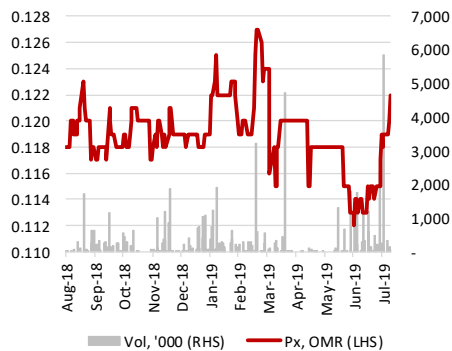


HSBC Bank Oman SAOG

TP : OMR 0.140 / share
Upside/ (Downside): 14.8%

Recommendation	Accumulate
Bloomberg Ticker	HBMO OM
Current Market Price (OMR)	0.122
52wk High / Low (OMR)	0.130/0.110
12m Average Vol. (000)	258.2
Mkt. Cap. (USD/OMR Mn)	634/244
Shares Outstanding (mn)	2,000.3
Free Float (%)	49%
3m Avg Daily Turnover (OMR'000)	38.4
6m Avg Daily Turnover (OMR'000)	34.2
PE 2019e (x)	6.64
PBv 2019e (x)	0.68
Dividend Yield '19e (%)	8.2%
Price Performance:	
1 month (%)	6.09
3 month (%)	3.39
12 month (%)	3.39
<i>Source: Bloomberg</i>	

Price-Volume Performance



Source: Bloomberg

18th August, 2019

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- **Lowest Loan-to-Deposit Ratio at 69% providing ample room to grow**
- **Well capitalized with CAR at 18.56%; Tier 1 capital ratio at 17.96%**
- **Highly liquid with average LCR at 223% as at the end of H1'19 vs. regulatory requirement of 100%**
- **Declining cost to Income amidst tight cost control; expected to fall to 54% in FY19e**
- **Dividend pay-out expected to be maintained at 60% of earnings**

We maintain our 12-month target price (TP) for HSBC Oman (HBMO) at OMR 0.140 per share and maintain its rating at **ACCUMULATE**. We have revised our forecasts upwards based on the bank's H1'19 performance, but a slower loan-book growth outlook along with reduction in peer-group valuations (our weighted average fair value is 80% Excess Returns and 20% peer-group P/B multiple based), has led us to maintain the fair value. Our fair value implies a P/e'19e of 0.78x and a P/b'19e of 0.78x, which we believe is justified given the bank's capital strength and improved credit quality metrics. The bank is focused on bringing its costs down (down 4%YoY in H1'19 vs. income growth of 3%YoY), which has helped buoy its profitability.

Valuation & Outlook

HSBC Oman boasts a strong surplus liquidity though reliance on CASA deposits which form about 68.3% of total customer deposits. Furthermore, cost of funding has risen but is still very low for the bank through its low-cost deposits, where about 76.1% of total customer deposits are booked in the 0-2% interest rate band, down from 89% as at 9M'19. The bank's balance sheet is primarily funded through customer deposits (c82%). It has no borrowing from wholesale markets or any other form of debt. This has led to a marked improvement in its spreads over the last few quarters, characteristic of a rising interest rate environment, where yields improve rapidly. However, with the recent Fed funds rate cut (not followed by Oman) and more cuts expected in the coming period (possibly followed by Oman), interest yield is expected to remain under pressure going forward. HSBC Oman's net interest income has shown a marked improvement in spite of a muted net loan growth (+0.7%YTD in H1'19). Furthermore, the bank's other operating income has been supported by its net trading income. We believe that the bank will continue to post operating income growth, which coupled with tight cost control (as is evident from decline in operating expenses of 4%YoY in H1'9), is expected to result in a net profit growth, in spite of a relatively subdued operating environment. The bank's profitability (ROaE) is expected to improve to 10.5% in FY19 from 9.5% in FY18. In the years thereafter, we expect ROaE to remain at about 10% as we have conservatively assumed ECL allowance charges, instead of allowance releases which the bank has been booking since last year.

