

Strong Fundamentals, but Political Backdrop a Risk for Short-Term Price Performance



SECTOR UPDATE

BANKS | LEBANON

≡ We initiate on Audi with a Buy rating; Reiterate Buy for BLOM and Byblos

Our fair value (FV) estimates for Lebanese banks are conservative and assume an average implied estimated P/BV multiple of 1.5x in 2011, well below our implied multiples for MENA banks, on account of low liquidity on the Beirut Stock Exchange (BSE) and political risk. We initiate coverage of Audi with a Buy rating and a FV of USD11.30/share (24% upside potential). We have increased our FV for BLOM from USD11.35/share to USD12.75 (23% upside potential) after a slight upgrade to our medium-term earnings forecasts. We adjust our FV for Byblos to USD2.27/share (28% upside potential) from USD2.6/share to reflect the bank's recent USD250 million rights issue. Byblos is the cheapest bank in our MENA banks coverage (ex-UAE), trading at an estimated 0.9x P/BV in 2011.

≡ GDP Growth to Slowdown in 2011, Political Tensions Hurting Confidence

Lebanon's security conditions improved following the election of a new president in May 2008 and the formation of a new cabinet in December 2009, leading to strong GDP growth since 2H2008. Strong capital inflows from Lebanese expatriates and an increase in tourist arrivals have supported private consumption, with banks benefiting from strong deposit and loan growth in 2009-2010. Our base case scenario assumes GDP growth of 5% in 2011, down from 6.5% in 2010, on weaker business and consumer confidence following increased political tensions linked to the upcoming verdict of the international tribunal investigating the assassination of Rafik Hariri.

≡ Expect 18% Loan Growth in 2011; Revenue Growth to Drive Earnings

We estimate an average 18% loan growth in 2011 (from an estimated 20% in 2010) for Audi, BLOM and Byblos. We expect volume growth to be driven by domestic lending demand, the banks' ongoing focus on lending to regional corporates by using their liquid domestic balance sheet (in USD), and by growth in the banks' regional subsidiaries. We expect net interest spreads to remain stable Y-o-Y, with lower deposit rates in USD and LBP offsetting pressure on asset yields. The provisioning burden was low in 2008-2009, and we do not expect provisioning to curb earnings growth in the short term.

≡ Political Climate a Risk to Short-Term Price Performance

Trading activity on the BSE has been subdued since July 2010 on increased political tensions, and we do not expect a change in trading dynamics in the short term. A main catalyst for short-term performance will be a resolution of the current deadlock between the country's two main political factions. We stress that the Lebanese economy and its banking sector have shown an ability to weather serious political shocks thanks to resilient capital inflows and the strong Lebanese banks deposit franchises.

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STOCKS ANALYSED IN THIS REPORT

	Price*	FV	Rating	P/E (x)			P/BV (x)			ROE	Div. Yld
	USD	USD		10e	11e	12e	10e	11e	12e		
Audi	9.08	11.30	Buy	9.6	8.0	6.7	1.5	1.4	1.2	18.1%	3.9%
BLOM	10.40	12.75	Buy	7.4	6.3	5.4	1.5	1.3	1.1	21.6%	3.9%
Byblos	1.78	2.27	Buy	7.8	6.4	6.1	1.0	0.9	0.8	14.2%	7.2%

*Prices as at 10 December 2010 (GDR prices for Audi and BLOM)

Source: EFG Hermes estimates



I. VALUATION

A. LEBANON BANKS STILL TRADE AT A LARGE DISCOUNT TO MENA (EX-UAE)

At an average estimated 2011 P/E of 6.9x and P/BV of 1.2x, Lebanese banks continue to trade at a discount to MENA banks (trading at an estimated P/E of 10.6x and P/BV of 2.0x for MENA banks under our coverage universe, excluding UAE banks).

In addition to low trading volumes on Beirut's stock market, the domestic political backdrop has traditionally played a major role in keeping Lebanese banks' valuation multiples below those of MENA banks. This is despite: i) Lebanese banks' earnings performance having been strong even in years where Lebanon saw major political shocks, ii) Lebanon's political and security conditions having improved markedly following the election of a new president in May 2008 and the formation of a new government in December 2009, and iii) Lebanese banks' asset and earnings growth having been above MENA banks since end-2008, when credit provisioning has been a major drag to earnings for most regional banks.

FIGURE 1: LEBANESE BANKS CURRENT VALUATION MULTIPLES*

	P/E (x)		P/BV (x)		Div. Yield
	2010e	2011e	2010e	2011e	2010e
Audi	9.6	8.0	1.5	1.4	3.9%
BLOM	7.4	6.3	1.5	1.3	3.9%
Byblos	7.8	6.4	1.0	0.9	7.2%
<i>Average MENA Banks (ex UAE)</i>	<i>11.5</i>	<i>9.4</i>	<i>1.8</i>	<i>1.6</i>	<i>3.50%</i>

*Share Prices as of 10 December 2010
Source: EFG Hermes estimates

We discuss below what, in our view, are other important valuation considerations for Lebanese banks.

MAIN INVESTMENT CONCERNS ON LEBANESE BANKS

i) Fiscal Imbalances is the Main Vulnerability of the Lebanese Economy; Banks are Highly Exposed to Sovereign Risk

The high indebtedness ratio of the country is one the main vulnerabilities of the economy. The public debt-to-GDP ratio has declined over the past three years, but remains high at 137%, down from 180% in 2006. Lebanon's budget deficit as a proportion to GDP has also improved and reached 6.7% as at October 2010, down from 13.5% in December 2006. Economic reforms, including privatisation, rationalisation of government expenditures and fiscal revenue-enhancing measures are key pillars to fiscal adjustment in Lebanon. We do not expect any major economic reforms in the short term, and therefore we assume only a minor decline in the public debt-to-GDP ratio as a result of nominal GDP growth.

Lebanese banks have traditionally played a key role in financing the government's budget deficits. Of the total USD51.5 billion of government debt outstanding as at June 2010 (roughly equally split between LBP- and USD-denominated debt) around 50% of the total is held by Lebanon's banking sector. Holdings of LBP-denominated T-bills and Eurobonds account for an average 35% of Lebanese banks' assets.



The exposure to the government rises to 45% when certificates of deposits (CDs) issued by the Central Bank of Lebanon are accounted for (the assessment of total exposure to the Lebanese government arguably needs to include exposure to the central bank, as the central bank is itself an important creditor to the government).

ii) Relatively High Credit Penetration in Lebanon

Private sector credit in Lebanon accounts for c80% of GDP, amongst the highest in the MENA region, and therefore suggests lower long-term growth opportunities relative to other neighbouring markets, such as Egypt or Syria, where private sector credit to GDP accounts for 37% and 32%, respectively.

iii) Profitability Levels below MENA Banks

Lebanese banks' profitability as measured by Return on Assets (ROA) is lower than for banks in other MENA countries. Aside from a higher tax burden than most MENA banks (ex-Morocco), Lebanese banks' lower ROA is explained by their much higher balance sheet liquidity: interbank assets account for 20% of total assets on average, with the majority of these interbank placements being USD-denominated. This has traditionally resulted in thinner net interest spreads compared with other MENA banks with higher customer lending exposure. Net interest margins have also been trending down over the past two years due to the decline in USD LIBOR since the end of 2008. Deposit rates in USD have declined, but not as rapidly as benchmark USD rates. Rates paid by Lebanese banks on USD deposits are high and reflect an embedded risk premium because of Lebanese-specific political conditions.

(iv) Political Climate Subject to Risks of Lack of Long-Lasting Agreement between Main Political Factions

A main short-term risk is the upcoming verdict by the international tribunal that is investigating the assassination of ex-Prime Minister Rafik Hariri. News during the summer that the verdict will likely indict Hezbollah members for the assassination has led to an increase in political tension in the country. The verdict is expected to be published at the end of December 2010.

... BUT POSITIVE VALUATION DRIVERS SUPPORT THE CASE FOR LEBANON BANKS

i) Lebanon's Economy has weathered Serious Political Shocks, Despite Apparent Vulnerability

Lebanon has weathered different episodes of political instability over the past few years. We believe a key risk for Lebanon and its banking system would be a situation of rapid deposit withdrawals, given that deposit inflows from Lebanese expatriates are key for covering the government's financing needs. Lebanon's banking system has been resilient following two recent political shocks (the assassination of ex-Prime Minister Rafik Hariri in 2005 and the Hezbollah-Israel conflict during the summer of 2006), with deposit outflows limited to 5% of the total customer deposit base and with deposits gradually returning to the system thereafter. Furthermore, deposit inflows have been strong in the aftermath of the global financial crisis, providing reassuring evidence of ongoing depositors' confidence in Lebanon's financial system.



ii) Lebanese Banks have entered Markets with Higher Growth Prospects than Lebanon; Syria has the Potential to Become a Key Market for Lebanese Banks in the Medium Term

Lebanese banks started in 2004 a geographical expansion strategy, which targets primarily under-penetrated banking systems and/or markets with a low level of competition: Syria (BLOM, Audi and Byblos), Egypt (BLOM and Audi) and Sudan (Audi and Byblos). Byblos has in addition opened two branches in Iraq (one in Erbil and another one in Baghdad), has bought a bank in Armenia and another one in the Democratic Republic of Congo, and has launched a representative office in Nigeria.

