Omani Banking Sector

December 24, 2017

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

- **Credit growth to pick up to an average of 6% over 2018-2021e**
- **Net interest margins are already showing signs of improvement on improving yields on re-priced assets; rising cost of funding continues to dampen yield improvement**
- **Limited growth in other operating income on highly competitive environment**
- **Cost-to-Income Ratio expected to improve on controlled costs and rising operating income across the sector**

We revise our target prices and ratings on the Omani Banking sector as follows: Bank Muscat (BKMB) –BUY, Bank Dhofar (BKDB) –HOLD, National Bank of Oman (NBOB) -HOLD, Bank Sohar (BKSB) –Accumulate, Ahli Bank (ABOB) -HOLD and HSBC Oman (HBMO) -Accumulate.

We believe that the Omani banking sector is beginning to show signs of improvement in the top line on the back of rising interest rates translating into improving yields. Furthermore, we are optimistic on credit growth as Government-led revenue diversification efforts begin to bear fruition over our forecast horizon. The IMF forecasts Oman's GDP growth at 3.8% for 2018, with an average growth of 2.4% over the period 2018-2022 which we believe will translate into a credit growth of ~5% in 2018 with an average growth of 6% over 2019-2022e.

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. In our forecasts, we have assumed a sector-wide mid-single digit growth in loan books of the banks for FY18. We expect credit growth levels to improve at the end of the forecast period on anticipation of improvements in macroeconomic situation as various Government-led diversification efforts like Tanfeedh program bear fruition in addition to improvement in hydrocarbon revenues (Khazzan Gas field capacity utilization), assuming oil prices remain at the current levels.

We prefer to position ourselves in banks that 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 banks are showing a large upside potential on their current prices as they have de-rated significantly over the past few months.

Key Risks

Our forecasts are based on mid-single-digit credit and deposit growth assumption, on the back of a modest macroeconomic outlook. However, we have assumed spreads to improve albeit slowly from 2018 onwards on the back of rising interest rates, which together with our assumption of improved cost controls, results in moderate improvement in the bottom line for most banks. However, deterioration in macroeconomic situation warrants downside risk to our valuation as it will have direct impact on credit growth. Furthermore, deposit growth constraints might put more pressure on cost of funding, dampening improvement in yields on assets expected to materialize in a rising interest rate environment.

Name	Mkt Cap (OMR mn)	Last Px (OMR)	Target Price (OMR)	Upside / (Downside) (%)	P/B'18e, (x)	P/E'18e, (x)	ROE'18e, (%)	Div Yield'18e, %
BKMB	1,078.3	0.398	0.495	24%	0.64	6.48	10.68	6.3%
BKDB	489.7	0.216	0.222	3%	1.00	10.16	10.80	6.0%
NBOB	306.6	0.198	0.214	8%	0.68	9.43	9.50	7.2%
BKSB	273.1	0.153	0.173	13%	0.96	9.92	9.28	3.2%
ABOB	240.8	0.169	0.179	6%	0.76	13.09	5.88	4.4%
HBMO	252.0	0.126	0.140	11%	0.98	9.71	10.38	5.3%

Source: Bloomberg, U Capital Research

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Valuation

We have used Excess Returns Methodology to arrive at our target prices for the banks whereby we find present value of the excess returns (net profit minus the cost of equity) for each year over the forecast period (2018-2021). 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	BKDB	NBOB	BKSB	ABOB	HBMO
	OMR mn	*OMR mn*	*OMR mn*	*OMR mn*	*OMR mn*	*OMR mn*
PV of Excess Returns & Terminal Value						
Year 1	(40)	(23)	(14)	(15)	(1)	(19)
Year 2	(43)	(21)	(13)	(16)	(0)	(16)
Year 3	(43)	(19)	(11)	(14)	(0)	(14)
Year 4	(44)	(17)	(9)	(14)	(0)	(13)
Terminal	(135)	159	(48)	82	9	25
Assumptions						
Risk Free Rate	5.1%	5.1%	5.1%	5.1%	5.1%	5.1%
Risk Premium (Market Risk, Company Risk, Country Risk)	7.0%	7.0%	7.0%	7.0%	7.0%	7.0%
Beta (3Yr Weekly)	1.26	1.12	1.14	1.08	0.85	1.066
Cost of Equity (COE) in extraordinary growth period	13.9%	12.9%	13.0%	12.6%	11.0%	12.5%
Retention Ratio in stable period	30%	40%	30%	30%	30%	40%
ROE in stable period	11%	13%	12%	14%	13%	13%
Equity Invested Currently	1,647	423	427	287	248	318
Fair Value of Equity	1,341	501	331	309	256	280
Outstanding Share (mn)	2,709	2,258	1,549	1,785	1,425	2,000
Fair Value						
Fair Value (OMR)	**0.495**	**0.222**	**0.214**	**0.173**	**0.179**	**0.140**
Current Market Price (OMR)	0.398	0.216	0.198	0.153	0.169	0.126
Upside/(Downside)	24%	3%	8%	13%	6%	11%
Recommendation	**BUY**	**Hold**	**Hold**	**Accumulate**	**Hold**	**Accumulate**

Source: Company Financials, Bloomberg, U Capital Research

Risks to Valuation

Key downside risks to our valuations include:

- A 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 further.
- Deterioration in asset quality and loan-loss coverage levels resulting in higher-than-expected cost of risk.

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.

Sensitivity Analysis

BKMB

Stable Period ROE

Cost of Equity	9.2%	10.2%	11.2%	12.2%	13.2%
11.9%	0.430	0.485	0.543	0.606	0.674
12.9%	0.410	0.462	0.519	0.580	0.645
13.9%	0.390	0.441	**0.495**	0.554	0.617
14.9%	0.371	0.420	0.473	0.529	0.591
15.9%	0.353	0.400	0.451	0.505	0.565

Stable Period Retention Ratio

Cost of Equity	20%	25%	30%	35%	40%
11.9%	0.550	0.547	0.543	0.539	0.534
12.9%	0.526	0.522	0.519	0.515	0.510
13.9%	0.502	0.499	**0.495**	0.492	0.487
14.9%	0.479	0.476	0.473	0.469	0.465
15.9%	0.457	0.454	0.451	0.447	0.443

BKDB

Stable Period ROE

Cost of Equity 0.222	12.5%	13.5%	14.5%	15.5%	16.5%
10.9%	0.191	0.217	0.247	0.280	0.319
11.9%	0.181	0.206	0.234	0.267	0.304
12.9%	0.171	0.195	**0.222**	0.254	0.290
13.9%	0.161	0.184	0.211	0.241	0.276
14.9%	0.152	0.174	0.200	0.229	0.263

Stable Period Retention Ratio

Cost of Equity 0.222	30%	35%	40%	45%	50%
10.9%	0.233	0.239	0.247	0.256	0.268
11.9%	0.221	0.227	0.234	0.243	0.255
12.9%	0.210	0.215	**0.222**	0.231	0.243
13.9%	0.199	0.204	0.211	0.219	0.230
14.9%	0.188	0.193	0.200	0.208	0.219

NBOB

Stable Period ROE

Cost of Equity	10.0%	11.0%	12.0%	13.0%	14.0%
11.1%	0.229	0.254	0.280	0.309	0.341
12.1%	0.202	0.222	0.243	0.267	0.292
13.1%	0.179	0.196	**0.214**	0.233	0.254
14.1%	0.159	0.174	0.189	0.206	0.223
15.1%	0.143	0.156	0.169	0.183	0.198

Stable Period Retention Ratio

Cost of Equity	20%	25%	30%	35%	40%
11.1%	0.277	0.278	0.280	0.283	0.285
12.1%	0.244	0.243	0.243	0.243	0.243
13.1%	0.216	0.215	**0.214**	0.212	0.210
14.1%	0.193	0.191	0.189	0.187	0.184
15.1%	0.174	0.171	0.169	0.166	0.163

BKSB

Stable Period ROE

Cost of Equity	11.8%	12.8%	13.8%	14.8%	15.8%
13.7%	0.140	0.163	0.188	0.215	0.244
14.7%	0.133	0.155	0.180	0.206	0.235
15.7%	0.126	0.149	**0.173**	0.199	0.227
16.7%	0.120	0.142	0.165	0.191	0.219
17.7%	0.114	0.135	0.159	0.184	0.211

Stable Period Retention Ratio

Cost of Equity	20%	25%	30%	35%	40%
13.7%	0.181	0.184	0.188	0.192	0.197
14.7%	0.173	0.176	0.180	0.184	0.189
15.7%	0.166	0.169	**0.173**	0.177	0.182
16.7%	0.159	0.162	0.165	0.170	0.175
17.7%	0.152	0.155	0.159	0.163	0.167

ABOB

Stable Period ROE

Cost of Equity	10.5%	11.5%	12.5%	13.5%	14.5%
9.0%	0.142	0.169	0.200	0.234	0.273
10.0%	0.142	0.164	0.189	0.216	0.247
11.0%	0.140	0.159	**0.179**	0.202	0.227
12.0%	0.137	0.153	0.170	0.189	0.210
13.0%	0.133	0.147	0.162	0.178	0.196

Stable Period Retention Ratio

Cost of Equity	20%	25%	30%	35%	40%
9.0%	0.197	0.198	0.200	0.202	0.204
10.0%	0.187	0.188	0.189	0.190	0.192
11.0%	0.178	0.179	**0.179**	0.180	0.181
12.0%	0.169	0.170	0.170	0.171	0.172
13.0%	0.161	0.161	0.162	0.162	0.163

HBMO

Stable Period ROE

Cost of Equity	11.5%	12.5%	13.5%	14.5%	15.5%
10.6%	0.117	0.138	0.164	0.193	0.229
11.6%	0.113	0.130	0.151	0.174	0.201
12.6%	0.108	0.123	**0.140**	0.159	0.181
13.6%	0.104	0.116	0.131	0.147	0.164
14.6%	0.099	0.110	0.122	0.136	0.151

Stable Period Retention Ratio

Cost of Equity	30%	35%	40%	45%	50%
10.6%	0.156	0.159	0.164	0.169	0.176
11.6%	0.146	0.148	0.151	0.154	0.159
12.6%	0.136	0.138	**0.140**	0.143	0.146
13.6%	0.128	0.129	0.131	0.133	0.135
14.6%	0.120	0.121	0.122	0.124	0.126

Source: Bloomberg, U Capital Research

Peer Group Analysis

Name	Mkt Cap (OMR mn)	Last Px (OMR)	Px Change (1M), %	P/B'18e, (x)	P/E'18e, (x)	ROE'18e, %	Div Yield'18e, %
BANK ALBILAD	1,262.1	2.103	10.93	1.44	11.85	11.80	2.9%
ABU DHABI ISLAMIC BANK	1,261.3	0.398	1.88	1.15	9.93	17.22	2.0%
COMMERCIAL BANK OF DUBAI	1,204.0	0.430	2.50	1.17	9.58	13.36	5.6%
COMMERCIAL BANK PQSC	1,229.0	3.037	10.56	0.68	11.60	7.49	2.7%
BOUBYAN BANK K.S.C	1,231.3	0.541	2.41	2.24	14.33		2.4%
SAUDI INVESTMENT BANK/THE	1,166.7	1.556	3.98	0.75	8.98	8.81	4.4%
UNION NATIONAL BANK/ABU DHAB	1,095.5	0.398	(0.52)	0.58	6.33	9.81	6.5%
BANKMUSCAT SAOG	1,078.3	0.398	(0.50)	0.65	6.58	10.68	6.3%
BLOM BANK	959.7	4.464	6.42	0.77	5.29	19.20	8.8%
GULF BANK	923.9	0.303	(0.83)	1.03	11.66		4.3%
DOHA BANK QPSC	935.0	3.016	7.26	0.84	9.82	11.08	6.9%
BANK AUDI SAL	884.5	2.213	4.55	0.69	7.49	17.80	6.7%
COMMERCIAL BANK OF KUWAIT	838.7	0.509	-	0.93	10.63	9.69	4.3%
BANK DHOFAR SAOG	489.7	0.216	8.78	1.07	10.92	10.80	5.6%
NATIONAL BANK OF OMAN SAOG	306.6	0.198	(1.00)	0.60	8.41	9.50	8.1%
BANK SOHAR	273.1	0.153	(2.55)	0.93	9.67	9.28	3.3%
HSBC BANK OMAN	252.0	0.126	1.61	0.76	13.09	5.88	4.4%
AHLI BANK	240.8	0.169	1.20	0.89	8.78	10.38	5.9%
Average				**0.95**	**9.72**	**11.42**	**5.1%**

Source: Bloomberg, U Capital Research

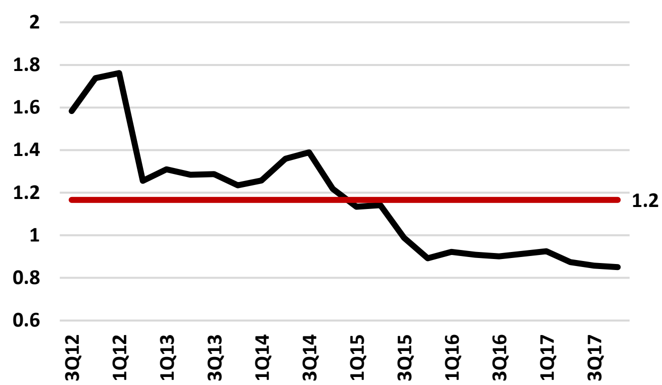
Investment Thesis

- ## Multiples depict room for price appreciation

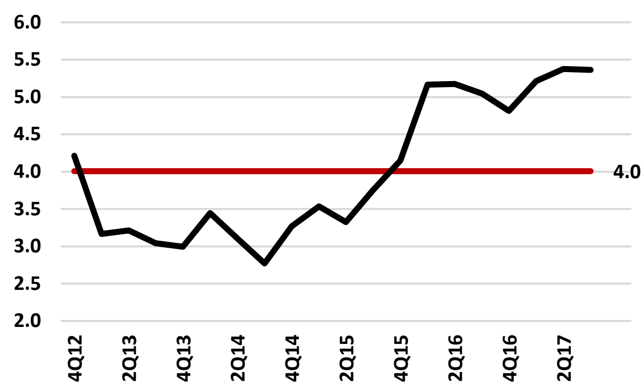
The Omani Banking sector's credit offtake has slowed down drastically from highs of pre-2015 era, primarily on the back of reduced Government revenues of an oil-dependent economy, which have inevitably resulted in the slowdown of the economy.

Nonetheless, we believe that the Omani banking sector has de-rated to 0.85x 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.

Average Quarterly Px to Book (x)



Average Quarterly Gross Dividend Yield (%)



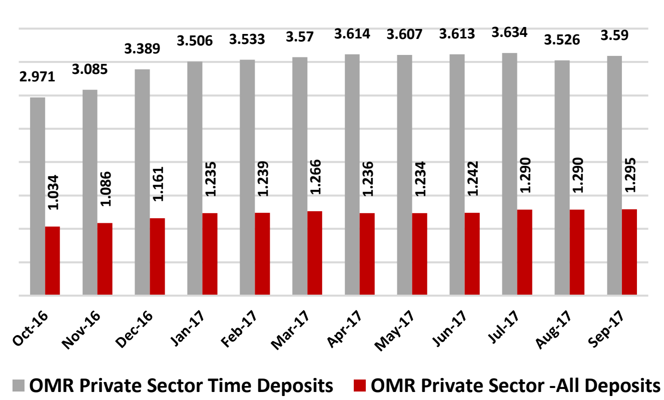
Source: Bloomberg

The banks' average gross dividend yield over the last 5 years also shows a significant upward deviation from the average at 4%, indicating room for price appreciation, given solid balance sheets of the banks as well as adequate capital adequacy measures which warrant payouts to be maintained at levels seen in FY16.

