Top 10 Banks remain strong entering 2014

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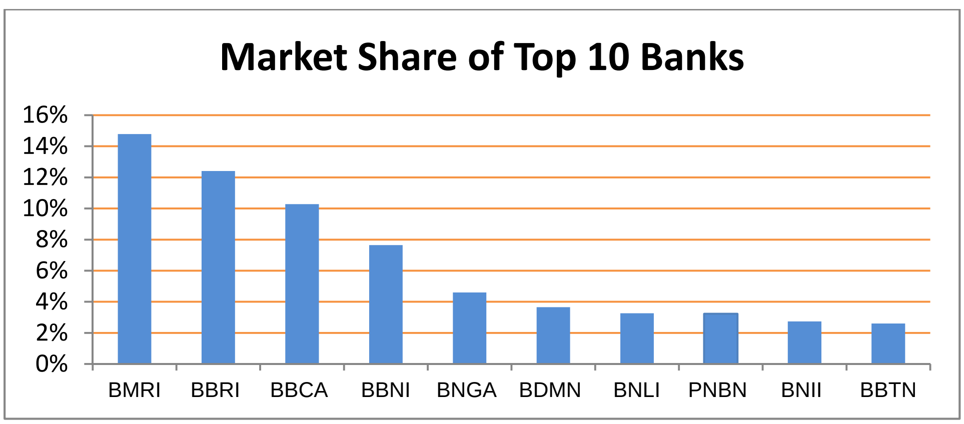
Introduction

PEFINDO views the outlook for the Indonesian banking industry to be stable in the near to medium term. This is underpinned by the banks' robust fundamentals, which are characterized by strong capitalization, profitability and asset quality indicators. PEFINDO currently assigns ratings to 37 Indonesian banks, representing 68% of the national banking industry's total assets. Of these banks, all but four are rated at $_{id}$A- or above, reflecting our view of the strength of the industry. All 37 banks have a stable outlook. We expect rating changes in 2014 to be relatively balanced overall, but we believe that there is a higher likelihood of downward pressure on ratings given more limited upside potential.

With 120 commercial banks in operation at the end of September 2013, Indonesia's banking industry is highly fragmented, providing a wide range of choice to the Indonesian public. The majority of these banks lack significant scale however, and the sector is dominated by the 10 largest players which account for almost two-thirds of the total industry. At 30 September 2013 (9M2013), the top 10 banks accounted for 65.2% of total assets, 65.6% of total gross loans, and 66.6% of total deposits in the industry. This compares to 66.3%, 66.1% and 67.5%, respectively, at FY2012.

Of the top 10 banks, four (Bank Mandiri [BMRI], Bank Rakyat Indonesia [BBRI], Bank Negara Indonesia [BBNI] and Bank Tabungan Negara [BBTN]) are majority-owned by the Government of Indonesia. Five others (Bank CIMB Niaga [BNGA], Bank Danamon [BDMN], Bank Permata [BNLI], Panin Bank [PNBN] and Bank Internasional Indonesia [BNII]) are either majority-owned by foreign institutions or have a foreign institution as a major shareholder. That leaves Bank Central Asia (BBCA), the third largest bank by assets, as the only fully independent bank in the top 10. PEFINDO rates nine of the top 10 banks (BBCA is the exception), with five banks attaining PEFINDO's highest rating of $_{id}$AAA (BMRI, BBRI, BBNI, BNGA and BNII), two banks rated $_{id}$AA+ (BDMN and BNLI) and the other two rated $_{id}$AA (PNBN and BBTN). The outlooks for all nine banks are stable.

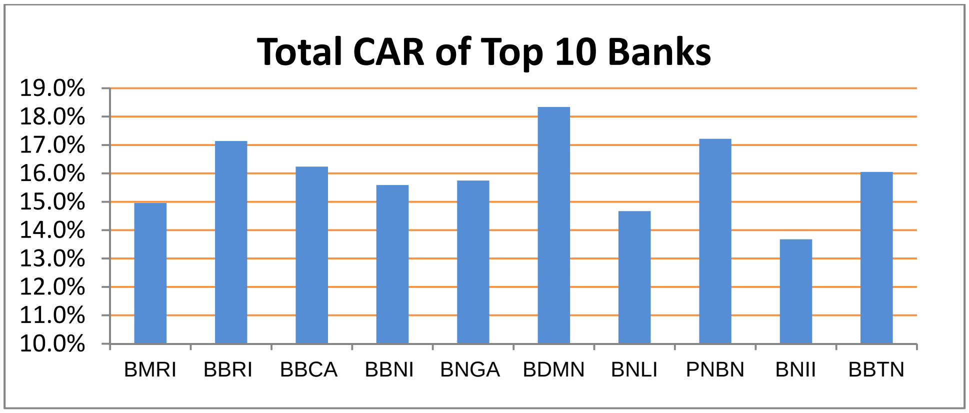
With a weaker economic outlook for 2014, the banking industry is facing a more challenging operating environment that features expectations for slower growth, higher credit losses, and lower profitability. It is in this context that PEFINDO examines the financial strength of the top 10 banks as a guide to their likely resilience in the face of these headwinds, considering that their performance continues to have a major impact on the health and stability of the industry as a whole.