We believe that Syria has the potential to become a key market for Lebanese banks in the medium term due to: i) the large size of its population at 15 million (compared with 3.6 million for Lebanon), ii) low credit penetration (loans-to-GDP ratio of 32%), and iii) strong business ties between the two countries. Within a period of only five years, Lebanese banks have been able to gather deposits and market share at a rapid pace, at the expense of Syria's state-owned banks. BLOM, Audi and Byblos currently account for an estimated 18% of system assets.

iii) Low Customer Loans-to-Deposits Ratio suggests Ample Room for Expansion

Lebanese banks' strategy is to reduce their share of revenues sourced from treasury investments and liquidity management and to increase their revenue exposure to customers, both in terms of net interest income and fee income. The banks' low customer loans-to-deposits ratio suggests ample room for expansion. Loan growth is being driven in the short term by strong domestic economic conditions, while in the medium term we expect regional markets to provide a sizeable opportunity for asset growth. Lebanese banks are leveraging their existing customer relationships to increase lending to regional corporates by using the USD liquidity in their domestic balance sheets, with Audi, in our view, being the most aggressive in this strategy.

B. FAIR VALUES AND RATINGS

Methodology

We have updated our fair value (FV) estimates for Lebanese banks by using a discounted equity cash flow model (DECF) based on consolidated earnings and consolidated risk-weighted asset (RWA) growth. Free equity cash flows are calculated by subtracting from attributable profits (after dividend payments to preferred shareholders) the amount of capital required to finance RWAs growth. We have maintained the capital adequacy ratio at 8% of RWAs. We use explicit forecasts for eight years and have calculated a terminal value for the business at the end of the forecast period, based on a terminal perpetuity of 4%.

We use a cost of equity of 14.5%, based on the current yield of one-year treasury bills (4.8%), to which we add a premium of 3.2% to compensate for short maturity. We use an equity risk premium of 6.5%.



Lebanese Banks' Share Prices well below Our Estimated Fair Values

We assign a FV for Bank Audi of USD11.30 (+24% upside potential) and initiate coverage with a Buy rating. We have raised our FV for BLOM to USD12.75/share from USD11.35/share (23% upside potential) after a slight upgrade to our medium term earnings forecasts. We adjust our FV for Byblos to take into account the USD250 million rights issue that was completed by end of June 2010. Our new FV for Byblos is USD2.27/share (down from USD2.60/share), and implies 28% upside potential.

Our FV estimates imply an estimated P/BV multiple in the area of 1.7x in 2010, more conservative than the implied P/BV multiple used in the valuation of most MENA banks under our coverage.

FIGURE 2: FAIR VALUES AND IMPLIED P/BV

	FV (USD)	Share Price* (USD)	Upside	Implied P/BV 10e (x)	Implied P/BV 11e (x)
Audi	11.30	9.08	24%	1.9	1.7
BLOM	12.75	10.40	23%	1.8	1.6
Byblos	2.27	1.78	28%	1.2	1.1

*Share prices as of 10 December 2010
Source: EFG Hermes estimates

Current Share Prices Do Not Reflect Potential Value Accretion from Regional Entities

While our FV estimates are derived from applying a DECF model to consolidated earnings, we have carried out a simple sum-of-the-parts analysis, which aims at estimating the value of the banks' largest MENA subsidiaries and Lebanon operations (which also include the banks' European operations and branches and representative offices outside of Lebanon).

We have assigned a range of "market cap-to-deposits" ratio for the purpose of this exercise. Using a "market cap-to-deposits" ratio rather than a P/BV multiple overcomes the issue of different capitalisation levels of Lebanese banks' foreign entities (for example, Audi's Sudanese subsidiary is strongly capitalised, with a shareholders' equity-to-assets ratio of 20%). We also believe that for Lebanese banks the value of their franchises resides to a great extent in their deposit franchises, with the majority of Lebanese banks' deposits being private sector/retail deposits.

Our analysis shows that the banks' current share prices almost assigns no potential value accretion to the banks' regional entities, in spite of these entities being already profitable.



FIGURE 3: BANK AUDI: SUM-OF-THE-PARTS ANALYSIS (BASED ON 2011 ESTIMATED EARNINGS)

In USD million, unless otherwise stated

	Lebanon	Syria	Egypt	Sudan	Total
Net Profit*	324	26	33	7	391
Shareholders' Equity	1,406	178	298	102	1,984
Assets	24,196	2,235	2,986	282	29,699
Deposits	18,662	1,802	2,227	117	22,807
Market Cap to Deposits	15.0%	20.0%	20.0%	15.0%	
Implied Value (Audi's share)	2,799	169	445	12	3,426
Market Cap					3,125

*Before dividends to common shareholders
Source: EFG Hermes estimates

FIGURE 4: BLOM BANK: SUM-OF-THE-PARTS ANALYSIS (BASED ON 2011 ESTIMATED EARNINGS)

In USD million, unless otherwise stated

	Lebanon	Syria	Egypt	Total
Net Profit*	319	17	23	360
Shareholders' Equity	1,417	125	207	1,749
Assets	23,641	2,140	1,809	27,590
Deposits	19,929	1,943	1,486	23,358
Market Cap to Deposits	15%	20%	20%	
Implied Value (BLOM's share)	2,989	152	267	3,408
Market Cap				2,236

*Before dividends to common shareholders
Source: EFG Hermes estimates



FIGURE 5: BYBLOS BANK: SUM OF THE PARTS ANALYSIS (BASED ON 2011 ESTIMATED EARNINGS)

in USD million, unless otherwise stated

	Lebanon	Syria	Sudan	Total
Net Profit*	126	13	18	156
Shareholders' Equity	980	73	101	1,154
Assets	15,907	1,029	500	17,436
Deposits	12,648	828	236	13,712
Market Cap to Deposits	15%	20%	15%	
Implied Value (Byblos' share)	1,897	69	23	1,989
Market Cap				753

*Before dividends to common shareholders
Source: EFG Hermes estimates

WE HAVE BUY RATINGS ON BLOM, AUDI AND BYBLOS

Our estimated FVs for all three banks imply more than 15% upside potential. Our Buy ratings for BLOM and Byblos remain unchanged, while we initiate coverage of Bank Audi with a Buy rating.

We have included common valuation drivers for Lebanese banks earlier in this section; however, we believe it is important also to highlight the main stock-specific valuation catalysts.

FIGURE 6: STOCK-SPECIFIC POSITIVE AND NEGATIVE VALUATION CATALYSTS

Bank	Positive	Negative
Audi	Audi should have a much stronger franchise in three years time, because of aggressive branch expansion in MENA region	Returns on investment in recent branch expansion (especially Egypt) may take longer to be realised in the event of slower economic growth or slower market share gains, particularly on the retail side
BLOM	Strong track record of high returns and strong image as a conservative, safe bank should continue to be a driver of deposit growth in the domestic market	The "domestic branding" might be difficult to replicate in other markets. Banks which are more aggressive in developing networks and new product areas, might be more successful in developing a strong franchise
Byblos	Strong consumer and SME franchise places. Byblos in a strong position to benefit from strong economic growth in the domestic market; aggressive expansionary strategy in markets where there is a large Lebanese Diaspora (Africa)	Integration risks in the face of potential acquisitions, both in the domestic market and abroad

Source: EFG Hermes estimates



II. RECENT INDUSTRY DYNAMICS

DEPOSIT GROWTH REMAINS STRONG, DE-DOLLARISATION CONTINUES

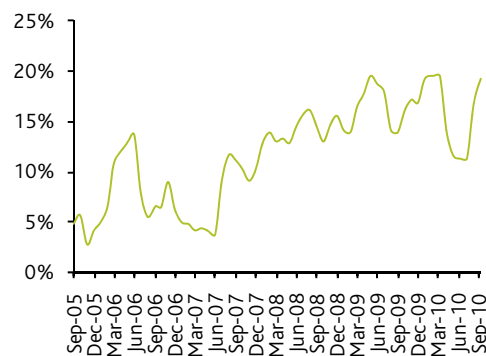
Deposit inflows from Lebanese expatriates, a recurrent driver of Lebanese banks' deposit growth

