

Investment Series 2009

Lebanon

A Phoenix Rising



Against all odds, Lebanon could prove to be one of the few national success stories of 2009. After years of unrest, peace has blossomed just as the banking sector's traditional prudence is coming into its own. Has Lebanon become the Switzerland of the Middle East once more?



INTERNATIONAL INVESTMENT GUIDE

A Blossoming Oasis

“We know that our patchwork heritage is a strength, not a weakness,” was one of Barack Obama’s many memorable phrases from his inauguration speech in January this year. After decades of ethnic and religious division, it is also an observation that is becoming increasingly relevant to Lebanon—albeit on a different scale to the U.S.



Although the country celebrated 65 years of independence last year, Lebanon has enjoyed its own continuously changing identity for more than two millennia, from the time that the sea-faring Phoenicians made it their base. Since those far-off days it has survived and assimilated successive empires, cultures, and gene pools, from the Persians and Assyrians to the Ottomans, and most recently the French. These days its mix is largely defined along both ethnic and religious lines, and is a patchwork of Christians and Muslims of varying persuasions.

Lebanon’s proximity to the fault line that runs between the civilizations of East and West has given its inhabitants both an instinct for survival and an eye



With its rich natural, historical, and cultural diversity, Lebanon is a meeting point between East and West.

for the entrepreneurial opportunity, and if there is one adjective that could be used to sum up the national character it would be ‘resilient.’ It is a resilience that could well see Lebanon ride out the current global economic storm in greater comfort than many nations which ostensibly lay claim to more stable and sophisticated financial infrastructures.

Meeting Today’s Challenges

For there is a renewed groundswell of confidence in Lebanon’s political and economic stability. Having rebuilt itself after the 15-year-long civil war only to be thrown into turmoil yet again in 2005 with the assassination of Prime Minister Rafic

Hariri, the country is once more defying the odds and rising from the ashes of discord.

The signing of the Doha Agreement in May 2008 marked the end of the political crisis triggered by Hariri’s death, with the subsequent election of Michael Suleiman as president and the establishment of a government of national unity. As a result, investment from the Lebanese diaspora is starting to flood back into the country in increasing quantities, with expatriate remittances reaching \$6 billion in 2008. The Doha Agreement also gave the tourist industry a welcome shot in the arm.

This upturn in fortunes has given the government the leeway and impetus to address the shortcomings in its physical

infrastructure, particularly in the utilities sector. Alain Tabourian, Minister of Energy and Water Resources, is currently working on a blueprint for major government-led investment in the country's gas-dependent power supplies. This is firstly going to involve a major restructuring of Électricité Du Liban, the state-owned electricity company.

"We need to diversify away from gas," Tabourian explains. "Because of the age of our power plants, it is costing us double what it should to generate power. All things considered, 40% of our power should come from coal, 30% from heavy fuel, and only 30% from gas." This is by its very nature a long-term vision, and Tabourian is looking at a public private partnership (PPP) business model that will present opportunities for foreign companies to participate in the initiative. In the meantime, responsibility for maintenance and distribution of the water supply has also been reorganized along regional lines to help make the regular seasonal water shortages a thing of the past.

Stabilizing the Economy

Maintaining the country's long-term equilibrium is now of paramount importance for long-term and sustainable economic growth, according to Mohammad Safadi, Lebanon's Minister of Economy and Trade. "We all appreciate the importance of security and stability to encourage growth," he says. "We have entered into a national dialogue to deliver this stability and to give confidence to investors. We have also introduced a lot of reforms to ease investment procedures and to make them more transparent."

Safadi is set to play a key role in attaining these goals and has identified three priorities for him and his colleagues. "First, we need to articulate a clear economic vision so that we can map out a comprehensive economic policy for Lebanon. Second," Safadi continues, "we need to strengthen protection for the consumer, as this has a profound effect on prices, quality, and hygiene; and third, we need to regulate and expand the insurance sector, but not to the detriment of the sector's liberalization." One of the more immediate and tangible benchmarks he has set himself is membership of the World Trade

Organization (WTO), and he expects ratification by the end of the year.

