FUNDAMENTAL ANALYSIS OF BANK RAKYAT INDONESIA BY USING RESIDUAL EARNINGS-PBR

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ABSTRACT

This paper investigates the fundamental value of the largest micro lender in Indonesia i.e. Bank Rakyat Indonesia. After financial crisis in 2008, due to improving macroeconomic condition and the increasing of banking income, some banks in the Jakarta Composite Index (JCI), such as BBCA, BMRI and BBRI were considered outperformed. Now, Banks become one of the most darling firms in market. Lately, Indonesian economy encountered some negative sentiments which downtrend in JCI including the banks. In beginning of 2014, Bank Rakyat Indonesia closed at IDR 7,250. By applying the residual earnings model-PBR, the writer considered that the current price of Bank Rakyat Indonesia was underperformed. The writer concluded that the target price of BBRI is IDR 11,155. This price implies that PER 13x and PBV 4.5x. Bank Rakyat Indonesia is valued at IDR 11,155 per share is rational and valid as from 2010, BRI have been moving at PER 11.6x and PBV 3.3x and it is in line compare to its industry PER & PBV.

Keyword: Bank Rakyat Indonesia, valuation, fundamental analysis, BBRI, target price

I. INTRODUCTION

Many investors are interested in investing at banking sector because banking is one of the biggest industries in Indonesia (Simorangkir & Simorangkir, 2012). Futhermore, Simorangkir and

Simorangkir (2012) added that the banking industry correlates positively with the economic development, production and consumptions. Hence, the banks' stock price derives by the economic growth.

The improvement of income has increased the value of companies through its stock's price, i.e. Bank Rakyat Indonesia or BBRI secured its position as a profitable banking with maintainable NPL (Detik Finance, 2014). The good performances of BBRI lead the investors to believe that BBRI can outperform in industry. Until now, the BBRI has recorded its return more than 100% of capital gain since 2009 (Bank Rakyat Indonesia, 2013).

Simorangkir & Simorangkir (2012) stated that the banking industry is one of industry that positively correlated with the economic development which makes banking firms are vulnerable to changing in economy. Moreover, Marina (2013) argued that the investors to stay selective with big banks. She argued that there would be tight competition for high qualify lending among the big banks in Indonesia due to deceleration of domestic economy. The competition will lead to new issues in banks' CASA management, risk management and asset- liabilities management (Marina, 2013).

Soedarmono (2013) stated that Indonesian economic faces some negative sentiments that will affect the market negatively. The foreign investors pulled out their money from emerging market asset as the Fed issued tapering on May 22nd, 2013 which is resulting the major declining of the Jakarta Composite Index. He added that uncertainty and suffered current account deficit drived Rupiah underperformed against dollars. The domestic investors are attentive to the inflation and the current account deficit.

The banks estimated that the increasing BI rate by 150 bps to7.25% will affect the banks' profit in 2014 by creating issues which are declining of net interest margin, increasing of credit risk, increasing of operational cost and the slowing down of business (Bisnis Indonesia, 2013). Added by the BCA's CEO (Setiaatmadja, 2013), the government targeted that the credit growth for 2014 is about in 16-1 7% which is lower than estimation in 2013.

These issues affected the all sectors include banking firms to revalue their strategies to maintain and increase their bottom line (Marina, 2013). Unavoidable, the global and domestic economic conditions lead an increasing competition in banking firms. The increasing of BI rate motivated the tough competition among banks on collecting the third party funds to lower their loan deposit ratio and maintained a lower NPL (Bisnis Indonesia, 2013). The tight competition from 1st quarter until the end of 2013 showed the significant decreasing of the net interest income in largest bank in Indonesia. Nationally, the net interest income was at point 5.46% dominated by BBRI (Bisnis Indonesia, 2013).

Regarding to the factors above, most of banks have considered shifting their revenue driver from interest income to fee based income (FBI). Not only the competition among largest banks has been hard, but also many small banks have penetrated the micro financing business such as Bank Sahabat Sampoerna, Bank Danamon, etc. has revalued the banks' strategies (Infobank, 2013).

In this paper, the writer want to value one of Indonesian banks which is fundamentally affected by the factors above and having more than 80% of its total revenue is coming from interest income which is Bank Rakyat Indonesia with the ticker's BBRI.

Research objective

The objective of this research is finding the BRI's fundamental target price in making investment decision in 2014 by using proper approach and considering the BRI's operational risk and financial risk. In order to value the Bank Rakyat Indonesia properly, there are some issues that the writer required to understand and answer. These questions are needed to answer before proceed to the projection and valuation.

- How the banks have different accounting perspective rather than the other industries?
- What are the regulation that engaged with banks' activities and how the regulations can affect the banks' financial statement and performance?
- How Bank Rakyat Indonesia will be valued and forecasted its earnings?

In doing this quantitative research, the writer is aware the limitation of this paper which is the result of the study directly responsive to the current news and information in market. Hence, the result can change due to how the market perceives and responses the information in market.

In writing this paper, the author will be divided the writing scheme in to five chapters. The flow of the paper is Chapter I develops the background and the research objective, Chapter II is about literature review and existing research that explains the valuation and banking industry. The data and methodology are described in Chapter III that shows how will get the data and how we value the firm, and following by the analysis and finding in Chapter IV. The conclusion and recommendation will be discussed in Chapter V.

II. LITERATURE REVIEW

Hamonangan and Sulistyawati (2012) quoted that according to Kartajawa (2006) valuation is ancient approach in financial system that has been used since 1800 BC by Babylon. It was developed by Merton Miller and Franco Modigliani by rooted to present value of capital budgeting. Simplify, valuation is approach to find the present value of money by concerning the time value of money itself. When we are talking valuation, it means the valuation is fundamental analysis.

Janjigian, Horan & Trzcinka (2011) argued that as the fundamentalist believe that there is a strong correlation between a company's ability to generate and increase profits and the performance of its common stock. Fundamental analysis is approach of analyzing business model, information, forecasting payoff and discounting its payoff with the firm's cost of equity or its weighted average (WACC) to arrive at intrinsic value of the stock or the target price of company (Penman, 2004).

Penman (2004) stated that fundamental analyst is the analysis that focuses on valuation of firm through the company's financial statement, management and the macroeconomic conditions. He added that a fundamental analysts/ investors will try to reduce the risk of incurring of loss by examining information about firms and reaching conclusions about the current price of the company in order making investment decision.

Manurung (2013) argued that fundamental analyst concerns more about the going concern of the company which reflects to the firm's efficiency, profitability, ability to expand the business and any issues about the macroeconomic that affect the firm. Therefore, the fundamental method of each company will differ from others (Penman, 2004). It varies depend on the company business model (revenues & expenses driver) and accounting perspective (Koller, Goedhart, and Wessels, 2010). Building valuation model of a firm depends on the business model or type of business (Damodaran, 2006) and accounting perspective of a company (Penman, 2004). Hence, understanding the industry of the firm in is matter in valuing a firm (Penman, 2004).

Banking Valuation

Marina (2013) explained that to value banking firm has its owned challenge as the financial service companies are heavily regulated by the government that can affect the companies' performance changes in the regulatory environment can create large shifts in value. Additionally, the unique transaction of financial firms generates a difficulty to estimate the firm's cash flows as items like capital expenditures, working capitals, and debts are not clearly defined (Dermine, 2009 & De Weert, 2011). Hence, valuing financial services firms differs and quite unique compare to others (Marina, 2013).

Dermine (2009), a professor banking & finance at INSEAD, wrote a book "Bank Valuation & Value- Based Asset Management", suggested that the reader to use a fundamental valuation that will shows and examines managerial issues such as fund transfer pricing, risk-adjusted performance evaluation, capital management (loan & deposit pricing, loan- loss provision, management interest risk on the banking books). He prefers to call as "Value- Based Management." Beside emphasizes the value based management of methods, he suggested that the analyst can use P/E, MBV, and Gordon Growth Model to value banking firms.

De Weert (2011), the entriprise value of banking firm is typically measured by discounted earnings analysis. Manurung (2011) discribed that discounted earning method is using when earnings are the premium to company's entriprise value or in other words bottom lines are the source of value and reserve for company to develop in future. Penman (2004) argued that discounted earnings analysis concerns whether the earnings of the company contibuted to incresing value of company by added value to its balance sheet. Added by Dermine (2009), there are two drivers of value in banking industry which are return on equity and growth of equity when ROE exceeds its opportunity cost (cost of capital).

In conclusion, according to Marina and Ariesandi (2013) and De Weert (2011) advised to use residual earning (RE) -PBR and discounted earning model to value a bank. However, some practionare JP Morgan and Merril Lynch is more likely to use DDM- Dividend discounted model. The discounted earnings is quite often used by several by analyst such as Panin Securities, Hamonangan and Sulistyawati (2012), in valuing BBCA (Bank Central Asia), and Simorangkir and Simorangkir (2012) that valued BBNI. The analysts are using PBR and discounted earnings because in valuing a bank, the analyst values the balance sheet of the bank (Marina and Ariesandi, 2013). De Weert argued that bank should be valued using discounted earning because what investors get from a bank is its earnings and should be discounted to its cost of equity.

Discounted Residual Earnings Analysis

De Weert (2011) argued that earning can reflect value of company that distributed o the shareholders freely from the core capital. Dermine (2009) also stated that to value a bank the analyst measures its value added to book value. It was presented by using residual earning model in valuing the firms (Penman, 2013). Penman (2013) added that residual earnings model (eq.1) can capture the value added to book value from forecasts of residual earning in future. Basically, this model is anchoring on a firm' book value and then adding extra value by forecasting its future residual earnings.

Value = Book value + Present value of expected residual earnings (eq.1)

According to Penman (2013), residual earning (RE) (eq. 2) is the comprehensive income available to common equity against the earnings for the book value of common equity the beginning of the period (B_{t-1}), earning at the required return (ρ_e -1). He also elaborated that residual earning can be expressed as differences between the rates of return on common equity (ROCE) (or some analysts express it as ROE) and required return on equity (or cost of capital) times beginning- of- period book value (eq.3).

$$\mathbf{RE = Earn_t - (\rho_e - 1)\, B_{t-1}} \quad \textbf{(eq. 2)}$$

$$\mathbf{RE = (ROCE - (\rho_e - 1))\, B_{t-1} \quad (eq.\,3)}$$

Penman (2013) showed that by using residual earning model, the analysts actually measure a firm's book value. After getting the value of company through its present value of forecasts of residual earnings, the analyst can derive the firm's **price to book value (PBR= V_0^E/B_0)** to evaluate which whether the firms trades at premium and discount. Rationally, this makes sense," if we expect a firm to earn income for shareholders over that required on the book value of equity, its equity will be worth more than its book value and should be trade at premium. And higher the earnings relative to book value, the higher will be premium," (Penman, 2013).

Penman (2013) explained the concept behind the price to book ratio as the value of the shareholders' investment is based on how much the investment is expected to earn in future. This model agreed that the investors are buying the expected future earnings of the company. Thus residual earnings model can also reflect this method as it measures the profitability of the firm (ROE).

III. METHODLOGY

Method of Analysis

The method of analysis will be the quantitative and qualitative which is applying what has been concluded from the chapter 2 discounted residual earnings. Besides that, the author needs to understand the quality of the Rakyat by analyzing its competitive advantages.

