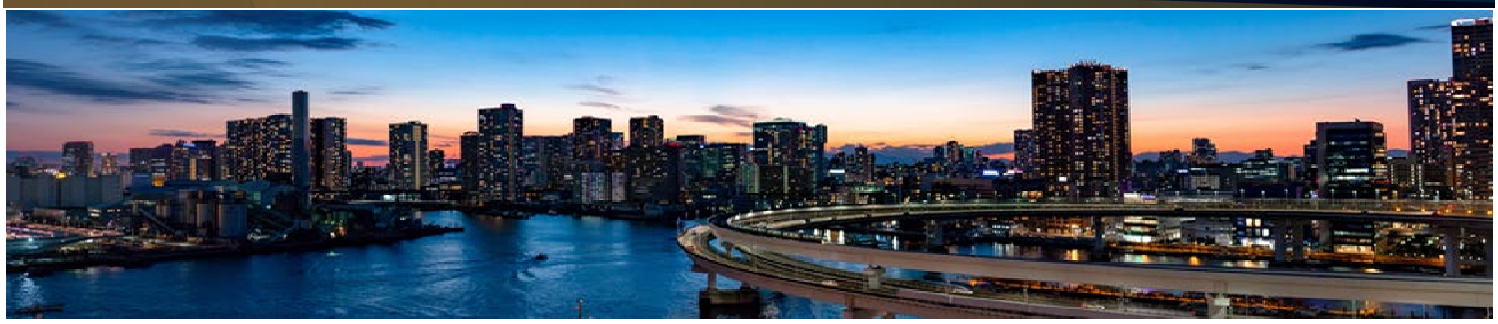

BANKING SECTOR UPDATE

Headwind From The Hawkish

Highlight of 9M18 Results: In-Line with Estimations

As we see from 9M18 results, our banks universe (BBCA, BBNI, BBRI, BMRI, BBTN, and BNGA) is mostly in-line with our estimate. Loan disbursement was a little bit aggressive if it is compared to third party funds growth, which loan growth of our banks universe (except BNGA) was above banking system in 9M18. Corporate loan was the main driver of loan growth, especially in trade, manufacture, and also construction. Meanwhile, third party funds growth was slow which led to LDR to spike up near its upper limit (except BBCA). We think that this results has already reflected at current price for most our banks universe.

Will Liquidity Tighten?

Loan growth in 9M18 reached 12.69% YoY, whereas Third-Party Funds growth was slower at 6.60% YoY (vs. 11.69% YoY in 9M17). Even so, tightening liquidity can also be noted from banking system LDR, which is slowly rising up to 93.39% (9M18) compared to 89.1% in January 2018. Banks is not only competitive in maintain its liquidity with other banks, but also with debt securities that is issued by the government to refinance its debt that reaches due date or to funding government program which is targeted until FY19F. Therefore, BBCA is leading from the liquidity side with LFR at ~80%, compare to its peers.

Stable Asset Quality with Exchange Rate Risk

During 9M18, banks could maintain the asset quality that was shown in NPL gross banking system at 2.66% (vs 2.93% in 9M17), as well as bank in our universe. However, we assess that there will be an increase in loan risk in the foreseeable future, especially related to the volatility of the Rupiah exchange rate, which up FY18E is projected to remain at >IDR14,500.

NEUTRAL Outlook with TOP PICKS: BBCA (BUY, TP: IDR27,200)

We conclude that loan disbursement had been improved and strong capital have been a positive catalyst for banks in FY18E/FY19F. New weighting for LQ45 and IDX30 index will incur capital inflow, especially once it is started. However, the volatility of Rupiah with external conditions that weigh down the economy and also threats asset quality, the downward trend in NIM, as well as tighten liquidity, has become risk-sharing for banks. Therefore, we recommend **NEUTRAL** for the banking sector, with **BBCA (BUY, TP: IDR27,200)** as our top picks with its big chunks of liquidity and CASA. Thereafter, **BBNI (BUY, TP: IDR8,700)** as relatively cheap valuation compared to its peers, **BBTN (BUY, TP: IDR3,000)**, **BBRI (HOLD, TP: IDR3,600)**, **BMRI (HOLD, TP: IDR7,200)**, and **BNGA (BUY; IDR1,160)** as selected stocks.

