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(Member of Arab Bank Group)
Investment Management Group – Research Division

Oman Banking Sector Update

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Sector Review

- Conservatism will take backseat in medium-term

We maintain our view that more exploration activities planned for the year and government's consistent investment expenditure will gradually translate into higher credit off-take in medium term. But considering the fact that Q2'10 credit growth has been modest, we still believe that despite of encouraging macro indicators banks will remain in cautious mode in FY'10 and will continue to concentrate on loan quality, which will limit the overall credit growth. Thus we have cut down our consolidated credit growth for FY10 from 10% y-o-y to 6.8% y-o-y.

- Deposit buildup to meet long-term credit demand

We still believe diminishing interest rates will induce banks to expand deposit base to feed long-term credit growth. But taking into account the latest quarterly sluggish run rate, we reduce our FY10 deposit (including CDs) growth assumption for our coverage universe from 15% to 10%.

- Domestic loan book quality issue prolongs

In view of the higher probability of defaults from personal loan portfolio, for FY10 we have revised upwards NPL/GL ratio to 4.9% (v/s our earlier estimate of 4.63%), for our coverage universe.

Stock Review

Coverage Universe	Target Price (RO)	Current Mkt Price (RO)	Upside or Downside	Rating
Bank Muscat	0.982	0.862	13.9%	BUY
NBO	0.398	0.336	18.4%	BUY
Bank Dhofar	0.606	0.724	-16.3%	SELL
Ahli Bank	0.312	0.273	14.4%	BUY
Bank Sohar	0.276	0.224	23.3%	BUY
OIB	0.250	0.268	-6.7%	HOLD

Bank Muscat

Bank Muscat remains our top pick as we believe being market leader the bank has a better growth potential considering reviving macro economic backdrop. On a relative basis (among local peers), with a FY10 ROE of 14.4% (vs. 13%) and P/BV of 1.45x (vs. 1.7x), Bank Muscat still seems to be a better contender. Based on our revised estimates, we cut our target price from RO 1.120 to RO 0.982 per share (with an upside potential of 14%), but maintain **BUY** rating on Bank Muscat.

National Bank of Oman (NBO)

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. NBO continues to remain a valuation play. At FY10 P/BV multiple of 1.35x, NBO is relatively cheaper compared to domestic industry average of 1.7x, thereby making it a compelling **BUY.** Based on our revised earnings estimates and rise in beta to 1.2, we revise down our target price from RO 0.402 to RO 0.398, with an upside potential of 18.4%.

Bank Dhofar

We reiterate that 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 2.58x Bank Dhofar remains expensive amongst local peers, thereby making it less attractive. Even though FY10 ROE of 16.5% is highest for Bank Dhofar but we believe current price is already factoring in high growth, which limits upside potential. Thus we retain our target price of RO 0.606 per share (downside of 16.3%) and **SELL** rating.

Ahli Bank

Even though Ahli Bank's FY10 P/BV of 1.83x, is still higher compared to domestic industry average of 1.7x but we remain optimistic on its loan off-take. Thus we maintain **BUY** rating and based on our revised earnings estimate, we raise the target price from RO 0.299 to RO 0.312, with potential upside of 14.4%.

Bank Sohar

Similar to Ahli Bank, FY10 P/BV multiple for Bank Sohar at 1.88x is higher compared to local banking sector average of 1.7x. We continue to believe Bank Sohar is a long-term story and being in expansion phase has higher potential for balance sheet growth, thus we sustain our **BUY** rating and target price of RO 0.276 (23.3% upside potential).

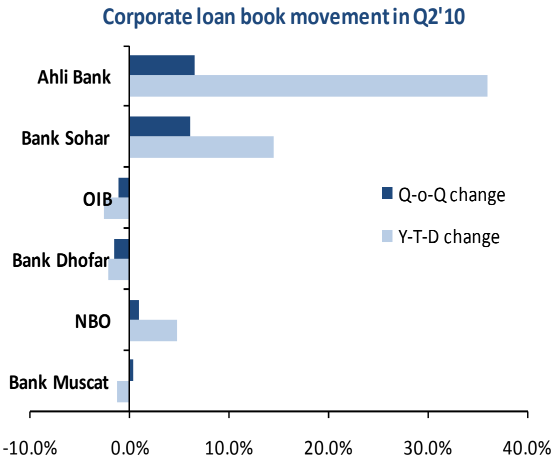
Oman International Bank (OIB)

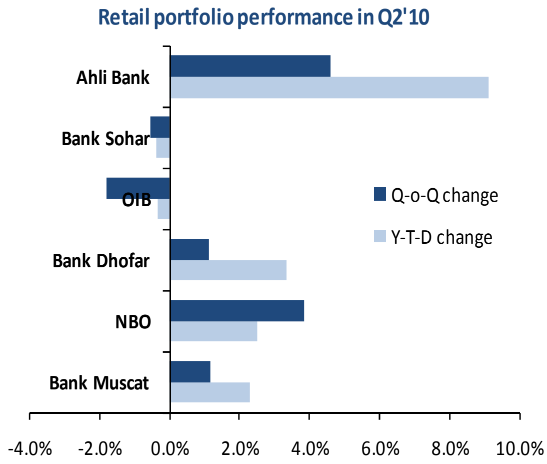
Considering the H1'10 plunge in loan book, we revised our growth assumptions downwards. Bank's near-term challenges are expansion in loan book and high NPLs. Based on our revised earnings forecast, we cut the bank's target price to RO 0.250 (with a potential downside of 6.7%) from RO 0.271. However, higher dividend payout ratio as compared to other banks makes this a good defensive stock we thus maintain **HOLD** rating for OIB.

Sector Review

✓ Conservatism will vanish over medium term

As an outcome of greater risk-aversion by banks, combined loan book growth (at system level) in Q2'10 continued to be dull with a change of 1.74% q-o-q at RO 10.2bn. Due to unavailability of consolidated sectoral breakup for Q2'10, we look at the figures of all 6 listed banks. In Q2'10, retail portfolio was in spotlight, as personal lending increased by 1.5% q-o-q as compared to 0.8% hike in corporate space.





Source: Company report, OABINVEST

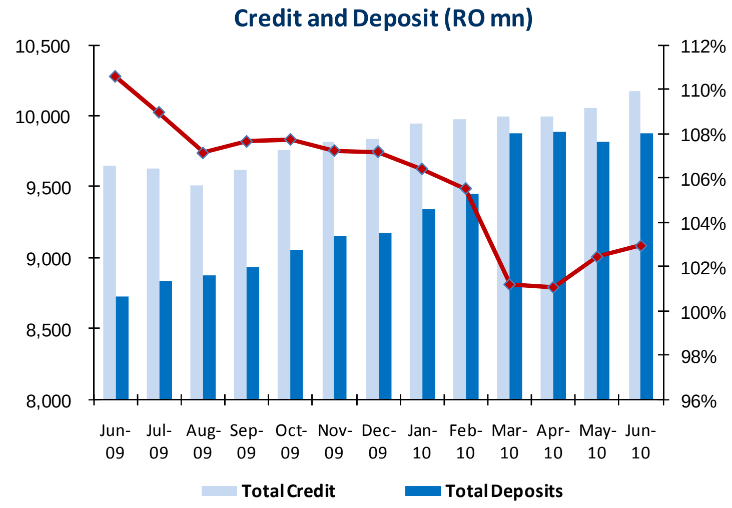
In Q2'10, Bank Dhofar and OIB's corporate book on quarterly basis receded by 1.6% and 1.1% q-o-q, respectively. In line with our view, smaller banks - Ahli Bank and Bank Sohar continued focusing more on corporate lending to capture market share from other banks which were following conservatism. After reducing corporate exposure in FY09, National Bank of Oman (NBO) opened its doors for corporates in H1'10 and thus achieved a 4.8% y-t-d growth. Other matured banks (Bank Muscat, Bank Dhofar and OIB) on y-t-d basis were shying away from corporates.

On the retail side, NBO and Ahli Bank on sequential basis were most active in Q2'10 while Bank Sohar and OIB were reluctant to retail lending. We believe as NBO and Bank Dhofar are nearing to CBO's stipulated level of 50% (including mortgage loans) retail lending out of total loan book, these bank's focus would shift to corporate side.

