

## ***Management Discussion and Analysis Report***

### ***Statement of objects and business:***

National Finance Co., established in November 1987, has completed 21 years of operations in the Sultanate. The Company's core business activity is lease financing. As a public joint stock company regulated by the Central Bank of Oman, the company's business operations are subject to compliance with the regulatory and statutory guidelines of the Central Bank of Oman, the Capital Market Authority, the Company's own manual of authority & procedures and the legal statutes of the Sultanate of Oman.

National Finance currently conducts its business from the head quarters at Muscat and the four branches at Salalah, Sur, Sohar and Nizwa. The lease financing activity is predominantly in the form of finance for saloon cars, light & heavy commercial vehicles and heavy machineries/equipments to individuals and small and medium enterprises. The Company's performance in 2008 has witnessed significant growth under all segments whilst continuing to lay a sound platform for future growth.

The following discussion and analysis, in the opinion of the management, is useful in understanding the Company's financial results and position. The discussion and analysis have been made keeping the going concern concept in mind and need to be read together with the financial statements and related notes forming part of the annual report.

Certain statements in these discussions are forward-looking statements, including those that discuss strategies, goals, outlook or other non-historical matters; or projected revenues, income, returns or other financial measures. These forward-looking statements speak only as of the date on which they are made. The forward-looking statements are subject to risks and uncertainties that may cause actual results to differ materially from those contained in the statements. Interest rate changes, demand and supply in the products financed, changes in Government regulations, tax laws etc., may have an influence on the financial results of the Company.

### ***Economic Environment:***

The financial crisis originating from the developed economies has spread globally from September 2008. Several major financial institutions have become bankrupt in the United States and Europe resulting in unprecedented government intervention to maintain the sanctity of the financial system. The substantial deleveraging of bank balance sheets has resulted in a sudden shortage of USD and Euro liquidity, which has led to knock-on impact on global demand.

Deflation of demand has resulted in a sudden and dramatic fall in demand for Crude which has resulted in the price falling from \$147 per barrel to nearly \$ 33 per barrel in a matter of months. The earlier mentioned deleveraging of global financial institutions has

also resulted in a drop in availability of overseas credit lines to banks and borrowers in Oman.

The impact of the above on the region and Oman in particular is threefold:

- Reduced liquidity has caused local banks to increase their funding rates
- The drop in the price of Crude reduces the flexibility available to Government and
- The continuing (widely reported) troubles of developed economies impacts on confidence and business and consumer spending

Oman's overall economic growth in current prices is estimated at 40% for 2008 on the back of strong growth in the oil and gas sector, as well as the manufacturing sector. While inflation was a problem till the third quarter, this is expected to decline in 2009 in line with global factors.

While Oman is not totally isolated from the impact of the global financial turmoil, the fundamentals of the economy remain sound. As per the budget for 2009, the Government has planned to increase expenditure 11% while continuing to complete the projects underway. The main risk to this plan arises from the continuing volatility of crude prices, at the budgeted level of \$45 per barrel, the budget already envisages deficit of RO 810 million (5% of GDP).

### ***Industry overview***

The Leasing and Finance sector had shown rapid growth till the end of 3<sup>rd</sup> quarter 2008. Since then, the global credit crunch has reduced the availability of funds and increased the borrowing cost. Small and medium-sized enterprises (SMEs) are particularly vulnerable to the credit crunch due to their heavy dependence on borrowings, and limited recourse to their internal accruals. Tight liquidity and pressure on margins is expected to slow down growth in 2009 and increase focus on maintaining strong collections.

Average yields have continued to drop due to strong competition amongst the major players in the industry. The retail vehicle financing industry will remain the most competitive segment of the market due to consumer resistance to spending.

### ***Overview of Operations***

National Finance's major strength has always been its customer base, dealer relationships, strong business practices and experienced and committed work force. As one of the oldest players in the industry, the Company has a mature understanding of the market and has developed systems and processes that are constantly updated to meet the market demands and to face the challenges posed by the changing business environments.

