Affin Bank Berhad

(5185 | ABANK MK) Financial Services | Finance

Management unveils A25

***Maintain* BUY**

***Revised* Target Price: RM2.55**

(Previously RM2.53)

KEY INVESTMENT HIGHLIGHTS

- **Earnings were within our expectation**
- **Upgrade our FY23/FY24 earnings projection**
- **Core drivers include special dividends, exceptional loan growth, increased focus on ESG initiatives, reduced dependence on volatile treasury income sources**
- **Key risks include execution risks pertaining to business model transformation, higher-than-expected credit costs, failure to improve CIR**
- **Maintain BUY call with higher TP of RM2.55**

Highlights from Affin's 2QFY22 quarterly results:

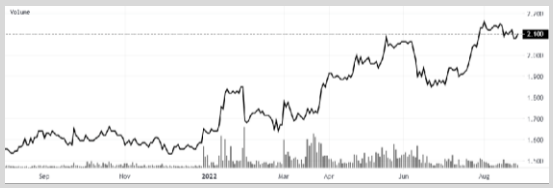
1. The Groups AHAM divestment is finished, and changes will be reflected in financial statements in the coming quarter. Special dividend to be distributed within this year
2. Management unveils A25, the Group's new multi-year strategic plan, with a focus on enhancing the customer experience, going digital and embracing ESG initiatives.
3. However, note that some targets are unfeasible and unlikely to be achieved.
4. NIM is elevated to 1.99% in 1HFY22 following OPR hikes, cost of funds to catch up eventually.
5. Affin has still yet to maintain a stable CIR, citing unstable incoming as the root of the issue.
6. Loan growth is at an exceptional +15.0%yoy, close to 3x the industry average.
7. No writebacks expected, as Group works towards achieving 100% LLC.
8. GIL ratio has been improving, but most likely due to dilution from high loan growth.

FINANCIAL SUMMARY

FYE Dec	FY20	FY21	FY22F	FY23F	FY24F
NII (RM m)	1,096	1,437	1,637	1,819	1,970
NOII (RM m)	1,168	804	836	838	845
Total income (RM m)	2,265	2,241	2,473	2,658	2,815
PPOP (RM m)	914	888	1,011	1,071	1,144
Core net profit (RM m)	230	527	551	681	758
Core EPS (sen)	10.9	25.0	26.1	32.3	35.9
Core P/E (x)	19.4	8.5	8.1	6.6	5.9
Gross DPS (sen)	3.5	12.5	15.7	9.7	10.8
Dividend yield (%)	1.7	5.9	7.4	4.6	5.1
BVPS (RM)	4.5	4.7	4.8	5.1	5.4
P/BV (x)	0.5	0.5	0.4	0.4	0.4
ROE (%)	2.4	5.4	5.5	6.5	6.8

RETURN STATISTICS	
Price @ 24 August 2022 (RM)	2.10
Expected share price return (%)	+20.2
Expected dividend yield (%)	+7.4
Expected total return (%)	**+27.6**

SHARE PRICE CHART



Share price performance (%)	Absolute	Relative
1 month	2.4	2.6
3 months	11.7	1.7
12 months	22.8	31.4

KEY STATISTICS	
FBM KLCI	1,467.26
Syariah compliant	No
F4GBM Index	Yes
ESG Grading Band (Star rating)	☆☆☆
Issue shares (m)	2124.06
Estimated free float (%)	13.36
Market Capitalisation (RM m)	4,645.89
52-wk price range	RM1.62 - RM2.23
Beta vs FBM KLCI (x)	1.11
Monthly velocity (%)	0.00
Monthly volatility (%)	10.62
3-mth average daily volume (m)	1.20
3-mth average daily value (RM m)	2.46
Top Shareholders (%)	
LTAT	33.32
Bank of East Asia Ltd	23.87
Boustead Holdings Bhd	21.00

Analyst
Samuel Woo
samuel.woo@midf.com.my
03-2173 1669

Within our and consensus expectations. Affin's 1HFY22 core net profit (ex-contributions from discontinued operations) of RM255m made up 46% and 47% of full-year forecasts respectively. 1HFY22 earnings strengthened by +86%yoy largely due to reduced allowances for loans and other purposes, as well as improved net interest income (NII) contributions. This offset higher operating and taxation expenses, as well as significantly poorer non-interest income (NOII). Quarterly earnings of RM129m similarly rose by +43%yoy, due to the aforementioned reasons.

