

**INITIATION REPORT**

31 Mar 2011

<b>Malaysia Building Society Berhad</b>		<b>Market Price:</b>	RM2.29
		<b>Market Capitalisation:</b>	RM1606.7m
		<b>Board:</b>	Main Market
<b>Recommendation:</b>	BUY	<b>Sector:</b>	Finance
<b>Target Price:</b>	RM3.05	<b>Stock Code/Name:</b>	1171 / MBSB

Analyst: Edmund Tham



Source: MBSB annual report

**BACKGROUND**

Malaysia Building Society Berhad (MBSB) originally started off as Federal and Colonial Building Society Limited that was incorporated in 1950. Later on in 1956, it changed its name to Malaya Borneo Building Society Limited (MBBS), with the Malaysian Government as its major shareholder. MBBS was listed on the Stock Exchange of Malaysia and Singapore in August 1963.

MBSB was incorporated in Malaysia under the Companies Act, 1965 in March 1970, before it was listed on the Kuala Lumpur Stock Exchange in March 1972. The Employees Provident Fund Board (EPF) and Permodalan Nasional Berhad (PNB) are now the major shareholders of MBSB.

MBSB offers a range of innovative products and services through its branch network located all over Malaysia including Sabah and Sarawak.

**“Special status”**

MBSB is a Scheduled Institution as defined under the Banking and Financial Institution Act 1989 (BAFIA). The status of an Exempt Finance Company was granted to MBSB in March 1972 by the Ministry of Finance (MOF) and the status has remained since then. This allows MBSB to carry on a finance business without a license.

**MBSB: Branch Locations**

State	No. of Branches
Perlis	1
Kedah	3
Penang	2
Perak	3
Selangor	4
Kuala Lumpur	3
Negeri Sembilan	1
Malacca	1
Johor	5
Pahang	1
Terengganu	2
Kelantan	0
Sabah	3
Sarawak	4

Source: MBSB

\*excluding 1 representative office in each of Kelantan, Terengganu and Pahang

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### **“Allowed to take deposits”**

Just like a bank, MBSB is also able to take deposits from the public. MBSB allows people to open Savings Accounts and Fixed Deposit (FD) Accounts (but not Current Accounts) at its branches. Individuals and corporate bodies are encouraged to place deposits. Senior citizens are also able to get preferential interest rates. MBSB also offers Islamic Fixed Deposit Accounts and Islamic Savings Accounts.

### **Personal Financing-i (PF-i)**

MBSB also offers conventional and Islamic personal financing for individuals. This business segment has been growing quite rapidly during the group's FY10. In particular, MBSB targets certain market segments such as PDRM staffs, Ministry of Health staffs, EPF staffs, teachers/school staffs and staffs of other government departments/ministries.

### **Property Financing**

Historically, MBSB's name and loan portfolio is more synonymous with property financing. MBSB provides financing for both residential and commercial properties. The group offers financing up to 105% (including MRTA) for residential properties and up to 80% for commercial properties. As property financing is a form of collateralized lending, MBSB holds a sizeable amount of properties as collateral. The new, high net worth clientele mortgage venture, MBSB Ultimate (for properties costing RM500,000 and above), was also launched during the year.

### **Corporate Loan**

For the Corporate Loan business segment, MBSB offers Commercial Financing, Project Financing, Contract Financing and Musharakah Business. Commercial financing is offered for the phases of under-construction, completed or refinancing of commercial properties. Project financing is typically offered to property developers. Contract financing is normally taken to serve a specific business undertaking or

project – e.g. government or oil and gas service contracts. Musharakah business refers to financing for “business partnerships”.

### **New - Credit Card and Hire Purchase**

For this rather new business segment, MBSB partners Bank Islam in offering the “MBSB-Bank Islam Credit Card” Mastercard. This credit card is based on Shariah principles. With this credit card, clients can access Bank Islam's nationwide network of ATMs (automated teller machines). MBSB is also in the midst of preparing to launch its Hire Purchase financing business segment to the public.

