Equity Research - Flash Note - Bank Audi Q3/17 Results

Sector: Banking
Country: Lebanon

MARKETWEIGHT	
Target Price	USD 7.00
Closing Price	USD 5.90
52 Week Range	USD 5.80-7.00
Year to Date %	-13.20%
Market Cap.	USD 2,358.5 million
Dividend Yield	8.5%
P/E (TTM)	4.8x
P/B to Common	0.76x

Note: the share data represents Bank Audi listed shares (AUDI LB)
Bank Audi GDR shares at USD 6.00 (BQAD LI) and USD 5.90 (AUSR LB)
Source: Bloomberg, FFA Private Bank
Market close on October 31, 2017

Bank Audi Q3/17 Results Summary vs. FFA Private Bank est.

USD million except per share data	Q3/17a	FFA Q3/17e	QoQ	YoY
Net interest income	273.2	278.1	2%	3%
Fees & commission	52.7	62.3	-15%	-92%
Trading & investment	78.8	45.2	90%	306%
Operating income	404.7	385.6	9%	-59%
Provisions	-53.6	-35.9	24%	-59%
Operating expenses	-191.5	-198.6	-3%	-48%
Income tax	-31.1	-31.8	6%	-72%
Net profits	**128.5**	**119.7**	**-35%**	**-17%**
Diluted EPS to common	0.30	0.27	-38%	-7%
Assets	44,682	45,372	2%	-1%
Deposits	35,749	36,915	-2%	-3%
Loans	17,153	17,943	-3%	-9%
BVPS to common	7.79	7.81	4%	2%
	Q3/17a	**FFA Q3/17e**	**Q2/17a**	**Q3/16a**
FFA Net interest margins	2.47%	2.49%	2.48%	2.37%
Core income to total operating income ratio	80.5%	88.3%	88.8%	99.9%
FFA Cost-to-income ratio	54.6%	51.5%	52.9%	40.7%
Immediate liquidity-to-deposit ratio	42.5%	43.7%	39.2%	41.7%
Loan-to-deposit ratio	48.0%	48.6%	48.6%	50.9%
Equity-to-asset ratio	8.5%	8.6%	8.7%	8.1%

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

Bank Audi's net profit at USD 128.5 million in Q3/17 (-35% QoQ, -17% YoY) exceeding FFA est. of USD 119.7 million on stronger-than-expected trading and investment income. Bank Audi's profits at USD 128.5 million (-35% QoQ, -17% YoY) in Q3/17 above FFA est. of USD 119.7 million and diluted EPS at USD 0.30 (-38% QoQ, -7% YoY) vs. FFA est. USD 0.27. We note that earnings were weighed QoQ by exceptional gains registered in Q2/17 from sales of Bank Audi's electronic payment and cards business and YoY by exceptional gains related to BDL debt swap in the back half of 2016. Operating income came in higher-than-expected at USD 404.7 million (vs. FFA est. USD 385.6 million) driven by trading and investment income at USD 78.8 million (vs. FFA est. USD 45.2 million) while net interest income and fees and commissions income were weaker-than-expected at respective USD 273.2 million (vs. FFA est. USD 278.1 million) and USD 52.7 million (vs. USD 62.3 million). Bottom line was further helped by opex slightly below our est. at USD 191.5 million (vs. FFA est. USD 198.6 million) and softer-than-expected tax rate at 19.5% (vs. FFA est. 21.0%). This positive variance to the bottom line was partly offset by stronger-than-expected credit loss provisions at USD 53.6 million (vs. FFA est. USD 35.9 million) weighed by an increase in collective provisions at Odea Bank while NPLs remained stable at 3.3%. We note that according to third party research, BDL recently carried a new financial engineering in order to attract deposits in LBP and USD, which consisted in allowing banks to i) subscribe to CDs for a period of 5-10 years at a rate of around 7% and ii) borrow up to 125% of their deposits at a rate of 2% on the condition that iii) they reinvest the borrowed amount into LBP government bonds at around 7%, which enhanced the banks' asset yields while raising their asset-liability mismatching risk given the shorter maturities of client deposits vs. BDL CDs. Balance sheet growth came in below our forecasts with assets at USD 44.7 billion (vs. FFA est. 45.4 billion), deposits at USD 35.7 billion (vs. FFA est. 36.9 billion) and loans at USD 17.1 billion (vs. FFA est. 17.9 billion) resulting in an lower-than-expected loan-to-deposit ratio at 48.0% (vs. FFA est. 48.6%), below Q2/17 level of 48.6% and Q3/16 level of 50.9%.

