

Oman International Bank - Strategic alliance to bring Synergies...

Closing: RO 0.285

Recommendation: Rating under Review

Event Flash...

Update on Merger between OIB and HSBC Oman...

10-Oct-11

Oman International Bank (CMP: RO 0.285; Fair Value: 0.283; Recommendation: Ratings under review)

Synergies remain strong; Positive over the long term

Event - OIB + HSBC Oman: Oman International Bank (OIB) has confirmed that it is in discussions with HSBC Holdings plc (HSBC) for a possible merger of HSBC's Oman operations with the OIB. As per the bank, the discussions are ongoing and there has been no decision made whether to recommend proceeding with the transaction. Overall we see this news on a positive front for the existing shareholders of OIB.

Further the Chairman of OIB has also clarified that the bank is in early stages of negotiations about a merger of its business with HSBC's Oman operations. The bank is not discussing buying the HSBC's business in Oman as discussed in various news sources. If the negotiations proceed to an agreement, the process would lead to a merger between the banks. As per the Chairman, currently OIB is Oman's fifth largest bank by assets, and HSBC Oman is the sixth largest in Oman.

Combined entity would become stronger in Oman: The Oman operations of HSBC is expected to be merged with OIB to create a stronger unit giving tougher competition to the top three banks in Oman. We believe that the combined entity (OIB + HSBC) would become one of the leading players in the fast-growing Omani banking market (with still Credit to GDP ratio less than 50% levels). **Looking at the initial information, we believe the combined entity may become the No.2 bank in Oman (in terms of Asset base) next to Bank Muscat (Source: GBCM Research Estimates).**

In line with the strategic review: During July 2011, OIB has announced that the Board has started a comprehensive strategic review process to take the bank to the next phase of growth in the coming years. Added, the strategy review is expected to evaluate diverse operating models which include whether to remain independent or to look for strategic alliances with the leading institutions to create a stronger business model augmenting future growth.

OIB move to take to the next level: As per OIB, the strategic review has been planned to improve its existing business model with the incorporation of innovative cum international standards in various segments which includes Credit, Market and operational risk parameters, introduction of new technologies and also widening of product mix. We believe that the current plans of repositioning of the bank would take to the next level of growth and also reclaim its position of being one of the leading banks in Oman.



Outlook - Merger - A win-win strategy for both...

Omani Bank with strong liability mix: OIB is one of the oldest banks in Oman which came into existence on Jan 1984 and became the first 100% Omani owned commercial bank. The bank has a strong network of more than 82 branches in Oman and 4 overseas branches at Mumbai and Cochin in India and Karachi & Lahore in Pakistan.

OIB - Lack in Asset Growth: Overall asset book growth of the bank remained subdued over the years as compared to the sectoral peers. The same trend continued during H1 2011 with the decline in gross loan book by about 1.8% YTD to RO 703.724 million. This is in line with our estimates. We have estimated the bank to show marginal improvement in asset growth during H2 2011 to report a marginal growth of about 2.5% for the current fiscal year.

Strong Low cost deposit base: The bank has been able to maintain its low cost deposit base, which is moving in tandem with the decline in the overall loan book decline. For H1 2011, the bank has seen a marginal reduction of 0.4% YTD in total deposits. Overall deposit base of the bank is at about RO 793.653 million. At the end of H1 2011, the total credit to deposit ratio is at about meager 88.7% levels. We always remain positive on OIB with its presence of significant low cost deposits, which can be effectively used for aggressive growth in the coming quarters, which needs to be watched out.

Merger Benefits to OIB: We believe OIB to get the synergies in the form of strong global banking brand (HSBC - dynamic brand), efficient implementation of new technologies (changing from legacy systems) and also the launch of innovative products to take the combined bank to the next phase of growth.

HSBC Oman - committed to growth: HSBC Oman is part of the global HSBC Group and being represented by HSBC Bank Middle East Limited. HSBC Oman offers a comprehensive range of Corporate Banking, Retail Banking and Wealth Management solutions. The bank also offers services include Trade Services, Treasury Services, Global Payments and Cash Management, Custody and Clearing Services etc.,

Merger Benefits to HSBC Oman: We see HSBC Oman to obtain the synergies in the form of robust distribution network of OIB, strong retail cum Omani brand image along with the favorable liability mix (catch in the deal) which may aid in achieving higher levels of growth in Omani market going forward.

