PhilRatings
PHILIPPINE RATING SERVICES CORPORATION

RATING REPORT

PHILIPPINE SAVINGS BANK

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Issuer Rating: PRS Aaa (corp.)

RATIONALE

The issuer credit rating for Philippine Savings Bank (PSBank) takes into consideration the following rating factors:

- Solid market position, underpinned by a well-defined growth strategy;
- Continued growth in core interest income, attributable to loan portfolio expansion;
- Expectations that funding profile will continue to improve, supported by increased levels of current and savings deposits; and
- Favorable outlook for domestic consumer credit.

PSBank is considered a significant player in the domestic consumer market, with bulk of its loans portfolio represented by consumer loans, as of end-2016. PSBank believes that its auto loans portfolio, which accounted for a significant portion of total consumer loans as of end-2016, still has ample room for growth, taking into account the bank's current share of the auto loans market. PSBank forecasts that its consumer loan portfolio will continue to post double-digit growth in 2017.

PSBank's solid market position is expected to receive strong support from its well-defined strategy; in particular, the bank's continued focus on customer experience and digitalization of products, channels and processes. While PSBank continues to target the retail deposit and consumer lending needs of the upper- and middle-markets, the bank's recent product and service offerings to these markets, however, have become more technology-based. This strategy is expected to bolster the bank's competitive position by satisfying clients' increasing demand for more control and speed, while also integrating efficiencies in its operations.

In line with the expansion of the bank's loan portfolio, interest income has been posting double-digit growth in the last three years (2014-2016), and with an average share of 76.3% in operating income. Net interest income significantly increased by 16.5% to P7.0 billion in the first half of 2017 (1H2017), largely attributable to higher interest revenues on loans and receivables. Share of net interest income to operating income was 80.6%. Interest income, which is a more stable and recurring revenue source, will continue to drive operating income growth.

PSBank's funding base predominantly consisted of customer deposits, based on its high deposits to liabilities ratio of 93.1% as of June 30, 2017. Share of current and savings accounts (CASA) to total deposits has been increasing for the last three years, from 25.0% in 2014 to 26.6% in 2015, and to 26.9% in 2016. CASA is considered as more stable and less expensive, compared to time deposits. While the share of CASA to total deposits dipped to 25.2% as of June 30, 2017 due to the bank's issuance of long-term negotiable certificate of time deposit (LTNCTD), projections show that the share of CASA will continue to increase.

The overall outlook for consumer lending is positive, driven by auto lending, card lending, and mortgages/housing. Factors which are expected to contribute positively to consumer lending include the Philippines' sustained economic growth, its stable banking system, and a demographic profile which suggests a strong retail market over the long-term.

The impact of the new tax reforms package contained in the proposed Tax Reform for Acceleration and Inclusion (TRAIN), also known as the Comprehensive Tax Reform Package (CTRP), on consumer lending has yet to be determined, as legislative work on the reforms remains ongoing. In summary, the package reduces personal income tax (PIT); simplifies estate and donor's taxes; expands the value-added tax (VAT); and increases oil and automobile excise taxes.

The reduction of PIT (by simplifying the country's personal income tax system) is seen to benefit consumer lending, as lower income tax rates translate to larger disposable incomes and consequently, increased spending power on the part of consumers. Oil and automobile prices, however, are expected to go up due to higher excise tax on these items. Nevertheless, the Department of Finance (DOF) claims that mass-market cars will remain affordable despite the proposed automobile excise tax increase, as cuts in PIT offset the slight price markups in these types of cars. The DOF also claims that the impact of higher oil prices, due to staggered increases in the excise tax rates on oil, will be manageable for consumers, with future inflation levels likely to remain stable.

PROFILE

Based on latest available data from the Bangko Sentral ng Pilipinas (BSP), Philippine Savings Bank (PSBank) was the Philippines' second largest thrift bank based on assets, as of March 31, 2017. While it is licensed as a savings and mortgage bank, PSBank's asset size ranks alongside the country's domestic mid-size universal banks (unibanks). PSBank offers a wide range of products and services such as deposits, loans, treasury and trust.

Among its peers in the thrift banking sector, BPI Family Savings Bank (BPI Family) is considered as PSBank's closest competitor, given similarities in both banks' business profiles. BPI Family is the Philippines' largest thrift bank, with assets of P276.9 billion as of March 31, 2017.

