Phillip Capital Management Sdn Bhd **18 October 2010**

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Public Bank Bhd ("PBB") – Safe growing premium bank

Recommendation **Buy**

Share Price **RM12.60**

FINANCIAL SUMMARY

FYE 31 Dec (RM mil)	2008A	2009A	2010F	2011F
Net revenue	5,739.3	6,125.0	6,737.5	7 411.3
Operating profit	3,948.1	4,015.1	4,446.8	4 965.5
Operating Margin (%)	69.3	64.2	66.0	67.0
Pretax Profit	3,379.2	3,321.4	3,735.3	4 220.7
Net Profit	2,581.2	2,517.3	2,801.5	3 165.5
EPS (sen)	76.9	73.3	79.3	89.6
DPS (sen)	80.3*	71.6*	43.6	49.3
PER (x)	16.4	17.2	15.9	14.1
Dividend Yield (%)	6.4*	5.7*	3.5	3.9

**Includes share dividend*

Source: Company, Bloomberg & PCM estimates

OTHER KEY DATA

Listing	Main Board
Issued Cap. (mil, RM1.00 par)	3,531.9
Market Cap. (RM m)	44,643.2
52 Week Low/High (RM)	10.33/12.76
ROE (%)	24.9
P/BV (x)	3.7
BV/share (RM)	3.44

Major Shareholders **(%)**

Chart 1: PBB's business operations

EPF	14.6
Sekuriti Pejal S/B	6.0

PBB is a laggard banking stock that has risen a mere 13% YTD vis-à-vis its banking peers that rose as high as 41% YTD.

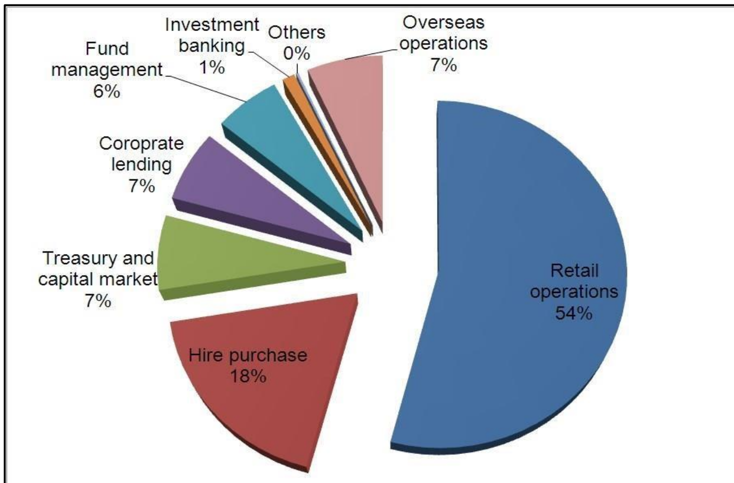
With net loans growing at CAGR of 15% but at lower than average net NPL of 0.9%, PBB is trading at PEGR of 1x, the cheapest among the big 4 Malaysian banks.

With good dividend paying track record, PBB is a cheap banking stock with potential FY10 dividend yield of at least 3.5%. As the market continues to rally, we feel that PBB is a safer buy should the market corrects as PBB has not appreciated much in terms of share price and hence lower downside. We recommend a ***Buy*** on PBB as a growing premium banking investment.

Price Chart of PBB (Oct '09 – Oct '10)

Source: Bloomberg

Highlights:



Source: PBB Annual Report 2009, PCM

Background – PBB is the 3rd largest bank in Malaysia. It was established in 1966 by Tan Sri Dato' Sri Dr. Teh Hong Piow (THP) and was subsequently listed in Bursa Malaysia in 1967. With operations in Malaysia, Hong Kong, China, Cambodia, Vietnam, Laos and Sri Lanka, PBB is one of the most well run banks regionally boasting above 20% ROE comparable to those of HSBC(HK) and is known for being prudent in its lending business which to date, PBB reported a net NPL ratio of below 1%. Its main business segment is in retail operations (54%) followed by hire purchases (18%)(See ***Chart 1***). Out of the retail operations, approx. 43.7% is made up of residential loans, whereas 28.8% comprises SME loans and another 8% for personal loans.