We maintain our view that more exploration activities planned for the year and government's consistent investment expenditure will gradually translate into higher credit off-take in medium term. But considering the fact that Q2'10 credit growth has been modest, we still believe that despite of encouraging macro indicators banks will remain in cautious mode in FY'10 and will continue to concentrate on loan quality, which will limit the overall credit growth. Thus we have cut down our consolidated credit growth for FY10 from 10% y-o-y to 6.8% y-o-y. In FY11, we expect loan book will grow in a healthier way as banks will reduce risk aversion.

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

In Q2'10, private deposits increased by 1.35% q-o-q while government and public enterprise deposits declined by 0.6% q-o-q and 21% q-o-q, respectively. Thus on sequential basis, overall deposit base in Q2'10 remained flattish at RO 9.8bn, thereby increasing loan-to-deposit ratio to 103% as against 101% in previous quarter.

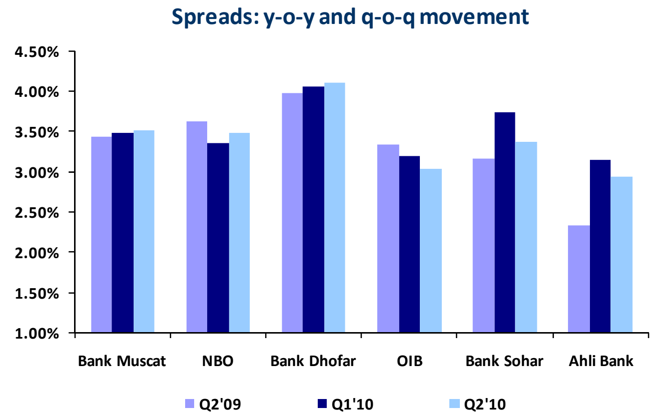


Source: CBO report, OABINVEST

By analyzing Omani banks y-t-d performance, we observed that deposits increased by 7.7% as compared to 3.4% growth in loan book, thus we maintain our view that by taking benefit of lower interest rates, banks will strategically increase deposit base. But considering the latest quarterly run rate, we expect H2'10 net additions will be lower compared to first half. Thus we reduce our FY10 deposit (including CDs) growth assumption for our coverage universe from 15% to 10%, which is higher than the loan book growth of 6.8% for the same period.

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

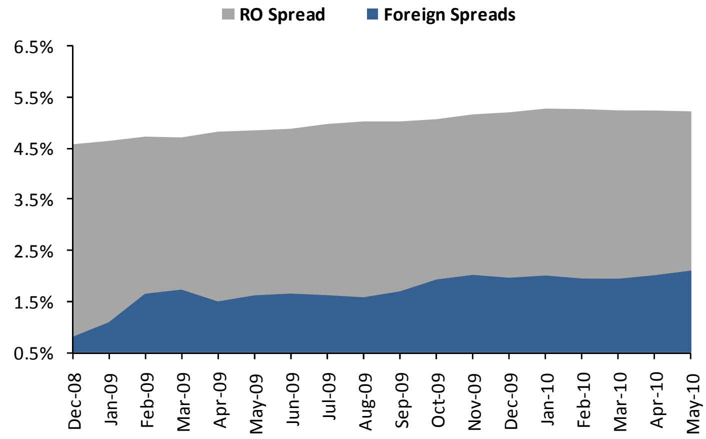
In Q2'10, Bank Dhofar gross yields remained stable compared to previous quarter. Additionally, bank's term deposits declined by 1.5% q-o-q, thus Bank Dhofar topped the charts with a spread of 4.1%.



Source: OABINVEST, Company Reports

In Q2'10, gross loans constitute more than 85% of interest earning assets for all listed banks (except Bank Muscat and OIB which have 81% and 76% contribution from loan book in IEA, respectively), which reflects that bank's yields are highly susceptible to downward interest rate movement. Thus on sequential basis all the listed banks in Q2'10 benefited from southward movement of funding cost, but 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 3.49% in Q1'10 to 3.41% in Q2'10.

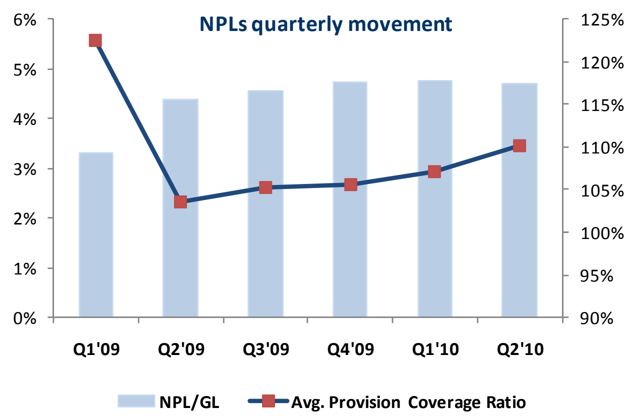
As declining assets yield will offset the benefit of lower deposit rates, we expect in near-term net interest margins to remain flattish. By the year end, as interest rates start increasing and loan demand picks up, we believe that upward re-pricing of asset yields will be faster than the cost of funds 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***

In line with our view that banks have exponentially grown its relatively riskier retail loan book, combined NPL/GL ratio for all 6 listed banks remained flattish at 4.7% in Q2'10 compared to previous quarter.



Source: OABINVEST, Company Reports

Considering the higher probability of defaults from personal loan portfolio, for FY10 we have revised upwards NPL/GL ratio to 4.9% (v/s our earlier estimate of 4.63%), 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.

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

In Q2'10 on sequential basis all banks except Bank Muscat and OIB posted rise in net earnings. For OIB, significant increase in specific provisioning from RO 0.475mn in Q1'10 to RO 1.7mn in Q2'10 was the key reason for 37% q-o-q decline in net earnings. In Bank Muscat, RO 4.4mn losses from BMI in Q2'10 came as a negative surprise, which together with sluggish operating profit resulted in 8% q-o-q decline in net profit to RO 22.5mn in Q2'10.

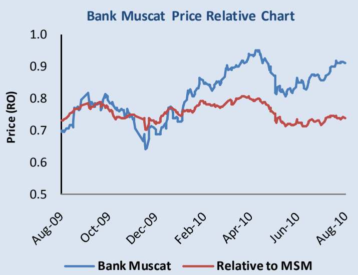
We reiterate our view that, although for FY10 we are conservative on loan book growth; foresee that NIMs will be flattish in near term but we still forecast combined net profit of all listed banks to grow by 49.8% y-o-y to RO 221mn, primarily due to the absence of regional provisioning. We expect the total credit loss charges in FY10 to decline by 48% to RO 71mn.

MSM Ticker	**BKMB**
Bloomberg code	**BKMB OM**
Reuters code	**BMAO.OM**
Target Price (RO)	**0.982**
Share Price (RO)	**0.862**
Upside	**14%**
Rating	**BUY**
Market cap (RO mn)	**1,160**
PE TTM (x)	**19.2**
P/BV TTM (x)	**1.58**
Dividend Yield (%)	**2.32**

	FY-10e	FY-11e	FY-12e
EPS	0.081	0.097	0.110
Implied PE	12.1x	10.1x	8.9x
Implied P/BV	1.7x	1.5x	1.4x

Absolute Performance

	BKMB	MSM
6M	8.0%	-6.4%
12M	33.2%	1.5%
YTD	30.8%	-0.9%



Source: Zawya; OABINVEST

Bank Muscat

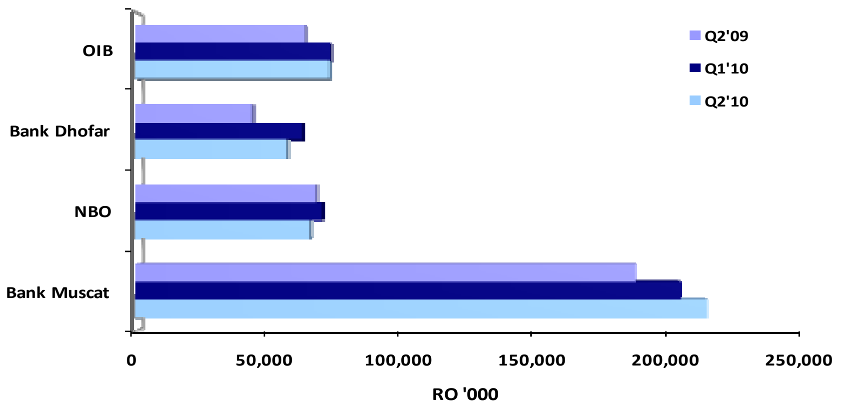
Bank's net interest income (NII) of RO 43.7mn in Q2'10, falls 4% short of our quarterly estimates. Compared to previous quarter, NII declined by 1.5% in Q2'10, while on annual basis it remained flattish. In Q2'10 non-interest income of RO 16.5mn was 4.6% lower compared to Q1'10 figures. Cost-to-income ratio was high at 41% in Q2'10 (as against 40% in Q1'10 and 26.7% in Q2'10). As expected, Bank Muscat's provisions for credit losses fell by 24% q-o-q to RO 8.9mn in Q2'10. But RO 4.4mn losses from BMI in Q2'10 came as a negative surprise, which together with sluggish operating profit resulted in 8% q-o-q decline in net profit to RO 22.5mn in Q2'10.

