

BANK AUDI

Equity Research **November 12th, 2010**

Sector: Banking
Country: Lebanon

– Current price*:	USD 7.99
– Target price:	USD 9.00
– Recommendation:	MARKETWEIGHT

Share Data

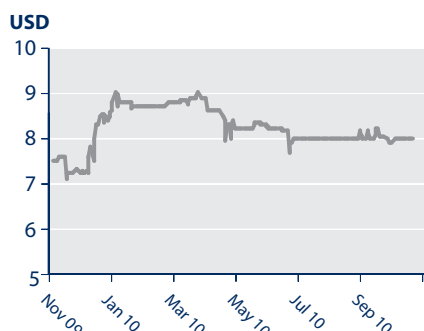
– Listing common shares:	Beirut Stock Exchange
– Listing GDRs:	BSE & London Stock Exchange
– Reuters code:	AUDI.BY, AUSR.BY, AUSRQ.L
– Bloomberg code:	AUDI.LB, AUSR.LB, BQAD.LI
– Market cap:	USD 2,784.5 mn
– Number of common shares:	348.5 mn

Share Price Information*

– YTD Δ	-3.7%
– 1M Δ	+1.0%
– 3M Δ	-0.1%
– 12M Δ	+6.5%
– 52 - Wk range	USD 7.10 - 9.03

*Bank Audi shares closing as of November 12, 2010

Share Price Performance



Key performance indicators:

USD mn	2009	2010e	2011e	2012e
- Net Interest Income	424	509	583	671
- Non-Interest Income	310	369	405	447
- Net Profits	289	354	408	472
- ROAA (%)	1.23	1.28	1.36	1.44
- ROAE (%)	13.9	15.4	16.1	16.8
- BVPS (USD)	5.98	6.59	7.28	8.10
- EPS diluted (USD)	0.78	0.93	1.06	1.24
- P/BV (x)	1.3	1.2	1.1	1.0
- P/E (x)	10.2	8.6	7.5	6.5

Contacts

Head of Research: Nadim Kabbara, CFA
n.kabbara@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

Expect Regional Expansion Strategy and Bottom Line Improvement to Pay Dividends

– Largest bank in Lebanon with a continuous focus on regional expansion

Driven by significant organic growth coupled with a series of mergers and acquisitions, Bank Audi grew to become the largest player in Lebanon and implemented its strategy with the aim of diversifying revenues by business lines and markets. Currently, the Bank offers a full array of banking services ranging from retail, commercial, investment and private banking to capital market activities and insurance through 157 domestic and foreign branches. The Bank is dynamically expanding its reach to international markets and most notably to regional markets seeking a balanced breakdown of earnings between Lebanese and foreign operations. The Bank's international activities cover: Switzerland, France, Egypt, Syria, Jordan, Sudan, Qatar, KSA and UAE. Bank Audi recently established a presence in Monaco and Gibraltar.

– Balance sheet growth and bottom line improvement maintained through 9M-2010

Assets and deposits growth continued in 9M-2010 registering a 6% and 5% year-to-date increase respectively, while Bank Audi's loan portfolio grew robustly in the same period (+ 21%). With USD 27,999 mn in assets, USD 24,242 mn in deposits and USD 8,169 mn in loans at end-September 2010, the Bank reinforced its top position among domestic peers over these three major banking criteria. Total earnings jumped 19% year-on-year, totaling USD 253 mn for 9M-2010.

– Going forward, we expect Bank Audi to maintain balance sheet expansion and to further grow earnings

Over our forecast period, we expect Bank Audi to maintain a healthy pace in deposits and loans growth as highlighted by a CAGR of 10% and 18% to USD 36,672 mn and USD 15,036 mn respectively in 2014e. In parallel, profits are expected to grow at a CAGR of 18% to USD 666 mn in 2014e, driven by balance sheet growth, widening interest spreads, non-interest income growth with potential to improve cost-efficiency from current levels. Liquidity should remain ample thereby fueling lending growth, while comfortable capitalization should provide support to the Bank's expansion plans. We expect no major threat on asset quality.

– We recognize Bank Audi's leadership and ambitious expansion strategy and view its shares to be fairly valued

We recognize Bank Audi's market share leadership in assets, loans, and deposits which reflect its solid franchise in its domestic market, and ambitious expansion plans across products and markets. We also like the firm's improving position in terms of profitability, asset quality, and capitalization in a difficult operating environment, a testament to the capable management team and corporate practices in place. We find Bank Audi's common shares valued as less expensive than comparable trading regional peers on a P/B basis, explained by the lack of shares' trading liquidity, a challenging geopolitical landscape in Lebanon, and a moderate profitability. However, we perceive Bank Audi's shares to be fairly valued given its in line valuation with its historical average and its premium valuation to its domestic trading peers, warranted given its superior leadership and growth profile.

– We rate Bank Audi shares at Marketweight with a fair value of USD 9.00 per share

Based on our revised forecasts and discount rate assumptions to our Dividend Discount Model, our fair value estimate is USD 9.00 per share, which implies a P/B of 1.38x on our book value per share 2010 estimate, in-line with the Bank's historical trading average. We accordingly assign a **Marketweight** recommendation given that the current price is approximately within +/- 10% of the fair value estimate.

– Disclaimer

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Investment Opinion

– We recognize Bank Audi's leadership and ambitious expansion strategy but view shares to be fairly valued

We recognize Bank Audi's market share leadership in assets, loans, and deposits reflecting its solid franchise in its domestic market, and ambitious expansion plans across products and markets. We also like the firm's improving position in terms of profitability, asset quality, and capitalization in a difficult operating environment, a testament to the capable management team and corporate practices in place. Although we find Bank Audi's common shares valued as less expensive than comparable trading regional peers, which we believe is explained by the lack of shares trading liquidity, challenging geopolitical landscape in Lebanon, and lower overall profitability, we perceive Bank Audi's shares to be fairly valued on a P/B basis from both given its in-line valuation with its historical average, and premium valuation to its domestic trading peers, warranted in our view given its superior leadership and growth profile.

▪ Demonstrated leadership in its domestic market and looking to grow regionally

Bank Audi has grown from a Lebanese commercial bank into the largest universal bank covering personal, commercial, private banking, and capital markets in Lebanon. The Bank boasts the largest share in assets, loans, and deposits in Lebanon, owing to its solid service levels and reputation throughout its 157 branches. More recently, the Bank has adopted a geographic expansion strategy to penetrate and develop in larger and under banked countries seeking to diversify its base and product and service portfolio outside Lebanon in MENA and Europe. We expect this strategy will allow the Bank to grow its share of private sector loans and non-interest income over the next several years translating into bottom line expansion.

▪ Bank Audi has scope for further improvement in profitability, asset quality, and capitalization

Bank Audi has grown its net earnings by 32% CAGR between 2004 and 2009 by growing its balance sheet, diversifying its operating income, lowering its cost-to-income ratio, and recently widening its interest spreads, thereby registering an improvement in return on average assets from 0.82% to 1.23%. Asset quality and provisioning have also been improving over time judging by the net doubtful loans/gross loans, and loan loss provisions/gross doubtful loans, improving from 2.85% and 63.98% in 2004 to 0.35% and 89.65% in 2009 respectively. Lastly, capitalization has solidified since 2004 with the equity-to-assets ratio strengthening from 4.55% in 2004 to 8.97% in 2009. While we view these developments as positive and a reflection of the solid management team and corporate practices in place, there is scope for the Bank to continue to improve its performance on these three fronts closer to regional peers, further increasing its profitability ratios, lowering its NPL ratio and strengthening its capital base in view of maintaining its compliance to regulatory requirements and capturing any appealing acquisition opportunities.

▪ Valuation stretched...Look for more interesting entry point for longer-term investors

We assign a Marketweight recommendation given that the current price is approximately within +/- 10% of the fair value estimate. Should the market pull back on additional uncertainty including those arising from the geopolitical or regulatory environment, we would advise longer term investors to revisit the shares, particularly as they provide an interesting dividend yield exceeding 4% (with net dividends to common shares growing at a 37% CAGR between 2004 and 2009) against a backdrop of a still low international interest rate yielding environment.

Company Overview

► Brief background

Incorporated in 1962, Bank Audi supplemented its organic growth by a series of mergers and acquisitions in the late 1990s and grew to become the largest player in the Lebanese banking sector. Over the years, the Bank has diversified its sources of revenues by business lines and by markets of presence, moving towards a regional universal Bank that currently offers a full range of commercial, retail and private banking services as well as insurance and capital market activities and is present in Lebanon and nine foreign countries, namely Egypt, France, Jordan, Qatar, Saudi Arabia, Sudan, Switzerland, Syria and the UAE. More recently, the Company has expanded its reach to Gibraltar and Monaco. As at end-December 2009, Bank Audi operated a network of 154 domestic and foreign branches, with 470,876 customers and 785,427 managed accounts, further raised to 157 branches, 510,000 customers and 850,000 managed accounts as at end-September 2010.

Recent financial results highlight Bank Audi's ability to have weathered the global financial crisis as compared to banking peers in other markets. In 2009, Bank Audi saw major a solid improvement in its major indicators, soaring at double-digit growth rates with assets, deposits, loans and net profits jumping by 29.9%, 32.6%, 10.1%, and 21.4%, respectively while liquidity levels remained ample, asset quality unscathed and capitalization levels comfortable providing further support for the Bank's expansionary strategy. Bank Audi held an asset base, a deposit base, and a loan portfolio of USD 26,486 mn, USD 22,985 mn, USD 6,747 mn respectively, by year-end 2009, consolidating its leading position among its domestic peers over these three major banking criteria. With USD 289 mn generated in net earnings during 2009, Bank Audi ranked 2nd in terms of net profits. On a regional scale, Bank Audi ranked 19th by assets among banks operating in the MENA region¹, and its objective is to rank among major MENA players.

The Q3 2010 results highlight a healthy progression in deposits and assets despite a significant slowdown relative to previous years, as highlighted by a growth of 6% and 5% respectively since the beginning of 2010. Lending activity was strong, seeing a 21% increase in the same period. Net profits totaled USD 235 mn over the first nine months of 2010, up 15.6% yoy, placing Bank Audi in the first position among its domestic peers, in terms of earnings for the most recent nine-month period.

