Ahli Bank (ABOB)

Target Price (TP): OMR 0.116

Upside / (Downside): 7%

Rating	**Hold**
Target Price (TP), OMR	**0.116**
Bloomberg Ticker	ABOB OM
Current Market Price (OMR)	0.108
52wk High / Low (OMR)	0.140/0.100
12m Average Vol. (000)	1,432
Mkt. Cap. (USD/OMR Mn)	547/211
Shares Outstanding (mn)	1,950
Free Float (%)	63%
3m Avg Daily Turnover (OMR'000)	28.3
6m Avg Daily Turnover (OMR'000)	20.6
P/E'21e (x)	8.3
P/B'21e (x)	0.7
Cash Dividend Yield '21e (%)	4.0%
Price Performance:	
1 month (%)	(1)
3 month (%)	(5)
12 month (%)	(21)

Source: Bloomberg

Price-Volume Performance

Source: Bloomberg

20th September 2021

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- **After a difficult 2020, Oman's GDP is expected to grow at 2.5% in 2021 with about a 3% average growth over the medium term (Source: IMF), supporting banking sector credit growth outlook.**
- **ABOB is a corporate-oriented bank, while retail branch network development has been on the bank's agenda lately.**
- **ABOB's asset quality has weakened due to the overall macroeconomic situation and covid-19 pandemic.**
- **Rights issuance boosted capital adequacy metrics that had weakened previously; CET1 Ratio continues to remain lowest within the sector**

We increase our **12-month Target Price (TP)** slightly for Ahli Bank (ABOB) to OMR 0.117 per share, on a lower cost of equity as compared to the one we used before when we set the TP at OMR 0.114 per share. The increase is despite a weaker-than-expected operating performance in 2020 and 1H21. Our TP implies a P/E'21 of 8.9x and a P/B'21e of 0.73x, which is equal to the sector average as the bank has weak asset quality metrics and low capital adequacy, despite lower liquidity of shares warranting a higher P/B multiple. The bank had recently strengthened its capital buffers through a rights issue of OMR 30mn. Despite that, its Core Equity Tier 1 (CET1) Ratio at 10.6% as at the end of 1H21 is the weakest amongst peers. CET1 Ratio is important in terms of certainty of dividend payout as the regulator, the Central bank of Oman (CBO) has previously advised banks in Oman to reduce dividend payouts if CET1 ratio is not adequate. Furthermore, a low buffer over the regulatory minimum also leaves the bank vulnerable to asset quality deterioration shocks since its ECL provision as a % of total loans & Islamic financing is also low as compared to peers.

A look at 1H21/2Q21 financial performance

ABOB was able to grow its interest income for 1H21 by about 6%YoY while its interest cost also rose but a little slowly by 5%YoY, resulting in a net interest income growth of 6.2%YoY. Its Islamic finance income grew about 4%YoY, but its Islamic finance cost rose about 60% resulting in a 21%YoY decline in net Islamic finance income (typically about 16-17% of total operating income). The bank's operating income at OMR 39.5mn for 1H21, rose 9%YoY supported by a 54%YoY increase in other operating income.

Other operating income was supported by a notable 17%YoY expansion in net fee and commission income. Further support was provided to other operating income by a one-off gain on sale of investments worth OMR 2.75mn. Operating expenses rose more slowly than income, at about 8%YoY, and supported operating profit growth of 9.4%YoY.

The net Expected Credit Loss (ECL) provision charge rose slightly by about 1.6%YoY, weighing on net profit, which grew by 6.4%YoY. The annualized cost of risk for 1H21 stood at 56bps (FY20: 56bps) as compared to 64bps recorded in 1H20, despite a 14% expansion in Interest Earning Assets (IEAs). It must be noted that the CBO has delayed re-classification of deferred loans until the 30th of September 2021.

The bank's net loans & Islamic financing assets rose 6.5%YoY and 1%QoQ during 2Q21. Its customer deposits have shown a commendable growth of 20%YoY and 1%QoQ. Net loan-to-deposit ratio has contracted to 116% from 131% recorded in 1H20.

