

SECURITY BANK CORPORATION

Recommendation: BUY (48% upside)



By: Team B-company



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KEY HIGHLIGHTS

Being one of the biggest banks in the Philippines, Security Bank Corporation is poised to grow with the country's economy and leverage on the developments in the banking sector. With the implementation of the Philippine government's "Build Build Build" program, a myriad of opportunities for the banking sector's growth has been made available.

Posting a double-digit growth in 2017, Security Bank's financials remain one of the strongest fundamentals among its peers. However, despite these growth prospects, the bank's share price dipped with the recent decline of the Philippine Stock Exchange Index. Nevertheless, valuations remain attractive for Security Bank, which ultimately provides a higher potential for upsides considering the recent dip in pricing. From a fundamental point of view, Security Bank's current pricing provides its investors an opportunity to partake in the both the industry's as well as the company's potential for growth.

Specifically, among the five (5) publicly listed banks in Philippines with market capitalization of more than One Hundred Billion Philippine Pesos (Php100,000,000,000+) (the "Comparables"), Security Bank has registered a 12.9% growth in its gross loans. For Fiscal Year 2017, its gross loans comprised of 88.9% of its deposit liabilities, and it also registered a deposit growth rate of 19.2% -- the highest among its Comparables. This shows that the bank is well placed to grow organically, as it is funding its loan portfolio from deposit liabilities.

Further, Security Bank's non-performing loans consist of only 0.712% of its total loans, which is the lowest among the five (5) screened banks. The one- (1) year growth rate of non-performing loans for Security Bank is at 8.21%, which is at the lowest among its Comparables.

The better quality of earnings coupled with a strong growth in deposit and loans makes Security Bank's shares of stock attractive for fund managers looking for stable and mid- to long- term capital appreciation.

BACKGROUND

As disclosed in the latest Security Bank Corporation (PSE:SECB) *Annual Report*,¹ the company is a publicly listed Philippine universal bank which serves wholesale and retail clients. Established in 1951, Security Bank has, for over 65 years, remained steadfast in its focus and commitment to serve its clients and stakeholders with distinction. Its headquarters are located at the Security Bank Centre, 6776 Ayala Avenue, Makati City, Metro Manila, Philippines.

Security Bank ranked as the 5th largest in total assets and in capital (P757 billion and P105 billion, respectively) and 5th largest in market capitalization among listed private domestic universal banks in the Philippines. In terms of financial results, Security Bank ranks 8th in return on shareholders' equity and 4th in asset quality (having the lowest NPL ratio). The Bank's strategy, execution and results are guided by its strong focus on shareholder value.

Security Bank's major businesses include wholesale banking, financial markets and retail banking. It is among the leading local players in government fixed income securities distribution, capital markets services, foreign exchange and derivatives products distribution, equities brokerage, and cash management. Security Bank continues to grow its consumer finance business. The Security Bank group has a total of 302 branches all over the country as of year-end 2017, growing by 12 additional branches.

The Group's operating businesses are recognized and managed separately according to the nature of services provided and the different markets served with each segment representing a strategic business unit. The Bank's principal business activities are organized as follows: Financial Markets Segment, Wholesale Banking Segment, Retail Banking Segment, and All Other Segments.

Financial Markets Segment - this segment focuses on providing money market, foreign exchange, financial derivatives, securities distribution, asset management, trust and fiduciary services, as well as the management of the funding operations for the Group.

¹ See Security Bank Corporation's SEC Form 17-A dated 12 April 2018.

The Financial Markets segment represents 35% of the Group's 2017 total revenue.

Wholesale Banking Segment - this segment addresses the top 1,000 corporate, institutional, and public sector markets. Services include relationship management, lending and other credit facilities, trade, cash management, deposit-taking and leasing services provided by the Group. It also provides structured financing and advisory services relating to debt and equity capital raising, project financing, and mergers and acquisitions. The Group's equity brokerage operations are also part of this segment.

The Wholesale Banking segment constitutes 30% of total revenues in 2017.

Retail Banking Segment - this segment addresses the individual, retail, small-and-medium enterprise and middle markets. It covers deposit-taking and servicing, commercial and consumer loans, credit card facilities and bancassurance.

The Retail Banking Segment makes up 25% of the Group's total revenue in 2017.

All Other Segments - this segment includes but not limited to branch banking and other support services. Other operations of the Group comprise the operations and financial control groups.

