Equity Report

Subject : Bank Muscat S.A.O.G – Investment Update
Prepared by : Global Investment House **"Global"**
Date : June 2008

- **Global** values BMAO stock at ***RO2.182*** and recommends ***'Hold'*** on the stock

Global Investment House – Oman - Bank Muscat S.A.O.G (BM) -Bank Muscat (BM) led the pack of Omani banks with a powerful performance in 2007. It recorded a net profit of RO84.3mn (our forecast RO85.2mn) in 2007 as compared to RO60.4mn in 2006 registering a robust YoY growth of 39.4%. This increase was driven by increase in fee and commission income. The bank earned RO37.6mn (our forecast RO29.2mn) as fee and commission income in 2007 against RO24.3mn in the previous year thereby increasing by 54.8% on a YoY basis. BM continued the trend of impressive growth by recording a net profit of RO26.5mn for 1Q08, up by 39.2% from RO19.1mn reported during 1Q07.

Our estimated value for this banking scrip works out to be RO2.182 per share based on DDM (80%) and adaptation of the Gordon Growth Model (20%). According to our fair value computation at RO2.182 per share, this banking scrip offers an upside of 3.7% on the closing price of RO2.104 per share (As at June 04, 2008); we therefore downgrade our earlier "Buy" recommendation on the stock to "HOLD" with a medium term perspective.

Financial Performance –FY07

BM captured the majority of the asset growth in the banking sector and emerged as the leader in terms of market share in 2007. Of the aggregate credit in 2007, it captured 41.3% share or RO2,686.9mn and its total assets increased at a CAGR of 28.3% during 2003-2007. Also, the loans and advances during the same period increased at a CAGR of 21.2%. The manufacturing, mining & quarrying and trade & services sectors were the sectors of focus for BM for 2007.

The customer deposits, comprising 55.1% of bank's total liabilities, had increased at a CAGR of 23.3% from RO1,005.6mn in 2003 to RO2,322.1mn in 2007. This growth surpassed the 22.1% CAGR registered by the all banks' deposits during the period 2003-07. Analysis of the deposits mix indicates that the bank was successful to tap the low cost deposits during 2007 as the deposit accounts decreased as a proportion of total deposits from 47.7% in 2006 to 36.4% in 2007 and the low cost savings and current accounts increased from 23.5% and 21.6% respectively in 2006 to 28.2% and 25.8% of total deposits in 2007.

The NPL coverage ratio has increased from 127% in 2006 to 146% in 2007 on account of reduction of provision on written off assets to the tune of RO19.0mn and additional provisions to the tune of RO14.5mn on the remaining NPLs. In the wake of lower recoveries it needs to tighten the credit monitoring for existing consumer loans. Of the RO93.5mn non-performing assets in 2006 the bank had written off about RO19.03mn during 2007, resulting in NPLs of RO74.5mn at the end of 2007. The bank has announced its intention to follow-up for recovery of the written off assets.

The shareholder's equity registered a CAGR of 38% during 2003-07. The same increased from RO320.1mn in 2006 to RO627.6mn in 2007 providing sufficient cushion for any future loan losses as the equity to gross loans increased from 16.4% in 2006 to 22.4% in 2007. BM is adequately capitalized and its risk weighted assets reduced over the period, as the Tier-I capital ratio increased from 10.4% in 2006 to 12.6% in 2007.

Financial Performance –1Q08

The bank achieved a net profit of RO26.5mn for 1Q08 as against a net profit of RO19.0mn reported during 1Q07, thereby recording an impressive growth of 39.2%. Net interest income increased by 31.4% to RO37.0mn during 1Q08 from RO28.2mn in 1Q07 driven by asset growth. Non-interest income had increased by 85.3% to RO17.9mn in 1Q08 as compared to RO9.7mn in the previous year. Operating income for the quarter increased by 45.2% to RO55.0mn from RO37.9mn registered in 1Q07.

Operating expenses have increased by RO5.8mn in 1Q08 as compared to the same period in 2007. This was mainly due to increase in labor and other administrative costs because of increased business activities and expansion of business lines. Impairment for credit and other losses was RO6.5mn in 1Q08 as compared to RO4.1mn in 1Q07.

BM's net Loans and Advances of RO2,979mn as at the end of 1Q08 had increased by 10.9% as compared RO2,686.9mn as at the end of Dec'07. Customer deposits increased by RO335.6mn or 14.5% on a YoY basis from RO2,322.1mn as at the end of Dec'07 to RO2,657.7mn as at the end of 1Q08. Within customer deposits, savings deposits have registered an impressive growth of RO242mn or 52.7% from RO459mn in 1Q07 to RO702mn in 1Q08. Aggressive asset growth profile with a complementing increase in non-interest income has resulted in a superior core as well as a non-core performance for the bank during 1Q08.

With increased focus on infrastructure and tourism in the Sultanate's Vision 2020, the bank should benefit from its expertise in project financing and further its asset growth. In view of increasing competition and softening interest rates, the bank should witness certain margin squeeze in the near term; however, with diversification into emerging markets and by forging alliances with various developers to provide home-finance for their projects, it should be able to sustain its market share in the medium term.

Investment Indicators

Price (RO as at June 04, 2008)		Shares in issue (mn)			Market Cap (ROmn)		52 - week price range (RO)
2.104		1,077			2,266.3		1.304 - 2.274
Year	Operating income(RO mn)	Net Profit(RO mn)	EPS Baisas	BVPS baisas	ROAE(%)	P/E (x)	P/BVPS (x)
2009F	311.8	161.7	150.1	671.1	2.7%	14.0	3.1
2008F	236.7	122.2	113.4	622.3	2.5%	18.6	3.4
2007A	168.0	84.3	78.2	582.6	2.3%	26.9	3.6
2006A	123.3	60.4	72.6	384.6	2.4%	29.0	5.5

Source : Global Research and Company Reports