Outlook & Valuation

We have factored into our model a notable loan growth for the bank at a CAGR of about 8% over the forecast period, given the positive outlook on GDP growth that the IMF is forecasting. Further, we expect the bank's top-line to grow at about 8%, given that interest rates are expected to rise from 2022e onwards. Operating expenses are expected to largely stay under control. We believe that the bank's cost of risk will stay inflated in 2021e but will ease over the rest of the forecast period, as pandemic-related asset quality delinquencies are resolved supported by a wider macroeconomic recovery.

Key Indicators

Year	FY - 18	FY-19	FY-20	FY-21e	FY-22e	FY-23e
Total Net Loans (OMR mn)	1,871	2,055	2,219	2,369	2,581	2,786
Total Customer Deposits (OMR mn)	1,712	1,925	2,031	2,214	2,391	2,558
Operating Income (OMR mn)	62	70	71	75	82	89
Net Profit (OMR mn)	29	31	24	25	30	33
Diluted EPS (OMR)	0.019	0.020	0.015	0.013	0.015	0.017
Diluted BVPS (OMR)	0.170	0.169	0.160	0.160	0.170	0.181
P/E (x)	7.6	6.6	8.7	8.3	7.1	6.3
P/BVPS (x)	0.9	0.8	0.8	0.7	0.6	0.6
Dividend Yield (Cash + Stock)(%)	10.3%	11.5%	3.9%	4.0%	4.7%	5.3%

Source: Company Financials, U Capital Research

** Market price for the current and subsequent years as per the latest closing price of 20-Sep-2021*

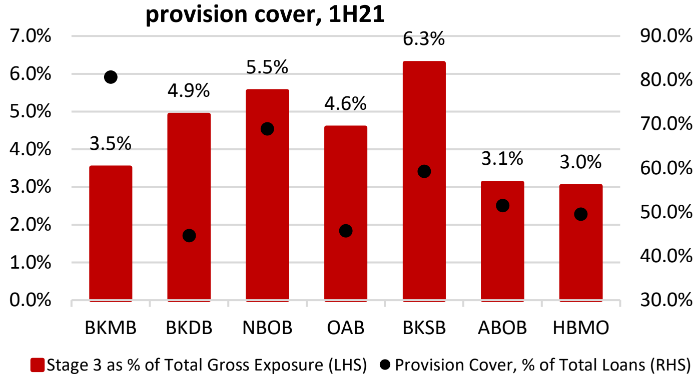
Asset quality pressures to ease from 2022e onwards

ABOB's asset quality has been under pressure from an already tough operating environment that has been exacerbated by the covid-19 pandemic. The bank's Stage 3 loans ratio rose to 3.1% at end-1H21 from 2.9% at end-2020 and 1.7% at end-2019. We believe that this understates the true extent of asset quality deterioration, given the large share of borrowers currently benefiting from the temporary Loan Deferral Programme as advised by the regulator (CBO) and regulatory forbearance on loan re-classification. Payment deferrals were introduced last year in the wake of the covid-19 pandemic and the Programme expiry deadline has been extended since then. The current deadline is September 30th, 2021.

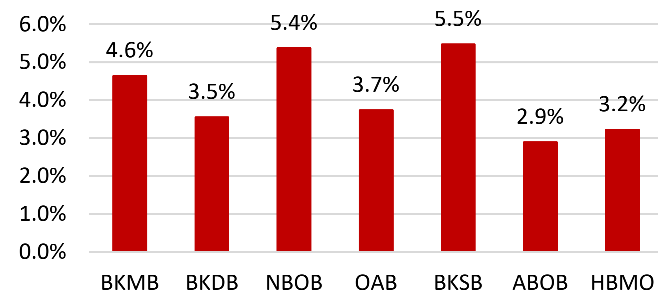
ABOB's asset quality metrics are currently stronger than peers, with one of the lowest NPL ratio within the sector, but provision for Stage 3 loans is relatively low at 52% as compared to peers. With a stable cost of risk since end-4Q20, the bank seems content with its provision buffers, but its total provision as a % of total Loans & Islamic Financing at about 2.9% is the lowest amongst peers, which renders the bank vulnerable to credit migration in 2021e.

