

Management Discussion and Analysis Report 2010

Economic Outlook

The domestic economic scenario improved in 2010, backed by sound and prudent macro-economic policies adopted by the government and higher oil price. IMF estimates the real GDP growth in 2010 to be around 4.1%, and expects the real GDP growth rate to improve to 5% in 2011, supported by increase in oil prices and higher contribution from the non-hydrocarbon sector. In line with the attainment of Vision 2020 objectives, the economic policy is expected to focus on reducing the dependence on the oil and gas sector. As per IMF the medium term outlook too is positive aided by improvement in global economic scenario, strong public expenditure program envisaged by the government in the eight five year plan (2011-2015) and growth in non-hydrocarbon GDP.

The Government revenue during the five year period is estimated at RO 37.5 billion with the total expenditure during the same period calculated at RO 42.7 billion resulting in a deficit of RO5.2 billion. The government targets average annual GDP growth during the plan period at 6% (current price) and 5% (constant price). Oil revenues have been forecasted based on average annual production of 897,000 barrels-per-day (bpd) and at an average price of US\$ 59 per barrel. The 2011 budget sets the tone for the development initiatives outlined in the eight five year plan by increasing public expenditure to a record RO 8.13 billion compared to RO 7.18 billion in 2010. The revenue is projected to be around RO 7.28 compared to RO 6.38 billion in the previous budget. The domestic oil production touched 864,000 bpd in 2010 from around 812,500 bpd in 2009, recording an increase of about 6.5%. Muscat Securities Market Index (MSM30) increased by 6.06% in 2010, becoming the third best performing market in GCC after Qatar and Saudi Arabia.

Strategy and Planning

Strategy and Planning Board Committee met several times during the year and were updated on the progress and constraints faced by each department in implementing the strategy, the board discussed with the management ways to take matter forward to achieve the objects in the strategy plan. While the ground work for several initiatives have been set, the launch has been rescheduled to ensure all staff members are focused on the new core banking system, making sure that customers have a smooth experience. We are proud that the transition has been smooth and 2011 will witness the launch of various activities.

In 2010 Quality Assurance started taking its current shape, all feedback and complaints if not resolved immediately are acknowledged and the customer is given a reference number for follow up. With the precise data that we have now, we are able to focus our recourse better. 92% of complaints are resolved within 15 working days. We have also initiated many programs to enhance customer service, from awareness presentations, surveys, training courses, providing MIS to the management committee to assist them in deciding better etc... We also have several other programs planned in 2011 to further strength the customer experience. Customer Service will be the driving force to gain more market share

Wholesale Banking Group (WBG):

Oman's economy and its Banking sector were relatively unaffected by the continuing economic and global crisis. However, due to the slow down in economic activities particularly in the private sector, the credit off take for the Banks had been on a low keel throughout the year. In this backdrop the Wholesale Banking Group (WBG) which caters to the needs of the Corporate Clientele performed reasonably well.

Wholesale Banking Group consists of following departments: **(i) Large Corporate Banking Department (ii) Project Finance & Syndications Department (iii) Mid segment (Corporate) Department (iv) Remedial & MIS and (v) Trade Finance Sales.**

The rationale behind this set up is to focus on different segments of businesses and provide full range of Commercial and Corporate banking services under a single umbrella.

Large Corporate Banking Department

Large Corporate Banking plays a vital role in WBG by concentrating on top end customers with large exposures. The customer base also spans across various industries which includes trading, manufacturing, services and contracting. The needs of these high end customers are varied and require constant interaction to understand their working capital requirements. The Bank has introduced customer segmentation based on their Balance Sheet turnover/quantum of Bank's credit exposure for focused customer service.

Experienced and dedicated Account Relationship Managers are assigned to individual corporate clients for quick and seamless service as a single point of contact. Our emphasis is on the development of tailor made financial solutions that are suited to the particular needs of the customers. Regular cooperation meetings among various departments of the Bank are being held to ensure prompt delivery and sale of different Bank's products (such as. retail banking and treasury) to our customers irrespective of the banking segment they belong to. The department also strengthened the Relationship Team by providing dedicated Credit Analysts for back office support functions, which has reduced the turnaround time to the customers and will also improve the control mechanism.

In the context of continuing uncertainties in global financial markets and macroeconomic environment, growth in the Bank's asset portfolio in this segment was cautiously undertaken during the year. The department funded several large contracts and arranged a club deal with a local bank for raising USD 50 Million for an industrial group.

Project Finance & Syndications Department

The global conditions have impacted project financing in the region due to reduced availability of long term USD financing. Added to this the changing dynamics of the world economic crisis have emphasized the need to revisit the basic project assumptions in individual cases and ensure that the viability of the project holds good. In Oman, during the current year the major projects which came up for financing were the two new Independent Power and Water Projects of Sohar and Barka which sourced their entire long term loan requirement from a syndicate of international banks.

Over the years the Bank has participated in many of the major infrastructural projects including the projects of Oman India Fertilizer Company LLC, Sohar Aluminum, Oman LNG, Oman Gas, Salalah Port, Oman Refinery (expansion), Octal Petrochemicals and the six power and water projects. The Bank has in place the technical capability to independently lead-arrange funds for medium sized ventures and has a strategic tie-up with regional and international banks for the purpose of ensuring full participation. During the latter half of 2010, the department successfully arranged a USD 175 M syndicated loan for a Corporate from a few international and regional banks which showcased its ability in this area.

