

# National Bank of Oman SAOG

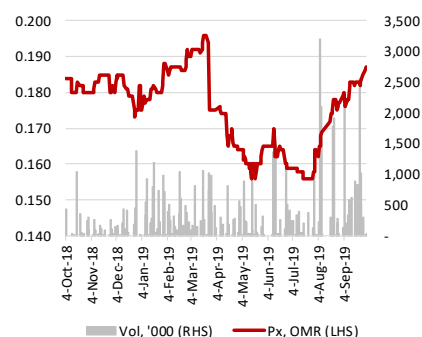
**TP: OMR 0.200 / share**  
**Upside/ (Downside): 7.0%**

<b>Recommendation</b>	<b>Hold</b>
Bloomberg Ticker	NBOB OM
Current Market Price (OMR)	0.187
52wk High / Low (OMR)	0.200/0.160
12m Average Vol. (000)	279.4
Mkt. Cap. (USD/OMR Mn)	791/304
Shares Outstanding (mn)	1,625.9
Free Float (%)	39%
3m Avg Daily Turnover (OMR'000)	78.4
6m Avg Daily Turnover (OMR'000)	57.5
PE 2019e (x)	6.1
PBv 2019e (x)	0.69
Dividend Yield '19e (%)	8.6%

<b>Price Performance:</b>	
1 month (%)	5.65
3 month (%)	17.61
12 month (%)	1.63

Source: Bloomberg

## Price-Volume Performance



Source: Bloomberg

1<sup>ST</sup> October, 2019

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- **Third-largest bank of Oman; Credit market share at 11.5% and deposit market share at 10.8%**
- **Robust Capital Adequacy with CAR at 16.3% as at the end of FY'18**
- **Loan-book growth has picked up, +5.5%YoY and +1.3%QoQ during Q2'19**
- **Deteriorating asset quality; Expected Credit Loss (ECL) allowance dropped to 88% at the end of H1'19 vs. 92.5% at the end of FY18**

We maintain our 12-month target price (TP) for National Bank of Oman (NBOB) at OMR 0.200 per share and maintain its rating at HOLD. We have revised our forecasts based on the bank's financial performance for H1'19, however, our target price (weighted average price: 80% Excess Returns and 20% local peer-group P/B'19e multiple) remains the same on changes in cost of equity and peer-group P/B'19e multiple. Our TP implies a P/e'19e of 6.3x and a P/b'19e of 0.77x, which we believe is justified given the bank's capital strength. The bank is focused on curtailing costs (operating expenses up 0.1%YoY in H1'19 vs. operating income growth of 1.2%YoY), which has helped preserve profitability. However, higher cost of risk and higher cost of funding continue to dampen profit growth. The bank has recently announced plans to raise capital through a Tier 2 issuance of OMR 50mn and a Tier 1 issuance of OMR 115.5mn over the next 5 years, subject to shareholder and regulatory approvals. This is expected to boost the bank's capital adequacy and increase its unexpected loss absorption capacity.

## Valuation & Outlook

NBO has seen improvement in interest and Islamic finance spread over the last few quarters. However, with the recent Fed funds rate cuts (not followed by Oman) and more cuts expected in the coming period (possibly followed by Oman), interest yield is expected to remain under pressure going forward. The bank has recently announced plans to raise capital through a Tier 2 issuance of OMR 50mn and a Tier 1 issuance of OMR 115.5mn over the next 5 years, subject to shareholder and regulatory approvals. This is expected to boost the bank's capital adequacy and increase its unexpected loss absorption capacity. Furthermore, it will provide the bank an opportunity to lock in lower interest rates as expectation of further cuts by the Fed will ease funding costs.

A key risk to our valuation is an unexpected deterioration of the asset quality of the bank. NBOB's non-performing loans (NPLs) to gross loans has been rising over the last few quarters, reaching 5.32% as at the end of H1'19. Even though this ratio is less than many GCC counterparts, it is still the highest within the local listed banks (sector average of 3.4%). Its ECL allowance coverage also dropped to 88% at the end of H1'19. We believe that the bank's cost of risk (currently at about 27bps annualized for H1'19) will continue to rise over the forecast horizon on account of upward pressure on NPLs. In spite of our conservative assumptions, we are expecting NBO's net profit to rise at a CAGR of 6.4% over 2019-2023e on account of a mid-single digit growth in net loans.

