SECTOR UPDATE

Banking – Malaysia

Fairly Insulated Fundamentally But Sentiment Remains Suppressed

The problems plaguing regional banks in the US are not apparent in domestic banks. As such, we do not envisage a direct spillover effect to Malaysia's banking system. However, as observed in recent recessions in the US, banking sector valuations de-rated to -2SD of historical mean P/B vs -1SD currently. This has prompted us to maintain MARKET WEIGHT on the sector. Our top sector pick is Public Bank as it could benefit from flight to quality.

WHAT'S NEW

- **Minimal direct spillover effects from SVB crisis.** The KL Finance (KLFin) index underperformed the FBMKLCI index by 1ppt since 10 Mar 23, which coincided with the onset of the Silicon Valley Bank (SVB) crisis. However, we believe that the direct spillover effects to Malaysian banks should be minimal. This is premised on the fact that: a) Malaysian banks average holdings of marketable investment securities at a manageable 22% of total assets vs SVB's 55%, b) Malaysian banks average liquidity coverage ratio (LCR) at a comfortable 145% (vs minimum regulatory requirement: 100%) while smaller regional banks in the US (<US$250b in assets) do not have to comply with LCR requirements, and c) the Overnight Policy Rate (OPR) remains below pre-COVID-19 levels despite the increase (2.75% currently vs 3.00% pre-COVID-19).
- **Minimal counterparty and bond exposure to Credit Suisse.** Based on our recent channel checks with banks under our coverage, banks in general do not have any exposure to Credit Suisse's (CS) bonds, with US$17b of CS's Additional Tier 1 (AT1) bonds written down to zero. Management of the banks under our coverage also alluded to negligible counterparty exposure.
- **Malaysian banks' Tier 1 capital structure largely equity-based.** The write-down of CS's AT1 debts to zero spooked the AT1 debt market (US$275b) for banks. This raises future concerns for banks wanting to tap the debt market for capital as the cost of raising future AT1 to boost Core Equity Tier 1 (CET1) may now be costlier. However, as shown in RHS chart, Malaysian banks does not rely much on AT1 debt to boost their Tier 1 capital ratio with 92-100% of Malaysian banks' Tier 1 capital in the form of CET1 capital. In addition, Malaysian banks' average CET1 ratio is also at a comfortable 14.7%, implying that they do not need to raise any Tier 1 capital in the foreseeable future.

ACTION

- **Maintain MARKET WEIGHT.** Although current valuations of -1SD to historical P/B are relatively attractive, we think that upside will be capped due to 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 justifies our MARKET WEIGHT call.
- **Top pick.** Public Bank is our top pick for its high provision buffers providing scope for potential provision write-backs when macroeconomic conditions permit.

MARKET WEIGHT

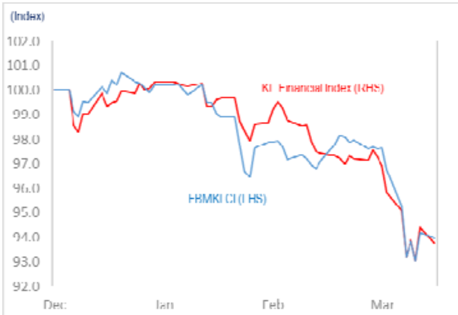
(Maintained)

TOP SECTOR PICKS

Company	Rec	Share Price (RM)	Target Price (RM)
Public Bank	BUY	3.95	5.10
CIMB Group	BUY	5.15	6.50
RHB Bank	BUY	5.50	6.65
Alliance Bank	BUY	3.25	4.30

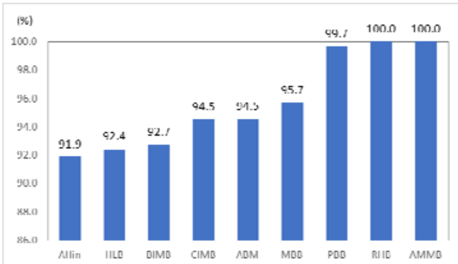
Source: UOB Kay Hian

KLFIN INDEX HAS MARGINALLY UNDERPERFORMED FBMKLCI



Source: Bloomberg, UOB Kay Hian

BANKS PROPORTION OF TIER 1 CAPITAL IN THE FORM OF CET1 CAPITAL



Source: Companies

ANALYST(S)

