COMPANY UPDATE

# Public Bank (PBK MK)

## Playing Catch-up

**Public Bank's share price has lagged due to its low beta and initial valuation premium. Its current P/B is 20% higher than the industry average, correlating with its 12% ROE versus the industry's 10%, indicating that it no longer commands a valuation premium. The share price is set for outperformance as the market factors in potential earnings surprises from lower credit costs and stronger loan growth, in our view. Maintain BUY with a target price of RM5.10 (1.73x 2024F P/B, 12.2% ROE).**

### WHATS NEW

- **Asset quality impacted largely by a single account in HK.** Public Bank's gross impaired loans (GIL) ratio rose to a 10-year high of 0.63% in 1Q24. This increase is largely attributed to a single syndicated commercial property loan from its Hong Kong (HK) operations. The GIL ratio for its HK operations increased from 1.29% in 4Q22 to 4.16% in 1Q24, with the aforementioned account contributing around 78% of this rise.

- **Deterioration in HK operations' asset quality not systemic in nature.** Despite ongoing economic challenges in HK, management has indicated that asset quality stress within its HK operations is largely contained to the above mentioned syndicated commercial property loan. This impacted loan has been fully impaired, and any additional potential provision will not be significant given its loans loss coverage ratio of over 50% and the accompanied property as collateral.

- **HK represents a small proportion of group loans.** Given that its HK operations represent only 4.5% of group loans, we do not anticipate a significant impact even if asset quality there deteriorates further. If the GIL ratio for its HK operations were to double to 8% in the worst-case scenario, the incremental impact on the overall group GIL ratio would be a manageable 14bp, raising the group GIL ratio to 0.76%, still below management's guidance of >1% GIL ratio. Additionally, the group has RM1.7b in pre-emptive provisions, which can be utilised against an estimated RM290m in required provisions on our worst-case scenario assumption.

- **Domestic asset quality holding up well.** The group's domestic asset quality has been holding up better than expected. Its current domestic loan delinquency rate of 2.3% is well below the pre-COVID-19 level of 3.6% in 2019, and the current domestic GIL ratio of 0.40% is also below the pre-COVID-19 level of 0.40%. As such, despite comprising 93% of total loans, domestic GIL represents a disproportionately lower 62% of total group GIL.

- **Provides scope for lower credit costs.** Management noted that if the domestic delinquency rate stays at the current 2% level, credit costs could fall below the 5-10bp guidance. Previously, when the delinquency rate was nearly double at 4% (2018-19), the group recorded an average net credit cost of 5bp (lower end of its current guidance). Coupled with a higher loan loss coverage ratio of 169% (pre-COVID-19: 124%), there is clearly a case for strong potential downside surprise in credit costs. We project 2024/25 net credit costs at 5bp, at the lower end of management's guidance. Our sensitivity analysis indicates a potential net credit cost writeback of up to 40bp, which could increase FY24 earnings by 19%.

### KEY FINANCIALS

| Year to 31 Dec (RMm) | 2022 | 2023 | 2024F | 2025F | 2026F |
|---|---|---|---|---|---|
| Net interest income | 9,167 | 9,055 | 9,511 | 10,088 | 10,744 |
| Non-interest income | 2,414 | 2,476 | 2,689 | 2,837 | 2,970 |
| Net profit (rep./act.) | 6,119 | 6,649 | 6,932 | 7,388 | 7,853 |
| Net profit (adj.) | 6,119 | 7,138 | 6,932 | 7,388 | 7,853 |
| EPS (sen) | 31.5 | 36.8 | 35.7 | 38.1 | 40.4 |
| PE (x) | 13.1 | 11.2 | 11.6 | 10.9 | 10.2 |
| P/B (x) | 1.6 | 1.5 | 1.4 | 1.4 | 1.3 |
| Dividend yield (%) | 4.1 | 4.6 | 4.8 | 5.1 | 5.4 |
| Net int margin (%) | 2.4 | 2.2 | 2.2 | 2.2 | 2.2 |
| Cost/income (%) | 31.5 | 33.7 | 34.3 | 34.2 | 34.0 |
| Loan loss cover (%) | 272.0 | 181.8 | 140.8 | 149.2 | 145.3 |
| Consensus net profit | - | - | 6,944 | 7,313 | 7,647 |
| UOBKH/Consensus (x) | - | - | 1.00 | 1.01 | 1.03 |

*Source: Public Bank, Bloomberg, UOB Kay Hian*

## BUY

(Maintained)

| | |
|---|---|
| Share Price | RM4.13 |
| Target Price | RM5.10 |
| Upside | +23.5% |

### COMPANY DESCRIPTION

Public Bank is the third-largest domestic banking group in Malaysia by assets with about 14.8% of system assets and 16.2% loan market share.