Below is a comparative table of BPI Family and PSBank, based on their published Statements of Condition as of December 31, 2016 and March 31, 2017.

	December 31, 2016		March 31, 2017	
	BPI Family	PSBank	BPI Family	PSBank
(P Billion)				
Assets	270.1	196.3	276.9	204.6
Loans and Receivables (Net)	205.6	128.0	207.0	130.6
Deposit Liabilities	238.9	158.4	244.0	170.3
Stockholders' Equity	25.6	18.8	26.8	19.3
(%)				
Share of Thrift Banking Sector Assets	25.07	18.22	25.08	18.54
Share of Thrift Banking Sector Loans & Receivables (Net)	27.37	17.04	27.09	17.09
Share of Thrift Banking Sector Deposits	27.36	18.15	27.11	18.92
Ratio of Net NPLs to Gross Total Loan Portfolio	1.35	1.06	1.42	1.12
Capital Adequacy Ratio (Solo Basis)	15.03	14.06	15.89	14.00
Return on Equity	16.61	12.69	19.01	10.39

Taking into account its more recent published Statement of Condition, PSBank accounted for 19.1% of thrift banking assets, 17.1% of loans, and 19.7% of deposits, as of June 30, 2017. PSBank is strong in the consumer market, where it has a very solid franchise. A significant portion of PSBank's loan portfolio was represented by consumer loans, as of end-2016. As of end-2016, the bank's consumer loans portfolio was comprised largely of auto loans. Mortgage loans had the second largest share of the bank's portfolio, as of end-2016.

PSBank expects the higher excise tax on automobiles proposed in the CTRP to have minimal impact on its loan portfolio. Management disclosed that bulk of its car financing covers low- to mid-priced automobiles, the prices of which are expected to post lower rates of increase (compared with rates of increase for prices of high-end luxury automobiles) under the CTRP. With its current share of the auto loans market, PSBank believes there is still ample room for growth in the bank's auto loans business. On a positive note, management expects the CTRP's simplified PIT system to result in higher disposable incomes, which will further encourage consumption activities in its market (Refer to Section on Outlook for Consumer Lending for more details on the CTRP).

With its Head Office located in Makati City, PSBank had an extensive distribution network of 250 branches and 608 ATMs. Of the bank's 250 branches, 113 are in Metro Manila. In the last few years, PSBank has been aggressively using digital technology to increase its market presence, making itself available in channels and platforms that are accessible and convenient to its customers.

PSBank's relationship with its labor union is viewed as harmonious, with the bank's current Collective Bargaining Agreement (CBA) covering the period January 1, 2016 to December 31, 2018. The Bank ended 2016 with manpower complement of 3,117. By end 2017, manpower complement is projected to slightly increase to 3,183 (57 senior officers, 1,096 junior officers, and 2,030 staff).

OWNERSHIP AND LEGAL STATUS

Ownership and control of PSBank is with Metropolitan Bank and Trust Co. (Metrobank). As of June 30, 2017, Metrobank had an ownership share of 82.7% in PSBank. Arthur V. Ty, Metrobank Chairman, is Vice Chairman of PSBank since 2001. PSBank management is led by Vicente R. Cuna Jr., who is President since 2013. Mr. Cuna is also Director of Metrobank. Jose T. Pardo is Chairman of PSBank since 2003, and is an Independent Director of the bank since 2007. Similar to other Philippine financial conglomerates, PSBank has common directors and officers with other financial institutions under the Metrobank Group.

Metrobank and PSBank serve distinct core markets, and coordinate on market segmentation. Based on PSBank's disclosure to the Securities and Exchange Commission (SEC), the bank was compliant with BSP regulations regarding lending by banks to directors, owners, shareholders and other related interests (DOSRI regulations), as of June 30, 2017.

Metrobank is one of the leading unibanks in the Philippines, with more than 800 local and international offices and subsidiaries. Metrobank was the country's second largest bank as of June 30, 2017, based on the following: assets, loans, deposits and capital. The bank is majority-owned by the Ty Family, whose major business interests include financial services, real estate development, power and manufacturing. As of report writing date, Metrobank has an investment grade long-term issuer default rating (IDR) of BBB-/Stable from Fitch Ratings.

STRATEGY

PSBank's strategic direction is based on the following: continued focus on customer experience; expansion of core business and customer base to include small and medium enterprises (SMEs); and digitalization of products, channels and processes. The expansion of PSBank's core business and customer base to include SMEs aims to balance the bank's portfolio.

