

Management Discussion & Analysis Report

(For the financial period ended 31st December 2015)

The Management Discussion & Analysis Report is a detailed overview of Bank Nizwa's business for the third financial year which covers the period from January 1st 2015 to December 31st 2015.

It focuses on the core segments of the business and discusses prospects and opportunities for the years ahead in the context of the prevailing macroeconomic environment and market penetration of Shari'a-compliant products and services.

Poised for Growth

The Islamic finance sector in Oman witnessed unparalleled growth over the last three years. With two full-fledged Islamic banks and six Islamic windows, Shari'a compliant banking assets accounted for 5.5% of Oman's total banking assets in 2015 and are projected to reach 10% by 2018. The financing assets of Islamic Banks have grown to OMR 1.4 Billion (43% since December 2014) and deposit has grown to OMR 1.2 Billion (90% since December 2014) as of September 2015. A key contributor to this unprecedented traction in the market has been the increased awareness on the benefits of Islamic banking amongst individuals and businesses alike; a responsibility Bank Nizwa has taken upon itself to continue to lead.

Bank Nizwa's financial performance this year demonstrated solid growth throughout its operation, reinforcing its leadership position within the sector. The Bank's customer financing portfolio, deposits, assets and operating income all reported substantial growth while net loss recorded a decrease. Bank Nizwa was able to gain the trust and confidence of customers by consistently delivering on its promise to offer high quality Islamic finance products and services, whilst investing in technology, customer reach and human capital.

Bank Nizwa will continue to focus on retaining its position as a leading full-fledged Islamic bank by enhancing its market share as well as its product and service offerings. This is a challenging juncture for the Islamic Banking industry and overall economy with the low level of oil prices. However, the Government will withstand these challenges with government economic diversification efforts and the contribution from the private sector which will fuel the Country's growth.

COUNTRY ECONOMIC & BUSINESS ENVIRONMENT

Oman's sovereign credit profile displays a number of strengths. Real GDP growth will likely remain positive, although it will slow to an average 2% to 3% in 2016 - 17, down from a previously higher growth trend of 4.9% on average between 2005 and 2014. Offsetting this strength to some degree is the likely sharp fall in nominal GDP this year from the collapse in oil prices. This will crimp government and private sector revenues. Even factoring in the reduced government revenues and resulting in higher government debt over the next one to three years, however Oman's debt metrics will still compare favorably with other regional economies.

The sluggish global growth along with the sharp decline in oil prices of about 45% since September 2014, have adversely impacted Oman's output growth rates. This has an adverse impact on the

Banking sector of Oman as it relies on the government as a major contributor in the growth of Banking assets and funding. The Omani government has substantial financial assets, as well as deposits in the domestic banking system. However, with the increase in oil production, efforts to cut back spending for costly subsidies and broader economic reforms will improve the situation.

Oman's current economic situation remains relatively stable; however downside risks have increased as a result of the decline in international oil prices. The Omani economy is expected to expand by an average of 2.4% of GDP in 2016-17.

OUTLOOK FOR THE BANKING SECTOR

Declining oil prices and slow economic growth will result in weaker credit growth for banks in addition to a moderate pressure on funding and earnings. However, key indicators from the banking sector illustrate a decent level of growth in total assets. Banks in the system continued to maintain capitalization levels well above the regulatory requirements which indicate the soundness and stability of the banking sector. The non-oil sector will continue to grow supported by private sector investment. The Country has a strong ability to progress with its investment programs, which will further support private consumption and non-oil exports as the population and capacity continue to grow.

Overall, the banking system is well-positioned for sustained growth in the future and will benefit from the Sultanate's systematic shift towards a more diversified economy.

NATURE OF BUSINESS OF BANK NIZWA

Bank Nizwa is a Shari'a-based financial institution in the business of both intermediation and participation that would lead to economic, social and ethical wellbeing of the society. The Bank's overall service proposition is divided into Personal Banking, Corporate & Commercial Banking and Financial Markets & Investments with customers being served through multiple channels including branches, direct sales, call center, ATM/CCDMs, mobile application, and internet banking.

