

OCBC Bank (OCBC SP)

Riding through mild turbulence

1Q18 a slight miss

1Q18 core PATMI of SGD1.1b (up 8% QoQ, 29% YoY) slightly missed our expectation and met 21% of our previous FY18E forecast on lower non-interest income (non-II), offset by lower provisions and higher income from associates. Excluding Great Eastern (GE SP, Not Rated), the bank's operating profit was decent (+6% QoQ, +10% YoY), which reflected good underlying performance and earnings momentum. We revise FY18-20E net profit downwards by -2%. With that, our assumed sustainable ROE is now 13.8% (14.0% previously), COE 10.5% and growth rate 3.5% (both unchanged). Our TP is also reduced by 2% to SGD14.60 based on -1.5x FY18E P/BV (unchanged), 1SD above its historical mean of 1.3x to reflect higher forecast ROEs. We believe its valuation multiple deserves to rise in view of its ability to expand ROEs from non-II growth.

Lower customer spreads disappointed

Unlike DBS and UOB, which saw higher repricing effects working their way through in a higher rate environment, OCBCs NIM were flat QoQ at 1.67% as cost of funds increased by 12bps QoQ (DBS: 9bps/UOB: 8bps). Customer spreads fell 6bps QoQ/10bps YoY to 1.85%, and sticky CASA deposit now form 47% of total deposits in 1Q18 (4Q17: 49%, 1Q17: 50%). Management attributed the flat NIM from margin compression in Indonesia and lower-yielding margins from trade loans, as OCBC's general commerce loans grew 4% QoQ vs peers' -2%. We factor in a higher SIBOR forecast for FY18/19E of 1.65%/1.90% (from 1.55%/1.75%) per our Singapore economist, offset by higher cost of funds. This raised net interest income slightly by 1-2% for FY18-20E. Management reiterated high single digit loan growth for FY18E and we maintain our loan growth assumption of 10% YoY. We lower non-II by 6% on lower net trading income, net gains from investment securities and Great Eastern's life profits. That said, we are still projecting 3-year CAGR of 12% for non-II.

Retain credit cost assumption

1Q18's total credit cost of 4bps is too low. We retain our credit costs of 18-20bps barring significant asset quality deterioration for FY18-20E. For every 10bps increase in credit costs, we estimate FY18-20E net profits could decline by 5%.

Maintain BUY

Decent yields of 3% should lend support to the share price. Risks to our call are: 1) lower income; 2) higher costs; and 3) higher allowances.

FYE Dec (SGD m)	FY16A	FY17A	FY18E	FY19E	FY20E
Operating income	8,489	9,528	11,121	12,021	13,378
Pre-provision profit	4,605	5,381	6,720	7,332	8,357
Core net profit	3,433	4,004	5,066	5,868	6,662
Core EPS (SGD)	0.8	1.0	1.2	1.4	1.6
Core EPS growth (%)	(9.1)	16.6	26.5	15.8	13.5
Net DPS (SGD)	0.4	0.4	0.4	0.4	0.4
Core P/E (x)	16.1	13.8	10.9	9.4	8.3
P/BV (x)	1.6	1.5	1.3	1.2	1.1
Net dividend yield (%)	2.7	2.8	3.0	3.1	3.3
Book value (SGD)	8.47	8.95	9.85	10.75	11.82
ROAE (%)	10.0	11.0	12.9	13.6	14.1
ROAA (%)	0.9	0.9	1.1	1.2	1.3
Consensus net profit	-	-	4,663	5,158	5,663
MKE vs. Consensus (%)	-	-	17.2	14.6	18.3

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BUY

Share Price	SGD 13.17
12m Price Target	SGD 14.60 (+11%)
Previous Price Target	SGD 14.83

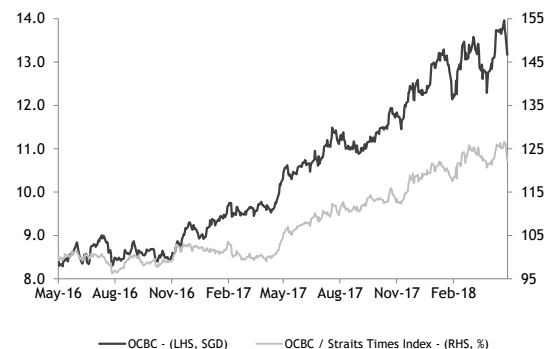
Statistics

52w high/low (SGD)	13.96/10.30
3m avg turnover (USDm)	62.9
Free float (%)	74.2
Issued shares (m)	3,993
Market capitalisation	SGD52.6B USD39.3B