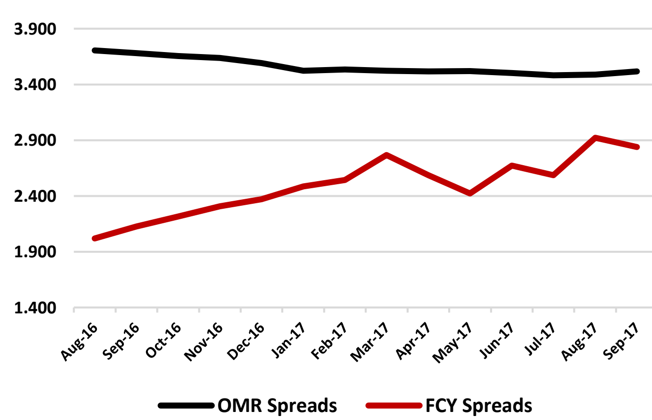
- ## Spreads (OMR) have bottomed out; expected to improve going forward

The recent US Fed's announcement of further rate hikes, possibly 3 more, during 2018 indicate that Oman's interest rates are expected to increase in sync with US policy interest rates in lieu of the OMR-USD peg. Already, we have seen cost of deposits to have risen by 0.134% during the first 9M of 2017. Weighted average interest rate on private sector deposits jumped by 0.20% from 3.389% in Dec'16 to 3.590% in Sept'17.
However, spreads have shown improvements over the last couple of months. FCY spreads have shown massive improvement from Aug'16 onwards, with slight dips seen in 2017, but in an overall upward trend. OMR spreads had been declining the great fall of oil prices that led liquidity reduction, but since July'17 we are seeing slight improvements in spreads, as banks continue to re-price assets are higher yields. Therefore, we believe that improving spreads will drive banks' operating income growth in the medium term.

Weighted Average Interest Rates, %



Spreads, %

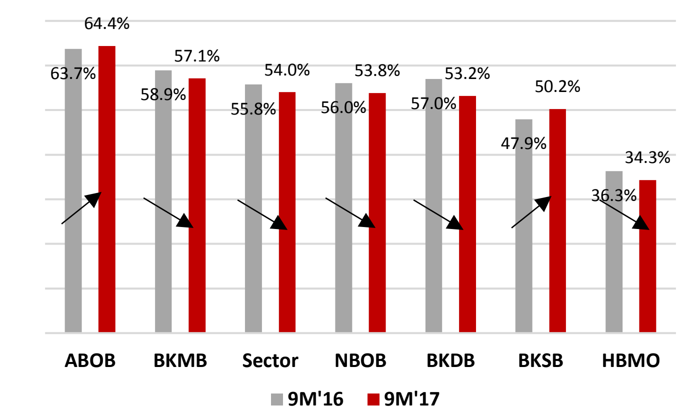


Source: CBO

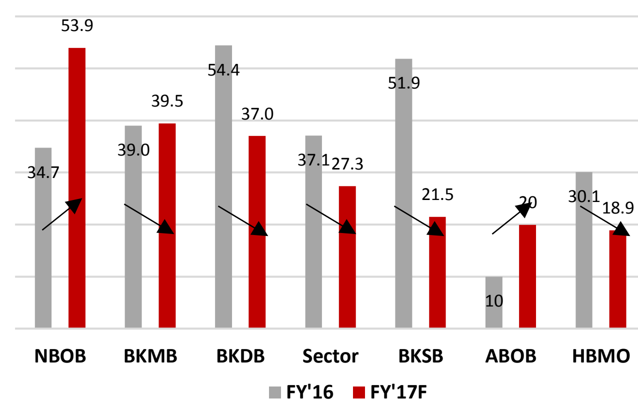
• ABOB and BKSB have shown improvements in operating margins in spite of a tough operating environment

ABOB and BKSB have shown operating margin improvements during 9M’17. All other banks are showing signs of operating margin erosion. However, all other banks have seen a roughly 2% decline in operating margin on the back of reduced operating income in spite of controlled operating costs. 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.

Omani Banks: Operating Margin



Omani Banks: Cost of Risk, bps



Source: Company Financials, U Capital Research

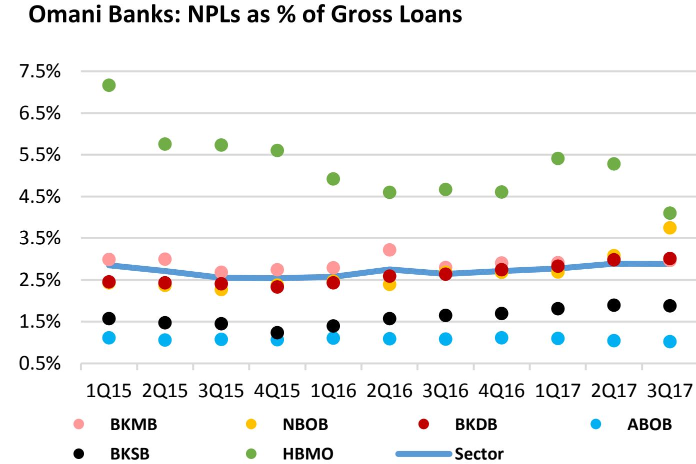
• Low NPL Ratios Suggest Well-contained Credit Risk

The banks have been able to grow their lending portfolio without much increase in NPLs, which augers well for the credit risk in the banking sector. The NPLs at the end of 9M’17 were 2.9% (2016: 2.7%) of the gross loans. The low NPL ratio suggests satisfactory asset quality and a well-contained credit risk. Moreover, the existing loan portfolio of banks is well covered against expected losses through adequate provisions with coverage ratio (provisions to NPLs) of 121% including general provisions, which compares favorably with regional peers.

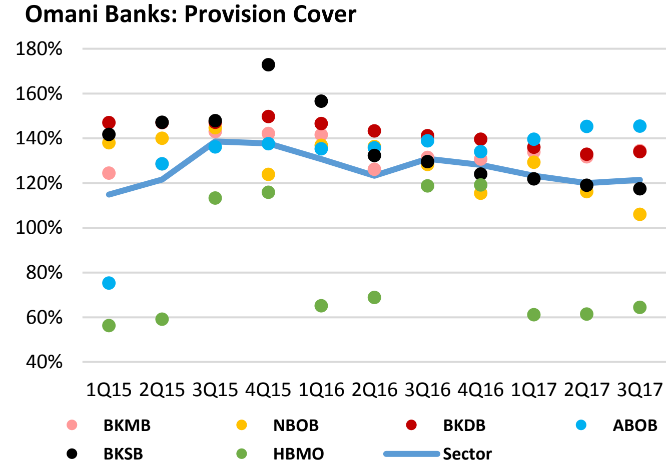
As at 9M’17, non-performing loans (NPL) ratio of HSBC Oman (HBMO) was the highest at 4.1%, which is higher than the average of the rest of the Omani banks in our coverage universe which hovers around 3%. HBMO’s provision cover at 64% falls short of the peer-group average at 140%. The provision cover for all other banks is above 100%, indicating adequate provisioning.

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

Omani Banks: NPLs as % of Gross Loans



Omani Banks: Provision Cover



Source: Bloomberg, Company Financials *Note: Ahli Bank does not disclose NPLs on quarterly basis*

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.

- **Robust Capital adequacy; above minimum regulatory capital requirements**

The banking sector of Oman boasts robust capital adequacy at a median capital adequacy ratio of 16% (simple average: 17%). All the banks are above the minimum capital adequacy requirements of CBO and currently fulfill the counter-cyclical as well as capital-conservation buffer requirements.

Bank	Tier 1 Cap Ratio -9M'17	Total Capital Adequacy Ratio - 9M'17
EMIRATES NBD PJSC	18.80	21.20
SAUDI BRITISH BANK	18.35	20.78
NATIONAL BANK OF RAS AL-KHAI	20.35	20.35
SAUDI INVESTMENT BANK/THE	16.84	19.92
ALAWWAL BANK	14.89	19.79
SAMBA FINANCIAL GROUP	19.20	19.70
RIYAD BANK	16.50	18.70
MASHREQBANK	17.10	18.01
FIRST ABU DHABI BANK PJSC	14.60	18.00
BANQUE SAUDI FRANSI	16.05	17.98
NATIONAL BANK OF FUJAIRAH	15.50	17.95
BANKMUSCAT SAOG	**15.77**	**17.51**
ARAB NATIONAL BANK	15.17	17.11
NATIONAL BANK OF OMAN SAOG	**13.25**	**17.50**
BANK SOHAR	**14.64**	**16.99**
QATAR NATIONAL BANK ALAHLY	15.20	16.81
COMMERCIAL BANK PQSC	11.20	16.00
HSBC BANK OMAN	**14.95**	**15.90**
BANK DHOFAR SAOG	**12.18**	**14.61**
AHLI BANK	**12.52**	**14.26**
Median	**15.35**	**17.97**
Average	**15.65**	**17.95**
Oman -Median	**13.74**	**15.95**
Oman -Average	**14.42**	**16.98**

Source: Bloomberg, U Capital Research

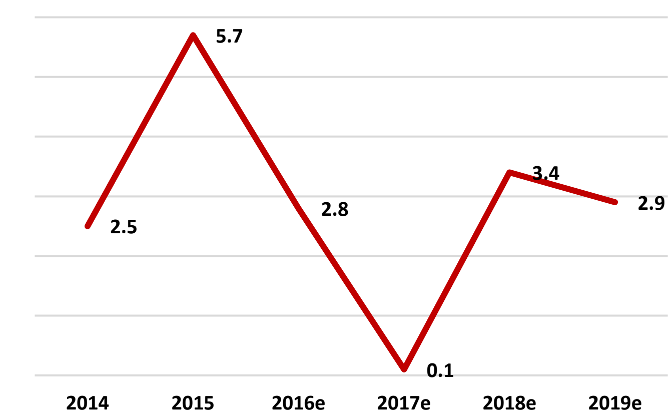
Furthermore, two banks in Oman have recently raised equity through various instruments post- 9M’17. Ahli Bank finished raising Tier 1 perpetual bonds worth OMR 50mn. Bank Dhofar is currently undergoing raising of Core Equity Tier 1 (CET-1) Capital of an amount up to OMR 40mn by way of rights issue of ordinary shares. These issuance are expected to improve the bank’s capital adequacy ratios. Bank Sohar earlier raised Tier 1 Perpetual Bonds worth OMR 100mn in Sept’17.

Macro & Sectoral Outlook

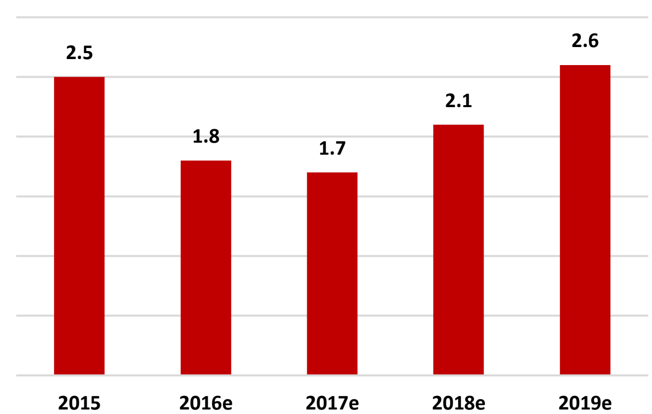
Oman's macroeconomic outlook is encouraging on the back of planned non-oil GDP growth triggers

Oman's economic growth is set to recover modestly over the medium term, as forecasted by the IMF & World Bank. A boost in the hydrocarbon sector is expected in 2018, mainly on end of "OPEC plus" restrictions on oil supply coupled with the Khazzan gas project's increased production capacity. As the gradual recovery of oil prices improves confidence and encourages private sector investment, overall GDP growth is projected to rebound to 2.9% by 2019. As has been the case for many years now, the government is focused on economic diversification. Over the longer term, pro-business reforms such as the foreign ownership law and the FDI law, and the lifting of sanctions on Iran are expected to increase trade and investment opportunities.

Oman Real GDP growth (%)



Gross Fixed Capital Investment Growth (%)

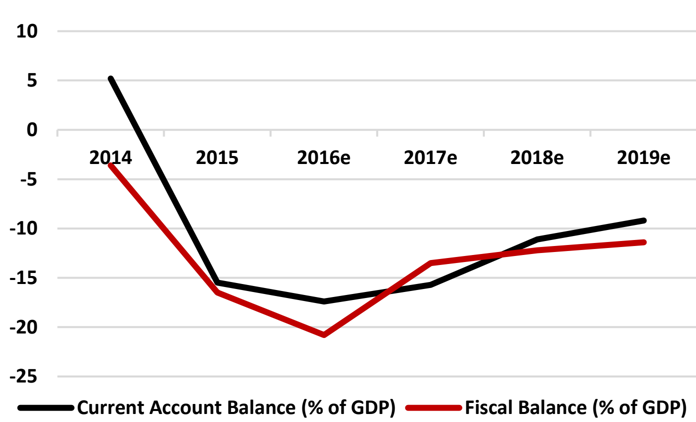


Source: World Bank (Note: GDP growth at constant market prices)

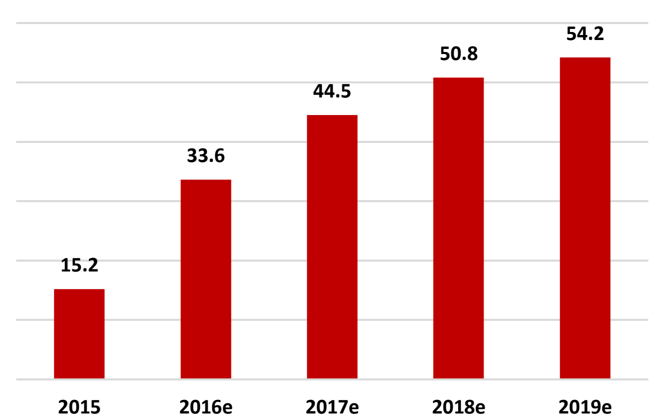
Current & Fiscal deficits are expected to decrease

Oman's fiscal deficit increased to OMR 5.2bn or 20.4% of GDP in 2016. However, IMF estimates suggest that the fiscal deficit will decline in 2017 and 2018 based on expectations of fiscal consolidation and increasing revenues from taxes, removal of subsidies on fuel, and expected higher oil prices. Low oil prices placed pressures on Oman's current account balance. The current account deficit stood at about 15% of nominal GDP in 2015 and 2016. It is expected to be 14% in 2017 and 13% in 2018. Government debt reached USD 19.8bn by the end of 2016, which is 32.6% of GDP, and it is projected at 44% in 2017 (IMF estimate) and to further increase to 50% in 2018.

Current Account & Fiscal Balances as % of GDP



Gross Government Debt as % of GDP



Source: World Bank, IMF

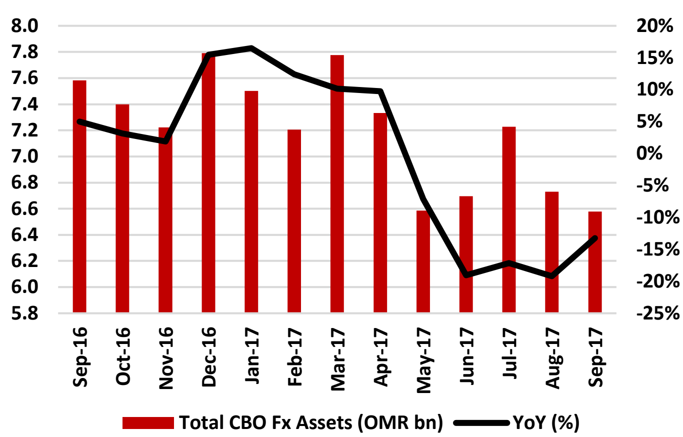
Ubhar Capital اوبار كابيتال

Research

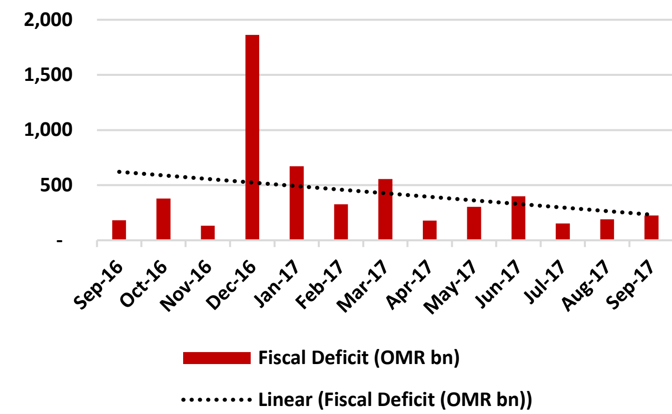
Central Bank of Oman (CBO) maintains adequate levels of Fx Reserves thereby preserving OMR-USD peg

Total foreign reserves at the CBO decreased substantially in 9M’17, however they are still sufficient to maintain the USD-OMR peg. Total Fx assets stood at OMR 6.58bn as at the end of 9M’17, -13%YoY and -2%MoM.

