

Omani Banking Sector

May 2016

Company	Rating
Bank Muscat (BKMB)	BUY
National Bank of Oman (NBOB)	ACCUMULATE
Bank Dhofar (BKDB)	Under Review
Bank Sohar (BKSB)	Under Review
Ahli Bank (ABOB)	HOLD
HSBC Oman (HBMO)	HOLD

- Credit growth to remain muted through FY16-FY17
- Liquidity under pressure due to constrained deposit growth
- Rising cost of debt to weigh on margins until assets renewed at higher yields
- Net interest margin to remain under pressure due to highly competitive environment

We revise our target prices and ratings on the Omani Banking sector as follows: Bank Muscat (BKMB) –BUY, National Bank of Oman (NBOB) –Accumulate, Ahli Bank (ABOB) –HOLD and HSBC Oman (HBMO) –HOLD. We have placed Bank Sohar and Bank Dhofar Under Review for a possible merger. Together these six banks command ~84%¹ share of the total sector credit pie, and collectively hold roughly the ~86% share in the total sector’s customer deposits.

We believe that the Omani banking sector is facing a challenging operating environment on account of the twin pressure of (1) Government austerity measures which constrain credit growth and pressurize delinquent loans and (2) tightening liquidity conditions resulting in rising cost of funds which pressurizes margins. Most of the banks in Oman are well-capitalized (with sector Capital Adequacy Ratio at 16%), and well above the regulatory minimum set by the Central Bank of Oman (CBO), facilitating stress absorption if required. However, the sector’s Loan-to-Deposit (LDR) ratio is beginning to show signs of upward pressure, indicating further constraints on credit growth in the medium to long term. In our model building process, we have assumed a sector-wide mid-to-high single digit growth in loan books of the banks for FY16, with growth levels flattening out towards the end of the forecast period on anticipation of further stress on Government expenditure levels assuming oil prices remain persistently low.

We prefer to position ourselves in banks which have sound capital management policies, have raised Tier 1 & 2 Capital over the last couple of years in order to lock in lower rates, better credit supervision, and stronger liquidity profiles. Additionally, we believe that in spite of our very modest assumptions, some key banks are showing a large upside potential on their current prices due to having de-rated to very low levels.

Top picks

Our top picks are Bank Muscat and NBO. We maintain a HOLD on Ahli Bank and HSBC Bank Oman. Currently, Bank Dhofar and Bank Sohar are undergoing due diligence for a possible merger of the entities. As per the latest disclosure on MSM website, Bank Dhofar SAOG has communicated to Bank Sohar SAOG the terms on which it is willing to proceed with the merger, following a financial and legal due diligence exercise. Those terms are now being considered by Bank Sohar SAOG and may be subject to further discussion and negotiation between the two banks. Therefore, we have placed these two stocks under review.

Hettish Karmani
Head of Research
h.karmani@oabinvest.com
Tel: 00968 – 24754316

Ayisha Zia
Research Analyst
a.zia@oabinvest.com
Tel: 00968 – 24754328

Coverage Summary, Valuations	Market Cap, OMR mn	Last Price, OMR	Target Price, OMR	Upside (Downside), %	P/B'16e	P/E'16e	Div Yield'16e
Bank Muscat	1,008	0.404	0.561	38.9%	0.7	5.5	6.2%
National Bank of Oman	382	0.259	0.305	17.8%	0.7	6.7	3.9%
Bank Dhofar	435	0.256	UR	NA	0.8	9.1	6.3%
Ahli Bank	257	0.180	0.186	3.3%	1.1	8.5	5.6%
Bank Sohar	279	0.176	UR	NA	1.0	8.8	4.5%
HSBC Oman	232	0.116	0.126	8.6%	0.7	17.6	3.0%
Average					0.84	9.37	4.9%

*UR = Under Review

Source: Bloomberg, OABInvest

¹ CBO figures and our calculations

Valuation

We have used Excess Returns Methodology to arrive at our target prices for the banks whereby

Excess Returns Methodology

We find present value of the excess returns after paying the cost of equity for each year over the forecast period (2016-2020). This present value is then added to the equity value invested currently and the terminal value. For terminal value calculation, we use the relationship between an estimated long-term ROE and retention ratio as proxy for growth rate for each entity. Also, we assume that at the end of the extraordinary growth period, the entity's beta reverts to 1.

Valuation	BKMB	NBOB	ABOB	HBMO
	OMR mn	OMR mn	OMR mn	OMR mn
PV of Excess Returns & Terminal Value				
Year 1	6	3	4	(18)
Year 2	1	2	4	(17)
Year 3	(5)	0	4	(15)
Year 4	(9)	(3)	3	(13)
Year 5	(15)	(6)	2	(12)
Terminal	9	(61)	27	27
Assumptions				
Risk Free Rate	1.9%	1.9%	1.9%	1.9%
Risk Premium (Market Risk, Company Risk, Country Risk)	10.0%	10.0%	10.0%	10.0%
Beta (5Yr Monthly)	1.07	1.14	0.93	0.868
Cost of Equity (COE) in extraordinary growth period	12.7%	13.3%	11.3%	10.6%
Retention Ratio in stable period	30.0%	30%	30%	30%
ROE in stable period	12.0%	12%	13%	13%
Cost of Equity (COE) in stable period	11.9%	11.9%	11.9%	11.9%
Equity Invested Currently	1,413	515	220	300
Fair Value of Equity	1,401	450	265	251
Outstanding Shares, mn	2,496	1,475	1,425	2,000
Fair Value				
Fair Value	0.561	0.305	0.186	0.126
Current Market Price	0.404	0.259	0.180	0.116
Upside/(Downside)	38.9%	17.8%	3.3%	8.6%
Recommendation	Buy	Accumulate	Hold	Hold

Source: OABInvest, Company Financials, Bloomberg

Risks to Valuation

Key downside risks to our valuations include:

- An even slower-than-expected credit offtake
- Any regulatory action which has a negative impact on the profitability of banks
- Higher-than-expected sovereign risk resulting in cost of equity to rise

Key upside risks to our valuation include:

- Better-than-expected sovereign risk profile resulting in a lower cost of equity
- Better-than-expected credit offtake
- Improvements instead of expected deterioration in asset quality and loan loss coverage levels resulting in lower-than-expected cost of risk.

Sensitivity Analysis

BKMB

		Stable Period ROE				
		10.0%	11.0%	12.0%	13.0%	14.0%
Cost of Equity	10.7%	0.492	0.550	0.612	0.679	0.751
	11.7%	0.471	0.526	0.586	0.650	0.720
	12.7%	0.451	0.504	0.561	0.623	0.690
	13.7%	0.432	0.483	0.538	0.597	0.661
	14.7%	0.414	0.463	0.515	0.572	0.634

		Stable Period Retention Ratio				
		20%	25%	30%	35%	40%
Cost of Equity	10.7%	0.611	0.611	0.612	0.612	0.612
	11.7%	0.585	0.586	0.586	0.586	0.587
	12.7%	0.561	0.561	0.561	0.562	0.562
	13.7%	0.537	0.538	0.538	0.538	0.538
	14.7%	0.515	0.515	0.515	0.516	0.516

NBOB

		Stable Period ROE				
		10.0%	11.0%	12.0%	13.0%	14.0%
Cost of Equity	11.3%	0.274	0.299	0.325	0.354	0.385
	12.3%	0.266	0.290	0.315	0.343	0.373
	13.3%	0.258	0.281	0.305	0.332	0.360
	14.3%	0.250	0.272	0.296	0.321	0.349
	15.3%	0.243	0.264	0.287	0.311	0.338

		Stable Period Retention Ratio				
		20%	25%	30%	35%	40%
Cost of Equity	11.3%	0.332	0.329	0.325	0.322	0.317
	12.3%	0.321	0.318	0.315	0.312	0.307
	13.3%	0.311	0.308	0.305	0.302	0.298
	14.3%	0.301	0.299	0.296	0.292	0.289
	15.3%	0.292	0.289	0.287	0.283	0.280

ABOB

		Stable Period ROE				
		11.0%	12.0%	13.0%	14.0%	15.0%
Cost of Equity	9.3%	0.165	0.183	0.202	0.224	0.247
	10.3%	0.158	0.175	0.194	0.214	0.237
	11.3%	0.151	0.168	0.186	0.205	0.227
	12.3%	0.144	0.161	0.178	0.197	0.217
	13.3%	0.138	0.154	0.170	0.188	0.208

		Stable Period Retention Ratio				
		20%	25%	30%	35%	40%
Cost of Equity	9.3%	0.199	0.201	0.202	0.204	0.207
	10.3%	0.191	0.192	0.194	0.196	0.198
	11.3%	0.183	0.184	0.186	0.188	0.190
	12.3%	0.175	0.176	0.178	0.180	0.182
	13.3%	0.168	0.169	0.170	0.172	0.174

HBMO

		Stable Period ROE				
		10.9%	11.9%	12.9%	13.9%	14.9%
Cost of Equity	8.6%	0.109	0.123	0.138	0.154	0.172
	9.6%	0.104	0.117	0.132	0.147	0.164
	10.6%	0.099	0.112	0.126	0.140	0.157
	11.6%	0.094	0.106	0.120	0.134	0.150
	12.6%	0.090	0.102	0.114	0.128	0.143

		Stable Period Retention Ratio				
		20%	25%	30%	35%	40%
Cost of Equity	8.6%	0.136	0.137	0.138	0.139	0.141
	9.6%	0.130	0.130	0.132	0.133	0.134
	10.6%	0.124	0.124	0.126	0.127	0.128
	11.6%	0.118	0.119	0.120	0.121	0.122
	12.6%	0.112	0.113	0.114	0.115	0.117

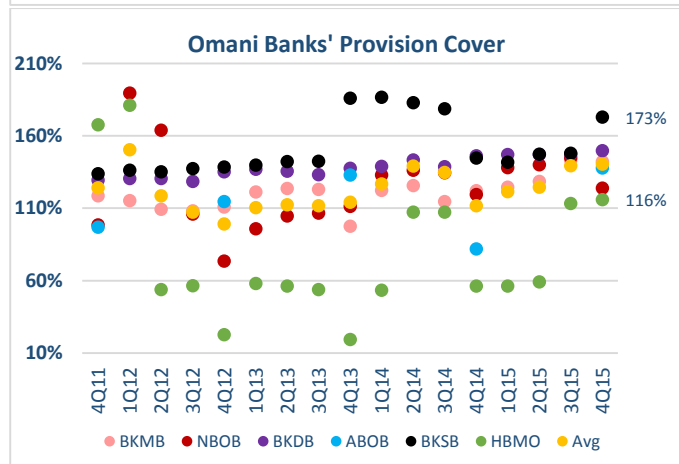
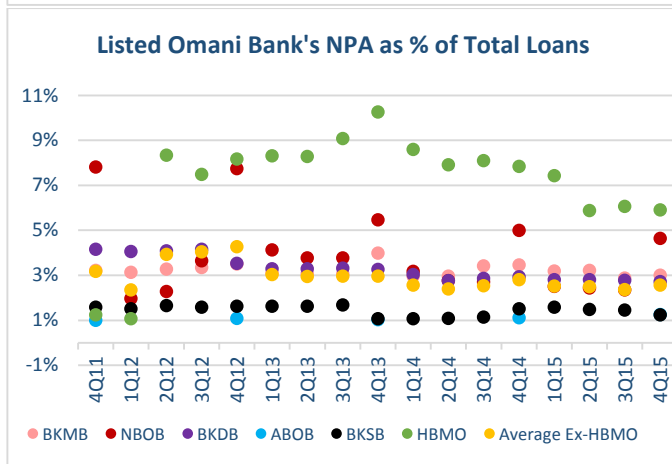
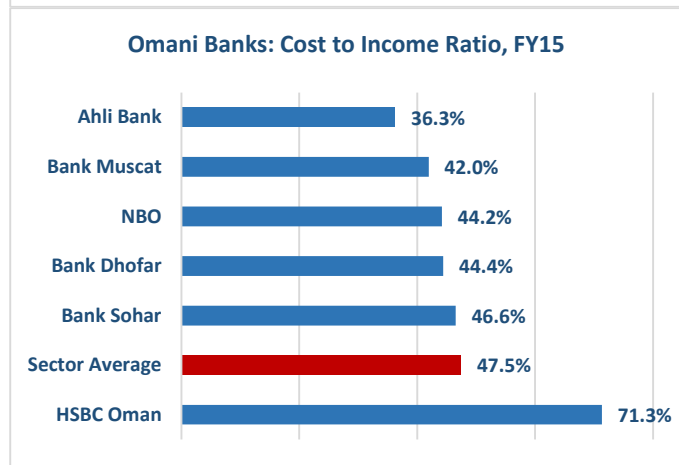
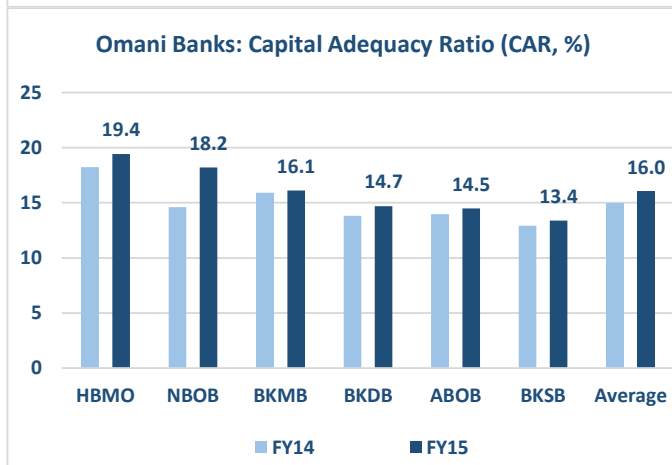
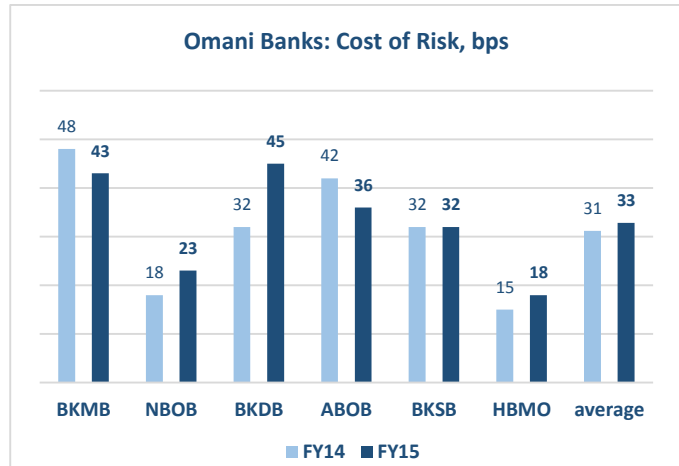
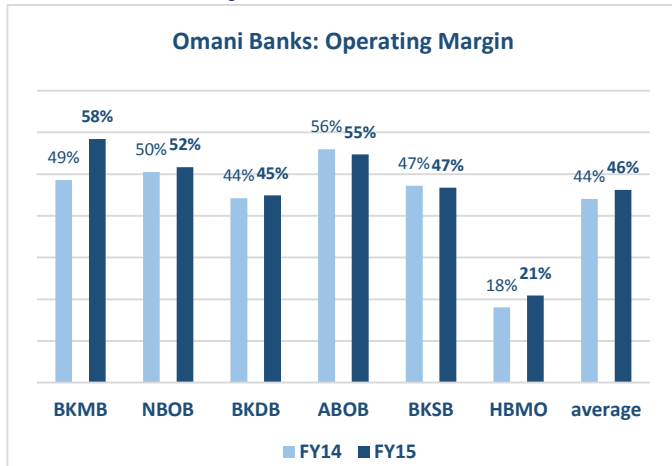
Source: Company Financials, OABInvest

Peer Group Analysis

Name	Mkt Cap (USD mn)	Last Px (LC)	Px Change (1M), %	P/B'16e, (x)	P/E'16e, (x)	ROE'16e, %	Div Yield'16e, %
COMMERCIAL BANK OF DUBAI	4,159	5.450	-3.7	1.75	14.3	16.6	3.7
AHLI UNITED BANK B.S.C	4,124	0.605	0.8	1.04	7.3	15.5	7.3
SAUDI HOLLANDI BANK	3,810	12.500	-0.4	1.07	7.2	13.4	2.8
COMMERCIAL BANK QSC	3,374	37.600	-4.8	0.76	8.9	8.8	7.5
ABU DHABI ISLAMIC BANK	3,295	3.820	-3.3	1.19	8.7	16.5	4.2
BANK ALBILAD	3,200	20.000	-3.7	1.70	13.8	11.8	2.1
BANKMUSCAT SAOG	2,622	0.404	3.6	0.66	5.5	12.6	6.2
QATAR INTERNATIONAL ISLAMIC	2,570	61.800	-3.4	1.71	14.0	14.0	6.3
UNION NATIONAL BANK/ABU DHAB	2,584	3.450	-7.0	0.57	5.8	10.4	5.6
DOHA BANK QSC	2,576	36.300	-1.1	0.98	7.9	12.6	7.6
NATIONAL BANK OF RAS AL-KHAI	2,396	5.250	-12.5	1.15	7.6	15.6	8.5
SAUDI INVESTMENT BANK/THE	2,389	12.800	-8.2	0.69	6.8	10.3	6.0
AL AHLI BANK	2,227	42.500	-7.7	1.55	13.0	13.9	3.6
BURGAN BANK	2,346	345	3.0	1.01	10.8	11.6	4.9
COMMERCIAL BANK OF KUWAIT	2,160	435	6.0	1.07	14.5	8.5	3.4
BANK DHOFAR SAOG	1,131	0.256	0.4	0.84	9.1	9.6	6.3
NATIONAL BANK OF OMAN SAOG	993	0.259	-1.1	0.76	6.9	12.8	3.8
BANK SOHAR	726	0.176	7.3	1.02	9.0	10.5	4.5
AHLI BANK	667	0.180	2.9	1.05	8.5	12.9	5.6
HSBC BANK OMAN	603	0.116	18.4	0.73	17.4	4.2	3.0
Average				1.07	9.8	12.1	5.1

Source: Bloomberg, OABInvest

Relative Comparison

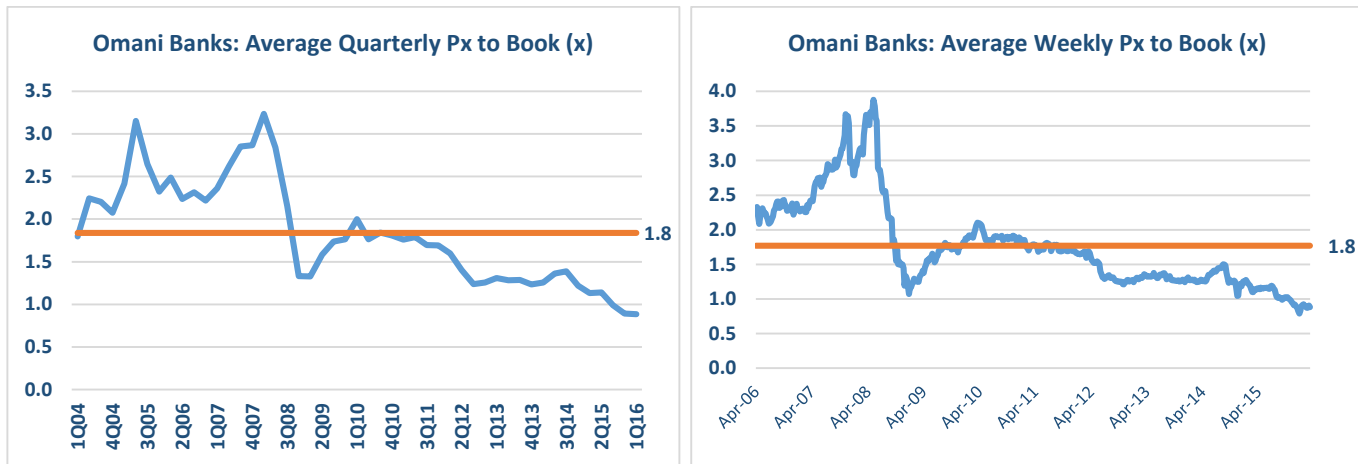


Source: Company Financials, OABinvest

Investment Thesis

The Omani Banking sector is showing a slowdown in growth in net loans & advances as well as deposits on the back of low oil prices which have driven the Government of Oman to adopt austerity measures as net oil revenues still account for roughly 63% of state revenues (for the first 11 months of FY15)², in spite of the Government’s incessant efforts to diversify revenue sources away from oil.

