Banking industry 2012: an analysis of activity performance, risk profile and return indicators

By Dr. Marwan S. Barakat

General Operating Environment

Within the context of the recent cross border expansion of Lebanon's banks, the analysis of the performance of Lebanese banking in terms of activity growth, risk profile and return indicators, has to be read in conjunction with the overall operating environment in the different regions where they are actually operating. The operating conditions of Lebanese banks over the past year were actually atypical in their different markets of presence, i.e in Lebanon, in the MENA region and even outside it.

To begin with, the global economy witnessed a somewhat weakening recovery during 2012, with activity momentum affected by sluggish private sector demand warranting extended relative weakness across labor markets, and lingering fiscal and financial uncertainties. Fiscal consolidation across some of the world's largest economies has continued to weigh on aggregate demand throughout the year 2012 which, coupled with a rather volatile appetite for risk, has had spillovers on other economies across the globe through both trade and financial channels adding to some domestic weaknesses. Within this context, global real GDP growth is estimated to have decelerated during 2012, moving from 3.9% in 2011 to 3.1% last year, as per the latest International Monetary Fund figures.

Amid such an environment, the financial system continued to report tough challenges, which prompted borrowing conditions to remain rather tight in a year where global banks continued to deleverage. As a matter of fact, bank lending remained more or less sluggish across many of the largest economies around the world at a time when appetite for credit remains rather weak both on the demand and supply sides amid an extended cautious wait-and-see mood. Nonetheless, policy actions have lessened severe crisis risks across the world's largest economies while stabilizing financial conditions and announced banking sector regulatory reforms somehow contributed to reducing the general uncertainty level.

A major support to economic growth throughout last year once again proved to be very accommodative monetary policies. Indeed, Central Banks maintained historically low key interest rates and pushed for additional quantitative easing and other stimulus measures. These were aimed at decreasing rates in specific markets and more generally at fostering better conditions across borrowing markets while ensuring liquidity support to the markets, which has been key in addressing investor concerns over the past year at a time when non-monetary stimulus channels are proving quite hard to resort to on the overall within large fiscal deficit and indebtedness ratios.

At the regional level, the operating environments were varying in the different markets of presence of Lebanese banks in the region. First, economic conditions of the Middle East and North Africa region were mixed during the year 2012. Most of the region's oil exporting countries have been growing at healthy rates while the oil importers faced subdued economic performances. The region's oil exporters were indeed able to post a solid real GDP growth of 5.7% in 2012, supported by expansionary fiscal policies and accommodative monetary conditions. For the other regional economies, ongoing political transitions have been weighing on growth. They have witnessed a marked decline in exports in 2012, tourism arrivals are recovering only slowly, and foreign direct investment inflows remain subdued, all generating a mild growth of about 2.7% per annum.

In parallel, at the banking sectors' level, the sound US$ 150 billion deposit growth in 2012 in the MENA region (42% above previous year's level) and the satisfactory US$ 98 billion of MENA loan growth are mainly driven by oil exporters while oil importers barely saw their deposit and loan bases growing. Not less importantly, the latter's net banking profitability remained under pressure within the context of relatively tough operating conditions in their respective economies underlined by narrowing net interest margins, growing provisioning requirements and slow fee income growth generation at large.

Banking sectors' assets in the Arab MENA region

in US$ billion	Dec-11	Dec-12	Var 12	Var 11
Egypt	216.7	226.6	9.8	-4.3
Jordan	53.2	55.5	2.3	3.8
Lebanon	167.2	181.3	14.1	11.9
Qatar	190.7	225.4	34.7	34.8
Saudi Arabia	411.8	462.4	50.6	34.4
Sudan	17.4	15.2	-2.2	0.2
United Arab Emirates	452.6	487.8	35.3	15.4
Bahrain	67.2	71.5	4.3	1.9
Kuwait	158.3	168.1	9.8	11.1
Oman	47.8	54.4	6.7	7.1
Algeria	119.7	124.2	4.5	11.0
Libya	56.4	65.6	9.2	4.3
Morocco	121.9	133.6	11.7	8.8
Tunisia	43.2	44.6	1.4	1.8
Yemen	8.1	10.7	2.6	-1.0
Arab MENA	**2,132.3**	**2,326.9**	**194.6**	**141.5**

Sources: Central Banks, Bloomberg.

Banking sectors' deposits in the Arab MENA region

in US$ billion	Dec-11	Dec-12	Var 12	Var 11
Egypt	163.9	171.5	7.5	-0.1
Jordan	34.4	35.3	0.9	2.6
Lebanon	138.0	150.1	12.2	9.7
Qatar	99.9	126.0	26.1	15.6
Saudi Arabia	294.3	336.2	41.9	31.7
Sudan	10.5	9.0	-1.4	-0.1
United Arab Emirates	291.3	318.0	26.7	5.5
Bahrain	31.7	34.4	2.7	3.1
Kuwait	109.8	118.6	8.8	8.6
Oman	32.7	36.8	4.2	5.3
Algeria	97.9	102.5	4.7	15.4
Libya	46.5	53.0	6.5	2.4
Morocco	95.1	100.5	5.4	6.2
Tunisia	24.0	25.2	1.2	0.1
Yemen	6.2	8.5	2.3	-0.9
Arab MENA	**1,475.9**	**1,625.4**	**149.5**	**105.1**

Banking sectors' loans in the Arab MENA region

in US$ billion	Dec-11	Dec-12	Var 12	Var 11
Egypt	81.1	81.2	0.1	2.2
Jordan	22.4	25.2	2.8	2.0
Lebanon	48.3	53.9	5.6	5.8
Qatar	110.9	140.1	29.3	24.5
Saudi Arabia	219.9	256.1	36.2	21.8
Sudan	8.6	6.9	-1.7	0.1
United Arab Emirates	291.6	299.3	7.7	10.8
Bahrain	17.1	18.2	1.1	2.0
Kuwait	101.4	103.5	2.1	3.5
Oman	28.1	32.2	4.2	3.2
Algeria	26.4	28.5	2.2	2.2
Libya	10.2	12.5	2.3	-0.2
Morocco	84.1	89.1	5.0	5.1
Tunisia	30.0	30.7	0.7	2.4
Yemen	1.7	1.8	0.1	-0.4
Arab MENA	**1,081.6**	**1,179.3**	**97.7**	**85.1**

Sources: Central Banks, Bloomberg.

In particular, the Egyptian economy, where a number of large Lebanese banks are present, has witnessed a slow recovery from a relatively low base in the previous year. As the local macro environment has been slightly better than that seen in 2011, real GDP reported a growth of 2.0% in 2012 while Egypt's inflation rate dropped to a single digit rate of 8.7% in 2012. But Egypt's financial vulnerabilities have risen owing to a decline in international reserves and an increase in the fiscal deficit. International reserves closed the year at US$ 15.0 billion at end-2012, reporting a yearly decline of US$ 3.1 billion after the drastic decline of the previous year. At the banking sector level, activity has been more or less faring well in a relatively cloudy economic environment, bearing witness to a relative resilience on the overall. Bank assets increased by 4.5% between end-2011 and end- 2012 compared with a nil growth a year earlier. Deposits are up by 4.6% over the same period and loans maintained their previous year's level. While operating conditions are still tough, banks' net profits underwent a relative recovery as the economy emerged gradually from the wider conflicts it had witnessed in 2011.

In Jordan, a combination of a fragile economy coupled with spillover fears from conflict stricken countries have curtailed economic activity, with the most significant impact felt on agriculture and mining and quarrying. Still, real GDP growth reported 3.0% in 2012, from 2.6% in 2011, as per IMF estimates. The economy has mainly benefited from the low base effect in the first half of this year, mainly in the category of trade, restaurants, and hotels. Within this environment, consolidated assets of domestic banks rose slightly by 4.4% between end-2011 and end-2012. Deposits and credit facilities grew by 2.6% and 12.6% over the same period, respectively. Listed Jordanian banks reported a 17.3% rise in profits in 2012, mainly supported by quantity effects stemming from new lending volumes that offset to a certain extent tighter interest margins.