Keith Wee Teck Keong
+603 2147 1981
keithwee@uobkayhian.com

PEER COMPARISON

Company	Ticker	Rec	Share Price (RM)	Target Price (RM)	Market Cap (US$m)	PE (x) 2022	PE (x) 2023F	PE (x) 2024F	ROE 2023F (%)	P/B 2023F (x)	Div 2023F (sen)	Div Yield (%)
Public Bank	PBK MK	BUY	3.95	5.10	17,092	11.6	11.4	10.8	13.1	1.5	17.4	4.4
CIMB Group	CIMB MK	BUY	5.15	6.50	12,244	9.8	8.5	7.8	9.8	0.8	30.5	5.9
RHB Bank	RHBBANK MK	BUY	5.50	6.65	5,208	7.5	7.2	6.6	10.2	0.7	42.1	7.7
HLFG	HLFG MK	BUY	18.00	21.30	4,595	8.4	7.4	7.0	11.0	0.8	47.5	2.6
Alliance Bank	ABMB MK	BUY	3.25	4.30	1,122	8.9	7.6	7.2	10.1	0.7	21.4	6.6
Maybank	MAY MK	HOLD	8.34	9.00	22,411	11.4	10.3	9.7	10.4	1.1	60.6	7.3
HL Bank	HLBK MK	HOLD	20.10	23.30	9,713	12.7	11.1	10.4	11.7	1.3	63.5	3.2
AMMB	AMM MK	HOLD	3.68	4.20	2,713	7.3	7.3	7.2	9.7	0.7	19.4	5.3
Bank Islam	BIMB MK	HOLD	2.22	2.40	1,111	9.4	8.2	7.7	8.1	0.6	12.2	5.5
Affin	ABANK MK	HOLD	1.99	2.14	1,009	22.1	7.7	7.2	4.6	0.4	11.6	5.8

Source: Bloomberg, UOB Kay Hian

ESSENTIALS

- **Manageable holdings in marketable investment securities.** Given that the spike in bond yields has raised considerable concerns on banks' mark-to-market losses on marketable investment securities, we will strive to address these concerns on Malaysian Banks. As shown in Table 1, investment securities comprise 22% of banks' total assets. Public Bank and Alliance Bank have the lowest compositions at 16% and 18% respectively while HLBank, Maybank, CIMB, AMMB and Affin stood above the sector average of 22%. Securities' Fair Value through Other Comprehensive Income (FVOCI) are marked to market into reserves, forming the largest component at an average of 50% of banks' investment securities portfolio, followed by Held to Maturity (37%) and Held for Trading (13%).

- **Banks' mark-to-market losses on FVOCI well-contained.** As shown in table 2 below, the swing in mark-to-market losses on banks' FVOCI portfolio from end-Dec 22 (10-year Malaysian Government Securities yield trough: 2.62%) to Dec 22 (10-year Malaysian Government Bond yield: 3.90%) accounted for only 2-6% of banks' FVOCI portfolio and an even much smaller percentage of equity. If banks were to realise losses on their current Securities Held to Maturity (HTM), we would expect a similar quantum of percentage losses.

- **CET1 ratio remains comfortable even if banks were to crystallise HTM books.** The sector currently has a healthy average CET1 ratio of 14.7% vs the optimal 13.0%. As securities under HTM are not mark-to-market, we can only conduct a potential sensitivity impact on CET1 ratio (Table 2) if banks were to crystallise their current losses on HTM books. Assuming the same percentage of losses on HTM books as what banks have marked to market on its FVOCI portfolio, we estimate that the industry average CET1 ratio would remain at a comfortable 13.9% with an average estimated impact of only 1ppt. Public Bank and Alliance Bank would be the least impacted (-0.3ppt) given their relatively smaller investment securities portfolios to total assets.

