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27 February 2018 | 2QFY18 Results Review

Hong Leong Bank Berhad

Earnings growth within expectations

***Maintain* NEUTRAL**
***Adjusted* Target Price (TP): RM18.55 (from RM15.72)**

INVESTMENT HIGHLIGHTS

- **Net profit for 1HFY18 came within expectations**
- **NII grew robustly while NOII was a drag. Cost well contained**
- **NII growth from NIM improved on better COF. CASA grew solidly**
- **Loans growth was disappointing and was lifted by mortgages**
- **Slight deterioration in asset quality**
- **Interim dividend of 16 sen**
- **No change to our FY18 but tweaked +3.3% upward FY19 forecasts**
- **Maintain NEUTRAL with adjusted TP of RM18.55 (from RM15.72), as we revert to pegging its FY19 BVPS to 1.5x, which is 5-year historical average.**

Net profit for 1HFY18 within expectations. Hong Leong Bank Berhad 1HFY18 net profit came in within expectations at 54.7% and 54.6% of ours and consensus' full year estimates respectively. The Group posted robust net profit growth of +21.0%yoy that was supported by strong NII growth, contained OPEX increase and recovery at its associate BOC.

NII momentum from improved NIM. NII (including Islamic Banking) in 1HFY18 grew +9.0%yoy, driven by +8bps yoy NIM improvement. The better NIM was due to disciplined asset & liability management. Interest expense fell -1.1%yoy to RM1.67b while interest income went up +2.3%yoy to RM3.16b.

Robust CASA growth. Meanwhile, CASA grew +9.3%yoy to RM41.3b which was a key driver in NIM improvement. This uplifted total deposit growth to +3.1%yoy to RM155.3b.

NOII was a drag. NOII fell -2.3%yoy to RM625m which stemmed from lower fee income. For 9MFY18, fee income fell -7.1%yoy to RM290.6m partly from -6.7%yoy to RM115.2m decline in credit card fees.

Cost was well contained. OPEX grew +3.2%yoy with personnel cost being contained, remaining flat at RM558.4m. IT expenses continued to be trend upwards with +22.4%yoy to RM40.1m as the Group continue to investment in digitalisation.

RETURN STATS	
Price (26 February 2018)	RM18.52
Target Price	RM18.55
Expected Share Price Return	+0.2%
Expected Dividend Yield	+2.5%
Expected Total Return	+2.7%

STOCK INFO	
KLCI	1,860.08
Bursa / Bloomberg	5819 / HLBK MK
Board / Sector	Main / Finance
Syariah Compliant	No
Issued shares (mil)	2,045.6
Market cap. (RM'm)	37,884.5
Price over NA	1.6x
52-wk price Range	RM13.28 - RM19.18
Beta (against KLCI)	0.84
3-mth Avg Daily Vol	1.14m
3-mth Avg Daily Value	RM19.48m
Major Shareholders	
Hong Leong Financial Group	65.66%
EPF	13.43%

Some banking abbreviations used in this report:
CI = Cost-Income Ratio
CET1 = Common Equity Tier 1
GIL = Gross Impaired Loan
LDR = Loan-Deposit Ratio
NII = Net Interest Income
NOII = Non-interest income
NIM = Net Interest margin
CASA = Current and Savings Accounts
COF = Cost of Funds
PPOP = Pre-provisioning Operating Profit
LLC = Loan Loss Coverage
JV = Joint Venture with BOC in a Consumer Finance Company in China
BOC = Bank of Chengdu

Disappointing loans growth. Gross loans growth came in much lower than expected with +1.8%yoy to RM125.5b as at 2QFY18. There was a pull back in working capital, unsecured and hire purchase loans. These loans segment fell -3.5%yoy to RM22.4b, -3.4%yoy to RM5.67b and -4.5%yoy to RM17.31b respectively. However, we understand that beside lower vehicle demand, the Group was also selective in regards to hire purchase loans. Conversely, mortgages grew strongly by +9.0%yoy to RM59.12b.

Slight deterioration in asset quality. While the Group's asset quality continues to be sound, there was a slight deterioration as overall GIL ratio increased by +11bps yoy to 0.97% as at 2QFY18. This came domestically and mostly from its residential properties and SME loans book. The GIL ratio for these segments as at 2QFY18 was 0.55% and 1.47% respectively as compared to the 0.46% and 1.32% as at 2QFY17 respectively. However, we noted that GIL was stabilised in the quarter.