Constituting the largest segment of the business, Retail Banking Division, serves the financial needs of individuals across the country providing them with the necessary means to lead financially secured lifestyles through innovative Shari'a compliant products including savings and current and Investment deposits accounts as well as home, personal and auto finance solutions.

The Wholesale Banking Division serves the needs of the government sector, government-owned entities, corporate and commercial clients as well as small-and-medium-enterprises (SMEs) through innovative structured working capital, long-term financing and trade finance facilities.

Critical Objectives Accomplished

At Bank Nizwa, we are on the path of moving from good to great. Ambition, commitment and discipline will take us there, propelled by the power of our strategy and the passion of our people. Our values are uncompromised, and the value we deliver continues to rise.

In the year 2015, the Bank achieved the following critical objectives:

- 1. Developed 2020 strategy for Five Years:** Bank Nizwa continues to operate with a clear vision, and mission that reaffirms the Bank's commitment to create value for all its stakeholders. Building on our vision and mission, the Bank has revised its strategy to focus on the following core principles:
 1. Deliver an excellent customer experience through technological breakthrough
 2. Enhance value for our Employees, Customer and Shareholders
 3. Increase our share in the Market through product innovation and efficiency
 4. Diversify revenue streams to improve financial performance
 5. Build a high performance work environment
- 2. Improved Financial Performance:** The bank demonstrated an impressive financial and operational performance driven by a combination of factors including exceptional performance across all business functions. We continued to improve our financial performance which is evident from the growth in both total revenue and pre-provision operating breakeven in the month of December 2015. Despite a competitive environment, Bank Nizwa has been able to achieve its financial targets of operational breakeven.
- 3. Enhanced Shari'a Compliant Product Portfolio:** Supported by our Sharia Supervisory Board, the Bank has a wider portfolio of customized solutions for Retail, Corporate, Commercial and SME customers. The products and services offered are in full-compliance with Sharia principles and are guided by the Islamic Banking Regulatory framework issued by the Central Bank of Oman, as well as the Sharia standards issued by the Auditing and Accounting Organization for Islamic Financial Institutions in Oman.
- 4. Recruit, Train and Develop Employees Capacities on Shari'a Financial Services:** Reflecting our culture and efforts to enhance performance, the Bank continued its drive to recruit professional and talented employees and enhance their knowledge of Shari'a financial services through extensive training opportunities and on-the-job coaching and mentoring.
- 5. Processes and Technology:** The Bank successfully completed several technology projects and integrated advanced technologies and innovations into the business in an effort to improve processes and automation to ensure customer service levels remain consistently high.
- 6. Customer Segments, Products, and Services:** The Bank continued engaging with potential customers across various segments, raising awareness on the benefits of Islamic banking by showcasing its Shari'a compliant innovative products and services. A key achievement in 2015 was the launch of our Mobile App and Credit Card which were well received and appreciated by our existing customer base.

KEY DEVELOPMENTS IN CORE SEGMENTS

Retail Banking

The Retail Banking Division has continuously worked towards redefining the banking experience in Oman by providing customers innovative products and services underpinned by responsive customer care and technologically advanced solutions to meet today's dynamic requirements. This approach has brought about positive change in Oman's retail banking space, prompting other institutions to re-examine their product and service offerings.

In 2015 the Retail Banking division launched a dedicated Mobile Banking App to complement its existing internet banking facility for Retail Banking customers. These digital channels provide convenience to customers and allow them to access their bank accounts from anywhere, anytime at their convenience. Towards the end of year, the Bank also launched the widest range of Shari'a Complaint Credit Cards packed with a vast range of privileges and offers that suit customers' needs and aspirations.

During the year, Retail Banking further consolidated its position as the leading Islamic Bank in Oman by increasing its number of accounts from approximately 32,000 to over 51,000, with a 57% increase in Retail deposits and 104% growth in assets. The Bank also expanded its branch network with the opening of new branches at Buraimi, bringing its total retail footprint to 11 branches in geographically-strategic locations across Oman to not only get closer to customers but also gain in-depth understanding of their needs.

Customers of Bank Nizwa continue to enjoy free transactions across the entire national ATM network. Internationally, customers are able to use their Debit Cards and Credit Cards at numerous ATM / Point-of-Sale locations which are part of the MasterCard network.