Modest growth in net interest income at USD 273.2 million (+2% QoQ, +3% YoY) capped QoQ by softer net interest margin and weaker lending in Turkey and Egypt

Bank Audi's net interest income at USD 273.2 million (+2% QoQ, +3% YoY) in line with balance sheet growth QoQ although capped by softer NIMs and weaker lending in foreign activities amid management focus on containing credit risk. We estimate net interest margins at 2.47% down from 2.48% in Q2/17 and up from 2.37% in Q3/16 weighed QoQ by higher cost of funds particularly in Egypt which offset increase in asset yields. Asset yields were helped by spread expansion in Turkey and higher yields on BDL placements. At the sector level, spreads in LBP remained stable while we highlight higher asset yields in USD between June 2017 and August 2017 driven by higher USD deposit rates at BDL and pick up in LIBOR which offset a slight increase in cost of funds. Bank Audi's NIMs increased YoY as higher cost of funds were largely offset by higher asset yields despite unfavorable f/x effects from TRY ad EGP devaluation on a consolidated basis.

Trading and investment income drove Bank Audi's non-interest income higher in Q3/17 while fees and commissions income was lower

Non-interest income came in at USD 131.5 million in Q3/17 (+27% QoQ, -82% YoY) driven by higher financial gains at USD 78.8 million (+90% QoQ, +306% YoY) while fees and commissions were lower at USD 52.7 million (-15% QoQ, -92% YoY) mainly weighed by the sales of Bank Audi's electronic payment and cards business in Q2/17. We note that YoY comparisons in Bank Audi's non-interest income are weighed by exceptional gains registered in the back half of 2016 as part of BDL's 2016 debt swap. Bank Audi's income quality mix stood at 81% in Q3/17 down from 89% in Q2/17 and ~100% in Q3/16 on lower contribution of core income (net interest income + net fees and commissions) to total operating income.

Improvement in cost-to-income at the group level supported by efficiencies in key pillars

Bank Audi's cost-efficiencies improved in Q3/17 with cost-to-income ratio at 54.6% down from 52.9% in Q2/17 and 40.7% in Q3/16 supported by the group's key pillars Lebanon, Turkey and Egypt. Improvement was driven by lower opex as personnel expenses declined QoQ and YoY on a consolidated basis while non-personnel expenses were contained.

Muted balance sheet growth in Q3/17 negatively affected YoY by currency devaluations in Turkey and Egypt on a consolidated basis. Domestic asset and loan growth likely outgrew peers amid continued efforts to attract deposits and challenged lending activity

Softer balance sheet growth QoQ with assets at +2%, deposits at -2% and loans at -3%. Negative loan growth reflected by slightly lower LDR at 48.0% in Q3/17 down from 48.6% in Q2/17 and 50.9% in Q3/16 from conservative lending approach in foreign entities while loan growth picked up in Lebanon, likely outperforming sector averages despite challenging macro environment. On a YoY basis, Bank Audi's assets were down -1% to USD 44.7 billion, deposits -3% to USD 35.7 billion and loans -9% to USD 17.1 billion. We note that currency devaluations in Turkey and Egypt which account to respective 23%/40% and 8%/10% of assets/loans weighed on consolidated balance sheet growth YoY despite significant expansion in local currency. We also highlight increasing placements with central banks likely resulting from recent BDL operations as banks benefitted from attractive terms on BDL CDs. NPLs remained contained at 3.3% in Q3/17 despite credit quality concerns at Odea Bank which accounts to more than 50% of the group's doubtful loans, reflected in higher collective provisions QoQ.

Bank Audi's regulatory capital improved, still above BDL's requirement while profitability metrics stable to lower in Q3/17

Capital adequacy ratio (as per Basel III) increased to 15.6% in Q3/17 from 15.2% in Q2/17, above BDL's requirement of 14.5% for 2017 (15.0% by end of 2018) with CET1 ratio at 10.1% up from 9.7% in Q2/17. TTM ROA at an est. ~1.0% unchanged from Q2/17 and Q3/16 and TTM ROE estimated at 12.3% down from 12.9% in q2/17 and 13.1% in Q3/16 as profitability gains in Turkey were offset by lower ROA in Lebanon and Egypt. TTM EPS at USD 1.00 roughly stable QoQ and below Q3/16 level of USD 1.06. Equity-to-asset ratio at 8.5% in Q3/17 up from 8.7% in Q2/17 and 8.1% in Q3/16 and est. BVPS at USD 8.98 (USD 7.79 to common, +4% QoQ, +2% YoY). We note that Odea Bank issued in July 2017 a subordinated Basel III compliant Tier 2 bond in the amount of USD 300 million maturing in 2027.

While we highlight challenges related to balance sheet growth given challenging macro, we expect Bank Audi's earnings to further benefit from improved operating leverage across pillars in addition to stable growth in interest income

We expect Bank Audi's profitability metrics to continue benefitting from management's efforts at improving the group's operating leverage across key pillars and business segments, particularly as foreign operations gain maturity. While NPLs remain contained amid management's conservative lending strategy, we highlight challenges related to asset quality in key pillars which could cap further gains particularly given muted loan growth and rising provisions, while attracting deposits also remains challenging. We value Bank Audi's capacity to expand within its key business segments through steady earnings streams while also improving its capital buffers, and view it as an interesting entry point for investors as shares are trading at -13% YTD and at discount to regional peers on a P/B and P/B basis.

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