CBO Fx Assets



Oman's Fiscal Deficit (OMR mn)

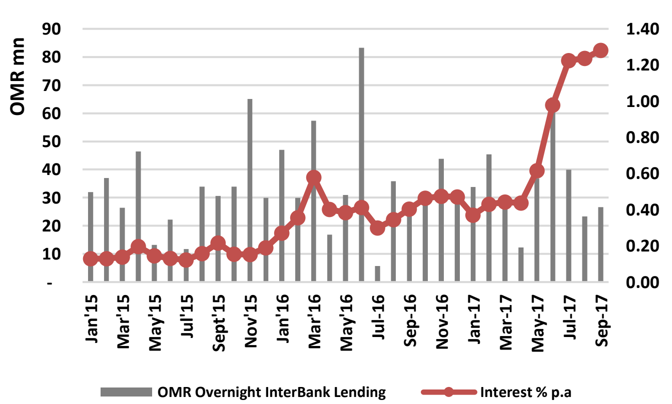


Source: CBO

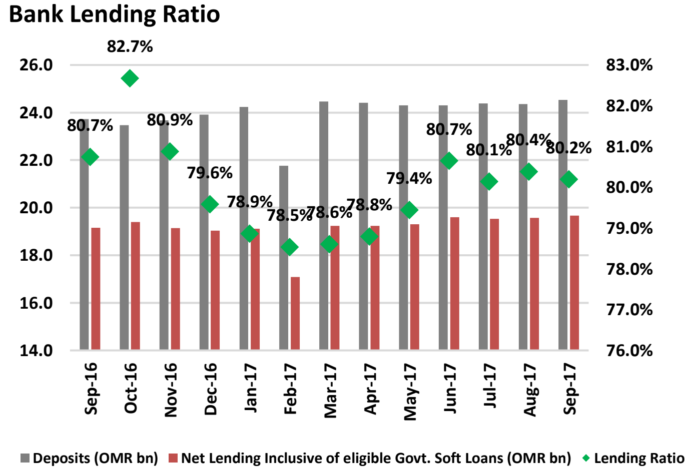
Money supply trends are improving

Within Oman, liquidity conditions have deteriorated but levels have been stable over the last few months. In fact, the total bank lending ratio has remained below the peak of 82.7% reached in Oct’16, and has remained at ~80% level over the last three months (80.1% in Sept’17).

Rial Omani Overnight Domestic Inter-Bank Lending



Bank Lending Ratio



For Bank Lending ratio:

1. Deposits include customers’ deposits as well as net balances due to banks abroad and capital funds

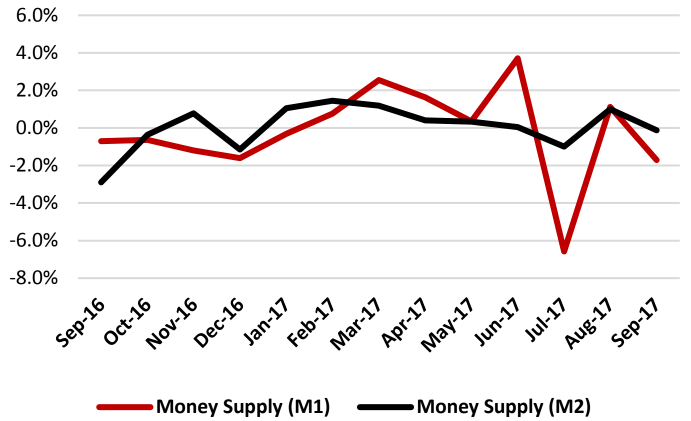
2. The lending ratio effective from 1st January 2009 is 87.5% of deposit base.

3. Amount in excess is the sum of excesses of individual banks and not the difference between aggregate net lending and permitted lending of all banks

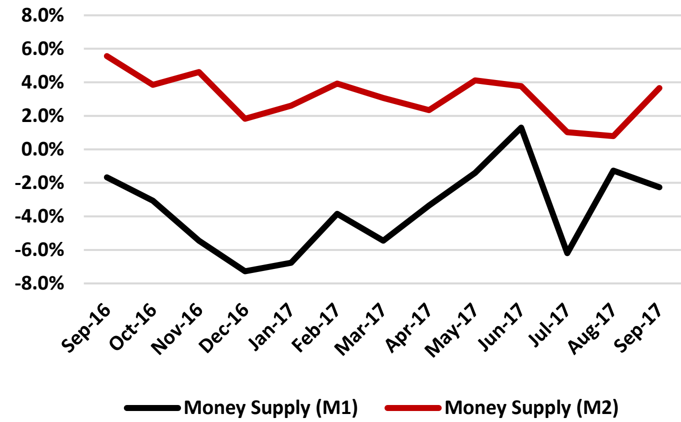
Source: CBO, U Capital Research

However, the Rial Omani domestic interbank lending rate has rapidly climbed to 1.281%, with an average rate over the last three months at 1.25%, up from a low of 0.370% in Jan’17. Broad Money Supply (M2) growth is outpacing the growth in Narrow Money Supply (M1), on monthly as well as yearly basis. Money supply trends seem to have picked up in Sept’17 as far as broad money supply is concerned, in spite of a 2.3%YoY decline in M1 (currency outside commercial banks & demand deposits), spurred on by a 6.6%YoY increase in quasi-money resulting in a 3.7%YoY increase in M2. M2 has grown at a simple average rate of 2.8%YoY on YTD basis, down from an average of 7.5%YoY over Jan-Sept’16.

Month-on-Month Growth, %



Year-on-Year Growth, %



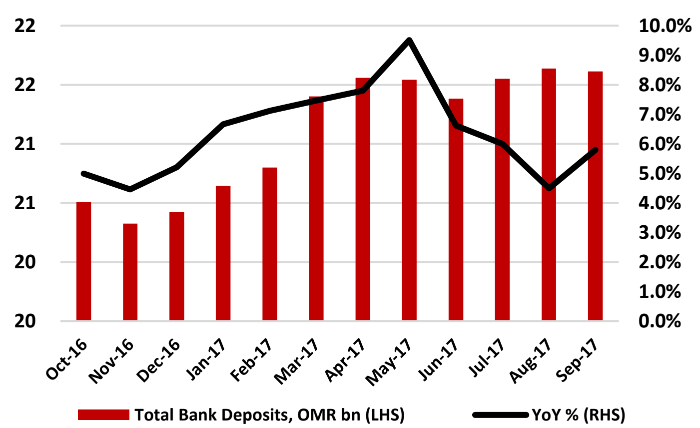
Source: CBO

Credit and Deposit are growing in line with each other

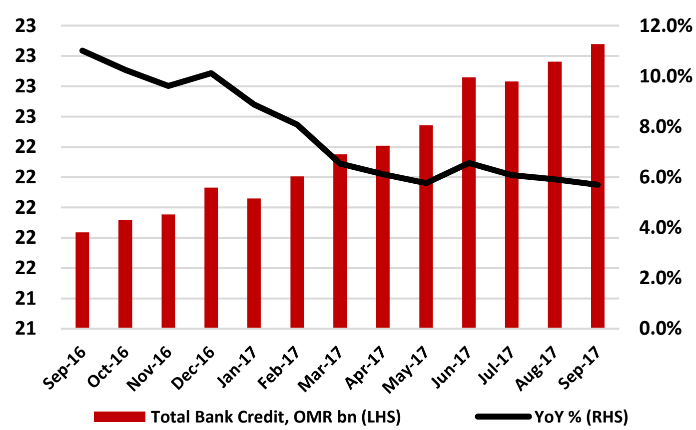
The total credit of the Omani Banking sector is OMR 23.08bn as of 9M'17 i.e. 90% of the expected GDP of Oman at OMR 25.3bn for FY17. Of this total credit, conventional banks account for OMR 20.18bn or 87.4%. The conventional banks' credit rose by 3.0%YoY as at the end of 9M'17, as compared to 7.8%YoY in 9M'16. The total deposits of the entire sector, including Islamic banks & Islamic Windows of conventional banks, stood at OMR 21.64bn as at the end of 9M'17, +5.8% YoY. Of this, OMR 18.81bn (+2.1% YoY) belonged to the conventional banks.

The total credit[1] within the Omani Banking sector grew by 5.7%YoY as at the end of Sept'17 vs. 10.1%YoY as at the end of Dec'16. We believe that going forward, total credit expansion will slow down to low- to mid-single digit for FY17 and FY18, with further slowing down in the subsequent years in case of persistent low oil prices.

Omani Banking Sector: Total Deposits



Omani Banking Sector: Total Credit



Source: CBO

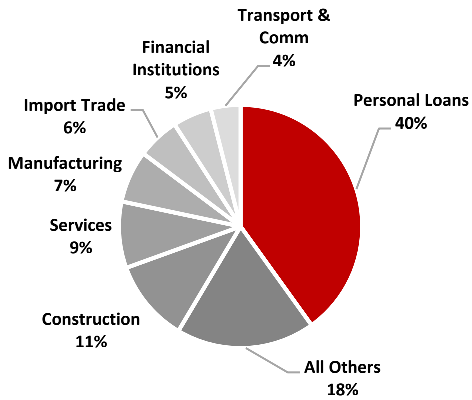
Real Estate Sector Credit Concentrations Exist

Omani banks, like their resource-dependent GCC counterparts, have substantial direct and indirect exposure to the real estate sector. Direct exposures include financing the residential or commercial real estate, whereas indirect exposures include other financing secured against real estate. The total real estate exposure of the banking sector is about 33% (Source: CBO) of the total lending portfolio which is considered large. Therefore, a

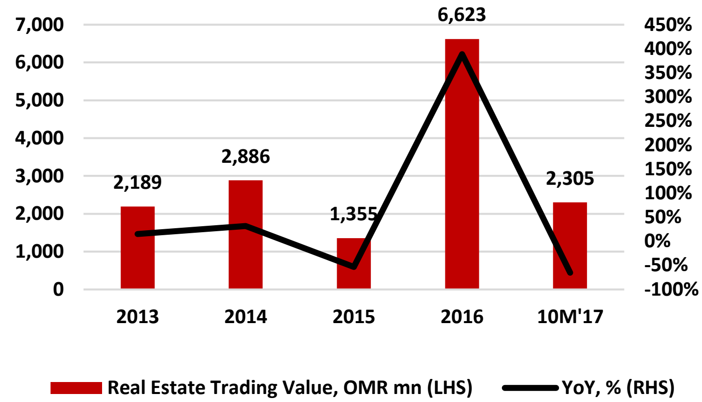
[1] Includes Conventional & Islamic Banks as well as Islamic windows of conventional banks

significant weakening in the real estate market may expose the banking sector to considerable risks e.g. a shift in investors' sentiments, decline in rents or higher vacancy rates for built-to-rent real estate may rapidly jeopardize the stability of the banking sector.

Credit Composition as of 9M'17



Real Estate Trading Value



Source: CBO, NCSI

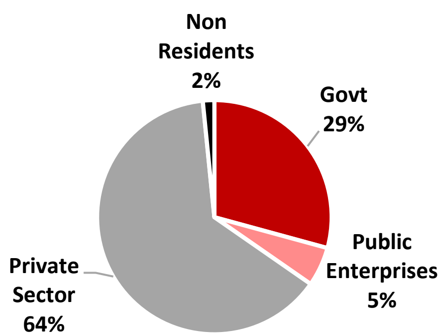
High household indebtedness poses another significant risk

Lending to individuals surpasses all other sectors in Oman at 40% of total credit extended as personal loans. Household Indebtedness in Oman is about 22 and 45 months of net salary for personal and housing loans respectively[2], higher than other OECD countries. At present, overall, household credit risk indicators remain at low levels and household debt as a percentage of GDP is low. Moreover, the prudential regulations on lending to households are expected to keep the risks in this sector at manageable levels.[3]

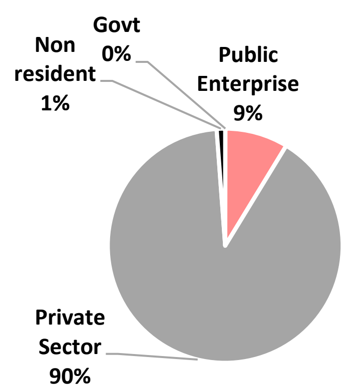
Government & Public Sector Deposits account for ~35% of total deposits; Deposit flight highly unlikely

Traditionally, Omani banks have had low reliance on wholesale markets. Government deposits have always been an important source of funding for the banks, as is characteristic of a resource dependent economy. However, the risk of withdrawal is not imminent as the government resorted to borrowing from international markets to finance its budget deficit. The government and public sector together comprise OMR 7.5bn or 34.7% of the total deposit base as at Sept'17, up from 33% in Feb'17.

Deposit Concentration, Sept'17



Credit Concentration, Sept'17



Source: CBO

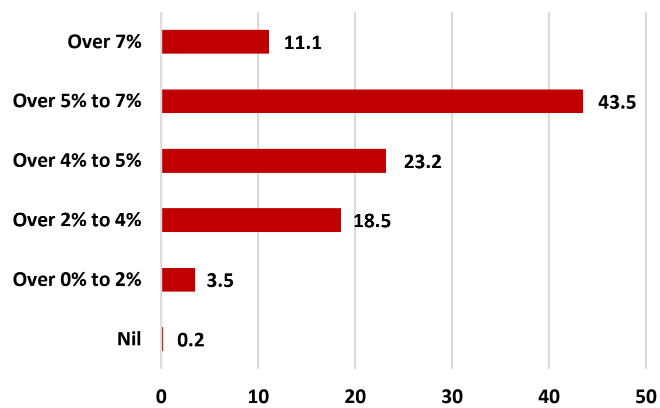
[2] CBO

[3] Debt service ratio is capped at 50% of net salary receipts on personal loans & 60% on housing loans

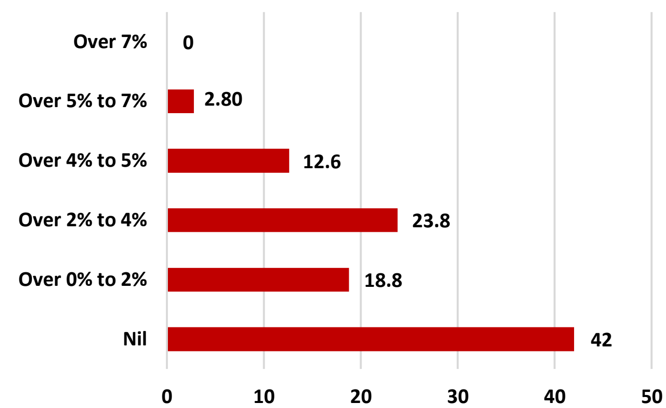
Interest Rates are rising in line with the US Monetary Policy as well as reduced system liquidity

Rising interest rates might put pressure on the borrowers as well as banks' bottom lines. Following the Federal Reserve's lead, the policy rates and interbank rates in Oman have been on the rise, also catapulted by reduced liquidity. The rising policy rates have also been partially passed through to the retail deposit and lending rates. The rising interest rates might put pressure on the bottom lines of the banks. Conversely, as banks continue to re-price their assets, their profitability can be supported, given cost of funding remains below Government stipulated ceiling on personal loans (at 6%) and corporate loans are not regulated by the CBO.

% of Conventional Bank OMR Lending, Sept'17



% of Conventional Bank OMR Deposits, Sept'17



Source: CBO

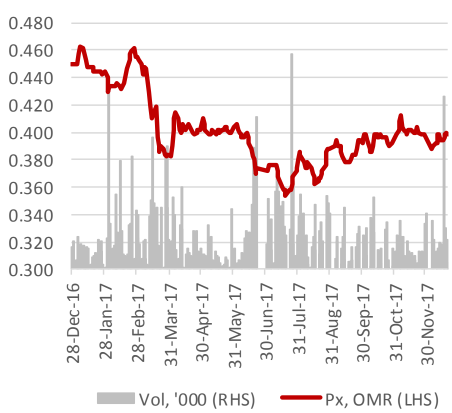
Bank Muscat SAOG

TP: OMR 0.495/share
Upside: 24%

Recommendation	**BUY**
Bloomberg Ticker	BKMB OM
Current Market Price (OMR)	0.398
52wk High / Low (OMR)	0.470/0.350
12m Average Vol. (000)	1,041.8
Mkt. Cap. (USD/OMR mn)	2,804/1,078
Shares Outstanding (mn)	2,709.4
Free Float (%)	65%
3m Avg Daily Turnover (OMR'000)	330.2
6m Avg Daily Turnover (OMR'000)	410.8
PE 2018e (x)	6.6
PBv 2018e (x)	0.6
Dividend Yield '18e (%)	6.3%
Price Performance:	
1 month (%)	(0.50)
3 month (%)	3.65
12 month (%)	(6.72)

Source: Bloomberg

Price-Volume Performance



Source: Bloomberg

- **Largest Bank in Oman with a market share of 40.2% in terms of assets as of 9M'17**
- **Solid Capital Position, CAR of 17.51% as at 30th Sept 2017**
- **Net profit expected to grow at a CAGR of 4.4% between 2017-2021**
- **NPLs expected at 3.5% of gross loans and provision cover at 128% of NPLs in 2018e**

We reiterate BUY rating on Bank Muscat with a reduced target price of OMR 0.495 per share, implying an upside of ~24% 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'18e of 8.3x, and P/b'18e of 0.79x. We believe that this fair value is justified because net interest margins are expected to improve over the forecast horizon in spite of modest credit offtake resulting in improving net profit growth prospects.