In Syria, another market of Lebanese banks presence in the region, the impact of the strife was heavily felt on the economy which has been bearing the brunt of an exodus of businesses and the depletion of its pre-war enterprise base. A combination of the decline of the Syrian pound, the shortage of basic products and the refugees fleeing the country has depressed private consumption which posted a drop of 16% in 2012 as per the EIU. Gross fixed investment declined by 22% in 2012 from an already low base in 2011. As widespread security drifts practically depleted economic activity throughout Syria, the country's real GDP contracted by 15.2% in 2012 following another decline of 3.4% in 2011, as per the same source. Within this environment, listed banks' activity reported a decline in December 2012 relative to end-2011. Customer deposits edged down by 27.4% in US$ terms. Net loans and advances dropped by 39.7% from end-2011 within the context of weakened economic activity. But Lebanese banks with operations in Syria took all provisions required to cover their Syrian risks, with asset quality figuring on the top of their priorities within a cloudy environment.

In Lebanon, the past year was characterized by a slowdown in the domestic economy amidst local political bickering and regional spillover effects in the realms of investment, trade and tourism, the IMF having estimated Lebanon's real GDP growth at 1.5% for full-year 2012. While the wait-and-see attitude governing investors amidst uncertainties continues to delay major investment decisions, consumption managed to report a "relative" resilience, partly supported by the favorable incoming of Lebanese expatriates and the spending of Syrian refugees.

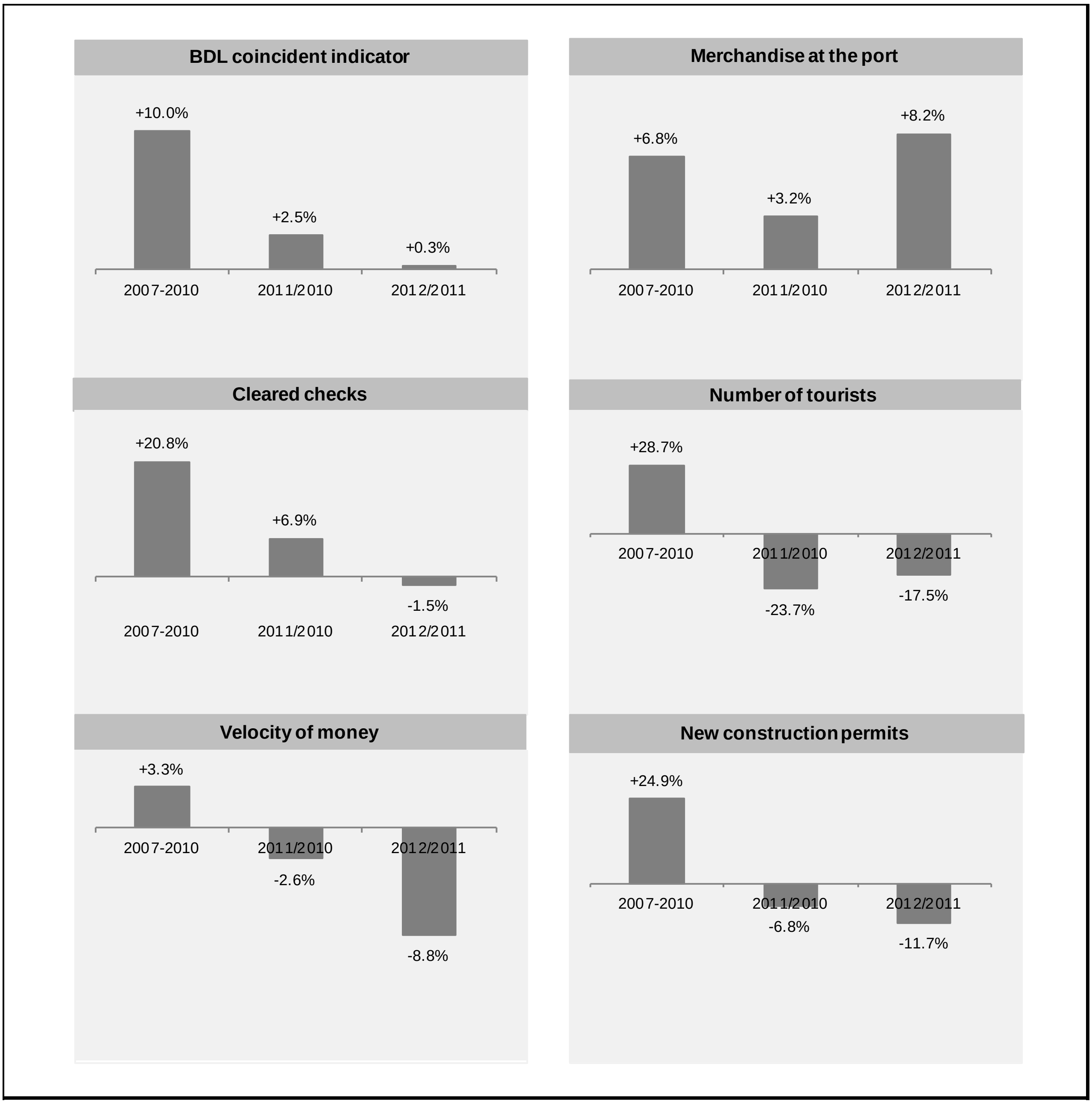
With the totality of inflows towards the Lebanese economy unable to fully offset the country's trade deficit, further pressures were reported on the balance of payments that recorded a deficit of US$ 1.5 billion in 2012, after a circa US$ 2 billion deficit in full-year 2011. At the monetary level, a relaxed mood governed the foreign exchange market throughout the past year. The year's net activity was more to the favor of the Lebanese Pound in 2012, as there were more conversions from foreign currencies to Lebanese Pounds than the opposite since the beginning of the year, with the Central Bank's foreign assets reaching a high of US$ 35.7 billion at its end.

As to Lebanon's capital markets, prices reported a relative standstill while trading volumes continued to contract. The Stock Market price index slightly decreased by 1.6% in 2012, following a reduction of 19.8% in 2011. The market increasingly suffers from weak liquidity and bad efficiency, with the trading volume declining by 20% to reach a new low of 4.1% of market capitalization in 2012. In parallel, the fixed income market reported some fluctuations in bond prices throughout 2012, with the 5-year CDS spreads managing to contract by 17 basis points during the year to reach 455 basis points by end-December, outlining an overall acceptable market perception of sovereign risks at large.

Lebanon's major economic indicators

US$ million	**2011**	**2012**	**Var 12/11**
Macroeconomy			
GDP	39,013	41,345	6.0%
Real GDP growth (%)	1.5%	1.5%	0.0%
GDP per capita (US$)	9,856	10,311	4.6%
Monetary sector			
Var M3	5,085	6,780	33.3%
Velocity	0.65	0.59	-8.8%
Average CPI inflation (%)	5.5%	5.7%	0.2%
Public sector			
Gross domestic debt	32,730	33,300	1.7%
Foreign debt	20,927	24,387	16.5%
Total gross debt	53,657	57,687	7.5%
Gross debt/GDP (%)	138%	140%	2.0%
Deficit	2,341	3,925	67.7%
Deficit/GDP (%)	6.0%	9.5%	3.5%
External sector			
Imports	20,158	21,280	5.6%
Exports	4,265	4,483	5.1%
Trade deficit	15,893	16,797	5.7%
Gross financial inflows	13,897	15,260	9.8%
Balance of payments	-1,996	-1,537	-23.0%

Sources: Lebanon Ministry of Finance, BDL & concerned public & private entities.



Lebanese Banks' Activity

Within this environment, the Lebanese banking sector has faced relatively tough operating conditions in the year 2012 but still managed to achieve acceptable results. The sluggish economic conditions at the global level adversely impacted interest rates that were kept at record low levels within the need to maintain an accommodative stance on behalf of monetary authorities. This meant an extension of the negative carry for Lebanese banks that have significant Libor-related placements in foreign banks. Regionally, the tough post-turmoil operating environment imposed on Lebanese banks with regional presence significant provisioning requirements to face rising uncertainties. Domestically, the economic slowdown had a negative impact on banks balance sheet growth and added to growing pressures on interest margins and fee income, thus putting on hold for the second consecutive year the streak of double digit profit growth that banks knew for almost a decade.