On a sequential quarter basis, non-loan provisioning writebacks and lower loan provisions kept earnings remained flattish despite 2QFY22's improved NII and NOII showings.

A25 multi-year strategic plan. Despite AIM-22 not having been completed yet, Affin has unveiled its most recent three-year plan. The core tenants of such a transformation are included in Exhibit 3. Further strategic objectives can be viewed in Exhibit 4-5.

Given the lofty targets, we are not expecting Affin to achieve the majority guided financial metrics. Management acknowledges that these are stretch goals.

Nevertheless, we believe that it is a step in the right direction, as it works towards resolving several issues that cause Affin to lag its peers, i.e. lack of digital touchpoints and specialisation, insufficient ESG initiatives and weak customer satisfaction scores. We believe that several of Affin's lacklustre operational and financial metrics stem from Affin's limited customer touchpoints, limiting their range of options and opportunities.

Asset quality. Affin's GIL ratio has improved to 2.28% (1QFY22: 2.43%, 2QFY21: 3.27%). Though its community portfolio maintains an excellent GIL of 0.72%, its corporate portfolio's GIL is still elevated at 4.70%, while its enterprise segment's value stands at 3.64%.

Although Affin attributes the reduction as result of improved underwriting standards and recovery efforts, we believe that it is due to dilution stemming from significant loan growth. Additionally, we are wary of the possibility that Affin may have taken a lenient approach towards loan approval to boost loan portfolio size abnormally quickly.

Also, worth noting is that Affin has made progress towards achieving its 4% of ESG loans per gross loans for FY23 – as of 2Q22, the number is up to 1.8%.

Provisioning. The Group's management overlays currently stand at RM300m. Management has no intention to perform any writebacks soon, given its intention to bring the LLC to 100%. Currently having improved to 77% in the quarter, the Group is striving for a 90% target by Dec-22.

The Group's gross credit cost (GCC) guidance remains at 30bps for FY22, having already crept up to 31bps in 1HFY22.

Repayment assistance (RA) loans. Total RA loans in Jun-22 are worth RM3.59b, making up 6.48% of total loans portfolio. In Apr-22, the figure was RM3.75b, making up 6.92% of the portfolio. While corporate and enterprise segment RA loan figures remain sticky, the retail segment seen much reduction, having gone down to RM408m from Apr-22's RM525m.

Management estimates <5% of RA loans have missed 3-months payment, while >90% are making regular monthly payments.

Net interest margins (NIM) and NII. NIM expanded by +7bps-qoq to 1.99% in 2QFY22 and averaged 1.99% in 1HFY22, up from 1.94% in 1HFY21. Deposit rates are still lagging lending rates, the inevitable NIM contraction to occur in Dec-2022. Every +25bps full-year OPR hike is expected to benefit the Group's NIM by 4-5bps, translating to +RM16-17m worth of earnings.

Similarly, NII rose by +12.6%qoq and was up +19.6%yoy, driven by extremely high loan growth, and improved NIM.

NOII. 1HFY22 NOII slipped by -35.9%yoy, continually plagued by lacklustre core fee and trading contributions. A potential risk-on in the coming quarter (as stipulated by the Group's peers) could signify a renewed interest in trading, driving up core fees.

To Affin's credit, it has been devoting resources in the last couple of years toward generating alternate earnings drivers to treasury gains. (Before worsening market conditions, the Group would draw in RM400m of treasury gains annually.) The Group's growing trade finance business and Affin Invikta would help buffer some losses from its recently divested asset management arm.

Concerning the Group's AmGenerali deal (expected to be finalised in the coming quarter), the Group expects a further 2-3 years of transformation to their insurance business before any material improvement of financial outcomes.

