

Bank of Palestine

Recent Developments and Highlights

We change our BUY recommendation to HOLD at a price objective of **USD 2.89**, after the stock price has increased from USD 2.6 to USD 2.8 in late October. Bank of Palestine was able to significantly improve profitability during the third quarter of the year after witnessing moderate growth in profitability during the second quarter, where the bank's net profit has reached USD 28.3 million for the first nine months of 2012 compared to USD 26.7 million in the same period last year, a growth of 6.08%.

Slight drop in credit facilities during Q3, growth expected during Q4 for both deposits and credit facilities

Credit facilities fell slightly during the third quarter, where they dropped from USD 839.34 million in H1 2012 to USD 821.20 million by the end of Q3 2012. The management of the bank expects the drop in facilities to reverse in the fourth quarter, where growth in facilities is expected to be around 8-10%, pushing the credit facilities to reach a record level of around USD 900 million.

Deposits witnessed the best Q-o-Q growth in the year where they grew by 6.87% during Q3 2012. Deposits grew by 12% since the beginning of the year to USD 1.452 billion compared to USD 1.297 billion.

Downside risks

The Palestinian economy is still one of our major concerns in our valuation, even though BOP's operation were affected by the economic conditions yet, the current fiscal position of the Palestinian Authority (PA), the high unemployment rates, the budget deficit and the deteriorating living conditions of the people in Palestine are all alarming signs.

Key Financial Highlights

	2010	2011	H1 2012	Q3 2012	2012 E
# of Shares (million)	100	120	134	134	134
Stock Price (USD)	3.4	2.6	2.7	2.8	2.8
Interest Income (USD m)	50.58	65.48	35.76	54.40	73.34
Net income (USD m)	30.12	33.98	16.84	28.30	37
EPS (USD)	0.30	0.28	0.13	0.21	0.28
P/E	11.29	9.29	10.38	12.4	11.7
Sh. Equity (USD m)	163.31	194.40	206.55	215.84	225
BV per share (USD)	1.63	1.62	1.54	1.61	1.68
P/BV	2.08	1.60	1.75	1.74	1.67

Source: Bank of Palestine, Bloomberg, Awraq Investments

November 12, 2012

Recommendation: **HOLD**

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Awraq Investments

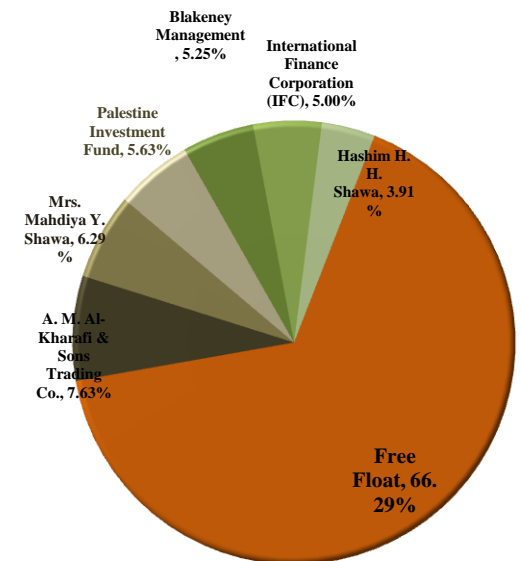
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Stock Data

Price*	2.80
Fair Value	2.89
Market Cap (Mn)	375.2
52 Week High	3.22
52 Week Low	2.59
Bloomberg	BOP PS
Free Float	66.29%

* Price as of November 11th 2012

Figure1: Ownership Structure



Source: BOP annual report

Economy Brief

Near the end of this September the world bank published their bi annual assessment of the Palestinian economy, the published report focuses on the Palestinian Authority's efforts for reform, and also highlights the stability of the Palestinian Banking Sector during the broad range of shocks the region has witnessed, in addition to the positive role the Palestinian Monetary Authority (PMA) has been playing in terms of regulating the sector and building its capacity to withstand even further shocks.

The report also focuses on the importance of a growing private sector to support economic growth and deems it an essential part to a more stable independent economy, in addition to the high need to find methods to ease Israeli restrictions especially those imposed on transportation and access to several areas.

The IMF reported estimates of real GDP growth for Palestine based on two scenarios; the first is that the fiscal situation of the PA will improve due to steady donor support and a gradual easing of the Israeli restrictions. Under this scenario the real GDP of the West Bank is estimated to grow by 5% during 2013, while Gaza's GDP is estimated to grow by 7% for the same year.