Key Indicators

Year	FY16	FY17	FY18	FY19e	FY20e	FY21e
Total Net Loans (OMR mn)	1,418	1,395	1,390	1,417	1,458	1,516
Total Customer Deposits (OMR mn)	1,867	1,932	1,926	2,053	2,098	2,166
Operating Income (OMR mn)	75	75	86	91	94	98
Net Profit (OMR mn)	17	19	31	37	35	36
Diluted EPS (OMR)	0.008	0.010	0.016	0.018	0.018	0.018
Diluted BVPS (OMR)	0.157	0.162	0.170	0.179	0.186	0.193
P/E (x)	14.20	13.39	7.59	6.64	6.96	6.74
P/BVPS (x)	0.77	0.79	0.70	0.68	0.66	0.63
Dividend Yield (%)	4.2%	4.5%	7.8%	8.2%	8.6%	8.6%

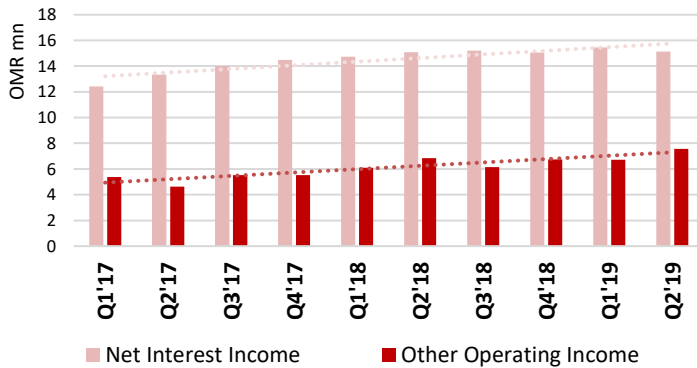
Source: Bank Financials, U Capital Research

**Market price for 2019 and subsequent years based on closing price of 08/08/2019*

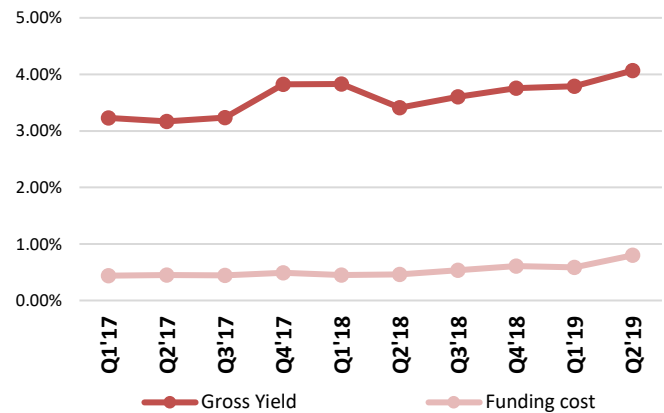
Stable net interest income on somewhat stable spreads

The bank's interest income has been rising on net loan growth as well as improvement in yields, characteristic of a rising interest rate environment. However, due to a rise in cost of funding, the bank's spreads are somewhat stable over the last 4 quarters, leading to a stable net interest income over the last few quarter at about OMR 15mn. Furthermore, with the recent Fed funds rate cut announcement and anticipation of further cuts over the near term, we believe that interest yield will remain under pressure.

HBMO: Topline drivers



HBMO: Interest yield and Funding cost

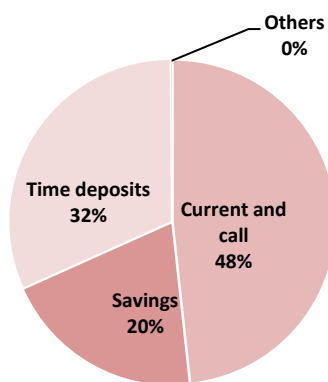


Source: Bank Financials, U Capital Research

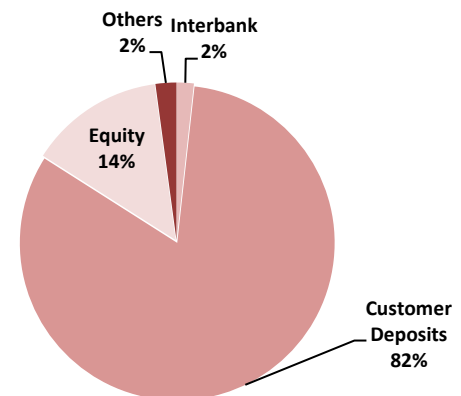
Strong liquidity position helping to control cost of funding

The bank boasts strong surplus liquidity though reliance on CASA deposits which form about 68.3% of total customer deposits. Furthermore, cost of funding has risen but is still very low for the bank through its low-cost deposits, where about 76.1% of total customer deposits are booked in the 0-2% interest rate band, down from 89% as at 9M'19. The bank's balance sheet is primarily funded through customer deposits (c82%). The bank has no borrowing from wholesale markets or any other form of debt.

