

1 March 2022

Financial Services | Banks

Hong Leong Bank (HLBK MK)

Buy (Maintained)

FY22 Targets Are Higher Now; Keep BUY

Target Price (Return): MYR23.50 (+17%)
 Price (Market Cap): MYR20.06 (USD10,355m)
 ESG score: 3.10 (out of 4)
 Avg Daily Turnover (MYR/USD) 20.2m/4.82m

- **Stay BUY, new MYR23.50 TP from MYR23.10, 17% upside with c.3% yield.** 1HFY22 (Jun) results are above expectations, driven by lower-than-expected credit costs. Business momentum gained pace in 2QFY22, although the sharp fall in trading gains was a dampener. This, coupled with its resilient asset quality, has led to positive revisions of FY22 targets. We continue to like Hong Leong Bank for its solid fundamentals, above-average loan growth, and its digital initiatives.
- **1HFY22 results above expectations.** 2QFY22 net profit of MYR739m (-14% QoQ) took 1HFY22 earnings to MYR1,597m, at 54% and 53% of our and consensus FY22 forecasts. The positive variance was mainly due to yet another quarter of lower-than-expected provisions. Reported ROAE was 10.7%, slight ahead of management's >10% target. CET-1 ratio is a healthy 13.1%. An interim DPS of 18 sen is declared (1HFY21: 14.78 sen).
- **Key trends in 2QFY22.** Net profit was impacted by the 25% QoQ drop in non-II and *Cukai Makmur* (one-time prosperity tax levied). PIOP was down 2% QoQ. NII grew by a healthy 5% QoQ, as NIM rebounded by 6bps QoQ to 2.19% on the absence of modification loss from loan moratorium and loans (+2.7% YTD). Non-II fell 25% QoQ as gains from trading & investments plunged 97% to MYR4m, negating the 3% rise in core fees. Opex growth remained well-controlled, up 1% QoQ. Loan allowances fell 32% QoQ, with credit cost at a lower 8bps in 2QFY22 (1QFY22: 13bps), helped by its resilient asset quality.
- **Asset quality.** In 2QFY22, GILs declined 3% QoQ, GIL ratio was stable at 0.46% and the LLC ratio was at a higher 251% (1QFY22: 239%). Loans under repayment assistance (LURA) have declined to MYR9.7bn or 6.1% of gross loans as at end-Feb 2022 (end-FY21: MYR33.5bn or 22.4% of loans) on the progressive expiry of relief assistance since Dec 2021. Like its peers, the bank has received very few sign-ups for the Financial Management & Resilience Programme (URUS).
- **FY22 targets raised.** With 1HFY22 numbers tracking ahead of guidance and the 2HFY22 operating environment expected to stay positive, management raised several of its FY22 targets. The pick-up in loan demand in 2QFY22 is expected to be sustained in the quarters ahead, resulting in a higher FY22 loan growth target of 6-7%, from 5-6%. NIM guidance is now at >2.1%, vs >2.05% previously – still pointing to margin pressure in 2HFY22 due to deposit competition and moderating growth in CASA deposits. Given the resilience in asset quality and the meaningful decline in LURA, management cut its loan credit cost guidance to c.10bps (from c.20bps). After several quarters of decline, it believes CIR will likely stabilise at c.37%, as there are plans to reinvest for growth. Overall, the favourable revisions should support a slightly higher ROE target of ≥10.5% (from >10%).
- **Earnings and TP.** We raise FY22F net profit by 4% after factoring in a lower credit cost of 11bps (from 20bps). Our new TP of MYR23.50 (from MYR23.10) is based on an intrinsic value of MYR23.50 (based on a GGM-derived 1.45x P/BV) with a 2% ESG premium applied, based on our in-house methodology.

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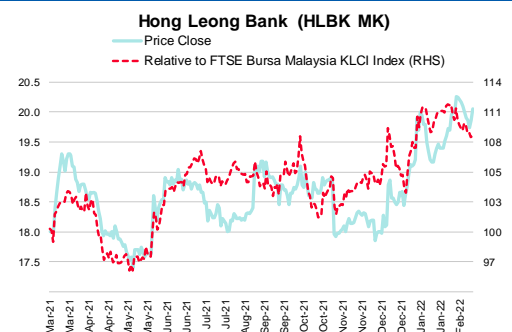


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Share Performance (%)

	YTD	1m	3m	6m	12m
Absolute	7.7	3.1	9.6	5.6	11.4
Relative	5.1	(2.7)	3.2	4.5	9.5
52-wk Price low/high (MYR)				17.4 – 20.3	



Source: Bloomberg

Overall ESG Score: 3.10 (out of 4)

E: GOOD

HL Bank reported a decrease in total greenhouse gas emissions of 800 tCO₂e in FY20. Being a retail-focused bank, lending exposures to the commodities and oil & gas sectors are insignificant. Still, management has embedded a sustainability framework in assessing the bank's asset risk, with a scoring system in line with Bank Negara Malaysia's CCPT requirements.

