LEBANON BANKING SECTOR REPORT

A LUCRATIVE YEAR FOR LEBANESE BANKS THAT STRENGTHENED THEIR ACTIVITY FUNDAMENTALS AND RISK METRICS

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- A satisfactory activity growth in a tough operating environment

Consolidated assets of Lebanese banks increased from US$ 228 billion at end-December 2015 to US$ 241 billion at end-December 2016, i.e. a growth of 5.9%. The growth in volume proved around 30% higher than the one registered during the previous year and in line with the rise seen on average in the last five years. This performance was nonetheless impacted by the 10.6% nominal decline in foreign activity as a result of the depreciation of respective currencies in main markets of presence which reflected on the conversion of these assets within the overall consolidation. As such the share of foreign entities declined in 2016 to the benefit of the share of domestic entities in the overall consolidated balance sheet (from 18.1% to 15.2%), again as a result of foreign currency translation movements and thus not tied to pressures on foreign operations, as most of the business in the latter is denominated in local currencies and has witnessed healthy growth.

- Lebanese banks still maintaining sound liquidity status

As banks partly resorted to their placements at foreign banks to engage in the Central Bank's financial engineering operations, core primary liquidity in foreign banks fell from 8.75% of assets in December 2015 to 7.93% of assets in December 2016. But when adding foreign currency liquidity available at central banks, banks' total primary liquidity ratio (as a % of assets) reached a high of 34.43% at end-2016, well above international benchmarks. As a result of the Lebanese banks' net sales of Lebanese Eurobonds to foreigners over the second half of 2016 during the BDL swaps operations to replenish their foreign currency prime liquidity, the Lebanese banks' Eurobond portfolio decreased from US$ 18.4 billion in December 2015 to US$ 16.2 billion in December 2016. As such, the Lebanese banks' sovereign Eurobond portfolio is now well below their consolidated shareholders' equity, which sheds light on the improving sovereign exposure profile.

- Significant rise in collective provisions enhancing risk coverage

At the level of lending activity, loans to the private sector reported a relatively mild growth of 2.0% in 2016 in an environment of sluggish economic conditions restricting lending opportunities. In parallel, the ratio of gross doubtful loans to gross loans reported 6.55% at end-December 2016. Wth loan loss reserves covering 75.52% at end-2016, the ratio of net doubtful loans to total loans registered 1.60%. More importantly, collective provisions reached a record high in absolute and relative terms, covering 1.55% of the net loan portfolio, as BDL requested Lebanese banks to mainly allocate the exceptional revenues from BDL swaps to collective provisions prior to IFRS 9 implementation in 2018 for the amount of 2% of consolidated risk weighted loans, bearing in mind that the pot of Lebanese banks reserves is in excess of real needs.

- Capitalization seeing a net noticeable improvement in 2016 with the freeing of regulatory capital

Lebanese banks' shareholders' equity grew by 10.0% over the past year, compared to a 6.9% growth in 2015, moving from US$ 21.0 billion at end-December 2015 to US$ 23.1 billion at end-December 2016. The BDL directives for the use of financial engineering proceeds translated into freeing regulatory capital (goodwill amortization and the effects of write-offs in Syria and Sudan). The banks' capital adequacy, with Basel II capital adequacy ratio rising to 16.51% as at end-December 2016 (from 15.06% as at end-December 2015), is well above regulatory requirements and constitutes a sound capital buffer for banks.

- BDL requiring banks to fully allocate exceptional revenues, with nil impact on bottom lines

The year 2016 was characterized by a significant growth in net fee and commission income, offsetting a significant growth in operating expenses and income taxes though largely non-recurrent, while net profits managed to grow by 12.6% year-on-year. Consequently, return ratios relatively improved, with the return on average assets rising to 1.06% and the return on average common equity increasing to 12.18% in 2016, yet remaining below the cost of equity of Lebanese banks. It is important to highlight here that the directives of the Central Bank for the allocation of the exceptional revenues in addition to the latest capital requirements (15% rather than 12% in 2018), call for a total allocation of US$ 7 billion, against US$ 5 billion of realized exceptional revenues, thus leaving no impact on domestic bottom lines.

The following banking sector research is based on "consolidated" Lebanese banking figures as at end-2016 as provided by Bankdata Financial Services. It aims at an in-depth analysis of Lebanon's banking industry, with a thorough investigation of banks' performance drivers, their current financial standing and their overall risk profile.

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The year 2016 was an atypical year for Lebanese banks that faced arising internal opportunities in an evolving overall domestic environment and aided by the financial engineering operations of the Central Bank of Lebanon, coupled with the challenges of tough operating conditions in a number of foreign markets of presence that witnessed depreciation of their currencies over the year, impacting foreign currency translation in the overall consolidation yet with no adverse impact on banks foreign operations at large.

The Central Bank of Lebanon, in tight coordination with Lebanese banks, has undertaken successfully innovative financial engineering operations that targeted reinforcing Lebanon's foreign assets and supporting the balance sheets of operating banks. Swap operations between the Central Bank and the Ministry of Finance and between banks and the Central Bank revolved around a total of US$ 14 billion, raising BDL foreign assets to a record high of above US$ 40 billion.

The financial engineering operations started with a swap of LP Treasury bills held by the Central Bank with new Eurobonds issued by the Lebanese Treasury by the end of May. The Ministry of Finance has accordingly increased the amount of public debt held in dollars by swapping with the Central Bank local currency debt into US$ 2 billion worth of Eurobonds. More importantly, the new Eurobonds acquired by the Central Bank were all subsequently sold to banks, in addition to the sale of additional Eurobonds and CDs by the Central Bank. As a matter of fact, BDL actually offered to discount LP Tbs and LP CDs held by banks at an attractive premium under the condition that banks invest in parallel at the Central Bank in US dollars by the same amounts (through Eurobonds or FX CDs). The amount of the operation was circa US$ 14 billion, reinforcing Central Bank reserves, reversing the deficit of the balance of payments to a net surplus and enhancing overall funding of Lebanese banks.

In December 2016, the Central Bank of Lebanon issued the Intermediary Circular No. 446 which provided how the exceptional revenues resulting from the financial engineering operations should be used, as detailed hereby: (1) To allocate additional collective provisions corresponding to 2% of risk-weighted loans. (2) To allocate any additional provisions required for the implementation of IFRS 9. (3) To book goodwill impairment. (4) To book impairment on investments for entities abroad. (5) With remainder amounts to be allocated as follows: 70% as reserves for capital increases accounted for as Common Equity Tier 1 capital, and 30% as deferred liabilities accounted for as Tier 2 capital.

