

Hong Leong Bank (HLBK MK)

Chengdu in lockdown

TP lowered

With the city of Chengdu going into lockdown, we anticipate a possible negative reaction to Bank of Chengdu's (BOCD; 601838 CH, Not Rated) share price. We trim HL Bank's FY23-25E net profit forecast by 3-7% to reflect potential MTM losses from its convertible bonds in BOCD and lower earnings growth at BOCD. BUY maintained but with a lower TP of MYR23.60 from MYR24.90 previously.

Chengdu in lockdown

China's city of Chengdu (population 21m vs 25m for Shanghai) went into COVID lockdown on Thursday Sep 1. The financial impact to HL Bank's 18%-associate BOCD will depend on the length of the lockdown. BOCD's fundamentals are nevertheless strong. 1H22 (FY Dec) operating income rose 17% YoY and net profit jumped 32% YoY, contributing to about 24% of HL Bank's earnings. Its gross impaired loans ratio stood at just 0.83% end-June 2022, with a very high loan loss coverage of 474%.

Trimmed our earnings

In FY22, HL Bank recognised about MYR240m of marked-to-market (MTM) gains on its convertible bonds in BOCD, which are listed. Taking a more cautious stance, we are assuming the full reversal of these MTM gains. We have also cut BOCD's earnings growth to 5%/5% from 18%/12% for FY23/24E and consequently, we have trimmed HL Bank's FY23/24/25E earnings forecasts by 7%/3%/4%.

Lowering our TP

With the cut in earnings, we now forecast a lower FY23 ROE of 11.2% from 12% previously. Our TP is correspondingly lowered to MYR23.60 from MYR24.90 on the back of a lower CY23 PBV target of 1.39x (1.45x previously), to reflect a lower CY23 ROE of 11.3% (11.8% previously).

FYE Jun (MYR m)	FY21A	FY22A	FY23E	FY24E	FY25E
Operating income	5,467	5,597	5,969	6,174	6,448
Pre-provision profit	3,389	3,499	3,768	3,877	4,051
Core net profit	2,861	3,289	3,608	3,920	4,180
Core EPS (MYR)	1.40	1.61	1.76	1.91	2.04
Core EPS growth (%)	9.9	14.9	9.7	8.7	6.6
Net DPS (MYR)	0.50	0.55	0.62	0.67	0.71
Core P/E (x)	13.4	12.7	11.9	10.9	10.2
P/BV (x)	1.4	1.4	1.4	1.3	1.2
Net dividend yield (%)	2.7	2.7	3.0	3.2	3.4
Book value (MYR)	13.59	14.30	15.37	16.55	17.81
ROAE (%)	10.1	10.9	11.2	11.3	11.2
ROAA (%)	1.2	1.3	1.4	1.4	1.4
Consensus net profit	-	-	3,866	4,121	4,380
MKE vs. Consensus (%)	-	-	(0.5)	(4.9)	(4.6)

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BUY

Share Price	MYR 20.88
12m Price Target	MYR 23.60 (+15%)
Previous Price Target	MYR 24.90

Company Description

Hong Leong Bank offers integrated financial services and is predominantly a retail bank. It also holds an 18% stake in Bank of Chengdu, China.

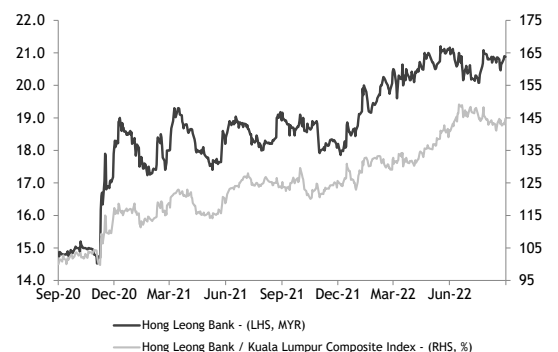
Statistics

52w high/low (MYR)	21.20/17.86
3m avg turnover (USDm)	5.5
Free float (%)	216,771.9
Issued shares (m)	2,168
Market capitalisation	MYR45.3B USD10.1B

Major shareholders:

Hong Leong Financial Group Bhd.	62.1%
Employees Provident Fund	10.0%
Hong Leong Bank Bhd.	3.7%

Price Performance



	-1M	-3M	-12M
Absolute (%)	(0)	(1)	10
Relative to index (%)	(1)	2	16

Source: FactSet

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Risk Rating & Score ¹	18.5
Score Momentum ²	-5.8
Last Updated	30 Jun 2022
Controversy Score ³ (Updated: 12 Aug 2020)	0