► Ownership structure

As of September 30, 2010 and adjusting for the 10 for 1 stock split that included the Bank's common shares, the Series D preferred shares, as well as the GDRs (Global Depository Receipts), the Bank's shares consisted of the following:

– Common shares

The common shares consisted of (i) 348,477,114 common shares outstanding, and (ii) 1,386,820 outstanding unexercised stock options

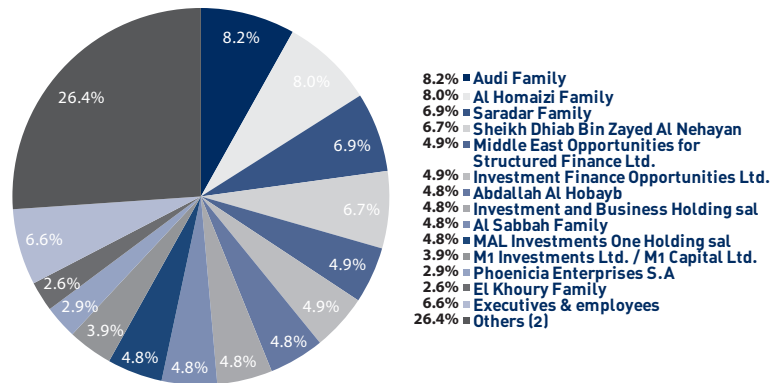
– Preferred shares

The preferred shares consisted of (i) 12,500,000 series D preferred shares which were issued in 2005 and callable in 2012; and (ii) 1,250,000 series E preferred shares which were issued in 2010 and are callable in 2015.

¹Source: Bank Audi

The figure below depicts Bank Audi's ownership of common shares and / or GDRs as of September 30, 2010.

Figure 1: Bank Audi's ownership structure of common shares and / or GDRs (Sept. 30, 2010)



Note:

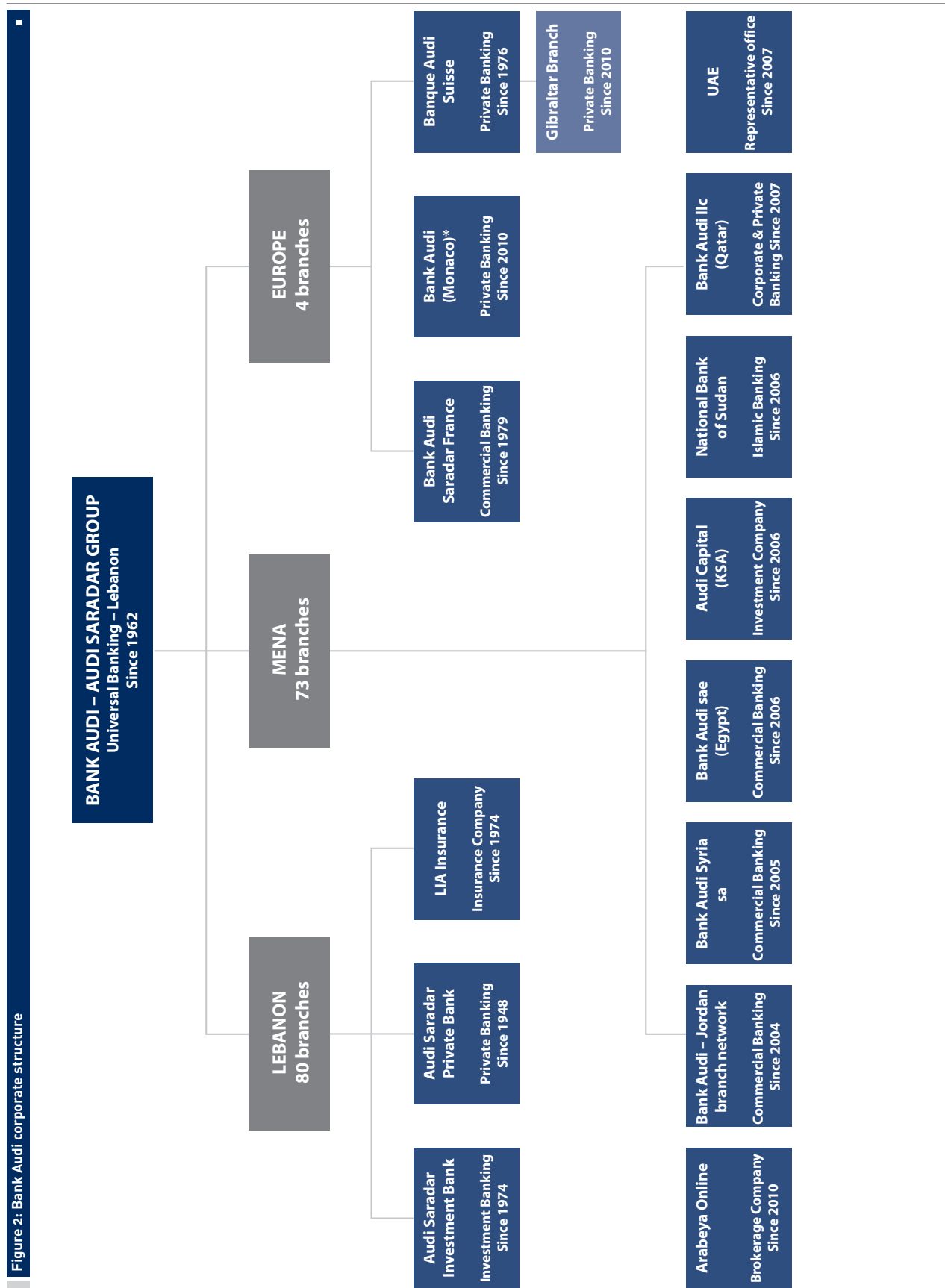
(1) Percentage ownership figures represent both Common shares and GDRs owned by the named Shareholders and are expressed as a percentage of the total number of Common Shares issued and outstanding, including the Common Shares represented by GDRs. Deutsche Bank Trust Company Americas, in its capacity as depositary under the Bank's GDR Programme, owns 93,687,854 Common Shares represented by GDRs representing 26.9% of the Common shares, including the GDRs owned by the Shareholders named in the above pie chart. Figures in the above pie chart reflect the ownership of common shares after giving effect to the resolutions of the General Assembly of shareholders held on October 1, 2010 that resolved to issue 12,317,460 shares (resulting from the exercise of stock options) and to cancel 8,029,756 attributable to GDRs held by the Bank in treasury.

(2) Other holders of Common Shares or GDRs, each with less than one percent

Source: Bank Audi

Corporate structure

The below figure depicts the major subsidiaries of Bank Audi sal – Audi Saradar Group as of September 2010:



Note: * Name change from Dresdner Bank SAM is under process and awaits final authorization
 Source: Bank Audi

Growth Strategy

Bank Audi has been implementing its strategy with the aim of diversifying its revenues both by business lines and countries of presence. While the Bank has transformed into a domestic universal bank with a focus on corporate, retail, private and investment banking, its geographic expansion strategy deployed in 2005 has paved the way for it to become a regional universal bank, as the Bank's assets and revenue streams continue to diversify by geographical segment.

► Geographic expansion

– Footprints in Europe since the mid 1970s through subsidiary banks in Paris and Geneva

Starting in the mid 1970s, Bank Audi expanded its activities into Europe by establishing entities in France and Switzerland, in order to mitigate the domestic risk that arose with the beginning of the civil war. While the French entity (Bank Audi Saradar France) is primarily a commercial bank engaged in trade finance activity catering specifically to Middle Eastern traders, the Swiss entity (Banque Audi Suisse) represents the main private banking arm of the Group and ranks as the second largest Arab private bank in Switzerland by assets under management.

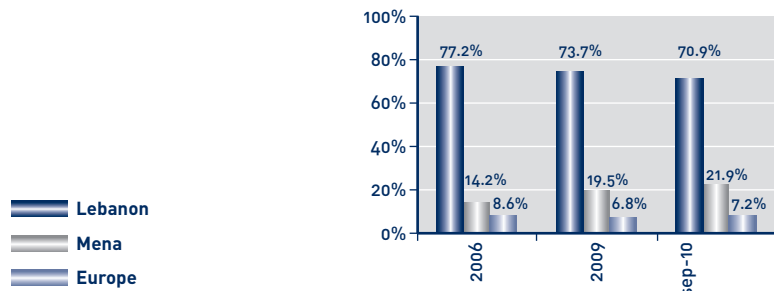
– Regional expansion starting in the first half of the past decade

In addition to its presence in Lebanon and Europe, Bank Audi stepped up its expansion efforts in the Middle East starting in 2003, adding footprints in seven countries across the MENA region (Egypt, Syria, Jordan, Sudan, Qatar, Saudi Arabia and the UAE), enabling the Group, in some cases, to benefit from new growth opportunities in markets with underdeveloped banking systems. While the Bank provides comprehensive retail and commercial banking products in Levant countries, the Saudi and the Qatari entities are specialized in capital market activities and corporate & private banking, respectively, while Islamic banking is the core business of the Bank in Sudan.

– Rising contribution from MENA operations to the Group's size and profitability

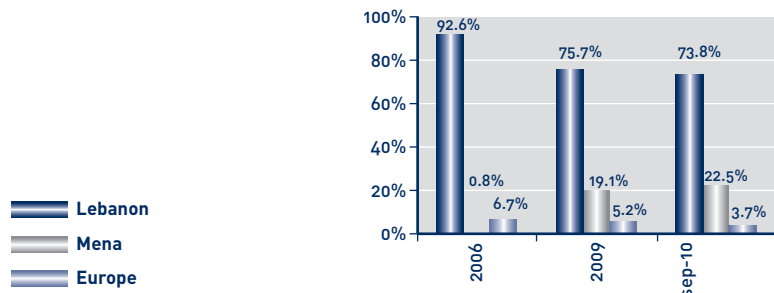
The regional expansion of the Bank is playing a catalytic role in the Group's diversification of assets and earnings. In three years of activity, Bank Audi has developed a profitable regional franchise of 260,000 accounts, 180,000 clients and 73 operating branches. The Group's assets from MENA operations totaled USD 5.2 bn and at the end of 2009 and further increased to USD 6.1 bn at the end of September 2010, equivalent to a respective contribution of 19.5% and 21.9% to the Group's consolidated assets as compared to 14.2% in 2006. With the European operations' share in total assets at 7.2% and 6.8% in September 2010 and 2009 respectively, the breakdown of assets between Lebanon and foreign operations is 70.9% and 29.1% in September 2010 and 73.7% and 26.3% in December 2009 as compared to 77.2% and 22.8% in 2006.

