

Management Discussion & Analysis Report

Statement of Business Objectives

National Finance Co. SAOG ('National Finance' or 'the Company') was established in November 1987 and has now completed 22 years of operations. The Company's main business objective is to be the preferred provider of financial products to its target customer base of individuals and Small and Medium Enterprises (SMEs) in Oman. National Finance currently conducts its business from its head quarters at Muscat and the four branches at Salalah, Sur, Sohar and Nizwa.

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.

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 Overview

Global Economy

The global meltdown in the financial markets that started from the 3rd quarter of 2008 was followed by an unprecedented liquidity crunch which was felt in the domestic market also. Given today's integrated world where trade links and cross-exposures are very large and complex, many systemically important commercial banks, investment banks, mortgage lenders, insurance companies and other financial institutions in the US and Europe suffered huge losses due to their investments in mortgage backed 'toxic' assets issued by the impacted entities. The weakening of financial institutions evolved into a global credit crisis resulting in tightening of money and credit markets and the disruption of international capital flows amidst extreme risk aversion.

Governments and Central Banks fulfilled their role as lenders of last resort by intervening in markets to extents unprecedented in history. Extreme fiscal stimuli and monetary measures (including widespread creation of new money in OECD countries) have resolved the worst of the systemic confidence issues but now pose new problems in areas of Government borrowing,

inflation expectations and moral hazard. The overhanging global economic imbalances (producing and lending East and debt fuelled consuming West) have not yet been corrected.

The above present potential for significant changes in the global economy and a return of instability and volatility is the process of correction gets out of control. It is with the backdrop of this potentially turbulent world that we need to plan our business for 2010 and beyond.

Domestic Economy

The past year presented a lot of challenges to the company due to the overall economic slowdown. The Oman economy, which was on a robust growth path up to Q3-2008, witnessed moderation in 2009. While the growth deceleration was primarily driven by the knock on effects of the global economic crisis, Oman has several strengths that helped in mitigating the adverse effects of global financial crisis. Proactive actions taken by the Government in announcing projects during 2009 resulted in containing negative business confidence. The rebound of oil prices in the second half of 2009 ensures that the country has sufficient financial flexibility to continue to implement its development plan.

The Country's 2010 budget which is based on a projected average oil price of \$50 a barrel (current price is \$76 per barrel) envisages continuing along the 2020 vision. The continuing flow of investments in the oil and infrastructure sectors has resulted in improving business confidence in the SME business community. Since the slowdown in 2009 was relatively muted in Oman, there has been no material impact on employment.

The liquidity problems of the first half of last year (caused by withdrawal of overseas liquidity from the domestic economy and build up of inventories) have now been resolved. Barring fresh turmoil in the global financial sector, we believe liquidity will be reasonably available in the near future.

Industry Overview

The Leasing and Finance sector showed negative growth during 2009. The reduced availability of funds, increased borrowing cost and stalling of job growth in the backdrop of the hyper growth of the previous 2 years resulted in a consolidation phase in 2009 both in vehicle and equipment sales. Restricted availability of funding and a more cautious credit approach adopted by FLCs further impacted the situation; as a result, fresh disbursements declined significantly during 2009.

While customer confidence appears to be improving, particularly in the SME sector, build up of vehicle and equipment sales seems to be more gradual. Overall, we expect growth in sales (and hence our disbursements) during 2010 within the context of possible global turbulence highlighted above.

Business Structure

National Finance's major strengths 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 key strategies to enhancing the profitability in our business depend on the Company's ability:

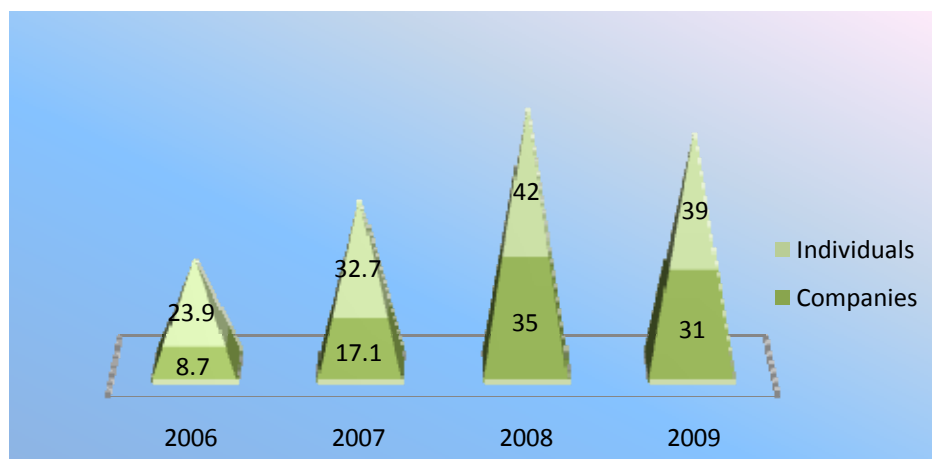
- to lend money at spreads sufficient to maintain appropriate return for the risk undertaken
- to maintain efficient operating platforms and infrastructure in order to run the business at competitive cost levels
- to originate quality new business at optimal cost through multiple customer acquisition channels
- to minimize the credit losses by proper evaluation of the credit worthiness of the customers, both during approval stage and post-disbursal collections
- to maintain a strong capital base
- to leverage the business at the optimal level