All Other Segments make up 10% of the Group's total revenue in 2017.

INVESTMENT THESIS

Economic Backdrop for the Banking Industry

The Philippines has been growing consistently at an average of 6.54%² over the past three (3) years and is still poised to grow further over the coming years. Because of this, the local banking sector has been growing profitably over the past years primarily due to the mentioned economic growth, better regulations in the sector by the central bank and push for increased capital.³

In terms of the market trends in the behavior of both political direction and credit ratings, these have also been favorable for a growth environment in the banking sector. In terms of the political direction, part of the administration's plans is the "Build, Build, Build" campaign which is set to improve the current infrastructures through high impact projects in the hopes to have better reforms for the economy. Through higher capital expenditures needed, this would have a significant contribution to the growth of loan revenues for the bank sector. Alongside this would be the improvement of the overall household income per capita as well as rising investor interests,⁴ which are spurring sustainable growth for both the banking sector and the country.

Looking at the consumer tendencies as well, the country's sovereign credit has improved for both Fitch ratings of "BBB-" to "BBB" (which signals a rating of stability) and for S&P ratings of "BBB" to "Baa2" (signaling a positive outlook).⁵ This is coupled with an improvement in the credit default rates in the Philippines at an all-time low of four percent (4%) with thirty- (30) day past due.⁶ The recent trends

² Available at https://ycharts.com/indicators/philippines_gdp_growth (last accessed Nov. 04, 2018).

³ *The Report: The Philippines 2017*, OXFORD BUSINESS GROUP (2017) <https://oxfordbusinessgroup.com/philippines-2017/banking>

⁴ *Economic Briefing in London showcases PH economic growth, infrastructure opportunities*, BANGKO SENTRAL NG PILIPINAS (Sept. 26, 2018) <http://www.bsp.gov.ph/publications/media.asp?id=4819>

⁵ *Id.*

⁶ Lawrence Agcaoili, *Credit scorer sees default remaining low in Philippines*, THE PHILIPPINE STAR (Jul. 10, 2018, 12:00AM) <https://www.philstar.com/business/banking/2018/07/10/1832031/credit-scorer-sees-default-remaining-low-philippines>

also show more than twenty percent (20%) increase in total limits extended, marking a highly competitive banking environment that benefit the consumers. Therefore, the banking sector in the Philippines has a growth potential with good promise especially amidst the rising economic performance moving forward.

Security Bank Stock Performance

Over the past three (3) years, Security Bank has been growing both as a business and in terms of its stock value. They have entered the last quarter of 2017 at an all-time high of Php266.80 per share, which is a far price difference from its price three years ago of only Php141.90 per share. However, during the recent dip of the Philippine Stock Exchange Index, the market value of Security Bank has reached an all-time low of Php139.20 over the last three years. This means that the stock is at a really low price and a large potential upside is projected to occur for Security Bank. Below diagram illustrates the historical stock price for movements for Security Bank:



[Figure 1: Stock Price of Security Bank over three years]⁷

Fundamental Analysis

The next steps would then to determine the financial state of Security Bank to justify that the dip of the stock price is primarily due to the downturn of the whole

⁷ Available at
<https://www.capitaliq.com/CIQDotNet/Charting4/ModernBuilder.aspx?fromC3=1&fromC2=1> (last accessed Nov. 04, 2018).

stock market and not because the company has fundamental concerns within its company. To get a better means of comparing ratios with other companies, we have considered the following metrics to help illustrate where Security Bank is relative to its peers:

| Fundamental Analysis with Comparable Banks | | | | | | | | |
|--|-------------------------------|-------------------------------------|------------------------------------|----------------------------|----------------------------------|---------------------|-------------------------|-------------------------|
| Banks | Revenue Growth (3-yr CAGR) | Net Profit Margin (3-yr Average) | Net Interest Income (3-yr CAGR) | Gross Loans (3-yr CAGR) | Net Income Growth (3-yr CAGR) | Total Capital Ratio | ROA % (3-yr Average) | ROE % (3-yr Average) |
| Security Bank | 15.64% | 42.27% | 20.28% | 14.78% | 12.74% | 18.46% | 1.34% | 14.23% |
| BDO | 17.42% | 25.91% | 16.86% | 16.93% | 7.17% | 13.93% | 1.14% | 11.31% |
| BPI | 8.19% | 32.19% | 11.34% | 8.30% | 7.51% | 17.30% | 1.22% | 12.43% |
| Metrobank | 2.75% | 29.30% | 10.20% | 3.71% | -3.24% | -- | 0.97% | 8.96% |
| Chinabank | 0.17% | 33.86% | 11.68% | 0.72% | 13.66% | 13.32% | 1.03% | 9.55% |
| RCBC | 5.62% | 20.85% | 6.39% | 4.41% | -0.78% | 14.52% | 0.84% | 7.16% |
| Unionbank | 5.86% | 36.80% | 17.83% | 6.63% | 0.04% | 13.40% | 1.54% | 12.12% |
| Average of Comps | 6.67% | 29.82% | 12.38% | 6.78% | 4.06% | 14.49% | 1.12% | 10.26% |

[Figure 2: Table of Financial Ratios of comparable Philippine Banks]⁶

From the analysis of the financial indicators, Security Bank ranks way above the average of its comparable companies. Apart from this, it ranks either first or second among its peers across all its comparable criteria.

Looking closer at the quantitative analyses, it has a high revenue growth rate at a double-digit growth – second only to BDO – meaning that it is still at an upward trajectory as a company. Security Bank also has the highest net profit margins relative to its counterparts, resulting to a double-digit growth in net income as well – second only to Chinabank. Apart from this, both revenue streams of net interest income and gross loan growths are the first and second respectively in terms of their growth rate relative to its peers. This means that since Security Bank is growing a lot faster than the industry average, they are able to capture a larger market share which is more than double the industry growth rate. Their total capital ratio is likewise the highest among all their peers, meaning they are able to fulfill their covenants better. Finally, in looking at the forward-looking growth rates, both their ROA and ROE's are a lot higher relative to the industry average. Therefore, not only is Security Bank consistent in its financial performance, but they are performing a lot better than its competitors by a huge margin.

Comparable Valuation

Upon comparing the multiples, we have chosen to get the average of all the banks as well as the average for the top three (3) banks for both the Price / Tangible Book

Value multiple and the P/E multiple. This is because with the current trajectory of Security Bank and increasing market share, it is poised to become a big player over the next few years and would merit potential upside to that extent. From here, we can create two (2) pairs of valuation multiples that can be used as basis:

| Valuation Multiples | | |
|------------------------|---------|-------|
| Banks | P/TangB | P/E |
| Security Bank | 1.00 | 11.27 |
| BDO | 1.80 | 18.50 |
| BPI | 1.50 | 15.90 |
| Metrobank | 1.00 | 11.20 |
| Chinabank | 1.00 | 10.50 |
| Unionbank | 1.10 | 8.10 |
| Average of all Banks | 1.28 | 12.84 |
| Average of Top 3 Banks | 1.43 | 15.20 |

[Figure 3: Comparison of Multiples]⁸

From here, assuming that the P/B and P/E ratios are to be retained moving forward, the book value/share and EPS are incorporated with their respective growth rates to illustrate the future value. These are then incorporated with the average multiples to get a series of ranges of potential stock price projections:

| Projected Upside | | |
|-----------------------------------|------------------|-------------------|
| | BV/Share | EPS |
| Current Values | 139.20 | 12.35 |
| | ROE | Net Income (CAGR) |
| Growth Rates | 14.23% | 12.74% |
| | Forward BV/Share | Forward EPS |
| Projected Values | 159.01 | 13.92 |
| Projected Price (Low - All Banks) | 203.53 | 178.77 |
| Projected Price (High - Top 3) | 227.92 | 211.63 |
| Projected Average | 205.46 | |

[Figure 4: Projected Upsides]

⁸ Available <https://www.capitaliq.com/CIQDotNet/Charting4/ModernBuilder.aspx?fromC3=1&fromC2=1> (last accessed Nov. 04, 2018). at

Given the foregoing, all the projected prices are a lot higher than the current stock price of Security Bank as of the moment. This simply shows that with the range of Php178.77 to Php227.92, this is a potential 28.43% to 63.73% upside of the price, taking an average of about Php205.46 with a 48% projected upside. This is deemed to be achievable as well especially since Security Bank was trading within the range of Php210.00 to Php240.00 before the downtrend occurred.

All told, we strongly recommend the purchase of this stock due to its sound fundamental indicators and its large potential upside.