

Bank Hapoalim

(Bloomberg Ticker: POLI IT)

Ahead of Q3: Don't Expect drama Waiting for Conclusion of Strategic Discussions

The 3rd quarter results to be published by Bank Hapoalim later this month will primarily show business as usual, but the focus will be on the strategic plan that is to be presented at the beginning of 2010.

- Net profit of 400 m. ILS.** In our opinion, the bank will show a net profit of 400 m. ILS for the current quarter, an 8% Return on Equity. The report will include one-time effects in both directions, but we are having difficulty identifying any major developments. Details below.
- Where is the strategic plan going?**

In our opinion, this is the key question for Bank Hapoalim. Over the last year several members of the management team were replaced, including the Chairman and General Manager, Business Division Manager, Retail Division Manager, and the CFO.

The bank's management will re-examine its strategic plan, released from historical decisions. The key topics are:

- Capital Adequacy targets.** The current target is a minimum of 12% adequacy rate, disregarding any reference to the primary Tier 1 Capital which is currently 7.1%. In our opinion, the bank will set over 12% as the capital adequacy target, and will aim to have a 7.3%-7.5% of primary Tier 1 capital, according to the Basel II accord.
- Target definition is an important phase in determining Return on Equity targets, potential for dividend distribution and growth targets for the bank.
- Return on Equity targets.** In the past, the bank considered a 15% Return on Equity target a viable target. Since the bank intends to be more conservative in its activities and strengthen its capital base, we believe that the bank will be able to meet viable targets of 11%-13% Return on Equity. In 2010 we believe a 10%-11% Return on Equity target is plausible.
- Increasing efficiency.** In the past, the bank set expense to revenue targets of 55%. In our opinion, under the current expense structure and under the expenses required by the Regulator in Israel, this target is far from being reached.
- Increased retail activity.** We have no doubt that the bank has declared its retail business as one of its key growth sectors, while allocating much of its efforts in recruiting new clients, coupled with a more aggressive growth strategy of its mortgage business where its market share of new credit has dropped below 20%.
- An important part of the retail strategy is the opening of a network of boutique branches and express banking branches. In our opinion, the bank will slow down on this initiative.
- Expansion of the commercial banking sector.** In this sector, Bank Hapoalim is at a clear disadvantage (25% market share) when compared to Bank Leumi (almost 40%).
- Opening new business branches to handle these customers is a milestone in this strategy. In our opinion, the bank will continue to pin its hopes on these steps.
- International business.** In the past, the bank set its target so that 30% of its business came from abroad. In our opinion, this target will be set aside for now.
- Real investments.** Bank Hapoalim's business strategy was to focus on banking, and in our opinion, this strategy will prevail. However, we believe the bank will take advantage of business opportunities relating to their usual business, such as Nostro investments in Bezeq shares as part of its financing package.

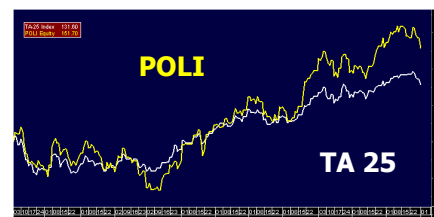
Updates

- Rating
- Price target
- Forecast

Key figures

Rating	Outperform
Price target (NIS)	15.70
Current price (NIS)	13.40
Market cap (m NIS)	18000
12-mo. high (NIS)	14.50
12-mo. low (NIS)	6.50
12-mo. change	60%
12-mo. change TA25	42%
Daily volume (Millions NIS)	100
Free float	74%
P/E 09E	16.50
P/E 10E	9.7
P/B	0.91
Previous rating	Outperform
Previous price target (NIS)	15.70

POLI – 12 Month vs TA-25 Index



In summary – we await the strategic presentation. In our opinion, Bank Hapoalim will aim at more conservative traditional banking with an 11%-13% Return on Equity target in the long term.

MAIN FORECASTS FOR Q3 2009

	2008	Q3/08	Q2/09	Q3/09E
Profits from Financing	3,256	2,083	1,955	1,800
Operating Revenues	4,655	1,153	1,231	1,290
Total Revenues	7,911	3,236	3,186	3,090
Provisions for Doubtful Debts	1,520	471	538	700
as % of Loan Portfolio	0.71%	0.89%	0.97%	1.30%
Operating Expenses	8,147	1,960	1,890	1,685
Expenses/Revenues	103.0%	60.6%	59.3%	54.5%
Pre Tax Profits	(1,756)	805	758	705
Tax	(397)	330	369	314
Net Profit	(895)	441	382	391
ROE	-4.8%	9.7%	8.1%	8.2%

1. Financing revenues will be characterized by relative stability:

- In 3Q08, financing revenues included huge accounting profits due to derivatives, which means that it is pointless to compare the current financing revenues to those of the same period last year.
 - Credit growth is not expected – and may even decline slightly due to the shekel's 4% gain vs the dollar during the quarter.
 - We are not expecting a material effect due to accounting handling of derivatives, since there was hardly any change in the index-linked curve.
 - An outlook for profits due to investments in securities of the CDS type in the bank's Nostro portfolio. In 2Q09 this item surprised everybody with 235 m. ILS in profits. In our opinion, there will also be profits in this category in the current quarter, due to full redemption of another part of the portfolio, but not at the same rate as in the second quarter.
 - Erosion of the margin on investments continues to cloud the bank's results. In 2Q09, the bank estimated the negative effect of Bank Israel's interest on this margin to total 150 m. ILS per quarter. In our opinion, this negative effect will continue to impact the bank in 3Q09 as well as in future quarters.
2. **Continued operating revenues growth.** These revenues will express the continued growth in revenue from commission, mostly from capital market and credit card activities. In addition, profit is expected from Bezeq shares, both as a result of the sale of shares held by the Trustee (Zeevi shares) and from distributed dividends.
3. **Increased provision for doubtful debts.** In our opinion, due to the market place condition and the exposure of the bank to the Leviev Group (Africa Israel), the outlook is for an increase in provision for doubtful debts for the quarter. However, we believe that part of the provision for doubtful debts due to the exposure to Africa Israel Group has already been carried out in previous quarters, so that the total provisions relating to these loans will total only 200-300 m. ILS. Also, a debt restructuring deal is in the works, which could ease pressure.
4. **Low operating expenses** thanks to the effect of the wage agreement, which will reduce expenses by 200 m. ILS in the current quarter.
5. **A relatively high tax rate.** As a result of the tax reform, an additional provision for tax is expected totaling 60 m. ILS, which will negatively affect the net profit.

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- a. **Buy** – the stock is expected to out perform TA100 by 20% or more in 12 months.
- b. **Outperform** - the stock is expected to out perform TA100 by 10% to 20% in 12 months.
- c. **Marketperform** – the stock is expected to out perform/ under perform TA100 by 10 % in 12 months.
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- e. **Sell** – the stock is expected to under perform TA100 by 20% or more in 12 months.

2. The approach used in setting our price target for the bank's shares combine a discounted cash flow method and a comparison to market-to-book multiples and price-earnings ratios of similar equities in the sector.

3. The main risks with the potential to materially affect Bank Hapoalim's shares include the following:

- Regulatory intervention, which could negatively affect the bank's business environment (particularly steps taken to regulate the bank's commissions, interest-rate charges, etc.), in addition to other areas the bank is active in.
- Macroeconomic developments, which directly affect the bank's operations.

5. Date of publication. This research report was issued on November 1, 2009

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