

Malaysia Company Guide

CIMB Group Hldgs

Version 8 | Bloomberg: CIMB MK | Reuters: CIMB.KL

Refer to important disclosures at the end of this report

DBS Group Research . Equity

1 Mar 2017

HOLD

Last Traded Price (28 Feb 2017): RM4.97 (KLCI : 1,693.77)

Price Target 12-mth : RM5.00 (1% upside) (Prev RM4.80)

Potential Catalyst: Delivery of strategic targets

Where we differ: Earnings below consensus on higher credit costs

Analyst

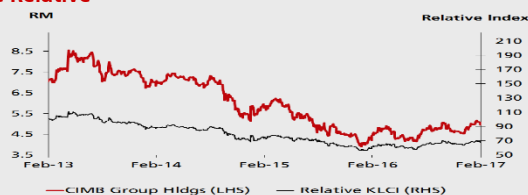
Sue Lin LIM +65 8332 6843 suelinlim@dbs.com

Lynette CHENG +60 32604 3907 lynettecheng@alliancedbs.com

What's New

- **In-line 4Q/FY16 earnings; provisions stayed high as expected, driven by Thai and Indo operations**
- **Loan growth accelerated in 4Q16; ROE hit 8.4% in FY16, missing initial target of 10%**
- **2017 should be better; 2H17 performance to improve compared to 1H17**
- **Earnings raised for higher topline growth and better cost control, but negated by higher credit cost; Maintain HOLD, TP raised to RM5.00**

Price Relative



Forecasts and Valuation

FY Dec (RMm)	2016A	2017F	2018F	2019F
Pre-prov. Profit	7,414	7,750	8,234	8,850
Net Profit	3,564	4,020	4,542	5,165
Net Pft (Pre Ex.)	3,564	4,020	4,542	5,165
Net Pft Gth (Pre-ex) (%)	25.1	12.8	13.0	13.7
EPS (sen)	41.0	45.0	50.1	56.1
EPS Pre Ex. (sen)	41.0	45.0	50.1	56.1
EPS Gth Pre Ex (%)	22	10	11	12
Diluted EPS (sen)	40.2	44.7	49.7	55.7
PE Pre Ex. (X)	12.1	11.0	9.9	8.9
Net DPS (sen)	20.0	22.0	25.0	29.0
Div Yield (%)	4.0	4.4	5.0	5.8
ROAE Pre Ex. (%)	8.3	8.5	8.9	9.3
ROAE (%)	8.3	8.5	8.9	9.3
ROA (%)	0.8	0.8	0.9	0.9
BV Per Share (sen)	511	545	583	626
P/Book Value (x)	1.0	0.9	0.9	0.8
Earnings Rev (%):		1	4	N/A
Consensus EPS (sen):		48.4	54.4	N/A
Other Broker Recs:		B: 13	S: 0	H: 13

Source of all data on this page: Company, DBS Bank, Bloomberg Finance LP

Half-way to the finish line

A better year but 1H17 will still see some sluggishness, HOLD.

Issues pertaining to credit costs may still spill over to 1H17 before diminishing in 2H17. Management seems a little more optimistic going into FY17 but managing credit costs will be crucial. ROE targets remain uninspiring for FY17. CIMB Niaga should gradually turn around in 2H17. Positively, its Malaysian operations have stayed stable. Its ASEAN expansion strategy is ongoing with the Philippines to be added to its list. CIMB is at its half-way mark in its T18 strategic initiatives but its ultimate 15% ROE target is unlikely to be achieved.

In-line 4Q/FY16 earnings, with provisions staying high particularly for its Thailand and Indonesia operations; NPL ratio rose to 3.3% for these markets. NIM slipped, while loan growth accelerated in 4Q16 from wholesale banking in Malaysia and Indonesia, bringing its full-year loan growth to 9% y-o-y. Excluding the one-off gain booked in 3Q16 from the sale of its stake in Sun Life insurance, non-interest income was sluggish from relatively weak capital markets. Expenses on a business-as-usual (BAU) basis were well contained. ROE came in at 8.4% in FY16, below its 10% target. CET1 rose to 11.3%. A second interim DPS of 12 sen was declared, bringing its full-year DPS to 20 sen, equivalent to a 50% payout.

