

Bank Nizwa SAOG

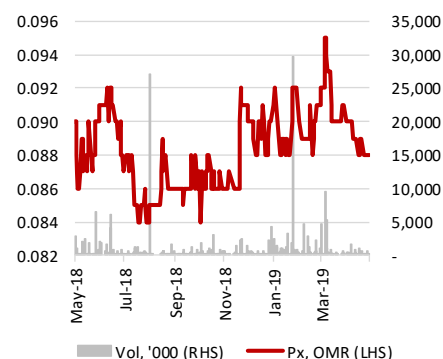
TP : OMR 0.103 / share
Upside/ (Downside): 17%

Recommendation	Accumulate
Bloomberg Ticker	BKNZ OM
Current Market Price (OMR)	0.088
52wk High / Low (OMR)	0.100/0.080
12m Average Vol. (000)	934.5
Mkt. Cap. (USD/OMR mn)	342.9/132
Shares Outstanding (mn)	1,500
Free Float (%)	78%
3m Avg Daily Turnover (000)	135.3
6m Avg Daily Turnover (000)	121.5
P/E'19e (x)	13.0
P/B'19e (x)	0.89
Dividend Yield '19e (%)	-

Price Performance:

1 month (%)	(3.30)
3 month (%)	(3.30)
12 month (%)	(2.22)

Source: Bloomberg

Price-Volume Performance


Source: Bloomberg

13th May, 2019

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- **Loan-to-Deposit Ratio declined from 107% in 2017 to 98% in 2018; rose to 103% in Q1'19.**
- **Well capitalized with CAR at 15.33% and Tier 1 Capital Ratio at 14.51% as at Q1'19; above regulatory minimum set by CBO.**
- **Net earnings margin has improved slightly to 3.21% in 2018 (2017: 3.20%, 2016: 3.57%).**
- **Cost to Income Ratio declined from 91.2% in FY16 and 73.3% in FY17 to 61.5% in FY18 and 52.6% in Q1'19, as operations normalize over 5 years post-inception of the bank.**

We reduce our target price for Bank Nizwa to OMR 0.103 per share and downgrade it to ACCUMULATE from a previous BUY rating. We believe that the bank's exceptional performance and balance sheet growth is not reflected in its current price level. However, due to a steep rise in the risk-free rate of Oman, the bank's fair value offers only about a 17% upside. Our target price implies a P/E'19e and P/E'20e of 15.2x and 13.2x, respectively, and a P/B'19e and P/B'20e of 1.04x and 0.96x, respectively.

Robust loan-book growth despite a challenging operating environment

The bank's total assets grew by 25%YoY to reach OMR 872mn as at the end of FY18, while total net loans increased by 24%YoY to reach OMR 696.5mn, showing significant growth despite a challenging operating environment. Bank Nizwa gained credit market share in FY18, reaching 19% as compared to 18% in FY17 and 16% in FY16, of the total gross Islamic finance assets of the country. We expect the total assets of the bank to grow at CAGR of 11% over the next six years on account of increasing loan book (expected CAGR of 12% over 2019-2025e).

Operating income to grow at a CAGR of 9% over 2019-2025e

Operating income of the bank is expected to increase from OMR 27.1mn in FY18 to OMR 51mn in 2025, growing at a CAGR of 9%. Revenue growth will primarily be driven by growth in loan book together with some recovery expected in the bank's net earning margins.

Superior asset quality amid tight cost control

The bank has been bringing its cost-to-income ratio down and we believe it will continue to maintain tight control on costs in order to bring the ratio down further through income growth. We expect the bank's operating profit before provisions to increase at a CAGR of 16% over 2019-2025e. Furthermore, we expect cost of risk to remain low as current asset quality is maintained over the forecast horizon. The bank boasts superior asset quality, inherent in the nature of Islamic banking business, with non-performing loans (NPLs) at 0.16% of total gross loans.

TP offers an upside of 17%; CMP: OMR 0.088/share

Our target price offers an upside of 17% compared to the current market price of OMR 0.088/share. The bank is trading at an attractive P/B multiple of 0.89x for 2019 compared to the regional peer-group average of 1.25x. Furthermore, the bank is expected to benefit from sequentially reducing its deferred tax asset from its loss-making years, where it has 5 years to amortize the asset from the date of creation. This might result in higher or lower earnings than our forecasts that are based on 50% asset amortization every year.

