Equity Research - Lebanese Banks - Q3/17 Preview

Stable operating environment in key markets expected to support results of banks under coverage on account of steady growth in core income and deposits although outlook weighed by uncertainty around reform efforts and subdued lending as credit appetite wanes

Stable deposit growth in Q2/17 supported by BDL intervention while loan growth underperformed amid challenging macro conditions

Commercial banks' balance sheet expanded in Q2/17 with assets/deposits/loans increasing by respective +9%/+8%/+7% YoY while growth was less pronounced on a QoQ basis, in the range of 1%-3%. Banks' assets reached USD 208 billion in Q2/17 funded at ~80% by deposits at USD 168 billion while loans amounted to USD 53 billion. Net profits of Alpha banks grew by 10% in H1/17 although banks maintained their conservative lending policies amid tougher operating environment which translated into softer lending growth and higher gross doubtful loans at 7.46% in June 2017 from 6.81% in 2016. We highlight that BDL stimulus package which offers subsidized loans in various sectors is likely to be renewed in 2018 at ~USD 1 billion similar to packages offered in previous years. According to third party research, BDL recently carried a new financial engineering in order to attract fresh money and retain deposits that were placed last year as part of 2016 BDL debt swap operations. In this context, investors, through banks, could i) reinvest deposits they placed last year for a period of 5-10 years at a rate of around 7% per year, ii) borrow up to 125% of their deposits at a rate of 2% on the condition that iii) they reinvest the borrowed amount into LBP government bonds at around 7%. This intervention came in the light of weakening external position with a cumulative balance of payments deficit of USD 647 million in August 2017 reversing a cumulative surplus observed in the first four months of the year. Going forward, we expect the outlook of the banking sector to be driven by i) persisting challenging conditions domestically despite a marginal revival since end of 2016 following positive political progress, ii) the implementation of tax reforms to finance public sector pay rise, resulting in higher taxes for Lebanese banks and iii) the economic slowdown in neighboring countries which could lead to further declines in financial inflows.

Moderate growth in balance sheet of banks under coverage in Q2/17 amid stable f/x and challenged lending conditions. Stable to higher profitability YoY helped by NIMs expansion and foreign operations while regulatory capital well above BDL requirements

Bank Audi's assets and deposits were flat to higher in Q2/17 at respective flat/+1% QoQ on management decision to prioritize balance sheet consolidation while Blom Bank grew its assets and deposit at respective +4%/+6% largely helped by HSBC acquisition and f/x stabilization in Egypt and Byblos Bank expanded at +2% QoQ, compared to domestic sector growth in the 1%-2% range. On a YoY basis, assets and deposits growth came in at +4%/-5% for Bank Audi, +6%/+5% for Blom Bank and +7%/+4% for Byblos Bank although weighed by deconsolidation of Syria and Sudan subsidiaries and unfavorable f/x effects in Turkey and Egypt. Lending growth rebounded QoQ/YoY for Blom Bank and Byblos Bank at respective +8%/+5% and +2%/+5% and came in at +4%/-5% for Bank Audi likely a result of the bank's conservative lending approach in Turkey. Bank Audi's LDR trended higher at ~49% with LDR in Turkey at ~93% and Egypt at ~64% while Blom Bank's stood at ~29% and Byblos Bank's at 30% vs. Lebanese banking sector at ~31%. CAR levels for banks under coverage above BDL regulatory requirements (15.0% by end of 2018) with Bank Audi at 15.2%, Blom Bank at 17.0% and Byblos Bank at 18.0%. We estimate YoY improvement in TTM ROA for Bank Audi and Blom Bank at respective 1.3% and 1.5% supported by material contribution to earnings growth from foreign operations while Byblos Bank stable at 0.8%.

We forecast stable balance sheet growth in Q3/17e supported by recent BDL intervention while lending remains subdued domestically. Bottom line growth weighed YoY by exceptional gains in Q3/16 while QoQ improvement driven by stronger NIMs

We forecast stable growth QoQ in deposits and assets supported by recent BDL intervention, marginal improvement in investor sentiment and stronger growth rates and more favorable operating conditions in foreign operations. While Bank Audi and Blom Bank benefit from higher LDRs in Turkey and Egypt, lending remains challenged domestically. For Q3/17e, we expect YoY growth in assets/deposits/loans at +0%/+0%/-5% for Bank Audi capped by exceptionally strong deposit growth in Q3/16, +5%/+5%/+3% for Blom Bank supported by HSBC acquisition in Q2/17 and +8%/+6%/+5% for Byblos Bank likely in line with domestic sector averages. We expect YoY bottom line growth to be capped by weaker lending and deconsolidation of foreign subsidiaries while Bank Audi and Blom Bank should continue to benefit from improved cost efficiencies and profitability stemming from Odea Bank and HSBC acquisition respectively. We forecast YoY net profits growth for Bank Audi at -4% on particularly strong Q3/16 and amid rising credit quality concerns in Turkish operations, Blom Bank at +1% and Byblos Bank at -17% as NIMs improvement is expect to be partly offset by softer loan growth and trading and investment income.