Valuation & Outlook

We expect the bank to have a tepid loan-book growth (at 3.9% CAGR over 2017-2021) as macroeconomic situation remains subdued. Our modest assumption is based on the current 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 NPLs in the medium term. We expect the bank to maintain payouts at FY16 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 rise through FY18-FY19 before leveling out).

Performance during 9M'17

The bank improved its net interest income (including Islamic finance income) by 1.6%YoY during 9M'17 at OMR 209.02mn. A 3.6%YoY decline in other operating income resulted in an operating income marginal decline of 0.2%YoY at OMR 313.57mn. A 4.3%YoY increase in operating expenses resulted in operating profit decline of 3.3%YoY at OMR 179.15mn. Impairment charges, however, declined by 9.4%YOY paring PBT decline to 2.1%YoY at OMR 152.98mn. Tax expense jumped by 17.2%YoY resulting in a net profit decline of 4.9%YoY at OMR 130.257mn.

Key Indicators

Year	FY14	FY15	FY16	FY17e	FY18e	FY19e
Total Net Loans (OMR mn)	6,386	6,695	7,102	7,345	7,600	7,866
Total Customer Deposits (OMR mn)	6,628	7,363	7,458	7,644	8,020	8,346
Operating Income (OMR mn)	383	408	416	421	449	474
Net Profit (OMR mn)	163	175	177	174	186	196
Diluted EPS (OMR)	0.075	0.077	0.071	0.064	0.061	0.062
Diluted BVPS (OMR)	0.563	0.601	0.610	0.620	0.616	0.592
P/E (x)	8.4	6.9	6.7	6.2	6.6	6.4
P/BVPS (x)	1.1	0.9	0.8	0.6	0.6	0.7
Dividend Yield (%)	4.0%	4.7%	5.3%	6.3%	6.3%	6.3%

Source: Company Financials, U Capital Research

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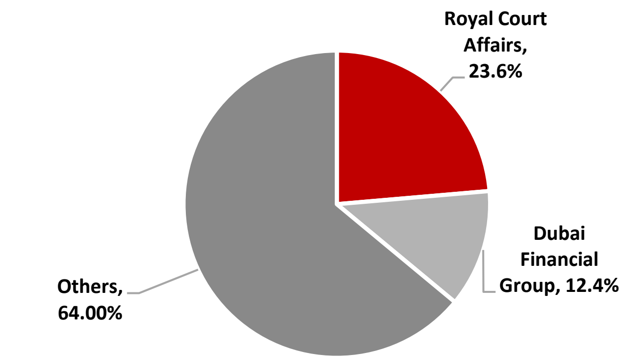
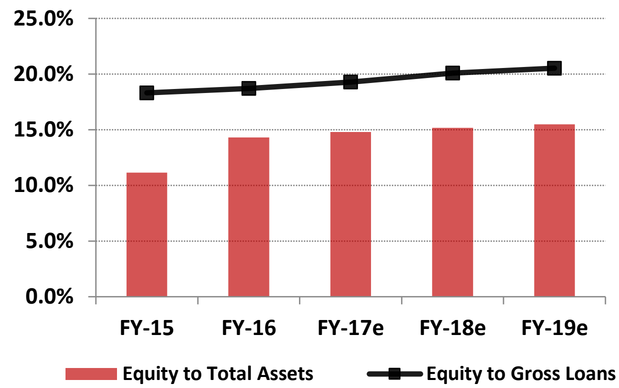
Government support & adequate capitalization work in favor of the bank

As the largest lender in Oman and largest in terms of deposits (at 35.7% and 34.8% 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 (~35% as per company documents), we believe that the bank stands to readily receive sovereign support if it is to comes under duress. The bank's capital adequacy ratio (CAR) stood at 17.51% as at the end of 9M'17 (Common equity Tier 1 at 14.46% and Tier 1 at 15.77%), comfortably above CBO-mandated minima, including Capital Conservation Buffer and Countercyclical Buffer requirements.

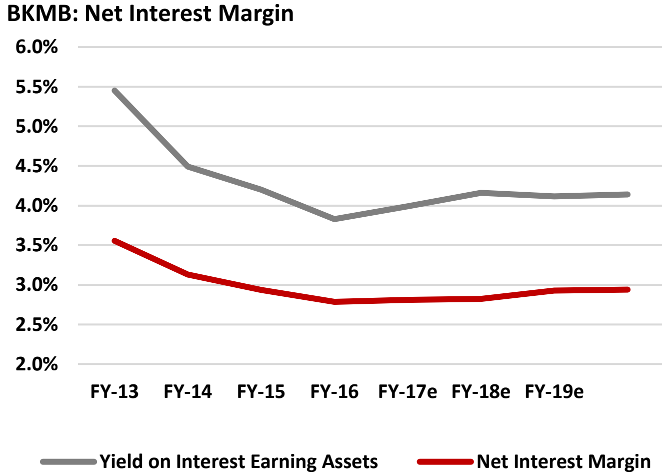


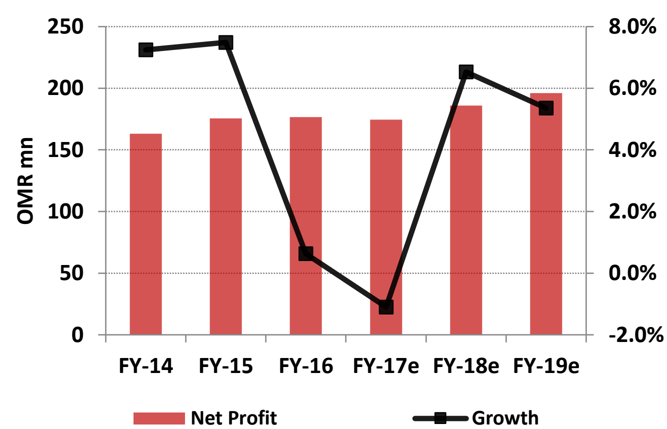


Source: Company Financials, U Capital Research

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 42.4% of total net profit at OMR 55.2mn in 9M'17. It also has a strong retail banking franchise (at 30.9% of 9M'17 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.





Source: Company Financials, U Capital Research

We believe that the bank's spreads bottomed out in FY16 and we are already seeing signs of improvement in the 9M'17 results. Therefore, we believe that improving spreads will lend some profitability growth to the bank in spite of muted growth in credit offtake. Additionally, we believe that the bank will continue to practice prudent cost controls in order to preserve profitability.

Key Financials

(OMR mn)	2014	2015	2016	2017e	2018e	2019e
Income Statement						
Interest/Financing Income	345.0	358.4	393.2	422.8	454.4	484.5
Interest Expense/Payment to Depositors	(101.3)	(97.8)	(119.0)	(141.9)	(142.4)	(155.1)
Net Interest/Financing Income	**243.6**	**260.5**	**274.1**	**280.9**	**312.1**	**329.4**
Fee & Commission Income	93.9	102.8	95.3	94.1	92.1	97.1
Other Income	45.6	44.4	46.7	46.2	45.1	47.6
Total Non-Interest/Financing Income	**139.5**	**147.2**	**142.0**	**140.3**	**137.2**	**144.7**
Total Operating Income	**383.1**	**407.7**	**416.2**	**421.2**	**449.3**	**474.1**
Provisions expense	(39.0)	(39.2)	(37.7)	(35.2)	(41.7)	(43.9)
Operating Expenses	(157.9)	(171.1)	(174.1)	(180.6)	(188.7)	(199.6)
Profit Before Taxation	**186.3**	**197.5**	**204.4**	**205.4**	**218.8**	**230.6**
Taxation & Minority Interest	(23.0)	(22.1)	(27.8)	(31.9)	(32.8)	(34.6)
Net Profit Attributable to Parent	**163.2**	**175.5**	**176.6**	**173.5**	**186.0**	**196.0**
Balance Sheet						
Cash Balances	837	2,412	1,042	502	460	409
Deposits with Banks & FIs	1,039	991	527	949	1,172	1,223
Gross Loans & Financings	7,045	7,628	8,271	8,661	9,029	9,415
Loan Loss Reserve	(259)	(298)	(314)	(345)	(361)	(375)
Net Loans & Financings	6,786	7,330	7,957	8,316	8,668	9,041
Investment in Associates	47	48	48	48	48	48
Net Fixed Assets	72	77	74	84	88	92
Other Assets	947	1,686	1,172	1,379	1,509	1,671
Total Assets	**9,728**	**12,545**	**10,820**	**11,278**	**11,945**	**12,484**
Deposits from Banks & FIs	889	2,860	832	838	845	871
Deposits from Customers	6,628	7,363	7,458	7,644	8,020	8,346
Other Borrowings	493	526	613	596	674	720
Other Liabilities	407	398	370	400	462	484
Paid-up Capital	218	229	250	271	306	315
Retained Earnings	242	296	364	374	388	403
Other Reserves	851	872	933	1,026	1,119	1,214
Shareholders' Equity	1,312	1,397	1,547	1,670	1,813	1,933
Minority Interest, Tier 1 Perpetual Notes	-	-	-	130.00	130.00	130.00
Total Equity & Liability	**9,728**	**12,545**	**10,820**	**11,278**	**11,945**	**12,484**
Cash Flow Statement						
Cash from operations	336	1,649	(1,228)	(573)	20	48
Cash from investing activities	27	16	11	24	19	21
Cash from financing	(54)	(58)	(132)	57	(43)	(77)
Net changes in cash	255	1,575	(1,370)	(539)	(42)	(50)
Cash at the end of period	837	2,412	1,042	502	460	409
Key Ratios						
Return on Average Assets	1.8%	1.6%	1.5%	1.6%	1.6%	1.6%
Return on Average Equity	12.9%	13.0%	12.0%	10.8%	10.7%	10.5%
Recurring Income/Operating Income	88.1%	89.1%	88.8%	89.0%	90.0%	90.0%
Interest Earning/Financing Assets Yield	4.2%	3.8%	4.0%	4.2%	4.1%	4.1%
Cost of Funds	1.4%	1.0%	1.2%	1.5%	1.4%	1.5%
Net Spread	2.8%	2.8%	2.8%	2.7%	2.7%	2.7%
Cost to Income Ratio	41.2%	42.0%	41.8%	42.9%	42.0%	42.1%
Net Loans to Customer Deposits	101.4%	99.4%	106.1%	110.1%	111.7%	112.3%
NPLs to Gross Loans	3.0%	3.0%	3.2%	3.5%	3.5%	3.5%
NPL Coverage	129.4%	142.1%	130.6%	128.5%	129.8%	130.2%
Cost of Risk (bps)	48.3	42.6	39.0	35.2	38.6	38.3
Equity to Total Assets	13.5%	11.1%	14.3%	14.8%	15.2%	15.5%
Dividend Payout Ratio	33.5%	32.8%	35.4%	40.0%	41.1%	40.2%
Adjusted EPS (OMR)	0.075	0.077	0.071	0.064	0.061	0.062
Adjusted BVPS (OMR)	0.563	0.601	0.610	0.620	0.616	0.592
Market Price (OMR) *	0.628	0.530	0.472	0.398	0.398	0.398
Dividend Yield	4.0%	4.7%	5.3%	6.3%	6.3%	6.3%
P/E Ratio (x)	8.4	6.9	6.7	6.2	6.6	6.4
P/BV Ratio (x)	1.1	0.9	0.8	0.6	0.6	0.7

** Market price for 2017 and subsequent years as per latest closing price of 21/12/2017*

Source: Company Financials, U Capital Research

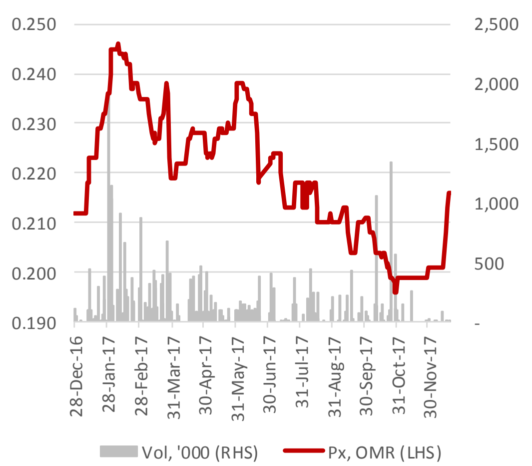
Bank Dhofar SAOG

TP: OMR 0.222/ share
Upside: 3%

Recommendation	**HOLD**
Bloomberg Ticker	BKDB OM
Current Market Price (OMR)	0.216
52wk High / Low (OMR)	0.250/0.200
12m Average Vol. (000)	123.6
Mkt. Cap. (USD/OMR Mn)	1,273/490
Shares Outstanding (mn)	2,267.1
Free Float (%)	13%
3m Avg Daily Turnover (OMR'000)	16.5
6m Avg Daily Turnover (OMR'000)	17.1
PE 2018e (x)	10.9
PBv 2018e (x)	1.1
Dividend Yield '18e (%)	5.6%
Price Performance:	
1 month (%)	8.78
3 month (%)	6.13
12 month (%)	0.81

Source: Bloomberg

Price-Volume Performance



Source: Bloomberg

- **Second-largest bank in Oman, with a market share of 14.3% of total Omani banking credit and a market share of 14.3% of Omani banking sector deposits**
- **Tier 1 Capital Adequacy Ratio below Omani as well as regional peers, at 12.18% but above the minima prescribed by the Central Bank of Oman**
- **Successful completion of the ongoing rights issue is expected to boost the bank's Core Equity Tier 1 capital by up to OMR 40mn**

We downgrade BKDB with a HOLD rating at a target price of OMR 0.222 per share, implying a limited upside of ~3%. The stock has already gained 8.78% on MTD basis, forcing us to rate it as a HOLD. Our target price implies a P/e'18e of 10.7x, and P/b'18e of 1.05x. We believe that this fair value is justified because even though net interest margin is expected to improve over the forecast horizon, the lackluster credit offtake together with potential asset quality deterioration will continue to dampen the stock's valuation.

Valuation & Outlook

We have a modest loan-book growth outlook in lieu of tepid deposit growth expectation. Operating performance over 2018-2022e is expected to be modest, growing at a CAGR of 6.8%, as loan book growth constraints weigh down operating income growth, in spite of our expectation of rapidly improving spreads. Operating expenses are expected to be curtailed at current levels, growing only moderately at a CAGR of 5.8% over the forecast period. Cost of risk is also expected to increase, weighing down on profit in the near-term.

Key Risks to Valuation

Key downside risks include:

- Slower than expected improvement in yields amid slow loan growth

Upside risks include:

- Better-than-expected credit offtake
- Improvement in asset quality

Performance during 9M'17

BKDB's 9M'17 net interest income declined by 9%YoY on account of a 63%YoY rise in interest cost in spite of a 15%YoY rise in interest income. However, its net income from Islamic financing activities rose by 17%YoY on buoyant Islamic finance asset growth (32%YoY). Therefore, the bank's total interest and Islamic income declined by 7%YoY to reach OMR 68.95mn during 9M'17. However, a 12%YoY rise in other operating income helped boost the total operating income, which ended up declining by 3%YoY to reach OMR 94.11mn. A 6%YoY rise in operating expenses weighed down the operating profit, which declined by 10%YoY to reach OMR 50.06mn. However, provision expense declined by a hefty 22%YoY, resulting in profit before tax to be salvaged at only a 6%YoY decline to reach OMR 40.93mn. A further boost came from a lower tax expense than the previous year (down by 9%YoY), resulting in net profit to have declined by 6%YoY at OMR 34.79mn.

