midf RESEARCH

16 August 2018 | 2QFY18 Results Review

Public Bank Berhad

Higher than expected interim dividend

***Maintain* BUY**

***Unchanged* Target Price (TP): RM27.30**

INVESTMENT HIGHLIGHTS

- **Earnings within expectations**
- **Net profit growth driven by lower provision and controlled OPEX**
- **NIM compression on loans pricing competition**
- **Asset quality remains good as ever**
- **Higher than expected interim dividend of 32 sen**
- **No change to FY18 and FY19 forecasts**
- **Maintain BUY with unchanged TP of RM27.30 based on pegging FY19 BVPS to 2.4x**

Earnings in line with expectations. The Group registered 1HFY18 net profit growth of +8.6yoy that were supported by +12.6%yoy growth in 1QFY18. Overall, 1HFY18 earnings were within ours and consensus' expectations coming in at 48.4% and 48.8% respective full year estimates. Main driver for the strong earnings growth were lower provisions and controlled OPEX.

Lower provisions and asset quality stable as always. Provisions fell -8.2%yoy to RM86.0m as CA was -23.2%yoy lower to RM91.5m. We opine that the impact of MFRS 9 seems to have normalised. As we come to expect from the Group, asset quality remain stable which contributed to the low credit cost. GIL ratio was 0.5% as at 2QFY18.

OPEX controlled. OPEX marginally improved on a sequential quarter basis where it fell -0.1%qoq in 2QFY18. As such, 1HFY18 OPEX grew +1.6%yoy only due to higher personnel cost. This lead to better CI ratio which improved -0.7ppts yoy to 33.1%.

NOII and Islamic Banking supported income growth. NOII in 1HFY18 grew +4.9%yoy due to solid growth in unit trust income where it grew +9.5%yoy to RM477.6m, contributing 42% to total NOII. Meanwhile, the second highest contributor (33%), fee & commission income grew +3.5%yoy to RM366.2m. Islamic Banking income grew +6.7%yoy. Both these supported NII, as 1HFY18 NII expanded only at a decent +3.1%yoy coming from NIM pressure.

NIM pressure from asset pricing competition. NIM in 2QFY18 fell -2bps yoy and -9bps qoq due intense competition in loans pricing. We also believe that this could be due to higher cost of fund, as deposit growth (+interest expense increased +9.4%yoy to RM2.15b in 2QFY18 and +7.0%yoy to RM4.14b in 1HFY18.

RETURN STATS	
Price (15 August 2018)	RM24.48
Target Price	RM27.30
Expected Share Price Return	+11.5%
Expected Dividend Yield	+2.6%
Expected Total Return	**+14.1%**

STOCK INFO	
KLCI	1,785.94
Bursa / Bloomberg	1295 / PBK MK
Board / Sector	Main / Finance
Syariah Compliant	No
Issued shares (mil)	3,882.1
Market cap. (RM'm)	95,034.7
Price over NA	2.5x
52-wk price Range	RM19.90 – RM25.78
Beta (against KLCI)	0.83
3-mth Avg Daily Vol	6.32m
3-mth Avg Daily Value	RM150.7m
Major Shareholders	
Consolidated Teh Holdings	22.78%
EPF	12.78%
State Street Corp	3.12%

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

Loans growth subdued to conservative lending practice. The Group's gross loans expanded +4.1%yoy to RM310.7b driven by the retail segment, more specifically mortgages where it grew +9.0%yoy to RM107.9b. However, we understand that the Group have been very conservative in its lending practice and will not boost loans growth by compromising on its risk assessment and its loans pricing discipline. Hence, we are not surprised that gross loans for the Group grew below industry's loans growth. This may have contributed to the NIM pressure and moderate interest income growth of +5.1%yoy to RM7.92b in 1HFY18.

Balancing between cost of fund and deposits growth. Total deposits grew +4.0%yoy to RM329.9b. Fixed deposits expanded +4.4%yoy to RM191.5b while CASA grew +3.8%yoy to RM84.4b. We believe this partly explains the faster pace rise in interest expense. However, going forward, the management indicated that it will be balancing the deposit growth with the cost of fund to ensure that there will be no negative carry.

