Malaysia

Overweight *(no change)*

Highlighted Companies

Hong Leong Bank
ADD, TP RM23.30, RM20.60 close

Hong Leong Bank (HLB) has one of the best asset qualities in the sector, making it one of the most defensive banks against credit risks from Covid-19. Earnings catalysts include a swift increase in associate contribution from Bank of Chengdu and above-industry loan growth.

Public Bank Bhd
ADD, TP RM5.07, RM4.51 close

We rate Public Bank Bhd (PBB) as an Add because we believe it is the most defensive against credit risks arising from the Covid-19 pandemic. This is premised on its superior gross impaired loan ratio, which is consistently the lowest in the sector.

RHB Bank Bhd
ADD, TP RM7.70, RM5.83 close

RHB Bank (RHBB) is our top pick for banks as its CY22F dividend yield of 5.6% is among the highest in the sector, while its CY22F P/E of 8.9x is attractive (vs. the sector's 12.2x). Furthermore, we regard it as one of the biggest beneficiaries of OPR hikes among big banks.

Summary Valuation Metrics

P/E (x)	Dec-22F	Dec-23F	Dec-24F
Hong Leong Bank	13.53	12.02	11.10
Public Bank Bhd	15.02	11.75	11.31
RHB Bank Bhd	8.86	6.72	6.20

P/BV (x)	Dec-22F	Dec-23F	Dec-24F
Hong Leong Bank	1.28	1.19	1.10
Public Bank Bhd	1.69	1.56	1.45
RHB Bank Bhd	0.75	0.69	0.64

Dividend Yield	Dec-22F	Dec-23F	Dec-24F
Hong Leong Bank	2.96%	3.33%	3.60%
Public Bank Bhd	3.33%	4.25%	4.42%
RHB Bank Bhd	5.65%	7.44%	8.06%

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Banks

Not underwhelmed by 1Q22 profit hiccup

- Following 4 quarters of double-digit growth, banks' 1Q22 CNP fell 0.2% yoy. We expect CNP growth to resume in 2Q22F at between +3 and +9% yoy.
- We are projecting CNP growth of 4% for banks in 2022F, underpinned by a 15.2% drop in LLP and a 7.8% rise in net interest income.
- Reiterate Overweight on banks, given the expected expansion in NIM (in tandem with the OPR upcycle) and an improvement in LLP.

The 4-quarter streak of strong CNP growth was broken in 1Q22…

Malaysian banks recorded impressive double-digit yoy growth of 25-45% in core net profit (CNP) for four consecutive quarters (from 1Q21 to 4Q21), but the trend was broken in 1Q22 with the sector's CNP inching down by 0.2% yoy. The earnings drag in 1Q22, which was largely expected, was due to the: 1) additional taxation from Cukai Makmur (CM), and 2) a 20.2% yoy slump in non-interest income, dented by adverse investment income. The positive take in 1Q22 was the 62.1% yoy plunge in loan loss provisioning (LLP).

…but two positive developments are on the cards for 2Q22F

We envisage a brighter earnings outlook for banks in 2Q22F, given two positive developments: 1) the beginning of an upcycle in the overnight policy rate (OPR), with the 25bp hike on 11 May 22, which would lift banks' net interest margins (NIM), and 2) two banks, i.e. AMMB and Alliance Bank, ceasing to incur CM taxation in 2Q22F. With this, we expect banks' CNP growth to resume to between +3% and +9% yoy in 2Q22F.

Expecting a continuous trend of yearly earnings recovery in 2022F

Notwithstanding the stalled earnings growth in 1Q22, the continuous yearly earnings recovery would be intact with our projected CNP growth of 4% in 2022F. The earnings catalysts in 2022F would be: 1) a 15.2% drop in LLP, and 2) healthy 7.8% growth in net interest income, lifted by OPR hikes. On the flip side, we estimate that the CM taxation would lower banks' CY22 CNP by c.7%. Excluding CM taxation, banks' CNP growth would be higher at an estimated 11% in 2022F.

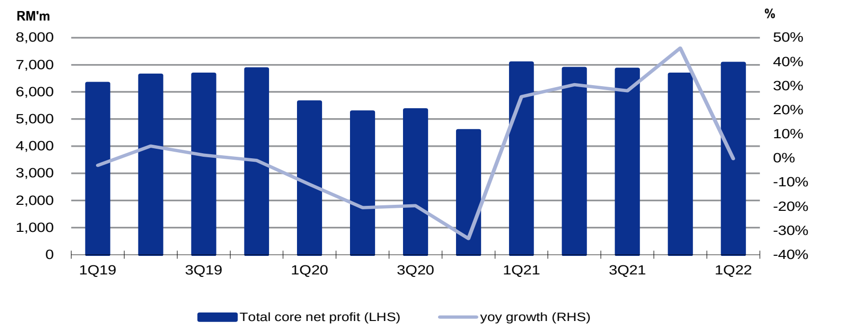
Risks from higher inflation and interest-rate hikes

The credit risks from Covid-19 have been subsiding since the re-opening of the economy, but there could be new risks emerging from the heightened inflation and interest-rate hikes, which could have negative impact on banks' loan growth and asset quality. However, we do not expect these to alter our forecasts, as we are: 1) projecting a downtrend in loan growth from 5% yoy at end-Apr 22 to 4-5% in 2022, and 2) forecasting a rise in the industry's gross impaired loan ratio from 1.5% at end-Dec 21 to 1.8-2.0% at end-Dec 22.

Reiterate Overweight on Malaysian banks

We continue to rate banks Overweight, predicated on the earnings recovery trend in 2021-23F. Potential re-rating catalysts would be: 1) an expansion in banks' NIM, in line with the OPR upcycle, and 2) a decline in LLP. Our picks for the sector are RHBB, HLB and PBB.

Figure 1: Banking sector's quarterly core net profits (and yoy growth)



SOURCES: CGS-CIMB RESEARCH, COMPANY

Figure 2: Sector Comparison table

Company	Bloomberg Ticker	Recom.	Price (local curr)	Target Price (local curr)	Market Cap (US$ m)	Core P/E (x) CY2021	Core P/E (x) CY2022F	3-year EPS CAGR (%)	P/BV (x) CY2021	P/BV (x) CY2022F	Recurring ROE (%) CY2021	Recurring ROE (%) CY2022F	Recurring ROE (%) CY2023F	P/PPOPS (x) CY2021	P/PPOPS (x) CY2022F	Dividend Yield (%) CY2021	Dividend Yield (%) CY2022F
DBS Group	DBS SP	Add	29.82	40.20	55,151	11.2	9.6	26.9%	1.39	1.29	12.8%	14.1%	15.7%	9.8	8.4	3.9%	4.8%
OCBC	OCBC SP	Add	11.43	14.20	36,918	10.6	9.5	21.0%	1.07	1.01	10.4%	11.0%	12.2%	9.0	8.2	4.6%	5.2%
United Overseas Bank	UOB SP	Add	27.09	35.60	32,602	11.7	10.2	21.9%	1.06	1.01	9.3%	10.2%	11.3%	8.3	7.6	4.4%	4.6%
Singapore average						**11.2**	**9.7**	**24.1%**	**1.19**	**1.12**	**11.0%**	**11.9%**	**13.3%**	**9.1**	**8.1**	**4.3%**	**4.9%**
Agricultural Bank of China	1288 HK	Add	2.91	4.40	154,543	3.8	3.5	9.2%	0.43	0.39	11.5%	11.5%	11.6%	1.9	1.8	8.3%	9.0%
Bank of China	3988 HK	Add	3.06	4.20	133,675	3.8	3.5	10.6%	0.41	0.37	11.2%	11.2%	11.3%	2.0	1.9	8.4%	9.1%
Bank of Communications	3328 HK	Add	5.19	5.30	52,170	4.0	3.7	10.0%	0.42	0.39	10.7%	10.9%	11.1%	2.0	1.9	8.0%	8.7%
China CITIC Bank	998 HK	Add	3.81	4.80	31,137	3.0	2.8	12.6%	0.31	0.29	10.8%	10.9%	11.4%	1.1	1.0	9.2%	10.2%
China Construction Bank	939 HK	Add	5.54	8.00	178,231	4.0	3.7	9.7%	0.48	0.44	12.5%	12.3%	12.3%	2.2	2.0	7.7%	8.3%
China Minsheng Bank	1988 HK	Hold	3.13	2.60	23,799	3.8	3.5	8.0%	0.24	0.23	6.6%	6.8%	7.5%	1.0	1.1	7.9%	8.6%
ICBC	1398 HK	Add	4.52	5.90	238,922	4.1	3.8	9.1%	0.48	0.44	12.2%	12.0%	12.1%	2.2	2.1	7.6%	8.2%
Hong Kong average						**3.9**	**3.6**	**9.7%**	**0.43**	**0.40**	**11.6%**	**11.5%**	**11.6%**	**2.0**	**1.9**	**7.9%**	**8.6%**
Bank Central Asia	BBCA IJ	Hold	7,400	8,100	62,061	29.0	25.0	16.1%	4.50	4.13	16.2%	17.3%	18.2%	18.8	17.6	1.7%	2.4%
Bank Danamon	BDMN IJ	Add	2,400	3,300	1,596	8.2	6.2	62.6%	0.49	0.47	6.5%	7.7%	8.4%	2.5	2.2	4.3%	5.6%
Bank Rakyat Indonesia	BBRI IJ	Add	4,360	5,000	44,955	19.3	15.7	30.6%	2.29	2.15	12.0%	14.2%	16.0%	8.8	8.5	4.0%	5.4%
Bank Tabungan Negara	BBTN IJ	Add	1,490	2,100	1,073	6.6	6.0	24.8%	0.74	0.67	na	na	12.4%	2.5	2.5	3.0%	3.3%
Indonesia average						**22.9**	**19.0**	**27.7%**	**2.88**	**2.68**	**na**	**na**	**16.0%**	**11.7**	**11.0**	**2.7%**	**3.7%**
Affin Bank Berhad	ABANK MK	Hold	1.92	2.19	923	7.7	8.2	22.7%	0.41	0.38	5.4%	5.0%	5.3%	4.5	4.6	6.5%	4.3%
Alliance Bank Malaysia Berhad	ABMB MK	Hold	3.45	3.45	1,208	10.2	7.4	28.3%	0.84	0.77	8.4%	11.0%	11.5%	5.1	4.6	4.5%	6.0%
AMMB Holdings	AMM MK	Add	3.76	4.28	2,818	8.6	7.6	12.9%	0.75	0.71	8.6%	9.8%	9.7%	4.7	4.6	1.0%	4.4%
Bank Islam Malaysia Bhd	BIMB MK	Add	2.78	3.48	1,355	11.2	11.6	7.4%	0.90	0.84	9.1%	7.7%	10.0%	6.5	5.3	3.9%	4.2%
Hong Leong Bank	HLBK MK	Add	20.60	23.30	10,102	15.2	13.5	8.8%	1.42	1.28	10.0%	10.1%	10.3%	13.1	12.4	2.6%	3.0%
Malayan Banking Bhd	MAY MK	Add	8.68	10.00	23,504	12.2	12.5	8.8%	1.20	1.07	9.7%	9.3%	9.6%	7.2	7.3	6.7%	4.8%
Public Bank Bhd	PBK MK	Add	4.51	5.07	19,804	15.3	15.0	10.8%	1.82	1.69	12.1%	11.9%	13.8%	10.2	9.1	3.4%	3.3%
RHB Bank Bhd	RHBBANK MK	Add	5.83	7.70	5,464	8.5	8.9	12.8%	0.86	0.75	10.2%	9.3%	10.7%	5.6	5.2	6.9%	5.6%
Malaysia average						**12.5**	**12.2**	**11.7%**	**1.23**	**1.11**	**10.0%**	**9.8%**	**10.6%**	**8.0**	**7.6**	**4.7%**	**4.1%**
Bangkok Bank	BBL TB	Add	134.5	164.0	7,339	9.5	8.4	24.4%	0.55	0.52	6.1%	6.2%	6.7%	4.4	4.1	3.0%	3.7%
Kasikornbank	KBANK TB	Add	147.5	170.0	9,990	10.0	8.9	11.7%	0.75	0.71	8.1%	8.2%	8.4%	3.9	3.7	2.0%	3.4%
Kiatnakin Phatra Bank	KKP TB	Hold	66.8	59.0	1,616	10.6	8.9	8.0%	1.19	1.16	11.9%	13.1%	13.6%	4.7	4.4	4.6%	6.4%
Krung Thai Bank	KTB TB	Hold	15.7	12.7	6,272	11.9	10.3	10.1%	0.61	0.59	5.4%	5.9%	5.9%	3.4	3.4	2.5%	3.5%
Tisco Financial Group	TISCO TB	Hold	89.5	101.0	2,048	10.9	10.2	5.9%	1.76	1.73	17.1%	17.1%	17.8%	6.6	6.4	7.6%	8.7%
Thailand average						**10.4**	**9.1**	**13.8%**	**0.69**	**0.66**	**7.1%**	**7.3%**	**7.6%**	**4.1**	**3.9**	**3.0%**	**4.1%**

SOURCES: CGS-CIMB RESEARCH ESTIMATE, COMPANY REPORTS, BLOOMBERG (AS AT 15 JUN 22)

Not underwhelmed by 1Q22 profit hiccup

Core net profit growth hit a bump in 1Q22

1Q22 net profit dented by CM and weak investment income

After expanding at double-digit rates for four consecutive quarters (yoy growth of between 25% and 46% from 1Q21 to 4Q21), the growth in Malaysian banks' CNP screeched to a halt in 1Q22, when the sector's CNP inched down by 0.2% yoy to RM7.05bn.

