

12 July 2022

Financial Services | Banks

## OCBC Bank (OCBC SP)

**Buy** (Maintained)

### Better NIM To Provide Some Reprieve

Target Price (Return): SGD13.90 (+21%)  
 Price (Market Cap): SGD11.50 (USD36,737m)  
 ESG score: 3.10 (out of 4)  
 Avg Daily Turnover (SGD/USD) 70.4m/51.0m

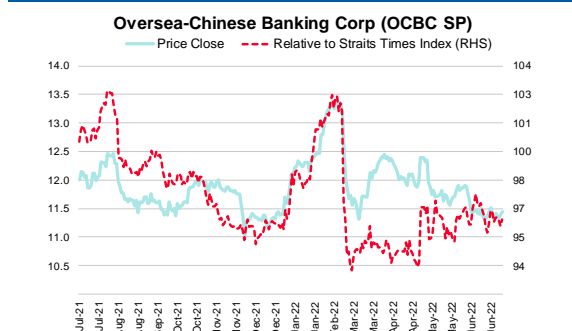
- **Stay BUY and SGD13.90 TP, 21% upside and c.5% yield.** OCBC Bank's share price is almost unchanged YTD, retreating from the 18% YTD gain in mid-Feb 2022. While recessionary fears may persist in the near term, its decent dividend yield should provide share price support while the current P/BV of 0.9x (or -1SD from its historical mean) is undemanding.
- **NIM uplift increasingly meaningful.** With the US Federal Funds Rate (FFR) rising faster than earlier anticipated, OCBC expects to see meaningful uplift in NIM in 2022. NIM, having ticked up 3bps QoQ in 1Q22, should see progressive expansion in the quarters ahead as Singapore banks have started to raise lending rates following the FFR hikes in March (+25bps) and June (+75bps). This is most evident in the rise in mortgage rates – OCBC's 2-year fixed-rate mortgage has risen to 2.65% from 1.3% in Dec 2021. With the dot plot pointing to a projection of 3.4% (+215bps) by end-2022 and 3.8% (+40bps) by 2023, loan yields should continue to improve through to 2023. This suggests upside to management's NIM guidance of 1.55-1.58% for FY22 (1Q22: 1.55%). A 25bps rate hike over a 12-month period would boost OCBC's NIM by 4-4.5bps and net profit by 3%.
- **CASA base to keep funding cost manageable.** On the liability side, management expects the rise in funding costs to be manageable. With the banking system flushed with liquidity, there are little concerns over deposit competition. There has been some shift to fixed deposits and the Singapore Savings Bonds (SSBs) with the interest rate uptrend. More importantly, the bank has sizeable CASA deposits of c.60% of customer deposits.
- **Businesses getting nervous.** While rising rates are positive for NIMs, it would inevitably have some dampening effect on demand for credit. Fallout from the Russia-Ukraine war, China's COVID-19 measures, and tighter global financial conditions are also fanning fears of a global recession. These are weighing on sentiment, causing OCBC's customers to put off huge projects and investments. New mortgage sales have also been impacted by the Dec 2021 property cooling measures, although the pipeline remains supported by previous sales. We believe 1H22 loans growth would continue to trail behind FY22 target of mid-to-high single-digit growth (1Q22: +5.6% annualised).
- **Non-II to be flattish.** OCBC's non-interest income (non-II), which fell 23% YoY in 1Q22, would likely be flattish at SGD1.0-1.1bn in 2Q22. Fees from wealth management is expected to see little change from 1Q22's SGD256m as volatility in the financial markets keeps clients sidelined. Fees from loans, trade and remittances would be subdued on softer loan demand and trade flows. That said, its SGD251bn AUM would provide steady income from fund management, credit cards fees should recover on higher consumption spending and travel, while its insurance business remains resilient.
- **Watchful on asset quality.** Management is very comfortable with asset quality with no particular weakness detected from internal stress tests. While we believe 2Q22 credit cost would remain low (1Q22: 6bps), management remains conservative, keeping credit cost guidance at 20-25bps for FY22. Our SGD13.90 TP includes a 2% ESG premium given our ESG score of 3.1.

#### Analyst

Singapore Research  
[sg.research@rhbgroup.com](mailto:sg.research@rhbgroup.com)

#### Share Performance (%)

	YTD	1m	3m	6m	12m
Absolute	0.4	(3.7)	(6.2)	(3.6)	(2.5)
Relative	0.2	(0.8)	1.3	(1.3)	(3.3)
52-wk Price low/high (SGD)	11.0 – 13.4				



Source: Bloomberg

#### Overall ESG Score: 3.10 (out of 4)

##### E: GOOD

OCBC has a sustainability framework that aligns the bank's approach to creating a positive social and environmental impact in line with the global sustainable development agenda. It 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, OCBC developed a new Responsible Investing Policy to integrate ESG considerations into the bank's investment decisions. It aims to build a sustainable finance portfolio of SGD50bn by 2025 (2021: SGD34bn).