Investment Case

- ✓ We continue to believe that Bank Muscat has the potential and can be most benefited with the recovery in the corporate activities in the medium-term. But considering the Q2'10 loans net additions, we reduce our FY10 loan growth assumption from 8.5% to 2.6%.

- ✓ After fully providing for Saudi exposure in FY09, the focus has shifted to domestic loan quality. Since Bank Muscat reported the highest net additions in NPLs in H1'10 amongst the peers, we reiterate our view that domestic portfolio remains a challenge. Thus conservatively we increase NPL-to-gross loan ratio for FY10e to 5.6% from earlier estimate of 5%.

Domestic NPLs on the run for major players



Source: Company Reports; OABINVEST

- ✓ In sync with our view, high deposit buildup in Q1'10 (+13% q-o-q) and flattish credit growth in Q2'10 restricted the need for further deposit accumulation. Thus in Q2'10, deposits declined by 2.7% q-o-q to RO 3.4bn.

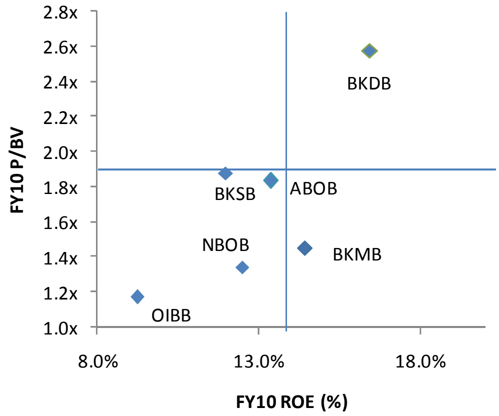
  We noticed that Bank Muscat's lending ratio at 81% in Q2'10 is lowest in last six consecutive quarters. Substantial rise in deposits (+10% y-t-d) and lower lending ratio makes us believe that its unutilized low cost deposit build up will give much needed support to its loan book growth in medium term. Thus we think that its deposits will not grow at the same pace in H2'10. Consequently, we forecast deposits to grow at 13% y-o-y for FY10.

- ✓ 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, first full year impact of interest paid on 7% convertible bond & 8% subordinate bonds will squeeze its net interest income. But on positive side, since Bank Muscat is market leader in bank placements and inter-bank borrowings, which forms 18.7% and 25.5% of its Q2'10 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 reiterate that NIM will remain stable at 3.5% in FY10, compared to previous year.

- ✓ We believe Bank Muscat is a recovery story, because the absence of provisioning against regional exposures; Silk bank losses and impairment charges will support net earnings. We envisage that Bank Muscat's fees based activities will get a boost from Nawras IPO income (planned in H2'10). However, considering BMI losses in Q2'10, we estimate for the full year 2010 a 2% decline in income from associates. Based on our revised estimates, we assume a net profit growth of 47.7% at RO 108mn for FY10 (9.5% lower than our earlier forecast).

Valuation

FY10 - ROE vs. P/BV of Omani Banks



Source: OABINVEST estimates

Bank Muscat continues to look cheaper at TTM P/BV of 1.58x as compared to industry average of 1.92x. Comparing domestic banking peers on FY10 ROE and FY10 P/BV matrix Bank Muscat with a ROE of 14.4% and at a P/BV of 1.45x is a better contender. Thus on a relative basis, current levels suggests a good entry point for Bank Muscat stock.

We have used 'Residual Income Approach', where target price is ascertained based on intrinsic value of bank. Based on our revised estimates, we cut our target price from RO 1.120 to RO 0.982 per share (with an upside potential of 14%). Since currently on relative valuation basis stocks looks attractive and being market leader has a better growth potential considering reviving macro economic backdrop, we maintain **BUY** rating on Bank Muscat.

Bank Muscat – Financials

Income Statement (in RO'000)	FY - 08	FY-09	FY-10e	FY-11e	FY-12e
Interest Income	263,463	279,530	280,068	309,728	343,795
Interest Expense	-101,356	-105,164	-100,964	-122,473	-139,261
Net Interest income	**162,107**	**174,366**	**179,104**	**187,254**	**204,534**
Other operating income	**74,694**	**116,679**	**71,654**	**84,027**	**98,457**
Operating Income	**236,801**	**291,045**	**250,759**	**271,281**	**302,991**
Operating Expenses	**-84,224**	**-82,125**	**-92,893**	**-105,064**	**-119,517**
Operating Profit	**152,577**	**208,920**	**157,866**	**166,216**	**183,474**
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	-41,574	-31,721	-30,765
Recoveries from impairment for credit losses	12,603	10,589	10,084	13,969	15,090
Share of profit(loss) from associates	-3,248	-10,455	-1,343	1,975	2,373
Recoveries from provision for placements	583	425	-	-	-
Impairment for placements	-4,813	-	-	-	-
Profit Before Taxation	**108,411**	**87,982**	**123,712**	**148,960**	**168,530**
Tax expense	-14,680	-14,264	-14,845	-17,875	-20,224
Net profit for the year	**93,731**	**73,718**	**108,866**	**131,085**	**148,307**

	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%	3.5%	3.4%	3.4%
Operating Profit margin	57.9%	74.7%	56.4%	53.7%	53.4%
Interest income/Operating income	68.5%	59.9%	71.4%	69.0%	67.5%
Non-interest income/Operating income	31.5%	40.1%	28.6%	31.0%	32.5%
Cost/Income ratio	35.6%	28.2%	37.0%	38.7%	39.4%
PROFITABILITY					
ROE (%)	14.0%	10.3%	14.4%	15.6%	16.2%
ROA (%)	1.8%	1.2%	1.8%	2.0%	2.1%
NAV per share	0.66	0.66	0.59	0.65	0.71
VALUATION MEASURES					
P/E	6.6x	12.0x	10.7x	8.9x	7.8x
P/BV	0.9x	1.2x	1.5x	1.3x	1.2x
ASSET QUALITY					
NPL/Gross loan	2.3%	5.0%	5.6%	5.6%	5.3%
Provision coverage ratio	138.8%	106.0%	107.3%	105.0%	104.7%
LIQUIDITY AND SOLVENCY RATIO					
Loan deposit ratio	113.3%	123.6%	113.1%	112.9%	114.2%
Lending ratio	83.8%	87.8%	81.0%	81.7%	82.6%
Leverage	8.4x	8.2x	8.0x	7.9x	7.7x
Gross loans as % total assets	63.9%	69.3%	65.0%	65.7%	67.0%
Deposits as % total liabilities	59.7%	59.7%	61.9%	63.1%	64.2%

Balance Sheet (in RO'000)	FY-08	FY-09	FY-10e	FY-11e	FY-12e
Cash	452,761	608,099	966,189	966,897	955,619
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	4,157,409	4,531,576	4,962,076
(-) Impairment	-125,574	-213,845	-249,787	-264,134	-275,363
Net loans and advances	3,727,700	3,838,211	3,907,622	4,267,443	4,686,713
Investments	378,646	144,366	157,587	174,711	192,321
Investment in associates	92,903	67,172	65,829	67,803	70,177
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**	**6,398,679**	**6,896,039**	**7,404,572**
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	3,467,320	3,796,716	4,138,420
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
Liabilities	**5,313,486**	**5,139,420**	**5,599,367**	**6,020,075**	**6,445,844**
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	181,458	258,110	340,874
Foreign currency translation reserve	-9,471	-884	-	-	-
Non-controlling interests in equity	-	212	-	-	-
Shareholders' Funds	**714,750**	**711,316**	**799,312**	**875,964**	**958,728**
Total Liab. & shareholders' funds	**6,028,236**	**5,850,736**	**6,398,679**	**6,896,039**	**7,404,572**