### STOCK DATA

| | |
|---|---|
| GICS sector | Financials |
| Bloomberg ticker: | PBK MK |
| Shares issued (m): | 19,410.7 |
| Market cap (RMm): | 81,166.2 |
| Market cap (US$m): | 17,513.3 |
| 3-mth avg daily t'over (US$m): | 18.9 |

**Price Performance (%)**

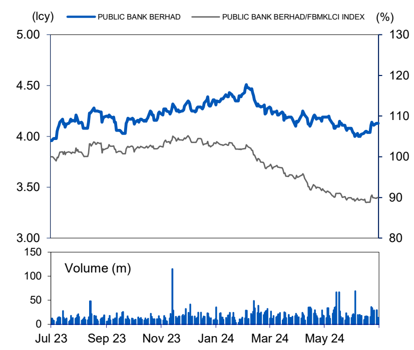
52-week high/low RM4.51/RM3.96

| 1mth | 3mth | 6mth | 1yr | YTD |
|---|---|---|---|---|
| 1.2 | 0.2 | (5.3) | 3.5 | (3.7) |

| Major Shareholders | % |
|---|---|
| Consolidated Teh Holdings Sdn Bhd | 21.6 |
| EPF | 15.9 |

| | |
|---|---|
| FY24 NAV/Share (RM) | 2.93 |
| FY24 CAR Tier-1 (%) | 15.63 |

### PRICE CHART




*Source: Bloomberg*

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- **Loan growth remains steady.** Based on the group's current loan approval pipeline, management is confident in achieving its 2024 loan growth target of 5-6%. Auto loan growth is expected to normalise downward in 2H24 from a robust annualised 17% growth in 1Q24 (industry: 11%) but is still expected to normalise to 10-15% growth from a high base. Stronger SME loans growth is expected to offset the slowdown in auto loans, helping to sustain the 1Q24 loan growth of 6.3% for the rest of 2024. This is above its full-year guidance of 5-6%. We maintain our 6% loan growth assumption for 2024 (2023: 5.9%) with potential upside depending on SME loan growth momentum.

- **SME loan growth momentum to gain traction.** Public Bank's SME growth, primarily driven by commercial property lending, is expected to accelerate from 4% in 1Q24 due to a new SME campaign launched in April offering lower first-year "teaser" interest rates. SME loan growth has already shown a meaningful recovery, increasing from 2% in 2023 to 4% in 1Q24, even before the campaign's launch. This reflects management's increased risk appetite and confidence in the financial strength of SME clients, based on the stable delinquency trends observed over the past two years post COVID-19 reopening.

- **NIM to remain stable.** Management expects NIM to remain fairly stable in 2024 with only a slight compression in a worst-case scenario. Lower funding cost is expected to offset slight yield pressure emanating from its mortgage portfolio on the back of increased industry-wide mortgage competition. We expect Public Bank's full-year NIM at 2.20% (1Q24: 2.21%). The eventual Federal Reserve interest rate pivot in 2H24 could allow banks to further lower fixed deposit (FD) promotional interest rates to help offset rising yield pressure on loans.

- **Lowering fixed deposit campaign interest rates.** To preserve NIM and offset pressure on lending yields, Public Bank reduced its FD promotional interest rates below that of its peers. It offers 3.55% interest rate on 12-month FD, while peers offer higher rates (Alliance Bank at 4.20% for 12 months and 3.80% for six months, MBSB and Bank Islam at 4.0% for 12 months, CIMB at 3.70% for seven months, Hong Leong Bank at 3.65% for six months, and RHB at 3.60% for six months).

- **Non-interest income should gain momentum on stronger unit trust growth.** We project an 8% growth in non-interest income for 2024 (2023: 3%), driven by a 10% increase in fee income. This is expected to be fuelled by a recovery in unit trust income, reflecting improved equity market sentiment. In 1Q24, unit trust income grew 19% (2023: 2%), comprising 50% of the group's total non-interest income.

- **Opex to remain slightly elevated but should normalise from 1Q24.** We expect opex growth to remain elevated at 7.5% in 2024, though it should normalise downward from 1Q24's 9.5% growth. Higher staff costs due to unionised salary accruals will keep opex growth elevated in 2024. However, a higher staff cost base in 2H23 compared to 1H23, following a group-wide salary adjustment in 2H23, should lead to a downward normalisation in opex growth in 2H24.

- **2024 outlook.** Management has retained its key 2024 key guidance as follows: a) loans growth: 5-6%, b) deposit growth: 5-6%, c) NIM: stable to slight compression, d) net credit cost: 5-10bp, and e) ROE: 12%.

