

Banking

Maintain BUY: 12M TP @ 0.338

Valuation Summary (TTM)

Price (RO)	0.285
PER TTM (x)	13.1
P/Book (x)	1.2
Dividend Yield (%)	5.3
Free Float (%)	57%
Shares O/S (mn)	7,506
YTD Return (%)	4%
Beta	1.0

(mn)	OMR	USD
Market Cap	2,139	5,557
Total assets	12,776	33,184

Price performance (%)	1M	3M	12M
Bank Muscat SAOG	2%	8%	-6%
MSX 30 Index	0%	3%	4%
Financial Index	0%	3%	6%

Trading liquidity (,000)	1M	3M	6M
Avg daily turnover (RO ,000)	530	372	385
Avg Daily Volume (,000)	1,533	1,342	1,388

52 week	High	Low	CTL*
Price (RO)	0.304	0.146	95.2

* CTL is % change in CMP to 52wk low

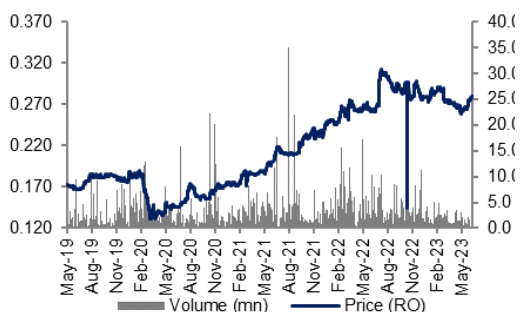
Major shareholders

Royal Court Affairs	23.8%
Dubai Financial Group	11.8%
Civil Service Pension Fund	7.9%
Others	56.6%

Other details

Exchange	MSX
Sector	Banks
Index weight (%)	9.92%

Key ratios	2020	2021	2022
EPS (RO)	0.021	0.024	0.026
BVPS (RO)	0.255	0.269	0.453
DPS (RO)	0.011	0.014	0.015
Payout ratio (%)	52%	59%	58%



Bank Muscat – Strong Performance in 1H23

BKMB reported 2Q23 net profit of RO 53mn, marginally higher than our estimates, driven by strong growth in balance sheet leading to higher net interest income, encouraging results from equity investments, and lower cost to income ratio. BKMB is a prime beneficiary of the gains in economy buoyant by improvement in oil prices. The bank had a remarkable market share of 44% in incremental loan disbursements during 1H23 in the country, solidifying its position as the largest lender who can grow at will. We assume that the loan growth has been triggered by renewed credit demand from a recovery in corporate segment while the bank might have restricted disbursements in retail segment due to relatively low margin environment. BKMB remains confident in maintaining its loan book addition albeit at slow pace for the remaining part of the year, and optimistic on further growth momentum as demand for project financing and retail loans gathers pace in FY24. The bank's focus on leveraging technology to reduce cost is showing favorable results in the form of lower cost to income ratio which has reached 38.8% during 1H23. The management targets to maintain its cost to income ratio within the vicinity of 40%, which we feel is healthy. Operating revenue growth, coupled with lower expenses and stable ECL provisions has resulted in the bank reporting net profit of 104mn during 1H23. We remain upbeat on the revival of lending growth in the country on the back of large-scale projects that are at various stages of planning. The lower price differential between RO and USD loans makes Omani banks more competitive, and target enhanced loan book growth over the medium term.

Economic recovery and project financing to drive credit demand

growth: Bank Muscat anticipates pick up in credit demand from across all sectors going forward. Big ticket projects which were announced in the recent past are likely to achieve financial closure by next year. SMEs used to face cash flow constraints in the past as a result of challenges in collections. Orderly payments to contractors by government agencies now are helping SMEs to enhance their cash flows. We believe that BKMB will continue to cement its leadership position in the incremental loan additions over the medium term. We expect BKMB to focus more on adding corporate credit than retail loans due to narrower spread from cap in lending rates. Management sees improved momentum and quality in new originations going forward as opposed to cashflow constraints and de-risking in the past.

Performance Summary

Amt in RO mn	2021	2022	2023E	2024E	2025E
Loan Book	9,191	9,417	10,176	11,001	11,882
Gross NPL (%)	3.7%	3.7%	3.9%	3.9%	3.9%
Deposits	8,775	8,647	9,252	9,741	10,423
NII	336	345	355	376	417
Non Int. Income	140	158	166	174	183
Operating Income	475	503	520	550	599
PAT	190	201	218	229	247
P/E	19.9	10.6	10.5	10.0	9.1
P/B	0.9	1.2	1.1	1.1	1.0

Ample liquidity to support growth at-will: Bank Muscat enjoys high liquidity with more than 21% of total assets parked in interbank books, T-bills, and CBO deposits. Reduced credit demand during 20-22, cautious approach to lending by the bank, early repayments, deleveraging by sovereign entities and higher savings rate by retail depositors, et al. resulted in the bank building up liquidity in its balance sheet. We do not expect this liquidity to dry out soon, thanks to higher oil prices, and growth in government's non-oil income and receipts from taxes. The loan to deposit ratio of 109% optically looks high, but BKMB's higher liquidity levels should help the bank to recycle its asset mix from relatively low yielding investment book to higher yielding loans in a rising interest rate scenario. Management is comfortable with the liquidity in the system, with the bank having ample liquidity as well to aid ramping up of loan book.

