MILITARY COMMERCIAL JSB (MBB) – EARNINGS UPDATE

Market Price	Target Price	Dividend Yield	Rating	Sector
VND23,100	VND27,700	2.60%	ADD	FINANCIALS

Outlook – Short term

Negative Neutral Positive

Outlook – Long term

Negative Neutral Positive

Valuation

Negative Neutral Positive

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We reiterate our ADD recommendation for MBB and lift the target price to VND27,700 on the back of higher-than-expected 9M2017 NIM expansion and our belief that the tapering-off of the current provisioning cycle will boost earnings over the next two years.

Continued push into retail lending paid off with a large expansion in net interest margin (NIM). With a high CASA (demand deposit) rate of 36.9%, MBB continues to enjoy a low funding cost while a 27.5% growth in the individual loan book during 9M2017 improved asset yields. A push into the retail segment resulted in a 58bps hike in NIM compared to full-year 2016. We expect NIM to continue trending-up in the coming years as retail lending will remain the main growth engine.

Sound performance in 9M2017 accelerated bad debt provisioning. MBB actively provisioned for VAMC bonds (bonds received from sales of bad debt to Vietnam Asset Management Company) over 9M2017 to speed up VAMC provisioning and will buy back all VAMC bonds in 2018, in line with the plan set out in the 2017 AGM. We estimate that 77% of outstanding VAMC bonds will be provisioned for by year-end 2017, thus VAMC provision expense will drop in 2018. As of 3Q2017, the un-provisioned VAMC bonds balance stood at circa VND800bn.

High profit growth forecasted for 2018 and 2019 as MBB reaches the end of the current provisioning cycle. Although we modelled for more provisioning for loans on the balance sheet, a reduction of VAMC provision expense in 2018 and zero VAMC provisioning in 2019 will boost bottom line growth.

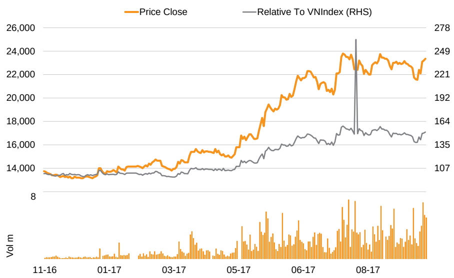
Healthy capital and loan-to-deposit position ensure high loan growth in the coming years. With a capital adequacy ratio (CAR) of 11.4% and a loan-to-deposit ratio (LDR) as per our estimate of 69.3% in 3Q2017, MBB can sustain 18% loan growth in the next two years.

We issue an ADD recommendation for MBB on account of good fundamentals and attractive valuation. At the current price, MBB is trading at a P/B of 1.5x, lower than the peer average of 1.7x. With profit before tax (PBT) growth of 39.3% and 28.8% forecasted for 2017 and 2018, forward P/B are only 1.5x and 1.3x, respectively. We increase our target price to VND27,700, implying a total stock return of 22.5%.

Financial summary (VND)	12-15A	12-16A	12-17E	12-18E
Net interest income (bn)	7,319	7,979	10,753	12,440
Net interest margin	3.7%	3.5%	4.2%	4.3%
Total operating income (bn)	8,772	9,855	13,478	15,516
Total provision charges (bn)	(2,102)	(2,030)	(2,868)	(2,450)
Net profit (bn)	2,496	2,912	3,990	5,140
Net profit growth	0.8%	16.7%	37.0%	28.8%
Adjusted EPS	1,395	1,390	1,877	2,406
BVPS	12,808	14,097	15,690	17,921
ROAE	12.7%	12.1%	14.8%	16.8%

Source: VNDIRECT

Price performance



Source: VNDIRECT

Key statistics

52w high (VND)	23,800
52w low (VND)	12,010
3m Avg daily volume (shares)	3.56mn
3m Avg daily value (VNDmn)	79,273
Market cap (VNDbn)	41,938
Outstanding shares (m)	1,816
Free float (%)	20

