# National Finance House BSC (c)

**Half Yearly Quantitative Public Disclosures**

**As At 30 June 2018**

## Executive Summary

The half yearly quantitative public disclosures of **National Finance House (NFH)** have been prepared in accordance with the Public Disclosure Module ("PD"), Section PD-2.1.6 Semi-annual Disclosures, CBB Rule Book-Volume 5 (Type 3: Financing Companies). These disclosures should be read in conjunction with the detailed disclosures made in the annual report for the year ended 31 December 2017, and the condensed consolidated interim financial information for the six months ended 30 June 2018.

***Basis of Preparation:***

The financial information has been prepared using the same accounting policies and methods of computation applied in the preparation of the latest audited financial statements for the year ended 31 December 2017, except as described below.

***Basis of consolidation***

Subsidiary is an enterprise controlled by the Group. Control is presumed to exist where more than one half of a subsidiary's voting power is controlled by the Group, or the Group is able to govern the financial and operating policies of a subsidiary so as to obtain benefit from its activities. The financial information of the subsidiary is included in the condensed consolidated interim financial information from the date that control commences until the date that control ceases. All significant inter-group balances and transactions and any gains and losses arising from inter-group transactions are eliminated in preparing the condensed consolidated interim financial information.

***New standards adopted by the Group***

A number of new standards became applicable for the current reporting period and the Group had to change its accounting policies and make retrospective adjustments as a result of adopting the following standards:

- IFRS 9 Financial Instruments, and
- IFRS 15 Revenue from Contracts with Customers.

IFRS 9 is adopted without restating comparatives. The impact of the adoption of this standard and the new accounting policies are disclosed in the condensed consolidated interim financial information for the six months ended 30 June 2018. IFRS 15 did not have any impact on the Group's accounting policies and did not require retrospective adjustments.

***Financial Highlights:***

The Group has realized a net profit of BD 672 thousand for the six months period ended on 30 June 2018 compared to a net profit of BD 564 thousand for the same period last year. NFH recorded a net profit of BD 305 thousand in the three months ended 30 June 2018 compared to BD 260 thousand for the same period of last year.

Total revenues has decreased slightly by 0.8% for the first half of 2018 to reach BD 1.621 million compared to BD 1.635 million for the same period last year. Total expenses decreased by 11% compared to the same period last year and this is mainly due to decrease in impairment loss allowance on loans to customers by BD 251 thousand.

The impact of transitioning to IFRS 9 at 1 January 2018 on the consolidated financial statements of NFH was a decrease of BD 692,014 in both shareholders' equity and total assets arising from additional impairment allowances.

For indicators of financial performance for past 5 years refer to the "5 years Financial Highlights" section on www.nfh.com.bh.

## 1. CORE CAPITAL

| | **30 June 2018** |
|---|---|
| Issued and fully paid ordinary shares | 7,500,000 |
| Share premium | 112,500 |
| Statutory reserve | 962,327 |
| Retained earnings | 5,341,145 |
| **Total Capital** | **13,915,972** |
| Regulatory deductions | - |
| **Core Capital** | **13,915,972** |

The Group's issued and paid up capital consists only of ordinary shares, which have proportionate voting rights. The Group does not have any other type of capital instruments.

The Group's authorized capital consists of 500,000,000 ordinary shares of 100 fils each.

## 2. RISK MANAGEMENT FRAMEWORK

The Group is exposed to the following types of risks:

- Credit risk
- Liquidity risk
- Market risk (including interest rate and currency risks)
- Operational risk
- Legal, Compliance, Regulatory & Reputation Risks

***Risk management framework and overview***

The Group has a risk management framework in place for managing these risks which is constantly evolving as the business activities change in response to credit, market, product and other developments. This note presents information about the Group's exposure to each of the above risks, the Group's objectives, policies and processes for measuring and managing risk, and the Group's management of capital.

