FFA Private Bank s.a.l

Lebanese Banks	**Bank Audi (AUDI LB)**	**MARKETWEIGHT**	**USD 7.50**
Equity Research	**Blom Bank (BLOM LB)**	**OVERWEIGHT**	**USD 11.00**
April 5th, 2012	**Byblos Bank (BYB LB)**	**MARKETWEIGHT**	**USD 1.80**

See no meaningful catalysts that can drive shares higher as banks will likely weather an improved albeit still challenging operating environment in 2012

▪ Banking activity weathered softer economic conditions and heightened developments in the region, while profits lulled due to higher provisions and pressured margins on declining asset yields. Liquidity and capitalization levels continued to remain healthy supporting the Lebanese banking system while asset quality deteriorated marginally on account of regional operations.

▪ In 2011, Lebanese banks managed to report decent balance sheet activity as highlighted by a respective 9%, 8% and 13% increase in assets, deposits and loans, despite a slowdown in the local economy and the political turmoil that impacted the MENA region and slowed capital flows into Lebanon.

▪ Lebanese banks had to cope with declining yields on Lebanese treasury bills, which translated into narrowing spreads in local currency to 1.13% in December 2011 from 1.59% in December 2010 and continued low policy rates on short-term USD liquidity. This decline in interest margins coupled with higher provisions facing rising uncertainties exerted pressures on income. We believe that banks could benefit from gradually higher yields on Lebanese securities by either supporting margins and/or becoming more competitive on deposits.

▪ Despite the fears on asset quality arising from heightened political risks in key regional countries and the decelerating economy in Lebanon, we note the shrinking share of the consolidated loan book to regional entities attributed to Egypt and Syria. Healthy liquidity and comfortable capitalization levels continued to buffer the banking system with an LDR at 34% at year-end 2011 and a CAR II ratio at 13.3% as of February 2011 (according to ABL).

▪ While earnings generation was under pressure in 2011 due to: i) tightening margins ii) higher provisions and, iii) moderate balance sheet growth, it benefited from continuous growth in non-interest income as well as efficiencies stemming from cost-control measures. Net interest income grew by 18%, 4% and 2% respectively for Bank Audi, Blom Bank and Byblos Bank while their non-interest income increased by a respective 10 %, 15 % and 7%.

FFA Private Bank Lebanese Banks Coverage

Company	Ticker	Recommendation	Target Price	Priced as of April 5, 2012	P/E	P/B	Dividend Yield
Bank Audi	AUDI.LB	Marketweight	USD 7.50	USD 6.07	6.1x	1.05x	6.6%
Blom Bank	BLOM.LB	Overweight	USD 11.00	USD 7.65	5.2x	0.96x	5.9%
Byblos Bank	BYB.LB	Marketweight	USD 1.80	USD 1.71	7.3x	0.84x	7.8%

Source: BSE, FFA Private Bank estimates

▪ Going forward, we expect bottom line to regain some momentum in 2012e, as banks see higher growth in key balance sheet indicators and banks continue to reign in non-core spending. Furthermore, it should be noted that banks under our coverage have already significantly increased their provision levels facing rising uncertainties, which could translate into additional bottom line improvement should NPL levels not significantly deteriorate from current levels. While we continue to expect Lebanese banking system resilience, absent any upcoming catalysts including an uneventful dividend season, we see no significant upside from current share price levels.

▪ **We are Overweight on Shares of Blom Bank (TP USD 11.00) and Marketweight on Shares of Bank Audi (TP USD 7.50) and Marketweight on Shares of Byblos Bank (TP USD 1.80).**

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

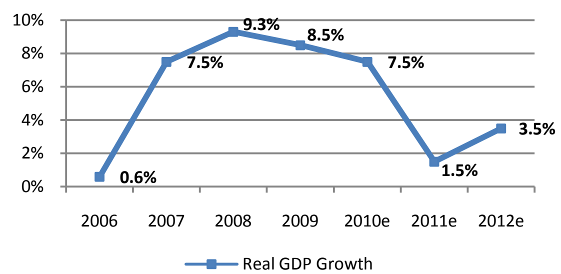
LEBANESE BANKING SECTOR – 2011 Performance

∎ Banking activity weathering softer economic conditions and political developments in the region

In 2011, the Lebanese banking sector managed to report decent growth in key balance sheet indicators despite the slowdown in the local economy and the political and security developments that affected the MENA region and slowed capital flows into Lebanon. IMF's GDP growth estimates were revised downwards to 1.5% for 2011e, from 7.5% in 2010e. Capital inflows into Lebanon were USD 14 billion in 2011 compared to USD 17 billion in 2010.

