

25 August 2017 | 4QFY17 Results Review

Hong Leong Bank Berhad

Surprised provisions but better to be prudent

INVESTMENT HIGHLIGHTS

- **FY17 was slightly below our expectation on surprised provisions in 4QFY17.**
- **Provision was due to taking prudent measure on an account for a shipping O&G company.**
- **Nevertheless, net profit growth was strong from robust income growth.**
- **NIM improvement contributed to NII growth.**
- **NOII growth came from trading and investment income.**
- **Decent gross loans and deposits growth.**
- **Slight deterioration in asset quality due to impairment in an account.**
- **Dividend of 30 sen. Total FY17 dividend of 45 sen, better than expectations.**
- **No change to our forecasts.**
- **Revert to NEUTRAL. Share price appreciated +18.1% since our BUY call (23 November 2016). Unchanged TP of RM15.70 based on 1.4x PB multiple.**

Earnings slightly below expectations. Hong Leong Bank Berhad (HLB) reported net profit for FY17 was slightly below our expectation but within consensus' at 93.4% and 97.0% of full year estimates respectively. However, core net profit was within our expectations.

Surprised provisions. The variance in reported earnings was due to higher than expected provision in 4QFY17. Credit cost came in at 13bps vs. our estimate of 5bps. This was due to the prudent steps HLB was taking in regards to an account related to a shipping O&G sector, as reflected by IA of RM79.0m in 4QFY17 vs. RM10.7m in 4QFY16.

But net profit growth still ended strong. Core net profit grew +10.5%yoy, while reported net profit grew +12.7%yoy to RM2.15b. The strong growth was due to solid NII and NOII growth.

NII growth from NIM improvement. NII grew +9.1%yoy as NIM improved +15bps yoy to 2.09%. This was largely contributed by effective funding cost management. Meanwhile, NOII grew +8.4%yoy on the back of higher trading and investment income.

Revert to NEUTRAL
Unchanged Target Price (TP): RM15.70

RETURN STATS	
Price (24 Aug. 2017)	RM15.50
Target Price	RM15.70
Expected Share Price Return	+1.3%
Expected Dividend Yield	+3.0%
Expected Total Return	+4.3%

STOCK INFO	
KLCI	1,775.50
Bursa / Bloomberg	5819 / HLBK MK
Board / Sector	Main / Finance
Syariah Compliant	No
Issued shares (mil)	2,045.5
Market cap. (RM'm)	31,704.5
Price over NA	1.4x
52-wk price Range	RM12.70 - RM16.30
Beta (against KLCI)	0.60
3-mth Avg Daily Vol	1.55m
3-mth Avg Daily Value	RM23.67m
Major Shareholders	
Hong Leong Financial Group	65.67%
EPF	12.92%
Blackrock	1.47%

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

Loans growth was decent but below target. Gross loans as at 4QFY17 grew +3.8%yoy to RM125.1b, below the 4-5% target set. The gross loans growth mostly came from mortgages and SME loans. These segments grew +10.4%yoy to RM56.9b and +6.0%yoy to RM20.4b respectively. However, this was moderated by the contraction of -4.7%yoy to RM17.6b in transport vehicle loans. Management are confident that mortgage and SME loans growth will continue in FY18.

Slight asset deterioration. However, we are concerned on the slight deterioration of asset. GIL ratio stood at 0.96% as at FY17 as compared to 0.79% as at FY16. This was due to the aforementioned prudent step. Nevertheless, management indicated that there is no undue stress to asset quality. In addition there was adequate coverage with LLC at 96%.


Retail franchise lead to decent deposit growth. Deposits was +4.5%yoy higher to RM155.2b as retail franchise continue to grow, where individual deposits increased by +5.9%yoy to RM86.2b. CASA expanded +4.2%yoy to RM38.8b while fixed deposit grew +3.8%yoy to RM88.0b.

Better than expected dividend. For 4QFY17, HLB announced a dividend of 30 sen. This brought the total dividend for FY17 to 45 sen or a payout ratio of 43%. This was above our expectations of 42 sen. Management indicated that this level of payout ratio may continue in the future.

FORECAST

We make no change to our forecasts as we do not expect credit cost to be as elevated in FY18.