Data Collection Method

To model the BBRI, the author uses the secondary data which is the balance sheet and income statement of the firms from the last few years (2002) to recently (2013) with intention to learn the financial structure of the BRI and growth performances. Besides that, this paper will use data macroeconomic and historical price of IDX and Rakyat for recently price that have been taken from Thomson Reuters. The other data also have been taken form the related resources.

Research Approach and Model

There are several important issues that an analyst should be aware in doing the valuation which understand the frameworks for valuation, reorganizing the financial statements, analyzing performance and competitive advantages, forecasting performances, estimating continuing value, estimating cost of capital, calculating and interpreting result.

1. Frameworks for Valuation

Before decided the method of the valuation, the author is required to understand the banking business model or Rakyat's revenue and expenses drivers (Dermine, 2009). In short, the analyst needs the Rakyat's balance sheet and income statement. After that, the author decided the appropriate method to be used to value Bank Rakyat Indonesia's price which are DDM and discounted earnings (residual earnings). Driven from the methods that the author decided to use, Rakyat's valuation will stem from 5-years projected earnings and cost of capital.

2. Reorganizing the Financial Statements

After obtaining the past financial data of Rakyat, the analyst needs to understand the accounting principles of Rakyat if there is accounting irregularities. Although, financial statements form can show the viewers the earning of the Rakyat, but it cannot be computed directly from the company's reported financial statements. Hence, the author needs to reformulate the financial statements to understand the revenue and expenses drivers, and other components that affect the income significantly.

3. Analyzing Performance and Competitive Advantages

Once, the analyst finished to reorganize the financial statement, the analyst analyzes the company's historical performance. By thoroughly, analyzing the past, the analyst can document whether the company has created value, whether it has grown, and how it compares to its competitors. The author needs to focus on return on invested capital and revenue growth by analyzing the past performances; the analyst can understand how revenue amd expenses drivers behaved and help making reliable estimates of future earnings.

4. Forecasting Performances

When the analysts forecast the performance of the firm, they need to focus on long-run value drivers that are consistent with economy theory and historical evidence. Hence, analyze the macroeconomic and firm industry in is important (Manurung. 2011) beside understand the business model of the firm and past performances (Penman, 2013).

In forecasting the future, the analysts concern the length and detail of the forecast. Normally, the analysts take five-year to seven-year forecast; it depends on the business cycle of the business itself (Manurung, 2011). For the banking industry, usually, the analysts apply three-year projection. While analyze the historical performances, the analyst needs to build the revenue drivers by analyze and forecast the firm's balance sheet and income statements.

Typically, it is natural that we are looking backward, the historical earnings and performances. Damodaran (2008) suggested that the analysts should use the historical data as learning tools to learn and forecast the future growth of the firm. The analyst analyzes the differences in growth rates across different measures of earnings from revenue, operating income to earning per share and why the differences exist. The historical growth rates can be computed in two different ways which are arithmetic and geometric average growth.

5. Estimating Growth and Continuing Value

According to Damodaran (2008), expected growth rate is a key input in valuing business as higher expected growth rate translates to higher value of the firm as well as Buffet expressed though its quotable words “the intrinsic value of company lies entirely in its future.” Thus, Damodaran (2008) suggested that growth is not exogenous input subject to inclination and fancies of individual analysts, but has to be earned by the firm in future.

Actually, the analysts can calculate the expected long term growth in earning by computing retention rate to its return on equity (eq. 6), but again the analysts should reconsider the future of the company through its competitive advantages and industry in and preserve information in market.

g = Retention rate (X) Return on equity (eq. 6)
As, Retention rate = retained earnings / current earning and,
ROE = Net Income/ Book value of equity

6. Discount Rate

Koller, Goedhart and Wessel (2010), value of company is the present value of all possible future cash flows. Thus, discounted rate is one of important factor to value a firm. Actually, there are some discount rates that analyst use when they are valuing a firm which is cost of equity and WACC. To compute the WACC (ρ_e), the author required the information of cost of equity (R_e), cost of debt (R_d) and weights (D/V and E/V) Damodaran (2010).

$$\textbf{WACC } (\rho_e) = * (D/V)* R_d * (1-tax) + R_e*(E/V) \quad \textbf{(eq. 7)}$$

In valuing banking, the author will discount the residual earning by cost of equity instead of the weighed average cost of capital. It is more appropiate for the analist to use cost of equity becasue the balance sheet straucture of the bank that really high leverage.

Table 1 Weighted Average Cost of Capital

Component	Methodology	Data Requirements	Considerations
Cost equity	Capital asset pricing model (CAPM)	Risk- free rate	Use a long-term government rate, no default risk, no reinvestment risk and in the same currency and term
		Market risk premium	Risk premium can be calculated based on equity premium and country premium
		Company Beta	Regress stock return to market return
After-tax cost of debt	Expected Return proxied by yield to maturity on long term-debt	Marginal tax rate	
Capital Structure	Proportion of debt and equity to enterprise value		Measure debt and equity on a market, not book, basis.
			Use a forward-lloking target capital structure

Sources: Koller, Goedhart, & Wessels (2010)

IV. ANALYSIS

1. Business Description

Bank Rakyat Indonesia was established on 16 December 1895 under the Dutch name, *De Poerwokertosche Hulp en Spaarbank der Inlandsche Hoofden.* On 22 February 1946, the name has changed to Bank Rakyat Indonesia until now. BRI has become one of the third largest banks in Indonesia that measured by assets. 57% of BRI's shares owned by the Indonesian government and the forth holds by public. BRI's subsidiaries are PT Bank BRI Syariah, PT Bank Agroniaga Tbk and BRIngin Remittance Co. Ltd. Recently, BRI has developed its international branch in Cayman Islands and two representative offices in New York and Hong Kong.

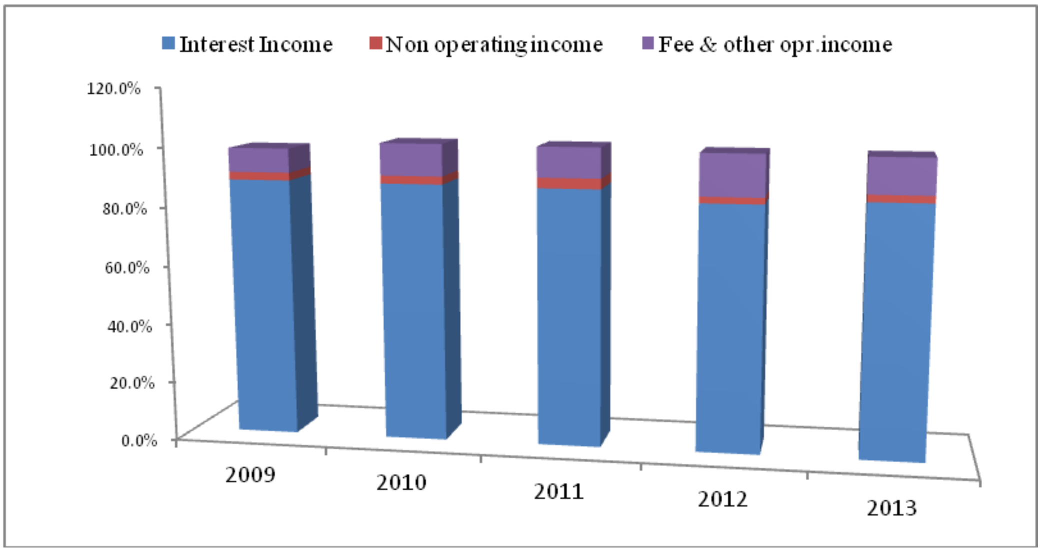


Figure 1BRI's revenue composition, Sources: Bank Rakyat Indonesia

Figure 1 shows that BRI's revenue composition is dominated by the net interest income which is more than 80% of BRI's total income in the last five years. It is following by fee income and the other operating income (such as gain in foreign exchange rate, provision and commission) that has been increasing from year to year due to the presence of e-banking and possession of large customer based.

Bank Rakyat Indonesia is one of the world largest micro- lenders that has been expanded its business to edges of the archipelago's 17,000 islands. Table 2 shows that BRI focus on micro lending via its 9,807 outlets across Indonesia.

Table 2 Number of the Rakyat's outlets

Conventional Outlet	2009	2010	2011	2012	2013	Q1'13	Q1'14
Head Offices	1	1	1	1	1	1	1
Regional Offices	17	18	18	18	18	18	18
Branches	406	413	431	446	453	446	456
Sub Branches	434	470	502	545	565	545	562
BRI Units	4,538	4,649	4,849	5,000	5,144	5,001	5,144
Cash Offices	728	822	870	914	950	919	953
Teras BRI	217	617	1,304	1,778	2,206	1,804	2,208
Teras Mobile			100	350	465	350	465
Total	**6,340**	**6,989**	**8,074**	**9,051**	**9,801**	**9,084**	**9,807**

Sources: Bank Rakyat Indonesia

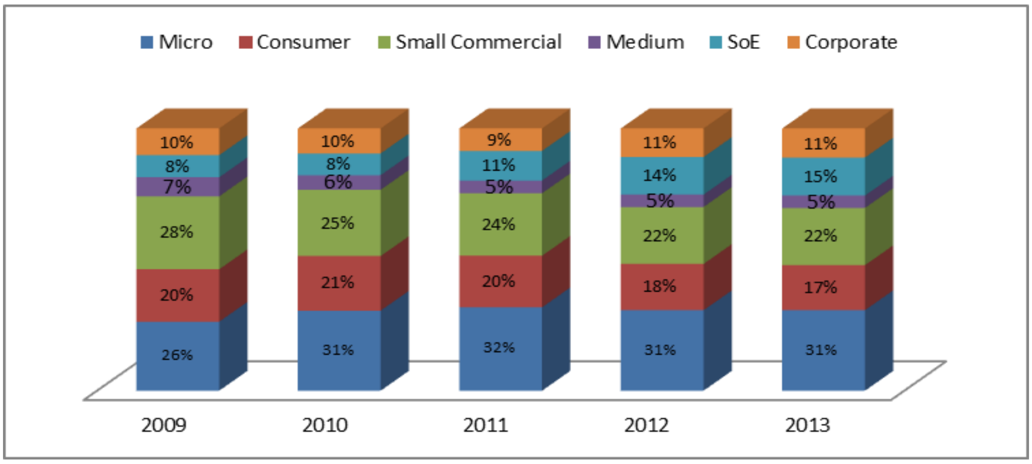


Figure 2 Loan Composition by Business Segment, Sources: Bank Rakyat Indonesia

Figure 2 depicts that Bank Rakyat Indonesia distributes its loans to micro, consumers, small commercial, medium, SoE and corporate credit. Over past few years, BRI's loan outstanding was increasing which was dominated by micro lending follows by consumer and small commercial lending. The figure shows that BRI has broadened its corporate lending presence with 11% of total loans which grew by 17% CAGR since 2009. However, micro lending still dominates the loan portfolio. The Figure also describes that Bank Rakyat Indonesia maintained its income from consumers and small commercial although it was declining over past years. The figure depicts that the total lending for MSME was more than 80% of total loans.

