

Flash Note

April 28, 2014

Bank Audi Q1/14 Results

Sector: Banking

Country: Lebanon

MARKETWEIGHT

Target Price	USD 7.00
Closing Price	USD 6.02
Year to Date %	-3.5%
52 Week Range	6.00 -6.94
Market Cap.	USD 2,105.5 million
Dividend Yield	6.6%
P/E (TTM)	7.6x
P/B to Common	0.93x

Note: the share data represents Bank Audi listed shares (Bloomberg ticker: AUDI LB)

Source: Bloomberg, FFA Private Bank

Net profits at USD 86 million in Q1/14, below USD 95 million estimate principally on lower financial gains as expectations for core income, provisions and opex were roughly in line

Bank Audi's net profits amounted to USD 86 million in Q1/14, flat from Q1/13 although doubled from exceptionally low earnings in previous quarter. Diluted EPS was USD 0.22 vs. USD 0.12 in Q4/13 and USD 0.23 in Q1/13. Higher bottom line QoQ was mostly driven by stronger financial gains in parallel to lower provisions and opex in the context of roughly flat proceeds from core income. Compared to our estimates for Q1/14, we note that costs are roughly in line including provisions (USD 18 million vs est. USD 20 million), opex (USD 157 million opex vs. est. 159 million) and income tax (USD 23 million vs. est. 24 million). On the revenue side, we note that higher than expected core income did not totally offset lower than expected financial gains, thus translating into lower net profits compared to estimates: Bank Audi beats our estimates for Q1/14 by USD 9 million in core income (which we positively view), while we anticipated higher trading and investment income (~USD 20 million in variance) which tends to be more volatile thus explaining the miss on the bottom line for the quarter. Q1/14 shows continuous growth in key balance sheet indicators at 4% QoQ for assets, deposits and loans (principally driven by Odea Bank) surpassing our forecasts for assets and deposits yet in line for loans.

Table 1: Bank Audi Q1/14 results vs. FFA Private Bank estimates

USD million	Q1/14a	FFA Q1/14e	Q4/13a	Q1/13a	QoQ %	YoY %
Net interest income	182	179	185	142	-1%	29%
Operating income	286	295	260	255	10%	12%
Net profits	86	95	43	86	98%	0%
Diluted EPS	0.22	0.25	0.12	0.23	85%	-3%
Assets	37,813	36,624	36,191	33,284	4%	14%
Deposits	32,320	31,703	31,095	28,735	4%	12%
Loans	15,293	15,243	14,713	11,587	4%	32%
BVPS to common	6.45	6.32	6.16	6.36	5%	1%
FFA Cost-to-income ratio	54.9%	54.0%	68.6%	51.8%		
Loans-to-deposits ratio	47.3%	48.1%	47.3%	40.3%		

Source: Bank Audi and FFA Private Bank estimates

Table 2: Summary Income Statement

USD million	Q1/14	Q4/13	Q1/13	QoQ%	YoY %
Net interest income	182.4	185.0	141.6	-1.4%	28.9%
As a % of total operating income	63.8%	71.2%	55.6%		
Fees and commissions income	52.1	54.3	43.9	-4.0%	18.7%
Trading and investment income	51.2	20.6	69.1	148.7%	-25.9%
Non-interest income	103.3	74.8	113.0	38.0%	-8.6%
As a % of total operating income	36.2%	28.8%	44.4%		
Total operating income	285.7	259.8	254.5	10.0%	12.2%
Personnel expenses	(88.8)	(91.1)	(72.8)	-2.5%	22.1%
Non-personnel expenses	(68.1)	(87.2)	(59.0)	-21.8%	15.5%
Total operating expenses	(157.0)	(178.3)	(131.8)	-12.0%	19.1%
Cost-to-income ratio	54.9%	68.6%	51.8%		
Pre-provision profit before tax	128.7	81.5	122.8	57.9%	4.9%
Provisions	(20)	(29)	(14)	-30.1%	41.3%
Provisions as a % of pre-provision profit	15.6%	35.2%	11.6%		
Profit before tax	108.6	52.8	108.5	105.8%	0.1%
Income tax	(22.9)	(9.1)	(23.0)	151.2%	-0.6%
Income tax rate	21.1%	17.3%	21.2%		
Profit after tax from continuing operations	85.7	43.7	85.5	96.3%	0.3%
Result of discontinued operations	0.0	(0.4)	0.0		
Net profits	85.8	43.3	85.5	98.1%	0.3%
Minority interest	(2.0)	4.0	(0.3)		
Net profits (group share)	83.7	47.3	85.2	77.2%	-1.8%
EPS to common (diluted)	0.22	0.12	0.23	85.0%	-2.6%
EPS TTM to common (diluted)	0.79				

