

OCBC Bank (OCBC SP)

Sustainable Momentum

BUY

[Prior:HOLD]

Share Price SGD 13.18
 12m Price Target SGD 14.83 (+13%)
 Previous Price Target SGD 13.50

Raised EPS and TP; U/G to BUY

We believe OCBC's earnings momentum is likely to be sustained in an upcycle. We raised our FY18-20E net profit by 4-12% due to higher assumptions for loan growth and non-interest income (non-II) from stronger wealth management (WM) earnings and life insurance contribution from Great Eastern (GEH) (GE SP Equity, Not Rated). With the revisions to our EPS forecasts, our assumed sustainable ROE is now 14.0% (13.1% previously), COE 10.5% and growth rate 3.5% (both unchanged). Our TP is raised 10% to SGD14.83, based on 1.5x FY18E P/BV (from ~1.4x), 1SD above its historical mean of 1.3x to reflect higher forecast ROEs. We also believe OCBC's valuation multiple deserves to rise in view of its ability to expand ROEs from non-II growth. U/G to BUY.

Benefit from higher loan growth

We estimate OCBC's multiplier between its loan growth and Singapore's GDP growth is 2.9x on average, higher than 2.4-2.6x for peers. OCBC's multiplier was higher in recent quarters, which could possibly be due to lending to more Singapore-based corporates for trade and investment flows. As a result, we raised our FY18-20E loan growth assumption to ~10% from ~9%.

Non-II driven by WM and insurance

WM will remain a key growth driver for OCBC, as WM income formed 34% of total FY17 income. We raised our FY18-20 forecasts for non-II by 6-14% on higher WM fees and GEH's insurance contribution. We believe WM growth can be sustained due to: 1) cross-selling efforts across its wealth platform; 2) tapping onshore private banking in Indonesia; and 3) increasing AUM for the Bank of Singapore. It will also see higher contribution from GEH as its underlying operations have been robust, as new business embedded value and total weighted new sales rose 17% YoY and 23% YoY in FY17. Moreover, GEH's presence in Singapore and Malaysia allows it to tap the underpenetrated life insurance sector. We forecast a 3-year CAGR of ~22% for GEH's life profits for OCBC, as we believe our previous estimates were conservative.

Risks to our call

Downside risks to our BUY thesis are: 1) lower WM fees; 2) lower insurance contribution from GEH; and 3) higher provisions.

FYE Dec (SGD m)	FY16A	FY17A	FY18E	FY19E	FY20E
Operating income	8,489	9,636	11,306	12,181	13,576
Pre-provision profit	4,605	5,498	6,916	7,515	8,591
Core net profit	3,433	4,106	5,176	5,961	6,791
Core EPS (SGD)	0.8	1.0	1.2	1.4	1.6
Core EPS growth (%)	(9.1)	19.6	26.1	15.2	13.9
Net DPS (SGD)	0.4	0.4	0.4	0.4	0.4
Core P/E (x)	16.1	13.5	10.7	9.3	8.1
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	8.94	9.87	10.88	12.07
ROAE (%)	10.0	11.2	13.1	13.7	14.1
ROAA (%)	0.9	0.9	1.1	1.2	1.3
Consensus net profit	-	-	4,662	5,101	5,497
MKE vs. Consensus (%)	-	-	19.6	17.7	24.3

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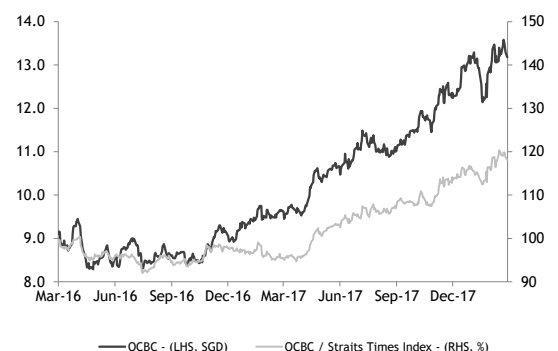
Statistics