Nonetheless, we believe that the Omani banking sector has de-rated to 0.88x book value which is unjustified as (a) the banks’ balance sheets are much stronger now and do no warrant trading values even below post 2008-2009 or Global Financial Crisis (GFC) levels, and (b) sovereign risk is already included in the higher risk-free rate translating into higher cost of equity. In spite of very modest growth assumptions, the current trading levels for some of the stocks are unjustified, in our view, and are not supported by fundamentals.



Source: Bloomberg

A little caution goes a long way: our take on the new regulation on provisions for re-structured loans

Towards the end of FY15, CBO introduced a regulation mandating banks to make prudential specific provisions on restructured loans balances not yet classified as non-performing in the light of the current challenging economic environment. This will apply to outstanding restructured loans that have not completed satisfactory performance of one year from the first date of payment of interest or principal. This was implemented in order to take proactive measures to safeguard banks against potential and to strengthen their resilience for any future challenges.

We believe that such regulatory measures are in favor of the banking industry as these provisions are easily reversible once the loans become fully performing. Additionally, such measures only help to strengthen balance sheets of the banks.

Double-edged sword: New regulation relaxing eligibility criteria of banks’ required reserves

The CBO recently adjusted its reserves policy to ease money market conditions and encourage banks to buy government debt as the Government tries to juggle its finances and liquidity in the system. Banks are now allowed to include Government securities such as Treasury bills, Government Development Bonds (GDBs) and Government Sukuk towards meeting their reserve requirements, up to a maximum of 2% of their deposits. The move, effective from 1st April, aims to "provide greater flexibility for banks in liquidity management, credit deployment and investments", CBO’s statement said. The already existing regulation mandating banks to deposit 5% of their deposits with CBO as part of cash reserve requirement remains unchanged. Essentially, banks are now able to use their government securities in place of cash.

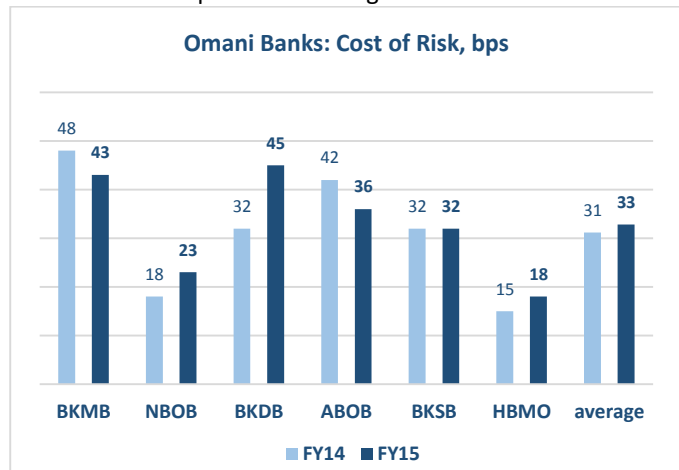
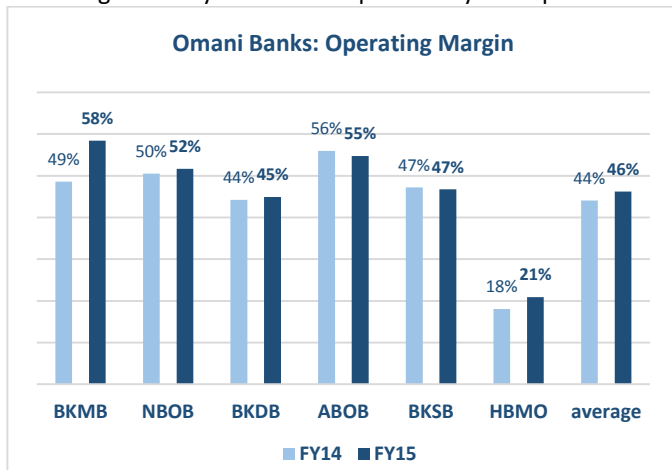
² NCSI Oman

Total deposits in Oman (including conventional and Islamic) touched OMR 19.4 bn as at the end of Feb'16, indicating that the policy change could potentially release the equivalent of ~OMR 39mn of fresh liquidity into the system.

We believe that this measure is a double-edged sword in reality. The measure is designed to encourage banks to replace cash reserves with government securities. The freed up liquidity can then be parked either in more government securities (as a new circular from CBO allows maximum investment limit in Government Development Bonds and Sukuk by licensed banks from 30% to 45% of a Bank's net worth effective from 1st April 2016) or private lending or both. This might lead to an increase in risk-weighted assets of the banks and might prove credit negative in the short to medium term. Also, the change in reserve eligibility reflects the Omani government's ever increasing borrowing needs to finance state budget with OMR 100mn worth of GDBs issued till Feb'16, OMR 500mn in FY15 and a Sukuk worth OMR 250mn vs. OMR 200mn bond issuance in FY14. The move is also aimed at easing gradual liquidity tightening in the Omani banking system as economic growth slows.

Cost control is key in an overall economic slowdown

In our view, banks which are able to improve efficiency in a slow economic growth environment will be better off in the short to medium term. We have assumed a modest growth in operating income across the sector, hence keeping operating costs under control is key to maintaining profitability at current levels in order to enhance shareholder value. Additionally, focus on minimizing or timely detection of potentially delinquent loans will also have an impact on reducing cost of risk for the banks.



Source: Company Financials, OABinvest

Sector Dynamics & Outlook

Oman's finances have been hit hard due to international oil price plunge since 2014. The country recorded a budget deficit of OMR 4.07 bn³ in the first 11 months of FY15 from a surplus of OMR233.4 mn a year earlier. In order to partially offset the deficit, Oman has introduced several austerity measures like spending cuts, tax increases and fuel subsidy reforms.

The International Monetary Fund (IMF) lowered its forecast for Oman's economic growth this year as it expects oil prices to remain low for longer and global growth to continue at a sluggish pace. IMF expects the sultanate's economy to grow by 1.8% in 2016, a percentage point down from 2.8% it had previously forecast in October 2015. The Fund projects Oman's economy to expand 1.7% in 2017.

Oman has an extended domestic borrowing programme, including regular Treasury bill auctions. This Government borrowing has added pressure to already declining liquidity in the local banking system and has therefore forced the government to raise money international markets. Recent news flows indicate that Oman is at an advanced stage of issuing an international bond worth up to USD 10 bn. We believe that this will auger well for the economy as it will inject a dose of much needed liquidity into the system, encouraging fiscal expansion through a revival of Government spending.

The country's banking sector, like its counter-parts within the wider GCC and MENA region, is faced with twin pressures of Government austerity measures leading to muted credit growth as well as rising cost of debt on the back of tightening liquidity conditions together with rising US Fed policy rates feeding into the economy due to USD pegs.

Omani Banking Sector: Credit Growth is outpacing Deposit Growth

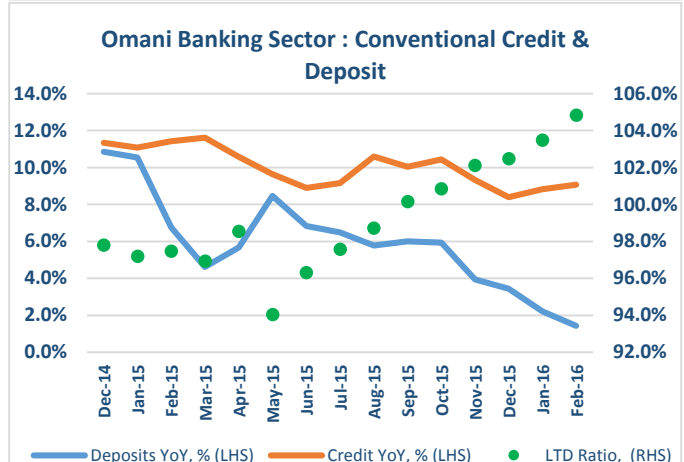
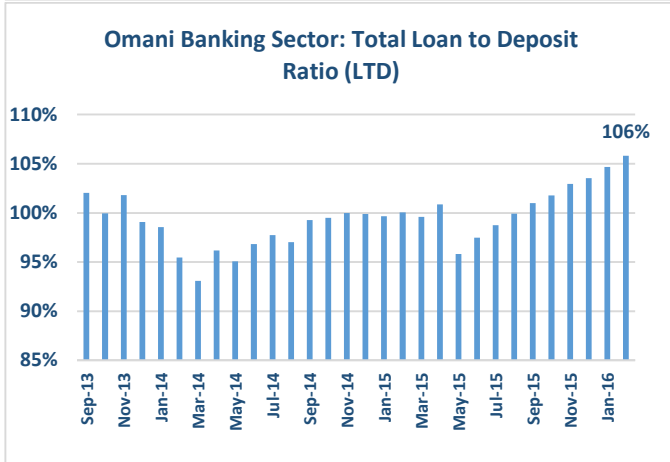
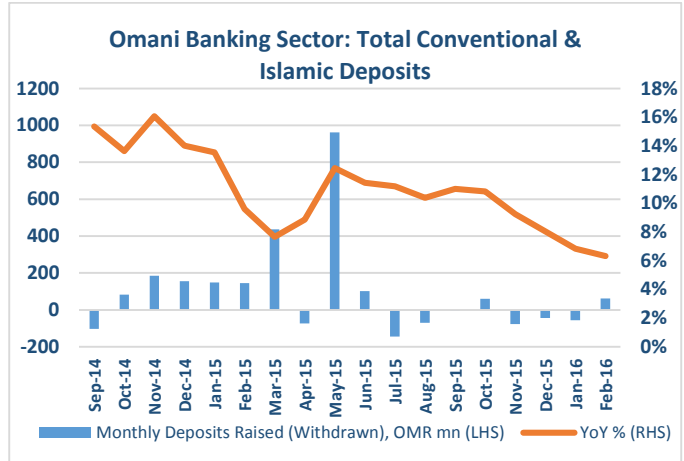
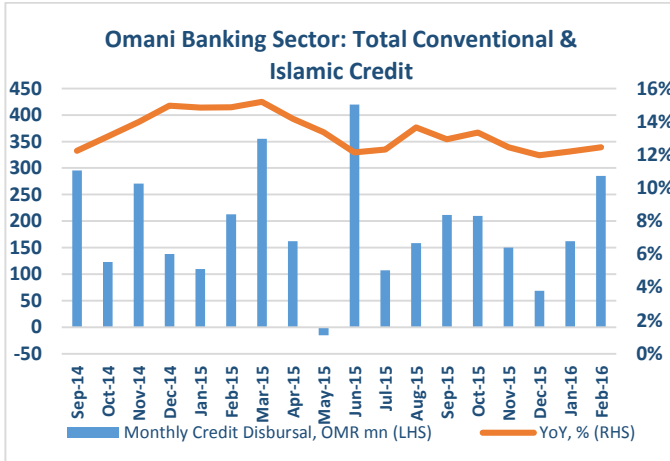
The total credit of the Omani Banking sector is OMR 20.1bn as of Dec'15 i.e. 76.6% of the expected GDP of Oman at OMR 26.24bn for FY15. Of this total credit, the conventional banks account for OMR 18.3bn or 91%. Oman's conventional banks' credit rose by 8.4%YoY as at the end of FY15. The total deposits of the entire sector, including Islamic banks & Islamic Windows of conventional banks, stood at OMR 19.42bn as at the end of FY15, +8.04% YoY. Of this, OMR 17.9bn (+3.44% YoY) belonged to the conventional banks.

The total credit⁴ within the Omani Banking sector is still expanding at a robust pace, albeit slowly at 12%YoY as at the end of Feb'16 vs. >14% as at the end of Feb'15. We believe that going forward, total credit expansion will slow down to low- to mid-single digit for FY16 and FY17, with further slowing down in the subsequent years in case of persistent low oil prices. This total credit expansion, however, outpaced total deposit growth which is a cause for concern for us, as we observe the yearly growth rate in deposits to fall down to 6% putting upward pressure on Credit-to-Deposit Ratio (at 106% at the end of Feb'16).

Within the conventional banking space, credit disbursement is slowing down but still, as expected, outpacing deposit growth. As at the end of Feb'16, Omani conventional banks' total credit stood at OMR 18.69 bn (+1.4% MoM; +9.1%YoY) and total deposits stood at OMR 17.83 mn (+0.1%MoM, +1.4%YoY). Loan-to-deposit ratio (LTD) stood at 104.8%, the highest since November 2012. During Feb'16, there was a disbursement of credit worth OMR 251mn, with extension of credit worth OMR 253.6 mn to the private sector and OMR 5.2mn to the public enterprises, slightly offset by the credit contraction of OMR 4.92 mn to the Government and OMR 2.44 mn to Non-residents. During Feb'16, there was an increase in deposits worth OMR 11 mn, mainly due to an increase of OMR 99mn worth of public deposits, which partially offset the decline of OMR 54mn worth of deposits from the private sector, a decline of OMR 21mn worth of Government deposits and a decline of OMR 13mn worth of non-resident deposits.

³ NCSI Oman

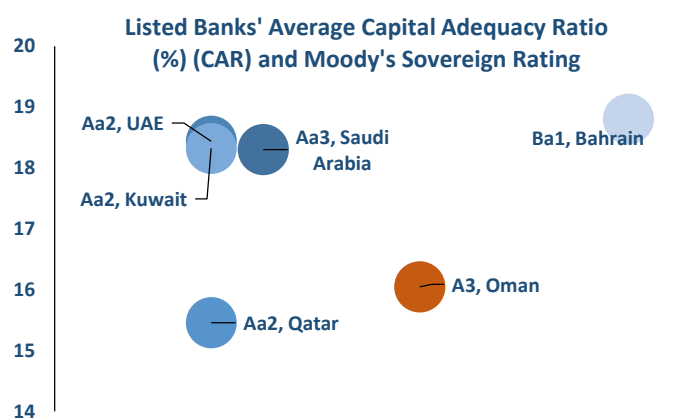
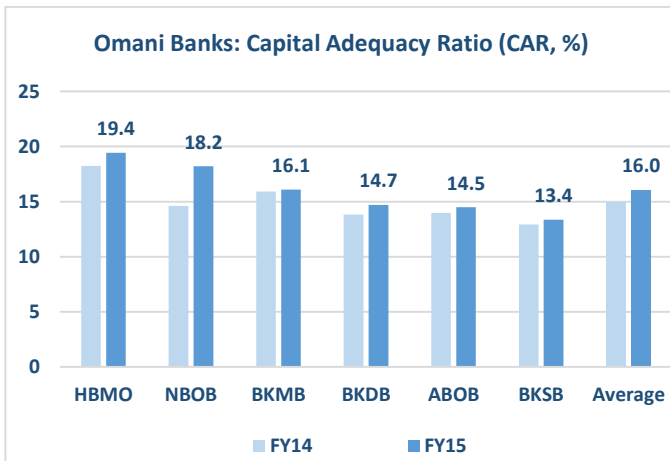
⁴ Includes Conventional & Islamic Banks as well as Islamic windows of conventional banks



Source: Central Bank of Oman, Feb'16 numbers are provisional

Omani Banking Sector: well-capitalized, above minimum thresholds set by regulatory body

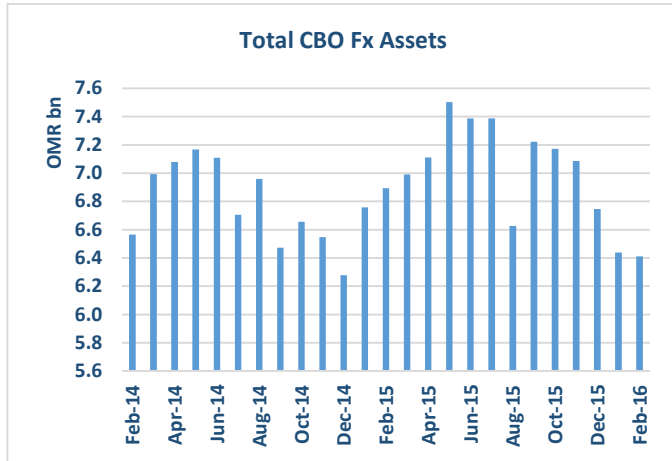
As per our data, the six listed Omani banks are well capitalized with the average Capital Adequacy Ratio (CAR) at 16.1% and average Tier 1 capital at 15.9% as at the end of FY15. The CBO minimum requirement for CAR is 12.625% and for Tier 1 capital is 7.625%. The banking system of Oman with a lending ratio of 80.6% in Jan'16, up from 77.4% in Dec'14, still remains well below the lending ratio limit of 87.5% (stipulated by the CBO on 1st January 2009). The CBO includes customer deposits as well as net balances due to banks abroad & capital funds as part of deposit base for lending ratio calculation.



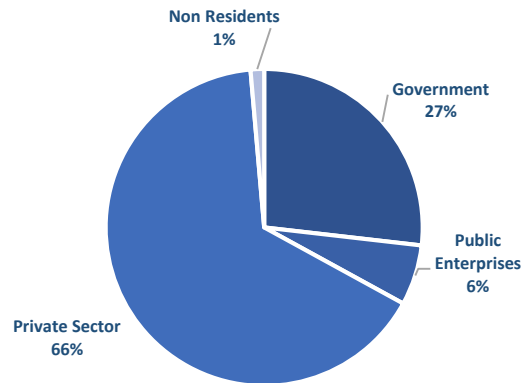
Source: Bloomberg, Company Financials, OABInvest

Tightening liquidity conditions -Key things to watch: Government & public sector deposits, Central Bank FX reserves

Currently, the Central Bank’s foreign currency assets are on the decline but still well-above OMR 6bn indicating ample reserves but declining liquidity. The Government and public sector together comprise OMR 6.4bn or 33% of the total deposit base in Feb’16, down from 36% in Jun-Sep’15, which could be a cause for concern going forward but is currently more than offset by the private sector and non-resident deposit growth momentum.



