25 July 2014 | 2QFY14 Results Review

Public Bank

ROE likely to continue to trend lower moving forward

Maintain **NEUTRAL**

Adjusted **Target Price (TP): RM19.60**
(previously **RM19.90*)***

INVESTMENT HIGHLIGHTS

- **Modest growth in net income in 1HFY14 of 3.5%yoy.**
- **Group loan growth decent at 9.9% annualised. Domestic loan growth moderated slightly at 10.6% annualised but remained above industry growth rate.**
- **Profit contribution from overseas operation to Group pre-tax profit rose to 7.4% in 1HFY14 (1HFY13: 6.8%) underpinned by stronger contribution of Campu Bank, Cambodia.**
- **Credit cost low at 11bp (annualised) in 2QFY14 due to recoveries but is likely to revert to normalised level in subsequent quarters.**
- **Net ROE for 1HFY14 of 20.8%. ROE on declining trend and is set to decline further after the completion of right issue exercise. We are expecting ROEs of 18.6% and 16.7% for FY14 and FY15 respectively.**
- **Declared interim dividend of 23 sen (payout of 42.7%)**
- **Maintain NEUTRAL with an adjusted TP of RM19.60 (previously RM19.90).**

1HFY14 net profit was within expectation. The Group reported 2QFY14 net profit of RM1.06b (+3.9%qoq, +3.2%yoy). This led to net profit of RM2.07b for 1HFY14 (+4.1%yoy). Cumulative net profit accounted for 47.1% of our FY14 net profit forecast.

Domestic loan market shares continue to be upheld for residential mortgage loans, financing for commercial property purchase and SME loans. Asset quality remain stable with GIL ratio of 0.7% below industry's 1.8%. Meanwhile, credit cost was low at 11bp in 2QFY14 due to recoveries.

Annualised domestic loan growth continued to exceed industry growth. Group loan growth (gross basis) expanded 2.5%qoq or 10.9%yoy to RM232.2b. Annualised Group loan growth remained stable at 9.9%. The Group is on track to meet its loan growth target for FY14 of 10.0-11.0%.

Domestic loan growth was steady at 10.6% annualised and continued to outpace the domestic industry growth of 6.9% annualised. Domestic loan growth moderated slightly compared to 1QFY14 with the Group's stringent credit assessment and selectiveness of quality customers and projects to lend to. Lending to SMEs remained strong with annualised growth of 23.0% with a still steady growth trend for residential and commercial property financing.

RETURN STATS	
Price (24 July 2014)	RM20.00
Target Price	RM19.60
Expected Share Price Return	-2.0%
Expected Dividend Yield	+2.7%
Expected Total Return	**+0.7%**

STOCK INFO	
KLCI	1,877.05
Bursa / Bloomberg	1295 / PBK MK
Board / Sector	Main / Finance
Syariah Compliant	No
Issued shares (mil)	3,852.30
Par Value (RM)	1.0
Market cap. (RM'm)	77,046.80
Price over NA	3.3x
52-wk price Range	RM16.08 - RM20.93
Beta (against KLCI)	0.71
3-mth Avg Daily Vol	7.74m
3-mth Avg Daily Value	RM154.81m
Major Shareholders	
Consolidated Teh Holdings	19.83%
EPF	12.60%
Sekuriti Pejal Sdn Bhd	5.46%

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
LLC = Loan Loss Coverage
NAV = Net Asset Value

INVESTMENT STATISTICS

FYE Dec	FY12	FY13	FY14F	FY15F
Net interest income (RM'm)	5,254.6	5,570.5	5,710.6	6,293.8
Islamic banking income (RM'm)	843.8	837.1	944.1	1,028.8
Non-interest income (RM'm)	1,648.3	1,750.6	1,953.7	2,169.7
Total income (RM'm)	7,746.7	8,158.3	8,608.3	9,492.3
Pretax profit (RM'm)	5,103.9	5,310.0	5,632.9	6,114.1
Net profit (RM'm)	3,869.3	4,064.7	4,186.7	4,544.3
EPS (sen)	110.5	116.0	108.0*	117.0*
PER (x)	18.1	17.2	18.5	17.1
Net Dividend (sen)	50.0	52.0	49.0	53.0
Net Dividend (%)	2.5	2.6	2.5	2.7

*Lower as we have factored in the enlarged number of shares from the Rights Issue
Forecast by MIDFR

HP financing growth was also steady at 8.3% annualised.

Slower growth in deposits and liquidity tightened slightly with a higher net LDR of 87.1%. Deposit growth remained strong with a Group deposit growth of 10.9% annualised (1QFY14: 12.8% annualised) through deposit campaigns to attract new funds and customers.

Annualised domestic customer deposit of 11.4% continued to outpace the industry growth of 4.5% annualised. Core customer deposit grew at a slower pace of 1.8%qoq (1QFY14: 3.9%qoq). Annualised CASA growth was 11.4% while that of FD was 12.8% annualised slower than 1QFY14. Arising from this, CASA ratio declined slightly by 30bp qoq to 25.2% in 2QFY14. Net LD ratio was slightly higher at 87.1% vs. 86.8% in the preceding quarter.