The most important is that Lebanese banks, known for their risk-averse philosophies, were able to sustain an acceptable activity growth, a good financial standing and sound risk exposure and coverage in the face of a deteriorating operating environment. The tougher conditions did not put at stake the banks sound risk profile given the rigorous regulatory framework on one hand and the banks conservative risk management practices on the other hand. The in-depth analysis of the various types of risk from liquidity and sovereign exposure risks to credit and capitalization risks and to profitability and efficiency risks represents henceforth tangible evidence that Lebanese banks continue to be well placed to face unforeseen contingencies.

Consolidated Activity Growth

To start with, consolidated banks' activity managed to pull out an 8.4% year-on-year growth throughout 2012, with total assets reaching US$ 181.3 billion at end-December 2012. Bank deposits, the traditional growth driver for the sector at large, registered a similar 8.8% yearly increase, moving from US$ 138.0 billion at end-December 2011 to a new high of US$ 150.2 billion at end-December 2012. The US$ 12.2 billion in additional deposits at Lebanese banks proved 26.6% higher than that achieved over the previous year. But unlike the previous year, the 2012 deposit growth was more or less equally attributed to additional funds in both local and foreign currencies. About 42% of total deposit growth at Lebanese banks was attributed to local currency funds which grew almost steadily last year. Within this context, banks' deposit dollarization ratio edged down, moving from 69.5% at end-December 2011 to 68.6% at end-December 2012.

The analysis by group of banks according to their size shows that growth was realized at different paces by the different bank groups. Bilanbanques divides the banking sector into four groups by size, the first being the Alpha Group (Banks with customer deposits above US$ 2 billion), then the Beta Group (Banks with customer deposits between US$ 500 million and US$ 2 billion), then the Gamma Group (Banks with customer deposits between US$ 200 million and US$ 500 million) and finally the Delta Group (Banks with customer deposits below US$ 200 million). The fastest activity growth in 2012 was realized by the group of medium sized banks, with the Gamma group displaying a growth rate of 14.8% and the Beta Group reporting a growth of 9.8%, while the Alpha Group grew by 8.4% and the Delta Group contracted by 4.2%. But banking activity continues to be significantly concentrated, with no significant changes in the shares of the different bank groups. The Alpha Group's share remains highly dominant at 87.0% of the sector's assets, followed by the Beta Group with 10.1%, the Gamma Group with 1.5% and the Delta Group with 1.4%.

The analysis of Lebanese banks groups by dollarization ratios suggests that the group of small banks is the most dollarized in terms of deposits and the least dollarized in terms of loans. Deposit dollarization stands at 74.3% for the Delta Group, followed by 68.8% for the Alpha Group, 67.2% for the Beta Group and 64.8% for the Gamma group which had witnessed a higher pace of conversions in relative terms in 2012 from foreign currency holdings to Lebanese Pound holdings. On the other hand, loan dollarization is the largest for the Gamma Group with 85.8%, followed by 82.8% for the Alpha Group, 80.5% for the Beta Group and 48.7% for the Delta Group.

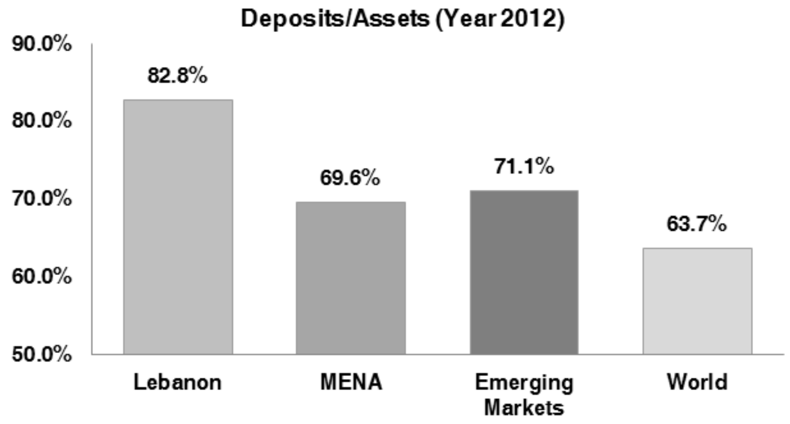
It is worth mentioning that following the gradual increase in the activity of foreign entities in the past years driven by the cross border expansion strategy of banks, mainly in the region, such shares reported a relative standstill in 2011 and 2012. On one hand, a number of markets of presence in the region reported political turmoil with adverse economic spillovers, thus impacting activity growth of Lebanese banks. On the other hand, the expansion strategies of Lebanese banks were somehow put on hold, shifting to a rather wait and see consolidation phase. It is within this context that the share of foreign entities in the consolidated activity remained narrow, accounting for 16.7% of assets at the end of 2012 (16.0% in 2011), 14.4% of deposits (14.1% in 2011), and 21.0% for loans (20.7% in 2011). It is thus evident that despite the important cross border expansion efforts realized over the pre-turmoil years, the domestic component of Lebanon's banking sector activity is still extensively dominant, a feature likely to persist for a while as long as regional uncertainties are lingering and the length of the transition phase is still questionable.

Growth rates of banking aggregates

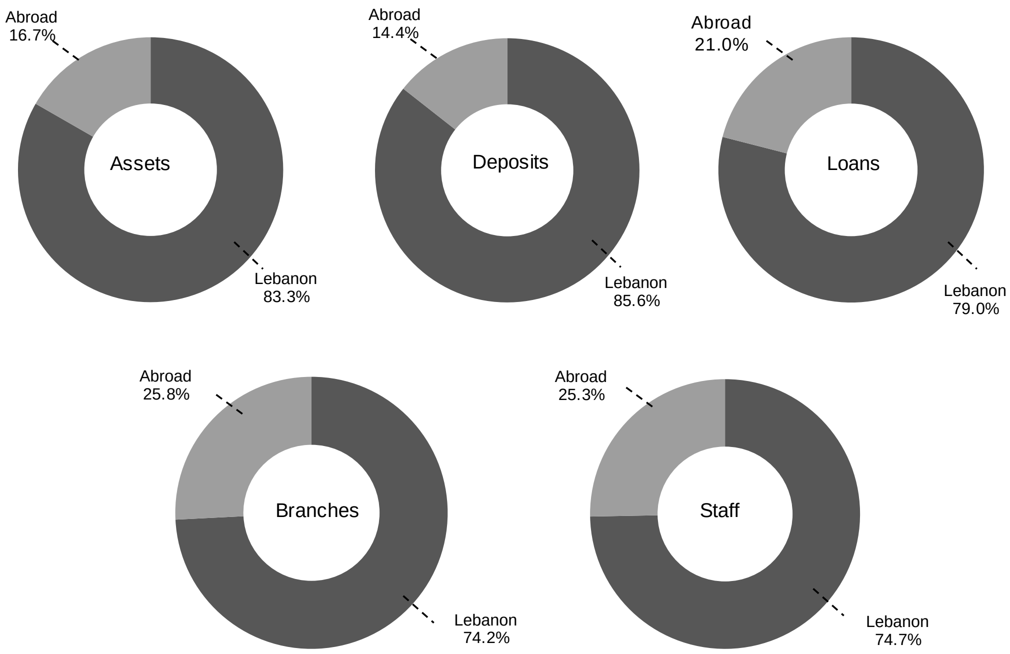
	2007	2008	2009	2010	2011	2012	Var 12/11
Assets	15.0%	12.8%	21.7%	11.9%	7.7%	8.4%	0.7%
Loans to customers	30.7%	24.9%	15.6%	25.2%	13.6%	11.7%	-1.9%
Deposits from customers	16.0%	13.9%	23.4%	12.4%	7.5%	8.8%	1.3%
Shareholders' equity	11.5%	14.7%	24.0%	15.9%	0.0%	12.9%	12.9%
Total L/C openings of the year	42.2%	55.2%	-21.4%	31.2%	-8.5%	-4.6%	3.9%
Net profits for the year	27.2%	26.6%	17.4%	28.6%	-5.1%	7.4%	12.5%

Growth Rates of Lebanese Banks' Groups (Year 2012)

	Alpha	Beta	Gamma	Delta
Assets	8.4%	9.8%	14.8%	-4.2%
Loans to customers	10.6%	19.3%	29.8%	8.1%
Deposits from customers	8.4%	12.1%	16.1%	5.4%
Shareholders' equity	13.0%	15.4%	5.0%	9.2%
Total L/C openings of the year	-7.0%	8.0%	-27.8%	76.8%
Net profits for the year	7.8%	-4.0%	0.6%	52.3%



Geographic Concentration



Liquidity and Sovereign Exposure

Solid liquidity buffers and depositor-based funding support banks' credit profiles and the system's shock absorption capacity. Lebanese banks continue to benefit from a stable deposit base, with a minimal reliance on market funding. Short term, granular customer deposits, which have remained historically stable, continue to make up the bulk of the sector's liabilities, funding approximately 82.8% of total assets as of December 2012 (against a regional average of 69.6% and a global average of 63.7%), supported by a resilient influx of remittances. The flow of remittances, sourced from the Lebanese Diaspora, remained stable over the past couple of years. Remittances that have historically been resilient to Lebanon's various shocks continue to constitute an important driver of deposits, accounting for 20% of Lebanon's GDP.

