

KEY DATA

Closing Price*	Avg. Value Traded per Day
RO 1.000	RO 1 million
52-Week High	Market Cap
RO 1.016	RO 1077 million
52-Week Low	Shares Outstanding
RO 0.471	1077.1 million
Reuters	Bloomberg
BMAO.OM	BKMB OM
Ownership Structure	
Closely Held: 73%	Public: 27% **

*As of March 11, 2010, **estimate Sources: Reuters, Muscat Securities Market, and NBK Capital

REBASED PERFORMANCE



Sources: Reuters and NBK Capital

KEY RATIOS

	2009 a	2010 f	2011 f	2012 f	2013 f
P/B	1.5	1.4	1.2	1.1	1.0
P/E	14.6	10.9	9.2	8.0	6.9
Dividend Yield	2.0%	2.7%	3.4%	4.2%	5.2%
Net Profit Growth	-21.4%	34.3%	18.1%	15.7%	15.4%
Net Interest Margin	3.1%	3.2%	3.1%	3.2%	3.2%
RoAE	10.3%	13.2%	14.1%	14.6%	15.2%
RoAA	1.2%	1.6%	1.8%	1.9%	2.0%

4Q2009 IBP a	4Q2009 IBP f
RO 42 million	RO 36 million
1Q2010 IBP f	2Q2010 IBP f
RO 34 million	RO 36 million

IBP= income before provisions, a = actual, f = forecast Sources: Reuters and NBK Capital

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HIGHLIGHTS

12-Month Fair Value: RO 1.160

Recommendation: Accumulate – Risk Level*: 3**

Reason for Report: FY2009 Update

- Our new estimate of Bank Muscat's fair value per share stands at RO 1.160, 16% above the share's closing price as of March 11, 2010; hence, our recommendation on the stock is "Accumulate". This value is 17% above our previous fair value estimate of RO 0.990, driven largely by higher loans, higher operating income, and higher net income at the end of our forecast horizon than previously forecasted.
- We believe Bank Muscat is in a good position to take advantage of the economic recovery expected in Oman, especially as the appetite for lending returns and the demand for banking products increases. Accordingly, we forecast loans to grow by 10% in 2010, followed by a CAGR of 7% in the five years ending in 2015. We expect deposit growth to be slightly quicker than loan growth at 12% in 2010, as Bank Muscat increases its focus on deposit mobilization.
- We expect margins and spreads to improve gradually, income from fees and commissions to pick up, and loan loss provisioning (although remaining high) to decline compared to 2009 levels. Accordingly, we forecast net profit to grow by 34% in 2010, followed by a CAGR of 12% in the five years ending in 2015. We believe loan loss provisions have peaked, and expect these to decline, provided there are no major surprises in 2010. However, we do think there will be further, albeit moderate, deterioration in asset quality in 2010.
- Bank Muscat reported a net profit of RO 73.7 million in 2009, 21% below 2008, as a result of several non-recurring events, including heavy loan loss provisioning towards overseas exposures, share of losses from associates, and impairment charges on associates. On the upside, the bank disposed of its 2.67% stake in HDFC Bank in India during the year, for a post-tax profit of RO 53.2 million. Excluding this gain, net profit in 2009 would have declined to RO 20.5 million, 78% lower than the net profit in 2008.
- We believe that the sale of the HDFC stake, non-participation in Silkbank's rights issue, and fully providing for the Saudi exposures have put Bank Muscat in a much stronger position for 2010. We believe the "de-risking" of the balance sheet will help Bank Muscat focus more on the operating business in 2010 and beyond.

*** Please refer to page 7 for recommendations and risk ratings.

VALUATION

Our new estimate of Bank Muscat's fair value per share stands at RO 1.160, 16% above the share's closing price as of March 11, 2010; hence, our recommendation on the stock is "Accumulate". This value is 17% above our previous fair value forecast of RO 0.990, driven largely by higher loans, higher operating income, and higher net income at the end of our forecast horizon than previously forecasted.

