

SECTOR UPDATE

Banking – Malaysia

Staying Resilient In The Face Of Economic Slowdown

The KLFIN index has experienced selling pressure of late due to the spillover effects of global economic growth concerns. However, we opine that Malaysian banks' earnings resilience will continue to prevail given the healthy provision buffers built in and still-commendable domestic macroeconomic growth. Sector valuations have declined to an attractive 1SD below the historical mean. Maintain OVERWEIGHT while switching our top pick to Public Bank from HLBank.

WHAT'S NEW

- Sentiment dragged down by fear of slowing macroeconomic growth.** The banking sector's share price performance has remained rather lukewarm of late, with the KL Finance index declining 5.0% (FBMKLCI: -6.2%) in Sep 22 despite Bank Negara Malaysia's (BNM) recent 3rd Overnight Policy Rate (OPR) rate hike for the year. Fears of a potential global economic recession had clearly dampened the sector's sentiment of late. That said, the banking sector remains one of the more defensive sectors, outperforming the FBMKLCI by 13% ytd 22.
- Simulating adverse scenario 1 & 2.** In addressing the investors' concerns over the impact of slowing GDP growth forecast (UOB forecast: 2022: 6.5% vs 2023: 4.8%) and a potential extension of the prosperity tax, we have simulated the potential impact of two adverse scenarios on our sector 2023 earnings assumptions.
- Adverse scenario 1 (AS1)** assumes: a) 20-30% increase in net credit cost assumptions (despite banks having built up comfortable pre-emptive provision buffers), b) 5% contraction in non-interest income vs our current low-to-mid single-digit growth, and c) flattish NIM trend vs our current 2bp expansion. Meanwhile, adverse scenario 2 (AS2) encompasses all the assumptions of AS1 coupled with potential extension of the prosperity tax.
- Sector still expected to deliver earnings growth in AS1 and flattish in AS2.** Despite a potential 10% and 18% downward earnings revision to our current 2023 earnings assumption under AS1 and AS2 respectively, we are still expecting the sector to deliver a commendable 7.6% yoy earnings growth for 2023 (current base case: +19% yoy) and a manageable 2% yoy contraction under AS2 (extension of prosperity tax). Public Bank and HLBank are expected to face a relatively more modest 5% and 8% potential earnings downgrade respectively vs peers' average of 11% under AS1.

ACTIONS

- Maintain OVERWEIGHT.** We remain positive on the sector. This is premised on: a) sector valuation of -1.0SD nearing average crisis trough of -1.5SD, b) earnings resilience sustained by potential positive NIM surprise as we remain at the early-to-mid stages of the OPR hike cycle, c) comfortable pre-emptive provisions which provide some buffer against any deterioration in asset quality on inflationary pressures, and iv) attractive 2022/23 dividend yields of 4.8%/5.4%.
- Top picks.** We take the opportunity to upgrade Public Bank to a BUY following its recent share price retracement. Consequently, we switch our top defensive stock pick to Public Bank from HLBank given the former's relatively more attractive risk-to-reward proposition. For higher beta names, we like Alliance Bank given its attractive valuations and it being the prime beneficiary of an interest rate hike cycle.