In our report dated 15 Mar 22 on the 4Q21 results roundup, we estimated banks' 1Q22 net profit to be at RM6.5bn-7.0bn. The total net profit for the sector came in at RM7.05bn in 1Q22 and, hence, the weak yoy growth in 1Q22 CNP was largely within our expectation. In fact, we see this as a reasonable performance as banks' 1Q22 CNP was primarily dragged down by the following two factors that do not frequently have negative impact on banks' earnings:

- The one-off tax expense under Cukai Makmur (CM) — In fact, 1Q22 was the only quarter when all banks had to incur the CM taxation. To explain, the CM taxation is imposed on companies' pre-tax profit for FY22. Banks that have a financial year-end of Dec (like Maybank, PBB, RHBB etc.) only started to reflect this taxation in 1Q22 (and will continue to do so until 4Q22).
  Two banks that have a financial year-end of Mar, i.e. AMMB and Alliance Bank, had already started to incur the CM taxation since 2QCY21 and will cease to do so in 2QCY22.
- Marked-to-market losses for banks' holdings of fixed-income securities due to the decline in bond prices amid the rising bond yield — the above caused banks' non-interest income to tumble by 20.2% yoy in 1Q22.

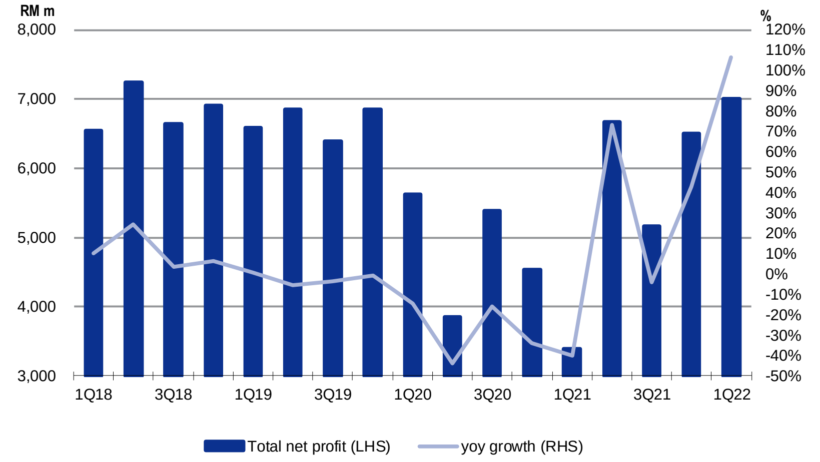
The above two negative factors were offset by the 62.1% yoy plunge in LLP. The decline in LLP could be due to lower pre-emptive provisions provided by banks, as banks have built up strong provision buffers while the credit risks triggered by the Covid-19 outbreak would have been subsiding amid the re-opening of the economy.

Meanwhile, banks' net interest income rose by a healthy 5.6% yoy in 1Q22, albeit slower than the momentum of 6.9% yoy in 4Q21. This was achieved on the back of a loan growth of 4.6% yoy at end-Mar 22 and stable net interest margins.

Strong growth in sector's reported net profit due to chunky one-off items by AMMB in 1Q21

Banks' reported net profit surged by 107.1% yoy in 1Q22, due to several one-off items for AMMB in 1Q21, i.e. impairment of goodwill of RM1.79bn, impairment of investment in associate of RM147.8m and 1MDB settlement of RM2.83bn.

Figure 3: Banks' quarterly reported net profit and yoy growth



SOURCE: CGS-CIMB RESEARCH, COMPANY REPORTS

1Q22 revenue brought down by weak non-interest income

Banks' revenue slid by 7.8% yoy as the 5.6% yoy increase in 1Q22 net interest income was more than offset by the 20.2% yoy drop in 1Q22 non-interest income. 1Q22 non-interest income was primarily dented by lower investment income.

The yoy increase in overheads contained by greater cost disciplines

The positive take for the 1Q22 results was banks' ability to keep the increase in the sector's overheads at only 1.4% yoy in 1Q22, which helped to cushion the negative impact from the lower non-interest income. We see this as a commendable performance, considering the fact that: 1) business activities for banks have been normalising in 1Q22 amid the re-opening of the economy, and 2) banks would have to continue to incur higher costs in several areas, such as digital banking, compliance and sustainability (relating to Environment, Social and Governance, or ESG).

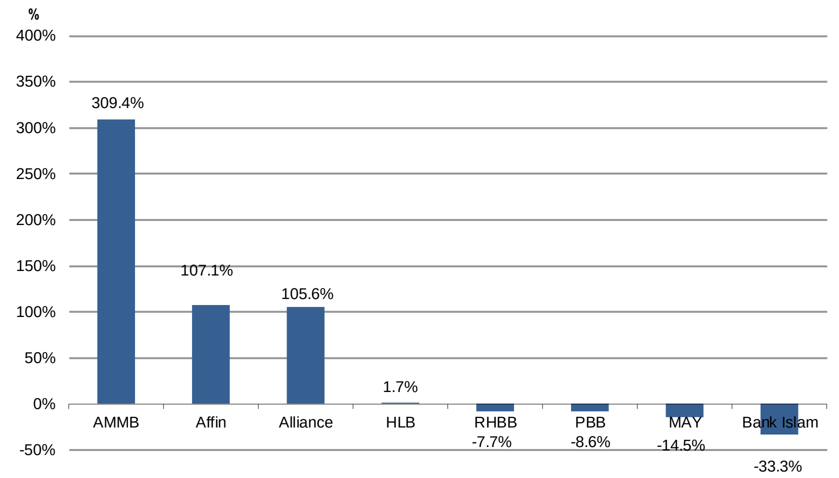
We did not observe any large-scale cost-cutting exercises embarked on by banks (like voluntary separation schemes) in the past few quarters, which would have helped to tame the increase in 1Q22 overheads. As such, in our view, the small 1.4% yoy rise in banks' 1Q22 overheads reflect their greater cost disciplines and tight cost controls for most banks.

A mixed bag in 1Q22's financial performance

Out of the eight Malaysian banks under our coverage, half of them (a total of four) recorded a yoy growth in 1Q22 CNP; three of these even posted triple-digit growth in 1Q22 CNP, i.e. AMMB (+309.4% yoy), Affin Bank (+107.1% yoy) and Alliance Bank (+105.6% yoy). The 1Q22 CNP of these three banks was primarily driven by favourable trends in 1Q22 LLP (even net write-backs in LLP for AMMB and Affin Bank), which more than offset the yoy slump in non-interest income.

Among the four banks that registered a drop in 1Q22 CNP, the worst performer was Bank Islam (-33.3% yoy). Bank Islam's 1Q22 CNP was dragged down by: 1) a 266.9% yoy surge in LLP, and 2) a 40.2% yoy plunge in non-interest income.

Figure 4: Banks' 1Q22 yoy core net profit growth



SOURCE: CIMB RESEARCH, COMPANY

Projected core net profit growth in CY22F

Forecasting a core net profit growth of 4% in CY22F

We are forecasting a CNP growth of 4% for Malaysian banks in CY22F, slightly lower than the 4.1% we had projected before the 1Q22 results season. Based on this, our projected CNP growth for FY22F would be significantly lower than the rate of 16.4% in 2021, due to additional tax expense from CM, which is a one-off tax imposed by the government on companies' FY22 net profit in excess of RM100m. We estimate that CM would reduce our projected net profit for Malaysian banks by about 7%.

On the flip side, the key catalyst for banks' earnings in 2022F would be our projected 15.2% drop in LLP. We believe this is achievable even if there is a qoq uptick in LLP in the upcoming quarters, considering the 62.1% plunge in 1Q22's LLP.

At the topline, we are forecasting a growth of 7.8% for net interest income and 8.9% for non-interest income. We expect banks' net interest income to be driven by the hikes in the OPR, which could lead to an expansion in banks' net interest margin in 2022. Bank Negara Malaysia raised the OPR by 25bp on 11 May 22; our economist expects another two OPR hikes (of 25bp each) in 2H22F.

Cost-wise, we project a wider increase of 6.7% in banks' overheads in 2022F (vs. a rise of 2.6% in 2021). This is premised on the resumption of most of the banking activities in conjunction with the re-opening of the economy and the removal of the movement control orders.

Our other projections for the banking sector in 2022F are:

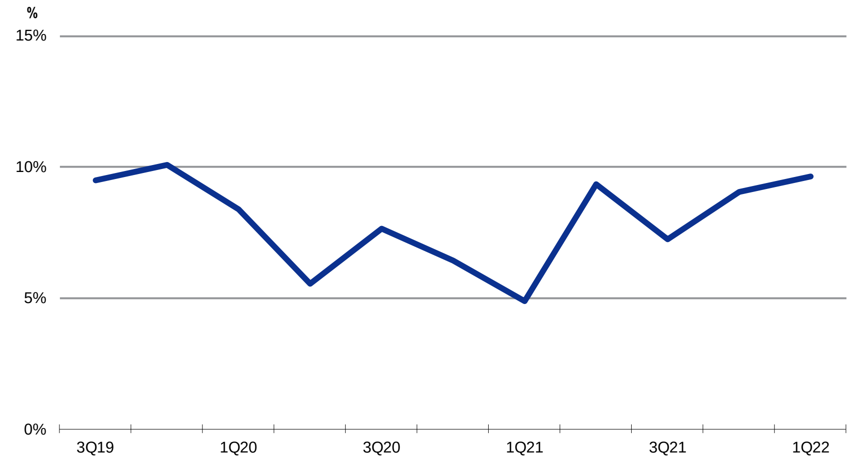
- A loan growth of 4-5% (vs. 4.5% in 2021),
- An increase in gross impaired loan ratio to 1.8-2.0% at end-Dec 22 (from 1.5% at end-Dec 21).

ROE

A yoy contraction in core ROE

The banking sector's core ROE contracted from 10.3% in 1Q21 (excluding the chunky one-off items by AMMB) to 9.7% in 1Q22. This was due to the marginal 0.2% yoy drop in 1Q22 CNP vs. a 4.8% yoy rise in shareholders' funds at end-Mar 22. However, the sector's 1Q22 core ROE was higher than the 9% recorded in 4Q22 (for qoq comparison).

