SECTOR UPDATE REPORT

MNC Sekuritas Research Division
June 22, 2017

BANKING SECTOR UPDATE

Surfing the Waves

Signs of Recovery: Loan Growth Back to Double Digits in 5M17

There was some improvement from the banking sector by May 2017 which loans grew from around 8% YoY in 5M16 to 10.39% YoY in 5M17. Government infrastructure projects were the main driver for loan disbursement, with infrastructure and construction loans boosted through May 2017. Meanwhile, NPL gross was still around 3%, but slightly lower than it was in April 2017. This indicates that the banking sector is improving, along with domestic economic recovery: GDP growth is forecasted to reach 5.1% - 5.3% in FY17E.

Investment Risk Concern: Will the Era of Financial Transparency Pull Out Liquidity?

Recently, Perppu No.1/2017 was issued, as an implication of the 'Automatic Exchange of Information' (AEoI) Agreement. Banks are obliged to disclose customer deposits worth more than Rp1 bn to the Tax Ministry. There was some concern about its impact on banks' liquidity, as customers will probably switch their account to an offshore bank. Meanwhile, S&P and Moody's recent rating upgrade will attract capital inflows, along with lower 10-year bond yield (as well as lower country risk). We foresee the impact of open customer information will be offset by S&P and Moody's ratings regarding banks' liquidity.

OVERWEIGHT Outlook: Selective BUY on Big Banks (BBCA and BBNI) and Conviction BUY on Mid-Caps (BNLI and BNGA)

We call **OVERWEIGHT** for banking sector, along with economic growth, S&P and Moody's upgraded rating, also better asset quality. Our top picks are **BBCA (BUY, TP: Rp19,750)** and **BBNI (BUY, TP: Rp7,400)**. BBCA will benefit from its low-cost funding and strong fee-based income, while BBNI will pick its sweet fruit from government infrastructure projects. Meanwhile, attractive potential from mid-caps comes from **BNLI (BUY, TP: Rp860)** and **BNGA (BUY, TP: Rp1,470).** The catalyst for BNLI is the recovery of asset quality, refinement on the bottom line, and stakeholder support. With its upgrade to BUKU IV, BNGA will enhance its banking capacity and robust net income in 1Q17.

Ticker	Market Cap (Rp tn)	P/E (x)		P/B (x)		Rec.	Target Price (Rp)
		FY17E	FY18F	FY17E	FY18F		
BBRI	362,020	13.91	11.63	2.35	2.04	HOLD	15,825
BBNI	121,216	10.35	8.83	1.41	1.25	BUY	7,400
BMRI	291,667	15.61	12.16	1.70	1.46	HOLD	12,800
BBCA	443,790	20.81	17.40	3.71	3.16	BUY	19,750
BNLI	19,209	13.03	14.06	1.27	1.09	BUY	860
BNGA	29,278	10.09	7.51	1.03	0.96	BUY	1,470

Sources: Companies, MNCS Estimate

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Welcoming Better Days for Banking Sector

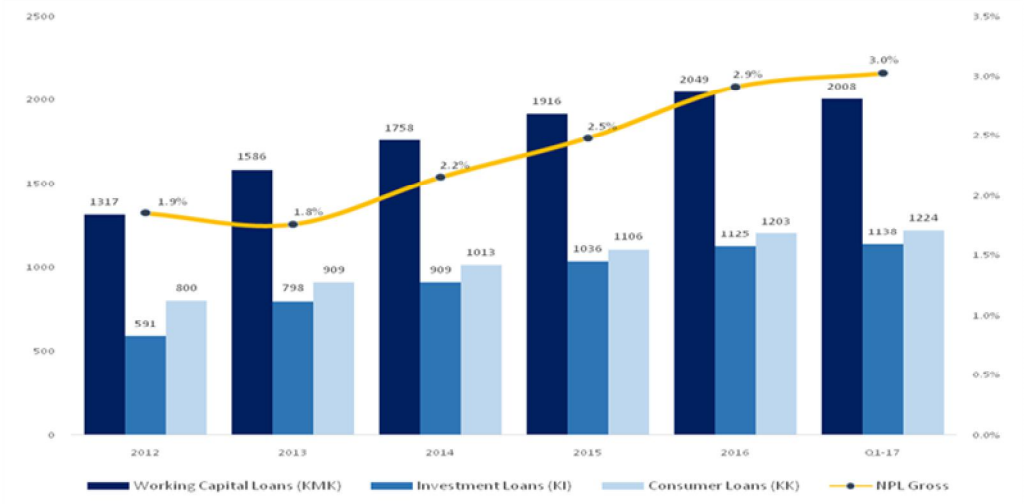
For the past two years, the Indonesian economy has been sluggish. Falling oil prices, a slowdown in world economic growth, and geopolitical uncertainty were prime factors that impacted the Indonesian economy, either directly or otherwise. Nearly all sectors bled red ink, including banks. As the prime excecutant of Indonesian economy, the banking sector was struggling with a GDP growth drop to 4.94% in 2016. However, better days are ahead.