52w high/low (SGD) 13.58/9.45
 3m avg turnover (USDm) 54.2
 Free float (%) 74.2
 Issued shares (m) 3,993
 Market capitalisation SGD52.6B
 USD39.9B

Major shareholders:

Lee Foundation 19.9%

Price Performance



	-1M	-3M	-12M
Absolute (%)	2	8	36
Relative to index (%)	1	4	23

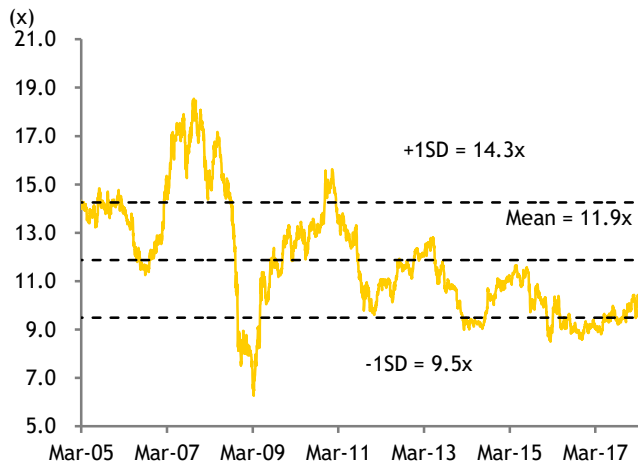
Source: FactSet

Fig 1: Revisions to estimates

OCBC	Revised			Previous		
	2018E	2019E	2020E	2018E	2019E	2020E
(SGD m)						
Net interest income	6,240.4	6,805.9	7,469.2	6,217.6	6,735.7	7,351.5
Non-interest income	4,706.9*	5,375.2	6,106.5	4,462.8 *	4,895.7	5,345.8
Total income	10,947.3*	12,181.1	13,575.8	10,680.4 *	11,631.5	12,697.3
Expenses	(4,390.0)	(4,665.9)	(4,984.8)	(4,390.0)	(4,665.9)	(4,984.8)
Provisions	(456.8)	(536.1)	(614.7)	(442.2)	(517.5)	(594.9)
Core net profit [^]	5,176.1	5,960.7	6,791.3	4,960.4	5,506.7	6,057.2
Revisions (%)						
Net interest income	0.4	1.0	1.6			
Non-interest income	5.5	9.8	14.2			
Total income	2.5	4.7	6.9			
Expenses	-	-	-			
Provisions	3.3	3.6	3.3			
Core net profit [^]	4.3	8.2	12.1			

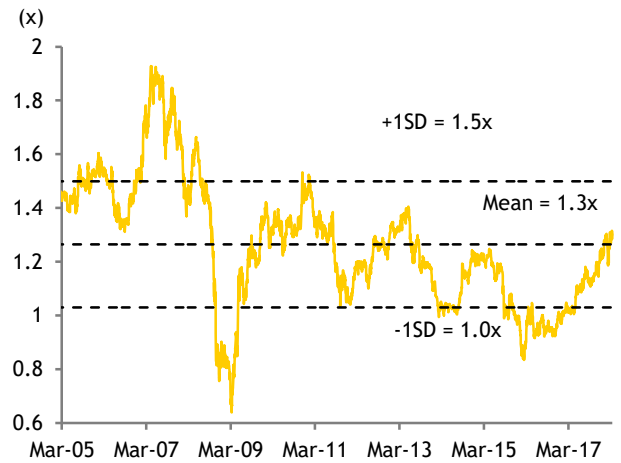
Source: Maybank Kim Eng. *Excludes one-off gains from sale of Hong Kong Life Insurance. ^Net profit excludes one-offs and preference share dividends.

