

## Event Update

### Bank Muscat (BKMB)

Target Price (TP): **OMR 0.640**  
per share

Adjusted Target Price (post-  
bonus share issuance): **OMR**  
**0.320** per share

Rating: **Hold**

Date: **15<sup>th</sup> August 2022**

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## Bank Muscat's Planned Capital Optimization

Bank Muscat informed the market that its Board of Directors have approved a proposal to optimize the Bank's current capital structure through a one-off dividend ("Proposed Dividend") comprising issuance of bonus shares and perpetual bonds to its shareholders. The Proposed Dividend is designed to improve the efficiency of the Bank's capital and in turn improve returns to shareholders; without impacting the Bank's capital position, liquidity, or profitability.

Key features of the Proposed Dividend are set out below:

- 1. One Ordinary Share of RO 0.100 for each Ordinary Share aggregating to 3,753,198,531 shares equivalent to RO 375.320 million; and**
- 2. One Perpetual Bond of RO 1 for every 10 Ordinary Shares aggregating to 375,319,853 bonds equivalent to RO 375.320 million.**

The proposed perpetual bonds being issued as part of the Proposed Dividend will be listed on the Muscat Stock Exchange (MSX), will carry a coupon of 4.25% per annum and will form part of the Bank's Tier 1 Capital. The bonds will not have a fixed maturity date; however, they may be callable at Par at the option of the Bank after 5 years from the date of issuance.

Overall, the Proposed Dividend will not have any effect on the Bank's **Total** Capital Adequacy Ratio and **Total Tier 1** Capital Ratio. Following the proposed dividend payout, all capital adequacy ratios will remain comfortably above the regulatory requirements and the Bank will continue to be well capitalized to support its growth aspirations.

The Proposed Dividend is **subject to the approval of the shareholders of the Bank, the Central Bank of Oman (CBO) and Capital Market Authority (CMA). The Market will be notified of the record date of the event after obtaining all the necessary approvals.**

**Our View:** Model adjustments to 1H22 financials and to this news reveal that while the proposed capital optimization plan will support returns for the shareholders by improving the key profitability metric, return on equity (ROE), the bank's book value per share will drop by OMR 375.2mn, through re-distribution of capital to Tier 1 Capital, with further reduction brought on by the bonus share issuance that will dilute earnings (potentially halve the earnings per share). In the longer run, however, the proposed structure is a more efficient use of the bank's capital, as excessive capitalization also results in bringing down market valuation multiples like price-to-book.

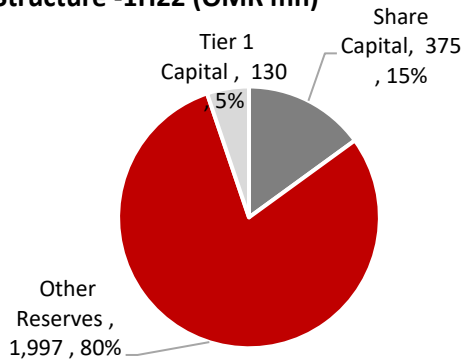
It must be noted that while the bank's Total Capital Ratio and Tier 1 Capital Ratio will remain the same through this re-distribution of capital, its Core Equity Tier 1 Capital (CET1) will reduce by OMR 375.2 as this amount will now be classified as Tier 1 Capital through perpetual bond issuance. At 1H22-end, the bank's CET1 Ratio stood at 18.33%, comfortably above the regulatory minimum including the capital conservation and countercyclical buffers, but could potentially drop to 14.6%, still higher than the regulatory minimum (9.5%) and local peer-group average except HSBC Oman.

We believe that this was a long overdue step from the bank, as excessive capitalization negatively affected shareholder returns and the resulting valuation of the bank. As is evident from the stock price rally, investors took well to this proposed move.

