The Lebanese Banking Industry in 2014: Sound and Moderate Growth

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The Lebanese banking sector was presented with many challenges in 2014. Not only did this sector have to deal with the ongoing repercussions from the Syrian spillovers, but it also had to manage a context where domestic growth is subdued and below potential, the security situation is fragile and the political deadlock is reigning. The list of challenges grows taller when we add the juggling act that banks have to do between profit making and new, stricter compliance rules.

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Solid Consolidated Activity

In spite of the numerous challenges, Lebanese banks achieved good results on all key parameters. The consolidated balance sheet of commercial banks at the end of the year 2014 revealed a 9.3% year-on-year (y-o-y) growth in total assets to $217.5B. Both the domestic and the foreign activity of Lebanese banks progressed during 2014. Domestically, Lebanese banks registered a 7.7% growth while foreign activity grew by 17.1%, owing to the successful expansion led by Lebanese banks abroad.

Lebanese commercial banks still benefitted from the loyal depositor base as shown by the 8.7% increase in total customer deposits to $174.28B. Customer deposits are a key pillar on which the banking sector relies on since they represent around 80% of total assets. The growth in domestic deposits was less pronounced during 2014 but the level of domestic deposits remains sound and capable of financing the private and the public sectors. Deposits denominated in Lebanese pounds grew by 7.1% in 2014 while deposits denominated in foreign currency grew by 9.1%, bringing the dollarization ratio of deposits higher in 2014.

However, lending activity proved to be slower in 2014 than it was in 2013. Net loans and advances to customers grew by 11.5% in 2014 to $67.99B, a slower growth when compared to the 15% rate recorded back in 2013. Lending in foreign currency represented 77% of the total while domestic currency lending accounted for the remaining 23%. The slower lending activity goes hand in hand with the slower overall economic growth.

Albeit slower overall, growth in lending was registered across various segments. Loans extended to the commercial real estate segment grew by 43.8% while the growth in housing loans followed suit with 17.8%, retail loans with 16.4%, loans to Small and Medium Enterprises (SMEs) with 12.2% and corporate loans with 3.2%. Corporate loans still take up the largest share of 39% in the overall loan portfolio of banks, followed by loans to SMEs with a share of 18%, Housing loans with a share of 14%, retail loans with a share of 12% and loans secured by commercial real estate with a share of 9%.

As for lending to the public sector, Lebanese banks reduced their exposure to the sovereign in 2014. The banks' foreign currency sovereign bond portfolio reached 0.86x total equity in 2014 as opposed to 1.01x in 2013. This was due to lower sovereign exposure combined with an increase in the banks' own equity.

Asset Quality Was Maintained in 2014

The Central Bank's stimulus packages benefitted housing loans the most. In fact, housing loans grew by 38.8% from 2012 to 2014, a growth rate that exceeds the total loan growth. However, loan affordability has deteriorated since loan maturities extended from an average of 30 months prior to 2009 to more than 50 months in 2014 pushed up by the maturity of retail loans that exceeded 70 months.

The quality of assets held by Lebanese banks was maintained in 2014. The growth in gross doubtful loans of 6.8% was slower than the 10.6% growth in total gross loans. Accordingly, gross doubtful loans, before deducting specific provisions and interest in suspense, represented only 6.58% of total gross loans in December 2014 as opposed to 6.81% in December 2013.

The largest banks are the ones with the highest asset quality. According to Bilanbanques, the Alpha Group (Group of Lebanese banks with customer deposits over $2B) registered the lowest doubtful loans to gross loans ratio of 5.76%, followed by the Beta group (Group of Lebanese banks with customer deposits between $500M and $2B) with a share of 8.07%. The ratio of doubtful loans to gross loans stood at 31.82% for the Gamma Group (Group of Lebanese banks with customer deposits between $200M and $500M) and 20.12% for the Delta Group (Group of Lebanese banks with customer deposits under $200M).

Lebanese Banks Well Equipped for All Potential Scenarios

The Lebanese banking system also benefits from a large financial flexibility which is revealed by its ample liquidity. Lebanon's commercial banks have low leverage as shown by the loans to deposits ratio of 38.56%, well below the regional average of 72.9% and a global average of 83.6%. Primary liquidity, which refers to the funds readily available and that are placed with the Central Bank and banks abroad accounted for around 32.2% of total assets in 2014 compared to 30.7% in 2013.

Should operating conditions deteriorate, Lebanese banks are equipped with the necessary buffers to weather stressful periods. According to the 2015 edition of Bilanbanques, Lebanese banks' international placements and securities as well as the Central Bank's foreign currency reserves make up around 55% of the system's foreign currency deposits which alleviates any liquidity concerns.

Robust Capital Adequacy, Higher Profits and Stable Return Ratios

Another element in favor of the soundness of the Lebanese banking sector is the higher capitalization seen in 2014. The banks' shareholders' equity grew by 10.8% from $17.8B at end December 2013 to $19.7B at end December 2014. The growth in shareholders' equity even outpaced that of total bank activity which lifted the equity to assets ratio from 8.9% in December 2013 to 9.1% in December 2014, one of its all-time highs.

According to Bilanbanques, the higher capitalization reinforced the capital adequacy of Lebanese banks since credit, market and operational risk are all soundly covered by the shareholders' own funds. The total Basel II capital adequacy ratio registered 14.61% at the end of December 2014 compared to 14.23% in 2013 well above the minimum requirement.

The profitability of Lebanese banks improved in 2014. The consolidated net profits of Lebanese banks grew by 9.7% in 2014 from $1.89B in 2013 to $2.07B in 2014. The higher net profit came about as the 9.3% growth in net operating income outpaced the 8.6% growth in operating expenses. The net operating income itself was boosted by the 9.4% growth in net interest income and an 11.9% growth in net fee and commission income.

