

20 August 2019

Financial Services | Banks

Oversea-Chinese Banking Corp (OCBC SP)

Neutral (Maintained)

Greater China Potential, But Already Priced In

Target Price (Return)	SGD11.50 (+7%)
Price:	SGD10.71
Market Cap:	USD33,399m
Avg Daily Turnover (SGD/USD)	63.5m/45.9m

- **Stay NEUTRAL with a new SGD11.50 TP from SGD11.80 TP, 7% upside plus 4.7% yield**, based on 1.07x 2020F P/BV. After attending the Oversea-Chinese Banking Corp's presentation on its Greater China franchise, we are optimistic on further growth there. However, NIM contraction could lower overall earnings growth. Our TP is derived from long-term ROE assumption of 11.7% (same as 1H19's), factoring in digitisation-driven cost efficiencies accompanied by marginally-narrowing NIM.

- **Greater China earnings share tripled to 19%**. In FY13, Greater China – comprising China, Hong Kong, Macau, and Taiwan – accounted for 6% of OCBC's PBT. The 2014 acquisition of Wing Hang Bank contributed to growth in this region. By FY18, Greater China accounted for a 19% share of OCBC's PBT. This region's SGD1,037m in FY18 PBT is 5x that of FY13's, and management is bullish on further growth.

- **2018 wealth management's assets under management (AUM) is 4x that of 2013's**. In the latter period, OCBC's Greater China franchise's AUM was USD9bn. By 2018, this had risen to USD36bn. The 2018 AUM/client is 2.5x that of 2013's, reflecting OCBC's ability to draw in clients with higher net worth. With greater economies of scale, the Greater China wealth management arm has also been able to lower the cost-income ratio 4ppts between 2013 and 2018.

- **OCBC Wing Hang Bank has shown recent PBT strength**. Between 2016 and 2018, this entity recorded 2-year PBT CAGR of 17.4%, reflecting its strength in the Greater China market. Worthy of mention is the increase in CASA ratio by 10ppts to 40% in 2018 from 2014.

- **The small & medium enterprise (SME) franchise and auto loans have strengthened**. OCBC had a Greater China SME loan balance of SGD2.8bn as at 2018 when compared with a not-meaningful number in 2013. Greater China's auto loans balance of SGD1.9bn in 2018 compares with a not-meaningful number in 2013.

- **Some of the significant 2023 targets for China's Greater Bay Area**: 5-year CAGR PBT of 11% (starting from 2018) and 12% 5-year CAGR loan book – also starting from 2018.

- **Our TP is based on 1.07x 2020F P/BV**. Our OCBC valuation is based on long-term ROE assumption of 11.7%. The previous TP was based on an 11.9% ROE assumption. We lower our long-term ROE assumption, given increasing global economic uncertainties. Our target 2020F P/BV is 1.07x, from which we derive our new TP of SGD11.50. We believe OCBC's share price could be volatile in the short term, given expectations of inorganic expansion – management has also indicated that it is looking at opportunities.

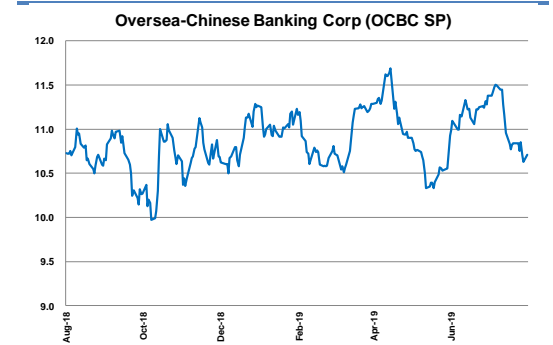
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Share Performance (%)

	YTD	1m	3m	6m	12m
Absolute	(4.9)	(8.0)	(3.9)	(8.0)	(4.5)
Relative	(6.8)	(0.6)	(1.5)	(4.0)	(2.0)
52-wk Price low/high (SGD)	10.36 – 12.19				



Source: Bloomberg

Forecasts and Valuation	Dec-17	Dec-18	Dec-19F	Dec-20F	Dec-21F
Reported net profit (SGDm)	4,045	4,492	4,790	4,940	5,222
Recurring net profit (SGDm)	4,146	4,492	4,790	4,940	5,222
Recurring net profit gr (%)	19.4	8.3	6.6	3.1	5.7
Recurring EPS (SGD)	0.99	1.06	1.10	1.09	1.11
BVPS (SGD)	8.96	9.56	10.16	10.72	11.26
DPS (SGD)	0.37	0.43	0.50	0.51	0.52
Recurring P/E (x)	10.8	10.1	9.7	9.8	9.7
P/B (x)	1.20	1.12	1.05	1.00	0.95
Dividend Yield (%)	3.5	4.0	4.7	4.8	4.9
Return on average equity (%)	11.0	11.5	12.0	11.3	11.0
Return on average assets (%)	1.11	1.17	1.22	1.24	1.27

