

Flash Note

April 18, 2011

Lebanese Banking Sector

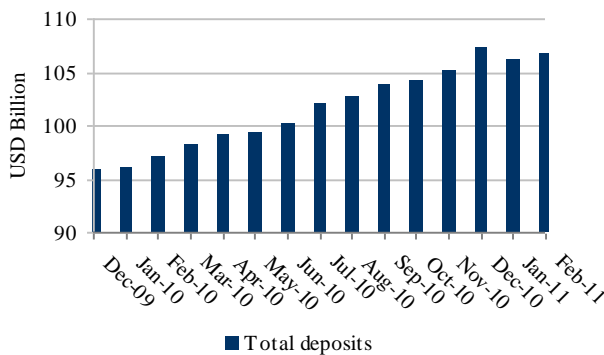
Sector: Banking

Country: Lebanon

Recent data from the Central Bank highlights a standstill in banking aggregates into February 2011

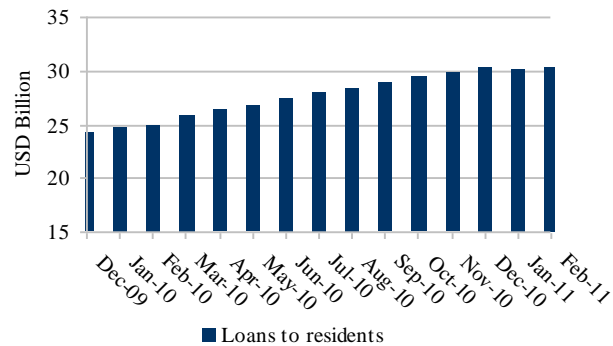
The consolidated balance sheet of commercial banks in Lebanon saw yoy growth in banking aggregates although reached a standstill in the first two months of 2011 over December 2010. Private sector deposits fell slightly to \$106.8 billion in February 2011 from \$107.2 billion in December 2010, and compared to \$97.1 billion in February 2010. While deposits have remained relatively unchanged over the two month period, the sector saw its currency makeup change with some conversions to the USD from LBP. The level of dollarization in resident private sector deposits increased to 65.6% in February from 63.2% in December. The Governor of the Central Bank expects deposits to grow by 7% this year, satisfying funding needs to private and public sectors. Loans to residents inched up to \$30.4 billion in February 2011 from \$30.3 billion in December 2010, although up a solid 22% yoy from \$25 billion in February 2010.

Figure 1: Lebanese Commercial Banks' total deposits



Source: Banque du Liban

Figure 2: Lebanese Commercial Banks' loans to residents

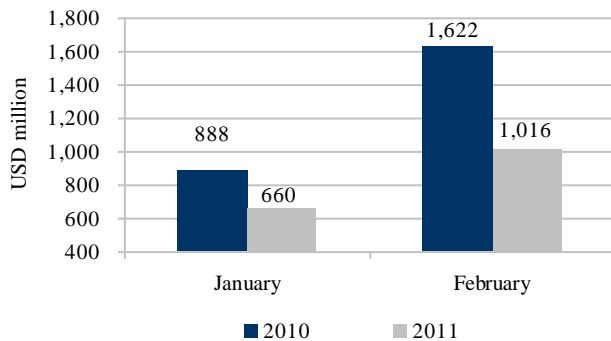


Source: Banque du Liban

Potential for tighter interest spreads as banks compete for deposits given lower financial inflows

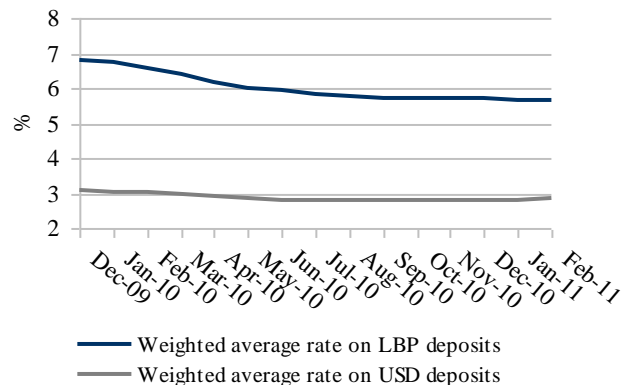
Interest rate spreads on LBP accounts fell to 1.60% in February 2011, as compared to 1.64% in January, and roughly flat from 1.59% in December 2010. On USD accounts, spreads were unchanged in February 2011 at 1.67% vs. December 2010 although down mom from 1.75% in January 2010. There are indications that some banks are raising cost of funds as they compete for lesser dynamic deposit activity, which could impact spreads for the market in 2011. Deposits are tied to financial inflows that enter the country, and based on the balance of payments and foreign trade information from the Lebanese Central Bank, we deduce that financial inflows have been down significantly as compared to the first two months in the corresponding period in 2010.

Figure 3: Financial inflows in January and February: 2010 vs. 2011



Source: Banque du Liban

Figure 4: Cost of funds in LBP and USD



Source: Association des Banques du Liban

Expect banking sector operating income to see pressures from soft banking activity and lessened impact from portfolio gains

We expect the standstill in banking aggregates coupled with flat interest margins so far into February to provide indication for decelerating loan and interest income growth on a yoy basis in Q1/2011, although flat on a qoq basis. The Lebanese banking sector saw solid gains from financial instruments in 2010, and we expect this trend will moderate this year given the sharp recovery in capital markets over the past couple years. More recently, rates on bank deposits at the BdL, Lebanese Treasury Bills and Eurobonds which generally make up the majority of bank portfolios, have remained relatively unchanged since December 2010. A marked slowdown in banking activity coupled with difficult comparisons on solid portfolio gains in 2010 will likely pressure operating income for the banking sector in Q1/2011.

