

# SECTORAL OUTLOOK

## BANKING SECTOR INSIGHTS

### Weathering the Headwinds

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## MARC'S BANKING OUTLOOK



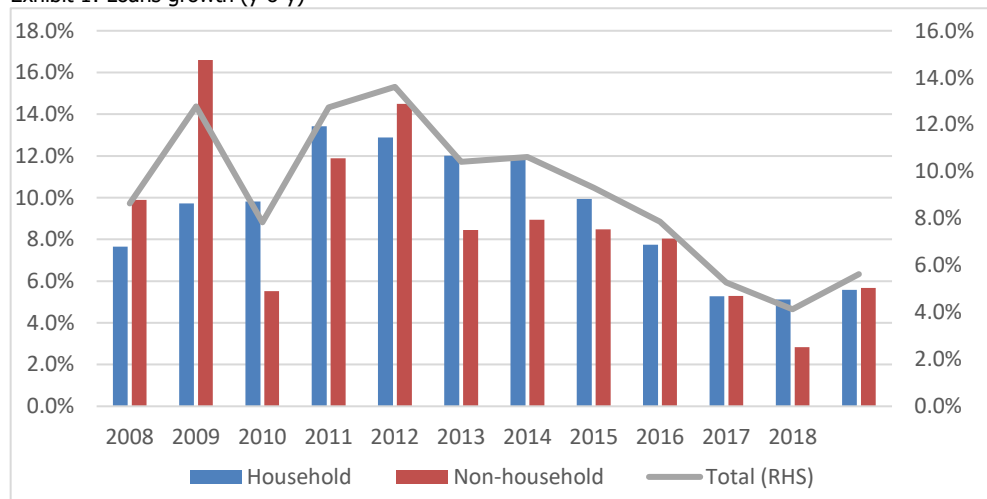
## INTRODUCTION

- Despite the challenging and uncertain economic environment, domestic commercial banks' performance has thus far remained on a good footing by all measures, from earnings and revenues to capital levels, asset quality and performance ratios. Overall impaired loans and delinquencies for banks have remained low. Banks have also strengthened loan loss provisioning requirements pursuant to their adoption of *MFRS 9 Financial Instruments* in 2018. The provisioning practice requires additional provisions to be set aside at the initiation of a financing to cover expected losses. Banks' burden of adjustment is expected to be relatively moderate based on available quantitative estimates of the corresponding decrease in regulatory capital.
- Economic growth, while moderating, remains healthy and should help keep credit quality for the banking sector within predictable boundaries. Overall, we expect asset quality to remain reasonably well controlled. MARC expects system-wide profitability to remain relatively healthy despite moderating earnings momentum on account of slowing loan growth and compressing net interest margins (NIMs). Pressure on profits has also come from the rising cost of risk management and compliance. Banks' operational risk management and compliance burden have increased significantly following the introduction of new regulations and financial reporting requirements since the global financial crisis.
- Crucial to the near-term outlook will be the supportiveness of the fiscal and monetary policy mix in the months ahead. We see the rate cut in the overnight policy rate (OPR) by Bank Negara Malaysia (BNM) in May 2019 as a pre-emptive move to provide support to the domestic economy amidst signs of tightening financial conditions.

## LOWER LOAN GROWTH

### Days of rapid growth are over

Exhibit 1: Loans growth (y-o-y)



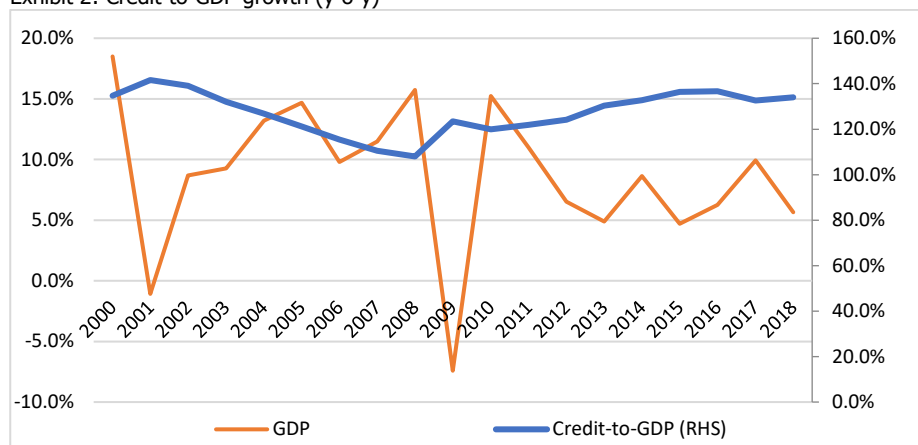
Source: BNM, MARC

As shown in Exhibit 1, the banking system's loan growth has steadily declined since its last peak in 2011. In 2018, the banking system registered loan growth of 5.6% y-o-y. Even though this was higher than the 4.1% registered in 2017, the loan growth was lower than its 2011 peak of 13.6%, as well as the 7.8% recorded in the last cycle in 2009. The half-year numbers ended June 2019 showed a further decline in loan growth to 4.2% y-o-y. We believe banks could be showing greater credit risk aversion because of uncertainty over the economy, among other factors. MARC expects loan growth of around 4%-5% for the whole of 2019.

The slowing pace of household loan growth has also occurred against the backdrop of BNM's responsible lending measures. With household debt as a percentage of income still high and not expected to reduce meaningfully in the near term, a loosening of macroprudential measures to ease household leverage in relation to household financing products is unlikely to happen any time soon. Elevated non-financial corporate sector debt levels are also expected to put a dampener on the demand for funds among borrowers. The business sector's debt-to-equity ratio stood higher at 49.3% in 2018 from 39.1% in 2013<sup>1</sup>. The main takeaway from recent past defaults in the oil and gas sector is that at elevated debt levels, substantial stress events can very quickly render debt much less affordable and potentially exert abrupt pressure on credit quality.

<sup>1</sup> BNM's Financial Stability and Payments System reports

Exhibit 2: Credit-to-GDP growth (y-o-y)



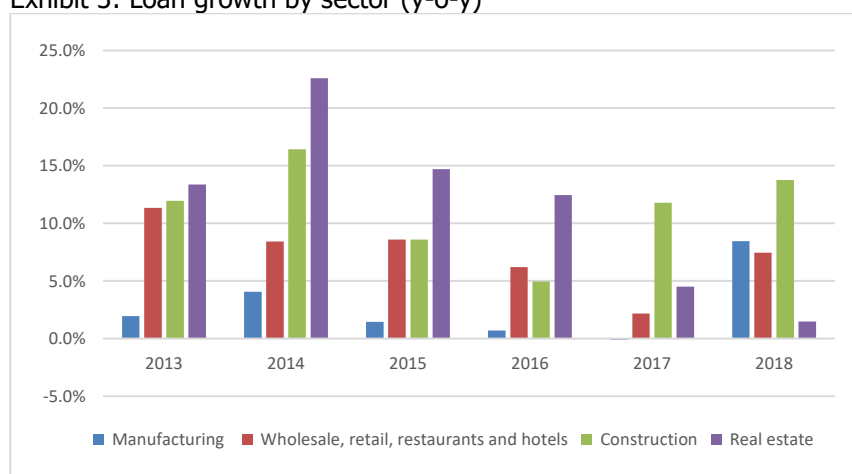
Sources: Department of Statistics Malaysia, Bank for International Settlements

Rapid credit growth in previous years has steadily increased the ratio of the country's credit-to-gross-domestic product (GDP) (Exhibit 2). As at end-2018, Malaysia's credit-to-GDP (defined as total credit to the private non-financial sector as a percentage to GDP) stood at 134.0%, approaching those of high-income countries (Singapore: 171.0%; US: 150.6%; UK: 170.7%)<sup>2</sup>. While high debt ratios can be more easily sustained in a low interest rate environment, as is currently the case, what also counts is whether debt service can also be sustainable as the banking sector adapts to an environment of lower growth. In this context, MARC considers the recent trend of lower loan growth and macroprudential measures put into place to curb a debt surge to be encouraging.

Malaysia's total household debt-to-GDP ratio eased further for the fourth consecutive year to a still-high 83.0% at end-2018 (2017: 83.8%) on the back of moderating housing and motor vehicle loan growths. Reduced housing affordability, particularly among low- to middle-income households, points to slower growth in housing loans in the months ahead.

### Plateauing demand for loans from business enterprises

Exhibit 3: Loan growth by sector (y-o-y)



Sources : BNM, MARC

In 2018, construction activities in the civil engineering sub-sector remained active, underpinned by the steady progress of ongoing transportation, petrochemical and power plant projects (Exhibit 3). Construction activity is expected to benefit from the recently announced revival of the East Coast Rail Link and Bandar Malaysia

<sup>2</sup> Bank for International Settlements

projects. Last year's post-election review of mega construction projects by the government resulted in a lower order book replenishment of domestic contractors. Correspondingly, loans applied and approved for the sector were also lower during the year (Exhibits 4 and 5).

Exhibit 4: Loans applied by sector (RM mil)



Source BNM, MARC

Exhibit 5: Loans approved by sector (RM mil)

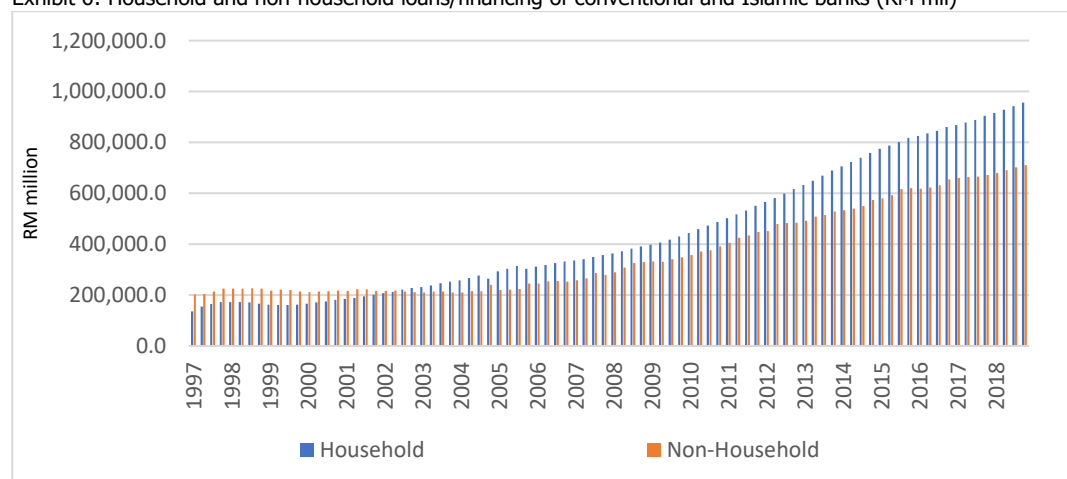


Source BNM, MARC

The manufacturing and wholesale trade sectors picked up the slack from the moderation in construction financing growth in 2018, evidenced by the increasing loan applications and approvals from these sectors. Global frontloading activities, in anticipation of higher trade tariffs between the US and China, have supported manufacturing activities, particularly in electrical and electronics production. However, this could be short-lived as headwinds posed by the US-China trade war test the resilience of the mainly export-oriented manufacturing sector in the months ahead.

### Loan growth is driven by household segment

Exhibit 6: Household and non-household loans/financing of conventional and Islamic banks (RM mil)



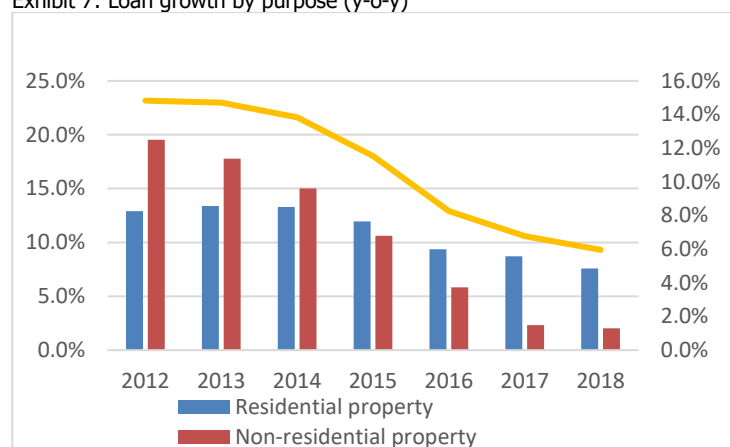
Sources: BNM, MARC

To date, loans to households continue to be the largest driver of banking sector loan growth, overtaking non-financial corporate sector financing after the turn of the millennium (Exhibit 6). The increasing importance of retail loan books to domestic banks coincided with rising household incomes and the expansion of the middle-income population segment. Banks with strong market presence and extensive branch network continue to possess competitive advantages at this juncture although the landscape could still change considerably in



response to the country's changing demography, customer expectations, regulation and technology. Banks' retail loan books provide greater loan diversification compared to corporates and about two-thirds of household borrowing is secured by properties or securities, which is beneficial from a credit loss exposure perspective. Support for this view comes from residential mortgages' historically low write-off ratios relative to other loan portfolio segments.

Exhibit 7: Loan growth by purpose (y-o-y)



Sources : BNM, Marc

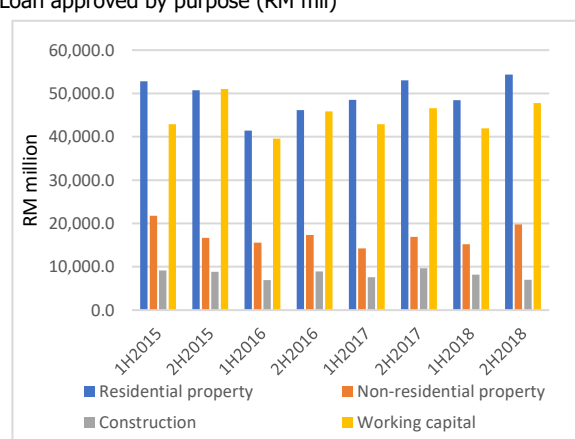
A significant portion of household loan growth came from residential lending, which contributed 44% of the loan growth in 2018. Loans for residential property grew in line with the higher volume of residential property transactions prior to 2015. This has since moderated mainly due to tighter lending criteria (Exhibit 7). In 2018, lending applications and approvals for purchase of residential property were sustained at levels that should keep the residential lending pipeline healthy for 2019 (Exhibits 8 and 9). Reduced housing affordability, however, will continue to weigh on the growth of the banking system's major loan portfolio.