### **New - Bancassurance**

Just like conventional commercial banks, MBSB also offers Bancassurance products. Its products include life insurance, education savings plan, P.A. (personal accident) insurance, home contents cover, motor insurance and MRTT (mortgage reducing term takaful). For this business segment, MBSB's strategic partners are MNI (a subsidiary of PNB) and Takaful Ikhlas (a subsidiary of MNRB). MNRB is owned by Amanah Raya Nominee S/B and PNB.

### **Will Writing**

MBSB has ventured into the legacy management business of will writing, custodianship and execution. This venture is via its partnership with Amanah Raya Bhd whereby MBSB serves as its agent.

### **Other Non-Core Businesses**

We note that MBSB also derives revenue from the non-core businesses of Property Development and Hotel Operations.

### **“Distinguished management”**

MBSB's group management is led by its Chairman Tan Sri Abdul Halim bin Ali and its CEO Dato' Ahmad Zaini bin Othman. Tan Sri Abdul Halim previously served in the Ministry of Foreign Affairs, was formerly the Chief



Secretary of the Government (i.e. head of the civil service) and also a former Chairman of the EPF (Employees Provident Fund). Dato' Ahmad Zaini on the other hand, has vast experience in investment banking, corporate banking and Islamic banking prior to joining MBSB. As is well known, MBSB is a GLC (government linked company), majority owned by the EPF.

## PERFORMANCE – FY10

4Q/ 31 Dec	4Q10	4Q09	yoy %	3Q10	qoq%
Rev (RMm)	208.9	158.8	31.6	317.7	(34.2)
PBT (RMm)	72.4	(8.1)	993.8	42.3	71.3
NPAT (RMm)	12.8	(9.7)	232.0	40.5	(68.4)
EPS (sen)	1.8	(1.4)	232.0	5.8	(68.4)

12M/ 31 Dec	FY10	FY09	yoy %
Rev (RMm)	769.9	538.0	43.1
PBT (RMm)	207.4	80.3	158.2
NPAT (RMm)	146.0	57.2	155.3
EPS (sen)	20.9	8.2	155.3

### “Strong FY10 performance”

MBSB's group profit before tax (PBT) for its FY10 ended 31<sup>st</sup> December 2010 of RM207.4 million had increased by RM127.1 million or 158.2% as compared to the preceding FY09's PBT of RM80.3 million. This increase in PBT was mainly due to the higher loan and financing income, particularly from the expansion of personal financing. This was partly off-set by the group's higher operating expenses and higher loan loss impairment.

MBSB's group profit before tax (PBT) for its 4Q/FY10 ended 31<sup>st</sup> December 2010 of RM72.4 million had increased by RM30.1 million or 71.3% as compared to the preceding 3Q/FY10 PBT of RM42.3 million.

The q-o-q increase in PBT was mainly due to the lower loan loss impairment and higher loans and financing income in 4Q/FY10. These gains were partially off-set by the group's lower other operating income and higher other operating expenses.

## OUTLOOK/CORP. UPDATES

In tandem with the improving domestic economy (in GDP terms), we expect that the group's financing revenues would grow as well. It is common for consumers to take up loans or financing, especially for housing, motor vehicles, credit cards or personal financing. MBSB's management is targeting strong demand from the public sector, i.e. the civil servants working for the government.

### “Economy growing steadily”

The latest available Malaysian economic data (January 2011) revealed reasonably positive growth rates in y-o-y percentage terms, for instance: IPI (+1.0 y-o-y), Manufacturing Sales (+7.7% y-o-y), Exports (+3.0% y-o-y) and Imports (+13.5% y-o-y).

Malaysia had also reported a very respectable 4Q/2010 GDP growth of +4.8% (+7.2% for full year 2010 GDP), stable 4Q/2010 unemployment rate of 3.2% and manageable CPI of 2.9% (February 2011). Meanwhile, Bank Negara Malaysia (BNM) had last reaffirmed its accommodative overnight policy rate (OPR) of 2.75% on 11<sup>th</sup> March 2011. BNM may decide to increase its OPR during the year to contain inflationary pressures.