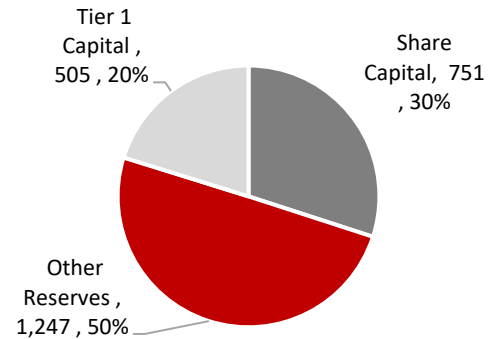
## Planned re-distribution of capital to different line items

The bank has planned re-distribution of capital to different line items to optimize its capital base. A large capital base typically affects shareholder returns in a negative way, as measured through return on equity (ROE). The bank was carrying a book value of OMR 1,997mn at 1H22-end and it will now be carrying OMR 1,622mn. Further, its share capital will increase while the shareholders' equity will be reduced by the same amount. This will result in doubling of the number of outstanding shares to 7.5bn.

**Capital Structure -1H22 (OMR mn)**



**Proposed Capital Structure (OMR mn)**

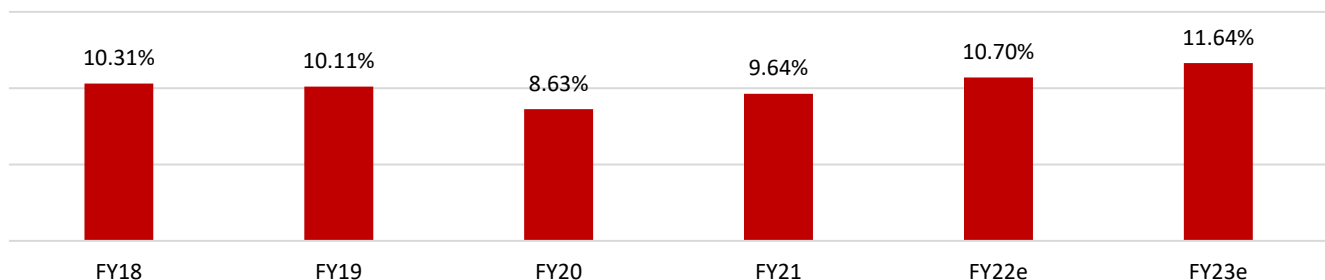


Source: Bank Financials, News Disclosure, U Capital Research

## Capital optimization to positively affect return on equity (ROE)

The bank's annual average ROE was **earlier** expected to remain below 10% over 2022-2024e. This is due to shareholder equity increasing from retained profits as there is constraint on cash dividend payout from the Central Bank of Oman (CBO). However, with the proposed new structure, ROE is expected to consistently increase over the forecast period, despite the payout constraint on profits.

### BKMB: Return on Average (ROaE)



Source: Bank Financials, News Disclosure, U Capital Research

## EPS dilution is inevitable

Given the planned increase in number of shares, earnings per share (EPS) dilution is inevitable. However, given the strong balance sheet of the bank, together with superior asset quality and robust capital adequacy, we believe that earnings per share will continue to grow over the forecast period. Once the proposed optimization is approved, the total number of outstanding shares of the bank will increase, thus reducing its stock price and making it accessible to more investors. With more shares in the market at a low price, the liquidity and investor engagement of the shares will improve considerably.

## Valuation Update

We have used a risk-free rate of 6.0%, US risk premium of 6.4%, and a 2-yr weekly adjusted Beta of 1.1 (Source: Bloomberg) for our valuation. Our base case cost of risk assumption for the year 2022e is 45bps, while our P/B ratio assumption is 2.6x for 2022e (premium to local peer group average of 1.0x). A terminal growth rate of 6% has been assumed based on retention ratio and terminal ROE assumption.

We have assigned a weightage of 80% to excess return methodology and 20% to P/B multiple-based approach.

Beginning book value, OMR'000	1,997,624				
	<b>FY22e</b>	<b>FY23e</b>	<b>FY24e</b>	<b>FY25e</b>	<b>FY26e</b>
<b>OMR'000</b>					
Net Income	200,730	206,575	213,243	220,543	225,512
Less: Equity Cost	263,624	225,866	237,089	249,189	262,238
Excess Equity Return	<b>(62,894)</b>	<b>(19,291)</b>	<b>(23,846)</b>	<b>(28,646)</b>	<b>(36,726)</b>
Present value of Excess Equity Return	(60,047)	(16,292)	(17,815)	(18,932)	(24,272)
Sum of present value of Excess Return	(137,359)				
<b>Terminal value projections</b>					
Book value of equity at start of year 6	2,115,228				
Net income in Stable period	317,284				
Less equity cost	275,936				
Excess return	41,348				
Terminal Value	622,109				
PV of Terminal Value	411,142				
Total Equity value , OMR'000	2,271,408				
Total shares out, '000	3,574,480				
Target price, OMR	0.640				
<b>Adjusted Price-to-Book Valuation</b>					
Expected P/B (x) '22e	2.6				
BVPS'22e	0.236				
Fair Value, OMR	0.620				
Weighted Average Fair Value (OMR)	0.640				
Current price , OMR	0.612				
Upside / (downside), %	4.6%				