The Lebanese banking sector has seen very strong deposit growth rates over the past two years (deposits at the system level grew 16% Y-o-Y in 2008 and 17% Y-o-Y in 2009, compared to a CAGR of 11% in 2005-2008) driven by private sector deposits, and particularly by large deposit inflows from Lebanese expatriates, who have been historically a recurrent driver of Lebanese banks' deposit growth. We believe that additional factors behind deposit growth over the past two years are:

High interest rates on LBP, flight to quality and depositors confidence on the LBP/USD peg, additional drivers of strong deposit inflows

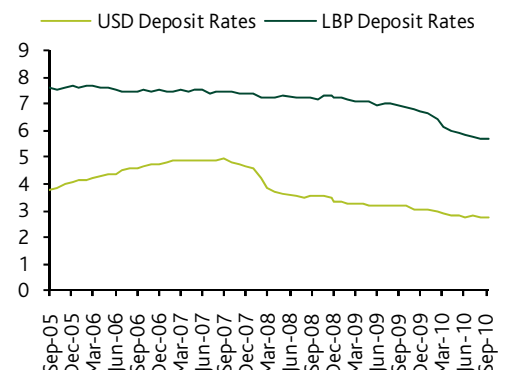
- i) The large interest rate differential between interest rates paid on deposits by Lebanese banks and rates paid by their counterparts in Europe, US and the Gulf, the three main areas where Lebanese expatriates are based. During 2009, the average rate credited by Lebanese banks was 6.9% on LBP short-term deposits (currently 5.7%) and 3.2% on USD short-term deposits (currently 2.8%);
- ii) A flight to quality, with trouble at some GCC banks or even European and US banks at the end of 2008/beginning of 2009 driving deposit transfers to Lebanese banks, which enjoy strong liquidity and have undergone serious stress events in the past because of difficult economic and political conditions in Lebanon;
- iii) Depositors' confidence in the LBP peg to the USD, with the central bank having built up a large FX reserve position (USD28.2 billion as of September 2010, excluding gold reserves, or 72% of Lebanon's GDP);
- iv) Improved security conditions in Lebanon following the appointment of a new president in May 2008 and the formation of a new cabinet in December 2009. The formation of a unity government (which includes members of the opposition party) has brought stability at the political front; however, the pace of reforms has been slow since then;

FIGURE 7: DEPOSIT GROWTH SYSTEM LEVEL Y-o-Y change



Source: Banque du Liban (BdL), EFG Hermes

FIGURE 8: USD AND LBP DEPOSIT RATES in % unless otherwise stated



Source: BdL, EFG Hermes



Deposits from Lebanese expatriates have been resilient during events of political instability

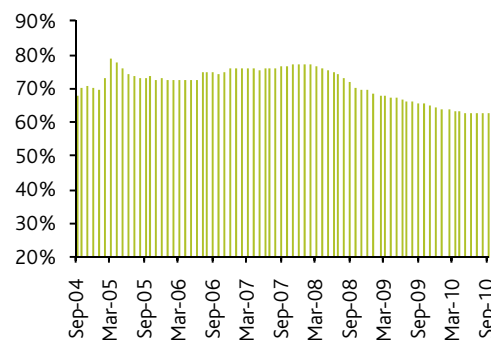
It can be argued that there was some speculative component in deposit growth during 2008 and 2009; however, it should be noted that the Lebanese banking sector has historically sourced a large component of its deposit base from Lebanese expatriates (the percentage is nevertheless difficult to precisely quantify given the blurred distinction between resident and non-resident Lebanese). Furthermore, deposit inflows from expatriates have occurred even during times of political uncertainty. The stability of private sector deposits from the Lebanese Diaspora is a feature that differentiates the Lebanese banking sector from other MENA banking systems, and particularly the Gulf, which saw a large outflow of deposits in mid-2008.

The Lebanese banking system has continued recording deposit inflows of USD11 billion during the first nine months of 2010, according to statistics released by the central bank (+19% Y-o-Y and 12% since December 2009).

Deposits' dollarisation ratio on a declining trend since 2008

The dollarisation ratio of deposits has declined from 80% in March 2005 to 63% in September 2010, with a large amount of deposit inflows being in LBP due to the high interest rate differential between LBP deposits and USD deposits.

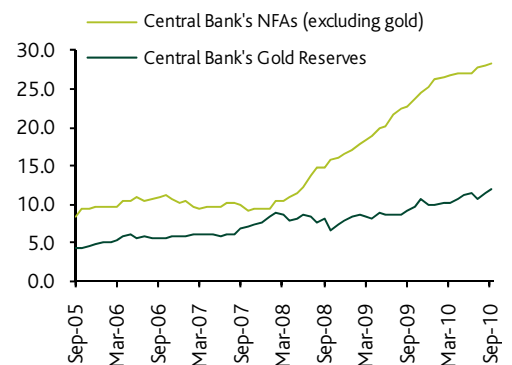
FIGURE 9: DOLLARISATION RATIO OF DEPOSITS



Source: BdL, EFG Hermes

FIGURE 10: CENTRAL BANK'S NET FOREIGN ASSETS (NFAS) AND GOLD RESERVES

In USD million, unless otherwise stated



Source: BdL, EFG Hermes

Remittances have supported private consumption in Lebanon

LOAN GROWTH EXPANSION ON BUOYANT DOMESTIC ECONOMY

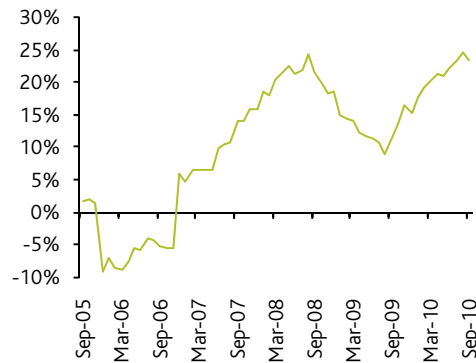
The domestic economic backdrop has been supportive for Lebanese banks during 2008, 2009, and the first-half of 2010, with the IMF estimating that GDP growth reached 7% in 2008 and 9% in 2009. Anecdotal evidence suggests that remittances have remained strong during last year, with remittances being a key driver of private consumption in Lebanon (remittances account for around 20% of GDP, according to the World Bank's estimates). Furthermore, stable political conditions have led to record-high tourism arrivals in 2008 and 2009, further supporting private consumption.

Against this backdrop, Lebanese banks have reported strong loan growth in 2009, well above the average growth rates for MENA banks. Loan growth has been mainly domestically driven, in both the retail and the corporate sectors.



FIGURE 11: LOAN GROWTH, SYSTEM LEVEL

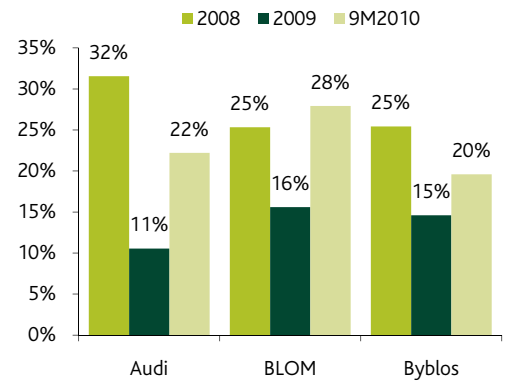
Y-o-Y change, unless otherwise stated



Source: Bdl, EFG Hermes

FIGURE 12: LOAN GROWTH FOR LEBANON BANKS' COVERAGE UNIVERSE

Y-o-Y growth, unless otherwise stated



Source: Banks Financials, EFG Hermes

Spreads negatively affected by USD LIBOR decline

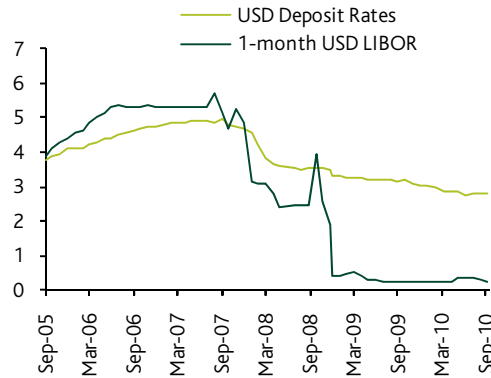
DECLINE IN USD LIBOR NEGATIVELY IMPACTS SPREADS

Lebanese banks enjoy higher levels of balance sheet liquidity than most of their MENA peers, with the majority of this liquidity invested in short-term interbank placements and denominated in foreign currency, mainly in USD. Lebanese banks' net interest spreads fell in 2009 (by 25bps on average for banks under our coverage), reflecting the decline in USD LIBOR and the fact that USD deposit rates have declined, but not by the same extent as interbank rates. This 'negative carry' is not new for Lebanese banks. The fragile political conditions in Lebanon and the need to maintain deposits inflows (as Lebanese banks are the main creditors to Lebanon's government) have meant that rates on USD deposits have been traditionally high as they include an embedded "risk premium". The spread between LIBOR rates and USD rates paid by Lebanese banks is now at the highest level of the past five years, suggesting there is further room for Lebanese banks to lower deposit rates.