Expect shares of banks under coverage to be supported by more stable operating environment and improved investor sentiment helping steady earnings, although capped by challenges related to reform efforts domestically and credit quality concerns in key geographical markets

We expect Bank Audi, Blom Bank and Byblos Bank's core income and balance sheet growth to be supported by more stable operating conditions in key pillars compared to 2016 on account of NIMs expansion and f/x stabilization. While shares should benefit from stable earnings and more favorable investor sentiment, we believe upside could be capped by uncertain outlook domestically given unclear implications of reform plans on the sector and economy as a whole in addition to concerns regarding credit quality in Turkey and Lebanon which could drive provisions higher. With shares trading at discount to historical, offering attractive dividend yields to investors, we continue to view banks as an interesting entry point, particularly Bank Audi and Blom Bank on account of higher visibility on their business plan and diversified earnings driving profitability higher while Byblos Bank income growth is limited by management preference to preserve strong regulatory capital and liquidity levels.

Table 1: FFA Private Bank - Lebanese Banks Coverage

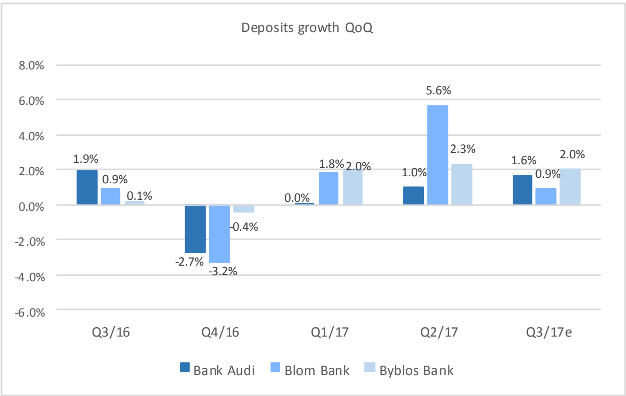
Company	Symbol	Recommendation	Target Price	Share Price *	YTD Change	P/E **	P/B to common	Dividend Yield ***
BANK AUDI	(AUDI LB)	MARKETWEIGHT	USD 7.00	USD 5.85	-14.0%	5.8x	0.78x	8.5%
BLOM BANK	(BLOM LB)	OVERWEIGHT	USD 13.00	USD 11.60	+9.4%	5.0x	0.93x	8.6%
BYBLOS BANK	(BYB LB)	MARKETWEIGHT	USD 1.50	USD 1.61	-5.3%	8.1x	0.68x	8.2%

Source: Company reports, BSE, FFA Private Bank estimates Note: *October 13, 2017 market close, **Based on TTM EPS, *** Based on approved dividends for 2016

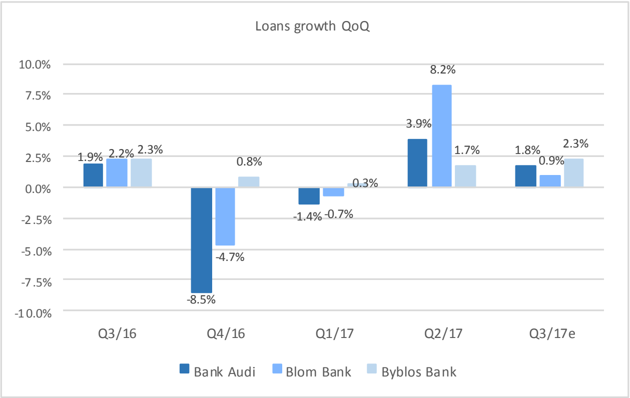
We maintain our target prices unchanged for Bank Audi, Blom Bank and Byblos Bank and note that Blom Bank is the sole Overweight in our coverage universe: We maintain our target prices for Bank Audi, Blom Bank and Byblos Bank unchanged at respective USD 7.00, USD 13.00 and USD 1.50. We note that Blom Bank is the sole Overweight in our coverage universe, given its higher quality core income, efficiencies, stable growth in earnings, solid capitalization, sizable liquidity and conservative approach to growth. While Bank Audi is Marketweight, we see upside on account of efforts to improve profitability and diversify risk through geographical expansion.

Banks Under Coverage - Comparative Snapshots

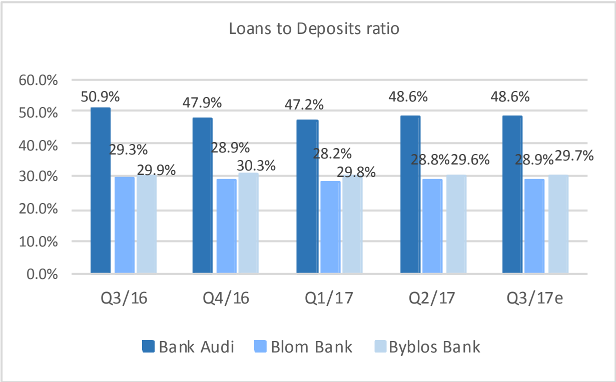
We forecast higher QoQ deposit growth for Bank Audi while still weighed YoY by f/x translation effects. Byblos Bank deposit growth expected roughly in line with domestic sector average. Slower deposit growth for Blom Bank following stronger Q2/17 boosted by HSBC acquisition



