

Flash Note

July 31, 2014

Bank Audi Q2/14 Results

Sector: Banking

Country: Lebanon

MARKETWEIGHT

Target Price	USD 7.00
Closing Price	USD 6.35
Year to Date %	+1.8%
52 Week Range	6.00 - 6.94
Market Cap.	USD 2,220.9 million
Dividend Yield	6.3%
P/E (TTM)	7.9x
P/B to Common	1.01x

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

Source: Bloomberg, FFA Private Bank

Net profits at USD 104 million in Q2/14, largely above our USD 91 million estimate from stronger operating income as net interest income, fees and commissions and financial gains came in higher

Bank Audi's net profits were at USD 104 million in Q2/14 (+21% QoQ, +1% YoY) largely above our USD 91 million estimate. Diluted EPS was USD 0.27 vs. USD 0.22 in Q1/14, USD 0.26 in Q2/13 and FFA est. USD 0.23. Earnings in Q2/14 were mostly driven by a surprise to the upside for net interest income (USD 192 million vs. FFA est. USD 184 million), fees and commissions (USD 63 million vs. FFA est. USD 51 million) and trading&investment income (USD 84 million vs. FFA est. USD 60 million). Earnings were also helped by an improvement in asset quality while provisions were lower at USD 15 million (below estimated USD 19 million), justified by lower NPLs down to 2.5%. We note that cost-to-income came in at 58% in Q2/14 above estimated 55% highlighting that the increase in earnings in Q2/14 was driven by higher revenues rather than improved efficiencies. Tax rate was at 19% in Q2/14 just below our estimated 20%. We note that Odea Bank reported its first set of profits in Q2/14 following quarterly losses since operations were launched in Turkey. On the balance sheet side, assets, deposits and loans grew in the 4%-5% range QoQ, slightly above our estimated 3%-4% range and mainly driven by operations in Turkey as well as Lebanon and Egypt to a lesser extent. LDR reached 47.2% at the end of Q2/14 vs. FFA est. 47.9%. Looking at H1/14, net profits edged up slightly YoY (+1%) to USD 190 million with an EPS at USD 0.49 vs. USD 0.48 in H1/13. Key balance sheet indicators grew by ~9% Ytd.

Table 1: Bank Audi Q2/14 results vs. FFA Private Bank estimates

USD million	Q2/14a	FFA Q2/14e	Q1/14a	Q2/13a	QoQ %	YoY %
Net interest income	192	184	182	160	5%	20%
Operating income	339	294	286	300	19%	13%
Net profits	104	91	86	102	21%	1%
Diluted EPS	0.27	0.23	0.22	0.26	21%	4%
Assets	39,262	38,330	37,813	33,694	4%	17%
Deposits	33,960	33,225	32,320	29,162	5%	16%
Loans	16,034	15,928	15,293	12,710	5%	26%
BVPS to common	6.28	6.51	6.45	6.12	-3%	2%
FFA Cost-to-income ratio	57.7%	55.0%	54.9%	47.1%		
Loans-to-deposits ratio	47.2%	47.9%	47.3%	43.6%		

