

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 23 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 year 2011 could represent a pivotal year for the global economic recovery. With the crisis of 2008 and 2009 receding, and following the unprecedented efforts expended in 2010 developing the outlines of a new, post-crisis world, 2011 could be the year in which post-crisis economic growth kicks off. The 2011 economic outlook is promising, with emerging economies continuing to post strong growth.

However there are several downside risks for the global economy, including renewed turbulence in sovereign debt markets, failure to reduce high unemployment coupled with downside risks for housing markets in several advanced economies, as well as rising asset prices and accelerating inflation in several emerging economies. Although domestic demand growth has quickened in most emerging economies, their aggregate trade surpluses remain substantial. At the same time, high unemployment, weakened household balance sheets, sluggish income gains and a still-healing financial sector are holding back advanced economy recoveries.

Domestic Economy

After witnessing a slowdown, Oman's economy bounced back during 2010. A large share of growth in the last financial year could be attributed to continued government spending. We are seeing increased traction on project implementation, job creation and some pick up in consumption expenditure.

While the fundamentals of the Oman economy remain strong, the fund flows of the domestic financial system are dependent on the changes and developments in oil prices to a large extent. The continuing flow of investment in the oil and infrastructure sectors has resulted in improving business confidence in the SME business community.

The financial system is quite liquid and we do expect our banking partners to retain sufficient liquidity.

Industry Overview

The Leasing and Finance sector showed positive growth during 2010. Availability of funds, lowering of borrowing costs, continued mobilization of infrastructure projects and improved confidence particularly in the SME sector has resulted in some build up in vehicle and equipment sales. However some SME customers continue to struggle with the problems of the last 2 years.

Business Structure

Your company's major strengths are its customer base, dealer relationships, strong business practices and experienced and committed work force. As one of the oldest players in the industry your 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 environment.

The key strategies to enhancing the profitability in our business depend on the Company's ability:

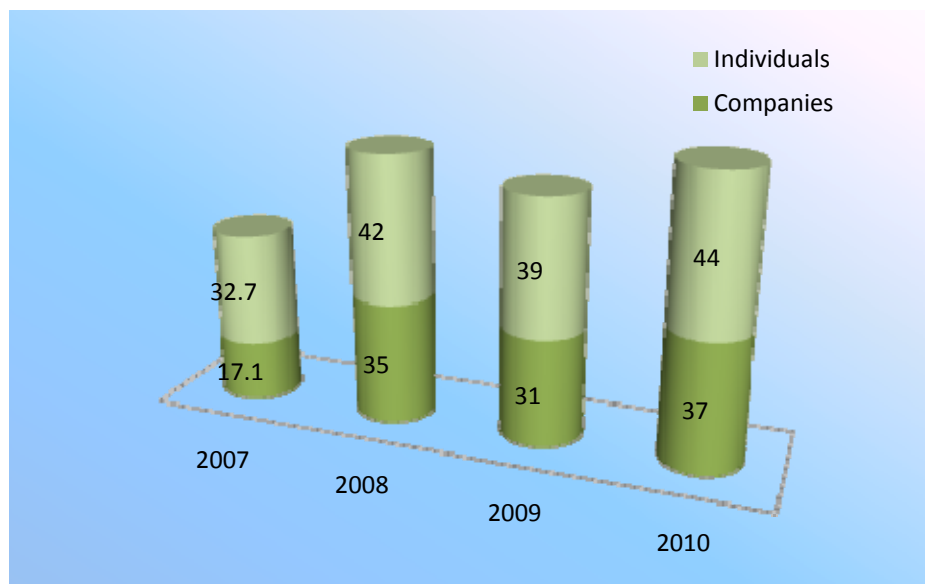
- a) to lend money at spreads sufficient to maintain appropriate return for the risk undertaken
- b) to maintain efficient operating platforms and infrastructure in order to run the business at competitive cost levels
- c) to originate quality new business at optimal cost through multiple customer acquisition 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 and 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. Our approach in SME has been to restrict our target to lower risk customers. Our business disbursements saw substantial increase in 2010 after the low levels of 2009.

