PP14767/09/2012(030761)

Friday, October 02, 2015

Market Access

Banking Sector

(Neutral)

"Stiff Competition for Loans and Deposits in the Market"

Banking sector is NEUTRAL in 2015 as we expect loans growth to decelerate to 9.0% vs. 9.5% in 2014. YTD banking sector loans growth had touched 9.2%, more or less in line with our expectation. Driver to the banking sector loans growth this year includes 1) steady ETP related financing 2) acceleration of re-financing drive towards shariah approve and 3) elevating cost containment measures. Our Top Picks for banking sector are Maybank (TP: RM9.92) and BIMB Holdings (TP: RM4.63).

2Q15 loans growth analysis

Aggregate loans growth for all banks in 6M15 expanded at respectable pace of 10.2% y-o-y (average) despite the tough operating environment due to weakening consumer sentiments. Although there was some weakness in household loans (HH) growth performance, banks' respectable loans growth during 2Q15 was not genuine as the growth was aided by foreign countries loans growth at the back of easiness in domestic loans growth to 8.0% y-o-y (average) vs. 10.5% y-o-y in 6M14.

1H15 Loans growth review

a) **Alliance Financial Group (AFG).** AFG started FY16 on the right footing. AFG's double digits loans growth was intact as evident in 1Q16's loans growth of 12.5% y-o-y, thanks to AFG's re-engineering of its SME segment loans that had pushed up overall performance. SME lending continues to be AFG's bread and butter, with loans from this segment upped by 2.4% q-o-q in 1Q16 versus 3.2% q-o-q in 4Q15. Its personal financing is another area of strength with loans rising by 4.2% q-o-q in 1Q16 vs. 2.5% q-o-q in 4Q15. Overall AFG netted loans growth of 12.5% in 1Q16 vs. management's guidance of 11%-12% for FY16.

b) **AMMB Bhd (AMMB).** AMMB negative loan growth was still a let-down as on-going rebalancing activity as well as lumpy corporate repayments contributed to the weaknesses. Loans growth fell for second consecutively quarters to 2.2% y-o-y vs. -1.6% y-o-y in 4Q15. Mortgages will continue to be its primary driver of growth in the coming quarters and is expected to improve underpins by the stabilization of auto loans book and a pick-up in corporate loans demand during the year. Overall, AMMB delivered loans growth of 2.2% in 1Q16 vs. the management's guidance of 7% for FY15.

c) **CIMB Bhd (CIMB).** Despite various issues facing by the group, its loans growth was steady after rising by 16.1% y-o-y in 2Q15, assisted by forex impact. Domestic loans growth decelerated marginally, albeit still strong at 10.5% y-o-y in 2Q15 vs. 10.9% y-o-y in 1Q15. Contributing to the steady pace was higher growth rate for Consumer Banking loans of 14.1% y-o-y and Commercial Banking loans which grew 17.1%y-o-y while Wholesale Banking loans recorded a slower growth of

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19.7% y-o-y. Overall CIMB belted loans growth of 5.7% in 1H15 vs. the management's guidance of 14% for FY15.

d) **Maybank Bhd (Maybank).** Maybank's loans growth came in at 15.6% y-o-y in 2Q15 vs. 14.2% y-o-y in 1Q15 driven by forex impact. Domestic loans growth grew stronger at 10.3% y-o-y in 2Q15 vs. 10.1% y-o-y in 1Q15 on the back of slowdown in Maybank's bread and butter in corporate loans segment. In consumer segment, loans for residential property remained strong with YTD annualized growth of 13.6% while auto loans, credit cards and loans for purchase of securities all showed a slowdown. Overall Maybank clocked-in loans growth of 5.7% in 1H15 vs. the management's guidance of 13% for FY15.

