Equity Research - Lebanese Banks - Q2/17 Preview

Banks under coverage expected to benefit from improving outlook in key geographical markets although capped by lack of visibility at the domestic level with challenges related to slow economic recovery possibly pressuring f/x funding conditions

Slower growth in banking sector aggregates in Q1/17 as domestic operating environment remained challenging despite revived hopes from long-awaited political developments

Favorable growth in Lebanese banking sector balance sheet in Q1/17 following stronger Q4/16 with assets/deposits/loans at respective +10%/+8%/+5% YoY although muted QoQ at +1%/+1%/flat weighed by seasonality factors and deconsolidation of several banks' foreign subsidiaries. Assets reached USD 206 billion in Q1/17 funded at 80% by deposits at USD 164 billion while loans totaled USD 51 billion. Alpha banks' profits registered a modest growth at +1.7% YoY reaching ~520 million as return on average assets declined to 0.95% in Q1/17 from 1.00% on materially lower financial gains, lower YoY returns on LBP and USD assets and deconsolidation of foreign subsidiaries. Slightly lower loan-to-deposits ratio at the sector level- trending higher in LBP and lower in USD- as banks look to utilize excess LBP liquidity. Net FDIs to Lebanon edged higher in 2016 at USD 1.8 billion from an average of USD 1.6 billion in 2011-2015 although material impact from improved sentiment following long-awaited political developments remains to be seen. We note a cumulative deficit of USD 358 million in May 2017 in the balance of payments reversing a cumulative surplus of USD 234 million in April 2017. Further deterioration in net foreign assets and tighter US sanctions on banks would pressure funding conditions and pose risks in a context of slow recovery in economic activity and delay of fiscal reforms to curb growing public debt.

Modest growth in balance sheet of banks under coverage in Q1/17 from seasonal effects and deconsolidation of foreign subsidiaries although helped QoQ by f/x stabilization in Turkey and Egypt. Profitability stable to higher helped by foreign operations and cost efficiencies

Bank Audi's assets and deposits were flat to lower in Q1/17 at respective -1%/flat QoQ on seasonal weakness and deconsolidation/write-off of subsidiaries in Syria and Sudan while Blom Bank saw its assets and deposit grow at respective +2%/+2% helped by f/x stabilization in Egypt and Byblos Bank outperformed domestically at +2% QoQ (vs. +1% sector average). On a YoY basis, assets and deposits growth came in at +7%/+5% for Bank Audi, +3%/flat for Blom Bank and +6%/+4% for Byblos Bank although weighed by deconsolidation of Syria and Sudan subsidiaries and unfavorable f/x effects. Lending growth remained weak QoQ/YoY at -1%/-6% for Bank Audi , -1%/-2% for Blom Bank and flat/+6% for Byblos Bank in line with sector trends, a result of conservative lending policies as economic activity has yet to pick up. Bank Audi's LDR trended lower at ~47% with LDR in Turkey at ~89% and Egypt at ~66% while Blom Bank's stood at ~28% and Byblos Bank's at 30% vs. Lebanese banking sector at ~31%. CAR levels for banks under coverage above BDL regulatory requirements (15.0% by end of 2018) with Bank Audi at 14.6%, Blom Bank at 18.5% and Byblos Bank at 18.0%. We estimate higher profitability QoQ and YoY for Bank Audi and Blom Bank at respective 1.1% and 1.6% helped by favorable operating leverage in Turkey and faster growth in Egypt while Byblos Bank stable at 0.8%. We highlight Byblos Bank's large exposure to the domestic market where NIMs were higher QoQ/lower YoY in LBP and lower QoQ and YoY in USD.

Expect moderate balance sheet growth in Q2/17e helped by foreign operations while domestic lending remains subdued. Weaker bottom line growth forecasted YoY from deconsolidation of foreign subsidiaries and largely lower financial gains despite stronger NIMs

We expect Bank Audi, Blom Bank and Byblos Bank to further benefit from improvement in sentiment in Q2/17 helped by the renewal of Riad Salameh's term as Central Bank Governor and agreement on new electoral law. Impact on deposit and loan growth remains limited amid hopes of pickup in economic activity during summer season although lending is supported by BDL stimulus package and higher LDR in LBP at the sector level. We highlight improved operating conditions in Turkey and Egypt supported by stabilizing f/x which should help Bank Audi and Blom Bank's balance sheet growth. For Q2/17e, we expect YoY growth in assets/deposits/loans at +7%/+4%/-7% for Bank Audi, +5%/+3%/+1% for Blom Bank and +5%/+3%/+5% for Byblos Bank. We expect stronger margins in Turkey and higher balance sheet growth in Egypt to drive earnings for Bank Audi and Blom Bank while we expect recovery in interest margins for Byblos Bank amid contained NPLs as interest rates increase in the US. We expect YoY bottom line growth for Bank Audi at +1%, Blom Bank at -1% and Byblos Bank at -18% weighed by deconsolidation of foreign subsidiaries, unfavorable f/x translation and largely lower financial gains from lesser trading activity on Lebanese securities following sizeable BDL debt swap in addition to BDL Circular 429 which includes new requirements on recognition of gains from sale of securities held at amortized cost.

