



Update for FY 2015

Sector: Banking

Country: Jordan

Date: March 8th, 2016

Share Price (JOD): 6.16

Target Price (JOD): 6.11

Downside: -0.81%

Recommendation: Hold

Risk: Medium (Market)

Maintaining Target Price at JOD 6.11 per share On Contrasting Indicators

Arab bank Net Income for the Year Takes a Hit

Arab Bank ended 2015 with a significant downturn in net income. The bank's net income for the year stood at \$442.12M (JOD 312.01M), equivalent to a 23.40% decline from 2014's figure. This decline was worse than our estimate of \$564.60M (JOD 398.45M), or a 2.17% drop from end-2014.

Arab Bank's Net Income was primarily dragged down by provisions for legal expenses. These provisions are primarily accounting for the expected \$1B settlement of the case against Arab Bank in New York, filed in 2004, regarding accusations towards the bank of financing members of Hamas via their branch in New York. On the income statement, Arab bank recognized \$349M (JOD 246.29M) of expenses related to such provisions.

Top-Line Matched with Blominvest Estimates

Arab bank's 2015 income statement revealed an annual increase of 1.46% in net revenues to reach \$1.551B (JOD 1.095B), compared to a Blominvest estimate of \$1.548B (JOD 1.092B). In detail, the bank's net interest income totaled \$1.09B (JOD 770.03M), up from 2014's \$1.07B (JOD 758.61M) for the year, despite the maintenance of an average interest rate spread of 2.27% on interest-bearing assets and liabilities from 2014. Blominvest estimates placed this figure at \$1.08B (758.86M) with an estimated average rate spread of 2.26%. Meanwhile, net fees and commission income ended the year with a 0.62% decrease from 2014's close as the average rate on expenses increased to 7.91% from 7.83% in 2014.

Continued Low Rates Boosting Arab Bank's LTD Ratio

Loans to customers demonstrated a 3.94% y-o-y increase, the best in years, to \$22.18B (JOD 15.62B) in 2015, while customer deposits grew at a decreasing pace of 2.29% to \$32.80B (JOD 23.15B). Consequently, the bank's Loan-to-Deposit (LTD) ratio rose from 66.55% in 2014 to 67.65% by the end of 2015. These results reflected the growth of Jordan's real GDP by 2.8% (IMF forecasts) during 2015, the slightly lower average interest rates on loans from 8.84% to 8.24%, in parallel to the much faster decrease in interests on deposits witnessed over the year, from 5.33% to 4.12%. The spread between interest rates in Jordan ended up widening from 3.51% to 4.12% according to the Central Bank of Jordan (CBJ).

The increases in customer loans and deposits drove the upward movements in total assets by 1.85% over the year to \$49.04B (JOD 34.61B).

Balance Sheet Reflecting Compromise of Profits for Safety

Arab Bank remains the largest bank in Jordan, sitting on deposits equivalent to 71% of the nation's total deposits in commercial banks, and with a portfolio of loans equal to 74% of total granted loans in Jordan. Over the year, Arab bank increased the weight of Jordanian loans in its portfolio from 24.69% in 2014 to 24.96% by end-2015. This increase came at the expense of loans in the remaining countries of the Arab World, which decreased from a weight of 65.02% to 64.95% over the year. Loans to Europe and Asia maintained constant weights of 4.88% and 1.34%, while the value of loans issued in America lost 20.48% over the year and held a new weight of 0.14%. The ratio of non-performing loans to total loans indicated an improvement from 6.7% by end-2014 to 5.46% by December 2015. This ratio is considered to be elevated, and results from the concentration of the bank's credit risk in Arab countries, such as Egypt, Sudan, and Yemen. Nevertheless, the decline in the NPL-to-total loans ratio is explained by the decreasing trend in global interest rates.

Share Data

Bloomberg Symbol	ARBK.JR
Reuters Symbol	ARBK.AM
Market Cap (JODm)	3,930.84
Number of Shares (m)	640.8
Free Float	46.0%
Price-to-Earnings	13.62
Price-to-Book	0.71

Source: Bloomberg,

Share Performance



1 Month Return	0.48%
3 Month Return	2.30%
6 Month Return	-6.88%
12 Month Return	2.47%
52 Week Range	5.24-7.20

Source: Reuters, Zawya

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Performance and Forecasts

	2013	2014	2015	2016e
Net Interest Income (USDm)	1,064	1,075	1,091	1,184
Net Income (USDm)	497	574	431	619
EPS (USD)	0.93	1.01	0.67	0.97
BVPS (USD)	14.27	13.63	12.31	13.03
ROA (%)	1.08	1.20	0.90	1.24
ROE (%)	6.46	7.32	5.52	7.36

Source: Arab Bank, Blominvest

Dividend Distribution for 2015

Following the release of Arab bank's financial statements for FY 2015, the Board of Directors announced an expected dividend payout of 25%, equivalent to \$0.17 (JOD 0.12) per share. The ex-dividend date is set for the 4th of March, 2016.