Exhibit 8: Loan applied by purpose (RM mil)



Sources : BNM, MARC

Exhibit 9: Loan approved by purpose (RM mil)



Sources : BNM, MARC

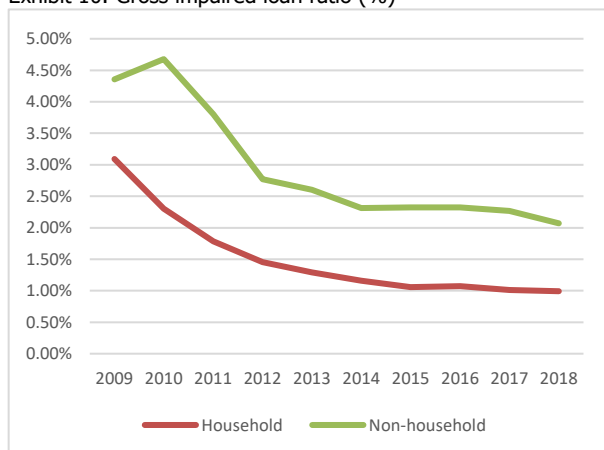


## Potential asset quality pressures from property market

Property sector financing growth has slowed since 2016 as a consequence of macroprudential measures implemented to cool the property market. In 2018, Malaysian banks' total exposure to the domestic property market grew at a slower pace of 6.0% (2015-2017 average: 8.9%). Growth in applied and approved loans for residential properties was somewhat muted at -0.1% and 1.2% in 2018 compared to the double-digit growth recorded the year before. At over 33% of their total lending in 2018, residential mortgages remain a substantial part of commercial banks' (including Islamic banks) retail lending. Potential areas of credit risk that warrant monitoring are commercial real estate credit exposures in the oversupplied luxury high-rise residential, office space and shopping complex segments. Given the current property overhang levels across the residential and commercial sectors, asset quality could noticeably decline for banks with exposures at the weaker end of the credit quality spectrum if the economic environment weakens. Overall, we believe that there is no near-term recovery in sight for the property market given the affordability issues, rising unsold units and the challenging economic outlook. Moreover, the banking system has not been tested by a housing downturn since 1998. Nevertheless, the cooling measures instituted by the government to curb property market speculation have, in our view, helped contain the risk of a potential housing bubble to some extent.

## STABLE ASSET QUALITY

Exhibit 10: Gross impaired loan ratio (%)



Sources: BNM, MARC

Exhibit 11: Impaired loans (RM mil)

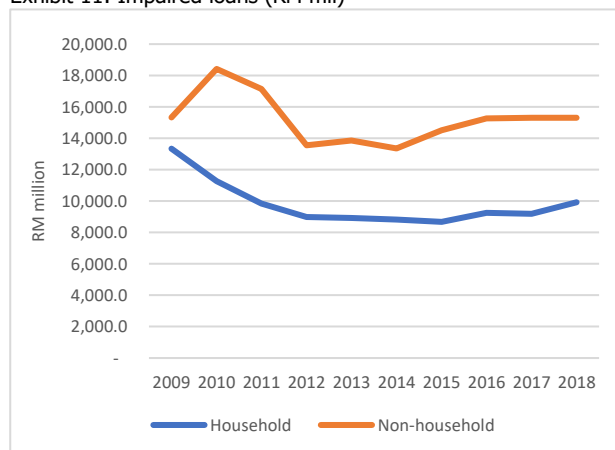


Exhibit 10 shows that the quality of banks' loan portfolio remains stable, as measured by the gross impaired loans (GIL) ratio which stood at 1.45% as at end-2018 (end-2017: 1.55%). The GIL ratio stood at 1.57% as at end-June 2019. The stable asset quality can be attributed to interest rates which remain relatively low by historical standards, sustained economic growth, stable employment and adequate credit risk management. The level of impaired financing in banks' corporate loan books declined following a sharp increase in impaired oil and gas sector (O&G) lending exposures in the immediately preceding four-year period (Exhibit 11). Most business sectors exhibited either broadly stable or improved credit performance as at end-2018, as measured by gross delinquency rates, with the exception of the wholesale & retail trade and transport & storage services segments. The gross impaired loans ratio of small and medium enterprises (SMEs) remained stable at 2.7% as at end-June 2019<sup>3</sup> (2018 GIL: 2.4%). Accounting for more than a third of Malaysia's GDP and 50% of total commercial loans in the banking system, the SME financing segment is typically a significant component of a commercial bank's loan portfolio. Looking ahead, we expect banks to uphold underwriting standards for SME financing to offset asset quality pressure.

<sup>3</sup> Source: BNM

## High household debt poses headwind for retail-dominated loan books

Household debt burdens remain high, at 83.0% of GDP (2017: 84.2%) in 2018. Strong household spending has been a factor behind the increase in household debt, which in turn makes households sensitive to increased unemployment and higher interest rates. As a share of GDP, the total banking system loans to households excluding lending by non-banks was 69.1% (2017: 69.3%). For now, employment trends, real wage growth and low interest rates continue to support expansion in housing residential property lending. However, given the high levels of household debt, a sharp increase in benchmark interest rates could lead to increased loan repayment delinquency, although this is an unlikely prospect at this juncture. If the interest rate rise were to be gradual rather than sharp, the impact on banking sector asset quality would be less severe.

We note that the GIL ratios actually dropped for the motor vehicles, personal financing and credit cards segments of household financing in 2018 for both the banking system and non-bank financial institutions while delinquencies trended down for all segments, including residential and non-residential property financing. Still, higher incidents of impairment exhibited by banks' personal and higher-valued residential property financing portfolios suggest that these exposures continue to warrant proactive monitoring. We believe that the high level of household indebtedness and the sensitivity of GIL ratio to economic growth warrant a more cautious view of banking system asset quality.

## Regulatory and reporting requirements drive improved provisioning

Provisioning against loan losses has, to a large extent, been driven by regulatory directives on collective impairment allowances (CA) and regulatory reserves (RR) for unidentified expected future loan losses. In early 2014, BNM had directed all banks to maintain minimum CA in combination with RR amounting to 1.2% of total loans, net of individual impairment allowances (IA) by end-2015. This ensured impairment provisions could keep pace with strong credit growth notwithstanding accounting conventions which encouraged laxity in the building of loan loss absorption buffers. Banks' loss allowances for non-credit impaired exposures had declined significantly following the full adoption of *MFRS 139 Financial Instruments: Recognition and Measurement*, which commenced in 2012. The CA were left to the discretion of the banks whereas previously the central bank had set a minimum general provisions requirement at 1.5% of total loans.

Under *MFRS 9*, reserving for potential losses begins when loans are first booked, reducing the need for rapid additions when delinquencies and defaults soar as is typically observed leading up to and during a recession. *MFRS 9* increases the convergence of reporting and regulatory standards (Basel II/III) with its two-stage (12 month and lifetime) recognition of expected credit losses. Banks using the advanced internal ratings-based approach will be able to leverage some of the data used by the Basel model to calculate *IFRS 9* expected credit loss. Our broad view is that the adoption of an expected loss framework for the recognition of impairment allows for a more accurate assessment of banks' financial positions and should engender financial system stability by promoting prudent risk taking.

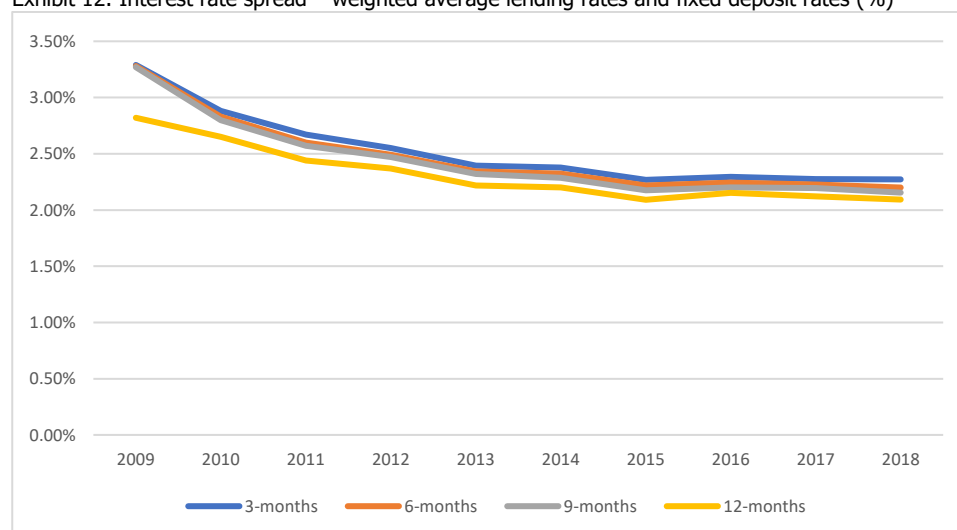
Under the more recent financial reporting guidelines issued by BNM in February 2018, the minimum two-stage loss allowances for non-credit impaired exposures and RR to be set aside by banks under *MFRS 9* is 1.0% of total credit exposures, net of IA. The minimum requirement also extends to banks' securities holdings. Importantly, the *MFRS 9* pre-migration increases in CA and RR help lower the risk of any sudden adverse impact on banks' capital ratios caused by transitioning to the new approach. The longer-term effects of *MFRS 9* on loan origination will become clearer in time, among which it is expected to lessen the procyclicality of bank lending.

Detailed analysis of loan loss reserve coverage across banks shows that there is notable dispersion in banks' loan loss reserve levels with some banks having far stronger loss reserve coverage than others. When assessing the strength of banks' capital buffers, we also consider how well their loan loss reserves position them for a credit cycle downturn. Being mindful that in all likelihood, loan losses will trend up from current

levels, we remain concerned that banks with loan loss reserve coverage ratios of below 100% may be entering the late stages of the credit cycle with a low loan loss reserve cushion relative to their loan portfolio.

## MODERATING PROFITABILITY

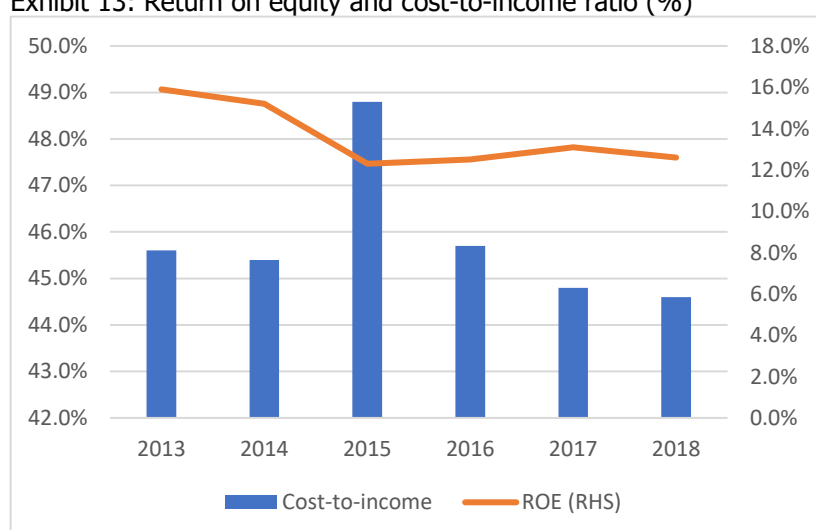
Exhibit 12: Interest rate spread – weighted average lending rates and fixed deposit rates (%)



Sources: BNM, MARC

In 2018, we saw lower profit growth for the banking system mainly due to higher funding costs and an increase in *MFRS 9*-related provisions. Major domestic banks saw their bank-level pre-tax profit increase 3.95% y-o-y, significantly lower than the 14.11% growth registered in 2017. While the higher cost of funds and lower non-interest income had pressured earnings growth (Exhibit 12), the lower operating costs from cost-saving initiatives have provided some reprieve to the overall profitability. Banks also benefitted from higher trading and investment income. Overall, returns on assets and equity of the banking system for 2018 came in lower compared to the year before (Exhibit 13).

Exhibit 13: Return on equity and cost-to-income ratio (%)



Sources: BNM, MARC

For 2019, we believe that the banking sector's ability to grow revenue will be challenged by lower credit growth, the competitive squeeze on NIM and increased credit risks across the board. Spread-related income growth is likely to become more of a challenge as the year wears on if spreads remain compressed and growth in earning assets provides an insufficient offset. The impact will most likely be felt hardest by smaller banks with limited branch network and undifferentiated franchises. Following BNM's 25 basis points cut in the OPR to 3.0% in May 2019, we expect banks' NIMs to remain relatively stagnant or decrease in the months ahead. This is because we anticipate deposit rates to display downward stickiness which, in turn, will limit the room to cut lending rates.

Unlike past years in which profitability was boosted by high loan loss reserve releases and unusually low credit costs, there are now noticeably fewer earnings sources to sustain a strong earnings momentum. Meanwhile, domestic banks that have been reliant on market-sensitive treasury income in recent years to bolster their bottom lines amid slower credit offtake and the benign interest rate environment would show higher earnings volatility. Overall, our view is that revenue growth rather than credit costs poses the greatest risk to earnings for domestic banks in 2019. The revenue growth challenges are likely to result in a continued focus on cost efficiency, which has been aided in some respects by increased digitalisation in banking. Additionally, banks also have to contend with higher regulatory and compliance costs. On this note, we believe that a focus on long-term value by banks' boards and executive management will be important to avoid across-the-board cuts that might result in underinvestment in their future.