As for the second scenario, it assumes that the fiscal conditions continue to deteriorate, which would hinder economic growth, where forecasts were around 2.6% and 4% for the West Bank and Gaza respectively under this scenario.

Figure 2: Real GDP Growth estimates

	Baseline Scenario			Lower Scenario		
	2013	2014	2015	2013	2014	2015
<i>West Bank</i>	5.00%	4.60%	4.30%	2.60%	1.60%	1.00%
<i>Gaza</i>	7.00%	6.50%	6.00%	4.00%	3.00%	1.00%

* Source : International Monetary Fund (IMF)

During the second quarter of 2012, the Palestinian Central Bureau of Statistics (PCBS) announced a high deficit in the Palestinian current account, which amounted to USD 793.6 million (29.5% of GDP). While the trade deficit amounted to USD 1.24 billion. Moreover, they announced that due to the surplus in the compensation of employees working in Israel reaching USD 251.2 million, the surplus in the income balance (compensations of employees and investments income) amounted to USD 278 million.

Total public debt amounted to USD 2.24 billion by the end of July, the PA plans to convert USD 200 million of its debt to bonds and other tradable securities by 2013 as an alternative of creating new debt. The bonds will only be available to banks and not the public. The PA believes that such move will add to stability for it will generate an interbank market and additionally an incentive as the bonds will be used as a daily collateral in the payment system.

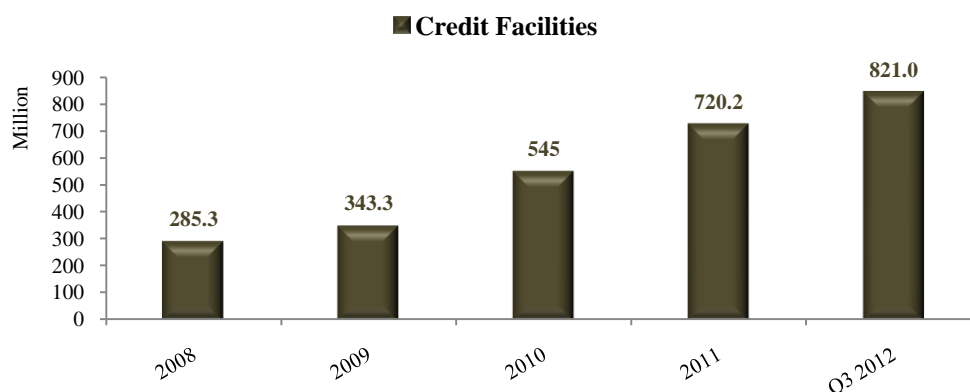
Bank of Palestine Q3 Developments

Credit facilities fell slightly during the third quarter, where they dropped from USD 839.34 million in H1 2012 to USD 821.20 million by the end of Q3 2012. The drop in facilities was a result to a drop in the overdrafts accounts which dropped due to seasonality related to merchants' transactions during and before the month of Ramadan. Even though total facilities have dropped, loans continued to grow during Q3 to reach USD 473.29 million, a growth of 14.5% since the beginning of the year. Also credit cards accounts grew to reach USD 32 million, a 13.65% increase since the beginning of the year.

The management of the bank expects the drop in facilities to reverse in the fourth quarter, where growth in facilities is expected to be around 8-10%, making the credit facilities reach a record level of around USD 900 million.

The bank has significantly improved profitability during the third quarter of the year after witnessing moderate growth in profitability during the second quarter, where the bank's net profit has reached USD 28.3 million for the first nine months of 2012 compared to USD 26.7 million in the same period last year, a growth of 6.08%. This was all under the light of an increase in interest income, where they increased 12% Y-o-Y and 52% Q-o-Q, while net commissions income increased 17% compared to the same period last year.

Figure 3: Bank of Palestine Credit Facilities



Source: BOP financial Statements

On the other hand, deposits witnessed the best Q-o-Q growth in the year where they grew by 6.87% during Q3 2012 only. Deposits grew by 12% since the beginning of the year to USD 1.452 billion compared to USD 1.297 billion. Deposits are expected to grow by 3-4% in the last quarter, which shows that the growth in deposits has recovered during 2012 compared to the sluggish growth of 3.44% in year 2011.

The loans-to-deposits ratio has dropped from 62% in H1 2012 to 57% by the end of Q3 2012 due to the drop in credit facilities and notable growth in deposits.

