Hong Leong Bank Berhad

(5819 | HLBK MK) Financial Services | Finance

Maintain BUY

Keeping its OPEX under control

***Revised* Target Price: RM24.88**

(Previously RM23.96)

KEY INVESTMENT HIGHLIGHTS

- **Earnings were within our expectations**
- **Maintaining our earnings forecast for now**
- **Core drivers: Strong foreign loan growth, BOCD contribution slated for further growth, Defensive play**
- **Key risks: BOCD growth is affected by protests, Volatile NOII income, OPEX unable to be controlled**
- **Maintain BUY call with upgraded TP of RM24.88 as we rollover our valuation to FY24**

Highlights from HLB's 1QFY23 quarterly results:

1. HLB's quarterly earnings rose by +8%qoq due to lower tax offsetting weaker BOCD contributions.
2. RA loans to shrink significantly. 0.6% of gross loans in Dec-22.
3. GIL flattish at 0.49% - areas of worry include overseas and local tourism sector portfolios.
4. NCC of 9bps in the quarter. Slight uptick from last quarter's 7bps.
5. 1QFY23's NIM rose by +8bps qoq to 2.18%.
6. 1QFY23's NOII down by -21%qoq due to poorer non-fee income.
7. Solid pace of loan growth: gross loans grew by +9%yoy, driven by foreign segments, SME and transport vehicle loans.
8. Deposit growth at a strong +8%yoy. CASA at 32.3%.
9. 1QFY23's OPEX was down -7%qoq. CIR at a laudable 36.0%.
10. BOCD contributions fell -14%qoq, likely due to lockdowns in Chengdu. BOCD expected to continue PAT growth at ~30%yoy in the year.

FINANCIAL SUMMARY

FYE Jun	FY21	FY22	FY23F	FY24F	FY25F
NII (RM m)	4,310	4,618	5,016	5,360	5,702
NOII (RM m)	1,157	979	1,026	1,188	1,475
Total income (RM m)	5,467	5,597	6,043	6,548	7,176
PPOP (RM m)	3,389	3,499	3,746	4,060	4,449
Core net profit (RM m)	2,861	3,289	3,865	4,191	4,564
Core EPS (sen)	139.6	160.5	188.6	204.5	222.7
Core P/E (x)	15.0	13.0	11.1	10.2	9.4
Gross DPS (sen)	50.0	55.0	66.0	71.6	78.0
Dividend yield (%)	2.4	2.6	3.2	3.4	3.7
BVPS (RM)	14.4	15.1	15.6	16.9	18.6
P/BV (x)	1.5	1.4	1.3	1.2	1.1
ROE (%)	10.1	10.9	12.3	12.6	12.5

RETURN STATISTICS	
Price @ 29 November 2022 (RM)	20.88
Expected share price return (%)	+17.2
Expected dividend yield (%)	+3.4
Expected total return (%)	**+20.6**

SHARE PRICE CHART



Share price performance (%)	Absolute	Relative
1 month	-1.4	-4.0
3 months	1.7	1.1
12 months	14.5	16.5

KEY STATISTICS	
FBM KLCI	1,476.96
Syariah compliant	No
F4GBM Index	Yes
ESG Grading Band (Star rating)	☆☆☆☆
Issue shares (m)	2048.35
Estimated free float (%)	33.45
Market Capitalisation (RM m)	45,175.24
52-wk price range	RM17.8 - RM21.8
Beta vs FBM KLCI (x)	0.76
3-mth average daily volume (m)	1.51
3-mth average daily value (RM m)	31.37
Top Shareholders (%)	
Employees Provident Fund Board	61.82
OSK Holdings Bhd	9.42
Amanah Saham Nasional Bhd	2.96

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Within our and consensus expectations. HLB's 1QFY23 core net profit of RM981m made up 25% and 26% of full-year forecasts respectively.

Quarterly earnings rose by +14%yoy due to as result of higher NII, NOII and Associate contributions offsetting higher OPEX and tax expenses. It rose by +8%qoq, though this was primarily due to lower tax charges – otherwise its BOCD contribution was weaker.

