

Equity Beat

2QFY10 Results

Hong Leong Bank Bhd

Results within expectation

Upgrade to **NEUTRAL** (from SELL)

Increased Target Price (TP) to RM8.40 (from RM7.50)

- 2Q10 net profit of RM224.7m was lower by 4.1%qoq and by 12.7%yoy.
- 6M10 net profit of RM459m was lower by 8.1%yoy and accounted for 50% of our forecast and 49.7% of consensus estimates.
- 6M10 net profit came in within expectation. Net interest income and non interest income were lower by RM39.4m and RM58.1m respectively compared to 6M09. Additionally, allowance for loan losses was higher by RM29.1m.
- However, the decrease in the above was offset by higher profit contribution from its associate, Bank of Chengdu by 11.3m for 6M10 and a write back of impairment charge of RM33.2m.

STOCK INFO

Price (25 Feb 10)	RM8.37	KLCI	1270.78
Issued shares (mil)	1,580.10	Bursa / Bloomberg	5819 / HLBK MK
Par Value (RM)	1.00	Board / Sector	Main/ Finance
Market cap. (RM'm)	13,225.50	Syariah Compliant	No
Price over NA (x)	2.2		
52-wk price Range	RM5.10 - RM8.43	Major Shareholders	
Beta (against KLCI) (x)	0.72x	Hong Leong Financial Group	60.97%
3-mth Avg Daily Vol	0.77m	EPF	11.98%
3-mth Avg Daily Value	6.48m		

- We are revising our target price to RM8.40 (from RM7.50), pegged at 14x FY10 EPS and are upgrading our call on the stock to NEUTRAL (from SELL).

Gross loan growth moderate. Loan grew 0.7%qoq and by 2.3%yoy. Contributing to the loan growth was 5%yoy growth in credit cards to RM2.13b, 4%yoy growth in housing loan and 2.6%yoy increase working capital loan.

For 6M10, loan to individual rose by 3.2%yoy while loan to SMEs fell 6.9%yoy.

Loan grew 2.3%yoy while deposit from customer grew higher at 6.2%yoy. This resulted in a further lowering of loan to deposit (LD) ratio to 53.5% in 2Q10 vs. 55.1% in 1Q10.

We believe that in the absence of any merger, acquisition or takeover exercise, the group's loan growth would be still be marginal compared to peers as seen from the past quarters.

Without a stronger expansion of loan base (increase in risk weighted assets), growth in net interest income will be limited and we believe that this would affect its earnings acceleration.

Net interest margin (NIM) improved for 6M10. NIM was higher in 6M10 of 2.37% vs. 2.25% for FY09.

Deposit cost (i.e. deposits from customers and deposit from banks and FIs) has been on a declining trend since 4Q09. We believe that this is due to repricing of the group's deposits. With 76% of loan comprised of floating rate loan, we believe that the group will stand to be one of the key benefactor of local banks for a potential interest rate rise

FYE 30 June	FY08	FY09	FY10F	FY11F
Net Interest Income (RM'm)	1,379.2	1,353.1	1,439.2	1,530.9
Islamic Banking Income (RM'm)	160.0	176.3	208.9	221.5
Other Operating Income (RM'm)	479.1	569.5	615.3	654.9
Pretax Profit (RM'm)	1,010.0	1,132.2	1,254.7	1,326.2
Net Profit (RM'm)	741.8	905.3	941.0	994.6
EPS (sen)	51.2	62.5	60.0	63.0
PER(x)	16.3	13.4	14.0	13.3
DPS (sen)	24.0	24.0	24.0	24.0
Dividend Yield (%)	2.9	2.9	2.9	2.9

Source: Company, Forecasts by MIDFR

following Bank Negara's indication of a normalisation of interest rates after a stronger economic growth.

Lower NPLs continue. Asset quality of the group remains strong, standing at 2nd lowest Net NPL ratio among local banks after Public Bank. The group has been conservative with its LD ratio of 53.5% which is below the banking industry's 78.4%.

Gross NPL fell to 2.0% in 2Q10 (vs. 2.15% in 1Q10) while net NPL drop to 1.0% (vs. 1.15% in 1Q10) edging closer to Public Bank's net NPL ratio of 0.8%. With exception for NPL for lending for personal use, NPL for other key lending segments improved (HL: -10.4%yoy to RM210.5m, credit cards: -13.2%yoy to RM30.6m and working capital loan: -16.9%yoy to RM282.3m).

With specific provisioning (SP) undertaken, the group's loan loss coverage rose to 123.5 times in 2Q10 (vs. 109's 115%).

Profit contribution of Bank of Chengdu's to PBT was 10% for 6M10. Share of contribution of profits from its associate, Bank of Chengdu to PBT in 2Q10 was 9.3% (vs.10.5% in 1Q10 and 13.9% in 4Q09).

Additional earnings boost from its commercial banking subsidiary in Ho Chi Minh, Vietnam, which was secured a license for operation and also the JV between the bank and Bank of Chengdu to operate a licensed consumer finance company in China on a 49 : 51 equity stake (Hong Leong Bank : Bank of Chengdu) to the group's PBT have yet to be seen.

We believe that with the offer to buy Eon Cap shares rejected, there would be no strong boost to the group's earnings at this juncture.

Interim dividend of 9 sen declared. A dividend payment of 9 sen per share (less 25% taxation) will be paid out to shareholders on 30 Mar 10.

Change in forecast. We raised our EPS forecast for FY10 from 58 sen to 60 sen by revising the forecast for net interest income higher by 3% in anticipation of higher margin from the potential rise in interest rate as aforementioned as well as raised the forecast for Islamic Banking income by 5% for FY10.

