11 May 2023

Financial Services | Banks

OCBC Bank (OCBC SP)

Buy (Maintained)

1Q23: Beat On Strong Non-II, Lower Provisions; BUY

Target Price (Return):	SGD14 (+14%)
Price (Market Cap):	SGD12.32 (USD41,773m)
ESG score:	3.10 (out of 4)
Avg Daily Turnover (SGD/USD)	64.0m/47.8m

- **Reiterate BUY, new SGD14 TP from SGD14.80, 14% upside with c.6% FY23F yield.** OCBC Bank's 1Q23 results are above expectations. Although loan growth guidance has been pared down – given the economic uncertainty – management was a bit more positive on NIM outlook. Upside risk to earnings would come from its wealth management business, which is seeing healthy net new money inflows, and a rebound in cross-border flows premised on China's reopening. Its current valuation of 1.0x P/BV, against an ROE of 12.5%, is compelling.
- **1Q23 beat expectations.** Net profit of SGD1.88bn in 1Q23 (+39% YoY; +44% QoQ) made up 27% and 28% of our and Street FY23F earnings. Reported ROE improved to 14.7% (4Q22: 10%). CET-1 was a solid 16.7% (15.1% after payment of FY22 final dividend). The positive variance was mainly due to the 257% QoQ jump in profit from its insurance and lower opex on the change in the classification of insurance claim expenses under Singapore Financial Reporting Standard (International) 17 (SFRS(I) 17). Against 4Q22, PIOP rose 23%, driven by 65% non-II growth and a 4% drop in opex. NII dipped 2% QoQ due to a shorter quarter. A 65% reduction in allowances led to the stronger bottomline growth.
- **Loan growth guidance lowered.** Reported loans were flat QoQ and YoY, but up 3% in constant currency (ccy) terms. Mortgages were up slightly, helped by a good pipeline built over the past year, but trade loans stayed weak as China had just reopened. Given the subdued economic outlook and new property cooling measures announced in late April, management revised its loan growth guidance to a low- to mid-single digit, from a mid-single digit.
- **NIM to be slightly higher at 2.2%.** In 1Q23, blended NIM was resilient at 2.30% (4Q22: 2.31%) even as higher asset yields was offset by the catch-up in funding cost. It also did not help that LDR was at a lower 79.2% (Dec 2022: 83.3%) as deposits grew at a faster pace of 5% QoQ. Although management sees limited room for loans to be repriced higher, a change in expectations on US rates has led to a revised NIM guidance of 2.2% (from 2.1%) for FY23F. OCBC had earlier expected interest rates to decline in the later part of 2023.
- **Credit cost guidance unchanged.** Non-performing assets (NPA) fell 5% QoQ on higher recoveries and upgrades, while new NPA formation stayed low. NPL ratio ticked down to 1.1% while NPA coverage rose 7-ppts to 121%. Loan credit cost was a lower 12bps vs 35bps in 4Q22 when OCBC took additional provisions for non-impaired assets. Although the bank is not seeing any sign of stress in its loan portfolio, its credit cost guidance remains at 15-20bps. Management prefers to be prudent, as the rise in interest rates could impact certain borrowers' ability to service their debts.
- **We raise FY23-24F net profit by 2-3%, mainly on revisions to NIM and opex.** Our TP falls to SGD14 (from SGD14.80) and with a 2% ESG premium applied, based on our in-house ESG methodology (Figure 4). With a greater focus on the E pillar due to climate change issues, we have tweaked our ESG weightage. For further details, see our research note titled *Envisioning a Better Future*.

