

Alpha banks in a consolidation mode this year

The Alpha Report, outlining the performance and positioning of the first 14 banks in Lebanon with deposits exceeding US\$ 2 billion, was issued by Bankdata Financial Services for the first nine months of 2017.

Upon the finalization of this Alpha report, Lebanon witnessed the unforeseen event of the resignation of Prime Minister Saad Hariri, a development which caught the country by surprise. It is still too early to tell about the possible repercussions on Lebanon's economy and markets within the country's long history of resilience and endurance. Below is an overview of banking conditions in the first nine months of 2017, prior to the newly arising development.

Measured by the consolidated assets of Alpha banks, banking activity rose by an acceptable 4.8% growth in the first nine months of 2017 to reach US\$ 227 billion at end-September. Alpha banks added 14 branches and 707 new employees in the first nine months of 2017, for their branch network to reach 1,202 branches in September 2017 and their staff count to reach 31,202 employees. It is worth mentioning that the totality of additional employees were recruited by their domestic entities, while the staff count abroad did not record any rise this year.

Once again, activity growth was driven by customer deposits whose growth accounted for two thirds of the asset growth in the first nine months of 2017. Customer deposits actually managed to report a growth of 4.0% over the period, with Alpha banks deposit growth mostly tied to domestic deposits which rose by 4.6% while foreign deposits grew by 0.7% year-to-date. In parallel, their consolidated loan portfolio grew at a slower pace in a tough operating environment restricting lending opportunities, with loan growth reporting a mere 2.6% over the nine-month period.

It is worth mentioning that while the bulk of deposit growth was tied to foreign currencies, almost the totality of new loans this year was in Lebanese Pounds within the context of a stagnant FX loan portfolio, contrary to what was observed last year. This has decreased domestic loan dollarization to a record low of 69.4% at end-September, thus approaching domestic deposit dollarization which stands today at 65.4%, noting that the difference between the two has been contracting from 7.4% at end-2016 to 4.0% at end-September 2017. This trend has been favored by last year's financial engineering operations' impact on banks liquidity in local currency.

The growth in the Alpha banks loan portfolio was coupled with a slight retreat in lending quality. The Banks gross doubtful and substandard loans as a percentage of gross loans rose from 6.81% in December 2016 to 7.78% in September 2017 in a low growth economic environment in Lebanon and tough operating conditions in some markets of presence. Net doubtful and substandard loans as a percentage of gross loans likewise rose from 2.43% to 3.19% over the same period. Nonetheless, while doubtful loans are provisioned to the extent of 71.8% by specific provisions, collective provisions were significantly enhanced, reaching an all-time high of 1.71% of net loans.

At the profitability level, Alpha banks net profits from operating activities grew by a mere 3.4% over the first nine months (a growth of 21.4% when adding profits from discontinued activities). It is yet important to mention that the growth in recurrent profits over the first nine months of 2017 underwent a real growth way above the nominal growth of 3.4% when normalizing the profits of the 2016 corresponding period for non-recurrent fees and commissions resulting from BDL financial engineering operations. Nominal profit growth was driven by a 2.6% growth in net interest income, yet offset by a 49.5% contraction in net fees and commission income for the reasons stated above, leading to a 6.2% contraction in net operating income, which within the context of an 11.1% contraction in operating expenses, lead to a stagnation in operating profit.

With respect to return ratios, a relative improvement was observed. While a slight increase in the return on average assets from 1.04% in the first nine months of 2016 to 1.19% in the same period of 2017 was reported, the return on average common equity rose from 12.77% to 14.33%, though still below the cost of equity of Alpha banks. The components of return ratios suggest that spread has contracted by 6 bps, moving from 1.94% to 1.88%, coupled with a decline in the ratio of non-interest income to average assets from 1.20% to 1.03%, all generating a retreat in asset utilization from 3.14% to 2.91%. This was yet offset by a noticeable rise in the net operating margin from 33.23% to 40.96%, mainly tied to the drop in credit cost from 8.00% to 5.76%, while cost to income improved from 49.70% to 44.89% over the same period. Again, it is worth mentioning that both the asset utilization ratio and the credit cost ratio of the corresponding 2016 period were inflated on one side by the non-recurrent revenues and on the other hand by the BDL requirement for banks to use their exceptional revenues in one-time extra provisions.