Equity Research - Lebanese Banks - Q1/16 Preview

Expect better entry point ahead as bank shares largely reflect investor enthusiasm around dividend season as banking sector still copes with challenging operating environment

Lebanese banking sector resilient in 2015, despite weaker economic conditions and political standstill, with assets, deposits, loans respectively growing YoY by +6%, +5%, +6%; operating environment expected to remain challenged in 2016: Lebanese banks are still navigating through unfavorable economic/political backdrops with real GDP growth expanding at less than ~2%, roughly a quarter of the pace before the Arab spring/ Syrian crisis began. Net profits of Alpha Banks rose +9% YoY in 2015 as largest Lebanese banks were able to grow assets and attract deposits, given attractive relative returns and resilient remittances, although below previous levels and despite weaker domestic economic conditions and political standstill (presidential election deadlock, ongoing trash crisis, continuous conflicts at the Lebanese borders). Figures for 2015 show moderating assets and deposits YoY growth at +6% and +5% reaching USD 186 billion and USD 152 billion respectively. Deposits continue to fund most of the sector's assets (82% in December 2015) which in turn largely exceed the economy's size given an estimated assets/GDP ratio at ~375%. Loans (claims on resident private sector in LBP and foreign currencies) grew at +6% YoY reaching USD 48 billion in 2015, partially driven by previous BDL stimulus, expected to be followed by another USD 1 billion in 2016, comprised of favorable borrowing rates for housing, SMEs and renewable energy. Pressures on fiscal and external accounts is expected to remain in 2016 on account of weaker economic conditions, trade and investor sentiment. In this context, the stable share of non-resident deposits in total deposits (~21%), continues to help fuel the sector's liquidity (LDR at ~32% in December 2015), which in turn goes to finance public/external needs (gross public debt at ~USD 70 billion as of December 2015, ~138%/GDP) and FX reserves (at ~USD 31 billion as of December 2015, ~61%/GDP).

Balance sheet of banks under coverage still seeing some growth, which we expect to continue into Q1/16e: Bank Audi and Blom Bank saw sluggish QoQ growth in assets and deposits in Q4/15 at 0%/-1% for Bank Audi and +1%/0% for Blom Bank, while Byblos Bank outperformed at +3%/+3%. On a YoY basis, assets and deposits growth was at +1%/-1% for Bank Audi and +4%/+5% for Blom Bank, both challenged by weakened local currencies in foreign operations, while Byblos Bank outperformed with YoY growth at +4%/+6%. Loans growth outdid other constituents with QoQ/YoY at +5%/+4% for Bank Audi, +3%/+4% for Blom Bank and +4%/+4% for Byblos Bank. LDR for Blom Bank and Byblos Bank came in at ~29% and ~30% respectively and at ~50% for Bank Audi, well above the sector's average of ~32%, on faster lending growth and significantly higher LDRs in Turkey. For Q1/16e, we believe domestic sluggishness to persist on the back of continued domestic/regional macro and political tensions arising from Saudi Arabia/other GCC countries that could likely result in lower remittances and capital inflows. We expect QoQ growth in assets, deposits and loans respectively at +2%/+2%/+3% for Bank Audi, +1%/+1%/+1% for Blom Bank and 0%/0%/+1% for Byblos Bank and YoY growth at +4%/ +4%/+13% for Bank Audi, +5%/+5%/+6% for Blom Bank and +5%/+6%/+6% for Byblos Bank.

Profitability of banks under coverage mainly driven by balance sheet, NIM improvement with relatively stable provisioning and flat to lower YoY cost-to-income: Lebanese banks continue to witness NIM improvement on higher spreads in LBP and USD at respectively +26 bps and +25 bps on improved asset yields at +24 bps in LBP and +35 bps in USD, despite constraints in reducing cost of funds (COF) in USD (for February 2016, COF in USD +10 bps YoY and COF in LBP -2 bps). We expect banks under coverage to see higher total operating income YoY mainly driven by i) higher net interest income in Q1/16e at +12% YoY for Bank Audi, +6% YoY for Blom Bank and +8% for Byblos Bank on balance sheet/NIM improvement and ii) higher net fees and commissions income to a lesser extent, at +24% YoY for Bank Audi (on low Q1/15), +1% YoY for Blom Bank and +3% YoY for Byblos Bank. Non-interest income growth is capped by lower gains on financial assets for banks under coverage, as sovereign assets reprice and cost of risk stabilizes. Bank Audi and Byblos Bank are expected to have almost flat loan loss provisioning YoY in Q1/16e with annualized cost of risk at respectively 80 bps and 108 bps while Blom Bank is expected to see slightly higher provisioning YoY with annualized cost of risk at 36 bps. Cost-to-income is expected to remain stable YoY in Q1/16e for Bank Audi and Blom Bank at respectively 52% and 41% while lower for Byblos Bank at 52% vs. 53% in Q1/15. We estimate YoY growth in net profits in Q1/16e for Bank Audi at +15% (EPS at USD 0.27 and BVPS at USD 7.36), +5% for Blom Bank (EPS at USD 0.44 and BVPS at USD 11.65) and +9% for Byblos Bank (EPS at USD 0.04 and BVPS at USD 2.29). For 2016e, we expect net profits to reach USD 453 million for Bank Audi (EPS at USD 1.05 and BVPS at USD 7.85), USD 421 million for Blom Bank (EPS at USD 1.93 and BVPS at USD 12.54) and USD 170 million for Byblos Bank (EPS at USD 0.22 and BVPS at USD 2.38).