S: GOOD

Embraces gender diversity, with 39% of women in senior management and 37.5% of women in the Board of Directors. In FY20, the staff attrition rate was reduced by 26%. Actively assists customers in financial difficulties.

G: EXCELLENT

Has not had any material data security or privacy issues over the past few years. The Board of Directors comprises one Executive Director and seven Non-Executive Directors, of which five are Independent Non-Executive Directors.

Forecasts and Valuation	Jun-20	Jun-21	Jun-22F	Jun-23F	Jun-24F
Reported net profit (MYRm)	2,495	2,861	3,063	3,547	3,783
Net profit growth (%)	(6.4)	14.7	7.1	15.8	6.6
Recurring net profit (MYRm)	2,495	2,861	3,063	3,547	3,783
Recurring EPS (MYR)	1.22	1.40	1.50	1.73	1.85
BVPS (MYR)	13.31	14.40	15.08	16.26	17.50
DPS (MYR)	0.36	0.50	0.55	0.60	0.65
Recurring P/E (x)	16.46	14.35	13.41	11.58	10.86
P/B (x)	1.51	1.39	1.33	1.23	1.15
Dividend Yield (%)	1.8	2.5	2.7	3.0	3.2
Return on average equity (%)	9.5	10.1	10.2	11.1	10.9

Source: Company data, RHB

Financial Exhibits

Asia	Financial summary (MYR)	Jun-20	Jun-21	Jun-22F	Jun-23F	Jun-24F
Malaysia	EPS	1.22	1.40	1.50	1.73	1.85
Financial Services	Recurring EPS	1.22	1.40	1.50	1.73	1.85
Hong Leong Bank	DPS	0.36	0.50	0.55	0.60	0.65
HLBK MK	BVPS	13.31	14.40	15.08	16.26	17.50
Buy						
Valuation basis	Valuation metrics	Jun-20	Jun-21	Jun-22F	Jun-23F	Jun-24F
GGM derived intrinsic value with an ESG overlay. Key GGM assumptions are:	Recurring P/E (x)	16.46	14.35	13.41	11.58	10.86
i. Cost of equity of 7.9%;	P/B (x)	1.5	1.4	1.3	1.2	1.1
ii. ROE of 10.5%;	Dividend Yield (%)	1.8	2.5	2.7	3.0	3.2
iii. Long-term growth of 3.0%.						
Key drivers	Income statement (MYRm)	Jun-20	Jun-21	Jun-22F	Jun-23F	Jun-24F
Our earnings forecasts are most sensitive to changes in:	Interest income	7,775	7,116	7,323	8,256	9,238
i. Net interest margin;	Interest expense	(4,370)	(2,806)	(2,888)	(3,582)	(4,311)
ii. Loan impairment allowances;	Net interest income	3,406	4,310	4,435	4,674	4,927
iii. Contributions from associates.	Non interest income	1,373	1,157	1,026	1,020	1,083
	Total operating income	4,778	5,467	5,461	5,694	6,010
	Overheads	(2,104)	(2,078)	(2,139)	(2,216)	(2,298)
	Pre-provision operating profit	2,675	3,389	3,322	3,478	3,712
	Loan impairment allowances	(328)	(654)	(169)	(175)	(172)
	Other impairment allowances	0	(0)	-	-	-
	Income from associates	642	736	854	905	950
	Pre-tax profit	2,989	3,471	4,006	4,208	4,491
	Taxation	(495)	(610)	(943)	(661)	(708)
	Reported net profit	2,495	2,861	3,063	3,547	3,783
	Recurring net profit	2,495	2,861	3,063	3,547	3,783
Key risks	Profitability ratios	Jun-20	Jun-21	Jun-22F	Jun-23F	Jun-24F
The downside risks include:	Return on average assets (%)	1.2	1.2	1.3	1.4	1.4
i. Weaker-than-expected loan growth;	Return on average equity (%)	9.5	10.1	10.2	11.1	10.9
ii. Softer-than-expected NIMs;	Return on IEAs (%)	3.8	3.3	3.2	3.4	3.6
iii. Lower-than-expected non-interest income;	Cost of funds (%)	2.4	1.5	1.4	1.7	1.9
iv. Lower-than-expected profits from Bank of Chengdu.	Net interest spread (%)	1.4	1.8	1.8	1.7	1.7
	Net interest margin (%)	1.7	2.0	1.9	1.9	1.9
	Non-interest income / total income (%)	28.7	21.2	18.8	17.9	18.0
	Cost to income ratio (%)	44.0	38.0	39.2	38.9	38.2
	Credit cost (bps)	23.1	43.3	10.5	10.3	9.6
Company Profile	Balance sheet (MYRm)	Jun-20	Jun-21	Jun-22F	Jun-23F	Jun-24F
Hong Leong Bank provides conventional and Islamic banking services. The group's operations span across Malaysia, Singapore, Hong Kong, Vietnam, Cambodia and China, via its strategic shareholding in Bank of Chengdu.	Total gross loans	145,954	155,840	165,969	175,098	183,853
	Other interest earning assets	65,068	70,284	72,075	74,829	77,714
	Total gross IEAs	211,022	226,124	238,044	249,927	261,566
	Total provisions	(1,259)	(1,769)	(1,909)	(1,996)	(2,096)
	Net loans to customers	144,695	154,071	164,061	173,102	181,757
	Total net IEAs	209,763	224,355	236,135	247,931	259,470
	Total non-IEAs	11,515	12,774	13,333	14,176	13,928
	Total assets	221,278	237,129	249,468	262,107	273,398
	Customer deposits	173,849	184,435	196,423	207,226	216,552
	Other interest-bearing liabilities	12,068	15,371	14,894	14,591	14,296
	Total IBLs	185,917	199,806	211,317	221,817	230,848
	Total non-IBLs	8,127	7,864	7,296	7,012	6,738
	Total liabilities	194,044	207,670	218,614	228,829	237,586
	Share capital	7,739	7,739	7,739	7,739	7,739
	Shareholders' equity	27,234	29,459	30,855	33,278	35,812
	Asset quality and capital	Jun-20	Jun-21	Jun-22F	Jun-23F	Jun-24F
	Reported NPLs / gross cust loans (%)	0.6	0.5	0.5	0.5	0.5
	Total provisions / reported NPLs (%)	141.5	246.6	238.0	225.5	211.5
	CET-1 ratio (%)	12.8	12.2	12.6	13.0	13.7
	Tier-1 ratio (%)	13.4	12.8	13.1	13.5	14.2
	Total capital ratio (%)	15.6	14.9	15.2	15.4	16.0

