

September 01, 2008

Israel

Pan-European Banks

Israel Discount Bank (DSCT.TA - ILS 5.91) 1-Overweight

Earnings Review/Sales Analysis

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Starting to Pay Dividends

Investment Conclusion

□ We reiterate our 1-OW on DSCT. We adjust our TP to ILS 11.00 from 11.50, equating to an unchallenging multiple of 1.0x forward 12 month BV. In conjunction with the results, which included a reduction in cost/income ratio and results that were operationally in-line to better than our expectations and CAR of 11.1%, DSCT announced an ILS 250m dividend. We see as this as the first of more to come - a formal policy will be announced in 1Q09.

FY Dec Currency ILS	2007A	2008E		2009E		2010E	
	Actual	Old	New	Old	New	Old	New
Net Income (m)	1265	927	748	1237	1024	N/A	1201
EPS (stated)	1.29	0.95	0.76	1.26	1.04	N/A	1.23
EPS (adj.)	0.94	1.00	0.82	1.26	1.04	N/A	122.51
PE (adj.)	0.0	8.2	0.0	6.5	0.0	N/A	0.0
ROE (stated %)	11.6	10.7	8.8	12.3	10.5	N/A	11.6
ROE (adj. %)	10.8	10.2	8.5	12.1	10.2	N/A	11.2
Price/NAV	0.9	N/A	0.8	N/A	0.8	N/A	0.7
Price/NAV (adj.)	0.0	N/A	0.0	N/A	0.0	N/A	0.0

Summary

- Highlights include 24% growth in net interest income, provisions of 0.41% of loans (DSCT's calculation; we calculate a still respectable 0.53%), loan growth of 5.4% from YE07, and salary expense increase of just 1.2%. Investors have been quite concerned about expense control at DSCT; this quarter showed the leverage to income growth.
- Like larger peers LUMI and POLI, commissions from securities transactions were weaker than over the last few qtrs, but also like the larger peers income from credit cards continues to grow at dbl digit rates.

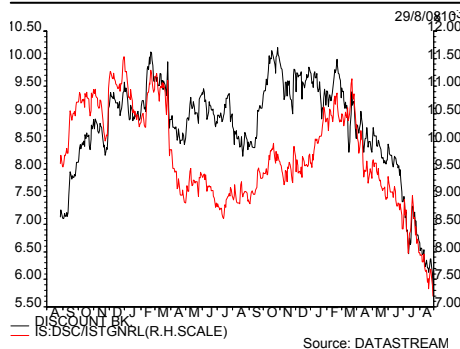
Market Data

Market Cap (m)	5796
Units Outstanding (m)	980.6
Float (%)	50
Net Distribution Yield (%)	4.10
Convertible	No
Shares per ADR	N/A

Financial Summary

NAV/Unit FY07	N/A
NAV(adj.)/Unit FY07	N/A
Tier 1 BIS Ratio FY08 (%)	8.0
Total BIS Ratio FY07 (%)	8.2

Stock Overview



Reuters	DSCT.TA
Bloomberg	DSCT IT
ADR	

Performance	1M	3M	12M
Absolute %	-13	-27	-31
Rel. Market %	-12	-19	-22
Rel. Sector %	-8	-14	-14

52 Week Range 10.20 - 5.91

Stock Rating

Target Price

New: 1-Overweight	New: ILS 11.00
Old: 1-Overweight	Old: ILS 11.50

Sector View: 1-Positive

Steady Progress

We believe that DSCT's results are just what investors have been waiting for. In our quarterly preview we noted that we were not willing to throw in the towel despite the underperformance of the stock and the past sets of results. In our view the better than sector net interest income growth, steady provisioning trends, positive developments at the NY branch and a good quarter on the expense control side all point to the value that we see in the restructuring story at DSCT.

In fact, while management pointed to the same indications that the other banks made reference too regarding the potential slowdown in 2H08 and into 2009 based on global economic conditions, it noted that it has yet to see such signs in its banking business.

