

BankMuscat (S.A.O.G) Annual Results 2004



Chairman's Report



Dear Shareholders,

The world economy posted its strongest performance in many decades last year with growth figures nearly touching the important 5% figure. However, spiraling oil prices in the second half of the year, while adding lustre to the bullish sentiment in many Gulf economies, resulted in many of the leading global economies treading slightly uncertain ground. International experts however opine that the slackness the global economy may witness during 2005 will turn the corner and the economy will rebound in 2006.

Oman's Economy

Oman's economy continues to be carefully monitored and managed. The Government has recently announced a growth-oriented budget with a conservative outlook. The Oil and Gas sector continue to play a dominant role in the Sultanate accounting for over 41% of nominal GDP and about 73% of Government revenue. Total revenues for the year have been projected at RO 3,140 million (up 7.3% over 2004) based on an average oil price of USD 23 per barrel and oil production estimates of 753,000 bpd. Total expenditure has been pegged at RO 3,680 million, a 7.4% growth over last year. The share of total investment expenditure has been estimated at RO 867 million. Focal areas of Government expenditure continue to be the Oil sector, development projects, education, healthcare and the development of human resources, all of which are critical to the sustained growth and development of the national economy. This year, a significant amount has also been earmarked for soft loans to be extended to the private sector in the areas of agriculture and fisheries, industry, tourism and education. The budget deficit for the year has been conservatively estimated at RO 540 million.

Capital Markets

Under the able guidance of the Capital Markets Authority of the Sultanate of Oman, the Muscat Securities Market (MSM) continued to register steady growth, reflecting the confidence of investors in the economy. The buoyancy in the local economy was also reflected in the performance of the MSM, during the year. The MSM index rose by 22.8% to close the year at 3,375 points. The Banking and Investment sector index increased by 24% during the year.

Financial Overview

The Bank achieved a net profit of RO 34.1 million during the year ended 31 December 2004, as against a net profit of RO 27.1 million for the year ended 31 December 2003, an increase of 25.8%. Net Interest Income grew by 9.3% from RO 68.8 million in 2003 to RO 75.2 million in 2004. Non-interest income grew from RO 19.8 million in 2003 to RO 22.8 million in 2004 an increase of 15.1%. The operating profit of RO 55.3 million in 2004 is 13.1% higher than RO 48.9 million achieved in 2003. The operating expenses of RO 42.7 million in 2004 are 7.7% higher than RO 39.7 million incurred in 2003. The Cost to Income ratio improved from 44.7% in 2003 to 43.5% in 2004.

The return on average assets improved from 1.75% as of 31 December 2003 to 2% as of 31 December 2004. The return on average equity improved from 21.5% as of 31 December 2003 to 21.8% as of 31 December 2004. The basic earnings per share improved from RO 0.498 as of 31 December 2003 to RO 0.570 as of 31 December 2004.

BankMuscat commands a market share of 36.7% in terms of total assets, 37.6% in terms of total credit and 33.3% in terms of total customer deposits. The Bank's share of total savings deposits was 36.9% as at 31 December 2004.

The Bank's net loans and advances portfolio grew by RO 85 million to RO 1,329 million as of 31 December 2004 compared to RO 1,244 million as of 31 December 2003. Customer deposits grew by RO 83 million to RO 1,162 million as of 31 December 2004 compared to RO 1,079 million as of 31 December 2003. Savings deposits increased by 21% from RO 237 million as of 31 December 2003 to RO 287 million as of 31 December 2004.

The Bank issued RO 29.8 million worth of bonds with a coupon rate of 6.25% during the year. The bonds, which were well received by investors, are non-convertible in nature, with a maturity of 10 years and listed on the MSM. Further, the Bank issued floating rate notes amounting to USD 250 million under its Euro Medium Term Note programme. The notes carry a floating interest rate of Libor plus 70 basis points. These are non-convertible and listed on the Luxembourg Stock Exchange.

The Bank made loan loss provisions of RO 20.4 million during the year compared to loan loss provision of RO 21.8 million made during the year ended 31 December 2003. The Bank holds a general loan loss provision of RO 8.9 million as of 31 December 2004. The Bank has recovered RO 6.3 million from classified assets in 2004, compared to RO 6.1 million in 2003.

The Bank absorbed a net loss of RO 1.42 million for the current year from its Indian associate, Centurion Bank (CBL). CBL as part of its restructuring, recapitalisation and clean up plan, as agreed with its investors, reported a loss for the year ended 31 March 2004, the financial year-end for CBL. The Bank's share of loss was RO 2.07 million. Having effected a total clean up of the balance sheet as of 31 March 2004, CBL has now announced a profit for the 9 months ended 31 December 2004. The Bank's share in the profit amounted to RO 0.65 million. We are confident that CBL is now well positioned to achieve sustained business momentum and profitability with a strong new management team and strategy in place.

