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
December 21, 2011	Byblos Bank (BYB LB)	MARKETWEIGHT	↓USD 1.75

Q3/11 Earnings Review: Weak deposit inflows within the context of regional political unrest, moderate lending activity on the back of softer economic conditions and significant provisions on key regional markets stalled Lebanese bank earnings in Q3/2011.

■ Banks under coverage (namely Bank Audi, Blom Bank and Byblos Bank) saw a sequential slowdown in deposits in Q3/11, at -2%, -1% and 1% respectively as macroeconomic conditions were softer and capital inflows into Lebanon slowed. Lending activity was moderate over the same period, reflecting softer macroeconomic conditions domestically and in the region, growing 0%, 2% and 1% for the three banks, respectively.

■ Banks under coverage remained highly liquid at period-end Q3/11 with a loans-to-deposits ratio at less than 35% (34.4% for Bank Audi, 27.8% for Blom Bank and 31.2% for Byblos Bank). Their capitalization levels remained sound with an equity-to-assets ratio over 8% in Q3/11 and a CAR II ratio over 11%.

■ Banks under coverage have not yet seen a marked deterioration in their consolidated non-performing loan levels into Q3/11, despite the recent events in their core regional countries and the slowing economy in Lebanon. While NPLs have increased in regional operations given difficult conditions in Syria and Egypt, the smaller share of the loan book on a consolidated basis has moderated their impact to consolidated NPLs.

FFA Private Bank Lebanese Banks Coverage

Company	Ticker	Recommendation	Target Price	Priced as of December 21, 2011	P/E 2011e	P/B 2011e	Dividend Yield
Bank Audi	AUDI.LB	Marketweight	USD 7.50	USD 5.85	6.0x	0.89x	6.8%
Blom Bank	BLOM.LB	Overweight	USD 11.00	USD 7.42	5.0x	0.95x	6.1%
Byblos Bank	BYB.LB	Marketweight	USD 1.75	USD 1.60	6.7x	0.57x	8.3%

Source: BSE, FFA Private Bank estimates

■ Bottom line growth for banks under coverage stalled due to decelerating balance sheet growth and increased provisions, while both fees & commissions and financial gains drove non-interest income. While increased provisions have negatively impacted earnings, provisions for some were down sequentially in Q3/11 from Q2/11 which we view as a possible signal of improving visibility on regional operations. We expect upcoming Q4 will follow Q3's roughly flat to down year on year growth in earnings.

We are Overweight on Shares of Blom Bank and Marketweight on Shares of Bank Audi and Byblos Bank

■ Based on the revision to our earnings estimates and outlook we have revised our fair value estimates for Bank Audi (rated Marketweight, to USD 7.50 from 9.00), Blom Bank (rated Overweight, to USD 11.00 from 12.00) and Byblos (rated Marketweight, to USD 1.75 from 1.90).

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

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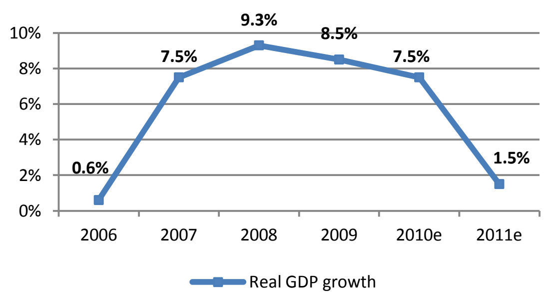
LEBANESE BANKING SECTOR - Q3/11 EARNINGS REVIEW

■ Less dynamic banking activity on slowing economic activity and political developments in the region

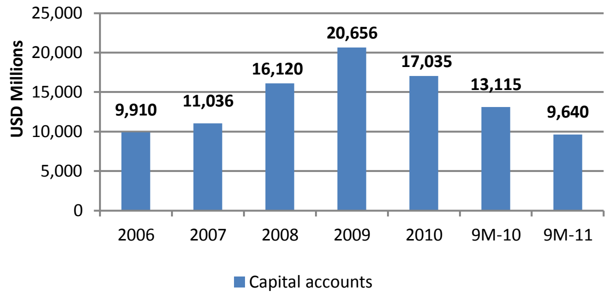
The Lebanese banking sector was affected by the slowdown in the local economy in light of a decline in confidence due to the domestic political impasse and political and security developments that shook the MENA region and slowed capital flows into Lebanon. IMF's GDP growth estimates were revised downwards to 1.5% for 2011e, with the slowdown in economic growth impacting loan activity as highlighted by loan growth of 11% in 9M/11 compared to 19% in 9M/10. Capital inflows into Lebanon were USD 9.6 billion in 9M/11 compared to USD 13.1 billion in 9M/10, resulting in slowing deposit inflows into Lebanese banks. Deposit growth in commercial banks was up 5.8% in 9M/11 compared to 8.4% in 9M/10. Dollarization rate was up to 66.3% at the end of September 2011 after a de-dollarization record of 63% in 2010 reflecting a decline in confidence since then.