##### S: GOOD

OCBC aims to maintain a balanced gender mix across its workforce, with 42% of women in leadership positions by 2022. In 2020, women accounted for 59% of total employees, 39% in leadership positions, and 20% in the board of directors. OCBC is active in talent management, and places 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.

Forecasts and Valuation	Dec-20	Dec-21	Dec-22F	Dec-23F	Dec-24F
Reported net profit (SGDm)	3,586	4,858	5,384	6,335	6,807
Net profit growth (%)	(26.4)	35.5	10.8	17.7	7.4
Recurring net profit (SGDm)	3,586	4,858	5,384	6,335	6,807
Recurring EPS (SGD)	0.81	1.09	1.20	1.42	1.52
BVPS (SGD)	11.09	11.72	12.38	13.19	14.08
DPS (SGD)	0.32	0.53	0.53	0.60	0.62
Recurring P/E (x)	14.17	10.54	9.51	8.09	7.52
P/B (x)	1.03	0.98	0.92	0.87	0.81
Dividend Yield (%)	2.8	4.6	4.6	5.2	5.4
Return on average equity (%)	7.4	9.5	10.0	11.1	11.9

Source: Company data, RHB

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## Financial Exhibits

<b>Asia</b>	<b>Financial summary (SGD)</b>	<b>Dec-20</b>	<b>Dec-21</b>	<b>Dec-22F</b>	<b>Dec-23F</b>	<b>Dec-24F</b>
Singapore	EPS	0.81	1.09	1.20	1.42	1.52
Financial Services	Recurring EPS	0.81	1.09	1.20	1.42	1.52
<b>OCBC Bank</b>	DPS	0.32	0.53	0.53	0.60	0.62
OCBC SP	BVPS	11.09	11.72	12.38	13.19	14.08
Buy						
<b>Valuation basis</b>	<b>Valuation metrics</b>	<b>Dec-20</b>	<b>Dec-21</b>	<b>Dec-22F</b>	<b>Dec-23F</b>	<b>Dec-24F</b>
GGM-derived intrinsic value with an ESG overlay. Key GGM assumptions are:	Recurring P/E (x)	14.17	10.54	9.51	8.09	7.52
i. COE of 10.11%;	P/B (x)	1.0	1.0	0.9	0.9	0.8
ii. ROE of 10.5%;	Dividend Yield (%)	2.8	4.6	4.6	5.2	5.4
iii. 4.0% long-term growth						
<b>Key drivers</b>	<b>Income statement (SGDm)</b>	<b>Dec-20</b>	<b>Dec-21</b>	<b>Dec-22F</b>	<b>Dec-23F</b>	<b>Dec-24F</b>
Our net profit forecast is most sensitive to changes in:	Interest income	9,143	7,425	9,356	11,831	12,625
i. Credit costs;	Interest expense	(3,177)	(1,570)	(2,968)	(4,772)	(5,134)
ii. Net interest margin (NIM);	<b>Net interest income</b>	<b>5,966</b>	<b>5,855</b>	<b>6,388</b>	<b>7,059</b>	<b>7,491</b>
iii. Non-interest income (Non-IL) growth.	Non interest income	4,173	4,741	4,901	5,252	5,580
	<b>Total operating income</b>	<b>10,139</b>	<b>10,596</b>	<b>11,289</b>	<b>12,311</b>	<b>13,071</b>
	Overheads	(4,543)	(4,867)	(5,132)	(5,364)	(5,592)
	<b>Pre-provision operating profit</b>	<b>5,596</b>	<b>5,729</b>	<b>6,157</b>	<b>6,947</b>	<b>7,480</b>
	Loan impairment allowances	(2,009)	(867)	(653)	(604)	(623)
	Other impairment allowances	(34)	(6)	(5)	(7)	(6)
	Income from associates	612	824	1,020	1,071	1,125
	<b>Pre-tax profit</b>	<b>4,165</b>	<b>5,680</b>	<b>6,519</b>	<b>7,407</b>	<b>7,975</b>
	Taxation	(437)	(648)	(985)	(852)	(933)
	Minority interests	(142)	(174)	(150)	(220)	(235)
