

Macquarie remains guarded on Malaysian banks

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Global research firm Macquarie Research said in a report today that it remains guarded on Malaysian banks, claiming that higher loan loss provisions will be the main earnings headwind in 2016 for these banks.

According to the research firm, while falling net interest margins (NIMs) have been the main earnings headwind for Malaysian banks this year, it believes a normalisation of loan loss provisions (no further writebacks and provisions for new non-performing loan [NPL] formation), will be the key earnings headwind for 2016.

“We find it difficult to believe that the market turbulence (including a sharp fall in commodities and significant ringgit depreciation against most major currencies) will not result into more stress on asset quality for Malaysian banks,” the research house opined.

“Consequently, we are conservatively positioned in Malaysia with Public Bank as our top-pick followed by Hong Leong Bank. To hedge our very cautious bottom up view on banks against our bullish top-down view on Malaysia, we maintain Alliance Financial Group on ‘outperform’ (100% Malaysia, SME and retail focus) and upgrade Maybank to ‘neutral’,” it added.

Macquarie noted that a major support for Malaysian banks’ earnings over the past three years has been high writebacks of loan loss provisions, accounting for around 10% of pre-tax profit for these banks in 2014.

“This support will fall away in 2016 we think. First of all, there is little to write back anymore and secondly we do not believe that this is the right (market and economic) environment for further punchy writebacks of provisions,” it said.

“Due to aggressive writebacks of loan loss provisions and new NPL formation, the NPL coverage ratio for Malaysia banks is on a declining trend. This trend is unsustainable –particularly in the current environment – we think,” the research house added.

Macquarie also pointed out that some Malaysian banks have an uncompetitive high cost/income ratio (excluding Public Bank) which results into a lower return on equity (RoE) profile.

“Interestingly, topline growth is still the main strategic focus while cost efficiency improvements seem less of a priority. Some banks have restructuring programs in place, but tangible cost benefits remain mostly untraceable.

“RoE in the past was artificially high for Malaysian banks due to high leverage, high NIMs and low loan loss provisions due to punchy writebacks. Capital ratios have been going up, NIMs are falling and loan loss provisions have to go up in our view. Bottom line is that we do not believe that RoE has bottomed yet for Malaysian banks,” the research house said.

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