Source: U Capital Research, Bloomberg

Note: Current market price is not adjusted for bonus shares

Given the recent price rally, we assign a **HOLD** rating to the stock with a target price of OMR 0.640 per share, implying a limited upside to the current market price. Our target price implies a P/E'22e of 23.4x, a P/E'23e of 22.7x, and a P/B'22e of 2.7x and P/B'23e of 2.6x at the current number of shares. Once the number of outstanding shares double, our adjusted target price is expected to halve accordingly, to OMR 0.320 per share, implying a P/E'22e of 11.7x, a P/E'23e of 11.4x, and a P/B'22e of 1.4x and P/B'23e of 1.3x.

## Peer Group Valuation

	Oman Banks			GCC Banks											Simple Average	Median
	BKMB	BKDB	NBOB	RJHI	SNB	RIBL	BSFR	QNBK	QIBK	KFH	BOUBAYAN	FAB	EIB	NBB		
Asset size (USD bn)	33.3	11.4	11.1	155.4	240.7	85.0	56.9	294.9	50.6	72.9	24.2	267.6	18.0	12.1	93.1	37.4
<b>Growth Metrics</b>																
Gross Loan Growth, YoY (%)	-1.9	0.6	9.1	32.5	6.8	16.7	12.3	3.2	0.7	9.7	11.8	14.6	13.6	9.8	12.0	9.8
Deposit Growth, YoY (%)	1.9	-3.4	14.2	23.6	0.8	17.3	12.2	3.6	3.2	1.4	4.2	12.7	11.4	1.8	8.4	4.2
<b>Profitability</b>																
ROA (%)	1.5	0.6	0.9	2.6	1.7	1.9	1.6	1.2	2.0	1.3	0.8	1.5	1.3	1.3	1.6	1.3
ROE (%)	9.4	2.8	6.2	24.0	10.6	13.9	10.8	15.7	17.8	14.7	8.2	15.2	11.1	12.1	14.0	12.1
NIM (%)	2.5	2.6	2.5	3.7	3.2	3.0	2.7	2.5	2.9	3.3	2.5	1.8	3.2	2.9	2.9	2.9
<b>Capital &amp; Liquidity Ratios</b>																
CAR (%)	20.6	17.2	15.3	19.0	18.4	19.5	19.2	18.9	18.5	18.7	16.4	15.6	19.7	22.3	18.8	18.7
Tier1 Ratio (%)	19.6	16.4	14.8	17.9	17.6	16.4	18.1	17.7	17.3	17.2	15.2	14.5	-	21.4	17.3	17.2
LCR (%)	199.0	147.8	170.8	121.0	261.0	176.0	194.0	-	118.9	224.3	-	135.0	-	-	181.4	173.4
<b>Asset Quality</b>																
Provision Cover (%)	127.9	114.7	90.9	293.0	99.4	111.2	116.2	151.9	287.4	318.0	314.7	79.9	120.1	81.5	179.4	116.2
NPL Ratio (%)	3.8	4.7	5.3	0.6	2.2	1.7	58.3	2.4	1.5	2.5	0.9	3.6	7.1	4.0	7.7	2.5
<b>Efficiency</b>																
Cost to Income Ratio (%)	40	47	45	25	31	34	34	20	17	50	49	32	41	47	34.7	34.2
<b>Valuation</b>																
P/E Ratio	12.8	25.1	17.2	21.8	21.0	17.5	18.4	15.9	17.8	29.1	55.3	15.3	42.6	14.7	21.5	17.6
P/B Ratio	1.1	0.7	1.0	4.7	2.2	2.4	1.9	2.5	3.0	4.1	4.0	2.2	4.6	2.1	2.6	2.2
Div Yield (%)	6.3	1.5	3.8	3.0	3.0	2.7	2.8	2.5	2.1	1.3	0.5	2.4	-	3.0	2.9	2.8

Source: U Capital Research, Bloomberg

All figures as at the end of 2Q22 and annualized if necessary, prior period values if unavailable.