The centerpiece of these reforms is likely to be the privatization of the telecommunications sector. Gebran Bassil, Minister of Post and Telecommunications, is working on a three-stage plan for the denationalization of the country's cellular networks that will benefit local as well as overseas investors. "I want the Lebanese to have a big share of this market," he says. "We want to bring foreign operators in and give them management control, but we also want to allow Lebanese people to be shareholders, Lebanese funds to hold shares, and small operators and stakeholders to be part of the operation." The timing and exact nature of the privatization arrangements are yet to be determined.

"Lebanon will be the hub of the region," is Bassil's confident claim. If the current peace holds and the government succeeds in pushing all its reforms through, that may prove to be true for the country's economy as a whole and not just its telecommunications sector. ●



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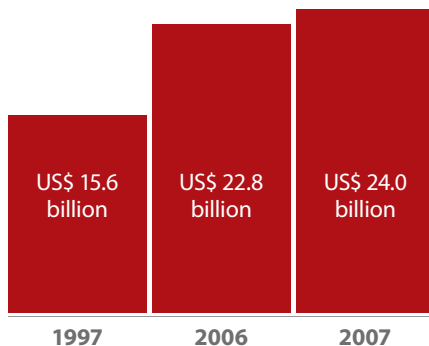
Before Lebanon was torn apart by civil war in the mid-1970s, it was commonly known as “the Switzerland of the Middle East,” with its banks being bywords for discretion, prudence, and reliability.

If ever the world needed them to display these characteristics again it is today, as the full gravity and implications of the credit crunch unfold—and just as the underlying strength of the country’s banking sector reasserts itself.

Unlike many of their global competitors, Lebanon’s banks have enjoyed a golden year with assets—principally fueled by a surge in customer deposits—growing by 13%, according to Bank Audi’s third-quarter *Lebanon Economic Report* of last year. BLOM, the country’s second largest bank, posted a 40% year-on-year increase in profits for the first half of 2008; and at the time of writing, the country’s

Lebanon’s GDP

Source: World Bank



fourth largest, BankMed, was predicting a 100% increase for the full calendar year.

Critical to this success has been the strength of the relationship between the banks and their Lebanese client base. “The loyalty and risk perception of the depositors—both those based here and the Lebanese abroad—is quite evident,” says the Minister of Finance, Mohammad Chatah. “They tend to stay with their original banks even if they live in Dubai or elsewhere. The nature of the relationship

between depositors and bankers is very traditional; people know their banks and their bankers. They can call them up and feel comfortable keeping their money here. This means that they don’t have the vulnerability to credit lines drying up as they have elsewhere,” he continues.

A Conservative Banking Approach

As well as good old-fashioned two-way loyalty, there are two other reasons for the banks’ counter-cyclical prosperity: a sense of perspective and an adherence to the traditional precepts of banking that have been either ignored or forgotten by some of the more spectacular casualties of the current global financial crisis. The physical danger that has periodically been a daily reality for many Lebanese has, firstly, put the credit crunch into an entirely different emotional context to the panic it has generated among the denizens of Wall Street or London’s Square Mile.

“In May 2008 we had to shut down our office in five minutes because there was a problem in downtown Beirut, and we had to move to our backup site in the mountains,” recalls Jean Riachi, chairman and CEO of FFA Private Bank. “We were up and fully operational again within an hour. So in all honesty the financial crisis is a joke in terms of the stress that we have lived through over recent years.”

Paradoxically—given the Lebanese business community’s reputation for entrepreneurial flair—the uncertainty of life in their country has also bred an innate conservatism in the banking sector, “Because we know that the worst-case scenario can always happen,” Riachi explains.

This deep-rooted caution underpins the country’s financial regulatory system. Under the auspices of its governor, Riad Salameh,

the Central Bank placed firm controls on lending in the real estate sector and investment in local and international stocks, which have protected both investors and banks from the sharp fluctuations that have affected other markets. “As a result of this conservative policy adopted by both the Central Bank and the regulatory authority, our margins have stayed at about 40%—even with a slump in the real estate market which has brought margins close to zero in countries like the U.S.,” Chatah says.

Salameh’s common sense has carried Lebanon’s banking fraternity along with him, not least because his policies are

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now paying dividends for organizations such as the Al-Mawarid Bank, which operates in two niches that depend on the country as a whole running a healthy balance sheet: microlending to individuals and small businesses geographically focused in the southern mountains of Lebanon; and credit cards, where it holds 30% market share of the whole Lebanese market.

