

"Net credit cost is expected to trend lower in 2HFY21 as more buffers are being set aside in 1HFY21"

Share price performance



	1M	3M	12M
Absolute (%)	3.1	5.4	18.6
Rel KLCI (%)	2.9	7.7	12.4

	BUY	HOLD	SELL
Consensus	15	3	-

Source: Bloomberg

Stock Data

Sector	Banking
Issued shares (m)	2,167.7
Mkt cap (RMm)/(US\$m)	39,019/9,645
Avg daily vol - 6mth (m)	1.0
52-wk range (RM)	11.7-19.68
Est free float	23.2%
Stock Beta	1.15
Net cash/(debt)	n.m.
ROE (FY21E)	9.9%
Derivatives	Nil
Shariah Compliant	No

Key Shareholders

HL Financial Group	62.0%
EPF	11.3%

Source: Affin Hwang, Bloomberg

Tan Ei Leen

T (603) 2146 7543

E eileen.tan@affinhwang.com

Hong Leong Bank (HLBK MK)

BUY (upgrade)

Up/Downside: +12.8%

Price Target: RM20.30

Previous Target (Rating): RM20.30 (HOLD)

A weaker 2QFY21 as more buffers are set aside

- Hong Leong Bank's (HLB) 2QFY21 net profit came in at RM670.8m (-4.4% yoy; -8% qoq), while 1HFY21 results were flat yoy. The results were within our and consensus estimates. ECL allowances rose substantially in 2QFY21 due to management's conservative approach
- Otherwise, HLB's 1HFY21 pre-provision profit remained robust (+22.3% yoy), driven by fund-based income growth (+15.7% yoy; NIM up 5bps yoy to 2.05%), and marginally lower overheads.
- We maintain our FY21E-23E earnings forecasts. Upgrade to BUY on valuation with an unchanged 12-month PT of RM20.30 (based on 1.47x CY21E P/BV target). DPS of 14.8 sen was proposed in 2QFY21

1HFY21 operating income grew a robust 12% yoy

HLB reported a robust set of operating results in 1HFY21, with net operating income up 12% yoy while pre-provision profit was up 22.3% yoy. 1HFY21 fund-based income reported a 15.7% yoy growth despite the rate cuts, as HLB benefited from the repricing down of deposit rates, a decrease in fixed deposits (-4.8% yoy) and robust CASA growth of 21.5% yoy (CASA ratio at 30%). As a result, NIM expanded by 5bps yoy to 2.05% in 1HFY21. Non-interest income grew 3% yoy, driven by Treasury gains, wealth management and credit card fees. Meanwhile, Bank of Chengdu's contribution (19.4% of 1HFY21 pre-tax profit) was up 8% yoy.

Building up more provision buffers in the event of a spike in default cases

HLB's management has raised its FY21 NCC target to 30bps (already pencilled into our forecasts) from its previous guidance of 15-20bps, implying a lower 2HFY20 NCC of 14bps (annualized). As a result, 2QFY21's ECL allowances rose substantially by 46bps qoq to an annualized NCC of 64.6bps (1HFY21 NCC stood at an annualized 46bps). Similar to what other banking peers have communicated, the pace of new applications for financial relief and assistance have moderated in Jan-Feb 21 compared to 4Q20. For HLB, the outstanding loans under the payment relief assistance plans have declined from 8% (as at 16 Nov20) to 7% (as at 31 Jan21).

Upgrade to BUY, Price Target unchanged at 20.30

We upgrade our rating from HOLD to **BUY** (largely on valuation grounds), though our 12-month **PT** is unchanged at **RM20.30** (based on a 1.47x P/BV on the CY21E BVPS) underpinned by a CY21E ROE at 9.74% and cost of equity of 7.6%. Our earnings forecasts for FY21E/22E/23E remain unchanged, while underlying assumptions include: loan growth of 4% yoy, CIR of 39-40%, NIM of 2.02-2.07%. Downside risks: interest rate cuts; higher NPL rates from the targeted assistance program.

Earnings & Valuation Summary

FYE 30 June	2019	2020	2021E	2022E	2023E
Total income (RMm)	4,725.8	4,778.4	5,255.4	5,372.8	5,635.9
PPOP (RMm)	2,634.3	2,674.6	3,151.6	3,227.0	3,425.6
Pretax profit (RMm)	3,186.0	2,989.4	3,376.3	3,546.4	3,814.2
Net profit (RMm)	2,664.5	2,494.6	2,802.3	2,943.5	3,165.8
EPS (sen)	125.6	121.7	136.7	143.6	154.4
Core net profit (RMm)	2,574.5	2,494.6	2,802.3	2,943.5	3,165.8
Core EPS (sen)	125.6	121.7	136.7	143.6	154.4
Core EPS growth (%)	(2.5)	(3.1)	12.3	5.0	7.6
Core PER (x)	14.3	14.8	13.2	12.5	11.7
ROE (%)	10.8	9.5	9.9	9.6	9.7
BVPS (RM)	12.45	13.28	14.45	15.38	16.50
P/BV (x)	1.4	1.3	1.2	1.1	1.0
Net DPS (sen)	50.0	36.0	34.2	43.1	46.3
Dividend Yield (%)	2.9	2.1	2.0	2.5	2.7
Chg in EPS (%)			-	-	-
Affin/Consensus (x)			1.0	1.0	0.97