Omani Banking Sector: Deposit Composition, Feb'16

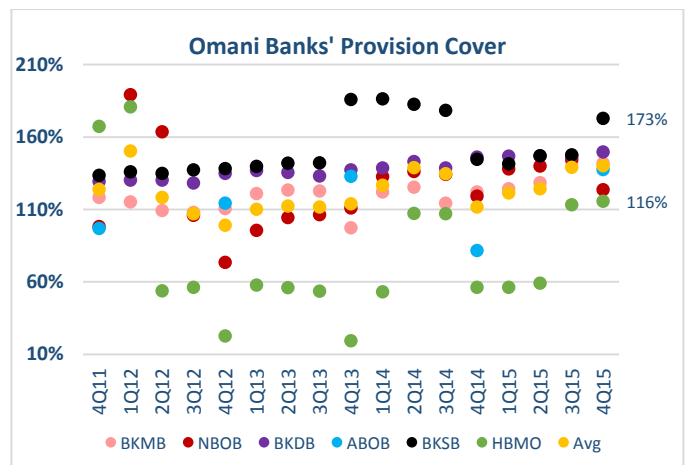
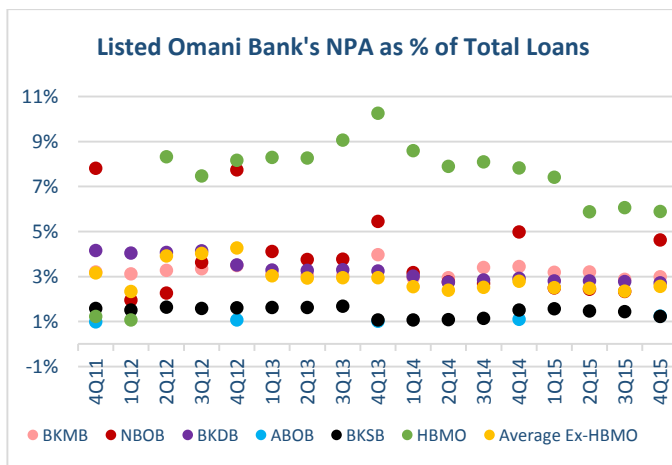


Source: CBO

Non-performing assets on our watch-list

As at FY15, non-performing assets (NPAs) ratio of HSBC Oman (HBMO) was the highest at 6% which is higher than the average of the rest of the Omani banks in our coverage universe which hovers around 3%. But at the same time, HBMO has adequately provided for its NPAs with provision cover being 116% albeit lowest amongst the six banks with average at 140%. The provision cover for all banks is above 100%, indicating adequate provisioning.

Nonetheless, we believe that there will upward pressure on NPAs in the short to medium term as there is lag in adjustment to the new norm of Government’s austerity measures as well as tight liquidity leading to rising cost of debt which burdens corporates and individuals alike and with added pressure of economic slowdown might translate into delinquent loans & advances.



Source: Bloomberg, Company Financials

Therefore, we have increased the cost of risk for each bank incrementally over the first couple of years during the forecast period before leveling it out at a higher level for the remaining forecast period.

Bank Muscat SAOG

TP: OMR 0.561/share

Recommendation

BUY

Bloomberg Ticker	BKMB OM
Reuters Ticker	BMAO.OM
Current Market Price (OMR)	0.404
52wk High / Low (OMR)	0.55/0.358
12m Average Vol. (000)	1,341
Mkt. Cap. (USD/OMR mn)	2622/1008.5
Shares Outstanding (mn)	2,496.2
Free Float (%)	65%
3m Avg Daily Turnover (000)	683
6m Avg Daily Turnover (000)	903
PE 2016e (x)	5.5
PBv 2016e (x)	0.7
Dividend Yield (%)	6.2%

Price Performance:

1 month (%)	3.59
3 month (%)	-4.46
12 month (%)	-20.56

Price Volume Performance



Source: Bloomberg

Ayisha Zia

Research Analyst

a.zia@oabinvest.com

Tel: 00968 – 2475 4328

- **Largest Bank in Oman with a market share of 45.5% in terms of assets as of Dec'15, a significant customer base in excess of 1.76 mn clients**
- **Solid Capital Position, CAR of 16.10% as of 31st Dec 2015**
- **Highest Government Ownership among Omani Banks; Direct & indirect combined at 38.5%**
- **Net profit expected to grow at a CAGR of 5.7% between 2015-2020**

We reiterate BUY rating on Bank Muscat with a reduced target price of OMR 0.561 per share, still implying a steep upside of ~40% to the last closing price due to a significant de-rating since the peak of 2014 on the back of the ongoing economic downturn. Our target price implies a P/e'16e of 7.6x, and P/b'16e of 0.92. We believe that this fair value is justified because the inevitable constraint on profitability growth over the forecast horizon in lieu of muted credit offtake along with pressurized interest margins still does not justify the large de-rating of the stock.

Valuation & Outlook

We expect the bank to have a muted loan-book growth (at 3.4% CAGR over 2016-2020) on the back of slower growth in GDP than that achieved in FY14 on the back of deposit growth constraints. Our modest assumption is based on the current weak fiscal scenario. We expect the bank's capital ratios to remain firm and above some of the regional peers, even though there will be an upward pressure on NPAs in the medium term. We expect the bank to maintain payouts at FY15 levels in order to maintain capital adequacy ratios.

Key Risks to Valuation

Key downside risks to our valuation include:

- Slower-than-expected credit offtake
- Worse-than-expected asset quality deterioration as well as reduction in loan loss coverage levels

Key upside risks to our valuation include:

- Better-than-expected loan growth resulting in higher interest income
- Improvements in asset quality and loan loss coverage levels rather than deterioration (We expect cost of risk to sequentially rise through FY16-FY18 before leveling out)

Key Indicators

Year	FY14	FY15	FY16e	FY17e	FY18e
Total Net Loans (OMR mn)	6,386	6,695	6,930	7,165	7,402
Total Customer Deposits (OMR mn)	6,628	7,363	7,883	8,412	8,827
Operating Income (OMR mn)	383	408	447	479	508
Net Profit (OMR mn)	163	175	184	196	206
Diluted EPS (OMR)	0.075	0.077	0.074	0.071	0.072
Diluted BVPS (OMR)	0.563	0.601	0.610	0.612	0.610
P/E (x)	8.4	6.9	5.5	5.7	5.6
P/BVPS (x)	1.1	0.9	0.7	0.7	0.7
Dividend Yield (%)	4.0%	4.7%	6.2%	7.4%	7.4%

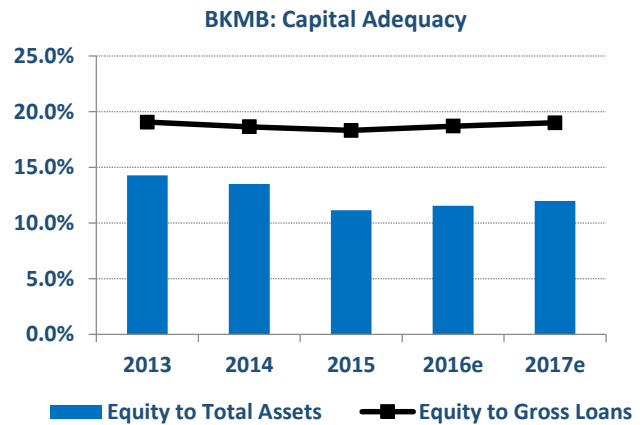
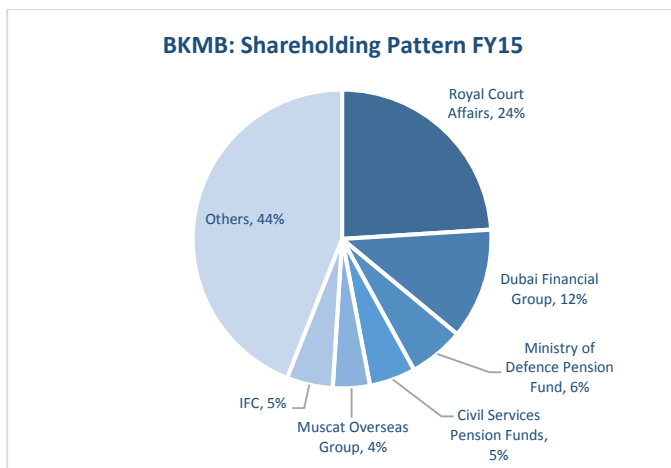
Source: Company Financials, OABInvest

Profitability supported by largest corporate and retail networks within Oman

BKMB has a leading position in corporate in the Omani banking space, with a profit contribution of 38% of total net profit of OMR 175mn in FY15. It also has a strong retail banking franchise (at c31% of FY15 net profit), which contributes significantly to the bank's profitability and we expect that it will continue to be key driver of stability in the bank's profits over our forecast horizon. Key drivers for retail banking growth include favorable demographics with over 49% of the population less than 25 years old and a cultural tendency to have nuclear families (requiring housing finance in many cases), product innovation etc.

High probability of government support if bank comes under duress

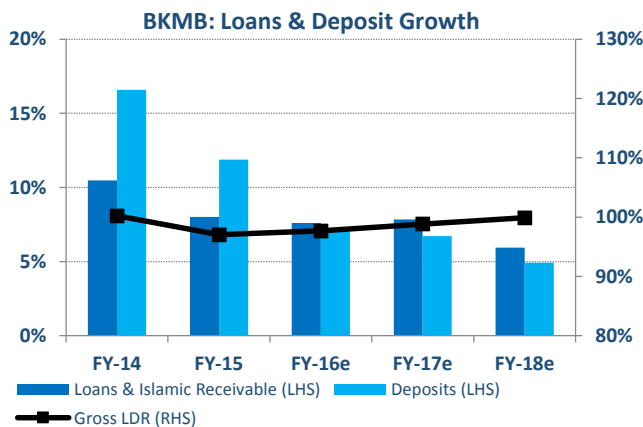
As the largest lender in Oman and largest in terms of deposits (at 33% and 38% respectively), BKMB is undoubtedly the most important bank within the country. Given its systemic importance and substantial Oman government direct as well as indirect ownership (~40%), we believe that the bank stands to readily receive sovereign support if it is to come under duress.



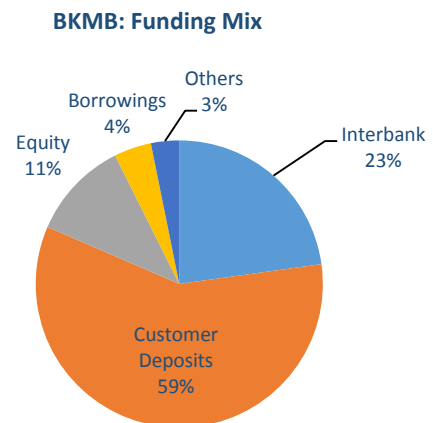
Source: Company Financials, OABINVEST, Company Website

Loan growth at par with sector

Bank Muscat's net loans grew by 11.9%YoY (sector: 12.4%YoY) in FY15 with strong growth in Islamic banking receivable which grew by 59%YoY in FY15. Conventional lending grew by 4.9% since end 2014, mainly due to auto loans and credit cards. We believe that this growth momentum will slow down further to 3.5% in FY16 and lower from thereon.



Source: Company Financials, OABinvest

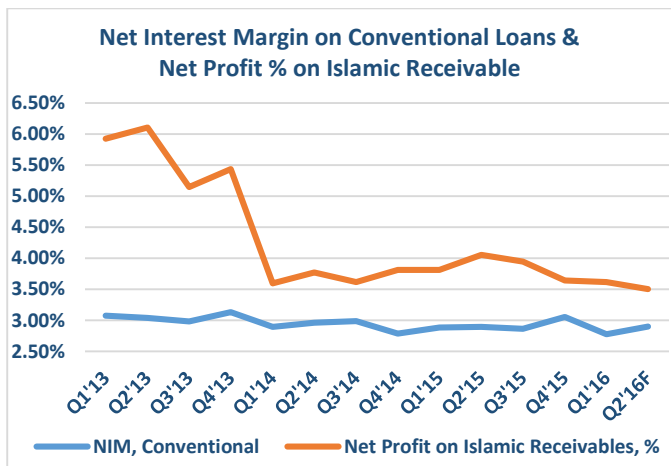


Funding mix provides ability to grow opportunistically

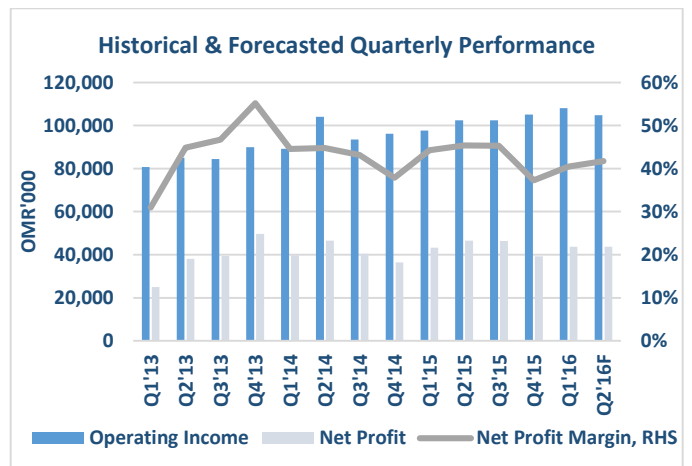
Borrowings represent 4% of total liabilities and equity of Bank Muscat. The bank is heavily reliant on interbank borrowings and customer deposits for growing its asset base. In the current economic scenario we expect customer deposits to remain flat or even decline by 1% YoY, hence the bank’s ability to grow its balance sheet is limited until it diversifies its sources of funding. Currently, Bank Muscat successfully closed a 5 year, USD 500 mn bond issuance under its Euro Medium Term Note (EMTN) programme with regional and international investors. The deal carried a coupon of 3.75%. The bonds will be listed on the Irish Stock Exchange and governed under English law. Bank Muscat’s previous 5 year, USD 500 million bond issuance EMTN issuance in 2013 was priced at Mid Swaps plus 170bps.

Financial performance highlights for 1Q16

Bank Muscat reported its financials for 1Q16, reporting a net profit of OMR 43.8mn (+1.2%YoY and +11.7%QoQ). The bank’s net interest income (including Islamic) was lower than our expectation by 3.5% in lieu of higher than expected net loans& advances and even higher deposits, but the bank surprised on other operating income with OMR 40mn vs OABe 34.1mn. Operating expenses were largely in line with our estimates as well as the provision for credit losses, but slower-than-expected recoveries and smaller share of profit from associates together with a larger tax charge weighed down on earnings.



Source: Company Financials, OABinvest



The bank’s customer deposits’ growth surprised positively at 12.1%YoY and 3.9%QoQ and outpaced net loans growth resulting in a 0.4 percentage points (pps) reduction in loan-to-deposit ratio from 99.5% in 4Q15. Net loans & advances (including Islamic financing) grew by 9.8%YoY and 3.4%QoQ.

Key Financials							
<i>(OMR mn)</i>	2013	2014	2015	2016e	2017e	2018e	2019e
Income Statement							
Interest/Financing Income	334.0	345.0	358.4	388.1	418.1	446.3	469.2
Interest Expense/Payment to Depositors	(98.6)	(101.3)	(97.8)	(121.0)	(128.2)	(135.2)	(140.9)
Net Interest/Financing Income	235.3	243.6	260.5	267.1	289.8	311.1	328.3
Fee & Commission Income	81.2	93.9	102.8	125.7	131.9	137.7	143.0
Other Income	23.7	45.6	44.4	54.3	57.0	59.5	61.8
Total Non-Interest/Financing Income	104.8	139.5	147.2	180.0	189.0	197.2	204.8
Total Operating Income	340.2	383.1	407.7	447.2	478.8	508.3	533.1
Provisions expense	(21.6)	(39.0)	(39.2)	(49.1)	(53.2)	(57.1)	(60.2)
Operating Expenses	(143.7)	(157.9)	(171.1)	(188.5)	(202.8)	(216.3)	(227.9)
Profit Before Taxation	174.9	186.3	197.5	209.6	222.8	234.9	245.0
Taxation & Minority Interest	(22.7)	(23.0)	(22.1)	(25.5)	(27.1)	(28.6)	(29.8)
Net Profit Attributable to Parent	152.2	163.2	175.5	184.0	195.7	206.3	215.2
Balance Sheet							
Cash Balances	582	837	2,412	2,315	2,198	2,125	2,083
Deposits with Banks & FIs	867	1,039	991	1,067	1,151	1,219	1,274
Gross Loans & Financings	6,360	7,045	7,628	8,201	8,836	9,356	9,774
Loan Loss Reserve	(218)	(259)	(298)	(313)	(330)	(345)	(358)
Net Loans & Financings	6,143	6,786	7,330	7,887	8,506	9,011	9,416
Investment in Associates	37	47	48	48	48	48	48
Net Fixed Assets	67	72	77	80	85	89	94
Other Assets	791	947	1,686	1,886	2,032	2,154	2,252
Total Assets	8,486	9,728	12,545	13,284	14,020	14,646	15,166
Deposits from Banks & FIs	669	889	2,860	2,931	2,990	3,049	3,110
Deposits from Customers	5,693	6,628	7,363	7,883	8,412	8,827	9,134
Other Borrowings	511	493	526	497	464	465	467
Other Liabilities	401	407	398	439	471	497	518
Paid-up Capital	215	218	229	250	276	287	297
Retained Earnings	203	242	296	393	497	590	687
Other Reserves	794	851	872	890	910	930	952
Shareholders' Equity	1,212	1,312	1,397	1,533	1,683	1,807	1,936
Minority Interest	0.22	-	-	-	-	-	-
Total Equity & Liability	8,486	9,728	12,545	13,284	14,020	14,646	15,166
Cash Flow Statement							
Cash from operations	(103)	336	1,649	(3)	(19)	28	65
Cash from investing activities	(1)	27	16	16	18	19	21
Cash from financing	21	(54)	(58)	(78)	(80)	(82)	(86)
Net changes in cash	(81)	255	1,575	(97)	(117)	(73)	(43)
Cash at the end of period	582	837	2,412	2,315	2,198	2,125	2,083
Key Ratios							
Return on Average Assets	1.9%	1.8%	1.6%	1.4%	1.4%	1.4%	1.4%
Return on Average Equity	13.4%	12.9%	13.0%	12.6%	12.2%	11.8%	11.5%
Recurring Income/Operating Income	93.0%	88.1%	89.1%	87.8%	88.1%	88.3%	88.4%
Interest Earning/Financing Assets Yield	4.5%	4.2%	3.8%	3.7%	3.7%	3.7%	3.7%
Cost of Funds	1.5%	1.4%	1.0%	1.1%	1.0%	1.0%	1.0%
Net Spread	3.0%	2.8%	2.8%	2.7%	2.6%	2.6%	2.6%
Cost to Income Ratio	42.2%	41.2%	42.0%	42.2%	42.4%	42.6%	42.8%
Net Loans to Customer Deposits	105.6%	101.4%	99.4%	100.3%	101.7%	103.0%	104.3%
NPLs to Gross Loans	2.8%	3.0%	3.0%	3.2%	3.2%	3.2%	3.2%
NPL Coverage	129.2%	129.4%	142.1%	128.3%	128.3%	128.3%	128.3%
Cost of Risk (bps)	29.2	48.3	42.6	47.9	48.1	48.3	48.4
Equity to Total Assets	14.3%	13.5%	11.1%	11.5%	12.0%	12.3%	12.8%
Dividend Payout Ratio	56.6%	60.3%	39.3%	39.0%	47.3%	46.7%	46.4%
Adjusted EPS (OMR)	0.071	0.075	0.077	0.074	0.071	0.072	0.072
Adjusted BVPS (OMR)	0.518	0.563	0.601	0.610	0.612	0.610	0.630
Market Price (OMR) *	0.614	0.628	0.530	0.404	0.404	0.404	0.404
Dividend Yield	5.8%	4.0%	4.7%	6.2%	7.4%	7.4%	7.4%
P/E Ratio (x)	8.7	8.4	6.9	5.5	5.7	5.6	5.6
P/BV Ratio (x)	1.2	1.1	0.9	0.7	0.7	0.7	0.6

* Market price for 2016 and subsequent years as per latest closing price of 10/05/2016

Source: OABInvest, Company Financials

National Bank of Oman SAOG

TP: OMR 0.305/ share

Recommendation	ACCUMULATE
Bloomberg Ticker	NBOB OM
Reuters Ticker	NBO.OM
Current Market Price (OMR)	0.259
52wk High / Low (OMR)	0.33/0.195
12m Average Vol. (000)	312
Mkt. Cap. (USD/OMR mn)	993/382
Shares Outstanding (mn)	1,474.8
Free Float (%)	39%
3m Avg Daily Turnover (000)	112
6m Avg Daily Turnover (000)	101
PE 2016e (x)	6.7
PBv 2016e (x)	0.7
Dividend Yield (%)	3.9%

Price Performance:

1 month (%)	-1.15
3 month (%)	5.52
12 month (%)	-9.84

Price Volume Performance


Source: Bloomberg

Ayisha Zia

Research Analyst

a.zia@oabinvest.com

Tel: 00968 – 2475 4328

- **Robust Capital Adequacy with CET1 Ratio at 12.4%, Tier 1 at 16.3%, and CAR at 18.2%**
- **Superior ROE at 13.2% vs sector average of 10.4%**
- **Record net profit in FY15 at OMR 60.1mn, expected CAGR of 7% between 2015-2020**
- **Actively pursuing diversification of income sources with focus on fee-based income**

We maintain our rating on National Bank of Oman (NBOB) at ACCUMULATE with a reduced target price of OMR 0.305 per share, which implies an ~18% upside to the current closing price. Our target price implies a PE'16e of 7.9x and PB'16e of 0.87. We believe that this fair value is justified because of the constraint on underlying profitability growth over the forecast horizon due to slower credit offtake and pressurized NIMs.