e) **Public Bank Bhd (PBB).** PBB's gross loans growth was still resilient despite the industry's slowdown in some sectors. PBB's loans growth in 1H15 reached 11.4% y-o-y, or 11.2% at annualized basis vs. 9%-10% full year guidance, aided by the strengthening of USD vs. Ringgit and improving retail loans by +5.4% YTD or 10.7% y-o-y. HK/China and Cambodia saw loans growth jumped by 24% y-o-y and 32% y-o-y respectively, supported in part by currency gains. Overall PBB loans growth touched 5.6% in 1H15 vs. management's guidance of 10%-11% for FY15.

f) **RHB Capital (RHB).** RHB's loans growth moderated from 14% y-o-y in 1Q15 to 9% y-o-y in 2Q15, hampered by lumpy corporate repayments during the period. Loan expansion was supported predominantly by residential (+22% annualized) and non-residential (+21%) property lending. SME lending grew at an annualized pace of 20% vs. 8% for individual lending. Management's initial loans growth target of 10% for FY15 was deemed unattainable and management now expects loans growth to average 6-7% for the full year. RHB's 1H15 loans growth touched a poor 1.6% vs. the management's target of 12% in FY15.

Table 1: Banking Players Loans Growth (y-o-y)

Company	Year End	Mar-14	Jun-14	Sept-14	Dec-14	Mar-15	Jun-15	Mgt Guidance
AFG	March	14.1%	15.2%	15.5%	16.2%	14.7%	12.5%	11%-12%
AMMB	March	5.3%	1.5%	0.9%	-2.1%	1.6%	-2.2%	7.0%
CIMB	Dec	11.9%	8.1%	9.8%	13.2%	12.4%	16.1%	14.0%
Maybank	Dec	13.5%	12.6%	14.3%	13.4%	14.3%	15.6%	13.0%
PBK	June	13.5%	12.6%	9.8%	10.8%	11.7%	11.5%	10%-11%
RHB Cap	Dec	11.2%	13.0%	11.9%	17%	13.7%	9.2%	12.0%

The challenge to achieve loans growth target

We are seeing limited opportunity for banks to push up loans growth given the weakening consumer sentiment as well as sluggish capital market activities. In household loans segment (HH), rising concern on impaired loans in selected segments has led banks to cut its exposure to reduce the risk. Loans in HH segment such as personal financing and hire purchase have moderated so far as banks were seen tightening credit approval. In business loans, the only area supporting performance is

SME's segment where banks are competing to attract applications by simplifying the application process. Overall the negative catalyst facing the industry can be seen as below:

a. **Slowdown in household loans.** Household (HH) debt reached 146% in June 2015 and this has forced Bank Negara Malaysia (BNM) to slow down credit growth in the country. This has impacted loans growth in the banking system as banks were seeing eyeing quality borrowers to limit the downside risk of impaired loans. Note that major components of HH debt as per BNM book include mortgages (52%), transport vehicle (21%) and personal use (8%). HH loan applications growth in 6-months for mortgages was at 13% vs. 13.6% in 6M14 with transport vehicle growth of 2% vs. 3% in 6M14. Note that the latter has been contracting and this would point to slower HH loans growth ahead. The slowdown in the major components of HH will inevitably weigh the pace of loans growth towards the end of 2015.

b. **Extra measures to contain gross impaired loans.** In 2013, BNM introduced a series of rulings to curb spiralling household debt, and this includes curbing loans on personal use and mortgages. The ruling saw tenure restriction on both loans to curb the household debt and banks placed extra credit assessment to select quality borrower. The tight credit assessment measures have dampened credit growth with sizeable application rejection in the segment.

c. **GST implementation bite consumer away.** Pre-GST, we witnessed banking system loans growth soaring to 9.3% y-o-y in March 2015 assisted by escalating HH loans as consumers rushed to apply loans. Post-GST implementation, we witnessed a slowdown in selected segments in HH loans as consumer took cautious stance on spending.

d. **Slowdown in capital market activity.** 1H15 saw only minute IPO transaction, with only 2 companies made their presence in Bursa Malaysia, namely Malakoff Bhd and Sunway Construction Bhd, accumulating total funds raised of RM4.3 billion with several big names e.g. 1MDB, Iskandar Waterfront all held back their intention to go for listing due to rough market environment. The muted IPO market has dampened non-interest income performance for most banks which already under pressure due to lower stockbroking income, resulting from cautious view approach as a result of US' intention to raise interest rate policy. On Investment Banks deals, we continue to expect a low execution of pipeline deals for capital raising via equities and bonds in 2H15.

