Lebanese Banks	Bank Audi (AUDI LB)	MARKETWEIGHT	↑ USD 7.50
Q4/13 Preview	Blom Bank (BLOM LB)	OVERWEIGHT	USD 10.00
January 15th, 2014	Byblos Bank (BYB LB)	MARKETWEIGHT	USD 1.60

While Lebanese banks trade at an appealing ~1x book valuation and offer attractive 5%+ dividend yields, we do not expect to see multiple expansion until earnings accelerate and heightened political risks subside

■ **Lebanese banks reported moderate balance sheet expansion in 11M/13** weathering the sluggish economic environment as suggested by assets, deposits and loans growing at a mid-to-high single digit rate. Latest figures pointed to growth in key indicators in the 6%-8% range in 11M/13 with assets, deposits and loans totaling USD 162 billion, USD 133 billion and USD 47 billion respectively. Non-resident deposits grew by 12.5% to reach USD 27 billion at the end of Nov. 2013 despite the rising political risks, and weak economic conditions with an estimated real GDP growth at 1.5% in 2013e as per the IMF. The sector's LDR was at 35% reflecting ample liquidity, while dollarization of deposits and loans was at a respective 66% and 77%.

■ **Turkey should remain the main driver for Bank Audi, further distancing it from Blom Bank and Byblos Bank in terms of size yet at a normalizing pace**.In 9M/13, Blom Bank and Byblos Bank saw their deposits and loans Ytd growth at a respective 2% and 3% for Blom Bank and a respective 8% and 3% for Byblos Bank with LDRs in the 28%-30% range, while Bank Audi saw vigorous growth (deposits +10% Ytd and loans +30% Ytd) triggered by Turkey (which accounted for 19% total assets at end-Q3/13 after just 11 months of operations) and driving LDR to 46%. In Q4/13e, a similar growth to the one seen in previous quarters should be maintained, lifting the 2013e growth of deposits and loans to 13% and 36% for Bank Audi, 4% and 6% for Blom Bank, 10% and 6% for Byblos Bank. In 2014e we expect Blom Bank and Byblos Bank to increase deposits and loans by a mid-single digit growth rate with the latter keeping an edge in deposits growth from higher cost of funds. Bank Audi deposits and loans growth are expected to stand at a respective 15% and 19% for 2014e, still outpacing peers yet at a more gradual growth rate.

■ **Besides heightened growth expectations for Bank Audi, we still see only moderate upside to peers' earnings given:** i) a low interest rate environment and a limited capacity to further decrease the cost of funds, ii) soft fee generation and iii) still relatively high provisioning levels. Our estimates for YoY net profit growth excluding non-recurring items in Q4/13e, stands at +22% (from unusually low earnings in Q4/12 due to heavy provisions and expenses) +2% and -8% for Bank Audi, Blom Bank and Byblos Bank respectively and note that the volatility in provisions and financial gains could remain a key variable. In 2014e, we expect that Blom Bank and Byblos Bank will grow net profits by a mid-single digit rate, contrasting with an estimate of ~15 % for Bank Audi explained by stronger NII growth than peers (from rising volumes and potential for better margins in Turkey) alleviating provisions and improving cost-efficiencies. Over the next 5 years, Turkey could represent over 20% of total profits.

■ **We revised our target price on Bank Audi upwards to USD 7.50 on account of rising growth prospects although enthusiasm is tempered from rising political risks and weak economic conditions.** Based on our revised forecasts and discount rate to our DDM our fair value estimate for Bank Audi was increased to USD 7.50 from USD 7.00 previously. We are currently encouraged by the Bank expansion in Turkey which should drive consolidated earnings growth and its diversification away from Lebanon risk. Given the Ytd performance, we expect the Bank to breakeven in Turkey in the short term as costs alleviate and margins gradually improve. On a consolidated level, we like Bank Audi's improving asset quality and value the attractiveness of its valuation at 1x book and div. yield at 6.3%.While investors could currently find a good entry point ahead of dividend season and breaking even in Turkey, we mitigate our enthusiasm based on the elevated political risk and domestic economic slowdown.

FFA Private Bank Lebanese Banks Coverage

Company	Ticker	Recommendation	Target Price	Listed shares Priced as of Jan. 15, 2014	P/E *	P/B to common	Dividend Yield
Bank Audi	AUDI.LB	Marketweight	↑ USD 7.50	USD 6.40	7.5x	1.02x	6.3%
Blom Bank	BLOM.LB	Overweight	USD 10.00	USD 8.25	5.3x	0.88x	5.5%
Byblos Bank	BYB.LB	Marketweight	USD 1.60	USD 1.61	7.7x	0.79x	8.2%

Source: Company reports, BSE, FFA Private Bank estimates Note: Based on a TTM EPS, Bank Audi's P/E includes one-time items in Q4/12*

■ **While Lebanese banks' shares trade at an appealing ~1x book valuation and attractive 5%+ dividend yield, their share price remain constrained by investors looking for further visibility in terms of a return to growth and abatement in political risks**
Sluggishness persisted on the BSE throughout 2013 as highlighted by total trading volumes down 7% from 2012 to 51 million shares and price performance remaining lackluster. While banks under coverage could benefit from their relative resilience in operations and favorable valuations at near 1x book with generous dividend yields at 5%+ (which tend to get paid in April of each year), we do not see any multiple expansion and expect share prices to remain constrained by investors who remain on the sidelines awaiting greater clarity towards a return to growth and abatement in political risks.

