

# Bank Muscat SAOG

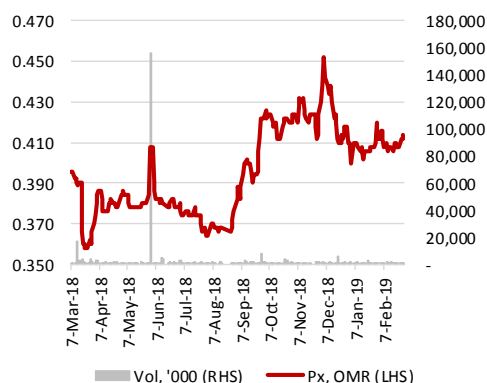
**TP : OMR 0.470 / share**  
**Upside/ (Downside): 13%**

<b>Recommendation</b>	<b>Accumulate</b>
Bloomberg Ticker	BKMB OM
Current Market Price (OMR)	0.416
52wk High / Low (OMR)	0.460/0.350
12m Average Vol. ('000)	1,686.3
Mkt. Cap. (USD/OMR mn)	3,188/1,226
Shares Outstanding (mn)	2,947.4
Free Float (%)	65%
3m Avg Daily Turnover (OMR'000)	454.3
6m Avg Daily Turnover (OMR'000)	471.0
PE 2019e (x)	6.8
PBv 2019e (x)	0.7
Dividend Yield '19e (%)	7.2%

<b>Price Performance:</b>	
1 month (%)	0.97
3 month (%)	(5.02)
12 month (%)	5.51

Source: Bloomberg

## Price-Volume Performance



Source: Bloomberg

- **Loan-to-Deposit Ratio declined from 112.3% in 2017 to 105.6% in 2018**
- **Well capitalized with CAR at 19.4%; Tier 1 Capital Ratio at 18.1%; superior to local peer-group**
- **Net interest margin has improved to 2.98% in 2018 (2017: 2.91%, 2016: 2.81%)**
- **Proposed cash dividend per share of OMR 0.030 implies a yield of 7.2% at the current market price; proposed stock dividend of 5%**

We revise our 12-month target price (TP) for Bank Muscat (BKMB) to OMR 0.470 per share from our earlier TP of OMR 0.480 per share on revision in cost of equity, but maintain its rating at **ACCUMULATE**. Our fair value implies a P/e'19 of 7.7x and a P/b'19e of 0.77x. The bank boasts capital strength and improving earnings profile but macroeconomic indicators warrant depressed valuations. Operationally, we expect the bank to display better than historical performance in the current macroeconomic environment, on the back of its fundamental soundness and sheer size.

## Q4'18 Financial Performance

Bank Muscat reported a 3%YoY rise in its net profit for 2018. However, if the OMR 17.5mn associate re-classification impairment is excluded from 2017 financials, then the bank actually posted a decline of about 6%YoY in 2018.

Nonetheless, operationally, the bank performed slightly better than last year as its operating profit increased by 1.8%YoY in 2018. On quarterly basis, its operating profit improved by 2.5%YoY to reach OMR 446.7mn. This increase was primarily driven by an 8.2%YoY increase in net interest & Islamic finance income. In spite of a 7.9% decline in other operating income, operating income grew by 2.5%YoY. Operating expenses grew by 3.4%YoY, leading to an operating profit rise of 1.8%YoY (almost flattish, in our view). Cost-to-income ratio for FY'18 has increased to 43% vs. 42% in FY'17, as expected, in lieu of the mandatory annual raise in salaries.

The net expected credit losses (ECL) allowance charge was OMR 43.8 vs. net impairment charge of OMR 18.37mn in FY17 (excluding the impairment for re-classification of associate).

## Outlook & Valuation

We expect the bank's top-line to grow on the back of improving net interest margin (NIM) as assets continue to be re-priced, with operating income growth at a CAGR of 6.6% over 2019-2023F. Operating expenses are expected to grow at a CAGR of about 5%. We expect expected credit loss (ECL) allowance charges to grow as loans grow, resulting in a modest growth expectation for net profit (CAGR: 5% over 2019-2023F).

