Equity Research - Flash Note - Bank Audi Q1/17 Results

Sector: Banking
Country: Lebanon

MARKETWEIGHT

Target Price	USD 7.00
Closing Price	USD 6.35
52 Week Range	USD 5.85-7.00
Year to Date %	-6.62%
Market Cap.	USD 2,538.4 million
Dividend Yield	7.9%
P/E (TTM)	6.0x
P/B to Common	0.86x

Note: the share data represents Bank Audi listed shares (AUDI LB)
Bank Audi GDR shares at USD 6.50 (BQAD LI) and USD 6.46 (AUSR LB)
Source: Bloomberg, FFA Private Bank
Market close on April 28, 2017

Bank Audi Q4/16 Results Summary vs. FFA Private Bank est.

USD million except per share data	Q1/17a	FFA Q1/17e	QoQ	YoY
Net interest income	265.4	265.8	2%	9%
Fees & commissions	65.1	67.6	-2%	1%
Trading & investment	31.7	53.7	-88%	-16%
Operating income	362.2	387.1	-38%	5%
Provisions	-28.1	-31.6	-87%	-17%
Operating expenses	-195.7	-198.0	-1%	2%
Income tax	-28.2	-33.9	-59%	17%
Net profits	110.2	123.6	-8.%	0%
Diluted EPS to common	0.25	0.28	14%	4%
Assets	43,921	44,983	-1%	7%
Deposits	35,966	36,666	0%	5%
Loans	16,976	17,573	-1%	-6%
BVPS to common	7.38	7.47	4%	0%
	Q1/17a	**FFA Q1/17e**	**Q4/16a**	**Q1/16a**
FFA Net interest margins	2.44%	2.40%	2.36%	2.41%
Core income to total operating income ratio	91.2%	86.1%	55.6%	89.0%
FFA Cost-to-income ratio	54.0%	51.1%	33.9%	55.3%
Immediate liquidity-to-deposit ratio	41.7%	44.5%	43.8%	33.8%
Loan-to-deposit ratio	47.2%	47.9%	47.9%	52.8%
Equity-to-asset ratio	8.6%	8.4%	8.4%	8.2%

Source: Company reports and FFA Private Bank estimates
Note: Q1/17 and Q1/16 figures may not be fully comparable due to deconsolidation of Syria and Sudan subsidiaries in Q3/16

Net profits at USD 110.2 million in Q1/17 (-8% QoQ, flat YoY) below FFA est. of USD 123.6 million with largely weaker-than-expected trading and investment income partly offset by lower provisions. Bank Audi posted Q1/17 profits at USD 110.2 million (-8% QoQ, flat YoY) below FFA est. of USD 123.6 million and diluted EPS at USD 0.25 (+14% QoQ, +4% YoY) vs. FFA est. USD 0.28. Operating income came in at USD 362.2 million (vs. FFA est. USD 387.1 million) with net interest income in line with our forecasts at USD 265.4 million considerably helped by Odea Bank contribution, and fees and commissions income at USD 65.1 million (vs. FFA est. USD 67.6 million) while trading and investment income came in largely below our estimates at USD 31.7 million (vs. FFA est. USD 53.7 million). Net profits helped by slightly lower-than-expected opex at USD 195.7 million (vs. FFA est. USD 198.0 million) and softer credit loss provisions at USD 28.1 million (vs. FFA est. USD 31.6 million) following stronger levels in Q4/16. NPLs slightly higher at 2.7% mainly from operations in Turkey although still at the lower end of peers under coverage and sector averages. Tax rate at 20.4% (vs. FFA est. 21.5%) with income tax at USD 28.2 million (vs. FFA est. USD 33.9 million). We highlight flat YoY growth in bottom line mainly due to the deconsolidation of Syria and Sudan subsidiaries which had accounted for ~15% of profits in Q1/16 with net profits growth before discontinued operations at +18% YoY. Softer-than-expected balance sheet growth with assets, deposits and loans at respective USD 43.9 billion (vs. FFA est. USD 45.0 billion), USD 36.0 billion (vs. FFA est. USD 36.6 billion) and USD 17.0 billion (vs. FFA est. USD 17.6 billion). Loan-to-deposit ratio trended lower at 47.2%, below FFA est. and Q4/16 level of 47.9% on lower lending in Lebanon and Turkey.

Higher net interest income at USD 265.4 million driven by improvement in net interest margins despite subdued balance sheet growth QoQ and softer LDR

Bank Audi's net interest income at USD 265.4 million (+2% QoQ, +9% YoY) mainly on higher net interest margins estimated at 2.44% up from 2.36% in Q4/16 and 2.41% in Q1/16 while seasonal effects weighed on balance sheet growth. On a QoQ basis, improvement in asset yields largely offset higher cost of funds mainly driven by higher spreads in Turkey which contributes to ~25% of assets, ~43% of loans and ~24% of net profits while margins deteriorated in Egypt on higher cost of deposits. Higher net interest margins in Turkey likely helped by increase in Turkish policy rates end of 2016 which likely reflected on Odea bank's asset yields. In the Lebanese banking sector, NIMs improvement was capped by higher cost of funds in LBP and USD despite higher asset yields in USD. On a YoY basis, balance sheet growth in Lebanon, Egypt and Turkey and NIM improvement in Turkey offset unfavorable impact from f/x devaluation in TRY and EGP and weaker LDR from conservative lending approach by Odea Bank resulting in LDR at ~89% well below Turkish sector average of ~120%.

