

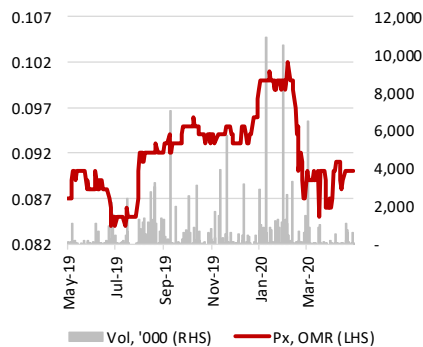
Bank Nizwa SAOG

TP: OMR 0.103 / share
Upside/ (Downside): 15%

Recommendation	Accumulate
Bloomberg Ticker	BKNZ OM
Current Market Price (OMR)	0.090
52wk High / Low (OMR)	0.100/0.080
12m Average Vol. (000)	586.9
Mkt. Cap. (USD/OMR mn)	350.7/135
Shares Outstanding (mn)	1,500
Free Float (%)	66%
3m Avg Daily Turnover (000)	65.4
6m Avg Daily Turnover (000)	109.0
P/E'20e (x)	14.0
P/B'20e (x)	0.96
Dividend Yield '20e (%)	-
Price Performance:	
1 month (%)	4.65
3 month (%)	(10.00)
12 month (%)	4.65

Source: Bloomberg

Price-Volume Performance



Source: Bloomberg

21st May, 2019

Ayisha Zia
Research Analyst
a.zia@u-capital.net
Tel: +968 24 94 90 36

- **Financing-to-Deposit Ratio declined from 107% in FY17 to 98% in FY18; but rose to 104% in FY19 and 105% in 1Q20.**
- **Capital adequacy ratio has fallen to 14.46% in 2019 from 16.24% in 2018 amid rapid risk-weighted asset growth (+23%YoY in FY19); still above the regulatory minimum set by CBO.**
- **Net finance margin has improved to 3.3% in 2019 (2018: 3.21%, 2017: 3.20%, 2016: 3.57%).**
- **Cost to Income Ratio declined from 61.5% in FY18 to 55.8% in FY19 and 51.8% in Q1'20 on faster income growth**

We **maintain** our target price for Bank Nizwa at OMR 0.103 per share and maintain its ACCUMULATE rating. Even though we have adjusted our estimates on the current macroeconomic scenario due to covid-19 and a higher cost of equity, we have factored in dividend payments from 2021e onwards. Our target price implies a P/E'20e and P/E'21e of 18x and 16x, respectively, and a P/B'20e and P/B'21e of 0.98x and 0.96x, respectively. We believe the bank will likely delay payment of its first dividend until 2021 given the current situation and its need to shore up capital

Robust finance asset growth despite a challenging operating environment

The bank's total assets grew by 19%YoY to cross the 1bn mark, reaching OMR 1.034bn as at the end of FY19, while total net financing increased by 19%YoY to reach OMR 892.5mn, showing significant growth despite a challenging operating environment. Bank Nizwa gained market share in FY19, reaching 21% of the total Islamic banking market of Oman (2018:19%, 2017:18% and 2016: 16%). While we believe that credit growth in Oman will remain muted this year given the current covid-19 crisis, we expect Bank Nizwa's total assets bank to grow at CAGR of 6% over the next five years on account of increasing finance asset (expected to grow at a CAGR of 7% over 2020-2025e).

Operating income to grow at a CAGR of 7% over 2020-2025e

The bank's operating income is expected to increase from OMR 33.02mn in FY19 to OMR 44.5mn in 2025, growing at a CAGR of 6%. Revenue growth will primarily be driven by growth in Islamic finance book, together with some recovery expected in the bank's net earning margins toward the end of the forecast period.

Superior asset quality amid tight cost control

The bank has sequentially brought its cost-to-income ratio down to 55.8% in FY19 and 51.8% in Q1'20 on faster income growth and we believe it will continue to maintain tight control on costs in order to bring the ratio down further through income growth. We expect the bank's operating profit before provisions to increase at a CAGR of 14% over 2020-2025e. Furthermore, we expect cost of risk to remain low as current asset quality is maintained over the forecast horizon. The bank boasts superior asset quality, inherent in the nature of Islamic banking business, with non-performing assets (NPAs) at 0.28% of total gross finance asset.

