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STOCK WATCH

Metrobank
▶ STRONG CORE OPERATIONS

BDO
▶ THE LARGEST BRANCH NETWORK

US Interest Rate Policy Loses its Sting For Now

By: Cristina S. Ulang

Fed Ditches "Patient" Language, But Rates Won't Rise Just Yet. The recent and much awaited turning point in US monetary policy was the Fed's policy language dropping the word "patient" as it held the key rate steady. It was supposed to signal a string of US interest rate policy fireworks, but not a few moderating factors have gotten in the way. A not so hot US economy, strong dollar (the dollar index up +25% since last July and more than +10% this year) and low core inflation (seen to be less than 2% in 2H2014) have convinced some economists that US interest rates are not going to rise earlier and faster such as those from Deutsche Bank. Deutsche Bank predicts the Fed may not at all hike rates in the next two meetings.

Prof. Roubini bets the US key rate is not moving as early as June, pointing to later and a less aggressive move, 3Q this year at the earliest and not much or by just 25 bps and 4Q at the latest, adding the word "patience" may be dropped in theory but not in practice, meaning US rates won't necessarily rise.

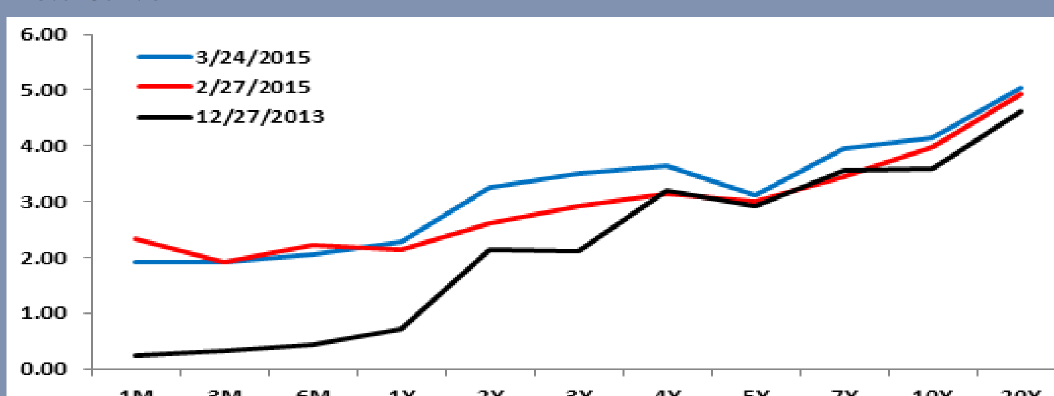
Debt Crisis Risk. The question further down the road is how will global markets react? Convulsively, panicky and more volatile? And what are the inherent risks panicky markets may bring about? Is another debt crisis in the cards? Recall that markets remained calm after the Fed ditched the word "patient." Market players praised the Fed's clearest ever and successful

Continued on page 4

Yields Rose on Defensive Market

By: Czen Alfie Q. Bico

Peso Yield Curve



Traders were generally defensive due to uncertainties abroad and caution on liquidity and pricing impact of non-restrictive trading. Yields rose by an average of 26 bps from Jan 2015 close and trading was low at Php10.9bn/day (-49.5%, m-o-m). First half of the month, the market was on the sidelines awaiting shifts in the Fed language in the latter's March 19 meeting. After the Fed chair's dovish statement, yields still rose and traded volume remained low. The market adopted a wait and see attitude towards the non-restrictive trading mechanism. Tax-exempt companies, e.g. state-run pension funds, currently hold Php800bn-worth of government securities (1/3 of the outstanding amount). We also saw offers from some foreign clients, mostly on their T-bill holdings.

Continued on page 4

Metrobank

Metropolitan Bank & Trust Co. (MBT):
Strong Core Business

By: Jarden Adrian C. Oblego

MBT Stock Data	
Price (PHP)	98.50
Market Cap (PHP Bn)	313.2
Outstanding shares (Bn)	2.7
2015E PE (X)	13.04
Price to Book (X)	1.94

Source: Bloomberg

Core Income Up 2.5x, Excluding One-Offs (Trading gains, fx gains, gain asset on asset sale). MBT reported earnings of Php23.1bn (-4.4%) in 2014 with earnings to parent of Php20.1bn (-10.6%). The primary driver for the decline was the softer trading gains in 2014 amounting to Php3.3bn, down 80.8% YoY from a record-breaking Php17.2bn in 2013. Nonetheless, the earnings was buoyed by the increase in net interest income to Php45.8bn (+19.6%) and declines in provisions for loan losses and FX losses to Php4.8bn (-54.8%) and Php102mn (-95.5%), respectively.