As a bank, BRI finances its business from the third party funds which is customers. To gather the third party funds, Bank Rakyat Indonesia provides saving in three types which are demand deposit, savings and times deposits as figure 3 shows. The figure illustrates that saving and time deposit dominated the funds composition. Furthermore, the figure also records that BRI can gather third party funds by growing 14% CAGR in the last five years.

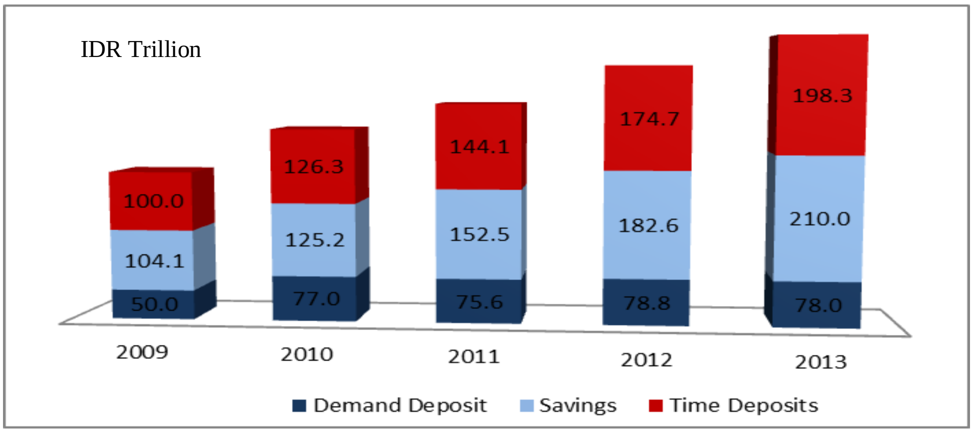


Figure 3 Deposit Composition/ trend, Sources: Bank Rakyat Indonesia

2. Macroeconomic analysis and Competitive Positioning

Macroeconomic Analysis

Bank Indonesia (2014) reported that the global economy performed under expectation. The economists were optimistically forecasted that global economy would be better in 2013. However, the global economy encountered negative sentiments which were declining of global economy from 3.2% to 3%, the downward correction of commodities' prices and uncertainty in financial markets. These conditions were affected by changing and shifting in world economic order. Bank Indonesia (2014) stated that changings in world economic landscape portrayed by increasing of economic growth in developed countries and slowing down of economic growth in developing countries, continued in decreasing world commodities price and the shift of capital flows due to tapering off by the Fed.

Table 2 Global Economy Indicator

% (YOY)	2010	2011	2012	2013	2014 F	2015F
GDP (World)	5.2%	3.9%	3.2%	3.0%	3.6%	3.9%
Developed Countires	3.0%	1.7%	1.4%	1.3%	2.2%	2.3%
United States	2.5%	1.8%	2.8%	1.9%	2.8%	3.0%
European	2.0%	1.5%	-0.7%	-0.5%	1.2%	1.5%
Japan	4.7%	-0.6%	1.4%	1.5%	1.7%	1.0%
Emerging Market	7.5%	6.2%	5.0%	4.7%	4.9%	5.3%
Asia	9.8%	7.8%	6.7%	6.5%	6.7%	6.8%
China	10.4%	9.3%	7.7%	7.7%	7.5%	7.3%
India	10.5%	6.3%	3.2%	4.4%	5.4%	6.4%
ASEAN-5	7.0%	4.5%	6.2%	5.2%	4.9%	5.4%

Sources: Bank Indonesia & IMF

The global economic challenges and tapering issue have been quickly responded by developed countries though their accommodative macroeconomic policies. Meanwhile, developing countries (emerging market) reacted varies policies by combining the government policies and the corporation among countries through international forum. To stimulate their economy, United State kept the low interest rate and quantitative easing; Japan employed its "**Abenomics**" policy, and European countries executed easing monetary and fiscal policy to support their economic development. On the other hand, the developing countries carried diverse policies. China issued a

"**Mini Stimulus**" and Brazil, India, and Indonesia imposed tight monetary policy (Bank Indonesia, 2014).

In the last two years advanced and emerging market endeavored the decreasing of inflation rate. This rate was strongly affected by the declining in world commodities price especially fuel and food (IMF, 2014). IMF (2014) reported that inflation rate of U.S and Japan is 1.5%. It was below the expectation of the Fed and Bank of Japan (BOJ) which was 2%. However, Japan can make it out from two last decades of deflation through its Abenomics.

On the other hands, the emerging markets experienced high inflation although it was declining from 6% to 5.8%. In 2013, inflation of Malaysia increased by 1.2% to 4.1% and India had 9.1% of inflation (Bank Indonesia, 2014). IMF (2014) forecasted that in 2014, the inflation in advanced economies will rise by 10 basis points and emerging market will decline by 20 basis points due to the economy improvement in advanced economies and slowdown economies in emerging markets.

Table 3 Global Economy Indicator of inflation,

Consumer Price	**2012**	**2013**	**2014 F**	**2015F**
Advanced Economies	2.0%	1.4%	1.5%	1.6%
Emerging Market	6.0%	5.8%	5.5%	5.2%

Sources: Bank Indonesia & IMF

Bank Indonesia (2014), the changing in economic global (especially, China and U.S as the primary trading partner of Indonesia) brought spillover effect to domestic economy. Indonesia economy was strongly affected through trade channel and financial market. The increasing U.S domestic demand of Indonesia export (such as textiles, processed rubber, electrical and footwear) improved the Indonesian economy activities. Meanwhile, China as one of the primary trading partner of Indonesia decreased its demand for several commodities such as coal, palm oil, and rubber processing due to the slowdown of China economy.

In the financial market channel, tapering off issues widen the spread between U.S interest rate and interest rate in emerging markets, and weakened the exchange rate of emerging markets against dollar (IMF, 2014). Indonesia as a destination of the foreign portfolio investment was affected by the tapering off issue. Many foreign investors pulled out their money from Indonesia in significant amount. Bank Indonesia (2014), the investors left Indonesia was triggered by the negative perception of the investors towards high inflation because of the high fuel price and widening current account deficit.

The changing in the world economic, tappering off issue, and the declining commodities price strongly affected the domestic economy. Bank Indonesia (2014) reported that GDP growth by the end of 2013 was 5.78%, decreased from 2012 (6.2%). In 2014, cushioned by domestic economy, Bank

Indonesia expected that GDP will grow by 5.5 – 5.9 % YOY, IMF estimated that the economic growth at 5.5%, and the World Bank forecasted at 5.3%.

The slowing down of economic in 2013 originated from the declining of the investment since the beginning of the year, limited of export due to the weak global economy and slump in commodity prices. Instead, the domestic consumption was still the main engine of the economic growth.

Bank Indonesia (2014), Indonesia inflation was high peak at level 8.4%, higher than in 2012, 4.3% as well as above the inflation target range 4.5%±1%. In 2013, instead of affected by the depreciation of Rupiah and declining of the commodity price, inflation was solidly provoked by the rising of fuel and food price.

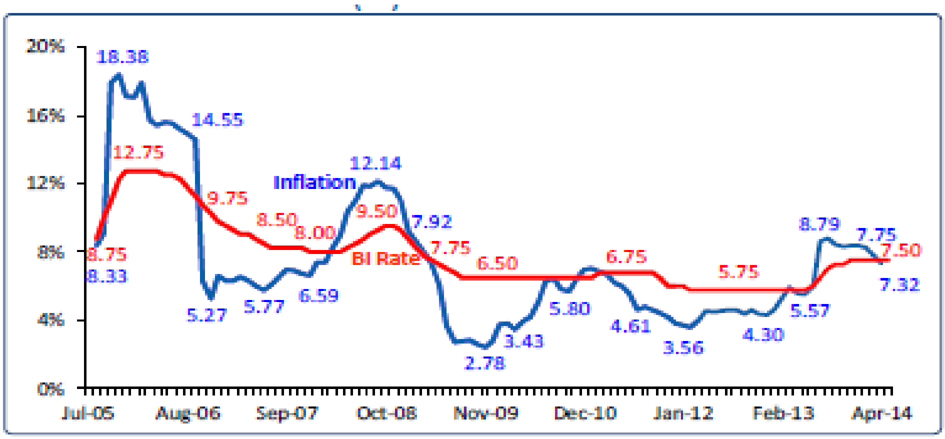


Figure 4 Inflation & BI Rate, Bank Indonesia, Sources: BBCA & Thomson Reuters

In June, Bank Indonesia made the tough decision to raise BI rates by 1.75 percentage points to attract capital, slow imports of consumer goods, and douse consumer-price inflation. However, Rupiah has failed to rebound; breached IDR 12,100 againts U.S. dollar in mid-December with inflation was remaining elevated.

In 2014, Indonesia economy showed a good sign by a positive trade balance in February and narrowing of CAD/GDP to -1.98% in Q4 of 2013. Furthermore, reserve assets increased and Rupiah appreciated against dollar with exchange rate of IDR 11,361 by the end of March 2014, but the Inflation rate was increasing at 7.3% in March 2014 compared to 5.9% in March 2013. This relatively benign inflation improved consumer purchasing power, shown by the increasing trend of consumer confidence and retail sales index. Investment still quite strong as indicated by the increase of Foreign Direct Investment reached IDR 71.2 Trillion in Q4 of 2013.

Industry: Commercial Banking

Indonesia banking remains strong resilience reflected in the high CAR and low NPL. The credit growth of Micro, Small and Medium Enterprises recorded higher growth than last year, although there is a tendency began to slow down since September 2013. The high growth of SME loans is indicating the magnitude of the role of SMEs in supporting the domestic economy amid of slowing down economy global.

Bank Indonesia (2014) stated that the growth of Indonesian banking income was supported by the payment systems that keep it running efficiently, safely and smoothly. The reliability of non -cash payment systems in the financial industry indicated by the fulfillment of the availability payment networks that utilized the service level satisfaction. It has been established since 2013. Trough their e-channel and internet banking, banks could earn more income from the fee based income (Bank Indonesia, 2014).

In 2013, the positive performance of the asset management could see from the ability of Bank Indonesia in provide sufficient currency, denominations appropriate, timely, and in decent condition in mid of the rising demand for currency. The growth of M1 and M2 are slowing down in the past year and the same trend was happened in deposit growth. Thus, LDR of Indonesia banking industry was increasing.

Strong market opportunity in the micro lending

In 2012, 84% of Indonesian SMEs did not have access to credit facilities from banking (Kementrian Indonesia, 2013). Table 4 shows that the number of SMEs in Indonesia accounted as 56.5 million and only few of 9 million of them that had saving credit account in banks. This number shows that the big up-tap potential micro lending market in Indonesia.

Table 4 Number MSME and Bank Account Nationally

Account	2012	percent
Total Number SMEs	56,534,592	100%
Number Saving Credit Acc. of SMEs	9,078,322	16%

Sources: Kementrian Koperasi

Election 2014 perishes the growth in micro lending business

Figure 5 depicts that BRI's credit growth in every election year was increasing significantly. In 2004 and 2009, the growth of BRI's credit was the highest form the past performance of company. In 2009, the credit growth was going up by 15% by previous years or hiked above of 30%. Moreover, Basir (2014) stated the election will impact the credit growth positively (The Jakarta Post, 2014). Thus, BRI is targeting the credit growth by 20-22% in this year (sindoweekly. 2014), but corporate and commerical lending are slightly will be decreasing in 2014 (Kompas, 2014). The election will bring the positive sign for the business and increase the level confidence of the citizen. Hence, it will create opportunity for new SMEs in publishing, textile, etc.