A little bit more to reach finish line. The item that stood out in its FY17 targets is its still uninspiring ROE of 9.5%. Although better than FY16, FY17 will be a year of two halves – a weak 1H, followed by a better 2H, hinging mainly on credit cost which is still relatively high at 60-65bps (FY16: 82bps). Loan growth is targeted at 7% while NIM guidance still points to a 5-10bps slippage. A sub-53% cost-to-income is targeted and CET1 is targeted at >11.5%. CIMB's T18 ROE target of 15% will be challenging to achieve given the current scenario. Post earnings adjustment, our TP rises to RM5.00.

Valuation:

CIMB is a HOLD with a RM5.00 TP that is based on the Gordon Growth Model and implies 0.9x FY17F BV. Our TP assumes 10% ROE, 5% long-term growth and 11% cost of equity.

Key Risks to Our View:

Faster-than-expected delivery of T18 strategies and core earnings recovery. We have imputed credit costs higher than guided on account of a slower recovery. A quicker-than-expected delivery of its T18 strategies would prove our bearish view on CIMB wrong.

At A Glance

Issued Capital (m shrs)	8,868
Mkt. Cap (RMm/US\$m)	44,076 / 9,927
Major Shareholders (%)	
Khazanah	29.7
EPF	17.3
Free Float (%)	41.6
3m Avg. Daily Val (US\$m)	14.5

ICB Industry : Financials / Banks

WHAT'S NEW

Unexciting end to the year

Highlights

CIMB's 4Q/FY16 earnings in line with expectations as provisions stayed high, particularly from its Thailand and Indonesia operations; NPL ratio rose to 3.29% (3Q16: 3.21%), from similar markets. Loan loss coverage ratio declined q-o-q, for the fourth consecutive quarter, ending the year at 80%. Including regulatory reserve, this would have stood at 92%. Oil and gas exposure remains largely similar, at less than 3% of total loan portfolio.

Boost in loan growth in 4Q16. NIM slipped, while loan growth accelerated in 4Q16 from wholesale banking in Malaysia and Indonesia, bringing its full-year loan growth to 9% y-o-y. This drove loan-to-deposit ratio higher to 96%. Excluding the one-off gain booked in 3Q16 from the sale of its stake in Sun Life insurance, non-interest income appeared to be sluggish from relatively weak capital markets. Expenses on a business-as-usual (BAU) basis were well contained. Its cost-to-income ratio was elevated due to overall weak revenues for the year.

Misses ROE and loan growth target, as expected. CIMB ended the year at 8.4% ROE, missing its initial target of 10%. This is largely due to miss in other targets such as 10% loan growth (FY16: 6.4% ex forex impact), 60-70bps credit cost (FY16: 82bps) and <53% cost-to-income ratio (FY16: 54%). Positively, the bank managed to exceed its CET1 ratio target of 11% and met its 40-60% dividend payout target. A second interim DPS of 12 sen was declared, bringing its full-year DPS to 20 sen, equivalent to a 50% payout.

Outlook

A little bit more to reach finish line. The item that stood out in its FY17 targets is its still uninspiring ROE of 9.5%. Although better than FY16, FY17 will be a year of two halves – a weak 1H, followed by a better 2H, hinging mainly on credit cost which is still relatively high at 60-65bps. Loan growth is targeted at 7%, expected to be driven by Malaysia and Indonesia. NIM guidance still points to a 5-10bps slippage, mainly from Indonesia and a little from Malaysia. A sub-53% cost-to-income is targeted. CET1 is targeted at >11.5% which we believe should be easily achievable with ongoing risk weight calibration and sale of its non-core assets. Dividend payout ratio should range between 40% and 60%. CIMB's T18 ROE target of 15% will be challenging to achieve given the current scenario.

Raise earnings by 1-4% across FY17-18F. In line with management guidance, we imputed higher loan growth assumptions (from 6%/8% to 7% each year), smaller NIM compression (from -10bps/-8bps to -8bps/-8bps/-7bps) and lower expense growth (from 5% each year to 3% each year). The impact was however negated by higher credit cost assumptions (from 55bps/50bps to 70bps/59bps/50bps) across FY17-19F. Our credit cost assumption has yet to account for the impact of IFRS 9 implementation (slated for 2018). Our sensitivity analysis shows that every 5bps change in credit cost changes net profit by 3%.

