

May 28, 2008

Israel

Pan-European Banks

Mizrahi-Tefachot (MZTF.TA - ILS 27.80) 2-Equal weight

Earnings Review/Sales Analysis

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Steady Performance in Tough Environment

Investment Conclusion

- We maintain our 2-EW rating on MZTF. The bank was able to post fairly solid results in a difficult macro environment but we do not expect to see conditions improve from this point. ROE did reach 13.5% in the quarter but we see it as too early to get excited about the prospect of 18% by 2012.

Summary

- Net interest income of ILS 549m was better than our ILS 524m estimate and provisions of ILS 41m were lower than our ILS 65m estimate. Other income was lower than we expected, and management stated that it is concentrating on generating better fee income over the remainder of 2008. Expenses were higher than we expected, and net income of ILS 180 fell a bit short of our ILS 193m estimate.
- MZTF just unveiled a 5 yr options plan for a tiered cross section of management which it expects to see align employee performance with the strategic plan outlined in late 2007. In this regard, we see MZTF as a leader in the domestic banking sector.

FY Dec	2007A	2008E		2009E		2010E	
		Actual	Old	New	Old	New	Old
Net Income (m)	908	733	739	824	869	N/A	0
EPS (stated)	4.09	3.31	3.33	3.72	3.92	N/A	0.00
EPS (adj.)	3.07	3.31	3.33	3.72	3.92	N/A	0.00
PE (adj.)	9.4	8.4	8.7	7.5	7.4	N/A	0.0
ROE (stated %)	17.9	13.2	13.3	13.3	14.0	N/A	0.0
ROE (adj. %)	17.9	13.2	13.3	13.3	14.0	N/A	0.0
Price/NAV	0.0	0.0	0.0	0.0	0.0	N/A	0.0
Price/NAV (adj.)	0.0	0.0	0.0	0.0	0.0	N/A	0.0

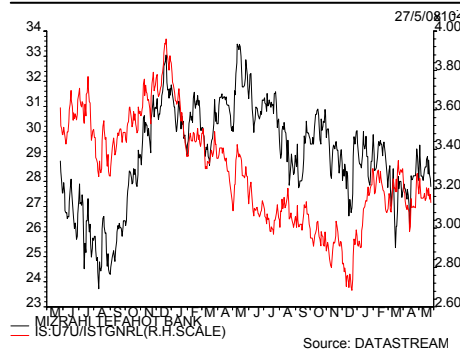
Market Data

Market Cap (m)	6172
Units Outstanding (m)	222.0
Float (%)	55
Net Distribution Yield (%)	7.57
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 (%)	6.7
Total BIS Ratio FY07 (%)	N/A

Stock Overview



Reuters	MZTF.TA
Bloomberg	MZTF IT
ADR	

Performance	1M	3M	12M
Absolute %	-2	-4	-13
Rel. Market %	-2	0	-6
Rel. Sector %	-3	1	1

52 Week Range 32.86 - 25.36

Stock Rating

New: 2-Equal weight	New: ILS 34.00
Old: 2-Equal weight	Old: ILS 34.00

Target Price

Sector View: 1-Positive

1Q08 Highlights

Net interest income of ILS 549 million was ahead of our ILS 524 million estimate as net interest income surprised us on the upside. On the other hand, loan growth was 5% compared to 1Q07, but only up 1% from YE07, indicating to us a slow down of sorts in the lending business. MZTF management noted on the conference call that with the drying up of the corporate bond market in Israel the corporates are returning to the banks to fund growth, but that MZTF is being somewhat cautious with regard to choosing which customers to focus on. It reiterated its focus on the SME and retail markets.

CFO Eldad Fresher started his remarks on the quarter by focusing on three areas that we feel bear highlighting here.

1. Salary expense – Employee related costs rose to ILS 312 million in the quarter compared to ILS 293 million in 1Q07. This 6.5% increase in salaries caught us a bit by surprise given the trends in 2007 which had salaries in the ILS 291 million–ILS 293 million range all year. Management stated that customer growth has led to the hiring of more than 200 new employees over the past several quarters and that the investment in new facilities to serve its customers explains the rising costs. It does not expect the total annual cost of the new employees to exceed ILS 40 million and it also anticipates that an early retirement program will more than offset the impact of these new hires. Cost income ratio of 60.2% is far from the 55% the bank would like to achieve, but inline with the average for 2007.

