Systematically building capabilities as an investment bank

An equity and IPO house until the mid-1990s

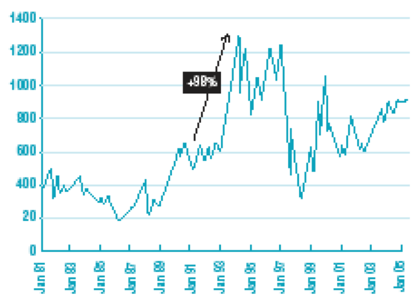
In the 1970s and through most of the 1980s, the scope of business of most merchant banks revolved largely around corporate advisory and IPO work, as the capital market was rather undeveloped. CIMB built up a good base of MNC clients, by leveraging on its foreign shareholders and developing expertise in assisting companies to comply with the New Economic Policy.

The situation started to change around the late 1980s and the early 1990s. A wave of privatisation of mega projects such as the North South Expressway and the award of Independent Power Producer licences created multi-billion Ringgit companies such as UEM Group Berhad and YTL Corporation Berhad.

Concurrently, the listings of Government Linked Companies (GLCs) such as Telekom Malaysia Berhad and Tenaga Nasional Berhad (Tenaga) helped give the capitalisation of Bursa Malaysia another boost. Tenaga's IPO, lead managed by CIMB, was a landmark deal by virtue of its RM3.3 billion size as well as its status as the first global equity offering by a Malaysian company.

These privatisation exercises and IPOs of gargantuan GLCs coincided with the strongest bull-run in Bursa Malaysia's history, lasting from early 1992 until January 1994. Fuelled by foreign funds buying into Malaysia, which had just been 'discovered' together with Emerging Markets Asia by the international fund management community, the KLCI went up by 98% in 1993 alone!

Figure 1: KLCI from 1981 to 2005



Source: Bloomberg

Merchant banks with stockbroking subsidiaries had a windfall. Trading volumes went through the roof, IPO and M&A activities escalated. At that time, CIMB as a merchant bank was not much different from most of the others, being largely a 'stockbroking and IPO house'. But that was enough to earn it an ROE of 200% in 1994. The acquisition of CIMB Securities had paid off many times over within a few years.

Debt capabilities developed through 1990s

CIMB had always operated on the philosophy that looking through the rearview mirror never got one anywhere. Hence, rather than dwell on the successes of the moment, the Group chose to contemplate on what else it could do to position itself for the future.

In most developed countries, both the equity and debt legs are equally important components of their capital markets. In Malaysia's case until the early 1990s, the growth of the capital market had rested largely on a single leg, the equity market.

Based on the experience of other markets, we felt that the corporate debt market had to expand substantially to support the growth of the real economy. Until 1992, the debt market was almost synonymous with government debt securities. Commercial banks and discount houses were the dominant players then, with no one focusing on corporate debt. CIMB set up a specialised debt capital markets team in 1993, whose focus was initially on origination. While the desk was small, the bought deals that it did proved to be quite lucrative.

The decision to develop the bond primary market business turned out to be quite apt, as bond issuance surged in the late 1990s. It was clear that there would be a natural flow-through in activities from the primary to the secondary market, just as we had seen with the experience of equities.

With a risk management infrastructure for debt trading put in place, the Debt Market and Derivatives (DMD) Division was set up in 1977 to undertake the businesses of fixed income, foreign exchange and derivatives, bond trading and market making operations, and this was significantly expanded in 2000 to encompass the debt origination franchise. The Division was further strengthened via the acquisition of CIMB Discount House Berhad from BCB in 2001.

In 2003, the Structured Products unit was set up in Treasury to develop yield enhancing derivative-linked solutions for the Group. Since the inception, it has achieved a number of firsts, pioneering new structured products to this market.

