

Philequity Corner (06/27/2011)
By Valentino Sy

A Pacquiao Bank

Two weeks ago, we wrote about the country's biggest banks (*The Philippine banking giants*, June 13, 2011). In that article, we discussed how size reinforces the financial strength of the local banking giants. We received a letter in response to that article from Mr. Tony Moncupa, Jr., President and CEO of EastWest Bank. We are publishing his letter in its entirety.

A letter from an esteemed banker

Dear Mr. Sy,

I hope you will not mind to hear some comments on your June 13, 2011 article, 'The Philippine Banking Giants'. But before that, let me congratulate your long-running column 'Philequity Corner' for its continued success. I am sure your readers, like myself, always find it very instructive and very helpful as we try to understand the context of our respective businesses.

I agree with the general ideas and conclusions you forwarded in the said article. Indeed, 'size matters' and 'size begets size', and that 'Bigger banks are also usually perceived as stronger and more stable than their smaller counterparts' and 'are a step above the rest in terms of generating recurring profits'. However, before the banking public starts to think that all smaller banks are not strong, unstable, and do not generate profits, I would like to say that there are smaller banks that can prove their capability to measure up to the bigger banks in terms of ROE, ROA, and the other metrics you used in your article. In the case of EastWest Bank, benchmarked against listed local banks, it registered the second-highest ROE in 2010 and the highest ROE in Q1 2011. While we have no doubt that you did not intend to mean that all small banks are not capable, we hope that this clarification could help your readers put more context to the general perceptions about size and performance. Thank you and more power!

Kindest regards,

Tony Moncupa, Jr.

EastWest Bank

EastWest Bank will be a Pacquiao Stock

We did not include EastWest Bank (EWB) in our June 13 article since it is not yet listed with the Philippine Stock Exchange (PSE). Nonetheless, we agree with Mr. Moncupa that there are smaller banks that can measure up to the bigger banks in terms of performance. EWB is the perfect example of a mid-sized bank that can rise to the top, as its focused management and supportive shareholders allowed it to deliver outstanding results for 2010 and 1Q2011. We believe that EWB will eventually be a Pacquiao stock (*Pacquiao Stocks*, May 16, 2011) since it is a bank that started small but has significantly grown and improved over the past few years, much like our beloved Filipino boxer.

The turning point

The turning point in Manny Pacquiao's career came when he met trainer Freddie Roach in 2001. It was the start of arguably the most successful boxer-trainer partnership of this generation. Filinvest Development Corporation (FDC), EWB's parent company, made a similar move when it hired Mr. Moncupa, a former Executive Vice President of International Exchange Bank (iBank), in the latter part of 2006. EWB likewise beefed-up its management team with key officers and middle managers, with many also coming from iBank, in the hope of continuing on the success of the customer-centric banking that iBank was well-known for.

Increasing size and strength

In order to compete against more formidable opponents, Pacquiao underwent strict strength and conditioning programs to put on more muscle mass as he moved up the weight classes. Likewise, EWB undertook a capital build-up program, with the support of FDC, in order to strengthen its financial muscle. Over the past few years, FDC infused P4.5B in new capital to support EWB's explosive growth in Assets, Loans and Deposits, as shown in Table 1.

Table 1 - EastWest Bank - Balance Sheet Highlights - 2006 to 1Q2011							
	2006	2007	2008	2009	2010	1Q2011	CAGR
Assets	30,303	38,055	49,076	75,002	83,757	75,652	24.0%
Loans	15,144	17,856	21,942	33,077	40,264	39,716	25.5%
Deposits	25,219	31,274	39,347	59,785	66,473	57,504	21.4%
Equity	2,881	4,123	3,978	8,140	9,759	9,706	33.1%
<i>Amounts in million pesos</i>							
<i>Source: Company Data, Wealth Securities estimates</i>							

A more potent attack

Though Pacquiao dominated most of his opponents when he was below 130 lbs., his brutal attack was exposed as one-dimensional through brilliant counterpunching by Morales and Marquez during their first encounters with him. From there, Pacquiao devoted time to develop his right hand and footwork to make his offensive game a more powerful and less predictable one. Like Pacquiao, EWB made serious efforts to improve and optimize each of its key businesses. This allowed EWB to exponentially grow and diversify its earnings base, as shown in Table 2.