## Key Indicators

Year	FY16	FY17e	FY18	FY19e	FY19e	FY20e
Total Net Loans (OMR mn)	7,957.3	8,328.7	8,938.9	9,510.9	10,130.4	10,704.1
Total Customer Deposits (OMR mn)	7,457.7	7,419.3	8,462.7	8,921.3	9,509.6	10,220.2
Operating Income (OMR mn)	416.2	436.0	446.7	465.9	485.1	515.6
Net Profit (OMR mn)	176.6	174.4	179.6	189.7	196.0	207.7
Diluted EPS (OMR)	0.071	0.064	0.061	0.061	0.060	0.061
Diluted BVPS (OMR)	0.620	0.623	0.610	0.616	0.620	0.624
P/E (x)	6.67	5.83	6.73	6.79	6.90	6.83
P/BVPS (x)	0.76	0.60	0.67	0.67	0.67	0.67
Dividend Yield (%)	5.3%	8.0%	7.3%	7.2%	7.2%	7.2%

Source: Company Financials, U Capital Research

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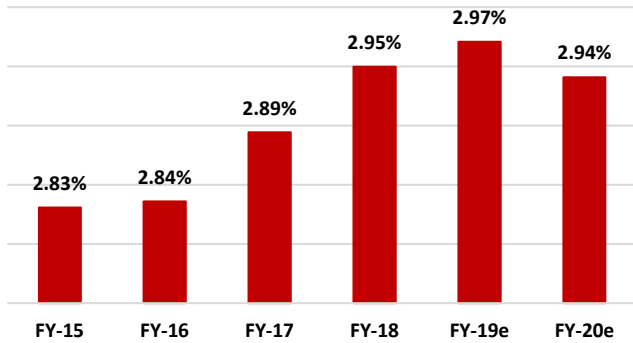
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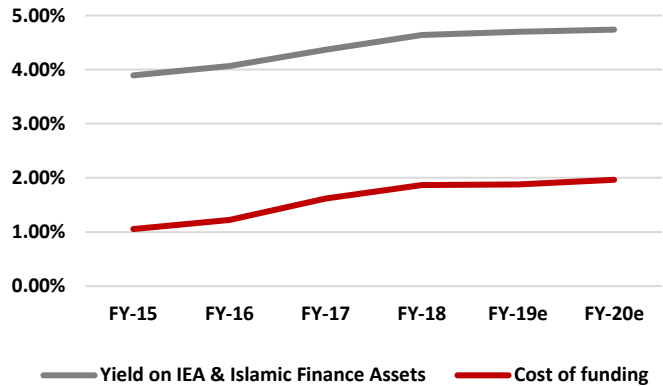
### Rapidly improving net interest income on rising yields

The bank’s interest income has been consistently rising on net loan growth as well as improvement in spreads characteristic of a rising interest rate environment. Current & Savings (CASA) deposits form about 54% of total customer deposits, allowing access to low-cost funding base.