While PSBank continues to focus on the retail deposit and consumer lending needs of the upper- and middle-markets, the bank's recent product and service offerings to these markets, however, have become more technology-based. This strategy is expected to support PSBank's strong competitive position by satisfying clients' increasing demand for more control and speed, while also integrating efficiencies in the bank's operations.

Among PSBank's technology-based products and initiatives that were launched in 2016 were: PSBank social media page (February 2016), PSBank Online Auto Loan Application (POLA, February 2016), PSBank ATM Lock facility (February 2016), PSBank e-Trust (April 2016), and Business Online Buddy (BOB, May 2016).

In June 2017, PSBank's re-designed and fully-loaded mobile app was made available at Google Play and Apple Stores. The app has new functionalities. The new app allows clients to request for money from other users with its PayMe feature; access their accounts using fingerprints via TouchID; and generate a one-time password (OTP) with in-app OTP feature.

PSBank is seen to continue enhancing its online and mobile facilities to keep up with the evolving needs of its markets. Based on expectations that competition in PSBank's chosen markets will continue to be largely technology-driven, keeping a reliable technology infrastructure, therefore, will be a significant factor in bank's the growth strategy, going forward. Also important is maintaining the integrity of PSBank's technology infrastructure, due to technology-related risks arising from various forms of cybercrimes, such as ATM-based theft. Management acknowledges the presence of and has taken active measures against these risks, such as the bank's continued investments for improvement of its technology system, and the creation of a special unit (within PSBank's Management Information Systems or MIS Group) which focuses on technology-related risks.

Outlook for Consumer Lending[1]

The Year 2016 was another very good year for consumer lending in the Philippines. Based on data from the BSP, the Philippine banking system ended 2016 with outstanding consumer loans of P1.3 trillion, and which accounted for a significant 17.6% of the system's total loan portfolio. The amount of outstanding consumer loans as of end-2016 represented an increase of almost 20.0% from 2015.

Demand for new car purchases continued to be robust. Based on the joint report of the Chamber of Automotive Manufacturers of the Philippines, Inc. (CAMPI) and Truck Manufacturers Association (TMA), automotive vehicle sales growth for full year 2016 further accelerated by 24.6% to 359,572 units, faster than the 22.9% expansion recorded in 2015. Sales have been posting double-digit increases for five consecutive years, since 2012. The aggressive promotions/campaigns of retail banks were seen as important factors in the aggressive growth of auto lending. Outstanding auto loans of the banking system stood at P376.4 billion as of end-2016, climbing by 28.3% from end-2015. As of June 30, 2017, outstanding auto loans stood at P416.5 billion.

Mortgages/housing loans continue to record the largest outstanding balance, given their relatively long installment periods. The Philippine banking system ended 2016 with outstanding Real Estate Residential Loans (RREL) of P519.9 billion, representing an annual increase of 17.1%. Outstanding RREL further went up to P549.9 billion, as of June 30, 2017. Primary demand for mortgage/housing loans comes from resident Filipinos, while overseas Filipino workers (OFWs) support secondary demand.

The overall outlook for consumer lending is positive, driven by auto lending, card lending, and mortgages/housing. As of June 30, 2017, outstanding credit card receivables (CRR) of the banking system stood at P210.0 billion. Outstanding CRR posted a 10.1% hike to P197.7 billion, as of end-2016.

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[1]Sources:
http://www.bsp.gov.ph/statistics/statclpbs.asp
http://www.euromonitor.com/consumer-lending-in-the-philippines/report
https://www.pressreader.com/philippines/business-world/20170307/281835758492615
http://primer.com.ph/tips-guides/2017/05/24/comprehensive-tax-reform-program-what-you-need-to-know/
https://www.update.ph/2017/01/more-vehicles-sold-in-2016/12959

Factors which are expected to contribute positively to consumer lending include the country's sustained economic growth, its stable banking system, and a demographic profile which suggests a strong retail market over the long-term. Favorable demographics will allow the country to remain a viable market for retail lending, as the number of Filipinos entering the workforce exceed the number of young and old Filipino dependents. Rising consumer credit comes on top of increased lending for corporates, particularly now that the government is aggressively pursuing its big-ticket infrastructure projects.