2017 will be a year of recovery. As Indonesian economic growth is predicted to reach 5.1% this year and 5.3% for 2018, it is unavoidable that a better outlook for banking sector prevails. Corporations indicate better performance, which means working capital loan demand increased by 8.6% YoY in 1Q17, compared to 2016 when it only grew by 6.9% YoY. The recovery of oil prices in this year predicts a barrel will cost around US$53, and this will also drive economic activity in the upcoming period.

Exhibit 1. Indonesia GDP Growth vs vs. Loan Growth

Sources: BI, OJK, MNCS

Exhibit 2. Indonesian Loans and NPL Gross Progress

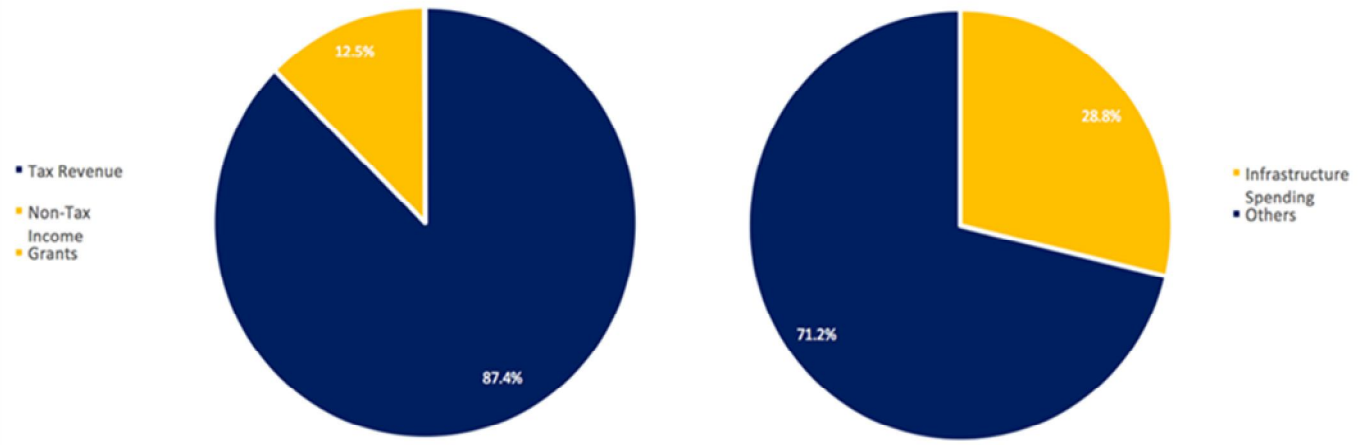


Sources: BI, OJK, MNCS

Supported by Multiplier Effect of Infrastructure Development

Goverment infrastructure program will continue as the star of the Indonesian economy until 2020. Toll roads, airports, harbors, etc. construction are all included in the government's budget. The Rp4,796 tn for projects will boost economic recovery; hence, investment loans will be vivacious at least through 2017-2018. In order to build infrastructure in 2017, the government needs Rp1,000 trillion, while its own budget only allocates Rp387,3 tn. The remainder of the funds will be provided by local government budget, State-own Enterprises (SoE), and the financial sector. Half of theRp1,000 tn infrastructure budget was assigned to SoEs (22% or Rp220 tn) and financial sector (28.3% or Rp283 tn), which means that investment and working capital loans only for government projects will increase around 8.95% this year. Along with economic improvement in 2017-2018, we estimate loans will grow by 11.7% YoY and 12.1% YoY for 2017E/2018F, respectively.