Ticker	Market Cap (IDR bn)	PER (x)		PBV (x)		Rec.	Target Price (IDR)
		FY18E	FY19F	FY18E	FY19F		
BBCA	596,034.8	22.74	20.15	3.97	3.46	BUY	27,200
BBNI	153,851.4	9.88	8.62	1.40	1.25	BUY	8,700
BMRI	345,333.3	14.29	12.17	1.85	1.67	HOLD	7,200
BBRI	420,609.2	13.32	11.88	2.27	2.02	HOLD	3,600
BBTN	24,357.0	7.26	6.53	1.00	0.90	BUY	3,000
BNGA	21,738.8	6.71	6.09	0.57	0.53	BUY	1,160
BNLI	12,282.7	-	-	-	-	UR	-

Sources: Bloomberg, MNCS (as of November 15, 2018)

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Highlight of 9M18 Results: In-Line with Estimations

As we see from 9M18 results, our banks universe (BBCA, BBNI, BBRI, BMRI, BBTN, and BNGA) is mostly in-line with our estimate. Loan disbursement was a little bit aggressive if it is compared to third party funds growth, which loan growth of our banks universe (except BNGA) was above banking system in 9M18. Corporate loan was the main driver of loan growth, especially in trade, manufacture, and also construction. Meanwhile, third party funds growth was slow which led to LDR to spike up near its upper limit (except BBCA). Asset quality was well maintained so far, although Rupiah exchange rate jumps up but a note for a little hiccup in consumer loan. NIM, as expected, was depressed as banks were competitive to maintain its liquidity. We think that this results has already reflected at current price for most our banks universe with BMRI, BBRI, and BBNI are already in the average of PBV band (November 15th 2018); except for BBCA which has high valuation. Meanwhile, BBTN and BNGA are mainly traded below average 3-years of PBV band at -1 STD.

Exhibit 01. 9M18 Results

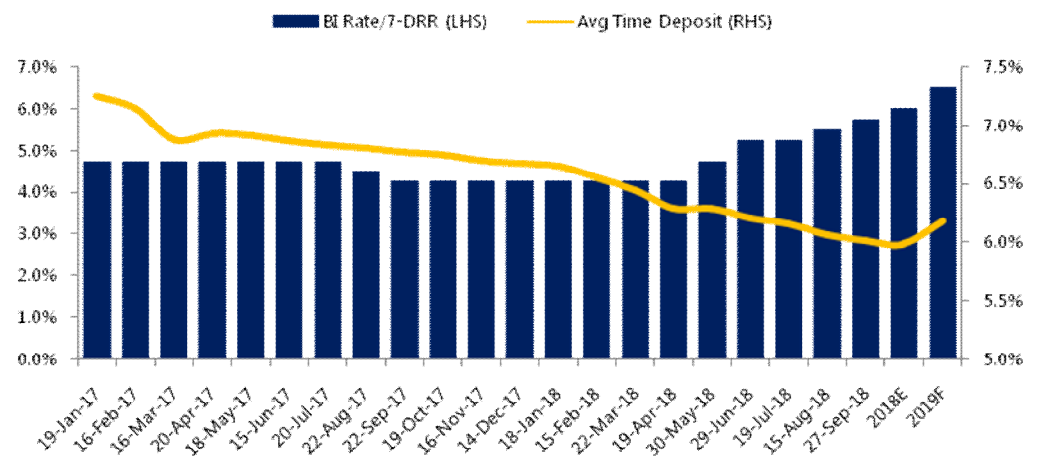
No	Ticker	TP	Net Profit 3Q18				NPL Gross		LDR/LFR		NIM	
			Rp Bn	g	% MNCS	% Cons	3Q17	3Q18	3Q17	3Q18	3Q17	3Q18
1	**BBCA**	27,200	18,508	9.90%	71%	72%	1.50%	1.40%	74.70%	80.90%	6.20%	6.10%
2	**BBNI**	8,700	11,438	12.60%	73%	74%	2.80%	2.00%	87.90%	89.00%	5.50%	5.30%
3	**BMRI**	7,200	18,092	20.10%	75%	74%	3.75%	3.01%	89.90%	93.50%	5.86%	5.76%
4	**BBRI**	3,600	23,548	14.60%	74%	72%	2.54%	2.33%	92.69%	90.09%	7.96%	7.49%
5	**BBTN**	3,000	2,236	11.51%	66%	65%	3.07%	2.65%	109.00%	112.00%	4.49%	4.35%
6	**BNGA**	1,160	2,592	18.00%	77%	79%	3.95%	3.41%	93.96%	92.44%	5.74%	5.12%
7	**BNLI**	UR	-	-	-	-	-	-	-	-	-	-

