

BANK AUDI

Equity Research **October 7th, 2009**

Sector: Banking
Country: Lebanon

- Current price*:	USD 72.9
- Target price:	USD 73.9
- Recommendation:	HOLD

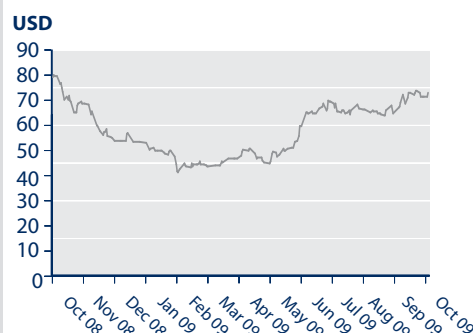
Share data

- Listing common shares:	Beirut Stock Exchange
- Listing GDRs:	BSE & London Stock Exchange
- Reuters code:	AUDI.BY, AUSR.BY, AUSRq.L
- Bloomberg code:	AUDI.LB, AUSR.LB, BQAD.LI
- Market cap:	USD 2492 mn
- Number of common shares:	34.2 mn

Share price information*

- YTD Δ	36.4%
- 1M Δ	8.2%
- 3M Δ	8.1%
- 12M Δ	-9.3%
- 52 - Wk range	USD 41 - 75

Bank Audi shares performance



* Bank Audi shares closing as of the 7th of October 2009

This report should be read in conjunction with the Lebanese banking sector review 2008.

Contacts

Head of Research and Advisory: Marwan Salem
m.salem@ffapivatebank.com +961 1 985195

Analyst: Raya Freyha
r.freyha@ffapivatebank.com +961 1 985195

Sales and Trading, FFA Private Bank (Beirut)
+961 1 985225

Sales and Trading, FFA Dubai Ltd (DIFC)
+ 971 4 3230300

A first class bank...made in Lebanon

- Largest Lebanese bank by assets, deposits and loans

Driven by its ambitious expansion strategy based on a series of mergers and acquisitions coupled with significant organic growth, Bank Audi has grown to be the largest bank in Lebanon, in terms of assets, deposits and loans. The Bank boasts the strongest local franchise supported by the widest branch-network in the country.

- A strategy of regional expansion coupled with business lines diversification

Starting in the late nineties, the Group engaged into a universal banking profile, covering a large spectrum of banking services ranging from retail, commercial, investment and private banking to capital markets activities and insurance. In more recent years, and aside from its 30-year presence in France and Switzerland, Bank Audi has built an extensive branch network in the MENA region. The Bank's regional presence currently covers: Egypt, Jordan, Saudi Arabia, Sudan, Syria, UAE and Qatar.

- We expect Bank Audi to witness a solid growth in its balance sheet and bottom line figure, outperforming the industry

We believe Bank Audi's capitalization levels will remain sound and no liquidity constraint could curtail future balance sheet growth. Over the forecast period, the Bank will continue to expand its deposit base and lending activities substantially, as highlighted by a CAGR of 12.7% and 12.4% for customer deposits and loans, respectively. In parallel, net income is expected to grow at a CAGR of 15.9% triggered by strong balance sheet growth, a tighter cost control policy and higher interest spreads.

- We value Bank Audi at USD 73.9 per share

Our fair value estimate, derived from the DECF projections equals to USD 73.9 per share, implying a P/B 09 of 1.39 and a P/E 09 of 9.83. We, accordingly, assign a **hold recommendation** to Bank Audi.

Key performance indicators:

	2008	2009e	2010e	2011e	2012e	2013e
- Net Interest Income (mn)	423	444	519	593	707	829
- Non Interest Income (mn)	238	255	268	290	317	345
- Net Profit (mn USD)	238	264	307	358	427	497
- ROaA	1.24%	1.15%	1.15%	1.20%	1.30%	1.38%
- ROaE	12.9%	13.1%	14.0%	14.9%	16.0%	16.8%
- BVPS (USD)	49.89	54.77	60.54	67.36	75.68	85.35
- EPS (USD)	7.03	7.76	9.04	10.55	12.57	14.63
- P/E	10.69	9.69	8.31	7.13	5.98	5.14
- P/BV	1.51	1.37	1.24	1.12	0.99	0.88

- Disclaimer

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Investment Summary

- Bank Audi was incorporated in 1962 under its present form and was named "Banque Audi sal". Through a string of mergers and acquisitions coupled with a significant organic expansion, Bank Audi sal has grown into the largest bank (in terms of assets, deposits, loans and shareholders' equity as at year-end 2008) in Lebanon, where it operated a network of 78 branches as of year-end 2008
- Since the first half of the current decade, Bank Audi has been implementing its strategy with the aim of becoming the most diversified regional bank by both business lines and countries of presence.
- Bank Audi offers a full range of commercial, investment, private and retail banking services. Bank Audi sal covers all activities, while Bank Audi Saradar France offers a full range of retail and commercial banking services; Banque Audi Suisse sa, with its representative office in Beirut, along with Audi Saradar Private Bank and the Saudi and Qatari entities, represent the private banking arm of the Group. All investment banking actions are conducted by Audi Saradar Investment Bank sal and Audi Saudi Arabia (Audi Capital – KSA), while bancassurance products are tailored by its fully owned subsidiary, LIA Insurance sal, and sold through Bank Audi's retail network.
- In the late 1970s, Bank Audi expanded its activities towards Europe by establishing entities in Switzerland and France. Over and above its 30-year presence in Europe, Bank Audi is currently building up a strong franchise in the Middle East and North Africa. In Jordan, Syria and Egypt, the Bank provides comprehensive retail and commercial banking products, while the Saudi and Qatari entities are specialized in capital markets activities and corporate & private banking, respectively. Islamic banking is the core business of the Bank in Sudan. The Bank is also present in the UAE through a representative office.
- Bank Audi's strategic orientations revolve around the strengthening of its domestic franchise through the following:
 - Consolidating its commercial banking franchise and corporate business relationships
 - Further strengthening the retail banking coverage and franchise
 - Developing private banking towards asset management.
 On the international level, Bank Audi's main strategic orientations revolve around:
 - Building a strong franchise in the MENA region
 - Consolidating the Bank's presence in Europe
 - Strengthening the Bank's existing coverage of the Diaspora in West Africa, Australia and Latin America
- With regard to H1 09 results, loans and advances recorded a 3.4% increase over the first half of the year while deposits recorded a significant 11.6% increase. On the back of pressures on interest spreads, the H1 09 results reveal a growth of only 1.5% in the net interest income figure. As for the non-interest income, it retreated, displaying a 7.6% y-o-y decrease as a result of the prevailing market conditions. Net profit of USD 132.9 mn was declared for H1 09, indicating a 1.9% increase y-o-y.
- Triggered by a steadier economic environment, and supported by the Bank's outstanding deposit growth during the first half of the current year, we anticipate customer deposits to grow by 21% in 2009e. Going forward, we expect this growth to gradually decelerate to 9% by the end of 2013e as a result of an anticipated upturn in international interest rates. More generally, we assume that customer deposits will grow by a CAGR of 12.7% during 2008-2013e with the bulk of the total growth originating from the Bank's international expansion strategy.
- Bank Audi is solidly capitalized with a Basel II capital adequacy ratio of 12.84% as of end 2008, comfortably higher than the required ratio of 8%.

- The Bank's loan portfolio growth accelerated in the last two years in line with the general trend in the Lebanese banking sector. Loans grew by 31.5% in 2008 to reach USD 6 bn by the end of the year, thus positioning the Bank as the largest in the industry in terms of loans. Over the first six months of 2009, loans and advances recorded a 3.4% increase. Supported by signs of higher lending activity over H2 2009, we expect loans to grow at a 16.14% rate in 2009e and assume the CAGR for the whole projection period to stand at 12.38%. We believe this solid growth will be triggered by a rise in the contribution of newly established regional entities to consolidated activity and by a steadier economic environment on the domestic scene.
- Even though loans witnessed a 31.5% growth in 2008, the Bank's asset quality improved as demonstrated by its NPL ratio declining from 4.4% in 2007 to 3.1% in 2008. We believe the risk of a deterioration in the asset quality to be mitigated by the Bank's strict risk management policy in this regard which, in turn, would lead to a very slight and gradual increase of the NPL ratio from 3.1% in 2008 to 3.9% in 2013e.
- Due to interest spread contraction on foreign currency holdings, we expect net interest income growth to decelerate in 2009e to 5% after having registered a 22.5% y-o-y growth in 2008. With downward pressures on interest spreads expected to ease starting 2010e, interest income will grow at a swifter pace as demonstrated by a CAGR standing at 16.9% for the remainder of the forecast period. Consequently, we expect the net-interest income to reach USD 829 mn by 2013e.
- In FY08, Bank Audi's non-interest income grew by 15.4% to USD 238 mn by the end of the year. During the first six months of 2009, it retreated, displaying a 7.6% y-o-y decrease as a result of the sluggish market conditions. In 2009e, we expect Bank Audi's non-interest income to grow at a slower pace compared to 2008 and to slightly regain momentum starting 2010e on the back of a potential improvement in the overall market conditions. As such, we forecast the non-interest income growth to increase by 7.2% and 5.1% for 2009e and 2010e respectively and to be in the range of 8.1%-9.3% over the remainder of the projection period.
- Bank Audi's cost-to-income ratio decreased slightly in 2008, moving from 55.96% in FY 2007 to 54.96% in FY 2008. The H1 09 results show that general operating expenses dropped by USD 14 mn, resulting in a substantial improvement of the cost-to-income ratio. However, this ratio is still considered high owing to the Bank's aggressive expansionary policy in addition to a heavy cost structure. Moving forward, we anticipate that Bank Audi is going to gradually decrease its cost-to-income ratio to reach 45.7% by the end of the forecast period on the back of a faster pace in revenues growth compared to costs growth.
- Bank Audi recorded a net profit of USD 238 mn in 2008, which represents an increase of 19% over the previous year. The net income CAGR we forecast for the entire projection period stands at a sustained 15.9% which will move the net profit from USD 238 mn in FY 08 to USD 497 mn in 2013e. In our view, this sustained growth pattern is set to be triggered by strong balance sheet growth, a tighter cost control policy and higher interest spreads.
- The solid net profit growth will directly impact the profitability ratios as noted by a growth in both ROAE and ROAA. The former is expected to increase from 12.9% in 2008 to 16.8% in 2013e and the latter from 1.24% in 2008 to 1.38% in 2013e.
- Our approach to providing a fair value estimate for Bank Audi is based on a Discounted Equity Cash Flow (DECF) methodology. Based on our projections, our fair value estimate derived from discounted dividends attributable to common shareholders and excess capital amounts to USD 73.9 per share, implying a P/B 09 of 1.39 and a P/E 09 of 9.83.

