Equity Research - Lebanese Banks - Q4/17 Preview

Expect steady income growth to support expansion of banks under coverage while outlook remains weighed by unsustainable macro setting. We view banks as an interesting entry point ahead of 2018 dividend season given favorable dividend yields and attractive trading multiples

Banking sector continued to expand in the back half of 2017 despite the temporary political crisis while the outlook for 2018 is contingent on key policy approvals and reform implementation

Commercial banks' balance sheet expanded in the first eleven months of 2017 with assets up +8% and deposits and loans up +5% although growth was less significant on a QoQ basis in the range of 1%-3%. Assets recorded at USD 216 billion as of November 2017 funded at ~77% by deposits which reached USD 167 billion while loans were recorded at USD 53 billion. Net profits of alpha banks were up by +3% in 9M/17 amid challenging operating environment reflected by banks' conservative lending policies and slight deterioration in lending quality as gross doubtful loans increased to 7.78% in September 2017. Although spillovers of PM Hariri's sudden resignation in November were short-lived, it resulted in higher political uncertainty reflected through i) a surge in Lebanese Eurobond yields and 5-year CDS spreads, ii) a temporary surge in interbank rates on the back of lower liquidity and iii) limited cash withdrawals and conversion of bank accounts from LBP to USD as banks offered attractive interest rates on deposits in LBP to contain withdrawals. We highlight slight progress related to policy issues that could materialize in better prospects for Lebanon's economic performance in the medium term including i) parliament's approval of the first budget in 12 years, ii) cabinet's approval of the bid by a consortium of three companies for two offshore blocks with oil drilling expected to begin in 2019 and iii) expected launch of a large scale infrastructure project projected at USD ~16 billion, financed through PPP framework and soft loans. Macroeconomic outlook and investors' sentiment in 2018 should be impacted by the cabinet's ability to move forward with the implementation of the budget and productive projects-with debt/GDP ratio at alarming levels and growing balance of payments deficit-as well as diplomatic relations with neighboring countries.

Muted balance sheet growth domestically amid costlier deposits and tougher lending environment for banks under coverage in Q3/17 which drove an increase in placements at BDL. Flat to lower profitability YoY weighed by H2 2016 exceptional gains despite NIMs expansion in Q3/17

Assets of Bank Audi, Blom Bank and Byblos Bank were higher QoQ in Q3/17 at +2%/+2%/+3% despite flat to lower loan growth at respective -3%/-1%/0% amid conservative lending approach across geographic pillars. Deposits were lower QoQ for Bank Audi at -2% while higher for Blom Bank and Byblos Bank at +1% compared to domestic sector growth in the 0%-1% range for deposits and loans. On a YoY basis, assets, deposits and loan growth came in at -1%/-3%/-9% for Bank Audi capped by f/x devaluation in Turkey despite solid expansion in local currency, +6%/+5%/+1% for Blom Bank and +9%/+5%/+3% for Byblos Bank. Bank Audi's LDR slightly declined to 48.0% while Blom Bank's stood at 28.4% and Byblos Bank's at 29.5% vs. Lebanese banking sector at ~31%. We highlight increasing placements with central banks in Q3/17 resulting from recent BDL operations as banks benefitted from attractive terms on BDL CDs. CAR levels for banks under coverage above BDL regulatory requirements (15.0% by end of 2018) with Bank Audi at 15.6%, Blom Bank at 17.7% and Byblos Bank at 17.2%. We estimate roughly flat TTM ROA YoY for Bank Audi, Blom Bank and Byblos Bank at respective 1.0%/1.5%/0.8%.

We expect slight pick up QoQ in balance sheet expansion in Q4/17e helped by foreign operations while domestic growth is expected to be limited. NIMs improvement expected to drive bottom line growth as banks benefit from higher interest rate environment

We expect a pick up in QoQ balance sheet growth of banks under coverage in Q4/17e amid increased efforts to attract deposits through higher interest rates while lending expected to be largely supported by foreign operations as credit appetite wanes domestically. As a result, we forecast roughly stable LDRs for Bank Audi, Blom Bank and Byblos Bank. For Q4/17e, we expect YoY growth in assets/deposits/loans at +2%/+1%/+2% for Bank Audi capped by exceptionally strong growth in 2016, +9%/+9%/+8% for Blom Bank supported by HSBC acquisition in Q2/17 and +9%/+6%/+3% for Byblos Bank forecasted slightly above domestic sector averages. We forecast steady bottom line growth for banks under coverage supported by expansion in net interest margins amid higher interest rate environment in key geographical pillars and increased placements at central bank. While NPLs remain contained for banks under coverage, we maintain our cautious outlook for provisions given challenging macro which could cap bottom line growth. We expect YoY net profit growth for Bank Audi at +4%, Blom Bank at +8% and Byblos Bank at +1%.