Surprised quantum for interim dividend. The management is proposing an interim dividend of 32 sen. This represents a payout ratio of 44.3%. We were pleasantly surprised by this as we have expected an interim dividend of 30 sen, in line with past payout ratio of circa 40% to our 1HFY18 estimate.

On track to reach 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%. The Group is on track to achieve its FY18 target, except for loans growth. The management expects challenging period going forward due to external and domestic uncertainties. Hence, the management are revising loans growth target of 4% to 5%. However, we believe that the Group is focused on the right segment which is mortgages as we believe this will be the main driver for loans growth for the industry.

FORECASTS

We maintain our FY18 and FY19 forecasts 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 the higher than expected interim dividend was a pleasant surprise. Although, there are potential headwinds stemming from external uncertainties, we remain optimistic of the Group's ability to sustain its profitability. Moreover, we believe that the Group's retail-centric should stand to benefit in the uplift of consumer sentiment. Therefore, we maintain our BUY call for the stock with unchanged TP of RM27.30. Our TP is based on pegging FY19 BVPS to 2.4x PBV 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)	18.2	17.3	16.3	15.5
Net dividend (sen)	58	61	63	66
Net dividend yield (%)	2.4	2.5	2.6	2.7
Book value per share (RM)	8.86	9.68	10.69	11.39
PBV (x)	2.8	2.5	2.3	2.1
ROE (%)	15.9	15.3	14.7	14.3

Forecast by MIDFR

DAILY PRICE CHART

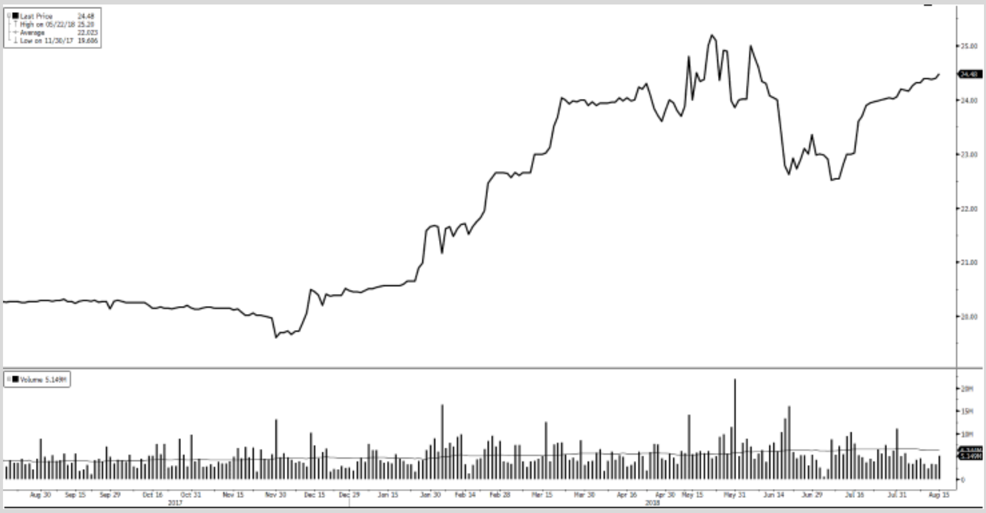

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Table 1: Comparison of quarterly results