Company Overview



Bank Audi was incorporated in 1962 in Lebanon



Bank Audi is a regional universal Bank that operates in Lebanon and in nine countries abroad, through a network of 152 domestic and foreign branches as at end-June 2009



Bank Audi ranks first among its domestic competitors in terms of assets, deposits, loans and equity and is positioned among the top 25 Arab banks

▶ Brief background

Bank Audi was incorporated in 1962 under its present form and was named “Banque Audi sal”. Through a string of mergers and acquisitions coupled with a significant organic expansion, Bank Audi sal has grown to be the largest bank (in terms of assets, deposits, loans and shareholders’ equity) in the crowded but gradually consolidating Lebanese banking sector. The bank’s expansion revolved around a series of acquisitions in the late 1990s that targeted Credit Commercial du Moyen-Orient, Orient Credit Bank, Libano-Arabe, 13 branches of Nasr Lebanese African Bank and Adcom Bank, followed by a series of mergers in the beginning of the current decade namely with Lebanon Invest and with Banque Saradar.

From a commercial bank by the end of the past decade, the Bank was transformed to a universal bank by the middle of this decade following the development of new business lines that enabled Bank Audi to be less reliant on its traditional commercial banking segment. Beyond its historical presence in France and Switzerland and following a successful diversification in its business lines, in the middle of the current decade, the Group embarked on a dynamic regional expansionary policy and recently gained ground in the three main regions of the Levant, North Africa and GCC countries.

Bank Audi is currently a regional universal Bank that offers a full range of commercial, investment, private and retail banking services in Lebanon and in nine countries, through a network of 152 domestic and foreign branches at end-June 2009.

By year-end 2008, the Group had built USD 23.6 bn in total footings, mainly triggered by a large customer deposit base totaling USD 17.3 mn. Despite the turmoil of global markets, the Bank managed to increase its assets, customer base, and earnings by 17.9%, 21% and 19% respectively in 2008, while maintaining an adequate capitalization and liquidity level. This suggests that the Bank has remained unaffected by the global crisis in line with the high performance of the Lebanese banking sector.

As at year-end 2008, the Bank ranked first among its domestic competitors in terms of total assets, customer deposits, loans and shareholders’ equity. On a regional level, the Bank is now positioned among the top 25 Arab banks according to all criteria, ranking 22nd in terms of deposits and 19th in assets.

▶ Capital history and share listing

In the mid-1990’s, the Bank floated part of its capital through two Global Depositary Receipt (GDR) issues on international markets. The GDR issues, presently listed on the London Stock Exchange, were the first of their kind in the Middle East and marked the first international public equity issues by a Lebanese institution.

In 2002, the Bank successfully closed a capital increase of USD 100 mn on local and regional financial markets, through a preferred share issue, further consolidating the Bank’s shareholder base and allowing it to ensure a greater coverage and more significant support to its customer base. In 2004, the Bank closed another USD 100 mn preferred share issue, in addition to a USD 59 mn capital increase, related to the issuance of new common shares dedicated to the shareholders of Banque Saradar sal,

following the merger operation with the bank. In 2005, the Bank issued USD 125 mn of preferred shares, and one year later Bank Audi's capital was increased by USD 600 mn to USD 1.5 bn of which 7.5 mn shares worth USD 450 mn were acquired by EFG-Hermes and 150 mn were acquired by existing and new shareholders through a rights issue.

The Bank's common shares are listed on the Beirut Stock Exchange and its GDRs are listed on both the Beirut Stock Exchange and the London Stock Exchange.

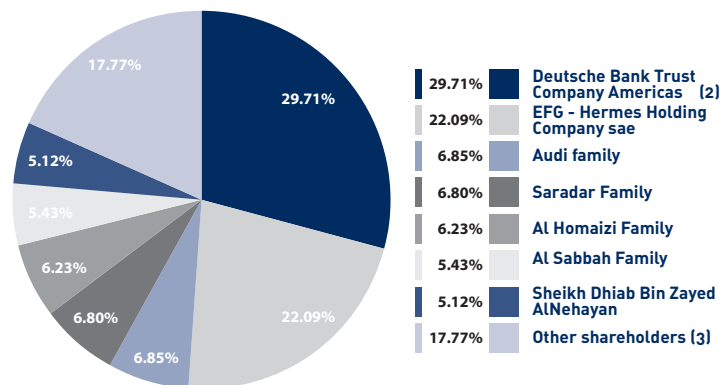
Ownership structure

As of July 2009, the Bank's shares, composed of common shares and preferred shares, consisted of the following:

- The common shares outstanding consisted of (i) 34,189,389 common shares (ii) 617,791 stock options vested and unexercised; (iii) 769,977 stock options allocated but not vested.
- The preferred shares outstanding consisted of 1,250,000 series D preferred shares which were issued in 2005 and are callable in 2012. The 4,000,000 series C preferred shares, which were issued in 2004, were recently redeemed by the Bank.

The table below lists the entities that held more than 5% of Bank Audi's total common shares as at August 31, 2009:

Figure 1: Bank Audi's ownership structure (1)



Source: Bank Audi

Notes:

(1) Excluding preferred shares: as at the date hereof, Bank Audi's total Share Capital consists of 34,189,389 Common (or Ordinary) Shares and 1,250,000 Preferred Shares.

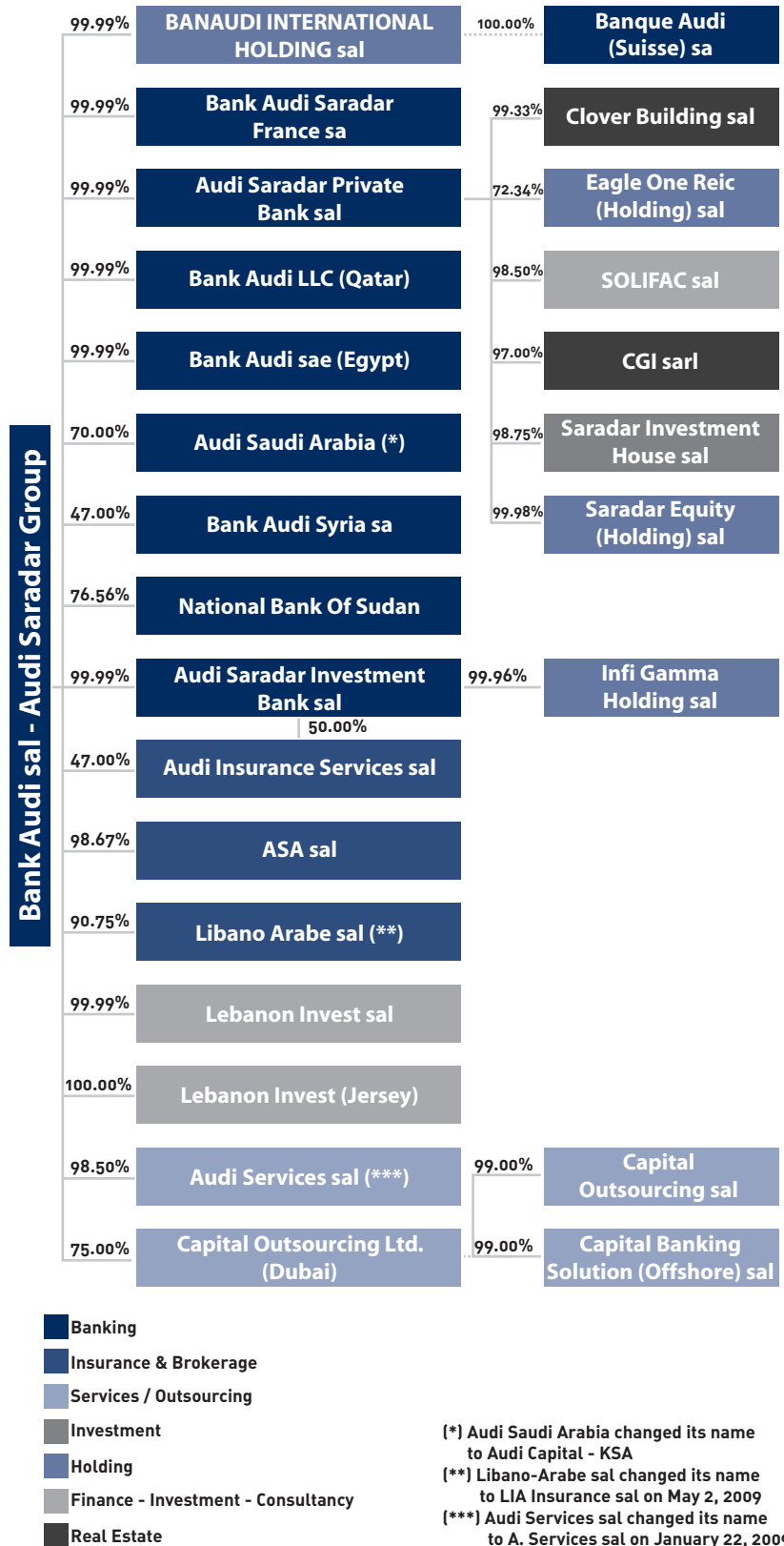
(2) As at the date hereof, Deutsche Bank Trust Company Americas holds 10,156,761 common shares represented by Global Depositary Receipts (GDRs) listed on the London Stock Exchange and on the Beirut Stock Exchange. EFG-Hermes Holding Company sae, the Al Homaizi Family, Sheikh Dhiab Bin Zayed AlNehayan and Audi Family owned GDRs representing, respectively, 5.8%, 1.9%, 1.7% and 1.2% of Bank Audi's common shares

(3) 1,499 other holders of common shares each owning, individually, less than 5%.

