Lebanese Banks	Bank Audi (AUDI LB)	MARKETWEIGHT	USD 7.00
Q1/14 Preview	Blom Bank (BLOM LB)	OVERWEIGHT	USD 10.00
April 16th, 2014	Byblos Bank (BYB LB)	MARKETWEIGHT	USD 1.60

Expect no sustainable multiple expansion as unfavorable economic and political conditions continue to weigh on profits and sentiment, yet note relative resilience in operations and appealing ~1x book and 5%+ dividend yield

- **Resilient growth in 2013 slows this year amidst difficult operating conditions, yet still early to draw a conclusion for the full year ahead:** Banks have been weathering the unfavorable political and economic conditions with a real GDP growth recently revised downwards to 1% for 2013e and 2014e from 1.5% previously as per the IMF. Key balance sheet indicators grew in the 7%-10% range in 2013, while profits stalled with net earnings of Alpha banks unchanged at USD 1.7 billion. While it is still early to draw a conclusion for 2014e in terms of growth in balance sheet we note a deceleration into Feb-14. Figures for the first two months of 2014 pointed to slower growth in key indicators at around 0.5% YTD, with assets, deposits and loans totaling USD 166 billion, USD 136 billion and USD 47 billion respectively. Non-resident deposits dropped by 4% in 2M-14 to USD 27 billion.

- **We expect banks under coverage to sustain moderate balance sheet growth in 2014e, with Bank Audi keeping an edge over peers driven by Turkey:** In 2013, Blom Bank and Byblos Bank saw their deposits and loans YTD growth at a respective 4% and 5% for Blom Bank and 10% in both indicators for Byblos Bank with LDRs in the 28%-31% range, while Bank Audi saw vigorous growth (deposits +16% YTD and loans +41% YTD) driven by Turkey (which accounted for 21% total assets at end-Q4/13 after 14 months of operations) and driving LDR to 48%. We expect moderate growth in balance sheet in Q1/14e across our coverage universe while Bank Audi should keep an edge in loans driven by Turkey yet at a more gradual rate (1%-2% range for Blom Bank and Byblos Bank in deposits and loans, 2% and 4% respectively for Bank Audi in deposits and loans).

- **Limited upside potential for earnings in the short term given:** i) a low interest rate environment refraining asset yields along with limited capacity to further decrease the cost of funds, ii) soft fee generation and iii) declining yet still relatively high provisioning levels . In 2013, Blom Bank increased profits by a moderate 5% which we positively view, while Byblos Bank's profits decreased by 6% on lower interest margins. Bank Audi saw the steeper decrease in earnings with a decline of 21% YoY due to lower financial gains, substantially higher opex on account of expansion in Turkey and a non-repeat of net gains incurred in 2012. Our estimates for YoY net profit growth in Q1/14e, stands in the 4%-5% range for Blom Bank and Byblos Bank while Bank Audi could surpass its peers with a 12% increase largely on account of higher balance sheet growth and margins driven by Turkey. We note that the volatility in provisions and financial gains could remain a variable and continue to monitor Odea Bank's impact after losses incurred in 2013. Expected EPS growth for the full year 2014e stands at 9%, 4% and 4% for Bank Audi, Blom Bank and Byblos Bank respectively.

- **Given attractive 5%+ yields, dividend season has seen recent investors' interest:** Dividend distribution of banks under coverage triggered local investors' appetite given generous dividend yields at 5%+ paid annually , favorable valuations at near 1x book and relative resilience in operations versus other domestic sectors. Bank Audi's BOD proposed a DPS of USD 0.40 for 2013 flat from last year, Blom Bank's BOD proposed a DPS of USD 0.50 for 2013 up from USD 0.45 in 2012, and Byblos Bank's BOD proposed a DPS of USD 0.13 unchanged from last year. At today's listed share prices, dividend yields remain attractive at 6.5%, 5.5% and 8.0% for Bank Audi, Blom Bank and Byblos Bank respectively. So far in 2014, we saw higher investors interest judging by higher trading volume on the BSE at 17.4 million share in Q1/14 (up 84% YoY), while listed shares of banks under coverage saw mixed performance (Bank Audi: -1.8% YTD, Blom Bank: +5.4% YTD, Byblos Bank: +7.7% YTD).