Creating Synergies would be the buzz: We see stronger synergies emerging out of the merger of HSBC Oman and OIB with both the banks getting the benefits to a greater extent, which would make the merger a viable option in our opinion. We also perceive that the existing shareholders of OIB to benefit in the longer run.



Merger to remain positive for existing shareholders of OIB...

Merger Valuations - Early stages: The lack of earnings momentum of OIB has led to the relative underperformance of the stock over the last three years. However the positive news on the possibilities of strategic alliances has in turn led to buying interest in the counter since the beginning of the year. We also remain positive on this front with the strategic partner may bring in synergies towards achieving aggressive growth moving forward. At the current levels, OIB is trading at PBV (FY2011E) of 1.7X, which is higher as compared to the Oman Banking sector average P/BV of 1.4X. ***Though we see significant operational synergies in the entire merger process, we are not in a position to come out with merger valuations at the early stages of the process.*** We have to wait for further additional information towards working on the valuations in the coming days.

On the valuations front, we remain 'Neutral' on the bank. Post the announcement of merger news; we have put in the stock under review for need of further clarifications. With the emergence of clarity from the bank on the merger process, we may possibly see the re-rating of the valuation multiples in the coming quarters. ***Overall, we feel that the successful completion of the entire merger process would be a clear win-win strategy for both the banks*** in competing with the upcoming competition (*In the form of new Islamic banks*) in Omani banks.

Please find the data on Omani Banks Comparative performance for H1 2011, OIB stock performance Vs MSM 30 Index over the last five years and OIB's PE and PBV trend in the coming pages...

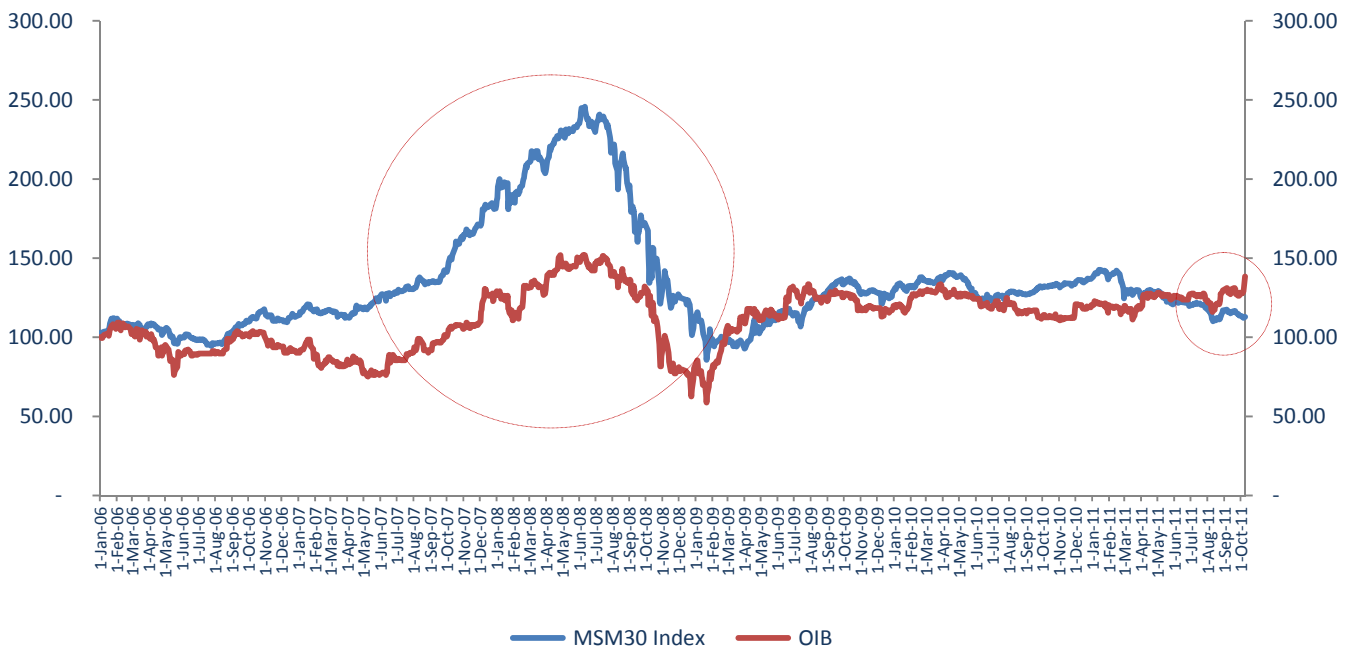
Omani Banks Comparison - H1 2011 Performance

