

27 August 2015 | 4QFY15 Results Review

Hong Leong Financial Group

Stronger insurance business in 4QFY15

Maintain BUY

Revised Target Price (TP): 17.80
(Previously RM18.30)

INVESTMENT HIGHLIGHTS

- **Hong Leong Bank (HLB) earnings contributed 90.8% of HLFG's PBT in FY15**
- **Earnings for FY15 were within expectations supported by a pickup in insurance earnings in 4QFY15**
- **For the full FY15, PBT for insurance business declined - 17.9%yoy due to lower interest rates for the financial year compared to FY14**
- **Total net dividend of 38 sen for FY15 was in line with our expectation**
- **Trimmed our FY16 net profit slightly by -1.0%**
- **Maintain BUY on HLFG with a revised TP of RM17.80 based on SOP valuation.**

HLFG's net profit for FY15 came in within expectations. HLFG 4QFY15 net profit of RM441.3m (+21.4%qoq, -2.0%yoy) led to a cumulative earnings of RM1.62b (-5.1%yoy). Cumulative net profit for FY15 was within expectations accounting for 98.4% of ours and 97.3% of consensus estimates respectively.

Improved earnings contribution from insurance business in 4QFY15. Earnings from insurance business improved in 4QFY15 compared to the preceding quarter due to higher MGS yield. However, for the full FY15, PBT of its insurance business declined - 17.9%yoy largely due to lower MGS yield in FY15 compared to FY14 resulting in higher actuarial provisions. PBT contribution from its 70% owned Hong Leong Assurance (HLA) declined -18.8%yoy.

Commercial Banking earnings contributions grew by +5.1%yoy while PBT of its Investment Banking business was flat. In FY15, contributions from its 64.4% owned Hong Leong Bank grew +5.1%yoy to RM2.75b. The improved contributions were underpinned by decent operating profit growth of HLB coupled with higher share of profit from Bank of Chengdu (BOC) and Sichuan Jincheng JV. Meanwhile, contribution from Investment Banking business under Hong Leong Cap (HLC) was flat with a growth of +0.5%yoy to RM78.5m in FY15 attributed to subdued capital markets with a lower profit contribution from asset management business.

RETURN STATS	
Price (26 Aug 15)	RM13.22
Target Price	RM17.80
Expected Share Price Return	+34.6%
Expected Dividend Yield	+2.7%
Expected Total Return	+37.3%

STOCK INFO	
KLCI	1,580.37
Bursa / Bloomberg	1082 / HLFG MK
Board / Sector	Main/ Finance
Syariah Compliant	Yes
Issued shares (mil)	1,052.8m
Par Value (RM)	1.00
Market cap (RM'm)	13,918.0
Price over NA	1.1x
52-wk price Range	RM12.50- RM18.48
Beta (against KLCI)	1.16
3-mth Avg Daily Vol	0.212m
3-mth Avg Daily Value	RM3.69m
Major Shareholders	
Hong Leong Co Malaysia	77.36%
Bank of Nova Scotia	2.58%
EPF	1.42%

AUM for asset management business stood at RM7.1b while market share for stock broking business was 4.1% as at end of FY15.

For FY15, HLA's premium grew +9.4%yoy due to slowdown in economy as well as a drop in persistency ratio. For FY15, HLA's premium grew +9.4%yoy and was slightly short of our expectation of 10-12% growth. Renewal premiums have dropped due to the slowdown in economy as well as due to some insurance products which were not fully understood by HLA's customers. This has been reflected by HLA's lower persistency ratio of 87.5% as of end FY15 as compared to 93.4% as of end FY14. For FY16, management has guided for a premium growth of 9-10% for HLA.