Key Indicators

	FY17	FY18	FY19	FY20e	FY21e	FY22e
Net Finance Asset, OMR'000	560,545	696,470	829,523	903,823	979,916	1,055,791
Customer Deposits, OMR '000	526,150	711,275	797,490	864,395	925,531	986,606
Operating Income, OMR '000	22,392	27,098	33,017	33,493	35,359	36,804
Operating Profit, OMR '000	5,972	10,440	14,588	14,880	16,559	17,816
Net Profit*, OMR '000	3,787	7,512	10,179	8,640	10,309	11,958
EPS, OMR	0.003	0.005	0.007	0.006	0.007	0.008
BVPS, OMR	0.087	0.091	0.099	0.105	0.108	0.113
P/E (x)	35.7	18.2	14.0	15.6	13.1	11.3
P/BVPS (x)	1.03	0.99	0.96	0.86	0.83	0.80

Source: Company Financials, U Capital Research

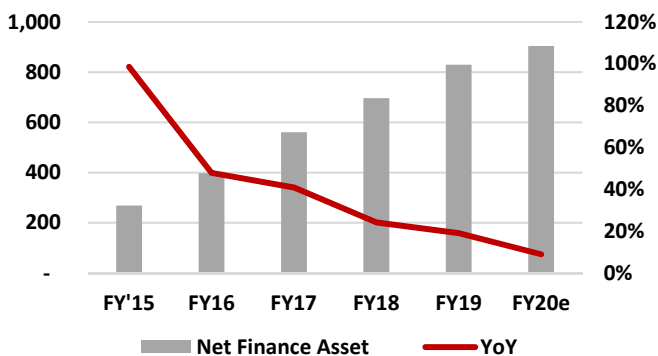
*Includes Tax Amortization Benefit

Credit & Deposit growth has normalized; Finance-to-Deposit rose to about 104% in FY19 from 98% in FY18

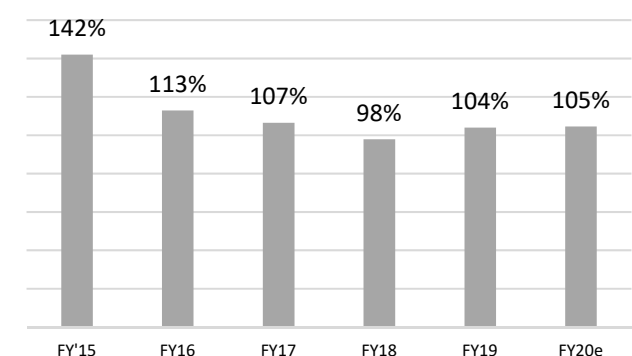
The bank’s total assets grew by 19%YoY to cross the OMR 1bn mark, at OMR 1.034bn as at the end of FY19, showing significant growth despite a challenging operating environment. We expect the total assets of the bank to grow at CAGR of 6% over the next five years on account of increasing finance asset (expected CAGR of 7% over 2020-2025e).

The bank’s net financing asset has grown by 19%YoY in FY19 to reach OMR 829.5mn. Bank Nizwa gained market share in FY19, reaching 21% of the total Islamic banking market of Oman (2018:19%, 2017:18% and 2016: 16%). Customer deposit growth was a little slower at 12%YoY in FY19. Therefore, finance asset-to-deposit ratio rose to 104% from 98% a year ago. In Q1’20, the ratio has risen further to 105%, as Islamic financing growth continues to outpace deposit growth. In Q1’20, Islamic financing grew by 18.5%YoY and 6.2%QoQ and customer deposits grew by 17.8%YoY and 5.0%QoQ.