Lower non-interest income at USD 96.8 million on seasonality driving weaker financial gains while fees and commissions income roughly stable

Non-interest income at USD 96.8 million in Q1/17 (-70% QoQ, -5% YoY) on lower trading and investment income at USD 31.7 million (-88% QoQ, -16% YoY) following particularly stronger levels in H2/16 resulting from Bank Audi's larger involvement in capital market activities in Lebanese securities. Fees and commissions income was roughly stable at USD 65.1 million (-2% QoQ, +1% YoY). Bank Audi's income quality mix shows higher contribution of core income (net interest income + net fees and commissions) to total operating income at 91% in Q1/17 from 56% in Q4/16 and 89% in Q1/16 which we view favorably.

Higher cost-to-income QoQ weighed by Egypt despite material income growth in Turkey driving more favorable operating leverage for Odea Bank

Bank Audi reported higher cost-to-income in Q1/17 at 54.0% up from 33.9% in Q4/16 which was helped by one-off gains, and down from 55.3% in Q1/16. Cost efficiencies at the group level deteriorated on a QoQ basis despite material improvement at Odea Bank and roughly stable cost-to-income in Lebanon. Cost-to-income in Turkey declined to 47.0% from 59.3% in Q4/16 from favorable operating leverage given larger increase in operating income offsetting higher opex.

Sequential decline in assets and loans in Q1/17, likely a result of seasonal weakness and slowdown in lending in key pillars while expansion in Egypt and Turkey drives YoY balance sheet growth

Subdued QoQ balance sheet growth in Q1/17 with assets and loans declining -1% to respective USD 43.9 billion and USD 17.0 billion while deposits remained unchanged at USD 36.0 billion resulting in a lower loan-to-deposit ratio at 47.2% down from 47.9% in Q4/16 and 52.8% in Q1/16. On a YoY basis, assets and deposits grew at respective +7% and +5% while loans underperformed at -6% likely a reflection of Bank Audi's conservative lending strategy in Turkey and subdued lending growth in Lebanon which account for respective ~43% and ~35% of total loans. We also highlight a marginal impact of deconsolidation and write-off of Bank Audi's subsidiaries in Syria and Sudan on Bank Audi's YoY balance sheet growth. NPLs trended higher at 2.7% from 2.4% in Q4/16, although still at the lower end of our coverage and below sector average, with ~50% of doubtful loans concentrated in Turkey.

Profitability improves YoY driven by Turkey and Lebanon while capitalization roughly stable although stretched on BDL regulatory requirements

Bank Audi's capital adequacy ratio (as per Basel III) at 14.6% in Q1/17 below Q4/16 level of 14.8% vs. BDL's 14.5% regulatory requirement, with CET1 ratio at 9.1% (BDL requirement 9.0%) and Tier 1 at 11.6% (BDL requirement 12.0%). CAR improved YoY from 13.7% in Q1/16 helped by gains from BDL debt swap which were partly allocated to CET1 and Tier 2 capital. TTM ROA at an estimated ~1.1% in Q1/17 unchanged from Q4/16 yet slightly higher than 1.0% in Q1/16 while TTM ROE at an estimated ~13.1% down from ~13.5% in Q4/16 and above ~12.3% in Q1/16. We highlight improved profitability QoQ in Turkey, Lebanon and private banking platform while ROA declined in Egypt on lower operating margins. Higher TTM EPS at USD 1.05 from USD 1.04 in Q4/16 and USD 0.93 in Q1/16. Equity-to-asset ratio at 8.6% in Q1/17 up from 8.4% in Q4/16 and 8.2% in Q1/16 while estimated book value per share was at USD 8.94 (USD 7.38 to common, +4% QoQ, flat YoY).

We believe Bank Audi shares should benefit from more stable operating environment across its diversified business pillars, building on steadier earning streams with interest margin improvement and contained asset quality despite recent challenges in Lebanon, Turkey and Egypt

Expect Bank Audi to benefit from improved operating conditions in key pillars should stabilizing political environment in Turkey and improved sentiment in Lebanon and Egypt materialize into steadier core income streams, more favorable operating leverage and higher ROA levels. We highlight Bank Audi's capacity to grow quality earnings, improve profitability and preserve asset quality as it diversifies risk from its domestic market although see need for improvement in capital buffers particularly at the CET1 level. Gross dividends approved at LBP 753.75 (USD 0.50) with shares trading at a ~8% dividend yield and multiples at discount to historical average and regional peers on a P/E and P/B basis, translating into double digit total returns and more favorable risk return profile for investors.

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