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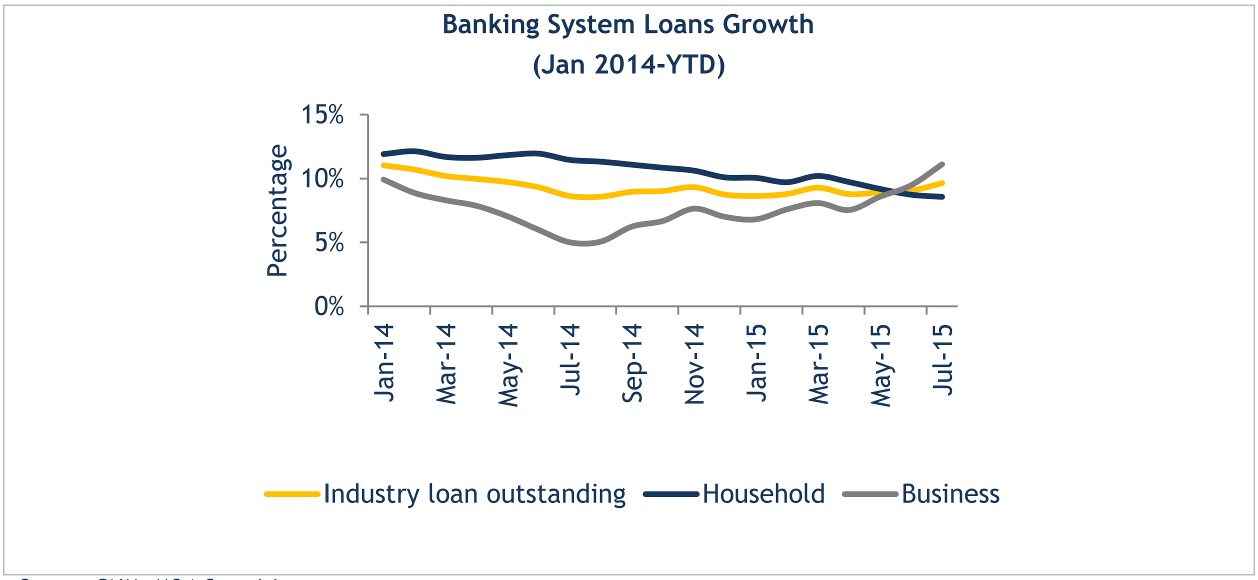
Table 2: Household Loans Growth (y-o-y)

	FY-14	Jan-15	Feb-15	Mar-15	Apr-15	May-15	Jun-15	Jul-15	Aug-15
Residential properties	13.0%	12.9%	13.0%	13.1%	13.0%	12.8%	12.8%	12.7%	12.2%
Non-residential properties	15.0%	15.3%	14.6%	16.3%	15.9%	15.2%	15.5%	14.7%	14.1%
Transport vehicles	1.5%	1.6%	1.9%	2.3%	2.1%	1.9%	2.1%	2.1%	2.2%
Personal use	3.9%	3.9%	4.0%	3.0%	4.2%	5.1%	5.2%	5.2%	6.1%
Purchase of securities	11.5%	8.2%	7.0%	7.2%	5.3%	4.5%	2.3%	4.0%	0.5%
Credit card	1.2%	1.4%	3.6%	5.0%	2.1%	1.5%	0.7%	1.9%	1.5%
Others	-3.2%	-5.9%	-12.5%	-9.6%	-10.8%	-8.8%	-4.6%	0.9%	2.8%
Total	10.1%	10.2%	9.7%	10.2%	9.7%	9.2%	8.7%	8.6%	8.3%

