

Outlook: Neutral Recommendation: **HOLD**

Key Figures (RO ,000)

Period	Q1 2009	Q2 2009	Q3 2009
Net Interest Income	13,093	14,755	14,534
Operating Profit	12,084	12,706	10,433
Net Profit	7,334	6,117	6,119

Balance Sheet (RO ,000)

Period	Q1 2009	Q2 2009	Q3 2009
Net Loans	1,413,741	1,391,708	1,378,197
Total deposits	1,423,298	1,308,418	1,244,630
Total Equity	233,646	242,872	248,989

Valuation

Period	Q1 2009	Q2 2009	Q3 2009
EPS (RO)	0.027	0.025	0.024
PE (x)	12.0	13.1	13.5
BVPS (RO)	0.216	0.225	0.230
P / BV (x)	1.50	1.45	1.41

Market Price RO	0.325
Shares OS	108,100,000
Market cap RO	35,132,500

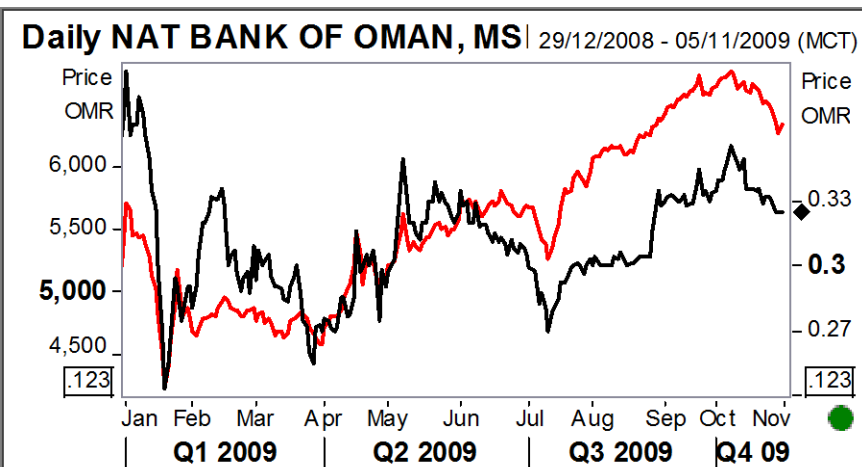
Relative Performance

	NBOB	MSM	Banking
1 month	-1.21%	-3.31%	-2.22%
6 months	10.85%	23.90%	45.00%
12 months	-15.06%	2.33%	27.55%

Reuters	NBO.OM
Bloomberg	NBOB OM

Shareholding Pattern %

Qatar Commercial Bank	34.85
Suhail Bahwan group holding LLC	14.74
MOD pension fund	7.66
Civil Service Employees Pension Fund	6.82
Public Authority for Social Insurance	5.99



National Bank of Oman's 44% decline in net profit was attributed by 31% decrease in non interest income and a whopping increase of RO 12.2 million towards provision expenses. Net Interest Margins improved by 3 bps Q-o-Q to 3.82%, Net Interest Income growth stood at 22.4% Y-o-Y. Provisions during 9M2009 reached RO 9.71 million which include an ad hoc provision of RO 3.99 million earmarked against credit loss expense towards International banking Corporation exposure. The bank has reported 12% growth in loan book Y-o-Y. However, loan book growth remains muted during the year with a sequential declining trend over the quarters. Deposits are on a declining path with the bank trying to get rid of high cost term deposits during the year. We are factoring in 15% increase in net interest income during FY09 and 11% decline in operating profit, resulting in FY09e EPS of RO 0.025. At current market prices the bank's shares are trading at 12.8x its FY09e earnings and 1.4x its current book value of RO 0.230. We give neutral outlook on the shares with HOLD recommendation. Sharper than expected rise in bad assets and subsequent increase in provisioning expenses is the key risk to our call.

► **Loan book growth lower than peers:** NBO's 12.0% Y-o-Y growth in loan book was slightly lower than the overall Y-o-Y loan book growth of listed commercial banks in Oman. The loan book growth remained muted with negative bias on YTD basis, while the net loan book of listed banks grew by a faster pace of 3.6% YTD. The sequential declining trend in loan book is visible only for the major banks in the country, while small players are still performing well in terms of loan addition. We assume that the bank is taking a relatively conservative approach towards loan disbursement keeping an eye on asset quality. Additionally, lower working capital requirement by manufacturing companies on account of lower commodity prices and demand slowdown has hampered the growth. The bank's loan book has shown substantial increase in personal loans vis a vis corporate credit. Personal loan portfolio increased by 10.4% during the year while the YTD appetite for corporate credit and overdraft facilities declined by 8.4% and 7.7% respectively.