HBMO: Deposits Classification H1'19



HBMO: Funding Mix H1'19

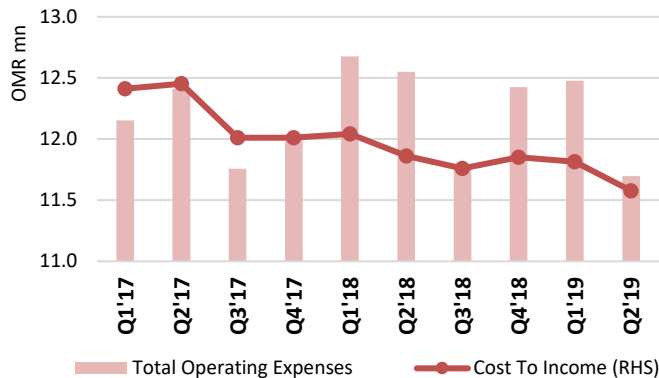


Source: Bank Financials, U Capital Research

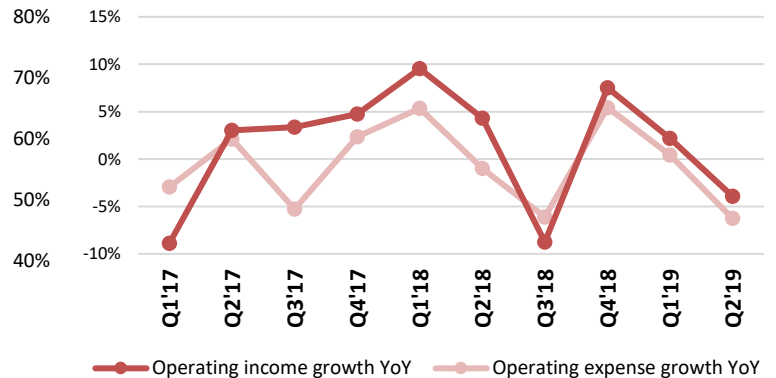
Rapidly Improving efficiency metrics

The bank's operating expenses have declined by 4%YoY in H1'19. Operating income growth has been consistently outpacing operating expense growth since Q1'17 and therefore cost-to-income ratio of the bank has declined to 54% in H1'19 from 59% in H1'18 and 58% in FY18. The bank is consciously pursuing cost control as one of the prime objectives over the next few years.

HBMO: Operating expenses



HBMO: Operating Income & Expense growth



Source: Bank Financials, U Capital Research

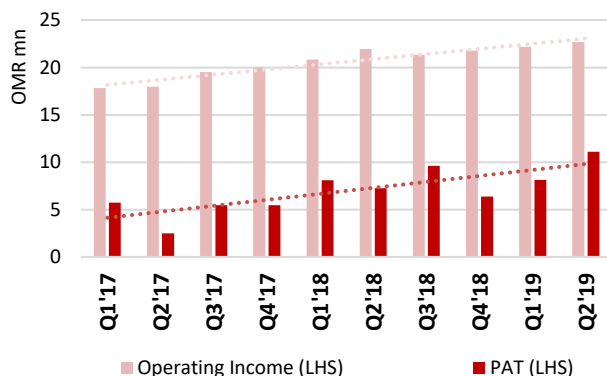
H1'19 Performance Review

In H1'19, the bank posted a 24.7%YoY increase in net profit at OMR 19.2mn, mainly due to a 4.9%YoY growth in revenue, releases in expected credit losses and continuing firm cost control. Net interest income grew by 2.7%YoY to OMR 30.6mn in H1'19, due to higher yield on wholesale loans and the benefit from investing our surplus liquidity in Interbank market partly offset by high cost on term deposits. Net fee income fell 16.7%YoY to OMR5.5mn during H1'19 mainly due to non-recurrence of some structuring and advisory fees from the bank's wholesale customers in the same period last year. Net trading income increased by 40.7%YoY to OMR8.3mn owing to higher income from FX SWAP.

A net release of OMR2.3mn has been reported for the change in the Bank's Expected Credit Losses (ECLs) and other credit impairment charges compared with a net release of OMR1.0mn for the same period last year. The bank booked a release instead of our expectation of a charge and therefore we have assumed an ECL provision release for the full year of a similar amount. As per the management, the lower ECLs was driven by a reduction in the Retail ECLs by OMR5.3mn (favorable movement in LGD rates), partly offset by increase in the wholesale ECLs of OMR 3.9mn (favorable movement in last year). Operating expenses fell 4.0%YoY to OMR24.2mn due to the bank's continued focus on firm cost control.

Loans and advances to customers marginally grew by 0.1%YoY and 8.4%QoQ to OMR 1.4bn whereas customer deposits fell by 1.1%YoY but grew by 6.0%QoQ to OMR 2.0bn. The bank's liquidity remains very strong in the market with a Loan-to-Deposit ratio (LDR) of 69.0% in H1'19.

