

Flash Note

July 19, 2013

Bank Audi Q2/13 Results

Sector: Banking

Country: Lebanon

MARKETWEIGHT

Target Price	USD 7.00
Closing Price	USD 6.10
Year to Date %	0.2%
52 Week Range	5.15 -6.90
Market Cap.	USD 2,133.5 million
Dividend Yield	6.6%
P/E (TTM)	7.0x
P/B to Common	1.00x

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

Source: Bloomberg, FFA Private Bank

Net profits at USD 103 million in Q2/13 while EPS at USD 0.26 in line with estimates

Bank Audi's net profits amounted to USD 103 million in Q2/13, 20% up from USD 85.5 million in Q1/13, and 9% up from USD 94.1 million in Q2/12 (excluding proceeds from LIA sale in Q2/12, yet down 24% as reported). Diluted EPS was USD 0.26 higher than USD 0.23 in Q1/13 and USD 0.24 in Q2/12 (from continuing operations). This increase in the bottom line in Q2/13 can be attributed to an increase in operating income to USD 300 million from i) higher net interest income (+12% QoQ and YoY) from expansion in earning assets driven by Turkey and ii) higher financial gains (+41% QoQ, + 18% YoY) in the context of a roughly stable income stream from fees and commissions. In Q2/13, strong operating income offset pressures from relatively high yet moderating provisioning levels and operating expenses, thus translating into earnings growth.

As highlighted in table 1 net earnings were slightly above our USD 98 million estimate while EPS of USD 0.26 was in line. This can be attributed to a higher than expected operating income (USD 300 million vs. est. USD 283 million) from higher than expected financial gains which was counterbalanced by higher than expected provisions (USD 32 million vs. est. USD 21 million).

Table 1: Bank Audi Q2/13 results vs. FFA Private Bank estimates

USD million	Q2/13a	FFA Q2/13e	Q1/13a	Q2/12a	QoQ %	YoY %
Net interest income	159	157	142	142	12%	12%
Operating income	300	283	255	272	18%	10%
Net profits (*)	103	98	86	135	20%	-24%
Diluted EPS (*)	0.26	0.26	0.23	0.36	13%	-30%
Assets	33,694	34,782	33,284	28,790	1%	17%
Deposits	29,162	29,994	28,735	24,706	1%	18%
Loans	12,710	12,201	11,587	9,076	10%	40%
BVPS to common	6.12	6.47	6.36	6.01	-4%	2%
FFA Cost-to-income ratio	47.1%	48.7%	51.8%	42.5%		
Loans-to-deposits ratio	43.6%	40.7%	40.3%	36.7%		

Source: Bank Audi and FFA Private Bank estimates

Note: (*) Net profits and diluted EPS for Q2/12 include the proceeds from the sale of LIA

Table 2: Summary Income Statement

USD million	Q2/13	Q1/13	Q2/12	QoQ%	YoY %	H1/13	H1/12	YoY%
Net interest income	159.0	141.6	141.7	12.3%	12.2%	300.6	284.5	5.6%
As a % of total operating income	53.0%	55.6%	52.2%			54.2%	52.9%	
Fees and commissions income	43.9	43.9	47.4	0.2%	-7.3%	87.8	94.7	-7.3%
Trading and investment income	97.2	69.1	82.6	40.7%	17.7%	166.3	158.6	4.9%
Non -interest income	141.2	113.0	130.0	25.0%	8.6%	254.1	253.3	0.3%
As a % of total operating income	47.0%	44.4%	47.8%			45.8%	47.1%	
Total operating income	300.2	254.5	271.7	17.9%	10.5%	554.7	537.9	3.1%
Personnel expenses	(78.3)	(72.8)	(61.6)	7.5%	27.0%	(151.0)	(121.3)	24.5%
Non-personnel expenses	(63.0)	(59.0)	(54.0)	6.7%	16.7%	(122.0)	(105.9)	15.2%
Total operating expenses	(141.2)	(131.8)	(115.6)	7.2%	22.2%	(273.0)	(227.2)	20.2%
Cost- to- income ratio	47.1%	51.8%	42.5%			49.2%	42.2%	
Pre-provision profit before tax	158.9	122.8	156.1	29.5%	1.8%	281.7	310.6	-9.3%
Provisions	(32.2)	(14.2)	(36.8)	126.5%	-12.5%	(46.4)	(67.9)	-31.7%
Provisions as a % of pre-provision profit	20.3%	11.6%	23.6%			16.5%	21.9%	
Profit before tax	126.7	108.5	119.3	16.8%	6.2%	235.3	242.7	-3.1%
Income tax	(23.0)	(23.0)	(25.3)	0.0%	-8.8%	(23.0)	(29.5)	-22.0%
Income tax rate	18.2%	21.2%	21.2%			9.8%	12.2%	
Profit after tax from continuing operations	102.5	85.5	94.1	19.9%	9.0%	188.0	187.9	0.1%
Result of discontinued operations	(0.0)	0.0	41.0	-	-	0.0	41.6	-
Net profits	102.7	85.5	135.1	20.1%	-23.9%	188.0	229.6	-18.1%
Minority interest	(6.7)	(0.3)	(1.4)	-	-	(7.0)	(2.4)	-
Net profits (group share)	96.0	85.2	133.7	12.6%	-28.2%	181.0	227.1	-20.3%
EPS to common (basic)	0.26	0.23	0.36	12.6%	-29.7%	0.48	0.62	-22.4%
EPS to common (diluted)	0.26	0.23	0.36	12.6%	-29.7%	0.48	0.62	-22.4%
Estimated diluted EPS from continuing operations	0.26	0.23	0.24	13.0%	8.3%	0.48	0.50	-4.0%
EPS TTM to common (diluted) (*)	0.87							

