



AmInvestment Bank

HONG LEONG FINANCIAL GROUP

(HLFG MK EQUITY, HLCB.KL)

20 Jan 2023

More favourable interest rate impact on securities portfolio of HLA; recovery for IB business ahead

Company report

BUY

(Maintained)

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Rationale for report: Company update

Price	RM19.04
Fair Value	RM22.10
52-week High/Low	RM20.38/RM18.10

Key Changes

Fair value	↔
EPS	↔

YE to Jun	FY22	FY23F	FY24F	FY25F
Total income (RM mil)	6,251.5	6,561.0	6,964.0	7,546.5
Core net profit (RM mil)	2,655.2	2,764.2	2,873.2	3,058.7
FD Core EPS (sen)	234.2	243.8	253.4	269.8
FD Core EPS growth (%)	17.2	4.1	3.9	6.5
Consensus Net Profit (RM mil)	-	2,774.0	2,977.0	3,191.0
DPS (sen)	46.0	56.1	58.3	64.9
BV/share (RM)	21.41	23.99	26.25	28.69
PE (x)	8.1	7.8	7.5	7.1
Div yield (%)	2.4	2.9	3.1	3.4
P/BV (x)	0.9	0.8	0.7	0.7
ROE (%)	10.4	10.7	10.1	10.3

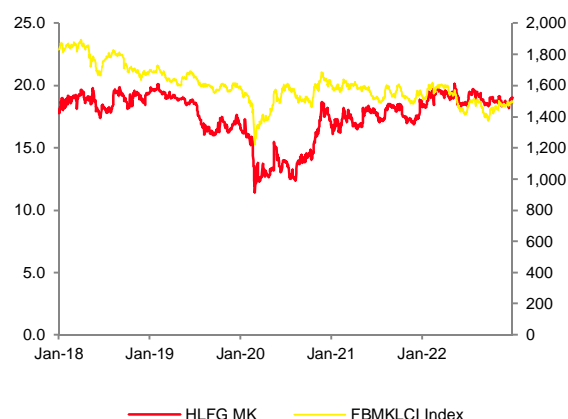
Stock and Financial Data

Shares Outstanding (million)	1,133.9
Market Cap (RMmil)	21,589.1
Book Value (RM/share)	21.41
P/BV (x)	0.9
ROE (%)	10.4

Major Shareholders	Hong Leong Company (Malaysia) Bhd (52.0%) Guoco Group (25.4%)
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Free Float	22.5
Avg Daily Value (RMmil)	5.1

Price performance	3mth	6mth	12mth
Absolute (%)	1.3	2.9	3.5
Relative (%)	(4.2)	(1.7)	5.8



Investment Highlights

- We maintain our BUY call on Hong Leong Financial Group (HLFG) with unchanged forecasts and fair value (FV) of RM22.10/share based on SOP valuation. Our FV reflects a neutral 3-star ESG rating.
- In 1QFY23, the key insurance subsidiary, Hong Leong Assurance (HLA) reported subdued gross premiums of RM726mil while new business regular premiums (NBRP) declined marginally by 1.5% YoY. We expect gross premiums of HLA in 2QFY23 to remain flattish due to higher interest rates and weaker investment sentiments amidst the global economic uncertainties that have led consumers to defer their purchase of longer term insurance plans.
- From our channel checks, medical insurance claims have continued to rise. This was attributed to the increase in the cost of medical expenses. As a result, generally life insurance companies have started to reprice their premiums upwards to mitigate the impact of higher medical claims.
- We gather that the bulk of HLA's life insurance policies are without medical riders. Although there will be some adjustments in pricing of policies, we understand that it will not be as steep as HLA's peers which have underwritten more life policies with medical coverage. This provides comfort that the repricing exercise will not materially result in a decrease in persistency ratio which has been steadily holding above 85%.
- We expect the group's family takaful operating subsidiary, Hong Leong MSIG Takaful to register a strong growth in 1HFY23 contributions with its strengthened agency channels and digital channels. The growth is expected to be driven by demand for credit-related products as well as regular contributions for takaful coverage.
- Following the opening of China borders with zero-Covid 19 policy restrictions lifted, we expect the group's overseas general insurance company, Hong Leong Insurance (Asia) in Hong Kong to register a stronger topline growth ahead.

This is based on our expectation that the general insurance entity would be able to benefit from the easing of restrictions in Hong Kong and China with an improvement in demand for travel insurance.

