Flash Note - Bank Audi Q1/16 Results

Sector: Banking
Country: Lebanon

MARKETWEIGHT

Target Price	**USD 7.00**
Closing Price	**USD 5.85**
52 Week Range	**USD 5.50 - 6.30**
Year to Date %	**-3.3%**
Market Cap.	**USD 2,338.5 million**
Dividend Yield	**6.8%**
P/E (TTM)	**6.3x**
P/B to Common	**0.79x**

Note: the share data represents Bank Audi listed shares (Bloomberg ticker: AUDI LB). Bank Audi GDR shares at USD 5.83 (Bloomberg ticker: BQAD LI) and USD 5.83 (Bloomberg ticker: AUSR LB)
Source: Bloomberg, FFA Private Bank
Market close on April 22, 2016

Net profits were at USD 110 million in Q1/16 (+11% QoQ, +10% YoY) below FFA estimate of USD 115 million

Bank Audi kicked off the Q1/16 Lebanese banks earnings season, posting net profits at USD 110 million (+11% QoQ, +10% YoY), below our USD 115 million FFA estimate. Diluted EPS was at USD 0.24 (+7% QoQ, +6% YoY), below FFA est. USD 0.27. Total operating income came in at USD 362 million, below FFA est. USD 378 million on lower net fees & commissions income at USD 66 million vs. FFA est. USD 73 million, lower net interest income at USD 245 million vs. FFA est. USD 250 million and trading & investment income at USD 51 million vs. FFA est. USD 55 million. This negative variance to the bottom line was partially offset by income tax registering at USD 24 million vs. FFA est. 30 million, operating expenses at USD 193 million vs. FFA est. USD 197 million (cost-to-income at 53.4% vs. FFA est. 52.0%, 56.4% in Q4/15 and 52.4% in Q1/15) and lower than expected provisions at USD 34 million vs. FFA est. USD 37 million, equivalent to an estimated 75 bps annualized cost of risk, slightly lower than Q4/15 cost of risk of 77 bps. NPL ratio was at 3.1%, just above Q4/15 level of 2.9% yet slightly below 3.2% in Q1/15 and still lower than peers under coverage. Balance sheet growth was subdued and missing our forecast, likely an effect of seasonal weakness, challenging domestic operating conditions and EGP devaluation, with assets and deposits sequential growth at -3% and -4% respectively, and YoY growth at -1% and -2%, below our low digit growth estimate. Loans outperformed other balance sheet constituents, witnessing growth at +1% QoQ and +10% YoY. LDR came in substantially higher at 52.8% vs. FFA est. 50.8%, 50.3% in Q4/15 and 46.9% in Q1/15.

Bank Audi Q1/16 results summary vs. FFA Private Bank estimates

USD million except per share data	Q1/16a	FFA Q1/16e	Q4/15a	Q1/15a	QoQ %	YoY %
Net interest income	245	250	254	223	-4%	10%
Net fees & commissions income	66	73	73	59	-10%	11%
Trading & investment income	51	55	54	58	-6%	-12%
Operating income	**362**	**378**	**381**	**339**	**-5%**	**7%**
Provisions	(34)	(37)	(35)	(33)	-2%	3%
Operating expenses	(193)	(197)	(215)	(178)	-10%	9%
Income tax	(24)	(30)	(33)	(29)	-25%	-15%
Net profits	**110**	**115**	**99**	**100**	**11%**	**10%**
Diluted EPS to common	0.24	0.27	0.22	0.23	7%	6%
Assets	41,022	42,959	42,270	41,458	-3%	-1%
Deposits	34,221	36,484	35,609	35,054	-4%	-2%
Loans	18,084	18,530	17,929	16,440	1%	10%
FFA BVPS to common	7.37	7.36	7.19	7.10	3%	4%
FFA Net interest margins	*2.4%*	*2.4%*	*2.4%*	*2.2%*		
Core income to total operating income	*86.0%*	*85.6%*	*85.9%*	*83.0%*		
FFA Cost-to-income ratio	*53.4%*	*52.0%*	*56.4%*	*52.4%*		
Immediate liquidity-to-deposits ratio	*33.8%*	*33.8%*	*35.5%*	*38.3%*		
Loan-to-deposit ratio	*52.8%*	*50.8%*	*50.3%*	*46.9%*		
Equity-to-asset ratio	*8.2%*	*7.8%*	*7.8%*	*8.1%*		