Figure 1 Weighted Average Fair Value per Share

Our estimate of Bank Muscat's fair value per share stands at RO 1.160

Valuation Method	Value (RO)	Weight (%)
Discounted Equity Cash Flow (DECF)	1.310	40%
Dividend Discount Model (DDM)	0.740	40%
Peer-Based Valuation	1.680	20%
Weighted Average Fair Value	1.160	100%

Source: NBK Capital

Performance in FY2009

Bank Muscat reported a net profit of RO 73.7 million in 2009, 21% below 2008, on the back of heavy loan loss provisioning, losses from associates, and impairment charges on associates. During the year, the bank disposed of its 2.67% stake in HDFC Bank in India, for a post-tax profit of RO 53.2 million. Excluding this one-off gain, net profit in 2009 would have declined to RO 20.5 million, 78% lower than the net profit in 2008.

Bank Muscat's bottom line was negatively impacted by net losses and impairment charges on its associates. BMI Bank in Bahrain, Bank Muscat's largest subsidiary, posted net losses during FY2009, due to large loan loss provisions taken against major overseas exposures, primarily in 4Q2009. The associate in Pakistan, namely Silkbank (formerly known as Saudi Pak Commercial Bank), also reported net losses during the period. Bank Muscat thus recorded a share of losses from associates of RO 10.5 million in 2009, compared with losses of RO 3.3 million in 2008. Another key factor in lowering the bank's net profit was the impairment charge on Silkbank. Bank Muscat held a 35.07% stake in Silkbank as of December 2009. However, this stake will drop to 8.5%, following the completion of Silkbank's rights issue in 2010, in which Bank Muscat will not participate. Accordingly, Bank Muscat re-classified the investment as "available-for-sale" (AFS) at the end of 2009; it was marked-to-market and the bank booked impairment losses of RO 20.3 million in 2009. The impairment charges resulted in a carrying value for the investment of RO 3.87 million as of December 2009, significantly below the current market value of approximately RO 4.6 million.

On the operational side, net interest income (NII) grew by a moderate 7.6% in 2009 to reach RO 174 million, in line with our forecast of RO 175.6 million (a difference of -0.7%). Between 2005 and 2008, NII recorded a compound annual growth rate (CAGR) of 28%. The slowdown in NII growth in 2009 was a result of weak lending growth (+3%) and a drop in margins compared to 2008. While overall spreads and margins declined in FY2009 compared to FY2008, there was an improvement in 4Q2009, as spreads and margins increased. This was largely driven by a decline in funding costs.

Income from fees and commissions stood at RO 49.8 million, 9% below 2008, and 5% above our forecast of RO 47.2 million. However, foreign exchange income reached RO 9.2 million in 2009, up 33% year-on-year (YoY). In fact, foreign exchange income was stronger in 2H2009 compared to 1H2009. As previously mentioned, Bank Muscat recorded a share of losses from associates

of RO 10.5 million in 2009. Total operating income (excluding the sale of HDFC) reached RO 227 million in 2009, 3% below the 2008 level.

Costs were very well controlled in 2009, declining by 2.5% YoY, compared with much higher growth in previous years (22% in 2006, 32% in 2007, and 20% in 2008). This helped the bank's cost-to-income ratio to remain stable at 36% in 2009, still below the bank's medium-term target of 38% to 40%.

Credit growth was weak, as net loans reached RO 3.84 billion as of December 2009, just 3% higher than 2008, with the majority of the growth occurring in 4Q2009. This was 3% below our forecast of RO 3.97 billion. Deposits dropped by 3% in 2009, to RO 3.07 billion as the bank witnessed a 17% decline in deposit accounts during the year. The bank's simple loans-to-deposits ratio (LDR) increased from 117% as of 2008 to a record high of 125% at the end of 2009. However, management has indicated that at the end of 2009, they were very much in line with the regulatory "lending ratio" (defined as total gross loans divided by the sum of total deposits, borrowings, equity, and net interbank abroad), which is capped at 87.5% by the Central Bank of Oman (CBO). While deposits declined in 2009, Bank Muscat relied heavily on certificates of deposit (CDs) as an additional source of funding. As part of the bank's RO 250 million issuance program, outstanding CDs stood at RO 139.2 million at the end of 2009, compared to RO 61.7 million at the end of 2008.