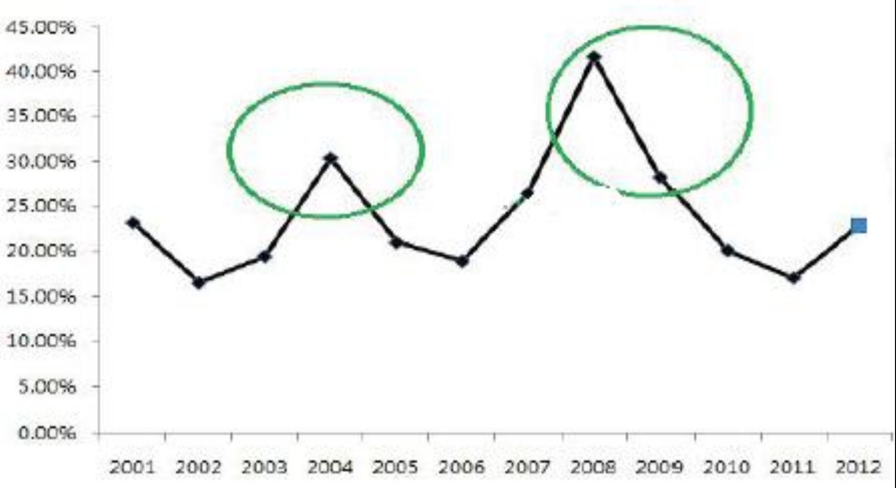


Figure 5 Bank Rakyat's credit growth, Sources: Bank Rakyat Indonesia

A favor high yield business model

Firms in banking industry have different types of business model which will generates a firm an organic growth or revenue drivers. For instance, Bank Central Asia focuses on commercial loan and corporate loans, Mandiri chooses to serve market in corporate loan, commercial and micro lending and BRI provides credit for MSME market.

In micro lending market, the usually has high yield compare to the other types of loans, 18-19% (high risk, high return). The yield will be increase if the inflation increases. The uniqueness of micro lending industry is that the customers are not significantly influences by the high interest rate to propose their loans. Basir (2014) argued that the micro customers are not very sensitive to higher interest rates. As long as they have access to banks and can get money quickly, they will take it. For them what's important is access. However, the banks which are interested to provide micro lending should concern about the costly infrastructure to remote area, knowledgeable and prudent employees, clear procedures and low cost of third party funds.

Table 5 percentage of MSME's credit distribution to total credit

Bank	6/1/2009	12/1/2009	6/1/2010	12/1/2010	6/1/2011	12/1/2011	6/1/2012
Bank Mandiri (Persero) Tbk	14.79%	14.96%	14.72%	14.99%	14.74%	14.79%	15.50%
Bank Negara Indonesia (Persero)	20.35%	44.34%	30.24%	40.64%	39.11%	27.38%	24.34%
Bank Rakyat Indonesia (Persero)	81.71%	69.09%	47.74%	54.48%	46.19%	47.37%	43.29%
Bank Tabungan Negara (Persero) (BTN)	89.15%	10.94%	15.89%	12.62%	19.62%	15.84%	16.77%

Sources: Bank Indonesia

Table 5 shows that the direct competitor of BRI in market is BNI, Mandiri, and other a new and little players (Bank Pembangunan Daerah). Figure 4.11 shows that the number outlet of some banks in Indonesia. The figure depicts that Bank Rakyat Indonesia dominated the number of the outlets.

Competitive Advantages

From the total national KUR (Kredit Usaha Rakyat), Bank Rakyat Indonesia had market by 90% of 5.85 million of accounts with 60% of the accounts are coming from remote areas. This number shows that BRI had a solid market power in micro lending that supported by the networks, infrastructure, and knowledge (experiences). In March 2014, BRI officially owned 5,144 of BRI units, 2,208 Teras BRI and 465 Teras Mobil which operated all around Indonesia.

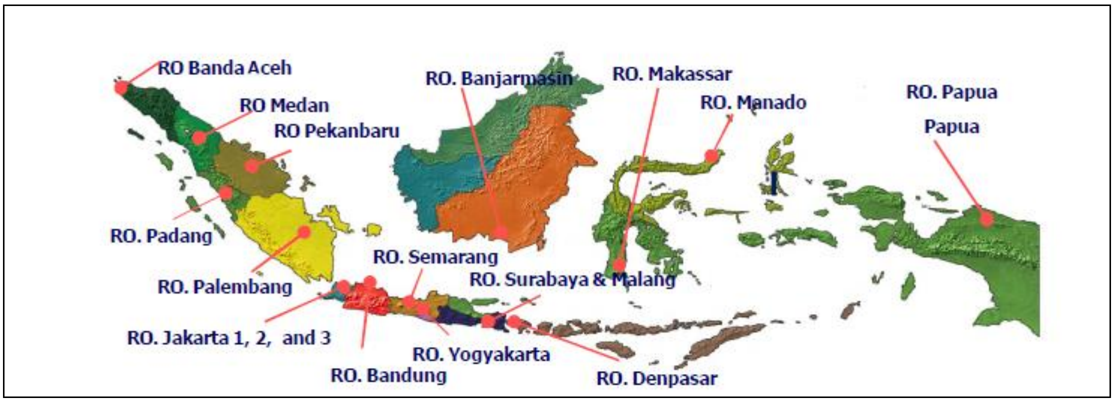


Figure 6 Regional Office distributions, Sources: Bank Rakyat Indonesia

BRI plans to open 571 small and micro lending sites to add its nearly 10,000 branches in the country as refers to table 2. Figure 6 depicts that Bank Rakyat Indonesia dominates the micro lending business through large possession of micro outlets compares to its competitors which are only nearly 5,000 branches. More than 2,000 of BRI's outlets are located nearly to the micro business environment such as traditional markets.

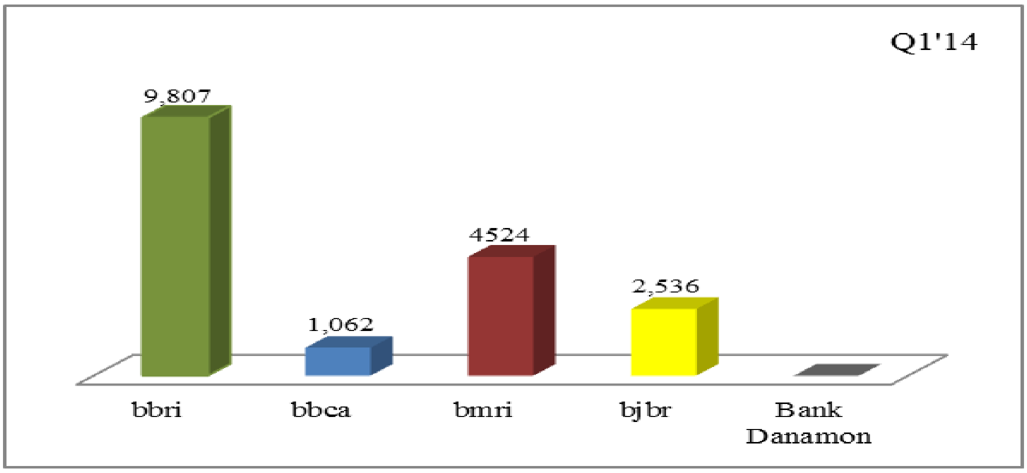


Figure 7 Outlet comparisons, Sources: Bank Rakyat Indonesia

Focus on micro lending business, Bank Rakyat Indonesia is expanding to the edges of the archipelago's 17,000 islands with over 500 new branches to develop local economies. It expects that 75% of total loans to micro credit, small and medium enterprises by distributing as low as a million rupiah for a day considering the shrugging off growing competition in the micro lenders. In order to achieve this aim, BRI builds Teras BRI. Teras BRI occupied small office with 3x3 meters of office and located near to micro customers like traditional markets. By doing this, BRI can monitor customers and spend less capital expenditure. In the end of 2013, BRI has been operated more 2,000 of Teras BRI.

Besides developing Teras BRI, BRI designed Teras Mobil to expand its micro networks. Teras Mobile is Teras BRIes in form of cars that have similar function with the Teras BRI which to facilitate the customers' transaction. Bank Rakyat Indonesia utilized cars instead of sophisticated offices to reduce the capital expenditure. Moreover, by using Teras Mobil, Bank Rakyat Indonesia has flexibility to move and mobile to do and provide its services. The table 2 shows that Bank Rakyat Indonesia has owned more than 400 of Teras Mobil that operated in remote areas.

After beginning to operate in 2011, Teras BRI continuously showed superior performances with loan growth of 78.8% and deposit of 95.8% yoy.

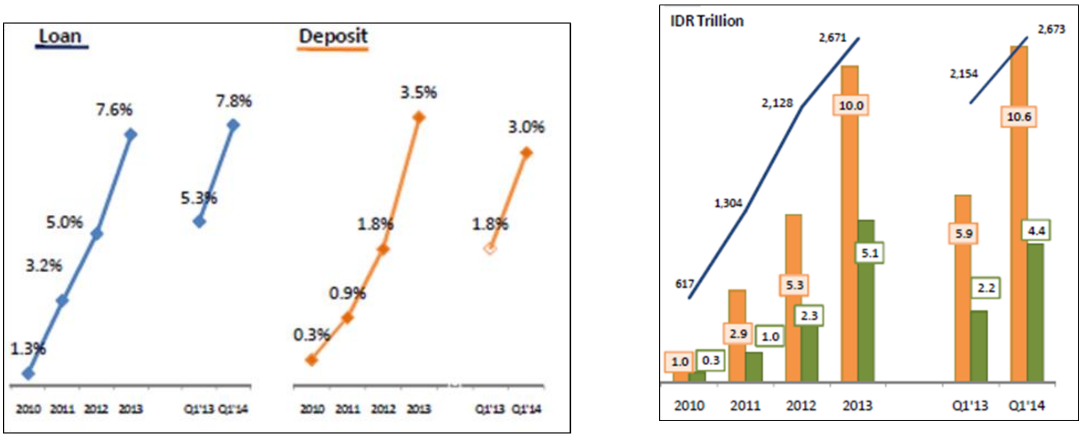


Figure 8 Teras BRI performances, Sources: Bank Rakyat Indonesia

Additionally, Bank Rakyat Indonesia is improving its service quality by increasing its e-channel system. In one of local newspapers, BRI shocked the market by buying the Indosat's towers (BRI, 2014). Bank Rakyat Indonesia argued that it was needed for the improvement of BRI's daily operational system from offline to online. BRI believed that Indosat's tower will strengthen the BRI's signal in remote area.

