



Hong Leong Financial Group (HLFG MK) : BUY

Mkt. Cap: US\$5,214m | 3m Avg. Daily Val: US\$1.00m

Last Traded Price (28 Aug 2018): RM18.64

Price Target 12-mth: RM24.40 (31% upside) (Prev RM22.00)

Analyst

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Banking and insurance arms driving growth

- FY18 earnings within expectations, 4QFY18 bolstered by lower provisions and strong associate profit
- Increasing contribution from HLA, HLCap dragged by soft capital market environment
- HLA to continue growing; expect better traction from HLCap in FY19
- Maintain BUY with higher RM24.40 TP from HLB's higher TP

What's New

Another good quarter for HLB. Hong Leong Bank Berhad's (HLB) 4QFY18 earnings were underpinned by better non-operating income, lower provisions and a lower effective tax rate. Net interest margins (NIMs) were lower y-o-y due to higher funding costs. Loan growth of 3% y-o-y continued to be underpinned by mortgages. HLB's associate Bank of Chengdu Limited continued to support its earnings. Expenses were contained, with cost-to-income hovering at 43.4% during the quarter. Credit costs were low at 3bps (annualised). Separately, capital ratios were solid.

Solid showing for HLA. Hong Leong Assurance Berhad (HLA) continued to benefit from higher interest rates during the fiscal year, but was impacted by a RM59m one-off adjustment to rebalance its asset share against its policy-related liabilities. It booked a FY18 pre-tax profit of RM266m, 8% higher from a year ago. On a normalised basis, HLA's operating profit would have been 31% higher at RM297m.

Outlook

FY19 targets. Hong Leong Bank is targeting to track industry loan growth, which stood at 5% as at end-June 2018. In addition, it is aiming to keep NIMs above 2%, although intensifying competition in the deposits space may pressure

Forecasts and Valuation

FY Jun (RMm)	2017A	2018A	2019F	2020F
Pre-prov. Profit	2,812	3,056	3,427	3,733
Net Profit	1,507	1,907	2,009	2,207
Net Pft (Pre Ex.)	1,507	1,907	2,009	2,207
Net Pft Gth (Pre-ex) (%)	0.6	26.6	5.3	9.9
EPS (sen)	132	167	176	193
EPS Pre Ex. (sen)	132	167	176	193
EPS Gth Pre Ex (%)	1	26	5	10
Diluted EPS (sen)	132	167	176	193
PE Pre Ex. (X)	14.1	11.2	10.6	9.7
Net DPS (sen)	38.0	40.0	56.2	61.7
Div Yield (%)	2.0	2.1	3.0	3.3
ROAE Pre Ex. (%)	9.4	11.1	11.0	11.4
ROAE (%)	9.4	11.1	11.0	11.4
ROA (%)	1.1	1.3	1.3	1.3
BV Per Share (sen)	1,452	1,556	1,645	1,744
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.

funding costs in the near term. The group's loan-to-deposits ratio (LDR), which was 82% as at end-June 2018, is likely to be maintained. Despite some cost savings from its ongoing digitalisation initiative, the group is maintaining a cost-to-income target of below 43% as it expects to incur more IT-related expenses.

Business as usual for HLA. Moving forward, HLA is expected to continue building on its key focus areas such as investment-linked and non-par products through its existing distribution channels, which would boost its profitability going forward. At the same time, it expects to maintain its industry leading management expense ratio of c. 6%. There has been little news on the possibility of a disposal or a spin-off, although we believe such corporate action could help unlock shareholder value, if it materialises.

HLCap should see better earnings in FY19. Hong Leong Capital (HLCap) is expected to provide better earnings contribution in FY19, given some spillover of deals from FY18 and the capital market momentum picking up towards 2HCY18.

Valuation and recommendation

Maintain BUY with higher TP of RM24.40. Our target price (TP) is based on the sum-of-parts method, using our revised TP for HLB (from rolling forward our valuation base to CY19F), while HLCap and HLA are valued at 1x and 1.5x BV, respectively.

Quarterly / Interim Income Statement (RMm)

FY Jun	4Q2017	3Q2018	4Q2018	% chg yoy	% chg qoq
Net Interest Income	717	706	690	(3.8)	(2.3)
Islamic Income	143	167	163	14.0	14.0
Non-Interest Income	414	514	467	13.0	(9.0)
Operating Income	1,273	1,386	1,320	3.7	(4.8)
Operating Expenses	(571)	(593)	(572)	0.2	(3.5)
Pre-Provision Profit	702	794	748	6.5	(5.8)
Provisions	(62.3)	(11.1)	(12.0)	(80.8)	7.3
Associates	128	160	135	4.8	(15.9)
Exceptionals	0.0	0.0	0.0	nm	nm
Pretax Profit	768	943	871	13.3	(7.7)
Taxation	(326)	(181)	(177)	(45.5)	(2.1)
Minority Interests	(184)	(259)	(239)	(30.1)	(7.8)
Net Profit	259	503	454	75.5	(9.6)

Growth (%)

Net Interest Income Gth	(0.3)	(5.5)	(2.3)
Net Profit Gth	(38.2)	1.5	(9.6)

Key ratio (%)

NIM*	1.9	1.9	1.8
NPL ratio*	1.0	0.8	0.9
Loan-to deposit*	79.9	80.7	81.4
Cost-to-income*	44.7	41.9	43.4
Total CAR*	15.8	16.3	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:	28 Aug 17	16.96	17.40	HOLD
2:	08 Sep 17	16.94	17.40	HOLD
3:	13 Nov 17	16.60	17.40	HOLD
4:	04 Dec 17	16.40	17.40	HOLD
5:	05 Dec 17	16.94	17.40	HOLD
6:	06 Dec 17	16.48	17.40	HOLD
7:	27 Feb 18	19.20	22.00	BUY
8:	09 Mar 18	18.58	22.00	BUY
9:	12 Mar 18	19.02	22.00	BUY
10:	22 May 18	19.10	22.00	BUY
11:	31 May 18	18.90	22.00	BUY
12:	05 Jun 18	19.20	22.00	BUY

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

Source: AllianceDBS

Analyst: CHIN Jin Han, CFA

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

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