Source: BNM



Source: BNM, M&A Securities

What have been done to curb rising HH debt

a) **Mortgages.** BNM has capped loan-to-value (LTV) ratio to 70% from 90% on individual with more than two housing loans. Additionally, a series of measure were introduced including responsible lending and the computation of debt service ratios (DSR) based on borrower's net income and higher Real Property Gains Tax (RPGT) to 15% from 10% for properties disposed within 2 years of purchase and to 10% from 5% for properties disposed within 3-5 years after purchase as well as capping the tenure for residential property loans to 35 years from maximum 40 years before.

b) **Auto.** BNM has capped the maximum loan tenure for auto loans to 9 years effective 2011.

c) **Personal finance.** A cap on PF tenures to 10 years and the prohibition of pre-approved PF products for applications made after 5 July 2013.

Crimping net interest margin (NIM)

The industry's NIMs contracted by 4bps q-o-q in 6M15 to 2.14% impacted by high cost of funds as a result of strong competition for deposits. Additionally, asset yield was lower due to replenishment of loans book especially in mortgage loans that contributed to the NIM's compression. Maybank and AFG were the only banks bucking-up the downtrend, thanks to better NIMs in Thailand and Indonesia. Below are details of the players NIMs in 2Q15 vs. 1Q15 and 2Q14:

Table 3: Net Interest Margin (March 2014-June 2015)

	Mar-14	Jun-14	Sep-14	Dec-14	Mar-15	Jun-15
AFG	2.17%	2.11%	2.27%	2.25%	1.85%	2.16%
AMMB	2.77%	2.45%	2.54%	2.38%	2.33%	2.12%
CIMB	2.85%	2.90%	2.82%	2.79%	2.65%	2.61%
Maybank	2.37%	2.35%	2.31%	2.20%	2.26%	2.28%
Public Bank	2.28%	2.20%	2.29%	2.20%	2.15%	2.11%
RHB Capital	2.33%	2.29%	2.29%	2.26%	2.22%	2.13%

Source: Various, M&A Securities

In sum, competitive pressures are unlikely to abate anytime soon amid tighter liquidity as well as the need to comply with Basel III's liquidity coverage ratio which BNM has set at a minimum of 60% by June 2015 and 70% by January 2016. This may inevitably keep the cost of financial intermediary at a very competitive level and given the scarcity of cheap liquidity, we don't expect it to escalate anytime soon.

2Q2015 Deposit performance

Overall deposit growth touched 4.5% y-o-y at August 2015 and has continued to trail loans growth of 10.2% y-o-y in August 2015. CASA growth had inched up to 27.3% as a result of competition among AMMB, RHB Cap, CIMB and AFG where all reported improvement in CASA ratios. The industry's loan-to-deposit ratio continued to climb to 86.7% end-August 2015 vs. 85.9% in July 2015, signalling on-going tightening liquidity situation in the banking system. Should this situation sustains, banks will either have to (i) scale back their loans book expansion in 2015 or (ii) compete more aggressively for deposits. Either way, it would appear that funding costs will continue to rise given the increasing scarcity of cheaper deposits.

Lending rates stable

Though we witnessed stiff competition for deposits with banks throwing their best rates, on the flip side, we saw banks stable fixed deposits rate with the only notable move by CIMB with the changes for 1 month, 6 months and 12 months rate respectively. The subdued deposits growth in FY15 has forced CIMB to take drastic measures in deposits competition. In our opinion, deposit competition is unlikely to abate anytime soon given that the industry deposit growth has continued to moderate and is now trailing behind loans growth. As such, liquidity is tighter than before with the industry's loan-to-deposit ratio hitting a recent high of 86.7% at end-August 2015.

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Liquidity coverage ratio

The liquidity coverage ratio (LCR) is one of the Basel III requirements that banks will have to meet before the set deadline. The requirement is to meet 60% LCR by June 2015 and 70% by January 2016 before building up to 100% by January 2019. The essence of this requirement is make banks hold sufficient high-quality liquid assets (HQLA) to withstand an acute liquidity stress scenario over a 30-days horizon. That said, this requirement had stirred up competition for retail and fixed deposits as the deposits carry lower run-off rates for calculation of LCR and will help banks to increase their LCR.

