

# Reasons of selecting bank muscat assignment

[Finance](#), [Banks](#)



In my report as requested, I picked one component of MSM30 Index sample. I have chosen to talk about Bank Muscat Share (BKMB) to analyze its performance based on historical trading data from the period of 2005 to 2008 and comparing it with the performance of the market performance represented by MSM30 Index. In addition, the report studied the relationship between the risk indicator "Beta" of the firm and the required rate of return that are asked by investor to invest his/her capital in that stock. This is in return the cost of capital for the company. Executive summary

Bank Muscat is very well known institution in the area and one of the main competitors in banking sector. He is really expanding very fast, he have an excellent management team. The bank has raised the money to finance his investments through both equity and debt (bonds). Currently the outstanding number of shares of the bank is (1, 077, 133, 715) and trades in the market for 0. 84 Baisa. Imperative to mention is that the bank had implemented stock split on March 2006, his par value now is . 100 Baiza.

The analysis show that the bank was doing well in the past few years but poorly in 2008 and this is because of the world financial crisis which affects all the markets around the world, in general the overall trend of the market in 2008 was going down. Analyzing the cost of capital of the bank either using book value or market value it mostly gave same result, it is 13. 28% and 13. 36% respectively. It is higher than market which was 12. 07% (average total return of 16 years). Because bank Muscat having a Beta of 1. 81 more than the market, therefore the bank trying to compensate his stockholders by giving them higher return than the market and this is reasonable. Bank Muscat at Glance He is the largest financial services

<https://assignbuster.com/reasons-of-selecting-bank-muscat-assignment/>

provider in Oman with a strong presence in Corporate Banking, Retail Banking, Investment Banking, Treasury, Private Banking and Asset Management. The Bank has a network of 119 branches and about 320 ATMs and 91 CDMs in Oman, a branch in Riyadh, Saudi Arabia, and a representative office in Dubai (UAE). The bank use both equity and debt to finance his projects. The following table shows the capital structure of the bank.

Table (1): shows the capital structure weights on a Market book value basis |

Type of Security	Number of shares	Market	Market Value	Market Value Weight	Closing Price based on	Prices
Common Stock (BKMB)	1,077,133,715	0.84	904,792,321	0.94	07/12/2008	
Bank Muscat Bond 6.25%	29,802,860	1.05	31,293,003	0.03	28/09/2009	
Bank Muscat Bond 7%	25,000,000	1.065	26,625,000	0.03	30/11/2010	
Total MV	1,131,936,575		962,710,324	1.000		

distributed dividends on March every year. The following table shows the historical dividends distribution for the bank for the last three years. Table (2): shows the yearly AGM date for Bank Muscat with the distributed dividends in percentage | Year | AGM DATE | CASH DIV.

O. R	CASH DIV.	BONUS SHARES	Year	AGM DATE	CASH DIV.	BONUS SHARES
			2005	19/3/06	0.035	35%
			2006	24/3/07	0.035	35%
			2007	22/3/08	0.050	50%

Reasons of choosing Bank Muscat Actually, there are several reasons for selecting the share of Bank Muscat to analyze it.

Mainly, because I my self interested to see the level of risk of this share and how it used to be compensated by a good return. Because I have some

<https://assignbuster.com/reasons-of-selecting-bank-muscat-assignment/>

shares in this bank, so as any investor, I need to know the relationship between the two (risk and return). Along side with this personal reason there are such other reasons: 1. It is one of the big companies dominated the stock market in general and the MSM 30 index in particular. 2. In many cases it is considered to be the benchmark for the whole market. 3. It has the highest market capitalization since it form around 28% of the total index market capitalization as on 20/10/2008. . EPS equal to R. O 0. 112 per share as recorded on third quarter of this year (30 Sept 2008). 5. Bank Muscat is a well known financial institution and one of the main competitors in banking industry. 6. From all aspects the share of Bank Muscat is one of the favorable shares for both individual and mutual funds. The Analysis Beta Calculation: Based on the daily return of Bank Muscat and comparing it with the daily return of MSM30 for the period from 2005 to 2008 (see appendix A) we get the Beta for BKMB equal to 1. 181 which indicates that the investment on this share is risky, it has beta more than the market.

