FFA Private Bank s.a.l.

Flash Note
October 24, 2014

Bank Audi Q3/14 Results

Sector: Banking
Country: Lebanon

MARKETWEIGHT

Target Price	**USD 7.00**
Closing Price	**USD 6.00**
Year to Date %	**-3.7%**
52 Week Range	**5.99 - 6.94**
Market Cap.	**USD 2,398.5 million**
Dividend Yield	**6.7%**
P/E (TTM)	**7.2x**
P/B to Common	**0.95x**

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

Source: Bloomberg, FFA Private Bank

Net profits at USD 90 million in Q3/14, slightly above our USD 88 million estimate. While Q3/14 net profits were higher YoY (+23%), they remained below their levels in previous quarter (-13%)

Bank Audi's net profits were at USD 90 million in Q3/14 (-13% QoQ, +23% YoY) slightly above our USD 88 million estimate. Diluted EPS was USD 0.22 vs. USD 0.27 in Q2/14, USD 0.19 in Q3/13 and FFA est. USD 0.20. While operating income and cost efficiencies came in higher than our estimates in Q3/14, the positive variance to our expectations was mostly offset by heavier than expected provisions. We value a strong increase in core income in Q3/14 (by nature less volatile than financial gains) as shown by NII reaching USD 212 million (+10% QoQ, +26% YoY) and F&C growing to USD 66 million (+4% QoQ, +44% YoY), while increase in financial gains was generally more moderate (-37% QoQ, +28% YoY). Opex were at USD 181 million in Q3/14, pointing to a decrease QoQ (-8%) yet remained higher YoY (+22%). The cost-to-income trended favorably to reach 55% in Q3/14, pointing to improved efficiencies QoQ and higher revenues YoY. Higher provisions were booked in Q3/14 amounting to USD 36 million, mainly justified by profits from Odea Bank being put aside in collective provisions as a prudent measure to mitigate expansion risks. NPL ratio rose to 2.8%. Tax rate was at 21% in Q3/14 just above our estimated 20%. On the balance sheet side, deposits and loans flattened in Q3/14, missing our estimated 3%-5% range as Turkish Lira's devaluation in Q3/14 offset Odea Bank's growth. LDR was at 47% in Q3/14 vs. FFA est. 47.9%. Looking at 9M/14, net profits upped 7% YoY to USD 280 million from USD 261 million with EPS at USD 0.71 vs. USD 0.68 in 9M/13. Key balance sheet indicators grew by 8%-10% Ytd.

Table 1: Bank Audi Q3/14 results vs. FFA Private Bank estimates

USD million	Q3/14a	*FFA Q3/14e*	Q2/14a	Q3/13a	QoQ %	YoY %
Net interest income (NII)	212	199	192	169	10%	26%
Operating income	331	318	339	256	-2%	29%
Net profits	90	88	104	73	-13%	23%
Diluted EPS	0.22	0.20	0.27	0.19	-17%	15%
Assets	39,889	40,493	39,262	34,470	2%	16%
Deposits	33,918	35,027	33,960	29,471	0%	15%
Loans	15,926	16,792	16,034	13,565	-1%	17%
BVPS to common	7.23	6.34	6.28	6.30	15%	15%
FFA Cost-to-income ratio	*54.6%*	*60.0%*	*57.7%*	*58.0%*		
Loans-to-deposits ratio	*47.0%*	*47.9%*	*47.2%*	*46.0%*		