Figure 1: Real GDP growth



Source: IMF

Figure 2: Capital inflows

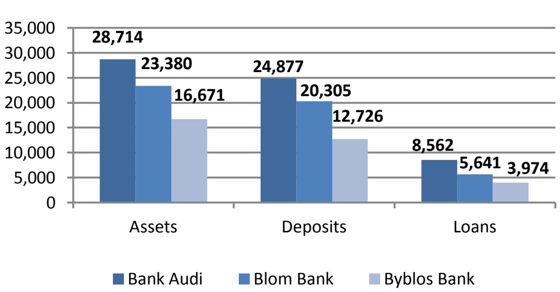


Source: BDL

■ Banks under coverage witnessed tepid sequential deposit and loan growth with ample liquidity levels

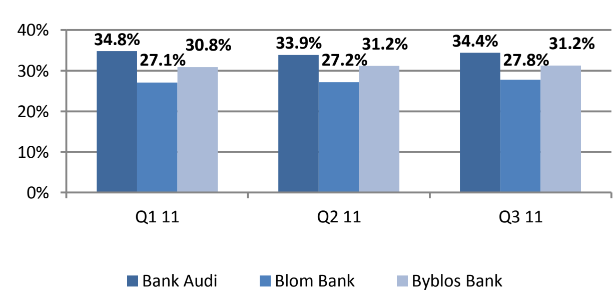
Banks under coverage (namely Bank Audi, Blom Bank and Byblos Bank) saw a sequential slowdown in deposits in Q3/11, at -2%, -1% and 1% respectively on the back of softer macroeconomic conditions on the domestic scene, slower capital inflows into Lebanon and challenging operations in core subsidiaries. The growth in balance sheet aggregates since the beginning of the year is healthier seen by a 4% and 7% year to date growth for Blom Bank and Byblos Bank compared to stagnation for Bank Audi. Balance sheet growth followed a similar trend to deposits, given that the majority of assets (approximately 80%) are funded by them: 87%, 87% and 76% for Bank Audi, Blom Bank and Byblos Bank respectively. Lending activity was moderate in Q3/11 over Q2/11 reflecting softer macroeconomic conditions domestically and in the region, growing 0.0%, 1.6% and 1.3% for Bank Audi, Blom Bank, and Byblos Bank, respectively.

Figure 3: Assets, deposits and loans as of Q3/11 (in USD millions)



Source: Company reports

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



Source: Company reports

Lebanese banks boast significant flexibility with a loans-to-deposits ratio at 34% at the end of September 2011 reflecting a comfortable level of liquidity compared to MENA peers. Banks under coverage remained highly liquid at end Q3/11 with a loans-to-deposits ratio at less than 35% (34.4% for Bank Audi, 27.8% for Blom Bank and 31.2% for Byblos Bank).

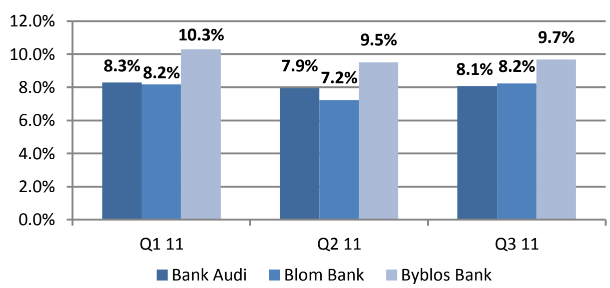
In the short term, we expect Lebanese banks to continue witnessing moderate balance sheet growth as deposit growth momentum will likely remain affected by the combined effect of soft economic conditions and regional unrest, while lending activity should see pressures from i) slower economic growth domestically and regionally and ii) the Lebanese banks conservative practices in view of maintaining high levels of liquidity and safeguarding asset quality.

■ Capitalization for banks under coverage remained sound

Bank Audi, Blom Bank and Byblos Banks capitalization remained sound with an equity-to-assets ratio at over 8% in Q3/11 and CAR II ratio over 11%. This compares with Alpha banks and the sector having an equity-to-assets ratio at 9% in 2010 and a CAR II ratio at 13% in 2010.

