

## ***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 29 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 headquarters at Muscat and the nine branches spread across Oman.

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***

The Oman Government has sent a positive message to overcome the stress on the economy due to reduced oil prices by proactively announcing measures to diversify revenue and rationalize expenditure, stimulate economic growth, continue to provide support and ideal environment for growth and investment in the private sector and to sustain the level of basic services provided to the community.

The 2017 Oman budget aims to further rationalize general spending and increase the contribution of non-oil revenue. The budget supports Government initiatives such as the Tanfeedh programme and the development of public-private partnership projects, in order to stimulate growth and sustain employment. However, on account of a RO 3 billion deficit budget for 2017 and the liquidity tightening, we do expect further increase in the borrowing rates in the medium term.

### ***Industry Overview***

The Leasing and Finance sector showed moderate growth during 2016 despite marked increase in cost of funds and a general slowdown in both the Government and

private sectors. We have witnessed a slowdown in credit offtake due to dearth of new projects combined with the slowdown of contracting companies in major segments viz. oil & gas, infrastructure, construction etc. due to delays in the payments to contractors.

### ***Business Structure***

Your company is one of the premier diversified non-banking finance companies in Oman, engaged in providing vehicle finance and loans to SMEs. The company enjoys a robust sourcing, underwriting, receivables collection and operational model commensurate with the size and risks of the respective underlying asset class. 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.

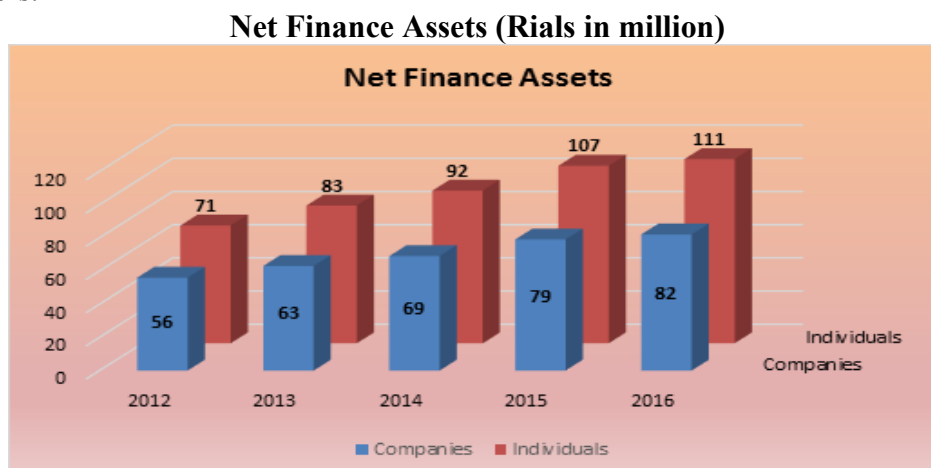
The key strategies to enhancing the profitability in our business depend on the Company's ability:

- 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***

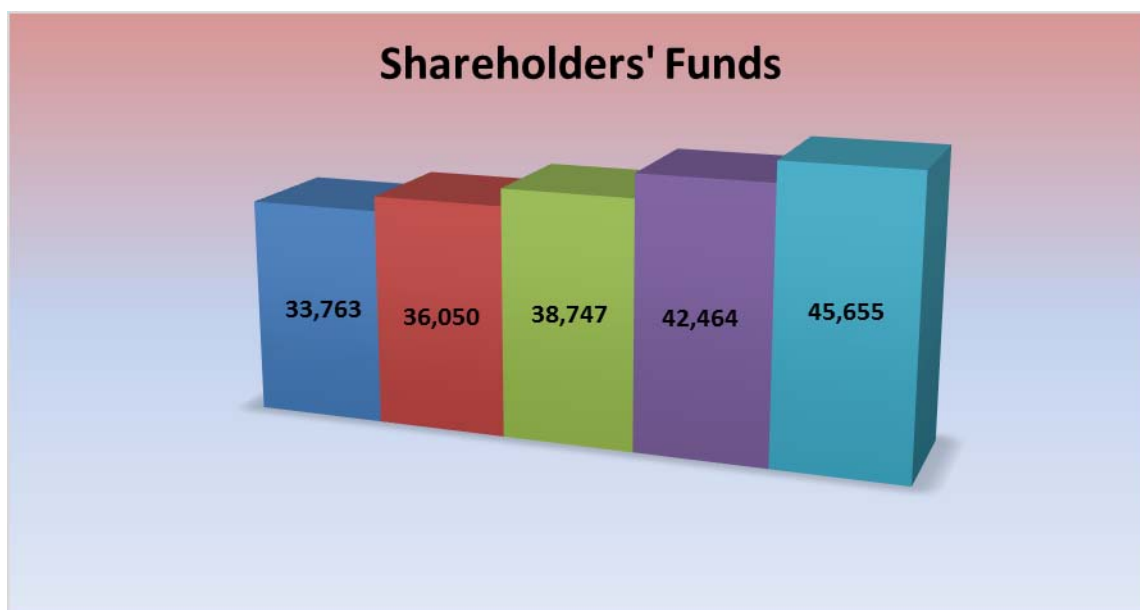
In vehicle finance, the company operates through established dealer as well as direct customer relationships while in the SME market the business is more focused on direct marketing. Our approach in SME has been to restrict our target to lower risk customers.



### ***Operational Performance***

Overall summary of performance for the year is as follows:

- Income from financing activities increased by 8.39%. Interest cost increased by 35.78% from Rials 3.73 million in 2015 to Rials 5.06 million in 2016. Consequently, net interest income remained flat at Rials 12.15 million (Rials 12.15 million FY-2015).
- General and administrative expenses increased by 1.49% to Rials 4.50 million (Rials 4.43 million).
- Profit after tax for the current year at Rials 6.35 million was up 5.45% from FY-2015 (Rials 6.02 million).



### ***Funding Profile***

As a result of the increase in business, our gearing is at a level of 3.37 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 long term relationships, banks constitute a substantial source of stable funding for us. The company's total bank borrowings as at 31st December 2016 amounted to Rials 131.63 million as compared to Rials 126.88 million as at 31st December 2015.

#### ***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 31 December 2016, the Company carried corporate fixed deposits totaling to Rials 15.86 million (Rials 13.86 million as of 31 December 2015).

#### ***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 has been 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 2016, 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, 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 31 December 2016, there were 159 employees of the Company of whom 130 employees were Omani nationals. The Omanisation ratio was at 81.76% which is higher than the statutory target of 80%.

#### ***Information Technology***

Your company believes that a strong and integrated IT system incorporating well laid out processes enables our people to expand productivity. An additional advantage of a strong information system is our ability to analyze and manage our credit portfolio in a proactive manner. We continue to invest in our IT systems in order to ensure that this resource remains a competitive advantage.

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 centralized 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 repricing 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. When deemed appropriate, we cover our US Dollar loan exposure through three month rolling forward cover.

***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 2017 budgeted revenues of Oman is at OMR 8.7 billion which is a 18% increase compared to the 2016 expected revenues. The budgeted 2017 deficit is estimated at OMR3.0 billion compared to expected deficit of OMR 5.3 billion for 2016. This deficit is expected to be mainly financed through international borrowing and the balance through a mix of domestic borrowing and from reserves.

We expect the outlook for the finance and leasing industry to remain challenging. We expect some further tightening of liquidity leading to compression in spreads due to 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.

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