In addition to depository and investment products and payment solutions such as debit cards and Credit Cards, the Bank offers financing options to help customers acquire automobiles, homes and other needs according to their lifestyle and personal aspirations.

Customers are able to interact with the Bank through multiple channels which include strategically located branches, a direct sales team, a state-of-the-art Call Center, mobile banking and Internet banking with a seamless experience across the various channels. Each of the Bank's branches is fitted with the latest Automated Teller Machines (ATMs) and Cash & Cheque Deposit Machines (CCDMs). In 2016, the Bank aims to further expand its network and customer-base through value-added services and offering a rewarding and enriching experience.

Wholesale Banking

In 2015, the Wholesale Banking Division expanded from four to six business lines. The Corporate and Commercial Banking department split into two departments, namely (1) the Corporate Banking department and the (2) SME and Commercial Banking department, as the growth in assets demanded the Bank to have more focus in each of these businesses. The Bank also introduced Project Finance and Syndications as a new standalone department to cater for more complex transactions and project finance. Global Markets department, Investment Banking department and International Banking department make up the remaining of the sextet of departments within the Division.

Corporate Banking

Corporate Banking continued its substantial growth from the last quarter of 2014 but experienced a slow down during the second half of 2015 due to the need to adhere to regulations pertaining to industry limits and ratios, especially those related to real estate. It was expected that the Bank's tremendous rate of growth would eventually come into the range where limits imposed on banks would become relevant. The Bank however, had plans to divert into other types of industries especially in project finance and the deal pipeline remains at a healthy level. However, there would possibly be some challenges where the asset growth may not be in tandem to the facilities approved, which is the norm for project finance cases as the disbursement schedule are often spread over a period of time. In terms of product development, the Bank launched a funded working capital facility for clients based on the concept of Wakala during the year under review.

SME and Commercial Banking

The SME and Commercial Banking Department is a new dedicated business operating under Wholesale Banking. Though the product suites are mostly similar to Corporate Banking, the type of clients differ substantially and the Bank is in the midst of launching customized products, a variant of the existing products, to suit the particular needs of SME and commercial clients.

Project Finance and Syndications

Project Finance and Syndications represents a new business function under Wholesale Banking, and it was launched in 2015 to undertake more complex transactions related to project finance. One such notable transaction was the Strategic and Precious Metals Processing LLC FZE based in Sohar related to the production of antimony, which involved six different partners. The Bank has several other transactions in the pipeline of a similar nature and expects these transactions to materialize in 2016. This area of business is crucial not only to the Bank, but also for the industry and mainly in infrastructure and utilities sector, where the Bank offers 100% Shari'a-compliant solutions.

Global Markets

The focus of Global Markets has switched from managing excess liquidity coming from capital funds during the inception days of the Bank, to more transactional dealings with clients in the liquidity and foreign exchange market. During the year under review, the Global Markets function has also secured substantial amount of funding from the market to help complement deposit growth for the Bank. The function also introduced "foreign exchange forward" under the wa'ad concept to its clients, which further enhanced its range of offerings, now clients can transact in the forward market in a Shari'a-compliant way as well as for their hedging needs. Global Markets have also contributed

to the Bank's revenue stream via management of a Sukuk portfolio, also newly-introduced in 2015. As the market for such products picks up in terms of volume traded and new issuances, Global Markets aims to be ready to play its next role as a market-maker in the local market in the near future.

Investment Banking

Investment Banking has done tremendously well within its scope to complement the Bank's income in 2015, through income-generating investments in several sectors, yielding superior short-term and high expected long-term returns. Investment Banking will continue to expand and has embarked on advisory services as well as funds creation. The contribution from Investment Banking is expected to become more prominent in the future, and would also assist in providing new revenue streams other than the credit exposures.

International Banking

International Banking is managing all the financial institutions and correspondent banking relationships. To date, the Bank has established its network with almost 100 banks locally and abroad, with approved limits to deal with over 80 banks in 44 countries worldwide. International Banking will continue to look for opportunities to establish new relationships to support the growth of the Bank especially in the area of international trade finance.