Source: Company reports and FFA Private Bank estimates

Table 2: Summary Income Statement

USD million	Q3/14	Q2/14	Q3/13	QoQ%	YoY %	9M/14	9M/13	YoY %
Net interest income	**211.8**	**191.8**	**168.6**	**10.4%**	**25.6%**	**586.0**	**470.4**	**24.6%**
As a % of total operating income	*64.0%*	*56.6%*	*65.9%*			*61.3%*	*58.0%*	
Fees and commissions income	65.8	63.0	45.7	4.4%	44.0%	180.9	133.5	35.5%
Trading and investment income	53.3	84.0	41.8	-36.6%	27.5%	188.5	206.9	-8.9%
Non-interest income	**119.1**	**147.1**	**87.4**	**-19.1%**	**36.2%**	**369.4**	**340.4**	**8.5%**
As a % of total operating income	*36.0%*	*43.4%*	*34.1%*			*38.7%*	*42.0%*	
Total operating income	**330.8**	**338.9**	**256.1**	**-2.4%**	**29.2%**	**955.4**	**810.8**	**17.8%**
Personnel expenses	(107.7)	(112.2)	(83.7)	-4.1%	28.6%	(308.7)	(235.9)	30.9%
Non-personnel expenses	(72.9)	(83.4)	(64.7)	-12.6%	12.7%	(224.4)	(185.5)	21.0%
Total operating expenses	**(180.5)**	**(195.6)**	**(148.4)**	**-7.7%**	**21.7%**	**(533.1)**	**(421.4)**	**26.5%**
Cost- to- income ratio	*54.6%*	*57.7%*	*58.0%*			*55.8%*	*52.0%*	
Pre-provision profit before tax	**150.3**	**143.3**	**107.7**	**4.8%**	**39.6%**	**422.3**	**389.3**	**8.5%**
Provisions	(36)	(15)	(14)	149.0%	150.1%	(70.8)	(61.1)	15.8%
Provisions as a % of pre-provision profit	*24.1%*	*10.1%*	*13.4%*			*16.8%*	*15.7%*	
Profit before tax	**114.1**	**128.8**	**93.2**	**-11.4%**	**22.4%**	**351.6**	**328.2**	**7.1%**
Income tax	(24.0)	(24.8)	(20.0)	-3.4%	20.1%	(71.7)	(67.0)	7.1%
Income tax rate	*21.0%*	*19.3%*	*21.4%*			*20.4%*	*20.4%*	
Net profits	**90.1**	**104.0**	**73.2**	**-13.3%**	**23.0%**	**279.9**	**261.3**	**7.1%**
Minority interest	(3.1)	(3.1)	0.1			(8.2)	(6.9)	
Net profits (group share)	**87.0**	**100.9**	**73.3**	**-13.8%**	**18.6%**	**271.7**	**254.3**	**6.8%**
EPS to common (basic)	0.22	0.27	0.19	-17.2%	15.4%	0.71	0.68	5.2%
EPS to common (diluted)	**0.22**	**0.27**	**0.19**	**-17.2%**	**15.4%**	**0.71**	**0.68**	**5.2%**
EPS TTM to common (diluted)	**0.83**							

Source: Company reports

Net interest income up to USD 212 million (+10% QoQ, +26% YoY). While YoY increase was driven by higher balance sheet volumes and margins improvement, QoQ growth was only on account of higher margins as balance sheet growth was rather muted

Bank Audi's net interest income totaled USD 212 million in Q3/14 (+10% QoQ, +26% YoY), from higher balance sheet volumes and margins improvement, although QoQ on account of higher margins as balance sheet growth was rather muted. Looking at 9M/14, net interest income increased by 25% YoY to USD 586 million from USD 470 million favorably impacted by solid growth in earning assets and widening net interest margins. Figures provided my Management reveal that interest spreads were up to 2.08% in 9M/14 from 1.96% in 9M/13 largely driven by Odea Bank as it remains challenged domestically by limited room to improve asset yields. Net interest income generated from Odea Bank in 9M/14 increased to USD 144 million up nearly ~ USD 100 million from 9M/13 from both balance sheet expansion and margins improvement. Odea Bank's net interest margins are estimated to have averaged 2.70% in Q3/14 (and >3% in Oct/14) up from 1.96% in previous quarter, and 1.72% in Q1/14 as Odea Bank is benefiting from lower cost of funds principally and higher spreads on new loans.

Sector's statistics from the ABL for the month of August 2014 reveal that Lebanese banks are still operating in a low interest environment, limiting potential to improve earning asset yields along with limited capacity to decrease the cost of funds given market share concerns amidst slower deposit accumulation

Spreads in USD decreased to 1.32% in August 2014 down from 1.46% one year earlier which has a substantial impact on Lebanese Bank's profitability given that the bulk of their liquidity is in USD. This decrease was driven by a 15 bps increase in the cost of funds to 3.04% in the context of roughly unchanged weighted average on uses of funds at ~4.35%. Reminder, banks are still dealing with a negative carry on USD liquidity. **Spreads in LBP** narrowed YoY in August 2014 (0.94% vs. 1.37% in Aug-13) from higher cost of funds (+8 bps to 5.51%) and lower return on uses of funds (-35 bps to 6.45%) which was dragged down by lower lending rates (-7 bps to 7.34%) and more essentially lower rates on CDs issued by the BDL (-67 bps to 8.12%) despite higher yields on T-bills (+20 bps to 6.92%).