► **Figure 3: Geographic breakdown of assets**



Source: Bank Audi

► **Figure 4: Geographic breakdown of earnings**



Source: Bank Audi

The breakdown of earnings between Lebanon and abroad of 73.8% and 26.2% in September 2010 and 75.7% and 24.3% in 2009 as compared to 92.6% and 7.5% in 2006, results from the rising share of regional entities in the Group's consolidated profits. Figures at the end of September 2010 highlight that Egypt, Syria and Jordan are the major contributors to the Group's assets in MENA region with 44%, 33% and 15% respectively, while the major contribution to earnings generated in the MENA region came from Egypt, Syria and Sudan with 35%, 19% and 18% respectively.

– **Slower growth from European entities due to difficult economic conditions**

Bank Audi saw a decrease in earnings from its European entities, from USD 23.5 mn in 2008 to USD 14.7 mn in 2009, mainly attributed to the economic woes and to the tightening of banking reporting regulations in Switzerland. However, Bank Audi's operations in Europe were less impacted by the global economic downturn and credit crisis compared to other banks in Europe, shielded by the Bank's wide base of Middle Eastern clients.

– **Expansion underway to the United Kingdom, after the recent entry into Monaco and Gibraltar**

In 2010, Banque Audi (Suisse) opened a branch in Gibraltar; allowing the Bank to develop its asset management customer base in the Iberian Peninsula and North Africa. Moreover, Bank Audi recently acquired Dresdner Bank SAM (Monaco) and is in the process of obtaining regulatory approvals for opening a branch for private banking activity in London; which would further expand the Bank's presence in Europe and allow it to

serve select private banking clientele from the Middle East.

– In the medium-term, the target is to reach a balanced breakdown of earnings between Lebanon and abroad

In the short-term, Bank Audi aims to generating 40% of its assets and earnings from foreign operations, while a balanced breakdown between domestic operations and foreign operations remains an objective in the medium term. The execution of its strategy consists of a further expansion of the Bank's activities abroad by expanding coverage to new untapped markets with interesting growth perspectives, while reinforcing its presence in existing markets as well. Deployment in neighboring countries slowed down during the past two years as a result of the regional recessionary environment but should resume given the gradual improvement in macroeconomic conditions and as the MENA region remains a core focus of the Bank. While Bank Audi aims at substantially increasing its network of branches in its Levant countries of operations, prospecting for new regional markets with high potential is also in progress with plausible entries into Tunisian and Algerian markets along with a strong interest in Turkey and Kuwait. We note the Lebanese Central Bank's encouragement provided to Lebanese banks to further expand in the Middle East, particularly to Syria and Turkey, looking to deepen banking relationships with Lebanon, as favorable to Bank Audi's regional expansion strategy. Bank Audi targets a strong franchise in the MENA region with an objective to build a regional network of more than 200 branches and a regional franchise of close to one million accounts in the foreseeable future.

The following table highlights Bank Audi's MENA and European operations.

Table 1: Highlights of Bank Audi's international operations						
Country	Subsidiaries	Launch date	% ownership	Services provided	Activity highlights in 2009	Key indicators 2009
Switzerland	Banque Audi Suisse sa	1976	100%	Private banking	Negative impact of the recession Decrease of 37% in earnings from both European entities	Assets & AUM: USD 3,805 mn Net profits: USD 7.8 mn
						Assets: USD 894 mn Net profits: USD 7.4 mn
France	Bank Audi Saradar France sa	1979	100%	Trade finance Commercial banking		
Egypt	Bank Audi sae	2006	100%	Retail & Commercial banking Network of 31 branches	+32% in assets +61% in earnings	Assets: USD 2.1 bn Net profits: USD 22.1 mn
Syria	Bank Audi Syria sa	2005	47%	Retail & Commercial banking		Assets: USD 1.7 bn Net profits: USD 13.4 mn
	Syrian Arab Insurance sa	2006			+36% in assets +70% in earnings	
	Audi capital (Syria)	2010	41%	Network of 21 branches		
Jordan	Bank Audi sal (Jordan branch network)	2004		Retail & Commercial banking Network of 11 branches	+34% in assets +15% in earnings	Assets: USD 824 mn Net profits: USD 7.8 mn
Sudan	National Bank of Sudan	2006	77%	Islamic banking	-10% in assets +18% in earnings	Assets: USD 229 mn Net profits: USD 14 mn
Qatar	Bank Audi LLC	2010	100%	Corporate & Private Banking	-18% in assets +127% in earnings	Assets: USD 159 mn Net profits: USD 3.4 mn
Saudi Arabia	Audi Capital KSA	2006	100%	Private Banking & advisory	-5% in assets 53% reduction in net losses	Assets: USD 125 mn Net profits: USD -3.5 mn
UAE	Bank Audi sal Abu Dhabi representative office	2007		Representative office		

Source: Bank Audi

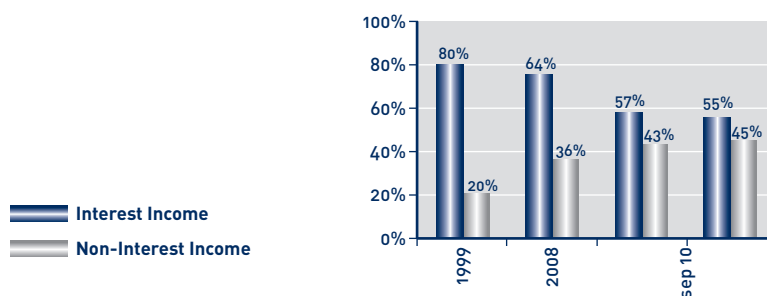
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► Business lines

– Well diversified revenue stream by business lines

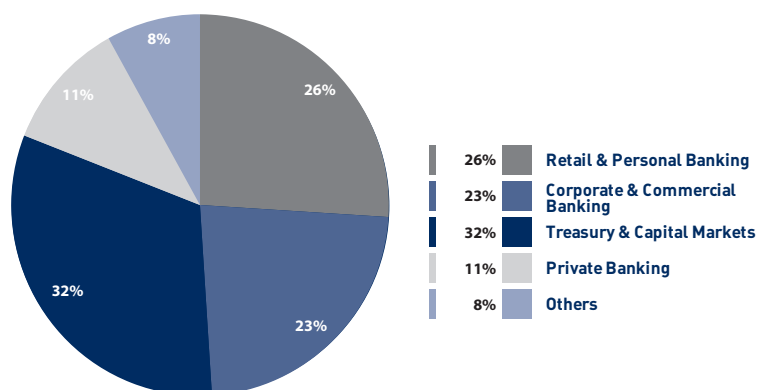
Starting in the late nineties, the Group started consolidating its universal banking profile covering a large spectrum of banking services and decreasing its dependency on traditional banking. Consequently, the contribution of non-interest income to total operating income has been on an upward trend, highlighting a decreasing reliance on interest income and placing Bank Audi in a comfortable position among its peers in terms of operating income diversification. The breakdown of total revenues by business line for September 2010 indicates that a substantial portion is being generated in treasury and capital markets (32%), while retail and commercial banking together accounted for 49%, and private banking for 11%.

► **Figure 5: Interest income vs. non-interest income**



Source: Bank Audi

► **Figure 6: Revenues breakdown by business lines (Sep-10)**



Source: Bank Audi

– ...With a wide range of banking activities

Currently, Bank Audi provides a full range of banking activities, ranging from traditional banking (including retail banking, commercial banking and trade finance), to bancassurance, private banking, investment banking, capital markets and research services. The table below provides an overview of Bank Audi's major business lines:

Table 2: Overview of Bank Audi's business lines

Retail & personal banking
<p>Facts and key figures</p> <ul style="list-style-type: none"> Wide range of 123 retail products and services Largest network of branches in Lebanon counting 80 branches Active branching out in the MENA region with 73 operating branches 26% contribution to total revenues into September 2010 <p>Strategic orientation</p> <ul style="list-style-type: none"> Grow a base of mid-market retail customers in Lebanon Further expand the retail network of branches in MENA countries
Corporate & commercial banking
<p>Facts and key figures</p> <ul style="list-style-type: none"> Diverse segments including trade finance, commercial banking and insurance Strong commercial banking activity in Lebanon Growing corporate banking franchise in the MENA region 23% contribution to total revenues into September 2010 <p>Strategic orientation</p> <ul style="list-style-type: none"> Strengthen corporate business relationships with SMEs and expand coverage of large companies in Lebanon Continue to expand the corporate banking franchise in the MENA region
Treasury & capital markets
<p>Facts and key figures</p> <ul style="list-style-type: none"> Important market making activity in Lebanon supported by research activities Largest market share by transaction value on the Beirut Stock Exchange (29% in 2009) Regional capital markets activities principally in KSA and Egypt 32% contribution to total revenues into September 2010 <p>Strategic orientation</p> <ul style="list-style-type: none"> Strengthen the capital market franchise in the MENA region

Private Banking

— Facts and key figures

- Performed domestically through Audi Saradar private bank
- Performed in Europe through Banque Audi Suisse (since 1976)
- Regional coverage out of Saudi Arabia, Qatar and the UAE
- USD 7 bn of assets under management at the end of 2009 further increasing to USD 8 bn as at end-September 2010
- 11% contribution to total revenues into September 2010

— Strategic orientation

- Expansion of private banking activities to the United Kingdom, after Gibraltar and Monaco
- Regroup the private banking business under one corporate structure and one management
- Develop private banking towards asset management
- Reach non-Lebanese and non-Arab customers

Recent Developments

► Relevant news

– **January 2010: EFG Hermes sells its stake in Bank Audi**

The Cairo-based investment bank EFG Hermes, who held the second-largest share in Bank Audi, sold its entire stake in the Bank for USD 913 mn to a group of investors, consisting of approximately 7.5 million common shares and 2.5 million Global Depositary Receipts. EFG returned to the Lebanese market in August with the announcement to purchase a majority 65% interest in Credit Libanais for USD 542 mn with a call option on another 25%, which closed in November 2010.

– **April 2010: Moody's and Fitch upgrade Bank Audi's ratings following upgrade on Lebanese Sovereign**

Moody's Investors Service upgraded four Lebanese banks' long-term foreign currency deposit ratings including Bank Audi to B1 from B2. Fitch Ratings upgraded Bank Audi's long-term issuer default ratings from B- to B. The upgrades follow similar actions taken on Lebanon's sovereign ceilings (Moody's: to B1 from B2, Fitch: to B from B-) which continue to act as a ceiling on the component banks' ratings, given their significant exposure to the public sector debt.