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 6.13	-1.8%	7.7x	1.00x	6.5%
Blom Bank	BLOM.LB	Overweight	USD 10.00	USD 9.01	+5.4%	5.7x	0.92x	5.5%
Byblos Bank	BYB.LB	Marketweight	USD 1.60	USD 1.67	+7.7%	8.4x	0.78x	7.9%

Source: Company reports, BSE, FFA Private Bank estimates Note: listed shares as of market close of April 16, 2014 **Based on TTM EPS*

- **Ultimately share prices of banks under coverage likely to remain constrained by investors looking for further visibility:** We do not see any sustainable multiple expansion on a P/E and P/B basis and expect share prices to remain constrained by investors looking for further visibility in terms of a return to growth, a pick-up in economic activity and abatement in political risks. We maintain our recommendation unchanged on the three banks (cf. table above) and remind that Blom Bank is Overweight in our coverage universe given higher than average efficiencies and ROE, stable growth in earnings despite difficult operating conditions, in addition to solid capitalization, sizeable liquidity buffers and conservative approach to growth.

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BANK AUDI

Company Description

Bank Audi is the largest bank in Lebanon in terms of assets with an asset base at USD 36.1 billion and TTM earnings at USD 305 million in 2013. The Bank had a total of 189 branches and 5,894 employees as of the end of 2013 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 57%/43% and 83%/17% in 2013. In terms of assets Turkey is currently the biggest international market for Bank Audi. The current strategy is geared towards three key markets: Lebanon, Turkey and Egypt following the active balance sheet downsizing in Syria. We highlight the Banks' sound asset quality (Gross NPL ratio at 2.7% as of Q4/13) amidst a difficult backdrop, the solid balance sheet growth and potential to pick up margins from current levels driven by turkey, as well as the Bank's proactive growth strategy.

Q4/13 Key Financial Highlights

Net profits at USD 44 million in Q4/13, EPS at USD 0.12, down from lower financial gains and higher opex

- Net profits amounted to USD 44 million in Q4/13 (~40% down QoQ and YoY). Diluted EPS was USD 0.12.
- This drop in earnings in Q4/13 can be attributed to lower financial gains and higher opex driven by expansion in Turkey. We favorably view strong revenues from core income from higher net interest income (+9% QoQ, +31% YoY) and fees and commissions (+19% QoQ, +7% YoY) to a lesser extent.
- Profits were also dragged down by a substantial amount of provisions (USD 29 million up ~100% QoQ).
- Assets and deposits grew ~5% during the quarter, while loans grew by 8% which led the LDR to 47%.

FFA Model Assumptions

- We forecast net profits of USD 95 million in Q1/14e, up 12% YoY driven by an improvement in net interest income from balance sheet growth and higher net interest margins.
- Expect net interest income to grow robustly (+27% YoY) from higher margins and vigorous earning assets momentum from Turkish expansion. In 14 months of activity the Turkish subsidiary of the Group (Odea Bank) added USD 7.6 billion to consolidated assets equivalent to 21%. Going forward, Odea Bank should continue to drive Bank Audi's margins gradually higher as Turkish banks typically boast higher margins.
- Fees and commissions are expected to be slightly higher in Q1/14e reaching USD 46 million (+4% YoY).
- Balance sheet is expected to remain driven by the branch rollout in Turkey, yet at a more moderate pace than the one seen in previous quarters. We expect QoQ growth at 2% in Q1/14e for assets and deposits, while loan growth (+4% QoQ) should remain more energetic driven by the Turkish expansion (sector's LDR in Turkey: ~110% vs. 35% for Lebanon as of Dec-13).
- The LDR is expected to trend higher reaching 48% by the end of Q1/14e.
- We forecast provisions of USD 18 million in Q1/14e in line with a gradual decrease in the cost of risk.
- Our estimate for cost-to-income in Q1/14e stands at 54%, lower than in previous quarter however still considerably higher than the pre-Turkey expansion levels.
- Looking at 2014e, net profits should total USD 340 million (+12% YoY) with EPS at USD 0.85, driven by strong net interest income growth and lower provisions. In terms of balance sheet growth, the increase in loans should trend towards more normal rates (18% in 2014e vs. 41% in 2013a). Overall balance sheet growth should remain more energetic than peers driven by the expansion in Turkey.

