Flash Note - Bank Audi Q2/16 Results

Sector: Banking
Country: Lebanon

MARKETWEIGHT

Target Price	**USD 7.00**
Closing Price	**USD 6.19**
52 Week Range	**USD 5.50 - 6.30**
Year to Date %	**+2.3%**
Market Cap.	**USD 2,474.4 million**
Dividend Yield	**6.5%**
P/E (TTM)	**6.4x**
P/B to Common	**0.87x**

Note: the share data represents Bank Audi listed shares (Bloomberg ticker: AUDI LB). Bank Audi GDR shares at USD 6.10 (Bloomberg ticker: BQAD LI) and USD 6.20 (Bloomberg ticker: AUSR LB)
Source: Bloomberg, FFA Private Bank
Market close on July 29, 2016

Net profits at USD 115 million in Q2/16 (+5% QoQ, +13% YoY) exceeding FFA estimate of USD 111 million as contribution from Bank Audi's foreign entities increases

Bank Audi posted net profits at USD 115 million (+5% QoQ, +13% YoY) with diluted EPS at USD 0.27 (+12% QoQ, +16% YoY) both above our respective USD 111 million and USD 0.25 FFA estimates. Total operating income came in at USD 450 million, well above FFA est. USD 359 million on significantly higher trading & investment income at USD 132 million vs. FFA est. USD 41 million and net interest income to a lesser extent which came at USD 253 million vs. FFA est. USD 247 million while net fees & commissions income was at USD 64 million below FFA est. USD 71 million. This positive variance to the bottom line was partially offset by higher than expected opex and provisions registering respective USD 239 million (vs. FFA est. USD 189 million) and USD 64 million (vs. FFA est. USD 35 million) mostly under collective provisioning predominantly in Turkey. Provisioning level equivalent to an estimated 139 bps annualized cost of risk, materially higher than Q1/16 cost of risk of 75 bps although NPL ratio was at 3.0% slightly improving from its Q1/16 and Q2/15 level of 3.1% and still lower than peers under coverage. Income tax also weighed on net profits, reaching USD 31 million (vs. FFA est. USD 24 million) representing a tax rate of 21.4% vs. FFA est. 18%. Cost-to-income slightly decreased to 53.1% vs. FFA est. 52.8%. Balance sheet growth exceeded our forecast on a QoQ basis despite challenging operating conditions, with assets, deposits and loan growth at +2% and LDR stable at 52.8%, in line with our expectations.

Bank Audi Q2/16 results summary vs. FFA Private Bank estimates

USD million except per share data	Q2/16a	FFA Q2/16e	Q1/16a	Q2/15a	QoQ %	YoY %
Net interest income	253.2	247.0	245.5	233.9	***3.1%***	***8.3%***
Net fees & commissions income	*64.0*	*71.0*	*65.6*	*66.5*	***-2.4%***	***-3.7%***
Trading & investment income	*132.4*	*41.0*	*50.7*	*35.5*	***161.1%***	***273.4%***
Operating income	**449.6**	**359.0**	**361.8**	**335.8**	***24.3%***	***33.9%***
Provisions	-64.0	-35.0	-34.0	-28.5	**88.2%**	**125.0%**
Operating expenses	-238.6	-189.0	-193.3	-182.0	**23.4%**	**31.1%**
Operating profit	210.9	170.0	168.5	153.8	**25.2%**	**37.1%**
Income tax	-31.4	-24.0	-24.3	-23.3	**29.6%**	**34.9%**
Net profits	**115.5**	**111.0**	**110.2**	**102.1**	**4.8%**	**13.1%**
Diluted EPS to common	0.27	0.25	0.24	0.23	**11.9%**	**16.5%**
Assets	41,938	41,413	41,022	42,310	***2.2%***	***-0.9%***
Deposits	34,993	34,647	34,221	36,106	***2.3%***	***-3.1%***
Loans	18,466	18,310	18,084	17,035	***2.1%***	***8.4%***
FFA BVPS to common	7.12	7.48	7.37	6.78	**-3.4%**	**5.0%**
FFA Net interest margins	2.45%	2.43%	2.43%	2.24%		
Core income to total operating income	70.6%	88.7%	86.0%	89.5%		
FFA Cost-to-income ratio	53.1%	52.8%	53.4%	54.2%		
Immediate liquidity-to-deposits ratio	34.9%	32.6%	33.8%	35.7%		
Loan-to-deposit ratio	52.8%	52.8%	52.8%	47.2%		
Equity-to-asset ratio	7.8%	8.2%	8.2%	7.4%		