## REGULATORY CAPITAL BUFFERS REMAIN SIZEABLE

Exhibit 14: Capital base (RM mil)

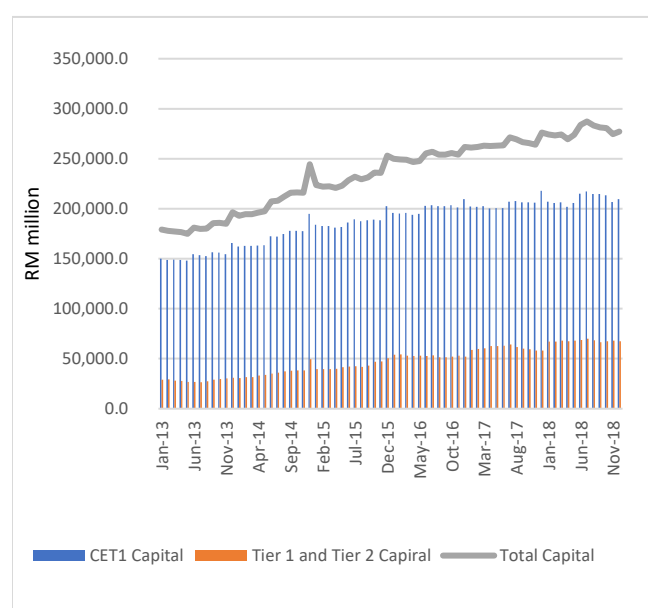
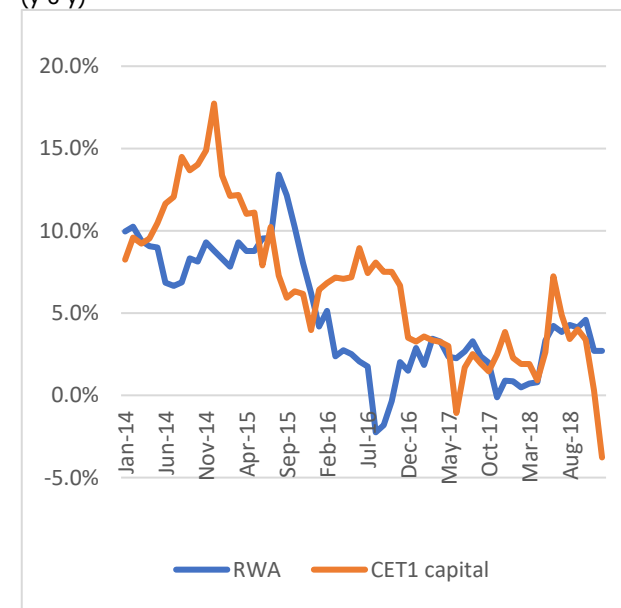


Exhibit 15: Risk weighted asset and CET1 capital growth (y-o-y)

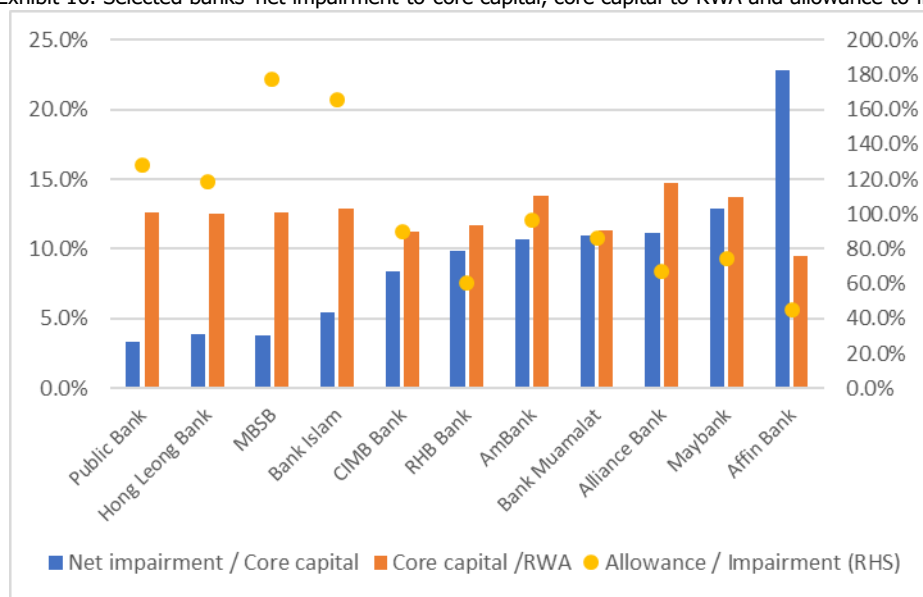


Banks remained well-capitalised with common equity tier 1 (CET1) and total capital adequacy ratios standing at 13.1% and 17.4% as at end-2018. While a significant portion of the capital base is currently contributed by high quality CET1 capital (Exhibit 14 and 15), we expect banks to increasingly rely on issuances of capital securities to support asset growth going forward. At the same time, we believe that Basel III's regulatory capital reforms raise important questions on banks' sustainable dividend-paying capability in a lower growth, low interest rate environment. As such, dividend payout ratios can no longer purely be a function of accounting earnings. Accordingly, dividend policies must now address banks' risk profiles and projected growth rates.

Banks have been building their CET1 capital by retaining earnings and raising new capital, while also increasing their reliance on capital securities. Banks with strong earnings generation capacity and capital market access generally have greater capital raising flexibility. Given that high dividend payouts have been a norm for the banking sector, the impact of the Basel III regulatory capital rules on individual banks' future dividend-paying capacity will be an increasing source of equity holders' focus. On a related note, the banking system's ROE has been steadily declining to 13.1% in 2017 and 12.6% in 2018 from 15.9% in 2013.

### Retail banks have stronger capital position relative to impairments

Exhibit 16: Selected banks' net impairment-to-core capital, core capital-to-RWA and allowance-to-impairment ratios



Sources: Banks' financials, MARC

The dispersion in banks' loan loss reserve coverage sufficiency (Exhibit 16) suggests that the regulatory capital ratios of some banks have stronger underpinnings than others. MARC notes that the capital position of banks with a strong presence in the retail loan segment such as Public Bank and Hong Leong Bank is less susceptible to credit quality issues given their relatively low impairments and higher provisions. On the other hand, the forward-looking provisions for loan losses set aside under *MFRS 9* provide increased assurance that banks have the required reserves for future loss potential for new financing bookings.

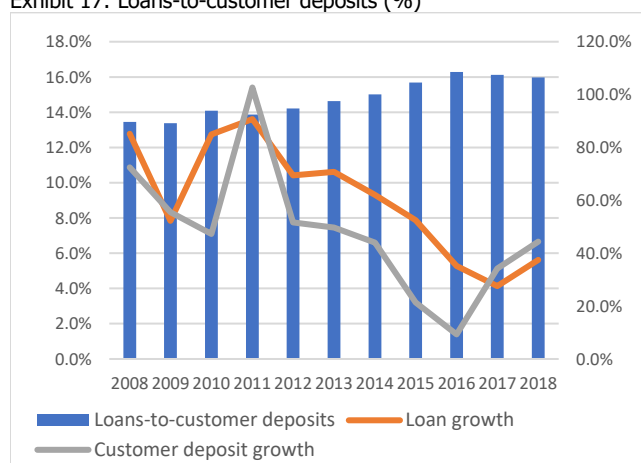
## SOUND FUNDING AND LIQUIDITY PROFILE

### Moderating CASA growth, but still sound funding profile

Banks' funding profiles remain sound overall with a loan-to-fund ratio of 82.7% as at end-2018. Low-cost core deposit growth has not kept up with the pace of loan growth, as reflected in the rise of loans-to-customer deposit (LDR) in the last 10 years (Exhibit 17). Retail deposits from households, both savings as well as fixed deposits, have been charting slower y-o-y growth. Apart from searching for yield in equities, unit trusts and other high-yielding assets, we suspect that deposits could also be growing at a slower clip because of higher spending of disposable income, especially on housing. Additionally, the growing presence of digital wallets would also provide some competition for deposits for banks. Hence, we believe that it will be challenging, amid the increased competition for retail deposits, to reprice these deposits with the 25 basis points cut in the OPR in May 2019.

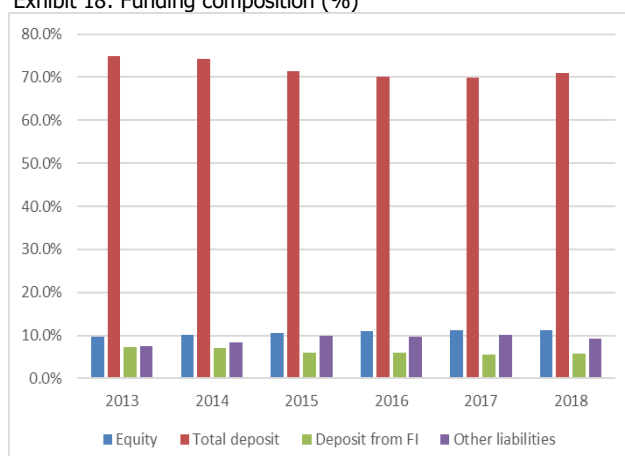
With loan growth outstripping deposit growth, banks have been increasingly diversifying their funding sources (Exhibit 18). Shifts in banks' funding composition towards hybrid capital instruments, issued to comply with BNM's Basel III regulatory capital requirements and a higher level of medium-term debt, would mitigate funding vulnerabilities otherwise emerging from a high sustained LDR.

Exhibit 17: Loans-to-customer deposits (%)



Sources: BNM, MARC

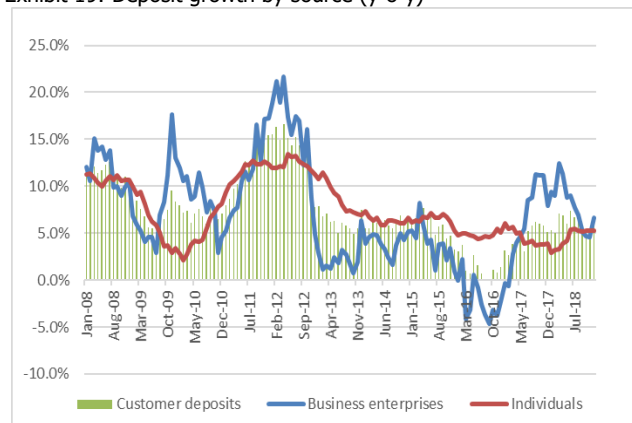
Exhibit 18: Funding composition (%)



Sources: BNM, MARC

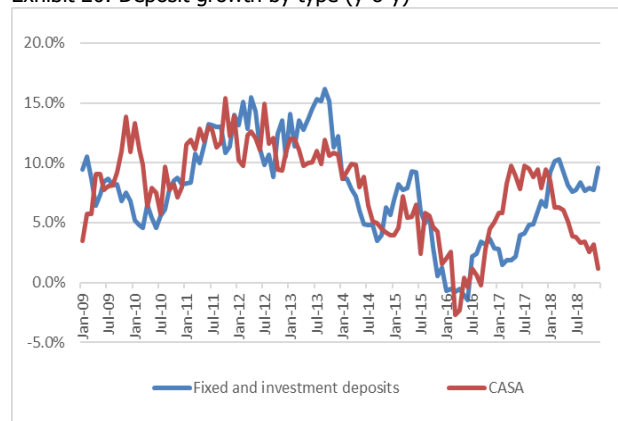
Banks have notably become more aggressive about competing for retail deposits during the period of transition towards full implementation of Basel III's liquidity coverage ratio (LCR) requirements on January 1, 2019, with the lower run-off rate that retail deposits attract in computation being a key consideration. While customer deposits grew 6.7% in 2018 y-o-y driven by higher growth in deposits from individuals (Exhibit 19), low-cost deposit growth has generally become harder to achieve. Most new deposits were in the form of fixed and investment deposits (Exhibit 20).

Exhibit 19: Deposit growth by source (y-o-y)



Sources: BNM, MARC

Exhibit 20: Deposit growth by type (y-o-y)



Sources: BNM, MARC

Going forward, apart from adding to NIM pressures, falling current and savings account (CASA) growth will also impinge on banks' ability to grow their loan books. The banking system's LDR, despite falling in 2018, is hovering close to its 10-year high. While we note that BNM has extended the observation period for net stable funding ratio (NSFR) requirements by another year to 2020, competition for retail deposits is not likely to abate, hence we believe that the redeeming factor here will be the expected moderation in loan growth in 2019. More importantly, the cost of funds is rising faster than loan yields.

## THE NEXT WAVE FOR THE FUTURE

### Room for consolidation and restructuring

The merger and acquisition (M&A) scene has been rather quiet this year. The last consolidation exercise between Malaysia Building Society Berhad and Asian Finance Bank (forming MBSB Bank Berhad) was completed in February 2018, creating the second-largest standalone Islamic bank after Bank Islam Malaysia Berhad. Meanwhile, merger talks between Al Rajhi Banking & Investment Corp (M) Berhad and Malaysian Industrial Development Finance Berhad are ongoing. In view of the increasingly competitive financial landscape, it is important for banks to proactively enhance their capacities and capabilities. MARC believes that besides charting out internal growth strategies, banks would also be carrying out rationalisation and consolidation activities that would increase their scale and potentially reduce overall cost in the long run.

Although consolidation is not an immediate necessity given the banks' resilient performance last year and up to 1H2019, mergers would enhance the scale of a bank's operations that may provide better synergies in operations and cost efficiencies. Nevertheless, the main question for potential M&As remains the pricing and valuation, which are often the main stumbling blocks.

### Digitalisation in bank strategies

MARC has seen positive developments in Malaysia's digital banking journey thus far. Most domestic banks are embracing fintech, realising its importance in the fast-moving digital landscape. Some banks have made steady headway by creating their own internal specialised fintech team, while others have sought collaborations with fintech companies both locally as well as regionally. The major banks have made bigger strides in this area which includes setting-up fully-digital banks as well as developing their own digital wallet platforms.

