

**The Management Discussion and Analysis**  
**Report for the year ending 31 December 2007**

# The Management Discussion and Analysis Report for the year ending 31 December 2007

## **Oman's Economy and Outlook**

The buoyant economic growth of the last 3 years continued in 2007 and the nominal Gross Domestic Product (GDP) growth for 2007 is estimated at 11.6 %, underpinned by the growth in the income of oil and natural gas sectors. The growth in oil sector is estimated at 5.5 %, non-oil sector at 17 % and exports at 4 %. Imports increased by 46 %, due to rising commodity prices in the international market and due to the weak dollar. The commodity prices caused a moderate inflationary pressure of around 5 %. The Government expects a budgetary surplus of RO 1.72 billion in 2007. Muscat Securities Market (MSM) achieved a record growth of 62 % in 2007, the best growth in the entire GCC region.

The 2008 government budget estimates a revenue growth of 20% over 2007, an expenditure growth of 19% and a nominal budgetary deficit of 3 % of the GDP. Oil income is estimated to contribute to 67% of the total income, with natural gas revenue accounting for 11% of the total income. Significant thrust has been given to health care and education sectors, with the expenditure allocation accounting for 49% of the total budgeted expenditure. Analysts forecast a real GDP growth of 5.2% in 2008.

## **Wholesale Banking Group**

The Wholesale Banking Group encompasses the Corporate Banking Department, Project Finance & Syndications Department, Small & Medium Enterprises (SME) Department and the Remedial, Trade Finance Sales and Corporate Advisory & Structured Finance Departments.

The metamorphosis of the erstwhile Corporate Banking Division (including the Mid-Sector unit) into the Wholesale Banking Group was a part of a planned strategy evolved by the Bank to focus on different segments of the Corporate market and provide the full range of Corporate services under a single umbrella. The framework for the re-organisation was laid down by the internationally reputed Management Consultants, Booz-Allen Hamilton. During the year staffing of key positions was taken through induction of highly qualified and trained professionals.

In the backdrop of a rapidly changing economic profile of the country, increased competition in the sector and the evolving banking regulatory regime, we believe that the Wholesale Banking Group will be the vehicle of future growth for the Bank. It is our cherished objective to become the 'preferred Bank' for corporate customers in Oman and serve as a 'one-stop shop' for all their banking requirements and services. Towards this objective and to serve promptly and effectively our existing as well as prospective customers, the Bank has streamlined internal procedures and as mentioned earlier, hired experienced professionals committed to deliver corporate banking services of the highest standard. The Bank is also upgrading its technological capabilities in various areas to effectively provide efficient delivery channels to its Corporate customers which, inter-alia, include the provision of internet-based banking facilities.

In 2007, all the lending arms of the Wholesale Banking Group have performed well under challenging circumstances. This was possible due to a leveraging of the existing relationships to increase our exposure to the extent possible, growth in new Corporate/SME lending, growth in the project finance/syndicated loan portfolio and growth in overseas lending. Also we have been able to lend to companies with larger fund requirements in consortium with regional banks.

### **Corporate Banking Department**

The Corporate Banking Department is staffed by qualified banking professionals with vast and varied experience of Credit delivery and the Omani market. It provides the entire gamut of Corporate Banking products – both funded and non-funded – to the customers and has been instrumental in developing the Bank into a 'Relationship Bank' which endeavors to build a long-lasting and mutually beneficial relationship with its clients. Typical products extended by the department include Term Loans of various maturities both for capital expenditure and working capital requirement, Letters of Credit, Loans against Trust Receipts, Guarantees, etc. The customer base of the Corporate Banking Department spans over a wide range of industry including Trading, Manufacturing, Services and Contracting. Depending on the industry sector, the banking products are suitably devised to effectively cater to the particular requirement of the sector.

Every customer or a group of customers is assigned a specialist relationship executive, who is in constant touch with the customers to understand their requirements and offer suitable services/products on most competitive terms. The emphasis is on the development of tailor-made financial solutions that are suited to the individual needs of the customers. The executive also liaises with other departments of the Bank to facilitate prompt delivery of the required services/products to the satisfaction of the customer. The Bank considers these relationship executives as vital links with its esteemed customers.

