

GBCM Research: Bank Muscat - 2019 Results Conference Call Update (Closing: RO 0.450, Rating- Accumulate, 12 Month Fair Value: RO 0.494)

Management of Bank Muscat had their annual results conference call to discuss on the 2019 performance and on the outlook for 2020. Key highlights discussed during the conference call are elaborated as follows.

Discussion on Oman Economy

2020 Oman Budget is based on the oil price estimates of USD 58/ barrel and focuses on investment spending, fiscal prudence, non-oil income diversification and job creation. The Government is aiming towards achieving stable growth along with fiscal discipline in preparation of its Vision 2040 program.

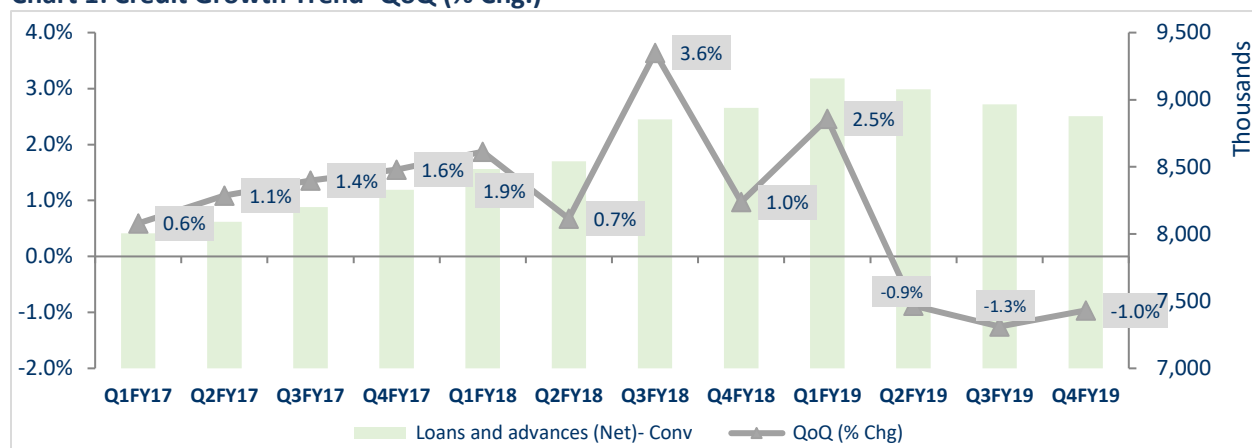
The Government has budgeted to continue its priority project investments and additional investment spending to be seen from Quasi-Government entities in the new year which would support overall stable economic growth rates. As per the management, the prolonged trend of further decline in global oil prices may impact the overall planned spending.

2019 Performance

Credit and deposit growth revealed negative trend amid certain one-off items...

End Q4 2019, Conventional loan book (net) of the bank is at RO 7.712 billion, reporting a decline of 1.5% YoY and -0.9% QoQ. The loan book revealed declining trend during H2 2019 amid repayment/prepayment of Quasi-Government entities and select private companies. Islamic book grew by 5% YoY in 2019. **Overall loan book (Conv and Islamic) declined by 0.7% YoY on the back of large client repayments.** As per the management, excluding the one-off repayments, the bank credit book could have grown by about 4% YoY (on a similar comparison). Of total loans, Personal and housing loans contribution has increased to 42% of total. The exposure to sensitive sectors like real estate and construction sector continued to decline and forms about 7.2% of total loan book in 2019 as compared to about 8.9% levels in 2016.

Chart 1: Credit Growth Trend- QoQ (% Chg.)



Source: Company Reports, GBCM Research

Customer deposits revealed declining trend during 2019 amid high base in the previous year. During Q4, Conventional deposits declined by 6.6% YoY and -1.8% QoQ; While the Islamic deposits grew 7.7% YoY and increased 0.5% QoQ. The combined customer deposits declined by 5% YoY and -1.5% QoQ mainly on the back of prevailing high base in Q4 2018. **Excluding the one-off increase in deposits, the comparable deposit growth in 2019 is at about 3% levels marginally lower than credit growth.**

Bank Muscat continued to maintain stable funding profile along with diversified funding base. As per the bank, the retail deposits increased to about 41% of total deposits, while the Government forms about 31.7% levels and the balance come from Private sector deposits.

Chart 2: Customer Deposits Growth Trend- QoQ (% Chg.)



Source: Company Reports, GBCM Research

Net Interest margins (NIM) marginally lowered amid large repayments...