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2. Operating and other income – Operating commissions were up slightly to ILS 256 million from ILS 253 million. Other income was down to ILS 19 million from ILS 37 million. However, if we neutralize the impact of the sale of the provident fund business then income rose slightly to ILS 19 from ILS 15. Net income from investment in shares (which we find very difficult to model) was down to ILS 8 from ILS 38; last years result included one major holding that accounted for ILS 36 million. Management was quite clear that it expects to do better in its commission based activities for the duration of 2008.
3. Deposits – Deposits from the public contracted in the quarter to ILS 73,237 million from ILS 75,250 in 1Q07 and from ILS 7,290 at YE2007. Management stated that this shrinkage was by design as MZTF is not interested in chasing deposit growth in a competitive environment. While there are likely two sides to this story, the growth in net interest margins does support this approach to a certain degree.

ROE in the quarter reached 13.5% compared to 13.3% in 1Q07 (excluding the impact of one-time gains).

In short, this was a steady quarter from MZTF. Management noted that it has not yet seen (or felt) the impact of an economic slowdown in Israel. On the other hand, it did note that it expects a slowdown in 2H08 (as does the Bank of Israel) that could continue into 2009. As such we do not see much in the way of a catalyst to drive stock outperformance and we remain at 2-EW.

Figure 1: Q108 Results vs. Expectations

	Q108 A	Q108 E	% difference	Q107 A	y/y
Net interest income before provisions	549	524	4.8%	467	17.6%
Provision for doubtful debts	-41	-65	-36.9%	-50	-18.0%
Net interest income after provisions	508	460	10.4%	417	21.8%
Total operating and other income	283	310	-8.7%	328	-13.7%
Total operating and other expenses	501	464	8.0%	467	7.3%
Operating profit before taxes	290	305	-4.9%	278	4.3%
Provisions for taxes on operating profit	-110	-112	-1.8%	-115	-4.3%
Net profit (excluding one time extraordinary item in Q107)	180	193	-6.7%	163	10.4%
EPS exclud one-offs	ILS 0.81	ILS 0.87	-6.7%	ILS 0.75	8.8%
Reported EPS	ILS 0.81	ILS 0.87		ILS 1.69	-52.1%
ROE	13.2%			29.2%	
Loan Growth	5.1%			9.1%	

Source: Company reports, Lehman Brothers estimates

Figure 2: Net Interest Income by Divisions

	Q108 A	Q107 A	% change
Households:			
Mortgages	98	91	7.7%
Other	140	131	6.9%
Private Banking	10	7	42.9%
Small Businesses	76	65	16.9%
Commercial Banking	39	26	50.0%
Business Banking	126	107	17.8%
International Activity	-14	26	
Finance Management	74	14	
Total	549	467	17.6%

Source: Company reports, Lehman Brothers estimates

Figure 3: Net Profit (Excluding one-offs) by Divisions

	Q108 A	Q107 A	% change
Households:			
Mortgages	69	62	11.3%
Other	21	12	75.0%
Private Banking	5	5	0.0%
Small Businesses	6	4	50.0%
Commercial Banking	15	7	114.3%
Business Banking	54	60	-10.0%
International Activity	-14	7	
Finance Management	14	6	
Total	170	163	4.3%

Source: Company reports, Lehman Brothers estimates

Figure 4: Bank Mizrahi - Income Statement (ILSm)