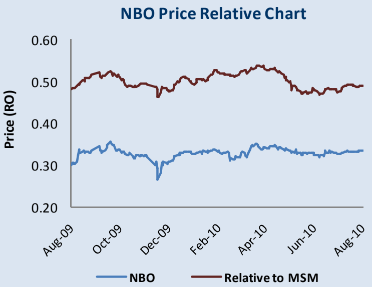
Source: Company Reports; OABINVEST

MSM Ticker	**NBOB**
Bloomberg code	**NBOB OM**
Reuters code	**NBO.OM**
Target Price (RO)	**0.398**
Share Price (RO)	**0.336**
Upside	**18.4%**
Rating	**BUY**
Market cap (RO mn)	**363**
PE TTM (x)	**13.3**
P/BV TTM (x)	**1.45**
Dividend Yield (%)	**3.60**

	FY-10e	FY-11e	FY-12e
EPS	0.030	0.036	0.043
Implied PE	13.2x	11.0x	9.4x
Implied P/BV	1.6x	1.5x	1.3x

Absolute Performance

	NBO	MSM
6M	0.3%	-6.4%
1 yr	11.3%	1.5%
YTD	4.7%	-0.9%



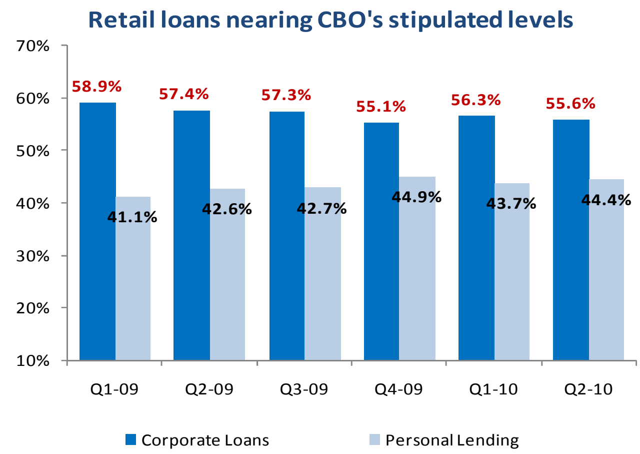
Source: Zawya, OABINVEST

National Bank of Oman

Decline in National Bank of Oman's (NBO) interest expenses by 3.7% q-o-q to RO 9.7mn in Q2'10, is a dual impact of declining funding cost and sequential reduction in deposit base. Thus despite of flattish interest income sequential growth in Q2'10, net interest income soared by 3.4% q-o-q. NBO's non-interest income in Q2'10 rose by 8.2% q-o-q to RO 6.7mn, which further boosted pre-provision profits. In line with our estimates of RO 8.5mn, NBO posted net profit of RO 8mn in Q2'10 (+31% y-o-y and 22% q-o-q) owing to higher operating profit, lower provisioning and higher recoveries.

Investment Case *(Extracted from our latest report on NBO dated 2 Aug'10)*

✓ NBO posted 2.2% q-o-q growth in loan book to RO 1.48bn in Q2'10, backed by 1% and 3.9% q-o-q rise in corporate lending and retail portfolio, respectively. Thus personal loan contribution increased to 44.4% in Q2'10 as against 42.6% in Q2'09 (and 43.7% in Q1'10). Though the exact proportion of mortgage lending is not known, we believe that NBO could be nearing to CBO's stipulated limit of 40% personal loan contribution. Thus we maintain our view that this will limit the scope of further increase on retail side. We take support from the fact that on y-t-d basis NBO's retail portfolio has grown 2.5%, while corporate book witnessed a higher growth rate of 4.8%. We expect with gradual improvement in infrastructure lending in medium-to-long term, this trend will continue.



Source: Company Reports; OABINVEST

Although we remain cautious on loan quality of increasing retail portfolio, but considering 7% q-o-q plunge in NPLs in Q2'10 (and consequent 43.7bps q-o-q reduction in NPL ratio to 4.5%), we revisited our full year 2010 NPL ratio and reduced it to 4.8% from our earlier estimates of 5%. Thus improving asset quality makes us optimistic about NBO's loan activities in H2'10. Moreover, in first six months of 2010, the bank has already achieved 3.8% credit growth. Thus our earlier conservative estimate of loan growth of 6.6% for FY10 looks reasonable and we keep it unchanged.

✓ Due to run down in current account and certificate of deposits (-18.3% q-o-q & -8.7% q-o-q, respectively) the overall deposit base shrunk by 4.8% q-o-q to RO 1.3bn in Q2'10. NBO has so far been successful in swinging the deposit mix more towards low cost deposits. This is evident from the fact that current accounts increased 31.4% y-t-d, while the expensive term deposits were trimmed down by 3.7% y-t-d.

On y-t-d basis deposit growth of 3.6% is near to credit growth of 3.8%. As we believe that deposit growth will be dictated by movement in loan portfolio, thus need to maintain high deposit base has reduced. Thus we reduce our FY10 deposit growth estimate from 12% to 9%.

- ✓ We reiterate our view that 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 18.5bps to 3.65%. Although due to rise in lending, increase in funding cost is quite certain in FY11 but we believe NBO will get benefit of low-cost deposit base.

- ✓ In Q2'10, 37.8% q-o-q growth in service charges was the key reason for 8% q-o-q growth in non-interest to RO 6.7mn, which was in line with our estimate of RO 6.5mn. Taking into account fees income growth in H1'10, we keep our earlier forecast of 12% growth in FY10 unchanged.

By providing fully for Saudi exposure and 75% provisioning for Kazakhstan exposure NBO has cleared its balance sheet in FY09. We foresee that domestic loan book quality will remain a challenge in medium term and we thus estimate in FY10 provisions at 120bps of gross loans. We believe absence of exceptional provisioning against regional exposures will enhance bottom line in FY10 and will reach RO 32.5mn, representing 53.6% growth.

Valuation

At FY10 P/BV multiple of 1.35x, NBO is relatively cheaper compared to domestic industry average of 1.7x, thereby making it a compelling **BUY.** Based on our revised earnings estimates and rise in beta to 1.2, we revise down our target price from RO 0.402 to RO 0.398, with an upside potential of 18.4%.

NBO – Financials

Income Statement (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	-42,423	-49,374	-57,012
Net Interest Income	**47,533**	**56,822**	**60,832**	**65,322**	**70,383**
Other operating income	**40,615**	**25,045**	**25,577**	**28,150**	**30,688**
Total operating income	**88,148**	**81,867**	**86,409**	**93,472**	**101,071**
Depreciation	-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	-12,097	-12,619	-12,129
Total expense	**-33,854**	**-34,784**	**-37,220**	**-39,664**	**-40,951**
Operating Profit	**54,294**	**47,083**	**49,189**	**53,808**	**60,120**
Provision for credit losses	-15,581	-20,483	-18,281	-14,945	-13,675
Recoveries from provision for impairme	8,551	7,036	6,883	6,435	6,430
Impairment losses on AFS	-3,703	-4,121	-814	-732	-633
Recoveries from bad debts written off a	8,094	3,465	-	-	-
PBT	**51,655**	**25,014**	**36,977**	**44,566**	**52,242**
Tax	-6,275	-3,909	-4,434	-5,344	-6,265
PAT	**45,380**	**21,105**	**32,543**	**39,222**	**45,977**

	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%	3.7%	3.6%	3.6%
Operating Profit margin	60.2%	46.0%	47.6%	46.9%	47.2%
Interest income/Operating income	53.9%	69.4%	70.4%	69.9%	69.6%
Non-interest income/Operating income	46.1%	30.6%	29.6%	30.1%	30.4%
Cost/Income ratio	38.4%	42.5%	43.1%	42.4%	40.5%
PROFITABILITY					
ROE (%)	19.0%	8.5%	12.5%	13.9%	15.0%
ROA (%)	2.6%	1.1%	1.7%	1.9%	2.1%
VALUATION MEASURES					
P/E	8.7x	16.4x	11.2x	9.3x	7.9x
P/BV	1.6x	1.4x	1.3x	1.2x	1.1x
ASSET QUALITY					
NPL/Gross loan	4.4%	5.0%	4.8%	4.4%	4.0%
Provision coverage ratio	100.0%	95.0%	98.8%	99.5%	100.1%
LIQUIDITY AND SOLVENCY RATIO					
Lending ratio	84.2%	87.0%	85.5%	86.1%	87.7%
Loan deposit ratio	109.2%	113.4%	110.9%	110.9%	112.7%
Leverage	8.1x	7.2x	7.2x	7.2x	7.1x
Gross loans as % total assets	73.8%	79.5%	78.3%	78.8%	80.2%
Deposits as % total liabilities	67.6%	70.1%	70.6%	71.0%	71.1%

