

24 February 2016 | 2QFY16 Results Review

## Hong Leong Financial Group

*Decline in contribution from Banking division*

**Maintain BUY**

**Adjusted Target Price (TP): 16.10**  
(previously RM16.90)

### INVESTMENT HIGHLIGHTS

- **HLFG core earnings for 6MFY16 declined -10.0%yoy due to lower contribution from its Banking division**
- **Core cumulative earnings were below expectations**
- **Insurance division earnings coming mainly from its 70% owned subsidiary, Hong Leong Assurance (HLA) was higher due to lower actuarial reserves from a rise in interest rate**
- **Contribution from Investment Banking was flat for 6MFY16**
- **Trimmed our net profit estimates for FY16/17 by 12.2%/14.9% respectively**
- **Maintain BUY on HLFG with a lower TP of RM16.10 based on SOP valuation.**

**HLFG's 6MFY16 core net profit was below expectations.** HLFG reported a 2QFY16 net profit of RM263.4m (-31.9%qoq, -37.8%yoy) due to lower contribution from its Banking and Insurance division. Reported cumulative net profit of RM650.3m for 6MFY16 declined -20.3%yoy. The Group's Commercial Banking division reported lower earnings for 6MFY16 compared to 6MFY15 due to one-off MSS cost of RM172m, higher provisions for loan impairment by RM152.9m and lower share of profit from Bank of Chengdu (BOC) and Sichuan Jincheng Consumer Finance JV by RM36.1m.

Meanwhile, earnings for Insurance division were higher by +17.7%yoy in 6MFY16 due to rise in HLA's profits. This was due to lower actuarial reserves from higher interest rates. For 6MFY16, HLA recorded a higher PBT of RM131.1m vs. RM111.3m in 6MFY15.

Excluding the one-off MSS cost, core earnings for HLFG were below expectations accounting for 41.2% of our and 43.8% of consensus estimates respectively.

**Contribution from Investment Banking business under Hong Leong Cap (HLC) was subdued for 6MFY16.** Contribution from Investment Banking business under Hong Leong Cap (HLC) was subdued with HLC reporting a flattish PBT growth of 0.3%yoy to RM34.3m for 6MFY16. This was largely due to the lower earnings of its fund management and unit trust management segment which offset the higher earnings from stock broking and investment banking business.

RETURN STATS	
Price (23 Feb 16)	RM14.14
Target Price	RM16.10
Expected Share Price Return	+13.9%
Expected Dividend Yield	+2.2%
<b>Expected Total Return</b>	<b>+16.1%</b>

STOCK INFO	
KLCI	1,677.28
Bursa / Bloomberg	1082 / HLFG MK
Board / Sector	Main/ Finance
Syariah Compliant	Yes
Issued shares (mil)	1,147.5m
Par Value (RM)	1.00
Market cap (RM'm)	16,225.7
Price over NA	1.1x
52-wk price Range	RM12.28- RM17.08
Beta (against KLCI)	1.13
3-mth Avg Daily Vol	0.26m
3-mth Avg Daily Value	RM3.60m
Major Shareholders	
Hong Leong Co Malaysia	77.47%
Bank of Nova Scotia	2.37%
EPF	2.14%

By business segments of HLC, the investment banking and stock broking business recorded a rise in PBT by +5.1%yoy with higher contribution from its debt market division. Meanwhile, HLC's fund management and unit trust management business' PBT slipped -33.3%yoy to 0.2m, largely due to higher OPEX.

**HLA's premium growth continued to trend lower +5.0%yoy in line with the industry trend for life insurance.** Gross premium of HLA grew slower at 5.0%yoy in contrast to 5.8%yoy as at end of 1QFY16. Nevertheless, HLA's remained focus on building up its Investment Linked/Non-Participating policies which are more profitable. This has been seen by the improvement in its non-par/par product mix.

## FORECAST

We trim our net profit forecast for FY16/17 by -12.2%/-14.9% to RM1,563m and RM1,640m respectively as we input in higher credit charge-off assumptions and lower our estimate for the share of profit from HLB's affiliate, BOC, due to the challenging environment in China.