Source : Companies, Bloomberg, MNCS

The End of Low Interest Era

During last Agus Martowardoyo's Bank Indonesia's governor council meeting, 7DRR was increased by 25bps to 4.5% in 5M18 for the first time since 7DRR was enforced. This policy was a strategic step in which the government tried to maintain the stability of Rupiah exchange rate. Rupiah has been fluctuated in 9M18, therefore it past the psychological level at IDR15,000. The increase in the benchmark interest rate ends the dovish policy trend that had been carried out since 2015. The replacement of the new Bank Indonesia (BI) Governor position, Perry Warjiyo whom prioritizes the stability of the Rupiah exchange rate by aggressively raising 7DRR to 6% in 11M18. The increase of 7DRR by 175bps YTD is intended to maintain the competitiveness of real interest rates in Indonesia, maintaining a high profile in the global market, in particular competitive with returns in India and also as an effort to stabilize Rupiah exchange rate. We consider that the era of low interest rates has ended, as there is still a probability of an interest rate increase of 50-75bps in FY19F.

Exhibit 02. 7DRR and Average Time Deposit Rate Banking System

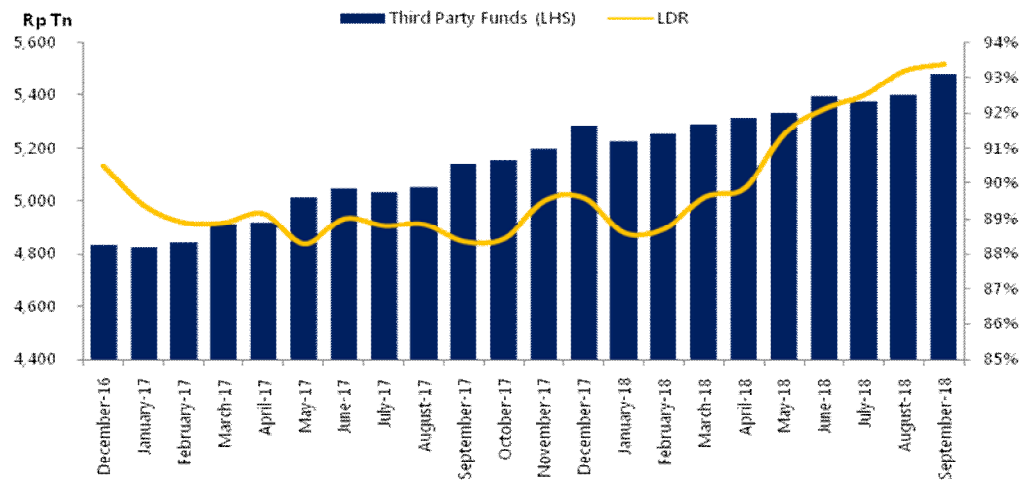


Sources : Bloomberg as of November 07, 2018, MNCS

Will Liquidity Tighten?

Loan growth in 9M18 reached 12.69% YoY, with working capital loans manifesting the highest growth level of 13.76% YoY, whereas Third-Party Funds growth was slower at 6.60% YoY (vs. 11.69% YoY in 9M17). Even so, tightening liquidity can also be noted from banking system LDR, which is slowly rising up to 93.39% (9M18) compared to 89.1% in January 2018. The increasing of 7DRR will trigger an increase in cost of funds in order to maintain its liquidity, with average deposit rate that reached out 6.36% in banking system along with rising 7DRR at 5.75% in 9M18. We see that a little aggressive loan disbursement despite of slower funding in banking system that has been happened in 9M18, will continue in the near future. It was also happened to big banks, such as BBRI and BMRI with its LDR at 92.69% and 93.50% in 9M18's result. Banks is not only competitive in maintain its liquidity with other banks, but also with debt securities that is issued by the government to refinance its debt that reaches due date or to funding government program which is targeted until FY19F. Therefore, BBCA is leading from the liquidity side with LFR at ~80%, compare to its peers.

