Hong Leong Bank Berhad

(5819 | HLBK MK) Financial Services | Finance

Maintain BUY

Bank of Chengdu is a Tier 1 contributor

***Revised* Target Price: RM23.96**

(Previously RM23.55)

KEY INVESTMENT HIGHLIGHTS

- **Earnings were within our expectations**
- **Raising our FY23 and FY24 forecast**
- **Core drivers: (1) BOCD's contributions are excellent, (2) Defensive play, (3) HLB's international loans are experiencing double-digit loan growth on a sequential year basis**
- **Key risks: (1) BOCD operational ability compromised, (2) Volatile NOII income, (3) HLB unable to maintain prudent OPEX**
- **Maintain BUY call with upgraded TP of RM23.96**

Highlights from Hong Leong Bank's 2QFY22 quarterly results:

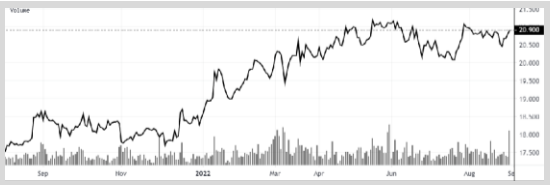
1. HLB's FY22 core net profit rose by +15%yoy due to higher NII and associate contributions.
2. RA loans as of Jul-22 down to RM3.4b (2.6% of gross portfolio).
3. GIL rose to 0.49%, spurred by RA loan graduation.
4. NCC averaged 10bps in FY22, allocating a 10-15bps target in FY23.
5. HLB's NIM contracted within the quarter by -5bps qoq to 2.10%
6. FY22's NOII fell by -15%yoy due to weaker trading and investment income.
7. Fast pace of loan growth: gross loans grew by 8.0%yoy, driven by international loans.
8. Deposit growth rapid, growth of +7.6%yoy.
9. FY22's OPEX +1.0%yoy as result of higher establishment, marketing and admin costs.
10. BOCD remains in the growth phase, boasting loan growth well in the ~30% range.
11. Dividend announced: Gross DPS of 55.0sen, payout of 35%

FINANCIAL SUMMARY

FYE Jun	FY20	FY21	FY22	FY23	FY24F
NII (RM m)	3,406	4,310	4,618	5,041	5,417
NOII (RM m)	1,373	1,157	979	1,060	1,196
Total income (RM m)	4,778	5,467	5,597	6,102	6,613
PPOP (RM m)	2,675	3,389	3,499	3,783	4,100
Core net profit (RM m)	2,603	2,861	3,289	3,866	4,193
Core EPS (sen)	120.1	132.0	151.7	178.3	193.4
Core P/E (x)	17.4	15.8	13.8	11.7	10.8
Gross DPS (sen)	36.0	50.0	55.0	62.4	67.7
Dividend yield (%)	1.7	2.4	2.6	3.0	3.2
BVPS (RM)	12.6	13.6	14.3	16.0	16.8
P/BV (x)	1.7	1.5	1.5	1.3	1.2
ROE (%)	9.9	10.1	10.9	11.8	11.8

RETURN STATISTICS	
Price @ 30 August 2022 (RM)	20.90
Expected share price return (%)	+14.6
Expected dividend yield (%)	+3.0
Expected total return (%)	**+17.6**

SHARE PRICE CHART



Share price performance (%)	Absolute	Relative
1 month	-1.0	-1.4
3 months	1.6	1.2
12 months	8.3	15.7

KEY STATISTICS	
FBM KLCI	1,512.05
Syariah compliant	No
F4GBM Index	Yes
ESG Grading Band (Star rating)	☆☆☆☆
Issue shares (m)	2047.63
Estimated free float (%)	23.47
Market Capitalisation (RM m)	45,045.18
52-wk price range	RM17.8 - RM21.8
Beta vs FBM KLCI (x)	0.86
Monthly velocity (%)	
Monthly volatility (%)	8.30
3-mth average daily volume (m)	1.24
3-mth average daily value (RM m)	25.67
Top Shareholders (%)	0
Amanah Saham Nasional	61.96
Employees Provident Fund Board	10.03
Yayasan Pelaburan Bumiputera	1.85

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Within our and consensus expectations. HLB's FY22 core net profit of RM3.29b made up 102% and 103% of full-year forecasts respectively. FY22 earnings rose by +15%yoy due to higher NII and associate contributions, despite lower NOII and higher tax income. Meanwhile, quarterly earnings of RM908m rose by +16%qoq as result of higher NOII and associate contributions, as well as lower loan provisions.

