

Flash Note

January 27, 2015

Bank Audi Q4/14 Results

Sector: Banking

Country: Lebanon

MARKETWEIGHT

Target Price	USD 7.00
Closing Price	USD 6.20
Year to Date %	+3.3%
52 Week Range	5.80 - 6.51
Market Cap.	USD 2,478.4 million
Dividend Yield	6.5%
P/E (TTM)	7.2x
P/B to Common	0.88x

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

Source: Bloomberg, FFA Private Bank

Net profits at USD 70 million in Q4/14, below our USD 91 million estimate on higher provisions and taxes although revenues came in stronger. Net profits at USD 350 million in 2014, up 15% YoY.

Bank Audi's net profits were at USD 70 million in Q4/14 (-22% QoQ, +63% YoY) below our USD 91 million estimate. Diluted EPS was USD 0.15 vs. USD 0.22 in Q3/14, USD 0.12 in Q4/13 and FFA est. USD 0.20. While operating income came in higher than our estimates (nearly all driven by stronger net interest income) and opex came in line, the favorable variance to our expectations was more than offset by heavier provisions and taxes. We value a strong increase in operating income in Q4/14 to USD 367 million (+11% QoQ, +41% YoY) mostly driven by net interest income (+15% QoQ, +45% YoY) as well as fees and commissions and financial gains yet to a lower extent. Opex were USD 197 million in Q4/14 meeting our estimates and representing a ~10% increase QoQ and YoY. Cost-to-income ratio at 54% in Q4/14 lower than expected 59%. Higher provisions were booked in Q4/14 amounting to USD 67 million, largely explained by collective provisions taken as a prudent measure across different entities. NPL ratio breached 3% from 2.8% QoQ, although still contained. Tax rate spiked to a surprising ~32% in Q4/14 driven by international operations. Key balance sheet indicators regained momentum in Q4/14 (5%-8% range) following a weak Q3/14 quarter, beating our low-single digit estimates. LDR at 48% in Q4/14 vs. 47% in Q3/14. In 2014, net profits increased 15% YoY to USD 350 million from USD 305 million with EPS at USD 0.86 vs. USD 0.80 in 2013. Key balance sheet indicators grew by 15%-17% YoY, well above sector average mostly driven by Turkey, as well as Lebanon and Egypt to a lesser extent.

Table 1: Bank Audi Q4/14 results vs. FFA Private Bank estimates

USD million	Q4/14a	FFA Q4/14e	Q3/14a	Q4/13a	QoQ %	YoY %
Net interest income (NII)	244	214	212	168	15%	45%
Operating income	367	334	331	259	11%	41%
Net profits	70	91	90	43	-22%	63%
Diluted EPS	0.15	0.20	0.22	0.12	-33%	23%
Assets	41,958	39,735	39,889	36,191	5%	16%
Deposits	35,823	34,294	33,918	31,095	6%	15%
Loans	17,168	16,146	15,926	14,713	8%	17%
BVPS to common	7.01	6.42	6.32	6.16	11%	14%
FFA Cost-to-income ratio	53.7%	59.0%	54.6%	68.6%		
Loans-to-deposits ratio	47.9%	47.1%	47.0%	47.3%		