Forecasts and Valuation	Dec-21	Dec-22	Dec-23F	Dec-24F	Dec-25F
Reported net profit (SGDm)	4,858	5,748	7,132	7,482	7,944
Net profit growth (%)	35.5	18.3	24.1	4.9	6.2
Recurring net profit (SGDm)	4,858	5,748	7,132	7,482	7,944
Recurring EPS (SGD)	1.09	1.28	1.59	1.67	1.78
BVPS (SGD)	11.72	11.83	12.64	13.49	14.38
DPS (SGD)	0.53	0.65	0.78	0.82	0.88
Recurring P/E (x)	11.35	9.59	7.73	7.37	6.94
P/B (x)	1.05	1.04	0.97	0.91	0.86
Dividend Yield (%)	4.3	5.3	6.3	6.7	7.1
Return on average equity (%)	9.5	10.7	12.5	13.1	13.9

Source: Company data, RHB

Analyst

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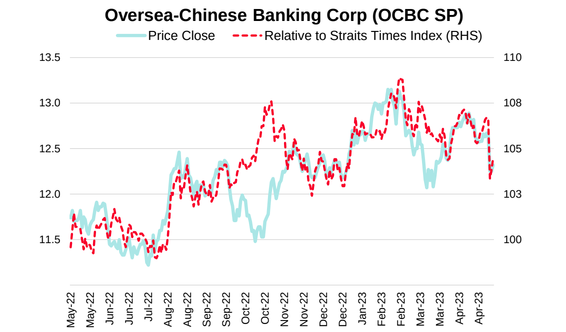
Share Performance (%)

	YTD	1m	3m	6m	12m
Absolute	1.1	(3.2)	(6.3)	0.7	4.9
Relative	1.4	(1.6)	(2.8)	(1.5)	4.6
52-wk Price low/high (SGD)					11.2 – 13.2



Source: Bloomberg

Overall ESG Score: 3.10 (out of 4)

E: GOOD

OCBC has a responsible lending framework, and is working towards enhancing the integration of climate-related considerations into its ESG Risk Assessment processes by 2022. In 2020, it developed a new responsible investing policy to integrate ESG considerations into investment decisions. It aims to build a sustainable finance portfolio of SGD50bn by 2025 (2021: SGD34bn), and achieve carbon-neutrality in its banking operations in 2022.

S: GOOD

OCBC aims to maintain a balanced gender mix across its workforce, with 42% of women in leadership positions by 2022. In 2021, women accounted for 58% of total employees, 39% in leadership positions, and 20% in the board of directors. It is active in talent management, and places the health, safety and wellbeing of staff at the top of its priorities as an employer.

G: EXCELLENT

OCBC is proactive in its approach to ensure resilience against risks of cyber-attacks, data breaches, fraud and money laundering. That said, a highly sophisticated phishing scam in Dec 2021 has highlighted the need for enhanced security measures.

Financial Exhibits

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Buy

Valuation basis

GGM-derived intrinsic value with an ESG overlay. Key GGM assumptions are:
i. COE of 12%;
ii. ROE of 12.5%;
iii. 3.0% long-term growth

Key drivers

Our net profit forecast is most sensitive to changes in:
i. Credit costs;
ii. Net interest margin;
iii. Non-interest income growth.

Key risks

Key risks include:
i. Higher-than-expected allowances;
ii. Weaker-than-expected NIM;
iii. Macroeconomic uncertainty and geopolitical tensions.

Company Profile

OCBC is the second largest banking group in Singapore by asset size. It also has sizeable operations in Malaysia, Greater China and Indonesia.

Financial summary (SGD)	Dec-21	Dec-22	Dec-23F	Dec-24F	Dec-25F
EPS	1.09	1.28	1.59	1.67	1.78
Recurring EPS	1.09	1.28	1.59	1.67	1.78
DPS	0.53	0.65	0.78	0.82	0.88
BVPS	11.72	11.83	12.64	13.49	14.38

Valuation metrics	Dec-21	Dec-22	Dec-23F	Dec-24F	Dec-25F
Recurring P/E (x)	11.35	9.59	7.73	7.37	6.94
P/B (x)	1.1	1.0	1.0	0.9	0.9
Dividend Yield (%)	4.3	5.3	6.3	6.7	7.1