Loan growth. The Group maintains its tremendous loan growth momentum, reporting a whopping +15.0%yoy gross loan growth in the quarter. Management has maintained its previous loan growth guidance of +12%yoy for FY22, citing a weaker 2HFY22 due to higher interest rates pushing down loan demand.

The retail segment acted as main driver to loan growth, growing by +22%yoy, although enterprise banking and corporate banking segments reported notable growth of +7.9% and +6.4% respectively. The primary contributor to the retail segment's growth was mortgage loans – primarily those of secondary market.

Affin attributes its loan growth tripling that of the industry average to "reactivating its workforce". This was done through better sales engagement as part of AIM-22's initiatives, evidenced by improved net promoter scores. The Group will continue to maintain the efficacy of its sales force by investing in customer relationship management systems and improving its touchpoint outreach via its app slated to release later in the year.

Deposit growth. The Group reported a similarly staggering deposit growth of +20%yoy, with the corporate banking segment acting as the core driver. CASA growth slid to 21.5% from 22.1% in 2QFY21. Loan/Deposit ratio currently stands at a comfortable 84.5%.

Cost efficiency. Affin's 1HFY22 operating expenses (OPEX) rose by +5.5%yoy, as marketing, establishment and general expenses continue to creep up. Only personnel costs saw some improvement, falling by -6.3%yoy.

The Group's progress in cost management remains lacklustre, with Affin's 1HFY22 cost/income ratio (CIR) averaging 63.5% (from 1HFY21's 63.0%). The Group did see some improvement on a quarterly basis, with 2QFY22's CIR improving to 61.4% from 65.9% in the previous quarter.

Rather than the unpredictability of OPEX, the Group cites volatile income sources as preventing cost management efforts from being effective. Management is instead building more reliable earnings drivers to resolve the issue.

Capital ratios. The Group's CET-1 ratio rests at a comfortable 13.4%. Management intends to maintain its CET-1 between the 13-14% level. This is inclusive of the RM1.0b worth of proceeds coming in from Affin Hwang Asset Management (AHAM)'s divestment, which will be recorded in the following quarter's financial statements.

No dividend announced. Affin typically divvies in 4th quarter. Special dividends following AHAM's divestment are to be announced within the year, though the quantum is yet to be determined.

Key risks. Key risks to earnings include (1) Failure to maintain a consistent/improving CIR, (2) Higher-than-expected credit costs following surge in loan growth, (3) Failure to provide alternate income drivers to compensate for the loss of AHAM's steady income contributions.

Earnings revised. We increase FY23/FY24 earnings forecasts by +2%/+6% to factor in improved NII performance on the back of further OPR hikes, as well as raise our fee income projections which may have been overly conservative previously.

Valuation and recommendation. Affin Bank faces multiple headwinds, most notably execution risks pertaining to its business model transformation. However, we feel that the Group also grapples with a lack of near-to-mid-term certainty, given that it seems to lack a well-drawn, comprehensive strategic plan, especially concerning funds derived from divestment activities.

Nonetheless, our outlook on Affin remains relatively positive. We continue to like Affin for its special dividends, high loan growth, serious measures undertaken to reduce dependence on volatile treasury income sources, and foray into ESG investing and customer service. While it may take some time to stand on a similar footing to its peers, it certainly seems to be moving in the right direction.

Thus, we maintain our **BUY call** with a upgraded **TP of RM2.55**, as we peg its FY23 BVPS to an unchanged FY23 P/BV of 0.5x, reflecting the upward revision on FY23 earnings. (Our GGM assumptions factors in FY23F ROE of 6.5%, LTG of 3.5% and COE of 9.6%).