Watch for impact of divestments in FY17. CIMB is still in the midst of exploring a 50:50 joint venture with China Galaxy Securities for its stockbroking business (which includes institutional and retail brokerage, equity research as well as associated securities businesses). If an agreement is reached, management expects cost-to-income to improve by 100bps. This should put CIMB on track to lower its cost-to-income ratio to meet its target. The negotiations will take place for three months from mid-October. Separately, at end-December 2016, CIMB announced the sale of its 18.21% stake in Bank of Yingkou to Shanghai Guozhijie Investment Development. The sales proceed is slated for an all-cash transaction, with expected completion in 2017. CET1 ratio is estimated to be enhanced by 15-20bps from current levels of 11.3%. With this divestment, CIMB is closing the gap towards achieving its 11.5% CET1 target for FY17F. There could well be further divestments of its non-core business to enhance costs as well as capital.

Valuation and recommendation

Maintain HOLD with higher TP of RM5.00. Post earnings adjustment, our TP is nudged up to RM5.00 (from RM4.80 previously). Our TP assumes 10% ROE, 5% growth and 11% cost of equity. We believe 2017 will remain a challenging year for CIMB, with provisions expected to still weigh on earnings. A re-rating beyond 1x BV is difficult, given that FY17 ROE would likely remain at sub-10%.

Quarterly / Interim Income Statement (RMm)

FY Dec	4Q2015	3Q2016	4Q2016	% chg yoy	% chg qoq	FY15	FY16	% chg yoy
Net Interest Income	2,461	2,445	2,645	7.5	8.2	9,337	9,826	5.2
Islamic Income	417	425	428	2.6	2.6	1,569	1,704	8.6
Non-Interest Income	1,164	1,253	1,240	6.6	(1.0)	4,489	4,535	1.0
Operating Income	4,042	4,124	4,313	6.7	4.6	15,395	16,065	4.4
Operating Expenses	(2,211)	(2,193)	(2,231)	0.9	1.7	(9,249)	(8,652)	(6.5)
Pre-Provision Profit	1,830	1,931	2,082	13.8	7.8	6,146	7,414	20.6
Provisions	(717)	(586)	(887)	23.7	51.5	(2,318)	(2,645)	14.1
Associates	19.3	15.6	16.7	(13.2)	7.0	86	116	35.1
Exceptionals	0.0	0.0	0.0	nm	nm	1	-	nm)
Pretax Profit	1,132	1,361	1,212	7.0	(11.0)	3,914	4,884	24.8
Taxation	(297)	(312)	(333)	12.4	6.8	(1,018)	(1,251)	22.9
Minority Interests	(9.9)	(25.7)	(24.0)	(143.6)	(6.3)	(46)	(69)	48.1
Net Profit	826	1,023	854	3.5	(16.5)	2,850	3,564	25.1
Growth (%)								
Net Interest Income Gth	1.9	4.0	8.2			7.9	5.2	
Net Profit Gth	2.7	17.2	(16.5)			(8.3)	25.1	
Key ratio (%)								
NIM	2.7	2.6	2.8			2.71	2.66	
NPL ratio	3.0	3.2	3.3			3.05	3.29	
Loan-to deposit	91.4	88.1	93.7			91.5	93.8	
Cost-to-income	54.7	53.2	51.7			59.0	60.1	
Total CAR	15.4	15.8	16.4			16.1	16.9	

Source of all data: Company, DBS Bank

CRITICAL DATA POINTS TO WATCH

Earnings Drivers:

No escape from NIM compression. We expect NIM to contract, dragged by its Malaysian and Indonesian operations. In Malaysia, deposit competition remains rife while in Indonesia, CIMB Niaga is shifting its focus to better quality loans, putting pressure on asset yields.

