BankMuscat SAOG

KEY DATA

MSM Code	BKMB
Reuters Code	BMAO.OM
Market Capitalization	RO 1874 Million USD 4865 Million
Paid-up Capital	RO 107.7 Million USD 279.8 Million
Par Value	RO 0.100
52 Weeks H/L	RO 2.274/ 1.400

Returns	YTD	6M	12M
BKMB	-9.6%	-18.7%	20.6%
MSM	11.0%	-0.2%	53.5%

STOCK PERFORMANCE (52 Week)



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Sector	Banking
Date of Report	August 25, 2008
Price (RO)	RO 1.739
Rating	BUY
Coverage	Update

RESULT HIGHLIGHTS

- BankMuscat (BKM) continues to display strong earnings momentum with its 1H FY08 results. Net Interest Income of the bank registered 26% growth Year on Year (YoY) to RO 74.7 million, and the Other Operating Income grew by 106% to RO 42.7 million. This growth, combined with a lower cost ratio has enabled BKM to post a 53% growth in operating profits for the same period at RO 74 million.

- Given that the sharper loan growth in 1HFY08 could repeat again in the second half, we have maintained our growth estimates for FY08 at 25%. Despite such strong growth expectations, management feels that the more worrying factors could be the weakening trend in Oil prices and rising inflation.

- Assuming a loan growth of 25% and non-interest income growth of 35%, we estimate an EPS of RO 0.140 for BKM in 2009. With the India investment gains being leveraged further, the book value is estimated to be at RO 0.771 by the end of 2009. The current market price discounts the EPS estimate by 12.4 times and the book value by 2.3 times. We are upgrading the stock - rating from HOLD to BUY

KEY FINANCIAL DATA

(RO '000)	1HFY 2008	1HFY 2007	Change
Net Interest Income	74,673	59,298	25.9%
Non-interest Income	42,715	20,770	105.7%
Operating Profit	73,858	48,402	52.6%
Provision for loan losses	13,081	7,738	69.0%
Recoveries	4,393	3,158	39.1%
Net Profit	57,827	40,212	43.8%
Loan & Advances (Net)	3,191,772	2,199,052	45.1%
Total Deposits	2,802,994	2,152,125	30.2%
Diluted EPS (RO)	0.108	0.075	44.0%
Book Value Per Share (RO)	0.662	0.364	81.9%
Price to Earnings (PE Ratio) X	16.1	23.2	--
Price to Book Value (PBV Ratio) X	2.6	4.8	--

