Mercury Securities Sdn Bhd

Your guide to making intelligent investment decisions

CBRS FREE Expert Analysis Reports

RESULTS REPORT

12 May 2011

Malaysia Building Society Berhad		***Market Price:***	*RM1.50*
		Market Capitalisation:	*RM1823.8m*
		Board:	*Main Market*
Recommendation:	*BUY*	***Sector:***	*Finance*
Target Price:	*RM1.78*	***Stock Code/Name:***	*1171 / MBSB*

***Analyst**: Edmund Tham*

KEY FINANCIALS

Key Stock Statistics	2011E
Earnings/share (sen)	17.8
P/E Ratio (x)	8.4
Dividend/share (sen)	7.0
NTA/share (RM)	1.00
Book Value/share (RM)	1.00
Issued Capital (mil shares)	1207.2
52-weeks price range (RM)	0.75 – 2.02
Major Shareholders:	%
.EPF Board	66.3
.PNB	14.9
.	.

**RM1 par value*

P&L Analysis (RM'mil)	2008	2009	2010	2011E
Year end: Dec 31				
Revenue	416.2	538.0	769.9	940.9
Operating Profit	81.8	190.2	319.6	465.2
Depreciation	(7.8)	(8.2)	(7.4)	(7.9)
Interest Expenses	(188.5)	(151.2)	(142.6)	(150.0)
Pre-tax Profit (PBT)	54.0	80.3	207.4	293.3
Effective Tax Rate (%)	39.2	28.1	29.3	25.9
Net Profit (NPAT)	32.6	57.2	146.0	215.4
Operating Margin (%)	19.6	35.4	41.5	49.4
Pre-tax Margin (%)	13.0	14.9	26.9	31.2
Net Margin (%)	7.8	10.6	19.0	22.9

**PBT=Operating profit-allowance for impairment losses (on loans, advances & financing); NPAT=PBT-taxation-zakat*

Basic Ratios Analysis	2008	2009	2010	2011E
Book Value/share (RM)	0.43	0.46	0.32	1.00
Earnings/share (sen)	2.7	4.8	12.2	17.8
Dividend/share (sen)	1.8	2.3	5.3	7.0
Div. Payout Ratio (%)	48.4	36.7	32.4	29.4
P/E Ratio (x)	55.3	31.5	12.3	8.4
P/Book Value (x)	2.1	3.3	4.7	1.5
Dividend Yield (%)	1.2	1.6	3.5	4.7
ROE (%)	6.4	10.4	38.3	17.8
Net Gearing 1(or Cash)(x)	13.0	12.4	25.7	9.9
Net Gearing 2(or Cash)(x)	0.6	(1.3)	(1.8)	(0.7)

**2011 figures are our estimates*
**Net gearing (1-including customer deposits; 2-excluding)*
**Including impact of rights issue*

PERFORMANCE – 1Q/FY11

1Q/ 31 Mar	1Q11	1Q10	yoy %	4Q10	qoq%
Rev (RMm)	311.6	279.4	11.5	208.9	49.2
PBT (RMm)	209.1	105.8	97.7	115.5	81.1
NPAT (RMm)	68.3	43.2	58.1	12.8	432.9
EPS (sen)	5.7	3.6	58.1	1.1	432.9

MBSB recorded strong 1Q/FY11 (period ended 31st March 2011) revenue and net profit after tax (NPAT) (annualized) that were above our earlier expectations.

"Positive 1Q/FY11 performance"

With its 1Q/FY11 revenue of RM311.6 million, MBSB recorded strong revenue growth of 11.5% y-o-y and 49.2% q-o-q. The group's profit before tax (PBT) of RM91.0 million for 1Q/FY11 had increased by 25.7% as compared to the preceding 4Q/FY10. This increase in profit was mainly due to the higher income from Islamic Banking operations (especially personal financing) and higher other operating income. These were nevertheless partially off-set by higher impairment allowances on loans, advances and financing and higher "other operating expenses".

"Strong contribution from Personal Financing segment"

The group 1Q/FY11 net profit after tax (NPAT) of RM68.3 million was higher by 58.1% y-o-y and 432.9% q-o-q. This increase was also mainly due to higher income from Islamic banking operation via the expansion of its personal financing portfolio.

OUTLOOK/CORP. UPDATES

In tandem with the improving domestic economy (in GDP terms), we expect that the group's financing revenues would grow as well. It is common for consumers to take up loans or financing, especially for housing, motor vehicles, credit cards or personal financing. MBSB's management is targeting strong demand from the public sector, i.e. the civil servants working for the government.

"Steady economic growth"

Malaysia had reported a very respectable 4Q/2010 GDP growth of +4.8% (+7.2% for full year 2010 GDP), stable 4Q/2010 unemployment rate of 3.2% and CPI of 3.0% (March 2011). Meanwhile, Bank Negara Malaysia (BNM) had recently increased its overnight policy rate (OPR) by 0.25% to 3.0% and the statutory reserve requirement (SRR) by 1% to 3% to rein-in inflationary pressures.