## EARNINGS REVISION/RISK

- **Earnings revision:** None.

## VALUATION/RECOMMENDATION

- **Maintain BUY and target price of RM5.10 (1.73x 2024F P/B, ROE: 12.2%)** which is in line with its historical mean P/B. Current P/B valuation of 1.40x values the stock at 1.0SD below its historical P/B mean which we deem attractive given its strong defensive qualities. Public Bank also stands to benefit once macroeconomic conditions improve as it has the strongest headroom for potential provision write-backs.

### HK OPERATIONS GIL SENSITIVITY

| | (RMm) |
|---|---|
| HK China Current GIL ratio | 4.10% |
| Worst case scenario GIL ratio | 8.00% |
| Worst case scenario rise in GIL ratio | 3.90% |
| Potential worst-case scenario incremental increase in GIL from HK China operations | 575.5 |
| Potential incremental impact to Group GIL Ratio | 0.14% |
| Current Group GIL ratio | 0.62% |
| Potential worst case scenario Group GIL ratio | 0.76% |
| Potential Provision Impact | |
| Potential additional provision top-up required (assuming conservative LGD of 50%) | 287.7 |
| Current Management overlay | 1,700.0 |
| Excess management overlay | 1,412.3 |

*Source: Public Bank, UOB Kay Hian*

### DOMESTIC DELINQUENCY RATE

| | Pre-COVID 2019 | 1Q24 |
|---|---|---|
| 1 month to < 2 months | 2.20% | 1.70% |
| 2 months to < 3 months | 1.00% | 0.20% |
| Impaired | 0.43% | 0.40% |
| Total | 3.63% | 2.30% |

*Source: Public Bank, UOB Kay Hian*

### KEY ASSUMPTIONS

| (%) | 2024F | 2025F | 2026F |
|---|---|---|---|
| Loan Growth | 6.0 | 6.2 | 6.2 |
| Credit Cost (bp) | 5.0 | 4.0 | 4.0 |
| ROE | 12.2 | 12.5 | 12.7 |

*Source: UOB Kay Hian*

### ENVIRONMENTAL, SOCIAL, GOVERNANCE (ESG) UPDATES

- Environmental
  - Green loan commitment. Launched a campaign in 2020 offering preferential rates for selected energy efficient vehicles (EEV) under its AITAB Hire Purchase-i, to promote the usage of EEVs.
  - Paperless initiative. Moving towards paperless operations with its enhanced Go Green initiatives in its daily operations, such as migrating reports to online verification module, issuing electronic statements and notices as well as introducing electronic signatures (eSignature) in new deposit account openings.
- Social
  - Board and upper management gender diversity. Maintained 33% female directors on the Board and 48% for top and senior management.
- Governance
  - Non-independent board of directors. Composition of Independent Non-Executive Directors (INED) – 55%.

*Source: Public Bank, UOB Kay Hian*

## PROFIT & LOSS

| Year to 31 Dec (RMm) | 2023 | 2024F | 2025F | 2026F |
|---|---|---|---|---|
| Interest income | 18,040 | 16,395 | 17,294 | 18,334 |
| Interest expense | (8,985) | (6,883) | (7,206) | (7,590) |
| Net interest income | 9,055 | 9,511 | 10,088 | 10,744 |
| Fees & commissions | 1,950 | 2,145 | 2,274 | 2,387 |
| Other income | 526 | 544 | 563 | 583 |
| Non-interest income | 2,476 | 2,689 | 2,837 | 2,970 |
| Income from islamic banking | 1,562 | 1,640 | 1,722 | 1,808 |
| Total income | 13,093 | 13,840 | 14,646 | 15,522 |
| Staff costs | (3,196) | (3,484) | (3,693) | (3,914) |
| Other operating expense | (1,219) | (1,263) | (1,310) | (1,358) |
| Pre-provision profit | 8,678 | 9,093 | 9,644 | 10,249 |
| Loan loss provision | (157) | (211) | (180) | (191) |
| Other provisions | (1) | 0 | 0 | 0 |
| Associated companies | 19 | 21 | 23 | 25 |
| Pre-tax profit | 8,539 | 8,902 | 9,487 | 10,083 |
| Tax | (1,884) | (1,964) | (2,093) | (2,224) |
| Minorities | (6) | (6) | (6) | (6) |
| Net profit | 6,649 | 6,932 | 7,388 | 7,853 |
| Net profit (adj.) | 7,138 | 6,932 | 7,388 | 7,853 |