Income statement (SGDm)	Dec-21	Dec-22	Dec-23F	Dec-24F	Dec-25F
Interest income	7,425	11,590	14,893	15,640	16,501
Interest expense	(1,570)	(3,902)	(5,667)	(6,022)	(6,400)
Net interest income	**5,855**	**7,688**	**9,226**	**9,618**	**10,101**
Non interest income	4,741	3,987	3,948	4,197	4,504
Total operating income	**10,596**	**11,675**	**13,174**	**13,815**	**14,605**
Overheads	(4,867)	(5,130)	(5,241)	(5,553)	(5,846)
Pre-provision operating profit	**5,729**	**6,545**	**7,933**	**8,263**	**8,759**
Loan impairment allowances	(867)	(505)	(500)	(495)	(491)
Other impairment allowances	(6)	(79)	(7)	(6)	(6)
Income from associates	824	978	1,027	1,089	1,143
Pre-tax profit	**5,680**	**6,939**	**8,453**	**8,850**	**9,405**
Taxation	(648)	(1,057)	(1,141)	(1,168)	(1,251)
Minority interests	(174)	(134)	(180)	(200)	(210)
Reported net profit	**4,858**	**5,748**	**7,132**	**7,482**	**7,944**
Recurring net profit	**4,858**	**5,748**	**7,132**	**7,482**	**7,944**

Profitability ratios	Dec-21	Dec-22	Dec-23F	Dec-24F	Dec-25F
Return on average assets (%)	0.9	1.1	1.2	1.3	1.4
Return on average equity (%)	9.5	10.7	12.5	13.1	13.9
Return on IEAs (%)	2.1	3.1	3.8	4.0	4.2
Cost of funds (%)	0.5	1.1	1.6	1.7	1.8
Net interest spread (%)	1.6	1.9	2.2	2.3	2.4
Net interest margin (%)	1.6	2.0	2.3	2.4	2.6
Non-interest income / total income (%)	44.7	34.1	30.0	30.4	30.8
Cost to income ratio (%)	45.9	43.9	39.8	40.2	40.0
Credit cost (bps)	31.5	17.3	16.2	16.1	15.9

Balance sheet (SGDm)	Dec-21	Dec-22	Dec-23F	Dec-24F	Dec-25F
Total gross loans	289,716	294,980	303,829	319,021	334,174
Other interest earning assets	87,217	101,064	105,405	110,631	116,532
Total gross IEAs	376,933	396,044	409,235	429,652	450,707
Total provisions	(3,904)	(3,991)	(4,250)	(4,380)	(4,400)
Net loans to customers	285,812	290,989	299,579	314,641	329,774
Total net IEAs	373,029	392,053	404,985	425,272	446,307
Total non-IEAs	169,158	167,903	182,106	189,341	201,240
Total assets	542,187	559,956	587,090	614,612	647,546
Customer deposits	342,395	350,081	371,086	389,640	411,070
Other interest-bearing liabilities	8,239	10,046	8,840	9,106	9,470
Total IBLs	350,634	360,127	379,926	398,746	420,540
Total non-IBLs	137,215	145,161	148,813	153,656	160,740
Total liabilities	487,849	505,288	528,740	552,402	581,281
Share capital	19,238	19,744	19,744	19,744	19,744
Shareholders' equity	52,663	53,087	56,719	60,522	64,518
Minority interests	1,675	1,581	1,632	1,689	1,748

Asset quality and capital	Dec-21	Dec-22	Dec-23F	Dec-24F	Dec-25F
Reported NPLs / gross cust loans (%)	1.5	1.1	1.1	1.1	1.1
Total provisions / reported NPLs (%)	92.6	118.0	123.8	122.6	118.6
CET-1 ratio (%)	16.0	16.0	15.5	16.1	0.0
Tier-1 ratio (%)	16.0	16.0	15.5	16.1	0.0
Total capital ratio (%)	17.6	17.6	16.9	17.4	0.0

