



Bank of Palestine Equity Report

May 19, 2011

Serene Zawaydeh
Head of Research
Research Division
Awraq Investments
szawaydeh@awraq.com



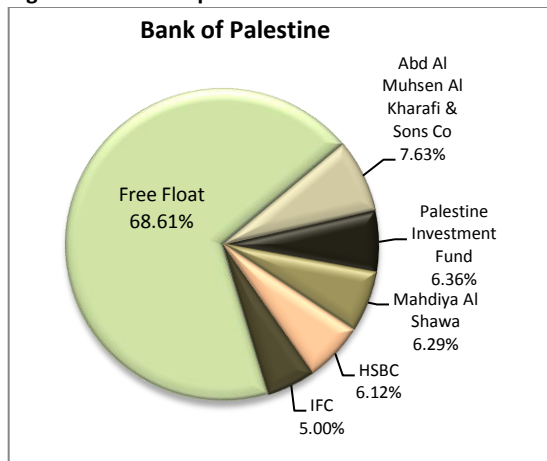
www.awraq.com

Table of Contents

Executive Summary	3
Ownership Structure	3
Regulatory Highlights and Palestine Monetary Authority.....	4
Banks in Palestine	6
Listed Banks on Palestine Stock Exchange	7
Consolidated Balance Sheet Indicators for Banks in Palestine	8
Bank of Palestine	8
Financial Highlights.....	9
Interest Income	10
Assets, Liabilities and Equity.....	11
Capital Adequacy and Risk Weighted Assets.....	11
Interest Bearing Assets and Liabilities.....	12
Customers' Deposits.....	12
Credit Facilities versus Balances at Banks	13
Credit Facilities by Segment	14
Currency Mismatch	15
Interest Rates	15
Valuation	18
Appendix.....	20
Bibliography.....	21
Related Awraq Investments Research.....	22
Disclaimer	23



Figure 1: Ownership Structure



Source: Bank of Palestine

Executive Summary

Bank of Palestine (Ticker: BOP) was founded in 1960 and commenced its operations on February 21, 1961 by giving small loans to projects and businesses and giving limited short-term personal loans. It offers services to individuals and companies. It had 983 employees at the end of March 2011, and a banking network of 43 branches and sub-branches covering Palestine.

Bank of Palestine has US\$ 120 million paid up capital, after distributing US\$ 20 million stock dividends to shareholders in May 2011. The bank has the second highest market capitalization on Palestine Stock Exchange following Paltel, and accounted for 13.88% of the total market capitalization of Palestine Stock Exchange in 2010, according to statistics by the stock exchange.

At the end of 2006, Bank of Palestine established its investment arm, Al-Wasata Securities Co., which has two branches in Gaza and Ramallah. On June 23, 2010, Bank of Palestine bought a strategic stake amounting to 8.75% of the capital of Jordan Invest Bank (Ticker: JIFB). The total number of shares acquired was 6,779,960 shares at an average price of JD 1.83 per share, for a total amount of JD 12.4 million.

In this valuation, we applied the Equity Cash Flow model weighted at 80%; and peer valuation with 10% to each of P/E and P/BV valuation methods. Our valuation yielded a target price of US\$ 3.44 per share. The bank's stock price closed to US\$ 3.08 per share on May 18, 2011. Our recommendation for Bank of Palestine is **HOLD**. We assumed 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.

Table 1: Summary of Indicators

Ticker	BOP PS		
	52Wk L 8/8/2010	52 Wk H 28/4/2011	Close 18/5/2011
Target Price	\$3.44	\$2.61*	\$ 3.08
	2009	2010	2011 E
# of Shares (m)	100.00	100.00	120.00
Unadjusted Stock Price (US\$)	3.75	3.40	3.08
Market Cap. (US\$ m)	375	340	370
Interest Income (US\$ m)	43.77	50.58	60.21
Net Income (US\$ m)	26.93	30.12	34.38
EPS (US\$)	0.27	0.30	0.29
P/E	13.93	11.29	10.75
Sh. Equity (US\$ m)	150.25	163.31	194.81
BV per Share (US\$)	1.50	1.63	1.62
P/BV	2.50	2.08	1.90
Dividends (US\$ m)	21.40	0%	0%
Div per Share	0.21	0%	0%
Div Yield	0.06	0%	0%

* Unadjusted

Source: Bank of Palestine, Palestine Stock Exchange, Awraq Investments

Ownership Structure

Shareholders with ownership exceeding 5% of the capital constituted 31.4% in 2010. The bank's shareholders include Abd Al Muhsen Al Kharafi & Sons (7.63%); Palestine Investment Fund (6.36%); HSBC (6.12%). The International Finance Corporation (IFC) bought 5% of the bank in 2008 for US\$ 15 million, which valued the bank at US\$ 3 per share, compared to an average stock price of US\$ 2.7 during the year. The bank's chairman is Mr. Hashim Al Shawa, who assumed his position in 2007, following his father and grandfather's footsteps.

According to Palestine Stock Exchange statistics, the total number of shareholders of Bank of Palestine increased from 3,071 in 2009 to 3,299 in 2010.

Regulatory Highlights and Palestine Monetary Authority

The Palestine Monetary Authority (PMA) is the emerging Central Bank of Palestine¹. Its overall purpose is to ensure the stability and effectiveness of the Palestinian financial system, promote sustained economic and financial growth of the Palestinian economy through the following procedures:

- Effective and transparent regulation and supervision of banks operating in Palestinian Territory.
- Development and deployment of Monetary Policy designed to achieve price stability.
- Overseeing the implementation of modern, efficient payment system.

PMA was initially established in 1994 by presidential decree as an independent institution and later by an act of the Palestine Legislative Council PMA Law Number 2, 1997 which outlined the full authority and autonomy of PMA. A new banking law (Law No. 9 for the year 2010) entered into force on November 27, 2010.²

The Banking Supervision Department³ at PMA is responsible for the supervision of banks as well as non-bank financial institutions, drafting regulations, licensing, risk management, and cross-border supervision. Overall, the Banking Supervision Department is in charge of monitoring the health of the banking system as a whole, identifying and monitoring systemic risks, strengthening relations with foreign supervisors ensuring that foreign owned entities are effectively supervised, and, through its risk management function, helps identify and deal with risks arising from the operations of banks and financial institutions under the PMA's supervision.

The Palestine Monetary Authority states that Palestine was one of the countries least affected by the global financial crisis. This was due to the limited opening of the Palestinian economy to the world's economies; the juvenility of the Palestinian banking system and its dependence mainly on traditional financial instruments; the limitation to equity trading on Palestine Stock Exchange; in addition to the economic and political restrictions imposed by Israel.

In April 2011, an IMF report⁴ commended advances made by the PMA to improve its banking sector. The PMA strengthened the supervision and regulatory framework, and advanced towards the implementation of Basel II standards, with full implementation expected by mid 2012. The PMA is preparing its monetary operations department for open market operations and the issuance of government securities and PMA certificates of deposits, with technical assistance from the IMF during 2011. The PMA would only need to become a fully functioning central bank if the territory adopts its own currency, which is the ultimate aim of the central bank.

The PMA recounts its efforts in managing a financial crisis in 2006 in its publications. In January 2006, government salaries were stopped for eighteen months in the wake of the legislative elections in Palestine. The Palestinian National Authority (PNA) owed a total of US\$ 350 million to the public employees, while the collected capital for the banks was around US\$ 220 million at that time. The PMA was able to overcome the crisis, by rescheduling loans, and increasing minimum capital requirements for banks, among other measures.

PMA issued instructions in 2009 regulating paid up capital. The instructions obligated all banks (national and foreign) to raise their capital to a minimum of US\$ 50 million, over two phases: Completing the payment of paid up capital to US\$ 35 million by the end of 2009; and completing the payment of capital to US\$ 50 million by the end of 2010. The long-term goal is to move minimum capital up to US\$100 million. Bank merger operations

1 http://www.pma.ps/index.php?option=com_content&view=article&id=47&Itemid=67&lang=en

2 http://www.pma.ps/index.php?option=com_content&view=article&id=99%3Aentry-into-force-the-new-banking-law-as-of-saturday&catid=37%3Apress-release&Itemid=107&lang=en

3 http://www.pma.ps/index.php?option=com_content&view=article&id=75&Itemid=92&lang=en

4 http://www.pma.ps/index.php?option=com_content&view=article&id=178%3Aimf-praises-pma-as-palestine-bids-for-statehood&catid=108%3Anews&Itemid=63&lang=en



represent a main option to achieve the capital requirements. The PMA released directives for merger between banks, including provisions and general conditions for mergers and the practical procedures for all their forms⁵.

Palestine Monetary Authority reduced banks' external investments from 65% of their assets to 55% in 2009, which increased the amount of loanable funds. Furthermore, a credit scoring system was launched in July 2010, which helped banks increase their credit facilities during the year. The system provides banks and lending institutions with a specific score for individuals to assist in their lending decisions, and all loan applications are subject to this process.

The minimum acceptable capital adequacy ratio adopted by the Palestine Monetary Authority is 12%, which is the minimum acceptable ratio by the Basel Committee. Moreover, foreign banks are required to keep with PMA, at least 21% of their capital (allocated to the branches in Palestine) as a non-withdrawable capital deposit that should not fall below US\$ 10 million.

Following are some of the requirements applied to banks in Palestine, which were mentioned in Bank of Palestine's 2010 Annual Report.

- The required reserve ratio is 9% on customers' deposits in Shekel and other currencies in 2010, compared to 8% on Shekel deposits in 2009.
- Compulsory reserve includes annual deduction amounting to 10% of net income before tax in 2009, and was adjusted to 10% of net income after tax in 2010. The deduction cannot be halted before the total amounts appropriated to this reserve reach the amount of the Bank's capital. The annual deduction to this reserve is made at year end. Compulsory reserve cannot be distributed to shareholders, unless approval of the PMA is obtained.
- Voluntary reserve, representing 10% of affiliates' net profit after tax.
- Reserve for cyclical changes introduced in 2010 amounted to 15% of net profit after tax, according to PMA regulations for 2011. The amount supports the bank's capital, and enables it to withstand the risks in the banking sector. It cannot be reduced unless approval of PMA is obtained.

⁵ <http://www.pifbs.com/etemplate.php?id=115>



Banks in Palestine

According to Palestine Monetary Authority, there are 19 banks operating in Palestine through a network of more than 200 branches and representative offices. There are 9 local banks, and 10 foreign banks comprising of 8 Jordanian banks, one Egyptian bank, and one branch for HSBC. Six banks are listed on Palestine Stock Exchange.