Expect shares of banks under coverage to remain challenged in the short-term as uncertain domestic outlook weighs on investor sentiment while we highlight attractive dividend yields and trading multiples at discount to historical and MENA peers ahead of dividend season

Bank Audi, Blom Bank and Byblos Bank continue to operate in a stabilizing environment although outcome of reform efforts and impact of new taxes on the banking sector remain uncertain. We forecast steady growth in earnings and expect banks to benefit from higher interest rates as NIMs further expand despite slower lending reflecting lower risk appetite as macro indicators have yet to significantly pick up in Lebanon. We remain cautious on credit quality in key operating pillars as higher provisions could cap earnings growth. We expect share prices of banks under coverage to remain challenged in the short-term as uncertain domestic outlook weighed by rising debt/GDP and balance of payments deficit weigh on investor sentiment. As dividend season approaches, we note attractive dividend yields at ~8%, trading multiples at discount to MENA peers on a P/B basis and 2018e BVPS growth forecasted in the 5%-9% range. We value Bank Audi and Blom Bank's diversified income supporting earning stability and note Byblos Bank's strong focus on maintaining solid risk management practices at the expense of business expansion.

Table 1: FFA Private Bank - Lebanese Banks Coverage

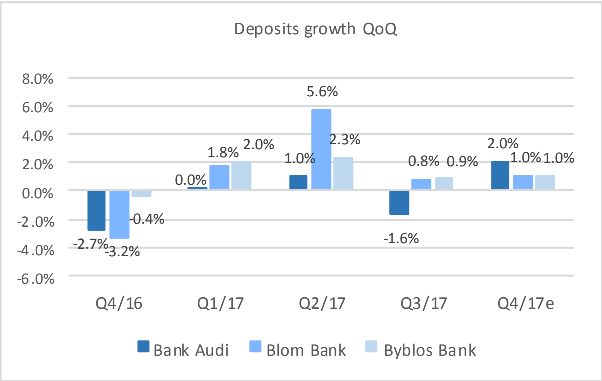
Company	Symbol	Recommendation	Target Price	Share Price *	YTD Change	P/E **	P/B to common	Dividend Yield ***
BANK AUDI	(AUDI LB)	MARKETWEIGHT	USD 7.00	USD 5.99	4.2%	6.0x	0.77x	8.3%
BLOM BANK	(BLOM LB)	OVERWEIGHT	USD 13.00	USD 11.75	1.0%	5.2x	0.89x	8.5%
BYBLOS BANK	(BYB LB)	MARKETWEIGHT	USD 1.50	USD 1.59	-0.6%	7.2x	0.64x	8.3%

Source: Company reports, BSE, FFA Private Bank estimates Note: *January 12, 2018 market close, **Based on TTM EPS, *** Based on approved dividends for 2016

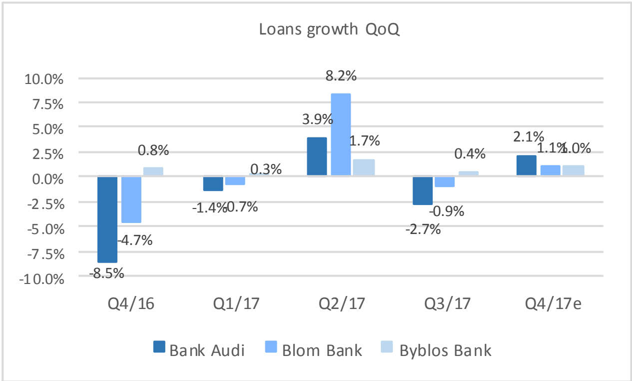
We maintain our target prices unchanged for Bank Audi, Blom Bank and Byblos Bank and note that Blom Bank is the sole Overweight in our coverage universe: We maintain our target prices for Bank Audi, Blom Bank and Byblos Bank unchanged at respective USD 7.00, USD 13.00 and USD 1.50. We note that Blom 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