Source: Company, Affin Hwang estimates

Fig 1: Results Comparison

FYE June (RMm)	2Q20	1Q21	2Q21	QoQ % chg	YoY % chg	1HFY20	1HFY21	YoY % chg	Comments
Interest income	1,625.4	1,404.0	1,410.9	0.5	(13.2)	3,237.4	2,814.9	(13.0)	Underpinned by loan growth of 6.2% yoy and 1.5% qoq, mostly underpinned by residential mortgages and commercial property financing.
Interest expense	(896.5)	(607.7)	(544.3)	(10.4)	(39.3)	(1,804.3)	(1,152.0)	(36.2)	Lower funding cost in tandem with the lagged downward repricing effects of deposit rates. CASA growth was robust at 21.5% yoy with CASA ratio rising from 26% in 1QFY20 to 30% in 2QFY21.
Net interest income	728.8	796.3	866.7	8.8	18.9	1,433.1	1,663.0	16.0	
Islamic fund-based income	183.2	195.7	216.3	10.5	18.1	359.9	412.0	14.5	
Fund-based income	912.0	992.0	1,083.0	9.2	18.8	1,793.0	2,075.0	15.7	1HFY21 NIM rose 5bps yoy to 2.05%, driven by substantially lower funding cost.
Non-interest income	325.5	356.9	317.1	(11.1)	(2.6)	659.6	673.9	10.3	Underpinned by higher realized investment gains from Treasury and wealth management income.
Net income	1,237.5	1,348.9	1,400.1	3.8	13.1	2,452.6	2,748.9	12.1	
Operating expenses	(527.0)	(521.0)	(511.7)	(1.8)	(2.9)	(1,049.3)	(1,032.7)	(1.6)	Prudent cost management. 1HFY21 CIR came in lower at 37.6% vs. 42.8%.
Pre-provision profit	710.5	827.8	888.4	7.3	25.0	1,403.4	1,716.2	22.3	
Allowance for loan impairment	(19.4)	(104.4)	(240.9)	>100	>100	(10.5)	(345.3)	>100	2QFY21 NCC rose sharply higher to 64.6bps (annualized) as more buffers were set aside. 1HFY21 NCC stood at 46bps annualized (pre-emptive buffers at 86.7%).
Impairment loss (on financial investments/ assets, others)	(1.5)	(0.3)	0.1	(>100)	(>100)	(1.6)	(0.2)	(88.2)	Bank of Chengdu's contribution (19.4% of 1HFY21 pre-tax profit) was up 8% yoy.
Profit from associates	167.4	167.1	167.7	0.3	0.2	312.3	334.8	7.2	
Pre-tax Profit	857.0	890.2	815.3	(8.4)	(4.9)	1,703.5	1,705.5	0.1	
Taxation	(155.2)	(161.3)	(144.5)	(10.4)	(6.9)	(313.1)	(305.8)	(2.3)	
Net profit	701.8	728.9	670.8	(8.0)	(4.4)	1,390.4	1,399.7	0.7	Annualized 1HFY21 net earnings within Affin and consensus estimates.
Core net profit	701.8	728.9	670.8	(8.0)	(4.4)	1,390.4	1,399.7	0.7	
EPS (sen)	34.3	35.6	32.8	(8.0)	(4.5)	67.9	68.4	0.7	
Core EPS (sen)	34.3	35.6	32.8	(8.0)	(4.5)	67.9	68.4	0.6	
DPS (sen)	16.00	-	14.78	<i>n.m.</i>	(7.6)	16.00	14.78	(7.6)	An interim DPS of 14.78 sen was proposed (vs. 2QFY20: 16 sen).
Net yield (%)	0.9	-	0.8	<i>n.m.</i>	(0.1)	0.9	0.8	(0.1)	