EXHIBIT 1: QUARTERLY RESULTS

FYE Dec (RM m)	2QFY22	1QFY22	2QFY21	Yoy (%)	Qoq (%)	1HFY22	1HFY21	Yoy (%)
Islamic banking income	164	149	127	29.7%	10.5%	313	256	22.6%
Other operating income	80	72	110	-27.5%	11.3%	151	235	-35.9%
Net income	**504**	**449**	**464**	**8.5%**	**12.0%**	**953**	**912**	**4.6%**
OPEX	(309)	(296)	(282)	9.8%	4.4%	(605)	(574)	5.5%
PPOP	**194**	**153**	**183**	**6.5%**	**26.8%**	**348**	**338**	**3.0%**
Loan allowances	(38)	(19)	(58)	-34.1%	97.4%	(58)	(111)	-47.9%
Other allowances	0	19	(23)	n.m.	n.m.	20	(64)	n.m.
JV & Associates	18	12	18	n.m.	n.m.	30	24	n.m.
Profit before tax	**174**	**165**	**119**	**46.5%**	**5.4%**	**339**	**186**	**82.2%**
Tax & zakat	(45)	(40)	(29)	57.5%	13.7%	(85)	(50)	70.4%
Discontinued operations	29	27	43	-33.7%	n.m.	56	78	-28.9%
NCI	(11)	(10)	(16)	-30.4%	9.1%	(21)	(28)	-26.6%
Reported net profit	**147**	**143**	**118**	**24.6%**	**3.0%**	**290**	**187**	**55.1%**
Core net profit	**129**	**126**	**90**	**43.0%**	**2.7%**	**255**	**137**	**86.2%**
Total NII	**424**	**378**	**354**	**19.6%**	**12.2%**	**802**	**676**	**18.6%**
Total NOII	**80**	**72**	**110**	**-27.5%**	**11.3%**	**151**	**235**	**-35.9%**
Gross DPS (sen)	-	-	-	n.m.	n.m.	-	-	n.m.
Core EPS (sen)	6.1	5.9	4.3	41.2%	2.7%	12.0	6.5	83.9%
Gross loans	55,429	53,499	48,204	15.0%	3.6%			
Gross impaired loans	1,262	1,299	1,578	-20.0%	-2.8%			
Customer deposits	64,452	62,255	53,796	19.8%	3.5%			
CASA	13,855	13,414	11,900	16.4%	3.3%			