Relative Valuation

The relative valuation approach based on the P/B multiple indicates that Arab Bank's stock is undervalued with respect to local comparable firms, with a P/B of 0.72x compared to a median multiple of 0.98x for the country. However, it is also worth noting that Arab bank's dividend yield is the lowest among these comparables, with a trailing yield ratio of 1.71%.

When compared to the region, the P/B multiple also reflects that the Arab Bank stock is slightly undervalued compared to a regional mean of 0.96x. The dividend yield is also lower compared to the comparable mean of 4.00%. Arab Bank's Return on Equity (ROE) also trails regional peers in terms of profitability, with a ratio of 5.52% compared to a median ROE of 13.30% for the selected peers.

Banking Industry in Jordan

Ticker	Name	Market Cap (USD M)	YTD Total Return %	P/B	P/E	Div Yield TTM
Median		695.66	-3.66%	0.98	11.19	3.99%
ARBK JR	Arab Bank PLC	5,570	-4.34%	0.71	13.62	1.71%
THBK JR	Housing Bank for Trade and Finance	3,320	-1.06%	2.45	18.57	3.76%
BOJX JR	Bank of Jordan	644.88	13.46%	1.26	11.19	6.76%
JOKB JR	Jordan Kuwait Bank	556.73	-3.66%	0.91	10.53	--
CABK JR	Cairo Amman Bank	541.23	-5.88%	0.98	8.81	4.23%

Source: Bloomberg, March 3rd, 2016

Regional Banking Companies

Ticker	Country	Name	Mkt Cap (USD B)	YTD Total Return %	P/B	P/E	Div Yield TTM
Median			4.24	-5.23%	0.96	11.42	4.00%
ARBK JR	JOR	Arab Bank PLC	5.57	-4.34%	0.71	13.62	1.71
COMI EY	EGY	Commercial International Bank	4.68	-13.42%	2.29	8.09	2.92
CBD UH	UAE	Commercial Bank of Dubai	4.24	-20.63%	1.70	13.03	4.00
CBQK QD	QAT	Commercial Bank of Qatar	3.90	-5.23%	0.96	11.42	6.54
BLOM LB	LEB	BLOM Bank	2.06	2.66%	0.84	5.35	6.88

Source: Bloomberg, March 3rd, 2016

Banking Activity in Jordan During 2015

The Jordanian banking sector witnessed significant policy changes that drove loan and deposit activity in the Kingdom. Over the year, the country's interbank and discount rates witnessed decreases to values of 2.08% and 3.75%, from respective rates of 3.00% and 4.75% at the end of 2014. As such, the average interest rates on loans and deposits in commercial banks shed 0.60% and 1.21% to 8.24% and 4.12%, respectively. This resulted in the widening of the average interest rate spread from 3.51% to 4.12%. Resultantly, total loans by end 2015 grew by 9.48% to reach \$29.90B (JOD 21.10B), compared to a slower 7.72% growth in total deposits to \$46.19B (JOD 32.60B). As such, the LTD ratio for commercial banks in Jordan edged up 1.04 percentage points to 64.73%.

Expected Performance During 2016

Jordan's economy is expected to grow by 3.75% in 2016 (IMF forecasts), and efforts to revive inflation from near zero levels to 3% will induce further interest rates cuts although we expect them to be limited. We therefore project lending to continue to grow although deposits are likely to grow at a much slower pace, unless expansionary efforts outside Jordan continue to bring in results.

Loan/deposit ratio is also likely to remain on an increasing trend, and directed more towards the private sector as the Jordanian government seems to be in less of a need for financing, and is even considering tapping the international markets for liquidity rather than domestic participants.