BANKS MARKETABLE INVESTMENT SECURITIES PORTFOLIO

	Maybank RM'm	CIMB RM'm	Public Bank RM'm	HLBank RM'm	RHB RM'm	AMMB RM'm	Alliance Bank RM'm	Affin RM'm
FVTPL	38,627	33,200	949	6,760	3,089	7,865	306	544
FVOCI	120,706	58,676	54,867	28,816	38,974	23,474	8,387	3,782
HTM	71,757	64,533	25,570	31,518	27,007	12,744	2,835	16,853
Total	231,090	156,409	81,386	67,094	69,070	44,083	11,528	21,179
Investment securities % of total assets	24%	23%	16%	25%	22%	24%	18%	23%
Loans % of total assets	61%	59%	75%	64%	67%	67%	71%	64%

Source: Respective companies, UOB Kay Hian

SENSITIVITY ANALYSIS OF POTENTIAL LOSSES ON INVESTMENT SECURITIES POTFOLIO ON CET1

FVOCI reserves (RM'm)	Maybank RM'm	CIMB RM'm	Public Bank RM'm	HLBank RM'm	RHB RM'm	AMMB RM'm	Alliance Bank RM'm	Affin RM'm
Dec 20	4,573	217	1,100	400	1,856	961	282	266
Dec 22	-1,631	-1,656	-800	-800	-547	401	-214	44
MTM losses	-6,204	-1,873	-1,900	-1,200	-2,403	-560	-496	-222
MTM losses % of FVOCI	-5%	-3%	-3%	-4%	-6%	-2%	-6%	-6%
HTM as @ end Dec 22	71,757	64,533	25,570	31,518	27,007	12,744	2,835	16,853
Hypothetical MTM losses on HTM	-3,688	-2,060	-885	-1,313	-1,665	-304	-168	-989
CET1	33,556	45,226	46,618	20,700	23,823	15,423	6,048	9,051
RWA	230,576	318,635	313,678	156,390	135,414	121,018	39,947	57,564
CET1 ratio	14.6%	14.2%	14.9%	13.2%	17.6%	12.7%	15.1%	15.7%
CET1 ratio assuming banks were to realise losses on HTM	13.0%	13.5%	14.6%	12.4%	16.4%	12.5%	14.7%	14.0%
CET1 impact if banks were to crystalise losses on HTM	1.6%	0.6%	0.3%	0.8%	1.2%	0.3%	0.4%	1.7%

Source: Respective companies, UOB Kay Hian

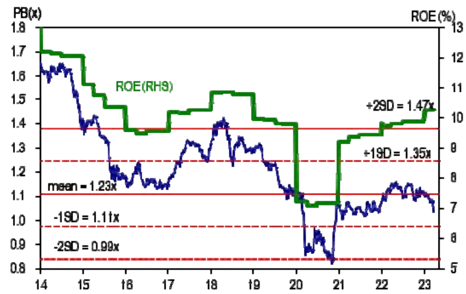
KLFIN INDEX VS OPR

Source: UOB Kay Hian

BANKING SECTOR VALUATIONS HAS DERATED TO -2SD DURING RECESSION IN THE US

Source: UOB Kay Hian

SECTOR TRADING AT -1SD PBV



Source: UOB Kay Hian

BANKS' LIQUIDITY COVERAGE RATIO

	LCR (%)
Alliance Bank	167.7
Affin	165.0
RHB	147.0
Maybank	145.0
HLBank	145.0
AMMB	141.0
CIMB	>130
Public Bank	128.0
Average	148.0

Source: Respective companies, UOB Kay Hian

- **Interest rate cycle peaking faster than expected to further weigh on sector sentiment.** The recent events impacting US and European banks could lead to an earlier-than-expected pause in the Federal Reserve Rate hike cycle. We believe that this could continue to weigh on sector sentiment as past interest rate hike pauses were followed by cuts in interest rate which would negatively impact banks' NIM.

- **Sector valuation de-rated to -2SD during recession in the US.** Although the sector is currently trading at a relatively attractive 1SD below its historical mean P/B, we note that the Malaysian banking sector valuations had de-rated to -2SD below their historical P/V during periods of US recession.

- **Unexciting earnings growth in 2023; NIM compression and opex key drags.** 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.

Disclosures/Disclaimers

This report is prepared by UOB Kay Hian Private Limited ("UOBKH"), which is a holder of a capital markets services licence and an exempt financial adviser in Singapore.

This report is provided for information only and is not an offer or a solicitation to deal in securities or to enter into any legal relations, nor an advice or a recommendation with respect to such securities.