Risk Management

The Bank is inherently exposed to various types of risks in carrying out its business activities. Since inception, the Bank has exerted dedicated efforts to build sound and strong Risk Governance and spread the risk-based decision making principles across all levels of the organization. Today, it has successfully built a robust and disciplined approach to managing risk and reward to assure that the Bank is well positioned to achieve its strategic objectives and to safeguard the interests of all stakeholders.

The Bank's primary responsibility of managing risk lies with the Board of Directors (BOD) who has formed an independent Board-level committee: Board Governance, Risk and Compliance Committee (BGRCC). The BGRCC is further supported by an independent Risk Management Group (RMG) that reports to the BOD through BGRCC.

As part of Risk Governance, Senior Management Committees were established within the Bank to manage the overall level of each risk type. This includes: the Assets and Liability Committee (ALCO), the Credit and Investment Committee (CIC) and the IT Steering Committee (ITSC). A well-defined governance structure is implemented where authority levels are clearly defined for manual and system based activities and is approved by the BOD while periodic audits and examinations by the internal auditors ensure that the culture of risk is embedded throughout the business divisions, which in turn is supported by a rigorous set of checks and balances.

As part of the Bank's continuous improvement initiative, the Bank reviewed existing approved risk policies and attuned them to changes in the regulatory and economic environment.

A critical component of risk management is liquidity risk. Therefore, the Bank developed policies and monitoring tools that enable management to assess liquidity gaps through a cash flow and static approach, reserve against deposits, financing ratio, mitigation of liquidity risk and contingency

measures. During the period in review, the Bank initiated the implementation of Basel III Liquidity and Capital Standards to meet regulatory requirements and international best practices.

A risk that is inherent in the Bank's daily operations is defined as 'Operational Risk'. To minimize this risk, an Operational Risk Management Policy was adopted and critical controls were implemented at all levels of the organization. During the period in review, the Bank also developed and implemented 'Risk and Control Self-Assessment' tool to capture and assess all key processes and controls to address operational risks within various businesses and support functions.

The Bank's disciplined approach to managing risk is integral to building the balance sheet, serving customers with the highest levels of quality, trust and transparency and maintaining a positive image and reputation in the marketplace. The Bank continues to build on its robust risk management foundation through a steadfast focus on continuous improvement and benchmarking against international best practices while enhancing the internal risk management infrastructure, processes and capabilities.

Raising Awareness

From the very beginning, Bank Nizwa has taken it upon itself to empower communities with the knowledge and understanding of the benefits of Shari'a-compliant solutions, presenting them with new, untapped opportunities. The Bank launched a country-wide roadshow called 'Islamic Finance Knowledge Series'. The knowledge series were launched as part of the commitment to empower local communities with knowledge on Islamic finance. They involved a series of workshops and round table discussions at universities, public sector entities and the private sector. Throughout 2015, the bank was successful in reaching out to over 1000 students at universities and colleges around the Sultanate. The series were also successful in hosting workshops for groups of teachers from the ministry of education and arranging for round table discussions and workshops for members of the media.

The bank also launched its flagship industry initiative, the Islamic Banking Knowledge Forum, in 2014. Attracting participants from across the sectors, it was designed to promote cross industry collaboration, dialogue and the sharing of best practices. Held again in 2015, the second edition proved to be even bigger and focused on the region's economic outlook. Attended by more than 150 government and public sector representatives, the 2nd edition served as a platform for industry experts to address the challenges and opportunities within the sector, as well as the bigger picture of the regional economic climate.

The Bank continuously utilizes various communication platforms to ensure it raises awareness on Islamic finance among a multitude of audiences. These include the Bank's social media channels in addition to a strategic partnership with Al Watan newspaper to publish a monthly column on Shari'a compliant banking products and services.

In 2016, Bank Nizwa will continue its efforts by raising awareness on Islamic Finance through various learning programs at key educational institutions and collaborations with various organizations to reinforce the beliefs and practices of social responsibility.

