

Flash Note

July 20, 2012

Bank Audi Q2/12 Results

Sector: Banking

Country: Lebanon

Bank Audi's net profits from continuing operations at USD 91.0 million in Q2/12, up 7% year on year

Bank Audi's net profits from continuing operations (which exclude the majority sale in LIA insurance) amounted to USD 91.0 million in Q2/12 up 7% from USD 85.4 million in Q2/11 although below our USD 95.8 million estimate. Estimated operating EPS was USD 0.24 compared to estimated operating EPS of USD 0.23 in Q2/11, just below our USD 0.25 estimate. Net profits and EPS (which include the majority sale in LIA insurance) were USD 135.6 million and USD 0.37, respectively.

The year on year increase in earnings from continuing operations in Q2/12 over Q2/11 can be attributed to i) robust 17% YoY increase in operating income to USD 267.0 million on the back of 8% growth in net interest income and 29% growth in non-interest income ii) improvement in cost efficiencies with a cost-to-income ratio at 42.7% in Q2/12 down from 45.0% in Q2/11. Higher provisions continued to mostly offset bottom line gains as they increased to USD 36.8 million in Q2/12 from USD 31.2 million in Q1/12 and USD 21.5 million in Q2/11. Income tax rate was also higher YoY at 21.7% versus 18.0% for the corresponding period of previous year.

Net profits from continuing operations were USD 91.0 million in Q2/12 compared to our USD 95.8 million estimate, and the asset base totaled USD 28,790 million at the end of Q2/12 compared to our USD 28,697 million estimate, as highlighted in the table below:

Table 1: Bank Audi Q2/12 results vs. FFA Private Bank estimates

USD millions	Q2 12a	FFA Q2 12e	Q1 12a	Q2 11a
Assets	28,790.2	28,696.5	28,661.5	29,081.8
Deposits	24,706.3	24,755.9	24,388.4	25,267.7
Loans	9,076.3	8,644.5	8,865.8	8,566.3
Operating Income	267.0	258.6	271.8	228.2
Net Profits from continuing operations	91.0	95.8	94.5	85.4
Net Profits	135.6	95.8	94.5	89.8
Net Profits (Group Share)	134.2	92.9	93.4	86.6
EPS	0.37	0.25	0.26	0.24
BVPS (to common)	6.01	6.04	6.13	5.57

Source: Bank Audi and FFA Private Bank estimates

Table 2: Summary Income Statement

USD millions except per share data	Q2 12a	Q2 11a	YoY%	H1 12a	H1 11a	YoY%
Net interest income	138.4	128.5	7.7%	285.1	260.7	9.3%
As a % of total operating income	51.8%	56.3%		52.9%	55.7%	
Fees and commission income	46.2	42.8	8.0%	95.0	87.4	8.7%
Trading and investment income	82.3	56.9	44.7%	158.8	120.2	32.1%
Non -interest income	128.6	99.7	28.9%	253.7	207.6	22.2%
As a % of total operating income	48.2%	43.7%		47.1%	44.3%	
Total operating income	267.0	228.2	17.0%	538.8	468.3	15.1%
Personnel expenses	(64.0)	(59.7)	7.3%	(124.8)	(123.5)	1.1%
Non personnel expenses	(50.0)	(43.0)	16.3%	(105.3)	(90.1)	17.0%
Total operating expenses	(114.0)	(102.6)	11.1%	(230.2)	(213.5)	7.8%
Cost- to- income ratio	42.7%	45.0%		42.7%	45.6%	
Pre-provision profit before tax	153.0	125.6	21.8%	308.6	254.7	21.1%
Provisions	(36.8)	(21.5)	71.4%	(67.9)	(36.8)	84.7%
Provisions as a % of pre-provision profit	24.0%	17.1%		22.0%	14.4%	
Profit before tax	116.2	104.1	11.6%	240.7	218.0	10.4%
Income tax	(25.2)	(18.8)	34.2%	(55.1)	(42.2)	30.7%
Income tax rate	21.7%	18.0%		22.9%	19.4%	
Profit after tax from continuing operations	91.0	85.4	6.7%	185.5	175.8	5.5%
Result of discontinued operations	44.5	4.5	895.7%	44.5	4.5	895.7%
Net profits	135.6	89.8	50.9%	230.1	180.2	27.6%
Minority interest	1.4	3.3	-58.2%	2.4	5.5	-56.1%
Net profits (group share)	134.2	86.6	55.0%	227.6	174.7	30.3%
EPS to common (diluted)	0.37	0.24	53.8%	0.62	0.48	30.0%
Estimated non-recurring EPS (diluted)	0.24	0.23				
EPS TTM to common (diluted)	1.14					

