Equity Research - Lebanese Banks - Q4/15 Preview

While Lebanese banks share prices could remain challenged by difficult operating conditions and macro backdrop, we note their relative outperformance vs. domestic peers, likely owing to banking system resiliency, balance sheet preservation, improved profitability measures and attractive dividend yields, particularly noteworthy as dividend season approaches

October 2015 data still shows resiliency in domestic banking sector with assets, deposits, loans respectively growing YoY by +6%, +5%, +6%: While real GDP growth is expanding at ~2%, a quarter of the pace before the Arab spring/Syrian crisis began, Lebanese banks are still showing resilience against the regional and domestic economic/political backdrop. Banks continued to attract deposits, witness some asset growth, albeit below previous levels, as political standstill (failure to elect a President, anti-government protests due to the trash crisis and ongoing conflicts at the Lebanese borders among others) added pressures on Banks' balance sheets. In October 2015, assets and deposits grew by +6% and +5% reaching USD 182 billion and USD 149 billion respectively. Deposits continue to fund most of the sector's assets (82% in October 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% reaching USD 47 billion in October 2015, partially driven by previous BDL stimulus, expected to be followed by another USD 1 billion in 2016, comprising low borrowing rates for housing and projects related to renewable energy, and extended loan terms for small and medium-sized businesses. Non-resident deposits represented a stable 21% share of deposits by end of October 2015, continuing to help fuel the sector's liquidity (LDR at ~32% in October 2015), which in turn go to finance public/external needs and international reserves.

Balance sheet of banks under coverage still witnessing growth, despite persistent sluggish domestic and regional backdrop: Balance sheet of banks under coverage saw subdued sequential growth in Q3/15 with assets and deposits negative to flat for Bank Audi, while Blom Bank and Byblos Bank saw assets and deposits grow +1% (FX translation from foreign operations that saw weaker local currencies impacted volumes for Bank Audi and Blom Bank). Loans remained flat for Bank Audi and Blom Bank, while growing +1% for Byblos Bank. LDR for Blom Bank and Byblos Bank at ~28% and ~29% respectively, while LDR for Bank Audi higher at ~47%, well above the sector's average of ~32%, mostly due to faster lending growth and significantly higher LDRs in Turkey. For Q4/15e, we expect sequential growth in assets, deposits and loans respectively for Bank Audi at +2%/+4%/+3%, +1%/+1%+1% for Blom Bank and in the 1%-2% range Byblos Bank. For 2015e, we expect banks under coverage to have been resilient despite persistent domestic sluggishness due to economic/political uncertainty, subdued growth in key diaspora markets, lower inflow in remittances from expatriates (mainly from Gulf countries) and weaker FDIs. We expect YoY growth in assets and deposits for banks under coverage in the 3%-5% range as loans lag with YoY growth at +2%.

In addition to growth in earning assets, we expect NIMs improvement, lower cost-to-income to drive profitability for banks under coverage: NIMs improving although banks continue to witness constraints in reducing cost of funds amid slower deposit accumulation (For November 2015, cost of funds in LBP up +5 bps YoY and cost of funds in USD up +8 bps YoY). Despite improving asset yields (return on uses of funds +4 bps YoY in LBP and +20 bps YoY in USD), spreads in LBP decreased -1 bps YoY while spreads in USD increased +12 bps YoY. Net interest income is expected to rise YoY, on NIMs improvement for banks under coverage, in Q4/15e at +10% YoY for Bank Audi, +5% YoY for Blom Bank and Byblos Bank. While fee income is expected to grow +8%/+5%/+2% for Bank Audi, Blom Bank and Byblos Bank respectively, we expect non-interest income and revenue growth to be capped by lower gains on financial assets. We expect higher efficiencies YoY with cost-to-income levels in Q4/15e for Bank Audi and Blom Bank at 52.2% and 37.8% (vs. 53.7 and 38.7% in Q4/14 respectively), while Byblos Bank is expected to see higher levels YoY at 39.6% (on lower Q4/14 level at 37.8%), although lower QoQ from 50.2% in Q3/15. Bank Audi and Blom Bank are expected to have lower provisioning YoY, while Byblos Bank should see higher levels YoY (on low Q4/14 levels). Net profits of Alpha Group of banks rose +10% YoY in 9M/15 and we estimate YoY growth in net profits in Q4/15e for Bank Audi at +41% (EPS at USD 0.23, +55% YoY), +6% for Blom Bank (EPS at USD 0.47, +12% YoY) and -7% for Byblos Bank (EPS at USD 0.08, -10% YoY), driving 2015e net profits at USD 403 million (+15% YoY, EPS at USD 0.92) for Bank Audi, USD 392 million (+7% YoY, EPS at USD 1.79) for Blom Bank and USD 172 million (-2% YoY, EPS at USD 0.22) for Byblos Bank. For 2016e, we expect net profits to reach USD 462 million for Bank Audi, USD 406 million for Blom Bank and USD 176 million for Byblos Bank.