Major shareholders:

Selat Pte Ltd	11.5%
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Price Performance



	-1M	-3M	-12M
Absolute (%)	3	8	29
Relative to index (%)	0	4	17

Source: FactSet

Fig 1: Revisions to estimates

OCBC	Revised			Previous		
	2018E	2019E	2020E	2018E	2019E	2020E
(SGD m)						
Net interest income	6,320.8	6,957.3	7,628.7	6,240.4	6,805.9	7,469.2
Non-interest income	4,440.6*	5,063.6	5,749.6	4,706.9*	5,375.2	6,106.5
Total income	10,761.4*	12,020.9	13,378.3	10,947.3*	12,181.1	13,575.8
Expenses	4,400.8	4,688.9	5,021.7	4,390.0	4,665.9	4,984.8
Provisions	457.7	536.3	614.9	456.8	536.1	614.7
Core net profit [^]	5,065.8	5,868.5	6,661.9	5,176.1	5,960.7	6,791.3
Revisions (%)						
Net interest income	1.3	2.2	2.1			
Non-interest income	(5.7)	(5.8)	(5.8)			
Total income	(1.7)	(1.4)	(1.5)			
Expenses	0.2	0.5	0.7			
Provisions	0.2	0.0	0.0			
Core net profit [^]	(2.1)	(1.5)	(1.9)			

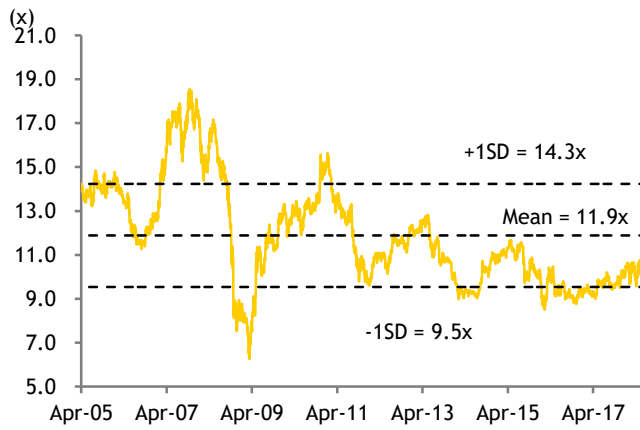
Source: Maybank Kim Eng. *Excludes one-off gains from sale of Hong Kong Life Insurance. [^]Net profit excludes one-offs and preference share dividends.

Fig 2: Quarterly profit and loss summary

SGD m (FYE Dec)	1Q17 (SGD m)	4Q17 (SGD m)	1Q18 (SGD m)	QoQ %	YoY %	% of FY	FY18E (SGD m)	Comments
Net interest income	1,272	1,424	1,415	(0.6)	11.2	22	6,321	1Q18 NIM flat QoQ/+5bps YoY to 1.67%. Customer spreads fell 6ps QoQ to 1.85%. Loan growth of 10% YoY was in-line with our expectation.
Non-interest income	850	1,214	918	(24.4)	8.0	21	4,441*	The decline QoQ came from lower profits from life assurance (-38% QoQ, +242% YoY), lower net trading income (-5% QoQ, -41% YoY) and lower net gains from investment securities (-97% QoQ, -87% YoY). This was offset by higher fees (+9% QoQ, +11% YoY).
Total income	2,122	2,638	2,333	(11.6)	9.9	22	10,761*	
Less: Overhead expenses	(973)	(1,075)	(1,032)	(4.0)	6.1	24	(4,297)	
Goodwill	(26)	(26)	(25)	(3.8)	(3.8)	24	(104)	
Pre-provision profit	1,123	1,537	1,276	(17.0)	13.6	20	6,361	
Less: Provisions	(168)	(178)	(12)	(93.3)	(92.9)	3	(458)	Total allowances fell 93% QoQ and 93% YoY to SGD12m. Management guided to FY18E credit costs of 15-20bps.
Operating profit	955	1,359	1,264	(7.0)	32.4	21	5,903	
Associates	114	28	125	346.4	9.6	27	467	
Pre-tax profit	1,069	1,387	1,389	0.1	29.9	22	6,370	
Less: Tax	(169)	(257)	(228)	(11.3)	34.9	23	(976)	
<i>Effective tax rate (%)</i>	<i>(16)</i>	<i>(19)</i>	<i>(16)</i>				<i>(15)</i>	
Profit after tax	900	1,130	1,161	2.7	29.0	22	5,395	
Minorities	(39)	(96)	(49)	(49.0)	25.6	17	(289)	
Core net profit[^]	861	1,034	1,112	7.5	29.2	22	5,106[^]	