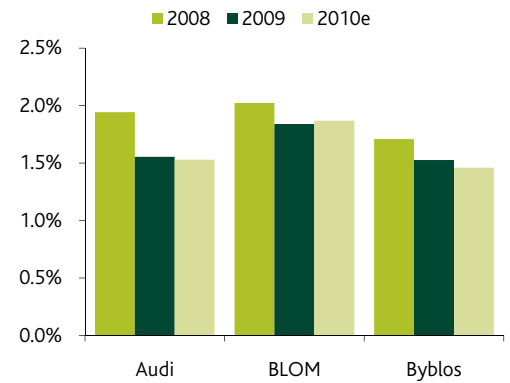
FIGURE 13: USD DEPOSIT RATES AND USD LIBOR

in %, unless otherwise stated



Source: BdL, BBA, and EFG Hermes

FIGURE 14: NET INTEREST SPREAD FOR LEBANON BANKS' UNIVERS

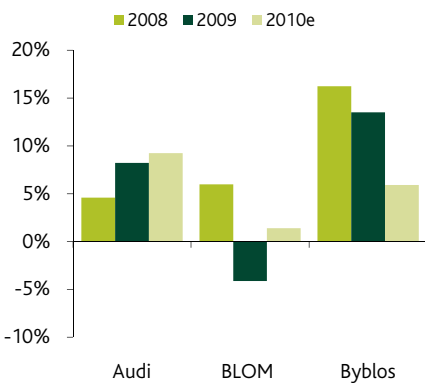


Source: Banks Financials, EFG Hermes estimates

CREDIT QUALITY: STABLE

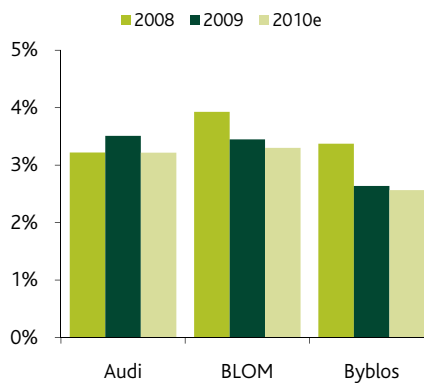
Lebanese banks' earnings growth has not been held back by provisioning charges in 2009 or in 9M2010, with provisioning averaging 15% of operating earnings. All banks have reported either stability or a slight improvement in NPL ratios, thanks to write-offs and recoveries. Lebanese banks' approach to lending tends to be conservative, with a large share of the loans backed by collateral.

FIGURE 15: PROVISIONING TO PRE-PROVISIONING EARNINGS



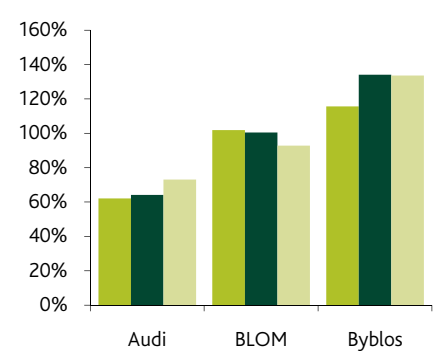
Source: Banks Financials, EFG Hermes estimates

FIGURE 16: NPL RATIOS



Source: Banks Financials, EFG Hermes estimates

FIGURE 17: NPL COVERAGE



Source: Banks Financials, EFG Hermes estimates



III. EARNINGS OUTLOOK IN 2011

Top-Down View: Comfortable on the Short-Term Growth Outlook

Our base case for Lebanon is that economic growth will remain solid in 2011 and that continued capital inflows will support private consumption in 2011. We do not factor in any serious deterioration in Lebanon's security conditions. With the Lebanese economy being primarily services-oriented and with tourism accounting for an estimated 25% share of GDP, political stability is key for economic growth.

Our in-house economics forecasts for GDP growth in 2011 are 5% (from an estimated 6.5% in 2010). The IMF estimates Lebanon's GDP growth at 6% in 2010 (according to the IMF, GDP growth reached 9% in 2009; we note that detailed national accounts are not available in Lebanon in a timely fashion).

Banks' Earnings Growth Drivers

We forecast an average of 18% expansion in net attributable earnings for Lebanese banks, with the main drivers being:

- i) **Loan Growth to Remain in Double-Digit Area:** Lebanese banks' managements expect loan growth to remain in high double-digit rates in 2011, and to possibly accelerate from the growth rates experienced in 2009. Growth will likely continue to be driven by domestic demand, both in retail and corporate, although we expect a slowdown vs. 2010 as we expect domestic companies to delay some of their investment plans due to the uncertain political backdrop. We also expect private consumption to slowdown in 2011 with anecdotal evidence suggesting consumer confidence has weakened since July 2010. Loan growth will also be driven in our view by the banks' regional ventures (mainly Egypt and Syria). We forecast average loan growth of 18% in 2011 (from an estimated 20% in FY2010) for Lebanese banks under our coverage
- ii) **Deceleration in Deposit Growth after Record-High Growth Rates in 2008-2009:** We factor in a slight deceleration in deposit growth rates compared to 2009. We estimate average deposit growth of 14% in 2011 compared to 15% in 2010. We therefore assume a slight improvement in the banks' asset mix, with the loans-to-deposits ratio expected to increase by three percentage points on average for the three banks.
- iii) **Net Interest Spreads Improvement Expected in 2011 on Lower Funding Costs:** On the LBP side, we expect a continued reduction in deposit rates to compensate for the decline in yields on T-bills. On the USD side, we assume flat LIBOR rates and also a slight decline in USD deposit rates. As we noted earlier, Lebanese banks are still crediting USD deposits at a sizable premium to LIBOR and therefore we believe there is room for further decline in USD deposit rates. We note that the upside for net interest spreads is large should benchmark rates increase towards the end of 2011.
- iv) **Provisioning:** With asset quality having improved or remained stable last year, we do not expect any overhang in provisioning from existing NPLs. We forecast provisioning charges to account for 12% of operating earnings compared to 15% in 2010.



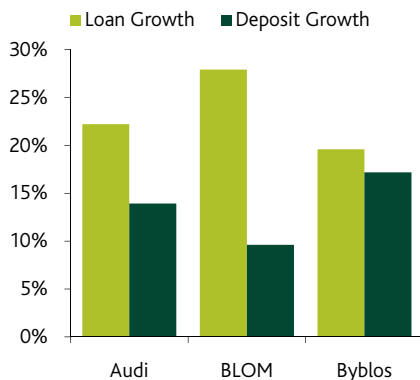
IV. 9M2010 RESULTS REVIEW

The three Lebanese banks reported a double-digit expansion in net earnings in 9M2010 on a Y-o-Y basis, with the main driver being revenue and operating earnings growth, rather than lower Y-o-Y provisioning charges. The provisioning burden (provisioning charges to pre-provision earnings) remained relatively low for the three banks, and especially for BLOM.

Loan growth was strong at 22% Y-o-Y (5% Q-o-Q) for Audi, 28% Y-o-Y (5% Q-o-Q) for BLOM, and 20% Y-o-Y (1% Q-o-Q) for Byblos. Lebanese banks have shown one of the strongest loan growth performances in the MENA region in 9M2010, together with some of the Egyptian and Qatari banks.

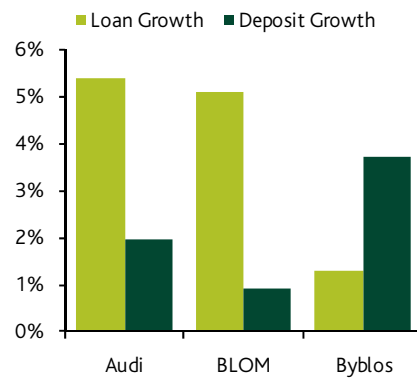
Net interest income growth has picked up for the three banks, on asset growth and a recovery in net interest spreads during 9M2010 for the three banks, as Lebanese banks have managed to reduce their funding costs in both USD and LBP.