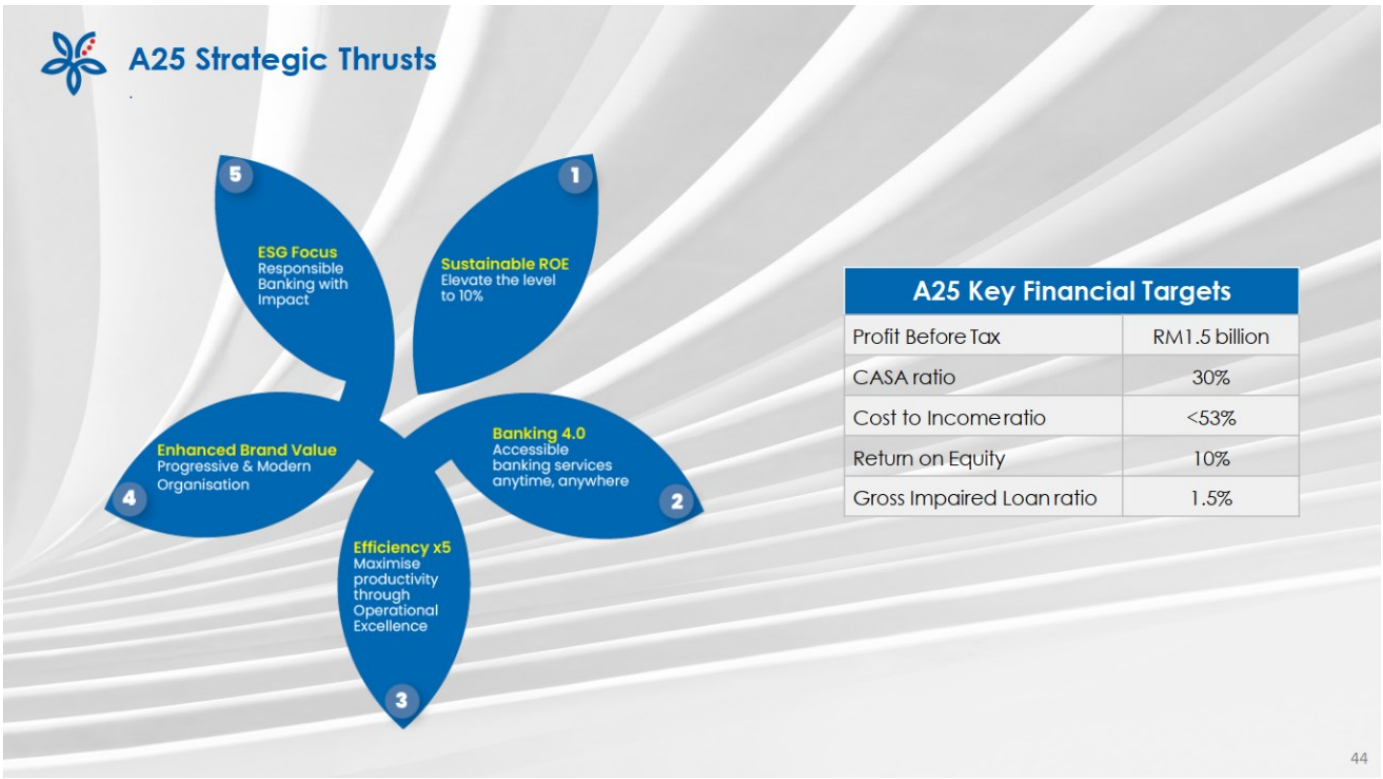
Source: Company, MIDFR

EXHIBIT 2: QUARTERLY FINANCIAL RATIOS

Financial Ratios (%)	2QFY22	1QFY22	2QFY21	Yoy (+/- %)	Qoq (+/- %)	1HFY22	1HFY21	Yoy (+/- %)
NIM (Reported)	**1.99**	**1.92**	**1.94**	**0.05**	**0.07**	**1.99**	**1.94**	**0.05**
NOII/Net income	15.8	15.9	23.6	-7.8	-0.1	15.8	25.8	-10.0
ROE (Ann.)	**5.1**	**5.1**	**3.8**	**1.3**	**0.1**	**5.0**	**2.9**	**2.2**
Cost-to-income ratio	61.4	65.9	60.7	0.7	-4.5	63.5	63.0	0.6
Net credit costs (Ann.) (bps)	29.7	15.5	50.1	-20.4	14.2	22.4	47.7	-25.4
GIL ratio	2.28	2.43	3.27	-1.00	-0.15			
Loan loss coverage	77.2	70.2	55.0	22.2	7.0			
L/D ratio	84.5	84.5	88.0	-3.5	0.0			
CET1	13.4	13.7	14.1	-0.6	-0.3			
Tier-1	14.9	15.3	15.8	-0.8	-0.4			
Total Capital	18.2	18.7	21.4	-3.2	-0.5			