Corporate structure

Figure 2: Bank Audi corporate structure

The major subsidiaries of Bank Audi sal - Audi Saradar Group are:



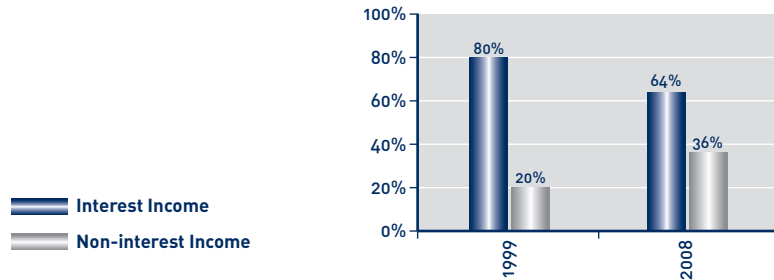
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Starting in the late nineties, the Group consolidated its universal banking profile, covering a large spectrum of banking services

▶ Business lines

Starting in the late nineties, the Group consolidated its universal banking profile, covering a large spectrum of banking services. Thus, Bank Audi decreased its reliance on its core business, as evidenced by the contribution of the non-interest income to the total earnings, which rose from 20% in 1999 to 36% in 2008.

▶ **Figure 3: Breakdown of total income between interest income and non-interest income**



Source: Bank Audi

Bank Audi sal covers all activities, while Bank Audi Saradar France offers a full range of retail and commercial banking activities; Banque Audi Suisse sa, with its representative office in Beirut, along with Audi Saradar Private Bank and the Saudi and Qatari entities, represent the private banking arm of the Group. All investment banking actions are conducted by Audi Saradar Investment Bank sal and Audi Saudi Arabia (Audi Capital – KSA), while bancassurance products are tailored by its fully owned subsidiary, LIA insurance sal, and sold through Bank Audi’s retail network.

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Bank Audi offers a wide range of more than 116 retail products, supported by a domestic network of 78 branches

– Retail banking

Throughout the years, Bank Audi has expanded its branch network via aggressive organic growth coupled with a series of acquisitions. Supported by a 78-branch network at year-end 2008, Bank Audi covered 28.8% of households in Lebanon and managed more than half a million accounts. The Bank is continuously diversifying its line of retail banking products and services, and today covers a wide spectrum of more than 116 retail products ranging from credit cards to internet banking and bancassurance, sold in all countries where it maintains a presence.

In addition to its wide coverage of the Lebanese retail banking market, Bank Audi is actively pursuing an extensive branch expansion in the region, which, given the significant retail banking potential in regional countries such as Egypt, Syria and Jordan, is enhancing growth in the retail business. Bank Audi has pursued an active branching out in the MENA region, building a network of 71 branches, in two and a half years of activity.

The breakdown of loans by customer type indicates that 13% of total outstanding loans in 2008 were issued to retail and consumer clients.

– Commercial banking

While Bank Audi currently holds a strong commercial banking franchise in Lebanon, it is looking at further consolidating its corporate banking franchise in the MENA region. Bank Audi offers a wide range of traditional banking products and services to small and medium-sized entities (SMEs), as well as large corporate businesses.

– Investment banking and capital markets activities

Bank Audi is active in the investment banking field through its subsidiary Audi Saradar Investment Bank sal. The latter was launched in 1974 and changed its name to Audi Saradar Investment Bank in 2004 when Bank Audi merged with Banque Saradar. Saradar Investment House and Lebanon Invest, which are stand alone entities, are also part of the investment banking arm of the Group.

The investment banking arm of Bank Audi is supported by wide research activities and covers a broad scope of services that includes: project finance, mergers and acquisitions, private placements, securitization and structured products, private equity, asset management, fund management and advisory services. It is worth noting that the total investment banking mandates awarded to Bank Audi in Lebanon and the region over the past six years stands at an approximate cumulative USD 4 bn.

In parallel, the capital markets department was set up in 1996. Its main role is market making on all instruments issued by Lebanese entities. In 2008, Audi Saradar Investment Bank sal covered a significant USD 510 mn trade on the Beirut Stock Exchange (BSE) out of a total 1,710 mn volume, accounting for a 30% market share, implying a leading position for Bank Audi among its peers.

By the end of 2008, Audi Saradar Investment Bank sal had amassed USD 969 mn in total assets, USD 658 mn in private customer deposits and USD 120 mn in shareholder equity. It generated USD 6.5 mn in net profit for the year 2008. In total, the investment banking and capital markets segments generated a substantial part of Bank Audi's non-interest income in 2008.

– Private banking

Banque Audi (Suisse) sa and Audi Saradar Private bank sal, along with Bank Audi llc (Qatar) and Audi Saudi Arabia represent Bank Audi's private banking arm.

Banque Audi (Suisse), which was launched in 1976, is the primary contributor to the private banking operation of Bank Audi. The Swiss entity is the largest Lebanese-owned banking institution in Switzerland in terms of assets under management and the second largest Arab private bank in Switzerland.

Audi Saradar Private Bank sal was launched in 1994. By the end of 2008, it had amassed USD 1,482 mn in total assets, USD 1,205 mn in private customer deposits and USD 116 mn in shareholder equity. The net profit for the year 2008 reached USD 22.4 mn.

Furthermore, it is worth noting that the private banking segment ensures a Middle Eastern coverage out of Saudi Arabia, Qatar and the UAE. On a consolidated basis, Bank Audi had USD 5 bn of assets under management and 1.8 bn of fiduciary deposits as at end-June 2009.

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By the end of 2008, Audi Saradar Investment Bank sal had amassed USD 969 mn in total assets and USD 658 mn in private customer deposits. It generated USD 6.5 mn in net profit for the year 2008

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On a consolidated basis, Bank Audi had 5 bn of assets under management and 1.8 bn of fiduciary deposits as at end-June 2009

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Bank Audi is active in the insurance field through its subsidiary LIA insurance sal, previously known as Libano Arabe

– Insurance

LIA insurance sal – previously, Libano Arabe, was established in 1974 as an insurance company and is fully owned by Bank Audi. It tailors bancassurance products which are sold by Bank Audi’s retail network. By the end of 2008, the company had accumulated USD 173 mn in total assets, USD 58 mn in written premiums and USD 55 mn in shareholder equity. The entity generated profits for the year 2008 totaling USD 7 mn.

In December 2007, marking the initial step in geographical expansion of its insurance arm, Bank Audi established an insurance company in Syria under the name Syrian Arab Insurance which operates currently through a network of five branches in the country.

More recently, Bank Audi has entered the Algerian insurance market.

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Bank Audi has been present in Europe since the late 1970s

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More recently, Bank Audi was able to develop a regional franchise of 185,000 accounts and 132,000 clients out of 71 operating branches, generating total assets of USD 3.3 bn

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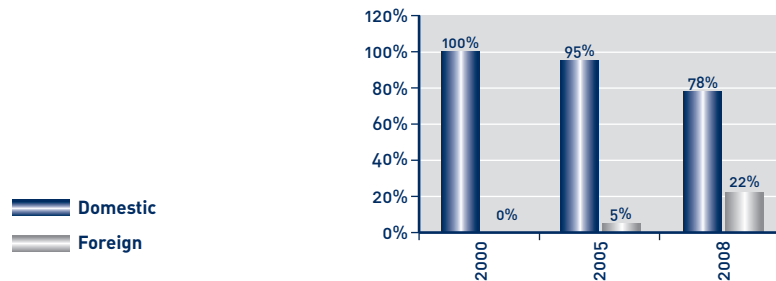
The breakdown of assets and earnings between Lebanon and abroad reveals a higher contribution of the foreign entities to the Group’s activity

▶ Geographic expansion

In the late 1970s, following the beginning of the Lebanese civil war, Bank Audi expanded its activities towards Europe by establishing entities in Switzerland and France, namely Banque Audi Suisse in 1976 and Banque Audi Saradar France in 1979. These were consolidated within the Group in 2000 and 2001 respectively. Over and above its 30-year presence in Europe, Bank Audi is currently building up a strong franchise in the Middle East and North Africa. In a three-year period it has been able to develop a regional franchise outside Lebanon of 185,000 accounts and 132,000 clients out of 71 operating branches, generating total assets of USD 3.3 bn. In Jordan, Syria and Egypt, the Bank provides comprehensive retail and commercial banking products, while the Saudi and Qatari entities are specialized in capital markets activities and corporate & private banking, respectively. Islamic banking is the core business of the Bank in Sudan.

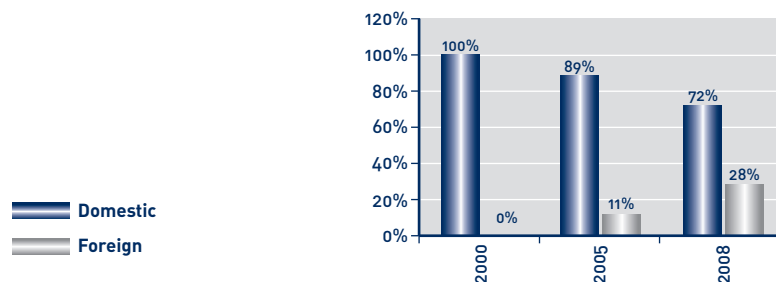
In this context, the regional expansion of Bank Audi is evolving rapidly. On a consolidated basis, at end 2008, Bank Audi managed a global activity of USD 20.4 billion, of which 28% was generated in Europe and the Middle East and 72% in Lebanon. As for the breakdown of earnings between Lebanon and abroad, it reveals a respective structure of 78% to 22% in 2008, against 95% to 5% in 2005, suggesting a higher contribution of foreign entities to the Group’s total earnings.

▶ **Figure 4: Earnings breakdown**



Source: Bank Audi

▶ **Figure 5: Assets breakdown**



Source: Bank Audi



Bank Audi Saradar France was launched in 1979. The entity generated USD 11.3 mn in net profit in 2008



Bank Audi has been present in Switzerland since 1976



Established in 2004, the activity of Bank Audi in Jordan mainly covers retail banking and related commercial banking activities and generated USD 6.8 mn in net profit in 2008

– France

Bank Audi Saradar France SA was launched in 1979. It is fully owned by Bank Audi and focuses on servicing a Middle Eastern customer base in Europe as well as European corporate clients that have business in the Middle East.