Source: Company data, RHB

Results At a Glance

Figure 1: HL Bank's 2QFY22 and 1HFY22 results summary

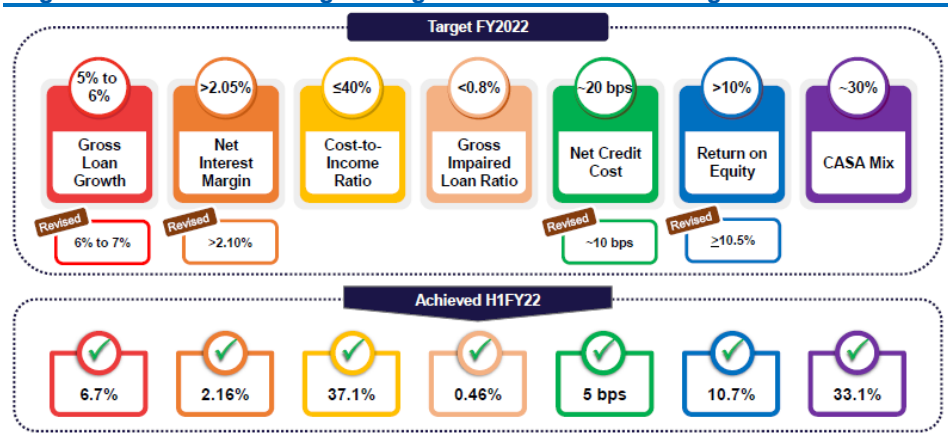
FYE Jun (MYRm)	2Q FY21	1Q FY22	2Q FY22	QoQ (%)	YoY (%)	1H FY21	1H FY22	YoY (%)	Comments – 1HFY22 vs 1HFY20
NII (+Islamic banking)	1,083	1,121	1,176	4.9	8.6	2,074	2,297	10.7	Healthy YoY growth underpinned by NIM expansion and 2.7% YTD loan growth.
NIM (%) - reported	2.15	2.13	2.19	6.0	4.0	2.08	2.16	8.0	Up 8bps YoY mainly due to improved funding cost on deposits optimisation.
Non-II	317	259	195	-24.7	-38.5	675	454	-32.6	Down YoY due to 64% YoY decline in trading and investment gains. Core fees grew 5% YoY with wealth management income up a healthy 26% YoY.
Non-II/total income (%)	22.7	18.8	14.2			24.5	16.5		
Operating income	1,400	1,380	1,371	-0.6	-2.1	2,749	2,751	0.1	
Overhead expenses	(512)	(507)	(513)	1.1	0.2	(1,033)	(1,020)	-1.2	Continued to reap benefits from digitalisation efforts and strategic cost management initiatives.
CIR (%)	36.5	36.8	37.4			37.6	37.1		
PIOP	888	873	858	-1.7	-3.4	1,716	1,731	0.9	
Impairments on financial assets	0	0	0	>100	>100	(0)	1	>100	
Impairments losses on loans	(241)	(49)	(33)	-31.8	-86.2	(345)	(82)	-76.2	Down YoY given resilient asset quality and strong build up of pre-emptive provision buffers in FY21.
Annualised credit cost (bps)	65	13	8			48	11		
Operating profit	648	824	825	0.2	27.5	1,371	1,649	20.3	
Associates	168	218	251	15.2	49.8	335	469	40.1	Bank of Chengdu contributed profits of MYR462m (+40% YoY), which is 21.9% of group pretax profits.
Pre-tax profit	815	1,042	1,077	3.3	32.0	1,706	2,119	24.2	
Tax	(145)	(184)	(338)			(306)	(522)		
Effective tax rate (%)	17.7	17.6	31.4			17.9	24.6		
Net profit	671	858	739	-13.9	10.1	1,400	1,597	14.1	
Other key data and ratios									
Gross loans	149,994	155,779	160,063	2.7	6.7				Up 2.7% YTD or an annualised 5.4%. Growth was driven by residential mortgages (+3.1% YTD), non-residential property loans (+4.1% YTD) and construction loans (+15.9% YTD).