The net interest income of the bank for 2019 has increased by 4.2% YoY to RO 316.972 million amidst full impact of corporate loan repricing and the increase in yield from new lending opportunities. The contribution of net interest income as percentage of total operating income stood at 67% levels in 2019. Overall fees and commission income contribution remained at 22% of total revenue. The contribution from other income increased to 11% of overall revenues. **The bank has reported improvement in asset yield during first three quarters of 2019, benefiting from repricing efforts and the incremental growth at higher rates.** While for Q4 2019, the net interest income (combined) has declined by 1.4% YoY and +0.1% QoQ. NIM during Q4 declined due to repayments.

Non-interest income of the bank for 2019 reported an increase of 9% YoY amid low base in 2018. During Q4 2019, the other operating income increased 11.4% YoY and increased 7% QoQ to RO 41.4 million. Fee income growth remained strong at about 9% YoY in 2019 amid higher contribution from Bank-assurance, Card business, transactional banking and wholesale banking.



Chart 3: Net Interest Income Growth Trend- QoQ (% Chg.)



Source: Company Reports, GBCM Research

Operating Expenses under control...

Total operating expenses (ex. Depreciation) for 2019 declined 1% YoY to RO 175.3 million. Depreciation charges increased 55% YoY in last fiscal mainly due to adoption of IFRS 16 on leases wherein there has been a reclassification of cost from lease cost to depreciation. For Q4 2019, total expenses (inc. depreciation) have increased 5.7% YoY and +8.4% QoQ to RO 51.4 million. **Cost to income ratio of the bank lowered to 41.5% levels, which is lower than last five years average of 42%.** Management has guided for increase in revenue along with containment of overall costs, this would eventually lead to improvement in cost to income ratio to about 40-41% levels in 2020. 2019 Operating profit of the bank is at RO 276.2 million, an increase of 7.7% YoY. Q4 2019 operating profit of the bank is at RO 69.045 million, increasing 0.5% YoY and declining 6.9% QoQ, this is in line with our estimates.

Cost of risk increased during Q4 2019

End 2019, overall Non-Performing loans to gross loans increased to 3.25% from 3.09% levels in the previous year amidst macro concerns impacting sensitive sectors like Construction and Contracting. As per the management, the bank has provisioned related to IFRS9 stage requirements and followed their conservative provisioning policy. As per our workings, the cost of risk (net) increased to 0.63% levels in 2019 as compared to 0.53% levels in 2018. As per the management, the increase in provisioning during Q4 mainly due to concerns in sensitive sectors and higher precautionary provisions. The bank also had higher provisioning from its Saudi and Kuwait exposure during the last fiscal year. **During Q4, the cost of risk increased to about 0.81% levels.**

2019 net profit of the bank has increased by 3.3% YoY to RO 185.6 million. Net profit of the bank for Q4 2019 stood at RO 44.1 million, reporting a decline of 1.7% YoY and -7.6% QoQ. This is more in line with our estimates. Despite challenging macro environment, the reported net profit of the bank is within a narrow band over the last four years, this reveal the stability in the numbers.



Chart 4: Net Profit Growth Trend- QoQ (% Chg.)



Source: Company Reports, GBCM Research

The bank has announced 2019 dividends of 35% in cash and 5% in stock, subject to CBO and shareholders' approval during the AGM (Mar 2020). The bank has maintained its dividend policy similar to the previous year and provides yield of about 8% at the current levels.

Outlook for 2020

Credit Growth- Oman Banking Sector lending growth to remain about 4-6% levels in 2020 higher than the growth rates seen in 2019 amidst demand from project financing and select retail lending opportunities. **Management of Bank Muscat estimates their credit growth to be in line with the market during 2020.** The growth is expected to be from diversified sectors of the economy driven majorly by the proposed investment spending of RO 5.3 billion in the current fiscal year.

Liquidity remain strong – We saw varied levels of liquidity in Omani Banks during 2019, few banks including Bank Muscat had surplus and select banks showed weakness and henceforth the cost of funding increased due to competition. During 2019, Bank Muscat has higher level of liquidity after the repayment of certain large loans since mid of last year.

Overall liquid assets of the bank remain at about 23% levels and the same would be deployed as credit opportunities emerge. Hence the bank is looking at lower growth of 2-3% in customer deposits in 2020. Funding base of the bank remain stable with about 69% funding coming from customer deposits in 2019.