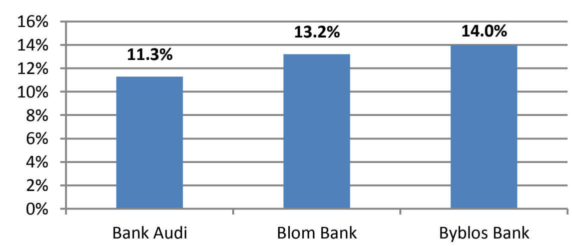
We expect Lebanese banks will look to shore up capital ahead of more restrictive capital requirements as the Lebanese Central Bank commits to abide by Basel III requirements.

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



Source: Company reports

Figure 6: Capital adequacy ratio (Basel II) as of Q2/11



Source: Company reports

■ Watching NPL levels although no marked deterioration as banks increased provision levels facing recent developments in Syria and Egypt

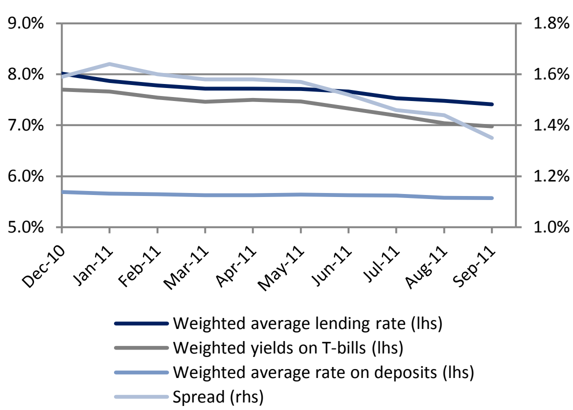
While NPLs have increased in regional operations given difficult conditions in Syria and Egypt, the smaller share of the loan book on a consolidated basis has moderated their impact. At the same time, banks have increased their provision levels as a preventive measure given disproportionate allocations to collective provisions. Despite the recent events in these core regional countries and the slowing economy in Lebanon, banks under coverage have not yet seen a marked deterioration in their consolidated non-performing loan levels into Q3/11 from a ratio of sub-standard and doubtful loans to total loans of less than 4% at end-2010. This compares favorably with a ratio of sub-standard and doubtful loans to total loans of 6.7% for Alpha banks and 8.0% for the sector at end-2010. While Syria and Egypt may represent less than 30% of total loans, and total loans may represent less than 30% of total assets, we see risks to the downside should the loan book deteriorate significantly impacting NPLs and profitability.

■ Net interest income impacted by slower balance sheet accumulation and softer interest margins

In order to maintain their profitability levels in light of decelerating balance sheet growth and less attractive asset yields, Lebanese banks have been attempting to offset interest margin pressures by offering less attractive interest rates on deposits. According to the ABL, interest rates on deposits in local currency continued to decline in 2011 from 5.69% in December 2010 to 5.57% in September 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 September 2011.

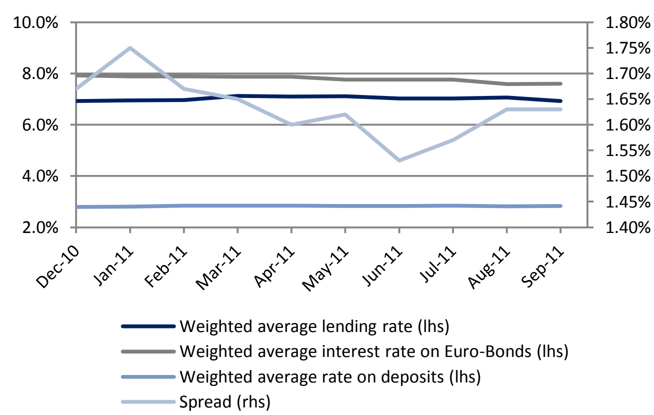
Declining yields on treasury bills and Eurobonds from 7.70% and 7.92% in December 2010 down to 6.98% and 7.60% respectively in September 2011, coupled with a decline in interest rate lending in local currency (from 8.01% in December 2010 to 7.41% in September 2011) have exerted pressures on interest spreads throughout 2011. Interest spreads in local currency tightened to 1.35% in September 2011 down from 1.59% in December 2010 while interest spreads in foreign currency followed a similar downward trend although to a lesser degree (from 1.67% in December 2010 down to 1.63% in September 2011).

Figure 7: Interest spreads in LBP



Source: ABL

Figure 8: Interest spreads in USD



Source: ABL

During Q3/11, banks under coverage saw softer interest margins from lower yields on assets including the negative carry on USD liquidity. As such, net interest income growth was roughly flat yoy in Q3/11 for Blom Bank and Byblos Bank on the back of moderate balance sheet growth, while Bank Audi net interest income was down 11% yoy in Q3/11 reflecting tepid balance sheet growth and weak lending activity.