Source: Company data, RHB

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Financial Exhibits

Financial model updated on: 2019-08-19

Asia	Financial summary	Dec-17	Dec-18	Dec-19F	Dec-20F	Dec-21F
Singapore	EPS (SGD)	0.97	1.06	1.10	1.09	1.11
Financial services	Core EPS (SGD)	0.99	1.06	1.10	1.09	1.11
Oversea-Chinese Banking Corp	DPS (SGD)	0.37	0.43	0.50	0.51	0.52
Bloomberg OCBC SP	BVPS (SGD)	8.96	9.56	10.16	10.72	11.26

NEUTRAL

Valuation basis

Gordon Growth Methodology (GGM)

Valuation metrics	Dec-17	Dec-18	Dec-19F	Dec-20F	Dec-21F
Recurring P/E (x)	10.8	10.1	9.7	9.8	9.7
P/B (x)	1.20	1.12	1.05	1.00	0.95
Dividend yield (%)	3.5	4.0	4.7	4.8	4.9

Key drivers

Our net profit forecast is most sensitive to

- Changes in NIM;
- Non-II growth;
- Credit costs.

Key risks

- Higher impairment charges;
- Weaker NIMs;
- Softer non-II.

Company Profile

OCBC is the second-largest Singapore bank by market capitalisation. Besides the island republic, the bank has significant operations in Greater China, Malaysia, and Indonesia.

Balance sheet (SGDm)	Dec-17	Dec-18	Dec-19F	Dec-20F	Dec-21F
Gross loans & advances	237,321	257,705	268,491	283,254	299,673
Loan impairment allowances	3,180	2,512	3,090	3,256	3,435
Net loans & advances	234,141	255,193	265,401	279,998	296,238
Total assets	452,693	467,543	462,487	478,900	495,462
Deposits from customers	283,642	295,412	299,843	313,336	327,436
Total liabilities	410,900	424,151	412,880	424,823	436,662
Shareholders' funds	39,028	42,137	46,484	50,953	55,675
Total equity	41,793	43,392	49,607	54,077	58,800

Income statement (SGDm)	Dec-17	Dec-18	Dec-19F	Dec-20F	Dec-21F
Net interest income	5,423	5,890	6,266	6,460	6,710
Non-interest income	4,105	3,811	4,316	4,670	5,007
Operating income	9,528	9,701	10,582	11,130	11,717
Overhead expenses	4,043	4,214	4,490	4,757	4,999
Pre-provision operating profit	5,485	5,487	6,092	6,373	6,718
Loan impairment allowances	671	288	750	595	608
Other impairment allowances	104	102	108	108	108
Pre-tax profit	5,099	5,552	5,858	6,182	6,521
Reported net profit	4,045	4,492	4,790	4,940	5,222
Recurring net profit	4,146	4,492	4,790	4,940	5,222

Profitability	Dec-17	Dec-18	Dec-19F	Dec-20F	Dec-21F
ROA (%)	1.11	1.17	1.22	1.24	1.27
ROE (%)	11.0	11.5	12.0	11.3	11.0
Yield on IEAs (%)	2.77	3.18	3.54	3.54	3.50
Cost of funds (%)	1.20	1.58	1.79	1.78	1.74
Net interest margin (%)	1.65	1.70	1.79	1.77	1.76
Non-II / Total income (%)	43.1	39.3	40.8	42.0	42.7
CIR (%)	42.4	43.4	42.4	42.7	42.7
Credit cost (bps)	27	11	28	21	20
PIOP growth (%)	16.7	0.0	11.0	4.6	5.4
Net profit growth (%)	16.5	11.1	6.6	3.1	5.7

Asset quality	Dec-17	Dec-18	Dec-19F	Dec-20F	Dec-21F
Gross impaired loans/Gross loans (%)	1.5	1.5	1.5	1.5	1.4
Loan loss coverage ratio (%)	76.9	70.3	76.0	77.6	79.4
NPL formation (bps)	103	67	56	60	62

Liquidity	Dec-17	Dec-18	Dec-19F	Dec-20F	Dec-21F
Loan growth (%)	8.0	9.0	4.0	5.5	5.8
Customer deposits growth (%)	8.5	4.1	1.5	4.5	4.5
LDR (%)	82.5	86.4	88.5	89.4	90.5