While Lebanese banks were able to generate circa US$ 5 billion in revenues from the financial engineering operations, the Central Bank required to fully allocate such revenues as per the above, leaving almost nil impact on the banks bottom lines.

Below is the analysis of activity performance, risk profile and return indicators during the year 2016, an atypical year for Lebanese banks at large that were able to strengthen their activity fundamentals and risk metrics at large.

CONSOLIDATED ACTIVITY GROWTH

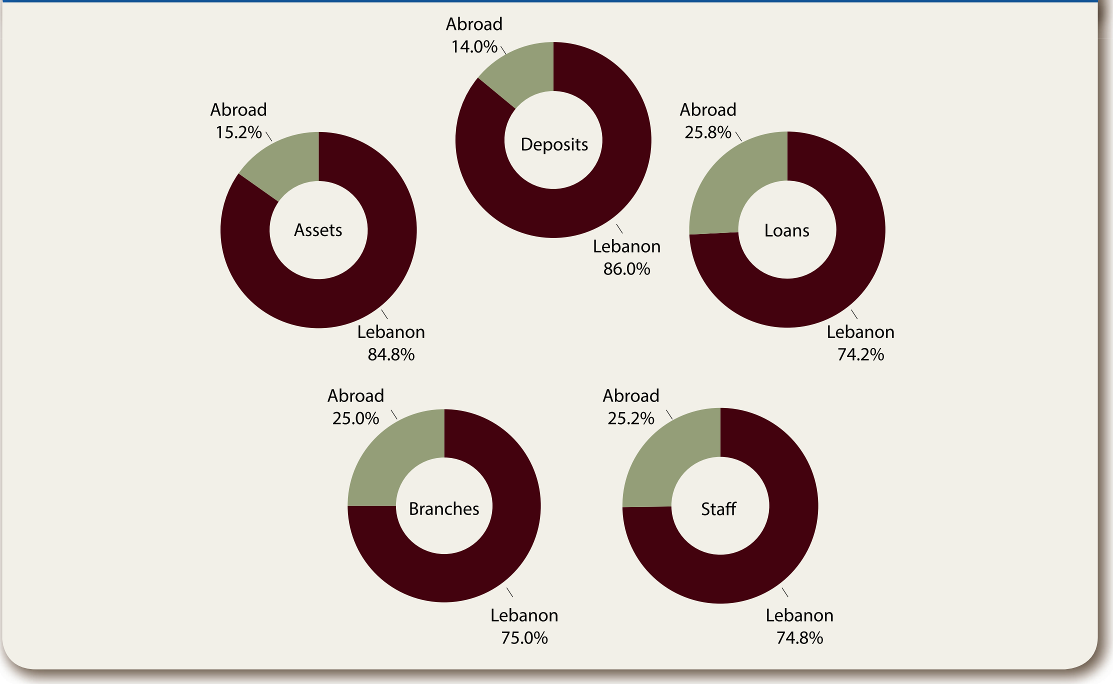
Lebanese banks actually registered a satisfactory activity growth in 2016 in a tough operating environment. Consolidated assets of Lebanese banks increased from US$ 227.9 billion at end-December 2015 to US$ 241.4 billion at end-December 2016, corresponding to a rise of US$ 13.5 billion, i.e. a growth of 5.9%. The growth in volume proved around 30% higher than the one registered during the previous year and in line with the rise seen on average in the last five years.

This performance was nonetheless impacted by the 10.6% nominal decline in foreign activity as a result of the depreciation of respective currencies in main markets of presence, namely the Egyptian Pound and the Turkish Lira (42% of the assets of Lebanese banks foreign subsidiaries being in Turkey and Egypt) which exchange rates lost 58% and 18% respectively versus the US dollar in 2016, which reflected on the conversion of these assets within the overall consolidation (foreign currency translation impact).

Consolidated deposits, which account for 80% of total activity, followed the same performance. While foreign deposits dropped by a nominal 12.2%, again driven by currency fluctuations, domestic deposits rose by 6.7%. It is worth mentioning that the growth in domestic deposits was mainly driven by FX deposits which grew by 8.2% while LL deposits increased by 4.2%, thus raising deposit dollarization over the year. The growth in domestic FX deposits was mainly tied to the financial engineering operations of the CentralBank.

It is important to mention that the share of foreign entities declined in 2016 to the benefit of the share of domestic entities in the overall consolidated balance sheet data, again as a result of foreign currency translation movements and thus not tied to pressures on foreign operations, as most of the business in the latter is denominated in local currencies and has witnessed healthy growth. For assets, the share of foreign entities dropped from 18.1% to 15.2%. For deposits, it decreased from 16.5% to 14.0%. For loans, it contracted from 27.1% to 25.8% respectively.

GEOGRAPHIC CONCENTRATION (YEAR 2016)



Source: Bankdata Financial Services wll

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 2016 was realized by the Gamma and Alpha groups displaying a growth rate of 6.4% and 6.1% respectively, while the Beta Group reported a growth of 4.9%, and the Delta Group's assets rose by a mere 1.5%.

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 89.7% of the sector's consolidated assets (89.6% in 2015), followed by the Beta Group with 8.1% (8.2% in 2015), the Delta Group with 1.3% (1.3% in 2015) and the Gamma Group with 0.9% (0.9% in 2015).

The analysis of Lebanese banks groups by dollarization ratios suggests that the group of large banks is the most dollarized in terms of deposits and loans. Deposit dollarization stands at 69.9% for the Alpha Group followed by 68.8% for the Delta Group, 64.8% for the Beta Group and 59.1% for the Gamma Group. On the other hand, loan dollarization is the largest for the Alpha Group with 80.2%, followed by 70.6% for the Beta Group, 48.2% for the Gamma Group, and 48.0% for the Delta Group.

