# Arab National Bank (ARNB)

## Lower LLP driving bottom-line; Credit growth – a 2011e story

**September 6, 2010**
**CMP: SAR 41.70**

**Arab National Bank (ARNB) is regarded as a retail and SME bank in the country and is an associate company of Arab Bank. It is one of the prominent mid-sized banks with a market share of 7.7% in Total Assets and 8.5% in terms of credit.**

**Investment Highlights**

- **Risk Aversion to delay credit growth to 2011e**
  ARNB has been active as being the banker to the medium sized enterprises and thus it became risk averse in 2009 and H1'10. Thus, as the economy sets rolling, the trickle down impact to these mid-size corporates should flow through only in 2011e thereby keeping credit growth muted in 2010e.

- **Flattish Margins and low credit outlook to pull down core income in 2010e**
  While declining asset yields negated the overall impact of lower funding costs keeping margins flat; we believe that lower credit volumes outlook could keep its core income down in 2010e with recovery seen in 2011e on back of improved credit off-take.

- **Deposit to play catch up with loans**
  With increased risk aversion on lending and lower avenues to deploy funds, the bank focused on drawing down its time deposits. As credit growth picks up, we could see deposits doing a catch up with loans.

- **Fee income to move in tandem with credit; Investment Income to drive Non-Interest Income in 2010**
  Total Non-Interest Income increased 17.5% Y-o-Y in H1'10 driven by 563% growth in investment income. Thus, Investment income in our view should dominate the growth in Non-Interest Income in 2010e. As majority of fee income is generated through banking services, we thus believe that it should move in-line with credit growth.

- **NPL cycle should have already peaked in our view; Lower credit loss charges to boost bottom-line**
  ARNB has managed its asset quality well with very minimal NPL's on the retail side while corporate book deterioration was driven by one-off events in 2009. We thus believe that NPL's should have peaked in 2009 and foresee lower credit charges to boost net income going forward.

- **ARNB well positioned to take advantage of the eagerly awaited Mortgage Law**
  Attractive demographics; low home ownership and the expected introduction of new mortgage law makes us positive of ARNB's venture and estimate it to contribute positively to the bottom-line.

**Initiate with HOLD; Target price at SAR 44. 50**
We value Arab National Bank (ARNB) at SAR 44.50 per share using a residual income approach which translates to an implied PB 2010e of 1.8x and 2011e PB of 1.6x.

On a relative basis, ARNB looks attractive at 2010e PB of 1.7x (trading at 10.5% discount to its local peers) together with average ROE expectation of 15.8% as against local peer group average of 12.7%, however given its weaker credit outlook; we believe its peers offer a much better play on the sector and thus we give it a HOLD rating.

**Report Purpose**
Coverage Initiation

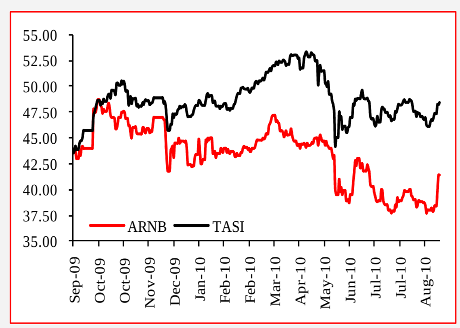
**Recommendation**
Target Price: SR 44.50
HOLD

**Stock Details**

| | |
|---|---|
| Exchange / Code | TASI / 1080 |
| Bloomberg Code | ARNB AB |
| Equity Capital | SAR 6.50bn |
| Face Value | SAR 10 |
| 52-Week H/L | SAR 49.10 / 36.50 |
| Market Cap | SAR 26.91bn |

**Shareholding Pattern**

| | |
|---|---|
| Arab Bank | 40.00% |
| GOSI | 10.80% |
| Rashed Abdul Rahman Al Rashed and Sons Company | 9.90% |
| Al Jabr trading Co | 5.60% |
| Public | 33.7% |

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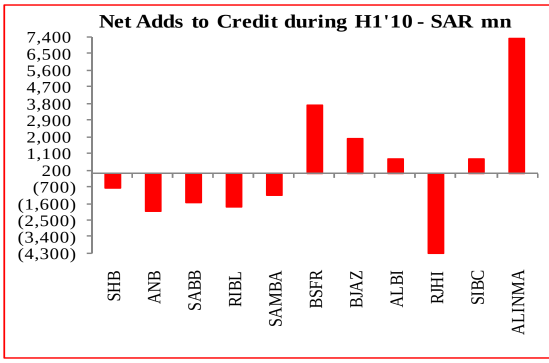
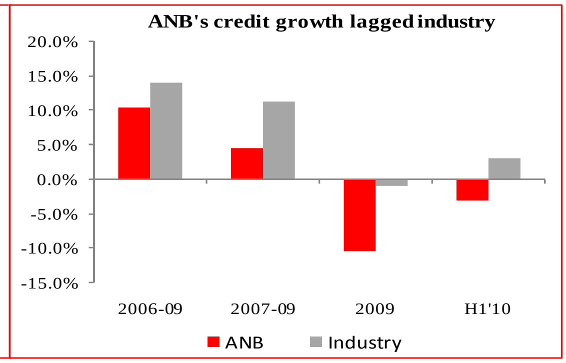
## Investment Summary

**Credit growth could lag industry in 2010; a 2011 story**

Arab National Bank (ARNB) is a conservative bank, which is evident from its credit growth of 10.3% CAGR 2006-2009 period as compared to 14.0% for the industry over the same period. We saw a similar trend in 2009 and H1'10 where ARNB saw its credit book declining by 10.5% and 3.0% respectively as against an overall decline of 1.1% in 2009 and a growth of 3.1% in H1'10 for the entire banking sector.