Balance Sheet (in RO '000)	FY-08	FY-09	FY-10e	FY-11e	FY-12e
Cash & balances with Central Bank	266,389	184,357	223,365	242,140	231,213
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	-72,679	-72,993
Net loans & advances	1,401,218	1,360,997	1,451,205	1,587,869	1,750,289
Other assets	77,765	25,736	27,623	29,465	31,233
Investments	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**	**1,946,683**	**2,108,422**	**2,273,958**
Subordinate debt	28,600	27,600	30,600	30,600	30,600
Current, deposits & other accounts	1,341,755	1,260,768	1,374,237	1,497,918	1,617,752
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**	**1,676,721**	**1,815,510**	**1,954,679**
Share capital	108,100	108,100	108,100	108,100	108,100
Proposed Stock Dividend	18,918	12,972	16,272	19,611	22,988
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	66,024	85,634	108,623
Shareholders' Funds	**245,385**	**250,391**	**269,963**	**292,912**	**319,279**
Total Liabilities and Equity	**1,984,480**	**1,798,213**	**1,946,683**	**2,108,422**	**2,273,958**

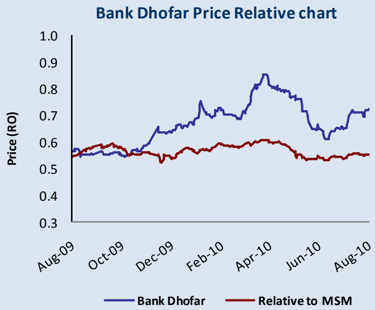
Source: Company Reports; OABINVEST

MSM Ticker	BKDB
Bloomberg code	BKDB OM
Reuters code	BDOF.OM
Target Price (RO)	0.606
Share Price (RO)	0.724
Downside	16.3%
Rating	SELL
Market cap (RO mn)	589
PE TTM (x)	10.5
P/BV TTM (x)	2.8
Dividend Yield (%)	2.07

	FY-10e	FY-11e	FY-12e
EPS	0.048	0.052	0.059
Implied PE	12.6x	11.6x	10.2x
Implied P/BV	2.2x	2.0x	1.8x

Absolute Performance

	BKDB	MSM
6M	0.6%	-6.4%
1 yr	32.8%	8.6%
YTD	8.9%	-0.9%



Source: Zawya, OABINVEST

Bank Dhofar

Bank's operating income of RO 17.6mn in Q2'10 (+1.8% y-o-y; -1.7% q-o-q), falls 6% short of our quarterly estimates. Operating expenses declined by 1.6% q-o-q, but cost-to-income ratio remained at Q1'10 level of 40%. Thus due to higher fall in operating income compared to expenses, operating profit at RO 10.6mn dropped by 1.7% q-o-q in Q2'10. In line with our estimates of RO 9mn, Bank Dhofar posted net profit of RO 8.9mn in Q2'10 (+16% y-o-y and 0.6% q-o-q)

Investment Case

- ✓ On sequential basis, gross loan remained stable at RO 1.26bn in Q2'10. Bank Dhofar continued to focus more on retail sector (+1.1% q-o-q to RO 560.5mn) in Q2'10, thereby increasing retail loans proportion to 44.5%, highest level since 2006. Thus we reiterate that the scope of further significant expansion on retail side is limited and thus bank would have to focus on corporate lending.

  Since Bank Dhofar's 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 in medium-term. However in view of lower H1'10 figures, we revise downwards our FY10 credit growth assumption from 8% to 2%.

- ✓ 26% q-o-q decline in government deposits in Q2'10, led to 3% quarterly fall in deposit base to RO 1.14bn. As a conscious effort to reduce cost, we noticed that Bank Dhofar's low-cost deposits grew by 7% y-t-d as compared to 1.2% y-t-d growth in expensive term deposits. Thus we maintain our view that 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 (excluding Bank Sohar). Consequently, we estimate 38bps improvement in spreads to 4% in FY10.

- ✓ Although the bank will be relieved from pressures of regional exposure, but we believe bank's near-term challenge is higher buildup in riskier retail portfolio. Thus we project NPL-to-gross loan ratio to be 4.8% in FY10 and provision charges to reach 40bps of gross loan.

Valuation

In our GCC peer set Bank Dhofar still remains costliest on TTM P/BV multiple at 2.8x (after Al Rajhi Bank). Additionally, based on FY10 P/BV multiple at 2.58x Bank Dhofar remains expensive amongst local peers, thereby making it less attractive. Even though FY10 ROE of 16.5% 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 maintain a target price of RO 0.606 per share, with a downside of 16.3%. Moreover, we believe that the stock has already moved upwards and adjusted for higher growth expectation and thus we retain **SELL** rating.

Regional Peer comparison:

Banks	Mkt cap (USD mn)	TTM P/BV	TTM PE
OMAN			
BANK MUSCAT SAOG	3,015	1.58x	19.23x
NATIONAL BANK OF OMAN	943	1.45x	13.33x
BANK DHOFAR SAOG	1,530	2.81x	10.55x
OMAN INTERNATIONAL BANK	636	1.53x	12.94x
AHLI BANK	505	2.06x	16.37x
BANK SOHAR	582	2.12x	27.92x
Peer Average		**1.92x**	**16.73x**
BAHRAIN			
AHLI UNITED BANK	3,898	1.58x	17.86x
NATIONAL BANK OF BAHRAIN	1,248	1.95x	11.62x
Average		**1.77x**	**14.74x**
KUWAIT			
NATIONAL BANK OF KUWAIT	15,402	2.40x	15.59x
COMMERCIAL BANK OF KUWAIT	3,878	2.55x	-
Average		**2.47x**	**15.59x**
QATAR			
QATAR NATIONAL BANK	15,098	2.60x	11.36x
COMMERCIAL BANK OF QATAR	4,514	1.49x	11.99x
DOHA BANK QSC	2,436	1.60x	9.26x
Average		**1.90x**	**10.87x**
SAUDI ARABIA			
AL RAJHI BANK	30,500	3.86x	17.00x
SAMBA FINANCIAL GROUP	14,220	2.17x	11.91x
SAUDI BRITISH BANK	8,520	2.25x	19.20x
RIYAD BANK	10,480	1.38x	12.59x
BANQUE SAUDI FRANSI	8,273	1.84x	12.37x
Average		**2.30x**	**14.61x**
UAE			
NATIONAL BANK OF ABU DHABI	7,424	1.22x	8.08x
EMIRATES NBD PJSC	3,753	0.42x	5.02x
FIRST GULF BANK	5,241	0.81x	5.92x
ABU DHABI COMMERCIAL BANK	2,253	0.44x	-
UNION NATIONAL BANK/ABU DH	1,859	0.61x	5.38x
Average		**0.70x**	**6.10x**

Source: OABINVEST, Bloomberg (last updated on 23 Aug'10)

Bank Dhofar – Financials

Income Statement (in RO '000)	FY-08	FY-09	FY-10e	FY-11e	FY-12e
Interest Income	63,671	77,729	81,136	88,764	98,196
Interest Expense	-23,772	-28,502	-25,657	-28,875	-32,403
Net Interest income	**39,899**	**49,227**	**55,478**	**59,889**	**65,793**
Other income	**16,265**	**15,802**	**16,411**	**17,817**	**19,284**
Operating Income	**56,164**	**65,029**	**71,889**	**77,706**	**85,077**
Operating Expenses	**-21,105**	**-23,658**	**-27,440**	**-30,348**	**-33,139**
Staff and administrative costs	-19,494	-21,871	-25,419	-28,049	-30,519
Depreciation	-1,611	-1,787	-2,021	-2,299	-2,620
Operating Profit	**35,059**	**41,371**	**44,449**	**47,358**	**51,938**
Provision for loan impairment	-5,470	-11,706	-5,132	-4,850	-4,877
Recoveries from allowance for loan impairı	2,350	1,524	1,511	1,848	3,118
Bad debts written-off	-2	-93	-	-	-
Financial instruments at fair value	4	-12	-	-	-
Impairment of AFS investments	-4,864	-2,063	-403	-426	-451
Profit Before Taxation	**27,077**	**29,021**	**40,425**	**43,930**	**49,727**
Income tax	-3,391	-3,628	-4,851	-5,272	-5,967
Net profit for the year	**23,686**	**25,393**	**35,574**	**38,658**	**43,760**