Key Indicators

Year	FY14	FY15	FY16	FY17e	FY18e	FY19e
Total Net Loans (OMR mn)	2,255	2,729	2,989	3,240	3,467	3,641
Total Customer Deposits (OMR mn)	2,482	2,592	2,885	3,216	3,373	3,569
Operating Income (OMR mn)	99	115	127	126	134	139
Net Profit (OMR mn)	40	47	48	47	51	53
Diluted EPS (OMR)	0.030	0.027	0.021	0.019	0.020	0.019
Diluted BVPS (OMR)	0.242	0.234	0.220	0.209	0.202	0.194
P/E (x)	12.0	7.9	11.0	11.3	10.9	11.4
P/BVPS (x)	1.5	0.9	1.0	1.0	1.1	1.1
Dividend Yield (%)	2.8%	7.0%	5.9%	5.6%	5.6%	5.6%

Source: Company Financials, U Capital Research

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

*** Market price for 2017 and subsequent years as per latest closing price of 21/12/2017*

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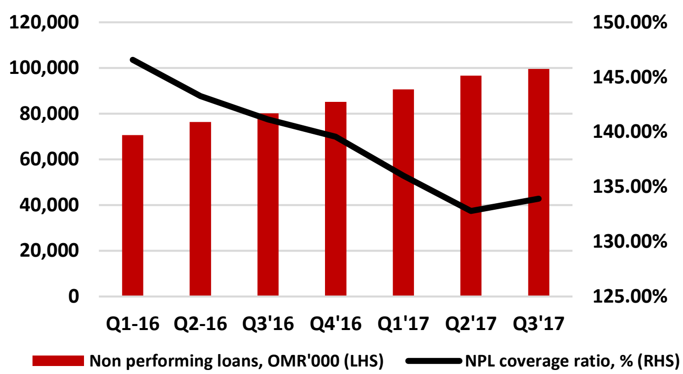
Capital Adequacy below peers

Bank Dhofar's current Tier 1 capital adequacy at 12.18% is well below the median capital adequacy ratio of 16.5% from Bloomberg of comparable banks within the region, and median capital adequacy ratio of Omani Banks' peer-group at 14.95%. However, its capital adequacy measures are well above the regulatory minima mandated by the Central Bank of Oman. The bank's total capital adequacy stood at 14.61% as at the end of 9M'17, as compared to minimum prescribed at 12%. The bank's CET1 ratio stood at 9.37% as at the end of 9M'17, which is expected to be boosted upon completion of this rights issue. However, it must be noted that the CBO has mandated Omani banks to maintain capital conservation and counter cyclical buffers in order to further preserve capital adequacy. Therefore, we believe that the bank needs to further increase capital in the coming years as well.

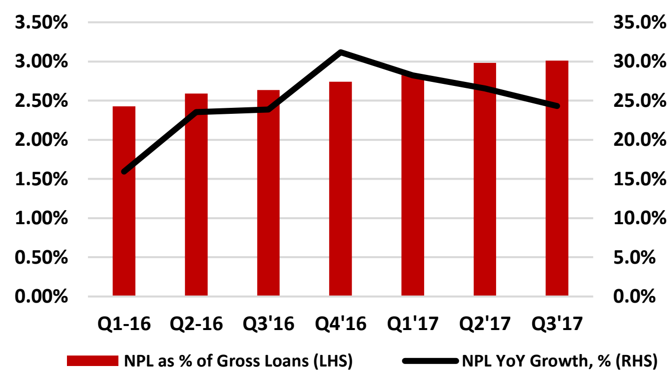
Non-performing loans on the rise; adequate provisioning

BKDB's non-performing loans (NPLs) are up by 24.3%YoY and 2.9%QoQ as at the end of 9M'17 at OMR 99.54mn. However, the bank has made adequate provisioning at 133%. NPLs now form 3.01% of total gross loans of the bank, as opposed to 2.64% of gross loans as at 9M'16. Sector NPL ratio stood at 2.9% of total gross loans of the six listed banks.

BKDB: Provision Coverage



BKDB: Asset Quality



Source: Company Financials, U Capital Research

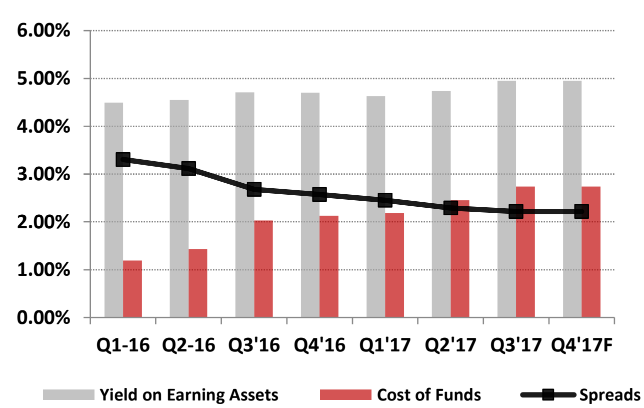
Spreads expected to improve on the back of asset re-pricing

BKDB's spreads are expected to improve from here onwards, as improvement in yield on assets is expected to outpace cost of funding as the bank has locked in a major chunk of its liabilities and equity (28%) for periods over 5 years in addition to 38% of its liabilities & equity as being non-interest bearing. Additionally, 40% of its total assets are becoming due for re-pricing within the next 6 months, which in a rising interest rate environment is bound to catapult yields.

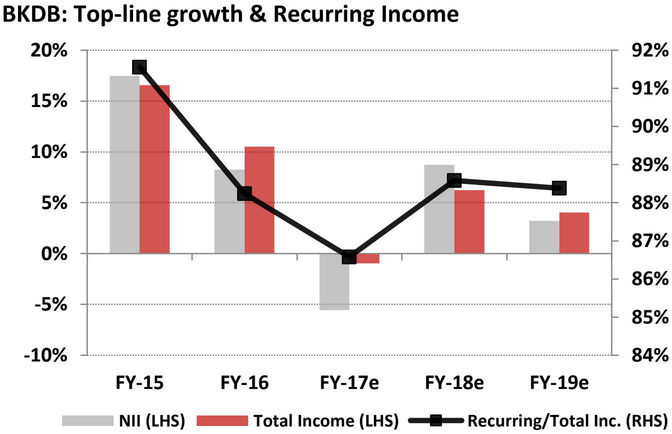
Net profit growth expected at a CAGR of 4.5% over 2018-2021e

In spite of the expected spread improvement outlined above, we have estimated a modest growth in the bottom line of the bank, as operating costs are expected to grow at a CAGR of 3.9% over the forecast period in addition to rising cost of risk (CAGR: 8.4% over 2018-2021e).

BKDB: Spreads



BKDB: Top-line growth & Recurring Income



Source: Company Financials, U Capital Research

Key Financials

(OMR mn)	2014	2015	FY-16	FY-17e	FY-18e	FY-19e
Income Statement						
Interest/Financing Income	110.4	125.9	154.3	180.6	188.8	199.2
Interest Expense/Payment to Depositors	(33.6)	(35.6)	(56.7)	(88.4)	(88.5)	(95.7)
Net Interest/Financing Income	**77**	**90.2**	**97.7**	**92.2**	**100.3**	**103.5**
Fee & Commission Income	12.1	15.3	14.7	17.0	18.4	19.7
Other Income	9.9	9.7	15.0	16.9	15.3	16.2
Total Non-Interest/Financing Income	**22**	**25.0**	**29.7**	**33.9**	**33.7**	**35.9**
Total Operating Income	**99**	**115.2**	**127.4**	**126.1**	**134.0**	**139.4**
Provisions expense	(6.9)	(11.5)	(16.2)	(12.0)	(13.6)	(15.1)
Operating Expenses	(46.2)	(51.2)	(56.8)	(59.0)	(60.0)	(62.3)
Profit Before Taxation	**46**	**52.5**	**54.4**	**55.1**	**60.4**	**62.0**
Taxation	(5.3)	(5.7)	(6.8)	(8.3)	(9.1)	(9.3)
Net Profit	**40**	**46.8**	**47.6**	**46.8**	**51.3**	**52.7**
Balance Sheet						
Cash Balances	584	440	266	236	427	464
Deposits with Banks & FIs	91	138	340	369	395	414
Gross Loans & Financings	2,342	2,828	3,107	3,376	3,613	3,793
Loan Loss Reserve	(88)	(99)	(119)	(136)	(146)	(153)
Net Loans & Financings	2,255	2,729	2,989	3,240	3,467	3,641
Other Assets	254	277	349	345	283	297
Total Assets	**3,194**	**3,593**	**3,952**	**4,220**	**4,592**	**4,827**
Deposits from Banks & FIs	175	309	351	253	410	434
Deposits from Customers	2,482	2,592	2,885	3,216	3,373	3,569
Other Borrowings	108	111	128	98	150	159
Other Liabilities	104	104	54	89	89	89
Paid-up Capital	134	154	190	226	232	239
Retained Earnings	56	45	72	67	64	58
Other Reserves	135	161	156	155	160	164
Perpetual Tier 1 Capital Securities	-	116	116	116	116	116
Shareholders' Equity	325	477	534	564	571	577
Total Equity & Liability	**3,194**	**3,593**	**3,952**	**4,220**	**4,592**	**4,827**
Cash Flow Statement						
Cash from operations	231	(247)	(131)	(23)	230	78
Cash from investing activities	2	2	3	4	3	3
Cash from financing	10	104	(40)	(3)	(35)	(37)
Net changes in cash	239	(145)	(174)	(30)	191	37
Cash at the end of period	584	440	266	236	427	464
Key Ratios						
Return on Average Assets	1.4%	1.2%	1.1%	1.0%	1.0%	1.0%
Return on Average Equity	12.9%	10.5%	7.9%	7.2%	7.9%	7.9%
Recurring Income/Operating Income	90%	92%	88.2%	86.6%	88.6%	88.4%
Interest Earning/Financing Assets Yield	4.9%	4.5%	4.6%	4.7%	4.7%	4.7%
Cost of Funds	-1.3%	-1.2%	-1.6%	-2.3%	-2.3%	-2.3%
Net Spread	3.6%	3.4%	3.0%	2.4%	2.4%	2.4%
Cost to Income Ratio	46.7%	44.4%	44.6%	46.8%	44.8%	44.7%
Net Loans to Customer Deposits	90.8%	105.3%	103.6%	100.8%	102.8%	102.0%
NPLs to Gross Loans	2.6%	2.3%	2.7%	2.9%	2.9%	2.9%
NPL Coverage	146.6%	151.9%	142.1%	141.4%	141.4%	141.4%
Cost of Risk (bps)	32.1	44.6	54.4	37.0	38.8	40.7
Equity to Gross Loans	13.9%	16.9%	17.2%	16.1%	15.5%	15.1%
Dividend Payout Ratio	33.2%	49.5%	53.8%	52.3%	51.3%	53.7%
Adjusted EPS (OMR)	0.030	0.027	0.021	0.019	0.020	0.019
Adjusted BVPS (OMR)	0.242	0.234	0.220	0.209	0.202	0.194
Market Price (OMR)	0.360	0.214	0.230	0.216	0.216	0.216
Dividend Yield	2.8%	7.0%	5.9%	5.6%	5.6%	5.6%
P/E Ratio (x)	12.0	7.9	11.0	11.3	10.9	11.4
P/BV Ratio (x)	1.5	0.92	1.04	1.03	1.07	1.11

**EPS from 2015 onwards adjusted for interest payable on Tier 1 perpetual bond, as per company notes.*

*** Market price for 2017 and subsequent years as per latest closing price of 21/12/2017*

Source: Company Financials, U Capital Research

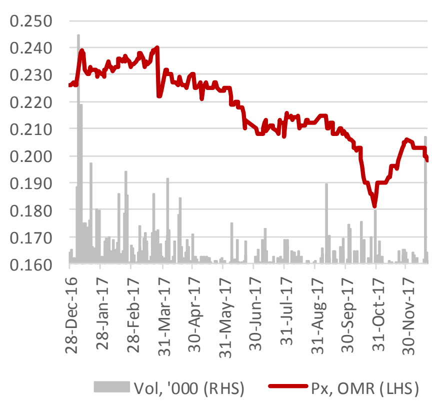
National Bank of Oman SAOG

TP: OMR 0.214/ share
Upside: 8%

Recommendation	**HOLD**
Bloomberg Ticker	NBOB OM
Current Market Price (OMR)	0.198
52wk High / Low (OMR)	0.240/0.180
12m Average Vol. (000)	329.0
Mkt. Cap. (USD/OMR Mn)	797/307
Shares Outstanding (mn)	1,548.5
Free Float (%)	28%
3m Avg Daily Turnover (OMR'000)	43.3
6m Avg Daily Turnover (OMR'000)	42.6
PE 2018e (x)	8.5
PBv 2018e (x)	0.6
Dividend Yield '18e (%)	8.0%
Price Performance:	
1 month (%)	(1.00)
3 month (%)	(4.81)
12 month (%)	(12.65)

Source: Bloomberg

Price-Volume Performance



Source: Bloomberg

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- **Robust Capital Adequacy with CAR at 17.5%**
- **Superior ROE at 12.3% vs sector average of 9.9%**
- **Asset quality deteriorating due to UAE operations but provisioning is adequate**
- **Loan-book growth has stalled**

We downgrade our rating on National Bank of Oman (NBOB) to HOLD with a reduced target price of OMR 0.214 per share, which offers an upside of 8% to the current closing price. Our target price implies a P/e'18e of 9.1x and P/b'18e of 0.65x. 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 expect the bank to have a muted loan-book growth (at 3.0% CAGR over 2017-2021) as macroeconomic situation remains subdued. We expect the bank's loan-book growth to pick up slightly over the forecast period accounting for GDP growth expectations for Oman as well as the UAE. Furthermore, we believe that the bank has locked in a major chunk of its funding base for maturities longer than 5 years. This is expected to provide some impetus to spread improvement in the near to medium term assuming that interest rates continue to rise as the US Fed has indicated. We believe that the bank's net profit will grow at a CAGR of 3.0% over the forecast period, mainly driven by improvement in spreads. Other operating income is expected to remain under pressure.

Key Risks to Valuation

Key downside risks to our valuation include:

- Further asset quality deterioration as well as reduction in loan loss coverage levels

Key upside risks to our valuation include:

- Better-than-expected loan-book growth resulting in higher interest income
- Improvements in asset quality and loan-loss coverage levels

Asset quality needs to be watched; large provision taken for UAE's growing NPLs

The bank's UAE operations continue to pose challenges. Due to prevailing tough market conditions, non-performing loans have increased resulting in the need to take higher provisions, which has in turn impacted profits on YTD basis. NBO's took impairment provision on loans of OMR 12.68mn during 9M'17, higher by 35.5%YoY, primarily due to elevated provisions in its UAE book (UAE operations accounted for ~83% of total). Recoveries improved marginally as compared to the previous year. NBO's coverage ratio as of Sept'17 stood at 107%, which is lower as compared to 139% in Dec'16 because of new non-performing loans during the year.

Key Indicators

Year	FY14	FY15	FY16	FY17e	FY18e	FY18e
Total Net Loans (OMR mn)	2,317	2,534	2,670	2,693	2,774	2,857
Total Customer Deposits (OMR mn)	2,178	2,250	2,399	2,494	2,668	2,707
Operating Income (OMR mn)	114	136	136	133	137	142
Net Profit (OMR mn)	50	60	56	47	47	48
Diluted EPS (OMR)	0.041	0.043	0.032	0.025	0.024	0.023
Diluted BVPS (OMR)	0.297	0.384	0.365	0.336	0.327	0.319
P/E (x)	7.7	6.2	7.3	8.1	8.4	8.6
P/BVPS (x)	1.1	0.7	0.6	0.6	0.6	0.6
Dividend Yield (%)	5.4%	6.4%	6.8%	8.1%	8.1%	8.1%

Source: Company Financials, U Capital Research

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

*** Market price for 2017 and subsequent years as per latest closing price of 21/12/2017*

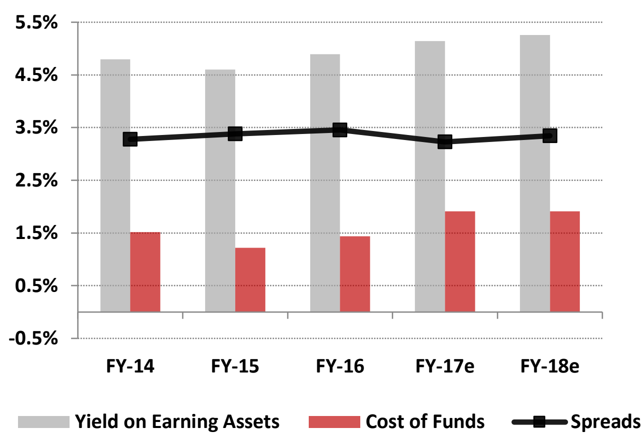
Performance during 9M'17

NBOs' net interest income (including Islamic financing income) decreased by 7%YoY to reach OMR 70.7mn, primarily due to higher deposit costs. Yields on assets have improved, partially offsetting the rising deposit costs. Non-interest income grew by 6.1%YoY to OMR 27.8mn as a result of an increase in loan fees, growth in Banc-assurance income and fee from alternative channels. In spite of growth in non-funded income, total operating income has reduced by 3.7%YoY primarily because of margin compression. Operating costs have been tightly managed and have grown by 1%YoY due to mandatory salary increases. The bank's net profit 9M'17 stood at OMR 34.5 million, a reduction of 18% - primarily due to margin compression on account of higher funding costs and higher loan loss provisions in UAE (c10.5mn in 9M'17).