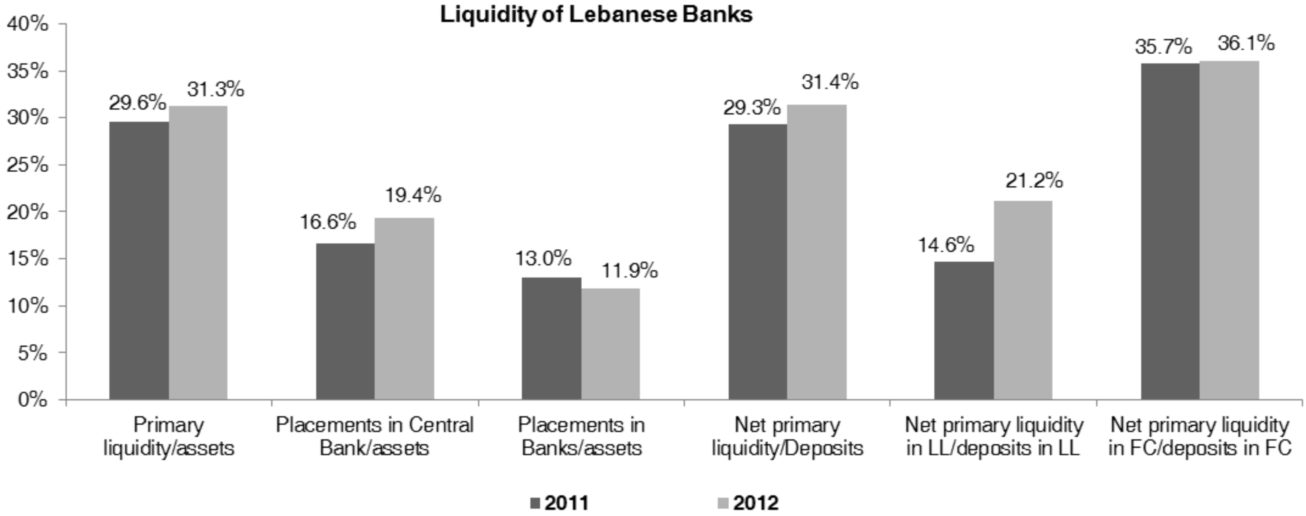
Robust liquidity remains a key strength for the system, as the Central Bank maintains high reserve requirements. Within the context of a low loan-to-deposit ratio standing at 35.9% at end-December 2012, Lebanese banks continue to boast a high primary liquidity ratio. Close to a third of their deposits are covered by readily available funds in the form of placements at the Central Bank and at highly rated banks abroad. Lebanese banks maintain indeed good liquidity buffers, but have reduced placements with foreign banks. Lebanese banks have been repatriating part of their low-yielding placements with international banks in favor of higher-yielding domestic liquidity instruments. The Lebanese banking system maintains substantial buffers to tolerate significant deposit outflows. Moody's argues that on aggregate, BDL's foreign currency reserves and Lebanese banks placements with international banks (which have previously allowed them to service obligations through their foreign branches during periods of extreme domestic disruption) are estimated at 55%-60% of the system's foreign currency deposits.

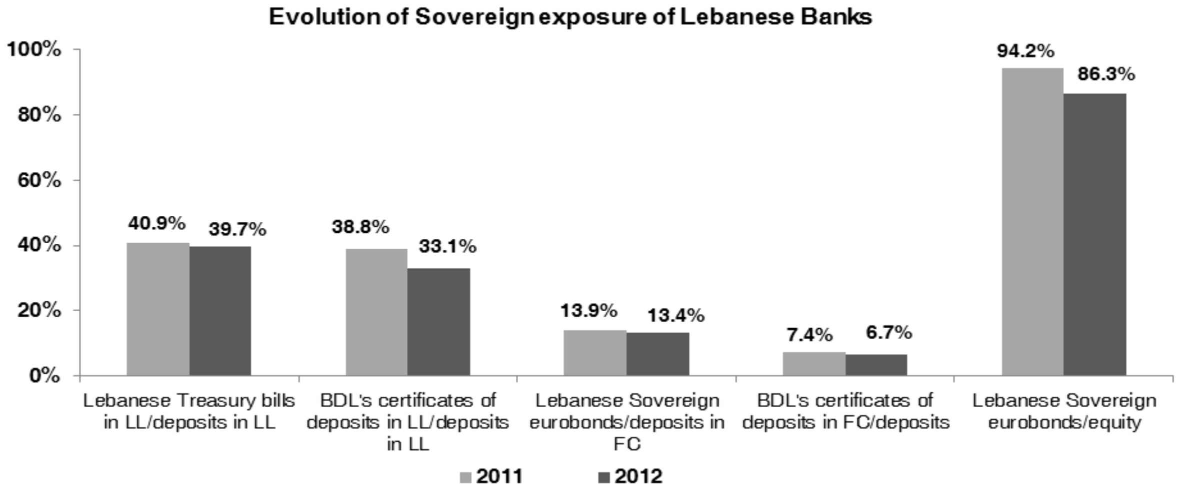
The comparative analysis of liquidity by group of banks in 2012 suggests that the most liquid is the Alpha group with net primary liquidity to customer deposits of 32.4%, followed by the Gamma Group with 25.8%, then the Beta group with 25.0%, while the net ratio for the Delta Group is quite low at 6.5%. In parallel, loans to deposits is the lowest for Gamma banks with 27.4%, followed by Alpha banks with 34.6%, Beta banks with 43.4% and then Delta banks with a ratio as high as 111.9%.

Liquidity of Lebanese Banks' Groups (Year 2012)

	Alpha	Beta	Gamma	Delta
Primary liquidity/assets	**31.7%**	**25.5%**	**38.8%**	**38.2%**
o.w. Central Bank/assets	20.0%	14.9%	18.0%	16.8%
o.w. Banks/assets	11.7%	10.6%	20.8%	21.4%
Net primary liquidity/Deposits	**32.4%**	**25.0%**	**25.8%**	**6.5%**
o.w. net primary liquidity in LL/deposits in LL	22.3%	13.3%	26.9%	-7.2%
o.w. net primary liquidity in FC/deposits in FC	37.0%	30.7%	25.3%	11.3%

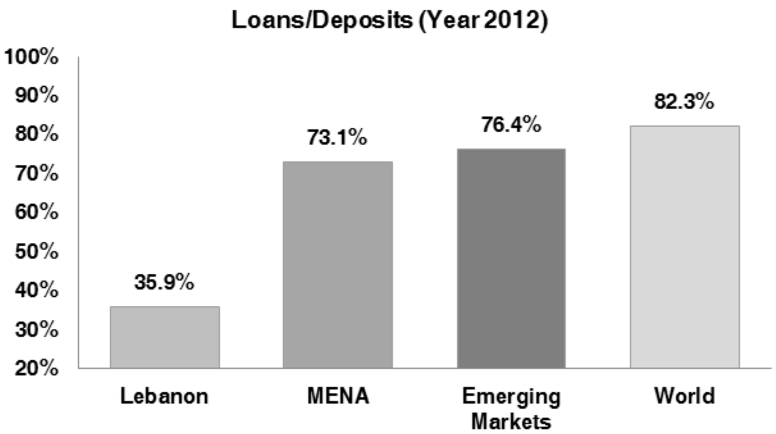
It is worth mentioning as well that banks also continued to ameliorate their sovereign risk profile, as evidenced by declining exposure to the State throughout last year. Though remaining relatively high, the ratio of banks' foreign currency sovereign bond portfolio to their equity base stood at 86.3% at end-December 2012, against 94.2% at end-December 2011. The group of banks with the most significant exposure on the State is the Gamma Group with 146.3% of Lebanese sovereign Eurobonds to their shareholders' equity, followed by the Beta Group with 106.7%, the Alpha Group with 85.6% and the Delta Group with 23.2%.