Table 2: Banks in Palestine

	Local Commercial Banks	Ticker		Foreign Banks		
				Jordanian Banks	Other Foreign Banks	
1	Bank of Palestine P.L.C	BOP	9	Cairo Amman Bank	18	Egyptian Arab Land Bank
2	Palestine Investment Bank	PIBC	10	Arab Bank	19	HSBC Bank Middle East Limited
3	Palestine Commercial Bank	PCB	11	Jordan Kuwait Bank		
4	Al Quds Bank	QUDS	12	Jordan Ahli Bank		
5	Al Rafah Microfinance Bank	AMB	13	Bank of Jordan		
6	Palestine International Bank	N/A	14	Union Bank		
	Local Islamic Banks		15	The Housing Bank for Trade & Finance		
7	Arab Islamic Bank	AIB	16	Jordan Commercial Bank		
8	Palestine Islamic Bank	N/A	17	Arab Palestinian Investment Bank		

Source: Palestine Monetary Authority

- On May 10, 2010, the Palestine Monetary Authority announced the completion of the process of liquidation of Al Aqsa Islamic Bank⁶.
- On March 22, 2011 Al Rafah Microfinance Bank decided to end merger talks⁷ with Jordan Commercial Bank (Ticker: JOGB). The bank will seek other ways to increase its capital from US\$ 30 million to US\$ 50 million, as required by the Palestine Monetary Authority.
- The Arab Islamic Bank initiated a new issue for subscription between January 12 and 31, 2011 to raise its capital by US\$ 9,303,061. Total issued shares will increase to 50 million assuming all rights are exercised. The 9,303,061 shares were offered to shareholders through a secondary public offering (rights issue).

6 http://www.pma.ps/index.php?option=com_content&view=article&id=95%3Aliquidation-of-al-aqsa-islamic-bank&catid=37%3Apress-release&Itemid=107&lang=en

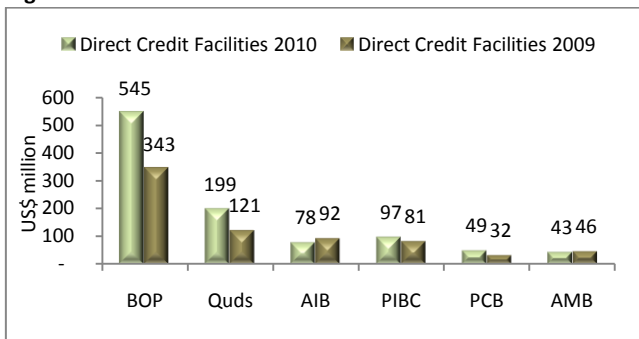
7 <http://www.pex.ps/PSEWebSite/Generalizations/Board-Meeting-Decisions-AMB-22032011.pdf>



Listed Banks on Palestine Stock Exchange

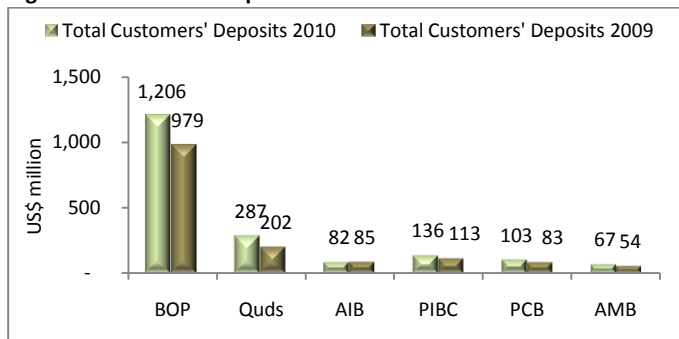
Bank of Palestine is the biggest bank among the 6 listed Banks in terms of direct credit facilities and customers' deposits. The following is a comparison of credit facilities and customers' deposits for the listed banks in Palestine.

Figure 2: Direct Credit Facilities for Listed Banks



Source: Banks' Financials

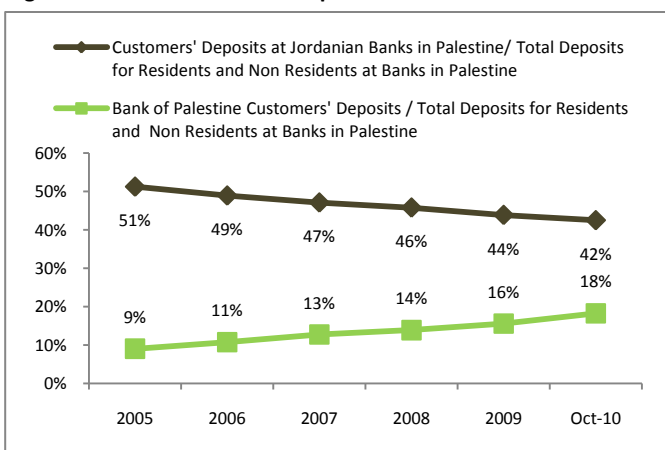
Figure 3: Customers' Deposits for Listed Banks



Source: Banks' Financials

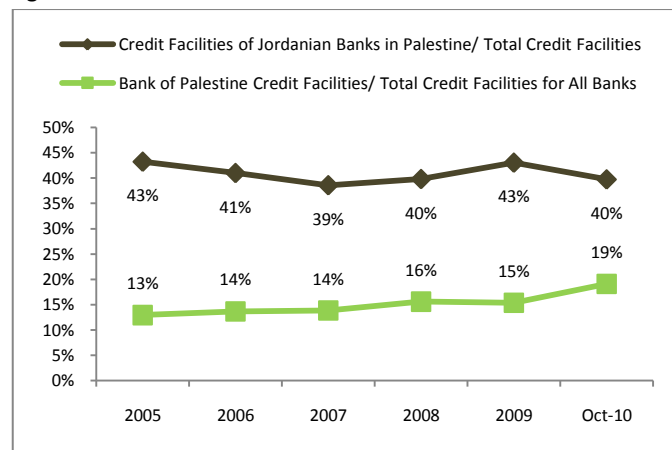
Bank of Palestine's market share steadily increased in terms of total deposits and total credit facilities. The bank's share of total deposits increased from 9% in 2005 to around 18% towards the end of 2010⁸; while its share of total credit facilities increased from 13% in 2005 to around 19% by end of 2010. Customers' deposits held at Jordanian banks as a percent of total residents' deposits declined steadily from 51% in 2005 to 42% in October 2010; and Jordanian banks' share of total credit facilities declined from 43% in 2005 to 40% in October 2010. Deposits of residents constituted 96% of total deposits for residents and non residents at the end of Q3 2010 for all banks in Palestine, compared to 95% in 2009 and 98% between 2005 and 2008.

Figure 4: Bank of Palestine's Deposits Market Share



Source: PMA, Central Bank of Jordan, Bank of Palestine

Figure 5: Bank of Palestine's Credit Facilities Market Share



Source: PMA, Central Bank of Jordan, Bank of Palestine

The credit facilities of operating banks in the Palestine represented about 42% of the Gross National Product by end of 2009 as opposed to 93% in Jordan, 133% in Egypt and 103% in Israel.⁹

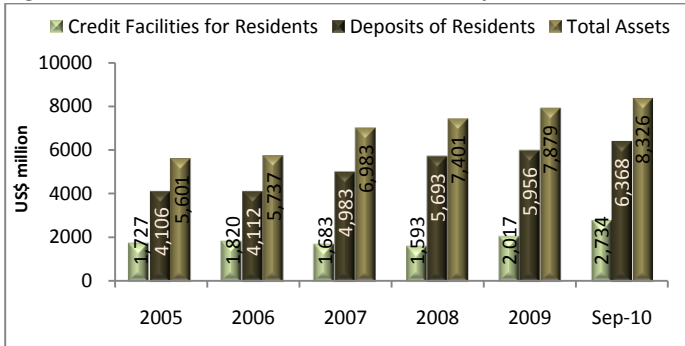
⁸ Yearend 2010 figures were used for Bank of Palestine, versus figures for October 2010 for Jordanian banks and the whole market.

⁹ <http://www.pifbs.com/etemplate.php?id=115>

Consolidated Balance Sheet Indicators for Banks in Palestine

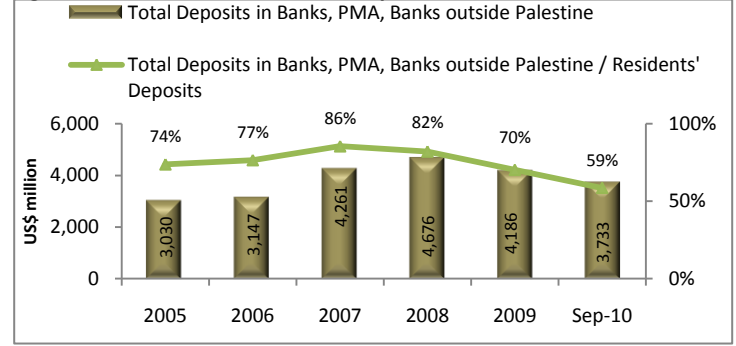
According to data from PMA, the consolidated balance sheet for banks in Palestine shows that the paid up capital was only US\$ 316 million in 2005, and increased to US\$ 762 million in September 2010. The total shareholders' equity stood at US\$ 573 million in 2005 and reached US\$ 986 million in September 2010. Total assets, on the other hand, increased from US\$ 5.6 billion in 2005 to reach US\$ 8.3 billion in September 2010. Credit facilities for residents amounted to US\$ 2.734 billion at the end of September 2010.