Figure 5: Banks' quarterly annualised ROE



SOURCE: CGS-CIMB, COMPANY REPORTS

The yoy expansion in AMMB's core ROE was the widest in 1Q22

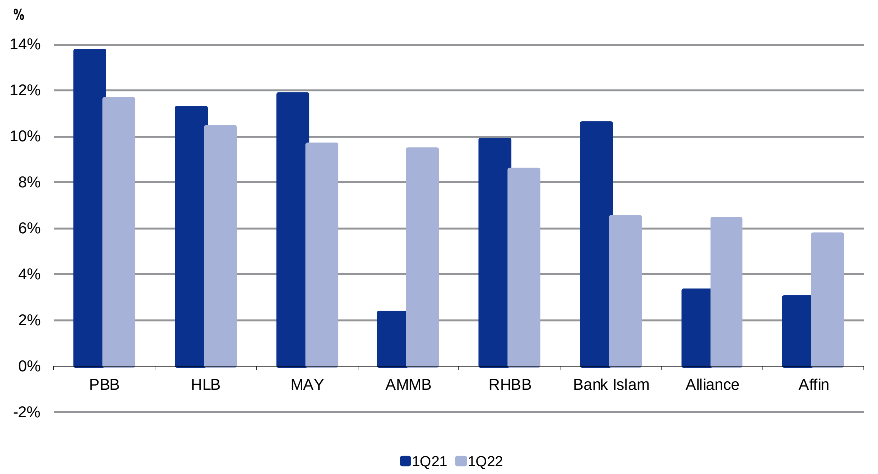
The performance for banks in terms of the changes in core ROEs was also mixed, with four banks recording a yoy increase in 1Q22 core ROEs, while another four banks saw a decline. The largest expansion in 1Q22 core ROE was the 7.1%-pt yoy rise for AMMB (to 9.4% in 1Q22) as its 1Q21 core ROE was brought down by hefty LLP.

The four banks that registered a yoy decline in 1Q22 core ROEs were PBB (-2.1% pts yoy to 11.6%), Maybank (-2.2% pts yoy to 9.6%), RHBB (-1.3% pts yoy to 8.6%) and Bank Islam (-4.1% pts to 6.5%).

Public Bank topped the rankings for ROE

Despite contracting by 2.1% pts yoy, PBB's core ROE of 11.6% in 1Q22 was still unrivalled by its peers — significantly higher than the sector's core ROE of 9.7% in 1Q22. At the other end of the spectrum, Affin Bank's core ROE of 5.7% in 1Q22 was still the lowest in the sector.

Figure 6: Banks' 1Q21 and 1Q22 annualised ROEs



SOURCE: CGS-CIMB, COMPANY REPORTS

COMPARED WITH EXPECTATIONS

1Q22 financial results within our expectations

Malaysian banks' 1Q22 financial results were within our expectation, with four out of the eight Malaysian banks under our coverage meeting our earnings forecasts (compared to three banks missing our forecasts and one bank outperforming our expectation). However, we regard banks' 1Q22 financial results as below market expectation, as four banks registered lower-than-expected 1Q22 earnings (relative to Bloomberg consensus' estimates), compared to two in-lines and two outperformance.

The following are the three Malaysian banks that recorded weaker-than-expected earnings in the 1Q22 results season (relative to our forecasts):

- At 21% of our full-year forecast, RHBB's 1Q22 net profit was below our expectation due to lower-than-expected non-interest income, which was dented by losses from its portfolio of fixed-income securities arising from rising bond yields.
- Alliance Bank's FY3/22 net profit was below our expectation, at 95% of our full-year forecast, due to lower-than-expected non-interest income and higher-than-expected LLP.
- Bank Islam's 1Q22 financial result was a miss as its 1Q22 net profit only accounted for 18% of our full-year forecast. The variance to our forecasts mainly came from lower-than-expected non-interest income, which was dented by adverse investment income.

Conversely, AMMB was the only Malaysian bank that turned in higher-than-expected financial results in 1Q22. Its FY3/22 net profit accounted for 110% of our full-year forecast due to lower-than-expected LLP, arising from the net write-back in provisioning in 4QFY3/22.

Figure 7: Comparison of 1Q22 results with CGS-CIMB's and consensus' estimates

RM m	Financial year-end	No of quarters	YTD net profit	Annualised	CGS-CIMB	Variance	Market consensus	Variance
Maybank	Dec-22	1	2,044.9	8,179.6	8,167.0	0.2%	8,507.3	-3.9%
Public Bank	Dec-22	1	1,398.6	5,594.4	5,791.2	-3.4%	5,849.5	-4.4%
RHB Bank	Dec-22	1	600.3	2,401.2	2,850.3	-15.8%	2,714.6	-11.5%
AMMB	Mar-22	4	1,502.7	1,502.7	1,362.8	10.3%	1,285.7	16.9%
Hong Leong Bank	Jun-22	3	2,381.6	3,175.5	2,993.1	6.1%	3,289.1	-3.5%
Alliance	Mar-22	4	572.8	572.8	601.4	-4.8%	551.7	3.8%
Affin	Dec-22	1	142.7	570.8	484.4	17.8%	538.2	6.1%
Bank Islam	Dec-22	1	105.9	423.6	583.9	-27.5%	530.8	-20.2%
TOTAL	**Jan-00**			**22,420.6**	**22,834.1**	**-1.8%**	**23,266.9**	**-3.6%**

SOURCES: CGS-CIMB, COMPANY REPORTS, BLOOMBERG

Figure 8: Comparing 1Q22 results to CGS-CIMB's and consensus' forecasts – snapshot

	vs CGS-CIMB' projection			vs Bloomberg's consensus estimates		
Banks	**Above**	**In line**	**Below**	**Above**	**In line**	**Below**
Maybank		X			X	
Public Bank		X			X	
RHB Bank			X			X
AMMB	X			X		
Hong Leong Bank		X				X
Alliance			X	X		
Affin		X				X
Bank Islam			X			X
Total	**1**	**4**	**3**	**2**	**2**	**4**
As % of all banks	12.5%	50.0%	37.5%	25.0%	25.0%	50.0%

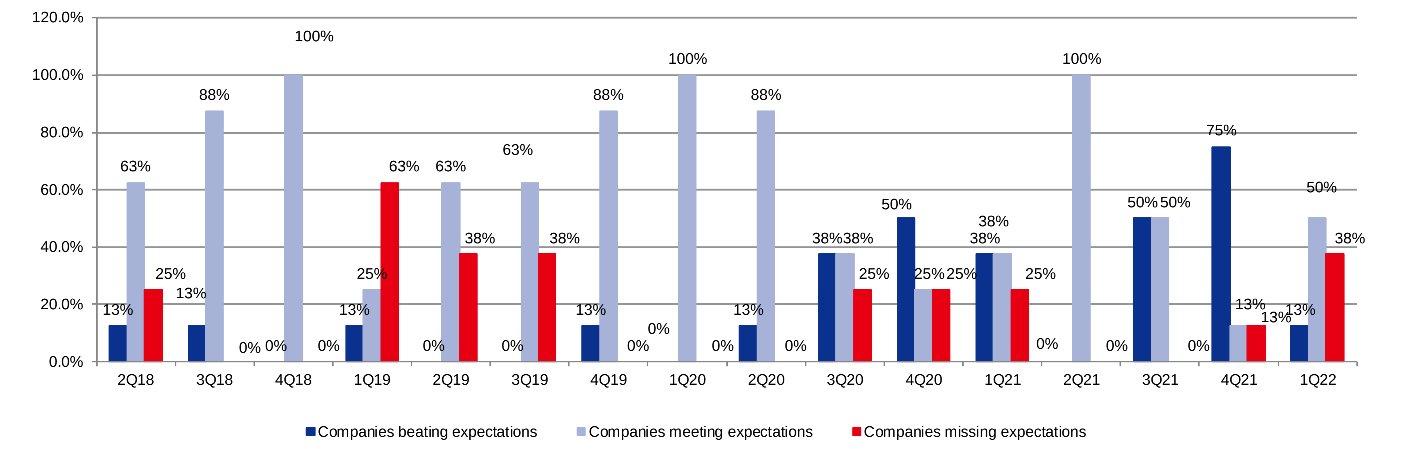
SOURCES: CGS-CIMB, COMPANY REPORTS, BLOOMBERG

An increase in underperformance ratio in 1Q22

Relative to our forecasts, the underperformance ratio for Malaysian banks' financial results (the percentage of Malaysian banks that turned in lower-than-expected net profits) increased from 12.5% in 4Q21 to 37.5% in 1Q22, while the outperformance ratio (percentage of Malaysian banks that recorded higher-than-expected net profits) fell from 75% in 4Q21 to 12.5% in 1Q22. This was mainly due to the increases in our net profit forecasts for banks during the 3Q21 and 4Q21 results seasons, considering their strong financial performance.

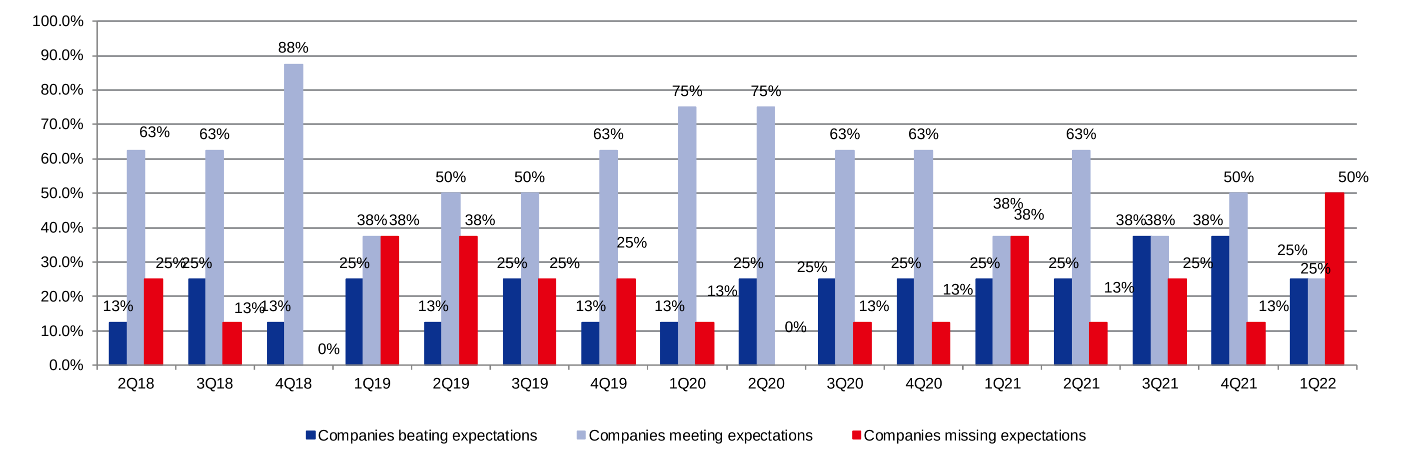
We observed the similar trend when we compared banks' 1Q22 earnings against Bloomberg consensus' estimates. Banks' underperformance ratio rose from 12.5% in 4Q21 to 50% in 1Q22, while the outperformance ratio declined from 37.5% in 4Q21 to 25% in 1Q22.

Figure 9: Performance of banks relative to CGS-CIMB's expectations in the reporting seasons



SOURCE: CGS-CIMB, COMPANY REPORTS

Figure 10: Performance of banks relative to expectations of the market in the reporting seasons



SOURCE: CGS-CIMB RESEARCH, COMPANY, BLOOMBERG

EARNINGS ADJUSTMENTS

FY23-24F net profit forecasts raised during 1Q22 results season

During the 1Q22 results season, we lowered our FY22F net profit forecasts for banks marginally by 0.2%. The reduction came from the following two banks:

- RHB Bank – our projected FY22F net profit was cut by 4.3% due to the 10.2% decline in our projected FY22F non-interest income.
- Bank Islam – our FY22F net profit forecasts were lowered by 12.8%, arising from: 1) a 17.4% cut in projected FY22F non-interest income, and 2) an increase of 49.6% in projected FY22F LLP.

However, we raised our FY23-24F net profit forecasts for the sector by c.2% as we factored in another 25bp hike in OPR in 2H22F, on top of the 25bp hike we had factored in.

