

### SECTOR UPDATE

## Banking – Malaysia

### Diminishing Earnings Tailwinds

The sector delivered a robust earnings growth of 20% yoy in 4Q22 on lower provisions and NIM expansion. However, earnings tailwinds are expected to dissipate on NIM compression and a milder improvement in credit cost in 2023. Excluding the impact of the prosperity tax, 2023 sector earnings are only expected grow by 4% vs 22% in 2022. Maintain MARKET WEIGHT. The unexciting earnings outlook is balanced by an attractive dividend yield of 5%. Public Bank remains our top pick.

### WHAT'S NEW

- 4Q22 results underpinned by lower provisions and NIM expansion.** Malaysian banks reported results that were broadly in line, with six out of the nine banks we cover reporting earnings that were in line. However, Public Bank, RHB and AMMB beat expectations on lower-than-expected provisions (RHB, AMMB) and stronger NIM (Public Bank). 4Q22 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 a 17bp expansion in NIM from two overnight policy rate hikes (OPR).
- YoY: Boosted by lower provisions and NIM.** 4Q22 sector earnings expanded 20% yoy, underpinned by lower provisions (-14% yoy) and NIM expansion (10bp yoy). Sector net credit cost declined to 28bp (4Q21: 35bp) on the back of lower management overlays and writebacks. The strong yoy expansion in NIM also helped the sector to sustain positive Jaws (total income: +12.1%, opex: +8.1% yoy). As such, sector cost-to-income ratio declined yoy to 44.3% (4Q21: 45.9%). Banks that delivered outsized earnings growth in 4Q21 were CIMB and Public Bank. The former was due to robust loans growth, strong non-interest income growth and absence of impairment relating to its double crediting error while the later was under pinned by strong NIM expansion and lower provisions.
- QoQ: Lower provisions offset negative Jaws.** 4Q22 sector profit rose 5.5% qoq, underpinned by 20% qoq decline in loan loss provision on the back of recoveries and writebacks. However, pre-provision operating profit contracted 2% qoq (3Q22: +8% qoq) as opex outpaced revenue growth by 3ppt qoq. On the revenue front, a 2% qoq increase in net interest income was partially offset by a 5% qoq drop in non-interest income. In addition, NIM only expanded 1bp qoq (3Q22: +11bp) as a number of banks (Maybank, HLBK, BIMB and AMMB) have started to experienced sequential slippage in NIM.

### ACTION

- Maintain MARKET WEIGHT.** Although current valuations of -1.0SD to historical P/B is relatively attractive, we think that upside will be capped on moderating earnings outlook in 2023 on the back of: a) NIM compression, b) moderating loans growth, and c) elevated opex growth. However, downside support will be underpinned by relatively attractive average sector dividend yield of 5%, relatively manageable asset quality trends and attractive sector valuations. As such, we think that current risk to reward is balanced which helps to justify our MARKET WEIGHT call.
- Top pick.** Public Bank is our top pick for its high provision buffers providing scope for potential provision writebacks when macroeconomic conditions permit.

### PEER COMPARISON

Company	Ticker	Rec	Share Price (RM)	Target Price (RM)	Market Cap (US\$m)	-----PE (x)-----			ROE 2023F (%)	P/B 2023F (x)	Div 2023F (sen)	Div Yield (%)
						2022	2023F	2024F				
Public Bank	PBK MK	BUY	4.13	5.10	17,724	12.1	11.9	11.3	13.1	1.5	17.4	4.2
CIMB Group	CIMB MK	BUY	5.50	6.50	12,969	10.5	9.0	8.3	9.8	0.8	30.5	5.5
RHB Bank	RHBBANK MK	BUY	5.72	6.65	5,371	7.8	7.5	6.8	10.2	0.7	42.1	7.4
HLFG	HLFG MK	BUY	18.56	21.30	4,699	8.7	7.6	7.2	11.0	0.8	47.5	2.6
AllianceBank	ABMB MK	BUY	3.49	4.30	1,195	9.5	8.1	7.8	10.1	0.8	21.4	6.1
Maybank	MAY MK	HOLD	8.71	9.00	23,213	11.9	10.8	10.1	10.4	1.1	60.6	7.0
HL Bank	HLBK MK	HOLD	20.52	23.30	9,835	13.0	11.3	10.6	11.7	1.3	63.5	3.1
AMMB	AMM MK	HOLD	3.98	4.20	2,910	7.9	7.9	7.8	9.7	0.7	19.4	4.9
Bank Islam	BIMB MK	HOLD	2.20	2.40	1,091	9.3	8.1	7.6	8.1	0.6	12.2	5.6
Affin	ABANK MK	HOLD	2.08	2.14	1,046	23.1	8.1	7.5	4.6	0.4	11.6	5.6