Table 1: FFA Model Forecasts

USD million	FFA Q1/14e	Q4/13a	Q1/13a	QoQ %	YoY %	2013a	FFA 2014e
Net interest income (NII)	179	185	142	-3%	26%	655	734
Operating income	295	260	255	14%	16%	1,071	1,168
Net profits	95	44	85	119%	12%	305	341
Diluted EPS	0.25	0.12	0.23	107%	9%	0.80	0.87
Assets	36,624	36,117	33,284	1%	10%	36,117	39,762
Deposits	31,703	31,095	28,735	2%	10%	31,095	34,553
Loans	15,243	14,704	11,587	4%	32%	14,704	17,290
BVPS to common	6.32	6.17	6.36	2%	-1%	6.17	6.81
FFA Cost-to-income ratio	54.0%	68.6%	51.8%			56.1%	57.5%
Loans-to-deposits ratio	48.1%	47.3%	40.3%			47.3%	50.0%

Source: Bank Audi and FFA Private Bank estimates

Investment Opinion

We value Bank Audi's domestic leadership, asset quality and improving margins, however investors likely to remain on the sidelines waiting for more visibility in terms of generating returns from its growth strategy

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 gradually higher margins. We seek Turkish operations to pare back losses towards breakeven in the shorter term as branch network gains in maturity. We continue to rate Bank Audi shares at Marketweight although recognize upside potential for the shares in the medium to longer term once investors gain greater confidence on management's execution of its growth plan.

Target Price Revision and Recommendation

We reiterate our Marketweight rating on Bank Audi shares with a fair value at USD 7.00 per share

Based on our revised forecasts and discount rate assumptions to our Dividend Discount Model, our fair value estimate for Bank Audi is at USD 7.00 per share. Our DDM assumes a 14.5% cost of equity and a 3% 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.

BLOM BANK

Company Description

Blom Bank is the second largest Bank in Lebanon in terms of assets with an asset base at USD 26.1 billion and TTM earnings at USD 352 million in 2013. The Bank had a total of 212 branches and 4,503 employees as of the end of 2013 with operations in its domestic market Lebanon as well 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 78%/22% and 83%/17% in 2013. The Bank's current strategy is geared towards two key markets: Lebanon and Egypt as the Bank's operations in Syria have been downsized in terms of balance sheet. Egypt 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 historically surpassed its peers in terms of profitability levels and cost-efficiencies.

Q4/13 Key Financial Highlights

Net profits at USD 88 million in Q4/13, 4% up yoy

- Blom Bank's net profits amounted to USD 88 million in Q4/13, edging up 4% YoY, while diluted EPS was USD 0.41 vs. USD 0.38 in Q4/12.
- In Q4/13 net earnings benefited from moderate core income growth including net interest income (+5% YoY to USD 135 million) and stable fees and commissions income. In parallel, financial gains dropped significantly (-52% to USD 16 million) which was offset by lower provisions down by half to USD 9 million, in the context of unchanged efficiencies.
- Cost-to-income ratio was 36% in Q4/13.
- Key balance sheet indicators grew in the 1%-2% range QoQ in Q4/13 with an LDR at 28%.