	Q107	Q207	Q307	Q407	2007	Q108	Q208E	Q308E	Q408E	2008E	2009E
Net interest income before provisions	467	529	523	507	2026	549	548	555	546	2199	2452
Provision for doubtful debts	-50	-63	-65	-50	-228	-41	-65	-66	-67	-239	-293
Net interest income after provisions	417	466	458	457	1798	508	484	489	480	1960	2159
Operating commissions	253	256	260	265	1034	256	269	273	278	1076	1130
Profit from sale of shares for trading	38	8	-1	20	65	8	5	5	5	23	0
Other income	37	22	14	18	91	19	23	15	19	76	82
Total operating and other income	328	286	273	303	1190	283	297	293	302	1175	1212
Salaries and related expenses	293	294	291	291	1169	312	294	291	291	1188	1224
Building and equipment maintenance	100	106	105	110	421	104	109	108	113	435	443
Other expenses	74	82	82	110	348	85	75	75	101	337	347
Total operating and other expenses	467	482	478	511	1938	501	479	475	506	1960	2014
Operating profit before taxes	278	270	253	249	1050	290	302	307	276	1175	1356
Provisions for taxes on operating profit	-115	-86	-72	-95	-368	-110	-111	-113	-102	-436	-487
Operating profit after taxes	163	184	181	154	682	180	191	194	175	739	869
Income before extras	163	184	181	153	682	180	191	194	175	739	869
Extraordinary item	207	23	3	-6	227	0	0	0	0	0	0
Net profit	370.00	207.00	184.00	147.00	908.00	180.00	190.74	194.07	174.56	739.37	869.26
Net profit exclud extras and one-offs	163.00	184.00	181.00	153.00	682.00	180.00	190.74	194.07	174.56	739.37	869.26
EPS exclud one-offs	0.7	0.8	0.8	0.7	3.1	0.8	0.9	0.9	0.8	3.3	3.9
Reported EPS	1.7	0.9	0.8	0.7	4.1	0.8	0.9	0.9	0.8	3.3	3.9
GOPS	1.50	1.52	1.45	1.35	5.76	1.49	1.65	1.68	1.55	6.37	7.43
BVPS	24.83	24.86	24.86	25.03	25.05	27.92	32.43	0.00	0.00	27.92	32.43
DPS	0.91	0.57	0.34	0.28	2.05	0.34	0.00	0.00	0.00	1.33	1.57
Weighted no of shares	218.6	218.6	218.6	222.0	221.8	221.8	221.8	221.8	221.8	221.8	221.8
Income Statement Drivers											
Net Interest Margin on IYA	2.0%	2.3%	2.3%	2.2%	2.3%	2.5%	2.4%	2.4%	2.4%	2.3%	2.6%
Provision/Loans	0.3%	0.4%	0.4%	0.3%	0.3%	0.2%	0.4%	0.4%	0.4%	0.3%	0.4%
Specific Provisions/Loans											
Tax Rate	41.4%	31.9%	28.5%	41.0%	35.0%	37.9%	36.8%	36.8%	36.8%	36.8%	35.9%
Payout Ratio	54.1%	60.4%	40.8%	0.0%	40.0%	40.0%	40.0%	40.0%	40.0%	40.0%	40.0%
Y/Y Change (%)											
Net interest income before provisions	16%	-1%	5%	-8%	2%	18%	5%	1%	3%	6%	10%
Provision for doubtful debts	-58%	3%	7%	-22%	-25%	-18%	4%	2%	33%	15%	17%
Net interest income after provisions	46%	-1%	5%	-6%	7%	22%	5%	1%	0%	5%	9%
Operating commissions	2%	2%	6%	4%	4%	1%	5%	5%	5%	5%	5%
Profit from sale of shares for trading	1800%	-72%	-200%	11%	30%	-79%					
Other income	-21%	-52%	-55%	-59%	-48%	-49%	5%	5%	5%	5%	8%
Total operating and other income	11%	-12%	-2%	-4%	-2%	-14%	4%	7%	0%	1%	0%
Salaries and related expenses	-13%	-38%	8%	-6%	-16%	6%	0%	0%	0%	0%	3%
Building and equipment maintenance	14%	14%	7%	4%	9%	4%	3%	3%	3%	3%	2%
Other expenses	-5%	-14%	14%	20%	3%	15%	-8%	-8%	-8%	-8%	3%
Total operating and other expenses	-7%	-28%	9%	1%	-8%	7%	-1%	-1%	-1%	-1%	3%
Operating profit before taxes	256%	108%	-8%	-16%	35%	4%	14%	11%	2%	11%	11%
Operating profit after taxes	360%	62%	-36%	-40%	5%	-4%	6%	-2%	4%	16%	8%
Extraordinary item	208%	145%	12%	11%	60%	10%	-100%	-100%	-100%	8%	12%
Net profit for the year	127%	-89%	200%	-300%	5%	-100%	-6%	-3%	9%	-100%	0%

Source: Company reports, Lehman Brothers estimates

Figure 5: Bank Mizrahi - Balance Sheet (ILSm)