Source: Company data, RHB

Results At a Glance

Figure 1: OCBC – summary of 1Q23 results

FYE Dec (SGDm)	1Q22	4Q22	1Q23	*QoQ (%)*	*YoY (%)*	Comments: 1Q23 vs 1Q22
Net interest income	1,503	2,386	2,338	*-2*	*56*	Robust YoY growth driven by strong NIM expansion and 5% growth in average assets.
NIM (%) – reported	*1.55%*	*2.31%*	*2.30%*	*-1bps*	*75bps*	NIM boosted by rapid increases in interest rates in 2H22.
Non-interest income	1,140	615	1,012	*65*	*-11*	
Net fee & commission income	522	399	453	*14*	*-13*	Down YoY, mainly on the 26% decline in wealth management income, which accounted for 42% of net fee income (1Q22: 49%). Loans and trade-related fees were up a modest 4%.
Income from insurance	330	66	238	*261*	*-28*	Lower YoY mainly due to the group's insurance results being reported based on SFRS(I) 17 with effect from 1 Jan 2023. Softer single premium sales from Singapore saw its total weighted new sales decline 22% YoY while new business embedded value was 11% lower.
Other non-interest income	288	150	321	*114*	*11*	Lifted by non-customer flow treasury income.
Non-II/total income (%)	*43.1%*	*20.5%*	*30.2%*			
Operating income	**2,643**	**3,001**	**3,350**	***12***	***27***	
Overhead expenses	(1,205)	(1,299)	(1,244)	*-4*	*3*	The 7% YoY rise in staff cost was partly offset by a deduction in insurance-related expenses against insurance revenue following the adoption in SFRS(I) 17.
CIR (%)	*45.6%*	*43.3%*	*37.1%*			
PIOP	**1,438**	**1,702**	**2,106**	***24***	***46***	
Impairments charges	(69)	(340)	(135)	*-60*	*96*	
Annualised credit cost (bps)	*6*	*35*	*12*			Loan credit cost is within management's guidance of 15-20 bps.
Operating profit	**1,369**	**1,362**	**1,971**	***45***	***44***	
Associates	254.0	223.0	260.0	*17*		
Pre-tax profit	**1,623**	**1,585**	**2,231**	***41***	***37***	
Tax	(226)	(254)	(300)			
Effective tax rate (%)	*13.9%*	*16.0%*	*13.4%*			
Minorities	(42)	(26)	(53)	*106*	*27*	
Net profit	**1,356**	**1,306**	**1,879**	***44***	***39***	
Other key data and ratios						
Gross loans	294,000	294,980	294,000	*0*	*0*	Loans grew 3% YoY in ccy terms, below management's guidance of mid single-digit growth. Growth was moderated by weakness in trade loans as China had just reopened.
Customer deposits	348,265	350,081	366,850	*5*	*5*	Growth driven by 61% YoY jump in fixed deposits as customers shift out of CASA to higher yielding fixed deposits, as well as new money inflows. CASA deposits fell by 21%, lowering CASA ratio to 47.1%.
Gross NPLs	4,189	3,383	3,234	*-4*	*-23*	Down QoQ largely due to the 60% drop in new NPA formation.
Total assets	552,787	559,956	565,808	*1*	*2*	
Shareholders' funds	53,094	53,087	53,727	*1*	*1*	
ROAA (%) - reported	1.23	1.11	1.63			
ROAE (%) - reported	10.6	10.0	14.7			
LDR (%)	83.3	83.3	79.2			
GIL ratio	1.46	1.15	1.13			
Loan loss coverage	90.7	118.0	121.3			
CET-1 ratio (%)	15.20	15.50	15.90			
Total capital ratio (%)	17.2	17.6	18.4			

Source: Company data, RHB

Management guidance

Figure 2: OCBC – management guidance and financial targets

	FY22 Achieved	1Q23 Achieved	FY23 Guidance	Comments
Loan growth	+2% YoY (+4.5% ccy)	Flat YoY (+3% ccy)	Low to mid single-digit (from mid single digit)	Guidance is lower, as loan demand may be impacted by concerns over growth, China's slow recovery and further property cooling measures announced in late April.
NIM	1.91%	2.30%	2.2% (from 2.1%)	Management sees limited room for loans to be repriced higher. Still, a change in view on US interest rates (no rate cut in 2023 vs expectations of rate cuts) has led a slight revision in its NIM guidance.
Loan credit cost	16bps	12bps	15-20 bps	Management expects credit cost to remain stable, as asset quality is holding up while LLC is at a very comfortable 121%.