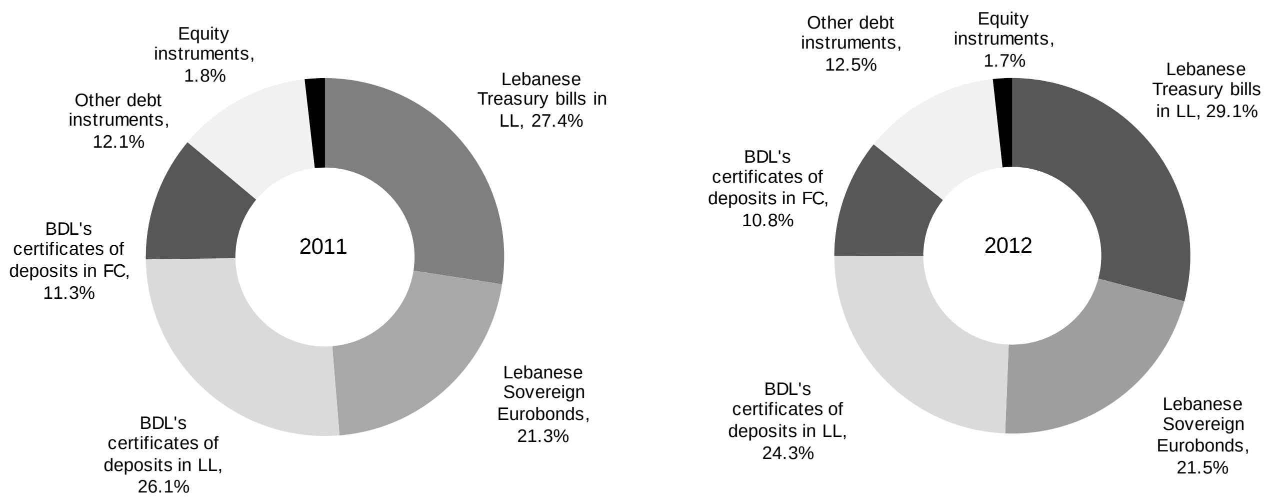


Sovereign exposure of Lebanese Banks' Groups (Year 2012)

	Alpha	Beta	Gamma	Delta
Lebanese Treasury bills in LL/deposits in LL	37.4%	52.8%	69.3%	87.8%
BDL's certificates of deposits in LL/deposits in LL	35.1%	20.1%	20.6%	2.3%
Lebanese Sovereign eurobonds/deposits in FC	12.8%	14.7%	48.7%	22.5%
BDL's certificates of deposits in FC/deposits in FC	7.0%	5.3%	4.1%	0.7%
Lebanese Sovereign eurobonds/equity	85.6%	106.7%	146.3%	23.2%



Portfolio securities breakdown



Lending Quality and Provisioning

In parallel, Lebanese banks saw last year an 11.7 % increase in lending activity, with loans to the private sector reaching a new high of US$ 53.9 billion at end-December 2012 and progressing at a pace almost similar to that of 2011 with a US$ 5.6 billion increase in lending volumes during 2012. The growth in total loans was attributed to foreign currency loans to the extent of 75%, which leaves US$ 1.4 billion in additional lending volumes last year driven by loans in local currency. This falls pretty much in line with the trend observed over the previous couple of years when Lebanese banks, encouraged by the Central Bank's measures aimed at fostering local currency lending, increased their share of LP loans in the total. As a result, the loan dollarization ratio extended its decline, reaching 81.9% at end-December 2012, against 82.6% at end-December 2011. The breakdown of bank loans by type of borrower reveals that corporates accounted for 54% of loans extended in 2012, followed by housing loans with 24% and SME loans with 22%.

The main adverse impact of the regional turmoil was felt on their large net provisions for credit losses which rose to US$ 406 million in 2012, growing by 76.3% from their 2011 level. The prudent provisioning policies of Lebanese banks prompted them to take all needed measures to maintain their good asset quality as their portfolio of gross doubtful loans grew by 13.8% over the year. At the current 79.5% level, the coverage of doubtful loans by loan loss provisions continues to be adequate, although lower than its previous year's level of 81.8%. It is important to mention that the ratio of net doubtful loans to gross loans stood at 1.44% reaching 1.96% when including substandard loans, which still compare favorably to international benchmarks. As to collective provisioning, the ratio of collective provisions to net loans maintained a sound 0.97% by end-2012.

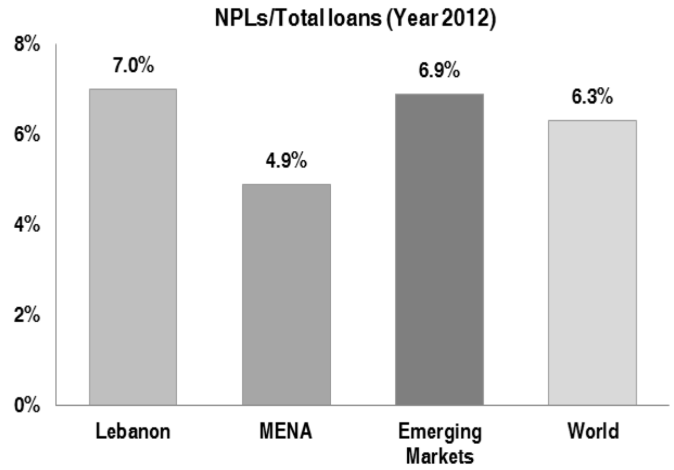
The analysis by group of banks suggests that large banks have the best asset quality. The Alpha group has indeed a ratio of doubtful loans to gross loans of 6.24%, with a coverage ratio by loan loss provisions of 79.1% at year-end 2012. Then comes the Beta group with a doubtful ratio of 7.2% and a provisioning coverage of 83.4%. The Delta Group of banks follows with a high doubtful loan ratio of 20.6%, covered to the extent of 67.2% by loan loss provisions. Last is the Gamma group which has a significant doubtful loan ratio of 35.3% yet coupled with loan loss provision coverage of 87.4%.

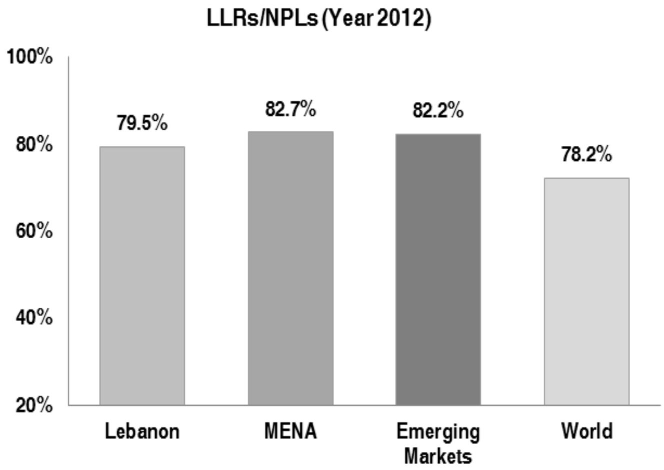
Asset Quality of Lebanese Banks

	2007	2008	2009	2010	2011	2012	Var 12/11
Doubtful loans/Gross loans	13.9%	10.7%	9.5%	7.3%	6.9%	7.0%	0.1%
Substandard loans + doubtful loans/Gross loans	15.7%	12.0%	10.4%	8.2%	7.7%	7.7%	0.0%
Net doubtful loans/Gross loans	2.1%	1.3%	1.1%	1.2%	1.2%	1.4%	0.2%
Loan loss reserves on doubtful /Doubtful loans	84.7%	87.7%	88.8%	83.2%	81.8%	79.5%	-2.3%
Net doubtful loans/Equity	6.6%	4.4%	3.2%	4.0%	4.6%	5.2%	0.6%

