

Flash Note

January 31, 2014

Bank Audi Q4/13 Results

Sector: Banking

Country: Lebanon

MARKETWEIGHT

| | |
|----------------|---------------------|
| Target Price | USD 7.50 |
| Closing Price | USD 6.40 |
| Year to Date % | 2.6% |
| 52 Week Range | 6.00 -6.94 |
| Market Cap. | USD 2,238.4 million |
| Dividend Yield | 6.3% |
| P/E (TTM) | 8.0x |
| P/B to Common | 1.04x |

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

Source: Bloomberg, FFA Private Bank

Net profits at USD 43 million in Q4/13, below estimates from lower than expected financial gains, heavier provisions and opex, despite stronger core income

Bank Audi's net profits amounted to USD 43 million in Q4/13 (~40% down QoQ and YoY). Diluted EPS was USD 0.12 vs. USD 0.19 in Q3/13 and USD 0.18 in Q4/12. This decline was mostly driven by weaker financial gains at ~ USD 20 million in Q4/13 (-50% QoQ, -80% YoY), in parallel to high provisions (USD 29 million in Q4/13, up ~100% QoQ) and opex (USD 178 million, up 20% QoQ and 14% YoY). We favorably view strong revenues from core income as highlighted by a solid growth in net interest income (+9% QoQ, +31% YoY) and fees and commissions (+19% QoQ, +7% YoY) to USD 185 million and USD 54 million respectively for the quarter. For the full year 2013, net profits were 21% down YoY to USD 305 million mostly due to lower financial gains and higher opex (partly due to the first year of operations in Turkey) and despite solid growth in net interest income and lower provisions. Net profits at USD 44 million in Q4/13 were well below our USD 95 million estimate from higher than expected provisions and opex and despite stronger than expected core income (which we positively view). Total assets, deposits and loans grew by a respective 5%, 6% and 8% QoQ in Q4/13 (principally driven by Odea Bank) and surpassing our 2%, 2% and 5% estimates.

Table 1: Bank Audi Q4/13 results vs. FFA Private Bank estimates

| USD million | Q4/13a | FFA Q4/13e | Q3/13a | Q4/12a | QoQ % | YoY % |
|--------------------------|--------|------------|--------|--------|-------|-------|
| Net interest income | 185 | 166 | 170 | 141 | 9% | 31% |
| Operating income | 260 | 291 | 256 | 285 | 1% | -9% |
| Net profits (*) | 43 | 95 | 73 | 74 | -41% | -42% |
| Diluted EPS (*) | 0.12 | 0.24 | 0.19 | 0.18 | -38% | -33% |
| Assets | 36,117 | 35,017 | 34,470 | 31,303 | 5% | 15% |
| Deposits | 31,095 | 30,169 | 29,471 | 26,805 | 6% | 16% |
| Loans | 14,704 | 14,189 | 13,565 | 10,428 | 8% | 41% |
| BVPS to common | 6.16 | 6.79 | 6.30 | 6.31 | -2% | -2% |
| FFA Cost-to-income ratio | 68.6% | 53.0% | 58.0% | 54.7% | | |
| Loans-to-deposits ratio | 47.3% | 47.0% | 46.0% | 38.9% | | |

Source: Bank Audi and FFA Private Bank estimates

Note: (*) Net profits and diluted EPS for Q4/12 include negative impact from discontinued operations