Figure 6: Banks in Palestine: Credit Facilities, Deposits, and Assets



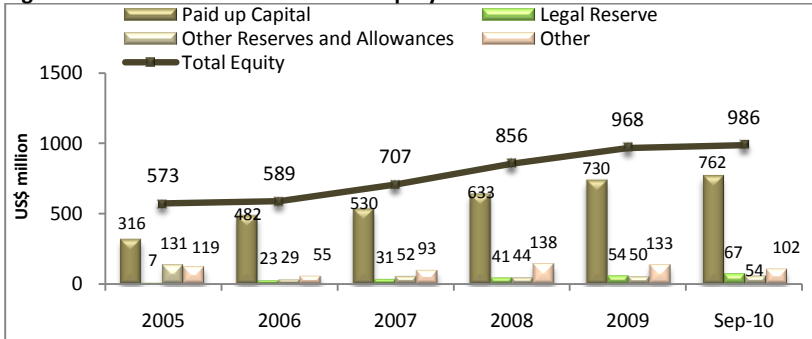
Source: Palestine Monetary Authority

Figure 7: Banks in Palestine: Total Deposits inside & Outside Palestine



Source: Palestine Monetary Authority

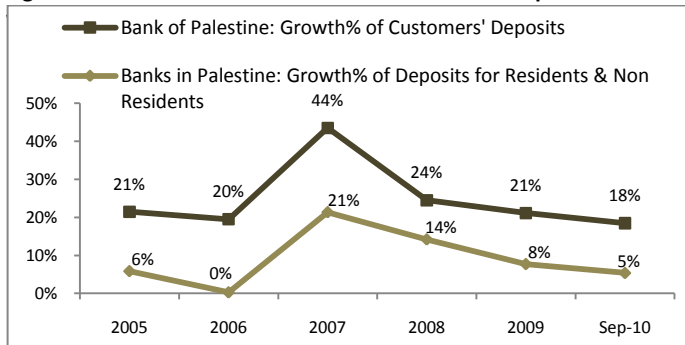
Figure 8: Consolidated Shareholders' Equity for Banks in Palestine



Source: Palestine Monetary Authority

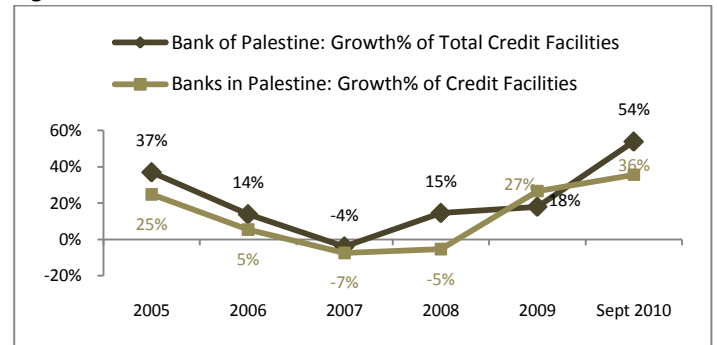
The following figures provide the growth rates in deposits and credit facilities for Bank of Palestine compared to growth rates for all banks operating in Palestine combined. Bank of Palestine's customers' deposits increased at higher rates than those recorded by all banks combined between 2005 and September 2010. It also had higher growth in credit facilities between 2005 and 2008. However, in 2009, the bank's credit facilities increased by 18%, lagging behind the overall growth rate of 27% for all banks. In the first 9 months of 2010, Bank of Palestine was more aggressive, and increased its credit facilities by 54% versus a 36% growth rate for all banks combined.

Figure 9: Growth in Bank of Palestine's Customers Deposits



Source: Palestine Monetary Authority, Bank of Palestine

Figure 10: Growth in Credit Facilities of Bank of Palestine



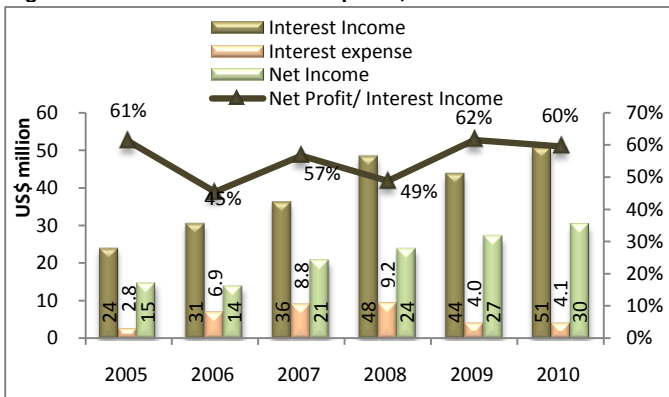
Source: Palestine Monetary Authority, Bank of Palestine



Financial Highlights

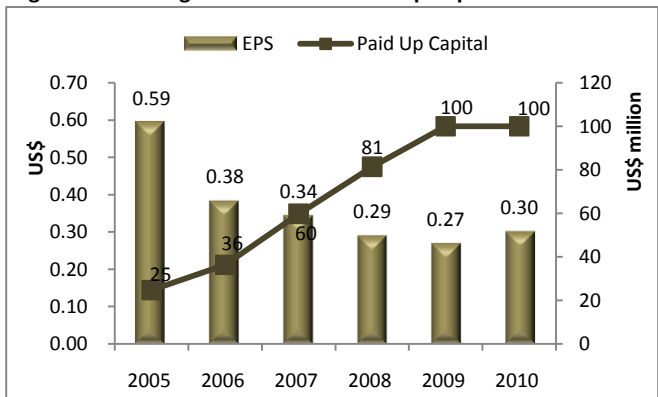
- Total assets increased at a Compound Annual Growth Rate (CAGR) of 25% between 2005 and 2010, reaching US\$ 1.5 billion by end of 2010 compared to US\$ 496.7 million in 2005. The bank increased its capital from US\$ 25 million in 2005 to US\$ 100 million in 2009. In April 2010, the general assembly approved raising the authorized capital from US\$ 100 million to US\$ 200 million, with par value of \$1.¹⁰ In May 2011, the bank's capital reached \$ 120 million with the distribution of 20% stock dividends.
- Customers' Deposits increased at a CAGR of 26% between 2005 and 2010, rising from US\$ 378.5 million in 2005 to reach US\$ 1.2 billion by end of 2010. Deposits declined in the first quarter of 2011, and reached US\$ 1.174 billion at the end of March 2011.
- Net credit facilities increased by 59% in 2010 reaching US\$ 545 million up from US\$ 232 million in 2005. Provision for credit facilities stood at US\$ 7.4 million in 2010, constituting 1.3% of total credit facilities; versus US\$ 6 million in 2005, constituting 2.5% of total credit facilities. The loan to deposit ratio was only 35% in 2008. It increased to 45% in 2010, and stood at 53% in March 2011.
- The Capital Adequacy Ratio was 22.8% in 2008 with risk weighted assets constituting only 37.7% of total assets. As the bank increased its loans, risk weighted assets increased to 42.7% in 2009, and the capital adequacy ratio declined to 16.5%. In 2010, risk weighted assets accounted for 47.7% of total assets, and the Capital Adequacy Ratio reached 12.9%. The future increase in capital will enable the bank to maintain its capital adequacy ratio within the required range, while loans and risk weighted assets increase.
- Interest income increased at a CAGR of 16% between 2005 and 2010, rising from US\$ 24 million in 2005 to US\$ 50.6 million in 2010. Interest expense dropped from US\$ 9.2 million in 2008 to US\$ 4.1 million, along with the decline in interest rates on deposits. In the first quarter of 2011, interest income amounted to US\$ 12 million compared to US\$ 9 million in Q1 2011; while interest expense increased from US\$ 1 million in Q1 2010 to reach US\$ 1.29 million.
- Net profit doubled from US\$ 14.7 million in 2005 to US\$ 30 million in 2010. Earnings per share declined from US\$ 0.59 in 2005 to US\$ 0.27 in 2009, and reached US\$ 0.30 in 2010. The bank distributed US\$ 0.215 cash dividends per share in 2010 based on 2009 profit, and had distributed stock dividends in previous years.

Figure 11: Interest Income and Expense, Net Income



Source: Bank of Palestine

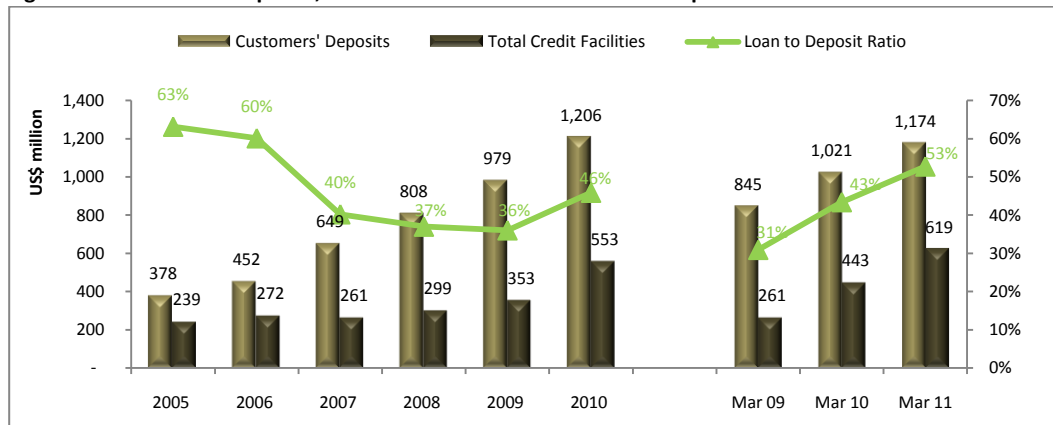
Figure 12: Earnings Per Share and Paid Up Capital



Source: Bank of Palestine

¹⁰ The added shares were not registered yet with the companies' controller as of end of 2010 (Bank of Palestine, Annual Report 2010)

Figure 13: Customers' Deposits, Total Credit Facilities and Loan to Deposit Ratio

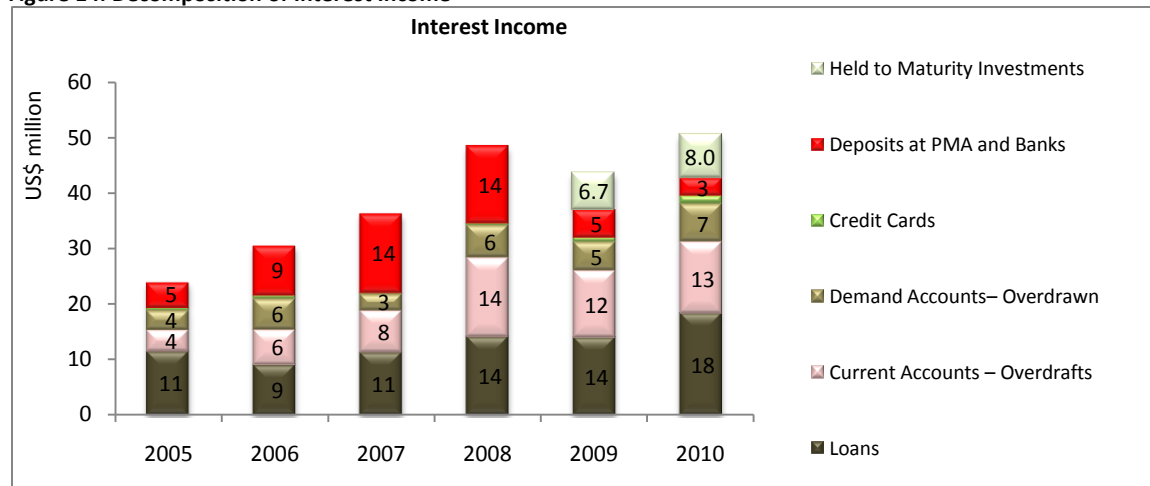


Source: Bank of Palestine

Interest Income

Loans generated US\$ 18 million interest income for Bank of Palestine in 2010, compared to US\$ 14 million in 2009 and 2008. Current accounts generated US\$ 13 million in 2010, compared to US\$ 14 million in 2008. There was a significant drop in interest income from deposits at banks, which had generated US\$ 14 million interest income in 2008, then dropped to US\$ 3 million in 2010. Held to maturity investments generated US\$ 8 million in 2010 and US\$ 6.7 million in 2007. The bank sold held to maturity investments in 2010, and the portfolio was reclassified into available for sale investments at the end of 2010. Interest income from credit cards is still limited, and amounted to US\$ 1.46 million in 2010, up from only US\$ 819,179 in 2009.