HLA has been focussing on building up its Investment Linked/Non-Participating policies. In 4QFY15, the non-participating/participating ratio improved to 55:45 as compared to 54:46 as of end 3QFY15. Premiums from bancassurance were decent with growth rate of +25.0%yoy tapping on HLB's 300 branches. In terms of HLA's products, investment linked premiums registered the highest growth of +37%yoy, followed by credit life premiums at +21%yoy and ordinary life premiums at +3.0%yoy. Arising from its focus on the more profitable investment linked insurance products, market share for new business regular premiums (NBRP) for ordinary life segment drop to 3rd position as of end FY14 vs. 1st in FY13. Meanwhile, market share for NBRP of investment linked segment rose to 5th position as of end FY14 as compared to 6th in the previous year.


Higher claims for medical insurance for HLA. We understand that due to higher claims for medical insurance, management is looking into repricing of its medical insurance as well as to tighten the underwriting of new medical insurance policies.

Double leverage ratio at Group level likely to rise to 109% from the present level of 106%. Recall that the Group plans to raise up to RM1.1b from rights issue to subscribe to its entitlement of the right shares of HLB which amounts to RM1.9b. In the recent analyst briefing, we understand that the Group will fund the remaining RM800m to take up the rights shares of HLB via borrowings. We also understand that once the additional borrowings have been completed, the Group's double leverage ratio is likely to rise to 109% from the present 106%. The Group intends to keep it double leverage ratio at below 110%.

FORECAST

We tweaked our net profit forecast for FY16 slightly by -1.0% after factoring in a lower NII estimate.

VALUATION

With the recent decline in share price, the stock currently trades at an attractive valuation of 1.0x to our BVPS forecast for FY16. We maintain our BUY recommendation with a revised TP of RM17.80 (previously RM18.30) based on SOP valuation after incorporating a lower PB multiple for HLB of 1.4x (previously 1.5x) due to the decline in banking sector valuation. Our BUY recommendation is based on: i) resilience earnings of its subsidiary, HLB which has a stable asset quality and earnings, ii) expected improvement in insurance earnings moving forward with potentially higher MGS yield ahead once US Fed Rate has been hiked, and iii) well diversified earnings of the Group. 

SOP Valuation

Companies	Shareholders' fund (RM'Mil)	As of	Equity Stake (%)	Book Value Multiple (X)	Basis	Valuation (RM'Mil)	RNAV per share (RM)
HLB	21,592		63.59%^	1.4	Base on forecast for FY16	19,223	16.8
HLC	602	30/6/14	81.3%	1.5		734	0.6
Insurance companies under HLA Holdings							
HLA	1,237	30/6/14	70.0%	3.0		2,597	2.3
MSIG	2,298	31/12/14	30.0%	2.0		1,379	1.2
HLMSIG Takaful	87	30/6/14	65.0%	1.0		56	0.05
SOP Valuation						23,989	21.0
Holding company discount				15.0%		(3,598)	(3.1)
SOP Valuation after holding company discount						20,391	
No of shares (Mil)						1,145	
Target Price (TP)						17.80	

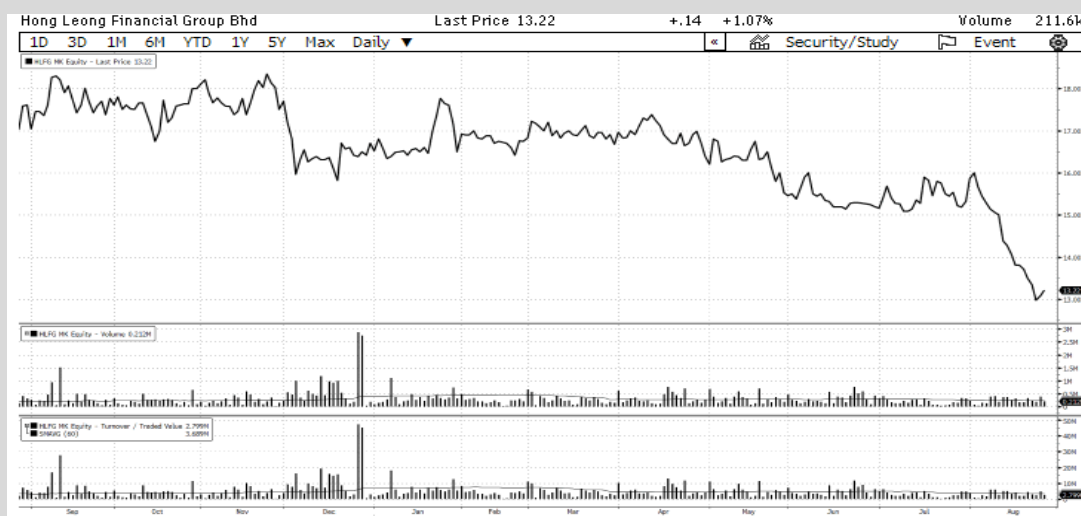
*PB multiple of 3x applied is significantly lower than the PB ratio for its MSIG deal of 8.2x. Earlier, MSIG acquired 30% stake in HLA. ^Includes ESOS share deduction from share base which differs from Company's Act. Base on Company's Act, HLFH holds 64.4% in HLB

