

27 February 2018 | 2QFY18 Results Review

Hong Leong Financial Group

Dragged by insurance and investment bank

INVESTMENT HIGHLIGHTS

- **Net profit for 1HFY18 was at the upper bound of expectations**
- **Hong Leong Bank Bhd was the key driver while insurance and investment bank was a drag**
- **HLB picked up robustly due to better net interest income stemmed from net interest margin improvement**
- **No dividend**
- **Tweaking our FY18 forecast upwards by +6.1%**
- **Reverting to NEUTRAL (from TRADING BUY) on HLFG with an adjusted TP of RM18.70 (from RM17.67) based on SOTP valuation**

HLFG 1HFY18 earnings upper bound of expectations. HLFG reported 1HFY18 net profit of RM950.6m, which was at the upper bound of ours and consensus' expectations coming in at 56.7% and 54.9% of respective full year estimates. The +14.6%yoy growth was due to solid performance of Hong Leong Bank (HLB).

HLB topline driven by net interest income. HLB net interest income (including Islamic Banking) in 1HFY18 grew +9.0%yoy, driven by +8bps yoy net interest margins (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. In addition, Bank of Chengdu contribution grew +111.7%yoy to RM273.1m.

Meanwhile, Current Account Savings Account (CASA) deposits 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.

However, 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.

**Revert to NEUTRAL
(from TRADING BUY)
Adjusted Target Price (TP): 18.70
(previously RM17.67)**

RETURN STATS	
Price (26 February 2018)	RM18.46
Target Price	RM18.70
Expected Share Price Return	+1.3%
Expected Dividend Yield	+2.1%
Expected Total Return	+3.4%

STOCK INFO	
KLCI	1,860.08
Bursa / Bloomberg	1082 / HLFG MK
Board / Sector	Main/ Finance
Syariah Compliant	No
Issued shares (mil)	1,145.2m
Market cap (RM'm)	21,141.2
Price over NA	1.2x
52-wk price Range	RM15.02 - RM19.24
Beta (against KLCI)	1.08
3-mth Avg Daily Vol	0.25m
3-mth Avg Daily Value	RM4.46m
Major Shareholders	
Hong Leong Co Malaysia	77.46%
EPF	1.92%
ING Groep NV	1.83%


Insurance division performance slumped. Insurance division PBT came in -19.4%yoy lower to RM152.4m. This was due to higher interest rates in 1HFY17 as compared to current year which led to much higher profits in 1HFY17. In addition, life fund surplus came in lower. Meanwhile, management expense ratio was 5.7% in 1HFY18.

Lower Investment Banking business under Hong Leong Cap (HLC). The Investment Banking business under Hong Leong Cap (HLC) fell 6.4%yoy to RM37.4m. This was despite revenue coming in higher. The lower contribution was due to higher variable overhead expenses. In terms of business segment, the drag came from investment banking and stockbroking.

FORECAST

We are tweaking our FY18 forecast upwards by +6.1% to take into account the performance of HLB.

VALUATION

We believe that the main driver for the Group is HLB. Although, HLB's prospects remain stable, we do not foresee any upside surprises in the coming quarters. This is premised on the lower than expected loans growth. However, improvement in NIM will moderate this impact and the recovery in Bank of Chengdu will provide a boost. With no immediate catalyst to the Group's earnings, we are reverting our call to NEUTRAL (from TRADING BUY). We are revising our TP to RM18.70 (from RM17.67) due to adjustment made to HLB's valuation. 

SOP Valuation

Companies	Shareholders' fund (RM'Mil)	As of	Equity Stake (%)	Book Value Multiple (X)	Basis	Valuation (RM'Mil)	RNAV per share (RM)
HLB	22,967		65.7%	1.5	Based on forecast for FY19	22,647	19.73
HLC	745	30/6/17	81.3%	1.5	Audited FY17 result	909	0.79
Insurance companies under HLA Holdings							
HLA	1,572	30/6/17	70.00%	1.9	Audited FY17 result	2,091	1.82
MSIG	2,609	30/6/17	30.00%	1.9	Interim FY17 result	1,487	1.3
HLMSIG Takaful	81	30/6/17	65.00%	1.9	Audited FY16 result	100	0.09
SOP Valuation						27,233	23.72
Holding company discount				21%		(5,760)	(5.02)
SOP Valuation after holding company discount						21,473	
No of shares (Mil)						1,148	
Target Price (TP)						18.70	

INVESTMENT STATISTICS

FYE 30 June (RM'Mil)	FY16	FY17	FY18F	FY19F
Net Interest Income	2,641	2,822	3,122	3,341
Income from Islamic Banking	467	550	726	741
Non interest income	1,435	1,663	1,737	1,898
Net/total income	4,543	5,035	5,585	5,979
Pre-provisioning operating profit	2,259	2,812	3,218	3,452
Profit before tax	2,565	3,090	3,418	3,655
Profit after tax	1,359	1,507	1,777	1,978
EPS (sen)	123.2	131.8	154.9	172.4
EPS Growth (%)	-20.2	7.0	17.5	11.3
PER (x)	13.0	12.2	11.9	10.7
Net Dividend (sen)	38	38	38	39
Dividend yield (%)	2.4	2.4	2.1	2.1
Book Value Per Share (sen)	13.91	14.52	15.08	16.41
PBV (x)	1.2	1.1	1.2	1.1
ROE (%)	8.9	9.9	10.3	10.5