- FY22 saw a negative interest rate impact of RM32mil from 100bps increase in the 10-year MGS yield on HLA earnings. In 1QFY23, HLA continued to be impacted by the marked-to-market revaluation losses on investments owing to higher interest rates. Nevertheless, the 10-year MGS yield in 2QFY23 declined to 4.1% vs. 4.4% in 1Q23. Hence, we expect a portion of the unrealised marked-to-market losses on HLA's securities portfolio to unwind in the upcoming 2QFY23 results, scheduled to be announced on 28 February 2023.
- With the tapering of US rate hike expectations, a smaller quantum Fed rate increase is expected ahead. Our economics team expects a further 75bs increase in the Fed rate in 1HCY23 from 4.25-4.5%, presently. Meanwhile, the 10-year MGS yield is projected to be lower by the end of 2023 at 3.8%-4%.
- Overall, we expect an improvement in earnings from the insurance division in 2QFY23. This will be underpinned by more favourable interest rate movements on the valuation of securities portfolio, stronger premium growth of overseas insurance subsidiaries while the claims ratio for HLA remain stable.
- Contributions from the investment banking (IB) division to group PBT are expected to remain minimal, below 5% for FY23F. We continue to observe a difference between Federal Open Market Committee (FOMC) and Fed Fund Futures stance on the magnitude of Fed Fund Rate hikes ahead with FOMC being more hawkish on the interest rate increase. This is likely to continue to cause markets to remain volatile until 1HCY23. With the potential end to monetary policy tightening in 1HCY23 coupled with a lower MGS yield moving into 2HCY23, we foresee an improvement in investor sentiments moving forward. We expect a stronger income from treasury and markets for banks in 2HCY23. 2HCY23 or 1HFY24 will likely see an improvement in IB and fund management business performance.
- Earnings of the commercial banking division under Hong Leong Bank (HLBB) in 2QFY23 are expected to be decent QoQ. The bank is likely to maintain its existing stock of pre-emptive provision buffers of RM629mil with no surprises to credit cost. Upticks in GIL ratio after the end of payment relief assistance plans (PRAP) should not be discounted. Nevertheless, we expect the overall asset quality of HLBB to be stable. HLBB is likely to still register a strong loans growth momentum in 2QFY23, above the industry trends, and is on track to meet its loans growth target of 7%-7.5% for FY23F.
- On NIM, though the OPR was hiked for the 4th time by another 25bps in Nov 2022, the upside to interest margin could be offset by the increase in funding cost from intensive deposit competition through various campaigns towards the end of 2022. We anticipate HLBB's NOII in 2QFY23 to improve compared to 1QFY23 with improvement in trading and investment income from favorable movements in interest rates with sustainable credit card-related fees and wealth management income.
- The stock is trading at a low FY23F PE of 8x and P/BV of 0.8x. We continue to like HLFM as a cheaper entry for exposure to HLBB which has shown resilient earnings and strong asset quality.

EXHIBIT 1: PB BAND CHART

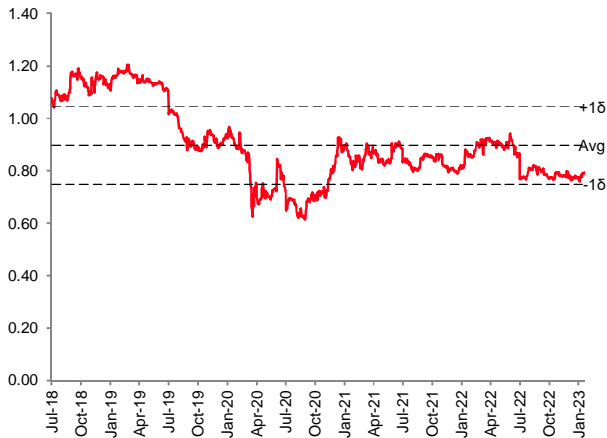


EXHIBIT 2: PE BAND CHART

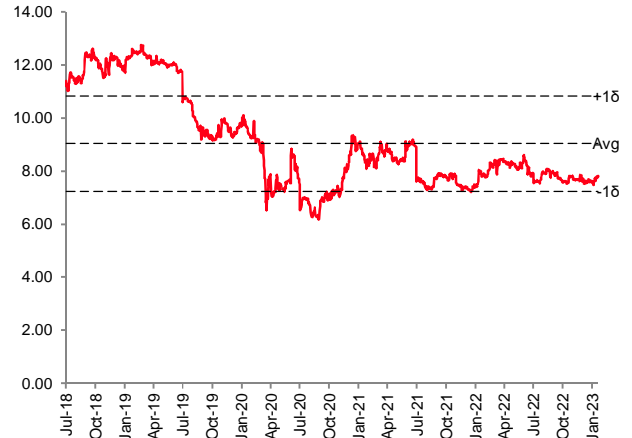


EXHIBIT 3: ESG RATING

Overall	★	★	★		
Board composition	★	★	★		
Employee welfare and environmental protection	★	★	★		
Corporate social responsibility	★	★	★		
Earnings quality	★	★	★		
Balance sheet strength	★	★	★	★	
Accessibility & transparency	★	★	★		

We accord a discount/premium of -6%, -3%, 0%, +3% and +6% on fundamental fair value based on the overall ESG rating as appraised by us, from 1-star to 5-star

EXHIBIT 4: SUM-OF-PARTS VALUATION

Companies	Shareholders funds (RM Mil)	As of	Equity Stake	Book Value Multiple	Basis	Valuation (RM mil)	Sum of parts per share (RM)
HLB	32,947		64.4%	1.4	Based on forecast for FY23	28,645	25.3
HLC	945	6/30/2022	81.3%	1.0		768	0.68
Insurance companies under HLA Holdings							
HLA	3,259	6/30/2022	70%		1x Embedded value of FY22	2,281	2.0
MSIG	3,039	6/30/2022	30%	1.6		1,459	1.3
HLMSIG Takaful	209	6/30/2022	65%	1.0		136	0.12
HLAI	130		100%	1.0		130	0.1
SOP Valuation						33,419	29.5
Holding company discount				25%		8,355	7.4
SOP Valuation after holding company discount						25,064	22.1

