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23 October 2018 | Visit Note

CIMB Group Holdings Berhad

Income weakness will be moderated by OPEX and provisions

***Maintain* BUY**

***Unchanged* Target Price (TP): RM7.85**

INVESTMENT HIGHLIGHTS

- **Headwinds in FY18 income remains due to challenging NII in Indonesia and NOII in Malaysia**
- **Lower OPEX and provisions will be a moderating factor**
- **Situation in Thailand continue to improve**
- **No undue concern in asset quality**
- **No change to our forecast**
- **Maintain BUY with unchanged TP of RM7.85 pegging the stock to 1.4x FY19 Price-to-Book multiple**

Meeting with management. We met with the Group's CFO yesterday. Below are some of the key take away from our meeting:

- Management are expecting for weaker FY18 income due to the NIM compression in Indonesia and volatile market condition in Malaysia.
- Situation in Thailand looking better overall.
- No undue worries on NIM compression (except Indonesia) or asset quality.
- CI ratio will likely flatten for the next couple of years due to investments.

Indonesia will continue to be challenging. The management expect that the situation in Indonesia, particularly in relation to NII, will continue to be challenging for the next 6 to 9 month. This is due to the fact that NIM continue to be compressed resulting from aggressive rate hike by Bank Indonesia. We understand that in Indonesia following a rate hike, deposits are repriced first while there would be significant time lag before loans are repriced. While this NII gap will be moderated by better NOII, OPEX and provisions, we understand that it will not be completely offset.

Weaken rupiah will also be an impact. Also, there would be translational impact due to the weaken rupiah. It was estimated that the weaken rupiah vs. ringgit had caused a negative translation impact of circa RM200m to Group's topline. We expect that Indonesia will continue to be drag for the Group's earnings at least until 1HFY19. To put into context, CIMB Niaga contributes circa 15-17% of Group's PBT.

RETURN STATS	
Price (22 October 2018)	RM5.98
Target Price	RM7.85
Expected Share Price Return	+31.3%
Expected Dividend Yield	+4.4%
Expected Total Return	+35.6%

STOCK INFO	
KLCI	1,722.47
Bursa / Bloomberg	1023 / CIMB MK
Board / Sector	Main / Finance
Syariah Compliant	No
Issued shares (mil)	9,365.8
Market cap. (RM'm)	56,007.5
Price over NA	1.1x
52-wk price Range	RM5.21 – RM7.39
Beta (against KLCI)	1.50
3-mth Avg Daily Vol	12.01m
3-mth Avg Daily Value	RM70.67m
Major Shareholders	
Khazanah	27.37%
EPF	13.42%
KWAP	7.25%

Some banking abbreviations used in this report:
CA = Collective Impairment Allowance
CI = Cost to Income
CET1 = Common Equity Tier 1
GIL = Gross Impaired Loan
NPL = Non Performing Loan
LD = Loan-Deposit
NII = Net Interest Income
NOII = Non-interest income
NIM = Net Interest margin
CASA = Current and Savings Accounts
COF = Cost of Funds
IB = Investment Banking
LLC = Loan Loss Coverage
PPOP = Pre-Provisioning Operating Profit

NOII weakness in Malaysia but will normalise in FY19. The management also expect that there will be weakness in NOII in Malaysia due to the volatile market condition following the surprise GE14 outcome. This had led to slower market activities from May to June. Recall, NOII declined -6.1%yoy to RM2.37b in 1HFY18. We understand that corporates have delayed fund raising as it seek further clarity on the policy direction of the Government. As such, we believe that there could be some clarity after the announcement of Budget 2019 next week. Hence, we believe that the weakness in NOII in Malaysia will normalise in FY19.

Relief may come from potentially lower OPEX and credit cost. We noted that the Group managed to perform within our expectation in 1HFY18 despite the pressure to income. As such, we believe that there will be moderating factors to offset the weakness in income, namely in the form of lower OPEX and credit cost. Cost management initiatives will be accelerated. Meanwhile, credit cost is expected to come in at lower end of guidance of 55 to 60bps, and may potentially be even lower than expected. This is expected to stem from some recoveries in addition to stable asset quality.

Situation in Thailand continue to improve. We understand that CIMB Thai's earnings continue to improve with robust income growth and lower provisions following from asset rebalancing there. Recall, CIMB Thai rebalanced its loans book to shrink its exposure to SMEs there in particularly in the agricultural sector. The higher OPEX growth in 9MFY18 (+10.8%yoy to THB6.02b) was due to hiring of personnel which we indicate as a positive sign.