## Key Indicators

Year	FY16	FY17	FY18	FY19e	FY20e	FY21e
Total Net Loans (OMR mn)	2,670	2,654	2,810	2,876	3,160	3,356
Total Customer Deposits (OMR mn)	2,399	2,461	2,452	2,539	2,807	3,008
Operating Income (OMR mn)	136	132	129	129	134	135
Net Profit (OMR mn)	56	44	51	50	52	52
Diluted EPS (OMR)	0.038	0.028	0.031	0.031	0.032	0.032
Diluted BVPS (OMR)	0.287	0.278	0.259	0.269	0.279	0.290
P/E (x)*	5.7	6.7	5.8	6.1	5.9	5.8
P/BVPS (x)*	0.75	0.68	0.70	0.69	0.67	0.64
Dividend Yield (%)*	7.4%	7.9%	8.8%	8.6%	8.6%	8.6%

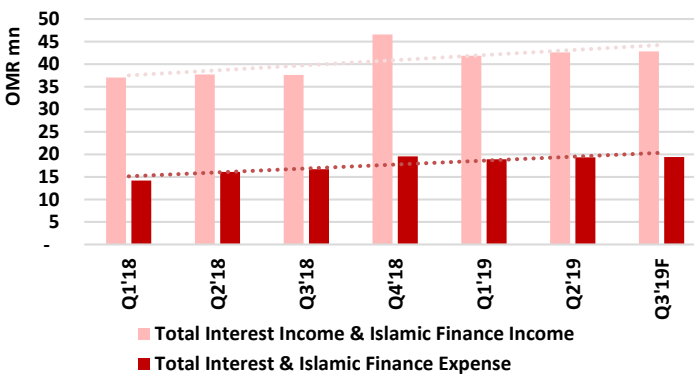
Source: Bank Financials, U Capital Research

\* Market price for 2019 and subsequent years as per latest closing price of 01/10/2019

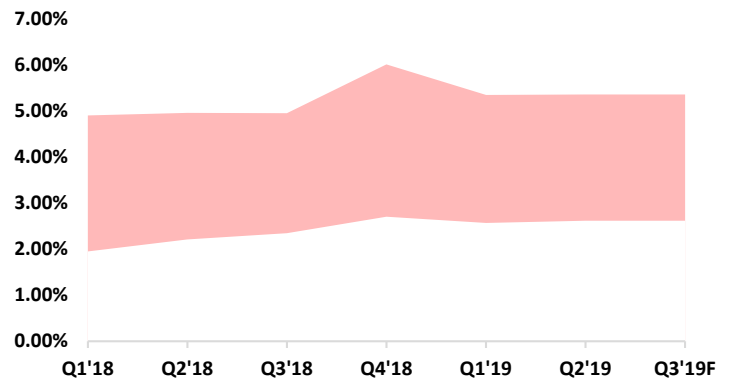
**Net Interest & Islamic Finance Income remains stable on somewhat stable interest spread**

The bank’s interest & Islamic finance income has been rising on net loan growth as well as improvement in yields, characteristic of a rising interest rate environment. However, due to rising cost of funding, the bank’s spreads are somewhat stable over the last 2 quarters, leading to a stable net interest income over the last two quarters at about OMR 23mn. Furthermore, with the recent Fed funds rate cut announcement and anticipation of further cuts over the near term, we believe that interest yield will remain under pressure, as Government finances remain subdued impacting liquidity negatively.

**NBOB: Topline drivers**



**NBOB: Spread**



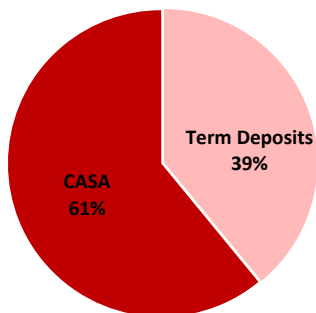
Source: Bank Financials, U Capital Research