► **Reprising of deposits; low cost deposits help in improved spread:** The bank had been successful in reducing the high cost long term deposits while mobilising more of low cost current accounts and savings accounts deposits. This has resulted in 22bps increase in the spreads Y-o-Y and 34bps YTD. However, on a Q-o-Q basis the spread has declined by 13bps. NIM has been increasing consistently during the year and is 19bps above year ago levels.

► **Noninterest income** of RO 18.69 million was RO 8.35 below that reported during 9M2008. Treasury income during the year had affected severely during the year. The 45% Y-o-Y decline in service charge revenue and 50% decline in investment income were the major contributors for the dent in noninterest income. Forex revenues declined by 20% while fee and commission income showed decline of 14% over year ago levels.

► **Asset quality remains under check:** The trend in overall asset quality is mixed with NPL/Gross Loans showing increase of 13bps on Q-o-Q while decrease of 71bps Y-o-Y. Provision expense of RO 9.71 million helped in provision coverage reaching 100% of the bad loans from 95.8% during end of September 2008. Provision expenses during 9M2009 reached 27.5% of the operating profit, and are showing sequential increase over the quarters. During the year earlier period the bank had benefitted from provision write backs that augmented its profitability. The bank has taken provisions of RO 3.99 million so far on its RO 6.25 million exposure to The International banking Corporation, Bahrain. We expect the bank provide fully for this exposure during the current fiscal. We anticipate the provision write backs to come down during the rest of the year and this trend to continue in FY2010 as well, resulting in provision coverage to hover around current levels.

► **Outlook neutral, recommends hold:** We factor in 22% increase in net interest income and 40% decline in noninterest income resulting in 11% decline in operating profit during FY2009. We are including the balance of TIBC exposure in provisions and estimate the provision expenses during FY2009 to reach RO 13.8 million, resulting in an EPS of RO 0.025. We expect capitalization to remain healthy, but sustainable ROEs taking a hit down to around 10% through FY2010. At current market prices the bank's shares are trading at 12.8x its FY09e earnings and 1.4x its current book value of RO 0.230. With ROE trying to stabilize at 10%, we give neutral outlook on the shares with HOLD recommendation. Sharper than expected rise in bad assets and subsequent increase in provisioning expenses are the key risk to our call.

Table 1: Margins improve sequentially, but on a slow pace

(%)	Mar-08	Jun-08	Sep-08	Dec-08	Mar-09	Jun-09	Sep-09
NIM	3.86%	3.75%	3.63%	3.41%	3.73%	3.79%	3.82%
Avg. cost of funds	3.66%	3.41%	3.26%	3.08%	3.62%	3.41%	3.26%
Avg. yield on assets	7.58%	7.05%	6.78%	6.48%	7.49%	7.15%	6.99%
Interest spread	3.91%	3.64%	3.52%	3.40%	3.40%	3.87%	3.74%

Table 2: Noninterest income profile - Service charges taken a beating

RO ,000	9M2008	9M2009	%
Net gains from forex	2,162	1,729	-20.0%
Fees and commissions	7,790	6,699	-14.0%
Realised investment income	4,075	2,019	-50.5%
Income from bonds	502	460	-8.4%
Dividend income	697	731	4.9%
Service charges	11,448	6,240	-45.5%
Miscellaneous income	369	812	120.1%

Table 3: Loans and deposits growth below sector average

RO ,000	Mar-08	Jun-08	Sep-08	Dec-08	Mar-09	Jun-09	Sep-09
Net Loans	1,015,354	1,174,138	1,230,783	1,401,218	1,413,741	1,391,708	1,378,197
Loans growth		16%	5%	14%	1%	-2%	-1%
Deposits	1,059,107	1,175,910	1,163,612	1,341,755	1,423,298	1,308,418	1,244,630
Deposit growth		11%	-1%	15%	6%	-8%	-5%

Table 4: Banking sector balance sheet

RO ,000	Sep-08	Dec-08	Sep-09	YTD %	Y-o-Y %
Net loans	7,161,780	7,783,710	8,065,478	3.6%	12.6%
Deposits	6,405,708	7,144,542	7,320,163	2.5%	14.3%

Table 5: Loan mix - Personal loans the key driver

RO ,000	9M2008	9M2009	%
Corporate loans	714,341	761,054	6.5%
Personal Loans	525,823	618,549	17.6%
Overdrafts	59,324	68,480	15.4%

Table 6: Deposit mix - Restructuring yields results, low cost deposits help in improved margins

RO ,000	Sep-09	Sep-08	%
Current Accounts	205,984	252,706	22.7%
Savings Accounts	222,354	267,474	20.3%
Certificate of deposits	53,800	63,520	18.1%
Term deposits	681,474	660,930	-3.0%
Total	1,163,612	1,244,630	7.0%