Asset Quality of Lebanese Banks' Groups (Year 2012)

	Alpha	Beta	Gamma	Delta
Doubtful Loans/Gross loans	6.2%	7.2%	35.3%	20.6%
Substandard Loans + Doubtful Loans/Gross loans	6.8%	8.5%	36.5%	22.4%
Net Doutful Loans/Gross loans	1.3%	1.2%	4.4%	6.8%
Loan Loss Reserves on Doubtful Loans/Doubtful Loans	79.1%	83.4%	87.4%	67.2%
Net Doubtful Loans/Equity	4.7%	6.0%	8.2%	12.4%





Capital Adequacy and Solvency

Lebanese banks have reinforced their capitalization status over the past year, with a 13% growth in shareholders' equity leading to a rise in the equity to assets ratio to 8.8% at end-December 2012, against 8.5% at end-December 2011. A related measure is the ratio of shareholders' equity to net loans and which stood at 29.7% for Lebanon's banking sector at end-2012 against a regional average of 23.1% and a global average of 15.2%. At the mirror image of Lebanon's banking sector capitalization is the leverage ratio of average assets to average equity. While leverage slightly rose from 11.38 in 2011 to 11.55 in 2012, comparative analysis suggests that Lebanese banks have still acceptable leverage relative to international benchmarks. Reflecting an adequate coverage of the aggregation of credit, market and operational risks, the Lebanese banks consolidated Basle II capital adequacy ratio reported 12.91% at end-2012, against 11.75% at end-2011. Despite the growth in risk weighted assets by 6.5% in 2012 within the context of a 60.0% share of risk weighted assets in total assets, the persistently sound capital adequacy ratio comes within the context of a strong growth in shareholders' equity over the year. The rise in the total capital ratio was actually driven by an increase in the common Tier 1 ratio from 8.67% to 9.09%, an increase in the additional Tier 1 ratio from 2.38% to 2.83% and a rise in the Tier 2 ratio from 0.69% to 0.99% over the past year.

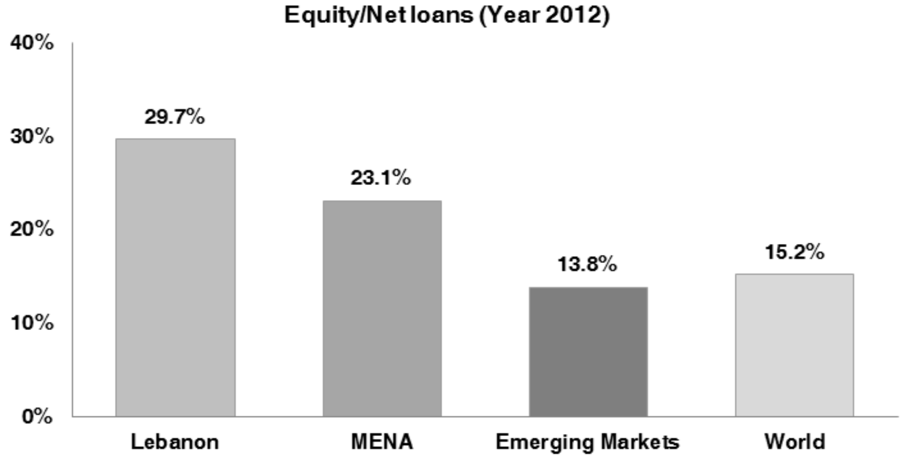
When looking at individual bank groups, it looks like small banks are better capitalized than large banks relative to the risk weighted size of their activity. While Alpha and Beta Groups reported Basle II ratios of 12.5% and 12.4% respectively, the Gamma and Delta Groups reported levels of 18.2% and 37.8% respectively in 2012. Likewise, while Alpha and Beta Groups reported equity to asset ratios of 8.6% and 7.9% respectively, the Gamma and Delta Groups reported levels of 13.3% and 25.3% respectively in 2012.

Capitalization of Lebanese Banks

	2007	2008	2009	2010	2011	2012	Var 12/11
Capital adequacy (as per Basel II requirements)	12.7%	12.0%	12.8%	13.1%	11.7%	12.9%	1.2%
Equity to assets	8.5%	8.6%	8.8%	9.1%	8.5%	8.8%	0.4%
Leverage	11.6	11.7	11.5	11.1	11.4	11.6	0.2

Capitalization of Lebanese Banks' Groups (Year 2012)

	Alpha	Beta	Gamma	Delta
Capital Adequacy (as per Basel II requirements)	12.5%	12.4%	18.2%	37.8%
Equity Assets	8.6%	7.9%	13.3%	25.3%
Leverage	11.9	13.0	7.2	4.2



Banking industry 2012: an analysis of activity performance, risk profile and return indicators

Profitability and Efficiency

Within this environment, the Lebanese banking sector witnessed a year of challenging operating environment in 2012 characterized by persistently narrow banking margins in a prolonged low interest rate environment globally, growing provisioning requirements amidst regional uncertainties, and a weaker fee income generation capacity in a slow domestic economic growth context. Still, as the downward pressures on banks' revenue base and the growing provisioning charge requirements were partly offset by the quantity-effect tied to satisfactory lending activity growth, the sector managed to report a 7.4% growth in consolidated net profits on a yearly basis in 2012 following a decline of 5.1% in 2011.

In details, amidst low interest rates domestically and globally, Lebanon's banks continued to face tight spread conditions, with spreads and interest margins almost stable at their lows of 1.95% and 2.04% respectively. In parallel, the ratio of their non-interest income to total income managed to rise slightly from 34.3% in 2011 to 35.7% in 2012, raising the ratio of non interest income to average assets from 1.01% to 1.08% and yielding a rise in asset utilization from 2.94% to 3.03%. Amid an increasingly burdening operating environment, Lebanese banks implemented further cost efficiency measures that helped them control their cost bases at large. Such cost containment efforts, based on few internal optimization initiatives, allowed them to maintain the ratio of operating expenses to average assets at 1.52% and their cost to income ratio at 50.1% in 2012. It is worth mentioning that Lebanese banks cost to income ratios compare favorable to those of regional peers despite the liquidity drag on their operating income. The analysis of cost efficiency by group of banks suggests that the most efficient group is that of large banks with an average cost to income ratio of 47.9%, followed by Delta banks with 62.9%, Beta banks with 65.3% and then Gamma banks with 67.1%. Likewise, cost to average assets is the lowest in the Alpha Group at 1.45%, followed by the Beta Group at 1.79%, the Gamma Group at 2.10% and the Delta Group at 3.26%. In other words, cost efficiencies are positively correlated with the size of banks, especially at the level of large banks that enjoy considerable economies of scale.

Within the context of lower profit growth rates than those of total activity, return ratios registered a slight drop in 2012 relative to the previous year. As a matter of fact, the return on average assets reported 1.06% last year (1.08% in 2011) while the return on average equity reached 12.3% (13.4% for the return on average common equity). Still, these remain very acceptable by today's regional and international standards, especially when considering the relatively tough banking operating conditions, domestically, regionally and internationally.

The analysis of profitability by group of banks suggests that bank spreads and interest margins are somehow inversely related to the size of banks. The Alpha and Beta Groups of large and medium sized banks indeed displayed the lowest spread of 1.93% and 1.92% respectively in 2012. On the other side of the spectrum stand the Gamma and Delta Groups of banks which displayed spreads of 2.49% and 2.92% respectively. Alpha and Delta banks are the most diversified in terms of business lines and corollary non-interest income contribution. Aside from Delta banks that reported a 43.7% ratio of non-interest income to total income, the Alpha banks reported a high ratio of 36.4% in 2012, while the Beta banks reported 30.0%, and the Gamma banks averaged a mere 20.5%. Having said that, the large banks continue to be the most profitable in terms of net returns, i.e the ratios of their net profits relative to their total asset or equity bases. The return on average equity is the highest for Alpha banks with 13.0%, while Beta banks reported 9.5%, Gamma banks 7.3% and Delta banks 5.8% in the same year. The return on average assets is the highest for Delta banks with 1.38%, followed by the Alpha banks which reported a ratio of 1.10%, while Gamma banks displayed a ratio of 1.01%, and Beta banks reported 0.73% over the year 2012.