Tweaking our target price. The challenging outlook for banks, of which we don't think is going to change much in the foreseeable future, has forced us to moderate our target price for banks under our coverage. Hence, we have incorporated a lower target price based on 1-standard deviation below mean of P/BV from mean previously. In sum, the reasons behind the shaving of targeted P/BV are as follows:

i. A pullback and cautious consumers sentiment at the back of challenging economic environment
ii. Selective lending measures by banks in order to curb non-performing loans (NPL)
iii. Stiff competition for liquidity that would push down NIM
iv. Challenging capital market outlook due to the impending US interest rates adjustment that will force sustained capital outflow

Table 4: M&A New Banks Target Price

Company	YE	CP (RM)	P/B (x)		Target Price		FY16 BV	Call
			Old	New	Old	New		
AFG	Mac	3.37	2.7	1.6	4.20	4.00	2.5	Hold
AMMB	Mac	4.60	2.2	1.5	6.15	5.10	3.6	Hold
BIMB	Dec	4.07	2.8	2.6	4.84	4.63	1.7	Buy
CIMB	Dec	4.49	1.8	1.4	6.10	4.90	3.5	Hold
Maybank	Dec	8.55	1.9	1.7	10.70	9.92	6.2	Buy
RHB Cap	Dec	5.98	3.9	0.9	7.70	6.60	7.8	Hold
Public Bank	Dec	17.66	4.01	2.9	20.70	19.14	6.6	Hold
Affin	Dec	2.36	NR	NR	NR	NR	NR	NR
MBSB	Dec	1.51	NR	NR	NR	NR	NR	NR
STMB	Dec	3.82	NR	NR	NR	NR	NR	NR
HL Bank	Jun	13.26	NR	NR	NR	NR	NR	NR

Source: M&A Securities

Summary

Moving forward, we will witness muted growth for banking sector as a result of various issues facing the banks. Slower loans growth, rising competition in deposits, GST implementation, NIM compression, lackluster capital market and rising expenses will be the key themes for banks in 2H15. Nevertheless, we project banks with discipline in managing expenses and deposits pricing will have an edge to sail in the current soft economic environments. All in, the strength in capital by banks that meet Basel III requirement will ensure the players to be safe from any rough external environment.

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Conclusion and Recommendations

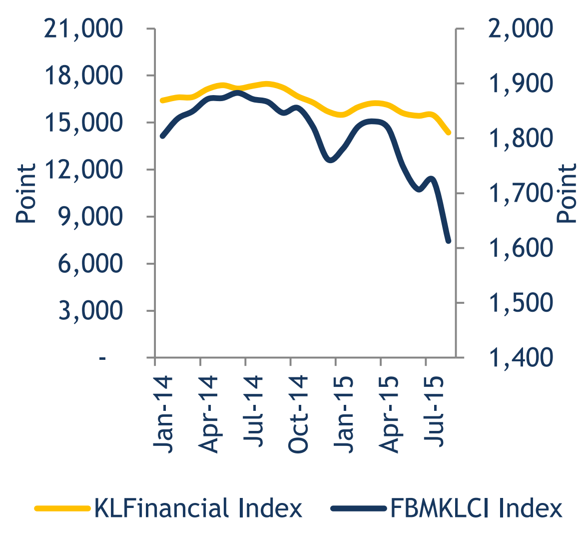
2015 will see banks slower but steady earnings growth due to the slowdown in HH loans segment that account for about 50 % of banking system loans growth. However, we foresee this situation could improve at the back of a pickup in lending from business loans linked to financing of ETP-related projects and also refinancing activities by listed companies from conventional debts to shariah-compliant instruments. Banking sector is a **NEUTRAL** in 2015 with 2 banks emerge as our **Top Pick** namely Maybank (TP: RM9.92) and BIMB Holdings (TP: RM4.63).