Mid Sector Corporate Division & Business Banking Unit

Realizing the importance of the Small and Medium enterprises (SME) to the development of a vibrant economy, BankDhofar had taken strategic initiatives to further the development of SMEs in the country.

The bank has a dedicated division the Mid Sector Corporate Banking Department, which caters to this particular segment. The Mid Sector Corporate Banking Department is geared to meet the financial requirements ranging from RO 100,000/- to RO 5,000,000/-. The Business Banking unit which forms part of the Mid Sector Corporate focuses on the

specific needs of the smaller businesses within the segment with financial needs aggregating up to RO 250,000/-. The banks' products and services are designed to enable this department to match the varying needs of the sector and enable them to meet the challenges in the marketplace.

During 2010, the department had given emphasis to maintaining and improving the quality of its portfolio. The Bank was able to nurture some troubled assets in the real estate sector through innovative solutions and strong recovery efforts. Over a longer term, this particular segment is expected to witness growth with the growth of the country's economy.

Remedial Management Department:

This department was created in year 2009 within WBG group, to identify early warning signals and problems in accounts. This department helps the front office business units in initiating appropriate advisory and restructuring measures for the account, in timely manner in order to maintain a healthy portfolio.

Trade Finance Sales Department:

A separate Trade Finance Sales Department was also created in year 2009 to market and develop products in the Trade Finance area. A dedicated officer from the department assesses the needs of corporate clients specific to trade finance area and suggests suitable structured products to improve usage of Non fund based (NFB) facilities from the Bank. The department plays a key role in marketing of the Bank's new Internet Banking service to improve the usage among corporate clients.

Retail Banking Division

Distribution Network

Consumer Banking Division (CBD) of BankDhofar continued its focus on providing value-added products and services to the customers. The Bank continued its growth and expansion strategy in 2010, strengthening its distribution channels with the addition of more branches, ATMs, CDMs and Bill Payment Machines (BPMs).

The year 2010 saw the addition of 2 new branches at Yanqul and Mudhaibi, relocated one branch Al-Mintrib, and renovated Suwaiq branch, the year ended with 56 branches, 128 ATMs, CDMs and Bill Payment Machines.

Products

Al Heson

Despite the tough competition on low-cost deposit witnessed in the market during the year, Al Heson savings scheme captured sensible growth. The scheme offered competitive prizes to customers. The Al Heson savings scheme is one of the most popular savings schemes in the market with its unique proposition which gives customers the opportunity to open an account, save and get the chance to win every week.

Card Business Centre

As part of the implementation of the centralization strategy, the bank allocated the operations function of the Card Center under the Central Operations Department in order to allow Retail Banking to focus on growing the card business and expanding the credit cards range.

In 2010 the Card Business Center introduced the chip on our debit cards. The chip technology has introduced many new powerful features to strengthen and improve security in the payment industry. With chip technology and the introduction of PIN, Issuers and Acquirers are increasingly protected from skimming, counterfeit and lost and stolen fraud.

Housing Loans

The Housing Loans portfolio growth remained positive in 2010 in terms of new customers as well as outstandings. Our housing loan product was further enhanced with reduction in interest rate. The product is very competitive in the market as it offers a low monthly installment, and low insurance. Housing loans are available to customers to buy, build or renovate their homes. Loans are also made available for buying plots of land.

Small Medium Enterprise (SME) Banking

The Bank focused on Small & Medium Enterprise (SME) Banking to support growth of the segment, as it impacts the economy in a large way and also creates employment opportunities for the nationals. The bank continued building-up the portfolio during the year in net lending and number of customers.

The Bank provided financing to the SME sector with products ranging from Funded to Non-Funded, from Short Term to Long Term and from Credit to Trade Services, ensuring that the customers get financing best suited to their business needs. This includes a wide range of facilities such as working capital requirements, term loans and other banking facilities that assist contractors to participate in various tenders or continue with their contracts. Assigned account managers facilitate the customer's access to other products and services available at the Bank.

The unit provides services to customers with fast turnaround time with special attention provided to the evaluation of the credit proposals and the risk assessment for each borrower.

E-Banking Channels

Following the centralization of the e-Banking unit in 2009 to oversee all electronic channels the unit now oversees the service activities of ATMs, Cash Deposit Machines, Phone Banking, SMS Banking, Internet Banking and the Call Centre

The Bank's 24-hour Call Centre, handles customer requests and enquiries for Internet Banking and other electronic channels. Call Centre services were improved through enhanced training and introduction of service monitoring tools. The Call Centre strength was increased to 17 call agents under a manager. To ensure customer satisfaction, a strict quality control procedure has been implemented. In addition, the Call Centre staff is put through periodic training programs on products and customer handling skills.

For the benefit of our customers the Call Centre continues to operate 24 hours a day and seven days a week. In the period of last 12 months, the call centre continued witnessing an increase in the number of calls being handled by staff.

In addition to adding new ATMs the unit worked on relocating 16 ATMs from locations with low utilization. An agreement was signed with a prominent company to install ATMs in convenience stores managed by them.

The unit also integrated Internet Banking with Finacle and introduced real time SMS alerts. The number of Internet Banking registrations increased by over 220%.

Direct Sales

Direct Sales Agents have aggressively marketed retail products of the bank with a distinct focus on saving deposits. During the year, BankDhofar continued building its own direct sales team providing banking services across all regions. The team strength was increased in the capital region to take advantage of the growing market. Frequent training programmes on products and sales were conducted to ensure the team is well versed with the Bank's products and services.