	Q107	Q207	Q307	Q407	2007	Q108	Q208E	Q308E	Q408E	2008E	2009E
Cash and deposits with banks	13,595	13,240	12,463	10,701	10,701	9,895	9,930	9,970	8,561	8,561	8,989
Securities	6,894	7,615	6,776	6,145	6,145	4,096	3,808	4,743	4,302	4,302	4,517
Credit to the public	71,452	72,285	73,688	74,320	74,320	75,117	75,899	77,372	78,036	78,036	81,938
Credit to governments	4	4	3	3	3	3	4	3	3	3	3
Investment in companies	26	17	18	17	17	18	17	18	17	17	17
Buildings and equipment	1,296	1,219	1,205	1,246	1,246	1,239	1,219	1,205	1,246	1,246	1,246
Other assets	2,480	2,268	2,727	2,885	2,885	4,322	3,969	4,636	4,905	4,905	4,905
TOTAL ASSETS	95,747	96,648	96,880	95,317	95,317	94,690	94,846	97,948	97,069	97,069	101,614
Deposits of the public	75,250	76,845	76,074	75,290	75,290	73,237	74,155	75,313	74,914	74,914	78,659
Deposits from banks	5,821	4,112	4,357	3,752	3,752	3,273	3,084	3,486	2,814	2,814	2,814
Deposits from governments	549	539	522	282	282	267	270	418	226	226	226
Debentures, bonds and capital notes	5,263	6,077	6,357	6,189	6,189	6,338	6,138	6,421	6,251	6,251	6,313
Other liabilities	3,437	3,628	4,124	4,247	4,247	5,954	5,442	6,186	6,371	6,371	6,402
Total liabilities	90,320	91,201	91,434	89,760	89,760	89,069	89,089	91,823	90,575	90,575	94,415
Minority Interest		13	12		0	0	6	6	6	6	6
Shareholders' equity	5,427	5,434	5,434	5,557	5,557	5,621	5,751	6,119	6,488	6,192	7,193
TOTAL LIABILITIES AND EQUITY CAPITAL	95,747	96,648	96,880	95,317	95,317	94,690	94,846	97,948	97,069	97,069	101,614
Interest Yielding Assets	91,945	93,144	92,930	91,169	91,169	89,111	89,640	92,088	90,901	90,901	95,446
Customer Loans/Assets					78.0%	79.3%	80.0%	79.0%	80.4%	80.4%	80.6%
Customer Deposits/Assets					79.0%	77.3%	78.2%	76.9%	77.2%	77.2%	77.4%
Customer Loans/Customer Deposits					98.7%	102.6%	102.4%	102.7%	104.2%	104.2%	104.2%
Shareholder's Equity/Assets					5.8%	5.9%	6.1%	6.2%	6.7%	6.4%	7.1%
Y/Y Change (%)											
Cash and deposits with banks	4.5%	-0.6%	-1.9%	5.0%	5.0%	-27.2%	-25.0%	-20.0%	-20.0%	20.0%	5.0%
Securities	22.6%	46.6%	17.7%	5.0%	5.0%	-40.6%	-50.0%	-30.0%	-30.0%	-30.0%	5.0%
Credit to the public	9.1%	9.6%	6.1%	7.0%	7.0%	5.1%	5.0%	5.0%	5.0%	5.0%	5.0%
Credit to governments	-95.6%	-95.3%	-40.0%	-2.0%	-2.0%	-25.0%	-2.0%	-2.0%	-2.0%	-2.0%	-2.0%
Investment in companies	-70.5%	-58.5%	-57.1%	0.0%	0.0%	-30.8%	0.0%	0.0%	0.0%	0.0%	0.0%
Buildings and equipment	6.0%	-1.7%	-3.8%	0.0%	0.0%	-4.4%	0.0%	0.0%	0.0%	0.0%	0.0%
Other assets	65.9%	13.0%	27.8%	0.0%	0.0%	74.3%	75.0%	70.0%	70.0%	0.0%	0.0%
TOTAL ASSETS	10.0%	10.1%	6.1%	0.0%	5.1%	-1.1%	3.9%	8.0%	7.0%	1.8%	5.1%
Deposits of the public	5.2%	6.6%	4.2%	2.8%	2.8%	-2.7%	-3.5%	-1.0%	-0.5%	1.0%	5.0%
Deposits from banks	70.3%	45.8%	-2.9%	22.1%	22.1%	-43.8%	-25.0%	-20.0%	-25.0%	0.0%	0.0%
Deposits from governments	-10.1%	-9.7%	-10.9%	-49.6%	-49.6%	-51.4%	-50.0%	-20.0%	-20.0%	0.0%	0.0%
Debentures, bonds and capital notes	14.5%	26.7%	31.2%	22.1%	22.1%	20.4%	1.0%	1.0%	1.0%	1.0%	1.0%
Other liabilities	59.9%	44.8%	76.9%	14.5%	14.5%	73.2%	50.0%	50.0%	50.0%	0.5%	0.5%
Total liabilities	9.8%	10.1%	7.3%	4.8%	4.8%	-1.4%	-2.3%	0.4%	0.9%	0.9%	6.0%
MINORITY INTERESTS	9.8%	10.1%	7.3%	4.8%	4.8%	-1.4%	-2.3%	0.4%	0.9%	0.9%	6.0%
SHAREHOLDERS EQUITY	-100.0%	116.7%	100.0%	-100.0%	-100.0%	#DIV/0! error	0.0%	0.0%	0.0%	0.0%	0.0%
TOTAL LIABILITIES AND EQUITY CAPITAL	10.0%	10.1%	7.3%	5.1%	5.1%	-1.1%	-1.9%	1.1%	1.8%	1.8%	7.3%
Interest Yielding Assets	9.2%	10.2%	5.7%	4.9%	4.9%	-3.1%	-3.8%	-0.9%	-0.3%	-0.3%	7.1%