Financial instruments comprise of financial assets and financial liabilities. Financial assets of the Group consist of cash and cash equivalents, placements with banks and other financial institutions, loans to customers and other assets. Financial liabilities of the Group consist of borrowings from banks, related party payable and other liabilities.

The Board of Directors of the Group has the overall responsibility for the establishment and oversight of the Group's risk management framework. The Board has established the Executive Committee, for developing and monitoring risk management policies in their specified areas. The Board of Directors set the Group's overall risk parameters and risk tolerances, and the significant risk management policies.

The Executive Committee reviews and reports to the Board of Directors on the Group's risk profile and risk taking activities.

The Chief Executive Officer has the primary responsibility for sanctioning risk taking activities and defining risk management policies within the overall risk parameters and tolerances defined by the Board of Directors. The risk management control process is based on a detailed structure of policies, procedures and limits, and comprehensive risk measurement and management information systems for the control, monitoring and reporting of risks. The principal risks associated with the Group's businesses and the related risk management processes are set out below.

## CREDIT RISK

Credit risk is the risk that a customer fails to perform under its contractual payment obligations thus causing the Group to suffer a loss in terms of cash flow or market value. Credit risk is the predominant risk type faced by the Group in its financing activities both on and off balance sheet. The Group is exposed to credit risk primarily on the loans to customers. Credit risk assessment and management is divided into personal and corporate loans.

The responsibility for the management of credit risk rest with the management, Credit Committee, comprising four members, Head of Retail, Head of Finance, Head of Risk Management and Head of Collection reporting to the Chief Executive Officer. The Credit Committee is responsible for oversight of the Group's credit risk, including:

- establishing the authorisation structure for the approval and renewal of credit facilities. The authorisation limits are allocated to the Retail and Credit Administration Departments. Larger facilities require approval by Chief Executive Officer, Credit Committee or Executive Committee. Each business unit is required to implement Group's credit policies and procedures, with credit approval authorities delegated from the Group's Credit Committee;

- reviewing and assessing credit risk. Credit committee assesses all credit exposures in excess of designated limits, prior to facilities being committed to customers by the business unit concerned. Renewals and reviews of facilities are subject to the same review process;

- limiting concentrations of exposure to counterparties, and industries for loans;

- reviewing and monitoring credit exposures on an ongoing basis to identify, as early as possible, customers that may be experiencing declining credit worthiness or financial difficulty;

- reviewing compliance of business units with agreed exposure limits. Regular reports are provided to the Chief Executive Officer and Board of Directors on the credit quality of local portfolios and appropriate corrective action is taken; and

- providing advice, guidance and specialist skills to other departments to promote best practice throughout the Group in the management of credit risk.

All loans are with local individuals and locally incorporated entities. The credit risk on these loans is actively managed and rigorously monitored in accordance with well-defined credit policies and procedures. The creditworthiness of each borrower is evaluated prior to sanctioning of facilities. Credit review procedures are in place for corporate customers to identify at an early stage, exposures which require more detailed monitoring and review. Appropriate procedures for follow-up and recovery (including recourse to legal action) are in place to monitor the credit risk on loans.

The Group is not exposed to any significant concentration of credit risk arising from exposures to a single debtor or to Group of debtors having similar characteristics such that their ability to meet their obligations is expected to be affected similarly by changes in economic or other conditions. The maximum credit risk exposure of the loans to customer is the carrying value amount net of the unearned interest income and net of impairment allowance. The Group establishes an allowance for impairment that represents its estimate of incurred losses in respect of loans and receivables. The allowance comprise of collective loss allowance established for groups of similar assets in respect of losses that have been incurred but not yet identified.

