

31 May 2018 | 3QFY18 Results Review

## Hong Leong Bank Berhad

*Surprised by associate's robust result*

**Maintain NEUTRAL**

**Adjusted Target Price (TP): RM18.85**  
(from RM18.55)

### INVESTMENT HIGHLIGHTS

- **Net profit for 9MFY18 above expectations. Variance due to our underestimation of BOC results**
- **Strong results from Islamic Banking and NOII**
- **Loans growth was disappointing but was lifted by mortgages**
- **Deposits growth was equally disappointing**
- **Improved asset quality**
- **Revising upwards our FY18 and FY19 forecasts**
- **Maintain NEUTRAL with adjusted TP of RM18.85 (from RM18.55), its FY19 BVPS to 1.5x, which is 5-year historical average**

**Above expectations.** Hong Leong Bank Berhad (HLB) registered 9MFY18 net profit growth of +21.1%yoy to RM2.01b. This had exceeded our expectations coming in at 83.7% of our full year forecast as we had underestimated the contribution from BOC. Meanwhile, HLB result came in at the upper bound of consensus' expectations at 79.2%.

**Strong showing in associate, Islamic banking and NOII.** Result from BOC came in +67.3%yoy higher to RM404.4m which was due to the robust operating income and improving asset quality. Besides that, Islamic banking was particularly strong as well, with income (both NII and NOII) expanding +18.7%yoy to RM483.3m. This had lifted overall NII to grow +6.3%yoy as compared to +3.6%yoy growth to RM2.20b for conventional NII alone. In addition, overall NOII grew +11.7%yoy due to higher trading & investment income (+39.8%yoy to RM453m) where there were disposal of some equity investments.

**Cost remains well contained.** OPEX grew +3.9%yoy with personnel cost being contained, remaining flat at RM835.5m. Main cost item continue to be IT expenses where it rose +11.3%yoy to RM122.7m as the Group continue to investment in digitisation.

**Sluggish loans growth.** Gross loans growth continues to be much lower than expected with +1.6%yoy to RM125.4b. Mortgages and SME loans remains robust with +8.2%yoy to RM60.2b and +2.9%yoy to RM20.6b respectively. However, auto loans continued its downtrend, falling -5.1%yoy to RM17.0b. Besides, there were also corporate repayments in the quarter.

RETURN STATS	
Price (30 May 2018)	RM18.60
Target Price	RM18.85
Expected Share Price Return	+1.3%
Expected Dividend Yield	+2.5%
<b>Expected Total Return</b>	<b>+3.9%</b>

STOCK INFO	
KLCI	1,719.28
Bursa / Bloomberg	5819 / HLBK MK
Board / Sector	Main / Finance
Syariah Compliant	No
Issued shares (mil)	2,045.6
Market cap. (RM'm)	38,048.2
Price over NA	1.7x
52-wk price Range	RM14.00 - RM20.00
Beta (against KLCI)	0.85
3-mth Avg Daily Vol	0.95m
3-mth Avg Daily Value	RM17.97m
Major Shareholders	
Hong Leong Financial Group	65.66%
EPF	13.29%

#### 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

**Expectations of lower bound of loans growth target.** Recall, the management had revised its loans growth target to 3-4%yoy for FY18 from 5-6%yoy previously. With the current run rate, the management are now expecting that loans growth may come in at the lower bound of its estimate. At current juncture, we believe that this target seems ambitious. However, the management have indicated that current loans pipeline suggest that this target to be achievable.


**Similarly disappointing for deposits growth.** Deposits grew by only +1.3%yoy to RM154.2b as at 9MFY18. Business enterprise was flat at RM60.9b. However, we were pleased to see solid CASA expansion at +5.9%yoy to RM41.1b. This had been one of the key reason for the improvement in NIM by +4bps yoy to 2.12% in 9MFY18.