HBMO: Quarterly Operational Performance



Source: Bank Financials, U Capital Research

Revised Estimates on H1'19 Performance

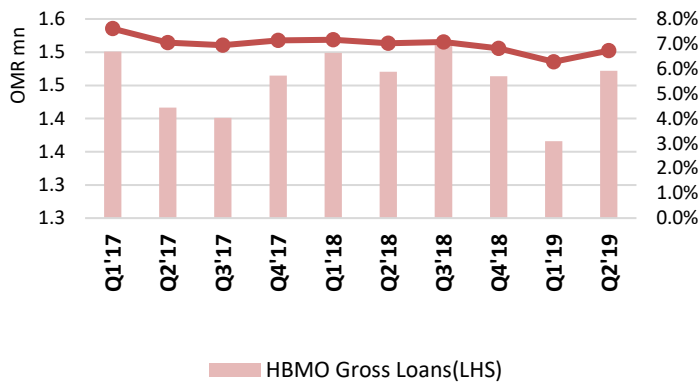
We have revised our estimates for the forecast years based on the bank's performance over H1'19. Our target price has not been affected, as the risk-free rate was lower when we issued our previous report. The risk-free rate for Oman rose during the first half of 2019, but has contracted recently on Fed funds rate cut, which effectively feeds into the Omani economy through the OMR-USD peg.

Revised Estimates	Old FY19e	New FY19e	Change
Net Interest Income	62	62	0%
Other Operating Income	26	29	11%
Operating Income	88	91	3%
Operating Expenses	(51)	(49)	-4%
Operating Profit	37	42	13%
Provisions	(3)	2	
PBT	34	44	30%
Taxes	(6)	(7)	24%
PAT	28	37	31%

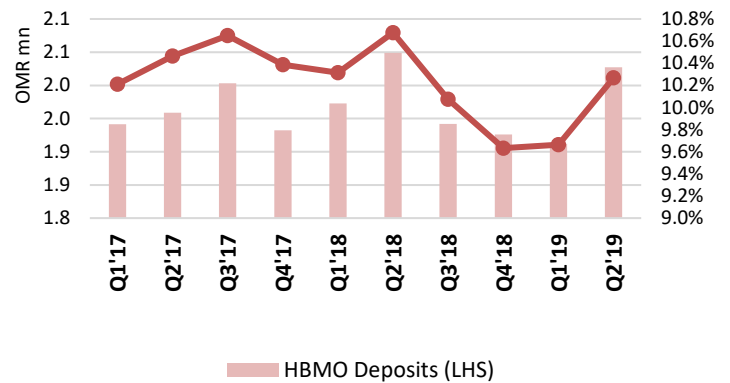
Source: Bank Financials, U Capital Research

