Malaysia Results Preview

20 February 2024

Financial Services | Banks

Hong Leong Bank (HLBK MK)

Buy (Maintained)

Steady Progress Expected; Stay BUY

Target Price (Return):	MYR23.20 (+20%)
Price (Market Cap):	MYR19.40 (USD8,799m)
ESG score:	3.0 (out of 4)
Avg Daily Turnover (MYR/USD)	13.9m/2.98m

- **Stay BUY and MYR23.20 TP, 20% upside with c.3% FY24F yield.** Hong Leong Bank (HL Bank) is expected to announce its 2QFY24 (Jun) results on 28 Feb. We expect it to book decent operating income growth QoQ, partly offset by normalising loan provisions from the net write-back in 1QFY24. Its share price performance has lagged, we believe, on concerns over its China exposure. In the near term, we expect a brighter China macroeconomic outlook, which should help allay concerns. Beyond that, its mid-term transformative plan attempts to redress the growth mix closer to home.
- **Operating income growth could be decent, led by NII.** Despite the slowdown in loan growth momentum in the recent 1QFY24 quarter (flat QoQ), which management said was due to corporate repayments and unattractive pricing, we understand from a recent conversation with HL Bank that the 2QFY24 loan growth momentum should be better – led by both retail and non-retail segments, and in line with the positive momentum from the broader system statistics. NIM is also expected to hold up well, despite the impact from deposit competition. HL Bank had started building up its deposits early in anticipation of seasonal competition. Together with better optimisation of its asset-liability mix, these should support management's optimism on NIM improvement ahead, as conveyed during its previous briefing.
- **Market-related non-II could provide a further boost, but harder to predict.** On the non-II front, we think fees should do well in 2QFY24, partly thanks to card- and loan-related fees. Meanwhile, bond yield movements indicate a favourable trading quarter for banks, but market-related income tends to be harder to predict. All-in, baring a sharp drop-off in market income, we think HL Bank should see a decent quarter in terms of operating income.
- **Credit cost – expect some normalisation.** The above, however, would partly be offset by our expectations of credit cost to normalise – vs the MYR51m write-back in 1QFY24 due to recoveries – where the gross provision charge was low due to stable asset quality and a flat loan base, we believe. Assuming loans pick up QoQ, we expect a net charge in 2QFY24 although 1H credit cost is likely to trail the 10bps guided for FY24.
- **Dividends.** We expect an interim DPS of 21 sen (2QFY23: 21 sen) and project FY24F DPS at 62 sen (FY23 DPS: 59 sen). This is based on a payout ratio of c.31% (FY23: 32%).
- **What are we watching out for?** Progress on its transformative 3-5-year plan, especially on the non-II front, as this is the major driver to raise ROEs to 12-12.5% over the next two years (FY23: 11.8%). Updates on Bank of Chengdu's (BOCD) performance will also be closely watched, although we gather that HL Bank remains comfortable with BOCD's customer base and book quality.
- **Forecasts and TP retained.** Our MYR23.20 TP has a 0% ESG premium/discount built in, as HL Bank's ESG score is in line with the country median.

Forecasts and Valuation	Jun-22	Jun-23	Jun-24F	Jun-25F	Jun-26F
Reported net profit (MYRm)	3,289	3,818	4,041	4,255	4,445
Net profit growth (%)	15.0	16.1	5.8	5.3	4.5
Recurring net profit (MYRm)	3,289	3,818	4,041	4,255	4,445
Recurring EPS (MYR)	1.61	1.86	1.97	2.08	2.17
BVPS (MYR)	15.13	16.59	17.85	19.29	20.80
DPS (MYR)	0.55	0.59	0.62	0.65	0.68
Recurring P/E (x)	12.08	10.41	9.84	9.34	8.95
P/B (x)	1.28	1.17	1.09	1.01	0.93
Dividend Yield (%)	2.8	3.0	3.2	3.4	3.5
Return on average equity (%)	10.9	11.8	11.5	11.2	10.8

Source: Company data, RHB

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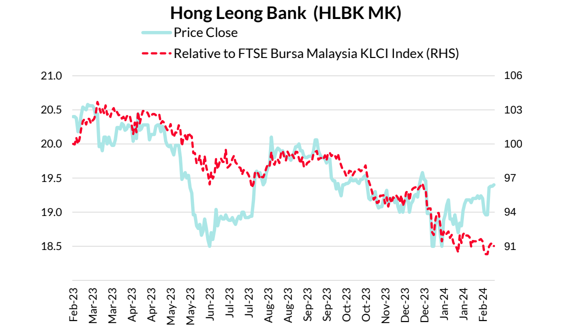
Share Performance (%)