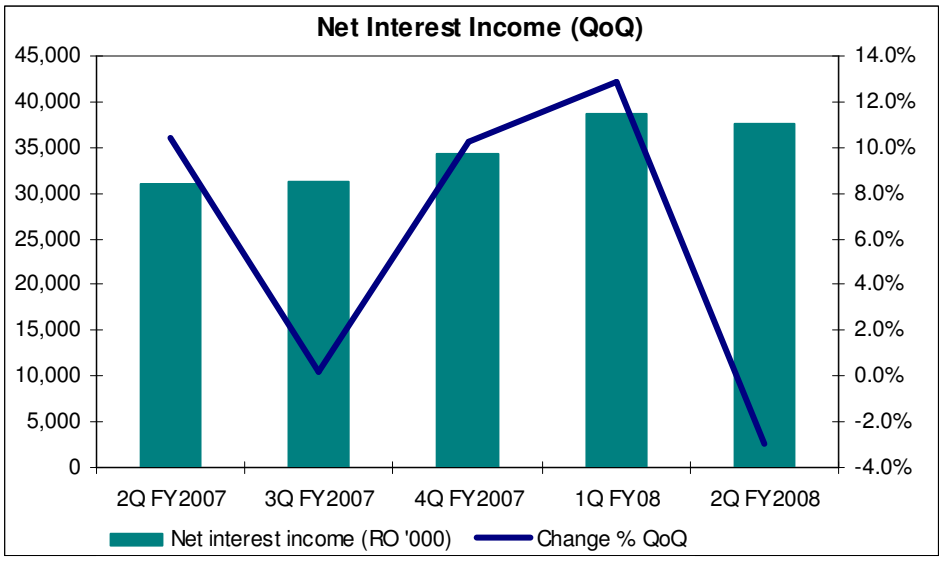
Highlights of 1HFY08 Results

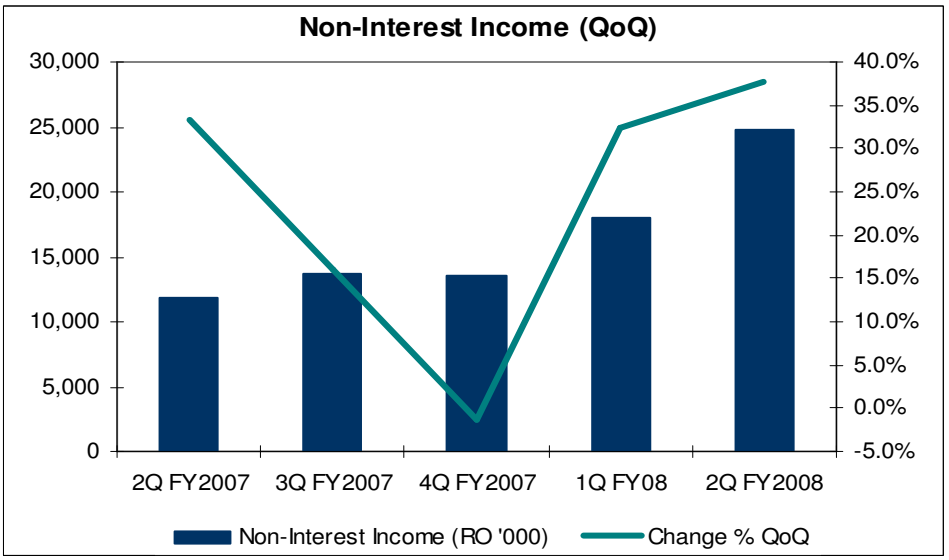
- Loan portfolio grows by over 45% YoY to touch RO 3.2 billion; supported by a 30% growth in deposits
- Interest income grows 18.4% to RO 123m YoY despite lower asset yields; rising loan volumes driving growth
- A surge in customer deposits (30% YoY) with lower cost of funds has boosted the growth in Net Interest Income (NII) to about 26% YoY at RO 75 million
- More significantly, fee-income (mostly from core activities) grows by 106% YoY, pushing operating profit up 53% YoY;
- Provisions rise to RO 13.1 million during 1HFY08 from RO 7.7 million in 1HFY07; provision coverage stands comfortable at 166%; coverage on specific provisions (excluding general) stands at 111%
- Despite growth in non-interest income ROE slips to 16.2% from 24.1% at the end of 1HFY07 owing to substantial increase in capital and networth; ROA gets better to 2.95% from 2.8%. Efficiency expected to be better in 2009 on higher leverage

(RO '000)	2Q FY07	3Q FY07	4Q FY07	1Q FY08	2Q FY08
Interest income	55,377	55,044	59,518	61,509	61,324
Change % QoQ	14.6%	-0.6%	8.1%	3.3%	-0.3%
Interest expense	24,261	23,874	25,164	24,467	23,693
Change % QoQ	20.4%	-1.6%	5.4%	-2.8%	-3.2%
Net interest income	31,116	31,170	34,354	38,762	37,631
Change % QoQ	10.4%	0.2%	10.2%	12.8%	-2.9%
Other operating income	11,871	13,758	13,579	17,974	24,741
Change % QoQ	33.4%	15.9%	-1.3%	32.4%	37.6%
Other operating exp.	16,810	17,599	21,061	20,982	22,548
Change % QoQ	13.2%	4.7%	19.7%	-0.4%	7.5%
Operating profit	25,346	27,329	26,872	34,034	22,548
Change % QoQ	9.9%	7.8%	-1.7%	26.7%	-33.7%
Gain/Loss from Associate	1,450	1,323	1,436	2,107	700
Change % QoQ	12.4%	-8.8%	8.5%	46.7%	-66.8%
Provision for loan losses	3,619	4,119	6,304	6,539	6,542
Impact of recoveries	1,121	1,171	3,330	1,688	2,705
Net profit after tax	21,148	22,404	21,641	26,540	31,287
Change % QoQ	10.9%	5.9%	-3.4%	22.6%	17.9%
Loans and adv. (net)	2,199,052	2,361,344	2,686,863	2,978,643	3,191,772
Change % QoQ	8.1%	7.4%	13.8%	10.9%	7.2%
Quarter's loans booking	164,028	162,292	325,519	291,780	213,129
Customer Deposits	2,152,125	2,276,597	2,322,089	2,657,720	2,802,994
Change % QoQ	5.5%	5.8%	2.0%	14.5%	5.5%
Quarter's Dep. booking	111,652	124,472	45,492	335,631	145,274