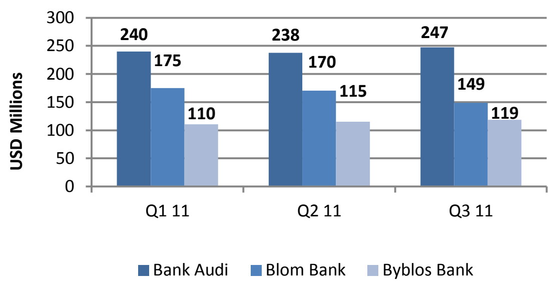
Going forward we believe net interest income growth will remain moderate on the back of moderate balance sheet growth and relatively stable interest margins. We expect yields to remain lackluster given tightening yields on Lebanese securities and low international rates in the interbank market as the U.S. Fed keeps benchmark interest rates near zero at least until mid-2013.

■ Banks under coverage have contained operating expenses although cost-to-income levels vary

Bank Audi and Byblos Bank efficiencies were relatively unchanged in Q3/11 represented by a cost-to-income ratio at 47.4% and 43.6% respectively in Q3/11 almost stable yoy. Blom Bank efficiencies deteriorated yoy in Q3/11 as highlighted by a cost-to-income ratio climbing to 44.3% from 40.6% in Q3/11 as a result of declining operating income (due to lower non-interest income) in light of relatively stable operating expenses. Going forward, prudent delays in the Banks' regional expansion plans as well as cost-control measures may prevent the cost-to-income ratio from seeing significant pressures given softer growth in income levels.

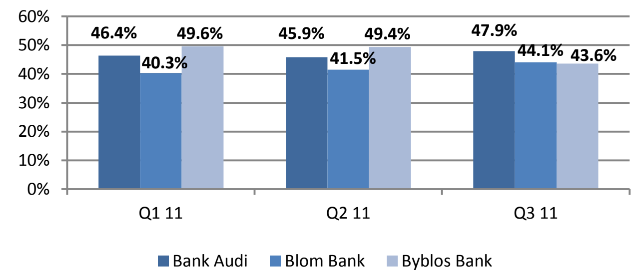
Lebanese banks have been continuously improving their cost-efficiencies during the past few years. In 2010, cost-control measures and delays in international expansion lead to a further improvement in the cost-to-income for the sector as highlighted by a decrease in the ratio to 47.2% for 2010 down from 51.6% for 2009, according to the ABL.

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



Source: Company reports

Figure 10: Cost-to-income ratio as of Q1/11, Q2/11 and Q3/11



Source: Company reports

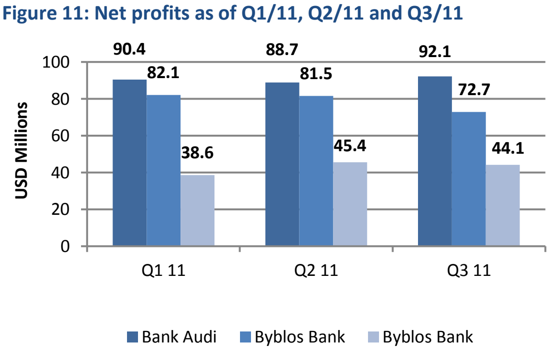
■ Continued growth in fees and commissions and gains on financial assets drove non-interest income in Q3/11

Banks' efforts to strengthen non-trading-based revenues, the insurance activities as well as lending resulted in continued pace in fees and commissions income. Bank Audi, Blom Bank and Byblos Bank fees and commissions grew by 5%, 9% and 32% respectively from Q3/10 to a respective USD 45.1 million, USD 27.3 million and USD 27.1 million in Q3/11. Except for Blom, banks also benefited from higher gains on financial assets which drove non-interest income to reach USD 115.3 million, USD 20.0 million, and USD 49.6 million for Bank Audi, Blom Bank, and Byblos Bank, respectively.

■ Bottom line growth stalled in Q3/11 due to decelerating balance sheet growth and increased provision levels

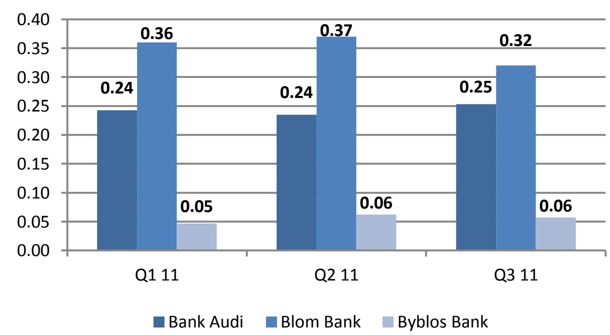
Bottom line growth for banks under coverage stalled due to decelerating balance sheet growth, softer interest spreads, and increased provision levels, while fees & commissions and financial gains drove non-interest income. Although increased provisioning has negatively impacted bottom line growth, provisions for some were down sequentially in Q3/11 from Q2/11 which we view as a possible signal of improving visibility on regional operations.

