

**AmResearch**

Sector Report

3 November 2014

BANKING SECTOR

*Proposed changes in credit card fees***NEUTRAL**

(Maintained)

Rachel Huang

huang-teng-siang@ambankgroup.com

+603 2036 2293

*Rationale for report : Sector update***Investment Highlights**

- **Proposed changes to credit card interchange fees.** Bank Negara Malaysia (BNM) has released a Payment Card Reform Framework Concept Paper, outlining some changes to the credit card and debit card interchange fees.
- **A cap of 1.00% is proposed, instead of the current 1.2%, effective from 2 January 2015 to 2020...** BNM has proposed that the interchange fees for credit card transactions shall not exceed 1.00% of the value of the transaction for the period between 2 January 2015 and 31 December 2020.
- **...and a further cap of 0.48% post 2021.** It is proposed that the cap be further reduced to 0.48% from 2021 onwards.
- **Move to reduce costs for the public.** BNM said the recent revision and increase in interchange fee rates by operators of the major international payment card networks has caused payment card acquirers to raise the merchant fees or merchant discount rates (MDR) of about 46,300 merchants to offset the increase in cost. BNM said merchants in turn are likely to recover the increase in cost by raising the prices of goods and services, thus adversely impacting not only the cardholders but the general public at large.
- **Estimated loss in revenue of RM202mil per annum between 2015 and 2020, based on current data.** We estimate that the difference in the 1.2% and 1.0% interchange fees will lead to a loss in revenue of about RM202mil per annum for the industry.
- **Estimated loss in revenue of RM728mil per annum post 2021.** Based on the eventual cap of 0.48% and the current rate of 1.2%, the loss in revenue would be RM728mil per annum.
- **CIMB and Maybank have relatively larger market share of credit cards receivables.** Of the local banks, we estimate that CIMB and Maybank have the largest market share currently in terms of credit card receivables, at 16% and 15% respectively. Next on line is HLBB's 12.2%, followed by RHB Cap at 5.8%, PBB at 4.6% and AFG at 1.7%. We think this will also closely reflect the market share of purchase transactions by credit card holders. The banks are likely to mitigate the impact of this through, perhaps, lesser reward programmes to credit card holders.
- **Maintain NEUTRAL.** We affirm our NEUTRAL rating on the sector, based on the latest news.

EXHIBIT 1: VALUATION MATRIX

Stock	Rating	Sh Pr (RM)	FV (RM)	Issued shares (m)	Mkt Cap (RMm)	PE (x)		EPS growth (%)		P/BV (x)		BV (RM)		ROE (%)		N Div. Yield (%)	
						Pros1	Pros2	Pros1	Pros2	FY14	FY15	FY15	Pros1	Pros2	Pros1	Pros2	
AMMB	NR	6.78	NA	3,014.2	20,436	12.3	11.4	9.9	10.1	1.6	1.4	4.77	14.2	14.4	4.0	4.4	
AFG	HOLD	4.79	5.30	1,548.1	7,415	13.8	13.2	6.1	9.8	1.8	1.6	2.93	13.8	14.1	3.8	4.1	
CIMB	HOLD	6.49	6.85	8,336.5	54,104	11.1	12.8	-13.5	11.9	1.5	1.3	4.81	12.7	12.5	3.7	3.9	
HLBB	BUY	14.62	17.00	1,879.9	27,484	12.3	12.0	1.6	2.3	1.8	1.7	8.78	14.1	13.2	2.6	2.7	
Maybank	HOLD	9.70	10.20	9,009.0	87,387	13.1	13.4	-2.3	6.4	1.7	1.6	6.02	13.5	13.3	5.7	5.5	
PBB	HOLD	18.54	20.00	3,882.1	71,975	16.6	16.3	1.9	14.7	2.6	2.4	7.87	18.4	17.4	3.1	3.3	
RHB Cap	HOLD	8.80	9.18	2,546.9	22,413	12.2	12.0	2.3	7.1	1.2	1.1	7.75	10.8	10.7	1.9	2.0	
Simple average						13.1	13.0	0.9	8.9	1.7	1.6		13.9	13.6	3.5	3.7	
Weighted average						13.4	13.6	-1.6	9.5	1.9	1.7		14.5	14.0	3.9	4.0	
MBSB	HOLD	2.59	2.40	2,621.8	6,790	7.6	10.9	-30.6	2.6	1.7	1.6	1.65	20.2	15.4	3.9	4.6	

