan through various circulars.

The disclosures made in these condensed interim financial statements have, however been limited based on the format prescribed by the State Bank of Pakistan vide BSD Circular No. 2 dated May 12, 2004 and the requirements of International Accounting Standards IAS 34 "Interim Financial Reporting". They do not include all of the information required for full annual financial statements and these financial statements should be read in conjunction with the financial statements of the bank for the year ended December 31, 2009.

4. BASIS OF MEASUREMENT

These financial statements have been prepared under the historical cost convention as modified for certain investments which are shown at revalued amounts.

The financial statements are presented in Pak Rupees, which is the Bank's functional and presentation currency.

5. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES AND ESTIMATES

The same accounting policies and methods of computation are followed in these condensed interim financial statements as compared with the annual financial statements issued for the year ended December 31, 2009. However BSD circular Letter No. 07 of 2010 dated April 20, 2010 on the subject "*Revised IAS-1 Presentation of Financial Statements*" is applicable and accordingly applied by the Bank in presentation of condensed interim financial statement.

6. FINANCIAL RESTRUCTURING

6.1 The Government of Pakistan (GoP) assisted by Asian Development Bank (ADB) is working on SME Sector Development Programme (SME SDP). Loan agreement for this programme between GoP and ADB and project agreement between ADB, SBP, Small and Medium Enterprise Development Authority (SMEDA) and the Bank have been signed on February 10, 2004. This programme, apart from other aspects on policy matrix relating to SME sector of Pakistan, also envisages restructuring of SME Bank Limited. Salient features of the restructuring of the Bank are given below:

- i) adjustment of accumulated balances due from SBP on account of its share in profits and losses of the Bank against credit lines provided by SBP;
- ii) payment of Rs 3 billion to SBP before January 1, 2004 against outstanding credit lines and conversion of balance of remaining credit lines into a loan repayable in full by June 30, 2006;
- iii) raising the paid-up capital to Rs 1,100 million by issuing additional shares to GoP;
- iv) the Ministry of Finance (MoF) shall ensure that SBP's shareholding in the Bank is terminated through the purchase of SBP held shares at nominal value by shareholders or otherwise;
- v) 100% provision to be made against non performing financial assistance extended by the defunct RDFC and SBFC prior to January 1, 2002 which provision to be adjusted against SBP credit lines. SBP will recover this amount from proceeds of ADB loan to GoP;
- vi) reduction in the number of recovery branches, staff rationalization through Voluntary Separation Scheme (VSS), human resource audit and hiring of new professional staff on merit;
- vii) reimbursement by GoP of costs related to VSS launched for all regular employees;
- viii) SBP to issue a banking license to the Bank on compliance with all conditions of restructuring and applicable SBP regulations. The commercial banking operations will be separate from the recovery operations of the defunct RDFC and SBFC portfolio and the two operations will be run as independent units within the Bank; and
- ix) privatization of the Bank by June 2006.

SME Bank Limited

Notes to the Condensed Interim Financial Statements (Un-audited)

For the half year ended June 30, 2010

6.2 Current status of the above referred financial restructuring is given below:

- i) Accumulated balances of Rs 3,275.752 million due from SBP on account of its share in profits and losses of the Bank have been adjusted against credit lines provided by SBP;
- ii) Amount of Rs. 7,393 million has been paid to SBP since 2003, to fully adjust the loan liability.
- iii) Paid-up capital has been increased to Rs. 2,393 million by issue of 73,502,453 additional shares of Rs 10 each to GoP without right issue in 2004, issue of 40,000,000 additional shares of Rs 10 each to GoP without right issue in 2005, issue of 50,000,000 additional bonus shares of Rs 10 each to GoP without right issue in 2006 and issue of 39,250,700 additional shares of Rs. 10 each to GoP without right issue in 2007. Proceeds against issue of additional shares in 2004 were paid by GoP to SBP against the Bank's loan balance due to SBP;
- iv) Provision of Rs 1,283.196 million against non performing financial assistance extended by the defunct RDFC and SBFC was adjusted against credit lines of SBP in 2003;
- v) VSS was approved by the Board of Directors of the Bank on November 7, 2003. Costs of VSS are reimbursable by GoP under the Small and Medium Enterprise Sector Development Programme loan agreement between GoP and Asian Development Bank. 712 employees opted for VSS. Aggregate estimated cost of VSS for 712 employees amounts to approximately Rs. 1,800 million. 707 employees were relieved under the scheme upto December 31, 2005 and the aggregate reported cost for 707 employees was Rs. 1,764.268 million, which has been received by the bank by March 31, 2007;
- vi) Human resource technical audit has been completed and report has been submitted to the Bank;
- vii) Banking license was issued by SBP on September 13, 2004 and the Bank has started banking operations after the issue of certificate for commencement of banking business by SBP on April 16, 2005; and
- viii) Privatization Commission (PC) has constituted a transaction committee which is represented by members from the Privatization Commission, State Bank of Pakistan, Ministry of Finance and the Bank. Privatization Commission has approved M/s BMA Capital as Financial Advisors for the bank and due diligence exercise for the privatization of the Bank has been carried out.
- ix) All the recovery offices and recovery booths have been closed with effect from December 31, 2009.
- x) 139 employees opted for VSS-2009 offered vide Circular No. HO/HR&SD/2009/5385 dated October 15, 2009. These employees have been relieved at a total cost of Rs.661 million with effect from November 14, 2009.
- xi) No further progress has been made on the privatisation of the bank.