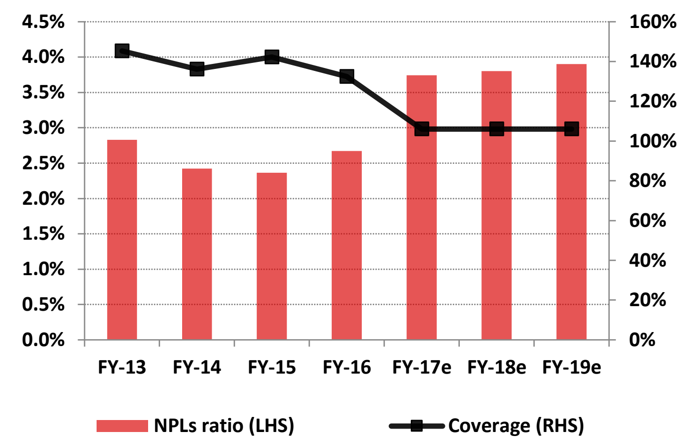
Spreads seem to have bottomed out

As at the end of 9M'17, the bank maintains a 59.6% low cost-to -high cost deposits ratio. Yield on interest-earning assets for the bank improved by 30 bps on YTD basis during 9M'17, but cost of interest-bearing liabilities increased by 48bps, resulting in contraction of spreads. However, we believe that the bank has locked in a major chunk of its funding base for maturities longer than 5 years. This is expected to provide some impetus to spread improvement in the near to medium term assuming that interest rates continue to rise as the US Fed has indicated.

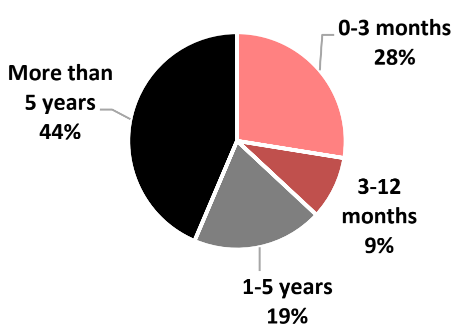
NBOB: Spreads



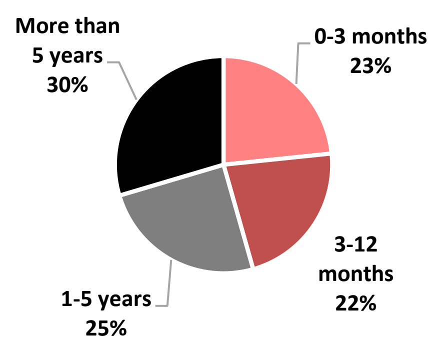
NBOB: Asset Quality



NBOB: Asset Maturities



NBOB: Equity & Liabilities' Maturities



Source: Company Financials, U Capital Research

We believe that the bank's net profit will grow at a CAGR of 3.0% over the forecast period, mainly driven by improvement in spreads. Other operating income is expected to remain under pressure.

Key Financials

(OMR mn)	2014	2015	2016	2017e	2018e	2019e
Income Statement						
Interest/Financing Income	119.6	125.9	141.5	152.5	157.4	165.2
Interest Expense/Payment to Depositors	(37.1)	(31.1)	(39.9)	(56.6)	(58.6)	(60.8)
Net Interest/Financing Income	**82.5**	**94.7**	**101.6**	**95.9**	**98.8**	**104.4**
Fee & Commission Income	14.3	18.6	16.0	17.2	17.5	17.8
Other Income	17.5	22.4	18.5	19.9	20.4	20.0
Total Non-Interest/Financing Income	**31.8**	**41.0**	**34.5**	**37.0**	**37.9**	**37.7**
Total Operating Income	**114.2**	**135.7**	**136.1**	**132.9**	**136.7**	**142.1**
Provisions expense	(2.3)	(6.3)	(10.0)	(16.0)	(17.7)	(19.3)
Operating Expenses	(54.4)	(60.0)	(62.7)	(62.0)	(63.7)	(66.3)
Profit Before Taxation	**57.5**	**69.4**	**63.4**	**55.0**	**55.3**	**56.5**
Taxation	(7.2)	(9.3)	(7.6)	(7.9)	(7.9)	(8.1)
Net Profit	**50.3**	**60.1**	**55.8**	**47.1**	**47.4**	**48.4**
Balance Sheet						
Cash Balances	289	304	512	481	700	666
Deposits with Banks & FIs	145	171	115	128	120	123
Gross Loans & Financings	2,396	2,622	2,768	2,804	2,888	2,975
Loan Loss Reserve	(79)	(88)	(98)	(111)	(115)	(118)
Net Loans & Financings	2,317	2,534	2,670	2,693	2,774	2,857
Net Fixed Assets	23	35	46	63	45	43
Other Assets	202	219	189	255	189	194
Total Assets	**2,976**	**3,263**	**3,533**	**3,619**	**3,827**	**3,883**
Deposits from Banks & FIs	102	163	225	234	250	254
Deposits from Customers	2,178	2,250	2,399	2,494	2,668	2,707
Other Borrowings	259	364	398	397	397	397
Other Liabilities	76	88	87	89	95	97
Paid-up Capital	122	134	147	155	163	171
Retained Earnings	83	106	115	116	115	114
Other Reserves	156	159	161	135	139	144
Shareholders' Equity	362	399	423	405	417	428
Total Equity & Liability	**2,976**	**3,263**	**3,533**	**3,619**	**3,827**	**3,883**
Cash Flow Statement						
Cash from operations	(40)	(51)	257	54	240	4
Cash from investing activities	6	14	15	20	(15)	2
Cash from financing	(33)	82	(35)	(65)	(35)	(37)
Net changes in cash	(79)	16	207	(31)	219	(35)
Cash at the end of period	289	304	512	481	700	666
Key Ratios						
Return on Average Assets	1.7%	1.9%	1.4%	1.3%	1.3%	1.3%
Return on Average Equity	14.6%	13.2%	11.6%	9.2%	9.3%	9.3%
Recurring Income/Operating Income	84.7%	83.5%	86.4%	85.0%	85.1%	85.9%
Interest Earning/Financing Assets Yield	4.8%	4.6%	4.9%	5.1%	5.3%	5.4%
Cost of Funds	1.5%	1.2%	1.4%	1.9%	1.9%	1.9%
Net Spread	3.3%	3.4%	3.5%	3.2%	3.3%	3.5%
Cost to Income Ratio	47.6%	44.2%	46.0%	46.6%	46.6%	46.6%
Net Loans to Customer Deposits	106.4%	112.6%	111.3%	108.0%	104.0%	105.5%
NPLs to Gross Loans	2.4%	2.4%	2.7%	3.7%	3.7%	3.7%
NPL Coverage	136.1%	142.3%	132.5%	106.0%	106.0%	106.0%
Provisions/Total Income	69.1%	65.0%	72.0%	83.7%	83.9%	83.1%
Cost of Risk (bps)	9.2	23.2	34.7	53.9	58.5	63.0
Equity to Gross Loans	15.1%	19.6%	19.4%	18.6%	18.4%	18.3%
Equity to Total Assets	12.1%	15.8%	15.2%	14.4%	13.9%	14.0%
Dividend Payout Ratio	41.2%	37.9%	42.3%	52.6%	54.9%	56.4%
Adjusted EPS (OMR)	0.041	0.043	0.032	0.025	0.024	0.023
Adjusted BVPS (OMR)	0.297	0.384	0.365	0.336	0.327	0.319
Market Price (OMR)	0.316	0.267	0.237	0.198	0.198	0.198
Dividend Yield	5.4%	6.4%	6.8%	8.1%	8.1%	8.1%
P/E Ratio (x)	7.7	6.2	7.3	8.1	8.4	8.6
P/BV Ratio (x)	1.1	0.7	0.6	0.6	0.6	0.6

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

*** Market price for 2017 and subsequent years as per latest closing price of 21/12/2017*

Source: U Capital Research, Company Financials

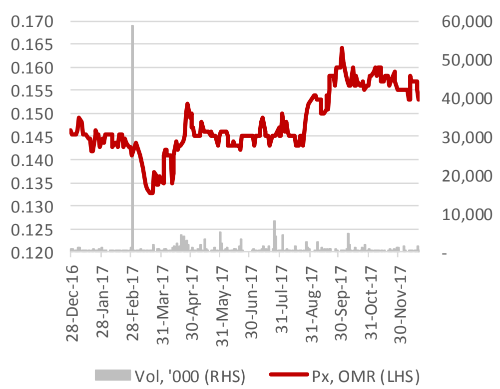
Bank Sohar SAOG

TP: OMR 0.173 per share
Upside: 13%

Recommendation	**Accumulate**
Bloomberg Ticker	BKSB OM
Current Market Price (OMR)	0.153
52wk High / Low (OMR)	0.160/0.130
12m Average Vol. (000)	873.7
Mkt. Cap. (USD/OMR Mn)	710/273
Shares Outstanding (mn)	1,784.6
Free Float (%)	87%
3m Avg Daily Turnover (OMR'000)	673.3
6m Avg Daily Turnover (OMR'000)	720.0
PE 2018e (x)	9.7
PBv 2018e (x)	0.9
Dividend Yield '18e (%)	3.3%
Price Performance:	
1 month (%)	(2.55)
3 month (%)	(3.16)
12 month (%)	3.25

Source: Bloomberg

Price-Volume Performance



Source: Bloomberg

- **Superior credit quality with 9M'17 NPLs at c1.9% of Gross Loans vs. Sector at 2.9%; Provision cover at par with sector at 117%**
- **2nd lowest operating margin (at ~50%) within local peers**
- **Strong credit growth (10%YoY as of 9M'17)**
- **Loan-to-deposit ratio is stretched at 128%**

We maintain our rating on Bank Sohar at **Accumulate** but raise the target price to OMR 0.173 on account of the bank's performance, which is slightly better than our expectation. Our target price implies an upside of 13% to the last closing price, and a P/E'18e and a P/B'18e of 10.0x and 1.05x respectively. We believe that this target price is justified because (1) the bank's capital adequacy remains robust within peer group, in lieu of the recent Tier 1 Perpetual securities issuance of OMR 100mn, (2) its net interest margin has shown recovery, albeit small, (3) its asset quality is well-maintained in spite of a 10%YoY growth in net loans & advances as at the end of 9M'17.

Valuation & Outlook

The bank has shown signs of improvement in its net interest margin, which has resulted in its net interest income, including Islamic finance income, to grow by 3%YoY during 9M'17. This improvement is expected to continue over the forecast horizon providing impetus to the bank's operating income growth. However, pressure on other operating income is expected to continue on the back of increasing competition, resulting in weighing down of total operating income growth. The bank's operating margin is expected to improve over the forecast horizon. We believe that the bank will be able to grow its net loan book at a CAGR of 6.0% over 2018-2021. It will be able to grow its net profit at a CAGR of 4.2%.

The bank is expected to maintain its dividend payout as the same as seen in FY16. However, dividend yield on the current stock price seems low due to increase in number of shares outstanding during 2017 because of MCB conversion and stock dividend.

Key Risks to Valuation

The key downside risks to our valuation are:

- Slower-than-expected improvement in net interest margin
- Deterioration in asset quality resulting in cost of risk to rise

The key upside risks to our valuation are:

- Better-than-expected loan growth
- Improvement in operating margin

Key Indicators

Year	FY14	FY15	FY16	FY17e	FY18e	FY19e
Total Net Loans (OMR mn)	1,423	1,647	1,913	2,036	2,158	2,288
Total Customer Deposits (OMR mn)	1,552	1,464	1,532	1,588	1,741	1,907
Operating Income (OMR mn)	69	71	67	72	86	91
Net Profit (OMR mn)	28	28	19	27	28	28
Diluted EPS (OMR)	0.026	0.024	0.013	0.017	0.016	0.014
Diluted BVPS (OMR)	0.156	0.168	0.176	0.171	0.164	0.160
P/E (x)	8.6	6.5	12.1	9.2	9.7	10.8
P/BVPS (x)	1.4	0.9	0.9	0.9	0.9	1.0
Dividend Yield (%)	4.5%	9.6%	9.4%	3.3%	3.3%	3.3%

Source: Company Financials, U Capital Research

** Market price for 2017 and subsequent years as per latest closing price of 21/12/2017*

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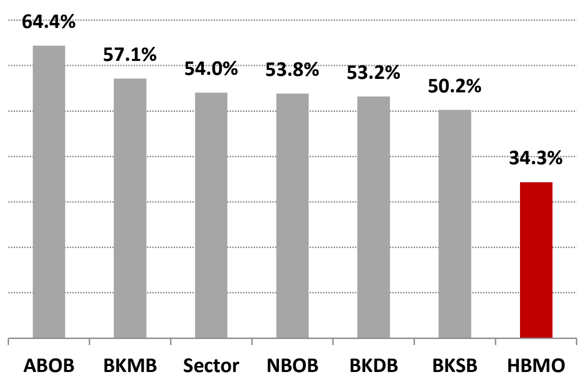
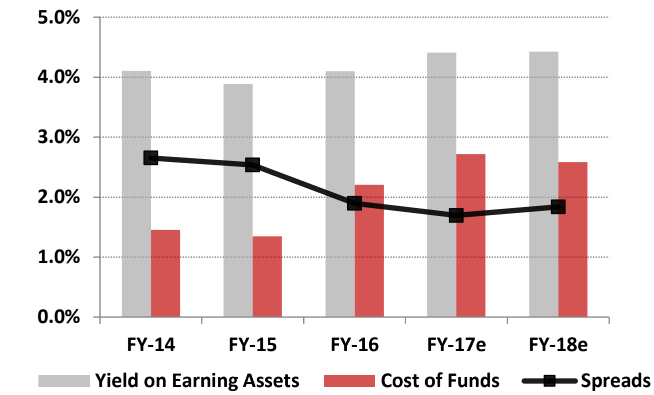
Spreads are on the rise; operating margin continues to be second-lowest amongst peers

The bank's spreads are showing signs of improvement on quarterly basis (however, still remain below FY16 levels), but its cost to income ratio at ~50% for 9M'17 is the second highest amongst the local peer group, dampening gains made from improving interest income. The bank has been actively pursuing efficiency improvements in terms of systems and procedures improvements but these measures are yet to reach fruition.

Operating Margin, 9M'17 (%)



BKSB: Spreads



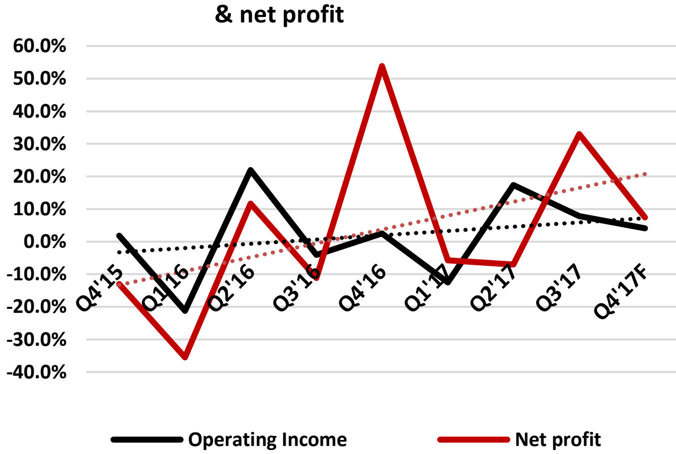
Source: Company Financials, U Capital Research

Profit improved in 9M'17 on lower provisions; asset growth stable ahead of sector

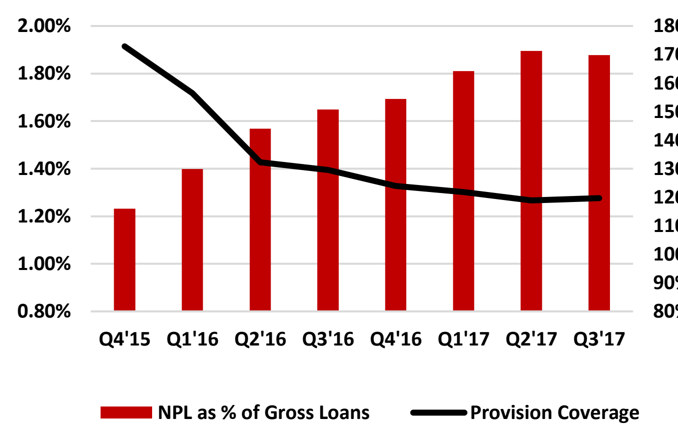
The bank's net interest income increased by 2%YoY during 9M'17 on the back of robust growth in net loans (at 10%YoY) and improvement in spreads. Its net Islamic financing income grew by 30%YoY again on the back of superior growth in Islamic financing portfolio. The bank's other operating income grew by 3.77%YoY to OMR 17.93mn. Its total operating income increased by 3.4%YoY to OMR 54.87mn in 9M'17. Net operating profit increased by 1.21%YoY to OMR 28.77mn in 9M'17. Total provision expense halved, on account of large drops in impairment of investments as well as impairment on portfolio basis, in spite of a doubling of specific provisions. Net profit of the bank for 9M17 amounted to OMR 18.98mn up by 46.6%YoY.