INVESTMENT STATISTICS

FYE 30 June (RM'Mil)	FY14	FY15	FY16F	FY17F
Net Interest Income	2,474	2,561	2,680	2,800
Income from Islamic Banking	434	495	549	641
Non interest income	1,654	1,274	1,427	1,583
Net/total income	4,563	4,329	4,656	5,024
Pre-provisioning operating profit	2,583	2,381	2,608	2,813
Profit before tax	3,009	2,953	3,193	3,457
Profit after tax	1,707	1,647	1,780	1,928
EPS (sen)	162.9	154.3	155.4	168.3
EPS Growth (%)	+14.2	-5.2	+0.7	+8.3
PER (x)	8.1	8.6	8.5	7.9
Net Dividend (sen)	38.0	38.0	35.7	38.7
Dividend yield (%)	2.9	2.9	2.7	2.9
Book Value Per Share (sen)	10.95	12.48	13.76	16.53
PBV (x)	1.2	1.1	1.0	0.8
ROE (%)	15.8	13.2	12.4	11.1

Source: MIDFR, Company

DAILY PRICE CHART



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Source: Company, MIDFR

Table 1: Quarterly results

Quarterly results						Comments
FYE June (RM m)	4Q15	3Q15	4Q14	Yoy (+/- %)	Qoq (+/- %)	
Net Interest Income	657.9	657.0	631.9	+4.1%	+0.1%	Marginally higher qoq with an expansion in loan book by +2.6%qoq and a NIM contraction of 2bp qoq for HLB.
Islamic Banking Income	104.8	99.0	104.2	+0.6%	+5.9%	
Non interest Income	456.2	289.9	424.5	+7.5%	+57.4%	Higher qoq due to increase in net income from insurance business by +391.8%qoq and net brokerage, commissions from brokerage business (+208.7%qoq) Fee income was flat at +0.8%qoq. Investment and trading income gained +138.5%qoq due to higher dividend income from securities as well as an unrealized gain from revaluation of HFT securities and derivatives in 4Q15 vs unrealized losses in 3Q15.
Net/Total income	1,218.9	1,046.0	1,160.6	+5.0%	+16.5%	
OPEX	(532.4)	(491.0)	(534.0)	-0.3%	+8.4%	
PPOP	686.5	554.9	626.6	+9.6%	+23.7%	

FYE June (RM m)	Quarterly results					Comments
	4Q15	3Q15	4Q14	Yoy (+/- %)	Qoq (+/- %)	
Write back/(Provision) for loan losses	(22.5)	6.4	(24.6)	-8.5%	-451.6%	
Share of results from associate	122.5	127.6	109.5	+11.9%	-4.0%	Still a strong contribution from associate, Bank of Chengdu (BOC)
Share of results from JV	3.7	4.9	3.3	+12.1%	-24.5%	
Pre-tax profit	780.5	699.7	715.6	+9.1%	+11.5%	
Taxation and zakat	(90.8)	(150.6)	(55.9)	+62.4%	-39.7%	
Net Profit	441.3	363.5	450.3	-2.0%	+21.4%	
EPS (sen)	42.0	34.7	43.0	-2.3%	+21.0%	

