

## Flash Note

April 21, 2015

## Bank Audi Q1/15 Results

Sector: Banking

Country: Lebanon

### MARKETWEIGHT

|                |                   |
|----------------|-------------------|
| Target Price   | USD 7.00          |
| Closing Price  | USD 6.25          |
| Year to Date % | +4.2%             |
| 52 Week Range  | 5.80 - 6.99       |
| Market Cap.    | USD 2,498 million |
| Dividend Yield | 6.4%              |
| P/E (TTM)      | 7.2x              |
| P/B to Common  | 0.88x             |

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

Source: Bloomberg, FFA Private Bank

**Net profits rose to USD 100 million in Q1/15 (+42% QoQ, +17% YoY), below our USD 105 million estimate helped by softer opex as revenues came in weaker than expected**

Bank Audi's net profits were at USD 100 million in Q1/15 (+42% QoQ, +17% YoY) below our USD 105 million estimate. Diluted EPS was USD 0.23 vs. USD 0.15 in Q4/14, USD 0.22 in Q1/14 and FFA est. USD 0.22, pointing to limited growth YoY due to the recent capital increase. While operating income came in lower than our estimates from lighter than expected net interest income and non-interest income, the negative variance to our expectations was mostly offset by lower opex and tax rate to a lower extent. On a YoY basis, Bank Audi's Q1/15 financials still show a significant increase in revenues (+19%) translating into stronger net profits (+17%), driven by the positive contribution of Odea Bank to consolidated results vs. losses in Q1/14. Cost-to-income ratio at ~52% in Q1/15 lower than expected 55%. Provisions came in line to our estimates at USD 33 million in Q1/15 equivalent to a 80 bps annualized cost of risk, notably lower from exceptionally high 160 bps in previous quarter yet still higher YoY. Despite lower cost of risk helping profits QoQ, NPL ratio edged up to 3.2% from 3.1% last quarter. Tax rate normalized to 22% in Q1/15 closer to our estimated 23% following a spike to 32% observed in Q4/14. Key balance sheet indicators were adversely impacted by currency devaluation in both Turkey and Egypt which dragged consolidated assets, deposits and loans lower QoQ (-1%, -2% and -4% respectively), vs. our estimated low-single digit growth. LDR was at 47% in Q1/15 vs. 48% in Q4/14.

Table 1: Bank Audi Q1/15 results vs. FFA Private Bank estimates

| USD million               | Q1/15a | FFA Q1/15e | Q4/14a | Q1/14a | QoQ % | YoY % |
|---------------------------|--------|------------|--------|--------|-------|-------|
| Net interest income (NII) | 223    | 238        | 243    | 188    | -9%   | 19%   |
| Operating income          | 339    | 372        | 367    | 286    | -8%   | 19%   |
| Net profits               | 100    | 105        | 70     | 86     | 42%   | 17%   |
| Diluted EPS               | 0.23   | 0.22       | 0.15   | 0.22   | 51%   | 2%    |
| Assets                    | 41,458 | 42,703     | 41,961 | 37,813 | -1%   | 10%   |
| Deposits                  | 35,054 | 36,778     | 35,821 | 32,320 | -2%   | 8%    |
| Loans                     | 16,440 | 17,661     | 17,171 | 15,293 | -4%   | 7%    |
| BVPS to common            | 7.10   | 7.09       | 7.02   | 6.45   | 1%    | 10%   |
| FFA Cost-to-income ratio  | 52.4%  | 55.0%      | 53.1%  | 54.9%  |       |       |
| Loans-to-deposits ratio   | 46.9%  | 48.0%      | 47.9%  | 47.3%  |       |       |