At end December 2008, Bank Audi Saradar France SA had accumulated USD 923 mn in total assets and USD 643 mn in private customer deposits, while its shareholder equity base amounted to USD 92 mn. The entity generated USD 11.3 mn in net profit in 2008.

Looking forward, the Bank aims at expanding corporate banking towards European corporations working in the Middle East and developing wealth management and family office services for high net worth individuals from the MENA region.

– Switzerland

Bank Audi has been present in Switzerland since 1976 through its fully-owned subsidiary Banque Audi Suisse SA.

By December 2008, Bank Audi Suisse SA had accumulated USD 3,477 mn in total footings and USD 1,805 mn in private customer deposits of which USD 1,579 mn were fiduciary deposits. Its shareholders' equity base amounted to USD 99 mn at end 2008, while the Bank registered USD 10.9 mn of net profit for the year.

Its medium-term targets revolve around expanding the franchise towards non-Lebanese and non-Arab customers, building an institutional franchise from the GCC region and ensuring a contribution of private banking of 10% to the Group's consolidated profits.

Over and above its historic presence in Lebanon, France and Switzerland, the Group is currently present in Jordan, Egypt, Sudan, Saudi Arabia and Qatar as well as the United Arab Emirates through a representative office. Most of Bank Audi's current expansion plans outside Lebanon are focused on the MENA region.

– Jordan

At the close of 2003, the Bank obtained a banking license to open a network of branches in the Kingdom of Jordan. Established in 2004, the Jordan branch network of Bank Audi mainly covers retail banking and related commercial banking activities, offering a wide range of products and services within the following categories: banking accounts, domiciliation services, bancassurance, personal loans, electronic banking and e-points. In June 2008, the Bank operated a network of 10 branches throughout the Kingdom.

While the Bank's 2005 performance ensured a break-even in net earnings, the following years were profitable. By the end of 2008, private customer deposits stood at USD 504 mn and the entity generated USD 6.8 mn in net profits.

Going forward, the Bank aims at developing an even stronger franchise in trade finance, and retail and corporate activities with the aim of ranking among the top banks in Jordan in the foreseeable future.



Bank Audi penetrated the Syrian market in 2005 through Bank Audi Syria, a SYP 2.5 bn venture, 47% owned by Bank Audi



Bank Audi entered the Egyptian banking market in 2006 by acquiring 100% of Cairo Far East Bank



In terms of profitability, Bank Audi sae recorded USD 13.7 mn in net profit for the year 2008



Bank Audi has been engaged in Islamic Banking in the Sudanese banking market, after it acquired a 76.6% stake in the National Bank of Sudan in 2006



The Sudanese entity recorded USD 11.9 mn in net profit in 2008

– Syria

Bank Audi entered the Syrian banking market in 2005 through Bank Audi Syria sa, a SYP 2.5 bn venture with 47% ownership belonging to Bank Audi sal. As the strategic partner in the venture, Bank Audi sal is actively involved in the management of the Syrian entity.

The Syrian entity is mainly dedicated to commercial, retail and corporate banking activities and manages a network of 21 branches throughout the country. Bank Audi is also engaged in providing insurance services through Syria Arab Insurance which was launched in 2006.

By the end of 2008, the Syrian entity had accumulated USD 1,248 mn in assets, USD 1,090 mn in private customer deposits and USD 66 mn in shareholders' equity. After having ensured a break-even in net earnings in 2006, the Bank generated USD 5.1 mn in net profit in 2007 which further increased to USD 7.9 mn in 2008, implying a 54.9% growth rate.

The Bank's medium-term targets revolve around consolidating its position among privately-owned banks in Syria and building captive market shares in all business segments. The Bank is targeting an extensive branch network throughout the country, where there is significant room for growth, bearing in mind that the Syrian banking sector is highly underdeveloped.

– Egypt

Bank Audi entered the Egyptian banking market in 2006 after acquiring 100% of Cairo Far East Bank which had USD 47 mn in customer deposits at the time. The latter was subsequently rebranded to Bank Audi sae and its capital was increased to USD 100 mn. The Egyptian entity is focused on providing comprehensive retail and commercial banking products.

The Bank closed 2007 with 18 operating branches, compared to three at the time of acquisition (March 2006) and further expanded its branch-network to 29 branches by end of 2008.

In 2008, Bank Audi sae reported a growth in aggregate activity, as measured by total assets, that moved from USD 1,476 mn at end 2007 to USD 1,599 mn at end 2008, the equivalent of a 8.3% y-o-y growth rate. In terms of profitability, Bank Audi sae recorded USD 13.7 mn in net profit for the year 2008.

Bank Audi sae's action plan mainly revolves around the development of commercial and retail banking based on significant branch expansion.

– Sudan

Since 2006, Bank Audi has been engaged in Islamic Banking in the Sudanese banking market, after it acquired a 76.6% stake in the National Bank of Sudan, one of the oldest banks in Sudan. At end 2008, the Bank operated a network of 11 branches throughout the country.

The bank managed to register a growth in assets of 46.9% in 2007 and 41.5% in 2008, thus building an asset base of USD 266 mn by year-end 2008. In addition, the Bank had built USD 117 mn in private customer deposits and USD 82 mn in shareholder equity.

After breaking even in 2006, the Bank generated USD 6.2 mn and USD 11.9 mn in net profit in 2007 and 2008 respectively, which suggests that the Bank generates substantial revenues in Soudan despite being a low profile entity.



In 2006, Bank Audi was granted a license to establish an investment company in Saudi Arabia



Audi Saudi Arabia registered net loss of USD 7.5 mn for the year 2008 due to losses incurred in capital markets activity in light of the global economic and financial downturn



Established in 2007, Bank Audi llc (Qatar) started offering broad financial services to corporations and high net worth individuals

The Bank's medium-term targets are to build a solid corporate/trade finance franchise in the large untapped market, consolidate retail banking and expand coverage to major cities, and become a major player in the developing money market.

– Saudi Arabia

In May 2006, Bank Audi was granted a license to establish an investment company in Saudi Arabia. Audi Saudi Arabia is a joint venture between Audi Saradar Group, which owns 70% of the entity, and prominent Saudi individuals and business groups who own 30%. It should be noted that Bank Audi is currently in the process of acquiring the 30% stake owned by Saudi individuals.

Backed by the investment expertise of the Audi Saradar Group, the Saudi entity aims at providing a wide scope of capital markets and private banking activities ranging from brokerage and offering dealing and asset management to wealth management, advisory and custody services, covering the whole GCC region.

The financial figures for 2008 reveal that Audi Saudi Arabia had accumulated USD 132 mn in total assets by year-end 2008 and USD 78 mn in shareholder equity.

After having generated a net profit of USD 10.9 mn for the year 2007, Audi Saudi Arabia incurred losses of USD 7.5 mn in 2008 as a result of the tough capital market environment amidst the global financial turmoil. However, it should be noted that the Saudi entity is, at this stage, moving towards being a market maker in the fixed income segment and is contributing to the further development of the Bank's investment banking activities.

Its medium-term targets revolve around building a comprehensive GCC institutional asset under management portfolio, ensuring a solid footprint in the developing fixed income market and strengthening investment banking and brokerage activities.

– Qatar

Bank Audi llc (Qatar), which is owned 100% by the Group, launched its operations in November 2007 and is still in an embryonic stage.

The Bank managed to end 2008 with USD 194 mn in assets, which implies a 76.4% growth rate, when compared to an asset base of USD 110 mn at 2007. By year-end 2008 the Bank had accumulated USD 91 mn in private customer deposits and USD 52 mn in shareholder equity.

In 2008, the Bank registered USD 1.5 mn in net profit and started offering broad financial services to corporations and high net worth individuals. Its medium-term targets revolve around providing project finance/syndications activity in a booming economic environment and building a strong private banking portfolio benefiting from the Group's presence in Saudi Arabia and the UAE.

– UAE

Bank Audi has a representative office in the UAE that was launched in 2007.



Prospecting for new regional markets with high potential is now in progress, with plausible perspectives in Algeria, Tunisia and Yemen

– Other opportunities

In the framework of its regional expansion strategy, Bank Audi aims at further expanding its activity abroad in order to reach a more balanced activity structure between Lebanon and overseas and to reinforce the global immunity of the Group. Such a strategy consists of reinforcing its presence in markets where it is already present as well as expanding into new markets.

The Bank's regional expansion focuses on countries where the environment for launching banking activities is supportive and that provide interesting growth perspectives.

Prospecting for new regional markets with high potential is now in progress, with plausible perspectives in Algeria, Tunisia and Yemen. It is worth noting that the license application has already been deposited at the Central Bank of Algeria and that the license application is about to be processed in Yemen.

► Strategy

Since the first half of the current decade, Bank Audi has been implementing its strategy with the aim of becoming the most diversified regional bank by both business lines and countries of presence.

– On the domestic level

In the first half of the current decade, Bank Audi's strategy revolved around the diversification of its business lines. From a Lebanese Commercial Bank in the late nineties, the Bank was transformed to a universal bank by the middle of the current decade. The strategy resulted in the development of new business lines that enabled the Bank to be less dependent on its traditional core business. Over the same period, the breakdown of total income between interest income and non-interest income revealed a structure of 80% to 20% in 1999 against a structure of 65% to 35% in 2008, suggesting a higher contribution of non-interest income to the Group's total income.

Going forward, the Bank aims to reach a breakdown of total income between interest income and non-interest income of 60% to 40% by 2010. The new strategic orientations revolve around the strengthening of its domestic franchise through the following:

- Consolidating its commercial banking franchise and corporate business relationships
- Further strengthening the retail banking coverage and franchise
- Developing private banking towards asset management.