Figure 14: Decomposition of Interest Income

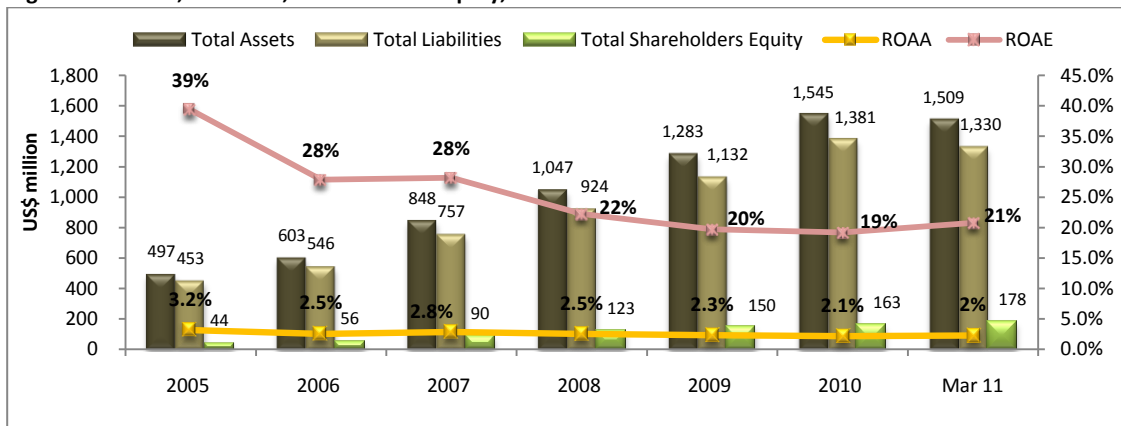


Source: Bank of Palestine

Assets, Liabilities and Equity

Bank of Palestine's total assets increased from US\$ 497 million in 2005, to reach US\$ 1.545 billion in 2010. Assets declined slightly in the first quarter of 2011, and reached US\$ 1.509 billion at the end of March 2011. Shareholders' equity amounted to US\$ 44 million in 2005, and stood at US\$ 178 million at the end of March 2011. Return on average assets declined from 3.2% in 2005 to 2%; while return on average equity declined from 39% in 2005 to 21% in March 2011.

Figure 15: Assets, Liabilities, Shareholders' Equity, ROAA and ROAE

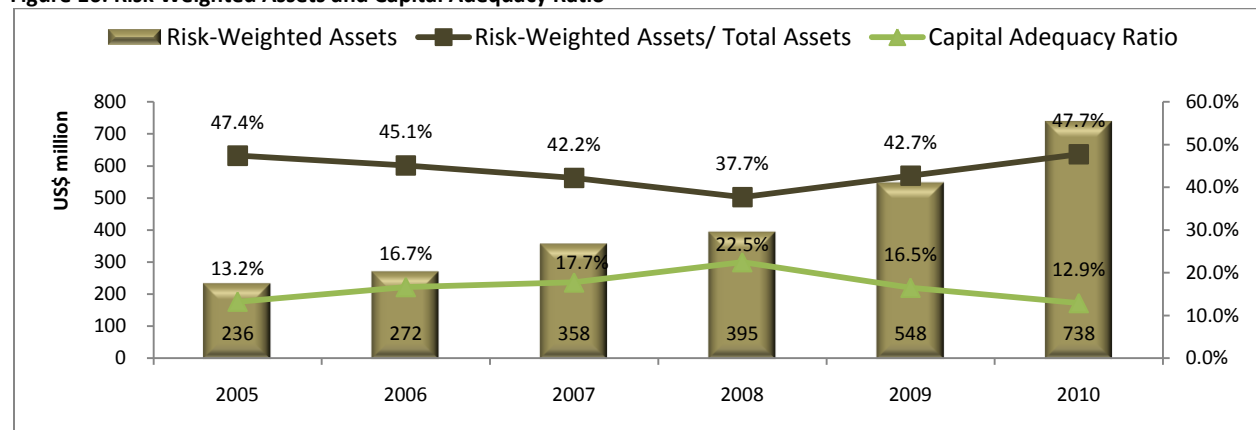


Source: Bank of Palestine

Capital Adequacy and Risk Weighted Assets

The capital adequacy ratio declined from 16.5% in 2008, to 12.9% in 2010. Back in 2008, risk weighted assets constituted only 37.7% of total assets, and the capital adequacy ratio was highest at 22.5%. Along with an increase in loans in 2010, Bank of Palestine's risk weighted assets increased from US\$ 548 million in 2009, accounting to 42.7% of total assets, to US\$ 738 million accounting to 47.7% of total assets in 2010.

Figure 16: Risk Weighted Assets and Capital Adequacy Ratio

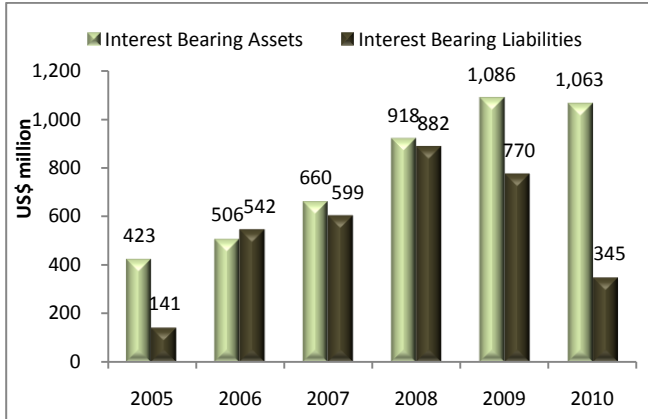


Source: Bank of Palestine

Interest Bearing Assets and Liabilities

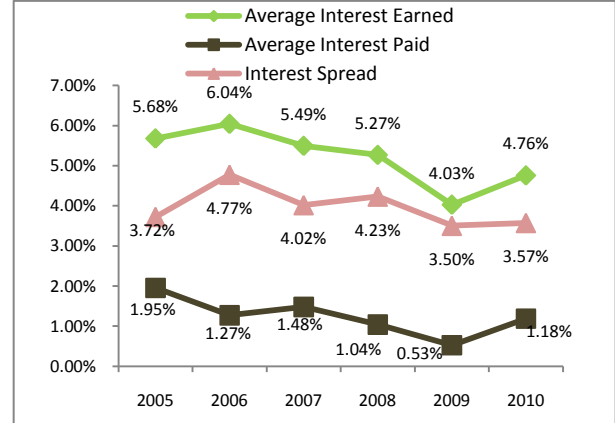
An analysis of interest price sensitivity based on re-pricing periods, shows that interest bearing assets increased from US\$ 423 million in 2005 to reach US\$ 1.063 billion in 2010. Interest bearing liabilities, however, significantly dropped in 2010, reaching US\$ 345 million, compared to US\$ 770 million in 2009. The average interest earned was calculated based on interest bearing assets and total interest income. It stood at 4.76% in 2010 compared to 4.03% in 2009. We also calculated the average interest paid based on interest bearing liabilities and interest expense, which yielded 1.18% in 2010 compared to 0.53% in 2009. The spread between the average interest earned and paid declined from 4.23% in 2008 to 3.57% in 2010.

Figure 17: Interest Bearing Assets and Liabilities



Source: Bank of Palestine

Figure 18: Average Interest Earned, Paid and Spread

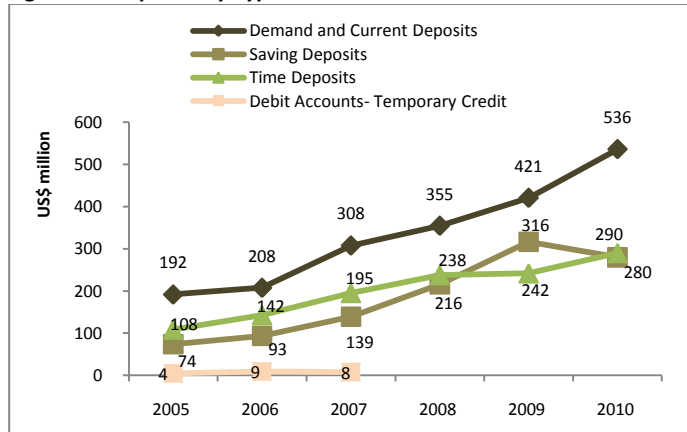


Source: Bank of Palestine

Customers' Deposits

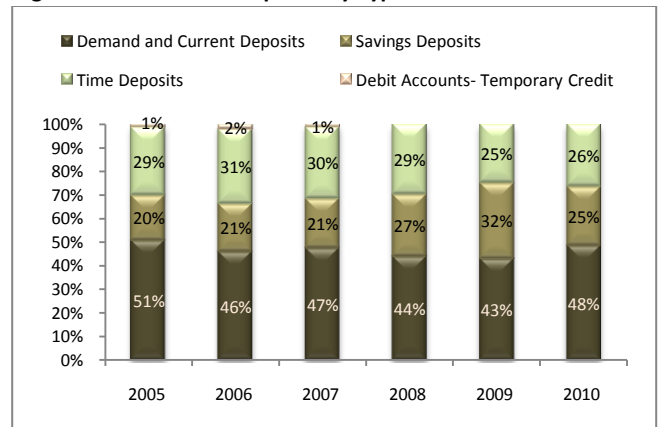
Customers' Deposits increased at a CAGR of 26% between 2005 and 2010, tripling from US\$ 378.5 million in 2005 to reach US\$ 1,205 million in 2010. Demand and current deposits accounted for 48% of total deposits in 2010, down from 51% in 2005. Time deposits accounted for 26% of total deposits in 2010, compared to 25% savings deposits in 2010. The interest rates on deposits are very low, and are lowest for demand deposits. This helped reduce interest expense in 2010.