Source: Company, AmInvestment Bank Bhd

EXHIBIT 5: FINANCIAL DATA

Income Statement (RMmil, YE 30 Jun)	FY21	FY22	FY23F	FY24F	FY25F
Net interest income	3,559.0	3,856.5	4,280.2	4,597.9	4,884.4
Non-interest income	1,720.5	1,490.2	1,345.4	1,399.4	1,662.8
Islamic banking income	919.4	904.8	935.4	966.7	999.3
Total income	6,198.9	6,251.5	6,561.0	6,964.0	7,546.5
Overhead expenses	(2,392.5)	(2,358.2)	(2,427.6)	(2,576.7)	(2,716.7)
Pre-provision profit	3,806.3	3,893.3	4,133.4	4,387.3	4,829.7
Loan loss provisions	(650.0)	(163.1)	(178.9)	(151.0)	(122.3)
Impairment & others	(0.7)	1.0	-	(0.2)	(0.3)
Associates	815.8	1,108.8	1,076.8	993.5	1,116.2
Pretax profit	3,971.5	4,840.0	5,031.3	5,229.7	5,823.3
Tax	(595.1)	(1,157.1)	(905.6)	(941.3)	(1,048.2)
Minority interests	(1,111.1)	(1,230.7)	(1,361.5)	(1,415.2)	(1,575.8)
Net profit	2,265.3	2,452.2	2,764.2	2,873.2	3,199.3
Core net profit	2,265.3	2,655.2	2,764.2	2,873.2	3,058.7
Balance Sheet (RMmil, YE 30 Jun)	FY21	FY22	FY23F	FY24F	FY25F
Cash & deposits with FIs	6,930.7	9,605.9	8,664.7	7,906.5	4,301.6
Marketable securities	96,776.6	93,735.3	95,698.0	102,538.1	111,192.1
Total current assets	103,707.3	103,341.2	104,362.7	110,444.6	115,493.7
Net loans & advances	154,778.8	167,177.3	179,677.6	189,514.3	204,718.4
Statutory deposits	nm	nm	nm	nm	nm
Long-term investments	493.6	520.7	4,224.0	4,519.7	4,881.2
Fixed assets	1,824.8	1,746.0	1,661.6	1,583.6	1,510.3
Intangible assets	2,937.3	2,956.2	2,949.9	2,949.9	2,949.9
Other long-term assets	9,011.4	10,457.3	11,191.3	15,503.1	17,793.5
Total LT assets	169,572.7	183,579.6	200,513.2	214,975.0	232,865.6
Total assets	273,280.0	286,920.8	304,875.8	325,419.7	348,359.3
Customer deposits	181,768.8	197,382.9	211,199.7	225,983.7	244,062.4
Deposits of other FIs	14,179.5	8,229.5	8,062.3	7,900.2	7,740.5
Subordinated debts	2,207.2	2,207.1	2,374.4	2,552.5	2,745.1
Hybrid capital securities	3,339.6	6,298.7	7,457.9	9,575.1	10,216.8
Other liabilities	37,851.5	36,812.9	35,525.0	35,355.0	35,457.3
Total liabilities	239,346.5	250,931.1	264,619.3	281,366.5	300,222.1
Shareholders' funds	22,818.4	24,275.6	27,200.3	29,765.6	32,525.1
Minority interests	11,115.0	11,714.1	13,056.2	14,287.5	15,612.1
Key Ratios (YE 30 Jun)	FY21	FY22	FY23F	FY24F	FY25F
Total income growth (%)	17.9	0.8	5.0	6.1	8.4
Pre-provision profit growth (%)	31.3	2.3	6.2	6.1	10.1
Core net profit growth (%)	13.3	17.2	4.1	3.9	6.5
Net interest margin (%)	1.8	1.8	1.9	1.9	1.9
Cost-to-income ratio (%)	38.6	37.7	37.0	37.0	36.0
Effective tax rate (%)	15.0	23.9	18.0	18.0	18.0
Dividend payout (%)	20.0	21.3	23.0	23.0	23.0
Key Assumptions (YE 30 Jun)	FY21	FY22	FY23F	FY24F	FY25F
Loan growth (%)	6.7	7.9	7.5	5.5	8.0
Deposit growth (%)	6.2	8.6	7.0	7.0	8.0
Loan-deposit ratio (%)	86.1	85.6	86.0	84.8	84.8
Gross NPL (%)	0.5	0.5	0.5	0.5	0.5
Net NPL (%)	0.5	0.5	0.5	0.5	0.5
Credit charge-off rate (%)	0.3	0.1	0.1	0.1	-
Loan loss reserve (%)	246.6	211.8	211.0	215.8	211.6

Source: Company, AmInvestment Bank Bhd estimates

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