Exhibit 3. Indonesia State Budget

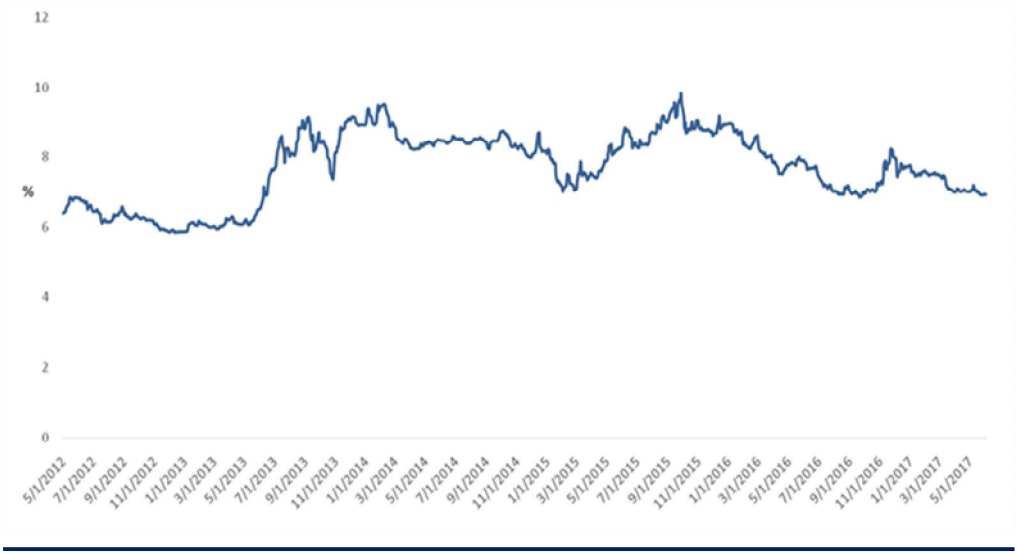


Sources: Ministry of Finance, MNCS

Positive Catalyst from Investment Grade of S&P

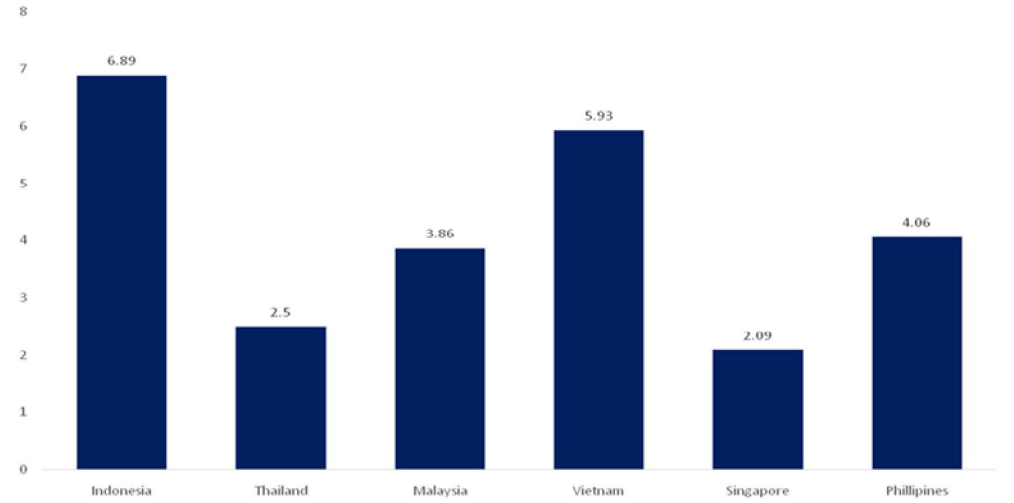
In May 2017, S&P upgraded Indonesia's rating to 'investment grade'. This upgrade will enhance foreign confidence to invest in Indonesia and support the government infrastructure program. Hence, capital inflow will increase in upcoming years, whether from Foreign Direct Investment (FDI) or financial instruments. After S&P's upgrade, there will be more bond issuances, since 10-year bond yields have declined, as shown in Exhibit 4. On the other hand, Indonesia's bond yield is still more attractive with its high numbers compared to those of other ASEAN countries (Exhibit 5). Cheaper bond yields, long fund periods from bonds will have an advantage for banking sector to obtain the funds it needs for financing infrastructure projects. It will be easier for banks to match the period between funds and loans related to infrastructure. The positive outlook from Moody's rating for the banking sector in Indonesia will also escalate investor confidence to collect bonds from the Indonesian banking sector.