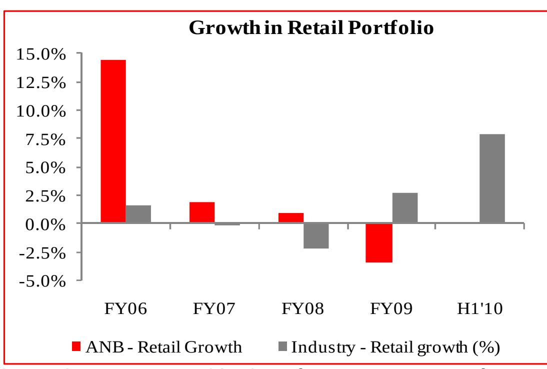



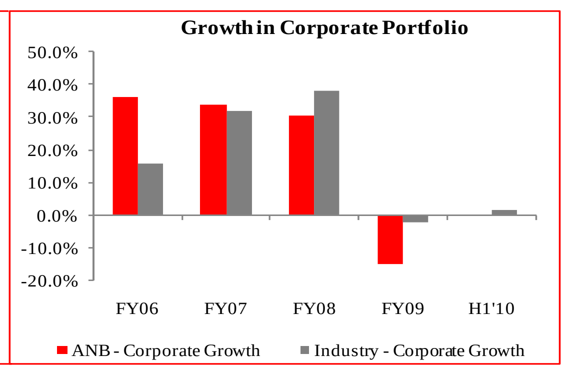

Source: Company Reports; SAMA; BankMuscat Equity Research

ARNB has been active as being the banker to the medium sized enterprises which partly explains its stringent risk aversion in 2009 and H1'10. However, we believe that as the economy sets rolling the trickle down impact to these mid-size corporates should flow through in 2011e while the credit growth in H2'10 should be driven by the large corporates primarily on back of re-financing of working capital needs as contractors exhaust the advance government payments.

In-line with industry trend, 70.1% of ARNB's credit book comprises of loans which are short-term in nature (as against 75% for the sector) and thus we continue to believe that as the upfront payments made by government to the contractors/developers are utilized the contractors and developers could again start approaching banks to re-finance their working capital needs. However, we believe that the incremental impact for ARNB could be relatively lower due to its skewness towards medium sized enterprises.

Historically, ARNB has been strong on the retail side with its retail book growing by 5.6% CAGR over 2005-08 period as against a decline of 0.3% for the industry over the same period. However, this trend reversed in 2009 as the bank became risk averse and other banks started to focus on retail. As a result, ARNB's retail book declined 3.4% in 2009 as compared to a sector-wide growth of 2.8%. The pace of retail lending further increased in H1'10 as retail book grew by 7.9% on a systemic level. ARNB has not disclosed the breakup of its loans, but we believe that its retail portfolio could have seen a growth in H1'10 while it continued to shy away from corporate sector.



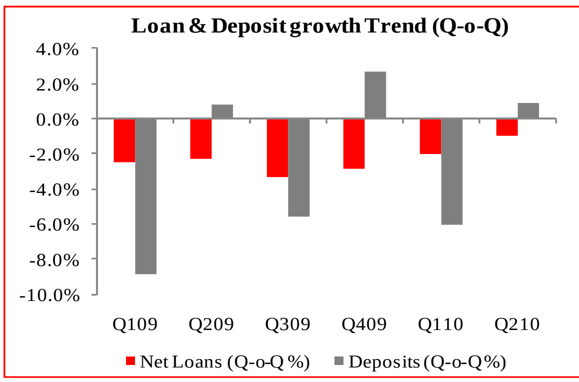



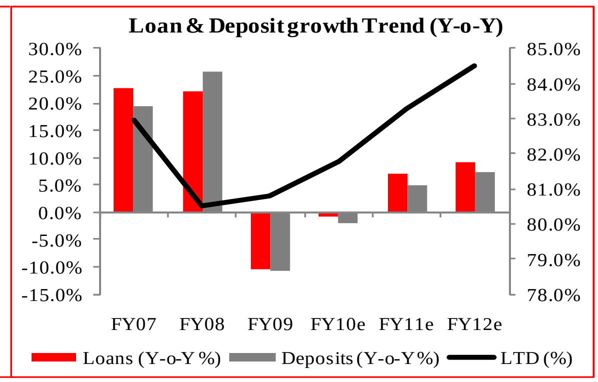

Source: Company Reports; SAMA; BankMuscat Equity Research

We thus anticipate a 1.8% credit growth in H2’10 but a 3.0% decline in H1’10 would result in an overall reduction of 0.8% in ARNB’s credit portfolio. This compares unfavorably to our overall expectation of 7-9% credit growth for the sector. However, we believe that loan growth should recover to 7.0% in 2011e on back of reduced risk aversion by banks; strong macro environment; re-financing of working capital needs by contractors working on government projects and a robust project finance pipeline and attractive demographics.