Retail Products Development

The year has seen the strengthening of our products development team. The team has worked on enhancing the existing products and services to improve product performance, and also focused on designing, developing and implementing new products and services to enhance the bank's product base and offering.

Financial Planning & MIS

The Financial Planning & MIS unit played major role in tracking and analyzing daily performance of the branches, in addition to reviewing, reporting, designing and developing the MIS reports for retail units.

Branch Operations

The Bank has created a dedicated set-up within Retail Banking to focus on operational matters of the branch network. This new function will help us to achieve operational excellence through strict and continuous adherence to set policies and procedures. Also ensuring that while Regional/Branch Managers grow the business of the network, this growth is done in compliance with the set regulations by the CBO and in accordance with the policies and procedures of the bank.

Treasury & International Banking

Treasury

The Bank has been an active member of the Oman financial markets. Through our team of seasoned professionals, we offer a comprehensive range of products and services to our clients, which today include not only the traditional Foreign Exchange (FX) and Money market products, but also a wide range of swaps, options and hedging products.

During 2010 the Bank has set up a dedicated derivatives products desk, which is committed to provide options and structured solutions to the satisfaction of our valued corporate customer's requirements. The derivatives desk is expected to commence operations in Q1 of 2011 after necessary approval from the regulators.

Our service is available every working day in Oman and on Fridays and local holidays when international markets are open. We also offer an order taking, monitoring, advisory, and execution service outside normal hours; ensuring clients' needs are being met.

In the wake of global economic crisis prevailing across major financial markets for more than 2 years, BankDhofar stands perseverant against the financial sector deterioration as evident from the consistent growth and being acknowledged as the No. 1 bank in Oman. The treasury team was also successful in securing new longer term funding from customers as well as their correspondent Banks across Middle East and Europe as the Bank sought to reduce liquidity risk.

International Banking:

The International Banking Department continuously develops and maintains relationships with Banks and Financial Institutions across the globe. BankDhofar has strengthened its relationship with major international banks through newly established credit lines and entered into new agreements with key correspondent banks in most countries. The unit handles establishment of correspondent banks, opening of nostro and vostro accounts and arranging AML requirements and coordinate with Treasury & Trade Finance for the compliance of all operational aspects. In coordination with Risk Management department, International Banking Department also establish and monitors Counterparty and country limits. During the year, despite the economic turmoil in the financial market worldwide the division was responsible for arranging bilateral loans for an amount of US\$ 110 Million from various regional and international banks at competitive pricing.

The Bank's credit ratings from the three international credit rating agencies for the year 2010 are as follows:

Moody's Investor Service affirmed A3/P-2 local currency rating, A3/P-2 foreign currency deposit rating, and a D+ Bank Financial Strength Rating (BFSR) with stable outlook to our Bank. Fitch Ratings affirmed our Bank's rating at long-term issuer debt (IDR) "BBB+" with a stable outlook and short-term IDR "F2", individual "C", support "2" and support rating floor 'BBB+'. Cyprus-based "Capital Intelligence (CI) raised our Bank's foreign currency long-term and short term ratings to "BBB+" and "A2" respectively, from "BBB" and "A3". The support rating is unchanged at 3 and the outlook for all the ratings remains "Stable". Our Bank's consistent credit ratings from the top three ratings agencies reflect its sound asset quality, strong Capital adequacy and good financial performance.

Investment Banking

The domestic stock market was the third best performer in GCC despite a decrease in volume and turnover. The Asset Management Division was able to generate satisfactory risk adjusted returns from its investments through a rigorous and disciplined value-driven investment strategy. The investment process is backed by better internal controls, improved compliance procedures and superior risk management practices.

The investment division has expanded its team of investment professionals improving the expertise and offerings of the department. Going forward the private banking team will be offering a whole range of products depending on the risk-return appetite of the clients. The bank is in discussions with some of the leading global financial institutions on possible strategic alliances in order to offer a more comprehensive, diversified and international product portfolio to the clients. In order to better manage both investment needs of its customers and strategic partnerships, a wealth management application is being put in place. The research desk has been strengthened and will be providing research on select stocks in Oman and GCC markets in addition to reports on promising themes and sectors to spot potential investment opportunities.

The brokerage division continues to cater to the requirements of the high net worth individuals, retail and institutional investors. The brokerage division also is in the process of implementing a state-of-the-art online trading system which would enable clients to trade in domestic and GCC stocks in the most convenient, efficient and transparent manner. The brokerage division is expected to benefit from the induction of new personnel, implementation of the new trading system and improved outlook for the domestic market and economy. The investment division is confident of building on its strengths and expertise and continue to offer a complete set of sophisticated and improved products and services to its clients.

Government Relations

The Government Relations Department is an important unit of the Bank. It has been streamlined to coordinate directly and indirectly with government departments and authorities to facilitate all the government's banking requirements such as deposits, loans, credits and foreign currency exchange. The unit also coordinates with various branches of the bank throughout the regions to provide the divisions of the Bank with information about projects under development by the government.

Support Services

Central Operations Division

The scope of the Central Operations Department (COD) has widened with the transfer of other functional areas from Retail Banking Department to COD, during the year. The volume of transactions processed at COD has continued to grow steadily with the effective utilization of technological solutions to automate routine processes, thereby increasing the productivity of the team. COD continues to maintain high operational standards to ensure better control of processes and efficient use of resources.