	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%	4.10%	4.22%	4.25%
Interest income/Operating income	71.0%	75.7%	77.2%	77.1%	77.3%
Non-interest income/Operating income	29.0%	24.3%	22.8%	22.9%	22.7%
Cost/Income ratio	37.6%	36.4%	38.2%	39.1%	39.0%
PROFITABILITY					
ROE (%)	15.8%	12.9%	16.5%	16.1%	16.6%
ROA (%)	2.1%	1.8%	2.3%	2.3%	2.5%
VALUATION MEASURES					
P/E	10.1x	19.4x	15.1x	13.9x	12.2x
P/BV	1.2x	2.4x	2.6x	2.3x	2.1x
ASSET QUALITY					
NPL/Gross loan	3.6%	4.8%	4.8%	4.5%	4.1%
Provision coverage ratio	131.6%	105.2%	117.0%	119.9%	120.5%
LIQUIDITY AND SOLVENCY RATIO					
Loan deposit ratio	110.0%	114.2%	108.9%	109.4%	111.6%
Lending ratio	81.4%	84.6%	79.5%	79.8%	83.4%
Leverage	7.0x	7.3x	7.0x	6.9x	6.6x
Gross loans as % total assets	80.7%	84.6%	79.9%	80.0%	83.1%
Deposits as % total liabilities	73.4%	74.1%	73.4%	73.1%	74.5%

Balance Sheet (in RO '000)	FY-08	FY-09	FY-10e	FY-11e	FY-12e
Cash and cash equivalents	116,249	182,248	276,401	294,651	250,338
Held-to-maturity investments	120,468	47,437	52,181	55,833	59,463
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	1,282,989	1,385,628	1,524,191
(-) Impairment allowance	-50,326	-63,589	-72,045	-74,766	-75,274
Net loans and advances	1,018,441	1,194,243	1,210,943	1,310,862	1,448,917
Financial instruments at fair value throu	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**	**1,604,810**	**1,731,701**	**1,834,149**
Due to banks	89,663	100,057	109,062	118,878	129,577
Deposits from customers	971,596	1,101,267	1,178,356	1,266,732	1,365,537
Other liabilities	35,628	43,093	50,405	56,454	61,535
Subordinated bonds and loan	38,500	38,500	38,500	38,500	-
Liabilities	**1,135,387**	**1,282,917**	**1,376,323**	**1,480,564**	**1,556,649**
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	52,118	74,768	101,132
Shareholders' Equity	**188,433**	**204,007**	**228,487**	**251,137**	**277,500**
Total liab. and shareholders' funds	**1,323,820**	**1,486,924**	**1,604,810**	**1,731,701**	**1,834,149**

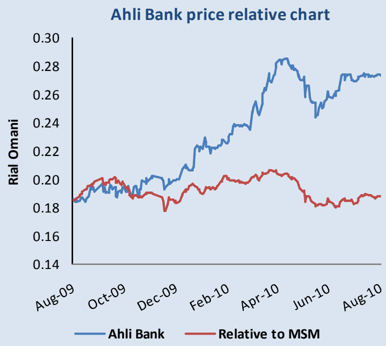
Source: Company Reports; OABINVEST

MSM Ticker	ABOB
Bloomberg code	ABOB OM
Reuters code	AHBK.OM
Target Price (RO)	0.312
Share Price (RO)	0.273
Upside	14.4%
Rating	BUY
Market cap (RO mn)	194
PE TTM (x)	16.4
P/BV TTM (x)	2.0
Dividend Yield (%)	2.56

	FY-10e	FY-11e	FY-12e
EPS	0.021	0.024	0.028
Implied PE	15.2x	13.0x	11.3x
Implied P/BV	2.1x	2.0x	1.8x

Absolute Performance

	ABOB	MSM
6M	20.3%	-6.4%
1 yr	59.6%	8.6%
YTD	31.9%	-0.9%



Source: Zawya, OABINVEST

Ahli Bank

Ahli Bank reported RO 6.3mn operating income in Q2'10, representing an impressive growth of 46.8% y-o-y and 12.6% q-o-q. Cost-to-income ratio improved from 35.7% in Q1'10 (and 46.6% in Q2'09) to 33.3% in Q2'10. Thus improvement in total operating income and cost reduction led to 16.8% q-o-q growth in operating profit to RO 4.2mn in Q2'10, which overshadowed the negative impact of 3 times rise in net provisioning (q-o-q) to RO 0.15mn. Thus bank posted an impressive net profit growth of 14.4% q-o-q to RO 3.6mn in Q2'10.

Investment case

- ✓ 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 now Ahli Bank is in a better position to capitalize its gradually developed corporate relationships. Consequently, its corporate lending proportion increased from 40.7% in FY09 and further to 46% in Q2'10.

  We expect 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. Thus we project credit growth at 29% to be higher than the industry average for FY10.

- ✓ Ahli Bank's deposit mix is highly tilted towards high cost time deposits (77% 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% in Q2'10). With focus shifting more towards corporate side, time deposits proportion is depleting gradually (from 93% in FY08 to 77% in Q2'10) and we anticipate this trend to continue. The increasing focus on low-cost deposits along with diminishing interest rates will certainly reduce funding cost, thus we anticipate 41bps decline in FY10 funding cost.

  Since majority of Ahli Bank's loan portfolio comprises of relatively higher yielding consumer loans, thus we anticipate Ahli Bank's FY10 yields to be flattish. However in FY11 as bigger players become more active, we believe to increase its market share Ahli Bank will have to resort to 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.

- ✓ Ahli Bank has the lowest NPL-to-gross loans of around 0.31% in Q2'10. 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 will pass through income statement and will impact the bottom-line.

Valuation

Even though Ahli Bank's FY10 P/BV of 1.83x, is still higher compared to domestic industry average of 1.7x but we remain optimistic on its loan off-take. Thus we maintain **BUY** rating and based on our revised earnings estimate, we raise the target price from RO 0.299 to RO 0.312, with potential upside of 14.4%.

Ahli Bank – Financials

Income Statement (RO'000)	FY-08	FY-09	FY-10e	FY-11e	FY-12e
Interest Income	22,967	28,088	34,066	41,057	47,986
Interest Expense	11,639	14,418	16,129	19,217	23,218
Net interest Income	**11,329**	**13,671**	**17,937**	**21,840**	**24,768**
Other operating income	**2,906**	**4,226**	**5,887**	**6,594**	**7,513**
Total Operating Income	**14,235**	**17,897**	**23,824**	**28,434**	**32,280**
Staff expenses	4,042	4,361	4,624	5,203	6,058
Other operating Expenses	3,256	2,689	2,850	3,021	3,202
Total Operating exp	**7,299**	**7,050**	**7,475**	**8,224**	**9,260**
Depreciation	383	871	941	1,051	1,164
Operating Profit	**6,553**	**9,976**	**15,409**	**19,158**	**21,856**
Net Provision / (Recoveries)	**-139**	**266**	**320**	**1,527**	**1,517**
Provisions	-	294	461	1,728	1,828
Recoveries	-	65	141	202	311
PBT	**6,692**	**9,710**	**15,089**	**17,631**	**20,339**
Income tax Expense	759	1,168	1,811	2,116	2,441
PAT	**5,933**	**8,541**	**13,278**	**15,516**	**17,898**
yoy growth	167.4%	43.9%	55.5%	16.8%	15.4%

	FY-08	FY-09	FY-10e	FY-11e	FY-12e
OPERATIONAL EFFICIENCY					
Gross Yield	6.27%	6.04%	6.10%	6.04%	6.05%
Funding cost	4.00%	3.31%	2.90%	2.92%	3.03%
Spread	2.28%	2.73%	3.20%	3.12%	3.02%
Net interest margin	3.1%	2.9%	3.2%	3.2%	3.1%
Operating Profit margin	0.0%	0.0%	0.0%	0.0%	0.0%
Interest income/Operating income	79.6%	76.4%	75.3%	76.8%	76.7%
Non-interest income/Operating income	20.4%	23.6%	24.7%	23.2%	23.3%
Cost/Income ratio	54.0%	44.3%	35.3%	32.6%	32.3%
PROFITABILITY					
ROE (%)	7.1%	9.5%	13.4%	14.4%	15.5%
ROA (%)	1.6%	1.6%	2.0%	2.0%	2.0%
NAV per share	0.13	0.14	0.15	0.15	0.17
VALUATION MEASURES					
P/E	15.5x	17.2x	14.6x	12.5x	10.9x
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%	167.1%	335.1%	251.3%
LIQUIDITY AND SOLVENCY RATIO					
Loan deposit ratio	118.4%	95.7%	102.9%	103.7%	103.7%
Lending ratio	85.6%	74.5%	81.8%	83.6%	84.3%
Leverage	5.2x	6.7x	6.9x	7.7x	8.0x
Gross loans as % total assets	82.8%	72.5%	79.1%	81.4%	82.2%
Deposits as % total liabilities	70.0%	75.8%	76.9%	78.5%	79.2%