Loans grew 13.4% yoy and 5.4% from YE2007. Adjusting for the loan book for the weak US\$, loan growth would have been in the 10% range.

DSCT has been focused on adding customers to its business, and a portion of the growth continues to come from customers being added as part of the tender for government employees awarded starting in 2008. DSCT has added 27,380 customers as part of its goal

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of 60,000 by the end of 2009. We see this leg of growth as supportive of the 7.6% loan growth in the household segment and 13.6% growth in the retail small enterprise segment. In the mortgage segment DCST remains in the 13.5% - 15% range that was reached in 3Q07. We do not expect much deviation from this range going forward.

In addition to this growth DSCT's credit card growth remains strong. Total credit card income grew from ILS 209 million to ILS255 million in 2Q08 compared to 2Q07. Net income from credit cards grew to ILS 56 million from ILS 47 million. DSCT also grew its cards issued to 1,470,000 in 2Q08 from 1,360,000 in 2Q07.

Trends similar to the other banks

Similar to trends at POLI and LUMI, provisions trended up in the quarter to 0.53% of loans by our calculation compared to 0.36% in 1Q08. This falls right between the performances of the larger banks. Our view on the banking sector is that the Israeli economy continues to trend below "mid-cycle" levels and we do not expect to see a dramatic uptick in provisioning levels in the near term for any of the banks.

Commissions were another area that fell short of our expectations. This is also a trend seen at the larger banks. Fees have been down due to the complete absence of asset management fees, the banks now only book distribution fees. In addition, security transactions had been making up for the lost asset management income, but the volatile capital markets of the last quarter have meant reduced transactions and reduced fees on smaller investment portfolios.

Expense Trends

Salaries grew a respectable 1.2% to ILS 649 million from ILS 649 million in 2Q07. Investors will likely recall that in 1Q08 expenses of ILS 859 million were higher than expected and cost income ratio grew to a bloated 83.4%, the 68% of 2Q08 is still well above the 55%-60% at the other banks, but as we have stated for some time, we expect slow and steady progress on this front.

Figure 1: Q108 Results vs. Expectations

	Q208 A	Q208 E	% difference	Q207 A	y/y
Net interest income before provisions	1132	1127	0%	916	24%
Provision for doubtful debts	-139	-104	34%	-158	-12%
Net interest income after provisions	993	1023	-3%	758	31%
Total operating and other income	589	687	-14%	675	-13%
Total operating and other expenses	1170	1327	-12%	1163	1%
Operating profit before taxes	412	383	8%	270	53%
Provisions for taxes on operating profit	-199	-141	41%	-69	188%
Net profit (before one times)	222	262	-15%	235	-6%
EPS excluding one-offs	ILS 0.23	ILS 0.27		ILS 0.24	
ROE	9.6%			9.1%	
Loan Growth	14.5%			12.2%	
Cost Income Ratio	68.0%			73.1%	

Source: Company Reports and Lehman Brothers

Figure 2: Net Interest Income by Divisions

	2q08	2q07	% Change	1h08	1h07	% Change
Households	318	301	5.6%	628	588	6.8%
Retail - SME	197	202	-2.5%	392	375	4.5%
Corporate Banking	233	250	-6.8%	482	458	5.2%
Commercial Banking	174	212	-17.9%	356	361	-1.4%
Private Banking	92	72	27.8%	182	142	28.2%
Financial Management	118	-121	-197.5%	157	4	3825.0%
Total	1132	916	23.6%	2197	1928	14.0%

Source: Company Reports and Lehman Brothers

Figure 3: Loans by Division

	2q08	YE07	% Change
Households	27,023	25,113	7.6%
Retail - SME	13,848	12,245	13.1%
Corporate Banking	42,297	39,925	5.9%
Commercial Banking	21,366	22,360	-4.4%
Private Banking	2,861	2,256	26.8%
Total	107,395	101,899	5.4%