Growing profits, above average profitability and relatively attractive valuation levels likely drove Lebanese banks to outperform other domestic sectors in 2015, with BSE outperforming most Mena markets engulfed by lower oil prices. While share prices could remain challenged in the S-T, we highlight attractive dividend yields ahead of upcoming distribution season: Despite economic, political and security conditions continuing to weigh on risk sentiment, Bank Audi and Byblos Bank managed to end the year positively at +0.8% and +0.6% respectively, while Blom Bank surpassed at +6.8%, driving the BSE to record the fourth best performance among Mena market peers at -1.5% in 2015. Banks under coverage outperformed other sectors in terms of profitability (earnings growth, return on capital) in 2015 and offered attractive returns with dividend yields in the range of 7%-8%, above Mena peers average of ~5.5% (dividend distribution expected in April), as well as P/E valuations at 7.2x/5.4x/7.5x for Bank Audi, Blom Bank and Byblos Bank, below Mena peers average of ~8.8x and P/B valuations ranging from 0.76x-0.88x vs. Mena peers average of 1.20x. While Lebanon suffers from twin deficits including sovereign debt levels among the highest globally, Lebanon as an oil importing economy, is expected to benefit from lower oil prices by positively impacting external and fiscal accounts. US rate normalization process will also benefit Lebanese banks as higher Libor rates will ease pressure on the negative carry found on USD interbank balances.

Table 1: FFA Private Bank - Lebanese Banks Coverage

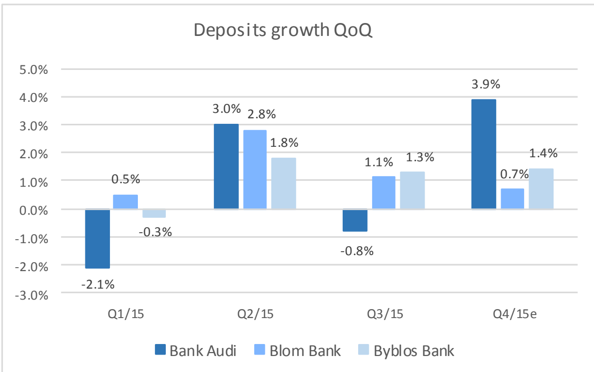
Company	Symbol	Recommendation	Target Price	Share Price *	YTD Change	P/E **	P/B to common	Dividend Yield
Bank Audi	(AUDI LB)	MARKETWEIGHT	USD 7.00	USD 6.08	+0.5%	7.2x	0.88x	6.76%
Blom Bank	(BLOM LB)	OVERWEIGHT	USD 11.00	USD 9.40	+0.0%	5.4x	0.86x	7.1%
Byblos Bank	(BYB LB)	MARKETWEIGHT	USD 1.60	USD 1.65	+2.5%	7.5x	0.76x	8.0%

Source: Company reports, BSE, FFA Private Bank estimates Note:* Listed shares as of January 21, 2016 market close, **Based on TTM EPS