Source: Company data, RHB

Revisions to earnings estimates

We raise FY23-24F earnings by 2-3% as we pencilled in the following revisions:

i. Slightly higher NIM on revised management guidance;
ii. Lower non-II and opex arising from adoption of SRFS(I) 17.

We also raise our DPS estimate to 78 cents (from 76 cents) for FY23, as we adjusted our assumption of the payout ratio to 49% from 47%.

Figure 3: OCBC – revisions to forecasts

FYE Dec	Previous FY23F	Previous FY24F	New FY25F	Revised FY23F	Revised FY24F	New FY25F	*Change FY23F*	*Change FY24F*	*Change FY25F*
(SGDm)									
Net interest income	9,099	9,606	10,131	9,226	9,618	10,101	*1%*	*0%*	*0%*
Non-interest income	4,339	4,715	5,089	3,948	4,197	4,504	*-9%*	*-11%*	*-11%*
Operating expenses	(5,665)	(6,118)	(6,480)	(5,136)	(5,448)	(5,741)	*-9%*	*-11%*	*-11%*
PIOP	7,772	8,203	8,739	8,038	8,368	8,864	*3%*	*2%*	*1%*
Provision expenses	(612)	(606)	(602)	(612)	(606)	(602)	*0%*	*0%*	*0%*
Pretax profit	8,197	8,687	9,288	8,453	8,850	9,405	*3%*	*2%*	*1%*
Net profit	**6,921**	**7,363**	**7,830**	**7,132**	**7,482**	**7,944**	*3%*	*2%*	*1%*
EPS (SGD)	1.53	1.63	1.73	1.58	1.66	1.76	*3%*	*2%*	*1%*
DPS (SGD)	0.76	0.82	0.88	0.78	0.82	0.88	*3%*	*0%*	*0%*
Loan growth (%)	5.0	5.5	5.0	3.0	5.0	4.8			
NIM (%)	2.24	2.25	2.26	2.29	2.29	2.29			
CIR (%)	42.2	42.7	42.6	39.0	39.4	39.3			
Credit cost (bps)	17	16	15	17	16	15			

Source: Company data, RHB

Valuation and TP

Our TP drops to SGD14 from SGD14.80, as we raise the equity risk premium, given the uncertain economic outlook. Our intrinsic value, based on a GGM-derived P/BV of 1.05x (from 1.14x), also decreases to SGD13.70 from SGD14.55. Our TP includes a 2% ESG premium applied, based on RHB's in-house ESG methodology.

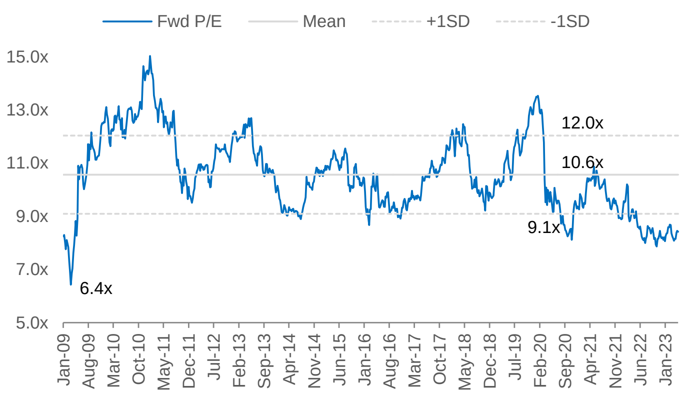
ESG framework update. As there is now greater focus on the E pillar due to critical climate change issues, we have tweaked our ESG weightage. Henceforth, we assign a weightage of 50% to the E pillar, followed by 25% each to the S and G pillars. Further details are in our 2 May thematic research note titled *Envisioning a Better Future*.