Source: Company reports and FFA Private Bank estimates

Table 2: Summary Income Statement

| USD million                               | Q1/15   | Q4/14   | Q1/14   | QoQ%   | YoY % |
|---|---------|---------|---------|--------|-------|
| Net interest income                       | 222.5   | 243.4   | 187.6   | -8.6%  | 18.6% |
| As a % of total operating income          | 65.6%   | 66.3%   | 65.7%   |        |       |
| Net fees and commissions income           | 59.2    | 66.8    | 52.1    | -11.3% | 13.7% |
| Trading and investment income             | 57.5    | 56.7    | 46.0    | 1.5%   | 25.2% |
| Non-interest income                       | 116.8   | 123.5   | 98.0    | -5.4%  | 19.1% |
| As a % of total operating income          | 34.4%   | 33.7%   | 34.3%   |        |       |
| Total operating income                    | 339.3   | 366.9   | 285.7   | -7.5%  | 18.8% |
| Personnel expenses                        | (101.4) | (110.9) | (88.8)  | -8.5%  | 14.2% |
| Non-personnel expenses                    | (76.3)  | (84.0)  | (68.1)  | -9.2%  | 12.0% |
| Total operating expenses                  | (177.7) | (194.9) | (157.0) | -8.8%  | 13.2% |
| Cost-to-income ratio                      | 52.4%   | 53.1%   | 54.9%   |        |       |
| Pre-provision profit before tax           | 161.5   | 171.9   | 128.7   | -6.0%  | 25.5% |
| Provisions                                | (33.0)  | (68.4)  | (20.1)  | -51.7% | 64.3% |
| Provisions as a % of pre-provision profit | 20.4%   | 39.8%   | 15.6%   |        |       |
| Profit before tax                         | 128.5   | 103.6   | 108.6   | 24.1%  | 18.3% |
| Income tax                                | (28.5)  | (33.1)  | (22.9)  | -13.9% | 24.5% |
| Income tax rate                           | 22.2%   | 32.0%   | 21.1%   |        |       |
| Net profits                               | 100.0   | 70.5    | 85.8    | 42.0%  | 16.6% |
| Minority interest                         | (4.4)   | (1.5)   | (2.0)   |        |       |
| Net profits (group share)                 | 95.6    | 69.0    | 83.7    | 38.6%  | 14.2% |
| EPS to common (basic)                     | 0.23    | 0.15    | 0.22    | 51.1%  | 1.8%  |
| EPS to common (diluted)                   | 0.23    | 0.15    | 0.22    | 51.1%  | 1.8%  |
| EPS TTM to common (diluted)               | 0.86    |         |         |        |       |

Source: Company reports

### Net interest income shrank QoQ in Q1/15 (-9%) on lower balance sheet volumes and tighter margins, although still up YoY (+19%)

Bank Audi's net interest income totaled USD 223 million in Q1/15 (-9% QoQ), from lower balance sheet volumes and tighter margins despite continuous margins improvement in Turkish operations (2.79% in Dec-14 to 2.84% in Mar-15). Looking at YoY growth, we note that net interest income increased strongly by 19% YoY favorably impacted by solid growth in earning assets and widening net interest margins. Based on our calculations, interest margins were at 2.20% in Q1/15 vs. 2.40% in Q4/14 and 2.04% in Q1/14 with the YoY improvement largely driven by Odea Bank as spreads remain likely challenged domestically by limited room to improve asset yields and decrease the cost of funds. Net interest income generated from Odea Bank in Q1/15 increased to USD 166 million adding around ~ USD 132 million YoY from both balance sheet expansion and margin improvement.

Going forward we expect Bank Audi consolidated margins to remain favorably impacted by higher margins from Odea Bank as they converge towards Turkish banking sector average.

### Latest banking sector's statistics from the ABL for the month of February 2015 reveal that Lebanese banks are still operating in a low interest environment, limiting potential to improve earning asset yields along with limited capacity to decrease the cost of funds given market share concerns amidst slower deposit accumulation

Both spreads in USD and LBP were lower in February 2015 compared to one year earlier. Latest statistics from the ABL for the month of February 2015 reveal that Lebanese banks are still operating in a low interest environment, limiting potential to improve earnings asset yields along with limited capacity to decrease the cost of funds given market share concerns amidst slower deposit accumulation.

**Spreads in USD** decreased to 1.22% in February 2015 from 1.27% in February 2014 which has a substantial impact on bank's profitability given that the bulk of their liquidity is in USD. This decrease was driven by a 16 bps increase in the cost of funds to 3.11% in the context of slightly higher weighted average on uses of funds at 4.33% up from 4.22%.

**Spreads in LBP** narrowed to 0.85% in February 2015 from 1.12% in February 2014 from higher cost of funds (+9 bps to 5.57%) and lower return on uses of funds (-17 bps to 6.42%) which was dragged down by lower rate on CDs issued by the BDL (-23 bps to 8.12%) despite higher weighted yields on T-bills (+7 bps to 6.94%) and higher lending rate (+4 bps to 7.31%).