Marginal improvement in operating environment, although still lacking visibility domestically, expected to support expansion of banks under coverage which we view as an interesting entry point with shares trading at discount to historical and providing favorable dividend yields

Expect lesser uncertainty in key operating environments to help banks under coverage as stronger core income from higher NIMs and lower provisions from contained NPLs should drive earnings amid stable credit risk in Turkey and Egypt. With 2017e BVPS growth estimated in the +9%/+13% range for Bank Audi and Blom Bank, favorable dividend yields and shares trading at discount to historical, we view banks as an interesting entry point as shares should benefit from further political progress including budget ratification and parliamentary elections scheduled for 2018 although potential risks include lack of visibility given unclear implications of new taxes on banks and timing of other fiscal reforms while material impact from political progress is yet to be seen. While we value Bank Audi and Blom Bank's diversified revenue supporting earnings, we note that Byblos Bank's business diversification is lagging behind its peers despite strong regulatory buffers which could weigh on profitability and payout.

Table 1: FFA Private Bank - Lebanese Banks Coverage

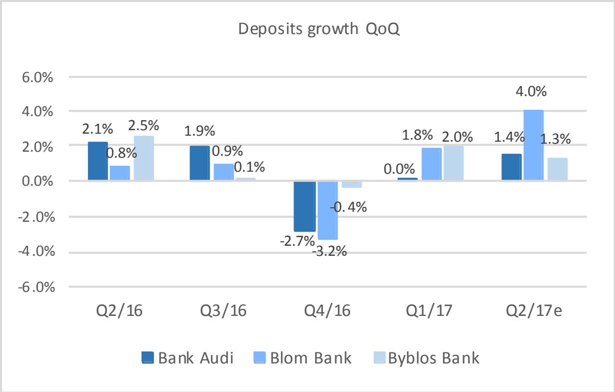
Company	Symbol	Recommendation	Target Price	Share Price *	YTD Change	P/E **	P/B to common	Dividend Yield ***
BANK AUDI	(AUDI LB)	MARKETWEIGHT	USD 7.00	USD 6.20	-8.8%	5.9x	0.84x	8.1%
BLOM BANK	(BLOM LB)	OVERWEIGHT	↑ USD 13.00	USD 11.25	6.1%	4.9x	0.86x	8.8%
BYBLOS BANK	(BYB LB)	MARKETWEIGHT	↓ USD 1.50	USD 1.63	-4.1%	8.2x	0.65x	8.1%

Source: Company reports, BSE, FFA Private Bank estimates Note: *July 11, 2017 market close, **Based on TTM EPS, *** Based on approved dividends for 2016 results

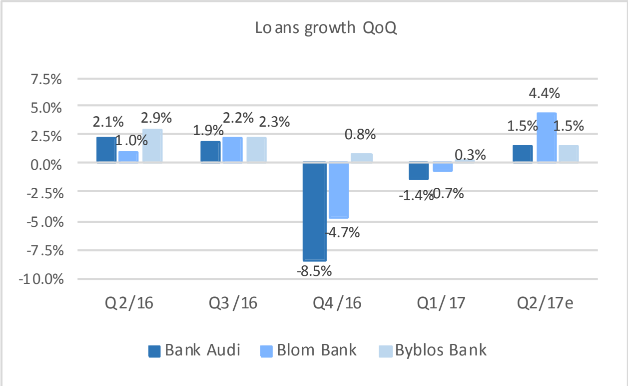
We update our target price for Blom Bank and Byblos Bank while keeping it unchanged for Bank Audi and note that Blom Bank is the sole Overweight in our coverage universe: We update our target price for Blom Bank to USD 13.00 from USD 12.50 and Byblos Bank to USD 1.50 from USD 1.55 while keeping it unchanged for Bank Audi at USD 7.00. We note that Blom Bank is the sole Overweight in our coverage universe, given its higher quality core income, efficiencies, stable growth in earnings, solid capitalization, sizable liquidity and conservative approach to growth. While Bank Audi is Marketweight, we see upside on account of efforts to improve profitability and diversify risk through geographical expansion.