Source: MIDFR, Company

DAILY PRICE CHART

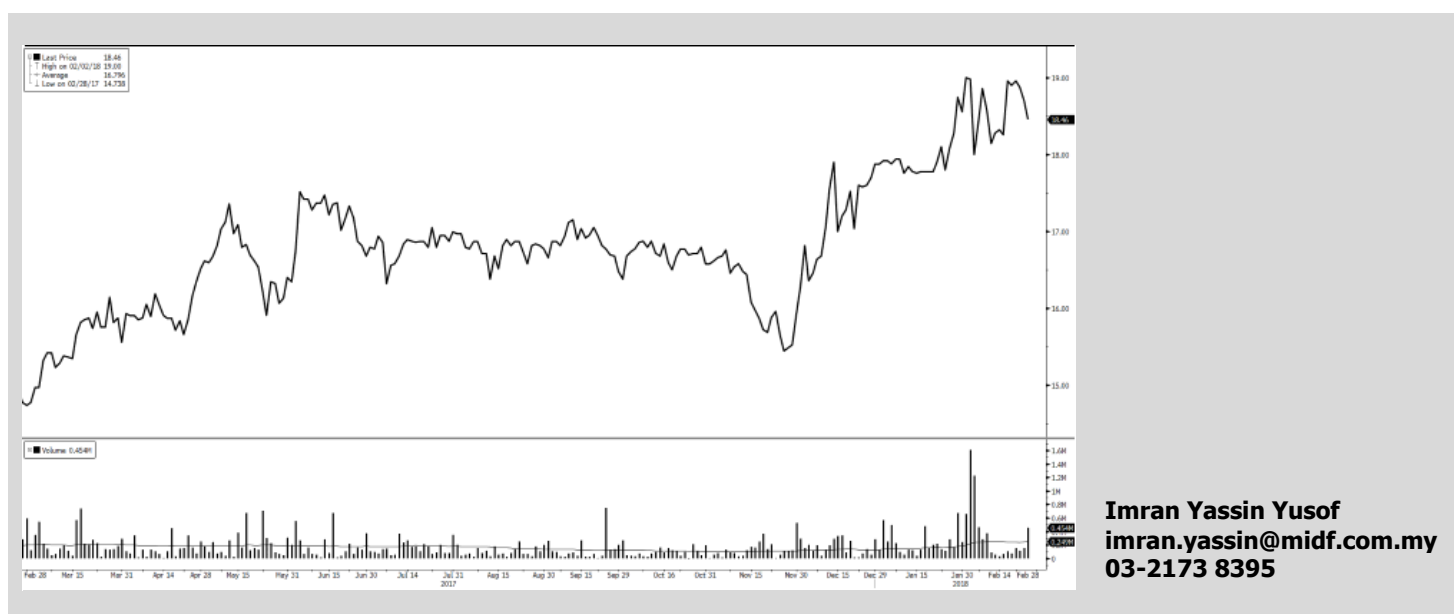


Table 1: Quarterly results

Quarterly results					
FYE June (RM m)	2Q18	1Q18	2Q17	Yoy (+/- %)	Qoq (+/- %)
Net Interest Income	747	729	703	6.1%	2.5%
Islamic Banking Income	157	160	138	13.3%	-1.9%
Non interest Income	463	390	513	-9.8%	18.5%
Net/Total income	1,366	1,279	1,354	0.9%	6.8%
OPEX	(572)	(558)	(561)	2.1%	2.5%
PPOP	794	721	794	0.0%	10.2%
Write back/(Provision) for loan losses	(10)	(44)	(27)	-62.5%	-76.9%
Share of results from associate	136	159	60	126.8%	-14.4%
Share of results from JV	5	5	6	-11.7%	7.9%
Pre-tax profit	925	840	832	11.1%	10.0%
Net Profit	495	455	443	11.8%	8.8%
EPS (sen)	44.3	39.8	38.7	14.5%	11.3%

Source: Company

Table 2: PBT of key segments (RM'Mil)

Business segments	1HFY18	1HFY17	Change (%)	Comments
Commercial Banking (HLB)	1,331	1,230	8.2%	Due broad based growth in NII and higher share of profit from associate and JV.
Investment Banking	37	40	-6.4%	Lower contribution from stockbroking and IB.
Insurance (HLA)	130	155	-16.2%	Lower life fund surplus and lower share of profit from an associate.

Table 3: Comparison of cumulative results and ratios (RM'Mil)

Cumulative results & ratios			
FYE June (RM m)	1HFY18	1HFY17	Yoy
Net Interest Income	1,475	1,386	6.5%
Islamic Banking Income	317	268	18.1%
Non Interest Income	853	882	-3.3%
Net/Total Income	2,645	2,536	4.3%
OPEX	(1,131)	(1,099)	2.9%
PPOP	1,514	1,437	5.3%
Writeback/(Provision) for loan losses	(54)	(54)	-0.3%
Share of results from associate, BOC	296	163	81.3%
Share of results from JV	9	12	-19.6%
Pre-tax profit	1,765	1,558	13.3%
Taxation and zakat	951	829	14.6%
Net Profit	83.1	72.5	14.6%
EPS (sen)	1,475	1,386	6.5%
			(+/-ppts)
ROE (%)	11.0	10.3	0.7
CI ratio (%)	42.7	43.3	-0.6

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.