

UBS Investment Research

Bank Leumi Le-Israel

Global Equity Research

Israel

Banks, Ex-S&L

Rating **Buy 2**
Unchanged

Price target NIS12.50/US\$2.86
Prior: NIS11.80/US\$2.70

Price NIS10.24/US\$2.34

RIC: LUMI.TA BBG: LUMI IT

30 November 2004

3Q Review; Reiterate Buy

■ 3Q Results Demonstrate Continued Improvement

Bank Leumi's 3Q results highlight continued improvement in the Israeli economy as net interest income exceeded our estimate by 3% and provisions for doubtful accounts were 13% lower than we expected. We believe that the provisions story will continue to improve next year.

■ Outlook for 2005

Bank Leumi's progress to date has been achieved in the absence of loan growth. We expect this to improve in 2005 as the economy continues to grow. Leumi is also focused on boosting its margins going forward by emphasizing wealth management in Israel and abroad and on consumer lending.

■ Improving ROE

With the improved operating results we now forecast ROE for 2005 at 14.4%, up from our prior estimate of 12.6%. This change has been driven by our higher level of conviction that Bank Leumi has costs under control and that the provision levels will continue to improve.

■ Valuation: Reiterate Buy; Valuation Very Attractive

We are raising our PT to NIS 12.50 from NIS 11.80 after fine-tuning our model. We continue to see shares as attractively valued at P/B ratios of 0.94x '04e and 0.85x '05e. Our PT equates to a P/B ratio of 1.0x '05e.

Trading data (local/US\$)

52-wk. range	NIS10.44-7.41/US\$2.38-1.67
Market cap.	NIS14.5bn/US\$3.32bn
Shares o/s	1,414m (ORD)
Free float	53%
Avg. daily volume ('000)	3,696
Avg. daily value (NISm)	35.4

Balance sheet data 12/04E

Shareholders' equity	NIS15.7bn
P/BV (UBS)	0.9x
Tier one capital ratio	7.5%

Forecast returns

Forecast price appreciation	+22.1%
Forecast dividend yield	5.5%
Forecast stock return	+27.6%
Market return assumption	9.4%
Forecast excess return	+18.2%

EPS (UBS, NIS)

	12/04E			12/03
	From	To	Cons.	Actual
Q1	0.33	0.33	-	0.12
Q2	0.38	0.39	-	0.24
Q3	0.27	0.38	-	0.29
Q4E	0.30	0.38	-	0.16
12/04E	1.29	1.48	1.07	
12/05E	1.39	1.65	1.15	

Highlights (NISm)	12/02	12/03	12/04E	12/05E	12/06E
Revenues	8,082	9,282	9,741	10,192	-
Pre-tax profits	1,427	1,840	3,056	3,446	-
Net income	1,024	1,145	2,062	2,339	-
EPS (UBS, NIS)	0.30	0.82	1.48	1.65	-
Net DPS (NIS)	0.00	0.23	0.51	0.57	0.00

Profitability & Valuation	5-yr hist. av.	12/03	12/04E	12/05E	12/06E
ROE %	9.0	8.2	13.5	13.8	-
P/Op x	3.7	2.3	3.3	3.1	-
P/BVPS x	0.9	0.6	0.9	0.9	-
PE (UBS) x	11.9	7.5	6.9	6.2	-
Net dividend yield %	3.6	3.7	5.0	5.5	0.0

Source: Company accounts, Thomson Financial, UBS estimates. UBS EPS is stated before goodwill, exceptionals and other special items. Valuations: based on an average share price that year, (E): based on a share price of NIS10.24 on 30 Nov 2004

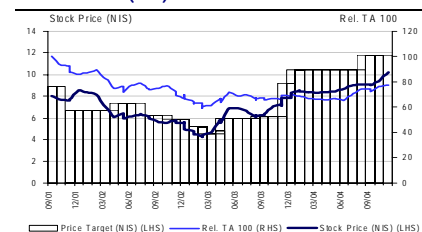
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Performance (NIS)



Source: UBS

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ANALYST CERTIFICATION AND REQUIRED DISCLOSURES BEGIN ON PAGE 5

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3Q Results Ahead of Expectations