Fig 2: OCBC's 12M forward rolling P/E band



Source: Bloomberg, Maybank Kim Eng

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

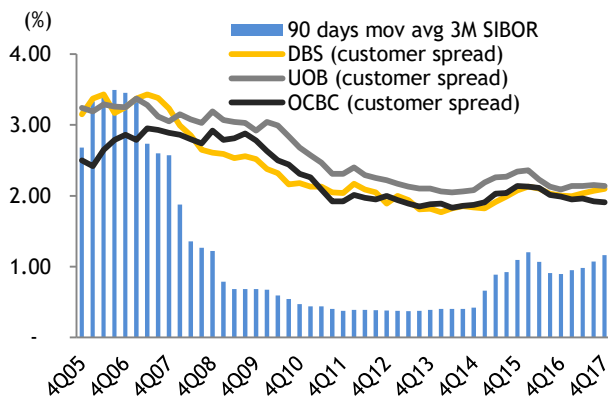


Source: Bloomberg, Maybank Kim Eng

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 at 1.91% in 4Q17

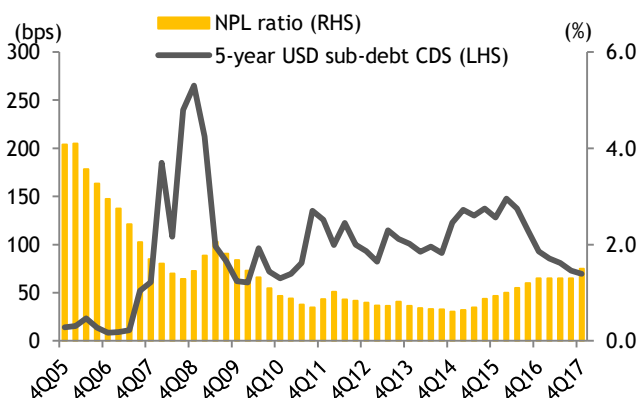


Source: Bloomberg, Companies

Financial Metrics

- Greater China a core business to the Group. Integration with WHB boosted region's 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 slight improvements in FY18/19/20E NIMs at 1.71%/1.73%/1.77%.
- Fully-loaded CET1 was 13.1% as at 4Q17. With comfort level at 12.5%, there is scope for dividend upside.
- Expect -10% loan growth in FY18-20E.
- Cost of capital a major consideration. Sector contagion risks may be reflected in corporate papers or CDS.

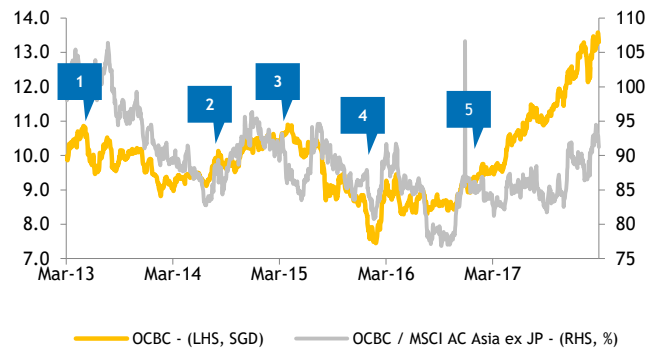
NPL ratio tracked CDS spreads with a lag during GFC



Source: Bloomberg, Company

Price Drivers

Historical share price



Source: FactSet, Maybank Kim Eng

1. 2012 earnings up 24% YoY from record income and higher contributions from Great Eastern.
2. Acquired and privatised Wing Hang Bank for USD5b. Issued rights to raise SGD3.3b.
3. 2014 core net profit up 25% YoY from robust lending and strong income growth. Included progressive consolidation of OCBC Wing Hang.
4. Sharp CNY devaluation in August 2015. O&G, commodities and China's NPL worries.
5. Share price rallied on positive sentiment from interest rate hikes, USD strength and economic recovery. Risks from O&G have abated.

