Oman Banking Sector Report

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Oman Banking Sector

- Conservatism to take backseat as credit outlook improves

We are of the view that conservatism (which was witnessed in Q1'10) should continue in the short-term but buoyant macro dynamics; strong government spending and active tendering activities makes us believe that latter part of FY10 will witness improved credit off-take. We, thus forecast credit growth of 10% in FY10.

- Deposit buildup to meet long-term credit demand

We believe diminishing interest rates will still induce banks to expand deposit base to feed long-term credit growth. Thus, we have assumed 15% deposit (including CDs) growth for FY10.

- Domestic loan book quality issue prolongs

We remain cautious of local loan portfolios as listed banks have exponentially grown its relatively riskier retail loan book. Thus for FY10 we expect NPL/GL ratio to remain at FY09 levels of 4.63%, for our coverage universe.

Coverage Universe	CMP (RO)	Target Price (RO)	Upside/ Downside	Rating
Bank Muscat	0.789	1.12	42.8%	BUY
NBO	0.331	0.402	21.3%	BUY
Bank Dhofar	0.76	0.606	-20.3%	SELL
Ahli Bank	0.266	0.299	12.3%	BUY
Bank Sohar	0.211	0.276	30.7%	BUY
OIB	0.287	0.271	-5.5%	HOLD

Top Pick: Bank Muscat

Bank Muscat is our top pick as we see its net profit in FY10 to grow the maximum (among local peers) by 63% on the back of cleaner balance sheet from regional exposures. Moreover, we believe that Bank Muscat is better placed to benefit from the uptick in infrastructure development activities in the medium-term. On a relative basis (among local peers), with a FY10 ROE of 15.8% (vs. 13%) and P/BV of 1.31x (vs. 1.7x), Bank Muscat seems to be a better contender. We thus reiterate our target price at RO 1.12 per share (upside of 42.8%) and maintain **BUY** rating on Bank Muscat.

Other stocks we like: NBO; Ahli Bank and Bank Sohar

NBO: Although we believe the benefit of reduction in overall interest rates and lower dependency on costlier time deposits will improve spreads by 14bps (to 3.5%) in FY10. But we remain cautious on deteriorating domestic asset quality which will keep credit growth subdued. However, NBO continues to remain a valuation play. At FY10 P/BV multiple of 1.33x, NBO is relatively cheaper compared to domestic industry average of 1.7x, thereby making it a compelling **BUY.** Based on our revised earnings estimates due to absence of regional exposure, we raise our target price from RO 0.365 to RO 0.402, with an upside potential of 21.3%.

Ahli Bank: Even though Ahli Bank's FY10 P/BV of 1.84x, is slightly higher compared to domestic industry average of 1.7x but in our view the stock offers the highest credit growth, thus we upgrade the stock from HOLD to **BUY** and based on our revised earnings estimate, we give a target price of RO 0.299, with potential upside of 12.3%.

Bank Sohar: Similar to Ahli Bank, FY10 P/BV multiple for Bank Sohar at 1.8x is close to local banking sector average of 1.7x. We believe Bank Sohar is a long-term story and being in expansion phase has higher potential for balance sheet growth, thus we initiate Bank Sohar with a **BUY** rating and a target price of RO 0.276 (30.7% upside potential).

Sell on Bank Dhofar

Bank Dhofar corporate portfolio is well diversified and less risky, which further increases its scope to expand corporate loan book as infrastructure spending trickles down to various sectors. But based on FY10 P/BV multiple at 2.7x Bank Dhofar is expensive amongst local peers, thereby making it less attractive. Moreover, we believe that the stock has already moved upwards and adjusted for higher growth expectation and thus based on our target price of RO 0.606 per share (downside of 20.3%) we downgrade our rating on Bank Dhofar from HOLD to **SELL**.

Hold on OIB

Slower growth in loan book (compared to peers) together with higher susceptibility to recoveries of already high NPL make us cautious but its dividend per share being on the higher side makes this a good defensive stock, we thus maintain **HOLD** rating for OIB (target price of RO 0.271, with a downside of 5.5%).

Sector Outlook

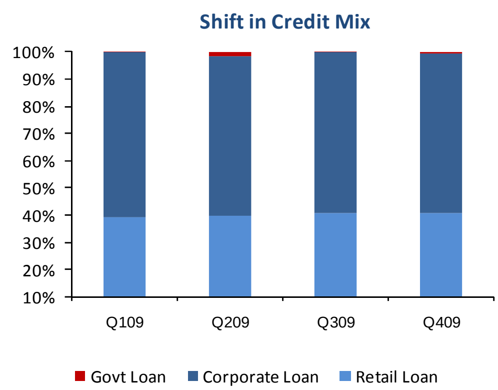
During the financial crisis, Central Bank of Oman's (CBO) strong and proactive regulatory framework helped Omani Banks to sail through the difficult times. We believe the nascent stage of real estate and prudent banking strategy has placed Oman economy and banking sector in a relatively better position in comparison to other GCC countries.

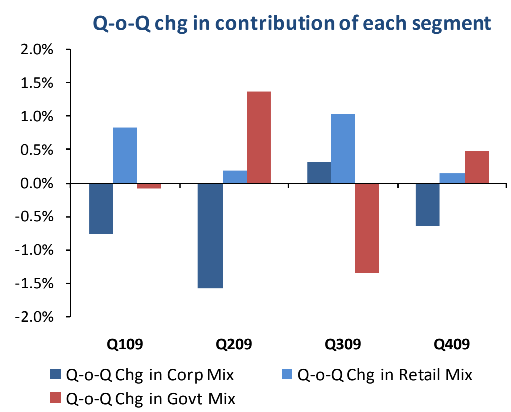
Due to prompt disclosures of cross-border exposures (Saudi conglomerate and Dubai World), domestic banks were able to regain regional and foreign investor's confidence. Moreover by fully providing for Saudi exposures, Omani Banks now have a strong and clean balance sheet. But we believe there are host of factors that will influence the banking sector performance.

✓ *Conservatism to take backseat as credit outlook improves*

In H1'09 there was slowdown in credit off-take as banks were facing a bigger challenge of maintaining deposit growth. In the latter part of 2009, the liquidity pressure eased out but credit growth remained subdued, as an outcome of greater risk-aversion by banks. Similar trend continued in Q1'10 and thus combined loan book growth (at system level) has been dull with a change of 1.67% q-o-q.

During the financial crisis retail portfolio was in spotlight, thus retail loan contribution in FY09 increased sequentially at an average q-o-q rate of 3% vs. 0.4% for corporate book. Due to unavailability of consolidated sectoral breakup for Q1'10, we look at the figures of all 6 listed banks. In Q1'10 trend slightly reversed, with all listed banks (except NBO) posting a marginal hike in personal lending of 1% as compared to 1.3% hike in corporate space.





Source: CBO report, OABINVEST

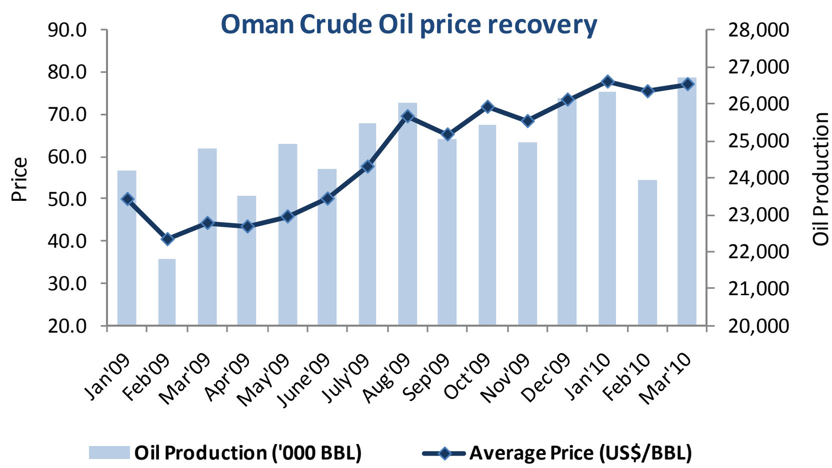
In Q1'10, Bank Muscat, Bank Dhofar and Oman International Banks' (OIB) corporate book on quarterly basis receded by 1.5%, 0.3% and 1.6% q-o-q, respectively. Smaller banks - Ahli Bank and Bank Sohar were focusing more on corporate lending to capture market share from other banks which were following conservatism. After reducing corporate exposure consecutively for four quarters, National Bank of Oman (NBO) opened its doors for corporates and thus achieved a 3.8% q-o-q growth.

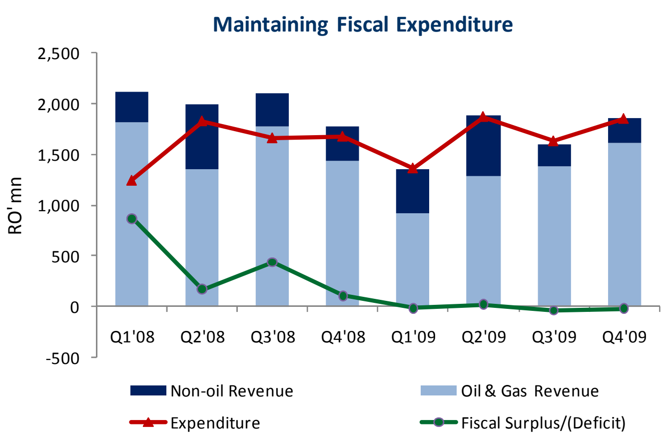
✓ *Demand pull factors in place for corporate loan revival*

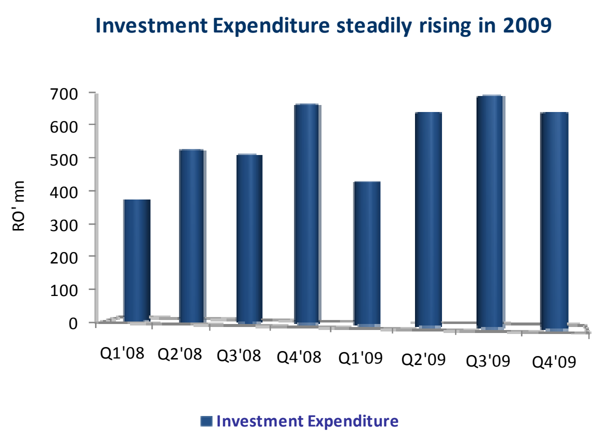
With revival of economy and consumer confidence, we assume corporates will come out of their cost cutting mode which will result in rise in working capital requirement. Additionally considering the lower interest rate regime, we think corporates will revisit and revaluate their on-hold expansion plans, which increase the probability of opening more credit-lines. This makes us bullish on corporate side demand factors.

✓ *Macro dynamics are buoyant*

Recovering oil prices created room for higher spending than envisaged in the budget. Even during economic turmoil, Oman's government continued its spending spree to stimulate local economy, which in our view is essential for turnaround. Thus actual total investment expenditure for the full year 2009 at RO 2,368mn is 23.4% higher to the budgeted figures. For 2010, budgeted investment expenditure will increase by 11% y-o-y (over 2009 budgeted figures) to RO 2,128mn. Taking cue from 2009 continuous fiscal spending and oil price recovery we are optimistic about infrastructure spending. We believe more exploration activities planned for the year and government's consistent investment expenditure will gradually translate into higher credit off-take in the latter part of FY10.

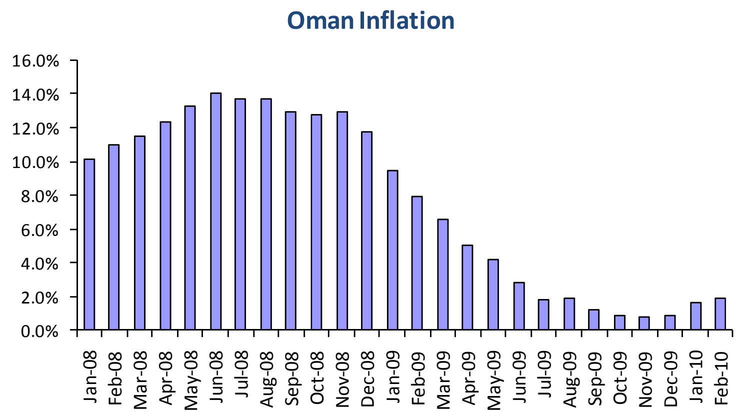






Source: Ministry of National Economy, OABINVEST

As per Tender Board announcements, total tenders awarded in Q1'10 is RO 0.5bn which is 71.4% higher compared to same period last year. We expect although with a lag impact the series of new tender announcements in H2'09 and this year together with government's intention to increase oil & gas production, will translate into sustained capital expenditure, which will instigate loan book growth. Moreover as projects become more viable in declining inflation scenario, it should boost overall investments in the economy.



Source: Ministry of National Economy

Unlike other regions, most of the mega projects in Oman (like - development of free zones and expansion of port facilities and airports), are need based thus probability of their continuation is higher, which makes us further optimistic about demand-side factors for loan growth. Its note worthy that with gradual improvement in sentiment and rise in government's infrastructure spending, the contribution of construction loans to total loan book of commercial banks increased from 8.3% in Q1'09 to 8.6% in Q2'09 and then stabilized at 9.1% in subsequent two quarters.

✓ ***Conservatism will vanish over medium term***

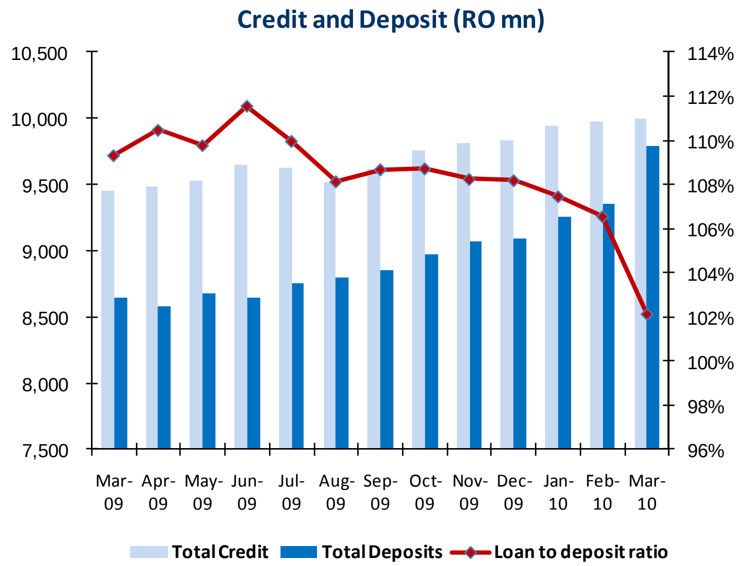
Although the lower lending ratio (averaging around 80% for all listed banks in Q1'10) and strong average capital adequacy ratio of around 15%, (which is higher than the regulatory requirement of 10%) gives enough scope of credit growth. But considering the fact that Q1'10 credit growth has been modest, we still believe that despite of encouraging macro indicators banks will remain in cautious mode in H1'10 and will continue to concentrate on loan quality, which will limit the overall credit growth.

Smaller asset base of Omani banks leads to high reliance on foreign bank participation essential for successful financial closure of larger syndications in the country. We believe as confidence in the inter-bank markets has taken a beating, access to syndicated loans will take longer to resume. This will further curtail corporate loan growth in near term. We envisage latter part of FY10 will witness improved credit off-take as banks will become less conservative. Thus we have conservatively assumed 10% y-o-y consolidated credit growth for FY10. In FY11, we expect loan book will grow in a healthier way as banks will reduce risk aversion.

