



Update for Q3 2012

Sector: Banking

Country: Jordan

Date: December 10, 2012

Share Price (JOD): 6.86

Target Price (JOD): 8.00

Upside: 16.6%

Recommendation: ACCUMULATE

Risk: Medium (Market)

### Maintaining an ACCUMULATE rating and a lower Target Price of JOD 8.00 per share on higher risk premium

#### Double digit expansion in earnings led by interest income growth

Arab Bank Group posted a net income of USD 484.5 million for the first 9 months of 2012, a 13.0% y-o-y increase in profitability as per our expectations. Despite turbulent market conditions, the bank was able to benefit from a 5.3% increase in its net interest income, along with an impressive 10.8% growth in the group's share of profits from associates. This resulted in an increase in operating income of 7.0% while operating expenses expanded by 5.0%.

#### Performance for 2012 hinges on provisioning with the bulk taken in Q4

Despite Arab Bank's solid performance over the last several years, the aggressive rise in provision levels has left a large dent in profits, leaving investors wary of possible further losses. So far in 2012, provisions taken on impaired loans have equaled USD 132 million, a 23.6% y-o-y decline and an encouraging sign that these levels might be set to normalize. Previously however, the majority of annual provisions taken had been reported during the fourth quarter, making the year-end period critical in truly assessing the improving credit quality of Arab bank's outstanding loans. We estimate a slight increase in fourth quarter provisions of 3%, which translates into USD 270 million of provisions, leading to a net loss of USD 110 million. This will result in a USD 16 million improvement versus 2011's year ending quarter.

#### Lingering US Lawsuit vs. Arab Bank Group finally dismissed

The United States court for the Eastern District of New York granted Arab Bank's motion for summary judgment and dismissed the Mati Gill v. Arab Bank case. Despite Arab Bank's ongoing denial of all claims, the accusations and trial had been constantly looming in the background, creating a negative impression among potential investors. Focus now will return to the bank's performance and future strategy.

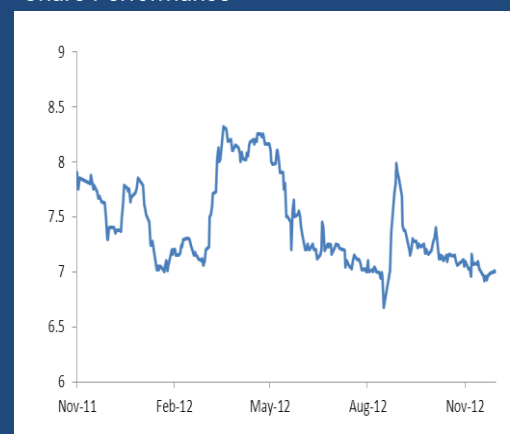
#### Political turmoil to impact share value as foreign investments dwindle

As long as the Jordanian government continues to struggle with the burden of higher energy prices and a weakening underlying economy, the risk of anti-government protests escalating into a more serious conflict will persist. For this reason we raised our discount rate from 12.68% to 13.74% in order to account for the additional risk premium. We still perceive Arab Bank Group as a well-diversified regional institution rather than a Jordanian Bank, but it currently makes up about 25% of the Jordanian stock exchange. The lack of liquidity and appetite for foreign investors to take on exposure to Jordanian equities will no doubt affect its share price. We therefore maintain our ACCUMULATE rating, with a lower target price of JOD 8.00.

#### Share Data

Bloomberg Symbol	ARBK.JR
Reuters Symbol	ARBK.AM
Market Cap (JODm)	2,428
Number of Shares (m)	534
Free Float	46.0%
Price-to-Earnings 12e	15.06
Price-to-Book 12e	0.65