Investor enthusiasm ahead of April-May dividend season drives shares ahead of fundamentals creating a more interesting entry point in the short-term: Blom Bank and Byblos Bank shares outperformed with YTD performance at +13% and +5% respectively, likely on investor enthusiasm ahead of dividend season starting mid-April. Blom Bank dividends were approved at LBP 1,250 (~USD 0.83), while Bank Audi dividends remained unchanged at LBP 603 (USD 0.40), both gross of tax. Byblos Bank dividends were proposed unchanged at LBP 200 (~USD 0.13), gross of tax and to be approved during next AGM. With BVPS expected to grow +~2% QoQ for banks under coverage, which we believe is a key driver of share prices, we expect to see some give back after ex-dividend dates. This could create an attractive entry point for OW rated Blom Bank and for Bank Audi, which is seeing improved interest income, loan quality and cost efficiencies, particularly as Bank Audi trades at discount to historical average on a P/B basis.

Table 1: FFA Private Bank - Lebanese Banks Coverage

Company	Symbol	Recommendation	Target Price	Share Price *	YTD Change	P/E **	P/B to common	Dividend Yield ***
BANK AUDI	(AUDI LB)	MARKETWEIGHT	USD 7.00	USD 5.85	-3.3%	6.4x	0.81x	6.8%
BLOM BANK	(BLOM LB)	OVERWEIGHT	↑ USD 11.50	USD 10.61	+12.9%	5.7x	0.93x	7.8%
BYBLOS BANK	(BYB LB)	MARKETWEIGHT	USD 1.60	USD 1.69	+5.0%	8.5x	0.73x	7.9%

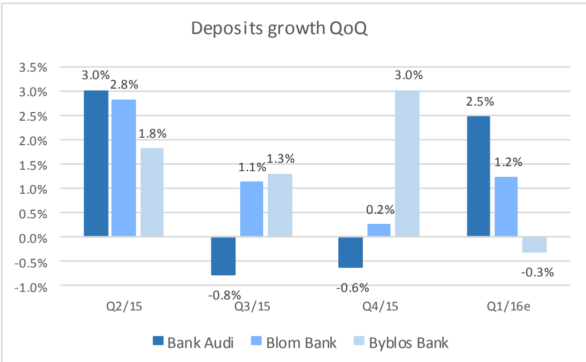
Source: Company reports, BSE, FFA Private Bank estimates

Note:* April 14, 2016 market close, **Based on TTM EPS, *** Based on proposed/approved dividends for 2015

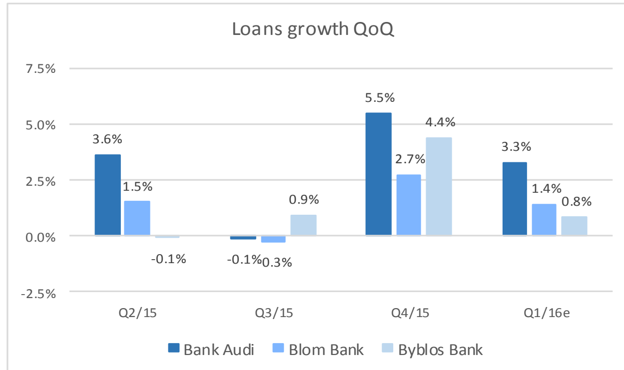
We update our target price on Blom Bank, while keeping it unchanged for Bank Audi and Byblos Bank and note that Blom Bank is the sole Overweight in our coverage universe: We maintain our target prices for Bank Audi and Byblos Bank unchanged at USD 7.00 and USD 1.60 respectively, while we update Blom Bank's target price to USD 11.50 from USD 11.00 and remind that Blom Bank is the sole overweight in our coverage universe, given its higher quality core income, above average margins, efficiencies, stable growth in earnings, solid capitalization, sizeable liquidity and conservative approach to growth.

Banks Under Coverage - Comparative Snapshots

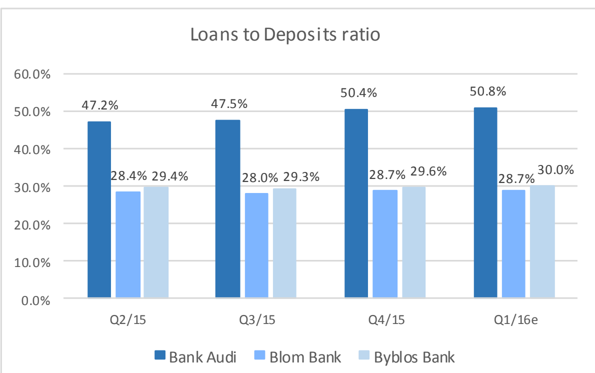
We expect Bank Audi and Blom Bank QoQ deposit growth at +2% and +1% respectively while Byblos Bank sequential deposit growth is expected to remain flat in Q1/16e