Source: Company reports and FFA Private Bank estimates

Net interest income at USD 253 million in Q2/16 supported by NIMs improvement in Turkey and Egypt despite challenged growth in balance sheet

Net interest income came in at USD 253 million in Q2/16 (+3% QoQ, +8% YoY) with growth mostly driven by margin improvement and increasing contribution from Bank Audi's foreign operations. Net interest margins increased to 2.45% in Q2/16 from 2.43% in Q1/16 and 2.24% in Q2/15 still at the higher end of our coverage, on lower cost of funds partially offset by weaker asset yields on a QoQ basis. YoY increase in net interest income was mainly driven by higher NIMs on improving asset yields despite slightly higher cost of funds. We expect Bank Audi consolidated NIMs to remain favorably impacted from operations expansion in Turkey and Egypt which benefit from higher margins compared to the domestic market and given the bank's margin preservation efforts.

Latest banking sector's statistics from the ABL for the month of May 2016 show an improvement in LBP and USD spreads given higher asset yields, despite limited capacity to decrease cost of funds in USD as funding conditions tighten

Spreads in USD and LBP were higher in May 2016 compared to one year earlier. Latest statistics from the ABL for the month of May 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 1.43% in May 2016 from 1.30% in May 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 (+26 bps to 4.70%), partially offset by higher cost of funds (+13 bps to 3.27%). Weighted return on uses of funds were weighed by higher LIBOR 3-month on USD deposits (+37 bps to 0.65%), higher rate on USD deposits at BDL (+27 bps to 2.84%), higher lending rate (+18 bps to 7.27%) despite lower interest rate on Eurobonds (-4 bps to 6.61%).

Spreads in LBP increased to 1.22% in May 2016 from 0.83% in May 2015 on higher weighted average on uses of funds (+40 bps to 6.81%) despite slightly higher cost of funds (+1 bps to 5.59%). Weighted return on uses of funds were weighed by higher lending rate (+147 bps to 8.52%), higher yields on T-bills (+6 bps to 7.01%) and higher rate on CDs issued by the BDL (+2 bps to 8.17%).

Non-interest income materially higher in Q2/16 as stronger trading and investment income weighs on core income mix

Non-interest income came higher on QoQ and YoY basis from higher trading and investment income at USD 132 million (+161% QoQ, +273% YoY) as Bank Audi benefitted from change in fair value of financial assets amid increased market activity in Q2/16, while net fees & commissions income came in slightly lower at USD 64 million (-2% QoQ, -4% YoY). Revenue breakdown for Q2/16 reflects less favorable income mix quality with core income (net interest income + fees & commissions income) contribution to total operating income at 71% in Q2/16 down from 86% in Q1/16 and 89% in Q2/15. However, we believe Bank Audi's core income should benefit from i) improved interest margins as branch network roll out gains maturity in Odea Bank, and increased fees and commissions from lending growth in Turkey and Egypt, and ii) business line diversification including increased focus on private banking and asset management operations.

Bank Audi saw higher opex reaching USD 239 million in Q2/16 resulting from the bank's regional expansion. Gross NPL ratio unchanged from previous quarter while cost of risk surged to 139 bps on higher provisioning

Operating expenses rose to USD 239 million (+23% QoQ, +31% YoY) resulting from an increase in personnel expenses (+24% QoQ, +26% YoY), as well as non-personnel expenses (+23% QoQ, +38 YoY) mainly on costs related to the roll-out of new branches in Egypt as well as other non-recurring expenses (IT transformation in Lebanon and Egypt). Cost-to-income ratio at 53.1% in Q2/16 below Q1/16 level of 53.4% and Q2/15 level of 54.2% helped by higher operating income in Q2/16. Bank Audi's consolidated gross NPL ratio at 3.0% slightly below Q1/16 and Q2/15 level of 3.1% and still lower than peers under coverage. Cost of risk rose to an estimated 139 bps in Q2/16, from an estimated 75 bps in Q1/16 and 67 bps in Q2/15 on higher provisioning at USD 64 million from USD 34 million in Q1/16 and USD 29 million in Q2/15 mostly allocated as collective provisions, given prudent management team in wake of rising macro and political risks in key markets.