The expected growth of the wholesale and retail trade, ICT, tourism, health, education, business services as well as finance and insurance sub-sectors, following the roll-out of programmes and initiatives under the 7 services-related National Key Economic Areas in 2011 augur well for MBSB's business prospects.

### “Better results due to Turnaround Plan”

MBSB's Turnaround Plan during years 2009-2010 have resulted in a much improved overall group performance. Its plan includes efforts to expand its range of products, better customer service and setting-up a Project Management & Monitoring Department and a Early Care Unit.

In the push for greater operational efficiencies, MBSB has performed several outsourcing

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exercises which have resulted in benefits such as reduced turnaround time, improvements in cost controls and also levels of customer service. Internal divisions have also been streamlined to reinforce a new organisational structure whereby the sales divisions of retail products have been consolidated into one division. It is expected that the combined marketing efforts will result in better sales and assist the development and introduction of new financial products.

#### “Streamlining operations”

Infrastructure at both MBSB’s Head Office and branches has also been improved, with some key departments at Head Office having undergone refurbishment while some branches have been relocated to more strategic locations. A new communications system has also been installed to provide better service to customers. The new Shariah Compliance Unit, which will seek the advice and guidance of the Shariah Advisory Council (SAC), will assist the business side on product development while ensuring Shariah compliance in all areas of operations.

#### “Target Headline KPIs”

As a GLC (government linked company), MBSB recently announced its 2011 Target Headline Key Performance Indicators (KPIs). These KPIs have been set and agreed by MBSB’s Board of Directors and management as part of the broader KPI framework in place under the GLC Transformation programme and is disclosed on a voluntary basis.

Item	FY10 KPI Targets	Actual FY10	FY11 KPI Targets
Group Net ROE	10%	31.3	15%
Group Revenue growth	15%	43.1	25%

Source: MBSB

The group’s FY10 net return on equity (ROE) and revenue growth had easily exceeded the targeted Headline KPIs. This was mainly due to the strong performance of the personal financing

business segment. This gain was partly off-set by the higher operating expenses and higher loan impairment during FY10.

#### “Recovery efforts ongoing”

The group remains focused on improving its assets quality and loan recovery through the continuing reinforcement of its risk management capabilities. In recent years, MBSB has been diligently reducing and restructuring its accumulated losses from legacy accounts from the post-Asian Financial Crisis period of 1998-2003. The group’s Net Loan Impairment Ratio has been steadily brought down in recent years to 16% in its FY10. MBSB’s management is targeting a loan impairment ratio of around 13% in its FY11. We are nevertheless wary of any further impact from the implementation of accounting standard FRS139 on the group’s impairment measures.

#### “Target market – civil servants”

Group management also revealed that the impairment of new loans during the past 2 years has been very minimal. This can be attributed to the fact that large portions of MBSB’s retail consumer base are civil servants, working with various government departments and ministries (i.e. in “secure jobs”). To mitigate its risks on civil servants defaulting, MBSB implements measures such as 60% loan-to-salary limit and also CCRIS-record checking. Even though MBSB is not regulated by BNM, MBSB’s management would adhere to any future guidelines of lending practices that BNM may announce.

MBSB’s management is particularly optimistic for strong growth for its personal financing to civil servants, given the strong demand and its attractive rates and packages. This is part of its business strategies on retail products being undertaken in “Taking MBSB to the Next Level”. Nevertheless, MBSB does face specific competitors for this niche market – with rivals such as Bank Rakyat, BSN, RCE Capital and AgroBank.

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MBSB's management aims to have personal financing make up 50% of the group's loan portfolio, with mortgage loans at 30%. Currently, approximately 50% of MBSB's loan portfolio comes from mortgage/property loans while more than 30% comes from personal financing loans.

#### **“Direct deduction facility”**

MBSB is able to get payments from its civil-servant clients in a “fail-safe” way via its direct salary deduction code with ANGKASA. ANGKASA (Angkatan Koerasi Kebangsaan Malaysia or National Co-operative Organisation of Malaysia) is the apex cooperative overseeing all types of cooperatives throughout Malaysia.