Note that management has revised several of its FY23 target positively. This was expected, given that these initial targets were far too conservative in our opinion.

Repayment assistance (RA) loans. As of Oct-22, HLB has RM2.4b worth of RA loans, which translates to 1.4% of its gross loan portfolio. By Jan-23, this figure will be further reduced to RM1.0b, translating to 0.6% of its current gross loans. 100% of RA loans are currently retail loans whereby SME loans have since graduated to BAU loans. All have resumed repayments.

Asset quality. The Group's GIL ratio was flattish at 0.49%. Observe notable deteriorations in overseas categories, primarily from Cambodia. Management worries less about asset quality in Cambodia, more so of potential COF and liquidity issues. Management notes pockets of stress in local SMEs (pertaining to tourism sectors).

The Group's LLC also remains flattish at 282%.

Provisioning. NCC of 9bps in the quarter, still below management's FY23 guidance of 10bps. (Last quarter: 7bps.) Writebacks unlikely anytime soon.

NIM and NII. NIM expanded by +8bps qoq to 2.18% in 1QFY23. Similarly, NII rose by +6%qoq and was up +10%yoy.

NOII. 1QFY23 NOII fell by -21% qoq due to poorer non-fee income. Fee income remained stable.

Loan growth. Gross loans expanded at a steady pace of +9%yoy. Foreign segments reported exceptional double-digit growth, while SME and transport vehicles also recorded >10%yoy growth.

Deposit growth. Group deposit growth expanded +8%yoy, with business enterprises reporting +8%yoy growth. CASA ratio currently stands at 32.3%.

> **Outlook.** Liquidity wise, management expects some tightness in market in Dec-22, before the option to use MGS and MGII to meet SRR compliance ends in Dec-22. Upon ending, competition should subside slightly.

Cost efficiency. OPEX fell by -7%qoq in 1QFY23. Due to higher income, the Group has reduced its quarterly CIR to a laudable 36.0%.

Capital ratios. The Group's CET-1 ratio has fallen to 12.9%, which is still well in the comfortable range.

BOCD contributions. Associate contributions have fallen by -14%qoq (likely due to recent lockdowns in Chengdu) but increased +22%yoy. BOCD reported +32%yoy growth in its 9MFY22 earnings – the growth figure is expected to persist.

Earnings maintained. We make no changes to our earnings forecast.

Key risks. Key risks to earnings include (1) BOCD growth or ability to function is compromised, (2) Volatile NOII income, (3) Inability to control OPEX.

Valuation and recommendation. We are optimistic on HLB's long-term prospects for several reasons: (1) Strong growth in international loans, (2) Defensive play, given its stellar asset quality, (3) BOCD contribution continues to deliver. Thus, we maintain our **BUY** with a higher **TP of RM24.88**, as we peg its FY24 BVPS (rolled on from FY23 BVPS) to a decreased P/BV of 1.45x (formerly 1.50x), as we feel that that this figure is more in line with its 5-year mean. (GGM assumptions: FY24 ROE of 12.6%, LTG of 3.5% and COE of 9.8%.)