SME Bank Limited**Notes to the Condensed Interim Financial Statements (Un-audited)****For the half year ended June 30, 2010****7. INVESTMENTS**

	Held by the bank	Given as collateral	Total
	(Rupees in '000')		
As at December 31, 2009	1,573,391	1,365,741	2,939,132
As at June 30, 2010	1,661,832	1,053,868	2,715,700

7.1 INVESTMENTS BY TYPES:**As at June 30, 2010****Available-for-sale securities**

Market Treasury Bills	274,811	-	274,811
Pakistan Investment Bonds (PIBs)	1,075,824	1,161,088	2,236,912
Fully paid ordinary shares/Units/Certificates	102,196	-	102,196
Term Finance Certificates (TFCs)	71,631	-	71,631
	1,524,462	1,161,088	2,685,550

Held-to-maturity securities

Certificates of Investments (COIs)	762	-	762
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Investment in subsidiary

SME Leasing Limited	215,457	-	215,457
Investments at cost	1,740,681	1,161,088	2,901,769
Provision for diminution/impairment in value of investments	(41,056)	-	(41,056)
Investments net of impairment	1,699,625	1,161,088	2,860,713
Deficit on revaluation of Available-for-sale-securities	(37,793)	(107,220)	(145,013)
Total Investments at market value	1,661,832	1,053,868	2,715,700

SME Bank Limited

Notes to the Condensed Interim Financial Statements (Un-audited)

For the half year ended June 30, 2010

	Note	(Un-audited) June 30, 2010	(Audited) December 31, 2009
(Rupees in '000')			
8. ADVANCES			
Loans, cash credits, running finances, etc- In Pakistan			
Extended by:			
Defunct SBFC	8.2	4,407,575	4,420,980
Defunct RDFC	8.2	551,234	560,315
The Bank		2,533,110	2,507,438
Due from ex-employees	8.2	21,218	22,867
Due from employees		197,031	209,116
		<u>7,710,168</u>	<u>7,720,716</u>
Net investment in finance lease - In Pakistan		1,253	1,253
Advances - gross		<u>7,711,421</u>	<u>7,721,969</u>
Provision for non-performing advances		(5,318,430)	(5,221,053)
Advances - net of provision		<u>2,392,991</u>	<u>2,500,916</u>

8.1 Advances include Rs. 5,657,096 thousand (2009: 5,543,241 thousands) which have been placed under non-performing status as detailed below:

Category of Classification	June 30, 2010			Provision Required	Provision Held
	Domestic	Overseas	Total		
----- (Rupees in '000') -----					
Substandard	115,370	-	115,370	26,570	26,570
Doubtful	130,901	-	130,901	49,596	49,596
Loss	5,410,825	-	5,410,825	5,242,264	5,242,264
	<u>5,657,096</u>	<u>-</u>	<u>5,657,096</u>	<u>5,318,430</u>	<u>5,318,430</u>

8.2 Assignment of Non-Performing Loan (NPL) portfolios of defunct SBFC & RDFC to National Bank of Pakistan (NBP)

The board through its resolution by circulation No.10/circ/33 dated March 08, 2010 has approved the transfer and assignment of the non-performing loan portfolio of defunct SBFC & RDFC to NBP which is subsequently transferred and assigned through "Transfer and Assignment Agreement" executed between the Bank and NBP at Karachi on July 01, 2010. The recovery shall be shared between NBP and SME, according to the terms of agreement. The agreement is effective from July 01, 2010 and no adjustments have been incorporated in these condensed interim financial statements.

