# BANKING

## *Maintain* POSITIVE

## A cut which have been foreseen

### KEY INVESTMENT HIGHLIGHTS

- **Bank Negara Malaysia announced a 25bp OPR cut yesterday**
- **Net interest margin compression in the short term is a given. However, normalisation could be quick as was the case after the May'19 OPR cut**
- **Banks could have already anticipated the rate cuts and would have likely manoeuvred early. This is suggested by the rebound in NIM in one quarter (3QCY19) and tepid growth in fixed deposits**
- **Another OPR cut would have already been priced in but banks remains undervalued**
- **We maintain our POSITIVE stance in the banking sector**

**OPR cut expected.** Bank Negara Malaysia announced a cut to its Overnight Policy Rate (OPR) of 25bp yesterday. The timing and magnitude of the cut was as our economics team had forecasted back in Nov'19. This brings the OPR to 2.75%. Our economist was one of only two economists (out of total 26) under the Bloomberg poll which had correctly forecasted the rate cut.

**Margin compression is expected in the short term.** Theoretically, an OPR cut will have a negative impact to banks' earnings from downward pressure in net interest income due to net interest margin (NIM) compression. This is due to the fact that there will be a near-immediate downward adjustment to loans and financing which has a floating rate, while term deposits (such as fixed deposits) are re-priced after maturity. The floating rate loans, on average, contributed circa 78.9% of total loans book of banks under our coverage as at end September 2019.

**Table 1: Banks' Percentage of Floating Rate Loans & Casa Ratio as at end September-19**

| Banks | Percentage of floating rate loans | CASA ratio |
|---|---|---|
| Maybank | 72.2% | 33.7% |
| Public | 78.2% | 25.4% |
| CIMB | 84.2% | 34.9% |
| Hong Leong Bank | 81.6% | 25.6% |
| RHB | 88.0% | 25.4% |
| AMMB | 75.2% | 22.8% |
| BIMB | 92.0% | 30.2% |
| Alliance Bank | 82.9% | 37.4% |
| Affin | 69.5% | 14.6% |
| *Average* | *78.9%* | *29.7%* |

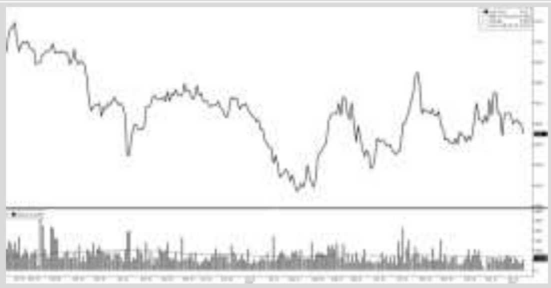
Source: Company, MIDFR

**COMPANY IN FOCUS**

**Malayan Banking Bhd**
Maintain **BUY** | Unchanged Target price: RM10.30
Price @ 22nd January 2020: RM8.55

- Earnings started to improve in 3QFY19
- Low exposure to floating rate which should moderate OPR cut impact
- It has scale and size
- Attractive dividend yield of circa 6%

**Share price chart**



**CIMB Group Holdings Bhd**
Maintain **BUY** | Unchanged Target price: RM6.30
Price @ 22nd January 2020: RM5.03

- Earning recovery in Indonesia and Thailand
- Net interest margin recovered
- Robust net income
- Relatively undemanding valuation
- Decent dividend yield of circa 5%

**Share price chart**

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**But normalisation could be surprisingly fast.** Under normal circumstances, we would expect it will take 2 to 3 quarters for the NIM to normalise due to cost of fund decreasing, in particular from adjustment to the fixed deposit rates which had been contracted before the OPR cut. However, we believe that this OPR had been expected by banks' management and could have already manoeuvred accordingly. This was evident by the subdued deposits competition we observed in 4QCY19, as banks would have avoided locking in deposits at higher rates. As such, we anticipate that NIM normalisation could be much faster.