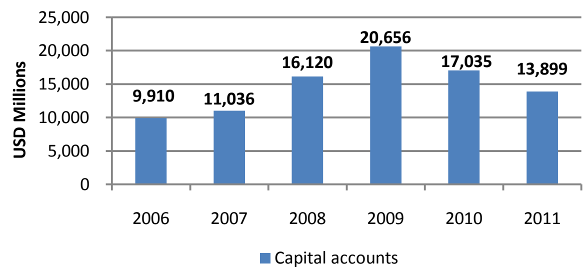
These softer domestic economic conditions decelerated the balance sheet activity of Lebanese banks with assets, deposits and loans growing at a high single digit growth rate in 2011. Commercial banks have increased their assets by 9% in 2011, mainly driven by an 8% increase in deposits as their assets remain mainly funded by customer deposits which accounted for 82% of total assets by year-end 2011 (with assets and deposits totaling USD 140.6 billion and USD 115.7 billion respectively) . Commercial banks grew their loan portfolio by 13% in 2011 to USD 39.4 billion compared to 2010. The dollarization rate of deposits was at 65.9% by year-end 2011, up from a de-dollarization record of 63.0% in 2010, yet slightly lower than its level at the end of Q3/11 which stood at 66.3%.

Figure 1: Real GDP growth



Source: IMF

Figure 2: Capital inflows

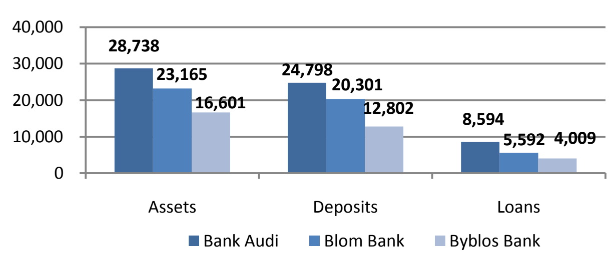


Source: BDL

∎ Banks under coverage reached a standstill in deposit and loan growth in Q4/11

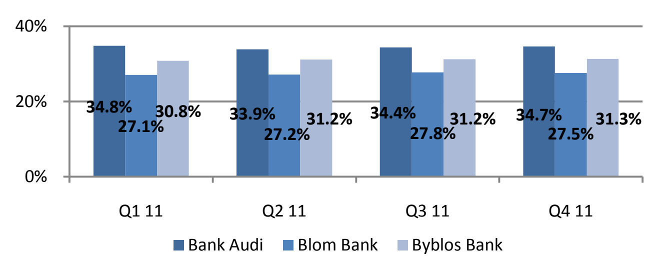
Banks under coverage (namely Bank Audi, Blom Bank and Byblos Bank) saw no growth in deposits and loans in Q4/11, at 0%, 0% and 1% respectively for deposits and 0%, -1% and 1% for loans respectively. Since the beginning of 2011, Blom Bank and Byblos Bank saw a respective 4% and 8% growth in deposits, along with a respective 8%, and 6% increase in loans, in contrast to flat performance for Bank Audi. Balance sheet growth for the three banks followed in parallel to deposits, given that the majority of assets were funded by deposits: 86%, 88% and 77% for Bank Audi, Blom Bank and Byblos Bank respectively.

Figure 3: Assets, deposits and loans as of Q4/11 (in USD millions)



Source: Company reports

Figure 4: Loans-to-deposits ratio as of Q1/11, Q2/11, Q3/11 and Q4/11



Source: Company reports

The Lebanese banking sector boasts a loans-to-deposits ratio at 34% at the end of December 2011, slightly up from 32.6% at year-end 2010 and reflecting a comfortable level of liquidity providing added potential to extend loans on an improving macro environment. The three banks under coverage remained highly liquid at end Q4/11 with a loans-to-deposits ratio at less than 35% (34.7% for Bank Audi, 27.5% for Blom Bank and 31.3% for Byblos Bank).

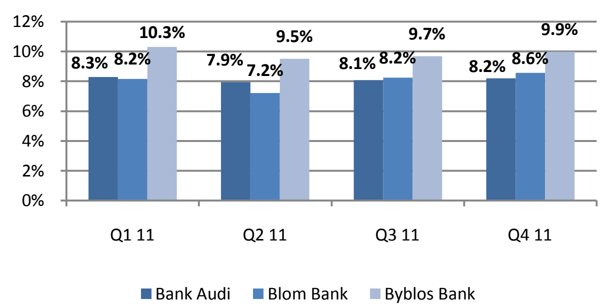
In the short term, we expect Lebanese banks to continue witnessing moderate deposit growth, yet at an accelerated pace than in 2011 as signs of improving economic conditions translated into capital inflows increasing 24% YoY for the month of January 2012.

We see loan growth regaining some momentum in 2012e as Lebanese banks channel more liquidity towards the private sector to offset the falling yields on Lebanese securities. Lending activity could, in addition, be bolstered by an improvement in real GDP growth (3.5% for 2012e according to the IMF up from 1.5% in 2011, although recognizes potential downside risks from Syria) translating into more demand for loans from the private sector. The Lebanese Central bank is focused on assisting the development of housing, education, and renewable energy, among other sectors. In fact the LCB has exempted banks from USD 4.5 billion in housing loans and USD 2 billion in the real economy. Overall we expect deposits (and loans in parallel) to grow at high single digit to low double digit rate in 2012e, picking up from 8% (with loans at 13%) in 2011.