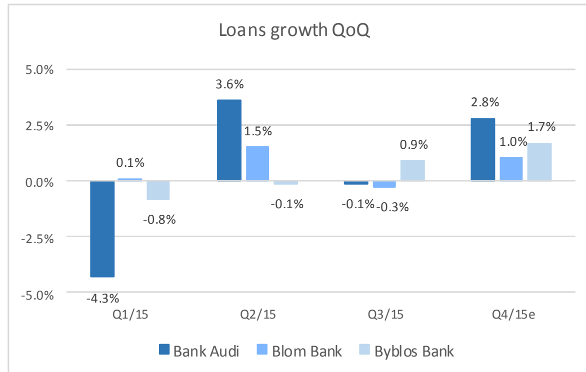
We maintain our target prices and recommendations unchanged for Bank Audi, Blom Bank and Byblos Bank: We maintain our target prices for banks under coverage unchanged at USD 7.00 for Bank Audi, USD 11.00 for Blom Bank and USD 1.60 for Byblos Bank and maintain our Overweight recommendation for Blom Bank and Marketweight recommendations for both Bank Audi and Byblos Bank.

Banks Under Coverage - Comparative Snapshots

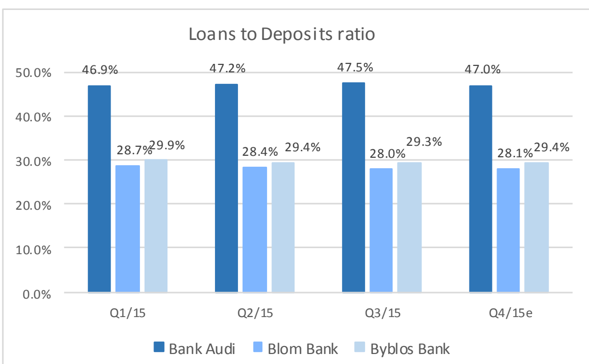
We expect Bank Audi, Blom Bank and Byblos Bank sequential deposit growth at +3.9%, +0.7% and +1.4% respectively in Q4/15e



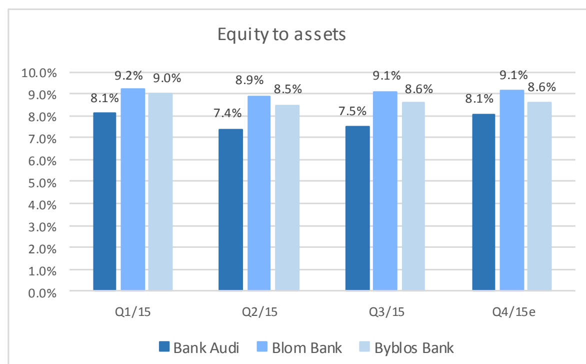
Bank Audi and Byblos Bank are expected to have loans growing sequentially between 2%-3% in Q4/15e, while Blom Bank QoQ growth expected at +1%



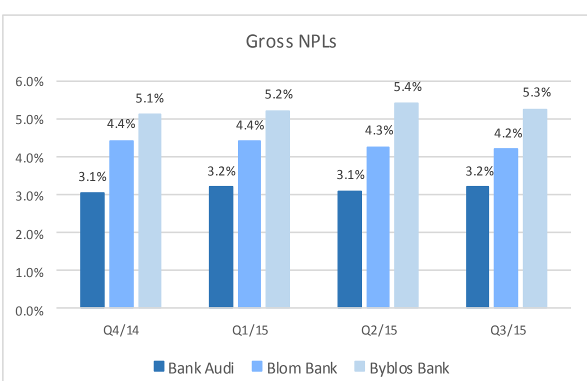
Bank Audi's LDR (~47%) expected to remain well above sector's average (~32%) while Blom Bank and Byblos Bank's LDRs expected to stay at ~28% and ~29% respectively in Q4/15e



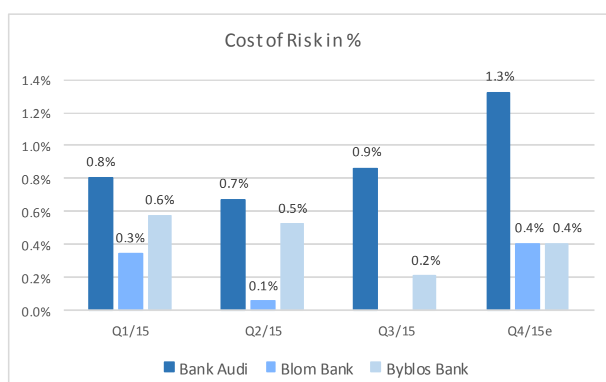
Blom Bank continues to boast highest capitalization among banks under coverage with E/A ratio expected at 9.1% in Q4/15e, while Bank Audi and Byblos Bank expected at 8.1% and 8.6% respectively



