



Hong Leong Financial Group (HLFG MK) : BUY

Mkt. Cap: US\$5,319m | 3m Avg. Daily Val: US\$0.98m

Last Traded Price (30 May 2018): RM18.50

Price Target 12-mth: RM22.00 (19% upside) (Prev RM22.00)

Analyst

Malaysian Research Team +603 2604 3333 general@alliancedbs.com

Bank and insurance growth in sync

- 3Q18 earnings trumped expectations on sustained low provisions and strong associate profit; topline dampened by lower NIM and sluggish loan growth
- Improved contribution from insurance business; investment banking stayed a small contributor
- Lift HLB's FY18-20F earnings by 3-4% for persistently low credit costs and strong BOCD contribution; flow-through to HLFG
- Maintain BUY, RM22.00 TP

Forecasts and Valuation

FY Jun (RMm)	2017A	2018F	2019F	2020F
Pre-prov. Profit	2,696	3,266	3,484	3,819
Net Profit	1,827	1,894	2,003	2,201
Net Pft (Pre Ex.)	1,737	1,894	2,003	2,201
Net Pft Gth (Pre-ex) (%)	16.0	9.0	5.8	9.9
EPS (sen)	159	165	175	192
EPS Pre Ex. (sen)	151	165	175	192
EPS Gth Pre Ex (%)	16	9	6	10
Diluted EPS (sen)	159	165	175	192
PE Pre Ex. (X)	12.2	11.2	10.6	9.6
Net DPS (sen)	75.1	52.8	55.9	61.4
Div Yield (%)	4.1	2.9	3.0	3.3
ROAE Pre Ex. (%)	10.7	11.1	11.1	11.5
ROAE (%)	11.4	11.1	11.1	11.5
ROA (%)	1.2	1.3	1.3	1.3
BV Per Share (sen)	1,448	1,532	1,621	1,719
P/Book Value (x)	1.3	1.2	1.1	1.1

Source of all data on this page: Company, AllianceDBS, Bloomberg Finance L.P.

What's New

Stellar 3Q18 for HLB. Hong Leong Bank's (HLB) 3QFYJun18 (3Q18) earnings came in above consensus and our forecasts on sustained low provisions/credit costs and strong contribution from its associate, Bank of Chengdu (BOCD). NIM was weaker q-o-q as the bank pre-empted a deposit drive to shore up additional retail deposits, driving cost of funds higher. The Jan 2018 overnight policy rate (OPR) hike did lift loan yields by 9bps q-o-q. Loans were flattish y-o-y, q-o-q and YTD despite continued growth in the key segments of mortgages and SME, but this was offset by corporate repayments. Islamic banking and non-interest income made up for the slack in net interest income. There was a one-off gain of RM68m from the sale of its Visa shares held as available-for-sale securities. Expenses remained in check with cost-to-income reaching a record low of 41.9% during the quarter. Credit cost stayed at a low annualised 7bps (gross credit cost at 26bps) with sustained recoveries and low incidences of new impairments. HLB's capital ratios were also solid.

Higher interest rates a boon for HLA. Hong Leong Assurance (HLA) benefited from higher interest rates. HLA booked a 9M18 pre-tax profit of RM247m, which is slightly higher than a year ago, thanks to rising interest rates. Its management expense ratio stood at 5.9%, among the lowest vs peers.

Interim dividend declared. A second interim dividend of 27 sen was declared during the quarter.

Flash Note

Outlook

HLB's loan growth target revised down further to 2-3% (from 3-4%) for FY18. We already had our FY18F loan forecast revised to 3%. With the strong macro environment, we expect loan growth to inch up to 5-6% in FY19-20F. With the adoption of MFRS9 by 1 Jul 2018 given that its financial year end is in June, we are assuming credit costs to be a little higher at 14bps, assuming that recoveries will gradually taper off. Preliminary guidance on capital impact upon the implementation of MFRS9 is at 25bps and for credit costs to rise by 25-30%. We believe our FY19-20F credit costs assumptions are fair for now. Separately, HLB's cost-to-income is targeted at below 40% in the next few years, largely owing to cost savings from its digital initiatives.

HLA – back to business-as-usual; focusing on investment-linked and non-par products. HLFG will continue to build its insurance business in key focus areas such as investment-linked and non-par products through its existing distribution

channels. On top of that, HLFG is exploring digital initiatives to enhance customer and agent experience. There has been no further buzz on the possibility of a disposal or a spin-off. However, we believe such corporate action could remain imminent and if it materialises, it could help unlock shareholder value.

HL Cap should see improved earnings trends. With the capital market momentum picking up, we would expect HL Cap's earnings traction to remain strong for the rest of 2018.

Valuation and recommendation

Maintain BUY, TP at RM22.00. Our TP is based on the sum-of-parts method, using our revised TP for HLB, while HL Cap and HLA are valued at 1x and 1.5x BV, respectively.