**Improved asset quality.** The Group's asset quality continues to be sound, with overall GIL ratio improving by +4bps yoy to 0.84% as at 3QFY18. On a YTD basis, GIL ratio improved in Malaysia by -14bps to 0.87% which saw better asset quality for mortgages. The GIL ratio for mortgages fell -3bps to 0.51%.

## FORECAST

We are revising our FY18 and FY19 forecast upwards by +8.2% and +11.0% respectively as we take into account the performance of its associate, BOC.

## VALUATION AND RECOMMENDATION

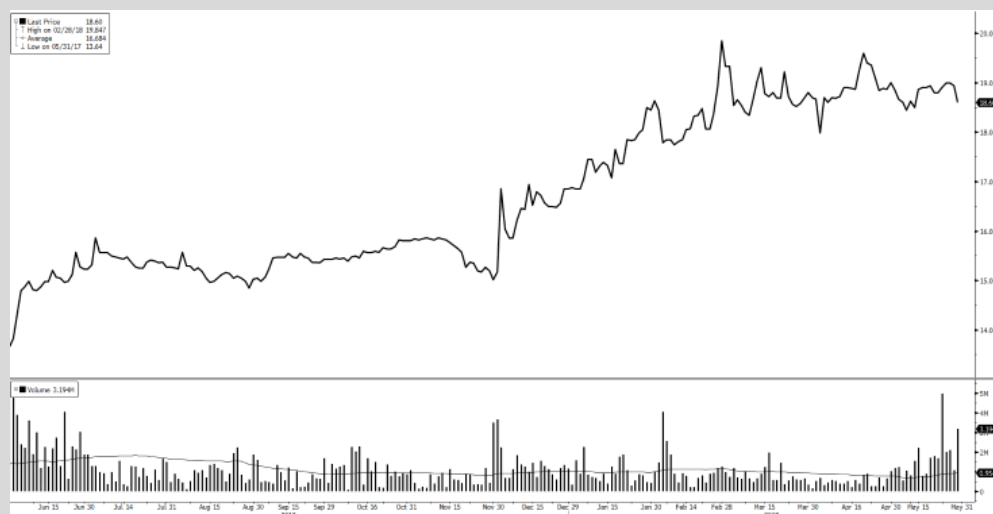
HLB continues to exhibit strong set of results especially with the contribution of BOC causing a pleasant surprise to us. Nevertheless, the strong results were tempered by the disappointing growth in terms of loans and deposits. This had led us to believe that there may be some delicateness to earnings momentum should there be any headwinds faced by BOC. As such, we maintain our NEUTRAL call for the stock. We are adjusting our TP to RM18.85 (from RM18.55) due to our revision of FY19 earnings affecting its BVPS. We pegged its FY19 BVPS to PBV of 1.5x 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	3,022	3,216
Islamic banking income (RM'm)	467	550	660	673
Non-interest income (RM'm)	1,055	1,146	1,200	1,273
Total income (RM'm)	4,178	4,551	4,883	5,163
Pretax profit (RM'm)	2,382	2,748	3,292	3,514
Net profit (RM'm)	1,903	2,145	2,601	2,776
Core net profit (RM'm)	2,034	2,247	2,601	2,776
Core EPS (sen)	99.1	109.9	127.2	135.8
PER (x)	18.8	16.9	14.6	13.7
Net dividend (sen)	41	45	47	47
Net dividend yield (%)	2.2	2.4	2.5	2.5
Book value per share (RM)	10.32	11.09	11.73	12.58
PBV (x)	1.8	1.7	1.6	1.5
ROE (%)	10.7	9.8	11.1	11.2

Forecast by MIDFR

## DAILY PRICE CHART



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**Table 1: Quarterly results**