Banks Under Coverage - Comparative Snapshots

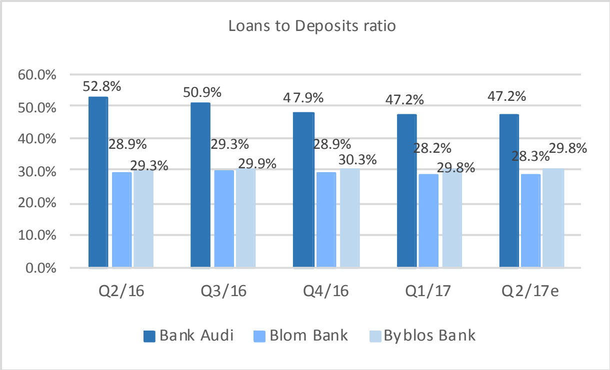
We forecast stronger QoQ deposit growth for Bank Audi helped by foreign operations and Blom Bank as a result of HSBC acquisition. Slower deposit growth for Byblos Bank expected roughly in line with domestic sector average



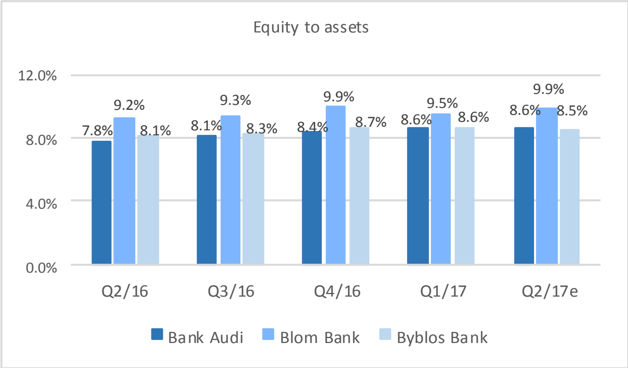
Expect pick-up in loan growth for banks under coverage following weakness in Q1/17. Bank Audi and Blom Bank should benefit from stronger LDRs in foreign operations while Blom Bank loan expansion also supported by HSBC acquisition



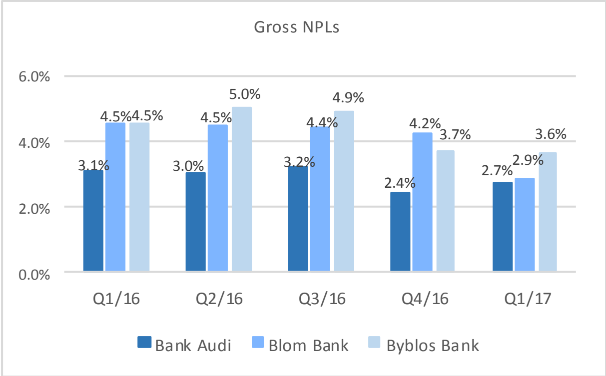
LDR expected to remain roughly stable for Bank Audi, Blom Bank and Byblos Bank despite pick up in loan growth. Bank Audi LDR forecasted at ~47% while Blom Bank and Byblos Bank expected at respective ~28% and ~30% below sector level of 31%



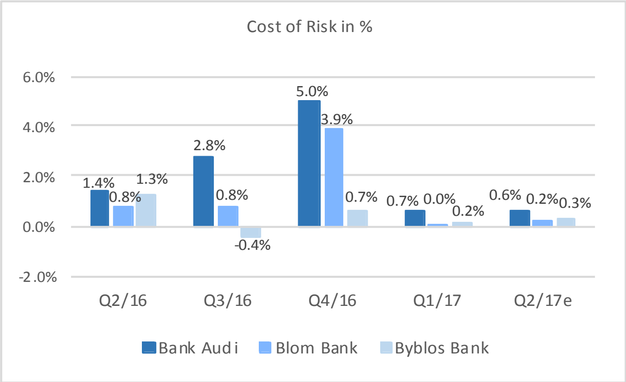
Blom Bank's equity to assets ratio expected to improve following weaker Q1/17 after the early redemption of Series 2011 preferred shares. Equity to assets roughly stable QoQ and higher YoY for Bank Audi and Byblos Bank



Bank Audi NPLs at the lower end of peers under coverage although NPLs trended higher in Q1/17 mainly from operations in Turkey. NPLs stable for Byblos Bank while materially lower for Blom Bank from transfer of bad loans to off-balance sheet

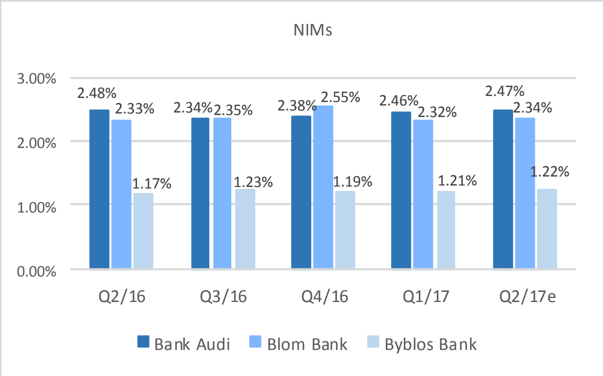


Expect broadly stable to higher cost of risk after weaker Q1/17 on the back of stronger provisions taken in the back half of 2016 following participation in BDL debt swap operations