Capital	Dec-17	Dec-18	Dec-19F	Dec-20F	Dec-21F
CET1 ratio (%)	13.9	14.0	15.2	16.4	17.4
Tier-1 ratio (%)	15.0	14.8	16.2	17.3	18.3
Total capital ratio (%)	17.2	16.5	17.8	18.8	19.7

Source: Company data, RHB

Greater China Potential

OCBC acquired Wing Hang Bank for its Greater China potential. Management explained that the acquisition of the bank was not on account of its Hong Kong business alone, but for the potential that Greater China offers. The foothold into Hong Kong enabled OCBC to better source USD funding, as USD funding from Singapore is not as good as those from Hong Kong.

By 2023, OCBC targets for Greater China to account for 20-25% of group PBT. By then, Singapore's share of PBT is likely to be c.50-55%, Malaysia 15-20%, and Indonesia 6-8%.

The bank will work on the following to achieve its targets:

- i. Deepening connectivity between OCBC Wing Hang Bank's China network with OCBC's networks in other countries;
- ii. Capturing the trade, wealth, and capital flows between Greater China and ASEAN;
- iii. Building strong treasury capabilities.

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Figure 1: OCBC's financial data

FYE Dec (SGDm)	FY17	FY18	FY19F	FY20F	FY21F
NII	5,423	5,890	6,266	6,460	6,710
Non-II	4,105	3,811	4,316	4,670	5,007
- Dividends	76	128	120	124	126
- Fee & Commission Income	1,953	2,031	2,102	2,357	2,498
- Rental income	83	79	81	99	101
- Insurance	918	911	907	986	1,006
- Other operating income	1,075	662	1,106	1,104	1,276
Total operating Income	9,528	9,701	10,582	11,130	11,717
Operating expenses	(4,043)	(4,214)	(4,490)	(4,757)	(4,999)
Operating profit	5,485	5,487	6,092	6,373	6,718
Provisions	(671)	(288)	(750)	(595)	(608)
Goodwill/Intangibles amortisation	(104)	(102)	(108)	(108)	(108)
Associates	389	455	624	512	519
Pre-tax profit	5,099	5,552	5,858	6,182	6,521
Taxation	(803)	(877)	(894)	(1,019)	(1,077)
Profit after tax	4,296	4,675	4,964	5,163	5,444
Minorities	(251)	(183)	(174)	(223)	(222)
Net profit	4,045	4,492	4,790	4,940	5,222
EPS (SGD cents)	96.7	106.5	110.5	109.6	111.3
Book value (SGD)	9.20	9.56	10.18	10.76	11.32
Revalued book (SGD)	11.57	11.38	11.93	12.44	12.93
P&L ratios (%)					
ROE (Avg)	11.0	11.5	12.0	11.3	11.0
NIM	1.65	1.70	1.79	1.77	1.76
NII/income	56.9	60.7	59.2	58.0	57.3
Opex/income	42.4	43.4	42.4	42.7	42.7
P&L YoY change (%)					
NII	7.3	8.6	6.4	3.1	3.9
Non-II	19.4	(7.2)	13.3	8.2	7.2
Fee & commission income	19.2	4.0	3.5	12.1	6.0
Total income	12.2	1.8	9.1	5.2	5.3
Opex	6.7	4.2	6.5	5.9	5.1
Operating profit	16.7	0.0	11.0	4.6	5.4
Provisions	(7.6)	(57.1)	160.4	(20.7)	2.2
Pre-tax Profit	19.3	8.9	5.5	5.5	5.5
Net Profit	16.5	11.1	6.6	3.1	5.7
BS data (SGDm)					
Assets	452,693	467,543	462,487	478,900	495,462
Non-bank loans	234,141	255,193	265,401	279,998	296,238
Customer deposit	283,642	295,412	299,843	313,336	327,436
Non-performing assets	3,468	3,938	4,067	4,196	4,325
Cumulative loan loss provisions	2,666	2,769	3,090	3,256	3,435
Balance sheet ratios (%)					
LDR	82.5	86.4	88.5	89.4	90.5
Non-bank loans growth (YoY %)	8.0	9.0	4.0	5.5	5.8
Customer deposit growth (YoY %)	8.5	4.1	1.5	4.5	4.5
Non-bank NPL/Non-bank loans	1.5	1.5	1.5	1.5	1.4
Loan loss coverage	76.9	70.3	76.0	77.6	79.4
Total CAR	17.2	16.5	17.8	18.8	19.7
Tier 1 CAR	15.0	14.8	16.2	17.3	18.3

Source: Bloomberg, RHB

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