#### **“Future plans”**

Going forward, MBSB has specific plans for its future via its Business Direction 2011-2015 plan. The plan involves a wider range of products for the retail, corporate and wholesale financing segments. For the corporate segment, MBSB would offer vendor financing, industrial hire purchase and commercial financing.

The wholesale financing business segment is related to PFIs (private finance initiatives) and structured businesses. In addition to facing numerous other rival financial institutions, MBSB also faces future challenges in improving its internal IT infrastructure, branding / recognition and branch networking.

In recent months, MBSB has partnered with SME Factors Sdn Bhd (SMEF) under the **Ekpres Tunai SME** programme, to disburse a total in RM500 million financing backed by MBSB to SME contractors servicing the government and GLCs. SMEF, a privately held factoring company targeting government contractors and suppliers, expects to grow its business to about 5,000 customers and over RM1 billion facilities by year end. Factoring is a scenario where a business sells its accounts receivables, or invoices, to a third party (called a factor) at a discount, in exchange for immediate money to finance ongoing business. SMEF is banking on its factoring products and the

opportunities from the RM30 billion budget under the government's 10th Malaysia Plan (10MP) 2011-2015 and the Economic Transformation Programme (ETP) to achieve its target.

#### **VALUATION/CONCLUSION**

As part of its capital management plan, MBSB had proposed a renounceable rights issue of up to 507.1 million new ordinary shares of RM1.00 each at an issue price of RM1.00 for each rights share on the basis of 5 rights shares for every 7 existing MBSB shares held as at an entitlement date to be determined later.

The proposed rights come together with up to 507.1 million free detachable warrants on the basis of 1 warrant for every 1 rights share subscribed. MBSB also proposed to raise its authorised share capital from RM1.8 billion to RM2.8 billion comprising 2.8 billion MBSB shares by the creation of one billion new MBSB shares.

MBSB's management had proposed a first and final gross dividend per share (DPS) of 9 sen less tax for its FY10 ended 31<sup>st</sup> December 2010, which has just been approved by shareholders' at its recent AGM. Based on the issued and paid up share capital as at 31<sup>st</sup> December 2010, MBSB would pay out RM47.3 million in dividends. This would account for a reasonable FY10 gross dividend yield of 3.9% and dividend payout ratio of 32.4% of its annual net earnings.

#### **“Reasonable dividend proposed”**

With a relatively high adjusted beta (correlation factor) of 1.62 to the KLCI, MBSB has outperformed the KLCI's performance this year (by +53.7% vs. +1.98% year-to-date (YTD)). Market conditions have also been volatile lately, impacted by the recent political uprisings in the Middle East/North Africa and major earthquake in Japan. MBSB's stock price recently surged, and this could be attributed to factors such as its positive FY10 results and dividend announcement.

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“Buy Call”

Based on our forecast of MBSB’s FY11 EPS and an estimated P/E of 10 times (within its historical range), we set a FY11-end Target Price (TP) of RM3.05. This TP offers investors a 33.3% upside from MBSB’s current market price. Our TP for MBSB reflects a P/BV of 3.2 times over its FY11F BV/share. Meanwhile, the local banking sector’s average P/E and P/BV is 11.7 times and 2.1 times, respectively.

“P/E valuations getting attractive”

MBSB’s strong FY10 results have pleasantly surprised the market. If the group sustains its strong business performance in its FY11, we would deem MBSB’s P/E valuation quite attractive indeed. The group’s ROEs of above 30% are quite admirable. Meanwhile, the group has been in a net cash position since its FY09 (excluding customer deposits as borrowings).

“Concerns and risk factors”

MBSB’s high loan impairment ratio (due to legacy accounts) has been dwindled down in recent years, and we are not overly concerned about it at the moment. Besides, most of the impaired property loans are backed by collateral. The group also has a higher than banking industry average loan-deposit ratio of more than 100%, but MBSB’s management is targeting to bring this down to a more palatable 95-98% level. We are nevertheless comfortable with MBSB’s current level of loans growth, deposits growth, Cost/Income ratio and Net Interest Margin.

