Lebanese Banks	Bank Audi (AUDI LB)	MARKETWEIGHT	USD 7.00
Q1/13 Preview	Blom Bank (BLOM LB)	OVERWEIGHT	USD 10.00
April 12th, 2013	Byblos Bank (BYB LB)	MARKETWEIGHT	USD 1.60

Improving sentiment, attractive dividends, and potential for upside surprise in Q1/13e could lend support to banks under coverage

Lebanese banks' activity seemed to hold up well weathering declining confidence levels and softer economic conditions as suggested by assets, deposits and loans growing at a high single digit to low double digit rates in 2012 at a respective 8%, 8% and 10% totaling USD 152 billion, USD 125 billion and USD 44 billion respectively. The first two months of 2013 pointed to an ongoing moderate growth in key activity indicators in the 1%-2% range Ytd for assets, deposits and loans.

We expect banks under coverage (namely Bank Audi, Blom Bank and Byblos Bank) to sustain a decent balance sheet growth in 2013e registering a low single digit growth in deposits and loans in Q1/13, while Bank Audi's could continue to gain from its growth expansion including the recent branch roll out in Turkey. In 2012, banks under coverage saw their deposit base grow by a respective 8%, 7% and 4% and their loan portfolio grow by 21%, 8% and 3% with their respective LDRs standing at 39%, 28% and 31% by end-year which highlights comfortable liquidity levels although mirroring disparities between the banks.

Lebanese banks have been witnessing pressures on earnings from i) a low interest rate environment including narrowing yields on Lebanese securities and low Libor levels, with a limited capacity to further decrease the cost of funds, ii) slower fee income generation and iii) growing provisioning levels as measures facing the Syrian unrest.

We believe that Q1/13e upcoming earnings of banks under coverage could surprise to the upside. Our expectations for net profits growth in Q1/13e, stands at 9% Yoy, 8% YoY and 14% Yoy for Bank Audi, Blom Bank and Byblos Bank respectively. Byblos Bank might get the benefit of low interest margins in Q1/12 and signs of improvement into Q4/12 which we expect to carry into Q1/13e along with cost-efficiencies and translate into healthy YoY increase in profits. We expect Bank Audi's earnings to gain from improving visibility and asset quality in Egypt translating into easing pressures from provisions. We note that while the listed banks' profits trended flat in 2012, Bank Audi, Blom Bank and Byblos Bank earnings came relatively in line at a respective 5%, 1% and -6%.

Pressures on earnings could ease in Q1/13e after the peak level of provisioning in 2012e. In Q1/13e, we expect earnings growth to gain momentum as provisioning pressures on earnings moderate. It is likely that managements will maintain satisfactory asset quality in light of a potential cap in NPL levels given that banks have significantly downsized their loan portfolios in Syria thus limiting the impact on consolidated asset quality. Additionally, asset quality remains largely contained domestically. The Q4/12 consolidated gross NPLs stood at 2.7% for Bank Audi, 5.4% for Blom Bank and 4% for Byblos Bank.

FFA Private Bank Lebanese Banks Coverage

Company	Ticker	Recommendation	Target Price	Priced as of April 12, 2013	P/E	P/B to common	Dividend Yield
Bank Audi	AUDI.LB	Marketweight	USD 7.00	USD 6.50	6.4x	1.03x	6.2%
Blom Bank	BLOM.LB	Overweight	USD 10.00	USD 8.25	5.4x	0.92x	5.4%
Byblos Bank	BYB.LB	Marketweight	USD 1.60	USD 1.68	7.3x	0.80x	7.9%

Source: BSE, FFA Private Bank estimates

Currently we believe recent positive catalysts to continue to support shares prices and trigger the appetite of investors despite the prevailing challenging operating conditions. First, we have been recently encouraged by an improving sentiment on the local scene after a general agreement on a new prime minister, adding comfort to stocks on the BSE. Additionally we highlight the relative attractiveness of the domestic banks' dividend payouts offering dividend yields of 6.2% for Bank Audi, 5.4% for Blom Bank and 7.9% for Byblos Bank typically paid in April. We also believe that there is potential for upside surprise in upcoming Q1/13e earnings as provisioning pressures alleviate following peak levels in 2012. Bank Audi could continue to benefit from improving visibility in Egypt and balance sheet expansion from branch roll out in Turkey, while Byblos Bank could gain from improving low margins and cost efficiencies YoY. We maintain our target prices and recommendations unchanged on the three banks and we continue to value the banks' ability in reporting moderate balance sheet growth within less favorable macro dynamics and in coping with the pressures on earnings generation while adopting prudent provisioning measures.

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BANK AUDI

FFA Model Assumptions

- We expect net profits of USD 103 million in Q1/13e, up 52% QoQ (from unusually low earnings in Q4/12 on account of non-recurring expenses including Turkey launch and impairments on SAM) and up 9% YoY as likely lower provisioning will be coupled with steady growth in operating income (+4% QoQ, +10% YoY).
- We expect NII to grow robustly in Q1/13e (+16% QoQ, + 12% YoY) on a marginal improvement in margins and as lending volumes maintain momentum. Fees and commissions are expected to trend higher, yet moderately (+5%).
- Key balance sheet indicators namely assets, deposits and loans are expected to witness a moderate growth at a low single digit in Q1/13e and could continue to gain from the branch rollout in Turkey.
- We forecast lower provisions of USD 24 million (-12% QoQ, -24% YoY) after sharp rise in 2011 and 2012, while our expectations for the cost-to-income stands at 48%, higher than 43% in Q1/12 although lower than a high 57% in Q4/12 partly attributed to the one time launch costs of the Turkish subsidiary.