Further increase in fees and commissions in Q3/14 to reach USD 66 million (+4% QoQ, +44% YoY), helps drive core income

Bank Audi's net fees and commissions income witnessed further increase in Q3/14 to USD 66 million (+4% QoQ, +44% YoY), which we positively view given their less volatile nature compared to financial gains. This positive momentum in fees and commissions is being triggered by the expansion of the Group including the rapidly growing franchise in Turkey. On the other hand, financial gains totaled USD 53 million in Q3/14 (-37% QoQ, +28% YoY). Non-interest income totaled USD 119 million for the quarter. The operating income mix for Q3/14 highlight a stable contribution from core income (including net interest income and fees and commissions income) compared to Q3/13 at 84% although well higher than 75% in previous quarter. In the first nine month of 2014, non-interest income totaled USD 369 million, 9% up YoY, as lower financial gains were totally offset by higher fees and commissions income.

Table 3: Summary Balance Sheet

USD million	Q3/14	Q2/14	Q4/13	QoQ%	YTD%
Cash and balances	8,677.8	7,326.3	6,097.6	18.4%	42.3%
Due from banks and other financial institutions	4,021.5	3,907.8	3,242.1	2.9%	24.0%
Financial assets	10,156.4	10,957.7	11,190.2	-7.3%	-9.2%
Loans and advances	**15,925.7**	**16,034.3**	**14,712.9**	**-0.7%**	**8.2%**
Intangible assets and goodwill	194.5	194.9	194.6	-0.2%	-0.1%
Other assets	912.8	841.3	753.8	8.5%	21.1%
Total assets	**39,888.7**	**39,262.3**	**36,191.3**	**1.6%**	**10.2%**
Due to Central Banks	262.6	237.0	167.2	10.8%	57.1%
Due to banks and other financial institutions	1,328.7	1,106.1	1,191.4	20.1%	11.5%
Deposits	**33,918.3**	**33,959.8**	**31,095.1**	**-0.1%**	**9.1%**
Immediate liquidity to deposits	*37.4%*	*33.1%*	*30.0%*		
Loans- to- deposits	*47.0%*	*47.2%*	*47.3%*		
Subordinated debt	510.0	507.4	356.3	0.5%	43.1%
Other liabilities	799.3	714.4	685.1	11.9%	16.7%
Total liabilities	**36,818.9**	**36,524.6**	**33,495.1**	**0.8%**	**9.9%**
Shareholders' equity	2,527.4	2,195.4	2,154.4	15.1%	17.3%
Preferred shares	500.0	500.0	500.0	0.0%	0.0%
Minority interest	42.4	42.3	41.8	0.3%	1.5%
Total shareholders' equity	**3,069.8**	**2,737.6**	**2,696.2**	**12.1%**	**13.9%**
Total liabilities and shareholders' equity	**39,888.7**	**39,262.3**	**36,191.3**	**1.6%**	**10.2%**
Book value per share	7.57	7.71	7.59	-1.7%	-0.2%
Book value per share to common	**6.32**	**6.28**	**6.16**	**0.7%**	**2.6%**
Tangible book value per share to common	5.84	5.72	5.60	2.0%	4.2%

Source: Company reports

Consolidated cost-to-income down to 55% in Q3/14, while Odea Bank's net profits accelerates as branch network gains in maturity

The cost-to-income ratio decreased to 54.6% in Q3/14 (-310 bps QoQ, -340 bps YoY) pointing to higher efficiencies QoQ and higher revenues YoY. Cost-to-income remains higher than pre-Turkey expansion levels where Bank Audi built USD 9.6 billion in assets and a network of 45 branches (including kiosk) in almost two years of activity. Looking at the first nine months of 2014, the cost-to-income was higher at ~56% vs. 52% for 9M/13 reflecting initial stages of expansion in Turkey which should gradually stabilize over time as the branch network gains in maturity.