Source: Company reports and FFA Private Bank estimates

Table 2: Summary Income Statement

USD million	Q4/14	Q3/14	Q4/13	QoQ%	YoY %	2014	2013	YoY %
Net interest income	243.9	211.8	167.9	15.2%	45.3%	829.9	638.2	30.0%
As a % of total operating income	66.5%	64.0%	64.8%			62.8%	59.7%	
Fees and commissions income	66.3	65.8	53.6	0.7%	23.8%	247.2	187.1	32.1%
Trading and investment income	56.3	53.3	37.8	5.8%	49.2%	244.8	244.6	0.1%
Non-interest income	122.6	119.1	91.3	3.0%	34.3%	492.0	431.7	14.0%
As a % of total operating income	33.5%	36.0%	35.2%			37.2%	40.3%	
Total operating income	366.5	330.8	259.2	10.8%	41.4%	1,322.0	1,069.9	23.6%
Personnel expenses	(104.5)	(107.7)	(91.1)	-2.9%	14.7%	(413.2)	(327.1)	26.3%
Non-personnel expenses	(92.2)	(72.9)	(86.5)	26.5%	6.6%	(316.6)	(272.0)	16.4%
Total operating expenses	(196.7)	(180.5)	(177.7)	9.0%	10.7%	(729.8)	(599.1)	21.8%
Cost- to- income ratio	53.7%	54.6%	68.6%			55.2%	56.0%	
Pre-provision profit before tax	169.8	150.3	81.5	13.0%	108.4%	592.2	470.8	25.8%
Provisions	(66.6)	(36.2)	(28.7)	84.1%	132.0%	(137.3)	(89.8)	52.9%
Provisions as a % of pre-provision profit	39.2%	24.1%	35.2%			23.2%	19.1%	
Profit before tax	103.3	114.1	52.8	-9.5%	95.5%	454.8	381.0	19.4%
Income tax	(32.8)	(24.0)	(9.1)	36.9%	259.2%	(104.5)	(76.1)	37.4%
Income tax rate	31.8%	21.0%	17.3%			23.0%	20.0%	
Net profits	70.5	90.1	43.3	-21.8%	62.8%	350.3	304.6	15.0%
Minority interest	(1.5)	(3.1)	4.0			(9.7)	(3.0)	
Net profits (group share)	68.9	87.0	47.2	-20.8%	45.9%	340.6	301.6	12.9%
EPS to common (basic)	0.15	0.22	0.12	-33.3%	23.2%	0.86	0.80	7.9%
EPS to common (diluted)	0.15	0.22	0.12	-33.3%	23.2%	0.86	0.80	7.9%
EPS TTM to common (diluted)	0.86							

Source: Company reports

Net interest income rises sharply in Q4/14 (+15% QoQ, +45% YoY) and for the full year 2014 (+30% YoY) on balance sheet growth and margin improvement.

Bank Audi's net interest income totaled USD 244 million in Q4/14 (+15% QoQ, +45% YoY), from higher balance sheet volumes and margin improvement. Looking at 2014, net interest income increased by a strong 30% YoY to USD 830 million from USD 638 million favorably impacted by solid growth in earning assets and widening net interest margins. Figures provided by Management reveal that interest spreads were up to 2.10% in 2014 from 2.00% in 2013 largely driven by Odea Bank as spreads remain challenged domestically by limited room to improve asset yields. Net interest income generated from Odea Bank in 2014 increased to USD 212 million adding around ~ USD 128 million YoY from both balance sheet expansion and margin improvement (equivalent to ~ 67% of consolidated net interest income growth in 2014). We estimate Odea Bank's net interest margins to have averaged ~2% in 2014 up from ~1% in 2013. Going forward we expect Bank Audi consolidated margins to remain favorably impacted by higher margins from Odea Bank as they converge towards Turkish banking sector average.

Latest banking sector's statistics from the ABL for the month of November 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.

Both spreads in USD and LBP were lower in November 2014 compared to one year earlier. Latest statistics from the ABL for the month of November 2014 reveal that Lebanese banks are still operating in a low interest environment, limiting potential to improve earnings 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 1.27% in November 2014 from 1.39% in November 2013 which has a substantial impact on 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 3.09% in the context of roughly unchanged weighted average on uses of funds at 4.36% edging up from 4.33%. Reminder, banks are still dealing with a negative carry on USD liquidity.

Spreads in LBP narrowed to 0.85% in November 2014 from 1.33% in November 2013 from higher cost of funds (+12 bps to 5.55%) and lower return on uses of funds (-36 bps to 6.40%) which was dragged down by lower lending rates (-21 bps to 7.11%) and more essentially lower rates on CDs issued by the BDL (-50 bps to 8.12%) despite slightly higher weighted yields on T-bills (+4 bps to 6.93%).

Stronger fees and commissions YoY (+24% in Q4/14, +32% in 2014) helped drive core income contribution to 81% in 2014 vs. 77% in 2013.