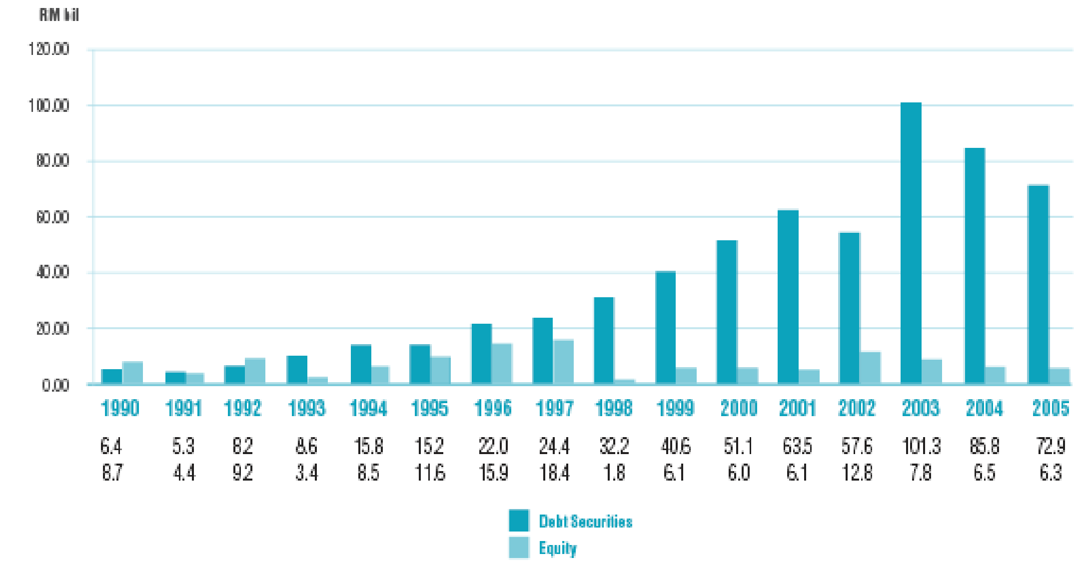
To improve corporate governance and enable individual business segments to specialise, the DMD division was split into two in 2004, with Debt Capital Market & Syndicate (DCMS) focusing on servicing issuers and investors, and Cross Markets Trading & Treasury (CMTT) concentrating on trading in fixed income securities using proprietary funds. In 2005, the range of instruments traded expanded to also include domestic and international equities and commodities.

The decision to grow the debt business when most merchant banks were still congratulating themselves over the success of their equity business turned out to be a visionary one. By the mid-1990s, fund raising in the debt market began to dramatically outpace that of the equity market. The lead has steadily widened every year, and by 2005, the value of total debt securities was 11.5 times that of equities. Reflecting the industry trend, the size of the debt business' contribution to CIMB's income was around 2.3 times that of equity's in 2005, even including CIMB-GK's contribution.

The strength of the debt business also helped CIMB during the Asian crisis, when the crumbling of the equity market led to the collapse of most merchant banks' main sources of earnings from primary equity issues and secondary equity trading.

CIMB would not be the premier investment bank in Malaysia it is today, if it had not made the strategic decision to grow its debt business ahead of its time.

Figure 2: Gross funds raised in the capital market



Source: BNM Monthly Statistical Bulletin

Evolution into an investment bank

British and European merchant banks had been a dominant force in the international banking scene for a long time. However, there was a shakeout in the 1990s, and one by one, many of these merchant banks started to drop out, either due to unsustainable losses or as a result of industry consolidation. By the time the dust had settled, a clear trend emerged - the European merchant banks had lost tremendous ground to the better equipped US banks operating under the investment banking model.

In Malaysia, a number of foreign banks providing advisory work to local corporates were already operating under the investment banking structure with regional head offices located in Singapore or Hong Kong. CIMB was under no immediate pressure to fix its successful business model at that time. Nevertheless, it once again made the decision to opt for the more powerful business model in order to position itself ahead for the future, and to further distance itself from the competition. So CIMB decided to become an investment bank.

An internal re-organisation was undertaken in 2002 to make the Group's services more integrated. Functionally, CIMB and CIMB Securities merged into one, even though they remained as separate legal entities. An Equity Capital Market unit was established, which provided the link between equity origination and distribution - this gap had made it difficult to price equity issues in the past, and proven costly to CIMB in some of the deals it had undertaken previously.

An investment banking unit was set up, so that corporate clients only had to deal with a single account manager for all their origination and distribution needs. Against the prevailing industry practice of corporates having to go to individual departments for their different needs, this decision helped cement ties with corporate clients and enabled it to garner more market share from other banks.

It was not until very recently that other merchant banks made similar decisions to reorganise themselves as investment banks, giving CIMB a good 3-year head-start.

Adding on the pieces

With leadership in debt and equities, CIMB was well ahead of the game, and the envy of other banks. Yet, there was never a sense that what the Group had was complete. There was always more to do in the job to assemble a premier investment bank.

