Lebanese Banks

Q2/13 Preview

July 9th, 2013

Bank Audi	(AUDI LB)	MARKETWEIGHT	USD 7.00
Blom Bank	(BLOM LB)	OVERWEIGHT	USD 10.00
Byblos Bank	(BYB LB)	MARKETWEIGHT	USD 1.60

Expect no major surprises in Q2/13e for banks under coverage which should continue to weather a challenging operating environment materializing into pressures on earnings and slower balance sheet expansion

■ **Lebanese banks' continue to report soft balance sheet growth** amidst a sluggish overall economic environment as suggested by assets, deposits and loans growing at a mid-single digit rate so far in 2013. The first five months of 2013 pointed to an ongoing moderate growth in key activity indicators in the 2%-4% range Ytd for assets, deposits and loans totaling USD 157 billion, USD 130 billion and USD 44 billion respectively at the end of May 2013. Latest statistics from the BDL and the ABL highlight that Lebanese banks maintained sound asset quality, solid capitalization and ample liquidity levels with NPLs at 3.5 %, CAR II at 12% and LDR at 34%.

■ **We expect Blom Bank and Byblos Bank to sustain a moderate balance sheet growth in Q2/13e, while Bank Audi should outperform peers driven by its expansion in Turkey.** In Q1/13, Blom Bank and Byblos Bank saw their deposits' growth rates standing at a respective 0% and 2% while their loan portfolio sluggishly performed (+0% and -2% respectively) with both LDRs in the 28%-29% range. We expect both banks will grow their deposits and loans by a low single digit rate in Q2/13e, while Bank Audi should continue to gain from the recent branch roll out in Turkey with expectations of a mid-single digit growth rate in deposits and loans following Turkey's strong balance sheet expansion seen in the last two quarters.

■ **Lebanese banks should continue to cope with 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) still high provisioning levels as measures facing the challenging operating environment. Latest statistics from the ABL reveal that Lebanese banks are still operating in a low interest environment, limiting potential to improve earning asset yields given relatively lower rates on Eurobonds, Tbills, CDs and Libor.

■ **We believe that Q2/13e upcoming earnings of banks under coverage hold no major surprise.** Our expectations for net profits growth in Q2/13e, stands at -28% YoY, (+8% YoY from continuing operations) +8% YoY and -3% YoY for Bank Audi, Blom Bank and Byblos Bank respectively, recognizing volatility between quarters. We note that in Q1/13 Bank Audi, Blom Bank and Byblos Bank YoY net earnings growth rates stood at -10%, +4% and -8% respectively.

■ **Provisioning levels should remain elevated, yet likely contained on downsized Syrian operations**. In Q2/13e, it is expected that some of the pressures on earnings growth will alleviate as we expect the provisioning amounts to stop escalating should NPL levels remain contained. In fact banks have significantly downsized their loan portfolios in Syria, and have built comfortable provisioning cushions facing rising uncertainties. Additionally, asset quality remains largely contained domestically. The Q1/13 consolidated gross NPLs stood at 2.7% for Bank Audi, 5.5% for Blom Bank and 6.0% for Byblos Bank.

FFA Private Bank Lebanese Banks Coverage

Company	Ticker	Recommendation	Target Price	Priced as of July 9, 2013	P/E	P/B to common	Dividend Yield
Bank Audi	AUDI.LB	Marketweight	USD 7.00	USD 6.10	6.2x	0.96x	6.6%
Blom Bank	BLOM.LB	Overweight	USD 10.00	USD 8.25	5.4x	0.89x	5.5%
Byblos Bank	BYB.LB	Marketweight	USD 1.60	USD 1.52	6.8x	0.71x	8.7%

Source: BSE, FFA Private Bank estimates

■ **We currently see no meaningful catalysts that can trigger the appetite of investors and drive shares higher**

We see no upcoming catalysts that can trigger the appetite of investors and drive current share price levels as the end of the dividend season coincides with rising concerns over political unrest and macroeconomic headwinds. Sluggishness has been translating into slower activity on the Beirut Stock Exchange with trading volumes down nearly 26% YoY in the first 5 months of 2013 to 17 million shares. On a positive note, we continue to expect Lebanese banking system resilience, some alleviating pressures on earnings for banks under coverage given more comfortable provision levels. More generally, we maintain our target prices and recommendations unchanged on the three banks (cf. table above) and we continue to recognize the banks' ability in limiting the adverse effects of less favorable macro dynamics and in coping with the pressures on earnings generation while adopting prudent provisioning measures.

Contacts:
Head of Research: Nadim Kabbara, CFA
n.kabbara@ffaprivatebank.com +961 1 985 195
Analyst: Raya Freyha
r.freyha@ffaprivatebank.com +961 1 985 195
Sales and Trading, FFA Private Bank (Beirut)
+961 1 985 225
Sales and Trading, FFA Dubai ltd (DIFC)
+971 4 3230300

BANK AUDI

FFA Model Assumptions

- We expect net profits of USD 98 million in Q2/13e, down 28% YoY (from unusually high earnings in Q2/12 on account of non-recurring proceeds from the sale of LIA) and up 15% QoQ as likely lower provisioning will be coupled with steady growth in operating income.
- We expect NII to grow robustly (+11% QoQ, +13% YoY) on a marginal improvement in margins and as earning assets keep momentum. Fees & commissions are expected to trend higher, yet slightly (+5% YoY).
- Key balance sheet indicators namely assets, deposits and loans are expected to maintain more energetic growth than peers triggered by the branch rollout in Turkey. We expect a QoQ growth in the 4%-5% range in Q2/13e for assets, deposits and loans.
- We forecast provisions of USD 21 million (+45% QoQ, -44% YoY). Our expectations for the cost-to-income stands at 49%, higher than 43% in Q2/12 yet lower than 52% in Q1/13 as the one-time costs attributed to the launch of Turkish operations subside.