Source: Affin Hwang, Company

Fig 2: Hong Leong Bank: Key financial ratios and performance

FYE June	4QFY19	1QFY20	2QFY20	3QFY20	4QFY20	1QFY21	2QFY21
Key Financial Ratios:							
Profitability							
Net interest margin (NIM) (%)	1.89	2.03	2.04	1.84	1.62*	2.00	2.15
Fee income ratio (%)	29.9	27.4	24.9	22.4	25.4	25.2	22.6
Cost-to-income ratio (%)	45.4	43.0	42.6	47.3	43.5	38.6	36.5
Annualised ROE (%)	10.3	10.7	10.8	10.8	8.5	10.5	9.5
Balance Sheet							
Gross loans (RMm)	137,566.4	138,694.0	141,273.3	142,406.1	145,932.4	148,126.0	149,993.7
Customer deposits (RMm)	163,072.5	163,548.2	167,869.5	168,816.6	173,849.1	175,132.7	176,487.6
Asset Quality							
Gross impaired loan(RMm)	1,071.1	1,123.8	1,179.9	1,401.3	889.8	704.6	807.0
Gross impaired loan ratio (%)	0.78	0.81	0.84	0.98	0.61	0.48	0.54
Annualized net credit charge (bps)	13.9	(2.6)	5.5	35.5	53.1	28.4	64.6
Loan loss cover (%)	118.0	110.0	103.0	91.0	142.0	142.0	193.0
Loan loss cover with Reg. reserves (%)	197.0	196.0	182.0	159.0	236.0	236.0	263.0
Capital Adequacy (Group)							
CET1 ratio (%)	13.10	12.80	13.10	12.90	13.70	13.50	13.80
Tier-1 Capital ratio (%)	14.10	13.40	13.70	13.50	14.10	14.10	14.40
Total Capital ratio (%)	16.30	15.70	15.90	15.70	16.30	16.30	16.60
Liquidity							
Gross Loan/Deposit ratio (%)	84.4	84.8	84.2	84.4	83.9	84.6	85.0
Liquidity Coverage Ratio (LCR) (%)	134.0	126.0	123.0	130.0	137.0	157.0	158.0

* 4QFY20 NIM excluding impact of RM142m net modification loss would be 1.92%

Source: Affin Hwang, Company data

Important Disclosures and Disclaimer

Equity Rating Structure and Definitions

BUY	Total return is expected to exceed +10% over a 12-month period
HOLD	Total return is expected to be between -5% and +10% over a 12-month period
SELL	Total return is expected to be below -5% over a 12-month period
NOT RATED	Affin Hwang Investment Bank Berhad does not provide research coverage or rating for this company. Report is intended as information only and not as a recommendation

The total expected return is defined as the percentage upside/downside to our target price plus the net dividend yield over the next 12 months.

OVERWEIGHT	Industry, as defined by the analyst's coverage universe, is expected to outperform the KLCI benchmark over the next 12 months
NEUTRAL	Industry, as defined by the analyst's coverage universe, is expected to perform inline with the KLCI benchmark over the next 12 months
UNDERWEIGHT	Industry, as defined by the analyst's coverage universe is expected to under-perform the KLCI benchmark over the next 12 months

This report is intended for information purposes only and has been prepared by Affin Hwang Investment Bank Berhad (14389-U) ("the Company") based on sources believed to be reliable and is not to be taken in substitution for the exercise of your judgment. You should obtain independent financial, legal, tax or such other professional advice, when making your independent appraisal, assessment, review and evaluation of the company/entity covered in this report, and the extent of the risk involved in doing so, before investing or participating in any of the securities or investment strategies or transactions discussed in this report. However, such sources have not been independently verified by the Company, and as such the Company does not give any guarantee, representation or warranty (expressed or implied) as to the adequacy, accuracy, reliability or completeness of the information and/or opinion provided or rendered in this report. Facts, information, estimates, views and/or opinion presented in this report have not been reviewed by, may not reflect information known to, and may present a differing view expressed by other business units within the Company, including investment banking personnel and the same are subject to change without notice. Reports issued by the Company, are prepared in accordance with the Company's policies for managing conflicts of interest. Under no circumstances shall the Company, be liable in any manner whatsoever for any consequences (including but are not limited to any direct, indirect or consequential losses, loss of profit and damages) arising from the use of or reliance on the information and/or opinion provided or rendered in this report. Under no circumstances shall this report be construed as an offer to sell or a solicitation of an offer to buy any securities. The Company its directors, its employees and their respective associates may have positions or financial interest in the securities mentioned therein. The Company, its directors, its employees and their respective associates may further act as market maker, may have assumed an underwriting commitment, deal with such securities, may also perform or seek to perform investment banking services, advisory and other services relating to the subject company/entity, and may also make investment decisions or take proprietary positions that are inconsistent with the recommendations or views in this report. The Company, its directors, its employees and their respective associates, may provide, or have provided in the past 12 months investment banking, corporate finance or other services and may receive, or may have received compensation for the services provided from the subject company/entity covered in this report. No part of the research analyst's compensation or benefit was, is or will be, directly or indirectly, related to the specific recommendations or views expressed in this report. Employees of the Company may serve as a board member of the subject company/entity covered in this report.

Third-party data providers make no warranties or representations of any kind relating to the accuracy, completeness, or timeliness of the data they provide and shall not have liability for any damages of any kind relating to such data.

This report, or any portion thereof may not be reprinted, sold or redistributed without the written consent of the Company.

This report is printed and published by:
 Affin Hwang Investment Bank Berhad (14389-U)
 A Participating Organisation of Bursa Malaysia Securities Berhad

22nd Floor, Menara Boustead,
 69, Jalan Raja Chulan,
 50200 Kuala Lumpur, Malaysia.

T : + 603 2142 3700
 F : + 603 2146 7630
 research@affinhwang.com

www.affinhwang.com