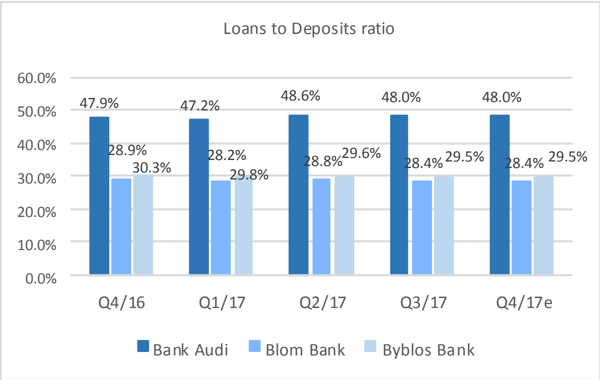
We expect a pick up in deposit growth QoQ and YoY for Bank Audi, Blom Bank and Byblos Bank amid higher interest rate environment, capped YoY by unfavorable f/x effects in foreign operations for Bank Audi and Blom Bank



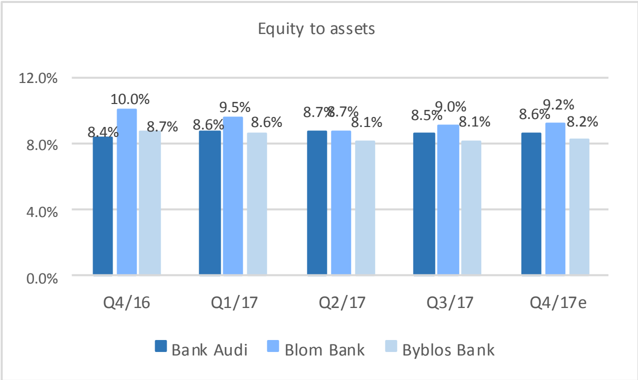
We forecast a QoQ and YoY recovery in loan growth although still at subdued levels as macro environment has yet to significantly pick up domestically and unfavorable f/x effects weigh on consolidation of foreign operations



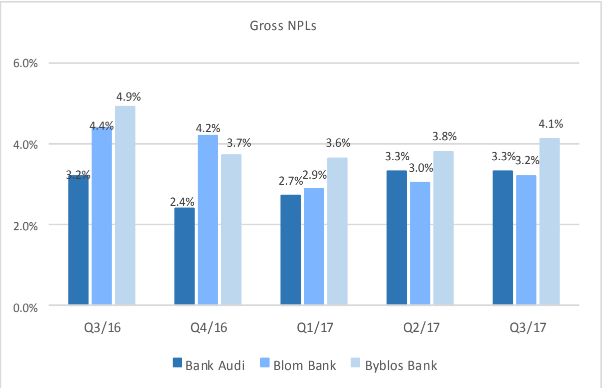
Stable LDR expected for banks under coverage, a reflection of the banks' lower risk appetite, with Bank Audi LDR forecasted at ~48% while Blom Bank and Byblos Bank expected at respective ~29% and ~30% slightly below domestic sector level of 31%



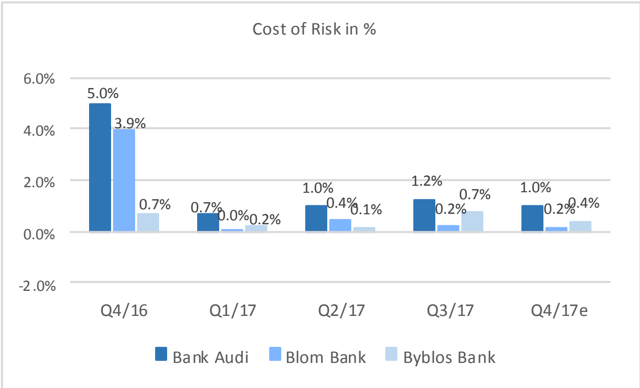
We forecast lower YoY equity to assets ratio yet higher sequentially for Blom Bank and Byblos Bank. Bank Audi's equity to assets expected to increase YoY and QoQ