BKNZ: Net Finance Asset, OMR mn



BKNZ: Finance Asset-to-Deposit Ratio

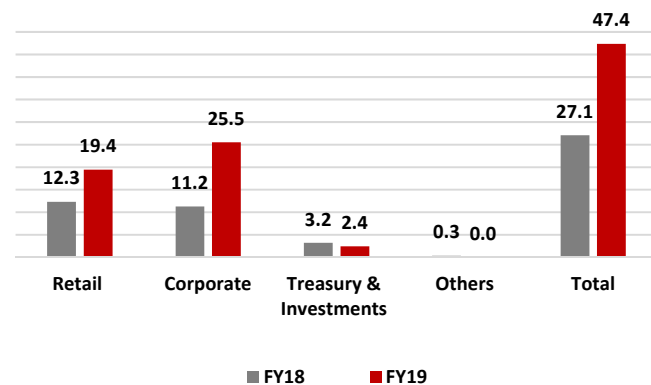


Source: Bank Financials, U Capital Research

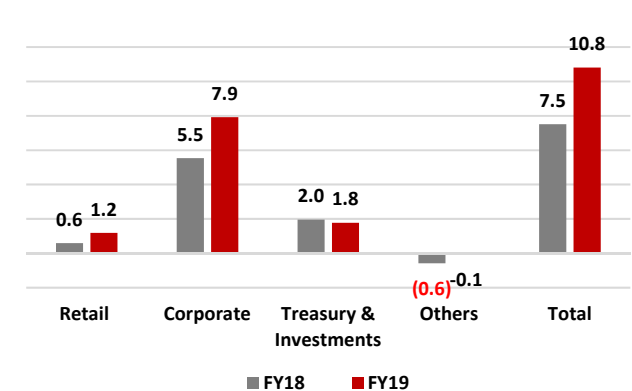
Robust Operational Performance

Bank Nizwa’s operating income rose by 22%YoY, while its operating expenses increased only by 10.6%YoY, largely on account of a 9.0%YoY rise in staff cost (staff costs were 68% of total operating expenses in FY19). Cost-to-income ratio declined to 55.8% in FY19 from 61.5% in FY18 and 73.3% in FY17. The ratio has declined further to 51.8% in Q1’20.

BKNZ: Segmental Revenues (OMR mn)



BKNZ: Segmental PAT (OMR mn)



Source: Bank Financials, U Capital Research

Within its operating segments, the bank’s retail revenues grew by 58%YoY in FY19 and corporate revenues rose by 127%YoY. Retail profit doubled in FY19 and corporate segment’s profit also showed good performance with profit rising by 43%YoY. Treasury & investments’ revenue and profit both fell in FY19.

We expect the operating income of the bank to grow at a CAGR of 6% over 2020-2025e, which together with controlled costs, is expected to boost net profit at a CAGR of 16% over 2020-2025e.

Asset quality remains high; cost of risk expected to rise in FY20

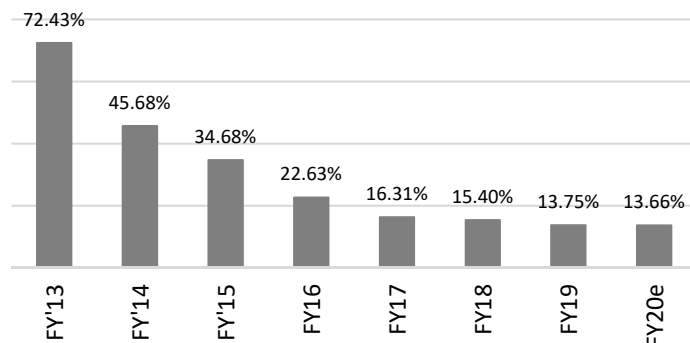
The bank has maintained its non-performing assets (NPAs) at a very 0.28% (FY18: 0.14%, 0.18% in FY17; 0.11% in FY16) of gross Islamic finance assets as compared listed peers’ simple average NPAs at ~4% of total, due to the inherent nature of asset-backed Islamic financing activities. ECL cover is more than sufficient as provisions are made as per IFRS 9 or CBO guidelines (higher of the two), since NPAs remain extremely low. Cost of risk rose slightly to 33.4% in FY19 from 31bps in FY18 (vs 37 bps in FY17). Given the significant rise in net ECL charge recorded in Q1’20, we have conservatively assumed a high cost of risk for FY20e at 55.8bps, with a sequential decline over the forecast horizon.