Net Interest Margin to remain stable- NIM lowered during 2019 on the back of large repayments. The new lending opportunities in 2020 to improve yield and thereby the management anticipates increase in NIM by around 5 basis points in 2020.

Cost to income ratios- Management has guided for increase in revenue along with containment of overall costs, this would eventually lead to improvement in cost to income ratio to about 40-41% levels in 2020.

Asset Quality- Overall asset quality is estimated to improve during 2020. Management sees relatively lower level of cost of risk during the current fiscal year and to be similar to 2018. During 2019, the portion of restructured loans increased sharply due to prevailing market conditions, precautionary measures in sensitive sectors and delay in project completions. Caveat to remain on the emerging macro scenario, Government fiscal policies and the global oil prices in 2020.

Capital Adequacy requirements- In terms of Basel III implementation, the total CAR requirements of Omani Banks as at end of 2020 would be about 14.5% levels (including SIB requirements). End 2019, Bank Muscat has total CAR of about 19.7% levels (after dividends) and the Tier 1 Capital ratio is at 18.8% levels, the highest levels within the sector.

Return on Equity- As per the bank, the return on average equity (RoAE) of the bank has declined to about 10.7% levels (2019) from about 13.7% in 2015. The decline in return ratios over the last five years is on the back of increase in capital requirements due to Basel III implementation and other regulatory requirements. Management has guided for multiple way of capital optimization measures through organic growth opportunities over the medium term.

Valuations and Outlook- Continue to offer demanding valuations and to outperform in 2020...

Bank Muscat remain as a proxy to both local economy and equity market (MSM) for the foreign investors. Despite the bank reporting stable profits since 2015, the stock price continued to remain under pressure and trade at discount (circa 30% discount to book value) on the back of macroeconomic concerns, investor sentiments and the foreign investors (ex-GCC) selling pressure (since Q4 2014). **As of now, the foreign ownership (ex-GCC investors) in Bank Muscat has reduced to meager 4.4%** levels as compared to the levels of c. 23.6% levels (as at end 2014), this clearly points out the level of outflows seen in the local market and particularly in the stock.

In terms of performance, the bank has outperformed the benchmark MSM30 Index and provided total annualized returns (including dividends) of over 12% over the last two years. **On the valuations front, the bank trades at PBV (2019) of 0.75X and PBV (2020E) of 0.72X, which is similar to average of Oman banking sector (refer page 7) and favors well as compared to the regional banking sector multiples (refer page 8 for GCC banks).** Based on the dividends announced, the cash div. yield (2019E) works out to be c. 7.7% levels. **We have an Accumulate** rating on the stock with the fair value of **RO 0.494**. The strong capital adequacy ratio (CAR- 19.7%) is enabling the bank to provide maximum dividends allowed by the regulator to the shareholders. As per the CBO, the cash dividends paid by the local banks is linked to CAR and restricted to 60% of payout ratio (net profits) or 30% of the paid-up capital.

We would be revising our financial estimates and fair value in a separate Investment update report soon.

Table 1: Bank Muscat- Key Ratios (Yearly Trend since 2012)