Stable NPLs for Bank Audi on a sequential basis although pressured by Turkish operations while we highlight slightly higher NPLs for Blom Bank and Byblos Bank QoQ

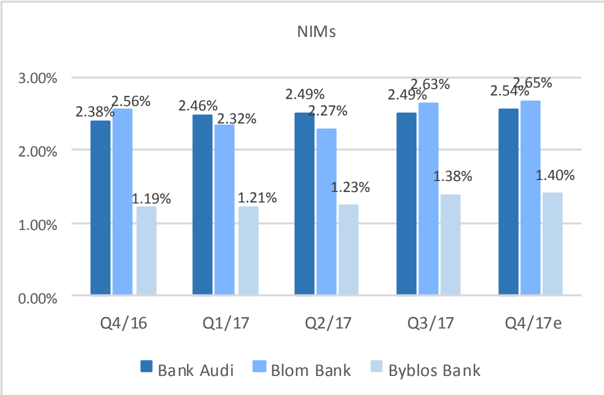


We forecast stable to lower cost of risk QoQfor Bank Audi, Blom Bank and Byblos Bank in Q4/17e. Largely lower cost of risk expected YoY as Q4/16 included banks' participation in BDL debt swap operations which resulted in stronger provisions

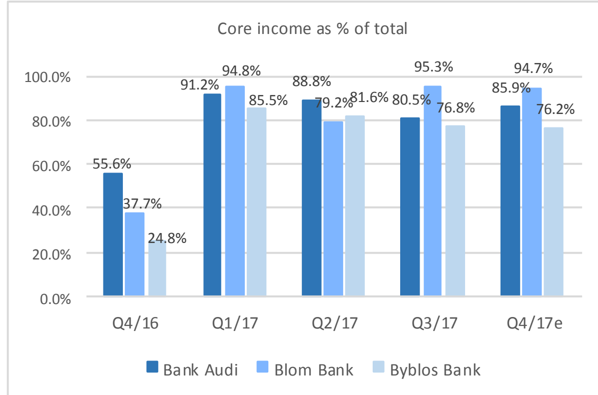


Source: Company reports and FFA Private Bank estimates

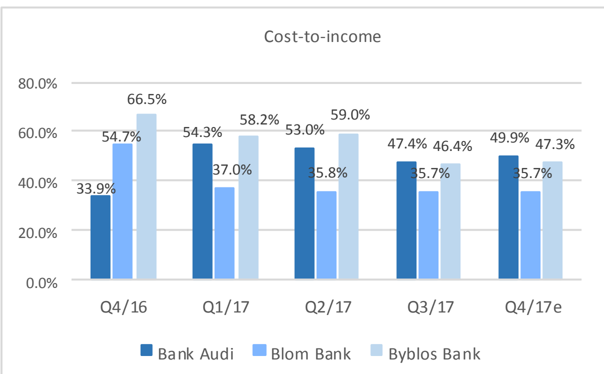
We forecast QoQ and YoY improvement in NIMs as banks under coverage operate in higher interest rate environment, particularly benefitting from attractive terms on their placements at BDL



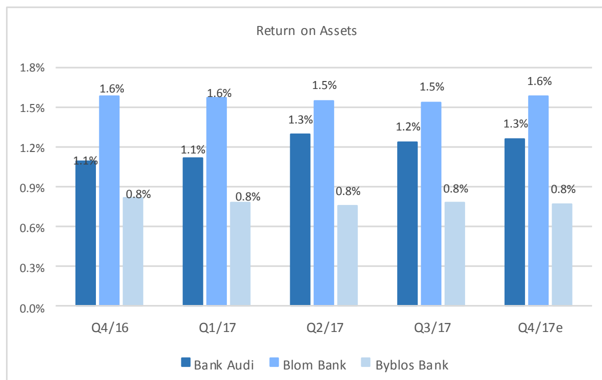
We expect income quality mix for banks under coverage in the 75%-95% range amid growth in core income of banks under coverage and contained financial gains