CASA migration to term deposits squeezes spreads, but 2Q23 funding cost in control: Bank Muscat continues to maintain highest market share in saving deposits among Omani banks. Low-cost CASA contributes around 60% of total deposits. We note a marked decline in CASA proportion, which is a function of deposit migration to lock in higher rates for short to medium term maturities. This is a trend that is being witnessed across the sector, and as a result, cost of funds gets pushed higher by 57bps YTD to 2.7%. However, we note that the velocity of rate increases has come down in 2Q23, which witnessed stable CoF as compared to 1Q23.

Partially successful in cost pass through; we expect margin compression in 23-24E; recovery in 25E: Taking support from ample liquidity, 2Q23 witnessed funding costs staying more in control as compared to previous quarters. CoF reached 2.7%, +5bps q/q, while yield and spreads remained stable at 5.25% and 2.55% respectively. We expect further upward push in CoF driven by increasing CASA migration to term deposits during this year, which would put pressure on NIMs to reach 2.53%. We expect rates to start easing by mid-24E, which will help BKMB's NIMs to recover by 15bps as opposed to FY23 levels. This is because we are anticipating the lower rates to reflect immediately in deposits rather than on credit rates. As the rates comes on a declining path, BKMB is likely to open its retail book, which will allow the bank to maintain margins.

Peaked out NPL and provisioning cycle: BKMB reported gross NPL ratio of 3.72%, a tad lower than 3.79% reported a year ago. The bank continued with its conservative provisioning approach, which helped improvement in provision coverage ratio to 151% as at 1H23. The management hinted at stable NPL levels and provisioning expenses, indicating further improvement in provision coverage during the year. We believe that most of the asset quality concerns are over for BKMB and also for Omani banks in general. Risks surrounding property price declines have reduced significantly in the recent past due reduced new supplies into the market and change in demographics in FY23. Despite a decline in new NPL formation, provisioning expenses are likely to remain at elevated levels due to continued cash flow challenges of restructured accounts and slow ECL reversals over the next 12 months. We factor in a y/y decline of 10bps in cost of risk for FY23, and expect it to stabilize at similar levels.

Superior earnings profile to continue; maintain BUY with TP of RO 0.338: We expect improved P&L performance in 2H21 on stable NIM, management's focus on enhancement of investment yield and marginal decline in ECL provisioning expenses. With an improved operating income, lower cost to income ratio and provisioning expenses, we expect the profitability to grow by 8.4% in 23E. Further, we estimate BKMB to report adjusted ROE of 11.2%, and RoRWA of 2.0% in FY24E. The stock is currently trading at 10.4x FY24E adjusted EPS and 1.1x adjusted book value. After the recent capital optimization exercise, we expect BKMB to revert to its 60% dividend payout policy in 23E and beyond, resulting in DPS CAGR of 6% over the next 3 years. Our forecasts suggest DPS reaching 18bz by 25E, leading to dividend yield of 6.3% by 25E. We believe at current price the shares are undervalued and have arrived at blended target price of RO 0.338/Share, implying FY24E P/B of 1.3x, P/E of 12.3x, and dividend yield of 4.9%. We maintain our BUY recommendation on the stock with return potential of 19% from current levels.