No undue concern over margins (except for Indonesia) and asset quality. The management expect that NIM elsewhere will remain flattish when compared to previous period as it has not observed any undue competitions in deposits especially in Malaysia. Therefore, Indonesia will be the main reason for NIM compression in FY18. In terms of asset quality, we echo the management's expectation in that there will be no undue stress. In fact, we have seen improvements in asset quality in Indonesia.

CI ration will plateau in the next couple of years due to investment in digitalisation. Recall, the management indicated that the Group will need to make investments in order to not only enhance its digital offerings but also streamline its processes. As such, it expects CI ratio to plateu around the 50% level in the next couple of years. However, we believe that this is necessary as the Group will need to keep up with its peers. In addition, we expect the investments in technology will result in cost savings such as improvement of its branch network, lower personnel cost and lower customer acquisition cost. We believe that it is possible for CI ratio to trend downwards towards the mid-40% level after the completion of its digital initiatives. Nevertheless, we opine that the Group's digital strategy may not have an immediate impact and can only assume that any benefit will be seen only in the medium term, i.e. 3 to 4 year period.

FORECAST

We make no changes to our forecast pending the Group's 3QFY18 result next month.

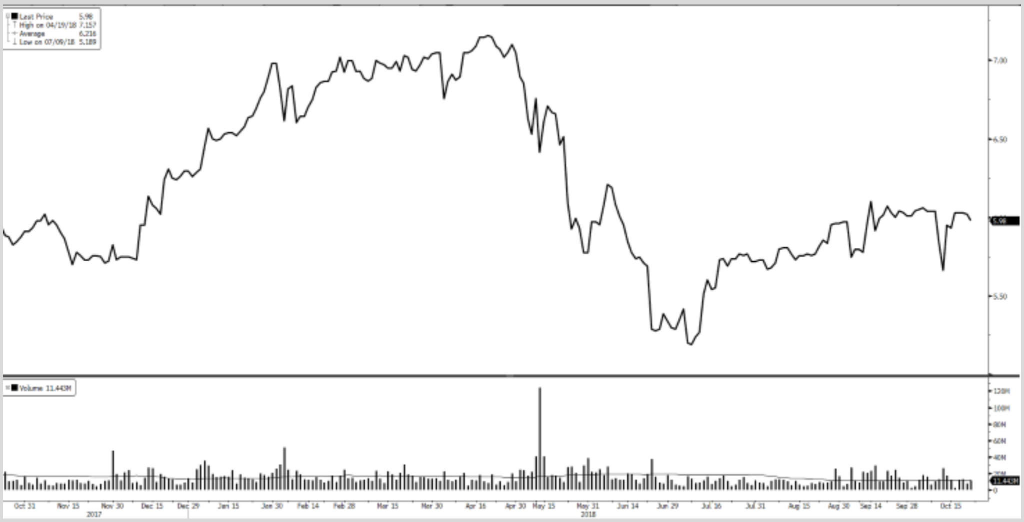
VALUATION AND RECOMMENDATION

While we recognized that the Group may be facing some headwinds in terms of its income this year, we also opine that lower OPEX and provisions will be a moderating factor. In fact, the Group have been performing more or less within our expectations thus far. We believe that some of the headwinds will normalise in FY19 and the Group's earnings potential remains intact. Therefore, we do not see a reason to change our **BUY** recommendation. Our **TP of RM7.85** remains unchanged and is based on pegging its FY19 BVPS to PBV multiple of 1.4x.

INVESTMENT STATISTICS OF CIMB GROUP

FYE Dec	FY16	FY17	FY18F	FY19F
Net interest income (RM'm)	9,826	10,459	10,980	11,415
Islamic banking income (RM'm)	1,704	2,132	1,951	2,068
Non-interest income (RM'm)	4,386	5,036	5,851	6,144
Total income (RM'm)	16,065	17,626	18,782	19,627
Pretax profit (RM'm)	4,884	6,110	7,366	7,434
Net profit	3,564	4,475	5,732	5,785
Core Net profit (RM'm)	3,564	4,475	4,985	5,785
Core EPS (sen)	41	50	61	58
PER (x)	14.6	12.1	9.8	10.1
Net Dividend (sen)	20	25	26	26
Net Dividend Yield (%)	3.3	4.2	4.4	4.3
Book value per share (RM)	5.11	5.23	5.54	5.88
PBV (x)	1.2	1.1	1.1	1.0
ROE (%)	8.3	9.6	11.3	10.3

DAILY PRICE CHART



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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	*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.