Source: Bank Audi

Net interest income at USD 182 million, substantially up YoY and roughly unchanged QoQ

Bank Audi's net interest income totaled USD 182 million in Q1/14 (-1% QoQ, +29% YoY) favorably impacted by solid growth in earning assets and improvement in net interest margins driven by i) Odea Bank, ii) domestic asset yields on lending and liquidity avenues which Management expects to improve further in the coming quarters. We highlight that Bank Audi is challenged by limited room to materially decrease the cost of funds and/or improve asset yields.

Statistics from the ABL reveal that Lebanese banks are still operating in a low interest environment, limiting potential to improve earning asset yields within little room to further decrease the cost of funds. Spreads in USD decreased to 1.27% in February 2014 down from 1.57% one year earlier which has a substantial impact on Lebanese Bank's profitability given that the bulk of their liquidity is in USD. This decrease was driven by a 6 bps increase in the cost of funds in addition to a 24 bps decline in the weighted return on uses of funds from i) lower average rate on USD deposits at the BDL (down 69 bps to 2.10%) ii) lower weighted average yields on Eurobonds (down 33 bps to 6.73%), iii) lower weighted average lending rate (down 8 bps to 6.89%) and iv) lower 3-month Libor on USD deposits (down 5 bps to 0.24%). On the LBP side, we highlight that interest spreads were unchanged in February 2014 from one year earlier.

Solid fees and commissions income in Q1/14 at USD 52 million, 19% up YoY and consistent with a stronger momentum seen in Q4/13

Bank Audi's net fees and commissions income was strong in Q1/14 at USD 52 million (+19% YoY) consistent with a stronger momentum seen in previous quarter, which we positively view given their less volatile nature compared to financial gains. On another hand, financial gains (at ~USD 51 million in Q1/14) were ~25% lower YoY yet constituted an increase (~+150%) from previous quarter. Non-interest income totaled USD 103 million for the quarter. The operating income mix for Q1/14 highlight a higher contribution from core income (including net interest income and fees and commissions income) and a lower contribution from financial gains compared to Q1/13, at 82%/18% in Q1/14 versus 73%/27% in Q1/13.

Table 3: Summary Balance Sheet

USD million	Q1/14	Q4/13	Q1/13	QoQ%	YoY%
Cash and balances	7,003.2	6,097.6	6,663.6	14.9%	5.1%
Due from banks and other financial institutions	3,453.3	3,242.1	3,473.3	6.5%	-0.6%
Financial assets	11,066.2	11,190.2	10,656.9	-1.1%	3.8%
Loans and advances	15,293.3	14,712.9	11,586.7	3.9%	32.0%
Intangible assets and goodwill	194.6	194.6	175.9	0.0%	10.6%
Other assets	802.8	753.8	728.0	6.5%	10.3%
Total assets	37,813.3	36,191.3	33,284.4	4.5%	13.6%
Due to Central Banks	189.1	167.2	88.9	13.1%	112.6%
Due to banks and other financial institutions	1,246.3	1,191.4	1,184.5	4.6%	5.2%
Deposits	32,320.0	31,095.1	28,735.4	3.9%	12.5%
<i>Immediate liquidity to deposits</i>	<i>32.4%</i>	<i>30.0%</i>	<i>35.3%</i>		
<i>Loans- to- deposits</i>	<i>47.3%</i>	<i>47.3%</i>	<i>40.3%</i>		
Subordinated debt	505.3	356.3	0.0	41.8%	-
Other liabilities	756.2	685.1	592.7	10.4%	27.6%
Total liabilities	35,016.8	33,495.1	30,601.5	4.5%	14.4%
Shareholders' equity	2,255.2	2,154.4	2,222.8	4.7%	1.5%
Preferred shares	500.0	500.0	400.0	0.0%	25.0%
Minority interest	41.3	41.8	60.1	-1.0%	-31.2%
Total shareholders' equity	2,796.5	2,696.2	2,682.9	3.7%	4.2%
Total liabilities and shareholders' equity	37,813.3	36,191.3	33,284.4	4.5%	13.6%
Book value per share	7.88	7.59	7.50	3.8%	5.0%
Book value per share to common	6.45	6.16	6.36	4.7%	1.5%
Tangible book value per share to common	5.89	5.60	5.85	5.1%	0.7%