■ Capitalization for banks under coverage supportive of more stringent regulatory capital requirements

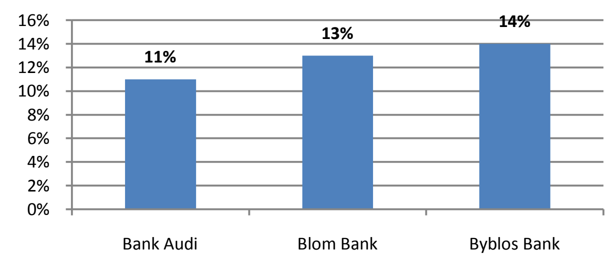
Bank Audi, Blom Bank and Byblos Bank capitalization remained sound with an equity-to-assets ratio at over 8% in Q4/11 and CAR II ratio over 11%. We expect Lebanese banks to continue to strictly monitor their capitalization ahead of more restrictive capital requirements as the Lebanese Central Bank commits to abide by Basel III requirements towards the near end of the 2015-2019 phase-in period.

Figure 5: Equity- to-assets ratio as of Q1/11, Q2/11, Q3/11 and Q4/11



Source: Company reports

Figure 6: Capital adequacy ratio (Basel II) as of Q4/11



Source: Company reports

■ Lebanese banks reported low levels of nonperforming loans at a consolidated level and adopted prudent provisioning measures facing developments in Syria and Egypt

NPLs have increased in regional operations given political developments in Syria and Egypt, yet the smaller share of these loans in the consolidated loan book has moderated the impact on overall asset quality. Banks under coverage saw some deterioration in their consolidated non-performing loan levels into 2011. Bank Audi, Blom Bank and Byblos NPLs rose to 2.9%, 3.2% and 3.0% respectively in 2011 from 2.3%, 2.7% and 2.3% respectively in 2010. At the same time, banks have been adopting conservative risk practices regarding their regional operations by setting aside recent profits into added collective provisions.

While we recognize the potential for a marked deterioration in loan quality from the spillover from political developments in regional countries and the decelerating economy in Lebanon, we note the smaller share of the loan book of regional entities in their consolidated assets particularly as their loans contract namely in Syria.

Following a decrease by 38%, 41% and 10% in the size of the loan book in Syria for Bank Audi, Blom Bank and Byblos Bank respectively, the share of these loans in the consolidated loan portfolio has fallen from a respective 10%, 13% and 13% in 2010 to 6%, 7% and 11% respectively in 2011.

Table 1: Loan quality and provisions in Syria for banks under coverage as at year-end 2011

In USD millions	Loan portfolio	NPLs	Specific provisions	Collective provisions	Specific and collective provisions
Bank Audi	523	5.4%	16.1	19.4	35.5
Blom Bank	383	2.7%	4.6	8.7	13.3
Byblos Bank	432	4.4%	5.6	11.3	16.9

Source: Company reports

Table 2: Loan quality and provisions in Egypt for banks under coverage as at year-end 2011

In USD millions	Loan portfolio	NPLs	Specific provisions	Collective provisions	Specific and collective provisions
Bank Audi	1,315	3.2%	26.2	24.7	50.9
Blom Bank	425	20%	72.2	-	72.2

Source: Company reports

Byblos Bank leads our coverage universe in terms of provision levels as we estimate the NPL coverage to exceed 100%, which we view as more than sufficient given relatively low NPLs, followed by Bank Audi and then Blom Bank.

■ Net interest income growth pressured by moderate balance sheet expansion, declining yields on Lebanese securities, and limited capacity to further decrease the cost of funds

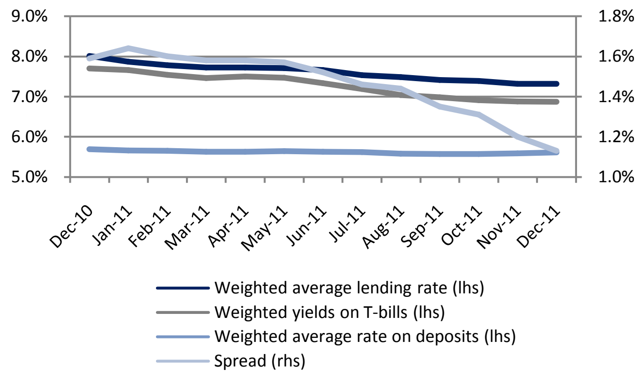
After a steady decline in the cost of funds in order to maintain profitability levels, Lebanese banks have maintained strict control on deposits rates during 2011 in an attempt to offset i) interest margin pressures on the back of less attractive asset yields , ii) decelerating balance sheet growth, and iii) lower contributions from regional operations.

According to the ABL, interest rates on deposits in local currency continued to decline, albeit slightly, from 5.69% in December 2010 to 5.61% in December 2011, while interest rates on deposits in foreign currency gained few basis points from 2.80% at the end of 2010 to 2.83% in December 2011. Declining yields on treasury bills from 7.70% in December 2010 down to 6.87% in December 2011, coupled with a decline in lending rates in local currency (from 8.01% in December 2010 to 7.32% in December 2011) have exerted pressures on LBP interest spreads throughout 2011. Interest spreads in local currency drastically tightened to 1.13% in December 2011 down from 1.59% in December 2010 while interest spreads in foreign currency reached 1.73% by year-end 2011, higher than 1.67% in December 2010 despite a decline in Eurobonds from 7.92% in December 2010 to 7.49% in December 2011.