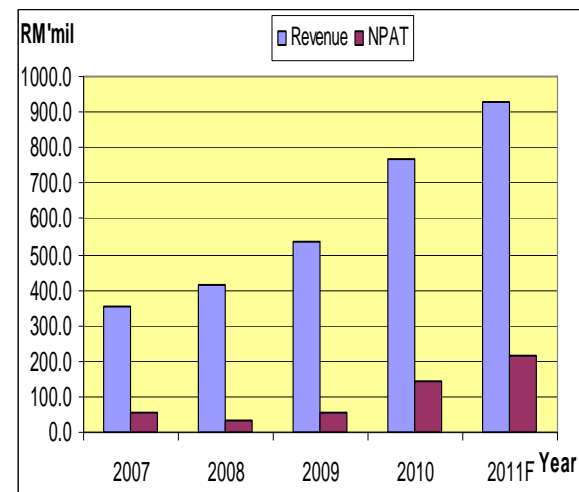
MBSB’s business also face possible risk factors such as a slower rate of economic growth, weak financing demand, rising loan impairments, rising cost of funds and stiff competition from other existing banks/financial institutions.

MBSB: Share Price



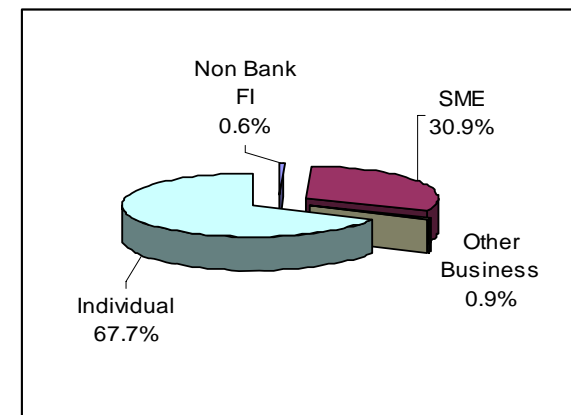
Source: NextView

MBSB: Revenue and NPAT trend



Source: MBSB
\*2011F figures are our estimates

MBSB: FY10 financing client categories





Source: MBSB

**KEY FINANCIALS**

Key Stock Statistics	2011F
Earnings/share (sen)	30.5
PER (x)	7.5
Dividend/share (sen)	12.0
NTA/share (RM)	0.95
Book Value/share (RM)	0.96
Issued Capital (mil shares)	700.2
52-weeks price range (RM)	1.00 – 2.38
Major Shareholders:	%
.EPF Board	66.2
.PNB	14.9

\*RM1 par value

P&L Analysis (RM'mil)	2008	2009	2010	2011F
<b>Year end: Dec 31</b>				
Revenue	416.2	538.0	769.9	925.9
Operating Profit	81.8	190.2	319.6	438.0
Depreciation	(7.8)	(8.2)	(7.4)	(7.2)
Interest Expenses	(188.5)	(151.2)	(142.6)	(154.0)
Pre-tax Profit (PBT)	54.0	80.3	207.4	300.5
Effective Tax Rate (%)	39.2	28.1	29.3	28.7
Net Profit (NPAT)	32.6	57.2	146.0	213.7
Operating Margin (%)	19.6	35.4	41.5	47.3
Pre-tax Margin (%)	13.0	14.9	26.9	32.5
Net Margin (%)	7.8	10.6	19.0	23.1

\*PBT=Operating profit-allowance for impairment losses (on loans, advances and financing)

\*NPAT=PBT-taxation-zakat

Basic Ratios Analysis	2008	2009	2010	2011F
Book Value/share (RM)	0.73	0.79	0.54	0.96
Earnings/share (sen)	4.7	8.2	20.9	30.5
Dividend/share (sen)	3.0	4.0	9.0	12.0
Div. Payout Ratio (%)	48.4	36.7	32.4	29.5
PER (x)	49.2	28.0	11.0	7.5
P/Book Value (x)	3.1	2.9	4.2	2.4
Dividend Yield (%)	1.3	1.7	3.9	5.2
ROE (%)	6.4	10.4	38.3	31.9
Net Gearing 1(or cash)(x)	13.0	12.4	25.7	18.2

