

## **MANAGEMENT DISCUSSION & ANALYSIS REPORT**

### **I - INDUSTRY AND COMPANY OVERVIEW**

#### **i. Economic Scenario**

The economic scenario in 2019 was characterised by an increase in macro-economic risks due to oil prices remaining at low levels through most of the year. This worked its way through the Omani economy by way of stressed cash flows and a culture of delayed payments. .

The government has made attempts to improve the flow of cash to the economy by borrowing offshore and diverting the income sources we expect the situation to improve going forward. Demand for automobiles remained low due to cautious market sentiment. However, as oil prices improve, we expect a more optimistic market in 2020.

#### **ii. Finance and Leasing Sector**

The Finance and Leasing sector was also affected by the challenging economic conditions, the net debtors decreased by 16% over the previous year. Muscat Finance had adopted a cautious approach to growth and focussed its attention on ensuring low accretion to non-performing loans and on maintaining asset quality, to ensure improvement in shareholder value.

#### **iii. Objects and Business**

Muscat Finance was incorporated in 1987, and is licensed and governed by the Central Bank of Oman under the Banking Laws of the Sultanate of Oman. As a listed company, it is also regulated by the Capital Markets Authority. The main objects under the licence are – Hire Purchase financing, Equipment leasing, Debt Factoring, Working Capital financing and Consumer durable loans. Over the last 32 years, the company has supported the local economy and enabled the dreams of many individuals and entrepreneurs. It has established an enviable reputation and continues to maintain its track record of consistent profits and uninterrupted dividends. The Company operates through its Head Office in Muscat as well as through an extensive network of six branch offices located at Barka, Sohar, Sur, Salalah, Ibri and Nizwa.

#### **iv. Products**

The company continues to provide products which support the needs of the customers and assist in the government's efforts to grow the economy. It provides financing of vehicles, equipment, warehouse financing and plant and machinery to business establishments in the form of financial leasing. It also provides short term finance to them by way of factoring of receivables. Loans are also provided to individual customers to purchase vehicles and consumer durables for their homes.

Muscat Finance also accepts deposits from corporate depositors, and offers attractive interest rates on these deposits, depending on their tenor.

#### **v. Business Development:**

During the nearly three decades of its operations, the Company has set up a large customer database comprising of almost 100,000 customers. This has enabled the company to obtain a substantial share of repeat business.

In addition, the six branches, and vehicle dealers serve as a source point of service and new business referrals.

An independent rating agency, Capital Intelligence, completed its review of the company in December 2019, and has re-calibrated its ratings of Muscat Finance to 'omA-' Long term and 'omA2' Short term, with a stable outlook. This has been an upward recalibration indicating the relative strength of Muscat Finance as a financial institution within Oman.

#### **vi. Opportunities and Challenges**

##### ***Opportunities***

- a) The Government's plans to diversify revenue streams away from oil and gas sectors combined with the focus on growing the private sector is likely to throw up a number of business opportunities. As the lifeblood of private sector business, SMEs that are a key focus area of Muscat Finance should be at the forefront of such diversification efforts. This presents a number of opportunities for equipment finance and working capital funding to our target profile of customers.
- b) We will continue to diversify our sources of funding and look at innovative funding opportunities, both onshore and offshore.

The urgency with which the government is encouraging the employment of recent graduates will certainly provide a boost to car ownership and create a more sustainable market going forward.

### ***Challenges***

- a) The curtailed cash circulation in the economy is creating a lot of stress for businesses with regard to honouring their payment obligations. Non-performing loans are likely to be a challenge in such an economic situation.
- b) Lack of liquidity would also drive up funding costs resulting in margin squeeze with a resultant impact on profitability.
- c) Adoption of full IFRS standards would also result in higher upfront provisioning costs.