Figure 19: Deposits by Type



Source: Bank of Palestine

Figure 20: Customers' Deposits by Type



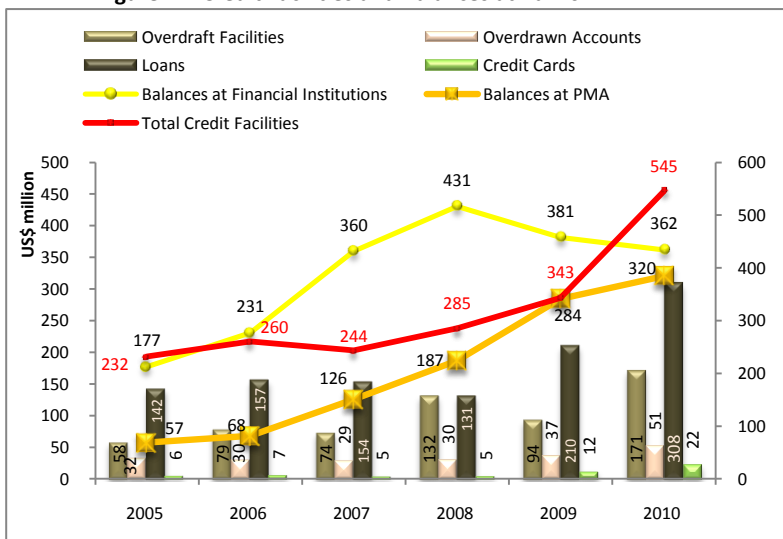
Source: Bank of Palestine



Credit Facilities versus Balances at Banks

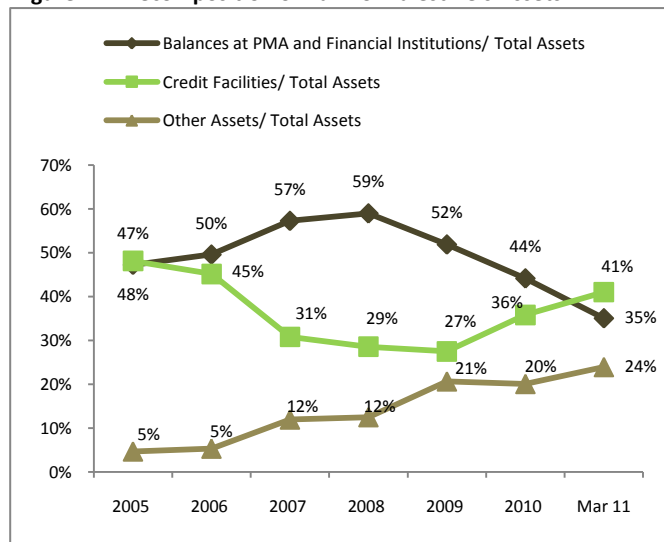
The PMA's decision to reduce deposits outside Palestine was reflected in a reduction in balances at banks, and an increase in credit facilities in 2010 and Q1 2011. Total credit facilities offered by Bank of Palestine increased by US\$ 200 million in 2010, representing 57% growth rate over 2009, compared to US\$ 113 million added loans between 2006 and 2009. Credit facilities accounted for 36% of total assets in 2010 and 41% at the end of March 2011, up from 27% in 2009. Loans accounted for 56% of credit facilities; compared to 31% overdraft facilities, 9% overdrawn accounts and only 4% credit card facilities in 2010. While balances at banks and PMA declined to 35% of total assets. Balances at PMA and financial institutions accounted for 35% of total assets at the end of March 2011, down from 59% in 2008.

Figure 21: Credit Facilities and Balances at Banks



Source: Bank of Palestine

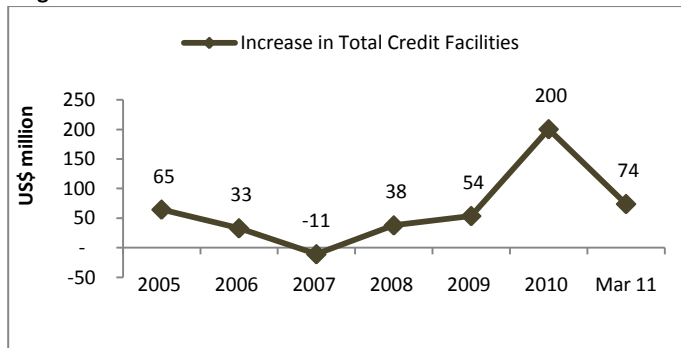
Figure 22: Decomposition of Bank of Palestine's Assets



Source: Bank of Palestine

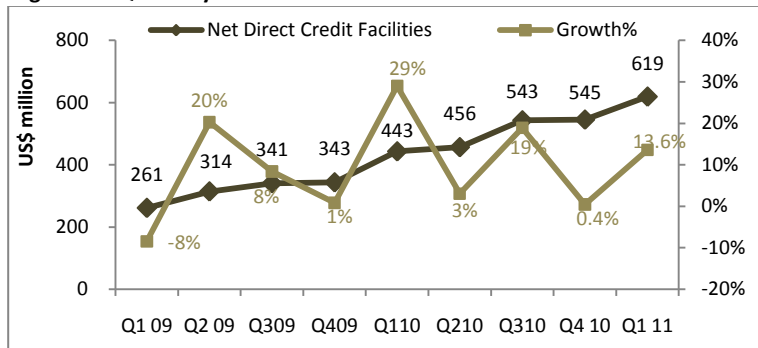
The first and third quarters of 2010 had significant growth in loans, in addition to the second quarter of 2009. In Q2 2009, net credit facilities (after deduction of provision for credit losses and interest in suspense), increased by 20%, rising from US\$ 261 million in Q1 2009 to US\$ 314 million. In Q1 2010, the bank recorded a 29% increase in credit facilities, rising from US\$ 343 million at the end of 2009 to reach US\$ 443 million. Q3 2010 recorded another 19% increase in loans, reaching US\$ 543 million. In Q1 2011, net direct credit facilities increased by 13.6% compared to the previous quarter, and reached US\$ 619 million.

Figure 23: Increase in Total Credit Facilities



Source: Bank of Palestine

Figure 24: Quarterly Growth in Net Credit Facilities

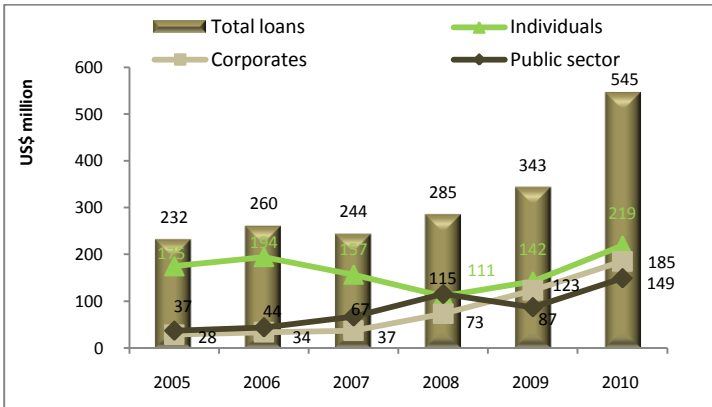


Source: Bank of Palestine

Credit Facilities by Segment

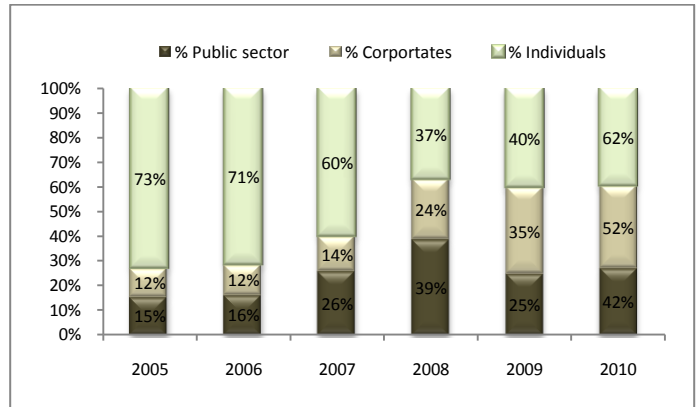
Credit facilities to individuals increased from US\$ 142 million in 2009 to US\$ 219 million in 2010, constituting 62% of total loans. Credit facilities to the government accounted for 42% of total loans in 2010, versus 25% in 2009. Government loans reached US\$ 149 million at the end of 2010, after having declined to US\$ 87 million in 2009. Corporate loans increased steadily to reach US\$ 185 million in 2010 up from US\$ 123 million, and constituted 52% of total loans in 2010.