#### Share Performance



1 Month Return	-1.50%
3 Month Return	-10.8%
6 Month Return	-4.80%
12 Month Return	-5.40%
52 Week Range	6.68 – 8.32

#### Performance and Forecasts

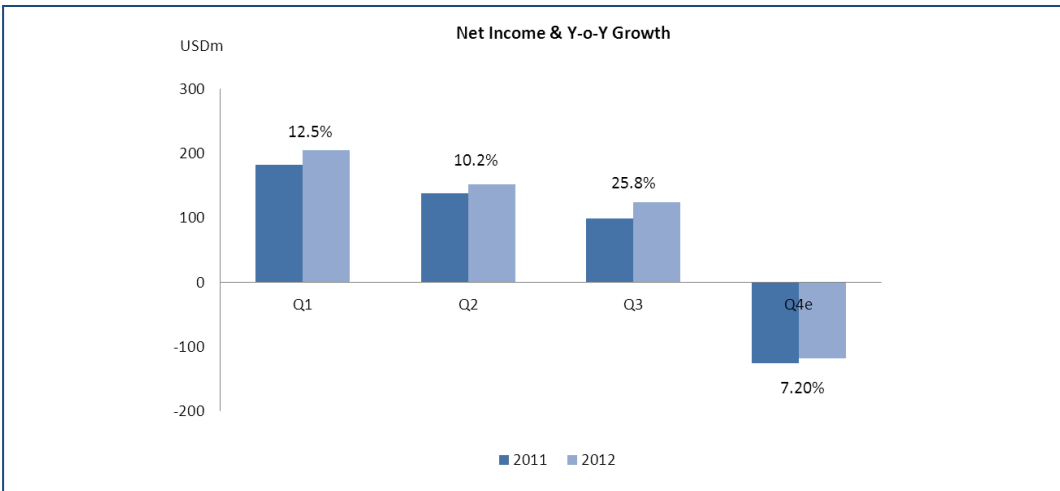
Contact Information:

Equity Analyst: Majed Rachidi  
majed.rachidi@blominvestbank.comHead of Equities: Issa Frangieh  
issa.frangieh@blominvestbank.comHead of Research: Marwan Mikhael  
marwan.mikhael@blominvestbank.com

(USD millions)	2010	2011	2012e	2013f	2014f	2015f
Net Interest Income	933	957	1,007	999	1,076	1,165
Net Income	271	306	374	420	513	607
EPS (USD)	0.47	0.55	0.67	0.75	0.91	1.08
BVPS (USD)	14.32	14.01	15.20	15.26	16.38	17.74
ROA (%)	0.60	0.67	0.82	0.87	1.00	1.11
ROE (%)	3.54	4.09	4.51	5.01	5.69	6.23

**Double digit expansion in earnings led by interest income growth**

Arab Bank group posted a net income of USD 484.5 million for the first 9 months of 2012. As per our expectations, this was a 13.0% y-o-y increase in profitability. Despite turbulent market conditions, the bank was able to benefit from a 5.3% increase in its net interest income generated, along with an impressive 10.8% growth in the group’s share of profits from associates. All this resulted in an increase in operating income of 7.0%, reaching USD 1,329.2 million compared to USD 1,245.9 million during this period in 2011, while operating expenses expanded by 5.0%.