We believe that Lebanese banks could benefit from higher yields on Lebanese securities, to avoid increasing pressures on the cost of funds which are already relatively low and could in turn negatively impact deposits inflows into the Lebanese banking system. We have seen in the latest auction that rates have increased on short term government securities in LBP as the LCB aims to increase the appetite of commercial banks.

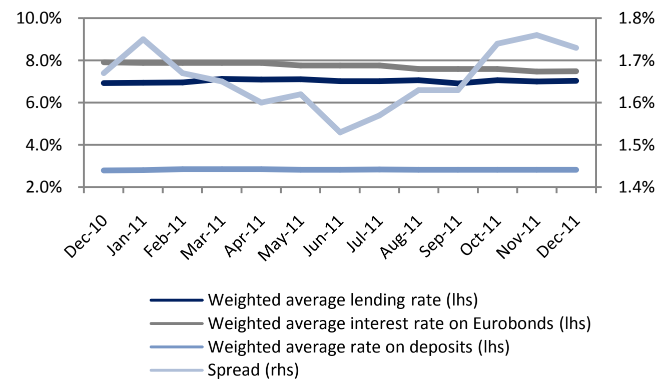
A report by the IMF published in February 2011, supported a gradual rise of interest rates on T-bills with maturities of less than 7 years, which would compensate for higher risks and make them attractive to banks, allowing the treasury to reduce its reliance on the BDL.

Figure 7: Interest spreads in LBP



Source: ABL

Figure 8: Interest spreads in USD



Source: ABL

Looking at the net interest income of banks under coverage in 2011, we notice that growth was moderate for Blom Bank and Byblos Bank (4% and 2% YoY respectively) reflecting pressures on interest margins from lower yields on assets including the negative carry on USD liquidity coupled with moderate balance sheet growth. On the other hand Bank Audi managed to increase its net interest income by 18% YoY in 2011, despite sharing the same headwinds and seeing balance sheet stagnation, as the Bank benefited from a pickup in interest margins which exceeded 2% for Q4/11 (given an improvement in spreads from 1.78% in 2010 to 1.97% in 2011).

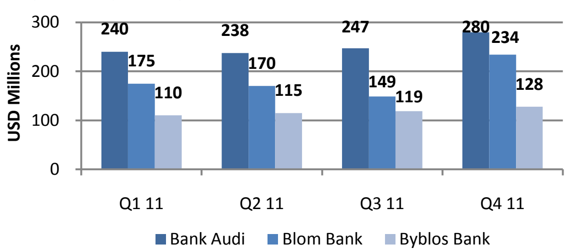
Going forward we believe net interest income growth will remain moderate on some balance sheet growth and relatively stable interest margins. We expect yields to remain lackluster given tight yields on Lebanese securities and low USD rates in the interbank market as central banks maintain their accommodative policies.

Cost-to-income ratio containment is helping to mitigate income headwinds

Blom Bank, which boasts high cost-efficiencies compared to the Alpha Banks average, managed to maintain its cost-to-income ratio relatively unchanged YoY in 2011 at 38.7%. On the other hand, Bank Audi and Byblos Bank saw an improvement in their efficiencies as highlighted by the cost-to-income ratio reaching a respective 45.3% and 43.3% in 2011 down from a respective 47.1% and 46.6% in 2010, the result of tightening cost-control measures offsetting softer growth in income levels.

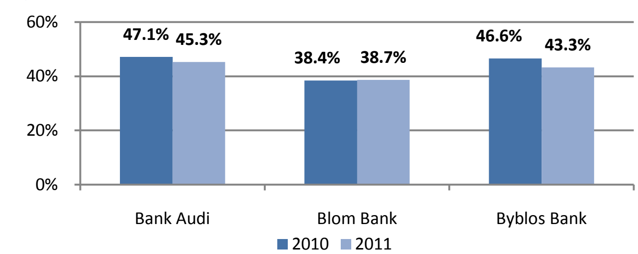
This trend of improving efficiencies has been seen in the sector over the past years and is expected to continue going forward as banks control costs by matching marginal increases in costs with marginal increases in revenues and rationing discretionary expenses. Cost-control measures are trending towards a further improvement in the cost-to-income for the banking sector as highlighted by a decrease in the ratio to 48.7% for 2010 down from 51.9% for 2009, according to Bilanbanques 2011.

Figure 9: Operating income as of Q1/11, Q2/11, Q3/11 and Q4/11



Source: Company reports

Figure 10: Cost-to-income ratio in 2010 and 2011



Source: Company reports

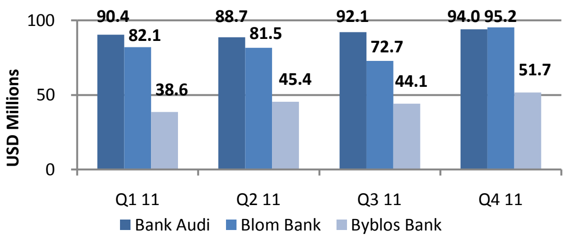
∎ Non-interest income continued to help supplement revenues for banks under our coverage

In 2011, banks under our coverage grew their non-interest income at 10%, 15% and 7% for Bank Audi, Blom Bank and Byblos Bank respectively driving it to a respective USD 465 million, USD 213 million and USD 191 million. This trend was mainly triggered by fees and commissions income for Blom Bank and Byblos Bank, while more broad based for Bank Audi. Bank Audi, Blom Bank and Byblos Bank fees and commissions grew YoY in 2011 by 6%, 22% and 15% while trading and investment income grew by 13%, 9% 0% respectively. Looking at the revenue mix for 2011, we note that fees and commissions, a resilient part of income, accounted for 18%, 16% and 20% of Bank Audi, Blom Bank and Byblos Bank operating income in 2011.