Gross loans of the bank have increased by 10%YoY to OMR 2.050bn as at 9M'17. Net loans and advances grew by 9.62% to OMR 2.0bn. Customer deposits declined marginally by 1.2% to OMR 1.6bn, letting the loan-to-deposit (LTD) ratio to be stretched at 128% as at the end of 9M'17, which is the highest level within the sector (sector LTD: 103%).

BKSB: Growth (QoQ) trends of operating income & net profit



BKSB: Asset Quality Metrics



Source: Company Financials, U Capital Research

Key Financials

(OMR mn)	2014	2015	2016	2017e	2018e	2019e
Income Statement						
Interest Income	73.2	75.2	90.6	108.2	115.9	123.5
Interest Expense	(25.6)	(25.3)	(45.5)	(60.4)	(60.5)	(65.6)
Net Interest & Islamic Financing Income	**49.3**	**52.1**	**47.7**	**51.1**	**59.6**	**63.1**
Fee & Commission Income	13.2	13.9	16.7	24.5	26.2	27.8
Other Income	7.8	4.9	2.1	(3.3)	-	-
Total Non-Interest/Financing Income	**21.0**	**18.8**	**18.8**	**21.2**	**26.2**	**27.8**
Total Operating Income	**70.3**	**70.9**	**66.6**	**72.3**	**85.8**	**90.9**
Provisions expense	(5.8)	(6.2)	(11.5)	(5.3)	(10.4)	(13.3)
Operating Expenses	(31.3)	(33.0)	(33.1)	(35.5)	(42.1)	(44.5)
Profit Before Taxation	**33.1**	**31.7**	**22.1**	**31.5**	**33.3**	**33.1**
Taxation & Minority Interest	(3.3)	(4.0)	(2.9)	(4.8)	(5.1)	(5.0)
Net Profit Attributable to Parent	**29.8**	**27.7**	**19.1**	**26.7**	**28.3**	**28.0**
Balance Sheet						
Cash Balances	219	122	120	76	152	237
Deposits with Banks & FIs	154	128	99	104	110	117
Gross Loans & Financings	1,455	1,683	1,954	2,083	2,208	2,341
Loan Loss Reserve	(32)	(36)	(41)	(47)	(50)	(53)
Net Loans & Financings	1,423	1,647	1,913	2,036	2,158	2,288
Investment Properties	3	3	3	3	3	3
Net Fixed Assets	13	13	16	17	15	15
Other Assets	264	293	370	429	455	482
Total Assets	**2,075**	**2,208**	**2,520**	**2,665**	**2,894**	**3,142**
Deposits from Banks & FIs	244	400	594	614	671	734
Deposits from Customers	1,552	1,464	1,532	1,588	1,741	1,907
Other Borrowings	58	58	91	38	30	27
Other Liabilities	29	32	29	32	35	38
Paid-up Capital	114	144	160	178	197	217
Retained Earnings	44	42	27	79	80	79
Other Reserves	34	67	86	36	38	41
Shareholders' Equity	192	253	274	293	316	337
Tier 1 Perpetual Bonds	-	-	-	100	100	100
Total Equity & Liability	**2,075**	**2,208**	**2,520**	**2,665**	**2,894**	**3,142**
Cash Flow Statement						
Cash from operations	155	(91)	41	(28)	114	124
Cash from investing activities	36	39	78	55	25	29
Cash from financing	(7)	33	35	39	(13)	(11)
Net changes in cash	113	(96)	(3)	(44)	77	85
Cash at the end of period	219	122	120	76	152	237
Key Ratios						
Return on Average Assets	1.4%	1.3%	0.8%	1.0%	1.0%	0.9%
Return on Average Equity	15.5%	12.5%	7.3%	9.4%	9.3%	8.6%
Recurring Income/Operating Income	91.1%	93.1%	96.9%	104.5%	100.0%	100.0%
Interest Earning/Financing Assets Yield	4%	4%	4.1%	4.4%	4.4%	4.4%
Cost of Funds	1.5%	1.3%	2.2%	2.7%	2.6%	2.6%
Net Spread	2.7%	2.5%	1.9%	1.7%	1.8%	1.9%
Cost to Income Ratio	45.7%	46.6%	49.7%	49.1%	49.0%	48.9%
Net Loans to Customer Deposits	92%	112%	125%	128%	124%	120%
NPLs to Gross Loans	1.5%	1.2%	1.7%	1.7%	1.8%	1.9%
NPL Coverage	144.6%	172.9%	124.0%	128.2%	124.0%	120.0%
Provisions/Total Income	46%	51%	62%	65%	58%	58%
Cost of Risk (bps)	32.4	31.8	51.9	21.5	39.7	48.0
Equity to Gross Loans	0.1	0.2	0.1	0.1	0.1	0.1
Equity to Total Assets	9%	11%	11%	11%	11%	11%
Dividend Payout Ratio	39%	62%	113%	30%	32%	35%
Adjusted EPS (OMR)	0.026	0.024	0.013	0.017	0.016	0.014
Adjusted BVPS (OMR)	0.156	0.168	0.176	0.171	0.164	0.160
Market Price (OMR)	0.220	0.157	0.160	0.153	0.153	0.153
Dividend Yield	4.5%	9.6%	9.4%	3.3%	3.3%	3.3%
P/E Ratio (x)	8.61	6.47	12.07	9.18	9.67	10.76
P/BV Ratio (x)	1.41	0.94	0.91	0.90	0.93	0.95

** Market price for 2017 and subsequent years as per latest closing price of 21/12/2017*

Source: Company Financials, U Capital Research

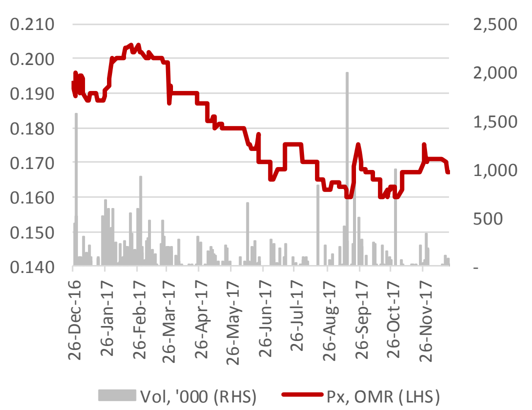
Ahli Bank SAOG

TP: OMR 0.179 / share
Upside: 6%

Recommendation	**HOLD**
Bloomberg Ticker	ABOB OM
Current Market Price (OMR)	0.169
52wk High / Low (OMR)	0.210/0.160
12m Average Vol. (000)	129.2
Mkt. Cap. (USD/OMR Mn)	626/241
Shares Outstanding (mn)	1,425.0
Free Float (%)	40%
3m Avg Daily Turnover (OMR'000)	15.1
6m Avg Daily Turnover (OMR'000)	17.2
PE 2018e (x)	8.7
PBv 2018e (x)	0.9
Dividend Yield '18e (%)	6.0%
Price Performance:	
1 month (%)	1.20
3 month (%)	-
12 month (%)	(11.98)

Source: Bloomberg

Price-Volume Performance



Source: Bloomberg

- **Superior ROaE and ROaA**
- **Lowest cost-to-income amongst peers at ~36% (sector: ~46%)**
- **High dependence on costlier time deposits (c70% of total deposits)**
- **Recently raised OMR 50mn Tier 1 Perpetual Subordinated Bonds, thereby enhancing capital adequacy metrics (9M'17 Tier 1 Cap Adequacy Ratio at 12.52%)**

We reiterate our rating on Ahli Bank at HOLD based on a revised target price of 0.179, implying an upside of 6% to the last closing price. Our target price implies a P/e'18e and a P/B'18e of 8.7x and 0.89x 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 decline in spreads.

Valuation & Outlook

We believe that the bank will be able to grow its net profit at a CAGR of 5% over 2018-2021F, on the back of improving spreads. A muted growth in net loans & advances (CAGR: 2.2%) for the bank is expected to result in marginal growth in net interest income. However, its other operating income is expected to provide impetus to net profit growth, weighed down only by a rising cost of risk. We believe that the bank will be able to maintain its operating cost-to-income ratio at the current levels.

The bank has historically relied heavily on term funding, which in our view, will become more expensive as time passes given a rising interest rate environment coupled with system-wide liquidity pressures already being felt.

Key Risks to Valuations

The key upside risks to our valuation are:

- Better-than-expected loan growth
- Improvement in systemic risk
- Improvement 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	FY16	FY17e	FY18e	FY19e
Total Net Loans (OMR mn)	1,389	1,518	1,522	1,697	1,748	1,783
Total Customer Deposits (OMR mn)	1,301	1,271	1,487	1,584	1,616	1,648
Operating Income (OMR mn)	52	56	54	54	61	65
Net Profit (OMR mn)	25	28	30	23	27	29
Diluted EPS (OMR)	0.019	0.019	0.021	0.016	0.019	0.021
Diluted BVPS (OMR)	0.154	0.159	0.170	0.181	0.190	0.201
P/E (x)	12.6	10.1	9.5	10.6	8.8	8.2
P/BVPS (x)	1.6	1.2	1.1	0.9	0.9	0.8
Dividend Yield (%)	4.1%	5.1%	5.1%	5.9%	5.9%	5.9%

Source: Company Financials, U Capital Research

** Market price for 2017 and subsequent years as per latest closing price of 21/12/2017*

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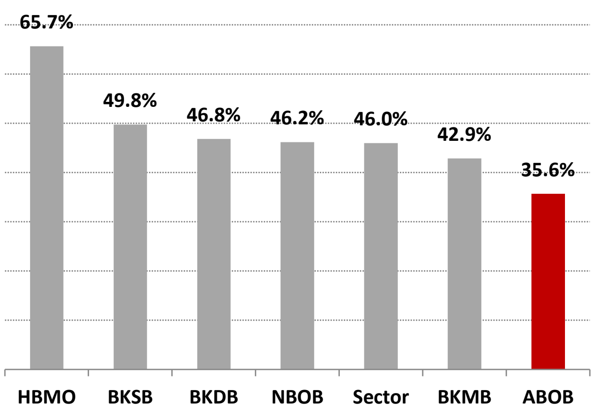
Spreads are expected to improve from 2018 onwards

Interest sensitivity profile of the bank indicates that the bank's spread decline has bottomed out, and we can expect to see spreads picking up at least in the next year. 56% of net loans & advances are becoming due for re-pricing within one year. We believe that the bank stands to gain from the rising interest environment. On the other hand, 52% of the bank's customer deposits as at FY16 are becoming due for re-pricing within the next 12 months. Additionally, 68% of total customer deposits as at the end of FY16 are term deposits (the highest within sector). This could potentially dilute the gains from re-pricing of assets.

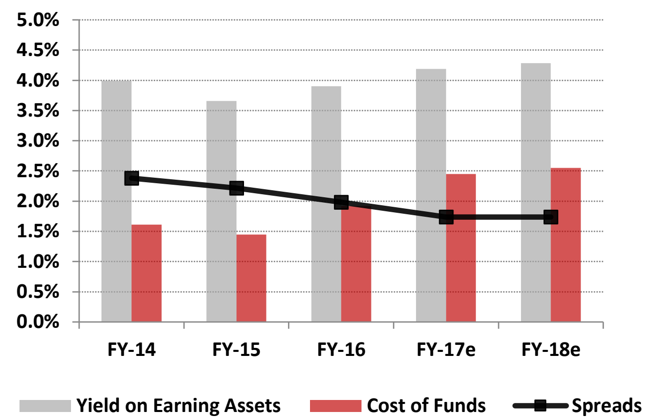
Superior efficiency metrics

Ahli bank boasts superior efficiency with cost-to-income ratio at 35.6% and cost to average total assets at 1.0% for 9M'17. The bank is more cost efficient than its listed local peers.

Cost-to-Income Ratio, 9M'17 (%)



ABOB: Spreads



Source: Company Financials, U Capital Research

Performance during 9M'17

In spite of lackluster economic environment, the bank was able to grow its net loans and advances and Islamic financing by 6.2%YoY to reach OMR 1.65bn by Sept'17. Its customer deposits also witnessed a robust growth of 17.3%YoY to OMR 1.45bn.

The bank's net interest income for 9M'17 declined by 2%YoY on the back of a 33%YoY rise in interest expense as compared to 14%YoY rise in interest expense. Its net income from Islamic financing also declined by 3%YoY on the back of rising cost of Islamic funding. However, the bank's other operating income increased by 22%YoY, as the bank had earlier indicated that it has established a renewed focus on improving its non-funded income. The operating expenses were contained at OMR 14.2mn for 9M'17, declining by 1%YoY. Therefore, operating profit increased by 3%YoY. Net provision charge doubled primarily because of new provisions made this year in spite of higher recoveries as compared to last year, to reach OMR 2.56mn. Hence, net profit after tax declined by 6.1%YoY to reach OMR 19.76mn. The bank does not disclose non-performing loans on quarterly basis.

Net profit expected to grow at a CAGR of 5% over 2018-2021e

We believe that the bank will be able to grow its net profit at a CAGR of 5% over 2018-2021e, on the back of improving spreads. A muted growth in net loans & advances (CAGR: 2.2%) for the bank is expected to result in marginal growth in net interest income. However, its other operating income is expected to provide impetus to net profit growth, weighed down only by a rising cost of risk. We believe that the bank will be able to maintain its operating cost-to-income ratio at the current levels.

Key Financials

(OMR mn)	2014	2015	2016	2017e	2018e	2019e
Income Statement						
Interest/Financing Income	62.1	70.1	79.1	90.2	99.5	107.0
Interest Expense/Payment to Depositors	(20.7)	(23.8)	(34.4)	(46.8)	(52.5)	(56.6)
Net Interest/Financing Income	**41.3**	**46.3**	**44.7**	**43.4**	**47.0**	**50.4**
Other Income	10.3	9.7	8.8	10.5	13.9	14.3
Total Non-Interest/Financing Income	**10.3**	**9.7**	**8.8**	**10.5**	**13.9**	**14.3**
Total Operating Income	**51.6**	**56.0**	**53.6**	**53.9**	**60.9**	**64.7**
Provisions expense	(5.2)	(5.3)	(0.7)	(7.3)	(8.0)	(8.4)
Operating Expenses	(17.7)	(20.3)	(19.2)	(19.2)	(21.6)	(22.9)
Profit Before Taxation	**28.7**	**30.4**	**33.0**	**35.5**	**37.7**	**39.1**
Taxation	(3.6)	(2.7)	(4.1)	(4.7)	(3.8)	(4.0)
Net Profit	**25.1**	**27.7**	**29.0**	**30.8**	**34.0**	**35.1**
Balance Sheet						
Cash Balances	54	124	140	128	171	182
Deposits from Banks & FIs	35	60	31	16	44	45
Gross Loans & Financings	1,407	1,541	1,545	1,723	1,774	1,810
Loan Loss Reserve	(18)	(23)	(23)	(25)	(26)	(27)
Net Loans & Financings	1,389	1,518	1,522	1,697	1,748	1,783
Net Fixed Assets	17	18	17	17	18	18
Other Assets	149	179	190	240	246	251
Total Assets	**1,645**	**1,898**	**1,900**	**2,098**	**2,226**	**2,279**
Deposits from Banks & FIs	236	218	232	192	204	208
Deposits from Customers	1,076	1,301	1,271	1,487	1,584	1,616
Other Borrowings	98	78	115	69	71	72
Other Liabilities	35	39	38	43	46	47
Paid-up Capital	130	143	143	143	143	143
Retained Earnings	16	18	26	66	74	84
Other Reserves	54	67	74	49	55	60
Shareholders' Equity	200	227	243	258	271	286
Tier 1 Perpetual Bond	-	-	-	50	50	50
Total Equity & Liability	**1,645**	**1,863**	**1,900**	**2,098**	**2,226**	**2,279**
Cash Flow Statement						
Cash from operations	24	46	31	(18)	57	26
Cash from investing activities	2	2	1	1	1	0
Cash from financing	(10)	(10)	21	7	(14)	(14)
Net changes in cash	11	34	52	(12)	42	12
Cash at the end of period	54	124	140	128	171	182
Key Ratios						
Return on Average Assets	1.7%	1.6%	1.6%	1.1%	1.3%	1.3%
Return on Average Equity	13.1%	13.0%	12.6%	9.1%	10.4%	10.5%
Recurring Income/Operating Income	91%	87%	86.9%	87.5%	88.0%	88.2%
Interest Earning/Financing Assets Yield	4.0%	3.7%	3.9%	4.2%	4.3%	4.5%
Cost of Funds	-1.6%	-1.4%	-1.9%	-2.4%	-2.5%	-2.6%
Net Spread	2.4%	2.2%	2.0%	1.7%	1.7%	1.8%
Cost to Income Ratio	34%	36%	36%	36%	35%	35%
Net Loans to Customer Deposits	129%	117%	119.8%	114.1%	110.3%	110.3%
NPLs to Gross Loans	1.0%	1.1%	1.1%	1.1%	1.1%	1.1%
NPL Coverage	133%	138%	134%	132%	133%	132%
Provisions/Total Income	35%	40%	43%	47%	43%	41%
Cost of Risk (bps)	41.5	35.8	4.7	44.9	45.9	46.9
Equity to Gross Loans	14%	15%	16%	15%	15%	16%
Equity to Total Assets	12%	12%	13%	12%	12%	13%
Dividend Payout Ratio	52%	51%	48%	63%	52%	49%
Adjusted EPS (OMR)	0.019	0.019	0.021	0.016	0.019	0.021
Adjusted BVPS (OMR)	0.154	0.159	0.170	0.181	0.190	0.201
Market Price (OMR)	0.245	0.196	0.196	0.169	0.169	0.169
Dividend Yield	4.1%	5.1%	5.1%	5.9%	5.9%	5.9%
P/E Ratio (x)	12.6	10.1	9.5	10.6	8.8	8.2
P/BV Ratio (x)	1.6	1.2	1.1	0.9	0.9	0.8