Source: Company reports and FFA Private Bank estimates

Net interest income at USD 245 million in Q1/16, lower sequentially on subdued balance sheet growth and lower margins, yet improving YoY mainly driven by higher NIMs

Net interest income came in at USD 245 million in Q1/16 (-4% QoQ, +10% YoY) with lower sequential growth on subdued balance sheet volumes and lower margins impacted by higher cost of funds, despite higher assets yields. YoY increase in net interest income was mainly driven by higher net interest margins on improving asset yields (mainly from Bank Audi Egypt with margins at ~3.3% in Q1/16 from ~2.7% in Q1/15) partially offset by higher cost of funds. Going forward, we expect Bank Audi consolidated net interest margins to remain favorably impacted from higher margins from international operations including Egypt and Turkey.

Latest banking sector's statistics from the ABL for the month of February 2016 reveal, in a continued low interest environment, improvement in LBP and USD spreads given higher asset yields, despite limited capacity to decrease cost of funds in USD amid slower deposit accumulation

Spreads in USD and LBP were higher in February 2016 compared to one year earlier. Latest statistics from the ABL for the month of February 2016 reveal that Lebanese banks are still operating in a low interest environment, with persistent challenges due to the limited capacity to decrease cost of funds in USD given market share concerns amidst slower deposit accumulation.

Spreads in USD increased to 1.47% in February 2016 from 1.22% in February 2015 which has a positive impact on banks' profitability given that the bulk of their liquidity is in USD. This difference was driven by an increase in weighted average on uses of funds (+35 bps to 4.68%), partially offset by higher cost of funds (+9 bps to 3.20%). Weighted return on uses of funds were weighed by higher rate on USD deposits at BDL (+45 bps to 2.79%), higher lending rate (+25 bps to 7.24%) and higher rate on Eurobonds to a lesser extent (+1 bps to 6.65%).

Spreads in LBP increased to 1.11% in February 2016 from 0.85% in February 2015 on higher weighted average on uses of funds (+24 bps to 6.66%) and lower cost of funds (-2 bps to 5.55%). Weighted return on uses of funds were weighed by higher lending rate (+66 bps to 7.97%), higher yields on T-bills (+4 bps to 6.98%) and higher rate on CDs issued by the BDL (+4 bps to 8.16%).

Non-interest income in Q1/16 lower sequentially, although flat YoY and core income mix unchanged QoQ, yet improving YoY

Non-interest income came in lower sequentially, weighed by lower net fees & commissions income at USD 66 million (-10% QoQ) and lower trading & investment income to a lesser extent at USD 51 million (-6% QoQ). On a yearly basis, non-interest income remained flat despite higher fees & commissions income (+11% YoY) on lending growth YoY, offset by lower trading & investment income (-12% YoY). Revenue breakdown for Q1/16 reflects unchanged income mix quality QoQ with core income (net interest income + fees & commissions income) contribution to total operating income at 86% in Q1/16. YoY, we note improving income mix quality, from 83% in Q1/15, which we view favorably given the stable nature of this income stream. We believe Bank Audi should continue to benefit from geographic expansion on i) improved interest margins as branch network roll out gains maturity in Odea Bank, and increased fees and commissions benefitting from lending growth and trade finance in growing franchises Turkey and Egypt, and ii) business line diversification including increased focus on private banking and asset management operations.

Improved efficiencies sequentially in Q1/16, yet slightly deteriorating from Q1/15, with opex at USD 193 million (-10% QoQ, +9% YoY). Gross NPL and cost of risk at 3.1% and an estimated 75 bps respectively in Q1/16

Bank Audi saw improved efficiencies on a sequential basis in Q1/16 as cost-to-income came in lower at 53.4% (still above pre-Turkey expansion levels) from 56.4% in Q4/15, on lower opex at USD 193 million (-10% QoQ) outpacing the decrease in operating income at 362 million (-5% QoQ). Efficiencies slightly deteriorated on a YoY basis with higher opex (+9% YoY) surpassing higher operating income (+7% YoY). We witness an improvement in overall cost control on personnel expenses on a sequential basis at USD 105 million in Q1/16 (-8% QoQ) and non-personnel expenses at 88 million (-13% QoQ), although still higher on a YoY basis with personnel expenses at +4% YoY and non-personnel at +15% YoY. Bank Audi's consolidated gross NPL ratio was at 3.1%, above Q4/15 level of 2.9% yet below 3.2% in Q1/15 and still lower than peers under coverage. Cost of risk came in lower at an estimated 75 bps in Q1/16, from an estimated 77 bps in Q4/15 and 80 bps in Q1/15 on provisioning levels at USD 34 million (-2% QoQ, +3% YoY).