Growth Indicators	FY12	FY13	FY14	FY15	FY16	FY17	FY18	FY19
Gross Loan Growth	16.3%	9.7%	10.5%	8.0%	8.6%	4.7%	7.3%	-0.7%
Asset Growth	9.5%	7.2%	14.6%	28.9%	-13.7%	3.0%	10.2%	0.0%
Customer Deposits Growth	12.1%	5.9%	16.4%	11.1%	1.3%	-0.5%	14.1%	-5.0%
Total Operating Income Growth	10.0%	5.1%	12.6%	6.4%	2.1%	4.8%	2.5%	5.7%
Net Income Growth	18.4%	9.3%	7.3%	7.5%	0.6%	0.1%	1.6%	3.3%
Profitability Indicators								
Return on Average Assets	1.84%	1.86%	1.79%	1.58%	1.51%	1.61%	1.53%	1.51%
Return on Average Equity	14.33%	13.32%	12.93%	12.95%	12.00%	10.93%	10.31%	10.11%
Interest Expenses/ Total Income	21.65%	23.22%	25.49%	22.24%	25.38%	27.90%	32.08%	34.13%
NIM (%)	3.41%	3.23%	3.00%	2.69%	2.71%	2.90%	2.96%	2.98%
Yield and Spread								
Yield on Interest Bearing Assets	4.43%	4.24%	3.93%	3.31%	3.45%	3.96%	4.19%	4.32%
Cost of Funds	1.45%	1.49%	1.37%	1.05%	1.22%	1.61%	1.86%	2.05%
Interest Spread	2.98%	2.75%	2.56%	2.26%	2.23%	2.35%	2.33%	2.27%
Efficiency Indicators								
Non-Int expenses/ Assets	1.70%	1.69%	1.62%	1.36%	1.61%	1.65%	1.55%	1.59%
Cost to Income Ratio (%)	41.59%	42.24%	41.21%	41.95%	41.83%	42.22%	42.61%	41.50%
Liquidity Indicators								
Customer Deposits/ Shareholders Equity	4.96	4.58	4.80	4.82	4.33	3.83	4.17	3.74
Credit to Deposit Ratio (%)	105.2%	108.8%	103.1%	99.5%	106.7%	112.3%	105.6%	110.4%
Equity to Assets Ratio (%) - CAR	13.6%	14.3%	13.5%	11.1%	14.3%	15.1%	14.6%	15.2%
Credit Quality Indicators								
NPAs to GL	2.99%	2.65%	2.84%	2.75%	2.91%	2.94%	3.09%	3.25%
Recoveries to GL	0.58%	0.51%	0.37%	0.47%	0.44%	0.48%	0.43%	0.00%
Provision Coverage (%)	121.37%	129.20%	129.38%	142.10%	130.62%	128.95%	114.75%	105.4%
Cost of Risk (%)	0.47%	0.31%	0.59%	0.51%	0.45%	0.27%	0.53%	0.63%

Source: Company Reports, GBCM Research Estimates

Table 2: Oman Banking Sector (Conventional Banks)- Comparable Valuations

Oman Banking Sector- Valuations	Closing (4-Feb-20)	Rating **	Market Cap (RO 000s)	PE (2019P)	PE (2020E)	PBV (2019P)	PBV (2020E)	Div. Yield (2019P)	Div. Yield (2020E)	RoAE (2019P)	RoAE (2020E)
Bank Muscat	0.454	Accumulate	1,405,030	7.6	7.4	0.75	0.72	7.7%	7.7%	10.1%	10.0%
Bank Dhofar	0.115	Neutral	344,580	11.4	7.8	0.65	0.62	6.1%	7.0%	5.6%	8.1%
National Bank of Oman	0.201	Accumulate	326,816	6.4	6.3	0.75	0.71	8.4%	8.5%	12.0%	11.5%
Bank Sohar	0.112	Accumulate	264,723	7.7	7.3	0.79	0.74	5.4%	6.3%	11.1%	10.4%
HSBC Bank Oman	0.123	Accumulate	246,038	8.4	7.9	0.70	0.67	7.1%	7.6%	8.5%	8.7%
Ahli Bank	0.145	Under Review	227,810	7.3	6.9	0.86	0.81	6.9%	6.9%	11.9%	12.1%
Sector Avg- Weighted			2,814,998	8.0	7.3	0.75	0.71	7.2%	7.5%	9.9%	10.0%

Source: Company Reports, GBCM Research Estimates, ** Rating is subject to change post updation of 2019 detailed results and revision in our estimates