Source: Bloomberg, UOB Kay Hian

## MARKET WEIGHT

(Maintained)

### TOP SECTOR PICKS

Company	Rec	Share Price (RM)	Target Price (RM)
Public Bank	BUY	4.13	5.10
CIMB Group	BUY	5.50	6.50
RHB Bank	BUY	5.72	6.65
Alliance Bank	BUY	3.49	4.30

Source: UOB Kay Hian

### BANKS' 4Q22 RESULTS CORE NET PROFIT

Company	4Q22 (RMm)	yoy % chg	qoq % chg	Results
Affin	138.3	(23.3)	n.m.	In-line
Alliance	177.1	17.3	11.6	In-line
AMMB	452.6	12.2	4.0	Above
BIMB	125.7	36.0	(12.0)	In-line
CIMB	1,314.9	53.8	(6.6)	In-line
HLBK	1,042.2	41.1	6.2	In-line
MBB	2,167.4	5.4	0.1	In-line
PBK	1,707.1	23.6	7.3	Above
RHBC	772.1	15.8	10.2	Above

Source: Bloomberg, UOB Kay Hian

### BANKS' SHARE PRICE PERFORMANCE

Company	Price (RM)	yoy % chg	ytd % chg
Affin Bank	2.08	24.8	2.5
Maybank	8.71	(1.1)	0.1
Hong Leong Bank	20.52	3.1	(0.2)
HLFG	18.56	(0.4)	(0.2)
RHB Bank	5.72	0.4	(1.2)
AMMB	3.98	21.0	(3.9)
Public Bank	4.13	(6.1)	(4.4)
Alliance Bank	3.49	5.8	(4.9)
CIMB Group	5.50	12.5	(5.2)
Bank Islam	2.20	(23.6)	(19.4)