Bank Muscat's asset quality indicators deteriorated significantly in 2009, with the majority of the deterioration occurring in 2Q2009. In June 2009, Bank Muscat became the first GCC bank to confirm its exposures to the Al Gosaibi Group and the Saad Group in Saudi Arabia, amounting to RO 66 million (RO 49 million directly through its Riyadh branch and RO 17 million indirectly through its unconsolidated Bahraini subsidiary, namely BMI Bank). Subsequently, Bank Muscat included the direct exposure to the Saudi groups in non-performing loans (NPLs) as of June 2009. As such, total NPLs increased to RO 172 million (excluding interest in suspense) by the end of 2009, compared to RO 64 million as of 2008. The NPLs-to-gross loans ratio surged from 1.68% as of December 2008 to 4.01% at the end of June 2009, and reached 4.28% by the end of December 2009. The NPL coverage ratio dropped from 154% at the end of 2008 to a record low of 92% at the end of June 2009, but rose to 107% at the end of December 2009. The increase in NPLs was accompanied by an increase in provisioning charges, which reached a record high of 2.23% of average gross loans in 2009. Net loan loss provisions jumped to RO 87.7 million in 2009, as Bank Muscat fully provided for its Saudi exposures, with the highest level of provisions being taken in 2Q2009. We would like to highlight that in December 2009, Bank Muscat announced their exposure to Dubai World of RO 19.25 million (0.5% of net loans as of December 2009), the payments on which, as indicated by management, continue to be serviced.

Bank Muscat's capital adequacy ratio (CAR) stood at 15.2% as of December 2009. This was up from the 13.02% recorded in 2008, boosted by the RO 75 million subordinated loan issued in 2009, which was included in the Tier II capital.

The Board of Directors at Bank Muscat has recommended the distribution of a cash dividend of RO 0.02 per share, which translates into a dividend payout ratio of approximately 29% for 2009 and a dividend yield of 2%. The board also recommended a stock dividend amounting to 25% of the existing shares, which, if approved by the shareholders during the Annual General Meeting, will increase the number of outstanding shares from the current 1.077 billion to 1.346 billion.

Figure 2 Performance in FY2009

Figures in '000 RO	2008	2009	Change %
Net Loans and Advances	3,727,700	3,838,211	3.0%
Customer Deposits	3,173,032	3,068,425	-3.3%
Shareholders' Equity	714,750	711,104	-0.5%
Total Assets	6,028,236	5,850,736	-2.9%

Profitability was weak in 2009, with Bank Muscat's net profit dropping by 21% on the back of heavy loan loss provisioning and impairments charges on associates

Figures in '000 RO	2008	2009	Change %
Net Interest Income	162,107	174,366	7.6%
Net Fees and Commissions	54,827	49,811	-9.1%
Share of Profit of Associates	(3,248)	(10,455)	n/m
Operating Income*	233,553	227,390	-2.6%
Total Costs	(84,224)	(82,125)	-2.5%
Prov. for Credit Losses, net	(12,022)	(87,653)	629.1%
Prov. for Investments and Placements	(15,146)	(2,515)	-83.4%
Impairment of Associates	(13,750)	(20,315)	47.7%
Gain from the sale of HDFC	-	53,200	n/m
Net Profit	93,731	73,718	-21.4%
Net Profit Excluding Sale of HDFC	93,731	20,518	-78.1%