Quarterly results						Comments
FYE June (RM m)	3Q18	2Q18	3Q17	Yoy (+/- %)	Qoq (+/- %)	
Net Interest Income	867	896	856	1.3%	-3.2%	NIM compression due to taking in more retail deposits in preparation for OPR hike.
Non-interest Income	389	332	268	45.4%	17.0%	Due to higher trading and investment income.
Net/Total income	1,256	1,229	1,123	11.8%	2.2%	
OPEX	(527)	(516)	(501)	5.1%	2.1%	Higher admin & general cost and IT expenses.
PPOP	729	713	623	17.1%	2.3%	
Write back/(Provision) for loan losses	(11)	(10)	(43)	-74.7%	11.0%	Due to RM2.7m IA write back vs. impairment of RM19.2m in 3QFY17.
Share of profit from associate and JV	137	130	118	16.2%	4.9%	Strong result from BOC.
Pre-tax profit	855	833	697	22.7%	2.6%	
Net Profit	690	683	569	21.2%	1.0%	
EPS (sen)	33.7	33.3	27.8	21.2%	1.2%	

**Table 2: Quarterly financial ratios based on normalised financials**

Financial Ratios (%)	3Q18	2Q18	3Q17	Yoy (+/- ppts)	Qoq (+/- ppts)	Comments
CET1*	12.0	13.1	12.7	-0.7	-1.1	
Tier 1 Capital*	12.7	13.8	13.1	-0.4	-1.1	
Total Capital*	15.3	15.8	15.1	0.2	-0.5	
NIM	2.10	2.13	2.14	-0.04	-0.03	Due to higher retail FDs
GIL	0.84	0.97	0.88	-0.04	-0.13	Vs. industry: 1.56%
Loan loss Coverage	96	96	106	-10	0	Vs. industry: 95%
Credit charge-off	0.04	0.03	0.15	-0.11	0.01	
Cost to income	42.0	42.0	44.6	-2.7	0.0	
Net LD	80.7	80.8	81.1	-0.4	-0.1	Vs. industry: 90.2%
ROEA	11.9	11.7	10.4	1.5	0.2	

\*Group ratios after deducting proposed dividend

**Table 3: Normalised cumulative results and ratios**

Cumulative results & ratios				Comments
FYE June (RM m)	9MFY18	9MFY17	Yoy	
NII	2,649	2,491	6.3%	Contributed by strong Islamic banking income and NIM improvement.
NOII	1,014	908	11.7%	Due to higher trading and investment income.
Net/Total Income	3,663	3,399	7.8%	
OPEX	(1,550)	(1,492)	3.9%	Higher IT expenses for digitization.
PPOP	2,114	1,906	10.9%	
Writeback/ (Provision) for loan losses	(64)	(97)	-34.0%	Due to lower IA.
Share of profit from associate and JV	419	258	62.4%	Strong showing from BOC.
Pre-tax profit	2,469	2,068	19.4%	
Net Profit	2,012	1,662	21.1%	
EPS (sen)	98.2	81.2	20.9%	
	<b>9MFY18</b>	<b>9MFY17</b>	<b>(+/-ppts)</b>	
ROE (%)	11.7	10.3	1.4	
CI ratio (%)	42.3	43.9	-1.6	
Credit charge-off	0.07	0.11	-0.04	
NIM	2.12	2.08	0.04	

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

Business segments	9MFY18	9MFY17	Change (%)	Comments
Personal Financial Services	875.8	866.7	1.1%	Higher total income, offset by higher OPEX and higher provisions.
Business and Corporate Banking	611.6	583.4	4.8%	Higher income and lower provisions.
Global Markets	382.0	337.1	13.3%	Higher income
International Banking	44.2	28.0	57.6%	Higher share of profit from BOC and lower provisions.
Others and Inter-Segment Elimination	135.7	(5.3)	>100%	
Total segment profit before tax	2,049.3	1,809.8	13.2%	

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 <i>rise</i> 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	<i>Negative</i> total return is expected, by -10% or more, over the next 12 months.
TRADING SELL	Stock price is expected to <i>fall</i> 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.