Net Investment in Lease (Rials in million)



Funding Profile

As a result of the increase in business, our gearing has risen to a level of 3.0 times as compared to our regulatory cap of 5 times. 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 2010 amounted to Rials 42.8 million as compared to Rials 42.4 million as at 31st December 2009.

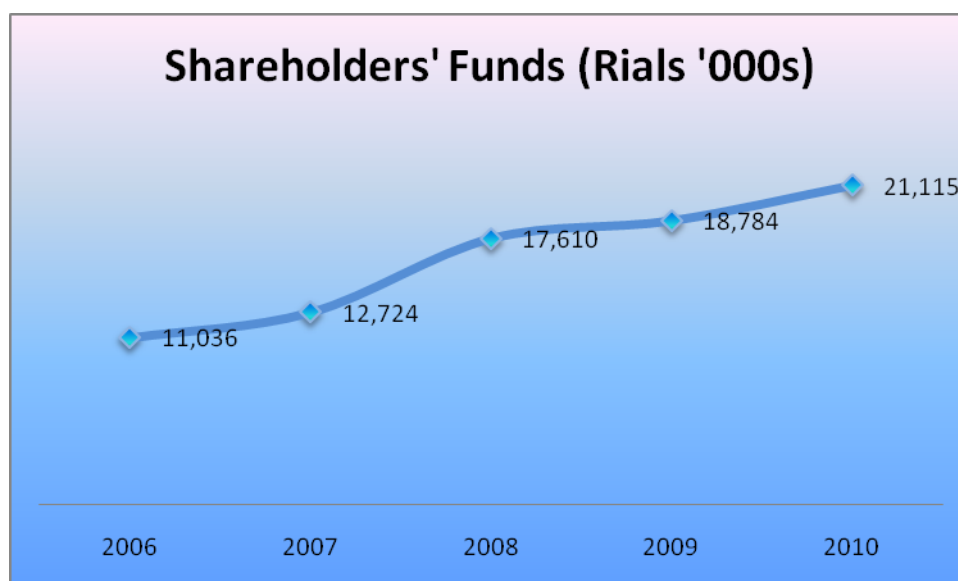
b) Fixed Deposits

Fixed deposits are an alternate source of funding for FLCs. 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 2010 the Company carried corporate fixed deposits totaling Rials 15.5 million (Rials 7.2 million as of 2009).

Operational Performance

Overall summary of performance for the year is as follows:

- Income from financing activities increased marginally by 0.4%. Interest cost reduced 21% as a result of decrease in interest rates charged by banks. As a result, Net Interest Income increased 20% to Rials 5.00 million (Rials 4.17 million).
- Operating expenses were well controlled, increasing by 4.4% to Rials 2.14 million (Rials 2.05 million).
- Profit for the year at Rials 2.33 million was up 0.4% from 2009. However, it should be noted that the company had a post tax gain from sale of property of Rials 0.43 million in 2009. Adjusted for that, net profit has actually grown by 23.1%.



Human Resources

National Finance 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, 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 2010, 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, leadership, motivation, customer service, graduate diploma program, anti-money laundering etc.

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, 2010, there were 104 employees of the Company of whom 71 employees were Omani nationals. The Omanisation ratio was at 68% which is higher than the statutory target of 65%.

Information Technology

The company considers Information Technology to be a key business enabler. During the year, the company invested considerable resources in designing a new IT software application 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 two key pillars of risk management for the company lie in:

- Adoption of standardized operating procedures;
- Review 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 Rial is pegged to the US Dollar, foreign exchange risk is considered low. 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 & Risk Management Committee of the Board of Directors. The Audit & Risk Management Committee monitors the implementation

of enterprise-wide risk management and control. The company has a strong IT security system to ensure information security.

Future Outlook

The current year is the first year of the Eighth Five Year Plan. Total appropriations for the 8th Five-Year Plan 2011-2015 (new and ongoing projects) are estimated to amount to Rials 12 billion compared to Rials 3 billion as actual appropriations for the Seventh Plan. As per Oman's 2011 budget, public expenditure is expected to increase by 13% with a sizeable quantum being earmarked for investment. This, along with the positive demographics present in the country, should result in growth.

We expect the outlook for the finance and leasing industry to remain challenging. While liquidity is expected to remain easy, we expect spread compression due to some increase in funding costs and increased competition for business.

Your 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