Flash Note
October 19, 2012

Bank Audi Q3/12 Results

Sector: Banking
Country: Lebanon

Bank Audi's net profits at USD 309.4 million in 9M/12, 14% up year on year

Bank Audi's net profits amounted to USD 309.4 million in 9M/12, up from USD 271.3 million in 9M/11 (including a USD 32.8 million gain from the sale of LIA) and below our USD 322.5 million estimate. This year on year increase in the bottom line in 9M/12 over 9M/11 can be attributed to a 15% growth rate in operating income to USD 815.3 million, an improvement in cost-efficiencies (with the cost-to-income ratio down to 44.1% in 9M/12 from 45.6% in 9M/11) and the USD 32.8 million gain from the sale of LIA. An increase in provisions and income taxes exerted pressures on earnings. Allocated provisions grew 81% YoY to USD 94 million in 9M/12 from cautious risk management while the income tax rate increased to 23.6% in 9M/12 from 19.6% in 9M/11. Diluted EPS was USD 0.83 in 9M/12 up from USD 0.73 in 9M/11 compared to our USD 0.87 estimate. We note that Bank Audi's net profits excluding the sale of LIA were at USD 277 million, up 3% from USD 268 million in 9M/11.

Net profits were USD 309.4 million in 9M/12 compared to our USD 322.5 million estimate, and the asset base totaled USD 29,182 million at the end of Q3/12 in line to our USD 29,193 million estimate, as highlighted in the table below:

Table 1: Bank Audi 9M/12 results vs. FFA Private Bank estimates

USD millions except per share data	9M 12a	FFA 9M 12e	9M 11a
Assets	29,182	29,193	28,714
Deposits	24,877	25,007	24,877
Loans	9,247	9,402	8,562
Operating Income	815.3	809.2	709.3
Net profits*	309.4	322.5	271.3
Diluted EPS*	0.83	0.87	0.73
BVPS (to common)	6.18	6.52	5.57

Source: Bank Audi and FFA Private Bank estimates
*Note: * include the results from discontinuing operations, namely the sale of LIA*

Table 2: Summary Income Statement

USD millions	9M 12a	9M 11a	YoY %
Net interest income	**431.7**	**387.8**	**11.3%**
As a % of total operating income	*52.9%*	*54.7%*	*-180 bps*
Fees and commission income	134.7	130.4	3.3%
Trading and investment income	249.0	191.1	30.3%
Non -interest income	**383.7**	**321.5**	**19.3%**
As a % of total operating income	*47.1%*	*45.3%*	*+180 bps*
Total operating income	**815.3**	**709.3**	**14.9%**
Personnel expenses	(193.6)	(187.4)	3.3%
Non-personnel expenses*	(166.0)	(136.3)	21.8%
Total operating expenses	**(359.6)**	**(323.7)**	**11.1%**
Cost- to- income	*44.1%*	*45.6%*	*-150 bps*
Pre-provision profit before tax	**455.7**	**385.6**	**18.2%**
Provisions	(93.9)	(51.9)	81.1%
Provisions as a % of pre-provision profit	*20.6%*	*13.5%*	*+710 bps*
Profit before tax	**361.8**	**333.7**	**8.4%**
Income tax	(85.2)	(65.3)	30.5%
Income tax rate	*23.6%*	*19.6%*	*+ 400 bps*
Profit after tax from continuing operations	**276.6**	**268.4**	**3.0%**
Result of discontinued operations	32.8	2.8	-
Net profits	**309.4**	**271.3**	**14.1%**
Minority interest	(2.9)	(6.3)	-
Net profits (group share)	**306.5**	**265.0**	**15.7%**
EPS to common (basic)	0.84	0.74	13.5%
EPS to common (diluted)	**0.83**	**0.73**	**13.7%**

Source: Bank Audi
*Note: *Non-personnel expenses include the impairment goodwill*

Net interest income up 15% YoY in Q3/12 reflecting an improvement in spreads given tepid balance sheet growth

Bank Audi's net interest income totaled USD 146.6 million in Q3/12, up 15% from USD 127.1 million in Q3/11 stemming from an improvement in interest margins (from previous reduction in the cost of funds, repricing of loans, and some attractive placements) as earning assets growth stalled as highlighted by a flat asset base between Q3/11 and Q3/12 at roughly USD 29 billion. Spreads widened by few basis points in 2012 totaling 2.09% for H1/12 higher than 1.90% in H1/11. For the nine month period, we note an 11% YoY growth rate in net interest income to USD 431.7 million.

