Date: February 1, 2018

Bank Muscat – Key Conference Call Takeaways

- ✓ **Lending growth to hover around 6-7% in 2018;**
- ✓ **Deposit growth to remain low-to-mid single digit (3-4%);**
- ✓ **Focus on both Retail & Corporate segments;**
- ✓ **Retail credit growth to come from mortgages;**
- ✓ **Retail lending interest rate ceiling is 6%; no expectation of revision from regulatory body expected at this time;**
- ✓ **Ample room for increase in interest rates in the corporate segment;**

- The bank's net interest margin (NIM) has improved during 2017, as expected. However, margin improvement for 2018 is expected to increase only with further increases in benchmark USD interest rates. The bank sees ample room to improve its net fee and commission income. Efforts to improve this segment of revenue are an ongoing process. The diversified segments like cards, transaction banking, bancassurance, remittances, and other initiatives taken in digital banking have continued to enhance the overall contribution.

- Bank Muscat has one of the lowest cost to income ratios (42% 2017) within the domestic banking space. The recent Government push for job creation (about 25,000) is not expected to have any major impact on the bank's staff expenses.

- The bank's credit quality remained stable during 2017. The bank's NPL ratio is at 2.94% and provision coverage is at 128.9%. The NPL increase in absolute terms is still minimal during 2017

- The bank has been in the Basel III adoption transition phase (since 2013); the increased capital has affected its return on equity negatively over the years. Total CAR of the bank has increased to 18.6% in 2017 as compared to 16.90% in 2016. In terms of regulatory capital, the bank would need CAR of about ~15.5% levels (Including buffers). CET1 ratio is at 15.5% levels and Total Tier 1 is at 16.9% levels. The bank is aiming to improve its profitability and further optimize its capital in order to improve RoE going forward.

- IFRS 9 Implementation: The Bank has completed the impact assessment of the IFRS 9 implementation. Positive or negative impact on capital will be roughly 1-2% on the shareholders equity while the management gave guidance that the provisions impact will be mostly positive because of prevailing general provisioning requirements of the CBO. This would be applicable for most of the Omani banks. As per the Bank, the Group has worked on the Expected Credit Loss (ECL) model as per IFRS 9 during 2017 based on regulatory guidelines and assessed the impact for 30 Sep 2017 and 31 Dec 2017. Based on the assessment, the Group expects that the ECL as per IFRS 9 would be well within the cumulative provision for impairment as per the regulatory requirements.

- With regards to the impairment requirements of IFRS 9, the bank estimates the transition impact on shareholders' equity will be in the range of +/- 1% to 2%. The adjustments would be taken in shareholders' equity in Q1 2018 and would not affect the income statement.

- **We believe that the bank is trading at attractive multiples**. At the current price levels, the bank trades at P/B'17 of 0.65x, P/B'18F of 0.64x, P/E'17 of 6.3x, and P/E'18F of 6.48x. The bank's Board has proposed OMR 0.030 per share cash dividend and 5% stock dividend (1 share for 20 shares), subject to regulatory and shareholder approval. The dividend yield on the proposed cash dividend for 2017 is ~7%. The RoAE of the bank is ~11%. In spite of challenging macro environment, the bank has maintained stable profitability and asset quality during 2017. Furthermore, as per the bank's management, no major negative impact is expected to arise due to the IFRS9 Implementation from Jan 1, 2017. The bank boasts a strong capital position. We have a positive outlook on the bank for 2018 which is trading at attractive valuations. Our 12m fair value of the stock is OMR 0.495, offering ~20% upside to the current price, and we rated the bank as **BUY** on Dec 24, 2017.

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