Ownership

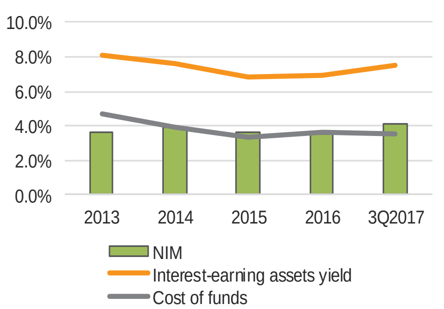
Viettel	14.75%
SCIC	9.83%
Vietnam Helicopter Corporation	7.84%
Tan Cang Saigon	7.52%
Vietcombank	6.97%
Others	53.09%

Source: VNDIRECT

9M2017 RESULTS: ROBUST PROFIT GROWTH SPEEDS UP BAD DEBT CLEARANCE

9M2017 posted the strongest bottom line growth on record since listing in 2011. Strong growth was observed across all major business activities: net interest income was up by 40.0% YoY, net fee income jumped by 2.3 times and other income was up by 55.2% YoY. The surge in fee income was driven by insurance income from Military Insurance Company (MIC). MIC became a subsidiary of MBB in 1Q2017 after MBB increased its stake in MIC from 49.8% to 69.6%, therefore, income from MIC was consolidated into the bank's financial statements. On a pro-forma basis (assuming consolidation of MIC results in 2016), net fee income growth was still strong at 48.2% YoY. Within other income, higher income from foreign currency trading and higher bad debt recoveries boosted growth.

Figure 1: Movement of NIM

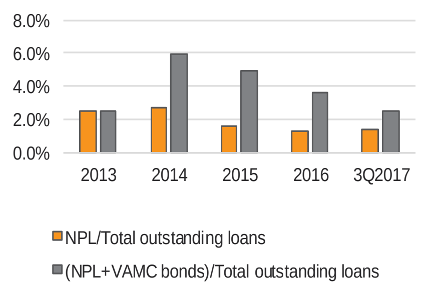


Source: VNDIRECT

A 64bps increase in NIM versus 9M2016 bolstered net interest income. The expansion of retail lending and the bank's strategy to increase lending rates helped NIM increase from 3.52% in 9M2016 to 4.16% in 9M2017. The weight of individual loans in the total loan book was 28.7% in 3Q2016 and 32.6% in 3Q2017. The loan book grew 16.9% YTD compared to 20.0% in the same period last year. Deposit growth reached 8.6%, higher than 2.9% in the comparable period last year. As loan growth slowed down and deposit growth picked-up, NIM expansion was the only real driver of net interest income growth.

Non-performing loans (NPL) ratio was kept at the same level as year-end 2016 by using loan write-offs. 3Q2017 NPL stood at 1.3%, same as year-end 2016. MBB was able to keep NPL at this level by writing-off VND1,024bn of bad debt over 9M2017, compared to just VND252bn in 9M2016. Current write-off rate is at 0.6% of the average loan book, equal to the write-off rate in full year 2016, because most of the loan write-offs in 2016 were pushed into the last quarter. We note that MBB started to write-off bad debt earlier this year versus last year and that the write-off rate for the full year could be slightly higher than 2016.

Figure 2: Movement of problem assets



Source: VNDIRECT

Robust profit growth despite a jump in provision expense. Provision expense surged by 71.1% YoY due to higher specific provisions and VAMC provisions. Specific provisions booked in 9M2017 doubled the figure seen in 9M2016, as MBB booked more provisions to write-off bad debts. VAMC provisions was also ramped up because MBB plans to buy back all VAMC bonds in 2018, and we consider this plan feasible. 9M2017 PBT and PAT still rose by 43.5% and 39.7% YoY, respectively, with the former fulfilling 88% of the 2017 PBT target.