Table 6 E-channel

E-channel	2009	2010	2011	2012	2013	Q1'13	Q1'14
ATM	3,778	6,085	7,292	14,292	18,292	14,367	18,479
EDC	6,398	12,719	31,590	44,715	85,936	49,381	85,936
CDM	22	39	89	92	192	92	192
Kiosk	60	96	100	100	100	100	100
E-buzz	1	2	19	42	50	45	45

Sources: Bank Rakyat Indonesia

To conclude, figure 6, 7, table 2 & 6 depict that Bank Rakyat Indonesia has the most solid and largest of infrastructure compares to its competitors by owning more 9,000 of outlet and increasing number of e-channel. Teras BRI and Teras Mobil act as the arm-length of conventional micro outlet which designed to develop the market and protect the market from the competitors. It will be difficult and costly for other banks to participate in micro lending as it is needed to have solid infrastructure, largest networks and skills to distribute and gather the loans in remote areas. The writer concludes that Bank Rakyat Indonesia has secured its position as micro lender to compete with other micro lenders.

3. Valuation

Target Price

By applying the residual earnings methodology, Bank Rakyat Indonesia's current price was underperformed. Bank Rakyat Indonesia (BBRI) should be priced at IDR 11,155 per share which implied PER 11.6x and PBV 3.8x. It is valid and logical as figure 4.15 explains as the historical performances of BBRI have been moving at PER 12.29x and PBV 3.3x in average.

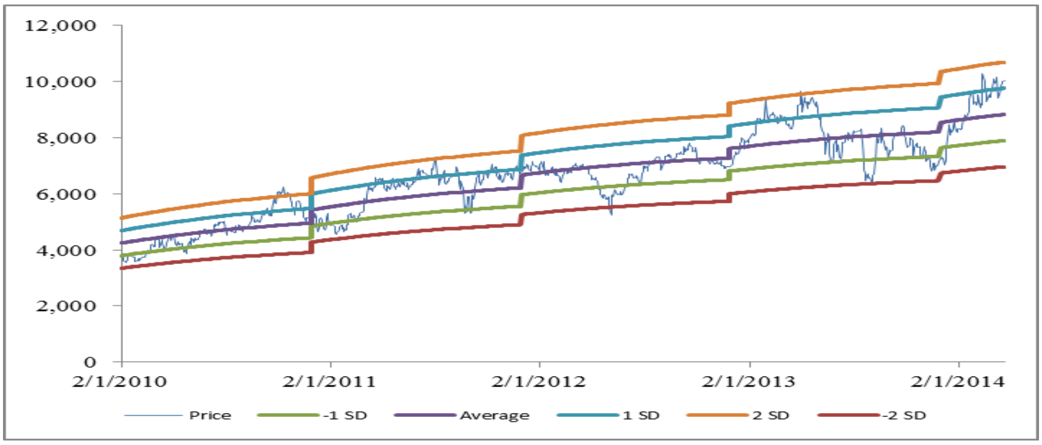


Figure 9 Historical Price with P/E Band & PBV Band, Sources: the writer's estimation

Table 7 records that trailing and forward PER and PBV of BBRI, BMRI and BBCA. The value in table 7 was based on analysts' consensus in market. The trailing and forward PER of Bank Rakyat Indonesia are 11.27x and 10 consecutively. It is slightly high compare to BMRI and low compare to BBCA. Based on DuPont analysis, BRI can gain high return on equity compare to BMRI. The investors believed the BRI's ability to give high returns will exist in some of extend years. Hence, BBRI is pricing above the BMRI. However, BBRI is pricing below to BBCA as sustainable growth of BBRI is questionable compare to BBCA. From year to years, ROE of BRI is declining and BBCA can produce stable ROE.

Table 7 Relative Valuation

	BBRI		Peers	BMRI		BBCA	
	T12M	F12M	F12M	T12M	F12M	T12M	F12M
PER	11.27	10	9.82	12.44	11.01	17.93	15.67
EV/EBITDA	8.61		7.78	7.77	7.12	13.46	11.78
DIV Yield	2.30%	2.60%	2.90%	2.40%	2.50%	1.20%	1.50%
EV/Sales	4.47	3.85	2.67	4.38	3.85	7.4	6.4
PBV	3.17	2.39	0.154	2.63	2.18	3.98	3.3

Sources: Thomson Reuters

Table 8 the analyst' coverage result

Analyst	Current Recommendation	Target Price	Review Date	EPS	
				This Year	Next Year
Mandiri Sekuritas	BUY	12,100	11-Jun-14	903	1,131
DBS Vickers	HOLD	11,600	3-Jun-14	957	1,143
Maybank Kim Eng	BUY	13,000	4-Jun-14	998	1,141
Sinarmas Sekuritas	BUY	9,550	27-Jan-14	1,056	1,126
CIMB Research	ADD	10,250	16-Apr-14	884	1,025
Bahana	BUY	13,100	9-Jun-14	978	1,125
Mean		10,848		962	1082
Median		10,700			

Sources: Thomson Reuters

Table 8 shows the coverage result of some analysts in market about the target price of BBRI. It shows that the writer's estimation is in line wih the consensus. The writer target price is IDR 11,155 in the end of 2014 with the current price in the beginning of 2014 at IDR 7,150 and IDR 9,750 in the end of March 2014. The mean of the analyst EPS estimation in 2014 is IDR 962 and 1,082 forward are in line with the writer's finding which is IDR 961.86 and 1,084.37 respectively. The writer target price and EPS are ranged in the band of market's estimation.

Projection & Assumptions

The writer decided to use the residual model as was explained in methodology. The other factors that writer used residual earnings model are less sensitive to the discount rate compare to other methods, less sensitive to the sustainable growth and less depend on terminal value of valuation. Besides that, Bank Rakyat Indonesia has premium return on equity (ROE) and the residual earning model can measure the premium return on equity of BBRI.

To value BRI, the writer needs discount factor which derives from the assumptions of risk free rate at 8.03%, risk premium at 4.1% and beta 1.38. In result, the discount rate of valuation is 12.86% by applying the Capital Asset Pricing Model (CAPM).

Projection & Assumptions of Income & Earning Assets

The writer believes that bank Rakyat Indonesia can grow its loan collection to 20% in 2014. Cushioned by the high demand of micro loan in remote areas, the election for 2014 and ASEAN Community in 2020, Bank Rakyat Indonesia increases and improves its infrastructure, networks and services.

BRI owns more than 9,500 outlets all over Indonesia which is able to maintain its position as the market leader of micro lending. Most of the MSMEs in Indonesia did not have access to banks facilities. Based on current news on International Business Times, only 34% of the total MSMEs in Indonesia had credit and saving accounts. There is more than 60% market of potential micro loans market in Indonesia. In addition, the election in 2014 will increase the BRI's credit performance by

20% as happened in the previous election of 2004 and 2009. BRI with its largest and solid networks and infrastructure can create and collect the loans.

More than 9,500 outlets BRI can distribute more than 180 trillion of micro loans in 2014 with the assumption of each its outlets can distribute loans IDR 2-3 billion of micro loans. This number is supporting by the strong performance of the Teras BRI and Teras Mobil. The growth of loan from the Teras BRI and Teras Mobil was exponentially inclining from 2012 to 2013.The growth of loan was 88%. From 2010, the credit and deposit grew by more 100% of CAGR. The writer believes that the credit will grow by 81% and deposit by 101% because more than 2,000 of Teras BRI and Teras Mobil operated in Indonesia since 2013.

The business model of BRI is playing in high yield lending favors BRI to earn stable and high interest income. Most of the BRI's credit portfolio is dominated by the high yield which is more 50%. In 2013, BRI has 58% of total loan in the high yield, 31% in micro credit, 22% in small commercial and 5% in medium loans. Usually, the yield of micro is 18-19%, corporate is 5-6% and retail 13-14%. The author estimated that the yield will not be different from previous year. Actually, the interest rate is positively correlated with the inflation. However, due to conservative projection, the author projected that in 2014, BRI will be able to earn interest income from loan 12% which will grow by 19%. The other interest income from the other earning assets will contribute by 5% of interest.

The other operating income will be driver by the fee income. From year to year fee income has established its presence through its deposit administration fee and the e-banking. The deposit fee administration will be growing as the number of deposit and credit growing. In Q1 of 2014, the deposit administration fee grew by 21% from IDR 662 billion in Q1 of 2013 so the writer projected that by taking the function of total deposit, the deposit adm. Fee will be growing by 18%. The e-banking contributes 14.5% of total income growing 45.5% from Q1 of 2013. The writer assumes that increasing in number of deposit accounts will increase the e-banking. The projection of e-banking income will depend on the number of transactions and the income from previous years.

In short, the growth driver of Bank Rakyat Indonesia is micro credit. The other loans portfolio slightly increases due to the economy activity and engagement of ASEAN Economy Community. Bank Rakyat Indonesia's income will be driven by the high yield of interest rate and presence of the fee based income.

Projection & Assumptions of Expenses

The projection of interest income will be depended on the outstanding of third party funds and other borrowing funds. The cost of fund is affected by the BI rate. The increasing of BI rate will increase the cost of funds. However, from 2010 BRI was able to manage the cost of fund below 5%

by more 55% of financing in low cost and other in high cost. Hence, the projected of the interest expenses will be derive from function of historical COF and the sum of deposit and other interest bearing liabilities. In 2014, the writer estimated that the deposit will grow by 18% with LDR ratio 91%. The writer assume that there is tight monetary in Indonesian economy. Thus, Bank Rakyat Indonesia is more focus on the repayment capacity.

The Operating expenses goes to the payment of salaries. G&A expenses, promotion, premium paid in government guarantees and other expenses. The writer applies the function of total revenue to estimate the operating expenses. The projected of gain from securities will be calculated from the sensitivity of the gain to the investment activities. The tax will be estimated by the average tax rate to earnings before tax (EBT) in the last five years multiply to the current EBT. The projected balance sheet and income will be in appendix 1 and 2.