Laggard banking stock, but loan growth highest – Save for PBB which only increased by 13% YTD in share price, the rest of the major banks soared at least 28% YTD in its share prices like CIMB's case, with RHB witnessing the highest jump by 41% YTD. Arguably PBB's PER valuation is the second highest after CIMB, but in terms of loan growth (see ***Table 1***), PBB's 5-year net loan CAGR of 15.2% is a close second to CIMB and its net Non-Performing Loan (NPL) ratio is the lowest vis-à-vis its banking peers (see ***Table 2***). Despite the high net loan growth, PBB is merely trading at Price Earnings Growth Ratio (PEGR) of 1x, the cheapest amongst the major banks suggesting the laggard price movements YTD is unwarranted for a premium banking stock.

Table 1: PBB other banks - Financial

Banks	Price (RM)	FY10 PER	Net loans CAGR (%)	PEGR (x)
CIMB	8.07	16.3	15.3	1.1
Maybank	9.01	14.9	9.4	1.6
PBB	12.60	15.9	15.2	1.0
RHB	7.71	12.0	6.7	1.8

Source: PCM and Bloomberg

CAR 7%, cash call unlikely – PBB's capital ratio of 7% is well above the new Basel III requirement of 4.5%. Previously, there was worry that the new Basel III requirement would cause PBB to reduce its dividend drastically to beef up its capital base. With a lower capital requirement under Basel III, PBB is likely to maintain its generous dividend payouts of 50%-55% as in the past.

Rising interest rates, better Net Interest Margins (NIM)
As the global economy recovers steadily, interest rates will be in uptrend to stem inflationary pressures. The increasing trend of interest rates bode well for banks in general as it will increase their NIM and hence profitability going forward. This is especially beneficial for PBB with high residential loan segment in its loan business as lending rates for residential properties financing are normally floating. We noted that PBB's residential loan segment increased by 19.1% from RM28.7 bn in 2008 to RM34.2 bn in 2009. Consequently, PBB's market share in residential loan increased from 18.4% in 2008 to 19.1% in 2009.

Table 2: PBB vs. other banks- Operational

Banks	FY10 Total assets (RM' bn)	FY09 Net Mortgages (RM 'bn)	FY09/10 Cost to income ratio (%)	NPL(%)
CIMB	256	29.0	54	2.0
Maybank	337	34.6	50	1.2
PBB	219	34.2	34	0.9
RHB	120	16.0	43	2.2

Source: PCM, Bloomberg and respective banks' latest annual reports

The 'inevitable' will not affect operations – Many investors are worried about potential negative impact on PBB after THP's eventual departure. However, we are of the view if PBB share dips after THP's departure it will only be temporary as the operations of PBB will continue to function professionally. Undoubtedly, PBB is what it is today partly due to THP's character and belief. But a bank is still a bank, It is managed by a large team of professionals adhering to a very structured system built up over the years. Therefore, we do not see THP's departure as major threat to the bank's fundamentals.

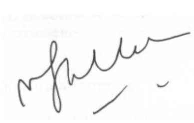
Safe investment with high dividends, best operational efficiency – Historically, PBB has been a bank that emphasizes a lot on integrity, especially towards its shareholders by rewarding them handsomely in the form of cash/stock dividends and bonus issues. Therefore, with the lesser need to build up its capital base, we believe

PBB will continue to pay out at least 50%-55% of its profit as dividend. Referring to ***Table 2***, we see that PBB has the lowest cost to income ratio of 34% indicating more efficient operations vis-à-vis other banks.

Recommendation:-

We favour PBB because in comparison to other banking peers which have risen as much as 41% YTD, PBB is a laggard that only increased by 13% YTD which is unjustifiable given its strong loan growth with a CAGR of 15%. Valuation wise, PBB is trading at PEGR of 1x, which is the cheapest among the big 4 Malaysian banks. We recommend a ***Buy*** on PBB.

For Phillip Capital Management Sdn Bhd



Nona Salleh
Executive Chairperson