GROWTH RATES OF BANKING AGGREGATES

	2011	2012	2013	2014	2015	2016	Var 16/15
Assets	7.9%	8.4%	9.6%	9.3%	4.8%	5.9%	1.1%
Loans to customers	13.6%	11.4%	15.1%	11.0%	5.6%	2.0%	-3.6%
Customer deposits	7.4%	8.8%	9.6%	8.5%	4.5%	3.6%	-0.9%
Shareholders' equity	1.9%	13.4%	8.5%	10.8%	6.9%	10.0%	3.1%
Annual L/C openings	-8.4%	-5.3%	-5.8%	1.5%	-21.0%	-11.0%	10.0%
Net profits for the year	-4.7%	7.6%	0.2%	9.1%	6.9%	12.6%	5.7%

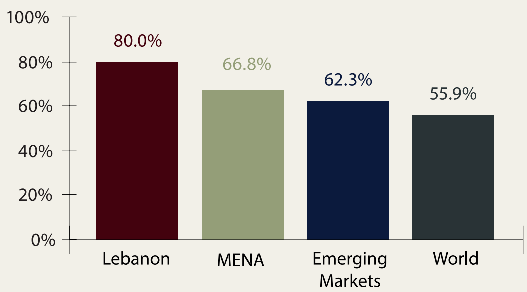
Source: Bankdata Financial Services wll

GROWTH RATES OF LEBANESE BANKS' GROUPS (YEAR 2016)

	Alpha	Beta	Gamma	Delta
Assets	6.1%	4.9%	6.4%	1.5%
Loans to customers	1.4%	6.1%	17.4%	7.6%
Deposits from customers	3.7%	3.7%	12.8%	-11.7%
Shareholders' equity	10.7%	7.0%	12.2%	0.9%
Total L/C openings of the year	-7.5%	-33.4%	-67.8%	-5.5%
Net profits for the year	10.5%	45.9%	-	-9.3%

Source: Bankdata Financial Services wll

DEPOSITS/ASSETS RATIOS (YEAR 2016)



Sources: Bankdata Financial Services, IMF, Orbis Bank Focus, Fitch, MENA Central Banks

LIQUIDITY AND SOVEREIGN EXPOSURE

As banks partly resorted to their placements at foreign banks to engage in the Central Bank's financial engineering operations, core primary liquidity in foreign banks fell from 8.75% of assets in December 2015 to 7.93% of assets in December 2016. But when adding foreign currency liquidity available at central banks, banks' total primary liquidity ratio (as a % of assets) reached a high of 34.43% at end-2016, well above international benchmarks.

As a result of the Lebanese banks' net sales of Lebanese Eurobonds to foreigners over the second half of 2016 during the BDL swaps operations to replenish their foreign currency prime liquidity, the Lebanese banks' Eurobond portfolio decreased from US$ 18.4 billion in December 2015 to US$ 16.2 billion in December 2016. Lebanese banks indeed enhanced their sales efforts with foreign investors holding Lebanese Eurobonds and that are mainly underweight relative to the bond indices. Some foreign investors have recommended to their customers as well to invest in Lebanese Eurobonds on the back of attractive relative bond prices raising the risks of underweight.

As such, the Lebanese banks' sovereign Eurobond portfolio is now well below their consolidated shareholders' equity, which sheds light on the improving sovereign exposure profile. The ratio of Lebanese sovereign Eurobonds to shareholders equity fell from 87.54% at end-2015 to 69.88% at end-2016.

The analysis of liquidity by Lebanese banks' groups in 2016 shows that liquidity is correlated with the size of banks. The most liquid group is the Alpha Group with a ratio of 36.49%, followed by the Beta Group with a ratio of 26.41%, the Gamma Group with a net primary liquidity to deposits ratio of 9.26%, and the Delta Group with a negative ratio of -26.0% as it holds a significantly large amount of government paper among its asset base.

The analysis of sovereign exposure by Lebanese banks' groups in 2016 suggests that sovereign exposure seems to be almost inversely related to the size of banks. The group with the highest exposure in Lebanese Pounds is the Delta Group with a ratio of Lebanese Treasury bills in LL to deposits in LL of 85.60%, followed by the Beta Group with 43.16%, the Alpha Group with 32.38%, and the Gamma Group with 31.71%. In parallel, the group with the highest exposure in foreign currency in 2016 is the Gamma Group with a ratio of Lebanese sovereign Eurobonds to deposits in foreign currency of 50.54%, followed by the Delta Group at 24.09%, the Beta Group with 13.84% and the Alpha Group with 11.63%.

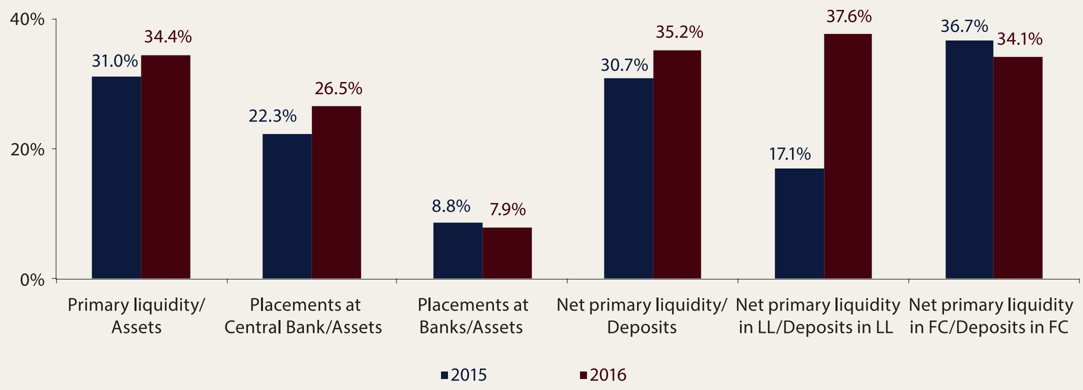
Nonetheless, the large banks tend to have the largest Central Bank exposure in relative terms. As a percentage of their asset base, placements at central banks represent 27.38% for the Alpha Group, followed by the Gamma Group with 20.38%, the Beta Group with 19.0% and the Delta Group with 16.03%.