4. Financial Analysis- Retail Funding, Selective Loan Growth

Table 9 Financial Highlight

Financial Highlights	**2009**	**2010**	**2011**	**2012**	**2013**	**Q1'13**	**Q1'14**
Asset/liabilities							
Total assets (IDR billion)	314,746	398,393	456,531	535,209	606,370	511,977	595,741
Total Loans (gross) (IDR billion)	205,522	246,964	283,583	348,227	430,618	361,250	432,436
Total Deposits (IDR billion)	254,118	328,556	372,148	436,098	486,366	403,089	470,017
Asset Quality							
NPL-gross	3.52%	2.78%	2.30%	1.78%	1.55%	1.97%	1.78%
NPL-nett	1.08%	0.74%	0.42%	0.34%	0.31%	0.46%	0.47%
Liquidity							
LDR	80.88%	75.17%	76.20%	79.85%	88.54%	89.62%	92.00%
Reserve Requirement-IDR	5.90%	8.05%	9.33%	10.64%	8.02%	8.02%	8.02%
Reserve Requirement-FX	1.00%	1.00%	8.00%	8.17%	8.00%	8.00%	8.00%
Profitability							
Net profit (IDR billion)	7,308	11,472	15,083	18,521	21,160	5,007	5,902
NIM	9.10%	10.80%	9.60%	8.42%	8.55%	8.19%	9.06%
ROE	35.20%	43.80%	42.50%	38.66%	34.11%	32.63%	30.95%
ROA-b.t	3.70%	4.60%	4.90%	5.15%	5.03%	4.76%	5.02%
Cost of Fund	6.00%	4.90%	4.70%	3.68%	3.71%	3.54%	3.94%
Cost of efficiency (CER)	46.80%	42.20%	41.20%	43.11%	42.13%	44.22%	41.80%
Opr expenses to opr.income	77.70%	70.90%	66.70%	60.58%	60.58%	60.46%	62.96%
Capital							
Tier 1 CAR	12.00%	12.00%	13.70%	15.86%	16.13%	16.90%	17.46%
Total CAR	13.20%	13.80%	15.00%	16.95%	16.99%	17.91%	18.27%

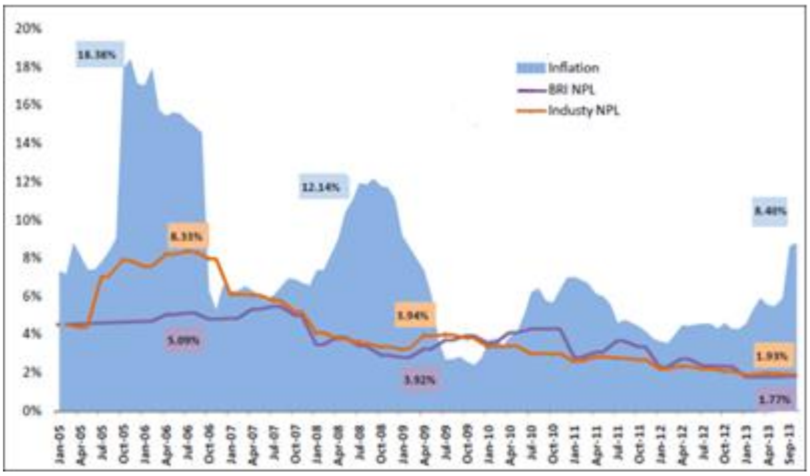
Sources: Bank Rakyat Indonesia

In the past few years, Bank Rakyat Indonesia awarded as one of the most profitable banks in Indonesia although its assets relatively small compares to its competitors Bank Mandiri. Table 9 shows that Bank Rakyat Indonesia performed solid and resilient financial position. Year to year, the Rakyat can secure low cost of funds by 14% CAGR and relocated 16% CAGR of loans from 2009 to 2013. Beside, BRI was able to manage its assets quality through better, improving and sound of NPL which were below the industry. After the financial crisis in 2008, Bank Rakyat Indonesia can fulfill the requirements that Bank Indonesia Imposed. The important thing was Bank Rakyat Indonesia gratified its investors through its high.

Balance Sheet

Bank Rakyat Indonesia had strong balance sheet structure, sufficient liquidity, and prudent loan distributions. BRI actively looked for the low cost of funds.

From 2009 to 2013, Bank Rakyat Indonesia's loan grew at the range 15% to 25% YOY with 16% of CAGR. Figure 2 identifies that loan composition of Bank Rakyat Indonesia was consistently dominated by the micro lending followed by the small commercial, consumer and corporate. The micro lending grew 21% YOY and maintained as the largest component of loan collection to be the growth driver.



Oct 05: subsidized fuel's price increased IDR 2,400 to IDR 4,500
May 08: subsidized fuel's price increased IDR 4,500 to IDR 4,000
June 13: subsidized fuel's price increased IDR 4,500 to IDR 6,500.

Figure 10 Inflation & NPL, Sources: Bank Rakyat Indonesia

Figure 10 proves that the quality loan portfolio of Bank Rakyat Indonesia is more stable than NPL of industry in the presence of economic shock. For instance, in 2005 and 2008 when there was rising in inflation rate due to the hiked fuel prices which was worsening the banking NPL, Bank Rakyat Indonesia can control its NPL below the industry.

Table 10 NPL

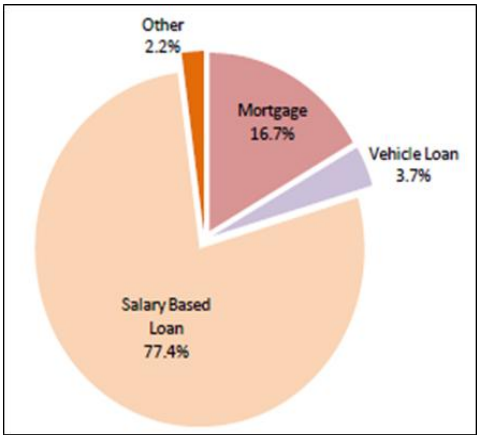
NPL	2009	2010	2011	2012	2013	Q1'13	Q1'14
Micro	1.4	1.21	1.19	1.09	1.04	1.29	1.33
Consumer	1.35	1.4	1.53	1.6	1.4	1.69	1.5
Small Commercial	4.21	5.11	4.53	3.75	3.13	4.63	3.85
Medium	12.31	6.9	7.11	5.09	4.38	5.47	5.27
SoE	0.23	0	0	0	0	0	0
Corporate	7.83	4.64	2.24	1	0.87	0.97	0.92
Total	3.52	2.78	2.3	1.78	1.55	1.97	1.78

Sources: Bank Rakyat Indonesia

Not only increased the loans portfolio and distributed it with high yield lending, Bank Rakyat Indonesia also can maintain the low non-performing loan (NPL) compare to industry which was around 5%. In the last five years, Bank Rakyat Indonesia can control its total NPL below 4%. The BRI's loan distribution was more resilient because the loan composition was dominated by the micro-loans. As result, in Q1 of 2014, NPL of BRI was in level 1.78% below the industry which was

1.99%. Hence, bankers give nickname for Bank Rakyat Indonesia as an expertise in micro lending and admire its ability to manage the quality of the loans.

Preserving the quality of micro-lending, BRI included the quality of credit as key performance of indicator (KPI) of the employees which is the Mantri Kredit. A Mantri Kredit acts as the marketing of BRI in micro-loans business. In past five years, NPL of micro loans was below 2%. In Q1 of 2014, NPL noted at 1.33% slightly increased from 1.29% in Q1 of 2013.



On the other hands, the allocation of loans portfolio to consumer loans grew by 18.4% YOY with the biggest contribution coming from the salary based loan (77%). Bank Rakyat Indonesia can maintain the repayment by automatically cut it from the salary. In the last five years, the loan quality can control at below 2% and in Q1 of 2014, the NPL recorded at 1.5%.

Figure 11 Consumer Loans, Bank Rakyat Indonesia

The other BRI's loan types are state owned enterprise (SOE) and Corporate loans. There is a shifting position in BRI's SOE and corporate loans collection. The SOE loan increased it presence at the loan by occupied 56% of the total loan of the SOE and corporate loans since 2011. From the figure 13 shows that the SOE loans collection was dominated by the agribusiness and infrastructure. The corporate loans portfolio was dominated by the agribusiness. The SOE loan quality is manageable with zero NPL in the last four years. From 2009, NPL of corporate loan dramatically declined from 7.83% to 4.64% in 2010 and went down again to 0.87% in the end of 2013. In Q1 of 2014, the NPL of corporate loan recorded at 0.92% slightly declined from 0.97% in Q1of 2013.

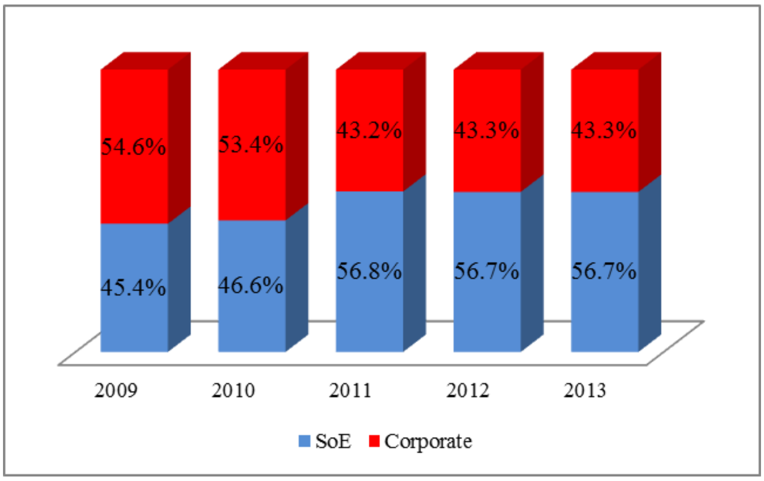


Figure 12 SOE & Corporate Loans, Sources: Bank Rakyat Indonesia

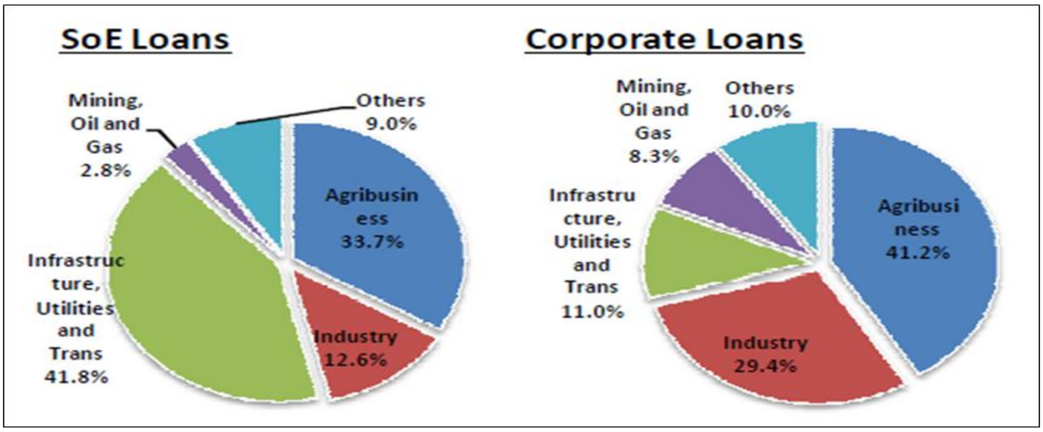


Figure 13 SOE & Corporate Loans Distribution, Sources: Bank Rakyat Indonesia

Table 10 depicts that the biggest contribution of the NPL came from the small and medium commercial as the loans contributed 4-12% of NPL for the last past five years. The reason of high NPL was because the characteristics of the consumers. The consumers of small and medium commercial loans are the low- middle income people that typically do not have permanent jobs or work in informal sectors. However, in the last five years, BRI can restructure its small commercial and medium and reduce its NPL. In Q1 of 2014, the small commercial loans had 3.85% and medium loans recorded at 5.27 % slightly declined from 5.47% in Q1of 2013.