FFA Model Assumptions

- We expect earnings of USD 90 million in Q1/14e, up 4% YoY and flat QoQ.
- We forecast operating income at USD 206 million in Q1/14e roughly flat YoY, yet 12% up QoQ.
- We expect net interest income to edge up in Q1/14e (+1% QoQ, +6% YoY) as roughly flat margins are likely to be matched with moderate earnings assets growth. We expect stable fees and commissions at around USD 30 million for the quarter.
- We forecast provisions of USD 16 million, slightly lower than the average per quarter reached in 2013 on account of lower cost of risk. Our cost-to-income estimate stands at 38% in Q1/14e (within the Bank's usual 35%-38% range).
- Key balance sheet indicators are expected to grow at a low single digit in Q1/14e, edging up ~1% for assets, deposits and loans.
- The LDR should remain roughly unchanged at 28% reflecting ample liquidity and significant room to expand lending from current levels.
- For the year 2014e, net profits should total USD 365 million (+4% YoY) with EPS at USD 1.62. On the balance sheet side, growth of key indicators namely assets, deposits and loans should be in the 5%-6% range.

Table 2: FFA Model Forecasts

USD million	FFA Q1/14e	Q4/13a	Q1/13a	QoQ %	YoY %	2013a	FFA 2014e
Net interest income (NII)	137	135	130	1%	6%	533	564
Operating income	206	184	210	12%	-2%	803	824
Net profits	90	90	87	0%	4%	352	365
Diluted EPS	0.40	0.41	0.39	-3%	2%	1.58	1.62
Assets	26,481	26,150	25,112	1%	5%	26,150	27,569
Deposits	22,818	22,572	21,792	1%	5%	22,572	23,704
Loans	6,435	6,345	6,059	1%	6%	6,345	6,756
BVPS to common	10.03	9.75	9.23	3%	9%	9.75	10.87
FFA Cost-to-income ratio	*38.0%*	*36.3%*	*35.8%*			*36.8%*	*37.4%*
Loans-to-deposits ratio	*28.2%*	*28.1%*	*27.8%*			*28.1%*	*28.5%*

Source: Blom Bank 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 like the firm's conservative strategy translating into superior profitability and return ratios relative to its domestic peers despite sizeable liquidity buffers. In the short term, we look to the prudent management team to focus on limiting asset quality deterioration in light of difficult operations in key regional markets, while steadily growing earnings.

Recommendation

We reiterate our Overweight rating on Blom Bank shares with a fair value at USD 10.00 per share
Based on our revised forecasts and discount rate assumptions to our Dividend Discount Model, our fair value estimate has been maintained at USD 10.00 per share. Our DDM assumes a 15.5% cost of equity and a 3% 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.

BYBLOS BANK

Company Description

Byblos Bank is the third largest Bank in Lebanon in terms of assets with an asset base at USD 18.5 billion and TTM earnings at USD 157 million in 2013. The Bank had a total of 101 branches and 2,536 employees as of the end of 2013 with operations in Lebanon as well across Europe, Africa and the MENA region. The Bank diversification across markets is lagging behind its peers with a breakdown of assets and earnings between domestic and international at 89%/11% and 87%/13% as of 2013. The Bank's balance sheet is mainly focused on Lebanon after operations in Syria have been downsized. The Bank has so far adopted a conservative growth strategy translating into ample liquidity levels and solid capitalization at the expense of weaker margins and profitability.