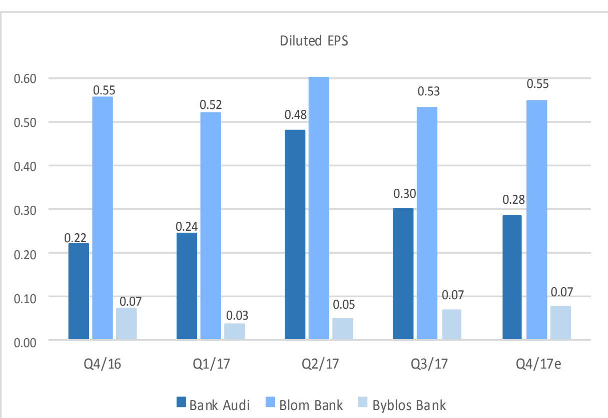
Expect stable cost-to-income QoQ for Blom Bank in Q4/17e while higher for Bank Audi and Byblos Bank despite Bank Audi' efforts at improving cost efficiencies in Turkey



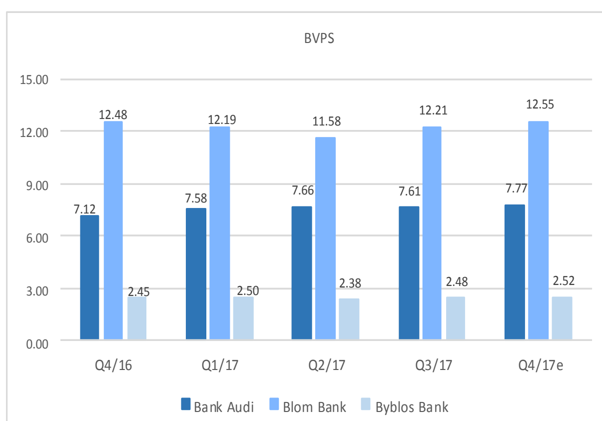
Profitability of bank under coverage expected stable to higher on a QoQ and YoY basis



We forecast stable to higher diluted EPS YoY for banks under coverage. On a QoQ basis, we expect slightly lower diluted EPS for Bank Audi, higher for Blom Bank and stable for Byblos Bank



Expect higher BVPS QoQ and YoY for Bank Audi, Blom Bank and Byblos Bank in Q4/17e



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 44.7 billion as well as earnings at USD 128.5 million in Q3/17. The Bank had a total of 208 branches and 6,995 employees as of Q3/17 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 60%/40% and 64%/36% in Q3/17. In terms of assets, Turkey is currently the biggest international market for Bank Audi with ~23% 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 Q3/17) amidst a difficult backdrop and consolidated margins to remain favorably impacted by higher margins driven largely by Turkey as they converge towards Turkish sector average.

Q3/17 Key Financial Highlights

Net profits at USD 128.5 million in Q3/17 (-35% QoQ, -17% YoY)

- Net interest income registered at USD 273.2 million in Q3/17 (+2% QoQ, +3% YoY). We estimate net interest margins at 2.47% in Q3/17 slightly lower than 2.48% in Q2/17 yet higher than 2.37% in Q3/16.
- Non-interest income came in significantly higher in Q3/17 on higher financial gains at USD 78.8 million (+90% QoQ, +306% YoY) while fees and commissions were lower at USD 52.7 million (-15% QoQ, -92% YoY). Revenue breakdown for Q3/17 shows lower contribution of core income (net interest income + fees & commissions income) to total operating income at 81% in Q3/17 down from 89% in Q2/17 and ~100% in Q3/16 which included exceptional gains from participation in BDL debt swap.
- Bank Audi saw lower cost-to-income QoQ in Q3/17 at 47.4% down from 52.9% in Q2/17 yet above Q3/16 level of 40.7%.
- Bank Audi's consolidated gross NPLs were at 3.3% in Q3/17, unchanged from Q2/17 and slightly higher than 3.2% in Q3/16 levels. Annualized cost of risk increased to an estimated 125bps in Q3/17 from an estimated 64 bps in Q2/17 yet was lower than an estimated 276 bps in Q3/16 on higher provisions QoQ at USD 53.6 million (+24% QoQ, -59% YoY).
- Softer balance sheet growth in Q3/17 with assets at +2% QoQ, deposits at -2% QoQ and loans at -3% QoQ. On a YoY basis, Bank Audi's assets were down -1% to USD 44.7 billion, deposits -3% to USD 35.7 billion and loans -9% to USD 17.1 billion.
- Bank Audi saw net profits at USD 128.5 million in Q3/17 (-35% QoQ, -17% YoY).