Performance Highlights

Vehicle & Equipment Finance

In vehicle finance, the company operates through established dealer as well as direct customer relationships while in the SME market the business is more focused on direct marketing. As mentioned earlier, our approach in SME has been to restrict our target to lower risk customers. Our business disbursements saw substantial decline in 2009 after 2 consecutive years of 50% plus growth.

Portfolio Mix (Rials in million)

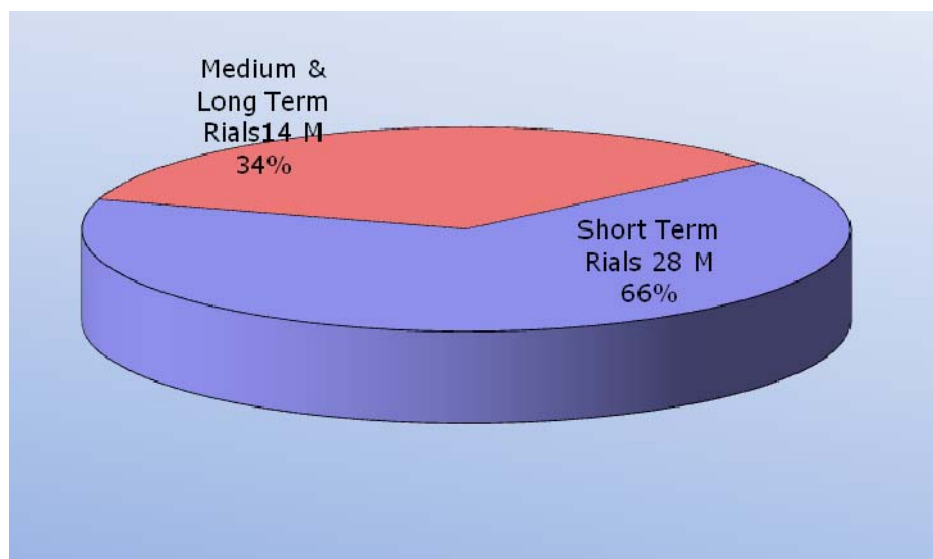


Funding Profile

As a result of the decline in business, our gearing has dropped to a low level of 2.8 times as compared to our regulatory cap of 5 times. This is a sub-optimally low position for a financial institution and we will work towards improving the situation by growing our portfolio this year. Our external funding comprises 2 main sources, bank borrowings and corporate deposits.

a) Bank Borrowings

Bank borrowings comprise our main source of funding. Since all our funding is from relationship banks with whom we have (and continue to cultivate) long term relationships, banks constitute a substantial source of stable funding for FLCs. The Company's total bank borrowings as at 31st December 2009 amounted to Rials 42.4 million as compared to Rials 48.2 million as at 31st December 2008.



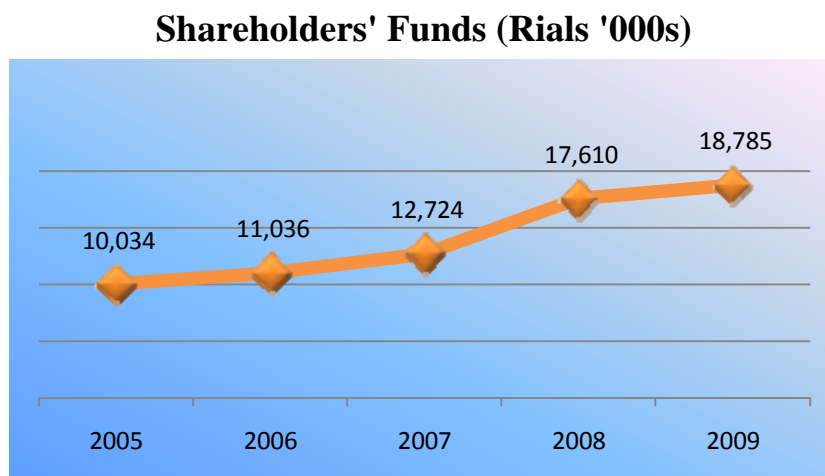
b) Fixed Deposits

Fixed deposits carry the advantage of being fixed rate for the term; consequently, interest rate risk can be successfully mitigated to an extent. Our deposits tend to be from both stable relationship based depositors as well as more opportunistic one time depositors. As at 31st December 2009 the Company carried corporate fixed deposits totaling Rials 7.2 million (Rials 10.2 million as of 2008).