We note relatively flat NPL formation in Q3/15 across banks under coverage and Bank Audi's higher asset quality versus peers

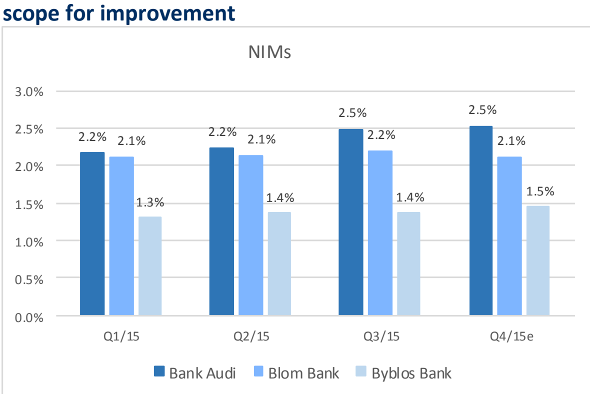


Cost of risk for the banks under coverage expected to increase QoQ in Q4/15e due to seasonally higher provisioning at year-end. Blom Bank has seen lower, although more volatile COR, expected to increase in line with other banks

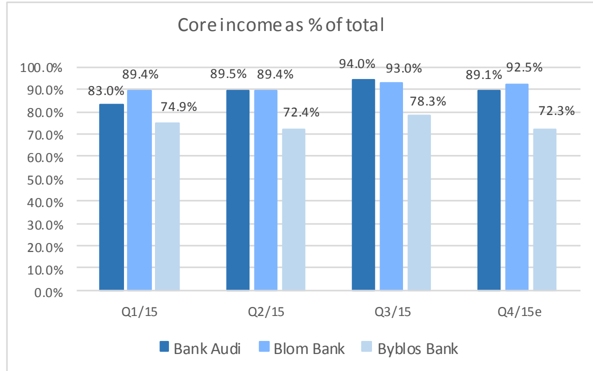


Source: Company reports and FFA Private Bank estimates

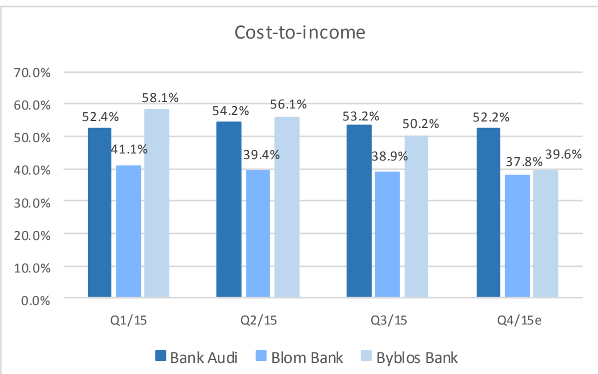
We note NIMs improvement for Bank Audi while Blom Bank remains stable in Q4/15e, at the high end of its range. Byblos Bank should see higher NIMs QoQ given scope for improvement



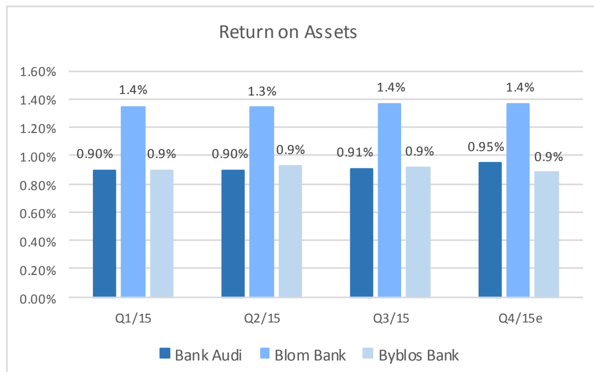
We expect continued weakness in Byblos Bank core income in Q4/15e owing to its less diversified model compared to its peers