Declining capital buffers albeit above regulatory minima

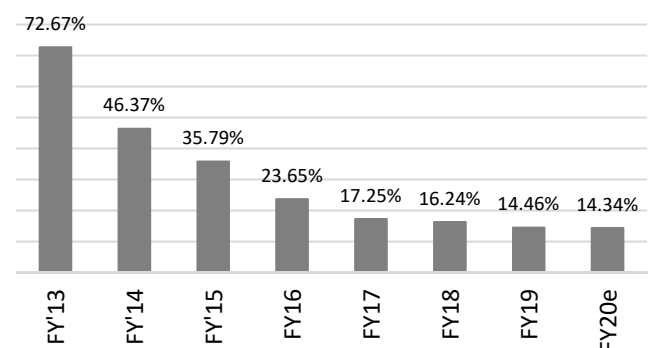
Bank Nizwa’s capital adequacy ratio stood at 14.46% as at the end of FY19, which is above the regulatory minimum of 13.5% including capital conservation buffer. However, the bank’s capital adequacy levels have been declining as the bank grows its risk-weighted assets (up by 23%YoY in FY19), with CAR consistently falling over the last few years (FY18: 16.24%, FY17: 17.25% , FY16:23.65%). We expect this ratio to be maintained around the current level over the forecast period, as the bank shores up capital through increasing earnings and dividend payouts commencing in 2021.

On 18 March 2020, the Central Bank of Oman announced a set of measures to support Omani banks in light of the subdued macro environment due to the coronavirus outbreak and the drop in oil price. These measures were effective immediately: Lowered the Capital Conservation Buffer by 125bps to 1.25% from 2.50% previously. This implies lower CAR requirements for Oman banks, down to a minimum CET1 ratio of 10.25% (11.5% in FY19) and a minimum CAR of 12.25% (13.5% in FY19). Bank Nizwa is currently above the regulatory requirement but we believe that the bank will prudently delay its first dividend payment until 2021 in order to shore up capital.

BKNZ: Common Equity & Tier 1 Ratio



BKNZ: Capital Adequacy Ratio (CAR)



Source: Company Financials, U Capital Research

Q1'19 Performance
1Q20 net profit met our estimate in spite of a much higher impairment charge

The bank has posted a net profit for 1Q20 that is down by 11.4%QoQ on a five-fold rise in net ECL & tax charge for the quarter. Net profit is up 31.4%YoY and met our expectation, even though operating profit was higher than our estimate.

Operating income growth in line with our estimate; efficiency ratio improved to 51.8% vs our estimate of 55.8%

Operating income is up 13.3%YoY and 10.1%QoQ, in line with our estimates, but due to 10.5% lower than expected operating expenses, operating profit beat our estimate by 12%.

Islamic financing and customer deposit growth largely in line with our estimates

The bank has posted an 18.5%YoY and 6.2%QoQ increase in its Islamic financing portfolio. Its customer deposits also increased by 17.8%YoY and 5.0%QoQ. Loans-to-Customer Deposits Ratio has increased to 105.2% in 1Q20 from 104.0% in 4Q19, on a slower customer deposit growth as compared to Islamic financing growth in this quarter.