It is noteworthy that MBT recorded a considerable amount of one-offs in 2014. To recall, the bank sold FMIC's stake in Charter Ping An and Parent company's and PSB's stake in Toyota Financial Services. In addition, the bank recorded a gain on sale of investment properties to Federal Land which yielded over Php8.0bn. These extraordinary items totaled Php11.4bn in 2014 which is relatively at par with 2013's one-offs that amounted to Php11.7bn.

We estimate that MBT posted almost flat reported net income decline (-5.5% to Php14.2bn) excluding one-off gains on asset sales. If we further take out the trading and fx gains, MBT's net income grew 250.1% to Php11.7bn vs 2013's Php3.3bn.

SRO as the Main Catalyst. The major catalyst for the bank is the stock rights offering (SRO) amounting to Php32.0bn. The rights were priced at Php73.50/sh with entitlement of 1 MBT common share for every 0.63 held. We see it boosting MBT's otherwise low CET1 ratio even as much of these cash (80% at most) are recycled back to risk asset creation (loans). We estimate that the proceeds will be invested in interest earning assets and we've seen historical levels of the same in the past that were a multiple of shareholders' equity up to 7.4x, which implies additional Php188.8bn worth of loans and the Php47.0bn investment portfolio.

Deposits and Loans. SEC filings showed loans grew by 24.3%, to Php759.5bn, faster than industry's 17.0% on the back of slower deposit growth of 16.5% to Php1.2tn. In effect, loans-to-deposits ratio (LDR) of 65.5% in 2014 was above the 61.8% in 2013. Nonetheless, MBT's deposits growth is faster than industry's 12.0%.

Cautious Investment Portfolio. As of end-2014, MBT's investment portfolio totaled Php382.7bn, up 4.2% from Php367.3bn in 2013. The investment portfolio mix of FVTPL, AFS and HTM was 12%-54%-34%, reflecting lower shares for MTM vulnerable trading and AFS securities portfolios, from 2013's greater shares of 15%-74%-21%, respectively, showed a cautiousness ahead of the Fed taper risk. This is also based on SEC filings.

Capitalization. Based on 4Q2014 published Statements of Conditions (SOCs), MBT ranked 5th in terms of total CAR among 12-listed banks at 16.03%. In terms of CET1 ratio, it ranked 9th with ratio of 12.14%, slightly above the BSP's minimum requirements after D-SIBs of 11.0%. The latter 11% minimum assumes a floor of 6.0% plus 2.5% conservation buffer and another 2.5% likely BSP D-SIB assignment for the big banks. Nonetheless, MBT's Php32bn rights offering will directly add around 200-300bps to its current CET1 ratio.

Asset Quality. MBT has the best asset quality (among the 13 listed banks) on the parent level (groupwide data not yet available on this metric) in terms of non-performing loans (NPL) ratio at 0.35% in 2014, better than last year's 0.57%. On a group-wide basis, the bank's NPL ratio improved to 1.03% vs 2013's 1.29%. (There is no groupwide NPL ranking yet as the disclosures are not yet complete).

Branch Network. MBT's branch network tallied at 920 with 2,100 ATMs in 2014. The bank opened 64 branches last year and plans to add 30 branches every year moving forward. It is also well positioned as more than half of its network is located outside Metro Manila.

Valuation. We used Gordon Growth Model (GGM) to derive the fair value by multiplying book value per share to P/B. The P/B was derived from dividing the excess return (ROE) that the company is generating above the normal growth (the latter defined as retention rate or 1 less dividend payout ratio x ROE) by the excess required return (cost of equity) above the normal growth. For MBT, we estimate the ROE at 15%, COE at 10.47% and normal growth rate of 6.5%. Essentially, this measures the how the stock price stands vs the book value (Php55.53) by looking at the excess return generated for the equityholders (15%-6.5% = 8.5%) over what they are requiring from their investment (10.47%-6.5% = 3.97%).