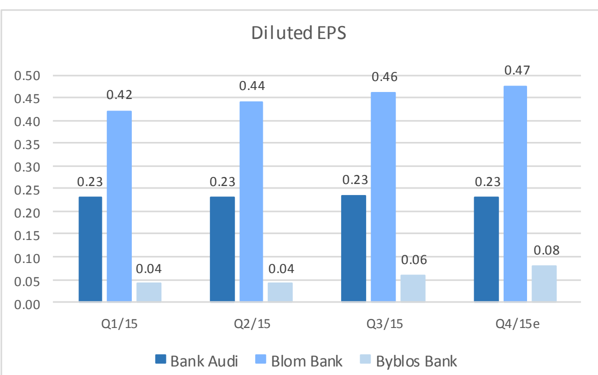
Blom Bank expected to continue seeing lower cost-to-income compared to peers under coverage, while we highlight QoQ efficiency gains for Byblos Bank in Q4/15e



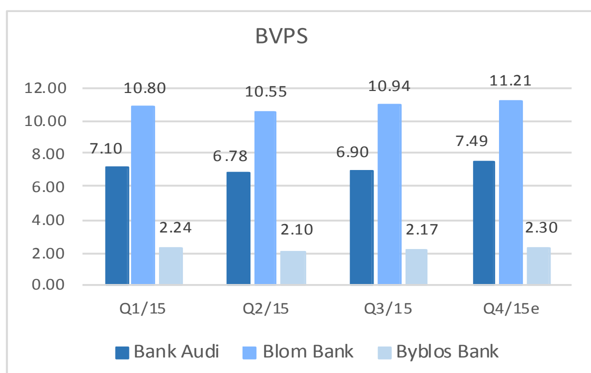
We value Blom Bank's higher expected profitability compared to peers at 1.4% ROA, while Bank Audi and Byblos Bank expected to remain under ~1.0%



Blom Bank expected to continue to demonstrate higher EPS among banks under coverage. Bank Audi shows EPS stability while Byblos Bank EPS improves in Q4/15e



Banks under coverage expected to witness improved BVPS in Q4/15e, which we expect will 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 2014 and 9M/15 respectively at USD 41.9 billion and USD 42.3 billion as well as earnings in 2014 and 9M/15 respectively at USD 350.3 million and USD 304.2 million. The Bank had a total of 214 branches and 6,807 employees as of the end of 9M/15 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 52%/48% and 54%/46% in 9M/15. 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 3.2% in Q3/15) amidst a difficult backdrop, solid balance sheet growth on a YoY basis and consolidated margins to remain favorably impacted by higher margins driven largely by Turkey as they converge towards Turkish sector average.

Q3/15 Key Financial Highlights

Net profits at USD 102 million in Q3/15 (flat QoQ, +13% YoY)

- Net interest income increased to USD 260 million in Q3/15 (+11% QoQ, +34% YoY) on growth in earning assets and improvement in interest margins. We highlight an improvement in estimated interest margins at 2.49% in Q3/15 vs. 2.23% in Q2/15 and 1.97% in Q3/14 likely driven by non-Turkish operations as Odea Bank saw margins improve only slightly YoY.
- Despite net fees and commissions displaying growth at USD 71 million (+7% QoQ, +8% YoY), non-interest income came in lower at USD 92 million (-9% QoQ, -34% YoY) as Bank Audi saw financial gains slow down to USD 21 million (-40% QoQ, -72% YoY). Revenue breakdown for Q3/15 reflects a high quality mix with core income contribution to total operating income at 94% up from 90% in Q2/15.
- Bank Audi saw improved efficiencies as cost-to income came at 53.2% in Q3/15 from 54.2% in Q2/15, despite higher operating expenses.
- Gross NPL ratio inched higher at 3.2% in Q3/15 from 3.1% in previous quarter, still contained and well lower than peers under coverage, with stronger cost of risk in Q3/15 at an estimated 86 bps from an estimated 67 bps in Q2/15 due to higher provisioning at USD 37 million in Q3/15 up from USD 28 million in Q2/15.
- Key balance sheet indicators muted in Q3/15 with assets, deposits and loans QoQ/YoY in Q3/15 at 0%/+6%, -1%/+6%, 0%/+7% to reach USD 42 billion, USD 36 billion and USD 17 billion respectively.