Table 2: Summary Income Statement

| USD million | Q4/13 | Q3/13 | Q4/12 | QoQ% | YoY % | 2013 | 2012 | YoY% |
|--|---------|---------|---------|--------|--------|---------|---------|--------|
| Net interest income | 185.0 | 169.8 | 141.3 | 8.9% | 30.9% | 655.3 | 572.9 | 14.4% |
| As a % of total operating income | 71.2% | 66.3% | 49.6% | | | 61.2% | 52.1% | |
| Fees and commissions income | 54.3 | 45.7 | 50.6 | 18.8% | 7.2% | 187.8 | 185.3 | 1.3% |
| Trading and investment income | 21 | 41 | 93.2 | -49.2% | -77.9% | 227.4 | 342.1 | -33.5% |
| Non-interest income | 74.8 | 86.2 | 143.8 | -13.2% | -47.9% | 415.2 | 527.4 | -21.3% |
| As a % of total operating income | 28.8% | 33.7% | 50.4% | | | 38.8% | 47.9% | |
| Total operating income | 259.8 | 256.1 | 285.0 | 1.5% | -8.9% | 1070.6 | 1100.4 | -2.7% |
| Personnel expenses | (91.1) | (84.9) | (79.5) | 7.3% | 14.6% | (327.1) | (273.1) | 19.7% |
| Non-personnel expenses | (87.2) | (63.5) | (76.4) | 37.2% | 14.1% | (272.7) | (242.4) | 12.5% |
| Total operating expenses | (178.3) | (148.4) | (156.0) | 20.1% | 14.3% | (599.7) | (515.6) | 16.3% |
| Cost- to- income ratio | 68.6% | 58.0% | 54.7% | | | 56.0% | 46.9% | |
| Pre-provision profit before tax | 81.5 | 107.7 | 129.1 | -24.3% | -36.8% | 470.8 | 584.8 | -19.5% |
| Provisions | (29) | (14) | (27.2) | 98.6% | 5.6% | (89.8) | (121.1) | -25.8% |
| Provisions as a % of pre-provision profit | 35.2% | 13.4% | 21.1% | | | 19.1% | 20.7% | |
| Profit before tax | 52.8 | 93.2 | 101.9 | -43.4% | -48.2% | 381.0 | 463.7 | -17.8% |
| Income tax | (9.1) | (20.0) | (17.3) | -54.3% | -47.2% | (76.1) | (102.5) | -25.8% |
| Income tax rate | 17.3% | 21.4% | 16.9% | | | 20.0% | 22.1% | |
| Profit after tax from continuing operations | 43.7 | 73.2 | 84.6 | -40.4% | -48.4% | 305.0 | 361.2 | -15.6% |
| Result of discontinued operations | (0.4) | 0.0 | (10.4) | | | (0.4) | 22.4 | |
| Net profits | 43.3 | 73.2 | 74.2 | -40.9% | -41.7% | 304.6 | 383.6 | -20.6% |
| Minority interest | 4.0 | 0.1 | (6.1) | | | (3.0) | (9.0) | |
| Net profits (group share) | 47.3 | 73.3 | 68.1 | -35.5% | -30.6% | 301.6 | 374.6 | -19.5% |
| EPS to common (basic) | 0.12 | 0.19 | 0.18 | -37.7% | -32.8% | 0.80 | 1.01 | -21.4% |
| EPS to common (diluted) | 0.12 | 0.19 | 0.18 | -37.7% | -32.7% | 0.80 | 1.01 | -21.4% |
| EPS to common from continuing ops. (diluted) | 0.12 | 0.19 | 0.21 | -37.7% | -42.4% | 0.80 | 0.95 | -16.1% |
| EPS TTM to common (diluted) | 0.80 | | | | | | | |

Source: Bank Audi

Net interest income saw solid growth in Q4/13 (+9% QoQ, +31% YoY) with a similar upward trajectory in FY2013

Bank Audi's net interest income totaled USD 185 million in Q4/13 (+9% QoQ, +31% YoY). Looking at the full year 2013, net interest income followed the same upward trajectory as it totaled USD 655 million representing a 14% increase from USD 573 million in 2012 attributed to a similar 15% growth in assets over the same period (mostly driven by Turkish operations) as net interest margins for 2013 nudged down to 2.06% from 2.12% in 2012. However, we note an improvement in net interest margins sequentially in 2013 to 2.24% in Q4/13 partly explained by an improvement in Odea Bank's net interest margins from 0.55% in Q1/13 up to 2.02% in Q4/13. 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 decreased to 1.39% in November 2013 down from 1.68% 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 i) lower rates on LIBOR (average 3 months on USD deposits down to 0.24% from 0.31%), ii) lower yields on Eurobonds (weighted average down to 7.18% from 6.73%), iii) lower rates on deposits at the BDL (average down to 2.30% from 3.05%) and lower lending rates (weighted average down to 7.13% from 6.89%). On the LBP side, it should be noted that yields on CDs issued were also lower YoY (at 8.62% down from 9.28% a year earlier), while yields on T-Bills edged up to 6.89% from 6.58% a year earlier.