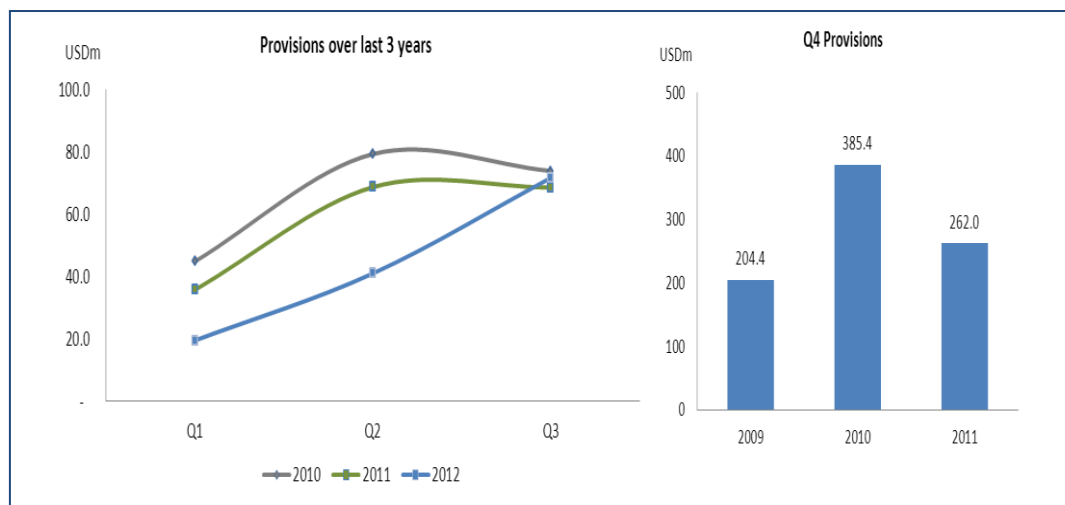


Source: Arab Bank

**Provisions remain key to improving performance**

Despite Arab Bank’s solid performance over the last several years, the aggressive rise in provision levels has left a large dent in profits, leaving investors wary of possible further losses. Through 2012, provisions taken on impaired loans witnessed a y-o-y decline of 23.6%, an encouraging sign that these levels might be set to normalize while raising expectations for further improvements going forward.

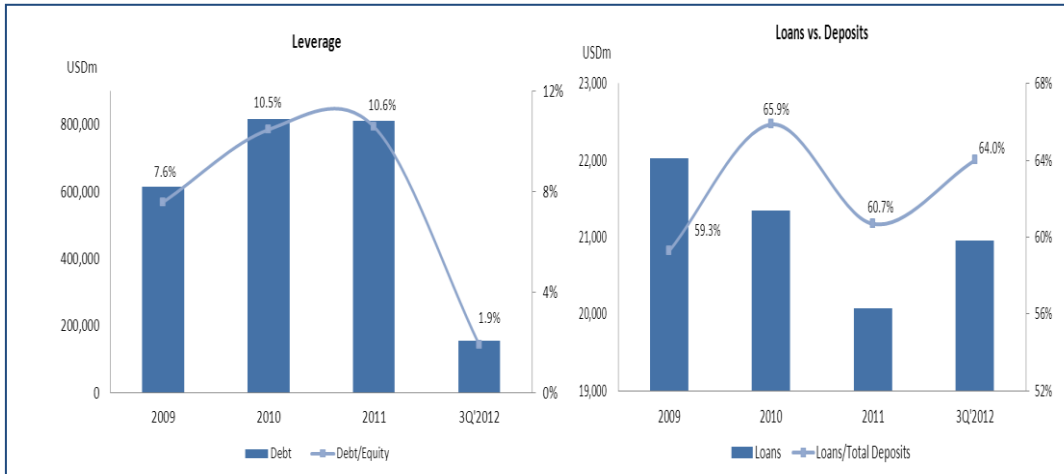
The large majority of provisions taken over the last several years have been during the fourth quarter. This makes the year-end period critical in truly assessing the improving credit quality of Arab bank’s outstanding loans. However, larger than expected provisions during the third quarter of 2012 have raised questions over whether the improved first half performance was the start of a new trend or an aberration.



Source: Arab Bank

**Ongoing trend of lower debt continues as USD 500 million syndicated loan matures**

Assets through the first three quarters of 2012 have slightly contracted, decreasing by 0.9% due to a reduction in the cash amounts held with other banks and financial institutions. Those funds have been used to pay down the majority of the bank’s outstanding debt, with borrowed funds declining by over USD 650 million, an 80.7% drop as management continues to maintain low leverage levels. The majority of this was due to the maturity of a USD 500 million syndicated term loan that Arab Bank had acquired in 2007 through its external banking unit in Bahrain.



Source: Arab Bank

**Attractive credit growth along with customer deposit resilience**

Direct credit facilities showed attractive growth, expanding by 4.4% y-o-y to reach USD 21 billion while customer deposits were resilient, posting a y-o-y expansion of nearly 1% despite the current deterioration in the Jordanian economic and political conditions. This has led to an increase in the bank’s loans to total deposits ratio to 64% as of 30 September 2012, while it stood at 60.7% at the end of 2011. Arab Bank has acted as a safe haven bank during previous crises, and we expect this to be reflected in increasing customer deposits if conditions worsen.