Balance Sheet (RO'000)	FY-08	FY-09e	FY-10e	FY-11e	FY-12e
Cash balances with CBO	14,765	108,820	94,238	102,052	111,141
Due from other banks	10,116	7,209	8,612	9,645	11,667
Gross loan	378,043	446,563	576,067	691,280	794,972
(-) Loan loss provision	2,672	2,902	3,222	10,221	11,738
(-) Reserved Interest provision	73	99	147	203	248
Net Loans & Advances	375,298	443,562	572,698	680,856	782,986
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	**456,405**	**616,058**	**728,320**	**849,364**	**967,533**
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
Taxation	1,076	1,757	1,000	1,000	1,000
Other Liabilities	6,654	11,959	18,635	24,582	26,549
Total Liabilities	**369,349**	**523,440**	**622,234**	**739,210**	**846,463**
Share Capital	64,615	67,846	71,238	71,238	71,238
Share Premium	6,290	-	-	-	-
Other Reserves	6,365	12,619	14,165	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
Non-distributable loan loss rese	2,273	3,933	5,473	-	-
Cumulative changes in fair value	-159	94	100	100	100
Retained Earnings	9,785	12,154	20,683	30,223	41,139
Total Shareholder's equity	**87,055**	**92,618**	**106,086**	**110,154**	**121,070**
Total Liabilities & Equity	**456,404**	**616,058**	**728,320**	**849,364**	**967,533**

Source: Company Reports; OABINVEST

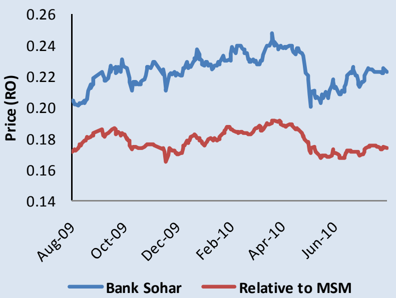
MSM Ticker	**BKSB**
Bloomberg code	**BKSB OM**
Reuters code	**BKSB.OM**
Target Price (RO)	**0.276**
Share Price (RO)	**0.224**
Upside	**23.3%**
Rating	**BUY**
Market cap (RO mn)	**224**
PE TTM (x)	**27.9**
P/BV TTM (x)	**2.1**
Dividend Yield (%)	**-**

	FY-10e	FY-11e	FY-12e
EPS	0.013	0.016	0.019
Implied PE	20.5x	17.3x	14.7x
Implied P/BV	2.3x	2.1x	1.9x

Absolute Performance

	BKSB	MSM
6M	-5.1%	-6.5%
1 yr	9.3%	1.4%
YTD	-0.9%	-0.9%

Bank Sohar Price Relative Chart



Source: Zawya, OABINVEST

Bank Sohar

Bank Sohar's total operating income at RO 8.8mn in Q2'10 (+19.6% y-o-y; +6.2% q-o-q) is completely in line with our estimates. On sequential basis operating expenses increased by 10.5% to RO 4.8mn, thereby increasing cost-to-income ratio from 52.3% in Q1'10 to 54.4% in Q2'10. Operating profit at RO 4mn in Q2'10, is also in sync with our projections. Reduction in provisioning by 46.6% q-o-q, supported bottom line 13.2% q-o-q growth in Q2'10 (at RO 3.2mn).

Investment case

- ✓ Taking advantage of big player's conservative and passive strategy on corporate side, 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 8.6% in FY09 and further to 9.7% in Q2'10. As the bank is in growth phase, we expect loan growth in FY10 to be around 16.5% vs. sector level credit growth estimate of 6.8%. 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.

- ✓ In Q2'10, Bank Sohar's time deposit proportion in total deposits is 67%, consequently bank's funding cost remained second highest amongst local peers. We believe due to overall diminishing interest rate scenario, Bank Sohar's funding cost for FY10 will remain stable at H1'10 level of 2.9%. On the yields front, to increase its credit market share the bank will compromise on yields. Thereby we project 42bps y-o-y decline in yields for FY10.

- ✓ 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 (Q2'10 NPL ratio at 0.35% is 2nd lowest amongst local banks) for long-term. Taking a cautious view on overall asset quality, we expect NPL will rise to 0.4% in FY10 and by FY12 it will be around 0.65%.

Valuation

Similar to Ahli Bank, FY10 P/BV multiple for Bank Sohar at 1.88x is higher compared 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 sustain our **BUY** rating and target price of RO 0.276 (23.3% upside potential).

Bank Sohar – Financials

Income Statement (RO 000)	FY08	FY09	FY10e	FY11e	FY12e
Interest Income	33,010	52,683	57,179	65,840	75,096
(-) Interest Expense	22,201	29,825	27,409	31,473	36,971
Net Interest Income	**10,809**	**22,858**	**29,770**	**34,367**	**38,125**
Other Operating Income	**6,920**	**6,273**	**6,583**	**7,740**	**9,066**
Operating Income	**17,729**	**29,131**	**36,353**	**42,108**	**47,191**
Staff Costs	7,059	10,203	10,864	12,180	13,367
Other Operating Expenses	4,491	5,414	5,955	6,551	7,010
Depreciation	1,031	1,598	1,765	2,030	2,313
Operating Profit	**5,148**	**11,916**	**17,768**	**21,346**	**24,501**
Impairment allowance on portfc	5,159	2,056	1,572	2,116	2,177
Impairment on investments	2,388	86	154	170	185
Specific provisions on loans	238	666	745	864	808
PBT	**-2,637**	**9,108**	**15,298**	**18,196**	**21,332**
Deferred tax income	-373	1,086	1,836	2,184	2,560
PAT	**-2,264**	**8,022**	**13,462**	**16,013**	**18,772**

	FY-08	FY-09	FY-10e	FY-11e	FY-12e
OPERATIONAL EFFICIENCY					
Gross Yield	6.3%	6.9%	6.5%	6.4%	6.3%
Funding cost	4.1%	3.7%	2.9%	3.0%	3.1%
Spread	2.2%	3.2%	3.5%	3.4%	3.2%
Net interest margin	2.1%	3.0%	3.4%	3.3%	3.2%
Non-interest income/Operating	39.0%	21.5%	18.1%	18.4%	19.2%
Cost/Income ratio	71.0%	59.1%	51.1%	49.3%	48.1%
PROFITABILITY					
ROE (%)	-3.1%	7.9%	12.0%	12.7%	13.4%
ROA (%)	-0.3%	0.9%	1.2%	1.3%	1.4%
VALUATION MEASURES					
P/E	-52.6x	28.0x	16.6x	14.0x	11.9x
P/BV	1.2x	2.1x	1.9x	1.7x	1.5x
ASSET QUALITY					
NPL/Gross loan	0.12%	0.24%	0.40%	0.60%	0.65%
Provision coverage ratio	1273%	656%	403%	280%	263%
LIQUIDITY AND SOLVENCY RATIO					
Loan deposit ratio	101.0%	91.7%	96.7%	100.6%	100.2%
Lending ratio	84.0%	80.4%	84.2%	87.3%	87.2%
Leverage	8.7x	9.7x	9.6x	9.5x	9.9x
Gross loans as % total assets	76.4%	78.0%	81.8%	84.9%	85.1%
Deposits as % total liabilities	85.5%	94.8%	94.4%	94.3%	94.5%