Exhibit 03. Third party Funds and LDR Banking System

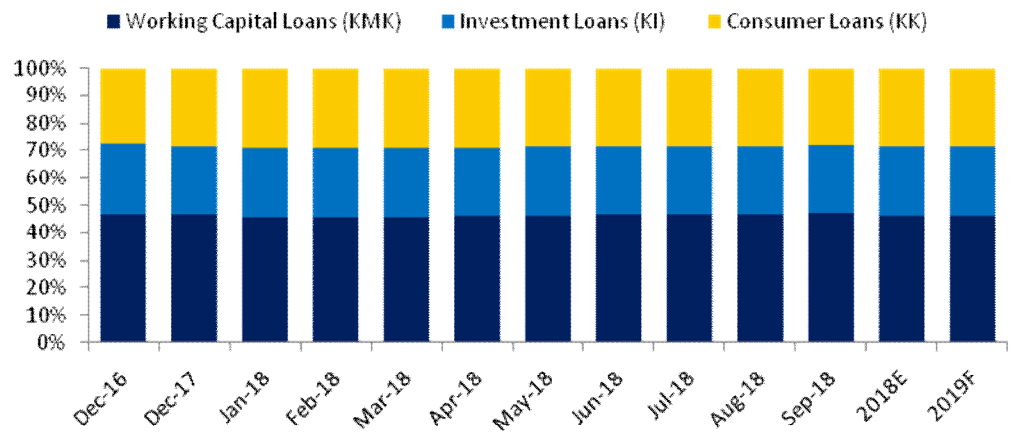


Sources : Financial Authority Services (OJK)

Small Room to Boost Loan Disbursement

Working capital loans, as the largest element of commercial bank lending, was seen as the highest growth (+13.76% YoY) compared to other segments during 9M18, where consumption and investment loans grew by 11.66% YoY and 11.83%, respectively. Meanwhile consumer loan was driven by the growth of vehicle loan (+14.49% YoY) and mortgage loan (+14.50% YoY). The decline in consumer loan rates by 107bps YoY in 9M18 was one of the factors that stimulated growth in of consumer loan, despite hawkish policy that has been applied by BI since May 2018. We foresee that there are several factors to withstand loan disbursement during 2019, such as: 1) Rupiah exchange rate volatility, which foreign currency loans reaches up to ~15% of total loan. Therefore, banks try to maintain asset quality by become more selective for debtors with USD exposure; 2) Loan interest rates that will eventually adjust the increase in cost of funds, and 3) Tighten liquidity that will continue in 2019 will withstand loan disbursement, as can be seen from LDR in 9M18 which near to its upper limit. However, we consider loan disbursement will continue to grow moderately, at a level of approximately 10%-11%, assuming economic growth reaches 5.2%-5.3% in FY18E/ FY19F. This is supported by the potential for economic growth, especially for domestic consumption as the 2-years lagging effect from gross domestic saving that peaked up at 2016-2017, and also government program that supports domestic consumption, in which helped working capital loan disbursement.

