

26 September 2019

Financial Services | Banks

## Oversea-Chinese Banking Corp (OCBC SP)

**Neutral** (Maintained)

### Softer NIM And Possible M&A To Limit Upside

Target Price (Return)	SGD11.50 (+7%)
Price:	SGD10.77
Market Cap:	USD33,912m
Avg Daily Turnover (SGD/USD)	36.2m/26.3m

- **Maintain NEUTRAL with unchanged SGD11.50 TP, 7% upside, 4.6% yield**, based on 1.07x 2020F P/BV. The US Federal Reserve cut the federal funds rate (FFR) at the mid-September FOMC meeting. Going forward, more cuts are expected. Given the historical positive correlation between the US FFR and 3-month SIBOR, we expect further softness in the latter. This is negative for the NIMs of the three Singapore banks. Market talk of OCBC's interest in buying Bank Permata may also cap OCBC's share price. Our Top Pick is UOB.
- **Recent Bloomberg reports indicate that OCBC is interested to acquire Bank Permata** (BNLI IJ, TRADING BUY, TP: IDR1,300). If OCBC is successful in acquiring BNLI, and merges with OCBC NISP, it will become Indonesia's fifth largest bank – we believe such a scenario will be a positive for OCBC's long term growth in Indonesia. However, there is market talk of Sumitomo Mitsui Banking Corp (SMBC) joining the bid to acquire BNLI – a move in line with the group's plan to expand presence in more Asian countries outside of Japan.
- **Our sensitivity analysis shows that OCBC has sufficient capital to acquire BNLI.** Assuming an aggressive scenario where OCBC acquires 100% of BNLI at IDR1,700/share cash (a 47% premium to BNLI's last traded price of IDR1,155), this would hypothetically lower OCBC's CET1 ratio to 12.5% (from pre-acquisition's 14.4%), which is still higher than regulatory requirements.
- **Further FFR cuts to narrow OCBC's NIM.** The US Fed cut the FFR in mid-September. The consensus is for further cuts ahead. This should translate to further softness in the 3-month SIBOR – current 3-month SIBOR of 1.88% is already 10bps lower than the 2Q19 average of 1.98%. We forecast OCBC 2020 NIM of 1.77%, lower than 2Q19's 1.79%.
- **OCBC's relatively high percentage loan exposure to Greater China not a positive.** 24.2% of OCBC's loans are to Greater China, vs DBS' (DBS SP, NEUTRAL, TP: SGD25.30) 29.9% and UOB's (UOB SP, BUY, TP: SGD29.50) 15.7%. With the US-China trade war adversely affecting China's economic growth, OCBC's relatively large percentage exposure is not a positive, as there is a risk of higher NPLs.
- **Dividend yield to support share price.** We forecast 2019 dividend of SGD0.50/share (4.6% dividend yield) – consistent with OCBC's 1H19 interim one-tier tax-exempt dividend of SGD0.25/share.
- **Our TP is based on 1.07x 2020F P/BV.** Our OCBC valuation is based on 11.7% long-term ROE assumption (vs 1H19's 11.7%) – factoring in weaker NIMs and competition from digital banks, offsetting strength from wealth management. This yields 2020F target P/BV of 1.07x (close to 1SD below the 6-year historical average of 1.24x), from which we derive our SGD11.50 TP.

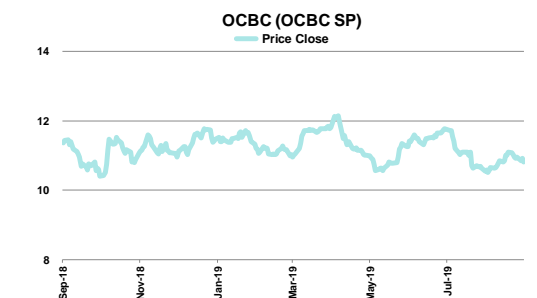
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#### Share Performance (%)