*Note: AMMB's forecasts based on consensus.**Source: Bloomberg / Company / AmResearch. Note: AMMB's forecasts based on Bloomberg consensus forecasts.*

CURRENT STRUCTURE

Our focus of discussion in this report will be on the credit card segment, given that debit cards transactions are not as significant currently and are less than 10% of credit card transactions.

The issuer bank issues credit cards to consumers, and is responsible for the payment obligation in relation to a credit card.

An acquirer bank is the registered operator of a payment system that provides merchant acquiring services for credit card.

We understand that the merchants are typically charged on an average of 1.5% to 2.0% of per transaction. This is normally referred to as the merchant fee or merchant discount rate (MDR), i.e. the payment made by the merchant to the acquirer for each domestic payment card transaction.

The MDR comprises the interchange fee, the processing and other fees imposed by an operator of a payment card network, other costs incurred by the acquirer and the acquirer's margin.

The interchange fees refers to the fee paid by the acquirer bank to the issuing bank. Currently the interchange fees range around 1.2%.

Thus, in a typical transaction, if a customer holds Bank A's credit card and undertakes a RM100 transaction at a merchant which has been acquired by Bank B, the merchant may be charge up to 2.0% or RM2.00 for the transaction.

The merchant will pay 2.0% or RM2.00 to the acquirer Bank B. Bank B will pay 1.2% of the transaction, or RM1.20 to Bank A which has issued the credit card to the customer. Bank B being the acquiring bank (of the merchant), thus get a net fee of 0.8%, or RM0.80 for the transaction.

If Bank A is both the issuing and acquiring bank, it will enjoy the full 2.0% fee.

We view the higher fees being accorded to the issuing bank as compensation for the free funding period between the transaction date and the payment date, as well as for bearing any potential credit costs arising from the credit card holder.

The acquirer bank does not bear any risks of credit costs, but it will have to bear the costs upfront for setting up the terminals at the merchants.

There is also a portion of fees paid to the major international payment card networks, which are called assessment fees.

The two major payment card networks currently are Visa and Mastercard. Per Wikipedia's website, it was stated that Visa's fee is 0.18% and Mastercard's fee is 0.11%, which are presumably paid by the issuer bank. We believe these are average historical rates, and, based

on NM's concept paper, there is now a range of rates likely being imposed by these two major operators.

PROPOSED CHANGES IN CREDIT CARD INTERCHANGE FEES

BNM had released a Payment Card Reform Framework Concept Paper, outlining some changes to the credit card, and debit card interchange fees.

BNM proposed that the interchange fees for credit card transactions shall not exceed 1.00% of the value of the transaction for the period between 2 January 2015 and 31 December 2020.

It is proposed that the cap be further reduced to 0.48% from 1.00%, from 2021 onwards.