∎ Bottom line growth stalled in 2011 on the back of moderate balance sheet growth, increased provision levels and pressured interest margins

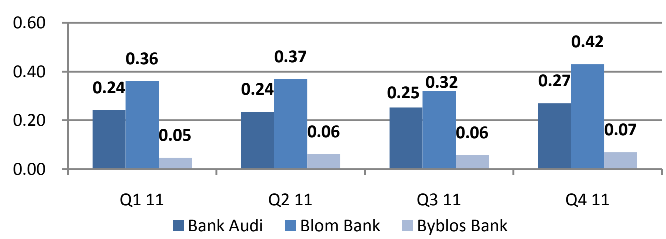
In 2011, bottom line growth for banks under our coverage lost momentum due to moderate balance sheet growth, pressured interest spreads, and increased provision levels, while fees & commissions, financial gains and improving efficiencies helped earnings.

Figure 11: Net profits as of Q1/11, Q2/11, Q3/11 and Q4/11



Source: Company reports

Figure 12: EPS in USD (to common) as of Q1/11, Q2/11, Q3/11 and Q4/11



Source: Company reports

Going forward, we expect bottom line growth to regain some momentum in 2012e, as banks see growth in key balance sheet indicators and banks continue to reign in non-core spending. Furthermore, it should be noted that banks under our coverage have increased their collective provision levels facing rising uncertainties, which could translate into some additional bottom line improvement should NPL levels not deteriorate significantly from current levels.

Lebanese banks as lenders to the government over the years have accumulated unrealized gains in sovereign paper, which could provide additional upside at the detriment of future interest margins.

∎ Political unrest and softer economic conditions have brought bank share levels closer to book value

Investor concerns on regional operations and political uncertainty in Lebanon have negatively impacted share price performance leading Bank Audi, Blom Bank and Byblos Bank to trade closer to their book values on weaker profitability, earnings, and visibility on regional operations.

For the Beirut Stock Exchange, activity is down nearly by half in Q1/12 with total trading volume at 13.4 million shares, representing a daily average of 215,965 shares in amount and about USD 1.5 million in value.

While we expect downside risks to continue to exist and the dividend season to be less eventful as in previous years, we see potential for Lebanese banks to surprise to the upside when Q1/12 earnings season begins. While there is no formal consensus for quarterly earnings reporting we expect market expectations should call for flat to down decline in earnings as compared to our flat to up forecasts.

BANK AUDI

Q4/11 Consolidated Financial Highlights

Bank Audi's net profits totaled USD 94 million in Q4/11, down 5% from USD 98.9 million in Q4/10 although growing 4% YoY in 2011 to USD 365.2 million. Diluted EPS was USD 0.27 in Q4/11 compared to USD 0.26 in Q4/10, while diluted EPS in 2011 was up 7% YoY to USD 1.00 as compared to USD 0.94 in 2010. In the context of a 21% increase in operating income and an improvement in cost-efficiencies, the 5% YoY decrease in the bottom line in Q4/11 can be attributed to i) significant increase in provisions (USD 39.1 million in Q4/11 vs. USD 1.8 million in Q4/10), and ii) higher taxes YoY. For the full 2011 year, net earnings grew by 4% as notably higher operating income and improved efficiencies were mostly offset by higher provisions YoY.

Q4/11 Financial Highlights for Operations in Syria and Egypt

In the Syrian market, Bank Audi saw deposit outflows and a slowdown in lending activity since the beginning of 2011. Assets, deposits and loans shrunk by 43%, 47% and 38% respectively totaling USD 1.2 billion, USD 1 billion and USD 523 million by the end of Q4/11. Net profits in Syria amounted to USD 2.4 million during 2011, down 84% from USD 15.1 million in 2010 as Management has been adopting a cautious attitude by increasing collective provision levels from USD 1.9 million in 2010 to USD 19.4 million in 2011. Gross doubtful loans (DLs) to gross loans increased in the Syrian entity to 5.4% from 1.2% in 2010 which drove specific provisions higher to USD 16.1 million from USD 4.7 million in 2010.

In Egypt, balance sheet aggregates did not observe any declines since the beginning of 2011 despite the ousting of the President and the difficult economic conditions that ensued. Assets, deposits and loans reflected by an increase of 10%, 10% and 7% respectively during 2011 to USD 3 billion, USD 2.6 billion and USD 1.3 billion by the end of 2011. NPLs levels deteriorated as gross doubtful loans to gross loans increased to 3.2% in 2011 as compared to 2.3% in 2010. Net profits amounted to USD 0.3 million during 2011 as USD 20.9 million of generated earnings were allocated to collective provisions while specific provisions reached USD 26.2 million (129% higher than in 2010) .