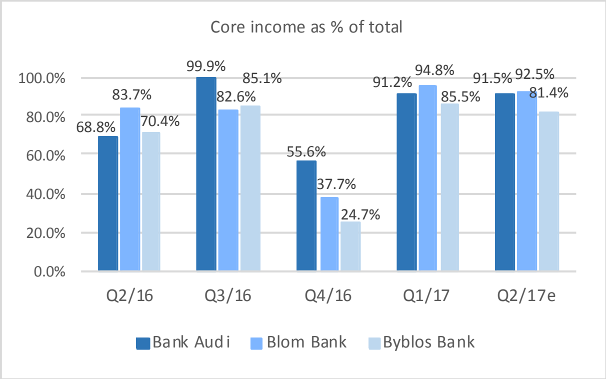


Source: Company reports and FFA Private Bank estimates

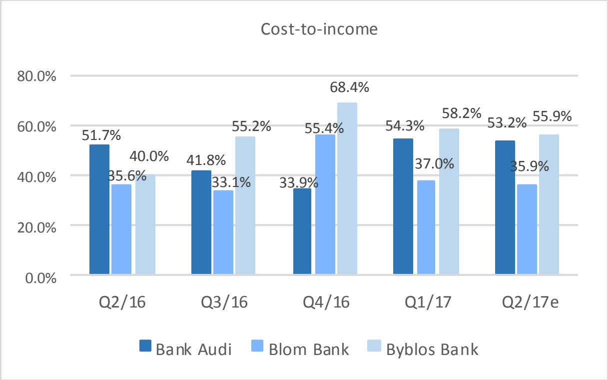
Expect NIMs to continue to improve for Byblos Bank and Bank Audi, largely helped by favorable results in Turkey. Blom Bank NIMs expected to pick up following weaker Q1/17 although still lower than end of 2016 levels as margins reach the higher end of the bank's targeted range



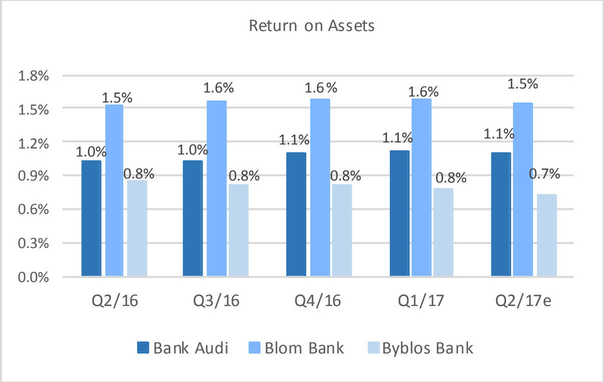
Expect considerable YoY improvement in income quality mix for banks under coverage, in the 80%-90% range, largely above Q2/16 level on materially lower financial gains following participation in BDL debt swap operations



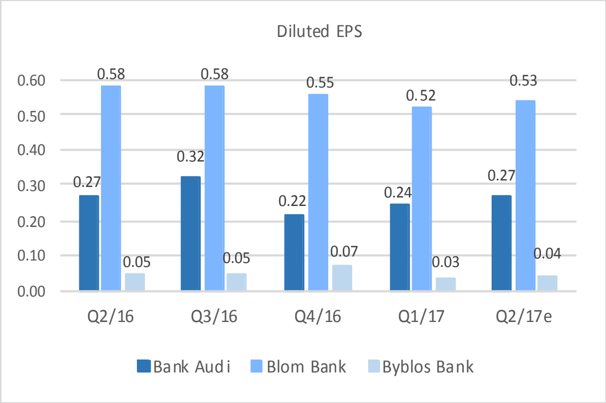
We forecast QoQ efficiency gains for Bank Audi, Blom Bank and Byblos Bank while cost-to-income higher YoY. We note a more favorable operating leverage in Odea Bank for Bank Audi helped by higher operating income



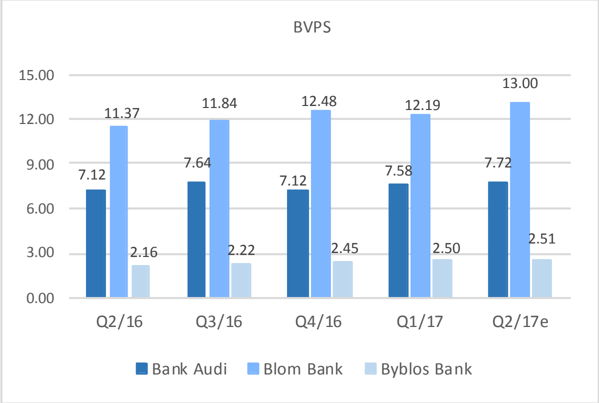
We expect stable to lower profitability for banks under coverage weighed by deconsolidation of foreign subsidiaries with Blom Bank at the higher end of our coverage