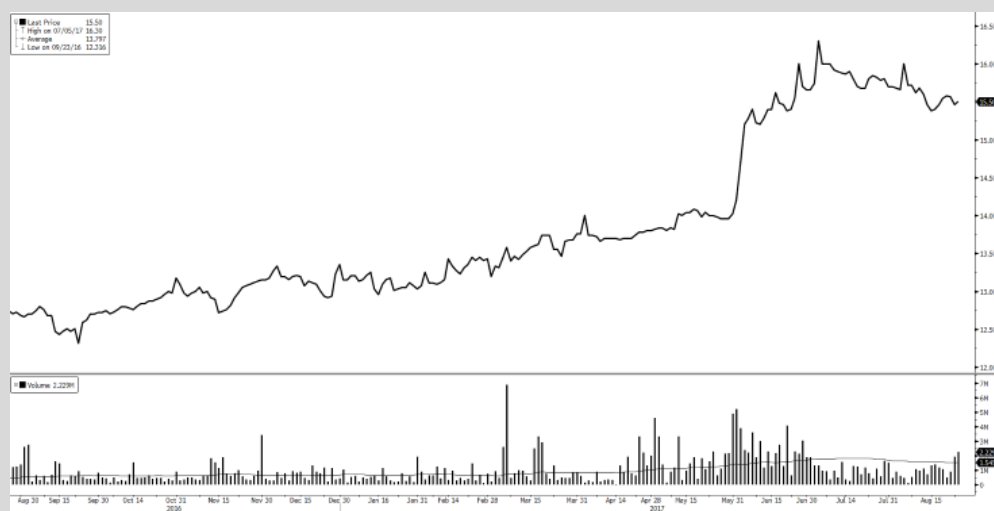
VALUATION AND RECOMMENDATION

We were surprised by the uptick in credit cost in 4QFY17 but any of our concerns were allayed by the fact this was due to the management taking a prudent measure. Operation-wise, we continue to like the Group especially its strong NII growth and NIM improvement. However, its share price had appreciated by +18.1% since we upgraded the stock to BUY last November. With limited upside and all the positives of the Group's performance priced in, we have to revert our recommendation to **NEUTRAL**. Our unchanged TP to RM15.70 is based on pegging its FY18 BVPS to a PB multiple of 1.4x which is 1 standard deviation below its 5-year historical average. 

INVESTMENT STATISTICS

FYE June	FY16	FY17	FY18F	FY19F
Net interest income (RM'm)	2,655	2,854	3,106	3,233
Islamic banking income (RM'm)	467	550	558	569
Non-interest income (RM'm)	1,055	1,146	1,198	1,249
Total income (RM'm)	4,178	4,551	4,861	5,052
Pretax profit (RM'm)	2,382	2,748	3,027	3,051
Net profit (RM'm)	1,903	2,145	2,392	2,410
Core net profit (RM'm)	2,034	2,247	2,392	2,410
Core EPS (sen)	99.1	109.9	116.9	117.9
PER (x)	15.6	14.1	13.3	13.1
Net dividend (sen)	41	45	47	47
Net dividend yield (%)	2.6	2.9	3.0	3.0
Book value per share (RM)	10.32	11.09	11.23	11.30
PBV (x)	1.5	1.4	1.4	1.4
ROE (%)	10.7	10.6	10.6	10.3

DAILY PRICE CHART



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Table 1: Quarterly results

Quarterly results						Comments
FYE June (RM m)	4Q17*	3Q17	4Q16	Yoy (+/- %)	Qoq (+/- %)	
Net Interest Income	864	856	774	11.6%	0.9%	Strong NIM improvement (+19bps yoy) on better funding management. For example, interest expense (excl. Islamic Bank) fell -10.1%yoy to RM813.2m.
Non interest Income	288	267	305	-5.5%	7.7%	Lower credit card related fees (-22.5%yoy to RM55.7m) and losses in derivate financial instruments (-RM55.0m).
Net/Total income	1,152	1,124	1,079	6.8%	2.5%	
OPEX	(515)	(500)	(493)	4.4%	2.9%	Contributed by higher IT expenses (+65.5%yoy to RM39.4m).
PPOP	637	623	586	8.7%	2.2%	
Write back/(Provision) for loan losses	(62)	(43)	54	<-100%	43.2%	Due to prudent provisioning stemmed from an account in the shipping O&G sector.
Share of profit from associate and JV	106	118	86	23.8%	-10.2%	
Pre-tax profit	680	697	725	-6.2%	-2.5%	
Net Profit	585	570	559	4.6%	2.7%	
EPS (sen)	28.6	27.8	27.3	4.6%	2.9%	