	YTD	1m	3m	6m	12m
Absolute	(4.0)	1.7	(3.9)	(1.6)	(5.6)
Relative	(6.1)	0.9	1.3	(0.1)	(2.4)
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	10.17	10.72	11.26
DPS (SGD)	0.37	0.43	0.50	0.51	0.52
Recurring P/E (x)	10.9	10.1	9.8	9.9	9.7
P/B (x)	1.20	1.13	1.06	1.00	0.96
Dividend Yield (%)	3.4	4.0	4.6	4.7	4.8
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: 2019-09-25

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
Financials	Core EPS (SGD)	0.99	1.06	1.10	1.09	1.11
OCBC	DPS (SGD)	0.37	0.43	0.50	0.51	0.52
OCBC SP	BVPS (SGD)	8.96	9.56	10.17	10.72	11.26
NEUTRAL						
	Valuation metrics	Dec-17	Dec-18	Dec-19F	Dec-20F	Dec-21F
<b>Valuation basis</b>	Recurring P/E (x)	10.9	10.1	9.8	9.9	9.7
Gordon Growth Methodology (GGM)	P/B (x)	1.20	1.13	1.06	1.00	0.96
	Dividend yield (%)	3.4	4.0	4.6	4.7	4.8
	Balance sheet (SGDm)	Dec-17	Dec-18	Dec-19F	Dec-20F	Dec-21F
<b>Key drivers</b>	Gross loans & advances	237,321	257,705	268,491	283,254	299,673
Our net profit forecast is most sensitive to:	Loan impairment allowances	3,180	2,512	3,090	3,256	3,435
i. Changes in NIM;	Net loans & advances	234,141	255,193	265,401	279,998	296,238
ii. Non-interest income growth;	Total assets	452,693	467,543	462,487	478,900	495,462
iii. Credit cost.	Deposits from customers	283,642	295,412	299,843	313,336	327,436
	Total liabilities	410,900	424,151	412,879	424,822	436,661
<b>Key risks</b>	Shareholders' funds	39,028	42,137	46,484	50,954	55,675
i. Higher impairment charges;	Total equity	41,793	43,392	49,607	54,078	58,800
ii. Weaker NIMs;						
iii. Softer non-II.						
<b>Company Profile</b>	Income statement (SGDm)	Dec-17	Dec-18	Dec-19F	Dec-20F	Dec-21F
OCBC is the second largest Singapore bank by market capitalisation. Besides Singapore, OCBC has significant operations in Greater China, Malaysia and Indonesia.	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
	Pretax 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

## What If OCBC Buys Bank Permata?

**OCBC has sufficient capital to buy BNLI.** We created a hypothetical scenario of OCBC buying 100% of Bank Permata for IDR1,700 per share in cash. This represents a premium of 47% over Bank Permata's last closing price of IDR1,155. Under this scenario, OCBC's CET1 CAR could fall to 12.5% (from pre-acquisition's 14.4%), but is still higher than the regulatory requirement of 11.5%.

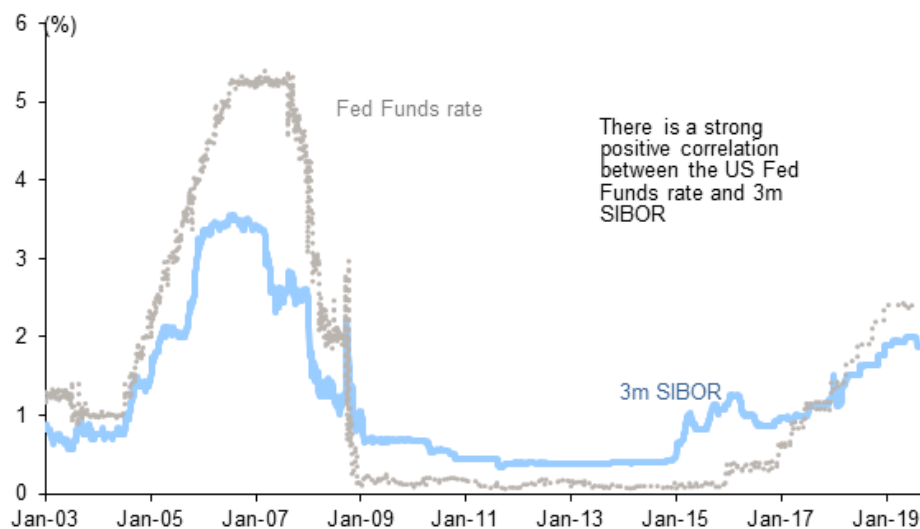
**Figure 1: Impact on OCBC's capital (from hypothetical acquisition of BNLI)**