So the expected return from this investment should be higher than the average return on the market because the investors are exposed to a higher risk. Below is the regression analysis showing beta figure for Bank Muscat in red. | Regression Statistics | | | BKMB | 1. 248 | 1. 0849 | | MSM30 | 1 | 1 |  
Table (3): shows the Beta of both Bank Muscat share (BKMB) and MSM 30 Index for the period 2007-2008:

Table (4): shows the total return for both Bank Muscat share (BKMB) and MSM 30 Index for the period 2007-2008: | | Total Return 2007 | Total Return 2008 | | BKMB | 0. 23% |-0. 30% | | MSM30 | 0. 20% |-0. 14% | Calculating

WACC In order to calculate the cost of equity for the firm, we actually need to get the historical average return on market so we get the average for approximately 12.7% for 16 years from 1992 to 2008. The yearly percent changes are summarized in the following table: Table (5): shows the yearly percent changes from 1992 to 2008

No.	Year	% change (yearly)
1	2008	-39%
2	2007	49%
3	2006	14%
4	2005	38%
5	2004	22%
6	2003	35%
7	2002	24%
8	2001	-28%
9	2000	-21%
10	1999	8.1%
11	1998	-67%
12	1997	94%
13	1996	26%
14	1995	8%
15	1994	29%
16	1993	0.62%
17	1992	
Average		12.07%

The average return on the market is equal to 12.07%. As mentioned earlier that the capital structure of Bank Muscat consists of both debt (bonds) and equity (common stocks), so there are actually two types of capital cost which are cost of debt (RD) and cost of equity (RE). Basically there are two ways of calculating WACC by either using book value or market value of bond and equity

Calculation of WACC based on Book Value:

1- The cost of Equity:  $R_s = R_f + \beta(R_m - R_f) = 1.975\% + 1.18 * (12.07\% - 1.976\%) = 13.89\%$

2- The cost of Debt: Actually Bank Muscat has two types of bonds one with 6.5% coupon rate and the other one has 7% coupon rate. So the cost of debt is the sum of both of them as in the following table: Table (6): shows the book value weight of both bonds

Bonds	Number of Bonds	Par Value	Book Value	% of total	Yield to	Book Value Weight	Maturity
Bank Muscat Bond 7%	25,000,000	1	25,000,000	0.456180572	6.2%		
	3%						
Total	54,802,860		54,802,860	1	5.83%		

As these calculations show, the cost of debt for the bank is 5.83% on a book value

basis. The table below shows the capital structure weights on a book value basis. Table (7): shows the capital structure weights on a book value basis |

Type of Security	Book Value	Book Value Weight
Common Stock (BKMB)	741, 210, 000	0. 3
Bank Muscat Bond 6. 25%	29, 802, 860	0. 04
Bank Muscat Bond 7%	25, 000, 000	0. 03
Total	796, 012, 860	1. 00

The book value of equity is equal to the total of stockholders equity recorded in the third quarter of the bank which is equal to R.

O (741, 210, 000) So the total value of the bank based on book value is: 741, 210, 000 + 29, 802, 860 + 25, 000, 000 = R. O 796, 012, 860 WACC = 0. 93 \* 13. 89% + (. 03+. 04) \* 5. 83% \* (1-. 12) = 13. 28% WACC Calculation using Market Value: 1- The cost of Equity: It is same as in the previous calculation, equal to 13. 89%. 1- The cost of Debt: It is almost the same as in with book value calculation because there is very small deference between the tow prices. That's why we get almost the same cost of debt which is equal to 5. 3%. Table (8): shows the Market value weight of both bonds |

Bonds	Number of Bonds	Market Price	Market Value	% of total	Yield to
Bank Muscat Bond 7%	25, 000, 000	1. 065	26, 625, 000	0. 459701623	6. 2%
Total	54, 802, 860		57, 918, 003	1	5. 83%

The table below shows the capital structure weights on a Market value basis. Table (9): shows the capital structure weights on a Market value basis |

Type of Security	Number of shares	closing prices	Market Value	Market Value Weight	Closing Price based on
Common Stock (BKMB)	1, 077, 133, 715	0. 4	904, 792, 321	0. 94	07/12/2008
Bank Muscat Bond 6. 25%	29, 802, 860	1. 05	31, 293, 003	0. 03	28/09/2009
Bank Muscat Bond 7%	25, 000, 000	1.			

065 | 26, 625, 000 | 0. 03 | 30/11/2010 | | Total MV | 1, 131, 936, 575 | | 962, 710, 324 | 1. 00 | | The stock market value = Number of outstanding shares \* Market price = 1, 077, 133, 715 \* 0. 84 = R. O 904, 792, 321 Total Bank Market Value = 904, 792, 321 + 57, 918, 003 = 962, 710, 324 WACC = 0. 94 \* 13. 89% + (. 03+. 03) \* 5. 83% \* (1-. 12) = 13. 36% The bank market value is mostly close to the book value which was R. O (796, 012, 860).

This actually because nowadays the stock prices coming down for whole market and start trading at prices very close to the book value and some companies their stocks are traded below the book value. Therefore, both ways of calculating WACC give almost similar result. Conclusion: To sum up the analysis show the bank Muscat stock is riskier than the market but in return there is actually good return compensating that risk. So for those who are really risk seeker it is recommended to invest in this stock but not in this time, let the situation get better because nowadays the whole markets around the world collapsing.