Repayment assistance (RA) loans. As of Jul-22, HLB has RM4.3b worth of RA loans, which translates to 2.6% of its gross loan portfolio. Previously, in of Jun-22, this figure was RM5.4b, translating to 3.2% of its previous gross loans. The most notable runoffs occurred in the mortgage, corporate and SME segments. So far RM3.5b worth of retail loans have incurred subsequent reapplications, while RM0.5b of SME & corporate loans have done so.

Asset quality. The Group's GIL ratio rose to 0.49% [FY21: 0.46%], which was well within the pre-pandemic range. Notably, GIL for transport vehicle loans went down significantly to 0.20% in FY22 [FY21:0.43%]. The Group's LLC currently stood at a high 282%.

Provisioning. The Group's 4QFY22 NCC was at 7bps, averaging 10bps in FY22 (which was within management guidance). Management has allocated a 10-15bps target in FY23, assuming a GIL ratio of <0.75%. The Group has reduced its cumulative overlays to RM629m from RM873m. The variance was allocated to both RA loans on retail and corporate side – thus the reduction was due to conversion from more general overlays to company specific ones. Note that HLB's NCC guidance for FY23 assumes no release on provisions.

NIM and NII. In contrast to its peers, HLB reported a NIM contraction within the quarter, falling by -5bps qoq and -10bps yoy to 2.10%. Management attributes NIM falling to several reasons: (1) higher FD costs and foreign currency fixed deposits (FCFD) due to the depreciation of ringgit, (2) The Group has building up longer term FDs since the start of the year, in anticipation of multiple OPR hikes within the year, (3) The maturity of several high yield securities. Management is waiting for further interest rate hikes before replenishing their securities. As a result, NII fell by -0.3% for the quarter, but rose +1.7%yoy. On the other hand, FY22's NIM remained flattish at 2.14%. Its NII rose +7.1%yoy.

HLB's FY23 guidance of NIM of >2.10% is extremely conservative. Management attributes this to: (1) Only factoring in 1 OPR hike in FY23, (2) The assumption SRR requirements are likely re-implemented in 2023 – HLB has replaced the cash normally held in the central bank with government bonds. The SRR reimplantation is expected to push NIM down by -2bps.

NOII. 4QFY22's NOII rose by +82%qoq and 76%yoy, on the back of stronger fee income and unrealised gains. FY22's NOII fell by -15%yoy on the back of weaker trading and investment income.

Loan growth. Gross loans expanded at a solid pace of +8%yoy. Performance was impressive throughout the board: while various retail segments posted mid-single digit growth, business & corporate loans rose by +11%yoy. Loans from international operations took this further, posting +27%yoy growth.

Deposit growth. Group deposit growth expanded at a rate of +7.6%yoy. CASA growth picked up pace to of +11%yoy, with HLB currently standing on a CASA ratio of 33.5%. Loan/Deposit ratio currently stands at 85.0%.

Cost efficiency. 4QFY22's OPEX showed a noteworthy +8.1%qoq increase. FY22's OPEX rose by +1.0%yoy as result of higher establishment, marketing, and admin costs, despite a decrease in personnel cost. This translates to a CIR ratio of 37.5% (an improvement from FY21's 38.0%). CIR is expected to remain within the 30-40% range in FY22.

Capital ratios. The Group's CET-1 ratio rests at a comfortable 13.4%. While the upcoming BOCD bond conversion is expected to impact the Group's capital ratios negatively by 60bps, management believes the recently issued green capital securities worth RM900m should cancel out its effect.

