



# HONG LEONG FINANCIAL GROUP

(HLFG MK EQUITY, HLCB.KL)

1 June 2020

## Company report

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03-2036 2294

*Slower contributions from all divisions in 3QFY20*

## BUY

(Maintained)

**Rationale for report: Company results/update**

Price	RM13.40
Fair Value	RM16.50
52-week High/Low	RM19.08/RM9.75

### Key Changes

Fair value	⬇️
EPS	⬇️

YE to Jun	FY19	FY20F	FY21F	FY22F
Total income (RM mil)	5,278.0	5,017.4	5,251.7	5,664.0
Core net profit (RM mil)	1,803.9	1,810.8	1,904.3	2,080.3
FD Core EPS (sen)	157.7	158.3	166.5	181.9
FD Core EPS growth (%)	(5.5)	0.4	5.2	9.2
Consensus Net Profit (RM mil)	-	1,930.0	2,034.0	2,181.0
DPS (sen)	42.0	38.2	40.1	43.8
BV/share (RM)	16.70	18.04	19.45	20.99
PE (x)	8.5	8.5	8.0	7.4
Div yield (%)	3.1	2.8	3.0	3.3
P/BV (x)	0.8	0.7	0.7	0.6
ROE (%)	10.4	9.1	8.9	9.0

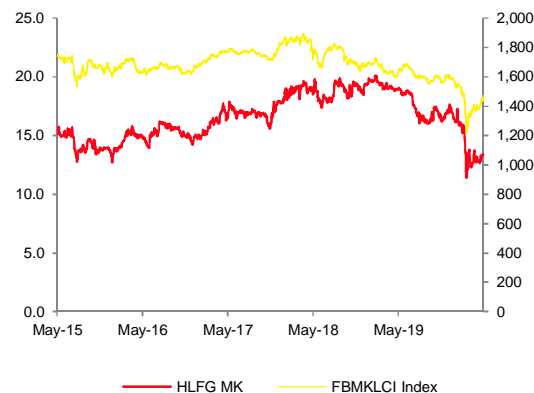
### Stock and Financial Data

Shares Outstanding (million)	1,137.0
Market Cap (RM mil)	15,235.8
Book Value (RM/share)	16.70
P/BV (x)	0.8
ROE (%)	10.4

Major Shareholders	Hong Leong Company (Malaysia) Bhd(51.9%) Guoco Assets(25.4%)
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Free Float	22.4
Avg Daily Value (RM mil)	3.6

Price performance	3mth	6mth	12mth
Absolute (%)	(12.4)	(17.8)	(29.1)
Relative (%)	(11.9)	(12.9)	(21.9)



### Investment Highlights

- We maintain our BUY call on Hong Leong Financial Group (HLFG) with a revised fair value to RM16.50/share (previously RM16.60/share) based on a lower derived SOP valuation. We fine-tune our net profit estimate for FY20/21 by -3.4%/-3.3 by lowering our non-interest income (NOII) estimates and factoring in a higher credit cost of 0.15% for FY20. HLFG remains a cheaper entry for gaining exposure to Hong Leong Bank (HLBB).
- HLFG reported a core net profit of RM339mil (-32.6% QoQ) in 3QFY20 with a lower contribution from commercial and investment banking, and the insurance division. Core earnings for 9MFY20 slipped 2.1% YoY to RM1.33bil after excluding the one-off gain of RM90mil from its subsidiary, HLBB's divestment of stake in a JV entity (Sichuan Jincheng Consumer Finance Company Ltd) in 9MFY19.
- Cumulative earnings were slightly below expectations, accounting for 69.0% of both our and consensus estimates.
- Its key subsidiary, HLBB reported a core PBT of RM2.34bil (-0.9% YoY) for 9MFY20. This was on the back of higher total income offset by higher operating expenses and provisions, which included a preemptive provisioning of RM65mil in 3QFY20 for the potential impact of Covid-19 (9MFY20 net credit cost: 13bps). HLBB's domestic loan growth remained robust at 5.9% YoY which outpaced the industry's 4.0% YoY growth. Meanwhile, its YTD NIM was only compressed by 1bps YoY to 1.97% despite two OPR cuts in 3Q20 (25bps each on Jan and Mar 2020).
- Asset quality of HLBB continues to be healthy with a low GIL ratio of 0.98% vs. the industry's 1.6%.
- On the insurance business, HLA Holdings Group (HLAH) recorded a lower PBT of RM83.3mil (-62.9% YoY) in 9M20. Revenue fell to RM69.9mil as a result of unrealised losses from the revaluation of equities of RM40.9mil which could turn around the next quarter with the improvement in the equity market performance. Also, HLAH's earnings were impacted by a lower life fund surplus of RM92.5mil.
- Hong Leong Assurance (HLA), the key insurance operating subsidiary, recorded a lower net profit of RM74.7mil for 9M20.