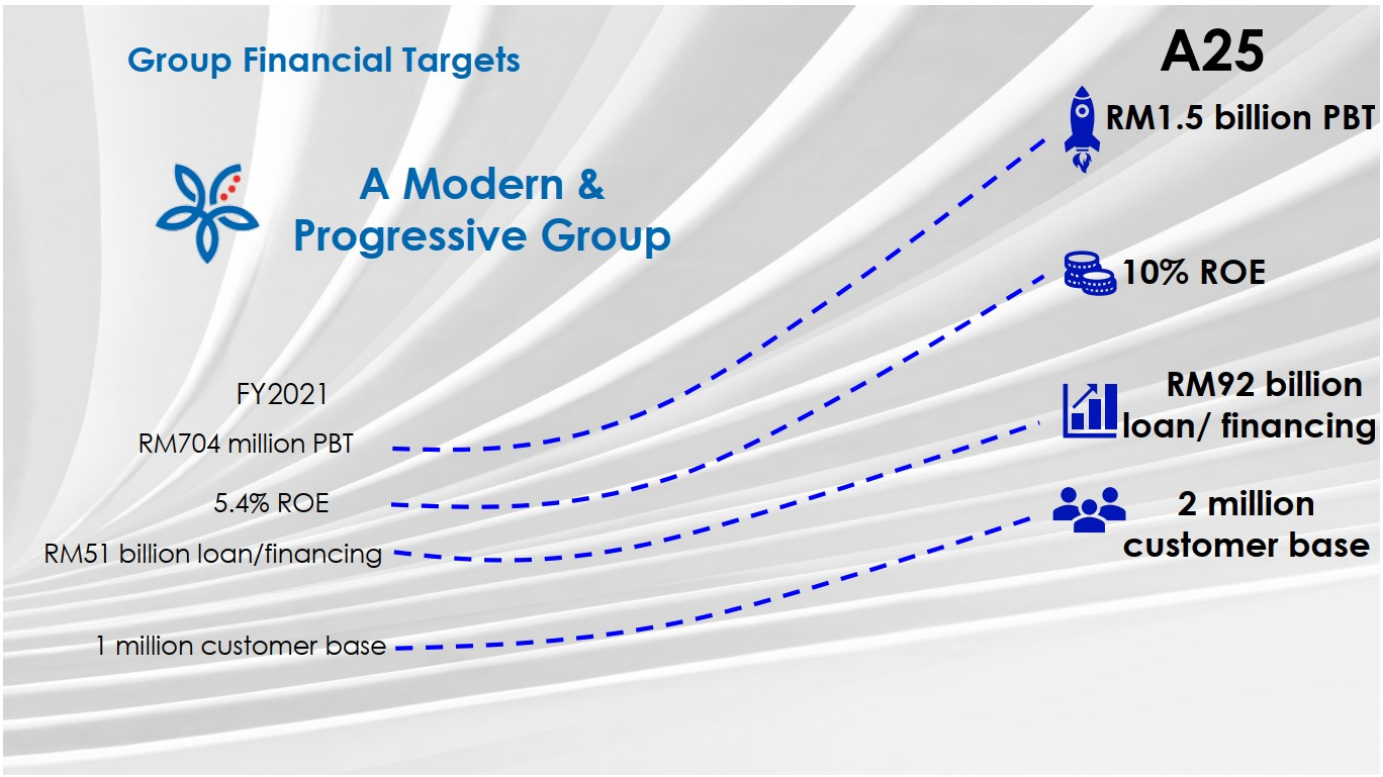
Source: Company, MIDFR

EXHIBIT 3: A25 (1)