COD has also been continuously working on streamlining many work-flows aimed at reducing the operational burden at the branches and thus eliminating operational errors.

Key Projects Completed by COD during the year 2010

Apart from the routine operations, COD is closely associated in implementing key projects, undertaken by the Bank, as per Bank's Strategic Plan.

In 2010, COD successfully completed the following projects :

1. Relocation of Card Service Centre Operations (CSCO) from Credit Card Department, in Retail Banking to COD.
2. Relocation of Cash Centre Operations (CCO) from MBD branch to COD.
3. Centralization of Balancing Certificate Unit of Branches, Finance, and Treasury & Investment back-up departments at COD.
4. Rollout of Electronic Cheque Clearing (ECC) system to all the branches of the Bank, as per the guidelines of CBO.
5. Implementation of new Core Banking Solution, with direct involvement of senior management of COD.

Trade Finance Department

Trade Finance Department is a full fledged specialized department of the Bank handling specific trade requirements of the Bank's Corporate and Retail customers. The department liaisons closely with the Bank's Wholesale Banking, Retail Banking and Treasury Departments in providing various fund based credit facilities such as Export Bills discounting and Import financing and non fund based credit facilities, Letters of Credit and Guarantees for local and overseas transactions to the Bank's Corporate and Retail customers.

In 2010, the Bank registered a 30% growth in off-balance sheet business in Letters of Credits and Guarantees. In an extremely competitive market, the only truly sustainable

path for such great achievement was through customer satisfaction. The Bank could achieve this target by providing quality customer service in commendable turnaround time. To meet the challenges in a turbulent international market, our Trade Finance team is continuously trained internally and updated with the latest developments in the local and international markets. The team has continuously guided our customers with their valuable advices and placed necessary checks and balances to avoid fraudulent claims by overseas traders.

Credit Control

In compliance with the directives of Central Bank of Oman on best risk management practices , the Bank established Credit Control Department (CCD) in 2007 under Support Services Division. This Department was formed primarily with the objective of strengthening the credit risk management processes through independent review of loan portfolio so as to bring about the qualitative improvement in loan administration and controls on an ongoing basis.

The Department is entrusted with the responsibility of implementation of Loan Review Mechanism (LRM), approved by the Bank's Board. LRM is a comprehensive and independent credit review process, distinct from Risk Management and Internal Audit functions. The scope of LRM covers evaluation of credit risk assessment and approval processes, adherence to loan policies and procedures, sufficiency of loan documentation, overall quality of post-disbursement follow up and loan administration, identification of early warning signals, independent review of risk grading, loan loss provisioning in respect of large, unsecured and critical borrower accounts handled by various departments under Wholesale Banking Division.

Reviews are conducted within three months of the grant of credit facilities. Findings of such reviews involving independent evaluation of various credit processes, are presented to the Bank's Management Credit Committee at its weekly meetings on an ongoing basis. Such review mechanism facilitates to undertake timely corrective measures and also to improve upon any weaknesses or irregularities observed in various processes.

All major findings and important observations are also reported to the Board. In terms of regulatory guidelines, at least 30% of the Corporate loan portfolio has to be subjected to LRM in a year. However during the calendar year 2010, CCD had conducted loan reviews in respect of around 75% of the aggregate Corporate credit facilities sanctioned by various authorities in the corresponding period of a year.

Since May 2010, all consumer loan proposals are reviewed by CCD for verifying compliance with the Bank's lending policies and delegation of authorities. CCD also conducts various portfolio analysis to review compliance by business divisions with various norms on advances as prescribed in the Bank's Credit Risk Policy approved by the Board. CCD also conducts IAS-39 impairment estimation exercise and independent review of Risk classification and de-classification of Non-Performing Assets. CCD has also actively participated in finalizing the requirements of new Core Banking Solution for

various loan modules and also has assisted in developing control reports , in resolving critical issues and challenges faced, post migration. In line with the objectives, CCD continues to play an important role in reviewing and strengthening various credit risk management processes and controls.

Information Technology

As part of the overall strategic plan that the bank embarked upon in 2008, to strengthen its position in the dynamic banking space in the Sultanate of Oman, the Bank underwent a major technology initiative which was completed during the year. The Bank successfully went live with a new core banking system on 4th July, 2010.

The bank went live with Finacle core banking solution simultaneously in all branches and channels. This strategic transition methodology, called the “Big Bang” approach, helped the bank achieve the assertive program timelines. In addition, this helped us keep the costs of the implementation program well within the allocated budget.

The seamless transition from the existing legacy system to the new core banking solution was achieved through a professionally planned and executed implementation program encompassing multiple rounds of rigorous testing and simulation exercises spanning over a year. Concentrated focus was given on migration of customers’ accounts and data from the legacy system into the new system to ensure that existing customers were not affected by the transition. This ensured there was no adverse effect on customer service levels after going live.

This implementation will positively enhance customer experience with the Bank as we will now be able to offer technology enabled products and services to our customers, bringing us ahead of competition in all fronts. We will be able to develop and deliver segment based product offerings. In addition, flexible and efficient channel integration will help us offer world class services to our customers. The turnaround time and cost to develop new products and services has come down substantially, as the new core banking system has the flexibility of developing new products and enhancing the existing product offerings. These factors will assist in increasing customer acquisition and retention to a great extent.

