midf RESEARCH

03 April 2018 | Visit Note

Affin Bank Berhad

Transitioning towards growth

Maintain BUY

***Revised* Target Price (TP): RM2.80**

INVESTMENT HIGHLIGHTS

- **Visited the Group for a review of its earnings prospect as the new listed entity following reorganization.**
- **Earnings will recover in FY18 despite being a transition year.**
- **Recovery will come from lower provisions.**
- **Loans and deposits rebalancing led to income improvement.**
- **Digital offering to be a key driver beyond the "low hanging fruit"**
- **There is still an investment case to be made.**
- **Maintain BUY due to optimism on its prospect. New TP of RM2.80 based on PBV of 0.6x.**

Key take away. We met with the Group recently for an update on the progress of its transformation program and further clarification in regards to its FY17 earnings result. Below are the key take away from our meeting:

- The Group's future earnings should be comparable to Affin Holdings Bhd's (AHB) historical earnings from FY18 onwards, as it will be able to account for its subsidiaries' full year results.
- FY18 will be a transition year.
- The Group will be launching its digital offering this year as one of its platform to drive loans and deposit growth.
- Cost and provisions will normalise.

Initial confusion to its FY17 result. There was some confusion in regards to the Group FY17 earnings result when it was announced in Feb'18. We were not initially able to compare with previous year earnings of the Group or that of AHB. This was due to the fact that the Group's previous year did not account for its newly acquired subsidiaries (from the former parent, Affin Holdings Bhd, stemming from Group reorganization) or that the Group accounted for one quarter of its subsidiaries earnings in FY17. However, from FY18 onwards, the reporting of its results will normalise.

RETURN STATS	
Price (2 April 2018)	RM2.40
Target Price	RM2.80
Expected Share Price Return	+16.7%
Expected Dividend Yield	+4.6%
Expected Total Return	**+21.3%**

STOCK INFO	
KLCI	1,858.35
Bursa / Bloomberg	5185 / ABANK MK
Board / Sector	Main / Finance
Syariah Compliant	No
Issued shares (mil)	1,942.9
Market cap. (RM'm)	4,663.1
Price over NA	0.6x
52-wk price Range	RM2.22–RM2.98
Beta against KLCI)	0.99
3-mth Avg Daily Vol	0.24m
3-mth Avg Daily Value	RM0.58m
Major Shareholders	
LTAT	35.42%
Bank of East Asia	23.52%
Boustead Holdings	20.69%

Some banking abbreviations used in this report:

IA = Individual Impairment Allowance
CA = Collective Impairment Allowance
CI = Cost-Income Ratio
CET1 = Common Equity Tier 1
GIL = Gross Impaired Loan
LD = Loan-Deposit
NII = Net Interest Income
NOII = Non-interest income
NIM = Net Interest margin
CASA = Current and Savings Accounts
IB = Investment Banking
BVPS = Book Value Per Share
LLC = Loan Loss Coverage
OPEX = Operating Expenses
R&R = Restructured and Rescheduled

Available comparison shows net profit (including minority interest) declined. The management did provide with AHB FY17 result on the assumption that there was no reorganization for comparative purpose during the result briefing. It showed that AHB FY17 net profit (including minority interest) would have registered a decline of -7.7%yoy to RM534.9m. This was due to higher OPEX stemming from its voluntary separation scheme (VSS) and provisions. We estimated that discounting the VSS cost, net profit would have declined only by -1.5%yoy to RM570.8m.

Earnings will recover in FY18 despite being a transition year. The management indicated that FY18 will be transition year as the Group rolled out further initiatives, including investments, for its Affinity transformation programs. We understand that the Group had only spent circa RM20m from a budgeted RM300m. However, we expect that earnings will recover in FY18, predicated on lower provisions and potential small savings from VSS.

Recovery will mainly contributed by lower provisions. While we expect that there will be savings from VSS, we believe this savings will be moderated by the cost of new hires and investments needed for its transformation program. As such, we are estimating FY18 OPEX to decline by -0.8%yoy (vs. FY17 OPEX excluding VSS cost) to RM1.17b. As an additional note, we understand that hiring have been frozen for FY18. In regards to the provisions, we expect that there will be write backs from two accounts which were accounted as impaired as it was rescheduled and restructured. We understand that these accounts to continue to be performing and fully covered. It is possible for these loans to be reclassified in 1HFY18. Taking everything into consideration, we are projecting FY18 net profit before minority interest to grow +4.8%yoy to RM598.4m. The FY18 earnings growth is based from normalised FY17 AHB earnings, i.e. excluding VSS cost.

Loan and funding portfolio readjustment contributed to income growth. The Group registered NIM of 2.02% in FY17. Meanwhile, AHB FY17 NIM was 2.20%, a +22bps improvement from FY16. The better NIM was due to portfolio readjustment in terms of lending and deposits. The Group had exited from several low yielding revolving credit and will be replacing it with better yielding asset. We understand it now has a yield threshold of any new lending. Similarly, it had exited from higher costing Negotiable Instruments of Deposit. However, we noted that it had increased its fixed deposits and this might be a concern as it might put NIM under pressure later. More preferably would be higher growth in CASA.