We forecast higher EPS for banks under coverage QoQ although stable to lower YoY. Expect material contribution from foreign operations for Bank Audi and Blom Bank and NIMs recovery for Byblos Bank



Expect higher BVPS for Bank Audi, Blom Bank and Byblos Bank in Q2/17e



Source: Company reports and FFA Private Bank estimates

BANK AUDI

Company Description

Bank Audi is the largest bank in Lebanon in terms of assets with an asset base at USD 43.9 billion as well as earnings at USD 110.2 million in Q1/17. The Bank had a total of 203 branches and 7,014 employees as of Q1/17 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 58%/42% and 55%/45% in Q1/17. In terms of assets, Turkey is currently the biggest international market for Bank Audi with ~25% of total assets. The current strategy is geared towards three geographic key markets: Lebanon, Turkey and Egypt, as well as private banking. We highlight the Bank's relatively sound asset quality (gross NPL ratio at 2.7% in Q1/17) amidst a difficult backdrop, balance sheet growth and consolidated margins to remain favorably impacted by higher margins driven largely by Turkey as they converge towards Turkish sector average.

Q1/17 Key Financial Highlights

Net profits at USD 110.2 million in Q1/17 (-8% QoQ, flat YoY)

- Net interest income registered at USD 265.4 million in Q1/17 (+2% QoQ, +9% YoY). We estimate net interest margins at 2.46% in Q1/17 higher than 2.38% in Q4/16 and 2.42% in Q1/16.
- Non-interest income was lower in Q1/17 on weaker financial gains at USD 31.7 million (-88% QoQ, -16% YoY) while fees and commissions were roughly stable at USD 65.1 million (-2% QoQ, +1% YoY). Revenue breakdown for Q1/17 shows higher contribution of core income (net interest income + fees & commissions income) to total operating income at 91% in Q1/17 significantly higher than 56% in Q4/16 and 89% in Q1/16.
- Bank Audi saw higher cost-to-income in Q1/17 at 54.3% from 33.8% in Q4/16 and 55.3% in Q1/16.
- Bank Audi's consolidated gross NPLs were at 2.7% in Q1/17, higher than Q4/16 and Q1/16 levels and still lower than peers under coverage. Annualized cost of risk declined to an estimated 66 bps in Q1/17, from an estimated 496 bps in Q4/16 and 75 bps in Q1/16 on significantly lower provisioning QoQ at USD 28.1 million (-87% QoQ, -17% YoY).
- Subdued QoQ balance sheet growth in Q1/17 with assets and loans declining -1% to respective USD 43.9 billion and USD 17.0 billion while deposits came in flat at USD 36.0 billion. Assets and deposits growth more pronounced on a yearly basis at respective +7% and +5% while loans underperformed at -6%.
- Bank Audi saw net profits at USD 110.2 million in Q1/17 (-8% QoQ, flat YoY).

Latest Key Regional/Operational Highlights

- Bank Audi's breakdown of assets and earnings between domestic and international operations stood at 58%/42% and 55%/45% in Q1/17.
- Odea Bank accumulated USD 10.8 billion in total assets representing ~25% of the group assets and is seeking to benefit from operating leverage as branch network expands (50 branches including kiosks) and gains maturity. Odea Bank reported profits of USD 26.0 million in Q1/17 representing ~24% of consolidated net profits. We expect Odea Bank's profitability to continue to improve as margins and efficiencies move higher and closer to peers, driving its share of consolidated net profits considerably higher.
- In Q1/17, the group had USD 3.1 billion in assets in Egypt and generated USD 12.0 million in earnings accounting for 7% of consolidated assets and 11% of total profits.
- Bank Audi's current key geographic markets are: Lebanon, Turkey and Egypt, as well as private banking.
- In September 2016, Bank Audi deconsolidated and wrote-off its investments in Bank Audi Syria, National Bank of Sudan and Arabeya Online.
- In Q4/16, the Bank sold its 76.56% participation in National Bank of Sudan.
- In April 2017, Bank Audi announced an agreement with M1 Financial Technologies SAL to sell its electronic payment and card services business in a deal estimated at USD 185 million.
- Samir Hanna has been appointed Chairman and Group CEO of Bank Audi replacing Raymond Audi. Sherine Audi, Carlos Obeid and Aristidis Vourakis were also appointed as board members.
- AGM agreed to increase dividend to USD 0.50 (gross of tax) per share for FY 2016 from USD 0.40 (gross of tax) per share for FY 2015 and paid them on 18/04/17.
- Bank Audi announced its intention to redeem all 1.5 million outstanding, non-cumulative redeemable series F preferred shares issued in May 2012.