LIQUIDITY OF LEBANESE BANKS' GROUPS (YEAR 2016)

	Alpha	Beta	Gamma	Delta
Primary liquidity/Assets	**35.2%**	**26.7%**	**37.5%**	**27.2%**
o.w. Central Bank/Assets	27.4%	19.0%	20.4%	16.0%
o.w. Banks/Assets	7.8%	7.7%	17.1%	11.2%
Net primary liquidity/Deposits	**36.5%**	**26.4%**	**9.3%**	**-26.0%**
o.w. Net primary liquidity in LL/Deposits in LL	40.5%	17.2%	20.3%	-55.5%
o.w. Net primary liquidity in FC/Deposits in FC	34.8%	31.4%	1.6%	-12.6%

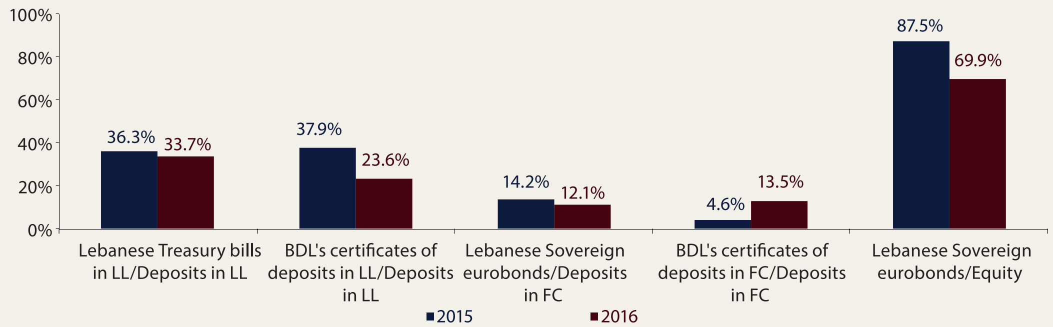
Source: Bankdata Financial Services wll

LIQUIDITY OF LEBANESE BANKS



Source: Bankdata Financial Services wll

SOVEREIGN EXPOSURE OF LEBANESE BANKS



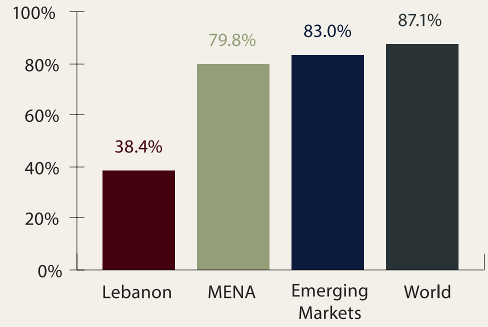
Source: Bankdata Financial Services wll

SOVEREIGN EXPOSURE OF LEBANESE BANKS' GROUPS (YEAR 2016)

	Alpha	Beta	Gamma	Delta
Lebanese Treasury bills in LL/Deposits in LL	32.4%	43.2%	31.7%	85.6%
BDL's certificates of deposits in LL/Deposits in LL	24.7%	14.4%	26.8%	4.9%
Lebanese Sovereign eurobonds/Deposits in FC	11.6%	13.8%	50.5%	24.1%
BDL's certificates of deposits in FC/Deposits in FC	13.7%	10.8%	13.7%	10.4%
Lebanese Sovereign eurobonds/Equity	70.2%	80.9%	110.8%	22.0%

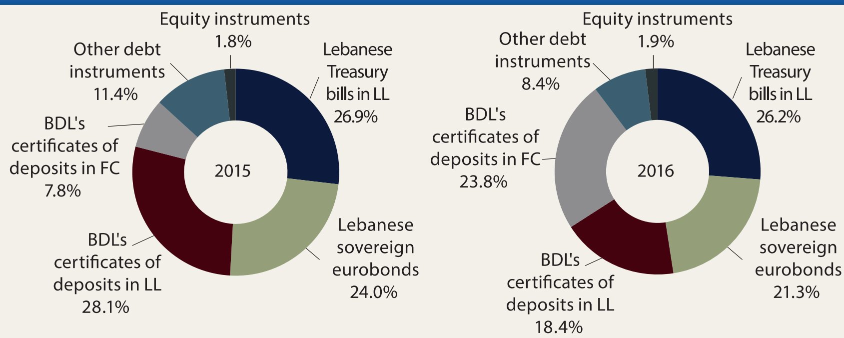
Source: Bankdata Financial Services wll

LOANS/DEPOSITS (YEAR 2016)



Sources: Bankdata Financial Services, IMF, Orbis Bank Focus, Fitch, MENA Central Banks

PORTFOLIO SECURITIES BREAKDOWN



Source: Bankdata Financial Services wll

LENDING QUALITY AND PROVISIONING

At the level of lending activity, loans to the private sector reported a relatively mild growth of 2.0% in 2016 in an environment of sluggish economic conditions restricting lending opportunities. The currency structure of domestic lending suggests that LL loans grew by a significant 13.3%, while FX loans rose by a mere 0.5%. The double-digit growth in LL loans was supported by the attractive stimulus packages in Lebanese Pounds, in addition to the excess liquidity in LL created by BDL swaps. The evolution of loans by type suggests that housing loans and SME loans rose by 8.9% and 4.8% respectively, while retail loans and corporate loans declined by 2.1% and 1.0% respectively.

BREAKDOWN OF LOANS AND ADVANCES TO CUSTOMERS (% OF TOTAL LOANS) IN 2016

	All Banks	Alpha Group	Beta Group	Gamma Group	Delta Group
Corporate	40%	38%	50%	30%	36%
SMEs	16%	16%	18%	39%	1%
Housing	16%	16%	12%	3%	49%
Retail	11%	12%	10%	14%	5%
Secured by commercial real estate	9%	9%	9%	5%	0%
Other loans	8%	9%	1%	8%	8%
Public sector	1%	1%	0%	-	-

Source: Bankdata Financial Services wll

In parallel, Lebanese banks realized a slight retreat in lending quality over the year. The ratio of gross doubtful loans to gross loans rose from 6.37% at end-December 2015 to 6.55% at end-December 2016. When adding substandard loans, the ratio rises from 7.30% to 8.01%. Concomitant to that direction, with loan loss reserves covering 75.52% at end-2016, against 75.44% at end-2015, the ratio of net doubtful loans to total loans rose from 1.56% to 1.60% (from 2.31% to 2.83% when including substandard loans). More importantly, collective provisions reached a record high in absolute and relative terms, covering 1.55% of the net loan portfolio, as BDL requested Lebanese banks to mainly allocate the exceptional revenues from BDL swaps to collective provisions prior to IFRS 9 implementation in 2018 for the amount of 2% of consolidated risk weighted loans, bearing in mind that the pot of Lebanese banks reserves is in excess of real needs.