Latest Key Regional Highlights

- Bank Audi's breakdown of assets and earnings between domestic and international operations stands at 52%/48% and 54%/46% in 9M/15.
- 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 (54 branches including kiosks) and gains maturity. Odea Bank reported profits of USD 24.0 million in 9M/15, representing ~8% of consolidated net profits, whereas net profits for the full year 2014 amounted to USD 16.2 million equivalent to ~5% 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 9M/15, the Group had USD 4.9 billion in assets in Egypt and generated USD 55.7 million in earnings accounting for 12% of consolidated assets and 18% of total profits.
- The Bank's current key pillar markets are: Lebanon, Turkey and Egypt.

FFA Model Assumptions

- We forecast net profits of USD 99 million in Q4/15e (-3% QoQ, +41% YoY).
- Expect net interest income at USD 269 million in Q4/15e (+3% QoQ, +10% YoY) with the YoY improvement being driven by higher margins and earning assets momentum from Turkish expansion. Going forward, Odea Bank should help Bank Audi's margins as Turkish banks typically boast higher margins and as branches gain maturity.
- Net fees and commissions to reach USD 72 million in Q4/15e (+1% QoQ, +8% YoY).
- We expect assets, deposits and loans to grow +2% QoQ /+3% YoY , +4% QoQ /+4% YoY , +3% QoQ /+2% YoY respectively.
- LDR is expected at 47.0% in Q4/15e.
- We forecast provisions of USD 57 million in Q4/15e with an estimated annualized cost of risk of 89 bps for 2015e.
- Our estimate for cost-to-income in Q4/15e at 52.2%, still high compared to pre-Turkey expansion levels.
- Looking at 2015e, net profits should reach USD 403 million (+15% YoY) with EPS at USD 0.92 (+7% YoY), driven by stronger operating income and gradually improving efficiencies. For 2016e, we expect net profits of USD 462 million (+15% YoY) and EPS at USD 1.05 (+14% YoY).

Table 2: FFA Model Forecasts

USD Million	FFA Q4/15e	Q3/15a	Q4/14a	QoQ%	YoY%	FFA 2015e	FFA 2016e
Net Interest Income	269	260	244	3%	10%	986	1,109
Operating Income	382	353	367	8%	4%	1,410	1,563
Net Profits	99	102	70	-3%	41%	403	462
Diluted EPS	0.23	0.23	0.15	-2%	55%	0.92	1.05
Assets	43,284	42,358	41,961	2%	3%	43,284	46,835
Deposits	37,213	35,829	35,821	4%	4%	37,213	40,281
Loans	17,490	17,015	17,171	3%	2%	17,490	19,335
BVPS to common	7.49	6.90	7.02	9%	7%	7.49	8.09
FFA Cost-to income ratio	52.2%	53.2%	53.7%			53.1%	53.0%
Loans-to-deposits ratio	47.0%	47.5%	47.9%			47.0%	48.0%

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 13.5% 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.

BLOM BANK

Company Description

Blom Bank is the second largest bank in Lebanon in terms of assets with an asset base in 2014 and 9M/15 respectively at USD 27.9 billion and USD 28.9 billion as well as earnings in 2014 and 9M/15 respectively at USD 365.4 million and USD 289.8 million. The Bank had a total of 257 branches and 4,758 employees as of the end of 9M/15 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 70%/30% respectively in 9M/15. 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.