	OCBC	BNLI	BNLI	Adjust- ments	Conso
	SGDbn	IDRtrn	SGDbn	SGDbn	SGDbn
Risk weighted assets	209.20	113.78	11.12		220.33
CET1	30.18	21.19	2.07	(4.66)	27.59
CET1 ratio	14.4%	18.6%	18.6%		12.5%

Source: Company data, RHB

## Falling SIBOR To Narrow OCBC NIM

**Figure 2: Forecast cuts in US FFR to lower 3-month SIBOR**



Source: Bloomberg

**OCBC's net interest income growth to slow on a falling SIBOR, just like the other two banks.** With SIBOR expected to trend down, OCBC's earnings would be negatively affected by narrowing NIM – although the impact on OCBC could be milder than for its peers (Figure 3). We still expect the three banks to record overall net interest income growth in 2020 and 2021 due to the forecast mid single-digit YoY increase in loan book. For OCBC, we forecast 2020 and 2021 net interest income growth of 3-4% pa (Figure 4).

**Figure 3: Sensitivity of net profit to SIBOR changes**

	DBS	OCBC	UOB
FY20F net interest income rise for 10bps rise in SIBOR (SGDm)	72.8	42.0	41.1
- net of tax & as % of net profit	0.9%	0.7%	0.8%

Source: RHB

**Figure 4: OCBC's 2020F-2021F net interest income growth of 3-4% pa**

Net interest income YoY % change	DBS	OCBC	UOB
FY18	14.9%	8.6%	12.5%
1Q19	8.6%	8.4%	8.0%
2Q19	9.2%	9.5%	7.1%
FY19F	9.4%	6.4%	5.4%
FY20F	2.6%	3.1%	2.5%
FY21F	2.1%	3.9%	4.0%

Source: Company data, RHB

Despite the recent SIBOR weakness, we forecast OCBC's 2020 and 2021 NIM to be still wider than the level in 2017 (Figure 5).

**Figure 5: Banks' NIMs to narrow over the next two years**

Net interest margin	DBS	OCBC	UOB
FY17	1.75%	1.65%	1.77%
FY18	1.85%	1.70%	1.82%
1Q19	1.88%	1.76%	1.79%
2Q19	1.91%	1.79%	1.81%
FY19F	1.88%	1.79%	1.81%
FY20F	1.86%	1.77%	1.78%
FY21F	1.84%	1.76%	1.77%

Source: Company data, RHB

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Figure 6: OCBC's financial data

FYE Dec (SGDm)	FY17	FY18	FY19F	FY20F	FY21F
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
- 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)
<b>Net Profit</b>	<b>4,045</b>	<b>4,492</b>	<b>4,790</b>	<b>4,940</b>	<b>5,222</b>
EPS (SGD¢)	96.7	106.5	110.4	109.3	110.7
Book value (SGD)	9.20	9.56	10.16	10.72	11.25
Revalued book (SGD)	11.57	11.38	11.91	12.39	12.85
<b>P&amp;L ratios (%)</b>					
ROE (Avg)	11.0	11.5	12.0	11.3	11.0
Net Interest Margin	1.65	1.70	1.79	1.77	1.76
Net interest income / income	56.9	60.7	59.2	58.0	57.3
Operating expenses / income	42.4	43.4	42.4	42.7	42.7
<b>P&amp;L YoY change (%)</b>					
Net Interest Income	7.3	8.6	6.4	3.1	3.9
Non-interest income	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
Operating expenses	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
<b>BS data (SGDm)</b>					
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
<b>Balance sheet ratios (%)</b>					
Loans Deposit ratio	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: Company data, RHB

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