This report is prepared for general circulation. It does not have regard to the specific investment objectives, financial situation and the particular needs of any recipient hereof. Advice should be sought from a financial adviser regarding the suitability of the investment product, taking into account the specific investment objectives, financial situation or particular needs of any person in receipt of the recommendation, before the person makes a commitment to purchase the investment product.

This report is confidential. This report may not be published, circulated, reproduced or distributed in whole or in part by any recipient of this report to any other person without the prior written consent of UOBKH. This report is not directed to or intended for distribution to or use by any person or any entity who is a citizen or resident of or located in any locality, state, country or any other jurisdiction as UOBKH may determine in its absolute discretion, where the distribution, publication, availability or use of this report would be contrary to applicable law or would subject UOBKH and its connected persons (as defined in the Financial Advisers Act, Chapter 110 of Singapore) to any registration, licensing or other requirements within such jurisdiction.

The information or views in the report ("Information") has been obtained or derived from sources believed by UOBKH to be reliable. However, UOBKH makes no representation as to the accuracy or completeness of such sources or the Information and UOBKH accepts no liability whatsoever for any loss or damage arising from the use of or reliance on the Information. UOBKH and its connected persons may have issued other reports expressing views different from the Information and all views expressed in all reports of UOBKH and its connected persons are subject to change without notice. UOBKH reserves the right to act upon or use the Information at any time, including before its publication herein.

Except as otherwise indicated below, (1) UOBKH, its connected persons and its officers, employees and representatives may, to the extent permitted by law, transact with, perform or provide broking, underwriting, corporate finance-related or other services for or solicit business from, the subject corporation(s) referred to in this report; (2) UOBKH, its connected persons and its officers, employees and representatives may also, to the extent permitted by law, transact with, perform or provide broking or other services for or solicit business from, other persons in respect of dealings in the securities referred to in this report or other investments related thereto; (3) the officers, employees and representatives of UOBKH may also serve on the board of directors or in trustee positions with the subject corporation(s) referred to in this report. (All of the foregoing is hereafter referred to as the "Subject Business"); and (4) UOBKH may otherwise have an interest (including a proprietary interest) in the subject corporation(s) referred to in this report.

As of the date of this report, no analyst responsible for any of the content in this report has any proprietary position or material interest in the securities of the corporation(s) which are referred to in the content they respectively author or are otherwise responsible for.

IMPORTANT DISCLOSURES FOR U.S. PERSONS

This research report was prepared by UOBKH, a company authorized, as noted above, to engage in securities activities in Singapore. UOBKH is not a registered broker-dealer in the United States and, therefore, is not subject to U.S. rules regarding the preparation of research reports and the independence of research analysts. This research report is provided for distribution by UOBKH (whether directly or through its US registered broker dealer affiliate named below) to "major U.S. institutional investors" in reliance on the exemption from registration provided by Rule 15a-6 of the U.S. Securities Exchange Act of 1934, as amended (the "Exchange Act"). All US persons that receive this document by way of distribution from or which they regard as being from UOBKH by their acceptance thereof represent and agree that they are a major institutional investor and understand the risks involved in executing transactions in securities.

Any U.S. recipient of this research report wishing to effect any transaction to buy or sell securities or related financial instruments based on the information provided in this research report should do so only through UOB Kay Hian (U.S.) Inc ("UOBKHUS"), a registered broker-dealer in the United States. Under no circumstances should any recipient of this research report effect any transaction to buy or sell securities or related financial instruments through UOBKH.

UOBKHUS accepts responsibility for the contents of this research report, subject to the terms set out below, to the extent that it is delivered to and intended to be received by a U.S. person other than a major U.S. institutional investor.

The analyst whose name appears in this research report is not registered or qualified as a research analyst with the Financial Industry Regulatory Authority ("FINRA") and may not be an associated person of UOBKHUS and, therefore, may not be subject to applicable restrictions under FINRA Rules on communications with a subject company, public appearances and trading securities held by a research analyst account.

