

23 Apr 2015 | Corporate Update

CIMB Group Holdings Bhd

High provisioning to impact Niaga's earnings in 1HFY15

Maintain NEUTRAL

Unchanged Target Price (TP): RM6.20

INVESTMENT HIGHLIGHTS

- **High provisioning for loan losses at CIMB Niaga (Niaga) to continue until 2QFY15.**
- **Niaga to focus on high quality Wholesale Banking (Commercial & Corporate) loans with lower yields.**
- **NIM pressure to persist for both CIMB Niaga and Thai.**
- **Loan growth for CIMB Niaga decelerated due to its strategy to focus on higher quality credits.**
- **Maintain NEUTRAL with unchanged TP of RM6.20 on CIMB Group.**

Operating environment continues to look challenging for Niaga.

For 1QFY15, Niaga recorded a modest growth in operating income of +0.7%yoy to IDR3.4t. Weaker NOII growth continued to dampen the top line growth of Niaga. Softer Treasury market activities and weaker bancassurance (banca) income from the new banca regulations imposed effective Mar'14 have resulted in the decline of its NOII.

Weaker commodity prices and IDR are expected to continue to pose challenges to the operating environment in Indonesia.

Provision for loan losses likely to remain elevated in 2QFY15 but lower than the preceding two quarters.

Although Niaga still reported high impairments for loan losses largely on its coal and coal related loans in 1QFY15, the amount of provision expenses for loan impairment was lower compared to 4QFY14.

Moving ahead, provision for loan losses is expected to remain elevated in 2QFY15 but the amount may be lower than 1QFY15 and 4QFY14. In 2HFY15, provision expenses are likely to trend lower for Niaga consequently leading to improved earnings.

We view that the significant jump in provisions for loan impairment in 1QFY15 as a stringent approach in raising the loan loss coverage ratio for Niaga to 102.6%.

On year-on year basis, NIM was flat for Niaga but still contracting for CIMB Thai in 1QFY15. Recall OJK in Oct'14 OJK imposed a cap on the maximum rates to be paid for Time Deposits.

RETURN STATS	
Price (22 Apr 2015)	RM6.24
Target Price	RM6.20
Expected Share Price Return	-0.6%
Expected Dividend Yield	+3.2%
Expected Total Return	+2.6%

STOCK INFO	
KLCI	1,854.77
Bursa / Bloomberg	1023 / CIMB MK
Board / Sector	Main / Finance
Syariah Compliant	No
Issued shares (mil)	8,423.70
Par Value (RM)	1.0
Market cap. (RM'm)	52,564.2
Price over NA	1.4x
52-wk price Range	RM5.05 – RM7.56
Beta (against KLCI)	1.25
3-mth Avg Daily Vol	8.81m
3-mth Avg Daily Value	RM51.90m
Major Shareholders	
Khazanah	29.31%
EPF	16.33%

Some banking abbreviations used in this report:

CI = Cost-Income Ratio
 CAR = Capital Adequacy Ratio
 GIL = Gross Impaired Loan
 LDR = Loan-Deposit Ratio
 NII = Net Interest Income
 NOII = Non-interest income
 NIM = Net Interest margin
 CASA = Current and Savings Accounts
 COF = Cost of Funds
 PPOP = Pre Provision Operating Profit
 OPEX = Operating Expenses
 OJK = Otoritas Jasa Keuangan

As a Bank classified under BUKU III category, this limits the rates for deposits below IDR2b at the insurance deposit rate (currently RM7.75%) while rate for deposits of >IDR2b have been capped at BI+2.25%. The imposed interest cap on time deposits by OJK has helped to improve Niaga's NIM to 5.63% in 4QFY14 but in 1QFY15, Niaga's NIM slipped to 5.22%. This is due to its focus on higher quality credits with lower yields as well as due to a lower LD ratio. Niaga's strategy to shift its loan mix more towards higher quality credits is expected to cause further pressure on its NIM ahead. We understand that this adjustment in asset/loan mix is expected to be ongoing until 1HFY16. Management has guided for Niaga's NIM to trend below 5.00% for FY15. Recall that BI has cut the benchmark interest rate in Indonesia by 25bp to 7.5% in Feb'15 which we believe is to lower the currency, IDR and boost exports for stronger economic growth as inflation pressure subsides. Looking at Niaga's NIM in 1QFY15, Niaga has not benefitted much on lowering its COF from the reduction of the BI rate in Feb'15.

Meanwhile, NIM for CIMB Thai contracted to 2.95% in 1QFY15 (4QFY14: 3.40%) due to higher COF, higher mix of lower yield assets and slower loan growth. We continue to expect pressures on CIMB Thai's NIM ahead. This is in view of its loan growth which is likely to continue to be still impacted by the slow economic growth in Thailand.