FFA Model Assumptions

- We forecast net profits at USD 116.4 million in Q2/17e (+6% QoQ, +1% YoY).
- We expect net interest income at USD 272.7 million in Q2/17e (+3% QoQ, +7% YoY) helped by stronger NIMs in Turkey and Egypt.
- Net fees and commissions expected to reach USD 66.5 million in Q2/17e (+2% QoQ, +2% YoY).
- We expect assets, deposits and loans at respective +2% QoQ /+7% YoY, +1% QoQ /+4% YoY, +2% QoQ /-7% YoY.
- LDR is expected at 47.2% in Q2/17e, slightly higher from Q1/17 and lower than 52.8% in Q2/16.
- We forecast net provisions of USD 27.6 million in Q2/17e with an estimated annualized cost of risk of 63 bps for 2017e.
- Our estimate for cost-to-income in Q2/17e is at 53.2%.
- Looking at FY 2017e, net profits should reach USD 488.0 million (+4% YoY) with EPS at USD 1.11 (+6% YoY).

Table 2: FFA Model Forecasts

USD Million	FFA Q2/17e	Q1/17a	Q2/16a	QoQ %	YoY %	FFA 2017e
Net Interest Income	272.7	265.4	255.2	3%	7%	1,112.8
Fees & commissions income	66.5	65.1	65.2	2%	2%	267.0
Trading & investment income	31.3	31.7	145.2	-1%	-78%	143.4
Operating Income	370.5	362.2	465.6	2%	-20%	1,523.3
Provisions	-27.6	-28.1	-64.0	-2%	-57%	-112.2
Operating expenses	-197.2	-196.8	-241.3	0%	-18%	-800.9
Income tax	-30.0	-28.2	-31.5	6%	-5%	-125.6
Net Profits	116.4	110.2	115.5	6%	1%	488.0
Diluted EPS	0.27	0.24	0.27	9%	-1%	1.11
Assets	44,869	43,921	41,938	2%	7%	46,246
Deposits	36,476	35,966	34,993	1%	4%	37,579
Loans	17,235	16,976	18,466	2%	-7%	17,793
BVPS to common	7.72	7.58	7.12	2%	8%	8.06
FFA Net interest margins	2.47%	2.46%	2.48%			2.45%
Core income to total operating income	91.5%	91.2%	68.8%			90.6%
FFA Cost-to income ratio	53.2%	54.3%	51.7%			52.6%
Immediate liquidity-to-deposits ratio	45.2%	41.7%	34.9%			45.0%
Loans-to-deposits ratio	47.2%	47.2%	52.8%			47.3%
Equity-to-asset ratio	8.6%	8.6%	7.8%			8.7%

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 Q1/17 at USD 30.1 billion as well as Q1/17 earnings at USD 112.0 million. The Bank had a total of 218 branches and 4,746 employees as of the end of Q1/17 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 81%/19% respectively in Q1/17. 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.

Q1/17 Key Financial Highlights

Net profits at USD 112.0 million in Q1/17 (-6% QoQ, +4% YoY)

- Net interest income came in at USD 170.6 million in Q1/17 (-7% QoQ, +2% YoY). We estimate NIMs at 2.32% in Q1/17 lower than 2.55% in Q4/16 and 2.34% in Q1/16 yet still higher than Blom Bank's targeted range of 2.00%-2.20%.
- Non-interest income was materially lower at USD 43.7 million in Q1/17 (-89% QoQ, -29% YoY) on substantially lower financial gains at USD 11.2 million (-97% QoQ, -52% YoY) and fees and commissions at USD 32.5 million (-15% QoQ, -14% YoY). Revenue breakdown for Q1/17 shows an improvement in income mix quality with core income (net interest income + fees & commissions income) contribution to total operating income at 95% up from 38% in Q4/16 and 90% in Q1/16.
- Blom Bank saw lower cost-to-income in Q1/17 at 37.0% down from 55.4% in Q4/16 and 38.8% in Q1/16 reflecting higher efficiencies vs. peers under coverage. Blom Bank's gross NPLs at 2.8% in Q1/17, down from 4.2% in Q4/16 and 4.5% in Q1/16. Annualized cost of risk also materially decreased to an estimated 2 bps in Q1/17 from an estimated 391 bps in Q4/16 and 26 bps in Q1/16 with provisions at USD 0.3 million (-100% QoQ, -107% YoY).
- Assets and deposits grew +2% QoQ in Q1/17, above domestic sector average, to respective USD 30.1 billion and USD 25.2 billion while loans underperformed at -1% likely reflecting management's conservative approach. On a YoY basis, assets grew +3%, deposits were flat while loans declined -2%.
- Capital adequacy ratio (as per Basel III) at 18.5% in Q1/17 from 19.0% in Q4/16, still at the higher end of peers under coverage, compared to BDL's 14.5% regulatory requirement for 2017. TTM ROA at ~1.6% in Q1/17 and TTM ROE at an estimated 16.5%.
- Blom Bank's net profit at USD 112.0 million in Q1/17 (-6% QoQ, +4% YoY).