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“Overall, the banking sector grew above average in 2008,” says Marwan Kheireddine, Al-Mawarid Bank’s general manager, “and on both sides of the balance sheet. We’ve grown significantly in terms of deposits and we’ve done the same on the loans side. We managed to avoid any liquidity issues and kept Lebanon away from a credit crunch, mainly because we identified the risks attached to the structured financial products that were being marketed all around the world by most of the leading

banks—and we identified those risks as long ago as 2004,” he continues.

It was at that point in 2004 that the Central Bank—with the blessing of the Association of Banks in Lebanon (ABL)—issued a memo forbidding the country’s banks to invest any more than 5% of their equity in any structured financial products, thereby deliberately dampening the sector’s enthusiasm for some of the more exotic derivatives that are now causing so many problems elsewhere.

Global Diversification

If there is an inherent challenge to the Lebanese banking system it lies in the size of its customer base. The country’s largest banks—Bank Audi, BLOM, Byblos Bank, and BankMed—already have a significant presence overseas. BankMed, for example, not only has a subsidiary in Switzerland, a branch in Cyprus, and owns Turkland Bank in Turkey; it also has a strong representation in Saudi Arabia through Saudi Oger and has launched the SaudiMed Investment Company, which operates as an investment bank.

Exposure to overseas markets has given companies like BankMed an international perspective, which is also standing them in good stead at home. “My managers are paid international salaries even compared to rich Gulf States,” explains BankMed’s chairman and CEO, Mohammed Hariri. “There are no good banks—or any other kind of business—without top people.”

But the innate conservatism remains. “We are always looking at new and promising opportunities and we will never walk away from a good deal,” Hariri says, “but we will also always try to maintain our liquidity and keep our position strong. Lebanon’s GDP is expected to grow by around 7% this year and by about the same again next year, so we need to keep growing and consolidating our position as there will be lots of good opportunities here in Lebanon as well as abroad.”

With the benefit of hindsight, there are one or two former CEOs of multinational banks who must be wishing they had adopted a similar philosophy over the past few years. ●



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Chartering a Course for Global Expansion

With its strategic location on the southern shores of the Mediterranean, commerce has always been a key function of Lebanon's economy. But its business community cannot be characterized as a fleet of wheeler-dealers and the country's manufacturing sector is currently enjoying a welcome resurgence.

In revenue terms, exports rose by 30% during the first nine months of 2008—an increase largely attributable to the relative weakness of the dollar, which works in favor of Lebanon's "dollarized" balance sheet. Fadi Abboud from the Association of Lebanese Industrialists does not believe it is an advantage that is likely to be reversed in the near future—but that is not all the country has going for it.

"We have a well-trained and multilingual workforce and are able to comprehend, understand, and use technology," Abboud claims, "so Lebanon is very suitable for high value-added industries that need a skilled workforce, because it's very difficult to import the skilled workforce and change them every two years."

A partner in free trade

Lebanon nevertheless needs to expand the geographical footprint of its export markets. In 2002 Lebanon signed an association agreement with the European Union, and has made membership of the World Trade Organization (WTO) a central objective for 2009. "We want to join the WTO," says Abboud, "as the industrial