## Key Financials

(OMR mn)	FY19	FY20	FY21	FY22e	FY23e	FY24e
<b>Income Statement</b>						
Interest/Financing Income	518.1	506.0	521.8	535.2	549.8	575.2
Interest Expense/Payment to Depositors	(201.1)	(183.9)	(186.3)	(197.2)	(205.1)	(218.4)
<b>Net Interest/Financing Income</b>	<b>317.0</b>	<b>322.1</b>	<b>335.5</b>	<b>338.0</b>	<b>344.6</b>	<b>356.8</b>
Fee & Commission Income	102.3	90.3	99.9	103.5	105.2	109.3
Other Income	52.9	44.1	40.0	41.4	42.2	43.8
<b>Total Non-Interest/Financing Income</b>	<b>155.2</b>	<b>134.4</b>	<b>139.9</b>	<b>144.9</b>	<b>147.4</b>	<b>153.0</b>
<b>Total Operating Income</b>	<b>472.2</b>	<b>456.5</b>	<b>475.5</b>	<b>482.9</b>	<b>492.1</b>	<b>509.8</b>
Operating Expenses	(195.9)	(179.9)	(191.5)	(197.4)	(204.0)	(214.5)
<b>Operating Profit</b>	<b>276.2</b>	<b>276.7</b>	<b>284.0</b>	<b>285.6</b>	<b>288.0</b>	<b>295.4</b>
Provisions expense	(56.1)	(81.0)	(60.1)	(46.8)	(42.3)	(41.7)
<b>Profit Before Taxation</b>	<b>220.1</b>	<b>195.6</b>	<b>224.0</b>	<b>238.7</b>	<b>245.7</b>	<b>253.6</b>
Taxation & others	(34.6)	(32.3)	(34.3)	(38.0)	(39.1)	(40.4)
<b>Net Profit Attributable to Parent</b>	<b>185.6</b>	<b>163.4</b>	<b>189.6</b>	<b>200.7</b>	<b>206.6</b>	<b>213.2</b>
Interest of Tier 1 Perpetual Securities	(7.2)	(7.2)	(7.2)	(23.1)	(23.1)	(23.1)
<b>Net Profit Attributable to shareholders</b>	<b>178.4</b>	<b>156.2</b>	<b>182.5</b>	<b>177.6</b>	<b>183.5</b>	<b>190.1</b>
check	-	-	-	-	-	-
<b>Balance Sheet</b>						
Cash Balances	782	657	1,047	1,120	1,104	1,306
Deposits with Banks & FIs	870	575	765	671	720	683
Gross Loans (Conventional)	8,001	8,093	8,255	8,338	8,588	9,017
Loan Loss Reserve (Conventional)	(289)	(362)	(425)	(373)	(384)	(403)
<b>Net Loans (Conventional)</b>	<b>7,712</b>	<b>7,731</b>	<b>7,830</b>	<b>7,965</b>	<b>8,204</b>	<b>8,614</b>
Gross Islamic Financing	1,192	1,285	1,405	1,419	1,462	1,535
Loan Loss Reserve (Islamic)	(26)	(34)	(44)	(37)	(39)	(41)
<b>Net Islamic Financing</b>	<b>1,166</b>	<b>1,251</b>	<b>1,361</b>	<b>1,382</b>	<b>1,423</b>	<b>1,494</b>
Gross Loans & Islamic financing	9,193	9,379	9,660	9,757	10,050	10,552
Loan Loss Reserve (Conventional + Islamic)	(315)	(396)	(469)	(411)	(423)	(444)
<b>Net Loans &amp; Islamic financing</b>	<b>8,878</b>	<b>8,983</b>	<b>9,191</b>	<b>9,346</b>	<b>9,627</b>	<b>10,108</b>
Investments	1,445	1,847	1,811	1,831	1,886	1,980
Net Fixed Assets	79	71	74	75	74	74
Other Assets	237	321	183	121	124	130
<b>Total Assets</b>	<b>12,291</b>	<b>12,454</b>	<b>13,073</b>	<b>13,164</b>	<b>13,534</b>	<b>14,282</b>
Deposits from Banks & FIs	1,173	940	1,218	1,219	1,252	1,329
Islamic Deposits	1,032	1,030	1,171	1,213	1,229	1,282
Conventional Deposits	7,011	7,429	7,604	7,566	7,789	8,286