**BKMB: Net Interest Margin**



**BKMB: Yield & Cost of Funding**

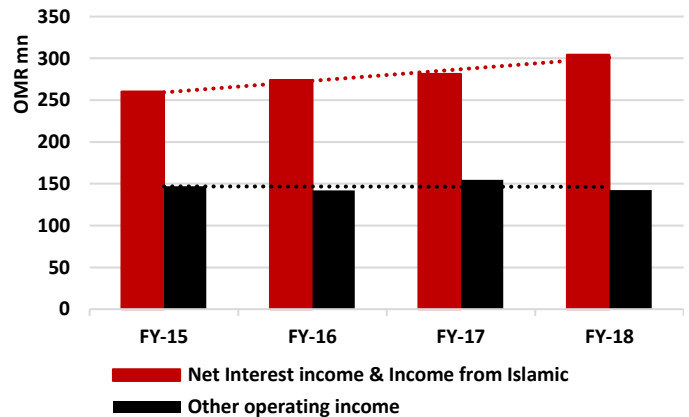
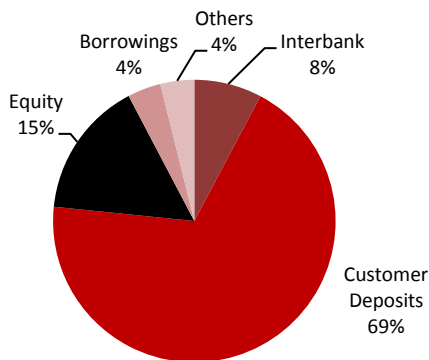


Source: Bank Financials, U Capital Research

The bank’s balance sheet is primarily funded through customer deposits (c69%). Furthermore, the bank has locked in relatively less expensive capital and some borrowing during the previous years. In 2017, the bank raised an OMR 44.6mn Sukuk with an indicative profit rate of 5%, and a Perpetual Tier 1 Capital notes worth OMR 130mn, at a fixed annual rate of 5.5%.

We believe that the bank’s net interest income (including Islamic finance income) will grow at a CAGR of 7.3% over 2019-2023F, based on our assumption that assets will continue to be re-priced higher, and growth in cost of funding will remain at current levels, resulting in some improvement in spreads.

**BKMB: Funding Mix 2018**



Source: Bank Financials, U Capital Research

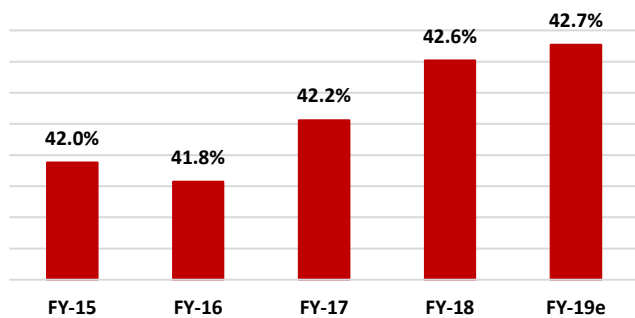
**Net Commission & Fee income rising on expanding loan-book**

Other operating income, which constituted about 32% of total operating income of 2018, declined by 8%YoY in FY18, primarily on account of a loss of OMR 2.2mn recorded as profit on sale of non-trading income, as opposed to an OMR 17.8mn profit that was booked in FY17. However, net fee & commission, foreign exchange and dividend income rose, supporting the other operating income. We believe that other operating income will stay under pressure due to competition from other local as well as regional players.

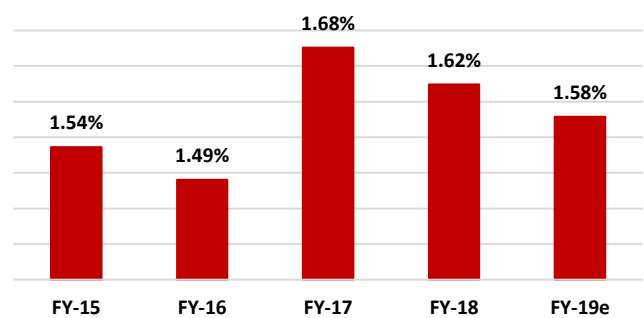
**Profitability metrics affected due to higher capital requirements**

The bank’s return on average equity (RoAE) has declined to about 10.8% from earlier highs of 13%+, primarily on account of higher capital requirements due to Basel III implementation and other regulatory requirements. We believe that the bank’s profitability metrics will remain subdued, as profit growth is expected to remain at a CAGR of 5% over 2019-2023e on subdued loan growth.