We expect ABOB's cost of risk to stay close to 65bps in 2021e vs. 56bps at end-1H21 and 45bps at end-FY20, before tapering off over the forecast period on the anticipated economic recovery.

Stage 3 Exposure of banks and corresponding provision cover, 1H21



Oman Banks: Total Provision as % of Total Loans & Islamic Financing

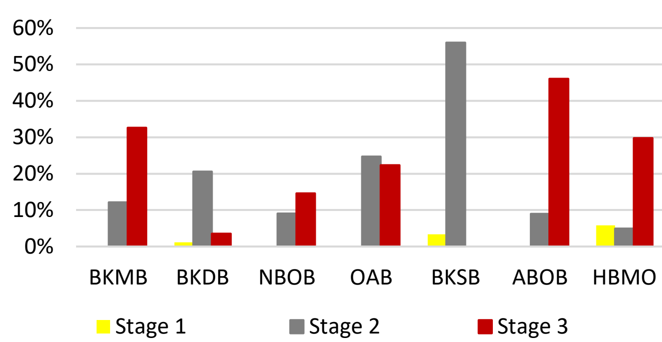


Source: Bank Financials, U Capital Research

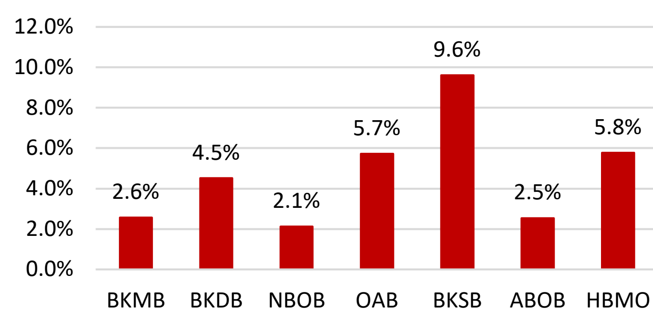
Based on principal and related balances, the total amount of borrowers that had elected to enter the deferrals Programme was a high 50% of gross loans at end-FY20 but has now dropped to 20% at end-1H21, which is a positive development. However, it must be noted that almost a half of restructured loans (2.5% of total) are classified as Stage 3 loans under IFRS-9.

We believe that the expiration of deferrals (currently expected at the end of September) poses a sizeable risk to asset quality metrics of the bank despite a fall in the deferred amounts.

Oman Banks: Stage-wise Restructured Loans as % of Total Loans & Islamic Financing



Oman Banks: Restructured Loans as % of Total Loans & Islamic Financing

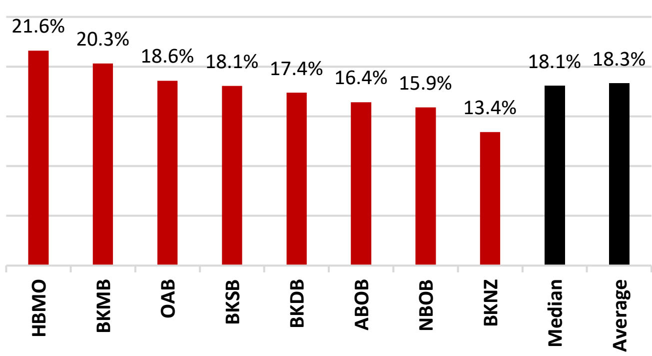


Source: Bank Financials for 1H21, U Capital Research

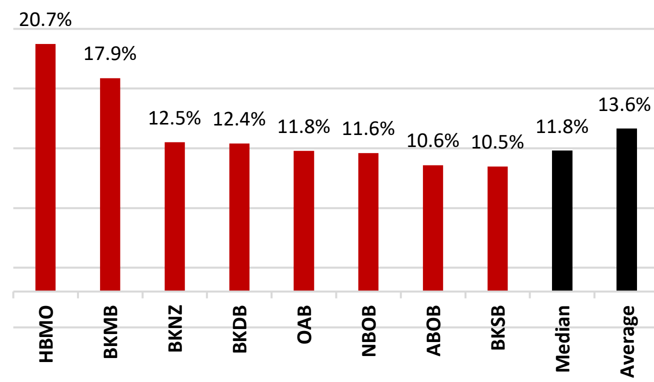
Capital adequacy is adequate; CET1 Ratio lowest amongst peers…