Source: Company Reports and Lehman Brothers

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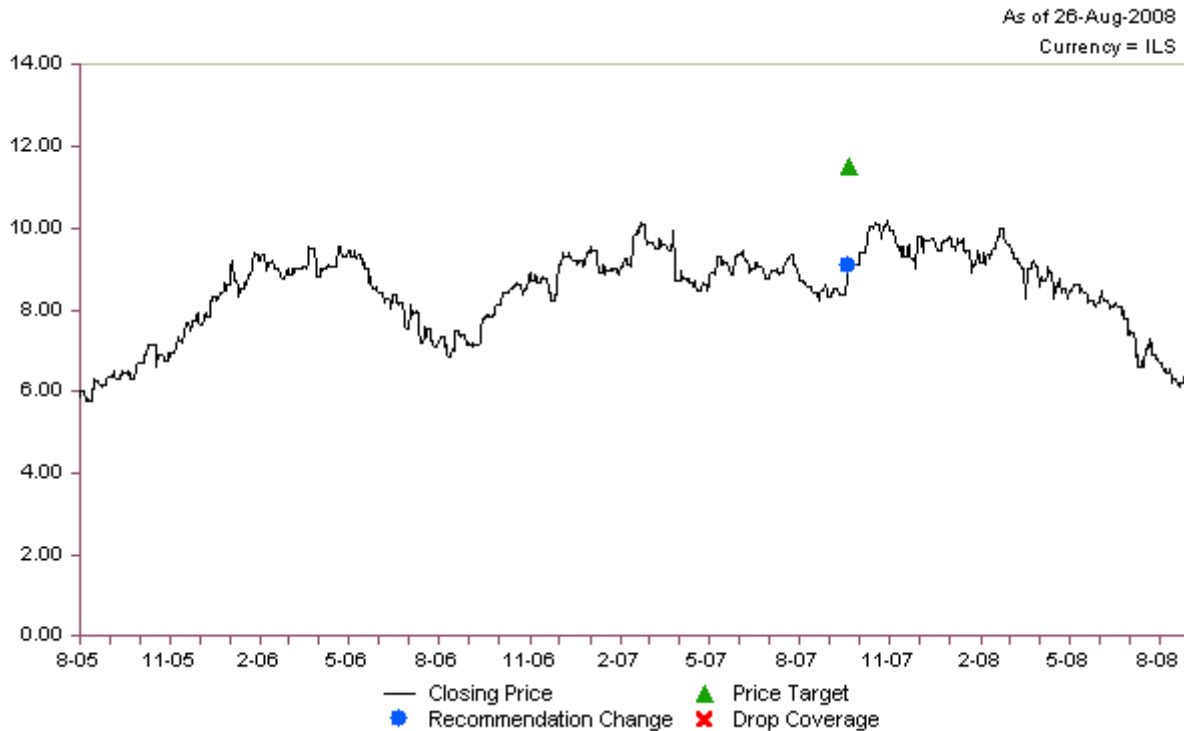
Important Disclosures:

Israel Discount Bank (DSCT.TA)
Rating and Price Target Chart:

ILS 5.91 (28-Aug-2008)

1-Overweight / 1-Positive

ISRAEL DISCOUNT BANK



Currency=ILS

Date	Closing Price	Rating	Price Target
20-Sep-07	9.05		11.50

Date	Closing Price	Rating	Price Target
20-Sep-07	9.05	1 -Overweight	

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Valuation Methodology: We value DCT at ILS 11.00 based on a multiple of 1.0x forward 12 month book value. Our growth model for deriving the multiple is based upon a 12% ROE, 3% growth, 10.5% cost of equity. We then apply a 15% discount to our implied P/B based upon volatility of earnings, risk, and the historical inability of the bank to trade at this multiple. We see internally generated improvement at the bank driving the valuation up towards our target multiple.