Earnings momentum continue

BankMuscat's earnings for 1HFY08 showed increased momentum with a 43.8% growth. According to the management, increased volumes from core banking activity (rising interest and non-interest income) have been the key drivers for earnings growth. While net interest income grew by 26%, non-interest income showed a sharper growth at 106%. Though rising loan provisions and lower recoveries have pushed down the bottom line growth as compared to the operating level, we are satisfied to see the strong influence of a sustainable core income stream in the BKM's profits.





Source: Co. financials & VSC Research

Operating Expenses

Operating expenses increased by RO 11.8 million or 37.3% during the first half of 2008 as compared to the same period in 2007 mainly due to increase in manpower and other administrative costs as a result of increased business activities and expansion of business lines. However, cost to income ratio reduced to 37.1% during the first half of 2008 as against 39.5% during the first half of 2007.

Loan, deposit growth

At net levels, BKM added RO 505 million in 1HFY08 to its loan book, which is a growth of 18.8% from Dec-07 levels. Conducive macro-economic conditions and a fast expanding economy are believed to be the key growth drivers, and BKM being the market leader, the systemic growth gets reflected on its asset base too. Sequentially however, the loan growth peaked in 4QFY07 (RO 326 m).

Within the loan assets, personal (retail, including housing) loans constituted about 39.7% of gross book. Combined with mortgage loans, the CBO prescribed limit for retail assets stands at 50%, with 10% specifically for mortgages alone. Chairman's report suggests that the mortgage business has exceeded RO 150 million in size currently, which is about 4.5% of the total lending.

Customer deposits grew by RO 651 million or 30.2% from RO 2,152 million as of June 30, 2007 to RO 2,803 million as of June 30, 2008. Savings deposits have registered an impressive growth of RO 270 million or 50.7% from RO 533 million as of June 30, 2007 to RO 803 million as of June 30, 2008. The branch network also expanded to reach 116, along with 283 ATMs and 67 Cash Deposit Machines (CDM).

Investment Outlook

The bank continues to grow in a robust economic environment, and that has been demonstrated by the 1H FY08 results. Business opportunities from the industrial /infrastructure/ tourism sectors expected to rise further, in tandem with govt./private sector investments in these areas. We have initiated our view on 2009 results of BankMuscat, wherein with an asset growth of 25% and non-interest income growth of 35%, we expect the bank's PAT to exceed RO 150 million.

Regulatory impact: According to the bank's management, recent regulatory issues were anticipated, and combined together, the CRR and Lending Ratio tightening would suck out about RO 500 million from the

financial system. In fact, we think that smaller banks would feel the higher impact of the new regulations due to rising cost of funds which are already high, and also the reduced cap on personal lending rates; however, in management's opinion, this could be somewhat absorbed without much pains, and the overall impact on the sector is very limited

Asset growth and profits are expected to be on the rise going forward despite new regulations forcing marginal dips. Given that the much aggressive loan growth in 1HFY08 could repeat again in the current fiscal, we have maintained our growth estimates for FY08 at 25%. Despite such strong growth expectations, management feels that the more worrying factors could be the weakening trend in Oil prices and rising inflation.