- ***Margin preservation through liability management will take forefront***

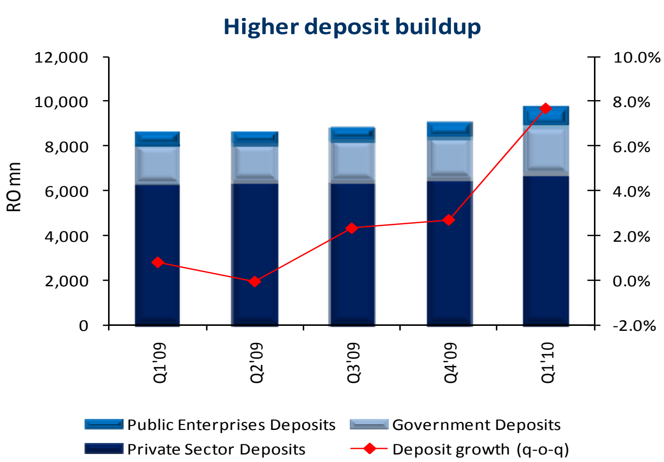
✓ ***Deposit buildup to meet long-term credit demand***

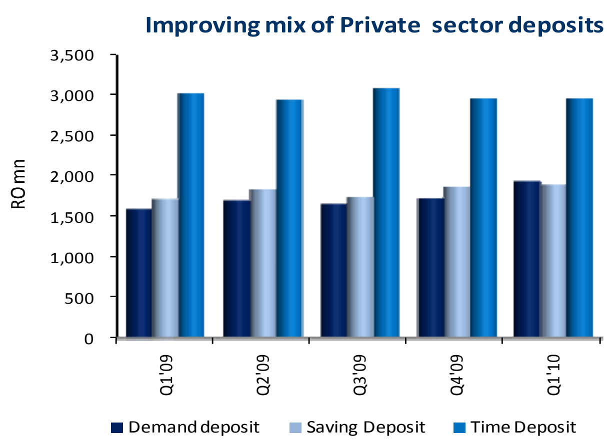
Taking benefit of lower interest rates, banks strategically increased deposit base, thereby at consolidated level in Q1'10 overall deposits (at RO 9.8bn; +7.7% q-o-q) constituted 65.8% of total liabilities, as compared to the average of 63% in Q1'09 and 64% in Q4'09. Owing to deposit base expansion, loan-to-deposit ratio of the banks at system level improved from 109.3% in Q1'09 to 108.2% in Q4'09 and further to 102% in Q1'10.



Source: CBO report, OABINVEST

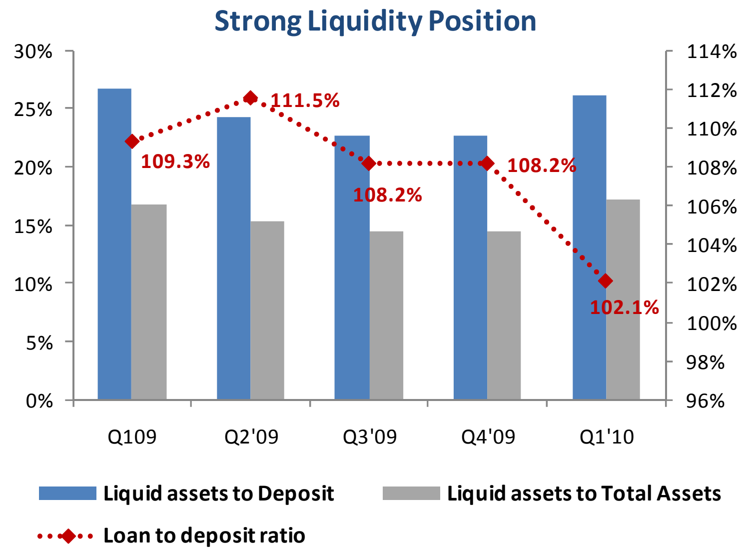
As an aftermath of Omani bank's conscious efforts to reduce cost, private sector time deposits plunged by 4.2% q-o-q in Q4'09 and remained flattish in the subsequent quarter. In line with the trend, other than Bank Muscat and Bank Sohar all other listed banks in Q1'10 shifted gears from high cost term deposits to cheaper deposits. Since Bank Muscat's term deposits proportion historically has been lower than the peer average, the bank took advantage of further downfall in interest rates and tried to better manage maturity mismatch issues. On the other hand, Bank Sohar replaced its matured CDs with long-term deposits, thereby increasing its proportion to 67.7% in Q1'10 from 63.7% in Q4'09.





Source: OABINVEST, CBO

Improvement in consolidated loan-to-deposit ratio from 109% in Q1'09 to 102% in Q1'10, reflects that core funding is stable and banks are in a comfortable position with sufficient liquidity to fuel loan growth. Further higher Liquid assets-to-Deposit ratio and Liquid assets-to-Total assets in Q1'10 at 26% and 17%, respectively, gives us confidence that at a later stage these assets can be converted to higher-yielding loans.

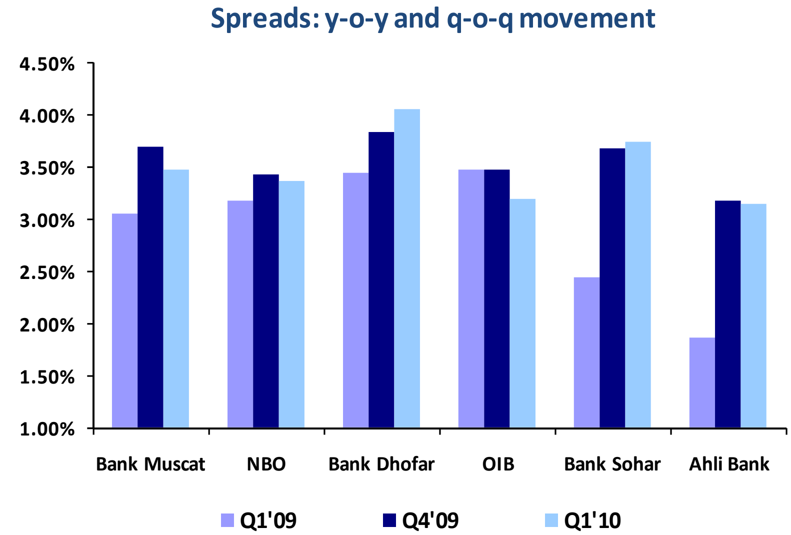


Source: OABINVEST, CBO

Although Omani Banks have adequate liquidity, but we believe diminishing interest rates will still induce banks to expand deposit base to feed long-term credit growth. Thus for our coverage universe (which consists of all 6 listed Omani banks), we have assumed 15% deposit (including CDs) growth for FY10, which is higher than the loan book growth of 10% for the same period. In our view, in FY11 the banks will utilize the low cost deposit build up of FY10 to furnish improved loan demand, as a result the balance sheet trend will reverse. Thus we foresee that in FY11 domestic banks lending growth at 12.3% will outpace deposit growth of 11%.

✓ ***Downward re-pricing of loan book outweigh low cost deposit build-up***

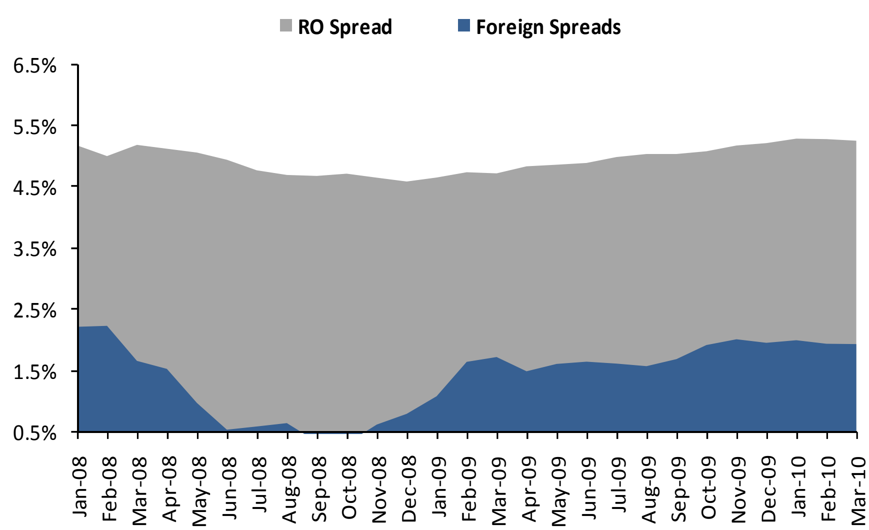
Quarterly performance of Bank Dhofar reflects that 75.5% of q-o-q deposit net additions in Q1’10 pertains to low cost deposits, which led to 31bps q-o-q decline in funding cost. Moreover, as drop in gross yields (-9bps) was lowest compared to -31bps for its peers, thus Bank Dhofar topped the charts with a spread of 4.05%. In Q1’10 as Bank Sohar maintained its last 4 quarters trend of highest yields in the peer group, thus the bank stood at second position with a spread of 3.74%.



Source: OABINVEST, Company Reports

In Q1'10, gross loans constitute more than 90% of interest earning assets for all listed banks (except Bank Muscat and OIB which have 80% and 73% contribution from loan book in IEA, respectively), which reflects that bank's yields are highly susceptible to downward interest rate movement. Thus although on annual basis all the listed banks in Q1'10 benefited from southward movement of funding cost and shift to cheaper deposits, but on sequential basis, probable downward re-pricing of loan book and new loans booked at current lower rate, overshadowed such cost advantage and thereby average spreads deteriorated from 3.55% in Q4'09 to 3.49% in Q1'10.

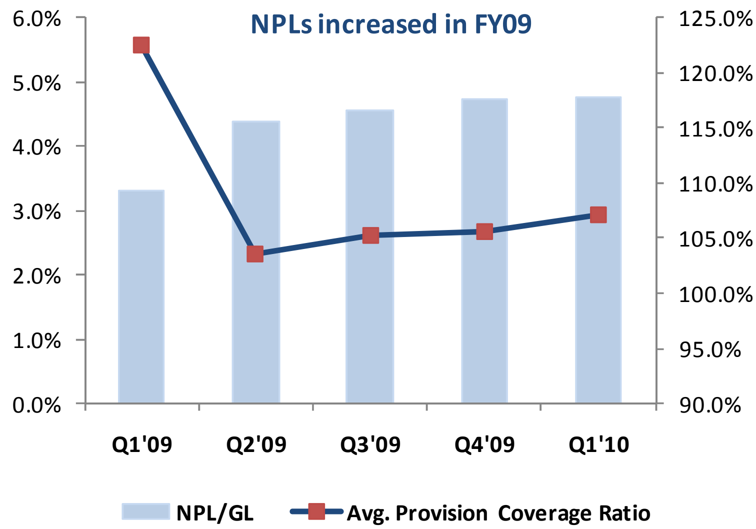
As declining assets yield will offset the benefit of lower deposit rates, we expect in near-term net interest margins to remain flattish. By the year end, as interest rates start increasing and loan demand picks up, we believe that upward re-pricing of asset yields will be faster than the cost of funds primarily due to the recent surge in low cost deposit base which should keep the funding costs sticky over medium term.



Source: OABINVEST, CBO

- ***Domestic loan book quality issue prolongs***

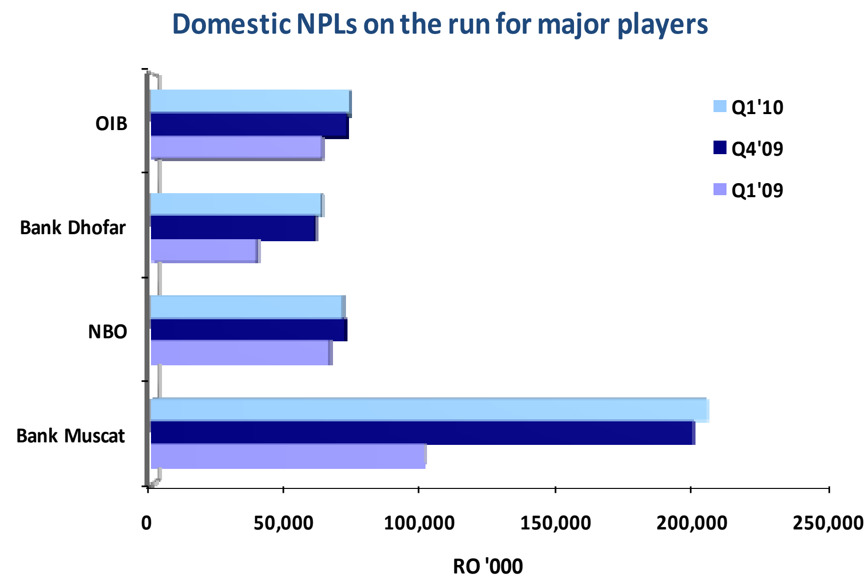
Major contributor to increasing provisioning and NPLs in 2009 was the exposure of Omani Banks to SAAD and Al Gosaibi, consequently NPLs reached its record level in June'09. Banks took full provisioning against the Saudi exposures at the end of the year, resulting in a 15.2% drop in net profits to RO 198mn in FY09.



Source: OABINVEST, Company Reports

Absence of regional provisioning (unlike Q4'09) gave much expected support to Q1'10 bottom line, consequently combined net earnings of all listed banks surged from RO 10.7mn in Q4'09 to RO 51.5mn in Q1'10. However we remain cautious of local loan portfolios as listed banks have exponentially grown its relatively riskier retail loan book by 11.4% in FY09 as against a sluggish growth of 4% on corporate side. Moreover, we take support from the fact that there is no deceleration in NPLs net adds in Q1'10 and Bank Muscat is topping the chart with a net adds of RO 5.36mn.

Considering the higher probability of defaults from personal loan portfolio, for FY10 we have assumed NPL/GL ratio of 4.63% (v/s 4.72% in FY09), for our coverage universe. For FY11 NPL/GL ratio will improve to 4.23%. These assumptions also take into account that relatively newer banks like Bank Sohar and Ahli Bank's NPL/GL ratio will also gradually converge towards the industry average. Though we expect the provisioning to be in sync with NPL trend, but at the same time we expect some amount of recoveries on the back of improved economic environment.



Note: Bank Sohar and Ahli Bank have not been included in graph as NPLs for both the banks are still in nascent stage
Source: OABINVEST, Company Reports

- ***Pullback in regional provisioning to be the main driver for profitability***

Prudent increase in provisioning dampened FY09 profitability. Moreover, slower pace of recovery of project financing activities; the lag impact of announced tenders together with non-active IPO market resulted in 5.5% y-o-y plunge in fees and commission income of all listed banks in FY09. But on the brighter side we noticed that due to gradual recovery of equity markets, there was a significant fall of 58% y-o-y to RO 2.3mn in impairment on AFS investments of all listed banks.

Although for FY10 we are conservative on loan book growth; foresee that NIMs will be flattish in near term and improve only towards the year end but we still forecast combined net profit of all listed banks to grow by 46.8% y-o-y to RO 232mn, primarily due to the absence of regional provisioning. We expect the total credit loss charges in FY10 to decline by 45% to RO 75mn. We additionally attribute positive investment income and gradual recovery in fees based income (FY10 estimate +11.7%) as other reasons for surge in bottom line.

- ***Banks are adequately capitalized***

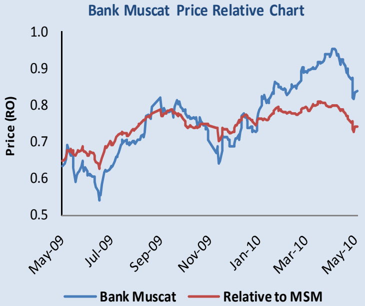
The average capital adequacy ratio (CAR) of all listed banks in FY09 stood at 15.57%, compared to the minimum regulatory requirement of 10%. Since Bank Muscat and Ahli Bank's CAR is undisclosed in Q1'10, thus peer average will not be truly comparable. Still other banks are fairly above the stipulated limit of CAR. The overall quality of capital of the banking system is good with no hybrid instruments. Even after upside revision of CAR to 12% (effective Dec'10), we are bullish about Omani listed banks as CAR for all of them currently is above 12%. Bank Sohar is a border line case as its CAR is 13% in Q1'10, but management's guidance to increase tier-2 capital if required, makes us comfortable about the bank.