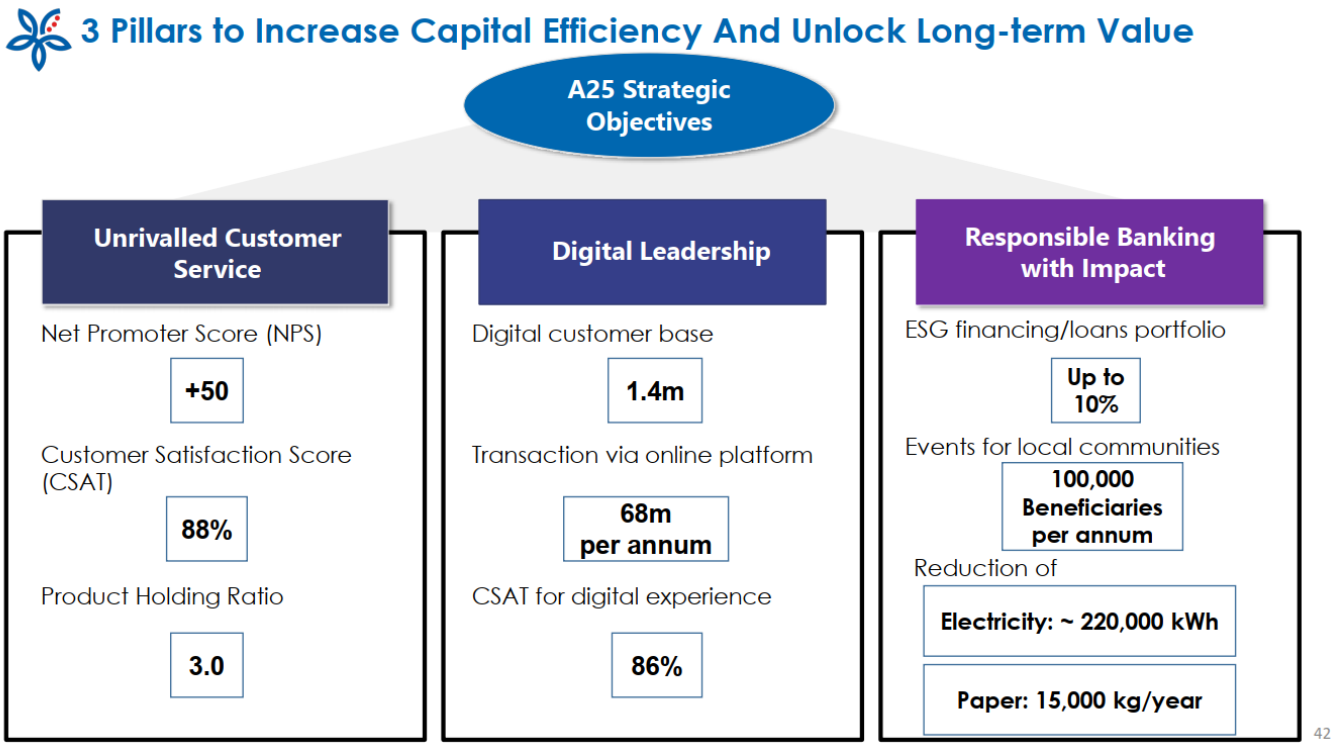
Source: Company, MIDFR

EXHIBIT 4: A25 (2)



Source: Company, MIDFR

EXHIBIT 5: A25 (3)



Source: Company, MIDFR

INVESTMENT STATISTICS

INCOME STATEMENT

FYE Dec (RM m)	FY20	FY21	FY22F	FY23F	FY24F
Interest income	1,728	1,672	2,056	2,389	2,828
Interest expense	(1,035)	(779)	(1,046)	(1,234)	(1,575)
Net interest income	**694**	**893**	**1,010**	**1,155**	**1,253**
Islamic banking income	481	549	626	664	717
Other operating income	1,090	798	836	838	845
Total income	**2,265**	**2,241**	**2,473**	**2,658**	**2,815**
OPEX	(1,351)	(1,354)	(1,461)	(1,587)	(1,671)
PPOP	**914**	**888**	**1,011**	**1,071**	**1,144**
Loan allowances	(490)	(165)	(164)	(150)	(160)
Other allowances	(72)	(57)	(63)	(41)	(14)
JV & Associates	42	45	49	51	55
Pretax profit	**394**	**710**	**833**	**931**	**1,025**
Taxation and zakat	(121)	(130)	(265)	(222)	(244)
NCI	(43)	(53)	(17)	(28)	(23)
Reported net profit	**230**	**527**	**551**	**681**	**758**
Core net profit	**230**	**527**	**551**	**681**	**758**
Total NII	1,096	1,437	1,637	1,819	1,970
Total NOII	1,168	804	836	838	845

BALANCE SHEET

FYE Dec (RM m)	FY20	FY21	FY22F	FY23F	FY24F
Cash and ST funds	5,511	7,564	8,512	8,850	9,043
Investment securities	13,875	15,911	17,841	21,627	23,923
Net loans	45,493	50,528	56,262	60,994	64,068
Other IEAs	-	-	-	-	-
Non-IEAs	4,656	4,425	4,755	7,258	7,870
Total assets	**69,535**	**78,429**	**87,370**	**98,729**	**104,904**
Customer & bank deposits	53,607	61,662	68,818	74,864	79,139
Other IBLs	3,462	4,001	4,531	4,568	4,151
Non-IBLs	2,829	2,833	3,908	8,483	10,199
Total liabilities	**59,898**	**68,495**	**77,257**	**87,915**	**93,489**
Share capital	4,902	4,969	4,969	4,969	4,969
Reserves & retained profit	4,664	4,920	5,094	5,791	6,390
Shareholders' funds	**9,567**	**9,889**	**10,063**	**10,760**	**11,359**
NCI	71	45	50	54	57
Total equity	**9,637**	**9,934**	**10,113**	**10,814**	**11,416**
Total liabilities & equity	**69,535**	**78,429**	**87,370**	**98,729**	**104,904**
Total IEAs	64,880	74,004	82,616	91,471	97,034
Total IBLs	57,069	65,663	73,349	79,432	83,289
Gross loans	46,273	51,417	57,592	62,394	65,518
CASA	11,082	13,540	16,113	19,174	21,092