2017 & 2018 FORECAST: NIM EXPANSION AND A DROP IN PROVISION EXPENSE TO HELP SUSTAIN STRONG GROWTH

Loan growth: High loan growth in 9M2017 prompted us to increase our loan growth assumption for 2017 from 18% to 20%. Given a healthy CAR and LDR, we forecasted MBB will maintain 18% loan growth in 2018.

Deposit growth: After subdued deposit growth in 2016, MBB improved deposit growth in 9M2017 to maintain a healthy LDR. We adjusted the deposit growth assumption for 2017 and 2018 to 13% from the previous forecasts of 10% and 12%, respectively.

NIM: NIM expansion beat our expectation, as a result, we increased the forecasted NIM to 4.2% (+60bps versus previous forecast) for 2017 and 4.3% (+65bps versus previous forecast) for 2018.

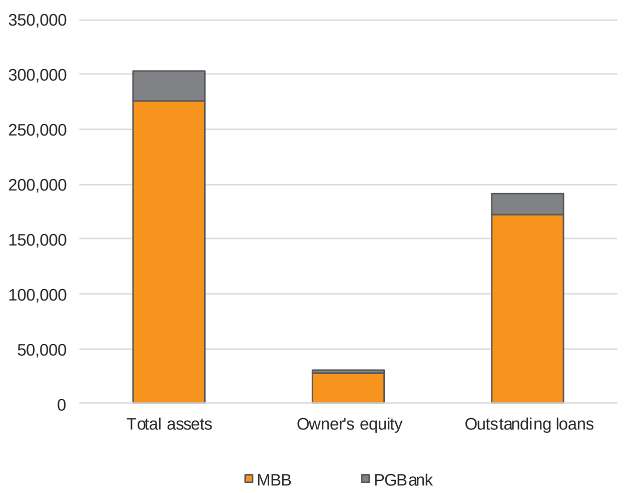
CIR: We revised upward our CIR assumption for 2017 from 40% to 41% as in 3Q2017 CIR reached 40.7%. In 2018, we forecast that CIR will increase to 42% due to expenses related to retail activities.

A drop in provision expense in 2018 will boost profit growth. We forecast that MBB will book VND1,200bn provision for VAMC bonds in 2017. In 2018, the bank will need to book circa VND560bn to fully provision for VAMC bonds. Provision expense is forecasted to fall by 14.6% in 2018 and 20.5% in 2019, leading to PBT growth of 28.8% and 25.3%, respectively.

MBB IS CONSIDERING A MERGER WITH PGBANK

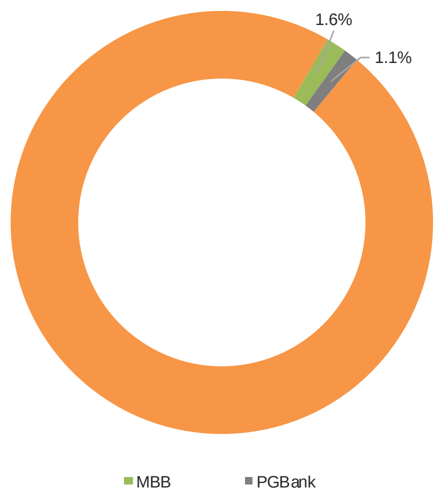
MBB is considering a merger with PGBank and is in the early stages of exploring this deal. In May 2015, VietinBank (CTG) and PGBank signed a merger agreement, but until now the merger has not gone through due to pricing issues. As the merger between CTG and PGBank seems to have fallen through, MBB is considering the possibility of merging with PGBank.

