

## Flash Note

January 21, 2011

# Bank Audi Q4 - 2010 Results

Sector: Banking

Country: Lebanon

### Bottom line up a solid 22% yoy in 2010

Bank Audi's net profits reached USD 352 million (mn) in 2010, up from USD 288 mn in 2009, and just shy of our USD 354 mn estimate. Non-interest income claimed a larger share of the yoy growth in operating income which reached USD 881 mn (just shy of our USD 878 mn estimate). Higher cost efficiencies and flat credit expenses were offset by a higher tax rate which was 19.0% vs. 17.3% in 2009. Net profits increased 30% to USD 99 mn from USD 76 mn on a yoy basis in the fourth quarter of 2010 alone. EPS to common shareholders basic and diluted was USD 0.96 and USD 0.94, respectively, in-line with our USD 0.96 and USD 0.93 estimates, and up from USD 0.80 and USD 0.78 in 2009.

### Summary Income Statement

| USD in millions                                     | Q4 10a     | Q4 09a     | 2010a      | 2009a      | FFA 2010e  | yoy%       |
|---|------------|------------|------------|------------|------------|------------|
| <b>Net Interest Income</b>                          | <b>128</b> | <b>113</b> | <b>490</b> | <b>424</b> | <b>509</b> | <b>16%</b> |
| Net Fees & Commissions Income                       | 45         | 40         | 173        | 147        | 153        | 18%        |
| Trading and investment income                       | 54         | 41         | 186        | 125        | 174        | 48%        |
| Other operating income                              | 3          | 4          | 33         | 37         | 41         | -12%       |
| <b>Non-interest income</b>                          | <b>102</b> | <b>84</b>  | <b>392</b> | <b>310</b> | <b>369</b> | <b>27%</b> |
| <b>Operating income</b>                             | <b>230</b> | <b>197</b> | <b>881</b> | <b>734</b> | <b>878</b> | <b>20%</b> |
| Operating expenses                                  | (102)      | (90)       | (387)      | (329)      | (383)      | 18%        |
| Depreciation and amortization                       | (8)        | (8)        | (30)       | (28)       | (29)       | 5%         |
| Net provisions for credit losses                    | (2)        | (11)       | (32)       | (31)       | (40)       | 4%         |
| <b>Operating profit</b>                             | <b>118</b> | <b>88</b>  | <b>433</b> | <b>346</b> | <b>425</b> | <b>25%</b> |
| Share of profits of associates under equity method  | 1          | 0          | 2          | 1          | 1          | 98%        |
| Net gain (loss) on sale or disposal of other assets | 0          | 1          | 0          | 2          | 0          | -92%       |
| Income tax expense                                  | (21)       | (14)       | (83)       | (60)       | (73)       | 37%        |
| <b>Net profit</b>                                   | <b>99</b>  | <b>76</b>  | <b>352</b> | <b>288</b> | <b>354</b> | <b>22%</b> |
| EPS to common basic                                 |            |            | 0.96       | 0.80       | 0.96       |            |
| EPS to common diluted                               |            |            | 0.94       | 0.78       | 0.93       |            |

Source: Bank Audi and FFA Private Bank estimates

### Net interest income benefits from a sequential improvement in interest margins

Net interest income was up 16% yoy to USD 490 mn, shy of our USD 509 mn estimate due to higher than expected interest expenses (interest income was in-line at USD 1.35 bn). Bank Audi's interest margin has been rising steadily since the beginning of 2010, from a low of 1.65% in Q1 10, driven by management's focus on preserving margins in a lower interest rate yielding environment. *We expect the improvement in interest margins to help offset the deceleration in earning assets (and funding) going forward.*

### Non-interest income driven largely by gains on financial assets

Net fees and commissions increased 18% yoy to USD 173mn, and represented 44.3% of non interest income, below 2009's level at 47.5%. Trading and investment income was up 48% yoy to USD 186 mn, which includes the firm's trading revenues and to a larger extent, gains / losses on financial assets. Non-interest income was USD 392 mn, and represented 44.4% of total operating income, ahead of our USD 369 mn estimate. *While we are encouraged by a more diversified revenue mix, we look for a greater share of fees and commissions in 2011 given that they are a less volatile component of income.*

### Cost efficiencies and loan quality continue to improve helping results

Cost-to-income ratio, a measure of cost efficiency, dropped to 47.3% in 2010 from 48.6% in the corresponding 2009 period, as the growth in operating expenses and depreciation & amortization reached USD 387 mn and USD 30 mn, respectively, and was outpaced by total operating income growth reaching USD 881 mn in 2010, in line with our USD 878 mn estimate. The improvement in cost efficiencies can be explained by international operations gaining maturity after 3-4 years of activity driving positive operating

leverage, coupled with efficient operations in Lebanon. Bank Audi's strategy aims to front-load expenses ahead of future increased income, and as "greenfield" branches reach maturity, aims to bring cost to income levels closer to the 42 - 45% range. Credit costs totaled USD 32 mn in 2010, roughly unchanged from the previous year at 31 mn, given greater release in reserves on lower impairments offsetting higher specific and collective provisioning. The net doubtful loans to gross loans ratio was 0.61%, down from 0.82% in Q3 2010 (doubtful loans less provisions and interest in suspense on doubtful loans, over gross loans), while collective provisions was 0.72% of net loans.