As a part of the Bank's increased emphasis on Trade Finance, a special cell is being created to attend to specialized requirements of the Customers in this area. The objective is to have a continuous interaction with the Customers in order to provide effective solutions in the area of Trade Finance.

## **Project Finance & Syndications Department**

The Government of Oman is continuing with its stated policy of wider and larger participation of the private sector in various spheres of economic activities, which were hitherto in its domain. Consequently, a number of large projects of national importance, requiring considerable sums of investments are being implemented at a rapid pace. Bank Dhofar has taken a conscious decision to actively participate in financing of these projects within its prudential exposure norms. Accordingly, the Project Finance & Syndication team continued to work closely with local and international banks, exploring/exploiting the lending opportunities to various projects.

Over the years the Bank has participated in several important local projects including the projects of Sohar Refinery LLC, Oman India Fertiliser Company LLC, Sohar Aluminum, Oman LNG, Oman Gas, Salalah Port, Oman Refinery (expansion) and the four power and water projects. The Bank has in place the technical capability to independently lead-arrange funds for mid-cap projects and has a strategic tie-up with a few regional and international banks for the purpose of ensuring full participation. A start in this direction has been made with lead-arranging the funds for various projects taken up by reputed companies. Realising the lending potential across the border the Bank has increased its participation in respect of cross-border deals within the permitted regulatory ceiling. The Bank is also making a foray into the provision of Advisory Services for Projects/Corporates and is in the process of building a suitable team.

Going forward we envisage a host of lending opportunities in the Infrastructure, Oil & Gas, Construction and Tourism sectors taking into account the large Government sponsored projects on the anvil as well as those privately sponsored. The 7<sup>th</sup> Five Year Plan (2005-2010), which is currently in its third year of implementation, envisages a Governmental & Private investment programme of RO 13.15 billion over the five-year period. Of this, Oil & gas-related investments aggregate RO 7.3 billion while investment in tourism projects is slated at RO 958 M. Investments in other mega-projects and in private sector projects aggregate to RO 2.9 billion. In the Budget for 2008, the Government has increased the spending on development projects by RO 2.4 billion to reach a level of RO 5.4 billion.

## **SME Department**

The SME Department has carved out a niche for itself by catering to the needs of small and medium-sized enterprises. The Department actively interfaces with the small and medium companies to understand their requirements and devise suitable solutions. The focused approach towards this segment has clearly shown impressive results not only in terms of the number of customers and volume of the portfolio but also in terms of profitability to the Bank. Going forward, we envisage widespread growth in this segment taking into account the percolation effect of the sustained increase in the price of oil. In addition there is widespread awareness in the concerned Ministries and Government departments on the need to revitalize this important segment of the Economy.

## **Consumer Banking Group**

### **Distribution Network**

It was an outstanding year for the Consumer Banking Division (CBD) of Bank Dhofar, as it continued its focus on providing value-added products and services to the customers. The Bank continued its growth and expansion strategy in 2007, strengthening its distribution channels with the addition of more branches, ATMs and Deposit & Bill payment Machines (DBPMs).

The year 2007 saw the addition of 2 new branches at Falaj Qabail (Batinah region) and Al Khuwair Ministries Area (Muscat region), 4 ATMs ( 2 offsite ATMs in Buraimi and Salalah) and 2 more Deposit & Bill Payment Machines at Ruwi and Jalan Bani Bu Ali. The year ended with 49 branches, 85 ATMs and 8 DBPMs.

### **Products**

#### **Al Heson**

The year also saw the growth of Bank Dhofar's flagship scheme Al Heson savings scheme offering bigger and better prizes to its customers. The Al Heson savings scheme is one of the most popular savings schemes in the market with its unique proposition of 'Win Now,' which gives customers the opportunity to open an account and get the chance to win every week.

The Al Heson scheme continued its promise of offering more prizes every week, and draws for various special occasions and festivals like Ramadan, Eid Al Fitr, National Day and Eid Al Adha. All this along with other special prizes and draws for various segments and age groups in the form of gold for Ladies and a Mazen & Mazoon draw for children.