Source: Bank Audi

Note: (*) The EPS TTM to common diluted reflects negative impacts from discontinued operations in Q3/12 and Q4/12

Net interest income up in Q2/13 mostly driven by expansion in earning assets

Bank Audi's net interest income totaled USD 159.0 million in Q2/13, up 12% from Q1/13 and Q2/12 stemming from solid balance sheet expansion and earning assets growth, driven by the Turkish entity. In fact spreads have stabilized QoQ (although down YoY) as the low interest rate environment was offset by improving interest margins in Turkey (which we estimate at +20 bps). Statistics from the ABL reveal that Lebanese banks are still operating in a low interest environment, limiting potential to improve earning asset yields. Figures highlight that spreads in USD have decreased to 1.44% in May 2013 down from 1.83% one year earlier driven by i) lower rates on LIBOR (average 3 months on USD deposits down to 0.27% down from 0.47%), ii) lower yields on Eurobonds (weighted average down to 6.96% from 7.39%), iii) lower rates on deposits at the BDL (average down to 2.53% from 3.20%) and lower lending rates (weighted average down to 6.94% from 7.09%). On the LBP side, it should be noted that yields on T-bills and CDs issued were also lower YoY (at 6.64% and 8.84% respectively in May 2013 down from a respective 6.69% and 9.27% a year earlier). Looking ahead, Bank Audi's margins could benefit from redeployment of liquidity and investments into more attractive yielding avenues including lending in Turkey.

Non-interest income up to USD 141 million in Q2/13 on higher financial gains and a roughly stable income from fees and commissions

In Q2/13 Bank Audi saw an 9% increase in non-interest income YoY at USD 141 million compared to USD 130 million in Q2/12, as fees and commissions income nudged down to USD 44 million from USD 47 million which was totally offset by higher trading and investment income which increased 18% YoY to USD 97 million on the back of higher gains on financial assets. Looking at the earnings mix for Q2/13, we note: i) the contribution of non-interest income to total operating income at 47% in Q2/13 roughly unchanged YoY and ii) the contribution of fees and commissions to total operating income at 15% in Q2/13 compared to 17% in Q2/12 and in Q1/13. In the medium term, Bank Audi is seeking a breakdown of revenues between interest income and non-interest income at 65%/35%.

More favorable operating leverage in Q2/13 driven by stronger operating income and as Turkey launch costs subside

Operating leverage improved in Q2/13 as the cost-to-income decreased to a more sustainable level at 47% down from 52% in previous quarter (yet still higher than its Pre-Turkey level at 43% in Q2/12). This improvement QoQ can be attributed to an 18% increase in operating income surpassing a 7% growth in total operating expenses. Total opex amounted to USD 141 million in Q2/13 and could be partly attributed to the expansion of operations in Turkey encompassing a network of 21 branches and 649 employees compared to 9 branches and 523 employees at the end of Q1/13. We note that Bank Audi seeks to breakeven in Turkey over the short to medium term as we highlight a net loss of USD 14 million in Q1/13 which improved to USD 4 million in Q2/13. In parallel, provisions remained elevated with a net allocation of USD 32 million in Q2/13 slightly lower YoY, yet higher than USD 23 million in previous quarter. It seems like provisioning pressures stopped escalating in 2013 in light of a potential cap in NPL levels given that the Bank have been downsizing its loan portfolio in Syria thus limiting the impact on consolidated asset quality. Income tax rate stood at 18% in Q1/13, down from 21% in Q1/13 and Q2/12.

