

New management, new strategy - no surprises

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Bank of America 
Merrill Lynch

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Rebuilding investor confidence

We met with senior management of Bank Hapoalim (POLI) late last week and came away optimistic that the new team is committed to getting the bank back on track to achieve pre-crisis levels of profitability, rebuild investor confidence and improve transparency. New management is refocusing on the domestic market while putting the bank's international expansion strategy on hold. Internal ROE targets have been adjusted for higher capital requirements and lower risk appetite, so we expect ROE to remain below 13-14% for the next couple of years.

Abandoning its international M&A strategy, for now ...

As expected, POLI has suspended its international expansion strategy for the moment, and we expect no M&A activity for the foreseeable future. Instead, we believe international growth will be primarily organic via the bank's GWM activities and renewed effort in participations in the US. That said, the Turkish operation remains a strategic focus and could warrant a small acquisition in our view.

Back to basics? Refocusing on the domestic market

Without an international expansion strategy, we believe POLI's growth will mainly be driven by a more aggressive domestic stance. Management aims to increase its below-average market share in the SME and mortgage sectors (c.25% in each vs an overall c.33% market share) by opening some 30-40 new POS. However, the bank claims it will not increase its work force, but rather retrain existing employees, as the centralisation of its back office operations allows it to reassign staff from other operations.

No more ROE >15% targets

Although management is reluctant to provide clear targets and projections at present, we believe it targets a feasible long-term ROE of 13-15%, while shorter-term ROE is likely to be around 12-13%, in line with our forecasts. Likewise, we believe management projects: 4-5% loan growth, primarily in higher margin segments (SME and mortgages); notably higher NIMs thanks to increased policy rates and asset repricing; minimal cost growth (c.2%), leaving its mid-term CIR target at 55%; CAR remaining above 12%; and plans no dividend before H2 2010.

POLI remains our top pick among Israeli banks

Bank Hapoalim remains our preferred bank play in Israel, as we expect it to benefit notably from rising policy rates, while higher yields and unrealized gains in its AfS portfolio should allow for marked MTM gains. Likewise, the firm economic recovery and improving economic backdrop for LSEs should allow LLPs to decline, further boosting earnings. Trading at 0.9x 2011E BV and 6.8x 2011E estimated earnings, we see substantial upside potential with only limited downside risk. We reiterate our Buy rating.

Stock Data

Price	ILS16.29
Price Objective	ILS20.80
Date Established	19-Jan-2010
Investment Opinion	B-1-9
Volatility Risk	MEDIUM
BofAML Ticker / Exchange	BKHPF / TLV
Bloomberg / Reuters	POLI IT / POLI.TA

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Refer to important disclosures on page 3 to 6. Analyst Certification on Page 2. Price Objective Basis/Risk on page 2.

Price objective basis & risk

Bank Hapoalim (BKHPF)

Our price objective of ILS20.8/s is based on the lower outcome of two valuation models: (1) a simple Gordon growth model (ILS 20.8/s) and a dividend discount model (which generates a fair value of ILS21.3/s). We prefer to be conservative and use the lowest price range. We use a simple target price-book model (a single-stage Gordon Growth Model), with a mid-term sustainable ROE target of 12.6%, an 11.0% cost of equity and a 3.5% nominal terminal growth rate. Our COE uses a 36-month rolling average, a 10-year nominal government bond yield of 5.5% and a 1.1 beta (a 36-month rolling adjusted beta vs the TA-100). Our perpetual growth rate of 3.5% is nominal and assumes a real long-term growth rate of 1.5% and a 2% long-term inflation rate target.

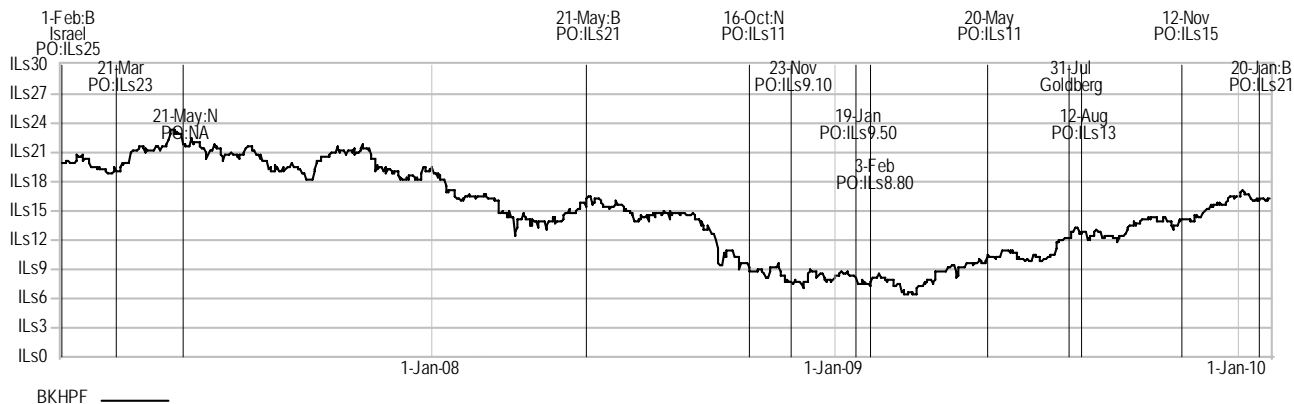
We group the risks into two categories: macroeconomic and microeconomic. On the macro level, the anticipated economic recovery might be slower than expected, both locally and globally. This could put the banking sector under pressure, in terms of both growth and asset quality. The bank's ability to contain costs, improve its net interest margin and maintain prudent risk management are the microeconomic risks, in our view.

Analyst Certification

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BKHPF Price Chart



B : Buy, N : Neutral, S : Sell, U : Underperform, PO : Price objective, NA : No longer valid

*Prior to May 31, 2008, the investment opinion system included Buy, Neutral and Sell. As of May 31, 2008, the investment opinion system includes Buy, Neutral and Underperform. Dark Grey shading indicates that a security is restricted with the opinion suspended. Light grey shading indicates that a security is under review with the opinion withdrawn. The current investment opinion key is contained at the end of the report. Chart is current as of January 31, 2010 or such later date as indicated.

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Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	120	48.98%	Buy	63	63.00%
Neutral	65	26.53%	Neutral	43	75.44%
Sell	60	24.49%	Sell	34	60.71%

Investment Rating Distribution: Global Group (as of 01 Jan 2010)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	1699	50.78%	Buy	904	58.82%
Neutral	841	25.13%	Neutral	491	65.03%
Sell	806	24.09%	Sell	368	49.80%

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