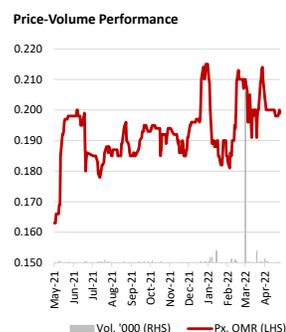


National Bank of Oman (NBOB)

TP: OMR 0.213 / share
Upside/ (Downside): +7%

Recommendation	HOLD
Bloomberg Ticker	NBOB OM
Current Market Price (OMR)	0.199
52wk High / Low (OMR)	0.220/0.160
12m Average Vol. (000)	1,637.4
Mkt. Cap. (USD/OMR Mn)	841/324
Shares Outstanding (mn)	1,625.9
Free Float (%)	27%
3m Avg Daily Turnover (OMR'000)	194.4
6m Avg Daily Turnover (OMR'000)	174.6
P/E'22e (x)	10.1
P/B'22e (x)	0.72
Cash Dividend Yield '22e (%)	2%
Price Performance:	
1 month (%)	(6.6)
3 month (%)	4.7
12 month (%)	23.6

Source: Bloomberg



Source: Bloomberg

19-May-22

Ayisha Zia

Acting Head of Research

a.zia@u-capital.net

Tel: +968 24 94 90 36

- Credit growth to pick up on a wider economic recovery.
- Cost of risk yet to peak as provision remains below 100% and regulatory forbearance unwinds.
- Adequate capital adequacy metrics: 1Q22 CAR at 15.6% vs. 2020: 16.4%; Tier 1 Capital Ratio at 15.0% & CET1 Ratio at 11.8%, above regulatory minima.
- AGM approved raising capital; might be Tier 1 perpetual securities up to USD 300mn (or OMR equivalent) within 5 years that can potentially boost capital adequacy metrics.
- Significant inroads made in raising CASA deposits 2021: 67% vs. 2020: 59%; however, NIMs not impacted yet.
- Loanbook skewed towards retail, unlike peers except Bank Muscat, with retail at 44% vs. peers at a simple average of 34% and sector at 38%

We raise our 12-month target price (TP) for **National Bank of Oman (NBOB)** to OMR 0.213 per share, on a drop in cost of equity and due to changes in our forecasts. Given the price increase over the last 12 months, we revise our rating for the stock to **HOLD**. Our fair value implies a P/E'22 of 10.4x and a P/B'22e of 0.77x that is slightly below peer average, due to weaker asset quality metrics, which we view as a higher risk or this bank. We believe that NBO's cost of risk has not peaked yet, and we expect it to remain elevated this year as the bank improves its provision cover which is currently below 100%. The bank could potentially see improvement in its earnings as efficiency is expected to improve and cost of risk is expected to decline from 2023e onwards.

A look at 1Q22 financial performance

NBOB posted a net profit of OMR 10.2mn in 1Q22 compared to a net profit of OMR 6.89mn in 1Q21, rising by 49%YoY and 51%QoQ. This has largely been driven by a hefty decrease in net Expected Credit Loss (ECL) provision as annualized cost of credit risk dropped to 70bps for the quarter compared to 84bps in 1Q21, as forecasts for Oman's economic outlook and probability of borrower default reduced due to higher oil and gas prices and resolution of covid-19-related challenges to businesses. The bank beat our net profit estimate by 20%, encouraging us to revise our estimates post-1Q22 results. The bank's net profit was also supported by a 7%YoY and 6%QoQ rise in its operating income, which reached OMR 33.2mn for the quarter. Furthermore, the bank's operating expenses declined 10%YoY and 15%QoQ, further supporting its net profit increase. The decline in operating expenses materialized from all sub-groups: staff costs (accounting for 61% of total operating expenses) dropped 18%QoQ, while other operating expenses (that account for 29% of total operating expenses) dropped 11%QoQ and depreciation fell 3%QoQ. The bank employed 1,468 employees as at end-1Q22, down by about 3%. NBOB's net loans and Islamic financing grew by 10%YoY and 3%QoQ to OMR 3.19bn, while its customer deposit growth surprised positively at 21%YoY and 7%QoQ to OMR 3.13bn, bringing its loan-to-deposit ratio down to 102% from 106% a quarter ago.