The domestic investment banking industry had several inherent flaws. From a shareholder perspective, the business was overly transaction based. Also, it was highly subject to the vagaries of the domestic capital market, as we saw during the 1997/98 financial crisis. In terms of client segmentation, the business was inherently skewed towards corporate clients, with retailers accounting for only a very small component.

Hence, CIMB was on the lookout for new business opportunities that could counter the cyclicality of the core business, either those with a more stable or recurrent income base, or those exposed to a different client or market segment. Promising new businesses could also provide a fresh leg for growth when the capital market became more matured.

In embarking on the business expansion drive, a strategic decision was made to be a top 3 player in every segment we entered and to do so in the shortest time possible. Where domestic expertise was lacking, a tie up with a foreign partner would be sought. Where in-house specialists were not available, we would go out and hire the best.

In 2004, CIMB Berhad acquired 70% of CTB and CAFM from BCHB, signifying a homecoming for both companies. CIMB first set up CTB in 1995 as a 70:30 joint venture with OCBC Bank of Singapore under the name CIMB-OCBC Unit Trust Management Berhad. CAFM had its origins as a division of CIMB Securities, before being incorporated in 1995 with the shareholding split 20:80 between CIMB and BCHB.
Bankers Trust took a stake in CAFM in 1996, and replaced OCBC as the joint venture partner in CTB in 1997. In 2000, CIMB's 70% stake in CTB and 20% in CAFM were sold to BCHB to streamline the shareholding of the asset management business under the Commerce Group. The foreign shareholding then changed hands to Principal Financial Group in 2002.

After coming back to CIMB, CTB and CAFM were subsequently merged to become CIMB-Principal Asset Management Berhad (CPAM), and a 10% stake was sold to the Principal Financial Group to increase its stake to 40%.

The asset management business was one that CIMB had always wanted because of its annuity income base, and the cross-selling opportunities the business offers to other units in the Group. Since coming back to the fold, CPAM has grown from being the 6th largest to the 4th largest asset manager in the country, with an Assets Under Management (AUM) of RM6.9 billion as at end of 2005, compared to only RM4.9 billion when CIMB took over.

CIMB set up a Private Equity unit in 2000 to focus on proprietary medium to long-term and venture capital investments. In 2001, it formed a partnership with Navis Capital Partner Ltd. to launch the CIMB Muamalat Fund, the first Islamic private equity fund in Asia. Private equity is a natural extension of the investment banking business because of the investment opportunities that the Group comes across in the course of its business. Today, with 4 funds and around RM800m in AUM, CIMB's Private Equity arm is one of the largest in the country.

In 2002, CIMB decided to set up a Private Banking unit as there was a conspicuous gap in financial services offerings to high net worth individuals at that time. As the leading investment bank, it felt that there were a lot of synergies in client referral, cross-selling and product innovation that it could bring to the business. The launch of CIMB Private Banking made it Malaysia's first full-fledged Private Banking service. The business has grown 100% p.a. in AUM terms each year since the end of the first year of inception. In 2003, Private Banking was combined with the Group's retail equities business to form the Private Client Services division, to focus the Group's thrust into retail financial services.

Cognisant of the potential of the Islamic debt origination market and the demand for Islamic instruments, CIMB Islamic was launched in 2003 to focus on providing Islamic capital market services. Today, it has the largest
in-house Islamic capital market team in Malaysia and one of the largest in South East Asia. It oversees all areas of the Group relating to Islamic financial transactions offering investment banking products and services in compliance with Shariah laws. It has earned a reputation for pioneering numerous new products and structures and managing/arranging some of the largest issues in the market.

CIMB Real Estate Sdn Bhd was set up in 2004. In 2005, the company formed a 60:40 joint venture with Mapletree Capital Management Pte. Ltd. of Singapore, called CIMB-Mapletree Management Sdn Bhd (CMM), to undertake real estate investment advisory and real estate fund management services. CMM's first fund, CMREF 1, was set up in August 2005 as the first private institutional property fund in Malaysia. A total of RM120 million has been raised, providing the fund an AUM of RM320 million together with sponsors' capital. The first 2 investments were in a 22-storey commercial office building and a retail cum office building.