Source: Bank Audi

Net profits surge to USD 135.6 million in Q2/12 when taking into account the recent LIA insurance company sale

In June 2012, Bank Audi completed the sale of an 81% stake in its insurance arm LIA insurance sal. The gain generated from this transaction totaled USD 44.5 million which drove Bank Audi's net profits in Q2/12 from USD 91.0 million up to USD 135.6 million, representing a 51% jump in comparison to Q2/11 earnings. The majority sale in the insurance business can be attributed to the fact that regulatory requirements are becoming more stringent on insurance companies owned by banking groups, thus weighing on capital adequacy ratios.

Net interest income up on margin preservation strategy given stagnation in the asset base

Bank Audi's net interest income totaled USD 138.4 million in Q2/12, up 8% from USD 128.5 million in Q2/11 stemming from an improvement in interest margins as earning assets growth lulled as highlighted by a 1% decrease in the asset base between Q2/11 and Q2/12 at roughly USD 29 billion. Interest margins have likely benefited from a strict control in the cost of funds along with an improvement in asset yields. It should be noted that Management has been adopting a margin preservation strategy in light of slower balance sheet growth targeting 2% in net interest margins. Bank Audi's interest spreads totaled 2.09% for the first half of 2012 higher than 1.90% in the first half of 2011.

Non-interest income up 29% YoY in Q2/12 mainly driven by trading and investment income

In Q2/12 Bank Audi saw a 29% increase in non-interest income YoY at USD 128.6 million compared to USD 99.7 million in Q2/11, as trading and investment income picked up 45% to USD 82.3 million along with a growth in fees and commissions income of 8% to USD 46.2 million. Fees and commissions moderated from the impact of weaker trade finance and syndication activity yet remains supported by higher income from retail and personal banking activities. Trading and investment income continued to be supported by active treasury and capital markets operations. Looking at the earnings mix for Q2/12, we note: i) the contribution of non-interest income to total operating income at 48% in Q2/12 up from 44% in Q2/11 and ii) the contribution of fees and commissions to total operating income at 17% in Q2/12 slightly down from 19% for Q2/11.

Higher provisions and taxes weigh on bottom line gains in contrast to continued improvement in cost-efficiencies

Cost-efficiencies improved in Q2/12 as the cost-to-income dropped to 42.7% down from 45.0% in Q2/11, as a 17% increase in operating income surpassed an 11% growth in operating expenses. In Q2/12, operating expenses were driven by a 7% increase in personnel expenses to USD 64 million and an increase of 16% in non-personnel expenses to USD 50 million. While bank efficiencies improved, the increased provisions as well as the higher tax rate weighed on bottom line gains. Provisions were USD 36.8 million in Q2/12 compared to USD 31.2 million in Q1/12 and USD 21.5 million in Q2/11 in light of regional developments. Income tax rate stood at 21.7% in Q2/12, up from 18.0% in Q2/11.