* Excluding the gain from the sale of HDFC Sources: Bank Muscat's financial statements and NBK Capital

Outlook and Forecasts

We believe Bank Muscat is in a good position to take advantage of the economic recovery expected in Oman, especially as the appetite for lending returns and the demand for banking products increases. Accordingly, we forecast loans to grow by 10% in 2010, followed by a CAGR of 7% in the five years ending in 2015. We expect deposit growth to be slightly quicker than loan growth at 12% in 2010, as Bank Muscat increases its focus on deposit mobilization. This will slightly ease the bank's LDR ratio (125% as of December 2009), which is considerably higher than the sector's average LDR (108% as of November 2009). Furthermore, Bank Muscat aims to increase its low-cost deposit base to help support margins and spreads in 2010. The bank will also continue to issue CDs through its RO 250 million issuance program. At the end of December 2009, total borrowings, including CDs, unsecured bonds, floating rate notes, subordinated liabilities, and convertible bonds, stood at RO 430 million, accounting for 7% of total assets. While we expect Bank Muscat to continue to rely on wholesale markets as an additional source of funding, we expect this to range between 5% and 7% of total assets.

We believe net interest income and income from fees and commissions will be the key drivers of earnings growth over the forecast horizon. We expect margins and spreads to improve gradually, income from fees and commissions to pick up, and loan loss provisioning to decline compared to 2009 levels. Overall, higher net interest income, lower loan loss provisioning, and controlled cost growth in 2010 will support net profit, which we forecast will grow by 34% in 2010, followed by a CAGR of 12% in the five years ending in 2015.

Figure 3 Forecasts

	2010 Forecasts ('000 RO)			2010	5-year
	Old	New	Change %	Change %	CAGR *
Net Loans and Advances	4,272,310	4,220,531	-1.2%	10.0%	7.2%
Customer Deposits	3,583,134	3,440,317	-4.0%	12.1%	7.9%
Net Interest Income	186,886	183,646	-1.7%	5.3%	8.5%
Net Fees and Commissions	50,672	54,377	7.3%	9.2%	8.0%
Operating Income**	250,993	254,748	1.5%	12.0%	8.7%
Total Costs	(96,334)	(95,389)	-1.0%	16.2%	10.1%
Provisions for Credit Losses	(34,161)	(44,714)	30.9%	-49.0%	-10.3%
Net Profit	104,181	99,007	-5.0%	34.3%	12.5%

Higher net interest income, lower loan loss provisioning, and controlled cost growth in 2010 will support net profit, which we forecast will grow by 34% in 2010

* CAGR: 2010–2015 ** Excluding the gain from the sale of HDFC Source: NBK Capital

Bank Muscat's personal loan portfolio posted only moderate growth (4.5%) in 2009. At the end of 2009, personal loans as a percentage of total loans stood at 39%, which we expect to decline slightly going forward. We expect Bank Muscat's margins to improve slightly in 2010, before gradually increasing over our forecast horizon. We expect net interest income to grow by 5% in 2010, and then record a CAGR of 8% in the five years ending in 2015.

In 2009, income from fees and commissions came under pressure primarily due to muted lending growth. As lending picks up in 2010, we expect income from fees and commissions to grow by 9% during the year. Furthermore, increased demand for banking products on the back of improved economic growth will further support the growth in income from fees and commissions, which we expect will record a CAGR of 8% in the five years ending in 2015.

Bank Muscat's operating income was negatively impacted by losses from associates, primarily driven by large provisioning charges at the bank's Bahraini subsidiary, BMI Bank (related to Saudi and other overseas exposures). However, BMI was profitable at the operating level, with the 2009 operating income growing by 4% YoY. We expect BMI to contribute positively, although very marginally, to Bank Muscat's operating income over our forecast horizon. In 2010, we expect Bank Muscat's operating income to grow by 12%, followed by a CAGR of 9% in the five years ending in 2015.