**Deposit to play catch up with loans**

While its loan book continued to trend south for the last six quarters declining by an average 2.3%, deposits declined by 2.7% over the same period. ARNB ended H1’10 with a deposit base of SAR 78.3bn (down 5.24% Ytd). We attribute the bank’s strategy to drawdown time deposits, which declined by SAR 19.5bn (down 31.6% Y-o-Y) in 2009 as the main factor for declining deposit base. Moreover, ARNB ended Q2’10 with a credit-to-deposit ratio at 82.7% (maintaining its historical average of 82%) which gives the bank enough room to grow on its existing resources. We thus believe that deposit growth could remain muted because of poor credit outlook for 2010e and more than adequate liquidity. However, credit growth expectation in 2011e and rock-bottom funding costs could induce ARNB to accumulate deposits during H2’10 and we thus forecast deposits to grow by 3.4% in H2’10 translating to 2010e deposit base of SAR 81bn (Y-o-Y decline of 2%).

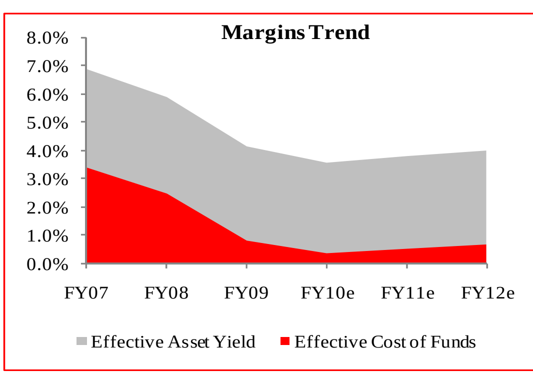


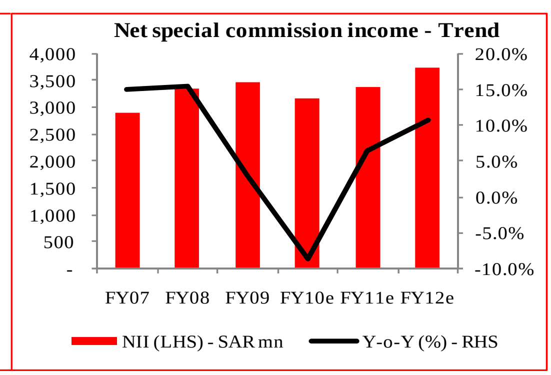




Source: Company Reports; BankMuscat Equity Research

**Flattish Margins and low credit outlook to pull down core income**

ARNB’s average effective cost of funds have been on a declining trend as it declined from 2.5% in 2008 to 0.8% in 2009 primarily driven by reducing interest rates and improving deposit mix. During 2009, Arab National Bank improved its deposit mix as it focused on drawing down its time deposits which declined by SAR 19.5bn (decline of 31.6%) and grew its demand deposits by SAR 8.7bn (30.4% Y-o-Y). As a result, proportion of demand deposits increased from 31.0% in 2008 to 45.3% in 2009 while the proportion of time deposits declined to 51.1% from 66.6% in 2008. Moreover, the proportion of non-commission bearing deposits also increased from 31.8% in 2008 to 47.0% in 2009. This further enabled the bank to reduce its costs to 0.3% in Q2’10.



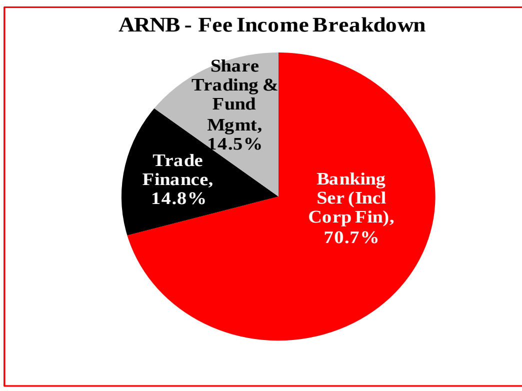

Source: Company Reports; BankMuscat Equity Research

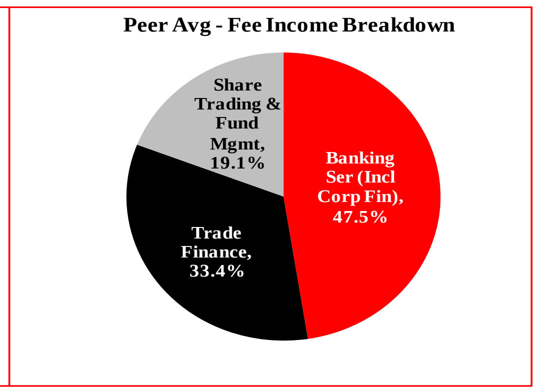
On the other hand, asset yields have also experienced a downhill journey as they declined from 5.9% in 2008 to 4.1% in 2009 and further to 3.6% in Q210. Our analysis reveals that in addition to lower investment yields in general, downward re-pricing of loan book could be the main reason for this. This in turn has kept the margins flat at around 3.3%-3.5% over the last six quarters.

As we believe project financing on government-backed projects to be the main driver for corporate credit growth in 2011e we thus opine improving yields may not be easy. We thus forecast flattish margins going forward. We thus anticipate, NII to decline by 8.6% in 2010e on back of lower credit volumes and flat margins and continue to believe that any NII improvement will be a factor of volume growth.