Strategy Update

Cautious attitude regarding operations in the MENA region and expected deployment of a branch network in Turkey

Bank Audi is currently adopting a cautious attitude in regional markets in the wake of political developments, particularly in Syria and Egypt as the profits of both entities (USD 42 million) were allocated to collective provisions. In both countries (and despite the contraction in the balance sheet of the Syrian entity), Bank Audi has been protecting its franchise and maintaining its resources, highlighting the unaltered longer term vision for these two markets. Alternatively, Management is focusing its expansion efforts on Turkey where the Bank was granted a license to establish a Bank in October 2011. Bank Audi subsequently announced that it is targeting a network of ten branches over 16 months reaching 50 branches in 2016 in Turkey. We view the Turkish market as offering an interesting growth potential given the relative political stability, young population, sizeable domestic market, and potential for trade finance between Turkey and the Arab world.

Margin preservation strategy amid slower balance sheet growth, less attractive yields on Lebanese securities and limits to further decrease the cost of funds

To offset slower balance sheet growth and preserve profitability levels, Bank Audi Management has been adopting a margin preservation strategy, targeting 2% in net interest margins. This target was achieved in Q4/11 as Bank Audi spreads totaled 2.08% for the quarter and 1.97% for the full year 2011. In light of less attractive yields on Lebanese securities (with average yields on Eurobonds and T-bills declining to 7.49% and 6.87% respectively by the end of 2011 down from 7.92% and 7.70% respectively by the end of 2010) and restricted room to further decrease the cost of funds, Management will look for attractive avenues to increase the yields on earning assets aiming to further improve interest spreads in 2012.

Cost-control measures aiming to maintain the efficiencies around their current level

Bank Audi is currently working on cost control measures including matching marginal cost increase by marginal increase in revenues, although some investments will be done in Turkey. It should be noted that Bank Audi has been gradually enhancing its cost-efficiencies during the past couple of years, as witnessed by a regular decrease in its cost-to-income ratio converging towards the 42%-45% range which was targeted by Management as being a sustainable level for this indicator.

Recent News

April 2012: The Annual General Assembly of Bank Audi will be held on the 10th of April 2012 to vote on the dividend amount among other resolutions.

March 2012: An Extraordinary General Meeting will be held on the 10th of April 2012 in order to address the issuance of a number of preferred shares and their listing on the Beirut Stock Exchange.

March 2012: The Board of Directors proposed a distribution of dividends for the year 2011 of USD 0.40 per share or USD 0.38 net of tax, equal to last year's amount.

March 2012: Bank Audi made an announcement regarding its expansion in Turkey, stating that the plan is to open around 50 branches in the market within a few years.

January 2012: Bank Audi announced the launch of 'Novo', a banking channel which provides customers with an interactive banking experience, the first version of which is set up in City Mall.

FFA Model Assumptions

In light of the current market conditions and recent financial performance of the Bank, we reviewed our model assumptions for Bank Audi. We maintained the growth of key balance sheet indicators roughly unchanged for 2012e at 6%, 6% and 7% for assets, deposits and loans respectively. Consequently the loans-to-deposits ratio was maintained at almost 35% for 2012e. We have also reflected the USD 300 million in share capital allocated to Turkey, assuming similar funding and liquidity over a gradual ramp up period over the next few years.

Based on our revised model, we expect net profits (group share) to grow by 11% in 2012e on the back of i) continued yet moderate balance sheet growth ii) stable interest margins iii) continued fees and commissions generation. Our model takes into account stable efficiencies as well as provisions YoY as the Bank has put aside significant provisions in 2011e facing rising uncertainties.

FFA Revised Forecasts

USD millions	Q1/11a	FFA Q1/12e	2011a	FFA 2012e	FFA 2013e
Assets	28,940	29,109	28,738	30,515	32,999
Deposits	24,891	25,177	24,798	26,327	28,434
Loans	8,662	8,792	8,594	9,193	10,070
Operating Income	240.0	264.1	1005.1	1106.3	1200.0
Net Profits	90.4	98.3	365.2	416.5	458.5
Net Profits (Group Share)	88.1	95.4	361.0	400.8	441.3
EPS	0.24	0.25	1.00	1.07	1.19
BVPS	5.82	5.90	5.77	6.40	7.09

Source: Bank Audi and FFA Private Bank estimates

Investment Opinion

We recognize Bank Audi's leadership at navigating through difficult operating conditions and highlight its attractive valuation levels
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 valuation 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 rate Bank Audi shares at Marketweight with a fair value of USD 7.50 per share
Based on our revised forecasts and discount rate assumptions to our Dividend Discount Model, our fair value estimate is USD 7.50 per share. 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