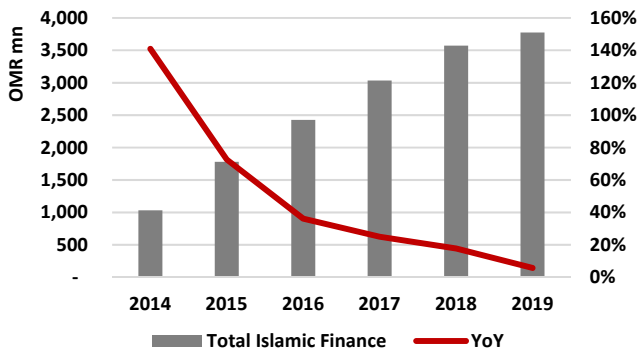
Income Statement					
<i>(OMR mn)</i>	1Q19	4Q19	1Q20	YoY (%)	QoQ (%)
Operating Income	8.1	8.4	9.2	13.3%	10.1%
Operating expenses	(4.3)	(4.9)	(4.8)	11.5%	-2.7%
Operating Profit	3.8	3.5	4.4	15.3%	28.3%
Net ECL charge	(1.4)	0.3	(1.2)	-8.3%	-581.7%
Tax	(0.4)	(0.6)	(0.4)	9.1%	-27.6%
Net Profit	2.1	3.1	2.8	31.4%	-11.4%
Balance Sheet					
<i>(OMR mn)</i>	1Q19	4Q19	1Q20	YoY (%)	QoQ (%)
Shareholders' Equity	139	148	149	6.9%	0.8%
Net Islamic Financing	743	830	881	18.5%	6.2%
Customers' Deposits & Islamic Equity Investment	711	797	837	17.8%	5.0%

Sector Overview

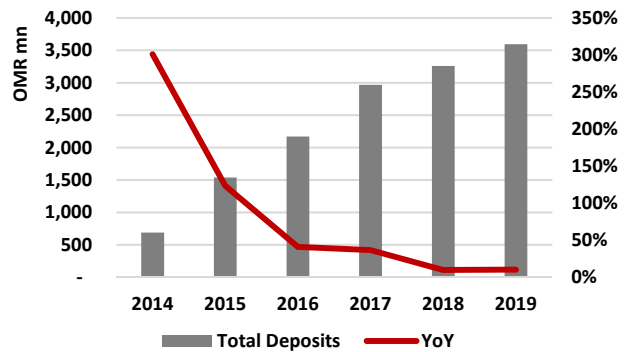
Oman's Islamic finance growth has normalized to 6%YoY in FY19...

Islamic deposit growth has also normalized to 10%YoY in FY19...

Omani Islamic Banking -Finance



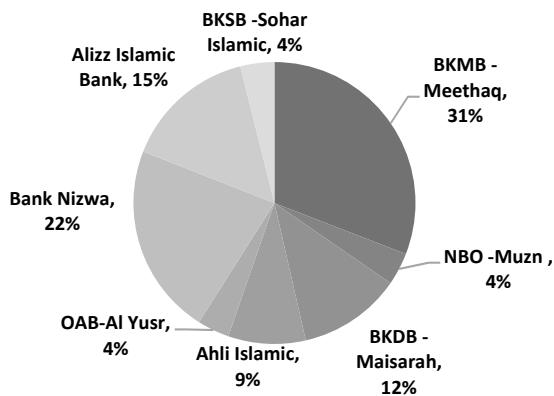
Omani Islamic Banking -Deposits



After Meethaq (Bank Muscat's Islamic Window), Bank Nizwa has the largest Finance market share...

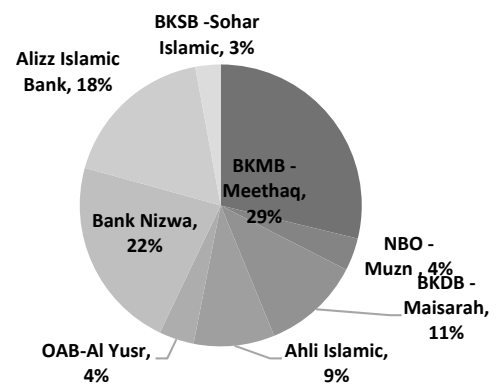
Bank Nizwa sports the second-largest market share of Oman's Islamic Deposits...