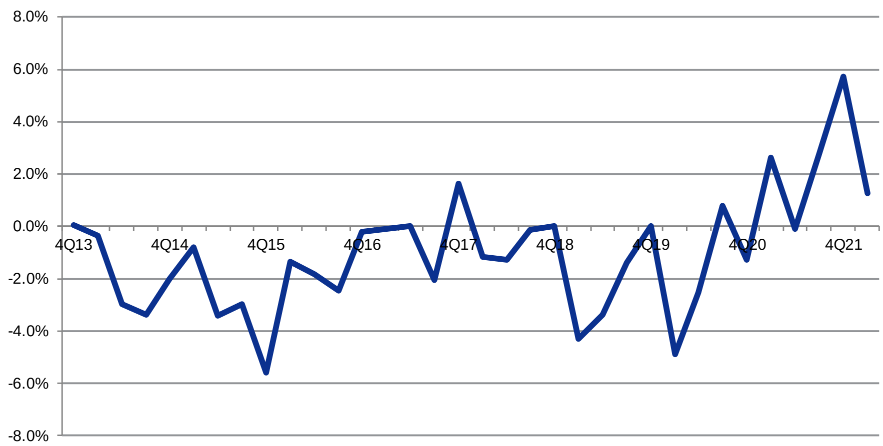
Figure 11: Earnings adjustments during the 1QCY22 results season

	Forecasts before 1Q22 results			Forecasts after 1Q22 results			Changes		
Banks	**FY22F**	**FY23F**	**FY24F**	**FY22F**	**FY23F**	**FY24F**	**FY22F**	**FY23F**	**FY24F**
Maybank	8,167.0	9,449.8	10,246.4	8,256.1	9,625.3	10,430.9	1.1%	1.9%	1.8%
Public Bank	5,791.2	7,351.3	7,638.1	5,829.6	7,447.9	7,740.0	0.7%	1.3%	1.3%
RHB Bank	2,850.3	3,490.0	3,785.0	2,727.5	3,592.2	3,895.1	-4.3%	2.9%	2.9%
AMMB	NA	1,628.1	1,705.2	NA	1,666.1	1,768.9	NA	2.3%	3.7%
Hong Leong Bank	2,993.1	3,541.7	3,768.5	2,993.1	3,601.0	3,839.7	0.0%	1.7%	1.9%
Alliance	NA	748.8	814.3	NA	772.3	847.1	NA	3.1%	4.0%
Affin	484.4	562.8	631.7	499.0	584.7	654.2	3.0%	3.9%	3.6%
Bank Islam	583.9	726.2	815.7	508.9	736.2	852.4	-12.8%	1.4%	4.5%
TOTAL	**20,869.8**	**27,498.6**	**29,404.8**	**20,814.2**	**28,025.7**	**30,028.3**	**-0.3%**	**1.9%**	**2.1%**

SOURCES: CGS-CIMB RESEARCH, COMPANY

On average, we raised our FY22-24 net profit forecasts by 1.3% in the 1Q22 results season, which was lower than the increases of 5.7% in 4Q21 results season and 2.8% in 3Q21 results season.

Figure 12: Average change in net profit forecasts for banks under our coverage during the results seasons



SOURCE: CGS-CIMB RESEARCH, COMPANY REPORTS

The good …

LOAN LOSS PROVISIONING

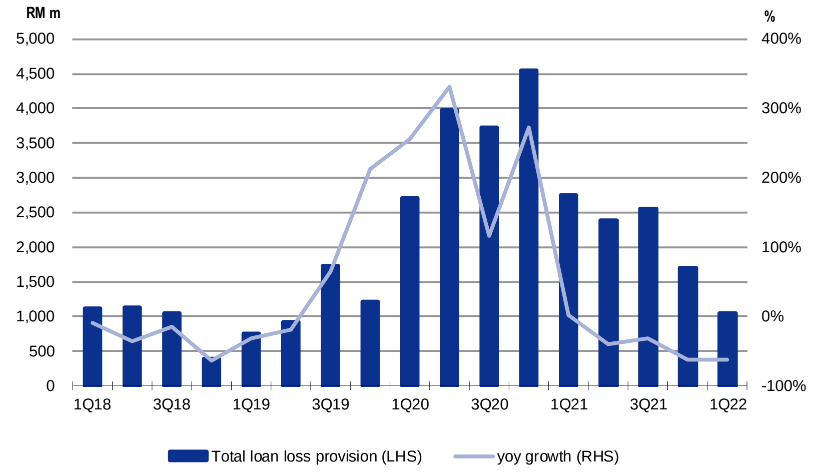
Loan loss provisioning dropped to below pre-Covid 19 level

In our report dated 3 May 22, we predicted a decline in banks' 1Q22 LLP. Indeed, the sector's LLP plunged by 62.1% yoy in 1Q22. This was the fourth consecutive quarter of double-digit yoy decline in banks' LLP. The LLP of RM1.04bn in 1Q22 was even lower than the pre-Covid 19 level of RM1.22bn in 4Q19. Meanwhile, the 1Q22 LLP also declined by 38.5% qoq.

The plunge in LLP was the key factor to limit the slide in banks' 1Q22 net profit, under the weight of a slump in non-interest income and additional tax expense from CM.

In our view, the plunge in 1Q22 LLP was mainly due to much lower management overlay provided by banks (compared to the levels from 2Q20 to 4Q21) as banks have built up strong provision buffers against the credit risks from the Covid-19 pandemic, which are subsiding amid the re-opening of the economy. In addition, there was no material deterioration in the asset quality for most banks that would warrant them to increase their LLP.

Figure 13: Banks' quarterly loan loss provision & yoy growth



SOURCE: CGS-CIMB RESEARCH, COMPANY

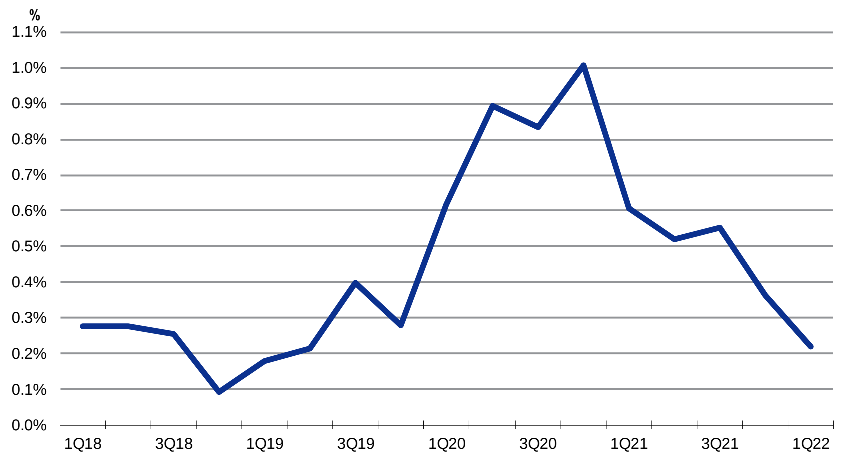
Significant improvement in loan loss provisioning for almost all banks

The LLP for almost all Malaysian banks declined by at least double-digit rates in 1Q22, while two banks, i.e. AMMB and Affin Bank, even recorded net write-backs in LLP. The only exception was Bank Islam, which saw its 1Q22 LLP surge by 266.9% yoy, in line with the rise in its gross impaired loan ratio. Bank Islam's 1Q22 LLP was also lifted by the unwinding of the repayment assistance it offered to its borrowers.

A steep decline in credit charge-off rates

The plunge in 1Q22 LLP brought the sector's annualised credit charge-off rate down from 61bp in 1Q21 to 22bp in 1Q22. This was even lower than the pre-Covid-19 level of 28bp (the 12-quarter average from 1Q17 to 4Q19). On a qoq comparison, the 1Q22 annualised credit charge-off rate was also significantly lower than the level of 36bp in 4Q21.

Figure 14: Banks' quarterly annualised credit charge-off rate

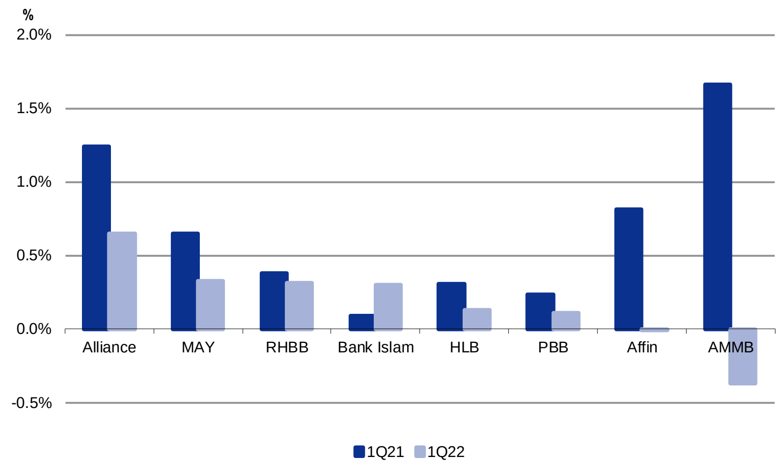


SOURCE: CGS-CIMB, COMPANY REPORTS

Alliance's annualised credit charge-off rate was the highest in 1Q22

Alliance Bank's annualised credit charge-off rate of 65bp in 1Q22 was the highest in the sector. This was followed by Maybank's 32bp. On the flip side, two banks, i.e. AMMB and Affin Bank, recorded net write-backs in LLP in 1Q22 (and hence, negative credit charge-off rate for both of them). Apart from the above two banks, PBB's annualised credit charge-off rate of 11bp in 1Q22 was the lowest in the sector.

Figure 15: Banks' 1Q21 and 1Q22 credit charge-off rates



SOURCE: CGS-CIMB RESEARCH, COMPANY REPORTS

Outlook for loan loss provisioning

We think that the sector's LLP would have bottomed in 1Q22, and we do not expect a spike in LLP in the upcoming quarters as banks have built up strong provision buffers against any residual credit risks from the Covid-19 pandemic. We continue to project a 15.2% drop in banks' LLP in 2022F, and a plunge in 1Q22 LLP has put banks in a comfortable position to achieve this.

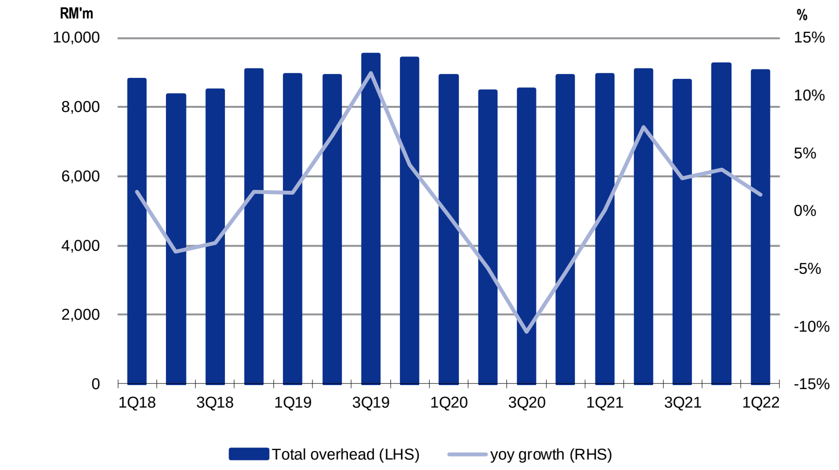
OVERHEADS

Keeping overhead growth at bay despite the normalisation of business activities

We are encouraged that banks managed to limit the growth in their overheads to only 1.4% yoy in 1Q22 (to a total of RM9.04bn for the sector) despite the normalisation of their business activities amid the re-opening of the economy. In addition, banks will have to continue to incur higher costs in several areas, like digital banking, compliance and sustainability initiatives (relating to ESG). It will be even more positive if we take into consideration that banks' overheads slid by 2.1% qoq in 1Q22.

In our view, the marginal growth in 1Q22 overheads would reflect the high cost disciplines and tight cost controls by most banks. Although several banks are currently on cost-cutting mode, there were no large-scale cost-reduction exercises (like voluntary separation schemes offered to their staff) by banks in the past few quarters.

Figure 16: Banks' total overheads & yoy growth

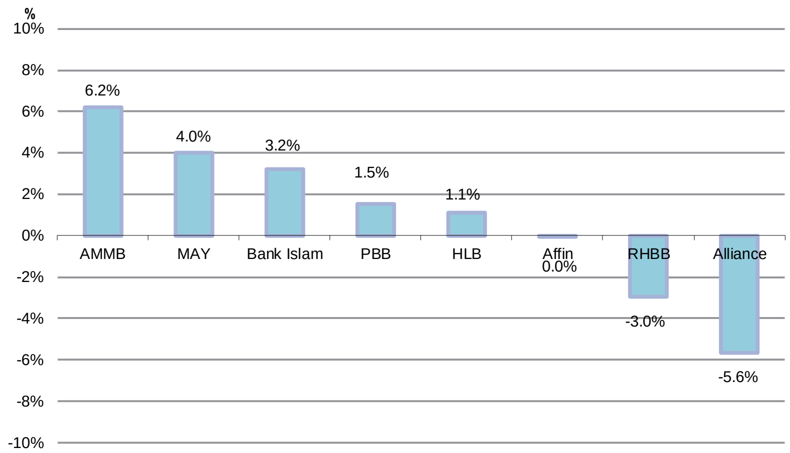


SOURCE: CGS-CIMB RESEARCH, COMPANY REPORTS

Lower overheads in 1Q22 for two banks

Among the Malaysian banks under our coverage, two banks even managed to reduce their overheads in 1Q22 — by 5.6% yoy for Alliance Bank and by 3% yoy for RHB Bank. In contrast, the 6.2% yoy increase in AMMB's 1Q22 overheads was the widest in the sector.