BNM and the Securities Commission Malaysia (SC) have in recent times issued regulations and consultative papers to facilitate the growth of digital banking. The facilitative environment has been a catalyst to attract fintech innovators to the country, creating stronger talent growth and promoting innovation.



An example is the push towards mobile and internet banking to enhance the overall competitiveness of the industry as digital banking is seen as more cost effective. The high mobile phone penetration in Malaysia has also meant that mobile phones can readily serve as a means of making and accepting payments with no additional infrastructure costs. While this has provided new opportunities at the industry level, the greater usage of digital payments will see shifts in banks' business model and consumer behaviour as well as lead to new risks, particularly cyber security. Additionally, the growth of mobile banking will reduce reliance on the 'brick and mortar' banking model.

Nevertheless, as the challenge for banks going forward is revenue growth, it is important that banks balance their fintech investments accordingly so as not to overburden their overall financial performance. The larger banks will stand to benefit as they have deeper pockets to absorb the cost of fintech-related investments.

### **Sustainability a key growth driver going forward**

Sustainability is becoming a competitive imperative with a growing awareness and acceptance among businesses that growth opportunities lie in solving key sustainability challenges. More and more businesses are stepping up to manage their total impact as an enterprise across the triple bottom line of profit, people and planet. The emergence of sustainable banking provides new growth opportunities for banks and helps address slowing growth rates.

Against the backdrop of the current climate and environmental concerns, green technology is emerging as a winning proposition for the domestic banking sector as well as capital market activities. We have seen financing for solar power plants take off in a big way. These efforts have been supported by the government which has set a target of 20% of the country's electricity to be generated from renewable sources by 2030, an increase from 2% currently.

On this note, MARC introduced the Impact Bonds Assessment Framework in July 2018 which assesses green bonds, social bonds or sustainability bonds including sukuk issued under Malaysia's Sustainable and Responsible Investment (SRI) Sukuk Framework. MARC continues to play its role in supporting the growth of the Islamic financial industry and is optimistic of the Impact Bond assessments' long-term potential in becoming a mainstay of fixed-income portfolios.

## MARC'S BANK ANALYSIS



## MALAYAN BANKING BERHAD

### Background

Malayan Banking Berhad (Maybank) is the largest banking group in Malaysia and the fourth largest in ASEAN, with total consolidated assets of RM807.0 billion as at end-2018. It has established branches in all ten ASEAN countries as well as a presence in China, Hong Kong, The United Kingdom, the United States and Pakistan, among others. Maybank's key markets are Malaysia, Singapore and Indonesia, which accounted for 58.3%, 25.2% and 7.7% of its consolidated gross loans as at end-2018. The group boasts a well-diversified loan book and has a strong domestic retail presence.

### Key Highlights

- **Record earnings for the banking group**  
Maybank saw record pre-tax profit of RM10.9 billion in 2018 (2017: RM10.1 billion), largely behind a reduction in net impairment losses. Earnings were also supported by better cost management, with the cost-to-income ratio marginally improving to 47.6% during the year (2017: 48.8%), in addition to higher loan growth. This was moderated by NIM compression behind stiff deposit competition in 2018. Going forward, earnings growth is expected to be impacted by sustained margin pressure in addition to the cut in the OPR rate by BNM in 2019.
- **Higher loan growth although net interest margins were pressured**  
Maybank registered higher y-o-y loan growth of 4.8% in 2018 (2017: 1.7%), driven by working capital and residential mortgage loans, the two largest segments of the group's loan portfolio. Loan growth in the near term will likely be driven by the retail and SME segments. Geographically, while loan growth from Malaysia and Singapore moderated, Indonesia recorded higher growth of 7% in 2018 (2017: 3.1%). Positively, although the loan growth was higher at 4.8%, Maybank's RWA declined by 1.7% which reflects a more cautious risk appetite.
- **Asset quality weakened behind Singapore exposure**  
Maybank's GIL ratio increased to 2.41% as at end-2018 (2017: 2.34%) after reclassifying exposure to Hyflux Ltd in Singapore as non-performing in 2Q2018. The Singapore exposure made up 35.4% of the group's impairments, although loans in Singapore constituted just 25.2% of Maybank's loan portfolio. The adoption of *MFRS139* contributed to the higher GIL of RM12.5 billion in 2018 (2017: RM11.5 billion). Loan loss coverage increased to 82.1% as at end-2018 (2017: 71.5%) as the adoption of *MFRS 9* led to higher provision buffers being set aside. Going forward, the banking group's asset quality could face moderate downside risk amid external uncertainties.
- **Comfortable capital and liquidity position**  
Maybank remained well capitalised with CET1 and total capital ratios of 15.0% and 19.0% in 2018. Its funding and liquidity profile is sound, underpinned by a substantial retail deposit base and easy access to the capital markets. The group's LCR stood at 132.4% as at end-2018, above BNM's minimum requirement of 100% in 2019. Its sizeable deposits from individuals which accounted for 39.2% of total customer deposits (2017: 40.9%) and CASA ratio of 34.6% (2017: 36.6%) are key factors in providing group funding stability.

## MALAYAN BANKING BERHAD

Table 1: Key financial indicators

Fye 31 December	2018	2017	2016
Total assets (RM bil)	807.0	765.3	736.0
Gross loans (RM bil)	517.3	493.8	485.7
Loan growth y-o-y (%)	4.8	1.7	5.7
Gross impaired loans (RM bil)	12.5	11.5	11.1
Customer deposits (RM bil)	532.7	502.0	485.5
Profit before tax (RM bil)	10.9	10.1	8.8
Shareholders' funds (RM bil)	77.7	75.2	70.5
Return on assets (%)	1.06	1.04	0.96
Return on equity (%)	10.93	10.71	10.39
Net interest margin (%)	2.18	2.25	2.16
Cost/income ratio (%)	47.6	48.8	47.3
Gross impaired loan ratio (%)	2.41	2.34	2.28
Loan loss reserve coverage (%)	82.1	71.5	72.0
CET1 capital ratio (%)	15.0	14.8	14.0
Tier 1 capital ratio (%)	16.0	16.5	15.7
Total capital ratio (%)	19.0	19.4	19.3
Loan-to-funds ratio (%)	86.9	87.0	88.1
Gross loans/Customer deposits (%)	86.9	87.0	88.1
CASA deposits/Customer deposits (%)	34.6	36.6	36.4

Figure 1 : Total loan exposure by segment

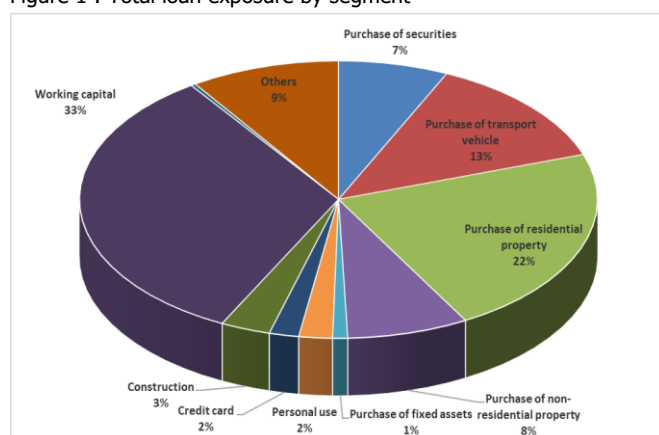


Figure 2: Loans and Impairment trend

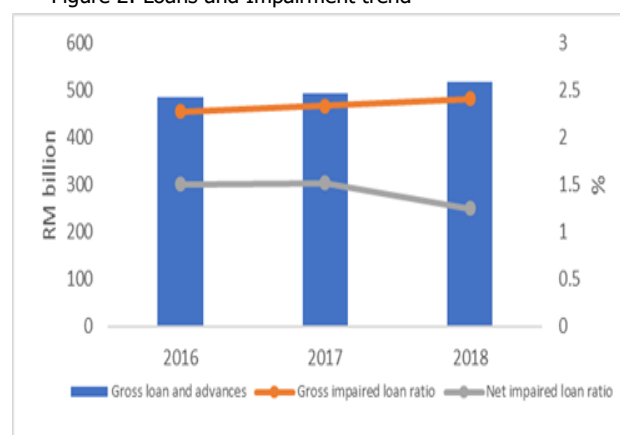


Figure 3 : Profitability trend

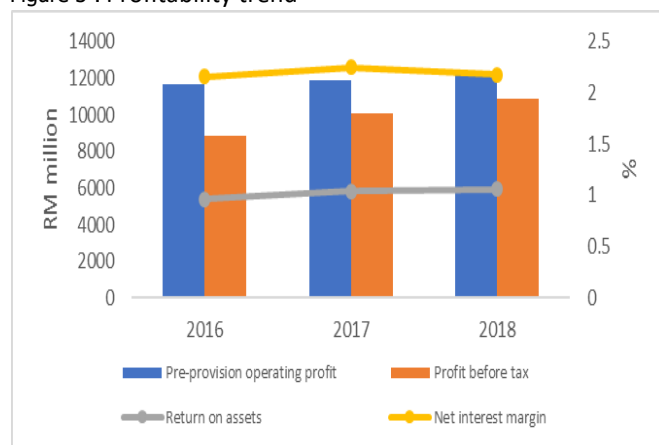
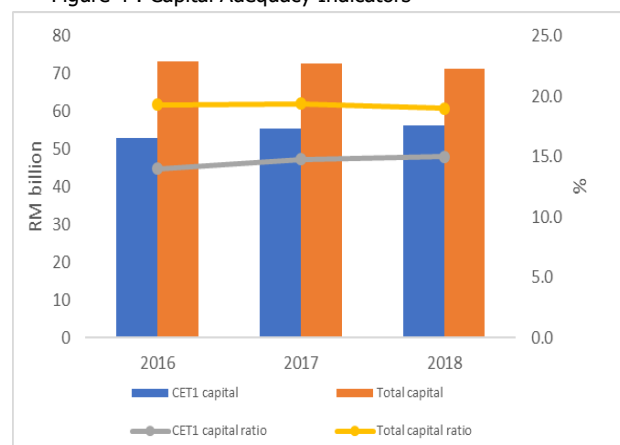


Figure 4 : Capital Adequacy Indicators



Sources: Company, MARC

## CIMB BANK BERHAD

### Background

CIMB Bank Berhad (CIMB Bank) is the second-largest banking group in Malaysia, with well-established banking franchise and strong domestic market position in loans and deposits. CIMB Bank is an ASEAN focused bank with primary exposure in retail banking, commercial banking, investment banking and Islamic banking. CIMB Bank is a core component of the CIMB Group, whose major shareholders are Khazanah Nasional Berhad and the Employees' Provident Fund.

### Key Highlights

- **Pressure on profitability from higher cost of funds and soft capital market conditions**  
CIMB Bank recorded pre-tax profit of RM5.1 billion in 2018, supported by higher net interest income and lower impairment charges. These were moderated by higher cost of funds during the year. Non-interest income declined due to soft capital market conditions in Malaysia which affected the Group's trading income. Looking ahead, the group's earnings are expected to improve from the current level underpinned by sustained loan growth momentum. Moderating this expectation is the continued pressure on NIM due to the competition in the banking industry.
- **Higher loan growth**  
CIMB Bank registered a higher loan growth of 8.9% (2017: 2.1%), following subdued growth in the last two years as the bank undertook portfolio realignment in its key overseas markets. The group's focus remains on the retail segment with loans to individual and SME businesses.
- **Stable asset quality**  
CIMB Bank's GIL ratio eased to 2.2% as at end-2018 amid an expanding loan base. However, its GIL increased slightly to RM6.3 billion from RM6.2 billion due to its Thai operations. Asset quality weaknesses in Thailand continued to be driven by the SME segment; as at end-2018, the GIL ratio in the country stood at 5.4% (2017: 6.0%). The adoption of *MFRS 9* in January 2018 had boosted its loan loss reserve coverage ratio to 80.1%.
- **Strong capital adequacy and liquidity position**  
The group's capitalisation remained comfortable, with a CET1 capital ratio of 12.9%. Its capital position continues to be supported by dividend reinvestment and good earnings accretion. MARC views that the group's strong capital buffer above the minimum regulatory requirement remains supportive of credit expansion. CIMB Bank's liquidity is strong, with a high LCR of 164% as at end-2018, well above the required 100%.
- **Rethinking the way forward**  
Having achieved the key targets its T18 strategic plan, CIMB Group recently announced its next five-year blueprint, "Forward 23", as it prepares for new challenges ahead. The Group has raised the bar through three key financial targets to be achieved by 2023, i.e. an ROE of more than 12%, a CET1 ratio of over 13% and a cost-to-income ratio of below 45%. CIMB Group also expects higher contribution from its overseas markets within the planning period. The success of T18 reflects well on the management's credibility in executing its business strategies. Nevertheless, given the more challenging outlook and moderating economic growth, it remains to be seen whether it can deliver its set targets.