### Although lower sequentially, fees and commissions still display solid growth YoY (-11% QoQ, +14% YoY) with contribution in total revenues at 17% in Q1/15 vs. 18% in previous quarters

Bank Audi's net fees and commissions income came in lower sequentially (-11% QoQ) at USD 59 million in Q1/15, yet still representing a solid 14% increase from Q1/14. On the other hand, financial gains totaled USD 58 million in Q1/15 (+1% QoQ, +25% YoY). Non-interest income totaled USD 117 million for the quarter (-5% QoQ, +19% YoY). The operating income mix for Q1/15 highlight no major change sequentially as well as on a YoY basis with contribution from net interest income, fees and commissions and financial gains at 66%, 17% and 17% respectively. Going forward we believe Bank Audi could continue to benefit from a positive momentum in fees and commissions, helped by the expansion of the Group including the rapidly growing franchise in Turkey as well as increased focus on private banking operations.

**Table 3: Summary Balance Sheet**

USD million

|   | Q1/15           | Q4/14           | Q1/14           | QoQ%         | YoY%         |
|---|-----------------|-----------------|-----------------|--------------|--------------|
| Cash and balances with Central Banks              | 8,928.3         | 8,787.7         | 7,003.2         | 1.6%         | 27.5%        |
| Due from banks and other financial institutions   | 4,485.4         | 4,336.7         | 3,453.3         | 3.4%         | 29.9%        |
| Financial assets                                  | 10,275.3        | 10,249.5        | 11,066.2        | 0.3%         | -7.1%        |
| Loans and advances                                | 16,440.3        | 17,171.0        | 15,293.3        | -4.3%        | 7.5%         |
| Intangible assets and goodwill                    | 183.4           | 192.5           | 194.6           | -4.7%        | -5.8%        |
| Other assets                                      | 1,144.7         | 1,223.3         | 802.8           | -6.4%        | 42.6%        |
| <b>Total assets</b>                               | <b>41,457.5</b> | <b>41,960.7</b> | <b>37,813.3</b> | <b>-1.2%</b> | <b>9.6%</b>  |
| Due to Central Banks                              | 359.2           | 290.8           | 189.1           | 23.5%        | 90.0%        |
| Due to banks and other financial institutions     | 1,151.6         | 1,184.6         | 1,246.3         | -2.8%        | -7.6%        |
| Deposits  | 35,054.3        | 35,820.8        | 32,320.0        | -2.1%        | 8.5%         |
| <i>Immediate liquidity to deposits</i>            | <i>38.3%</i>    | <i>36.6%</i>    | <i>32.4%</i>    |              |              |
| <i>Loans- to- deposits</i>                        | <i>46.9%</i>    | <i>47.9%</i>    | <i>47.3%</i>    |              |              |
| Subordinated debt                                 | 647.8           | 507.4           | 505.3           | 27.7%        | 28.2%        |
| Other liabilities                                 | 866.6           | 809.5           | 756.2           | 7.1%         | 14.6%        |
| <b>Total liabilities</b>                          | <b>38,079.5</b> | <b>38,613.1</b> | <b>35,016.8</b> | <b>-1.4%</b> | <b>8.7%</b>  |
| Shareholders' equity                              | 2,836.3         | 2,805.7         | 2,255.2         | 1.1%         | 25.8%        |
| Preferred shares                                  | 500.0           | 500.0           | 500.0           | 0.0%         | 0.0%         |
| Minority interest                                 | 41.7            | 42.0            | 41.3            | -0.5%        | 0.9%         |
| <b>Total shareholders' equity</b>                 | <b>3,378.0</b>  | <b>3,347.6</b>  | <b>2,796.5</b>  | <b>0.9%</b>  | <b>20.8%</b> |
| <b>Total liabilities and shareholders' equity</b> | <b>41,457.5</b> | <b>41,960.7</b> | <b>37,813.3</b> | <b>-1.2%</b> | <b>9.6%</b>  |
| Book value per share                              | 8.35            | 8.27            | 7.88            | 0.9%         | 5.9%         |
| <b>Book value per share to common</b>             | <b>7.10</b>     | <b>7.02</b>     | <b>6.45</b>     | <b>1.1%</b>  | <b>10.0%</b> |
| Tangible book value per share to common           | 6.64            | 6.54            | 5.89            | 1.5%         | 12.6%        |