Table 7: Asset quality remains under check

RO ,000	Mar-08	Jun-08	Sep-08	Dec-08	Mar-09	Jun-09	Sep-09
NPA	73,200	73,900	71,700	64,200	66,000	68,400	69,600
NPA/Gross loans	6.7%	5.9%	5.52%	4.4%	4.5%	4.68%	4.81%
Provisions	69,753	70,347	68,705	64,246	65,820	69,857	69,886
Provision coverage	95.3%	95.2%	95.8%	100.1%	99.7%	102.1%	100.4%

Income Statement	FY2008	1Q2009	2Q2009	3Q2009	QoQ %	9M2008	9M2009	YoY %	Q3 2008	Q32009	YoY %
Interest Income	90,220	26,302	26,207	25,021	-4.5%	64,628	77,530	20.0%	22,914	25,021	9.2%
Interest Expense	42,687	13,209	11,452	10,487	-8.4%	30,014	35,148	17.1%	10,533	10,487	-0.4%
Net Interest Income	47,533	13,093	14,755	14,534	-1.5%	34,614	42,382	22.4%	12,381	14,534	17.4%
Other Operating Income	40,615	7,200	6,785	4,705	-30.7%	27,043	18,690	-30.9%	8,352	4,705	-43.7%
Operating income	88,148	20,293	21,540	19,239	-10.7%	61,657	61,072	-0.9%	20,733	19,239	-7.2%
Staff costs	19,570	4,907	5,320	5,099	-4.2%	14,299	15,326	7.2%	5,255	5,099	-3.0%
Other Operating Expenses	12,479	2,828	2,849	2,888	1.4%	9,026	8,565	-5.1%	3,423	2,888	-15.6%
Depreciation	1,805	474	665	819	23.2%	1,299	1,958	50.7%	486	819	68.5%
Operating expenses	33,854	8,209	8,834	8,806	-0.3%	24,624	25,849	5.0%	9,164	8,806	-3.9%
Operating profit before impairments	54,294	12,084	12,706	10,433	-17.9%	37,033	35,223	-4.9%	11,569	10,433	-9.8%
Net loan provisions	-1,064	1,591	4,979	3,137	-37.0%	-2,555	9,707	479.9%	-2,339	3,137	-234.1%
Impairment on investments	3,703	1,744	1,135	256	-77.4%	0	3,135	na	0	256	na
Profit before tax	51,655	8,749	6,592	7,040	6.8%	39,588	22,381	-43.5%	13,908	7,040	-49.4%
Tax	6,275	1,415	475	921	93.9%	4,776	2,811	-41.1%	1,672	921	-44.9%
Net profit	45,380	7,334	6,117	6,119	0.0%	34,812	19,570	-43.8%	12,236	6,119	-50.0%

Balance Sheet	FY2008	1Q2009	2Q2009	3Q2009
Cash and balances with central bank	266,389	323,682	222,682	211,642
Due from banks and other money market placements	198,611	177,604	127,442	89,051
<i>QoQ change</i>		<i>-10.6%</i>	<i>-28.2%</i>	<i>-30.1%</i>
Loans and advances	1,401,218	1,413,741	1,391,708	1,378,197
<i>QoQ change</i>		<i>0.9%</i>	<i>-1.6%</i>	<i>-1.0%</i>
Non trading financial investments	30,845	30,271	33,205	31,828
Premises and equipment	9,570	11,161	12,202	12,495
<i>QoQ change</i>		<i>16.6%</i>	<i>9.3%</i>	<i>2.4%</i>
Other assets	77,765	48,778	33,601	30,671
Total Assets	1,984,480	2,005,373	1,820,962	1,771,355
<i>QoQ change</i>		<i>1.1%</i>	<i>-9.2%</i>	<i>-2.7%</i>
Due to banks	276,531	243,582	207,769	212,382
Customers deposits	1,341,755	1,423,298	1,308,418	1,244,630
<i>QoQ change</i>		<i>6.1%</i>	<i>-8.1%</i>	<i>-4.9%</i>
Other liabilities	84,896	72,032	41,185	43,758
Taxation	7,313	2,715	3,118	3,996
Total liabilities	1,710,495	1,741,627	1,560,490	1,504,766
<i>QoQ change</i>		<i>1.8%</i>	<i>-10.4%</i>	<i>-3.6%</i>
Subordinated private placement	28,600	30,100	17,600	17,600
Share capital	108,100	108,100	108,100	108,100
Share premium	34,465	34,465	34,465	34,465
Legal reserve	30,564	30,564	30,564	30,564
General reserve	4,419	4,419	4,419	4,419
Other non distributable reserve	15,311	15,311	2,811	2,811
Cumulative changes in fair value	-842	-997	2,112	2,110
Proposed cash dividend	18,918	0	0	0
Retained earnings	34,450	41,784	60,401	66,520
Total equity	245,385	233,646	242,872	248,989
<i>QoQ change</i>		<i>-4.8%</i>	<i>3.9%</i>	<i>2.5%</i>