***Exposure to credit risk***

The carrying amount of funded financial assets represents the maximum credit exposure. The maximum exposure to credit risk at the reporting date was:

| | **30 June 2018** | **2018 Six Months Average** |
|---|---|---|
| Cash and cash equivalents | 2,796,018 | 2,227,999 |
| Fixed Deposit | - | 1,000,000 |
| Loans to customers | 51,762,065 | 49,547,855 |
| | **54,558,083** | **52,775,854** |

| ***Distribution of exposure by sector / counterparty:*** | **30 June 2018** |
|---|---|
| Corporate (excluding financial institutions) | 13,480,046 |
| Retail | 38,282,019 |
| Financial institutions | 2,796,018 |
| | **54,558,083** |

| ***Geographic distribution of exposure:*** | **30 June 2018**<br>**Bahrain** |
|---|---|
| Cash and cash equivalents | 2,796,018 |
| Loans to customers | 51,762,065 |
| | **54,558,083** |

***Past due exposure:***

In accordance with the Group's policy and Central Bank of Bahrain guidelines, loans on which payment of interest or repayment of principal are 90 days past due, are defined as non-performing.

The Group has systems and procedures in place to generate alerts in case of past dues in any account. A stringent classification process is followed for all accounts with past dues of 90 days and over. The Group applies rigorous standards for provisioning and monitoring of non-performing loans. Level of provisions required is determined based on the security position, discounted values of cash flows, etc and adequate provisions are carried to guard against inherent risks in the portfolio.

Loans that are "past due below 90 days but not impaired" are those for which contractual interest and principal payments are past due but the Group believes that impairment is not appropriate on the basis of the level of security or collateral available and / or the stage of collection of amounts owed to the Group. As at 30 June 2018, loans past due below 90 days but not impaired amounted to BD 3,619,116.

***Geographic Distribution & Aging analysis of all loans including impaired and past due loans by sector / counterparty:***

All loans are domestic and are granted to borrowers within the Kingdom of Bahrain. Following is the ageing analysis of impaired and past due loans:

| **30-Jun-18** | **Gross amount** | | **Impairment allowance** | | **Net amount** | |
|---|---|---|---|---|---|---|
| | **Retail** | **Corporate** | **Retail** | **Corporate** | **Retail** | **Corporate** |
| ***Current*** | 12,566,577 | 35,674,549 | 139,053 | 378,908 | 12,427,524 | 35,295,641 |
| ***Past Due Loans:*** | | | | | | |
| 1 day to 89 days(1) | 910,810 | 2,708,306 | 172,279 | 339,144 | 738,531 | 2,369,162 |
| 90 days - 1 year(2) | 390,986 | 758,231 | 212,515 | 379,593 | 178,471 | 378,638 |
| 1 year - 3 years(2) | 296,897 | 484,736 | 161,377 | 246,158 | 135,520 | 238,578 |
| More than 3 years | - | 20,997 | - | 20,997 | - | - |
| | **14,165,270** | **39,646,819** | **685,224** | **1,364,800** | **13,480,046** | **38,282,019** |

(1) Classified as Stage 1 and Stage 2 and subject to 12 month ECL and lifetime ECL, respectively.
(2) Classified as Stage 3 and subject to lifetime ECL.

| | **Collective Impairment Provision** | **Specific Provision** | **Total** |
|---|---|---|---|
| ***Movement in impairment provision for loans:*** | | | |
| At 1 January 2018 | 1,844,234 | - | 1,844,234 |
| IFRS 9 transition amount | 653,461 | - | 653,461 |
| Charge for the period | - | 56,586 | 56,586 |
| Provision cancelled due to improvement | - | (1,237) | (1,237) |
| Written off during the period | (468,668) | (34,352) | (503,020) |
| **At 30 June 2018** | **2,029,027** | **20,997** | **2,050,024** |

Full provision is specifically taken on all loans that have been non-performing for more than three years.

Loans written-off during the period amounted to BD 503,020 in which BD 144,723 pertains to Corporate and BD 358,297 individuals. During the six months ended 30 June 2018, the Group recovered BD 47,586 from loans written off in the previous years.