Islamic Financing Market Share, FY19



*Sohar Islamic is estimate

Islamic Deposits' Market Share, FY19

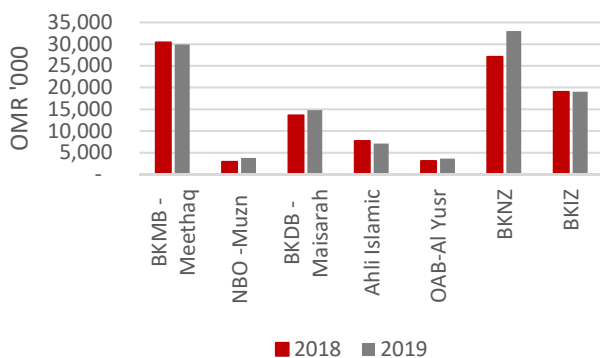


*Sohar Islamic is estimate

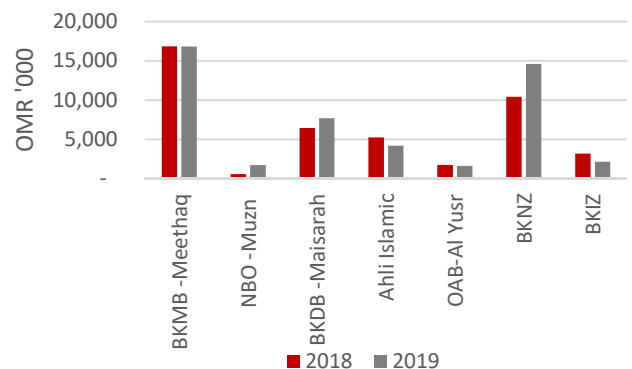
Bank Nizwa posted the largest increase in its operating income in FY19...

Bank Nizwa posted the largest improvement in its operating profit in FY19...

Operating Income



Operating Profit

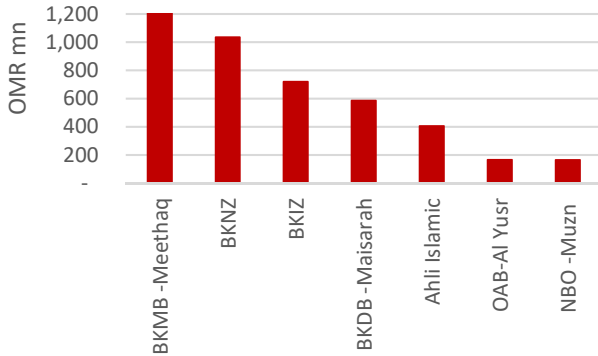


Source: Company Financials, U Capital Research

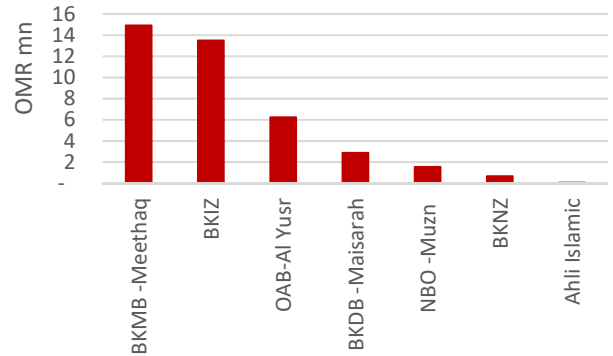
Note: Sohar Islamic's Financials for FY19 are not available

Sector Overview (cntd.)