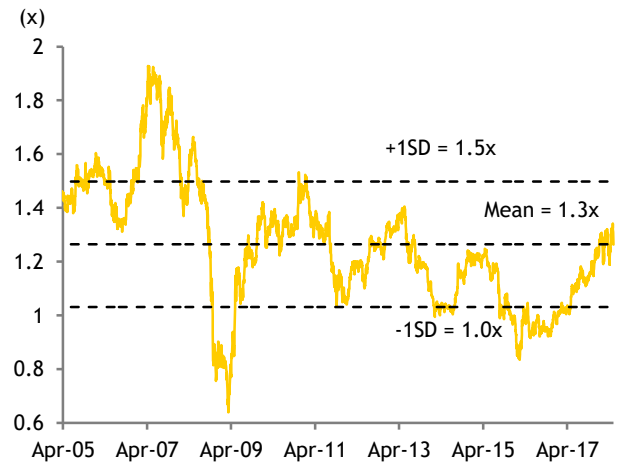
Source: Company, Maybank Kim Eng. *Excludes one-off gains from sale of Hong Kong Life Insurance. [^]Includes preference share dividends.

Fig 3: OCBC's 12M forward rolling P/E band



Source: Bloomberg, Maybank Kim Eng

Fig 4: OCBC's 12M forward rolling P/BV band

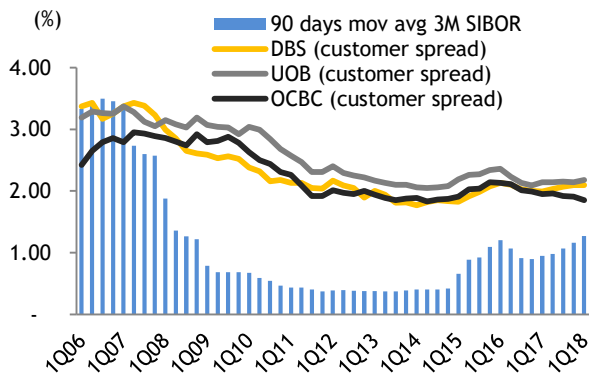


Source: Bloomberg, Maybank Kim Eng

Value Proposition

- Second-largest Singapore bank by assets. Present in Malaysia, Indonesia and Greater China.
- Acquired ING Asia Private Bank and Barclays's wealth units in HK and Singapore to build up wealth management.
- 87.8%-owned subsidiary Great Eastern is a leader in Singapore life insurance. Close partnership also makes OCBC a leader in the Singapore bancassurance market.
- Lending profile and competencies are not as distinctive as UOB (SMEs) and DBS (large corporates).
- Bought Wing Hang Bank (WHB) in HK in 2014 to strengthen presence in Pearl River Delta. Execution risks remain, due to fierce competition.
- Likely to reduce expansion plans due to restraints in fully-loaded CET1, asset impairments and limited M&A activities.