** Market price for 2017 and subsequent years as per latest closing price of 21/12/2017*

Source: Company Financials, U Capital Research

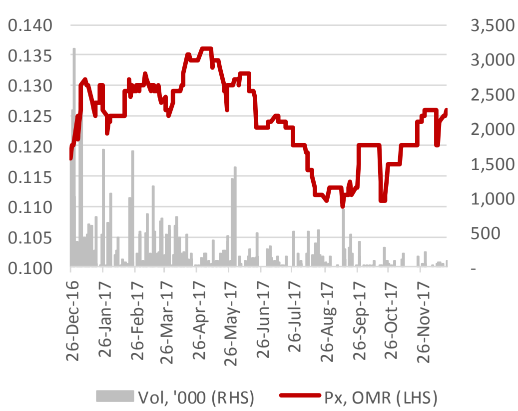
HSBC Bank Oman SAOG

TP : OMR 0.140 / share
Upside: 11%

Recommendation	**Accumulate**
Bloomberg Ticker	HBMO OM
Current Market Price (OMR)	0.126
52wk High / Low (OMR)	0.140/0.110
12m Average Vol. (000)	262.6
Mkt. Cap. (USD/OMR Mn)	655/252
Shares Outstanding (mn)	2,000.3
Free Float (%)	49%
3m Avg Daily Turnover (OMR'000)	4.9
6m Avg Daily Turnover (OMR'000)	10.1
PE 2018e (x)	13.1
PBv 2018e (x)	0.8
Dividend Yield '18e (%)	4.4%
Price Performance:	
1 month (%)	1.61
3 month (%)	12.50
12 month (%)	6.78

Source: Bloomberg

Price-Volume Performance



Source: Bloomberg

- **Lowest LDR at 67% within the sector (sector: 103%), providing ample room to grow**
- **Superior spreads at ~2.6%**
- **Well capitalized with CAR at 15.9%**
- **High probability of parent support (HSBC Middle East Holdings BV, share: 51%)**

We maintain our rating on HBMO as ACCUMULATE with the same target price as March'17, at OMR 0.140 per share, implying a ~11% upside to the current market price. Our target price implies a P/e'18e of 14.5x and a P/b'18e of 0.84. We believe that the bank's capital strength and improving credit quality are key drivers for its fundamental soundness. Operationally, we expect the bank to display a better than historical performance in the current macroeconomic environment, on the back of its fundamental soundness and international parentage.

Valuation & Outlook

We believe that the bank will be able to grow its net loan book at a CAGR of 3.0 % over the forecast period. We have been very conservative in our estimates for top line as well bottom line growth prospects of the bank, and yet we see a large upside to the last closing price.

The bank's net interest margin has been trending upwards over the last couple of quarters and we expect this to continue in 2018 and onwards. We are expecting the bank's operating income to increase at CAGR of 5.4%, which coupled with slower growth in operating expenses as the bank continues aim at reduction in cost-to-income ratio, will lead to a CAGR of 10% in the operating profit of the bank. We have increased provision expense over the forecast horizon based on our expectation of a rise in cost of risk, which will dampen net profit growth to a CAGR of 7% over 2018-2021. We believe that the bank will maintain payouts at the same level as seen in FY16.

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:

- NPLs rising faster than anticipated
- Deterioration in macroeconomic outlook of the country, resulting in slower credit offtake as well as reduced liquidity

Key Indicators

Year	FY14	FY15	FY16	FY17e	FY18e	FY19e
Total Net Loans (OMR mn)	1,161	1,201	1,418	1,339	1,379	1,421
Total Customer Deposits (OMR mn)	1,852	1,802	1,867	2,013	2,122	2,186
Operating Income (OMR mn)	71	74	75	75	84	86
Net Profit (OMR mn)	12	13	17	18	19	21
Diluted EPS (OMR)	0.006	0.006	0.008	0.009	0.010	0.010
Diluted BVPS (OMR)	0.155	0.154	0.157	0.162	0.166	0.170
P/E (x)	23.0	19.4	14.2	14.2	13.1	12.0
P/BVPS (x)	0.9	0.8	0.8	0.8	0.8	0.7
Dividend Yield (%)	3.9%	3.1%	4.2%	4.0%	4.4%	4.4%

**Market price for 2017 and subsequent years based on closing price of 21/12/2017*

Source: Company Financials, U Capital Research

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Robust Capital Adequacy

HBMO's capital adequacy ratio stood at 15.9% as at Sept'17 compared to 17.9% as at Sept'16, mainly due to the impact of regulatory changes in relation to the treatment of investments in certain overseas government securities.

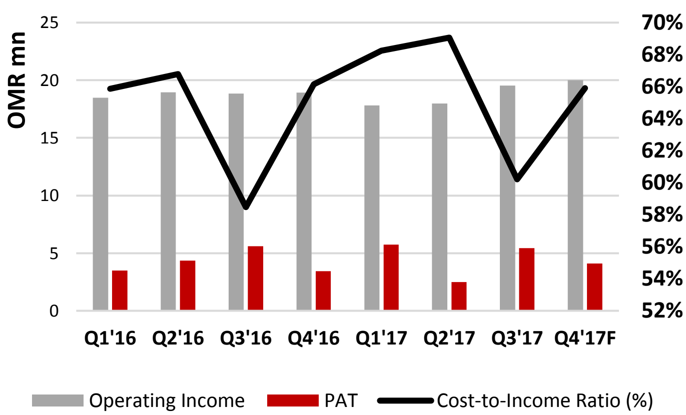
Cost-to-Income rose a little in 9M'17 on a one-off expense; Impairment charge dropped by 50%YoY

The bank showed a 1.5%YoY increase in net profit to OMR 13.7mn, mainly due to a 50% lower loan impairment charge. Net operating income, before loan impairment charges, decreased by 1.8% to OMR 55.3mn as net interest income declined by 1.7%YoY to OMR 39.8mn for 9M'17. This is mainly due to higher interest expenses on corporate deposits. Net fee income decreased by 8.9%YoY to OMR 8.2mn, due to lower credit structuring fees from corporate customers and lower cards and wealth revenue from retail customers.

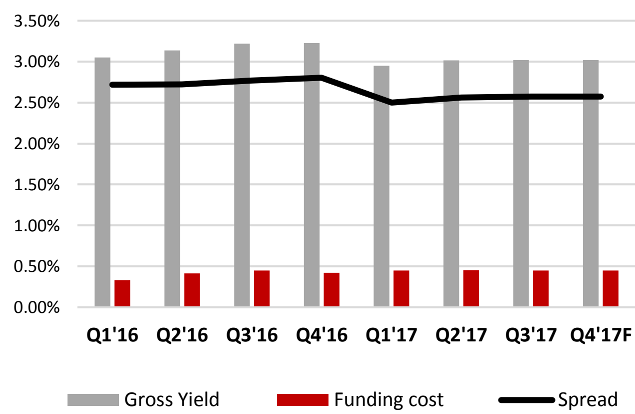
The net trading income increased by 20.0%YoY to OMR 7.2mn mainly due to higher trading volumes. A net charge of OMR 2.6mn was reported for loan impairment charges. This was mainly due to a release from the general provision of RO1.0m due to the overall reduction in corporate loans and this was partly offset by a net charge of OMR 0.3mn in Wholesale and OMR 3.3mn in the Retail portfolio.

Operating expenses increased by 1.4%YoY to OMR 36.3mn due to some one-off expenses. Loans and advances, net of provisions and reserved interest, fell by 4.5% to RO1.33bn, mainly due to the aforementioned reduction in corporate loans. Customer deposits increased by 6.1%YoY to OMR 2.0bn.

HBMO: Quarterly Operational Performance



HBMO: Spreads

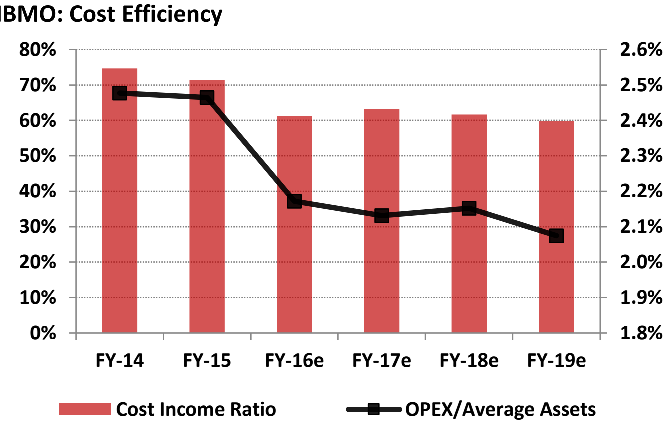


Source: Company Financials, U Capital Research

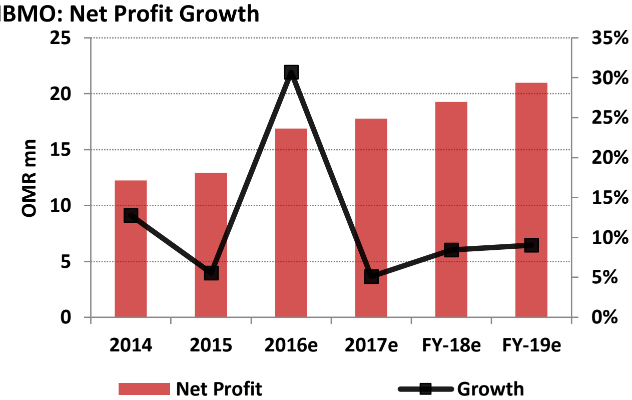
Net profit expected to grow at a CAGR of 7% over 2018-2021e

We are expecting the bank's operating income to increase at CAGR of 5.4%, which coupled with slower growth in operating expenses as the bank continues aim at reduction in cost-to-income ratio, will lead to a CAGR of 10% in the operating profit of the bank. We have increased provision expense over the forecast horizon based on our expectation of a rise in cost of risk, which will dampen net profit growth to a CAGR of 7% over 2018-2021e.

HBMO: Cost Efficiency



HBMO: Net Profit Growth



Source: Company Financials, U Capital Research

(OMR mn)	2014	2015	2016	2017e	2018e	2019e
Income Statement						
Interest/Financing Income	56.1	56.1	61.9	63.3	70.4	73.3
Interest Expense/Payment to Depositors	(7.2)	(6.9)	(7.6)	(9.0)	(9.8)	(10.5)
Net Interest/Financing Income	**48.9**	**49.2**	**54.3**	**54.3**	**60.6**	**62.8**
Fee & Commission Income	12.6	12.5	12.3	11.2	10.6	10.2
Other Income	9.6	11.9	8.6	9.8	12.4	13.3
Total Non-Interest/Financing Income	**22.1**	**24.4**	**20.9**	**21.0**	**23.0**	**23.5**
Total Operating Income	**71.0**	**73.5**	**75.2**	**75.3**	**83.6**	**86.3**
Provisions expense	(2.9)	(3.4)	(5.6)	(3.9)	(6.8)	(7.4)
Operating Expenses	(55.3)	(54.7)	(48.4)	(49.9)	(53.5)	(53.5)
Profit Before Taxation	**12.8**	**15.4**	**21.2**	**21.5**	**23.3**	**25.4**
Taxation & Minority Interest	(0.5)	(2.4)	(4.3)	(3.7)	(4.1)	(4.4)
Net Profit Attributable to Parent	**12.2**	**12.9**	**16.9**	**17.8**	**19.3**	**21.0**
Balance Sheet						
Cash Balances	180	278	285	132	186	219
Deposits with Banks & FIs	156	10	80	52	53	28
Gross Loans & Financings	1,261	1,284	1,501	1,408	1,450	1,494
Loan Loss Reserve	(100)	(83)	(82)	(69)	(71)	(73)
Net Loans & Financings	1,161	1,201	1,418	1,339	1,379	1,421
Net Fixed Assets	30	27	27	26	20	18
Other Assets	716	684	444	878	904	932
Total Assets	**2,243**	**2,200**	**2,254**	**2,428**	**2,543**	**2,618**
Deposits from Banks & FIs	30	36	37	46	48	49
Deposits from Customers	1,852	1,802	1,867	2,013	2,122	2,186
Other Borrowings	-	-	-	-	-	-
Other Liabilities	51	53	36	45	42	43
Paid-up Capital	200	200	200	200	200	200
Retained Earnings	69	71	78	86	92	98
Other Reserves	41	37	35	38	39	42
Total Equity & Liability	**2,243**	**2,200**	**2,254**	**2,428**	**2,543**	**2,618**
Cash Flow Statement						
Cash from operations	(88)	76	(201)	286	84	70
Cash from investing activities	(158)	(36)	(220)	431	19	24
Cash from financing	(8)	(14)	(12)	(8)	(11)	(13)
Net changes in cash	62	98	7	(153)	54	33
Cash at the end of period	180	278	285	132	186	219
Key Ratios						
Return on Average Assets	0.5%	0.6%	0.8%	0.8%	0.8%	0.8%
Return on Average Equity	4.0%	4.2%	5.4%	5.6%	5.9%	6.3%
Fee Income Yield	0.6%	0.7%	0.7%	0.5%	0.5%	0.4%
Interest Earning/Financing Assets Yield	2.8%	2.9%	3.3%	3.1%	3.1%	3.2%
Cost of Funds	0.4%	0.4%	0.4%	0.5%	0.5%	0.5%
Net Spread	2.4%	2.6%	2.9%	2.6%	2.6%	2.7%
Cost to Income Ratio	74.7%	71.3%	61.3%	63.2%	61.7%	59.8%
Net Loans to Customer Deposits	63%	67%	76%	67%	65%	65%
Non Performing Loans	93	72	69	59	60	62
NPL Coverage	107.9%	115.8%	119.1%	117.5%	118.3%	117.9%
Provisions/Total Income	141%	113%	109%	91%	85%	85%
Cost of Risk (bps)	14.7	17.9	30.1	18.9	29.8	31.8
Equity to Gross Loans	25%	24%	21%	23%	23%	23%
Equity to Total Assets	14%	14%	14%	13%	13%	13%
Dividend Payout Ratio	90%	60%	59%	56%	57%	52%
Adjusted EPS (OMR)	0.006	0.006	0.008	0.009	0.010	0.010
Adjusted BVPS (OMR)	0.155	0.154	0.157	0.162	0.166	0.170
Market Price (OMR) *	0.141	0.126	0.120	0.126	0.126	0.126
Dividend Yield	3.9%	3.1%	4.2%	4.0%	4.4%	4.4%
P/E Ratio (x)	23.03	19.45	14.20	14.19	13.09	12.01
P/BV Ratio (x)	0.91	0.81	0.77	0.78	0.76	0.74

**Market price for 2017 and subsequent years based on closing price of 21/12/2017*

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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