#### **NRI Connect**

Bank Dhofar announced the launch of a joint product offering along with ICICI Bank, making it convenient for the large Non-resident Indian population in Oman to enjoy the services of 2 world-class banks with a single account. NRIs can get a Twin account as well as do online remittances from 49 branches at preferential rates.

#### **Card Centre**

The year 2007 saw the introduction of Oman's first and only Chip Credit Card. The Chip Credit Card brings in advanced chip technology that offers unparalleled security to customers by providing them with maximum protection against fraud through theft, or losses through counterfeit transactions.

The new Chip Credit Card has both the magnetic strip as well as chip functionality. The chip functionality offers Bank Dhofar's Chip credit card users complete security and greatly enhances the procedure of fraud detection at terminals that are chip-enabled. The Chip Credit Card is offered on both Visa and MasterCard platforms.

Along with security the Bank's credit cards come with various benefits and advantages like privileged access to Oman Air Airport lounge at Muscat and Salalah, free travel insurance including accident, baggage and flight delay for cardholder and family, interest-free repayment period up to 52 days, emergency card replacement, etc. Chip Credit Cards can now also be availed by customers without transferring their salary to Bank Dhofar by offering an undated cheque.

## **Housing Loans**

The Housing loan product was well received by customers. The product was the most competitive in the market as it offered the lowest monthly installment, the lowest processing fees and lowest insurance and it comes along with a free credit card. Housing loans are available to customers to buy, build or renovate their homes, for more than one property, to buy land, and to invest in a residential project.

## **Outbound Sales**

It was a remarkable year for Outbound Sales Department in 2007, which launched the new Home banking service. The service is specially designed to serve customers from the convenience of their homes or offices. All that a customer has to do is to call Bank Dhofar's toll-free number and request for Home Banking at a location and time convenient to him. A representative from Bank Dhofar will personally attend to the customer, and look after all their banking needs. This service was recently launched in Muscat and will be taken across the Sultanate in due course of time.

Home Banking Service is an extension of Bank Dhofar's philosophy of putting the 'customer first.' A highly motivated direct sales team comprising of young and energetic Omanis cater to the customers' banking needs.

The Call Centre services also saw improvement with the increase in the number of Omanis specially trained to provide information on various services and products.

## **Consumer Marketing**

The division is involved with Advertising, Public Relations, Direct Marketing and Events, to promote the Bank's products and improve its image.

Aggressive media strategies were used to generate top of mind awareness with a number of mass media campaigns for the Bank's 'Al Heson' savings products, credit cards, housing loans and electronic channels.

Bank Dhofar has always believed in celebrating various community activities, and used such platforms to avail the tremendous marketing potential these events offer. The Muscat Festival and Khareef Festival are the perfect avenues for advertising opportunities especially for brand building, as it helps in creating a larger customer-base. Sponsorships and donations have also provided extensive marketing opportunities.

Bank Dhofar has also placed focus on its Mazen & Mazoon customers by hosting a QaranQashow party at Marah Land during Ramadan as well as initiating a full region-wide colouring competition.

The year 2007 also saw special promotions and offers for the customers of Bank Dhofar. In November a special promotion was run by Bank Dhofar where customers were urged to apply for a Chip Credit Card and receive special gift vouchers from Lulu Hypermarket.

## **Treasury & International Banking Division**

The Treasury Division at Bank Dhofar offers a wide range of treasury-related services to all of our valued corporate, retail and high networth individual customers. The major functions of the Treasury are to control the interest rate risk for reserve holding, exchange rate risk, and liquidity management on daily basis. The Treasury also supports corporate clients for their hedging requirements such as IRS, Options and ICAPs.

We are one of the leading market contributors in USD/OMR spot and swaps. We offer attractive interest rates on deposits in all major currencies to corporate, retail and high networth individual clients. At Bank Dhofar, we offer highly competitive exchange rates against all currencies. Through the Treasury, we provide services of buying and selling Government securities like Government Development Bonds.

The Treasury and International Division performed better in 2007 in comparison with 2006. Foreign Exchange income grew by 49.86% as compared to the 2006 figures. During 2007, investment in international and regional T-Bills, currency swaps, and corporate relationships with increased business from trade-related activities played a major role in the robust growth.