H1 2011 Vs H1 2010 (YoY)	Bank Muscat	NBO	Bank Dhofar*	Bank Sohar	OIB	Ahli Bank
Growth Indicators (YoY %)						
Gross Loan Growth	10.0%	8.8%	9.0%	16.3%	4.4%	37.2%
Asset Growth	2.2%	8.9%	9.3%	13.0%	5.5%	36.7%
Customer Deposits Growth	24.2%	11.4%	8.7%	12.6%	8.0%	29.9%
Total Operating Income Growth	20.5%	12.1%	7.9%	20.1%	6.1%	39.5%
Net Income Growth	21.7%	16.9%	-125.7%	14.8%	-9.2%	28.8%
Profitability Indicators (%)						
Return on Average Assets	1.8%	1.8%	-0.6%	1.2%	1.5%	2.3%
Return on Average Equity	14.8%	13.3%	-4.3%	12.2%	10.4%	17.0%
Interest Expenses/ Total Income	16.9%	39.3%	27.7%	63.6%	13.9%	43.5%
NIM (%)	3.7%	3.0%	4.0%	3.1%	3.0%	3.1%
Yield on Interest Bearing Assets	5.7%	4.9%	5.5%	5.3%	3.6%	5.1%
Cost of Funds	1.0%	2.2%	1.6%	2.4%	0.7%	2.1%
Interest Spread	4.7%	2.7%	3.9%	2.9%	2.9%	3.0%
Efficiency Indicators (%)						
Non-Int expenses/ Assets	1.0%	1.0%	1.0%	0.9%	1.0%	0.6%
Cost to Income Ratio	41.6%	45.9%	42.8%	56.1%	55.4%	29.5%
Liquidity Indicators						
Customer Deposits/ Shareholders Equity (x)	5.2	5.5	5.9	8.5	4.9	6.1
Credit to Deposit Ratio (%)	103.1%	110.9%	105.0%	99.4%	88.7%	108.4%
Equity to Assets Ratio (%) – CAR	12.9%	13.1%	12.7%	9.4%	14.4%	12.6%
Credit Quality Indicators (%)						
NPAs to GL	4.3%	3.4%	4.6%	1.0%	11.5%	0.6%
Recoveries to GL	0.3%	0.5%	0.2%	NM	0.2%	NM
Provision Coverage	103.6%	117.4%	117.7%	181.5%	100.3%	122.3%

Source: Company Report, GBCM Research Estimates; * H1 2011 results of Bank Dhofar includes non-recurring legal costs of RO 26.1 million



OIB Stock performance Vs MSM Performance (Since Jan 2006)...



Source: Bloomberg, GBCM Research

- Since Jan 2006, the stock performance of OIB has underperformed the benchmark index (last five years)
- OIB has shown outperformance since the beginning of the year (since the news of strategic alliance came in)
- 2011 YTD return of OIB is at 8.7% (clear outperformance) while the MSM 30 Index is down by 17.6%

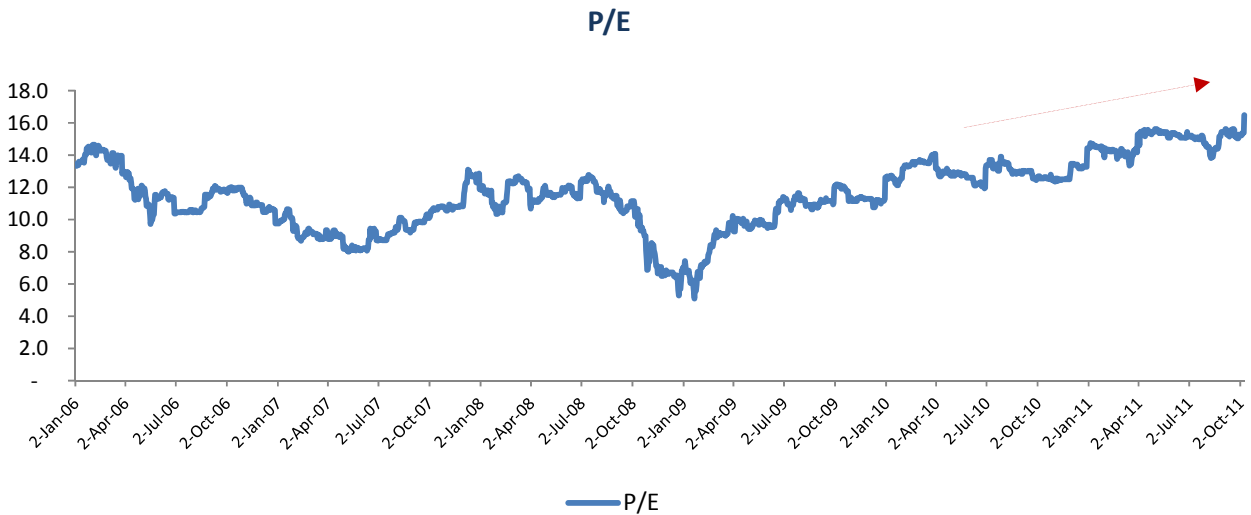
Omani Banks Comparison - H1 2011 Performance