Odea Bank started reporting first sets of profits in Q2/14 at USD 3.3 million, which further accelerated to USD 11.2 million in Q3/14 accounting for 12% of consolidated net profits as margins, efficiencies and LDRs move higher and closer to peers.

Gross NPL ratio rose to 2.8% in Q3/14, and higher cost of risk (est. 0.9%) mostly from general provisions allocated at Odea Bank

Bank Audi's consolidated gross NPLs rose to 2.8% in Q3/14 from 2.5% in previous quarter, still contained below the 3.0% level and lower than peers under coverage. We note an increase in the cost of risk in Q3/14 to an estimated ~ 0.9%, with net provisions at USD 36 million likely as part of a restructuring plan related to corporate banking accounts booked in Lebanon and mostly the reflection of an increase in Odea Bank's general provisions to help mitigate expansion risks. For the first half of 2014, net provisions were at USD 71 million compared to USD 61 million in the corresponding period of previous year with a cost of risk mostly unchanged at ~ 0.9%.

Growth in key balance sheet indicators muted in Q3/14, as Turkish Lira's devaluation offsets Odea's Bank growth

The Bank's deposits and loans remained almost flat in Q3/14 totaling ~ USD 34 billion and USD 16 billion respectively, despite a 2% QoQ growth in consolidated assets . This could be explained by Turkish Lira's devaluation in Q3/14 (from ~2.12 USD/TRY at end-June 2014 to ~ 2.28 USD/TRY at end-September 2014), which offset the growth of Odea Bank which added around TL 1.0 billion, TL 1.5 billion, TL 1.1 billion in assets, deposits and loans during Q3/14. The contribution of Turkey to Bank Audi's total assets remained stable at 24% compared to previous quarter. Lebanon and Egypt contribution to total assets remained roughly stable at 55% and 10% respectively in Q3/14 (62% and 15% share in consolidated profits respectively), which along with Turkey represent the three main pillars of Bank Audi's current growth strategy. The loans-to-deposits ratio at 47% is well above the Lebanese banking sector average (~35%), attributed to fast lending growth driven by Turkey. Looking at the first half of 2014, consolidated assets, deposits and loans grew by 8%-10% Ytd.

CAR III increased to 13.5% in Q3/14 from 12.3% in Q2/14 as a result of the capital increase which closed in September, while profitability ratios were roughly unchanged

Bank Audi's capital adequacy ratio (Basel III) increased to 13.5% from 12.3% in previous quarter as a result of the capital increase which was closed in September 2014, representing 50 million in additional common shares at an issue price of USD 6.00 per share and 3 warrants on Odea Bank. The capital increase aims to strengthen conformance vis-à-vis regulatory requirements and fund the expansion plan. In parallel, the equity-to-assets ratio increased to 7.7% compared to 7.0% in previous quarter. Looking at profitability, the TTM ROA was at an estimated 0.87% vs. 0.84% in previous quarter while the TTM ROE is estimated at around 11.1% vs. 11.3% in previous quarter given higher capitalization levels QoQ. The TTM EPS was USD 0.83 in Q3/14 (vs. USD 0.80 in previous quarter) while book value per share is estimated at USD 7.57 (USD 6.32 to common).

With rising profits, valuation at attractive levels (P/B to common: 0.95x, P/E: 7.2x), coupled with interesting 6%+ dividend yield

Based on today's listed share price of USD 6.00 (down 3.7% so far in 2014), Bank Audi is trading at 7.2x P/E, 0.79x P/B (P/B to common of 0.95x) and dividend yield of 6.7%, 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 lower multiples relative to regional peers similarly to other banks under coverage. This could be partly explained by a need for a sustained return to earnings growth to drive Bank Audi's EPS and ROE closer to regional peers as well as i) structural illiquidity on the BSE and ii) need for further visibility in terms of a pick-up in economic activity and abatement in political risks. For Q3/14, we value the Company's improved results largely stemming from core income growth and improved efficiencies driving pre provision profits, continued execution of its growth strategy resting on three key pillars as well as attractive dividend yield at 6%+ (likely defended given below 50% payout and rising profits).

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