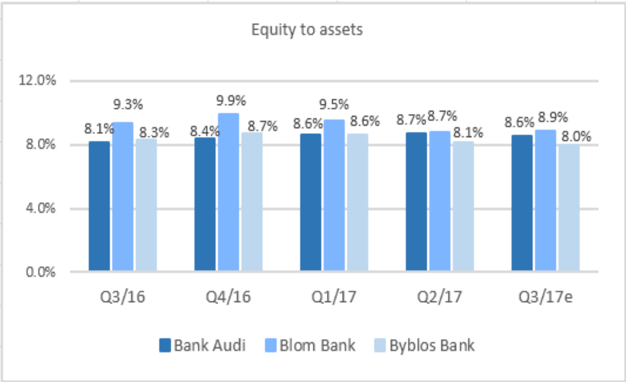
We expect recovery in loan growth to be maintained sequentially in Q3/17e with Bank Audi and Blom Bank benefitting from stronger lending in foreign operations while Byblos Bank expected to outperform domestic sector loan growth which remains subdued



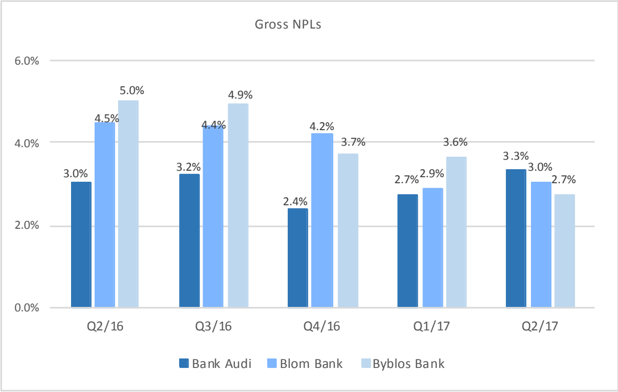
LDR expected to remain stable for Bank Audi, Blom Bank and Byblos Bank. Bank Audi LDR forecasted at ~49% while Blom Bank and Byblos Bank expected at respective ~29% and ~30% slightly below domestic sector level of 31%



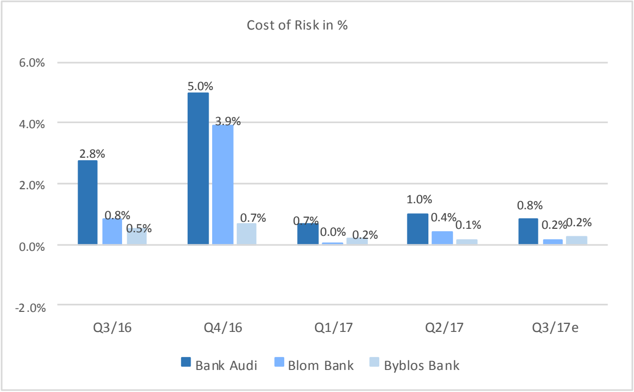
We forecast higher YoY equity to assets ratio for Bank Audi and lower for Blom Bank and Byblos Bank



Bank Audi NPLs at the higher end of peers under coverage driven by Turkey operations . NPLs roughly stable for Blom Bank while materially lower for Byblos Bank

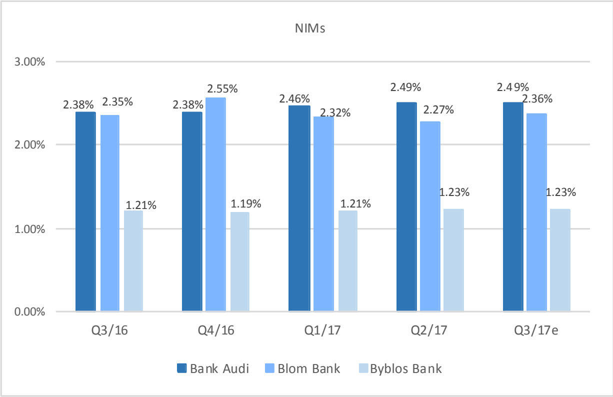


We forecast softer cost of risk for Bank Audi and Blom Bank in Q3/17e while slightly higher sequentially for Byblos Bank. Lower cost of risk expected YoY for banks under coverage as Q3/16 included banks' participation in BDL debt swap operations which resulted in stronger provisions