Source: Company reports and FFA Private Bank estimates

Table 2: Summary Income Statement

USD million	Q2/14	Q1/14	Q2/13	QoQ%	YoY %	H1/14	H1/13	YoY %
Net interest income	191.8	182.4	160.2	5.2%	19.7%	374.2	301.8	24.0%
As a % of total operating income	56.6%	63.8%	53.4%			59.9%	54.4%	
Fees and commissions income	63.0	52.1	43.9	21.0%	43.5%	115.1	87.8	31.1%
Trading and investment income	84.0	51.2	96.0	64.2%	-12.5%	135.2	165.1	-18.1%
Non-interest income	147.1	103.3	140.0	42.4%	5.1%	250.4	252.9	-1.0%
As a % of total operating income	43.4%	36.2%	46.6%			40.1%	45.6%	
Total operating income	338.9	285.7	300.2	18.6%	12.9%	624.6	554.7	12.6%
Personnel expenses	(112.2)	(88.8)	(79.4)	26.3%	41.3%	(201.1)	(152.2)	32.1%
Non-personnel expenses	(83.4)	(68.1)	(61.8)	22.4%	34.9%	(151.5)	(120.8)	25.4%
Total operating expenses	(195.6)	(157.0)	(141.2)	24.6%	38.5%	(352.5)	(273.0)	29.1%
Cost- to- income ratio	57.7%	54.9%	47.1%			56.4%	49.2%	
Pre-provision profit before tax	143.3	128.7	158.9	11.4%	-9.8%	272.1	281.7	-3.4%
Provisions	(14.5)	(20.1)	(32.4)	-27.7%	-55.2%	(34.6)	(46.6)	-25.8%
Provisions as a % of pre-provision profit	10.1%	15.6%	20.4%			12.7%	16.6%	
Profit before tax	128.8	108.6	126.5	18.6%	1.8%	237.5	235.0	1.0%
Income tax	(24.8)	(22.9)	(24.0)	8.4%	3.7%	(47.7)	(47.0)	1.6%
Income tax rate	19.3%	21.1%	18.9%			20.1%	20.0%	
Net profits	104.0	85.8	102.5	21.3%	1.5%	189.8	188.0	0.9%
Minority interest	(3.1)	(2.0)	(6.7)			(5.1)	(7.0)	
Net profits (group share)	100.9	83.7	95.7	20.5%	5.4%	184.6	181.0	2.0%
EPS to common (basic)	0.27	0.22	0.26	20.8%	4.5%	0.49	0.48	1.2%
EPS to common (diluted)	0.27	0.22	0.26	20.8%	4.5%	0.49	0.48	1.2%
EPS TTM to common (diluted)	0.80							

Source: Company reports

Net interest income up to USD 192 million (+5% QoQ, +20% YoY), from higher balance sheet volumes and margins improvement

Bank Audi's net interest income totaled USD 192 million in Q2/14 (+5% QoQ, +20% YoY). Looking at the first half of 2014, net interest income increased by 24% YoY to USD 374 million from USD 302 million favorably impacted by solid growth in earning assets and widening net interest margins. Figures provided by Management reveal that interest spreads were up to 2.04% in H1/14 from 1.92% in H1/13 driven largely by Odea Bank as we note that Bank Audi is challenged domestically by limited room to materially decrease the cost of funds and/or improve asset yields. Net interest income generated from Odea Bank in H1/14 increased to USD 78 million up nearly ~ USD 60 million from H1/13 from both balance sheet expansion and margins improvement.

We highlight that Lebanese banks have been coping with a low interest environment, placing pressures on earning asset yields within little room to further decrease the cost of funds. Figures from the ABL reveal that both spreads in USD and LBP are on a downward trend in May 2014 compared to one year earlier. Spreads in USD decreased to 1.21% in May 2014 down from 1.44% one year earlier which has a substantial impact on Lebanese Banks' profitability given that the bulk of their liquidity is in USD. This decrease was driven by a 4 bps increase in the cost of funds in addition to a 19 bps decline in the weighted return on uses of funds from i) lower average rate on USD deposits at the BDL (down 43 bps to 2.10%) ii) lower weighted average yields on Eurobonds (down 38 bps to 6.58%), iii) lower 3-month Libor on USD deposits (down 4 bps to 0.23%). On the LBP side, we highlight that interest spreads were also lower in May 2014 from one year earlier (1.04% vs 1.30% in May 2013) mainly from a drop of 63 bps in the weighted average rate on CDs issued by the BDL to 8.21%.