The Board of Directors is pleased to recommend a cash dividend of 25% and a stock dividend of 15% for the year 2004, subject to due approval by the shareholders and regulatory authorities, thus keeping up the practice of consistently providing good returns to shareholders.

The Year in Retrospect

The year 2004 was amongst the busiest that the Bank has seen in the recent past. While the year saw the issuance of the Bank's maiden Euro Medium Term Note programme and the second issuance of the Bank's 10-year Rial Omani bonds, it also saw the Bank winning a series of mandates in the power sector and being awarded the prestigious Omantel privatization mandate. Towards the end of the year, the Bank, in association with SBI Capital Markets (a subsidiary of India's

leading public sector bank, the State Bank of India) was also retained as advisor to the Government of Oman for the first proposed Independent Water Project (IWP) to be set up in the country.

On the retail side, the Bank took a significant step in its vision to diversify its revenue streams by introducing bancassurance in the Sultanate. The Bank's offerings in this area are issued and underwritten by two of the leading names in the insurance sector – National Life and Norwich Union.

The Bank, otherwise, continued to try to harness the power of technology to innovate and periodically introduce products and services that meet the current and emerging need of customers. The Bank's emphasis on improving quality and service standards across business lines and departments bore rich dividends during the year as BankMuscat earned the rare distinction of becoming the first bank in the Middle East region to be completely ISO:9001 certified.

The Bank's international operations also saw considerable activity with the Bank exercising its full option to maintain its strategic stake in Centurion Bank in India. During the year, the Bank was also granted the necessary regulatory approvals to set up a branch in the Kingdom of Saudi Arabia. The end of the year saw the Bank deciding to convert its erstwhile Bahrain operations into an independent entity named, BankMuscat International (BMI) effective 1st January 2005. BMI has been set up in association with strong regional partners and is envisioned to become a strong regional bank in future.

The most potentially significant development of the year was in the Board of Directors of BankMuscat and the National Bank of Oman (NBO) approving a proposal to possibly merge the operations of the two banks. However, in the absence of an agreement being finally reached on the consideration to be exchanged between the two organizations, the merger talks had to be prematurely called off.

The Bank would like to confirm that the merger talks with NBO have always been accorded the highest level of importance. The Bank would also like to place on record its appreciation to the Central Bank of Oman, the Capital Markets Authority and all the well-wishers of the Bank who have supported it in its efforts to merge with NBO and create a even more significant banking entity in the Sultanate. The Bank would also like to wish NBO and its stakeholders all the best for the future.

The Bank continued to make a favourable impression on various awards juries during the year and was adjudged the Best Bank in Oman by Euromoney for the third successive time and by Global Finance and The Banker, Financial Times for the fourth consecutive time. Other accolades that came the Bank's way during the year included: Best Retail Bank and Best Corporate Bank in Oman (Banker Middle East), Best Consumer Internet Bank (Global Finance), Best Trade Finance Bank and Provider and Best Forex Bank and Provider in Oman (Global Finance) and Best Financial Services Brand, Oman (BusinessToday, one of the leading business magazines in the Sultanate). However, perhaps the most cherished award of the year was the People Development Award that the Bank won at the Oman Awards of Excellence, last year.

Managing Risks

During the year the Bank realized its objective of putting in place a robust Business Continuity Plan (BCP) with the completion of the assignment awarded to leading international BCP advisory firm, Insight Consulting, UK. The Bank has now well documented BCP policies and procedures in place and has also set up and tested a well-equipped Disaster Recovery Site (DRS) to minimize downtime and customer inconvenience in case of an emergency or unforeseen eventuality. The Bank has also appointed a special taskforce and officer in charge of the Bank's BCP programme. This group has also been entrusted with the responsibility of ensuring the systematic dissemination of information of the Bank's programme to all employees and conducting periodic exercises, drills and workshops to ensure greater familiarization of all concerned with the Bank's BCP policies and procedures.

Corporate Governance

The year 2004 saw the Bank reach new vistas in the implementation of Corporate Governance best practices. The Board and Management of the Bank have ensured a culture of respect for the laws and regulations of Oman and the countries in which the Bank has a presence. The Bank follows a clear dividend policy, offers remuneration commensurate with contribution and maintains high standards of disclosure and overall transparency. A robust and dynamic system of internal control, focused policies and regular brainstorming are other notable 'embedded' features of Corporate Governance in practice at BankMuscat. Board-Management harmony enabling growth, profitability and stakeholder welfare elicited the delight of stakeholders during the year.

We expect that the coming year will see Corporate Governance practiced at the Bank set even higher standards.

A detailed Corporate Governance Report duly audited by the External Auditors of the Bank, forms part of the Annual Report presented to you.

Dividend Policy

The Board has a dividend policy that is conservative in its approach so as to provide adequate reserves and provisions to meet any circumstances that may arise due to internal or external contingencies. The policy seeks to reward shareholders yet look at future growth in terms of capital adequacy, especially bearing in mind the coming of Basel II.