FIGURE 18: LOAN AND DEPOSIT GROWTH Y-O-Y IN SEPTEMBER 2010



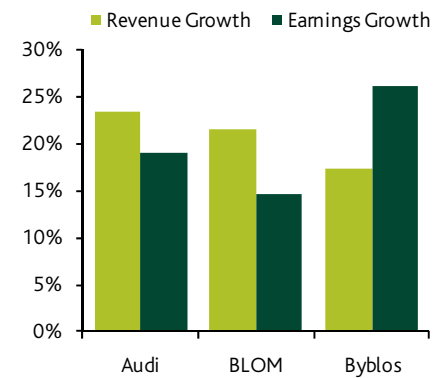
Source: Banks Financials, EFG Hermes

FIGURE 19: LOAN AND DEPOSIT GROWTH Q-O-Q IN SEPTEMBER 2010



Source: Banks Financials, EFG-Hermes

FIGURE 20: REVENUE AND EARNINGS GROWTH Y-O-Y IN 9M2010



Source: Banks Financials, EFG Hermes

Building a Strong MENA Franchise; Initiate with Buy

≡ FV of USD11.30/Share Implies 24% Upside Potential; Initiate with Buy

We initiate coverage of Bank Audi with a Buy rating given that our fair value (FV) estimate of USD11.30/share implies 24% upside potential. Our FV implies an estimated P/BV multiple of 1.7x in 2011, which is undemanding, in our view, considering Audi's strong corporate and retail franchise in Lebanon as well as its exposure to high-growth MENA markets, particularly Syria and Egypt. The current share price implies an estimated 2011 P/BV of 1.4x, which we believe does not reflect the potential value accretion from Audi's regional entities.

≡ Execution of Regional Diversification Strategy On Track

Audi has been growing both loans (CAGR of 25%) and deposits (CAGR of 28%) at a faster rate than its domestic competitors over the past three years. This growth has been primarily organically-driven. The bank has also rapidly increased the size of its regional entities and has organically built a network of close to 60 branches since 2005 (compared to Audi Lebanon's network of 78 branches). Regional entities now account for c30% of the group's total revenues.

≡ Expect Loan Growth and Cost Efficiency Gains to Result in ROE Expansion

We expect loan growth to be a key revenue growth driver in the short term, with the bank continuing to focus on lending to large regional corporates using the USD liquidity in its domestic balance sheet. We believe loan growth at the foreign subsidiaries level will be a strong driver of revenue growth in the medium term. We also expect Audi to continue to report an improvement in cost efficiency following a slowdown in capex in its regional subsidiaries after a strong investment effort in 2006-2009. We expect the bank's ROE to improve to 18% in 2011 from 16% in 2009.

KEY FINANCIAL HIGHLIGHTS

December Year End (USD mn)	2009a	2010e	2011e	2012e
Banking Income	734	873	997	1,160
Operating Income (Pre-provisions)	377	455	523	627
Net Attributable Income (Common)	269	317	381	455
EPS (USD)	0.80	0.95	1.14	1.35
P/E* (x)	11.3	9.6	8.0	6.7
P/BV* (x)	1.7	1.5	1.4	1.2
Dividend Yield	3.7%	3.9%	4.4%	5.2%
ROAE	16.0%	16.8%	18.1%	19.3%
Capital Adequacy Ratio	11.9%	12.2%	11.6%	10.9%
Provisions / NPLs	64%	73%	75%	79%

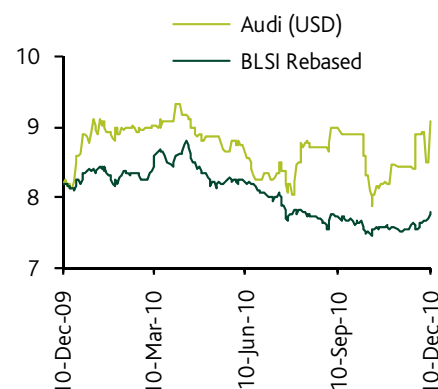
*Price as at 10 December 2010

Source: Bank Audi, EFG Hermes estimates

BUY

Price	USD9.08
Fair Value (FV)	USD11.30
Last Ex / Div. Date	USD 0.33 on 12 Apr 10
Mkt. Cap / Shares (mn)	USD3,125 / 344.2
Av. Mthly Liqdy (mn)	USD9.4
52-Week High / Low	USD9.32 / USD7.90
Bloomberg / Reuters	BKAD LB / AUSRq.L
Est. Free Float	30.3%

SHARE PRICE PERFORMANCE RELATIVE TO BLSI REBASED



QUARTERLY EARNINGS

USD mn	2009a	2010a/e
Q1	58.2	79.7
Q2	69.4	75.0
Q3	76.5	88.2
Q4	74.2	84.3

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FINANCIAL FORECASTS

FIGURE 21: INCOME STATEMENT (DECEMBER YEAR END)

In USD million, unless otherwise stated

	2009a	2010e	2011e	2012e	2013e
Interest Income	1,248	1,346	1,538	1,837	2,126
Interest Expense	(824)	(855)	(962)	(1,137)	(1,320)
Net Interest Income	424	491	576	699	806
Fee & Commission Income	147	172	207	242	280
Trading & Investment Income	126	174	166	169	182
Other Income	37	36	48	50	52
Non-interest Income	310	382	421	461	515
Total Income	734	873	997	1,160	1,320
Operating Expenses	(357)	(418)	(474)	(533)	(588)
Operating Income (Pre-provisions)	377	455	523	627	732
Loan Loss Provisions	(23)	(42)	(27)	(38)	(38)
Other Provisions	-	-	-	-	-
Other Income / Expense	(5)	-	-	--	--
Pre-tax Income	349	413	495	589	695
Taxes	(60)	(72)	(86)	(102)	(121)
Net Income before Minorities	289	341	409	486	574
Minorities	(11)	(14)	(18)	(22)	(26)
Preferred Dividends	(10)	(10)	(10)	(10)	(10)
Net Attributable Income	269	317	381	455	538

Source: Bank Audi, EFG Hermes estimates

FIGURE 22: BALANCE SHEET (DECEMBER YEAR END)

In USD million, unless otherwise stated

	2009a	2010e	2011e	2012e	2013e
Cash & Central Bank Deposits	4,117	4,598	4,951	5,594	6,265
Interbank Assets	5,133	5,109	5,824	6,581	7,002
Financial Investments	9,995	10,981	12,355	13,628	15,123
Customer Loans (Net)	6,588	8,284	9,858	11,633	13,377
Goodwill	145	145	145	145	145
Fixed & Other Assets	509	582	614	652	682
Total Assets	26,486	29,699	33,747	38,233	42,596
Interbank Liabilities	603	511	582	987	1,106
Customer Deposits	22,807	25,544	29,121	32,906	36,855
Borrowings	102	60	60	60	60
Other Liabilities	919	1,188	1,317	1,407	1,311
Total Liabilities	24,431	27,303	31,080	35,360	39,332
Minority Interests	134	149	167	189	215
Preferred Equity	125	125	125	-	-
Shareholders' Equity (Common)	1,796	2,123	2,375	2,683	3,050
Total Liabilities & Shareholders' Equity	26,486	29,699	33,747	38,233	42,596

Source: Banks Audi, EFG Hermes estimates

**FIGURE 23: DUPONT ANALYSIS (AS A % OF AVERAGE ASSETS)**

	2009a	2010e	2011e	2012e	2013e
Net Interest Income	1.81%	1.75%	1.82%	1.94%	1.99%
Non Interest Income	1.32%	1.36%	1.33%	1.28%	1.27%
Operating Expenses	-1.52%	-1.49%	-1.50%	-1.48%	-1.45%
Other Revenue / (Expenses)	0.01%	0.00%	0.00%	0.00%	0.00%
Total Provisioning	-0.13%	-0.15%	-0.09%	-0.11%	-0.09%
Taxes	-0.26%	-0.26%	-0.27%	-0.28%	-0.30%
Minorities & Preferred Dividends	-0.09%	-0.09%	-0.09%	-0.09%	-0.09%
ROAA	1.15%	1.13%	1.20%	1.26%	1.33%
Gearing (Assets/Equity)	14.0	14.9	15.1	15.2	15.1
ROAE	16.0%	16.8%	18.1%	19.3%	20.1%

Source: Banks Audi, EFG Hermes estimates

FIGURE 24: VALUATION METRICS

	2009a	2010e	2011e	2012e	2013e
Per Share Data (USD)					
EPS	0.80	0.95	1.14	1.35	1.60
DPS (Net)	0.33	0.36	0.40	0.48	0.52
Payout Ratio	45%	41%	38%	38%	35%
BVPS	5.3	5.9	6.6	7.4	8.5
Valuation					
P/E (x)	11.3	9.6	8.0	6.7	5.7
Dividend Yield	3.7%	3.9%	4.4%	5.2%	5.8%
P/B (x)	1.7	1.5	1.4	1.2	1.1
Market Cap / Deposits	13.7%	12.2%	10.7%	9.5%	8.5%