Table 3: Summary Balance Sheet

USD million	Q2/13	Q1/13	Q4/12	QoQ%	YTD%
Cash and balances	6,437.5	6,663.6	6,276.9	-3.4%	2.6%
Due from banks and other financial institutions	2,901.7	3,473.3	3,543.1	-16.5%	-18.1%
Financial assets	10,766.6	10,656.9	10,209.5	1.0%	5.5%
Loans and advances	12,709.7	11,586.7	10,428.5	9.7%	21.9%
Intangible assets and goodwill	177.8	175.9	180.7	1.1%	-1.6%
Other assets	701.2	728.0	663.1	-3.7%	5.7%
Total assets	33,694.5	33,284.4	31,301.8	1.2%	7.6%
Due to Central Banks	98.8	88.9	88.3	11.1%	11.9%
Due to banks and other financial institutions	1,203.6	1,184.5	1,229.0	1.6%	-2.1%
Deposits	29,162.1	28,735.4	26,804.6	1.5%	8.8%
<i>Immediate liquidity to deposits</i>	<i>32.0%</i>	<i>35.3%</i>	<i>36.6%</i>		
<i>Loans- to- deposits</i>	<i>43.6%</i>	<i>40.3%</i>	<i>38.9%</i>		
Other liabilities	546.4	592.7	502.5	-7.8%	8.7%
Total liabilities	31,010.9	30,601.5	28,624.4	1.3%	8.3%
Shareholders' equity	2,141.9	2,222.8	2,213.2	-3.6%	-3.2%
Preferred shares	500.0	400.0	400.0	25.0%	25.0%
Minority interest	41.7	60.1	64.2	-30.6%	-35.1%
Total shareholders' equity	2,683.6	2,682.9	2,677.4	0.0%	0.2%
Total liabilities and shareholders' equity	33,694.5	33,284.4	31,301.8	1.2%	7.6%
Book value per share	7.55	7.50	7.48	0.7%	1.0%
Book value per share to common	6.12	6.36	6.33	-3.6%	-3.3%
Tangible book value per share to common	5.62	5.85	5.82	-4.0%	-3.4%

Source: Bank Audi

Key balance sheet indicators mostly driven by Turkish operations and offsetting shrinkage seen elsewhere

On the balance sheet side, the Bank's assets, deposits and loans grew by 1.2%, 1.5% and 9.7% respectively in Q2/13 to USD 33.7 billion, USD 29.2 billion and USD 12.7 billion respectively at the end of the quarter. This increase stems from operations in Turkey and has offset the shrinkage seen elsewhere. In fact assets, deposits and loans from Turkish operations grew by 35%, 19% and 57% respectively during Q2/13 amounting to USD 5.8 billion, USD 4.3 billion and USD 3.3 billion at the end of the quarter (equivalent to a contribution of 17% in total assets, 15% in total deposits and 26% in total loans), which raised the contribution of entities abroad to consolidated assets from 32.4% at end-December 2012 to 39% at end-June 2013 in line with Management's objective to reach a more balanced breakdown of assets between Lebanon and abroad. We note that the expansion of Turkish operations fully offset further asset contractions in Syrian (most notably) and Egyptian operations. During Q2/13 the assets of Bank Audi Syria has contracted to USD 337 million while assets in Egypt declined to USD 2,883 million and those of Lebanon amounted to USD 20,679 million (lower than USD 21,109 million in previous quarter) on account of challenging political and economic conditions.

Looking at the first half of the year, we note a strong growth in key balance sheet indicators at 8%, 9% and 22% respectively for assets, deposits and loans. The loans-to-deposits ratio reached 44% (well above the sector average at 34%) which could be attributed to fast lending growth in Turkey while the immediate liquidity to deposits ratio stood at 32% (lower QoQ and Ytd).

We favorably view a gross NPLs ratio at a relatively low 2.3% level in comparison to peers

We favorably view Bank Audi's consolidated gross NPLs improving to 2.3% in Q2/13 down from 2.7% by the end of Q1/13 and lower than peers under coverage. The coverage of gross doubtful loans by specific loan loss provisions was 78% in Q2/13 up from 71% in Q1/13 and highlighting satisfactory provisioning levels. Additionally, we favorably view a further decrease in bad debts written off to around USD 5 million in H1/13 compared to a total of USD 105 million for the full year 2012. These indicators give comfort to our view that Bank Audi has potentially seen a ceiling on provision levels which should eventually reverse gradually over time and favorably impact the bottom line.

CAR III at 10.3% on account of higher risk weighted assets and ROE estimated at around 14.2%

Bank Audi's capital adequacy ratio (Basel III) went down from 11% in Q1/13 to 10.3% and the firm's equity to assets ratio was roughly stable at 8.0%. On another hand, the TTM ROA stood at 1.2% unchanged from previous quarter while the TTM ROE is estimated around 14.2% compared to an estimated 14.5% in Q4/12. The TTM EPS was USD 0.87 in Q2/13 while book value per share is estimated at USD 7.55 (USD 6.12 to common). Based on today's listed share price, Bank Audi is trading at 7.0x P/E, 0.81x P/B (P/B to common of 1.00x) and dividend yield of 6.6%.

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