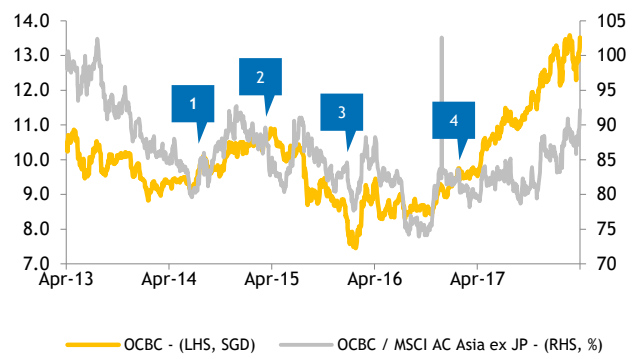
OCBC's customer spreads fell to 1.85% in 1Q18



Source: Bloomberg, Companies, Maybank Kim Eng

Price Drivers

Historical share price



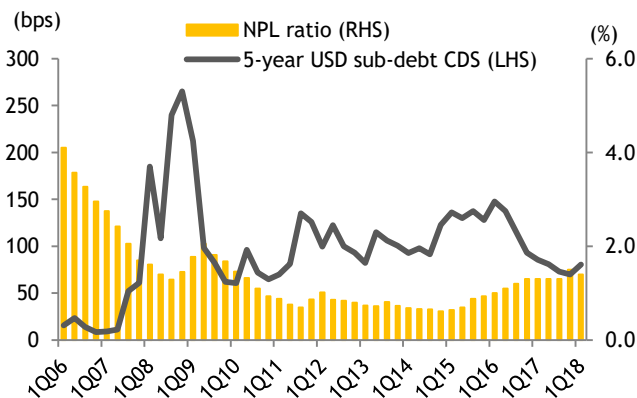
Source: FactSet, Maybank Kim Eng

1. Acquired and privatised Wing Hang Bank for USD5b. Issued rights to raise SGD3.3b.
2. 2014 core net profit up 25% YoY from robust lending and strong income growth. Included progressive consolidation of OCBC Wing Hang.
3. Sharp CNY devaluation in August 2015. O&G, commodities and China's NPL worries.
4. Share price rallied on positive sentiment from interest rate hikes, USD strength and economic recovery. Risks from O&G have abated.

Financial Metrics

- Greater China a core business for the Group. Integration with WHB boosted the regional contribution to pretax profit from a mere -6% in 2013 to -19% in 2017. Loans from Greater China now form 25% of total loans.
- Expect FY18/19/20E NIMs at 1.73%/1.77%/1.80%.
- Fully-loaded CET1 was 13.1% as at 1Q18, slightly higher than management's comfort level at 12.5-13%.
- Expect -10% loan growth in FY18-20E.
- Cost of capital a major consideration. Sector contagion risks may be reflected in corporate papers or CDS.

NPL ratio tracked CDS spreads with a lag during GFC



Source: Bloomberg, Company

Swing Factors

Upside

- Widening credit spreads from re-pricing of assets at higher interest rates.
- Higher non-interest income from wealth management and higher contributions from Great Eastern.
- Sharp and sustained rebound in commodity prices.
- Better-than-expected asset quality through proactive restructuring of loans, with no major credit slippages.
- Better demand for Singapore mortgages from easing of property-cooling measures.

Downside

- Oil prices stay low, causing more NPLs in O&G support services.
- Job losses in Singapore become pervasive, hurting its mortgage portfolio.
- Sharp decline in value of trading securities and shocks in fixed-income portfolio.
- Lack of liquidity of a funding currency.
- Translation losses from MYR/IDR depreciation.
- Emergence of dominant financial competitors in Singapore.
- Capital-raising by peers may depress sentiment.

FYE 31 Dec	FY16A	FY17A	FY18E	FY19E	FY20E
Key Metrics					
Core P/E (x)	16.1	13.8	10.9	9.4	8.3
Core FD P/E (x)	16.1	13.8	10.9	9.4	8.3
P/BV (x)	1.6	1.5	1.3	1.2	1.1
P/NTA (x)	1.8	1.7	1.5	1.4	1.2
Net dividend yield (%)	2.7	2.8	3.0	3.1	3.3

INCOME STATEMENT (SGD m)

