23 February 2018 | 4QFY17 Results Review

Public Bank Berhad

Better NIM led to solid income growth

***Maintain* BUY**

***Revised* Target Price (TP): RM25.70 (*previously:* RM23.50)**

INVESTMENT HIGHLIGHTS

- **FY17 earnings within ours and consensus' expectations**
- **Solid income growth from NII, NOII and Islamic Banking**
- **NII growth from better NIM and CI still amongst the lowest in industry**
- **Gross loans moderated but growing in the right segment**
- **CASA expanded robustly**
- **Revised our FY18 forecasts upwards by +3.9%**
- **Second interim dividend of 34 sen. Total dividend for FY17 is 61 sen, 43% payout ratio**
- **Maintain BUY with a revised TP of RM25.70 (previously RM23.50) as we pegged FY18 BVPS to PBV of 2.4x**

Full year earnings within expectations. Full year net profit for the Group came in within ours and consensus' expectations at 102.7% and 103.4% of respective estimates. Solid income expansion was the main driver for the +5.1%yoy earnings growth.

Solid income growth. Total income grew +7.9%yoy which was the result of growth in NII, NOII and Islamic Banking income. These grew +7.2%yoy, +11.3%yoy and +6.1%yoy respectively. Strong NII growth was due to improved NIM. Despite margin pressure, NIM came in +8bps yoy better on efficient cost of fund management. Interest expense fell -3.5%yoy to RM7.86b.

Continue to grow unit trust. NOII growth was driven by unit trust income which grew +16.5%yoy to RM899.0m. As a result, the Group continue to solidify its market position as the leader in private unit trust sector with a retail market share of 40.9% and NAV of RM81.4b. Meanwhile, fee & commission income grew +2.4%yoy to RM734.4m.

CI remains the lowest in the industry. OPEX was well contained and lower than expected. OPEX increased +6.7%yoy from higher admin & general expenses which rose +13.3%yoy to RM277.8m. Staff cost went up +6.8%yoy to RM1.97b due to salary increment. However, this was compensated by higher productivity. Gross loan per employee and deposit per employee grew +3.8%yoy and +3.6%yoy to RM16.4m and RM17.2m respectively. CI was 31.9%, still the lowest in the industry.

RETURN STATS	
Price (22 Feb. 2018)	RM22.28
Target Price	RM25.70
Expected Share Price Return	+15.4%
Expected Dividend Yield	+2.7%
Expected Total Return	**+18.1%**

STOCK INFO	
KLCI	1,855.07
Bursa / Bloomberg	1295 / PBK MK
Board / Sector	Main / Finance
Syariah Compliant	No
Issued shares (mil)	3,861.5
Market cap. (RM'm)	86,043.1
Price over NA	2.3x
52-wk price Range	RM19.66 – RM22.62
Beta (against KLCI)	0.69
3-mth Avg Daily Vol	5.13m
3-mth Avg Daily Value	RM108.03m
Major Shareholders	
Consolidated Teh Holdings	22.90%
EPF	14.25%
JPMorgan Chase & Co.	3.34%

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

Gross loans growth moderated but remain resilient. FY17 gross loans moderated to +3.6%yoy to RM304.5b from the +7.5%yoy registered as at FY16. The moderation of the loans were due to pull back in overseas loans and selective lending. Domestic gross loans grew +4.6%yoy to RM282.3b while total overseas gross loans declined -8.1%yoy to RM22.1b. Gross loans growth was mainly attributable to expansion in the mortgages and SME loans segment. Domestic residential mortgages grew +10.0%yoy to RM101.9b, while domestic commercial mortgages grew +4.3%yoy to RM75.7b where the bulk was for SME borrowers. Domestic commercial mortgages from SME sector were RM71.7b and this was +7.7%yoy higher from previous year. In terms of overall housing mortgage, gross loans were +8.4%yoy higher to RM103.7b. Conversely, corporate lending and hire purchase declined -4.9%yoy to RM39.3b and -2.9%yoy to RM48.1b respectively. We understand that this was due to the Group being selective on the profile of its borrowers for this segment.

Asset quality strong as ever. The Group's asset quality remains strong with GIL ratio as at FY17 coming in flat at 0.5%, substantially below industry's GIL ratio of 1.5%. The GIL in its main segment was also stable with residential properties, transport vehicle and domestic SME GIL ratio at 0.5%, 0.6% and 0.3% respectively. Credit cost was 7bps.

Domestic deposits led growth. Deposits grew +3.0%yoy to RM319.3b which was mainly led by domestic deposits where it grew +3.6%yoy. Meanwhile, core deposits expanded +4.5%yoy to RM269.7b driven by CASA growth. As at FY17, CASA grew +6.6%yoy to RM83.1b while fixed deposits grew +3.6%yoy to RM186.6b.

Neutral impact of MFRS 9. The Group indicated that CA will increase for Day One impact and subsequent quarters. However, the Group has sufficient buffers in terms of retained earnings and regulatory reserves to mitigate the Day One impact. Going forward, the Group believes that its cautious lending and vigilant monitoring practice will ensure asset quality will remain healthy. Therefore, it does not foresee any significant increase in credit cost.

Guidance for FY18 targets. 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%. In addition, the management indicated that loans growth will be driven by residential property in the affordable segment and SME. Loans approved was strong in FY17 for these two segments and will provide the pipeline for FY18. On NIM, the management guided stable to mid-single digit improvement due to the effect of the OPR hike. Overall, we believe that the FY18 targets are achievable. Moreover, we believe that its loans growth target to be conservative due to the strong domestic economic performance in FY17, which will have a lag spill over effect to loans growth. Typically, loans growth will lag GDP result by 1 to 2 quarters.