**Fee income to move in tandem with credit; Investment Income to drive Non-Interest Income in 2010**
Total Non-Interest Income increased from SAR 562.6mn in H1'09 to SAR 661.2mn in H1'10 (17.5% Y-o-Y) primarily driven by 563% growth in investment income which more than offset 5% decline in fee income. As a result contribution of investment income increased from 4.0% in H1'09 to 22.5% in H1'10. We thus, believe that Investment income will continue to drive Total Non-Interest Income in 2010e.

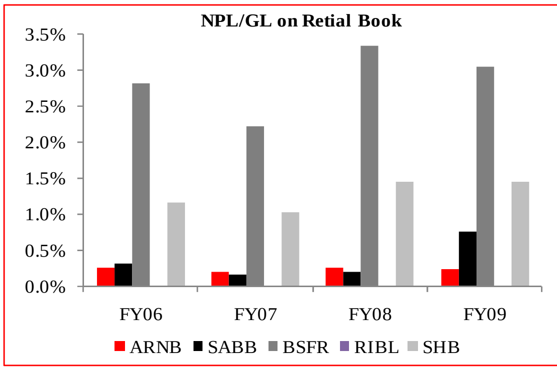
Arab National bank generated 70.7% of its total gross fee income from other banking services while Share Trading and Trade Finance contributed another 14.5% and 14.8% respectively in 2009. We believe that the bank has classified corporate finance and advisory income under other banking services, which makes comparison across banks difficult as Riyad bank clubs corporate finance income with trade finance. However, if we exclude Riyad Bank and compare ARNB with other banks, we find that other banking services (including corporate finance) forms 49% for Saudi Hollandi; 45.3% for Saudi British and 48.2% for Saudi Fransi. We attribute this highly skewed nature of fee income to ARNB's high retail focus compared to its peers. We thus believe that fee income should remain stable in 2010e and move in tandem with credit growth in 2011e.

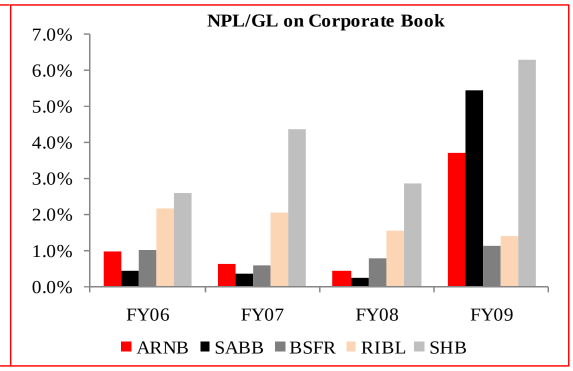



Source: Company Reports; BankMuscat Equity Research

**NPL cycle should have already peaked in our view; Lower credit loss charges to boost bottom-line**
ARNB was also a victim of the twin high ticket defaults in KSA whereby its NPL/GL increased from 0.4% in 2008 to 2.8% in 2009 and surged the cost of risk to 0.8% as compared to 0.1% in 2008. As a result, its coverage ratio declined from 349% to 76%. Looking at sectoral breakup of ARNB's credit portfolio, we find that Arab National Bank is well entrenched in the retail side (as compared to other banks under our coverage) with consumer loans forming 28.8% of total loan book (average for last four years) as compared to 15.5% average exposure for other Saudi banks under our coverage. However, ARNB has managed its asset quality well on the retail side with its NPL/GL ratio in consumer segment hovering in the range of 0.2%-0.3% over the last four years as compared to an average NPL/GL of 1.1% for other banks under our coverage. We thus remain confident of the bank's ability to control NPL's on the retail side and thus do not foresee any major incremental NPL's from the retail side.



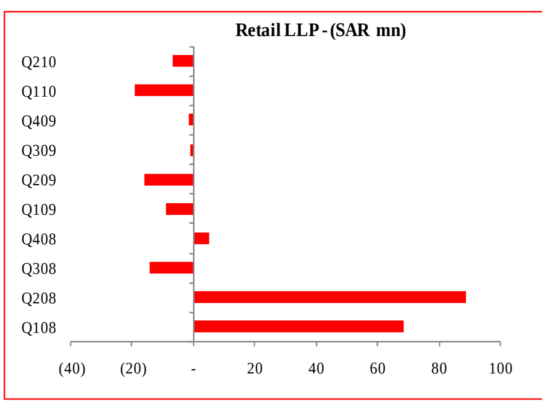



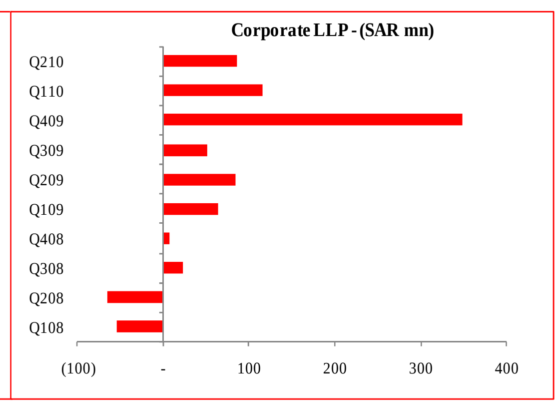

Source: Company Reports; BankMuscat Equity Research

On the corporate side, Commerce and Manufacturing sectors forms around 29% of total loan book for ARNB as against 42% contribution of these two sectors for other banks in Saudi. Once again, ARNB has better managed its asset quality in these dominant sectors with NPL/GL reaching 6.1% in 2009 as compared to 9.0% for its peers. Moreover, the majority of asset quality deterioration (NPL/GL) came from – “Banks & other Financial Institutions” and “Services” sectors which in turn contributed only 3.1% and 2.0% to total loan book thereby making the threat of these minimal. We thus believe that these corporate NPLs were more of one-offs and thus see NPLs from the corporate side improving going forward and estimate NPL/GL to improve in 2010e and 2011e.