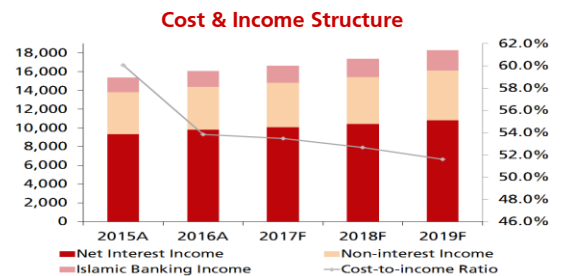
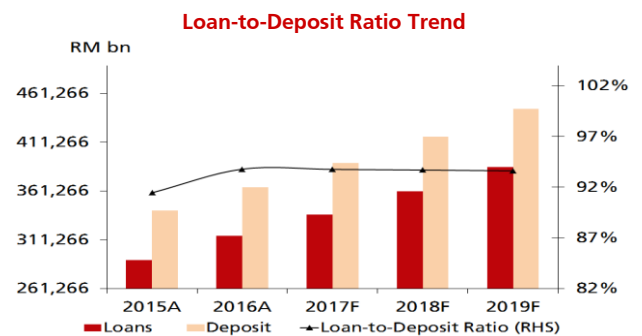
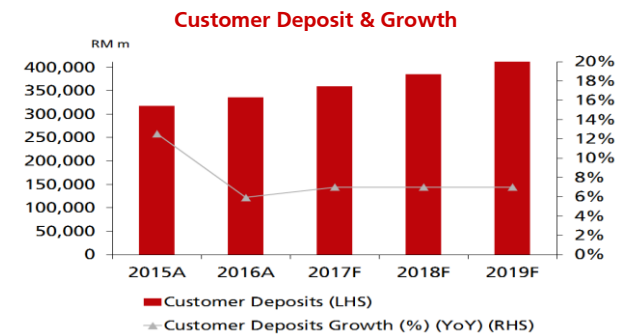
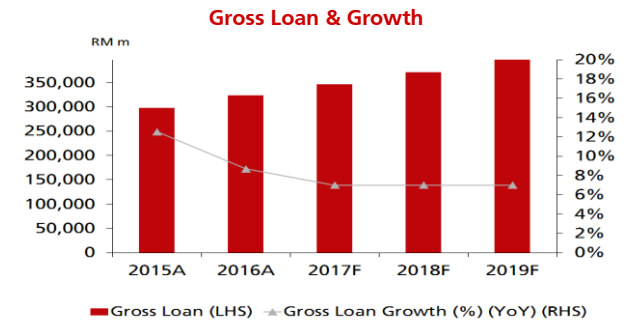
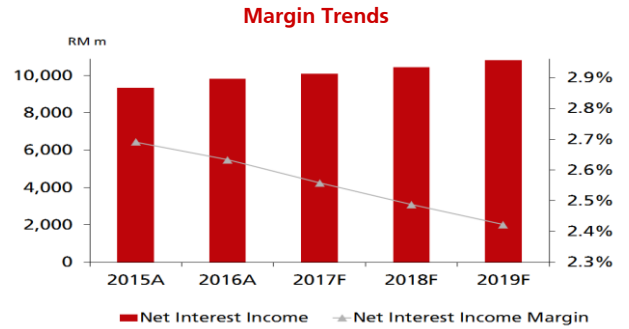
We forecast 7% loan growth in FY17, in line with management guidance. This is expected to be driven by its Malaysian and Indonesian operations. CIMB continues to focus on CASA but even then it was unable to fend off funding cost pressures in Malaysia. We assume deposits will grow at the same pace as loans, keeping the loan-to-deposit ratio intact.

Capital markets still soft. Although a pick-up was noted in 2Q16 and 3Q16, capital markets as a whole is expected to stay soft compared to previous years. CIMB regularly tops the Malaysian league table for equity and debt issuance, and is one of the key players within the ASEAN region.

Cost management is the key focus for CIMB as it aspires to drive cost-to-income ratio to below 50% by FY18. To achieve this, CIMB is looking to reduce the overall IB operating cost and realign its cost structure and operating efficiencies. CIMB did a voluntary Mutual Separation Scheme (MSS) in May 2015 for employees in Malaysia and Indonesia as part of this initiative. The materialisation of the joint-venture arrangement for its stockbroking business with China Galaxy could further accelerate cost reduction.

Regional performance remains a drag in 2017. Historically, overseas operations contribute 40% of CIMB's total PBT, with Indonesia taking the lead at 30%, followed by Thailand and Singapore at c.5% each. However, the Indonesian operations have been plagued by high provisions since 4Q14, resulting in its contribution declining significantly. We expect CIMB Niaga's performance to remain dismal in FY17.

T18 transformation targets may be challenging to achieve. The T18 plan kicked off in 1Q15 with a reorganisation encompassing changes to key management positions and a shift to more regional-focused entities. CIMB strives to reduce costs (targeted at its overall processes and investment banking division) and build up three key businesses (Commercial and SME Banking, Transaction Banking and Digital Banking). The T18 initiatives aim to reduce the cost-to-income ratio to below 50%, increase consumer banking contribution to 60% of income but we view these as challenging targets. It appears be on track to boost CET1 ratio to 12% (FY16: 11.3%)



Source: Company, DBS Bank

Balance Sheet:

Asset-quality issues in Singapore and Thailand; Indonesia stabilising but warrants attention. CIMB Niaga's outlook remains uncertain and we would not discount the possibility of some stress in its portfolio. CIMB's NPL ratio is the highest among peers at c.3% (vs industry average of less than 2%). Meanwhile, in Malaysia, asset quality has remained surprisingly benign.