***Write-off policy:***

The Group writes off a loan balance (and any related allowances for impairment losses) when Group determines that the loans are uncollectible. This determination is reached after considering information such as the occurrence of significant changes in the borrower financial position such that the borrower can no longer pay the obligation, or that proceeds from collateral will not be sufficient to pay back the entire exposure. Moreover, the Group adopted a policy to write-off all loans that have been non-performing for more than 3 years by taking full provision. Those loans will be marked in the system as “Write-off Open” and followed up for recovery by the Collection team as per current procedures. The final write-off of those loans shall be done only after taking necessary approvals from the appropriate approving authority and the accounts treated as “Write-off Close”.

***Restructuring:***

| | **30 June 2018** |
|---|---|
| Loans restructured during the period | 38,840 |
| Impact of restructured facilities and loans on provisions | 189 |

The Group renegotiates loans to customers in financial difficulties (referred to as ‘forbearance activities’) to maximise collection opportunities and minimise the risk of default. Under the Group’s forbearance policy, loan forbearance is granted on a selective basis if the debtor is currently in default on its debt or if there is a high risk of default, there is evidence that the debtor made all reasonable efforts to pay under the original contractual terms and the debtor is expected to be able to meet the revised terms.

The above restructuring did not have any significant impact on present and future earnings and were primarily extentions of the loan tenor, revisions in interest rate, and additional collateral received.

***Collateral:***

The Group holds collateral against loans to customers in the form of mortgage interests over vehicles financed. Estimates of fair value are based on the value of collateral assessed at the time of borrowing, and generally are not updated except when a loan is individually assessed as impaired. As at 30 June 2018, the market value of collaterals represents 108% of the Group’s credit exposure (loans to customers).

***Related Party:***

Parties are considered to be related if one party has the ability to control the other party or exercise significant influence over the other party in making financial and operating decisions. These represent transactions with shareholders, Board of Directors and key members of management having authority and responsibility for planning, directing and controlling the activities of the Group. Balances at the reporting date in regard to related parties and transactions during the six months with related parties comprised the following:

| **30 June 2018** | **Shareholders** | **Board of Directors** | **Senior Management** |
|---|---|---|---|
| ***Related Part Balances:*** | | | |
| Payables for vehicles financed | 795,765 | - | - |
| Payable for Insurance premiums | 27,515 | - | - |
| Prepaid expenses | 9,533 | - | - |
| Staff loans | - | - | 3,450 |
| ***Expenses:*** | | | |
| Insurance Premium charges | 380,713 | - | - |
| Call Centre charges | 9,000 | | |
| Board of directors attendance allowance | - | 31,108 | - |
| Key Management compensation | - | - | 183,319 |

No impairment losses have been recorded during the period against balances outstanding with related parties and no specific allowance has been made for impairment losses on balances with related parties at 30 June 2018.

Controlling relations with related party transactions are enshrined in various policies, charters and agreements. The Group's dealings with its shareholders and/or Board of Directors are conducted on an arms-length basis in respect of borrowings received from them. If loans are extended to related parties, these are approved on the basis of authorities delegated by the Board of Directors to the CEO. If the loans exceed these authorities, then further approval from the Board is requested.

All loans to management members and staff of the Group, are governed by the policies applicable to staff. These policies are reviewed by the Board regularly.

## LIQUIDITY RISK

Liquidity risk is the risk that the Group will encounter difficulty in raising funds to meet commitments associated with financial instruments.

### *Management of liquidity risk*

The Group's approach to managing liquidity is to ensure, as far as possible, that it will always have sufficient liquidity to meet its liabilities when due, under both normal and stressed conditions, without incurring unacceptable losses or risking damage to the Group's reputation. It manages its liquidity requirements mainly by financial support from collection of vehicle loans with varying maturities, borrowings from financial institutions and financial support from shareholders.