Corporate Social Responsibility

Bank Nizwa aims to play a pioneering role in supporting social, economic, and industry-related activities through strategic collaborations with various organizations and entities in Oman. In an effort to continue its support and endorsement of Islamic values, Bank Nizwa partnered with the Ministry of Endowment and Religious Affairs to support a Zakat campaign during the holy month of Ramadan. The bank also offered customers a chance to pay Zakat by depositing cash or regularly transferring directly into an account allocated for the Ministry of Endowment and Religious Affairs. This tie-up offered Bank Nizwa customers a convenient, secure and seamless service to meet their religious obligations.

The Bank's commitment to giving back to the community is demonstrated by its employees through the establishment of a Volunteer Group called "Masoliyati" to instill values of compassion, responsibility and community spirit. The Group has successfully conducted several volunteer projects including an Iftar Sa'em outreach program, beach clean-ups to preserve and protect Oman's picturesque coastline in addition to a blood donation drive among others.

Awards & Accolades

Since inception, Bank Nizwa has won a number of prestigious awards and accolades for its role in the development of Islamic banking in Oman. In 2015 alone, it won more than four awards. In addition to being named the 'Best Performing Islamic Bank in Oman' by WIBC, the Bank received the 'Best Islamic Bank in Oman' title at the 6th annual Islamic Finance Awards, the 'Best Employee Retention & Motivation Program' award at the annual Middle East Call Centre Awards and was recently honored with the 'Strongest Islamic Retail Bank in Oman' title at the 7th World Islamic Retail Banking Conference.

Shari'a Process

Compliance to Shari'a principles and standards are inherently built into the Banks' products and services by following a framework comprised of several key elements listed below that sets the standards and practices that ensures compliance to these standards and practices:

1) **Islamic Banking Regulatory Framework (IBRF)**

A 'rule book' issued by the Central Bank of Oman on Islamic banking practices that sets guidelines on Shari'a concepts which are permitted in Oman for Islamic banks.

2) **AAOIFI Standards**

Shari'a, accounting and governance standards are published by the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) and mandated by CBO; represent a

major reference for Shari'a compliance in the Islamic banking sector. Shari'a resolutions which are not available in the AAOIFI Shari'a standards are covered by resolutions from SSB.

3) Shari'a Supervisory Board (SSB)

SSB members are well-respected Omani and International Shari'a scholars who review and provide Shari'a resolutions and Fatwas on all products and related processes. This is in addition to overall Shari'a supervision to ensure that Bank Nizwa transactions and operations are Shari'a compliant at all times. The Bank's SSB which meets on quarterly basis consists of Sheikh Dr. Abdul-Sattar Abou-Ghuddah (Chairman), Sheikh Dr. Mohammad Bin Rashid Al-Gharbi (Member), and Sheikh Ibrahim Bin Nasser Al-Sawwafi (Member). SSB has established a Shari'a Executive Committee comprises of Sheikh Al-Gharbi and Sheikh Al-Sawwafi, which meets on monthly basis to accommodate for current banking requirements. Shari'a Ex-com resolutions are based on previous SSB Shari'a guidelines and Fatwas.

4) Shari'a Compliance

This function provides Shari'a review and supervision for business transactions before execution to confirm that structuring has been concluded based on IBRF, AAOIFI, and SSB Shari'a guidelines and controls. Shari'a review reports are prepared to document this supervision activity. To support the Sharia compliance activity, Shari'a non-compliance risks are continuously scrutinized, and specific mitigation controls are set to minimize these risks which occur due to un-intentional human errors. Any income of Shari'a non-compliant transactions are diverted to charity as per SSB guidelines.

5) Shari'a Audit Function

A dedicated function within the Bank that reports directly to the Bank's SSB, staffed with experienced professionals who conduct Shari'a audit after execution of transactions to confirm adherence to Shari'a guidelines as issued by SSB and per Shari'a reviews. Any Shari'a non-compliance event is immediately reported to Shari'a Ex-com for review and decision and further reported to SSB.

6) External Shari'a Audit

As required by IBRF, the Bank appoints an independent and qualified external Shari'a Auditor to audit the activities of the Bank on an annual basis.

7) Shari'a Training

To ensure that all members of management and staff have sufficient working knowledge of Islamic banking principles and guidelines, Shari'a compliance department staff continues to exert major focus on Shari'a training so that these principles are understood and practiced. Shari'a training also encompasses external parties based on an awareness campaign on Islamic banking for all constituents of society such as school teachers and students, university students, employees in ministries and public sector institutions.