CIMB's CET-1 ratio picking up as it optimises its risk-weighted assets. Management guided for no capital raising but it is instead looking at initiatives to optimise risk-weighted assets. Meanwhile, we believe CIMB's dividend reinvestment plan (DRP) will remain in place to provide support to its capital position. Under T18, CIMB is targeting CET-1 to reach 12% by 2018.

Share Price Drivers:

Limited valuation upside. CIMB is currently trading just below 1.0x BV, which is significantly below its average mean valuation. Although valuations are undemanding, a pick-up in earnings momentum remains uncertain as the operating environment remains a challenge. So, as long as there is no visibility for an earnings pick-up, we expect valuations to stay range-bound.

Short-term pain for long-term gain. Delivery of the T18 strategy would be a re-rating catalyst for CIMB. Post-restructuring, CIMB will be a leaner outfit with improved cost efficiency. In our view, the bank will subsequently emerge as a sturdier organisation to strengthen its footing, especially within the commercial banking space.

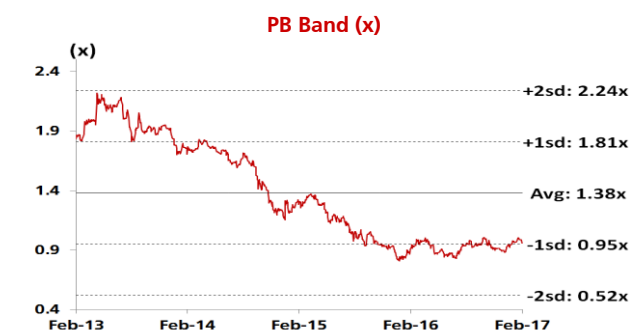
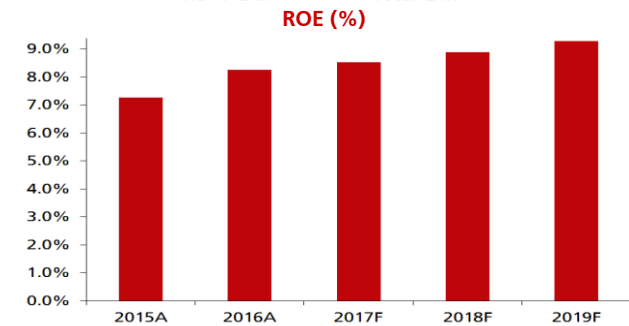
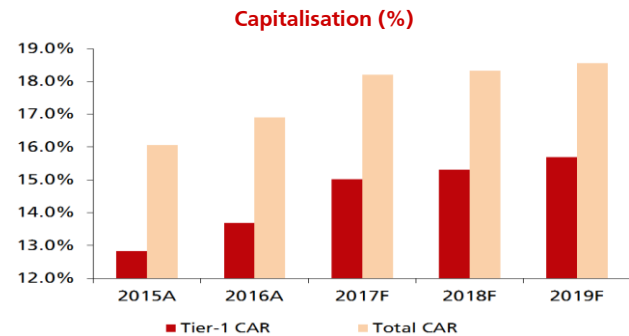
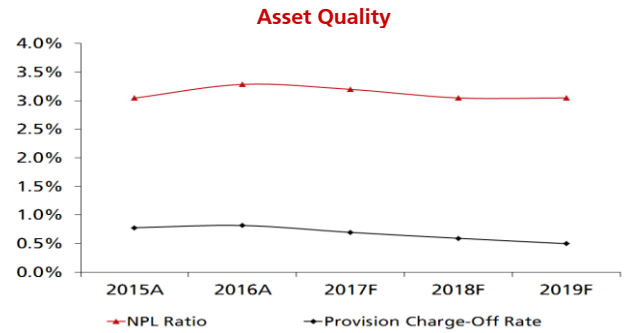
Key Risks:

Ability to rebuild Indonesian business. Expect Indonesian operations to remain soft up till 1H17 and if momentum does not pick up in 2H17, there could be downside risk to earnings.

