Equity Research - Flash Note - Bank Audi Q4/17 Results

Sector: Banking
Country: Lebanon

MARKETWEIGHT

Target Price	USD 7.00
Closing Price	USD 5.90
52 Week Range	USD 5.40-7.00
Year to Date %	+2.61%
Market Cap.	USD 2,358.5 million
Dividend Yield	8.5%
P/E (TTM)	5.7x
P/B to Common	0.74x

Note: the share data represents Bank Audi listed shares (AUDI LB)
Bank Audi GDR shares at USD 5.90 (BQAD LI) and USD 5.94 (AUSR LB)
Source: Bloomberg, FFA Private Bank
Market close on January 31, 2018

Bank Audi Q4/17 Results Summary vs. FFA Private Bank est.

USD million except per share data	Q4/17a	FFA Q4/17e	QoQ	YoY
Net interest income	255.1	281.3	-7%	-2%
Fees & commission	63.2	63.5	20%	-4%
Trading & investment	50.0	56.7	-37%	-81%
Operating income	368.4	401.6	-9%	-37%
Provisions	-21.8	-43.8	-59%	-90%
Operating expenses	-183.5	-200.2	-4%	-7%
Income tax	-40.4	-33.2	30%	-41%
Net profits	122.5	124.9	-5%	17%
Diluted EPS to common	0.25	0.28	-16%	15%
Assets	43,752	45,057	-2%	-1%
Deposits	33,451	36,471	-6%	-7%
Loans	16,294	17,518	-5%	-5%
BVPS to common	7.98	7.77	2%	12%
	Q4/17a	**FFA Q4/17e**	**Q3/17a**	**Q4/16a**
FFA Net interest margins	2.36%	2.54%	2.27%	2.36%
Core income to total operating income ratio	86.4%	85.9%	80.5%	80.5%
FFA Cost-to-income ratio	49.8%	49.9%	47.3%	33.9%
Immediate liquidity-to-deposit ratio	44.6%	44.8%	42.5%	43.8%
Loan-to-deposit ratio	48.7%	48.0%	48.0%	47.9%
Equity-to-asset ratio	9.6%	8.6%	8.5%	8.4%

Source: Company reports and FFA Private Bank estimates
Note: Net profits excluding discontinued operations

Bank Audi's net profit at USD 122.5 million in Q4/17 (-5% QoQ, +17% YoY excl. exceptional gains registered in 2016 and 2017) slightly below FFA est. of USD 124.9 million while balance sheet aggregates largely below our estimates. Bank Audi's profits at USD 122.5 million (-5% QoQ, +17% YoY) in Q4/17 slightly below FFA est. of USD 124.9 million and diluted EPS at USD 0.25 (-16% QoQ, +15% YoY) vs. FFA est. USD 0.28. Operating income came in below our forecasts at USD 368.4 million (vs. FFA est. USD 401.6 million) driven by largely weaker-than-expected net interest income at USD 255.1 million (vs. FFA est. USD 281.3 million) from decline in balance sheet despite improvement in NIMs. Fees and commission income came in line with our estimates at USD 63.2 million while trading and investment income was at USD 50.0 million (vs. FFA est. USD 56.7 million). This negative variance to the bottom line was partly offset by lower-than-expected credit loss provisions at USD 21.8 million (vs. FFA est. USD 43.8 million) and opex at USD 183.5 million (vs. USD 200.2 million) from softer non-personnel expenses. Income tax came in at USD 40.4 million (vs. FFA est. USD 33.2 million) resulting in an income tax rate at ~25% (vs. FFA est. 21%). We expect tax levels to rise in the next quarters as a result of newly introduced taxes in Lebanon on interest earned from placements with the central bank as well as interbank deposits, and weigh on profitability given Bank Audi's sizeable balances with BDL and interbank placements. Balance sheet growth came in largely below our forecasts with assets at USD 43.7 billion (vs. FFA est. 45.0 billion), deposits at USD 33.4 billion (vs. FFA est. 36.4 billion) and loans at USD 16.3 billion (vs. FFA est. 17.5 billion) weighed by significant contraction in Odea Bank balance sheet components in local currency. Loan-to-deposit ratio at 48.7% (vs. FFA est. 48.0%), slightly above Q3/17 and Q4/16 levels of ~48.0%.

Net profits for the full year 2017 at USD 463.8 million (excl. exceptional gains) slightly below FFA est. at USD 466.3 million while EPS at USD 1.03 (vs. FFA est. USD 1.05). Odea Bank and Bank Audi Egypt contributed respectively to 19% and 12% of net profits, and 20% and 7% of total assets.