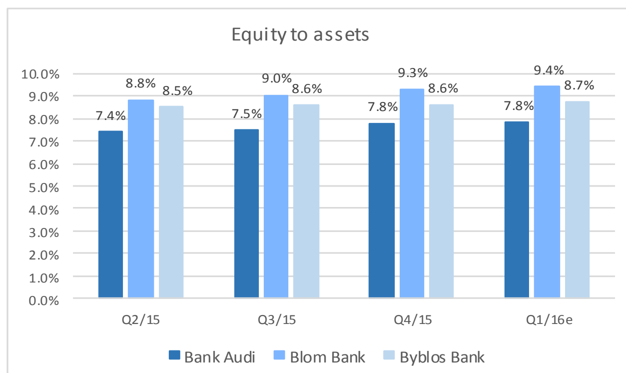
Banks under coverage are expected to have loans growing sequentially in the +1%/+3% range in Q1/16e



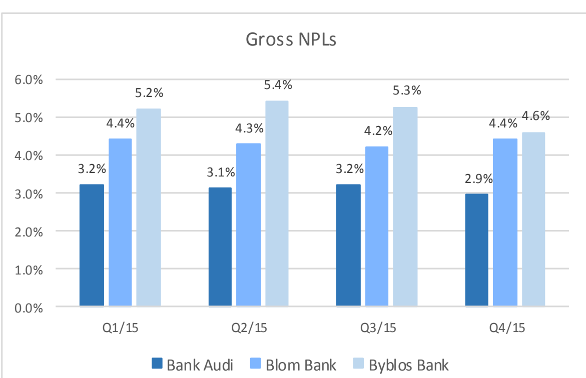
Bank Audi's LDR (~51%) expected to remain well above sector's average (~32%) while Blom Bank and Byblos Bank's LDRs expected to stay at ~29% and ~30% respectively in Q1/16e



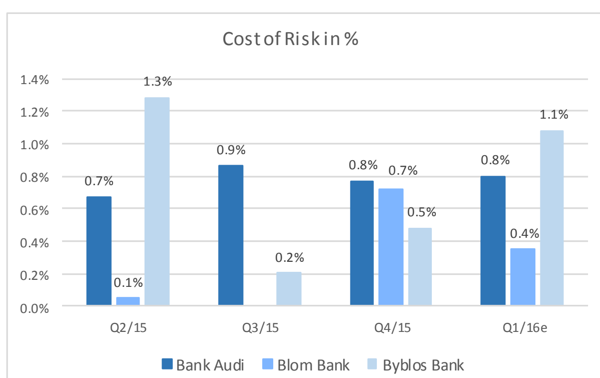
Blom Bank expected to continue boasting highest capitalization among banks under coverage with E/A ratio forecasted at 9.4% in Q1/16e, while Bank Audi and Byblos Bank expected at 7.8% and 8.7% respectively



We note lower NPL formation in Q4/15 for Bank Audi and Byblos Bank while NPL formation was almost flat for Blom Bank. We highlight Bank Audi's higher asset quality versus peers

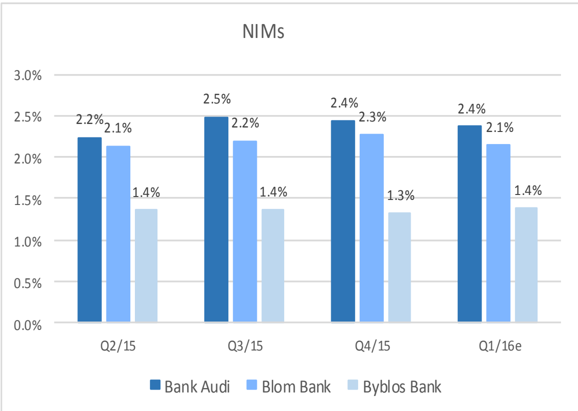


Blom Bank continues to see lower cost of risk, although volatile. Bank Audi's cost of risk expected to remain unchanged QoQ while Byblos Bank 's cost of risk expected to increase in Q1/16e

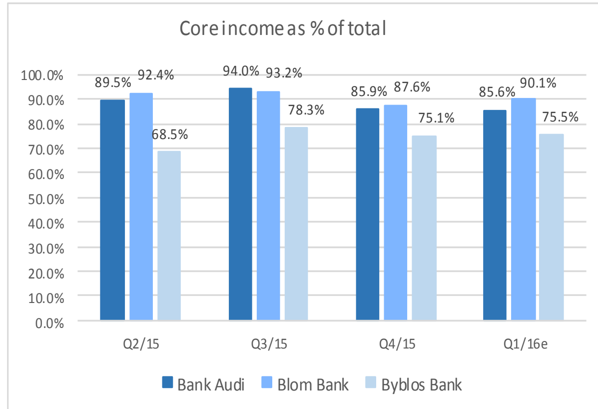


Source: Company reports and FFA Private Bank estimates

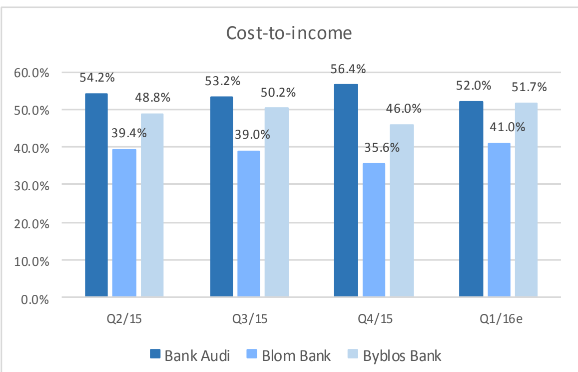
We note flat to improved NIMs for Bank Audi and Byblos Bank while Blom Bank NIMs expected slightly below 2.2%, the high end of its range