Total Assets, FY19



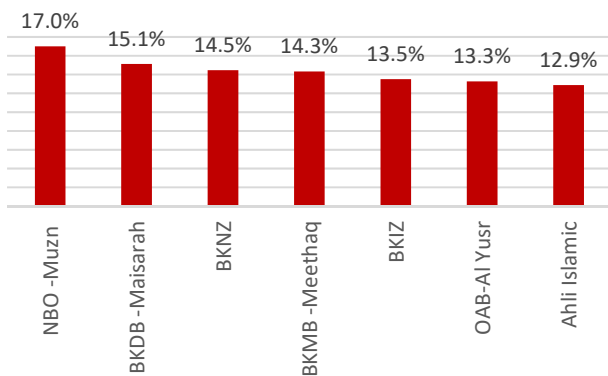
Non-performing assets, FY19



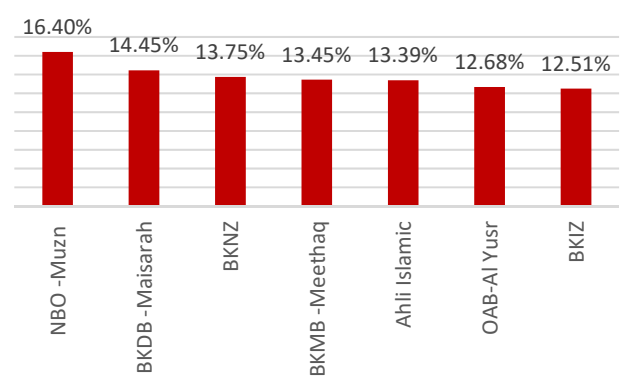
Bank Nizwa’s Capital Adequacy Ratio (CAR) is fair, as compared to its Islamic peers. However, as compared to local conventional peer group (Average CAR: 18.1%), the bank’s CAR is the lowest...

Bank Nizwa’s Tier 1 capital ratio is fair, as compared to peers, however we expect some pressure to build on the bank to maintain capital adequacy given the current situation ...

Capital Adequacy Ratio (CAR), FY19



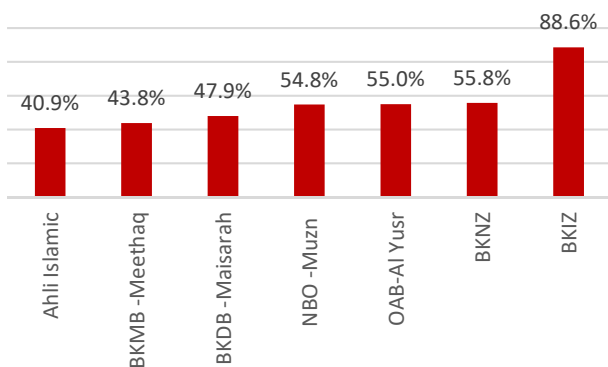
Tier 1 Capital Adequacy Ratio, FY19



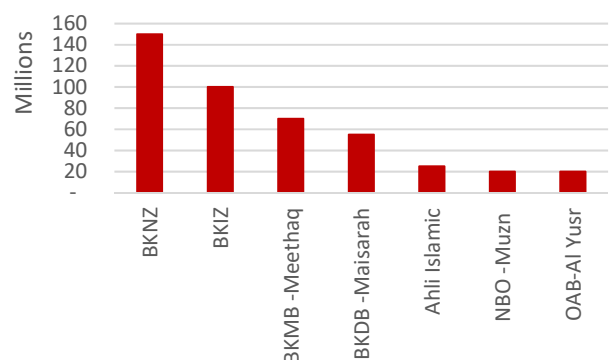
Bank Nizwa has shown consistent reduction in its cost-to-income ratio on improving income despite being a full-fledged Islamic bank with higher costs..

Invested share capital of each bank and window is given below...