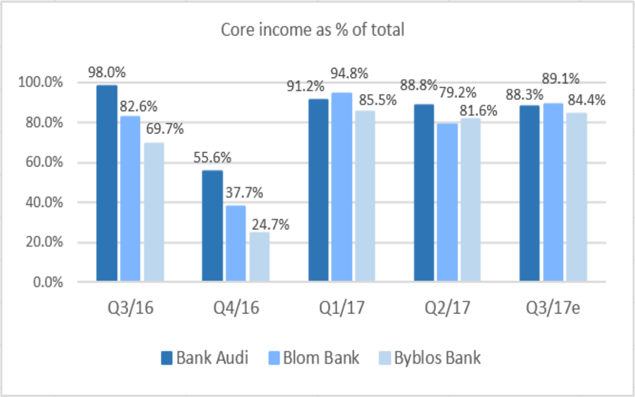


Source: Company reports and FFA Private Bank estimates

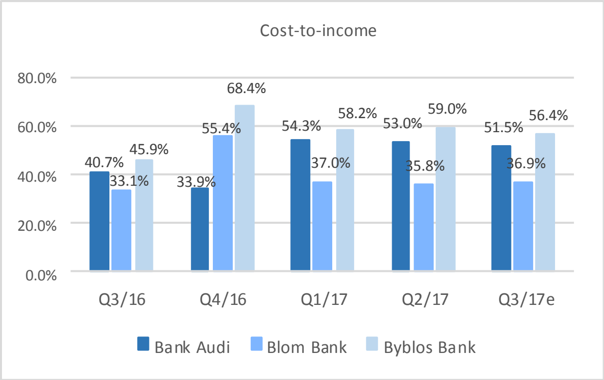
We expect stable to higher net interest margins for banks under coverage particularly as Bank Audi NIMs are supported by foreign operations and Blom Bank benefits from HSBC acquisition



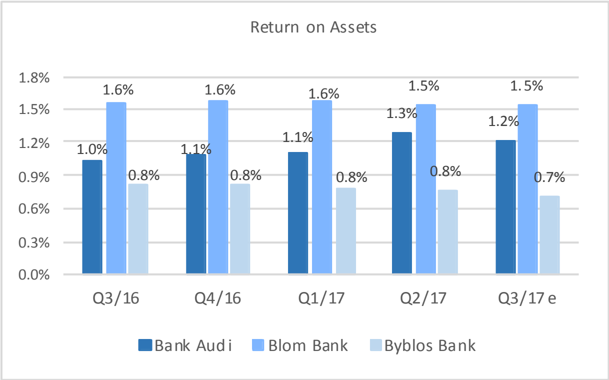
We expect income quality mix for banks under coverage in the 85%-90% range as financial gains remain contained compared to pre-BDL debt swap operations



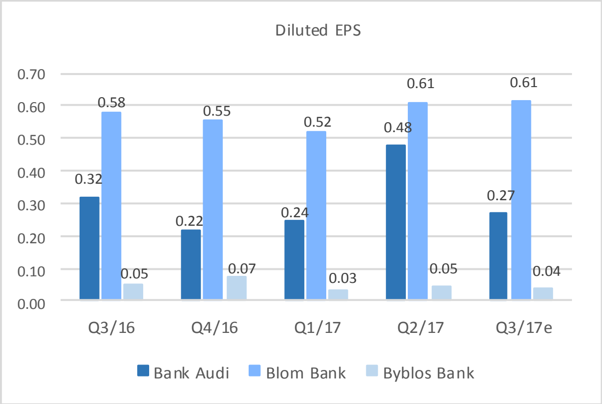
We forecast stable to lower cost-to-income QoQ for banks under coverage although higher YoY as Q3/16 included exceptional gains from participation in BDL debt swap. We note a more favorable operating leverage in Odea Bank for Bank Audi helped by higher operating income



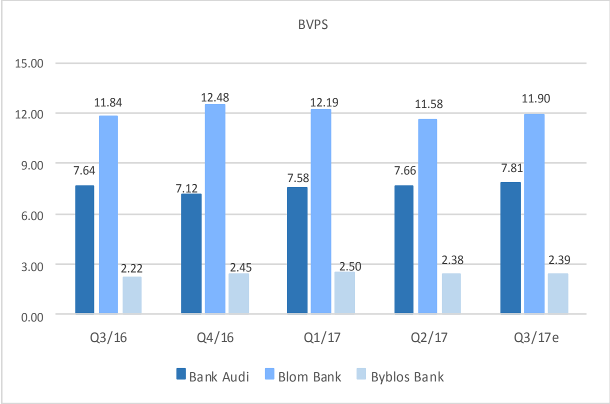
We expect stable to lower profitability for banks under coverage QoQ. We note that Bank Audi earnings included exceptional gains from sales of its cards and electronic payments business in Q2/17



We forecast lower diluted EPS QoQ for Bank Audi although higher when excluding exceptional gains from sale of card and electronic payment business in Q2/17. We expect stable diluted EPS QoQ for Blom Bank and lower for Byblos Bank



Expect higher BVPS for Bank Audi, Blom Bank and Byblos Bank in Q3/17e



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 at USD 43.9 billion as well as earnings at USD 197.9 million in Q2/17. The Bank had a total of 206 branches and 7,062 employees as of Q2/17 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 59%/41% and 66%/34% in Q2/17. In terms of assets, Turkey is currently the biggest international market for Bank Audi with ~25% of total assets. The current strategy is geared towards three geographic key markets: Lebanon, Turkey and Egypt, as well as private banking. We highlight the Bank's relatively sound asset quality (gross NPL ratio at 3.3% in Q2/17) 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.