Figure 14 shows that Bank Rakyat Indonesia can raise the third party funds (TPF) in three types which were demand deposits, savings and time deposits. From 2009 until 2013, third party funds grew by 20% in average with 14% CAGR. The deposit trend was dominated by the saving account and followed by the time deposits. Besides that, the tighter liquidation system in banking system tightened the competition to gather the third party funds which was resulting a surge in the cost of funds. There were some banks that increased their interest rate of saving, but Bank Rakyat Indonesia focused on repayment capacity to eliminate the risk of non-performing loans

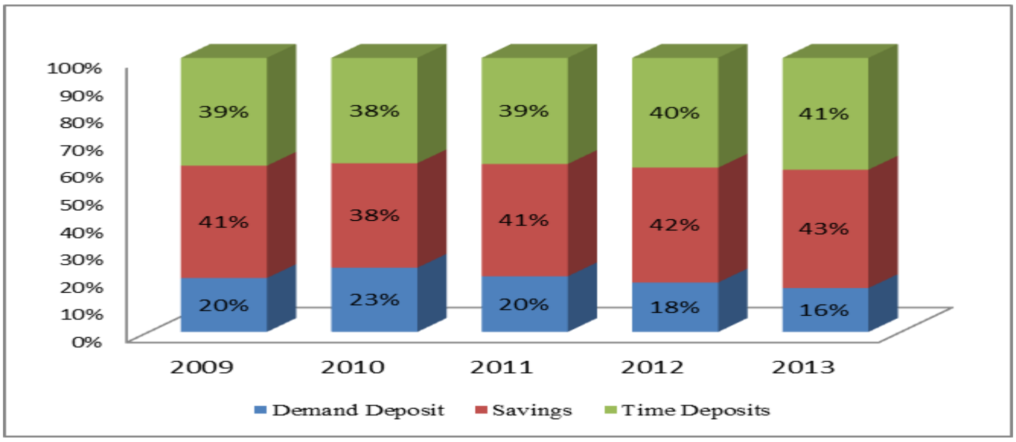


Figure 14 Deposit Trend, Sources: Bank Rakyat Indonesia

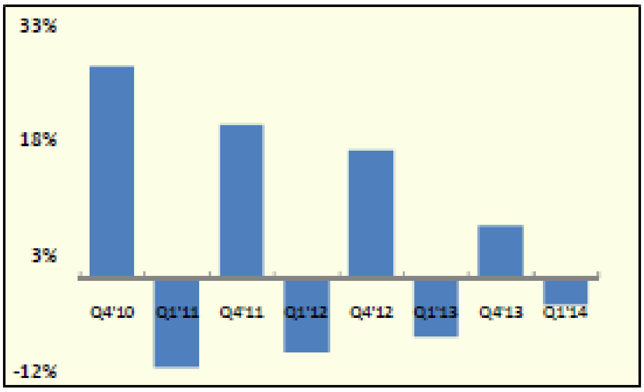


Figure 15 Deposit-QoQ growths, Sources: BRI

Bank Rakyat Indonesia not only succeed to cultivate its TPF, but also to secure the TPF in low cost of funds. Figure 16 explains that the 60% of the funds were coming from the low cost of financing. In 2013, when the tighter liquidation system in banking system, Bank Rakyat Indonesia can manage its low cost of funds slightly below the previous years.

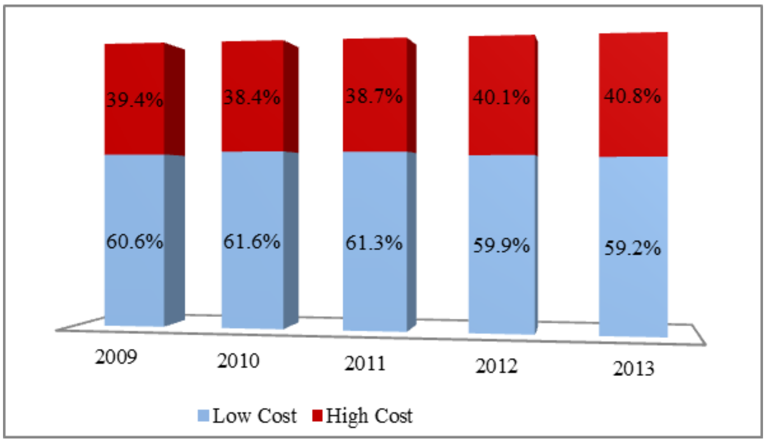


Figure 16 Deposit Compositions, Sources: Bank Rakyat Indonesia

Bank Rakyat Indonesia has a long-term commitment to optimize CASA through utilizing its robust network, which has more than 9,000 real-time online outlets. More than 85% of the total outlets BRI are micro-owned outlets accordance with the target segment, 80% of the micro-finance.

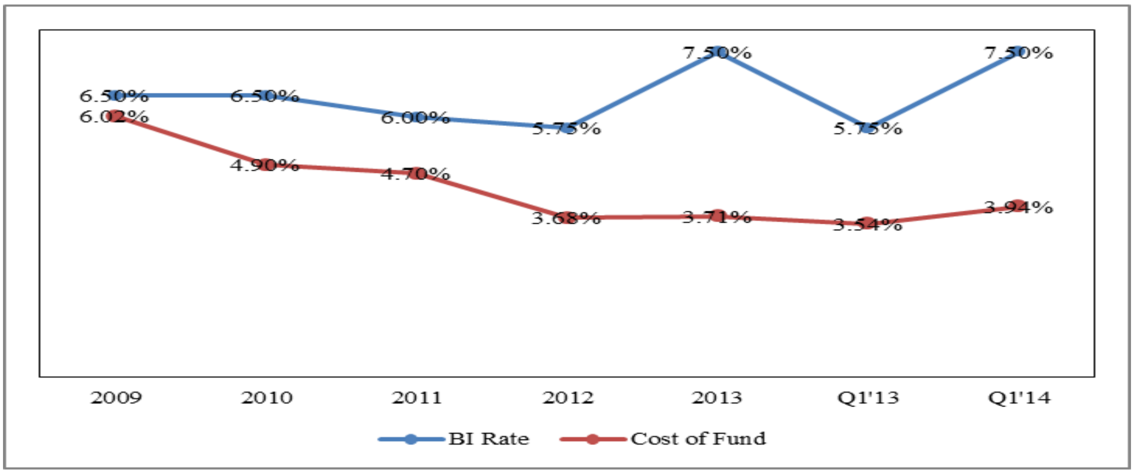


Figure 17 BI Rate & CoF, Sources: Bank Rakyat Indonesia

Figure 17 is the line chart of BI rate and cost funds. The figure shows that BI Rate slightly affected the cost of funds from year to year although we are not sure how and how much the BI Rate impacts the third party fundraising. If BI rate increase, the cost of fund will increase and another way around will happen. However, when look the line chart, Bank Rakyat Indonesia can eliminate its interest expenses far below the BI rates since 2009 until 2013.

Income Statement

There was still a downward trend in net interest margin (NIM) that occurred since 2010. However, the declining of NIM was more sloping in the year 2013. In Q1of 2014, NIM showed little improvement. Alongside, BRI's NIM compared to its competitors counted was high which industry recorded at 3.43% and BRI was at 8% in average. In the middle of BI policies that were continuing to increase interest rates, BRI can maintain its NIM above the average banking.

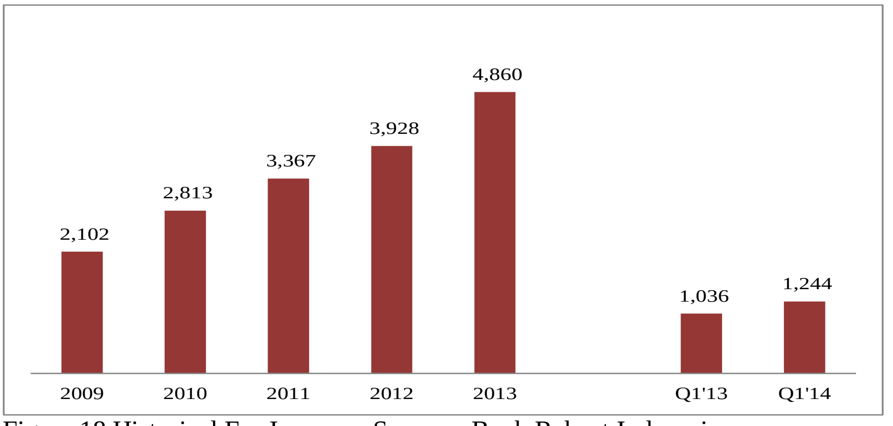


Figure 18 Historical Fee Incomes, Sources: Bank Rakyat Indonesia

As stated in business description, interest income is still the main cash machine for Bank Rakyat Indonesia. The distribution of loans to micro consumers which grew by 21% yoy, the bank was able to charge in premium yield. Beside, commit in micro lending, BRI strenthen its fee income presence. From 2009, the fee income increased exponentially above 20%. Bank Rakyat Indonesia believes that fee income has room to grow as it owns the largest customers baased in Indonesia.

Figure 19 shows that the biggest contribution of the fee income was coming from the deposit administration fee. In 2014, Bank rakyat Indonesia expects that the income from e-banking will be growing because there is improvement and increasing the number of e-banking falities (ATM, internet Mobile, etc.). In the end of 2013, the fee based income contribute 7.2% of total income and growing 24% yoy from 2012.

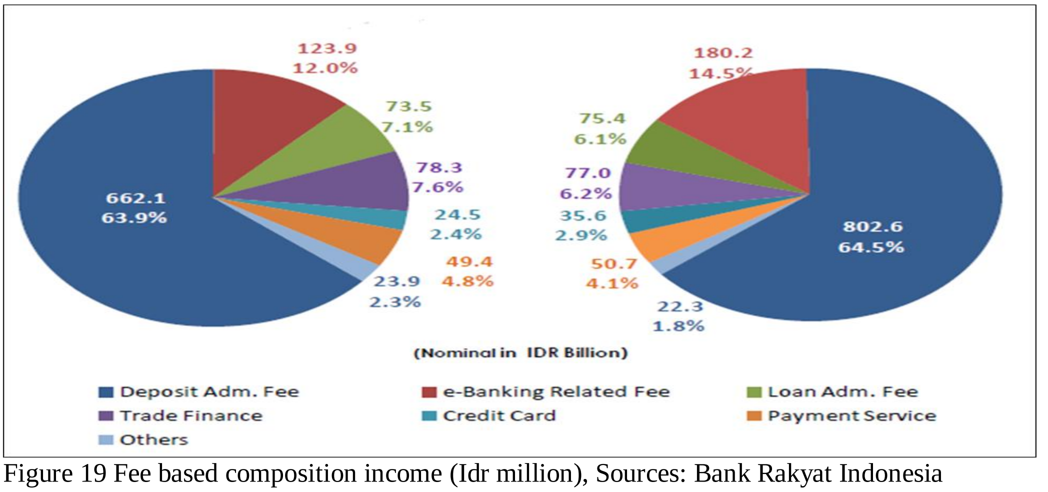


Figure 19 Fee based composition income (Idr million), Sources: Bank Rakyat Indonesia

The return on equity (ROE) of the BRI was well maintained with at 28-40%. The 28- 40% of ROE show the ability of the bank to generate income and efficiently operate and utilize its eaning assets. The high ROE was one of the attractive figure for the investors to invest in Bank Rakyat Indonesia.

5. Investment Risks

1. Macro-economy Risk

Bisnis Indonesia (2013) reported that the increasing of BI rate by 150 bps to7.25% will affect the banks' profit in 2014 by creating issues which are declining of net interest margin, increasing of credit risk, increasing of operational cost and the slowing down of business activities. Even, the government tightens the financial regulation by increasing the minimum reserve requirement, LDR and CAR to control the financial stability.

Fifty percent of BRI's loan portfolio went to MSME (Financial Statement, 2014) and 60% of its accounts came from villages (Sindo, 2013) benefited BRI through its uniqueness that has been tested in economic shock/ crisis.