## BALANCE SHEET

| Year to 31 Dec (RMm) | 2023 | 2024F | 2025F | 2026F |
|---|---|---|---|---|
| Cash with central bank | 7,527 | 8,459 | 8,983 | 9,567 |
| Govt treasury bills & securities | 23,568 | 24,039 | 24,520 | 25,010 |
| Interbank loans | 0 | 0 | 0 | 0 |
| Customer loans | 394,750 | 418,970 | 445,341 | 474,840 |
| Investment securities | 63,163 | 68,059 | 73,299 | 78,907 |
| Derivative receivables | 415 | 508 | 601 | 694 |
| Associates & JVs | 142 | 164 | 181 | 199 |
| Fixed assets (incl. prop.) | 1,258 | 1,458 | 1,658 | 1,858 |
| Other assets | 19,775 | 19,988 | 20,813 | 26,617 |
| Total assets | 510,598 | 541,645 | 575,396 | 617,693 |
| Interbank deposits | 12,602 | 11,530 | 10,548 | 9,651 |
| Customer deposits | 412,897 | 433,542 | 457,387 | 485,745 |
| Derivative payables | 354 | 319 | 287 | 258 |
| Debt equivalents | 0 | 0 | 0 | 0 |
| Other liabilities | 28,364 | 37,660 | 46,229 | 58,603 |
| Total liabilities | 454,218 | 483,050 | 514,451 | 554,257 |
| Shareholders' funds | 54,674 | 56,882 | 59,228 | 61,712 |
| Minority interest - accumulated | 1,706 | 1,712 | 1,718 | 1,724 |
| Total equity & liabilities | 510,598 | 541,645 | 575,396 | 617,693 |

## OPERATING RATIOS

| Year to 31 Dec (%) | 2023 | 2024F | 2025F | 2026F |
|---|---|---|---|---|
| Capital Adequacy | | | | |
| Tier-1 CAR | 14.7 | 15.0 | 15.1 | 15.4 |
| Total CAR | 17.6 | 17.2 | 17.3 | 17.5 |
| Total assets/equity (x) | 9.3 | 9.5 | 9.7 | 10.0 |
| Tangible assets/tangible common equity (x) | 9.8 | 10.0 | 10.2 | 10.5 |
| Asset Quality | | | | |
| NPL ratio | 0.6 | 0.7 | 0.6 | 0.5 |
| Loan loss coverage | 181.8 | 140.8 | 149.2 | 145.3 |
| Loan loss reserve/gross loans | 1.0 | 0.9 | 0.8 | 0.7 |
| Increase in NPLs | 47.4 | 20.7 | (9.2) | (5.5) |
| Credit cost (bp) | 4.0 | 5.0 | 4.0 | 4.0 |
| Liquidity | | | | |
| Loan/deposit ratio | 95.6 | 96.6 | 97.4 | 97.8 |
| Liquid assets/short-term liabilities | 7.3 | 7.3 | 7.2 | 7.0 |
| Liquid assets/total assets | 6.1 | 6.0 | 5.8 | 5.6 |

## KEY METRICS

| Year to 31 Dec (%) | 2023 | 2024F | 2025F | 2026F |
|---|---|---|---|---|
| Growth | | | | |
| Net interest income, yoy chg | (1.2) | 5.0 | 6.1 | 6.5 |
| Fees & commissions, yoy chg | 1.8 | 10.0 | 6.0 | 5.0 |
| Pre-provision profit, yoy chg | (5.7) | 4.8 | 6.1 | 6.3 |
| Net profit, yoy chg | 8.7 | 4.3 | 6.6 | 6.3 |
| Net profit (adj.), yoy chg | 16.6 | (2.9) | 6.6 | 6.3 |
| Customer loans, yoy chg | 5.9 | 6.1 | 6.3 | 6.6 |
| Customer deposits, yoy chg | 4.6 | 5.0 | 5.5 | 6.2 |
| Profitability | | | | |
| Net interest margin | 2.2 | 2.2 | 2.2 | 2.2 |
| Cost/income ratio | 33.7 | 34.3 | 34.2 | 34.0 |
| Adjusted ROA | 1.4 | 1.3 | 1.3 | 1.3 |
| Reported ROE | 12.7 | 12.4 | 12.7 | 13.0 |
| Adjusted ROE | 13.6 | 12.4 | 12.7 | 13.0 |
| Valuation | | | | |
| P/BV (x) | 1.5 | 1.4 | 1.4 | 1.3 |
| P/NTA (x) | 1.5 | 1.5 | 1.4 | 1.4 |
| Adjusted P/E (x) | 11.2 | 11.6 | 10.9 | 10.2 |
| Dividend Yield | 4.6 | 4.8 | 5.1 | 5.4 |
| Payout ratio | 55.5 | 55.0 | 55.0 | 55.0 |

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