Beyond low hanging fruits. We view the portfolio readjustments as "low hanging fruit" in terms of income improvement and we are concerned on the sustainability of its growth. However, our concerns were allayed as the Group clarified on its future plans to drive loans and deposits growth amongst others. Part of its strategy is to launch a digital offering which it is lacking at presently. We understand that this will be in FY18. We believe that it is important for the Group to have a digital offering, which includes mobile banking, due to changing demographics and prevalent of technology. The Group is confident that with the launch of its digital offering, it will be able to attract new customers in terms of new depositors and borrowers. There will be an emphasis on attracting retail clients and SMEs in order to change the profile of its customers, which currently are skewed towards corporates. In our opinion, this will be one of the key to ensure earnings improvement are sustained as it will be able to attract CASA deposits, better yielding loans and, lessen volatility in loans and deposits.

Focusing on the right segment. Besides attracting CASA, we understand that the Group will also focus on mortgages, hire purchase and SME loans as the driver for its loans growth. The Group will be focusing on loans for affordable housing which in our opinion still has robust demand. Meanwhile, the choice to focus on hire purchase was surprising to us. However, we understand this will be targeted towards certain middle to high end brand which, given the borrowers' profile, lessen the risk of defaulting. On SMEs, the Group have built a dedicated team to drive this initiative forward. It has improved on the turnaround time and opened 16 business centres, i.e. more akin to a one-stop centre. We believe that amongst the advantage of this targeted approach and the digital offering will the bundling of its product. For example, the bundling of SME loans with CASA and cash management services. This will also drive fee income that can be derived from its customers. As such, we are estimating a gross loans growth of +5.7% and deposits growth of +4.4%yoy for FY18.

There is still an investment case. We continue to be encouraged by the Group's future outlook. We believe that the Group's prospect remains a medium to long term as it has yet to fully complete its transformation, while its relatively small size allows it to be nimble to institute changes needed and will be able to be realised some of the benefits in the short term. Observing the improvements that the Group have made in the previous few quarters have led us to conclude that the Group is moving in the right direction. Consequently, we opine that the transformation will leave the Group on a better footing. We also maintain our view that the Group is building its niche and believe that this will ensure future profitability.

FORECAST

After our review and following from our visit, we are introducing our FY18 and FY19 earnings estimates for the Group.

VALUATION AND RECOMMENDATION

We believe that there are still pockets of opportunity still present for Group. For example, in Islamic Banking and NOII. The higher cost incurred in FY17 will normalise as the Group continue with its Affinity transformation program. We expect this to also apply with credit cost in FY18. Hence, we expect that earnings will recover this year. Going forward, we believe that the transformation will place the Group in a firmer footing, with its digital offering to be a key component. As we are maintaining our optimistic view of the Group, we make no change to our **BUY** call for the stock. Following our review of Affin Bank Bhd as the new financial holding company, our new TP for the stock is **RM2.80** based on PBV of 0.6x.

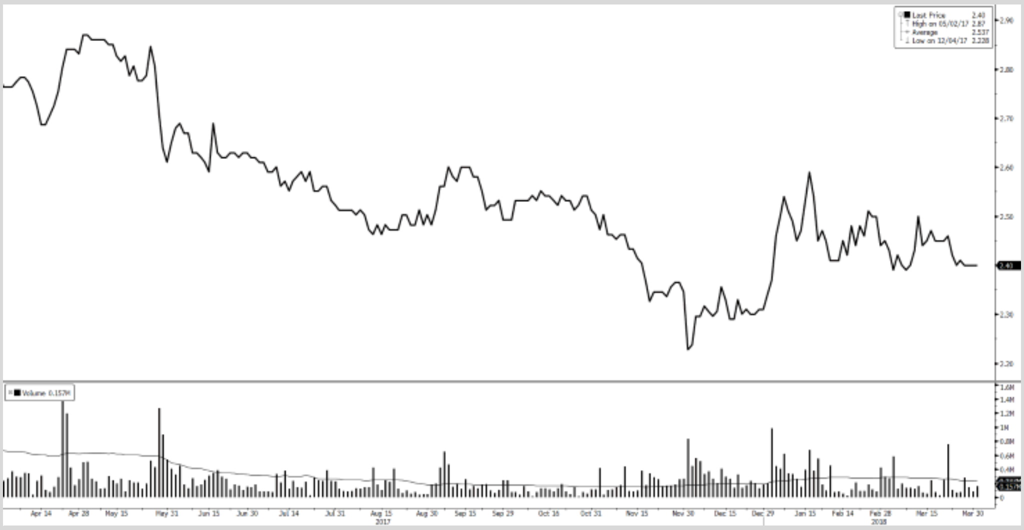
INVESTMENT STATISTICS

FYE Dec	FY16*	FY17	FY18F	FY19F
Net Interest income (RM'm)	971	855	973	1,085
Islamic Banking income (RM'm)	273	334	384	404
Other income (RM'm)	693	371	667	699
Net/Total income (RM'm)	1,936	1,560	2,024	2,188
Pretax Profit (RM'm)	738	551	762	901
Net Profit (RM'm)	564	418	588	698
EPS (sen)	29	24	30	36
EPS Growth (%)	52.6	-17.2	26.1	18.6
PER (x)	8.3	10.0	7.9	6.7
Net Dividend (sen)	11	2.3	11.0	12.0
Net dividend yield (%)	4.6	1.0	4.6	5.0
Book value per share (RM)	4.47	4.26	4.53	4.74
PBV (x)	0.5	0.6	0.5	0.5
ROE (%)	6.5	5.1	6.7	7.6

* Based on Affin Holdings Bhd as the financial holding co. of the Group.

Source: Company, MIDFR

DAILY PRICE CHART



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MIDF AMANAH INVESTMENT BANK : GUIDE TO ROMMENDATIONS	
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	*Negative* total return is expected, by -10% or more, 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.