Latest Key Regional/Operational Highlights

- Bank Audi's breakdown of assets and earnings between domestic and international operations stood at 60%/40% and 64%/36% as of Q3/17.
- Odea Bank accumulated USD 10.1 billion in total assets representing ~23% 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 23.0 million in Q3/17 representing ~15% 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 higher.
- In Q3/17, the group had USD 3.4 billion in assets in Egypt accounting for 8% of the group assets and generated USD 19.0 million in earnings representing 9% of 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.
- 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.
- 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%).
- 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.
- 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.

FFA Model Assumptions

- We forecast net profits at USD 124.9 million in Q4/17e (-3% QoQ, +4% YoY).
- We expect net interest income at USD 281.3 million in Q4/17e (+3% QoQ, +9% YoY).
- Net fees and commissions expected to reach USD 63.5 million in Q4/17e (+21% QoQ, -4% YoY).
- We expect assets, deposits and loans at respective +1% QoQ /+2% YoY, +2% QoQ /+1% YoY, +2% QoQ /+2% YoY.
- LDR is expected at 48.0% in Q4/17e, unchanged from Q3/17 and slightly up from 47.9% in Q4/16.
- We forecast net provisions of USD 43.8 million in Q4/17e with an estimated annualized cost of risk of 96 bps for 2017e.
- Our estimate for cost-to-income in Q4/17e is at 49.9%.
- Looking at FY 2017e, net profits should reach USD 561.6 million (+19% YoY) with EPS at USD 1.30 (+25% YoY); USD 466.3 million (-1% YoY) with EPS at USD 1.05 (+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 Q4/17e	Q3/17a	Q4/16a	QoQ %	YoY %	FFA 2017e
Net Interest Income	281.3	273.2	259.1	3%	9%	1,088.9
Fees & commissions income	63.5	52.7	66.2	21%	-4%	242.9
Trading & investment income	56.7	78.8	259.8	-28%	-78%	208.8
Operating Income	401.6	404.7	585.0	-1%	-31%	1,540.7
Provisions	-43.8	-53.6	-213.6	-18%	-80%	-168.8
Operating expenses	-200.2	-192.0	-198.1	4%	1%	-786.4
Income tax	-33.2	-31.1	-68.6	7%	-52%	-122.0
Net Profits	124.9	128.6	119.8	-3%	4%	466.3
Diluted EPS	0.28	0.30	0.22	-4%	31%	1.05
Assets	45,057	44,682	44,267	1%	2%	45,057
Deposits	36,471	35,749	35,955	2%	1%	36,471
Loans	17,518	17,153	17,215	2%	2%	17,518
BVPS to common	7.77	7.61	7.12	2%	9%	7.77
FFA Net interest margins	2.54%	2.49%	2.38%			2.46%
Core income to total operating income	85.9%	80.5%	55.6%			86.4%
FFA Cost-to income ratio	49.9%	47.4%	33.9%			51.0%
Immediate liquidity-to-deposits ratio	44.8%	42.5%	43.8%			44.8%
Loans-to-deposits ratio	48.0%	48.0%	47.9%			48.0%
Equity-to-asset ratio	8.6%	8.7%	8.4%			8.6%

Note: Net profits and FFA EPS 2017e exclude profit from discontinued operations
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 Q3/17 at USD 31.8 billion as well as Q3/17 earnings at USD 123.4 million. The Bank had a total of 222 branches and 5,007 employees as of the end of Q3/17 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 Q3/17. 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.