Strong net fees and commissions income in Q4/13 at USD 54 million, above the ~ USD 45 million average over past quarters

Bank Audi's net fees and commissions income was strong in Q4/13 at USD 54 million (+19% QoQ, +7% YoY), surpassing the ~USD 45 million average over past quarters, which we positively view given their less volatile nature compared to financial gains. On another hand, financial gains were relatively low in Q4/13 at USD 21 million (-50% QoQ, -78% YoY) which dragged the non-interest income down for the quarter to USD 75 million. Looking at FY2013, non-interest income totaled USD 415 million representing a ~20% drop on account of lower financial gains, as fees and commissions were roughly flat during the year. The operating income mix for 2013 highlight a higher contribution from net interest income (at 61% vs. 52% in 2012) and a relatively stable contribution of fees and commissions (~18%) from stronger NII, lower financial gains and roughly flat FC during the year.

Table 3: Summary Balance Sheet

| USD million | Q4/13 | Q3/13 | Q4/12 | QoQ% | YTD% |
|---|-----------------|-----------------|-----------------|--------------|--------------|
| Cash and balances | 6,097.6 | 6,021.0 | 6,276.9 | 1.3% | -2.9% |
| Due from banks and other financial institutions | 3,144.9 | 2,686.8 | 3,543.1 | 17.0% | -11.2% |
| Financial assets | 11,190.2 | 11,299.4 | 10,209.5 | -1.0% | 9.6% |
| Loans and advances | 14,703.6 | 13,565.4 | 10,428.5 | 8.4% | 41.0% |
| Intangible assets and goodwill | 194.6 | 182.5 | 180.7 | 6.7% | 7.7% |
| Other assets | 786.4 | 714.7 | 664.1 | 10.0% | 18.4% |
| Total assets | 36,117.3 | 34,469.8 | 31,302.8 | 4.8% | 15.4% |
| Due to Central Banks | 167.2 | 118.1 | 88.3 | 41.6% | 89.4% |
| Due to banks and other financial institutions | 1,105.8 | 1,190.4 | 1,229.0 | -7.1% | -10.0% |
| Deposits | 31,094.7 | 29,471.0 | 26,804.6 | 5.5% | 16.0% |
| <i>Immediate liquidity to deposits</i> | <i>29.7%</i> | <i>29.5%</i> | <i>36.6%</i> | | |
| <i>Loans- to- deposits</i> | <i>47.3%</i> | <i>46.0%</i> | <i>38.9%</i> | | |
| Subordinated debt | 356.3 | 350.1 | 0.0 | 1.8% | |
| Other liabilities | 695.8 | 593.8 | 510.6 | 17.2% | 36.3% |
| Total liabilities | 33,419.7 | 31,723.4 | 28,632.5 | 5.3% | 16.7% |
| Shareholders' equity | 2,155.8 | 2,203.8 | 2,206.0 | -2.2% | -2.3% |
| Preferred shares | 500.0 | 500.0 | 400.0 | 0.0% | 25.0% |
| Minority interest | 41.8 | 42.5 | 64.2 | -1.8% | -35.0% |
| Total shareholders' equity | 2,697.6 | 2,746.4 | 2,670.2 | -1.8% | 1.0% |
| Total liabilities and shareholders' equity | 36,117.3 | 34,469.8 | 31,302.8 | 4.8% | 15.4% |
| Book value per share | 7.59 | 7.73 | 7.46 | -1.8% | 1.8% |
| Book value per share to common | 6.16 | 6.30 | 6.31 | -2.2% | -2.4% |
| Tangible book value per share to common | 5.61 | 5.78 | 5.80 | -3.0% | -3.3% |