Q3/15 Key Financial Highlights

Net profits at USD 99 million in Q3/15 (flat QoQ, +10% YoY)

- Net interest income increased to USD 155 million from USD 149 million in Q3/15 (+4% QoQ, +7% YoY) on improved interest margins despite tepid balance sheet growth. We highlights an improvement in NIMs at 2.20% in Q3/15 vs. 2.14% in Q2/15, at the higher end of the Bank's targeted range of 2.0%-2.2%.
- Fees and commissions income came in lower at USD 36 million (-10% QoQ, +6% YoY) on muted balance sheet growth and softer lending. We continue to favorably view Blom Bank's high quality income mix with core income (net interest income + net fees and commissions income) contribution to total operating income at ~93% up from ~92% in Q2/15.
- Blom Bank carried out a provision reversal in Q3/15, adding back USD 0.2 million, while previous quarters saw provisions amounting to approximately USD 1 million in Q2/15 and USD 10 million in Q3/14. Blom Bank saw improved efficiencies as estimated cost-to-income ratio came in at 38.9% in Q3/15 (vs. 39.4% in Q2/15 and 40.4% in Q3/14) still reflecting higher efficiencies compared to peers.
- Balance sheet was muted sequentially with aggregates flat to +1%. Assets and deposits grew YoY by +5% and +6% to USD 29 billion and USD 25 billion respectively while loans lagged at USD 7 billion (+1% YoY) likely on BdL's restrictive caps on retail lending and FX pressures on international operations.
- Solid capital position with CAR III at 17.8%, unchanged sequentially and profitability ratios at the high end of our coverage universe. TTM ROA at 1.4% and TTM ROE at 15.0%.

Latest Key Regional Highlights

- Blom Bank breakdown of assets and earnings between domestic and international operations stands at 77%/23% and 70%/30% respectively in 9M/15.
- At the end of 9M/15, the Group had around USD 2.4 billion in assets in Egypt and generated USD 33.9 million in net earnings accounting for around ~8% of consolidated assets and ~12% of consolidated profits.
- The Bank's key pillar markets are: Lebanon and Egypt.

FFA Model Assumptions

- We expect net profits of USD 102 million in Q4/15e (+3% QoQ, +6% YoY).
- We expect net interest income at USD 154 million in Q4/15e (-1% QoQ, +5% YoY).
- Net fees and commissions to reach USD 45 million in Q4/15e (+26% QoQ; +5% YoY).
- We expect provisions of USD 7 million equivalent to an estimated annualized cost of risk at 19 bps for 2015e.
- We estimate cost-to-income at 37.8% in Q4/15e.
- Key balance sheet indicators including assets, deposits and loans are expected to grow by +1% QoQ in Q4/15e, while we expect them to grow +4%, +5%, +2% YoY respectively.
- At these growth levels, LDR should be at 28.1% in Q4/15e, which reflects ample liquidity and significant room to expand lending from current levels.
- For the year 2015e, net profits should reach USD 392 million (+7% YoY) with EPS expected at USD 1.79 (+11% YoY). For 2016e, we expect net profits of USD 406 million (+4% YoY) and EPS at USD 1.89 (+5% YoY).

Table 3: FFA Model Forecasts

USD Million	FFA Q4/15e	Q3/15a	Q4/14a	QoQ%	YoY%	FFA 2015e	FFA 2016e
Net Interest Income	154	155	147	-1%	5%	604	641
Operating Income	215	205	206	5%	4%	825	869
Net Profits	102	99	96	3%	6%	392	406
Diluted EPS	0.47	0.46	0.42	3%	12%	1.79	1.89
Assets	29,227	28,931	27,975	1%	4%	29,227	30,629
Deposits	25,199	25,029	24,006	1%	5%	25,199	26,270
Loans	7,076	7,004	6,910	1%	2%	7,076	7,431
BVPS to common	11.21	10.94	10.50	3%	7%	11.21	12.31
FFA Cost-to income ratio	37.8%	39.0%	38.7%			39.3%	38.6%
Loans-to-deposits ratio	28.1%	28.0%	28.8%			28.1%	28.3%

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 see scope for dividends to grow over time 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 maintain our fair value unchanged at USD 11.00 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 unchanged at USD 11.00 per share and reiterate our Overweight rating. Our DDM assumes a 15.0% 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 2014 and 9M/15 respectively at USD 19.0 billion and USD 19.4 billion as well as earnings in 2014 and 9M/15 respectively at USD 175.6 million and USD 113.1 million. The Bank had a total of 102 branches and 2,531 employees as of end of December 2014 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 and earnings between domestic and international at ~93%/7% and ~81%/19% for 2014. 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.