The new core banking solution has also enabled better operational controls and regulatory compliance as compared to the legacy system besides prevention of revenue leakage.

In today’s competitive and challenging market environment, empowerment of staff through new age technology is paramount for enhancing customer experience and streamlining operational efficiencies. The new core banking system – Finacle, enables us to provide this empowerment, while ensuring tight operational controls.

The bank went live with Internet Banking (English) in 2009. In 2010, we launched BankDhofar Online Internet Banking in Arabic for both Corporate and Retail customers and become a fore runner in providing such services in the region.

We have implemented state-of-the-art middleware technology, which securely and transparently manages and integrates the channels through which banking services are delivered. These services include SMS Banking, Call Centre, Interactive Voice Recording (IVR) banking and eBanking. In addition, this will provide the infrastructure and flexibility to add new delivery channels and enable integrations with other service providers and partners.

To mitigate internal and external threats and vulnerabilities, a thorough security assessment (penetration testing, vulnerability assessment and technical audit) was completed before going live with the new core banking solution. During Annual Surveillance Audit for ISO 27001 certification E-Banking infrastructure was audited and certified by the accredited international entity.

For smoother functioning of the new core banking application the core network was revamped with addition of new devices in bank's networking infrastructure to strengthen the security, handle increased load and improve the availability of services.

To automate staff Performance Management process, the bank implemented an advanced HRMS Appraisal Module. This system will facilitate easy management of appraisal tasks and reporting for the HR Department

We are the first Omani Bank to issue chip based Visa electron cards. This will benefit the bank through increased security, protection from frauds and liability shift. This will also help the bank increase card acquisition.

Earlier, Banks in Oman were operating through two national switches - *Shamel* and *Watani*, for ATM transactions. An integrated National ATM/POS Switch (OmanNet) was implemented in December 2010 by Central Bank of Oman. This state of the art implementation has made the overall processes more efficient and provides additional service transactions. Our Bank has integrated with OmanNet and now offers more services to our customers and other banks' customers through our ATMs and OmanNet ATMs.

The bank has initiated a Brokerage and Wealth Management System for the Investment Banking Department. This project will implement new technology based solutions with enhanced business functionality for strengthening our position in the investment banking area. The implementation of new systems for Brokerage functions and Wealth management in 2011 will improve customer service, augment business acquisition and increase revenue in the business. The first phase of the project is expected to go live in the first quarter of 2011.

Human Resources Division

The year has proved to be a successful year for the HR Division in terms of the achievements and accolades received by the division. Fair and friendly HR practices have played a major role in sustaining the staff retention at 4%. The staff strength of the Bank increased by 15% over 2009 and crossed the 1000 mark.

Towards supporting the nation's drive of Omanization and developing young Omanis, the HR Division participated in career fairs to provide an informative platform on the banking opportunities for young Omanis and was awarded accolades and certificates of appreciation by prominent colleges across the Sultanate.

A batch of 25 young Omanis were integrated to the Bank's operation after completing their training in Accounting, Administration and Call Centre operations provided jointly by Bahwan Cybertek and Ministry of Manpower.

Training on Finacle was imparted to all users of the Bank with practice and refresher sessions which helped the smooth implementation of the Core Banking system across the regions.

The HR Division has achieved another milestone in automating the 'Performance Management System' after a hands-on training for all users was conducted across the regions.

Human Resources Development is of utmost importance and main pillar in the Banks' strategic plan. The HR Division of the Bank believes in strengthening its intellectual capital through specific development programs to enhance their development and functional skills at all levels through in-house and external training programs.

Corporate Communications & Marketing

The Corporate Communications and Marketing department has placed a heavy emphasis on brand visibility and publicity through several publications, events and sponsorships, during the year. CC&M played a pivotal role in increasing customer awareness of the Bank's achievements, where the Bank has won several prestigious 'Best Bank' awards from respected publications.

Throughout the year, several events have been conducted at the regional branches by the department to help the bank continue strengthening relationships with our customers and creating new relationships within the regions.

Internal communication has been a focus for the Bank, whereby the CC&M department has consistently contributed to delivering the Bank's news to all staff members, and offered undivided support throughout the regional road shows where the Management team shared the plans and targets for the year, conveying the Bank's key priorities and

goals for the third year of its 5 year strategic plan, assuring that we all work coherently in the same direction towards achieving our goals.

Policies & Procedures Department

Being cognizant of the critical importance of sound policies and procedures framework as a strategic link between the Bank's vision and day-to-day operation, a specialized Policies & Procedures Department (PPD) was established under the Support Services Division.

PPD has been mandated to act the central point for all documents of the Bank concerning the policies and procedures. The department ensures the dissemination of information among all stakeholders in the Bank through easy accessibility and timely update and review of the documents.

During the year, PPD coordinated with various departments for updating and review of many policies in a standardized format within the sound policies and procedures framework. The department will continue its efforts to maintain a framework which will be instrumental for improved customer service, profound corporate governance to meet various regulatory requirements in order to maintain a healthy relationship with investors and stakeholders.

Recovery Dept

The Bank has a well established and centralized Recovery Dept under the Support Services Group which is specialized and primarily responsible in handling and monitoring all Non-Performing Assets. The main objective of the department is to maximize the recoveries by adopting various methods such as;

- Close follow up with the customers for recovery of past dues before initiating legal action.
- Liaison with Legal Department for demand notices and taking legal action for recovery.
- Constantly monitoring the progress of legal cases with the Bank's external lawyers.
- Coordinating with ROP and regulatory bodies to expedite various legal processes and execution of decrees and court orders.
- Gathering and maintaining market information on assets and investments of defaulters.
- Negotiating for mutually acceptable settlement.