– **May 2010: Stock split at a ratio of 10 to 1, with aim to improve liquidity and traded volume on the shares**

Announced by the Bank's Extraordinary General Assembly of Shareholders on March 5th 2010 and approved by the Central Bank of Lebanon on April 21st 2010, the recent stock split of Bank Audi's outstanding share capital became effective as of May 24th 2010. The stock split included the Bank's common shares and Series D preferred shares, as well as the GDRs representing common shares; in each case at a ratio of 10 to 1. The trade on a post-split basis started after May 25th 2010. The stock split aims to improve the liquidity and the traded volume of Bank Audi shares from increased shares outstanding and more attractive pricing to retail investors.

– **June 2010: Preferred share E issue**

In 2010, the Bank closed a USD 125 mn preferred share issue, increasing its shareholders' base. The offering revolved around 1,250,000 non-cumulative redeemable preferred shares Series E 2010 at an issue price of USD 100 per preferred share, each with a nominal value of LBP 1,225.

– **July 2010: Acquisition of a majority stake in Arabeya Online, an online trading platform in Egypt**

Bank Audi acquired a 90% ownership in Arabeya Online, the first online trading platform in Egypt from Naeem Holding and founder Hesham Tawfic. This acquisition falls within the Bank's regional growth strategy and provides access to the Egyptian retail brokerage market. Furthermore, Arabeya Online has a license in the GCC, providing support to a regional brokerage platform expansion plan.

► Financial performance

– October 2010: Q3 2010 results

▪ Balance sheet

Over the first nine months of 2010, assets and deposits growth moderated to 6% and 5% respectively. Bank Audi's deposit base grew from USD 22,985 mn at the end of 2009 to USD 24,242 mn in Q3 10, while total assets reached USD 27,999 mn by the end of Q3 10, up from USD 26,486 mn at year-end 2009. Assets and deposits both grew by 2% qoq in Q3 10 relative to Q2 10, representing an increase of USD 678 mn and USD 460 mn, respectively. The loan portfolio grew robustly over the first nine months of 2010, with loans and advances increasing by 21% since the beginning of 2010, to reach USD 8,169 mn by the end of September 2010, up from USD 6,747 mn at the end of 2009. A closer look at growth levels achieved sequentially between quarters reveals that lending activity decelerated in Q2 2010 relative to Q1 10, as reflected by a growth of 3% in Q2 10 against 12% in Q1 2010 and regained momentum in Q3 10 with a 5% qoq growth. Within the context of strong lending activity against a more moderate growth in deposits, the loans-to-deposits ratio, increased to 33.7% in Q3 10, up from 29.4% in Q4 09.

Table 3: Bank Audi's Q3 2010 summary balance sheet

USD million	Q4 09	Q2 10	Q3 10	qoq %	ytd%
Cash and balances with BDL	4,117	3,905	4,299	10%	4%
Financial assets	9,647	10,784	10,521	-2%	9%
Due from banks	5,133	4,026	4,079	1%	-21%
Loans & advances	6,747	7,756	8,169	5%	21%
Other assets	843	850	931	10%	11%
Total assets	26,486	27,321	27,999	2%	6%
Due to banks and other financial institutions	603	604	635	5%	5%
Deposits	22,985	23,783	24,242	2%	5%
Other liabilities	705	681	763	12%	8%
Shareholders' equity	2,193	2,253	2,358	5%	8%
Total liabilities and shareholders' equity	26,486	27,321	27,999	2%	6%

Source: Bank Audi

▪ Income statement

Net interest income reached USD 361 mn for the first nine months of 2010, highlighting a robust 16% yoy increase on the back of continuous growth in earning assets and within the context of lower yet improving interest spreads. Non-interest income grew substantially to USD 260 mn (+35% yoy) in the first nine months of 2010. This revenue segment has been mainly driven by a strong lift in trading and investment income (+55% yoy), highlighting important gains on financial investments. On the other hand, net fees and commissions income, typically a more stable revenue stream, registered +19% growth yoy, totaling USD 128 mn for the first nine months of 2010. Benefiting from considerable growth in operating income, along with a focus on cost-control initiatives, Bank Audi's cost-to-income ratio fell from 48.3% in Q3 09 ytd to 47.1% in Q3 10 ytd (although up in the recent quarter on a yoy basis). Bank Audi generated USD 92 mn in net profits in Q3 10 and USD 253 mn for the first nine months of 2010, which represented 19.1% growth yoy. The improvement in net profits ytd Q3 10 was driven by a

considerable contribution of trading and investment income, coupled with growth in net interest income, and improvement in cost-efficiency levels. Bank Audi maintained a sound level of capitalization as reflected by a capital adequacy ratio of 11.95%, well above the 8% minimum requirement (as per Basel II).

Table 4: Bank Audi's Q3 2010 summary income statement

USD million	Q3 09 ytd	Q3 10 ytd	yoy%
Net interest income	311	361	16%
Net fees and commissions income	107	128	19%
Trading and investment income	85	131	55%
Non-interest income	192	260	35%
Other operating income	34	30	-10%
Operating income	537	651	21%
Operating expenses	(238)	(285)	19%
Depreciation and amortization	(21)	(22)	6%
Net provisions for credit losses	(20)	(30)	51%
Operating profit	258	314	22%
Share of profits of associates under equity method	1	1	67%
Net gain (loss) on sale or disposal of other assets	1	(0)	-131%
Income tax expense	(46)	(62)	34%
Net profit	213	253	19%

Source: Bank Audi

SWOT Analysis

Strengths

- Ranks 1st in Lebanon in terms of deposits, loans, and assets.
- Highly liquid balance sheet with a loans-to-deposits ratio standing at 33.7% in Q3-2010.
- High contribution of non-interest income to total income (45% in Q3-2010), providing earning growth support and diversification.
- Significant contribution of Middle Eastern and European operations to the Group earnings (26% in Q3-2010), mitigating Lebanon's country risk.
- Risk management practices translating into a superior loan book quality, with net doubtful loans to gross loans ratio at 0.82% in Q3-2010.
- Growing capital markets operations including significant market making activities on Lebanese and regional fixed income securities reaching USD 13 bn annual turnover.

Weaknesses

- Less competitive interest spreads
- Lower visibility in GCC markets including Saudi Arabia and UAE which count largest deposits, compared to operations in Levant countries.
- Significant contribution of trading and investment income, which we view as less recurring than net interest and fees & commissions.

Opportunities

- Presence in high growth regional markets with potential for expansion in new countries with under-developed banking systems.
- Opportunity to cross-sell products and services between business lines and geographic markets, particularly in private banking.
- Scope to increase lending activity from current levels as local and regional economies continue to expand.
- Potential for further cost-efficiencies improvement as greenfield operations in regional markets mature.

Threats

- Deterioration of the political and security situation in Lebanon and in other high-risk countries
- Substantial exposure to Lebanese sovereign bonds.
- Potential pressure on asset quality should economic conditions deteriorate amid a growing retail loan book.

Financial Highlights and Revised Forecasts

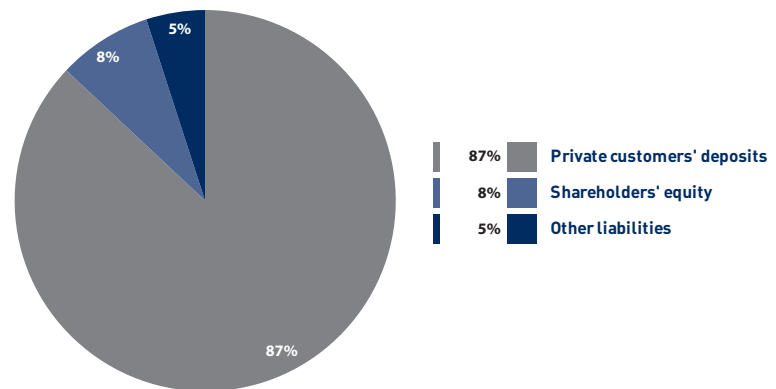
► Balance sheet snapshots

– Moderated assets and deposits growth in 9M-2010 after outstanding progression in 2009

In 2009, Bank Audi grew its asset base and its deposit base faster than the sector average, sustaining its position as the strongest banking franchise in Lebanon. Financial results highlight that the Bank's assets increased by 29.9% in 2009, fueled by a 32.6% surge in deposits over the same period, notably higher than the 21.2% registered in 2008. At these levels, Bank Audi's assets and deposits reached USD 26,486 mn and USD 22,985 mn, respectively, at the end of 2009.

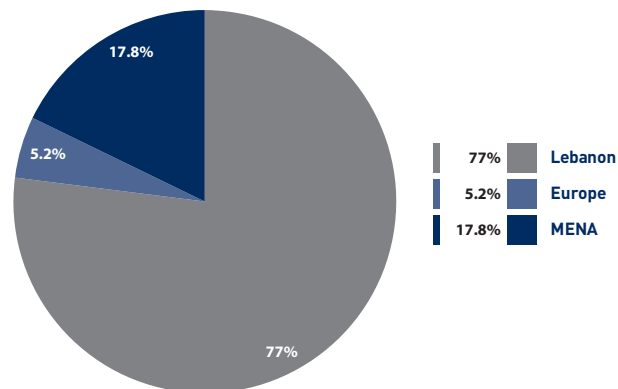
The breakdown of liabilities and shareholders' equity for 2009 demonstrates that the Bank remains, in-line with a typical balance sheet structure of a Lebanese bank, a deposit rich bank largely funded by deposits, with a contribution of 87% to total assets, higher than the respective 83% and 85% reported in 2007 and 2008 respectively.

► **Figure 7: Breakdown of liabilities and shareholders' equity at end 2009** ■



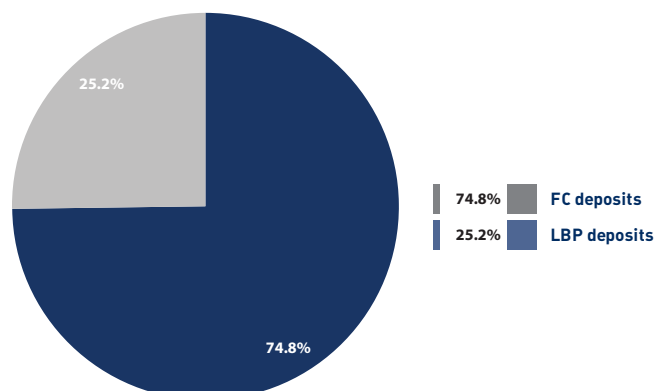
Source: Bank Audi

► **Figure 8: Geographic breakdown of deposits at end 2009** ■



Source: Bank Audi

Figure 9: Currency breakdown of deposits at end 2009



Source: Bank Audi

As for the breakdown of deposits in 2009, it should be noted that 23% were derived from the Group's international operations as compared to 19% in 2006, resulting from MENA entities' rapid growth. Moreover, 74.8% of total deposits were denominated in USD, with the remaining 25.2% in Lebanese Pound denominated deposits.