RATIONALE FOR THE PROPOSED CHANGES

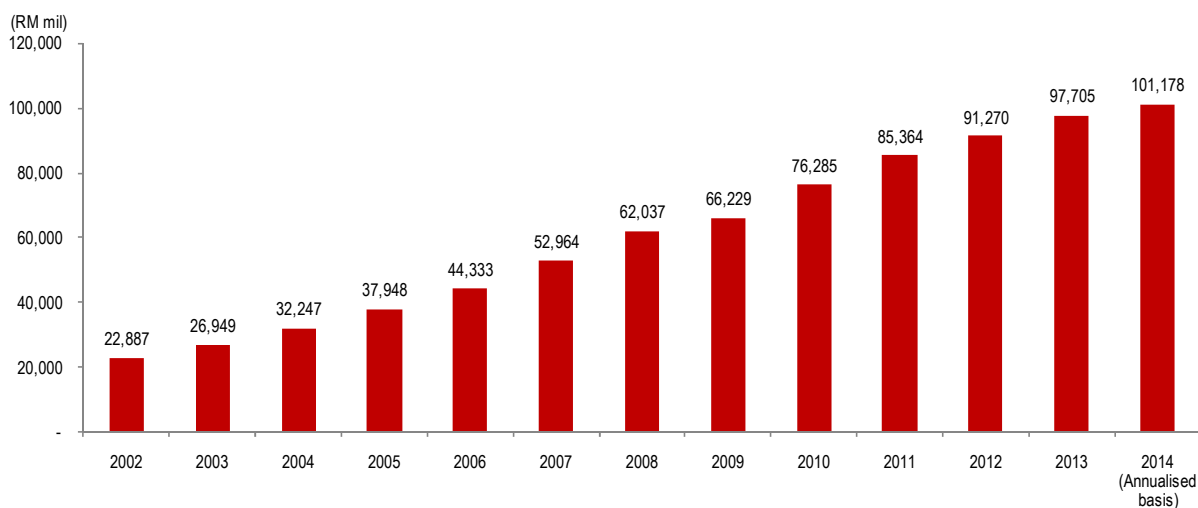
BNM said the recent revision and increase in interchange fee rates by operators of the major international payment card networks have caused payment card acquirers to raise the merchant fees or merchant discount rates (MDR) of about 46,300 merchants to offset the increase in cost. BNM said merchants in turn are likely to recover the increase in cost by raising the prices of goods and services, thus adversely impacting not only the cardholders but the general public at large.

BNM added the higher MDR level in Malaysia which averages between 1.5% and 2.5% is one of the key hindrances to the wider acceptance of payment cards amongst small merchants in Malaysia.

Malaysia also has a higher ratio of credit card transactions at 11.3 transactions per capita as compared to debit card transactions at 1.6 transactions per capita in 2013.

BNM added that although the total credit card transaction volume and value have increased by 15% to 25.5% respectively over the past three years from 295mil transactions amounting to RM79.8bil in 2010, to 339mil transactions amounting to RM100.1bil in 2013, there has been a slowdown in the growth rate of POS terminals since 2012, which indicates a potential saturation of POS terminals at merchants who can afford the current MDR level.

BNM added the recent interchange fee hikes by operators of the major international payment card networks have made the acceptance of payment cards increasingly less affordable to small merchants.

EXHIBIT 1: TOTAL PURCHASES BY CREDIT CARD (BOTH LOCAL AND ABROAD) BY LOCAL CARDHOLDERS (RM MIL)

Source: Bank Negara / AmResearch

IMPACT ON BANKS

There is a total of RM87bil worth of domestic purchases done by local credit cardholders in 2013. On top of this, there was also an additional RM10.7bil purchases by local credit card holders abroad in 2013. Thus, we estimate total purchases to amount to RM97.7bil (see chart above).

Based on the latest reported industry figures for September 2014, we estimate the total purchases to amount to RM101.7bil on annualised basis (see chart above).

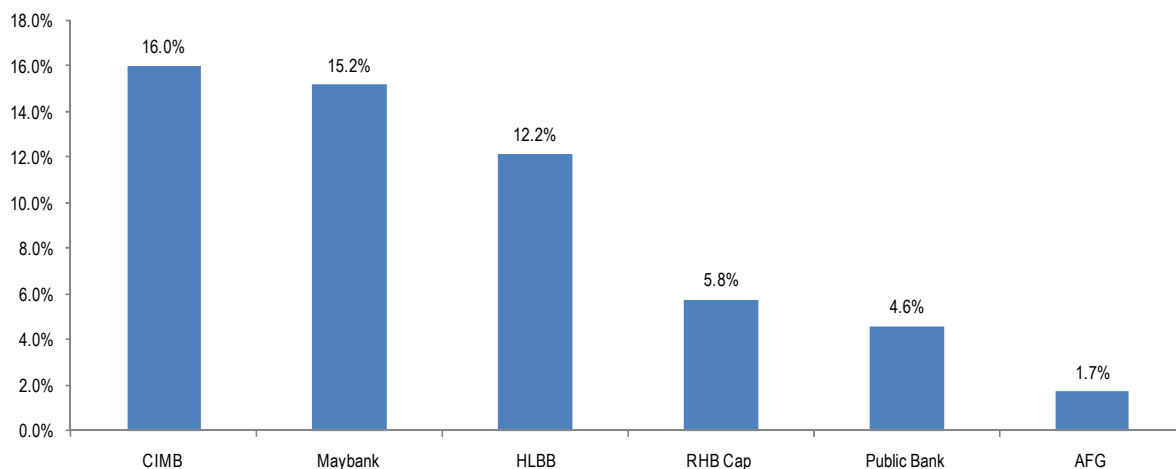
We estimate that the difference in the 1.2% and 1.0% interchange fees will lead to a loss in revenue of about