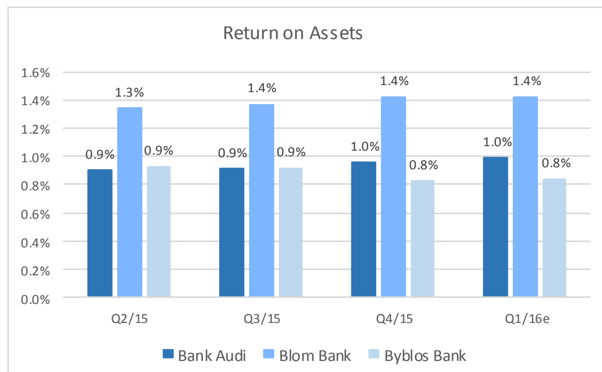
We expect continued weakness in Byblos Bank's core income in Q1/16e owing to its less diversified model compared to its peers, while we expect higher income quality for Blom Bank and stable for Bank Audi



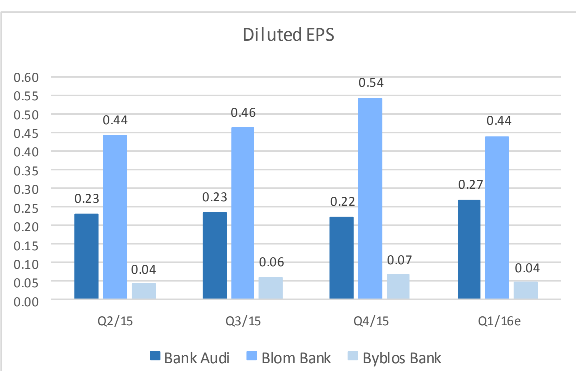
Blom Bank and Byblos Bank expected to see a deterioration in efficiencies in Q1/16e, while we highlight QoQ efficiency gains for Bank Audi



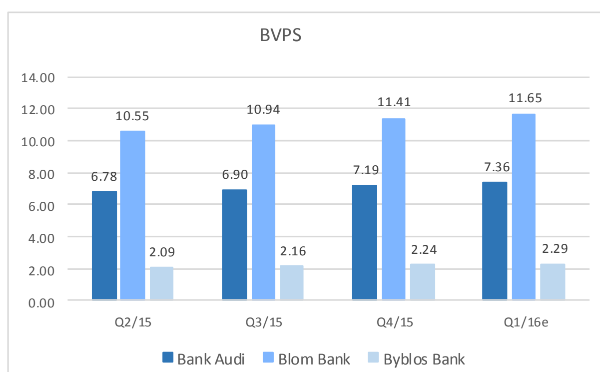
We value Blom Bank's higher expected profitability compared to peers at 1.4% ROA, while Bank Audi and Byblos Bank ROAs are expected at 1.0% and 0.8% respectively



Blom Bank expected to continue demonstrating higher EPS among banks under coverage, despite lower QoQ. Bank Audi expected to show EPS growth in Q1/16e, while Byblos Bank EPS growth is expected to slow down



Banks under coverage expected to witness improved BVPS in Q1/16e, which should continue to drive share prices



Source: Company reports and FFA Private Bank estimates

BANK AUDI

Company Description

Bank Audi is the largest bank in Lebanon in terms of assets with an asset base in 2015 at USD 42.3 billion as well as earnings at USD 403.1 million. The Bank had a total of 217 branches and 6,891 employees as of the end of 2015 with operations in its domestic market Lebanon as well as across Europe, Mena and Turkey. The Bank's diversification across markets translates into a breakdown of assets and earnings between domestic and international at a respective 51%/49% and 56%/44% in 2015. In terms of assets, Turkey is currently the biggest international market for Bank Audi with 26% of total assets. The current strategy is geared towards three key markets: Lebanon, Turkey and Egypt. We highlight the Bank's relatively sound asset quality (gross NPL ratio at 2.9% in Q4/15) amidst a difficult backdrop, balance sheet growth and consolidated margins to remain favorably impacted by higher margins driven largely by Turkey as they converge towards Turkish sector average.

Q4/15 Key Financial Highlights

Net profits at USD 99 million in Q4/15 (-3% QoQ, +40% YoY)