Exhibit 4. Indonesian 10-year Bond Yield Movement



Sources: Bloomberg, MNCS

Exhibit 5. ASEAN 10-year Bond Yields

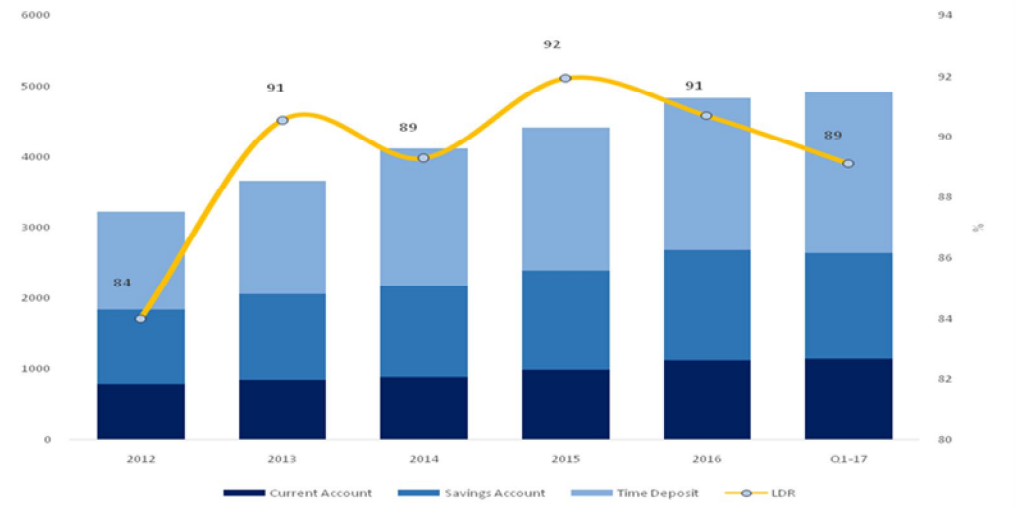


Sources: Bloomberg, MNCS

Refinement of Liquidity: No Longer a Main Concern

Liquidity will be better in 2017-2018. An improved economic environment,as shown by recovery of corporate performance, will enhance liquidity, as indicated by Loan to Deposit Ratio (LDR) slipping to 89.1% and third party funds that growing by 10% YoYin 1Q2017. The upgrade rating from S&P and Moody will also help liduidity to improve, along with capital inflow.

Exhibit 6. Indonesia Third Party Funds and LDR Progress

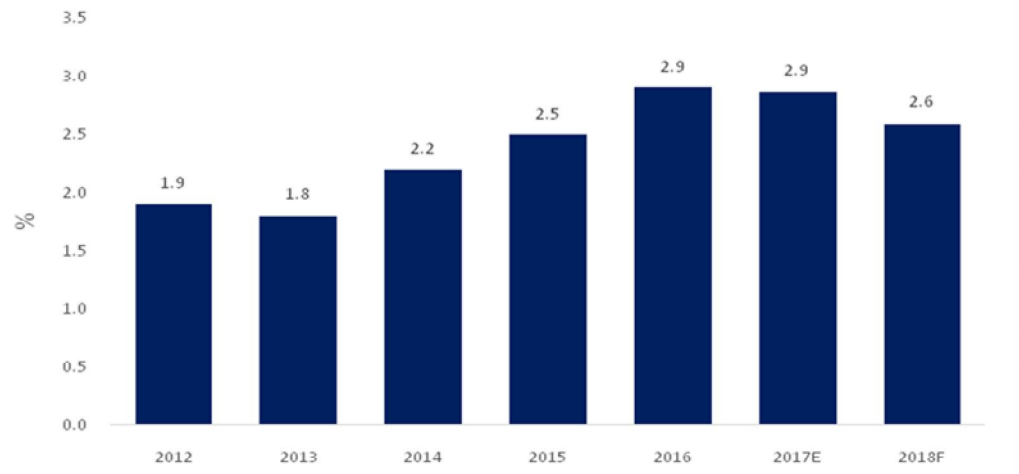


Sources: BI, OJK, MNCS

Recovery of Asset Quality to Support Banks' Profitability, but...