RM202mil per annum for the industry, on the annualised credit card purchase transaction of RM101.7bil.

Based on the eventual cap of 0.48%, the difference would be RM728mil per annum.

The impact is not as large in the short-to-medium term, but in the longer term post 2021, there is some difference to the revenue.

Of the local banks, we estimate that CIMB and Maybank have the largest market share currently in terms of credit card receivables, at 16% and 15% respectively. Next on line is HLBB's 12.2%, followed by RHB Cap at 5.8%, PBB at 4.6% and AFG at 1.7% (see chart below).

EXHIBIT 2: ESTIMATED DOMESTIC MARKET SHARE OF CREDIT CARD RECEIVABLES (JUNE 2014)

Source: Bank Negara / AmResearch

EXHIBIT 3: SENSITIVITY ANALYSIS ESTIMATED LOSS IN NET EARNINGS, BASED ON MARKET SHARE OF CARD RECEIVABLES (MIL)

Estimated loss in net earnings (RM mil) based on interchange fees of	1.00%	0.48%
CIMB	-24.30	-87.48
Maybank	-23.07	-83.05
HLBB	-18.46	-66.44
RHB Cap	-8.79	-31.63
Public Bank	-6.96	-25.05
AFG	-2.62	-9.43

Source: Bank Negara / AmResearch

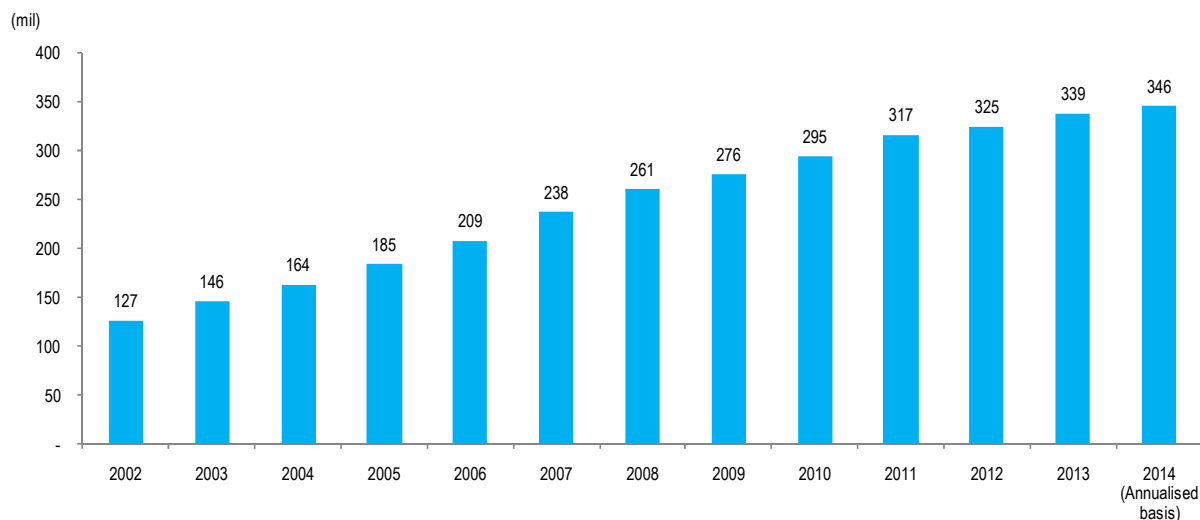
We think this will also closely reflect the market share of purchase transactions by credit card holders.