Latest Key Regional/Operational Highlights

- Blom Bank breakdown of assets and earnings between domestic and international operations stands at 82%/18% and 81%/19% respectively in Q1/17.
- At the end of Q1/17, the Group had USD 1.6 billion in assets in Egypt and generated USD 11.7 million in net earnings accounting for around ~5% of consolidated assets and ~10% 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 2016, HSBC Middle East Limited had three branches in Lebanon and around USD 953 million in assets. 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 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 116.7 million in Q2/17e (+4% QoQ, -1% YoY).
- We expect net interest income at USD 176.6 million in Q2/17e (+3% QoQ, +6% YoY).
- Net fees and commissions expected at USD 36.5 million in Q2/17e (+12% QoQ, -5% YoY).
- We expect provisions of USD 4.4 million equivalent to an estimated annualized cost of risk at 18 bps for 2017e.
- We estimate cost-to-income at 35.9% in Q2/17e, below Q1/17 level of 37.0% and roughly unchanged from Q2/16 level of 35.6%.
- We expect assets, deposits and loans QoQ growth at +3%, +4% and +4% while YoY growth is expected at +5%/+3%/+1%.
- We expect LDR at 28.3% in Q2/17e from 28.2% in Q1/17 and 28.9% Q2/16.
- Looking at FY 2017e, net profits should reach USD 482.2 million (+4% YoY) with EPS expected at USD 2.22 (+1% YoY).

Table 3: FFA Model Forecasts

USD Million	FFA Q2/17e	Q1/17a	Q2/16a	QoQ %	YoY %	FFA 2017e
Net Interest Income	176.6	170.6	167.4	3%	6%	727.1
Fees & commissions income	36.5	32.5	38.4	12%	-5%	150.4
Trading & investment income	17.4	11.2	40.1	55%	-57%	64.3
Operating Income	230.4	214.4	245.8	8%	-6%	941.7
Provisions	-4.4	-0.3	-14.7	1289%	-70%	-13.7
Operating expenses	-82.8	-79.4	-87.6	4%	-5%	-339.2
Income tax	-26.5	-23.3	-24.9	14%	6%	-107.3
Net Profits	116.7	112.0	118.4	4%	-1%	482.2
Diluted EPS	0.53	0.52	0.58	3%	-8%	2.22
Assets	30,914	30,153	29,502	3%	5%	31,827
Deposits	26,272	25,252	25,413	4%	3%	26,800
Loans	7,425	7,111	7,353	4%	1%	7,579
BVPS to common	13.00	12.19	11.37	7%	14%	13.63
FFA Net interest margins	2.34%	2.32%	2.33%			2.34%
Core income to total operating income	92.5%	94.8%	83.7%			93.2%
FFA Cost-to income ratio	35.9%	37.0%	35.6%			36.0%
Immediate liquidity-to-deposits ratio	54.2%	56.8%	48.6%			55.4%
Loans-to-deposits ratio	28.3%	28.2%	28.9%			28.3%
Equity-to-asset ratio	9.9%	9.5%	9.2%			10.0%

Source: Company reports and FFA Private Bank estimates

Investment Opinion

We view Blom Bank's higher returns and solid liquidity and capitalization levels as a reflection of a prudent management team and highlight the Bank's ability to propose higher dividends on account of lower than average payouts and excess capital buffers

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

Target Price Revision and Recommendation

We reiterate our Overweight rating on Blom Bank shares and revise our fair value to USD 13.00 from USD 12.50 per share

Based on our revised forecasts and discount rate assumptions to our Dividend Discount Model, we revise our fair value estimate for Blom Bank to USD 13.00 from USD 12.50 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 Q1/17 at USD 21.3 billion with earnings at USD 28.7 million. The Bank had a total of 97 branches and 2,347 employees as of end of December 2016 (excluding Byblos Bank Syria and Byblos Bank Africa) with operations in Lebanon as well as across Europe, Africa and the MENA region. The Bank's diversification across markets is lagging behind its peers with a breakdown of assets between domestic and international at ~92%/8% for 2016 excluding Byblos Bank Syria and Byblos Bank Africa). The Bank's balance sheet is mainly focused on Lebanon. The Bank has so far adopted a conservative growth strategy translating into ample liquidity levels at the expense of weaker margins and profitability.

