Flash Note - Bank Audi Q3/15 Results

Sector: Banking
Country: Lebanon

MARKETWEIGHT

Target Price	USD 7.00
Closing Price	USD 5.98
Year to Date %	-0.3%
52 Week Range	USD 5.50 - 6.99
Market Cap.	USD 2,391 million
Dividend Yield	6.7%
P/E (TTM)	7.1x
P/B to Common	0.87x

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

Net profits were at USD 102 million in Q3/15 (flat QoQ, +13% YoY) above our USD 99 million estimate on higher than expected core income and lighter OPEX, partially offset by lower financial gains

Bank Audi kicked off the Q3/15 Lebanese banks earnings season, posting net profits at USD 102 million in Q3/15 (flat QoQ, +13% YoY) above our USD 99 million estimate. Diluted EPS was at USD 0.23 unchanged from Q2/15 and in line with FFA estimate of USD 0.23. Despite stronger than expected core income (net interest income and fees and commissions to a lesser extent), total operating income came in lower than our estimates mainly from lower than expected financial gains (trading and investment income). The negative variance to our expectations was offset by lower than expected opex (cost-to-income ratio improved to ~53% in Q3/15 below our 56% estimate) and income tax, despite slightly higher than expected provisions. Provisions were higher than our forecast at USD 37 million in Q3/15 equivalent to an estimated 86 bps annualized cost of risk, higher than Q2/15 cost of risk of 67 bps, on account of stronger than expected collective provisions as credit quality remain stable QoQ. NPL ratio was at 3.2% in Q3/15 slightly above Q2/15 level of 3.1%, still lower than peers under coverage. Tax rate was at 20.4% from 18.6% in Q2/15 but lower than our estimate of 23.0%. Assets, deposits and loans' sequential growth was flat to negative, while YoY growth was at +6%, +6% and +7% respectively, in line with our estimates, despite FX pressures in key international markets and challenging operating conditions. On a YTD basis, balance sheet grew +1% in US Dollar terms, and +5% excluding Egyptian Pound and Turkish Lira devaluation. LDR reached 47.5% at the end of Q3/15 vs. FFA est. 46.6%. Net profits at 9M/15 rose +9% YoY to USD 304 million with EPS at USD 0.69 vs. USD 0.71 in 9M/14 (due to capital increase).

Table 1: Bank Audi Q3/15 results vs. FFA Private Bank estimates

USD million except per share data	Q3/15a	FFA Q3/15e	Q2/15a	Q3/14a	QoQ %	YoY %
Net interest income	260	237	234	194	11%	34%
Operating income	353	369	336	335	5%	5%
Net profits	102	99	102	90	0%	13%
Diluted EPS to common	0.23	0.23	0.23	0.22	2%	6%
Assets	42,358	41,925	42,310	39,889	0%	6%
Deposits	35,829	36,073	36,106	33,918	-1%	6%
Loans	17,015	16,801	17,035	15,926	0%	7%
BVPS to common	6.90	7.04	6.78	6.32	2%	9%
FFA Cost-to-income ratio	53.2%	56.0%	54.2%	55.3%		
Loans-to-deposits ratio	47.5%	46.6%	47.2%	47.0%		