BOCD. Bank of Chengdu continues to maintain sequential year loan growth well in the ~30% range, while maintaining a low Gil ratio of 0.83%. Management is still very optimistic on BOCD's prospects, given that Chengdu's sizeable population growth and heavy infrastructure financing. BOCD does not have any major exposure to housing loans.

Dividend announced. HLB announced a dividend of 55.0 sen, which translates to a dividend payout of 35%. This came slightly below our expectations of a 40% payout.

Earnings revised. We increase FY23/FY24 earnings forecasts by +6%/+8% to factor higher associate contributions as well as reduced CIR.

Key risks. Key risks to earnings include (1) BOCD growth or ability to function is compromised, (2) Volatile NOII income, (3) HLB is unable to maintain a prudent OPEX.

Valuation and recommendation. We are optimistic on ABMB's long-term prospects for several reasons: (1) BOCD's contribution seems to be ramping up, to HLB's benefit, (2) As a defensive play, HLB has less downside risk for asset deterioration or NCC, (3) HLB's international loans are ramping up at an incredible rate. Thus, we maintain our **BUY** call with a higher TP of **RM23.96**, as we peg its FY23 BVPS to a unchanged P/BV of 1.50x based on its FY23 ROE (GGM assumptions: FY23 ROE of 11.8%, LTG of 3.5% and COE of 9.0%.)

EXHIBIT 1: QUARTERLY RESULTS

FYE June (RM m)	4QFY22	3QFY22	4QFY21	Yoy (%)	Qoq (%)	FY22	FY21	Yoy (%)
Net interest income	929	948	918	1.2%	-2.0%	3,755	3,458	8.6%
Islamic banking income	239	224	232	3.2%	6.7%	905	919	-1.6%
Non-interest income	331	176	182	81.2%	87.9%	937	1,090	-14.0%
Net income	**1,498**	**1,348**	**1,332**	**12.5%**	**11.2%**	**5,597**	**5,467**	**2.4%**
OPEX	(560)	(518)	(532)	5.2%	8.1%	(2,098)	(2,078)	1.0%
PPOP	**938**	**830**	**800**	**17.3%**	**13.1%**	**3,499**	**3,389**	**3.2%**
Loan provisions	(30)	(51)	(194)	-84.5%	-41.1%	(164)	(654)	-75.0%
Other provisions	0	(0)	(0)	n.m.	n.m.	1	(0)	n.m.
JV & Associates	309	253	219	n.m.	n.m.	1,030	736	n.m.
Profit before tax	**1,217**	**1,031**	**825**	**47.6%**	**18.1%**	**4,367**	**3,471**	**25.8%**
Tax	(310)	(246)	(135)	129.2%	25.9%	(1,078)	(610)	76.6%
NCI	-	-	-	n.m.	n.m.	-	-	n.m.
Reported net profit	908	785	689	31.6%	15.7%	3,289	2,861	15.0%
Core net profit	**908**	**785**	**689**	**31.6%**	**15.7%**	**3,289**	**2,861**	**15.0%**
Total NII	**1,159**	**1,162**	**1,140**	**1.7%**	**-0.3%**	**4,618**	**4,311**	**7.1%**
Total NOII	**339**	**186**	**193**	**75.6%**	**82.3%**	**979**	**1,157**	**-15.4%**
Gross DPS (sen)	37.0	-	35.2	n.m.	n.m.	55.0	50.0	n.m.
Core EPS (sen)	44.3	38.3	33.7	31.6%	15.7%	160.5	139.7	14.9%
Gross loans	168,234	162,494	155,822	8.0%	3.5%			
Gross impaired loans	820	779	717	14.3%	5.2%			
Customer deposits	195,227	188,605	181,931	7.3%	3.5%			
CASA	66,051	62,987	59,232	11.5%	4.9%			