Key Indicators

	FY'15	FY16	FY17	FY18	FY19e	FY20e
Net Loans, OMR'000	268,986	397,807	560,545	696,470	734,008	824,326
Customer Deposits, OMR '000	189,387	352,268	526,150	711,275	747,726	832,452
Operating Income, OMR '000	11,913	17,379	22,392	27,098	30,132	33,622
Operating Profit, OMR '000	(3,464)	1,525	5,972	10,440	13,232	16,477
Net Profit*, OMR '000	(5,260)	110	3,787	7,512	10,131	11,738
EPS, OMR	-0.004	0.000	0.003	0.005	0.007	0.008
BVPS, OMR	0.084	0.085	0.087	0.091	0.099	0.107
P/E (x)	NM	NM	35.7	18.2	13.0	11.2
P/BVPS (x)	0.83	0.98	1.03	0.99	0.89	0.82

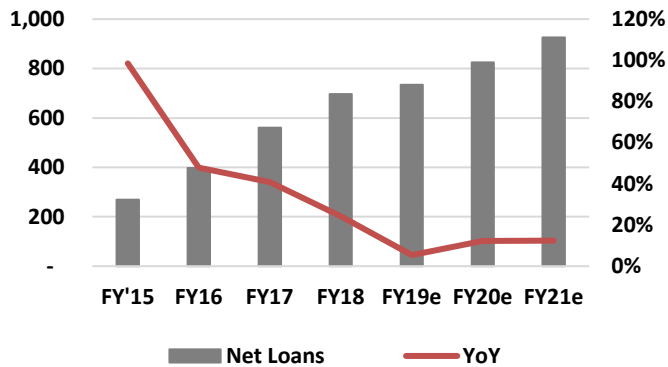
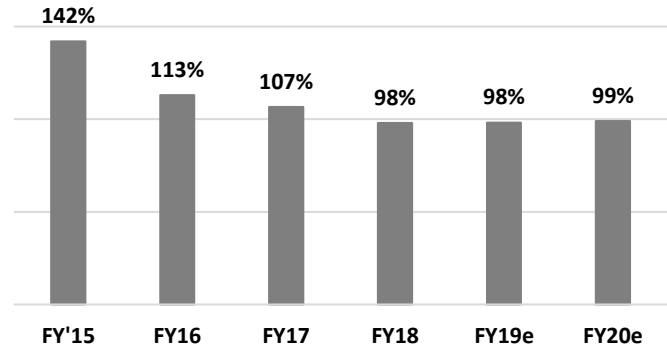
Source: Company Financials, U Capital Research

NM = Not meaningful

*Includes Tax Amortization Benefit

Credit & Deposit growth has normalized; LTD fell to about 98% from +107% previously

The bank's net loans have grown by 24%YoY in FY18 to reach OMR 696.5mn. Customer deposit growth surprised positively with a 35%YoY increase in FY18. Therefore, Loan-to-deposit ratio contracted to record low at 98%. However, in Q1'19, the ratio has once again increased to 103%, on a marginal drop in customer deposits and a 5.4%QoQ growth in net loans.