Reported Quarterly results						Comments
FYE Dec (RM m)	**2Q18**	**1Q18**	**2Q17**	**Yoy**	**Qoq**	
Net Interest Income	1,879.7	1,897.4	1,841.0	2.1%	-0.9%	Due to NIM compression. Interest expense grew at faster pace (+9.4%yoy) vs. interest income (+5.9%yoy).
Islamic Banking Income	262.6	265.7	247.4	6.1%	-1.2%	
Non-interest Income	533.9	594.7	561.7	-5.0%	-10.2%	Lower gains on financial instruments.
Net/Total income	2,676.2	2,757.8	2,650.1	1.0%	-3.0%	
OPEX	(898.3)	(899.3)	(881.8)	1.9%	-0.1%	Higher personnel cost.
PPOP	1,777.8	1,858.5	1,768.3	0.5%	-4.3%	
Provision for loan losses	(17.5)	(68.5)	(26.5)	-34.0%	-74.5%	Lower CA due to stable asset quality.
Pre-tax profit	1,757.7	1,794.0	1,736.0	1.3%	-2.0%	
Taxation	(342.2)	(371.2)	(384.0)	-10.9%	-7.8%	
Net Profit (PATAMI)	1,396.2	1,405.4	1,331.8	4.8%	-0.7%	
EPS (sen)	36.1	36.4	34.5	4.6%	-0.8%	

Table 2: Comparison of financial ratios based on reported numbers

Financial Ratios (%)	2Q18	1Q18	2Q17	Yoy (*/- ppts)	Qoq (+/- ppts)
CET 1* capital	12.7	12.2	11.8	0.9	0.5
Tier 1* capital	13.4	12.8	12.6	0.8	0.6
Total* capital	16.3	15.8	16.4	-0.1	0.5
GIL	0.5	0.5	0.5	0	0
LLC	117.3	125.2	98.1	19.2	-7.9
Credit cost	0.02	0.09	0.04	-0.02	-0.07
CI	33.6	32.6	33.8	-0.2	1.0
Net LD ratio	93.6	93.6	93.6	0.0	0.0
NIM	2.24	2.33	2.26	-0.02	-0.09
ROEA	14.1	15.2	15.3	-1.2	-1.1

*Group level capital ratio after deduction of interim dividend

Table 3: Comparison of cumulative results

Reported Cumulative results				Comments
FYE Dec (RM m)	**1HFY18**	**1HFY17**	**Yoy**	
Net Interest Income	3,777.1	3,665.2	3.1%	NIM compression in 2QFY18 due to loans pricing competition and repricing of deposits following OPR hike in January.
Islamic Banking Inc	528.3	495.1	6.7%	
Other Operating Income	1,128.6	1,076.1	4.9%	Strong income growth from fund management fee.
Net/Total income	5,434.0	5,236.5	3.8%	
OPEX	(1,797.6)	(1,768.7)	1.6%	Higher personnel cost.
PPOP	3,636.4	3,467.8	4.9%	
Provision for loan losses	(86.0)	(93.6)	-8.2%	Lower CA in 2QFY18 on stable asset quality.
Pre-tax Profit	3,551.7	3,367.5	5.5%	
Tax & zakat	(713.4)	(750.1)	-4.9%	
Net Profit	2,801.6	2,579.8	8.6%	
EPS (sen)	72.5	66.8	8.5%	
Ratios (%)			**(+/- ppts)**	
CI	33.1	33.8	-0.7	Controlled OPEX vs. higher increase in income.
NIM	2.28	2.29	-0.01	Compression in 2QFY18.
ROEA	15.0	15.3	-0.3	
Credit cost	0.06	0.06	0.0	

Table 4: Comparison of pretax profits by business segments (RM m)

Business segments	1HFY18	1HFY17	Change (%)	Comments
Hire purchase	171.9	194.4	-11.6%	Lower NII on lower average loan balance.
Retail operations	1,813.6	1,766.8	2.6%	Higher net writeback of loan impairment allowance, higher NII on higher average loan and deposit balances and higher NOII.
Corporate Lending	277.9	264.7	5.0%	Higher NII on higher average loan balances.
Treasury & Capital Market Operations	395.0	360.8	9.5%	Higher NII on treasury gapping, funding and liquidity management activities offset by lower investment income.
Investment Banking	25.7	23.6	8.9%	Higher fee income.
Fund Management	339.6	311.6	9.0%	Mainly due to higher management fee earned on higher average net asset value of funds under management.
Overseas Operation	298.2	342.8	-13.0%	Unfavourable forex movements and higher loan impairment allowance.
Others	226.5	106.9	>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.