International Banking Division supports and assists in the areas of trade finance, foreign exchange and building relationships with financial institutions globally. Our Bank has a well-established network of correspondents around the world. With our personalized and professional approach to our customers' varied requirements, Bank Dhofar has emerged as an important player in the field of Correspondent Banking

2007 proved to be another successful year for International Banking Division. The Bank secured a new long term borrowing of US\$ 100 Million for 5 years and one month and a new medium term borrowing of US\$ 75 Million for 3 years. US\$ 100 Million raised the Tier II capital to strengthen the Bank's net worth and thereby accelerate asset growth. The facility was jointly underwritten by ABN Amro Bank and Emirates Bank International. US\$ 75 Million was raised with a view to further improving the balance sheet structure, specifically matching the maturity profile of assets and liabilities. Seventeen international banks from the USA, Europe and the Middle East participated in the facility. The participation of these banks was a reflection of confidence of the international banking community in the country and in our Bank.

During the year, Moody's Investor Service assigned for the first time A3/P-2 local currency rating, A3/P-2 foreign currency deposit rating, and a D+ Bank Financial Strength Rating (BFSR) to our Bank. The outlooks on all ratings are stable. 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) affirmed our Bank's foreign currency long-term and financial strength ratings at "BBB" and the foreign currency short-term rating at "A3". The support rating is unchanged at 3 and the outlook for all the ratings remains "Stable".

## **Private Clients and Investment Management**

Private Clients and Investment Management Division continues to offer a range of investment banking services. Backed by a highly professional and experienced team, institutional, high net worth and retail clients are offered brokerage services in Muscat Securities Market. The Brokerage Services Department plans to broad-base this service to other GCC markets by entering into strategic tie up with brokerage houses in other GCC markets. The research department manned by qualified professionals provides investment research and advisory services covering Oman market. Our asset management team currently manages discretionary investment portfolio. Backed by strong research and asset management capabilities, the team plans to build up the size of funds under management. The private clients department currently provides a very significant support for the resource mobilization and marketing initiatives of the Bank.

## **Central Operations Division**

2007 was another challenging and exciting year for COD. The Division continued to strengthen its capabilities by continuously looking at ways and means to improve existing processes without compromising quality and control through extensive use of technology and take on additional processes to improve the operational efficiency and accuracy.

The organization restructuring in the last quarter of 2006 saw two crucial operations being merged with COD – Communications in Q4 2006 and Trade Finance in Q1 2007.

Despite the above challenges faced, core COD transaction volume grew by over 30% without any significant increase in staffing. The key reason for this was the continuous focus by the team to effectively utilize technological solutions to automate processes thereby increasing the productivity of the team. This also resulted in the ability of the team to handle the increasing volume of transactions and activities effectively.

### **Key achievements**

- Successfully implemented the online payments for INR through ICICI Bank (Money to India) in 2007 which is a unique service provided to clients in Oman by Bank Dhofar.
- COD was the first division of the Bank to introduce an Online Electronic Version of Instruction Manual Operations (IMO) which was launched in April 2007.
- Successful implementation of Remote Cheque Deposit System with Bank of New York (BONY RCD)
- All Customers' External Payrolls being transferred electronically through ACH System (Automated Clearing House System), except some formats in Arabic language.

- Centralization of all local currency payments through RTGS.
- Partnered with the IT Department and automated the external standing order function for all clients resulting in timely and accurate processing.

## **Credit Control**

In compliance with the directives of Central Bank of Oman on best risk management practices, the Bank established the Credit Control Department (CCD) during the year under Support Services Group. This new department was formed primarily with the objective of strengthening credit risk management processes through independent reviews of loan portfolio so as to bring about a qualitative improvement in loan administration and control 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. Under LRM, the Bank's Corporate Loan portfolio is reviewed before management on an ongoing basis by independent evaluation of various credit processes to ensure timely corrective measures. The scope of LRM covers evaluation of credit risk assessment and approval processes, adherence to loan policies/ procedures, sufficiency of loan documentation, overall quality of post-disbursement follow up / loan administration, identification of early warning signals, independent review of risk grading, provisioning etc. In terms of regulatory guidelines, CCD has ensured that at least 30% of the loan portfolio is brought under LRM in 2007 by undertaking timely reviews of large and critical accounts of Corporate Banking and SME departments.