Source: Hong Leong Bank, MIDFR

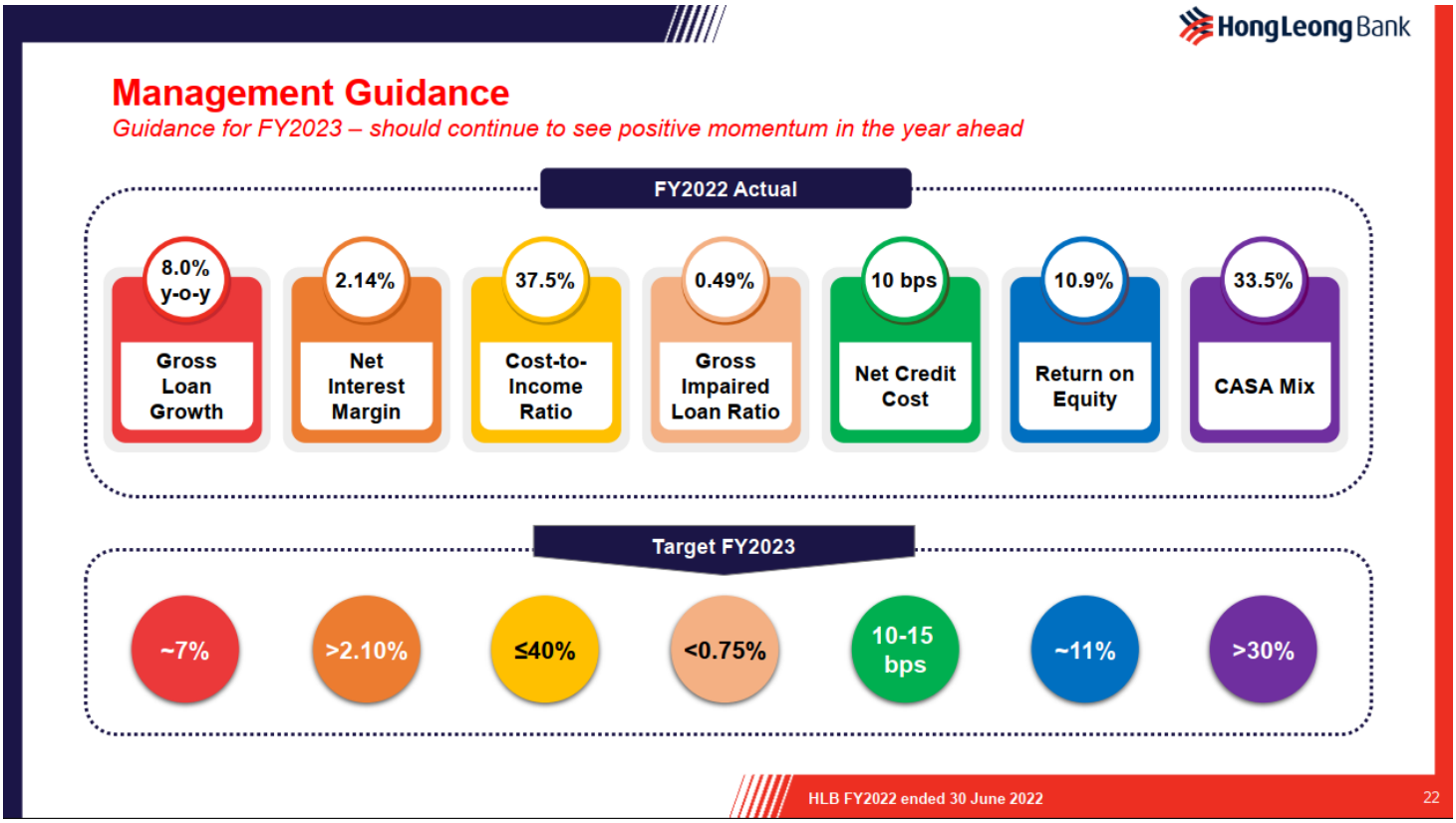
EXHIBIT 2: QUARTERLY FINANCIAL RATIOS

Financial Ratios (%)	4QFY22	3QFY22	4QFY21	Yoy (+/- ppts)	QoQ (+/- ppts)	FY22	FY21	Yoy (+/- ppts)
NIM (Reported)	**2.10**	**2.15**	**2.20**	**-0.10**	**-0.05**	**2.14**	**2.14**	**0.00**
NOII/Total income	22.6	13.8	14.5	8.1	8.8	17.5	21.2	-3.7
ROE (Ann.)	**11.7**	**10.3**	**9.4**	**2.4**	**1.4**	**10.6**	**9.7**	**0.9**
Cost-to-income ratio	37.4	38.4	40.0	-2.6	-1.1	37.5	38.0	-0.5
Net credit costs (Ann.) (bps)	7	13	52	-44	-6	10	43	-33
GIL ratio	0.49	0.48	0.46	0.03	0.01			
Loan loss coverage	211.8	217.8	246.6	-34.8	-6.0			

L/D ratio	85.3	81.7	84.7	0.6	3.6			
CET1	13.4	12.7	13.6	-0.1	0.7			
Tier-1	14.5	13.3	14.1	0.5	1.2			
Total Capital	16.7	15.4	16.2	0.4	1.3			

Source: Hong Leong Bank, MIDFR

EXHIBIT 3: FY23 MANAGEMENT GUIDANCE



Source: Hong Leong Bank, MIDFR

INVESTMENT STATISTICS

INCOME STATEMENT

FYE Jun (RM m)	FY20	FY21	FY22	FY23F	FY24F
Interest income	6,181	5,557	5,723	7,524	8,572
Interest expense	(3,416)	(2,099)	(1,968)	(3,338)	(4,035)
Net interest income	**2,764**	**3,458**	**3,755**	**4,186**	**4,536**
Islamic banking income	847	919	905	950	979
Other operating income	1,167	1,090	937	965	1,098
Total income	**4,778**	**5,467**	**5,597**	**6,102**	**6,613**
OPEX	(2,104)	(2,078)	(2,098)	(2,319)	(2,513)
PPOP	**2,675**	**3,389**	**3,499**	**3,783**	**4,100**
Loan allowances	(328)	(654)	(164)	(174)	(186)
Other allowances	0	(0)	1	(0)	(0)