Outlook & Valuation

We expect the bank's top-line to grow on the back of a better sector credit growth outlook. We believe that despite rising US interest rates that feed into the Omani economy, given the USD-OMR peg, most local banks' NIMs might continue to remain under pressure for some time due to intense competition, and NBO's operating income growth is expected to remain at a CAGR of 6% over 2022-2025F. Operating expenses are expected to grow more slowly, boosting earnings over the forecast horizon, as the elevated cost of risk also tapers off.

Key Indicators

Year	FY19	FY20	FY21	FY22e	FY23e	FY24e
Total Net Loans (OMR mn)	2,802	2,888	3,089	3,300	3,558	3,766
Total Customer Deposits (OMR mn)	2,532	2,527	2,918	3,088	3,345	3,532
Operating Income (OMR mn)	128	117	123	128	138	147
Net Profit (OMR mn)	51	18	30	32	40	48
Diluted EPS (OMR)	0.032	0.011	0.019	0.020	0.025	0.029
Diluted BVPS (OMR)	0.270	0.255	0.271	0.277	0.292	0.310
P/E (x)*	5.8	14.3	10.7	10.1	8.1	6.8
P/BVPS (x)*	0.68	0.63	0.74	0.72	0.68	0.64
Dividend Yield (%)*	9.1%	0.0%	1.9%	2.0%	2.5%	2.9%

Source: Bank Financials, U Capital Research

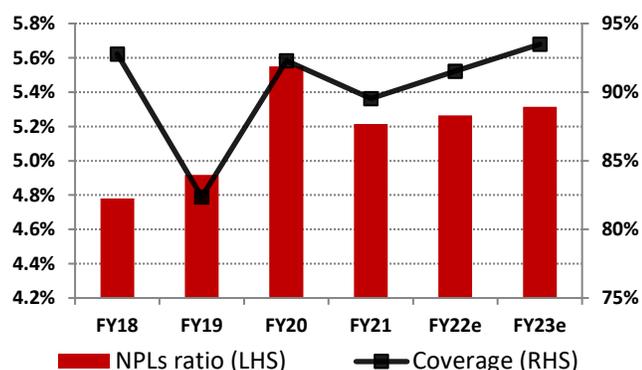
* Market price for the current and subsequent years as per the latest closing price

Relatively weak asset quality as compared to local peers; improved from FY20

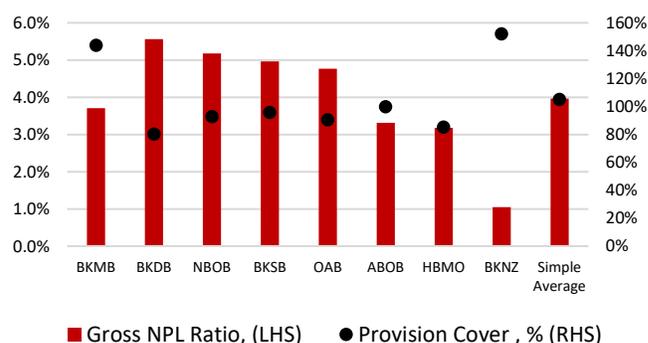
We believe that NBOB's cost of risk might remain inflated for this year before beginning to ease off from next year, eating away at earnings in the short term, but supporting building up of provisions. However, we believe that the bank's low exposure to relatively higher risk segments of Oman's economy such as construction (5% of gross loans as at FY21-end, stable from FY20) will support its asset quality metrics. This year sees the unwinding to a large extent of CBO's forbearance measures in relation to the covid-19 pandemic, through restructuring or of exposures that were previously in moratorium or re-classification to non-performing.

At end-1Q22, NBOB's non-performing ratio stood at 5.2% (FY20: 5.2%, FY20: 5.6%), the second highest within the sector after Bank Dhofar. Its provision cover stood at 93% at end-1Q22 (FY21: 90% and FY20: 92%).