HLFG: Sum-of-parts valuation

	Stake (%)	Share price (RM)	No. of shares		Value (RMm)	RNAV/share (RM)
Hong Leong Bank	64.4%	21.00	2,045.50		27,663	24.11
Hong Leong Capital	81.3%	n.a	238.97		570	0.50
Fair value of investment in listed companies	(a)				28,233	24.60
HLFG's key unlisted assets				Assets (RMm)	Liabilities (RMm)	Net Assets (RMm)
Insurance - HLA Holdings (100%)						Value (RMm)
Hong Leong Assurance Berhad	70%	14,852	13,414	1,439	1,511	1.32
Hong Leong-MSIG Takaful	65%	528	447	80	78	0.07
MSIG Insurance	30%					
Net assets of core divisions based on BV	(b)				1,589	1.38
RNAV	(a)+(b)				29,822	26.00
HLFG's no. of shares						1,147.52
Holding Company discount						15%
Fair Value						22.00

Source: AllianceDBS

Quarterly / Interim Income Statement (RMm)

FY Jun	3Q2017	2Q2018	3Q2018	% chg yoy	% chg qoq
Net Interest Income	719	747	706	(1.9)	(5.5)
Islamic Income	139	157	167	19.7	19.7
Non-Interest Income	367	463	514	40.0	11.1
Operating Income	1,226	1,366	1,386	13.1	1.5
Operating Expenses	(553)	(572)	(593)	7.2	3.5
Pre-Provision Profit	673	794	794	18.0	0.0
Provisions	(43.4)	(10.2)	(11.1)	(74.4)	9.7
Associates	134	141	160	19.2	13.4
Exceptionals	0.0	0.0	0.0	nm	nm
Pretax Profit	764	925	943	23.4	2.0
Taxation	(136)	(175)	(181)	32.8	3.6
Minority Interests	(209)	(254)	(259)	(24.1)	1.8
Net Profit	419	495	503	20.0	1.5

Growth (%)

Net Interest Income Gth	2.2	2.5	(5.5)
Net Profit Gth	(5.5)	8.8	1.5

Key ratio (%)

NIM*	2.14	2.13	2.10
NPL ratio*	0.9	1.0	0.8
Loan-to deposit*	80.3	80.1	80.7
Cost-to-income	45.1	41.9	42.7
Total CAR*	15.1	15.8	16.3

* HLB numbers

Source of all data: Company, AllianceDBS

Target Price & Ratings History



S.No.	Date of Report	Closing Price	12-mth Target Price	Rating
1:	30 May 17	16.48	17.00	HOLD
2:	02 Jun 17	17.10	17.00	HOLD
3:	05 Jun 17	17.90	17.00	HOLD
4:	28 Aug 17	16.96	17.40	HOLD
5:	08 Sep 17	16.94	17.40	HOLD
6:	13 Nov 17	16.60	17.40	HOLD
7:	04 Dec 17	16.40	17.40	HOLD
8:	05 Dec 17	16.94	17.40	HOLD
9:	06 Dec 17	16.48	17.40	HOLD
10:	27 Feb 18	19.20	22.00	BUY
11:	09 Mar 18	18.58	22.00	BUY
12:	12 Mar 18	19.02	22.00	BUY
13:	22 May 18	19.10	22.00	BUY

Note: Share price and Target price are adjusted for corporate actions.

Source: AllianceDBS

Analyst: Malaysian Research Team

DISCLOSURE

Stock rating definitions

STRONG BUY	-	> 20% total return over the next 3 months, with identifiable share price catalysts within this time frame
BUY	-	> 15% total return over the next 12 months for small caps, >10% for large caps
HOLD	-	-10% to +15% total return over the next 12 months for small caps, -10% to +10% for large caps
FULLY VALUED	-	negative total return > -10% over the next 12 months
SELL	-	negative total return of > -20% over the next 3 months, with identifiable catalysts within this time frame

Commonly used abbreviations

Adex = advertising expenditure	EPS = earnings per share	PBT = profit before tax
bn = billion	EV = enterprise value	P/B = price / book ratio
BV = book value	FCF = free cash flow	P/E = price / earnings ratio
CF = cash flow	FV = fair value	PEG = P/E ratio to growth ratio
CAGR = compounded annual growth rate	FY = financial year	q-o-q = quarter-on-quarter
Capex = capital expenditure	m = million	RM = Ringgit
CY = calendar year	M-o-m = month-on-month	ROA = return on assets
Div yld = dividend yield	NAV = net assets value	ROE = return on equity
DCF = discounted cash flow	NM = not meaningful	TP = target price
DDM = dividend discount model	NTA = net tangible assets	trn = trillion
DPS = dividend per share	NR = not rated	WACC = weighted average cost of capital
EBIT = earnings before interest & tax	p.a. = per annum	y-o-y = year-on-year
EBITDA = EBIT before depreciation and amortisation	PAT = profit after tax	YTD = year-to-date

DISCLAIMER

This report has been prepared for information purposes only by AllianceDBS Research Sdn Bhd ("ADBSR"), a subsidiary of Alliance Investment Bank Berhad ("AIBB") and an associate of DBS Vickers Securities Holdings Pte Ltd ("DBSVH"). DBSVH is a wholly-owned subsidiary of DBS Bank Ltd. This report is strictly confidential and is meant for circulation to clients of ADBSR, AIBB and DBSVH only or such persons as may be deemed eligible to receive such research report, information or opinion contained herein. Receipt and review of this report indicate your agreement not to distribute, reproduce or disclose in any other form or medium (whether electronic or otherwise) the contents, views, information or opinions contained herein without the prior written consent of ADBSR.