Regional operations continues to do well for BankMuscat. Saudi branch is expected to break even in 2008, and BMI (Bahrain) has been on a strong growth track. The recently acquired Kuwait banking license is expected to be utilized to have a smaller establishment, with some niche banking activities. On the other hand, a new entity would be set up like BMI, for handling off-shore operations in the central/ south east/ far east Asian countries. BMI would be targeting North and East African countries. Investment in centurion bank has contributed to about USD 200 million profits for BKM, and an appropriate decision would be taken soon on how the post-merger investment in HDFC Bank should be utilized.

Assuming a loan growth of 25% and non-interest income growth of 35%, we estimate an EPS of RO 0.140 for BKM in 2009. With the HDFC Bank investment being leveraged further, the book value is estimated to be at RO 0.771 by the end of 2009. The current market price discounts the EPS estimate by 12.4 times and the book value by 2.3 times. With the scope of a higher leverage on its increased networth, we think that one could expect positive earnings surprises from BKM in 2008 and 2009. Given its sustainable growth in core earnings and also the strong footing in the local market, we believe that the stock has currently come to a level where it makes good sense to invest for a longer term. We raise our rating from HOLD to BUY with a price target of RO 2.240 per share.

Income Statement

RO'000	2005	2006	2007	2008E	2009E
Interest income	116,017	158,866	218,272	268,624	331,521
Interest expense	37,956	59,361	93,450	94,890	113,321
Net interest income	78,061	99,505	124,822	173,734	218,200
Gains from investments	2495	2061	2491	2500	3000
Other operating income	20,776	29,087	45,616	61,582	83,135
Total income	101,332	130,653	172,929	237,815	304,335
Other operating expenditure	44,030	53,330	70,326	95,126	121,734
Operating profit	57,302	77,323	102,603	142,689	182,601
Gain/Loss from Associate	3,664	4,145	5,499	2,500	2,500
Extra Ordinary Gain/Loss	-1,119	0	107	0	0
Provision for loan impairment	24,857	18,966	18,161	20,967	26,208
Impact of recoveries	17,837	7,455	7,659	10,000	12,000
Net profit before tax	52,827	69,957	97,707	134,222	170,893
Taxation	7,383	9,525	13,450	16,103	20,504
Net profit after tax	45,444	60,432	84,257	118,119	150,389
Diluted EPS	0.042	0.056	0.078	0.110	0.140

Balance Sheet

RO'000	2005	2006	2007	2008E	2009E
Assets					
Cash and bal. with CBO	32,936	116,217	487,912	326,061	203,496
Due from other banks	316,735	524,741	587,802	558,412	530,491
Loans and adv. (gross)	1,481,833	1,953,204	2,795,563	3,494,454	4,368,067
Provision and res. Int.	109,903	118,526	108,700	136,656	171,600
Loans and adv. (net)	1,371,930	1,834,678	2,686,863	3,357,798	4,196,467
Investments	164,780	301,165	218,098	261,718	314,061
Fixed assets	10,636	11,438	19,090	20,045	21,047
Other assets	96,800	166,619	217,960	217,960	217,960
Total assets	1,993,817	2,954,858	4,217,725	4,741,993	5,483,522
Liabilities					
Deposits from others	1,290,839	1,817,107	2,322,089	2,554,298	2,937,443
Total deposits	1,290,839	1,817,107	2,322,089	2,554,298	2,937,443
Due to banks	287,954	593,130	952,459	1,095,328	1,259,627
Other liabilities	128,917	224,536	315,607	378,728	454,474
Total liabilities	1,707,710	2,634,773	3,590,155	4,028,354	4,651,544
Shareholders' funds					
Share capital	75,666	83,233	107,713	107,713	107,713
Reserves	163,468	165,810	410,500	410,500	410,500
Retained profit	46,973	71,042	109,357	195,426	313,765
Total sh. holders' funds	286,107	320,085	627,570	713,639	831,978
Total liabilities and SFs	1,993,817	2,954,858	4,217,725	4,741,993	5,483,522
Contingent Liabilities	418,708	592,927	1,015,838	1,219,006	1,462,807

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