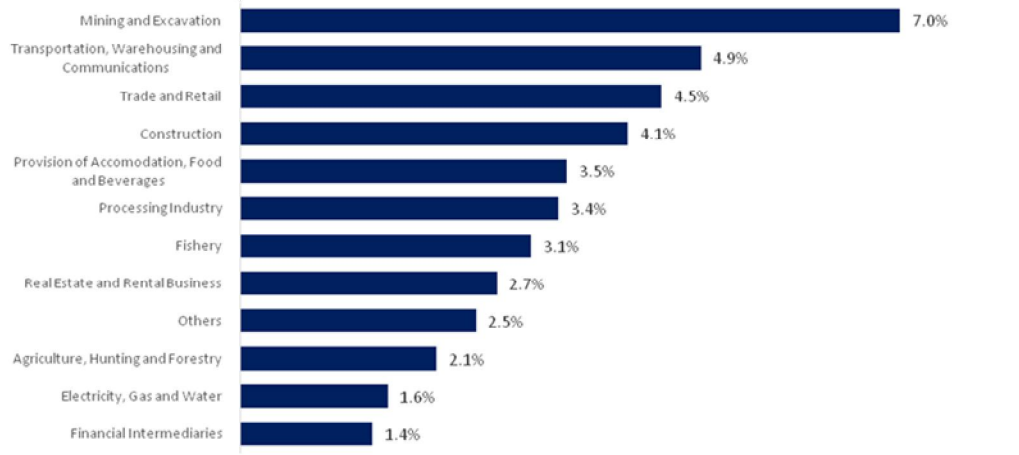
Last year showed trend of deterioration of asset quality, with gross Non Performing Loans (NPL) reaching 2.9%. The mining sector was the main reason for lower asset quality. Meanwhile, loan restucturing was carried outmassively as well as bulky provisioning in 2016. Therefore, asset quality will be stable in the upcoming period along with oil price recovery, more aggresive loan disbursement and a sufficient buffer for asset quality. Lower provisioning is expected in the future, as alower cost of credit. Hence, the bottom line will improve, also helped by fee-based income that is targeted to grow by 25%-30% YoY by banks this year.

Exhibit 7. Indonesia NPL Gross Progress



Sources: BI, OJK, MNCS

Exhibit 8. IndonesianGross NPL by Segment in 1Q17



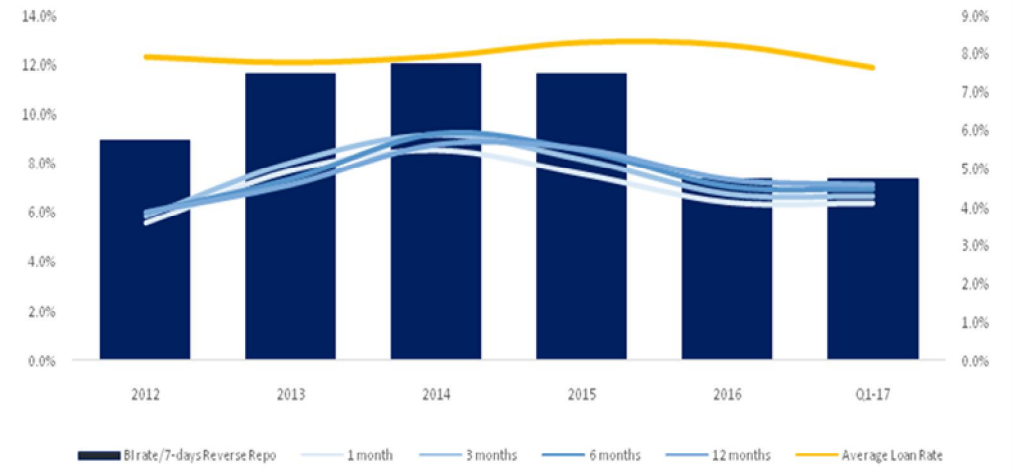
Sources: BI, OJK, MNCS

....Overshadowed by Normalization of NIM Trend

From the regulatory side, it seems like the government will support the banking sector, along with economy recovery. The 7-day reverse repo and soon-to-be-enacted statutory reserve requirement averaging (which will give room to the banking sector to manage its liquidity) are examples of supportive regulation. On the other hand, in the second half of 2017 credit interest and deposit interest will be difficult to suppress again. This is due to a predicted rise in the Fed Fund Rate (FFR), regarding which Bank Indonesia (BI) will maintain the level of 7-day reverse repo. In order to maintain its liquidity and thrive in tight competition, it will be unlikely for banks to lower deposit interest rates, as they did during 2016. Therefore, NIMs are predicted to decline, as seen during 1Q17 and are projected to be 5.4% at the end of year.

