
Banking Sector

Moderate Growth



Upon the peak of the global economic crisis last 2008, the Philippine Banking Industry is now under a period of challenge as it strives to recover from its losses last year. Despite the expressed optimism and underlying strength of the sector, questions remain on the condition and stability of the industry.

Local banks had tremendous swings last year as the global economic slowdown pounded heavily on the world's economies and markets. The Philippine banks were dragged along the steep decline of the local index while some had exposure to the losses and bankruptcies of companies abroad. The extreme volatility in the market and adverse economic conditions aggravated the plight of the industry. Gains narrowed and earnings were slightly affected and were reduced. Nevertheless, the banks remained firm throughout the year as it battled through the unfavorable environment.

	FIN	PSEI
1 Year	-47.14%	-48.29%
YTD	-2.84%	-0.18%

QUICK LOOK

The volatility in the financial environment led the BSP to take successive monetary measures to address the crisis. The rate increases tightened liquidity in the market so that the rapid rise of inflation may be reined in. As an effect, lending activity became sluggish and anemic. The higher gains that could have been achieved by the banks through increased rates were also not attained as cost of borrowing went up. Net interest income likewise declined as interest expenses grew faster than interest income. As the rates increased, deferring of payments became common, leading to lower interest income. Meanwhile, the rate cuts recently taken by the BSP may have been done to support economic growth. However, this also lowered banks' interest income on investments. The extreme volatility and the monetary measures taken by the BSP became a double edged sword which took a toll on the banks' earnings. With several things happening at once, the banks' operations took a minor downturn.

LIQUIDITY – Despite the negative conditions last year, the banking industry was able to maintain an adequate amount of capital. The average CAR (Capital Adequacy Ratio) of the major banks, ranging between 14%-15% per quarter, is above the minimum BSP requirement of 10%. This is a generally accepted level indicating sufficient liquidity and stability. The loans to deposit ratio of the banks were slightly varied. Most banks' loans and receivables grew marginally towards the end of year as borrowers began to hold back payments, increasing the interval of payment periods. The select banks' loans to deposits ranged from 45% to as high as 72% for 2008.

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PROFITABILITY – When the industry was shook by the onslaught of the global financial crisis last year, bank profits weakened to some extent. Lending activity slowed down causing Net Interest Income to squeeze. Interest expenses also outpaced the growth of interest income from assets. In a positive note, the banks were still able to give fair returns on assets and equity for the past period.

REVENUE ALLOCATION – Despite the difficult operating environment, revenues were well allocated as non-interest expenses took only less than 45% of most banks' net revenues. Also, the banks' income from fees and other charges on the average is 10%-15% of total revenues. The only downside for the industry was the volatility of the trading environment leading to lower trading gains of the banks.

LOAN QUALITY – Most banks struggled with deteriorating assets and slow loan income growth. For the first six months, the industry's average NPL (Non-Performing Loans) ratio was at its worst at a level above 5%. As banks took out its bad loans coupled with expansion of loan portfolio, the industry was able to improve its NPL ratio to just 3.97% by October.

ADEQUATELY COVERED

Since the banking industry hangs in the balance, several factors must be assessed to determine its present condition and stability.

- The robust CAR levels achieved last year could cushion the banks from capital shortfall and keep it liquid this 2009. Since lending movement and growth is expected to be somewhat muted, the banks' will make use of the funds it accumulated last year to continue its operations.
- NPL ratios will keep close to its figures last year as banks try to keep their balance sheets healthy. However, the risk remains that the returns on loans would not be received on the expected time. If this continues, the banks must take the appropriate measures against keeping bad loans.

Table 1: CAR and NPL of Selected Local Banks

	As of September 2008					
	BDO	BPI	MBT	PNB	RCB	UBP
CAR	13.68%	13.18%	13.00%	16.60%	18.70%	13.21%
NPL	4.65%	3.39%	4.80%	10.55%	3.90%	7.20%

- The prevailing risk aversion and slow market activity may slow down lending growth. The conservative spending of consumers and tight business condition becomes a disadvantage to the industry. Lending policies will be more cautious this time considering the volatility of the market and the vulnerability of the sector. In a measure to assure stability and liquidity, the BSP recently required banks to assess their capital adequacy relative to the risks. This is under a new guideline called Internal Capital Adequacy Assessment Process (ICAAP) wherein banks are to determine their rightful level of capital. This is to ensure resource sufficiency in the light of the risks unique to the sector. The BSP also issued another guideline regarding proper banking practices so that bankruptcy may be prevented.

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- Presently, it may be difficult for banks to take away some of its bad assets. The prevailing local market condition and dismal outlook over the whole financial industry points to an exigent road towards recovery. The current amount of bad loans and weak returns in interest earning assets may affect profits of banks this year.
- The worries over the financial markets of the world finally dragged the share prices of the local banks. Over the last few months, the banks' P/E ratios declined drastically as prices dropped from previous highs. The exposure to foreign bankruptcy, which led to losses and write offs also made valuation ratios differ exceedingly from the industry average. Despite the low cost, shares continued its descent as local market and the industry itself found no respite in the fall of major markets abroad.

Table 2: Ratios of Selected Local Banks

	2008			2009		
	P/E	P/B	ROE	P/E	P/B	ROE
BDO	11.94	0.96	8.01%	8.27	0.94	11.32%
BPI	16.89	1.97	11.70%	14.43	1.87	12.98%
MBT	7.82	0.62	7.94%	7.08	0.65	9.16%
PNB	7.82	0.31	4.00%	7.69	0.31	4.07%
RCB	4.41	0.35	7.82%	4.90	0.35	7.19%
UBP	6.64	0.53	7.97%	6.06	0.49	8.11%

The lower earnings and the decline in share prices led to lower valuation ratios for this year. Given an industry P/E average that lies at 7.3x, only a few of the major banks are considered undervalued. Meanwhile, the P/B of the major banks improved and lies within an acceptable range around the industry's average of 0.56x. The changes in expected returns however, are mixed. But on the average, ROE will remain upbeat and steady. Among the major banks included in the study, RCB has a cheap P/E of 4.9x. Its P/B is also at a low cost of 0.35x against the other banks. Though the valuation ratios seem attractive, the returns only lie on the average.

Business and investments conditions may be hushed this year as risk aversion prevails. Despite this slowdown, the BSP estimates lending activity to remain healthy, growing at least 10% to over 20%. This modest to optimistic projection will allow banks to regain a firm position in the economy. Though the risk remains on how the local economy itself will fare this year, the banks and the industry itself are adequately prepared to face this testing period.