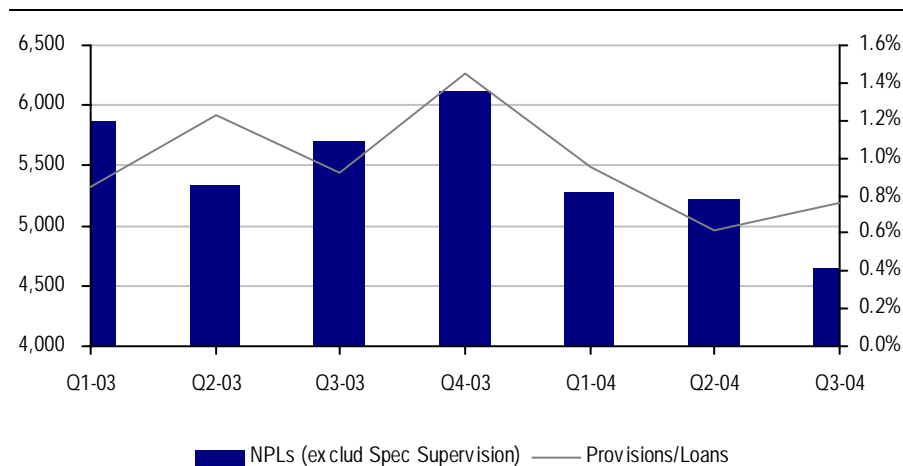
The table above highlights the 3Q results compared to our estimates. The results highlight the continued improvement in the Israeli economy as net interest income exceeded our estimate by 3% (despite the –0.2% inflation in the quarter compared to a 1.5% increase in the previous quarter) and provisions for doubtful accounts were 13% lower than we expected. We believe that the provisions story and the falling NPLs excluding loans under special supervision will continue to improve next year. Provisions and NPLs excluding loans under special supervision over the last seven quarters are shown in the chart below.

Table 1: Q3 Results – Actuals versus Estimates

	Q3-04a	Q3-04e	Diff
Net Interest Income before Provisions	1,601	1,550	3%
Provision for Doubtful Debts	-322	-369	-13%
Net Interest Income after Provisions	1,279	1,181	8%
Total Operating and Other Income	835	827	1%
Total Operating and Other Expenses	1,354	1,350	0%
Operating Profit before Taxes	760	658	15%
Net Profit (excluding extras)	541	454	19%
Net Profit	539	454	19%
Loan Growth	0.34%	0.00%	
Net Interest Margin	2.71%	2.60%	
Provisions/Loans	0.76%	0.87%	
Cost Income	55.6%	67.2%	
Tax Rate	43.3%	44.5%	

Source: UBS estimates

Chart 1: Downward Trend in Provisions and NPLs Continues



Source: Bank Leumi, UBS

Raising 2004 and 2005 estimates

On the back of these results we are upping our FY 2004 and 2005 estimates. The changes to our numbers are shown in the table below.

Table 2: New and Old 2004 and 2005 Estimates

	2004e		2005e	
	New	Old	New	Old
Net Interest Income before Provisions	6,382	6,283	6,649	6,625
Provision for Doubtful Debts	-1,304	-1,394	-1,220	-1,359
Net Interest Income after Provisions	5,078	4,889	5,429	5,265
Total Operating and Other Income	3,359	3,339	3,543	3,393
Total Operating and Other Expenses	5,381	5,454	5,526	5,611
Operating Profit before Taxes	3,056	2,774	3,446	3,048
Net Profit (excluding extras)	2,087	1,880	2,339	2,076
Net Profit	2,062	1,857	2,339	2,076
Loan Growth	1.50%	1.00	3.00%	3.00%
Net Interest Margin	2.69%	2.66%	2.73%	2.72%
Provisions/Loans	0.77%	0.82%	0.70%	0.78%
Cost Income	55.2%	57.4%	54.2%	56.9%
Tax Rate	44.7%	44.5%	43.6%	43.5%
RoE (excluding extras)	14.1%	12.3%	14.4%	12.6%

Source: UBS estimates

Our changes relate primarily to our higher level of conviction regarding Leumi's ability to continue to decrease its provisions and also on its ability to continue to keep stable and then slowly boost net interest margin. The net result of our modifications is an increase in projected ROE to 14.4% from 12.6%.

Our EPS forecast for 2005 goes to NIS 1.65 from NIS 1.47 based on these changes.

Valuation

Bank Leumi remains an attractive Buy in our view. The shares are trading at a P/B ratio of just 0.94x and 0.85x '05e. We believe the shares can appreciate to 1.0x '05e, which is the basis of our NIS 12.50 PT.

We see this multiple, which is in line with historic multiples as conservative, but stick with it given the on-going plans to privatize 35% of the shares. We see the prospective privatization as a positive catalyst (though as the distribution occurs the stock could be under pressure) and believe that '05 could be a year of multiple expansion for Bank Leumi as the economy picks up, and the geopolitical environment in Israel continues to improve.

In our view, the stock also appears 'cheap' compared to global emerging market peers as highlighted in the table below.