Exhibit 04. Loan Segmentation Banking System

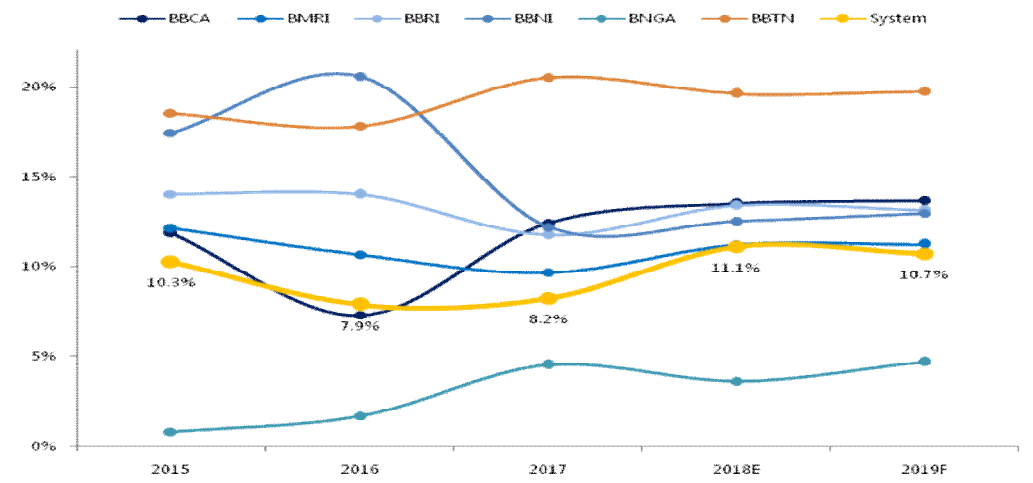


Sources : Financial Authority Services (OJK), MNCS

Competitive CoF Surpressed NIM

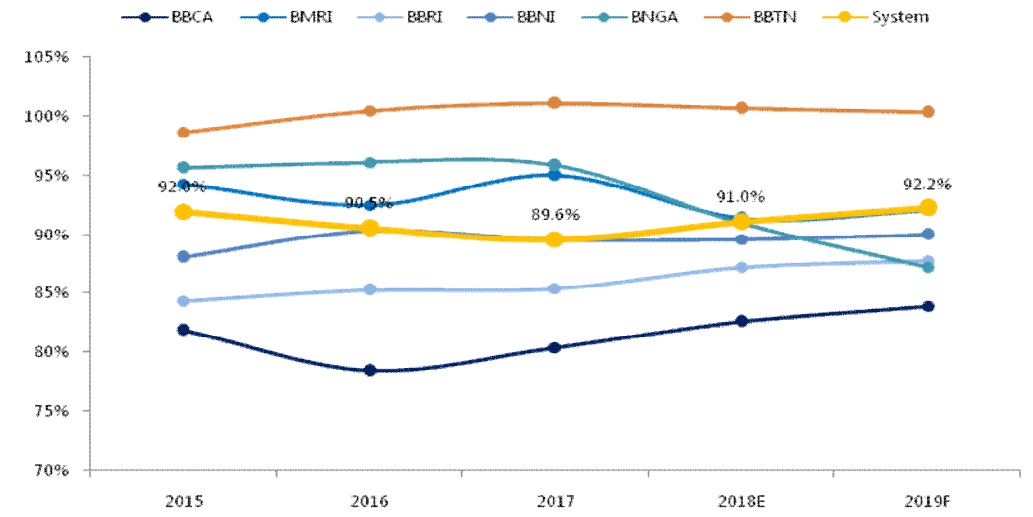
As we can see from 9M18 results, NIM form our bank universe was decreased. Although cost of fund was increased, but loan yield couldn't cover its loss from higher cost of fund as one of the efforts to maintain the liquidity. Banks tried to maintain consumer loan demand as can be seen from interest consumer loan bank system that was lower at 11.90% in 9M18 (vs 12.34% in 5M18), compared to increasing 7DRR which was started in 5M18. We think that banks will raise loan interest gradually as they try to maintain debtors payment capability, hence quality asset remains stable. As a results, strong loan growth helped to maintain the interest income. We predict that NIM is still going to be depressed in the midst of tighten liquidity environment, which is unfavourable for BMRI and BBRI. Otherwise, BBCA that is known for its higher resilience compared to other big banks, has more defense as its supported by high liquidity with LDR FY18E/ FY19F at 83%/84% and high CASA ~76%.

Exhibit 05. Loan Growth Banking System and MNCS Banks Universe



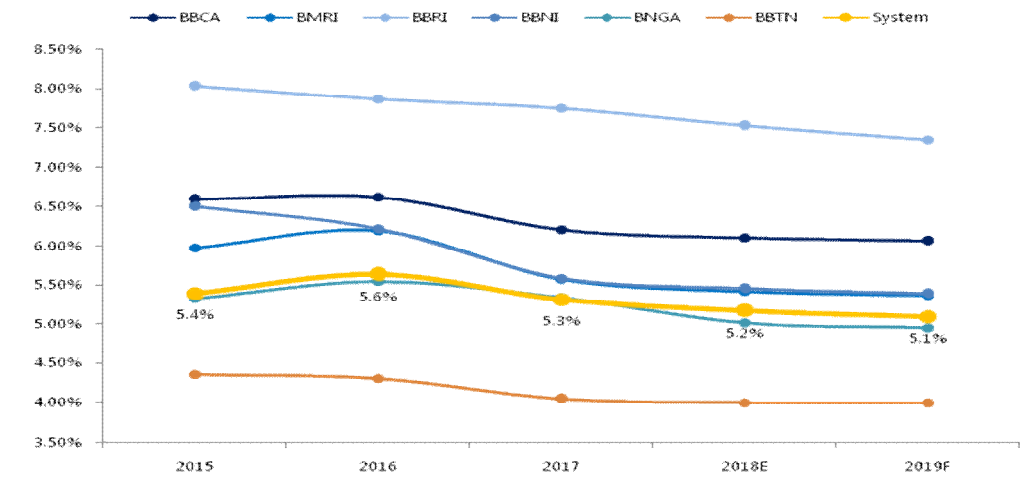
Sources : Financial Authority Services (OJK), MNCS