Business Model & Industry Issues

- HL Bank has consistently maintained one of the lowest impaired loans in the industry and one of the most liquid balance sheets. This, in our view, is testimony to strong management capabilities and the group's emphasis on corporate governance.
- The banking sector is one of the transmission mechanisms for government stimulus programs under COVID-19 relief schemes. Targeted Repayment Assistance under the PEMULIH and URUS programmes are ongoing, and the TRA elevates social priorities over shareholders returns in the near term.
- HL Bank displays no exceptional risks not typical of a large bank for ESG. That the bank is principally a retail bank with limited corporate lending exposure significantly reduces its environment and corporate governance issues, in our view.

Material E issues

- With its "Digital at the Core" ethos, 2 out of 3 of its over 2m online and mobile banking customers are monthly active users. In FY21, the digitally enabled customer base grew by 11% and 22% respectively, with average monthly transactions increasing 33% and 54% respectively.
- It has introduced a reduction target of 15-25% by 2026 and 40-50% by 2031 for its Scope 1 and 2 emissions.
- HL Bank is a constituent of the FTSE4Good Index. It has been internally rated by RAM Sustainability with a "Gold" rating in overall ESG aspects. It ranks above average on the WWF Sustainable Banking Assessment.
- Based on the bank's initial sector screening in Dec 2020, 18% of its portfolio were deemed to be from high E&S risk sectors, mainly manufacturing (7%), palm oil (6%) and metals/mining & quarrying (3%). However, preliminary screening results show that >50% of these could transition to medium or low risk based on mitigating factors.
- In FY21, it had sector lending guidelines for four sectors - forestry, metals and mining, quarrying, non-renewable energy and palm oil. This will soon be extended to the agriculture, fisheries, selected manufacturing as well as recycling and waste treatment sectors.

Material S issues

- In FY21, employee turnover at HL Bank was 818 (937 in FY20, 1,196 in FY19) versus new hires of 866 (1,075 in FY20, 1,310 in FY19).
- In FY21, the bank approved MYR22.3b worth of pandemic relief assistance for over 97,000 retail, SME and corporate customers. This included relief assistance to over 20k customers from the B40 community, totalling MYR2b.
- HL Bank's female employees outnumber male employees, with the former accounting for 62.6% of total employees in FY21. In FY21, 3 of the 8 Board of Directors members were female.

Key G metrics and issues

- Hong Leong Bank has not had any material accounting & tax, lobbying & public policy, sanctions related, data privacy or security controversies in the past 5 years.
- Hong Leong Bank has consistently maintained one of the highest levels of asset quality in the industry as well as one of the most liquid balance sheets with an internal loan/deposit ratio cap of 85%.
- The CEO's remuneration was MYR14.6m in FY21, representing 0.4% of the group's pretax profit.
- The Board of Directors comprises 1 Executive Director and 7 Non-Executive Directors, of whom six are Independent Non-Executive Directors.
- The group discloses the remuneration of each individual Director in its annual report.
- IT expenses amounted to MYR186m in FY21, representing a higher 9.0% total operating expenses (8.3% in FY20).
- HL Bank is audited by PricewaterhouseCoopers, the world's second largest network of professional firms. PwC has been their auditors over the past 10 years, at the very least.
- HL Bank has an 18% stake in China's Bank of Chengdu (BOC), which accounted for a significant 22% of group pretax profit in FY20. Although HL Bank has two Board representatives at BOC, there is no guarantee that HL Bank can influence the ESG direction of BOC, in our view. BOC is a separately listed entity on the Shanghai Stock Exchange.

¹**Risk Rating & Score** - derived by Sustainalytics and assesses the company's exposure to unmanaged ESG risks. Scores range between 0 - 50 in order of increasing severity with low/high scores & ratings representing negligible/significant risk to the company's enterprise value, respectively, from ESG-driven financial impacts. ²**Score Momentum** - indicates changes to the company's score since the last update - a **negative** integer indicates a company's improving risk score; a **positive** integer indicates a deterioration. ³**Controversy Score** - reported periodically by Sustainalytics in the event of material ESG-related incident(s), with the impact severity scores of these events ranging from Category 0-5 (0 - no reports; 1 - negligible risks; ...; 5 - poses serious risks & indicative of potential structural deficiencies at the company).