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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 34.5 billion and TTM earnings at USD 329 million as of 9M/13. The Bank had a total of 176 branches and 5,671 employees as of the end of Sep-13 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 79%/21% as of 9M/13. 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' improving asset quality (Gross NPL ratio at just 2.2% as of Q3/13) 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.

Q3/13 Key Financial Highlights

Net profits at USD 73 million in Q3/13, EPS at USD 0.19, dragged down by lower financial gains

- Net profits amounted to USD 73 million in Q3/13 (-29% QoQ, -8% YoY). Diluted EPS was USD 0.19.
- This drop in earnings in Q3/13 can be attributed to lower financial gains (-58% QoQ, -55% YoY). We favorably view strong revenues from core income which were mainly driven by net interest income (+7% QoQ, +15% YoY) and fees and commissions (+4% QoQ, +14% YoY) to a lesser extent.
- Provisions declined at higher than expected pace in the context of improving asset quality and partially offsetting the drop in income. Provisions amounted to USD 14 million in Q3/13.
- Assets and deposits grew 10% Ytd, while loans grew by 30% which led the LDR to 46%.

Q3/13 Key Regional Highlights

- Bank Audi breakdown of assets and earnings between domestic and international operations stands at 59%/41% and 79%/21% respectively for the 9M/13 period.
- In just 11 months of activity Odea Bank accumulated USD 6.6 billion in total assets representing 19% of the group total assets and is gradually converging towards breakeven in profits.
- The Bank operations in Syria were downsized to just 1% of consolidated assets and 4% of consolidated profits as of 9M/13, thus limiting the exposure of Bank Audi to Syria's heightened risk.
- The Bank has been accounting for net profits in Egypt in the last two years after the bulk of profits were allocated to provisions in 2011 in the outbreak of the political crisis. In 9M/13, the Group generated USD 39 million in earnings from Egypt accounting for 15% of consolidated profits.
- Given the extreme tensions in Syria, the Bank's key growth markets are: Lebanon, Turkey and Egypt.

Table 1: Key Indicators on Regional Operations as of Q3/13

USD million	Assets	Growth YTD	As % of total assets	Net profits in 9M/13	Growth YoY	As % of total profits	Gross NPL ratio	Collective provisions in 9M/13	Specific provisions in 9M/13
Turkey	6,588	+225%	19%	-24.3	n/a	n/a	n/s*	9.0	
Egypt	3,137	-8%	9%	39.3	+46%	15%	2.6%	-	28.4
Syria	353	-44%	1%	10.4	10.4 vs. -0.2 in 9M/12	4%	26.0%	8.8	43.2 (adj.)

*Note: the Bank also has operations in Europe, Jordan, Sudan, KSA and Qatar, * not significant*

FFA Model Assumptions

FFA Q4/13e model assumptions

- We forecast net profits of USD 95 million in Q4/13e, up 41% YoY (+22% YoY before non-recurring impairments in Q4/12)and up 30% QoQ as lower than usual financial gains dragged down profits in Q3/13.
- Expect NII to grow robustly (+18% YoY) from an improvement in margins and vigorous earning assets momentum from Turkish expansion. In 11 months of activity the Turkish subsidiary of the Group (Odea Bank) added USD 6.6 billion in assets, or 19% of consolidated assets. In parallel Odea Bank should drive Bank Audi's margins gradually higher as Turkish banks typically boast higher margins (3.5% vs.2% in 2012).
- Fees and commissions could exceed the USD 50 million level similar to Q4/12, which represents flat YoY growth and a significant increase from previous quarter.
- 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 as the growth starts normalizing. We expect QoQ growth at 2% in Q4/13e for assets and deposits, while loan growth (+5% QoQ) should remain more energetic driven by the Turkish expansion (sector's LDR in Turkey: 107% vs. 35% for Lebanon as of Sep-13).
- The LDR is expected to trend higher reaching 47% by the end of Q4/13e.
- We forecast provisions of USD 16 million roughly unchanged from previous quarter. Our expectations for cost-to-income stands at 53% lower than the 57% reached in Q4/12 as one-time costs attributed to the launch of Turkish operations subside.

FFA 2013e and 2014e model assumptions

- Taking into account these assumptions, net profits should total USD 357 million in 2013e (-7% YoY; +5% YoY when excluding results from discontinued operations in 2012) and the EPS should stand at USD 0.90. Assets, deposits, and loans should grow at a respective 12%, 13% and 36%.
- In 2014e, loans growth should trend towards more normal rates (19% in 2014e vs. 36% in 2013e). Overall balance sheet growth should remain more energetic than peers driven by the expansion in Turkey. Earnings should grow 15% driven by strong NII growth, alleviating provisions and better efficiencies.
- Given the 20%+ devaluation of the Turkish Lira in 2013, we performed a sensitivity analysis on Odea Bank, assuming a +/- 5% change in the Turkish Lira. With TRY 13.5 billion in assets (of which 64% in TRY and 36% in FC) and TRY 12.5 billion in liabilities (of which 52% in TRY and 48% in FC), representing an asset/liability mismatch of TRY 1.1 billion equivalent of FC. We estimate every +/-5% change in the Turkish Lira would impact capitalization by ~ 35 bps. While we also expect an impact on the income statement, we do not expect it to be material at this stage. The Bank is currently exploring possible fx hedges.