**Possibility to repeat the 3QCY19 NIM recovery.** During the review of 2QCY19 and 3QCY19 results of banks under our coverage, we noted that NIM declined on average -5bp qoq in 2QCY19, when BNM cut OPR by 25bp in May'19. However, NIM rebounded on average by +4bp qoq in 3QCY19 with some banks reporting much better NIM in that quarter. We posit that banks were careful in taking term deposits then which allowed the deposits to be released much earlier. For example, aggregate non-CASA deposits of banks under our coverage increased only +0.6%qoq to RM1.32t and declined -0.4%qoq to RM1.31t as at 3QCY19 and 2QCY19 respectively. We believe that this situation may repeat this year.

**Table 2: Banks Reported Net Interest Margins (NIM) and Sequential Quarter Comparison**

| Banks | 2QCY19 NIM (%) | + / - bp QoQ | 3QCY19 NIM (%) | + / - bp QoQ |
|---|---|---|---|---|
| Maybank | 2.19 | -11 | 2.32 | 13 |
| Public | 2.12 | -7 | 2.12 | 0 |
| CIMB | 2.37 | -11 | 2.53 | 16 |
| Hong Leong Bank | 1.89 | -11 | 2.03 | 14 |
| RHB | 2.09 | -7 | 2.13 | 4 |
| AMMB | 1.87 | 9 | 1.91 | 4 |
| BIMB | 2.56 | -3 | 2.53 | -3 |
| Alliance Bank | 2.40 | -10 | 2.34 | -6 |
| Affin | 1.65 | 4 | 1.61 | -4 |
| *Average* | *2.13* | *-5* | *2.17* | *4* |

Source: Company, MIDFR

**Impact from another rate cut could be muted.** Taking into consideration the previous trend that we had observed, we opine that the impact of the OPR cut yesterday will likely be muted to banks' full year net income and earnings. In our view, it will probably be less than our previous estimate of an average decline of -3% to our earnings forecast. While we do not discount a short term compression to NIM but it will likely be only for a quarter and will recover rather quickly.

**In addition, less intense deposits competition will likely continue.** The requirement to meet the Net Stable Funding Ratio (NSFR) as prescribed by BNM played a key factor in banks accumulating deposits in CY18 and early parts of CY19. We understand that all the banks under our coverage have complied with the NSFR requirement. As such, we opine that banks will be less keen to fight aggressively for deposits. Consequently, we expect deposits competition will normalize in CY20 leading to a moderation in deposits growth.

**Pressure on margin will be manageable.** Combined by the positioning of banks and the less intense deposits competition, we expect that NIM compression will be manageable in CY20. Furthermore, banks will not have to lock-in pre-OPR fixed deposits due to the absence of any immediate need, and will have managed its rates.

**Potential booster for loans growth.** One of the possible upside from any OPR cut will be a boost to loans growth with the lower rates possibility giving support to loans demand. This could be due to borrowers taking advantage of the better rates. However, we do not believe that the steep upswing in loans demand as loan affordability will continue to be a determinant.

**Banks continue to be undervalued.** In our opinion, the impact of another OPR cut have been fully priced in earlier as half of the consensus expected the second cut in the Nov'19 MPC meeting. We have already taken yesterday's rate cut into consideration and have imputed it into our CY20 earnings forecast. Nevertheless, we view that banking stocks in general are relatively undervalued and any price weakness attributed to the rate cut could be a knee-jerk reaction. Majority of the banks are trading below its 3-year historical average. We opine that this is unjustified given that in our view, banks have thus far managed to navigate the headwinds the sector faced and will continue to do so. In addition, we have not yet observed any significant negative earnings surprise nor are we expecting it in the short terms.

**Monitoring asset quality but so far it had been isolated incidence.** One metrics that could be affecting banks' valuation is asset quality. We have noted banks reporting few corporate accounts turned non-performing last year. We opine that this could be due to the external headwinds. Also, with the slowing economic growth, banks would have to make some judgmental provisioning. Yet, we believe that it does not yet constitute a trend at current juncture. With our economics team expecting CY20 to see an improvement in trade, higher government investment (and the related spill over effect) and most importantly stable labour market, we expect that asset quality will be kept in check in CY20.

**Cautiously optimistic, maintain POSITIVE.** Based on the ability of banks in general to navigate the headwinds it faced, we opine that banking stocks are undeservedly undervalued currently. Hence, we are cautiously optimistic and maintain our POSITIVE stance at the moment. However, we are cognizant of the potential headwinds this year coming from the risk to asset quality. Not to mention the increase volatility of share price performance. Therefore, our top picks for this sector will banks with scale and size or the potential to maintain its earnings momentum. These are **Maybank (BUY, TP: RM10.30), CIMB (BUY, TP: RM6.30)** and **RHB Bank (BUY, TP: RM6.35)**. Good dividends yields will be an added bonus.