Credit Administration Department

Credit Administration Department (CAD) forms part of Support Services Group, it is a specialized department of the Bank which handles issues related to credit facilities documentation, security and limit management at post approval stage. With the implementation of the New Core Banking System, in 2010, a significant expansion process has taken place in CAD's operational area as well as on the administrative side. There has been a tremendous boost in the control side of the department where stringent policies and procedures are implemented to minimize Operational Risk, Legal Risk and Credit Risk. The department has ensured that various processes in loan documentation and disbursement are executed efficiently in a timely and accurate manner. It is the backbone of the Wholesale Banking Group and liaisons closely with them in improving customer service and in protecting the Bank's interest.

CAD is also entrusted with the responsibility of handling New Online BCSB system of Central Bank of Oman. CAD is the main coordinating department for secured data transfer. In 2010, the department has ensured that the BCSB project was successfully completed by the Bank. As desired by regulatory authorities, a large database was created and corrected at the bank wide level for retail and corporate accounts. CAD played a major role in coordinating the same. The New BSCB System went live in August 2010. With the new BCSB system, banks and financial institutions will follow a more regulated and disciplined lending in the Sultanate. This will be a key factor in country's economical growth and stability.

The scope of CAD has widened with the introduction of more controls and transfer of some of the functional areas from Wholesale Banking, SME and Consumer Banking during the year. CAD also had taken over of functional and operational areas of Treasury and Trade Finance. At present CAD is under process of centralizing the operation aspects of the borrowing clients and has already completed 75% of the centralization process. This includes Wholesale Banking, Retail Banking and Housing Loans. Plans are laid down to centralize the remaining Consumer Banking facilities once the requirement of logistics is fulfilled. The vision of CAD is to be a fully centralized department staffed with specialized and skilled Omani personnel.

Compliance Department

Compliance, defined as adherence to laws, regulations, rules, related self-regulatory organization standards and codes of conduct applicable to the banking activities, is an integral part of the Bank's business activities and concerns everyone within the Bank.

A well established Compliance Policy and Standards Manual clearly specifies roles, responsibilities of the Compliance Division and duties of other departments towards the compliance function. The Compliance Department performs its roles independently and the Board oversees management of compliance risk in the Bank.

The Compliance Department is responsible for identifying, assessing, advising, monitoring, reporting various compliance risks and specifically deals with matters such as prevention of money laundering and terrorist financing. The function is organized through a risk based approach and an annual compliance plan which is approved by the Board.

Some of the critical tasks performed under the annual compliance plan entail the following:

- Monitoring of compliance through self assessment by the departments against all applicable regulations
- Ensuring timely submission of regulatory returns
- Independent compliance testing and assessing compliance risk associated with the bank's functions
- Coordination and compliance monitoring for regulatory reviews
- Transaction monitoring to safeguard the bank against risk of money laundering and terrorism financing
- Reviewing and advising on changes in the policies, procedures and products to gear them for assurance of continuing compliance with applicable rules and regulations
- Reporting regulatory and compliance issues to the board of directors and the regulatory authorities

The compliance function has been strengthened over the years to complement the growth of the Bank's business.

Risk Management:

a. Risk management structure:

The primary responsibility of understanding the risks assumed by the Bank and ensuring that these risks are appropriately managed, is vested with the Board of Directors of the Bank. Board has set risk policies, limits and procedures by assessing the risk bearing capacity of the Bank.

The overall risk management has been delegated to an independent Risk Management Committee of the Board of Directors (RMC) of the Bank, which monitors and controls the overall risk profile of the Bank. The RMC reports to the full Board, on matters of significance and keeps the board continuously updated with the Risk Management process in the Bank. In this task RMC relies on an independent Risk Management Division.

Bank has a well established Risk Management Division (RMD) with a team of competent and experienced professionals. The primary responsibility of the RMD is to ensure on a continuous basis that an effective risk management framework exists and the various divisions of the Bank function within this framework. RMD also functions as an interface between the Management and the Board in defining appropriate risk tolerance levels for various business lines and operating divisions of the Bank and in ensuring that policies and procedures are tailored to the defined tolerance levels.

b. Risk management strategy:

The Risk Management strategy of the Bank is pivoted on the following:

1. Understand, measure and manage risk and aims at ensuring sustained growth of healthy asset portfolio
2. Well defined risk measurement processes and procedures by way of documented authority levels and limits
3. Continuous monitoring and control of these limits at business unit level and at portfolio level and
4. Updating various authorities on risk profile of the Bank and suggest ways for risk mitigation.

c. Management of various risks:

A brief account on the various identifiable risks and their risk management process is given below:

1. Credit Risk

Credit risk is defined as the possibility that a borrower or counterparty will fail to meet its obligation in accordance with agreed terms in relation to lending, trading, hedging, settlement and other financial transactions. This risk is primarily managed by proper assessment of inherent risks in credit proposals and ensuring a balanced portfolio of customers meeting the risk appetite of the Bank. The Bank also ensures dealing with customers of good credit standing, a thorough and professional credit assessment process, obtaining collaterals to mitigate risks and continuous monitoring of the account. Bank has taken the following measures to mitigate credit risk:

- Credit Risk Policy addresses credit risk emanating from lending to corporate and individuals in a structured manner and is reviewed and updated on regular basis. The policy of the Bank encompasses organizational responsibilities, prudential limits, credit risk rating standards, risk pricing standards, loan review mechanism, delinquent account management and portfolio management.

