**3 May 2018 | 1QFY18 Results Review**

# Public Bank Berhad

***Robust income mitigate higher provisions***

***Maintain* BUY**

***Adjusted* Target Price (TP): RM27.30**
**(*previously:* RM25.70)**

## INVESTMENT HIGHLIGHTS

- **Earnings in line with expectations.**
- **NOII led total income growth.**
- **NII expansion respectable despite slower loans growth.**
- **Asset quality remains good.**
- **Impact of MFRS 9 seems positive.**
- **No change to FY18 and FY19 forecast.**
- **Maintain BUY with an adjusted TP of RM27.30 (previously RM25.70) as we roll over our valuation to FY19, pegging the BVPS to its 5 year historical PB multiple of 2.4x.**

**Earnings within expectations.** The Group posted net profit growth of +12.6%yoy to RM1.41b which was within ours and consensus' expectations. It came at 24.3% and 24.1% of respective full year estimates. Main driver for the strong earnings growth was the robust income expansion.

**NOII and Islamic banking drove income growth.** Total income grew +6.6%yoy largely contributed by strong NOII and Islamic banking income growth. NOII expanded +15.6%yoy supported by increase of +17.3%yoy, +4.6%yoy and +20.6%yoy in unit trust, fee & commission and forex income respectively. Also, Islamic banking income grew +7.3%yoy which came from higher income derived from investment of depositors' funds and others.

**NII expansion respectable despite slower loans growth.** NII grew at a respectable +4.0%yoy despite gross loans growing only +3.4%yoy to RM306.8b (vs. 7.0%yoy as at 1QFY17). We believe that this was partly due to better margins as NIM improved +2.0bps yoy possibly due to the impact of OPR hike in Jan'18. The slower gross loans growth was due to the -2.9%yoy decline to RM50.0b in hire purchase (HP) loans. Stripping the HP loans, gross loans would have grown +4.8%yoy. Meanwhile, mortgages continue to drive loans growth. It went up by +8.7%yoy to RM105.7b.

**Asset quality remains strong.** GIL ratio for the Group continues to be the lowest in the industry with 0.48%, a -1bps yoy improvement. As for LLC, it had jumped to 125.2% from 95.5% registered as at 4QFY17.

**Cost well maintained.** OPEX grew only +1.4%yoy due to higher personnel cost and marketing cost. Combined with the strong growth in income, CI ratio improved by -1.7ppt yoy to 32.6%.

| **RETURN STATS** | |
|---|---|
| Price (2 May 2017) | RM24.00 |
| Target Price | RM27.30 |
| Expected Share Price Return | +13.8% |
| Expected Dividend Yield | +2.5% |
| **Expected Total Return** | **+16.3%** |

| **STOCK INFO** | |
|---|---|
| KLCI | 1,852.03 |
| Bursa / Bloomberg | 1295 / PBK MK |
| Board / Sector | Main / Finance |
| Syariah Compliant | No |
| Issued shares (mil) | 3,861.5 |
| Market cap. (RM'm) | 92,675.9 |
| Price over NA | 2.2x |
| 52-wk price Range | RM19.90 – RM24.50 |
| Beta (against KLCI) | 0.73 |
| 3-mth Avg Daily Vol | 5.66m |
| 3-mth Avg Daily Value | RM131.08m |
| Major Shareholders | |
| Consolidated Teh Holdings | 22.90% |
| EPF | 13.86% |
| JP Morgan Chase & Co | 3.33% |

**Some banking abbreviations used in this report:**
CA = Collective Impairment Allowance
CI = Cost-Income Ratio
CET1 = Common Equity Tier 1
GIL = Gross Impaired Loan
LD = Loan-Deposit
NII = Net Interest Income
NOII = Non-interest income
NIM = Net Interest margin
CASA = Current and Savings Accounts
COF = Cost of Funds
OPEX = Operating Expenses
LLC = Loan Loss Coverage
NAV = Net Asset Value

**Higher provisions but impact of MFRS 9 seems positive.** For 1QFY18, provisions grew by +2.1%yoy to RM68.5m. Comparatively, it was RM23.8m in 4QFY17. The higher provisions was due to higher CA. However, the Day One impact of MFRS 9 seems to be positive. Although, allowance for impaired loans and financing increased 32% to RM1.86b and lower regulatory reserves due to the utilisation of reserves to mitigate the higher impairment allowances, it had also led to an increase in shareholders fund due to gain on re-measurement of certain equity investments and enhanced the Group's capital adequacy ratio. CET1, Tier 1 and Total Capital ratio improved by +20bps.