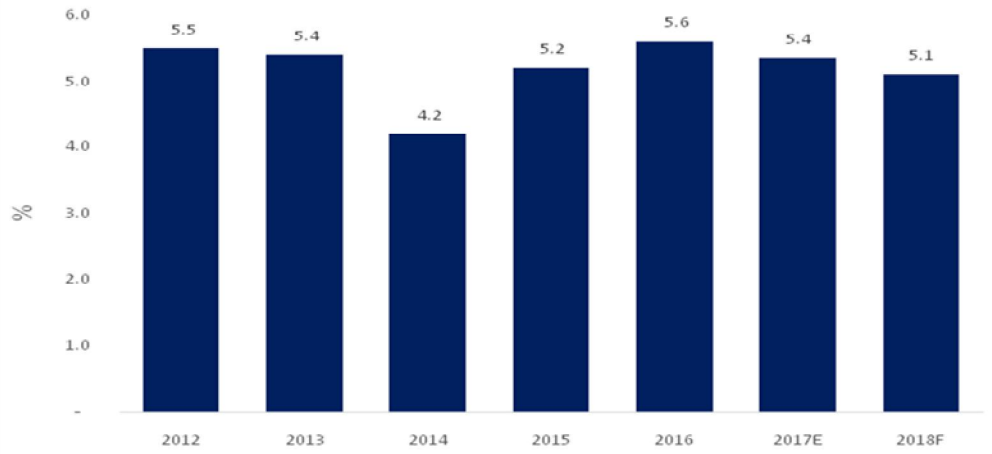
Infrastructure projects will be the main driver for economic growth in the upcoming year, as the banking sector needs long-term funds to match with infrastructure term loans. As more bond issuance is predicted for upcoming years, this will result in increased cost of funds. Investment and working capital loans,as the main driver of loan growth for several years, have lower marginsthan consumer loans. Thus, NIM will likely be more depressed.

Exhibit 9. Deposit and Loan Rate Movement



Sources: BI, OJK, MNCS

Exhibit 10. NIM Progress

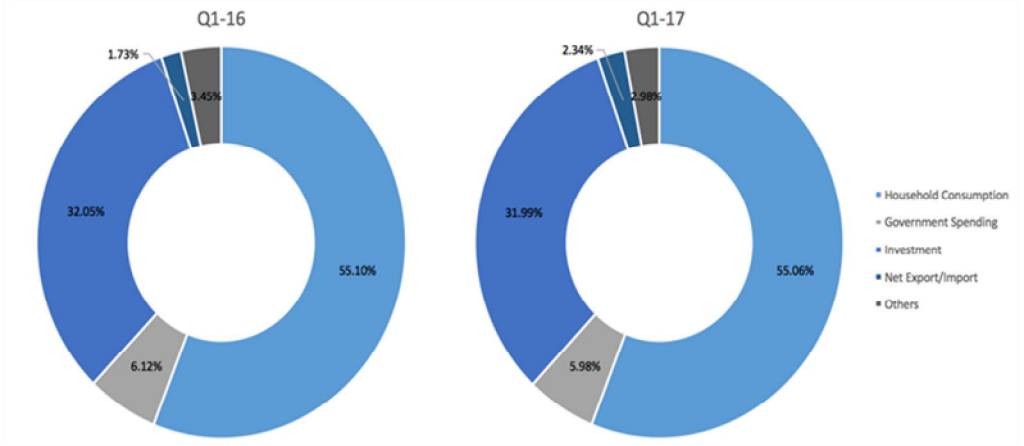


Sources: BI, OJK, MNCS

Lagging Impact but It Will Taste Sweet...

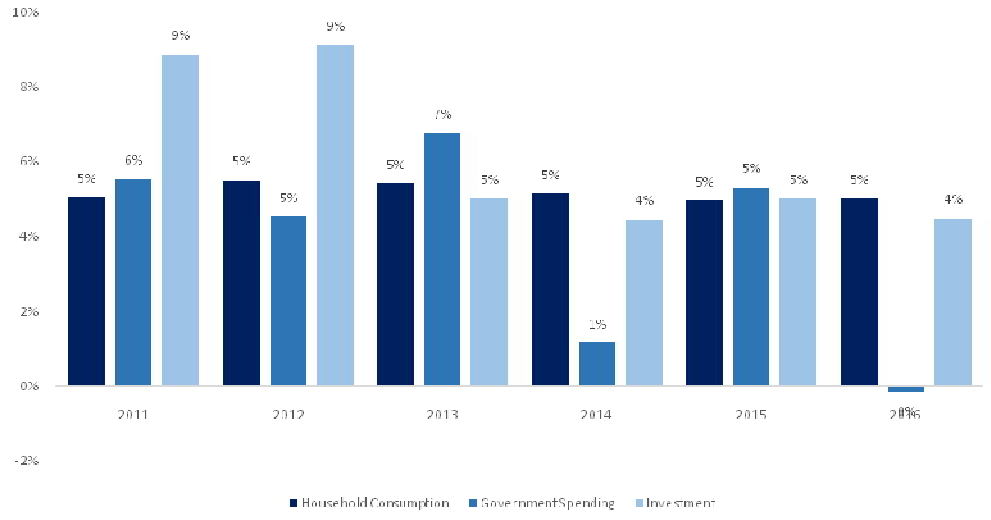
The biggest contribution to GDP is household consumption, which in 1Q17 amounted to 55% of total GDP. Investment and goverment spending contributed 32% and 9% to total GDP, respectively. While infrastructure programs are the main driver of economic growth for the next couple of years, it takes time for real sector to have massive impact, as indicated by consumer loans, that still grew in a stable manner at 9% YoY for 1Q17.