- Net interest income registered at USD 254 million in Q4/15 (-2% QoQ, +5% YoY) with YoY improvement on higher NIMs. We estimate net interest margins at 2.44% in Q4/15 vs. 2.49% in Q3/15 and 2.35% in Q4/14, with YoY improvement likely driven by Turkish operations as Odea Bank saw margins improve YoY to 2.34% in Q4/15 from 2.0% in Q4/14.
- Despite net fees & commissions displaying YoY growth for 2015 at USD 270 million (+9% YoY), non-interest income came in at USD 438 million (-11% YoY) weighed by softer trading & investment income at USD 168 million (-32% YoY). Revenue breakdown for Q4/15 reflects lower income mix quality QoQ with core income (net interest income + fees & commissions income) contribution to total operating income at 86% down from 94% in Q3/15, although higher from 85% in Q4/14.
- Bank Audi saw lower efficiencies in Q4/15 as cost-to income came in at 56.4% (still above pre-Turkey expansion levels) from 53.2% in Q3/15 and 53.7% in Q4/14, on higher opex, despite improved operating income.
- Bank Audi's consolidated gross NPLs were lower at 2.9% vs. 3.2% in Q3/15 and 3.1% in Q4/14, still well contained and below peers under coverage. Cost of risk lower at an estimated 77 bps in Q4/15, from an estimated 86 bps in Q3/15 and 161 bps in Q4/14 on lower provisioning levels at USD 35 million (-6% QoQ, -49% YoY).
- With FX pressures in key international markets and challenging domestic operating conditions, Bank Audi saw muted growth in consolidated balance sheet constituents with assets at USD 42 billion, 0% QoQ/+1% YoY, while deposits were lower at USD 36 billion, -1% QoQ/-1% YoY. Loans outperformed at USD 18 billion, +5% QoQ/+4% YoY. Assets, deposits and loans growth registered at +5%, +3% +11% respectively in 2015 when excluding Egyptian Pound and Turkish Lira devaluation.

Latest Key Regional Highlights

- Bank Audi's breakdown of assets and earnings between domestic and international operations stands at 51%/49% and 56%/44% in 2015.
- Odea Bank accumulated USD 11 billion in total assets representing 26% of the group assets and is seeking to benefit from operating leverage as branch network expands (55 branches including kiosks) and gains maturity. Odea Bank reported profits of USD 23.0 million in 2015, representing ~6% of consolidated net profits. We expect Odea Bank's profitability to continue to improve as margins, efficiencies and LDRs move higher and closer to peers, driving its share of consolidated net profits considerably higher.
- In 2015, the Group had USD 4.9 billion in assets in Egypt and generated USD 70.0 million in earnings accounting for 11% of consolidated assets and 17% of total profits.
- The Bank's current key pillar markets are: Lebanon, Turkey and Egypt.

FFA Model Assumptions

- We forecast net profits at USD 115 million in Q1/16e (+16% QoQ, +15% YoY).
- We expect net interest income at USD 250 million in Q1/16e (-2% QoQ, +12% YoY) with Turkish operations continuing to help with higher earning assets and margins improvement as Turkish banks typically boast higher margins and as branches gain maturity.
- Net fees and commissions expected to reach USD 73 million in Q1/16e (+1% QoQ, +24% YoY).
- We expect assets, deposits and loans to grow by respectively +2% QoQ /+4% YoY, +2% QoQ /+4% YoY, +3% QoQ /+13% YoY.
- LDR is expected at 50.8% in Q1/16e, above Q4/15 level of 50.4% and Q1/15 level of 46.9%.
- We forecast net provisions of USD 37 million in Q1/16e with an estimated annualized cost of risk of 76 bps for 2016e.
- Our estimate for cost-to-income in Q1/16e is at 52.0%, still above pre-Turkey expansion levels.
- Looking at 2016e, net profits should reach USD 453 million (+12% YoY) with EPS at USD 1.05 (+16% YoY), driven by stronger operating income and gradually improving efficiencies.

Table 2: FFA Model Forecasts

USD Million	FFA Q1/16e	Q4/15a	Q1/15a	QoQ%	YoY%	FFA 2016e
Net Interest Income	250	254	223	-2%	12%	1,076
Fees & commissions income	73	73	59	1%	24%	298
Trading & investment income	55	54	58	1%	-5%	164
Operating Income	**378**	**381**	**339**	**-1%**	**11%**	**1,538**
Provisions	(37)	(35)	(33)	7%	12%	(152)
Operating expenses	(197)	(215)	(178)	-9%	11%	(816)
Income tax	(30)	(33)	(29)	-6%	7%	(120)
Net Profits	**115**	**99**	**100**	**16%**	**15%**	**453**
Diluted EPS	0.27	0.22	0.23	20%	18%	1.05
Assets	42,959	42,272	41,458	2%	4%	45,198
Deposits	36,484	35,609	35,054	2%	4%	38,376
Loans	18,530	17,943	16,440	3%	13%	19,952
BVPS to common	7.36	7.19	7.10	2%	4%	7.85
FFA Net interest margins	*2.4%*	*2.4%*	*2.2%*			*2.4%*
Core income to total operating income	*85.6%*	*85.9%*	*83.0%*			*89.3%*
FFA Cost-to income ratio	*52.0%*	*56.4%*	*52.4%*			*53.0%*
Immediate liquidity-to-deposits ratio	*33.8%*	*35.5%*	*38.3%*			*32.3%*
Loans-to-deposits ratio	*50.8%*	*50.4%*	*46.9%*			*52.0%*
Equity-to-asset ratio	*7.8%*	*7.8%*	*8.1%*			*7.9%*

Source: Company reports and FFA Private Bank estimates

Investment Opinion

We value Bank Audi's domestic leadership, asset quality and improving margins, and expect investors to gain confidence in its growth plan as earnings accelerate and risk diversifies away from domestic market

Bank Audi is the largest bank in Lebanon with a demonstrated franchise and the confidence of its clients in Lebanon and abroad. In light of difficult operating conditions, we value its fundamentals mainly from the preservation of its asset quality and interest margins as well as an ambitious expansion strategy in Turkey that is materializing into assets diversifying away from Lebanon's risk and towards gradually higher margins, comfortable cost of risk and improved CAR levels. We continue to rate Bank Audi shares at Marketweight although see upside on account of: i) Turkey expansion with balance sheet expected to increase from one-quarter to one-third of total balance sheet by M-T ii) Egypt balance sheet expansion potentially reaching USD 10 billion by M-T iii) international expansion coupled with continued growth in domestic market should drive assets to target USD 60 billion by M-T, which on improved profitability should accelerate earnings and diversify risk.