Figure 17: Banks' 1Q22 yoy growth in overheads

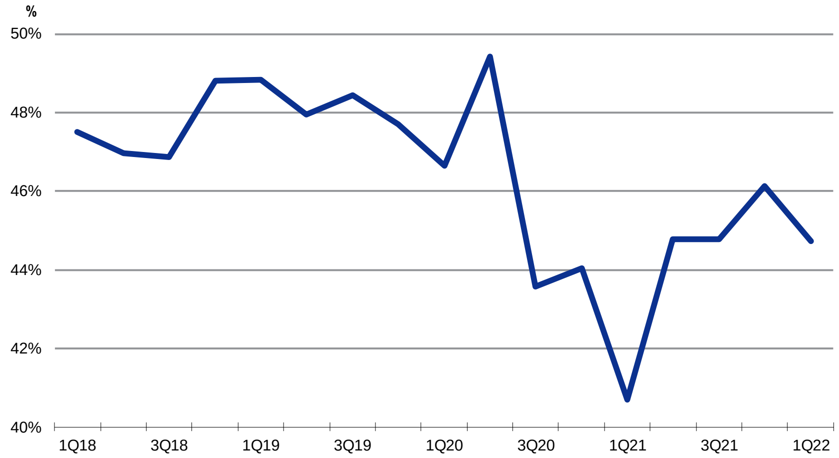


SOURCE: CGS-CIMB, COMPANY REPORTS

A yoy deterioration in cost-to-income ratio due to lower revenue

Despite banks' abilities to limit the increase in overheads, the sector's cost-to-income ratio deteriorated from 40.7% in 1Q21 to 44.7% in 1Q22, due to the 7.8% yoy decline in banks' 1Q22 revenue (vs. an increase of 1.4% yoy in overheads). However, the sector's cost-to-income ratio improved from the level of 46.1% in 4Q21, as 1Q22 overhead contracted by 2.1% qoq, while revenue rose marginally by 0.9% qoq in 1Q22.

Figure 18: Banks' quarterly cost-to-income ratio



SOURCE: CGS-CIMB, COMPANY REPORTS

Higher cost-to-income ratios for most banks

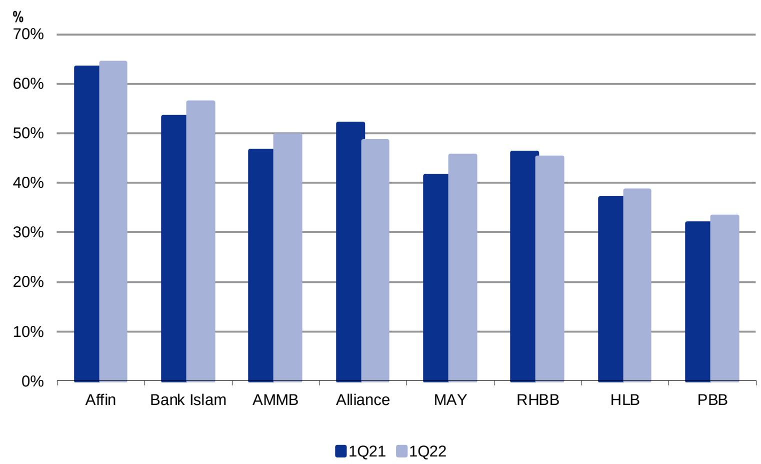
Six out of the eight Malaysian banks under our coverage posted higher cost-to-income ratios in 1Q22, with the yoy increases ranging from 1% pt (for Affin Bank) to 4.1% pts (for Maybank). Only two banks, i.e. RHBB and Alliance, managed to buck the trend with a 0.9% pt and 3.6% pts yoy reduction, respectively, in their 1Q22 cost-to-income ratios.

Public Bank still the most efficient bank

None of the Malaysian banks have been able to rival PBB's operational efficiency, as reflected by its consistently lowest cost-to-income ratio — 33.2% in 1Q22, significantly below the sector average of 44.7%. There is no secret to PBB's superior operating efficiency as it practises strict cost discipline in all areas of its operations while consistently pushing for topline growth.

HLB was in a distant second place, with a cost-to-income ratio of 38.4% in 1Q22. At the other end of the spectrum, Affin Bank's cost-to-income ratio of 64.4% in 1Q22 was the highest in the sector, reflecting the lack of economies of scale for the bank. In our view, its overhead in 1Q22 was also lifted by the additional costs for its ongoing transformation programme.

Figure 19: Banks' 1Q21 and 1Q22 cost-to-income ratios



SOURCE: CGS-CIMB RESEARCH, COMPANY

Outlook for overheads

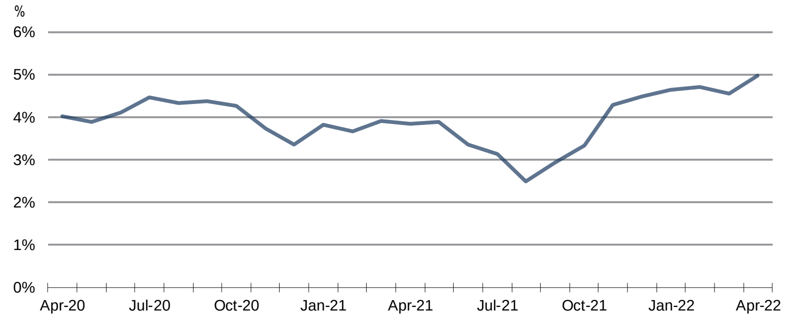
We expect banks' overheads to increase by a wider margin of 3-5% yoy in 2Q22F (vs. 1.4% yoy in 1Q22), due to cost pressures from higher inflation. We regard the 3-5% increase as the normalised yoy growth rate for banks' overheads. Banks will need to continue to incur higher expenditure in certain areas (like digital banking and sustainability initiatives), but this could be partly offset by tight cost control in other areas (like branch operations etc).

LOAN GROWTH

Loan growth sustained at a healthy rate

The industry's loan growth inched up from 4.5% yoy at end-Dec 21 to 4.6% yoy at end-Mar 22, which is viewed by us as a healthy rate. By segments, loan growth picked up from 4.3% yoy at end-Dec 21 to 4.9% yoy at end-Mar 22 for household loans, but this was offset by the moderation in business loan growth from 5% yoy at end-Dec 21 to 4.5% yoy at end-Mar 22.

Figure 20: Malaysian banking system's loan growth

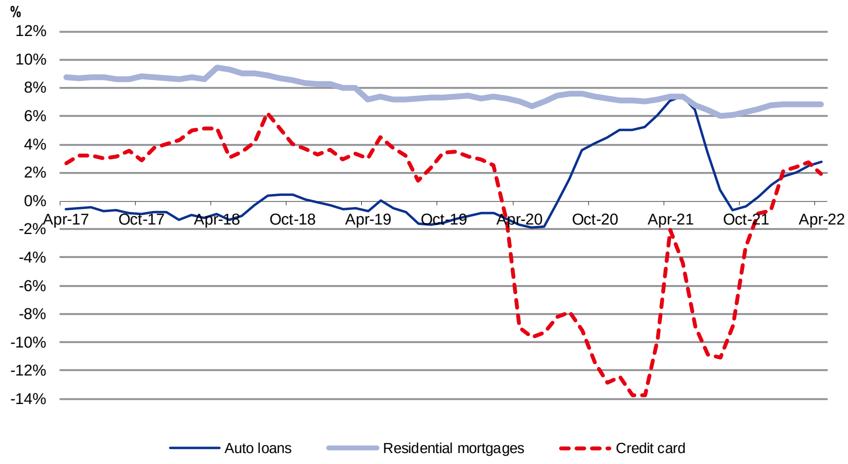


SOURCE: BANK NEGARA MALAYSIA

There was an across-the-board improvement in the growth of all household loan segments in 1Q22, as shown in the following:

- An acceleration in growth from 1.1% yoy as at end-Dec 21 to 2.5% yoy as at end-Mar 22 for auto loans.
- A marginal pick-up in momentum from 6.8% yoy at end-Dec 21 to 6.9% yoy at end-Mar 22 for residential mortgages.
- A wider expansion of 2.1% yoy at end-Mar 22 for personal loans compared to a rise of 0.8% yoy at end-Dec 21.
- A reversal of a decline of 0.7% yoy at end-Dec 21 to an expansion of 2.8% yoy at end-Mar 22 for credit card receivables.

Figure 21: Yoy growth of various consumer loan sub-segments



CGS-CIMB RESEARCH, COMPANY

The business loan growth was primarily dragged down by the slowdown in the momentum for the following three sub-segments:

- From 11.2% yoy at end-Dec 21 to 10.2% yoy at end-Mar 22 for general commerce loans.
- From 13.7% yoy at end-Dec 21 to 12% yoy at end-Mar 22 for transport loans.
- From 5.9% yoy at end-Dec 21 to 4% yoy at end-Mar 22 for finance loans.
-

Conversely, the momentum for manufacturing loans growth improved from 9.1% yoy at end-Dec 21 to 9.7% yoy at end-Mar 22.