BKNZ: Net Loans, OMR mn

BKNZ: Loan-to-Deposit Ratio


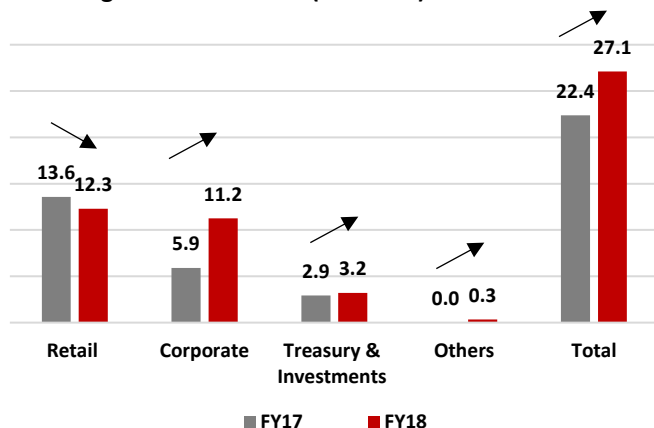
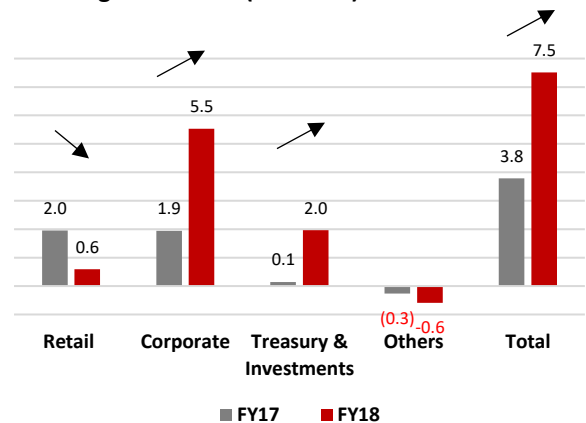
Source: Bank Financials, U Capital Research

Stellar balance sheet growth

The bank's total assets grew by 25%YoY to reach OMR 872mn as at the end of FY18, while total net loans increased by 24%YoY to reach OMR 696.5mn, showing significant growth despite a challenging operating environment. Bank Nizwa gained credit market share in FY18, reaching 19% as compared to 18% in FY17 and 16% in FY16, of the total gross Islamic finance assets of the country. We expect the total assets of the bank to grow at CAGR of 11% over the next six years on account of increasing loan book (expected CAGR of 12% over 2019-2025e).

Solid Operational Performance

Bank Nizwa's operating income rose by 21%YoY, while its operating expenses increased only by 1.5%YoY, reflecting tight cost control. As a result, cost-to-income ratio has been consistently declining since the bank's inception, and has reached 61.5% in FY18, from 73.3% a year ago. The ratio has declined further to 52.6% in Q1'19.

BKNZ: Segmental Revenues (OMR mn)

BKNZ: Segmental PAT (OMR mn)


Source: Bank Financials, U Capital Research

We expect the operating income of the bank to grow at a CAGR of 10% over 2019-2025e, which together with controlled costs, is expected to boost net profit at a CAGR of 16% over 2019-2025e.

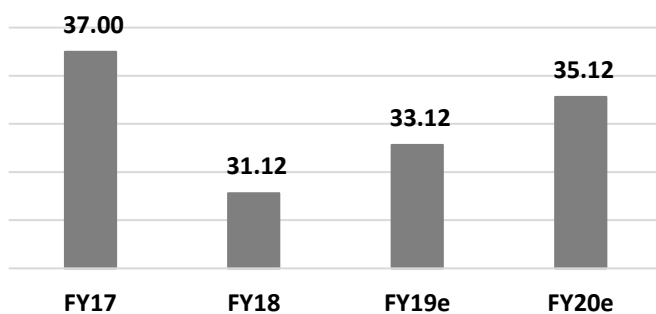
Superior Asset Quality

The bank has maintained its non-performing loans (NPLs) at a very low 0.14% (0.18% in FY17; 0.11% in FY16) of gross Islamic finance assets as compared to Oman’s total banking sector at ~3% of total, due to the inherent nature of Islamic financing activities. ECL cover is more than sufficient as provisions are made as per IFRS 9 or CBO guidelines (higher of the two), since NPLs remain extremely low. Cost of risk also declined by about 6bps in FY18 from 37 bps in FY17. We have been conservative in our estimates, and therefore we have increased cost of risk sequentially over the forecast horizon, given the current weak macroeconomic environment.

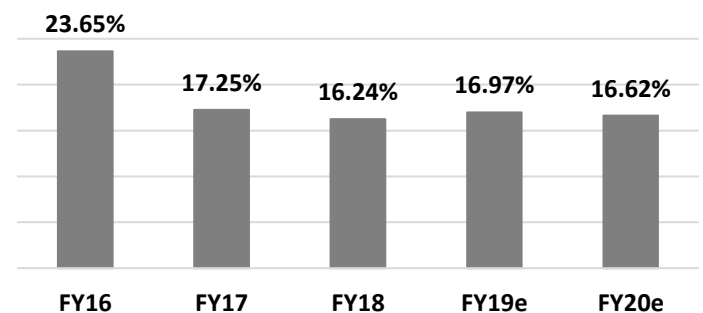
Robust Capital Buffers albeit expected to decline

Bank Nizwa maintains capital adequacy ratio at 16.24%, which is above the regulatory minimum of 13.5% including capital conservation buffer. However, the bank’s capital adequacy levels have been declining as the bank takes on more risk, down from 17.25% in FY17 and 23.65% in FY16. We expect this ratio to be maintained around the current level over the forecast period, as the bank shores up capital through increasing earnings and no dividend payouts for the first few years.