Q2/17 Key Financial Highlights

Net profits before discontinued operations at USD 102.6 million in Q2/17 (-7% QoQ, -11% YoY)

- Net interest income registered at USD 269.0 million in Q2/17 (+1% QoQ, +7% YoY). We estimate net interest margins at 2.48% in Q2/17 higher than 2.44% in Q1/17 and 2.43% in Q2/16.
- Non-interest income came in higher in Q2/17 on higher financial gains at USD 41.6 million (+31% QoQ, -67% YoY) while fees and commissions were lower at USD 61.6 million (-5% QoQ, -3% YoY). Revenue breakdown for Q2/17 shows higher contribution of core income (net interest income + fees & commissions income) to total operating income at 91% in Q2/17 up from 89% in Q1/17 and 53% in Q2/16.
- Bank Audi saw lower cost-to-income in Q2/17 at 52.9% from 54.3% in Q1/17 and 54.7% in Q2/16.
- Bank Audi's consolidated gross NPLs were at 3.3% in Q2/17, higher than Q1/17 and Q2/16 levels and still lower than peers under coverage. Annualized cost of risk decreased to an estimated 64 bps in Q2/17, from an estimated 83 bps in Q1/17 and 139 bps in Q2/16 on higher provisioning QoQ at USD 43.3 million (+54% QoQ, -32% YoY).
- Muted assets and deposit growth at respective USD 43.9 billion and USD 36.3 billion in Q2/17 while loans outperformed, increasing +4% QoQ to USD 17.6 billion. Assets and deposits growth more pronounced on a yearly basis at respective +5% and +4% while loans underperformed at –5%.
- Bank Audi saw net profits before discontinued operations at USD 102.6 million in Q2/17 (-7% QoQ, -11% YoY).

Latest Key Regional/Operational Highlights

- Bank Audi's breakdown of assets and earnings between domestic and international operations stood at 59%/41% and 66%/34% as of Q2/17.
- Odea Bank accumulated USD 10.5 billion in total assets representing ~25% of the group assets and is seeking to benefit from operating leverage as branch network expands (50 branches including kiosks) and gains maturity. Odea Bank reported profits of USD 16.0 million in Q2/17 representing ~14% of consolidated net profits. We expect Odea Bank's profitability to continue to improve as margins and efficiencies move higher and closer to peers, driving its share of consolidated net profits considerably higher.
- In Q2/17, the group had USD 3.0 billion in assets in Egypt and generated USD 10.0 million in earnings accounting for 7% of consolidated assets and total profits.
- Bank Audi's current key geographic markets are: Lebanon, Turkey and Egypt, as well as private banking.
- In July 2017, Odea Bank sold an international bond in the amount of USD 300 million maturing in 2027 and subject to Tier 2 treatment under the Turkish law.
- Bank Audi redeemed and cancelled series F preferred shares issued in May 2012 (1.5 million shares, USD 1.10 at 6%) and issued series J preferred shares expected to constitute additional Tier 1 (2.75 million, USD 1.10 at 7%)
- In September 2016, Bank Audi deconsolidated and wrote-off its investments in Bank Audi Syria, National Bank of Sudan and Arabeya Online.
- In Q4/16, the Bank sold its 76.56% participation in National Bank of Sudan.
- In April 2017, Bank Audi announced an agreement with M1 Financial Technologies SAL to sell its electronic payment and card services business in a deal estimated at USD 185 million.
- Samir Hanna has been appointed Chairman and Group CEO of Bank Audi replacing Raymond Audi. Sherine Audi, Carlos Obeid and Aristidis Vourakis were also appointed as board members.
- AGM agreed to increase dividend to USD 0.50 (gross of tax) per share for FY 2016 from USD 0.40 (gross of tax) per share for FY 2015 and paid them on 18/04/17.

FFA Model Assumptions

- We forecast net profits at USD 119.7 million in Q3/17e (-39% QoQ, -4% YoY).
- We expect net interest income at USD 278.1 million in Q3/17e (+3% QoQ, +5% YoY) helped by stronger NIMs in Turkey and Egypt.
- Net fees and commissions expected to reach USD 62.3 million in Q3/17e (+1% QoQ, -91% YoY).
- We expect assets, deposits and loans at respective +3% QoQ /flat YoY, +2% QoQ /flat YoY, +2% QoQ /-5% YoY.
- LDR is expected at 48.6% in Q3/17e, unchanged from Q2/17 and lower than 50.9% in Q3/16.
- We forecast net provisions of USD 35.9 million in Q3/17e with an estimated annualized cost of risk of 79 bps for 2017e.
- Our estimate for cost-to-income in Q3/17e is at 51.5%.
- Looking at FY 2017e, net profits should reach USD 552.5 million (+17% YoY) with EPS at USD 1.28 (+23% YoY); USD 457.2 million (-3% YoY) with EPS at USD 1.03 (-1% YoY) when excluding exceptional profits from sale of the card and electronic payment business in Q2/17