## VALUATION

Stock valuation remains undemanding at 1.0x to our FY16 BVPS forecast for FY16. We maintain our BUY recommendation with a revised TP of RM16.10 (previously RM16.90) based on SOP valuation after adjusting the valuation of the companies under the Group, trimming our net profit estimates with the lower contribution expected from its Commercial Banking division due to lower share of profits from BOC. Our BUY recommendation is based on: i) the stable asset quality of HLB, ii) well diversified earnings of the Group, and iii) attractive 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	21,581		64.4%	1.3	Base on forecast for FY16	18,068	15.7
HLC	654	30/6/15	81.3%	1.5		798	0.7
<b>Insurance companies under HLA Holdings</b>							
HLA	1,328	30/6/15	70.0%	3.0		2,789	2.4
MSIG	2,309	30/6/15	30.0%	2.0		1,385	1.2
HLMSIG Takaful	87	30/6/15	65.0%	1.0		56	0.05
<b>SOP Valuation</b>						23,096	20.1
Holding company discount				20.0%		(4,574)	(4.0)
SOP Valuation after holding company discount						18,522	
<b>No of shares (Mil)</b>						1,148	
<b>Target Price (TP)</b>						<b>16.10</b>	

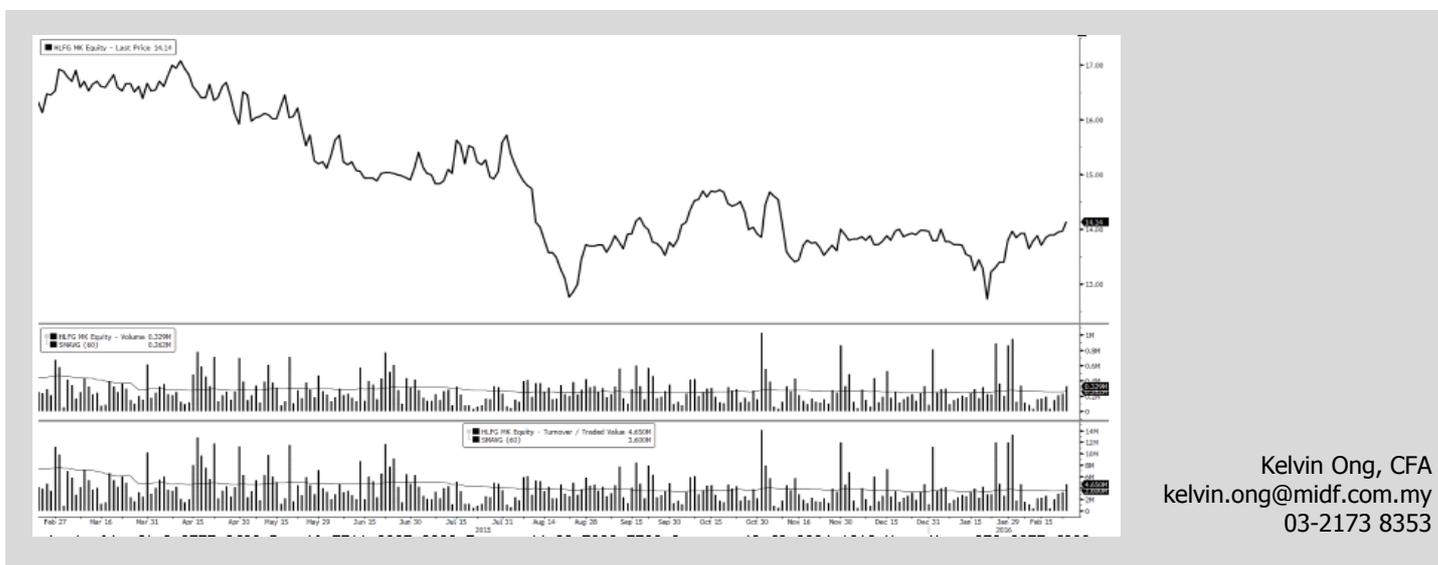
\*PB multiple of 3x applied is significantly lower than the PB ratio for its MSIG deal of 8.2x. Earlier, MSIG acquired 30% stake in HLA.

