

10 Oct 2014 | Sector update

Maintain NEUTRAL

BANKING - CIMB, RHB CAP AND MBSB PROCEEDING WITH PROPOSED MERGER

CIMB, RHB Cap and MBSB have made formal announcements to proceed with its proposed three way merger. This was after the end of the 90 day exclusive period to negotiate and finalise the pricing, structure and relevant terms & conditions for a proposed merger and to form a mega-Islamic Bank.

- CIMB, RHB Cap and MBSB have reached a principal agreement on the terms & conditions to merge to form a larger banking entity and a mega-Islamic Bank. An application has been submitted to BNM for approval on the proposed merger. BNM's approval will first be required before the due diligence exercise can be carried out. Thereafter, a definitive Sales & Purchase agreement between the three parties will be executed.
- The proposed merger and the formation of the mega-Islamic Bank involves various steps and the share prices agreed in principal for CIMB, RHB Cap and MBSB shares as shown in Table 1:

TABLE 1: Summary of pricing for shares of CIMB, RHB CAP and MBSB which have been agreed in principal

	CIMB	RHB Cap	MBSB
Net Assets ('Mil)	36,625	17,957	4,030
Number of shares ('Mil)	8,336.5	2,572.5	2,755*
Net asset per shares (RM)	4.28	6.97	1.50
Agreed price per share (RM)	7.24	10.028	2.82
PB multiple based on agreed price	1.70x	1.44x	1.91x

*Based on fully dilutive number of shares.

TABLE 2: Steps in the proposed merger and creation of a mega-Islamic Bank.

	Transactions/Steps	Purchase Consideration	Basis	Manner of funding
i	CIMB Islamic Bank Berhad (CIMB Islamic) to acquire all assets and liabilities of MBSB. MBSB will eventually be delisted.	RM7,768.1m (valuing MBSB share at 2.82 per share). Issue price per CIMB Islamic share: RM5.399	1.91x PB multiple of MBSB net assets as at 30 June 2014	Either by cash or by share swap with issuance of unlisted CIMB Islamic shares. Should the shareholders of MBSB all opt for a share swap, it will be roughly 0.52 CIMB Islamic share for 1 MBSB share.
ii	CIMB Islamic to acquire all assets and liabilities of RHB Islamic.	RM4,146.8m (valuing RHB Islamic shares at RM3.53 per share)	1.96x PB multiple of RHB Islamic net assets as at 30 June 2014	All share swap. Roughly 0.65 CIMB Islamic share for 1 RHB Islamic share

		Issue price per CIMB Islamic share: RM5.399		
iii	Upon completion, CIMB Islamic, MBSB and RHB Islamic will form a mega-Islamic Bank. The meg-Islamic Bank will not be listed.			
iv	RHB Cap will acquire all assets and liabilities of CIMB Group. CIMB Group will eventually be delisted.	RM60,581.5m (valuing CIMB Group shares at RM7.27 per share)	1.7x PB multiple of CIMB Group's net assets as at 30 June 2014	All share swap (RHB Cap shares valued at RM10.028). Share swap of 1 RHB Cap share for 1.38 CIMB Group share
v.	The merged RHB Cap and CIMB Group together with ex-MBSB shareholders and/or new strategic shareholders will hold shares in the mega-Islamic Bank. The mega-Islamic Bank will be a subsidiary of the merged CIMB-RHB entity.			

- Valuation wise, the PB multiple on the agreed pricing for CIMB Group and RHB Cap (see Table 1 above) at 1.7x and 1.44x to facilitate the share swap exercise appears to be decent. On MBSB, the valuation of 1.91x PB multiple was slightly higher than expectation of 1.75x. Nevertheless, this was justified on basis that MBSB will be privatized and on consideration that MBSB shareholders will be offered either unlisted CIMB Islamic shares or cash as payment.
- Based on the proposed structure, on the transactions perspective, RHB Cap will acquire all assets and liabilities of the CIMB Group. However, from an accounting standpoint, CIMB Group will be treated as the acquirer as we understand that larger entity will always be deemed as acquirer. Eventually, 70% of the enlarged entity (merged CIMB-RHB) will be owned by shareholders of CIMB Group with the remaining 30% by shareholders of RHB Cap. In regards to the major shareholders, EPF and Khazanah will cumulatively have in circa 45% stake in the merged entity post merger. Meanwhile, Aabar Investments stake will be diluted to 6.3% in the enlarged entity from a stake of 21.2% in RHB Cap.
- In terms of the all share swap for the merger of the main vehicle (merger of CIMB Group and RHB Cap), this would imply a ratio of 1.0 RHB Cap Shares for every 1.38 CIMB Group share. It will require an issuance of 6.04b new RHB Cap shares and enlarge the share capital of RHB Cap to 8.61b shares.
- We understand that the merger entity (merged CIMB-RHB) will be a majority shareholder in the mega-Islamic Bank. In view that the shareholders of MBSB will be offered either cash or unlisted CIMB Islamic shares, in the event that shareholders of MBSB elect to receive all cash payment, then the merged CIMB-RHB will hold 100% stake in the mega-Islamic Bank. In contrast, should the MBSB shareholders all elect to receive unlisted CIMB Islamic shares in a share swap, then the merged CIMB-RHB will hold in circa 58% stake in the mega Islamic Bank.