Table 2: FFA Model Forecasts

USD Million	FFA Q3/17e	Q2/17a	Q3/16a	QoQ %	YoY %	FFA 2017e
Net Interest Income	278.1	269.0	264.9	3%	5%	1,100.0
Fees & commissions income	62.3	61.6	691.8	1%	-91%	252.5
Trading & investment income	45.2	41.6	19.4	9%	133%	164.4
Operating Income	385.6	372.2	976.1	4%	-61%	1,516.9
Provisions	-35.9	-43.3	-129.6	-17%	-72%	-143.9
Operating expenses	-198.6	-197.3	-381.8	1%	-48%	-795.8
Income tax	-31.8	-29.4	-110.0	8%	-71%	-122.6
Net Profits	119.7	197.9	124.7	-39%	-4%	457.2
Diluted EPS	0.27	0.48	0.32	-43%	-15%	1.03
Assets	45,372	43,871	45,275	3%	0%	46,178
Deposits	36,915	36,317	36,963	2%	0%	37,579
Loans	17,943	17,634	18,814	2%	-5%	18,285
BVPS to common	7.81	7.66	7.64	2%	2%	7.97
FFA Net interest margins	2.49%	2.49%	2.38%			2.42%
Core income to total operating income	88.3%	88.8%	98.0%			89.2%
FFA Cost-to income ratio	51.5%	53.0%	40.7%			52.5%
Immediate liquidity-to-deposits ratio	43.7%	39.2%	41.7%			43.6%
Loans-to-deposits ratio	48.6%	48.6%	50.9%			48.7%
Equity-to-asset ratio	8.6%	8.7%	8.1%			8.6%

Source: Company reports and FFA Private Bank estimates

Investment Opinion

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

Bank Audi is the largest Alpha bank in Lebanon in terms of balance sheet size with a demonstrated franchise and the confidence of its clients in Lebanon and abroad. 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 and trade finance driving higher quality core income despite some room for improvement on Tier 1 capital. We continue to rate Bank Audi shares at Marketweight although we 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 55 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 at USD 7.00

Based on our revised forecasts and discount rate assumptions to our Dividend Discount Model, we maintain our fair value estimate for Bank Audi at USD 7.00 per share 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 Q2/17 at USD 31.3 billion as well as Q2/17 earnings at USD 121.5 million. The Bank had a total of 221 branches and 4,976 employees as of the end of Q2/17 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 82%/18% and 84%/16% respectively in Q2/17. The Bank's main geographic markets are Lebanon and MENA led by Egypt and Jordan. 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.

Q2/17 Key Financial Highlights

Net profits at USD 121.5 million in Q2/17 (+8% QoQ, +3% YoY)

- Net interest income came in at USD 172.7 million in Q2/17 (+1% QoQ, +3% YoY). We estimate NIMs at 2.27% in Q2/17 lower than 2.32% in Q1/17 and 2.33% in Q2/16 yet still higher than Blom Bank's targeted range of 2.00%-2.20%.
- Non-interest income was higher at USD 87.5 million in Q2/17 (+100% QoQ, +11% YoY) on stronger financial gains at USD 54.0 million (+382% QoQ, +35% YoY) and fees and commissions at USD 33.5 million (+3% QoQ, -13% YoY). Revenue breakdown for Q2/17 shows a deterioration in income mix quality with core income (net interest income + fees & commissions income) contribution to total operating income at 79% down from 95% in Q1/17 and 84% in Q2/16.
- Blom Bank Q2/17 cost-to-income at 35.8% down from 37.0% in Q1/17 yet slightly higher than 35.6% in Q2/16 still reflecting higher efficiencies vs. peers under coverage. Blom Bank's gross NPLs at 3.0% in Q2/17, slightly up from 2.9% in Q1/16 and down from 4.5% in Q2/16. Annualized cost of risk at an estimated 44 bps in Q2/17 up from an estimated 2 bps in Q1/17 yet lower than an estimated 81 bps in Q2/16 with provisions materially higher at USD 8.5 million (+2793% QoQ, -43% YoY).
- Assets, deposits and loans grew at respective +4%, +6% and +8% QoQ in Q2/17, above domestic sector average, to respective USD 31.3 billion, USD 26.7 billion and USD 7.7 billion largely supported by HSBC acquisition. On a YoY basis, assets grew +6%, deposits +5% and loans +5%.
- Capital adequacy ratio (as per Basel III) at 17.0% in Q2/17 down from 18.5% in Q1/17 and 18.0% in Q2/16, still at the higher end of peers under coverage, compared to BDL's 14.5% regulatory requirement for 2017. TTM ROA at ~1.5% in Q2/17 and TTM ROE at an estimated 17.2%.
- Blom Bank's net profit at USD 121.5 million in Q2/17 (+8% QoQ, +3% YoY).

Latest Key Regional/Operational Highlights

- Blom Bank breakdown of assets and earnings between domestic and international operations stands at 82%/18% and 84%/16% respectively in Q2/17.
- At the end of Q2/17, the Group had USD 1.8 billion in assets in Egypt and generated USD 7.5 million in net earnings accounting for around ~6% of consolidated assets and ~6% of consolidated profits.
- The Bank's key pillar markets are: Lebanon and Egypt.
- Blom Bank completed the acquisition of HSBC Middle East Limited in June 2017. As of June 2017, HSBC Middle East Limited had three branches in Lebanon and USD 840 million in assets, USD 600 million in deposits and USD 473 million in loans. The acquisition will allow Blom Bank to expand its corporate and commercial business and retail activities which will help diversify its assets and revenues.
- AGM agreed to increase dividends to USD 1.00 (gross of tax) per share for FY 2016 from USD 0.82 (gross of tax) per share for FY 2015 and paid them on 13/04/17.
- Blom Bank fully redeemed 20 million Preferred Shares Class 2011 in June 2017 at their issue price of USD 10.00 per share.