## 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	450	465
Non interest income	1,654	1,274	1,427	1,583
Net/total income	4,563	4,329	4,557	4,848
Pre-provisioning operating profit	2,583	2,381	2,552	2,715
Profit before tax	3,009	2,953	2,804	2,942
Profit after tax	1,707	1,647	1,563	1,640
EPS (sen)	162.9	154.3	136.5	143.2
EPS Growth (%)	+14.2	-5.2	-11.5	+4.9
PER (x)	8.7	9.2	10.4	9.9
Net Dividend (sen)	38.0	38.0	31.4	32.9
Dividend yield (%)	2.7	2.7	2.2	2.3
Book Value Per Share (sen)	10.95	12.48	13.61	16.18
PBV (x)	1.3	1.1	1.0	0.9
ROE (%)	15.8	13.2	10.9	9.6

Source: MIDFR, Company

## DAILY PRICE CHART



Source: Company, MIDFR

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**Table 1: Quarterly results**

Quarterly results						Comments
FYE June (RM m)	2Q16	1Q16	2Q15	Yoy (+/- %)	Qoq (+/- %)	
Net Interest Income	677.5	656.7	709.5	-4.5%	+3.2%	Higher qoq as interest income rose by +2.1%qoq while interest expense grew by +1.4%qoq
Islamic Banking Income	117.6	114.5	105.9	+11.0%	+2.7%	
Non interest Income	369.9	375.4	327.2	+13.1%	-1.5%	Lower qoq due to forex gains, lower net income from insurance business and, drop in brokerage and commission from stockbroking business which offset higher fee income as well as increase in investment and trading income
Net/Total income	1,165.0	1,146.6	1,142.6	+2.0%	+1.6%	
OPEX	(711.5)	(505.6)	(510.1)	+39.5%	+40.7%	OPEX higher due to one-off MSS expenses of HLB of RM172m
PPOP	453.6	641.0	632.5	-28.3%	-29.2%	
Write back/(Provision) for loan losses	(60.3)	(24.0)	53.8	-212.1%	+151.3%	
Share of results from associate	79.2	97.2	105.8	-25.1%	-18.5%	
Share of results from JV	5.3	5.0	2.3	+130.4%	+6.0%	
Pre-tax profit	487.4	697.0	796.1	-38.8%	-30.1%	
Taxation and zakat	(91.0)	(115.3)	(166.4)	-45.3%	-21.1%	
Net Profit	263.4	386.9	423.8	-37.8%	-31.9%	
EPS (sen)	24.5	36.9	40.5	-39.5%	-33.6%	

**Table 2: Comparison of segmental results (RM'Mil)**

Business segments	6M16	6M15	Change (%)	Comments
Commercial Banking	896.7	1,220.9	-26.6%	Higher OPEX due to one-time MSS cost of RM172m, higher allowance for loan impairment and lower share of profit from associate, BOC in China.
Investment Banking	34.3	34.3	-	Flattish earnings contribution from IB
Insurance	98.2	81.7	+20.2%	Lower actuarial reserve provisions from higher interest rates
Others	295.5	529.2	-44.2%	
Eliminations	(327.1)	(541.6)	-39.6%	
Consolidated	997.7	1,324.5	-24.7%	

Source: Company

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

Cumulative results & ratios				Comments
FYE June (RM m)	6M16	6M15	Yoy	
Net Interest Income	1,334.2	1,394.8	-4.3%	Contributed by expansion in loan book of +9.9%yoy while NIM contracted 10bp to 1.95% for 6MFY16 for HLB
Islamic Banking Income	232.2	215.9	+7.5%	Supported by gross financing growth of HLIB of +17.6%yoy.
Non Interest Income	745.3	615.4	+21.1%	Supported by higher forex gains of Commercial Banking division from revaluation gain from strengthening of USD and stronger FX client transactions
Net/Total Income	2,311.7	2,226.1	+3.8%	
OPEX	(1,217.1)	(976.8)	+24.6%	
PPOP	1,094.6	1,249.2	-12.4%	
Writeback/(Provision) for loan losses	(84.3)	68.7	-222.7%	A writeback in provision for loan impairment largely due to lower writeback in IA and lower recoveries of Commercial Banking division
Share of results from associate, BOC	176.4	213.2	-17.3%	
Share of results from JV	10.2	5.4	+88.9%	Represents share of results from Sichuan Jincheng consumer finance JV
Pre-tax profit	1,184.3	1,543.1	-23.3%	
Taxation and zakat	(206.3)	(321.6)	-35.9%	
Net Profit	650.3	816.0	-20.3%	
EPS (sen)	61.2	77.9	-21.4%	
			<b>(+/- ppts)</b>	
ROE (%)	9.3	13.8	-4.5	
CI ratio (%)	52.7	43.9	+8.8	

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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.