

Flash Note

October 21, 2013

Bank Audi Q3/13 Results

Sector: Banking

Country: Lebanon

MARKETWEIGHT

Target Price	USD 7.00
Closing Price	USD 6.15
Year to Date %	1.0%
52 Week Range	5.26 -6.90
Market Cap.	USD 2,151.0 million
Dividend Yield	6.5%
P/E (TTM)	7.2x
P/B to Common	0.98x

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

Source: Bloomberg, FFA Private Bank

Net profits at USD 73 million in Q3/13, EPS at USD 0.19, below estimates from lower financial gains

Bank Audi's net profits amounted to USD 73 million in Q3/13 (-29% QoQ, -8% YoY). Diluted EPS was USD 0.19 lower than USD 0.27 in Q2/13 and USD 0.21 in Q3/12. This decline in the bottom line in Q3/13 can be attributed to weaker operating income at USD 256 million due to lower financial gains (-58% QoQ, -55% YoY). In parallel, we favorably view strong revenues from core income which were mainly driven by net interest income (+7% QoQ, +15% YoY) and fees and commissions (+4% QoQ, +14% YoY) to a lesser extent. Net earnings and EPS were below our USD 105 million and USD 0.27 estimates due to lower than expected financial gains (USD 41 million vs. est. USD 92 million) as core income came roughly in line. Cost-to-income came higher than expected as we were in line with opex (USD 148 million vs. estimated USD 147 million). Provisions declined at higher than expected pace in the context of improving asset quality and partially offsetting the drop in income. Provisions amounted to USD 14 million in Q3/13 (vs. estimated USD 23 million, and USD 32 million in Q2/13). In line with estimates, assets and deposits grew 10% Ytd, while loans grew by 30% which led the LDR ratio to 46% (slightly above our estimated 45%).

Table 1: Bank Audi Q3/13 results vs. FFA Private Bank estimates

USD million	Q3/13a	FFA Q3/13e	Q2/13a	Q3/12a	QoQ %	YoY %
Net interest income	170	166	159	147	7%	15%
Operating income	256	304	300	277	-15%	-8%
Net profits (*)	73	105	103	80	-29%	-8%
Diluted EPS (*)	0.19	0.27	0.26	0.21	-25%	-9%
Assets	34,470	34,655	33,694	29,182	2%	18%
Deposits	29,471	29,828	29,162	24,877	1%	18%
Loans	13,565	13,476	12,710	9,247	7%	47%
BVPS to common	6.30	6.65	6.12	6.18	3%	2%
FFA Cost-to-income ratio	58.0%	48.4%	47.1%	47.7%		
Loans-to-deposits ratio	46.0%	45.2%	43.6%	37.2%		

Source: Bank Audi and FFA Private Bank estimates

Note: (*) Net profits and diluted EPS for Q3/12 include negative impact from discontinued operations

Table 2: Summary Income Statement

USD million	Q3/13	Q2/13	Q3/12	QoQ%	YoY %	9M/13	9M/12	YoY%
Net interest income	169.8	159.0	147.1	6.8%	15.4%	470.4	431.7	9.0%
As a % of total operating income	66.3%	53.0%	53.0%			58.0%	52.9%	
Fees and commissions income	45.7	43.9	40.0	4.0%	14.2%	133.5	134.7	-0.9%
Trading and investment income	40.5	97.2	90.4	-58.3%	-55.1%	206.9	249.0	-16.9%
Non-interest income	86.2	141.2	130.3	-38.9%	-33.8%	340.4	383.7	-11.3%
As a % of total operating income	33.7%	47.0%	47.0%			42.0%	47.1%	
Total operating income	256.1	300.2	277.5	-14.7%	-7.7%	810.8	815.3	-0.6%
Personnel expenses	(84.9)	(78.3)	(72.3)	8.5%	17.4%	(235.9)	(193.6)	21.9%
Non-personnel expenses	(63.5)	(63.0)	(60.1)	0.8%	5.7%	(185.5)	(166.0)	11.7%
Total operating expenses	(148.4)	(141.2)	(132.4)	5.1%	12.1%	(421.4)	(359.6)	17.2%
Cost-to-income ratio	58.0%	47.1%	47.7%			52.0%	44.1%	
Pre-provision profit before tax	107.7	158.9	145.1	-32.3%	-25.8%	389.3	455.7	-14.6%
Provisions	(14.5)	(32.4)	(26.0)	-55.4%	-44.4%	(61.1)	(93.9)	-34.9%
Provisions as a % of pre-provision profit	13.4%	20.4%	17.9%			15.7%	20.6%	
Profit before tax	93.2	126.5	119.1	-26.3%	-21.7%	328.2	361.8	-9.3%
Income tax	(20.0)	(24.0)	(30.4)	-16.7%	-34.4%	(67.0)	(85.2)	-21.5%
Income tax rate	21.4%	18.9%	25.6%			20.4%	23.6%	
Profit after tax from continuing operations	73.2	102.5	88.6	-28.6%	-17.4%	261.3	276.6	-5.5%
Result of discontinued operations	0.0	(0.0)	(8.8)			0.0	32.8	
Net profits	73.2	102.5	79.8	-28.5%	-8.2%	261.3	309.4	-15.5%
Minority interest	0.1	(6.7)	(0.4)			(6.9)	(2.9)	
Net profits (group share)	73.3	95.8	79.4	-23.4%	-7.7%	254.3	306.5	-17.0%
EPS to common (basic)	0.19	0.26	0.21	-24.9%	-8.9%	0.68	0.83	-19.0%
EPS to common (diluted)	0.19	0.26	0.21	-24.9%	-9.0%	0.68	0.83	-19.0%
Estimated diluted EPS from continuing operations						0.68	0.74	-8.6%
EPS TTM to common (diluted) (*)	0.85							