– On the international level

Following the successful diversification of its business lines, Bank Audi has been looking at a regional diversification by market of presence. Beyond its historical presence in France and Switzerland, since the middle of the current decade the Group has embarked on an aggressive regional expansion. As a result, it is now present in several markets across the MENA region, namely Syria, Egypt, Jordan, Sudan, Saudi Arabia, Qatar and the United Arab Emirates through a representative office. The breakdown of earnings between Lebanon and abroad reveals a ratio of 95% to 5% in 2005 against 78% to 22% in 2008, suggesting a higher contribution of regional entities to the Group's total earnings in recent times. Bank Audi is on its way to becoming a regional universal bank by the end of the decade. In the medium-term, it is targeting a balanced breakdown of earnings and assets between Lebanon and abroad of 50% to 50% by 2012. This would in turn decrease the Group's reliance on domestic markets and segments and improve earnings immunity and reinforce their quality. In this framework, the main strategic orientations abroad revolve around:

- Building a strong franchise in the MENA region (prospecting for new regional markets with high potential is underway, with plausible perspectives in Yemen, Tunisia and Algeria.)
- Consolidating the Bank's presence in Europe
- Strengthening the Bank's existing coverage of the Diaspora in West Africa, Australia and Latin America.

Bank Audi's regional expansion aims to encompass several business and financial targets that the Bank plans to reach in a three-year timeframe.



The Bank aims at reaching a breakdown of total income between interest income and non-interest income of 60% to 40% by 2010



In the medium-term, Bank Audi is targeting a balanced breakdown of earnings and assets between Lebanon and abroad of 50% to 50%

The main business targets revolve around:

- Building a regional network of more than 200 branches
- Building an account franchise of close to one million accounts
- Comprehensive universal banking products offering
- Ranking among the top 15 Arab banks
- Integrating the inner circle of truly regional banks

The financial targets revolve around:

- Building more than USD 35 bn of assets
- Reaching an operating margin in excess of 40% (cost-to-income ratio)
- Achieving a ROAA of 1.4%
- Yielding a sustainable ROACE of close to 20%

▶ SWOT analysis

Strengths

- Ranks 1st in Lebanon at end 2008 in terms of deposits, loans, assets and equity
- Largest network of branches in Lebanon
- High levels of corporate governance
- Market leader in capital markets activity on the BSE by transaction value
- Superior asset quality with very low level of NPL/gross loans ratio (at 3.1% for 2008) and satisfactory level of NPLs provisioning (86.6% in 2008)
- Ample levels of liquidity

Weaknesses

- Absence of visibility of Saudi operations which contributed negatively to 2009 results
- High exposure to sovereign debt, although below peers

Opportunities

- Potential expansion in markets offering room for growth: Yemen, Tunisia and Algeria
- Low price to book and price to earnings compared to regional, emerging and global average
- Potential to improve the cost-to-income ratio
- High level of capitalization (12.84% Basel II ratio at end 2008) allowing Bank Audi to acquire peers in the domestic market and in neighboring countries
- Targeted presence to serve Lebanese and Arabs in the Middle East and Europe

Threats

- High sensitivity to local political factors
- Persistent economic imbalances in the quasi absence of adjustment reforms
- Lower interest spreads in 2009
- Chronic political instability in Lebanon

▶ Latest developments

- On the back of pressures on interest spreads, the H1 09 results reveal a growth of only 1.5% in the net interest income figure. As for the non-interest income, it retreated, displaying a 7.6% y-o-y decrease as a result of the prevailing market conditions. Net profit of USD 132.9 mn was declared for H1 09, indicating a 1.9% increase y-o-y. This was driven by a decrease of 1.8% in operating income in parallel with a 9.2% decrease in operating expenses, suggesting a tremendous improvement in cost-efficiency.

Table 1: Audi Bank's H1 2009 summary income statement

USD million	H1 08	H1 09	y-o-y%
Net interest income	200.5	203.5	1.5%
Net fees & commissions income	72.3	68.0	-6.1%
Trading and investment income	58.0	52.4	-9.5%
Non-interest income	130.3	120.4	-7.6%
Other operating income	25.5	25.8	1.3%
Operating income	356.3	349.7	-1.8%
Operating expenses	(174.4)	(158.4)	-9.2%
Depreciation and amortization	(11.6)	(13.6)	17.7%
Net provisions for credit losses	(12.2)	(16.3)	34.2%
Provision on impairment of financial instruments	(0.5)	0.0	-104.0%
Profit before taxes	157.7	161.5	2.4%
Share of profit of associates under equity method	0.3	0.2	-37.4%
Net gain (loss) on sale or disposal of other assets	0.0	0.4	-
Income tax expense	(27.5)	(29.2)	6.0%
Net profit	130.5	132.9	1.9%

Source: Bank Audi

- Bank Audi's balance sheet recorded a 9.9% growth over the first half of 2009. Loans and advances recorded a 3.4% increase over the first half of 2009. Deposits on the other hand recorded a significant 11.6% increase reaching USD 19,224 mn in H1 09 sustaining the Bank's leading position in terms of customer deposits.

Table 2: Audi Bank's H1 2009 summary balance sheet

USD million	H2 08	H1 09	Ytd %
Cash & Balances with BDL	2,946	3,470	17.8%
Financial assets	6,880	8,009	16.4%
Due from banks	3,622	3,749	3.5%
Loans & advances	6,129	6,338	3.4%
Other assets	833	864	3.8%
Total assets	20,410	22,429	9.9%
Due to banks and other financial institutions	464	497	7.1%
Deposits	17,230	19,224	11.6%
Other liabilities	751	797	6.2%
Shareholders' equity	1,966	1,912	-2.8%
Total liabilities and shareholders' equity	20,410	22,429	9.9%

Source: Bank Audi

Financial Highlights and Forecasts

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Bank Audi is positioned as the largest bank in Lebanon by deposit-base, which stood at USD 17,230 mn at the end of 2008

▶ Customer deposits

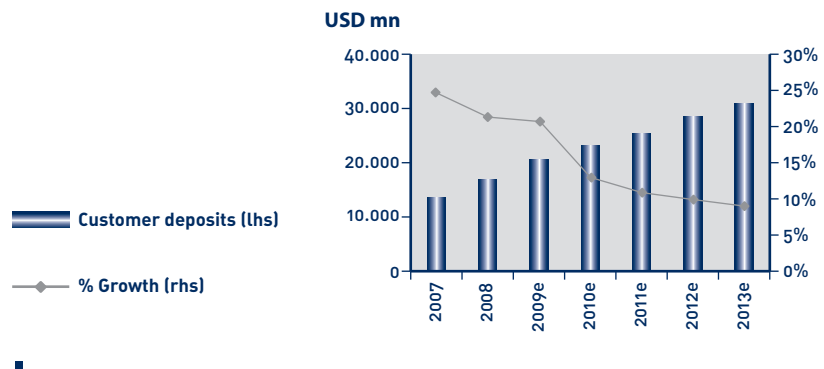
Over the last 18 years, Bank Audi's private customer deposits base has steadily grown as witnessed by a CAGR of 27.6% during the 1992-2009 period. This strong performance has positioned the Bank as the largest in Lebanon by deposit base, which stood at USD 17,230 mn at the end of 2008 (including deposits from related parties).

During the last two years, Bank Audi's deposit expansion was remarkable as total deposits grew by a CAGR of 21%, highlighting the Bank's resilience to the chronic political instability on the domestic scene and the turmoil in global markets that surged in the last quarter of 2008.

During the first six months of 2009, total deposits increased sharply despite the persistent instability of global financial markets. The H1 09 results indicate that the figure grew by 11.6% to reach USD 19,224 mn by the end of June 2009, thus sustaining the Bank's leading position in terms of deposits.

In line with the typical balance sheet structure of a Lebanese Bank, Bank Audi is heavily reliant on deposits as a source of funding, as evidenced by deposits constituting 83.6% of the Bank's total funding in 2008. Looking ahead, we expect this ratio to hover around 84.8% for the remainder of the forecast period, which implies that the deposit base expansion will be the main driver behind the Group's balance sheet growth.

▶ **Figure 6: Customer deposits and growth rates**



Source: FFA Private Bank

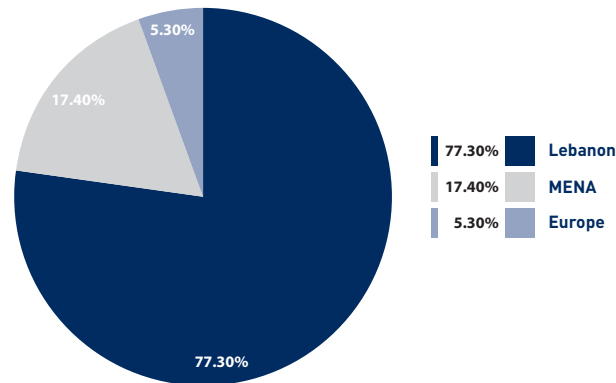
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We anticipate customer deposits to grow at a CAGR of 12.7% over the 2008-2013 projection period

Triggered by a steadier economic environment, and supported by the Bank's outstanding deposit growth during the first half of the current year, we anticipate customer deposits to grow by 21% in 2009e. Going forward, we expect this growth to gradually decelerate to 9% by the end of 2013e as a result of an anticipated upturn in international interest rates. More generally, we assume that customer deposits will grow by a CAGR of 12.7% during 2008-2013e with an important part of the total growth originating from the Bank's international expansion strategy.

As of end-June 2009, the deposit structure revealed that 22.7% of the Bank's deposit base is generated from international operations, with deposits from MENA countries accounting for 17.4% of the total deposit base and European operations contributing 5.3% of the Group's deposits.

Figure 7: Customer deposits breakdown between Lebanon and abroad as of 30 June 2009



Source: Bank Audi

It is worth mentioning that the Bank is witnessing a significant rise in the contribution of newly established regional entities to consolidated activity. Looking ahead, we believe that Bank Audi's regional operations will increasingly contribute to the Group's deposit base as management intends to continue to pursue opportunities in new and existing high value-added markets.

▶ Shareholders' equity

Due to the accumulation of profits at a swift pace and the Bank's ability to attract equity funding, total shareholders' equity (including minority interest) grew at a CAGR of 33% over the past five years to reach USD 1,966 mn by the end of 2008.