We have done a sensitivity analysis on the possible loss in net earnings (net of tax), which is prorated based on the market share of card receivables. This is shown in the table above.

On a more positive note, the banks are likely to mitigate the impact of this through, perhaps, lesser reward programmes to credit card holders.

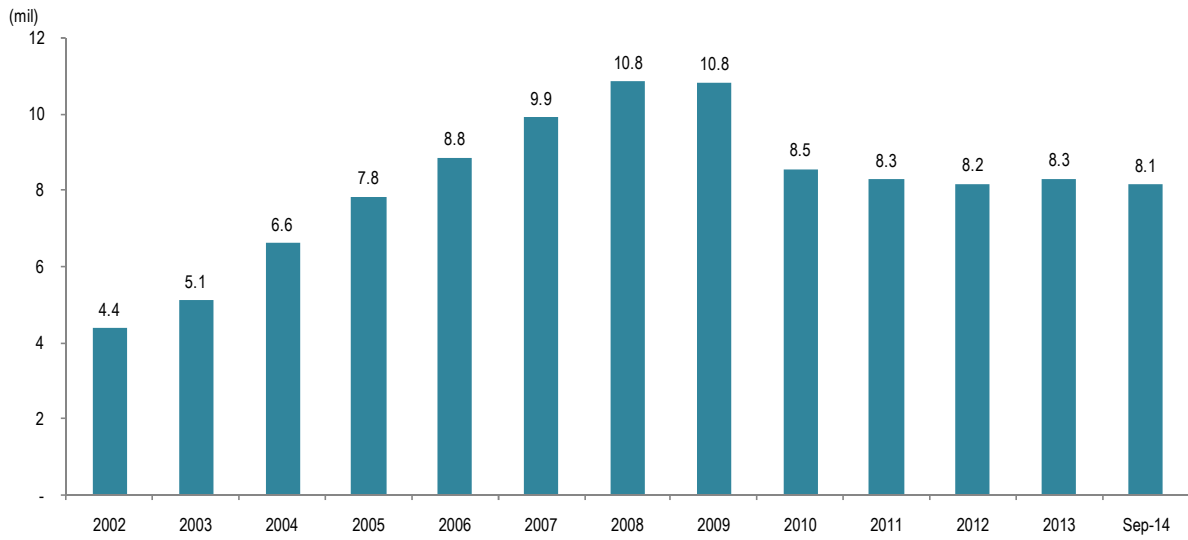
MAINTAIN HOLD

We affirm our NEUTRAL rating on the sector based on latest news.

EXHIBIT 4: NUMBER OF CREDIT CARD TRANSACTIONS (MIL)


Source: Bank Negara / AmResearch

EXHIBIT 5: NUMBER OF CREDIT CARD HOLDERS (PRINCIPAL AND SUPPLEMENTARY) (MIL)



Source: Bank Negara / AmResearch

Published by

AmResearch Sdn Bhd (335015-P)
(A member of the AmInvestment Bank Group)

15th Floor
Bangunan AmBank Group
55 Jalan Raja Chulan
50200 Kuala Lumpur

Tel: (03)2036-2633 (general)
(03)2072-1866/99 (dealing)
(03)2070-2444 (research)

Fax: (03)2078-3162

The information and opinions in this report were prepared by AmResearch Sdn Bhd. The investments discussed or recommended in this report may not be suitable for all investors. This report has been prepared for information purposes only and is not an offer to sell or a solicitation to buy any securities. The directors and employees of AmResearch Sdn Bhd may from time to time have a position in or with the securities mentioned herein. Members of the AmInvestment Group and their affiliates may provide services to any company and affiliates of such companies whose securities are mentioned herein. The information herein was obtained or derived from sources that we believe are reliable, but while all reasonable care has been taken to ensure that stated facts are accurate and opinions fair and reasonable, we do not represent that it is accurate or complete and it should not be relied upon as such. No liability can be accepted for any loss that may arise from the use of this report. All opinions and estimates included in this report constitute our judgement as of this date and are subject to change without notice.

For AmResearch Sdn Bhd



Benny Chew
Managing Director