Figure 25: Credit Facilities by Segment



Source: Bank of Palestine

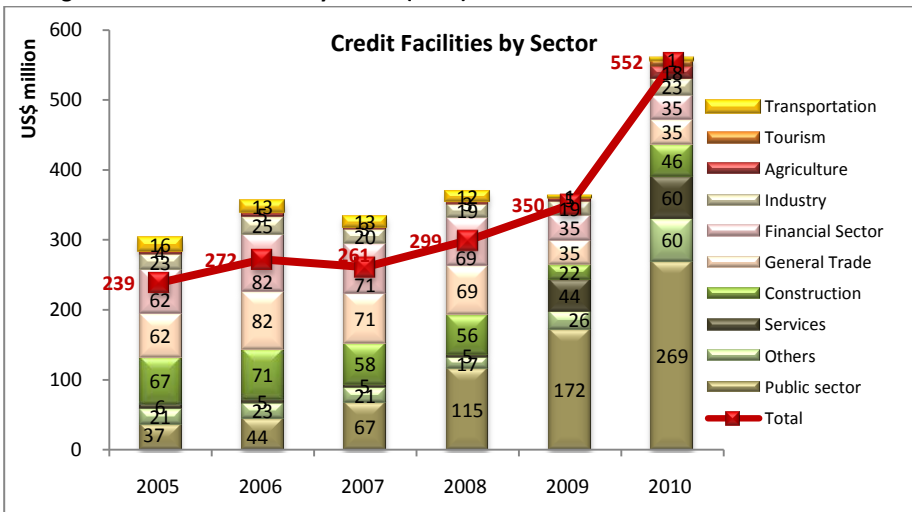
Figure 26: % Credit Facilities by Segment



Source: Bank of Palestine

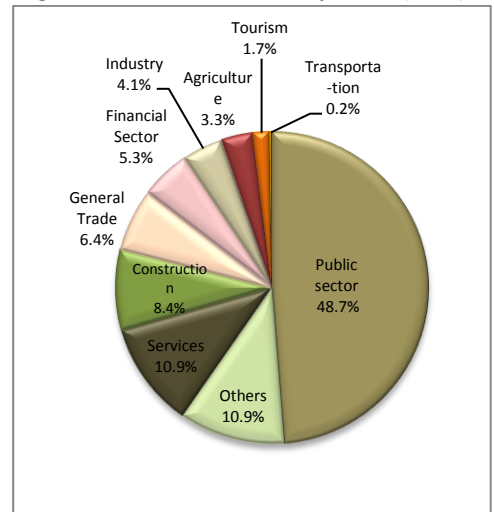
As shown in figure 27 and 28, credit extended to the government and public sector employees constituted 48.7% of total credit facilities and reached US\$ 269 million compared to US\$ 172 million in 2009. The services sector was granted US\$ 60 million, constituting 10.9% of total credit facilities, compared to US\$ 46 million for the construction sector in 2010.

Figure 28: Credit Facilities by Sector (2010)



Source: Bank of Palestine

Figure 27: % Credit Facilities by Sector (2010)

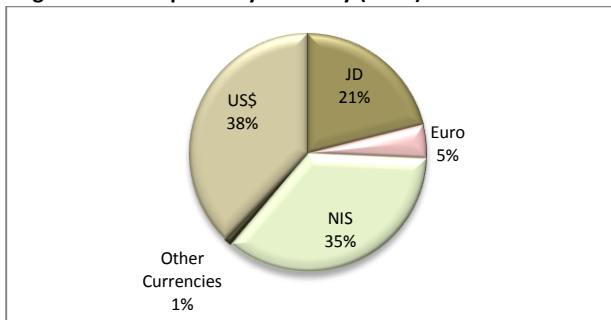


Source: Bank of Palestine

Currency Mismatch

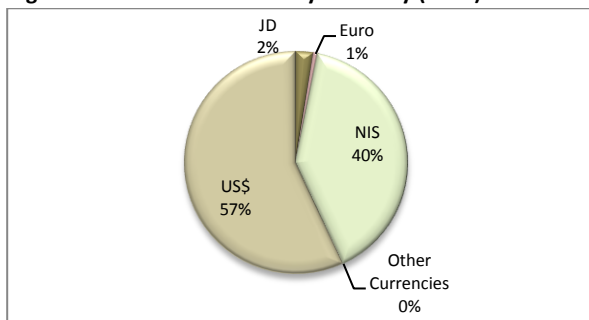
Three main currencies are circulated in Palestine: US dollar, Jordanian Dinar and Israeli Shekel. The banks face a currency mismatch due to differences in amounts of deposits and credit facilities in each of the currencies. Deposits in Jordanian Dinar constituted 21% of deposits in 2010, while only 2% of credit facilities were given in JD. US dollar denominated deposits constituted 38% of total deposits in 2010, versus 57% of credit facilities. Israeli Shekel deposits accounted for 35% of total deposits, while 40% of credit facilities were given in Shekel.

Figure 29: % Deposits by Currency (2010)



Source: Bank of Palestine

Figure 30: % Credit Facilities by Currency (2010)

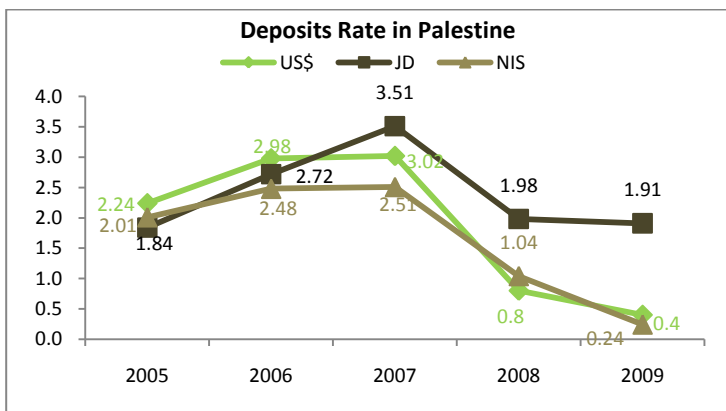


Source: Bank of Palestine

Interest Rates

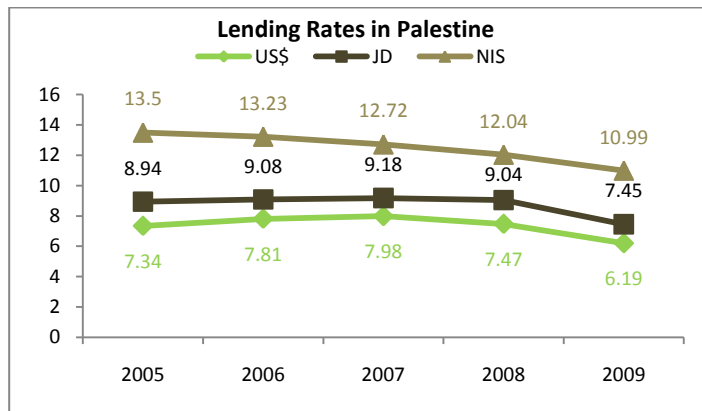
The interest rates on deposits and loans in Palestine declined in line with developments in the global interest rate markets. Since 57% of extended credit facilities are denominated in US\$, the overall average interest rates declined for Bank of Palestine. In addition to a large spread between interest rates on deposits and credit facilities, there is a difference in interest rates applied in Palestine and the country of domicile where the original currency is used. Please refer to the appendix for details on currency rates on deposits and credit facilities for the period between 2001 and 2009, according to figures published by Palestine Monetary Authority.

Figure 31: Deposits Rates in Palestine



Source: Palestine Monetary Authority

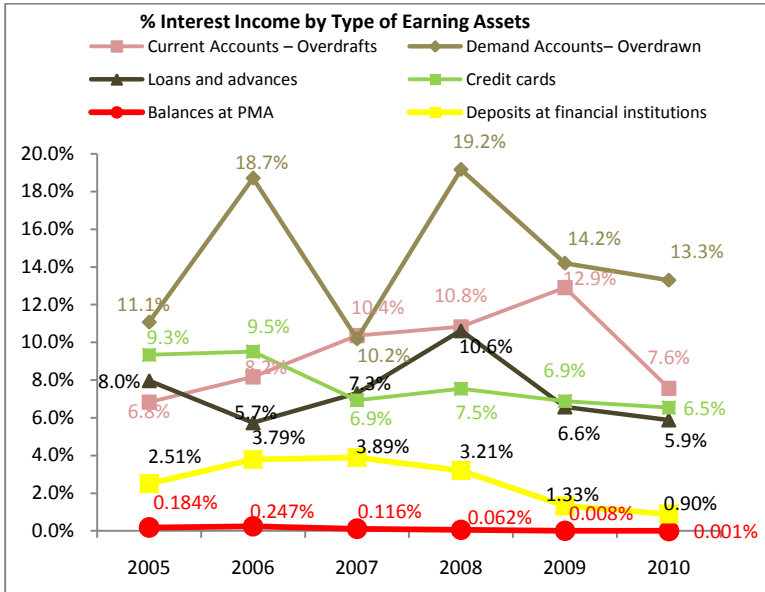
Figure 32: Lending Rates in Palestine



Source: Palestine Monetary Authority

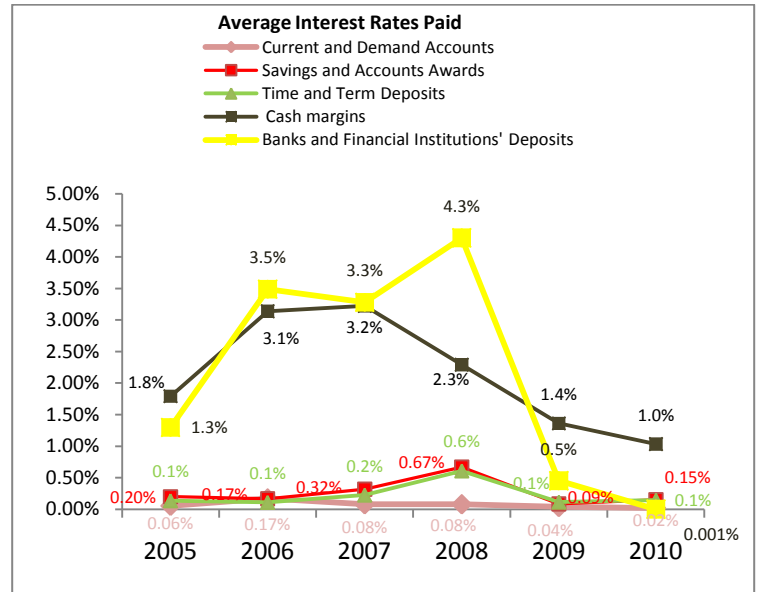
Loans and overdraft accounts are the most important interest bearing assets for Bank of Palestine. The average interest rate on loans was highest in 2008, having reached 10.6%; then dropped to 6.6% in 2009 and 5.9% in 2010. The average interest rate on overdraft accounts reached 12.9% in 2009, and declined to 7.6% in 2010. Interest rates paid on deposits declined in 2009 and 2010 after having peaked in 2008. This was reflected in a decline in interest expense from US\$ 9.16 million in 2008 to US\$ 4 million in 2010.