Despite raising OMR 30mn through rights issue during 1Q21 in order to strengthen its capital ratios, (ABOB's Core Equity Tier 1 (CET1) Ratio had been the lowest within the peer group at end-FY20), the bank's CET1 Ratio continues to be the lowest amongst peers, while still higher than the regulatory minimum of 8.25%. CET1 Ratio is important in terms of certainty of dividend payout as the regulator, the Central bank of Oman (CBO) has previously advised banks in Oman to reduce dividend payouts if CET1 ratio is not adequate. Furthermore, a low buffer over the regulatory minimum also leaves the bank vulnerable to asset quality deterioration shocks since its ECL provision as a % of total loans & Islamic financing is also low as compared to peers.

Total Capital Adequacy Ratio, 1H21



Core Equity (CET1) Ratio, 1H21



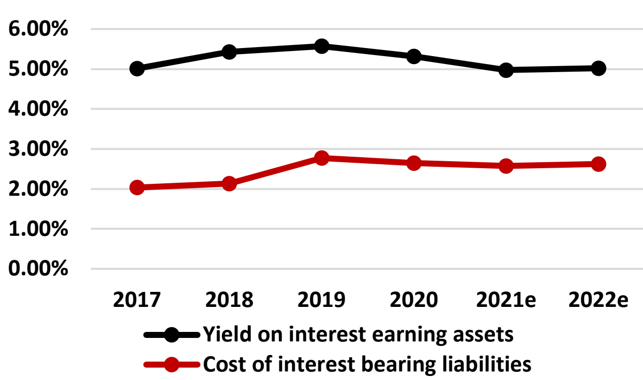
Source: Bank Financials; BKNZ is currently undergoing capital raising activity through rights issue as at the date of publishing while Sohar International Bank successfully raised OMR 55.6mn recently.

The bank's Tier 1 and Total Capital Adequacy Ratio are adequate at 15.6% and 16.4% respectively, supported by issuance of additional Tier 1 instruments.

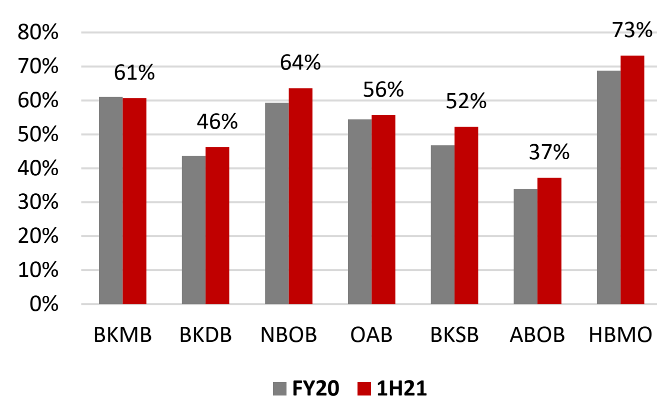
Reliance on costlier deposits reduced during 1H21…

ABOB supported its net interest margin during 1H21 through raising its share of low-cost CASA deposits during 1H21. Even though the bank's CASA Ratio is still the lowest within its local peers, it has improved from 34% at end-2020 to 37% at end-1H21, reflecting conscious effort to improve the bank's profitability through low-cost deposits. We believe that the bank's net interest margin will further improve once interest rates begin to rise.

ABOB: Spreads



Oman Banks: CASA %



Source: Bank Financials, U Capital Research

Valuation Assumptions & Sensitivity Analysis

We have used a risk-free rate of 5% (April'21: 5.25% vs. May'20: 7.3%) US risk premium of 9% (previously: 7.9%), and a 2-yr weekly adjusted Beta of 0.8 (Source: Bloomberg). Our base case cost of risk assumption for the year 2021e is 60bps vs previous estimate of 50bps, while our assumption for average peer-group P/B multiple is 0.73x for 2021e. We have assigned a weightage of 80% to excess return methodology and 20% to P/B multiple-based approach.