FORECASTS

We are revising our FY18 forecast upwards by +3.9% to take into account the guidance from the management.

VALUATION AND RECOMMENDATION

The Group continue to generate solid profitability and we foresee that this will continue in FY18. We believe that its loans are growing in the right segment while its asset quality remains healthy as ever. We are also encouraged by its ability to improve NIM. Furthermore, impact from MFRS 9 will be neutral to Group's capital. With no downward shift in the Group's prospects, we maintain our BUY call. The revision to our FY18 earnings forecast and, loans and deposits expectations had led to a +9.3% increase in our FY18 BVPS estimate. As such, we are revising our TP to **RM25.70** (from RM23.50). Our TP is based on pegging FY18 BVPS to PBV of 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)	**4Q17**	**3Q17**	**4Q16**	**Yoy**	**Qoq**	
Net Interest Income	1,887.6	1,864.2	1,799.9	4.9%	1.3%	Efficient funding cost management via tightening of higher cost deposit. Interest expense fell -1.6%yoy to RM1.98b.
Islamic Banking Income	252.9	250.7	232.0	9.0%	0.9%	
Non-interest Income	646.1	608.8	528.9	22.2%	6.1%	Higher fee & commission income (+8.2%yoy to RM445.7m)
Net/Total income	2,786.6	2,723.7	2,560.8	8.8%	2.3%	
OPEX	(813.7)	(845.8)	(805.5)	1.0%	-3.8%	Contained cost.
PPOP	1,972.9	1,877.9	1,755.3	12.4%	5.1%	
Provision for loan losses	(23.8)	(85.7)	37.1	>100%	-72.2%	Write back in CA allowance in 4QFY16.
Pre-tax profit	1,957.2	1,792.3	1,792.7	9.2%	9.2%	
Taxation	(451.9)	(368.7)	(293.4)	54.0%	22.6%	
Net Profit (PATAMI)	1,485.5	1,404.8	1,482.8	0.2%	5.7%	
EPS (sen)	38.5	36.4	38.4	0.3%	5.8%	

Table 2: Comparison of financial ratios based on reported numbers

Financial Ratios (%)	4Q17	3Q17	4Q16	Yoy (+/- ppts)	Qoq (+/- ppts)
CET 1* capital	12.2	11.7	11.4	0.8	0.5
Tier 1* capital	13.0	12.4	12.2	0.8	0.6
Total* capital	16.0	15.4	15.5	0.5	0.6
GIL	0.5	0.5	0.5	0.0	0.0
LLC	95.5	98.2	102.7	-7.2	-2.7
Credit charge-off	0.03	0.11	-0.05	0.08	-0.08
CI	29.2	31.1	31.5	-2.3	-1.9
Net LD ratio	94.9	93.0	94.3	0.6	2.0
NIM	2.27	2.24	2.22	0.05	0.03
ROEA	15.9	15.6	17.3	-1.4	0.3

*Group level capital ratio after deduction of interim dividend

Table 3: Comparison of cumulative results

Reported Cumulative results				Comments
FYE Dec (RM m)	**FY17**	**FY16**	**Yoy**	
Net Interest Income	7,417.1	6,920.4	7.2%	To the +8bps yoy NIM improvement from more efficient funding cost management. Interest expense fell -3.5%yoy to RM7.86b.
Islamic Banking Income	998.7	941.6	6.1%	
Other Operating Income	2,331.0	2,094.4	11.3%	Due to strong growth in unit trust income (+16.5%yoy to RM899.0m) and fee & commission income (+2.4%yoy to RM734.4m)
Net/Total income	10,746.8	9,956.5	7.9%	
OPEX	(3,428.2)	(3,211.5)	6.7%	Due to higher personal cost (+6.0%yoy) and admin expenses (+13.3%yoy)
PPOP	7,318.6	6,745.0	8.5%	
Provision for loan losses	(203.3)	(192.7)	5.5%	CA allowance write back in 4QFY16.
Pre-tax Profit	7,117.7	6,554.0	8.6%	
Tax & zakat	(1,570.7)	(1,286.6)	22.1%	
Net Profit	5,470.0	5,206.9	5.1%	
EPS (sen)	141.7	134.8	5.1%	
Ratios (%)			**(+/- ppts)**	
CI	31.9	32.3	-0.4	
NIM	2.28	2.2	0.08	
Net ROE	15.8	16.5	-0.7	
Credit charge-off	0.07	0.07	0	

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

Business segments	**FY17**	**FY16**	**Change (%)**	**Comments**
Hire purchase	451.1	453.8	-0.6%	Tightening of loans.
Retail operations	3,796.6	3,466.2	9.5%	Higher NII on higher average loan and deposit balances and higher fee and other operating income.
Corporate Lending	553.5	502.5	10.1%	Higher NII on higher average loan and deposit balances.
Treasury & Capital Market Operations	553.8	558.2	-0.8%	
Investment Banking	46.2	48.9	-5.5%	Higher OPEX and writeback of loan impairment allowance in FY16.
Fund Management	660.9	572.9	15.4%	Higher management fee earned on higher average NAV of funds under management, and higher fee income from sale of trust units.
Overseas Operation	687.8	618.2	11.3%	Favourable forex movements, higher NII, lower loan impairment allowance and higher other operating income.
Others	371.1	331.9	11.8%	Higher NII from investments.

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.