Source: Company reports and FFA Private Bank estimates

Table 2: Summary Income Statement

USD million	Q3/15a	Q2/15a	Q3/14a	QoQ%	YoY%	9M/15a	9M/14a	YoY%
Net interest income	**260.3**	**233.9**	**194.3**	**11.3%**	**33.9%**	**716.7**	**586.0**	**22.3%**
As a % of total operating income	73.8%	69.6%	58.0%			69.7%	61.3%	
Fees and commissions income	71.2	66.7	65.8	6.8%	8.3%	197.1	180.9	8.9%
Trading and investment income	21.0	35.2	74.9	-40.3%	-71.9%	113.8	188.5	-39.6%
Non-interest income	**92.2**	**101.9**	**140.7**	**-9.5%**	**-34.4%**	**310.9**	**369.4**	**-15.8%**
As a % of total operating income	26.2%	30.4%	42.0%			30.3%	38.7%	
Total operating income	**352.5**	**335.8**	**335.0**	**5.0%**	**5.2%**	**1027.6**	**955.4**	**7.6%**
Personnel expenses	(103.3)	(103.3)	(112.3)	0.0%	-8.1%	(308.0)	(308.7)	-0.2%
Non-personnel expenses	(84.3)	(78.7)	(72.8)	7.2%	15.8%	(240.9)	(224.4)	7.4%
Total operating expenses	**(187.6)**	**(182.0)**	**(185.1)**	**3.1%**	**1.3%**	**(548.9)**	**(533.1)**	**3.0%**
Cost-to-income ratio	53.2%	54.2%	55.3%			53.4%	55.8%	
Pre-provision profit before tax	**164.9**	**153.8**	**149.9**	**7.2%**	**10.0%**	**480.3**	**422.3**	**13.7%**
Provisions	(36.6)	(28.5)	(36.1)	28.7%	1.4%	(98.1)	(70.8)	38.6%
Provisions as a % of pre-provision profit	22.2%	18.5%	24.1%			20.4%	16.8%	
Profit before tax	**128.3**	**125.4**	**113.8**	**2.4%**	**12.8%**	**382.2**	**351.6**	**8.7%**
Income tax	(26.2)	(23.3)	(23.7)	12.6%	10.9%	(78.1)	(71.7)	8.9%
Income tax rate	20.4%	18.6%	20.8%			20.4%	20.4%	
Net profits	**102.1**	**102.1**	**90.1**	**0.0%**	**13.3%**	**304.2**	**279.9**	**8.7%**
Minority interest	(2.8)	(4.8)	(3.1)			12.0	(8.2)	
Net profits (group share)	**99.3**	**97.2**	**87.0**	**2.1%**	**14.1%**	**292.1**	**271.7**	**7.5%**
EPS to common (basic)	0.23	0.23	0.22	2.0%	5.6%	0.69	0.71	-3.1%
EPS to common (diluted)	**0.23**	**0.23**	**0.22**	**2.0%**	**5.6%**	**0.69**	**0.71**	**-3.1%**
EPS TTM to common	**0.84**							

Source: Company reports

Net interest income rose to USD 260 million in Q3/15 (+11% QoQ, +34% YoY) on growth in earning assets and improvement in interest margins

Despite muted balance sheet growth QoQ, Bank Audi's net interest income rose substantially to USD 260 million in Q3/15 (+11% QoQ, +34% YoY) on growth in earning assets (approximately equally driven by Turkish and non-Turkish operations) and improvement in interest margins. Net interest income rose to USD 717 million in 9M/15 from USD 586 million in 9M/14, a +22% YoY increase. We highlight an improvement in estimated interest margins at 2.49% in Q3/15 vs. 2.23% in Q2/15 and 1.97% in Q3/14 likely driven by non-Turkish operations as Odea Bank saw margins improve only slightly YoY. Net interest income generated from Odea Bank increased to ~USD 169 million in 9M/15 from ~USD 144 million in 9M/14, translating into higher total income for Odea Bank at ~USD 210 million in 9M/15 vs. ~USD 186 million in 9M/14. We continue to expect Bank Audi consolidated net interest margins to benefit favorably from higher margins from international operations including Egypt and Turkey.

Latest banking sector's statistics from the ABL for the month of July 2015 reveal, in a continued low interest environment, an improvement in USD spreads compared to LBP, with challenges due to limited capacity to decrease the cost of funds

Spreads in USD were higher in July 2015 while spreads in LBP were lower compared to one year earlier. Latest statistics from the ABL for the month of July 2015 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 given market share concerns amidst slower deposit accumulation.

Spreads in USD increased to 1.31% in July 2015 from 1.27% in July 2014 which has a positive impact on bank's 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 (+20 bps to 4.47%), partially offset by higher cost of funds at (+16 bps to 3.16%).

Spreads in LBP narrowed to 0.88% in July 2015 from 0.97% in July 2014 from higher cost of funds (+4 bps to 5.55%) and lower return on uses of funds (-5 bps to 6.43%) which was dragged down by lower lending rate (-39 bps to 7.04%) despite higher weighted yields on T-bills (+4 bps to 6.96%) and higher rate on CDs issued by the BDL (+4 bps to 8.16%).