Figure 22: Breakdown of loans and yoy % growth

RM m	Aug-21	Sep-21	Oct-21	Nov-21	Dec-21	Jan-22	Feb-22	Mar-22	Apr-22
Total loans	**1,859,824**	**1,877,737**	**1,887,493**	**1,903,589**	**1,913,660**	**1,923,884**	**1,926,908**	**1,938,128**	**1,946,151**
Purchase of securities	85,992	88,087	88,670	91,140	90,052	90,414	90,355	90,926	91,277
Auto	172,089	172,490	173,833	175,649	177,605	178,804	179,143	180,433	181,811
~ passenger cars	164,144	164,483	165,744	167,493	169,384	170,478	170,547	171,872	173,173
Residential	672,100	676,549	681,234	685,918	691,660	696,070	698,785	703,143	706,779
Non-residential	227,695	229,423	229,823	230,367	230,903	231,508	231,805	233,161	233,394
Purchase of fixed asset	12,717	12,741	12,711	12,709	13,373	13,262	13,040	13,144	13,210
Personal use	100,572	100,810	101,158	101,711	102,226	102,594	103,051	103,348	103,360
Credit card	32,333	32,921	33,982	34,832	35,812	36,222	35,429	35,521	35,441
Consumer durables	70	70	68	68	67	67	67	68	66
Construction	61,459	60,881	59,973	59,521	59,444	58,437	58,230	57,781	57,553
Working capital	415,663	420,362	424,047	428,699	429,128	433,571	435,582	438,670	442,165
Other purposes	79,136	83,404	81,995	82,976	83,389	82,935	81,420	81,934	81,096
By sector									
Total loans	**1,859,824**	**1,877,737**	**1,887,493**	**1,903,589**	**1,913,660**	**1,923,884**	**1,926,908**	**1,938,128**	**1,946,151**
Agriculture	33,989	35,230	34,832	34,970	33,799	33,116	33,047	32,354	32,412
Mining	11,279	11,403	11,683	11,387	10,426	11,373	10,479	9,485	9,381
Manufacturing	130,525	132,273	133,264	134,988	132,335	134,636	135,623	138,070	139,504
Utility	15,729	15,809	16,480	16,715	17,556	18,600	19,269	18,721	21,005
General commerce	144,982	146,090	149,179	150,693	153,619	153,789	155,265	156,868	159,256
Construction	88,659	89,335	88,843	88,583	89,098	89,070	89,247	89,067	88,602
Real estate	111,742	111,841	111,503	112,333	112,892	112,658	112,032	112,032	112,615
Transport	38,503	39,573	39,851	42,898	44,363	45,111	45,383	45,340	44,749
Finance	119,010	123,102	122,477	122,514	121,631	121,459	121,511	123,130	122,332
Education, health and others	53,602	53,983	54,656	54,145	55,375	55,865	56,198	56,193	55,723
Household	1,097,165	1,103,316	1,111,497	1,120,157	1,128,486	1,134,791	1,136,597	1,142,789	1,147,510
Others	14,640	15,783	13,228	14,205	14,079	13,414	12,257	14,081	13,063
YoY growth (%)	**Aug-21**	**Sep-21**	**Oct-21**	**Nov-21**	**Dec-21**	**Jan-22**	**Feb-22**	**Mar-22**	**Apr-22**
Total loans	**2.5%**	**2.9%**	**3.3%**	**4.3%**	**4.5%**	**4.7%**	**4.7%**	**4.6%**	**5.0%**
Purchase of securities	3.3%	4.8%	3.6%	5.7%	3.9%	5.2%	5.9%	6.9%	7.5%
Auto	0.8%	-0.6%	-0.4%	0.3%	1.1%	1.7%	2.0%	2.5%	2.8%
~ passenger cars	0.9%	-0.6%	-0.3%	0.3%	1.2%	1.7%	1.8%	2.4%	2.7%
Residential	6.1%	6.1%	6.3%	6.5%	6.8%	6.9%	6.9%	6.9%	6.8%
Non-residential	-0.4%	-0.2%	0.2%	0.6%	0.9%	1.4%	1.5%	2.1%	2.3%
Purchase of fixed asset	-5.0%	-6.7%	-1.8%	-2.2%	3.1%	3.2%	1.9%	3.4%	3.9%
Personal use	0.3%	-0.5%	-0.5%	0.2%	0.8%	1.4%	2.0%	2.1%	2.0%
Credit card	-11.1%	-8.9%	-3.3%	-0.9%	-0.7%	2.1%	2.4%	2.8%	2.0%
Consumer durables	-14.9%	-15.8%	-16.6%	-15.5%	-15.1%	-14.5%	-13.5%	-38.1%	-38.8%
Construction	1.8%	0.8%	-0.1%	-1.0%	-0.3%	-4.3%	-4.0%	-5.9%	-5.9%
Working capital	2.9%	3.8%	4.8%	7.0%	7.1%	7.2%	7.1%	5.6%	7.1%
Other purposes	-5.6%	1.1%	0.0%	3.4%	2.6%	1.5%	0.5%	1.6%	2.2%
By sector									
Total loans	**2.5%**	**2.9%**	**3.3%**	**4.3%**	**4.5%**	**4.7%**	**4.7%**	**4.6%**	**5.0%**
Agriculture	-4.5%	0.0%	0.9%	1.5%	-0.9%	-2.0%	-3.5%	-4.9%	-3.7%
Mining	3.7%	-2.0%	4.5%	2.1%	-2.2%	4.5%	-3.7%	-12.8%	-15.9%
Manufacturing	7.1%	7.8%	9.5%	11.1%	9.1%	10.0%	10.3%	9.7%	10.8%
Utility	-2.5%	4.5%	9.6%	22.6%	18.8%	17.2%	29.3%	17.6%	32.0%
General commerce	6.9%	7.1%	8.8%	9.3%	11.2%	10.5%	9.9%	10.2%	12.5%
Construction	-3.9%	-4.0%	-4.6%	-5.0%	-5.9%	-5.2%	-4.6%	-6.0%	-5.6%
Real estate	-4.7%	-3.9%	-4.1%	-3.2%	-1.6%	-1.8%	-2.2%	-1.8%	-0.5%
Transport	-5.7%	-1.4%	-0.9%	12.9%	13.7%	16.1%	16.4%	12.0%	12.0%
Finance	3.2%	6.3%	5.2%	6.6%	5.9%	4.7%	4.6%	4.0%	3.9%
Education, health and others	-1.1%	-1.3%	-0.9%	-1.8%	5.8%	6.3%	7.0%	6.8%	5.7%
Household	3.4%	3.2%	3.7%	4.1%	4.3%	4.7%	4.7%	4.9%	4.9%
Others	5.0%	13.1%	-2.5%	12.4%	-1.4%	-15.3%	-15.7%	-5.3%	-6.7%

SOURCES: BANK NEGARA MALAYSIA

Stable loan growth in 1Q22 for most banks

The loan growth for most banks was largely stable in 1Q22 (with qoq changes of less than 1% pt). The exceptions were the improvements in loan momentum for two banks, i.e. +2.7% pts from 11.1% yoy at end-Dec 21 to 13.8% yoy at end-Mar

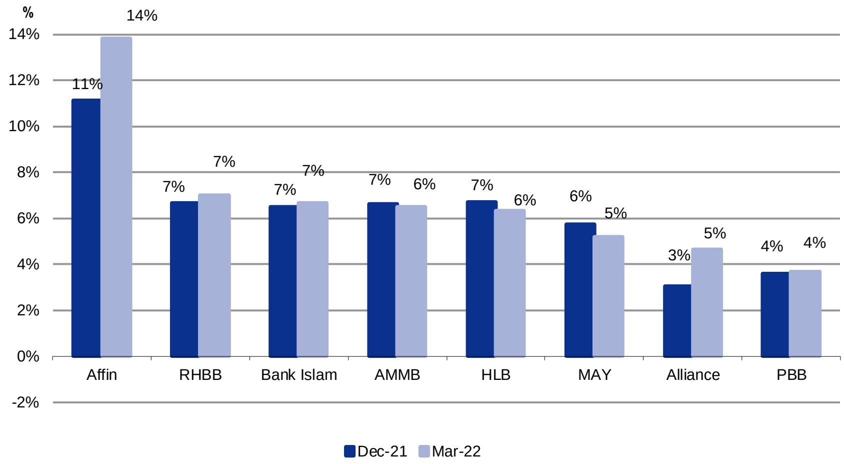
22 for Affin Bank and +1.6% pt from 3% yoy at end-Dec 21 to 4.6% yoy at end-Mar 22 for Alliance Bank.

Affin Bank still topped the league for loan growth

Affin Bank took the pole position for the second consecutive quarter, with the sector-highest loan growth of 13.8% yoy at end-Mar 22, about triple of the industry's growth rate. In the distant second place was RHBB with a loan growth of 7% yoy at end-Mar 22.

At the other end of the spectrum, PBB's loan growth of 3.7% yoy at end-Mar 22 was the weakest in the sector. This could be due to the bank's stringent lending practices and its focus on lending to high-quality borrowers.

Figure 23: Banks' yoy gross loan growth in Dec 21 and Mar 22



SOURCE: CGS-CIMB RESEARCH, COMPANY REPORTS

Outlook for loan growth

The banking industry's loan growth improved from 4.6% at end-Mar 22 to 5% at end-Apr 22. We expect loan growth to peak at just over 5% in the next 1-2 months and moderate in 2H22F, due to higher inflation and interest-rate hikes (which could lead to smaller capability to borrow and higher borrowing costs). As such, we stick to our projected loan growth of 4-5% for 2022F.

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ASSET QUALITY

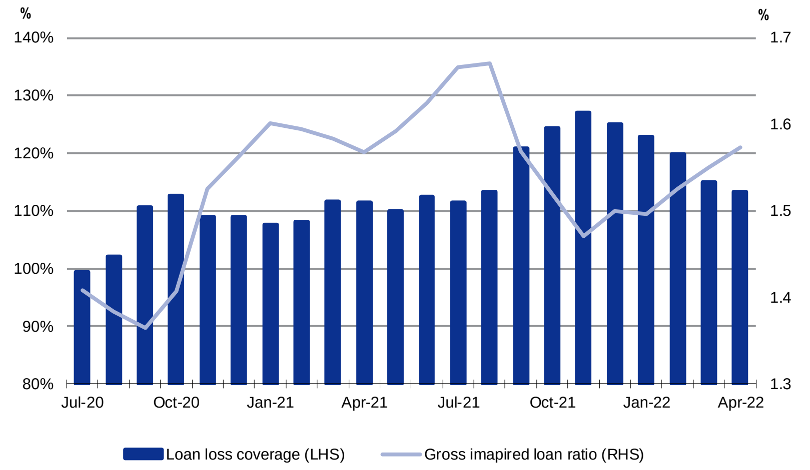
An uptrend in gross impaired loan ratio

The banking industry's gross impaired loan rose by 4.7% qoq to RM30.1bn at end-Mar 22. This pushed up the gross impaired loan ratio from 1.5% at end-Dec 21 to 1.55% at end-Mar 22, in line with our expected uptrend in bank's gross impaired loan ratio.

We think that the increase in gross impaired loan ratio was due to the slippages in banks' asset qualities arising from the unwinding of repayment assistance offered by them to their borrowers. In fact, we draw comfort from the fact that banks' gross impaired loan ratio did not spike amid the unwinding of repayment assistance.

Although banks' loan loss coverage declined in 1Q22 from the level of 125.1% at end-Dec 21, it remained at a comfortable level of 115.1% at end-Mar 22.

Figure 24: Banking industry's gross impaired loan and loan loss coverage



SOURCE: BANK NEGARA MALAYSIA

Gross impaired loan ratios largely stable for most banks

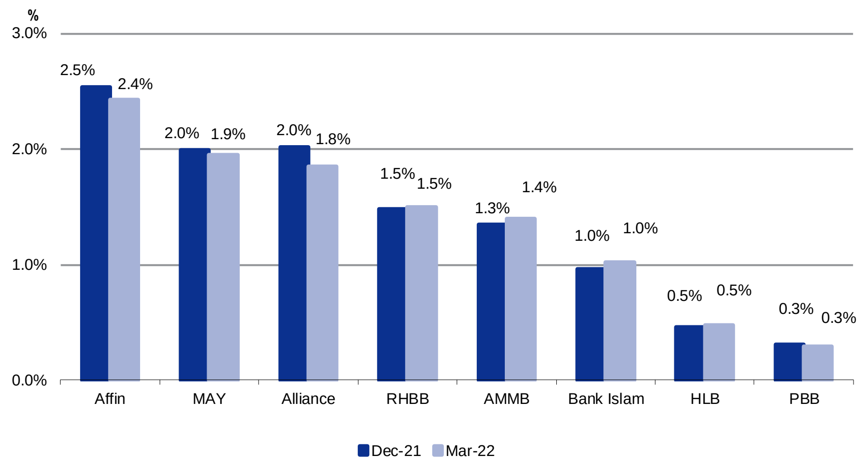
The gross impaired loan ratios were largely stable for most Malaysian banks in 1Q22, with qoq changes of less than 10bp. The exceptions were the notable improvements for two banks — down by 17bp qoq to 1.85% at end-Mar 22 for Alliance Bank and 11bp qoq to 2.43% at end-Mar 22 for Affin Bank.

Public Bank's gross impaired loan ratio still the lowest in the sector

PBB's gross impaired loan ratio was still the lowest in the sector, at 0.29% at end-Mar 22 (lower than the level of 0.31% at end-Dec 21), substantiating our view that it is the most defensive bank against the credit risks from the Covid-19 pandemic, among its peers. This was followed by HLB's gross impaired loan ratio of 0.48% at end-Mar 22.

Among the Malaysian banks under our coverage, Affin Bank's gross impaired loan ratio was still the highest at 2.43% as at end-Mar 22. On a positive note, Affin Bank's gross impaired loan ratio has been on a downtrend in the past five quarters, improving significantly from 3.52% at end-Dec 20 to 2.43% at end-Mar 22.

Figure 25: Banks' gross impaired loan ratios in Dec 21 and Mar 22



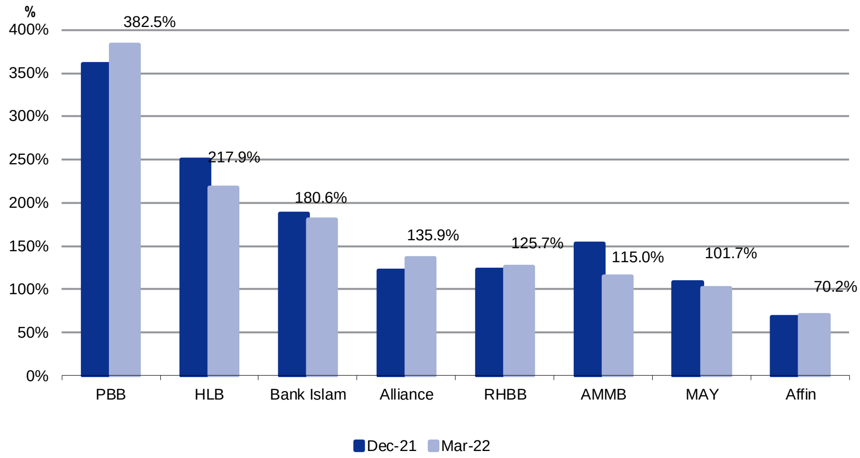
SOURCE: CGS-CIMB RESEARCH, COMPANY

More than 100% loan loss coverage for almost all banks

Loan loss coverage exceeded 100% for almost all Malaysian banks (as at end-Mar 22), a testimony to the sector's strong asset quality, in our view. The loan loss coverage of two banks even surpassed the 200% mark at end-Mar 22, at 217.9% for HLB and a staggering 382.5% for PBB.