Performance of other Palestinian Banks

Credit facilities of listed Palestinian banks witnessed a drop during the third quarter of the year to USD 1.786 billion compared to USD 1.809 billion in H1 2012. Making the growth in credit facilities granted by listed Palestinian banks 16.05% in the first nine months of 2012.

The majority of total credit facilities were granted by Jordanian bank branches operating in Palestine, where facilities granted by those banks amounted to USD 2.07 billion by the end of August 2012, a 3.6% increase than their level at the beginning of the year.

Figure 4: Credit Facilities of Listed Palestinian Banks

	2011	Q3 2012	Growth
	USD (Mn)	USD(Mn)	%
<i>AIB</i>	133	170	27.82%
<i>AMB</i>	76	134	76.32%
<i>QUDS</i>	288	291	1.04%
<i>PIBC</i>	79	92	16.46%
<i>PCB</i>	56	72	28.57%
<i>ISBK</i>	187	206	10.16%
<i>BOP</i>	720	821	14.03%

Source: Banks' Financials

Bank of Palestine has the largest loan portfolio of all the listed banks, making the bank a bit incomparable to other listed banks in terms of growth. The bank's portfolio grew by 14.03% since the beginning of the year, a substantial growth considering the loan portfolio size.

The second largest listed Palestinian bank in terms of credit facilities (QUDS) witnessed a minor growth of 1.04% in its portfolio which is the lowest growth of all listed banks. While the third largest bank (ISBK) credit facilities grew by 10.16% to reach USD 206 million.

In terms of customers' deposits, the banks' performance has varied significantly, Al Rafah Microfinance Bank deposits grew by 39.19% during the period, due mostly to its current attractive rates. While the two largest Palestinian banks, BOP and QUDS, witnessed rates of 8.61% and -1.78% respectively during the first nine months of the year.

Figure 5: Customers' Deposits of Listed Palestinian Banks

	2011	Q3 2012	Growth
	USD(Mn)	USD(Mn)	%
<i>AIB</i>	74	103	39.19%
<i>AMB</i>	130	176	35.38%
<i>QUDS</i>	338	336	-0.01%
<i>PIBC</i>	137	146	7.35%
<i>PCB</i>	115	126	9.57%
<i>ISBK</i>	92	110	19.35%
<i>BOP</i>	1,297	1,452	8.61%

Source: Banks' Financials, rounded

In terms of profitability, most of the listed banks have witnessed substantial growth in net income, where BOP's net income increased 6.08% to reach USD 28.3. While AMB and ISBK have more than doubled their net income to reach USD 1.9 million and USD 4.18 million respectively.

QUDS bank witnessed a notable increase in employee compensation which increased by 24% compared to Q3 2011 which is one of the major reasons for the drop in its profits, while PCB witnessed losses in financial assets. As for ISBK's major change in profitability, it was due to the bank taking several provisions in the same period during last year, while this year the bank did not add to those provisions.

Figure 6: Income from operations of Listed Palestinian Banks

	Interest Income			Commissions Income			Net Income		
	Q3 2011	Q3 2012	Growth	Q3 2011	Q3 2012	Growth	Q3 2011	Q3 2012	Growth
	USD	USD	%	USD	USD	%	USD	USD	%
<i>AIB</i>	7,085,732	8,536,353	20.47%	724,695	952,839	31.48%	1,203,490	(493,372)	-141.00%
<i>AMB</i>	4,245,116	7,644,105	80.07%	951,297	1,566,049	64.62%	424,523	1,899,060	347.34%
<i>QUDS</i>	13,981,693	15,117,582	8.12%	3,439,100	3,960,824	15.17%	4,163,736	2,326,599	-44.12%
<i>PIBC</i>	7,006,082	6,106,873	-12.83%	2,014,647	1,982,829	-1.58%	1,170,613	1,296,018	10.71%
<i>PCB</i>	4,717,735	5,001,452	6.01%	634,443	743,905	17.25%	660,753	126,480	-80.86%
<i>ISBK</i>	10,978,348	12,361,042	12.59%	1,668,149	1,850,569	10.94%	620,076	4,182,213	574.47%
<i>BOP</i>	48,452,478	54,397,948	12.27%	13,166,506	15,373,914	16.77%	26,682,337	28,304,954	6.08%