Source: Bank Audi

Cost-efficiencies deteriorated in Q4/13 from a steep increase in opex, reflecting the initial stage of expansion in Turkey

The cost-to-income increased drastically in Q4/13 (to 69% vs. 58% in Q4/12 and 55% in Q3/13) which can be attributed to weaker operating income from lower financial gains contrasting with significant increase in total operating expenses (+20% QoQ, +14% YoY). For the full year 2013, cost-to-income was 56%, substantially up from 47% in 2012 as total operating income stalled over the year (-3%) in parallel to a jump in opex (+16%). This strong growth in costs in 2013 (which includes non-cash costs) reflects the initial stage of expansion in Turkey where Bank Audi built USD 7.6 billion in assets and a network of 31 branches in 14 months of activity (noting that 11 branches were opened during Q4/13). A net loss of USD 20 million was recorded in Turkey in Q4/13, translating into a total net loss of USD 44 million for 2013. The acceleration in net loss in Q4/13, did not deter Management plan to breakeven over the short term.

Gross NPL ratio up to 2.7% with a coverage ratio virtually reaching the 100% level

Bank Audi's consolidated gross NPLs increased to 2.7% in Q4/13 up from 2.3% in Q3/13, still significantly lower than peers under coverage. The coverage of these loans by specific and collective provisions was 98% in Q4/13 highlighting solid provisioning levels. Net allocated provisions amounted to USD 29 million in Q4/13 (higher QoQ and YoY), yet they remain lower than their peak in 2012 (USD 90 million in 2013 vs. USD 121 million in 2012). The increase in provisions could be partly attributed to a deteriorating quality in some GCC loans booked in Lebanon as well as general provisions taken in Turkey in line with regulatory requirements. We favorably view a further decrease in bad debts written off to around USD 10 million in 2013 compared to a total of USD 105 million for the full year 2012.

Strong growth in key balance sheet indicators over 2013, driven by Turkish operations

On the balance sheet side, the Bank's assets, deposits and loans grew by 5%, 6% and 8% respectively in Q4/13 to USD 36.1 billion, USD 31.1 billion and USD 14.7 billion respectively at the end of the quarter. This increase stems from operations in Turkey where the Bank operates a network of 31 branches. In fact assets, deposits and loans from Turkish operations grew by 15%, 16% and 26% respectively during Q4/13 amounting to USD 7.6 billion, USD 5.8 billion and USD 5.3 billion at the end of the quarter (equivalent to a contribution of 21% in total assets, 19% in total deposits and 36% in total loans). Looking at the full year 2013, we note a strong growth in key balance sheet indicators at 15%, 16% and 41% respectively for assets, deposits and loans. The loans-to-deposits ratio reached 47% (well above the sector average at ~35%) attributed to fast lending growth in Turkey while the immediate liquidity to deposits ratio stood at 30%.

CAR III at 11% (down sequentially) and valuation metrics at attractive levels (P/B: 1.04x, P/E: 8.0x, div%: 6.3%)

Bank Audi's capital adequacy ratio (Basel III) was 11% in 2013 down sequentially from 11.8%. On another hand, the TTM ROA stood at 0.9% down from 1.1% in previous quarter while the TTM ROE is estimated at around 11.3% compared to an estimated 12.8% in Q3/13. The TTM EPS was USD 0.80 in Q4/13 while book value per share is estimated at USD 7.59 (USD 6.16 to common). Based on today's listed share price of USD 6.40, Bank Audi is trading at 8.0x P/E, 0.84x P/B (P/B to common of 1.04x) and dividend yield of 6.3%, with a DPS recommendation likely to remain unchanged for 2013 although at a higher than historical average payout.

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.