Q3/17 Key Financial Highlights

Net profits at USD 123.4 million in Q3/17 (+2% QoQ, +5% YoY)

- Net interest income came in at USD 203.6 million in Q3/17 (+18% QoQ, +18% YoY). We estimate NIMs at 2.63% in Q3/17 significantly up from 2.27% in Q2/17 and 2.35% in Q3/16 and well-above Blom Bank's targeted range of 2.00%-2.20%.
- Non-interest income came in lower at USD 44.0 million in Q3/17 (-50% QoQ, -45% YoY) as financial gains materially declined to USD 11.7 million (-78% QoQ, -73% YoY) and fees and commissions at USD 32.3 million (-4% QoQ, -10% YoY). Revenue breakdown for Q3/17 shows an improvement in income quality mix with core income (net interest income + fees & commissions income) contribution to total operating income at 95% up from 79% in Q2/17 and 83% in Q3/16.
- Blom Bank Q3/17 cost-to-income at 36.5% up from 35.8% in Q2/17 and 34.6% in Q3/16, reflecting higher efficiencies vs. peers under coverage. Blom Bank's gross NPLs at 3.2% in Q3/17, slightly up from 3.0% in Q2/17 and down from 4.4% in Q3/16. Annualized cost of risk at an estimated 39 bps in Q3/17 down from an estimated 44 bps in Q2/17 and significantly lower than an estimated 84 bps in Q3/16 with provisions at USD 3.2 million (-63% QoQ, -80% YoY).
- Moderate balance sheet growth QoQ in Q3/17 with assets up +2%, deposits up +1% while loans underperformed at -1%. Growth more pronounced YoY with assets increasing +6% to USD 31.8 billion, deposits up +5% to USD 26.9 billion and loans up +2% to USD 7.6 billion.
- Blom Bank's net profit at USD 123.4 million in Q3/17 (+2% QoQ, +5% 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 Q3/17.
- At the end of Q3/17, the Group had USD 1.9 billion in assets in Egypt and generated USD 9.6 million in net earnings accounting for around ~6% of consolidated assets and ~8% 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 128.1 million in Q4/17e (+4% QoQ, +8% YoY).
- We expect net interest income at USD 207.6 million in Q4/17e (+2% QoQ, +13% YoY).
- Net fees and commissions expected at USD 32.5 million in Q4/17e (+1% QoQ, -15% YoY).
- We expect provisions of USD 3.1 million equivalent to an estimated annualized cost of risk at 19 bps for 2017e.
- We estimate cost-to-income at 35.7% in Q4/17 down from 36.5% in Q3/17 and 54.7% in Q4/16.
- We expect assets, deposits and loans QoQ growth at +1%, +1% and +1% while YoY growth is expected at +9%,+9%, and +8%.
- We expect LDR at 28.4% in Q4/17e unchanged from Q3/17 yet slightly lower than 28.9% in Q4/16.
- Looking at FY 2017e, net profits should reach USD 485.0 million (+5% YoY) with EPS expected at USD 2.21 (+1% YoY).

Table 3: FFA Model Forecasts

USD Million	FFA Q4/17e	Q3/17a	Q4/16a	QoQ %	YoY %	FFA 2017e
Net Interest Income	207.6	203.6	183.9	2%	13%	754.5
Fees & commissions income	32.5	32.3	38.2	1%	-15%	130.8
Trading & investment income	13.6	11.7	366.7	16%	-96%	90.5
Operating Income	253.6	247.6	588.7	2%	-57%	975.8
Provisions	-3.1	-3.4	-70.0	-9%	-96%	-14.6
Operating expenses	-90.6	-90.3	-322.2	0%	-72%	-351.2
Income tax	-31.9	-30.8	-76.9	4%	-58%	-123.2
Net Profits	128.1	123.4	118.8	4%	8%	485.0
Diluted EPS	0.55	0.53	0.55	3%	-1%	2.21
Assets	32,156	31,800	29,395	1%	9%	32,156
Deposits	27,158	26,884	24,811	1%	9%	27,158
Loans	7,706	7,625	7,164	1%	8%	7,706
BVPS to common	12.55	12.21	12.48	3%	1%	12.55
FFA Net interest margins	2.65%	2.63%	2.56%			2.41%
Core income to total operating income	94.7%	95.3%	37.7%			90.7%
FFA Cost-to income ratio	35.7%	36.5%	54.7%			36.0%
Immediate liquidity-to-deposits ratio	66.4%	66.1%	56.8%			66.4%
Loans-to-deposits ratio	28.4%	28.4%	28.9%			28.4%
Equity-to-asset ratio	9.2%	9.0%	10.0%			9.2%

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 Q3/17 at USD 22.4 billion with earnings at USD 48.3 million. The Bank had a total of 97 branches and 2,492 employees as of end of September 2017 (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 ~89%/11% as of September 2017 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.