Market share, based on total assets, of the top 10 banks at 30 September 2013. Data sourced from Bank Indonesia and banks' financial statements.

Capitalization

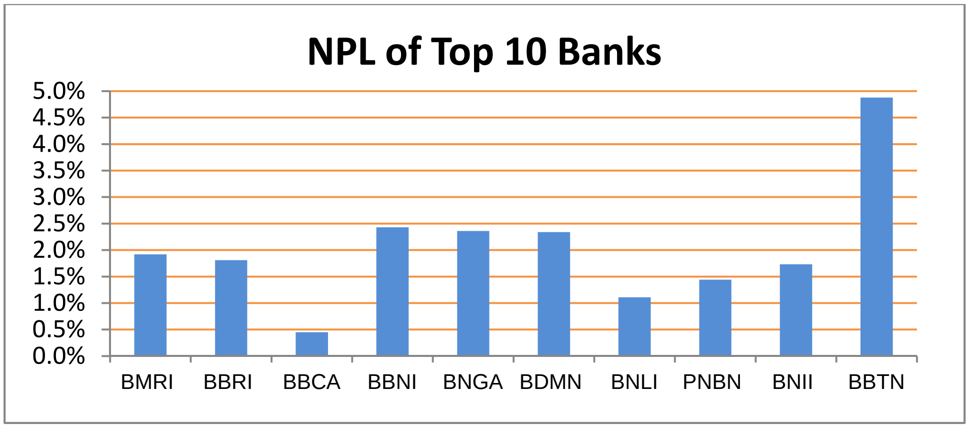
The top 10 banks are well capitalized as measured by both their total capital adequacy ratios (CAR) and tier-1 CAR. The average total CAR and tier-1 CAR ratios for the top 10 at 9M2013 were 16.0% and 13.7%, respectively. This compares to 18.1% and 16.4%, respectively, for the industry as a whole. BNII had the lowest total CAR ratio of the top 10 at 9M2013 of 13.7%, which is well in excess of the regulatory minimum of 8.0%. BNLI, a frequent issuer of subordinated bonds, with IDR6.1 trillion of such instruments on its balance sheet at 9M2013, had the lowest tier-1 CAR of 9.2%. Despite strong loan growth of 16.2% since the start of the year the top 10 banks, capitalization levels are relatively unchanged from FY2012 (when average total CAR was 16.1% and tier-1 CAR was 13.7%) due to strong profitability over the period. PEFINDO expects that these banks will maintain strong levels of capitalization during 2014.



Total CAR of the top 10 banks at 30 September 2013. Data sourced from banks' financial statements and published quarterly reports.