Fees and commissions displayed growth in Q3/15 while non-interest income weighed down by lower financial gains. We continue to favorably view a stronger share of core income in total revenues

Despite net fees and commissions displaying growth at USD 71 million (+7% QoQ, +8% YoY), non-interest income came in lower at USD 92 million (-9% QoQ, -34% YoY) as Bank Audi saw financial gains slow down to USD 21 million (-40% QoQ, -72% YoY). Revenue breakdown for Q3/15 reflects a high quality mix with core income contribution to total operating income at 94% up from 90% in Q2/15, which we favorably view given the stable nature of this income stream. Financial gains contribution to total operating income registered at 6% in Q3/15, down from 10% in Q2/15. Total revenues in 9M/15 grew to USD 1,028 million (+8% YoY).

Going forward, we believe Bank Audi should continue to benefit from i) improved yields as branch network roll out gains maturity ii) increased fees and commissions, helped by the expansion of the Group including the growing franchise in Turkey and Egypt, and iii) increased focus on private banking and asset management operations.

Table 3: Summary Balance Sheet

USD million	Q3/15a	Q2/15a	Q4/14a	QoQ%	YTD%
Cash and balances with Central Banks	9,555.4	8,841.0	8,787.7	8.1%	8.7%
Due from banks and other financial institutions	3,475.6	4,056.1	4,336.7	-14.3%	-19.9%
Financial assets	10,973.3	11,040.6	10,249.5	-0.6%	7.1%
Loans and advances	**17,014.6**	**17,034.6**	**17,171.0**	**-0.1%**	**-0.9%**
Intangible assets and goodwill	201.7	188.1	192.5	7.2%	4.8%
Other assets	1,137.8	1,149.8	1,223.3	-1.1%	-7.0%
Total assets	**42,358.3**	**42,310.2**	**41,960.7**	**0.1%**	**0.9%**
Due to Central Banks	335.9	315.4	290.8	6.5%	15.5%
Due to banks and other financial institutions	1,533.0	1,261.0	1,184.6	21.6%	29.4%
Deposits	**35,829.5**	**36,106.1**	**35,820.8**	**-0.8%**	**0.0%**
Immediate liquidity to deposits	36.4%	35.7%	36.6%		
Loans- to- deposits	47.5%	47.2%	47.9%		
Subordinated notes	648.0	645.1	507.4	0.4%	27.7%
Other liabilities	837.7	854.4	809.5	-2.0%	3.5%
Total liabilities	**39,184.1**	**39,182.0**	**38,613.1**	**0.0%**	**1.5%**
Shareholders' equity	2,756.4	2,711.0	2,805.7	1.7%	-1.8%
Preferred shares	375.0	375.0	500.0	0.0%	-25.0%
Minority interest	42.9	42.3	42.0	1.5%	2.2%
Total shareholders' equity	**3,174.3**	**3,128.3**	**3,347.6**	**1.5%**	**-5.2%**
Total liabilities and shareholders' equity	**42,358.3**	**42,310.2**	**41,960.7**	**0.1%**	**0.9%**
Book value per share	7.83	7.72	9.45	1.5%	-17.1%
Book value per share to common	**6.90**	**6.78**	**7.02**	1.7%	-1.8%
Tangible book value per share to common	6.39	6.31	7.47	1.3%	-14.5%

Source: Company reports

Improved efficiencies in Q3/15 YoY with continued cost control on personnel expenses. Gross NPL ratio and COR came in higher at 3.2% and an estimated 86 bps respectively in Q3/15

Bank Audi saw improved efficiencies as cost-to income came at 53.2% in Q3/15 from 54.2% in Q2/15, despite higher operating expenses. This level remains above pre-Turkey expansion levels where Bank Audi built an ~USD 11 billion asset base since the launch of operations. We witness an improvement in overall cost control on personnel expenses at USD 103 million in Q3/15, stable QoQ and vs. USD 112 million in Q3/14 (total opex at USD 188 million in Q3/15 vs. USD 182 million in Q2/15 and USD 185 million in Q3/14). Bank Audi's consolidated gross NPLs inched higher at 3.2% in Q3/15 from 3.1% in previous quarter, still contained and well lower than peers under coverage. We saw a stronger cost of risk in Q3/15 at an estimated 86 bps from an estimated 67 bps in Q2/15 due to higher provisioning at USD 37 million in Q3/15 up from USD 28 million in Q2/15, due to regulatory requirements on a growing balance sheet and cautious management team rather than deteriorating asset quality.