Following the NPL trend cost of risk also increased to 0.8% in 2009 as compared to 0.2% average over last four years. While retail segment led the way in 2008 with credit impairment charges (net of recoveries) of SAR 148mn corporate segment asset quality remained healthy with net recoveries of SAR 87.6mn. However, this trend reversed in 2009 with corporate segment leading the way with credit impairment charges of SAR 549mn, out of which 63% came in Q409 due to SAAD/AHAB defaults. On the other hand, the bank managed to record net recoveries in retail to the tune of SAR 27.3mn. Moreover, looking at H1’10 we find that the bank is continuing to record net recoveries in the retail segment to the tune of SAR 26mn.

Additionally, the credit impairment charges on the corporate side seem to be declining sequentially over the last three quarters from SAR 348mn in Q409 to SAR 116mn in Q110 and further to SAR 86mn in Q210. Though the current rate still remains higher than average rate of SAR74mn for H1’09, we believe that in-line with our expectation of improving asset quality, cost of risk will mirror a declining trend. We thus estimate the total cost of risk to decline from 0.8% in 2009 to 0.6% in 2010e and further to 0.5% in 2011e thereby boosting the bottom-line by 6.1% (stand alone impact) in 2010e and 1.5% in 2011e.




Source: Company Reports; BankMuscat Equity Research

**ARNB well positioned to take advantage of the eagerly awaited Mortgage Law**

In 2008, ARNB established a specialized Islamic home finance products company – "Saudi Home Loans" - a joint venture with Dar-Al-Arkan to provide mid-level housing units and financing options for buyers. As per the Ministry of Economy and Planning, total demand for housing in the country should be around 1.25mn new units out of which 1mn housing units are planned to come up by 2014 (as part of the ninth development plan), (roughly 200,000 units/year). The government has earmarked a SAR 1.4bn to speed up the construction of these 1mn new housing units.

Moreover, with attractive demographics, of around 65% of the total population being under 25 years and additions to the workforce every year together with emerging nuclear family concept and low house ownership makes this market lucrative. Additionally, as the new mortgage law is introduced it should further provide an impetus to the home finance market. We thus remain positive of ARNB's venture and estimate it to contribute positively to the bottom-line.

**Initiate with HOLD; Target price at SAR 44. 50**

We value Arab National Bank (ARNB) using a residual income approach in which the intrinsic value of a bank is the sum of current NAV and the present value of future excess earnings. We use a risk free rate of 5%, risk premium of 7.5% and a beta of 1.14 (which is calculated over the last 3 years) to arrive at a cost of equity of 13.6%. We further assume a terminal ROE of 20.0% and thus value ARNB at SAR 44.50 per share translating to an implied PB 2010e of 1.8x and 2011e PB of 1.6x.

On a relative basis, ARNB looks attractive at 2010e PB of 1.7x (trading at 10.5% discount to its local peers) together with average ROE expectation of 15.8% as against local peer group average of 12.7%, however given its weaker credit outlook; we believe its peers namely Saudi Fransi and Riyad bank offer a much better play on the sector and thus we give it a HOLD rating. Our sensitivity analysis of our target price by varying the terminal ROE with the cost of equity yields the most probable price range of SAR 37.37 – 51.31 per share.

| QATAR BANKS | PE | | PB | | ROE % | |
|---|---|---|---|---|---|---|
| | 2010e | 2011e | 2010e | 2011e | 2010e | 2011e |
| Qat. National Bank | 11.0x | 9.4x | 2.5x | 2.2x | 23.8% | 23.3% |
| Qat. Islamic Bank | 9.5x | 8.1x | 1.9x | 1.7x | 17.9% | 20.0% |
| Comm. Bank Of Qatar | 9.7x | 8.1x | 1.4x | 1.3x | 14.1% | 15.9% |
| Rayan | 12.1x | 11.1x | 1.6x | 1.6x | 14.1% | 14.1% |
| Doha Bank | 8.4x | 6.9x | 1.5x | 1.4x | 17.7% | 19.5% |
| Intl. Islamic Bank | 9.6x | 7.7x | 1.6x | 1.5x | 16.6% | 19.8% |
| **Mean** | **10.0x** | **8.5x** | **1.8x** | **1.6x** | **17.4%** | **18.8%** |
| **Median** | **9.7x** | **8.1x** | **1.6x** | **1.5x** | **17.2%** | **19.7%** |