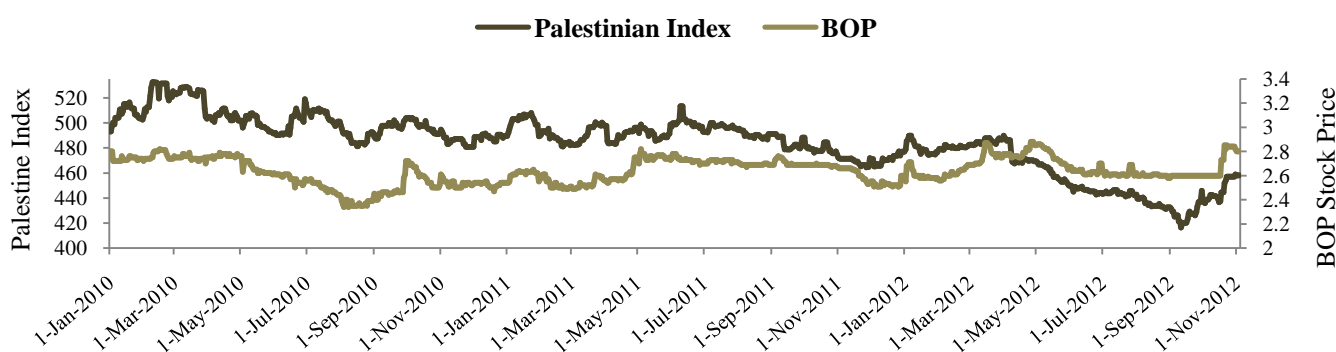
Source: Banks' Financials

Stock Performance of Bank of Palestine

The year so far looks pretty dim for the Palestinian stock exchange, where the index has been dropping since the beginning of the year, especially since the beginning of the second quarter of the year where the drop began to escalate and eventually the index dropped 8% YTD. On the other hand, Bank of Palestine remained almost unaffected with the market drop, as its share price – using adjusted prices – maintained the same level they had at the beginning of the year, during the last three months the share remained trading around its USD 2.6 per share level.

The bank witnessed a sudden increase in its price immediately after the announcement of the third quarter results, where the stock price increased from USD 2.6 to USD 2.85, a 9.6% increase in only the two days following the announcement. The stock price gradually dropped to USD 2.8 and is trading around that level now.

Figure 7: Palestine Stock Exchange Index & BOP Stock Price



Source: Palestine Stock Exchange, using adjusted prices

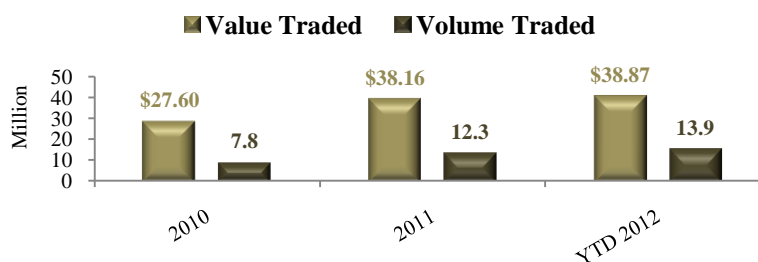
Figure 8: Close Price & 52 weeks High & Low Prices

	Close Price	52 Week High	52 Week Low
2010	3.4	3.78	3.15
2011	2.9	3.61	2.8
YTD 2012	2.8	3.23	2.57

Source: Palestine Stock Exchange
 YTD 2012 as of the 11th of November, normal prices

In terms of trading value and volume, total volume traded YTD in the Palestine stock exchange has reached 117 million traded shares, a 26.5% drop from the same period last year, where traded volume amounted to 159 million. The drop in volume in addition to the general drop in the index has resulted in drop of 26.5% in value traded where it amounted to USD 220 million YTD. Even though the exchange has witnessed a drop in both volume and value, BOP’s share trading volume has increased 71.3% to reach 13.9 million YTD, while trading value increased 47.6% to USD 38.9 million, showing that the bank’s stock was not affected by the general conditions in the exchange and solidifying the stability of the stock.

Figure 9: Value Traded & Trading Volume for BOP



Source: Palestine Stock Exchange 2012 as of the 11th of November.

BOP remained the most traded bank in 2012 in terms of value and volume, the second most traded bank was the ISBK, were value traded amounted to USD 10.84 million in 2012 and volume reached 12.36 million shares.