Table 2: Cumulative results and ratios

Cumulative results & ratios				Comments
FYE June (RM m)	FY15	FY14	Yoy	
Net Interest Income	2,709.7	2,474.4	+9.5%	Contributed by loan expansion of +8.9%yoy while NIM contracted 7bp to 2.01% in FY15 for HLB
Islamic Banking Income	419.8	434.4	-3.4%	
Non Interest Income	1,361.5	1,640.4	-17.0%	Mainly due to lower net income from insurance business as a result of lower interest rates in FY15 than FY14, lower investment trading income from softer Treasury market gains for HLB and lower FX gains in FY15 as HLB recorded FX losses in 1Q15 due to unfavourable market condition which impacted its FX swap position negatively.
Net/Total Income	4,490.9	4,549.2	-1.3%	
OPEX	(2,000.3)	(1,966.1)	+1.7%	
PPOP	2,490.7	2,583.1	-3.6%	

Cumulative results & ratios				Comments
FYE June (RM m)	FY15	FY14	Yoy	
Writeback/(Provision) for loan losses	52.6	(52.4)	-200.4%	A writeback in provisions for loan impairment due to writeback in IA and lower CA due to improved credit profile of HLB. Net credit charge off was -0.05% for FY15 vs. 0.05% for FY14
Share of results from associates	463.3	429.6	+7.8%	
Share of results from JV	14.1	9.4	+50.0%	Represents share of results from Sichuan Jincheng consumer finance joint venture.
Pre-tax profit	3,023.3	3,009.2	+0.5%	
Taxation and zakat	(562.9)	(491.9)	+14.4%	
Net Profit	1,620.7	1,706.9	-5.1%	
EPS (sen)	154.3	162.9	-5.3%	
	FY15	FY14	(+/- ppts)	
ROE (%)	13.2	15.8	-2.6	
CI ratio (%)	44.5	43.2	+1.3	

Table 3: Segmental Profit contribution

Group (FYE June) RM'Mil	FY15	% contribution	FY14	% contribution	Change Yoy (%)	Comments
HLB operating profit & Sichuan Jincheng JV	2,344.9	77.6	2,244.7	74.6	+4.5	Higher NII from a stable loan growth but still a lower NOII due to softer Treasury market activities for HLB in 1H15
Bank of Chengdu @ 20%	401.3	13.3	368.5	12.2	+8.9	
Banking (HLB)	2,746.2	90.8	2,613.2	86.8	+5.1	
HLA (Life & Shareholders' funds)	232.7	7.7	286.6	9.5	-18.8	At HLA level, stripping out interest rate impact and one-off adjustment from change in actuarial assumptions, operating profit drop was -3.5%yoy
MSIG @ 30% (General Insurance)	62.0	2.1	61.1	2.0	+1.5	Stable earnings contribution from MSIG. Claims ratio stable with high underwriting margins
Others: HLA, HLMT & Others	(7.1)	(0.2)	2.7	0.1	n.m	
Insurance	287.6	9.5	350.4	11.5	-17.9	
Investment Banking (HLC)	78.5	2.6	78.9	2.6	-0.5	Earnings flat due to subdued capital market activities with lower contribution from asset management business
Others	(89.0)	(2.8)	(33.3)	(1.0)	+167.5	
Pretax profit	3,023.3	100.0	3,009.2	100.0	+0.5	
Taxation	(562.9)			(491.9)	+14.4	
Profit after Tax	2,460.4			2,517.3	-2.3	
Minority Interest	(839.6)			(810.5)	+3.6	
Net Profit after tax and minority interest	1,620.7			1,706.8	-5.0	
EPS (sen)	154.3			162.9	-5.3	

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	Total return is expected to be <15% 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.