## PEER COMPARISON TABLE

| | FYE | Rec. | Price @ 22/1/20 | Target Price | EPS (sen) | | PER | | Net DPS | | Net Div Yield | | BV | | PBV | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | | | | | 19/20 | 20/21 | 19/20 | 20/21 | 19/20 | 20/21 | 19/20 | 20/21 | 19/20 | 20/21 | 19/20 | 20/21 |
| Maybank | Dec | BUY | 8.55 | 10.30 | 74.1 | 73.9 | 11.5 | 11.6 | 58.0 | 58.0 | 6.8 | 6.8 | 7.1 | 7.4 | 1.2 | 1.2 |
| Public Bank | Dec | BUY | 19.02 | 24.00 | 145.6 | 148.7 | 13.1 | 12.8 | 72.0 | 73.0 | 3.8 | 3.8 | 11.3 | 12.0 | 1.7 | 1.6 |
| CIMB | Dec | BUY | 5.03 | 6.30 | 50.0 | 49.0 | 10.1 | 10.3 | 26.0 | 26.0 | 5.2 | 5.2 | 5.6 | 5.7 | 0.9 | 0.9 |
| RHB Bank | Dec | BUY | 5.84 | 6.35 | 62.4 | 67.7 | 9.4 | 8.6 | 25.0 | 27.0 | 4.3 | 4.6 | 6.3 | 6.5 | 0.9 | 0.9 |
| Hong Leong | Jun | NEUTRAL | 16.24 | 17.70 | 130.0 | 143.1 | 12.5 | 11.3 | 50.0 | 50.0 | 3.1 | 3.1 | 12.5 | 13.0 | 1.3 | 1.2 |
| AMMB | Mar | T. BUY | 3.82 | 4.20 | 50.0 | 46.6 | 7.6 | 8.2 | 20.0 | 20.0 | 5.2 | 5.2 | 5.9 | 6.1 | 0.7 | 0.6 |
| Affin | Dec | NEUTRAL | 1.86 | 2.10 | 29.0 | 29.0 | 6.4 | 6.4 | 5.0 | 7.0 | 2.7 | 3.8 | 4.7 | 4.7 | 0.4 | 0.4 |
| Alliance | Mar | T. BUY | 2.49 | 3.35 | 34.7 | 32.6 | 7.2 | 7.6 | 16.7 | 14.5 | 6.7 | 5.8 | 3.7 | 3.7 | 0.7 | 0.7 |
| BIMB | Dec | BUY | 4.06 | 5.05 | 43.7 | 44.0 | 9.3 | 9.2 | 16.0 | 18.0 | 3.9 | 4.4 | 3.2 | 3.5 | 1.3 | 1.2 |
| **Average** | | | | | **68.8** | **70.5** | **9.7** | **9.6** | **32.1** | **32.6** | **4.6** | **4.7** | **6.7** | **7.0** | **1.0** | **1.0** |

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| **MIDF AMANAH INVESTMENT BANK : GUIDE TO RECOMMENDATIONS** | |
|---|---|
| **STOCK RECOMMENDATIONS** | |
| **BUY** | Total return is expected to be >10% over the next 12 months. |
| **TRADING BUY** | Stock price is expected to *rise* by >10% within 3-months after a Trading Buy rating has been assigned due to positive newsflow. |
| **NEUTRAL** | Total return is expected to be between -10% and +10% over the next 12 months. |
| **SELL** | Total return is expected to be <10% over the next 12 months. |
| **TRADING SELL** | Stock price is expected to *fall* by >10% within 3-months after a Trading Sell rating has been assigned due to negative newsflow. |
| **SECTOR RECOMMENDATIONS** | |
| **POSITIVE** | The sector is expected to outperform the overall market over the next 12 months. |
| **NEUTRAL** | The sector is to perform in line with the overall market over the next 12 months. |
| **NEGATIVE** | The sector is expected to underperform the overall market over the next 12 months. |