Other businesses set up by CIMB included: CIMB Futures Sdn Bhd in 1993 as the pioneer futures company in the Kuala Lumpur Options and Financial Futures Exchange to spearhead the Group's thrust into the derivatives business; CIMB (L) Limited in 2001 to develop activities in the region and offer non-RM financial solutions to clients; and CIMB Strategic Assets Sdn Bhd (CIMBSA) in 2005 which subsequently formed a joint venture with Standard Bank plc in 2006 to invest in strategic assets.

IPO of the country's first investment bank in 2003

On 8 January 2003, the Chairman of CIMB Berhad, Dr. Rozali Mohamed Ali hit the gong on Bursa Malaysia to symbolise the listing of CIMB Berhad on the exchange.

The listing of CIMB Berhad brought tremendous value to the business, and proved to be one of the best decisions made by the management.

For a while though, this did not seem like the case. Response to the IPO was lukewarm, as the market was uncertain how to value an investment banking business. Investors' maiden experience with the previous IPO of a merchant bank that came to the market in the late-1990s was not good.

After the listing, the timing of which was unfortunately just before the Asian Crisis, shares of the company languished for a long time.

For three months, CIMB Berhad's share price was stagnant, hovering around the RM1.75 IPO price. We were worried, but not deterred, and persevered with communicating CIMB's value proposition to investors, both local andoverseas. It was only in late March 2003 before the price broke the RM2 barrier.

The turnaround in perception came after we announced a special dividend within four months of listing, sending a strong message of management's clear focus on capital management and delivering shareholder value. Over the next 30 months, it continued on an upward trajectory, hitting an all time high of RM6.55 in September 2005.

Figure 3: CIMB Berhad's share price

Source: Bloomberg

CIMB's management was able to obtain the approval of its shareholders on the rationale that the IPO would enhance its ability to attract and retain staff, achieve better alignment of employee and shareholder interest, improve its brand positioning and provide its access to the equity capital market for fund raising purposes.

The last argument is a standard feature that appears in the prospectuses of companies going for IPO, but beyond the initial fund raising exercise, is seldom actually used by many of them to raise funds for capital investments or to fund acquisitions.

The higher the valuation of a company's shares in Price-to-Earnings or Price-to-Book terms, the more likely it is that the new investment would be value accretive, that is, the return of the investment would be higher than the cost of the company's capital. A high valuation hence enables a company to use its shares as currency to fund commercially viable acquisitions.

CIMB Berhad understood the power of having cheap cost of capital. One year after its IPO, it proposed to issue new capital as a way of funding the proposed acquisition of TA Securities Holdings Berhad. Later, it was used in the acquisition of G.K. Goh Securities Pte. Ltd., and subsequently, the acquisition of BCB. It is unlikely that the consolidation of the BCHB Group's banking business under CIMB would have been possible if CIMB Berhad had not been separately listed.

Beyond the stated rationale for listing, the experience of existing as a listed entity brought many other benefits to the Group. It was a period of an extremely steep learning curve, coming to terms with what the market was looking for from a listed company. The importance of our roles as stewards for the assets of shareholders was constantly re-emphasised to us.

Capital management took on a new priority that a non-listed company may not as easily appreciate. We developed a first class Investor Relations department and had invaluable feedback from shareholders, which helped bring our business up to speed against an international comparison.

In the process, we also learned to identify the drivers of a listed company's valuation, and to understand the market psyche better from the orientation of a listed company. All of which made us much better equipped to advise our clients looking to IPO, or our other corporate clients in their continuing existence as listed entities.

CIMB Berhad's listing of 3 years gives the company the distinction of being one of the shortest listings in Malaysian history. It also earned the company the honour of being the most rewarding IPO experience for investors ever, with 340% total returns generated over the 3 short years.

CIMB Berhad's delisting may actually have been quite timely. New regulations introduced in 2005 requiring that most of an investment bank's investments to be marked to market (vs. carried at lower of cost or market) would create tremendous volatility in its earnings. As a result, earnings could fluctuate wildly from quarter to quarter, with the long-term earnings growth pattern masked by short-term volatility. The market would be unwilling to accord a premium valuation to a company with apparently volatile earnings.

Given the above, the delisting of CIMB Berhad was not adverse to its long-term strategic needs, and by inference, neither was it an adverse development for its shareholders.

Some near misses

History could have been very different. RHB Bank Berhad made a bid for the Commerce Group in 1998 in the midst of the Asian Crisis. Had that bid not been successfully fend off, there would not be a CIMB story to relate today.