**Cost of funding to remain under pressure**

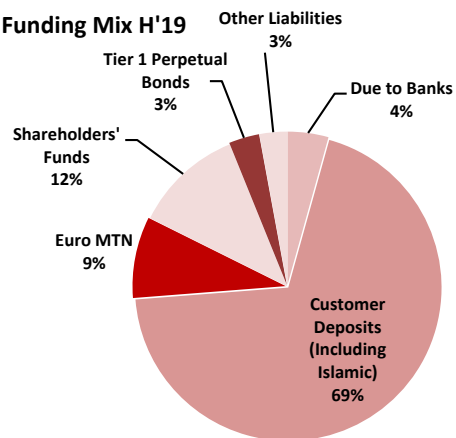
The bank boasts strong surplus liquidity though reliance on CASA deposits which form about 61% of its total customer deposits. However, cost of funding has risen as the bank relies on wholesale funding to finance about 9% of its balance sheet. The bank issued a 5-year, USD 600mn Regulation S in October 2014. These notes mature in October 2019. Subsequently during 2018 the bank concluded a further issuance of USD 500 million and simultaneously increased the Euro Medium Term Notes (EMTN) Programme size to USD 1,500mn. The bank also bought back USD 300mn from the issuance made in year 2014. As a result of the above fresh issuance and buyback, the bank has USD 800mn (OMR 307.69mn) outstanding as at the end of H1'19. The bank is reported to have recently raised USD 300mn through a three-year Syndicated Term Loan Facility as well.

Furthermore, the bank has announced its plan to increase its Tier 2 capital by OMR 50mn. It has also announced its plan to double its current Tier 1 capital through an issuance of USD 300mn (OMR 115.5mn) perpetual bonds. As at the date of publication of this report, the bank has invited shareholders to attend an Extraordinary General Meeting related to the aforementioned, and this capital raising is subject to the relevant regulatory and shareholder approvals.

**NBOB: Deposit Mix H1'19**



**NBOB: Funding Mix H'19**



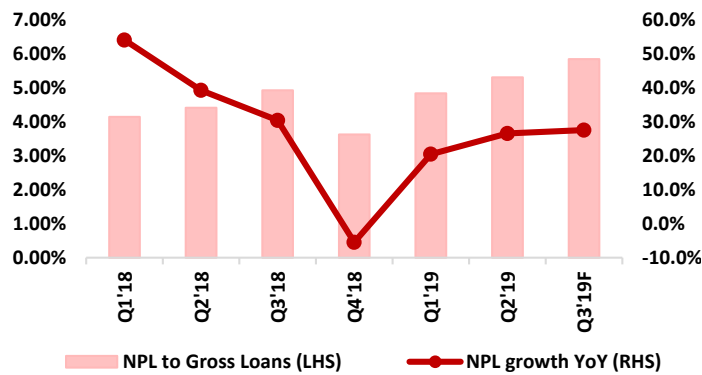
Source: Bank Financials, U Capital Research

In case the aforesaid capital raising activity goes through, the bank is expected to see a significant boost in its capital adequacy ratios, with capital increasing by about 23.4%. As at the end of FY18, the bank's capital adequacy ratio stood at 16.3% (Mar'19 CAR at 16.2%).

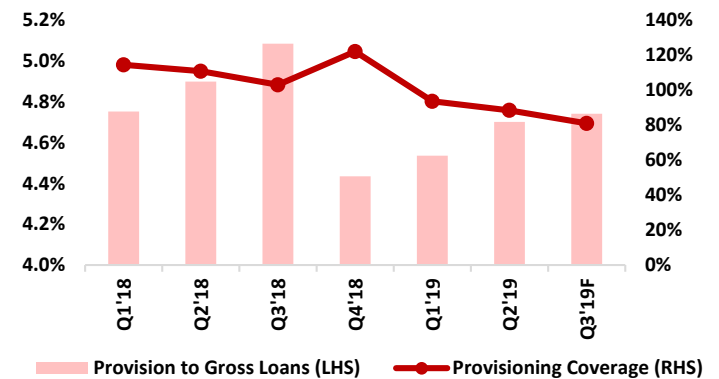
**Asset quality needs to be watched; High capital adequacy ensures unexpected loss absorption capacity**

NBOB's Non-performing loans (NPLs) to gross loans has been rising over the last few quarters, reaching 5.32% as at the end of H1'19. Its ECL allowance coverage also dropped to 88% at the end of H1'19. We believe that the bank's cost of risk (currently at about 27bps annualized for H1'19) will continue to rise over the forecast horizon on account of upward pressure on NPLs.