Q4/13 Key Financial Highlights

Net profits at USD 44 million in Q4/13, roughly flat YoY

- Net profits amounted to USD 44 million in Q4/13, roughly flat YoY, with diluted EPS at USD 0.05.
- Flat earnings YoY can be explained by lower operating income from weaker net interest income (-9% YoY to USD 62 million) and financial gains (-53% to USD 22 million) offset by lower provisions down by half to USD 2 million, reaffirming a trend of declining provisions we started seeing in the second half of 2013.
- The cost-to-income ratio was at 46% in Q4/13 and for the full year 2013, unchanged compared to 2012.
- On the balance sheet side, the Bank saw a healthy single digit growth in assets and deposits during Q4/13 in the 2%-3% range to USD 18.5 billion and USD 14.7 billion respectively by the end of 2013, while the growth in loans was more energetic at 6% QoQ to USD 4.5 billion.

FFA Model Assumptions

- We expect net profits of USD 37 million in Q1/14e, up 5% YoY yet down 14% QoQ.
- We forecast net interest income of USD 62 million in Q1/14e roughly flat QoQ and YoY as we expect net interest margins to remain unchanged in parallel to a soft growth in balance sheet.
- Fees and commissions income expected at 23 million in Q1/14e, up 3% YoY and unchanged QoQ.
- Key balance sheet indicators namely assets, deposits and loans are expected to witness moderate growth at a low single digit in Q1/14e (+2% QoQ), with an LDR maintained at 31%.
- We forecast provisions of USD 15 million in Q1/14e. Our cost-to-income estimate stands at 49% in Q1/14e and 46% for the full year 2014e (roughly flat from 2013a).
- Looking at the full year 2014e, net profits should reach USD 164 million (+4% YoY) with EPS at USD 0.21. Assets, deposits, and loans should amount to USD 19.8 billion, USD 15.9 billion and USD 4.9 billion respectively by the end of the year following YTD growth rates in the 7%-9% range.

Table 3: FFA Model Forecasts

USD million	FFA Q1/14e	Q4/13a	Q1/13a	QoQ %	YoY %	2013a	FFA 2014e
Net interest income (NII)	62	62	63	1%	-2%	238	256
Operating income	118	107	115	10%	3%	454	477
Net profits	37	44	36	-14%	5%	157	164
Diluted EPS	0.05	0.05	0.05	-17%	-2%	0.20	0.21
Assets	18,941	18,486	17,604	2%	8%	18,486	19,843
Deposits	15,050	14,749	13,695	2%	10%	14,749	15,929
Loans	4,620	4,513	4,030	2%	15%	4,513	4,937
BVPS to common	2.15	2.14	2.15	1%	0%	2.14	2.23
FFA Cost-to-income ratio	*49.3%*	*46.0%*	*48.4%*			*46.1%*	*45.9%*
Loans-to-deposits ratio	*30.7%*	*30.6%*	*29.4%*			*30.6%*	*31.0%*

Source: Byblos Bank 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.

Recommendation

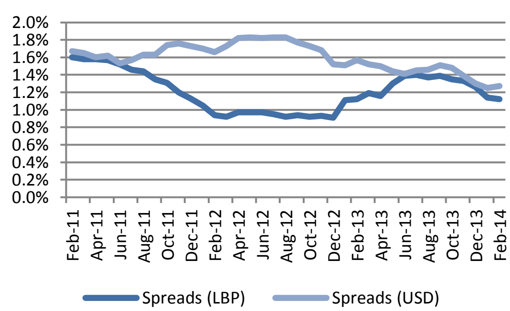
We reiterate our Marketweight rating on Byblos Bank shares with a fair value of USD 1.60 per share

Based on our revised forecasts and discount rate assumptions to our Dividend Discount Model, our fair value estimate has been maintained at USD 1.60 per share. Our DDM assumes a 15.5% cost of equity and a 3% 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.