Q4/11 Consolidated Financial Highlights

Blom Bank's bottom line amounted to USD 95.2 million in Q4/11, roughly flat from USD 94.8 million in Q4/10. In the context of a 16% growth in operating income in Q4/11 over Q4/10 coupled with an improvement in cost-efficiencies, this stagnation in net profits is mainly attributed to higher provisions (USD 38.1 million in Q4/11 vs. USD 14.9 million in Q4/10) and higher income taxes (USD 27.0 million in Q4/11 vs. USD 22.1 million in Q4/10). The growth in operating income came from i) a 5% growth in net interest income reflecting similar pace in balance sheet volumes and ii) a strong increase in non-interest income including fees and commissions (+45%) and trading and investment (+33%). Basic and diluted EPS was USD 0.43 in Q4/11, 2% higher than in the corresponding period of previous year. The flat growth rate in earnings was similarly reported for the full year 2011. Net profits of USD 331.5 million in 2011 were roughly flat YoY compared to USD 330.6 million in 2010, as a 7% increase in operating income was matched by an 8% increase in operating expenses while higher levels of provisioning and higher taxes (to a lower extent) exerted pressures on earnings generation. Basic and diluted EPS was USD 1.48 in 2011, compared to USD 1.46 in 2010.

Q4/11 Financial Highlights for Operations in Syria and Egypt

In the Syrian market, Blom Bank saw deposits outflows and lending activity slow down since the beginning of 2011. Assets, deposits and loans declined by almost 40% throughout 2011 to USD 1,226 million, USD 1,093 million and USD 383 million respectively. Over the same period, NPLs rose from 0.95% in Q4/10 to almost 2.7% in Q4/11. In parallel to this increase, Management has increased provision levels in the Syrian entity to amount to USD 12.48 million by year-end 2011 in net provisions. Net profits in Syria declined by 20 % YoY in 2011 to USD 14.7 million.

In Egypt, assets and deposits did not see a decline since the beginning of 2011 despite political events. Both indicators increased by 7% and 6% respectively totaling USD 1,408 million and USD 1,133 million respectively, while the size of the loan book declined by 3% reaching USD 425 million at the end of Q4/11. Asset quality deteriorated as highlighted by an increase in the gross NPLs to gross loans ratio from 17.3% to 20%. Net profits amounted to USD 9.5 million during 2011 up 50% from 2010.

Strategy Update

Cautiousness in Syria, improving visibility in Egypt, and growing interest in Iraq

Blom Bank is currently adopting a wait and see attitude in Syria while increasing level of provisioning facing recent developments. In Egypt, the situation is getting back to normal despite the Bank having to cope with a devaluation of the currency and increasing level of NPLs. Blom Bank is currently looking at the Iraqi market.

Strengthening the revenue mix through the enhancements of revenues from non-interest sources

The medium term target for Blom Bank is to reach a balanced breakdown of revenues between net interest income and non-interest income through the enhancement of non-interest activities. To reach this target Management is deploying efforts seeking to increase this portion of revenues by increasing investment activities, brokerage, and asset management. Investment banking activities and the real estate fund in KSA are viewed by Management as providing significant opportunities.

Growing emphasis on lending supported by ample liquidity levels

Management is putting a growing emphasis on expanding its loan portfolio to enhance balance sheet expansion as a way to counterbalance pressures from interest margins on interest income. The loan portfolio grew by 8% YTD in 2011 despite softer economic conditions in Lebanon and political developments in regional countries. With a loans-to-deposits ratio at 27.5% by year-end 2011, Blom Bank boasts significant liquidity buffers to comfortably increase lending to the private sector.

Recent News

April 2012: The Annual General Assembly of Blom Bank will be held on the 19th of April 2012 to vote on dividend amount among other resolutions.

February 2012: BlomInvest Saudi Arabia announced the closing of the private placement offering of "BlomInvest Maskan Arabia for Real Estate Development Fund" amounting to USD 75 million. The project aims at building residential units in north and north-west Riyadh in collaboration with Maskan Arabia, the project developer.

FFA Model Assumptions

In light of the current market conditions and recent financial performance, we reviewed our model assumptions for Blom Bank. Based on our revised model, we expect Blom Bank will grow its assets, deposits and loans by 8%, 6% and 8% in 2012e respectively, unchanged from our previous assumptions and the loans-to-deposits ratio was maintained at 28%. We expect net profits (group share) to grow by 10% in 2012e on the back of i) continued yet moderate balance sheet growth, ii) relatively stable interest margins, iii) continued fees and commissions generation. Our revised model takes into account stable cost-efficiencies as well as similar provisions year-on-year.

FFA Revised Forecasts

USD millions	Q1/11a	FFA Q1/12e	2011a	FFA 2012e	FFA 2013e
Assets	22,811	24,413	23,165	24,893	26,962
Deposits	19,879	21,078	20,301	21,513	23,234
Loans	5,386	5,816	5,592	6,033	6,632
Operating Income	175.0	191.5	728.1	798.1	877.6
Net Profits	82.1	86.4	331.5	365.2	402.2
Net Profits (Group Share)	79.0	83.8	323.5	354.2	390.1
EPS	0.36	0.37	1.48	1.57	1.74
BVPS	7.46	8.75	7.94	9.55	10.77

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 maintain asset quality in light of difficult operations in key regional markets.

