Analyst Comment

June 17, 2009

BANK MUSCAT (BMAO.OM)

- Bank Muscat announced yesterday its intention to dispose of its remaining 0.51% stake in India's HDFC Bank (HDFC) within the next 30 days. The announcement follows the bank's disclosure last week of exposure worth RO 66 million (directly and indirectly) to two troubled Saudi groups, namely the Saad Group and the Al Gosaibi Group.

- Taking the above into consideration, we revisited our forecasts to examine the impact of these one-off events on the bank's valuation. Accordingly, we incorporated an increase in loan loss provisioning and non-performing loans, assuming the worse-case scenario of a 100% default on these loans. Bank Muscat's NPL coverage ratio stood at 150% as of March 2009 and we believe this will provide some cushion for the bank. Accordingly, we expect an increase in our loan loss provisions forecasts to RO 53.7 million in 2009 and RO 35.3 million in 2010. We also estimated 100% provisions on the RO 17 million exposure via the bank's Bahraini subsidiary, Bank Muscat International (BMI), split equally over 2009 and 2010. Based on these assumptions, we expect Bank Muscat's NPLs-to-gross loans to reach 3% and 3.5%, by the end of 2009 and 2010, respectively.

- The increase in provisioning, however, could be partly offset by the sale of Bank Muscat's 0.51% stake in HDFC. As of March 2009, the bank held around RO 12 million of unrealized gains on this investment. The sale of the HDFC shares, which have risen by almost 94% since their most recent low in March 2009, could translate into a potential gain of approximately RO 23 million at current market prices. We would like to note that given this scenario, Bank Muscat's management may decide to take a greater amount of provisions in 2009, than in 2010, in order to reduce earnings volatility over these years.

- Implementing all of the above changes drops our fair value per share slightly (2%) to RO 0.970,from our prior fair value per share of RO 0.990. The slight decrease in fair value was driven by higher loan loss provisioning and a deterioration of asset quality in the short term. However, since the bank is trading at 1.1x book and this fair value is still 37% above today's closing price, we reiterate our "Buy" recommendation, keeping our 12-month fair value per share at RO 0.990. Nevertheless, while we believe that the bank is currently undervalued and its long term growth prospects remain strong, we caution against short-term pressure on the stock price driven by the recent events.

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Related Research

- Bank Muscat Update - 28 May 2009
- Bank Muscat Initiation of Coverage - 04 Dec. 2008

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