Liquidity management policies are designed to ensure that funds are available at all times to meet the funding requirements of the Group, even in adverse conditions. In normal conditions, the objective is to ensure that there are sufficient funds available not only to meet current financial commitments but also to facilitate business expansion. These objectives are met through the application of prudent liquidity controls. These controls provide security of access to funds without undue exposure to increased costs from the liquidation of assets.

The liquidity position of the Group is monitored by the Chief Executive Officer and Financial Controller. Surplus and deficit of short and long term positions of the Group are managed as appropriate by the Finance Department. The Group ensures that it has sufficient cash on demand to meet expected operational expenses, including the servicing of financial obligations; this excludes the potential impact of extreme circumstances that cannot reasonably be predicted, such as natural disasters.

The contractual maturities of financial liabilities, including interest payments and excluding the impact of netting agreements is set out below. This shows the undiscounted cash flows on the Group's financial liabilities and unrecognised loan commitments on the basis of their earliest possible contractual maturity.

| **30 June 2018** | **Carrying amount** | **Contractual cash flows** | **6 months or less** | **6 - 12 months** | **More than 12 months** |
|---|---|---|---|---|---|
| Bank borrowings | 39,095,138 | 43,510,644 | 11,191,881 | 6,191,313 | 26,127,449 |
| Accounts payable | 2,139,806 | 2,139,806 | 2,139,806 | - | - |
| | **41,234,944** | **45,650,450** | **13,331,687** | **6,191,313** | **26,127,449** |

## MARKET RISK

Market risk is the risk that changes in market prices, such as interest rate and credit spreads (not relating to changes in the issuer's credit standing) will affect the Group's income or the value of its holdings of financial instruments. The objective of market risk management is to manage and control market risk exposures within acceptable parameters, while optimising the return on risk. The principal market risk to which the Group is exposed is interest rate risk with its asset and liability management activities.

## INTEREST RISK

Market risk is the risk that changes in market prices, such as interest rate and credit spreads (not relating to changes in the issuer's credit standing) will affect the Group's income or the value of its holdings of financial instruments. The objective of market risk management is to manage and control market risk exposures within acceptable parameters, while optimising the return on risk.

Interest rate risk is the risk that the Group's earnings will be affected as a result of movements in interest rates. The Group's interest rate exposures arise from its interest earning assets and interest-bearing liabilities i.e. of cash and cash equivalents, placements with banks and other financial institutions, loans to customers and borrowings from banks. The distribution of financial instruments between interest rate categories is summarised below:

| **30 June 2018:** | **Fixed rate** | **Floating rate** | **Non-interest bearing** | **Total** |
|---|---|---|---|---|
| Cash and cash equivalents | - | - | 2,796,018 | 2,796,018 |
| Loans to customers | 51,762,065 | - | - | 51,762,065 |
| Other assets | - | - | 308,411 | 308,411 |
| | **51,762,065** | **-** | **3,104,429** | **54,866,494** |
| Bank loans | - | 39,095,138 | - | 39,095,138 |
| Other liabilities | - | - | 2,139,806 | 2,139,806 |
| | **-** | **39,095,138** | **2,139,806** | **41,234,944** |

## CURRENCY RISK

Currency risk is the risk that the value of a financial instrument will fluctuate due to changes in foreign exchange rates. The Group's exposure to currency risk is not significant as a significant portion of the Group's transactions are in Bahraini Dinars.

## OPERATIONAL RISK

Operational risk is the risk of direct or indirect loss arising from a wide variety of causes associated with the Group's processes, personnel, technology and infrastructure, and from external factors other than credit, market and liquidity risks such as those arising from legal and regulatory requirements and generally accepted standards of corporate behaviour. Operational risks arise from all of the Group's operations and are faced by all business units.

The Group's objective is to manage operational risk so as to balance the avoidance of financial losses and damage to the Group's reputation with overall cost effectiveness and to avoid control procedures that restrict initiative and creativity. The primary responsibility for the development and implementation of controls to address operational risk is assigned to senior management within each business unit.

