



## The Event: Bank Muscat likely to reclassify its investment in Silkbank-Pakistan

Bank Muscat has disclosed that its associate, Silkbank in Pakistan (35% Holding) is planning for a rights issue. The Bank has stated that regulatory approvals in Oman have not been forthcoming and the bank is not in a position to participate in the same. As per the disclosure, due to the non-participation of Bank Muscat in the rights issue, the bank's stake in Silkbank is expected to be diluted, though the actual dilution is not known at this stage. However, if the Bank Muscat stake is reduced to below 20% it is likely that the accounting of this investment could change from "associate" to "marked to market" investment.

As of 30 Sep 09, the holding value of Silkbank investment was RO 23.4 million, which included RO 14 million of book value and RO 9.4 million of amount adjusted against equity on account of depreciation of the Pakistan Rupee. Against this holding value, the market value as of that date was approximately RO 8.3 million. Bank Muscat has said that it will assess the accounting treatment of this investment in consultation with its external auditors and will account for this as required by international accounting standards. However as per the bank's statement, it is likely that the bank could write down a significant part of this investment of RO 23.4 million during the last quarter of 2009 (Q4FY09).

## Comments

### Silkbank Rights Issue: Restructuring to meet Minimum Capital Requirement

**Silkbank is yet to announce the details of its rights issue.** We believe, the Bank would restructure its capital to write off its accumulated losses and looks forward to plough in additional capital through rights issue (we have assumed the same to happen at face value- PKR 10.00) to meet the Minimum Capital Requirement (MCR) set by State Bank of Pakistan (SBP). As per SBP norms, MCR for banks by end of 2009 is set to be PKR 6 Billion and by end of year 2010, the same is set to be PKR 10 Billion.

Silk Bank (PKR Million)	Sep-09
Capital	9,003.15
Accumulated Losses	(7,459.57)
Reserves	218.56
Networth	1,762.14

### Post Rights Bank Muscat Holding in Silkbank to fall from 35.0% to est. 9.02%

Post rights issue we believe Silkbank to achieve its MCR of PKR 6 billion. After this (assuming rights issue is done at Face Value of PKR 10.00) holding of Bank Muscat is estimated to fall from 35.07% to 9.02% (PKR 541.33 Million) (Any discount in rights pricing would lead to additional dilution in its holding.) Hence, we believe Bank Muscat requires to reclassify the investment in Silkbank from an 'Investment in Associate' to "Available For Sale".

Impact of Silkbank capital restructuring		
Assumption: Rights Issue at Face Value of PKR 10.00		
Adjusted Capital	PKR Million	1,543.58
Additional Capital Required	PKR Million	4,456.42
New Capital	PKR Million	6,000.00
Bank Muscat Holding As of Now	%	35.07%
Bank Muscat Holding in Adj. capital	PKR Million	541.33
Bank Muscat Holding Post Rights Issue	%	9.02%

### Impact on Reclassification

As of 30<sup>th</sup> September 2009, Bank Muscat carries its Investment in Associate – Silkbank at RO 13.962 Million as Investment in Associate and RO 9.459 Million as cumulative exchange loss through its equity. Post rights issue of Silkbank, holding value (@PKR 10.00), reduces to RO 2.500 Million. After this we have estimated an total impact of RO 20.921 Million on its Q4'09 earnings. However the impact on the equity will be limited to RO 11.462 Million.

Impact of Reclassification		
Silkbank -CMP	PKR	4.11
Silkbank-Adjusted Price assuming at Face Value	PKR	10
Value of Bank Muscat's Holding in Silkbank-Post Rights	PKR Million	541,335
Conversion Rate	PKR Million	216.54
Value of Bank Muscat's Holding in Silkbank-Post Rights (Assumption that the mkt price adjusts to post-money book value)	RO Million	2,500
Carrying Value of Silkbank -Bank Muscat end of Sep'09	RO Million	13,962
Impact on Earnings - on reclassification	RO Million	11,462
Impact on Earnings - on Exchange loss	RO Million	9459
Total Loss on earnings		20,921
Loss adjusted to Shareholders Equity	RO Million	11,462

We have estimated the Bank to report RO 94.331 Million, assuming the Bank fully provides for its exposure in Saudi based Saad and Ghosaibi groups. Now, if reclassification of its investments in Silk Bank happens we arrive at an estimated Net profit of RO 73.410 Million for FY09E, which translates to reported EPS of RO 0.068. Bank Muscat's reported Book Value per Share as on 30th September 2009 is RO 0.656. The impact from reclassification of Silkbank is a reduction of only est. RO 0.011 to RO 0.645. The stock is currently trading at a multiple of 12.5X on FY 09E and P/BV of 1.32X, one among the lowest in the region. With the balance sheet been cleaned up during the year and the likelihood of growth picking up in 2010, we recommend investors to buy on decline.

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