The expected growth of the wholesale and retail trade, ICT, tourism, health, education, business services as well as finance and insurance sub-sectors, following the roll-out of programmes and initiatives under the 7 services-related National Key Economic Areas in 2011 augur well for MBSB's business prospects.

"Better Results due to Business Plan"

MBSB's strong Q1 earnings were the result of the group's continuous efforts in executing its Business Plan to increase its loans in the retail segment. The group is expecting to launch several new products (e.g. credit card and hire purchase) this year, giving more focus on fee-based income and to improve customer service levels. MBSB plans to establish additional Sales and Service Centres and Representative Offices to further extend its network, especially in East Malaysia and the southern region of Peninsular Malaysia.

The group's Business Plan also entails improvement of asset growth in its corporate business segment, partly to be achieved via its SME Cash Express program (already launched early this year). Meanwhile, its Contract Financing product targeted at companies that have been awarded contracts by the government or its related entities, has also been getting good response. MBSB is also supporting the government's Economic Transformation Program (ETP) with the establishment of a Wholesale Banking Division, seeking to finance Private Finance Initiative (PFI) projects.

"Easily Exceeding KPI Targets"

As a GLC (government linked company), MBSB maintains a set of Target Headline Key Performance Indicators (KPIs). These KPIs have been set and agreed by MBSB's Board of Directors and management as part of the broader KPI framework in place under the GLC Transformation programme and is disclosed on a voluntary basis.

KPI	Actual FY10	Actual 1Q/ FY11	FY11 KPI Targets
Group Net ROE	31.3%	65.6%	15%
Group Revenue growth	43.1%	61.9%	25%

Source: MBSB

The group's 1Q/FY11 net return on equity (ROE) and revenue growth had easily exceeded the targeted Headline KPIs. This was mainly due to the strong performance of the personal financing business segment and also higher "other operating income". This gain was partly off-set by the higher operating expenses and higher loan impairment.

"Prime pickings – civil servants"

MBSB's management is particularly optimistic for strong growth for its personal financing to civil servants, given the strong demand and its attractive rates and packages. Nevertheless, MBSB does face specific competitors for this niche market – with rivals such as Bank Rakyat, BSN, RCE Capital and AgroBank.

MBSB is able to get payments from its civil-servant clients in a "fail-safe" way via its direct salary deduction code with ANGKASA. ANGKASA (Angkatan Koerasi Kebangsaan Malaysia or National Co-operative Organisation of Malaysia) is the apex cooperative overseeing all types of cooperatives throughout Malaysia.

Going forward, MBSB has specific plans for its future via its Business Direction 2011-2015 plan. The plan involves a wider range of products for the retail, corporate and wholesale financing segments. For the corporate segment, MBSB would offer vendor financing, industrial hire purchase and commercial financing. The wholesale financing business segment is related to PFIs (private finance initiatives) and structured businesses.

VALUATION/CONCLUSION

As part of its capital management plan, MBSB had proposed a renounceable rights issue of up to 507.1 million new shares of RM1.00 each at an issue price of RM1.00 for each rights share on the basis of 5 rights shares for every 7 existing MBSB shares held. The proposed rights came together with up to 507.1 million free detachable warrants on the basis of 1 warrant for every 1 rights share subscribed. The rights shares subsequently went-ex on 4th May 2011.

The first and final dividend for FY10 (9 sen less tax) ended 31st December 2010 were paid in April 2011. Based on the current market price, this would account for a reasonable FY10 gross dividend yield of 3.5% and dividend payout ratio of 32.4% of its annual net earnings.

With a relatively high adjusted beta (correlation factor) of 1.55 to the KLCI, MBSB (+34.8 YTD) has easily outperformed the KLCI's (+1.1%) performance this year. Market conditions have also been volatile in recent months, impacted by the political uprisings in the Middle East/North Africa, public debt issue in Europe and the major Tohoku tsunami/earthquake disaster in Japan.

"Maintain Buy Call"

Based on our forecast of MBSB's FY11 EPS and an estimated P/E of 10 times (within its historical range), we set a **FY11-end Target Price (TP) of RM1.78.** This TP offers investors a 19.0% upside from MBSB's current price. Our TP for MBSB reflects a P/BV of 1.78 times over its FY11F BV/share. Meanwhile, the local banking sector's average P/E and P/BV is 10.9 times and 2.1 times, respectively. The group's P/E and P/BV valuations are undemanding, while it has solid ROEs. The group has been in a net cash position (excluding customer deposits as borrowings) since its FY09.

"Concerns and risk factors"

MBSB's high loan impairment ratio (due to legacy accounts) has dwindled down in recent years, and we are not overly concerned about it at the moment. Besides, most of the impaired property loans are backed by collateral. The group also has a higher than banking industry average loan-deposit ratio of more than 100%, but MBSB's management is targeting to bring this down to a more palatable 95-98% level.

MBSB's business also face possible risk factors such as a slower rate of economic growth, weak financing demand, rising loan impairments, rising cost of funds and stiff competition from other existing banks/financial institutions. In addition, MBSB also faces routine challenges in improving its internal IT infrastructure, branding / recognition and branch networking.

MBSB: Share Price

Source: NextView