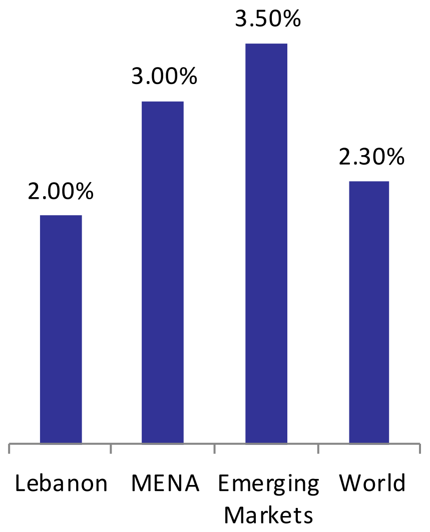
There was little gap between the growth in profits and the growth in total assets and equity which allowed for the return ratios to stabilize in 2014. Similarly to 2013, the return on average assets (ROAA) was around 0.99% in 2014 and the return on average equity stood 11%. Should interest rates increase in the US, Lebanese banks will benefit from rising spreads and interest margins which could in turn generate higher profits.

Although return ratios were stable in 2014, they remain below global and regional levels. The ROAA of 1% registered in Lebanon is lower than the MENA's average of 1.6%, the emerging markets' average of 1.9% and the global average of 1.6%. As for the ROAE which stood at 11% in 2014, it was below the MENA's average of 12.3%, the emerging markets' average of 16.9% and the average global return of 15%. This is mainly explained by the high liquidity ratios kept by Lebanese banks in order to face any potential shock scenario.

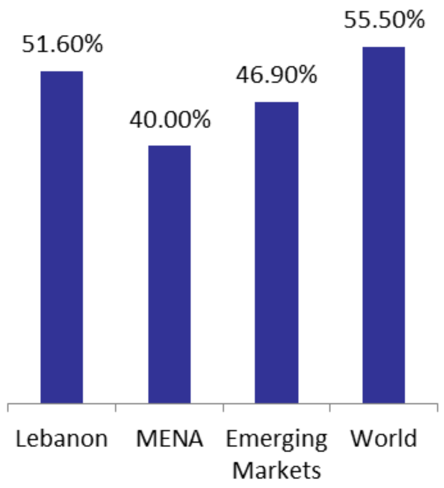
In terms of cost to income, Lebanon outperformed the global benchmark but not the regional and emerging one. The cost to income ratio of Lebanese banks stood at 51.6% in 2014 compared to 40% in the MENA region, 46.9% in emerging markets and 55.5% globally. It is important to note that the cost to income ratio in the region is pressured down by the behavior of depositors who do not take interest on their deposits in order to comply with the Islamic sharia.

The large banks, i.e. the Alpha Group displayed the highest cost efficiency since they benefit from economies of scale. The Alpha Group registered a cost to income ratio of 49.92% while the BETA Group followed with a ratio of 62.99%, Delta Banks with a share of 64.67% and Gamma Banks with a share of 69.21%.

Net Interest Margin



Cost to Income Ratio

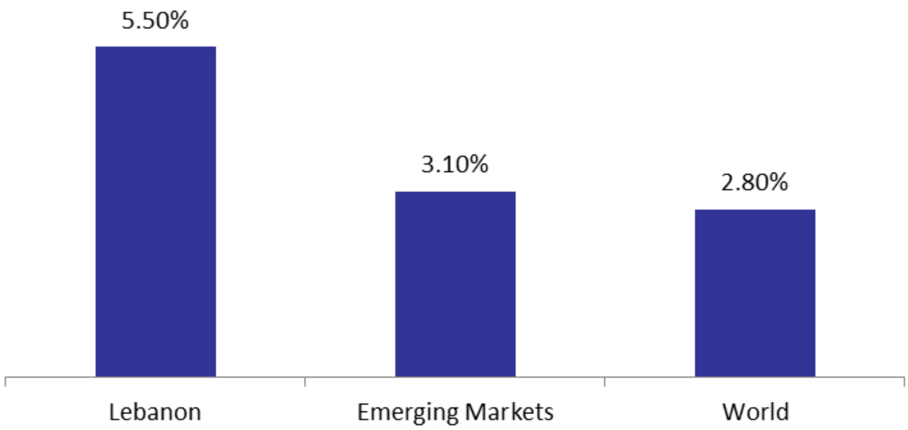


Source: Bilanbanques, 2015 Edition

Lebanese banks issued more capital in 2014. Common shares outstanding rose by 1.6% in 2014 and preferred shares outstanding by 1.3%. With the growth in profits outpacing the growth in share issuance, Lebanese banks' common earnings per share rose by 6.4% to reach LBP 680.

In spite of a subdued activity on the Beirut Stock Exchange, shareholders were still compensated in 2014. The turnover on the BSE was quite low at $619M and accounts for only 5.9% of total market capitalization and equity prices grew by a minor 0.6% in 2014. Despite all of this, dividends distributed to common shareholders grew by 2.6% and those distributed to preferred shareholders grew by 10.7%.

Average Dividend Yield on Banking Stocks (Listed and Preferred Shares)



Source: Bilanbanques, 2015 Edition

The banking sector has proved its resiliency amidst tough operating environments. The sector still enjoys a loyal depositor base and continues to assume its function of financier for both the private and public sectors. Lebanese banks have maintained sound liquidity levels and adequate capitalization and still managed to generate profits and compensate shareholders.

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