PEER COMPARISON

Company	Ticker	Rec	Share Price (RM)	Target Price (RM)	Market Cap (US\$m)	PE (x)			ROE 2022F (%)	P/B 2022F (x)	Div 2022F (sen)	Div Yield (%)
						2021	2022F	2023F				
Maybank	MAY MK	BUY	8.68	9.45	22,387	12.1	11.8	10.2	9.2	1.1	55.0	6.3
Public Bank	PBK MK	BUY	4.27	4.85	17,849	13.5	14.5	12.2	11.6	1.6	14.7	3.4
CIMB Group	CIMB MK	BUY	5.23	6.30	11,797	12.2	10.1	8.1	8.5	0.8	25.9	5.0
HL Bank	HLBK MK	BUY	20.62	24.00	9,626	13.0	11.1	10.4	12.0	1.3	65.2	3.2
RHB Bank	RHBBANK MK	BUY	5.66	6.60	5,134	7.9	8.9	7.3	8.8	0.8	35.1	6.2
HLFG	HLFG MK	BUY	18.60	21.70	4,587	8.7	7.6	7.2	11.0	0.8	47.5	2.6
Alliance Bank	ABMB MK	BUY	3.57	4.50	1,190	9.7	8.0	7.5	10.5	0.8	22.3	6.3
AMMB	AMM MK	HOLD	3.93	3.70	2,803	7.8	8.1	7.5	9.3	0.7	18.6	4.7
Bank Islam	BIMB MK	HOLD	2.60	2.45	1,207	9.3	11.9	10.2	6.9	0.8	9.8	3.8
Affin Bank	ABANK MK	HOLD	2.03	1.90	967	7.4	7.7	6.5	5.1	0.4	7.9	3.9

Source: UOB Kay Hian

OVERWEIGHT (Maintained)

TOP SECTOR PICKS

Company	Rec	Target Price (RM)	Share Price (RM)
Public Bank	BUY	4.85	4.27
Alliance Bank	BUY	4.50	3.57

Source: UOB Kay Hian

KLFIN INDEX OUTPERFORMED FBMKLCI IN RATE HIKE CYCLE



Source: Bloomberg, UOB Kay Hian

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ESSENTIALS

- **Upgrade Public Bank (BUY, Target: RM4.85).** Given Public Bank's recent share price sell-down, we take the opportunity to upgrade our recommendation to a BUY from HOLD as valuations have declined to an attractive -1SD below its historical mean PBV. Public Bank also has among the highest provision buffer which provides significant earnings resilience and opportunity for potential provision write-backs in 2023.
- **Assessed fair values under AS1 still provide ample upside.** As shown in the table below, most of the banks are still expected to exhibit ample upside to our AS1 potential fair values from current levels and only in an AS2 scenario would we expect a potential average downside of 10%.
- **AS2 incorporates a potential prosperity tax extension which is a slim probability.** However, AS2 incorporates a potential extension of the prosperity tax which is not our in-house view and hence we assign a slim probability of it materialising. As observed, stock prices did not fully reflect the impact of the prosperity tax when it was first announced given the one-off nature of it.
- **Valuations have adequately priced in potential slowdown.** The sector is trading at an undemanding 0.96x 2023 PBV, implying a -1SD from its historical five-year mean. We believe this has adequately priced in an AS1 earnings risk scenario as macroeconomic conditions, while expected to face a slower growth outlook in 2023 vs 2022, are still expected to be significantly stronger than the COVID-19 lockdown period when the banking sector hit a trough at -2SD PBV. This is reflected in our AS1 and AS2 assessed fair values, implying a more pragmatic -0.5SD and -1.2SD from historical mean PBV while AS2 implies a lower -1.2SD from historical mean PBV. In addition, Malaysian banks have largely kept most of the conservative pre-emptive provisions that they have built up over the past two years which can act as shock absorbers.

ASSESSED POTENTIAL FAIR VALUE UNDER AS1 AND AS2

	Current Share price (RM)	Potential Fair Value (RM)		Percentage Upside/(Downside) (%)	
		AS1	AS2	AS1	AS2
Maybank	8.56	8.55	7.35	(0.1)	(14.1)
CIMB Group	5.14	5.40	4.55	5.1	(11.5)
Public Bank	4.21	4.85	4.30	15.2	2.1
RHB Bank	5.57	5.90	5.00	5.9	(10.2)
HL Bank	20.42	21.50	19.50	5.3	(4.5)
AMMB	3.90	3.20	2.70	(17.9)	(30.8)
Alliance Bank	3.56	4.00	3.40	12.4	(4.5)