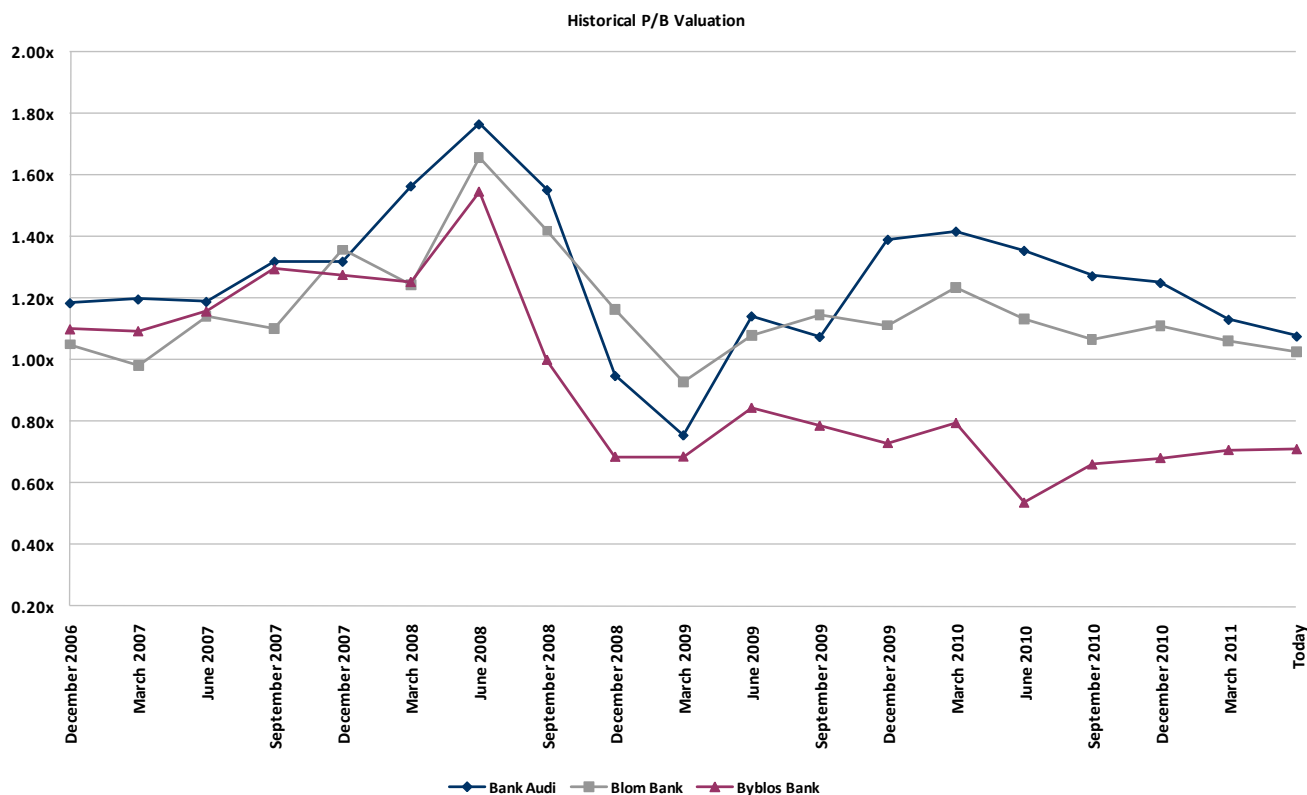
Lebanese Central Bank Governor denounces additional banks are on a U.S. Treasury watch list

Lebanese Central Bank Governor Riad Salameh assured participants at a Lebanese Saudi Forum earlier this month that Lebanese banks were safe and denied rumors that a second Lebanese bank was under review. The U.S. Ambassador to Lebanon Maura Connelly reiterated to the Association of Banks in Lebanon that its government was not targeting the Lebanese banking sector, rather in protecting its territory from illicit activities, whereby Lebanese Canadian Bank was an isolated case. The Central Bank will continue to implement international standards, domestic controls, and enforcement mechanisms, while also continuing to support the real economy by incentivizing banks to make low interest loans in certain segments including to SMEs.

Political unrest and unfounded negative newsflow has brought bank shares to more attractive valuation levels

The unfolding of political developments in the region and in Lebanon, coupled with the action taken by the U.S. Treasury on LCB and ensuing unfounded market rumors regarding the targeting of other banks, has brought bank shares to more attractive valuations as compared to their historical trends. Bank Audi, Blom Bank, and Byblos Bank have seen their price to book fall to 1.08x, 1.03x, and 0.71x, respectively on the listed shares (1.13x and 1.11x on the Audi and Blom GDRs, respectively). We also recognize Bank Audi shares' convergence to Blom Bank shares' valuation on a P/B and dividend yield basis so far this year as compared to last year (current dividend yield of 5.6% for Bank Audi vs. 5.2% for Blom Bank on the listed shares, 5.4% and 4.8% on the respective GDRs).

Figure 5: Historical P/B valuation for Bank Audi, Blom Bank and Byblos Bank (listed shares on the BSE)



Source: Zawya, Company Reports, FFA Private Bank, Beirut Stock Exchange

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