Asset Quality

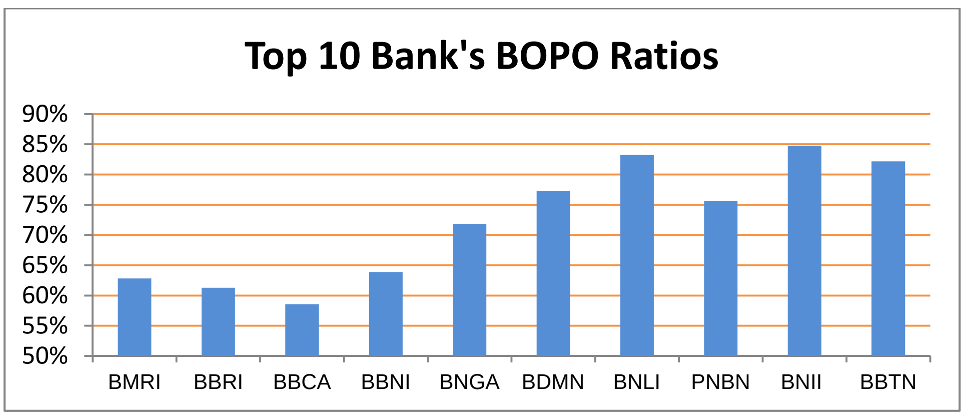
The asset quality indicators of the top 10 banks at 9M2013, as measured by non-performing loan (NPL) ratios and special mention loans, remain strong and are stable on FY2012 levels. The average NPL ratio of the top 10 was 2.0% at 9M2013 compared to 2.1% at FY2012 and 1.9% for the total industry. The top 10 banks' special mention loan levels have increased to an average of 5.0% at 9M2013 from 4.7% at FY2012, partly due to higher fuel prices, inflation, and interest rates over the period, and PEFINDO continues to monitor asset quality indicators closely for further signs of deterioration over the coming quarters. However, PEFINDO notes a marked contrast between the asset quality indicators of BBTN and the other top 10 players. BBTN had both the highest NPL and special mention loan ratios of the top 10: 4.9% and 13.3%, respectively, at 9M2013, up from 4.1% and 11.9% at FY2012. Indeed, excluding BBTN from the top 10 results in an NPL average of 1.7% at 9M2013, better than that of the industry, with the average special mention loans ratio falling significantly to 4.1%. Given a less favorable economic outlook, PEFINDO is of the view that deterioration in the top 10 banks' asset quality indicators is highly likely during 2014, but we expect such weakening to be controlled at a manageable level.



NPL ratios of the top 10 banks at 30 September 2013. Data sourced from banks' financial statements.

Profitability

Indonesia has one of the most profitable banking industries in the world and, unsurprisingly, its top 10 banks are highly profitable institutions. The average net interest margin (NIM) of the top 10 banks at 9M2013 was 5.5%, exactly in line with that of the industry as a whole, and only marginally lower than its 5.6% average at FY2012. Of the top 10, BNLI reported the lowest NIM at 9M2013 of 3.8%, in part due to its large exposure to the lower-yielding corporate segment. Due to their scale, many of the top 10 banks benefit from lower operating expenses to operating income (BOPO) ratios, at an average of 72.1% as of 9M2013, compared to the industry average of 74.4%. BNII, which has the weakest operating efficiency of the top 10, as it continues to invest heavily in its infrastructure and IT systems, reported a BOPO of 84.8% at 9M2013, down from 85.6% at FY2012. The return on average assets (ROAA) generated by the top 10 averaged a strong 2.1% at 9M2013, down marginally from 2.2% at FY2012, with BNLI, BNII, and BBTN reporting the lowest returns at 1.2%. Despite continued pressure on margins and anticipated higher provision expenses in 2014, PEFINDO expects the top 10 banks to largely be able to absorb these effects and to remain highly profitable in the coming year.

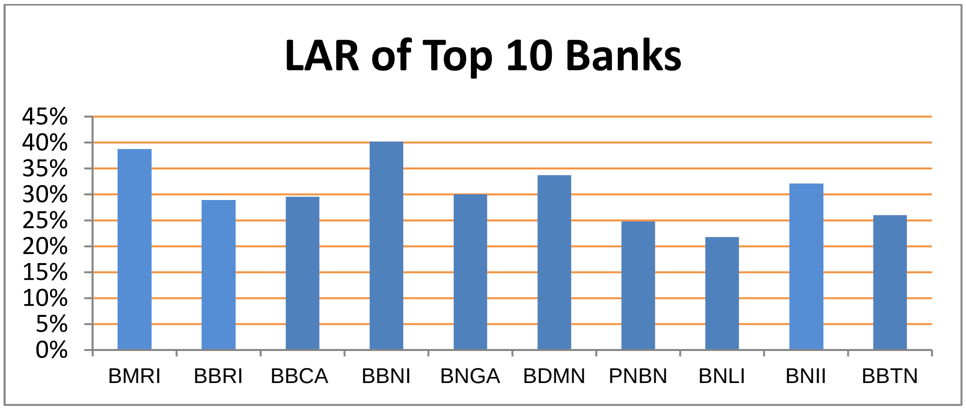


BOPO ratios of the top 10 banks at 30 September 2013. Data sourced from banks' financial statements.