Risks Which May Impede the Achievement of the Price Target: Israeli banks are a high-beta way to invest in the domestic economy and sentiment on the stocks and the market can be impacted by geopolitical sentiment regarding Israel and its relations with its Arab and Palestinian neighbors. Israel Discount Bank is currently undergoing a global restructuring program which has inherent risks that may impact the bank's operating results.

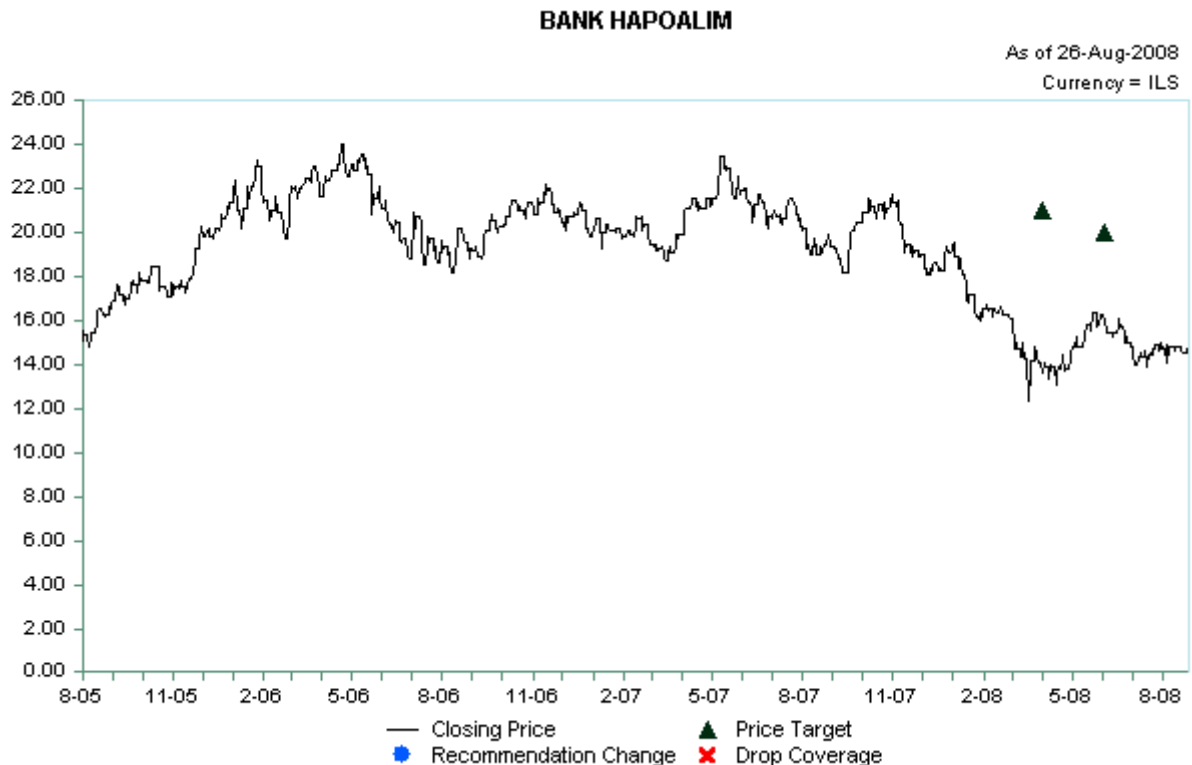
Important Disclosures Continued:

Bank Hapoalim (POLI.TA)

ILS 14.05 (28-Aug-2008)

1-Overweight / 1-Positive

Rating and Price Target Chart:



Currency=ILS

Date	Closing Price	Rating	Price Target
02-Jun-08	16.08		20.00

Date	Closing Price	Rating	Price Target
01-Apr-08	13.60		21.00

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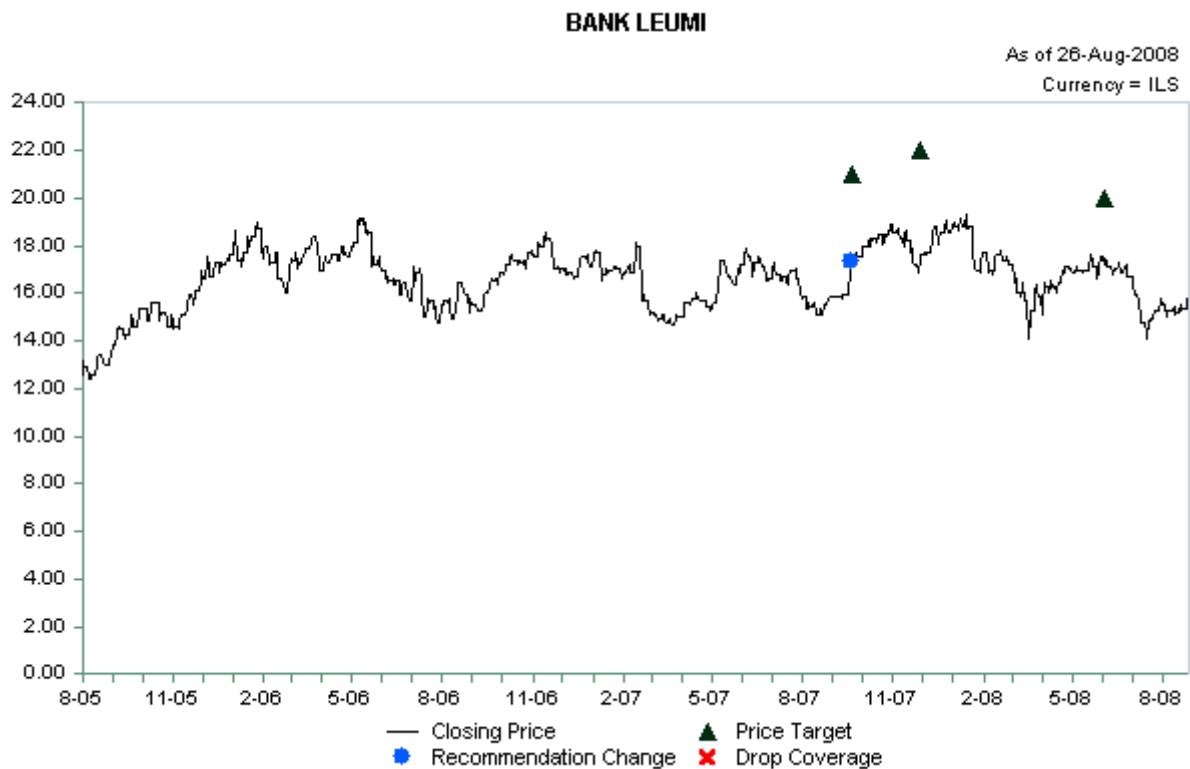
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Bank Leumi (LUMI.TA)

ILS 14.85 (28-Aug-2008)

2-Equal weight / 1-Positive

Rating and Price Target Chart:



Currency=ILS

Date	Closing Price	Rating	Price Target
02-Jun-08	17.26		20.00
29-Nov-07	17.65		22.00

Date	Closing Price	Rating	Price Target
20-Sep-07	17.31		21.00
20-Sep-07	17.31	1 -Overweight	

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Risks Which May Impede the Achievement of the Price Target: Israeli Banks are high-beta ways of investing in the local economy and results are influenced by changes in interest rates and CPI. LUMI's own economists are forecasting a decline in GDP growth in 2009 to 2.7% from 4.7% in 2008.