This responsibility is supported by the development of overall Group standards for the management of operational risk in the following areas:

- Requirements for appropriate segregation of duties, including the independent authorisation transactions
- Requirements for the reconciliation and monitoring of transactions
- Compliance with regulatory and other legal requirements
- Documentation of controls and procedures
- Requirements for the periodic assessment of operational risks faced, and the adequacy of controls and procedures to address the risks identified
- Requirements for the reporting of operational losses and proposed remedial action
- Development of contingency plans
- Training and professional development
- Ethical and business standards
- Risk mitigation, including insurance where this is effective.

Compliance with Group standards is supported by a programme of periodic reviews undertaken by Internal Audit. The results of Internal Audit reviews are discussed with the management of the business unit to which they relate, with summaries submitted to the Audit and Corporate Governance Committee and senior management of the Group.

The Group is committed to providing uninterrupted service of all key business resources required to support critical business activities. This is achieved through identifying potential threats to the Group, and providing a framework for a response that safeguards all stakeholders, including employees and customers. The Group's Business Continuity Plan (BCP) includes data recovery and information security. To ensure the highest levels of information security, internal and external vulnerability assessment and penetration testing (VAPT) is also conducted on a semi-annual basis.

***Legal Contingencies risk***

Legal risk is the risk relating to losses due to legal or regulatory action that invalidates or otherwise precludes performance by the end user or its counterparty under the terms of the contract or related netting agreements.

Due to the nature of its operations, the Group may be involved in litigations arising in the ordinary course of business. Provision for contingent liabilities arising from litigations is based on the probability of outflow of economic resources and reliability of estimating such outflow. Such matters are subject to many uncertainties and the outcome of individual matters is not predictable with assurance.

## 3. MATURITY PROFILE

The maturity profile of the Group's financial assets and liabilities based on the expected repayment arrangements is given below. The contractual maturities of assets and liabilities are not significantly different from the expected repayment dates.

| 30 June 2018: | Up to 3 months | 3-6 months | 6 months to 1 year | 1-5 years | 5-10 years | Total |
|---|---|---|---|---|---|---|
| Cash and cash equivalents | 2,796,018 | - | - | - | - | 2,796,018 |
| Loans to customers | 2,949,239 | 3,864,008 | 7,357,013 | 36,452,199 | 1,139,606 | 51,762,065 |
| Other assets | 308,411 | - | - | - | - | 308,411 |
| | **6,053,668** | **3,864,008** | **7,357,013** | **36,452,199** | **1,139,606** | **54,866,494** |
| Bank loans | 2,499,442 | 7,627,642 | 5,383,488 | 22,374,166 | 1,210,400 | 39,095,138 |
| Other liabilities | 2,139,806 | - | - | - | - | 2,139,806 |
| | **4,639,248** | **7,627,642** | **5,383,488** | **22,374,166** | **1,210,400** | **41,234,944** |

The collective impairment provision of BD 2,029,027 and specific provision of BD 20,997 have been netted against the cash-flows expected within 3 months.

## 4. CAPITAL MANAGEMENT

The Central Bank of Bahrain sets and monitors capital requirements for the Group. According to the conventional financing Company license granted by the Central Bank of Bahrain the Group should maintain a minimum paid-up capital of BD 5,000,000 and the borrowings may not exceed five times the capital and reserves (shareholders equity) of the Group. As on 30 June 2018 Group's paid-up share capital is BD 7,500,000, the borrowing to capital and reserves ratio is 2.81 and the gearing ratio is 33.75%.

The Group's policy is to maintain a strong capital base so as to maintain investor, creditor and market confidence and to sustain the future development of the business. The impact of the level of capital on shareholders' return is also recognised as well as the need to maintain a balance between the higher returns that might be possible with greater gearing and the advantages and security afforded by a sound capital position. The Group manages its capital structure and makes adjustments to the structure taking account of changes in economic conditions and strategic business plans.