Bank Audi is solidly capitalized with an equity to assets ratio standing at 9.2% in FY 2008 and a Basel II capital adequacy ratio of 12.84% as of year-end 2008, comfortably higher than the required ratio of 8%. We believe this solid capital base will be a catalyst in Bank Audi's expansion program which should result in higher profitability levels.

In April 2009, USD 100 million Series C preferred shares were redeemed, thus moving the Bank's total shareholders' equity from USD 1,966 mn at the end of 2008 to USD 1,912 mn in June 2009.

▶ Asset allocation

We anticipate Bank Audi will witness an asset allocation shift in line with the expected trend in the Lebanese banking sector, namely an increase in loans and advances at the expense of financial assets.

The asset structure should move to higher interest assets while decreasing the overall exposure of the Bank to sovereign risk. This change is expected to be triggered by the Bank's planned geographical expansion and goals for better asset deployment.

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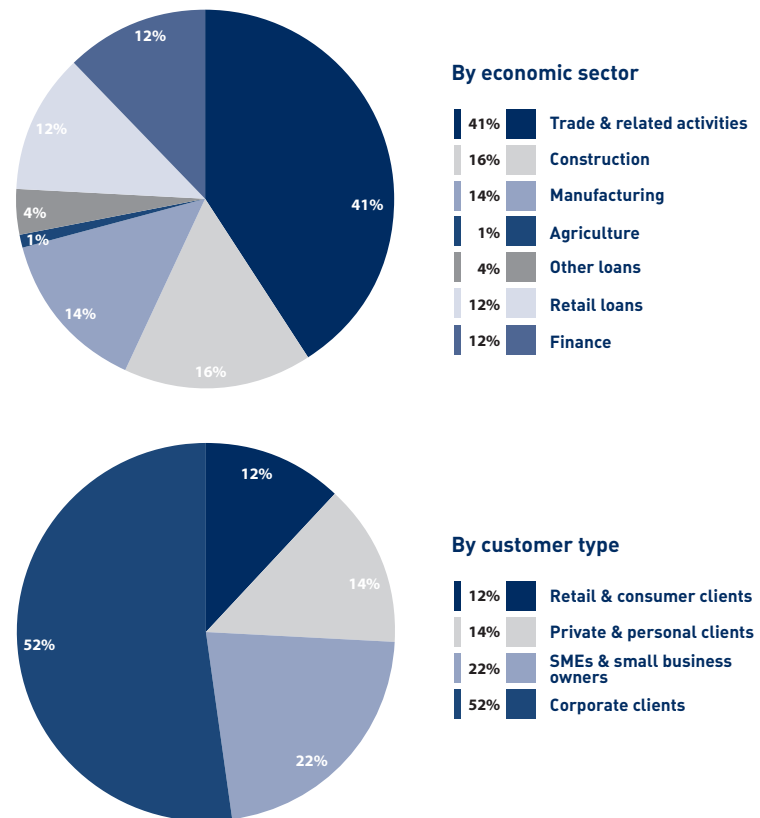
Bank Audi is highly capitalized; it had a capital adequacy ratio of 12.84% in 2008

▶ Lending activity

– Loans breakdown

The lending allocation by customer type reveals that the retail loans account for approximately 12% of the Bank’s total loan portfolio, while 52% of the loans are provided to corporate clients. The lending allocation by economic sector mirrors the fact that Bank Audi has a significant exposure to the trade and related activities sector with 41% of the loan portfolio being allocated to these sectors.

▶ **Figure 8: Loans breakdown (as at end-June 2009)**



Source: Bank Audi

– Loans’ growth and forecasts

Bank Audi’s loan portfolio growth accelerated in the last two years in line with the general trend in the Lebanese banking sector. Loans grew by 31.5% in 2008 to reach USD 6 bn by the end of the year, thus positioning the Bank as the largest in the industry in terms of loans. The H1 2009 results show that loans and advances recorded a 3.4% increase over the first six months of 2009.

Supported by signs of higher lending activity over H2 2009, we expect loans to grow at a 16.14% rate in 2009e and assume the CAGR for the whole projection period to stand at 12.38%; this implies a sustained pace over the forecast period. We believe this solid growth will be triggered by a significant rise in the contribution of newly established regional entities to consolidated activity as well as by a steadier economic environment on the domestic scene which would, in turn, lead to a surge in demand from the private sector.



In FY 08 Bank Audi witnessed a strong growth in its loan portfolio (+31.5%)

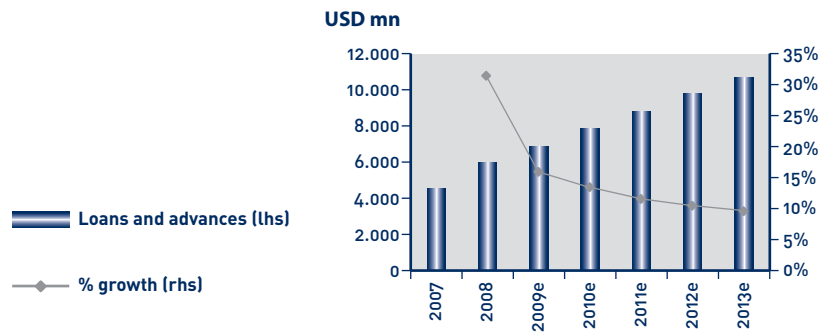


We expect loans to grow at a 12.38% CAGR over the projection period



Bank Audi's liquidity levels are expected to remain ample as witnessed by the loans-to-deposits ratio hovering around 34% over the forecast period

Figure 9: Total loans and growth rates



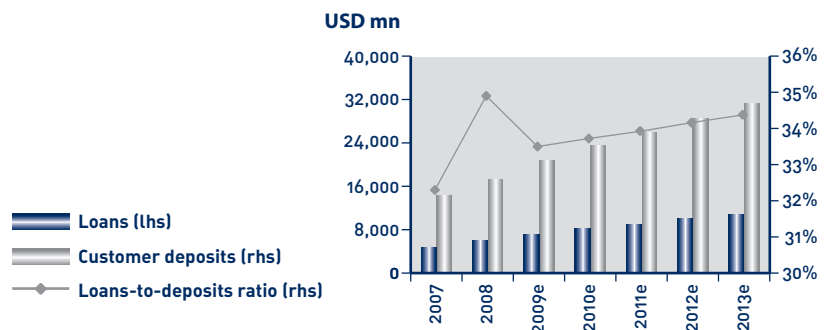
Source: FFA Private Bank

Loans-to-deposits ratio

As a result of the growth in loans surpassing the growth in deposits in 2008, Bank Audi's loans-to-deposits ratio has increased, moving from 32.3% in 2007 to 34.9% in 2008. Despite the slight increase, this ratio implies high liquidity levels by international standards, as demonstrated by the MENA loans-to-deposits ratio and the world loans-to-deposits ratio, which stood at 75% and 92% respectively as of end December 2008.

Going forward, we expect the Bank's loans-to-deposits ratio to hover around 34% over the forecast period.

Figure 10: Loans-to-deposits ratio



Source: FFA Private Bank



Bank Audi holds a sound asset quality, reflected by an NPL ratio of 3.1% in 2008

Asset quality and provision coverage

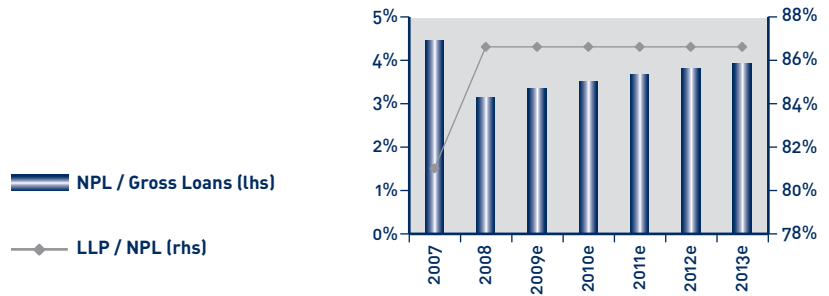
Even though loans and advances witnessed a 31.5% growth between 2007 and 2008, the Bank's asset quality improved as demonstrated by its Non Performing Loans (NPL) ratio declining from 4.4% in 2007 to 3.1% in 2008.

We believe the risk of a deterioration of the asset quality will be mitigated by the Bank's strict risk management policy in this regard which, in turn, would lead to a very slight and gradual increase of the NPL ratio from 3.1% in 2008 to 3.9% by 2013e. This trend encompasses potential pressure on the economic environment in the context of a significant growth of the loan portfolio but does not take into account any major deterioration in the country's political and economic framework that could more severely affect the Bank's asset quality indicators.



A minor deterioration in the asset quality is expected to occur as reflected by a slight and gradual increase of the NPL ratio from 3.1% in 2008 to 3.9% in 2013e

Figure 11: NPLs and provisioning



Source: FFA Private Bank

With regard to the coverage ratio, we expect Bank Audi to sustain a high provisioning strategy, with the coverage ratio (Loan Loss Provision LLP / Non performing Loans NPL) staying close to its 2008 level of 86.6% over the projection period.



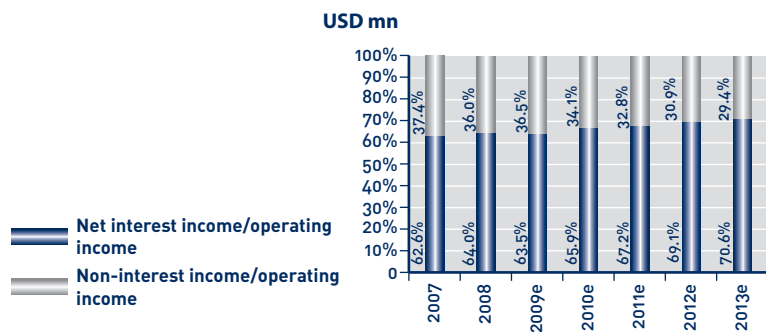
Bank Audi boasts one the most diversified revenue streams in the industry as reflected by non-interest income contributing 36% of total operating income in 2008

Revenue mix

Following a successful diversification of its business lines, transforming the Bank from a commercial bank to a regional universal bank, Bank Audi currently boasts one of the most diversified revenue streams in the industry as highlighted by non-interest income contributing 36% of total operating income in 2008.