CCD also conducts various portfolio reviews to ensure compliance with various norms on advances as prescribed in the Bank's Credit Risk Policy approved by the Board. Since inception, CCD has taken up various portfolio review exercises to clean up the loan database in the system, to improve the quality of MIS reports by modification of IT programmes, etc. In line with the objectives, CCD would continue to play an important role in reviewing and strengthening various credit risk management processes.

## **Information Technology**

Information Technology (IT) Division of the Bank completed the implementation of Automated Settlements module at all the branches to offer Straight through Processing for Transfer of Funds to the customers of the Bank. The division facilitated the introduction of Asset Liability Manager (ALM) system in the Bank as a part of the Risk Management and Control System. This system would enable the Bank to prudently manage Liquidity and Interest risks.

IT Division upgraded the Trade Finance system of the Bank and enriched the functionality of eZtrade to enhance the service capability of its on-line Trade Finance offering to its corporate customers. The division acquired Business Intelligence tools to track and interpret patterns in its historical data to provide information to the managers to make more knowledgeable business decisions.

The Bank upgraded its Information Security Policies in line with ISO27001 standards.

## **Human Resources**

Human Resources at Bank Dhofar remain integral to our sustainability and undoubtedly, our continual success has been a resounding testament to the excellence we have within Team Bank Dhofar. We have always striven and have succeeded in identifying, recruiting and developing the promising young blood of the Sultanate and providing them great careers in banking. We pride ourselves for being able to maintain the Omanisation ratio above the stipulated limit at 91.9% in the year 2007 .This demonstrates amply our commitment towards identifying and grooming the local talent.

The total staff strength of the Bank increased from 636 in the year 2006 to 720 by the end of 2007 to support the rapid expansion of delivery channels. Further, this year almost 35 per cent of our staff advanced up their career ladder to take up higher responsibilities.

In line with the Bank's business plan a number of key initiatives were implemented within HR this year. Competency mapping was one such initiative where HR Department developed competency profiles for all positions in the branch network and mapped out each branch staff against the ideal skills they should possess in discharging their duties effectively. The training needs for the year 2008 were identified after completing the skill mapping exercise across the branch network.

Organizational development is also linked to HR development and we have introduced special programmes which look into this aspect. "Future Managers " programme is one such initiative where 25 potential leaders at supervisory level identified by the management are being groomed to take over managerial positions in the immediate future. The Future Manager programme launched in September 2007 prepares the participants to take over challenging assignments by enhancing their "job mastery" as well as soft skills through regular workshops, special assignments, job enrichment and

rotation. Job Mastery programme conducted for the staff members of the “Trade Finance Team” is yet another specialized training launched in 2007.

The increased staff participation and valuable contribution made by staff at all levels in the “suggestion scheme’ launched in the past year is another noteworthy achievement recorded this year. Over 66 staff suggestions were evaluated by the Management and 29 good suggestions were implemented and the respective staff rewarded during the year.

Introduction of e-learning to the branch staff in March 2007 was one of the milestones in the Bank’s staff development initiatives. With the availability of brief on-line training modules covering the full product range, the branch staff can now log on to his/her own computer and learn in their own free time at the branch.

## **Risk Management :**

### **a) Risk Management Structure:**

The primary responsibility of understanding the risks assumed by the Bank in its normal course of business and ensuring that these risks are appropriately managed, is vested with the Board of Directors of the Bank.

As required by the Central Bank of Oman (CBO), the impending implementation of the Basel II Accord and in line with the international best practices, an independent Risk Committee of the Board of Directors (RC) of the Bank monitors and controls the overall risk profile of the Bank. The RC reports to the full board, on matters of significance and keeps the board continuously updated on the RC’s comfort with the Risk Management Process in the Bank. In this task RC relies on an independent Risk Management Division.

The Bank has a well established Risk Management Division 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 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 pivots on the following :

1. A clear understanding of various risks assumed by the business and operating divisions of the Bank;
2. Well-defined and disciplined risk measurement processes and procedures for the divisions by way of well-documented authority levels and limits;
3. Continuous monitoring and control of these limits; and
4. Continuous reporting systems to various authority levels on compliance.