Table 2 - EastWest Bank - Income Statement Highlights - 2006 to 1Q2011							
	2006	2007	2008	2009	2010	1Q2011	CAGR
Net Interest Income	940	1,368	1,992	3,530	4,318	1,091	43.5%
Non-Interest Income	521	548	960	1,921	3,076	489	36.5%
Trading Income	164	42	46	662	1,449	70	13.5%
Operating Expenses	1,268	1,633	2,092	3,544	4,063	958	29.7%
Provisions for Losses	102	101	556	1,237	1,552	80	30.7%
Net Income	127	137	122	622	1,811	443	85.8%
<i>Amounts in million pesos</i>							
<i>Source: Company Data, Wealth Securities estimates</i>							

Playing with the big boys

We never quite saw the full extent of Pacquiao's brilliance until he dominated much bigger boxers, such as dela Hoya, Hatton, Cotto, Clottey, Margarito and Mosley. Pacquiao not only retained his speed and power, but also vastly improved his skills during his meteoric rise in weight. The same can be said of EWB when it achieved explosive asset growth and dynamic improvements in profitability over the past few years. EWB accomplished this even if it is usually difficult for banks to increase asset size and improve profitability at the same time.

Benchmarked against listed local banks (Table 3), EWB ranked 1st in ROE and 2nd in ROA for 1Q2011. Also noteworthy is that EWB also ranked 1st in both Recurring ROE and Recurring ROA for 1Q2011. This means that EWB is leading the local banking industry not only in terms of profitability but also in generating income that would be less susceptible to external shocks or crises. So far, EWB has clearly shown that it can deliver outstanding results despite its fairly recent turnaround.

	MBT	BDO	BPI	SECB	UBP	PNB	RCB	CHIB	EWB
ROE	13.4%	11.1%	14.1%	15.6%	8.0%	3.9%	11.9%	9.8%	18.2%
ROA	1.4%	1.0%	1.4%	2.3%	1.1%	0.4%	1.3%	1.4%	2.2%
Recurring ROE	14.2%	14.3%	16.9%	15.2%	9.3%	6.2%	9.7%	11.6%	22.7%
Recurring ROA	1.5%	1.3%	1.7%	2.2%	1.3%	0.7%	1.1%	1.7%	2.8%
Cost-to-Assets	2.9%	3.7%	3.1%	2.1%	3.1%	3.2%	3.5%	2.8%	5.1%
Loan-to-Deposit	54.3%	77.5%	59.6%	77.3%	45.2%	48.8%	72.5%	58.0%	69.1%
Leverage	9.1	10.9	9.2	6.9	7.1	9.3	8.5	6.8	7.8

Sources: Company Data, Wealth Securities estimates

The next Universal Bank

Once EWB complies with the public ownership and listing requirements, it will finally be considered a Universal Bank. EWB will then have to measure up to its bigger counterparts, not only in terms of performance, but also in terms of size and market share.

A future champion

With its recent results, EWB has clearly shown that it is of championship caliber and that it can measure up to the country's biggest banks. It is an example of a company that we at Philequity admire and would like to invest in. EWB has displayed strong asset and earnings growth. It has also built a strong recurring income base and it is run by a competent and diligent management team. As such, we would like to encourage PSE to invite EWB to list as soon as possible. We believe that companies with remarkable growth stories such as EWB will entice more active investor participation in our stock market. We at Philequity look forward to participating in EWB's listing and we would strongly recommend investors to do the same.

For further stock market research and to view our previous articles, please visit our online trading platform at www.wealthsec.com or call 634-5038. Our archived articles can also be viewed at www.philequity.net.