Swing Factors

Upside

- Widening credit spreads from re-pricing of assets at higher interest rates.
- Higher non-interest income from WM 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	13.5	10.7	9.3	8.1
Core FD P/E (x)	16.1	13.5	10.7	9.3	8.1
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	10,504.6	11,647.1	12,996.5
Interest expense	(3,316.1)	(3,695.0)	(4,264.2)	(4,841.2)	(5,527.3)
Net interest income	5,052.1	5,423.0	6,240.4	6,805.9	7,469.2
Net insurance income	649.3	1,027.0	1,283.8	1,514.8	1,742.0
Net fees and commission	1,638.3	1,953.0	2,324.9	2,685.5	3,120.1
Other income	1,149.6	1,233.0	1,457.3	1,174.8	1,244.3
Total non-interest income	3,437.2	4,213.0	5,066.0	5,375.2	6,106.5
Operating income	8,489.3	9,636.0	11,306.4	12,181.1	13,575.8
Staff costs	(2,346.6)	(2,471.0)	(2,618.9)	(2,772.3)	(2,935.1)
Other operating expenses	(1,538.2)	(1,667.0)	(1,771.0)	(1,893.6)	(2,049.7)
Operating expenses	(3,884.8)	(4,138.0)	(4,390.0)	(4,665.9)	(4,984.8)
Pre-provision profit	4,604.5	5,498.0	6,916.5	7,515.1	8,590.9
Loan impairment allowances	(725.9)	(671.0)	(456.8)	(536.1)	(614.7)
Other allowances	0.0	0.0	0.0	0.0	0.0
Associates & JV income	396.7	389.0	419.0	452.5	488.7
Pretax profit	4,275.4	5,216.0	6,878.7	7,431.5	8,464.9
Income tax	(628.9)	(803.0)	(997.4)	(1,077.6)	(1,227.4)
Minorities	(173.4)	(267.0)	(307.1)	(353.1)	(406.1)
Discontinued operations	0.0	0.0	0.0	0.0	0.0
Reported net profit	3,473.1	4,146.0	5,574.2	6,000.8	6,831.4
Core net profit	3,433.0	4,105.9	5,176.1	5,960.7	6,791.3
Preferred Dividends	40.1	40.1	40.1	40.1	40.1

BALANCE SHEET (SGD m)

Cash & deposits with banks	39,800.7	49,377.0	50,364.5	51,371.8	52,399.3
Sec. under resale agreements	1,788.9	1,056.0	1,119.4	1,186.5	1,257.7
Derivatives financial assets	7,837.6	6,386.0	6,833.0	7,311.3	7,896.2
Dealing securities	5,334.6	5,402.5	5,856.3	6,028.1	6,036.0
Available-for-sale securities	26,605.5	30,572.1	29,400.4	29,988.4	30,185.9
Investment securities	15,581.0	16,825.4	17,058.3	17,537.6	18,097.7
Loans & advances	216,830.0	234,141.0	257,777.5	282,988.2	310,692.7
Central bank deposits	16,559.5	19,594.0	21,765.4	23,075.1	24,953.5
Investment in associates/JVs	2,415.5	2,352.0	2,469.1	2,642.0	2,826.9
Insurance assets	61,972.3	73,927.0	76,144.8	78,429.2	80,782.0
Fixed assets	4,571.6	4,281.0	4,376.1	4,473.4	4,572.9
Intangible assets	5,472.8	5,160.0	5,263.2	5,368.5	5,475.8
Other assets	5,113.6	5,864.0	4,812.6	4,837.7	4,944.3
Total assets	409,883.6	454,938.0	483,240.7	515,237.8	550,120.9
Deposits from customers	261,691.7	283,862.0	305,373.1	329,887.5	356,732.7
Deposits from banks & FIs	10,739.6	7,485.0	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	4,556.0	4,556.0	4,556.0	4,556.0
Other securities in issue	14,444.2	28,679.0	28,679.0	28,679.0	28,679.0
Other borrowings	499.1	499.0	499.0	499.0	499.0
Insurance liabilities	61,961.2	73,755.0	75,967.7	78,246.7	80,594.1
Other liabilities	8,427.9	9,371.0	9,502.5	9,859.5	9,927.3
Total liabilities	371,741.0	414,661.0	439,063.5	466,784.0	496,638.5
Share capital	2,096.9	2,096.9	2,096.9	2,096.9	2,096.9
Reserves	33,411.1	35,412.1	39,281.6	43,522.9	48,510.9
Shareholders' funds	35,507.9	37,509.0	41,378.5	45,619.8	50,607.8
Preference shares	0.0	0.0	0.0	0.0	0.0
Minority interest	2,634.9	2,768.0	2,798.7	2,834.0	2,874.6
Total equity	38,142.9	40,277.0	44,177.2	48,453.8	53,482.4
Total liabilities & equity	409,883.6	454,938.0	483,240.7	515,237.8	550,120.9