BKNZ: Cost of risk



BKNZ: Capital Adequacy Ratio (CAR)



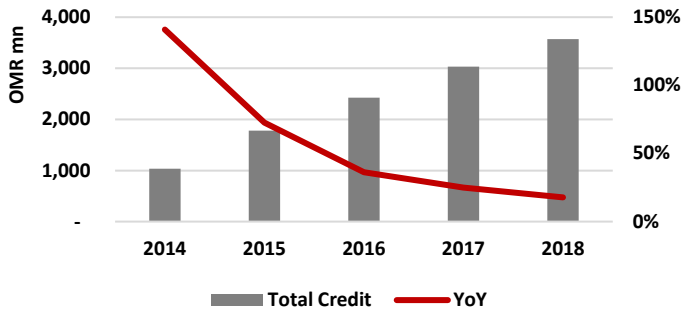
Source: Company Financials, U Capital Research

Q1'19 Performance

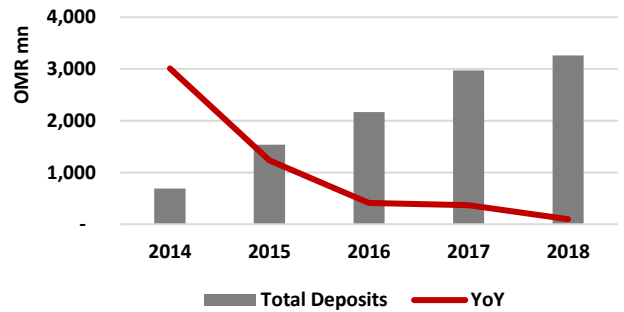
The bank posted a 34.6%YoY and 11.9%QoQ rise in its total operating income, on account of a 25%YoY and 3%QoQ rise in net Islamic financing. Its operating expenses grew by 2.4%YoY and 2.6%QoQ, amid tight cost control. This resulted in an operating profit increase of 107.2%YoY and 24.4%QoQ at OMR 3.85mn for the quarter. A large increase in ECL allowance expense resulted in profit before tax to decline on quarterly basis by 15.7%QoQ (it rose on YoY basis by 101.4%). Additionally, a rise in tax expense resulted in a net profit decline of 28.3%QoQ. Net profit rose by 103%YoY.