FFA Model Assumptions

- We expect net profits of USD 122.9 million in Q3/17e (+1% QoQ, +5% YoY).
- We expect net interest income at USD 181.7 million in Q3/17e (+5% QoQ, +5% YoY).
- Net fees and commissions expected at USD 39.4 million in Q3/17e (+17% QoQ, +10% YoY).
- We expect provisions of USD 3.1 million equivalent to an estimated annualized cost of risk at 18 bps for 2017e.
- We estimate cost-to-income at 36.9% in Q3/17e, above Q2/17 level of 35.8% and Q3/16 level of 34.7%.
- We expect assets, deposits and loans QoQ growth at +1%, +1% and +1% while YoY growth is expected at +5%,+5%, and +3%.
- We expect LDR at 28.9% in Q3/17e from 28.8% in Q1/17 and 29.3% in Q3/16.
- Looking at FY 2017e, net profits should reach USD 487.1 million (+5% YoY) with EPS expected at USD 2.40 (+9% YoY).

Table 3: FFA Model Forecasts

USD Million	FFA Q3/17e	Q2/17a	Q3/16a	QoQ %	YoY %	FFA 2017e
Net Interest Income	181.7	172.7	172.4	5%	5%	709.9
Fees & commissions income	39.4	33.5	35.8	17%	10%	147.4
Trading & investment income	27.1	54.0	43.9	-50%	-38%	119.9
Operating Income	248.2	260.3	252.1	-5%	-2%	977.2
Provisions	-3.1	-7.8	-15.7	-61%	-80%	-14.4
Operating expenses	-91.5	-93.1	-87.4	-2%	5%	-351.8
Income tax	-30.7	-37.2	-31.7	-17%	-3%	-123.9
Net Profits	122.9	121.5	117.4	1%	5%	487.1
Diluted EPS	0.61	0.61	0.58	1%	6%	2.40
Assets	31,684	31,327	30,131	1%	5%	32,000
Deposits	26,909	26,674	25,644	1%	5%	27,178
Loans	7,765	7,695	7,514	1%	3%	7,846
BVPS to common	11.90	11.58	11.84	3%	0%	12.25
FFA Net interest margins	2.36%	2.27%	2.35%			2.28%
Core income to total operating income	89.1%	79.2%	82.6%			87.7%
FFA Cost-to income ratio	36.9%	35.8%	34.7%			36.0%
Immediate liquidity-to-deposits ratio	58.0%	57.6%	49.3%			58.1%
Loans-to-deposits ratio	28.9%	28.8%	29.3%			28.9%
Equity-to-asset ratio	8.9%	8.7%	9.3%			9.0%

Source: Company reports and FFA Private Bank estimates

Investment Opinion

We view Blom Bank's higher returns and solid liquidity and capitalization 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 and excess capital buffers
We recognize Blom Bank's solid positioning in its domestic market. We highlight the firm's conservative strategy focusing on preserving asset quality and higher capitalization ratios which translates in lower cost of risk and excess common equity Tier 1 capital respectively. We highlight Blom Bank's superior profitability and return ratios relative to its domestic peers from relatively higher operating efficiencies and margins, despite sizeable liquidity buffers. We also value Blom Bank's higher quality core income which translates into steady earnings growth while dividends should continue to benefit from lower than average payouts and above average excess Tier 1 common equity capital.

Target Price Revision and Recommendation

We reiterate our Overweight rating on Blom Bank shares and maintain our fair value at USD 13.00 per share
Based on our revised forecasts and discount rate assumptions to our Dividend Discount Model, we maintain our fair value estimate for Blom Bank at USD 13.00 per share and reiterate our Overweight rating. Our DDM assumes a 13.5% 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.

BYBLOS BANK

Company Description

Byblos Bank is the third largest bank in Lebanon in terms of assets with an asset base in Q2/17 at USD 21.8 billion with earnings at USD 37.5 million. The Bank had a total of 97 branches and 2,347 employees as of end of December 2016 (excluding Byblos Bank Syria and Byblos Bank Africa) 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 ~92%/8% for 2016 excluding Byblos Bank Syria and Byblos Bank Africa). 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 at the expense of weaker margins and profitability.

Q2/17 Key Financial Highlights

Net profits at USD 37.5 million in Q2/17 (+31% QoQ, -4% YoY)

