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|---|-----------------------------|---------------------|------------------|
| Lebanese Banks Q3/13 Preview October 9 th , 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 |

While Lebanese banks' shares could benefit from recent abatement in geopolitical tensions and relative sector resilience, investors are likely to remain on the sidelines awaiting more visibility towards a return to growth

■ **So far in 2013, Lebanese banks have reported moderate balance sheet expansion** weathering the sluggish economic environment as suggested by assets, deposits and loans growing at a mid-single digit rate. Latest statistics from the BDL and the ABL pointed to a growth in key activity indicators in the 4%-5% range in the first eight months of 2013 with assets, deposits and loans totaling USD 159 billion, USD 131 billion and USD 46 billion respectively. We note that non-resident deposits grew more vigorously, having increased by 10% over the same period to reach USD 26 billion at the end of August 2013. However banks under coverage have seen more modest balance sheet growth partially explained by the downsizing in their Syrian operations. The sector's loans-to-deposits ratio was at 35% at the end of August 2013 highlighting ample liquidity levels, while the dollarization of deposits and loans stood at a respective 66% and 77%.

■ **Bank Audi should continue to report more energetic lending growth than its peers triggered by its branch rollout in the Turkish market.** During Q2/13, Blom Bank and Byblos Bank saw the growth of their loan portfolio standing at a respective -1% and 2% with LDRs hovering around 28%, while Bank Audi grew its loan portfolio by a strong 10% from its expansion in Turkey which drove its consolidated LDR to 44%. We expect Blom Bank and Byblos Bank will grow their loans by a low single digit rate during Q3/13e, 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 loans following Turkey's strong balance sheet expansion seen in the last three quarters.

■ **As we approach third quarter earnings season, we still see only moderate upside to earnings given the following factors:** i) a low interest rate environment with a limited capacity to further decrease the cost of funds weighing on net interest income growth, ii) moderate fee income generation and iii) still relatively high provisioning levels as measures facing the challenging operating environment partially offset by cost containment. Our estimates for YoY net profit growth in Q3/13e, stands at +8% (excluding results from discontinued operations) +5% and +1% for Bank Audi, Blom Bank and Byblos Bank respectively. We note that during the last quarter, earnings of banks under coverage have met our estimates with Bank Audi, Blom Bank and Byblos Bank YoY net profit growth rates standing at +13% (excluding results from discontinued operations), +9% and -3% respectively.

■ **We believe that Q3/13e upcoming earnings of banks under coverage hold no major surprise although the volatility in provisions and financial gains will remain a key variable.** During the last quarter banks under coverage have surprised us with higher than expected provisions. In Q3/13e we could see some variance in provisions, however believe the trend of relatively high provisioning levels is likely to sustain yet without further escalation as banks have significantly downsized their loan portfolios in Syria and as asset quality has recently seen improvement. Gross NPLs of banks under coverage improved in Q2/13 to 2.3% for Bank Audi, 4.7% for Blom Bank and 5.1% for Byblos Bank compared to 2.7%, 5.5% and 6.2% respectively in Q1/13.

FFA Private Bank Lebanese Banks Coverage

| Company | Ticker | Recommendation | Target Price | Priced as of October 9, 2013 * | P/E ** | P/B to common | Dividend Yield |
|--------------------|---------|----------------|--------------|-----------------------------------|-----------|------------------|----------------|
| Bank Audi | AUDI.LB | Marketweight | USD 7.00 | USD 6.10 | 6.5x | 1.00x | 6.6% |
| Blom Bank | BLOM.LB | Overweight | USD 10.00 | USD 8.30 | 5.3x | 0.93x | 5.4% |
| Byblos Bank | BYB.LB | Marketweight | USD 1.60 | USD 1.52 | 7.1x | 0.76x | 8.8% |

Source: Company reports, BSE, FFA Private Bank estimates

Note: *Represent the price of listed shares, ** Based on a TTM EPS, Bank Audi's P/E excludes one-time items (as reported P/E at 7.0x)

■ **Share prices could gain comfort in the domestic banking sector's resilience relative to other segments of the economy and in the recent abatement of geopolitical tensions, yet likely to remain constrained by investors looking for further visibility.**

Sluggishness has persisted on the BSE in recent months as highlighted by total trading volumes down nearly 29% in the first 9 months of 2013 to 31 million shares and price performance remaining lackluster. On a positive note, we believe that the recent abatement in geopolitical tensions after the international agreement on Syria led to a renewed favorable investor sentiment in the region particularly Lebanon. While banks under coverage could benefit from this trend gaining comfort in their relative resilience in operations and favorable valuations at near 1x book value with generous dividend yields at 5%+, share prices are likely to remain constrained by the cautiousness of investors who remain on the sidelines awaiting greater clarity towards a return to growth. We maintain our target prices and recommendations unchanged on the three banks. (cf. table above)

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BANK AUDI

FFA Model Assumptions

- We forecast net profits of USD 105 million in Q3/13e, up 22% YoY (+8% YoY before non-recurring impairments in Q3/12) and up 2% QoQ.
- We expect NII to grow robustly (+4% QoQ, +13% YoY) on a slight improvement in margins and as earning assets keep momentum. Fees and commissions are expected to trend higher, yet slightly (+5% YoY).
- Key balance sheet indicators are expected to outperform peers triggered by the branch rollout in Turkey. We expect a QoQ growth in the 2%-6% range in Q3/13e for assets, deposits and loans.
- The LDR is expected to trend higher reaching 45% in Q3/13e as loan growth remains more energetic than deposits driven by the Turkish expansion (sector's LDR in Turkey: 107% vs. 33% for Lebanon as of Jun-13).
- We forecast provisions of USD 23 million (-29% QoQ, -12% YoY). Our expectations for cost-to-income stands at 48%, slightly higher than 47% in Q2/13 yet lower than the 50%+ level reached in Q4/12 and Q1/13 as one-time costs attributed to the launch of Turkish operations subside. Quarterly losses in Turkey have declined over the past three quarters possibly gearing towards breaking even in the short term.

