Banking

Planting Seeds on Healthier Soil

OVERWEIGHT

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By Clement Chua I clement.chua@kenanga.com.my

The banking sector is poised for favourable tidings as economic activity picks up post-2020 pandemic saga. We anticipate little headwinds against system loans growth supported by projected recovery in GDP alongside our house-view that OPR could remain at 1.75% throughout the year, making financing accessible to prospective borrowers and expansionary activities. Even assuming that loans growth remains shy, we believe that cost saving efforts implemented by the banks in the prior years will continue to contribute positively to bottom-lines. Overall credit cost allowances should also be less distended with most banks already front-loaded provisions in the 4QCY20 period and with less restrictive movement controls liberating business activities. We lower our TPs sector-wide as we account for higher risk-free rates amidst better MGS yields, resulting in downgrades to ABMB (TP: RM2.30) from MP to UP and PBBANK (TP: RM4.40) from OP to MP. Our Top Picks for 2QCY21 are MAYBANK (OP; TP: RM8.75) and RHBBANK (OP; TP: RM6.25). We advocate MAYBANK for its attractive package of industry-leading dividend yields, solid ROE and loans market share amongst industry peers. Its high CASA-to-deposit ratio provides cheap source of funds to support future loans growth. On the flipside, we like RHBBANK for its strong CET-1 reserves which enable greater capital management flexibility for the group. It also commands the only applied valuation which is above its negative standard deviation territory within our coverage, which could speak for the continuous market support for the stock.

4QCY20 earnings reporting season wrapped up nicely, as 6 banks performed as expected with 2 banks (MBSB, PBBANK) registered better-than-expected earnings, as we were previously conservative with their respective NIIs and CIRs. We only saw 2 disappointments this quarter namely AFFIN and CIMB posting higher-than-expected impairments which raises concerns on asset quality. Collectively, the banks saw NIMs expanding post OPR cuts to 1.75% in Jul 2020 with most of their fixed deposits being repriced. NOII also improved, particularly from fair value gains on investment and brokerage income but this was offset by lower commission and fees from fewer loan applications.

We anticipate 1QCY21 NII to remain weaker YoY due to low-based interest charges (1QCY20 OPR: 2.50%-3.00%) but improve QoQ from continuous loans growth with small opportunities in further NIM normalisation. **Our in-house expectation is no further rate cuts for the rest of CY21.** 1QCY21 operating expenses are expected to be effectively lower YoY, translating to stable or lower CIR for the banks. That said, as the economy reopens, we opine greater branch activities and marketing could fuel costs for the ensuing quarters. NOII could remain vibrant on strong momentum held in the trading landscape. *(We updated our TPs and calls for certain banks as we incorporate a higher risk-free rate to our Gordon Growth Model assumptions. Refer to Table 1 for a full breakdown of changes to our ratings).*

Brighter days ahead…We believe that the worst is over in terms of the economic battle with Covid-19. As vaccination programs are progressively rolled out, it would be a matter of time before businesses fully lick their wounds and consumer spending returns to pre-pandemic levels. R&R measures (15-20% of total domestic loans) are still in place, with likelihood for extension as banks are committed to continue assisting at-risk assets in vulnerable sectors. This could delay and remedy potential delinquencies and ease provisioning needs for the year. Additionally, we reckon that national economic contingencies are now firmer and another loan moratorium could be unwarranted, avoiding shocks of day-one modification losses from the banks**…barring an unexpected worsening of the pandemic.**

Reiterate OVERWEIGHT on the Banking Sector. We favour the sector as a sound proxy of the impending economic recovery as business and spending outlook normalises with the rolling out of vaccination efforts. Conservatively speaking, even if loans and net interest income growth remains tepid and vaccination progress is slower-than-expected, we believe banks could continue to yield earnings growth having implemented leaner cost structures amidst the tight operating environments during the heights of the MCO. Plus, with most impairments being frontloaded in 4QCY20, we anticipate any further provisioning during CY21 to be milder.