Sector Overview in Pictures

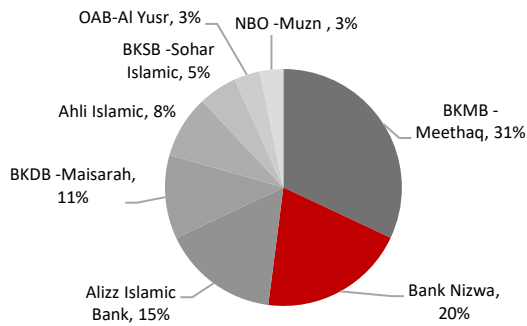
Omani Islamic Banking -Credit



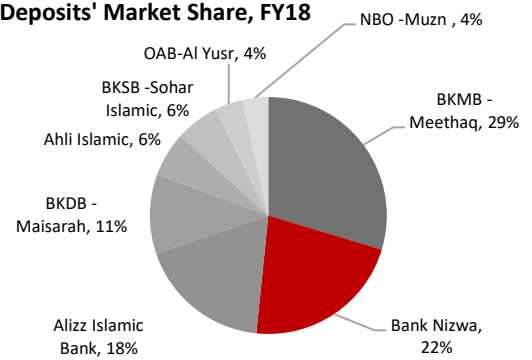
Omani Islamic Banking -Deposits



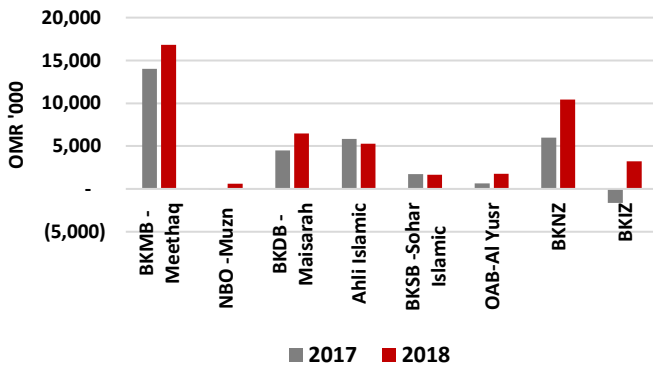
Islamic Financing Market Share, FY18



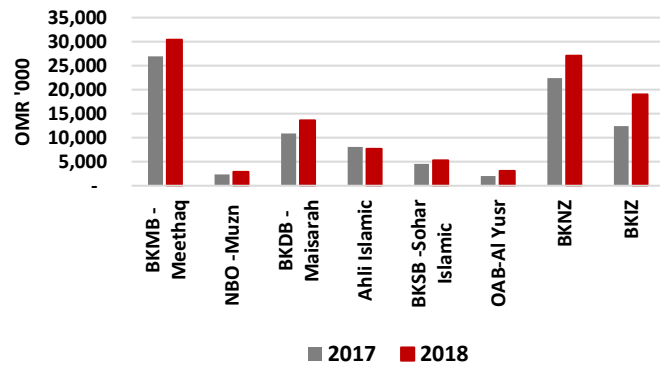
Islamic Deposits' Market Share, FY18



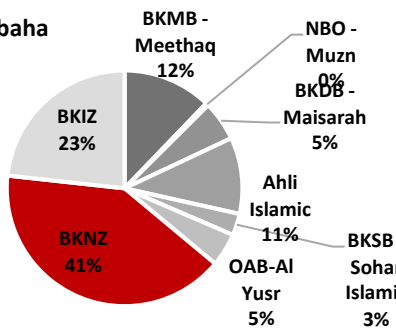
Operating Profit



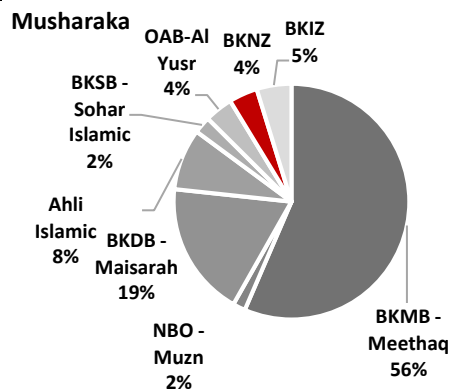
Operating Income



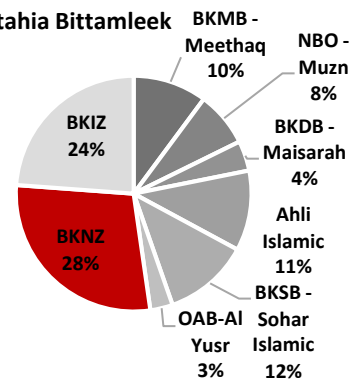
Murabaha



Musharaka



Ijara Muntahia Bittamleek



Source: Company Financials, U Capital Research

Financial Statements

(OMR '000)	2016	2017	2018	2019e	2020e	2021e
Income Statement						
Financing Income	17,982	27,956	37,968	44,187	49,641	55,827
Payment to Depositors	(4,480)	(11,285)	(17,387)	(21,376)	(23,985)	(27,731)
Net Interest/Financing Income	13,502	16,671	20,582	22,811	25,656	28,096
Fee & Commission Income	1,922	3,502	4,474	5,027	5,470	6,141
Investment Income	1,744	1,806	1,459	1,639	1,783	2,002
Other Income	211	412	583	655	713	801
Total Non-Interest/Financing Income	3,877	5,721	6,516	7,321	7,967	8,943
Total Operating Income	17,379	22,392	27,098	30,132	33,622	37,040
Provisions expense	(1,415)	(1,926)	(1,997)	(2,532)	(2,912)	(3,445)
Operating Expenses	(15,854)	(16,420)	(16,658)	(16,900)	(17,146)	(17,395)
Profit Before Taxation	110	4,046	8,443	10,700	13,564	16,200
Taxation	-	(260)	(931)	(568)	(1,827)	(2,430)
Net Profit	110	3,787	7,512	10,131	11,738	13,770
Balance Sheet						
Cash Balances	16,600	42,814	92,966	97,197	103,441	97,233
Deposits with Banks & FIs	4,920	3,464	6,400	4,932	5,666	5,299
Investment Securities	29,360	47,721	50,034	57,443	59,965	62,613
Sales receivables & other receivables -net	100,103	161,398	182,269	205,838	232,454	262,513
Ijara Muntahia Bittamleek -net	234,054	282,110	316,397	354,853	397,982	446,353
Wakala Bel Istithmar -net	62,851	91,311	137,924	151,716	166,887	183,576
Other Assets	130,960	159,130	224,103	200,571	222,025	246,423
Total Assets	515,995	696,638	872,168	920,833	1,021,532	1,120,433
Deposits from Banks & FIs	23,233	19,339	116	122	128	134
Deposits from Customers	193,294	298,074	388,768	408,668	451,616	498,110