* Excluding one-off impact of RM102m for tax expenses

Table 2: Quaterly financial ratios based on normalised financials

Financial Ratios (%)	4Q17	3Q17	4Q16	Yoy (+/- ppts)	Qoq (+/- ppts)	Comments
CET1*	13.3	12.7	12.7	0.6	0.6	
Tier 1 Capital*	13.7	13.1	13.1	0.6	0.6	
Total Capital*	15.8	15.1	14.7	1.1	0.7	
NIM	2.14	2.14	1.95	0.19	0	Better funding cost management.
GIL	0.96	0.88	0.79	0.17	0.08	vs. industry which came in at 1.63%.
Loan loss Coverage	96	106	120	-24	-10	vs. industry which came in at 84%.
Credit charge-off	0.21	0.15	-0.17	0.38	0.06	
Cost to income	44.7	44.5	45.7	-1.0	0.2	
Net LD	80.6	81.1	81.2	-0.6	-0.5	vs. industry which came in at 91.3%.
ROEA	10.4	10.4	10.8	-0.4	0.0	

*Group ratios after deducting proposed dividend

Table 3: Normalised cumulative results and ratios

Cumulative results & ratios				Comments
FYE June (RM m)	FY17*	FY16^	Yoy	
NII	3,355	3,075	9.1%	Driven by prudent loans pricing and effective funding cost management. This was evident by NIM improvement of +15bps yoy. Interest expense (excl. Islamic Bank) fell -9.3%yoy to RM3.31b.
NOII	1,196	1,103	8.4%	Higher trading and investment income (+59.3%yoy to RM427m).
Net/Total Income	4,551	4,178	8.9%	
OPEX	(2,008)	(1,915)	4.9%	Higher IT expenses (+33.8%yoy to RM147.7m).
PPOP	2,543	2,263	12.4%	
Writeback/ (Provision) for loan losses	(159)	(43)	>100%	Large impairment in 4QFY17 due to prudent provisioning of an account relating to shipping O&G.
Share of profit from associate and JV	364	333	9.3%	Rebound in profit contribution from BOC in 2HFY17.
Pre-tax profit	2,748	2,554	7.6%	
Net Profit	2,247	2,034	10.5%	
EPS (sen)	109.9	99.4	10.5%	

* Excluding one-off impact of RM102m for tax expenses; ^ Excluding MSS cost of RM171.7m

Ratios (%)	FY17*	FY16^	(+/-ppts)	
ROE	10.3	10.7	-0.4	
CI ratio	44.1	45.8	-1.7	
Credit charge-off	0.13	0.04	0.09	
NIM	2.09	1.94	0.15	

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

Business segments	FY17	FY16	Change (%)	Comments
Personal Financial Services	1,119.9	995.0	12.5%	Higher total income, and lower provisions, offset by higher OPEX.
Business and Corporate Banking	718.4	684.0	5.0%	Driven by higher total income, partially offset by higher provisions and higher OPEX.
Global Markets	405.9	504.6	-19.6%	Lower total income, higher impairment losses on financial investments and higher OPEX.
International Banking	36.2	24.8	46.2%	Contributed by higher share of profit from associated company in China, higher total income, lower allowance for impairment losses on loans, advances and financing, partially offset by higher OPEX from other overseas operation.
Others and Inter-Segment Elimination	103.8	(160.2)	<-100%	
Total segment profit before tax	2,384.2	2,048.3	16.4%	

Source: Company

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MIDF AMANAH INVESTMENT BANK : GUIDE TO RECOMMENDATIONS

STOCK RECOMMENDATIONS

BUY	Total return is expected to be >15% over the next 12 months.
TRADING BUY	Stock price is expected to <i>rise</i> by >15% within 3-months after a Trading Buy rating has been assigned due to positive newsflow.
NEUTRAL	Total return is expected to be between -15% and +15% over the next 12 months.
SELL	<i>Negative</i> total return is expected, by -15% or more, over the next 12 months.
TRADING SELL	Stock price is expected to <i>fall</i> by >15% 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.