Interest income	8,368.2	9,118.0	10,720.5	12,042.4	13,424.6
Interest expense	(3,316.1)	(3,694.9)	(4,399.7)	(5,085.1)	(5,795.9)
Net interest income	5,052.1	5,423.1	6,320.8	6,957.3	7,628.7
Net insurance income	649.3	916.8	1,147.1	1,353.6	1,556.7
Net fees and commission	1,638.3	1,952.5	2,332.2	2,693.3	3,128.4
Other income	1,149.6	1,235.1	1,320.4	1,016.6	1,064.5
Total non-interest income	3,437.2	4,104.4	4,799.7	5,063.6	5,749.6
Operating income	8,489.3	9,527.5	11,120.5	12,020.9	13,378.3
Staff costs	(2,346.4)	(2,471.0)	(2,620.3)	(2,785.1)	(2,960.7)
Other operating expenses	(1,538.2)	(1,675.8)	(1,780.4)	(1,903.8)	(2,061.0)
Operating expenses	(3,884.6)	(4,146.8)	(4,400.8)	(4,688.9)	(5,021.7)
Pre-provision profit	4,604.7	5,380.7	6,719.8	7,332.0	8,356.6
Loan impairment allowances	(725.9)	(671.5)	(457.6)	(536.3)	(614.9)
Other allowances	0.0	0.0	0.0	0.0	0.0
Associates & JV income	396.7	389.2	465.9	503.2	543.4
Pretax profit	4,275.6	5,098.4	6,728.1	7,298.9	8,285.1
Income tax	(628.9)	(802.9)	(975.6)	(1,058.3)	(1,201.3)
Minorities	(173.4)	(251.0)	(288.7)	(331.9)	(381.7)
Discontinued operations	0.0	0.0	0.0	0.0	0.0
Reported net profit	3,473.3	4,044.4	5,463.9	5,908.6	6,702.0
Core net profit	3,433.2	4,004.3	5,065.8	5,868.5	6,661.9
Preferred Dividends	40.1	40.1	40.1	40.1	40.1

BALANCE SHEET (SGD m)

Cash & deposits with banks	39,800.7	49,377.4	50,364.5	51,371.8	52,399.3
Sec. under resale agreements	1,788.9	1,055.5	1,119.4	1,186.5	1,257.7
Derivatives financial assets	7,837.6	6,385.9	6,833.0	7,311.3	7,896.2
Dealing securities	5,616.2	6,534.5	6,429.0	6,612.3	6,631.8
Available-for-sale securities	26,303.2	28,945.7	28,801.9	29,377.9	29,563.1
Investment securities	15,601.7	17,319.7	17,084.4	17,564.7	18,125.8
Loans & advances	216,830.0	234,141.5	257,875.9	283,096.1	310,811.2
Central bank deposits	16,559.5	19,594.4	21,785.3	23,118.0	25,034.5
Investment in associates/JVs	2,415.5	2,351.6	2,468.7	2,641.5	2,826.4
Insurance assets	61,972.3	73,927.4	76,144.8	78,429.2	80,782.0
Fixed assets	4,571.6	4,281.6	4,376.1	4,473.4	4,572.9
Intangible assets	5,472.8	5,159.8	5,263.2	5,368.5	5,475.8
Other assets	5,113.6	5,820.6	4,883.4	4,755.3	4,872.1
Total assets	409,883.6	454,895.6	483,429.6	515,306.6	550,249.0
Deposits from customers	261,691.7	283,862.6	305,656.7	330,499.4	357,889.8
Deposits from banks & FIs	10,739.6	7,485.4	7,709.6	7,940.8	8,179.1
Derivatives financial instruments	7,474.2	6,454.0	6,776.7	7,115.5	7,471.3
Subordinated debt	6,503.2	4,556.2	4,556.0	4,556.0	4,556.0
Other securities in issue	14,444.2	28,678.5	28,679.3	28,679.3	28,679.3
Other borrowings	499.1	499.1	499.1	499.1	499.1
Insurance liabilities	61,961.2	73,755.2	75,967.7	78,246.7	80,594.1
Other liabilities	8,427.9	9,310.2	9,502.5	9,859.5	9,927.3
Total liabilities	371,741.0	414,601.3	439,347.6	467,396.3	497,796.0
Share capital	2,096.9	2,093.4	2,093.4	2,093.4	2,093.4
Reserves	33,411.1	35,436.0	39,194.8	42,989.8	47,494.4
Shareholders' funds	35,507.9	37,529.3	41,288.2	45,083.2	49,587.8
Preference shares	0.0	0.0	0.0	0.0	0.0
Minority interest	2,634.9	2,765.0	2,793.9	2,827.1	2,865.2
Total equity	38,142.9	40,294.3	44,082.0	47,910.3	52,453.0
Total liabilities & equity	409,883.6	454,895.6	483,429.6	515,306.6	550,249.0