MSM Ticker	**BKMB**
Bloomberg code	**BKMB OM**
Reuters code	**BMAO.OM**
Target Price (RO)	**1.12**
Share Price (RO)	**0.789**
Upside	**42.8%**
Rating	**BUY**
Market cap (RO mn)	**1,062**
Current PE (x)	**21.3**
Current P/BV (x)	**1.49**
Dividend Yield (%)	**2.53**

	FY-10e	FY-11e	FY-12e
EPS	0.089	0.105	0.124
Implied PE	12.6x	10.8x	9.1x
Implied P/BV	1.9x	1.7x	1.5x

Absolute Performance

	BKMB	MSM
6M	20.1%	-0.6%
12M	33.3%	14.8%
YTD	19.7%	-0.8%



Source: Zawya; OABINVEST

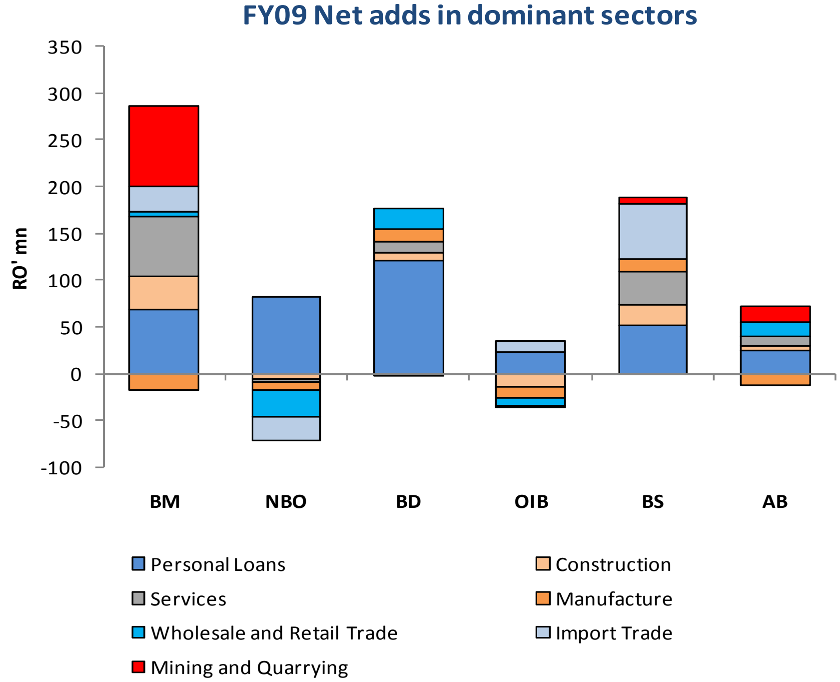
Bank Muscat

On quarterly basis, net interest income in Q1'10 was victim of higher decline in gross yields (-31bps q-o-q), as compared to 9bps dip in funding cost. In Q4'09 bank posted exceptionally higher 'other income' of RO 2.8mn (which represented 16.7% to non-interest income in Q4'09), lack of such incremental gains led to slowdown in quarterly growth rate of non-interest income of 2.6%. Absence of one-time impairment loss on Silk Bank and exceptionally high provisioning against regional exposures gave much expected support to bottom line and overshadowed the negative impact of 37.4% q-o-q surge in operating expenses. Consequently, bank posted net profit of RO 24.5mn in Q1'10 as against a net loss of RO 6.7mn in Q4'09.

Investment Case

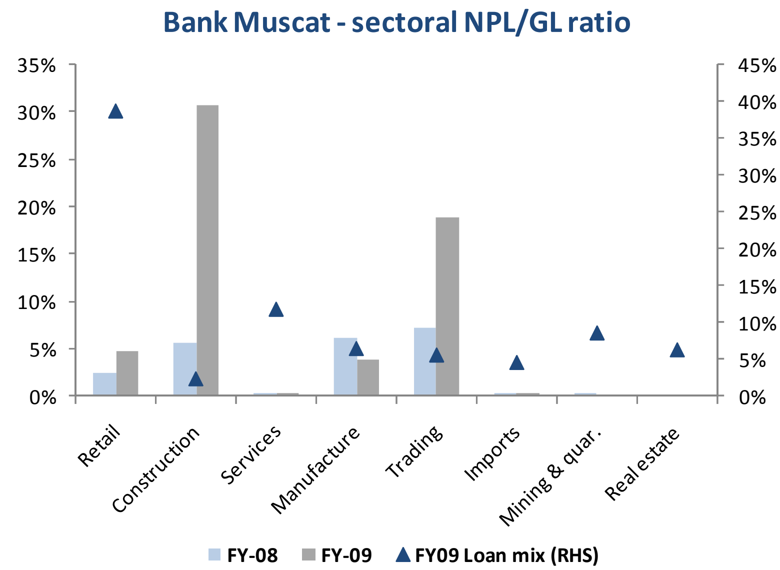
✓ ***Better diversified portfolio give edge over peers***

Analysis of FY09 net additions in dominant sectors by various Omani banks suggests that Bank Muscat diversified its corporate portfolio and was less retail focused. Amongst peers Bank Muscat was most active in construction (including real estate), services and mining and quarrying sector with y-o-y hike of 11.2%, 15.4% and 32.6%, respectively. While NBO and OIB were shying away from most of the prominent sectors other than retail, Bank Sohar and Ahli Bank were grabbing their market share. Although Bank Dhofar's loan book did not show any de-growth in major sectors, but it is evident that its loan portfolio is skewed towards retail lending.



Source: Company Reports; OABINVEST

We believe Bank Muscat's diversification strategy will help it to spread out its risk and thus places the bank in a better position compared to its local peers. We take cue from the fact that as bank saw its NPL-to-gross loan increasing from construction sector (which increased from 5.6% in FY08 to 30.7% in FY09) the bank adopted a strategy to reduce its exposure to the said sector (from 3.4% of gross loan in FY08 to 2.4% in FY09) and shift to other sectors such as real estate which saw a zero NPL in both the years. The share of real estate exposure increased from 4.9% in FY08 to 6.3% in FY09.



Source: Company Reports; OABINVEST

Services Sector is the biggest contributor (on corporate side) in Bank Muscat's loan book with a contribution of 11.8%. Moreover, the asset quality in this sector has remained steady with NPL/GL of 0.4% for FY08 and FY09 respectively. We continue to believe that service sector will do well with recovery in place and thus foresee higher incremental demand for credit from this sector. Looking at past FY09 trend, although bank might be cautious in building position on construction side, but we believe that Bank Muscat has the potential and can be most benefited with the uptick in infrastructure development activities in the medium-term. Moreover, as Bank Muscat expands its network (opening of Kuwait Branch), it will lend support to gross loan growth over the longer term. Thus we assume that for FY10 bank's loan book growth at 8.5%.

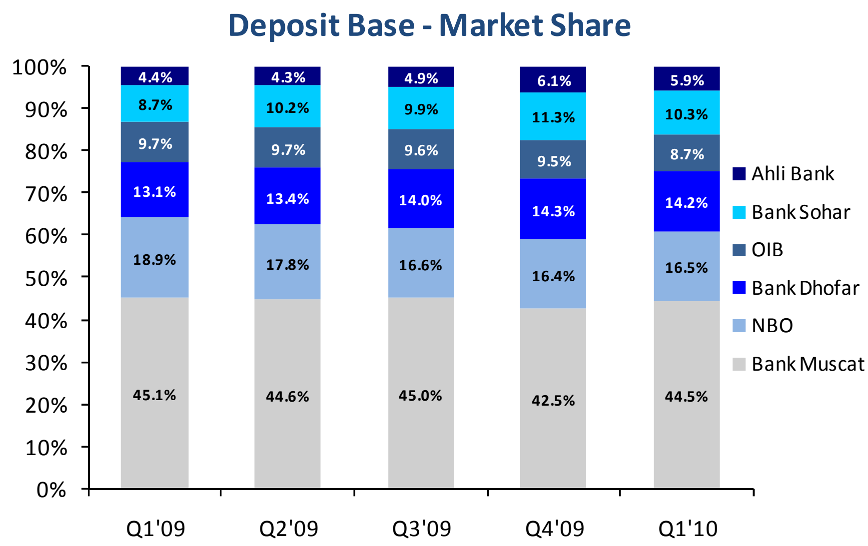
✓ ***Asset Quality pressure from Saudi exposure eased, but domestic portfolio challenges remain***

Al Gosaibi and Saad Group exposure deteriorated Bank Muscat's asset quality in FY09 with NPL-to-gross loan ratio at 4.98% was higher than average rate of 3.5% over last 3 years. Consequently Bank Muscat lost its top ranking in terms of best asset quality among the established local players (excluding Bank Sohar and Ahli Bank). After fully providing for Saudi exposure in FY09, the focus has shifted to domestic loan quality.

Being highest contributing sector in loan book, rise in retail NPL-to-gross loan ratio from 250bps in FY08 to 480bps in FY09, seems to be a cause of concern. Moreover since Bank Muscat reported the highest net additions in NPLs in Q1'10 amongst the peers, we take a conservative stance and assume NPL-to-gross loan ratio for FY10e at 4.9% and provisions to be 100bps of gross loan as compared to 120 bps (excluding Saudi exposures in FY09). Considering the gradual improvement in business environment on the back of oil rally and uninterrupted government spending, we believe that pace of increase in NPLs in FY11e will be sluggish, thus we have assumed lower NPL ratio of 4.6%.

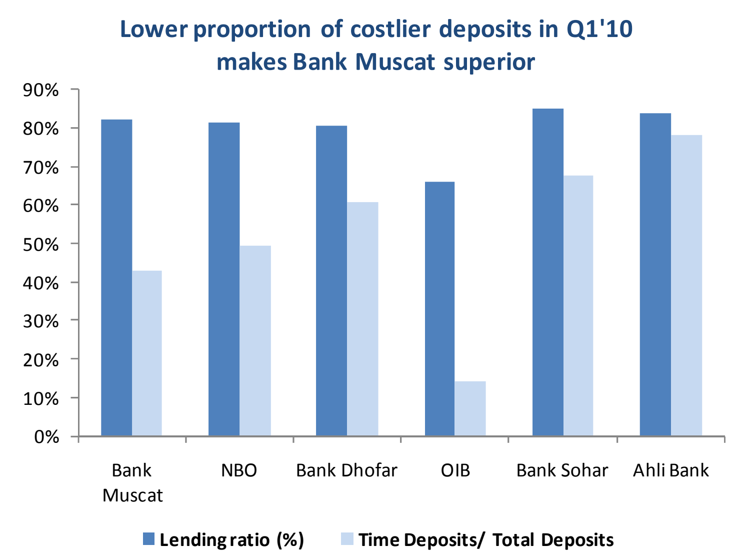
✓ *Capitalizing low cost deposit buildup*

Bank Muscat has maintained its legacy of being the market leader in terms of all the major parameters - asset base, loans and deposits. By taking advantage of declining interest rate scenario, Bank Muscat in Q1'10 posted 18% surge in term deposits (to RO 1.5bn) but still proportion of its time deposits to total deposit base remained second lowest (after OIB) amongst peers. Overall deposit base (including CDs) expanded by 12.8% q-o-q to RO 3.7bn in Q1'10.



Source: Company Reports; OABINVEST

We noticed that Bank Muscat's lending ratio at 82% in Q1'10 is lowest in last five consecutive quarters. Substantial rise in deposits and lower lending ratio makes us believe that its unutilized low cost deposit build up will give much needed support to its loan book growth in medium term. Thus we think that its deposits will not grow at the same pace as loan book. Consequently, we forecast deposits (including CDs) to grow at 11.4% CAGR 2010-2012e as compared to 13% CAGR of loan book during the same period.



Source: Company Reports; OABINVEST

✓ ***Net interest margin will remain stable***

As Bank's 25-27% of loan book is maturing in FY10, we believe that replacement loans will be given at current lower yields. Additionally, despite of falling deposit rates – bank's strategy to build up relatively costlier time deposits and first full year impact of interest paid on 7% convertible bond & 8% subordinate bonds will squeeze its net interest income. But on brighter side, since Bank Muscat is market leader in bank placements and inter-bank borrowings, which forms 20% and 24.4% of its Q1'10 IEA and IBL mix, respectively (highest compared to all other domestic banks), thus downward journey of inter-bank rates will improve net interest income to certain extent as bank has historically remained net borrower. Thus we have projected sluggish growth in net interest income at 4.4% to RO 182mn and NIM will remain stable at 3.4% in FY10, compared to previous year.

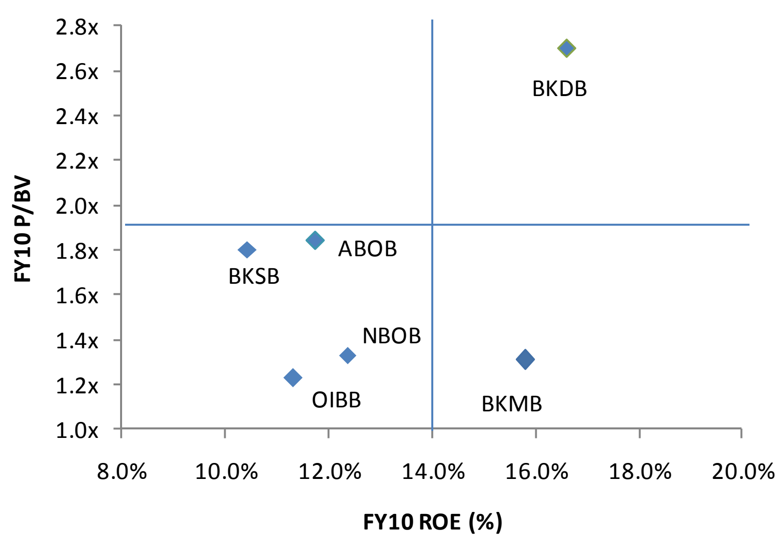
✓ ***Let bygones be bygones***

Discounting the unpleasant surprises of FY09 – provisioning against regional exposures; Silk bank losses and impairment charges; losses from BMI and impairment for AFS investments – we think worse is over for Bank Muscat and stage is set for a new start. Thus we project a net profit growth of 63% at RO 120mn for FY10. We see scope for modest earnings in long-run from its newly incorporated subsidiary - Muscat Securities House LLC in Saudi Arabia and recently opened Kuwait branch.

Valuation

We have used 'Residual Income Approach', where target price is ascertained based on intrinsic value of bank. We have calculated residual income for actual forecasted years based on detailed financial forecasts. For the maturity stage, we have assumed net profit to grow at a CAGR of 7% and in declining stage our basic assumption for calculating residual income is that as ROE tend towards COE, it will become equal to the cost of equity.

FY10 - ROE vs. P/BV of Omani Banks



Source: OABINVEST estimates

Bank Muscat looks cheaper at TTM P/BV of 1.49x as compared to industry average of 1.96x. Comparing domestic banking peers on FY10 ROE and FY10 P/BV matrix Bank Muscat with a ROE of 15.8% and at a P/BV of 1.31x is a better contender. Thus on a relative basis, current levels suggests a good entry point for Bank Muscat stock.

After cleaning up its balance sheet from regional exposures, and considering the reviving macro economic backdrop, based on our estimates FY10 net profit growth of 63% for Bank Muscat will be highest compared to domestic peers. We thus reiterate our target price at RO 1.12 per share (upside of 42.8%) and maintain **BUY** rating on Bank Muscat.