| OMAN BANKS | PE | | PB | | ROE % | |
|---|---|---|---|---|---|---|
| | 2010e | 2011e | 2010e | 2011e | 2010e | 2011e |
| Bank Muscat | 10.8x | 8.6x | 1.5x | 1.3x | 18.2% | 15.2% |
| Bank Dhofar | 17.4x | 15.3x | 2.6x | 2.4x | 15.0% | 15.4% |
| Nat. Bk. Of Oman | 9.8x | 8.4x | 1.4x | 1.2x | 14.3% | 15.5% |
| Oman Int. Bk. | 11.1x | 10.6x | 1.4x | 1.4x | 12.9% | 13.4% |
| Bank Sohar | 17.8x | 14.3x | 1.9x | 1.7x | 11.2% | 12.5% |
| Ahli Bank | 14.6x | 11.3x | 1.9x | 1.8x | 13.5% | 16.3% |
| **Mean** | **13.6x** | **11.4x** | **1.8x** | **1.6x** | **14.2%** | **14.7%** |
| **Median** | **12.9x** | **11.0x** | **1.7x** | **1.6x** | **13.9%** | **15.3%** |

| SAUDI BANKS | PE | | PB | | ROE % | |
|---|---|---|---|---|---|---|
| | 2010e | 2011e | 2010e | 2011e | 2010e | 2011e |
| Al Rajhi Bank | 16.1x | 12.8x | 3.8x | 3.3x | 23.6% | 26.2% |
| Samba Financial Group | 12.0x | 10.1x | 2.2x | 1.9x | 19.6% | 19.6% |
| Riyad Bank | 13.5x | 12.2x | 1.4x | 1.3x | 10.6% | 10.9% |
| The Saudi British Bank | 14.9x | 12.1x | 2.3x | 2.0x | 16.1% | 17.7% |
| Banque Saudi Fransi | 11.0x | 9.6x | 1.9x | 1.7x | 17.7% | 18.2% |
| Arab National Bank | 10.3x | 9.0x | 1.5x | 1.3x | 15.8% | 15.9% |
| Saudi Hollandi Bank | 19.1x | 15.5x | 1.8x | 1.6x | 9.6% | 11.0% |
| The Saudi Investment Bank | 18.7x | 11.7x | 1.2x | 1.1x | 6.7% | 10.1% |
| Bank AlBilad | 44.8x | 22.8x | 1.8x | 1.7x | 4.2% | 7.6% |
| Bank AlJazira | 32.4x | 13.1x | 1.1x | 1.0x | 3.4% | 8.0% |
| **Mean** | **19.3x** | **12.9x** | **1.9x** | **1.7x** | **12.7%** | **14.5%** |
| **Median** | **15.5x** | **12.2x** | **1.8x** | **1.6x** | **13.2%** | **13.5%** |

| UAE BANKS | PE | | PB | | ROE % | |
|---|---|---|---|---|---|---|
| | 2010e | 2011e | 2010e | 2011e | 2010e | 2011e |
| National Bank of AD | 9.1x | 10.2x | 1.2x | 1.1x | 13.7% | 11.0% |
| First Gulf Bank | 6.2x | 6.6x | 0.8x | 0.7x | 12.9% | 11.1% |
| Emirates NBD | 5.8x | 3.7x | 0.5x | 0.4x | 7.0% | 11.6% |
| Dubai Islamic Bank | 8.7x | 6.3x | 0.7x | 0.7x | 10.9% | 11.3% |
| AD Commercial Bank | - | 5.6x | 0.5x | 0.6x | 0.5% | 8.3% |
| Union National Bank | 5.8x | 4.7x | 0.7x | 0.6x | 12.8% | 13.7% |
| AD Islamic Bank | 6.9x | 4.6x | 1.1x | 1.0x | 15.2% | 20.6% |
| **Mean** | **7.1x** | **5.9x** | **0.8x** | **0.7x** | **10.4%** | **12.5%** |
| **Median** | **6.6x** | **5.6x** | **0.7x** | **0.7x** | **12.8%** | **11.3%** |

| BAHRAIN BANKS | PE | | PB | | ROE % | |
|---|---|---|---|---|---|---|
| | 2010e | 2011e | 2010e | 2011e | 2010e | 2011e |
| Ahli United Bank | 11.5x | 8.9x | 1.4x | 1.3x | 12.4% | 14.8% |
| Al Salam Bank | 12.8x | 9.5x | 0.6x | 0.5x | 4.2% | 5.6% |
| Bahrain Islamic Bank | -44.0x | 23.2x | 0.8x | 0.8x | -1.9% | 3.6% |
| **Mean** | **-6.6x** | **13.9x** | **0.9x** | **0.8x** | **4.9%** | **8.0%** |
| **Median** | **11.5x** | **9.5x** | **0.8x** | **0.8x** | **4.2%** | **5.6%** |

| KUWAIT BANKS | PE | | PB | | ROE % | |
|---|---|---|---|---|---|---|
| | 2010e | 2011e | 2010e | 2011e | 2010e | 2011e |
| National Bank Of Kuwait | 14.6x | 12.9x | 2.4x | 2.1x | 16.2% | 18.1% |
| Commercial Bank Of Kuwait | 37.8x | 15.3x | 2.4x | 2.2x | 4.3% | 13.9% |
| Al-Ahli Bank Of Kuwait | 15.1x | 14.5x | 1.6x | 1.5x | 12.7% | 11.0% |
| Burgan Bank | 21.9x | 14.4x | 1.4x | 1.3x | 7.2% | 9.5% |
| Kuwait International Bank | 35.1x | 20.6x | 1.4x | 1.3x | 4.5% | 7.2% |
| **Mean** | **24.9x** | **15.5x** | **1.8x** | **1.7x** | **9.0%** | **11.9%** |
| **Median** | **21.9x** | **14.5x** | **1.6x** | **1.5x** | **7.2%** | **11.0%** |

| | PE 2010e | PE 2011e | PB 2010e | PB 2011e | ROE % 2010e | ROE % 2011e |
|---|---|---|---|---|---|---|
| **Combined Mean** | **13.4x** | **11.1x** | **1.6x** | **1.4x** | **12.1%** | **14.0%** |
| **Combined Median** | **11.7x** | **10.2x** | **1.5x** | **1.3x** | **12.9%** | **13.9%** |