- On the timeline for the merger, management expects BNM to grant its approval on the application for the proposed merger and a definitive S&P agreement to be executed by 1QCY15. Thereafter, shareholders approval will be required to complete the merger by 1HCY15.

Table 3: Asset of Islamic Banks by comparison

	Total assets (RM'Mil)	Loans (RM'Mil)
New mega Islamic Bank	126,865	88,790
Bank Islam	42,919	26,258
Public Bank Islamic	36,753	24,022
Maybank Islamic	134,401	95,042
Am Islamic	33,443	24,206
Hong Leong Islamic	21,798	14,312
Alliance Islamic	7,997	5,284
Affin Islamic	10,677	6,344

- The table above compares assets size of Islamic Banks. On proforma basis, the new mega Islamic Bank will have a total asset size of RM126.8b post merger. In terms of asset size, this will rank the new mega Islamic Bank 2nd behind Maybank Islamic. This will then be followed by Bank Islam and Public Bank Islamic at 3rd and 4th spot.
- We gather that on proforma basis, the merged entity will raise the contribution from Malaysia and Singapore operations from 68% under CIMB Group to 79%. Meanwhile, PBT from Malaysia and Singapore will be raised from 71% to 83%. Elsewhere, Malaysia and Singapore Consumer Banking of CIMB will be raised from 44% to 51%.
- Management hinted that from the merger, synergistic benefits will largely be from the cost side (approximately 86% of total synergies). Amongst the cost synergies that could be extracted will be IT synergies and the potential shift of some duplicative cost to the mega-Islamic Bank. We understand some legacy RHB and CIMB staffs will be moved to the mega-Islamic Bank. Also, cost rationalization could also be undertaken at the main vehicle (merged CIMB-RHB). On the potential revenue synergies, management sees synergistic benefits from the retail, SME banking and Singapore operations. Guidance on the quantum of cost and revenue synergies has yet to be provided.
- Below are rationales for the merger and formation of a mega-Islamic Bank:
 - Creation of larger and diversified base for funding and liquidity. Financing cost for MBSB will be lowered as it is able to be access to customer deposit base of CIMB and RHB Islamic;
 - Expansion of network which will enable a wider reach to customers locally and abroad for the banks;
 - Enlarged scale and size to compete in the intensively competed environment;
 - Potential revenue synergies from clientele base of the three parties. Revenue synergies include synergies from retail, SME banking as well as operations in Singapore;
 - Some complementary markets for IB business with the merger of CIMB Group and RHB Cap, further strengthening of IB capabilities albeit a large number of duplicated markets for IB business;

- vi. Enabling RHB Cap to gain access to commercial banking business in Indonesia via CIMB Niaga after the termination of Bank Mestika deal while CIMB's could further benefit from the market presence of RHB Cap in Singapore;
 - vii. The eventual creation of Mega Islamic Bank will provide opportunities to grow micro Islamic finance beyond the civil servants segment which has all this while been a strength of MBSB.
- Apart from the positives factors for the merger, we see the following as drawbacks on the merger:
 - i. Duplication of corporate and investment banking in which there are similar markets for the IB business of CIMB Group and RHB Cap which will cause dissynergies and
 - ii. Potential increase in the impaired loan ratio after merging due to the weaker asset quality of MBSB compared to RHB and CIMB.

Below are our assessments of the potential impacts from proposed merger on RHB Cap with firmer details. These are based on our assumption of the shareholders of MBSB elect to take cash payment consequently resulting in the merged entity (merged CIMB-RHB) holding 100% stake in the mega-Islamic Bank.

Existing RHB Cap share capital @ 30/6/2014 :	2,572 mil shares
New shares to be issued for share swap with RHB Share valued at RM10.028 and CIMB Group shares at RM7.27. Share swap exchange ratio: 1 RHB Cap share for 1.38 CIMB Group share.	6,041 mil shares
Enlarged share capital of RHB Cap:	8,613 mil shares
FY15 RHB Cap's Shareholders' fund (before):	RM19,434 mil
FY15 RHB Cap's Shareholders' funds (after):	RM81,976 mil
FY15 RHB Cap net profit (inclusive of expected RHB Islamic Banking income):	RM2,308 mil
Add FY15 CIMB Group net profit (inclusive of expected CIMB Islamic Banking Income):	RM2,454 mil*
Add FY15 MBSB net profit assuming the merged CIMB-RHB will hold 100% stake in the new mega-Islamic Bank:	RM345 mil*
Enlarged net profit (yet to factor in any merger cost as well as revenue and cost synergies which may occur)	RM5,107 mil
*denotes MIDF net profit forecast for 6 months of FY15 as the merger is expected to only complete by 1HFY15.	
RHB Cap's FY15 EPS (before)	91.0 sen
RHB Cap's FY15 EPS (after)	59.2 sen
Change	-35.0%^