Our top pick for the sector is **MAYBANK (OP; TP: RM8.75)** which we tout for its industry-leading dividend yield (7-8%) and dividend-to-ROE amongst its peers. We also projected MAYBANK to be one of the better beneficiaries from economic recovery, being the leader with 28% and 29% market share in total deposits and total financing, respectively, among the 10 banks within our coverage. On another note, its high fixed-rate loan proportion (c.28%) could be offset by access to cheaper funds (CASA-to-deposit ratio: c.40%), muting the effects of rate hikes. We also favour **RHBBANK (OP; TP: RM6.25)** as a preferred pick for those seeking safety, boasting a leading CET-1 reserve of 16.2% which enables greater allowance to implement capital management strategies. Following the recent global settlement saga as seen in AMBANK (UP; TP: RM2.40), investors could be emphasising greatly on capital reserves. It does not hurt that RHBBANK comes with the next best dividend returns of 4-5% amongst the rest of its conventional peers (2-4%).

Factoring in greater favour for bond. In this report, we revise our applied risk-free rate for the sector to 3.3% from 3.1%, in line with our overall 2QCY21 Investment Strategy for equities. We highlight that MGS yield has been inching upwards in tandem to our low interest rate environment and wider spread between 10-year US Treasury notes and MGS. Reflecting the lower incentive in equities into our Gordon Growth Model-derived PBV computations, we have arrived at the lower TPs for all banks within our coverage. This reduction resulted in downgrade of ABMB to Underperform from Market Perform and PBBANK to Market Perform from Outperform. Although capital upside prospects for our Top Picks, MAYBANK and RHBBANK, are less impressive with the revised TPs, they are still attractive for their respective dividend yields.

Table 1: Summary of changes to TP and calls

Company	Previous Rating		Updated Rating		Previous valuations	Updated valuations
	Target Price	Call	Target Price	Call		
ABMB	2.50	MP	**2.30**	**UP**	0.56x FY22E PBV (-2.0SD below 5-year mean)	0.54x FY22E PBV (-2S.0D below 5-year mean)
AFFIN	1.40	MP	**1.35**	UP	0.29x FY22E PBV (-2.0SD below 5-year mean)	0.28x FY22E PBV (-2.0SD below 5-year mean)
AMBANK	3.05	MP	**2.40***	**UP**	0.51x FY22E PBV (-1.5SD below 5-year mean)	0.50x FY22E PBV (-1.5SD below 5-year mean)
BIMB	5.25	OP	**5.15**	OP	SoP valuation - 0.90x FY22E PBV - 0.25x TAKAFUL fair value of RM6.00	SoP valuation - 0.87x FY22E PBV - 0.25x TAKAFUL fair value of RM6.00
CIMB	3.60	UP	**3.50**	UP	0.61x FY22E PBV (-1.5SD below 5-year mean)	0.60x FY22E PBV (-1.5SD below 5-year mean)
HLBANK	18.50	MP	**17.80**	MP	1.14x CY22E PBV (-0.5SD below 5-year mean)	1.10x CY22E PBV (-0.5SD below 5-year mean)
MAYBANK	9.10	OP	**8.75**	OP	1.18x FY22E PBV (-0.5SD below 5-year mean)	1.13x FY22E PBV (-0.5SD below 5-year mean)
MBSB	0.820	OP	**0.720#**	OP	0.51x FY22E PBV (-1.5SD below 5-year mean)	0.49x FY22E PBV (-1.5SD below 5-year mean)
PBBANK	4.55	OP	**4.40**	**MP**	1.67x FY22E PBV (-1.0SD below 5-year mean)	1.60x FY22E PBV (-1.0SD below 5-year mean)
RHBBANK	6.40	OP	**6.25**	OP	0.86x FY22E PBV (5-year mean)	0.83x FY22E PBV (5-year mean)

Notes:
** Inclusive of share dilution from the proposed private placement of 300.0m shares and impairment of goodwill announced in 1-Apr-2021.*
 # Inclusive of model updates on book value assumptions