Human Resources

Employees are the driving force behind the Bank's success, and efforts were centered on advancing their capacities and capabilities to become the future leaders of tomorrow. As a result, the Bank maintained a sustained level of strong performance. In addition, a "Succession Planning" program was initiated with the aim of preparing and developing the skills of a selected group of high-potential employees to fill key positions within the organization.

In 2015, the Bank initiated and implemented the Human Resources Management System (HRMS) which includes modules related to recruitment, management and training of staff, performance management and evaluation, compensation and benefits.

Recruitment

The Bank aims to be a leading institution in attracting the best and brightest talent in the local market by hiring exceptional fresh graduates that demonstrate great promise as well as attracting highly qualified and experienced employees with notable industry experience. To this end, the Bank implements precise and clear recruiting policies based on levels of educational and professional qualifications and the suitability of the specialization for vacant positions. Similarly, the Bank is fully committed to retaining key talents and Omanization which increased to 88.36 % during 2015.

Training & Development

Training is a vital component for preparing and equipping employees with the necessary skillsets to carry out various Islamic Banking activities and improve quality of service to customers. Therefore, training was a top priority for the Human Resources Department which facilitated and provided more than 700 training opportunities by conducting around 200 training programs for employees across all departments and branches in various fields of Islamic Banking, customer service and capacity development to promote innovative and forward thinking.

The Bank also worked on strengthening an internal culture of learning and self-development through regularly sending a number of employees to obtain academic and professional qualifications from renowned local and international academic institutions and training centers.

Information Technology

With its existing state-of-the-art and robust IT systems, Bank Nizwa continued its focus on providing maximum reliability and availability of information and systems. This is achieved by creating a highly secure environment with an advanced electronic delivery channel which includes features and services that are available in today's fast growing world.

During 2015, the Information Technology department focused primarily on improving its e-channels' services and expanding customer delivery systems to provide customers with multiple alternative banking channels such as ATMs, CCDMs, Internet Banking, Mobile Banking and phone banking services to enrich the overall experience with the latest generation technology. Bank Nizwa's Internet Banking and Mobile Banking solutions conveniently and securely enable customers to conduct their banking transactions, generate their full account statements, transfer funds, open accounts and request cheque books in real-time, while on the move. Interactive Voice Response (IVR) services on these channels were also upgraded. Bank Nizwa also introduced a new innovative service called Miss Call and get your balance on your mobile as a first service in the Sultanate, which

allowed customers to miss call a dedicated phone number and receive an instant message detailing their balance.

Going Forward

Given the competitive environment in the market, current economic challenges and the Bank's growth target, the Bank has to observe balanced management practices and remain vigilant to any unexpected changes in the operating environment.

We believe that through a prudent approach to business, supported by the Bank's highly competent management and strategy, Bank Nizwa is well-positioned to steer a steady path through the challenges of the current period and to achieve future growth strategy in order to compete with the peers.

Our strategic focus will remain on improving profitability as we grow. However, we believe a bank ought to be resilient as well as high-performing for its shareholders. We manage our balance sheet conservatively to protect shareholders interest. We will work more to diversify our portfolio across all economic sectors to minimize risk. We will control costs efficiently and always look for ways to build value for our businesses, improve shareholder returns, offer the best products and services to our customers and continue to turn challenges into opportunities in an ever-evolving operating environment. We will continue to be creative and innovative in the sector, consistently setting ourselves apart from our peers.

We will continue to follow a strategy based on target growth and discipline to deliver better profitability and operating performance. We run a stable and resilient business — a strong, liquid and focused Sharia Compliant Bank — with a clear mission and vision.

In closing, I would like to thank the Central Bank of Oman, the Chairman, Sayyid Amjad Al Busaidi, the Vice Chairman H.E. Sheikh Ahmed Al Rawahi, the Board of Directors, the Executive Management team and all Bank Nizwa employees for their support, guidance and efforts as we continue our journey to grow our market share. I look forward to another exciting year ahead.

Dr. Jamil El Jaroudi

Chief Executive Officer