This report is based on data and information obtained from various sources believed to be reliable at the time of issuance of this report and any opinion expressed herein is subject to change without prior notice and may differ or be contrary to opinions expressed by ADBSR's affiliates and/or related parties. ADBSR does not make any guarantee, representation or warranty (whether express or implied) as to the accuracy, completeness, reliability or fairness of the data and information obtained from such sources as may be contained in this report. As such, neither ADBSR nor its affiliates and/or related parties shall be held liable or responsible in any manner whatsoever arising out of or in connection with the reliance and usage of such data and information or third party references as may be made in this report (including, but not limited to any direct, indirect or consequential losses, loss of profits and damages).

The views expressed in this report reflect the personal views of the analyst(s) about the subject securities or issuers and no part of the compensation of the analyst(s) was, is, or will be directly or indirectly related to the inclusion of specific recommendation(s) or view(s) in this report. ADBSR prohibits the analyst(s) who prepared this report from receiving any compensation, incentive or bonus based on specific investment banking transactions or providing a specific recommendation for, or view of, a particular company.

This research report provides general information only and is not to be construed as an offer to sell or a solicitation to buy or sell any securities or other investments or any options, futures, derivatives or other instruments related to such securities or investments. In particular, it is highlighted that this report is not intended for nor does it have regard to the specific investment objectives, financial situation and particular needs of any specific person who may receive this report. Investors are therefore advised to make their own independent evaluation of the information contained in this report, consider their own individual investment objectives, financial situations and particular needs and consult their own professional advisers (including but not limited to financial, legal and tax advisers) regarding the appropriateness of investing in any securities or investments that may be featured in this report.

ADBSR, AIBB, DBSVH and DBS Bank Ltd, their directors, representatives and employees or any of their affiliates or their related parties may, from time to time, have an interest in the securities mentioned in this report. AIBB, DBSVH and DBS Bank Ltd, their affiliates and/or their related persons may do and/or seek to do business with the company(ies) covered in this report and may from time to time act as market maker or have assumed an underwriting commitment in securities of such company(ies), may sell or buy such securities from customers on a principal basis and may also perform or seek to perform significant investment banking, advisory or underwriting services for or relating to such company(ies) as well as solicit such investment, advisory or other services from any entity mentioned in this report.

AIBB, DBSVH, DBS Bank Ltd (which carries on, inter alia, corporate finance activities) and their activities are separate from ADBSR. AIBB, DBSVH and DBS Bank Ltd may have no input into company-specific coverage decisions (i.e. whether or not to initiate or terminate coverage of a particular company or securities in reports produced by ADBSR) and ADBSR does not take into account investment banking revenues or potential revenues when making company-specific coverage decisions.

ADBSR, AIBB, DBSVH, DBS Bank Ltd and/or other affiliates of DBS Vickers Securities (USA) Inc ("DBSVUSA"), a U.S.-registered broker-dealer, may beneficially own a total of 1% or more of any class of common equity securities of the subject company mentioned in this report. ADBSR, AIBB, DBSVH, DBS Bank Ltd and/or other affiliates of DBSVUSA may, within the past 12 months, have received compensation and/or within the next 3 months seek to obtain compensation for investment banking services from the subject company. DBSVUSA does not have its own investment banking or research department, nor has it participated in any investment banking transaction as a manager or co-manager in the past twelve months. Any US persons wishing to obtain further information, including any clarification on disclosures in this disclaimer, or to effect a transaction in any security discussed in this report should contact DBSVUSA exclusively. DBS Vickers Securities (UK) Ltd is an authorised person in the meaning of the Financial Services and Markets Act and is regulated by The Financial Services Authority. Research distributed in the UK is intended only for institutional clients.

In reviewing this report, an investor should be aware that any or all of the foregoing, among other things, may give rise to real or potential conflicts of interest. Additional information is, subject to the overriding issue of confidentiality, available upon request to enable an investor to make their own independent evaluation of the information contained herein.



Wong Ming Tek, Executive Director

Published by
AllianceDBS Research Sdn Bhd (128540 U)
19th Floor, Menara Multi-Purpose, Capital Square, 8 Jalan Munshi Abdullah, 50100 Kuala Lumpur, Malaysia.
Tel.: +603 2604 3333 Fax: +603 2604 3921 email: general@alliancedbs.com