We would like to reiterate that Bank Muscat held the Silkbank investment in Pakistan as part of the AFS portfolio at RO 3.8 million as of December 2009, lower than the current market value of approximately RO 4.6 million. According to management, the impairment incurred on the investment already incorporates the dilution impact post the capital injection, hence the lower carrying value compared to the current market value. On the other hand, the losses on the AFS portfolio decreased from RO 10.9 million in 2008 to RO 2.9 million in 2009. We are not forecasting further impairment on the investment portfolio over our forecast horizon.

While we believe the decline in costs in FY2009 is not sustainable, we do expect cost growth to remain controlled going forward. In 2010, Bank Muscat's expansion plans include the opening of a branch in Kuwait. Accordingly, we expect costs to grow by 16% in FY2010, followed by a CAGR of 10% in the five years ending in 2015. We expect the cost-to-income ratio to trend towards 38% to 40% over our forecast horizon.

We expect further weakening of asset quality in 2010, with the NPLs-to-gross loans ratio reaching 5%, before improving over our forecast horizon. We expect the NPL coverage ratio to decrease slightly to 103% by the end of December 2010, even as provisioning remains high during the year, and to remain over 100% in our forecast horizon.

All in all, we expect operating income and net profit to grow by 12% and 34%, respectively, in 2010, followed by a CAGR of 9% and 12% in the five years ending in 2015. We believe loan loss provisions have peaked, and expect these to decline compared with 2009, in the absence of any major surprises. However, we think there will be further, albeit moderate, deterioration in asset quality in 2010.

FINANCIAL STATEMENTS

Balance Sheet (RO Thousands)	Historical		Forecast				
	2008	2009	2010	2011	2012	2013	2014
Fiscal Year Ends December							
ASSETS							
Cash and balances with Central Banks	452,761	608,099	692,925	727,728	759,502	791,940	832,339
Due from Banks	1,077,557	1,015,691	1,052,880	1,124,330	1,190,863	1,252,513	1,311,135
Net Investments	469,321	209,219	221,287	249,241	283,666	324,825	373,734
Net Loans and Advances	3,727,700	3,838,211	4,220,531	4,618,514	4,959,410	5,283,839	5,613,615
Property and Equipment	21,948	26,276	29,214	33,362	38,132	43,618	49,926
Other Assets	278,949	153,240	160,842	169,034	177,808	186,727	195,904
Total Assets	6,028,236	5,850,736	6,377,679	6,922,208	7,409,380	7,883,461	8,376,653

LIABILITIES & EQUITY	Historical		Forecast				
	2008	2009	2010	2011	2012	2013	2014
Fiscal Year Ends December							
Due to Banks	1,412,576	1,395,747	1,442,446	1,472,872	1,542,168	1,559,378	1,612,696
Customer Deposits	3,173,032	3,068,425	3,440,317	3,797,564	4,130,233	4,438,479	4,731,592
Other Purchased Funds	341,628	397,903	413,783	455,166	412,000	418,869	425,998
Other Liabilities	386,250	277,345	292,352	320,516	350,629	381,844	410,892
Total Liabilities	5,313,486	5,139,420	5,588,899	6,046,118	6,435,030	6,798,570	7,181,179
Minority Interest	-	212	212	212	212	212	212
Total Shareholders' Equity	714,750	711,104	788,568	875,879	974,138	1,084,678	1,195,262
Total Liabilities and Equity	6,028,236	5,850,736	6,377,679	6,922,208	7,409,380	7,883,461	8,376,653