Q3/15 Key Financial Highlights

Net profits at USD 43 million in Q3/15 (+15% QoQ, -1% YoY)

- Net interest income was at USD 66 million in Q3/15 (+2% QoQ, +6% YoY) likely on improved interest margins YoY despite muted balance sheet growth. We estimate interest margins edged higher at 1.37% in Q3/15 from 1.36% in Q2/15 and 1.32% in Q3/14.
- Non-interest income at USD 44 million in Q3/15 (-25% QoQ, -21% YoY) weighed down by lower financial gains at USD 24 million (-39% QoQ, -28% YoY) while fees and commissions were muted at USD 20 million (+3% QoQ, -10% YoY) likely from softer lending.
- Cost of risk in Q3/15 rose substantially to an estimated 148 bps in Q3/15 from an estimated 52 bps in Q2/15 due to higher provisioning at USD 17 million in Q3/15 up from USD 6 million in Q2/15, likely suggesting a deterioration of credit quality.
- Balance sheet growth sluggish in Q3/15, likely on persistent softness in Lebanese banking sector growth, given Byblos Bank's large domestic exposure with assets, deposits and loans edging up slightly QoQ/YoY respectively by +1%/+2%, +1%/4% and 1%/0%.
- Assets continue to be largely funded by deposits at ~83% and LDR remained unchanged at ~29%, below Lebanese banking sector average (~35%) due to muted lending growth. Immediate liquidity to deposits ratio (including cash and balances with Central Banks and interbank placements) came in lower sequentially at ~43% in Q3/15 vs. ~45% in Q2/15.
- Profitability ratios were slightly lower with TTM ROA at an estimated 0.92% in Q3/15 vs. 0.93% in previous quarter and TTM ROE at an estimated 10.7% vs. 10.9% in Q2/15, still at the lower end of our coverage universe.

Latest Key Regional Highlights

- Byblos Bank breakdown of assets and earnings between domestic and international operations stands at ~93%/7% and ~81%/19% respectively for 2014.
- The Bank operations in Syria have been downsized to just ~1.4% of total assets as of December 2014.

FFA Model Assumptions

- We expect net profits of USD 59 million in Q4/15e (+36% QoQ, -7% YoY).
- We forecast net interest income of USD 71 million in Q4/15e (+7% QoQ, +5% YoY).
- Net fees and commissions expected at USD 23 million in Q4/15e (+12% QoQ, +2% YoY).
- Key balance sheet indicators namely assets, deposits and loans are expected to witness growth in Q4/15e in the 1%-2% range QoQ and 2%-4% range YoY.
- At these growth levels, LDR should be at 29.4%.
- We forecast provisions of USD 5 million in Q4/15e equivalent to an estimated annualized cost of risk at 73 bps for 2015e.
- Our cost-to-income estimate is at 39.6% for Q4/15e .
- Looking at 2015e, net profits should reach USD 172 million (-2% YoY) with EPS at USD 0.22 (-3% YoY). For 2016e, we expect net profits of USD 176 million (+3% YoY) and EPS at USD 0.23 (+3% YoY).

Table 4: FFA Model Forecasts

USD Million	FFA Q4/15e	Q3/15a	Q4/14a	QoQ%	YoY%	FFA 2015e	FFA 2016e
Net Interest Income	71	66	67	7%	5%	264	281
Operating Income	129	110	131	17%	-1%	475	493
Net Profits	59	43	63	36%	-7%	172	176
Diluted EPS	0.08	0.06	0.09	45%	-10%	0.22	0.23
Assets	19,646	19,347	19,035	2%	3%	19,646	20,499
Deposits	16,384	16,154	15,715	1%	4%	16,384	17,121
Loans	4,809	4,726	4,728	2%	2%	4,809	5,049
BVPS to common	2.30	2.17	2.21	6%	4%	2.30	2.40
FFA Cost-to income ratio	39.6%	50.2%	37.8%			47.5%	47.3%
Loans-to-deposits ratio	29.4%	29.3%	30.1%			29.4%	29.5%

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 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 gains visibility on its outlook and redeploys capital to create additional shareholder value by way of expansion, acquisition, or return of capital.

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 per share and reiterate our Marketweight rating. Our DDM assumes a 15.0% 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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