Table 2: FFA Model Forecasts

USD million	FFA Q4/13e	Q3/13a	Q4/12a	QoQ %	YoY %	FFA 2014e	FFA 2013e
Net interest income (NII)	166.1	169.8	141.3	-2%	18%	733.2	636.4
Operating income	291.4	256.1	285.0	14%	2%	1221.8	1102.2
Net profits	95.4	73.1	67.7	30%	41%	417.0	356.8
Diluted EPS	0.24	0.19	0.18	26%	36%	1.06	0.90
Assets	35,017	34,470	31,302	2%	12%	40,319	35,017
Deposits	30,169	29,471	26,805	2%	13%	34,944	30,390
Loans	14,189	13,565	10,428	5%	36%	16,890	14,189
BVPS to common	6.79	6.59	6.33	3%	7%	7.61	6.79
FFA Cost-to-income ratio	*53.0%*	*58.0%*	*57.0%*			*50.7%*	*52.3%*
Loans-to-deposits ratio	*47.0%*	*46.0%*	*38.9%*			*48.3%*	*46.7%*

Source: Bank Audi and FFA Private Bank estimates

Investment Opinion

We value the Bank leadership at navigating through tough operating conditions & the restart of its growth plan

Bank Audi is the leader among Alpha Banks in terms of assets, deposits, and earnings, has 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. At this pace, operations in Turkey should converge towards breaking even in the short term and translate into a positive contribution in the medium term while driving shares higher as investor concerns regarding key regional operations and earnings slowdown subside. The market currently provides investors with a good entry point ahead of dividend season and targeted breakeven in Turkey at an attractive 1x P/B valuation. 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.

- **Ambitious and proactive growth strategy based on market diversification away from Lebanon's risk**

Bank Audi's growth strategy is currently geared towards: Lebanon, Turkey and Egypt in the context of a quick deleveraging in Syria. Latest financial results (9M/13) highlight that the assets breakdown between Lebanon and abroad stood at 59%/41% with the Bank targeting 55%/45% by 2015e. As for the earning breakdown between Lebanon and abroad it stood at 79%/21% with the Bank targeting 65%/35% by 2015e. While Bank Audi's operations are focused on Lebanon, the Bank's assets allocation highlights a substantial exposure to Egypt and Turkey (9% and 19% respectively), while the Bank generated 15% of its profits from Egypt in 9M/13 and should gradually converge towards breaking even in Turkey (cf. next paragraph).

- **Expansion in Turkey translates into solid growth in assets&gradual convergence towards breaking even**

The current balance sheet size of Bank Audi comprises USD 34.5 billion in assets, USD 29.5 billion in deposits and USD 13.6 billion in loans, with the contribution of Turkey at 19%, 17% and 31% of totals assets, deposits and loans respectively. In just 11 months of operations Bank Audi was able to build a network of 20 branches and 905 employees organically rather than through acquisition of an existing player. Assets, deposits and loans of Odea Bank stood at USD 6.6 billion, USD 4.9 billion and USD 4.2 billion respectively. In 3-5 years from now the target is to reach USD 15 billion in assets. This growth pattern could lead Bank Audi away from its peers in terms of balance sheet and profits which we are following closely. We note that Bank Audi seeks to breakeven in Turkey in the short term as we highlight a net loss of USD 14.5 million in Q1/13 which shrank to USD 4 million and USD 6 million in Q2/13 and Q3/13 respectively. Over next 3-5 years, Turkey could represent over 20% of consolidated profits. Bank Audi typically frontloads expenses during the rollout of its branch network which puts a drag on profits in the short term although could prove beneficial rather than buying an existing bank network at a premium to book value (particularly that Bank Audi shares currently trade at ~1x book.)

- **Net interest income expected to trend positively driven by a potential to improve margins in Turkey**

Net interest income is seeing solid growth (+7% QoQ, +15% YoY in Q3/13) mainly stemming from earning assets growth driven by Turkish entity and from an improvement in interest spreads to a lesser extent (despite Lebanese banks still operating in a low interest environment limiting potential to improve earning asset yields). In fact, spreads of Odea Bank are increasing (Q1/13: 0.65%, Q2/13: 1.3%, Q3/13: 1.7%) as cost of deposits is gradually decreasing in addition to increased lending volumes. Looking ahead, Bank Audi's margins should continue to benefit from a gradual decrease in the cost of funds in Turkey as well as from a redeployment of liquidity into more attractive yielding avenues including lending in the Turkish market. We note that interest spreads in Turkish banking sector were at 3.5% for 2012 vs. 2.0% for the Lebanese banking sector which represents favorable upside although could be impacted in the short term because Turkish Lira volatility on its USD based liabilities.

- **Adequate capitalization strategy facing the expansion in Turkey fueled by recent issues and internal funds**

We highlight the recent USD 350 million subordinated debt issue which helped the Bank's CAR III ratio virtually reach 12% (11.8% in Q3/13 from 10.3% in Q2/13), a required level set by Lebanese regulators to be met by the end of 2015e in the framework of Basel III. This issue and a previous preferred shares issue in 2013 (amounting to USD 225 million to replace a USD 150 million maturing series of preferred shares) along with internally generated funds were aimed at financing the expansion in Turkey.