**BKMB: Cost-to-Income Ratio**



**BKMB: Cost-to-Average Total Assets**

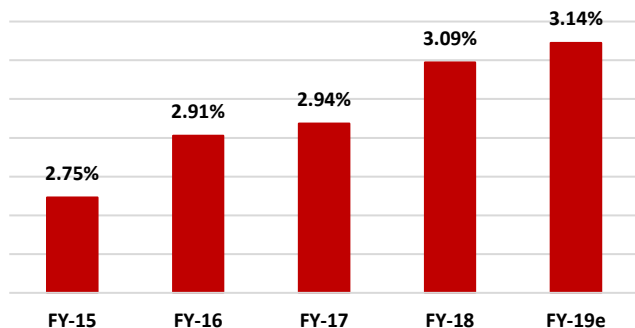


Source: Bank Financials, U Capital Research

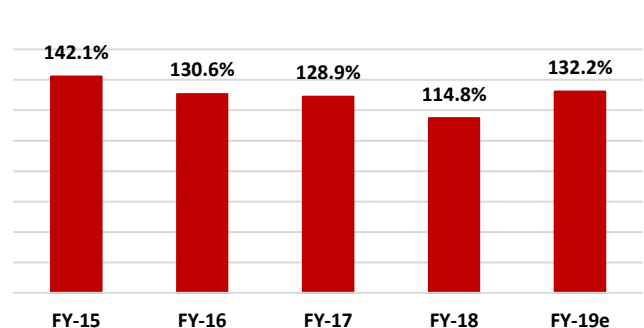
**Cost of risk to normalize; Asset quality metrics declined but still sound**

While loan asset quality metrics have weakened further, they remain sound with a moderately low level of non-performing loans (NPLs) as % of gross loans at 3.14%, which remains more than fully covered by provisions (FY:18 115%). We believe there might be further pressure on asset quality but the bank maintains sufficient provisions to cover any unexpected losses. However, management has expressed concern regarding the bank’s real estate exposure since the real estate market of Oman has been under pressure for a couple of years now. We have conservatively factored in a rise in cost of risk over the forecast period.

**BKMB: Non-performing loans as % of gross loans**



**BKMB: Provision cover (x)**

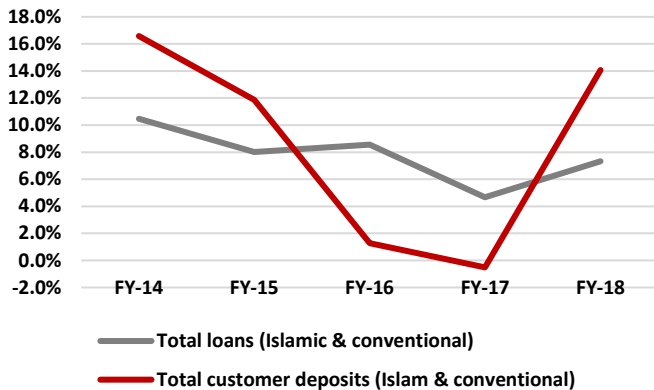


Source: Bank Financials, U Capital Research

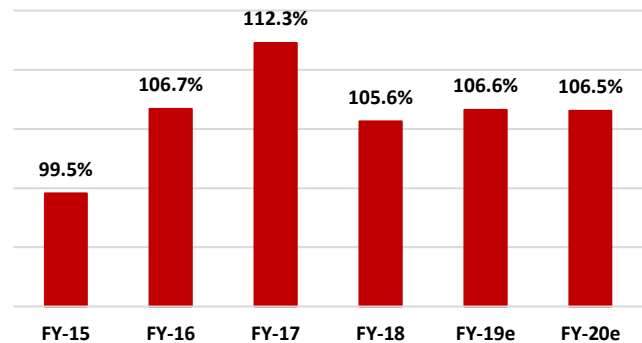
## Deposit growth has picked up; LTD fell to about 106% from +110% previously

The bank's net loans have grown in line with our estimate (+7.3%YoY in 2018). Customer deposit growth surprised positively with a 16.2%YoY and 10.7%QoQ growth in conventional customer deposits. However, the bank pointed out in its Results Conference Call that the rise in deposits was fleeting in nature, and we might see some deposit flight in Q1'19. Loan-to-deposit ratio contracted to 106% from earlier highs of >110% in the previous quarters.