JV & Associates	642	736	1,030	1,135	1,230
Pretax profit	**2,989**	**3,471**	**4,367**	**4,744**	**5,144**
Taxation and zakat	(495)	(610)	(1,078)	(878)	(952)
NCI	-	-	-	-	-
Reported net profit	**2,495**	**2,861**	**3,289**	**3,866**	**4,193**
Core net profit	**2,603**	**2,861**	**3,289**	**3,866**	**4,193**
Total NII	3,406	4,310	4,618	5,041	5,417
Total NOII	1,373	1,157	979	1,060	1,196

BALANCE SHEET

FYE Jun (RM m)	FY20	FY21	FY22	FY23	FY24F
Cash and ST funds	9,615	3,953	6,937	7,179	7,417
Investment securities	55,453	66,332	65,799	72,017	78,838
Net loans	144,695	154,071	166,488	178,254	189,998
Other IEAs	-	-	-	-	-
Non-IEAs	11,515	12,774	15,107	19,375	20,903
Total assets	**221,278**	**237,129**	**254,331**	**276,825**	**297,156**
Customer & bank deposits	180,350	196,565	206,283	217,532	231,119
Other IBLs	5,567	3,241	7,431	7,738	9,313
Non-IBLs	8,127	7,864	9,629	16,935	20,285
Total liabilities	**194,044**	**207,670**	**223,342**	**242,204**	**260,717**
Share capital	7,739	7,739	7,739	7,739	7,739
Reserves & retained profit	19,495	21,720	23,250	26,882	28,700
Shareholders' funds	**27,234**	**29,459**	**30,989**	**34,621**	**36,439**
NCI	-	-	-	-	-
Total equity	**27,234**	**29,459**	**30,989**	**34,621**	**36,439**
Total liabilities & equity	**221,278**	**237,129**	**254,331**	**276,825**	**297,156**
Total IEAs	209,763	224,355	239,224	257,450	276,253
Total IBLs	185,917	199,806	213,714	225,269	240,432
Gross loans	145,932	155,822	168,234	180,010	191,711
CASA	48,358	59,232	66,051	68,528	70,631