	<b>Reported net profit</b>	<b>3,586</b>	<b>4,858</b>	<b>5,384</b>	<b>6,335</b>	<b>6,807</b>
	<b>Recurring net profit</b>	<b>3,586</b>	<b>4,858</b>	<b>5,384</b>	<b>6,335</b>	<b>6,807</b>
<b>Key risks</b>	<b>Profitability ratios</b>	<b>Dec-20</b>	<b>Dec-21</b>	<b>Dec-22F</b>	<b>Dec-23F</b>	<b>Dec-24F</b>
Key risks include:	Return on average assets (%)	0.7	0.9	1.0	1.1	1.2
i. Higher-than-expected allowances;	Return on average equity (%)	7.4	9.5	10.0	11.1	11.9
ii. Weaker-than-expected NIM;	Return on IEAs (%)	2.6	2.1	2.5	3.0	3.2
iii. Prolonged COVID-19 pandemic and geo-political tensions.	Cost of funds (%)	1.0	0.5	0.9	1.3	1.4
	Net interest spread (%)	1.6	1.6	1.6	1.7	1.8
	Net interest margin (%)	1.7	1.6	1.7	1.8	1.9
	Non-interest income / total income (%)	41.2	44.7	43.4	42.7	42.7
	Cost to income ratio (%)	44.8	45.9	45.5	43.6	42.8
	Credit cost (bps)	75.5	31.5	22.4	19.6	20.2
<b>Company Profile</b>	<b>Balance sheet (SGDm)</b>	<b>Dec-20</b>	<b>Dec-21</b>	<b>Dec-22F</b>	<b>Dec-23F</b>	<b>Dec-24F</b>
OCBC Bank is the second largest banking group in Singapore by asset size. It also has sizeable operations in Malaysia, Greater China and Indonesia.	Total gross loans	267,240	289,716	311,445	331,689	349,931
	Other interest earning assets	88,930	87,217	89,478	93,103	97,282
	Total gross IEAs	356,170	376,933	400,922	424,792	447,214
	Total provisions	(4,596)	(3,904)	(4,200)	(4,300)	(4,390)
	Net loans to customers	262,644	285,812	307,245	327,389	345,541
	Total net IEAs	351,574	373,029	396,722	420,492	442,824
	Total non-IEAs	169,821	169,158	179,992	190,950	202,858
	Total assets	521,395	542,187	576,714	611,441	645,681
	Customer deposits	314,907	342,395	366,363	389,443	412,031
	Other interest-bearing liabilities	9,586	8,239	7,827	8,062	8,271
	Total IBLs	324,493	350,634	374,190	397,505	420,303
	Total non-IBLs	145,726	137,215	145,166	152,875	160,232
	Total liabilities	470,219	487,849	519,355	550,381	580,534
	Share capital	19,031	19,238	19,238	19,238	19,238
	Shareholders' equity	49,622	52,663	55,600	59,240	63,263
	Minority interests	1,554	1,675	1,759	1,820	1,884
	<b>Asset quality and capital</b>	<b>Dec-20</b>	<b>Dec-21</b>	<b>Dec-22F</b>	<b>Dec-23F</b>	<b>Dec-24F</b>
	Reported NPLs / gross cust loans (%)	1.5	1.5	1.4	1.4	1.4
	Total provisions / reported NPLs (%)	117.3	92.6	94.3	92.6	90.9
	CET-1 ratio (%)	15.8	16.0	14.5	14.8	15.2
	Tier-1 ratio (%)	15.8	16.0	14.5	14.8	15.2
	Total capital ratio (%)	17.9	17.6	15.9	16.1	16.4

Source: Company data, RHB

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## Valuation and TP

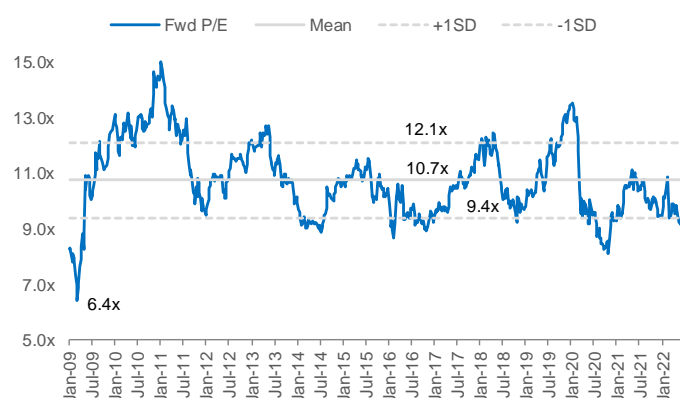
Our SGD13.90 TP is based on an intrinsic value of SGD13.62 with a 2% ESG premium applied, based on RHB's in-house ESG methodology. The lower intrinsic value is based on GGM-derived P/BV of 1.06x, which is in line with its historical mean of 1.1x.