**Comparison with FY18 targets.** Recall, the Group guided its FY18 targets of: i) ROE of 14-15%, ii) Total capital ratio of >13%, iii) GIL ratio < 1%, iv) CI ratio of 33.0-34.0%, v) Loans growth of 5% and vi) Deposit growth of 5%. Thus far, it appear that the Group is on track to achieve its FY18 target, except for loans and deposits growth as it came in at +3.4% and +3.1% respectively. However, in terms of loans growth, we believe the Group are growing in the right segment which is mortgages. Although, it will be a challenge, we expect that the Group will be able to meet its loans growth target. In term of deposits, CASA will continue to be a driver as it grew +2.9%yoy to RM82.9b. As such, we do not expect much headwinds for the Group to reach its deposits growth target.

## FORECASTS

We maintain our FY18 and FY19 forecast for now given the result were in line with our expectation.

## VALUATION AND RECOMMENDATION

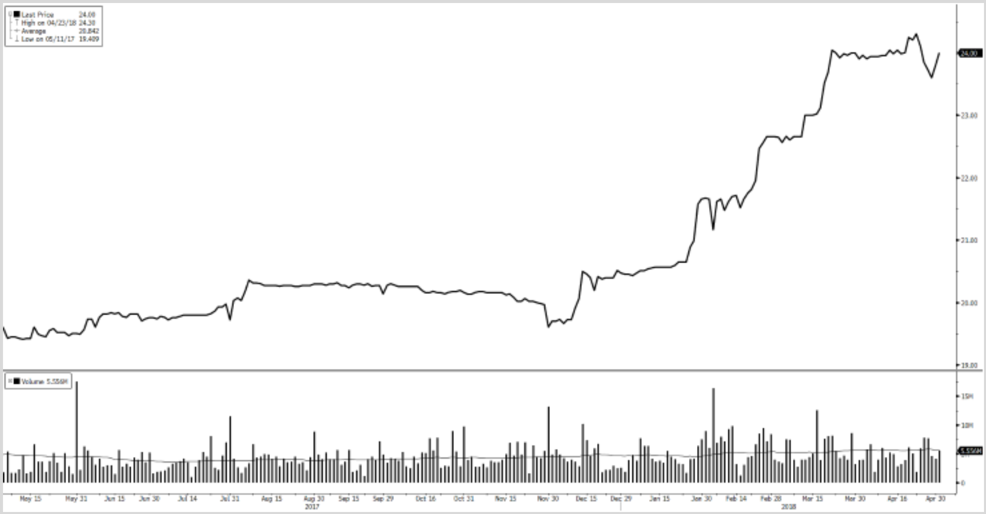
We continue to like the Group's ability to maintain its profitability and earnings growth momentum. Although, provisions came higher in the quarter possibly from the impact of MFRS 9, the Group managed to grow its income at a faster pace. We believe that the fund management segment have become a strong support to the Group as it led NOII. With the expectations of sustainable profitability, we maintain BUY for the stock. We are adjusting our TP to RM27.30 (previously RM25.70) as we roll over our valuation to FY19. Our TP is based on pegging PBV to 2.4x which is its 5 year historical PB multiple.

## INVESTMENT STATISTICS

| FYE Dec | FY16 | FY17 | FY18F | FY19F |
|---|---|---|---|---|
| Net interest income (RM'm) | 6,920 | 7,417 | 7,917 | 8,405 |
| Islamic banking income (RM'm) | 942 | 999 | 1,049 | 1,112 |
| Non-interest income (RM'm) | 2,094 | 2,331 | 2,524 | 2,642 |
| Total income (RM'm) | 9,956 | 10,747 | 11,490 | 12,159 |
| Pretax profit (RM'm) | 6,554 | 7,118 | 7,486 | 7,892 |
| Net profit (RM'm) | 5,207 | 5,470 | 5,787 | 6,101 |
| Core net profit (RM'm) | 5,207 | 5,470 | 5,787 | 6,101 |
| Core EPS (sen) | 134.8 | 141.7 | 149.9 | 158.0 |
| Core EPS growth (%) | 5.1 | 5.1 | 5.8 | 5.4 |
| PER (x) | 14.9 | 15.7 | 14.9 | 14.1 |
| Net dividend (sen) | 58 | 61 | 63 | 66 |
| Net dividend yield (%) | 2.9 | 2.7 | 2.8 | 3.0 |
| Book value per share (RM) | 8.9 | 9.68 | 10.69 | 11.39 |
| PBV (x) | 2.3 | 2.3 | 2.1 | 2.0 |
| ROE (%) | 16.3 | 15.3 | 14.7 | 14.3 |