	YTD	1m	3m	6m	12m
Absolute	2.6	3.1	0.4	(2.6)	(4.9)
Relative	(2.8)	0.4	(4.3)	(7.4)	(8.2)
52-wk Price low/high (MYR)					18.5 –20.6



Source: Bloomberg

Overall ESG Score: 3.0 (out of 4)

E: GOOD
HL Bank is committed to reducing its GHG emissions by 15-25% by 2026, and achieving net zero in Scope 1 and 2 emissions by 2030, and being carbon-neutral by 2050. Being a retail-focused bank, lending exposures to the commodities and oil & gas sectors are insignificant. It targets to approve MYR4.0bn in renewable energy financing by FY25 (FY23: 3.2bn) while, by FY23, it had exceeded its MYR12bn green and affordable mortgages targets by MYR1.2bn.

S: GOOD
It embraces gender diversity, with 41% of women in senior management and 43% of women in the Board of Directors.

G: EXCELLENT
It has not had any material data security or privacy issues over the past few years. The Board of Directors comprises one executive member and six non-executive ones. Of these, five are independent non-executive directors.

Financial Exhibits

Asia
Malaysia
Financial Services
Hong Leong Bank
HLBK MK
Buy

Valuation basis

GGM-derived intrinsic value with an ESG overlay. Key GGM assumptions are:
i. Cost of equity of 9.5%;
ii. ROE of 11.0%;
iii. Long-term growth of 3.5%.

Key drivers

Our earnings forecasts are most sensitive to changes in:
i. Net interest margin;
ii. Loan impairment allowances;
iii. Contributions from associates.

Key risks

The downside risks include:
i. Weaker-than-expected loan growth;
ii. Softer-than-expected NIM;
iii. Lower-than-expected non-interest income;
iv. Lower-than-expected profits from Bank of Chengdu.

Company Profile

Hong Leong Bank provides conventional and Islamic banking services. The group's operations span across Malaysia, Singapore, Hong Kong, Vietnam, Cambodia and China – the latter, via its strategic shareholding in Bank of Chengdu.

Financial summary (MYR)	Jun-22	Jun-23	Jun-24F	Jun-25F	Jun-26F
EPS	1.61	1.86	1.97	2.08	2.17
Recurring EPS	1.61	1.86	1.97	2.08	2.17
DPS	0.55	0.59	0.62	0.65	0.68
BVPS	15.13	16.59	17.85	19.29	20.80

Valuation metrics	Jun-22	Jun-23	Jun-24F	Jun-25F	Jun-26F
Recurring P/E (x)	12.08	10.41	9.84	9.34	8.95
P/B (x)	1.3	1.2	1.1	1.0	0.9
Dividend Yield (%)	2.8	3.0	3.2	3.4	3.5

Income statement (MYRm)	Jun-22	Jun-23	Jun-24F	Jun-25F	Jun-26F
Interest income	7,327	9,708	10,983	11,428	11,888
Interest expense	(2,709)	(5,155)	(6,329)	(6,634)	(6,962)
Net interest income	**4,618**	**4,552**	**4,655**	**4,794**	**4,926**
Non interest income	979	1,133	1,224	1,323	1,407
Total operating income	**5,597**	**5,686**	**5,879**	**6,117**	**6,333**
Overheads	(2,098)	(2,233)	(2,325)	(2,417)	(2,511)
Pre-provision operating profit	**3,499**	**3,452**	**3,555**	**3,700**	**3,823**
Loan impairment allowances	(164)	(115)	(172)	(178)	(203)
Other impairment allowances	1	0	1	1	1
Income from associates	1,030	1,289	1,418	1,525	1,639
Pre-tax profit	**4,367**	**4,627**	**4,802**	**5,048**	**5,260**
Taxation	(1,078)	(808)	(761)	(793)	(815)
Reported net profit	**3,289**	**3,818**	**4,041**	**4,255**	**4,445**
Recurring net profit	**3,289**	**3,818**	**4,041**	**4,255**	**4,445**

Profitability ratios	Jun-22	Jun-23	Jun-24F	Jun-25F	Jun-26F
Return on average assets (%)	1.3	1.4	1.4	1.4	1.4
Return on average equity (%)	10.9	11.8	11.5	11.2	10.8
Return on IEAs (%)	3.1	3.9	4.1	4.1	4.1
Cost of funds (%)	1.3	2.3	2.6	2.6	2.7
Net interest spread (%)	1.8	1.6	1.5	1.5	1.4
Net interest margin (%)	2.0	1.8	1.7	1.7	1.7
Non-interest income / total income (%)	17.5	19.9	20.8	21.6	22.2
Cost to income ratio (%)	37.5	39.3	39.5	39.5	39.6
Credit cost (bps)	10.1	6.6	9.2	9.1	9.9