FYE 31 Dec	FY16A	FY17A	FY18E	FY19E	FY20E
Key Ratios					
Growth (%)					
Net interest income	(2.6)	7.3	16.6	10.1	9.7
Non-interest income	(2.7)	19.4	16.9	5.5	13.5
Operating expenses	3.3	6.8	6.1	6.5	7.1
Pre-provision profit	(7.2)	16.9	24.9	9.1	14.0
Core net profit	(7.5)	16.6	26.5	15.8	13.5
Gross loans	4.5	7.8	9.9	9.8	9.8
Customer deposits	6.1	8.5	7.7	8.1	8.3
Total assets	5.0	11.0	6.3	6.6	6.8
Profitability (%)					
Non-int. income/Total income	40.5	43.1	43.2	42.1	43.0
Average lending yields	2.76	2.77	2.93	3.06	3.17
Average cost of funds	1.17	1.20	1.32	1.42	1.51
Net interest margin	1.67	1.65	1.73	1.77	1.80
Cost/income	45.8	43.5	39.6	39.0	37.5
Liquidity (%)					
Loans/customer deposits	83.0	82.7	84.4	85.7	86.8
Asset quality (%)					
Net NPL	1.3	1.5	1.2	1.2	1.3
Gross NPL	1.3	1.5	1.2	1.2	1.3
(SP+GP)/average gross loans	0.3	0.3	0.2	0.2	0.2
Loan loss coverage	100.0	76.9	93.2	91.8	87.9
Capital adequacy (%)					
CET1	14.7	13.9	13.1	13.7	14.3
Tier 1 capital	15.1	15.0	14.0	14.5	15.0
Risk-weighted capital	17.1	17.2	15.6	15.9	16.4
Returns (%)					
ROAE	10.0	11.0	12.9	13.6	14.1
ROAA	0.9	0.9	1.1	1.2	1.3
Shareholders equity/assets	8.7	8.3	8.5	8.7	9.0

Source: Company; Maybank

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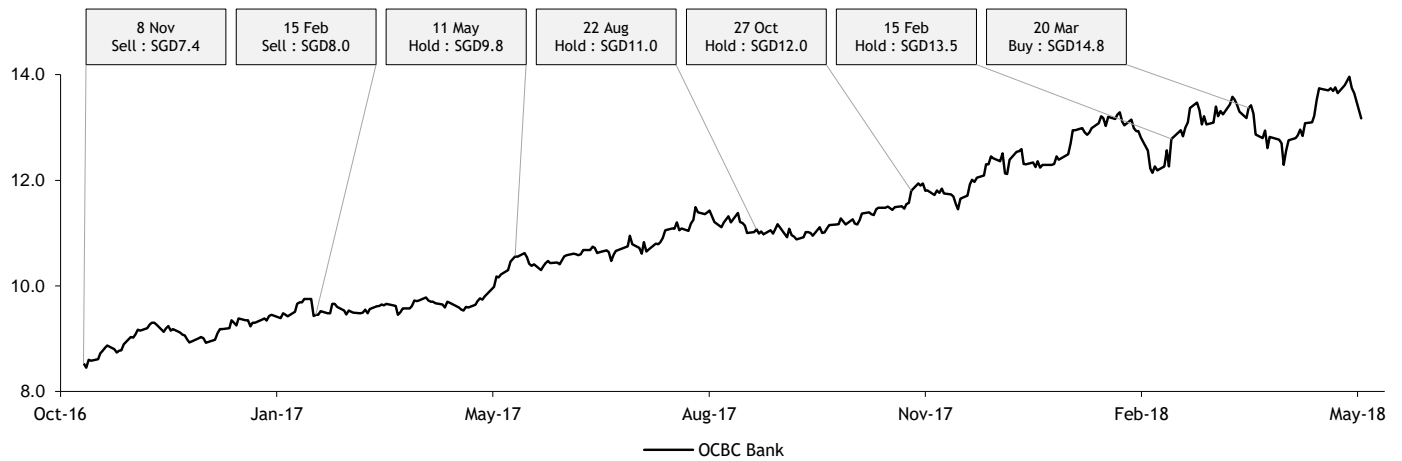
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