Only Affin Bank's loan loss coverage (excluding regulatory reserve), which stood at 70.2% at end-Mar 22, was below the 100% mark. However, we are encouraged that Affin Bank's loan loss coverage improved significantly from 47.9% at end-Dec 20 to 70.2% at end-Mar 22 and that the bank is targeting to achieve a loan loss coverage of 90% by end-Dec 22F.

Figure 26: Banks' loan loss coverage in Dec 21 and Mar 22



SOURCE: CGS-CIMB RESEARCH, COMPANY

Outlook for asset quality

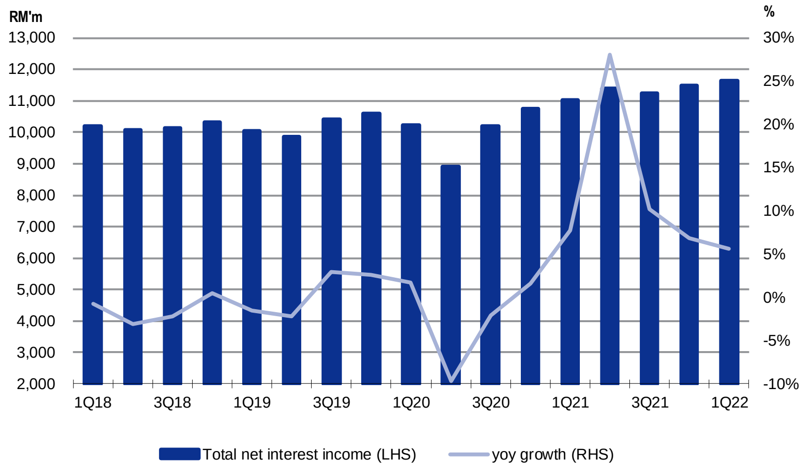
We continue to expect an increase in banks' gross impaired loan ratio in the next three quarters (until end-2022), due to: 1) the residual credit risks from the Covid-19 outbreak, and 2) the potential risks from heightened inflation and interest-rate hikes (which would lead to lower capacity for borrowers to service their loans and higher borrowing costs). We are projecting a higher gross impaired loan ratio of 1.8-2.0% at end-Dec 22F (vs. 1.5% at end-Dec 21 and 1.57% at end-Apr 22).

NET INTEREST INCOME

A downtrend in net interest income growth

The banking sector's net interest income expanded by 5.6% yoy to RM11.6bn in 1Q22 (slower than the 6.9% yoy increase in 4Q21). In fact, the yoy growth in banks' net interest income has been moderating from a spectacular 28.1% yoy in 2Q21 to 5.6% yoy in 1Q22. This trend was not a surprise to us given the lower bases for net interest income in 2020 (brought down by modification loss) and banks' net interest margin hitting a peak in 2Q21 (as we have expected). On a qoq basis, banks' net interest income rose by a decent 1.2%.

Figure 27: Banks' total net interest income & yoy growth



SOURCE: CGS-CIMB RESEARCH, COMPANY

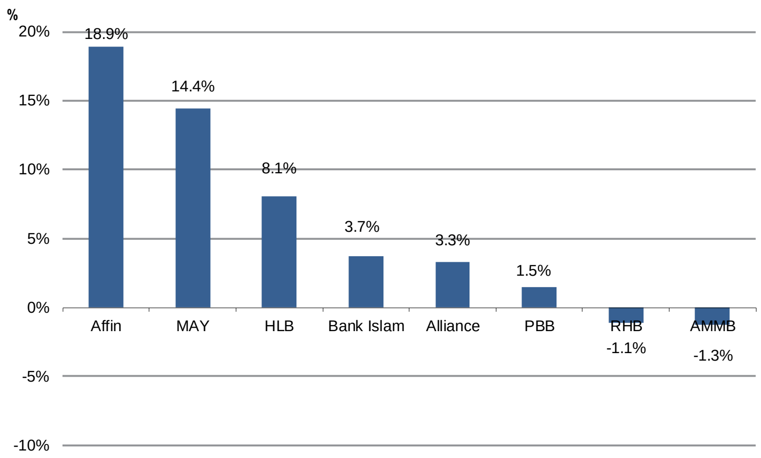
Double-digit growth in 1Q22 net interest income for two banks

On a positive note, two Malaysian banks recorded double-digit yoy growth in 1Q22 net interest income, as follows:

- Affin Bank's net interest income surged by 18.9% yoy in 1Q22, on the back of swift loan growth of 13.8% yoy at end-Mar 22 and a 2bp yoy expansion in 1Q22 net interest margin.
- Maybank's net interest income rose by 14.4% yoy in 1Q22, underpinned by a loan growth of 5.2% yoy at end-Mar 22 and 3bp yoy expansion in 1Q22 net interest margin.

On the flip side, the net interest income for two banks, i.e. RHBB and AMMB, declined by 1-2% yoy in 1Q22.

Figure 28: Banks' 1Q22 yoy growth in net interest income

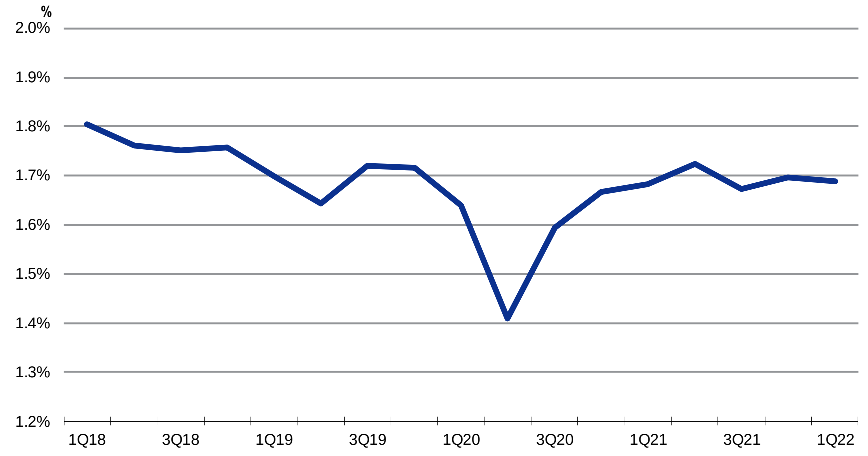


SOURCE: CGS-CIMB RESEARCH, COMPANY

A marginal yoy expansion in net interest margin

We expected banks' net interest margin to be largely stable or slightly lower yoy and qoq in 1Q22 due to a pick-up in the deposit competition. In this regard, banks' performance in the 1Q22 was largely in line with our expectation as the sector's net interest margin expanded by only 1bp yoy but contracted by 1bp qoq.

Figure 29: Quarterly annualised net interest margins



SOURCE: CGS-CIMB, COMPANY REPORT

Outlook for net interest income

We expect an upturn in the trend for banks' net interest margin in 2Q22F, riding on the upcycle in OPR, which would have started in May 22. On 11 May 22, Bank Negara Malaysia raised the OPR by 25bp, and our economist expects another 50bp hikes in OPR in 2H22. On this note, we are expecting stronger yoy and qoq growth in net interest income in 2Q22F (vs. the expansion of 5.6% yoy and 1.2% qoq in 1Q22).

… and the ugly

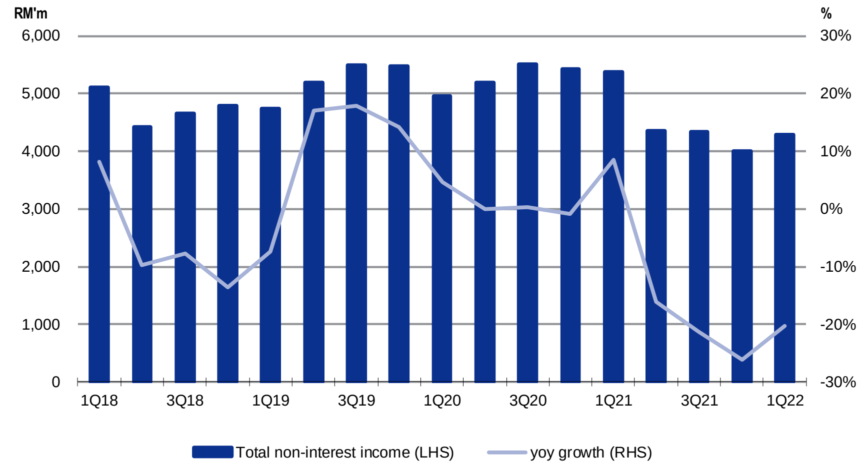
NON-INTEREST INCOME

The fourth consecutive quarter of double-digit decline in non-interest income

Banks' non-interest income continued to be lacklustre in the 1Q22 as it declined by 20.2% yoy to RM4.29bn in 1Q22. This was the fourth consecutive quarter of double-digit decline in non-interest income. The drag for banks' 1Q22 non-interest income was the adverse investment income, brought down by losses from their holdings of fixed-income securities caused by rising bond yields.

On a positive note, the yoy contraction in non-interest income narrowed from 26.2% yoy in 4Q21 to 20.2% yoy in 1Q22. In addition, non-interest income rose by 7.1% qoq in 1Q22.

Figure 30: Quarterly non-interest income and yoy growth

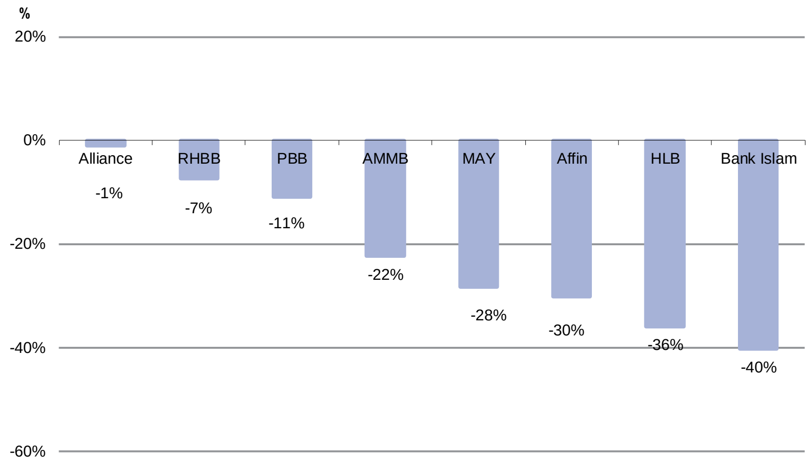


SOURCE: CGS-CIMB RESEARCH, COMPANY

No banks were spared from the contraction in non-interest income ➤

All banks saw their non-interest income decline yoy in 1Q22. The yoy contraction ranged from 1% (for Alliance Bank) to 40.2% (for Bank Islam).

Figure 31: Banks' 4Q21 yoy growth in non-interest income

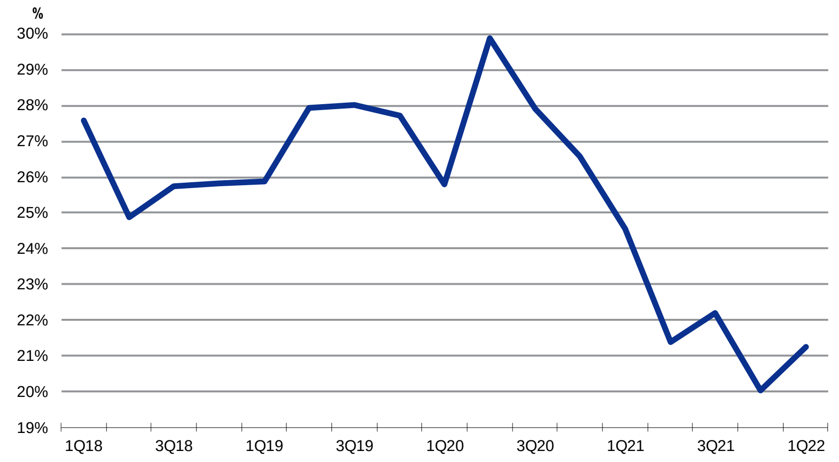


SOURCE: CGS-CIMB RESEARCH, COMPANY

A yoy decline in 1Q22 non-interest income ratio ➤

Banks' non-interest income ratio dipped from 24.6% in 1Q21 to 21.2% in 1Q22, as the 20.2% decline in 1Q22 non-interest income was wider than the contraction of 7.8% in banks' 1Q22 revenue. However, the 1Q22 non-interest income ratio was higher than the level of 20% in 4Q21.