FYE 30 Jun	FY21A	FY22A	FY23E	FY24E	FY25E
Key Metrics					
Core P/E (x)	13.4	12.7	11.9	10.9	10.2
Core FD P/E (x)	13.4	12.7	11.9	10.9	10.2
P/BV (x)	1.4	1.4	1.4	1.3	1.2
P/NTA (x)	1.4	1.4	1.4	1.3	1.2
Net dividend yield (%)	2.7	2.7	3.0	3.2	3.4
INCOME STATEMENT (MYR m)					
Interest income	5,556.7	5,722.9	8,611.4	9,093.7	9,548.9
Interest expense	(2,099.0)	(1,967.5)	(4,530.5)	(4,855.1)	(5,084.1)
Net interest income	3,457.7	3,755.3	4,080.9	4,238.6	4,464.8
Islamic banking income	919.4	904.8	931.9	959.9	988.7
Net insurance income	0.0	0.0	0.0	0.0	0.0
Net fees and commission	570.5	609.7	621.9	634.3	647.0
Other income	519.3	327.6	334.2	340.9	347.7
Total non-interest income	1,089.8	937.3	956.0	975.2	994.7
Operating income	5,466.9	5,597.4	5,968.8	6,173.6	6,448.2
Staff costs	(1,191.6)	(1,153.8)	(1,211.5)	(1,272.0)	(1,335.6)
Other operating expenses	(886.2)	(944.6)	(989.1)	(1,024.7)	(1,061.9)
Operating expenses	(2,077.8)	(2,098.4)	(2,200.6)	(2,296.7)	(2,397.5)
Pre-provision profit	3,389.1	3,499.0	3,768.2	3,876.9	4,050.7
Loan impairment allowances	(653.8)	(163.6)	(261.7)	(273.4)	(182.7)
Other allowances	(0.3)	0.9	0.0	0.0	0.0
Associates & JV income	736.0	1,030.5	1,082.0	1,136.1	1,192.9
Pretax profit	3,470.9	4,366.8	4,588.6	4,739.7	5,060.9
Income tax	(610.3)	(1,077.5)	(740.7)	(819.4)	(880.6)
Minorities	0.0	0.0	0.0	0.0	0.0
Discontinued operations	0.0	0.0	0.0	0.0	0.0
Reported net profit	2,860.6	3,289.3	3,847.9	3,920.3	4,180.3
Core net profit	2,860.6	3,289.3	3,607.9	3,920.3	4,180.3
BALANCE SHEET (MYR m)					
Cash & deposits with banks	3,953.0	6,937.2	3,367.8	2,793.8	2,820.6
Sec. under resale agreements	0.0	0.0	0.0	0.0	0.0
Derivatives financial assets	1,005.2	1,863.3	1,956.5	2,054.3	2,157.0
Dealing securities	8,246.4	7,244.5	7,389.4	7,537.2	7,687.9
Available-for-sale securities	58,085.1	58,554.7	62,770.7	67,290.1	72,135.0
Investment securities	0.0	0.0	0.0	0.0	0.0
Loans & advances	154,070.7	166,487.6	176,873.9	185,717.6	194,139.2
Central bank deposits	493.6	520.7	216.3	227.2	237.5
Investment in associates/JVs	5,501.5	6,455.5	7,267.0	8,119.1	9,013.8
Insurance assets	0.0	0.0	0.0	0.0	0.0
Fixed assets	1,412.5	1,415.4	1,585.2	1,775.4	1,988.5
Intangible assets	2,073.6	2,043.0	2,043.0	2,043.0	2,043.0
Other assets	2,287.5	2,809.5	4,346.8	4,462.4	3,205.7
Total assets	237,129.2	254,331.4	267,816.6	282,020.1	295,428.2
Deposits from customers	184,434.9	199,960.9	210,564.2	221,092.4	231,118.1
Deposits from banks & FIs	12,130.0	6,322.3	6,638.4	6,970.3	7,318.8
Derivatives financial instruments	0.0	0.0	0.0	0.0	0.0
Subordinated debt	1,502.3	1,502.2	1,502.2	1,502.2	1,502.2
Other securities in issue	806.4	1,715.7	1,715.7	1,715.7	1,715.7
Other borrowings	952.5	4,182.3	4,380.9	4,589.3	4,808.3
Insurance liabilities	0.0	0.0	0.0	0.0	0.0
Other liabilities	7,843.9	9,659.1	9,688.2	10,275.1	10,363.9
Total liabilities	207,670.1	223,342.4	234,489.5	246,145.0	256,827.0
Share capital	7,739.1	7,739.1	7,739.1	7,739.1	7,739.1
Reserves	21,720.1	23,249.9	25,588.0	28,136.0	30,862.1
Shareholders' funds	29,459.1	30,989.0	33,327.0	35,875.1	38,601.2
Preference shares	0.0	0.0	0.0	0.0	0.0
Minority interest	0.0	0.0	0.0	0.0	0.0
Total equity	29,459.1	30,989.0	33,327.0	35,875.1	38,601.2
Total liabilities & equity	237,129.2	254,331.4	267,816.6	282,020.1	295,428.2