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



Source: Company reports

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



Source: Company reports

■ Political unrest and softer economic conditions have brought bank shares to even cheaper levels

The unfolding of political developments in the region and in Lebanon as well as the economic slowdown domestically and in key markets have moderated the operating performance of banks under coverage as highlighted by slower balance sheet growth, weaker interest margins and higher provision levels resulting in downward pressures on earnings growth.

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 at roughly their book values on weaker profitability, earnings, and visibility with P/B at respective 0.93x, 0.87x, 0.60x (P/B to common at respective 1.05x, 0.97x, and 0.81x) at the end of Q3/11.

We view this decline in share price performance as exaggerated given their: i) fundamentals remain relatively sound particularly regarding asset quality, ii) proven management teams with experience operating in difficult conditions, and iii) positive, albeit slower, growth in balance sheet and earnings. We remind investors that Syria and Egypt represent less than 10% of earnings for Bank Audi and Blom Bank as Lebanon continues to be the core driver of earnings generation, while Byblos has operations solely in Syria.

While we expect earnings and therefore dividends to moderate next year, the significant YTD declines in share prices for the three Lebanese banks under coverage (-29%, -21% and -13% for Bank Audi, Blom Bank and Byblos Bank respectively), result in attractive dividend yields at a respective 6.8%, 6.1 % and 8.3%. We expect investors will get more enthusiastic closer towards the end of Q1 2012 as investors look forward to payment of annual dividends, providing a possible short term catalyst.

■ No change to discount assumptions as Lebanese government securities have performed relatively well

Lebanese government securities including the Treasury bills in local currency and Eurobonds in foreign currency have performed relatively well compared to their regional peers, despite slower economic growth and heightened political and fiscal risks. As such we have not revisited our assumptions regarding discount rates used in our valuation methodologies for the three Lebanese banks under coverage. Our cost of equity is derived starting with the U.S. risk free rate and built up with additional spreads estimated by the differential on Lebanese over US debt securities as well as the equity risk premium multiplied by the beta.

BANK AUDI

Q3/11 Consolidated Financial Highlights

Bank Audi's net profits totaled USD 92.1 million in Q3/11 relatively unchanged from USD 91.7 million in Q3/10 although growing 7% yoy in 9M/11 to USD 271.3 million. Diluted EPS was USD 0.25 in Q3/11 flat from Q3/10, while 9M/11 EPS was up 8.5% yoy to USD 0.73 as compared to USD 0.67 in 9M/10. A decline by 11% in net interest income between Q3/10 and Q3/11 on the back of tepid balance sheet growth and weak lending activity was more than counterbalanced by a 41% increase in non-interest income in Q3/11 over Q3/10 mainly driven by a surge in trading and investment income (+81%). Higher provisioning levels as well as a higher income tax rate at 19.9% in Q3/11 up from 18.3% in Q3/10 capped the bottom line, as bank efficiencies were unchanged represented by a cost-to-income of 47.4% in Q3/11 relatively stable yoy.

Q3/11 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 have shrunk by almost 25% totaling around USD 1.5 billion, USD 1.3 billion and USD 645 million respectively by the end of Q3/11. In parallel to this increase, Management has been adopting a cautious attitude by increasing provision levels. Net profits in Syria amounted to USD 8 million during 9M/11. NPLs increased in the Syrian entity to 4.4% from 1.2% possibly attributed to a shrinking loan book as the amount of bad loans remained constant.

In Egypt, balance sheet aggregates didn't witness any declines since the beginning of 2011 despite political events. Assets and deposits were resilient as both indicators increased during the first nine months of the year (given an increase from USD 2.7 billion and USD 2.4 billion to USD 3 billion and USD 2.6 billion respectively), while the size of the loan book was roughly maintained at 1.3 USD billion. The asset quality was relatively preserved as NPLs levels witnessed a slight deterioration by the end of Q3/11. Net profits amounted to USD 13 million during 9M/11.

Strategy Update

Cautious attitude regarding operations in Syria and Egypt and acquisition of a license to operate in Turkey

Bank Audi is current adopting a cautious attitude in Syria and Egypt in the wake of political turbulences thereby safeguarding the quality of assets. However, the longer term vision for growth in these markets has not changed and expansions plans to consolidate footprints should be resumed as visibility improves. On the other hand, the Bank was recently granted a license to establish a Bank in Turkey, a market offering significant potential given the sizeable population and income growth opportunities. Bank Audi will likely provide services for trade finance and mid-segment corporate banking.