Figure 3: Size comparison between MBB and PGBank (VND bn)



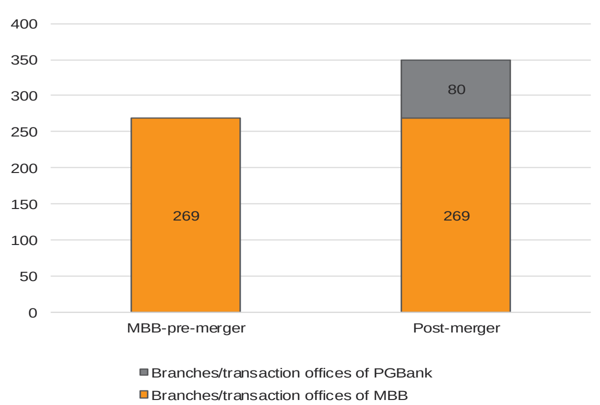
Source: VNDIRECT

Figure 4: (NPL + un-provisioned VAMC bonds)/Combined loan book



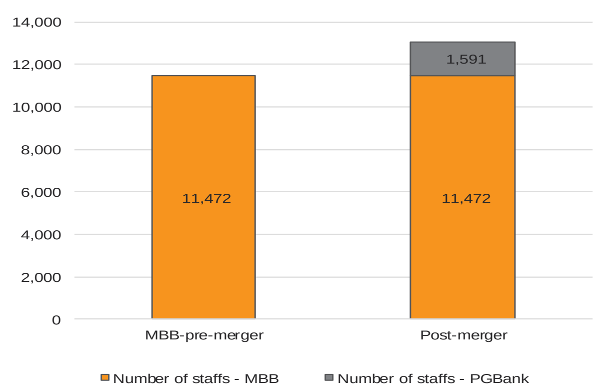
Source: VNDIRECT

Figure 5: Number of branches/transaction offices



Source: VNDIRECT

Figure 6: Number of staffs



Source: VNDIRECT

PGBank has low profitability due to bad debt-related expense. PGBank is a small bank with among the smallest total asset base in the banking sector. The bank had asset quality issues in the past with NPL ratio rising to 8.4% in 2012 while profitability was low with 8.3% ROE. During the past few years, the bank has maintained subtle credit growth but focused more on bad debt management and provisioning. NPL ratio was reduced to 2.5% in 2Q2017 by using loan write-offs and debt sales to VAMC (total NPL and un-provisioned VAMC bonds was at 11.3% of total outstanding loans). ROE declined to 4.2% in 2Q2017 due to the provision burden for legacy bad debts.

The merger will help MBB expand its network and will not have a serious impact on MBB. Although PGBank has a NPL issue, its size is small relative to MBB. Total assets are only 10% that of MBB's; NPL is 0.3% and NPL plus un-provisioned VAMC bonds is 1.1% of the outstanding loans of the two banks combined. Given the high profitability at MBB and the completion of VAMC bonds provisioning in 2018, we feel that the merger with PGBank will not significantly impact MBB. The merger with PGBank will help MBB to grow its network and customer base, which is important in pursuing its retail banking expansion strategy. Opening new branches/transaction offices are costly and there are regulatory restrictions, therefore, a merger could be a faster way to expand the network. MBB just started due diligence on PGBank and it will be a lengthy process until the final decision is made. Given the uncertainty in the time being, we have not included the merger in our model and current valuation, but we will keep a close watch on any announcements related to the planned merger.

VALUATION

We use residual income and P/B multiples approach for valuation, with the weight of each approach being 70% and 30%, respectively. Residual income approach is based on the forecasted earnings and growth of MBB, and factors in bank's current capital buffer and its business strategy. On the other hand, P/B multiples approach allows us value MBB relative to other banks and factors in over market sentiment on the banking sector. However, each bank has different dynamics and earnings prospects and, therefore, we only give a 30% weighting to this valuation approach. For that reason, we assign a higher weight for the residual income approach in our valuation.