Table 5: Peers Comparison

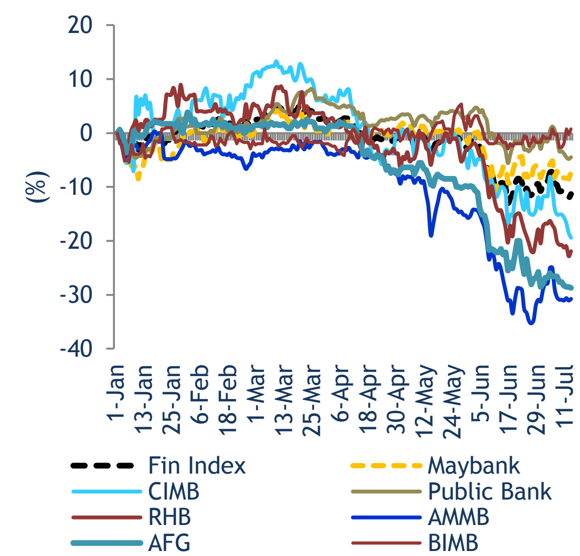
Company	YE	Price (RM)	EPS (RM)		P/E (x)		P/B (X)		ROE (%)	Div Yield (%)	TP (RM)	Call
			FY15	FY16	FY15	FY16	FY15	FY16				
AFG	Mac	3.37	0.4	0.4	12.7	12.0	1.7	1.6	14.3	1.9	4.00	Hold
AMMB	Mac	4.60	0.6	0.6	11.0	11.0	1.4	1.3	14.1	4.5	5.10	Hold
BIMB	Dec	4.07	0.3	0.4	11.7	11.3	1.8	2.0	16.0	5.8	4.63	Buy
CIMB	Dec	4.49	0.5	0.6	12.1	10.4	1.3	1.5	9.2	3.5	4.90	Hold
Maybank	Dec	8.55	0.7	0.8	12.6	11.9	1.5	1.5	13.6	6.2	9.92	Buy
RHB Cap	Dec	5.98	0.8	0.9	9.7	9.1	1.1	1.1	11.5	1.3	6.60	Hold
Public Bank	Dec	17.66	1.2	1.3	15.3	14.2	2.6	2.8	18.7	2.9	19.14	Hold
Affin	Dec	2.36	0.3	0.3	9.0	8.5	0.7	0.7	7.8	5.1	NR	NR
MBSB	Dec	1.51	0.2	0.3	9.1	8.4	1.2	1.1	29.6	2.3	NR	NR
STMB	Dec	3.82	NA	NA	NA	NA	NA	NA	24.3	6.6	NR	NR
HL Bank	Jun	13.26	1.2	1.3	12.0	11.2	1.6	1.5	14.7	2.9	NR	NR
Average			0.6	0.7	11.5	10.8	1.5	1.5	15.8	3.9		

Source: BNM, M&A Securities

FBM KLCI vs Financial Index (January 2014 -YTD)



Banking Share Performance (January 2015-YTD)



Source: Bloomberg, M&A Securities

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PBK Deposits Campaign

AMMB Deposits Campaign

Source: Banks, M&A Securities

CIMB Deposits Campaign

Maybank Deposits Campaign

Source: Banks, M&A Securities

RHB Bank Deposits Campaign

AFG Bank Deposits Campaign

Source: Banks, M&A Securities

STOCK RECOMMENDATIONS
BUY *Share price is expected to be ≥+10% over the next 12 months.*
TRADING BUY *Share price is expected to be ≥+10% within 3-months due to positive newsflow.*
HOLD *Share price is expected to be between -10% and +10% over the next 12 months.*
SELL *Share price is expected to be ≥-10% over the next 12 months.*

SECTOR RECOMMENDATIONS
OVERWEIGHT *The sector is expected to outperform the FBM KLCI over the next 12 months.*
NEUTRAL *The sector is expected to perform in line with the FBM KLCI over the next 12 months.*
UNDERWEIGHT *The sector is expected to underperform the FBM KLCI over the next 12 months.*

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