Source: Company reports

**Efficiencies improved in Q1/15 although still below pre-Turkey expansion levels. Odea's net profits reached USD 11 million in Q1/15 (11% of consolidated) after turning positive in Q2/14**

The cost-to-income ratio was at 52% in Q1/15 pointing to an improvement in cost efficiencies QoQ and YoY, favorably impacted by a stronger decrease in opex vs. income QoQ and a softer increase in opex vs. income YoY. More generally, Bank Audi's cost-to-income ratio remains higher than pre-Turkey expansion levels where Bank Audi built a USD 10 billion asset base coupled with a network of 54 branches (including kiosks) since the launch of operations towards the end of 2012.

Odea Bank reported net profits of USD 11 million in Q1/15 confirming a trend initiated in Q2/14 when Odea Bank started showing its first set of net profits. We expect profitability in the Turkish entity to continue to improve as margins, efficiencies (and LDR to a lesser extent) move higher towards peers.

**Gross NPL ratio edged up to 3.2% in Q1/15 from 3.1% in Q4/14, while cost of risk normalized at an annualized 80 bps following a provisioning spike in previous quarter**

Bank Audi's consolidated gross NPLs (Doubtful loans) edged up to 3.2% in Q1/15 from 3.1% in previous quarter, still contained and lower than peers under coverage. We note a normalization in the cost of risk in Q1/15 to an estimated ~ 80 bps following a provisioning spike to ~160 bps in previous quarter. On a YoY basis, cost of risk increased from: i) tick up in NPL formation, ii) improved specific coverage, iii) prudent collective provisioning across various entities. For Q1/15, net provisions were at USD 33 million compared to USD 68 million in Q4/14 and USD 20 million in Q1/14.

We note that tax rate was at 22% in Q1/15 following a surprising 32% tax rate in Q4/14.

**Key balance sheet indicators were adversely impacted by currency devaluation in key growth markets despite domestic outperformance**

Following a strong performance in Q4/14, the Bank's balance sheet volumes were hurt in Q1/15 by Turkish lira and Egyptian pound devaluation combined with a seasonal weakness usually witnessed in the first quarter. However Bank Audi managed to grow domestic assets by 1.6% QoQ despite persistent softness in the domestic banking sector (+0.5% assets, +0.2% deposits, -0.6% loans). Bank Audi's consolidated assets, deposits and loans decreased by 1%, 2% and 4% respectively during the quarter to reach USD 41 billion, USD 35 billion, and USD 16 billion respectively. Bank Audi's deposits to assets ratio was at 85% and LDR at 47% well above the Lebanese banking sector average (~35%), attributed to fast lending growth driven by Turkey.

**CAR III at 13.7% in Q1/15 unchanged from previous quarter, while profitability ratios trended slightly upwards sequentially**

Bank Audi's equity to assets ratio edged up to 8.1% in Q1/15 up from 8.0% in previous quarter. Bank Audi's capital adequacy ratio (Basel III) remained unchanged from previous quarter at 13.7%. Profitability ratios trended slightly higher sequentially, the TTM ROA was at an estimated 0.92% vs. 0.90% in previous quarter while the TTM ROE is estimated at around 11.8% vs. 11.6%. The TTM EPS was USD 0.86 in Q1/15 (unchanged from previous quarter) while book value per share is estimated at USD 8.35 (USD 7.10 to common up 1% QoQ and 10% YoY).

**We highlight a 6.5% dividend yield based on current market price, despite recent dividend distribution which could create a more interesting entry point for investors**

Based on today's listed share price of USD 6.25 (up 4.2% so far in 2015), Bank Audi is trading at 7.2x P/E, 0.75x P/B (P/B to common of 0.88x). Bank Audi's listed shares reflect lower multiples relative to regional peers similar to other banks under coverage. We remind that Bank Audi recently paid its dividends for the financial year 2014 according to the following schedule: ex-dividend April 08, 2015; record date April 14, 2015; payment date April 15, 2015. Bank Audi distributed USD 0.40 per common share (before a 5% tax) unchanged from previous payment despite rising profits YoY in 2014.

As expected in our latest preview report, Bank Audi's listed share price decreased following dividend payment which coupled with pressures on balance sheet from FX devaluation and lower YoY EPS growth from capital increase, could create an interesting entry point for investors wishing to take part in Bank Audi's growth story and risk diversification across markets.

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