Margin preservation strategy amidst slower balance sheet growth and declining yields on Lebanese securities

Management is closely monitoring interest margins to offset slower balance sheet growth and preserve profitability levels, with a target of 2% in the short term.

Cost-control measures in light of tougher operating conditions

Bank Audi is currently working on cost tightening although some investments will be done in Turkey.

Implementation of a standardized IT software platform across the Group

Bank Audi is implementing an enterprise wide software program that aims to improve bank efficiencies.

Recent News

October 2011: Bank Audi increased its share capital by LBP 1,207,388,820 through issuance of 962,830 common shares. Its capital structure reaches 363,189,944 shares (349,439,944 common and 13,750,000 preferred).

October 2011: Bank Audi received approval from the Beirut Stock Exchange to list one million in additional global depositary receipts (GDRs). The bank converted previously one million of its common shares into GDRs, which will bring the overall number of listed GDRs to about 100 million (99,581,430).

October 2011: Turkey's banking regulator granted a license to Bank Audi to expand operations in the country. Turkey is a market with interesting growth potential given the sizeable population and high GDP. Bank Audi will likely provide services for trade finance and mid-segment corporate banking.

FFA Model Assumptions

In light of the change in market conditions and recent financial performance of the Bank, we reviewed our model assumptions for Bank Audi. We revised our deposit growth assumption to 6% in 2012e and moderated our expansion in the loans to deposit ratio to 34.7%. 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 years.

Based on our revised model, we expect Bank Audi will grow its assets, deposits and loans by 7%, 6% and 8% in 2012e respectively. We expect profits to grow by 12% in 2012e on the back of i) continued yet moderate balance sheet growth ii) relatively stable interest margins iii) continued fees and commissions generation and iv) gradual improvement in cost efficiencies and, v) stable provision levels year-on-year.

FFA Revised Forecasts

USD millions	Q4 10a	Q4 11e	2010a	2011e	2012e
Assets	28,688	29,239	28,688	29,239	31,321
Deposits	24,848	25,373	24,848	25,373	26,930
Loans	8,548	8,683	8,548	8,683	9,350
Operating Income	230.6	252.9	881.8	977.8	1,071.3
Net Profits	98.9	91.7	352.2	364.8	408.4
EPS	0.26	0.24	0.94	0.97	1.05
BVPS	6.61	6.59	6.61	6.59	7.79

Source: Bank Audi and FFA Private Bank estimates

Investment Opinion

We recognize Bank Audi's leadership at navigating through difficult operating conditions and attractive valuation levels although prefer to wait on improved visibility possibly ahead of dividend season

Bank Audi has reclaimed leadership among Alpha banks in terms of assets, deposits, and earnings as well as demonstrated strong franchise and confidence by 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 from this year's sell-off resulting in attractive earnings and dividend yields providing a possible catalyst ahead of the next dividend season.

Recommendation

We rate Bank Audi shares at Marketweight with a fair value of USD 7.50 per share (down from 9.00 previously)

Based on our revised forecasts and discount rate assumptions to our Dividend Discount Model, our fair value estimate is now 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

Q3/11 Consolidated Financial Highlights

Blom Bank's bottom line amounted to USD 72.7 million in Q3/11, equivalent to a decrease of 8% yoy compared to USD 79.4 million in Q3/10. This decline in net profits in Q3/11 over Q3/10 can be mainly attributed to lower operating income (-10%) as solid growth in fees and commissions income (+9%) was offset by a substantial decline in trading and investment income (-177%) in the context of roughly stable net interest income (-2%). Pressures on net earnings were alleviated by lower provisioning levels in Q3/11 over Q3/10, roughly flat operating expenses and lower income tax rate. Basic and diluted EPS was USD 0.32 in Q3/11, 9% lower than in the corresponding period of previous year. In 9M/11, net earnings were roughly flat yoy compared to 9M/10, as an increase in operating income (+4%) driven by a growth in net interest income (+5%) was offset by higher operating expenses (+9%) and levels of provisioning to a lower extent. Basic and diluted EPS was USD 1.05 in 9M/11, compared to USD 1.04 in 9M/10.