NBOB: Asset Quality



Oman Banks: Asset Quality -1Q22



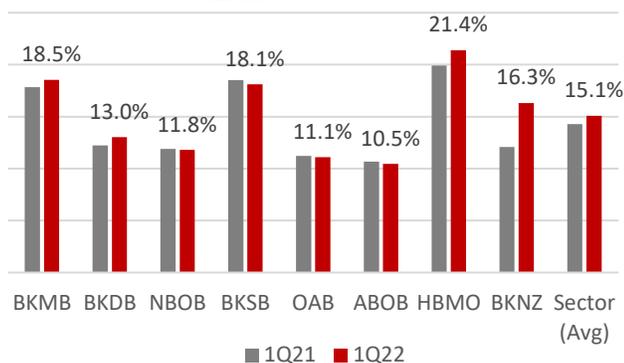
Source: Bank Financials, U Capital Research

Capital adequacy metrics deteriorated from FY20 but continue to be moderately above regulatory minima

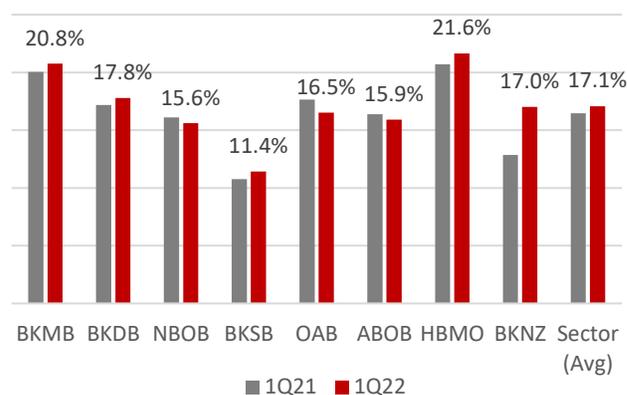
NBOB's capital ratios, while adequate at the end of FY21, with CET1 at 11.8%, Tier 1 Ratio at 15.0% and Total Capital Ratio (CAR) at 15.8%), deteriorated slightly from those at the end of FY20 (CET1: 12%, Tier 1 Ratio: 15.4% and Total Capital Ratio (CAR): 16.4%), and while moderately above the minimum regulatory requirements, are still lower than peers. The bank's Annual General Meeting (AGM) approved raising capital, possible Tier 1 perpetual securities up to USD 300mn (or OMR equivalent) within 5 years and this will potentially boost capital adequacy metrics.

Nevertheless, the bank has adequate provision buffers (NPL provision cover at about 93% vs. peer-group average of 105%), and hence we do not see strain on capital ratios even if asset quality were to deteriorate. However, we expect dividend distribution to remain low until capital adequacy metrics are improved.

Oman Banks: Common Equity Tier 1 (CET1) Ratio



Oman Banks: Capital Adequacy Ratio (CAR)

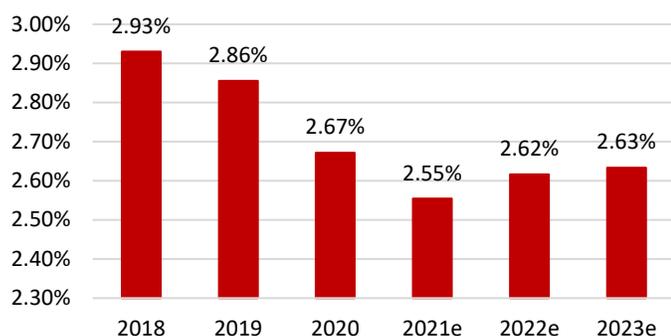


Source: Bank Financials, U Capital Research

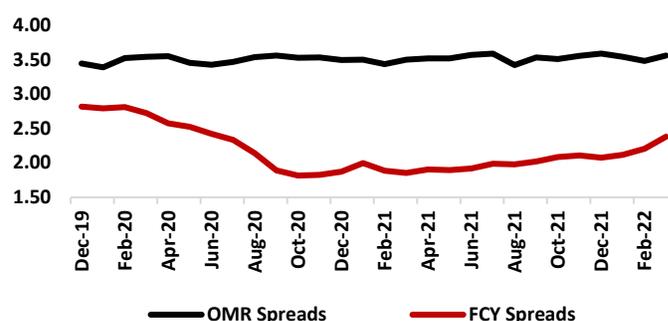
Improvement in Net Interest Margin (NIM) unlikely in the short term...