Source: Bloomberg Consensus Estimates; BankMuscat Equity Research

Note: 2010e and 2011e numbers for Omani Banks (excl. BKMB); SABB; RIBL and SHB are our estimates while others are consensus estimates

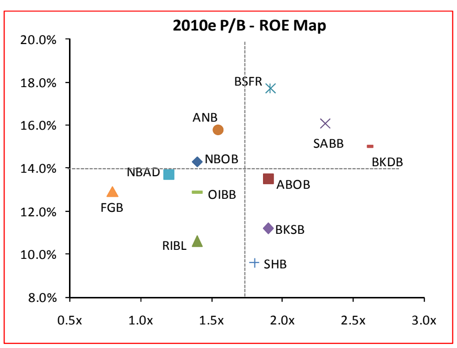
## Financial Statements

| Income Statement (SAR mn) | FY08 | FY09 | FY10e | FY11e | FY12e |
|---|---|---|---|---|---|
| **Special commission income** | **5,639** | **4,234** | **3,471** | **3,826** | **4,362** |
| *Y-o-Y Growth* | *4.1%* | *-24.9%* | *-18.0%* | *10.2%* | *14.0%* |
| **Special commission expense** | **2,285** | **778** | **311** | **462** | **639** |
| *Y-o-Y Growth* | *-9.1%* | *-65.9%* | *-60.0%* | *48.4%* | *38.3%* |
| **Net special commission income** | **3,354** | **3,456** | **3,160** | **3,364** | **3,723** |
| *Y-o-Y Growth* | *15.5%* | *3.1%* | *-8.6%* | *6.5%* | *10.7%* |
| | | | | | |
| **Fee Based Income** | **1,253** | **982** | **1,048** | **1,167** | **1,302** |
| *Y-o-Y Growth* | *24.1%* | *-21.7%* | *6.8%* | *11.3%* | *11.6%* |
| Fees from banking services, net | 839 | 563 | 591 | 641 | 712 |
| Exchange income, net | 266 | 260 | 338 | 388 | 435 |
| Other operating income | 148 | 159 | 119 | 137 | 155 |
| | | | | | |
| **Investment & Trading Income** | **(413)** | **69** | **186** | **203** | **223** |
| *Y-o-Y Growth* | *-12925.7%* | *-116.7%* | *170.4%* | *9.3%* | *9.4%* |
| Income (Loss) from FVIS financial instruments, net | - | - | - | - | - |
| Trading income, net | 5 | 11 | 33 | 38 | 42 |
| Dividend income | 6 | 13 | 23 | 25 | 27 |
| Gains (Losses) on non-trading investments, net | (424) | 45 | 130 | 141 | 153 |
| **Total Non-Interest Income** | **840** | **1,050** | **1,234** | **1,370** | **1,524** |
| *Y-o-Y Growth* | *-16.5%* | *25.1%* | *17.5%* | *11.0%* | *11.3%* |
| | | | | | |
| **Total Income** | **4,193** | **4,507** | **4,394** | **4,735** | **5,247** |
| *Y-o-Y Growth* | *7.2%* | *7.5%* | *-2.5%* | *7.8%* | *10.8%* |
| | | | | | |
| **Total Operating Expenses** | **1,582** | **1,601** | **1,636** | **1,671** | **1,694** |
| *Y-o-Y Growth* | *10.8%* | *1.2%* | *2.2%* | *2.1%* | *1.4%* |
| | | | | | |
| **Total Operating Income** | **2,612** | **2,905** | **2,758** | **3,064** | **3,553** |
| *Y-o-Y Growth* | *5.2%* | *11.2%* | *-5.1%* | *11.1%* | *16.0%* |
| | | | | | |
| Share in earnings of associates | (7) | 2 | 9 | 11 | 13 |
| **Profit before LLP and Inv Impairments** | **2,605** | **2,907** | **2,767** | **3,075** | **3,567** |
| *Y-o-Y Growth* | *4.9%* | *11.6%* | *-4.8%* | *11.1%* | *16.0%* |
| | | | | | |
| Provision for credit losses, net | 60 | 527 | 380 | 345 | 277 |
| Impairment of other financial assets | - | - | - | - | - |
| **PBT** | **2,544** | **2,380** | **2,387** | **2,730** | **3,289** |
| **PAT** | **2,544** | **2,380** | **2,387** | **2,730** | **3,289** |
| *Y-o-Y Growth* | *5.3%* | *-6.4%* | *0.3%* | *14.4%* | *20.5%* |
| Shares | 650 | 650 | 650 | 650 | 650 |
| **EPS** | **3.91** | **3.66** | **3.67** | **4.20** | **5.06** |