\*2011 figures are our estimates

\*Net gearing 1(including customer deposits)

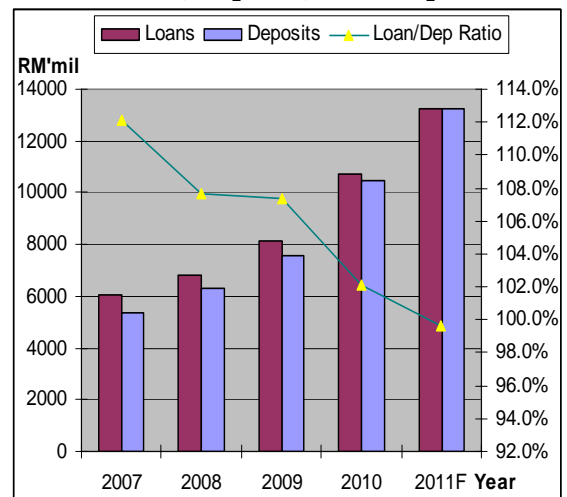
\*Excluding impact of rights issue

F.I. Ratios Analysis	2008	2009	2010	2011F
Net Gearing 2(or cash)(x)	0.6	(1.3)	(1.8)	(1.6)
Loan/Deposit (%)	107.6	107.4	102.1	99.7
Net Loan Impairment (%)^	23.0	19.0	16.0	13.0
Loans Growth (%)	12.3	19.7	31.9	23.6
Deposits Growth (%)	17.0	20.0	38.6	26.6
Cost/Income (%)^	46.3	37.6	27.6	n.a.
Net interest margin (%)^	1.95	2.91	3.38	n.a.

\*2011 figures are our estimates (but net loan impairment is MBSB's target)

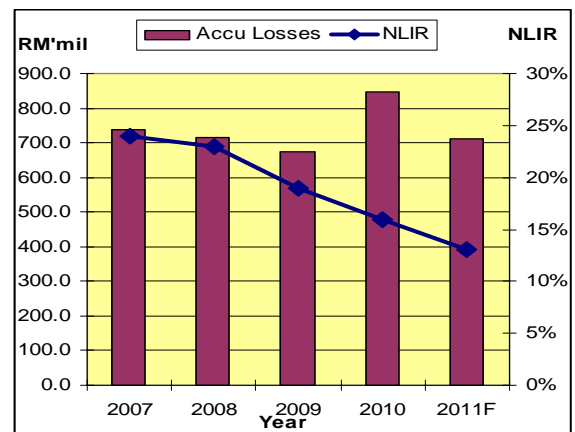
\*Net gearing 2(excluding customer deposits)

^Figures from MBSB

**MBSB: Loans, Deposits, Loan/Deposit Ratio**

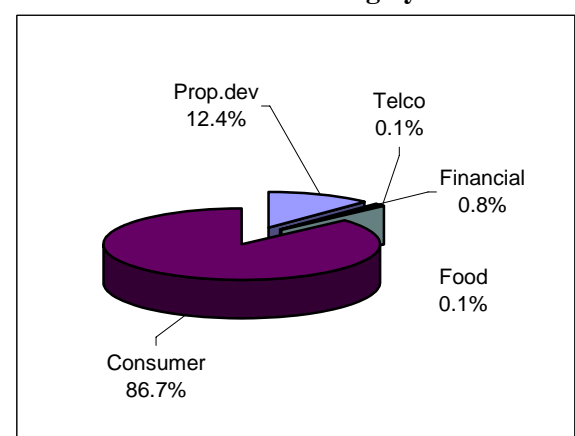
Source: MBSB

\*2011F figures are our estimates

**MBSB: Accumulated Losses & NLIR**

Source: MBSB

\*NLIR = net loan impairment ratio

**MBSB: FY10 Loan Financing by Sectors**

Source: MBSB

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