SME Bank Limited
Notes to the Condensed Interim Financial Statements (Un-audited)
For the half year ended June 30, 2010

	(Un-audited) June 30, 2010	(Audited) December 31, 2009
	(Rupees in '000')	
9. CONTINGENCIES AND COMMITMENTS		
9.1 Transaction-related contingent liabilities		
Guarantees in favour of:		
Government	106,591	71,156
Others	89,462	90,411
9.2 Other Contingencies		
a) Claims not acknowledged as debt from various borrowers for loss sustained due to non-disbursement.	24,972	24,972
b) Damages claim by borrower for delay in recording repayments received from borrower , not acknowledged as debt.	49,800	49,800
c) Damages claim by Ravi Securities (Private) Limited and Taas Securities (Private) Limited, not acknowledged as debt.	23,800	23,800
d) Tax demands of Rs 612.707 million raised by the Income Tax Authorities related to VSS staff cost which has been re-imbursed by GOP to the Bank by issuing show cause notice to amend the assessment of tax year 2005 u/s 122 (3). Appeal has been filed against the order. The Management, based on tax advisor assessment, is expecting a favourable outcome, however on the direction of SBP vide Letter No BID (Insp)/595/45-49-2010 dated March 22, 2010, 50% of the total demand has been provided in these financial statements.	306,353	612,707
e) Adjustment of loan guarantee against borrowing from IDBP repaid in prior years, disputed by IDBP	9,939	9,939
f) Back benefits and claims of staff/employees under litigation	71,400	90,800
	682,317	973,585
9.3 Commitments in respect of forward lending		
Commitments to extend credit	244,350	243,700
9.4 Commitments for the acquisition of operating fixed assets	1,103	680
9.5 Commitments against Repo/Reverse Repo transactions		
Purchase and resale agreements	-	33,445
Sale and repurchase agreements	1,051,898	1,371,750
	1,051,898	1,405,195
9.6 Other commitments		
Undrawn facilities	207,057	201,747
9.7 Bills for collection		
Payable in Pakistan	482	2,076

SME Bank Limited**Notes to the Condensed Interim Financial Statements (Un-audited)****For the half year ended June 30, 2010****10. OTHER PROVISIONS/WRITE OFFS**

This includes miscellaneous charges relating to Non-Performing Loan (NPL) of the Bank and SBFC.

11. TAXATION- PRIOR YEARS

This represents 50% of total tax demand raised by Income Tax Authorities as detailed in Note # 9.2 (d) to these condensed interim financial statements. This provision has been made on the direction of State Bank of Pakistan vide Letter No BID (Insp)/595/45-49-2010 dated March 22, 2010.

12. RELATED PARTY TRANSACTIONS

The Bank has a related party relationship with its subsidiary - SME Leasing Limited (SMEL), its directors, executive officers and employees' funds.

Details of balances outstanding at quarter end and transactions with related parties are as follows:

	(Un-audited)	(Audited)
	June 30, 2010	December 31, 2009
	(Rupees in '000')	
Balances outstanding		
SME Leasing Limited :		
Investment in subsidiary	215,457	215,457
Loan to SMEL	119,984	43,561
Receivable from SMEL	2,148	1,442
Liability against assets subject to finance lease	10,975	12,087
Investment in TFC's issued by SMEL	41,667	58,333
Transaction during the year	(Un-audited)	(Un-Audited)
	June 30, 2010	June 30, 2009
SME Leasing Limited :		
Interest income on loan to SMEL	4,451	2,699
Loan disbursed	159,973	45,000
Repayment of loan	83,550	5,847
Repayment of interest on loan	3,809	1,468
Payment received against TFC's	16,666	16,667
Markup on liability against assets subject to finance lease	217	432
Payment for liability against assets subject to finance lease	1,112	1,508

Principal terms of loan to SMEL

Year	Amount (Rupees '000')	Term	Interest rate	Repayment	Number of installments
2010	10,000	1 Month	15% for one month	Monthly	1
2010	10,000	10 Days	3 months Kibor + 3 %	10 Days	1
2010	15,000	1 Month	3 months Kibor + 3 %	Monthly	1
2010	30,000	3 Months	3 months Kibor + 3 % per quarter	Quarterly	1
2010	32,000	3 Months	3 months Kibor + 3 % per quarter	Quarterly	1
2010	70,000	3 Years, Reviewable 6 monthly	3 months Kibor + 3 %	RF	-

SME Bank Limited

Notes to the Condensed Interim Financial Statements (Un-audited)

For the half year ended June 30, 2010

13. GENERAL

Figures have been rounded to the nearest thousand rupees unless otherwise stated.

14. DATE OF AUTHORIZATION

These financial statements were authorized for issue by the Board of Directors of the Bank on _____, 2010.

CFO & Company Secretary

President/Chief Executive

Director

Director

Director