

Equity Research - Flash Note - Bank Audi Q2/17 Results

Sector: Banking
Country: Lebanon

MARKETWEIGHT

Target Price	USD 7.00
Closing Price	USD 6.10
52 Week Range	USD 5.99-6.97
Year to Date %	-10.29%
Market Cap.	USD 2,438.5 million
Dividend Yield	8.2%
P/E (TTM)	6.0x
P/B to Common	0.82x

Note: the share data represents Bank Audi listed shares (AUDI LB)
Bank Audi GDR shares at USD 6.12 (BQAD LI) and USD 6.10(AUSR LB)
Source: Bloomberg, FFA Private Bank
Market close on July 28, 2017

Bank Audi Q2/17 Results Summary vs. FFA Private Bank est.

USD million except per share data	Q2/17a	FFA Q2/17e	QoQ	YoY
Net interest income	269.0	272.7	1%	7%
Fees & commission	61.6	66.5	-5%	-3%
Trading & investment	41.6	31.3	31%	-67%
Operating income	372.2	370.5	3%	-16%
Provisions	-43.3	-27.6	54%	-32%
Operating expenses	-197.0	-197.2	0%	-18%
Income tax	-29.4	-30.0	4%	-3%
Net profits	102.6	116.4	-7%	-11%
Diluted EPS to common	0.23	0.27	-8%	-15%
Assets	43,871	44,869	0%	5%
Deposits	36,317	36,476	1%	4%
Loans	17,634	17,235	4%	-5%
BVPS to common	7.46	7.72	1%	5%
	Q2/17a	FFA Q2/17e	Q1/17a	Q2/16a
FFA Net interest margins	2.48%	2.47%	2.44%	2.43%
Core income to total operating income ratio	91.2%	91.5%	88.8%	52.8%
FFA Cost-to-income ratio	52.9%	53.2%	54.3%	54.7%
Immediate liquidity-to-deposit ratio	39.2%	45.2%	41.7%	34.9%
Loan-to-deposit ratio	48.6%	47.2%	47.2%	52.8%
Equity-to-asset ratio	8.7%	8.6%	8.6%	7.8%

Source: Company reports and FFA Private Bank estimates
Note: 1) Net profits exclude profit from discontinued operations, 2) Q2/17 and Q2/16 figures may not be fully comparable due to deconsolidation of Syria and Sudan subsidiaries in Q3/16

Net profits before discontinued operations at USD 102.6 million in Q2/17 (-7% QoQ, -11% YoY) below FFA est. of USD 116.4 million on stronger-than-expected provisions. Net profits at USD 197.9 million when including exceptional profits from the sale of the Card and Electronic Payment processing and acquiring activities. Bank Audi's profits before discontinued operations at USD 102.6 million (-7% QoQ, -11% YoY) in Q2/17 below FFA est. of USD 116.4 million and diluted EPS at USD 0.23 (-8% QoQ, -15% YoY) vs. FFA est. USD 0.27. When including exceptional profits from sales of electronic payment and cards business, net profits at USD 197.9 million and diluted EPS at USD 0.48. Operating income was reported at USD 372.2 million above. FFA est. USD 370.5 million with net interest income at USD 269.0 million slightly below our forecasts of USD 272.5 million although helped by net interest margin expansion in Odea Bank. Fees and commission income came in at USD 61.6 million vs. FFA est. USD 66.5 million while trading and investment income at USD 41.6 million exceeding our forecasts of USD 31.3 million. Opex came in line with our est. at USD 197.0 million. This positive variance to the bottom line was largely offset by heavier-than-expected credit loss provisions at USD 43.3 million (vs. FFA est. USD 27.6 million) as NPLs increased to 3.3% from 2.7% in Q1/17 and 3.0% in Q2/16 likely driven by Turkish operations although still below sector averages. Higher-than-expected tax rate at 22.3% (vs. FFA est. 20.5%) with income tax at USD 29.4 million (vs. FFA est. USD 30.0 million). We note that YoY bottom line growth was weighed by deconsolidation of Syria and Sudan subsidiaries and unfavorable f/x translation effects mainly in Egypt. Assets came in below our forecasts at USD 43.9 billion (vs. FFA est. USD 44.9 billion) while deposits were in line at USD 36.3 billion and loans slightly above our est. at 17.6 billion resulting in higher-than-expected loan-to-deposit ratio at 48.6%, above Q1/17 level of 47.2% and below 52.8% in Q2/16.

Stronger net interest income at USD 269.0 million as growth is driven by NIM expansion in foreign operations and stronger LDR

Bank Audi's net interest income at USD 269.0 million (+1% QoQ, +7% YoY) supported by higher net interest margins estimated at 2.48% up from 2.44% in Q1/17 and 2.43% in Q2/16 in addition to higher LDR helped by stronger lending in foreign operations. On a QoQ basis, spread expansion in Turkey drove asset yields higher, offsetting heavier cost of funds while we note that Odea bank contributed to ~25% of assets, ~43% of loans and ~24% of net profits in Q1/17. At the domestic sector level, we highlight higher cost of funds in USD between March 2017 and May 2017 offsetting higher returns on USD interbank placements and loans while spreads improved in LBP as yields on Lebanese Tbills and BDL CDs trended higher. Bank Audi's NIMs increased YoY as decline in cost of funds offset lower asset yields while asset growth also helped.