**Lingering US lawsuit finally dismissed**

The United States District Court for the Eastern District of New York granted Arab Bank’s motion for summary judgment and dismissed the Mati Gill v. Arab Bank case. Mati Gill was found unable to prove that the bank was responsible for injuries he sustained in 2008 from gunshots fired from Gaza into Israel. Despite Arab Bank’s ongoing denial of all claims, the accusations and trial had been constantly looming in the background, creating a negative impression among potential investors. Focus now will return to the bank’s performance and future strategy as it should.

## VALUATION

As the Arab spring continues to spread throughout the region, reality has set in concerning the chaos and instability that accompany revolutions. Despite the perceived democratic achievements the people are striving for, investors are inherently risk-averse, and local stock markets have felt the brunt of the unfolding uncertainty. As long as the Jordanian government continues to struggle with the burden of higher energy prices and a weakening underlying economy, the risk of anti-government protests escalating into a more serious conflict will persist. For this reason we raised our discount rate from 12.68% to 13.74% in order to account for the additional risk premium. We still perceive Arab Bank Group as a well-diversified regional institution rather than a Jordanian Bank, but it currently makes up about 25% of the Jordanian stock exchange. The lack of liquidity and appetite for foreign investors to take on exposure to Jordanian equities will no doubt affect its share price.

We therefore maintain our ACCUMULATE rating, but lower our target price for ARBK to JOD 8.00 from JOD 8.96 a share using a Dividend Discount Model (DDM) method based on a 5-year forecast with the following assumptions:

### Discount Rate

We used a WACC of 13.47% for the purpose of valuing ARBK's equity derived as follows:

$$\begin{aligned} \text{WACC} &= (\text{Weight of Equity} * \text{Cost of Equity}) + (\text{Weight of Debt} * \text{Cost of Debt}) * (1 - \text{Tax Rate}) \\ &= (0.98 * 13.65\%) + (0.02 * 5.0\%) * (1 - 30.0\%) = 13.47\% \end{aligned}$$

$$\begin{aligned} \text{ARBK Cost of Equity} &= \text{Risk-Free Rate} + (\text{Beta} * \text{Market Risk Premium}) \\ &= 8.50\% + (1.14 * 4.50\%) = 13.65\% \end{aligned}$$

- We used a Risk-Free Rate of 8.50% represented by the 5-year Treasury bond recently issued by the Jordanian government. This captures the additional risk of investing in a developing country such as Jordan as opposed to the U.S. Treasury.
- ARBK's beta over the past 10 years is estimated at 1.14. This is a measure of the share volatility against the Amman Stock Exchange, of which Arab Bank share make up about 25% of total market capitalization.
- A Market Risk Premium of 5.10% is the result of the difference between the expected return of investing in the Amman Stock Exchange, estimated at 13.00%, and the Risk-Free Rate of 8.50%. This represents the premium investors expect to gain for realizing the additional risk of investing in securities.

### Calculating Dividends and Share Value

With regards to the cash dividends, Arab Bank follows an established policy of distributing between 20-30% of its share's par value. In 2011, the Board of Directors recommended the distribution of cash dividends of 25% of par, or JOD 133.5 million, compared to 20%, or JOD 106 million for the year 2010. We forecast periodic growth in this policy, mirroring expected improvements in earnings and overall performance.

In JODm	2012e	2013f	2014f	2015f	2016f	2017f
Net Income (Att. To Shareholders)	253	283	346	410	478	554
Payout Ratio (%)	53.5	56.5	46.3	45.6	39.1	38.5
Dividends	133	160	160	186	186	213
PV of Terminal Value	3,519					
PV of Dividends & Terminal Value	3,652	141.2	124.4	127.9	112.7	113.6
<b>Estimated Fair Value (Sum of PV)</b>	<b>4,273</b>					
Outstanding Shares (in millions)	534					
Dividend per Share (in JOD)	0.25	0.30	0.30	0.35	0.35	0.40
Growth (%)	0.0	20.0	0.0	16.7	0.0	14.3
<b>Fair Value per Share (in JOD)</b>	<b>8.00</b>					

Source: BlomInvest

As for the Terminal Growth Rate, we assumed a 5.0% growth rate for dividends beyond 2017. We believe this is an adequate level considering the bank's ability to grow along with the current inflation rates in the region.