NBOB posted a drop in net interest & Islamic finance income in FY21 to 2.5% vs. 2.67% in FY20 and 2.86% in FY19, on a 3%YoY increase in interest & Islamic finance cost and despite a 2%YoY rise in interest & Islamic finance income. Interest income was pressured due to lower interest rates, even though net loans & Islamic financing grew 7.0%YoY. Even though the bank sits on a large Current & Savings (CASA) deposit base (FY21: 67%; FY20: 59% of total deposits) allowing access to low-cost funding, we believe that net interest margin will continue to be weighed down in the near to medium term as interest yield on loans will remain under pressure due to competition, and possibly due to easing of liquidity given the elevated oil and gas prices supporting Government revenues. Furthermore, Interest on retail loans (where NBO has the highest exposure within the sector) is capped at 6%. Overall, sector OMR spreads are also somewhat stable since FY19.

NBOB: Net Interest Margin



Weighted Average Interest Rate Spreads, %



Source: CBO, Bank Financials, U Capital Research

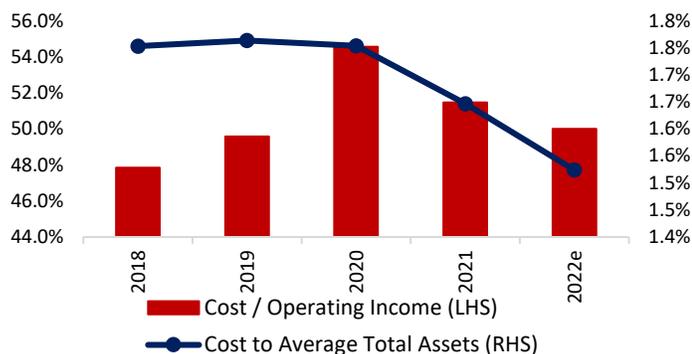
We believe that the bank's net interest income (including Islamic finance income) will grow at a CAGR of 6% over 2022-2026e, based on our assumption that credit growth will likely pick up.

Improving efficiency metrics...

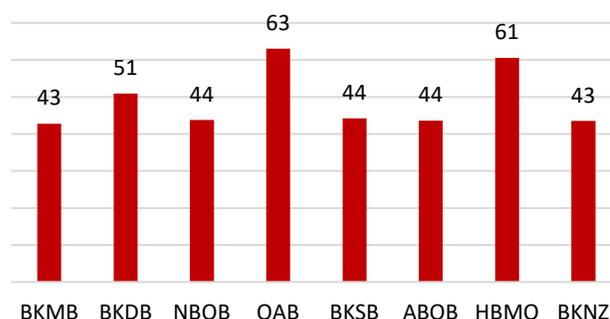
NBOB's operating costs remained tightly controlled in FY20 and FY21, with expenses rising only a marginal 0.3%YoY in FY20 and contracting by 0.5%YoY in FY21. During 1Q22, the bank's operating expenses declined 10%YoY and 15%QoQ, further supporting its net profit increase. The decline in operating expenses materialized from all sub-groups: staff costs (accounting for 61% of total operating expenses) dropped 18%QoQ, while other operating expenses (that account for 29% of total operating expenses) dropped 11%QoQ and depreciation fell 3%QoQ. Cost-to-income ratio contracted to 44% for the quarter from 51.5% in FY21. The bank employed 1,468 employees as at end-1Q22, down by about 3%.

Its cost efficiency ratios are now stronger than peers in 2021. We expect efficiency metrics to roughly return to pre-covid levels in 2021 and foresee a marginal improvement in cost efficiency over the forecast horizon.

NBOB: Efficiency Metrics



Cost-to-Income Ratio (%) -1Q22



Source: Bank Financials, U Capital Research

Valuation Assumptions & Sensitivity Analysis

We have used a risk-free rate of 6.35% (Oman 10-Yr Government Bond Yield) vs. FY21: 5.25% and May'20: 7.3%, US risk premium of 6.52% vs. FY21: 7.9% and FY20: 8.2%), and a 2-yr weekly adjusted Beta of 1.496 (previous 1.127, Source: Bloomberg). Our base case cost of risk assumption for the year 2022e is 73bps, while peer-group P/B multiple assumption is 0.9x for 2022e. We have assigned a weightage of 80% to excess return methodology and 20% to P/B multiple-based approach.