Arab Bank's Net Income is expected to significantly improve by 43.69% to \$619.05M (JOD 436.87M) due to the increase in net interest revenue and lower provisions. The bank's net interest income is expected to gain 8.53% during the year and close at \$1.18B (JOD 835.72M) as a result of the increased lending activity expected to arise from the persistence of low interest rates. The bank also announced that it has

completed at end-2015 the set of large provisions taken to settle the New York case. Therefore, we expect provisions to substantially decline from 2016 onward.

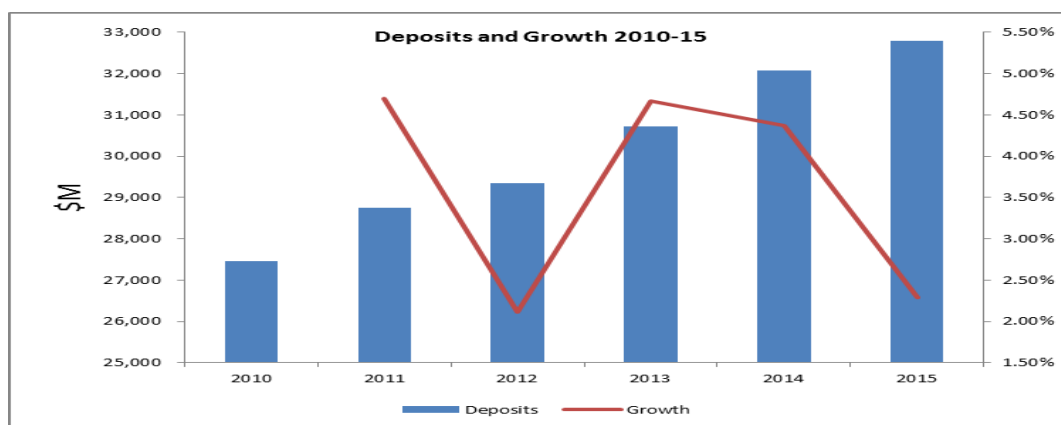
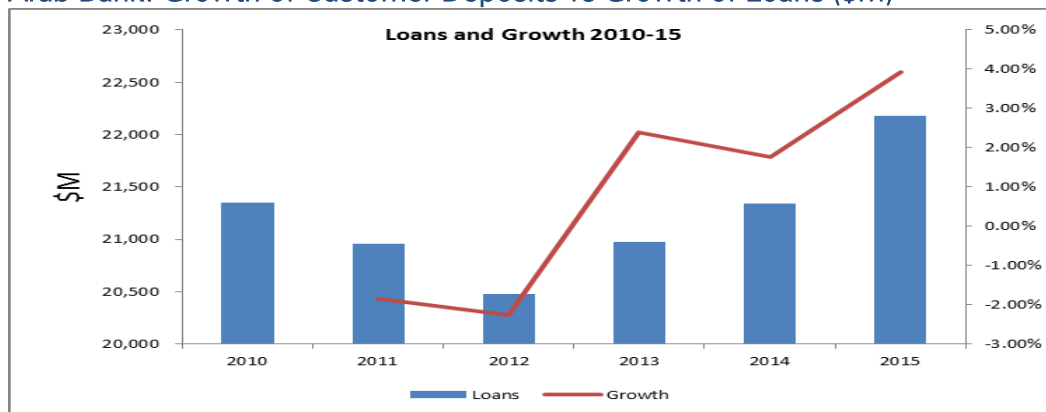
On the balance sheet, the developments in the bank's loan and deposit activities are expected to sustain the witnessed increasing trend of the LTD ratio during 2016, with an estimated LTD ratio of 68.60% by the end of the year. Loans to customers are forecasted to augment by 3.98% to \$23.06B (JOD 16.27B) over the year, with customer deposits expected to increase by a slower 2.50% in comparison to \$33.62B (JOD 23.72B) over the same period.