Income Statement (RO Thousands)	Historical		Forecast				
	2008	2009	2010	2011	2012	2013	2014
Fiscal Year Ends December							
Net Interest Income	162,107	174,366	183,646	199,087	218,530	237,475	255,884
Income from Fees and Commissions	54,827	49,811	54,377	58,772	62,893	67,767	73,291
Other Operating Income	16,619	3,213	16,726	20,810	23,188	25,877	28,425
Total Operating Income	233,553	227,390	254,748	278,669	304,611	331,119	357,600
Provisions for Credit Losses	(12,022)	(87,653)	(44,714)	(35,022)	(28,156)	(19,461)	(22,387)
Salaries and Employee-Related Expenses	(48,899)	(45,883)	(53,587)	(60,762)	(67,026)	(72,859)	(78,686)
General and Administrative Expenses	(29,472)	(29,500)	(34,453)	(39,066)	(43,094)	(46,844)	(50,590)
Depreciation	(5,737)	(6,622)	(7,349)	(8,418)	(9,680)	(11,132)	(12,802)
Other Provisions and Operating Expenses	(29,012)	(22,950)	-	-	-	-	-
Total Operating Expenses	(125,142)	(192,608)	(140,103)	(143,268)	(147,956)	(150,296)	(164,465)
Net Operating Profit	108,411	34,782	114,645	135,401	156,654	180,822	193,134
Other Income / (Expenses)	-	53,200	-	-	-	-	-
Income Taxes	(14,680)	(14,264)	(15,638)	(18,470)	(21,369)	(24,666)	(26,345)
Net Profit	93,731	73,718	99,007	116,932	135,286	156,157	166,789
EPS (RO)	0.087	0.068	0.092	0.109	0.126	0.145	0.155

Key Ratios	Historical		Forecast				
	2008	2009	2010	2011	2012	2013	2014
Fiscal Year Ends December							
Growth in Loans	38.7%	3.0%	10.0%	9.4%	7.4%	6.5%	6.2%
Growth in Deposits	36.6%	-3.3%	12.1%	10.4%	8.8%	7.5%	6.6%
Growth in Net Profit	11.2%	-21.4%	34.3%	18.1%	15.7%	15.4%	6.8%
Growth in Operating Income	30.9%	-2.6%	12.0%	9.4%	9.3%	8.7%	8.0%
Loans-to-Assets	61.8%	65.6%	66.2%	66.7%	66.9%	67.0%	67.0%
Loans-to-Deposits	117.5%	125.1%	122.7%	121.6%	120.1%	119.0%	118.6%
NPLs-to-Gross Loans	1.7%	4.3%	5.0%	4.9%	4.8%	4.7%	4.5%
NPL Coverage	154.5%	107.1%	103.4%	110.9%	116.4%	119.1%	124.0%
Capital Adequacy	13.0%	15.2%	15.5%	15.6%	16.0%	15.5%	16.0%
Growth in Costs	19.8%	-2.5%	16.2%	13.5%	10.7%	9.2%	8.6%
Non Interest Expense-to-Average Assets	2.4%	3.2%	2.3%	2.2%	2.1%	2.0%	2.0%
Cost-to-Income	36.1%	36.1%	37.4%	38.8%	39.3%	39.5%	39.7%
Non Interest Income-to-Operating Income	30.6%	23.3%	27.9%	28.6%	28.3%	28.3%	28.4%
Dividend Payout	23.0%	29.2%	29.9%	31.7%	33.7%	36.0%	37.5%
Net Interest Margin	3.4%	3.1%	3.2%	3.1%	3.2%	3.2%	3.3%
RoAE	14.0%	10.3%	13.2%	14.1%	14.6%	15.2%	14.6%
RoAA	1.8%	1.2%	1.6%	1.8%	1.9%	2.0%	2.1%

Sources: Bank's financial statements and NBK Capital

RISK AND RECOMMENDATION: GUIDE

RECOMMENDATION		UPSIDE (DOWNSIDE) POTENTIAL		
BUY		MORE THAN 20%		
ACCUMULATE		BETWEEN 5% AND 20%		
HOLD		BETWEEN -10% AND 5%		
REDUCE		BETWEEN -25% AND -10%		
SELL		LESS THAN -25%		
RISK LEVEL				
LOW RISK			HIGH RISK	
1	2	3	4	5

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