Source: Companies, Kenanga Research

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High chance for loan growth to stay positive. 2020 national GDP was wrecked by Covid-19 with movement controls leading to a YoY decline of 5.6%. Naturally, 2QCY20 was the worst performer at the height of the MCO and when fear of contraction was at its peak, plunging 17.1% as compared to 2QCY19. 3QCY20 and 4QCY20 which subsequently registered YoY decline of 2.6% and 3.6%, respectively. Notwithstanding this, system loans undeterredly saw new injections (+3.4% YoY) as loan demand was helmed by households (+5.0% YoY) capitalising on low interest rates to venture into the property market. On the flipside, business loans were unsurprisingly less upbeat (+1.0% YoY) as manufacturers and service providers (retail, tourism sectors) had to scale back operations in conjunction with movement control procedures, particularly during the 1HCY20 period.

With consideration to the abovesaid, given that the economy is expected to pick up with looser movement controls alongside vaccination efforts, we should anticipate loans growth to accelerate at a greater projected rate, especially with more business accounts seeking financing. We also reckon that new household loans would continue to be injected so long as interest rates remain close to presently low levels.

Table 2: Yearly and Quarterly GDP Growth (1QCY15-CY21F)

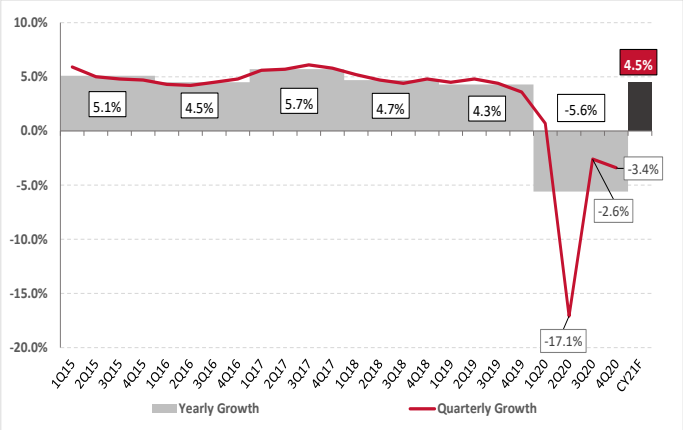
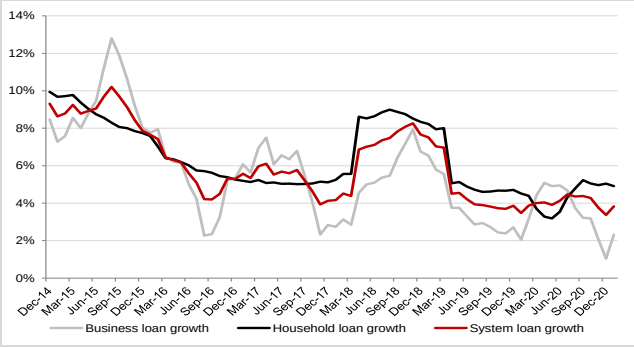


Table 3: System Loans Growth as at Jan'21

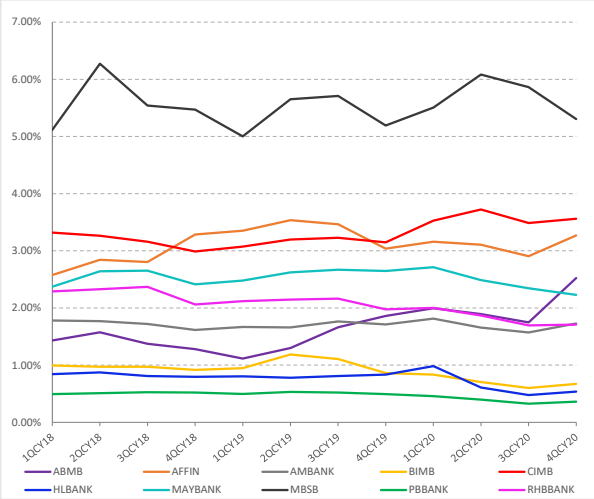


	Annual Growth		
	Total Loans	Household Loans	Business Loans
Dec-15	7.9%	7.7%	8.0%
Dec-16	5.3%	5.3%	5.3%
Dec-17	4.1%	5.1%	2.8%
Dec-18	7.7%	8.3%	6.8%
Dec-19	3.9%	4.7%	2.7%
Dec-20	3.4%	5.0%	1.0%