Net profits came in at USD 110 million in Q1/16 (+11% QoQ, +10% YoY) with sequential improvement mainly on lower income tax and opex, despite lower operating income

Net profits came in at USD 110 million in Q1/16 (+11% QoQ, +10% YoY) with sequential improvement mainly driven by lower income tax at USD 24 million (vs. USD 33 million in Q4/15, -25% QoQ) with tax rate of 18.0% in Q1/16 vs. 24.7% in Q4/15 and 22.2% in Q1/15, lower opex at USD 193 million (vs. USD 215 million in Q4/15, -10% QoQ), despite lower operating income at USD 362 million (vs. USD 381 million, -5% QoQ). On a YoY basis, net profits were mainly driven by lower income tax (-15% YoY), higher operating income (+7% YoY), despite higher opex (+9% YoY) and provisions (+3% YoY). Diluted EPS registered at USD 0.24 (+7% QoQ, +6% YoY). Bank Audi Egypt net profits amounted to ~USD 28 million in Q1/16, equivalent share of ~ 25% of total profits, while Odea Bank net profits amounted to ~USD 7 million in Q1/16, equivalent share of ~6% of total profits.

Bank Audi saw balance sheet growth subdued likely on seasonal weakness, challenging domestic operating conditions and EGP devaluation

Bank Audi saw subdued balance sheet growth in Q1/16, likely an effect of seasonal weakness, challenging domestic operating conditions and EGP devaluation, with assets and deposits at USD 41 billion (-3% QoQ, -1% YoY) and USD 34 billion (-4% QoQ, -2% YoY) respectively. Loans outperformed other balance sheet constituents at USD 18 billion (+1% QoQ, +10% YoY). Bank Audi's deposit to asset ratio was at ~83% in Q1/16 vs. ~84% in Q4/15 and ~85% in Q1/15, with LDR higher at 52.8% in Q1/16 vs. 50.3% in Q4/15 and 46.9% in Q1/15, well above the Lebanese banking sector average (~32.0% in February 2016), driven by lending growth. Bank Audi continues to diversify its geographic presence with ~48% of total assets coming from international operations.

Bank Audi saw CAR III level higher sequentially to 13.7% in Q1/16 from 13.4% in Q4/15 and improvement in profitability

Bank Audi's capital adequacy ratio (Basel III) improved sequentially to 13.7% in Q1/16 from 13.4% in Q4/15, unchanged from Q1/15 level, still above BDL's requirement of 12.5% for 2016. Profitability ratios flat to higher with TTM ROA at an estimated ~1.0% in Q1/16, unchanged from Q4/15 and higher than Q1/15 level of ~0.9%, and TTM ROE higher at an estimated ~12.3% in Q1/16, from ~12.1% in Q4/15 and ~11.8% in Q1/15. TTM EPS slightly improved to USD 0.92 in Q1/16 from USD 0.91 in Q4/15 and USD 0.86 in Q1/15. Equity-to-asset higher at 8.2% vs. 7.8% in Q4/15 and 8.1% in Q1/15 while our estimated book value per share (to common) came in at USD 7.37 in Q1/16 vs. USD 7.19 in Q4/15 and USD 7.10 in Q1/15.

Bank Audi shares provide an attractive entry point on improved fundamentals and profitability, with increased visibility on its expansion plan despite challenging operating conditions

Despite muted balance sheet, we believe Bank Audi shares to provide an attractive entry point with shares trading at 0.79x on a P/B basis, a discount to historical, as well as improving fundamentals and profitability with net interest margin expansion, NPLs still lower than peers under coverage containing cost of risk, driving profitability with improving ROA as well as BVPS expansion. We highlight as well Bank Audi's risk diversification as visibility on its expansion plan improves, with nearly ~50% exposure to international markets, despite largely difficult domestic operating environment and FX devaluation in key markets. Bank Audi shares gave back recently, declining ~6% after dividends of LBP 603 (USD 0.40) for 2015, gross of tax and unchanged from last year.

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