FFA Q2/13e Forecasts

USD million	FFA Q2/13e	Q1 13a	Q2/12a	QoQ %	YoY %
Net interest income (NII)	156.9	141.6	138.4	11%	13%
Operating income	283.2	254.5	267.0	11%	6%
Net profits	98.0	85.5	135.6	15%	-28%
Diluted EPS	0.26	0.23	0.37	13%	-30%
Assets	34,782	33,284	28,790	4%	21%
Deposits	29,994	28,735	24,706	4%	21%
Loans	12,201	11,587	9,076	5%	34%
BVPS to common	6.47	6.36	6.44	2%	0%
FFA Cost-to-income ratio	*48.7%*	*51.8%*	*42.7%*		
Loans-to-deposits ratio	*40.7%*	*40.3%*	*36.7%*		

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 improving fundamentals mainly at the asset quality level as well as an ambitious growth expansion strategy (notably the branch rollout in Turkey) that should translate into a positive return in the medium to longer term and drive shares price higher as investor concerns regarding key regional operations and earnings slowdown subside. More generally, we continue to rate Bank Audi shares at Marketweight although recognize upside potential for the share price on the medium to longer term once investors gain greater clarity on management's execution of its regional growth plan.

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 earnings of USD 88 million in Q2/13e, roughly flat QoQ and up 8% YoY.
- We expect operating income at USD 187 million, up 7% YoY although down 11% QoQ due to high revenues from financial gains in previous quarter which helped finance substantial provisions.
- We expect NII to be roughly flat in Q2/13e (+2% QoQ, +0% YoY) as our forecasted flat interest margins are likely to be matched with moderate earnings assets growth. Fees and commissions should pursue a moderate momentum (+5% YoY).
- Key balance sheet indicators namely assets, deposits and loans are expected to witness a moderate growth at a low single digit in Q2/13e (+2% QoQ).
- We forecast provisions of USD 12 million (down from USD 27 million in Q1/13 and roughly flat compared to Q2/12) as we expect provision levels to lighten following a significant downsizing in Syria and a provisioning peak in 2012. Our expectations for the cost-to-income stands at 35% in Q2/13e, slightly lower than 36% in Q2/12.

FFA Q2/13e Forecasts

USD million	FFA Q2/13e	Q1 13a	Q2/12a	QoQ %	YoY %
Net interest income (NII)	132	130	133	2%	0%
Operating income	187	210	174	-11%	7%
Net profits	88	87	81	1%	8%
Diluted EPS	0.39	0.39	0.37	0%	5%
Assets	25,681	25,112	23,825	2%	8%
Deposits	22,293	21,792	20,864	2%	7%
Loans	6,199	6,059	5,808	2%	7%
BVPS to common	9.44	9.23	8.15	2%	16%
FFA Cost-to-income ratio	*35.2%*	*35.8%*	*38.5%*		
Loans-to-deposits ratio	*27.8%*	*27.8%*	*27.8%*		

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. More generally, we continue to rate Blom Bank shares at Overweight comforted by its relatively high profitability, ample liquidity and conservative strategy.

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 40 million in Q2/13e, up 13% QoQ and down by 3% YoY.
- We forecast NII of USD 70 million in Q2/13e (+10% QoQ, +6% YoY) as we expect interest margins to edge up from previous quarter.
- Fees and commissions should pursue a weak momentum (+2% YoY).
- Key balance sheet indicators namely assets, deposits and loans are expected to witness weak growth at a low single digit in Q2/13e, with an LDR maintained at 29%.
- We forecast provisions of USD 11 million (as compared to USD 6 million in Q2/12 and USD 18 million in Q1/13). Our expectations for cost-to-income stands at 49% in Q2/13e, representing a slight increase QoQ and YoY.

FFA Q2/13e Forecasts

USD million	FFA Q2/13e	Q1 13a	Q2/12a	QoQ %	YoY %
Net interest income (NII)	70	63	65	10%	6%
Operating income	114	115	110	0%	4%
Net profits	40	36	42	13%	-3%
Diluted EPS	0.05	0.05	0.06	17%	-2%
Assets	17,724	17,604	16,586	1%	7%
Deposits	13,876	13,695	13,270	1%	5%
Loans	4,077	4,030	4,094	1%	0%
BVPS to common	2.16	2.15	1.91	1%	13%
FFA Cost-to-income ratio	*48.7%*	*48.4%*	*48.2%*		
Loans-to-deposits ratio	*29.4%*	*29.4%*	*30.9%*		

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 in its outlook and redeploys capital to create additional shareholder value by way of expansion, acquisition, or return of capital. We continue to rate Byblos Bank shares at Marketweight.

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.