Customer deposits	176,488	184,424	189,591	2.8	7.4				CASA deposits rose 5.2% YTD or an annualised 10.5%. CASA ratio rose to 33% (Jun 2021: 32.6%).
Gross impaired loans	807	755	732	-3.1	-9.3				Down 3% QoQ (+2% YTD) on higher recoveries and write-offs.
Total assets	228,423	242,355	244,806	1.0	7.2				
Shareholders' funds	28,262	29,434	30,066	2.1	6.4				
ROAA (%)	1.18	1.43	1.21			1.24	1.33		
ROAE (%)	9.5	11.7	9.9			10.1	10.7		Ahead of its FY22 target of >10%.
LDR (%)	84.1	83.5	83.5						
GIL ratio (%)	0.54	0.48	0.46						
Loan loss coverage (%)	192.7	238.5	250.6						

Source: Company data, RHB

Management guidance

With 1HFY22 results still tracking ahead of guidance, management has revised its projections on loan growth, NIM and credit costs. The favourable revisions would cumulatively translate to a slight higher ROE target of $\geq 10.5\%$ (from $>10\%$).

Figure 2: HL Bank – management guidance and financial targets



Source: Company, RHB

Revisions to earnings forecasts

We increase FY22F net profit by 4%, as we lowered our credit cost assumption to 11bps from 20bps. FY23F-24F earnings are relatively unchanged, given the very small adjustments in credit costs estimates.

Figure 3: HL Bank – revisions to earnings forecasts

	Previous FY22F	Previous FY23F	Previous FY24F	Revised FY22F	Revised FY23F	Revised FY24F	% Change FY22F	% Change FY23F	% Change FY24F
FYE Jun (MYRm)									
NII	4,419	4,639	4,888	4,435	4,674	4,927	0.4%	0.8%	0.8%
Non-II	1,026	1,020	1,083	1,026	1,020	1,083	0.0%	0.0%	0.0%
Opex	(2,139)	(2,216)	(2,298)	(2,139)	(2,216)	(2,298)	0.0%	0.0%	0.0%
PIOP	3,306	3,443	3,673	3,322	3,478	3,712	0.5%	1.0%	1.1%
Impairment charges	(320)	(182)	(204)	(169)	(175)	(172)	-47.1%	-3.9%	-15.7%
Pre-tax profit	3,840	4,166	4,420	4,006	4,208	4,491	4.3%	1.0%	1.6%
Net profit	2,943	3,514	3,726	3,063	3,547	3,783	4.1%	1.0%	1.5%
EPS (MYR)	1.44	1.72	1.82	1.50	1.73	1.85			
DPS (MYR)	0.53	0.60	0.64	0.55	0.60	0.65			
Loan growth (%)	5.5	5.5	5.0	6.5	5.5	5.0			
NIM (%)	1.93	1.93	1.94	1.93	1.93	1.94			
CIR (%)	39.3	39.2	38.5	39.2	38.9	38.2			
Credit cost (bps)	20	11	11	11	10	10			