Source: Bloomberg

### ANALYST(S)

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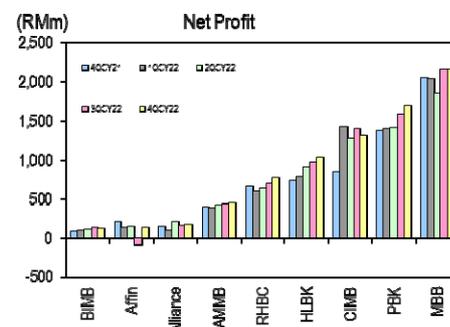
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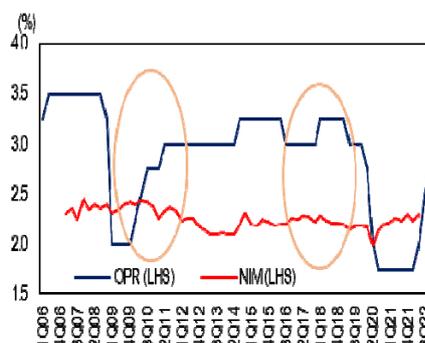
- KLFinance index has marginally underperformed since our downgrade.** The KLFinance index has marginally underperformed the FBMKLCI index by 0.4% since we downgraded the banking sector to Market Weight back in early-Dec 22. Given the lack of earnings catalysts, we expect the sector to continue tracking the overall performance of the FBMKLCI. Lacklustre earnings growth (ex-impact of prosperity tax in 2022) is expected to be offset by relatively attractive dividend yields of 5% and inexpensive valuations (-1SD to historical P/B).
- Unexciting earnings growth in 2023. Key drags:** NIM compression and opex. Despite sector valuations residing at a relatively inexpensive -1SD to its historical mean P/B, we envisage minimal earnings catalysts to drive sector outperformance in the near term. Excluding the impact of the prosperity tax in 2022, the sector is only expected to eke out an estimated 4% earnings growth in 2023 (2022: +22% excluding impact of prosperity tax). Key drags to 2023 sector earnings are: a) flattish net interest income trend as mid to high single-digit NIM compression will essentially offset a 4.5% loans growth expectation, and b) opex is also expected to remain elevated given the persistent inflationary pressure (high single-digit growth). Additionally, loans growth is expected to moderate downwards to 4.5% from 5.3% in 2022.
- Earnings underpinned by non-interest income and lower credit cost.** The only two catalysts driving earnings growth in 2023 are: a) slight improvement in net credit to 27bp (2022: 30bp), and b) 6% non-interest income growth. We note that given the volatility in the capital markets (bond yields starting to rise back up), this could place some downside risk to our non-interest income growth forecast. That said, note that our sector net credit cost assumption of 27bp in 2023 has not taken into account any material writebacks in excess provisions. Apart from Public Bank, most banks remain guarded on any potential provision writebacks in 2023, given the softening macroeconomic outlook.
- NIM tailwinds have moderated significantly in 4Q22 with NIM reversing from 1Q23.** The average sector NIM expanded by only 1bp qoq in 4Q22 (+11bp qoq in 3Q22), essentially marking the peak of the current NIM upcycle. The intense deposit competition and CASA normalisation had offset most of the benefits of the OPR hikes. We expect banks' NIM to start reversing downwards in the subsequent quarter.
- More pessimistic NIM guidance for 2023.** The intensity of the prevailing deposit competition has continued to take most banks by surprise, prompting banks to provide a higher-than-expected NIM compression guidance for 2023. Banks are now guiding for a 3-12bp NIM compression for 2023 (average 7bp compression). In comparison, we were initially expecting a 3bp compression while consensus was even more optimistic, expecting NIM to remain flattish in 2023. Inherent in the assumptions driving banks' more pessimistic NIM guidance for 2023 are: a) deposit competition remaining protracted, and b) CASA ratio normalising downwards to pre-COVID-19 levels (currently: 30% vs pre-COVID-19: 26%). As such, we now expect a 5bp (previous: 3bp) slippage in sector NIM in 2023.
- Provision writeback in 2023 still lacking visibility.** 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 of 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. After the 4Q22 results, we noted that only Public Bank was guiding for a moderate writeback in excess pre-emptive provisions in 2023.
- Net credit cost assumption close to pre-COVID-19 levels.** All in all, we have pencilled in a slight improvement in sector net credit to 27bp in 2023 vs 30bp in 2022. Note that our 27bp sector net credit cost assumption for 2023 is already close to the pre-COVID-19 average of 25bp. As such, any credit cost tailwind would have to emanate from writebacks of pre-emptive provisions.

### BANKS NET PROFIT TREND



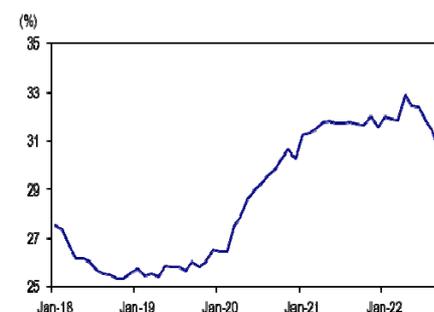
Source: Respective companies, UOB Kay Hian

### NIM TENDS TO START TO COMPRESS AT PEAK OF RATE HIKE CYCLE



Source: Respective companies, UOB Kay Hian

### SECTOR CASA RATIO



Source: Respective companies, UOB Kay Hian

### SECTOR TRADING AT -1SD PBV



Source: Respective companies, UOB Kay Hian

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