Delays in delivery of T18 strategies. Although the 3-year plan with costs as its initial key agenda paints a positive picture for the group in the longer term, cost overruns could derail its target to achieve >15% ROE by FY18. The consumer banking business is not easy to build up and the group may not achieve 60% income contribution from this segment.

Company Background

CIMB Group Holdings Berhad provides commercial banking and related financial services. The company and its subsidiaries operate as a regional universal bank, offering a full range of financial products and services, covering corporate and investment banking, consumer banking, treasury and asset management.



Source: Company, DBS Bank

Key Assumptions

FY Dec	2015A	2016A	2017F	2018F	2019F
Gross Loans Growth	12.5	8.7	7.0	7.0	7.0
Customer Deposits Growth	12.5	5.9	7.0	7.0	7.0
Yld. On Earnings Assets	4.5	4.3	4.3	4.2	4.2
Avg Cost Of Funds	2.2	2.1	2.1	2.2	2.2

Income Statement (RMm)

FY Dec	2015A	2016A	2017F	2018F	2019F
Net Interest Income	9,337	9,826	10,085	10,438	10,824
Islamic Income	1,569	1,704	1,840	1,988	2,147
Non-Interest Income	4,489	4,535	4,730	4,975	5,315
Operating Income	15,395	16,065	16,655	17,400	18,285
Operating Expenses	(9,249)	(8,652)	(8,905)	(9,166)	(9,434)
Pre-provision Profit	6,146	7,414	7,750	8,234	8,850
Provisions	(2,318)	(2,645)	(2,412)	(2,197)	(1,978)
Associates	85.6	116	127	140	154
Exceptionals	1.14	0.0	0.0	0.0	0.0
Pre-tax Profit	3,914	4,884	5,465	6,177	7,026
Taxation	(1,018)	(1,251)	(1,366)	(1,544)	(1,757)
Minority Interests	(46.4)	(68.8)	(79.1)	(90.9)	(105)
Preference Dividend	0.0	0.0	0.0	0.0	0.0
Net Profit	2,850	3,564	4,020	4,542	5,165
Net Profit bef Except	2,848	3,564	4,020	4,542	5,165
Growth (%)					
Net Interest Income Gth	7.9	5.2	2.6	3.5	3.7
Net Profit Gth	(8.3)	25.1	12.8	13.0	13.7
Margins, Costs & Efficiency (%)					
Spread	2.3	2.2	2.1	2.0	2.0
Net Interest Margin	2.7	2.7	2.6	2.5	2.4
Cost-to-Income Ratio	60.1	53.9	53.5	52.7	51.6
Business Mix (%)					
Net Int. Inc / Opg Inc.	60.6	61.2	60.6	60.0	59.2
Non-Int. Inc / Opg inc.	29.2	28.2	28.4	28.6	29.1
Fee Inc / Opg Income	12.8	12.1	12.0	11.8	11.6
Oth Non-Int Inc/Opg Inc	16.4	16.2	16.4	16.8	17.5
Profitability (%)					
ROAE Pre Ex.	7.3	8.3	8.5	8.9	9.3
ROAE	7.3	8.3	8.5	8.9	9.3
ROA Pre Ex.	0.7	0.8	0.8	0.9	0.9
ROA	0.7	0.8	0.8	0.9	0.9

Provisions expected to taper off but remain elevated

Source: Company, DBS Bank

Quarterly / Interim Income Statement (RMm)

FY Dec	4Q2015	1Q2016	2Q2016	3Q2016	4Q2016
Net Interest Income	2,461	2,384	2,352	2,445	2,645
Islamic Income	417	438	413	425	428
Non-Interest Income	1,164	904	1,138	1,253	1,240
Operating Income	4,042	3,725	3,903	4,124	4,313
Operating Expenses	(2,211)	(2,137)	(2,091)	(2,193)	(2,231)
Pre-Provision Profit	1,830	1,588	1,812	1,931	2,082
Provisions	(717)	(515)	(657)	(586)	(887)
Associates	19.3	49.8	33.5	15.6	16.7
Exceptionals	0.0	0.0	0.0	0.0	0.0
Pretax Profit	1,132	1,123	1,189	1,361	1,212
Taxation	(297)	(293)	(313)	(312)	(333)
Minority Interests	(9.9)	(16.0)	(3.1)	(25.7)	(24.0)
Net Profit	826	814	873	1,023	854
Growth (%)					
Net Interest Income Gth	1.9	(3.1)	(1.3)	4.0	8.2
Net Profit Gth	2.7	(1.4)	7.3	17.2	(16.5)