The impact of the new tax reforms package contained in the proposed TRAIN, also known as the CTRP, on consumer lending has yet to be determined, as legislative work on the reforms remains ongoing. In summary, the package reduces PIT; simplifies estate and donor's taxes; expands the VAT base; and increases oil and automobile excise taxes.

The reduction of PIT (by simplifying the country's personal income tax system) is seen to benefit consumer lending, as lower income tax rates translate to larger disposable incomes and consequently, increased spending power on the part of consumers. Oil and automobile prices, however, are expected to go up due to higher excise tax on these items. Nevertheless, the DOF claims that mass-market cars will remain affordable despite the proposed automobile excise tax increase, as cuts in PIT offset the slight price markups in these types of cars (see following table). The DOF also claims the impact of higher oil prices, due to staggered increases in excise tax rate on oil, will be manageable for consumers, with future inflation levels likely to remain stable.

Suggested retail price (SRP) of automobiles (in pesos)

Brand and Model	Current SRP	Proposed SRP*	Change in SRP
Toyota Vios 1.3 Base	599,000 [illegible]	611,796 4%	12,796
Mitsubishi Mirage G4 GLS	740,000 [illegible]	775,514 4%	35,514
Toyota Innova 2.0 J	919,000 [illegible]	983,465 24,000 + 40% in excess of 600,000	64,465
Ford Everest Titanium 2.2 4x2	1,739,000 [illegible]	1,985,083 224,000 + 100% in excess of 1.1 million	246,083
Toyota Land Cruiser 4.5 V8	4,455,000 [illegible]	5,360,130 1,224,000 + 200% in excess of 2.1 million	905,130

Proposed SRP was computed as (VAT + excise tax + net manufacturers' price)

ASSET QUALITY

Non-performing assets (NPA) ratio continued to decline in 2016, as loan portfolio expansion and a minimal hike in non-performing loans (NPLs) combined to counterbalance the increase in repossessed assets (investment properties). Investment Properties was up by 15.5% to P3.9 billion, due to the increase in the number of foreclosed mortgaged properties. PhilRatings notes that higher NPAs resulted in a lower coverage ratio as of end-2016, despite the increase in loan loss reserves. PSBank stated that the increase in Investment Properties was in line with the growth of its loan portfolio.

Loans and Receivables went up by 11.7% to P127.2 billion, as the bank's auto and mortgage loans portfolios continued their growth. Auto loans climbed by 14.7% to P68.1 billion, while mortgage loans increased by 8.2% to P43.4 billion. PSBank continued to benefit from the Philippines' consumption-driven economic expansion, albeit there was a noticeable slowdown in Loans and Receivables growth from 18.9% in 2015. Loans and Receivables will continue their growth, albeit at a slower pace, going forward. Reflecting the slower growth in Loans and Receivables was their smaller share in total assets, from 67.2% (2015) to 64.6% (2016). This share further went down to 61.7% as of June 30, 2017. PSBank's non-lending assets, on the other hand, were generally liquid and short-term, as of report writing date.

On a per industry basis, about 60.4% of the bank's loan portfolio was categorized under "Activities of Households as Employer and Undifferentiated Goods and Services Producing Activities of Households for Own Use", as of June 30, 2017. "Real Estate Activities" had the second-largest share of the portfolio, at 29.5%. Other industry categories had portfolio shares of less than 2.0%. While the bank's loan portfolio can be viewed as concentrated based on industry, loan concentration as to borrower is minimal. As of June 30, 2017, PSBank's largest borrower accounted for a very small portion of its portfolio. PhilRatings also positively notes that loans of the bank's top ten borrowers were all current, as of report writing date. About 78.6% of the loan portfolio is secured, bolstering PSBank's credit standing. Chattel and Real Estate accounted for 71.6% and 27.9% of the secured loan portfolio, respectively, as of June 30, 2017.

PROFITABILITY

Audited 2016

Return on average assets (ROAA) slightly went down to 1.3% in 2016 (2015: 1.5%). While net income growth improved to 4.3% in 2016 (from 1.4% in 2015), the growth rate for assets remained faster at 16.3%, as the bank's loan portfolio continued to expand. Operating income went up by 15.5% to P12.5 billion, due to increases in both interest and non-interest revenues.