## CIMB BANK BERHAD

Table 1: Key financial indicators

FYE 31 December	2018	2017	2016
Total assets (RM bil)	451.9	417.1	395.5
Gross loans (RM bil)	289.5	265.9	260.4
Loan growth y-o-y (%)	8.9	2.1	8.9
Gross impaired loans (RM bil)	6.3	6.2	5.6
Customer deposits (RM bil)	238.2	224.1	208.7
Profit before tax (RM bil)	5.1	4.9	4.2
Shareholders' funds (RM bil)	41.1	38.1	34.9
Return on assets (%)	0.91	0.96	0.84
Return on equity (%)	10.0	10.7	9.6
Net interest margin (%)	2.08	2.22	2.17
Cost/income ratio (%)	49.9	48.0	50.0
Gross impaired loan ratio (%)	2.18	2.33	2.15
Loan loss reserve coverage (%)	80.1	68.5	77.5
CET1 capital ratio (%)	12.9	12.2	11.6
Tier 1 capital ratio (%)	14.0	13.4	12.8
Total capital ratio (%)	17.8	17.0	16.4
Loan-to-funds ratio (%)	81.9	81.0	86.1
Gross loans/ Customer deposits (%)	89.7	89.0	92.7
CASA deposits / Customer deposits (%)	29.7	32.2	32.6

Figure 1 : Total loan exposure by segment

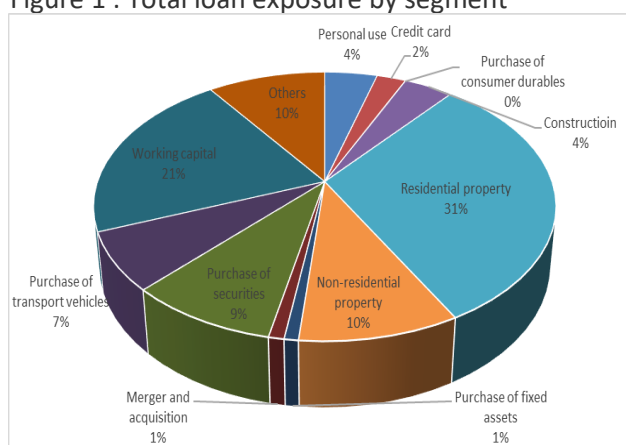


Figure 2 : Loans and impairment trend

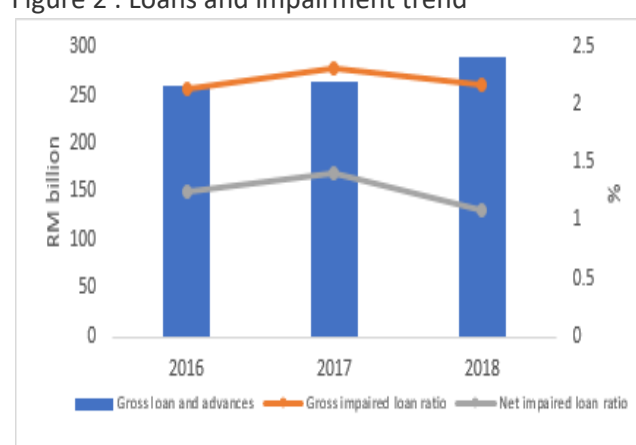


Figure 3 : Profitability trend

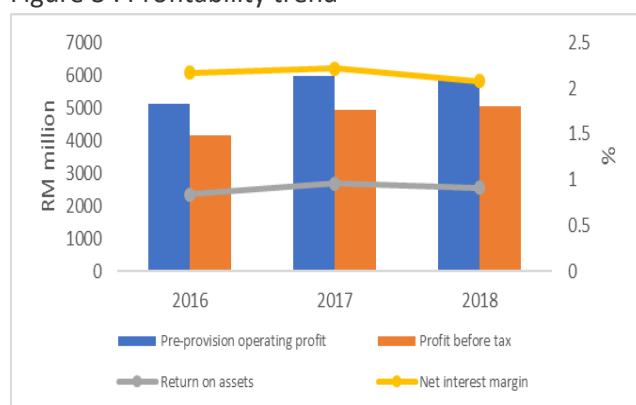
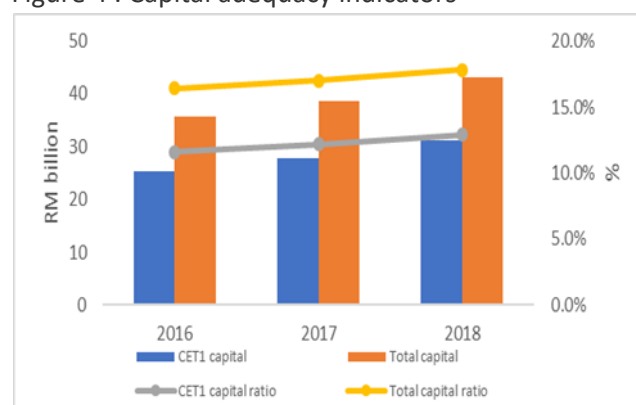


Figure 4 : Capital adequacy indicators



Sources: Company, MARC

## PUBLIC BANK BERHAD

### Background

Public Bank Berhad (Public Bank) is the third-largest banking group in Malaysia in terms of assets. The Group's founder and chairman, Tan Sri Dato' Sri Dr Teh Hong Piow, remains its largest shareholder with an effective 23.5% stake, followed by the Employees' Provident Fund with a 14.1% shareholding. Public Bank is a market leader in residential mortgage financing and vehicle financing as well as in the private unit trust business. Its exposure is mainly in the domestic market.

### Key Highlights

#### ➤ **Superior asset quality metrics**

Public Bank's prudent underwriting standards and sound risk management continue to support its excellent asset quality position. Its GIL ratio remained relatively stable at 0.5%, which is superior to that of its domestic peers. Additionally, its loan loss reserve coverage of 126.0% remained robust. Given its strong credit culture, MARC expects the group's asset quality to remain strong in 2019 despite the challenging environment.

#### ➤ **Healthy profitability may come under pressure**

The Group's pre-tax profit remained flat at RM7.1 billion in 2018 compared to the previous year. Operating performance was supported by higher net interest income and lower impairment charges during the year. These were partially offset by higher operating expenses. The Group's cost-to-income ratio increased slightly to 33.4%, despite remaining as the lowest in the industry. MARC expects further margin compression for the Group with the recent 25 basis points OPR cut.

#### ➤ **Loan growth slowing down**

The banking group is known for its above-industry loan growth with the exception of the last few years. Amid weak consumer sentiment, the Group's loan growth remains subdued, registering 4.2% as at end-2018. In terms of lending exposure, Public Bank's loan book continues to be retail-centric. Residential properties, non-residential properties and transport vehicles collectively accounted for 77.9% of the loan book as at end-2018. Although it has a sizeable exposure to the properties sector, we are comforted by the robust asset quality of the sector, with GIL of 0.5% and 0.3% for residential properties and non-residential properties. Loan growth is expected to remain resilient although muted at the mid-single digit level.

#### ➤ **Healthy capitalisation, with sound liquidity and funding profile**

Its CET1 and total capital ratios increased to 13.6% and 16.8% due to good internal capital generation. These capital ratios remained above the minimum regulatory requirement. In terms of funding, the Group recorded a 5.2% growth in its core customer deposits, outpacing loan growth. Although the Group has a high gross loan-to-customer deposit ratio of 93.6%, we draw comfort from its sound liquidity and funding position, as reflected by its high LCR and NSRF - both stood well above 100% in 2018.



## PUBLIC BANK BERHAD

Table 1 : Key financial indicators

FYE 31 December	2018	2017	2016
Total assets (RM bil)	419.7	395.3	380.1
Gross loans (RM bil)	317.3	304.5	294.0
Loan growth y-o-y (%)	4.2	3.6	7.5
Gross impaired loans (RM bil)	1.6	1.5	1.5
Customer deposits (RM bil)	283.8	269.7	258.2
Profit before tax (RM bil)	7.1	7.1	6.6
Shareholders' funds (RM bil)	42.1	38.4	35.4
Return on assets (%)	1.39	1.43	1.39
Return on equity (%)	14.1	15.0	14.9
Net interest margin (%)	1.94	2.00	1.91
Cost/income ratio (%)	33.4	32.4	32.9
Gross impaired loan ratio (%)	0.51	0.48	0.51
Loan loss reserve coverage (%)	126.0	95.5	102.7
CET1 capital ratio (%)	13.6	12.8	11.9
Tier 1 capital ratio (%)	14.3	13.5	12.7
Total capital ratio (%)	16.8	16.5	16.0
Loan-to-funds ratio (%)	90.0	91.8	91.4
Gross loans/Customer deposits (%)	93.6	95.4	94.8
CASA deposits/Customer deposits (%)	25.7	26.0	25.2

Figure 1: Total loan exposure by segment

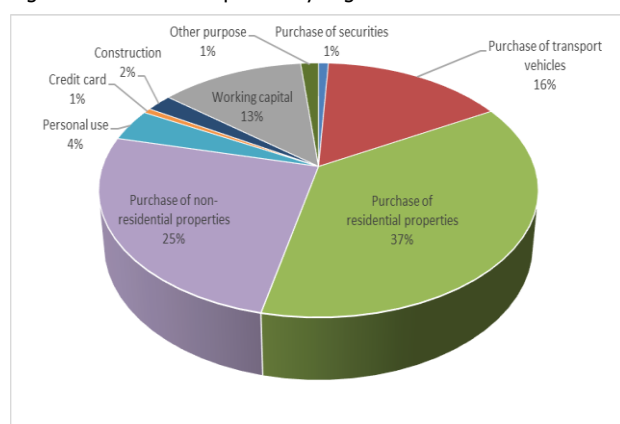


Figure 2: Loans and impairment trend

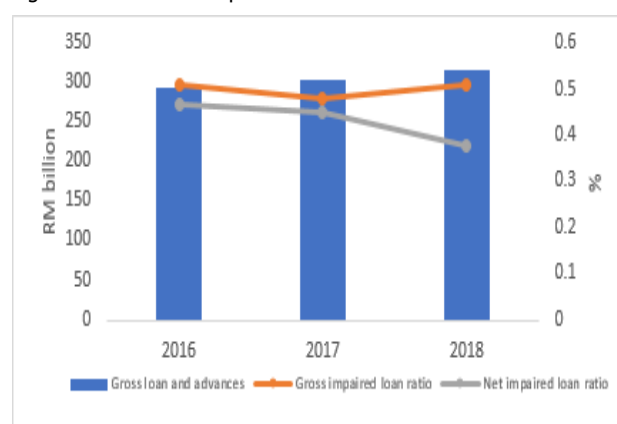


Figure 3: Profitability trend

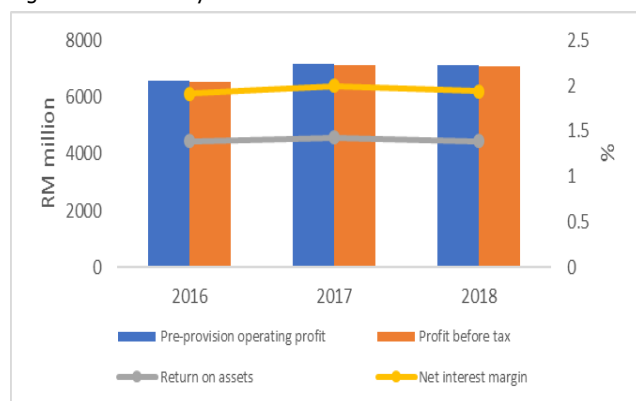
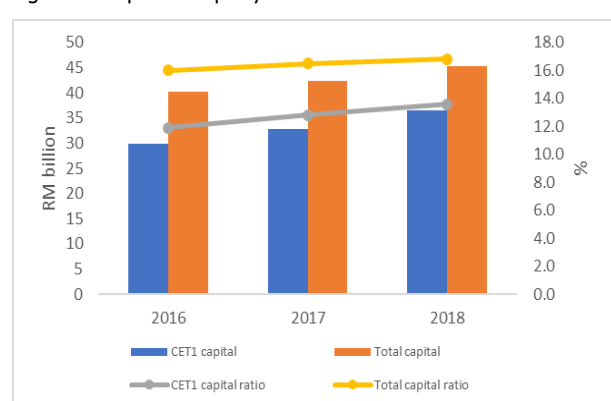


Figure 4: Capital adequacy indicators



Sources: Company, MARC

## RHB BANK BERHAD

### Background

RHB Bank Berhad (RHB Bank) is the fourth-largest bank in Malaysia, with well-established banking franchise and strong domestic market position in loans and deposits. Other than Malaysia, the Group operates in Singapore, Laos, Cambodia and Thailand.

### Key Highlights

#### ➤ **Strong earnings growth**

RHB Bank recorded higher pre-tax profit of RM3.1 billion in 2018 (2017: RM2.6 billion), mainly due to a larger loan base as well as lower net impairments for the year. The Group has been able to avoid margin compression by improving its funding mix, and has been able to manage costs well despite the ongoing investments in its digital systems, in line with its five-year transformation programme, FIT22. This can be seen in its improved cost-to-income ratio of 49.3% for the year (2017: 49.9%). Over the near term, earnings growth will likely be driven by loan expansion in the retail and SME segments, both of which are targeted under FIT22.

#### ➤ **Loan growth driven by the retail and SME segments**

RHB Bank registered a higher y-o-y loan growth of 5.5% in 2018 (2017: 3.7%). Its transformation plan has outlined strategies to continue strengthening the Group's presence in the domestic market, which accounts for 89.0% of its loan portfolio. Domestic loans grew 5.9% behind resilient growth in residential mortgages, though this was moderated by corporate repayments. Retail and SME made up 72% of its total domestic financing in 2018, up from 69% in 2017.

#### ➤ **Improved asset quality**

RHB Bank's asset quality has continued to improve, with the GIL ratio dropping to 2.06% as at end-2018 (2017: 2.23%). This was primarily due to improvements in impaired loans to the construction segment. The Group's loan loss coverage stood at 93.3%. Problematic loans particularly in the oil and gas segment in Singapore, have largely been provided for, though an existing exposure of around 3% of the loan book could potentially pressure impairment ratios given the uncertainty that remains in the sector in 2019.

#### ➤ **Capital ratios continue to strengthen**

RHB Bank remains well capitalised, with consolidated CET1 and total capital ratios rising to 15.5% and 18.8% as at end-2018 (2017: 13.9%, 17.2%). The Group's capital ratios remained well above the minimum regulatory requirements of 7.0% and 10.5% (including the capital conservation buffer) upon full implementation of BNM's Basel III in 2019. RHB Bank's capital position improved behind strong profitability which offset the capital reduction of over 6% arising from the adoption of MFRS 9 at the start of the 2018. This was further supported by capital optimisation measures which resulted in lower RWA despite a larger loan base in 2018. Liquidity and funding position remained sound, with a loans-to-customer deposit ratio of 94.4% and CASA ratio of 25.9% as at end-2018.