Valuation & Outlook

We believe the bank will be able to achieve a ~6% growth in its net loans in FY16, due to a stretched Loan-to-Deposit ratio at 110% (1Q16) within the peer-group average at 102% providing limited room for further leverage. However, the bank has raised OMR 115.5mn in terms of Tier 1 Perpetual bond securities, garnering its CAR at 18.2% in FY15 vs. 14.6% in FY14, providing room for growth.

NIMs will however be under pressure, although once again the bank will be at an advantage with reduced cost of funding through a robust funding mix. The bank has also locked in lower interest rate (7.875%) in a rising interest rate environment through its perpetual bond issuance in Nov'15 to support growth and investment.

Key Upside Risks to Valuation

The key upside risks to valuation include a slower-than-expected credit offtake, worse-than-expected asset quality deterioration as well as reduction in loan loss coverage levels, and costs outpacing income growth.

Key Downside Risks to Valuation

The key downside risks to valuation include better-than-expected loan-book growth leading to better-than-expected interest income growth, better-than-expected growth in fee income.

Key Indicators

Year	FY14	FY15	FY16e	FY17e	FY18e
Total Net Loans (OMR mn)	2,317	2,534	2,675	2,755	2,810
Total Customer Deposits (OMR mn)	2,178	2,250	2,412	2,411	2,446
Operating Income (OMR mn)	114	136	149	157	165
Net Profit (OMR mn)	50	60	66	71	74
Diluted EPS (OMR)	0.041	0.043	0.039	0.037	0.035
Diluted BVPS (OMR)	0.297	0.384	0.350	0.339	0.327
P/E (x)	9.0	7.2	6.7	7.0	7.4
P/BVPS (x)	1.3	0.8	0.7	0.8	0.8
Dividend Yield (%)	2.7%	3.2%	3.9%	3.9%	3.9%

Source: Company Financials, OABInvest

Robust Capital buffers

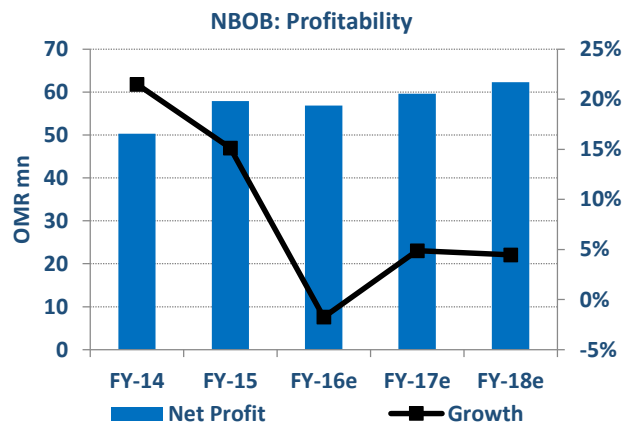
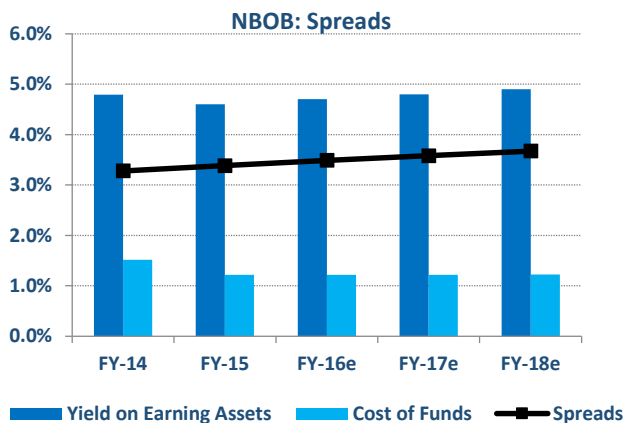
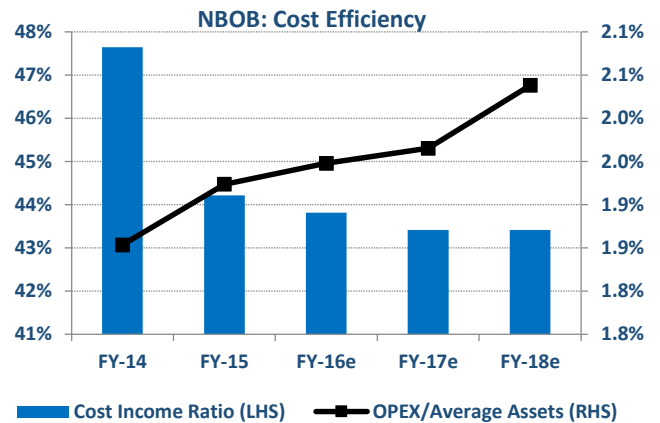
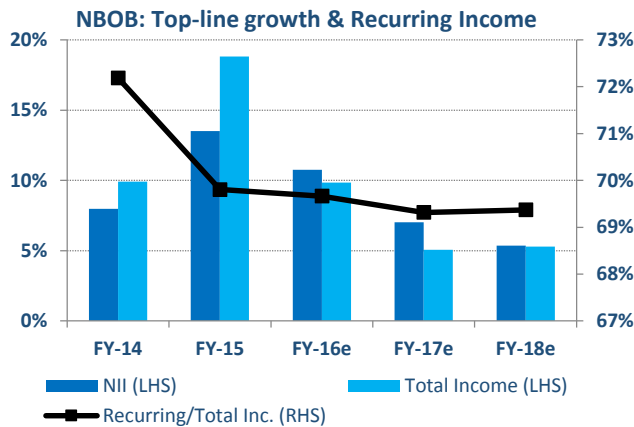
With a Tier 1 capital ratio of 16.3% and a Total Capital ratio of 18.2% as at FY15, NBO’s capitalization is robust and is higher than most banks under our coverage in Oman, providing it with ability to grow.

Record underlying profitability growth in FY15

The bank delivered a record performance in 2015 with net profit of OMR 60.1 mn (2014: OMR 50.3 mn), +20%YoY, demonstrating strong results in line with the Bank’s strategy of expansion and ambition to deliver sustainable growth. This increase is due to a strong growth in income – both funded and non-funded. Net interest income from conventional banking and revenues from Islamic financing activities grew by 15%YoY to OMR 94.7 mn, while loans and advances grew by 9%YoY, demonstrating the Bank’s strong asset/liability management. Lower deposit costs and a better asset mix have enabled the Bank to maintain its spreads at a time when asset yields were falling rapidly and margins were under pressure. Total non-interest income grew by 29 per cent to OMR 41.0 mn, reflecting the Bank’s well-diversified income streams. Total income as a result grew by a healthy 19 %YoY against a backdrop of challenging market conditions in 2015. Operating expenses increased by 10% to OMR 60 mn. This growth was largely the result of investments in the Bank’s human capital, branding/publicity and other technology infrastructure in Oman and the UAE. Net impairment on assets increased by 174%YoY to OMR 6.4 mn in 2015, due to the recent Central Bank regulations that have mandated Banks to make additional provisions on restructured accounts. As a result, the Bank’s coverage ratio has increased to 153%in December 2015 (2014: 142%). Non-performing loans (NPLs) at the end of the period were at an acceptable level of 1.9% (2014: 2.0%).

UAE business continues to outshine

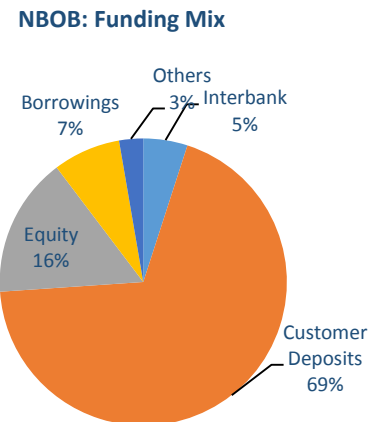
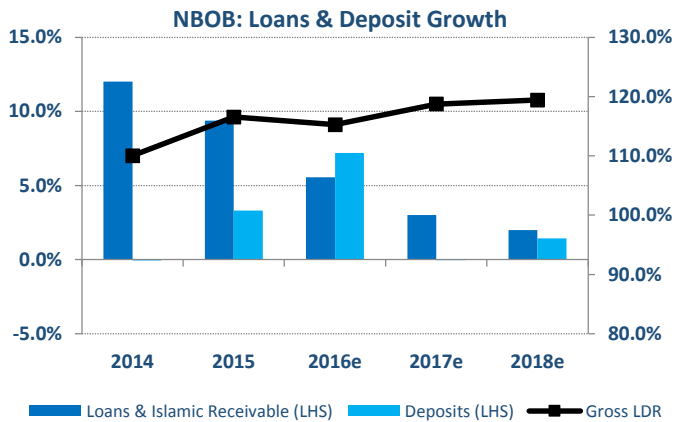
The bank continues to witness strong growth in its UAE operations by leveraging its international presence. Loans and advances grew by 79%YoY in FY15 and net profit grew by 129%YoY in FY15. The bank has been granted permission to open an office in Jebel Ali; this expansion will support the UAE business’ growth in FY16 and beyond.



Source: Company Financials, OABinvest

Loan growth

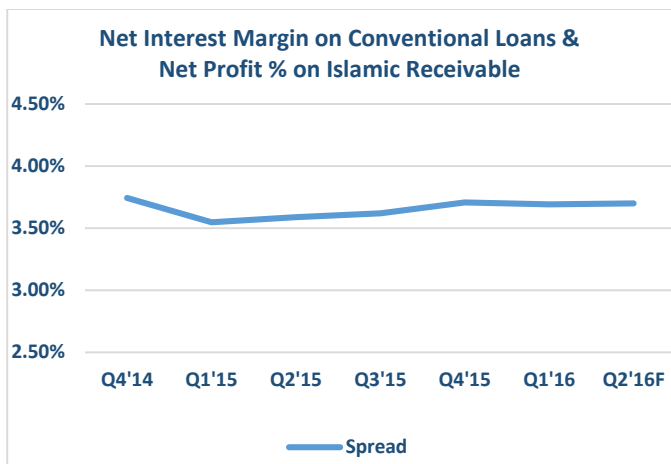
NBO's net loan growth has outpaced deposit growth in FY15, as has been the case for most banks within Oman. We believe that net loans growth will be better than the sector average as the bank can leverage the additional capital it has recently raised but this growth will nonetheless be restrained on the back of slower growth pace expected in deposit base. We expect net loans to grow at a CAGR of 2.5% between 2015 and 2020.



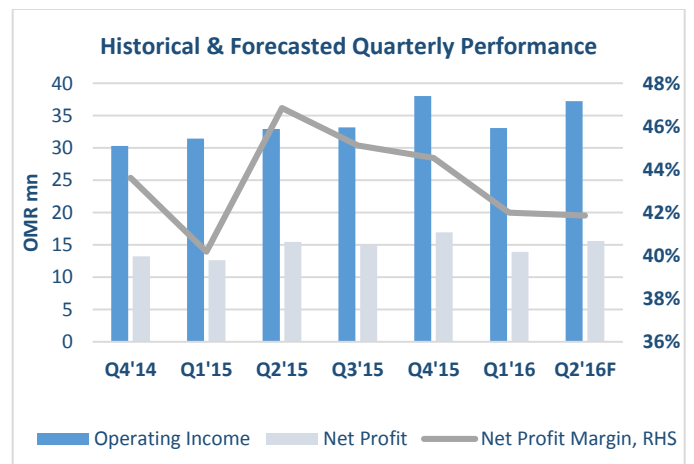
Source: Company Financials, OABinvest

Financial performance highlights for 1Q16

NBO posted a lackluster performance for 1Q16, with a net profit of OMR 13.9mn, +9.7%YoY and -12.1%QoQ vs. OABe of OMR 20.7mn. The bank was able to grow its net loans & advances by 10%YoY and 3.6%QoQ, which is slightly better than expected, and was able to grow its customer deposits by 6.4%QoQ (-1.9%YoY) vs. our expectation of a marginal quarterly decline in deposits, which comes as a positive surprise. This indicated an erosion of net interest margin as the bank's net interest income (including Income from Islamic financing) was ~5% below our expectation. Operating expenses have been maintained at 2015 levels.



Source: Company Financials, OABinvest



Key Financials

(OMR mn)	2013	2014	2015	2016e	2017e	2018e	2019e
Income Statement							
Interest/Financing Income	117.0	119.6	125.9	136.9	145.4	151.8	156.9
Interest Expense/Payment to Depositors	(42.0)	(37.1)	(31.1)	(33.1)	(34.1)	(34.5)	(35.0)
Net Interest/Financing Income	75.0	82.5	94.7	103.9	111.2	117.3	121.9
Fee & Commission Income	10.9	14.3	18.6	20.0	20.8	21.3	21.7
Other Income	18.1	17.5	22.4	25.2	27.2	29.2	31.6
Total Non-Interest/Financing Income	29.0	31.8	41.0	45.2	48.1	50.5	53.3
Total Operating Income	103.9	114.2	135.7	149.1	159.3	167.8	175.2
Provisions expense	(8.4)	(2.3)	(6.3)	(7.7)	(9.3)	(11.0)	(12.5)
Operating Expenses	(48.6)	(54.4)	(60.0)	(65.3)	(68.0)	(71.6)	(74.7)
Profit Before Taxation	47.0	57.5	69.4	76.1	82.0	85.3	88.0
Taxation	(5.6)	(7.2)	(9.3)	(10.2)	(10.6)	(11.0)	(11.3)
Net Profit	41.4	50.3	60.1	65.9	71.4	74.3	76.7
Balance Sheet							
Cash Balances	368	289	304	327	271	279	342
Deposits with Banks & FIs	229	145	171	180	186	190	192
Gross Loans & Financings	2,157	2,396	2,622	2,780	2,863	2,920	2,949
Loan Loss Reserve	(89)	(79)	(88)	(105)	(108)	(110)	(111)
Net Loans & Financings	2,068	2,317	2,534	2,675	2,755	2,810	2,838
Net Fixed Assets	20	23	35	36	32	33	31
Other Assets	211	202	219	226	233	237	240
Total Assets	2,896	2,976	3,263	3,444	3,477	3,550	3,643
Deposits from Banks & FIs	226	102	163	174	174	177	179
Deposits from Customers	2,179	2,178	2,250	2,412	2,411	2,446	2,482
Other Borrowings	80	259	364	364	364	364	364
Other Liabilities	83	76	88	95	95	96	97
Paid-up Capital	111	122	134	147	162	178	196
Retained Earnings	66	83	106	123	135	146	173
Other Reserves	151	156	159	129	136	143	151
Shareholders' Equity	328	362	399	400	434	468	520
Total Equity & Liability	2,896	2,976	3,263	3,444	3,477	3,550	3,643
Cash Flow Statement							
Cash from operations	155	(40)	(51)	93	(21)	50	85
Cash from investing activities	3	6	14	5	-	5	2
Cash from financing	0	(33)	82	(65)	(35)	(37)	(21)
Net changes in cash	153	(79)	16	23	(56)	8	63
Cash at the end of period	368	289	304	327	271	279	342
Key Ratios							
Return on Average Assets	1.5%	1.7%	1.9%	2.0%	2.0%	2.0%	2.0%
Return on Average Equity	13.1%	14.6%	13.2%	12.8%	12.9%	12.6%	12.1%
Recurring Income/Operating Income	82.6%	84.7%	83.5%	83.1%	82.6%	82.3%	81.6%
Interest Earning/Financing Assets Yield	5.0%	4.8%	4.6%	4.7%	4.8%	4.9%	5.0%
Cost of Funds	1.8%	1.5%	1.2%	1.2%	1.2%	1.2%	1.2%
Net Spread	3.2%	3.3%	3.4%	3.5%	3.6%	3.7%	3.8%
Cost to Income Ratio	46.7%	47.6%	44.2%	43.8%	43.4%	43.4%	43.4%
Net Loans to Customer Deposits	94.9%	106.4%	112.6%	110.9%	114.3%	114.9%	114.4%
NPLs to Gross Loans	2.8%	2.4%	2.4%	2.4%	2.4%	2.4%	2.4%
NPL Coverage	145.3%	136.1%	142.3%	157.1%	157.1%	157.1%	157.1%
Provisions/Total Income	85.3%	69.1%	65.0%	70.3%	68.9%	66.8%	64.6%
Cost of Risk (bps)	35.9	9.2	23.2	26.1	30.5	34.9	39.4
Equity to Gross Loans	15.2%	15.1%	19.6%	18.5%	19.2%	20.0%	21.6%
Equity to Total Assets	11.3%	12.1%	15.8%	15.0%	15.8%	16.4%	17.5%
Dividend Payout Ratio	66.9%	65.5%	60.2%	60.4%	59.0%	62.5%	40.1%
Adjusted EPS (AED)	0.037	0.041	0.043	0.039	0.037	0.035	0.033
Adjusted BVPS (AED)	0.296	0.297	0.384	0.350	0.339	0.327	0.324
Market Price (AED)	0.263	0.372	0.310	0.259	0.259	0.259	0.259
Dividend Yield	3.8%	2.7%	3.2%	3.9%	3.9%	3.9%	3.9%
P/E Ratio (x)	7.0	9.0	7.2	6.7	7.0	7.4	7.9
P/BV Ratio (x)	0.9	1.3	0.8	0.7	0.8	0.8	0.8

*EPS from 2015 onwards adjusted for interest payable on Tier 1 perpetual bond

** Market price for 2016 and subsequent years as per latest closing price of 10/05/2016

Source: OABInvest, Company Financials

Bank Dhofar SAOG

Under Review

Recommendation

Under Review

Bloomberg Ticker	BKDB OMR
Reuters Ticker	BDOF.OMR
Current Market Price (OMR)	0.256
52wk High / Low (OMR)	0.27/0.187
12m Average Vol. (000)	141
Mkt. Cap. (USD/OMR mn)	1131/435
Shares Outstanding (mn)	1,699.2
Free Float (%)	41%
3m Avg Daily Turnover (000)	49
6m Avg Daily Turnover (000)	46
PE 2016e (x)	9.1
PBv 2016e (x)	0.8
Dividend Yield (%)	6.3%

Price Performance:

1 month (%)	0.39
3 month (%)	2.03
12 month (%)	0.57

Price Volume Performance



Source: Bloomberg

Ayisha Zia

Research Analyst

a.zia@oabinvest.com

Tel: 00968 – 24 75 4328

- **Healthy asset quality and strong balance sheet**
- **Funding diversification and adequate liquidity**
- **Robust operational profitability with C/TOI less than average of the six banks**

Due to a possible impending merger with Bank Sohar, we have placed the stock Under Review until full granularity on this subject is received. Our analysis reveals that the bank has improved its capital adequacy with a T1 perpetual bond issuance worth OMR 115.5mn last year. Currently, the T1 ratio stands at 12.7% and CAR at 14.7% (both fairly above regulatory requirements). This provides the bank with leverage to grow its balance sheet opportunistically. Additionally, it has a well-diversified asset portfolio and is working towards lowering its cost-to-income ratio further.