Source: Company reports, Lehman Brothers estimates

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Company Description:

Mizrahi is the fourth largest banking group in Israel, with number one share in the mortgage market.

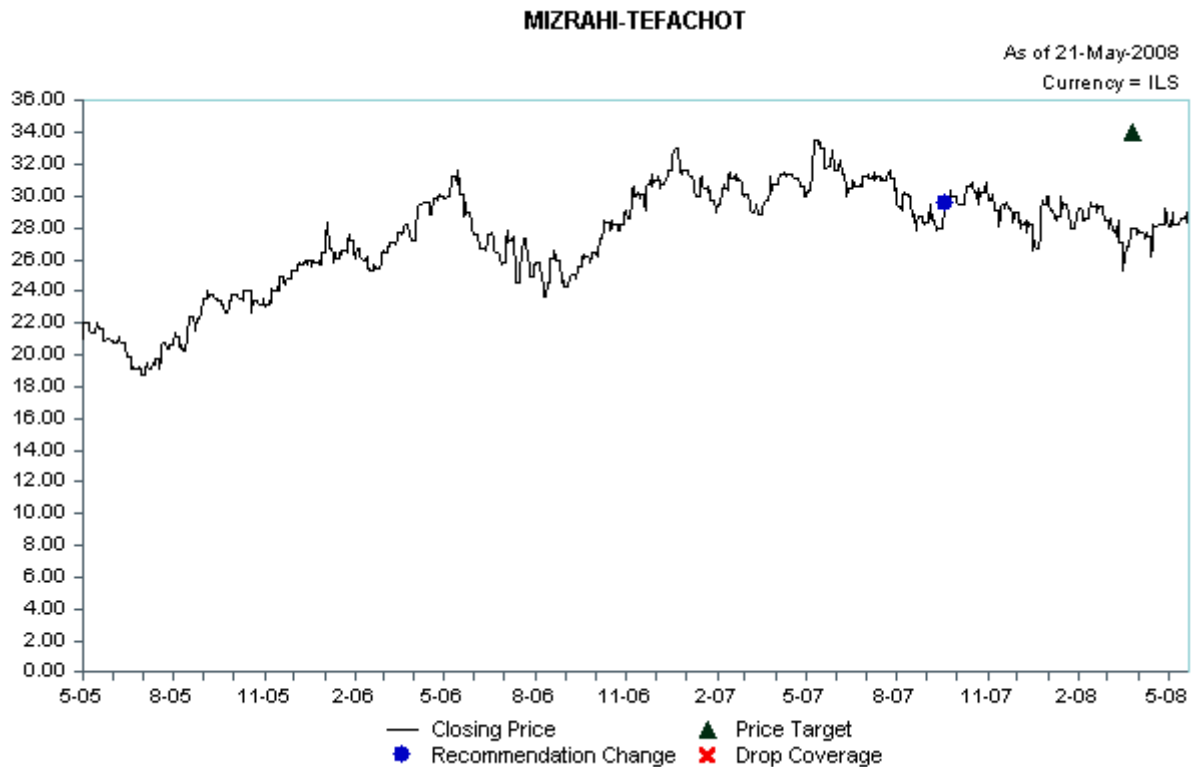
Important Disclosures:

Mizrahi-Tefachot (MZTF.TA)

ILS 27.80 (26-May-2008)

2-Equal weight / 1-Positive

Rating and Price Target Chart:



Currency=ILS

Date	Closing Price	Rating	Price Target	Date	Closing Price	Rating	Price Target
26-Mar-08	28.00		34.00	20-Sep-07	29.52	2 -Equal weight	

FOR EXPLANATIONS OF RATINGS REFER TO THE STOCK RATING KEYS LOCATED ON THE PAGE FOLLOWING THE LAST PRICE CHART.