Source: EFG Hermes estimates

FIGURE 25: PROFITABILITY RATIOS

	2009a	2010e	2011e	2012e	2013e
Yield on Earning Assets	5.53%	4.95%	5.00%	5.25%	5.40%
Cost of Funds	-3.97%	-3.42%	-3.42%	-3.55%	-3.65%
Net Interest Spread	1.55%	1.53%	1.58%	1.70%	1.75%
Net Interest Margin	1.88%	1.81%	1.87%	2.00%	2.05%
Non-Interest Income / Total Banking Income	39%	41%	39%	37%	36%
Cost to Income	48.6%	47.9%	47.6%	46.0%	44.5%
Tax Rate	17.3%	17.4%	17.4%	17.4%	17.4%
ROAA	1.15%	1.13%	1.20%	1.26%	1.33%
ROAE	16.0%	16.8%	18.1%	19.3%	20.1%

Source: EFG Hermes estimates



FIGURE 26: CREDIT QUALITY AND CAPITAL

	2009a	2010e	2011e	2012e	2013e
Credit Quality					
NPL Ratio	3.5%	3.2%	2.9%	2.7%	2.7%
Provisions / NPLs	64.2%	73.1%	75.4%	79.2%	80.1%
Provisioning to Average Gross Loans (bps)	49.5	55.0	30.0	35.0	30.0
(NPLs-Provisions) / Equity	5%	12%	12%	12%	12%
Provisions / Pre-Provisions Profit	8%	9%	5%	6%	5%
Tier-1	11.0%	12.0%	11.3%	10.0%	10.5%
CAR	11.9%	12.2%	11.6%	10.9%	11.1%
RWAs / Total Assets	56%	58%	60%	61%	62%

Source: Bank Audi, EFG Hermes estimates

FIGURE 27: GROWTH RATIOS

	2009a	2010e	2011e	2012e	2013e
Loans	11%	26%	19%	18%	15%
Deposits	34%	12%	14%	13%	12%
Assets	30%	12%	14%	13%	11%
Risk-Weighted Assets (RWAs)	13%	17%	18%	15%	12%
Net Interest Income	0%	16%	17%	21%	15%
Fee Income	4%	17%	20%	17%	16%
Non Interest Income	41%	27%	8%	10%	13%
Total Income	11%	19%	14%	16%	14%
Operating Expenses	-8%	26%	12%	11%	8%
Operating Income (Pre-provisions)	26%	21%	15%	20%	17%
Net Attributable Income	25%	18%	20%	19%	18%

Source: Bank Audi, EFG Hermes estimates

FIGURE 28: BALANCE SHEET STRUCTURE AND OTHER RATIOS

	2009a	2010e	2011e	2012e	2013e
Loans / Deposits (Net)	28.9%	32.4%	33.9%	35.4%	36.3%
Loans / Assets (Net)	24.9%	27.9%	29.2%	30.4%	31.4%
Net Interbank / Assets	17.4%	15.5%	15.5%	14.6%	13.8%
Financial Investments / Assets	37.7%	37.0%	36.6%	35.6%	35.5%
Deposits / Assets	86.1%	86.0%	86.3%	86.1%	86.5%
LT & MT Borrowings / Liabilities	0.4%	0.2%	0.2%	0.2%	0.1%

Source: Bank Audi, EFG Hermes estimates

Low Risk, High Returns, Reiterate Buy Rating

≡ Maintain Fair Value of USD11.35/Share; Reiterate Buy

We upgrade our fair value (FV) for BLOM Bank from USD11.35/share to USD12.75/share after upgrading our medium term earnings forecasts. BLOM's loan growth positively surprised in 9M2010, and we expect that Lebanon's strong macro-economic backdrop will continue to support loan growth momentum for the remainder of 2010. We now expect BLOM to report an estimated CAGR in earnings of 15% in 2009-2011.

≡ A Conservative Bank Delivering Above-Sector Average Returns

BLOM has traditionally been the most conservative of the large Lebanese banks as measured by its loan-to-deposit ratio and by the share of liquid assets to total assets relative to the sector. The bank's conservative attitude has also resulted in a much lower domestic lending market share (estimated at 15%) relative to its deposits markets share (estimated at 22%) and compared to Bank Audi. This has not been at the expense of lower returns, however, with the bank maintaining a ROE above local peers at 18% in 2009 (16% for both Bank Audi and Byblos). The main reasons are BLOM's higher equity multiplier and its higher cost efficiency.

≡ Improvement in Balance Sheet Efficiency is a Positive Valuation Driver

We do not expect operating leverage to be a driver of returns expansion given the bank's already low cost-to-asset ratio. We do expect that margin expansion and an increase in balance sheet efficiency in favour of higher customer lending exposure could drive returns higher over the next few years. We also expect an increasing contribution from BLOM's foreign entities, mainly Egypt and Syria. MENA operations accounted for 25% to total assets and 18% of earnings as at December 2009.

≡ At 1.3x 2011 P/BV, only Lebanon is Reflected in the Current Share Price

BLOM currently trades at an estimated 1.3x P/BV, 6.3x P/E and 10% market cap to deposits in 2011, well below the MENA banks average P/B of 1.8x and P/E of 10.6x. Our sum-of-the-parts (SOTP) analysis shows that the current share price does not warrant any potential value accretion to the bank's Syrian and Egyptian operations. BLOM is currently Syria's largest private sector bank, with 12% estimated market share.

KEY FINANCIAL HIGHLIGHTS

December Year End (USD mn)	2009a	2010e	2011e	2012e
Banking Income	567	642	754	862
Operating Income (Pre-provisions)	336	388	470	552
Net Attributable Income	269	297	350	410
EPS (USD)	0.13	0.14	0.17	0.19
P/E* (x)	8.2	7.4	6.3	5.4
P/BV* (x)	1.7	1.5	1.3	1.1
Dividend Yield	3.7%	3.9%	4.2%	4.8%
ROAE	21.3%	21.6%	21.6%	21.2%
Capital Adequacy Ratio	14.0%	13.4%	13.0%	12.7%
Provisions / NPLs	100%	93%	92%	91%

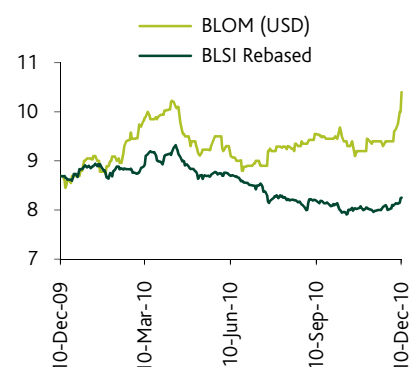
*Price as at 10 December 2010

Source: BLOM Bank, EFG Hermes estimates

BUY

Price	USD10.40
Fair Value (FV)	USD12.75
Last Ex / Div. Date	USD4.0 on 15 Apr 10
Mkt. Cap / Shares (mn)	USD2,236 / 215
Av. Mthly Liqdy (mn)	USD13.0
52-Week High / Low	USD10.40 / USD8.48
Bloomberg / Reuters	BLQLB / BLBD.BY
Est. Free Float	21%

SHARE PRICE PERFORMANCE RELATIVE TO BLSI REBASED



QUARTERLY EARNINGS

USD mn	2009a	2010a/e
Q1	61	71
Q2	73	80
Q3	66	77
Q4	86	78

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FINANCIAL FORECASTS

FIGURE 29: INCOME STATEMENT (DECEMBER YEAR END)

In USD million, unless otherwise stated

	2009a	2010e	2011e	2012e	2013e
Interest Income	1,136	1,317	1,558	1,814	2,057
Interest Expense	(717)	(824)	(956)	(1,117)	(1,267)
Net Interest Income	419	493	602	697	790
Fee & Commission Income	81	89	102	118	132
FX Income	-	-	-	-	-
Trading & Investment Income	54	40	27	21	17
Other Income	12	20	23	27	28
Non-Interest Income	148	149	152	165	176
Total Income	567	642	754	862	966
Operating Expenses	(231)	(254)	(283)	(310)	(340)
Operating Income (Pre-Provisions)	336	388	470	552	627
Loan Loss Provisions	3	(5)	(16)	(22)	(18)
Other Provisions	10	-	-	-	-
Other Income / Expense	-	-	-	-	-
Pre-tax Income	350	383	454	531	609
Taxes	(57)	(65)	(79)	(92)	(107)
Net Income before Minorities	293	318	376	439	502
Minorities	(8)	(11)	(16)	(19)	(23)
Preferred Dividend	(16)	(10)	(10)	(10)	(10)
Net Attributable Income	269	297	350	410	470

Source: BLOM Bank, EFG Hermes estimates

FIGURE 30: BALANCE SHEET (DECEMBER YEAR END)