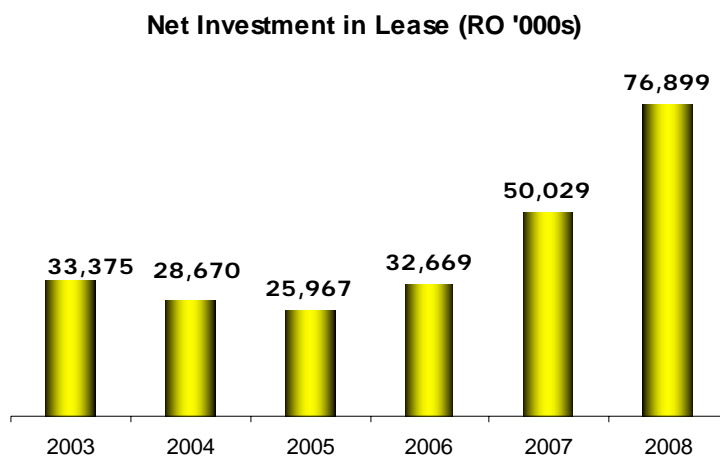
The keys to enhancing the profitability in finance business depend on the Company's ability:

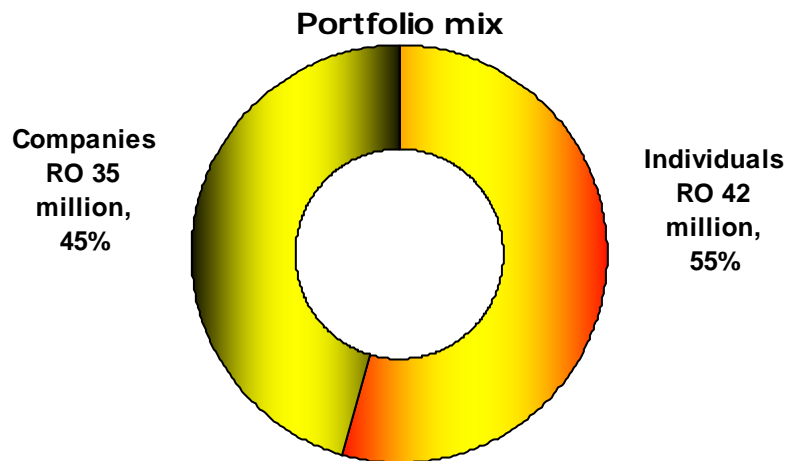
- a) to lend money at rates in excess of the cost of borrowing.
- b) to maintain efficient operating platforms and infrastructure in order to run the business at competitive cost levels
- c) to originate quality new business at optimal cost through multiple customer acquisition channels
- d) to minimize the credit losses by proper evaluation of the credit worthiness of the customers, both during approval stage and post-disbursal collections
- e) to maintain a strong capital base
- f) to leverage the business at the optimal level

Over the years, the Company has gained substantial expertise in managing its business against these requirements. This has resulted in improvement in the company's operating performance and position as highlighted in this note. The company remains well positioned to grow its business in the Sultanate of Oman in future as well.

### ***Financing activity***

The Company's core business is asset based financing for the individual and SME segments. After a period of selective and controlled growth till 2005, the Company has been achieving impressive growth for the past 3 years. The Company's Net Investment in Lease recorded a growth rate of over 54% in 2008 as compared to 53% in 2007.





### ***Performance highlights***

- ✚ Business writings increased by 54 % as compared to 2007.
- ✚ Net Finance portfolio increased by 54% as compared to 2007.
- ✚ Provision coverage of non-performing loans increased by 10% from 93% in 2007 to 103% in 2008.
- ✚ Profit after tax increased to RO 1.995 million from RO 1.437 million in 2007.
- ✚ 20% dividend of which 10% will be in cash and 10% in stock proposed for the year.