Evolution of Return Ratios of Lebanese Banks

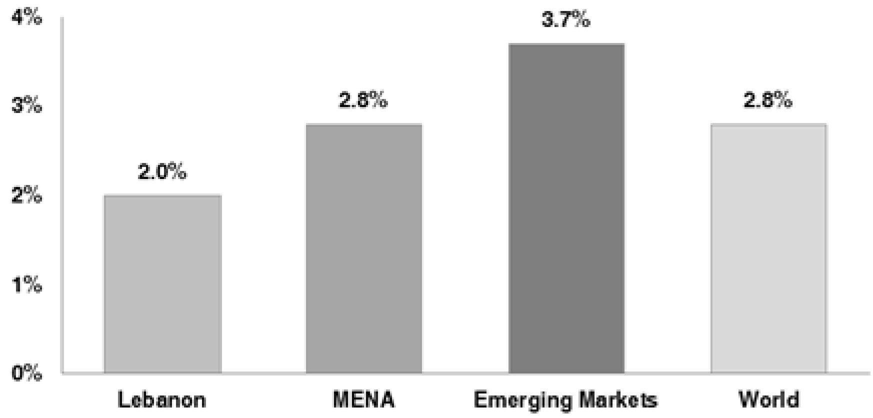
	2011	**2012**	**Var 12/11**
Yield on earning assets	5.4%	5.5%	0.1%
o.w. in LL	*6.9%*	*7.2%*	*0.2%*
o.w. in FX	*4.7%*	*4.8%*	*0.1%*
- Cost of earning assets	3.4%	3.5%	0.1%
o.w. in LL	*4.6%*	*4.9%*	*0.3%*
o.w. in FX	*2.8%*	*2.8%*	*0.0%*
= Interest margin	2.0%	2.0%	0.0%
o.w. in LL	*2.3%*	*2.2%*	*-0.1%*
o.w. in FX	*1.9%*	*1.9%*	*0.0%*
x Average interest earnings/Average assets	94.9%	95.6%	0.7%
o.w. in LL	*94.9%*	*95.5%*	*0.5%*
o.w. in FX	*94.9%*	*95.6%*	*0.7%*
= Spread	1.9%	1.9%	0.0%
o.w. in LL	*2.2%*	*2.1%*	*-0.1%*
o.w. in FX	*1.8%*	*1.9%*	*0.1%*
+ Non interest income/Average assets	1.0%	1.1%	0.1%
= Asset utilization	2.9%	3.0%	0.1%
x Net operating margin	36.6%	35.0%	-1.6%
o.w. cost to income	*49.8%*	*50.1%*	*0.3%*
o.w. credit cost	*4.9%*	*7.7%*	*2.8%*
o.w. other provisions	*0.4%*	*-0.2%*	*-0.6%*
o.w. tax cost	*8.3%*	*7.4%*	*-0.9%*
= ROAA	**1.1%**	**1.1%**	**0.0%**
x Leverage	11.4	11.6	0.2
= ROAE	**12.3%**	**12.3%**	**0.0%**

Banking industry 2012: an analysis of activity performance, risk profile and return indicators

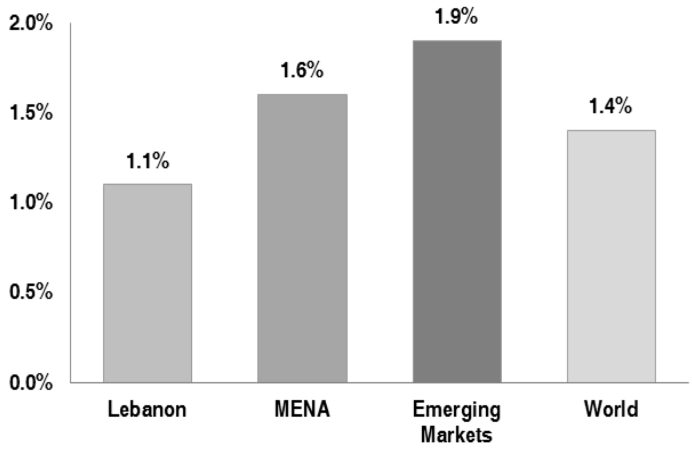
Profitability of Lebanese Banks' Groups (Year 2012)

	Alpha	Beta	Gamma	Delta
Spread	1.93%	1.92%	2.49%	2.92%
Interest margin	2.01%	2.02%	2.57%	3.15%
Non interest income/total income	36.4%	29.9%	20.5%	43.7%
ROAA	1.10%	0.73%	1.01%	1.38%
ROAE	13.0%	9.5%	7.3%	5.8%

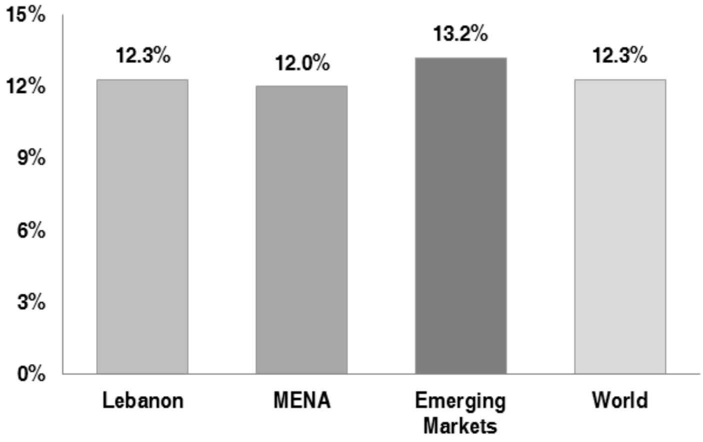
Net interest margin (Year 2012)



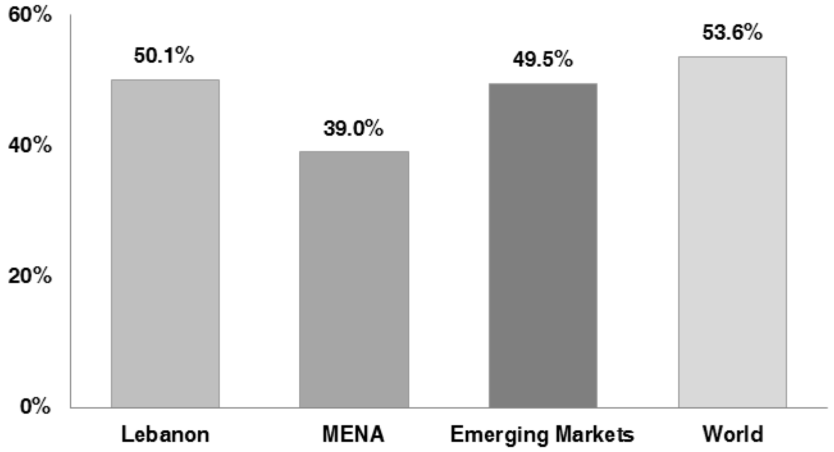
Return on average assets (Year 2012)



Return on average equity (Year 2012)



Cost to income (Year 2012)



Management efficiency of Lebanese Banks

	2007	2008	2009	2010	2011	2012	Var 12/11
Cost per average branch (US$ million)	1.42	1.65	1.73	1.87	1.88	2.02	0.1%
Staff expenses per average staf (US$ 000s)	36.5	40.5	40.5	42.2	43.0	45.2	2.2%
Staff expenses /general operating expenses (%)	53.1%	53.9%	53.6%	54.0%	55.6%	54.1%	-1.5%
Cost to income (%)	54.0%	52.9%	51.9%	48.2%	49.8%	50.1%	0.3%
Cost to average assets (%)	1.52%	1.64%	1.54%	1.52%	1.47%	1.52%	0.1%

Management efficiency of Lebanese Banks' Groups (Year 2012)

	Alpha	Beta	Gamma	Delta
Cost per average branch (US$ million)	2.12	1.48	1.74	2.70
Staff expenses per average staf (US$ 000s)	46.7	36.4	49.0	45.7
Staff expenses to general operating expenses (%)	54.0%	53.2%	62.4%	54.0%
Cost to income (%)	47.9%	65.3%	67.1%	62.9%
Cost to average assets (%)	1.45%	1.79%	2.10%	3.26%