- **Improving asset quality as highlighted by noticeably low gross NPL ratio and alleviating provisioning levels that could ease pressure on the bottom line**

In light of a smaller balance sheet in Syria and already satisfactory provisioning levels, we started seeing a trend of declining provisioning in Q3/13 at a higher than expected pace. In parallel we favorably view an improving asset quality as highlighted by a noticeably low gross NPL ratio (at 2.2% significantly lower than peers under coverage) which has been seeing further improvement in the past few quarters (2.2% in Q3/13 down from 2.7% in Q4/12).

- **At this time, investors could find a good entry point ahead of dividend season and targeted breakeven in Turkey**

Bank Audi paid its dividends for 2012 in April 2013 with common shareholders receiving LBP 603 per share (USD 0.40 gross or USD 0.38 net of 5% withholding tax). The dividend payment for 2013 is expected in April 2014. In terms of breakeven in Turkey, quarterly losses declined over the past three quarters possibly gearing towards breaking even in the short term. We remind the relative attractiveness of Lebanese banks dividends and we note that Lebanon has one of the highest dividend yield in the MENA+Turkey region. We calculated an average dividend yield for banks in MENA and Turkey at 3.6% versus an average of 4.6% for banks in Leb. (cf. appendix).

- **We highlight the attractive valuation of Bank Audi at 1x P/B to common with a 6.3% dividend yield**

Based on today's listed share price of USD 6.40, Bank Audi is trading at 7.5x P/E, 0.83x P/B (P/B to common of 1.02x) dividend yield of 6.3% and TTM ROE of 12.5%. For a benchmark, banks in the MENA region (including Turkey) trade at an average 12.5x P/E, 1.5x P/B and offer 3.6% dividend yield and a 14.5% ROE. (cf. appendix).

Target Price Revision and Recommendation

We reiterate our Marketweight rating on Bank Audi shares with a fair value increase to USD 7.50 per share from USD 7.00 previously

Based on our revised forecasts and discount rate assumptions to our Dividend Discount Model, our fair value estimate has been increased to USD 7.50 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. Our target price of USD 7.50 equates to ~ 1x P/B on our 2014e BVPS estimates.

Key Investment Risks

- High exposure of Lebanese Banks to the sovereign in light of weak economic conditions, worsening public finances and higher debt/GDP ratio.
- Signs of deceleration in non-resident deposit growth and weaker capital inflows which typically fuel the liquidity in the banking sector and the appetite to purchase additional government securities.
- Execution risks in growth markets particularly Turkey.
- Political instability and heightened security events in Lebanon.

BLOM BANK

Company Description

Blom Bank is the second largest Bank in Lebanon in terms of assets with an asset base at USD 25.7 billion and TTM earnings at USD 347 million as of 9M/13. The Bank had a total of 213 branches and 4,446 employees as of the end of September 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 79%/21% as of 9M/13. 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.

Q3/13 Key Financial Highlights

Net profits at USD 87 million in Q3/13, 2% up yoy

- Blom Bank's net profits amounted to USD 86.9 million in Q3/13, edging up 2% YoY, while diluted EPS was USD 0.39 vs. USD 0.40 in Q3/12.
- The YoY flat bottom line figure in Q3/13 can be attributed to roughly stable income from core activities including net interest income (+1% to USD 135 million) and fees and commissions income (+5% to USD 28 million). In parallel, financial gains dropped significantly (-72% to USD 12 million) which was offset by lower provisions (USD 0.4 million reversal vs. provisions of USD 21.5 million in Q3/12) and non-personnel expenses (-24% to USD 25 million).
- Cost-to-income ratio increased to 40% in Q3/13 (exceeding the Bank's usual 35%-38% range) on account of lower operating income, yet was maintained at 37% for the nine month period.
- We were anticipating soft growth in key balance sheet indicators which came in line for deposits and assets. Lending was slightly more energetic than expected (at 4% QoQ). LDR edged up to 27.9%.

Q3/13 Key Regional Highlights

- Blom Bank breakdown of assets and earnings between domestic and international operations stands at 78%/22% and 79%/21% respectively
- The Bank operations in Syria have been downsized to just 1.5% of total assets and 2.5% of total profits as of 9M/13, thus limiting the exposure of Blom Bank to Syria's heightened risk.
- Within the context of extreme tensions in Syria, the Bank's key growth markets are: Lebanon and Egypt.
- Management expects two branches (in Baghdad and Erbil) to be opened in the Iraqi market during 2014.

Table 3: Key Indicators on Regional Operations as of Q3/13

USD million	Assets	Growth YTD	As % of total assets	Net profits in 9M/13	Growth YoY	As % of total profits	Gross NPL ratio	Total provisions in 9M/13
Egypt	1,617	-4%	6.3%	17.2	+179%	6.6%	14.8%	1.6
Syria	398	-44%	1.5%	6.6	+157%	2.5%	74.7%	26.1