Cost-to-Income Ratio, FY19



Share Capital, FY19



Source: Company Financials, U Capital Research

Note: Sohar Islamic’s Financials for FY19 are not available

Financial Statements

(OMR '000)	2017	2018	2019	2020e	2021e	2021e
Income Statement						
Financing Income	27,956	37,968	47,379	48,875	52,658	56,288
Payment to Depositors	(11,285)	(17,387)	(21,776)	(23,870)	(26,537)	(29,482)
Net Financing Income	16,671	20,582	25,603	25,005	26,121	26,806
Fee & Commission Income	3,502	4,474	5,396	6,178	6,723	7,277
Investment Income	1,806	1,459	1,553	1,778	1,935	2,095
Other Income	412	583	465	532	579	627
Total Financing Income	5,721	6,516	7,414	8,488	9,238	9,998
Total Operating Income						
Total Operating Income	22,392	27,098	33,017	33,493	35,359	36,804
Provisions expense	(1,926)	(1,997)	(2,595)	(4,960)	(4,431)	(3,748)
Operating Expenses	(16,420)	(16,658)	(18,430)	(18,614)	(18,800)	(18,988)
Profit Before Taxation	4,046	8,443	11,993	9,920	12,129	14,068
Taxation	(260)	(931)	(1,815)	(1,280)	(1,819)	(2,110)
Net Profit	3,787	7,512	10,179	8,640	10,309	11,958
Balance Sheet						
Cash Balances	42,814	92,966	89,293	88,969	70,404	59,108
Deposits with Banks & FIs	3,464	6,400	20,321	23,531	27,012	30,739
Investment Securities	47,721	50,034	68,098	71,718	75,530	79,539
Sales receivables & other receivables -net	161,398	182,269	211,058	244,395	280,554	319,257
Ijara Muntahia Bittamleek -net	282,110	316,397	318,134	319,880	321,635	323,401
Wakala Bel Istithmar -net	91,311	137,924	183,672	211,223	236,569	257,861
Other Assets	159,130	224,103	327,460	367,493	406,823	443,421
Total Assets	696,638	872,168	1,034,364	1,115,985	1,181,959	1,255,464
Deposits from Banks & FIs	19,339	116	66,825	70,166	73,675	77,358
Deposits from Customers	298,074	388,768	487,094	525,696	557,775	589,783
Other Liabilities	20,400	23,588	22,141	24,160	20,149	21,741
Equity of unrestricted inv acctholders & owners' equity	228,076	322,507	310,396	338,699	367,756	396,823
Paid-up Capital	150,000	150,000	150,000	150,000	150,000	150,000
Retained Earnings / (Accumulated Losses)	(21,771)	(14,933)	(5,772)	2,867	7,177	13,135
Other Reserves	2,127	831	1,371	1,371	1,371	1,371
Shareholders' Equity	130,749	137,189	147,907	157,265	162,605	169,759
Total Equity & Liability	696,638	872,168	1,034,364	1,115,985	1,181,959	1,255,464
Cash Flow Statement						
Cash from operations	44,079	53,196	13,802	2,924	(9,403)	(2,064)
Cash from investing activities	17,767	1,972	18,014	3,966	4,192	4,429
Cash from financing	(99)	(1,072)	540	718	(4,969)	(4,804)
Net changes in cash	26,214	50,152	(3,673)	(324)	(18,564)	(11,297)
Cash at the end of period	42,814	92,966	89,293	88,969	70,404	59,108
Key Ratios						
Return on Average Assets	0.6%	1.0%	1.1%	0.8%	0.9%	1.0%
Return on Average Equity	2.9%	5.6%	7.1%	5.7%	6.4%	7.2%
Recurring Income/Operating Income	90.1%	92.5%	93.9%	93.1%	92.9%	92.6%
Profit Yield	5.4%	5.9%	6.1%	5.5%	5.4%	5.4%
Profit Paid	2.5%	2.8%	2.8%	2.7%	2.7%	2.7%
Net Spread	2.9%	3.2%	3.3%	2.8%	2.7%	2.6%
Cost to Income Ratio	73.3%	61.5%	55.8%	55.6%	53.2%	51.6%
Net Financing to Customer Deposits	106.5%	97.9%	104.0%	104.6%	105.9%	107.0%
NPAs to Gross Financing	0.18%	0.14%	0.28%	0.29%	0.30%	0.31%
NPA Coverage	738%	1183%	738%	968%	1131%	1336%
Cost of Risk (bps)	37.0	31.1	33.4	55.8	45.8	35.8
Equity to Gross Financing	22.0%	18.8%	16.9%	16.5%	15.7%	15.3%
Equity to Total Assets	18.8%	15.7%	14.3%	14.1%	13.8%	13.5%
Dividend Payout Ratio	-	-	-	-	58.2%	50.2%
Adjusted EPS (OMR)	0.003	0.005	0.007	0.006	0.007	0.008
Adjusted BVPS (OMR)	0.087	0.091	0.099	0.105	0.108	0.113
Market Price (OMR) *	0.090	0.091	0.095	0.090	0.090	0.090
P/E Ratio (x)	NM	18.2	14.0	15.6	13.1	11.3
P/BV Ratio (x)	1.03	0.99	0.96	0.86	0.83	0.80

Source: Company Financials, U Capital Research

* Market price for the current and subsequent years is as per the closing price of 20-May-20

NM = not meaningful

Recommendation

BUY	Greater than 20%
ACCUMULATE	Between +10% and +20%
HOLD	Between +10% and -10%
REDUCE	Between -10% and -20%
SELL	Lower than -20%