Beginning book value of Equity invested currently	446,258				
OMR'000	FY22e	FY23e	FY24e	FY25e	FY26e
Net Income attributable to shareholders	31,925	39,993	47,560	52,427	59,601
Less: Equity Cost	70,824	72,604	76,393	81,155	86,545
Excess Equity Return	(38,899)	(32,612)	(28,833)	(28,728)	(26,943)
Present value of Excess Equity Return	(35,478)	(25,620)	(19,510)	(16,744)	(13,526)
Sum of present value of Excess Return	(110,879)				

Equity Cost	FY22e	FY23e	FY24e	FY25e	FY26e
	439,955	451,017	474,549	504,135	537,614
Cost of Equity	16.1%	16.1%	16.1%	16.1%	16.1%
Equity Cost	70,824	72,604	76,393	81,155	86,545

Terminal value projections

Book value of equity at start of year 6	214,565
Net income in Stable period	27,893
Less equity cost	28,644
Excess return	(751)
Terminal Value	(7,249)
PV of Terminal Value	(4,225)

Total Equity value	331,154
Total shares out (mn)	1,625,950
Fair Value per share (OMR)	0.204
Upside / (downside)	2.3%

Peer-Group Multiple-based Valuation

Peer-Group P/B Multiple	0.9
BVPS'22e	0.277
Fair Value per share (OMR)	0.250
Upside / (downside)	25.5%

Weighted Average Fair Value (OMR)	0.213
Current price (OMR)	0.199
Upside / (downside)	7.0%

NBOB

Cost of Equity	Cost of Risk, bps					Peer-Group Average P/B'22 Multiple				
	33	53	73	93	113	0.80	0.85	0.90	0.95	1.00
14.1%	0.236	0.232	0.227	0.222	0.218	0.221	0.224	0.227	0.230	0.233
15.1%	0.229	0.224	0.220	0.215	0.211	0.214	0.217	0.220	0.223	0.225
16.1%	0.222	0.217	0.213	0.208	0.204	0.207	0.210	0.213	0.216	0.218
17.1%	0.215	0.211	0.206	0.202	0.198	0.201	0.203	0.206	0.209	0.212
18.1%	0.208	0.204	0.200	0.196	0.191	0.194	0.197	0.200	0.203	0.205

Our TP is sensitive to +/-20bps increase/decrease in cost of risk from our base case scenario for 2022e, with TP rising/dropping about +/-2% with every 20bps increase/decrease in cost of risk. Our TP is slightly more sensitive to

changes in cost of equity with all else constant. Our TP changes about +/-3% with the ever +/-100bps change in cost of equity.

Our TP changes by +/-1.4% with every +/-0.05x change in P/B multiple for 2022e.

Key Risks

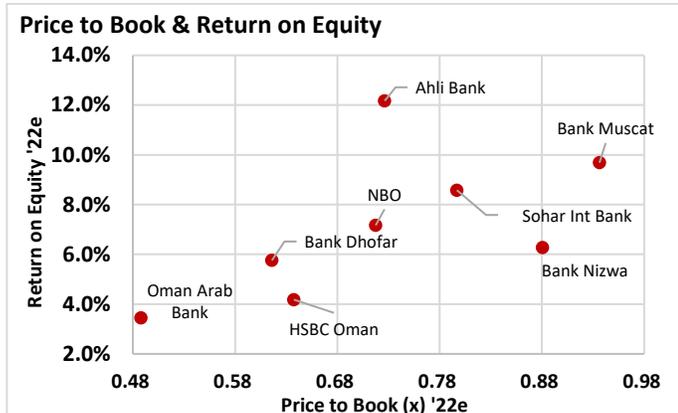
The key downside risks to our valuation are: (1) continuing uncertainty surrounding the duration of the Russia-Ukraine war and the coronavirus pandemic impact (2) Deterioration in macroeconomic indicators warranting a rise in cost of equity (3) Higher-than-expected level of loan re-classification once regulatory measures unwind this year.