- Counterparty Credit Risk Policy addresses credit risk from banks as counterparties. The maximum exposure that can be taken on a counterparty is specified by an internally developed model.
- The credit risk rating system of the Bank has been revised and a risk grade is assigned objectively to a borrower based on the single point score provided by the rating model. The grade is assigned to the Standard category of borrowers on a scale of 7.
- Bank Conducts stress tests to assess the impact of credit risk on capital adequacy and profitability under stress situations.
- All the corporate credit proposals are reviewed by the RMD to assess the risk factors and suggest mitigants. The observations of RMD form an important input in credit decision.

The Bank employs experienced and competent staff in the areas of corporate Banking and provides them with regular training to upgrade and hone their credit skills. Detailed credit policies and procedures, strict adherence to the segregation of duties principle, elaborate and well defined authority levels, periodical audit and examination by the internal auditors ensure that the culture of risk permeates through the business divisions supported by a rigorous environment of checks and balances.

2. *Liquidity Risk :*

Liquidity Risk is the potential inability of the Bank to meet its maturing obligations to a counter party. Liquidity planning and management are necessary to ensure that the Bank has the ability to fund its liquidity requirement effectively and to meet current and future potential obligations such as loan commitments, contingent liquidity commitments and unexpected deposit outflows.

While the Bank's Asset-Liability Management Committee (ALCO) is responsible for setting the broad framework for managing the liquidity risk effectively, the responsibility of managing the liquidity risk of the Bank, within this framework, lies with the Treasury Department, which discharges this function with the assistance of other business divisions of the Bank.

Bank has Board approved policy on liquidity management which encompasses assessment of liquidity gaps through cash flow and static approach, reserve against deposits, lending ratio, mitigation of liquidity risk and contingency measures. Bank has set up Middle office within RMD to ensure that Treasury Department operates within these guidelines.

Middle office regularly monitors the liquidity position of the Bank and helps in managing the liquidity gaps, well in time. It also conducts liquidity risk stress test periodically and Treasury Department ensures that sufficient liquid assets are available with the Bank to meet any business exigency.

3. Market Risk

Market risk is the risk of loss arising from unexpected changes in financial prices arising out of changes in interest rate, exchange rate, bond, equity and commodity prices. Bank has major exposure in currency, equity and interest rate risk.

Treasury Risk Policy and Investment Management Policy of the Bank address all the aspects of the market risks. The Treasury Risk Policy address foreign exchange risk and interest rate risk whereas the Investment Management Policy addresses the equity risk.

The major foreign currency in which the Bank deals on a regular basis is US Dollar. The established parity between US Dollar and Rial Omani substantially reduces this risk. However, in order to control currency exposure risk, limits for intra day and overnight positions have been set up in addition to currency wise stop loss limits. Limit on net open position has been placed to restrict the Treasury department to take undue currency exposure as per prudential norm set by Central Bank of Oman (CBO).

The Bank manages the interest rate risk by matching the re-pricing of assets and liabilities and operating within the set gap limits. The Middle office in RMD regularly monitors the impact of adverse movement in interest rate on profitability and economic value of equity.

The Middle office monitors equity portfolio through daily reporting and assess the risk inherent in the quoted domestic equity portfolio through Value at Risk (VaR) approach. Various limits like stop loss limit, transaction deal limit and realized loss limit are in place to manage the equity risk.

The Middle office conducts stress tests periodically to assess the impact of adverse movement of market variables on profitability and capital adequacy and places the same to the RMC.

All the investment proposals categorized under Available for Sale (AFS) or Held Till Maturity (HTM) are reviewed by RMD to provide independent view on the risks associated with them.

4. Operational Risk

Operational risk is the risk of loss resulting from inadequate or failed internal systems, processes, people or from external events. The Bank has detailed policies and procedures that are regularly updated to ensure that a sound internal control environment exists in the Bank. Trained and competent staff oversee the various operational functions of the Bank.

Tested and up-to-date business continuity plan exists to provide normal banking services in the event of any unforeseen disruption to business. The Bank has also issued detailed guidelines to the operating units and branches on identifying potential operational risks and to put in place appropriate key controls to mitigate such risks.

Risk Management Division (RMD) conducts regular training programmes for staff at various levels to inculcate 'risk awareness' and to spread the general 'risk management culture' in the Bank.

5. Country Risk

Country risk arises from changes in the value of foreign exposure due to country specific conditions. These country specific conditions may result from economic, social, political or natural events and may relate to factors such as exchange controls, currency devaluations, nationalization or expropriation of assets among others.

A Country risk policy addresses the country risk that may arise due to cross border exposure in a structured manner. The Bank has in place a country risk assessment methodology which grades each country based on their risk profile. Suitable limits are assigned to undertake the business based on the internal risk rating grade of the countries.

The Middle office in association with Treasury department monitors the country risk and takes suitable steps in an event of any downgrade or change in the economic activity of any country.

d. Implementation of Basil II:

CBO has directed that the banks operating in the Sultanate of Oman are required to compute their capital adequacy as per Basel II framework with effect from 01 January 2007. As per the CBO directives, the Bank has adopted Standardized Approach for Credit and Market Risk and Basic Indicator Approach for Operational Risk.