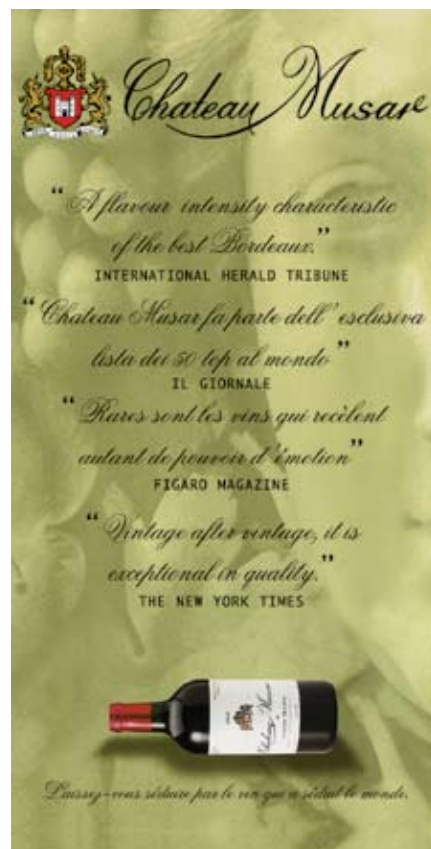
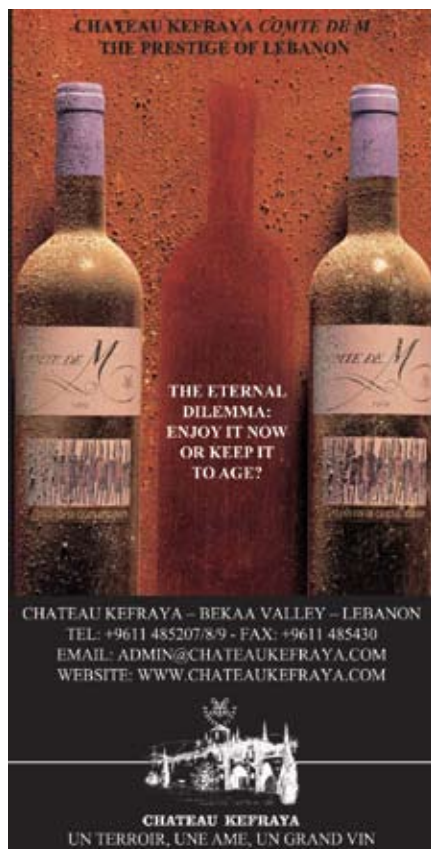
sector is already subjected to a liberal economy, free trade, and competition, and WTO membership will open the country up properly."

Established companies such as industrial packaging conglomerate INDEVCO Group are not, of course, waiting for WTO membership to strengthen their already substantial international networks. "We have many major expansion plans either already underway or in the pipeline," says INDEVCO Group's CEO Neemat Frem. "In the last two years we have developed a tissue mill in Egypt and a biomass power plant in Pennsylvania, both of which

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should become operational in 2009. Taken together with organic growth, this should enable us to deliver 15% growth annually."

Another sector with high export potential is food and produce. Combining as it does the sophistication and subtlety of European cuisine with the exotic ingredi-



ents of the Middle East, Lebanese cuisine is now gaining in popularity. It is a potential that companies such as nut producers Al Rifai Roastery are striving to fulfill.

The company first set its sights on neighboring markets in the Middle East, explains its chairman and general manager Mohamed Al Rifai, and set up a joint venture with a Kuwaiti partner. He now has around 100 outlets—mainly franchises—spread across the region. Expanding into Europe has presented different challenges. “For the last 30 years we have been doing our best to convince retailers in the U.K., Spain, France, and Italy to display our goods. They say our nuts are beautiful but usually end up putting them in the ethnic food area,” says Al Rifai. He has had more success now that he has focused his efforts on Scandinavia and particularly Sweden, where he convinced buyers to display his products on the main nut sections. “The Al Rifai Roastery now has 12 shops in Sweden and moves are afoot to open in Denmark, Finland, and Norway,” he continues. Next stop is the U.S.

Nurturing a Viticulture

If there is one industry that epitomizes the ingenuity of the Lebanese business community then it has to be the wine industry. Over the past 20 years it has survived its vineyards being bombed and the successive collapse of both its domestic and international markets, yet it has come up not just fighting, but—with the help of technological advances and sophisticated marketing techniques—flourishing.

Take Château Kefraya, which was established by its chairman and CEO Michel de Bustros in the Bekaa Valley back in 1950. What started as a series of terraces on a hillside sprinkled with rocks has developed into a vineyard of more than 300 hectares, whose adjacent manicured lawns have become part of the brand’s attraction in their own right. “Since we already had a good wine we could not put it in any old bottle,” explains de Bustros, “so now we have a new painting on each year’s vintage. But we also reasoned that a good wine in a beautiful bottle could not be produced in any environment—it also had to be a beautiful one. So we created 10,000 acres of beautiful lawns and named each one after a famous opera



Lebanon’s landscape ranges from snowy mountains and beautiful valleys to rolling vineyards and Mediterranean beaches.

composer such as Verdi and Puccini.” Since then de Bustros has opened both a wine shop and a restaurant, and produces an average of two million bottles each year for export to more than 35 countries.