Upside risks include faster-than-expected improvement in cost efficiency and faster-than-expected loan growth.

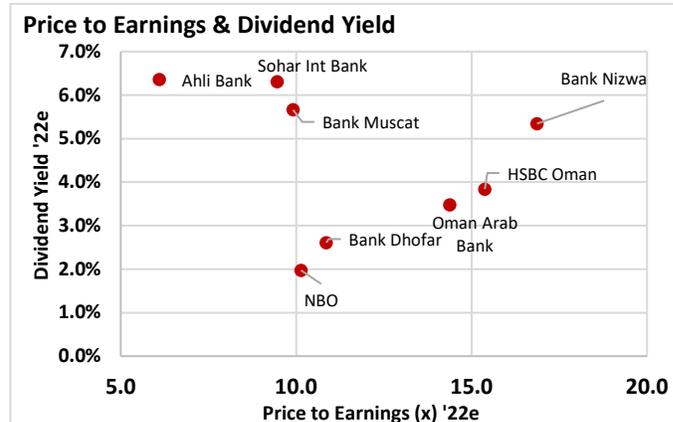
Peer Group Valuation

Name	Mkt Cap (OMR mn)	Last Px (OMR)	Px Change 1M, %	Px Change 3M, %	Px Change YTD, %	Current P/B	P/B'22e, (x)	P/E'22e, (x)	ROE'22e, (%)	Cash Div Yield'22e, %
Bank Muscat	1,989.2	0.530	-3	7	15	1.01	0.94	9.9	9.7%	5.7%
Bank Dhofar	344.6	0.115	-2	-3	-8	0.63	0.62	10.9	5.8%	2.6%
NBO	323.6	0.199	-7	5	2	0.73	0.72	10.1	7.2%	2.0%
Sohar Int Bank	331.9	0.111	-1	3	-4	0.86	0.80	9.5	8.6%	6.3%
Oman Arab Bank	213.7	0.128	0	-16	-20	0.60	0.49	14.4	3.5%	3.5%
Ahli Bank	230.1	0.118	0	-2	2	0.78	0.73	6.1	12.2%	6.4%
HSBC Oman	224.0	0.112	-1	14	8	0.66	0.64	15.4	4.2%	3.8%
Bank Nizwa	214.7	0.096	-1	-1	-1	0.92	0.88	16.9	6.3%	5.3%
Average						0.77	0.72	11.6	7.2%	4.4%
Median						0.75	0.72	10.5	6.7%	4.6%