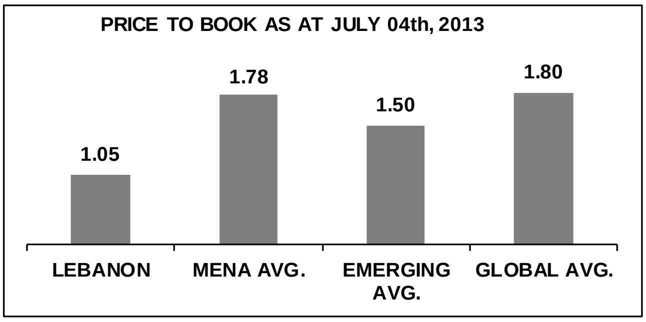
Investment Considerations

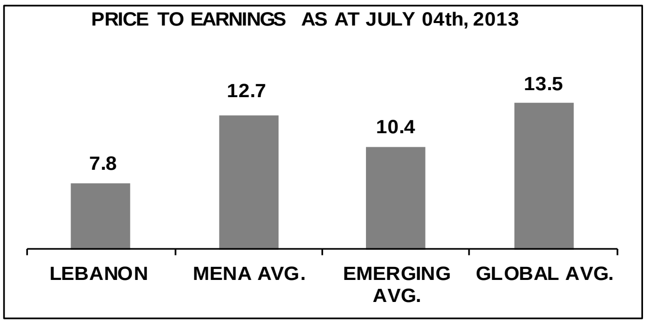
As Lebanese banks realized additional share issuances throughout the year and further reinforced their equity base, the common shares outstanding -including GDRs- posted a 6.1% increase. Within this context, the common earnings per share ratio of Lebanese banks on a consolidated basis almost stagnated relative to the year 2011. Higher share capital, reserves and retained earnings led the common book per share ratio to grow by 5.3% year-on-year.

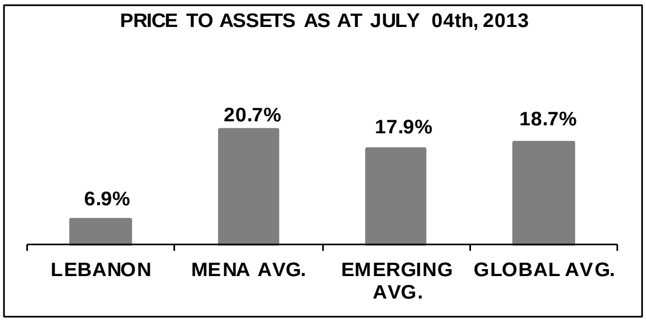
Lebanese banks continued to offer investors attractive dividend payouts last year. As a matter of fact, the common pay out ratio almost stood still, reaching 28.7% in 2012, slightly dropping from a high of 30.7% in the previous year given the relatively recovering profit base in

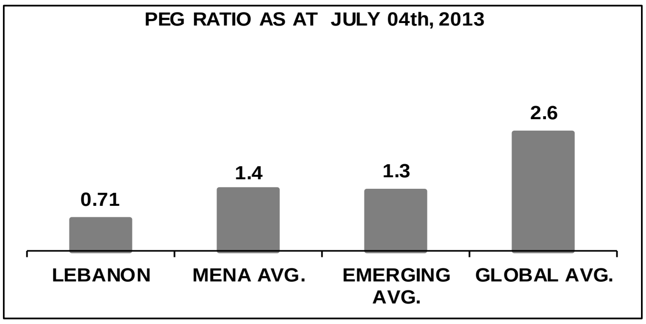
2012. Nonetheless, the sector reported an increase in preferred dividend payments of 18.9% year-on-year amid new preferred shares issuances. The total payout ratio, including preferred shares, thus practically stood at its previous year's level, reaching 36.5% in 2012.

The sector is maintaining relatively high dividend yields within the context of a domestic equity market continuing to suffer from a lack of liquidity and efficiency, with a turnover ratio at a very low level of 4.1% in 2012 and a BSE price index dropping by a further 1.6% following a 19.8% contraction in the previous year. The average dividend yield on banking stocks for large listed Lebanese banks (common and preferred altogether) reached 5.6% in 2012, much higher than the banking sector average for emerging markets (3.5%) and almost twice higher than the global banking sector average (2.9%).









Sources: Bloomberg, Zawya Investor, Citigroup, IMF, Beirut Stock Exchange, Bank Audi's Group Research Department

Banking industry 2012: an analysis of activity performance, risk profile and return indicators

With fundamentals remaining quite healthy and the domestic stock exchange suffering from low turnover, Lebanese banks continue to trade at a significant discount relative to regional and international peers. In this sense, they offer relative value in the global banking universe. For instance, the large listed Lebanese banks' average P/E ratio stood at 7.8x at the closing of July 04, 2013, against an average of 12.7x for MENA banks, and broad market averages of 10.4x for emerging countries and 13.5x for the world average. Similarly, they trade at an average P/BV of 1.05x, against much higher regional and international benchmarks in the 1.50x-1.80x range, and at a price to assets ratio of merely 6.9%, against similar averages in the 18%-21% range. The average PEG ratio, measuring current P/Es over the average EPS per annum growth of the past five years, reflects as well relative value on a global scale. The Lebanese PEG ratio stands at 0.71x on average, trading at a 45%-50% discount relative to MENA banks and emerging markets and at a circa 70% discount to global market stocks.

Lebanese banks' story is not just one of attractive dividend payouts and enticing valuation ratios though. It is true that the current unsettled politico-security conditions domestically as well as in a few countries of presence of Lebanese banks abroad are dampening activity growth and revenue generation. But banks' fundamentals and financial soundness with high liquidity and a solid funding profile, favorable asset quality and adequate capitalization not only ensured they weathered turbulences relatively well, but also provides a lot of room for healthy financial intermediation and growth prospects both in the domestic market and in under-banked regional countries in the period ahead.

Concluding Remarks

In sum, Lebanese banks have fared well the adverse operating conditions that have been prevailing in their different markets of presence, maintaining their adequate financial standing and continuing to grow at relatively lower but still satisfactory levels. The past year's deteriorating operating environment in the countries where Lebanese banks are present actually constitutes another proof of the strong foundation and the sound practices of Lebanese banks and added to the various episodes of resilience that Lebanese banking has born witness to over the past decades.

It is yet worth mentioning that opportunities for cross border banking expansion were limited, pushing banks to hold back their aggressive expansion strategies abroad and rather move into consolidation strategies. They had to move into wait and see strategies in the markets that witnessed adverse conditions in regional countries in turmoil. On the other hand, other mostly resilient regional countries continued to have significant barriers to entry in the face of new comers. Outside the region, the relatively weak economic post crisis recovery kept the banking operating environment relatively depressed, discouraging expansionary initiatives of Lebanese banks. Still, a kind of breakthrough in the current atypical environment was reported by few expansions undertaken here and there on behalf of Lebanese banks, looking quite promising on the overall as their fundamental rationale rests on solid ground and appears attractive and enticing.

An assessment of the current positive and negative risk drivers of Lebanon's banking system is actually key to evaluating the outlook of Lebanese banking at large. At the level of strengths actually rises the deposit-based funding outlining deposit-rich banks, the sizeable liquidity buffers at all times, the strict regulatory framework praised by all international reference institutions, the banks' historically proven ability to overcome severe systemic shocks and the banks universal banking profile covering the various facets of banking services. At the level of weaknesses, we mention the challenging operating conditions, characterized by depressed business sentiment, slow economic growth and growing provisioning requirements, the Lebanese banks' large exposures to the Lebanese highly indebted sovereign, and the larger banks' regional exposures to countries under turmoil or indirectly impacted by the Arab turmoil.

But we believe that opportunities outweigh risks at the horizon. The banks recent business and financial performances clearly reveal the banks' capacity to develop, expand, improve and diversify, even in the most atypical operating environments witnessed in decades. Lebanon's banks that have succeeded in their business line diversification policies and that strengthened significantly their support functions are apt to well benefit from a trend reversal in their operating environment where the upside for their activity prospects is undeniably enticing and lucrative. As soon as the global and regional situation settles downs and the outlook becomes clearer, Lebanese banks are apt to reinforce their strategy of business development and overseas expansion in the aim of further expanding their franchises in existing or new markets within the region or outside it.