Q1/17 Key Financial Highlights

Net profits at USD 28.7 million in Q1/17 (-44% QoQ, -15% YoY)

- Net interest income was at USD 63.6 million in Q1/17 (+4% QoQ, +2% YoY). We estimate interest margins at 1.21% in Q1/17 slightly higher than 1.19% in Q4/16 yet lower than 1.27% in Q1/16.
- Non-interest income substantially lower at USD 35.7 million in Q1/17 following a decline in financial gains at USD 14.4 million (-94% QoQ, -74% YoY) offsetting higher fees & commissions t USD 21.3 million (+7% QoQ, +6% YoY). We highlight an improvement 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 86% in Q1/17 up from 25% in Q4/16 and 60% in Q1/16.
- Cost of risk decreased to an estimated 20 bps in Q1/17 from 66 bps in Q4/16 and 62 bps in Q1/16 with lower provisions at USD 2.6 million (-69% QoQ, -28% YoY).
- Moderate balance sheet growth in Q1/17 with asset and deposits up +2% to respective USD 21.3 billion and USD 17.4 billion while loans remained flat at USD 5.2 billion. Balance sheet growth more significant on a YoY basis with assets and loans up +7% and deposits up +4% despite deconsolidation of Syria and Sudan subsidiaries.
- Assets continue to be largely funded by deposits at ~82% while LDR remains below Lebanese banking sector average (~31%). Immediate liquidity to deposits ratio (including cash and balances with central banks and interbank placements) came in higher at 52% in Q1/17 up from 48% in Q4/16 and 45% in Q1/16.
- Profitability ratios came in slowly lower with TTM ROA at an estimated 0.78% and TTM ROE at an estimated 9.0% in Q1/17, still at the lower end of our coverage universe.
- Byblos Bank saw net profits at USD 28.7 million in Q1/17 (-44% QoQ, -15% YoY).

Latest Key Regional/Operational Highlights

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

FFA Model Assumptions

- We expect net profits of USD 32.9 million in Q2/17e (+14% QoQ, -18% YoY).
- We forecast net interest income of USD 64.9 million in Q2/17e (+2% QoQ, +10% YoY).
- Net fees and commissions expected at USD 20.6 million in Q2/17e (-3% QoQ, +3% YoY).
- We expect assets, deposits and loans to grow by a respective +1% QoQ /+5% YoY, +1% QoQ /+3% YoY, +1% QoQ /+5% YoY.
- At these growth levels, LDR should be at 29.8%, unchanged from Q1/17 and up from 29.3% in Q2/16.
- We forecast provisions of USD 4.2 million in Q2/17e equivalent to an estimated annualized cost of risk at 28 bps for 2017e.
- Our cost-to-income estimate is at 55.9% for Q2/17e.
- Looking at FY 2017e, net profits should reach USD 134.9 million (-18% YoY) with EPS at USD 0.17 (-17% YoY).

Table 4: FFA Model Forecasts

USD Million	FFA Q2/17e	Q1/17a	Q2/16a	QoQ %	YoY %	FFA 2017e
Net Interest Income	64.9	63.6	58.8	2%	10%	261.8
Fees & commissions income	20.6	21.3	20.0	-3%	3%	83.6
Trading & investment income	19.6	14.4	33.0	36%	-41%	74.9
Operating Income	105.0	99.3	111.8	6%	-6%	420.4
Provisions	-4.2	-2.6	-16.2	61%	-74%	-15.4
Operating expenses	-58.7	-57.8	-44.7	2%	31%	-230.0
Income tax	-9.3	-10.2	-10.9	-9%	-15%	-40.1
Net Profits	32.9	28.7	40.0	14%	-18%	134.9
Diluted EPS	0.04	0.03	0.05	20%	-12%	0.17
Assets	21,519	21,277	20,434	1%	5%	22,022
Deposits	17,656	17,438	17,150	1%	3%	18,100
Loans	5,270	5,193	5,024	1%	5%	5,421
BVPS to common	2.51	2.50	2.16	0%	16%	2.55
FFA Net interest margins	1.22%	1.21%	1.17%			1.20%
Core income to total operating income	81.4%	85.5%	70.4%			82.2%
FFA Cost-to income ratio	55.9%	58.2%	40.0%			54.7%
Immediate liquidity-to-deposits ratio	51.5%	51.7%	43.3%			51.2%
Loans-to-deposits ratio	29.8%	29.8%	29.3%			29.9%
Equity-to-asset ratio	8.5%	8.6%	8.1%			8.4%

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 revise our fair value to USD 1.50 from USD 1.55 per share
Based on our revised forecasts and discount rate assumptions to our Dividend Discount Model, we revise our fair value estimate for Byblos Bank to USD 1.50 from USD 1.55 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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