Booster from contribution of associate, BOC. BOC's contribution grew +111.7%yoy to RM273.1m. This had contributed 16.9% to the Group's profit before tax.

Revising loans growth target. The management are revising its loans growth target to 3-4%yoy for FY18 from 5-6%yoy previously. We believe that this target seems more achievable given current run rate. However, we believe that this might affect income should NIM come under pressure. Nevertheless, we expect NIM to remain steady given the OPR hike recently.

FORECAST

As results came in within expectiations we make no change to our FY18 forecast but tweak FY19 earnings estimate by +3.3% to take into account the performance from BOC.

VALUATION AND RECOMMENDATION

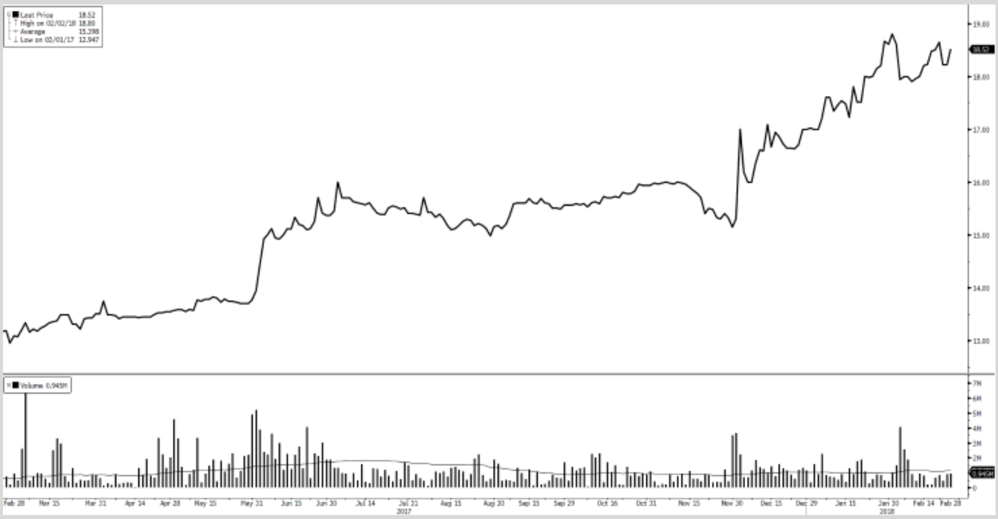
We like the fact that NIM continued to improve. However, in our opinion, this had only moderated the effect from a disappointing loans growth. As such, we do not foresee any immediate catalyst that will provide a boost or any upside surprises to the Group earnings. We believe that the recent share price momentum was due to investors adjusting the valuation of the Group towards its historical average. Likewise, with no pressure to the Group earnings in the near term, we are adjusting our TP to RM18.55 (from RM15.72) as we pegged its FY19 BVPS to PBV of 1.5x (from 1.4x previously) which is its 5-year historical average PBV.

INVESTMENT STATISTICS

FYE June	FY16	FY17	FY18F	FY19F
Net interest income (RM'm)	2,655	2,854	3,052	3,264
Islamic banking income (RM'm)	467	550	660	673
Non-interest income (RM'm)	1,055	1,146	1,200	1,276
Total income (RM'm)	4,178	4,551	4,912	5,212
Pretax profit (RM'm)	2,382	2,748	3,060	3,194
Net profit (RM'm)	1,903	2,145	2,417	2,523
Core net profit (RM'm)	2,034	2,247	2,417	2,523
Core EPS (sen)	99.1	109.9	118.2	123.4
PER (x)	15.3	13.8	15.7	15.0
Net dividend (sen)	41	45	47	47
Net dividend yield (%)	2.7	3.0	2.5	2.5
Book value per share (RM)	10.32	11.09	11.64	12.35
PBV (x)	1.5	1.4	1.6	1.5
ROE (%)	10.7	10.6	10.4	10.3

Forecast by MIDFR

DAILY PRICE CHART



Imran Yassin Yusof
imran.yassin@midf.com.my
03-2173 8395

Table 1: Quaterly results

Quarterly results						Comments
FYE June (RM m)	**2Q18**	**1Q18**	**2Q17**	**Yoy (+/- %)**	**Qoq (+/- %)**	
Net Interest Income	896	885	833	7.6%	1.2%	Supported by NIM improvement
Non interest Income	332	293	345	-3.8%	13.4%	Lower fee income
Net/Total income	1,229	1,179	1,179	4.2%	4.2%	
OPEX	(516)	(507)	(501)	3.0%	1.7%	
PPOP	713	672	678	5.1%	6.1%	
Write back/(Provision) for loan losses	(10)	(44)	(27)	-62.9%	-77.1%	
Share of profit from associate and JV	130	152	45	>100%	-14.5%	Turnaround at BOC.
Pre-tax profit	833	780	696	19.6%	6.8%	
Net Profit	683	639	550	24.2%	6.9%	
EPS (sen)	33.3	31.2	26.9	23.9%	6.6%	