Figure 4: OCBC – GGM valuation

Cost of equity (COE) computation:		Sustainable ROE (%)	12.50
Risk free rate (%)	3.00	COE (%)	12.0
Equity premium (%)	8.20	Long-term growth (g)	3.00
Beta (x)	1.10	Implied P/BV (x)	1.05
Cost of equity - CAPM (%)	12.0	Rolling 12-mth forward BVPS	SGD13.00
		Intrinsic value	SGD13.70
ESG premium/(discount) (%)	2.0	ESG premium/(discount)	SGD0.27
		TP (rounded)	**SGD14.00**

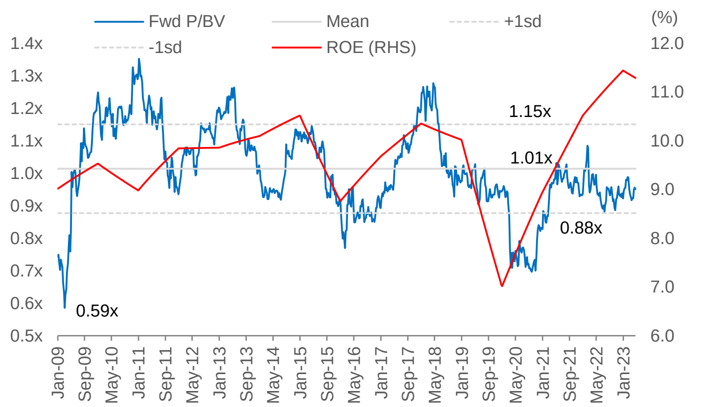
Source: Company data, RHB

Figure 5: OCBC's 12-month forward consensus P/E



Source: Bloomberg, RHB

Figure 6: OCBC's 12-month forward consensus P/BV



Source: Bloomberg, RHB

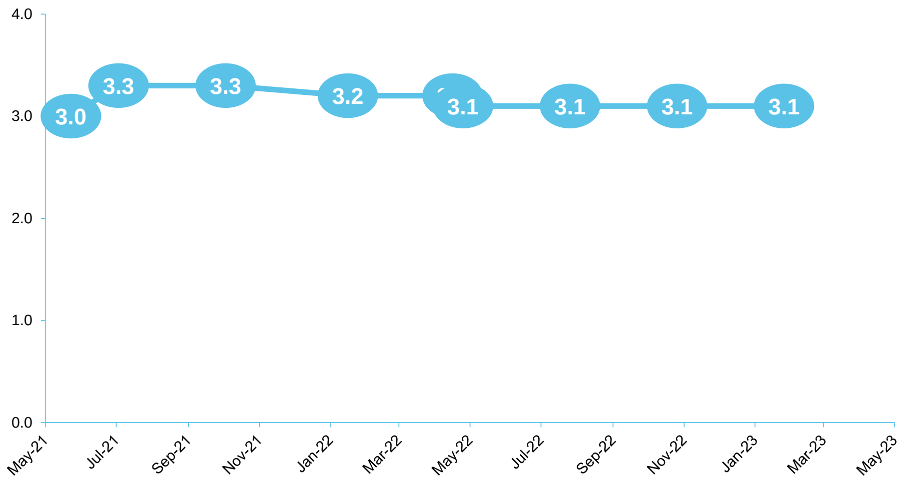
Recommendation Chart

Source: RHB, Bloomberg

Date	Recommendation	Target Price	Price
2023-02-26	Buy	14.8	12.7
2022-11-07	Buy	15.0	12.1
2022-08-03	Buy	13.9	12.0
2022-05-03	Buy	13.9	12.4
2022-02-24	Buy	14.4	12.0
2022-01-24	Buy	14.8	12.3
2021-11-04	Buy	15.1	11.9
2021-08-05	Buy	14.3	12.4
2021-05-09	Buy	14.3	12.6
2021-04-09	Buy	13.3	11.8
2021-02-25	Buy	12.5	11.1
2020-11-06	Neutral	9.5	8.9
2020-08-10	Neutral	8.7	8.7
2020-05-08	Neutral	8.7	8.9
2020-04-22	Neutral	9.0	8.6

Source: RHB, Bloomberg

ESG Rating History



Source: RHB

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Buy:	Share price may exceed 10% over the next 12 months
Trading Buy:	Share price may exceed 15% over the next 3 months, however longer-term outlook remains uncertain
Neutral:	Share price may fall within the range of +/- 10% over the next 12 months
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Sell:	Share price may fall by more than 10% over the next 12 months
Not Rated:	Stock is not within regular research coverage

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