Exhibit 06. LDR Banking System and MNCS Banks Universe



Sources : Financial Authority Services (OJK), MNCS

Exhibit 07. NIM Banking System and MNCS Banks Universe

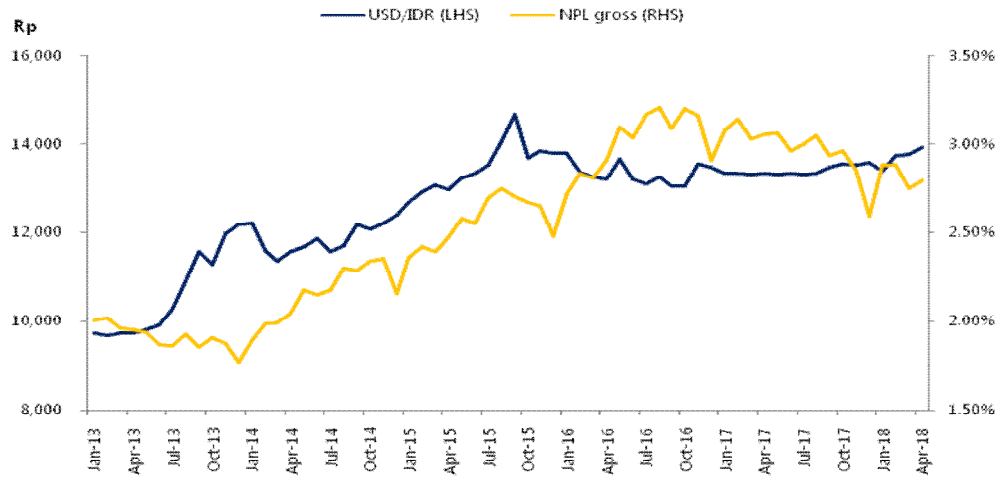


Sources : Financial Authority Services (OJK), MNCS

Stable Asset Quality with Exchange Rate Risk

During 9M18, banks could maintain the asset quality that was shown in NPL gross banking system at 2.66% (vs 2.93% in 9M17), as well as bank in our universe. While Rupiah was volatile during 3Q18 and reached its peak level at >IDR15,200, banks still could manage its asset quality by restructuring or even write-off. BBCA was still remain the most solid from asset quality point of view, with NPL gross level at 1.40% while BBNI booked strong quality by decreasing NPL gross to 2% in 9M18 (vs 2.80% in 9M17). However, we assess that there will be an increase in loan risk in the foreseeable future, especially related to the volatility of the Rupiah exchange rate, which up until the end of 2018 is projected to remain at >IDR14,500. The NPL gross relationship has a fairly close correlation (0.79) with the Rupiah exchange rate, hence it will have the potential of increasing NPL gross for banks, especially in USD exposure (BMRI and BBNI with USD exposure to approximately ~17% of total loan), as well as sectors that have high USD exposure for its material, such as manufacture and construction which NPL gross of construction sector was increased to 4.10% in 9M18 (vs 3.50% in 9M17). Meanwhile, coverage ratio still quite strong as banks gradually maintain its ratio to prepare the IFRS 9 requirement that will start in 2020. From our bank universe, BBTN will have the most impact from IFRS 9 since the others have been already had quite enough bumper in terms of coverage ratio (~≥100%).