Bank Muscat - Key Indicators

	FY-08	FY-09	FY-10e	FY-11e	FY-12e
OPERATIONAL EFFICIENCY					
Gross Yield	6.2%	5.5%	5.4%	5.6%	5.8%
Funding cost	2.5%	2.1%	2.0%	2.2%	2.3%
Spread	3.8%	3.4%	3.4%	3.4%	3.4%
Net interest margin	3.8%	3.4%	3.4%	3.4%	3.5%
Interest income/Operating income	68.5%	59.9%	71.4%	70.0%	69.4%
Non-interest income/Operating income	31.5%	40.1%	28.6%	30.0%	30.6%
Cost/Income ratio	35.6%	28.2%	36.0%	36.8%	36.8%
PROFITABILITY					
ROE (%)	14.0%	10.3%	15.8%	16.6%	17.8%
ROA (%)	1.8%	1.2%	1.9%	2.0%	2.2%
VALUATION MEASURES					
P/E	6.6x	12.0x	8.8x	7.5x	6.3x
P/BV	0.9x	1.2x	1.3x	1.2x	1.1x
ASSET QUALITY					
NPL/Gross loan	2.3%	5.0%	4.9%	4.6%	4.3%
Provision coverage ratio	138.8%	106.0%	110.5%	111.1%	111.5%
LIQUIDITY AND SOLVENCY RATIO					
Loan deposit ratio	113.3%	123.6%	113.0%	114.4%	116.3%
Lending ratio	83.8%	87.8%	82.4%	84.5%	86.5%
Leverage	8.4x	8.2x	8.2x	8.1x	8.0x
Gross loans as % total assets	63.9%	69.3%	66.4%	68.4%	70.9%
Deposits as % total liabilities	59.7%	59.7%	63.3%	64.8%	66.7%

Source: Company Reports; OABINVEST

Income Statement Summary:

in RO'000	FY - 08	FY-09	FY-10e	FY-11e	FY-12e
Interest Income	263,463	279,530	287,584	327,474	375,755
Interest Expense	-101,356	-105,164	-105,510	-127,778	-147,928
Net Interest income	**162,107**	**174,366**	**182,074**	**199,696**	**227,827**
yoy growth	29.9%	7.6%	4.4%	9.7%	14.1%
Other operating income	**74,694**	**116,679**	**72,985**	**85,613**	**100,407**
yoy growth	55.3%	56.2%	-37.4%	17.3%	17.3%
Foreign exchange	6,946	9,217	11,798	14,759	18,301
Commission and fees (net)	54,827	49,811	55,788	64,157	75,063
Dividend income	2,587	1,045	1,118	1,219	1,320
Profit on sale of non trading investments	7,547	53,481	1,000	2,000	2,000
Other income	2,787	3,125	3,281	3,478	3,722
Unrealised gain on AFS investments	-	-	-	-	-
Operating Income	**236,801**	**291,045**	**255,060**	**285,309**	**328,233**
yoy growth	36.9%	22.9%	-12.4%	11.9%	15.0%
Operating Expenses	**-84,224**	**-82,125**	**-91,935**	**-105,096**	**-120,720**
yoy growth	19.8%	-2.5%	11.9%	14.3%	14.9%
Other operating expenses	-78,487	-75,503	-83,165	-94,788	-108,668
Depreciation	-5,737	-6,622	-8,770	-10,308	-12,052
Operating Profit	**152,577**	**208,920**	**163,125**	**180,213**	**207,513**
yoy growth	48.7%	36.9%	-21.9%	10.5%	15.1%
Impairment for associates	-13,750	(20,315)	-	-	-
Recoveries(provision) for collateral assets	13	-	-	-	-
Impairment for investments	-10,929	-2,940	-1,321	-1,479	-1,642
Impairment (provision) for credit losses	-24,625	-98,242	-43,965	-39,392	-33,119
Recoveries from impairment for credit losses	12,603	10,589	16,134	17,234	14,021
Share of profit(loss) from associates	-3,248	-10,455	2,687	3,493	3,668
Recoveries from provision for placements	583	425	-	-	-
Impairment for placements	-4,813	-	-	-	-
Profit Before Taxation	**108,411**	**87,982**	**136,660**	**160,068**	**190,441**
Tax expense	-14,680	-14,264	-16,399	-19,208	-22,853
Net profit for the year	**93,731**	**73,718**	**120,261**	**140,860**	**167,588**
yoy growth	11.2%	-21.4%	63.1%	17.1%	19.0%

Source: Company Reports; OABINVEST

Balance sheet Summary:

in RO'000	FY-08	FY-09	FY-10e	FY-11e	FY-12e
Cash	452,761	608,099	937,502	863,980	797,998
Placements with banks	1,077,557	1,015,691	1,097,895	1,183,126	1,226,355
Gross loans and advances	3,853,274	4,052,056	4,396,481	4,924,058	5,613,427
(-) Impairment	-125,574	-213,845	-238,017	-253,348	-266,019
Net loans and advances	3,727,700	3,838,211	4,158,464	4,670,710	5,347,408
Investments	378,646	144,366	157,587	174,711	192,321
Investment in associates	92,903	67,172	69,859	73,352	77,019
Net Property and equipment	21,948	26,276	29,998	35,165	39,345
Other assets	276,721	150,921	173,559	200,895	234,042
Assets	**6,028,236**	**5,850,736**	**6,624,863**	**7,201,938**	**7,914,489**
Deposits from banks	1,412,576	1,395,747	1,444,598	1,516,828	1,592,669
Customers' deposits	3,173,032	3,068,425	3,682,110	4,087,142	4,618,471
Certificate of deposits	61,675	139,200	154,512	160,692	152,658
Floating rate notes	111,650	15,400	-	-	-
Unsecured bonds	54,803	54,803	54,803	54,803	54,803
Other liabilities	360,138	245,767	258,055	270,958	287,216
Taxation	26,112	31,578	31,578	31,578	31,578
Subordinated liability	113,500	113,500	113,500	113,500	113,500
Subordinate bonds	-	75,000	75,000	75,000	75,000
Laibilities	**5,313,486**	**5,139,420**	**5,814,156**	**6,310,502**	**6,925,894**
Share capital	107,713	107,713	134,642	134,642	150,799
Share premium	301,505	301,505	301,505	301,505	301,505
Convertible bonds	-	32,314	32,314	32,314	16,157
General reserve	56,308	56,308	56,308	56,308	56,308
Legal reserve	35,905	35,905	35,905	35,905	35,905
Revaluation reserve	3,957	3,957	3,957	3,957	3,957
Subordinated loan reserve	24,200	48,400	48,400	48,400	48,400
Cumulative changes in fair value	69,276	4,823	4,823	4,823	4,823
Retained profit	125,357	121,063	192,853	273,582	370,740
Shareholders' Funds	**714,750**	**711,316**	**810,707**	**891,436**	**988,594**

Source: Company Reports; OABINVEST

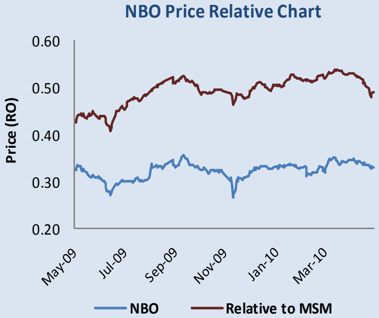
MSM Ticker	**NBOB**
Bloomberg code	**NBOB OM**
Reuters code	**NBO.OM**
Target Price (RO)	**0.402**
Share Price (RO)	**0.331**
Upside	**21.3%**
Rating	**BUY**
Market cap (RO mn)	**357**
Current PE (x)	**14.1**
Current P/BV (x)	**1.47**
Dividend Yield (%)	**3.63**

	FY-10e	FY-11e	FY-12e
EPS	0.030	0.036	0.042
Implied PE	13.5x	11.2x	9.7x
Implied P/B	1.6x	1.5x	1.4x

Absolute Performance

	NBO	MSM
6M	3.8%	-0.6%
1 yr	1.5%	14.8%
YTD	3.1%	-0.8%

NBO Price Relative Chart



Source: Zawya, OABINVEST

National Bank of Oman

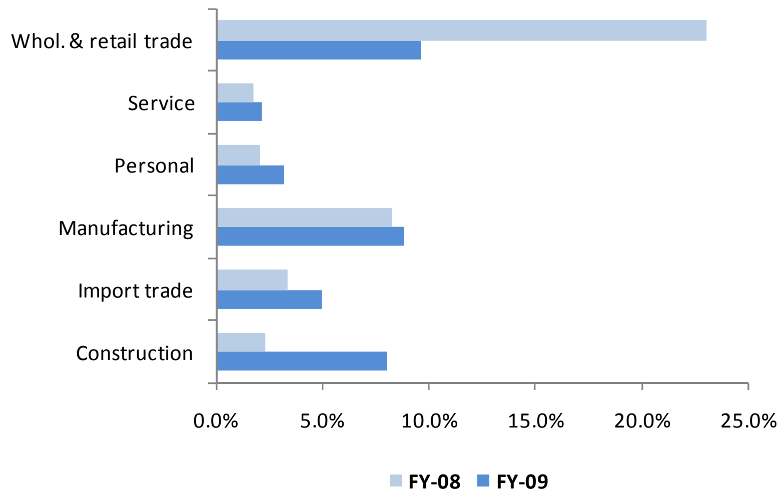
Decline in National Bank of Oman's (NBO) net interest income by 5.3% q-o-q to RO 13.6mn in Q1'10, is primarily because of 2.4% q-o-q dip in interest earning assets and 8.9% q-o-q rise in deposit base. NBO's non-interest income in Q1'10 fell by 2.6% q-o-q to RO 6.2mn, which further put pressure on pre-provision profits. But absence of exceptionally higher provisions related to regional exposures in Q1'10 compared to previous quarter supported bottom line on quarterly basis (RO 6.5mn in Q1'10 v/s RO 1.5mn in Q4'09).

Investment Case

✓ ***Deteriorating domestic asset quality will keep asset growth subdued***

In FY09, NBO reported the highest fall in corporate loan book (-13% y-o-y to RO 787mn) compared to all domestic listed peers and thus lost its corporate market share from 18.7% in FY08 to 15.6% in FY09. 14.6% y-o-y growth on retail side lent support to loan book (which plunged by 2.5% to RO 1.43mn in FY09), as a result personal loan contribution at 45% reached its highest levels in last 4 years. Thus scope of further increase on retail side is limited. Moreover, we noticed that NBO's FY09 loan portfolio included all-time high RO 30mn government loan as against RO 0.004mn in FY08. Excluding this amount loan book declined by 4.5% in FY09. In our view, it is unlikely that FY10 loan book will witness such hike in government loans, thus bank will be focusing more on corporate side.

NPL/GL ratio rising in dominant sectors



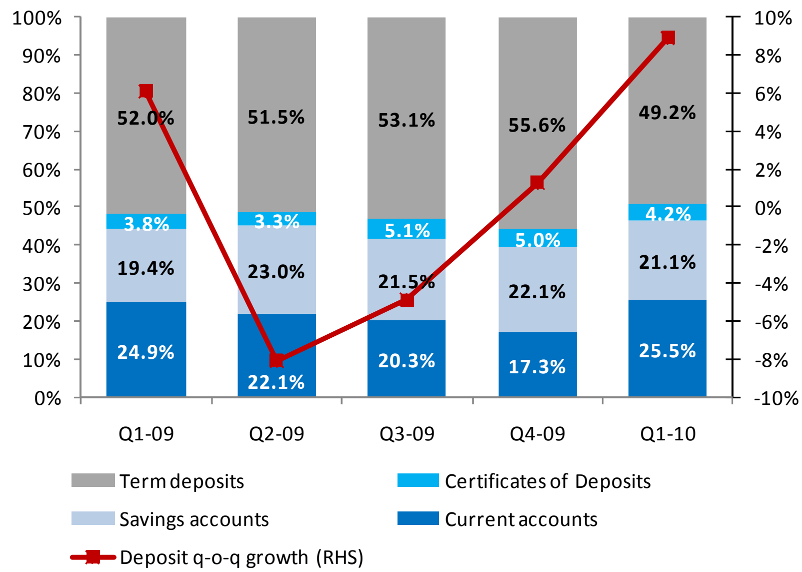
Source: Company Reports; OABINVEST

Loan quality in corporate book is deteriorating as NPL-to-gross loan ratio of dominant sectors has increased in FY09, compared to previous year. NPL/GL ratio of construction sector (which has 18.8% contribution in corporate book) significantly increased from 2.3% in FY08 to 8% in FY09, which makes us believe bank will be cautious on the construction side lending. Moreover, NBO's NPL at RO 71mn in Q1'10 remained flattish compared to Q4'09, we take a conservative stance and assume a sluggish loan growth of 6.6% in FY10.

✓ ***Low-cost deposit buildup***

Capitalizing on falling deposit rates, NBO substantially expanded its deposit base in Q1'10 (+9% q-o-q to RO 1.37bn). In Q1'10, 61% q-o-q growth in current accounts replaced expensive term deposits which declined by 3.6% q-o-q. Consequently, time deposit's contribution to total deposits reached at 49%, which is lowest in last 4 years. Considering the strong deposit growth in Q1'10, we estimate that FY10 deposit growth at 12% which will surpass loan book growth of 6.6%. This should be seen in positive light as this unutilized low-cost deposit buildup in FY10 will fuel loan growth in FY11.

Changing deposit mix



Source: Company Reports; OABINVEST

✓ ***Slight improvement in spreads***

We expect gross yield will decline slightly in FY10, on account of general fall in interest rate. However, the benefit of reduction in overall interest rates and lower dependency on costlier time deposits will increase spreads by 14bps (to reach 3.5% in FY10) and improve NIM by 15.5bps to 3.6%. Although due to rise in lending, increase in funding cost is quite certain in FY11 but we believe NBO will get benefit of unutilized low-cost deposit base.

✓ ***Impact of regional exposure is fading but retail loan quality will be a bigger challenge***

In FY09 NBO suffered from inter-bank exposure of RO 6.6mn against Saudi groups and RO 1.9mn against Kazakhstan. By providing fully for Saudi exposure and 75% provisioning for Kazakhstan exposure NBO has cleared its balance sheet in FY09. We believe although absence of exceptional provisioning against regional exposures will enhance bottom line in FY10, but loan quality of increasing retail portfolio will continue to be a concern. In FY09, consumer NPL ratio increased to 3.2% from 2% in FY08. Retail NPLs constituted 29% of total NPLs in FY09 as against 18.3% in FY08. We foresee that domestic loan book quality will remain a challenge in medium term and we thus estimate in FY10 NPL-to-gross loan ratio will be stable at Q1'10 level of 5% and provisions will be at 120bps of gross loans.

Valuation

At FY10 P/BV multiple of 1.33x, NBO is relatively cheaper compared to domestic industry average of 1.7x, thereby making it a compelling **BUY.** Based on our revised earnings estimates due to absence of regional exposure, we raise our target price from RO 0.365 to RO 0.402, with an upside potential of 21.3%.