Source: DOSM, BNM, Kenanga Research

Asset quality - stirred but not shaken. Wrapping up the year, risks of widespread defaults were well-contained aided by the initial 6-month loan moratorium in addition to banks having practiced tight credit screening policies. That said, asset quality concerns are still at play in the event that economic activity does not recover quick enough to resuscitate accounts at-risk. Heavy impairments have been frontloaded by most banks in 4QCY20 and we take comfort that most loan-loss coverage are above c.90%. According to BNM stats, industry LLC stood at 107.9% in Dec 2020 and 106.0% in Jan 2021. Given that the respective GILs for banks have been relatively well-managed, with some performing better than prior years, we are more eager to believe that there should not be any major dents in the near-term.

Table 4: Gross impaired loans ratio (1QCY18-4QCY20)



Notable observations

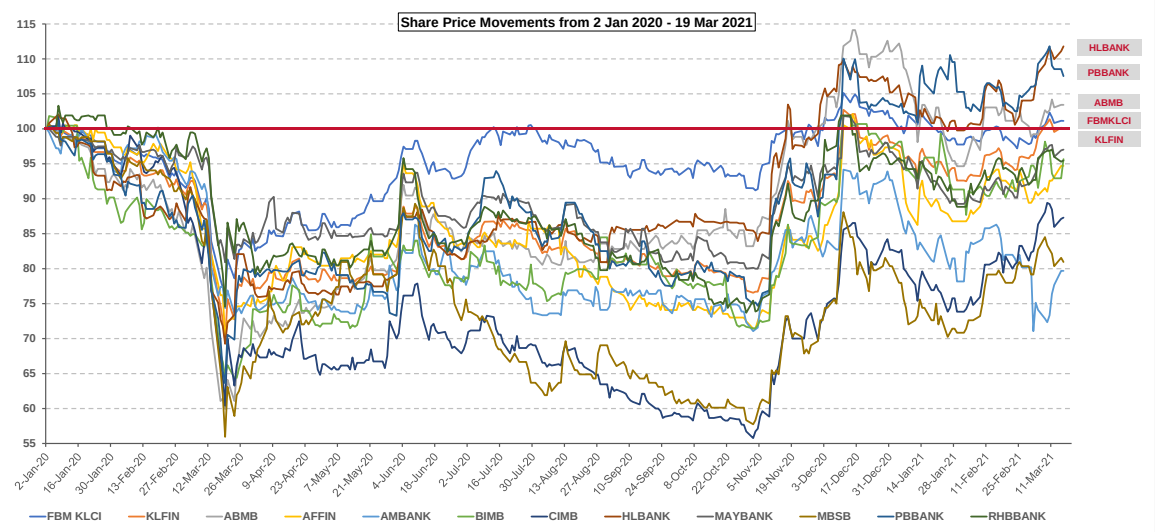
- ABMB's GIL rose from 4QCY19 at 1.86% to 2.52% in 4QCY20. Asset quality is stressed by the MCO which we believe could extend further into the coming months.
- CIMB's GIL lingered between 3.5-3.7% in CY20, as compared to 3.0-3.2% in CY19. Given regional risks (c.40% of total loans), it is possible that CY21 could remain at current levels or worse.
- Other larger institutions (i.e. HLBANK, MAYBANK, and PBBANK) were successful in containing portfolio deterioration from tighter credit screening procedures prior to the MCO. However, this could also be due to the loan moratorium delaying the loss of assets-at-risk.
- MBSB saw a progressive rise in its GIL but managed to narrow it in 4QCY20 to 5.30% (from 4QCY19 of 5.19%) mainly due to the delinquencies of its corporate financing account in 2QCY20 being normalised over time.