Note: the Bank also has operations in Jordan, UAE, KSA, Qatar and Europe

FFA Model Assumptions

- We expect earnings of USD 86 million in Q4/13e, up 2% YoY and nudging down 1% QoQ.
- We forecast operating income at USD 205 million in Q4/13e, up 5% YoY and 17% QoQ from low financial gains in previous quarter at USD 11 million vs. an average of USD 41 million per quarter for 2013 so far.
- We expect NII to edge up in Q4/13e (+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.
- Key balance sheet indicators are expected to grow at a low single digit in Q4/13e noting that we expect loan growth to be more energetic than deposits growth (3% vs. 1%) similar to previous quarter.
- The LDR is likely to edge up to 28.3%, reflecting ample liquidity and potential to expand lending.
- We forecast provisions of USD 24 million, lower than the USD 40 million peak level reached in Q1/12 and Q2/13 yet substantially higher than in previous quarter when the Bank had no provisions. Our estimates for the cost-to-income stands at 36% in line with the Bank's target of maintaining it in the 35%-38% range.
- Taking into account these assumptions, net profits should total USD 349 million in 2013e (+4% YoY) and the EPS should stand at USD 1.52. Assets, deposits, and loans are expected to reach USD 26.1 billion, USD 22.6 billion and USD 6.4 billion respectively with the YTD growth at a respective 4%, 4% and 6%.
- In 2014e, assets, deposits and loans should grow by 5%-6%, while we expect profits to pick up by 6%.

Table 4: FFA Model Forecasts

USD million	FFA Q4/13e	Q3/13a	Q4/12a	QoQ %	YoY %	FFA 2014e	FFA 2013e
Net interest income (NII)	136.8	135.3	128.8	1%	6%	574.3	534.6
Operating income	204.7	175.7	194.2	17%	5%	875.5	823.2
Net profits	86.3	86.9	84.8	-1%	2%	371.4	349.0
Diluted EPS	0.38	0.39	0.38	-2%	0%	1.65	1.52
Assets	26,100	25,694	25,051	2%	4%	27,536	26,100
Deposits	22,577	22,313	21,791	1%	4%	23,706	22,577
Loans	6,394	6,230	6,028	3%	6%	6,715	6,394
BVPS to common	10.21	9.35	8.93	9%	14%	11.36	10.21
FFA Cost-to-income ratio	*36.2%*	*40.3%*	*35.9%*			*36.5%*	*36.7%*
Loans-to-deposits ratio	*28.3%*	*27.9%*	*27.7%*			*28.3%*	*28.3%*

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 18.0 billion and TTM earnings USD 158 million as of 9M/13. The Bank had a total of 101 branches and 2,538 employees as of the end of September 2013 with operations in its domestic market 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 87%/13% and 86%/14% as of H1/13. The Bank's balance sheet is mainly focused on Lebanon after the Bank's 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.

Q3/13 Key Financial Highlights

Net profits at USD 38 million in Q3/13, 11% down yoy

- Byblos Bank's net profits amounted to USD 38 million in Q3/13, 11% down from USD 42 million in Q3/12, while diluted EPS was USD 0.05 down from USD 0.06 in Q3/12.
- This drop was mainly driven by a 5% YoY decrease in operating income in Q3/13 due to lower net interest income (-14% to USD 57 million) from compressed interest margins coupled with lower financial gains (-10% to USD 22 million) and despite stronger fees and commissions income (+ 31% to USD 25 million).
- Sequentially, we note that the drop in financial gains was even more significant in Q3/13 (-59 QoQ%) which was partially offset by significantly lower provisions (-76% QoQ to USD 7 million), a trend we have been seeing across our coverage universe in the context of likely improving visibility requiring less provisions and consequently lower gains on financial assets to fund them.
- Cost-to-income ratio reached 52% in Q3/13 on account of lower operating income and roughly stable operating expenses reflecting cost containment measures.
- On the balance sheet side, the Bank saw a healthy single digit growth in assets, deposits and loans during Q3/13 in the 2%-4% range to USD 18.0 billion, USD 14.4 billion and USD 4.3 billion respectively.

Latest Key Regional Highlights

- Byblos Bank breakdown of assets and earnings between domestic and international operations stands at 87%/13% and 86%/14% respectively.
- The Bank operations in Syria have been downsized to just 2% of total assets and 1% of total profits as of 9M/13.

Table 5: Key Indicators on Regional Operations as of Q3/13

USD million	Assets	Growth YTD	As % of total assets	Net profits in 9M/13	Growth YoY	As % of total profits	Gross NPL ratio	Total provisions in 9M/13
Syria	353	-	2.0%	1.5	-	1.3%	56.7%	45.9

Note: the Bank also has operations in Europe, Africa, Iraq, UAE, Armenia, Cyprus

FFA Model Assumptions

- We expect net profits of USD 41 million in Q4/13e, up 9% QoQ yet down 8% YoY.
- We forecast NII of USD 60 million in Q4/13e (+6% QoQ, -11% YoY) as we expect interest margins to edge up from previous quarter yet to remain lower than their levels in Q4/12.
- Fees and commissions are expected to be below USD 20 million (USD 16 million) in line with a relatively weak momentum observed in the last quarter of the past two years.
- Key balance sheet indicators namely assets, deposits and loans are expected to witness moderate growth at a low single digit in Q3/13e (+2% QoQ), with an LDR maintained at 29.6%.
- We forecast provisions of USD 18 million in line with the Bank provisioning average in 2013 so far. Our expectations for the cost-to-income stands at 44% in Q4/13e.
- Taking into account these assumptions, net profits should total USD 155 million in 2013e (-8% YoY) and the EPS would stand at USD 0.21. Assets, deposits, and loans should amount to USD 18.4 billion, USD 14.7 billion and USD 4.4 billion respectively with the YTD growth at a respective 8%, 10% and 6%.
- In 2014e, we forecasted balance sheet growth at 6% and a positive 7% growth in the bottom line.

