Banking

OVERWEIGHT

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Far from Being in Shambles

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We maintain our OVERWEIGHT call on the sector. The recent collapse of certain US banks (Silicon Valley Bank, Signature Bank) and abrupt takeover of systemically important Credit Suisse by UBS have unnerved many on the integrity of the global financial system. The consensus view points to factors leading to the debacles being idiosyncratic, and by most measures, have been contained. Locally, we believe the landscape remains highly sound and stable with limited risk of contagion, with key notes being: (i) continued economic expansion, albeit lower from CY22 higher growth base (in line with our CY23 industry loans growth target of 4.0%-4.5% from CY22 of 5.7%), (ii) tight and adequate capital and liquidity controls, (iii) well-guarded asset quality and provision management, and (iv) limited direct exposure to non-ASEAN markets. Meanwhile, we believe OPR will remain steady state at 2.75% throughout CY23, giving banks and the economy space to adjust against inflation headwinds. That said, we understand that current investor sentiment could be wavering and may demand safer bets to remain invested. Hence, our sector top picks are: (i) PBBANK (OP; TP: RM4.90) for its stellar asset quality and highly collateralised loans portfolio, a fair trade-off for lower-than-industry growth, and (ii) RHBBANK (OP; TP: RM7.10) for its leading CET-1 and refreshed dividend potential (c.7% yield) serving as a high-yield alternative.

Safe from a perfect storm? The ongoing commotion in the global banking scene appears to be mainly rooted in mismanagement and nonchalance on concentration risks. We summarise the key banes to be: (i) lackadaisical capital and liquidity management, (ii) investment risk oversight against developing macros, and (iii) heavily skewed and undiversified customer profiles. While the intense hike of US Fed rates (+475 bps since March 2022 vs. BNM's OPR +100 bps since May 2022) is partially pointed as one of the catalysts, we believe better control of the above could lead to different outcomes. On the contrary, we have evaluated key readings between Malaysian banks which we believe are largely sheltered against similar occurrences. This is thanks to tight regulation imposed by BNM to ensure strict adherence to capital and risk management, also enabled by frequent stress testing and scrutiny.*(refer to the overleaf our analysis at "A Case to Favour Malaysian Banks")*

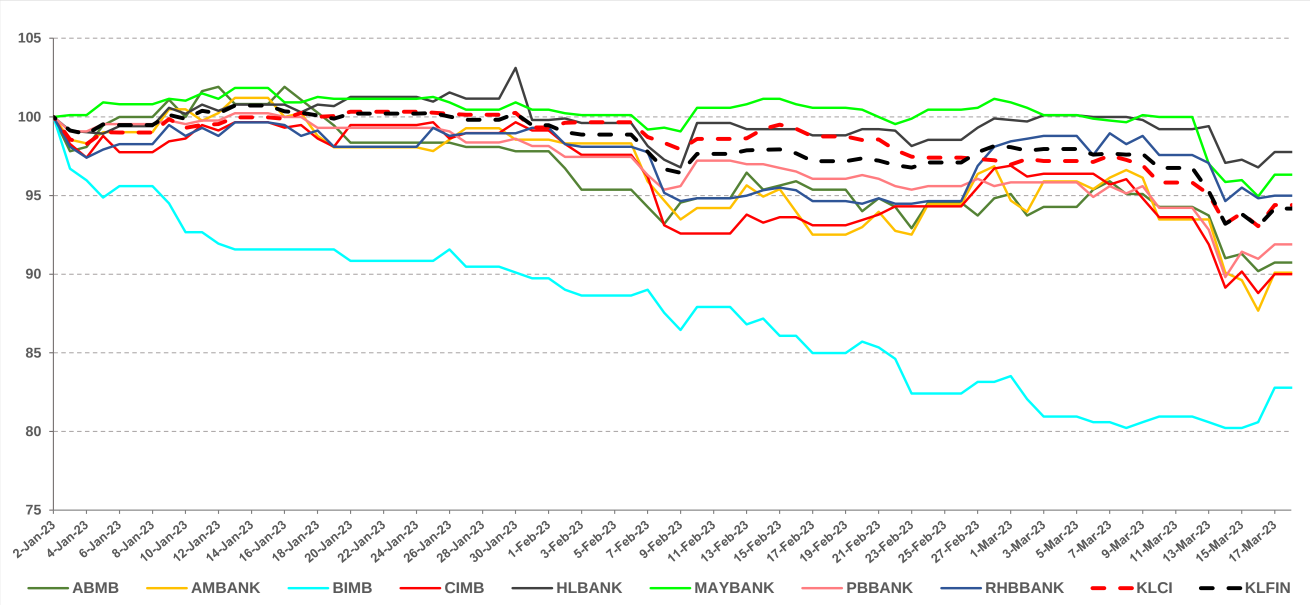
Local macros remain firm. We opine that the stability of the Malaysian landscape would be reason enough for investors to stay invested with the banks. The country is still expected to ride on a more modest recovery path, with our in-house CY23 GDP expectation of 4.7% (CY22: 8.7%). This is carried by strong export-driven manufacturing industries which could be supported by reopening economies. Meanwhile, the overall services industry could remain intact as the retail, food & beverages and tourism sub-segments could still be in demand, albeit with possible moderation as consumers may down trade in the face of general inflation. All in, we perceive this to be supportive to the strength and stability of the domestic financial system, as opposed to more heavily inflation-affected markets such as the United States (CY22 GDP: 2.7%, CY23 consensus estimates: 0.9%). This is also apparent in respective Dec 2022 CPI inflation readings of 3.3% and 6.5% for Malaysia and the United States.*(refer to the overleaf for further commentary on industry fundamentals)*

Earnings expected to expand in spite of shaky top line. Looking towards 1QCY23 earnings, the banks are anticipating similar shifts of slower fund-based income on the back of abating loans growth and softer interest margins as price competition for deposits heightens. On the flipside, non-interest income which were previously dragged by subsequently lower investment returns are expected to normalise. This could be chiefly led by the absence of hefty fair value losses from fixed income securities on stabilising interest rates. Meanwhile, more active trading conditions could boost brokerage performance while also encouraging fee-based income streams, namely wealth management. Ultimately, while income streams may show mixed signals, we opine that the banks should collectively reflect easing credit cost numbers, with some hints of write-offs as Covid-related provisions could lapse. In addition, the ending of prosperity tax would be a definite blessing to bottomline, with some banks previously seeing effective tax rates of c.30%. Within our coverage, we still anticipate a commendable c.12% increase in FY23 earnings across the sector.

Maintain OVERWEIGHT on the banking sector. We continue to believe that the fundamentals of the banking sector is well grounded and is not likely to experience any pressures which gravitates anything close to what is happening abroad. That said it is understandable if investors prefer to stay on the side line as global sentiment for the financial sectors have tumbled. While this could present numerous buying opportunities across our coverage calls, we opine to selectively promote names which offer greater safety nets amongst its peers. We also avoid banks with a higher non-interest income exposure as investors may also view this space with greater caution. With that, for 2QCY23, we opt to promote: **(i) PBBANK** as it is the leading bank in terms gross impaired loans (GIL) reading at 0.4% (vs peer average: 1.5%) backed by a highly collateralised loans book thanks to a substantial mortgage portion (41% of total books). Meanwhile, its recent shares sell-down owing to uncertainties of its shareholder and ownership structure may see an inversion when clarity on the matter unfolds. We also like **(ii) RHBBANK** as we believe the relevancy of strong capital safety will be in the limelight once more. RHBBANK continues to lead its peers with its CET-1 buffers (17% vs peer average: 14%). On the other hand, RHBBANK's dividend prospects become more promising with targeted payouts of c.55% looking to generate yields of 7%-8%. Also, developments on its upcoming digital bank with Boost could support interest.

Shaky start of the year. Unlike CY22, banking stock shares experienced mixed performances in relation to key indices. Despite having reported commendable 4QCY22 earnings in Feb 2022; YTD-Mar 2023, only **HLBANK (OP; TP: RM23.35), MAYBANK (OP; TP: RM10.10)** and **RHBBANK** have outperformed the FBM KLCI and Bursa Financial Index, albeit still lower than when they started the year. We see these names to be credited as more conservative bets by investors for their asset quality safety and dividend returns. Notably, although PBBANK also demonstrated strong earnings (beating our FY22 forecast), concerns over its shareholdings structure has led to some apparent profit taking since Dec 2022. **BIMB (MP; TP: RM2.30)** was the main underperformer possibly due to guidances that asset quality could lag from inflation-led affordability concerns, owing to its high retail portfolio.

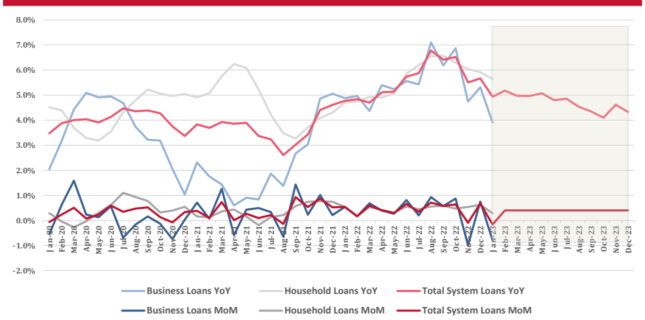
YTD CY23 Performance of Banking Stocks against the FBM KLCI and Bursa Finance Index (KLFIN)



Source: Bloomberg

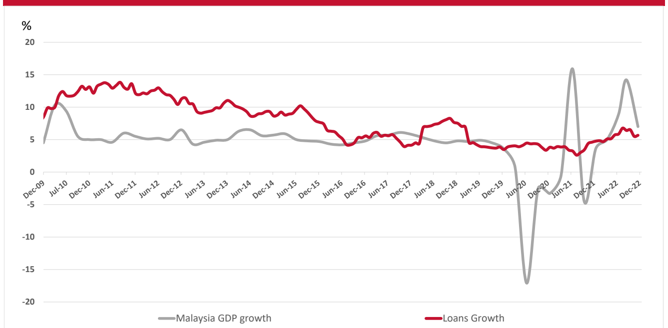
CY23 industry loans could peg lower at 4.0%-4.5% (CY22: 5.7%). Jan 2023 industry statistics reported a 4.9% YoY system loans growth, reflective of better spending sentiment from both household and business accounts. This could also be pushed by earlier financing bookings in anticipation of subsequently higher OPR, which saw four 25 bps hikes from May 2022 to Nov 2022. That said, it also translated to a MoM cooling off by 0.2%, as customers may be less impulsive with regards to further lending decisions. Businesses may also hold back amidst a possible easing in economic activities as inflationary pressures progressively materialise. **This is in line with our in-house GDP target for CY23 of 4.7% (from 8.7% in CY22).**

YoY and MoM Loans Growth and Projection



Source: Kenanga Research

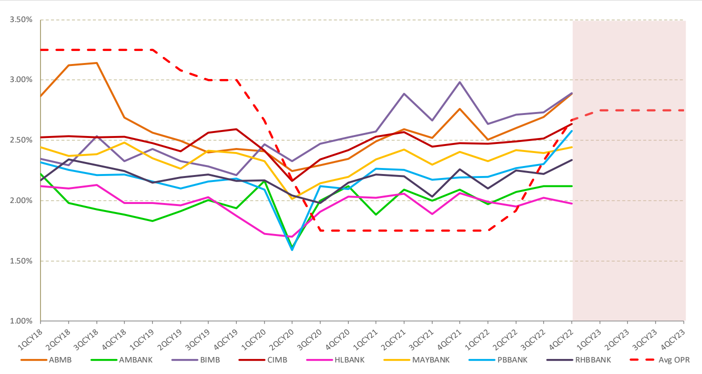
GDP and Loans Growth Trajectory



Source: Kenanga Research

NIMs to erode amidst flat OPR expectations. Past OPR hikes did result in expanding NIMs as loan rates were more proactively re-priced from variable rate financing whereas deposit rates tend to lag, mainly due to locked fixed deposit rates. However, **we anticipate that OPR could remain in a steady state throughout CY23** which could make industry profit rates less obscure, allowing banks to better identify competitive pricing opportunities to capture market share. Ultimately, this could dilute the NIM gains that banks enjoyed in the past year. This ties in with the lower margin guidances for CY23 by corporates, with some anticipating double digit-level compression.

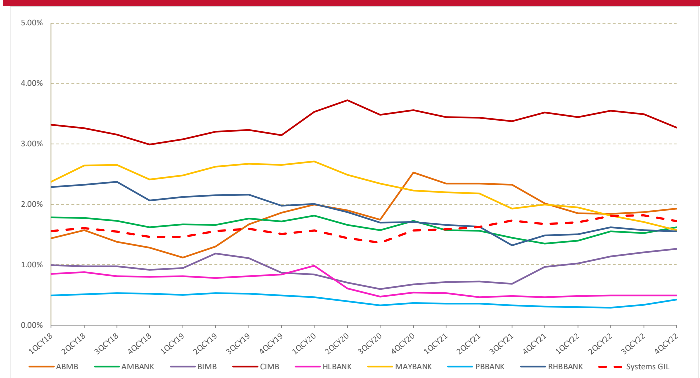
Est. Annualised NIMs



Note:
- Orange bar indicates our in-house OPR expectations in the coming periods
Source: Kenanga Research

Coverage GIL mostly unconcerning. Sector gross impaired loan (GIL) appears to have settled at a normal state, as past increments were contributed from certain troubled accounts falling to delinquency from the lapse of repayment assistance programs. That said, while some banks are easing progressive improvements, some are seeing minor bumps as inflationary pressures have pushed previously healthy accounts into close observation. However, we are still not perturbed by this as most banks are still operating below system GIL levels. **CIMB (OP; TP: RM6.55)** continues to be the outlier owing to its wide regional exposure (i.e. Indonesia and Thailand) which distorts group-wide readings. HLBANK and PBBANK persist to be the industry gold standard with GIL readings of 0.5% and 0.4%, respectively, thanks to strict credit risk measures and selective retail-focused portfolios.

Est. GIL trends (1QCY18-4QCY22)



Source: Kenanga Research

A Case to Favour Malaysian banks

As mentioned, we identified the key factors for the recent fallout of foreign banks to be due to mismanagement as well as heavily concentrated asset profiles, aggravating their exposure to very specific risk factors. We provide the following tables to extol that Malaysian banks are shielded from such incidences.

Asset Breakdown

4QCY22	ABMB	AMBANK	BIMB	CIMB	HLBANK	MAYBANK	PBBANK	RHBBANK
Total assets (RM'm)	**65,088**	**185,205**	**89,852**	**665,956**	**265,189**	**947,813**	**493,263**	**310,788**
Gross loans	47,276	126,338	65,942	407,057	172,281	587,122	376,892	212,200
Financial Investments	11,528	44,542	15,455	218,983	69,234	311,842	82,164	79,740
FVTPL - Malaysia	*306*	*7,865*	*299*	*33,200*	*6,760*	*38,627*	*949*	*3,089*
FVTPL - Outside Malaysia	*-*	*435*	*-*	*17,841*	*639*	*15,868*	*-*	*910*
FVOCI - Malaysia	*8,387*	*23,474*	*12,093*	*58,676*	*28,816*	*120,706*	*54,867*	*38,974*
FVOCI - Outside Malaysia	*-*	*24*	*7*	*26,086*	*1,023*	*57,943*	*169*	*6,234*
FVAC - Malaysia	*2,835*	*12,744*	*3,055*	*64,533*	*31,518*	*71,757*	*25,570*	*27,007*
FVAC - Outside Malaysia	*-*	*-*	*-*	*18,646*	*476*	*6,942*	*608*	*3,525*
As % of total assets								
Gross loans	73%	68%	73%	61%	65%	62%	76%	68%
Financial investments - Malaysia	18%	24%	17%	23%	25%	24%	16%	22%
Financial investments - Outside Malaysia	0%	0%	0%	9%	1%	9%	0%	3%

Source: Companies, Kenanga Research

Financing focused, as banks should be. It has been identified that Silicon Valley Bank (SVB)'s failure was due to disparities in its capital management, namely having a large proportion of its assets being locked in low-yielding US government bonds (>40% of total assets) which suffered major face value revaluation from the aggressive 475 bps hike in US Fed Rates.

With regards to the Malaysian banks, we identified that only the largest banks (CIMB, MAYBANK) have total investments of slightly more than 30% of their overall assets. Focusing on risks that they could be exposed to further downward revaluation of bonds, FVOCI holdings do not make more than 20% of total assets with further comfort taken that most allocation are towards Malaysian issuers (government and corporate). Given the Malaysian economic macros and inflation are more stable than the US, we believe BNM can continue to afford mild and progressive rate hikes, if any, prompting better bond price security relative to other markets.

Customer Breakdown

4QCY22	ABMB	AMBANK	BIMB	CIMB	HLBANK	MAYBANK	PBBANK	RHBBANK	Peer Average	Industry
Loans Interest Rate Profile										
Fixed Rate	18%	21%	8%	19%	17%	28%	22%	11%	18.0%	
Variable Rate	82%	79%	92%	81%	83%	72%	78%	89%	82.0%	
Loans Demographic										
Individuals / Retail	49%	54%	74%	53%	65%	50%	68%	50%	57.8%	
SME	35%	21%	4%	13%	18%	12%	19%	15%	17.0%	
Foreign Entities	1%	1%	0%	10%	2%	7%	1%	15%	4.8%	
Others	15%	24%	22%	24%	15%	30%	11%	20%	20.4%	
Deposits Demographic										
Individuals / Retail	43%	40%	14%	42%	50%	38%	53%	35%	39.4%	
Business Enterprise	34%	51%	35%	38%	47%	45%	29%	52%	41.4%	
Government and Statutory Bodies	7%	4%	34%	3%	2%	8%	3%	9%	8.9%	
Others	16%	5%	16%	16%	1%	9%	15%	3%	10.3%	
CASA-to-deposit ratio	45.8%	32.2%	33.6%	42.1%	31.8%	39.1%	29.9%	29.2%	35.5%	29.0%
Loan-to-deposit ratio	95.1%	107.5%	111.9%	91.3%	88.1%	93.4%	95.7%	93.8%	97.1%	86.0%
Gross impaired loans ratio	1.93%	1.62%	1.27%	3.27%	0.49%	1.57%	0.42%	1.55%	1.51%	1.72%
Loan loss coverage ratio	125.0%	95.3%	124.5%	93.1%	210.1%	127.5%	272.0%	112.8%	145.0%	97.4%
CET-1 capital	15.1%	12.2%	13.6%	14.5%	13.0%	15.7%	14.6%	16.9%	14.4%	15.2%

Source: Companies, Kenanga Research

Shelter from stormy weather. Further on SVB, its bank run was also aggravated by its extremely low concentration on retail depositors (<3% of total books have deposits of less than USD250k), catering mostly to niche start-up and venture capital funds market. Between Malaysian banks, we can see that most have a sizeable inclination towards retail depositors (peer average: 39%). That said, some may argue that an excessive deposits liquidity from a high CASA-to-deposit ratio could ease the occurrence of bank runs, most Malaysian banks register a loan-to-deposit ratio of less than 100%, which should support unexpected shifts in funding requirements.

On the flipside, we see loans demographics to also be fairly retail driven, mostly made up by safer collateralised mortgage financing. To reiterate, we believe asset quality risks between Malaysian banks to be mostly well managed with most banks still reserving provisions and management overlays amidst unexpected asset quality shocks. Loan loss coverage readings also appear well cushioned with most banks lingering above 100%.

Further, all banks conserve significant CET-1 with industry readings being close to 15%. This is well above BNM's slated requirement of 7.0% for CET-1 and 8.5% for Tier 1 capital. This is starkly higher against US Fed's minimum CET-1 requirement of 4.5%. The safety that this provides is capital buffers against unexpected losses which may arise from unexpected lumpy impairments while securing a dividend pool which could be paid out to investors.

Peer Table Comparison

Name	Rating	Last Price (RM)	Target Price (RM)	Upside	Market Cap (RM'm)	Shariah Compliant	Current FYE	Core EPS (sen)		Core EPS Growth		PER (x) - Core Earnings		PBV (x)	ROE	Net. Div. (sen)	Net Div Yld
								1-Yr. Fwd.	2-Yr. Fwd.	1-Yr. Fwd.	2-Yr. Fwd.	1-Yr. Fwd.	2-Yr. Fwd.	1-Yr. Fwd.	1-Yr. Fwd.	1-Yr. Fwd.	1-Yr. Fwd.
Stocks Under Coverage																	
ALLIANCE BANK MALAYSIA BHD	OP	3.38	4.40	30.2%	5,233	N	03/2023	44.7	49.4	20.9%	10.4%	7.6	6.8	0.8	10.5%	22.0	6.5%
AMMB HOLDINGS BHD	OP	3.72	5.00	34.4%	12,302	N	03/2023	51.0	54.8	12.0%	7.4%	7.3	6.8	0.7	9.7%	16.0	4.3%
BANK ISLAM MALAYSIA BHD	MP	2.16	2.30	6.5%	4,847	Y	12/2023	26.2	27.2	14.4%	4.2%	8.3	7.9	0.7	8.1%	15.5	7.2%
CIMB GROUP HOLDINGS BHD	OP	5.35	6.55	22.4%	57,058	N	12/2023	59.7	68.4	14.3%	14.7%	9.0	7.8	0.9	9.7%	30.0	5.6%
HONG LEONG BANK BHD	OP	20.24	23.35	15.4%	43,875	N	06/2023	197.0	199.7	22.7%	1.4%	10.3	10.1	1.2	12.5%	70.0	3.5%
MALAYAN BANKING BHD	OP	8.63	10.10	17.0%	104,027	N	12/2023	79.6	79.3	15.7%	-0.3%	10.8	10.9	1.2	11.0%	68.0	7.9%
PUBLIC BANK BHD	OP	3.98	4.90	23.1%	77,255	N	12/2023	35.9	37.0	13.8%	3.2%	11.1	10.7	1.4	13.4%	18.0	4.5%
RHB BANK BHD	OP	5.57	7.10	27.5%	23,658	N	12/2023	77.4	77.6	15.8%	0.2%	7.2	7.2	0.7	10.7%	43.0	7.7%
Sector Aggregate					**328,255**					**12.4%**	**4.9%**	**9.7**	**9.3**	**1.0**	**10.5%**		**5.8%**

Source: Kenanga Research

Gordon Growth Model Inputs

Name	Cost of Equity (%)	Terminal growth (%)	Sustainable ROE (%)	Fair value P/BV (x)	Applied BVPS (RM)	Call	Target Price (RM)	Remarks
ALLIANCE BANK MALAYSIA BHD	11.0	3.0	10.0	0.88	4.78	OP	4.40	+5% ESG Premium
AMMB HOLDINGS BHD	10.7	4.0	9.5	0.82	6.05	OP	5.00	
BANK ISLAM MALAYSIA BHD	10.4	3.0	8.0	0.68	3.38	MP	2.30	
CIMB GROUP HOLDINGS BHD	11.0	3.0	10.5	0.94	6.63	OP	6.55	+5% ESG Premium
HONG LEONG BANK BHD	9.7	3.5	12.0	1.37	17.05	OP	23.35	
MALAYAN BANKING BHD	9.7	3.25	12.0	1.36	7.44	OP	10.10	
PUBLIC BANK BHD	9.7	4.0	13.0	1.58	2.94	OP	4.90	+5% ESG Premium
RHB BANK BHD	10.7	3.0	10.0	0.91	7.79	OP	7.10	

Source: Kenanga Research

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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