FINANCIAL RATIOS

FYE Dec (RM m)	FY20	FY21	FY22F	FY23F	FY24F
Interest (%)					
NIM	1.71	2.07	2.09	2.09	2.09
Return on IEAs	2.82	2.42	2.63	2.74	3.00
Cost of funds	1.82	1.27	1.50	1.62	1.94
Net interest spread	1.00	1.15	1.12	1.13	1.06
Profitability (%)					
ROE	2.4	5.4	5.5	6.5	6.8
ROA	0.3	0.7	0.7	0.7	0.7
NOII/Total income	51.6	35.9	33.8	31.5	30.0
Effective tax rate	30.8	18.3	31.8	23.8	23.8
Liquidity & Efficiency (%)					
Cost-to-income ratio	59.6	60.4	59.1	59.7	59.4
Loan/Deposit ratio	91.2	85.9	85.7	85.8	85.7
CASA ratio	22.2	23.0	24.5	27.0	28.2
Asset Quality (%)					
GIL ratio	3.52	2.54	2.31	2.24	2.21
NIL ratio	2.59	1.92	1.51	1.40	1.27
LLC ratio	47.9	68.1	100.0	100.0	100.0
LLC (incl. reserves)	95.9	125.9	169.2	175.6	149.7
Gross credit cost (bps)	113	41	37	32	30
Net credit cost (bps)	106	34	30	25	25
% Floating rate loans	74.1	74.5	74.0	74.0	74.0
% Domestic loans	99.8	99.8	99.8	99.8	99.8
Capital (%)					
CET 1	14.5	14.4	14.0	13.8	13.8
Tier 1 capital	14.5	14.4	14.0	13.8	13.8
Total capital	20.5	19.7	19.5	19.1	19.0
Growth (%)					
Total NII	(5.0)	31.1	13.9	11.2	8.3
Total NOII	53.6	(31.2)	4.0	0.3	0.8
Core net profit	(52.8)	128.8	4.6	23.6	11.2
Gross loans	0.7	11.1	12.0	8.3	5.0
Customer deposits	(2.4)	17.9	11.7	8.2	5.2
CASA	13.6	22.2	19.0	19.0	10.0
Valuation metrics					
Core EPS (sen)	10.9	25.0	26.1	32.3	35.9
Gross DPS (sen)	3.5	12.5	15.7	9.7	10.8
Div payout ratio (%)	30.6	50.1	60.0	30.0	30.0
BVPS (RM)	4.5	4.7	4.8	5.1	5.4
Core P/E (x)	19.4	8.5	8.1	6.6	5.9
Dividend yield (%)	1.7	5.9	7.4	4.6	5.1
P/BV (x)	0.5	0.5	0.4	0.4	0.4

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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.
ESG RECOMMENDATIONS* - source Bursa Malaysia and FTSE Russell	
☆☆☆☆	Top 25% by ESG Ratings amongst PLCs in FBM EMAS that have been assessed by FTSE Russell
☆☆☆	Top 26-50% by ESG Ratings amongst PLCs in FBM EMAS that have been assessed by FTSE Russell
☆☆	Top 51%- 75% by ESG Ratings amongst PLCs in FBM EMAS that have been assessed by FTSE Russell
☆	Bottom 25% by ESG Ratings amongst PLCs in FBM EMAS that have been assessed by FTSE Russell

* ESG Ratings of PLCs in FBM EMAS that have been assessed by FTSE Russell in accordance with FTSE Russell ESG Ratings Methodology