<b>Total Customer Deposits</b>	<b>8,044</b>	<b>8,459</b>	<b>8,775</b>	<b>8,779</b>	<b>9,018</b>	<b>9,569</b>
Other Borrowings	502	494	481	481	481	481
Other Liabilities	569	518	448	448	460	488
<b>Total Liabilities</b>	<b>10,288</b>	<b>10,410</b>	<b>10,922</b>	<b>10,927</b>	<b>11,212</b>	<b>11,866</b>
Paid-up Capital	309	325	357	733	733	733
Retained Earnings	526	538	595	272	324	383
Other Reserves	1,037	1,051	1,069	726	760	795
Shareholders' Equity	1,873	1,914	2,021	1,731	1,817	1,910
Minority Interest, Tier 1 Perpetual Notes	130	130	130	505	505	505
<b>Total Equity &amp; Liabilities</b>	<b>12,291</b>	<b>12,454</b>	<b>13,073</b>	<b>13,164</b>	<b>13,534</b>	<b>14,282</b>
<b>Cash Flow Statement</b>						
Cash from operations	(437)	2	497	180	103	324
Cash from investing activities	10	(8)	11	(7)	(1)	1
Cash from financing	(78)	(135)	(96)	(115)	(121)	(120)
Net changes in cash	(525)	(125)	390	73	(16)	202
Cash at the end of period	782	657	1,047	1,120	1,104	1,306
<b>Key Ratios</b>						
Return on Average Assets	1.5%	1.3%	1.5%	1.5%	1.5%	1.5%
Return on Average Equity	10.1%	8.6%	9.6%	10.7%	11.6%	11.4%
Net Interest Income & Islamic Finance Income/ Operating Income	67.1%	70.6%	70.6%	70.0%	70.0%	70.0%
Other Operating Income/Operating Income	32.9%	29.4%	29.4%	30.0%	30.0%	30.0%
Net fee income/Operating Income	21.7%	19.8%	21.0%	21.4%	21.4%	21.4%
Interest Earning/Finance Asset Yield	4.7%	4.5%	4.5%	4.5%	4.6%	4.6%
Cost of Funds	2.1%	1.9%	1.8%	1.9%	1.9%	2.0%
Net Spread	2.7%	2.6%	2.7%	2.6%	2.6%	2.6%
Cost to Income Ratio	41.5%	39.4%	40.3%	40.9%	41.5%	42.1%
Net Loans & Islamic Financing to Customer Deposits (Total LTD)	110%	106%	105%	106%	106%	105%
Non Performing Loans, OMR mn	299	338	356	365	376	395
NPLs to Gross Loans & Islamic Financing, %	3.2%	3.6%	3.7%	3.7%	3.7%	3.7%
NPL Coverage, %	105.5%	117.3%	131.5%	112.5%	112.5%	112.5%
Cost of Risk (bps)	60.8	87.3	63.3	48.4	37.0	27.7
Shareholders' Equity to Total Loans & Islamic Financing, x	0.20	0.20	0.21	0.18	0.18	0.18
Shareholders' Equity to Total Assets, x	0.15	0.15	0.15	0.13	0.13	0.13
Capital Adequacy Ratio, %	19.8%	20.8%	21.3%	18.9%	19.2%	19.3%
EPS (OMR)	0.060	0.050	0.053	0.027	0.028	0.029
BVPS (OMR)	0.605	0.589	0.565	0.236	0.248	0.261
Market Price (OMR) *	0.434	0.394	0.484	0.612	0.612	0.612
Cash Dividend Payout Ratio, %	58.4%	49.7%	56.6%	127.8%	124.2%	120.3%
Cash Dividend Yield, %	8.1%	6.3%	6.2%	5.7%	5.7%	5.7%
P/E Ratio (x)	7.2	7.8	9.1	22.3	21.7	21.0
P/BV Ratio (x)	0.7	0.7	0.9	2.6	2.5	2.3

\*Market price for current year and subsequent years as per the closing price on 14-Aug-2022

Source: Company Financials, U Capital Research

**Note: Current market price is not adjusted for bonus shares**



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