Q3/17 Key Financial Highlights

Net profits at USD 48.3 million in Q3/17 (+29% QoQ, +18% YoY)

- Net interest income was at USD 76.0 million in Q3/17 (+15% QoQ, +24% YoY). We estimate interest margins at 1.36% in Q3/17 substantially higher than 1.22% in Q2/17 and 1.20% in Q3/16.
- Non-interest income at USD 52.7 million (+33% QoQ, -10% YoY) on higher financial gains at USD 29.8 million (+53% QoQ, -22% YoY) as well as fees and commissions at USD 22.9 million (+14% QoQ, +11% YoY). We highlight a 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 77% in Q3/17 down from 82% in Q2/117 although higher than 68.4% in Q3/16.
- Cost of risk increased to an estimated 73 bps in Q3/17 from an estimated 15 bps in Q2/17 and from an estimated 50 bps in Q3/16 on higher provisions at USD 9.7 million (+397% QoQ, +52% YoY).
- Subdued QoQ balance sheet growth in Q3/17 with assets up +3% while loans and deposits muted. Balance sheet growth more pronounced on a YoY basis with assets up +9% to USD 22.4 billion, deposits up +5% to USD 18.0 billion and loans up +3% to USD 5.3 billion.
- Assets continue to be largely funded by deposits at ~80% 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 61% in Q3/17 up from 54% in Q2/17 and 44% in Q3/16.
- Byblos Bank saw net profits at USD 48.3 million in Q3/17 (+29% QoQ, +18% YoY).

Latest Key Regional/Operational Highlights

- Byblos Bank breakdown of assets between domestic and international operations stood at ~89%/11% as of September 2017.
- 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 52.3 million in Q4/17e (+8% QoQ, +1% YoY).
- We forecast net interest income of USD 77.9 million in Q4/17e (+3% QoQ, +27% YoY).
- Net fees and commissions expected at USD 20.9 million in Q4/17e (-9% QoQ, +5% YoY).
- We expect assets, deposits and loans to grow by a respective +1% QoQ /+9% YoY, +1% QoQ /+6% YoY, +1% QoQ /+3% YoY.
- At these growth levels, LDR should be at 29.5%, unchanged from Q3/17 and down from 30.3% in Q4/16.
- We forecast provisions of USD 5.4 million in Q4/17e equivalent to an estimated annualized cost of risk at 37 bps for 2017e.
- Our cost-to-income estimate is at 47.3% for Q4/17e.
- Looking at FY 2017e, net profits should reach USD 166.8 million (+1% YoY) with EPS at USD 0.22 (+5% YoY).

Table 4: FFA Model Forecasts

USD Million	FFA Q4/17e	Q3/17a	Q4/16a	QoQ %	YoY %	FFA 2017e
Net Interest Income	77.9	76.0	61.4	3%	27%	283.5
Fees & commissions income	20.9	22.9	19.9	-9%	5%	85.2
Trading & investment income	30.9	29.8	246.2	4%	-87%	94.5
Operating Income	129.7	128.7	327.5	1%	-60%	463.2
Provisions	-5.4	-9.7	-8.5	-45%	-37%	-19.7
Operating expenses	-61.4	-59.8	-217.7	3%	-72%	-241.2
Income tax	-10.7	-10.9	-49.6	-2%	-78%	-35.6
Net Profits	52.3	48.3	51.7	8%	1%	166.8
Diluted EPS	0.07	0.07	0.07	10%	2%	0.22
Assets	22,620	22,396	20,812	1%	9%	22,620
Deposits	18,182	18,002	17,102	1%	6%	18,182
Loans	5,360	5,307	5,179	1%	3%	5,360
BVPS to common	2.52	2.48	2.45	2%	3%	2.53
FFA Net interest margins	1.40%	1.38%	1.19%			1.27%
Core income to total operating income	76.2%	76.8%	24.8%			79.6%
FFA Cost-to income ratio	47.3%	46.4%	66.5%			52.1%
Immediate liquidity-to-deposits ratio	61.1%	61.0%	48.1%			61.1%
Loans-to-deposits ratio	29.5%	29.5%	30.3%			29.5%
Equity-to-asset ratio	8.2%	8.1%	8.7%			8.2%

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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