Q3/11 Financial Highlights for Operations in Syria and Egypt

In the Syrian market, Blom Bank has seen deposits outflows and lending activity slowdown since the beginning of 2011. Assets, deposits and loans have shrunk by almost 25% totaling USD 1.5 billion, USD 1.3 billion and USD 488 million respectively by the end of Q3/11. Over the same period, NPLs rose from 0.95% in Q4/10 to 1.63% in Q3/11. In parallel to this increase, Management has been increasing provision levels. Net profits in Syria amounted to USD 13.4 million during 9M/11, slightly down (-2%) from 9M/10.

In Egypt, assets and deposits didn't witness any decline since the beginning of 2011 despite political events. Both indicators increased by 3% and 5% respectively totaling USD 1.4 billion and USD 1.1 billion respectively, while the size of the loan book declined (-6%) reaching USD 414 million at the end of Q3/11. The asset quality deteriorated as highlighted by an increase in the gross NPLs to gross loans ratio from 17.3% to 19.1%. Net profits amounted to USD 6.9 million during 9M/11 down 36% from 9M/10.

Strategy Update

Conservative approach to growth as witnessed by a prudent and organic expansion

Blom Bank's strategy consists of gradual organic growth with a strict cost-control policy.

Strengthening the revenue mix through the enhancements of fees and commissions

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 fees and commissions. To drive to this target Management is deploying efforts seeking to increase this portion of revenues by increasing lending, growing fund management and realizing cross selling opportunities.

Growing emphasis on lending to provide support for earning growth

Management is putting a growing emphasis on expanding its loan portfolio to enhance balance sheet growth as a way to counter balance pressures on interest margins. The loan portfolio grew by 9% YTD despite the challenging operating environment.

Recent News

December 2011: Blom Bank shares added to the S&P AFE 40, a Pan-Arab index that also includes companies from Bahrain, Egypt, Jordan, Kuwait, Morocco, Oman, Palestine, Qatar, Saudi Arabia, Tunisia and the United Arab Emirates.

July 2011: Blom Bank Preferred Shares Class 2011 were issued in July with trading in August, representing 20 million non-cumulative perpetual redeemable preferred shares with a coupon of 7%.

July 2011: Blom Bank and Citibank were lead managers for a USD 1.2 billion two-tranche Eurobond, proceeds earmarked to refinance maturing government debt, which comprises USD 500 million maturing in 2016 and USD 700 maturing in 2022.

FFA Model Assumptions

In light of changes in market conditions and recent financial performance, we reviewed our model assumptions for Blom Bank. We revised our deposit growth assumption to 6% in 2012e and moderated our expansion in the loans to deposit ratio to 28.2%.

Based on our revised model, we expect Blom Bank will grow its assets, deposits and loans by 8%, 6% and 8% in 2012e respectively. We expect profits to grow by 11% in 2012e on the back of i) continued yet moderate balance sheet growth, ii) relatively stable interest margin, iii) continued fees and commissions generation, iv) gradual improvement in cost efficiencies and, v) stable provision levels year-on-year.

FFA Revised Forecasts

USD millions	Q4 10a	Q4 11e	2010a	2011e	2012e
Assets	22,336	23,513	22,336	23,513	25,409
Deposits	19,553	20,736	19,553	20,736	21,980
Loans	5,180	5,753	5,180	5,753	6,208
Operating Income	202.5	198.4	679.7	693.5	774.6
Net Profits	94.9	88.0	330.7	324.6	361.9
EPS	0.38	0.38	1.42	1.43	1.56
BVPS	8.46	7.84	8.46	7.84	10.52

Source: Blom Bank and FFA Private Bank estimates

Investment Opinion

We like Blom Bank's high returns and improving risk profile and view the valuation of its shares as attractive
We recognize Blom Bank' solid positioning in its domestic market and improving risk profile stemming from its efforts at better earnings diversification across products and markets. 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 cautious 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 (down from 12.00 previously)
Based on our revised forecasts and discount rate assumptions to our Dividend Discount Model, our fair value estimate is now 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

Q3/11 Consolidated Financial Highlights

Byblos Bank's net profits totaled USD 44.1 million in Q3/11, representing a 9% decrease from USD 48.3 million in Q3/10. In the context of an 8% growth in operating income (mainly driven by a 26% growth in non-interest income as net interest income remained roughly stable) and a 9% growth in operating expenses, earnings were mostly squeezed by a significant higher level of credit expenses at USD 11.4 million in Q3/11 up from USD 1.9 million in Q3/10. Diluted EPS was USD 0.06 in Q3/11 flat from Q3/10. In 9M/11, net earnings were up 6% to USD 128.1 million from 9M/10 driven by growth in both net interest income (+7%) and non-interest income (+13%), improved efficiencies (cost-to-income at 47.4% in 9M/11 vs. 49.0% in 9M/10) which was partially offset by a higher level of provisioning (USD 23.1 million in 9M/11 vs. USD 11.4 million in 9M/10). Diluted EPS was 0.17 in 9M/11 unchanged from 9M/10 despite higher net profits as a result of a conversion of Byblos Bank priority shares to common shares in May 2011.

