

### *Alpha banks maintaining positive growth in a relatively tough year*

The Alpha Report, outlining the performance and positioning of the first 16 banks in Lebanon with deposits exceeding US\$ 2 billion, was issued by Bankdata Financial Services WLL for the fourth quarter of 2018.

The year 2018 saw an 11.3% growth in the consolidated activity of Alpha banks, almost double their growth in the previous year mainly driven by BDL financial engineering operations, with their total assets reaching US\$ 261.5 billion at end-December 2018. It also saw a rise in their branch network by 7 branches to 1,223 branches at end-2018, along with a contraction in their staff count by 199 employees, translating noticeable efficiency measures introduced.

Deposits from customers managed to report a positive growth of 2.1% over the year 2018, with domestic deposits rising by 2.8% while deposits of foreign entities contracted by 1.9% mainly due to FX translation impact in foreign markets that witnessed exchange rate depreciation relative to the US dollar. The breakdown of domestic deposits by currency suggests that there were net conversions from LL deposits to FX deposits, raising deposit dollarization to a 10-year high at 69.2%. As a matter of fact, LL deposits contracted by 3.1% in 2018, while domestic FX deposits rose by 5.6% over the year.

Amid a persistently challenging environment in Lebanon and foreign markets of presence, Alpha banks adopted a policy focusing on improving efficiency and de-risking, resulting mainly in net loan settlements and a reduction of loan exposures. As such, loans to customers contracted by 4.6% in 2018, with a 3.2% reduction in domestic loans and an 8.8% decrease in loans in foreign entities that were also affected by a certain FX translation impact. The reduction in domestic loans to the private sector was especially due to a contraction in the LP loan portfolio of 5.7%, noting that the BDL requested banks during 2018 to reduce the LP loans to LP deposits ratio to a maximum of 25% by end-2019.

The year 2018 also portrayed a continuation of the Bank's good financial standing in terms of liquidity, capital adequacy, financial flexibility and asset quality, suggesting a sound risk coverage in a tough operating environment. With respect to liquidity, net primary liquidity represented 58.4% of customers' deposits at year-end 2018, against 46.8% at end-2017. As to financial flexibility, the Alpha banks' shareholders' equity rose as well (+2.2% year-on-year to reach US\$ 22.0 billion in December 2018), thus reinforcing banks' cushions against potential pressure on capital.

At the level of asset quality, gross NPLs represented 8.93% of gross loans at year-end 2018 post adoption of IFRS 9 as compared to 7.63% as at end-December 2017. In parallel however, provisioning slightly increased, as loan loss reserves on NPLs to total NPLs expanded from 60.80% at end-2017 to 62.14% at end-2018, exceeding 100% when including real guarantees. Collective provisions on loans amounted to 1.33% of net loans.

Rising interest rates were offered by banks on both local and foreign currency deposits amid the prevailing market conditions in the covered period. As a matter of fact, the cost of funds in US dollars rose by 32 basis points, from 4.11% in 2017 to 4.43% in 2018. The cost of funds in LL increased by 46 basis points, from 5.41% in 2017 to 5.87% in 2018. The rise in the cost of funds in Lebanon's Alpha banks comes along with rising international rates, bearing in mind that the US Fed effectuated four consecutive hikes over the past year.

Despite cost control efforts on behalf of Alpha banks, the overall tough operating conditions, as reflected by the net contraction in lending portfolios last year and the adverse effects of domestic tax hikes, lead to a 5.5% contraction in net profits in 2018. As such, Alpha banks posted declining profitability ratios, with an annualized return on assets ratio of 0.91% and an annualized return on equity ratio of 10.31%, declining respectively by 14 bps and 95 bps relative to 2017. The components of return ratios suggest that asset utilization declined noticeably by 39 bps to 2.45%, driven mainly by the decrease in non-interest income to average assets by 34 bps to 0.58%, while spreads and net interest margins almost stabilized (rising in Lebanese Pounds and contracting in FX), while the net operating margin slightly increased in parallel by 20 bps to 37.30% in 2018.

In sum, there is no doubt that Lebanese banks in general and Alpha banks in particular have gone through a difficult year in 2018, amid domestic political tensions and the lack of a government formation for the better part of the year, in addition to market pressures in foreign markets of presence. Nonetheless, confidence in the banking system and the sticky deposit base, coupled with banks' sound liquidity at hand, have allowed the sector to withstand difficult times and post a growth - albeit more modest than in previous years- in deposits, its traditional engine of growth, while keeping overall profitability at relatively acceptable standards.