In USD million, unless otherwise stated

	2009a	2010e	2011e	2012e	2013e
Cash & Central Bank Deposits	3,114	3,550	4,082	4,261	4,687
Interbank Assets	3,839	4,468	5,372	6,391	7,030
Financial Investments	9,338	10,392	11,922	13,565	15,390
Customer Loans (Net)	4,011	4,944	5,735	6,596	7,453
Goodwill	42	42	42	42	42
Fixed & Other Assets	359	410	436	463	490
Total Assets	20,702	23,806	27,590	31,317	35,092
Interbank Liabilities	468	609	934	1,331	2,050
Customer Deposits	17,817	20,311	23,358	26,628	29,291
Borrowings	-	-	-	-	-
Other Liabilities	763	1,086	1,223	950	961
Total Liabilities	19,048	22,007	25,515	28,909	32,302
Minority Interests	85	100	118	139	164
Preferred Equity	175	100	100	100	100
Shareholders' Equity (Common)	1,394	1,599	1,857	2,169	2,526
Total Liabilities & Shareholders' Equity	20,702	23,806	27,590	31,317	35,092

Source: BLOM Bank, EFG Hermes estimates

**FIGURE 31: DUPONT ANALYSIS (AS A % OF AVERAGE ASSETS)**

	2009a	2010e	2011e	2012e	2013e
Net Interest Income	2.17%	2.22%	2.34%	2.37%	2.38%
Non Interest Income	0.77%	0.67%	0.59%	0.56%	0.53%
Operating Expenses	-1.19%	-1.14%	-1.10%	-1.05%	-1.02%
Other Revenue/(Expenses)	0.00%	0.00%	0.00%	0.00%	0.00%
Total Provisioning	0.07%	-0.02%	-0.06%	-0.07%	-0.05%
Taxes	-0.30%	-0.29%	-0.31%	-0.31%	-0.32%
Minorities & Preferred Dividends	-0.12%	-0.09%	-0.10%	-0.10%	-0.10%
ROAA	1.39%	1.34%	1.36%	1.39%	1.41%
Gearing (Assets/Equity)	16.1	16.0	15.8	15.5	15.0
ROAE	22.4%	21.3%	21.6%	21.6%	21.2%

Source: BLOM Bank, EFG Hermes estimates

FIGURE 32: VALUATION METRICS

	2009a	2010e	2011e	2012e	2013e
Per Share Data (USD)					
EPS	1.27	1.40	1.65	1.94	2.22
DPS (net)	0.38	0.40	0.44	0.50	0.57
Payout Ratio	32%	31%	28%	28%	27%
BVPS	6.0	7.0	8.1	9.5	11.1
Valuation					
P/E (x)	8.2	7.4	6.3	5.4	4.7
Dividend Yield	3.7%	3.9%	4.2%	4.8%	5.5%
P/B (x)	1.7	1.5	1.3	1.1	0.9
Market Cap / Deposits	13%	11%	10%	8%	8%

Source: BLOM Bank, EFG Hermes estimates

FIGURE 33: PROFITABILITY RATIOS

	2009a	2010e	2011e	2012e	2013e
Yield on Earning Assets	6.02%	6.04%	6.18%	6.27%	6.30%
Cost of Funds	-4.18%	-4.17%	-4.20%	-4.25%	-4.25%
Net Interest Spread	1.84%	1.87%	1.98%	2.02%	2.05%
Net Interest Margin	2.22%	2.26%	2.39%	2.41%	2.42%
Non-Interest Income / Total Banking Income	24%	21%	18%	17%	16%
Cost to Income	40.7%	39.5%	37.6%	36.0%	35.2%
Tax Rate	16.3%	17.0%	17.3%	17.3%	17.5%
ROAA	1.39%	1.34%	1.36%	1.39%	1.41%
ROAE	21.3%	21.6%	21.6%	21.2%	19.7%

Source: BLOM Bank, EFG Hermes estimates



FIGURE 34: CREDIT QUALITY AND CAPITAL

	2009a	2010e	2011e	2012e	2013e
Credit Quality					
NPL Ratio	3.45%	3.30%	3.20%	3.25%	3.35%
Provisions / NPLs	100%	93%	92%	91%	86%
Provisioning to Average Gross Loans (bps)	5.92	12.00	30.00	35.00	25.00
(NPLs-Provisions) / Equity	123	123	123	123	124
Provisions / Pre-Provisions Profit	-4%	1%	3%	4%	3%
Tier-1	13.7%	13.4%	13.0%	12.7%	12.5%
CAR	14.0%	13.4%	13.0%	12.7%	12.5%
RWAs / Total Assets	51%	52%	54%	56%	59%

Source: BLOM Bank, EFG Hermes estimates

FIGURE 35: GROWTH RATIOS

	2009a	2010e	2011e	2012e	2013e
Loans	16%	23%	16%	15%	13%
Deposits	19%	14%	15%	14%	10%
Assets	16%	15%	16%	14%	12%
Risk-Weighted Assets (RWAs)	6%	18%	20%	19%	18%
Net Interest Income	2%	18%	22%	16%	13%
Fee Income	0%	10%	15%	15%	12%
Non Interest Income	21%	-4%	0%	8%	7%
Total Income	8%	13%	17%	14%	12%
Operating Expenses	11%	10%	12%	9%	10%
Operating Income (Pre-provisions)	5%	16%	21%	17%	13%
Net Attributable Income	19%	10%	18%	17%	14%

Source: BLOM Bank, EFG Hermes estimates

FIGURE 36: BALANCE SHEET STRUCTURE AND OTHER RATIOS

	2009a	2010e	2011e	2012e	2013e
Loans / Deposits (Net)	22.5%	24.3%	24.6%	24.8%	25.4%
Loans / Assets (Net)	19.4%	20.8%	20.8%	21.1%	21.2%
Net Interbank / Assets	16.3%	16.2%	16.1%	16.2%	14.2%
Financial Investments / Assets	45.1%	43.7%	43.2%	43.3%	43.9%
Deposits / Assets	86.1%	85.3%	84.7%	85.0%	83.5%
LT & MT Borrowings / Liabilities	0.0%	0.0%	0.0%	0.0%	0.0%

Source: BLOM Bank, EFG Hermes estimates

Cheapest Bank in MENA at 0.9x 2011 P/B (ex UAE), Reiterate Buy

Adjust FV to USD2.27/Share on Recent Capital Increase, Maintain Buy

We adjust Byblos Bank's fair value (FV) estimate to incorporate the bank's USD250 million capital increase, which was completed by end-June 2010. Our new FV of USD2.27/share, down from USD2.60 /share, implies 28% upside potential, therefore we retain our Buy rating on the stock. Byblos is the smallest of the Lebanese banks under our coverage, but has been growing fast over the past few years thanks to regional expansion in countries with low banking penetration and/or with a large base of Lebanese expatriates. Byblos is now present in Syria, Sudan, Armenia, the Democratic Republic of Congo, Nigeria and Iraq.

USD250 Million Increase in Capital to Support Regional Investments

The recent USD250 million increase in capital by which the International Finance Corporation (IFC) become a c9% shareholder in Byblos will be used to strengthen the bank's existing regional operations as well as allow it to be opportunistic in terms of potential acquisition opportunities. The bank has said in the past that it would participate in domestic consolidation to increase its local market share to 15% from 10% currently. It is also considering new markets, such as Egypt and Jordan, for future expansion. The proceeds will also be used to increase the capital at some subsidiaries, Iraq, where Byblos plans to open a third branch and Syria.

Profitability Weaker than Large Peers on More Expensive Capital Structure

The bank's ROA (common) of 0.9% is weaker than that of its peers (Audi's ROA is 1.3% and BLOM's ROA is 1.4%), the result to a great extent of lower income from its capital market operations as well as the bank's more expensive capital structure. The bank issued priority shares in 2005, which carry a fixed yearly dividend, in addition to the common dividend distributed to common shareholders. The bank's priority shares will be automatically converted into common shares by end-2010.

Expect Returns to Improve in the Medium Term

Our model incorporates a gradual improvement in the bank's profitability thanks to the contribution from its foreign entities and its focus on increasing exposure to fee income-generating activities, particularly trade finance. We forecast a CAGR earnings growth of 20% in 2009-2012 and the bank's ROA to improve to 1.05% in 2012. The bank has shown a tight control on costs despite its regional expansion.