Recommendation. We recommend a Buy rating on MBT. We valued the company using Gordon Growth Model and Residual Income Model, resulting in a price target of Php115.19/sh or 22.7% upside potential. The biggest catalyst for the bank remains to be the SRO deployment in earning assets, excellent asset quality and wide net interest margin. ▲

BDO Unibank, Inc. (BDO):

The largest branch network

By: Jarden Adrian C. Oblego

BDO Stock Data	
Price (PHP)	122.5
Market Cap (PHP Bn)	438.7
Outstanding shares (Bn)	3.6
2015E PE (X)	17.32
Price to Book (X)	2.52

Source: Bloomberg; FMIC Research Estimates

Earnings Flat for 2014. BDO's earnings for 2014 tallied at Php22.8bn, 0.9% up from 2013 level of Php22.6bn. The bank was also hit by lower trading gains that was experienced by majority of the banking sector. Trading gains were down 30.3% to Php5.9bn while FX gains were also down by 39.6% to Php2.6bn. Nonetheless, the core operations of the company remained strong. Net interest income grew by 18.7% to Php51.2bn on the back of an increase in interest income to Php63.6bn (+12.3%) and decrease in interest expenses to Php12.4bn (-8.1%). Service fees grew 18.4% to Php15.4bn while the provision of loan losses declined by 27.0% to Php5.1bn.

Deposits and Loans. The bank's loans grew by 20%, faster than industry's 17%. Loans to middle market (companies outside top 1,000) spearhead the growth at 29% to Php328.0bn. Consumer loans grew 14% to Php197.0bn while corporate loans inreased by 17% to Php511.0bn.

The shift in loan portfolio mix was in line with the company's goal of getting bigger slices of consumer and middle market loans from the pie. The loan portfolio mix ended 2014 with corporates still accounting for the largest share of 47%. On the other hand, middle market and consumer loans accounted for 30% and 18%, respectively.

BDO's deposits grew 11% to Php1.5tn, slightly slower than industry's 12% growth. CASA still accounted for the biggest portion of total deposits at 64% while time deposits accounted for the remaining. The bank's loans-to-deposits for 2014 was 73% while loans and receivables-to-deposits ratio was at 81%.

Investment Portfolio Mix. As of end-2014, BDO only holds FVTPL (Php8.8bn) and AFS securities (Php212.7bn). The mix has been very stable with 96% of total investment portfolio allocated to AFS while the rest is to FVTPL. Note that BDO didn't have HTM securities since 2013, cautious of increasing interest rates. Dollar-denominated government securities accounted for 80% of its investment portfolio (on strong dollar view) while the rest were peso-denominated.

Capitalization. Based on 4Q2014 published Statements of Conditions (SOCs), BDO ranked 11th in terms of total CAR among 12-listed banks at 14.56%. In terms of Tier1 ratio, it ranked 8th with ratio of 12.79%. There is no immediate plan to raise more capital after the Tier 2 notes issued last October which are Basel 3 compliant, amounting to Php10bn.

Profitability. BDO's return on average equity (ROAE) declined to 13.4% in 2014 from 14.0% in 2013. Subsequently, its return on average assets (ROAA) declined to 1.3% from 1.6%, for the same periods, respectively. The decline in both ratios were driven by flat earnings but higher denominator as both of BDO's equity and assets grew over the year.

Asset Quality. BDO's non-performing loans (NPL) ratios were constantly declining due to conservative credit standards. To recall, BDO's NPL ratio was at 4.7% in 2010, significantly higher than 2014's level of 1.3%. This brought BDO to rank 6th among 13-listed banks in terms of asset quality. The best and ranked no. 1 was Metrobank.

Branch Network. As of end-2014, BDO has 875 operating branches. Given that the bank acquired One Network Bank (ONB) and its 105 branches, BDO's total branch network will be at 980 branches, eclipsing MBT's 920 and is thus now the largest in the country. Moreover, the bank's guidance suggests that it will continue expanding 50 branches per year.

Valuation. We used Gordon Growth Model (GGM) to derive the fair value by multiplying book value per share to P/B. The P/B was derived from dividing the excess return that the company is generating above the normal growth by the excess required return above the normal growth. For BDO, we estimate the ROE at 14.5%, COE at 10.14% and growth rate of 6.5%. Essentially, this measures the how the stock price stands vs the the book value (Php54.16) by looking at the excess return generated for the equityholders (14.5%-6.5% = 8.0%) over what they are requiring from their investment (10.14%-6.5% = 3.64%).