Lebanese Banking Sector Highlights

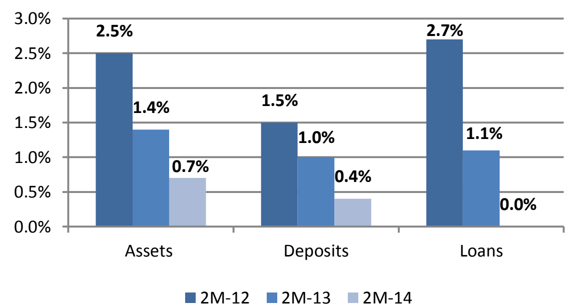
- **Resilient growth in 2013 slows amidst difficult operating conditions, yet still early to draw a conclusion for the full year ahead:** Banks have been weathering the unfavorable political and economic conditions with a real GDP growth recently revised downwards to 1% for 2013e and 2014e from 1.5% previously as per the IMF. Key balance sheet indicators grew in the 7%-10% range in 2013, while profits stalled with net earnings of Alpha banks unchanged at USD 1.7 billion. While it is still early to draw a conclusion for 2014e in terms of growth in balance sheet we note a deceleration into Feb-14. Looking into 2014, figures for the first two months pointed to slower growth in key indicators at around +0.5% YTD, with assets, deposits and loans totaling USD 166 billion, USD 136 billion and USD 47 billion respectively. Non-resident deposits dropped by 4% in 2M-14 to USD 27 billion. We note an LDR at 35% in February 2014, reflecting ample liquidity and a dollarization of deposits and loans at 66% and 76% respectively.

Figure 1: Spreads in USD and LBP



Source: Association of Banks in Lebanon

Figure 2: YTD growth in two first months of the year



Source: BDL

- **Latest statistics highlight that Lebanese banks are still operating in an environment limiting potential for earnings growth**. Banking sector's profits trended flat in 2013 on account of pressured margins, relatively high provisions against difficult backdrop, slower fee income and moderate balance sheet expansion. Alpha banks saw their profits unchanged in 2013 at USD 1.7 billion. Statistics from the ABL reveal that Lebanese banks are still operating in a low interest environment, limiting potential to improve earning asset yields within little room to further decrease the cost of funds. Spreads in USD decreased to 1.27% in February 2014 down from 1.57% one year earlier which has a substantial impact on Lebanese Bank's profitability given that the bulk of their liquidity is in USD. This decrease was driven by a 6 bps increase in the cost of funds in addition to a 24 bps decline in the weighted return on uses of funds from i) lower average rate on USD deposits at the BDL (down 69 bps to 2.10%) ii) lower weighted average yields on Eurobonds (down 33 bps to 6.73%), iii) lower weighted average lending rate (down 8 bps to 6.89%) and iv) lower 3-month Libor on USD deposits (down 5 bps to 0.24%). On the LBP side, we highlight that interest spreads were unchanged in February 2014 from one year earlier.

- **Sovereign ratings of Lebanon were downgraded by various rating agencies in 2013**, which cited the increased political risk, weak economic conditions and deteriorating public finance and debt. Last year Lebanon was assigned lower outlooks by the three main credit agencies: Fitch revised the outlook on Lebanon from stable to negative while maintaining its B long term ratings unchanged. Moody's also revised the outlook on Lebanon from stable to negative while maintaining its B1 long term rating. Standard and Poor's which downgraded the long term rating on Lebanon from B to B- and the outlook from stable to negative, recently reversed the outlook to stable citing the country's stable financial system, steady deposits inflows and recent cabinet formation. While less likely should Republic of Lebanon's ratings be downgraded further this could potentially add strain on banks capitalization levels to abide by Basel given the banks sizeable exposure to Lebanese securities.

- **Recently proposed taxes on banks to fund public sector wages could be a drag on profitability.** The Government is currently proposing increasing taxes on interest earned on deposits as well as on income earned from financial assets tied to sovereign securities. The tax on interest earned on deposits could slow deposits growth which has already seen deceleration in the first two months of 2014 while tax on income earned from financial assets could impact profitability. We note that since details are lacking and the law is yet to be agreed upon, we have not reflected this impact on the forecast of banks under coverage. The ongoing debate over the funding of the increase in public sector wages was put forward two weeks.