**BKMB: Loan & Deposit Growth**



**BKMB: Loan-to-Deposit Ratio**



Source: Bank Financials, U Capital Research

## FY18 performance review

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The net expected credit losses (ECL) allowance charge was OMR 43.8 in FY18 vs. net impairment charge of OMR 18.37mn in FY17 (excluding the impairment for re-calcification of associate).

## Revised forecasts on FY'18 performance cues

We have revised our estimates for 2019 and onwards, based on FY'18 performance of BKMB. We have adjusted our net ECL impairment charge upwards, in order to reflect the bank's growing NPLs. However, our forecast revision has not had any significant impact on the net profit of the bank for 2019.

Revised Estimates	Old FY19e	New FY19e	Change (%)
Net Interest & Islamic Income	323.8	328.4	1.4%
Other operating income	138.6	137.5	-0.8%
<b>Operating Income</b>	<b>462.4</b>	<b>465.9</b>	<b>0.8%</b>
Operating expenses	-197.6	-199.0	0.7%
<b>Operating profit</b>	<b>264.8</b>	<b>266.9</b>	<b>0.8%</b>
Net ECL Allowances charge	-34.0	-41.8	23.0%
<b>Profit before tax</b>	<b>230.8</b>	<b>225.1</b>	<b>-2.5%</b>
Tax	-37.4	-35.4	-5.3%
<b>Net Profit</b>	<b>193.4</b>	<b>189.7</b>	<b>-1.9%</b>