Source: Bank Audi

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

Net interest income saw solid growth in Q3/13 mostly driven by expansion in earning assets

Bank Audi's net interest income totaled USD 170 million in Q3/13 (+7% QoQ, +15% YoY) mainly stemming from earning assets growth, driven by the Turkish entity and from an improvement in interest spreads to a lesser extent (1.96% in 9M/13 vs. 1.92% in H1/13). 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 1.46% in August 2013 down from 1.83% one year earlier driven by i) lower rates on LIBOR (average 3 months on USD deposits down to 0.26% from 0.43%), ii) lower yields on Eurobonds (weighted average down to 6.90% from 7.39%), iii) lower rates on deposits at the BDL (average down to 2.32% from 3.16%) and lower lending rates (weighted average down to 7.05% from 7.20%). On the LBP side, it should be noted that yields on CDs issued were also lower YoY (at 8.79% down from 9.28% a year earlier), while yields on T-Bills almost stabilized at 6.7%. Looking ahead, Bank Audi's margins should continue to benefit from a gradual decrease in the cost of funds in Turkey as well as from redeployment of liquidity into more attractive yielding avenues including lending in Turkey.

Non-interest income down to USD 86 million in Q3/13 on lower financial gains as fees and commissions held up well

Bank Audi's non-interest income decreased to USD 86 million in Q3/13 (-39% QoQ, -34% YoY,) with the decline being largely explained by lower financial gains (-58% QoQ, -55% YoY to USD 41 million). In parallel, fees and commissions income held up well as highlighted by an increase of 4% QoQ and 14% YoY to USD 46 million. Looking at the earnings mix we highlight the lower volatility of the income stream in Q3/12 as we note the following: i) the contribution of core income (net interest income+fees and commissions income) to total operating income at 84% in Q3/13 significantly higher than 67% in Q3/12 and ii) the contribution of fees and commissions to total operating income at 18% in Q3/13 compared to 14% in Q3/12. In the medium term, Bank Audi is seeking a breakdown of revenues between interest income and non-interest income at 65%/35%.

Less favorable operating leverage in Q3/13 due to lower, yet more stable, operating income and as costs increased

The cost-to-income increased to 58% which can be attributed to lower operating income (-8% YoY) from lower financial gains in the context of a moderate increase in total operating expenses (+12% YoY). Total opex amounted to USD 148 million in Q3/13 and were mainly driven by higher personnel expenses (+17% YoY) reflecting the expansion in Turkey where total employees increased from 649 to 905 during Q3/13. We note that Bank Audi seeks to breakeven in Turkey by year-end (or beginning of 2014) as we highlight a net loss of USD 14.5 million in Q1/13 which shrank to USD 4 million and 6 million in Q2/13 and Q3/13 respectively. In light of a smaller balance sheet in Syria and already high provisioning levels, provisions declined at a higher pace than expected at USD 14 million in Q3/13 (compared to estimated USD 23 million, and USD 32 million in Q2/13) despite a rapidly growing loan book translating in lower cost of risk levels. We note that Bank Audi's asset quality has been improving as highlighted by a noticeable 2.2% consolidated NPLs in Q3/13. Income tax rate stood at 21% in Q3/13, down from 26% in Q3/12.