Exhibit 11. Indonesia's GDP Contribution



Sources: BPS, MNCS

Exhibit 12. Indonesia's GDP Contribution - Progress



Sources: BPS, MNCS

....If Tax Collection is Effective

Around 38.7% of total infrastructure budget for 2017 (Rp1,000 tn) is to derive from the government budget. Meanwhile, goverment revenue from tax collection has reached up to 85.6%, or Rp1,498.9 tn for 2017. Until April 2017, tax realization reached Rp343.7 trillion, or around 22.9% of the target, while it should be at around 33.3% of the target. Infrastructure program is the second-highest government budget allocation after education, at around 18.6% of the total government budget. Thus, if tax collection doesn't reach its target, infrastructure projects could be obstructed.

Campaign Year in 2018: Are You Ready to Surf the Waves?

2019 will be anelection year, which means 2018 will be a campaign year. This could impact on investor confidence because of political uncertainty. Hence, the risk will be slightly higher, especially concerningthe continuation of infrastructure programs. As shown in the past (Exhibit 4), investors tend to take a wait-and-see position at the end of campaign years, resulting in JCI being more volatile.

Exhibit 13. JCI Movement

Sources: Bloomberg, MNCS

AEoI Era: Another New Worry?

As the government is raising tax collections and entering an AEoI era, Perppu No.1/2017 has been issued. The new regulation stipulates reportage of information on account holders worth more than Rp1 billion on deposit. Around 496 thousand accounts, or 25% of the total in Indonesia, are worth more than Rp1 bn. This could have a chilling effect, resulting in priority customers being reluctant to hold their funds in local banks. This in turn could raise questions about the stability of a bank's liquidity.

OVERWEIGHT Outlook

Selective BUY on BBCA, BBNI, BNLI and BNGA

2017 will be a year of recvery for the banking sector, driven by 1) Economic recovery along with higher estimate of GDP growth at 5.1%, which would boost loan disbursement for 2017around 11.7% by our forecast, 2) S&P and Moody's upgrade as a positive catalyst for capital inflows into Indonesia, hence helping liquidity, 3) Infrastructure projects as the star of loan demand, 4) Better asset quality, where the restructured loan phase was done last year and stable NPL is expected this year. Therefore, there will be apoint of investment risk, which is the downtrend of NIM,caused by a higher cost of funds from long-term funding, lagging impact from infrastructure projects to real sector, tax collection less than expected, and a campaign year in 2018 could all spike volatility.

Overall, we call **OVERWEIGHT** as we see improvement in banking sector with our **TOP PICKS: BBCA (BUY, TP: Rp19,750)** and **BBNI (BUY, TP: Rp7,400)** for the big banks. Meanwhile, we see attractive potential from mid caps BNLI and BNGA. The recovery of asset quality, refinement onthe bottom line, and stakeholder support (ASII and Standard Chartered) which will strengthen its capital are catalysts for **BNLI (BUY, TP: Rp860)**. Another mid-cap bank, **BNGA (BUY, TP: Rp1,470)** is upgraded to BUKU IV, and this will enhance its banking capacity and robust net income for 1Q17.