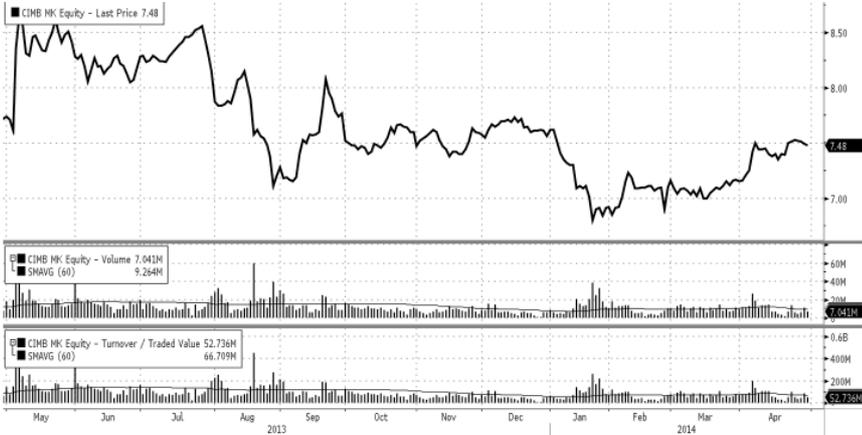
^EPS dilution is due to the consolidation of 6 months results of CIMB and MBSB as the merger is expected to complete by 1HCY15. Otherwise, on 12 months results of CIMB and MBSB, the EPS of the merged entity will be slightly accretive at 91.8 sen.

RHB Cap's FY15 BVPS (before)	RM7.63
RHB Cap's FY15 BVPS (after)	RM9.52
Change	+24.8%
RHB Cap's FY15 ROE (before)	12.4%
RHB Cap's FY15 ROE (after)	10.2%
Change	-2.2 pts

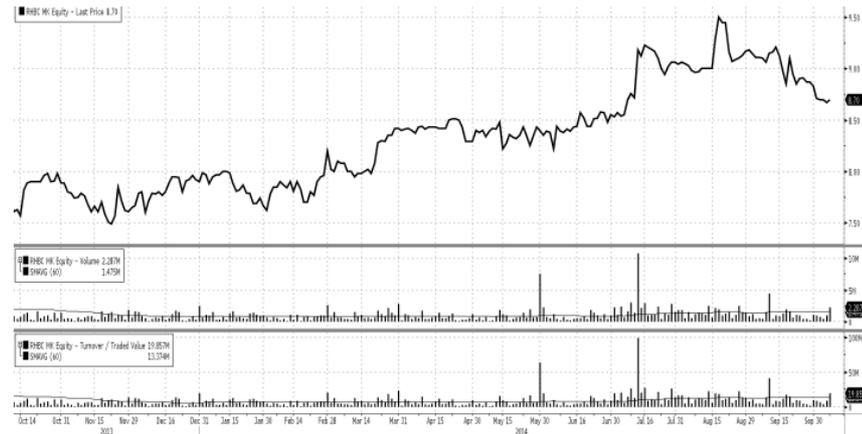
- Based on our assessment of the impact to RHB Group with all share swaps for the merger with CIMB Group, there will be a dilution to FY15 EPS of 35.0%. This is due to the consolidation of 6 months results of CIMB and MBSB as the merger is expected to complete by 1HCY15. However, on 12 months results of CIMB and MBSB, the EPS of the merged entity will be slightly accretive at 91.8 sen.
- Meanwhile, the impact on the merged entity's BVPS looks positive while there will be an expected dilution to the merged entity's ROE for FY15. Overall, there will be an immediate dilution impact on ROE as well as on its EPS which the latter is due to the timing for consolidation of the results of CIMB Group and MBSB. Nevertheless, the merger is positive over the longer term. This is in view that EPS and ROE are likely to be accretive towards the later years once synergistic benefits (revenue and cost synergies) kick in.
- As of now, we maintain our BUY call on RHB Cap with an unchanged TP of RM10.70 and well as our NEUTRAL rating on CIMB Group with an unchanged TP of RM8.00 pending further clarity on the outcome of the regulatory approvals required. This is particularly with regard to approval from Bursa on the right of key shareholders to vote for the proposed merger. 

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DAILY PRICE CHART OF CIMB



DAILY PRICE CHART OF RHB CAP



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MIDF AMANAH INVESTMENT BANK : GUIDE TO RECOMMENDATIONS

STOCK RECOMMENDATIONS

BUY	Total return is expected to be >15% over the next 12 months.
TRADING BUY	Stock price is expected to <i>rise</i> by >15% within 3-months after a Trading Buy rating has been assigned due to positive newsflow.
NEUTRAL	Total return is expected to be between -15% and +15% over the next 12 months.
SELL	<i>Negative</i> total return is expected, by -15% or more, over the next 12 months.
TRADING SELL	Stock price is expected to <i>fall</i> by >15% 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.