Outlook

We believe that the bank will be able to grow its net loan book only marginally during FY16, with macroeconomic situation modulating any significant hikes in growth levels over the entire forecast period. We have been very conservative in our estimates for top line as well as for bottom line growth prospects of the bank. In spite of that, the fundamental soundness of the bank as well as its dividend policy dictates a higher valuation than the current price.

Key Risks

Key risks include:

- Slower than expected topline growth
- Any anomalies which might arise due to concentration risk of assets as well as liabilities.
- Better-than-expected loan growth
- Further improvements in capital and profitability.

Key Indicators

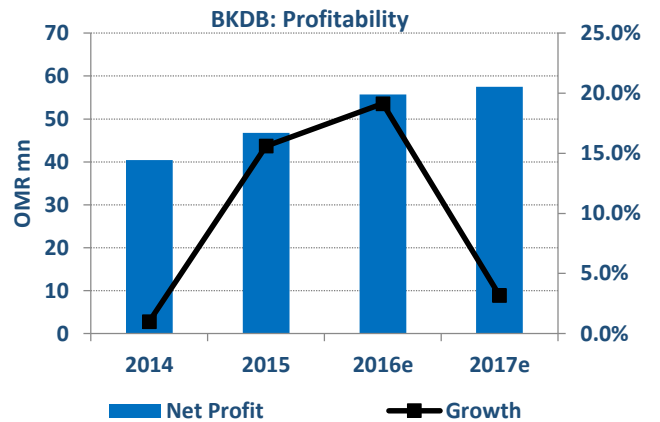
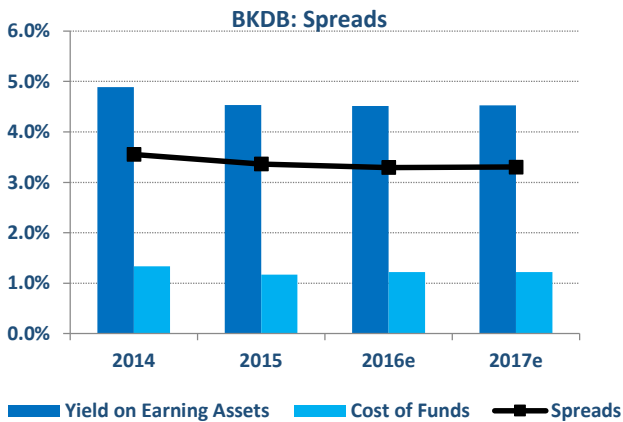
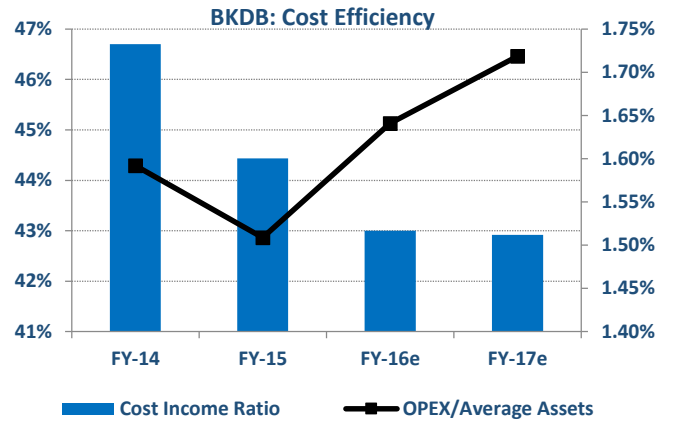
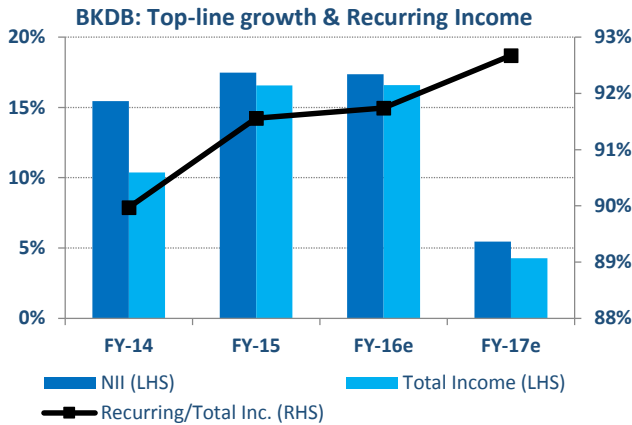
Year	FY14	FY15	FY16e	FY17e	FY18e
Total Net Loans (OMR mn)	2,255	2,729	2,851	2,965	3,054
Total Customer Deposits (OMR mn)	2,482	2,592	2,541	2,642	2,748
Operating Income (OMR mn)	99	115	134	140	144
Net Profit (OMR mn)	40	47	56	57	59
Diluted EPS (OMR)	0.030	0.027	0.028	0.027	0.025
Diluted BVPS (OMR)	0.242	0.308	0.304	0.296	0.287
P/E (x)	12.0	9.4	9.1	9.7	10.4
P/BVPS (x)	1.5	0.8	0.8	0.9	0.9
Dividend Yield (%)	5.6%	9.8%	6.3%	6.2%	6.2%

Source: Company Financials, OABInvest

*Net profit excludes interest payable on T1 perpetual bond

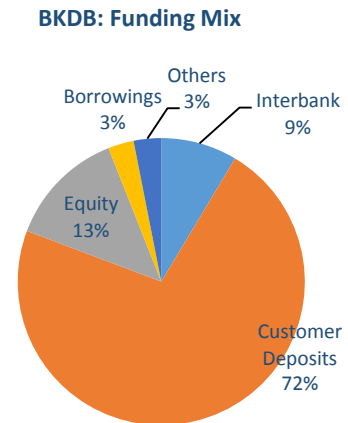
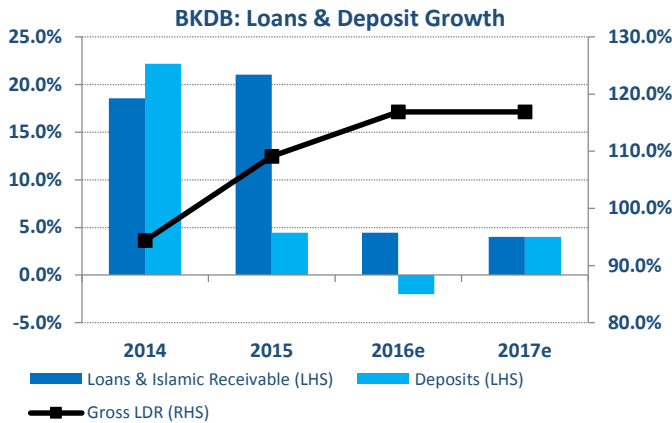
Strong profitability growth in FY15

The key profitability indicators of the bank showed positive growth, with net interest and financing income achieving a solid growth of 17.5%YoY to reach OMR 90.21 mn in FY15. Non-interest and non-financing income such as fees and commission, foreign exchange profit, investment and other income grew by 13.4%YoY to reach OMR 25 mn in FY15. The Cost to Income ratio during FY15 improved to 44.4% as compared to 46.7% in FY14. In line with loan growth and regulatory requirement, the provision for loan impairment, net of recovery, during the year 2015 stood at OMR 8.78 mn against OMR 6.93 mn during the previous year 2014.



Source: Company Financials, OABinvest

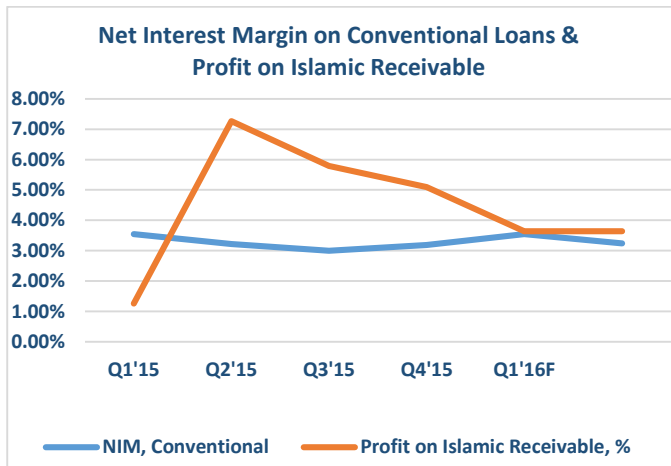
The impairment of investments due to downward market movements during the year was OMR 2.74 mn. Non-performing loans to gross loans improved from 2.55% at 31st December 2014 to 2.30% at 31st December 2015. Non-performing loans, net of interest suspense, to gross loans improved from 1.24 % at 31st December 2014 to 1.11 % at 31st December 2015 year on year. The net profit for the year 2015 was OMR 46.8 mn as against OMR 40.5 mn, showing a strong growth of 15.6% YoY.



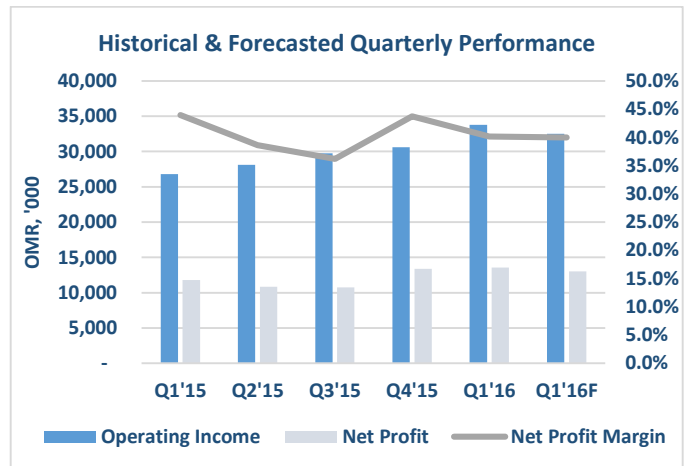
Source: Company Financials, OABinvest

Financial performance highlights for 1Q16

Bank Dhofar reported a good set of results, indicating operating income growth of 26%YoY and 10%QoQ. Cost to income ratio improved to 40.4% as compared to 44.5% a year ago. Hence, operating profit rose by 35%YoY and 13%QoQ. Due to a larger than expected provision and tax expense, this operating profit growth could not translate into net profit growth, which still managed to grow by 15%YoY and 1%QoQ.



Source: Company Financials, OABinvest



Net loans & advances grew by 17%YoY and 3%QoQ but customer deposits' growth outpaced loan book growth on quarterly basis with deposits growing by 6%YoY and 8%QoQ. This came as a positive surprise to us as we were expecting a sector-wide deposit decline trend from last few months of FY15 to continue into the early part of FY16.

Key Financials

(OMR mn)	2013	2014	2015	2016e	2017e	2018e	2019e
Income Statement							
Interest/Financing Income	100.2	110.4	125.9	141.7	146.8	151.1	155.1
Interest Expense/Payment to Depositors	(33.7)	(33.6)	(35.6)	(35.8)	(35.2)	(36.2)	(37.6)
Net Interest/Financing Income	66.5	76.8	90.2	105.9	111.7	114.9	117.5
Fee & Commission Income	8.9	12.1	15.3	17.4	18.2	18.9	19.7
Other Income	14.1	9.9	9.7	11.1	10.3	10.6	10.9
Total Non-Interest/Financing Income	23.0	22.1	25.0	28.5	28.4	29.5	30.6
Total Operating Income	89.6	98.9	115.2	134.3	140.1	144.4	148.1
Provisions expense	(4.2)	(6.9)	(11.5)	(13.7)	(15.1)	(15.7)	(16.1)
Operating Expenses	(45.3)	(46.2)	(51.2)	(57.8)	(60.1)	(62.5)	(64.9)
Profit Before Taxation	66.1	45.8	52.5	62.9	64.8	66.2	67.0
Taxation	(7.7)	(5.3)	(5.7)	(7.2)	(7.3)	(7.4)	(7.6)
Net Profit	58.4	40.5	46.8	55.7	57.5	58.8	59.5
Balance Sheet							
Cash Balances	346	584	440	158	180	211	305
Deposits with Banks & FIs	121	91	138	144	150	154	158
Gross Loans & Financings	1,983	2,342	2,828	2,969	3,088	3,181	3,244
Loan Loss Reserve	(81)	(88)	(99)	(118)	(123)	(127)	(129)
Net Loans & Financings	1,902	2,255	2,729	2,851	2,965	3,054	3,115
Net Fixed Assets	11	10	9	9	8	9	9
Other Assets	225	254	277	286	245	249	252
Total Assets	2,605	3,194	3,593	3,449	3,548	3,678	3,838
Deposits from Banks & FIs	106	175	309	179	186	194	201
Deposits from Customers	2,032	2,482	2,592	2,541	2,642	2,748	2,858
Other Borrowings	89	108	111	109	114	118	123
Other Liabilities	75	104	104	104	54	29	29
Paid-up Capital	121	134	154	170	187	206	226
Retained Earnings	65	56	45	44	98	130	136
Other Reserves	118	135	161	187	152	138	149
Perpetual Tier 1 Capital Securities	-	-	116	116	116	116	116
Shareholders' Equity	304	325	477	516	552	589	627
Total Equity & Liability	2,605	3,194	3,593	3,449	3,548	3,678	3,838
Cash Flow Statement							
Cash from operations	159	231	(247)	(262)	96	82	118
Cash from investing activities	5	2	2	4	3	4	3
Cash from financing	(17)	10	104	(16)	(71)	(47)	(21)
Net changes in cash	137	239	(145)	(282)	22	31	93
Cash at the end of period	346	584	440	158	180	211	305
Key Ratios							
Return on Average Assets	2.5%	1.4%	1.2%	1.4%	1.4%	1.4%	1.4%
Return on Average Equity	20.7%	12.9%	10.5%	9.6%	9.3%	8.9%	8.5%
Recurring Income/Operating Income	84%	90%	92%	91.7%	92.7%	92.7%	92.6%
Interest Earning/Financing Assets Yield	5.3%	4.9%	4.5%	4.5%	4.5%	4.5%	4.5%
Cost of Funds	-1.7%	-1.3%	-1.2%	-1.2%	-1.2%	-1.2%	-1.2%
Net Spread	3.6%	3.6%	3.4%	3.3%	3.3%	3.3%	3.3%
Cost to Income Ratio	50.6%	46.7%	44.4%	43.0%	42.9%	43.3%	43.8%
Net Loans to Customer Deposits	93.6%	90.8%	105.3%	112.2%	112.2%	111.1%	109.0%
NPLs to Gross Loans	3.0%	2.6%	2.7%	2.8%	2.9%	2.9%	2.9%
NPL Coverage	137.4%	146.6%	151.9%	142.4%	139.9%	139.9%	139.9%
Provisions/Total Income	90.0%	88.6%	85.6%	88.1%	87.9%	87.8%	87.4%
Cost of Risk (bps)	22.7	32.1	44.6	47.2	50.0	50.1	50.2
Equity to Gross Loans	15.3%	13.9%	16.9%	17.4%	17.9%	18.5%	19.3%
Equity to Total Assets	11.7%	10.2%	13.3%	15.0%	15.6%	16.0%	16.3%
Dividend Payout Ratio	51.8%	66.4%	82.6%	48.8%	52.0%	56.0%	57.1%
Adjusted EPS (AED)	0.048	0.030	0.027	0.028	0.027	0.025	0.023
Adjusted BVPS (AED)	0.251	0.242	0.308	0.304	0.296	0.287	0.277
Market Price (AED)	0.325	0.360	0.256	0.256	0.256	0.256	0.256
Dividend Yield	7.7%	5.6%	9.8%	6.3%	6.2%	6.2%	5.9%
P/E Ratio (x)	6.7	12.0	9.4	9.1	9.7	10.4	11.2
P/BV Ratio (x)	1.3	1.5	0.8	0.8	0.9	0.9	0.9

*EPS from 2015 onwards adjusted for interest payable on Tier 1 perpetual bond

** Market price for 2016 and subsequent years as per latest closing price of 10/05/2016

Source: OABInvest, Company Financials

Ahli Bank SAOG

TP: OMR 0.185 / share

Recommendation

HOLD

Bloomberg Ticker	ABOB.OM
Reuters Ticker	AHBK.OM
Current Market Price (OMR)	0.180
52wk High / Low (OMR)	0.23/0.169
12m Average Vol. (000)	175
Mkt. Cap. (USD/OMR mn)	667/256.5
Shares Outstanding (mn)	1,425.0
Free Float (%)	30%
3m Avg Daily Turnover (000)	31
6m Avg Daily Turnover (000)	201
PE 2016e (x)	8.5
PBv 2016e (x)	1.1
Dividend Yield (%)	5.6%

Price Performance:

1 month (%)	2.86
3 month (%)	-2.70
12 month (%)	-14.29

Price Volume Performance



- Superior ROaE and ROaA
- Highest provision coverage levels amongst local peers
- Lowest cost-to-income amongst peers at ~36% (sector: ~47%)
- High dependence on costlier time deposits; Concentrating on diversification of deposit base

We reiterate HOLD rating on Ahli Bank based on a revised target price of 0.185, implying limited upside to the last closing price. Our target price implies a P/E'16e and a P/B'16e of 8.7x and 1.08x respectively. We believe that this target price is justified because (1) currently there is a lack of any positive triggers for the stock price in the ST to MT, and (2) the bank's performance is under pressure because of its dependence on costlier time deposits in a rising rate environment leaving it vulnerable to larger than the expected sector-wise declines in NIMs.