Figure 10: Value Traded for Palestinian Listed Banks

	2011		YTD 2012	
	Value Traded	Trading Volume	Value Traded	Trading Volume
<i>BOP</i>	38,157,142	12,327,737	38,870,623	13,925,379
<i>AIB</i>	2,075,831	2,515,060	4,057,442	5,146,791
<i>AMB</i>	5,536,710	7,159,640	4,456,161	5,510,097
<i>ISBK</i>	6,750,276	7,822,799	10,842,196	12,356,041
<i>PIBC</i>	2,149,292	2,026,265	503,054	530,736
<i>QUDS</i>	3,857,226	3,520,768	548,843	580,871
<i>PCB</i>	2,081,120	2,695,278	251,328	316,430

Source: Palestine Stock Exchange
 YTD 2012 as of the 11th of November.

Valuation

In this valuation, we applied the Equity Cash Flow model, in addition to P/E peer valuation, giving the larger weight to the Equity Cash Flow model. The following is an overview of the banks included in the peer valuation. The selected banks include 4 banks in Jordan, one bank in Oman, UAE and Egypt. Although Bank of Palestine has the highest market capitalization compared to other listed banks in Palestine, it has the lowest between the considered peers.

Figure 11: Peers considered for P/E valuation

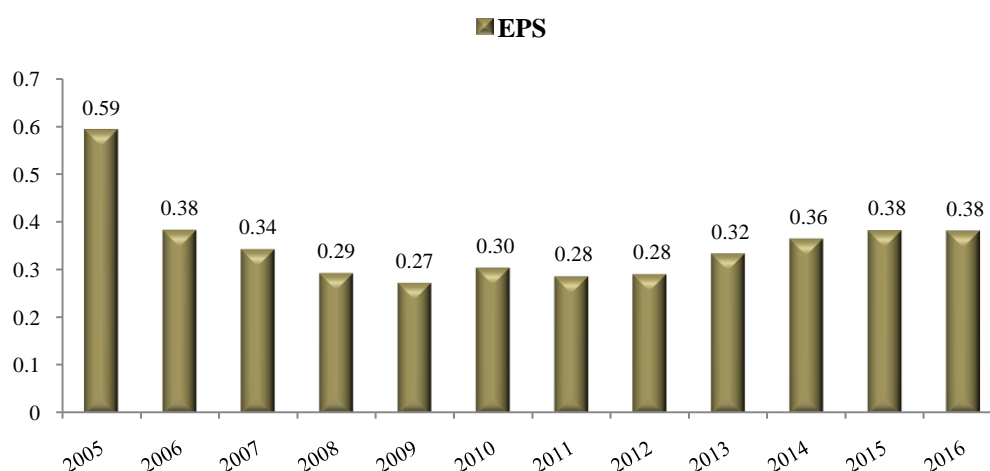
Name	Country	P/E
Bank Of Palestine	Palestine	11.35
Jordan Kuwait Bank	Jordan	8.05
Credit Agricole	Egypt	9.01
Bank of Jordan	Jordan	7.69
Cairo Amman Bank	Jordan	6.96
Bank Sohar	Oman	8.46
Commercial Bank	UAE	5.4
Jordan Ahli Bank	Jordan	7.57

Source: Bloomberg

Our discounted equity cash flow model yielded USD 3.04 per share. This is based on a 2% terminal growth rate, with 14.94% cost of equity, adjusted Beta of 0.72, market risk premium of 15% and risk free rate of 7.75%. We applied a weight of 90% to Equity Cash Flow model, and a weight of 10% to the P/E valuation. The P/E valuation yielded USD 2.37.

Bank of Palestine is the largest financial institution in Palestine and one of the major employers, yet we believe that the bank still has several growth areas that can be further explored, we expect that the additional branches to be opened, serving rural areas that are under served or not served at all, in addition to the possibility to branch out of the borders of Palestine will positively affect the future performance of the bank. We expect that credit facilities will grow 12% during 2012, 10% during 2013 and then growth will stabilize around 5% for the following years. EPS will maintain steady growth over the years as the following figure shows.

Figure 12: Historical and Forecasted EPS



Source : Bloomberg, Awraq investments

Our target price for Bank of Palestine is still USD 2.89, slightly higher than the close price of USD 2.8 on November 11, 2012. Based on this valuation, our recommendation for Bank of Palestine is HOLD. This valuation is based on the assumption that no major adverse events would happen throughout the forecast period. Should any negative developments arise, there could be a downside risk to our estimates.

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