FYE 31 Dec	FY16A	FY17A	FY18E	FY19E	FY20E
Key Ratios					
Growth (%)					
Net interest income	(2.6)	7.3	15.1	9.1	9.7
Non-interest income	(2.7)	22.6	20.2	6.1	13.6
Operating expenses	3.3	6.5	6.1	6.3	6.8
Pre-provision profit	(7.2)	19.4	25.8	8.7	14.3
Core net profit	(7.5)	19.6	26.1	15.2	13.9
Gross loans	4.5	7.8	9.9	9.8	9.8
Customer deposits	6.1	8.5	7.6	8.0	8.1
Total assets	5.0	11.0	6.2	6.6	6.8
Profitability (%)					
Non-int. income/Total income	40.5	43.7	44.8	44.1	45.0
Average lending yields	2.76	2.77	2.88	2.96	3.07
Average cost of funds	1.17	1.20	1.28	1.36	1.44
Net interest margin	1.67	1.65	1.71	1.73	1.77
Cost/income	45.8	42.9	38.8	38.3	36.7
Liquidity (%)					
Loans/customer deposits	83.0	82.7	84.4	85.8	87.1
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	93.6	92.1	88.2
Capital adequacy (%)					
CET1	15.1	15.0	14.0	14.6	15.2
Tier 1 capital	15.1	15.0	14.0	14.6	15.2
Risk-weighted capital	17.1	17.2	15.6	16.0	16.5
Returns (%)					
ROAE	10.0	11.2	13.1	13.7	14.1
ROAA	0.9	0.9	1.1	1.2	1.3
Shareholders equity/assets	8.7	8.2	8.6	8.9	9.2

Source: Company; Maybank

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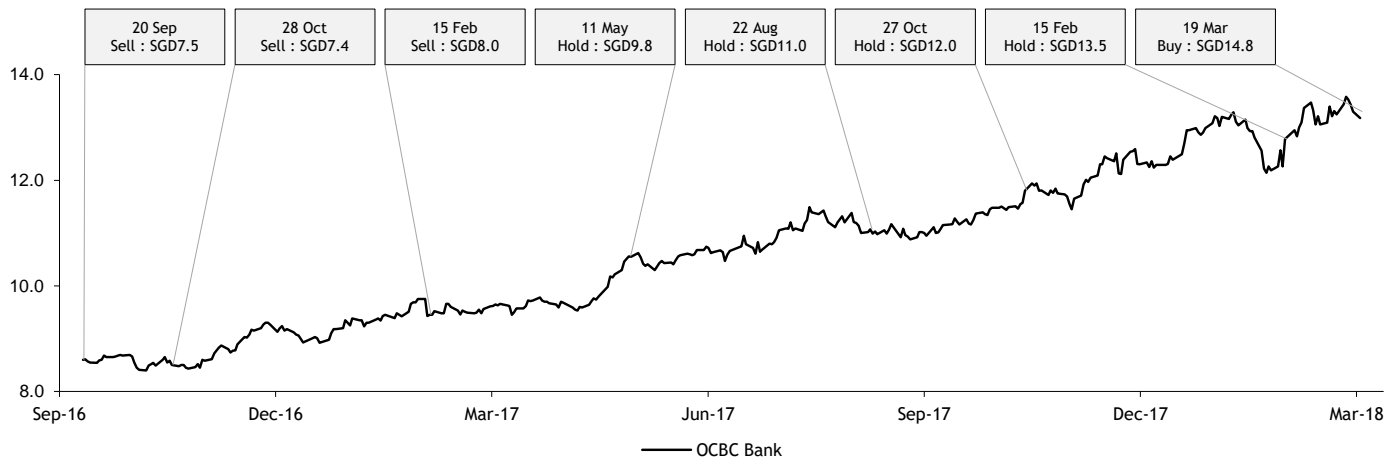
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