Since the beginning of 2010, the Lebanese banking sector has seen a deceleration in assets and deposits growth, in contrast to the rapid accumulation of deposits during 2008-2009. While capital inflows to Lebanon were down 8% from the record highs achieved in 2009, commercial banks' deposits managed to grow 9% in the first nine months of 2010 to USD 110 bn, yet lower than the 14% achieved the previous year. Recent financial results highlight that Bank Audi has, in-line with the Lebanese banking sector, been recording a slower progression of assets and deposits since the beginning of the year. In the first nine months of 2010, the Bank's assets and deposits grew by a moderate, yet healthy, 6% and 5% respectively, as compared to 21% and 24% respectively in the same period of 2008.

— **Going forward we expect deposit growth to remain moderate and we assume the CAGR for the whole forecasted period to stand at 10%**

Looking ahead, we anticipate assets and deposits growth to stabilize at more moderate levels, as highlighted by a CAGR of 10% over the 09-14e forecasted period, given the two following factors:

First, the outstanding growth in deposits in 2008 and more particularly in 2009 was the result of a timing impact where Bank Audi has, representing the favorable image of the Lebanese banking sector, benefited from strong capital inflows given relatively attractive interest rates and perceived relative safe haven status amid a global financial crisis. As the global economy continues to recover and the credit markets unthaw, we expect neighboring nations to attract an increased share of regional capital inflows, largely made up of foreign direct investments and expatriates remittances.

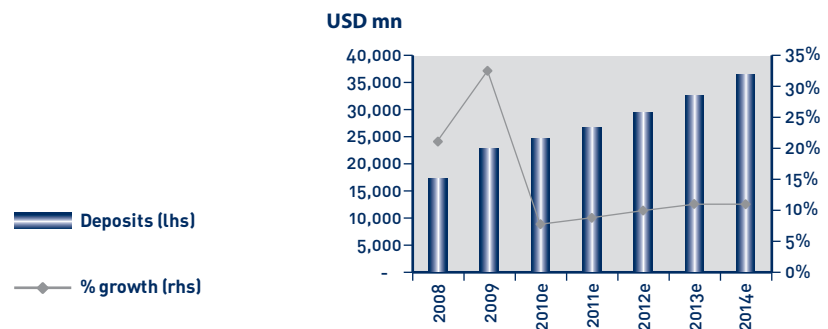
Second, Lebanese banks have been decreasing their costs of funds since the beginning of 2010 by 31 bps and 107 bps on USD and LBP deposits respectively. In view of widening its spreads and preserving its profitability

levels, Bank Audi has been dropping its interest rates on USD deposits and LBP deposits over the same period. We do not expect Bank Audi to lift interest rates on deposits from current levels in the short-term; particularly, those on USD deposits should stabilize given their current low level, while there is still room for further reduction on LBP deposits.

– **The pace of deposits growth throughout the forecast period highlights a gradual regain of momentum**

Taking a close look at the expected deposits growth, we anticipate the figure to grow by 8% in 2010e, following the 5% recorded in 9M-2010. Should the reduction in the costs of funds ease as interest rates on deposits stabilize, as we expect, this growth should gradually accelerate to 11% in 2014e, with a sizeable share of it originating from the Bank's operations in new and existing MENA countries as well as its ability to attract a large portion of incremental deposits in Lebanon. Ultimately, we expect the Bank's deposit base to reach USD 36,672 mn in 2014e.

Figure 10: Deposits



Source: Bank Audi and FFA Private Bank

– **Adequate capitalization level and no additional capital required to finance organic growth**

The equity-to-assets ratio stands at 8.3% in 2009, down from 9.6% in 2008, which we view as satisfactory and in-line with the domestic banking sector at 8.8%. Bank Audi held a Capital Adequacy Ratio (CAR as per Basel II) of 11.93% and 11.95% in 2009 and Q3 2010 respectively, comfortably higher than the required ratio of 8%, while below 12.84% achieved in 2008. The Common Tier 1 of Bank Audi (calculated under Basel II) stood just below 10% (at 9.99%) in Q3 2010.

Since the revision of the Basel Accords and the completion of a new international regulatory framework for banks known as "Basel III", Bank Audi has been closely monitoring its capital position based on the new requirements. The preliminary CAR (estimated under Basel III) stood at 9.84% and 10.46% in 2009 and Q3 2010 respectively, which compares to the total capital requirement of 10.5% to be phased in by 2019 by adopting nations (8% minimum plus 2.5% conservation buffer). The strengthened capital framework includes an 8.5% required Tier 1 and a common equity required component of 7%, up from 2% under Basel II.

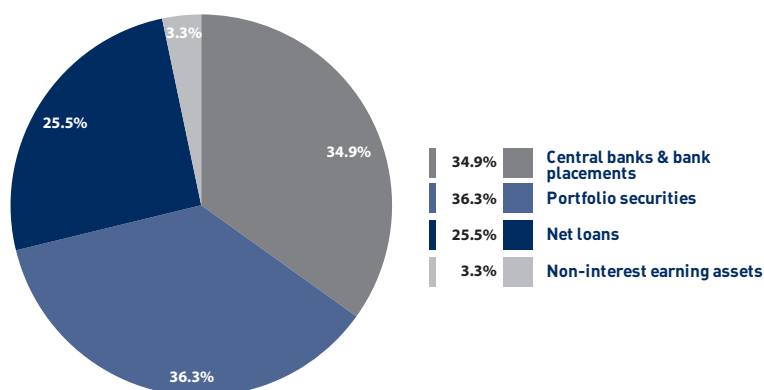
Looking ahead, we expect the Bank to continue demonstrating adequate capital levels, with the CAR (as per Basel II) steadily improving over the 12% level during the forecasted period. Management believes that no capital

increase will be needed to finance growth over the coming three years, barring any large acquisitions.

– **Loan portfolio picks up to 21% during 9M-2010 yet Bank Audi remains highly liquid although exposed to sovereign risk**

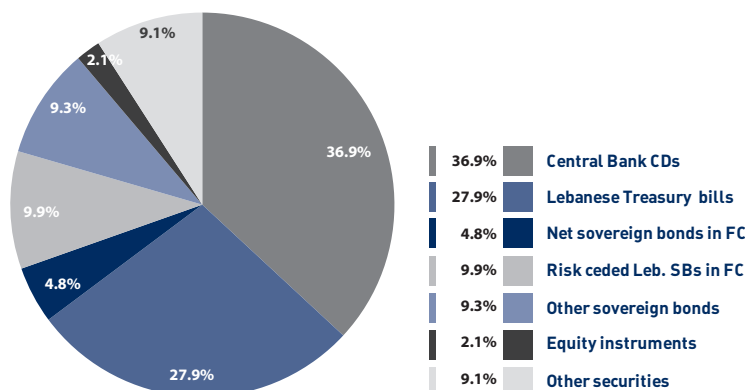
Bank Audi's loan portfolio growth moderated in 2009 to 10.1%, in contrast to an outstanding 30.2% growth in 2008. In absolute terms, Bank Audi's loan book grew from USD 6,129 mn in 2008 to reach USD 6,747 mn in 2009. The below figures depict the asset allocation of Bank Audi for 2009, as well as the breakdown of loans by geographical segment and currency. As reflected below (c.f: figure 11), the asset allocation of Bank Audi in 2009 reflects a 25.5% exposure to private sector lending, a 34.9% exposure to Central banks and banks placements as well as a 36.3% allocation to securities. In-line with a typical balance sheet structure of a Lebanese bank, Bank Audi's asset allocation reflects a highly liquid although important exposure to Lebanese sovereign securities as the portfolio securities at end 2009, which represent 36.3% of total assets, comprised of 36.9% Central Bank CDs and 27.9% of Lebanese Treasury bills. We estimate the overall exposure to the sovereign, including Central Bank's CDs, T-Bills and reserves at the Central Bank to be in the low 40% range of the Bank's total asset base.

Figure 11 : Asset allocation at end 2009



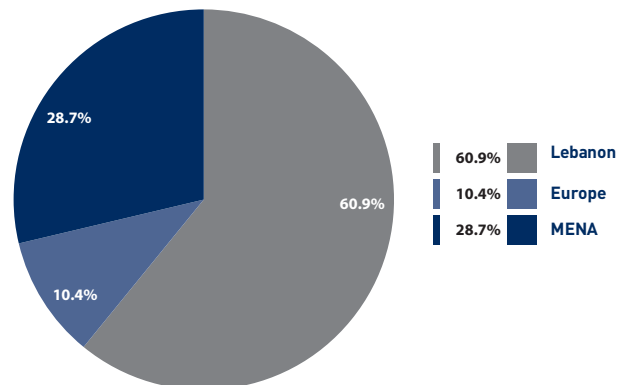
Source: Bank Audi

Figure 12 : Breakdown of portfolio securities at end 2009



Source: Bank Audi

Figure 13 : Geographic breakdown of loans at end 2009

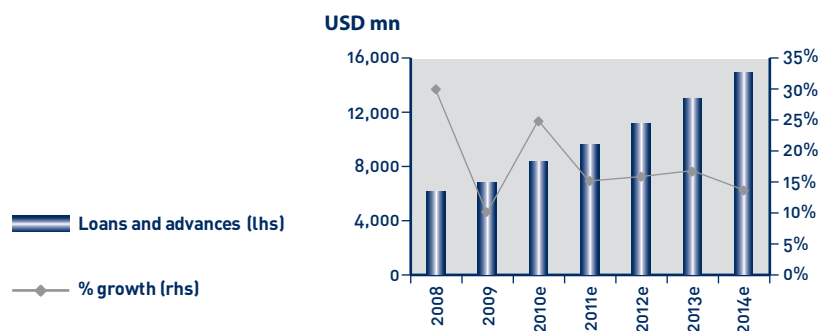


Source: Bank Audi

– **We assume the loan portfolio to grow robustly at a CAGR of 17.4% in 2009-2014e**

In light of a 21.1% progression of the loan portfolio in the first nine months of 2010, we anticipate Bank Audi's lending activity to grow by 25.1% for the full year 2010e given the Bank's high liquidity levels to meet increased demand for loans from the private sector stemming from an expanding domestic economy and additional supportive measures from the Central Bank to lend in local currency via the easing of required reserves. As for the 2011e-2014e period, we have assumed that loans' growth will hover in the 14%-17 % range. Ultimately, we expect the loan portfolio to reach USD 15,036 mn in 2014e.