National Finance's operations resulted in a gross income of RO 7.84 million compared to RO 4.96 million for the year 2007 showing a growth of 58%. The Company's sustained efforts in collecting old overdue exposures resulted in higher collections.

Due to a higher level of borrowings and increased cost of funding, the interest cost increased by 68% to RO 2.67 million in 2008 from RO 1.59 million in 2007. Operating expenses increased by 20% from RO 1.84 million in 2007 to RO 2.21 million in 2008.

In line with the Company's continued good collection record, the non-performing portfolio decreased by 2% from RO 6.4 million in 2007 to RO 6.3 million in 2008.

As a net result of the overall improvement in business writings and collections, despite the contracting margins & high interest charges, the Company registered a 39% growth in Net Profit from RO 1.43 million in 2007 to RO 1.99 million in 2008.

### ***Risk management***

The business activities of National Finance involve various elements of risk. We consider the principal types of risks to be credit risk and market risk (which includes interest rate risk, foreign currency risk and liquidity risks). Managing these risks is the

major challenge facing the finance industry today. The Company aims to ensure that its risk management structure provides the required infrastructure to be able to implement best practice standards available within the industry.

### ***Credit risk management***

As the Company's core business is lease financing, Credit risk forms the major risk to which the company is exposed. Credit risk is the risk that counterparty will cause financial loss for the company by failing to discharge an obligation and the management, therefore, carefully manages its exposures to credit risk. The company employs range of policies and practices to manage, limit and control concentration of credit risk to individual counter parties, groups and industries.

The Company reviews and monitors credit exposures on an ongoing basis to identify the early warning signals and take appropriate corrective action.

### ***Market risk management***

Market risk is the risk of loss arising from changes in values of financial assets and liabilities and includes interest rate risk, foreign exchange risk and liquidity risk.

The Company engages in financial transactions in the normal course of business that exposes the Company to these market risks. The management conducts what it believes are appropriate management practices and maintains policies designed to effectively mitigate such risks. The objectives of the market risk management efforts are to preserve the economic and accounting returns of the assets by matching the re-pricing and maturity profiles of the assets with that of the liabilities.

### ***Interest rate risk***

Interest rate risk arises from the possibility of changes in interest rates and mismatches or gaps in the amounts of assets and liabilities that mature or re-price in a given period. Except for pricing the leases of varying maturity appropriately, the company does not actively hedge against interest rate risk.

### ***Liquidity risk***

Liquidity risk is the risk that an enterprise will encounter in raising funds to meet its obligations at any given time. The company's liquidity management policies are designed to ensure that the company would be in a position to meet its obligations as they fall due even under adverse conditions. The Asset & Liability committee monitors, reviews and reports the liquidity position in line with the contingency funding plan.

### ***Foreign currency risk***

Foreign currency risk is the risk that arises from assets or liabilities denominated in a currency that is not the entity's functional currency. The majority of the company's transactions are denominated in the local currency. Foreign currency transactions of the company are restricted to US Dollar denominated borrowings. Since the Omani Rial is pegged to the US Dollar, foreign exchange risk is considered low. The company has established foreign currency reserve in accordance with the requirements of the Central Bank of Oman to mitigate this risk. In addition, the company has the option of entering into forward exchange contracts, where necessary, to hedge any significant risks arising from foreign currency transactions.

### ***Internal Control & Audit***

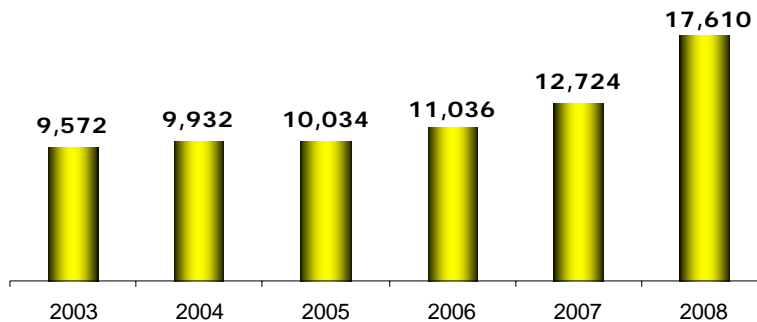
The various segments of the general operations of the Company and the adherence of the staff to internal regulations, policies and procedures are evaluated by the Internal Audit department. A periodical assessment of the risks and the controls embedded to overcome such risks is also undertaken by them. The audit findings are independently reported to the Audit Committee of the Board of Directors.