Analyst Certification/Regulation AC

Each research analyst of UOBKH who produced this report hereby certifies that (1) the views expressed in this report accurately reflect his/her personal views about all of the subject corporation(s) and securities in this report; (2) the report was produced independently by him/her; (3) he/she does not carry out, whether for himself/herself or on behalf of UOBKH or any other person, any of the Subject Business involving any of the subject corporation(s) or securities referred to in this report; and (4) he/she has not received and will not receive any compensation that is directly or indirectly related or linked to the recommendations or views expressed in this report or to any sales, trading, dealing or corporate finance advisory services or transaction in respect of the securities in this report. However, the compensation received by each such research analyst is based upon various factors, including UOBKH's total revenues, a portion of which are generated from UOBKH's business of dealing in securities.

Reports are distributed in the respective countries by the respective entities and are subject to the additional restrictions listed in the following table.

General	This report is not intended for distribution, publication to or use by any person or entity who is a citizen or resident of or located in any country or jurisdiction where the distribution, publication or use of this report would be contrary to applicable law or regulation.
Hong Kong	This report is distributed in Hong Kong by UOB Kay Hian (Hong Kong) Limited ("UOBKHHK"), which is regulated by the Securities and Futures Commission of Hong Kong. Neither the analyst(s) preparing this report nor his associate, has trading and financial interest and relevant relationship specified under Para. 16.4 of Code of Conduct in the listed corporation covered in this report. UOBKHHK does not have financial interests and business relationship specified under Para. 16.5 of Code of Conduct with the listed corporation covered in this report. Where the report is distributed in Hong Kong and contains research analyses or reports from a foreign research house, please note: (i) recipients of the analyses or reports are to contact UOBKHHK (and not the relevant foreign research house) in Hong Kong in respect of any matters arising from, or in connection with, the analysis or report; and (ii) to the extent that the analyses or reports are delivered to and intended to be received by any person in Hong Kong who is not a professional investor, or institutional investor, UOBKHHK accepts legal responsibility for the contents of the analyses or reports only to the extent required by law.
Indonesia	This report is distributed in Indonesia by PT UOB Kay Hian Sekuritas, which is regulated by Financial Services Authority of Indonesia ("OJK"). Where the report is distributed in Indonesia and contains research analyses or reports from a foreign research house, please note recipients of the analyses or reports are to contact PT UOBKH (and not the relevant foreign research house) in Indonesia in respect of any matters arising from, or in connection with, the analysis or report.
Malaysia	Where the report is distributed in Malaysia and contains research analyses or reports from a foreign research house, the recipients of the analyses or reports are to contact UOBKHM (and not the relevant foreign research house) in Malaysia, at +603-21471988, in respect of any matters arising from, or in connection with, the analysis or report as UOBKHM is the registered person under CMSA to distribute any research analyses in Malaysia.
Singapore	This report is distributed in Singapore by UOB Kay Hian Private Limited ("UOBKH"), which is a holder of a capital markets services licence and an exempt financial adviser regulated by the Monetary Authority of Singapore.Where the report is distributed in Singapore and contains research analyses or reports from a foreign research house, please note: (i) recipients of the analyses or reports are to contact UOBKH (and not the relevant foreign research house) in Singapore in respect of any matters arising from, or in connection with, the analysis or report; and (ii) to the extent that the analyses or reports are delivered to and intended to be received by any person in Singapore who is not an accredited investor, expert investor or institutional investor, UOBKH accepts legal responsibility for the contents of the analyses or reports only to the extent required by law.
Thailand	This report is distributed in Thailand by UOB Kay Hian Securities (Thailand) Public Company Limited, which is regulated by the Securities and Exchange Commission of Thailand.
United Kingdom	This report is being distributed in the UK by UOB Kay Hian (U.K.) Limited, which is an authorised person in the meaning of the Financial Services and Markets Act and is regulated by The Financial Conduct Authority. Research distributed in the UK is intended only for institutional clients.
United States of America ('U.S.')	This report cannot be distributed into the U.S. or to any U.S. person or entity except in compliance with applicable U.S. laws and regulations. It is being distributed in the U.S. by UOB Kay Hian (US) Inc, which accepts responsibility for its contents. Any U.S. person or entity receiving this report and wishing to effect transactions in any securities referred to in the report should contact UOB Kay Hian (US) Inc. directly.

http://research.uobkayhian.com

RCB Regn. No. 197000447W