The analysis by group of banks suggests the Alpha Group and Gamma Group reported the lowest net doubtful loans to gross loans ratio of 1.43%, followed by the Beta Group with 2.26% and the Delta Group with 5.76%. On the other hand, small Gamma banks were the best provisioned, as the ratio of loan loss reserves on doubtful loans as a percentage of doubtful loans reported 96.92%, followed by the Alpha Group with 74.51%, the Beta Group with a ratio of 73.18% and the Delta Group with 65.20%.

ASSET QUALITY OF LEBANESE BANKS

	2011	2012	2013	2014	2015	2016	Var 16/15
Doubtful loans/Gross loans	6.9%	7.1%	6.8%	6.6%	6.4%	6.6%	0.2%
Substandard loans + doubtful loans/Gross loans	7.7%	7.8%	7.8%	7.4%	7.3%	8.0%	0.7%
Net doubtful loans/ Gross loans	1.3%	1.4%	1.5%	1.5%	1.6%	1.6%	0.0%
Loan loss reserves on doubtful loans/Doubtful loans	81.8%	79.6%	78.3%	77.3%	75.4%	75.5%	0.1%
Net doubtful loans/Equity	4.6%	5.1%	5.5%	5.5%	5.8%	5.5%	-0.3%

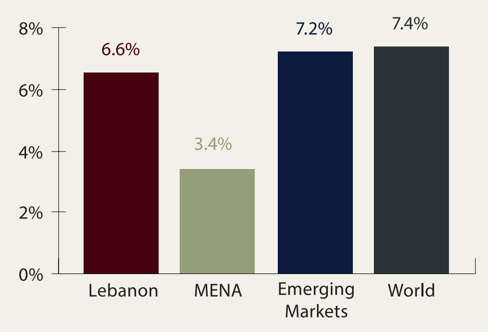
Source: Bankdata Financial Services wll

ASSET QUALITY OF LEBANESE BANKS' GROUPS (YEAR 2016)

	Alpha	Beta	Gamma	Delta
Doubtful Loans/Gross loans	5.6%	8.4%	46.4%	16.6%
Substandard Loans + Doubtful Loans/Gross loans	6.8%	11.9%	49.0%	18.0%
Net Doubtful Loans/Gross loans	1.4%	2.3%	1.4%	5.8%
Loan Loss Reserves on Doubtful Loans/Doubtful Loans	74.5%	73.2%	96.9%	65.2%
Net Doubtful Loans/Equity	4.9%	10.1%	4.0%	11.8%

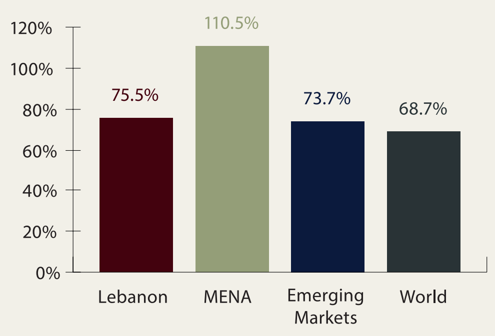
Source: Bankdata Financial Services wll

NPLs/TOTAL LOANS (YEAR 2016)



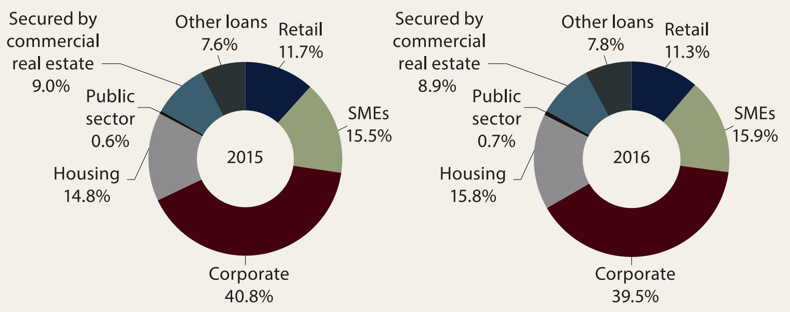
Sources: Bankdata Financial Services, IMF, Orbis Bank Focus, Fitch, MENA Central Banks

LLRs/NPLs (YEAR 2016)



Sources: Bankdata Financial Services, IMF, Orbis Bank Focus, Fitch, MENA Central Banks

LOANS AND ADVANCES BREAKDOWN



Source: Bankdata Financial Services wll

CAPITAL ADEQUACY AND SOLVENCY

Lebanese banks' capitalization saw a net improvement in 2016. In fact, banks' shareholders' equity grew by 10.0% over the past year, compared to a 6.9% growth in 2015, moving from US$ 21.0 billion at end-December 2015 to US$ 23.1 billion at end-December 2016. The BDL directives for the use of financial engineering proceeds translated into freeing regulatory capital (goodwill amortization and the effects of write-offs in Syria and Sudan).

Having said that, with the growth in equity outpacing activity growth, the equity to assets ratio rose from 9.2% in December 2015 to 9.6% in December 2016, one of its highest levels ever. A related measure is the ratio of shareholders' equity to net loans which reported a high of 31.2% for Lebanon's banking sector at end-2016 against a regional average of 23.0% and an average of 15.3% in emerging markets and in the world at large. As to the leverage ratio of average assets to average equity, it went down from 10.94 in 2015 to 10.62 in 2016.

In parallel, the reinforcement of capitalization actually strengthened the banks' capital adequacy, with Basel II capital adequacy ratio standing at 16.51% as at end-December 2016 (from 15.06% as at end-December 2015), well above regulatory requirements and constituting a sound capital buffer for banks. The total capital ratio in 2016 is the result of a total capital of US$ 21.6 billion in 2016, against a total of risk-weighted assets of US$ 130.6 billion that represents in turn 54.1% of total assets (54.5% in 2015). Having said that, it is worth mentioning that more than 89% of the total capital of Lebanese banks is made up of common equity Tier 1. The total capital ratio is broken down over a Tier 1 ratio of 14.72% and a Tier 2 ratio of 1.79% at year-end 2016.

The analysis of capital adequacy by Group of banks suggests that the relation of capital adequacy to the size of banks is uneven. Capital adequacy (as per Basle II requirements) reported a high of 39.56% for the Delta Group, followed by a ratio of 16.36% for the Alpha Group, 15.82% for the Gamma Group and 14.72% for the Beta Group in 2016. Likewise, the equity to assets is the highest for the Delta Group with 25.8%, followed by the Gamma Group with 13.8%, the Alpha Group with 9.3% and the Beta Group with 9.2% in 2016.