### Sensitivity Analysis

Terminal Growth Rate	Discount Rate				
	11.5%	12.5%	<b>13.5%</b>	14.5%	15.5%
4.0%	9.56	8.26	7.25	6.44	5.77
4.5%	10.18	8.73	7.60	6.71	5.99
<b>5.0%</b>	10.90	9.25	<b>8.00</b>	7.02	6.24
5.5%	11.74	9.85	8.45	7.37	6.51
6.0%	12.73	10.54	8.95	7.75	6.81

Source: BlomInvest

## PROJECTED INCOME STATEMENT

<i>USDm</i>	2010	2011	2012e	2013f	2014f	2015f
Interest Income	1,568	1,624	1,776	1,769	1,973	2,205
Interest Expense	635	667	770	770	897	1,247
<b>Net Interest Income</b>	<b>933</b>	<b>957</b>	<b>1,007</b>	<b>999</b>	<b>1,076</b>	<b>1,389</b>
Commission Income	303	322	330	349	370	395
Commission Expense	(17)	(19)	(26)	(21)	(22)	(23)
<b>Net Commission Income</b>	<b>287</b>	<b>303</b>	<b>316</b>	<b>328</b>	<b>348</b>	<b>371</b>
Other Revenue	171	99	145	143	152	162
<b>Net Revenue</b>	<b>1,391</b>	<b>1,359</b>	<b>1,468</b>	<b>1,471</b>	<b>1,576</b>	<b>1,698</b>
Loan Impairment Loss/Provision	(473)	(435)	(403)	(357)	(308)	(253)
<b>Net Revenue After Provisions</b>	<b>917</b>	<b>924</b>	<b>1,066</b>	<b>1,113</b>	<b>1,268</b>	<b>1,445</b>
Non-Interest Expense	(717)	(723)	(783)	(779)	(836)	(900)
<b>Operating Income</b>	<b>199</b>	<b>202</b>	<b>283</b>	<b>334</b>	<b>433</b>	<b>545</b>
Profits from Associates	248	266	291	279	300	323
<b>Pretax Income</b>	<b>447</b>	<b>468</b>	<b>574</b>	<b>613</b>	<b>732</b>	<b>867</b>
Income Tax Expense	(177)	(162)	(200)	(193)	(220)	(260)
<b>Net Income</b>	<b>271</b>	<b>306</b>	<b>374</b>	<b>420</b>	<b>513</b>	<b>607</b>
Minority Interest	(20)	(14)	(19)	(21)	(26)	(30)
Gain from discontinued Operations	-	-	-	-	-	-
<b>Net Income Att. to Shareholders</b>	<b>251</b>	<b>292</b>	<b>356</b>	<b>399</b>	<b>487</b>	<b>577</b>

Source: Arab Bank, BlomInvest

## PROJECTED BALANCE SHEET

<i>USDm</i>	2010	2011	2012e	2013f	2014f	2015f
<b>Assets</b>						
Cash and Due from Central Bank	7,645	7,788	8,472	8,370	8,891	9,485
Due from Banks	4,800	4,261	4,183	4,480	4,756	5,070
Direct Credit Facilities	21,347	20,955	20,745	22,321	23,710	25,293
Total Investments	7,915	9,129	8,941	9,068	9,632	10,275
Investments in Subsidiaries/Associates	2,078	2,245	2,222	2,356	2,521	2,697
Other Assets	1,478	1,236	1,232	1,592	1,688	1,795
<b>Total Assets</b>	<b>45,263</b>	<b>45,613</b>	<b>45,796</b>	<b>48,188</b>	<b>51,198</b>	<b>54,615</b>
Due to Banks	4,950	4,323	3,718	3,867	4,021	4,182
Due to Customers	27,455	28,745	29,255	31,010	33,026	35,338
Cash margin	3,182	2,975	3,352	3,453	3,556	3,663
Borrowed funds	817	810	157	160	163	166
Other liabilities	1,049	1,103	1,020	1,309	1,427	1,517
<b>Total Liabilities</b>	<b>37,453</b>	<b>37,956</b>	<b>37,502</b>	<b>39,798</b>	<b>42,194</b>	<b>44,867</b>
<b>Total Equity (att. to shareholders)</b>	<b>7,648</b>	<b>7,482</b>	8,119	8,148	8,749	9,475
Minority Interest	161	174	175	241	256	273
<b>Total Equity</b>	<b>7,809</b>	<b>7,657</b>	<b>8,294</b>	<b>8,389</b>	<b>9,004</b>	<b>9,748</b>
<b>Total Liabilities &amp; Equity</b>	<b>45,263</b>	<b>45,613</b>	<b>45,796</b>	<b>48,188</b>	<b>51,198</b>	<b>54,615</b>