Income Statement (RO '000)	2021	1Q22	2Q22	3Q22	4Q22	2022	1Q23	2Q23	2023E	2024E	2025E
Interest Income	444,705	109,488	113,106	118,756	126,726	468,076	133,786	138,467	480,219	522,865	575,051
Interest Expense	-143,020	-36,317	-38,080	-39,903	-48,224	-162,524	-51,233	-54,940	-166,639	-187,230	-203,929
Net Interest Income	301,685	73,171	75,026	78,853	78,502	305,552	82,553	83,527	313,580	335,635	371,122
Non Interest Income	173,795	45,926	53,570	45,405	52,357	197,258	40,650	44,457	206,896	214,523	228,351
Net Operating Income	475,480	119,097	128,596	124,258	130,859	502,810	123,203	127,984	520,476	550,158	599,474
Operating Expenses	-191,459	-50,946	-51,759	-53,477	-51,114	-207,296	-48,702	-48,741	-210,793	-222,814	-245,784
Provision expense	-60,050	-11,461	-16,228	-12,945	-18,380	-59,014	-13,587	-16,318	-53,613	-57,902	-62,534
Profit Before Taxation	223,971	56,690	60,609	57,836	61,365	236,500	60,914	62,925	256,070	269,442	291,155
Tax expense	-34,346	-8,427	-9,615	-8,803	-8,902	-35,747	-9,619	-9,899	-38,411	-40,416	-43,673
Profit for the year	189,625	48,263	50,994	49,033	52,463	200,753	51,295	53,026	217,660	229,025	247,482
Interest on Perpetual Tier I capital	-7,150	-1,763	-3,565	-1,783	-39	-7,150	0	-11,475	-23,101	-23,101	-23,101
Profit attributable to shareholders	182,475	46,500	47,429	47,250	52,424	193,603	51,295	41,551	194,558	205,924	224,381
Balance sheet (RO '000)	2021	1Q22	2Q22	3Q22	4Q22	2022	1Q23	2Q23	2023E	2024E	2025E
Cash and balances with CBO	1,047,224	835,209	951,850	584,607	883,060	883,060	746,238	806,959	859,831	731,931	738,453
Due from banks	765,151	839,017	794,761	830,882	641,480	641,480	689,591	568,055	679,969	720,767	764,013
Loans, advances & financing	9,191,417	9,009,206	9,002,134	9,229,125	9,416,894	9,416,894	9,761,723	9,879,454	10,175,795	11,001,439	11,881,554
Investment securities	1,811,496	1,848,591	1,813,401	1,782,400	1,571,984	1,571,984	1,609,671	1,847,702	1,524,824	1,402,839	1,290,611
Fixed Assets	74,187	70,458	68,004	68,804	68,304	68,304	67,277	69,564	76,111	84,364	93,356
Other Assets	183,063	203,457	228,129	246,681	194,260	194,260	201,822	184,380	212,807	233,208	255,649
Total Assets	13,072,538	12,805,938	12,858,279	12,742,499	12,775,982	12,775,982	13,076,322	13,356,114	13,529,337	14,174,547	15,023,636
Due to banks	1,218,465	931,013	1,001,565	928,378	1,004,106	1,004,106	1,193,859	1,278,344	1,054,311	1,107,027	1,162,378
Customers' deposits	8,774,606	8,853,274	8,833,959	8,708,955	8,646,821	8,646,821	8,991,859	9,083,510	9,252,098	9,741,172	10,423,054
Borrowings	480,979	477,516	436,255	432,262	436,252	436,252	239,347	241,008	436,252	436,252	436,252
Other liabilities	447,644	453,608	458,876	500,500	456,679	456,679	478,418	515,520	476,728	497,779	519,882
Total Liabilities	10,921,694	10,715,411	10,730,655	10,570,095	10,543,858	10,543,858	10,903,483	11,118,382	11,219,389	11,782,230	12,541,567
Paid-up Capital	888,983	906,855	906,855	906,855	906,855	906,855	906,855	906,855	906,855	906,855	906,855
Other Reserves	537,014	535,927	525,594	521,336	552,253	552,253	554,269	577,613	552,253	552,253	552,253
Retained earnings	594,847	517,745	565,175	614,213	267,696	267,696	206,395	247,944	345,519	427,889	517,641
Shareholder's Equity	2,020,844	1,960,527	1,997,624	2,042,404	1,726,804	1,726,804	1,667,519	1,732,412	1,804,627	1,886,997	1,976,749
Tier 1 perpetual subordinated bonds	130,000	130,000	130,000	130,000	505,320	505,320	505,320	505,320	505,320	505,320	505,320
Total Equity	2,150,844	2,090,527	2,127,624	2,172,404	2,232,124	2,232,124	2,172,839	2,237,732	2,309,947	2,392,317	2,482,069
Total Liabilities and Equity	13,072,538	12,805,938	12,858,279	12,742,499	12,775,982	12,775,982	13,076,322	13,356,114	13,529,337	14,174,547	15,023,636
Cash Flow Statement (RO '000)	2021	1Q22	2Q22	3Q22	4Q22	2022	1Q23	2Q23	2023E	2024E	2025E
Cash flow from operating activities	351,893	1,363	87,779	-298,287	-23,529	-233,601	361,604	159,016	95,472	-75,722	81,998
Cash flow from investing activities	-57,950	-27,767	-49,327	-26,924	30,095	-73,923	5,527	15,008	21,136	94,478	82,253
Cash flow from financing activities	-101,478	-107,234	-48,173	0	-3,585	-158,992	-305,096	-11,475	-139,836	-146,656	-157,729
Net change in cash	192,465	-133,638	-9,721	-325,211	2,981	-466,516	62,035	162,549	-23,229	-127,900	6,522
Cash at the end of period	1,395,450	1,261,812	1,252,091	926,880	929,861	928,934	990,969	1,153,518	905,705	777,805	784,327