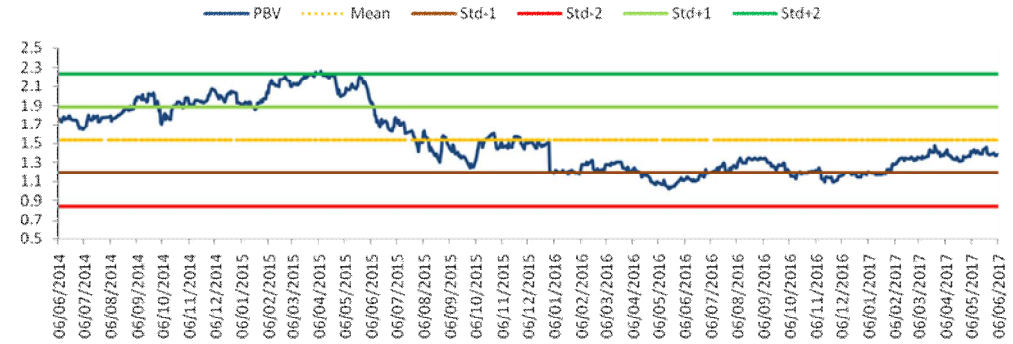
Exhibit 14. BMRI P/B Ratio Band

Sources: Bloomberg

Exhibit 15. BBRI P/B Ratio Band

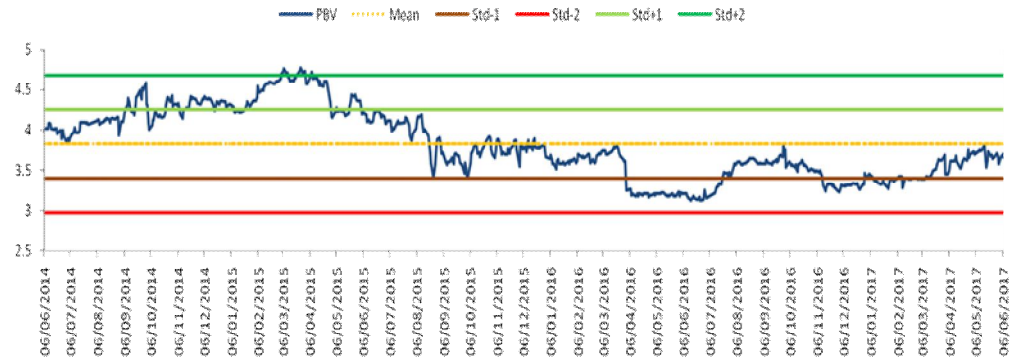
Sources: Bloomberg

Exhibit 16. BBNI P/B Ratio Band



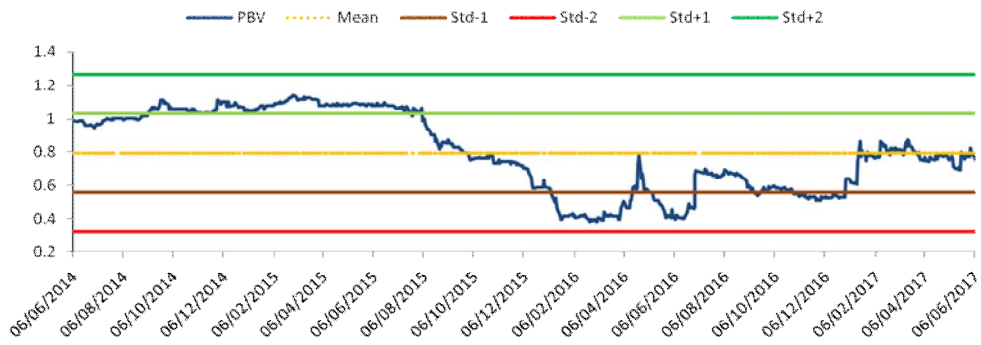
Sources: Bloomberg

Exhibit 17. BBCA P/B Ratio Band



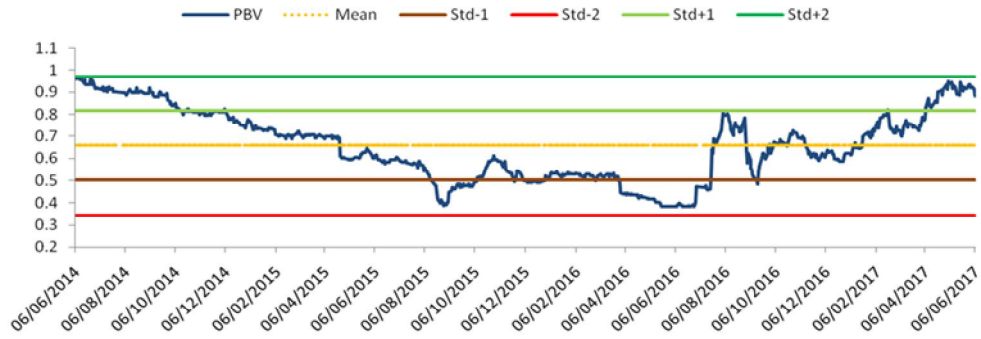
Sources: Bloomberg

Exhibit 18. BNLI P/B Ratio Band



Sources: Bloomberg

Exhibit 19. BNGA P/B Ratio Band



Sources: Bloomberg

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MNC Research Investment Ratings Guidance

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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