Figure 7: Valuation

Approach	Weight	Fair value	Contribution
Residual income	70%	27,249	19,075
P/B multiple (at 1.6x)	30%	28,674	8,602
Target price			**27,677**

Source: VNDIRECT

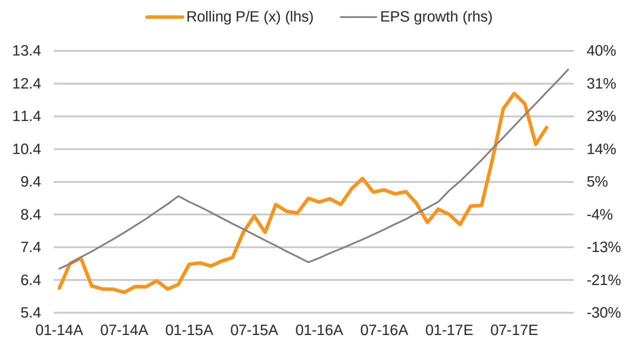
MBB is trading at discount to peers despite better profitability. We think that MBB should be trading at least in line with peers given high ROE, good asset quality and healthy capital buffer. For the P/B multiples approach, we have a target P/B of 1.6x on 2018 book value per share. Combining the P/B multiple approach and residual income approach, we get a target price of VND27,700. At our target price, 2017 and 2018 forward P/B are 1.8x and 1.5x, respectively.

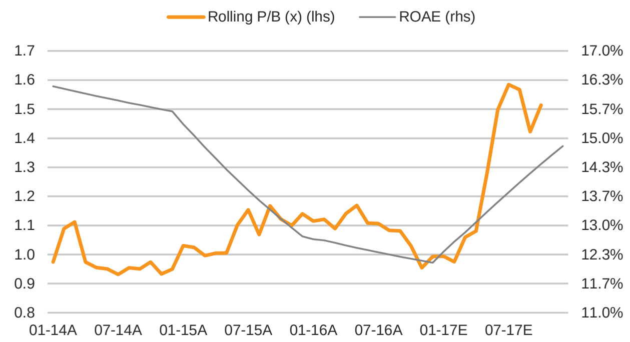
Figure 8: Bank multiples comparison

Banks	Market cap (VND bn)	ROE %	ROA %	P/B	P/E	2017E P/B	2017E P/E	2018E P/B	2018E P/E
VCB	157,582	15.8%	1.0%	2.9	22.7	3.0	22.4	2.7	18.5
BID	81,878	12.5%	0.5%	1.9	14.5	1.7	17.1	1.6	17.9
CTG	77,819	12.3%	0.7%	1.3	10.4	1.2	12.9	1.1	13.2
ACB	31,746	12.6%	0.7%	2.1	17.1	2.0	18.1	1.8	11.7
Average	*87,256*	*13.3%*	*0.7%*	*2.0*	*16.2*	*2.0*	*17.6*	*1.8*	*15.3*
Average-ex VCB	***63,814***	***12.4%***	***0.7%***	***1.7***	***14.0***	***1.6***	***16.0***	***1.5***	***14.2***
MBB	**41,938**	**13.8%**	**1.4%**	**1.5**	**10.8**	**1.5**	**10.6**	**1.3**	**8.3**

Source: VNDIRECT, Bloomberg

Valuation





Income statement

(VNDbn)	12-16A	12-17E	12-18E
Net interest income	**7,979**	**10,753**	**12,440**
Non interest income	**1,876**	**2,724**	**3,076**
Total operating income	**9,855**	**13,478**	**15,516**
Total operating costs	(4,175)	(5,526)	(6,517)
Pre-provision operating profit	**5,681**	**7,952**	**8,999**
Total provision charges	**(2,030)**	**(2,868)**	**(2,450)**
Income from associates & JVs			
Net other income			
Pre-tax profit	**3,651**	**5,084**	**6,549**
Taxation	(767)	(1,068)	(1,376)
Profit after tax	**2,884**	**4,016**	**5,173**
Minority interests	28	(26)	(33)
Net profit	**2,912**	**3,990**	**5,140**