**NBOB: Asset quality metrics**



**NBOB: ECL Allowance Coverage**



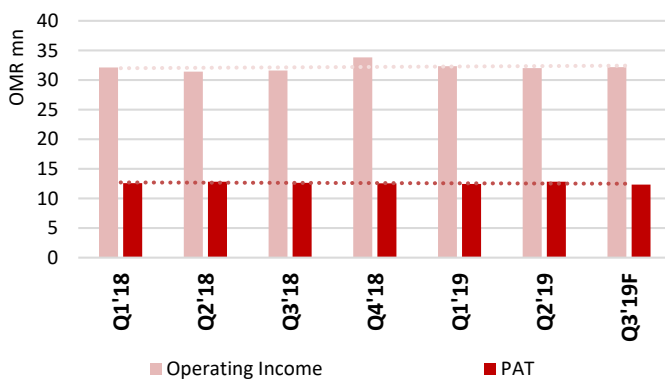
Source: Bank Financials, U Capital Research

**H1'19 Performance Review**

In H1'19, the bank posted a 0.5%YoY decline in net profit at OMR 25.3mn, mainly due to a 19%YoY growth in net ECL charge in spite of a 1.2% growth in continuing operating income amid firm cost control. Net interest & Islamic Finance Income grew by 4.1%YoY to OMR 46.3mn in H1'19 whereas other operating income contracted by 5.4%YoY.

Loans and advances to customers grew by 5.5%YoY and 1.3%QoQ to OMR 2.82bn whereas customer deposits grew marginally by 0.1%YoY but declined by 1.7%QoQ to OMR 2.49bn. The bank's Loan-to-Deposit ratio (LDR) stood at 113% as at the end of H1'19.

**NBOB: Quarterly Operational Performance**



Source: Bank Financials, U Capital Research

**Revised Estimates on H1'19 Performance**

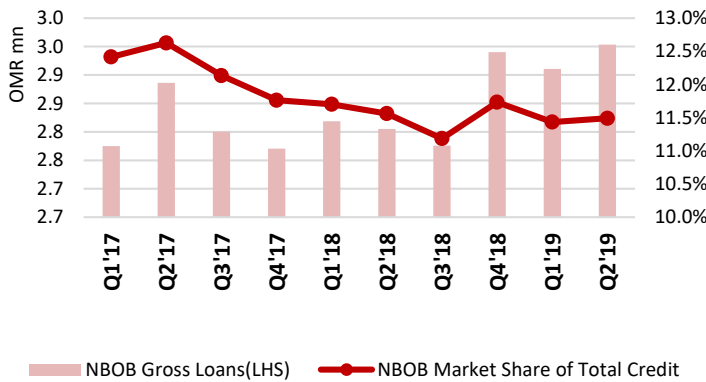
We have revised our estimates for the forecast years based on the bank's performance over H1'19.

Revised Estimates	Old FY19e	New FY'19e	Var (%)
Total Interest Income & Islamic Finance Income	159	170	7%
<b>Total Interest &amp; Islamic Finance Expense</b>	<b>(66)</b>	<b>(77)</b>	16%
Net Interest Income and Income from Islamic Financing	93	93	0%
Other operating income	38	36	-6%
<b>Operating Income</b>	<b>131</b>	<b>129</b>	-2%
Operating Expenses	(62)	(61)	-2%
<b>Operating Profit</b>	<b>69</b>	<b>68</b>	-1%
Net Credit provisions including Banks	(9)	(9)	-4%
<b>PBT</b>	<b>60</b>	<b>59</b>	-1%
Tax	(9)	(9)	2%
<b>PAT</b>	<b>51</b>	<b>50</b>	-2%