Key Ratios	2021	1Q22	2Q22	3Q22	4Q22	2022	1Q23	2Q23	2023E	2024E	2025E
Yield on average earning assets	3.8%	3.7%	3.9%	4.1%	4.3%	4.0%	4.5%	4.5%	4.0%	4.1%	4.3%
Cost of funds	1.8%	1.8%	1.9%	2.0%	2.4%	2.0%	2.6%	2.7%	2.1%	2.2%	2.3%
NIM	2.6%	2.5%	2.6%	2.7%	2.7%	2.6%	2.7%	2.7%	2.5%	2.6%	2.7%
Cost to income ratio	40.3%	42.8%	40.2%	43.0%	39.1%	41.2%	39.5%	38.1%	40.5%	40.5%	41.0%
Gross NPL ratio	3.7%	3.7%	3.8%	3.7%	3.7%	3.7%	3.7%	3.7%	3.9%	3.9%	3.9%
Total provision as a % of gross loans	4.9%	5.2%	5.4%	5.5%	5.6%	5.6%	5.6%	5.7%	5.1%	5.0%	5.0%
NPL Coverage	132%	139%	142%	147%	150%	150%	153%	151%	131%	128%	128%
Capital Adequacy	21.3%	20.8%	20.6%	20.4%	21.2%	21.2%	20.5%	20.4%	21.9%	21.4%	21.0%
Interest income/operating income	93.5%	91.9%	88.0%	95.6%	96.8%	93.1%	108.6%	108.2%	92.3%	95.0%	95.9%
Net Equity to Gross Loans	20.9%	20.6%	21.0%	20.9%	17.3%	17.3%	16.1%	16.5%	16.8%	16.3%	15.8%
Net Equity to Total Assets	15.5%	15.3%	15.5%	16.0%	13.5%	13.5%	12.8%	13.0%	13.3%	13.3%	13.2%
Gross Loan to Deposit Ratio	110.1%	107.3%	107.7%	112.1%	115.4%	115.4%	115.0%	115.3%	115.9%	118.9%	120.0%
Net Loan to Deposit Ratio	104.8%	101.8%	101.9%	106.0%	108.9%	108.9%	108.6%	108.8%	110.0%	112.9%	114.0%
ROE	9.8%	9.7%	10.3%	9.7%	11.1%	10.3%	12.1%	12.5%	12.3%	12.4%	12.8%
Adjusted ROE	9.4%	9.3%	9.6%	9.4%	11.1%	9.9%	12.1%	9.8%	11.0%	11.2%	11.6%
ROA	1.5%	1.5%	1.6%	1.5%	1.6%	1.6%	1.6%	1.6%	1.7%	1.7%	1.7%
RoRWA	1.9%	2.0%	2.0%	2.0%	2.1%	2.0%	2.0%	2.0%	2.1%	2.0%	2.1%
BVPS (RO)	0.565	0.522	0.532	0.544	0.230	0.230	0.222	0.231	0.240	0.251	0.263
EPS (RO)	0.056	0.006	0.006	0.006	0.007	0.026	0.007	0.006	0.026	0.027	0.030
DPS (RO)	0.030					0.015			0.016	0.016	0.018
Price	0.484					0.273			0.285	0.285	0.285
P/E (x)	8.6					10.7			11.0	10.4	9.5
P/BV (x)	0.9					1.2			1.2	1.1	1.1
Dividend Yield (%)	6.2%					5.5%			5.5%	5.8%	6.3%

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Rating Criteria and Definitions

Rating	Rating Definitions
 Strong Buy	Strong Buy This recommendation is used for stocks whose current market price offers a deep discount to our 12-Month target price and has an upside potential in excess of 20%
 Buy	Buy This recommendation is used for stocks whose current market price offers a discount to our 12-Month target price and has an upside potential between 10% to 20%
 Hold	Hold This recommendation is used for stocks whose current market price offers a discount to our 12-Month target price and has an upside potential between 0% to 10%
 Neutral	Neutral This recommendation is used for stocks whose current market price offers a premium to our 12-Month target price and has a downside side potential between 0% to -10%
 Sell	Sell This recommendation is used for stocks whose current market price offers a premium to our 12-Month target price and has a downside side potential between -10% to -20%
 Strong Sell	Strong Sell This recommendation is used for stocks whose current market price offers a premium to our 12-Month target price and has a downside side potential in excess of 20%
Not rated	Not rated This recommendation used for stocks which does not form part of Coverage Universe

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