Surge in fees and commissions in Q2/14 to reach USD 63 million (+21% QoQ, +43% YoY)

Bank Audi's net fees and commissions income surged in Q2/14 to USD 63 million (+21% QoQ, +43% YoY), which we positively view given their less volatile nature compared to financial gains. On the other hand, financial gains (at ~USD 84 million in Q2/14) were ~12% lower YoY yet constituted an increase (~+64%) from previous quarter. Non-interest income totaled USD 147 million for the quarter. The operating income mix for Q2/14 highlight a higher contribution from core income (including net interest income and fees and commissions income) and a lower contribution from financial gains compared to Q2/13, at 75%/25% in Q2/14 versus 68%/32% in Q2/13. In the first half of 2014, non-interest income totaled USD 250 million roughly unchanged YoY, as higher fees and commissions were totally offset by lower financial gains.

Table 3: Summary Balance Sheet

USD million	Q2/14	Q1/14	Q4/13	QoQ%	YTD%
Cash and balances	7,326.3	7,003.2	6,097.6	4.6%	20.2%
Due from banks and other financial institutions	3,907.8	3,453.3	3,242.1	13.2%	20.5%
Financial assets	10,957.7	11,066.2	11,190.2	-1.0%	-2.1%
Loans and advances	16,034.3	15,293.3	14,712.9	4.8%	9.0%
Intangible assets and goodwill	194.9	194.6	194.6	0.1%	0.1%
Other assets	841.3	802.8	753.8	4.8%	11.6%
Total assets	39,262.3	37,813.3	36,191.3	3.8%	8.5%
Due to Central Banks	237.0	189.1	167.2	25.3%	41.7%
Due to banks and other financial institutions	1,106.1	1,246.3	1,191.4	-11.2%	-7.2%
Deposits	33,959.8	32,320.0	31,095.1	5.1%	9.2%
<i>Immediate liquidity to deposits</i>	<i>33.1%</i>	<i>32.4%</i>	<i>30.0%</i>		
<i>Loans- to- deposits</i>	<i>47.2%</i>	<i>47.3%</i>	<i>47.3%</i>		
Subordinated debt	507.4	505.3	356.3	0.4%	42.4%
Other liabilities	714.4	756.2	685.1	-5.5%	4.3%
Total liabilities	36,524.6	35,016.8	33,495.1	4.3%	9.0%
Shareholders' equity	2,195.4	2,255.2	2,154.4	-2.7%	1.9%
Preferred shares	500.0	500.0	500.0	0.0%	0.0%
Minority interest	42.3	41.3	41.8	2.2%	1.2%
Total shareholders' equity	2,737.6	2,796.5	2,696.2	-2.1%	1.5%
Total liabilities and shareholders' equity	39,262.3	37,813.3	36,191.3	3.8%	8.5%
Book value per share	7.71	7.88	7.59	-2.2%	1.5%
Book value per share to common	6.28	6.45	6.16	-2.7%	1.9%
Tangible book value per share to common	5.72	5.89	5.60	-2.9%	2.1%

Source: Company reports

Cost-to-income at 58% in Q2/14, reflecting weaker efficiencies sequentially and YoY, partly on account of the expansion in Turkey

The cost-to-income was at 58% in Q2/14 highlighting lower efficiencies QoQ and YoY as the growth in opex (+25% QoQ, +38% YoY) surpassed the one in operating income (+19% QoQ, +13% YoY), which partly reflects the expansion in Turkey, where Bank Audi built USD 9.6 billion in assets and a network of 45 branches (including kiosk branches) in 20 months of activity. Odea Bank reported its first set of profits following quarterly losses since operations were launched in Turkey with net profits of USD 3.3 million in Q2/14 accounting for 3% of consolidated net profits and noting that management is looking for greater contribution from Turkey.

We also note that the share of personnel expenses in total opex remained roughly flat at 57% in Q2/14. Looking at the first half of 2014, cost-to-income was also higher at 56% for H1/14 vs. 49% for H1/13.