Figure 32: Banks' quarterly non-interest income ratio



SOURCE: CGS-CIMB RESEARCH, COMPANY

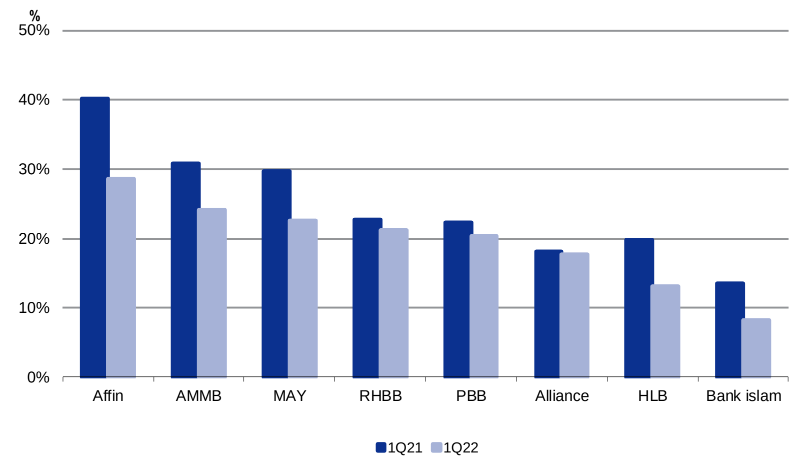
A yoy decline in non-interest income ratios for all banks

No banks were spared in terms of the declines in the non-interest income ratios in 1Q22. The yoy contraction ranged from 0.4% pt (to 17.7% in 1Q22 for Alliance Bank) to 11.7% pts (to 28.6% in 1Q22 for Affin Bank).

Affin Bank's non-interest income ratio the highest in the sector

In 1Q22, Affin Bank's non-interest income ratio of 28.6% was the highest in the sector, thanks to the strong contributions from its investment banking and asset management entities. On the flip side, the ratio for Bank Islam was the lowest at 8.3% in 1Q22, reflecting weak contribution from non-lending businesses. Bank Islam does not have a direct takaful unit, and the contributions from its investment banking business are small.

Figure 33: Banks' 1Q21 & 1Q22 non-interest income ratio



SOURCE: CGS-CIMB RESEARCH, COMPANY

Outlook for non-interest income

We expect banks' non-interest income to remain lacklustre in 2Q22F, close to the level of RM4.3bn in 1Q22 as bond yields continued to trend upward, which could lead to additional mark-to-market losses for banks' holdings of fixed-income securities. However, the yoy decline in non-interest income would narrow from

20.2% yoy in 1Q22 to single-digit rates in 2Q22F considering the lower base of non-interest income of RM4.35bn in 2Q21 (vs. RM5.38bn in 1Q21).

SECTOR OUTLOOK AND RATING

Expecting core net profit growth to resume in 2Q22F ➤

We estimate higher CNP of RM7.1bn-7.5bn for banks in 2Q22F (vs. RM7.05bn in 1Q22). This would represent a CNP growth of between 3% and 9% yoy in 2Q22F (compared to a marginal 0.2% yoy decline in 1Q22 CNP).

Two positive developments on the cards in 2Q22F ➤

We expect banks' CNP growth to be driven by two positive developments in 2Q22F, as follows:

- Two banks, i.e. AMMB and Alliance Bank (which have financial year end of March), would cease to incur the CM taxation in 2Q22F as they entered into FY3/23F. Note that CM is imposed on companies' FY22 net profit.
  For AMMB, the non-recurrence of CM taxation in 2Q22 could be offset by lower write-back of the over-provision of taxation in the previous year (of RM38.5m in 1Q22). However, without the CM taxation, the effective tax rate for Alliance Bank should decline from 35.1% in 1Q22 to the normalised level of 23-25% in 2Q22.
- We envisage an upward reversal in the trend for banks' net interest margin from 2Q22 onwards, in tandem with the upcycle in OPR (which would have started in May 22). Note that Bank Negara Malaysia raised the OPR by 25bp on 11 May 22 and our economist expects another two rounds of OPR hikes (of 25bp each or a total of 50bp) in 2H22F.

In addition, we expect the yoy decline in banks' non-interest income to narrow from 20.2% in 1Q22 to single-digit rates in 2Q22F. Meanwhile, although we expect banks' quarterly LLP to bottom at RM1.04bn in 1Q22 and increase qoq in 2Q22F, the 2Q22F LLP should be lower than the level of RM2.39bn in 2Q21 (and hence, potential yoy improvement in 2Q22F LLP).

Projecting core net profit growth of 4% in 2022F ➤

Despite the stalled CNP growth in 1Q22, we continue to expect a yearly earnings recovery for Malaysian banks in 2022F. We are projecting a CNP growth of 4% for the sector in 2022F, mainly underpinned by our projected 15.2% drop in LLP and a healthy 7.8% increase in net interest income. However, our projected CNP growth in 2022F would be lower than the 16.4% registered in 2021, primarily due to additional tax expense from CM, which is estimated by us to reduce banks' 2022F net profit by c.7%.

Reiterate Overweight on banks ➤

We continue to rate banks as Overweight as we expect: 1) an expansion in banks' net interest margin in the upcoming quarters, in tandem with the upcycle in OPR (which would have started in May 22), and 2) a decline in LLP. We see the above as the potential re-rating catalysts for the sector.

Potential downside risks ➤

The key potential downside risks to our Overweight call on Malaysian banks include weaker-than-expected economic growth in 2022F, as this could cause banks to register higher-than-expected LLP and softer loan growth.

Banks have started to unwind the repayment assistance offered to their borrowers amid the reopening of the economy. The potential risk from this is a spike in banks' gross impaired loans, mainly from borrowers whose financial positions have been severely impaired by the Covid-19 outbreak. Should the industry's gross impaired loan ratio increase significantly above our projected 1.8-2.0% by end-Dec 22F, banks will have to increase their LLP in 2022F.

ESG in a nutshell

ESG

We assess the direct ESG risks for Malaysian banks to be low because: 1) they are not among the primary sources of environmental pollution in the country; and 2) most banks offer decent remuneration packages and employee benefits to their staff, while the wellbeing of most of their lower-paid staff is protected by unions. In addition, under the stringent supervision of BNM, all banks uphold high levels of governance in their operations. In fact, we think banks could contribute to improvements in the overall ESG standards of the country as they can act as enablers for a lot of companies' transition to higher ESG standards. Banks can achieve this by leveraging on their business (primarily lending) relationships with these companies to engage with them to formulate plans to improve their ESG standards.

In our view, one of the key areas that determines the ESG standard of a bank is its ESG disclosure. Although we see room for improvement for some banks in this aspect, we are encouraged that most banks have shown the commitment to elevate their standards of ESG disclosures. A notable development is the ESG briefings to investors hosted by four banks, i.e. Maybank, HLB, AMMB and Alliance Bank, since 2021. In addition, some banks have started to provide updates on their ESG developments in their quarterly results presentation slides.

Keep your eye on	Implications
Banks will have to address their exposures to sectors with high ESG risks, including plantation, oil and gas, and non-renewable energy sectors, as well as some manufacturing sub-sectors. Another area that banks need to provide more ESG information on is the risks from climate change.	Some banks have started to work with their borrowers in the ESG-vulnerable sectors to improve their respective ESG standards. These banks even set ESG-related targets for certain borrowers to meet, followed by periodic reviews of their progress towards achieving these targets.

ESG highlights	Implications
Our ESG pick for the sector is Maybank as: 1) it was among the first to introduce the well-articulated ESG Risk Acceptance Criteria (based on our observation), which are the ESG guidelines for its lending activities; 2) it has a dedicated task force (Scrum teams) to advise (and monitor) its clients on ESG-related matters, especially clients in sectors with high ESG risks; and 3) through its regional network, it has been implementing its ESG initiatives in various countries, widening the base of beneficiaries.	We will monitor the progress of the banks in improving their ESG standards, especially in the areas of disclosure, and initiatives to mitigate the risks from their exposure to ESG-vulnerable sectors. Going forward, another area that banks will focus on in terms of ESG is the risks from climate change. We expect the central bank to introduce new regulations in the next few years to require banks to improve their analysis of the risks associated with climate change and provide more information on these risks. For instance, we understand that banks would have to conduct stress testing for the risks from climate change by 2024.

Trends	Implications
To support the ESG development of the country, most banks have started to focus on growing their green financing, particularly for renewable energy projects, as well as other 'green' projects, like green buildings.	We do not have the statistics on the size of green financing in the banking industry. However, based on what we have gathered from banks, we estimate that green financing makes up less than 1-2% of total loans for most banks. Most banks project swift expansion in their green financing in the next few years, but we think the proportion of green financing over gross loans for most banks will remain small, at below 2%, over the next 3-5 years. Several banks have disclosed their longer-term targets for the size of sustainable finance (i.e. RM50bn for Maybank and RM5bn for Alliance). The scope for sustainable finance is broader as apart from the financing of green projects, it also comprises certain consumer and SME loans (like the financing of the purchase of electric vehicles and installation of solar panels), and investments in green bonds, as well as ESG-compliant wealth and asset management products.

SOURCES: CGS-CIMB RESEARCH, REFINITIV

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Description:	Excellent	Very Good	Good	N/A	N/A

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	Rating Distribution (%)	Investment Banking clients (%)
Add	70.3%	0.8%
Hold	22.0%	0.0%
Reduce	7.8%	0.2%

Corporate Governance Report of Thai Listed Companies (CGR). CG Rating by the Thai Institute of Directors Association (Thai IOD) in 2021, Anti-Corruption 2021

ADVANC – Excellent, Certified, **AMATA** – Excellent, Certified, **ANAN** – Excellent, n/a, **AOT** – Excellent, n/a, **AP** – Excellent, Certified, **ASP** – Excellent, n/a, **AWC** – Excellent, Declared, **AU** – Good, n/a, **BAM** – Very Good, Certified, **BAY** – Excellent, Certified, **BBL** – Excellent, Certified, **BCH** – Very Good, Certified, **BCP** - Excellent, Certified, **BCPG** – Excellent, Certified, **BDMS** – Excellent, n/a, **BEAUTY** – Good, n/a, **BEM** – Excellent, n/a **BH** - Good, n/a, **BJC** – Very Good, n/a, **BLA** – Very Good, Certified, **BTS** - Excellent, Certified, **CBG** – Very Good, n/a, **CCET** – n/a, n/a, **CENTEL** – Excellent, Certified, **CHAYO** – Very Good, n/a, **CHG** – Very Good, n/a, **CK** – Excellent, n/a, **COM7** – Excellent, Certified, **CPALL** – Excellent, Certified,

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- CG Score 2021 from Thai Institute of Directors Association (IOD)

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Recommendation Framework

Stock Ratings	Definition:
Add	The stock's total return is expected to exceed 10% over the next 12 months.
Hold	The stock's total return is expected to be between 0% and positive 10% over the next 12 months.
Reduce	The stock's total return is expected to fall below 0% or more over the next 12 months.

The total expected return of a stock is defined as the sum of the: (i) percentage difference between the target price and the current price and (ii) the forward net dividend yields of the stock. Stock price targets have an investment horizon of 12 months.

Sector Ratings	Definition:
Overweight	An Overweight rating means stocks in the sector have, on a market cap-weighted basis, a positive absolute recommendation.
Neutral	A Neutral rating means stocks in the sector have, on a market cap-weighted basis, a neutral absolute recommendation.
Underweight	An Underweight rating means stocks in the sector have, on a market cap-weighted basis, a negative absolute recommendation.

Country Ratings	Definition:
Overweight	An Overweight rating means investors should be positioned with an above-market weight in this country relative to benchmark.
Neutral	A Neutral rating means investors should be positioned with a neutral weight in this country relative to benchmark.
Underweight	An Underweight rating means investors should be positioned with a below-market weight in this country relative to benchmark.

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