Forecast by MIDFR

## DAILY PRICE CHART



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## Table 1: Comparison of quarterly results

| Reported Quarterly results | | | | | | Comments |
|---|---|---|---|---|---|---|
| **FYE Dec (RM m)** | **1Q18** | **4Q17** | **1Q17** | **Yoy** | **Qoq** | |
| Net Interest Income | 1,897.4 | 1,887.6 | 1,824.2 | 4.0% | 0.5% | Due to NIM improvement of +2bps yoy. Gross loans grew +3.4%yoy. We believe it was partly due to OPR hike in Jan'18. |
| Islamic Banking Income | 265.7 | 252.9 | 247.7 | 7.3% | 5.1% | From higher income derived from investment of depositors' funds and others (+8.3%yoy to RM600.9m). |
| Non-interest Income | 594.7 | 646.1 | 514.5 | 15.6% | -8.0% | Driven by unit trusts income (+12.1%yoy to RM456.2m), fee & commission income (+4.6%yoy to RM178.9m) and forex income (+20.6%yoy to RM95.4m). |
| Net/Total income | 2,757.8 | 2,786.6 | 2,586.4 | 6.6% | -1.0% | |
| OPEX | (899.3) | (813.7) | (886.9) | 1.4% | 10.5% | Due to higher personnel cost (+2.7%yoy to RM634.5m) and marketing expense (+22.2%yoy to RM38.8m). |
| PPOP | 1,858.5 | 1,972.9 | 1,699.5 | 9.4% | -5.8% | Attributed to strong income growth. |
| Provision for loan losses | (68.5) | (23.8) | (67.1) | 2.1% | >100% | Higher CA impairment allowance. |
| Pre-tax profit | 1,794.0 | 1,957.2 | 1,631.5 | 10.0% | -8.3% | |
| Taxation | (371.2) | (451.9) | (366.1) | 1.4% | -17.9% | |
| Net Profit (PATAMI) | 1,405.4 | 1,485.5 | 1,248.0 | 12.6% | -5.4% | Strong NOII and Islamic Banking income growth. |
| EPS (sen) | 36.4 | 38.5 | 32.3 | 12.7% | -5.5% | |

**Table 2: Comparison of financial ratios based on reported numbers**

| Financial Ratios (%) | 1Q18 | 4Q17 | 1Q17 | Yoy (*/- ppts) | Qoq (+/- ppts) |
|---|---|---|---|---|---|
| CET 1* capital | 12.2 | 12.2 | 11.4 | 0.8 | 0.0 |
| Tier 1* capital | 12.8 | 13.0 | 12.2 | 0.6 | -0.2 |
| Total* capital | 15.8 | 16.0 | 15.2 | 0.6 | -0.2 |
| GIL | 0.48 | 0.48 | 0.49 | -0.01 | 0.0 |
| LLC | 125.2 | 95.5 | 104 | 21.2 | 29.7 |
| Credit cost | 0.09 | 0.03 | 0.09 | 0.00 | 0.06 |
| CI | 32.6 | 29.2 | 34.3 | -1.7 | 3.4 |
| Net LD ratio | 93.6 | 94.9 | 93.3 | 0.3 | -1.3 |
| NIM | 2.33 | 2.27 | 2.31 | 0.02 | 0.06 |
| ROEA | 15.2 | 15.9 | 14.9 | 0.3 | -0.7 |

*Group level capital ratio after deduction of interim dividend

**Table 3: Comparison of pretax profits by business segments (RM m)**

| Business segments | 1QFY18 | 1QFY17 | Change (%) | Comments |
|---|---|---|---|---|
| Hire purchase | 88.7 | 90.4 | -1.9% | Lower NII on lower loan balance partially offset by lower loan impairment allowance. |
| Retail operations | 900.2 | 859.6 | 4.7% | Higher NII on higher average loan and deposit balances, and higher fee income and other operating income, moderated by higher OPEX and loan impairment allowance. |
| Corporate Lending | 137.4 | 129.9 | 5.8% | Higher NII on higher average loan balances. |
| Treasury & Capital Market Operations | 190.6 | 172.9 | 10.2% | Higher NII on treasury gapping, funding and liquidity management activities and higher investment income. |
| Investment Banking | 12.5 | 11.0 | 14.0% | Higher brokerage income. |
| Fund Management | 176.1 | 151.1 | 16.6% | Higher management fee earned on higher average net asset value of funds under management. Also from higher fee income from sale of trust units. |
| Overseas Operation | 145.5 | 161.8 | -10.1% | Due to unfavourable forex movements. |
| Others | 138.3 | 55.4 | >100% | |

*Source: Company*

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| **MIDF AMANAH INVESTMENT BANK : GUIDE TO RECOMMENDATIONS** | |
|---|---|
| **STOCK RECOMMENDATIONS** | |
| BUY | Total return is expected to be >10% over the next 12 months. |
| TRADING BUY | Stock price is expected to *rise* by >10% within 3-months after a Trading Buy rating has been assigned due to positive newsflow. |
| NEUTRAL | Total return is expected to be between -10% and +10% over the next 12 months. |
| SELL | *Negative* total return is expected, by -10% or more, over the next 12 months. |
| TRADING SELL | Stock price is expected to *fall* by >10% within 3-months after a Trading Sell rating has been assigned due to negative newsflow. |
| **SECTOR RECOMMENDATIONS** | |
| POSITIVE | The sector is expected to outperform the overall market over the next 12 months. |
| NEUTRAL | The sector is to perform in line with the overall market over the next 12 months. |
| NEGATIVE | The sector is expected to underperform the overall market over the next 12 months. |