	Q1 08	Q2 08	Q3 08	Q4 08	Q1 09	Q2 09	Q3 09
Profitability							
Average yield on interest earnings assets	7.58%	7.05%	6.78%	6.48%	7.49%	7.15%	6.99%
Average cost of interest bearing liabilities	3.66%	3.41%	3.26%	3.08%	3.62%	3.41%	3.26%
Net interest spread	3.91%	3.64%	3.52%	3.40%	3.87%	3.74%	3.74%
Net interest margin	3.86%	3.75%	3.63%	3.41%	3.73%	3.79%	3.82%
Operating income / total assets	5.87%	5.70%	5.32%	5.09%	4.54%	4.72%	4.61%
Return on average equity	21.66%	20.84%	20.37%	18.98%	12.25%	11.02%	10.56%
Return on equity	19.52%	18.62%	18.80%	18.49%	12.56%	11.08%	10.48%
Return on average assets	3.70%	3.57%	3.42%	2.98%	1.96%	1.73%	1.69%
Return on assets	3.18%	2.98%	2.99%	2.60%	1.75%	1.68%	1.68%
Per share ratios							
Quarterly EPS (RO)	0.010	0.011	0.011	0.010	0.007	0.006	0.006
Annualised EPS (RO)	0.040	0.042	0.043	0.042	0.027	0.025	0.025
BVPS	0.208	0.224	0.228	0.227	0.216	0.225	0.230
PER	-	-	-	-	11.9	13.0	12.8
PBV	-	-	-	-	1.5	1.4	1.4
Efficiency							
Cost / income	36.07%	39.37%	44.20%	34.84%	40.45%	41.01%	45.77%
Cash cost / income	34.02%	37.45%	41.86%	32.93%	38.12%	37.92%	41.51%
Cost / total assets	0.45%	0.48%	0.52%	0.47%	0.41%	0.49%	0.50%
Staff cost / income	21.05%	23.08%	25.35%	19.90%	24.18%	24.70%	26.50%
Depreciation / fixed assets	6.09%	6.18%	5.93%	5.29%	4.25%	5.45%	6.55%
Asset quality							
NPL / Gross customer loans	6.75%	5.94%	5.52%	4.38%	4.46%	4.68%	4.81%
Provisions / NPL	95.29%	95.19%	95.82%	100.07%	99.73%	102.13%	100.41%
Provisions / gross customer loans	6.43%	5.65%	5.29%	4.38%	4.45%	4.78%	4.83%
Provisions expense / gross customer loans	0.02%	-0.03%	-0.18%	0.10%	0.11%	0.34%	0.22%
Provision expense / operating profit	1.33%	-3.00%	-20.22%	8.64%	13.17%	39.19%	30.07%
Income and cost growth (Q-o-Q)							
Net interest income	17.32%	18.55%	2.66%	4.35%	1.35%	12.69%	-1.50%
Noninterest income	14.57%	-5.77%	-7.90%	62.50%	-46.95%	-5.76%	-30.66%
Operating income	-69.59%	6.73%	-1.87%	27.77%	-23.40%	6.14%	-10.68%
Operating costs	-75.08%	16.50%	10.16%	0.72%	-11.06%	7.61%	-0.32%
Operating profit	-65.27%	1.22%	-9.68%	49.20%	-29.99%	5.15%	-17.89%
Net income	-75.47%	6.27%	5.20%	-13.63%	-30.60%	-16.59%	0.03%
Income breakdown							
Interest income / total income	66.64%	65.51%	69.20%	64.94%	78.78%	72.21%	74.09%
Noninterest income / total income	48.61%	42.92%	40.28%	51.23%	35.48%	31.50%	24.46%
Balance sheet growth (Y-o-Y)							
Customer loans	32.91%	47.14%	37.55%	54.53%	39.24%	18.53%	11.98%
Customer deposits	24.73%	31.58%	19.85%	43.35%	34.39%	11.27%	6.96%
Total assets	39.01%	49.63%	32.97%	34.39%	27.73%	5.71%	0.45%
Shareholder equity	24.64%	27.12%	18.25%	5.41%	4.15%	0.16%	0.85%
Balance sheet structure							
Customer loans / total assets	64.67%	68.16%	69.80%	70.61%	70.50%	76.43%	77.80%
Equity participations & investments / total assets	2.90%	2.97%	3.01%	1.56%	1.51%	1.83%	2.78%
Interest earning assets / total assets	75.58%	80.46%	82.66%	82.17%	80.86%	85.25%	84.63%
Net loans / deposits	95.87%	99.85%	105.77%	104.43%	99.33%	106.37%	110.73%

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