Recommendation

We rate Blom Bank shares at Overweight with a fair value of USD 11.00 per share

Based on our revised forecasts and discount rate assumptions to our Dividend Discount Model, our fair value estimate is USD 11.00 per share. 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

Q4/11 Consolidated Financial Highlights

Byblos Bank's net profits totaled USD 51.7 million in Q4/11, representing a 9% decrease from USD 57.1 million in Q4/10. Despite a significant reduction in non-personnel expenses (-56%), dragging total operating expenses down (-29%), the decrease in operating income in Q4/11 over Q4/10 (-8%) coupled with higher provisions (USD 20.8 million in Q4/11 vs. USD 13.9 million in Q4/10) and higher income taxes (USD 14.4 million in Q4/11 vs. USD 10.9 million in Q4/10) have led to a 9% decline in earnings. Diluted EPS was USD 0.07 in Q4/11 down from USD 0.08 in Q4/10. For the full year 2011, net earnings edged up 1% YoY to USD 179.7 million from USD 177.7 million in 2010, in the context of 4% growth in operating income and 3% decrease in operating expenses which were partially offset by higher allocation of provisions for credit losses (USD 43.9 million in 2011 vs. USD 25.3 million in 2010) and taxes to a lower extent. Diluted EPS was USD 0.23 in 2011, down from USD 0.25 in 2010.

Q4/11 Financial Highlights for Operations in Syria

Byblos Bank's Syrian operations saw a decrease in balance sheet indicators by roughly 10% for assets, deposits and loans during 2011 to a respective USD 856 million, USD 682 million and USD 432 million. Profits were down 30% YoY to USD 3.5 million in 2011 as bottom line was impacted by significantly higher provision levels to USD 16.9 million up from USD 3 million in 2010. NPLs rose to 4.4% by year-end 2011 up from 1.6% at year-end 2010.

Strategy Update

Conservative approach to growth regionally amid political turbulences and growing interest in Iraq

Byblos Bank will maintain its conservative approach to growth regionally, while continuing to look at any interesting market that could enhance growth. In this framework, Management is currently focusing on Iraq, an under banked market offering an attractive growth potential. Byblos Bank has recently opened a branch in the Iraqi city of Basra. Byblos Bank established a presence in Iraq in May 2007 through a branch in Erbil and has branch in Baghdad (February 2010). We expect Management will maintain its focus on the Iraqi market and will expand operations depending on the Bank's performance and available opportunities.

Growing emphasis on lending to ease pressures on interest margins

To preserve profitability in 2012 and offset softer balance sheet growth, Management aims to closely monitor interest margins and enhance them by focusing on lending and more specifically on trade finance, while avoiding increasing exposure to the real estate segment. It should be noted, that Byblos Bank has been adopting a liquidity accumulation strategy in the wake of softer economic conditions and regional developments in order to assess the heightened geopolitical risks and revaluate attractive investment avenues. The Bank boasts ample liquidity levels as highlighted by i) a loans-to-deposits ratio at 31.3% in Q4/11 unchanged from the previous quarter and year-end 2010 and ii) an immediate liquidity ratio (cash + due from banks / deposits) at 48.1% in Q4/11 up from 44.2% at year-end 2010.

Recent news

April 2012: The Annual General Assembly of Byblos Bank will be held on the 10th of April 2012 to vote on the dividend amount among other resolutions.

March 2012: Opening of a branch in Basra, Iraq.

March 2012: The board of Directors proposed a distribution of dividends for the year 2011 of LBP 200 per share or LBP 190 net of tax equal to last year's amount.

FFA Model Assumptions

In light of the current market conditions and recent financial performance, we reviewed our model assumptions for Byblos Bank, we expect Byblos Bank will grow its assets, deposits and loans by 8% in 2012e with a loans- to-deposits ratio expected to be maintained at 31.3%.

We expect profits (group share) to grow by 10% in 2012e on the back of i) continued yet moderate balance sheet growth, ii) relatively stable interest margins, iii) continued fees and commissions generation, iv) slightly improving efficiencies. Our revised model takes into account roughly unchanged provision levels YoY.

FFA Revised Forecasts

USD millions	Q1/11a	FFA Q1/12e	2011a	FFA 2012e	FFA 2013e
Assets	15,912	16,890	16,601	17,873	19,268
Deposits	12,219	13,077	12,820	13,877	15,021
Loans	3,768	4,095	4,009	4,346	4,778
Operating Income	110.4	112.8	471.9	515.6	563.6
Net Profits	38.6	41.1	179.7	198.0	218.9
Net Profits (Group Share)	37.0	39.3	172.4	189.4	209.3
EPS	0.05	0.05	0.24	0.27	0.30
BVPS	2.02	2.12	2.03	2.23	2.37

Source: Byblos Bank and FFA Private Bank estimates

Investment Opinion

While we like Byblos Bank's solid domestic retail franchise and growth in earnings 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 quality and coverage metrics, 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 rate Byblos Bank shares at Marketweight with a fair value of USD 1.75 per share
Based on our revised forecasts and discount rate assumptions to our Dividend Discount Model, our fair value estimate is USD 1.75 per share. We corroborate our DDM valuation by means of the residual income method as well as historical and comparable P/E and P/B multiples.