Source: Company Reports; BankMuscat Equity Research

| Balance Sheet (SAR mn) | FY08 | FY09 | FY10e | FY11e | FY12e |
|---|---|---|---|---|---|
| Cash and balances with SAMA | 12,051 | 10,457 | 9,606 | 9,462 | 9,796 |
| Due from banks and other financial institutions | 2,747 | 6,082 | 4,258 | 4,598 | 5,058 |
| Investments, net | 28,228 | 23,261 | 24,947 | 26,981 | 29,544 |
| *Y-o-Y Growth* | *34.3%* | *-17.6%* | *7.3%* | *8.1%* | *9.5%* |
| **Loans and advances, net** | **74,662** | **66,811** | **66,259** | **70,850** | **77,273** |
| *Y-o-Y Growth* | *22.2%* | *-10.5%* | *-0.8%* | *6.9%* | *9.1%* |
| Investment in associates | 193 | 315 | 324 | 335 | 349 |
| Property and equipment, net | 935 | 1,240 | 1,192 | 1,153 | 1,104 |
| Other assets | 2,388 | 2,030 | 2,944 | 3,533 | 3,956 |
| **Total assets** | **121,307** | **110,297** | **109,630** | **117,013** | **127,181** |
| | | | | | |
| Due to banks and other financial institutions | 10,509 | 8,714 | 7,407 | 7,963 | 8,759 |
| **Customer deposits** | **92,743** | **82,680** | **81,027** | **85,078** | **91,459** |
| *Y-o-Y Growth* | *25.9%* | *-10.9%* | *-2.0%* | *5.0%* | *7.5%* |
| Debt securities in issue | 1,875 | 1,688 | 1,688 | 1,688 | 1,688 |
| Term Loans | - | - | - | - | - |
| Other liabilities | 3,508 | 2,737 | 3,640 | 4,368 | 4,893 |
| **Total liabilities** | **108,636** | **95,819** | **93,762** | **99,096** | **106,798** |
| | | | | | |
| **Total shareholders' equity** | **12,671** | **14,369** | **15,760** | **17,808** | **20,275** |
| **Total liabilities and shareholders' equity** | **121,307** | **110,297** | **109,630** | **117,013** | **127,181** |

| Ratios | FY08 | FY09 | FY10e | FY11e | FY12e |
|---|---|---|---|---|---|
| **Capital Adequacy** | | | | | |
| Equity/Assets | 10.4% | 13.0% | 14.4% | 15.2% | 15.9% |
| Equity/Average Net Loans | 18.7% | 20.3% | 23.7% | 26.0% | 27.4% |
| **Earnings** | | | | | |
| ROAA | 2.3% | 2.0% | 2.2% | 2.4% | 2.7% |
| ROAE | 21.4% | 17.5% | 15.8% | 16.3% | 17.3% |
| NIM | 3.5% | 3.4% | 3.2% | 3.3% | 3.4% |
| **Liquidity** | | | | | |
| LTD Ratio | 80.5% | 80.8% | 81.8% | 83.3% | 84.5% |
| Customer Deposits/Equity | 7.3x | 5.8x | 5.1x | 4.8x | 4.5x |
| Customer Deposits/Total assets | 76.5% | 75.0% | 73.9% | 72.7% | 71.9% |
| Net Loans / Total Assets | 61.5% | 60.6% | 60.4% | 60.5% | 60.8% |
| Liquid Assets / Total Assets | 33.2% | 30.6% | 31.5% | 31.1% | 30.9% |
| Due from Banks/Due to Banks | 26.1% | 69.8% | 57.5% | 57.7% | 57.7% |
| **Efficiency** | | | | | |
| Cost to Income | 38.3% | 35.6% | 37.2% | 35.3% | 32.3% |
| Non-Interest Income/Total Income | 20.0% | 23.3% | 28.1% | 28.9% | 29.1% |
| Fee Income/Non-Interest Income | 149.2% | 93.4% | 84.9% | 85.2% | 85.4% |
| **Credit Quality** | | | | | |
| NPL/Gross Loans | 0.4% | 2.8% | 2.5% | 2.4% | 2.1% |
| Provision Coverage Ratio | 349.0% | 75.9% | 98.2% | 107.2% | 120.1% |
| LLP Charges, Net / Gross Loans | 0.1% | 0.8% | 0.6% | 0.5% | 0.4% |
| Provisions / Gross Loans | 1.4% | 2.1% | 2.5% | 2.5% | 2.5% |
| **Valuation** | | | | | |
| P/E | | | **11.4x** | **9.9x** | 8.2x |
| P/BV | | | **1.7x** | **1.5x** | 1.3x |
| Implied P/E | | | **12.1x** | **10.6x** | 8.8x |
| Implied P/BV | | | **1.8x** | **1.6x** | 1.4x |




Source: Bloomberg Consensus Estimates; BankMuscat Equity Research

**Terminal Return on Equity**

| Cost of Equity | 15.8% | 17.8% | 19.8% | 21.8% | 23.8% |
|---|---|---|---|---|---|
| **12.6%** | 38.46 | 43.92 | 49.38 | 54.84 | 60.30 |
| **13.1%** | 36.42 | 41.39 | 46.35 | 51.31 | 56.28 |
| **13.6%** | 34.70 | 39.22 | 43.75 | 48.27 | 52.79 |
| **14.1%** | 33.24 | 37.37 | 41.50 | 45.64 | 49.77 |
| **14.6%** | 32.00 | 35.78 | 39.57 | 43.35 | 47.14 |

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