Table 6: FFA Model Forecasts

USD million	FFA Q4/13e	Q3/13a	Q4/12a	QoQ %	YoY %	FFA 2014e	FFA 2013e
Net interest income (NII)	60.3	57.0	67.8	6%	-11%	253.2	236.7
Operating income	118.4	103.4	131.2	15%	-10%	488.7	465.7
Net profits	41.1	37.7	44.8	9%	-8%	165.7	154.6
Diluted EPS	0.06	0.05	0.06	11%	-12%	0.23	0.21
Assets	18,384	18,029	17,015	2%	8%	19,422	18,384
Deposits	14,734	14,407	13,384	2%	10%	15,618	14,734
Loans	4,358	4,260	4,120	2%	6%	4,638	4,358
BVPS to common	2.07	2.05	2.09	1%	-1%	2.19	2.07
FFA Cost-to-income ratio	*44.2%*	*51.8%*	*35.7%*			*45.3%*	*45.6%*
Loans-to-deposits ratio	*29.6%*	*29.6%*	*30.8%*			*29.7%*	*29.6%*

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

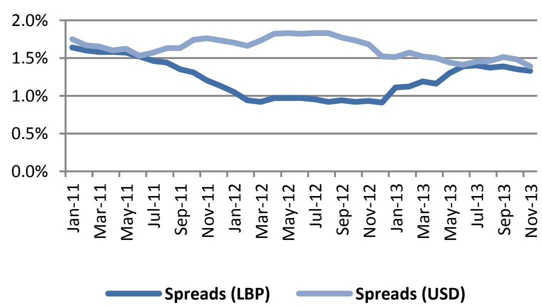
Based on our revised forecasts and discount rate assumptions to our Dividend Discount Model, our fair value estimate has been maintained at USD 1.60 per share. Our DDM assumes a 15.5% cost of equity and a 3% terminal growth rate. We corroborate our DDM valuation by means of the residual income method as well as historical and comparable P/E and P/B multiples.

LEBANESE BANKING SECTOR AND MACRO HIGHLIGHTS

Lebanese Banking Sector Highlights

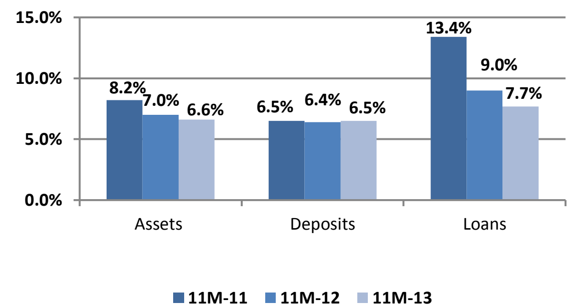
- **Lebanese banks reported moderate balance sheet expansion in 11M/13** weathering the sluggish economic environment as suggested by key balance sheet indicators growing at a mid-to-high single digit rate. Official statistics pointed to a growth in key activity indicators in the 6%-8% range in the 11M/13 period with assets, deposits and loans totaling USD 161.9 billion, USD 133.2 billion and USD 46.8 billion respectively. Non-resident deposits grew more vigorously, having increased by 12.5% over the same period to reach USD 27.1 billion at the end of November 2013. However we note that the growth of non-resident deposits was uneven having registered decreases during the months of April, July and September offset by increases in other months. Banks under coverage have seen more modest balance sheet growth partially explained by the downsizing in their Syrian operations. The sector's LDR was at 35% at the end of November 2013. The dollarization of deposits and loans stood at a respective 66% and 77%.

Figure 1: Spreads in USD and LBP



Source: Association of Banks in Lebanon

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



Source: BDL

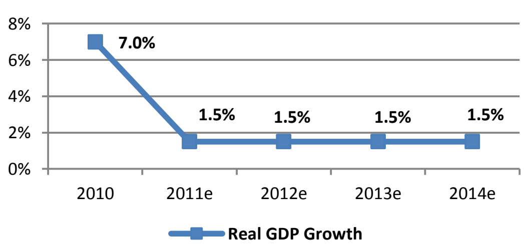
- **Latest statistics highlight that Lebanese banks are still operating in a difficult environment limiting potential for earnings growth**. In fact banking sector's profits trended flat in 2013 on account of pressured margins, relatively high provisions against difficult backdrop, slower fee income growth and moderate balance sheet expansion. After reporting double-digit growth in earnings from 2005 to 2010, Lebanese banks' profits started seeing a slowed down in 2011. This slowdown in earnings continued to be felt in 2013. The financial results at end-September 2013 show that the combined profits of the Alpha Group banks reached USD 1.28 billion in the first nine months of 2013 edging up 1.2% from 9M/12.
  Statistics from the ABL reveal that Lebanese banks are still operating in a low interest environment, limiting potential to improve earning asset yields. Figures highlight that spreads in USD decreased to 1.39% in November 2013 down from 1.68% 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 i) lower rates on LIBOR (average 3 months on USD deposits down to 0.24% from 0.31%), ii) lower yields on Eurobonds (weighted average down to 7.18% from 6.73%), iii) lower rates on deposits at the BDL (average down to 2.30% from 3.05%) and lower lending rates (weighted average down to 7.13% from 6.89%). On the LBP side, it should be noted that yields on CDs issued were also lower YoY (at 8.62% down from 9.28% a year earlier), while yields on T-Bills edged up to 6.89% from 6.58% a year earlier. Interest rates figures for the month of November 2013, highlights a further decrease in USD spreads MoM to 1.39% down 9 bps from 1.48% mostly triggered by a significant 10 bps decline in lending rates.