Higher non-interest income at USD 103.2 million as financial gains picked up following weaker Q1/17 while fees and commission income declined QoQ and YoY

Non-interest income came in at USD 103.2 million in Q2/17 (+7% QoQ, -46% YoY) as financial gains picked up QoQ while largely below Q2/16 levels as we highlight Bank Audi's larger involvement in capital market activities in Lebanese securities. We note a trend of lower financial gains across the Lebanese banking sector given lesser trading activity on Lebanese securities following BDL debt swap transactions in the back half of 2016 in addition to BDL Circular 429 which included new requirements on recognition of gains from sale of securities held at amortized cost. Fees and commission income declined to USD 61.6 million (-5% QoQ, -3% YoY). Slight QoQ deterioration in Bank Audi's income quality mix with lower contribution of core income (net interest income + net fees and commissions) to total operating income at 89% in Q2/17 from 91% in Q1/17 while we note YoY improvement from 71% in Q2/17.

Improved cost-to-income at the group level supported by better cost-efficiencies at Odea Bank

We highlight an improvement in cost efficiencies in Q2/17 with cost-to-income ratio at 52.9% down from 54.0% in Q1/17 and 54.7% in Q2/16. Improvement in cost efficiencies at the group level was helped by better operating leverage at Odea Bank benefitting from higher profitability as operations continue to gain maturity in Turkey. We note that YoY growth in operating income in Q2/17 was capped by deconsolidation of Bank Audi Syria, National Bank of Sudan and Arabeya online in 2016.

Subdued QoQ growth in assets and deposits while loans declined YoY weighed by unfavorable f/x translations in key lending pillars Turkey and Egypt

Muted asset and deposit growth QoQ at respective USD 43.9 billion and USD 36.3 billion amid management strategy to prioritize balance sheet consolidation. Loans outperformed at +4% reaching USD 17.6 billion translating into higher LDR at 48.6% in Q2/17 from 47.2% in Q1/17 yet lower than 52.8% in Q2/16. Assets and deposits were up YoY by respective +5%/+4% while loans underperformed at -5% on softer lending growth in Lebanon amid marginal macro improvement and management's conservative lending approach in Turkey. We also highlight YoY impact from unfavorable f/x translation in Turkey and Egypt which account for over 50% of Bank Audi's loan portfolio and deconsolidation and write-off of Bank Audi's subsidiaries in Syria and Sudan. NPLs came in higher at 3.3% up from 2.7% in Q1/17 and 2.1% in Q2/16 below sector average, with ~50% of doubtful loans concentrated in Turkey at March 2017 partly driving higher credit loss provisions.

Bank Audi's capitalization above BDL's 2017 requirements while profitability was stable to lower despite material contribution from Odea Bank

Capital adequacy ratio (as per Basel III) at 15.2% in Q2/17 up from 14.6% in Q1/17 (BDL's requirement 14.5%), with CET1 ratio at 9.7% (BDL requirement 9.0%). TTM ROA at an est. ~1.1% in Q1/17 (~1.3% incl. exceptional profits) unchanged from Q1/17 and up from ~1.0% in Q2/16 while TTM ROE at an est. ~12.9% (~15.6% incl. exceptional profits) down from ~13.1% in Q1/17 and ~13.4% in Q2/16. We highlight material contribution to earnings growth from Odea Bank on stronger margins and operating efficiencies in addition to improvement in Egypt and private banking platform. TTM EPS at USD 1.01 (USD 1.26 incl. exceptional profits) from USD 1.05 in Q1/17 and USD 0.97 in Q2/16. Equity-to-asset ratio at 8.7% in Q2/17 up from 8.6% in Q1/17 and 7.8% in Q2/16 while est. BVPS was at USD 9.02 (USD 7.46 to common, +1% QoQ, +4% YoY). In July 2017, i) Bank Audi redeemed and cancelled series F preferred shares issued in May 2012 (1.5 million shares, USD 1.10 at 6%), ii) issued Series J preferred shares expected to constitute additional Tier 1 capital (2.75 million shares, USD 1.10 at 7%) and iii) Odea Bank issued an international bond in the amount of USD 300 million maturing in 2027 and subject to Tier 2 capital treatment under Turkish law.

We favorably view Bank Audi's income diversity across geographical and business segments particularly as risk stabilizes in key foreign markets which should help shares although remain cautious on asset quality given challenging macro environment

We value Bank Audi's diversified income streams as profitability is driven by improvement in NIMs and operating leverage in Turkey, favorable contribution from Egypt and expansion of its private banking platform, while maintaining steady growth in its domestic pillar. We view Bank Audi as an interesting entry point for investors as we expect shares to further benefit from stabilization in risk associated to its key foreign markets adding to attracting dividend yield and favorable outlook for BVPS growth. We remain cautious on asset quality as NPLs trend higher which could weigh on profitability particularly as macro environment remains challenging domestically and regionally.



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