Balance sheet (MYRm)	Jun-22	Jun-23	Jun-24F	Jun-25F	Jun-26F
Total gross loans	168,224	181,662	190,305	199,820	208,812
Other interest earning assets	72,736	79,379	82,521	85,813	89,265
Total gross IEAs	240,960	261,041	272,825	285,633	298,076
Total provisions	(1,736)	(1,759)	(2,036)	(2,138)	(2,235)
Net loans to customers	166,488	179,903	188,268	197,682	206,576
Total net IEAs	239,224	259,282	270,789	283,495	295,841
Total non-IEAs	15,107	20,568	20,663	21,347	21,952
Total assets	254,331	279,850	291,452	304,842	317,793
Customer deposits	199,961	213,902	226,736	238,073	248,787
Other interest-bearing liabilities	13,753	23,398	19,815	19,228	18,665
Total IBLs	213,714	237,301	246,551	257,301	267,451
Total non-IBLs	9,629	8,563	8,333	8,007	7,695
Total liabilities	223,342	245,864	254,884	265,309	275,146
Share capital	2,168	2,168	2,168	2,168	2,168
Shareholders' equity	30,989	33,987	36,568	39,533	42,647

Asset quality and capital	Jun-22	Jun-23	Jun-24F	Jun-25F	Jun-26F
Reported NPLs / gross cust loans (%)	0.5	0.6	0.6	0.6	0.6
Total provisions / reported NPLs (%)	211.8	168.8	178.3	181.3	175.3
CET-1 ratio (%)	17.1	13.0	14.2	15.2	16.2
Tier-1 ratio (%)	18.2	14.1	15.2	16.2	17.2
Total capital ratio (%)	20.3	16.2	17.2	18.1	19.0

Source: Company data, RHB

Management guidance

Figure 1: Management guidance and financial targets

	FY23	1QFY24	FY24 targets	Comments
Reported ROE	11.8%	12.1%	c. 12%	
Gross loan growth	8%	7.2% YoY	6-7%	QoQ loan base is flat but loan growth target and drivers are unchanged, ie SMEs, commercial banking, retail, and overseas.
NIM	1.98%	1.84%	1.8-1.9%	Management expects the seasonal effect to impact funding cost, and has seen deposit rates rise by 10-15bps in Nov 2023 vs Oct 2023. That said, deposit pricing rationality is much better currently compared to a year ago. Also, with plans to further optimise its asset-liability management, management is hopeful of an upward NIM trajectory.
CIR	39.3%	39.9%	<40%	
GIL	0.57%	0.57%	<0.7%	Reaping the efforts of more stringent credit underwriting standards earlier.
Net credit cost	7bps	-11bps (annualised)	c. 10bps	Overlays unchanged at MYR574m.
CASA mix	30.8%	29.6%	>30%	

Source: Company data, RHB

Valuation and TP

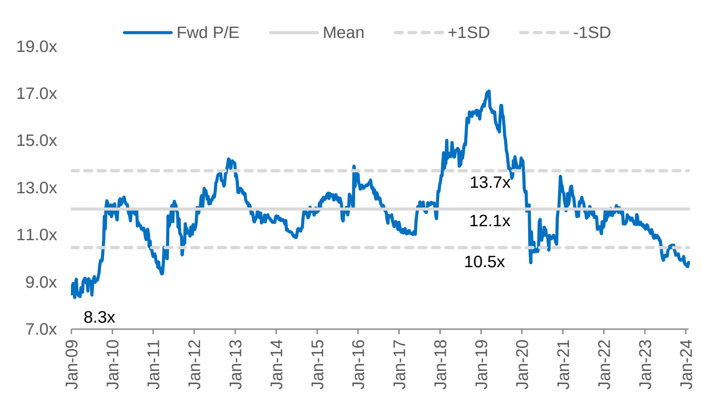
We make no change to our MYR23.20 TP, which is based on an intrinsic value of MYR23.21. The intrinsic value has been derived from our GGM-based fair P/BV of 1.25x – at a slight discount to the stock's historical mean of 1.44x, to reflect the macroeconomic headwinds China is going through. We applied a parity ESG premium or discount to the intrinsic value as HL Bank's ESG score of 3.0 is in line with the country median of 3.0.