## RHB BANK BERHAD

Table 1: Key financial indicators

FYE 31 December	2018	2017	2016
Total assets (RM bil)	245.8	230.2	236.7
Gross loans (RM bil)	168.9	160.1	154.5
Loan growth y-o-y (%)	5.5	3.7	2.0
Gross impaired loans (RM bil)	3.5	3.6	3.7
Customer deposits (RM bil)	177.7	166.3	165.7
Profit before tax (RM bil)	3.1	2.6	2.2
Shareholders' funds (RM bil)	23.4	23.2	21.8
Return on assets (%)	0.97	0.84	0.73
Return on equity (%)	9.91	8.70	8.55
Net interest margin (%)	2.08	2.08	2.07
Cost/income ratio (%)	49.3	49.9	50.0
Gross impaired loan ratio (%)	2.06	2.23	2.43
Loan loss reserve coverage (%)	93.3	51.2	56.9
CET1 capital ratio (%)	15.5	13.9	13.1
Tier 1 capital ratio (%)	15.7	14.2	13.4
Total capital ratio (%)	18.8	17.2	17.2
Loan-to-funds ratio (%)	87.5	90.3	84.7
Gross loans/Customer deposits (%)	94.4	96.0	93.2
CASA deposits/Customer deposits (%)	25.9	30.2	25.6

Figure 1: Total loan exposure by segment

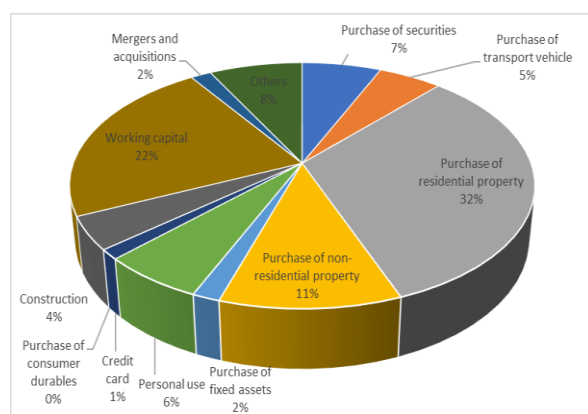


Figure 2: Loans and impairment trend

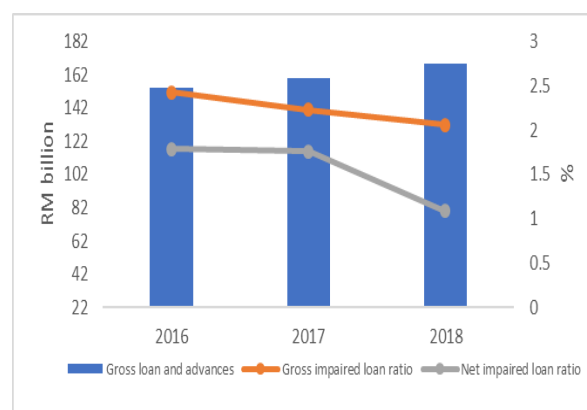


Figure 3: Profitability trend

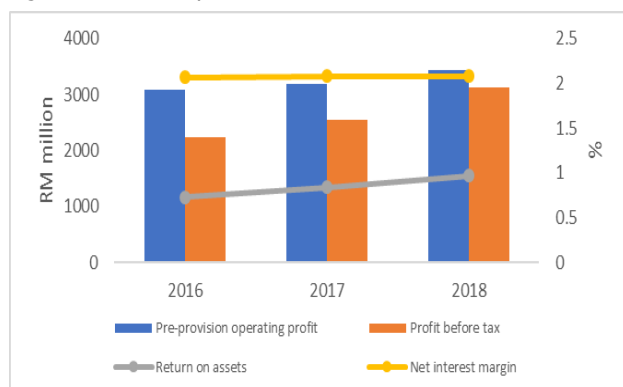
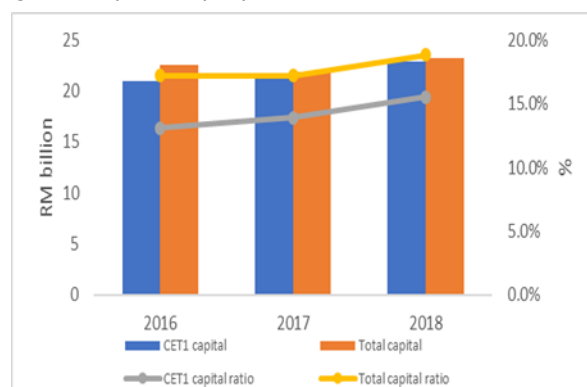


Figure 4: Capital adequacy indicators



Sources: Company, MARC

## HONG LEONG BANK BERHAD

### Background

Hong Leong Bank (HLB) is currently Malaysia's fifth-largest banking group and has regional presence in Singapore, Hong Kong, Vietnam, Cambodia and China. It went through a series of consolidation exercises, the last being with EON Capital Berhad in 2011. The domestic market is the main driver of its business. The Group has a strong market presence in mortgage financing, vehicle financing and credit cards. Exposure to mortgage financing formed about 60% of its total loan exposure in 2018.

### Key Highlights

- **Superior asset quality supported by solid impaired loans coverage**  
HLB maintained strong asset quality with a GIL ratio of 0.80% as at 1H2019 and has consistently kept the ratio healthier than the industry average. Impairment level declined during the period, mainly from lower impairment from loans for working capital. Loan loss coverage inclusive of regulatory reserves stood at 201%. Given its conservative risk appetite and prudent underwriting, we do not anticipate any major deterioration in its loan portfolio.
- **Moderate earnings growth behind write-backs**  
HLB's earnings rose 5.5% to RM1.4 billion during its financial year ended June 2019, largely driven write-backs of impairment losses on loans. While margins have come under pressure, with the annualised NIM dropping to 2.01% in 1HFY2019 (FY2018: 2.12%) amid keen deposit competition, HLB remains among the more cost-efficient banks, with a cost-to-income ratio of 43.9%. Its conservative liquidity position allows the Group the flexibility to expand at a faster pace if necessary and achieve stronger NIM and earnings, moving forward.
- **Residential mortgage segment continued to dominate the loan book**  
HLB registered a higher y-o-y loan growth of 4.8% as at end-December 2018 (FY2018: 3.1%). Growth was evident in most segments, though the most notable would be residential mortgage financing, which recorded an 8.8% y-o-y growth and accounted for 48.9% of the loan portfolio as at end-2018. Loan growth moving forward is expected to be driven by the retail and business banking segments.
- **Capital ratios continue to strengthen**  
HLB's consolidated CET1 and total capital ratios stood at 12.7% and 16.3% as at end-2018 (FY2018: 12.6%, 16.3%). The group's capital ratios remained well above the minimum regulatory requirements of 7.0% and 10.5% (including the capital conservation buffer) upon full implementation of BNM's Basel III in 2019. HLB continues to demonstrate prudent liquidity policy with a loans-to-funds ratio of 79.0%, allowing it room to scale up and expand its loan growth if needed. The group's CASA ratio stood at 24.8% as at end-2018.

## HONG LEONG BANK BERHAD

Table 1: Key financial indicators

FYE 30 June	1H2019	2018	2017
Total assets (RM bil)	212.0	202.9	195.6
Gross loans (RM bil)	131.6	129.1	125.1
Loan growth y-o-y (%)	4.8	3.1	3.8
Gross impaired loans (RM bil)	1.0	1.1	1.2
Customer deposits (RM bil)	162.6	157.4	155.2
Profit before tax (RM bil)	24.5	3.2	2.7
Shareholders' funds (RM bil)	212.0	23.9	22.7
Return on assets (%)	1.34*	1.32	1.11
Return on equity (%)	11.5*	11.3	9.8
Net interest margin (%)	2.01*	2.12	2.12
Cost/income ratio (%)	43.3	42.6	44.1
Gross impaired loan ratio (%)	0.80	0.87	0.96
Loan loss reserve coverage (%)	121.8	89.5	96.0
CET1 capital ratio (%)	12.7	12.6	13.3
Tier 1 capital ratio (%)	13.3	13.3	13.7
Total capital ratio (%)	16.3	16.3	15.8
Loan-to-funds ratio (%)	79.0	80.0	79.0
Gross loans/Customer deposits (%)	81.0	82.0	80.6
CASA deposits/Customer deposits (%)	24.8	26.2	25.0

\*annualised

Figure 1: Total loan exposure by segment

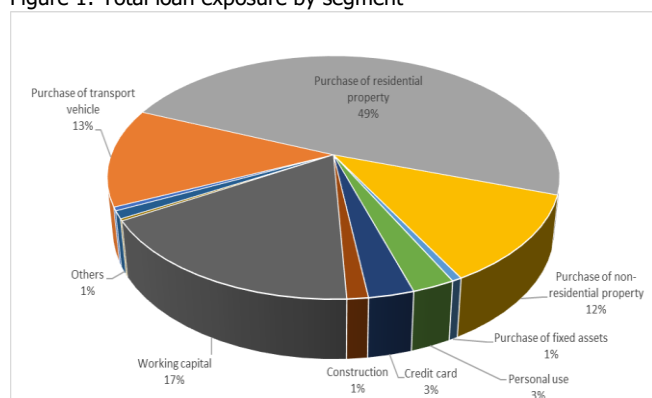
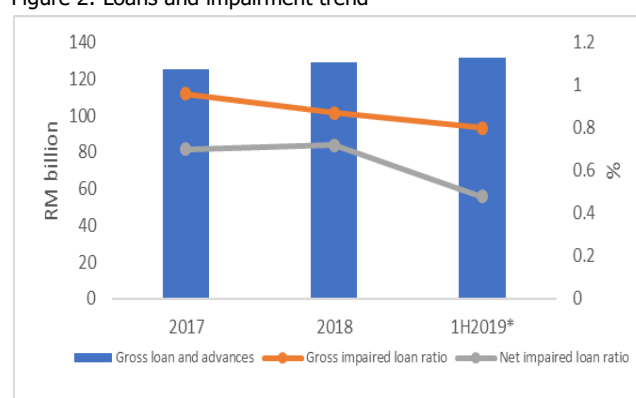
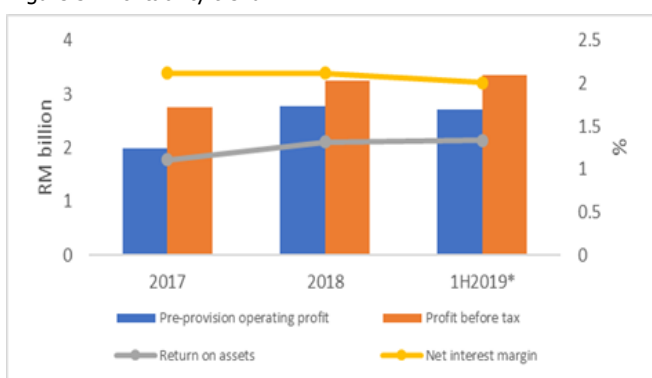


Figure 2: Loans and impairment trend



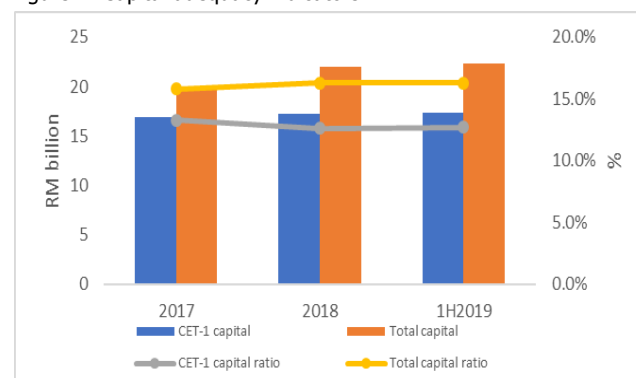
\*annualised

Figure 3: Profitability trend



\*annualised

Figure 4: Capital adequacy indicators



Sources: Company, MARC

## AMBank (M) BERHAD

### Background

Ambank (M) Berhad (Ambank) is the core subsidiary of AMMB Holdings Berhad (AMMB), which is the sixth-largest banking group in Malaysia by assets. The bank is involved in commercial banking, investment banking and general and life insurance, and its exposure is mainly in the domestic market. AMMB's major shareholders are ANZ Funds Pty Limited, Tan Sri Azman Hashim (via Amcorp Group Berhad) and the Employees' Provident Fund.

### Key Highlights

➤ **Stable operating performance despite challenging environment**

Ambank recorded 28.1% y-o-y growth in pre-tax profit to RM972.5 million for 9MFY2019 (9MFY2018: RM759.4 million). This was mainly due to higher net interest income as loans grew 4.1% y-o-y, as well as write-backs on allowances for impairments on loans and advances. Although there was some margin compression, with the annualised NIM for 9MFY2019 standing at 2.3%, Ambank's operating performance was supported by better cost management during the period. Its cost-to-income ratio improved to 51.7% in 9MFY2019 (FY2018: 62.3%).

➤ **Loan growth driven by residential mortgages and SME lending**

Ambank has gone through a rebalancing of its portfolio over the past few years, reducing its auto loan exposure to the vulnerable income group. Ambank registered y-o-y loan growth of 6.1% as at end-9MFY2019, faster than the industry's 5.6% growth. SME and residential mortgage loans were the main growth catalysts, increasing by 21.2% and 13.2% over the same period. As residential mortgage loan growth is expected to ease in 2019 on the back of a cautious outlook on the property sector, the key driver of net interest income expansion in the near term is likely to be a sustained SME loan growth.