Table 3: Summary Balance Sheet

<i>USD millions except per share data</i>	Q2 12a	Q1 12a	Q4 11a	QoQ%	YTD%
Cash and balances	5,897.4	5,883.8	5,773.4	0.2%	2.1%
Due from banks and other financial institutions	2,819.7	2,906.9	3,171.9	-3.0%	-11.1%
Financial assets	10,100.5	10,049.1	10,280.6	0.5%	-1.8%
Loans and advances	9,076.3	8,865.8	8,594.3	2.4%	5.6%
Intangible assets and goodwill	179.6	184.7	182.4	-2.8%	-1.6%
Other assets	716.8	771.3	734.3	-7.1%	-2.4%
Total assets	28,790.2	28,661.5	28,736.8	0.4%	0.2%
Due to Central Banks	394.6	267.4	88.5	47.6%	345.9%
Due to banks and other financial institutions	649.9	798.3	668.4	-18.6%	-2.8%
Deposits	24,706.3	24,388.4	24,797.7	1.3%	-0.4%
<i>Immediate liquidity to deposits</i>	<i>35.3%</i>	<i>36.0%</i>	<i>36.1%</i>	<i>-70bps</i>	<i>-80bps</i>
<i>Loans- to- deposits</i>	<i>36.7%</i>	<i>36.4%</i>	<i>34.7%</i>	<i>+30bps</i>	<i>+200bps</i>
Other liabilities	460.9	732.2	825.3	-37.1%	-44.2%
Total liabilities	26,211.7	26,186.3	26,379.8	0.1%	-0.6%
Shareholders' equity	2,101.9	2,141.6	2,013.3	-1.9%	4.4%
Preferred shares	400.0	250.0	250.0	60.0%	60.0%
Minority interest	76.6	83.6	93.6	-8.3%	-18.2%
Total shareholders' equity	2,578.5	2,475.2	2,357.0	4.2%	9.4%
Total liabilities and shareholders' equity	28,790.2	28,661.5	28,736.8	0.4%	0.2%
Book value per share	7.16	6.84	6.48	4.6%	10.5%
Book value per share to common	6.01	6.13	5.76	-1.9%	4.4%
Tangible book value per share to common	5.50	5.60	5.24	-1.8%	5.0%

Source: Bank Audi

Consolidated deposits up 1% in Q2/12 while the deposit base in Syria continues to shrink

Bank Audi's asset base remains mainly funded by deposits with a deposits-to-assets ratio at 86% at the end of Q2/12. The Bank's consolidated assets remained flat in Q2/12 to USD 28,790 million at the end of the quarter while deposits grew by 1% to USD 24,706 million accelerating from Q1/12 despite the continued contraction in deposits in the Syrian entity. The loan portfolio edged up 2% in Q2/12 to USD 9,076 million growing 6% since the beginning of the year, highlighting more vitality in lending activity compared to deposit accumulation. The loans-to-deposits ratio picked up to 36.7% at the end of Q2/12 from 36.4% in Q1/12 and 34.7% at year-end 2011, while the immediate liquidity to deposits ratio stood at 35.3% slightly down from 36% in Q1/12 and Q4/11.

Slight increase in NPL levels in Q2/12 and growing provisions amidst tougher operating conditions in Syria

Bank Audi's consolidated NPLs (doubtful loans to gross loans) stood at 2.9% by the end of Q2/12 up from 2.7% in Q1/12 and 2.9% in Q4/11, highlighting a recent reversal in asset quality. The coverage of gross doubtful loans by specific loan loss provisions was 77% unchanged from Q4/11 although down from 82% in Q1/12. Bad asset charges reached USD 36.8 million in Q2/12 higher yoy and sequentially.

Gross doubtful loans increased in Syria from 5.6% in 2011 to 13.1% in H1/12, while improving from 3.2% in 2011 to 2.8% in Egypt. Operating profits in Egypt have improved in H1/12 and trend favorably for the remainder of the year although deteriorated significantly in Syria.

Capital adequacy ratio at 12.2% as per Basel III improved as profitability ratios were roughly unchanged

Bank Audi's capital adequacy ratio (Basel III) was 12.2% up from 10.7% in Q1/12, highlighting stronger capitalization levels on account of the increase in capital from the recent preferred share issue and the disinvestment from the insurance business. In parallel the firm's equity to assets ratio improved to 9.0% from 8.6% in Q1/12 and 8.2% in Q4/11. The operating ROA was unchanged at 1.3% from Q1/12. The reported TTM EPS (including the majority sale in LIA) was USD 1.14 while the book value per share is estimated at USD 7.16 (USD 6.01 to common). The current P/E is now 5.0x (including the majority sale in LIA), while estimated P/B is 0.79x (P/B 0.95x to common). The dividend yield is 7.0%.

Recent news include the increase in the Bank's capital through the issuance of the Series F preferred shares

Bank Audi increased its capital through the issuance of 1,500,000 Series F preferred shares. The price of subscription amounted to USD 100 per share. Consequently the capital (and issue premium) made up of preferred shares increased by USD 150 million to USD 400 million at the end of Q2/12 from USD 250 million in the previous quarter.

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