The Company shall monitor the emerging market scenario, align its business targets and expand its size cautiously in tune with the emerging market conditions

## **II - OPERATING AND FINANCIAL PERFORMANCE**

During the year, the company shrunk its Debtors' portfolio owing to the increase in the macroeconomic risks. However, it was able to achieve a net profit after tax of RO.431K. During the year, the Company increased its provision charge to the profits twice than previous year. Incremental provisions for the year after write offs, comprised of almost RO 4.211 million and cumulative provisions, including reserve interest, reached RO 24.2 million, representing 15.16% of net assets. The financial highlights for the past five years are tabulated below:

(in RO '000s)

<b>Particulars</b>	<b>2019</b>	<b>2018</b>	<b>2017</b>	<b>2016</b>	<b>2015</b>
Gross Income	12,626	14,066	13,266	14,415	13,218
Interest Expense	4,848	4,222	3,900	4,072	3,015
Net Interest Income	7,778	9,844	9,366	10,343	10,203
Operating Expenses	3,054	3,081	3,558	3,485	3,194
Provision for doubtful debts	4,211	2,026	1,173	1,294	1,998
Net Profit after Tax	431	4,051	4,048	5,138	4,356
Net Investment in Finance Debtors	135,480	161,129	141,911	149,858	154,015

Provisions for impairment	24,212	18,907	16,551	14,941	13,556
Provision coverage ratio	66%	64%	80%	95%	100%
Net Worth	40,205	41,638	39,789	38,391	35,724
Dividend (%)	Nil	10%	13%	17%	16%

Overall, the performance was muted in keeping with a cautious approach towards lending in a stressed economic situation.

## **RISK MANAGEMENT**

The Company recognizes that strong risk management framework is essential to ensure sustained performance. The objective of Risk Management function is to protect earning, cash flow and, ultimately stakeholder's value. Risk Management forms an integral part of the Company's business process and constitutes an important element of decision making.

The Company's risk management framework is based on a holistic understanding of various risks, disciplined risk assessment, risk measurement and continuous risk monitoring. The policies and procedures established for this purpose are continuously benchmarked with international best practices. The Board of Directors has an oversight on all the risks assumed by the Company.

The key risks faced by the Company and its preparedness for the same are summarized below:

### **I. Credit & Portfolio Risk:**

Credit risk is the risk of loss arising from a borrower defaulting on a loan or failing to fulfill its obligation under the loan agreement. Credit risk emanates from non-payment by one or more borrowers or a systemic failure of a particular segment of business.

The risk is mitigated by conservative credit policies, which are reviewed at regular intervals, and revised in the light of developments in the external environment. The Company adopts a strategy of distributing risk across customers and industry segments. Segmental risk and industry trends are reviewed by the Risk Management Committee and Board at least on a quarterly periodicity. The Company follows a prudent policy of provisioning that is compliant with the requirements of the Central Bank of Oman.

### **II. Liquidity Risks:**

Liquidity risk is the risk that the Company may be unable to meet its financial obligation in a timely manner. Such an event could be triggered by inability to convert an illiquid asset like security to cash without a loss of capital and / or income in the process. The liquidity position is monitored daily by the treasury department, monthly by Asset Liability Management Committee and on a quarterly frequency by the Risk Management Committee. The company, as a strategy, sources a part of the borrowings on a long term basis, in order to minimize maturity mis-matches. The company also arranges offshore funding lines to partially mitigate risks associated with liquidity in the domestic banking system.

### **III. Market Risks:**

#### **a) Interest Rate Risk:**

The Company is exposed to interest rate risk which may arise due to changes in borrowing rates. The Company mitigates this risk by borrowing at fixed rates, wherever commercially viable, and maintaining a spread on new business. Further, to mitigate risk on floating rate borrowing company may enter in to hedging contracts. Interest rate risk and trends are monitored closely by ALCO committee and management.

#### **b) Foreign Exchange Rate Risk**

The foreign exchange risk arises from the fluctuation in currency rates. The Company's exposure in foreign currency borrowing exposes it to foreign exchange rate risk. The Company has created a special reserve, in line with regulatory requirement, as a measure of self-insurance against fluctuation in the US Dollar- Omani Rial parity. In addition, based on market conditions, the company may enter into forward contracts to cover its outstanding foreign exchange positions.

### **Internal Systems & Controls and IT Systems**

The Company's procedure manuals provide for clearly defined levels of authority for the Board, the Executive Committee and the internal Management. Most of the processes are built into the customised industry specific functional software. The company has an in-house Internal Audit Division which is supervised by the Audit Committee Members & Board of Directors. Overall operations are subject to periodic reporting to and examination by the Central Bank of Oman. The company has also put in place a Disaster Recovery and Business Continuity Plan and an annual testing is conducted to ensure its state of preparedness.

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