Figure 2: HL Bank – GGM valuation with ESG overlay

Cost of equity (COE) computation:		Sustainable ROE (%)	11.0
Risk free rate (%)	4.0	COE (%)	9.5
Equity premium (%)	5.5	Long-term growth (g)	3.5
Beta (x)	1.0	Implied P/BV (x)	1.25
Cost of equity - CAPM (%)	9.5	BVPS – 12-month forward	MYR18.58
		Intrinsic value	MYR23.21
ESG premium/(discount) (%)	-	ESG premium/(discount)	-
		TP (rounded)	**MYR23.20**

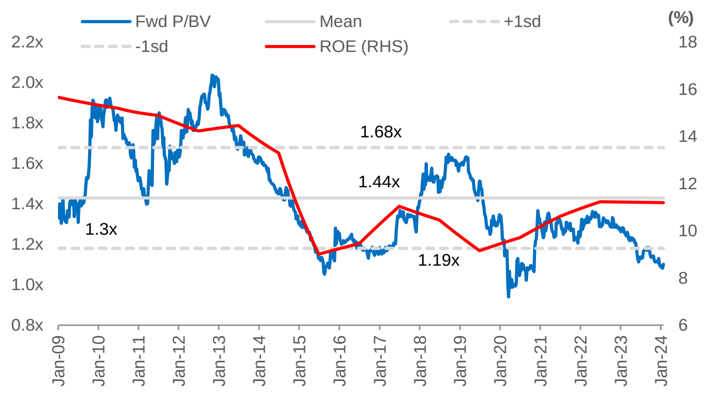
Source: Company data, RHB

Figure 3: HL Bank's 12-month forward consensus P/E



Source: Bloomberg, RHB

Figure 4: HL Bank's 12-month forward consensus P/BV



Source: Bloomberg, RHB

Emissions And ESG

Trend analysis

Hong Leong Bank's GHG emissions disclosures include emissions data from its Malaysia, Singapore and Hong Kong operations. In FY23 (Jun), the group recorded a 19% reduction in total emissions across the three markets.

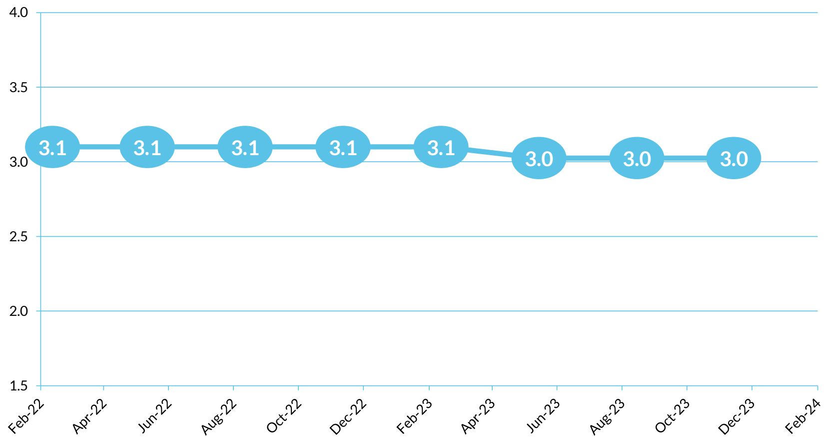
Emissions (tCO2e)	Jun-21	Jun-22	Jun-23
Scope 1	146	97	130
Scope 2	30,436	28,575	27,699
Scope 3	7,691	9,360	12,384
Total emissions	38,273	38,032	40,213

Source: Company data, RHB

Latest ESG-Related Developments

- **Launched e-payment programme in rural Selangor:** Hong Leong Bank recently launched the e-Duit Desa programme in Sabak Bernam, Selangor, providing residents with access to e-payments and other financial solutions as part of its financial inclusion agenda.
- **ESG awards:** Hong Leong Bank was recently awarded the Bank of the Year - ESG Leadership Award at the 2023 Sustainability & CSR Malaysia Awards ceremony, its first win in an ESG category.

ESG Rating History



Source: RHB

Recommendation Chart

Source: RHB, Bloomberg

Date	Recommendation	Target Price	Price
2023-12-01	Buy	23.2	19.1
2023-09-01	Buy	23.2	20.0
2023-05-31	Buy	22.6	19.4
2023-03-08	Buy	23.1	20.6
2022-11-30	Buy	24.6	20.9
2022-08-31	Buy	23.9	20.9
2022-05-30	Buy	23.7	21.1
2022-03-01	Buy	23.5	20.4
2021-11-30	Buy	23.1	18.1
2021-08-31	Buy	21.7	19.2
2021-05-27	Buy	22.5	18.3
2021-02-28	Buy	21.9	18.0
2020-12-16	Buy	21.9	18.7
2020-11-29	Buy	19.6	17.0
2020-11-16	Buy	19.6	17.1

Source: RHB, Bloomberg

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Trading Buy:	Share price may exceed 15% over the next 3 months, however longer-term outlook remains uncertain
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