Source: UOB Kay Hian

BANKS CURRENT PBV VS AS1 AND AS2 ASSESSED PBV

	Current (x)	AS1 (x)	AS2 (x)	Mean (x)	-1SD (x)	-2SD (x)
Maybank	1.04	1.04	0.89	1.20	1.15	1.10
CIMB Group	0.77	0.81	0.68	0.90	0.73	0.56
Public Bank	1.55	1.82	1.58	1.90	1.60	1.30
RHB Bank	0.72	0.77	0.65	0.85	0.74	0.63
HL Bank	1.26	1.33	1.20	1.30	1.10	0.90
AMMB	0.69	0.57	0.48	0.80	0.60	0.40
Alliance Bank	0.84	0.95	0.81	1.00	0.70	0.40
Average	0.96	1.04	0.90	1.14	0.95	0.67

Source: UOB Kay Hian

- **Healthy pre-emptive provisions provide a healthy position of strength.** Apart from AMMB, most banks have retained a large proportion of their pre-emptive provisions (management overlays + macroeconomic variables) despite a faster-than-expected decline in repayment assistance with the take-up rate averaging 5% as at Jul 22 vs 26% as at end-Dec 21. This will allow banks to partially draw down on these buffers in 2023 if inflationary pressures and weaker-than-expected economic growth conditions were to lead to an unexpected deterioration in asset quality. As shown on the RHS table, the average pre-emptive provision coverage ratio to vulnerable loans is currently standing at an estimated 160% and an even higher 260% assuming 70% of the loans are collateralised. We have not incorporated any potential provision write-backs into our earnings assumptions and our current 2023 net credit cost assumptions remain above pre-COVID-19 levels.

POTENTIAL IMPACT OF ASSESSED ADVERSED SCENARIOS ON 2023 EARNINGS FORECASTS

	AS1	AS2
Maybank	-11.5%	-18.6%
CIMB Group	-12.6%	-21.7%
Public Bank	-5.4%	-14.9%
RHB Bank	-12.4%	-19.4%
HLBank	-8.0%	-15.1%
AMMB	-11.8%	-17.6%
Alliance Bank	-7.1%	-15.7%
Sector Average	-9.8%	-17.6%

Source: UOB Kay Hian

2023 EARNINGS GROWTH ASSUMPTIONS VS AS1 AND AS2

	Current Assumption	AS1	AS2
Maybank	18.0%	4.5%	-3.9%
CIMB Group	25.0%	9.2%	-2.1%
Public Bank	18.9%	12.9%	3.5%
RHB Bank	21.4%	8.0%	-2.1%
HL Bank	17.8%	8.4%	0.0%
AMMB	6.4%	-6.2%	-12.3%
Alliance Bank	21.8%	13.2%	2.6%
Sector Average	19.3%	7.6%	-1.7%

Source: UOB Kay Hian

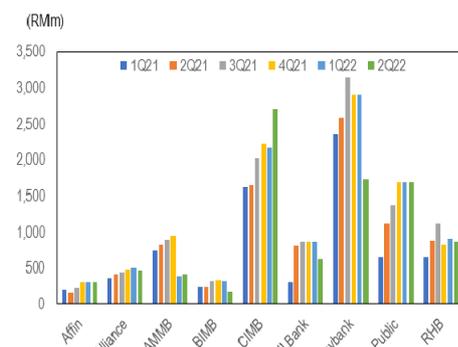
HIGH PRE-EMPTIVE PROVISION COVERAGE RATIO

---- Pre-emptive provision coverage ratio ----
to vulnerable loans assuming (%)

	Zero Collateral	70% Collateral
Alliance Bank	340	595
AMMB	107	202
Affin	80	168
BIMB*	103	162
CIMB Group*	447	629
Maybank	70	105
Public Bank	284	621
RHB Bank	178	282
HL Bank *	204	380
Average	160	262

Source: Respective Companies, UOB Kay Hian

BANKS STOCK OF PRE-EMPTIVE PROVISION



Source: Respective Companies, UOB Kay Hian

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