The Internal Auditor resigned from the Company during 2008. Pending recruitment of a suitable replacement, the Company has outsourced the internal audit services to Horwath Mak Ghazali LLC who currently performs this function.

### ***Shareholders' funds***

National Finance's total equity crossed RO 17 million during the year 2008. During the year, shares worth RO 3.3 million was issued to the shareholders on rights basis in the ratio of 0.412 share for every share held and to employees up to 5.64 times of their monthly basic salary. The existing shares have also been subdivided into 100 Baiza denomination and the rights issue carried a premium of 40 Baiza per share including issue expenses.

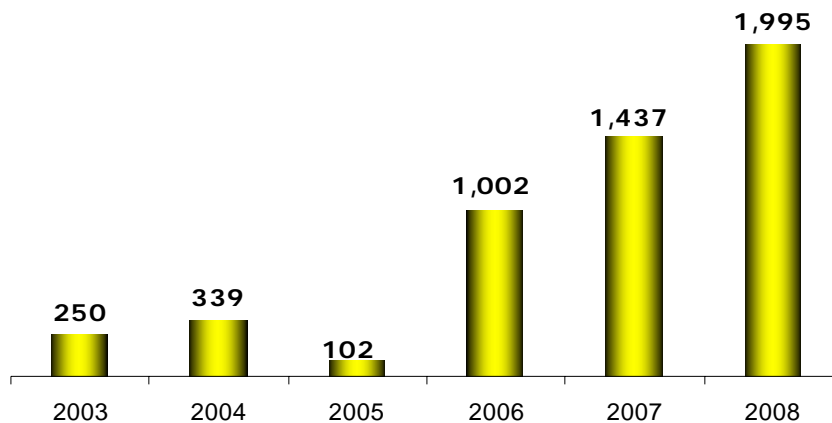
#### Shareholders' Funds (RO '000s)



#### *Profitability*

The company made a net profit of RO 1.99 million during the year, registering a growth of 39% from RO 1.43 million in 2007.

#### Profit after tax (RO '000s)



#### *Dividend*

The company proposes to distribute 20% dividend of which 10% will be in cash and 10% in stock to its shareholders for the year 2008. This will be accounted for in shareholders' equity as an appropriation of retained earnings in the year ending 31 December 2009.

#### *Borrowings*

During the year 2008, the Company, raised fixed deposits worth RO 4.4 million from various corporates in Oman. Bank borrowings increased from RO 31.26 million at the end of 2007 to RO 48.22 million at the end of 2008 to fund the increased business. The

debt equity ratio was 3.54:1 (2007 – 3.19:1) and was well below the CBO approved level of 5 times.

***Human Resources***

The Company continued its efforts on Omanisation and training of manpower in 2008. The Omanisation was at 66% as at the end of 2008 (2007: 64%) which is substantially higher than the prescribed target of 50%.

***Future Outlook:***

The outlook for the finance and leasing industry for 2009 will be challenging. Liquidity has remained tight and the increase in interest rates effected by the banks has compressed margins. In addition, slowdown of the economy from the high growth rates of the past 3 years as well as some oversupply in the equipment segment may result in an increase in delinquencies.

The Company will continue to strive hard to improve its service levels, the main differentiator in service oriented industries and will continue in its pursuit to develop strategies for maintaining margins through efficient operations. This combined with improved asset quality and focus on maintaining good collections is expected to provide satisfactory returns to the investors.

**Ali Abdullah Saleh Al Tamimi**  
**General Manager**

**Robert Pancras**  
**Chief Executive Officer**