FYE 30 Jun	FY21A	FY22A	FY23E	FY24E	FY25E
Key Ratios					
Growth (%)					
Net interest income	25.1	8.6	8.7	3.9	5.3
Non-interest income	(6.7)	(14.0)	2.0	2.0	2.0
Operating expenses	(1.2)	1.0	4.9	4.4	4.4
Pre-provision profit	26.7	3.2	7.7	2.9	4.5
Core net profit	9.9	15.0	9.7	8.7	6.6
Gross loans	6.8	8.0	5.9	5.0	4.5
Customer deposits	6.1	8.4	5.3	5.0	4.5
Total assets	7.2	7.3	5.3	5.3	4.8
Profitability (%)					
Non-int. income/Total income	19.9	16.7	16.0	15.8	15.4
Average lending yields	2.62	2.52	3.49	3.49	3.48
Average cost of funds	1.13	0.99	2.12	2.15	2.15
Net interest margin	2.14	2.14	2.12	2.08	2.07
Cost/income	38.0	37.5	36.9	37.2	37.2
Liquidity (%)					
Loans/customer deposits	83.5	83.3	84.0	84.0	84.0
Asset quality (%)					
Net NPL	0.3	0.3	0.3	0.2	0.2
Gross NPL	0.5	0.5	0.5	0.4	0.3
(SP+GP)/average gross loans	0.4	0.1	0.2	0.1	0.1
Loan loss coverage	246.6	211.8	166.7	214.3	250.0
Capital adequacy (%)					
CET1	14.0	13.9	13.8	14.5	15.3
Tier 1 capital	14.6	15.1	14.4	15.1	15.8
Risk-weighted capital	16.7	17.2	15.9	16.6	17.3
Returns (%)					
ROAE	10.1	10.9	11.2	11.3	11.2
ROAA	1.2	1.3	1.4	1.4	1.4
Shareholders equity/assets	12.4	12.2	12.4	12.7	13.1

Source: Company; Maybank IBG Research

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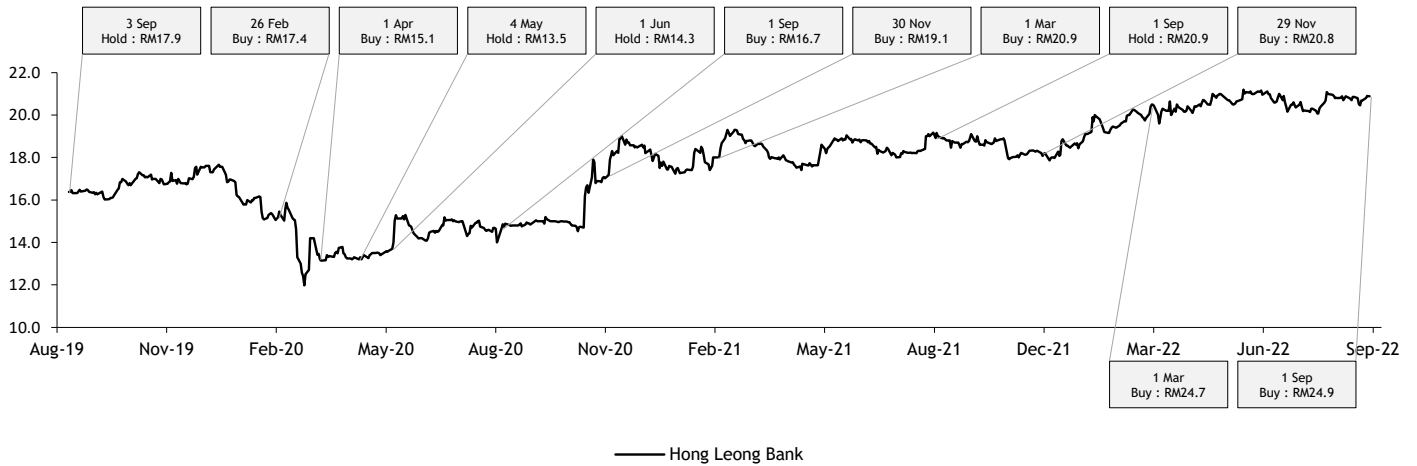
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