Target Price Revision and Recommendation

We reiterate our Marketweight rating on Bank Audi shares and maintain our fair value unchanged at USD 7.00 per share

Based on our revised forecasts and discount rate assumptions to our Dividend Discount Model, we maintain our fair value estimate for Bank Audi unchanged at USD 7.00 and reiterate our Marketweight rating. Our DDM assumes a 13.0% discount rate and a 3.0% terminal growth rate. We corroborate our DDM valuation by means of the residual income method as well as historical and comparable P/E and P/B multiples.

Key Investment Risks

Key investment risks include credit, interest rate, sovereign, economic/political and foreign operations risks.

BLOM BANK

Company Description

Blom Bank is the second largest bank in Lebanon in terms of assets with an asset base in 2015 at USD 29.1 billion as well as earnings at USD 404.7 million. The Bank had a total of 258 branches and 4,818 employees as of the end of 2015 with operations in its domestic market Lebanon as well as across Europe and the Mena region. The Bank's diversification across markets translated into a breakdown of assets and earnings between domestic and international at 77%/23% and 74%/26% respectively in 2015. The Bank's current strategy is geared towards two key markets: Lebanon and Egypt which is currently the biggest international market for Blom Bank. The Bank has so far adopted a conservative approach to growth translating into ample liquidity buffers and solid capitalization. We also note that Blom Bank has surpassed its peers in terms of earnings stability, interest margins and cost-efficiencies.

Q4/15 Key Financial Highlights

Net profits at USD 115 million in Q4/15 (+16% QoQ, +20% YoY)

- Net interest income came in at USD 161 million in Q4/15 (+4% QoQ, +10% YoY) helped YoY by higher NIMs (more favorable asset yields despite higher cost of funds) and balance sheet improvement YoY to a lesser extent, although muted sequentially. We estimate NIMs at 2.27% in Q4/15, above Blom Bank's targeted range of 2.00%-2.20%, vs. 2.20% in Q3/15 and 2.15% in Q4/14. In 2015, net interest income registered at USD 611 million (+8% YoY), with higher asset yields despite coping with a low interest rate environment.
- Despite fees & commissions at USD 37 million (+4% QoQ, -12% YoY), Blom Bank saw non-interest income improve in Q4/15 to USD 65 million (+31% QoQ, +8% YoY) driven by higher trading & investment income at USD 28 million (+100% QoQ, +58% YoY). For 2015, non-interest income came in at USD 225 million from USD 251 million in 2014 (-10% YoY) on lower trading & investment income at USD 79 million (-27% YoY), a more volatile income stream. Revenue breakdown for Q4/15 reflects a deterioration of income mix quality with core income (net interest income + fees & commissions income) contribution to total operating income at ~88% down from ~93% in Q3/15 and ~91% in Q4/14.
- Blom Bank saw improved efficiencies in Q4/15 with cost-to-income at 35.8%, below Q3/15 level of 38.9% and 39.4% in Q4/14, reflecting higher efficiencies vs. peers under coverage. Blom Bank's gross NPLs were higher at 4.4% vs. 4.2% in Q3/15 and flat from Q4/14, and cost of risk came in higher at an estimated 72 bps in Q4/15, after provision reversal in Q3/15 and vs. an estimated 67 bps in Q4/14. For 2015, cost of risk was estimated at 27 bps, lower from an estimated 60 bps for 2014 on softer provisioning levels at USD 19 million in 2015 vs. USD 41 million in 2014.
- Despite YoY improvement, balance sheet growth was sequentially muted, likely a reflection of challenging domestic operating conditions. Assets grew to USD 29 billion (+1% QoQ, +4% YoY), deposits at USD 25 billion (0% QoQ, +5% YoY) while loans outpaced at USD 7 billion (+3% QoQ, +4% YoY).
- Blom Bank continues to boast the highest capitalization among peers under coverage. Capital adequacy ratio (as per Basel III) came in at 18.0%, higher than Q3/15 level of 17.8%, above BDL's requirement of 12.0% for 2015. TTM ROA estimated at 1.4% and TTM ROE estimated at 15.4%.

Latest Key Regional Highlights

- Blom Bank breakdown of assets and earnings between domestic and international operations stands at 77%/23% and 74%/26% respectively in 2015.
- At the end of 2015, the Group had around USD 2.5 billion in assets in Egypt and generated USD 44.8 million in net earnings accounting for around ~9% of consolidated assets and ~11% of consolidated profits.
- The Bank's key pillar markets are: Lebanon and Egypt.