	12-16A	12-17E	12-18E
Growth rate (yoy)			
Cust deposit growth	7.3%	13.0%	13.0%
Gross cust loan growth	24.2%	20.0%	18.0%
Net interest income growth	9.0%	34.8%	15.7%
Pre provision operating profit growth	6.7%	40.0%	13.2%
Net profit growth	16.7%	37.0%	28.8%
Growth in IEAs	16.2%	12.6%	12.2%
Share value			
Basic EPS (VND)	1,635	2,208	2,831
BVPS (VND)	14,097	15,690	17,921
DPS (VND)	600	600	600
EPS growth	(0.4%)	35.1%	28.2%

Balance sheet

(VNDbn)	12-16A	12-17E	12-18E
Gross loans to customers	150,738	180,885	213,445
Loans to banks			
Total gross loans	**150,738**	**180,885**	**213,445**
Securities - total	55,833	56,112	56,673
Other interest earning assets	37,009	37,194	37,566
Total gross IEAs	**243,579**	**274,191**	**307,683**
Total provisions	**(3,671)**	**(4,004)**	**(4,540)**
Net loans to customers	**148,687**	**178,511**	**210,550**
Total net IEAs	**239,908**	**270,187**	**303,144**
Cash and deposits	1,520	1,611	1,740
Total investments	991	1,051	1,135
Other assets	13,839	14,669	15,843
Total non-IEAs	**16,351**	**17,332**	**18,718**
Total assets	**256,259**	**287,519**	**321,862**
Customer deposits	194,812	220,138	248,756
Cds outstanding	2,367	4,367	6,367
Customer interest-bearing liabilities	197,179	224,505	255,123
Bank deposits	0	0	0
Broad deposits	197,179	224,505	255,123
Other interest-bearing liabilities	24,971	24,976	24,982
Total IBLs	**222,151**	**249,481**	**280,104**
Deferred tax liability			
Other non-interest bearing liabilities	7,520	8,242	7,911
Total non-IBLs	**7,520**	**8,242**	**7,911**
Total liabilities	**229,670**	**257,723**	**288,015**
Share capital	17,127	18,155	18,155
Additional paid-in capital	0	0	0
Treasury shares			
Retained earnings reserve	4,699	6,805	10,855
Other reserves	3,525	3,525	3,525
Shareholders' equity	**25,352**	**28,485**	**32,536**
Minority interests	1,236	1,311	1,311
Total equity	**26,588**	**29,796**	**33,846**
Total liabilities & equity	**256,259**	**287,519**	**321,862**

Key ratios

	12-16A	12-17E	12-18E
Net interest margin	3.5%	4.2%	4.3%
Cost-income ratio	(42.4%)	(41.0%)	(42.0%)
Reported NPLs / gross cust loans	1.3%	1.2%	1.1%
Reported NPLs / net cust loans	1.3%	1.2%	1.1%
GP charge / average cust loans	1.5%	1.7%	1.2%
Total CAR	12.5%	11.9%	11.2%
Loan deposit ratio	76.4%	80.6%	83.7%
Margins and spreads			
Return on IEAs	6.9%	7.5%	7.7%
Cost of funds	3.6%	3.6%	3.7%
Interest return on average assets	3.3%	4.0%	4.1%
ROAE	12.1%	14.8%	16.8%

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Hold	The stock's total return is expected to be between negative 10% and positive 15% over the next 12 months.
Reduce	The stock's total return is expected to fall below negative 10% over the next 12 months.

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Overweight	An Overweight rating means stocks in the sector have, on a market cap-weighted basis, a positive absolute recommendation.
Neutral	A Neutral rating means stocks in the sector have, on a market cap-weighted basis, a neutral absolute recommendation.
Underweight	An Underweight rating means stocks in the sector have, on a market cap-weighted basis, a negative absolute recommendation.

Country Ratings	Definition:
Overweight	An Overweight rating means investors should be positioned with an above-market weight in this country relative to benchmark.
Neutral	A Neutral rating means investors should be positioned with a neutral weight in this country relative to benchmark.
Underweight	An Underweight rating means investors should be positioned with a below-market weight in this country relative to benchmark.

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