All figures in OMR mn, unless stated otherwise

**Key Financials**

(OMR mn)	FY-16	FY-17	FY-18	FY-19e	FY-20e	FY-21e
<b>Income Statement</b>						
Interest/Financing Income	393.2	424.4	478.6	518.4	555.3	593.9
Interest Expense/Payment to Depositors	(119.0)	(143.0)	(174.4)	(189.9)	(209.8)	(225.3)
<b>Net Interest/Financing Income</b>	<b>274.1</b>	<b>281.3</b>	<b>304.3</b>	<b>328.4</b>	<b>345.4</b>	<b>368.7</b>
Fee & Commission Income	95.3	93.1	96.5	94.8	96.3	101.3
Other Income	46.7	61.6	46.0	42.7	43.4	45.6
<b>Total Non-Interest/Financing Income</b>	<b>142.0</b>	<b>154.6</b>	<b>142.4</b>	<b>137.5</b>	<b>139.7</b>	<b>146.9</b>
<b>Total Operating Income</b>	<b>416.2</b>	<b>436.0</b>	<b>446.7</b>	<b>465.9</b>	<b>485.1</b>	<b>515.6</b>
Provisions expense	(37.7)	(43.3)	(43.2)	(41.8)	(44.9)	(47.9)
Operating Expenses	(174.1)	(184.1)	(190.3)	(199.0)	(207.7)	(221.2)
<b>Profit Before Taxation</b>	<b>204.4</b>	<b>208.6</b>	<b>213.2</b>	<b>225.1</b>	<b>232.6</b>	<b>246.4</b>
Taxation & Minority Interest	(27.8)	(34.2)	(33.5)	(35.4)	(36.6)	(38.8)
<b>Net Profit Attributable to Parent</b>	<b>176.6</b>	<b>174.4</b>	<b>179.6</b>	<b>189.7</b>	<b>196.0</b>	<b>207.7</b>
<b>Balance Sheet</b>						
Cash Balances	1,042	935	1,307	1,254	1,297	1,546
Deposits with Banks & FIs	527	592	476	507	539	570
Gross Loans & Financings	8,271	8,657	9,268	9,869	10,511	11,105
Loan Loss Reserve	(314)	(328)	(329)	(358)	(381)	(401)
Net Loans & Financings	7,957	8,329	8,939	9,511	10,130	10,704
Other Assets	1,295	1,294	1,566	1,665	1,768	1,863
<b>Total Assets</b>	<b>10,820</b>	<b>11,149</b>	<b>12,288</b>	<b>12,936</b>	<b>13,734</b>	<b>14,683</b>
Deposits from Banks & FIs	832	910	952	1,003	1,070	1,150
Deposits from Customers	7,363	7,458	7,419	8,463	8,921	9,510
Other Borrowings	549	550	469	471	474	477
Other Liabilities	529	413	1,520	961	1,124	1,286
Paid-up Capital	250	271	295	309	325	341
Retained Earnings	364	421	485	479	470	466
Other Reserves	933	997	1,018	1,119	1,221	1,324
Shareholders' Equity	1,547	1,688	1,798	1,908	2,015	2,130
Minority Interest, Tier 1 Perpetual Notes	-	130.00	130.00	130.00	130.00	130.00
<b>Total Equity &amp; Liabilities</b>	<b>10,820</b>	<b>11,149</b>	<b>12,288</b>	<b>12,936</b>	<b>13,734</b>	<b>14,683</b>
<b>Cash Flow Statement</b>						
Cash from operations	(1,240)	(223)	554	28	127	338
Cash from investing activities	(2)	(50)	(3)	2	(1)	(0)
Cash from financing	(132)	66	(185)	(78)	(85)	(89)
Net changes in cash	(1,370)	(107)	372	(53)	43	249
Cash at the end of period	1,042	935	1,307	1,254	1,297	1,546
<b>Key Ratios</b>						
Return on Average Assets	1.5%	1.6%	1.5%	1.5%	1.5%	1.5%
Return on Average Equity	12.0%	10.8%	10.3%	10.2%	10.0%	10.0%
Recurring Income/Operating Income	88.8%	85.9%	89.7%	90.8%	91.1%	91.1%
Interest Earning/Financing Assets Yield	4.0%	4.3%	4.5%	4.6%	4.6%	4.6%
Cost of Funds	1.2%	1.5%	1.7%	1.7%	1.8%	1.8%
Net Spread	2.8%	2.8%	2.8%	2.9%	2.8%	2.9%
Cost to Income Ratio	41.8%	42.2%	42.6%	42.7%	42.8%	42.9%
Net Loans to Customer Deposits	106.7%	112.3%	105.6%	106.6%	106.5%	104.7%
NPLs to Gross Loans	2.9%	2.9%	3.1%	3.1%	3.2%	3.2%
NPL Coverage	130.6%	128.9%	114.8%	132.2%	130.4%	128.8%
Cost of Risk (bps)	39.0	44.5	41.9	37.9	38.2	38.5
Equity to Total Assets	14.3%	15.1%	14.6%	14.7%	14.7%	14.5%
Cash Dividend Payout Ratio	35.3%	46.6%	49.2%	48.9%	49.7%	49.3%
Adjusted EPS (OMR)	0.071	0.064	0.061	0.061	0.060	0.061
Adjusted BVPS (OMR)	0.620	0.623	0.610	0.616	0.620	0.624
Market Price (OMR) *	0.472	0.375	0.410	0.416	0.416	0.416
Cash Dividend Yield	5.3%	8.0%	7.3%	7.2%	7.2%	7.2%
P/E Ratio (x)	6.7	5.8	6.7	6.8	6.9	6.8
P/BV Ratio (x)	0.8	0.6	0.7	0.7	0.7	0.7

\* Market price for 2019 and subsequent years as per latest closing price of 04/03/2019

Source: Company Financials, U Capital Research

## Recommendation

BUY	Greater than 20%
ACCUMULATE	Between +10% and +20%
HOLD	Between +10% and -10%
REDUCE	Between -10% and -20%
SELL	Lower than -20%

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