FFA Model Assumptions

- We expect net profits of USD 95 million in Q1/16e (-17% QoQ, +5% YoY).
- We expect net interest income at USD 154 million in Q1/16e (-4% QoQ, +6% YoY).
- Net fees and commissions expected at USD 34 million in Q1/16e (-7% QoQ; +1% YoY).
- We expect provisions of USD 7 million equivalent to an estimated annualized cost of risk at 35 bps for 2016e.
- We estimate cost-to-income at 41.0% in Q1/16e, above Q4/15 level of 35.6% yet below Q1/15 level of 41.2%.
- We expect assets, deposits and loans to grow by respectively +1% QoQ /+5% YoY , +1% QoQ /+5% YoY , +1% QoQ /+6% YoY.
- At these growth levels, LDR should be at 28.7% in Q1/16e, which reflects ample liquidity and significant room to expand lending from current levels.
- For the year 2016e, net profits should reach USD 421 million (+4% YoY) with EPS expected at USD 1.93 (+4% YoY).

Table 3: FFA Model Forecasts

USD Million	FFA Q1/16e	Q4/15a	Q1/15a	QoQ%	YoY%	FFA 2016e
Net Interest Income	154	161	145	-4%	6%	652
Fees & commissions income	34	37	34	-7%	1%	148
Trading & investment income	21	28	21	-25%	-1%	79
Operating Income	**210**	**227**	**201**	**-8%**	**4%**	**879**
Provisions	(7)	(13)	(6)	-44%	25%	(27)
Operating expenses	(86)	(81)	(83)	6%	4%	(336)
Income tax	(22)	(18)	(21)	22%	2%	(96)
Net Profits	**95**	**115**	**91**	**-17%**	**5%**	**421**
Diluted EPS	0.44	0.54	0.42	-19%	4%	1.93
Assets	29,464	29,097	28,091	1%	5%	30,648
Deposits	25,397	25,091	24,084	1%	5%	26,361
Loans	7,295	7,194	6,914	1%	6%	7,612
BVPS to common	11.65	11.41	10.80	2%	8%	12.54
FFA Net interest margins	*2.1%*	*2.3%*	*2.1%*			*2.1%*
Core income to total operating income	*90.1%*	*87.6%*	*89.4%*			*91.0%*
FFA Cost-to income ratio	*41.0%*	*35.6%*	*41.2%*			*38.2%*
Immediate liquidity-to-deposits ratio	*49.2%*	*49.1%*	*48.0%*			*49.5%*
Loans-to-deposits ratio	*28.7%*	*28.7%*	*28.7%*			*28.9%*
Equity-to-asset ratio	*9.4%*	*9.4%*	*9.2%*			*9.7%*

Source: Company reports and FFA Private Bank estimates

Investment Opinion

We view Blom Bank's higher returns and solid liquidity levels as a reflection of a prudent management team and highlight the Bank's ability to propose higher dividends on account of lower than average payouts

We recognize Blom Bank's solid positioning in its domestic market. We highlight the firm's conservative strategy translating into superior profitability and return ratios relative to its domestic peers from relatively higher margins and operating efficiencies, despite sizeable liquidity buffers. We also value Blom Bank's higher quality core income. In the short-term, we look to the prudent management team to continue to focus on asset quality in light of difficult operations and further develop its regional presence. We value the Bank's ability to steadily grow earnings while dividends should continue to benefit from lower than average payouts.

Target Price Revision and Recommendation

We reiterate our Overweight rating on Blom Bank shares and revise our fair value to USD 11.50 from USD 11.00 per share

Based on our revised forecasts and discount rate assumptions to our Dividend Discount Model, we revise our fair value estimate for Blom Bank to USD 11.50 from USD 11.00 per share and reiterate our Overweight rating. Our DDM assumes a 14.0% discount rate and a 3.0% terminal growth rate. We corroborate our DDM valuation by means of the residual income method as well as historical and comparable P/E and P/B multiples.

Key Investment Risks

Key investment risks include credit, interest rate, sovereign, economic/political and foreign operations risks.

BYBLOS BANK

Company Description

Byblos Bank is the third largest bank in Lebanon in terms of assets with an asset base in 2015 at USD 19.9 billion as well as earnings at USD 160.6 million. The Bank had a total of 105 branches and 2,548 employees as of end of December 2015 with operations in Lebanon as well as across Europe, Africa and the Mena region. The Bank's diversification across markets is lagging behind its peers with a breakdown of assets between domestic and international at ~91%/9% for 2015. The Bank's balance sheet is mainly focused on Lebanon. The Bank has so far adopted a conservative growth strategy translating into ample liquidity levels and solid capitalization at the expense of weaker margins and profitability.

Q4/15 Key Financial Highlights

Net profits at USD 48 million in Q4/15 (+11% QoQ, -24% YoY)