Recommendation

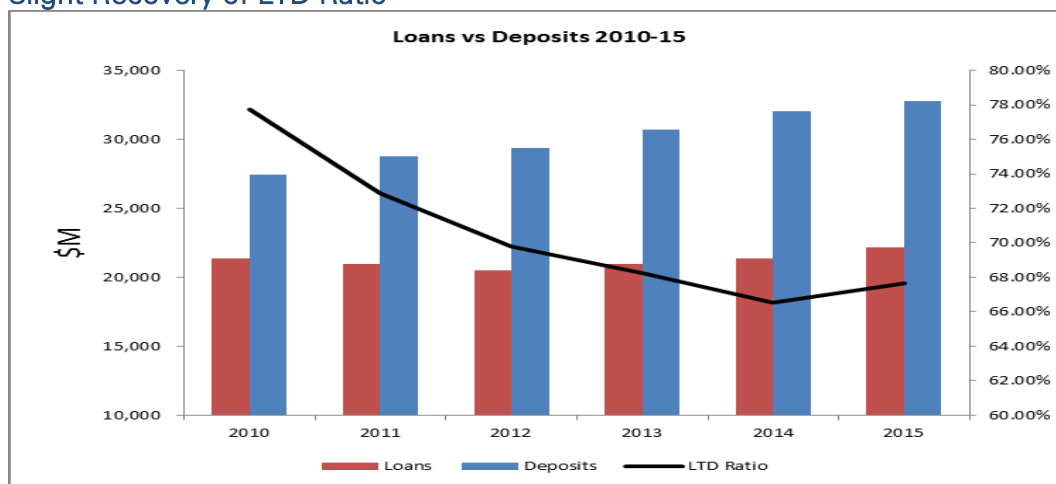
Based on the above, Blominvest maintains its HOLD rating on the Arab Bank stock, with a target price of JOD 6.11 per share. However, we expect some price volatility to be witnessed in the short term following the bank's payment of settlement charges. Underlying economic expectations linked to the bank's operations remain too weak and unpredictable for a more positive outlook.

Appendix:

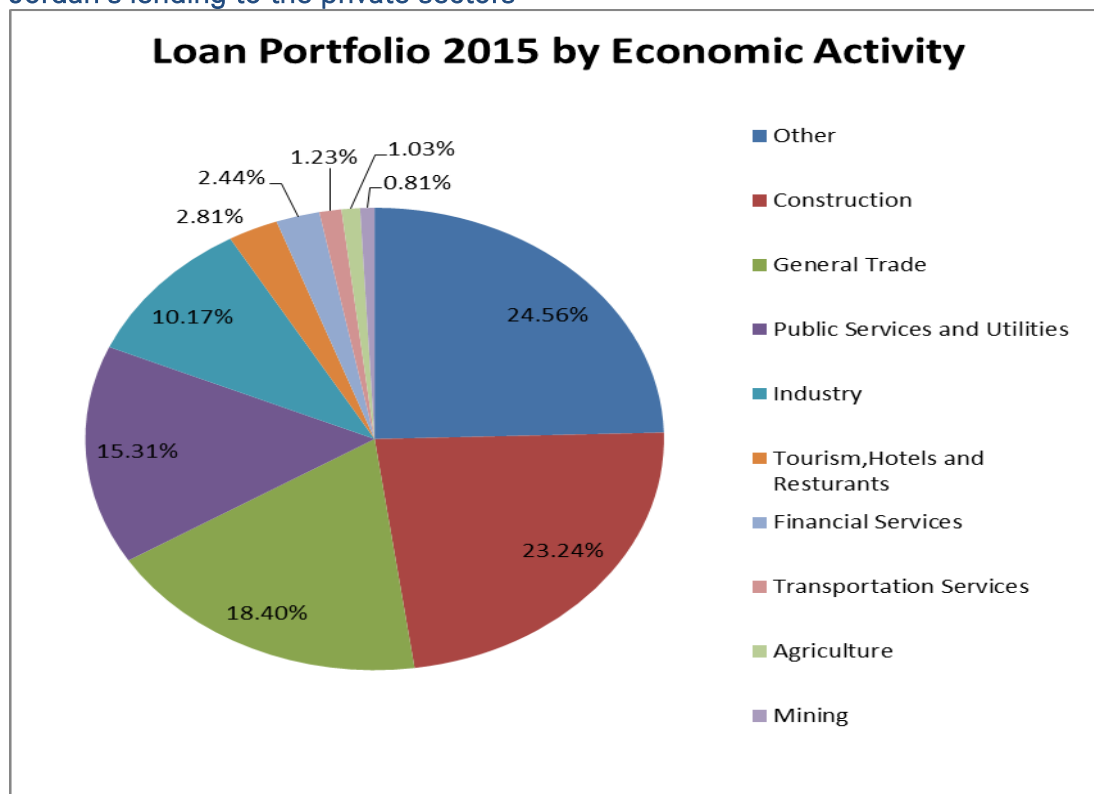
Arab Bank: Growth of Customer Deposits vs Growth of Loans (\$M)



Slight Recovery of LTD Ratio



Jordan's lending to the private sectors



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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