NBO - Key Indicators

	FY-08	FY-09	FY-10e	FY-11e	FY-12e
OPERATIONAL EFFICIENCY					
Gross Yield	6.35%	6.25%	6.20%	6.40%	6.52%
Funding cost	3.04%	2.89%	2.70%	2.90%	3.10%
Spread	3.31%	3.36%	3.50%	3.50%	3.42%
Net interest margin	3.3%	3.5%	3.6%	3.6%	3.5%
Interest income/Operating income	53.9%	69.4%	70.2%	69.5%	69.2%
Non-interest income/Operating income	46.1%	30.6%	29.8%	30.5%	30.8%
Cost/Income ratio	38.4%	42.5%	43.2%	42.8%	40.9%
PROFITABILITY					
ROE (%)	19.0%	8.5%	12.4%	13.7%	14.7%
ROA (%)	2.6%	1.1%	1.7%	1.9%	2.0%
NAV per share	0.23	0.23	0.25	0.27	0.29
VALUATION MEASURES					
P/E	8.7x	16.4x	11.1x	9.3x	8.0x
P/BV	1.6x	1.4x	1.3x	1.2x	1.1x
ASSET QUALITY					
NPL/Gross loan	4.4%	5.0%	5.0%	4.4%	4.0%
Provision coverage ratio	100.0%	95.0%	94.8%	99.0%	99.6%
LIQUIDITY AND SOLVENCY RATIO					
Lending ratio	84.2%	87.0%	83.7%	84.3%	85.9%
Loan deposit ratio	109.2%	113.4%	107.9%	107.9%	109.7%
Leverage	8.1x	7.2x	7.4x	7.4x	7.3x
Gross loans as % total assets	73.8%	79.5%	76.8%	77.3%	78.7%
Deposits as % total liabilities	67.6%	70.1%	71.2%	71.6%	71.7%

Source: Company Reports; OABINVEST

Income statement summary

in RO '000	FY-08	FY-09	FY-10e	FY-11e	FY-12e
Interest Income	90,220	102,361	103,254	114,695	127,395
Interest Exp	-42,687	-45,539	-42,933	-50,520	-58,341
Net Interest Income	**47,533**	**56,822**	**60,321**	**64,176**	**69,054**
as a % of total operating income	53.9%	69.4%	70.2%	69.5%	69.2%
yoy growth	15.8%	19.5%	6.2%	6.4%	7.6%
Other operating income	**40,615**	**25,045**	**25,577**	**28,150**	**30,688**
as a % of total operating income	46.1%	30.6%	29.8%	30.5%	30.8%
yoy growth	68.8%	-38.3%	2.1%	10.1%	9.0%
Net gains from foreign exchange dealings	2,907	2,250	2,348	2,471	2,623
Fees and commissions	10,047	9,100	10,192	11,619	12,897
Profit on sale of investments	10,139	2,510	1,000	1,000	1,000
Investment income	648	721	822	921	1,013
Dividend income	737	756	794	833	875
Service Charges	14,532	8,663	9,356	10,198	11,116
Miscellaneous income	1,605	1,045	1,066	1,109	1,164
Total operating income	**88,148**	**81,867**	**85,898**	**92,326**	**99,742**
yoy growth	35.4%	-7.1%	4.9%	7.5%	8.0%
Dep	-1,805	-2,840	-3,107	-3,193	-2,993
Staff costs	-19,570	-20,505	-22,016	-23,852	-25,830
Other operating exp	-12,479	-11,439	-12,026	-12,464	-11,969
Total expense	**-33,854**	**-34,784**	**-37,149**	**-39,509**	**-40,791**
yoy growth	18.2%	2.7%	6.8%	6.4%	3.2%
Operating Profit	**54,294**	**47,083**	**48,750**	**52,817**	**58,951**
yoy growth	49.0%	-13.3%	3.5%	8.3%	11.6%
Provision for credit losses	-15,581	-20,483	-18,281	-14,945	-13,675
Recoveries from provision for impairments	8,551	7,036	6,883	6,703	6,430
Impairment losses on AFS	-3,703	-4,121	-814	-732	-633
Recoveries from bad debts written off and (	8,094	3,465	-	-	-
PBT	**51,655**	**25,014**	**36,538**	**43,842**	**51,073**
yoy growth	2.5%	-51.6%	46.1%	20.0%	16.5%
Tax	-6,275	-3,909	-4,381	-5,257	-6,125
PAT	**45,380**	**21,105**	**32,157**	**38,585**	**44,948**
yoy growth	1.7%	-53.5%	52.4%	20.0%	16.5%

Source: Company Reports; OABINVEST

Balance sheet summary

in RO '000	FY-08	FY-09	FY-10e	FY-11e	FY-12e
Cash & balances with Central Bank	266,389	184,357	260,801	282,201	273,861
Bank placements & due from banks	198,611	166,916	176,931	189,316	200,675
Gross loan	1,465,464	1,429,117	1,523,439	1,660,548	1,823,282
Less: provisions for impairment	-64,246	-68,120	-72,234	-72,343	-72,657
Net loans & advances	1,401,218	1,360,997	1,451,205	1,588,205	1,750,625
Other assets	77,765	25,736	27,623	29,465	31,233
Investments (incl Financial Assets at fair v	30,866	47,444	48,698	50,868	53,211
Net Premises and equipment	9,570	12,763	18,861	8,765	7,337
Defered tax	61	-	-	-	-
Total Assets	**1,984,480**	**1,798,213**	**1,984,120**	**2,148,820**	**2,316,942**
yoy growth	34.4%	-9.4%	10.3%	8.3%	7.8%
Subordinate debt	28,600	27,600	30,600	30,600	30,600
Current, deposits & other accounts	1,341,755	1,260,768	1,412,060	1,539,146	1,662,277
Bank borrowings & due to banks	276,531	219,662	229,547	242,172	259,124
Tax liability	7,313	5,092	5,092	5,092	5,092
Other liability	84,896	34,700	37,245	39,728	42,111
Total Liabilities	**1,739,095**	**1,547,822**	**1,714,544**	**1,856,737**	**1,999,204**
Share capital	108,100	108,100	108,100	108,100	108,100
Proposed Stock Dividend	18,918	12,972	16,078	19,292	22,474
Share premium	34,465	34,465	34,465	34,465	34,465
Non-distributable reserves	18,888	12,427	12,427	12,427	12,427
Legal reserves and general reserves	30,564	32,675	32,675	32,675	32,675
Retained profits	34,450	49,752	65,830	85,123	107,597
Shareholders' Funds	**245,385**	**250,391**	**269,576**	**292,083**	**317,738**
Total Liabilities and Equity	**1,984,480**	**1,798,213**	**1,984,120**	**2,148,820**	**2,316,942**

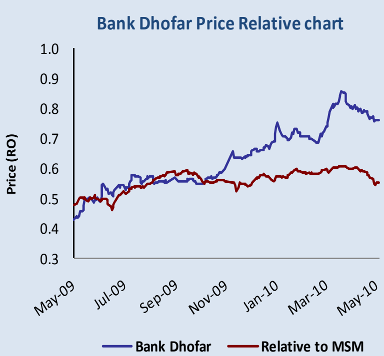
Source: Company Reports; OABINVEST

MSM Ticker	BKDB
Bloomberg code	BKDB OM
Reuters code	BDOF.OM
Target Price (RO)	0.606
Share Price (RO)	0.760
Downside	20.3%
Rating	SELL
Market cap (RO mn)	626.4
Current PE (x)	22.3
Current P/BV (x)	3.0
Dividend Yield (%)	1.97

	FY-10e	FY-11e	FY-12e
EPS	0.049	0.056	0.064
Implied PE	12.5x	10.8x	9.4x
Implied P/BV	2.2x	1.9x	1.7x

Absolute Performance

	BKDB	MSM
6M	26.7%	-0.6%
1 yr	77.6%	15.7%
YTD	14.3%	-0.8%



Source: Zawya, OABINVEST

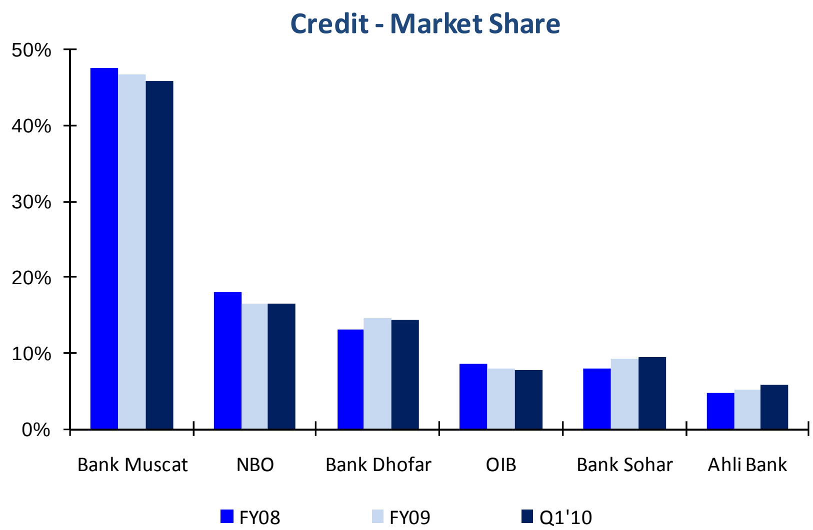
Bank Dhofar

In Q1'10 on sequential basis, stable interest income at RO 20.3mn and 10.7% q-o-q drop in interest expense, resulted in 5.6% q-o-q jump in net interest income. But 11.6% and 10.7% sequential decline in fees income and foreign exchange income, respectively, decelerated the total operating income growth to 3.4% (at RO 17.9mn). As expected after providing adequately for regional exposure in Q4'09, the absence of such higher provisioning in Q1'10 lent support to the bottom line despite of unexpected surge in expenses (+22% q-o-q to RO 7mn). Consequently, net profit substantially grew from RO 3.85mn in Q4'09 to RO 8.8mn in Q1'10, representing 129% quarterly gain (+35% y-o-y).

Investment Case

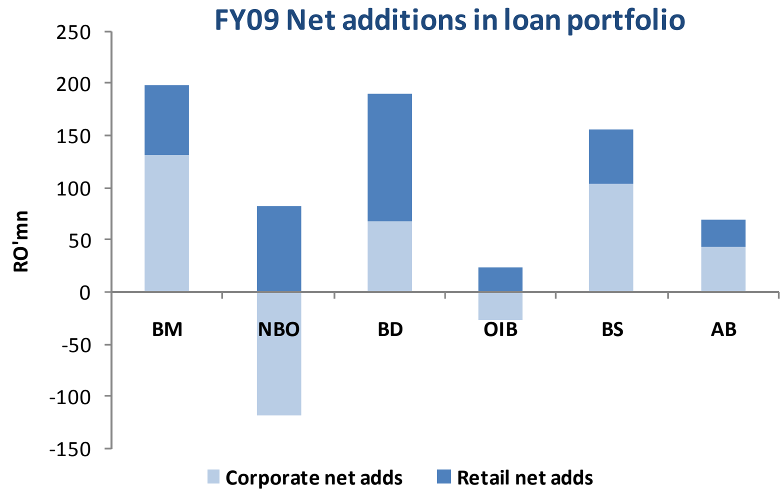
✓ ***Higher potential to grow on corporate side***

Net additions in FY09 in credit portfolio of all 6 listed banks shows that Bank Dhofar with net adds of RO 189mn was the second most aggressive bank (after Bank Muscat's net adds of RO 199mn) in lending. Amongst the matured banks (excluding Bank Sohar and Ahli Bank), Bank Dhofar was the only player who expanded its credit market share in FY09, mainly on the back of aggressive retail lending.



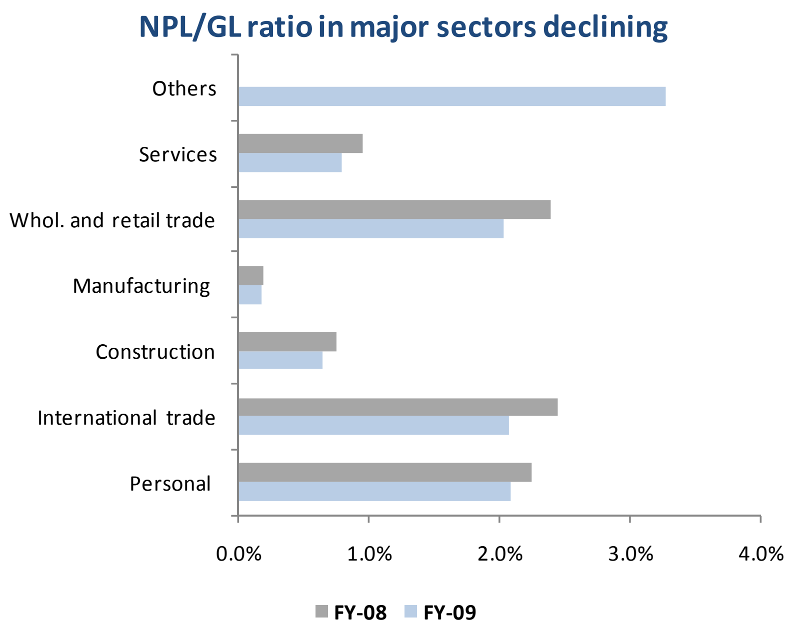
Source: Company Reports; OABINVEST

Bank Dhofar reported the highest net additions in consumer loans in FY09, which represents 27.6% of the system level net additions in consumer loan segment. In Q1'10, Bank Dhofar continued to focus more on retail sector (+2.2% q-o-q to RO 554mn), while its corporate and government sector loans fell by 0.5% and 1.6% q-o-q, respectively. Thus retail loans proportion increased from 39.4% in FY08 to 43.8% in Q1'10. In our view, this limits the scope of further significant expansion on retail side and thus bank would have to focus on corporate lending.



Source: Company Reports; OABINVEST

In FY09 NPL-to-gross loan ratio increased mainly due to exposure to Algosaibi. While analyzing the sectoral NPLs of Bank Dhofar, we observed that NPL/GL ratio is reducing in dominant sectors. This gives us confidence that Bank Dhofar corporate portfolio is well diversified and less risky. We believe this increases its scope to expand corporate loan book as infrastructure spending trickles down to various sectors, thus we assume 8% credit growth for FY10.



Source: Company Reports; OABINVEST

- ✓ ***Reduction in term deposits will improve spreads***

In Q3'09 term deposits proportion in total deposits at 64.7% reached its highest levels since 2003. We believe in last two quarters Bank is making conscious efforts to reduce such expensive deposits, consequently the time deposits proportion has reduced to 63% in Q4'09 and further to 60.5% in Q1'10. We envisage bank's strategy to shun time deposits along with overall diminishing deposit rates trend will result in higher fall in Bank Dhofar's funding cost (decline by 44bps to reach 2%) in FY10, compared to its local peers. Moreover, this will also offset the negative impact of industry wide trend of declining gross yields to certain extent, consequently we estimate 38bps improvement in spreads to 4% in FY10.

- ✓ ***Local retail book to keep asset quality stressed***

In current year the bank will be relieved from pressures of regional exposure and thereby bottom line will expand by 41.5% to RO 36mn. But we believe rise in NPL ratio will prolong in FY10 on the back of higher buildup in riskier retail portfolio. We project NPL-to-gross loan ratio to increase from 4.8% in FY09 to 5% in FY10 and provision charges to reach 50bps of gross loan. We expect in FY11 asset quality will improve and provision charges will come down to historical trend of 44bps of gross loan.

Valuation

In our GCC peer set Bank Dhofar is costliest on TTM P/BV multiple at 3.04x (after Al Rajhi Bank). Additionally, based on FY10 P/BV multiple at 2.7x Bank Dhofar remains expensive amongst local peers, thereby making it less attractive. Even though FY10 ROE of 16.6% is highest for Bank Dhofar but we believe current price is already factoring in high growth, which limits upside potential.

We have used 'Residual Income Approach', to derive the intrinsic value of bank. Based on our revised valuation model we have achieved a target price of RO 0.606 per share, with a downside of 20.3%. Moreover, we believe that the stock has already moved upwards and adjusted for higher growth expectation and thus we downgrade our rating on Bank Dhofar from HOLD to **SELL**.