EXHIBIT 1: QUARTERLY RESULTS

FYE Jun (RM m)	1QFY23	4QFY22	1QFY22	Yoy (%)	Qoq (%)	3MFY23	3MFY22	Yoy (%)
Net interest income	990	929	919	8%	7%	990	919	8%
Islamic banking income	252	239	208	21%	5%	252	208	21%
Non-interest income	259	331	253	2%	-22%	259	253	2%
Net income	**1,500**	**1,498**	**1,380**	**9%**	**0%**	**1,500**	**1,380**	**9%**
OPEX	(541)	(560)	(507)	7%	-3%	(541)	(507)	7%
PPOP	**959**	**938**	**873**	**10%**	**2%**	**959**	**873**	**10%**
Loan provisions	(38)	(30)	(49)	-23%	24%	(38)	(49)	-23%
Other provisions	0	0	0	n.m.	n.m.	0	0	n.m.
JV & Associates	265	309	218	22%	-14%	265	218	22%
Profit before tax	**1,187**	**1,217**	**1,042**	**14%**	**-2%**	**1,187**	**1,042**	**14%**
Tax	(206)	(310)	(184)	12%	-34%	(206)	(184)	12%
NCI	-	-	-	n.m.	n.m.	-	-	n.m.
Reported net profit	981	908	858	14%	8%	981	858	14%
Core net profit	**981**	**908**	**858**	**14%**	**8%**	**981**	**858**	**14%**
Total NII	**1,232**	**1,159**	**1,121**	**10%**	**6%**	**1,232**	**1,121**	**10%**
Total NOII	**268**	**339**	**259**	**3%**	**-21%**	**268**	**259**	**3%**
Gross DPS (sen)	-	37.0	-	n.m.	n.m.	-	-	n.m.
Core EPS (sen)	47.9	44.3	41.9	14%	8%	47.9	41.9	14%
Gross loans	169,452	168,234	155,779	9%	1%			
Gross impaired loans	837	820	755	11%	2%			
Customer deposits	194,557	195,227	183,221	6%	0%			
CASA	63,731	66,051	59,156	8%	-4%			

Source: HLB, MIDFR

EXHIBIT 2: QUARTERLY FINANCIAL RATIOS

Financial Ratios (%)	1QFY23	4QFY22	1QFY22	Yoy (+/- ppts)	QoQ (+/- ppts)	3MFY23	3MFY22	Yoy (+/- ppts)
NIM (Reported)	**2.18**	**2.10**	**2.13**	**0.05**	**0.08**	**2.18**	**2.21**	**-0.03**
NOII/Total income	17.9	22.7	18.8	-0.9	-4.8	17.9	18.8	-0.9
ROE (Ann.)	**12.6**	**11.7**	**11.7**	**0.9**	**0.9**	**12.6**	**11.7**	**0.9**
Cost-to-income ratio	36.0	37.4	36.8	-0.7	-1.3	36.0	36.8	-0.7
Net credit costs (Ann.) (bps)	9	7	13	-4	2	9	13	-4
GIL ratio	0.49	0.49	0.48	0.01	0.01			
Loan loss coverage	212.2	211.8	238.5	-26.4	0.3			
L/D ratio	86.2	85.3	84.0	2.1	0.9			
CET1	12.9	13.4	13.0	-0.1	-0.5			
Tier-1	14.0	14.5	13.5	0.5	-0.5			
Total Capital	16.1	16.7	15.7	0.4	-0.6			

Source: HLB, MIDFR

INVESTMENT STATISTICS

INCOME STATEMENT

FYE Jun (RM m)	FY21	FY22	FY23F	FY24F	FY25F
Interest income	5,557	5,723	7,401	8,377	9,018
Interest expense	(2,099)	(1,968)	(3,338)	(4,035)	(4,400)
Net interest income	**3,458**	**3,755**	**4,063**	**4,341**	**4,618**
Islamic banking income	919	905	1,003	1,107	1,178
Other operating income	1,090	937	976	1,100	1,380
Total income	**5,467**	**5,597**	**6,043**	**6,548**	**7,176**
OPEX	(2,078)	(2,098)	(2,296)	(2,488)	(2,727)
PPOP	**3,389**	**3,499**	**3,746**	**4,060**	**4,449**
Loan allowances	(654)	(164)	(174)	(185)	(194)
Other allowances	(0)	1	(0)	(0)	(0)
JV & Associates	736	1,030	1,123	1,217	1,290
Pretax profit	**3,471**	**4,367**	**4,696**	**5,093**	**5,546**
Taxation and zakat	(610)	(1,078)	(831)	(901)	(982)
NCI	-	-	-	-	-
Reported net profit	**2,861**	**3,289**	**3,865**	**4,191**	**4,564**
Core net profit	**2,861**	**3,289**	**3,865**	**4,191**	**4,564**
Total NII	4,310	4,618	5,016	5,360	5,702
Total NOII	1,157	979	1,026	1,188	1,475