- **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. Standard & Poor's downgraded the long term sovereign ratings from B to B- and maintained its negative outlook and its B rating on the short term unchanged. Fitch revised the outlook on sovereign ratings to negative from stable while maintaining its B rating. Moody's has also downgraded the outlook of Lebanon's sovereign from stable to negative while maintaining its B1 rating on LT foreign currency. Given the Lebanese banking sector's large exposure to the sovereign, Banks were also constrained by the downgrades. In recent months, S&P downgraded the long-term counterparty credit ratings of Bank Audi, Blom Bank and Bank Med from B to B- , while Fitch revised its outlook on long-term IDRs of Byblos Bank and Bank Audi to negative from stable.

Macroeconomic Highlights

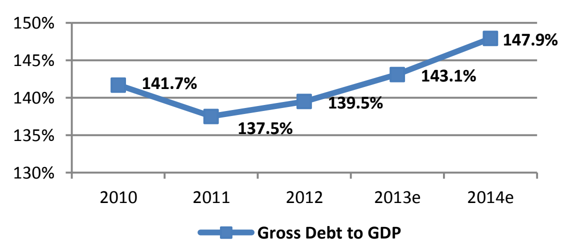
- **Continued slowdown in economic growth in 2013 in light of rising uncertainties**: In 2013, economic developments continued to be soft (following a trend initiated in 2011) with a real GDP growth rate estimated at 1.5% in 2013 similar to the one estimated in 2011 and 2012 according to the IMF. Capital inflows into Lebanon edged up by ~4% YoY from USD 13.5 billion in 11M/12 to USD 13.9 billion in 11M/13, which did not offset the large trade deficit at nearly USD 15.6 billion in first 11 months of 2013 (roughly unchanged from the same period of 2012), thus translating into a balance of payments deficit at USD 1.66 billion in the first 11 months of 2013 compared to a deficit of USD 1.85 billion in the same period last year.

Figure 3: Real GDP Growth



Source: IMF World Economic Outlook Database Oct-13

Figure 4: Gross Debt to GDP ratio



Source: IMF World Economic Outlook Database Oct-13

- **Drop in FDI inflows and resilience in remittances:** FDI inflows are estimated to have been among the most affected in the context of cautiousness related to regional uncertainties and a sluggish real estate market. The Investment Development Authority of Lebanon (IDAL) expects a fall in FDI inflows to Lebanon by 21 percent in 2013 down from USD 3.78 billion in 2012. In parallel, remittances from the Lebanese Diaspora, considered to be one of the largest in terms of proportion to the resident population, have proved to be resilient and are estimated by the World Bank to have reached USD 7.6 billion in 2013 (around 17% of nominal GDP), edging up from USD 7.3 billion 2012 and maintaining Lebanon's ranking among top recipients in developing countries.

- **Growing structural imbalances:** The first eleven months of 2013 saw an increase in the gross public debt (up 10% YoY to USD 63.3 billion in 11M/13) while the gross debt-to-GDP ratio estimate for 2013 stands at 143% higher than 140% in 2012, ranking among the highest in the world, suggesting required efforts to improve the country's fiscal imbalances. Furthermore, Lebanon's public finance continued to weaken in the context of slowing economic activity and the prevailing policy stalemate. Figures released by the Ministry of Finance show that the fiscal deficit reached USD 3.5 billion in the first ten months of 2013 and widened by 31% from USD 2.7 billion in the same period of 2012. The estimated fiscal deficit as % of GDP should widen to 10.4% in 2013e from 9% in 2012 according to the IMF.

- **Mixed performance in key sectors:** Tourism and real estate which are viewed as the backbone of the Lebanese economy continue to saw weaker conditions following a deceleration initiated in 2011. The real estate market pursued its slowdown as witnessed by property sales in number terms declining 5% in first 11 months of 2013 compared to the same period of 2012, reflecting lower demand levels. Incoming tourists continued to decline in 2013 reaching 1.16 million in the first eleven months of the year, the equivalent of a 7% decrease compared to 1.26 million tourists in 2012 with a noticeable 13% decline in tourist arrivals from Arab countries. As for the banking sector it continued to grow moderately with key balance sheet indicators growing in the 6%-8% range in the 11M/13 period, while maintaining healthy financial standings and operating in a difficult environment limiting potential for earnings growth.