Valuation. With the revision in EPS higher for FY10 to 60 sen and the increase of target forward PE to 14x (from 13x previously), we increase to TP for the stock to RM8.40 (from RM7.50) and upgrade our call on the stock from SELL to NEUTRAL.

MIDF EQUITY BEAT

Thursday, 25 February 2010

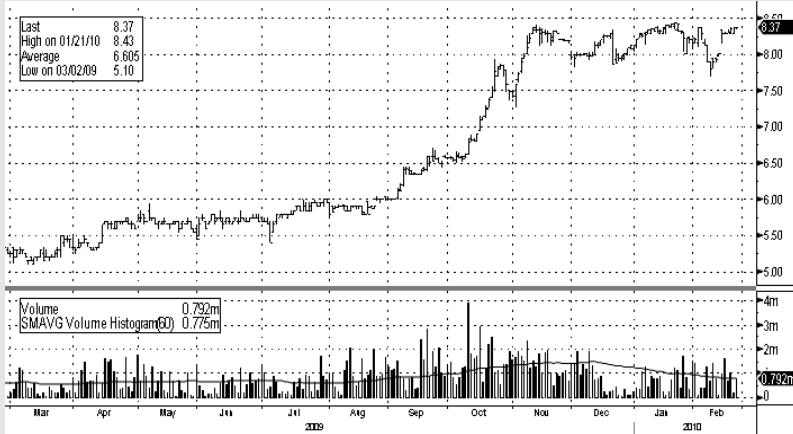
Quarterly Results						Cumulative		Comments
FY 30 June (RM'Mil)	2Q10	1Q10	2Q09	%Qoq	%Yoy	6M10	%Yoy	
Net Interest Income	346.1	334.8	363.2	+3.4	-4.7	680.9	-5.5	Higher qoq due to: Stronger interest income from the following: i. Money at call and deposits placed with other FIs of RM79.4m vs. RM72.1m and ii. Held to maturity securities of RM61.6m vs. RM48.8m Interest income from loan was lower at RM377.9m vs. RM386.8m. Also due lower interest expenses from the following: i. Deposit and placement of banks and FIs of RM5.5m vs. RM7.8m and ii. Deposit from customers of RM216.8m vs. RM227.7m
Islamic Banking Income	47.9	48.1	38.3	-0.4	+25.1	96.0	17.4	Gross Islamic Banking loan grew by 2.2% while net loan grew 2.3% comparing 2Q10 with 4Q09.
Other Operating Income	125.5	128.8	162.6	-2.6	-22.8	254.2	-18.6	Lower qoq due to: Unrealized loss from revaluation of held for trading (HFT) securities and derivatives of RM32.6m vs. unrealized gain of RM1.8m in 1Q10. The above offset the following: i. Higher gain from sale of HFT securities of RM31.2m vs. RM12.9m; ii. Higher forex gain of RM30.4m vs. RM27.1m and iii. Higher net unrealized gain on fair value hedges of RM16.8m vs. RM0.1m .
Total income	519.4	511.7	564.2	+1.5	-7.9	1,031.1	-7.5	
Pre-tax profit	291.3	288.8	340.1	+0.9	-14.3	580.1	-11.6	Profit contribution from associate company, Bank of Chengdu lower at RM27.1m in 2Q10 vs. RM30.5m in 1Q10. Also contributed to higher per-tax profit was an impairment write back of RM6.1m in 2Q10. Allowance for loan losses was lower by RM20.5m in 2Q10 compared to 1Q10.
Tax	(66.5)	(54.7)	(82.9)	21.6	-19.8	(121.2)	-22.7	
Net Profit	224.7	234.2	257.4	-4.1	-12.7	459.0	-8.1	
EPS (sen)	15.5	16.2	17.8	-4.3	-12.9	31.7	-8.1	

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Financial Ratios (%)	2Q10	1Q10	2Q09	%Qoq	%Yoy			
CCR	15.6	14.9	13.7	+0.7	+1.9			Higher than banking industry CCR: 13.3% as at Jan 10. Highest Tier 1 Capital among local banks. Composition of equity to total Tier 1 Capital comprised of almost 100% equity.
RWCR	15.9	15.3	14.1	+0.6	+1.8			Higher than banking industry RWCR of 14.8% as at Jan 10.
Net NPL	1.0	1.2	1.3	-0.1	-0.2			Banking industry net NPL: 1.7%. 2 nd lowest in NPL ratio among local banks after Public Bank.
Gross NPL	2.0	2.2	2.4	-0.2	-0.4			Lower than banking industry's ratio of 3.7%.
Cost to income	45.9	41.1	38.5	+4.8	+7.4			Higher qoq due to: <ul style="list-style-type: none"> i. Higher personnel cost (salary, allowances & bonuses) of RM116.2m vs. RM109.6m; ii. Higher marketing expenses (advertising, handling fee) of RM28.9m vs. RM26.2m and iii. Higher general and admin expenses of RM45.7m vs. RM28.2m.
Loan Loss Coverage	123.5	115.0	106.7	+8.5	+16.8			Higher than banking industry's 96.9% as at Jan 10.
Loan to Deposit	53.5	55.1	52.6	-1.6	+0.9			Net loan grew 1%qoq while deposit from customer grew higher at 3.8%qoq.
ROAE	14.9	15.9	21.3	-1	-6.4			
ROAA	1.1	1.2	1.3	-0.1	-0.2			

DAILY PRICE CHART



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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

OVERWEIGHT	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.