BALANCE SHEET

FYE Jun (RM m)	FY21	FY22	FY23F	FY24F	FY25F
Cash and ST funds	3,953	6,937	7,179	7,417	7,614
Investment securities	66,332	65,799	70,399	77,439	85,183
Net loans	154,071	166,488	177,411	188,213	195,884
Other IEAs	-	-	-	-	-
Non-IEAs	12,774	15,107	19,407	20,879	22,365
Total assets	**237,129**	**254,331**	**274,396**	**293,947**	**311,045**
Customer & bank deposits	196,565	206,283	219,148	231,159	240,346
Other IBLs	3,241	7,431	7,738	9,313	11,356
Non-IBLs	7,864	9,629	15,643	18,883	21,173
Total liabilities	**207,670**	**223,342**	**242,529**	**259,356**	**272,875**
Share capital	7,739	7,739	7,739	7,739	7,739
Reserves & retained profit	21,720	23,250	24,128	26,853	30,431
Shareholders' funds	**29,459**	**30,989**	**31,867**	**34,592**	**38,170**
NCI	-	-	-	-	-
Total equity	**29,459**	**30,989**	**31,867**	**34,592**	**38,170**
Total liabilities & equity	**237,129**	**254,331**	**274,396**	**293,947**	**311,045**
Total IEAs	224,355	239,224	254,989	273,068	288,680
Total IBLs	199,806	213,714	226,886	240,472	251,702
Gross loans	155,822	168,234	179,169	189,919	197,516
CASA	59,232	66,051	68,143	69,705	70,645

FINANCIAL RATIOS

FYE Jun (RM m)	FY21	FY22	FY23F	FY24F	FY25F
Interest (%)					
NIM	1.99	1.99	2.03	2.03	2.03
Return on IEAs	2.56	2.47	3.00	3.17	3.21
Cost of funds	1.09	0.95	1.52	1.73	1.79
Net interest spread	1.47	1.52	1.48	1.45	1.42
Profitability (%)					
ROE	10.1	10.9	12.3	12.6	12.5
ROA	1.2	1.3	1.4	1.4	1.5
NOII/Total income	21.2	17.5	17.0	18.1	20.5
Effective tax rate	17.6	24.7	17.7	17.7	17.7
Liquidity & Efficiency (%)					
Cost-to-income ratio	38.0	37.5	38.0	38.0	38.0
Loan/Deposit ratio	84.1	84.4	84.7	85.2	85.4
CASA ratio	32.3	33.5	32.5	31.6	30.8
Asset Quality (%)					
GIL ratio	0.46	0.49	0.55	0.54	0.53
NIL ratio	0.31	0.29	0.34	0.29	0.25
LLC ratio	246.6	211.8	176.2	164.1	155.0
LLC (incl. reserves)	305.7	291.7	235.4	222.2	212.9
Gross credit cost (bps)	55	24	22	22	22
Net credit cost (bps)	43	10	10	10	10
% Floating rate loans	82.6	82.8	83.0	83.0	83.0
% Domestic loans	94.1	93.0	94.1	94.1	94.1
Capital (%)					
CET 1	14.0	14.0	14.3	14.3	14.2
Tier 1 capital	14.6	14.6	14.8	14.8	14.7
Total capital	16.7	16.7	17.0	17.0	16.9
Growth (%)					
Total NII	26.5	7.1	8.6	6.8	6.4
Total NOII	(15.7)	(15.3)	4.8	15.8	24.1
Core net profit	9.9	15.0	17.5	8.4	8.9
Gross loans	6.8	8.0	6.5	6.0	4.0
Customer deposits	5.6	7.6	6.2	5.4	3.8
CASA	22.5	11.5	3.2	2.3	1.3
Valuation metrics					
Core EPS (sen)	139.6	160.5	188.6	204.5	222.7
Gross DPS (sen)	50.0	55.0	66.0	71.6	78.0
Div payout ratio (%)	35.8	34.2	35.0	35.0	35.0
BVPS (RM)	14.4	15.1	15.6	16.9	18.6
Core P/E (x)	15.0	13.0	11.1	10.2	9.4
Dividend yield (%)	2.4	2.6	3.2	3.4	3.7
P/BV (x)	1.5	1.4	1.3	1.2	1.1

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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