Table 2: Quaterly financial ratios based on normalised financials

Financial Ratios (%)	**2Q18**	**1Q18**	**2Q17**	**Yoy (+/- ppts)**	**Qoq (+/- ppts)**	**Comments**
CET1*	13.1	12.9	13.4	-0.3	0.2	
Tier 1 Capital*	13.8	13.3	13.8	0	0.5	
Total Capital*	15.8	15.3	15.3	0.5	0.5	
NIM	2.13	2.13	2.08	0.05	0	Better management of COF
GIL	0.97	0.96	0.86	0.11	0.01	Vs. industry: 1.52%. Deterioration from residential properties and SMEs
Loan loss Coverage	96	96	107	-11	0	Vs. industry: 84%
Credit charge-off	0.03	0.14	0.09	-0.06	-0.11	
Cost to income	42.0	43.0	44.8	-2.8	-1.0	
Net LD	80.8	81	81	-0.2	-0.2	Vs. industry: 91.4%
ROEA	11.7	11.1	10.1	1.6	0.6	

**Group ratios after deducting proposed dividend*

Table 3: Normalised cumulative results and ratios

Cumulative results & ratios				Comments
FYE June (RM m)	**1HFY18**	**1HFY17**	**Yoy**	
NII	1,782	1,635	9.0%	Contributed by improvement in NIM. Loans growth was weaker than expected.
NOII	625	640	-2.3%	Lower fee income especially from credit card fees.
Net/Total Income	2,407	2,275	5.8%	
OPEX	(1,023)	(991)	3.2%	Well contained. Personnel cost was flat.
PPOP	1,384	1,284	7.8%	
Writeback/ (Provision) for loan losses	(53)	(53)	0.3%	
Share of profit from associate and JV	283	141	100.7%	Recovery in BOC.
Pre-tax profit	1,613	1,371	17.7%	
Net Profit	1,322	1,093	21.0%	
EPS (sen)	64.5	64.5	0.0%	

	1HFY18	**1HFY17**	**(+/-ppts)**	
ROE (%)	11.5	10.2	1.3	
CI ratio (%)	42.5	43.6	-1.1	
Credit charge-off	0.09	0.14	-0.05	
NIM	2.13	2.05	0.08	From better management of COF. CASA grew faster than deposits.

Table 4: Comparison of pretax profits by business segments (RM'Mil) based on reported numbers

Business segments	**1HFY18**	**1HFY17**	**Change (%)**	**Comments**
Personal Financial Services	596.9	569.3	4.8%	Higher total income, offset by higher OPEX and higher provisions.
Business and Corporate Banking	402.8	385.6	4.5%	Higher income and lower provisions.
Global Markets	232.6	250.1	-7.0%	Lower income
International Banking	40.3	19.4	108.1%	Higher share of profit from BOC, higher total income and lower provisions.
Others and Inter-Segment Elimination	58.3	6.0	>100%	
Total segment profit before tax	1,330.9	1,230.4	8.2%	

Source: Company

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MIDF AMANAH INVESTMENT BANK : GUIDE TO RECOMMENDATIONS	
STOCK RECOMMENDATIONS	
BUY	Total return is expected to be >10% over the next 12 months.
TRADING BUY	Stock price is expected to *rise* by >10% within 3-months after a Trading Buy rating has been assigned due to positive newsflow.
NEUTRAL	Total return is expected to be between -10% and +10% over the next 12 months.
SELL	*Negative* total return is expected, by -10% or more, over the next 12 months.
TRADING SELL	Stock price is expected to *fall* by >10% within 3-months after a Trading Sell rating has been assigned due to negative newsflow.
SECTOR RECOMMENDATIONS	
POSITIVE	The sector is expected to outperform the overall market over the next 12 months.
NEUTRAL	The sector is to perform in line with the overall market over the next 12 months.
NEGATIVE	The sector is expected to underperform the overall market over the next 12 months.