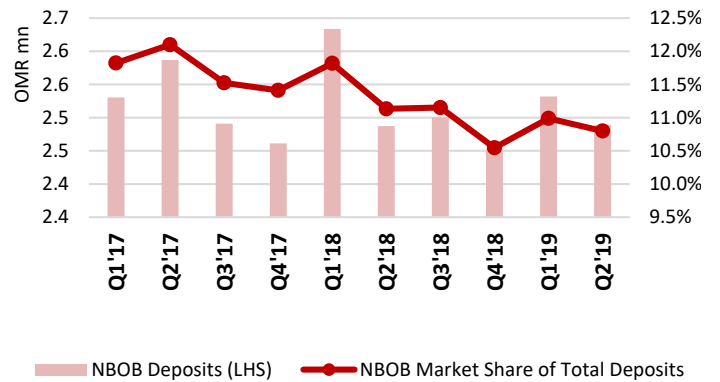
Source: U Capital Research; to access our earlier report please [click here](#)

**Loan and Deposit Snapshot**

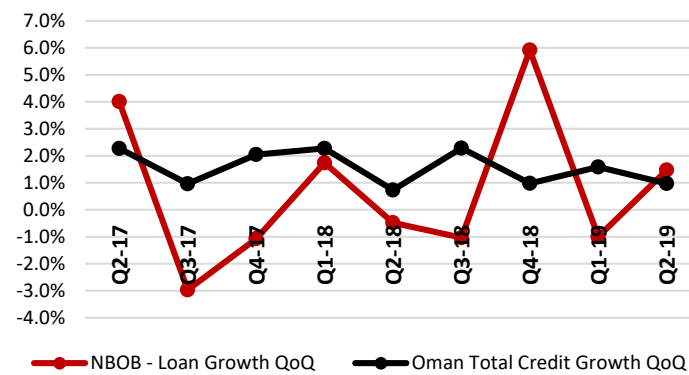
**NBOB: Credit Market Share**



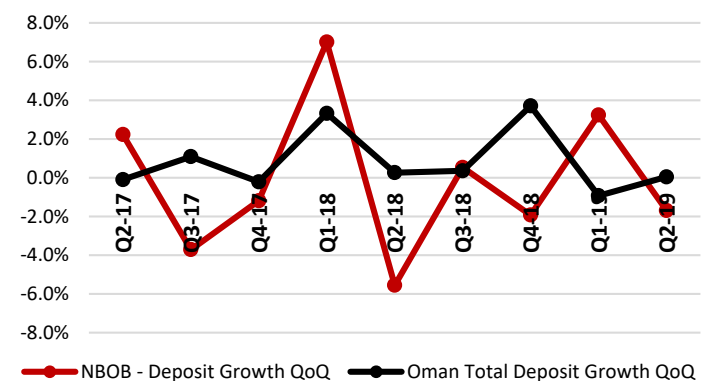
**NBOB: Deposit Market Share**



**NBOB: Loan Growth QoQ vs Sector**



**NBOB: Deposit Growth vs Sector**



Source: Bank Financials, U Capital Research

**Key Financials**

(OMR mn)	2016	2017	2018	2019e	2020e	2021e
<b>Income Statement</b>						
Interest/Financing Income	141	150	159	170	167	176
Interest Expense/Payment to Depositors	(40)	(57)	(67)	(77)	(78)	(84)
<b>Net Interest/Financing Income</b>	<b>102</b>	<b>93</b>	<b>92</b>	<b>93</b>	<b>89</b>	<b>92</b>
Fee & Commission Income	16	19	20	20	22	23
Other Income	19	20	16	16	22	20
<b>Total Non-Interest/Financing Income</b>	<b>35</b>	<b>39</b>	<b>37</b>	<b>36</b>	<b>45</b>	<b>44</b>
<b>Total Operating Income</b>	<b>136</b>	<b>132</b>	<b>129</b>	<b>129</b>	<b>134</b>	<b>135</b>
Provisions expense	(10)	(16)	(7)	(9)	(11)	(12)
Operating Expenses	(63)	(65)	(62)	(61)	(63)	(63)
<b>Profit Before Taxation</b>	<b>63</b>	<b>51</b>	<b>60</b>	<b>59</b>	<b>60</b>	<b>61</b>
Taxation	(8)	(7)	(9)	(9)	(9)	(9)
<b>Net Profit</b>	<b>56</b>	<b>44</b>	<b>51</b>	<b>50</b>	<b>52</b>	<b>52</b>
Net Profit after Interest on Tier 1 Securities	48	35	42	41	42	43
<b>Balance Sheet</b>						
Cash Balances	512	383	315	247	418	437
Deposits with Banks & FIs	115	139	98	155	136	145
Gross Loans & Financings	2,768	2,770	2,940	3,116	3,307	3,512
Loan Loss Reserve	(98)	(117)	(130)	(138)	(147)	(156)
Net Loans & Financings	2,670	2,654	2,810	2,978	3,160	3,356
Net Fixed Assets	46	66	64	64	66	68
Other Assets	189	229	286	(88)	(108)	(96)
<b>Total Assets</b>	<b>3,533</b>	<b>3,470</b>	<b>3,573</b>	<b>3,357</b>	<b>3,672</b>	<b>3,910</b>
Deposits from Banks & FIs	225	126	156	158	179	191
Deposits from Customers	2,399	2,461	2,452	2,539	2,807	3,008
Other Borrowings	398	371	440	116	116	116
Other Liabilities	87	81	104	106	117	124
Paid-up Capital	147	155	163	163	163	163