Improved asset quality with the gross NPL ratio down to 2.5% translating into lower cost of risk

Bank Audi's consolidated gross NPLs decreased to 2.5% in Q2/14 from 2.9% in previous quarter, still well contained below the 3.0% level and lower than peers under coverage. Justified by lower NPLs, we note a decrease in the cost of risk in Q2/14, as net allocated provisions amounted to USD 15 million in Q2/14 (lower QoQ and YoY). Estimated cost of risk for Q2/14 is at 0.4%, lower from 0.5% in previous quarter and 1.0% in Q2/13. For the first half of 2014, net allocated provisions were also lower at USD 35 million compared to USD 47 million in the corresponding period of previous year with a cost of risk at 0.4% in H1/14 vs. 0.7% in H1/13.

Solid growth in key balance sheet indicators in Q2/14, mainly driven by Turkish operations as well as Lebanon and Egypt to a lesser extent

On the balance sheet side, the Bank's assets, deposits and loans grew by 4%-5% in Q2/14 to USD 39.3 billion, USD 34.0 billion and USD 16.0 billion respectively at the end of the quarter. This increase was mainly driven by operations in Turkey where the Bank operates a network of 45 branches with a strategy to build a franchise ranking second to Lebanon in terms of size and earnings. In fact assets, deposits and loans from Turkish operations grew by 9%, 14% and 12% respectively during Q2/14 amounting to USD 9.6 billion, USD 7.9 billion and USD 6.7 billion at the end of the quarter (equivalent to a contribution of 24% in total assets up from 23% in Q1/14). Lebanon and Egypt contribution to total assets remained stable at 55% and 9% respectively in Q2/14, which along with Turkey represent the three main pillars of Bank Audi's growth strategy. Although unchanged from previous quarter, the loans-to-deposits ratio at 47% is well above the Lebanese banking sector average (~35%), attributed to fast lending growth driven by Turkey (Odea Bank's LDR at ~ 85%). Looking at the first half of 2014, consolidated assets, deposits and loans grew by ~9% YTD.

While Bank Audi should continue to focus its growth strategy around Lebanon, Turkey and Egypt, Management is also looking to consolidate its presence in Egypt and Jordan, to increase efficiencies in its domestic market Lebanon and to focus on the development of its private banking activities. The medium term expansion plans under consideration for Bank Audi includes i) a branching out in Iraq with 7 licenses acquired so far, ii) an interest in UK, Latin America and Sub-Saharan Africa.

CAR III at 12.3% in Q2/14, while profitability ratios were flat to slightly up

Bank Audi's capital adequacy ratio (Basel III) nudged down to 12.3% from 12.5% in Q1/14. In parallel, the equity-to-assets ratio was at 7.0% compared to 7.4% in previous quarter. Looking at profitability, the TTM ROA stood at an estimated 0.84% roughly unchanged from previous quarter while the TTM ROE is estimated at around 11.3% vs. 11.1% in previous quarter. The TTM EPS was USD 0.80 in Q2/14 while book value per share is estimated at USD 7.71 (USD 6.28 to common).

Valuation at attractive levels (P/B: 1.01x, P/E: 7.9x, div %: 6.3%) as growth and profitability (albeit improves) lags behind regional peers

Based on today's listed share price of USD 6.35 (1.8% up so far in 2014), Bank Audi is trading at 7.9x P/E, 0.82x P/B (P/B to common of 1.01x) and dividend yield of 6.3%, with dividends for 2013 paid earlier in April 2014 at USD 0.40 per common share (LBP 603 before a 5% tax), unchanged from last year. Bank Audi's listed shares reflect a lower multiple relative to regional peers, likely looking for an acceleration in profits to drive EPS growth, ROE and capitalization levels closer to regional peers. While we value the Company's improved results and recent positive outcome from the execution of its growth strategy, we expect the valuation to trend towards regional peers, upon a sustainable return to growth and profitability.

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