Exhibit 08. NPL Gross Banking System vs Rupiah Exchange Rate



Sources : Financial Authority Services (OJK), MNCS

Banking Corporate Action

Indonesian banks have a fairly high capital ratio: up to 5M18, commercial bank CAR reached 22%. However, along with the implementation of Basel III, banks continue to strive to strengthen capital. One way is through the rights issue mechanism. This is mostly done by BUKU I-III banks which have a need of additional capital as a 'bumper' for lending. Banks that conducted rights issues in 2018 included BRI Agroniaga (AGRO), Bank Bukopin (BBKP), and Bank Banten (BEKS). In addition to the rights issue, acquisitions and mergers are an alternative in efforts to increase capital and to strengthen positions in a severely competitive banking environment, as happened with the Bank Tabungan Pensiun Negara (BTPN) and Bank Danamon (BDMN). We see that corporate actions in the context of additional capital, such as rights issues, acquisitions and mergers, will frequently take place in the banking sector.

A Note From Free Float Weighting Plan

Indonesian capital market regulator (Indonesia Stock Exchange/IDX) plans to change the implementation of composition of LQ45 and IDX30 index from total market capitalization to free float of each stocks that is listed in both index. As we know, banking sector is one of top contributors to both index and the majority of our banking universe have free float around ~40% (BBCA, BBRI, BBNI, BMRI, and BBTN). As could be seen in the Exhibit 9, all banking stocks in LQ45 is increased in terms of weighting based on free float with BBCA has the highest spread from old to new weighting (based on price at November 9th 2018). We see that with this new calculation for IDX30 and LQ45, will be a temporary positive catalyst for banking sector as there will be capital inflow to rebalancing from old weighting portfolio to new weighting portfolio.

Exhibit 09. Comparison of Banking Sector in LQ45 Based on Free Float Weighting Plan

No.	Ticker	Shares (million shares)	Free Float %	Market Cap Full (IDR)	Market Cap Free Float (IDR)	% Weight Full	% Weight Free Float	Spread
1	BBCA	24,408	43.06%	591,720,194,506,752	254,807,296,670,730	13.59%	16.51%	2.92%
2	BBRI	122,112	43.25%	425,543,044,431,872	184,036,149,590,179	9.78%	11.93%	2.15%
3	BMRI	46,200	39.99%	350,000,005,513,216	139,967,798,530,463	8.04%	9.07%	1.03%
4	BBNI	18,462	41.16%	147,324,391,129,088	60,640,545,657,277	3.38%	3.93%	0.55%
5	BBTN	10,484	39.99%	25,521,899,438,080	10,205,218,853,134	0.59%	0.66%	0.08%
	Total Market Cap Banks LQ45 (exclude BJBR)			1,540,109,535,019,010	649,657,009,301,783			

Source : Bloomberg, MNCS

NEUTRAL Outlook with TOP PICKS: BBCA (BUY, TP: IDR27,200)

We conclude that loan disbursement had been improved and strong capital have been a positive catalyst for banks in FY18E/FY19F. Domestic consumption that act as the last defense of economy growth, will drive loan disbursement especially in working capital loan. New weighting for LQ45 and IDX30 index will incur capital inflow especially once it is started. However, the volatility of Rupiah with external conditions that weigh down the economy and also threats asset quality, the downward trend in NIM, as well as tighten liquidity, has become risk-sharing for banks. Therefore, we recommend **NEUTRAL** for the banking sector, with **BBCA (BUY, TP: IDR27,200)** as our top picks with its big chunks of liquidity and CASA. Thereafter, **BBNI (BUY, TP: IDR8,700)** as relatively cheap valuation compared to its peers, **BBTN (BUY, TP: IDR3,000)** with strong demand for subsidized mortgage and also is traded below average PBV, with **BBRI (HOLD, TP: IDR3,600)**, **BMRI (HOLD, TP: IDR7,200)**, and **BNGA (BUY; IDR1,160)** as selected stocks.