Regional Peer comparison:

Banks	Mkt cap (USD mn)	TTM P/BV	TTM PE
OMAN			
BANK MUSCAT SAOG	2,759	1.49x	21.33x
NATIONAL BANK OF OMAN	929	1.47x	14.12x
BANK DHOFAR SAOG	1,606	3.06x	22.33x
OMAN INTERNATIONAL BANK	681	1.66x	12.59x
AHLI BANK	492	2.08x	18.43x
BANK SOHAR	548	2.00x	26.30x
Peer Average		**1.96x**	**19.18x**
BAHRAIN			
AHLI UNITED BANK	3,596	1.45x	17.49x
NATIONAL BANK OF BAHRAIN	1,238	2.01x	11.02x
Average		**1.73x**	**14.26x**
KUWAIT			
NATIONAL BANK OF KUWAIT	13,333	2.16x	13.80x
COMMERCIAL BANK OF KUWAIT	3,246	2.13x	-
Average		**2.14x**	**13.80x**
QATAR			
QATAR NATIONAL BANK	14,160	2.60x	15.24x
COMMERCIAL BANK OF QATAR	3,901	1.33x	10.81x
DOHA BANK QSC	2,311	1.60x	8.50x
Average		**1.84x**	**11.52x**
SAUDI ARABIA			
AL RAJHI BANK	31,000	4.17x	17.30x
SAMBA FINANCIAL GROUP	13,080	2.12x	10.90x
SAUDI BRITISH BANK	8,500	2.32x	16.84x
RIYAD BANK	10,800	1.46x	12.37x
BANQUE SAUDI FRANSI	8,293	1.97x	12.73x
Average		**2.41x**	**14.03x**
UAE			
NATIONAL BANK OF ABU DHABI	6,772	1.16x	7.58x
EMIRATES NBD PJSC	4,161	0.46x	4.78x
FIRST GULF BANK	5,915	0.99x	6.72x
ABU DHABI COMMERCIAL BANK	2,226	0.43x	-
UNION NATIONAL BANK/ABU DHAB	1,964	0.73x	5.99x
Average		**0.75x**	**6.27x**

Source: OABINVEST, Bloomberg (last updated on 30 May'10)

Bank Dhofar - Key Indicators

	FY-08	FY-09	FY-10e	FY-11e	FY-12e
OPERATIONAL EFFICIENCY					
Gross Yield	6.13%	6.06%	6.00%	6.25%	6.35%
Funding cost	2.48%	2.44%	2.00%	2.10%	2.22%
Spread	3.65%	3.62%	4.00%	4.15%	4.13%
Net interest margin	3.84%	3.84%	4.11%	4.26%	4.30%
Interest income/Operating income	71.0%	75.7%	77.2%	78.1%	78.8%
Non-interest income/Operating income	29.0%	24.3%	22.8%	21.9%	21.2%
Cost/Income ratio	37.6%	36.4%	36.8%	36.6%	36.1%
PROFITABILITY					
ROE (%)	15.8%	12.9%	16.6%	17.2%	17.7%
ROA (%)	2.1%	1.8%	2.3%	2.4%	2.5%
NAV per share	0.27	0.28	0.28	0.31	0.35
VALUATION MEASURES					
P/E	10.1x	19.4x	15.6x	13.6x	11.8x
P/BV	1.2x	2.4x	2.7x	2.4x	2.2x
ASSET QUALITY					
NPL/Gross loan	3.6%	4.8%	5.0%	4.4%	4.0%
Provision coverage ratio	131.6%	105.2%	103.3%	112.8%	119.4%
LIQUIDITY AND SOLVENCY RATIO					
Loan deposit ratio	110.0%	114.2%	110.1%	112.0%	113.1%
Lending ratio	81.4%	84.6%	81.6%	83.3%	86.2%
Leverage	7.0x	7.3x	7.3x	7.2x	7.0x
Gross loans as % total assets	80.7%	84.6%	81.8%	83.4%	86.1%
Deposits as % total liabilities	73.4%	74.1%	74.3%	74.5%	76.1%

Source: OABINVEST, Company Reports

Income statement summary

in RO '000	FY-08	FY-09	FY-10e	FY-11e	FY-12e
Interest Income	63,671	77,729	83,386	95,762	108,857
Interest Expense	-23,772	-28,502	-26,213	-30,561	-35,210
Net Interest income	**39,899**	**49,227**	**57,172**	**65,201**	**73,647**
yoy growth	31.4%	23.4%	16.1%	14.0%	13.0%
as a % of total operating income	71.0%	75.7%	77.2%	78.1%	78.8%
Other income	**16,265**	**15,802**	**16,873**	**18,319**	**19,830**
yoy growth	18.9%	-2.8%	6.8%	8.6%	8.2%
as a % of total operating income	29.0%	24.3%	22.8%	21.9%	21.2%
Fees and commissions (net)	4,516	4,980	5,378	5,809	6,302
Foreign exchange	1,512	1,125	1,204	1,300	1,417
Investment income	3,789	1,868	1,757	1,909	2,018
Miscellaneous income	6,448	7,829	8,534	9,302	10,092
Operating Income	**56,164**	**65,029**	**74,046**	**83,520**	**93,477**
yoy growth	27.5%	15.8%	13.9%	12.8%	11.9%
Operating Expenses	**-21,105**	**-23,658**	**-27,229**	**-30,593**	**-33,745**
yoy growth	24.4%	12%	15%	12%	10%
as a % of total operating income	38%	36%	37%	37%	36%
Staff and administrative costs	-19,494	-21,871	-25,208	-28,294	-31,125
Depreciation	-1,611	-1,787	-2,021	-2,299	-2,620
Operating Profit	**35,059**	**41,371**	**46,816**	**52,927**	**59,732**
yoy growth	29.5%	18.0%	13.2%	13.1%	12.9%
Provision for loan impairment	-5,470	-11,706	-6,792	-6,754	-6,795
Recoveries from allowance for loan impairment	2,350	1,524	1,209	1,358	1,486
Bad debts written-off	-2	(93)	-	-	-
Financial instruments at fair value	4	(12)	-	-	-
Impairment of available-for-sale investments	(4,864)	(2,063)	(403)	(426)	(451)
Property and equipment	-	-	-	-	-
Profit Before Taxation	**27,077**	**29,021**	**40,830**	**47,105**	**53,972**
yoy growth	6.8%	7.2%	40.7%	15.4%	14.6%
Income tax	-3,391	-3,628	-4,900	-5,653	-6,477
Net profit for the year	**23,686**	**25,393**	**35,930**	**41,453**	**47,495**
yoy growth	3.9%	7.2%	41.5%	15.4%	14.6%

Source: OABINVEST, Company Reports

Balance sheet summary

in RO '000	FY-08	FY-09	FY-10e	FY-11e	FY-12e
Cash and cash equivalents	116,249	182,248	255,449	255,125	223,306
Held-to-maturity investments	120,468	47,437	51,706	55,326	58,922
Loans and advances to banks	37,586	32,948	31,136	32,693	34,981
Gross loans and advances	1,068,767	1,257,832	1,358,459	1,535,058	1,711,590
(-) Impairment allowance	-50,326	-63,589	-70,169	-76,209	-81,739
Net loans and advances	1,018,441	1,194,243	1,288,290	1,458,850	1,629,851
Financial instruments at fair value through prof	2,519	-	-	-	-
Available-for-sale investments	13,787	12,338	13,448	14,188	15,039
Intangible asset	3,971	3,971	3,971	3,971	3,971
Net Property and equipment	4,597	5,037	5,399	5,895	6,471
Other assets	6,202	8,702	11,331	13,608	14,969
Assets	**1,323,820**	**1,486,924**	**1,660,730**	**1,839,655**	**1,987,511**
yoy growth	38.6%	12.3%	11.7%	10.8%	8.0%
Due to banks	89,663	100,057	109,562	119,423	130,171
Deposits from customers	971,596	1,101,267	1,233,419	1,371,151	1,512,836
Other liabilities	35,628	43,093	50,405	56,454	61,535
Subordinated bonds and loan	38,500	38,500	38,500	38,500	0
Liabilities	**1,135,387**	**1,282,917**	**1,431,887**	**1,585,528**	**1,704,542**
yoy growth	0.0%	13.0%	11.6%	10.7%	7.5%
Share capital	70,774	73,959	81,355	81,355	81,355
Share premium	58,506	58,506	58,506	58,506	58,506
Legal reserve	14,612	17,151	17,151	17,151	17,151
Subordinated bonds and loan reserve	10,267	17,967	17,967	17,967	17,967
Investment revaluation reserve	239	1,390	1,390	1,390	1,390
Retained earnings	34,035	35,034	52,474	77,759	106,600
Shareholders' Equity	**188,433**	**204,007**	**228,843**	**254,128**	**282,969**
Total liabilities and shareholders' funds	**1,323,820**	**1,486,924**	**1,660,730**	**1,839,655**	**1,987,511**

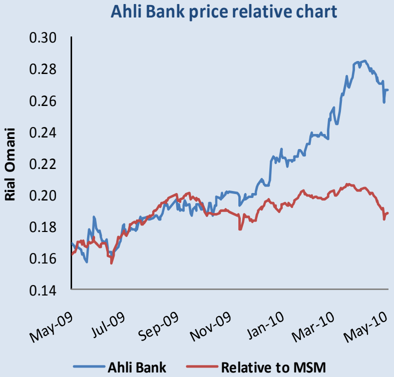
Source: OABINVEST, Company Reports

MSM Ticker	ABOB
Bloomberg code	ABOB OM
Reuters code	AHBK.OM
Target Price (RO)	0.299
Share Price (RO)	0.266
Upside	12.3%
Rating	BUY
Market cap (RO mn)	189.5
Current PE (x)	18.4
Current P/BV (x)	2.0
Dividend Yield (%)	2.63

	FY-10e	FY-11e	FY-12e
EPS	0.018	0.020	0.024
Implied PE	16.9x	14.6x	12.4x
Implied P/BV	2.1x	2.0x	1.8x

Absolute Performance

	ABOB	MSM
6M	31.7%	-0.6%
1 yr	57.4%	15.7%
YTD	28.5%	-0.8%



Source: Zawya, OABINVEST

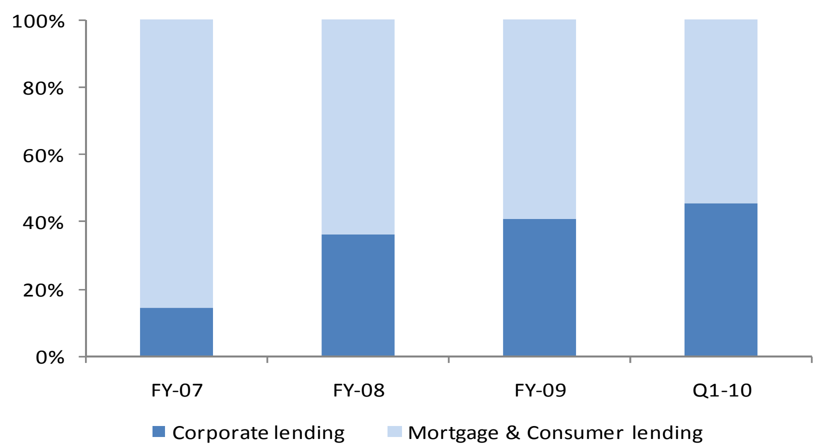
Ahli Bank

In Q1'10, net interest income remained flattish at RO 4mn compared to Q4'09, while non-interest income surged by 72% q-o-q to RO 1.65mn, consequently operating income (RO 5.6mn) showed an impressive growth of 65% y-o-y and 14% q-o-q. On sequential basis, staff expenses declined by 16% to RO 1mn. Thus improvement in total operating income and cost reduction led to 26.4% q-o-q growth in operating profit to RO 3.6mn. Net provisions on q-o-q basis declined, which further positively impacted the bottom line which grew by 28.7% q-o-q to RO 3.15mn.

Investment case

✓ ***Loan portfolio under transformation***

Since Ahli Bank's evolution phase (which started in Dec'07) to transform itself to a full-fledged commercial bank from a mortgage bank, we believe that the bank has focused on strengthening its corporate banking activities and has successfully adopted strong corporate relationships. We believe now Ahli Bank is in a better position to en-cash these associations and translate it into corporate loans. Consequently, its corporate lending proportion increased from 36.5% in FY08 to 40.7% in FY09 and further to 45.7% in Q1'10.

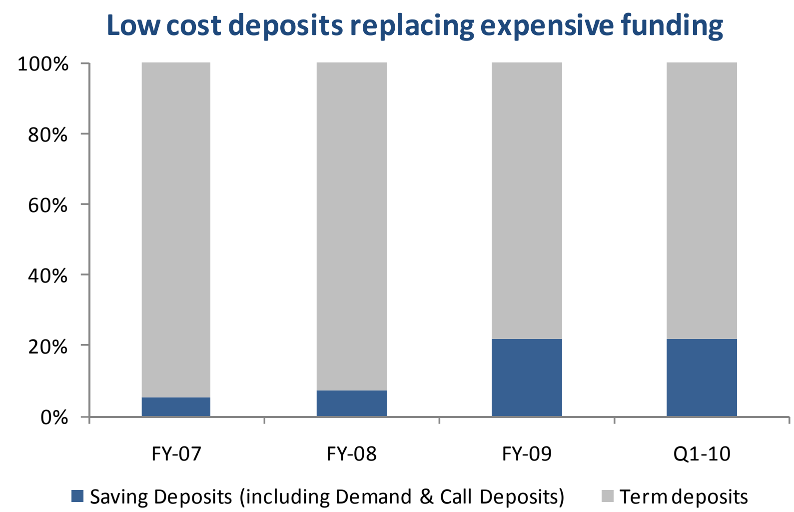


Source: OABINVEST, Company Reports

We believe Ahli Bank will continue to be aggressive on corporate side in order to lower the share of its retail & mortgage loans in its loan portfolio to comply with CBO's guideline of 40% cap in personal loan by year 2010. Moreover, opening up of 5 new branches in 2009 will boost credit and deposits growth over the medium to long-term. Thus we project credit growth at 26% to be higher than the industry average for FY10. We believe bigger players will become more active on lending front in FY11, with improvement in confidence level, which will restrict Ahli Bank's current pace of growth and thus we estimate 20% credit growth for FY11. In long-run the bank's growth rates will converge towards industry average.

✓ *Competition outweighs benefit of reducing reliance on term deposits*

Ahli Bank's deposit mix is highly tilted towards high cost time deposits (78% of total deposits – highest among peer group). This is mainly due to managing the maturity mismatch of long-term mortgages, which still represents majority of loan portfolio (54.3% in Q1'10). With focus shifting more towards corporate side, time deposits proportion is depleting gradually (from 93% in FY08 to 78% in Q1'10) and we anticipate this trend to continue. The exponential growth in low-cost deposits along with diminishing interest rates will certainly reduce funding cost, thus we anticipate 41bps decline in FY10 funding cost.



Source: OABINVEST, Company Reports

We noticed that amongst its domestic peers, Ahli Bank's IEA mix is highly skewed towards relatively higher yielding assets with Gross loan forming 97% of total IEA in Q1'10, (which is next to Bank Sohar's proportion of 97.7%). Moreover, 54% of its total loan portfolio comprises of relatively higher yielding consumer loans, which in our view should keep Ahli Bank's FY10 yields flattish. However in FY11 as bigger players become more active, we believe to increase its market share Ahli Bank will have to resort more competitive pricing. Also, by adhering to CBO guidelines of 40% cap in personal loan from 2010, its yield will fall due to shift in portfolio mix. Thus we believe the bank will not be able to maintain its historical trend of 2nd highest yields.

✓ *NPL way below peer average*

Ahli Bank has the lowest NPL-to-gross loans of around 0.28% in Q1'10. To sustain such levels of NPL with high retail exposure could prove to be a formidable challenge for the bank to maintain the healthy asset quality as its loan book matures.

On 29 Dec'07, CBO had allowed ABOB to create a non-distributable loan loss reserve to meet requirement of additions to the portfolio based provision instead of debiting to income statement. This exemption is effective from 1 Jan'08 to 31 Dec'2010. Thus from FY11, loan loss provision (estimated at RO 1.5mn) will pass through income statement and will impact the bottom-line. In line with our view, we have assumed 34% growth in net earnings in FY10 (to RO 11.4mn) and for FY11 the growth will slow down to 15.3% to RO 13mn.

Valuation

Even though Ahli Bank's FY10 P/BV of 1.84x, is slightly higher compared to domestic industry average of 1.7x but in our view the stock offers the highest balance sheet growth, thus we upgrade the stock from HOLD to **BUY** and based on our revised earnings estimate, we give a target price of RO 0.299, with potential upside of 12.3%.