Ahli Bank

Equity invested currently, OMR'000	291,766				
OMR'000	**FY-21e**	**FY-22e**	**FY-23e**	**FY-24e**	**FY-25e**
Net Income	25,431	29,780	33,495	36,480	39,621
Less: Equity Cost	32,813	38,636	41,094	43,859	46,870
Excess Equity Return	**(7,381)**	**(8,856)**	**(7,599)**	**(7,379)**	**(7,249)**
Present value of Excess Equity Return	**(7,143)**	**(7,623)**	**(5,819)**	**(5,027)**	**(4,393)**
Sum of present value of Excess Return	**(30,005)**				
Terminal value					
Book value of equity at start of year 6	**403,947**				
Net income in Stable period	44,434				
Less equity cost	48,878				
Excess return	(4,443)				
Terminal Value	(57,895)				
PV of Terminal Value Above	**(35,085)**				
Total Equity value (OMR '000)	**226,675**				
Total shares out (mn)	**1,949,660**				
Target Price (OMR)	**0.116**				
Upside / (Downside)	**7.4%**				
Peer-Group Multiple Based Valuation					
Peer Group P/B'21e	0.73				
BVPS'21e	0.160				
Target Price (OMR)	**0.117**				
Upside / (Downside)	8.3%				
Weighted Average Target Price (OMR)	**0.116**				
Current price (OMR)	0.108				
Upside / (Downside)	**7.4%**				

Source: U Capital Research

Our target price (TP) is sensitive to 10bps changes in cost of risk from our base case scenario for 2021e, with TP increasing/decreasing by +3%/-3% with every +10bps/-10bps change in cost of risk.

Our TP is not sensitive to 50bps changes in cost of equity from our base case scenario for 2021e, with TP dropping/rising by only about 1-2% with every 50bps increase/decrease in cost of risk.

With the first 0.5x increase/decrease in peer-group average forward P/B multiple, our TP increases/decreases by about +/-2%. With the next 0.5x change, it increases/decreases by +/-1%.

ABOB

Cost of Equity	Cost of Risk '21e, bps: 45	55	65	75	85
11.4%	0.125	0.122	0.119	0.115	0.112
11.9%	0.124	0.121	0.118	0.114	0.111
12.4%	0.123	0.119	**0.116**	0.113	0.110
12.9%	0.121	0.118	0.115	0.112	0.109
13.4%	0.120	0.117	0.114	0.110	0.107

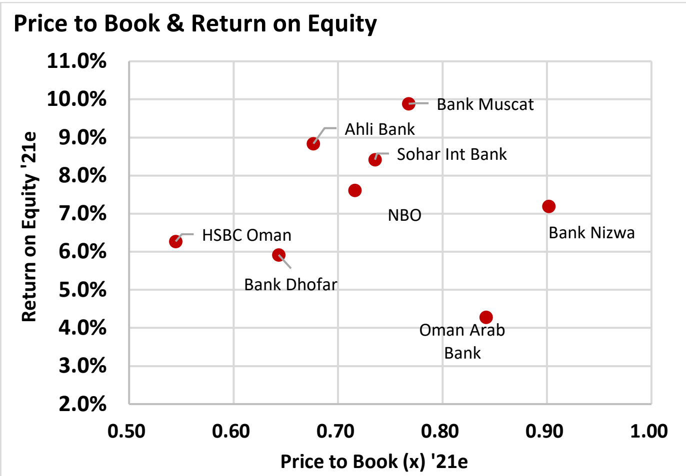
Cost of Equity	Peer-Group Average P/B'21 Multiple: **0.63**	**0.68**	**0.73**	**0.78**	**0.83**
10.4%	0.117	0.119	0.120	0.122	0.123
11.4%	0.115	0.117	0.119	0.120	0.122
12.4%	0.113	0.115	**0.116**	0.118	0.119
13.4%	0.111	0.112	0.114	0.115	0.117
14.4%	0.107	0.109	0.111	0.112	0.114

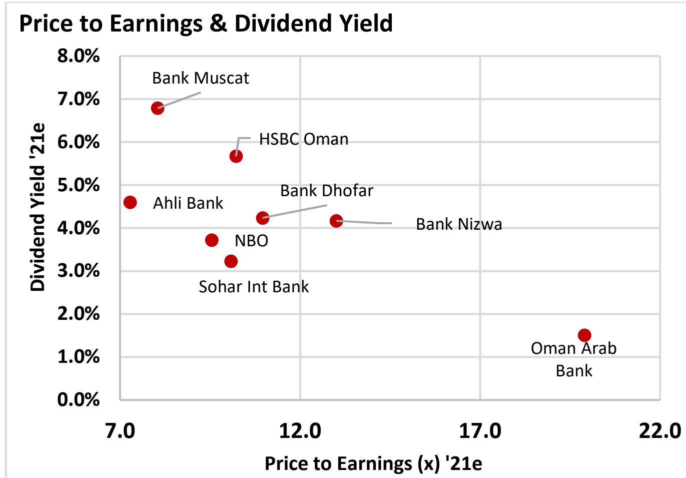
Key Risks

The key downside risks to our valuation are: (1) continuing uncertainty surrounding the duration of the coronavirus impact (2) Deterioration in macroeconomic indicators warranting a rise in cost of equity (3) Higher-than-expected level of loan re-classification once regulatory measures unwind.

Upside risks include better-than-expected economic recovery along with improvements in asset quality metrics.

Peer Group Valuation





Source: Bloomberg, U Capital Research

Name	Mkt Cap (OMR mn)	Last Px (OMR)	Px Change 1M, %	Px Change 3M, %	Px Change YTD, %	Current P/B	P/B'21e, (x)	P/E'21e, (x)	ROE'21e, (%)	Cash Div Yield'21e, %
Bank Muscat	1,579.9	0.442	0	7	23	0.82	0.77	8.0	9.9%	6.8%
Bank Dhofar	353.6	0.118	-2	-4	22	0.66	0.64	11.0	5.9%	4.2%
Oman Arab Bank	308.8	0.185	0	6	-3	0.86	0.84	19.9	4.3%	1.5%
NBO	305.7	0.188	0	-5	18	0.71	0.72	9.5	7.6%	3.7%
Sohar Int Bank	227.5	0.093	1	-6	2	0.67	0.74	9.3	8.4%	3.2%
Ahli Bank	210.6	0.108	-1	-5	-15	0.72	0.68	8.3	8.8%	4.0%
HSBC Oman	184.0	0.092	-1	-14	1	0.55	0.54	10.2	6.3%	5.7%
Bank Nizwa	144.8	0.096	0	-1	0	0.88	0.90	13.0	7.2%	4.2%
Average						**0.73**	**0.73**	**11.2**	**7.3%**	**4.2%**
Median						**0.72**	**0.73**	**9.9**	**7.4%**	**4.1%**