Source: Bloomberg, U Capital Research



Source: Bloomberg, U Capital Research



Key Financials

(OMR mn)	2019	2020	2021	2022e	2023e	2023e
Income Statement						
Interest & Islamic Financing Income	171.4	172.1	175.3	182.0	199.0	214.3
Interest Expense & Payment to Depositors	(77.4)	(81.2)	(83.7)	(87.8)	(96.2)	(105.2)
Net Interest/Financing Income	94.0	90.9	91.6	94.2	102.8	109.1
Fee & Commission Income	19.6	12.9	18.9	23.0	28.0	34.2
Other Income	14.7	13.1	12.9	10.4	7.3	3.7
Total Non-Interest/Financing Income	34.3	26.1	31.8	33.4	35.4	37.8
Total Operating Income	128.3	117.0	123.4	127.5	138.2	146.9
Operating Expenses	(63.6)	(63.8)	(63.5)	(63.8)	(69.0)	(73.2)
Operating Profit	64.7	53.1	59.9	63.8	69.2	73.8
Provisions expense	(7.7)	(31.3)	(24.0)	(27.6)	(23.5)	(19.5)
Profit Before Taxation	57.0	21.8	35.9	36.2	45.7	54.3
Taxation	(5.5)	(3.7)	(5.6)	(4.3)	(5.7)	(6.7)
Net Profit	51.4	18.1	30.3	31.9	40.0	47.6
Interest on Tier 1 Perpetual Securities	(9.1)	(9.1)	(8.5)	(8.5)	(8.5)	(8.5)
Net Profit Attributable to shareholders	42.3	9.1	21.6	23.5	31.5	39.1
Balance Sheet						
Cash Balances	334	216	308	261	266	258
Deposits with Banks & FIs	109	95	115	143	154	163
Net Loans & Islamic financing	2,802	2,888	3,089	3,300	3,558	3,766
Investments	293	319	447	455	491	520
Net Fixed Assets	67	63	60	62	64	65
Other Assets	3,135	3,259	3,599	3,822	4,121	4,362
Total Assets	3,645	3,633	4,081	4,288	4,605	4,848
Deposits from Banks & FIs	284	289	298	315	341	360
Total Customer Deposits	2,532	2,527	2,918	3,088	3,345	3,532
Other Borrowings	308	308	308	308	308	308
Other Liabilities	83	94	118	126	136	143
Total liabilities	3,091	3,102	3,526	3,721	4,015	4,228
Paid-up Capital	163	163	163	163	163	163
Retained Earnings	161	162	177	194	218	248
Other Reserves	115	90	100	94	94	94
Shareholders' Equity	438	415	440	451	475	504
Tier 1 Perpetual Notes	116	116				
Total Equity & Liabilities	3,645	3,633	4,081	4,288	4,605	4,848
Cash Flow Statement						
Cash from operations	78	(74)	100	(18)	30	19
Cash from investing activities	8	2	3	8	9	9
Cash from financing	(51)	(42)	(5)	(21)	(16)	(18)
Net changes in cash	19	(118)	92	(47)	5	(8)
Cash at the end of period	334	216	308	261	266	258
Key Ratios						
Return on Average Assets	1.4%	0.5%	0.8%	0.8%	0.9%	1.0%
Return on Average Equity	12.0%	4.3%	7.1%	7.2%	8.6%	9.7%
Net Interest & Islamic Finance Income / Operating Income	70.6%	74.3%	70.6%	73.8%	74.4%	74.2%
Other operating income / Operating Income	29.4%	25.7%	29.4%	26.2%	25.6%	25.8%
Net fee Income/Operating Income	15.3%	11.1%	15.3%	18.0%	20.3%	23.3%
Interest Earning/Financing Assets Yield	5.16%	5.02%	4.76%	4.82%	4.91%	4.96%
Cost of Funds	-2.46%	-2.54%	-2.45%	-2.51%	-2.57%	-2.64%
Net Spread	2.70%	2.48%	2.32%	2.31%	2.34%	2.31%
Cost to Income Ratio	49.6%	54.6%	51.5%	50.0%	49.9%	49.8%
Net Loans & Islamic Financing to Customer Deposits (Total LTD)	110.7%	114.3%	105.9%	106.9%	106.4%	106.6%
NPLs to Gross Loans & Islamic financing	4.9%	5.6%	5.2%	5.3%	5.3%	5.4%
NPL Coverage, %	82.4%	92.3%	89.5%	91.5%	93.5%	95.4%
Cost of Risk, bps	24.4	96.3	69.0	73.0	58.0	45.0
Shareholders' Equity to Total Loans & Islamic Financing, x	0.19	0.17	0.17	0.16	0.16	0.16
Shareholders' Equity to Total Assets, x	0.15	0.15	0.14	0.13	0.13	0.13
Capital Adequacy Ratio, %	16.7%	16.4%	15.8%	15.1%	14.6%	14.5%
EPS, OMR	0.032	0.011	0.019	0.020	0.025	0.029
BVPS, OMR	0.270	0.255	0.271	0.277	0.292	0.310
Market Price, OMR*	0.184	0.160	0.199	0.199	0.199	0.199
Cash Dividend Payout Ratio, %	53.1%	0.0%	19.9%	20.0%	20.0%	20.0%
Cash Dividend Yield, %	9.1%	0.0%	1.9%	2.0%	2.5%	2.9%
P/E Ratio, x	5.8	14.3	10.7	10.1	8.1	6.8
P/BV Ratio, x	0.7	0.6	0.7	0.7	0.7	0.6

*Market price for current year and subsequent years as per the closing price on 18-May-2022

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%

Ubhar Capital SAOC (U Capital)

Website: www.u-capital.net
PO Box 1137
PC 111, Sultanate of Oman
Tel: +968 2494 9000
Fax: +968 2494 9099
Email: research@u-capital.net

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