CAPITALIZATION OF LEBANESE BANKS

	2011	2012	2013	2014	2015	2016	Var 16/15
Capital adequacy (as per Basel II requirements)	11.8%	13.8%	14.2%	14.6%	15.1%	16.5%	1.5%
Equity to assets	8.5%	9.0%	8.9%	9.1%	9.2%	9.6%	0.4%
Leverage (times)	11.4	11.3	11.1	11.1	10.9	10.6	-0.3

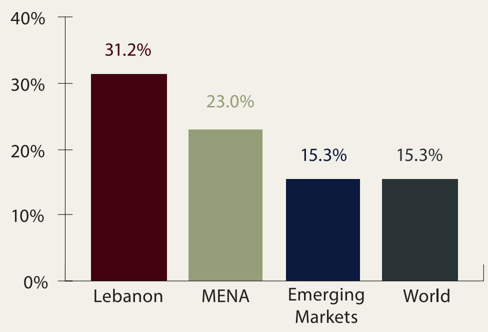
Source: Bankdata Financial Services wll

CAPITALIZATION OF LEBANESE BANKS' GROUPS (YEAR 2016)

	Alpha	Beta	Gamma	Delta
Capital adequacy (as per Basel II requirements)	16.4%	14.7%	15.8%	39.6%
Equity/Assets	9.3%	9.2%	13.8%	25.8%
Leverage (times)	10.9	11.0	7.4	3.9

Source: Bankdata Financial Services wll

EQUITY/NET LOANS (YEAR 2016)



Sources: Bankdata Financial Services, IMF, Orbis Bank Focus, Fitch, MENA Central Banks

PROFITABILITY

As a result of the financial engineering operations of the Central Bank over the second half of 2016, substantial capital gains were realized across the banking sector, while the balance sheet of Lebanese banks and their credit profiles were bolstered.

Within this context, the year 2016 was characterized by a significant growth in net fee and commission income, driving a double-digit growth in operating income and offsetting a significant growth in operating expenses and income taxes, all leaving a 12.6% rise in bottom line to reach US$ 2.5 billion over the year. In fact, while net interest income rose by 6.9%, net fee and commission income surged by 66.8%, generating a 36.6% growth in total operating income, thus outpacing the rise in provisions and that of operating expenses (16.3%), leaving a decent rise in gross and net profits, bearing in mind that there were significant non-recurrent revenues and expenses in 2016 tied to the financial engineering operations of the Central Bank, yet with zero impact on banks' bottom lines.

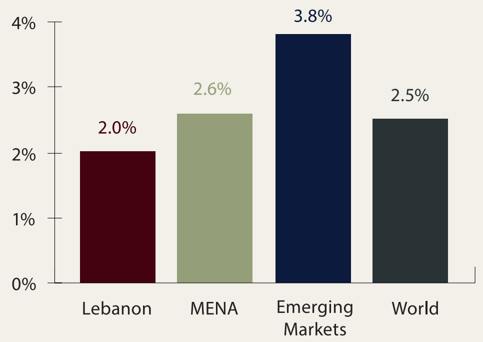
Subsequently, return ratios relatively improved, with the return on average assets rising from 0.99% to 1.06% and the return on average equity increasing from 10.82% to 11.23% (12.18% for the return on average common equity). The components of return ratios suggest that asset utilization rose significantly from 2.87% to 3.59%, driven mainly by the noticeable increase in non-interest income to average assets from 0.95% to 1.65%, while interest margins and spreads maintained somewhat stable levels (2.02% and 1.94% respectively). Yet, the net operating margin fell from 34.47% to 29.43%, driven by a rise in credit cost from 7.50% to 14.72% (mainly due to the Central Bank directive of allocating out of the exceptional revenues an additional collective provision corresponding to 2% of consolidated risk weighted loans) and an increase in tax cost from 7.68% to 9.75% (driven by the non-recurrent tax paid on the financial engineering operations proceeds for circa US$ 775 million). It is worth mentioning that return ratios of Lebanese banks are still below their cost of equity.

Moving on to a comparative global analysis, Lebanon's return on average assets and return on average equity ratios came short of global benchmarks. The local banking sector's return on average assets attained 1.1% in 2016, well below an average of 1.5% for the MENA region, an average of 1.9% for emerging markets and an average of 1.6% globally. At the same time, Lebanese banks' return on average equity reported 11.2% in 2016, compared to an average of 11.4% for the MENA region, an average of 14.3% for emerging markets and an average of 13.0% for the global return.

Regarding the profitability of banks by group, Alpha and Beta banks reported profit expansions of 10.5% and 45.9% respectively, while Delta banks witnessed a decline of 9.3% in their bottom line in 2016. With regards to return ratios, they seem to be almost positively correlated with the size of banks, with the return on average equity registering the highest ratio of 11.74% for Alpha banks in 2016, 9.85% for Beta banks, followed by Delta banks with 4.65% and Gamma banks with 3.42%. Interest margin reported a low of 1.92% for Beta banks, followed by 2.01% for Alpha banks, 2.33% for Gamma banks and 3.19% for Delta banks. The share of non-interest income to total income reported 20.83% for Gamma banks, 37.66% for Delta banks, 46.19% for Alpha banks, and 48.15% for Beta banks.

Last but not least, larger banks proved to be more efficient due to the economies of scale and strong organizational structures, with the lowest cost-to income ratio reported for Alpha banks at 43.02%, followed by Beta banks with 52.97%, followed by Delta banks with 61.17% and Gamma banks with 75.79%. Parallel to the cost-to-income ratio, the cost-to-average assets fell as the size of banks increased. Banks in the Alpha group posted the lowest ratio of 1.54%, followed by the Beta Group with 1.87%, the Gamma Group with 2.07% and the Delta Group with 2.88% in 2016.