FFA Q1/13e Forecasts

USD million	FFA Q1/13e	Q4 12a	Q1/12a	QoQ %	YoY %
Net interest income	164	141	147	16%	12%
Operating income	298	285	272	4%	10%
Net profits	103	68	94	52%	9%
Diluted EPS	0.27	0.16	0.26	69%	5%
Assets	31,950	31,302	28,661	2%	11%
Deposits	27,479	26,805	24,388	3%	13%
Loans	10,584	10,428	8,866	1%	19%
BVPS to common	6.48	6.33	6.13	2%	6%
FFA Cost-to-income ratio	*48.0%*	*57.0%*	*42.8%*		
Loans-to-deposits ratio	*38.5%*	*38.9%*	*36.4%*		

Source: Bank Audi and FFA Private Bank estimates

Investment Opinion

We recognize Bank Audi's leadership at navigating through difficult operating conditions and 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 notice improving fundamentals that should help shares return to a premium valuation to book once investor concerns regarding key regional operations and earnings slowdown subside. We continue to rate Bank Audi shares at Marketweight although recognize upside potential on improved sentiment in the shorter term and the return to a growth expansion strategy including the branch roll out in Turkey in the medium to longer term.

Recommendation

We reiterate our Marketweight rating on Bank Audi shares with a fair value of USD 7.00 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 7.00 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.

BLOM BANK

FFA Model Assumptions

- We expect net profits of USD 91 million in Q1/13e, up 7% QoQ and 8% YoY as stable provisions and slightly higher opex will be coupled with steady growth in operating income (+18% QoQ, +4% YoY).
- We expect NII to grow moderately in Q1/13e (+6% QoQ, + 7% YoY) as our forecasted flat interest margins are likely to be matched with moderate earnings assets growth. Fees and commissions should pursue a weak momentum (+2%).
- Key balance sheet indicators namely assets, deposits and loans are expected to witness a moderate growth at a low single digit in Q1/13e (+2% Ytd).
- We forecast provisions of USD 42 million (up from USD 27 million in Q4/12 and flat YoY) as we expect Management to adopt prudent risk practices facing the recent deterioration in gross NPLs (from 3.2% in 2011 to 5.4% in 2012). Our expectations for the cost-to-income stands at 34% in Q1/13e, higher than 28% in Q1/12 although slightly lower than the 36% average for 2012.

FFA Q1/13e Forecasts

USD million	FFA Q1/13e	Q4 12a	Q1/12a	QoQ %	YoY %
Net interest income	137	129	128	6%	7%
Operating income	229	194	221	18%	4%
Net profits	91	85	84	7%	8%
Diluted EPS	0.40	0.37	0.38	8%	6%
Assets	25,404	25,016	23,774	2%	7%
Deposits	22,106	21,745	20,678	2%	7%
Loans	6,133	6,027	5,683	2%	8%
BVPS to common	9.10	8.93	8.33	2%	9%
FFA Cost-to-income ratio	*33.5%*	*35.9%*	*27.8%*		
Loans-to-deposits ratio	*27.7%*	*27.7%*			

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 superior profitability and return ratios in Lebanon 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.

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

FFA Model Assumptions

- We expect net profits of USD 44 million in Q1/13e, down 5% QoQ and up by a healthy 14% YoY as roughly stable provisions and opex YoY will be coupled with steady growth in operating income (+8% YoY).
- We forecast NII of USD 65 million in Q1/13e (-11% QoQ, + 10% YoY) as we expect interest margins to remain stronger than their unusual level in Q1/12 following the improvement seen in Q4/12. Fees and commissions should pursue a weak momentum (+2%).
- Key balance sheet indicators namely deposits and loans are expected to witness a moderate growth at a low single digit in Q1/13e, with an LDR maintained at 31%.
- We forecast provisions of USD 11 million (flat YoY). Our expectation for the cost-to-income stands at 50% in Q1/13e, representing a slight YoY improvement.

FFA Revised Forecasts

USD million	FFA Q1/13e	Q4 12a	Q1/12a	QoQ %	YoY %
Net interest income	65	73	59	-11%	10%
Operating income	128	138	119	-7%	8%
Net profits	44	47	39	-5%	14%
Diluted EPS	0.06	0.06	0.05	2%	24%
Assets	16,761	17,014	16,761	-1%	0%
Deposits	13,653	13,384	13,101	2%	4%
Loans	4,213	4,129	4,029	2%	5%
BVPS to common	2.12	2.09	2.06	1%	3%
FFA Cost-to-income ratio	*49.6%*	*35.2%*	*51.8%*		
Loans-to-deposits ratio	*30.9%*	*30.8%*	*30.8%*		

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 management 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 in 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.