The Year Ahead

The strong performance of the Bank and the milestones achieved during the past year will once more set a foundation for future growth during 2005. In fact, the challenges and possibilities that lie ahead over the next 12 months promise to make the year one of the most significant in the Bank's young history.

However, we cannot for a moment forget that central to achieving our vision of becoming one of the foremost banks in the region by the turn of the decade is the continuing and unstinted support and patronage of the Bank by our family of valued customers, shareholders, employees, business associates, well-wishers and the community in which we operate. The Bank remains firm in its commitment to provide each one of these segments with the greatest possible value by pursuing its overarching goal of excellence and by trying to meet each and every current and emerging need of the discerning customer, both in Oman and across the countries in which we operate.

A Word of Thanks

On behalf of the Board of Directors, I would like to take this opportunity to thank the international banking community for the confidence reposed in the Bank and also thank the Bank's Management Team and all our employees for their dedication, commitment and efforts to make the Bank reach even higher levels of excellence.

The Board of Directors welcome and support the measures taken by the Central Bank of Oman and the Capital Markets Authority with a view to improving the financial markets in the Sultanate of Oman. The Bank's growth would not have been possible without the foresight and market-friendly policies adopted by His Majesty's Government.

The Board of Directors is also deeply thankful to His Majesty Sultan Qaboos bin Said for his vision and for ably steering the nation along its path of growth and prosperity.

AbdulMalik bin Abdullah Al-Khalili

BALANCE SHEET (AUDITED)

As at 31 December 2004

ASSETS	2004 RO'000	2003 RO'000
Cash	22,889	19,249
Balances with CBO	8,703	56,893
Capital Deposit with CBO	500	500
Treasury Bills & Other Bills Eligible for re-discounting	145,400	87,302
Due from H.O., Branches, Principal Shareholders & Affiliates Abroad	4,962	-
Due from Banks Placements	271,481	91,520
Investments	78,169	53,746
Loans, Advances & Overdrafts (Net of provisions for bad & doubtful debts & reserved interest)	1,273,689	1,211,855
Tangible Fixed Assets	11,902	12,030
Other Assets	34,693	21,683
Total Assets	1,852,388	1,554,778

LIABILITIES	2004 RO'000	2003 RO'000
Deposits (Incl. Govt.)	1,110,603	1,005,624
Demand	307,126	310,244
Savings	287,078	237,068
Time	516,399	458,312
Certificates of Deposit	51,517	73,592
Due to Banks Placements	125,745	136,441
Other Money Market Deposits	48,125	48,125
Capital/Assigned Capital*	59,815	78,589
Reserves	97,325	66,580
Profits Carried Forward \$	22,250	15,071
Other Liabilities #	291,387	85,135
Subordinated Loan	45,621	45,621
Total Liabilities	1,852,388	1,554,778

* Includes Convertible bonds of RO NIL (2003 - RO 27,100 K)

\$ Includes proposed stock dividend of RO 8,972 K (2003 - RO 2,848K)

Includes Bonds RO 54,803K (2003 - RO 25,000K),

Floating Rate notes RO 96,250K (2003 - RO NIL)

and proposed cash dividend of RO 14,954K (RO 12,872K)

PROFIT & LOSS ACCOUNT (AUDITED)

For the year ended 31 December 2004

	2004 RO'000	2003 RO'000
Gross Interest Income	116,290	109,944
Interest Expense	(29,441)	(32,295)
Net Interest Income	86,849	77,649
Interest Reserved	(11,612)	(10,604)
	75,237	67,045
Other Operating Income		
Dividend Income	623	485
Net Fee & Commission Income	15,970	14,264
Fee & Commission Income	16,105	14,375
Less: Fee & Commn. Expense	(135)	(111)
Net Foreign Exchange Income	2,761	2,646
Income	22,992	21,604
Less: Expense	(20,231)	(18,958)
Net Income from Dealing in Securities	2,138	2,428
Income	2,138	2,428
Less: Expense	-	-
Net Income from Investment in Securities	1,306	1,778
Income	1,306	1,778
Less: Expense	-	-
Gross Income	98,035	88,646
General Administrative Expenses	39,063	36,333
Depreciation	3,613	3,190
Total Operating Costs	42,676	39,523
Net Operating Profit (Profit on Ordinary Activities before Provisions)	55,359	49,123
Income from Subsidiaries	-	(56)
Income from Associate Companies (Centurion Bank)	(1,417)	-
Income from other licensed activities	-	-
Bad debts written off	(60)	(129)
General provisions	(6,878)	-
Specific provisions for loan losses (net of recoveries)	(7,242)	(15,693)
Provision for placements with the Bank	-	(2,310)
Provision for crystallised unbooked risks & commitments (collateral pending sale)	(102)	(175)
Profit for the year after loan loss provisions	39,660	30,760
Taxation	(5,555)	(3,679)
Net profit for the year	34,105	27,081

Note: The complete accounts will be sent by mail to any shareholder who requests them, in either Arabic or English as requested, within 7 days of receipt of the request.