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 controlled and managed by dealing with customers of good credit standing, a thorough and professional credit assessment, obtaining collaterals and continuous monitoring of the conduct of the account. The Bank has framed a credit risk policy to establish prudent standards, practices in managing credit risk and setting up prudent benchmarks, limits for management of credit risk. At the portfolio level, the risk is further monitored by various limits established including group exposure limits.

The Bank employs experienced and competent staff in the areas of corporate banking, provides them with regular training to upgrades and hones their credit skills. Detailed credit policies and procedures, strict adherence to the segregation of duties principle, elaborate and well-defined authority levels, periodic 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 and Interest Rate 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 operations cost 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 Committee (ALCO) is responsible for setting up 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 Division which discharges this function with the assistance of other business divisions of the Bank.

The Bank has clearly documented Board and ALCO-approved policy guidelines on critical liquidity and gap ratios and RMD monitors that the Bank operates within these guidelines.

A high level ALCO meeting is held every month to discuss strategic medium and long term liquidity and interest rate issues. Additionally ALCO meets as and when required, to discuss dynamic day-to-day market issues impacting the Bank's liquidity and interest rates. The approach to effective liquidity and interest rate risk management in the Bank is built on diversification of deposit base, reducing dependence on large depositors,

maintaining a suitable mix of deposits including low cost deposits and periodic review of asset pricing mechanism. In addition to the above, the Bank maintains a stock of high quality liquid assets which can be liquidated at short notice to raise cash if required and arrangements with several international banks to raise funds, if necessary.

### **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. The risks which are important to the Bank are currency and interest rate risk.

The major foreign currency in which the Bank deals on a regular basis is the US Dollar. The established parity between the 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. The Central Bank of Oman (CBO) has also set prudential norms for the net open position to restrict banks from taking undue currency exposures.

The Bank manages the interest rate risk by matching the re-pricing of assets and liabilities through various means and operating within the set gap limits. Foreign currency loans are linked to LIBOR (London Inter-bank Offered Rate) and re-priced regularly to reduce the attendant interest rate risk.

### **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 disaster recovery plans exist 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 also conducts regular training programmes for staff at various levels to inculcate 'risk awareness' and to spread the general 'risk management culture' in the Bank.

#### **c. Initiatives: For Further Enhancement in the Risk Management Process:**

- The Bank has been using the Moody's Risk Advisor (MRA) credit rating model, a globally reputed credit analysis tool to aid in assessing the credit risk in lending proposals. The Bank is reviewing the process of assigning the risk grading of the borrowers based on the score thrown by MRA and also based on the collaterals provided by the borrower. The revised system of grading, which will take into account the

collaterals available, can be used in pricing the loan assets. In addition to the risk grading, the corporate credit proposals are reviewed by the RMD whose observations form an important input in the credit risk management process.

- The Bank has put in place a front-end software package for effective management of its assets and liabilities from a risk perspective. The system has been implemented and it is expected that when the system is implemented full fledged, the Bank will not only be able to enhance the quality of the risk management of this important part of its business but also assist the line management to enhance its performance levels.

- A system to conduct stress tests with assumed stress/worst case scenarios of credit risk, interest rate risk, foreign exchange risk and equity price risk on a quarterly basis is put in place to assess the impact on the Bank's profits under these stress scenarios.

#### d) Basel II

CBO has directed that the banks operating in the Sultanate of Oman are required to compute their capital adequacy under Basel II with effect from 01 January 2007. As per the CBO directives, the Bank has adopted the Standardized Approach for Credit Risk and the Basic Indicator Approach for Operational Risk. The Bank is confident that with the Risk Management Processes established within the Bank and their continued up-gradation, it will move towards adopting more advanced approaches of Basel II for best risk management practices and improve the quality of the assets on its books.