NIM continues to be under pressure. NIM continues to be pressured by higher cost of funding due intense competition for deposits as well as price competition on loans. On quarterly basis, NIM declined 8bp qoq to 2.20%. Comparing 6MFY14 to 6MFY13, NIM compressed by 12 bp. Management guidance of NIM compression of 10-12bp for FY14 remains.

To focus more on commercial property loans and loans to civil servants with higher yields. Moving ahead, price pressure on loans and funding pressure will continue but is likely to be partially mitigated by the repricing of loan rates following the recent 25bp rise in OPR. Management plans to focus more of lending to SMEs for purchase of commercial properties as well as grow the Group's lending to civil servants with repayment through Angkasa's direct salary deduction scheme. These financings will be higher in yields to defend its NIM. The lending to civil servant will the through its arrangement with an agency which already has access to the Angkasa code. The other plans to defend its NIM will be through expanding of CASA deposits as well as increasing the mix of retail CASA relative to its wholesale CASA.

NOII growth moderated to 6.9%yoy (1QFY14: 7.5%yoy). Growth of NOII was supported mainly by higher unit trust income (+9.8%yoy). Fee income growth was modest at 4.6%yoy. NOII/total income ratio rose by 30bp qoq to 22.3% in 2QFY14. NAV of funds under management remained stable at RM64.2b in 2QFY14.

Asset quality remained stable. GIL ratio for the Group was 0.7% against the industry's 1.8%. The Group's LLC ratio remained healthy at 117.6% higher than the industry's 104.9%.

CI ratio remained lowest among peers. The CI ratio at Group level for 6MFY14 remained lowest in the industry, lower than the domestic industry average CI ratio of 45.6%.

The Group is on track to achieve all FY14 KPI targets. On its net ROE target for FY14, management has revised it lower from >20.0% to 18.0%. This is due to its rights issue exercise which upon completed will raise its equity base hence resulting in a lower ROE.

After the completion of its acquisition of another 50% equity in VAD Public Bank (VPB) presently held by Joint Stock Commercial Bank for Investment and Development of Vietnam (BIDV), VPB will be converted into a 100% owned foreign bank. Management highlighted that VPB will focus on consumer/retail banking. The acquisition of another 50% equity will enable the Group to fully own VPB. This will allow it to accept savings deposits like other banks in Vietnam. In addition, it also allows the Group to operate VPB with its own business model.

Group CET 1 ratio at 8.9%. Upon completion of the right issue exercise (right issue of 1 to 10 @ RM13.80 per share) to raise RM4.83b and setting aside regulatory reserves to meet the collective assessment (CA) ratio of at least 1.2%, Group CET1 ratio will be enhanced to 10.6%, while CCR and RWCR will rise to 12.1% and 16.1% respectively. The rights issue exercise is likely to complete in Aug'14 and upon completion, the Group will transfer the required regulatory reserves to meet the CA ratio of 1.2% ahead of the dateline set by BNM of 31st December 2015.

FORECAST

We lower our NIM assumption for FY14 and FY15. This reduces our net profit estimate for FY14 and FY15 by 4.9% and 4.8% respectively to RM4,186.7m and RM4,544.3m.

VALUATION AND RECOMMENDATION

The stock continues to trade at rich valuation compared to peers with PB multiple of 2.8x to our FY14 BVPS. We believe that its premium valuation has been due to its resilience with a stable asset quality and low credit cost. Dividend payout for FY14 is expected to be 45.0% similar to that in FY13. Meanwhile, growth in the profit from its retail operations has been subdued at 0.03% due to pressures on margin while its hire purchase segment's profit for 1HFY14 declined 8.2%yoy to higher impairment allowance and NIM compression. With no near term rerating catalyst, we remain NEUTRAL on the stock. We roll over our valuation period to FY15 with an adjusted TP of RM19.60 pegged to a 2.5x PB multiple on FY15 BVPS.

DAILY PRICE CHART

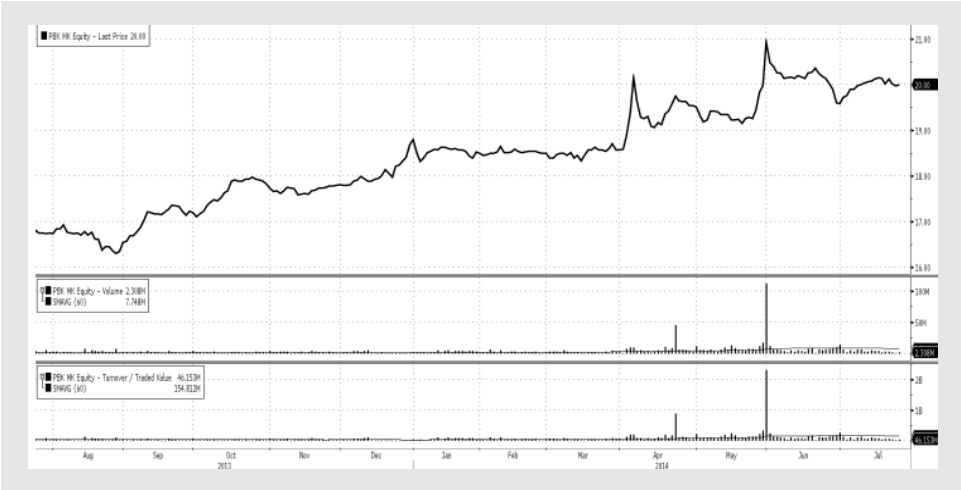

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Table 1: Comparison of quarterly results