Bank Audi's net fees and commissions income remained roughly flat sequentially at USD 66 million in Q4/14, yet representing a solid 24% increase from Q4/13. On the other hand, financial gains totaled USD 56 million in Q4/14 (+6% QoQ, +49% YoY). Non-interest income totaled USD 123 million for the quarter (+3% QoQ, +34% YoY). The operating income mix for Q4/14 highlight a stable contribution from core income (including net interest income and fees and commissions income) at 85%.

Looking at the full year 2014, non-interest income totaled USD 492 million (+14% YoY), from flat financial gains at USD 245 million and a 32% growth in fees and commissions income at USD 247 million which we positively view given the less volatile nature of this income stream. We note that this positive momentum in fees and commissions is being triggered by the expansion of the Group including the rapidly growing franchise in Turkey as well as increased focus on private banking operations. The operating income mix for 2014 highlight a higher contribution from core income (including net interest income and fees and commissions income) at 81% vs. 77% in 2013.

Table 3: Summary Balance Sheet

USD million	Q4/14	Q3/14	Q4/13	QoQ%	YTD%
Cash and balances	8,787.7	8,677.8	6,097.6	1.3%	44.1%
Due from banks and other financial institutions	4,369.0	4,021.5	3,242.1	8.6%	34.8%
Financial assets	10,213.6	10,156.4	11,190.2	0.6%	-8.7%
Loans and advances	17,167.9	15,925.7	14,712.9	7.8%	16.7%
Intangible assets and goodwill	192.5	194.5	194.6	-1.0%	-1.1%
Other assets	1,227.2	912.8	753.8	34.4%	62.8%
Total assets	41,957.7	39,888.7	36,191.3	5.2%	15.9%
Due to Central Banks	290.8	262.6	167.2	10.7%	73.9%
Due to banks and other financial institutions	1,184.6	1,328.7	1,191.4	-10.8%	-0.6%
Deposits	35,823.0	33,918.3	31,095.1	5.6%	15.2%
Immediate liquidity to deposits	36.7%	37.4%	30.0%		
Loans- to- deposits	47.9%	47.0%	47.3%		
Subordinated debt	507.4	510.0	356.3	-0.5%	42.4%
Other liabilities	808.8	799.3	685.1	1.2%	18.1%
Total liabilities	38,614.7	36,818.9	33,495.1	4.9%	15.3%
Shareholders' equity	2,801.0	2,527.4	2,154.4	10.8%	30.0%
Preferred shares	500.0	500.0	500.0	0.0%	0.0%
Minority interest	42.0	42.4	41.8	-0.9%	0.5%
Total shareholders' equity	3,343.0	3,069.8	2,696.2	8.9%	24.0%
Total liabilities and shareholders' equity	41,957.7	39,888.7	36,191.3	5.2%	15.9%
Book value per share	8.26	7.57	7.59	9.0%	8.8%
Book value per share to common	7.01	6.32	6.16	10.8%	13.7%
Tangible book value per share to common	6.53	5.84	5.60	11.8%	16.5%

Source: Company reports

Cost-to-income stabilizes in the mid 50% range (54% in Q4/14, 55% for 2014) yet still above pre-Turkey expansion levels. Odea's net profits turn positive at USD 16 million for 2014, representing around 5% of consolidated net profits.

The cost-to-income ratio was at 54% in Q4/14 pointing to roughly stable efficiencies QoQ as stronger operating income was offset by higher opex driven by a rise in non-personnel expenses (including acceleration in branch rollouts in Q4+ and general corporate purposes). Looking at 2014, the cost-to-income was at 55% vs. 56% in 2013. Cost-to-income remains higher than pre-Turkey expansion levels where Bank Audi built USD 11.1 billion in assets and a network of 48 branches (including kiosks) in over two years of activity.

Odea Bank started reporting first sets of profits in Q2/14 at USD 3.3 million (vs. a loss USD 8.6 million in Q1/14), which further accelerated to USD 11.2 million in Q3/14 and USD 10.2 million in Q4/14. Odea Bank's net profits for the full year 2014 amounted to USD 16.2 million equivalent to ~5% of consolidated net profits. We expect profitability in the Turkish entity to continue to improve as margins, efficiencies and LDRs to a lesser extent move higher towards peers.