- The first point is it has low correlation with fluctuation of exchange rates due to distribution of loan to remote areas where the borrowers are not (less) engaged with the export and import activities. According to Sander and Cornett (2011) sources of foreign exchange risk exposure is coming from the trading and dealing in foreign currency and the number of foreign liabilities and assest that bank has. BRI committed its business in domestic lender (Basir, 2014) will not be directly engaged to the foreign currency risk.

- The next point is it has premium yield compares to corporate loan. The distribution of loans to remote areas allows BRI to charge the borrower with the high yield. Bisnis Indonesia (2013) reported that the increasing of BI rate increase the cost of fund of banks includes BRI. To mitigate the risk, the manager can calculate the sensivity of the assets or liabilities of bank using duration model or earning simulation model to manage the asset liabilities of bank. However, Bank Rakyat indonesia's balance sheet is asset sensitive. Although, there are increasing in cost of fund, BRI can charge high yield to its borrowers (Basir, 2014). Figure 10 and figure 17 show the cost of funds were less sensitive to high inflation and BI rate. Additionally, from past financial performance of BRI, BRI's loans and deposits outstanding were growing from year to year instead of the tight monetary policy.

Bisnis Indonesia (2013) stated that changing in BI rate will influence the banks performance. It can affect the NIM, and cost of credit. Based on JP Morgan analysis in 2012, the sensitivity of profit and loss due to the changing in interest rate is shown by the table 11.

Table 11

	PPOP Impact (%)	EPS Impact (%)
NIM Assumption	8.09%	
Impact of each 10 bps	1.80%	2.10%
Cost- Income Ratio	44.30%	
Impact of each 1%	4.10%	4.70%
Credit Cost	1.90%	
Impact of each 10bps	0.00%	1.60%

Sources: JP Morgan's estimation

The JP Morgan's analyst concluded that by assuming the NIM at level 8.09%, increasing of 10 bps in NIM will increase the Pre-provision operating profit (PPOP) by 1.8% and EPS 2.1%. Hence, increasing the NIM level from 8.09% to 8.19% will increase the value by 1.8% of PPOP and 2.1% of EPS' estimation. The changing in credit cost by 10bps slightly will not affect the PPOP, but will affect the EPS' estimation by 1.6%.

- Tchana (2014) found that the large reserve requirement reduce crissi duration and capital adequacy requirment improve stability means that the regulation is absolute in banking system. The government imposed the banks with tight monetary policies which were the inclining of BI rate, the increasing of LDR and the changing in CAR and reserve requirement tighten the liquidity of banks. BRI solve its liquidity problem by increasing number of deposits. The alternative solution is increasing its fee income through internet banking and derivative products. Bank Rakyat Indonesia can occupy its large customer base to increase fee income by providing timely and efficient internet banking. Also, Bank Rakyat Indonesia can utilize its large customer base to the new derivative products such as insurances and asset management. It can be Sharia deposit, Insurances, Education Saving, etc.

Increase the fee income instead of increase the loan's distribution is more alternative solution for banks to increase their liquidity. However, Bank Rakyat Indonesia can develop both of the strategies. Bank Rakyat Indonesia can distribute loans to micro customers as the customers are less sensitive to the high interest rate. Bank Rakyat Indonesia also can occupy its large customer base to increase fee income by providing timely and efficient internet banking. Also, Bank Rakyat Indonesia can utilize its large customer base to the new derivative products such as insurances and asset management.

2. Operational Risk (Technology & People)

It has been proved that internet banking (IB) enabled people to complete their financial activities in cost-effective and effecient time (Markis et al., 2009) and can beneficial for financial institution in way eliminate cost relative to other form banking and give more timely and complete customer information (Gerrad & Cunningham, 2003) in Khedmatgozar, Keating, & Hanafizadeg (2013). Kimball & Gregor (1995) in Calisir and Gumussoy (2008) stated to attract new customers and retain the existing customers, the bank is required to develop alternative channels. Hence, Gerrad & Cunningham (2003) stated that banks spent much money on internet banking.

BRI is conscious on the role of e-channel and internet banking so BRI developed and strengthen its infrastucture and e-channel and even build BRI mobile (infobank, 2012). However, there are some complaints from the customers (konsumen.org, 2009; kompas, 2013; Rumah Pangaduan, 2014) about BRI's services, the high cost of BRI mobile, transparency, and broken ATMs. Reputation and trust is important for banks to do their activities, so BRI is required to improve its quality services and technology. One of big step

3. Threat from New Entrants

Many small banks enter the battle of micro lending as it offers premium yield. There are local banks such Bank Perkreditan Rakyat and private banks enter the market. However, not all banks can success in market as they require networks, infrastructure, experiences, people and reputation. It will be costly for small banks to develop their infrastructure and networks. If they did not have reputation and ability to raise fund in low cost of financing, it will reduce it income. Moreover, providing loans to MSMEs business has its challenge. Bank Rakyat Indonesia in the beginning of their business faced high yield of non- performing loan.

4. Risk to Target Price

Table 12 Sensitivity of price to Terminal growth & Cost of equity

		Terminal Growth				
Cost of equity	11,155	4%	5%	6%	7%	8%
	11.69%	12,242	13,525	15,258	17,732	21,547
	12.69%	10,759	11,689	12,899	14,533	16,865
	13.69%	9,583	10,278	11,155	12,293	13,831
	14.69%	8,629	9,160	9,813	10,636	11,706
	15.69%	7,840	8,253	8,750	9,363	10,135

Sources: the writer's estimation

Table 12 shows the relationship of price to terminal growth and cost of equity. 1% decreases in terminal growth will decrease the price by 9% and 1% increases in terminal growth will increase the price by 10%. Then, 1% declines in cost of equity will eliminate the price by 12% and increases in 1% of cost of equity will raise the price by 16%. The writer concludes that, the target price of Bank

Rakyat Indonesia is sensitive to the growth and cost of equity, but if it is compared between cost of equity and terminal growth, target price is more sensitive to the cost of equity.

V. CONCLUSION

Conclusion

The target price of Bank Rakyat Indonesia is IDR 11,155 by applying the discounted of residual income. The assumption of EPS will grow by 12% from 2013 and discounted rate at 13.69%. The current price of BBRI in market was underperformed. Bank Rakyat Indonesia has achieved high of return equity (ROE) through its strategy and commitment focus on micro lending business.

Bank Rakyat Indonesia owns the largest network which is supported by the younger & well educated people. BRI also has the solid infrastructure and improvement of service quality with the largest client base. Bank Rakyat Indonesia utilizes abundant factors it has will be able to grab huge and un-tap potential market in Indonesian, operate efficiently and endeavor huge business potential development.

Based on the financial performance of BRI in the last five years, Bank Rakyat Indonesia becomes the most profitable bank in Indonesia by focusing its business in micro credit. By concentrating in micro lending, BRI can take the high yield. Not only that, BRI can increases its loan portfolio with maintainable quality of the loan and manage its CASA and liquidity by developing its fee income presence.

Recommendation

Using the residual earnings model the writer recommends the investors to buy BBRI's share as the current price was underperformed. Bank Rakyat Indonesia should be priced at IDR 11,155 per share with implied PER 11.6x and PBV 3.8 x. BRI's historical prices have been moving at PER 11x and PBV 3.3x from last five year. The comparison of BBRI to its competitors, Bank Rakyat Indonesia's target price is still in line with the consensus.

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APPENDIX

Appendix 1: Income Statement

Income Statement	2010	2011	2012	2013	2014F	2015F	2016F
IDR Billion							
Interest Income	43,971.00	46,949.00	47,922.00	57,301.00	67,106.17	78,506.32	93,110.36
Interest Expenses	(11,449.00)	(13,079.00)	(12,461.00)	(14,395.00)	(17,791.27)	(20,826.46)	(27,016.97)
Net Interest Income	32,523.00	33,870.00	35,461.00	42,906.00	49,314.90	57,679.86	66,093.39
Fee & Other Opr. Income	5,458.00	5,524.00	8,166.00	8,165.00	8,260.74	9,406.85	10,513.03
Gross Operating Income	37,980.00	39,394.00	43,627.00	51,071.00	57,575.64	67,086.71	76,606.43
Other operating expenses	(15,648.00)	(16,288.00)	(18,602.00)	(21,284.00)	(24,608.09)	(26,823.82)	(32,386.36)
Pre Provision Opr profit	22,332.00	23,106.00	25,025.00	29,787.00	32,967.55	40,262.90	44,220.07
Provision	(7,926.00)	(5,532.00)	(2,555.00)	(3,916.00)	(4,738.36)	(5,591.26)	(6,709.52)
Non Opr profit/loss	497.00	1,157.00	1,169.00	1,776.00	2,420.00	1,403.80	5,615.20
Profit Before tax n minor.int	14,903.00	18,731.00	23,639.00	27,647.00	30,649.19	36,075.43	43,125.75
Income tax	(3,435.85)	(3,667.88)	(5,172.19)	(6,555.74)	(6,922.18)	(9,326.44)	(13,249.28)
Net profit	11,472.00	15,083.00	18,521.00	21,160.00	23,727.02	26,748.99	29,876.47
EPS	465.00	611.40	750.80	857.80	961.86	1,084.37	1,211.15
Dividend	89.01	70.04	122.28	257.33	480.93	542.19	605.58

Sources: BRI & Author's estimation

Appendix 2: Balance Sheet

Balance Sheet	2010	2011	2012	2013	2014F	2015F	2016F
IDR Billion							
Total Assets	398,393	456,531	535,209	606,370	708,115	819,707	961,857
Gross Loans	246,964	283,583	348,227	430,618	521,048	614,836	737,804
Government Bonds (Recap)	13,626	8,996	4,316	4,511	4,511	4,449	3,553
Other Earnings Assets	113,669	127,774	131,547	115,168	116,317	123,208	125,150
Total Earning Assets	374,259	420,353	484,089	550,297	641,876	742,493	866,507
Earning Assets Provision	(13,981)	(15,869)	(14,584)	(15,072)	(14,216)	(14,849)	(14,576)
Total Earning Assets (Net)	360,252	404,484	469,505	535,225	627,660	727,644	851,931
Total non earning assests	38,141	52,047	65,704	71,145	80,455	92,062	109,926
Total Liabilities & S.E	398,393	456,531	535,209	606,370	708,115	819,707	961,857
Total Customer deposits	328,556	372,148	436,098	486,366	573,912	671,821	799,467
Demand deposits	77,049	75,579	78,753	78,017	92,060	107,766	120,810
Saving Deposits	125,198	152,474	182,643	210,004	247,805	290,080	340,100
Time Deposit	126,310	144,095	174,702	198,346	234,048	273,977	338,557
Other Interest bearing Liabilities	16,595	18,413	14,466	19,873	19,947	20,086	20,469
Non Interest Bearing Liabilities	16,595	16,195	20,008	21,261	21,899	22,556	23,007
Tier 1 Capital	27,673	38,215	51,593	65,964			
Share capital	6,167	6,167	6,167	6,167	6,167	6,167	6,167
Paid In capital	2,774	2,774	2,774	2,774	2,774	2,774	2,774
Others equity	609	814	785	(646)	686		
Retained earning	27,123	40,019	55,080	70,868	82,732	96,106	109,867

Sources: BRI & Author's estimation