Figure 33: Average Interest Rate by Type of Earning Assets



Source: Bank of Palestine

Figure 34: Average Interest Rates Paid



Source: Bank of Palestine



Stock Price

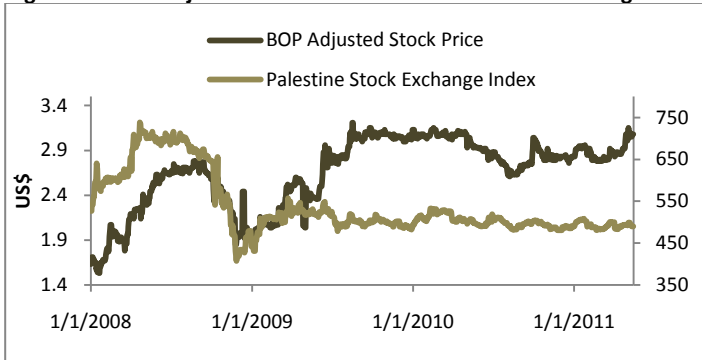
Palestine Stock Exchange data shows that Bank of Palestine started trading on November 9, 2005. The highest price was US\$ 6.75 in 2005, which accompanied an increase in overall prices on Palestine Stock Exchange index. The share recorded its lowest level in 2006, having reached US\$ 2.55. It was most volatile in 2007, with the difference between the annual low and high prices reaching US\$ 3.54.

Following the effects of the global financial crisis in 2008, Bank of Palestine’s stock price declined to US\$ 2.73 on November 24, 2008, representing a 37% drop over the annual high price of US\$ 4.31 recorded on April 21, 2008. The stock price dropped further to reach US\$ 2.66 on January 4, 2009, and has not reached this level since then. The share ranged between US\$ 3.13 and US\$ 3.78 in 2010. The correlation coefficient between the stock price and Palestine Stock Exchange index is low, and was 32% for the period between May 2010 and May 2011.

Bank of Palestine’s share had the highest trading value and volume in 2008. The average trading volume reached 246,098, while the total trading value reached US\$ 158 million during 2008. In 2010, the trading value and volume dropped by 75%, with a trading value of US\$ 27.6 million for the whole year.

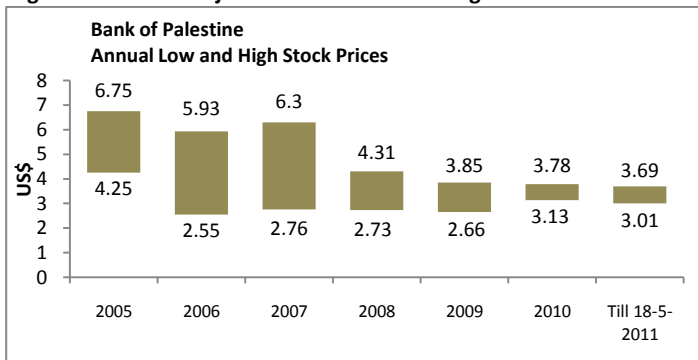
Prior to distribution of stock dividends in May 2011, Bank of Palestine recorded an exceptional trading volume of 3 million shares on April 28, 2011, with the price closing at US\$ 3.69. This was the highest trading volume on one single day since December 20, 2009, which recorded a trading volume of 3.1 million shares with a close price of US\$ 3.7. The stock price closed at US\$ 3.08 on May 18, 2011.

Figure 35: BOP Adjusted Stock Price vs Palestine Stock Exchange Index



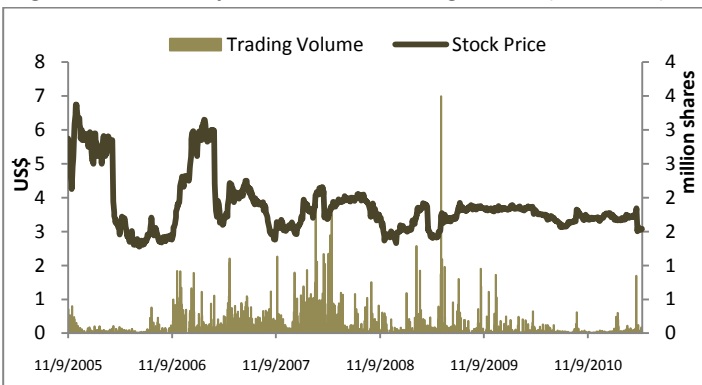
Source: Bloomberg

Figure 36: BOP Unadjusted Annual Low and High Stock Prices



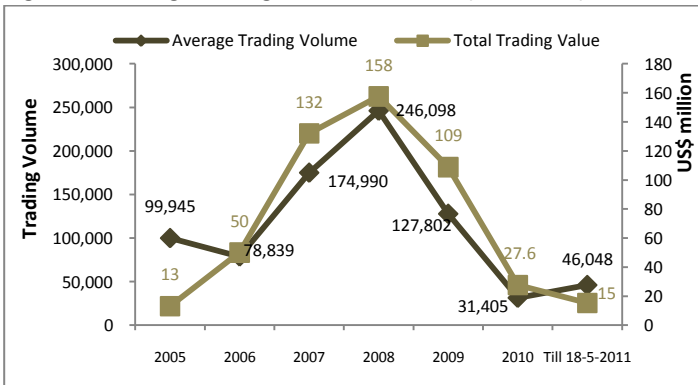
Source: Palestine Stock Exchange

Figure 37: BOP Unadjusted Price and Trading Volume (2005-2011)



Source: Palestine Stock Exchange

Figure 38: Average Trading Value and Volume (2005-2011)



Source: Palestine Stock Exchange

Valuation

In this valuation, we applied the Equity Cash Flow model, in addition to P/E and P/BV peer valuations. Following is an overview of the banks included in the peer valuation. The selected banks include 4 banks in Jordan, two banks in UAE and two banks in Oman, while the screening process included 120 banks in the region. The selected banks have market capitalization between US\$ 300 million and US\$ 660 million. Although Bank of Palestine has the highest market capitalization compared to other listed banks in Palestine, it has the lowest shareholders' equity compared to all considered banks in the peer analysis.

Table 3: Comparison between Bank of Palestine and Selected Peers

Bank	Country	Total Shareholders	Average Number of	Net Profit (US\$)	Market Cap (US\$)	Stock Price (US\$)	P/E	P/BV
		Equity US\$ (2010)	Shares (2010)	(2010)	18-05-2011	18-5-2011		
BANK OF PALESTINE	Palestine	163,884,250	120,000,000	30,119,469	369,600,000	3.08	12.27	2.26
OMAN INTL BANK	Oman	439,285,677	968,050,000	45,676,917	653,748,052	0.68	14.31	1.49
JORDAN KUWAIT BK	Jordan	467,263,192	100,000,000	73,328,930	623,943,662	6.13	8.36	1.31
CREDIT AGRICOLE	Egypt	394,924,257	287,000,000	79,197,135	566,653,773	1.99	7.22	1.45
INVESTBANK	UAE	547,336,542	1,155,000,064	81,914,372	553,444,082	0.48	6.76	1.01
BANK OF JORDAN	Jordan	333,087,575	141,000,000	44,742,242	423,000,000	3.00	9.45	1.27
CAIRO AMMAN BANK	Jordan	290,938,472	100,000,000	49,056,929	422,535,211	4.23	8.61	1.45
BANK SOHAR	Oman	302,717,260	1,000,000,000	26,546,380	402,597,403	0.39	14.68	1.29
COMMERCIAL BANK	UAE	490,278,020	1,407,015,808	38,972,915	375,408,519	0.27	9.63	0.77
JORDAN AHLI BANK	Jordan	323,068,971	110,000,000	32,324,621	303,661,972	2.80	9.54	0.95

Source: Bloomberg

Sensitivity Analysis

Following are the results of 4 types of sensitivity analysis for our valuation: Sensitivity to changes in Cost of Equity and Terminal Growth Rates between 2011 and 2014; sensitivity to Cost of Equity in 2015; sensitivity to the projected growth in loans and deposits for 2011; and the sensitivity to changes in 2015 projections for the average interest earned and paid. In our valuation, we assumed that loans would grow at 18% in 2011 compared to 58.8% in 2010. Should the bank be able replicate the performance of 2010, there might be a considerable upside effect on Bank of Palestine's share price. The changes in interest rates in the coming years have a significant impact on the valuation and are difficult to predict.

Table 5: Sensitivity to Cost of Equity & Terminal Growth Rate

		Fair Value Sensitivity Analysis						
		Cost of Equity (2011 to 2014)						
		12.2%	13.2%	14.2%	15.2%	16.2%	17.2%	18.2%
Terminal Growth Rate	2.0%	3.26	3.26	3.26	3.25	3.25	3.24	3.24
	2.5%	3.35	3.35	3.34	3.34	3.33	3.33	3.33
	3.0%	3.45	3.44	3.44	3.44	3.43	3.43	3.43
	3.5%	3.56	3.56	3.55	3.55	3.55	3.54	3.54
	4.0%	3.69	3.69	3.68	3.68	3.67	3.67	3.67

Source: Awraq Investments

Table 4: Sensitivity to Required Return for 2015 & Perpetuity

		Fair Value Sensitivity Analysis				
		Required Return for 2015 and Perpetuity				
		9.5%	10.0%	10.5%	11.0%	11.5%
Terminal Growth Rate	2.0%	3.74	3.48	3.25	3.05	2.87
	2.5%	3.87	3.59	3.34	3.12	2.93
	3.0%	4.02	3.71	3.44	3.20	2.99
	3.5%	4.20	3.85	3.55	3.29	3.07
	4.0%	4.41	4.01	3.68	3.40	3.15

Source: Awraq Investments

Table 6: Loans & Deposits Growth in 2011

		Loans and Deposits Sensitivity Analysis					
		Loan Growth in 2011					
		12%	15%	18%	21%	24%	40%
Deposits Growth Rate in 2011	5%	3.35	3.40	3.45	3.50	3.56	3.84
	10%	3.34	3.39	3.44	3.50	3.55	3.83
	15%	3.33	3.38	3.44	3.49	3.54	3.83
	20%	3.32	3.38	3.43	3.48	3.54	3.82
	25%	3.32	3.37	3.42	3.47	3.53	3.81

Source: Awraq Investments

Table 7: Sensitivity to Interest Earned & Paid in 2015

		Net Interest Spread Sensitivity Analysis						
		Average Interest Earned in 2015						
		4.0%	4.4%	4.8%	5.2%	5.6%	6.0%	6.4%
Average Interest Paid in 2015	0.5%	3.12	3.26	3.40	3.54	3.68	3.81	3.95
	1.0%	3.07	3.21	3.35	3.49	3.63	3.76	3.90
	1.5%	3.02	3.16	3.30	3.44	3.58	3.71	3.85
	2.0%	2.97	3.11	3.25	3.39	3.53	3.66	3.80
	2.5%	2.92	3.06	3.20	3.34	3.48	3.61	3.75