Loan and Deposit Snapshot

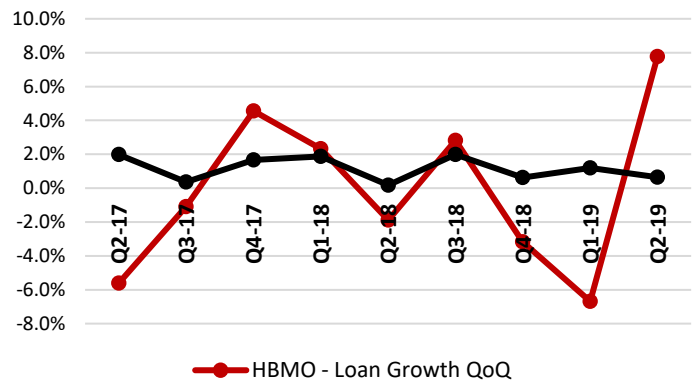
HBMO: Credit Market Share



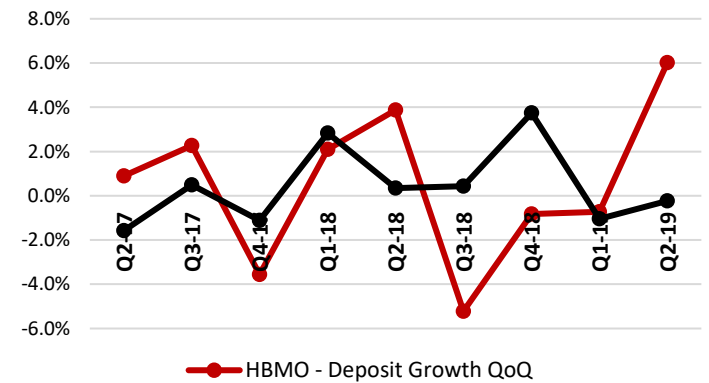
HBMO: Deposit Market Share



HBMO: Loan Growth QoQ vs Sector



HBMO: Deposit Growth vs Sector



Source: Bank Financials, U Capital Research

Key Financials

(OMR mn)	2016	2017	2018	2019e	2020e	2021e
Income Statement						
Interest Income	62	63	70	77	79	81
Interest Expense	(8)	(9)	(10)	(15)	(15)	(16)
Net Interest Income	54	54	60	62	63	66
Fee & Commission Income	12	12	12	11	16	25
Other Income	9	9	14	18	15	8
Total Non-Interest Income	21	21	26	29	31	33
Total Operating Income	75	75	86	91	94	98
Provisions expense	(6)	(6)	2	2	(1)	(2)
Operating Expenses	(48)	(48)	(49)	(49)	(50)	(52)
Profit Before Taxation	21	21	38	44	43	44
Taxation & Minority Interest	(4)	(2)	(7)	(7)	(8)	(8)
Net Profit Attributable to Parent	17	19	31	37	35	36
Balance Sheet						
Cash Balances	285	224	271	371	370	370
Deposits with Banks & FIs	80	40	133	135	139	145
Gross Loans & Financings	1,501	1,465	1,464	1,493	1,538	1,600
Loan Loss Reserve	(82)	(70)	(74)	(77)	(80)	(84)
Net Loans & Financings	1,418	1,395	1,390	1,417	1,458	1,516
Net Fixed Assets	27	26	26	26	26	26
Other Assets	444	649	542	553	569	591
Total Assets	2,254	2,334	2,361	2,502	2,563	2,648
Deposits from Banks & FIs	37	36	38	40	41	42
Deposits from Customers	1,867	1,932	1,926	2,053	2,098	2,166
Other Borrowings	-	-	-	-	-	-
Other Liabilities	36	43	56	51	52	54
Paid-up Capital	200	200	200	200	200	200
Retained Earnings	78	86	98	111	121	133
Other Reserves	35	38	43	46	50	54
Total Equity & Liability	2,254	2,334	2,361	2,502	2,563	2,648
Cash Flow Statement						
Cash from operations	(201)	150	(53)	131	35	42
Cash from investing activities	(220)	202	(114)	10	15	21
Cash from financing	(12)	(10)	(14)	(20)	(21)	(21)
Net changes in cash	7	(61)	47	100	(1)	0
Cash at the end of period	285	224	271	371	370	370
Key Ratios						
Return on Average Assets	0.8%	0.8%	1.3%	1.5%	1.4%	1.4%
Return on Average Equity	5.4%	6.0%	9.5%	10.5%	9.6%	9.6%
Fee Income Yield	0.7%	0.6%	0.6%	0.5%	0.8%	1.1%
Interest Earning/Financing Assets Yield	3.29%	3.20%	3.46%	3.77%	3.76%	3.75%
Cost of Funds	0.41%	0.47%	0.53%	0.73%	0.72%	0.72%
Net Spread	2.89%	2.73%	2.93%	3.04%	3.04%	3.04%
Cost to Income Ratio	64.3%	64.2%	57.5%	53.9%	53.4%	52.9%
Net Loans to Customer Deposits	76%	72%	72%	69%	70%	70%
Non Performing Loans	69	55	55	59	60	64
NPL Coverage	119.1%	126.6%	134.6%	130.6%	132.6%	131.6%
Provisions/Total Income	109%	93%	87%	84%	85%	85%
Cost of Risk (bps)	30.1	27.9	(7.4)	(11.3)	5.0	10.0
Equity to Gross Loans	21%	22%	23%	24%	24%	24%
Equity to Total Assets	14%	14%	14%	14%	14%	15%
Dividend Payout Ratio	59%	60%	59%	54%	60%	58%
Adjusted EPS (OMR)	0.008	0.010	0.016	0.018	0.018	0.018
Adjusted BVPS (OMR)	0.157	0.162	0.170	0.179	0.186	0.193
Market Price (OMR) *	0.120	0.128	0.119	0.122	0.122	0.122
Dividend Yield	4.2%	4.5%	7.8%	8.2%	8.6%	8.6%
P/E Ratio (x)	14.20	13.39	7.59	6.64	6.96	6.74
P/BV Ratio (x)	0.77	0.79	0.70	0.68	0.66	0.63

*Market price for 2018 and subsequent years based on closing price of 08/08/2019

Source: Company Financials, U Capital Research

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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