This ratio is expected to gradually drop to 29.4% by 2013e as a result of strong interest income growth due to widening spreads along with a significant increase in deposits.

Figure 12: Revenue mix



Source: FFA Private Bank



The non-interest income/operating income ratio is expected to gradually drop to 29.4% by 2013e as a result of strong interest income growth due to widening spreads along with a significant increase in deposits



In 2009e, Bank Audi's net interest spread is expected to contract further, declining from 2.08% in 2008 to 1.77% in 2009e. Starting 2010e, the figure is expected to widen should pressures on Libor ease

Net interest income

In the aftermath of the global financial crisis that surged during the last quarter of 2008, central banks around the world started to cut prime rates which resulted in a trend of falling interest rates. Being mostly pegged to Libor, interest rates on loans, interbank rates on deposits and interest rates on deposits at the Central Bank have significantly dropped while interest rates on deposits were relatively stable due to their low elasticity to international rates. Consequently, interest spreads on foreign currency holdings have significantly shrunk, resulting in downward pressure on the net interest income.

We expect Libor to remain under pressure in the remaining months of 2009e. Consequently, Bank Audi's net interest spread and net interest margin are expected to contract further, declining from 2.08% and 2.39% in 2008 to 1.77% and 2.08% in 2009e respectively.

Starting 2010e, spreads are expected to widen should pressures on Libor ease. Thus, we anticipate the net interest spread and the net interest margin to gradually increase, moving from 1.80% and 2.09% in 2010e to 2.14% and 2.47% in 2013e respectively.

Figure 13: Net interest margin vs. Net interest spread



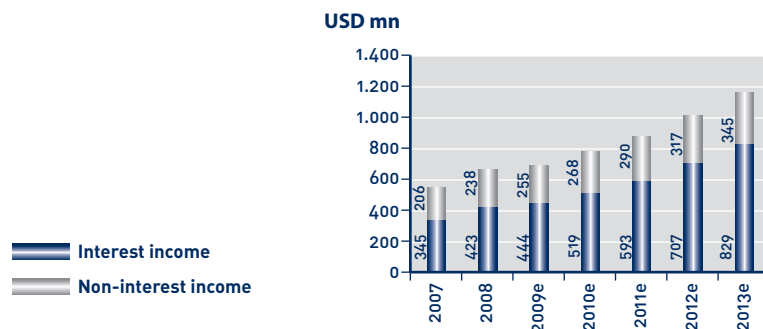
Source: FFA Private Bank



Net interest income growth is expected to decelerate to 5% in 2009e and to significantly regain momentum over the remainder of the forecast period

Due to interest spread contraction on foreign currency holdings, we expect net interest income growth to decelerate in 2009e to 5% after having registered a 22.5% y-o-y growth in 2008. With downward pressures on interest spreads expected to ease starting 2010e, interest income will grow at a swifter pace, as demonstrated by a CAGR standing at 16.9% for the remainder of the forecast period. Consequently, we expect the net-interest income to reach USD 829 mn by 2013e.

Figure 14: Non-interest income vs. interest income



Source: FFA Private Bank

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Non-interest income growth is expected to drop to 5.1% in 2009e and to gradually accelerate over the remainder of the forecast period on the back of a potential improvement in the overall market conditions

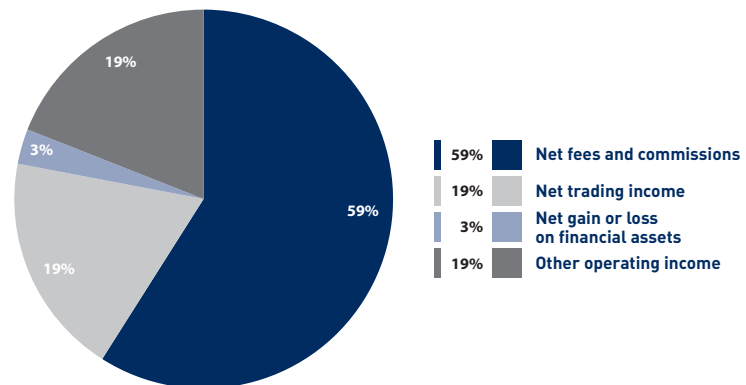
▶ Non-interest income

In FY08, Bank Audi's non-interest income grew by 15.4% to USD 238 mn by the end of the year. During the first six months of 2009, it retreated, displaying a 7.6% y-o-y decrease as a result of the sluggish market conditions.

In 2009e, we expect Bank Audi's non-interest income to grow at a much slower pace compared to 2008 and to slightly regain momentum starting 2010e on the back of a potential improvement in the overall market conditions. As such, we forecast the non-interest income growth to increase by 7.2% and 5.1% for 2009e and 2010e respectively and to be in the range of 8.1% - 9.3% over the remainder of the projection period.

Fee and commission income accounts for the biggest share of non-interest income (59% in 2008). This component, which is a more stable source of revenue compared to other non-interest income components, is anticipated to grow at a CAGR of 4.2% over the 2008-2013e period. More specifically, the figure is expected to register a 4.4% decrease in 2009e (in line with the declining trend witnessed in the H1 09 results) and to gradually increase to 8% by 2013e.

▶ **Figure 15: Non-interest income breakdown for the year 2008**



Source: Bank Audi

Profit from financial operations, which combines net trading income and net gain on financial assets, significantly retreated in 2008 (-26.7% y-o-y). Using the Bank's 2007 performance as a base for our assumption, we expect this figure to regain momentum in 2009 (+40.8% y-o-y), moving from USD 53 mn in FY 08 to USD 74 mn in 2009e, a result of an upturn in the global markets. Looking ahead, this growth is expected to decelerate as reflected by a CAGR of 9.2% starting 2010e.



Bank Audi's cost-to-income ratio slightly decreased between 2007 and 2008, falling from 55.96% in 2007 to 54.96% in 2008, however it is still considered high in comparison to the Bank's peers



Moving forward, we anticipate that Bank Audi is going to gradually decrease its cost-to-income ratio to 45.7% by the end of the forecast period on the back of a faster pace in revenues growth compared to costs growth

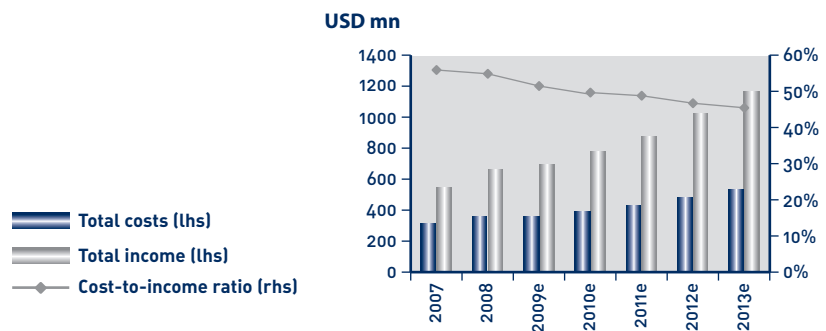


We expect net profit to grow at a 15.9% CAGR over the forecast period

► Cost-efficiency

Bank Audi's cost-to-income ratio decreased slightly in 2008, moving from 55.96% in FY 2007 to 54.96% in FY 2008. The H1 2009 results show that general operating expenses dropped by USD 14 mn, resulting in a substantial improvement of the cost-to-income ratio. However, this ratio is still considered high owing to the Bank's aggressive expansionary policy revolving around an active branching out in the domestic market and in MENA countries where Bank Audi has built a network of 70 branches in three years of average activity, in addition to a heavy cost structure.

Figure 16: Cost-to-income ratio



Source: FFA Private Bank

Moving forward, we anticipate that Bank Audi is going to gradually decrease its cost-to-income ratio to reach 45.7% by the end of the forecast period on the back of a faster pace in revenues growth compared to costs growth. In fact, we anticipate total income to grow by a CAGR of 12.2% over the forecast period in parallel with an 8.1% average growth in costs.

► Net profit and returns

– Net profit growth, forecasts and drivers

Bank Audi recorded a net profit of USD 238 mn in 2008, which represents an increase of 19% over the previous year. As for the Bank's H1 09 results, a net profit of USD 132.9 mn was declared, indicating a 1.9% increase y-o-y.

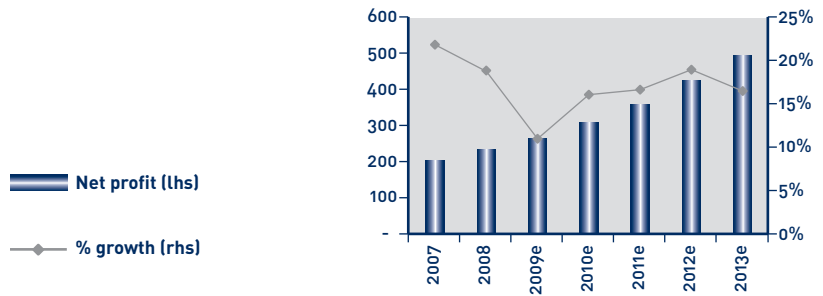
Looking ahead, we anticipate the Bank's net earnings to grow by 10.9% in 2009e. Starting 2010e, we expect net income growth to accelerate, as illustrated by a CAGR standing at 17.1% over the remainder of the projection period.

More generally, the net income CAGR we forecast for the entire projection period stands at a sustained 15.9% which will move the net profit from USD 238 mn in FY 08 to USD 497 mn in 2013e. In our view, this sustained growth pattern is set to be triggered by strong balance sheet growth, a tighter cost control policy and higher interest spreads.