➤ **Superior asset quality supported by solid impaired loans coverage:** Ambank's GIL ratio improved marginally to 1.52% as at end-9MFY2019 (FY2018: 1.55%) as the loan base grew faster than impairment levels. Loan loss coverage inclusive of regulatory reserves rose to 122%. Given the high growth in the SME segment, a deterioration in the Malaysian economy could have a more pronounced impact on Ambank's asset quality.

➤ **Comfortable capital and liquidity position**

Ambank's capital ratios remain above minimum requirements with CET1 and total capital ratios of 11.4% and 17.0% for 9MFY2019. The group's funding and liquidity profile remained healthy, underpinned by a high proportion of individual depositors at 46.8% of its total customer deposits as at end-December 2018, as well as a loan-to-customer deposit ratio of 91.0%. Ambank's relatively low CASA ratio of 19.2% will continue to pressure its cost of funds and as such NIMs going forward.

➤ **M&A talks back in the fray?**

The Australia and New Zealand Banking Group (ANZ) previously stated its intention to exit from its investment in Ambank, in line with ANZ's divestment plans from the Asian region. Tan Sri Azman Hashim also plans to retire and eventually sell his stake in Ambank. We do not rule out the possibility of M&A talks resurfacing in the near future.

## AMBANK (M) BERHAD

Table 1 : Key financial indicators

FYE 31 March	9M2019	2018	2017
Total assets (RM bil)	107.5	95.1	90.6
Gross loans (RM bil)	70.8	68.0	63.2
Loan growth y-o-y (%)	6.1	7.6	5.7
Gross impaired loans (RM bil)	1.1	1.1	1.2
Customer deposits (RM bil)	77.8	69.8	67.4
Profit before tax (RM bil)	1.0	0.9	1.2
Shareholders' funds (RM bil)	9.3	8.9	8.8
Return on assets (%)	0.97*	0.76	1.08
Return on equity (%)	10.83*	8.02	11.18
Net interest margin (%)	2.30*	2.34	2.24
Cost/income ratio (%)	51.7	62.3	52.2
Gross impaired loan ratio (%)	1.52	1.55	1.90
Loan loss reserve coverage (%)	86.4	64.7	70.9
CET1 capital ratio (%)	11.4	10.7	11.5
Tier 1 capital ratio (%)	12.3	11.7	12.7
Total capital ratio (%)	17.0	16.2	16.4
Loan-to-funds ratio (%)	79.8	85.2	81.5
Gross loans/Customer deposits (%)	91.0	97.5	93.7
CASA deposits/Customer deposits (%)	19.2	19.7	20.2

\*annualised

Figure 1: Total loan exposure by segment

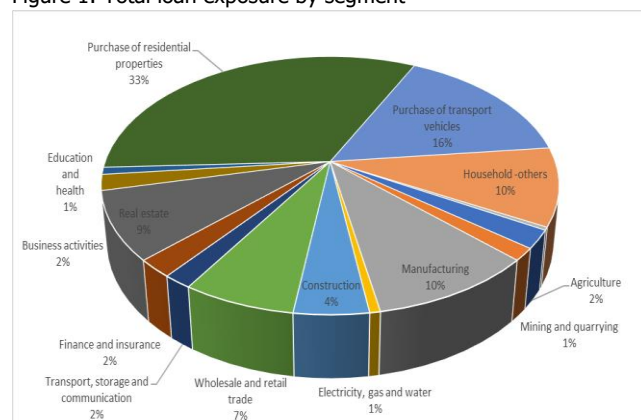
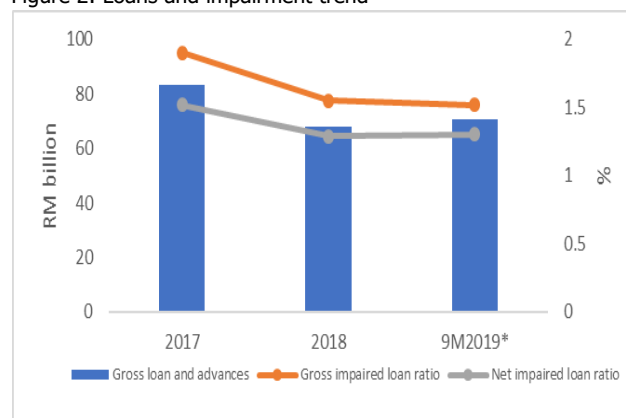
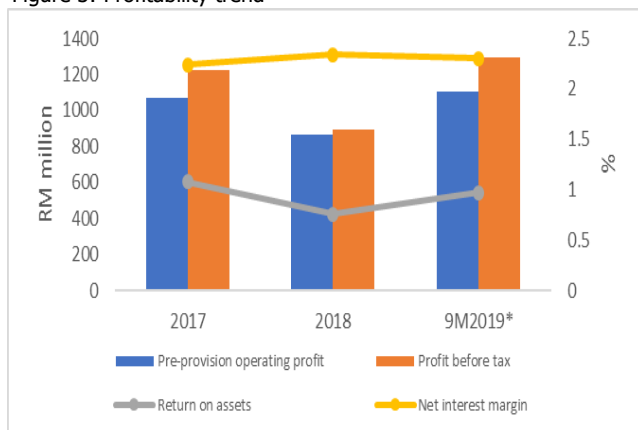


Figure 2: Loans and impairment trend



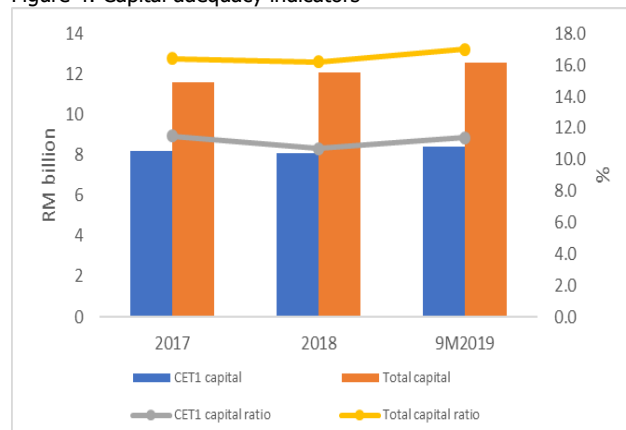
\*annualised

Figure 3: Profitability trend



\*annualised

Figure 4: Capital adequacy indicators



Sources: Company, MARC



## UNITED OVERSEAS BANK (MALAYSIA) BERHAD

### Background

Incorporated in 1993, United Overseas Bank (Malaysia) Berhad (UOBM) is a wholly-owned subsidiary of UOB Limited - the third-largest banking group in Singapore. UOBM is UOB Limited's largest subsidiary outside Singapore, constituting about 10% of the Group's asset base. UOBM has a strong presence in the residential property mortgage and SME financing segments. UOBM is highly strategic to its parent company, with strong operational ties and business strategies that are aligned.

### Key Highlights

#### ➤ **Earnings momentum continues**

UOBM continued its strong performance with a 6.7% increase in its pre-tax profit to RM1.6 billion for FY2018. This was achieved on the back of lower impairment charges. The Group's NIM dipped slightly to 2.0% after hovering at 2.1% over the years, in line with the broader banking industry. UOBM's cost optimisation efforts continue to underscore its cost-to-income ratio, which came in at 38.9% as at end-2018, among the lowest in the industry.

#### ➤ **Mid-single digit loan growth**

Following modest loan growth of 1.7% in 2017, the Group's loan book expanded by 5.3% in 2018. In terms of sector, loan growth was largely fuelled by the residential mortgage, manufacturing as well as wholesale and retail trade segments. UOBM's loan growth is expected to continue its mid-single digit trend amid recent headwinds.

#### ➤ **Sound asset quality**

UOBM's asset quality is deemed sound, although its GIL ratio increased slightly to 1.72% as at end-2018 (2017: 1.71%). UOBM's loan portfolio is largely concentrated in residential properties and non-residential properties, forming about 56% of its financing as at end-2018. The credit quality of the property segments weakened slightly with GIL ratios of 1.40% and 0.87% as at end-2018 (2017: 1.27%; 0.66%). Although substantial exposure to the property sector may expose the Group to any sudden and prolonged downturn in the sector, the credit quality of these segments has stayed strong.

#### ➤ **Capitalisation among the best in the industry**

UOBM's capital position remained robust and stood among the best in the industry, with CET1 and total capital ratios of 15.4% and 18.7% as at end-2018, due to good internal capital generation.

#### ➤ **Good funding and liquidity profile**

UOBM has a large retail deposit base, constituting 54.3% of customer deposits as at end-2018.

## UNITED OVERSEAS BANK (MALAYSIA) BERHAD

Table 1: Key financial indicators

FYE 31 December	2018	2017	2016
Total assets (RM bil)	113.1	102.1	100.5
Gross loans (RM bil)	83.3	79.1	77.8
Loan growth y-o-y (%)	5.3	1.7	7.9
Gross impaired loans (RM bil)	1.4	1.4	1.2
Customer deposits (RM bil)	85.4	76.6	75.2
Profit before tax (RM bil)	1.6	1.5	1.5
Shareholders' funds (RM bil)	10.1	9.3	8.5
Return on assets (%)	1.15	1.13	1.12
Return on equity (%)	12.7	12.9	13.5
Net interest margin (%)	2.00	2.08	2.05
Cost/income ratio (%)	38.9	37.2	38.5
Gross impaired loan ratio (%)	1.72	1.71	1.58
Loan loss reserve coverage (%)	95.8	113.9	110.7
CET1 capital ratio (%)	15.4	15.5	14.5
Tier 1 capital ratio (%)	15.4	15.5	14.5
Total capital ratio (%)	18.7	19.0	18.0
Loan-to-funds ratio (%)	92.2	93.2	93.0
Gross loans/Customer deposits (%)	85.0	90.1	89.4
CASA deposits/Customer deposits (%)	27.8	27.3	27.9

Figure 1: Total loan exposure by segment

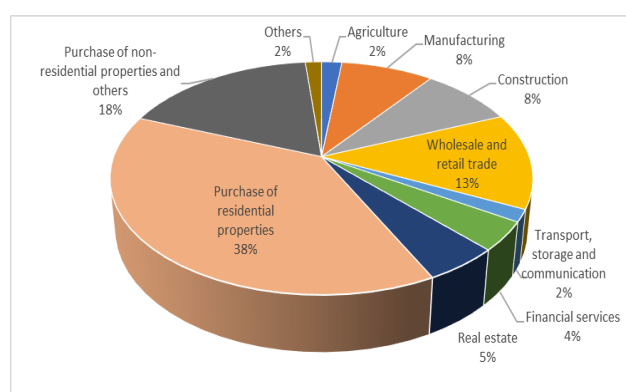


Figure 2: Loans and impairment trend

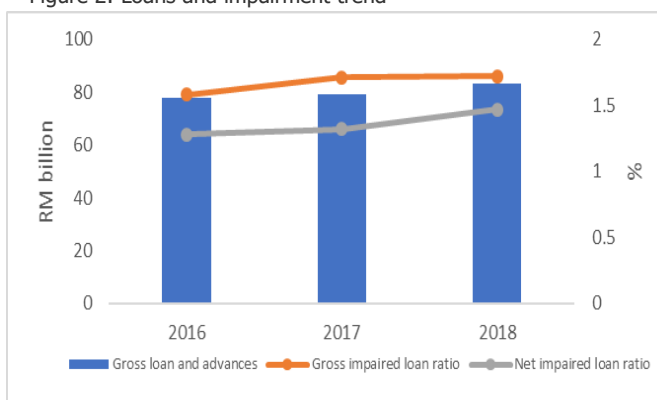


Table 3: Profitability trend

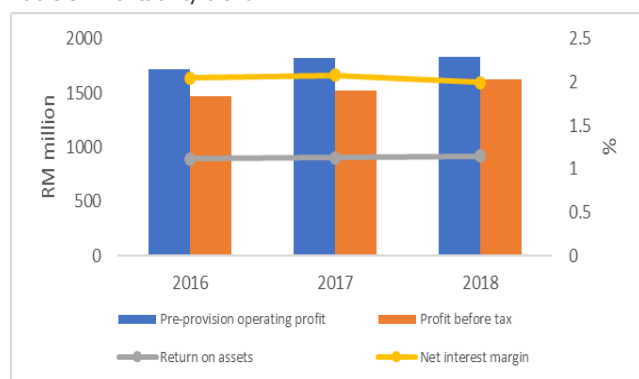
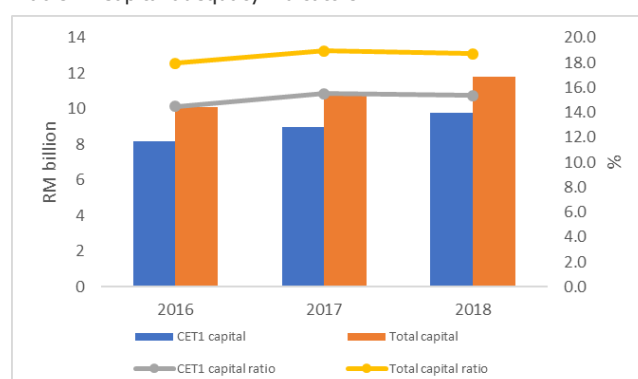


Table 4: Capital adequacy indicators



Sources: Company, MARC

## OCBC BANK MALAYSIA BERHAD

### Background

OCBC Bank (Malaysia) Berhad (OCBC Bank) is a wholly-owned subsidiary of OCBC Limited, Singapore's second-largest banking group by assets. The Group's Shariah-compliant operations have been conducted through its subsidiary, OCBC Al-Almin Bank Berhad. OCBC Bank has a strong reputation among mid-sized corporates and SMEs, which have always been its main earnings drivers. These segments constitute the bulk of its pre-tax profit. OCBC Bank is highly strategic to its parent company, with strong operational ties and business strategies that are aligned.

### Key Highlights

➤ **Earnings affected by lower non-interest income**

OCBC Bank's pre-tax profit declined by 13.9% to RM1.1 billion due to decreased non-interest income on lower forex gains as well as higher impairment charges in 2018. This translated into a lower ROA of 0.86%. Positively, the Group's NIM continued its improving trend, increasing to 1.65% from 1.57% in 2017. This was achieved on higher net interest income following the pick-up in loan growth.