- Net interest income was at USD 66.1 million in Q2/17 (+4% QoQ, +11% YoY). We estimate interest margins at 1.23% in Q2/17 higher than 1.20% in Q1/17 and 1.18% in Q2/16.
- Non-interest income at USD 39.5 million in Q2/17 as higher financial gains at USD 19.4 million (+35% QoQ, +64% YoY) offset lower fees & commissions at USD 20.1 million (-6% QoQ, +1% YoY). We highlight a slight deterioration in Byblos Bank's income quality mix with revenue breakdown showing core income (net interest income + net fees & commissions income) contribution to total operating income at 82% in Q2/17 down from 86% in Q1/16 and 87% in Q2/16.
- Cost of risk decreased to an estimated 15 bps in Q2/17 from 20 bps in Q1/17 and 36 bps in Q2/16 with lower provisions at USD 2.0 million (-23% QoQ, -57% YoY).
- Moderate balance sheet growth in Q2/17 with asset, deposits and loans up +2% to respective USD 21.8 billion, USD 17.8 billion and USD 5.3 billion. Balance sheet growth more significant on a YoY basis with assets, deposits and loans up by respective +7%, +4% and +5% despite deconsolidation of Syria and Sudan subsidiaries.
- Assets continue to be largely funded by deposits at ~82% while LDR remains below Lebanese banking sector average (~31%). Immediate liquidity to deposits ratio (including cash and balances with central banks and interbank placements) came in higher at 54% in Q2/17 up from 52% in Q1/17 and 43% in Q1/16.
- Byblos Bank's TTM ROA declined in Q2/17 at an estimated 0.75% from 0.78% in Q1/17 and 0.83% in Q2/16 while TTM ROE rose QoQ to an estimated 9.3% although declined YoY from 10.0% in Q2/16, still at the lower end of our coverage universe.
- Byblos Bank saw net profits at USD 37.5 million in Q2/17 (+31% QoQ, -4% YoY).

Latest Key Regional/Operational Highlights

- Byblos Bank breakdown of assets between domestic and international operations stood at ~92%/8% for 2016.
- Byblos Bank completed its acquisition of Banque Pharaon & Chiha in Q4/16 for a total consideration of USD 98 million. At end of April 2016, Banque Pharaon & Chiha's assets and deposits stood at respective USD 308 million and USD 229 million.
- Byblos Bank deconsolidated its subsidiaries Byblos Bank Syria which was 59.87% owned by the Group and Byblos Bank Africa (Sudan) which was 56.86% owned by the Group.
- Byblos Bank dividends of USD 0.13 (gross of tax) per share for FY 2016 were approved by AGM and paid on 05/05/17.

FFA Model Assumptions

- We expect net profits of USD 33.2 million in Q3/17e (-12% QoQ, -19% YoY).
- We forecast net interest income of USD 67.3 million in Q3/17e (+2% QoQ, +10% YoY).
- Net fees and commissions expected at USD 21.3 million in Q3/17e (+6% QoQ, +3% YoY).
- We expect assets, deposits and loans to grow by a respective +2% QoQ /+8% YoY, +2% QoQ /+6% YoY, +2% QoQ /+5% YoY.
- At these growth levels, LDR should be at 29.7%, unchanged from Q2/17 and slightly down from 29.9% in Q3/16.
- We forecast provisions of USD 3.2 million in Q3/17e equivalent to an estimated annualized cost of risk at 20 bps for 2017e.
- Our cost-to-income estimate is at 56.4% for Q3/17e.
- Looking at FY 2017e, net profits should reach USD 135.8 million (-18% YoY) with EPS at USD 0.16 (-23% YoY).

Table 4: FFA Model Forecasts

USD Million	FFA Q3/17e	Q2/17a	Q3/16a	QoQ %	YoY %	FFA 2017e
Net Interest Income	67.3	66.1	61.5	2%	10%	265.9
Fees & commissions income	21.3	20.1	20.6	6%	3%	83.1
Trading & investment income	16.4	19.4	35.8	-15%	-54%	67.0
Operating Income	105.0	105.6	117.9	-1%	-11%	416.0
Provisions	-3.2	-2.0	-6.4	66%	-49%	-11.1
Operating expenses	-59.2	-62.3	-54.1	-5%	10%	-235.5
Income tax	-9.4	-3.8	-16.6	149%	-44%	-33.5
Net Profits	33.2	37.5	40.8	-12%	-19%	135.8
Diluted EPS	0.04	0.05	0.05	-17%	-22%	0.16
Assets	22,189	21,792	20,572	2%	8%	22,593
Deposits	18,194	17,838	17,172	2%	6%	18,558
Loans	5,404	5,284	5,138	2%	5%	5,521
BVPS to common	2.39	2.38	2.22	0%	8%	2.41
FFA Net interest margins	1.23%	1.23%	1.21%			1.19%
Core income to total operating income	84.4%	81.6%	69.7%			83.9%
FFA Cost-to income ratio	56.4%	59.0%	45.9%			56.6%
Immediate liquidity-to-deposits ratio	54.0%	54.2%	44.4%			53.7%
Loans-to-deposits ratio	29.7%	29.6%	29.9%			29.7%
Equity-to-asset ratio	8.0%	8.1%	8.3%			7.9%

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 by providing additional visibility on its growth plan via geographic diversification and new business segments
We recognize Byblos Bank's position in its domestic retail market as well as its capacity to show sizeable liquidity buffers and superior asset/ liability management practices, a validation of management's risk practices although at the detriment of 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. We favor further efforts towards both organic and inorganic growth targeting geographical expansion and new business segments with focus on new markets and private banking/asset management which would respectively improve interest margins and core income.

Target Price Revision and Recommendation

We reiterate our Marketweight rating on Byblos Bank shares and maintain our fair value at USD 1.50 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 at USD 1.50 per share and reiterate our Marketweight 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.

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