Figure 1: OCBC – GGM valuation

<b>Cost of equity (COE) computation:</b>		Sustainable ROE (%)	10.50
Risk free rate (%)	2.50	COE (%)	10.11
Equity premium (%)	7.50	Long-term growth (g)	4.00
Beta (x)	1.02	Implied P/BV (x)	1.06
Cost of equity - CAPM (%)	10.11	Rolling 12-mth forward BVPS	SGD12.80
		Intrinsic value	SGD13.62
ESG premium/(discount) (%)	2.0	ESG premium/(discount)	SGD0.27
		<b>TP (rounded)</b>	<b>SGD13.90</b>

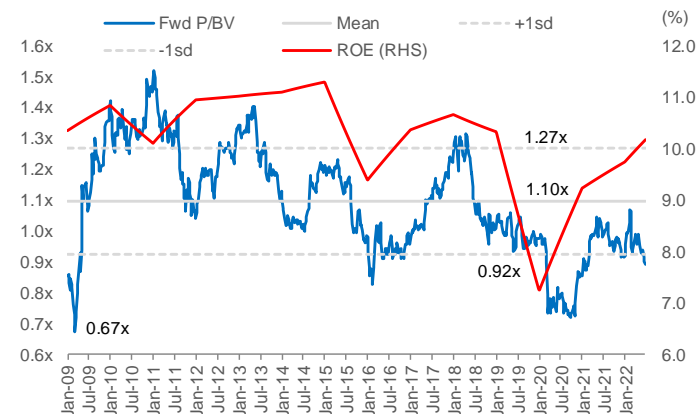
Source: Company data, RHB

Figure 2: OCBC's 12-month forward consensus P/E



Source: Bloomberg, RHB

Figure 3: OCBC's 12-month forward consensus P/BV



Source: Bloomberg, RHB

## Recommendation Chart

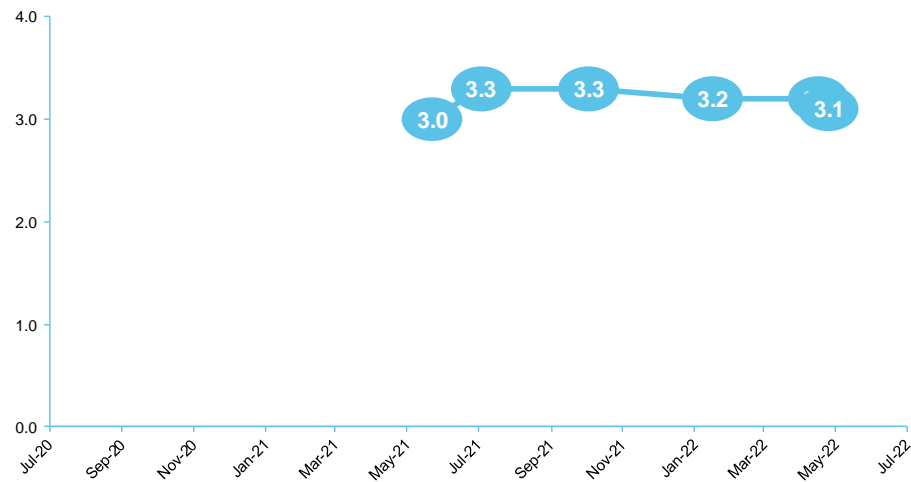


Source: RHB, Bloomberg

Date	Recommendation	Target Price	Price
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
2020-03-17	Neutral	9.6	8.6
2020-02-23	Neutral	11.2	11.0
2019-11-05	Neutral	11.5	11.1

Source: RHB, Bloomberg

ESG Rating History



Source: RHB

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#### KUALA LUMPUR

**RHB Investment Bank Bhd**  
Level 3A, Tower One, RHB Centre  
Jalan Tun Razak  
Kuala Lumpur 50400  
Malaysia  
Tel : +603 9280 8888  
Fax : +603 9200 2216

#### JAKARTA

**PT RHB Sekuritas Indonesia**  
Revenue Tower, 11th Floor, District 8 - SCBD  
Jl. Jendral Sudirman Kav 52-53  
Jakarta 12190  
Indonesia  
Tel : +6221 509 39 888  
Fax : +6221 509 39 777

#### BANGKOK

**RHB Securities (Thailand) PCL**  
10th Floor, Sathorn Square Office Tower  
98, North Sathorn Road, Silom  
Bangrak, Bangkok 10500  
Thailand  
Tel: +66 2088 9999  
Fax :+66 2088 9799

#### SINGAPORE

**RHB Bank Berhad (Singapore branch)**  
90 Cecil Street  
#04-00 RHB Bank Building  
Singapore 069531  
Fax: +65 6509 0470