Net profits came in at USD 115 million in Q2/16 (+5% QoQ, +13% YoY) mainly on higher non-interest income and NIMs improvement to a lesser extent, despite higher opex

Net profits came in at USD 115 million in Q2/16 (+5% QoQ, +13% YoY) with improvement mainly driven by higher contribution of non-interest income to total operating income at 44% in Q2/16 from 32% in Q1/16 overshadowing higher net interest income. Stronger operating income was partially offset by higher opex at USD 239 million (+23% QoQ, +31% YoY), increasing income tax at USD 31 million (vs. USD 24 million in Q1/16, +30% QoQ) with tax rate of 21.4% in Q2/16 vs. 18.0% in Q1/16 and 18.6% in Q2/15 and heavier provisioning. Diluted EPS registered at USD 0.27 (+12% QoQ, +16% YoY). The share of Bank Audi's foreign operations led by Odea Bank and Bank Audi Egypt reached 51% of the group's total profits for the first half of 2016 compared to 48% during the same period in 2015.

Bank Audi balance sheet grew in Q2/16 yet contracted on a yearly basis mainly on EGP devaluation

Assets, deposits and loans grew 2% sequentially in Q2/16 to respective USD 41.9 billion, USD 35.0 billion and USD 18.5 billion. However, on a YoY basis, assets and deposits declined -0.9% and -3.1% respectively from Q2/15 on the back of significant devaluation in the Egyptian Pound and management efforts to preserve margins at the expense of slower balance sheet growth. On the other hand, loans outperformed at +8.4% despite concerns around the sector's lending environment. Bank Audi's deposit-to-asset ratio unchanged at ~83% in Q2/16 and Q1/16 yet lower than ~85% in Q2/15, with LDR also stable at 52.8% from Q1/16 yet higher than 47.2% in Q2/15 and well above the Lebanese banking sector average (~32.0% in May 2016) mainly helped by solid lending growth mostly in Egypt. Bank Audi continues to diversify its geographic presence with ~48% of total assets coming from international operations.

Bank Audi sees improvement in profitability and higher CAR III ratio at 13.9% from 13.7% in Q1/16

Bank Audi's capital adequacy ratio (Basel III) improved sequentially to 13.9% in Q2/16 from 13.7% in Q1/16, higher than Q2/15 level, and above BDL's requirement of 12.0% for 2016. Profitability ratios flat to higher with TTM ROA at an estimated ~1.0% in Q2/16, unchanged from Q1/16 and higher than Q2/15 level of ~0.9% while TTM ROE improved to an estimated ~13.5% in Q2/16, from ~12.3% in Q1/16 and ~12.4% in Q2/15. TTM EPS improved to USD 0.96 in Q2/16 from USD 0.92 in Q1/16 and USD 0.83 in Q2/15. Equity-to-asset lower at 7.8% vs. 8.2% in Q1/16 yet higher than 7.4% in Q2/15 while estimated book value per share (to common) came in at USD 7.12 in Q2/16 lower than USD 7.37 in Q1/16 yet higher than 6.78 in Q2/15. Given improving profitability with TTM ROA at an estimated ~1.0% in Q2/16, improving margins and contained NPLs, we should see shares re-rate at closer to 1x book and towards our fair value estimate.

Contacts

Head of Research: Nadim Kabbara, CFA
n.kabbara@ffaprivatebank.com +961 1 985195

Analyst: Anna Maria Chaaraoui
a.chaaraoui@ffaprivatebank.com +961 1 985195

Analyst: Nadine Mezher
n.mezher@ffaprivatebank.com +961 1 985195

Sales and Trading, FFA Private Bank (Beirut)
+961 1 985225

Sales and Trading, FFA Dubai ltd (DIFC)
+971 4 3230300

FFA Private Bank s.a.l.

- One FFA Gate - Marfaa 128 - Foch Street
- Beirut Central District
- PO Box 90-1283 - Beirut - Lebanon
- Tel: +961.1.985 195
- Fax: +961.1.985 193
- http://www.ffaprivatebank.com

FFA Dubai Ltd

- Building 5 – Office 410
- Gate Precinct
- Dubai International Financial Centre (DIFC)
- PO Box 506567 - Dubai - UAE
- Tel: +971.4.363 74 70
- Fax: +971.4.363 74 71
- http://www.ffadubai.com