NET INTEREST MARGIN (YEAR 2016)



Sources: Bankdata Financial Services, IMF, Orbis Bank Focus, Fitch, MENA Central Banks

NON INTEREST INCOME OF LEBANESE BANKS

	2011	2012	2013	2014	2015	2016	Var 16/15
Non interest income/Total income	34.4%	35.5%	33.9%	33.6%	33.0%	46.0%	13.0%
Net fees and commissions/Average assets	0.5%	0.5%	0.5%	0.5%	0.5%	0.7%	0.3%
Operating expenses/Average assets	1.5%	1.5%	1.5%	1.5%	1.4%	1.6%	0.2%
Credit cost/Pre-provision, pre-tax profit	9.7%	15.6%	13.9%	13.5%	15.2%	25.5%	10.3%
Income tax/Profit before tax	18.5%	17.9%	17.5%	18.3%	18.4%	23.6%	5.2%

Source: Bankdata Financial Services wll

RETURN RATIOS OF LEBANESE BANKS

	2015	2016	Var 16/15
Yield on earning assets	5.7%	5.8%	0.1%
o.w. in LL	6.8%	6.6%	-0.3%
o.w. in FX	5.2%	5.4%	0.3%
- Cost of earning assets	3.7%	3.8%	0.1%
o.w. in LL	4.7%	4.6%	-0.1%
o.w. in FX	3.2%	3.4%	0.2%
= Interest margin	2.0%	2.0%	0.0%
o.w. in LL	2.1%	2.0%	-0.2%
o.w. in FX	2.0%	2.1%	0.1%
x Average interest earning assets/Average assets	95.9%	96.0%	0.1%
o.w. in LL	95.3%	95.5%	0.2%
o.w. in FX	96.2%	96.2%	0.0%
= Spread	1.9%	1.9%	0.0%
o.w. in LL	2.0%	1.9%	-0.1%
o.w. in FX	1.9%	2.0%	0.1%
+ Non interest income/Average assets	1.0%	1.7%	0.7%
= Asset utilization	2.9%	3.6%	0.7%
x Net operating margin	34.5%	29.4%	-5.0%
o.w. cost-to-income	50.3%	44.4%	-6.0%
o.w. credit cost	7.5%	14.7%	7.2%
o.w. other provisions	0.0%	1.8%	1.7%
o.w. tax cost	7.7%	9.8%	2.1%
= ROAA	**1.0%**	**1.1%**	**0.1%**
x Leverage	10.9	10.6	-0.3
= ROAE	**10.8%**	**11.2%**	**0.4%**

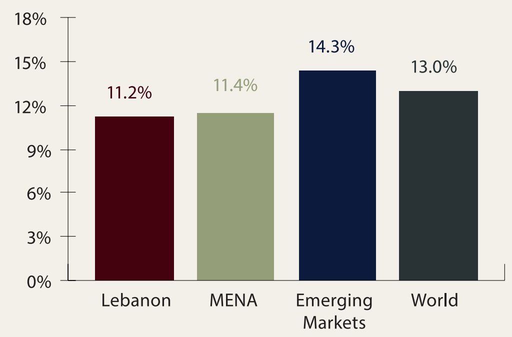
Source: Bankdata Financial Services wll

PROFITABILITY OF LEBANESE BANKS' GROUPS (YEAR 2016)

	Alpha	Beta	Gamma	Delta
Spread	1.93%	1.83%	2.17%	2.93%
Interest margin	2.01%	1.92%	2.33%	3.19%
Non-interest income/total income	46.2%	48.2%	20.8%	37.7%
ROAA	1.08%	0.90%	0.46%	1.20%
ROAE	11.7%	9.9%	3.4%	4.7%

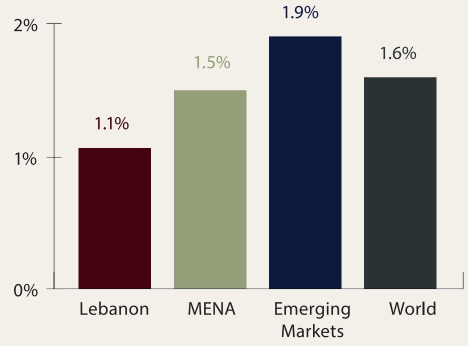
Source: Bankdata Financial Services wll

RETURN ON AVERAGE EQUITY (YEAR 2016)



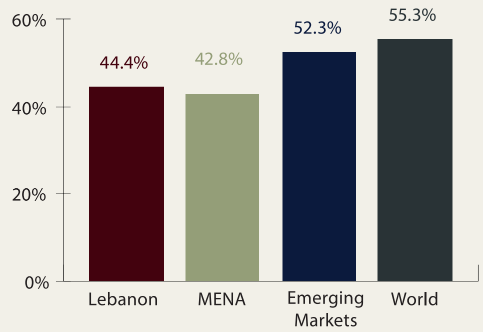
Sources: Bankdata Financial Services, IMF, Orbis Bank Focus, Fitch, MENA Central Banks

RETURN ON AVERAGE ASSETS (YEAR 2016)



Sources: Bankdata Financial Services, IMF, Orbis Bank Focus, Fitch, MENA Central Banks

COST-TO-INCOME (YEAR 2016)



Sources: Bankdata Financial Services, IMF, Orbis Bank Focus, Fitch, MENA Central Banks

MANAGEMENT EFFICIENCY OF LEBANESE BANKS

	2011	2012	2013	2014	2015	2016	Var 16/15
Cost per average branch (US$ million)	1.89	2.01	2.10	2.18	2.19	2.57	17.3%
Staff expenses per average staff (US$ 000s)	43.1	45.8	48.4	51.1	50.4	54.4	7.9%
Staff expenses to general operating expenses (%)	55.6%	54.6%	55.6%	56.4%	55.8%	52.1%	-3.7%
Cost-to-income (%)	49.7%	49.7%	51.8%	51.5%	50.3%	44.4%	-6.0%
Cost-to-average assets (%)	1.46%	1.51%	1.50%	1.48%	1.44%	1.59%	0.2%

Source: Bankdata Financial Services wll

MANAGEMENT EFFICIENCY OF LEBANESE BANKS' GROUPS (YEAR 2016)

	Alpha	Beta	Gamma	Delta
Cost per average branch (US$ million)	2.67	1.83	3.08	3.13
Staff expenses per average staff (US$ 000s)	54.4	49.8	55.1	55.1
Staff expenses to general operating expenses (%)	51.7%	53.5%	58.7%	59.0%
Cost-to-income (%)	43.0%	53.0%	75.8%	61.2%
Cost-to-average assets (%)	1.54%	1.87%	2.07%	2.88%

Source: Bankdata Financial Services wll

INVESTMENT CONSIDERATIONS

In 2016, the Lebanese banks' common earnings per share increased significantly on a yearly basis to reach US$ 0.52, driven by the earnings increase and the decline in the number of shares following the merger operation of two Beta banks during the year. Similarly, banks strived to boost their capital levels in line with requirements and further shield their shareholders from potential pressures. This translated into a noticeable rise in the sector's common book per share measure, which reached US$ 4.36 in 2016.