Figure 14: Loans and advances



Source: Bank Audi and FFA Private Bank

We assume loans and advances to post a CAGR of 17.8% for the forecasted period. We believe this solid growth will be driven on two fronts. Domestically, by Bank Audi's leading franchise and ability to attract the bulk of additional demand for credit from the private sector, particularly in the retail segment that is less developed in Lebanon and at Bank Audi as compared to peers, demand from regional corporate booked in Lebanon, as well as from the eventual wave of privatizations in key sectors in later years. In this regard, it is worth mentioning that loans to the private sector will remain closely linked to the domestic economic environment which has a significant potential to remain buoyant should the political and fiscal situation not

worsen. Regionally, we believe regional operations will remain an important driver for consolidated lending activity as regional economies recover and Bank Audi intensifies its penetration in MENA countries through increased network expansion, entry into new attractive markets with under-developed banking systems, and growing activity in its syndicated loan book. As depicted in figure 13, 28.7% of loans were booked in MENA subsidiaries in 2009 as compared to 13.9% in 2006, with the bulk of MENA loans originating from Egypt and Syria.

– We foresee an asset allocation shift towards higher lending to private sector, geographic realignment of portfolio securities, and anticipation of Basel III

Our expectations for robust lending activity coupled with a more geographically aligned asset mix as the Bank strengthens its international operations, should translate into an asset allocation shift, namely an increase in loans and advances and corporate debt securities against a lower dependency on government securities, namely those of the Republic of Lebanon. Particularly as Lebanese sovereigns cost the Bank a higher risk weight allocation given their non-investment grade status, as risky weighted assets may be reduced ahead of higher capital requirements from Basel III at a time when the Bank is executing its regional growth strategy. Bank Audi has been redistributing its portfolio of securities by replacing a portion of its Lebanese sovereign debt securities by better rated regional government and corporate debt securities.

– We remain cautious on the Bank's significant asset and liabilities mismatch

There is a near USD 10 bn mismatch on assets and liabilities on maturities of over one year, with greater than one year asset maturities representing 40% of total assets, while greater than one year liabilities representing less than 3%, explained by the Bank's shorter term deposit rich funding structure. While we remain cautious on the asset-liability mismatch, our view is tempered by the following reasons: 1) The vast majority of financial assets, including placements with banks, loans and advances, loans and receivables, held to maturity investments, and some available for sale instruments are carried at amortized cost and not subject to repricing risk, and 2) by the sticky and less transient nature of deposits. We await the potential effects of IFRS 9 on the Bank's financial liabilities and how that may impact the Bank's reclassifications and ALM practices.

– We expect the asset quality to remain sound, while exposure to the property market should be closely monitored

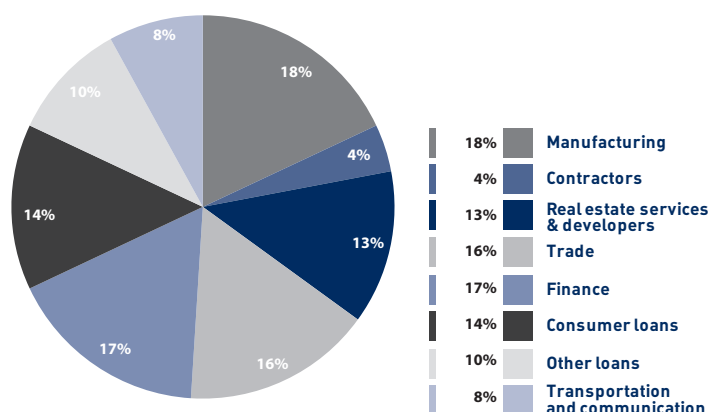
With regards to asset quality, Bank Audi enjoys sound asset quality despite a growing loan portfolio. Despite a slight increase in the level of substandard and doubtful loans (SLs+DLs) in gross loans in 2009 as compared to 2008 at 3.22% and 3.51%, respectively, Bank Audi has seen an improvement in loan quality over the years. Bank Audi increased its provisioning to 86.94% from 85.56%, with potential for portions to be reversed in the future. We expect loan quality to remain relatively stable as the Bank's conservative lending practices (including required cash flows, collaterals, credit enhancements, credit limits, and monitoring of loan files), to offset the double digit loan growth expected over next few years impacting quality, particularly on loans to the retail sector.

Table 7: Asset quality and provisioning

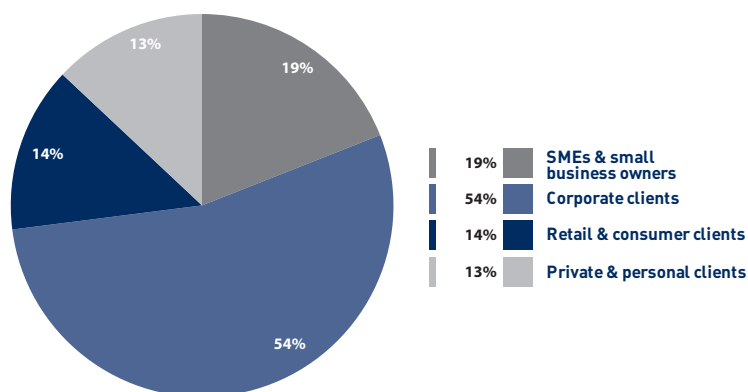
	2008	2009
SLs+DLs to gross loans	3.22%	3.51%
LLRs / gross loans	2.76%	3.05%
LLRs on DLs+SLs/DLs+SLs	85.56%	86.94%

Source: Bank Audi

Taking a closer look at the breakdown of Bank Audi's loan portfolio by economic sector, figures at end-September 2010 indicate (cf: figure 15) that 4% and 13% of loans were allocated to contractors and real estate services & developers respectively, while 2% were housing loans. This 19% exposure of the loan portfolio to the property market remained unchanged from end-2009. Going forward, the exposure of the Bank to the property market should be closely monitored as the market shows signs of a slowdown and any substantial increase in the exposure to the property sector could give rise to concern. However, we believe the risk to be manageable given it represents an estimated 5% share of total assets as well as the conservative practices of regulatory authorities including bank lending limits of 60% on the value of real estate projects.

Figure 15 : Loans breakdown by economic sector as at end-September 2010 ■

Source: Bank Audi

Figure 16 : Loans breakdown by customer type as at end-September 2010 ■

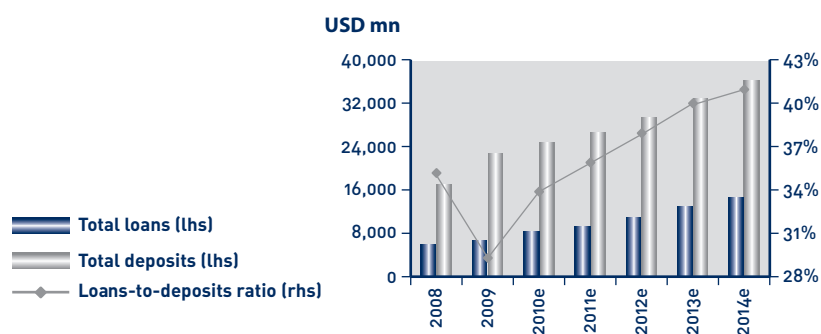
Source: Bank Audi

Not taking into account any significant risks of deterioration in the country's economic or political situation and should Bank Audi's maintain its current level of provisioning, we do not foresee any major threats on loan portfolio quality.

– **Given our forecast, the loans-to-deposits ratio should gradually increase to 41% in 2014e**

The exceptionally high deposit growth recorded in 2009 coupled with a modest growth in the loan portfolio, translated into a significant decline of the loans-to-deposits ratio to 29.4% in 2009 (including financial assets classified as loans and receivables into loans as per IFRS would increase the 2009 ratio to 50.4%) down from 35.4% a year earlier. However this trend was reversed over the first nine months of 2010 as loans growth surpassed deposits growth which translated into the loans-to-deposits ratio reaching 33.7% in Q3 2010.

► **Figure 17: Loans-to-deposits ratio***



Note: * excludes financial assets classified as loans and receivables

Source: Bank Audi and FFA Private Bank

Given our estimates revolving around a high loans growth against a moderate deposits growth, the loans-to-deposits ratio of Bank Audi is expected to gradually increase to 41% in 2014e.

► Income statement snapshots

– Net interest income up 16.2 % yoy in 9M-2010 after a lull in 2009

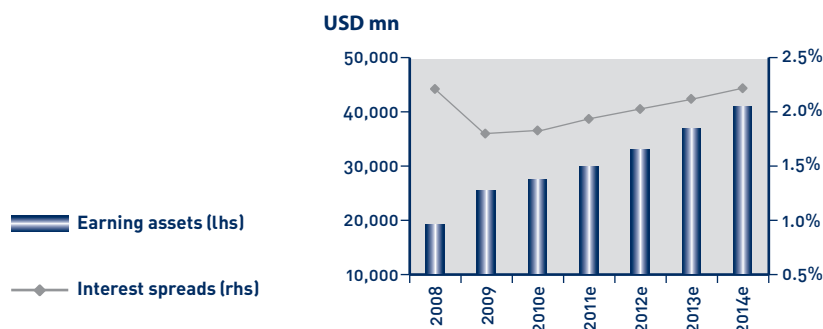
The tightening interest spread environment which prevailed throughout 2009 translated into Bank Audi's net interest income remaining almost flat at USD 424 mn in 2009 compared to USD 423 mn in 2008. However, the results reported by the Bank for the first nine months of 2010 indicate that net interest income totaled USD 229 mn, highlighting a robust progression of 16.2% compared to the same period of 2009, which can be attributed to the continuous increase in earning assets driving a 21.1% growth in the loan portfolio and a 9.1% increase in financial assets. Also, Bank Audi's interest margins have been on an upward trend since the beginning of 2010, from 1.65% in Q1 10 to 1.89% in Q3 10, driven by management's focus to preserve margins and profitability in a low yielding interest rate environment by searching for additional yield and decreasing its cost of funds both on LBP and USD deposits. .