Source: Company data, RHB

Valuation and TP

We lift our TP to MYR23.50 (from MYR23.10), based on an intrinsic value of MYR23.02 (revised from MYR22.68) with a 2% ESG premium applied. The latter is based on RHB's in-house ESG methodology. The intrinsic value has been upgraded, as we raised our long term growth assumption to 3.5% from 2.0%. The GGM-derived P/BV of 1.45x (unchanged) is at the historical mean.

Figure 4: HL Bank – GGM valuation with ESG overlay

Cost of equity (COE) computation:		Sustainable ROE (%)	10.72
Risk free rate (%)	3.70	COE (%)	8.49
Equity premium (%)	4.65	Long-term growth (g)	3.5
Beta (x)	1.03	Implied P/BV (x)	1.45
Cost of equity - CAPM (%)	8.49	BVPS – FY20F-21F average	MYR15.90
		Intrinsic value	MYR23.02
ESG premium/(discount) (%)	2.00	ESG premium/(discount)	MYR0.46
		TP (rounded)	MYR23.50

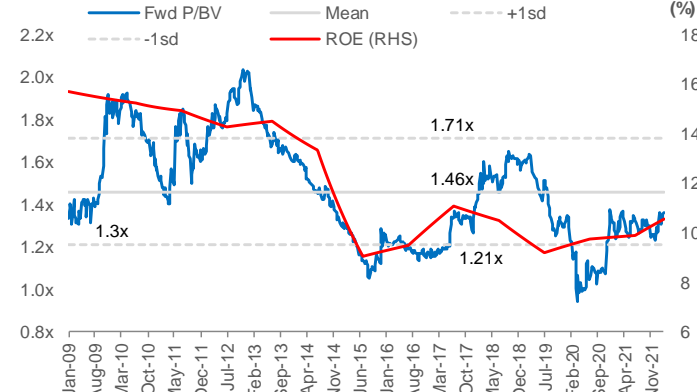
Source: Company data, RHB

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



Source: Bloomberg, RHB

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



Source: Bloomberg, RHB

Recommendation Chart

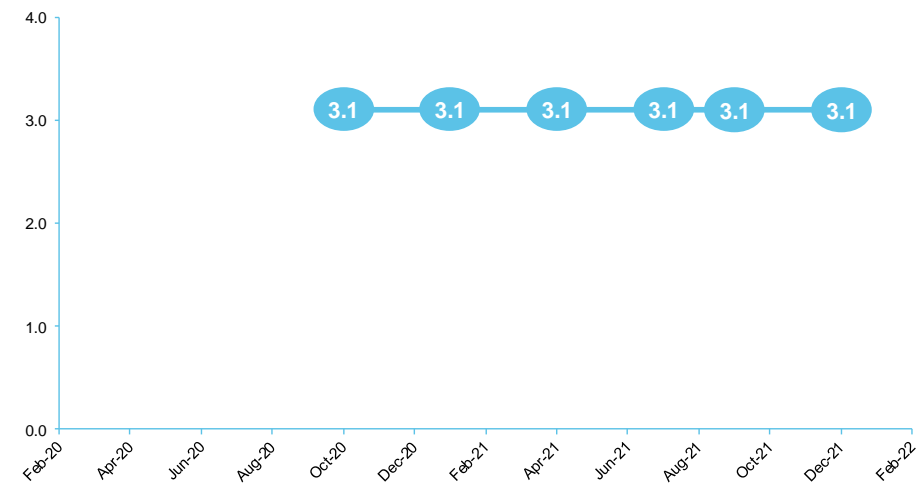


Source: RHB, Bloomberg

Date	Recommendation	Target Price	Price
2021-11-30	Buy	23.1	18.1
2021-08-31	Buy	21.7	19.2
2021-05-27	Buy	22.5	18.3
2020-12-16	Buy	21.9	18.7
2020-11-16	Buy	19.6	17.1
2020-08-31	Buy	18.3	14.0
2020-06-10	Buy	18.2	15.2
2020-05-31	Buy	15.8	13.6
2020-03-31	Buy	16.2	13.5
2020-02-27	Buy	17.6	15.5
2019-11-28	Buy	19.2	17.3
2019-09-18	Buy	18.7	16.5

Source: RHB, Bloomberg

ESG Rating History



Source: RHB

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