Net interest income declined to USD 255.1 million (-7% QoQ, -2% YoY) as balance sheet contraction in Turkey largely offset QoQ improvement in net interest margins in Lebanon

Bank Audi posted net interest income at USD 255.1 million (-7% QoQ, -2% YoY) which came in line with the decline in balance sheet despite significant improvement in net interest margins and higher LDRs in key pillars. We estimate net interest margins at 2.36% up from 2.27% in Q3/17 and unchanged YoY as the improvement was capped by higher cost of funds particularly in Egypt while asset yields in Lebanon were supported by higher returns on BDL placements. At the sector level, spreads in LBP remained stable while we highlight higher asset yields in USD between September 2017 and November 2017 driven by higher USD deposit rates at BDL and pick up in LIBOR which offset increasing cost of funds.

Lower non-interest income in Q4/17 at USD 113.2 million (-14% QoQ, -65% YoY) driven by weaker trading and investment income QoQ and YoY

Non-interest income came in at USD 113.2 million in Q4/17 (-14% QoQ, -65% YoY) driven by weaker trading and investment income at USD 50.0 million (-37% QoQ, -81% YoY) despite higher fees and commission income QoQ at USD 63.2 million (+20% QoQ, -4% YoY). We note that YoY comparisons in Bank Audi's non-interest income are largely weighed by exceptional gains registered in the back half of 2016 as part of BDL's 2016 debt swap. Bank Audi's quality mix improved with higher contribution of core income (net interest income + net fees and commissions) to total operating income at 86% in Q4/17 up from 81% in Q3/17 and 56% in Q4/16.

Higher cost-to-income QoQ driven by softer operating income despite cost containment efforts

Bank Audi's cost-efficiencies deteriorated in Q4/17 with cost-to-income ratio at 49.8% up from 47.3% in Q3/17 and 33.9% in Q4/16 partly weighed by higher cost-to-income in Odea Bank on a QoQ and YoY basis. At the group level, decline in operating efficiencies was driven by lower operating income despite lower opex QoQ and YoY amid management efforts to contain costs. We highlight that YoY change in operating leverage is largely weighed by Bank Audi's participation in BDL debt swap operations in the back half of 2016 which resulted in exceptionally strong non-interest income as well as expense items.

Balance sheet aggregates contracted in Q4/17 mainly on material decline in Odea Bank's assets, deposits and loans amid management focus on risk control

Bank Audi's assets, deposits and loans declined QoQ at respective -2%, -6% and -5% and YoY at -1%, -7% and -5% to reach USD 43.7 billion, USD 33.4 billion and USD 16.3 billion. LDR increased to 48.7% despite management's conservative approach to lending from 48.0% in Q3/17 and 47.9% in Q4/16 as loan growth picked up in Lebanon likely outperforming sector averages despite challenging macro environment. We also highlight material QoQ decline in deposits in Lebanon, Egypt and Turkey as part of Bank Audi's strategy to reduce costly deposits and preserve interest rate margins. At the end of 2017, Turkey and Egypt accounted to respective 20%/36% and 7%/10% of Bank Audi's assets/loans amid management's policy to consolidate activities and reinforce risk control at the expense of balance sheet expansion. Gross NPLs slightly increased to 3.5% in Q4/17 as credit quality concerns persisted at Odea Bank which accounted to more than 50% of the group's doubtful loans reflecting challenging operating conditions.

Material improvement in regulatory capital which remains above BDL's requirements while profitability was lower YoY at the group level

Capital adequacy ratio (as per Basel III) increased to 16.9% in Q4/17 from 15.6% in Q3/17, above BDL's requirement of 14.5% for 2017 (15.0% by end of 2018) with CET1 ratio at 10.5% up from 10.1% in Q3/17. TTM ROA at an est. ~1.05% above Q4/17 level of ~1.03% yet lower than an est. ~1.09% in Q4/16 as higher ROA in Turkey was offset by lower profitability in Lebanon and Egypt YoY and TTM ROE estimated at 11.8% down from 12.3% in Q3/17 and 13.3% in Q4/16 as profitability gains in Turkey were offset by lower ROA in Lebanon and Egypt. TTM EPS at USD 1.03 slightly up from USD 1.00 in Q3/17 and lower than USD 1.08 in Q4/16. Equity-to-asset ratio at 9.6% in Q4/17 up from 8.5% in Q3/17 and 8.4% in Q4/16 and est. BVPS at USD 7.98 (USD 7.78 to common, +2% QoQ, -2% YoY).

We highlight steady earnings growth and reinforced capital buffers while asset quality concerns, particularly in Turkey, are expected to further cap expansion. Shares provide interesting entry point for investors ahead of dividend season given attractive dividend yield and discount valuation vs. regional peers

We value Bank Audi's stable earnings growth and improved capital buffers supported by a more favorable income quality mix and the group's diversified business segments as it continues to operate in challenging macro environments in Lebanon, Turkey and Egypt. We expect management's focus on risk control- which translates into contained NPLs levels- to continue capping balance sheet expansion, particularly in Turkey, while newly introduced taxes in Lebanon- which currently accounts to ~55% of total profits- could weigh on bottom line growth in 2018. As dividend season approaches, we favorably view Bank Audi shares as they trade at a ~8% dividend yield, multiples at discount to regional peers and 2018e BVPS growth expected at ~7%, providing an interesting entry point for investors.

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