Source: Companies, Kenanga Research

Risk-to-reward ratio for the banking sector is presently favourable. In facilitating the argument that our economy would return to "normal levels" and hence be reflected in the stock market, we track movements in the price and Fwd. PBV for the banks. Up to our cut-off date of 19 Mar 2021, only ABMB, HLBANK and PBBANK have exceeded their 2 Jan 2020 prices while valuation-wise, it was ABMB, CIMB and PBBANK.

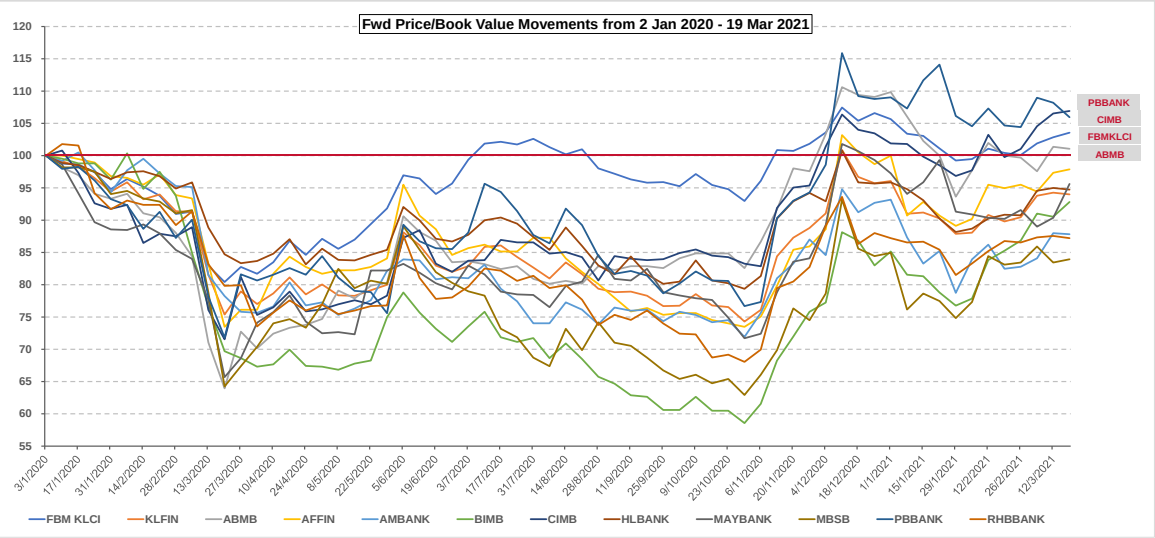
PBBANK's better-than-peers recovery could be mainly due to a boost in liquidity premium following its 4:1 bonus issue which was completed in Jan 2021. On the flipside, we reckon CIMB's valuation expansion was due to investors positioning the stock based on pre-MCO price points at around RM5.00 despite softer earnings expectations, thus inflating its effective Fwd. PBV.

Table 5: Only 3 banks have returned to pre-MCO price levels…



Source: Bloomberg, Kenanga Research

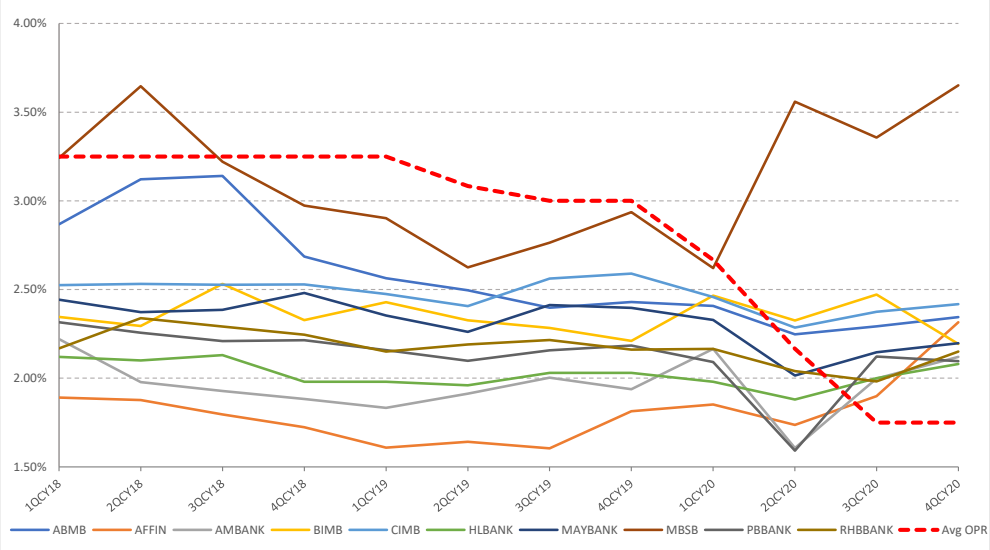
Table 6: …but even fewer caught up in terms of valuation



Source: Bloomberg, Kenanga Research

To give benefit of the doubt to the underperformers, sentiment for these banks are probably muted due to: (i) lower interest rate environment diverting favour to the bonds market, and (ii) tighter product pricing opportunities for banking products, and (iii) wavering confidence in an economic recovery until the results present itself. While we relate to the shift in (i), we propose that concerns raised in points (ii) and (iii) are less warranted as banks were able to sustain NIMs via product repricing *(refer to Table 7)*. That said, the efficiency in implementing product repricing is dependent on the individual banks' CASA-to-deposit and fixed/variable rate loans mix *(refer to Table 8)*. On the other hand, we believe that putting a position based on economic recovery would be a more tactical approach given the investor's stance. Still, we suggest that there are more tailwinds than headwinds in the coming quarters, premised on looser movement controls as compared to 2HCY20 and progressive rollout of vaccinations (with our government's 80% target of total adult population by 1QCY22) . Those who are patient could position themselves early while the risk adverse could await further confirmations from reported GDP and earnings numbers in the coming quarters.

Table 7: NIMs and OPR trends (1QCY18-4QCY20)



Source: Companies, Kenanga Research

Table 8: Fixed and variable loans and deposits (as at 4QCY20)

ABMB	AFFIN	AMBANK	BIMB	CIMB	HLBANK	MAYBANK	MBSB	PBBANK	RHBBANK
Fixed rate loans proportion *(Lower % is more favourable with flat-to-higher OPR expectations)*									
15.92%	25.87%	21.20%	8.26%	16.13%	18.11%	28.35%	8.60%	21.90%	13.10%
CASA-to-deposits ratio *(Higher % is more favourable with flat-to-higher OPR expectations)*									
44.56%	22.22%	28.11%	35.13%	41.87%	29.96%	41.30%	2.35%	28.86%	30.85%

Source: Companies, Kenanga Research

All matters considered, we continue to highlight buying opportunities for our Top Picks MAYBANK (OP; TP: RM8.75) and RHBBANK (OP; TP: RM6.25). To recap, MAYBANK provides investors with strong dividend returns (7-8%) supported by its solid ROEs and market leader position. Meanwhile, RHBBANK's key highlight is its strong capital reserves acting as safety net helping it to better weather through further down-cycles compared to its peers. Further from our investment thesis on the two, we believe the sector could see further re-rating on the back of: (i) better sentiment from faster-than-expected economic recovery, (ii) OPR hikes, (iii) faster-than-expected loans growth, and (iv) sustained cost savings from more efficient operating practices adopted, such as leaner manpower structures and more digitalised business functions and outreach. **We reiterate our OVERWEIGHT call on the Banking sector.**

Peer Table Comparison

Name	Last Price (RM)	Market Cap (RM'm)	Shariah Compliant	Current FYE	Revenue Growth		Core Earnings Growth		PER (x) - Core Earnings			PBV (x)		ROE (%)	Net DivYld (%)	Target Price (RM)	Rating
					1-Yr. Fwd.	2-Yr. Fwd.	1-Yr. Fwd.	2-Yr. Fwd.	Hist.	1-Yr. Fwd.	2-Yr. Fwd.	Hist.	1-Yr. Fwd.	1-Yr. Fwd.	1-Yr. Fwd.		
Stocks Under Coverage																	
AFFIN BANK BHD	1.73	3,598.0	N	12/2021	-4.6%	2.7%	46.5%	11.2%	15.6	10.7	9.6	0.4	0.4	3.5%	2.9%	1.35	UP
ALLIANCE BANK MALAYSIA BHD	2.68	4,148.9	N	03/2021	-10.1%	-6.4%	-14.7%	34.8%	9.8	11.5	8.5	0.7	0.7	5.9%	2.2%	2.30	UP
AMMB HOLDINGS BHD	3.00	9,024.3	N	03/2021	-10.9%	4.6%	-205.4%	190.0%	6.7	N.A.	7.8	0.5	0.5	-7.9%	0.0%	2.40	UP
BIMB HOLDINGS BHD	4.20	7,785.3	Y	12/2021	7.6%	3.9%	6.1%	0.8%	10.9	10.3	10.2	1.2	1.1	11.5%	3.3%	5.15	OP
CIMB GROUP HOLDINGS BHD	4.36	43,264.1	N	12/2021	-9.3%	-0.3%	-73.8%	176.0%	9.5	36.2	13.1	0.8	0.8	2.1%	1.1%	3.50	UP
HONG LEONG BANK BHD	18.58	40,276.2	N	06/2021	14.8%	9.6%	14.3%	6.3%	15.2	13.3	12.5	1.4	1.3	10.1%	1.9%	17.40	MP
MALAYAN BANKING BHD	8.25	94,165.5	N	12/2022	-4.7%	2.8%	8.8%	19.7%	13.6	12.5	10.5	1.1	1.1	8.7%	6.8%	8.75	OP
MALAYSIA BUILDING SOCIETY BHD	0.670	4,673.5	N	12/2021	66.6%	3.0%	173.9%	14.4%	17.0	6.2	5.4	0.5	0.5	8.1%	4.5%	0.720	OP
PUBLIC BANK BHD	4.22	81,913.1	N	12/2021	1.4%	2.3%	15.6%	3.1%	16.8	14.5	14.1	1.7	1.6	11.6%	3.3%	4.40	MP
RHB BANK BHD	5.37	21,533.9	N	12/2021	-6.6%	-2.6%	-18.1%	16.0%	8.7	10.6	9.1	0.8	0.8	7.7%	3.3%	6.25	OP
Simple Average					**4.4%**	**2.0%**	**-4.7%**	**47.2%**	**12.4**	**14.0**	**10.1**	**0.9**	**0.9**	**6.1%**	**2.9%**		

Source: Kenanga Research

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Stock Ratings are defined as follows:

Stock Recommendations

OUTPERFORM	: A particular stock's Expected Total Return is MORE than 10%
MARKET PERFORM	: A particular stock's Expected Total Return is WITHIN the range of -5% to 10%
UNDERPERFORM	: A particular stock's Expected Total Return is LESS than -5%

Sector Recommendations***

OVERWEIGHT	: A particular sector's Expected Total Return is MORE than 10%
NEUTRAL	: A particular sector's Expected Total Return is WITHIN the range of -5% to 10%
UNDERWEIGHT	: A particular sector's Expected Total Return is LESS than -5%

******Sector recommendations are defined based on market capitalisation weighted average expected total return for stocks under our coverage.***

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KENANGA INVESTMENT BANK BERHAD (15678-H)
Level 17, Kenanga Tower, 237, JalanTunRazak, 50400 Kuala Lumpur, Malaysia
Telephone: (603) 2172 0880 Website: www.kenanga.com.my E-mail: research@kenanga.com.my