– Looking ahead we expect net interest income to grow at a CAGR of 16% over 2009-2014e

Moving forward, we forecast net interest income to grow at a 16.3% CAGR over 2009-2014e. We believe that dynamic lending activity coupled with alleviating pressures on interest spreads stemming from (i) an eventual pick-up in international benchmark rates, notably LIBOR (ii) a reduction in the cost of funds, (iii) an asset allocation shift towards higher yielding loans and fixed income securities; will provide support for net interest income growth. We note the negative carry (yields net of higher average cost of deposits) Bank Audi is witnessing in its primary liquidity in foreign currency, which amounted to USD 4.6 bn in 2009, impacting spreads by approximately 40 basis points (bps). As international benchmark rates increase or the Bank sees a reduction in its cost of funds in USD, we expect an improvement of 20 bps for every 1% reduction in negative carry or approximately USD 50 mn on an annual basis.

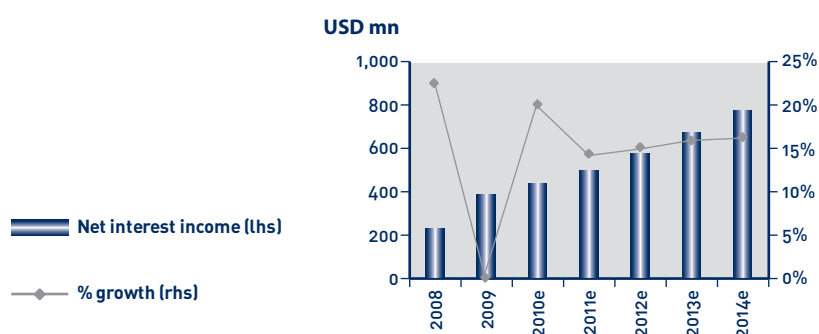
Taking a look at the net interest income progression over our forecast period, we believe Bank Audi's net interest income will pursue its vigorous growth in the remaining months of 2010 as spreads stabilize, benefiting from earning asset growth and the reduction in the cost of funds. We expect a 20.1% progression for net interest income in 2010, following its 16.2% growth in 9M-2010 compared to 9M-2009. From 2011e onwards, healthy net interest income growth should persist and we expect it to hover in the 15%-16% range, slightly lower than the growth for 2010e benefiting from both price and volume effects.

Figure 18: Earnings assets and interest spreads



Source: Bank Audi and FFA Private Bank

Figure 19: Net interest income



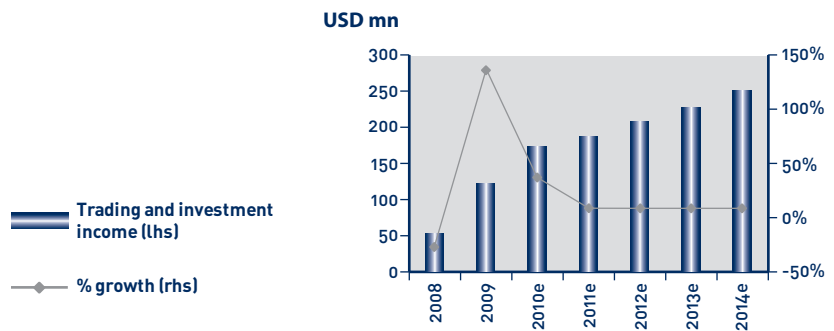
Source: Bank Audi and FFA Private Bank

– **After its strong surge in 2009 and 9M-2010, we anticipate trading and investment income growth to curtail at more sustainable levels**

An important contributor to Bank Audi's operating performance in 2009 was non-interest income which progressed by 30% yoy to reach USD 310 mn. Taking a closer look at the two major non-interest income components (i) net fees & commissions income and (ii) trading and investment income, it is notable that this strong growth came on the back of an impressive increase in trading and investment income (+138%) after its contraction by 26.7% in 2008, in the context of an upturn in global markets. At this growth level, trading and investment income totaled USD 126 mn for 2009. More recent financial results highlight that Bank Audi generated USD 131 mn from trading and investment income during the first nine months of 2010, which represents a 55.1% increase compared to the same period of previous year. We expect the Bank will be able to add around USD 40 mn in trading and investment income in the fourth quarter of 2010 which would send it to USD 174 mn for the full year 2010, equivalent to a 39% yoy growth.

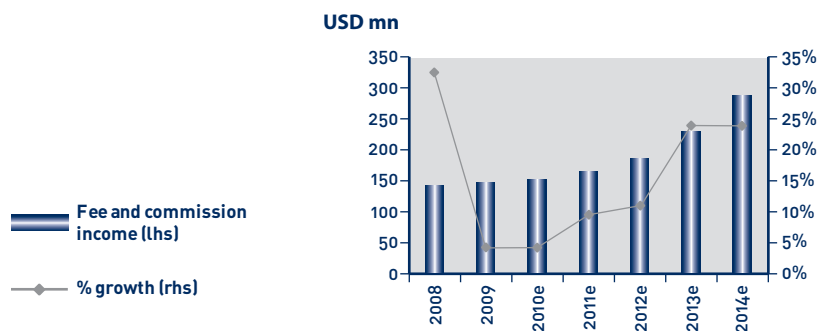
Looking ahead, we expect trading and investment income growth to curtail at more sustainable levels as demonstrated by a 10% annual growth from 2011e onwards.

► **Figure 20: Trading and investment income**



Source: Bank Audi and FFA Private Bank

► **Figure 21: Fee and commission income**



Source: Bank Audi and FFA Private Bank

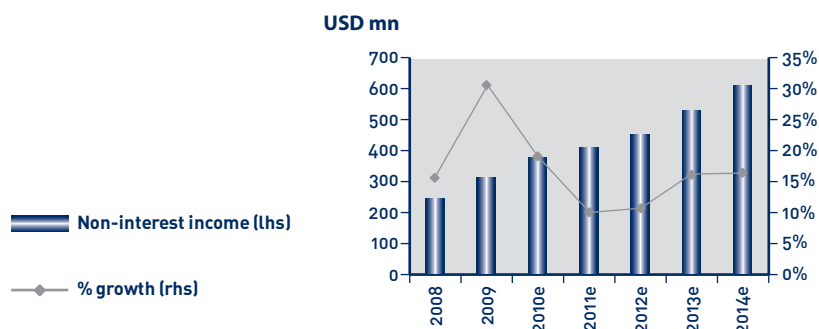
– **Net fees & commissions income should grow at a healthy pace**

Income from fees and commissions, which we view as a stable source of revenue, recorded a 4.3% growth in FY 09 totaling USD 147 mn for the whole year, thus contributing 47.3% to non-interest income. In the first nine months of 2010, Bank Audi generated USD 128 mn in revenues from net fees & commissions, growing 19.5% higher yoy. Going forward, we expect net fees and commissions growth to gradually pick up, driven by solid balance sheet growth and the Bank's continuous efforts for business lines diversification and opportunity to cross sell products and services between operations and markets. The net fees & commissions CAGR for 2009-2014e period stands at 14%.

– **Non-interest income should maintain its substantial contribution to operating income**

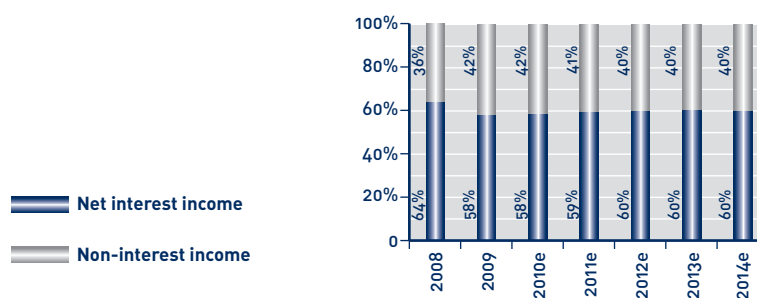
Bank Audi boasts one of the most diversified revenue streams in the industry. The Bank generated USD 310 mn in non-interest income in 2009, equivalent to a contribution of 42% to total operating income. Driven by a sustained growth in both net fees & commissions income and trading & investment income, Bank Audi's non-interest income is set to increase at a CAGR of 14% in 2009-2014e. Ultimately, we expect Bank Audi's non-interest income to reach USD 603 mn by 2014e sustaining a share in total operating income at around 40%.

Figure 22: Non-interest income



Source: Bank Audi and FFA Private Bank

Figure 23: Net interest income vs. non-interest income

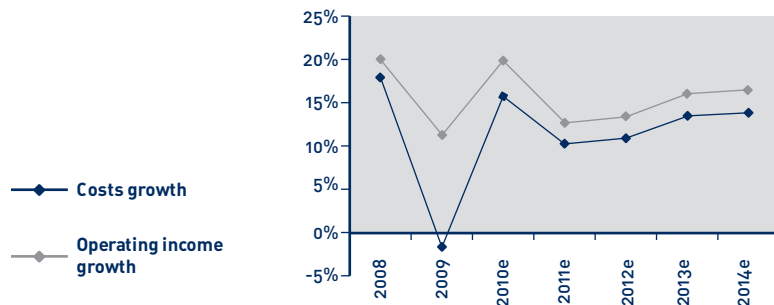


Source: Bank Audi and FFA Private Bank

– Remarkable improvement in cost-efficiency levels, with positive outlook for the coming years

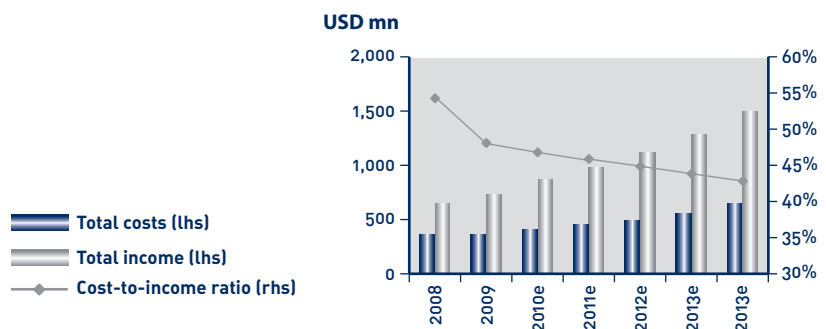
In 2009, Bank Audi succeeded in substantially decreasing its cost-to-income ratio from 55% in 2008 to 48.5% in 2009. This remarkable improvement in cost-efficiency was mainly the result of a higher pace in revenue growth than in cost growth, on the back of a significant focus on cost-containment policy as well as a slow down in network expansion in Syria and Egypt. Bank Audi typically enters new markets via greenfield operations, front running costs including branch roll out, staff additions, and support activities ahead of a ramp up in revenues as branches gain maturity. Moreover, Bank Audi has considerably lowered its bonuses and managed to keep its personnel expenses practically stable in FY 09 as evidenced by total staff costs standing at USD 199 mn and USD 201 mn in 2008 and 2009 respectively. Going forward, we believe costs will remain under control and will ultimately translate into a cost-to-income ratio gradually decreasing from 48.5% in 2009 to 41% in 2014e. The figure below reflects the Bank's expected economies of scale and group wide efficiency measures improving cost-efficiency levels, partially offset by the impact from its network expansion strategy, in Lebanon and abroad.