➤ **Loan growth has started to pick-up**

After a period of strong growth from 2010 to 2015 particularly in the property sector, the Group's loan growth contracted for the following two years. OCBC Bank took a more cautious strategy as it experienced some stresses in its residential property mortgages. The Group tightened its lending strategy and remained selective in lending to this segment. In 2018, loan growth resumed at a modest rate of 1.5%. We expect loan growth to remain tepid in the next few years. Mirroring its parent's direction, OCBC Bank focuses on mid-sized corporates and SMEs. The group also has a prominent presence in the Malaysian property financing market, despite having a smaller branch network than its larger peers. As at end-2018, OCBC Bank held 5% of the Malaysian banking system's residential property mortgages.

➤ **Cautious strategy translated into improved asset quality**

The Group's GIL ratio improved to 1.92% as at end-2018 (2017: 2.09%), which was above the domestic banking industry average of 1.57%. The Group recorded further write-backs of collective provisions in 2018 which had caused loan loss coverage to decline further to 67.4% as at end-2018 (2017: 69.2%). Even so, OCBC Bank's substantial exposure to property mortgages (40%) renders it susceptible to any sudden and prolonged downturn in the sector.

➤ **Capitalisation remains sound**

OCBC Bank recorded lower CET1 and total capital ratios of 13.2% and 17.4% as at end-2018, due to higher RWA. Credit RWA increased by 9.1% on the back of a larger loan base.

➤ **Sound funding and liquidity**

Customer deposits grew by 4.7% in 2018, outpacing loan growth. As a result, the loans-to-funds ratio improved to 89.4% (2017: 90.6%). OCBC Bank's LCR and NSFR are above the regulatory minimums. Given its strategic importance to the Group, OCBC Bank may receive liquidity support from OCBC Limited in times of need.

## OCBC BANK MALAYSIA BERHAD

Table 1: Key financial indicators

FYE 31 December	2018	2017	2016
Total assets (RM bil)	96.9	92.0	94.4
Gross loans (RM bil)	69.5	68.4	68.5
Loan growth y-o-y (%)	1.5	(0.1)	(1.6)
Gross impaired loans (RM bil)	1.3	1.4	1.5
Customer deposits (RM bil)	68.6	65.5	68.6
Profit before tax (RM bil)	1.1	1.3	1.1
Shareholders' funds (RM bil)	7.5	6.9	6.7
Return on assets (%)	0.86	1.02	0.86
Return on equity (%)	11.4	14.0	12.7
Net interest margin (%)	1.65	1.57	1.46
Cost/income ratio (%)	46.6	44.4	45.6
Gross impaired loan ratio (%)	1.92	2.09	2.17
Loan loss reserve coverage (%)	67.4	69.2	74.0
CET1 capital ratio (%)	13.2	13.4	11.9
Tier 1 capital ratio (%)	14.8	15.3	13.9
Total capital ratio (%)	17.4	18.1	16.9
Loan-to-funds ratio (%)	89.4	90.6	93.9
Gross loans/Customer deposits (%)	91.6	92.9	96.6
CASA deposits/Customer deposits (%)	32.4	30.4	33.7

Figure 1: Total loan exposure by segment

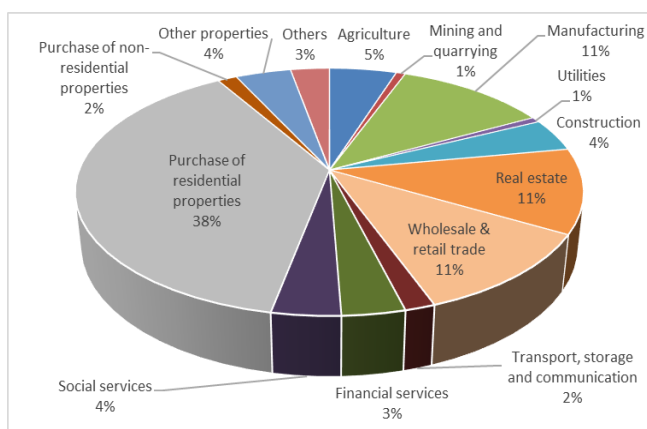


Figure 2: Loans and impairment trend

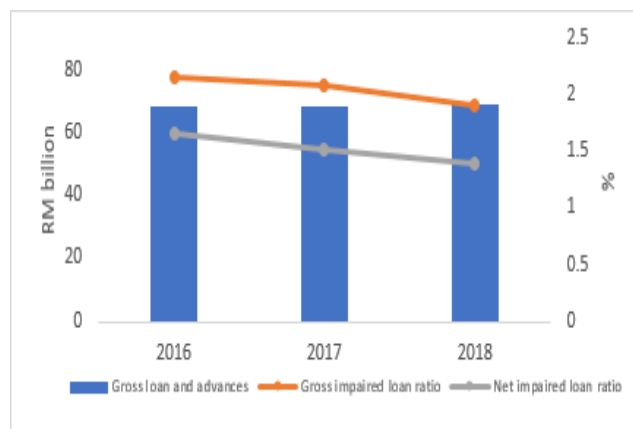


Figure 3: Profitability

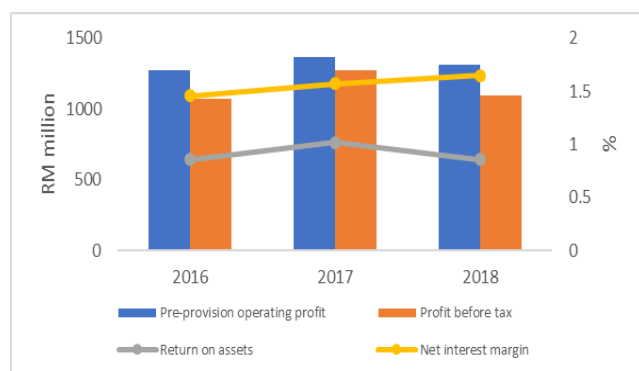
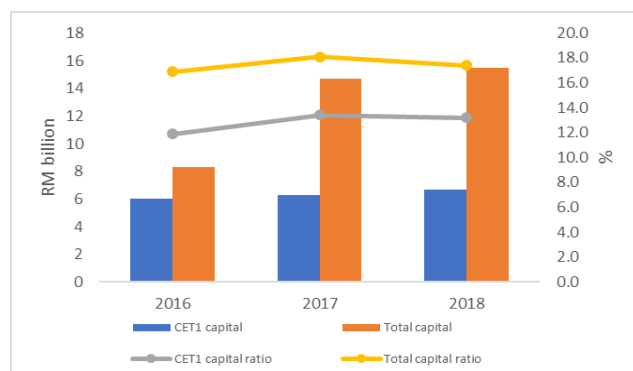


Figure 4: Capital adequacy indicators



Sources: Company, MARC

## HSBC BANK MALAYSIA BERHAD

### Background

Incorporated in 1994, HSBC Bank Malaysia Berhad (HSBC Bank) is a wholly-owned subsidiary of The Hongkong and Shanghai Banking Corporation Limited, with HSBC Holdings as its ultimate parent. HSBC Holdings is one of the world's largest banking groups by assets. The Group has around 3,900 offices across 67 countries and is listed on the London, Hong Kong, New York, Paris and Bermuda stock exchanges. HSBC Bank has 68 branches nationwide, which is the largest network among locally-incorporated foreign banks in Malaysia. HSBC Bank has a prominent presence in retail, corporate and commercial banking.

### Key Highlights

#### ➤ **Satisfactory earnings performance**

In 2018, HSBC Bank recorded a 23% increase in its pre-tax profit to RM1.5 billion. Its profitability was supported by higher net interest income, higher profit contribution from its Islamic banking operations and lower impairment charges recorded during the year. However, these were partially offset by lower trading income. In line with the global group's greater emphasis in managing operating expenses through better streamlining of processes, HSBC Bank improved its cost-to-income ratio to 48.5% in 2018 (2017: 51.0%).

#### ➤ **Weaker momentum in loan growth**

The Group's loan book grew slower at 2.2% in 2018 after registering strong growth in 2017 (10.9%). HSBC Bank has been tightening its lending criteria for the retail segment in recent years, which had led to a contraction in the residential property and personal use loan segments. On the retail side, we understand that the Group will continue to focus on growing its credit card portfolio while remaining selective in underwriting residential property loans and loans for personal use. MARC views positively its de-risking exercise, as this is expected to improve the Group's asset quality in the medium to long term.

#### ➤ **Asset quality improving**

HSBC Bank's de-risking exercise has started to show some positive results marginally. The Group's GIL ratio eased slightly to 2.05% as at end-2018 (2017: 2.07%). The impairments are mostly from its retail loan portfolio (residential mortgages and loans for personal use). We note that the stricter loan origination will take time to yield results.

#### ➤ **Strong capital and liquidity position**

The Group's capitalisation further strengthened, with its CET1 and total capital ratios increasing to 15.0% and 18.0% as at end-2018. HSBC Bank's proportion of CASA to customer deposits is among the highest in the industry at 57.4% as at end-2018. This further contributed to its high LCR which remained well above the required 100%. The Group's loans-to-funds ratio stood at a comfortable 94.4% as at the same date.

## HSBC BANK MALAYSIA BERHAD

Table 1: Key financial indicators

FYE 31 December	2018	2017	2016
Total assets (RM bil)	83.9	80.7	85.4
Gross loans (RM bil)	53.9	52.8	47.6
Loan growth y-o-y (%)	2.2	10.9	(8.3)
Gross impaired loans (RM bil)	1.1	1.1	1.0
Customer deposits (RM bil)	57.1	56.5	57.2
Profit before tax (RM bil)	1.5	1.2	1.3
Shareholders' funds (RM bil)	10.2	9.4	8.7
Return on assets (%)	1.43	1.13	1.17
Return on equity (%)	12.1	10.4	11.4
Net interest margin (%)	2.06	1.84	1.81
Cost/income ratio (%)	48.5	51.0	50.1
Gross impaired loan ratio (%)	2.05	2.07	2.16
Loan loss reserve coverage (%)	56.4	74.5	68.1
CET1 capital ratio (%)	15.0	14.8	14.0
Tier 1 capital ratio (%)	15.0	14.8	14.0
Total capital ratio (%)	18.0	18.1	17.5
Loan-to-funds ratio (%)	92.6	91.6	76.2
Gross loans/Customer deposits (%)	94.4	93.4	78.2
CASA deposits/Customer deposits (%)	57.4	58.6	54.0

Figure 1: Total loan exposure by segment

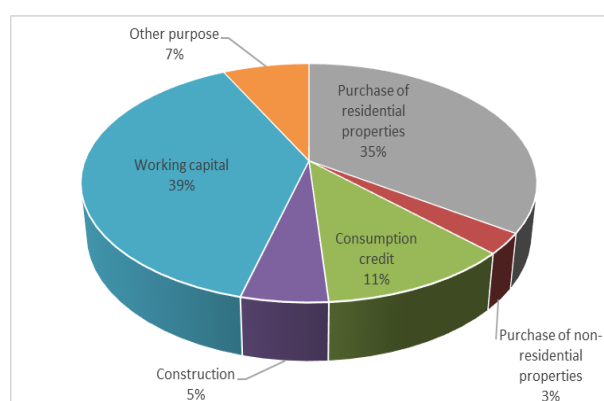


Figure 2: Loans and impairment trend

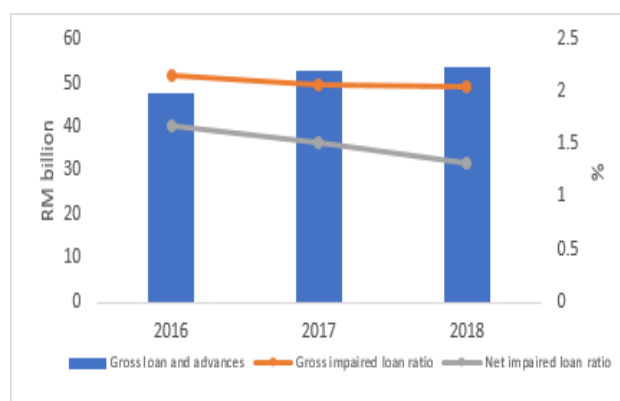


Figure 3: Profitability trend

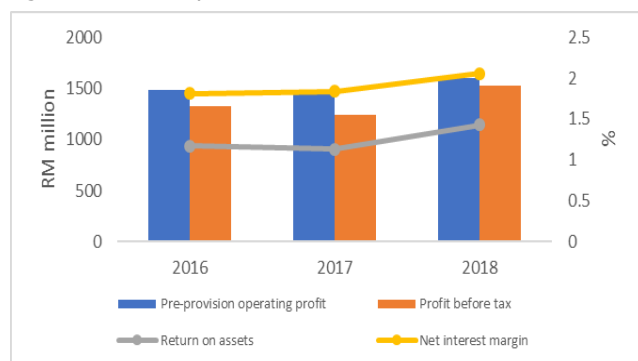
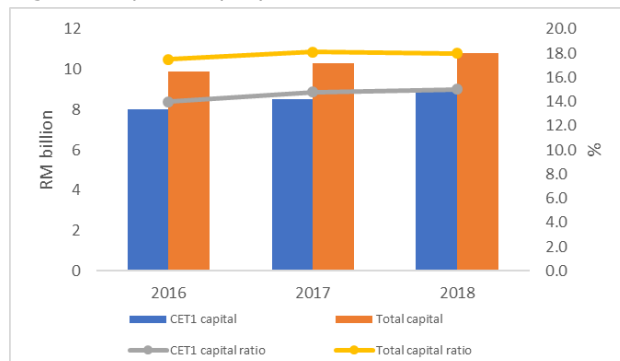


Figure 4: Capital adequacy indicators



Sources: Company, MARC

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