Table 3: Summary Balance Sheet

<i>USD million</i>	Q3/13	Q2/13	Q4/12	QoQ%	YTD%
Cash and balances	6,021.0	6,437.5	6,276.9	-6.5%	-4.1%
Due from banks and other financial institutions	2,686.8	2,901.7	3,543.1	-7.4%	-24.2%
Financial assets	11,299.4	10,766.6	10,209.5	4.9%	10.7%
Loans and advances	13,565.4	12,709.7	10,428.5	6.7%	30.1%
Intangible assets and goodwill	182.5	177.8	180.7	2.6%	1.0%
Other assets	714.7	701.2	663.1	1.9%	7.8%
Total assets	34,469.8	33,694.5	31,301.8	2.3%	10.1%
Due to Central Banks	118.1	98.8	88.3	19.6%	33.7%
Due to banks and other financial institutions	1,190.4	1,203.6	1,229.0	-1.1%	-3.1%
Deposits	29,471.0	29,162.1	26,804.6	1.1%	9.9%
<i>Immediate liquidity to deposits</i>	<i>29.5%</i>	<i>32.0%</i>	<i>36.6%</i>		
<i>Loans- to- deposits</i>	<i>46.03%</i>	<i>43.58%</i>	<i>38.91%</i>		
Subordinated debt	350.1	0.0	0.0		
Other liabilities	593.8	546.4	502.5	8.7%	18.2%
Total liabilities	31,723.4	31,010.9	28,624.4	2.3%	10.8%
Shareholders' equity	2,203.8	2,141.9	2,213.2	2.9%	-0.4%
Preferred shares	500.0	500.0	400.0	0.0%	25.0%
Minority interest	42.5	41.7	64.2	2.0%	-33.8%
Total shareholders' equity	2,746.4	2,683.6	2,677.4	2.3%	2.6%
Total liabilities and shareholders' equity	34,469.8	33,694.5	31,301.8	2.3%	10.1%
Book value per share	7.73	7.55	7.48	2.3%	3.4%
Book value per share to common	6.30	6.12	6.33	2.9%	-0.5%
Tangible book value per share to common	5.78	5.62	5.82	2.9%	-0.6%

Source: Bank Audi

Key balance sheet indicators driven by Turkish operations

On the balance sheet side, the Bank's assets, deposits and loans grew by 2%, 1% and 7% respectively in Q3/13 to USD 34.5 billion, USD 29.5 billion and USD 13.6 billion respectively at the end of the quarter. This increase stems from operations in Turkey where the Bank operates a network of 20 branches. In fact assets, deposits and loans from Turkish operations grew by 15%, 15% and 26% respectively during Q3/13 amounting to USD 6.6 billion, USD 5.0 billion and USD 4.2 billion at the end of the quarter (equivalent to a contribution of 19% in total assets, 17% in total deposits and 31% in total loans), which raised the contribution of entities abroad to consolidated assets from 32.4% at end-December 2012 to 41% at end-September 2013 in line with Management's objective to reach a more balanced breakdown of assets between Lebanon and abroad. Bank Audi is seeking to double its asset base in Turkey in the medium term from current levels.

Looking at the first nine months of the year, we note a strong growth in key balance sheet indicators at 10%, 10% and 30% respectively for assets, deposits and loans. The loans-to-deposits ratio reached 46% (well above the sector average at 33%) which could be attributed to fast lending growth in Turkey while the immediate liquidity to deposits ratio stood at 30% (lower QoQ and Ytd).

We favorably view a gross NPL ratio at a relatively low 2.2% level in comparison to peers

We favorably view Bank Audi's consolidated gross NPLs improving to 2.2% in Q3/13 down from 2.7% by the end of 2012 and lower than peers under coverage. The coverage of gross doubtful loans by specific loan loss provisions was 80% in Q3/13 up from 78% in Q2/13 and highlighting satisfactory provisioning levels. Additionally, we favorably view a further decrease in bad debts written off to around USD 7 million in 9M/13 compared to a total of USD 105 million for the full year 2012.

CAR III increased to 11.8% following the USD 350 million subordinated debt issue

Bank Audi's capital adequacy ratio (Basel III) went up from 10.3% in Q2/13 to 11.8% following the USD 350 million subordinated debt issue as well as higher retained earnings. The subordinated notes (which have a maturity of 10 years from the issue date, a coupon of 6.75% and trading just over par) and previous preferred shares issues are aimed at financing the strong balance sheet expansion in Turkey. On another hand, the TTM ROA stood at 1.1% down from 1.2% in previous quarter while the TTM ROE is estimated at around 12.8% compared to an estimated 14.2% in Q2/13. The TTM EPS was USD 0.85 in Q3/13 while book value per share is estimated at USD 7.73 (USD 6.30 to common). Based on today's listed share price of USD 6.15, Bank Audi is trading at 7.2x P/E, 0.80x P/B (P/B to common of 0.98x) and dividend yield of 6.5%.

Contacts:

Head of Research: Nadim Kabbara, CFA

n.kabbara@ffapivatebank.com

+961 1 985 195

Analyst: Raya Freyha

r.freyha@ffapivatebank.com

+961 1 985 195

Sales and Trading, FFA Private Bank (Beirut)

+961 1 985 225

Sales and Trading, FFA Dubai Ltd (DIFC)

+ 971 4 3230300

Disclaimer:

This document has been issued by FFA Private Bank for informational purposes only. This document is not an offer or a solicitation to buy or sell the securities mentioned. This document was prepared by FFA Private Bank from sources it believes to be reliable. Past performance is not necessarily indicative of future results. Therefore, FFA Private Bank makes no guarantee or warranty to the accuracy and thoroughness of the information mentioned, and accepts no responsibility or liability for damages incurred as a result of opinions formed and decisions made based on information presented in this document. All opinions expressed herein are subject to change without prior notice.