He is not the only Lebanese vintner to boast exceptional surroundings. The country’s largest wine producer is Château Ksara, founded by the Jesuits in 1857. The vineyard stores its wines in the famous natural Ksara caves that were discovered by the Romans and boast almost two kilometers of tunnels, which alone make the chateau worth a visit and attract around 40,000 visitors each year. “We are an established brand name and the natural caves, our history, and especially the modernity of our equipment give us a competitive edge,” says chairman and CEO Zafer Chaoui. “Internationally we are also doing extremely well.” Export sales will have undoubtedly been helped by the handful of gold medals his wines have won in recent years—two at the International Weinprämierung and two at the VinAgora Concours.

Although competitive, the Lebanese wine producers are also mutually supportive and have, under their own initiative,

organized themselves into the Union Vinicole du Liban (UVL) to promote their interests. While fighting for market share both domestically and abroad, they are all agreed on one thing: Given the limitations imposed by the size of their vineyards, the key to success must lie with the quality, not the quantity, of the product.

Serge Hochar, chairman of the family-run Château Musar (and the UVL’s current president), will not release any of his wines to the market until they are seven years old, a policy that has won him a place on the wine lists of up to a dozen Michelin Guide restaurants in Europe. His wines can be found as far afield as Las Vegas, Aspen, and Dubai. But, like his colleagues in the other châteaux, he understands there is more to the wine trade than hard cash. “We are considered a very successful sector of the Lebanese economy,” he says, “although we do not contribute much to the GDP. They are not big figures but we send a good message about Lebanon to the world.”

And the world could do worse than listen to the message that has become one of Hochar’s mantras: “If you talk about wine you forget about the war.” ●

A Cultural Epicenter

If Lebanon is well on its way to reclaiming its reputation as the Switzerland of the Middle East in business terms, then it is also fast reclaiming its role as the region's cultural epicenter, too. Being Lebanese has become cool and sophisticated again.

It is a movement spearheaded by iconic fashion designers such as Elie Saab—the internationally renowned couturier whose customers include actress Halle Berry, Princess Stephanie of Monaco, and singer Beyoncé Knowles—and the likes of globally recognized architect Bernard Khoury, whose career and works are somehow emblematic of the spirit and indomitable optimism of his native country. The growing reputation of Lebanon's fashion and architectural stars is now being echoed in other creative industries, and Beirut is once again the fulcrum of the Middle East's TV, entertainment, and marketing industries.

In the process of leaving their recent past behind them, the Lebanese are also giving more expression to the national traits that have traditionally been part of the country's charm—an appreciation of the good things in life, the age-old tradition of hospitality, and a general *joie de vivre* that has survived against the longest of odds. The evening promenade on Beirut's Corniche shows that the Lebanese way of life has not fundamentally changed that much over the years or even centuries.

If there has been a discernible change in the last two or three years it is in the briskness of trade that bars, cafes,

and restaurants are currently enjoying. This comes as no surprise to Pierre Achkar, president of the Federation of Tourism and the Hotel Association in Lebanon. "Lebanon is a way of life," he explains. "People are well received, we have a good level of service, we speak three languages, and we have summer, winter, and cultural tourism. We also

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have a nightlife, freedom for women, and alcohol, none of which are so readily available elsewhere in the Middle East," he continues.

Yet the country remains largely dependent on the Lebanese diaspora for its tourist trade and—because of the limitations of its size and its cultural idiosyncrasies—it is never going to compete with some of its Mediterranean neighbors in terms of tourist volume. Like its wine industry, the emphasis will remain on quality, not quantity.


The industry's plans for growth are accordingly both targeted and realistic. "If you look at the Foreign Office's website, it advises you to come here






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with caution,” says Dr. Khater Abi Habib, chairman and general manager of the Casino du Liban, which celebrates its 50th anniversary this year. “But I think you will have noticed that it is pretty safe here. Nevertheless we are not marketing too aggressively because that would look ridiculous given the Foreign Office’s advice. We would like to attract more visitors from places like Turkey, Cyprus, and Egypt, but visitors from such countries are the icing on the cake; our cake is tourists from neighboring countries like Syria, Jordan, and Iraq as well as Lebanese expatriates who keep coming here because we are a natural outlet.” This is not to say Lebanon will cease to extend the warmest welcome to family groups or independent travelers looking for a different Mediterranean experience—it just means that those who come are guaranteed a genuine taste of the Lebanese lifestyle. ●



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