Source: Bank Audi

Cost-efficiencies improve sequentially, yet still weaker YoY reflecting the expansion in Turkey

The cost-to-income was at 55% in Q1/14 highlighting an improvement sequentially as previous quarter was exceptionally low in revenues and heavy in costs with a cost-to-income at 69%. On a YoY basis we note a higher cost-to-income, reflecting the initial stage of expansion in Turkey where Bank Audi built USD 8.8 billion in assets and a network of 36 branches in 17 months of activity. A net loss of USD 8.6 million was recorded in Turkey in Q1/14, well below a USD 20 million loss in previous quarter possibly gearing towards a breakeven over the short term.

Gross NPL ratio up to 2.9% with a coverage ratio closer to the 100% level

Bank Audi's consolidated gross NPLs increased to 2.9% in Q1/14 up from 2.8% in Q4/13 and 2.3% in Q3/13, still contained below the 3.0% level and lower than peers under coverage. We remind that the increase in NPLs is partly attributed to the downgrade of some corporate GCC accounts. The coverage of these loans by specific and collective provisions was 94% in Q1/14 highlighting solid provisioning levels. Net allocated provisions amounted to USD 20 million in Q4/13 (lower QoQ and higher YoY). Cost of risk for Q1/14 is at 0.5% unchanged YoY yet lower from 0.8% in previous quarter.

Solid growth in key balance sheet indicators in the first quarter of 2014, mainly driven by Turkish operations

On the balance sheet side, the Bank's assets, deposits and loans grew by 4% in Q1/14 to USD 37.8 billion, USD 32.3 billion and USD 15.3 billion respectively at the end of the quarter. This increase was mainly driven by operations in Turkey where the Bank operates a network of 36 branches with a strategy to build a franchise ranking second to Lebanon in terms of size and earnings. In fact assets, deposits and loans from Turkish operations grew by 16%, 21% and 13% respectively during Q1/14 amounting to USD 8.8 billion, USD 7.0 billion and USD 6.0 billion at the end of the quarter (equivalent to a contribution of 23% in total assets). Lebanon and Egypt contribution to total assets is at 55% and 9% respectively in Q1/14, which along with Turkey represent the three main pillars of Bank Audi's growth strategy. Although unchanged from previous quarter, the loans-to-deposits ratio at 47% is well above the Lebanese banking sector average (~35%), attributed to fast lending growth. We remind that in 2013, Bank Audi saw strong growth in key balance sheet indicators at 15%, 16% and 41% respectively for assets, deposits and loans driven by the expansion in Turkey.

CAR III up to 12.5% following lowered RWA weighting on liquidity and portfolio securities at the BDL

Bank Audi's capital adequacy ratio (Basel III) increased to 12.5% in Q1/14 following a recent circular lowering the risk weighted assets (RWA) weighting from 100% to 50% on liquidity and portfolio securities at the Central Bank of Lebanon including CDs, deposits and reserves. Looking at profitability, the TTM ROA stood at an estimated 0.9% unchanged from previous quarter while the TTM ROE is estimated at around 11.1% also unchanged. The TTM EPS was USD 0.79 in Q1/14 while book value per share is estimated at USD 7.88 (USD 6.45 to common).

Valuation at attractive levels (P/B: 0.93x, P/E: 7.6x, div%: 6.6%), although likely constrained by investors looking for further visibility

Based on today's listed share price of USD 6.02 (4% down so far in 2014), Bank Audi is trading at 7.6x P/E, 0.76x P/B (P/B to common of 0.93x) and dividend yield of 6.6%, with a dividend distribution of USD 0.40/common share (before a 5% tax) for 2013 unchanged from last year. Trading at this level, Bank Audi listed shares reflect a lower multiple relative to regional peers, likely constrained by investors looking for further visibility in terms of a return to growth, a pick-up in economic activity and abatement in political risks.

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