4Q16 saw strong loan growth but provisions stayed high

Balance Sheet (RMm)

FY Dec	2015A	2016A	2017F	2018F	2019F
Cash/Bank Balance	29,319	26,710	33,289	38,417	44,325
Government Securities	9,714	5,315	2,908	3,054	3,206
Inter Bank Assets	1,829	2,308	2,912	3,348	3,683
Total Net Loans & Adv.	290,296	315,373	337,349	360,707	385,643
Investment	90,916	96,686	101,584	106,764	112,245
Associates	1,037	251	276	304	335
Fixed Assets	2,404	2,140	1,907	1,698	1,513
Goodwill	10,118	10,509	10,509	10,509	10,509
Other Assets	25,944	26,474	26,790	27,151	27,558
Total Assets	461,577	485,767	517,524	551,952	589,016
Customer Deposits	317,424	336,246	359,783	384,968	411,915
Inter Bank Deposits	23,692	28,736	30,173	31,682	33,266
Debts/Borrowings	34,009	30,651	31,528	32,447	33,410
Others	44,220	43,055	45,124	47,628	50,328
Minorities	982	1,571	1,650	1,741	1,846
Shareholders' Funds	41,251	45,508	49,267	53,487	58,251
Total Liab& S/H's Funds	461,577	485,767	517,524	551,952	589,016

Source: Company, DBS Bank

Financial Stability Measures (%)

FY Dec	2015A	2016A	2017F	2018F	2019F
Balance Sheet Structure					
Loan-to-Deposit Ratio	91.5	93.8	93.8	93.7	93.6
Net Loans / Total Assets	62.9	64.9	65.2	65.4	65.5
Investment / Total Assets	19.7	19.9	19.6	19.3	19.1
Cust . Dep./Int. Bear. Liab.	84.6	85.0	85.4	85.7	86.1
Interbank Dep / Int. Bear.	6.3	7.3	7.2	7.1	7.0
Asset Quality					
NPL / Total Gross Loans	3.0	3.3	3.2	3.1	3.1
NPL / Total Assets	2.0	2.2	2.1	2.0	2.1
Loan Loss Reserve Coverage	84.7	79.8	82.9	89.2	91.8
Provision Charge-Off Rate	0.8	0.8	0.7	0.6	0.5
Capital Strength					
Total CAR	16.1	16.9	18.2	18.3	18.6
Tier-1 CAR	12.8	13.7	15.0	15.3	15.7

NPL ratio highest among peers

Source: Company, DBS Bank

Target Price & Ratings History



S.No.	Date of Report	Closing Price	12-mth Target Price	Rating
1:	21 Apr 16	4.86	4.60	HOLD
2:	27 May 16	4.32	4.60	HOLD
3:	20 Jul 16	4.19	4.60	HOLD
4:	05 Sep 16	4.74	4.80	HOLD
5:	31 Oct 16	5.03	4.80	HOLD
6:	17 Nov 16	4.70	4.80	HOLD
7:	07 Dec 16	4.64	4.80	HOLD
8:	03 Jan 17	4.54	4.80	HOLD
9:	17 Jan 17	4.74	4.80	HOLD
10:	23 Jan 17	4.88	4.80	HOLD
11:	20 Feb 17	5.09	4.80	HOLD
12:	21 Feb 17	5.08	4.80	HOLD

Note: Share price and Target price are adjusted for corporate actions.

Source: DBS Bank

Analyst: Sue Lin LIM

Lynette CHENG

DBS Bank recommendations are based on an Absolute Total Return* Rating system, defined as follows:

STRONG BUY (>20% total return over the next 3 months, with identifiable share price catalysts within this time frame)

BUY (>15% total return over the next 12 months for small caps, >10% for large caps)

HOLD (-10% to +15% total return over the next 12 months for small caps, -10% to +10% for large caps)

FULLY VALUED (negative total return i.e. > -10% over the next 12 months)

SELL (negative total return of > -20% over the next 3 months, with identifiable catalysts within this time frame)

Share price appreciation + dividends

Completed Date: 28 Feb 2017 23:05:00 (MYT)

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DBS Bank Ltd
12 Marina Boulevard, Marina Bay Financial Centre Tower 3
Singapore 018982
Tel. 65-6878 8888
e-mail: equityresearch@dbs.com
Company Regn. No. 196800306E