Loan growth trended lower for CIMB Niaga and Thai. Niaga's gross loans moderated to 9.6%yoy in 1QFY15 (4QFY14: 12.4%yoy) due to a shift in focus to high quality credits. Commercial, SME Banking and Corporate Banking loan growths were seen slower at 3.3%yoy, 10.9%yoy and 16.3%yoy respectively. Meanwhile, consumer loans growth gained momentum to 6.6%yoy with a strong growth in personal and credit loans of 33.2%yoy and 32.0%yoy respectively. Moving ahead, Niaga will shift its focus on growing its Wholesale Banking (Commercial and Corporate loans). It aims to grow working capital loans for Commercial and Corporate borrowers which are of higher credit quality and lower yields. Management highlighted that through this strategy, it will be able to cross sell on FX, transaction banking services and cash management services to grow its CASA consequently lifting its NOII.

For CIMB Thai, gross loan growth was slower at 10.9%yoy. With the slower economic growth in Thailand, we expect CIMB Thai's loan momentum to be at a slow pace for the remaining quarters of FY15.

Deposit growth slower than industry but CASA above industry growth rate for Niaga. Niaga's customer deposit growth accelerated to 12.5%yoy against the industry's 14.7%yoy in 1QFY15. Meanwhile, its CASA growth improved to 9.1%yoy ahead of the industry's 7.1%yoy. CASA ratio for Niaga continues to remain stable at 43.4%.

Gross NPL ratios for Niaga and CIMB Thai still rising. For Niaga, Gross NPL ratio continued to rise to 4.07% in 1QFY15 from 3.9% in 4QFY14. The jump in NPL ratio was largely to the NPLs of Commercial and Corporate loans at Niaga while the NPL ratios for Consumer and SMME and Consumer loans were relatively more stable. Meanwhile, gross impairment ratio which is a leading indicator showed an increase to 5.33% vs. 4.79% in the previous quarter.


For 2QFY15, Niaga's NPL ratio is expected to rise in tandem with more provisions for loan impairments. For FY15, management has guided its gross NPL to be between 4.0-4.5% while its net NPL is likely to be below or close to 2.0% (1QFY15 net NPL ratio: 1.81%). The percentage of Niaga loans classified under Special Mention also rose to 5.92% in 1QFY15 from 4.33% in 4QFY14. Management continues to be cautious on coal sectors as well as the manufacturing and garment sector for lending. We gather that coal and coal related NPL's comprise of 40% of Niaga's total NPLs. On the comforting side, we understand that the coverage ratio for the NPLs of its coal and coal related loans is high at 60%.

For CIMB Thai, its gross NPL ratios rose to 3.7% in 1QFY15 from 3.3% in 4QFY14. This was contributed by the recognition of several corporate loans as NPL due to slower repayment.

Change of key leadership position at Niaga. With the retirement of Niaga's President Director, Arwin Rasyid, Tigor M.Siahaan has been appointed as his replacement at the AGM. The change in President Director is now subject to OJK's approval and Tigor M.Siahaan is expected to take office on 1st June.

VALUATION AND RECOMMENDATION

We leave our earnings forecasts unchanged for now pending our meeting with the management on 27th April. In summary, operating environment in Indonesia and Thailand is expected to remain challenging with potentially further provisions for loan impairment. The high provisions for loan impairment for Niaga are expected to continue in 2QFY15. Indonesia's economy is likely to improve only in 2HFY15 with government spending for infrastructure.

Niaga will focus on growing high quality corporate and commercial loans. This will result in further pressure on Niaga's NIM. We expect pressure on NIM to persist for both Niaga and CIMB Thai. We maintain our NEUTRAL recommendation on CIMB Group with an unchanged TP of RM6.20, pegging the stock to 1.3x PB multiple on FY15 BVPS. 

INVESTMENT STATISTICS OF CIMB GROUP

FYE Dec	FY13	FY14	FY15F	FY16F
Net interest income (RM'm)	7,954	8,656	9,139	9,932
Islamic banking income (RM'm)	1,593	1,461	1,636	1,679
Non-interest income (RM'm)	4,600	4,029	4,107	4,352
Total income (RM'm)	14,672	14,146	14,881	15,963
Pretax profit (RM'm)	5,849	4,276	5,420	5,710
Net profit (RM'm)	4,540	3,107	4,228	4,454
Core Net profit (RM'm)	4,188	3,159	4,228	4,454
EPS (sen)	60.0	37.5	50.0	53.0
Core EPS (sen)	55.3	38.1	50.0	53.0
PER (x)	11.3	16.4	12.5	11.8
Net Dividend (sen)	23.8	21.0	20.0	21.0
Net Dividend Yield (%)	3.8	3.4	3.2	3.4
Book value per share (sen)	3.92	4.44	4.80	5.13
PBV (x)	1.6	1.4	1.3	1.2
ROE (%)	15.5	9.2	10.7	10.5