Table 3: GCC Banking Sector- Comparable Valuations

	Closing Price (4-Feb-20)	YTD (% Chg)	P/E- TTM	P/BV (Latest)	Div. Yield (TTM)	ROE- LF	ROA- LF
Saudi Banks							
National Commercial Bank	46.4	(5.8)	12.0	2.3	4.7	18.4	2.3
Al Rajhi Bank	66.3	1.4	15.0	3.4	4.5	21.9	3.1
Samba Financial Group	28.9	(10.9)	13.8	1.3	6.0	10.9	2.1
Riyad Bank	23.1	(3.9)	12.0	1.7	4.0	14.9	2.3
Saudi British Bank	30.9	(11.0)	15.2	1.2	5.2	7.6	1.5
Banque Saudi Fransi	36.9	(2.8)	14.4	1.4	4.9	9.5	1.6
Alinma Bank	25.1	(1.2)	14.4	1.7	4.0	13.1	2.2
Arab National Bank	25.8	(5.8)	12.1	1.4	4.1	12.2	1.9
Bank Albilad	27.0	0.4	16.2	2.2	1.5	14.6	1.6
Bank Al-Jazira	15.0	(0.4)	12.1	1.1	5.3	8.9	1.3
Saudi Banks- Average			13.7	1.8	4.4	13.2	2.0
Qatar Banks							
Qatar National Bank	20.6	0.2	15.2	2.6	2.9	19.0	1.6
Masraf Al Rayan	4.1	4.3	14.2	2.2	4.8	16.0	2.1
Qatar Islamic Bank	16.4	6.7	13.6	2.3	3.1	17.5	1.9
Commercial Bank	4.5	(3.6)	10.4	1.0	3.3	10.6	1.4
Doha Bank	2.6	2.0	11.3	0.8	3.9	7.5	0.9
Qatar International Islamic	9.1	(5.7)	15.8	2.3	4.4	14.7	1.7
Al Ahli Bank	3.6	2.9	12.3	1.4	2.5	11.8	1.6
Al Khalij Commercial Bank	1.3	0.8	8.0	0.8	5.7	10.2	1.2
Qatar Banks- Average			12.6	1.7	3.8	13.4	1.6
UAE Banks							
FAB	15.2	-	13.7	1.7	4.9	12.7	1.6
Emirates NBD	13.5	3.8	8.2	1.2	2.8	14.9	2.5
Dubai Islamic Bank	5.7	2.7	7.7	1.5	6.2	19.8	2.3
Commercial Bank of Dubai	4.0	(1.3)	8.0	1.1	5.2	14.7	1.8
Mashreq Bank	70.4	0.1	6.1	NA	5.7	NA	NA
National Bank of RAK	4.8	0.4	7.4	1.1	6.3	15.0	2.0
National Bank of UAQ	2.0	2.6	8.5	0.8	5.6	9.3	2.9
United Arab Bank	0.8	(18.7)	NA	0.7	NA	(3.5)	(0.4)
National Bank of Fujairah	5.0	-	15.0	1.8	1.3	12.8	1.6
Commercial Bank Int.	1.0	-	9.0	0.8	NA	7.2	0.8
Sharjah Islamic Bank	1.3	3.3	6.9	0.7	6.3	9.6	1.2
UAE Banks- Average			9.0	1.1	4.9	11.3	1.6
Kuwait Banks							

National Bank of Kuwait	1,039.0	(2.9)	17.4	2.0	3.2	14.4	1.4
Kuwait Finance House	830.0	2.3	22.8	2.8	2.2	12.7	1.4
Ahli United Bank B.S.C	1.1	6.2	14.1	2.4	4.1	17.6	2.0
Boubyan Bank K.S.C	646.0	0.8	30.7	3.2	1.1	12.2	1.3
Commercial Bank Of Kuwait	520.0	(1.7)	15.8	1.4	3.5	9.3	1.5
Burgan Bank	305.0	0.3	13.0	1.1	3.7	8.5	1.2
Ahli United Bank (Kuwait)	341.0	(0.3)	12.3	1.4	4.2	11.7	1.3
Gulf Bank	307.0	1.3	17.2	1.4	3.3	8.2	0.8
Al Ahli Bank of Kuwait	265.0	3.5	18.8	0.7	5.3	5.3	0.6
Kuwait International Bank	276.0	0.7	18.7	1.0	3.8	5.3	0.7
Warba Bank	277.0	0.7	36.4	2.0	NA	7.2	0.6
Kuwait Banks- Average			19.7	1.8	3.4	10.2	1.2
Bahrain Banks							
Ahli United Bank B.S.C	1.1	6.2	14.1	2.4	4.1	17.6	2.0
National Bank of Bahrain BSC	0.7	3.3	13.7	2.2	3.1	14.6	2.3
BBK BSC	0.6	4.7	10.8	1.6	8.3	14.0	2.0
Al-Salam Bank	0.1	-	10.2	0.7	3.4	7.2	1.2
Bahrain Islamic Bank	NA	NA	NA	NA	NA	8.1	0.8
Ithmaar Bank	0.0	(10.0)	NA	1.3	NA	(10.1)	(0.2)
Khaleeji Commercial Bank	0.0	(25.0)	NA	0.4	NA	(6.3)	(0.7)
Bahrain Banks- Average			12.2	1.4	4.7	6.4	1.1
GCC Banks- Avg. (ex. Oman)			13.5	1.6	4.3	10.9	1.5



Stock Rating Methodology:

Buy - Upside more than 20%

Accumulate - Upside between 10% and 20%

Neutral - Upside or downside less than 10%

Reduce - Downside between 10% and 20%

Sell - Downside more than 20%

Not Rated - Stocks not in regular research coverage

LT- Long Term

ST- Short Term

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