APPENDIX

Appendix 1: Comparable Valuation

Ticker	Name	Market Cap. In USD mn	Div. Yield (in %)	EPS Growth (in %)	ROE (in %)	PE ratio	PB ratio
AUDI LB Equity	BANK AUDI SAL	2,238	6.23	-1.85	13.57	6.59	1.01
BLOM LB Equity	BLOM BANK	1,774	5.40	7.71	16.65	5.16	0.86
BYB LB Equity	BYBLOS BANK	910	8.21	-5.16	10.53	5.53	0.57
BEMO LB Equity	BANQUE EUROPEENNE MOY ORIENT	133	0.91	-19.93	5.92	21.28	1.30
BOB LB Equity	BANK OF BEIRUT	958	2.49	18.39	10.88	8.23	0.87
BLC LB EQUITY	BLC BANK SAL	298	n/a	-30.73	9.12	8.93	0.80
Average Lebanon		**1,052**	**4.6**	**-5.3**	**11.1**	**9.3**	**0.90**
ADCB UH EQUITY	ABU DHABI COMMERCIAL BANK	10,481	3.63	-8.42	14.79	11.60	1.53
DIB UH EQUITY	DUBAI ISLAMIC BANK	6,491	2.49	13.85	12.23	16.37	1.71
FGB UH EQUITY	FIRST GULF BANK	15,519	4.39	11.02	15.70	12.52	1.91
NBAD UH EQUITY	NATIONAL BANK OF ABU DHABI	17,583	2.12	16.85	15.16	13.40	1.93
UNB UH EQUITY	UNION NATIONAL BANK/ABU DHAB	4,388	1.55	6.19	10.98	10.23	1.09
Average UAE		**10,892**	**2.8**	**7.9**	**13.8**	**12.8**	**1.63**
COMI EY EQUITY	COMMERCIAL INTERNATIONAL BAN	4,317	2.50	37.87	26.08	10.58	2.64
CIEB EY EQUITY	CREDIT AGRICOLE EGYPT	630	5.36	53.60	25.15	7.12	1.65
Average Egypt		**2,474**	**3.9**	**45.7**	**25.6**	**8.8**	**2.15**
BURG KK EQUITY	BURGAN BANK	3,210	1.70	12.32	5.62	33.20	1.82
KFIN KK EQUITY	KUWAIT FINANCE HOUSE	10,837	1.07	9.97	4.61	28.37	1.26
NBK KK EQUITY	NATIONAL BANK OF KUWAIT	14,214	3.25	1.56	11.37	14.37	1.60
Average Kuwait		**9,420**	**2.0**	**7.9**	**7.2**	**25.3**	**1.56**
BKMB OM EQUITY	BANK MUSCAT SAOG	3,712	3.77	-1.93	12.57	9.32	1.23
NBOB OM EQUITY	NATIONAL BANK OF OMAN SAOG	979	5.15	18.89	13.52	9.11	1.18
Average Oman		**2,345**	**4.5**	**8.5**	**13.0**	**9.2**	**1.21**
QNBK QD EQUITY	QATAR NATIONAL BANK	34,204	3.37	13.93	19.29	13.11	2.48
MARK QD EQUITY	MASRAF AL RAYAN	7,168	2.87	6.80	17.30	15.62	2.58
DHBK QD EQUITY	DOHA BANK QSC	4,513	6.52	4.76	16.10	11.15	1.81
QIBK QD EQUITY	QATAR ISLAMIC BANK	4,782	5.09	-10.56	9.49	16.11	1.51
CBQK QD EQUITY	COMMERCIAL BANK OF QATAR QSC	5,056	8.06	5.54	12.39	10.51	1.34
Average Qatar		**11,145**	**5.2**	**4.1**	**14.9**	**13.30**	**1.94**
ARNB AB EQUITY	ARAB NATIONAL BANK	7,071	3.21	6.36	13.13	10.51	1.40
RJHI AB EQUITY	AL RAJHI BANK	28,897	4.84	6.86	21.83	13.89	2.94
ALINMA AB EQUITY	ALINMA BANK	6,359	n/a	35.71	5.51	23.55	1.37
BSFR AB EQUITY	BANQUE SAUDI FRANSI	8,292	3.49	-20.19	12.93	12.93	1.34
RIBL AB EQUITY	RIYAD BANK	13,399	3.88	13.86	11.72	12.73	1.54
SAMBA AB EQUITY	SAMBA FINANCIAL GROUP	12,419	3.19	4.15	13.64	10.33	1.39
Average KSA		**12,739**	**3.7**	**7.8**	**13.1**	**14.0**	**1.66**
AKBNK TI EQUITY	AKBANK T.A.S.	12,343	2.11	18.47	16.61	7.66	1.24
ASYAB TI EQUITY	ASYA KATILIM BANKASI AS	541	n/a	-18.81	8.16	6.06	0.47
GARAN TI EQUITY	TURKIYE GARANTI BANKASI	12,960	2.10	0.27	16.83	7.83	1.26
HALKB TI EQUITY	TURKIYE HALK BANKASI	7,549	2.79	30.33	24.40	5.93	1.33
ISCTR TI EQUITY	TURKIYE IS BANKASI-C	9,808	3.10	50.21	16.38	6.15	0.96
ALBRK TI EQUITY	ALBARAKA TURK KATILIM BANKAS	628	n/a	19.78	15.42	8.14	1.00
VAKBN TI EQUITY	TURKIYE VAKIFLAR BANKASI T-D	4,603	1.01	9.13	14.19	6.14	0.84
YKBNK TI EQUITY	YAPI VE KREDI BANKASI	7,529	1.83	-8.62	23.28	6.85	0.92
Average Turkey		**6,995**	**2.2**	**12.6**	**16.9**	**6.8**	**1.00**
TOTAL AVERAGE		**7,133**	**3.6**	**11.2**	**14.5**	**12.5**	**1.51**

Source: Bloomberg priced as of market close on January 15th 2014