Table 3: Emerging Market Banks Relative Valuations

	Price	US\$m	P/E		Adjusted RoE		P/B	
			2004E	2005E	2004E	2005E	2004E	2005E
Hapoalim	12.66	3,619	9.0	7.2	11.9	13.9	1.0	1.0
Leumi	10.24	3,315	6.9	6.2	14.1	14.4	0.9	0.9
<u>Israel</u>			8.5	7.3	11.9	12.9	1.0	0.9
Komercni	3,353	5,460	13.6	12.9	22.7	21.7	3.0	2.6
<u>Czech</u>			13.6	12.9	22.7	21.7	3.0	2.6
OTP	5,281	7,957	10.4	9.3	37.0	33.0	3.4	2.8
<u>Hungary</u>			10.4	9.3	37.0	33.0	3.4	2.8
BPH	455.00	4,116	16.8	13.4	14.1	16.1	2.2	2.1
Bre	115.50	1,045	19.0	11.8	9.2	12.0	1.4	1.3
BZWBK	88.30	2,029	13.4	11.1	17.6	18.2	2.1	1.8
Pekao	127.50	6,671	15.7	13.0	17.2	19.4	2.7	2.5
<u>Poland</u>			16.2	12.3	14.5	16.4	2.1	1.9
Akbank	6,800	7,125	10.1	11.4	17.6	13.4	1.6	1.5
Garanti	3,580	3,001	9.1	8.2	16.0	14.6	1.3	1.1
IsBank	6,950	7,992	16.9	15.5	10.2	9.4	1.5	1.4
Yapi	3,780	1,987	18.0	20.6	4.7	3.2	0.7	0.7
<u>Turkey</u>			13.5	14.0	12.1	10.2	1.3	1.2
Sberbank	482	9,895	12.8	9.0	15.9	19.2	1.9	1.6
<u>Russia</u>			12.8	9.0	15.9	19.2	1.9	1.6
ABSA	7,200	8,108	5.6	8.7	24.9	24.7	1.3	2.0
FirstRand	1,320	11,925	8.0	10.1	25.4	26.1	1.9	2.5
Nedcor	7,504	5,096	15.0	8.9	9.9	15.9	1.7	1.5
Standard	6,035	14,044	11.1	9.5	23.1	22.9	2.4	2.0
<u>South Africa</u>			9.9	9.3	20.8	22.4	1.8	2.0
<u>EMEA (ex Israel)</u>			13.0	11.6	17.7	18.0	2.0	1.8

Source: UBS estimates

■ Bank Leumi Le-Israel

Bank Leumi is Israel's oldest banking group with a 30% market share in most traditional banking activities. It has the largest deposit base in Israel with a market share of 32%, and is second only to Bank Hapoalim in terms of asset size and profitability. Over the past few years, the bank has implemented cost control measures, and gradually improved the quality of its loan book following the agricultural crisis of the early 1990s.

■ Statement of Risk

The Israeli Banks are highly correlated to the Israeli economy and any reversal of recent positive economic and political trends could negatively impact their results. In addition, Bank Leumi shareholders are subject to the uncertainty associated with the government's efforts to privatize 35% of the bank.

■ Analyst Certification

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Required Disclosures

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UBS Investment Research: Global Equity Ratings Definitions and Allocations

UBS rating	Definition	UBS rating	Definition	Rating category	Coverage ¹	IB services ²
Buy 1	FSR is > 10% above the MRA, higher degree of predictability	Buy 2	FSR is > 10% above the MRA, lower degree of predictability	Buy	41%	33%
Neutral 1	FSR is between -10% and 10% of the MRA, higher degree of predictability	Neutral 2	FSR is between -10% and 10% of the MRA, lower degree of predictability	Hold/Neutral	50%	33%
Reduce 1	FSR is > 10% below the MRA, higher degree of predictability	Reduce 2	FSR is > 10% below the MRA, lower degree of predictability	Sell	9%	27%

1: Percentage of companies under coverage globally within this rating category.

2: Percentage of companies within this rating category for which investment banking (IB) services were provided within the past 12 months.

Source: UBS; as of 30 September 2004.

KEY DEFINITIONS

Forecast Stock Return (FSR) is defined as expected percentage price appreciation plus gross dividend yield over the next 12 months.

Market Return Assumption (MRA) is defined as the one-year local market interest rate plus 5% (an approximation of the equity risk premium).

Predictability Level The predictability level indicates an analyst's conviction in the FSR. A predictability level of '1' means that the analyst's estimate of FSR is in the middle of a narrower, or smaller, range of possibilities. A predictability level of '2' means that the analyst's estimate of FSR is in the middle of a broader, or larger, range of possibilities.

Under Review (UR) Stocks may be flagged as UR by the analyst, indicating that the stock's price target and/or rating are subject to possible change in the near term, usually in response to an event that may affect the investment case or valuation.

Rating/Return Divergence (RRD) This qualifier is automatically appended to the rating when stock price movement has caused the prevailing rating to differ from that which would be assigned according to the rating system and will be removed when there is no longer a divergence, either through market movement or analyst intervention.