Source: Company Reports; OABINVEST

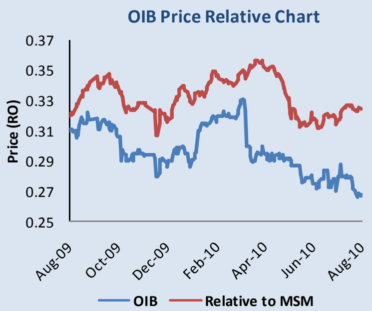
Balance Sheet (RO 000)	FY08	FY09	FY10e	FY11e	FY12e
Cash & Balances with CBO	93,912	132,270	95,981	70,173	86,858
Due from banks	69,216	20,280	21,902	23,874	26,022
Net Loans & Advances	634,265	786,784	916,340	1,062,258	1,221,172
Gross Loans	*644,101*	*799,451*	*931,360*	*1,080,378*	*1,242,435*
Impairment Allowance	*-9,836*	*-12,667*	*-15,021*	*-18,120*	*-21,263*
Available for sale investments	25,788	61,690	77,113	84,824	92,458
Property, Equipment & Fixtures	13,730	14,340	15,168	16,119	16,778
Other Assets	6,000	9,246	12,759	14,673	16,434
Total Assets	**842,911**	**1,024,610**	**1,139,262**	**1,271,921**	**1,459,722**
Due to banks	90,234	21,400	27,820	33,384	38,392
Certificate of Deposits	90,100	39,038	39,038	39,038	39,038
Customer's Deposits	547,913	832,449	924,018	1,034,901	1,200,485
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**	**1,020,064**	**1,138,729**	**1,311,762**
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	15,932	29,925	44,694
Total Equity	**96,487**	**105,429**	**119,198**	**133,191**	**147,960**
Total Equity & Liabilities	**842,911**	**1,024,610**	**1,139,262**	**1,271,921**	**1,459,722**

MSM Ticker	**OIBB**
Bloomberg code	**OIBB OM**
Reuters code	**OIB.OM**
Target Price (RO)	**0.250**
Share Price (RO)	**0.268**
Downside	**6.7%**
Rating	**HOLD**
Market cap (RO mn)	**245**
PE TTM (x)	**13.0**
P/BV TTM (x)	**1.53**
Dividend Yield (%)	**8.21**

	FY-10e	FY-11e	FY-12e
EPS	0.019	0.023	0.026
Implied PE	13.0x	10.8x	9.6x
Implied P/BV	1.1x	1.0x	0.9x

Absolute Performance

	OIB	MSM
6M	-16.0%	-6.4%
1 yr	-13.5%	1.5%
YTD	-9.8%	-0.9%



Source: Zawya, OABINVEST

Oman International Bank

In line with our view that OIB's conservative policy restricts the credit growth, in Q2'10 the bank posted 1.3% q-o-q decline in loan book to RO 673mn. Sequential decrease in interest earning assets and decline in gross yields resulted in 2% q-o-q fall in interest income in Q2'10 to RO 8.8mn. Moreover, 10% q-o-q rise in interest expense to RO 1.7mn put further pressure on interest income which declined by 4.4% q-o-q to RO 7.2mn in Q2'10. On quarterly basis, lower total income and 8% q-o-q rise in operating expenses to RO 5mn, led to rise in cost-to-income ratio to 52.6% in Q2'10 as against 46% in Q1'10. Significant increase in specific provisioning from RO 0.475mn in Q1'10 to RO 1.7mn in Q2'10 came as a negative surprise. Consequently net earnings for Q2'10 were down by 37% q-o-q to RO 3.6mn.

Investment case

- ✓ Although OIB's lowest loan-to-deposit ratio of 91.7% in Q2'10 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 5.5% 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 3% in FY10.

- ✓ OIB preserves its cost leadership with the lowest funding cost (0.85% in Q2'10) primarily on account of higher proportion of low cost savings deposits in total deposits (its time deposits proportion is lowest at 14.5% in Q2'10).

  Moreover in comparison to its peers, having least gross loan proportion in IEA mix (76% in Q2'10) 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 (3.89% in Q2'10) 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 56bps decline in yields at 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. Thus we maintain our view that FY10 funding cost will be stable at FY09 levels of 1%. But owing to fall in gross yields we anticipate 54bps drop in FY10 spreads.

- ✓ Maintaining its historical trend, OIB's NPL-to-gross loan ratio is highest (10.8% in Q2'10) in comparison to its peers which makes us bearish on this bank. Thus cautiously we anticipate that FY10 NPLs would be 108bps of gross loan and accordingly provisioning charges will be 0.48% of gross loans.

- ✓ 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 8.2% is highest compared to average dividend yield of 4% for sector. We reiterate that 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.

Valuation

Based on our revised earnings forecast, we cut the bank's target price to RO 0.250 (with a downside of 6.7%) from RO 0.271. However, higher dividend payout ratio as compared to other banks makes this a good defensive stock we thus maintain **HOLD** rating for OIB.

OIB – Financials

Income Statement (000's)	FY-08	FY-09	FY-10e	FY-11e	FY-12e
Interest Income	44,148	40,234	36,378	40,879	45,503
Interest Expense	-14,394	-8,378	-8,255	-9,373	-11,900
Net Interest income	**29,754**	**31,856**	**28,123**	**31,506**	**33,602**
Other operating income	**15,167**	**11,200**	**11,438**	**12,126**	**12,862**
as a % of total operating income	33.8%	26.0%	28.9%	27.8%	27.7%
Total Income	**44,921**	**43,056**	**39,561**	**43,632**	**46,464**
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**	**19,890**	**23,035**	**24,879**
Provision for loan impairment	-2,051	-3,259	-3,325	-3,273	-3,238
Impact of recoveries / write bac	8,978	4,047	3,376	4,245	5,487
Profit before taxation	**33,198**	**24,446**	**19,941**	**24,007**	**27,128**
Taxation	-3,724	-2,924	-2,385	-2,871	-3,245
Net profit for the year	**29,474**	**21,522**	**17,556**	**21,135**	**23,883**

	FY-08	FY-09	FY-10e	FY-11e	FY-12e
OPERATIONAL EFFICIENCY					
Gross Yield	4.66%	4.56%	4.00%	4.30%	4.55%
Funding cost	1.67%	1.02%	1.00%	1.10%	1.35%
Spread	2.99%	3.54%	3.00%	3.20%	3.20%
Net interest margin	3.1%	3.6%	3.1%	3.3%	3.4%
Interest income/Operating incor	66.2%	74.0%	71.1%	72.2%	72.3%
Non-interest income/Operating	33.8%	26.0%	28.9%	27.8%	27.7%
Cost/Income ratio	41.5%	45.1%	49.7%	47.2%	46.5%
PROFITABILITY					
ROE (%)	17.6%	12.5%	9.2%	9.7%	10.0%
ROA (%)	2.8%	2.1%	1.6%	1.9%	2.0%
VALUATION MEASURES					
P/E	6.8x	12.6x	13.9x	11.6x	10.2x
P/BV	1.2x	1.6x	1.2x	1.1x	1.0x
ASSET QUALITY					
NPL/Gross loan	8.9%	10.5%	10.8%	10.3%	9.5%
Provision coverage ratio	103.3%	98.5%	101.8%	102.5%	103.1%
LIQUIDITY AND SOLVENCY RATIO					
Loan deposit ratio	94.7%	94.0%	92.1%	93.5%	95.7%
Lending ratio	64.0%	64.0%	60.3%	60.8%	61.8%
Leverage	6.6x	6.2x	5.9x	5.9x	6.1x
Gross loans as % total assets	67.8%	66.0%	62.6%	63.0%	63.5%
Deposits as % total liabilities	71.6%	70.2%	67.9%	67.4%	66.3%

Balance Sheet (000's)	FY-08	FY-09	FY-10e	FY-11e	FY-12e
Cash and balances with centra	131,122	107,260	135,871	136,323	134,512
Treasury bills and certificates (	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	616,532	650,500	695,415
Gross loan	690,332	685,792	692,650	727,282	770,919
(-) Impairment provision	-63,544	-71,182	-76,117	-76,782	-75,505
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**	**1,106,864**	**1,154,536**	**1,213,876**
Due to banks	103,142	83,387	85,889	88,465	91,119
Deposits from customers	729,315	729,884	751,781	778,093	805,326
Other liabilities	13,148	54,880	60,368	63,185	65,713
Total Liabilities	**845,605**	**868,151**	**898,037**	**929,743**	**962,158**
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	39,621	60,756	84,640
Shareholders' Funds	**172,591**	**171,179**	**208,827**	**224,793**	**251,718**
Total Liabilities & Equity	**1,018,196**	**1,039,330**	**1,106,864**	**1,154,536**	**1,213,876**

Source: Company Reports; OABINVEST

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