Source: Arab Bank, BlomInvest

**BLOMINVEST BANK s.a.l.**

Research Department  
Verdun, Rashid Karamah Str.  
POBOX 11-1540 Riad El Soloh  
Beirut 1107 2080 Lebanon

Tel: +961 1 747 802  
Fax: +961 1 737 414  
[research@blominvestbank.com](mailto:research@blominvestbank.com)

**For your Queries:**

Marwan Mikhael, Head of Research  
[marwan.mikhael@blominvestbank.com](mailto:marwan.mikhael@blominvestbank.com)  
+961 1 991 784 Ext: 360

Issa Frangieh, Head of Equities  
[issa.frangieh@blominvestbank.com](mailto:issa.frangieh@blominvestbank.com)  
+961 1 991 732 Ext: 361

Majed Rachidi, Equity Analyst  
[majed.rachidi@blominvestbank.com](mailto:majed.rachidi@blominvestbank.com)  
+961 1 991 732 Ext: 369

**Equity Rating Key**

Recommendations are based on the upside (downside) between our 12-month Fair Value estimate and the current Market Price.

- Buy:** Fair Value higher than Market Price by at least 20%  
**Accumulate:** Fair Value higher than Market Price by 10% to 20%  
**Hold:** Fair Value ranges between -5% to +10% in relation to Market Price  
**Reduce:** Fair Value lower than Market Price by 5% to 15%  
**Sell:** Fair Value lower than Market Price by at least 15%

Risks are based on share price volatility along with qualitative factors such as the nature of the business, the country risk and sensitivity to a single event, single product or single buyer. We've arranged the risk factor into 5 trenches:

- High Risk
- Medium-to-High Risk
- Medium Risk (similar to Market Risk)
- Medium-to-Low Risk
- Low Risk

**IMPORTANT DISCLAIMER**

This research is based on current public information that we consider reliable, but we do not represent it is accurate or complete, and it should not be relied on as such.

Blom Bank SAL or Blom Invest SAL can have investment banking and other business relationships with the companies covered by our research. We may seek investment banking or other business from the covered companies referred to in this research.

Our salespeople, traders, and other professionals may provide oral or written market commentary or trading strategies to our clients and our proprietary trading desks that reflect opinions that are contrary to the opinions expressed in this research. Our asset management area, our trading desks and investing businesses may make investment decisions that are inconsistent with the recommendations or views expressed in this research.

We and our affiliates, officers, directors, and employees, excluding equity analysts, will from time to time have long or short positions in, act as principal in, and buy or sell, the securities or derivatives (including options and warrants) thereof of covered companies referred to in this research.

This research is not an offer to sell or the solicitation of an offer to buy any security in any jurisdiction where such an offer or solicitation would be illegal. It does not constitute a personal recommendation or take into account the particular investment objectives, financial situations, or needs of individual clients. Clients should consider whether any advice or recommendation in this research is suitable for their particular circumstances and, if appropriate, seek professional advice. The price and value of the investments referred to in this research and the income from them may fluctuate.

Past performance is not a guide to future performance, future returns are not guaranteed, and a loss of original capital may occur. Certain transactions, including those involving futures, options, and other derivatives, give rise to substantial risk and are not suitable for all investors. Fluctuations in exchange rates could have adverse effects on the value or price of, or income derived from, certain investments.

Copyright 2012 BlomInvest SAL.

No part of this material may be copied, photocopied or duplicated in any form by any means or redistributed without the prior written consent of Blom Invest SAL.