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Valuation Methodology: We value Mizrahi-Tefachot at 1.2x book value. This assumes ROE of 14%, growth of 3%, cost of equity if 10.5%. We apply a 15% discount to our implied P/B value from this equation to account for the volatility of earnings at the Israeli banks, the high level of regulatory scrutiny, and the historic trading range of the stock.

Risks Which May Impede the Achievement of the Price Target: Israeli banks are a high beta play on the domestic economy and as such results are impacted by general economic conditions, interest rates, and inflation. Mizrahi's current strategy is built around growing local market share in a highly competitive market. Failure to achieve goals may cause results to differ from expectations.

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Company Name	Ticker	Price (26-May-2008)	Stock / Sector Rating
Mizrahi-Tefachot	MZTF.TA	ILS 27.80	2-Equal weight / 1-Positive

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Banca Popolare di Milano (PMII.MI)	Banco Espirito Santo (BES.LS)
Banco Popolare (BAPO.MI)	Banco Popular (POP.MC)
Banco Sabadell (SABE.MC)	Banesto (BTO.MC)
Bank Hapoalim (POLI.TA)	Bank Leumi (LUMI.TA)
Bank Millennium (BIGW.WA)	Bank of Ireland (BKIR.I)
Bank Pekao (BAPE.WA)	Bankinter (BKT.MC)
Barclays (BARC.L)	BBVA (BBVA.MC)
BCP (BCP.LS)	BNP Paribas (BNPP.PA)
BPI (BBPI.LS)	Bradford & Bingley (BB.L)
BRE Bank (BREP.WA)	BZ WBK (BZWB.WA)
Commerzbank (CBKG.DE)	Crédit Agricole (CAGR.PA)
CS Group (CSGN.VX)	Danske Bank (DANSKE.CO)
Deutsche Bank (DBKGn.DE)	Deutsche Postbank (DPBGn.DE)
Dexia (DEXI.BR)	DnB NOR (DNBNOR.OL)
EFG Eurobank Ergasias (EFGGr.AT)	EFG International (EFGN.S)
Erste Bank (ERST.VI)	Espirito Santo Financial Group (ESF.LS)
Fortis (FOR.AS)	Garanti Bank (GARAN.IS)
Halkbank (HALKB.IS)	Halyk Bank (HSBKq.L)
HBoS (HBOS.L)	HSBC Holdings (HSBA.L)
Hypo Real Estate Group (HRXG.DE)	Intesa Sanpaolo (ISM.MI)
Isbank (ISCTR.IS)	Israel Discount Bank (DSCT.TA)
Julius Baer (BAER.VX)	Kazkommertsbank (KKGByq.L)
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Lloyds TSB (LLOY.L)	Mizrahi-Tefachot (MZTF.TA)
Monte dei Paschi di Siena (BMPS.MI)	National Bank of Greece (NBGr.AT)
Natixis (CNAT.PA)	Nordea (NDA.ST)
Northern Rock (NRK.L)	OTP Bank (OTPB.BU)
PKO BP (PKOB.WA)	Raiffeisen International Bank (RIBH.VI)
Royal Bank Of Scotland (RBS.L)	Santander (SAN.MC)
Sberbank (SBER.RTS)	SEB (SEBa.ST)
SNS REAAL (SR.AS)	Société Générale (SOGN.PA)
Standard Chartered (STAN.L)	Svenska Handelsbanken (SHBa.ST)
Swedbank (SWEDa.ST)	UBI Banca (BPUN.MI)
UBS (UBSN.VX)	Unicredit Group (CRDI.MI)
Van Lanschot (VLAN.AS)	VTB Bank (VTBRq.L)
Yapi Kredi Bank (YKBNK.IS)	

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Stock Rating

1-Overweight - The stock is expected to outperform the unweighted expected total return of the sector coverage universe over a 12-month investment horizon.

2-Equal weight - The stock is expected to perform in line with the unweighted expected total return of the sector coverage universe over a 12- month investment horizon.

3-Underweight - The stock is expected to underperform the unweighted expected total return of the sector coverage universe over a 12- month investment horizon.

RS-Rating Suspended - The rating and target price have been suspended temporarily to comply with applicable regulations and/or firm policies in certain circumstances including when Lehman Brothers is acting in an advisory capacity in a merger or strategic transaction involving the company.

Sector View

1-Positive - sector coverage universe fundamentals/valuations are improving.

2-Neutral - sector coverage universe fundamentals/valuations are steady, neither improving nor deteriorating.

3-Negative - sector coverage universe fundamentals/valuations are deteriorating.

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