FINANCIAL RATIOS

FYE Jun (RM m)	FY20	FY21	FY22	FY23F	FY24F
Interest (%)					
NIM	1.69	1.99	1.99	2.03	2.03
Return on IEAs	3.06	2.56	2.47	3.03	3.21
Cost of funds	1.89	1.09	0.95	1.52	1.73
Net interest spread	1.17	1.47	1.52	1.51	1.48
Profitability (%)					
ROE	9.9	10.1	10.9	11.8	11.8
ROA	1.2	1.2	1.3	1.4	1.4
NOII/Total income	28.7	21.2	17.5	17.4	18.1
Effective tax rate	16.6	17.6	24.7	18.5	18.5
Liquidity & Efficiency (%)					
Cost-to-income ratio	44.0	38.0	37.5	38.0	38.0
Loan/Deposit ratio	83.4	84.1	84.4	85.7	86.1
CASA ratio	27.9	32.3	33.9	33.0	32.0
Asset Quality (%)					
GIL ratio	0.61	0.46	0.49	0.55	0.54
NIL ratio	0.43	0.31	0.29	0.34	0.29
LLC ratio	141.5	246.6	211.8	176.2	164.1
LLC (incl. reserves)	236.9	305.7	291.7	235.2	221.6
Gross credit cost (bps)	35	55	24	22	22
Net credit cost (bps)	23	43	10	10	10
% Floating rate loans	82.9	82.6	76.5	83.0	83.0
% Domestic loans	94.7	94.1	87.1	94.1	94.1
Capital (%)					
CET 1	13.9	14.0	14.0	14.3	14.3
Tier 1 capital	14.5	14.6	14.6	14.8	14.8
Total capital	16.7	16.7	16.7	17.0	17.0
Growth (%)					
Total NII	0.4	26.5	7.1	9.2	7.5
Total NOII	2.9	(15.7)	(15.4)	8.3	12.8
Core net profit	(2.3)	9.9	15.0	17.5	8.4
Gross loans	6.1	6.8	8.0	7.0	6.5
Customer deposits	6.4	5.6	6.2	6.8	6.2
CASA	15.9	22.5	11.5	3.8	3.1
Valuation metrics					
Core EPS (sen)	120.1	132.0	151.7	178.3	193.4
Gross DPS (sen)	36.0	50.0	55.0	62.4	67.7
Div payout ratio (%)	28.3	35.8	34.2	35.0	35.0
BVPS (RM)	12.6	13.6	14.3	16.0	16.8
Core P/E (x)	17.4	15.8	13.8	11.7	10.8
Dividend yield (%)	1.7	2.4	2.6	3.0	3.2
P/BV (x)	1.7	1.5	1.5	1.3	1.2

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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 *rise* 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	Total return is expected to be <-10% over the next 12 months.
TRADING SELL	Stock price is expected to *fall* 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.
ESG RECOMMENDATIONS* - source Bursa Malaysia and FTSE Russell	
☆☆☆☆	Top 25% by ESG Ratings amongst PLCs in FBM EMAS that have been assessed by FTSE Russell
☆☆☆	Top 26-50% by ESG Ratings amongst PLCs in FBM EMAS that have been assessed by FTSE Russell
☆☆	Top 51%- 75% by ESG Ratings amongst PLCs in FBM EMAS that have been assessed by FTSE Russell
☆	Bottom 25% by ESG Ratings amongst PLCs in FBM EMAS that have been assessed by FTSE Russell

* ESG Ratings of PLCs in FBM EMAS that have been assessed by FTSE Russell in accordance with FTSE Russell ESG Ratings Methodology