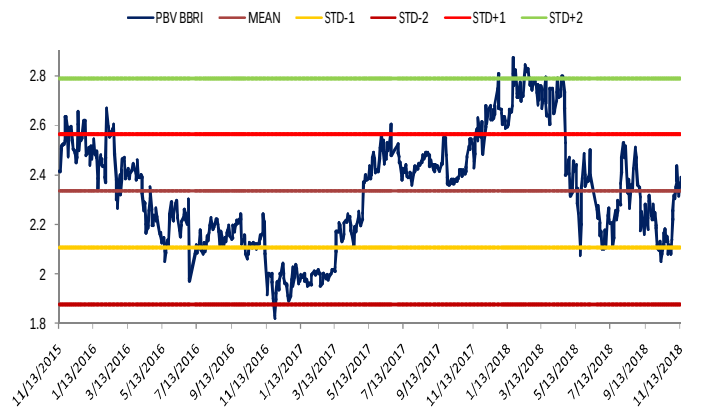
Exhibit 10. BBCA's PBV Band (3 years)

Source: Bloomberg as of November 15,2018

Exhibit 11. BBNI's PBV Band (3 years)

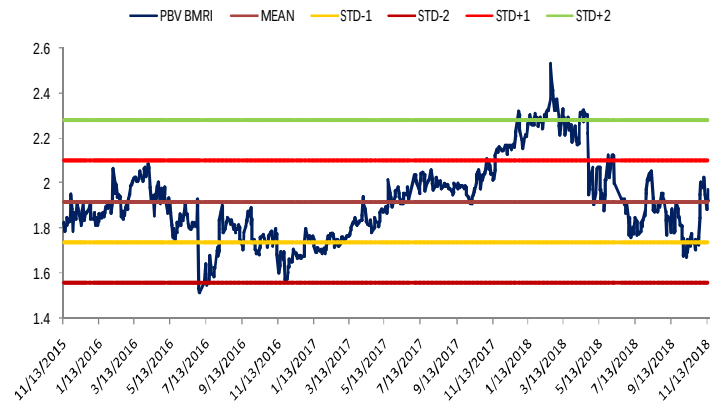
Source: Bloomberg as of November 07,2018

Exhibit 12. BBRI's PBV Band (3 years)



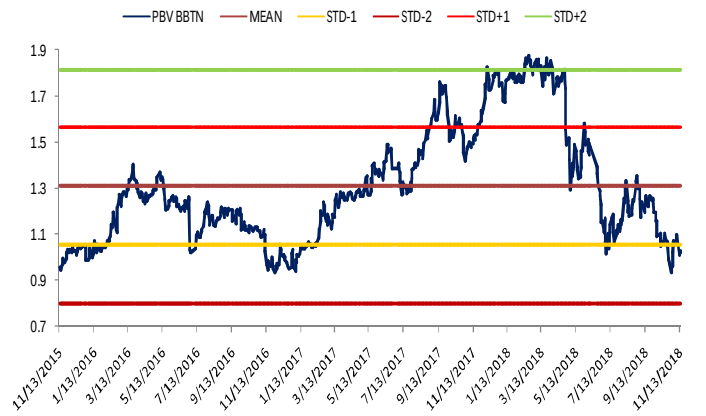
Source: Bloomberg as of November 15,2018

Exhibit 13. BMRI's PBV Band (3 years)



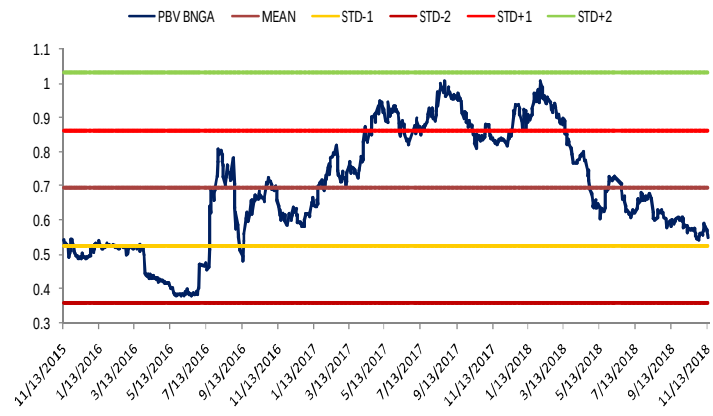
Source: Bloomberg as of November 07,2018

Exhibit 14. BBTN's PBV Band (3 years)



Source: Bloomberg as of November 15,2018

Exhibit 15. BNGA's PBV Band (3 years)



Source: Bloomberg as of November 07,2018

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BUY : Share price may exceed 10% over the next 12 months
HOLD : Share price may fall within the range of +/- 10% of the next 12 months
SELL : Share price may fall by more than 10% over the next 12 months
Not Rated : Stock is not within regular research coverage

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