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ROAE and ROAA are expected to move from 12.9% and 1.24% in 2008 to 16.8% and 1.38% in 2013e respectively

Figure 17: Net income and growth rates

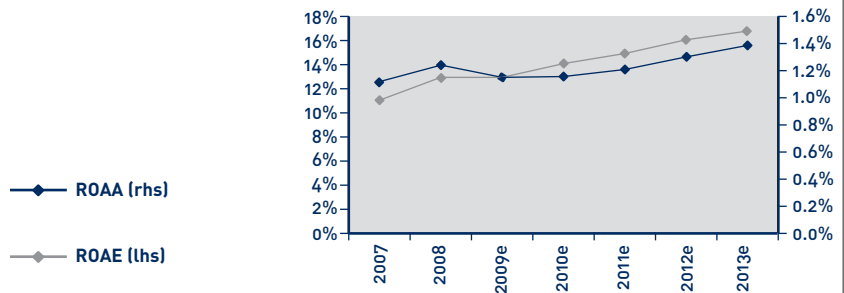


Source: FFA Private Bank

ROAE and ROAA

The solid net profit growth will directly impact the profitability ratios as noted by a growth in both ROAE and ROAA. The former is expected to increase from 12.9% in 2008 to 16.8% in 2013e and the latter from 1.24% in 2008 to 1.38% in 2013e.

Figure 18: ROAE and ROAA



Source: FFA Private Bank

Valuation

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Our valuation methodology is based on a Discounted Equity Cash Flow (DECF)

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The discount rate was derived using the capital asset pricing model weighted by size of geographical operation

▶ Valuation Methodology

Our approach to providing a fair value estimate for Bank Audi is based on a Discounted Equity Cash Flow (DECF) methodology.

Equity cash flows are calculated by subtracting preferred share dividends from net income to derive the attributable earnings to common shareholders, and the retention required to maintain a capital adequacy ratio in excess of 8%.

In other words, the discounted cash flows are the dividends to be distributed in addition to excess capital to reach the target capital adequacy ratio.

Our projection spans a five year period followed by a 15 year fading period where ROE converges to the discount rate. Additionally, the terminal value was calculated using a perpetual growth rate of 3%.

▶ Discount rate calculation

The discount rate was derived using the capital asset pricing model weighted by size of geographical operation.

Given the lack of data and financial products in the region, discount rates were calculated using several methodologies:

– Lebanon operations

We chose to calculate the foreign currency and local currency risk-free rates separately and allocate their respective weightings on a pro rata basis to the capital structure of the Bank.

The foreign currency risk-free rate is based on the Eurobond 2021 yield of 7.27%.

Given the absence of long-term government securities denominated in LBP, we opted to calculate the LBP risk-free rate by deriving the spread between comparables, namely August 2010 Treasury bills (denominated in LBP) and November 2010 Eurobonds (denominated in USD), and by adding the spread to the USD Eurobond 2021.

We believe this would reflect what the yield on a long-term bond denominated in LBP would have been.

The resulting local currency risk-free rate is 10.16%

Assuming an equity risk premium of 7.5% and a Beta of 1, the weighted discount rate on the Bank's Lebanese operations is 15.93 %

– Foreign operations

We have estimated the discount rate of the European, Sudanese, Syrian, Jordanian and Egyptian operations by adding the country risk premium to the US risk-free rate and the estimated equity risk premium.

The different steps were as follows:

The US risk-free rate was calculated by averaging the yield on the 10-year and 30-year US treasury bonds resulting in a rate of 3.65%.

The country risk premium was derived by conversion of the country rating,

equivalent to the following:

Table 3: Country risk premiums

	Country risk premium
Europe	0.75%
Syria	7.50%
Jordan	4.00%
Sudan	9.00%
Egypt	3.25%

Source: FFA Private Bank

The resulting discount rates are 11.90% for Europe, 18.65% for Syria, 15.15% for Jordan, 20.15% for Sudan and 14.4% for Egypt, using the same equity risk premium.

By weighting the discount rate of each geographical location in relation to its contribution to operations of the Bank, we reach a weighted discount rate of 15.10%.

► Fair value estimate and recommendation

Based on our projections, our fair value estimate derived from discounted dividends attributable to common shareholders and excess capital amounts to USD 73.9 per share, implying a P/B 09 of 1.39 and a P/E 09 of 9.83.

Accordingly, we assign a **Hold Recommendation** to Bank Audi.

It is worth noting that an improvement in the country risks associated with the operations of Bank Audi and further geographical diversification to less risky countries would lower the discount rate and positively impact the valuation of the Bank.

On the other hand, any deterioration in the country rating will have a negative effect on the price of the shares. Thus, we have performed a sensitivity analysis to pinpoint the result of a 2% change in the discount rate on the fair value estimate of the stock price.

Table 4: Sensitivity analysis

Discount rate	17.10%	15.10%	13.10%
Fair value per share	USD 62.8	USD 73.9	USD 90.6

Source: FFA Private Bank

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Our fair value estimate amounts to USD 73.9 per share, implying a P/B 09 of 1.39 and a P/E 09 of 9.83

Financial statements

► Balance Sheet

In USD mn	2007	2008	2009e	2010e	2011e	2012e	2013e
- Cash & Balances with BDL	2,804	2,946	3,702	4,160	4,576	5,036	5,531
- Financial assets held for trading	477	14	382	420	466	513	559
- Financial assets designated at fair value through profit & loss	315	215	207	233	259	285	311
- Available for sale financial instruments	2,800	2,527	2,869	3,224	3,540	3,851	4,151
- Financial assets - loans & receivables	1,953	3,923	5,110	5,727	6,305	6,879	7,436
- Held to maturity financial instruments	340	172	277	318	358	400	442
- Due from Banks	3,159	3,622	3,822	4,377	4,923	5,487	6,058
- Loans & advances (net of provisions)	4,530	5,959	6,920	7,871	8,794	9,736	10,681
- Loans & advances to related parties	178	170	181	190	199	209	220
- Property and equipment (net)	311	331	352	375	400	426	453
- Bank acceptance	132	155	160	181	201	221	241
- Investment in associates	15	22	22	24	27	31	35
- Goodwill	143	139	149	156	164	172	181
- Other assets	163	216	240	271	312	359	412
• Total Assets	17,320	20,410	24,393	27,528	30,524	33,603	36,710
- Customer deposits	14,039	17,072	20,658	23,343	25,911	28,502	31,067
- Due to banks	634	464	561	700	777	855	932
- Deposits to related parties	260	157	207	233	259	285	311
- Engagement by acceptance	132	155	160	181	201	221	241
- Debt & borrowed funds	102	102	102	102	102	102	102
- Other liabilities	320	479	560	616	678	746	820
- Provisions	10	15	16	18	21	24	27
- Minority Interest	80	87	89	102	117	135	155
- Total shareholders' equity	1,743	1,879	2,041	2,232	2,459	2,734	3,055
• Total liabilities and equity	17,320	20,410	24,393	27,528	30,524	33,603	36,710

► Income Statement

	2007	2008	2009e	2010e	2011e	2012e	2013e
- Interest and similar income	1,012	1,147	1,211	1,415	1,660	1,923	2,172
- Interest expense and similar charges	(667)	(724)	(767)	(895)	(1,067)	(1,215)	(1,343)
• Net interest income	345	423	444	519	593	707	829
- Net commissions	106	141	135	141	149	161	174
- Net profit from financial operations	72	53	74	78	87	96	106
- Net other income	28	44	46	50	55	60	66
• Net non-interest income	206	238	255	268	290	317	345
- General & administrative expenses	(168)	(199)	(198)	(217)	(236)	(261)	(288)
- Depreciation & amortization	(21)	(25)	(27)	(31)	(35)	(40)	(48)
- Provisions	(2)	(14)	(21)	(24)	(20)	(28)	(39)
- Other operating expense	(119)	(140)	(135)	(146)	(161)	(180)	(202)
- Investment in associate	1	2	3	4	5	6	8
- Net loss from sale of other assets	(0)	(2)	1	-	-	-	-
• Profit before tax	242	285	322	374	437	521	606
- Income tax	(42)	(46)	(58)	(67)	(79)	(94)	(109)
• Net profit	200	238	264	307	358	427	497
- Minority interest	(8)	(5)	(6)	(7)	(8)	(10)	(12)

► KPIs and Key ratios

Growth	2008	2009e	2010e	2011e	2012e	2013e
- Total equity	7.8%	8.6%	9.4%	10.1%	11.2%	11.7%
- Total assets	17.8%	19.5%	12.9%	10.9%	10.1%	9.2%
- Total loans	31.6%	16.1%	13.7%	11.7%	10.7%	9.7%
- Customer deposits	21.6%	21.0%	13.0%	11.0%	10.0%	9.0%
- Earning assets	21.8%	20.0%	13.1%	11.0%	10.0%	9.0%
- Interest bearing liabilities	18.4%	21.0%	13.2%	11.0%	10.0%	9.0%
- Net profit	18.9%	10.9%	16.2%	16.7%	19.2%	16.5%
Capital adequacy	2008	2009e	2010e	2011e	2012e	2013e
- Shareholders' equity (USD mn)	1,879	2,041	2,232	2,459	2,734	3,055
- Equity / assets	9.2%	8.4%	8.1%	8.1%	8.1%	8.3%
Earnings and Margins	2008	2009e	2010e	2011e	2012e	2013e
- ROaE	12.9%	13.1%	14.0%	14.9%	16.0%	16.8%
- ROaA	1.24%	1.15%	1.15%	1.20%	1.30%	1.38%
- Interest income / Interest earning assets	6.49%	5.67%	5.70%	5.98%	6.26%	6.46%
- Interest expense / Interest bearing liabilities	4.41%	3.90%	3.90%	4.15%	4.28%	4.32%
- Interest spread	2.08%	1.77%	1.80%	1.83%	1.98%	2.14%
- Net interest margin	2.39%	2.08%	2.09%	2.14%	2.30%	2.47%
Efficiency	2008	2009e	2010e	2011e	2012e	2013e
- Cost/income	54.96%	51.65%	49.97%	48.88%	47.03%	45.72%
Share data	2008	2009e	2010e	2011e	2012e	2013e
- EPS (USD)	6.82	7.52	8.77	10.23	12.19	14.18
- EPS growth (%)	16.77%	10.29%	16.57%	16.64%	19.15%	16.39%
- P/E (x)	10.69	9.69	8.31	7.13	5.98	5.14
- BVPS (USD)	48.38	53.11	58.71	65.33	73.40	82.78
- P/BV (x)	1.51	1.37	1.24	1.12	0.99	0.88
- DPS (USD)	2.26	2.25	2.63	3.07	3.58	4.27
- Dividend yield (%)	3.09%	3.09%	3.61%	4.21%	4.91%	5.85%