SECTOR UPDATE

Banking – Malaysia

Staying Resilient In The Face Of Economic Slowdown

The KLFIN index has outperformed the FBMKLCI by 11% ytd. While the economic slowdown may temper growth, the sector is likely to retain its relative outperformance. This is premised on: a) sector valuation of -1.0SD nearing average crisis trough of -1.5SD, b) potential positive NIM surprise on an early interest rate hike cycle, c) comfortable pre-emptive provisions, and d) attractive 2022/23 dividend yields of 4.8%/5.4% respectively. Maintain OVERWEIGHT with HLBank as our top pick.

WHAT'S NEW

- **Sector resilience despite challenging market conditions.** The sector has outperformed the FBMKLCI by 11% ytd with the KLFIN index delivering a 2% absolute return vs a 9% ytd decline in the FBMKLCI. In the past periods of market uncertainty, the KLFIN index had declined in tandem with the FBMKLCI and in most cases underperforming the FBMKLCI index marginally. In this report, we strive to dissect and explain the key reasons underpinning the current sector resilience in the current market uncertainty compared with previous periods.
- **Valuations starting at a lower base.** As shown on the next page, we noted that during all the past periods of market uncertainty/crisis, overall sector valuations were heading into the crisis at a much higher P/B valuation averaging +1SD to historical mean P/B. This tends to be a natural phenomenon of inflection points in business/market upcycles and downcycles. However, due to Malaysia's recovery lag from the COVID-19 pandemic vs other more developed markets, there was not sufficient time for the market to price in the full recovery in the banking sector valuations before the current market uncertainty had begun to set in. As such, the sector is entering the current market/economic uncertainty at a much lower valuation metric of -1.0SD to 2023 P/B.
- **Limits downside risk as valuations are close to average troughs in past crises.** As shown on the next page, the sector trough valuations for mid and severe crises averaged at -1.0SD and -2.0SD to its historical mean P/B respectively, which is fairly close to the sector's current valuation of -1.0SD on 2023 P/B. Given that the sector is entering the current period of uncertainty at a much lower valuation metric, we are unlikely to witness a large implosion in sector share price performance as what was seen in past downturns and market volatility.

ACTION

- **Maintain OVERWEIGHT.** We view the current market weakness as an opportunity to accumulate as the risk-to-reward is certainly turning increasingly favourable in our view. This is premised on: a) sector valuation of -1.0SD nearing average crisis trough of -1.5SD, b) earnings resilience sustained by potential positive NIM surprise as we remain in the early stages of the overnight policy rate (OPR) hike cycle, c) comfortable pre-emptive provisions provide some buffer against any deterioration in asset quality on inflationary pressures, and d) attractive 2022/23 dividend yields of 4.8%/5.4%.
- **Top pick: Defensive and balanced approach.** Given the current market uncertainty, we adopt a more defensive and balanced approach. In this respect, we have identified Hong Leong Bank as our top sector pick. We like Hong Leong Bank for its: a) low loans-to-deposit ratio (83% vs industry: 87%), which makes it less susceptible to deposit competition given scope for asset-liability optimisation, b) robust loans-loss coverage ratio (second highest after Public Bank, and c) robust growth from associate-Bank of Chengdu.

OVERWEIGHT

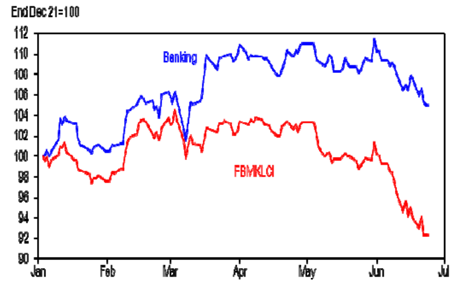
(Maintained)

TOP SECTOR PICKS

Company	Rec	Target Price (RM)	Share Price (RM)
HL Bank	BUY	24.00	20.16
RHB Bank	BUY	6.60	5.66

Source: UOB Kay Hian

KLFIN INDEX OUTPEFROMED FBMKLCI YTD2022



Source: Bloomberg, UOB Kay Hian

BANKS SECTOR PBV

Source: Bloomberg, UOB Kay Hian

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PEER COMPARISON

Company	Ticker	Rec	Share Price (RM)	Target Price (RM)	Market Cap (US$m)	PE (x) 2021	PE (x) 2022F	PE (x) 2023F	ROE (%) 2022F	P/B (x) 2022F	Div (sen) 2022F	Div Yield (%)
CIMB Group	CIMB MK	BUY	4.90	6.30	11,657	11.4	9.5	7.6	8.5	0.8	26.0	5.3
HL Bank	HLBK MK	BUY	20.16	24.00	9,926	14.7	13.2	10.9	10.4	1.3	54.4	2.7
RHB Bank	RHBBANK MK	BUY	5.66	6.60	5,415	7.9	8.8	7.3	8.9	0.8	35.7	6.3
HLFG	HLFG MK	BUY	18.38	21.70	4,781	9.3	9.7	8.2	9.2	0.9	38.6	2.1
Alliance	ABMB MK	BUY	3.30	4.30	1,160	9.0	7.8	7.3	10	0.8	21.1	6.4
Maybank	MAY MK	HOLD	8.60	9.45	23,381	12.0	11.7	10.1	9.2	1.1	55.0	6.4
Public Bank	PBK MK	HOLD	4.43	4.85	19,531	14.0	15.0	12.7	11.6	1.7	14.6	3.3
AMMB	AMM MK	HOLD	3.73	3.50	2,805	7.4	8.0	7.5	8.9	0.7	17.9	4.8
Bank Islam	BIMB MK	HOLD	2.65	2.45	1,297	9.4	12.1	10.4	6.9	0.8	9.8	3.7
Affin	ABANK MK	HOLD	1.88	1.90	907	6.9	7.1	6.0	5.1	0.4	7.9	4.2

Source: UOB Kay Hian

ESSENTIALS

- **Early stages of interest rate upcycle.** In addition, we noted that during the past periods of economic uncertainty and market volatility, the interest rate cycle was either unchanged or on a downward trend which would have compounded the negative sentiment on banks by pressuring NIM. In the current cycle, not only are interest rates on an uptrend but we remain in the early stages of the interest rate upcycle. Our in-house economic team is expecting a total of three OPR hikes in 2022 and two in 2023. This implies an additional four OPR hikes over the next 12-18 months. Factoring in rising deposit competition and lower CASA mix, we have conservatively built in a 2-3bp NIM enhancement for the sector in 2022 on the back of our in-house expectation of three OPR hikes in 2023 vs the theoretical uplift of 4-6bp.

- **Management overlays provide a comfortable buffer.** Apart from AMMB, most banks have retained their pre-emptive provisions (management overlays + macroeconomic variables) despite a faster-than-expected decline in repayment assistance with the take-up rate averaging 5% as at mid-May 22 vs 26% as at end-Dec 21. This will allow banks to partially draw down on these buffers in 2023 if inflationary pressures were to lead to an unexpected deterioration in asset quality. We conservatively pencilled in a fairly elevated sector net credit cost of 38bp/34bp for 2022/23 vs pre-COVID-19 average of 30bp.

- **Earnings outlook remains resilient.** We expect sector earnings growth to remain flattish at 1.1% in 2022 due to the impact of the prosperity tax before staging a much stronger 19% yoy earnings growth in 2023, given the one-off nature of the prosperity tax in 2022 and continued improvement in provisions. Despite a challenging non-interest income outlook in 2022, where we have pencilled in 5% yoy contraction due to rising bond yields and weak wealth and brokerage income, we are still expecting the sector to register a 4% revenue growth, driven by 2-3bp NIM expansion (three OPR hikes in 2022) and commendable loans growth of 5.0% (2021: 4.6%).

- **Earnings flattish during mild to mid-level crisis intensity.** The sector was still able to eke out a 1% earnings growth even during periods of mild to mid-level crisis. As such, the large selldown was largely due to de-rating in valuations from a high base in the past, which is less relevant in the current period with the sector trading at -1SD to historical mean P/B.

KLFIN INDEX PEFORMANCE AND PEAK TO TROUGH VALUATION

	Period	KLFIN index (% chg)	Sector earnings (% yoy chg)	Change in valuation (SD)	OPR trend
Global Financial Crisis	2007-09	-45	-12	+1.8 to -1.8	-150bp to 2.00%
European Debt Crisis	2H11	-16	4	+1.0 to -0.5	Unchanged
Oil Price Crash and GST implementation	2014-16	-21	-3	+0.2 to -1.8	Unchanged
GE15 and US-China Trade War	2018-19	-18	2	+1.0 to -1.0	-25bp to 3.00%
COVID-19	2020-21	-33	-21	+1.0 to - 2.2	-125bp to 1.75%
Average		-27	-6	+1.0 to -1.5	
YTD 2022 (Current)		2		-1.0	+75bp to 2.50% (f)

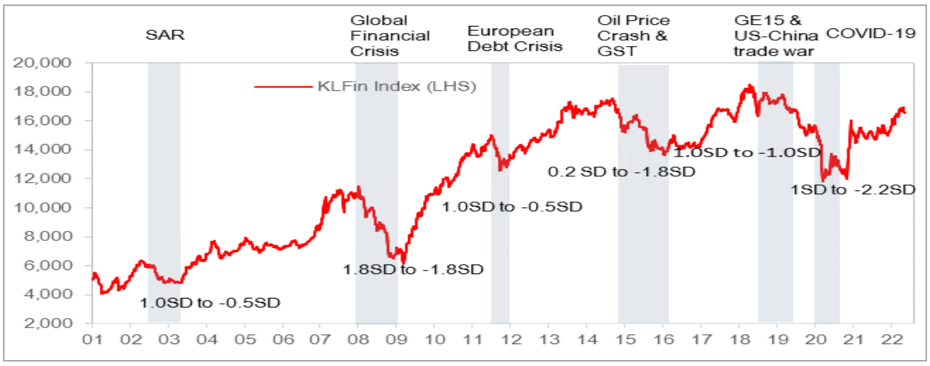
Source: Bloomberg, UOB Kay Hian

CRISIS INTENSITY ON AVERAGE VALUATION AND EARNINGS TREND

Level of crisis intensity	KLFIN index performance	Sector earnings	Trough PBV to 10 years historical mean
Mild to Medium	-18%	1%	-1.0 standard deviation
Severe	-39%	-17%	-2.0 standard deviation

Source: Bloomberg, UOB Kay Hian

KLFIN INDEX AND PEAK TO TROUGH PBV TREND DURING CRISIS



Source: Bloomberg, UOB Kay Hian

PEAK TO TROUGH PERIOD

Peak to trough (month)	KLFIN index	Sector earnings
Global Financial Crisis	17	12
European Debt Crisis	2	9
Oil Price Crash and GST implementation	20	24
US-China trade war & GE15	17	12
COVID-19	10	12
Average	13	14

Source: Bloomberg, UOB Kay Hian

KLFIN INDEX VS FBMKLCI PERFORMANCE IN PAST DOWNTRUNS

	KLFIN index (%)	FBMKLCI index (%)	KLFIN Under-performance (%)
Dotcom Crash	-43	-33	-10
911 Terrorist Attack	-33	-25	-8
SARS Outbreak	-29	-23	-6
Global Financial Crisis (GFC)	-47	-45	-1
Europe Debt Crisis	-25	-22	-4
Crash In Oil & Gas	-26	-23	-3
Covid-19	-41	-36	-6

Source: Bloomberg, UOB Kay Hian

BANKS TRADING AT -1.0SD TO HISTORICAL MEAN PBV

	2022F	2023F	Mean	-1.0SD	-1.5SD	-2.0SD
Maybank	1.12	1.08	1.20	1.10	1.05	1.00
CIMB	0.77	0.74	0.90	0.72	0.63	0.54
Public Bank	1.67	1.60	1.90	1.60	1.45	1.30
RHB	0.74	0.72	0.85	0.75	0.70	0.65
HLBank	1.35	1.23	1.45	1.25	1.15	1.05
AMMB	0.67	0.63	0.80	0.60	0.50	0.40
Alliance	0.74	0.70	1.00	0.70	0.55	0.40
Average	1.01	0.96	1.16	0.96	0.86	0.76

Source: Bloomberg, UOB Kay Hian

KLFIN INDEX VS EARNINGS GROWTH TREND

Source: Bloomberg, UOB Kay Hian

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