Valuation & Outlook

We believe that the bank, like its counterparts, will be able to grow its net loan book at a slower pace during FY16 than what was achieved during FY15, with the macroeconomic situation modulating any significant hikes in growth levels over the entire forecast period. We have been very conservative in our estimates for top line as well bottom line growth prospects of the bank. At the current point in time, we believe that the stock is priced at its fair value.

Key Risks to Valuations

The key upside risks to our valuation are:

- Better-than-expected loan growth
- Improvement in systemic risk
- Further improvements in capital and profitability
- Continued improvements in asset quality and loan loss coverage levels

The key downside risks to our valuation are:

- Slower-than-expected credit offtake
- Cost of risk to spike higher-than-expected affecting profitability
- Higher-than-expected sovereign risk

Key Indicators

Year	FY14	FY15	FY16e	FY17e	FY18e
Total Net Loans (OMR mn)	1,389	1,518	1,594	1,658	1,707
Total Customer Deposits (OMR mn)	1,301	1,314	1,340	1,380	1,422
Operating Income (OMR mn)	52	56	61	66	71
Net Profit (OMR mn)	25	28	30	33	35
Diluted EPS (OMR)	0.019	0.019	0.021	0.023	0.024
Diluted BVPS (OMR)	0.154	0.159	0.171	0.184	0.198
P/E (x)	12.0	10.4	8.5	7.9	7.4
P/BVPS (x)	1.5	1.3	1.1	1.0	0.9
Dividend Yield (%)	4.3%	5.0%	5.6%	5.6%	5.6%

Source: Company Financials, OABInvest

Source: Bloomberg

Ayisha Zia

Research Analyst

a.zia@oabinvest.com

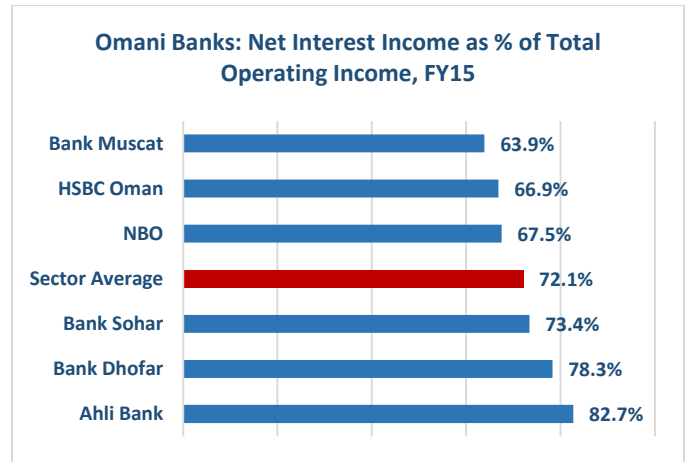
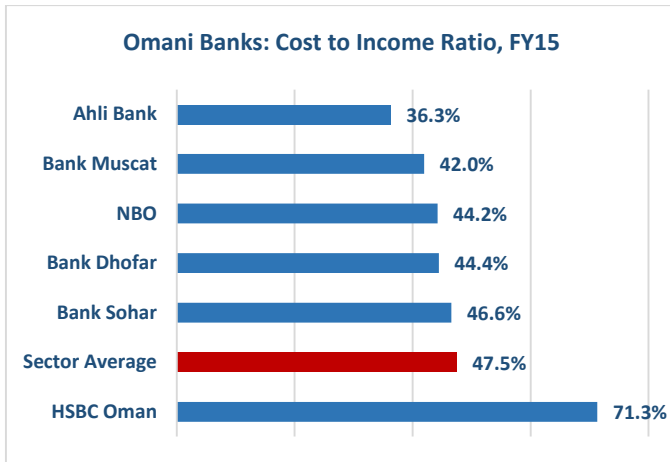
Tel: 00968 – 24 75 4328

Superior efficiency metrics

Ahli bank boasts superior efficiency with cost-to-income ratio at 36.3% and cost to average total assets at 1.1% for FY15. The bank is more cost efficient than all of its peers under our coverage.

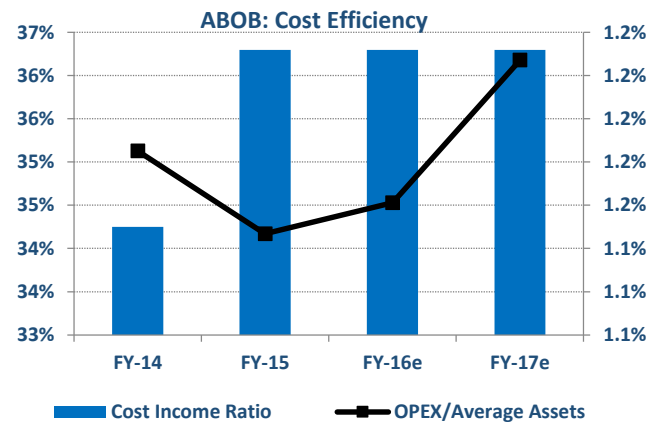
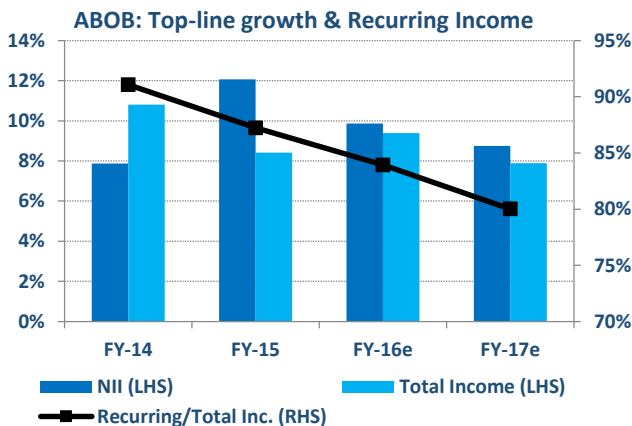
Heavy reliance on net interest income

The bank is heavily reliant on interest income as it is major part of its income (c83% in FY15). Where it could have once been considered as a strength for the bank, it is now a weakness in our view. This is because of the fact that declining net interest margins as the sector faces diminishing liquidity coupled with muted credit offtake which will likely impact this bank the most. The bank is actively pursuing raising its net fee income and diversifying its income sources.

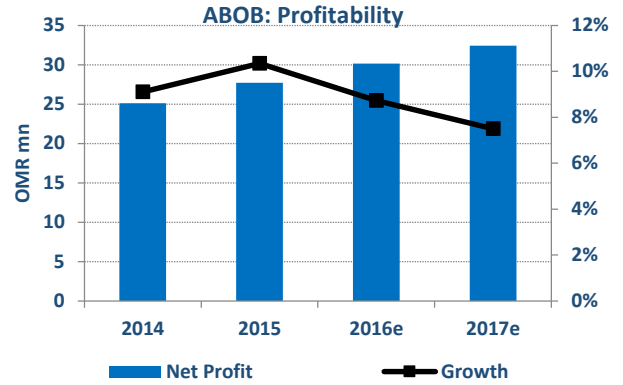
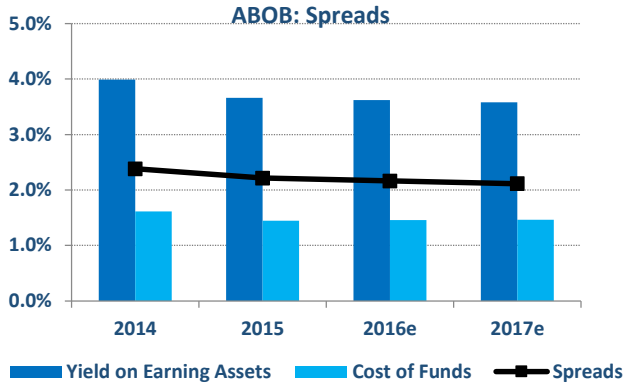


Profitability & asset growth stable; actively pursuing improvement in deposit mix to increase low-cost CASA

The bank's performance was good in FY15 where its performance has improved over the previous year registering a net profit of OMR 27.7 mn compared to OMR 25.1 mn for the previous year, a year-on-year increase of 10.4%. The gross loans and financings grew annually at the compound growth rate of 14.7% to reach at OMR 1,540.7 mn as at 31 December 2015 from OMR 776.0 mn as at 31 December 2011. The customer deposits increased to OMR 1,300.8 mn in 2015, an increase of over 14.2% compounded annually from the year ended 2011. The growth in deposit is in line with the Bank's strategy to create a diversified stable low cost funding base. The Bank has been able to post strong profit growth over the period of last five years as corroborated by good EPS and return on equity. Profit after tax has grown from OMR 18.2 mn for the year 2011 to OMR 27.7 mn for the year 2015. The profitability ratios have been in line with strategic growth plan and are reflective of the continued focus on enhanced productivity and business diversification.

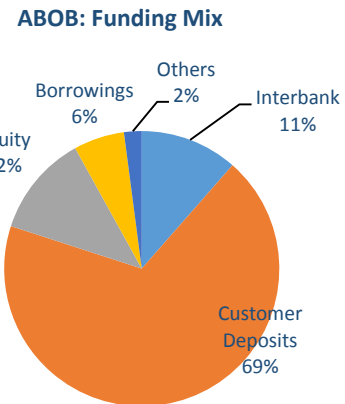
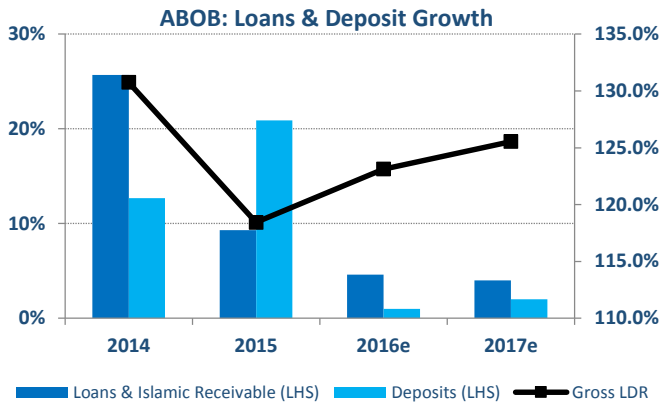


Source: Company Financials, OABinvest



Source: Company Financials, OABinvest

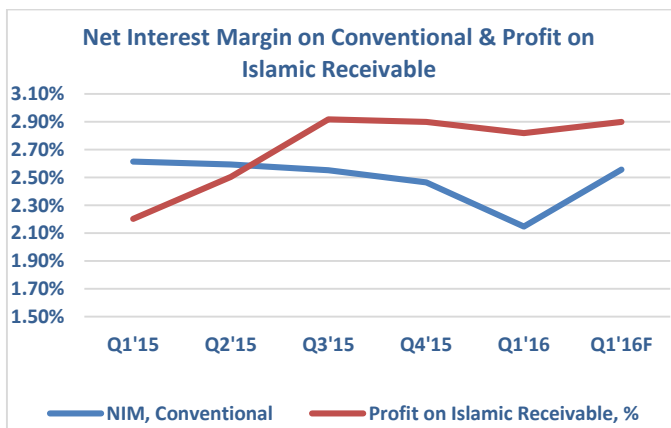
As mentioned earlier, the bank is actively pursuing raising low-cost CASA deposits to replace its costlier time deposits, in order to mitigate the adverse impact of rising cost of funds.



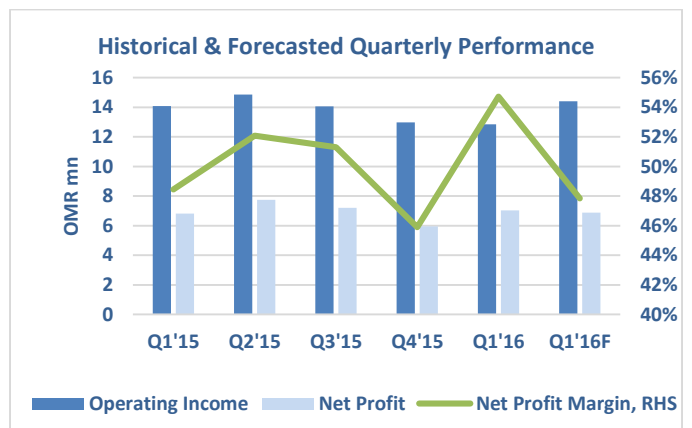
Source: Company Financials, OABinvest

Financial performance highlights for 1Q16

Ahli Bank reported its results for 1Q16, indicating operating income decline of 9.1%YoY and 1.6%QoQ. Cost to income ratio improved to 34.4% as compared to 39.7% in 4Q15. Hence, operating profit increased by 7.1%QoQ (even though declined by 9.8%YoY). Due to a smaller than expected provision and/or tax expense, this operating profit decline did not trickle down to net profit, which still managed to grow by 2.6%YoY and 18.1%QoQ. Net loans & advances grew by 4.4%YoY and 1.3%QoQ but customer deposits' growth outpaced loan book growth on yearly basis with deposits growing by 9.8%YoY. The deposits declined on quarterly basis by 5%QoQ. Loan-to-deposit ratio shot up to 124%.



Source: Company Financials, OABinvest



Key Financials

(OMR mn)	2013	2014	2015	2016e	2017e	2018e	2019e
Income Statement							
Interest/Financing Income	56.5	62.1	70.1	77.5	83.8	89.7	94.2
Interest Expense/Payment to Depositors	(18.2)	(20.7)	(23.8)	(26.5)	(28.2)	(30.1)	(31.8)
Net Interest/Financing Income	38.3	41.3	46.3	51.0	55.6	59.6	62.4
Fee & Commission Income	5.8	7.9	8.1	8.9	9.6	10.2	10.7
Other Income	2.5	2.4	1.6	1.5	1.2	0.9	0.8
Total Non-Interest/Financing Income	8.3	10.3	9.7	10.4	10.8	11.1	11.5
Total Operating Income	46.6	51.6	56.0	61.4	66.4	70.8	73.8
Provisions expense	(4.6)	(5.2)	(5.3)	(6.0)	(6.6)	(7.1)	(7.7)
Operating Expenses	(15.8)	(17.7)	(20.3)	(22.3)	(24.1)	(25.7)	(26.8)
Profit Before Taxation	26.3	28.7	30.4	33.0	35.5	37.7	39.1
Taxation	(3.2)	(3.6)	(2.7)	(2.9)	(3.1)	(3.3)	(3.4)
Net Profit	23.0	25.1	27.7	30.1	32.4	34.4	35.7
Balance Sheet							
Cash Balances	43	54	124	95	72	83	95
Deposits from Banks & FIs	81	35	60	40	41	43	44
Gross Loans & Financings	1,119	1,407	1,541	1,618	1,682	1,733	1,785
Loan Loss Reserve	(14)	(18)	(23)	(24)	(25)	(25)	(26)
Net Loans & Financings	1,105	1,389	1,518	1,594	1,658	1,707	1,759
Net Fixed Assets	17	17	18	14	14	14	14
Other Assets	93	149	179	187	193	199	204
Total Assets	1,339	1,645	1,898	1,929	1,978	2,046	2,116
Deposits from Banks & FIs	96	236	218	220	224	231	238
Deposits from Customers	955	1,076	1,301	1,314	1,340	1,380	1,422
Other Borrowings	69	98	113	113	113	113	113
Other Liabilities	34	35	39	39	39	39	39
Paid-up Capital	126	130	143	143	143	143	143
Retained Earnings	14	16	18	34	52	73	94
Other Reserves	45	54	67	67	67	67	67
Shareholders' Equity	185	200	227	243	262	282	304
Total Equity & Liability	1,339	1,645	1,898	1,929	1,978	2,046	2,116
Cash Flow Statement							
Cash from operations	30	24	46	(18)	(9)	25	26
Cash from investing activities	5	2	2	(4)	-	-	-
Cash from financing	(6)	(10)	25	(14)	(14)	(14)	(14)
Net changes in cash	19	11	69	(29)	(23)	11	12
Cash at the end of period	43	54	124	95	72	83	95
Key Ratios							
Return on Average Assets	1.9%	1.7%	1.6%	1.6%	1.7%	1.7%	1.7%
Return on Average Equity	13.1%	13.1%	13.0%	12.9%	12.9%	12.7%	12.3%
Recurring Income/Operating Income	97%	91%	87%	84.0%	80.1%	76.8%	74.5%
Interest Earning/Financing Assets Yield	4.7%	4.0%	3.7%	3.6%	3.6%	3.5%	3.5%
Cost of Funds	-1.9%	-1.6%	-1.4%	-1.5%	-1.5%	-1.5%	-1.5%
Net Spread	2.9%	2.4%	2.2%	2.2%	2.1%	2.1%	2.0%
Cost to Income Ratio	34%	34%	36%	36%	36%	36%	36%
Net Loans to Customer Deposits	116%	129%	117%	121.3%	123.7%	123.7%	123.7%
NPLs to Gross Loans	1.0%	1.0%	1.1%	1.1%	1.1%	1.1%	1.1%
NPL Coverage	133%	133%	138%	131%	131%	131%	131%
Provisions/Total Income	31%	35%	40%	39%	37%	36%	35%
Cost of Risk (bps)	44.3	41.5	35.8	37.8	39.8	41.8	43.8
Equity to Gross Loans	17%	14%	15%	15%	16%	16%	17%
Equity to Total Assets	14%	12%	12%	13%	13%	14%	14%
Dividend Payout Ratio	56%	52%	51%	47%	44%	41%	40%
Adjusted EPS (AED)	0.018	0.019	0.019	0.021	0.023	0.024	0.025
Adjusted BVPS (AED)	0.146	0.154	0.159	0.171	0.184	0.198	0.213
Market Price (AED)	0.183	0.232	0.202	0.180	0.180	0.180	0.180
Dividend Yield	5.6%	4.3%	5.0%	5.6%	5.6%	5.6%	5.6%
P/E Ratio (x)	10.0	12.0	10.4	8.5	7.9	7.4	7.1
P/BV Ratio (x)	1.3	1.5	1.3	1.1	1.0	0.9	0.8

*Market price for 2016 and subsequent years as per latest closing price of 10/05/2016

Source: OABInvest, Company Financials

Bank Sohar SAOG

Under Review

Recommendation

Bloomberg Ticker	BKSB OM
Reuters Ticker	BKSB.OM
Current Market Price (AED)	0.176
52wk High / Low (AED)	0.21/0.12
12m Average Vol. (000)	929
Mkt. Cap. (USD/AED mn)	726/279.1
Shares Outstanding (mn)	1,585.6
Free Float (%)	87%
3m Avg Daily Turnover (000)	293
6m Avg Daily Turnover (000)	204
PE 2016e (x)	8.8
PBv 2016e (x)	1.0
Dividend Yield (%)	5%

Under Review

Price Performance:

1 month (%)	7.32
3 month (%)	9.32
12 month (%)	-2.76

- **Historically better than Sector Loan Growth**
- **Superior credit quality with FY15 NPAs at c1.2% of Gross Loans; Provision cover at 173%**
- **Upcoming conversion of 1st tranche of OMR 7.1mn Compulsorily Convertible Bond (expected share count increase: 18.9mn or 1.2% of current share count)**

We place the stock Under Review until further clarification is made available by the bank on the possible merger with Bank Dhofar. Our analysis reveals that: (1) the bank has the lowest capital adequacy levels within its peer-group (2) it has the highest cost-to-income ratio within the peer group, after HSBC Oman (3) Its FY15 net profit has declined marginally from FY14 level. Operationally, we expect the bank to display a moderate performance in the new tougher environment.