FFA Q3/13e Forecasts

| USD million | FFA Q3/13e | Q2/13a | Q3/12a | QoQ % | YoY % |
|----------------------------------|------------|--------|--------|-------|-------|
| Net interest income (NII) | 166.0 | 159.0 | 146.6 | 4% | 13% |
| Operating income | 303.5 | 300.2 | 276.6 | 1% | 10% |
| Net profits | 105.1 | 102.8 | 85.9 | 2% | 22% |
| Diluted EPS | 0.27 | 0.26 | 0.21 | 5% | 29% |
| Assets | 34,656 | 33,694 | 29,182 | 3% | 19% |
| Deposits | 29,828 | 29,162 | 24,877 | 2% | 20% |
| Loans | 13,476 | 12,710 | 9,247 | 6% | 46% |
| BVPS to common | 6.65 | 6.41 | 6.61 | 4% | 1% |
| FFA Cost-to-income ratio | 48.4% | 47.1% | 44.4% | | |
| Loans-to-deposits ratio | 45.2% | 43.6% | 37.2% | | |

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 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 higher as investor concerns regarding key regional operations and earnings slowdown subside. 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 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 89 million in Q3/13e, roughly flat QoQ and up 5% YoY.
- We forecast operating income at USD 215 million, up 5% YoY although down 8% QoQ due to high revenues from financial gains in previous quarter which helped finance substantial provisions.
- We expect NII to edge up (+2% QoQ, +1% YoY) as a slight increase in margins is likely to be matched with moderate earnings assets growth. Fees and commissions should remain roughly stable.
- 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).
- The LDR is likely to remain unchanged at 27% highlighting ample liquidity levels and significant room to pick up lending from current levels.
- We forecast provisions of USD 25 million (down from USD 41 million in previous quarter and up from USD 21 million in Q3/12). Our expectations for the cost-to-income stands at 37% in line with the Bank's target of maintaining its cost-to-income in the 35%-38% range.

FFA Q3/13e Forecasts

| USD million | FFA Q3/13e | Q2/13a | Q3/12a | QoQ % | YoY % |
|----------------------------------|------------|--------|--------|-------|-------|
| Net interest income (NII) | 135.2 | 132.8 | 133.6 | 2% | 1% |
| Operating income | 214.6 | 232.6 | 204.5 | -8% | 5% |
| Net profits | 89.5 | 88.7 | 85.4 | 1% | 5% |
| Diluted EPS | 0.40 | 0.39 | 0.40 | 2% | -1% |
| Assets | 25,837 | 25,274 | 24,373 | 2% | 6% |
| Deposits | 22,391 | 22,056 | 21,323 | 2% | 5% |
| Loans | 6,114 | 5,989 | 5,884 | 2% | 4% |
| BVPS to common | 9.84 | 8.95 | 8.56 | 10% | 15% |
| FFA Cost-to-income ratio | 36.9% | 35.2% | 37.5% | | |
| Loans-to-deposits ratio | 27.3% | 27.2% | 27.6% | | |

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 43 million in Q3/13e, up 7% QoQ and 1% YoY.
- We forecast NII of USD 60 million in Q3/13e (+7% QoQ, -10% YoY) as we expect interest margins to edge up from previous quarter yet to remain lower than their levels in Q3/12.
- Fees and commissions should remain stable (+2% YoY).
- Key balance sheet indicators namely assets, deposits and loans are expected to witness moderate growth at a low single digit in Q3/13e, with an LDR maintained at 29%.
- We forecast provisions of USD 15 million (up from USD 5 million in Q3/12 and down from USD 30 million in Q2/13). Our expectations for cost-to-income stands at 40% in Q2/13e, almost flat QoQ.

FFA Q3/13e Forecasts

| USD million | FFA Q3/13e | Q2/13a | Q3/12a | QoQ % | YoY % |
|----------------------------------|------------|--------|--------|-------|-------|
| Net interest income (NII) | 59.9 | 56.2 | 66.8 | 7% | -10% |
| Operating income | 112.1 | 129.1 | 107.0 | -13% | 5% |
| Net profits | 43.2 | 40.2 | 42.6 | 7% | 1% |
| Diluted EPS | 0.06 | 0.05 | 0.06 | 17% | 1% |
| Assets | 17,716 | 17,567 | 16,897 | 1% | 5% |
| Deposits | 14,257 | 14,063 | 13,354 | 1% | 7% |
| Loans | 4,173 | 4,100 | 4,136 | 2% | 1% |
| BVPS to common | 2.00 | 1.98 | 1.99 | 1% | 1% |
| FFA Cost-to-income ratio | 40.0% | 39.6% | 47.0% | | |
| Loans-to-deposits ratio | 29.3% | 29.2% | 31.0% | | |

Source: Byblos Bank and FFA Private Bank estimates

Investment Opinion

While we like Byblos Bank's solid domestic retail franchise with strong risk management practices, we believe additional value could be generated for investors as visibility and cost-efficiencies improve

We recognize Byblos Bank's position in its domestic retail market and solid fundamentals benefiting from sizeable liquidity buffers, strong capitalization and superior asset/liability management practices, a validation of management's risk practices although at the detriment to profitability ratios. We also recognize the firm's leadership at better managing its asset liability mismatch with the issuance of costlier longer term liabilities. We believe Byblos Bank's shares could generate more value once the firm gains visibility 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.