### Financial Performance

The total assets of the Bank in 2007 increased by 37.5% and reached RO 955.1 million compared RO 694.8 million at the end of 2006. The net loans and advances to customers also increased from RO 548.8 million at the end of 2006 to RO 704.6 million at the end of 2007, a growth of 28.4%. An analysis of our loans and advances portfolio as at December 31, 2007 along with the comparative figures for the prior period is as follows:

	<b>RO million</b>	
	<b>2007</b>	<b>2006</b>
Overdrafts	73.1	75.3
Loans	621.8	471.1
Loans against trust receipts	38.2	33.4
Bills discounted	3.2	1.5
Advance against credit cards	4.7	4.1
Others	9.0	9.3
Gross loans and advances to customers	750.0	594.7
Less: Allowance for impairment	45.4	45.9
<b>Net Loans and Advances</b>	<b>704.6</b>	<b>548.8</b>

The ratio of total non-performing loans to total loans reduced to 4.9% at the end of 2007 from 7% at the end of 2006.

The total customer deposits increased from RO 497.1 million at the end of 2006 to RO 674.5 million at the end of 2007, a creditable growth of 35.7%. The composition of customer deposits at the end of 2007 along with the corresponding figures for the prior period is as follows:

	<b>RO million</b>	
	<b>2007</b>	<b>2006</b>
Current accounts	178.1	123.2
Saving accounts	142.9	86.6
Time deposits	351.4	285.7
Margin accounts	2.1	1.6
<b>Total customer accounts</b>	<b>674.5</b>	<b>497.1</b>

### **Shareholders' Equity**

The shareholders' equity at the end of 2007 was RO 110.5 million compared with RO 93.3 million at the end of 2006. At the end of 2007 we transferred RO 2.3 million to legal reserve being 10% of net profit, RO 1.47 million to subordinated bonds reserve, RO 2.57 million to subordinated loan reserve and RO 3.2 million to retained earnings.

The analysis of shareholders' funds at the end of 2007 along with the corresponding figures for the prior period is as follows:

	<b>RO million</b>	
	<b>2007</b>	<b>2006</b>
Share capital	53.08	46.16
Share premium	5.43	5.43
Legal reserve	12.15	9.87
Subordinated bonds reserve	7.36	5.89
Subordinated loan reserve	2.57	-
Proposed distribution - cash	13.27	6.92
Proposed distribution – bonus shares	-	6.92
Investment reserve revaluation	3.58	2.23
Retained earnings	13.06	9.86
<b>Total Shareholders' Equity</b>	<b>110.50</b>	<b>93.28</b>

As a result of the increase in shareholders' equity the net assets per share reached RO 0.208 at the end of 2007 compared with RO 0.202 at the end of 2006.

### **Income Statement**

The net interest income increased by 15.7% from RO 26.25 million for the year ended 2006 to RO 30.36 million for the year ended 2007. Other income increased by 57.6% and reached RO 13.86 million at the end of 2007, net fees/commissions, profit from foreign exchange and investment income recorded growths of 37%, 50% and 39% respectively. Although the total operating expenses increased by 24.6% from RO 13.61 million in 2006 to RO 16.96 million in 2007, the cost to income ratio improved to 38.5%

The Bank made all provisions as required for impaired assets. The amount of additional provisions for impaired loans provided in 2007 was RO 3.3 million and the amount recovered from provisions was RO 1.52 million.

The net profit in 2007 grew by 13.2% and reached RO 22.79 million compared with RO 20.13 million in 2006. The earning per share (EPS) increased from RO 0.038 in 2006 to RO 0.043 in 2007.

The Board of Directors proposes to pay 25% cash dividend amounting to RO 13.27 million. Also the Bank will retain RO 1.47 million and RO 2.57 million to be transferred to subordinated bonds and loan reserves respectively and RO 3.2 million to retained earnings. The proposed profit appropriation for 2007 is as follows:

	<b>RO Millions</b>	
	<b>2007</b>	<b>2006</b>
Proposed dividends – cash	13.27	6.92
Proposed dividends - bonus shares	-	6.93
To legal reserve	2.28	2.01
To subordinated bonds reserve	1.47	1.47
To subordinated loan reserve	2.57	-
To retained earning	3.20	2.80
<b>Net profit for the year</b>	<b>22.79</b>	<b>20.13</b>

## **Future Prospects**

The strong financial performance since the inception of the Bank coupled with the expected growth in the local and regional economies give us the confidence of further business growth in 2008.