Bank has laid down a road map to move towards adoption of advanced approaches of Basel II and to improve the risk management systems. The road map defines various activities/projects to be undertaken along with the timeline and is monitored by Risk Management Committee of Board of Directors. Most of the models and systems are developed by the risk management team internally through the expertise available in the Bank.

The Bank is confident that with the established Risk Management Processes and their continued enhancement, it will move towards adopting advanced approaches of Basel II, to adopt best risk management practices and improve the quality of the assets on its books.

Financial Performance

The Bank continued to achieve good results throughout 2010. The total assets of the Bank reached RO 1,664.3 million as compared to RO 1,509.3 million at the end of 2009 signifying a sustained growth of 10.3%. The net loans and advances to customers stood at RO 1,261.7 million as compared to RO 1,194.2 million at the end of 2009 reflecting a growth of 5.7%.

An analysis of our loans and advances portfolio as at December 31, 2010 along with the comparative figures for the prior period is as follows:

	RO Million	
Particulars	2010	2009
Overdrafts	100.3	109.4
Loans	1,140.6	1,046.7
Loans against trust receipts	67.6	76.6
Bills discounted	5.6	3.7
Advance against credit cards	9.6	10.5
Others	9.7	10.9
Gross loans and advances to customers	1,333.4	1,257.8
Less: Allowance for impairment	71.7	63.6
Net Loans and Advances	1,261.7	1,194.2

The ratio of total non-performing advances (NPA) to gross loans increased to 4.75% at the end of 2010 from 4.81% at the end of 2009.

There was a growth of 13.5% in customer deposits from RO 1,101.3 million at the end of 2009 to RO 1,249.6 million at the end of 2010. This reiterated the trust and confidence reposed by the customers in the Bank.

The composition of customer deposits at the end of 2010 along with the corresponding figures for the prior period is as follows:

	RO Million	
Particulars	2010	2009
Current accounts	299.9	221.2
Saving accounts	202.5	182.4
Time deposits	743.4	693.7
Margin accounts	3.8	4.0
Total customer accounts	1,249.6	1,101.3

Shareholders' Equity

The shareholders' equity at the end of 2010 increased to RO 226.5 million from RO 204.0 million at the end of 2009. At the end of 2010 an amount of RO 3.33 million was transferred to legal reserve being 10% of net profit. Further, an amount of RO 7.7 million was transferred to subordinated loan reserve.

The analysis of shareholders' funds at the end of 2010 along with the corresponding figures for the prior period is as follows:

	RO Million	
Particulars	2010	2009
Share capital	81.36	73.96
Share premium	58.51	58.51
Legal reserve	20.48	17.15
Subordinated loan reserve	25.67	17.97
Proposed distribution - cash	10.17	11.09
Proposed distribution – bonus shares	10.17	7.39
Investment reserve revaluation	1.70	1.39
Retained earnings	18.44	16.54
Total Shareholders' Equity	226.50	204.00

As a result of the increase in shareholders' equity the net assets per share reached RO 0.278 at the end of 2010 compared with RO 0.276 at the end of 2009.

Income Statement

	(RO '000)	
Particulars	2010	2009
Net Interest Income	57,251	49,227
Fees and Commissions	5,069	4,980
Other Income	8,995	10,822
Operating Income	71,315	65,029
Total Operating Costs	(29,195)	(23,658)
Operating Profit	42,120	41,371
Net Profit	33,280	25,393

The Bank achieved good results in all key areas. The net interest income earned until December 2010 improved significantly by 16.30% to reach RO 57.3 million from RO 49.2 million for the year ended 2009. Non-Interest income decreased by 11.0% and reached RO 14.06 million at the end of 2010, the investments were marked to market and

the impairment was charged off to the income statement. The total impact in the income statement due to impairment of investments was RO 0.37 million.

Although the total operating expenses increased from RO 23.66 million in 2009 to RO.29.20 million in 2010, the cost to income ratio reached to 40.94% as compared to 36.38% last year.

The amount of additional provisions for impaired loans made in 2010 was RO 6.6 million and the recovery from provisions was RO 2.8 million.

The net profit in 2010 grew by 31.06% reaching RO 33.28 million compared with RO.25.39 million in 2009. The earning per share (EPS) reached RO 0.041 in 2010 compared with RO 0.031 in 2009.

The Board of Directors proposed to pay 12.5% cash dividend amounting to RO 10.17 million and 12.5% bonus shares amounting to 101,693,148 shares of RO 0.100 par value each amounting to RO 10.17 million. Also the Bank will retain RO.7.70 million to be transferred to subordinated loan reserve.

The proposed profit appropriation for 2010 is provided in the following table:

Particulars	(RO '000)	
	2010	2009
Proposed dividends – cash	10,169	11,094
Proposed dividends - bonus shares	10,169	7,396
To legal reserve	3,328	2,539
To subordinated loan reserve	7,700	7,700
To/(From) retained earning	1,914	(3,336)
Net profit for the year	33,280	25,393

Future Prospects

The Bank has performed well in 2010, and was ranked as ‘Number 1 Bank’ and the ‘Best Bank’ in Oman. With focus on the implementation of its 5 year strategy, the Bank will continue to emerge strong within the local financial market.

The Bank has planned the introduction of several new products in 2011 to cater to its customers, and enhancement of services through technology to provide fast, easy and convenient banking, in its vision to become the Bank to do business with.