Quarterly results						Comments
FYE Dec (RM m)	**2Q14**	**1Q14**	**2Q13**	**Yoy**	**Qoq**	
Net Interest Income	1,421.7	1,403.0	1,386.0	+2.6%	+1.3%	NII declined 8bp qoq. NIM will continuing to be under pressure while growth of loan book has been decent.
Islamic Banking Income	203.6	205.6	210.0	-3.0%	-1.0%	
Non-interest Income	474.2	455.0	446.0	+6.3%	+4.2%	NOII increase by 4.2%qoq. Total fee income rose by 7.6%qoq while investment and trading income increase by 4.5%qoq.
Net/Total income	2,099.6	2,063.5	2,041.9	+2.8%	+1.7%	Net income growth was subdued at 1.7%qoq due to muted growth in Islamic Banking income and NII.
Provision of loan losses	(64.7)	(84.8)	(76.3)	-15.2%	-23.7%	
Pre-tax profit	1,367.7	1,327.1	1,340.6	+2.0%	+3.1%	
Net Profit	1,056.4	1,016.9	1,023.5	+3.2%	+3.9%	
EPS (sen)	30.2	29.0	29.2	+3.4%	+4.1%	

Table 2: Comparison of financial ratios

Financial Ratios (%)	2Q14	1Q14	2Q13	Yoy	Qoq	Comments
CET 1* capital	8.9	8.5	8.5	+0.4	+0.4	Industry CET1 as at May'14: 12.1%
CCR*	10.4	10.1	10.4	-	+0.3	Industry CCR as at May'14: 12.8%
RWCR*	13.8	13.3	12.8	+1.0	+0.5	Industry RWCR as at May'14: 14.5%
Gross impaired loan/Gross NPL	0.7	0.7	0.7	-	-	Lower than industry GIL ratio: 1.8%
Loan loss coverage (LLC)	117.6	119.1	123.2	-5.6	-1.5	Higher than industry LLC: 104.9%
Cost to income	31.7	31.8	30.8	+0.9	-0.1	
Net loans to deposit (LD ratio)	87.1	86.8	86.4	+0.7	+0.3	
NIM	2.20	2.28	2.36	-0.16	-0.08	
ROEA	20.2	19.9	22.2	-2.0	+0.3	

*Group level capital ratios

Table 3: Comparison of cumulative results

Cumulative results				Comments
FYE Dec (RM m)	1HFY14	1HFY13	Yoy	
Net Interest Income	2,824.7	2,735.7	+3.3%	
Islamic Banking Income	409.2	417.3	-1.9%	
Other Operating Income	929.2	869.2	+6.9%	Fee income and unit trust contributed 67.5% of the Group's total non interest income. NOII growth in 1HFY14 was supported by the following: i. Increase in fee income by 4.6%yoy to RM227m; ii. Increase in unit trust income by 9.8%yoy to RM349.9m and iii. Increase in investment income by 34.0%yoy to RM100.4m The percentage of NOII to total income was slightly higher at 22.3% in 1HFY14 vs. 21.6% in 1HFY13.
Net/Total income	4,163.1	4,022.1	+3.5%	
Pre-tax profit	2,694.8	2,610.5	+3.2%	In terms of business segments, retail operations pre-tax contribution to Group PBT remained the largest at 59.1% in 1HFY14. (1HFY13: 61.0%) Meanwhile, contribution from hire purchase financing business to Group's total pre-tax profit eased to 9.3% in 1HFY14 (1HFY13: 10.4%) due to higher impairment allowance and NIM pressure. Overseas operations pre-tax contribution was slightly higher at 7.4% in 1HFY14 vs. 6.8% in 1HFY13.
Taxation and zakat	(599.9)	(597.3)	+0.4%	
Net Profit	2,073.3	1,991.8	+4.1%	
EPS (sen)	59.2	56.9	+4.0%	

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MIDF AMANAH INVESTMENT BANK : GUIDE TO RECOMMENDATIONS	
STOCK RECOMMENDATIONS	
BUY	Total return is expected to be >15% over the next 12 months.
TRADING BUY	Stock price is expected to *rise* by >15% within 3-months after a Trading Buy rating has been assigned due to positive newsflow.
NEUTRAL	Total return is expected to be between -15% and +15% over the next 12 months.
SELL	*Negative* total return is expected, by -15% or more, over the next 12 months.
TRADING SELL	Stock price is expected to *fall* by >15% 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.