Net interest income recorded a hike of 13.9% to P9.7 billion, attributable to higher interest revenues from Loans and Receivables. Non-interest income similarly went up by 21.4% to P2.8 billion, due to gains on foreign exchange (P24.0 million), and gains on foreclosure and sale of investment properties (P364.4 million). Net interest income, which is a more stable and recurring source of revenue, continued to account for bulk of operating income, with a share of 77.4%. Expense (ex-provisions) to average assets ratio slightly improved to 4.2% (2015: 4.4%), and indicating that non-interest expense growth remained manageable amid asset expansion.

Interim June 2017

ROAA for 1H2017 was 1.1%, lower from a year ago (1.3%) and relative to the last three years (2014-2016), and also reflecting the almost flat growth in earnings for the period. Net income posted a marginal increase of 2.1% to P1.2 billion, as the 18.9% decline in non-interest income capped operating revenue growth at 7.9% to P6.7 billion. The bank recorded a trading loss of P88.5 million, a reversal from its P511.6 million trading gain in 1H2016.

In contrast, interest income climbed by 16.5% to P7.0 billion, attributed to higher interest revenues on loans and receivables. Also, interest income on investment securities jumped by 30.4% to P869.1 million, due to the bank's higher investment portfolio. Net interest income accounted for 80.6% of operating income in 1H2017.

Expense to average assets ratio was 4.1%, an improvement from 4.4% a year ago. Average assets posted a significant increase of 20.1% to P207.7 billion. Non-interest expense (excluding provisions), on the other hand, went up by 11.8% to P4.3 billion. Compensation and fringe benefits, which had the largest share of non-interest expense (ex-provisions) at 36.8%, posted a modest hike of 3.2% to P1.6 billion.

Projections 2017-2018

No significant changes in PSBank's profitability metrics are expected for the forecast period. Forecast ROAA is within historical levels. Net interest income, particularly interest income on loans and receivables, will continue to drive operating income growth. The share of net interest income to operating income will be 78.5% and 76.2% in 2017 and 2018, respectively.

Expense to average assets ratio will reach a low of 4.0% in 2018, due to the minimal increase in non-interest expense (excluding provisions). Except for Miscellaneous Expenses, all other non-interest expenses are expected to post single-digit hikes in 2018. Provision for Impairment and Credit Losses will go up by in 2018, due to the implementation of Philippine Financial Reporting Standard (PFRS) 9 on January 1, 2018. PFRS 9 marks a fundamental change in the provisioning paradigm for financial institutions (FIs), moving away from the actual, incurred credit loss model to an expected loss approach. Under PFRS 9, FIs must provision for bad loans much earlier.

ASSET-LIABILITY MANAGEMENT

PSBank's funding base predominantly consists of customer deposits, and demonstrates a low reliance on wholesale sources, based on its high deposits to liabilities ratio of 93.1% as of June 30, 2017. Loans and Receivables to Deposits ratio stood at 73.4% as of June 30, 2017, down from 80.3% as of end-2016. From end-2016, deposits went up by 15.9% to P183.6 billion, while Loans and Receivables posted a minimal increase of 5.9% to P134.7 billion. Closer examination of PSBank's Interim June 2017 financial statements would show a jump of 66.8% to P23.3 billion in Due from BSP, indicating that a large part of PSBank's funds was also channeled to this asset account during 1H2017.

CASA accounted for 25.2% of total deposits, as of June 30, 2017. The ratio represented a decline from 26.9% as of end-2016, attributable to the 18.6% hike in time deposits to P137.3 billion. In January 2017, PSBank issued LTNCTD with aggregate principal amount of P3.37 billion due on April 30, 2022, and fixed interest rate of 3.5% per annum. Nevertheless, forecasts are for CASA to continue increasing its share in total deposits. Deposits to liabilities ratio will remain high, as the hike in deposits make up for lower level of funds from wholesale sources (i.e. subordinated notes and bills payables).

CAPITAL

Equity to assets ratio declined to 9.7% as of June 30, 2017, from 10.2% as of end-2016. Equity increase was modest at 6.3%, attributable to higher retained earnings. Also, unrealized loss on available-for-sale (AFS) investments dropped by 52.7% to P398.5 million, from P842.9 million unrealized loss as of end-2016. Forecast equity to assets ratio is within historical levels.

CAR stood at 14.2% as of June 30, 2017, almost unchanged from end-2016 and well above the BSP minimum requirement of 10.0%. While licensed as a savings and mortgage bank, PhilRatings notes that PSBank’s P21.3 billion capital base and 14.2% CAR were higher compared with the capital base and CAR of some domestic universal and commercial banks.