	Bank Muscat	NBO	Bank Dhofar*	Bank Sohar	OIB	Ahli Bank
Valuation Indicators						
Closing Price	0.663	0.305	0.535	0.157	0.285	0.260
Market Capitalization (In RO 000s)	1,026,578	329,705	489,653	157,000	275,893	208,371
P/E (H1 2011 - Annualized)	9.0	9.7	NM	11.3	16.5	12.0
P/BV (Latest)	1.26	1.25	2.32	1.35	1.71	1.88

Source: Company Report, GBCM Research Estimates; * H1 2011 results of Bank Dhofar includes non-recurring legal costs of RO 26.1 million

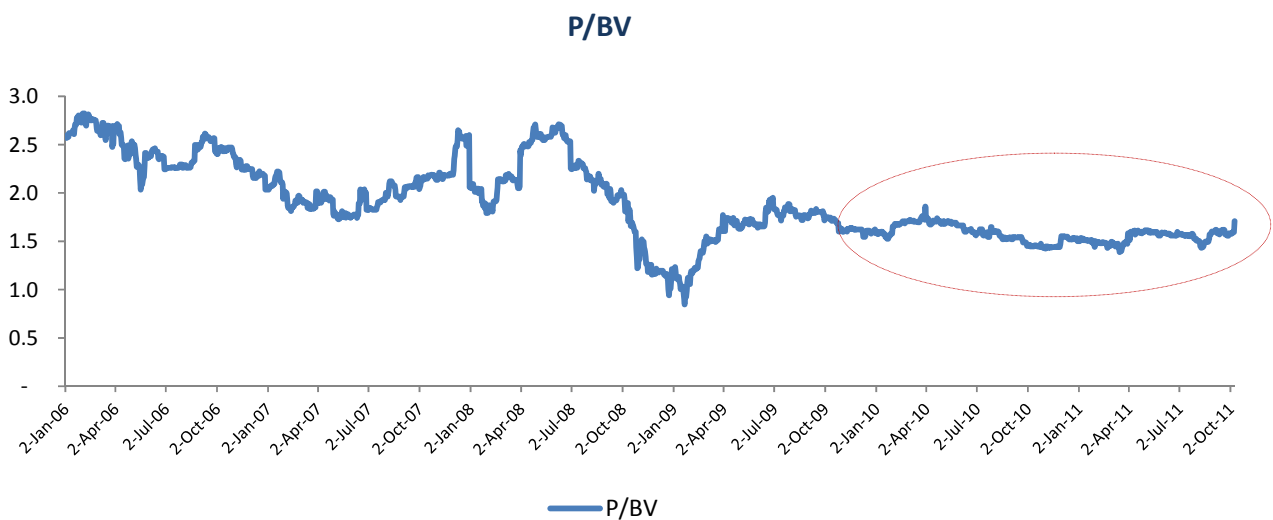


OIB - PE Trend (since Jan 2006)



Source: Bloomberg, GBCM Research

OIB - PBV Trend (since Jan 2006)



Source: Bloomberg, GBCM Research



Stock Rating Methodology:

Buy - Upside more than 20%

Accumulate - Upside between 10% and 20%

Neutral - Upside or downside less than 10%

Reduce - Downside between 10% and 20%

Sell - Downside more than 20%

Not Rated - Stocks not in regular research coverage

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