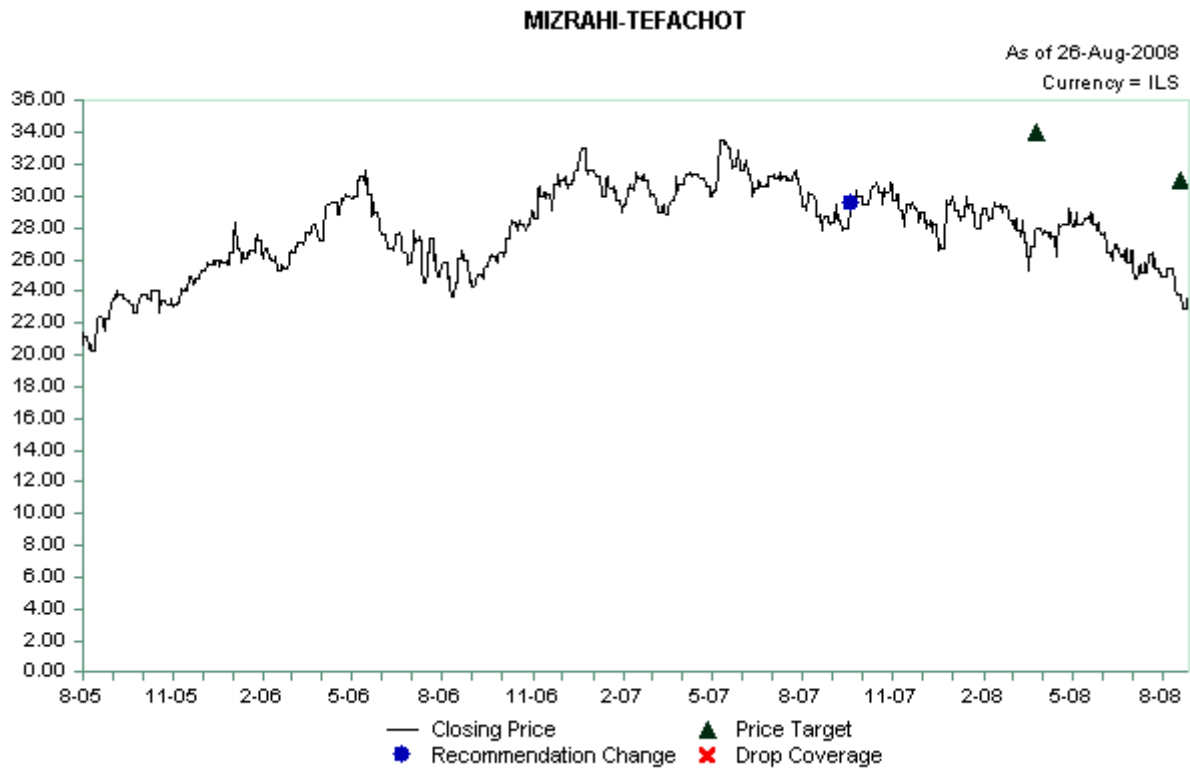
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Mizrahi-Tefachot (MZTF.TA)

ILS 22.90 (28-Aug-2008)

2-Equal weight / 1-Positive

Rating and Price Target Chart:



Currency=ILS

Date	Closing Price	Rating	Price Target
19-Aug-08	23.50		31.00
26-Mar-08	28.00		34.00

Date	Closing Price	Rating	Price Target
20-Sep-07	29.52	2 -Equal weight	

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Company Name	Ticker	Price	Price Date	Stock / Sector Rating
Israel Discount Bank	DSCT.TA	ILS 5.91	28-Aug-2008	1-Overweight / 1-Positive

Mentioned Company	Ticker	Price	Price Date	Stock / Sector Rating
Bank Hapoalim	POLI.TA	ILS 14.05	28 Aug 2008	1-Overweight / 1-Positive
Bank Leumi	LUMI.TA	ILS 14.85	28 Aug 2008	2-Equal weight / 1-Positive
Mizrahi-Tefachot	MZTF.TA	ILS 22.90	28 Aug 2008	2-Equal weight / 1-Positive

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Bank Pekao (BAPE.WA)	Bankinter (BKT.MC)
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