Recommendation. We think BDO is fully valued as is thus a sell. Valuation uses the Gordon Growth Model and Residual Income Model, resulting in a price target of Php125.48/sh, very little upside from the current price of Php121.60. Moving forward, the catalysts for the bank would be its wide NIM, better than BPI as of of 9mo14, fastest loan growth among the top three banks at 30%, pay-off of its recent acquisition in terms of the branch reach. ▲

(Fed.. continued from page 1)

policy communication, a far cry from the "taper tantrum" of the Bernanke years that roiled markets. Successful because it kept market composure amid a key global risk: that rapid and sharp hikes in US interest rates could destabilize highly indebted emerging market sovereigns and companies, those that borrowed heavily in the ever strengthening US dollar. How much of that debt is out there, waiting to sour, the Bank for International Settlements (BIS) estimates to be $9.2 trillion. Lendings to emerging economies had risen to $3.1 trillion as of last May, 2014, another BIS statistic. The BIS asked to what degree is the corporate sector of EMs exposed to dollar denominated debt, finding comfort in the difference between now and the 1997 Asian financial crisis and the Latin American debt crisis in the 2000s. And the difference was that today private companies, not governments, have amassed debts in a currency not their own but in USD. The IMF warned these entities could face steep jumps in debt servicing costs. India's corporate sector has $120bn in debt, double its level five years ago, and was cited by the IMF as facing huge risks.

Lull, But For How Long? A moderating US economy has kept this foreign currency debt risk in the back burner. Markets are now threading under a US interest rate lull that is prolonging the equity bull run in fundamentally sound economies like the Philippines. The Fed cited weak US numbers, except for resurgent US labor market - with 12m lost jobs already back in the workplace and 220k jobs generated in 10 out of the last 12 months and a further 290k gained last Feb. - when it toned down the near-term assessment of US economic activity. These included retail sales on their biggest three-month drop since the Lehman's failure, consumer sentiment plummeting, as did producer prices, a surprisingly tame 0.1% industrial production rise in Feb. after a big downward January revision and weakness in the New York Business Conditions index (except employment components). All these stats plus the Fed's language shift helped push down the yield on 10 yr US gov't bond to below 2.00% on the eve of the Fed announcement to 1.9%.

What about the USD? Is it going to disappoint the overly dollar bulls, those believing the USD has further to run. Or will the US current necessarily begin a corrective phase that followed the start of all Fed tightening cycles? A strong US dollar has shaved off 7% of multinational corporate offshore earnings in 4Q14 and remains a key Fed concern. It is a threat to US exports and to US growth itself. It has thus created a strong case for a dovish Fed, yet the dollar bulls continues to charge because they are fixated on the certainty of jobs market recovery. Their long speculative bets, their biggest ever on the futures market, have pushed the dollar index more than 10% year-to-date and more than 25% since last May. For these dollar longs what matters more are only two: strong US job creation and wage growth, the latter showed an uptick in average hourly rate last Feb. of 0.2%. (slower than) vs 0.5% January. But that's too weak than what some believe it will take for a rate hike to kick in by the summer, a wage hike of 3%-4%. The dollar's momentum is also reinforced by the latest economists' prediction of a rebound in full year US GDP growth of 3.0%, up from the forecasts made last Feb. and January of 2.4% and 2.8%, respectively.

Tight Liquidity. A strong dollar can tighten global money supply, according to BIS. Developing economies have seen a surge in capital from the industrialized world in recent years, receiving $4.5 trillion of gross capital inflows between 2009 and 2012, according to IMF data. For economist Stanley Fischer, also a former Israel central bank governor, the risk is about rising interest rates and the strong dollar hitting emerging economies with overly rigid exchange rate policies. He expects some companies to crash. How many of them out there in the EM is unknown.▲

(Yield Curve.. continued from page 1)

They were in search of good yields for exit. Benchmark 10-yr ended at 4.1544%, up by 17 bps, while FXTN 10-59 rose to 3.49% (+4 bps).

T-bill Yields at auction fell last March 02, as investors positioned ahead of the release of February inflation number (@ 2.5% released last March 05). Yields were 40 bps lower than benchmark short-term rates (-6.7 bps vs previous auction) and the bid-cover ratio was at 3x. (91-day @ 1.397%; 182-day @ 1.699%; 364-day @ 1.948%).

On the contrary, the market was at the sideline as waited for the results of the Fed meeting during the last bond auction (FXTN 07-57 last March 17). Bid-cover ratio was only at 1.4x, lower than the 2.44x ratio last auction of the same security. Average yield was at 3.458%, 11 bps higher than its close yield of 3.3450% at the secondary market prior auction (March 16 yield).

Outlook: Global volatility will continue motivate local traders to remain defensive. Economic data from developed markets point to uneven growth and so we expect monetary policies to continue being accommodative. At the local front, the implementation of non-restrictive trading will contribute to upward bias of yields. Local fundamentals, however, will continue to support low yields. We might see some strong bids around the period of inflation release but the market will take quick profits after the announcement of March inflation figure.▲

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