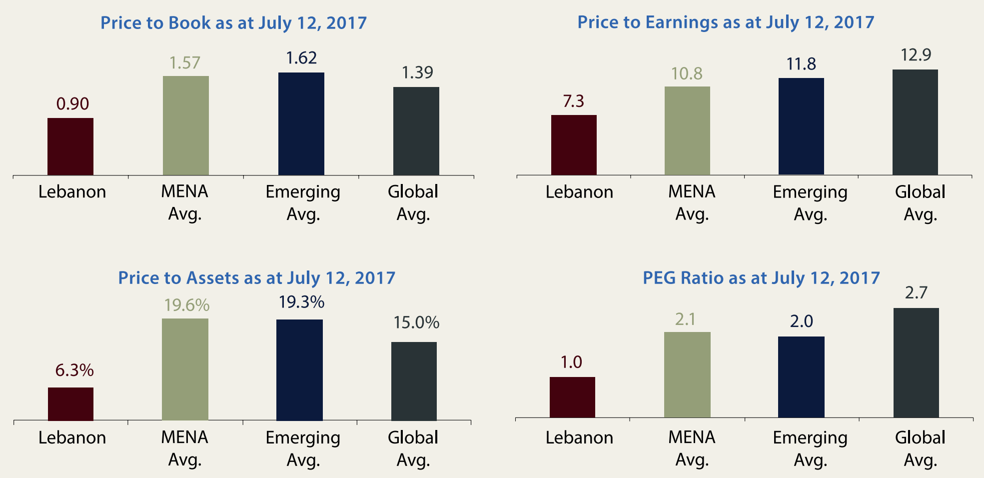
It is worth mentioning that Lebanese banks trade at a P/E of 7.3x, which is 30%-45% lower than regional and global standards. Similarly, their shares trade at a P/BV ratio of less than 1x (0.90x), i.e 35%-45% below foreign benchmarks. The banking institutions also trade at a low price to assets of 6.3%, against regional and international averages between 15% and 20%. Last but not least, when comparing the P/E to the average earnings per common share growth of the past few years, banks in Lebanon trade at a PEG ratio of 1.0, which is also noticeably lower than the corresponding benchmarks that are in the 2-3 range. Such discounts are to be read in conjunction with the lack of efficiency and liquidity in domestic capital markets, in addition to the lower return on equity realized by Lebanese banks relative to their corresponding cost of equity.

Within this environment, it was normal that part of the rise in profits be distributed to shareholders in the form of dividends, especially that the price performance on the Beirut Stock Exchange has been lukewarm over the past few years, with either slightly negative or slightly positive price variations on a yearly basis. This means that a good way of rewarding shareholders is through granting higher dividend yields in the absence of any market value added.

Common dividends rose by close to 20% last year and preferred dividends edged up by 8% in 2016 across the banking universe. Consequently, the common dividends per share measure surged to US$ 0.18, translating into a common payout ratio of 32.8%, higher than the 31.0% attained in 2015. This is in line with international averages, as peers across the world on average also distributed close to a third of the profits realized each year.

For listed Lebanese banks, the average dividend yield reached 6.3% in 2016. higher than regional peers, emerging market peers or global peers for which averages reached 3.9%, 3.4% and 2.5% respectively last year.

COMPARATIVE STOCK MARKET PRICING RATIOS



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

CONCLUSION

In brief, the year 2016 was an atypical year for Lebanese banks that faced arising internal opportunities in an evolving domestic environment, coupled with the challenges of tough operating conditions in a number of foreign markets of presence.

Domestically, the most important development was the financial engineering operations of the Central Bank and its impact on Lebanon's financial sector at large. While the swap operations had some adverse effects at the level of banks' primary liquidity and banks' exposure at the Central Bank, they held significant benefits reported at various levels and in different realms: The overall BDL swaps reinforced Central Bank reserves to a new record high. BDL's foreign assets have reported a total of US$ 41 billion at the end of December 2016, the equivalent of 74% of the Lebanese Money Supply and 26 months of imports, which suggests monetary resilience is continuing on a bolstered overall Central Bank standing. On the other hand, the BDL swaps had positive effects on banks' balance sheets as per Central Bank regulatory requirements.

At this level, there were several analyses by the media on the significant benefits realized by banks from these operations. It is important to highlight here that the directives of the Central Bank for the allocation of exceptional revenues in addition to the latest capital requirements (15% rather than 12% in 2018), call for a total allocation of US$ 7 billion, against US$ 5 billion of realized exceptional revenues.

Within the same context, the reinforced financial sector resilience, in both its banking and Central Bank components, carries positive spillover effects on the sovereign risk and the ability of the government to meet its borrowing needs. Within this context lies the S&P decision to improve Lebanon's rating outlook from "negative" to "stable" on the back of a resilient financial system and deposit inflows.

At the level of foreign entities of Lebanese banks, the most significant development of the past year was the currency depreciation of a number of countries relative to the USD, mainly Egypt and Turkey. As such, major balance sheet aggregates of foreign entities witnessed a net contraction, not because of pressures on the operations of those entities but due to foreign currency translation movements at large. It is important to mention that the exchange rate correction that both Egypt and Turkey, two main markets of Lebanese banks abroad, recently went through did not affect overall economic performances in both countries as witnessed by their relatively sound GDP growth rates. It also did not have a material impact on banks operating conditions as witnessed by their KPIs.

Finally, on the back of a strong financial standing, Lebanese banks have been perfectly assuming their fiduciary responsibilities through enjoying adequate corporate governance standards, well developed corporate social responsibility programs and very good transparency and disclosure practices. The Lebanese banks' strong financial fundamentals, their well-diversified activity profile, their innovative management strategies, their pioneering services and product mixes, all put them in an adequate position to reap the benefits of a pent-up demand for financial services in a number of markets of presence alongside those of a lucrative domestic market which recently benefited from improved politico-economic prospects in Lebanon. In addition, such qualitative strengths, added to sound performance metrics and a rigorous risk profile, put Lebanese banks in opportunistic conditions to take advantage of expansion opportunities to potentially captive markets at large.

DISCLAIMER

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