Source: Awraq Investments

Table 8: Selected Financial Indicators and Forecasts

Growth Ratios	2008	2009	2010	2011e	2012e	2013e	2014e	2015e
Loans	17%	20%	59%	18%	16%	15%	8%	5%
Deposits	24%	21%	23%	15%	10%	8%	8%	8%
Assets	23%	23%	20%	21%	16%	15%	7%	5%
Shareholders' Equity	37%	23%	9%	19%	18%	18%	13%	10%
RWA	10%	39%	35%	26%	16%	15%	7%	5%
Net Interest Income	43%	1%	17%	19%	18%	17%	9%	7%
Fees & Commission Income	20%	36%	17%	30%	25%	20%	20%	20%
Other income	-11%	50%	30%	20%	9%	9%	9%	9%
Expenses	42%	21%	30%	21%	18%	17%	7%	11%
Loan provisions	25%	-86%	8%	271%	16%	15%	8%	5%
Net income	15%	14%	12%	14%	18%	17%	17%	11%
Balance Sheet Ratios								
Cash at Palestine Monetary Authority / Total Assets	18%	22%	21%	20%	20%	20%	20%	20%
Balances at Banks & Financial Institutions/ Total Assets	41%	30%	23%	24%	24%	24%	24%	24%
Loans/ Deposits	35%	35%	45%	46%	49%	52%	52%	51%
Loans/ Assets	27%	27%	35%	34%	34%	34%	34%	34%
Deposits / Liabilities	87%	86%	87%	83%	79%	74%	74%	77%
Deposits/ Assets	77%	76%	78%	74%	71%	66%	66%	68%
Capital Adequacy Ratio	23%	17%	13%	14%	14%	14%	14%	14%
RWA/ Total Assets	38%	43%	48%	50%	50%	50%	50%	50%
Retained Earnings/ Equity	16%	15%	13%	13%	13%	13%	13%	13%
ROAA	2%	2%	2%	2%	2%	2%	2%	2%
ROAE	22%	20%	19%	19%	19%	19%	19%	19%

Source: Bank of Palestine, Awraq Investments Estimates

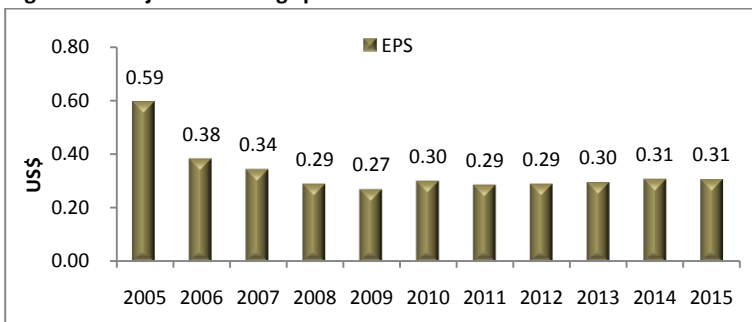
Our discounted equity cash flow model yielded US\$ 3.8 per share. This is based on 3% terminal growth rate with 15.2% cost of equity; adjusted Beta of 0.626; market risk premium of 15%, and 5.8% risk free rate. We applied a weight of 80% to the Equity Cash Flow model, and a weight of 10% to the P/E and P/BV valuations. The P/E valuation yielded US\$ 2.3 compared to US\$ 1.65 for the P/BV valuation.

Table 9: Valuation

Valuation Method	US\$	Weight%	Weighted Valuation
DECF	3.80	0.80	3.04
P/E	2.30	0.10	0.23
P/BV	1.65	0.10	0.16
Target Price			3.44
Stock Price (18-5-2011)			3.08
Valuation vs Stock Price %			11.6%

Source: Awraq Investments

Figure 39: Projected Earnings per Share



Source: Bank of Palestine, Awraq Investments Estimates

Our target price for Bank of Palestine is US\$ 3.44, 11.6% higher than the close price of US\$ 3.08 on May 18, 2011. 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.

Appendix

Three currencies are used in Palestine: Jordanian Dinar, US Dollar and Israeli Shekel. Figures from Palestine Monetary Authority indicate the existence of a large spread between interest rates in different currencies, and the interest rates implemented in Palestine and the country of domicile of the corresponding currency. Lending interest rates on US\$ were 6.19% on average in 2009, compared to 7.45% interest on JOD lending 10.99% on lending in Israeli Shekel. The lending rates in Jordan on Jordanian Dinar were 9.25%, which was higher than the rate implemented in Palestine. Meanwhile, lending rates in US\$ were 3.25% in USA, which was lower than the rate implemented in Palestine; and this was also the case for Interest rates in Israel which stood at 3.73%.

Table 10: Average Lending Rates in Palestine

Year	Lending Rates					
	Palestine			USA	Jordan	Israel
	US\$	JD	NIS	US\$	JD	NIS
2001	8.36	9.82	16.37	6.92	10.9	10
2002	7.97	9.41	15.47	4.68	10.2	9.9
2003	7.56	8.74	13.66	4.12	9.3	10.65
2004	6.92	8.47	13.46	4.34	8.26	7.44
2005	7.34	8.94	13.5	6.19	7.61	6.39
2006	7.81	9.08	13.23	7.96	8.18	7.42
2007	7.98	9.18	12.72	8.05	8.68	6.27
2008	7.47	9.04	12.04	5.09	9.03	6.06
2009	6.19	7.45	10.99	3.25	9.25	3.73

Source: PMA

In 2009, Interest rates on US\$ deposits in Palestine stood at 0.4% compared to 0.16% in USA. Deposits in Jordanian Dinar gained 1.91% interest in Palestine compared to 4.94% in Jordan. Meanwhile, deposits in Israeli Shekel in Palestine gained 0.24% interest compared to 1.08% in Israel.

Table 11: Average Deposit Rates in Palestine

Year	Deposits Rates					
	Palestine			USA	Jordan	Israel
	US\$	JD	NIS	US\$	JD	NIS
2001	1.48	3.62	2.78	3.69	5.8	6.2
2002	2.74	2.74	2.55	1.73	4.4	6
2003	0.78	2.53	4.25	1.13	3.14	6.65
2004	1.12	1.61	2.59	1.35	2.49	3.62
2005	2.24	1.84	2.01	3.21	2.91	3.24
2006	2.98	2.72	2.48	4.96	4.62	4.31
2007	3.02	3.51	2.51	5.02	5.45	3.5
2008	0.8	1.98	1.04	1.93	4.46	3.3
2009	0.4	1.91	0.24	0.16	4.94	1.08

Source: Palestine Monetary Authority

Bibliography

Al Rafah Microfinance Bank. (2011, March 22). *Board Meeting Decision*. Retrieved April 18, 2011, from www.p-s-e.com: <http://www.pex.ps/PSEWebSite/Generalizations/Board-Meeting-Decisions-AMB-22032011.pdf>

Palestine Institute for Financial & Banking Studies. (2010, October 15). *Bank Mergers Between Global Requirements and Palestinian Reality*. Retrieved April 21, 2011, from www.pifbs.com: <http://www.pifbs.com/etemplate.php?id=115>

Palestine Monetary Authority. (2011, April 20). *Banking Supervision Department*. Retrieved April 20, 2011, from www.pma.ps: http://www.pma.ps/index.php?option=com_content&view=article&id=75&Itemid=92&lang=en

Palestine Monetary Authority. (2010, November 27). *Entry Into Force of the New Banking Law*. Retrieved April 21, 2011, from www.pma.ps: http://www.pma.ps/index.php?option=com_content&view=article&id=99%3Aentry-into-force-the-new-banking-law-as-of-saturday&catid=37%3Apress-release&Itemid=107&lang=en

Palestine Monetary Authority. (2010, June). *Financial Stability Report 2009*. Retrieved April 18, 2011, from www.pma.ps: <http://www.pma.ps/images/stories/pdfs/financial%20stability%20report%202009.pdf>

Palestine Monetary Authority. (2010, May 10). *Liquidation of Al Aqsa Islamic Bank*. Retrieved April 16, 2011, from www.pma.ps: http://www.pma.ps/index.php?option=com_content&view=article&id=95%3Aliquidation-of-al-aqsa-islamic-bank&catid=37%3Apress-release&Itemid=107&lang=en

Wazir, D. J. (2010, October). *The Impact of Global Financial Turmoil on Banknig Sector and Financial Stabilitiy, a Mediterranean view, a case of Palestine*. Retrieved April 17, 2011, from www.pma.ps: http://docs.google.com/viewer?a=v&q=cache:ddOoNycrDDkJ:www.pma.ps/resources/file/publications/128862003506/financial_turnmiol_banking_sectors_palestine.pdf+The+Impact+of+the+Global+Financial+Turmoil+on+Banking+Sector+and+Fi+nancial+Stability,+a+Mediterrane

Related Awaq Investments Research

Research on Palestine Stock Market

- **AWRAQ- Paltel 2010 Results, published on 16-02-2011**

<http://www.awraq.com/Researchers/UploadDocuments/AWRAQ-%20Paltel%202010%20Results%2016-02-2010.pdf>

- **AWRAQ- Palestine Stock Exchange 9M 2010 Results, published on 18-1-2011**

<http://www.awraq.com/Researchers/UploadDocuments/AWRAQ%20Investments%20-Palestine%20Stock%20Exchange%209M%202010%20Results%2018-01-2011.pdf>



Disclaimer

Awraq Investments and its affiliates obtain information from sources they believe to be reliable, but do not warrant its accuracy or fitness for a particular purpose, and disclaim for themselves and their information providers all liability arising from the use.

The Information in this publication is provided in good faith for informational purposes only. The information provided is not offered as tax, legal, or investment advice, or an offer to buy or sell securities or otherwise. The information provided in this publication may be displayed and printed for your personal, non-commercial use only. You may not reproduce, re-transmit, distribute, disseminate, sell, publish, broadcast, or circulate the information in any form or media to anyone, without the expressed written consent of Awraq Investments.

Awraq Investments is not liable for any loss resulting from any action taken or reliance made by any person on any information or material posted by it. You should make your own inquiries and seek independent advice from relevant industry professionals before acting or relying on any information or material made available to you in this publication. You rely on this information at your own risk.

Awraq Investments, its subsidiaries, parent, and/or any connected parties, may act or trade and/or enter into any transaction that maybe inconsistent or disregard any information contained herein.