The Asian Crisis changed the face of the local corporate scene in many ways. CIMB had exposure to a deal that caused it to go into the red in 1998, but relative to many others, it came out of the Crisis unscathed. After the Crisis, the landscape was drastically altered, with many of the corporate stars of the early to mid-90s cut down to size.

Like others, we had some hard lessons to learn. But it was also a time of opportunity. We had the chance to offer our expertise to clients who needed help with rebuilding their capital and their businesses. Furthermore, with many of the pre-Crisis leading merchant banks no longer the force they used to be, the path was clear for us to firmly grasp the market leadership and distance ourselves from the rest.

In 2004, we announced the offer to acquire 100% of TA Securities from TA Enterprise Berhad for RM400 million. The acquisition fitted our plans to grow the retail broking business - to buy market leadership and gain scale, diversify earnings to have greater balance, between retail and corporate business, and between equity and debt. It was disappointing when the deal fell through.

In the end, the decision to walk away turned out to be a huge blessing in disguise, as we were able to conserve our capital to acquire G.K. Goh Securities Pte. Ltd., which provided not only all the benefits we were looking for in TA Securities, but also a regional platform to diversify our business. It also provided us with distribution synergies we would not have found in TA Securities.

Strong focus on support services

CIMB's ascension to the pinnacle of the industry would not have been possible purely on the back of a dogmatic focus on earnings delivery. Using football as an analogy, as much as a team needs star forwards to score goals, it also needs a sound defence and a creative midfield to prevent goals from being scored and to support the forwards.

In a business which is inherently cyclical, CIMB had resolved to overcome the natural tendency to invest only for the short term - a highly common practice falling back on the argument that the future income for such businesses was too uncertain to make long-term investments. Investments in risk management, human resource, operations and information technology seldom pay off in the immediate year. However, CIMB allocated sizeable resources and good managers to these services anyway on the belief that they will pay off over time. And they have.

One of CIMB's greatest unsung heroes is its Risk Management department. The Group started its risk management focus in 1996, just before the Asian Crisis struck, but not in time to save the Group from going into the red. Today, however, CIMB's Risk Management division is one of the most established in the industry, and forms an integral part of its business.

CIMB operates with an enterprise-wide risk management framework which enables it to identify, monitor and manage market, credit, liquidity, operational and strategic risks at all functional levels. Not only does it help improve the soundness of CIMB's business, but it has also contributed significantly to the Group's profitability. Via the ability to take more calculated risks, the Group is able to optimise its utilisation of capital, including via developing more aggressive proprietary trading capabilities, following the trend of US investment banks. The bottom-line impact is hence a higher return on equity as well as less volatile earnings.

On the operations side, CIMB's Group Information and Operations Division (GIOD) is unique in its structure and the manner in which its core functions, these being Operations, Information Technology, Legal and Risk Monitoring, leverage on one another to provide an integrated service to its clients, the front-office divisions of the Group, while ensuring adherence to legal and regulatory requirements.

"Of all the trophies we have won, the one that make me proudest is the National Award for Excellence in Human Resource 2003." - Group Chief Executive

CIMB recognises that its greatest assets, its people, are highly mobile, literally walk out of the door at the end of each day, and may not necessarily come back the next day.

A company's greatest assets do not come into being by chance. In a specialised service industry where creativity, intellect and dedication are probably the greatest differentiators among the players, the process of identifying, developing, empowering and rewarding these assets take on even greater significance. CIMB appreciates that managing people involves planning and processes.

The Human Resource Division (HR) of CIMB is a mission critical part of the organisation because it manages the plan and the process. Back in 1999, HR started to move away from the vicious cycle that plagues most human resource departments - being caught in dead-end administrative functions of handling payroll, processing leave and claims, and doing fire-fighting recruitment.

By automating the basic functions through using tools such as information technology and a robust eHR system, HR managed to break itself free from the chains of these low value-add functions. The more important services it focuses on today include managing the recruitment process, being actively involved in compensation planning, setting up the annual planning programme, engaging staff to identify their needs and organising team building events where management's objectives and targets for the year are communicated and brought to life via an experiential learning process.

Within HR, there is a Talent Management unit which was established to help minimise the loss of talent through mismatch or neglect, and to provide counselling on career opportunities within the Group. As the Group Chief Executive said, 'CIMB is obsessed with talent management'.

The knowledge-centric nature of the investment banking business necessitated that information storing had to be systematic, centralised and efficient, to allow sharing and facilitate quick and painless information retrieval.