KEY FINANCIAL HIGHLIGHTS

December Year End (USD mn)	2009a	2010e	2011e	2012e
Banking Income	380	426	494	570
Operating Income (Pre-provisions)	204	220	256	303
Net Attributable Income	137	160	188	224
EPS (USD)	0.20	0.23	0.28	0.29
P/E* (x)	9.0	7.8	6.4	6.1
P/BV* (x)	1.0	1.0	0.9	0.8
Dividend Yield	7.1%	7.2%	7.9%	8.1%
ROAE	16.0%	16.8%	18.1%	19.3%
Capital Adequacy Ratio	11.6%	13.2%	12.1%	11.5%
Provisions / NPLs	134%	134%	135%	136%

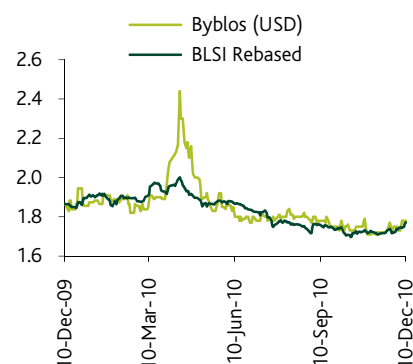
*Price as at 10 December 2010

Source: Byblos Bank, EFG Hermes estimates

BUY

Price	USD1.78
Fair Value (FV)	USD2.27
Last Ex / Div. Date	USD0.13 29 April 10
Mkt. Cap / Shares (mn)	USD753 / 423
Av. Mthly Liqdy (mn)	USD14.3
52-Week High / Low	USD2.44 / USD1.71
Bloomberg / Reuters	BYBK LB / BYB.BY
Est. Free Float	32%

SHARE PRICE PERFORMANCE RELATIVE TO BLSI REBASED



QUARTERLY EARNINGS

USD mn	2009a	2010a/e
Q1	23	29
Q2	36	39
Q3	31	46
Q4	47	47

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FINANCIAL STATEMENTS

FIGURE 37: INCOME STATEMENT (DECEMBER YEAR END)

In USD million unless otherwise stated

	2009a	2010e	2011e	2012e	2013e
Interest Income	757	817	1,007	1,162	1,361
Interest Expense	(501)	(538)	(679)	(776)	(919)
Net Interest Income	257	279	329	386	442
Fee & Commission Income	77	88	102	120	139
Trading & Investment Income	35	48	44	43	30
Other Income	11	11	19	21	23
Non-Interest Income	123	147	165	184	192
Total Income	380	426	494	570	634
Operating Expenses	(176)	(206)	(238)	(267)	(296)
Operating Income (Pre-Provisions)	204	220	256	303	338
Total Provisions	(28)	(13)	(13)	(15)	(18)
Other Income / Expense	0	0	0	0	0
Pre-tax Income	176	207	243	289	320
Taxes	(31)	(36)	(43)	(50)	(56)
Net Income before Minorities	146	170	201	238	264
Minorities, Preferred & Fixed Priority Dividends	(8)	(10)	(12)	(14)	(16)
Preferred & Fixed Priority Dividends	(26)	(32)	(32)	(32)	(32)
Net Attributable Income	137	160	188	224	248

Source: Byblos Bank, EFG Hermes estimates

FIGURE 38: BALANCE SHEET (DECEMBER YEAR END)

In USD million unless otherwise stated

	2009a	2010e	2011e	2012e	2013e
Cash & Central Bank Deposits	1,681	1,924	2,194	2,479	2,777
Interbank Assets	2,085	2,285	2,605	2,789	3,124
Financial Investments	6,372	7,024	7,732	8,545	9,333
Customer Loans (Net)	3,189	3,845	4,595	5,297	6,048
Goodwill	-	-	-	-	-
Fixed & Other Assets	250	277	310	330	356
Total Assets	13,576	15,356	17,436	19,440	21,638
Interbank Liabilities	1,119	972	1,381	1,408	1,578
Customer Deposits	10,193	12,028	13,712	15,495	17,354
Borrowings	386	381	371	176	166
Other Liabilities	668	444	326	374	383
Total Liabilities	12,366	13,826	15,790	17,452	19,482
Minority Interests	82	92	104	118	134
Preferred Equity	387	387	387	387	387
Shareholders' Equity (Common)	742	1,051	1,154	1,482	1,635
Total Liabilities & Shareholders' Equity	13,577	15,356	17,436	19,440	21,638

Source: Byblos Bank, EFG Hermes estimates



FIGURE 39: DUPONT ANALYSIS (AS A % OF AVERAGE ASSETS)

	2009a	2010e	2011e	2012e	2013e
Net Interest Income	2.07%	1.93%	2.00%	2.09%	2.15%
Non Interest Income	0.90%	0.94%	0.90%	0.88%	0.82%
Operating Expenses	-1.42%	-1.43%	-1.45%	-1.45%	-1.44%
Other Revenue/(Expenses)	0.03%	0.07%	0.11%	0.12%	0.11%
Total Provisioning	-0.22%	-0.09%	-0.08%	-0.08%	-0.09%
Taxes	-0.25%	-0.25%	-0.26%	-0.27%	-0.27%
Minorities & Preferred Dividends	-0.22%	-0.29%	-0.27%	-0.25%	-0.23%
ROAA	0.90%	0.89%	0.95%	1.04%	1.05%
Gearing (Assets/Equity)	18.3	14.6	15.1	13.1	13.2
ROAE	16.0%	16.8%	18.1%	19.3%	20.1%

Source: EFG Hermes estimates

FIGURE 40: VALUATION METRICS

	2009a	2010e	2011e	2012e	2013e
Per Share Data (USD)					
EPS	0.20	0.23	0.28	0.29	0.33
DPS (net)	0.13	0.13	0.14	0.14	0.15
Payout Ratio	32%	38%	34%	33%	30%
BVPS	1.8	1.9	2.0	2.3	2.5
Valuation					
P/E (x)	9.0	7.8	6.4	6.1	5.4
Dividend Yield	7.1%	7.2%	7.9%	8.1%	8.3%
P/B (x)	1.0	1.0	0.9	0.8	0.7
Market Cap / Deposits	7.4%	6.3%	5.5%	4.9%	4.3%

Source: EFG Hermes estimates

FIGURE 41: PROFITABILITY RATIOS

	2009a	2010e	2011e	2012e	2013e
Yield on Earning Assets	6.34%	5.85%	6.35%	6.50%	6.82%
Cost of Funds	-4.82%	-4.39%	-4.80%	-4.82%	-5.10%
Net Interest Spread	1.53%	1.46%	1.55%	1.68%	1.72%
Net Interest Margin	2.15%	2.00%	2.07%	2.16%	2.22%
Non-Interest Income / Total Banking Income	30%	33%	31%	30%	28%
Cost to Income	46.3%	48.5%	48.1%	46.9%	46.7%
Tax Rate	17.5%	17.5%	17.5%	17.5%	17.5%
ROAA	0.90%	0.89%	0.95%	1.04%	1.05%
ROAE	16.1%	14.3%	14.2%	14.5%	13.9%

Source: EFG Hermes estimates

**FIGURE 42: CREDIT QUALITY AND CAPITAL**

	2009a	2010e	2011e	2012e	2013e
Credit Quality					
NPL Ratio	2.6%	2.6%	2.4%	2.4%	2.3%
Provisions / NPLs	134%	134%	135%	136%	139%
Provisioning to Average Gross Loans	0.46%	0.35%	0.30%	0.28%	0.30%
(NPLs-Provisions) / Equity	1.8%	1.8%	1.5%	1.3%	1.2%
Provisions / Pre-Provisions Profit	14%	6%	5%	5%	5%
Tier-1	9.3%	11.7%	10.8%	11.5%	11.1%
CAR	11.6%	13.2%	12.1%	11.5%	11.1%
RWAs / Total Assets	71%	74%	77%	79%	79%

Source: Byblos Bank, EFG Hermes estimates

FIGURE 43: GROWTH RATIOS

	2009a	2010e	2011e	2012e	2013e
Loans	15%	21%	20%	15%	14%
Deposits	23%	18%	14%	13%	12%
Assets	21%	13%	14%	11%	11%
Risk-Weighted Assets (RWAs)	10%	18%	16%	14%	12%
Net Interest Income	9%	9%	18%	18%	14%
Fee Income	9%	14%	16%	17%	16%
Non Interest Income	29%	21%	8%	11%	4%
Total Income	13%	12%	16%	15%	11%
Operating Expenses	11%	18%	15%	12%	11%
Operating Income (Pre-provisions)	16%	8%	17%	18%	11%
Net Attributable Income	24%	9%	22%	23%	13%

Source: Byblos Bank, EFG Hermes estimates

FIGURE 44: BALANCE SHEET STRUCTURE AND OTHER RATIOS

	2009a	2010e	2011e	2012e	2013e
Loans / Deposits (Net)	31.3%	32.0%	33.5%	34.2%	34.9%
Loans / Assets (Net)	23.5%	25.0%	26.4%	27.2%	28.0%
Net Interbank / Assets	7.1%	8.6%	7.0%	7.1%	7.1%
Financial Investments / Assets	46.9%	45.7%	44.3%	44.0%	43.1%
Deposits / Assets	75.1%	78.3%	78.6%	79.7%	80.2%
LT & MT Borrowings / Liabilities	34.4%	39.2%	26.9%	12.5%	10.5%

Source: Byblos Bank, EFG Hermes estimates

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