Q3/11 Financial Highlights for Operations in Syria

The Bank's operations in Syria did not witness any deposit outflows. Balance sheet indicators were up as witnessed by an increase of 11%, 6% and 7% for assets, deposits and loans during the first nine months of 2011 to a respective USD 0.9 million, USD 0.7 million and USD 0.5 million. However profits were impacted by a significantly higher provision levels. In 9M/11 net profits were down 70% compared to 9M/10 to USD 0.9 million. NPLs rose to 7.2%.

Strategy Update

Conservative approach to growth regionally amidst rising uncertainties

Byblos Bank will maintain its conservative approach to growth both domestically and regionally, while continuing to look for any interesting acquisition opportunities to enter new markets or grow certain segments, while also cautiously roll out branches in existing markets.

Strengthening capitalization to comfortably meet regulators' requirements

Byblos Bank's main strategic objective is to strengthen its capital base to comfortably meet regulators' requirements. The Bank enjoys high levels of capitalization (as witnessed by a Tier 1 at 13.4% and a CAR II at approximately 14% in Q2/11), allowing it flexibility to grab any interesting acquisition opportunities.

Liquidity accumulation strategy awaiting for attractive investment avenues

Additionally and despite its negative impact on spreads, management has also 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. Byblos Bank boasts ample liquidity levels as highlighted by i) a loans-to-deposits ratio at 31.2% in Q3/11 unchanged from the previous quarter and year-end 2010 and ii) an immediate liquidity ratio (cash + due from banks / deposits) at 48.6% in Q3/11 up from 44.2% at year-end 2010.

Grow private banking given its underdeveloped nature

Another pillar of Byblos Bank's strategy is to strengthen private banking given its undeveloped nature and the Bank's potential to benefit from cross selling opportunities with its wide retail and corporate client base.

Recent news

June 2011: Byblos Bank issued USD 300 million unsubordinated unsecured notes priced at par, bearing a coupon rate of 7% per year, paid semi-annually and deemed for general corporate purposes.

July 2011: As a part of its expansion strategy, Byblos Bank opened a new branch in Vanadzor, Armenia, looking to play a role in the development of Vanadzor and nearby areas while benefiting from the long-term growth of the market. It should be noted that Byblos Bank established a presence in the Armenian market in 2007.

November 2011: Damascus Securities Exchange reflected a capital increase of four million shares by issuing stock with a par value of 500 Syrian Pounds per share, which resulted in an increase of 2 billion Syrian Pounds.

FFA Model Assumptions

In light of changes in market conditions and recent financial performance, we reviewed our model assumptions for Byblos Bank. We revised our deposit growth assumption to 9% in 2012e and moderated our expansion in the loans- to-deposits ratio to 31.3%.

Based on our revised model, we expect Byblos Bank will grow its assets, deposits and loans by 8%, 8% and 10% in 2012e respectively. We expect profits to grow by 9% in 2012e on the back of i) continued yet moderate balance sheet growth, ii) relatively stable interest margin, iii) continued fees and commissions generation, iv) gradual improvement in cost efficiencies and, v) stable provision levels year-on-year.

FFA Revised Forecasts

USD millions	Q4 10 a	Q4 11e	2010a	2011e	2012e
Assets	15,288	16,978	15,288	16,978	18,289
Deposits	11,892	12,981	11,892	12,981	14,051
Loans	3,771	4,002	3,771	4,002	4,401
Operating Income	139.4	139.5	453.8	479.8	522.5
Net Profits	57.1	53.1	177.7	177.6	193.0
EPS	0.08	0.07	0.25	0.24	0.26
BVPS	2.69	2.79	2.69	2.79	2.90

Source: Byblos Bank and FFA Private Bank estimates

Investment Opinion

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

We recognize Byblos Bank's positioning in its domestic retail market and solid fundamentals benefiting from sizeable liquidity buffers, solid capitalization and superior asset quality metrics, a validation of management's prudent approach 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 longer term liabilities. We believe Byblos Bank's shares could generate more value once Byblos gains visibility in its outlook and redeploys capital to create additional shareholder value including an expansion, acquisition, or return of capital.

Recommendation

We rate Byblos Bank shares at Marketweight with a fair value of USD 1.75 per share (down from 1.90 previously)

Based on our revised forecasts and discount rate assumptions to our Dividend Discount Model, our fair value estimate is now 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.