Outlook

We believe that the bank will be able to grow its net loan book during FY16 at a slower pace than FY15, given the subdued macroeconomic indicators. We have been very conservative in our estimates for top line as well as bottom line growth prospects of the bank. Dividend prospects for the bank are also not very bright due to potential straining of capital adequacy ratios which hover close to the regulatory requirement.

Key Risks

The key risks are:

- Better-than-expected loan growth
- Any potential improvements in capital
- Higher-than-expected sovereign risk

Key Indicators

Year	FY14	FY15	FY16e	FY17e	FY18e
Total Net Loans (OMR mn)	1,423	1,647	1,713	1,765	1,800
Total Customer Deposits (OMR mn)	1,552	1,464	1,501	1,531	1,546
Operating Income (OMR mn)	69	71	77	80	85
Net Profit (OMR mn)	28	28	29	31	35
Diluted EPS (OMR)	0.026	0.024	0.020	0.019	0.021
Diluted BVPS (OMR)	0.156	0.168	0.176	0.182	0.190
P/E (x)	9.0	8.3	8.8	9.1	8.4
P/BVPS (x)	1.5	1.2	1.0	1.0	0.9
Dividend Yield (%)	4.3%	7.4%	4.5%	4.5%	4.5%

Source: Company Financials, OABInvest

Price Volume Performance



Source: Bloomberg

Ayisha Zia

Research Analyst

a.zia@oabinvest.com

Tel: 00968 – 24 75 4328

Bank Dhofar and Bank Sohar merger on the cards

Following a financial and legal due diligence exercise, on 23 April 2016 Bank Dhofar has communicated to Bank Sohar the terms on which it is willing to proceed with the merger. Those terms are now being considered by Bank Sohar and may be subject to further discussion and negotiation between the two banks. If and when an agreement is reached on the terms, disclosure of the agreed terms will be made available to the market and approval will be sought from the regulators and the Bank's shareholders.

We believe that Bank Sohar has recently witnessed a price run due to this merger news announcement and might see a further price increase if the merger is to go through.

Cost to income highest amongst peers excluding HSBC Oman

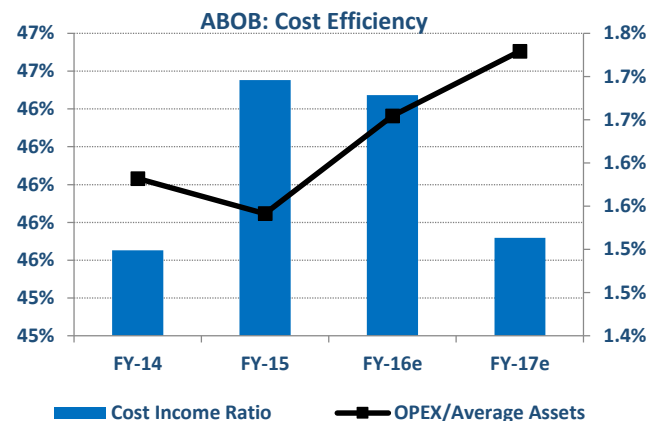
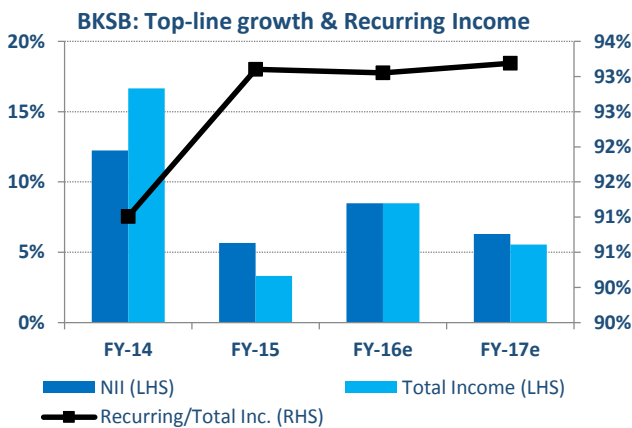
The bank's cost to income ratio at 46.6% for FY15 is highest amongst the peer group, after HSBC Oman. The bank has been actively pursuing efficiency improvements in terms of systems and procedures improvements but these measures are yet to reach fruition.

Please refer to Page 24 for a cost-to-income comparison.

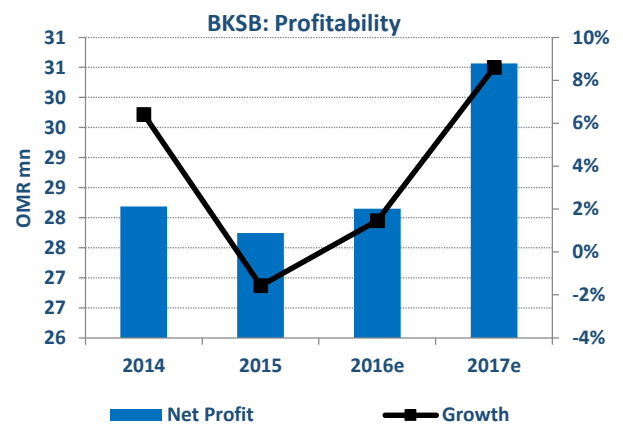
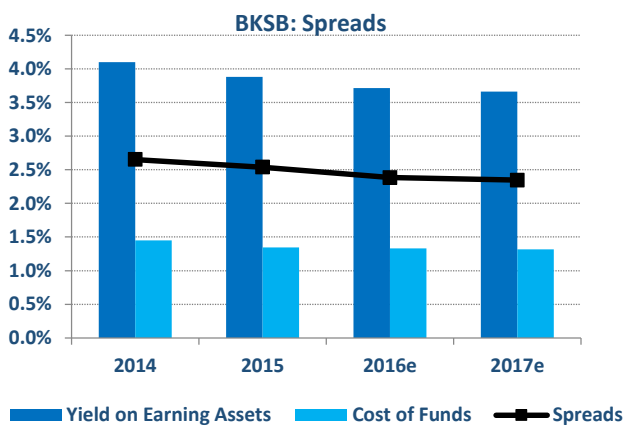
Profitability declined in FY15 on higher provisions; asset growth stable ahead of sector

Bank Sohar registered a net profit of OMR 27.8mn for the year 2015 compared to OMR 29.9mn for the previous year, a year-on-year drop of 7.14% mainly due to provision of OMR 2.98mn towards impairment of investments as a result of declining stock markets and oil prices. The operating profit for the year was OMR 38mn compared to OMR 39mn in 2014, dropping by 2.79%. Net interest income during the year climbed 4.74% to OMR 49.9mn, compared to OMR 47.6mn in 2014. The operating income for the year 2015 increased by 0.83% from OMR 70.32mn in 2014 to OMR 70.9mn. The cost-to-income ratio stood at 46.6% in 2015 as against 44.5% in 2014.

Net loans and advances jumped by 15.7% during the year to touch OMR 1.7bn, against the previous year's level of OMR 1.4bn. However, customer deposits experienced a drop of 5.7% to OMR 1.5bn during the year, as compared to OMR 1.6bn in 2014 due to the bank's strategy of diversifying the funding sources.

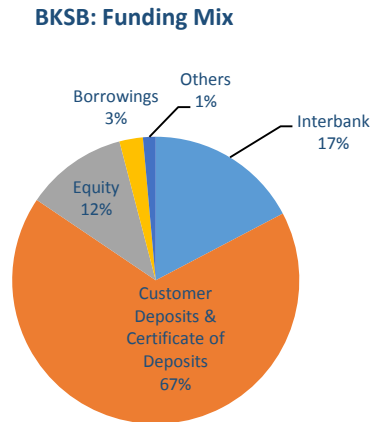
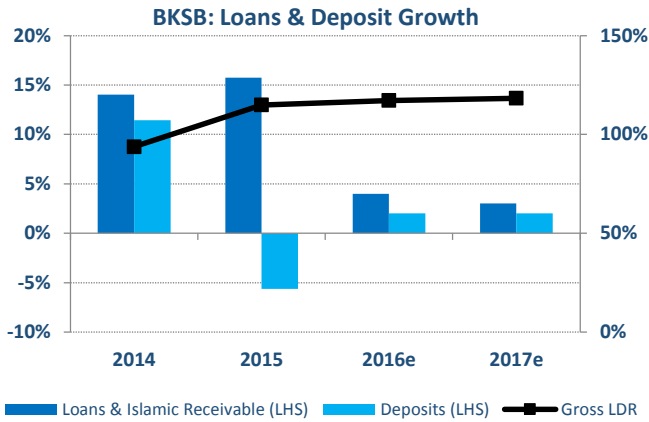


Source: Company Financials, OABinvest



Source: Company Financials, OABinvest

As mentioned earlier, the bank is actively pursuing low-cost CASA deposits to replace its costlier time deposits, in order to mitigate the adverse impact of rising cost of funds.

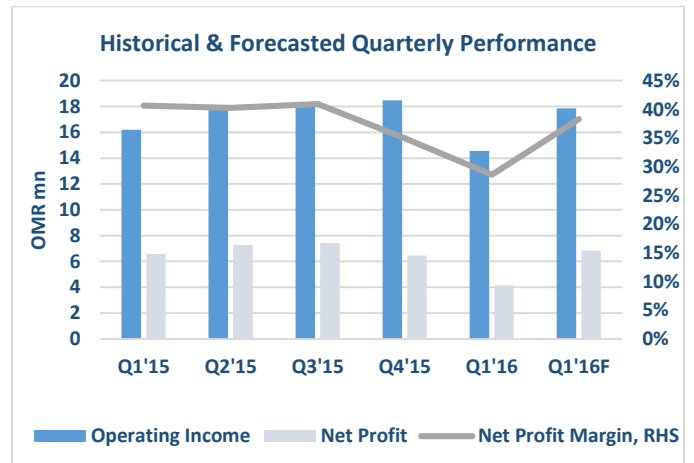
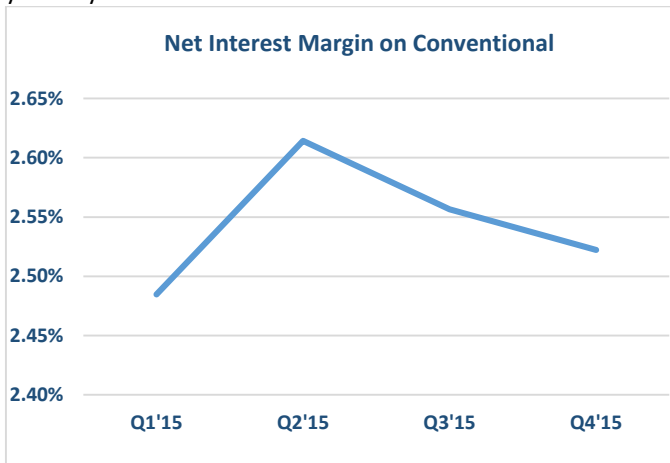


Source: Company Financials, OABinvest

Financial performance highlights for 1Q16

Bank Sohar’s operating income has declined by 10%YoY and 21%QoQ mainly on account of a loss realized on AFS instruments. Excluding this loss, the bank’s core operating income grew by 6.2%YoY. It must be noted that realized gains and losses on AFS instruments are part of the normal course of investment income-generating activities of a bank. In FY15, investment income accounted for 3% of total operating income of the bank. At the end of FY15, a net loss in fair value of available for sale financial assets net of income tax worth OMR 2mn was disclosed as part of Comprehensive Income for the year. Such a loss is unrealized in nature and is directly accounted for through equity. It must be noted that such a gain or loss is re-classifiable to profit or loss once the AFS securities are sold in order to fulfil liquidity requirements of the bank.

Total expenses were as per our expectation (+4.7%YoY and 1.5%QoQ). Operating profit declined by 37%YoY and 40%QoQ (35% below OABe). Along with realized loss on AFS, higher than expected provision expense and/or taxes led the bank to miss our net profit estimate by a hefty 40%.



Source: Company Financials, OABinvest

Key Financials

(OMR mn)	2013	2014	2015	2016e	2017e	2018e	2019e
Income Statement							
Interest Income	72.3	73.2	75.2	78.2	79.3	80.1	80.2
Interest Expense	(28.8)	(25.6)	(25.3)	(24.8)	(24.0)	(20.6)	(20.5)
Net Interest & Islamic Financing Income	43.9	49.3	52.1	56.8	59.9	65.3	67.0
Fee & Commission Income	9.8	13.2	13.9	14.8	15.0	15.3	15.6
Other Income	5.5	7.9	4.9	4.9	4.7	4.8	4.9
Total Non-Interest/Financing Income	15.3	21.0	18.8	19.7	19.7	20.2	20.6
Total Operating Income	59.2	70.3	70.9	76.6	79.6	85.4	87.6
Provisions expense	(1.6)	(5.8)	(6.2)	(8.7)	(8.6)	(8.2)	(8.8)
Operating Expenses	(27.5)	(31.3)	(33.0)	(35.0)	(35.7)	(36.7)	(37.6)
Profit Before Taxation	30.1	33.2	31.7	32.8	35.3	40.5	41.1
Taxation & Minority Interest	(3.3)	(3.3)	(4.0)	(4.1)	(4.5)	(5.1)	(5.2)
Net Profit Attributable to Parent	26.9	29.9	27.7	28.7	30.9	35.4	35.9
Balance Sheet							
Cash Balances	106	219	122	65	68	74	81
Deposits with Banks & FIs	296	154	128	88	90	92	94
Gross Loans & Financings	1,273	1,455	1,683	1,750	1,803	1,839	1,876
Loan Loss Reserve	(25)	(32)	(36)	(37)	(38)	(39)	(40)
Net Loans & Financings	1,248	1,423	1,647	1,713	1,765	1,800	1,836
Investment Properties	3	3	3	3	3	3	3
Net Fixed Assets	13	13	13	13	13	13	13
Other Assets	219	264	293	254	261	266	272
Total Assets	1,886	2,075	2,208	2,135	2,200	2,248	2,298
Deposits from Banks & FIs	239	244	400	254	259	261	264
Deposits from Customers	1,392	1,552	1,464	1,501	1,531	1,546	1,562
Other Borrowings	58	58	58	56	57	55	55
Other Liabilities	24	29	32	32	33	33	34
Paid-up Capital	110	114	144	160	168	176	183
Retained Earnings	35	44	42	44	112	133	155
Other Reserves	26	34	67	87	40	43	47
Shareholders' Equity	171	192	253	292	320	352	384
Total Equity & Liability	1,886	2,075	2,208	2,135	2,200	2,248	2,298
Cash Flow Statement							
Cash from operations	32	155	(91)	(96)	14	18	19
Cash from investing activities	56	36	39	(31)	10	7	8
Cash from financing	8	(7)	33	7	(1)	(5)	(4)
Net changes in cash	(16)	113	(96)	(57)	3	6	7
Cash at the end of period	106	219	122	65	68	74	81
Key Ratios							
Return on Average Assets	1.4%	1.4%	1.3%	1.3%	1.4%	1.6%	1.6%
Return on Average Equity	16.8%	15.5%	12.5%	10.5%	10.1%	10.5%	9.8%
Recurring Income/Operating Income	91.3%	91.0%	93.1%	93.6%	94.1%	94.4%	94.4%
Interest Earning/Financing Assets Yield	4.3%	4.1%	3.9%	3.8%	3.8%	3.8%	3.7%
Cost of Funds	1.7%	1.5%	1.3%	1.3%	1.3%	1.1%	1.1%
Net Spread	2.5%	2.7%	2.5%	2.5%	2.5%	2.7%	2.6%
Cost to Income Ratio	46.7%	45.7%	46.6%	45.8%	44.8%	43.0%	43.0%
Net Loans to Customer Deposits	89.6%	91.7%	112.5%	114.1%	115.2%	116.4%	117.5%
NPLs to Gross Loans	1%	2%	1%	2%	2%	2%	2%
NPL Coverage	186%	145%	173%	114%	115%	116%	118%
Provisions/Total Income	43%	46%	51%	49%	48%	46%	46%
Cost of Risk (bps)	9	32	32	43	41	39	41
Equity to Gross Loans	13%	13%	15%	17%	18%	19%	20%
Equity to Total Assets	9%	9%	11%	14%	15%	16%	17%
Dividend Payout Ratio	30%	39%	62%	40%	42%	38%	39%
Adjusted EPS (AED)	0.026	0.026	0.024	0.020	0.019	0.021	0.020
Adjusted BVPS (AED)	0.145	0.156	0.168	0.176	0.182	0.190	0.200
Market Price (AED)	0.188	0.230	0.202	0.176	0.176	0.176	0.176
Dividend Yield	4.3%	4.3%	7.4%	4.5%	4.5%	4.5%	4.5%
P/E Ratio (x)	7.1	9.0	8.3	8.8	9.1	8.4	8.6
P/BV Ratio (x)	1.3	1.5	1.2	1.0	1.0	0.9	0.9

* Market price for 2016 and subsequent years as per latest closing price of 10/05/2016

Source: OABInvest, Company Financials

HSBC Bank Oman SAOG

TP : OMR 0.126 / share

Recommendation

HOLD

Bloomberg Ticker	HBMO OM
Reuters Ticker	HBMO.OM
Current Market Price (OMR)	0.116
52wk High / Low (OMR)	0.15/0.092
12m Average Vol. (000)	314
Mkt. Cap. (USD/OMR mn)	603/232
Shares Outstanding (mn)	2,000.3
Free Float (%)	49%
3m Avg Daily Turnover (000)	49
6m Avg Daily Turnover (000)	31
PE 2016e (x)	17.6
PBv 2016e (x)	0.7
Dividend Yield (%)	3.0%

Price Performance:

1 month (%)	18.37
3 month (%)	18.37
12 month (%)	-13.43

Price Volume Performance



Source: Bloomberg

Ayisha Zia

Research Analyst

a.zia@oabinvest.com

Tel: 00968 – 24 75 4328

- **Lowest LDR within the sector providing ample room to grow**
- **Most liquid bank (FY15 LCR⁵:162%); Exceptionally low cost of funds at ~0.37% vs. sector average of 1.1%**
- **Well capitalized (FY15 Cet 1/ Tier 1 capital ratio: 18.36%; Total capital ratio: 19.42%)**
- **High probability of parent support (HSBC Middle East Holdings BV, share: 51%)**

We revise our target price on HBMO to OMR 0.126 per share, implying a ~9% upside to the current market price. The stock has witnessed a recent price run, forcing us to rate it as a HOLD. Our target price implies a PE'16e of 7.3x and PB'16e of 1.5. We believe that the bank's capital strength and improving credit quality are key drivers for its fundamental soundness. We have also witnessed a credit growth rate of 13%YoY in 1Q16 vs a sector-wide average growth rate of 11%, bringing its LTD (Loan-to-Deposit ratio) to an ever high of 78%. Operationally, we expect the bank to display a better than historical performance in the new tougher environment, on the back of its fundamental soundness and parent support.