► **Figure 24: Growth in costs vs. growth in revenues**



Source: Bank Audi and FFA Private Bank

► **Figure 25: Cost-to-income ratio**

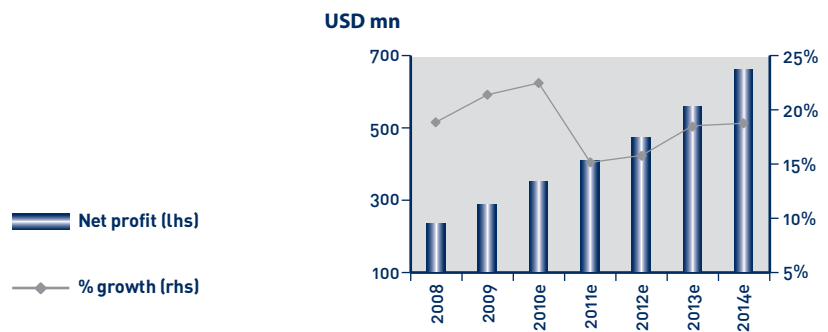


Source: Bank Audi and FFA Private Bank

— Strong net profit outlook should help lift profitability ratios

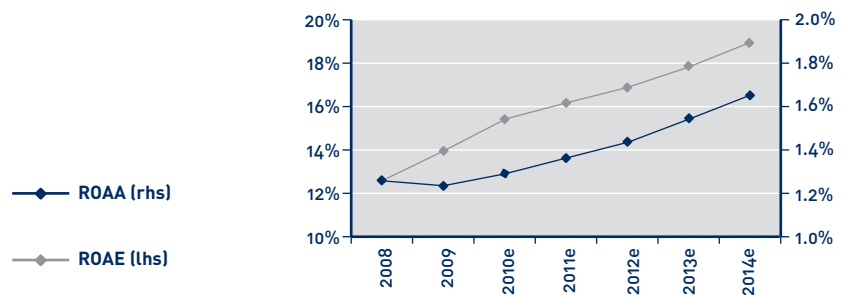
Stemming from an important surge in non-interest income and coupled with an important improvement in the cost-efficiency level, Bank Audi's bottom line recorded a solid 21.4% yoy growth in 2009 to reach USD 289 mn. In the first nine months of 2010, Bank Audi's earnings totaled USD 253.4 mn, 19.1% higher than profits generated during the 2009 corresponding period, positioning Bank Audi in the 1st rank among its peers in terms of net profit for the most recent nine month period. We expect total profit generation of USD 354 mn in 2010e, equivalent to a 22.5% yoy growth, as the Bank will benefit from stabilization in interest spreads, substantial non-interest income growth and further improvement of its cost efficiency levels. From 2011e onwards, we expect Bank Audi to report solid growth in earnings from 1) interest earning assets growth, 2) improvement in interest margins, 3) substantial non-interest income generation, 4) continuous focus on cost-control initiatives, and 5) the Bank's regional expansion plan. Our expectations for growth in net profits start at 15.2% in 2011e and gradually increase to 18.9% in 2014e. The overall CAGR for 2009-2014e stands at 18.2% and should see earnings at USD 666 mn for 2014e.

Figure 26: Net profit



Source: Bank Audi and FFA Private Bank

Figure 27: ROAA and ROAE



Source: Bank Audi and FFA Private Bank

Profitability ratios for 2009 stood at 1.2% and 13.9% for ROAA and ROAE respectively, in-line with the Lebanese banking sector's moderate profitability ratios given low spreads and heavy cost structure compared to regional peers.

Going forward, both ratios are expected to gradually increase to reach 1.7% and 18.9% respectively by 2014e and EPS to common shareholders should increase from USD 0.78 in 2009 to USD 1.76 in 2014. We forecast a book value per share (shareholder's equity over common shares outstanding) of USD 10.30 in 2014, up from USD 5.98 in 2009.

Revised Valuation

– Valuation methodology

Our valuation methodology is based on the Dividend Discounted Model (DDM). Our forecasts span a five year forecasted period followed by a 15 year fading period whereby the return on equity converges to the cost of equity. The cost of equity of 14.5% is derived using the capital asset pricing model weighted by the size of geographical operations. The terminal value assumes a perpetual growth rate of 3%. Additionally, we have corroborated our DDM methodology by means of a residual income valuation. We note that for every 1% change in our cost of equity assumption, our fair value estimate would be impacted by approximately USD 1.00 per share.

– Revised fair value estimate and recommendation

Based on our revised forecasts and discount rate assumptions to our Dividend Discount Model, our fair value estimate of USD 9.00 per share, is derived from discounted dividends attributable to common shareholders in excess of required capital amounts, which implies a P/B of 1.38x on our book value per share 2010 estimate, in-line with Bank Audi's one-year historical trading average.

Table 8: Fair Value Derivation

Valuation (USD mn)	
PV Forecasted (5 year period)	544.8
PV Fading (15 year period)	1,212.9
PV Terminal Value	452.2
PV Excess Capital	958.1
Equity Value	3,168.0
Number of shares	348.5
Value per share	9.09
Value per share (rounded)	9.00

With our fair value estimate of USD 9.00, we accordingly assign a **Marketweight** recommendation given that the current price is approximately within +/- 10% of the fair value estimate.

Key Investment Risks

– Credit Risk

We have assumed stable credit quality over the forecasted period. Any significant deterioration in the credit portfolio beyond our expectations would require greater provisions for credit losses unfavorably impacting operating results.

– Interest Rate Risk

Bank Audi is susceptible to changes in interest rates given its mismatch in assets and liabilities. We expect a stable and rising interest rate environment over our forecasted period and any shocks would adversely impact equity levels.

– Sovereign Risk

While the strong economic expansion is improving the public debt burden over the past years, and the majority of sovereign assets are domestic banks holding for the longer-term, Bank Audi's exposure to Lebanese government assets including reserves, certificates of deposits, treasury bills, and Eurobonds is significant.

– Economic and Political Risk

Bank Audi is subject to the macroeconomic environment in which it operates, and a downturn in the economy or rising political or security pressures would impact the company negatively, particularly in its domestic Lebanese market.

– Foreign Operations Risk

Bank Audi's growth strategy is in part dependent on the execution of its geographic expansion in the region and on its current operations in key foreign markets including Egypt, Syria, and Jordan.

Financial statements

► Balance Sheet

In USD mn	2008a	2009a	2010e	2011e	2012e	2013e	2014e
- Cash and Balances with central banks	2,946	4,117	3,870	3,715	3,524	3,292	3,366
- Due from banks and financial institutions	3,622	5,133	4,926	5,370	5,907	6,557	7,278
- Financial assets held for trading	14	554	616	671	738	820	910
- Financial assets designated at fair value through profit & loss	215	-	-	-	-	-	-
- Loans and advances to customers	5,959	6,588	8,375	9,666	11,223	13,113	14,919
- Loans and advances to related parties	170	159	65	75	87	102	116
- Debtors by acceptances	155	189	208	228	251	276	304
- Available for sale financial instruments	2,527	3,982	4,434	4,833	5,316	5,901	6,550
- Financial assets classified as loans & receivables	3,921	4,841	5,173	5,638	6,202	6,884	7,642
- Financial instruments held to maturity	172	244	246	268	295	328	364
- Investment in associates	22	21	23	25	28	31	34
- Property and equipment	318	334	367	404	445	489	538
- Goodwill	139	145	145	145	145	145	145
- Other assets	203	180	198	217	239	263	289
• Total Assets	20,385	26,486	28,646	31,257	34,401	38,200	42,455
- Due to Central banks, banks and financial institutions	464	603	640	698	768	852	946
- Customer deposits	17,180	22,807	24,632	26,849	29,534	32,783	36,389
- Deposits to related parties	157	178	192	209	230	255	284
- Debt issued and other borrowed funds	102	102	102	102	102	102	102
- Engagements by acceptances	155	189	208	228	251	276	304
- Other liabilities	346	399	439	483	531	584	643
- Provisions	15	16	21	24	28	33	38
- Minority Interest	87	134	145	156	170	186	205
- Shareholders' equity	1,879	2,059	2,268	2,507	2,787	3,129	3,545
• Total liabilities and shareholders' equity	20,385	26,486	28,646	31,257	34,401	38,200	42,455

Source: Bank Audi and FFA Private Bank

► Income Statement

In USD mn	2008a	2009a	2010e	2011e	2012e	2013e	2014e
- Interest and similar income	1,147	1,248	1,346	1,478	1,636	1,828	2,051
- Interest expense and similar expense	(724)	(824)	(837)	(895)	(965)	(1,050)	(1,147)
• Net interest income	423	424	509	583	671	777	904
- Net fee and commission income	141	147	153	168	187	232	287
- Net profit from financial operations	53	126	174	192	211	232	255
- Other operating income	44	37	41	45	50	55	60
• Net non-interest income	238	310	369	405	447	518	603
- Personnel expenses	(199)	(201)	(239)	(263)	(291)	(331)	(378)
- Depreciation & amortization	(25)	(28)	(29)	(32)	(36)	(39)	(43)
- Net provisions for credit losses	(14)	(31)	(40)	(43)	(48)	(53)	(59)
- Other operating expenses	(140)	(127)	(144)	(159)	(176)	(200)	(227)
- Investment in associates	2	1	1	2	2	2	3
- Net gain (loss) on disposal of assets	(2)	(0)	0	0	0	0	0
• Profit before tax	285	349	427	491	569	675	803
- Income tax	(46)	(60)	(73)	(84)	(97)	(115)	(136)
• Net profit	238	289	354	408	472	560	666
- Group share	233	278	344	396	459	544	647
- Minority interest	5	11	10	12	14	16	19

Source: Bank Audi and FFA Private Bank