Ahli Bank - Key Indicators

	FY-08	FY-09	FY-10e	FY-11e	FY-12e
OPERATIONAL EFFICIENCY					
Gross Yield	6.27%	6.04%	6.04%	6.00%	6.05%
Funding cost	4.00%	3.31%	2.90%	2.92%	3.03%
Spread	2.28%	2.73%	3.14%	3.08%	3.02%
Net interest margin	3.1%	2.9%	3.1%	3.1%	3.1%
Interest income/Operating income	79.6%	76.4%	78.7%	79.9%	80.0%
Non-interest income/Operating income	20.4%	23.6%	21.3%	20.1%	20.0%
Cost/Income ratio	54.0%	44.3%	38.9%	36.2%	35.4%
PROFITABILITY					
ROE (%)	7.1%	9.5%	11.7%	12.6%	13.9%
ROA (%)	1.6%	1.6%	1.7%	1.7%	1.7%
NAV per share	0.13	0.14	0.14	0.15	0.16
VALUATION MEASURES					
P/E	15.5x	17.2x	16.5x	14.3x	12.2x
P/BV	1.1x	1.6x	1.8x	1.8x	1.6x
ASSET QUALITY					
NPL/Gross loan	0.2%	0.3%	0.4%	0.5%	0.6%
Provision coverage ratio	386.8%	212.6%	168.1%	287.8%	219.3%
LIQUIDITY AND SOLVENCY RATIO					
Loan deposit ratio	118.4%	95.7%	100.5%	101.3%	101.3%
Lending ratio	85.6%	74.5%	80.2%	82.2%	83.0%
Leverage	5.3x	6.7x	7.1x	8.0x	8.4x
Gross loans as % total assets	82.3%	72.1%	77.3%	79.0%	79.8%
Deposits as % total liabilities	70.0%	75.8%	77.3%	78.8%	79.6%

Source: OABINVEST, Company Reports

Income statement summary

(RO'000)	FY-08	FY-09	FY-10e	FY-11e	FY-12e
Interest Income	22,967	28,088	33,295	39,870	46,940
Interest Expense	11,639	14,418	16,129	19,217	23,218
Net interest Income	**11,329**	**13,671**	**17,166**	**20,653**	**23,722**
yoy growth	89.0%	20.7%	25.6%	20.3%	14.9%
as a % of total operating income	79.6%	76.4%	78.7%	79.9%	80.0%
Other operating income	**2,906**	**4,226**	**4,649**	**5,204**	**5,929**
yoy growth	75.7%	45.4%	10.0%	11.9%	13.9%
as a % of total operating income	20.4%	23.6%	21.3%	20.1%	20.0%
Fees & Commission income	*2,510*	*4,077*	*4,485*	*5,023*	*5,726*
Other Income	*396*	*149*	*164*	*180*	*202*
Total Operating Income	**14,235**	**17,897**	**21,815**	**25,857**	**29,651**
yoy growth	86.1%	25.7%	21.9%	18.5%	14.7%
Staff expenses	4,042	4,361	4,701	5,282	6,140
Other operating Expenses	3,256	2,689	2,850	3,021	3,202
Total Operating exp	**7,299**	**7,050**	**7,551**	**8,304**	**9,343**
Depreciation	383	871	941	1,051	1,164
Operating Profit	**6,553**	**9,976**	**13,324**	**16,502**	**19,144**
yoy growth	94.6%	52.2%	33.6%	23.9%	16.0%
Net Provision / (Recoveries)	**(139)**	**266**	**309**	**1,491**	**1,482**
PBT	**6,692**	**9,710**	**13,015**	**15,011**	**17,662**
yoy growth	166.7%	45.1%	34.0%	15.3%	17.7%
Income tax Expense	759	1,168	1,562	1,801	2,119
PAT	**5,933**	**8,541**	**11,453**	**13,209**	**15,542**
yoy growth	167.4%	43.9%	34.1%	15.3%	17.7%

Source: OABINVEST, Company Reports

Balance sheet

(RO'000)	FY-08	FY-09e	FY-10e	FY-11e	FY-12e
Cash balances with CBO	14,765	108,820	105,251	113,140	123,231
Due from other banks	10,116	7,209	7,578	9,645	11,667
Gross loan	378,043	446,563	562,670	675,204	776,484
(Less) Loan loss provision	2,672	2,902	3,211	8,641	10,123
(Less) Reserved Interest provision	73	99	100	105	95
Net Loans & Advances	375,298	443,562	559,358	666,458	766,267
yoy growth	56.8%	18.2%	26.1%	19.1%	15.0%
Investments	46,004	42,415	36,052	37,855	40,883
Net Property & Equipment	8,283	9,190	9,670	10,143	10,457
Other Assets	1,937	4,862	7,050	8,813	10,399
Total Assets	**459,150**	**619,059**	**728,272**	**854,799**	**973,122**
yoy growth	48.7%	34.8%	17.6%	17.4%	13.8%
Customer Deposits	319,256	466,710	560,052	666,462	766,432
Due to banks	18,426	35,150	34,447	38,581	43,210
Other Borrowed Funds	23,937	7,863	8,099	8,585	9,272
Certificate of Deposits	-	-	-	-	-
Taxation	1,076	1,757	1,000	1,000	1,000
Other Liabilities	6,654	11,959	18,635	24,582	26,549
yoy growth	93.4%	79.7%	55.8%	31.9%	8.0%
Total Liabilities	**369,349**	**523,440**	**622,234**	**739,210**	**846,463**
yoy growth	64.2%	41.7%	18.9%	18.8%	14.5%
Share Capital	64,615	67,846	71,238	71,238	71,238
Share Premium	6,290	-	-	-	-
Other Reserves	6,365	12,619	12,631	8,692	8,692
Legal reserve	3,120	7,034	7,034	7,034	7,034
General & other Reserves	1,131	1,559	1,559	1,559	1,559
Cumulative changes in fair value	-159	94	100	100	100
Retained Earnings	9,785	12,154	18,857	26,913	36,511
Total Shareholder's equity	**87,055**	**92,618**	**102,727**	**106,844**	**116,442**
yoy growth	7.5%	6.4%	10.9%	4.0%	9.0%
Total Liabilities & Equity	**456,404**	**616,058**	**724,960**	**846,054**	**962,904**

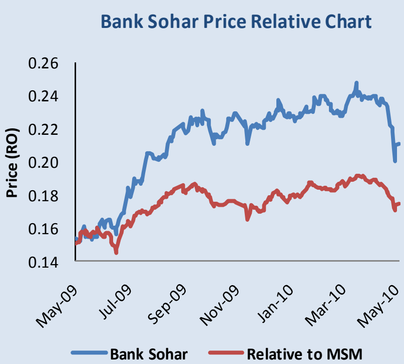
Source: OABINVEST, Company Reports

MSM Ticker	**BKSB**
Bloomberg code	**BKSB OM**
Reuters code	**BKSB.OM**
Target Price (RO)	**0.276**
Share Price (RO)	**0.211**
Upside	**30.7%**
Rating	**BUY**
Market cap (RO mn)	**211**
Current PE (x)	**26.3**
Current P/BV (x)	**2.0**
Dividend Yield (%)	**-**

	FY-10e	FY-11e	FY-12e
EPS	0.012	0.015	0.018
Implied PE	23.8x	18.3x	15.2x
Implied P/BV	2.3x	2.1x	1.9x

Absolute Performance

	BKSB	MSM
6M	-7.9%	-0.6%
1 yr	37.0%	15.7%
YTD	-6.2%	-0.8%



Source: Zawya, OABINVEST

Bank Sohar

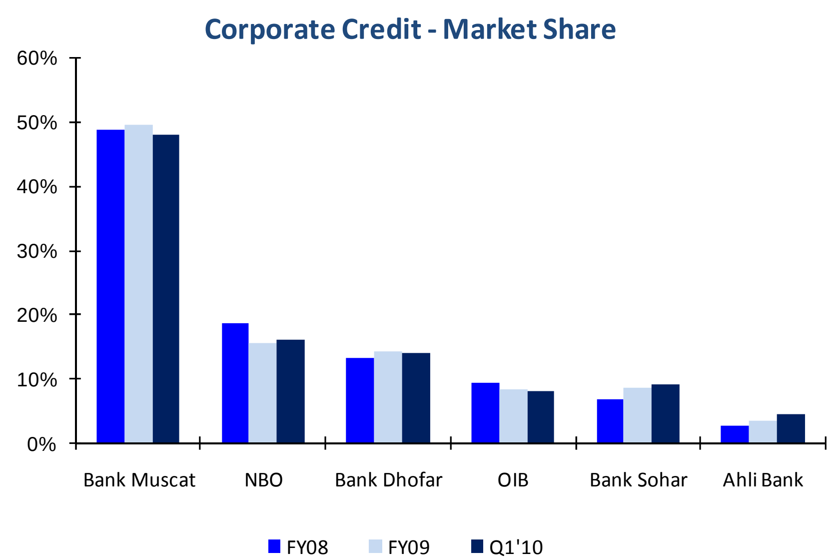
In Q1'10, 1.5% q-o-q decline in interest income was overshadowed with 10% q-o-q plunge in interest expenses, resulting in 7.3% q-o-q jump in net interest income to RO 7.48mn. But total operating income (-10.8% q-o-q) in Q1'10 was dented by 69.5% q-o-q fall in fees income. Moreover, specific provisioning in Q1'10 increased from RO 0.113mn in Q4'09 to RO 0.641m, which led to 21% q-o-q drop in bottom line to RO 2.8mn.

Investment case

✓ ***Loan portfolio well diversified***

Taking advantage of big player's conservative and passive strategy on corporate side in FY09, Bank Sohar with its continued growth focus was able to capture their market share. Consequently, Bank Sohar's market share in corporate loans increased from 6.8% in FY08 to 8.6% in FY09 and further to 9.2% in Q1'10. Analysis of net additions during FY09 depicts that compared to other players, Bank Sohar was very active in import segment with a total net additions during FY09 of RO 60mn (forming 38.8% of its total additions to gross loans) as against RO 97mn decline in credit to import segment at system level.

Moreover, net additions in Bank Sohar's loans to construction, services and manufacturing sectors were second highest amongst local peers. This shows that bank is diversifying in all sectors. Additionally, as the bank is in growth phase, we expect loan growth in FY10 to be around 20% vs. sector level credit growth estimate of 10%. As other banks come out of cautious mode and competition intensifies, continuing the same run rate will be difficult for Bank Sohar and thus we foresee loan growth to move towards industry average over long term.



Source: Company Reports; OABINVEST

✓ *Spreads to remain flattish in medium-term*

In Q1’10, 92.6% of Bank Sohar’s IBL consist of deposits and out of these 67.7% are time deposits, consequently bank’s funding cost is second highest amongst local peers. We believe that although in Q1’10 term deposits proportion increased from 63.7% in Q4’09 to 67.7%, as Bank Sohar replaced its matured CDs with long-term deposits. But looking at the overall historical trend of term deposits contribution (76% in FY08 v/s 63.7% in FY09) it seems bank is committed to reduce its reliance on expensive funding. Thus we expect 28bps y-o-y dip in funding cost in FY10 to 3.4%.

On the yields front, with increasing competition it is unlikely that Bank Sohar will be able to maintain its first position in yields. Thereby we projected 27bps y-o-y decline in yields for FY10, which will wash out the positive impact of declining cost and keep spreads stable.

In Q1’10, Bank Sohar CAR is 13% but to adhere to the recent upside revision of CAR to 12% (effective Dec’10), bank might have to increase tier-2 capital in the form of subordinate debt towards the end of this year. Due to lack of clarity on the amount and costing of the new issue, we have not built this added cost in our forecast and thus it can be a downside risk to our spread assumption.

✓ *Remain cautious on asset quality in long-term*

We are bullish on Bank Sohar in the short term because of its clean balance sheet and expect it to outpace its peers in terms of growth. But we remain cautious about sustainability of lower NPLs level (Q1’10 NPL ratio at 0.38% is 2nd lowest amongst local banks) for long-term. As per management guidance, the bank is conservative and thus roughly 86% of its retail customers are government employees, which reduce the probability of major defaults from retail segment. But taking a cautious view on overall asset quality, we expect NPL ratio from 0.35% in Q1’10 should rise to 0.5% in FY10 and by FY12 it will be around 0.65%.

Valuation

Similar to Ahli Bank, FY10 P/BV multiple for Bank Sohar at 1.8x is close to local banking sector average of 1.7x. We believe Bank Sohar is a long-term story and being in expansion phase has higher potential for balance sheet growth, thus we initiate Bank Sohar with a **BUY** rating and a target price of RO 0.276 (30.7% upside potential).

Bank Sohar- Key Indicators

	FY-08	FY-09	FY-10e	FY-11e	FY-12e
OPERATIONAL EFFICIENCY					
Gross Yield	6.3%	6.9%	6.6%	6.4%	6.2%
Funding cost	4.1%	3.7%	3.4%	3.4%	3.4%
Spread	2.2%	3.2%	3.2%	3.0%	2.9%
Net interest margin	2.1%	3.0%	3.0%	3.0%	2.9%
Non-interest income/Operating income	39.0%	21.5%	21.8%	22.3%	22.9%
Cost/Income ratio	71.0%	59.1%	53.9%	50.7%	48.9%
PROFITABILITY					
ROE (%)	-3.1%	7.9%	10.4%	12.1%	13.1%
ROA (%)	-0.3%	0.9%	1.1%	1.2%	1.3%
NAV per share	0.10	0.11	0.12	0.13	0.14
VALUATION MEASURES					
P/E	-52.6x	28.0x	18.2x	14.0x	11.7x
P/BV	1.2x	2.1x	1.8x	1.6x	1.5x
ASSET QUALITY					
NPL/Gross loan	0.12%	0.24%	0.50%	0.60%	0.65%
Provision coverage ratio	1273.4%	655.6%	324.6%	277.8%	262.6%
LIQUIDITY AND SOLVENCY RATIO					
Loan deposit ratio	101.0%	91.7%	99.6%	102.3%	103.7%
Lending ratio	84.0%	80.4%	87.0%	89.3%	90.9%
Leverage	8.7x	9.7x	9.7x	9.8x	10.2x
Gross loans as % total assets	76.4%	78.0%	84.4%	87.0%	88.7%
Deposits as % total liabilities	85.5%	94.8%	94.5%	94.7%	94.9%

Source: Company Reports; OABINVEST

Income statement

(RO 000)	FY08	FY09	FY10e	FY11e	FY12e
Interest Income	33,010	52,683	59,432	67,702	77,026
yoy	*252.9%*	*59.6%*	*12.8%*	*13.9%*	*13.8%*
Interest Expense	22,201	29,825	32,006	35,547	40,668
yoy	*293.8%*	*34.3%*	*7.3%*	*11.1%*	*14.4%*
Net Interest Income	**10,809**	**22,858**	**27,426**	**32,155**	**36,358**
yoy	*190.9%*	*111.5%*	*20.0%*	*17.2%*	*13.1%*
Other Operating Income	**6,920**	**6,273**	**7,665**	**9,226**	**10,823**
yoy	*47.0%*	*-9.3%*	*22.2%*	*20.4%*	*17.3%*
Other operating income/Total income	***39.03%***	***21.53%***	***21.84%***	***22.30%***	***22.94%***
Net Gain from foreign exchange dealings	*143*	*443*	*642*	*867*	*1,041*
Fees and Commissions	*6,680*	*5,696*	*6,835*	*8,134*	*9,517*
Investment income	*97*	*134*	*188*	*225*	*266*
Operating Income	**17,729**	**29,131**	**35,092**	**41,381**	**47,181**
yoy	*110.4%*	*64.3%*	*20.5%*	*17.9%*	*14.0%*
Staff Costs	7,059	10,203	11,292	12,525	13,865
Other Operating Expenses	4,491	5,414	5,955	6,551	7,010
Total Operating Expenses	**11,550**	**15,617**	**17,248**	**19,076**	**20,874**
yoy	*121.1%*	*35.2%*	*10.4%*	*10.6%*	*9.4%*
Depreciation	1,031	1,598	1,672	1,923	2,191
Operating Profit	**5,148**	**11,916**	**16,172**	**20,382**	**24,116**
yoy	*79.7%*	*131.5%*	*35.7%*	*26.0%*	*18.3%*
Net Pre-incorporation Expense	-	-	-	-	-
Net pre-operating expense	-	-	-	-	-
Impairment allowance on portfolio basis	5,159	2,056	2,161	2,305	2,448
Impairment on investments	2,388	86	154	170	185
Specific provisions on loans	238	666	672	789	915
PBT	**-2,637**	**9,108**	**13,185**	**17,118**	**20,567**
yoy	*6.1%*	*445.4%*	*44.8%*	*29.8%*	*20.1%*
Deferred tax income	-373	1,086	1,582	2,054	2,468
PAT	**-2,264**	**8,022**	**11,603**	**15,064**	**18,099**
yoy	*-8.9%*	*454.3%*	*44.6%*	*29.8%*	*20.1%*