*Lower than FY13 as we have taken into account a higher number of shares from its DRP as well as from share private placement exercise in Jan'14

Forecast by MIDFR

DAILY PRICE CHART



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RESULTS HIGHLIGHTS OF CIMB NIAGA

Quarterly results						Comments
FYE Dec (Rp b)	1Q15	4Q14	1Q14	Yoy (%)	Qoq (%)	
Net interest Income	2,798	2,904	2,525	+10.8	-3.7	Higher yoy due to loan expansion of 9.6%yoy while NIM was flat yoy at 5.22%.
Net non interest income	604	806	855	-29.4	-25.1	Lower yoy due to weaker Treasury market activities and lower bancassurance income.
Operating Income	3,402	3,710	3,380	+0.7	-8.3	Flat yoy dampened by lower NOII
OPEX	(1,848)	(1,687)	(1,698)	+8.8	+9.5	OPEX growth in line with Indonesia's inflation rate of 8.4%. Personal cost higher due to pay increase of 8.0% for employees, implementation of new social security scheme and realignment of medical benefits.
PPOP	1,554	2,023	1,682	-7.6	-23.2	
Provision expenses	(1,446)	(1,959)	(201)	+619.4	-26.2	Provision for loan impairment of coal and coal related loans still high but total provisions in 1QFY15 lower than 4Q14.
Pre-tax profit (PBT)	108	64	1,481	-92.7	+68.8	
Tax	(25)	(18)	(381)	-93.4	+38.9	
Profit after tax	83	46	1,100	-92.5	+80.4	
Minority Interest (MI)	(0.0)	(0.1)	1,590	-100.0	-100.0	
Net profit after tax and MI	83	46	1,098	-92.4	+80.4	
EPS (IDR)	3.29	1.85	43.71	-92.5	+77.8	

Financial Ratios (%)	1Q15	4Q14	1Q14	Yoy (+/- pts)	Qoq (+/- pts)	Comments
NIM*	5.22	5.63	5.22	-	-0.41	Flat yoy but on qoq declined due to focus on higher quality credits and lower LD ratio.
Cost to income	54.31	45.46	50.24	+4.1	-99.8	
Loan to deposit (LD)	95.79	99.46	98.37	-2.6	-195.3	Liquidity remains tight.
Gross NPL	4.07	3.90	2.57	+1.5	-8.0	
Loan loss coverage	102.60	88.78	98.75	+3.8	-191.4	Increase in provisions lifted ratio above 100%.
CAR	16.46	15.58	16.41	+0.1	-32.0	
ROE	1.15	0.66	16.67	-15.5	-1.8	

RESULTS HIGHLIGHTS OF CIMB THAI

Quarterly results						Comments
FYE Dec (THB m)	1Q15	4Q14	1Q14	Yoy (%)	Qoq (%)	
Net interest Income	1,914	2,107	1,855	+3.2	-9.2	
Net fee and services income	410	408	319	+28.5	+0.5	Higher yoy contributed by higher fees from insurance premium
Non interest and fee Income	639	254	524	+21.9	+151.6	Losses of THB156.9b on financial liabilities at FV were reported for 1QFY15 against a gain of THB44.7b in 1QFY14. Gain in investments declined 30.4%yoy or by RM60.9m
Total Operating Income	2,963	2,769	2,698	+9.8	+7.0	
OPEX	(1,782)	(1,936)	(1,678)	+6.2	-8.0	
PPOP	1,181	833	1,020	+15.8	+41.8	
Provision expense	1,022	720	470	+117.6	+41.9	
Pre-tax profit (PBT)	159	113	550	-71.1	+40.7	
Tax	(29)	(24)	(110)	-73.6	+20.8	
Net profit after tax and MI	130	89	440	-70.4	+46.1	

Financial Ratios (%)	1Q15	4Q14	1Q14	Yoy (+/- pts)	Qoq (+/- pts)	Comments
Cost to income	60.1	69.9	62.2	-2.1	-9.8	
Loan to deposit (LD)	91.8	90.1	92.4	-0.6	+1.7	Represents modified LD ratios where Bill of Exchanges, Debentures and selected Structured Deposit Products have been included in deposits
NIM	2.95	3.40	3.27	-0.3	-0.5	Contracted due to higher mix of lower yielding assets, rise in COF and slower loan growth
Gross NPL	3.7	3.3	3.1	+0.6	+0.4	Higher due to recognition of NPL for several corporate loans where loan repayments have turned slower
Loan loss coverage	94.1	95.2	100.6	-6.5	-1.1	Lower to due to increase in provisions by 117.6%yoy
Tier 1 Capital	9.7	10.1	10.1	-0.4	-0.4	
BIS ratio	14.5	15.2	13.4	+1.1	-0.7	

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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.