Non-interest income up 14% YoY in Q3/12 driven by trading and investment income

In Q3/12 Bank Audi saw a 14% increase in non-interest income YoY at USD 130 million compared to USD 114 million in Q3/11, as trading and investment income picked up 27% to USD 90.2 million counterbalancing an 8% decrease in fees and commissions income to USD 39.8 million. Fees and commissions momentum moderated on account of softer trade finance and loan syndication from regional developments while trading and investment income continued to be supported by active treasury and capital markets operations. Looking at the earnings mix for Q3/12, we note: i) the contribution of non-interest income to total operating income at 47% in Q3/12 roughly stable from 47.3% in Q3/11 and ii) the contribution of fees and commissions to total operating income at 14% in Q3/12 down from 18% for Q3/11. For the nine month period, we note a 19% YoY growth in non-interest income mostly driven by a 30% jump in trading and investment income along with a moderate 3% YoY increase in revenues from fees and commissions.

Higher operating expenses, provisions and taxes exerted pressures on earnings generation in Q3/12

Cost-efficiencies slightly deteriorated in Q3/12 as the cost-to-income increased to 46.8% in Q3/12 up from 45.7% in Q3/11, from a 18% increase in operating expenses surpassing a 15% growth in operating income. Operating expenses were driven by an increase in non-personnel expenses (+31% YoY in Q3/12) as personnel expenses increased by a moderate 7% over the same period. The significant growth in non-personnel expenses equivalent to USD 14.5 million could be partly attributed to a USD 6.5 million impairment on goodwill. In parallel, the increased provisions as well as the higher tax rate have exerted further pressures on bottom line gains. Significantly higher provisions were allocated (USD 26.0 million in Q3/12 compared to USD 15.1 million in Q3/11 although down QoQ) as Management has been adopting prudent provisioning measures given the regional turmoil. Income tax rate stood at 24.9% in Q3/12, up from 20.0% in Q3/11, impacted by higher taxes in Egypt. For the nine month period, cost-efficiencies saw an improvement with a cost-to-income ratio at 44.1% in 9M/12 down from 45.6% in 9M/11 while provisions and taxes followed an upward trajectory.

Table 3: Summary Balance Sheet

USD millions	Q3 12a	Q2 12a	Q4 11a	QoQ%	YTD%
Cash and balances	6,057.8	5,897.4	5,773.4	2.7%	4.9%
Due from banks and other financial institutions	2,767.6	2,819.7	3,171.9	-1.8%	-12.7%
Financial assets	10,216.9	10,100.5	10,280.6	1.2%	-0.6%
Loans and advances	**9,247.3**	**9,076.3**	**8,594.3**	**1.9%**	**7.6%**
Intangible assets and goodwill	187.4	179.6	182.4	4.4%	2.8%
Other assets	704.8	716.8	734.3	-1.7%	-4.0%
Total assets	**29,181.8**	**28,790.2**	**28,736.8**	**1.4%**	**1.5%**
Due to Central Banks	566.9	394.6	88.5	43.7%	540.7%
Due to banks and other financial institutions	622.1	649.9	668.4	-4.3%	-6.9%
Deposits	**24,876.6**	**24,706.3**	**24,797.7**	**0.7%**	**0.3%**
Immediate liquidity to deposits	*35.5%*	*35.3%*	*36.1%*	*+20 bps*	*-60 bps*
Loans- to- deposits	*37.2%*	*36.7%*	*34.7%*	*+50 bps*	*+250 bps*
Other liabilities	488.6	460.9	825.3	6.0%	-40.8%
Total liabilities	**26,554.1**	**26,211.7**	**26,379.8**	**1.3%**	**0.7%**
Shareholders' equity	2,161.2	2,101.9	2,013.3	2.8%	7.3%
Preferred shares	400.0	400.0	250.0	0.0%	60.0%
Minority interest	66.6	76.6	93.6	-13.2%	-28.9%
Total shareholders' equity	**2,627.7**	**2,578.5**	**2,357.0**	**1.9%**	**11.5%**
Total liabilities and shareholders' equity	**29,181.8**	**28,790.2**	**28,736.8**	**1.4%**	**1.5%**
Book value per share	7.33	7.16	6.48	2.4%	13.2%
Book value per share to common	**6.18**	**6.01**	**5.76**	**2.8%**	**7.3%**
Tangible book value per share to common	5.65	5.50	5.24	2.7%	7.8%