Source: Company Reports; OABINVEST

Balance sheet

(RO 000)	FY08	FY09	FY10e	FY11e	FY12e
Cash & Balances with CBO	93,912	132,270	65,528	48,105	36,553
Due from banks	69,216	20,280	21,902	23,874	26,022
Net Loans & Advances	634,265	786,784	943,770	1,108,437	1,285,263
Gross Loans	*644,101*	*799,451*	*959,341*	*1,127,226*	*1,307,582*
Impairment Allowance	*-9,836*	*-12,667*	*-15,571*	*-18,789*	*-22,319*
Available for sale investments	25,788	61,690	77,113	84,824	92,458
Property, Equipment & Fixtures	13,730	14,340	15,260	16,319	17,100
Other Assets	6,000	9,246	12,759	14,673	16,434
Total Assets	**842,911**	**1,024,610**	**1,136,333**	**1,296,231**	**1,473,830**
Due to banks	90,234	21,400	26,750	30,763	34,454
Certificate of Deposits	90,100	39,038	39,038	39,038	39,038
Customer's Deposits	547,913	832,449	924,018	1,062,621	1,222,014
Deferred Income	7,000	7,000	7,000	7,000	7,000
Other Liabilities	11,177	19,294	22,188	24,407	26,848
Total Liabilities	**746,424**	**919,181**	**1,018,994**	**1,163,828**	**1,329,354**
Share capital	100,000	100,000	100,000	100,000	100,000
Legal reserve	1237	2959	3266	3266	3266
Retained Earnings	-4,750	2,470	14,073	29,137	41,210
Total Equity	**96,487**	**105,429**	**117,339**	**132,403**	**144,476**
Total Equity & Liabilities	**842,911**	**1,024,610**	**1,136,333**	**1,296,231**	**1,473,830**

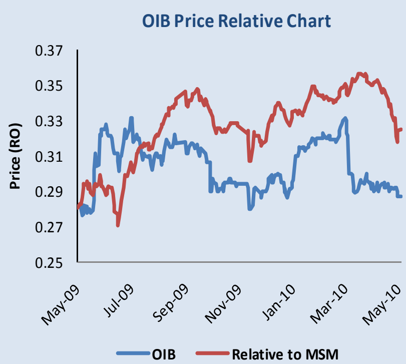
Source: Company Reports; OABINVEST

MSM Ticker	**OIBB**
Bloomberg code	**OIBB OM**
Reuters code	**OIB.OM**
Target Price (RO)	**0.271**
Share Price (RO)	**0.287**
Downside	**5.5%**
Rating	**HOLD**
Market cap (RO mn)	**262**
Current PE (x)	**12.6**
Current P/BV (x)	**1.66**
Dividend Yield (%)	**7.67**

	FY-10e	FY-11e	FY-12e
EPS	0.024	0.025	0.028
Implied PE	11.4x	10.7x	9.5x
Implied P/BV	1.2x	1.0x	0.9x

Absolute Performance

	OIB	MSM
6M	-2.4%	-0.6%
1 yr	2.1%	15.7%
YTD	-3.4%	-0.8%



Source: Zawya, OABINVEST

Oman International Bank

In Q1'10, despite of flattish funding cost (compared to Q4'09) OIB's net interest income declined by 6.8% q-o-q to RO 7.5mn, due to 38bps q-o-q decline in gross yields and marginal dip (0.4% q-o-q) in loan book in Q1'10. During the same period, non-interest income was down by 10% q-o-q to RO 2.73mn primarily owing to 20% q-o-q decline in fees and commission income. Thereby bottom line shrank by 5.3% q-o-q to RO 5.6mn in Q1'10.

Investment case

✓ ***Conservative policy restricting the credit growth***

Despite of having a 2nd highest branch network (after Bank Muscat), the bank is not aggressive in lending, and thus its loan portfolio in Q1'10 declined marginally by 0.4% q-o-q to RO 683mn. Looking at the sectoral breakup of credit, it seems that in FY09 OIB was exiting all major sectors except retail and import trade, which depicts its conservatism. As a result OIB for fourth consecutive year lost its credit market share from 8.5% in FY08 to 7.9% in FY09. Although OIB's lowest loan-to-deposit ratio of 94.4% in Q1'10 reflects that the bank has sufficient deposits to fuel its credit line but its highly conservative stance restricts its credit growth. We believe that as the bank is overcautious, it will not be able to adopt an aggressive strategy in lending thus we expect credit to grow at a CAGR of 7.5% for FY10-12 period.

Slower credit growth expectation and historical loan-to-deposit ratio less than 100%, gives us confidence that in FY10 OIB will already be adequately equipped with deposits to support loan book, thus we estimate deposits will grow at a slower pace of 6% in FY10.

✓ ***Spreads will squeeze***

OIB preserves its cost leadership with the lowest funding cost (0.77% in Q1'10) primarily on account of higher proportion of low cost savings deposits in total deposits (its time deposits proportion is lowest at 14% in Q1'10). Bank's interest rate band shows that in Q1'10, 97.7% of total deposits were lying in the band of 0-2% interest rates and additionally 1.8% is part of 2-4% interest rate band.

Moreover in comparison to its peers, having least gross loan proportion in IEA mix (73% in Q1'10) signifies that in order to pursue a risk-averse strategy, the bank seems to prefer investing in secured treasury bills and certificates of deposits as against exploring opportunities to lend more. As a result, it has the lowest gross yield (3.96% in Q1'10) amongst its peers. Thus advantage of low funding cost is set off by low gross yield, thereby squeezing spreads.

However, lowest yields compared to other banks give OIB scope for upside. But in current scenario of declining interest rates together with continued risk aversion by the bank (which would keep the share of loans in IEA low), we do not foresee rates to increase much and thus we project 16bps decline in yields at 4.4% in FY10.

Considering the fact that the bank has enough liquidity to sustain its current loan book (lending ratio is merely 66%, much lower than the industry average of 80%) and we are cautious on longer-term prospects for credit growth, we believe rapid expansion in deposit base is unlikely. This in a way is advantageous for the bank as it does not have to offer competitive rates to attract more funding, thus we believe that FY10 funding cost will be stable at FY09 levels of 1%. But owing to fall in gross yields we anticipate 14bps drop in FY10 spreads.

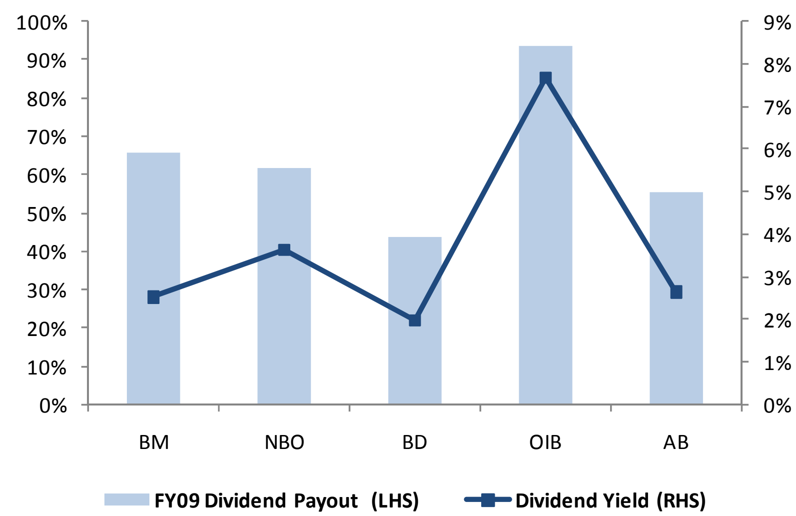
✓ ***Weaker asset quality***

Maintaining its historical trend, OIB's NPL-to-gross loan ratio is highest (10.8% in Q1'10) in comparison to its peers which makes us bearish on this bank. Thus cautiously we anticipate that FY10 NPLs could be 102bps of gross loan and accordingly provisioning charges will be 0.48% of gross loans.

✓ ***Highest dividend yields amongst domestic players***

OIB has always been market leader in terms of dividend payout and continuing the trend in FY09, the bank's payout ratio was all time high at 93.4%. Similarly its dividend yield at 7.67% is highest compared to average dividend yield of 3.7% for sector. Slower growth in loan book (compared to peers) together with higher susceptibility to recoveries of already high NPL make us cautious but its dividend per share being on the higher side makes this a good defensive stock.

OIB has higest dividend yields



Source: Company Reports; OABINVEST

Valuation

Based on 'Residual Income Approach' we have arrived at a target price of RO 0.271, with a downside of 5.5%. However, higher dividend payout ratio as compared to other banks makes this a good defensive stock we thus maintain **HOLD** rating for OIB.

OIB - Key Indicators

	FY-08	FY-09	FY-10e	FY-11e	FY-12e
OPERATIONAL EFFICIENCY					
Gross Yield	4.66%	4.56%	4.40%	4.45%	4.75%
Funding cost	1.67%	1.02%	1.00%	1.10%	1.35%
Spread	2.99%	3.54%	3.40%	3.35%	3.40%
Net interest margin	3.1%	3.6%	3.5%	3.5%	3.5%
Interest income/Operating income	66.2%	74.0%	73.0%	73.2%	73.7%
Non-interest income/Operating income	33.8%	26.0%	27.0%	26.8%	26.3%
Cost/Income ratio	41.5%	45.1%	44.1%	43.3%	41.9%
PROFITABILITY					
ROE (%)	17.6%	12.5%	11.3%	10.3%	10.5%
ROA (%)	2.8%	2.1%	2.0%	2.0%	2.1%
NAV per share	0.19	0.19	0.23	0.26	0.29
VALUATION MEASURES					
P/E	6.8x	12.6x	12.1x	11.4x	10.1x
P/BV	1.2x	1.6x	1.2x	1.1x	1.0x
ASSET QUALITY					
NPL/Gross loan	8.9%	10.5%	10.2%	9.5%	8.7%
Provision coverage ratio	103.3%	98.5%	95.9%	96.8%	98.9%
LIQUIDITY AND SOLVENCY RATIO					
Loan deposit ratio	94.7%	94.0%	94.7%	94.7%	95.1%
Lending ratio	64.0%	64.0%	63.1%	63.2%	63.4%
Leverage	6.6x	6.2x	5.9x	5.9x	6.1x
Gross loans as % total assets	67.8%	66.0%	64.8%	64.8%	64.9%
Deposits as % total liabilities	71.6%	70.2%	68.5%	68.5%	68.2%

Source: Company Reports; OABINVEST

Income statement

(000's)	FY-08	FY-09	FY-10e	FY-11e	FY-12e
Interest Income	44,148	40,234	40,921	44,590	50,795
Interest Expense	-14,394	-8,378	-8,371	-9,805	-12,855
Net Interest income	**29,754**	**31,856**	**32,549**	**34,785**	**37,940**
yoy growth	-9.40%	7.06%	2.18%	6.87%	9.07%
as a % of total operating income	66.2%	74.0%	73.0%	73.2%	73.7%
Other operating income	**15,167**	**11,200**	**12,029**	**12,748**	**13,519**
yoy growth	32.64%	-26.16%	7.40%	5.98%	6.04%
as a % of total operating income	33.8%	26.0%	27.0%	26.8%	26.3%
Fee and commission income	6,448	6,726	7,130	7,486	7,898
Exchange income	2,370	1,785	1,901	2,025	2,156
Realised gains on investments	-	-	-	-	-
Unrealised gain / (loss) on trading investments	913 -	13	-	-	-
Dividend income	2,390	69	76	81	87
Profit on sale of property and equipment	-	-	-	-	-
Other income	3,046	2,633	2,923	3,156	3,377
Total Income	**44,921**	**43,056**	**44,578**	**47,533**	**51,459**
yoy growth	1.5%	-4.2%	3.5%	6.6%	8.3%
Staff costs	-10,961	-11,088	-11,106	-11,727	-12,381
Occupancy costs	-1,554	-1,693	-1,744	-1,796	-1,868
Depreciation	-1,130	-1,164	-1,150	-1,176	-1,202
Other operating costs	-5,005	-5,453	-5,671	-5,898	-6,134
Other operating expenditure	**-18,650**	**-19,398**	**-19,671**	**-20,598**	**-21,585**
Operating profit	**26,271**	**23,658**	**24,907**	**26,936**	**29,874**
yoy growth	-2.3%	-9.9%	5.3%	8.1%	10.9%
Provision for loan impairment	-2,051	-3,259	-3,522	-3,786	-3,562
Impact of recoveries / write back	8,978	4,047	3,304	3,053	3,208
Proposed directors' remuneration	-	-	-	-	-
Profit before taxation	**33,198**	**24,446**	**24,689**	**26,202**	**29,521**
yoy growth	4.9%	-26.4%	1.0%	6.1%	12.7%
Taxation	-3,724	-2,924	-2,953	-3,134	-3,531
Net profit for the year	**29,474**	**21,522**	**21,736**	**23,068**	**25,990**
yoy growth	5.0%	-27.0%	1.0%	6.1%	12.7%

Source: Company Reports; OABINVEST

Balance sheet

(000's)	FY-08	FY-09	FY-10e	FY-11e	FY-12e
Cash and balances with central banks	131,122	107,260	115,333	132,716	148,267
Treasury bills and certificates of deposit	160,000	179,931	212,319	222,935	234,081
Due from other banks	25,712	24,138	24,049	22,116	22,780
Net Loans and advances	626,788	614,610	662,045	716,271	775,009
Gross loan	690,332	685,792	733,797	788,832	847,995
yoy growth	8.0%	-0.7%	7.0%	7.5%	7.5%
(-) Impairment provision	-63,544	-71,182	-71,752	-72,562	-72,986
Investments	33,842	31,038	32,745	34,710	36,706
Net Property and equipment	30,022	30,085	30,205	30,328	30,454
Other assets	10,710	52,268	55,143	57,624	59,929
Total Assets	**1,018,196**	**1,039,330**	**1,131,839**	**1,216,700**	**1,307,225**
yoy	-5.9%	2.1%	8.9%	7.5%	7.4%
Due to banks	103,142	83,387	85,889	88,465	91,119
Deposits from customers	729,315	729,884	775,137	833,272	891,601
Other liabilities	13,148	54,880	57,807	60,505	62,925
Total Liabilities	**845,605**	**868,151**	**918,832**	**982,242**	**1,045,645**
yoy	-8.1%	2.7%	5.8%	6.9%	6.5%
Share capital	91,325	91,325	91,325	91,325	91,325
Non-distributable reserves	55,015	57,789	57,789	57,789	57,789
Retained profits	26,251	22,065	43,801	66,869	92,858
Shareholders' Funds	**172,591**	**171,179**	**213,007**	**234,458**	**261,580**
Total Liabilities & Equity	**1,018,196**	**1,039,330**	**1,131,839**	**1,216,700**	**1,307,225**

Source: Company Reports; OABINVEST

Disclaimer: