SECTOR UPDATE

Banking – Malaysia

Diminishing Earnings Tailwinds; Downgrade To MARKET WEIGHT

The sector delivered a robust earnings growth of 20% yoy in 3Q22 on lower provisions and NIM expansion. However, earnings tailwinds are expected to dissipate as we approach the tail end of the interest rate upcycle coupled with moderating loans growth. This has prompted us to downgrade the sector from OVERWEIGHT to MARKET WEIGHT with the sector now trading close to its historical mean P/B. Our two sector top picks are CIMB and Public Bank.

WHAT'S NEW

- **3Q22 results underpinned by lower provisions and NIM expansion.** Malaysian banks reported results that were broadly in line, with six out of the nine banks that we cover reporting earnings that were in line. However, CIMB and Public Bank beat expectations on lower-than-expected provisions coupled with solid cost control in CIMB's case, while Affin disappointed due to higher provisions. 3Q22 earnings grew 20.6% yoy and 11.6% qoq. The yoy growth was underpinned by a 37% yoy decline in loan loss provisions as net credit cost declined to 30bp in 3Q22 from 53bp in 3Q21 on significantly lower management overlays. 3Q22 earnings also benefited from 17bp expansion in NIM from two overnight policy rate hikes (OPR).
- **Approaching tail end of current sector upcycle as earnings tailwinds dissipate.** The banking sector has outperformed the FBMKLCI index by 31% since Mar 20 (COVID-19 market trough), translating into 32 months of outperformance, largely in line with past periods of upcycle outperformance. However, the sector could be at the tail end of its cyclical outperformance given dissipating earnings tailwinds. Peaking interest rates and even potential reversal in 2H23 coupled with the re-pricing of deposits are likely to weigh on NIM post-1Q23. Loans growth is also expected to moderate downwards while GIL ratio will continue to edge upwards.
- **Leading loans growth indicator softening.** Although loans growth remains firm at 6.5% yoy as at Oct 22, leading loans growth indicators have been moderating downwards as the higher lending rates are beginning to have an impact. Loans approval and application growth has moderated significantly to 17.5% yoy and 12.8% yoy respectively vs ytd growth of 62.4% yoy and 42.1% yoy respectively.

ACTION

- **Downgrade to MARKET WEIGHT.** We are downgrading our call on the sector to Market Weight, having outperformed the FBMKLCI since Mar 20. Although current valuations of -0.5SD to historical P/B is not particularly rich, we think that upside will be capped as sector earnings tailwinds in the form of NIM expansion and declining provision diminishes in 2023. Sector earnings growth is likely to moderate downwards in 2023 due to: a) slight compression in NIM, b) moderating loans growth, and c) potential top-ups in macroeconomic variables. However, downside support will be underpinned by the sector's healthy CET1 ratio of 14.3% and relatively manageable asset quality trends. As such, we think that current risk to reward is balanced which helps to justify our Market Weight call.
- **Top picks.** Our top two sector picks are CIMB and Public Bank. Given CIMB's high beta nature, it could be a beneficiary of the current market sentiment on risk. We also like Public Bank for its high provision buffers providing scope for potential provision write-backs when macroeconomic conditions permit.

MARKET WEIGHT

(Downgrade)

TOP SECTOR PICKS

Company	Rec	Share Price (RM)	Target Price (RM)
Public Bank	BUY	4.44	5.00
CIMB Group	BUY	5.64	6.50
RHB Bank	BUY	5.60	6.40
Alliance Bank	BUY	3.74	4.30

Source: UOB Kay Hian

BANKS' 3Q22 RESULTS CORE NET PROFIT

Company	3Q22 (RMm)	yoy % chg	qoq % chg	Results
Affin	-94.3	n.a.	n.a.	Below
Alliance	158.7	(8.3)	(25.5)	In-line
AMMB	435.4	35.6	11.2	In-line
BIMB	141.9	40.6	20.5	In-line
CIMB	1,407.2	21.5	9.9	Above
HLBK	981.4	14.3	8.9	In-line
MBB	2,165.2	28.5	16.5	In-line
PBK	1,590.3	16.8	12.2	Above
RHBC	700.5	(13.3)	10.4	In-line

Source: Bloomberg, UOB Kay Hian

BANKS' SHARE PRICE PERFORMANCE

Company	Price (RM)	yoy % chg	ytd % chg
AMMB	4.16	32.1	31.2
Alliance Bank	3.74	31.7	30.8
Affin	2.05	35.9	28.0
HL Bank	20.50	12.6	10.1
HLFG	18.70	7.7	7.8
Public Bank	4.44	13.6	6.7
RHB Bank	5.60	6.9	4.3
CIMB Group	5.64	9.3	3.5
Maybank	8.58	7.9	3.4
Bank Islam	2.57	(11.7)	(14.3)

Source: Bloomberg

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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 2022F (x)	Div 2022F (sen)	Div Yield (%)
Public Bank	PBK MK	BUY	4.44	5.00	19,752	14.0	14.9	13.0	11.7	1.7	14.9	3.4
CIMB Group	CIMB MK	BUY	5.64	6.50	13,786	13.2	11.0	9.2	8.7	0.9	25.6	4.5
RHB Bank	RHBBANK MK	BUY	5.60	6.40	5,451	7.8	8.9	7.7	8.7	0.7	34.7	6.2
Alliance Bank	ABMB MK	BUY	3.74	4.30	1,327	10.2	8.6	8.1	10.2	0.9	21.7	5.8
Maybank	MAY MK	HOLD	8.58	9.00	23,704	12.0	12.7	11.5	9.2	1.1	50.7	5.9
HL Bank	HLBK MK	HOLD	20.50	23.30	10,185	13.0	11.3	10.7	11.7	1.3	63.3	3.1
HLFG	HLFG MK	HOLD	18.70	21.30	4,908	8.8	7.7	7.3	11.0	0.8	47.5	2.5
AMMB	AMM MK	HOLD	4.16	4.00	3,157	8.3	8.6	8.3	9.2	0.8	18.5	4.5
Bank Islam	BIMB MK	HOLD	2.57	2.40	1,269	9.1	11.2	9.7	7.3	0.8	10.4	4.0
Affin	ABANK MK	HOLD	2.05	2.05	1,039	7.5	14.8	8.9	2.6	0.4	4.2	2.0

Source: UOB Kay Hian

ESSENTIALS

- **Milking the last leg.** Post the 15th Malaysian General Election, we believe that the current positive market sentiment could result in the sector's favourable performance spilling over into 1Q23. As such, we opine that investors should take this opportunity to sell into strength by milking the last leg of potential sector outperformance and position into higher beta large capitalisation banking stocks like CIMB which should outperform in a broad-based market risk-on mode into 1Q23. However, post-1Q23, we are adopting a more prudent approach.

- **Adopting a more prudent approach after 1Q23.** As macroeconomic data and lower interest rate expectations in 2023 starts to impact the banking sector's earnings outlook (ie NIM pressure, moderating loans growth and rising GIL ratio), we think that sector outperformance could start to reverse post-1Q23 and the sector could start to track the FBMKLCI. This has prompted us to downgrade our sector call from OVERWEIGHT to MAREKET WEIGHT and we could be looking to switch our sector top pick from CIMB to Public Bank post-1Q23.

- **Excluding base effect of prosperity tax, only expecting a modest 4% earnings growth for 2023.** Our expectation of a 14% yoy sector earnings growth in 2023 is largely driven by the low base effect of 2022's earnings which was impacted by the Cukai Makmur. In terms of PBT, the sector is only expected to eke out a 4% yoy growth in 2023 driven by a slight improvement in net credit cost from 37bp in 2022 to 36bp in 2023 and expectation of a modest recovery in non-interest income (+5% yoy). This will be partly offset by the expectation of moderating loans growth to 5% in 2023 (2022: 6%) and a slight 2bp compression in NIM (2022: +5bp).

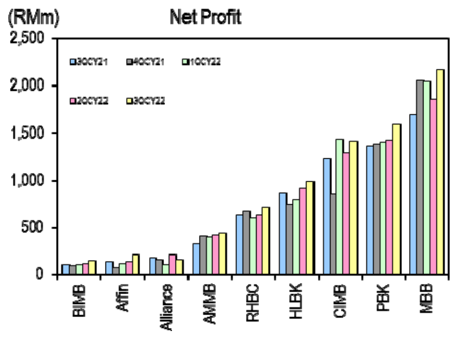
- **Multiple headwinds looming.** Despite a relatively aggressive upward normalisation in interest rates and relatively strong sector fundamentals (CET1 ratio < 14.8%, high pre-emptive provisions buffers and ample liquidity), the KL Finance index has only risen by 4% ytd. Given the expectations of looming near-term headwinds (ie moderating NIM, loans growth outlook and further uptick in GIL ratio), we believe that the sector's relative outperformance will start to reverse.

- **More NIM outlook into 2023.** We expect sector NIM to rise only 3bp on average in 2022 as declining CASA ratio and intensifying fixed deposit competition is set to dilute the positive benefits of the sharp rise in OPR (+100bp) on asset yields. Moving into 2023, we expect sector NIM to potentially compress by 2bp due to: a) declining CASA mix due to cannibalisation effect from attractive fixed deposit rates, b) intense fixed deposit competition with current banks' 6-month and 12-month fixed deposit campaign rates hovering at 90-110bp above the board rates, and c) re-pricing of deposits against the backdrop of plateauing OPR trajectory (in-house expectation of 50bp in 2023 vs 100bp in 2022). Also, a better-than-expected inflation outcome may result in an even milder-than-expected OPR hike in 2023.

- **Provision write-back in 2023 may not materialise.** The combination of higher interest rates and macroeconomic slowdown in 2023 is expected to lead to a further uptick in sector GIL ratio in 2023. We are expecting sector GIL ratio to continue edging upwards to 2.0% by 1H23 from 1.83% (Sep 22). This will limit the ability for banks to reverse out any excess provisions in 2023, erasing any hopes of potential earnings tailwinds from provision reversal that the market had initially banked on.

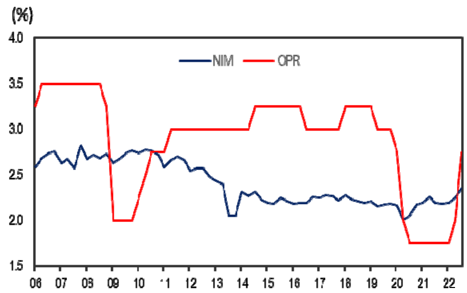
- **Net credit cost to remain stable in 2023 vs 2022 but elevated vs pre-COVID-19.** We think that banks that had begun consuming some of their pre-emptive provisions may need to potentially top up additional pre-emptive provisions in the form of macroeconomic variables in 2023 to account for the more challenging macroeconomic backdrop. This will result in overall sector net credit cost remaining elevated at 34bp in 2023 vs the 25bp pre-COVID-19. However, as overall pre-emptive provisions by banks are still deemed to be healthy, we think that sector net credit cost should remain stable in 2023 vs 35bp in 2022. We believe that any potential credit cost tailwinds may only start to materialise from 4Q23 onwards which we have not yet factored into our earnings forecasts.

BANKS NET PROFIT TREND



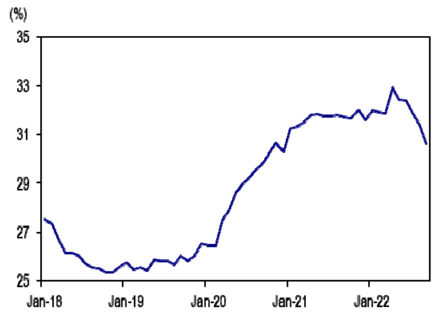
Source: Respective companies, UOB Kay Hian,

NIM TENDS TO START TO COMPRESS AT PEAK OF RATWE HIKE CYCLE



Source: Respective companies, UOB Kay Hian

SECTOR CASA RATIO



Source: Respective companies, UOB Kay Hian

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