Source: Bank Audi

Flat deposit base on account of strict cost of fund control and Syrian operations, while loans edged up 2% in Q3/12

Bank Audi's consolidated assets and deposits grew by a moderate 1% in Q3/12 to a respective USD 29,182 million and USD 24,877 million at the end of the quarter as the Syrian entity saw further deposit outflows and Bank Audi maintained its strict control of the cost of funds in light of its margin preservation strategy. At end-September 2012, the assets of Bank Audi Syria had contracted to a third of their December 2010 levels according to Management. The loan portfolio edged up 2% in Q3/12 to USD 9,247 million. The loans-to-deposits ratio gained few points to 37.2% at the end of Q3/12 from 36.7% at the end of Q2/12 (although significantly up from 34.4% at year-end 2011), while the immediate liquidity to deposits ratio remained roughly stable at 36%.

Roughly contained NPLs and satisfactory provisioning levels, a testament to asset quality preservation amidst a challenging operating environment

Bank Audi's consolidated NPLs (doubtful to gross loans) stood at 3.1% by the end of Q3/12 slightly up from 2.9% in Q2/12. The coverage of gross doubtful loans by specific loan loss provisions was 77% in Q3/12 unchanged from Q2/12 and highlighting satisfactory provisioning levels as Management has been adopting a cautious approach (allocation of USD 26 million in provisions in Q3/12 vs. USD 15.1 million in Q3/11 although down sequentially from USD 36.8 million in Q2/12 from improved visibility) . The consolidated total provisions reached USD 294 million at end-September 2012. We note an increase of bad debts written off to USD 77 million at end-September 2012 from USD 9 million at year-end 2011.

Capital adequacy ratio at 12% as per Basel III and ROA edged up to 1.4%

Bank Audi's capital adequacy ratio (Basel III) was 12%, highlighting a comfortable capitalization level and the firm's equity to assets ratio was maintained at 9% from previous quarter yet up from 8.2% in Q4/11. The TTM ROA (including the sale of LIA) edged up to 1.4% from 1.3% in the previous quarter. The EPS was USD 0.83 in 9M/12 up from USD 0.73 in 9M/11 when including the profits from the sale of LIA, while book value per share is estimated at USD 7.33 (USD 6.18 to common). The current P/E is now 5.0x when including the sale of LIA, while estimated P/B is 0.77x (P/B 0.92x to common). The dividend yield is now 7.2%.

Recent news include the issuance of additional common shares

Bank Audi increased its capital through the issuance of 309,260 common shares. The total capital is now made up of 364,999,204 shares including 349,749,204 common shares, 12,500,000 preferred shares D, 1,250,000 preferred shares E, and 1,500,000 preferred shares F.

Odeabank, the Turkish entity of Bank Audi, to open the first 7 branches in the country before year-end

In October 2011, Bank Audi was granted the permission to establish a banking subsidiary in Turkey. The Bank is targeting a network of 28 branches over 18 months reaching 57 branches in 2016, making Turkey a key driver of growth for the Group in the coming years. Odeabank will start operating over the next weeks targeting 5 branches in Istanbul and 1 branch in Ankara and 1 branch in Izmir before year-end. We view the Turkish market as offering interesting growth potential given the relative political stability, young population, sizeable domestic market and potential for trade finance between Turkey and the Arab World.

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