Gross NPL ratio breaches 3% in Q4/14 with higher cost of risk (est. 1.6%) mostly from general provisions allocated across various entities.

Bank Audi's consolidated gross NPLs (Doubtful loans) breached 3% in Q4/14 from 2.8% in previous quarter, although still contained and lower than peers under coverage. We note an increase in the cost of risk in Q4/14 to an estimated ~ 1.6% (from 0.9% in Q3/14), with net provisions at USD 67 million, largely explained by collective provisions booked as a prudent measure across different entities. For 2014, net provisions were at USD 137 million compared to USD 90 million in 2013 with an estimated cost of risk at 0.8% vs. 0.6% last year. We note that tax rate spiked to a surprising ~32% rate in Q4/14 from around 20% driven by international operations.

Expansion in key balance sheet indicators resumed in Q4/14, driving annual growth in the 15%-17% range with the three main growth pillars being Turkey, Lebanon and Egypt.

The Bank's balance sheet growth regained momentum in Q4/14 following a weak performance in Q3/14. Consolidated assets, deposits and loans grew 5%, 6% and 8% respectively during the quarter to reach USD 42 billion, USD 36 billion, and USD 17 billion respectively with a deposits to assets ratio at 85% and an LDR at 48% well above the Lebanese banking sector average (~35%), attributed to fast lending growth driven by Turkey.

Key balance sheet indicators grew strongly in the 15%-17% range in 2014 significantly above Lebanese banking sector average gearing towards the mid to high single digits. Turkey was the key driver for balance sheet growth followed by Lebanon and Egypt in line with the Group's strategy. The Bank's assets in Turkey reached USD 11,065 million at the end of 2014 (+47% YoY) representing 26% of consolidated assets. The Bank's assets in Lebanon reached USD 22,079 million at the end of 2014 (+6% YoY) representing 53% of consolidated assets. The Bank's assets in Egypt reached USD 4,348 million at the end of 2014 (+33% YoY) representing 10% of consolidated assets.

CAR III increased to 13.7% at the end of 2014 vs. 12.1% last year, while profitability ratios trended slightly upwards sequentially.

Bank Audi's equity to assets ratio increased to 8.0% in Q4/14 up from 7.7% in previous quarter mostly driven by an additional USD 236 million of reserves for revaluation of fixed assets booked in accordance with BDL Intermediary Circular No. 44. Bank Audi's capital adequacy ratio (Basel III) increased to 13.7% from 13.5% in previous quarter and 12.1% at the end of 2013. We remind that the capital increase which was closed in September 2014 revolving around the issuance of 50 million additional shares strengthened Bank Audi's conformance vis-à-vis regulatory requirements while supporting the expansion plan. It also allowed the Bank to revalue its real estate reserves higher. Profitability ratios trended slightly higher sequentially, the TTM ROA was at an estimated 0.90% vs. 0.87% in previous quarter while the TTM ROE is estimated at around 11.6% vs. 11.1%. The TTM EPS was USD 0.86 in Q4/14 (vs. USD 0.83 in previous quarter) while book value per share is estimated at USD 8.26 (USD 7.01 to common up 11% QoQ and 14% YoY) from capital increase, real estate revaluation and higher TTM profits.

We value Bank Audi's 2014 financial results given solid balance sheet and earnings growth and highlight a 6.5% dividend yield in light of the upcoming dividend season.

Based on today's listed share price of USD 6.20 (up 3.3% so far in 2015), Bank Audi is trading at 7.2x P/E, 0.75x P/B (P/B to common of 0.88x). Bank Audi's listed shares reflect lower multiples relative to regional peers similar to other banks under coverage.

We remind income oriented investors that dividends for 2014 are expected to be paid in April 2015 and highlight Bank Audi's attractive dividend yield of 6.5%, likely defended given 50% payout and rising profits YoY. Last year, Bank Audi distributed USD 0.40 per common share (before a 5% tax).

Looking at 2014 financial results, we value the Company's improved results largely stemming from core income growth driving pre provision profits, above average balance sheet expansion across all key indicators and successful execution of its growth plan resting on three key pillars including Lebanon, Turkey and Egypt. Key risks include sovereign, economic, interest rate, foreign currency, and execution risks.

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