Despite improved net profits on a YoY basis, we saw flat sequential net profit growth mainly on higher opex, provisioning and income tax. Odea Bank's net profits reached ~USD 21 million in Q3/15 from ~USD 6 million in Q3/14

Despite higher operating income QoQ at USD 353 million in Q3/15 vs. USD 336 million in Q2/15, driven by stronger net interest income, net profits came at USD 102 million in Q3/15 unchanged from Q2/15, weighed down by higher opex at USD 188 million in Q3/15 vs. USD 182 million in Q2/15, higher provisioning at USD 37 millions in Q3/15 vs. USD 28 million in Q2/15 and increased income tax at USD 26 million in Q3/15 vs. USD 23 million in Q2/15. On a YoY basis, net profits saw an improvement of +13% to USD 102 million in Q3/15 from USD 90 million in Q3/14 (EPS at USD 0.23 in Q3/15, unchanged sequentially and vs. USD 0.22 in Q3/14). Net profits at 9M/15 registered at USD 304 million vs. USD 280 million in 9M/14 (+9% YoY), while EPS came in at USD 0.69 for 9M/15 vs. USD 0.71 for 9M/14 due to capital increase. Odea Bank results showed net profits of ~USD 21 million in Q3/15 up from ~USD 6 million in Q3/14. We expect profitability in the Turkish entity to continue to improve as margins, efficiencies (and LDR to a lesser extent) move higher towards Turkish peers.

Bank Audi saw balance sheet growth on a YoY basis, while still muted sequentially due to FX pressures in key international markets and challenging conditions

With FX pressures in key international markets and challenging operating conditions, Bank Audi saw muted sequential growth in consolidated assets, deposits and loans. On a YTD basis, balance sheet grew +1% in US Dollar terms, and +5% excluding Egyptian Pound and Turkish Lira devaluation. YoY, balance sheet aggregates grew within the range of 6%-7% to reach USD 42 billion in assets, USD 36 billion in deposits and USD 17 billion in loans. Bank Audi's deposits to assets ratio was unchanged sequentially at ~85%, and LDR at ~47% well above the Lebanese banking sector average (~35%), attributed to continued fast lending growth driven by Turkey and Egypt. Bank Audi continues to diversify its geographic presence with nearly 50% of total assets coming from international operations.

Bank Audi saw CAR III level improved to 13.0% in Q3/15 from 12.8% in Q2/15 and slight improvement in profitability

Bank Audi's capital adequacy ratio (Basel III) improved to 13.0% in Q3/15 from 12.8% in Q2/15 and in contrast with BDL's requirement of 12% at 2015 (Bank Audi CAR III would reach 13.5% when including additional surplus from revaluation of fixed assets). Profitability ratios mixed QoQ with TTM ROA at an estimated ~0.91% slightly higher than Q2/15 level of ~0.90%, quarter while the TTM ROE was lower at an estimated 12.0% vs. 12.4% in Q2/15, on account of improved capitalization. The TTM EPS was USD 0.84 in Q3/15 from USD 0.83 in Q2/15, while book value per share (to common) came at an estimated at USD 6.90 in Q3/15 vs. USD 6.78 in Q2/15. Bank Audi's equity to assets ratio was higher at 7.5% in Q3/15 from 7.4% in Q2/15.

We believe recent correction in Bank Audi shares to provide more attractive entry point for longer-term investors

We previously believed that slowing international growth, devaluation of key markets FX, wind down of dividend season and lower share count from capitalization increase to put pressure on Bank Audi shares in the short-term. With a near ~5% correction since June 2015, we view improving fundamentals from stronger core income, cost efficiencies and relatively stable asset quality to provide investors with the entry point we have been anticipating.

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