Operational Performance

Overall summary of performance for the year is as follows:

- Income from financing activities increased 10% due to higher earning assets and increased pricing on fresh leases
- Interest cost jumped up 42% as a result of increased rates charged by banks as well as slightly higher utilizations
- Operating overheads were well contained – reducing by Rials 156 K from the 2008 figures
- Profit for the year at Rials 2.32 million was up 16% from 2008 profit, however, this includes a one time after tax gain of Rials 428 K from sale of collateral land acquired.



Human Resources

NFC firmly believes that its competitive edge is derived from its people. As a financial services company which takes pride in knowing and serving its customers better than most, people remain the Company's most valuable asset. The past success was built on the soundness of the Company's strategy which by the quality and determination of the employees had turned into action. Going forward also, the Company not only plans to maintain this key source of competitive advantage but also build on it through well-structured training initiatives.

With a rapidly changing business environment comes a need to constantly upgrade existing skill sets and to new challenges. During 2009, the focus of our Human Resources function has been on improving the skills of its employees by organizing various job based training programs. During the year the company conducted structured training programs in spoken English, risk assessment & management, anti-money laundering and information technology.

Preparing our Omani employees for the changing environment is a strategic imperative which is followed closely within the company. The Company is well equipped in terms of processes to continue to meet the upcoming requirements of growth. As of 31st December, 2009, there were 99 employees of the Company of whom 64 employees were Omani nationals. The Omanisation ratio was at 65% which is substantially higher than the statutory target of 50%.

Information Technology

The company considers Information Technology to be a key business enabler. During 2010, an approved system change will be carried out which will transition the company into a more stable, user friendly and efficient technology platform.

The company has a well developed and tested Disaster Recovery infrastructure which involves maintenance of operations in the event of loss of the main production system. The company has also put in place Business Continuity Plans as required by best practice for financial institutions.

Risks and Concerns

Managing risk is an inherent part of the Company's business. The Company's goal in risk management is to understand, measure and monitor the various risks that arise, and to evolve upto date policies and procedures to mitigate and manage these risks. The Company is primarily exposed to credit risk, interest rate risk, liquidity risk and operational risks. The Company has a Risk Management Committee in place which manages and reviews the risk management system, policy and strategy from time to time

The two key pillars of risk management for the company lie in:

- Adoption of standardized operating procedures;
- Reviews and audits to evaluate the extent of compliance as well as to spot any gaps.

Credit Risk

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 a 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 a 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

Operational Risk

Operational Risk is defined as the risk that the company will incur due to inadequate or failed internal processes, people or systems.

The management of operational risk is carried out through a comprehensive system of internal controls, documented delegation of authority, separation of duties between key functions and detailed standard operating procedures. The key operational processes are centralised at head office that reduces the operational risk at the branch level. The company has an empowered in house internal auditor. The company also adopts a whistle blower policy. The company periodically reviews the information security policy and aligns the systems to the revised policy guidelines.

Market Risk

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 mitigation techniques deployed by the company is to spread the borrowing basket among different banks to reduce the concentration risk. It also monitors the structural liquidity mismatches between the assets and the liabilities on a projected cash flow basis and periodically reviews the open credit lines available with the banks. The liquidity risk is reviewed on a monthly basis by the ALCO.

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 Systems

The company has put in place extensive internal controls to mitigate risks. An established set of procedures provides clear delegation of authorities and standard operating procedures for all parts of the business. Clear segregation of duties exists between various functions. The in-house internal auditor evaluates the adequacy and effectiveness of controls and all audit findings are independently reported to the Audit Committee of the Board of Directors

Future Outlook

The GDP of the Sultanate of Oman is expected to grow by 6.1% during 2010 but the outlook for the finance and leasing industry for 2010 will remain challenging. Liquidity is expected to ease and funding interest rates are reducing but on the other hand increased competition will compress margins. In addition, slowdown of the Dubai economy and 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 our shareholders.

Ali Abdullah Saleh Al Tamimi
General Manager

Robert Pancras
Chief Executive Officer