In order to institutionalise information management, a Knowledge Management unit was set up, comprising an intranet site and a library which houses a good collection of books, publications, training materials, annual reports and others. The CIMB intranet has a wealth of information ranging from the latest market data - share prices, bond prices, interest rates, forex rates and commodity prices, to company and market news, in-house research and access to online journal subscriptions.

One of the biggest challenges that CIMB faces in human resource management is staff retention. It could easily have become a victim of its own success, with its top managers constantly under threat of poaching by competitors hoping to buy their way into emulating its success. However, in an industry with an inherently high staff turnover, CIMB's staff force has been relatively stable, especially at the top management end.

This can probably be attributed to CIMB's principle of aligning the interest of employees with that of the Company's. If the company does well, the performing employees are well rewarded through attractive pecuniary benefits and quick career progression. At the core of this is a compensation framework that identifies the Key Performance Indicators (KPIs) which individual staff are expected to deliver, a reward system that links up with the KPI but at the same time a common understanding that KPI frameworks must not be rigidly applied. Non-performers do not feel at home in the Group, and eventually tend to leave. This system has successfully promoted a culture of meritocracy among CIMB staff.

CIMB Berhad's IPO gave the company an opportunity to use an employee share option scheme to further strengthen the reward system, and in the process further align staff's interest with that of shareholders.
At IPO, employees were offered options that could enable them to own up to 18% of the company.

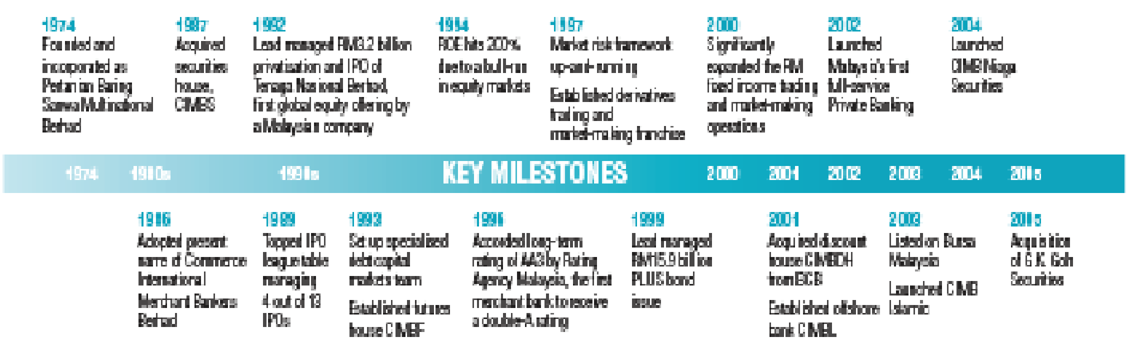
Beyond monetary incentives however, job satisfaction, pride and association with a strong and successful brand have also served as powerful factors in helping to attract and retain staff. Of the staff who have left the Group, many of the CIMB alumni today hold senior positions in the Malaysian corporate scene, and many of them disclose their stints with CIMB with pride. They are among the best spokesmen for the CIMB brand in the market.

In 2003, CIMB won the National Award for Excellence in Human Resource. The award recognises CIMB as the best among all foreign and local companies operating in Malaysia in the field of human resource. It was a vindication of the strength of CIMB's human resource infrastructure in effectively supporting the business.

Many people have contributed to CIMB's success, and the current Group Chief Executive deserves special mention for the way he has worked unfailingly to lead, inspire, motivate, cajole and just about do every thing necessary to bring and demand the best out of CIMBians. There are not many organisations in Malaysia today who can claim to have a Group Chief Executive who has 'fought in the trenches with the troops', is often seen as one of the guys, and yet is able to stand on the high ground to provide uncompromised leadership for the Group.

The success of CIMB has been one that is deliberate and planned. Beyond any single individual, it has else been due to teamwork, having a vision and the willingness to tweak the business model to fit that vision, hunger for success, and old fashioned hard work.

Figure 4: A deliberate and well-planned growth story



Corporate citizenship

As a leading local organisation and a GLC, CIMB recognises that it has social obligations to the community. Every year, the Group actively contributes to society in cash, in kind and via voluntary efforts. Causes it had contributed to over the years include charities for the poor, the needy and the handicapped, social welfare organisations, sponsorships for arts, education and sports and nature conservation.