- Net interest income was at USD 66 million in Q4/15 (0% QoQ, +7% YoY) likely on subdued balance sheet growth despite lower NIMs. We estimate interest margins lower sequentially in Q4/15 at 1.33% vs. 1.37% in Q3/15 although slightly higher YoY from 1.30% in Q4/14.
- Non-interest income was at USD 48 million in Q4/15 (+10% QoQ, -26% YoY) with fees & commissions income at USD 20 million (-1% QoQ, -10% YoY), on subdued yet improving lending growth (likely impacted by BdL's more restrictive measures on retail lending), while trading & investment income came in at USD 28 million (+19% QoQ, -34% YoY).
- Cost of risk rose substantially in Q4/15 to an estimated 46 bps from 20 bps in Q3/15 and 13 bps in Q4/14 (cost of risk for 2015 at 73 bps) on higher provisioning at USD 6 million in Q4/15 up from USD 2 million in Q3/15 and USD 1 million in Q4/14, on seasonally higher provisions by year-end.
- Assets and deposits sequential growth at +3% in Q4/15 to USD 20 billion and USD 17 billion respectively while loans sequential growth was at +4% to USD 5 billion. On a YoY basis, assets and loans grew +4% while deposits surpassed at +6%, still lower than previous years' levels on subdued domestic banking sector given Byblos Bank's large domestic exposure.
- Assets continue to be largely funded by deposits at ~84% and LDR remained higher at ~30%, below Lebanese banking sector average (~32%). Immediate liquidity to deposits ratio (including cash and balances with Central Banks and interbank placements) came in higher sequentially at ~44% in Q4/15 vs. ~43% in Q3/15.
- Profitability ratios were lower with TTM ROA at an estimated 0.83% in Q4/15 vs. 0.92% in Q3/15 and TTM ROE at an estimated 9.4% in Q4/15 vs. 10.7% in Q3/15, still at the lower end of our coverage universe.

Latest Key Regional Highlights

- Byblos Bank breakdown of assets between domestic and international operations stands at ~91%/9% for 2015.

FFA Model Assumptions

- We expect net profits of USD 36 million in Q1/16e (-25% QoQ, +9% YoY).
- We forecast net interest income of USD 68 million in Q1/16e (+4% QoQ, +8% YoY).
- Net fees and commissions expected at USD 21 million in Q1/16e (+6% QoQ, +3% YoY).
- We expect assets, deposits and loans to grow by a respective 0% QoQ /+5% YoY , 0% QoQ /+6% YoY , +1% QoQ /+6% YoY.
- At these growth levels, LDR should be at 30.0%, above Q4/15 level of 29.6% and Q1/15 level of 29.9%.
- We forecast provisions of USD 13 million in Q1/16e equivalent to an estimated annualized cost of risk at 74 bps for 2016e.
- Our cost-to-income estimate is at 51.7% for Q1/16e .
- Looking at 2016e, net profits should reach USD 170 million (+6% YoY) with EPS at USD 0.22 (+8% YoY).

Table 4: FFA Model Forecasts

USD Million	FFA Q1/16e	Q4/15a	Q1/15a	QoQ%	YoY%	FFA 2016e
Net Interest Income	68	66	63	4%	8%	279
Fees & commissions income	21	20	21	6%	3%	83
Trading & investment income	29	28	28	4%	3%	120
Operating Income	**119**	**114**	**112**	**4%**	**6%**	**483**
Provisions	(13)	(6)	(13)	135%	5%	(39)
Operating expenses	(61)	(53)	(59)	17%	4%	(235)
Income tax	(8)	(9)	(7)	-5%	10%	(39)
Net Profits	**36**	**48**	**33**	**-25%**	**9%**	**170**
Diluted EPS	0.04	0.06	0.04	-26%	16%	0.22
Assets	19,913	19,871	18,963	0%	5%	20,925
Deposits	16,585	16,637	15,670	0%	6%	17,552
Loans	4,973	4,932	4,689	1%	6%	5,230
BVPS to common	2.29	2.24	2.23	2%	3%	2.38
FFA Net interest margins	*1.4%*	*1.3%*	*1.3%*			*1.4%*
Core income to total operating income	*75.5%*	*75.1%*	*74.9%*			*75.1%*
FFA Cost-to income ratio	*51.7%*	*46.0%*	*52.7%*			*48.7%*
Immediate liquidity-to-deposits ratio	*43.9%*	*43.7%*	*44.4%*			*43.4%*
Loans-to-deposits ratio	*30.0%*	*29.6%*	*29.9%*			*29.8%*
Equity-to-asset ratio	*8.7%*	*8.6%*	*9.0%*			*8.6%*

Source: Company reports and FFA Private Bank estimates

Investment Opinion

While we like Byblos Bank's solid domestic retail franchise with strong risk management practices, we believe additional value could be generated for investors as business plan visibility and cost-efficiencies improve

We recognize Byblos Bank's position in its domestic retail market and solid fundamentals benefiting from sizeable liquidity buffers, strong capitalization and superior asset/liability management practices, a validation of management's risk practices although at the detriment to profitability ratios. We also recognize the firm's leadership at better managing its asset liability mismatch with the issuance of costlier longer term liabilities. We believe Byblos Bank's shares could generate more value once the firm provides visibility on its business plan as it relates to its business line and geographic diversification and possible redeployment of excess capital back to shareholders.

Target Price Revision and Recommendation

We reiterate our Marketweight rating on Byblos Bank shares and maintain our fair value unchanged at USD 1.60 per share

Based on our revised forecasts and discount rate assumptions to our Dividend Discount Model, we maintain our fair value estimate for Byblos Bank unchanged at USD 1.60 and reiterate our Marketweight rating. Our DDM assumes a 14.5% discount rate and a 3.0% terminal growth rate. We corroborate our DDM valuation by means of the residual income method as well as historical and comparable P/E and P/B multiples.

Key Investment Risks

Key investment risks include credit, interest rate, sovereign, economic/political and foreign operations risks.

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