### Summary Balance Sheet

| <i>USD in millions</i>                            | <b>Q4 09a</b> | <b>Q3 10a</b> | <b>Q4 10a</b> | <b>FFA<br/>Q4 10e</b> | <b>qoq %</b> | <b>yoy %</b> |
|---|---------------|---------------|---------------|-----------------------|--------------|--------------|
| Cash and balances with BDL                        | 4,117         | 4,299         | 4,434         | 3,870                 | 3%           | 8%           |
| Financial assets                                  | 9,647         | 10,521        | 10,585        | 10,469                | 1%           | 10%          |
| Due from banks                                    | 5,133         | 4,079         | 4,204         | 4,926                 | 3%           | -18%         |
| Loans & advances                                  | 6,747         | 8,169         | 8,548         | 8,440                 | 5%           | 27%          |
| Other assets                                      | 843           | 931           | 923           | 941                   | -1%          | 9%           |
| <b>Total assets</b>                               | <b>26,486</b> | <b>27,999</b> | <b>28,693</b> | <b>28,646</b>         | <b>2%</b>    | <b>8%</b>    |
| Due to banks and other financial institutions     | 603           | 635           | 692           | 640                   | 9%           | 15%          |
| Deposits  | 22,985        | 24,242        | 24,847        | 24,824                | 2%           | 8%           |
| Other liabilities                                 | 705           | 763           | 728           | 769                   | -5%          | 3%           |
| Total shareholders' equity                        | 2,193         | 2,358         | 2,426         | 2,413                 | 3%           | 11%          |
| <b>Total liabilities and shareholders' equity</b> | <b>26,486</b> | <b>27,999</b> | <b>28,693</b> | <b>28,646</b>         | <b>2%</b>    | <b>8%</b>    |

Source: Bank Audi and FFA Private Bank estimates

### **Assets and deposits up high single digits in 2010**

Bank Audi finished the 2010 year with assets and deposits both growing 8% yoy to USD 28.7 billion (bn) and USD 24.8 bn, respectively (in line with our USD 28.6 bn and USD 24.8 bn estimates, respectively). Bank deposits, which provide balance sheet funding (representing 87% of assets), have seen a slowdown in 2010 following a more robust pace in previous years as capital inflows into Lebanon moderated from record highs. *Even with this slowdown, Bank Audi managed to increase deposits by USD ~1.9 bn in 2010 alone, a testament to the Bank's solid franchise, in our view, when we equate it with the USD 2 bn that characterizes an alpha bank in Lebanon.*

### **Loans see robust activity in economic growth from domestic and international contributions**

Bank Audi saw its private sector loan portfolio grow a solid 27% yoy to USD 8.4 bn in 2010 (in line with our USD 8.4 bn estimate), as the Bank allocated some excess liquidity into the real sector, thereby driving their loans to deposit ratio up to 34.4% from 29.4% in Q3 2010. Bank Audi's loan book grew on domestic demand from an improving economy, which has been estimated by IMF at 9% and 8% for 2009 and 2010, respectively, as well as good commercial loan demand, stemming from the MENA region. *Despite this, Bank Audi still enjoyed solid liquidity levels with primary liquidity to deposits at 49%, unchanged q-o-q from September 2010.*

### **Capitalization levels roughly unchanged in 2010**

The capital adequacy ratio as per Basel II was 11.7%, while well above the required 8.0%, trails the top alpha banks in Lebanon (as of end 2009). Average equity to assets dipped 50bps to 8.4% from 8.9% in 2009. Return on average common equity was 16%, in-line with the previous nine month period.

#### Contacts:

**Head of Research: Nadim Kabbara, CFA**  
n.kabbara@ffapivatebank.com  
+961 1 985 195  
**Analyst: Raya Freyha**  
r.freyha@ffapivatebank.com  
+961 1 985 195  
**Sales and Trading, FFA Private Bank (Beirut)**  
+961 1 985 225  
**Sales and Trading, FFA Dubai Ltd (DIFC)**  
+ 971 4 3230300

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