EXCEPTIONS AND SPECIAL CASES

US Closed-End Fund ratings and definitions are: Buy: Higher stability of principal and higher stability of dividends; Neutral: Potential loss of principal, stability of dividend; Reduce: High potential for loss of principal and dividend risk.

UK and European Investment Fund ratings and definitions are: Buy: Positive on factors such as structure, management, performance record, discount; Neutral: Neutral on factors such as structure, management, performance record, discount; Reduce: Negative on factors such as structure, management, performance record, discount.

Core Banding Exceptions (CBE): Exceptions to the standard +/-10% bands may be granted by the Investment Review Committee (IRC). Factors considered by the IRC include the stock's volatility and the credit spread of the respective company's debt. As a result, stocks deemed to be very high or low risk may be subject to higher or lower bands as they relate to the rating. When such exceptions apply, they will be identified in the Companies Mentioned table in the relevant research piece.

Companies mentioned

Company Name	Reuters	Rating	Price
Bank Hapoalim	POLI.TA	Buy 2	NIS12.66
Bank Leumi Le-Israel ^{2,16}	LUMI.TA	Buy 2	NIS10.24

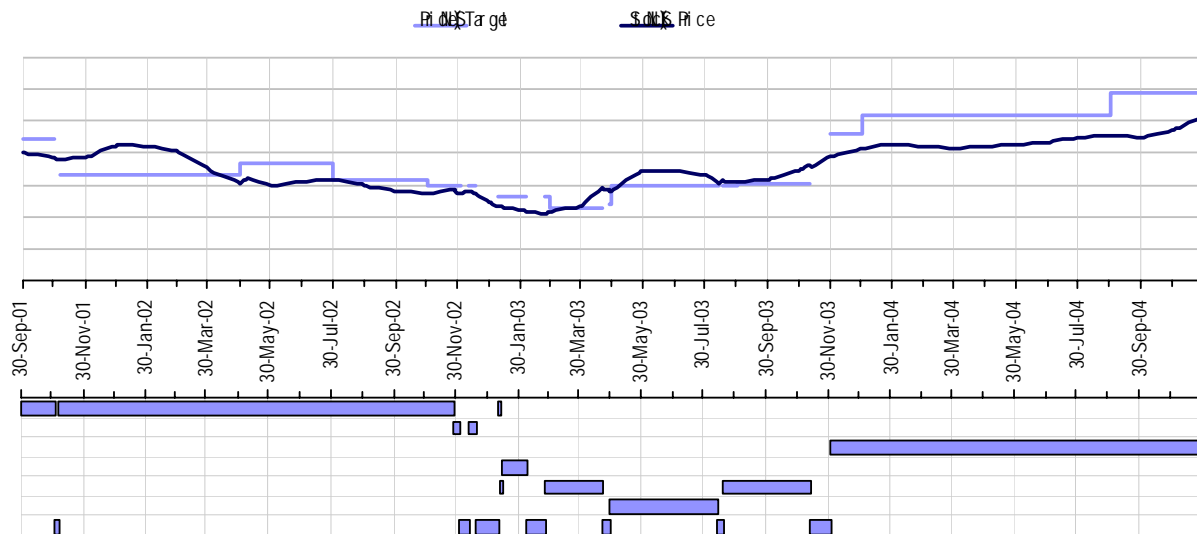
Price(s) as of 29 November 2004. Source: UBS.

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16. UBS Securities LLC and/or UBS Capital Markets LP makes a market in the securities and/or ADRs of this company.

Unless otherwise indicated, please refer to the Valuation and Risk sections within the body of this report.

Bank Leumi Le-Israel (NIS)



Source: UBS; as of 29 November 2004.

Note: On October 13, 2003, UBS adopted new definition criteria for its rating system. (See 'UBS Investment Research: Global Equity Ratings Definitions and Allocations' table for details.) Between January 11 and October 12, 2003, the UBS ratings and their definitions were: Buy 1: Excess return potential > 15%, smaller range around price target; Buy 2: Excess return potential > 15%, larger range around price target; Neutral 1: Excess return potential between -15% and 15%, smaller range around price target; Neutral 2: Excess return potential between -15% and 15%, larger range around price target; Reduce 1: Excess return potential < -15%, smaller range around price target; Reduce 2: Excess return potential < -15%, larger range around price target. Prior to January 11, 2003, the UBS ratings and definitions were: Strong Buy: Greater than 20% excess return potential, high degree of confidence; Buy: Positive excess return potential; Hold: Low excess return potential, low degree of confidence; Reduce: Negative excess return potential; Sell: Greater than 20% negative excess return potential, high degree of confidence. Under both ratings systems, excess return is defined as the difference between the FSR and the one-year local market interest rate.

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