Liquidity

The top 10 banks had an average liquid assets to short-term funding ratio (LAR) of 30.6% at 9M2013, down from an average of 33.9% at FY2012, continuing its trend in recent years (average LAR for the top 10 was 38.4% at FY2011 and 39.9% at FY2010) as these banks continue to channel a greater portion of their funding into higher yielding loans. This is also reflected in their rising loans to deposits ratio (LDR) over the same period. The average LDR for the top 10 at 9M2013 was 91.2%, up from 87.5% at FY2012 and higher than that of the industry as a whole, which had an LDR of 89.3% at 9M2013 (FY2012: 84.0%). The majority of these liquid assets were held in low risk instruments such as government bonds

(28.9%) and certificates of, and current accounts and placements with Bank Indonesia (41.4%). Of the top 10 banks, BNLI, whose loan portfolio has grown faster than the industry in recent periods, had the lowest LAR at 9M2013 of 21.8%, down from 29.8% at FY2012. In PEFINDO's view, the top 10 banks' relatively high levels of stable customer deposits, in addition to low exposures to foreign exchange assets and funding, is positive for their liquidity positions in an environment of a depreciating rupiah. The support provided by, and the profile and resources of, the top 10 banks' owners also support their liquidity profiles.



Liquid assets ratios of the top 10 banks at 30 September 2013. Data sourced from banks' financial statements.

Conclusion

While the outlook for the general economy and consequently the banking industry is less optimistic than in recent years, with most estimates for Indonesian GDP growth for 2013 and 2014 falling below 6%, in PEFINDO's view the top 10 banks in the industry are well positioned entering into 2014. With strong fundamentals, these banks are expected to be resilient in the face of expected lower growth, higher interest rates, and a weaker rupiah. Of the top 10, we view BBTN to be the most vulnerable in the event of a prolonged downturn, given how its asset quality indicators deteriorated in 2013. However, given the bank's majority ownership by, and strong support from the Government of Indonesia, its sound capitalization and its very strong business position in the mortgage market, we expect BBTN to be able to withstand a weaker economic environment in 2014 and maintain its strong position in the industry.

Nonetheless, a weaker outlook may provide a platform for consolidation in the industry during 2014 with, in PEFINDO's view, a high likelihood of strategic and opportunistic acquisitions, as some banks may seek to take advantage of reduced organic growth prospects and lower valuations to expand their market segments and customer bases. While acquisition activity during 2013 was mainly centered on foreign institutions, given recent clarity and stricter stance on foreign ownership rules, PEFINDO expects consolidation during 2014 to be driven by domestic banks. We project that the top 10 banks will be at the forefront of any such activity, with mid-range and niche banks in the industry their most likely targets.

PEFINDO believes that the financial profiles of the top 10 banks could weaken in the near term due to tighter competition and upward pressure on NPLs. Nevertheless, the fundamentals of these banks will remain strong. The banks will continue to entrench their robust market positions and remain at the forefront of the Indonesian banking industry during 2014. Indeed, given the large gap between BBTN, the 10th largest bank with IDR123.3 trillion of assets at 9M2013, and Bank OCBC NISP, the eleventh largest with IDR88.5 trillion, we do not expect a change to the composition of the top 10 banks for the foreseeable future.

Peer Comparison

Bank	Rating	Outlook	Total Assets	CAR	NPL	BOPO	ROAA	LAR
BMRI	$_{id}$AAA	Stable	700.1	15.0%	1.9%	62.8%	2.6%	38.7%
BBRI	$_{id}$AAA	Stable	587.7	17.1%	1.8%	61.3%	3.6%	28.9%
BBCA	NR	NR	487.1	16.2%	0.5%	58.6%	3.0%	29.5%
BBNI	$_{id}$AAA	Stable	362.4	15.6%	2.4%	63.9%	2.5%	40.2%
BNGA	$_{id}$AAA	Stable	218.2	15.8%	2.4%	71.8%	2.1%	30.0%
BDMN	$_{id}$AA+	Stable	173.1	18.3%	2.3%	77.3%	2.4%	33.7%
BNLI	$_{id}$AA+	Stable	154.5	14.7%	1.1%	83.2%	1.2%	24.8%
PNBN	$_{id}$AA	Stable	153.2	17.2%	1.4%	75.6%	1.6%	21.8%
BNII	$_{id}$AAA	Stable	129.7	13.7%	1.7%	84.8%	1.2%	32.1%
BBTN	$_{id}$AA	Stable	123.3	16.1%	4.9%	82.2%	1.2%	26.0%

All ratings information as of the date of this article. All financial information as of 30 September 2013.
The above ratios have been computed based on information from the company and published accounts.
Where applicable, some items have been reclassified according to PEFINDO's definitions.
Total Assets are stated in IDR trillions. NR: not rated.