Retained Earnings	115	135	127	190	201	213
Other Reserves	161	141	131	86	91	96
Shareholders' Equity	423	431	421	438	454	471
Tier 1 Perpetual Notes	116	116	116	116	116	116
<b>Total Equity &amp; Liability</b>	<b>3,533</b>	<b>3,470</b>	<b>3,573</b>	<b>3,357</b>	<b>3,672</b>	<b>3,910</b>
<b>Cash Flow Statement</b>						
Cash from operations	257	(45)	3	(14)	213	61
Cash from investing activities	15	24	3	4	7	7
Cash from financing	(35)	(60)	(68)	(50)	(35)	(35)
Net changes in cash	207	(128)	(68)	(68)	171	19
Cash at the end of period	512	383	315	247	418	437
<b>Key Ratios</b>						
Return on Average Assets	1.4%	1.0%	1.4%	1.4%	1.3%	1.3%
Return on Average Equity	13.6%	10.3%	11.9%	11.7%	11.5%	11.3%
Recurring Income/Operating Income	86.4%	85.1%	87.3%	87.6%	83.3%	85.0%
Interest Earning/Financing Assets Yield	4.9%	4.9%	5.0%	5.1%	4.9%	5.0%
Cost of Funds	1.4%	1.9%	2.2%	2.5%	2.5%	2.5%
Net Spread	3.5%	3.0%	2.8%	2.6%	2.5%	2.5%
Cost to Income Ratio	46.0%	48.8%	47.9%	47.2%	46.7%	46.2%
Net Loans to Customer Deposits	111.3%	107.8%	114.6%	113.2%	112.6%	111.6%
NPLs to Gross Loans	2.7%	4.1%	3.4%	5.3%	5.4%	5.5%
NPL Coverage	132.5%	103.1%	132.0%	83.7%	82.1%	80.6%
Provisions/Total Income	72.0%	88.2%	101.1%	107.4%	109.2%	115.0%
Cost of Risk (bps)	34.7	55.5	24.2	26.8	33.5	33.5
Equity to Gross Loans	19.4%	19.7%	18.2%	17.8%	17.2%	16.7%
Equity to Total Assets	15.2%	15.7%	15.0%	15.1%	14.3%	13.9%
Dividend Payout Ratio	42.3%	52.8%	51.4%	51.9%	50.5%	49.9%
EPS (OMR)	0.038	0.028	0.031	0.031	0.032	0.032
BVPS (OMR)	0.287	0.278	0.259	0.269	0.279	0.290
Adjusted EPS (OMR)*	0.032	0.023	0.026	0.025	0.026	0.026
Market Price (OMR)**	0.215	0.190	0.182	0.187	0.187	0.187
Dividend Yield	7.4%	7.9%	8.8%	8.6%	8.6%	8.6%
P/E Ratio (x)	5.7	6.7	5.8	6.1	5.9	5.8
Adjusted P/E Ratio (x)*	6.6	8.4	7.1	7.4	7.2	7.1
P/BV Ratio (x)	0.75	0.68	0.70	0.69	0.67	0.64

\*Adjusted for Interest Payable on Tier 1 Perpetual Securities

\*\*Market price for 2019 and subsequent years as per latest closing price of 01/10/2019

Source: Bank 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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