Other Liabilities	13,433	20,400	23,588	24,798	27,854	18,626
Equity of unrestricted inv acctholders & owners' equity	158,974	228,076	322,507	339,058	380,836	427,318
Paid-up Capital	150,000	150,000	150,000	150,000	150,000	150,000
Retained Earnings / (Accumulated Losses)	(25,175)	(21,771)	(14,933)	(4,802)	6,936	20,706
Other Reserves	2,226	2,127	831	831	831	831
Shareholders' Equity	127,061	130,749	137,189	148,187	161,099	176,245
Total Equity & Liability	515,995	696,638	872,168	920,833	1,021,532	1,120,433
Cash Flow Statement						
Cash from operations	5,475	44,079	53,196	11,326	7,459	(4,907)
Cash from investing activities	3,779	17,767	1,972	7,961	2,389	2,678
Cash from financing	278	(99)	(1,072)	867	1,174	1,377
Net changes in cash	1,974	26,214	50,152	4,231	6,244	(6,208)
Cash at the end of period	16,600	42,814	92,966	97,197	103,441	97,233
Key Ratios						
Return on Average Assets	0.0%	0.6%	1.0%	1.1%	1.2%	1.3%
Return on Average Equity	0.1%	2.9%	5.6%	7.1%	7.6%	8.2%
Recurring Income/Operating Income	88.8%	90.1%	92.5%	92.4%	92.6%	92.4%
Profit Yield	4.7%	5.4%	5.9%	6.4%	6.3%	6.3%
Profit Paid	1.5%	2.5%	2.8%	2.9%	3.0%	3.2%
Net Spread	3.2%	2.9%	3.2%	3.4%	3.3%	3.2%
Cost to Income Ratio	91.2%	73.3%	61.5%	56.1%	51.0%	47.0%
Net Loans to Customer Deposits	86.3%	96.6%	99.1%	99.3%	99.3%	99.4%
NPLs to Gross Loans	0.11%	0.18%	0.14%	0.15%	0.16%	0.17%
NPL Coverage	1388%	738%	1183%	1574%	1816%	2103%
Cost of Risk (bps)	37.4	37.0	31.1	35.1	37.1	39.1
Equity to Gross Loans	30.2%	22.0%	18.8%	19.2%	18.6%	18.1%
Equity to Total Assets	24.6%	18.8%	15.7%	16.1%	15.8%	15.7%
Dividend Payout Ratio	-	-	-	-	-	-
Adjusted EPS (OMR)	0.000	0.003	0.005	0.007	0.008	0.009
Adjusted BVPS (OMR)	0.085	0.087	0.091	0.099	0.107	0.117
Market Price (OMR) *	0.083	0.090	0.091	0.088	0.088	0.088
P/E Ratio (x)	NM	NM	18.2	13.0	11.2	9.6
P/BV Ratio (x)	0.98	1.03	0.99	0.89	0.82	0.75

Source: Company Financials, U Capital Research

* Market price for 2019 and subsequent years as per latest closing price of 12-May-19

NM = not meaningful

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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