Source: Bloomberg, U Capital Research

Key Financials

(OMR mn)	FY - 18	FY-19	FY-20	FY-21e	FY-22e	FY-23e
Income Statement						
Interest/Financing Income	108	125	131	132	144	158
Interest Expense/Payment to Depositors	(56)	(68)	(71)	(71)	(77)	(85)
Net Interest/Financing Income	**52**	**57**	**60**	**62**	**67**	**73**
Fee & Commission Income	-	10	8	8	9	9
Other Income	10	13	11	13	15	16
Total Non-Interest/Financing Income	**10**	**13**	**11**	**13**	**15**	**16**
Total Operating Income	**62**	**70**	**71**	**75**	**82**	**89**
Operating Expenses	(23)	(28)	(30)	(31)	(34)	(37)
Operating Profit						
Provisions expense	(5)	(6)	(14)	(15)	(14)	(14)
Profit Before Taxation	**34**	**36**	**27**	**29**	**34**	**38**
Taxation	(5)	(5)	(3)	(3)	(4)	(4)
Net Profit	**29**	**31**	**24**	**25**	**30**	**33**
Interest on Tier 1 Perpetual Securities	(4)	(9)	(9)	(9)	(9)	(9)
Net Profit Attributable to shareholders	**25**	**22**	**15**	**17**	**21**	**25**
Balance Sheet						
Cash Balances	153	108	79	67	57	49
Deposits with Banks & FIs	24	50	46	59	65	70
Net Loans & Islamic financing	**1,871**	**2,055**	**2,219**	**2,369**	**2,581**	**2,786**
Investments	214	258	306	327	356	385
Net Fixed Assets	17	21	23	25	28	30
Other Assets	11	25	29	29	29	29
Total Assets	**2,290**	**2,519**	**2,702**	**2,876**	**3,115**	**3,349**
Deposits from Banks & FIs	147	198	135	143	156	168
Islamic Deposits	197	207	285	301	328	355
Conventional Deposits	1,465	1,505	1,639	1,730	1,885	2,036
Total Customer Deposits	**1,662**	**1,712**	**1,925**	**2,031**	**2,214**	**2,391**
Other Borrowings	77	144	172	181	196	210
Other Liabilities	46	76	82	87	95	102
Total liabilities	**1,931**	**2,129**	**2,314**	**2,441**	**2,660**	**2,871**
Paid-up Capital	150	157	165	195	195	195
Retained Earnings	55	55	47	61	78	97
Other Reserves	50	53	52	55	58	62
Shareholders' Equity	**255**	**265**	**264**	**311**	**331**	**353**
Tier 1 Perpetual Notes	104	124	124	124	124	124
Total Equity & Liabilities	**2,290**	**2,519**	**2,702**	**2,876**	**3,115**	**3,349**
Cash Flow Statement						
Cash from operations	10	12	50	(10)	31	35
Cash from investing activities	(2)	48	50	23	32	31
Cash from financing	25	(9)	(30)	21	(10)	(11)
Net changes in cash	37	(45)	(29)	(12)	(10)	(7)
Cash at the end of period	153	108	79	67	57	49
Key Ratios						
Return on Average Assets	1.3%	1.3%	0.9%	0.9%	1.0%	1.0%
Return on Average Equity	11.3%	11.9%	9.1%	8.8%	9.3%	9.8%
Net Interest & Islamic Finance Income / Operating In	83.8%	81.8%	84.1%	82.1%	82.2%	82.2%
Other operating income / Operating Income	16.2%	18.2%	15.9%	17.9%	17.8%	17.8%
Net fee Income/Operating Income	0.0%	14.3%	10.7%	10.7%	10.7%	10.7%
Interest Earning/Financing Assets Yield	5.4%	5.6%	5.3%	5.0%	5.0%	5.1%
Cost of Funds	2.1%	2.8%	2.6%	2.6%	2.6%	2.7%
Net Spread	3.3%	2.8%	2.7%	2.4%	2.4%	2.4%
Cost to Income Ratio	37%	40%	42%	42%	42%	42%
Net Loans & Islamic Financing to Customer Deposits	112.6%	120.1%	115.3%	116.6%	116.6%	116.5%
Non Performing Loans, OMR mn	33	36	67	78	85	92
NPLs to Gross Loans & Islamic financing	1.7%	1.7%	2.9%	3.2%	3.2%	3.2%
NPL Coverage, %	104.9%	114.0%	88.1%	87.5%	88.8%	90.1%
Cost of Risk, bps	25.7	26.3	58.4	65.0	55.0	50.0
Shareholders' Equity to Total Loans & Islamic Financi	0.13	0.13	0.12	0.13	0.12	0.12
Shareholders' Equity to Total Assets, x	0.11	0.11	0.10	0.11	0.11	0.11
Capital Adequacy Ratio, %	17.5%	16.9%	15.7%	17.3%	16.6%	16.0%
EPS, OMR	0.019	0.020	0.015	0.013	0.015	0.017
BVPS, OMR	0.170	0.169	0.160	0.160	0.170	0.181
Market Price, OMR*	0.146	0.130	0.127	0.108	0.108	0.108
Cash Dividend Payout Ratio, %	52.0%	50.7%	34.4%	33.5%	33.5%	33.5%
Cash Dividend Yield, %	6.8%	7.7%	3.9%	4.0%	4.7%	5.3%
P/E Ratio, x	7.6	6.6	8.7	8.3	7.1	6.3
P/BV Ratio , x	0.9	0.8	0.8	0.7	0.6	0.6

*Market price for current year and subsequent years as per the closing price on 20-Sep-2021

Source: Company Financials

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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