Valuation & Outlook

We believe that the bank will be able to grow its net loan book by 8%YoY during FY16, We have been very conservative in our estimates for top line as well bottom line growth prospects of the company, and yet we see some upside to the last closing price.

Key Risks to Valuations

The key upside risks to our valuation are:

- Better-than-expected loan growth
- Any significant improvements in macroeconomic situation

The key downside risks to our valuation are:

- Slower-than-expected credit offtake
- NPAs rising faster than anticipated
- Further deterioration in macroeconomic outlook of the country

Key Indicators

Year	FY14	FY15	FY16e	FY17e	FY18e
Total Net Loans (OMR mn)	1,161	1,201	1,297	1,375	1,443
Total Customer Deposits (OMR mn)	1,852	1,802	1,784	1,838	1,911
Operating Income (OMR mn)	71	74	74	78	82
Net Profit (OMR mn)	12	13	13	14	15
Diluted EPS (OMR)	0.006	0.006	0.007	0.007	0.007
Diluted BVPS (OMR)	0.155	0.154	0.157	0.160	0.164
P/E (x)	23.0	19.4	17.6	16.8	15.9
P/BVPS (x)	0.9	0.8	0.7	0.7	0.7
Dividend Yield (%)	3.9%	3.1%	3.0%	3.4%	3.4%

Source: Company Financials, OABInvest

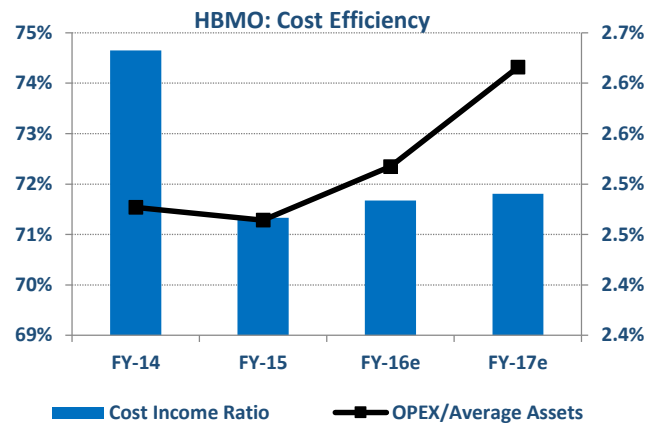
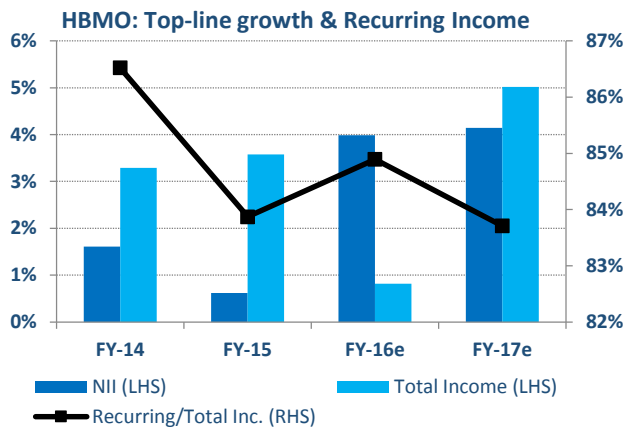
⁵ Liquidity coverage ratio (LCR) is guided by the CBO through circular BM 1127 (BASEL III : Framework on Liquidity coverage ratio and LCR disclosure standards). Liquidity coverage ratio is calculated on monthly intervals and reported to the CBO. The Banks are required to maintain minimum liquidity coverage ratio of 60% for 2015 in accordance with CBO stipulated guidelines

Lead arranger of Liwa Plastic Industries Complex for ORPIC

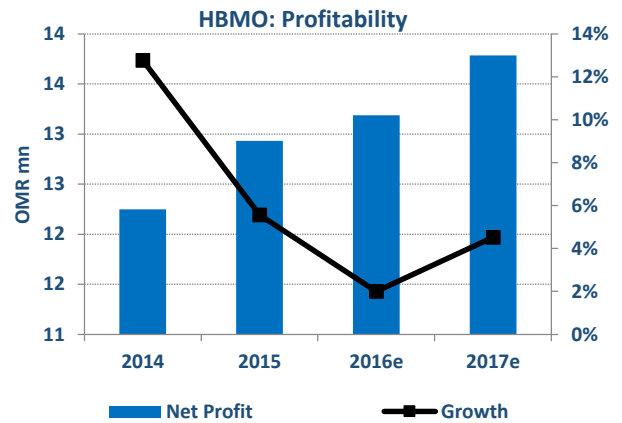
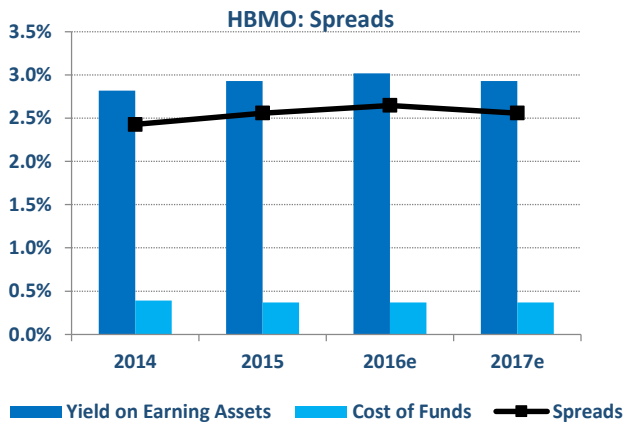
HSBC Bank Oman’s commercial banking arm was the lead arranger on the USD6.4 billion project financing for the Liwa Plastic Industries Complex signed with ORPIC – the largest ever financing transaction to date in Oman.

Profitability improved in FY15 on account of better efficiency

HBMO recorded a 5.7%YoY increase in its net profit of OMR 12.9mn in FY15. This increase was mainly due to an increase in net operating income before loan impairment charges and a reduction in operating expenses. Net Interest Income for FY15 rose by 0.6%YoY to reach OMR 49.2mn, despite the cap on personal loan interest rates and the increased competition for both retail and corporate banking businesses. Global Banking & Markets group continued to show margins improvement due to an upward movement in interest rates on government securities. Net fees, trading and other operating income was OMR 24.4mn. The reasons for the underlying movements were: Net fee income stood at OMR12.5mn. Other operating income increased by OMR 3.0mn largely due to a gain on the sale of HBMO’s India operations of OMR0.8mn and a gain on sale of non-core investments of OMR4.6mn which were partly offset by the loss on sale of HBMO’s Pakistan operations of OMR1.2mn and non-repeat of the gain on sale of properties of OMR1.3mn which took place in the previous year. A net charge of OMR3.4mn was reported for loan impairment charges compared to OMR2.9mn for 2014. Total operating expenses reduced by 1.1% to OMR54.7m reflecting a focus on firm cost control. The reduction was primarily due to a decrease in employee compensation and benefits costs of OMR0.2mn, marketing and advertisement costs of OMR0.2mn and other administrative costs of OMR0.5mn. HBMO’s LTD ratio stood at 66.6% as compared to 62.7% in 2014. Net loans increased by 3.4% from OMR 1.16bn in 2014 to RO1.2bn as at 31 December 2015, primarily due to an increase in corporate loans and advances. Deposits from customers decreased by 2.7%YoY to OMR 1.8bn in FY15. The Cost Efficiency Ratio was mainly impacted by operating revenue being below target. HBMO has maintained a high capital adequacy ratio at 19.4%, in line with HBMO’s policy of preserving capital strength to support future growth.

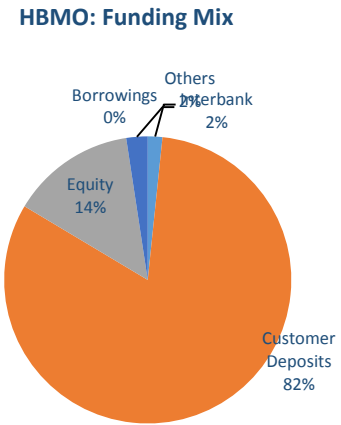
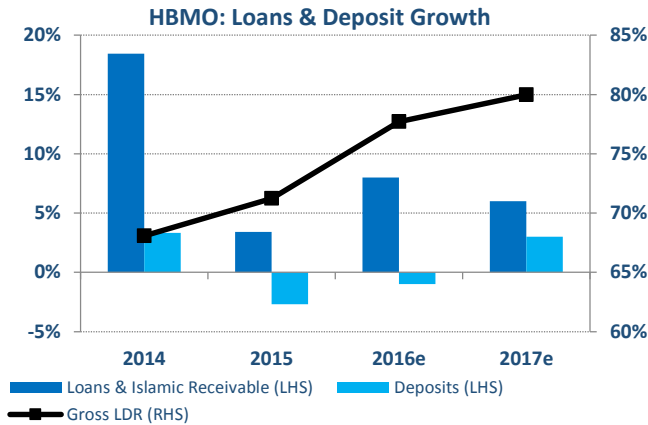


Source: Company Financials, OABinvest



Source: Company Financials, OABinvest

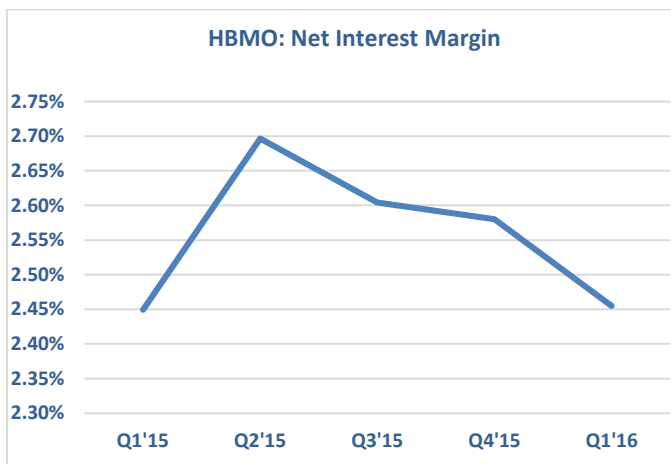
We believe that because the bank has the lowest LTD (Loan-to-Deposit Ratio) amongst its peers, therefore we believe that the bank is at an advantage to grow its net loans at a faster pace than the sector, given asset quality is not compromised and deposits do not decline at a faster pace.



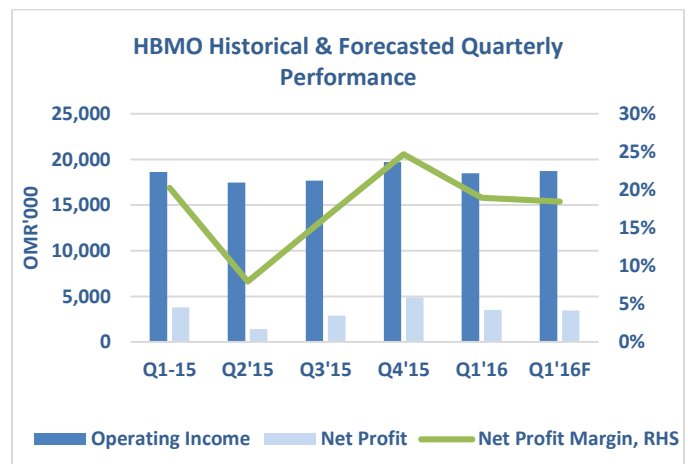
Source: Company Financials, OABinvest

Financial performance highlights for 1Q16

HSBC Oman posted its 1Q16 results with a net profit beat of 40% on our estimates at OMR 3.5 mn vs. OABe 2.5mn, primarily on a 64% beat on Operating Profit for 1Q16 at OMR 6.3mn vs. OABe of OMR 3.84mn. Operating Income for 1Q16 was lower by 1%YoY and 6%QoQ, at OMR 18.5mn vs. OABe OMR 17.5mn. Operating expenses were lower by 8%YoY and 10%QoQ at OMR 12.2mn vs. OABe 13.7mn, leading to a Cost to Income ratio of 66% vs. OABe of 78%. This cost to income ratio is the lowest recorded since 1Q14. The bank has booked a large provision expense which is understandable as there has been a hefty increase in its net loans & advances. Must be noted that the bank booked a large pre-tax profit of its legacy shares in Visa Inc in 4Q15 worth about OMR 3.6mn. The Operating profit for 1Q16 shows a robust growth on the back of an exceptional growth in net loans & advances of 13%YoY and 15%QoQ, bringing the Loan-to-Deposit ratio to an ever high of 78% (vs OABe 66%; consistent with the bank's prudent policies inherited from the parent). Customer deposits are, however, showing a negative sign with a decline of 8%YoY and 1%QoQ and could be a worrisome trend going forward.



Source: Company Financials, OABinvest



Key Financials

(OMR mn)	2013	2014	2015	2016e	2017e	2018e	2019e
Income Statement							
Interest/Financing Income	57.1	56.1	56.1	57.9	60.1	63.4	66.6
Interest Expense/Payment to Depositors	(9.1)	(7.2)	(6.9)	(6.8)	(6.8)	(7.1)	(7.4)
Net Interest/Financing Income	48.1	48.9	49.2	51.1	53.2	56.3	59.1
Fee & Commission Income	11.5	12.6	12.5	11.8	11.9	12.7	14.2
Other Income	9.1	9.6	11.9	11.2	12.7	13.3	13.0
Total Non-Interest/Financing Income	20.6	22.1	24.4	23.0	24.6	26.0	27.3
Total Operating Income	68.7	71.0	73.5	74.1	77.9	82.3	86.4
Provisions expense	2.2	(2.9)	(3.4)	(3.9)	(4.2)	(4.4)	(4.6)
Operating Expenses	(57.8)	(55.3)	(54.7)	(55.2)	(58.0)	(61.2)	(64.3)
Profit Before Taxation	13.1	12.8	15.4	15.1	15.7	16.6	17.5
Sale of associate (net)	-	-	-	-	-	-	-
Taxation & Minority Interest	(2.3)	(0.5)	(2.4)	(1.9)	(2.0)	(2.1)	(2.2)
Net Profit Attributable to Parent	10.9	12.2	12.9	13.2	13.8	14.6	15.3
Balance Sheet							
Cash Balances	118	180	278	116	61	41	40
Deposits with Banks & FIs	194	156	10	11	12	12	13
Gross Loans & Financings	1,081	1,261	1,284	1,387	1,470	1,543	1,621
Loan Loss Reserve	(101)	(100)	(83)	(90)	(95)	(100)	(105)
Net Loans & Financings	980	1,161	1,201	1,297	1,375	1,443	1,516
Net Fixed Assets	31	30	27	26	24	22	20
Other Assets	897	716	684	735	776	812	850
Total Assets	2,221	2,243	2,200	2,185	2,247	2,330	2,438
Deposits from Banks & FIs	42	30	36	36	37	38	40
Deposits from Customers	1,793	1,852	1,802	1,784	1,838	1,911	2,007
Other Borrowings	-	-	-	-	-	-	-
Other Liabilities	81	51	53	50	51	53	56
Paid-up Capital	200	200	200	200	200	200	200
Retained Earnings	66	69	71	77	83	90	98
Other Reserves	40	41	37	37	37	37	37
Shareholders' Equity	306	310	309	315	321	327	335
Minority Interest	-	-	-	-	-	-	-
Total Equity & Liability	2,221	2,243	2,200	2,185	2,247	2,330	2,438
Cash Flow Statement							
Cash from operations	(0)	72	114	(154)	(48)	(12)	7
Cash from investing activities	3	1	(1)	1	-	-	-
Cash from financing	1	(8)	(14)	(7)	(8)	(8)	(8)
Net changes in cash	(3)	62	101	(162)	(55)	(20)	(1)
Cash at the end of period	118	180	281	116	61	41	40
Key Ratios							
Return on Average Assets	0.5%	0.5%	0.6%	0.6%	0.6%	0.6%	0.6%
Return on Average Equity	3.6%	4.0%	4.2%	4.2%	4.3%	4.5%	4.6%
Recurring Income/Operating Income	87%	87%	84%	85%	84%	84%	85%
Interest Earning/Financing Assets Yield	2.8%	2.8%	2.9%	3.0%	2.9%	2.9%	2.9%
Cost of Funds	0.5%	0.4%	0.4%	0.4%	0.4%	0.4%	0.4%
Net Spread	2.3%	2.4%	2.6%	2.6%	2.6%	2.6%	2.6%
Cost to Income Ratio	81%	75%	71%	72%	72%	72%	72%
Net Loans to Customer Deposits	55%	63%	67%	73%	75%	76%	76%
NPLs to Gross Loans	9%	7%	6%	6%	6%	6%	6%
NPL Coverage	107%	108%	116%	112%	114%	113%	113%
Provisions/Total Income	147%	141%	113%	121%	122%	122%	122%
Cost of Risk (bps)	(11)	15	18	20	20	20	20
Equity to Gross Loans	28%	25%	24%	23%	22%	21%	21%
Equity to Total Assets	14%	14%	14%	14%	14%	14%	14%
Dividend Payout Ratio	70%	90%	60%	53%	57%	54%	51%
Adjusted EPS (AED)	0.005	0.006	0.006	0.007	0.007	0.007	0.008
Adjusted BVPS (AED)	0.15	0.15	0.15	0.16	0.16	0.16	0.17
Market Price (AED)	0.188	0.141	0.126	0.116	0.116	0.116	0.116
Dividend Yield	2.0%	3.9%	3.1%	3.0%	3.4%	3.4%	3.4%
P/E Ratio (x)	34.6	23.0	19.4	17.6	16.8	15.9	15.2
P/BV Ratio (x)	1.2	0.9	0.8	0.7	0.7	0.7	0.7

Source: OABInvest, Company Financials

Market price for 2016 and subsequent years based on closing price of 10/05/2016

Recommendation

BUY	Greater than 20%
ACCUMULATE	Between +10% and +20%
HOLD	Between +10% and -10%
REDUCE	Between -10% and -20%
SELL	Lower than -20%

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Research Division

Email: Research@oabinvest.com

Business Development Division

Email: BD@oabinvest.com

Product Development Division

Email: b.alrousan@oabinvest.com

Asset Management Division

Email: assetmanagement@oabinvest.com

Brokerage Division

Email: brokerage@oabinvest.com

Corp. Finance & Advisory Division

Email: corporatefinance@oabinvest.com

Wealth Management-NRI

Email: S.parvez@oabinvest.com

Custody Division

Email: custody@oabinvest.com

Customer Services Division

Email: customerservice@oabinvest.com

PO Box 2010, Ruwi, 112, Muscat-Oman. Tel: +968 24754576 Fax: +968 24125125

Web site: <http://www.oabinvest.com>

e-mail: research@oabinvest.com