- The decline was due to lower interest rates and the minimum allocation rate (MAR) regulation implemented on 1 July 2019 requiring higher allocation of 60.0% from life insurance premiums to reserves compared to 45.0% previously in the first 2 years of the policy, thus affecting the profitability for the new business premiums.
- HLA's management expense ratio remained low at 6.3% for 9MFY20.
- HLA is staying focused on driving the growth of embedded value (EV) for its insurance business. This will be through changing the product mix by increasing the non-par/par ratio. In general, non-par/investment-linked policies have higher EV margins than ordinary life policies.
- The outlook for premium growth remains challenging due to the Covid-19 outbreak while flexibility has been granted by BNM for policyholders impacted by the pandemic virus to defer premium payment by 3 months without impacting the policy coverage.
- Its investment banking division under Hong Leong Capital (HLC) reported a higher PBT of RM58.1mil (+3.8% YoY) for 9MFY20. The stronger PBT was driven by higher earnings contribution from the fund management, investment banking and stockbroking business.
- No dividends have been declared in 3QFY20.
- HLFG's consolidated CET1, tier 1 and total capital ratios slipped to 10.8%, 11.7% and 14.8% in 3QFY20 compared to 10.9%, 11.9% and 15.0% respectively in 2QFY20. The ratios stayed above the regulatory requirements of 7.0%, 8.5% and 10.5% respectively.

## EXHIBIT 1: 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	29,553		64.40%	1.1	Based on forecast for FY21	20,936	18.4
HLC	798	6/30/2019	81.30%	1.0		648	0.57
<b>Insurance companies under HLA Holdings</b>							
HLA	2,445	6/30/2019	70.0%		1x Embedded value of FY19	1,712	1.5
MSIG	2,828	6/30/2019	30.0%	1.8		1,527	1.3
HLMSIG Takaful	77	12/31/2016	65.0%	1.0		50	0.04
HLAI	130		100.0%	1.0		130	0.1
<b>SOP Valuation</b>						<b>25,003</b>	<b>22.0</b>
Holding company discount				25.0%		6,251	5.5
<b>SOP Valuation after holding company discount</b>						<b>18,752</b>	<b>16.5</b>
No of shares						1,137	
<b>Fair Value</b>						<b>16.5</b>	

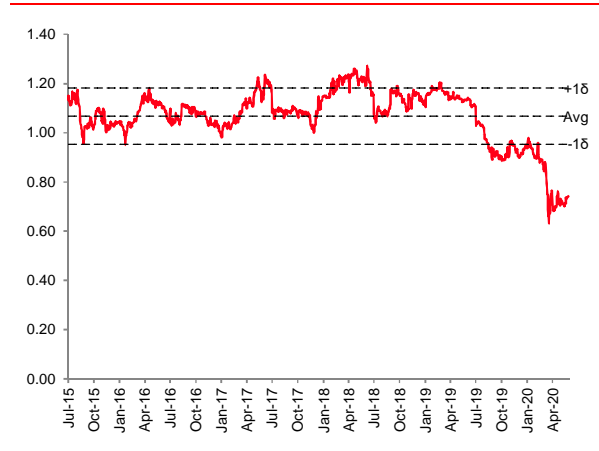
Source: Company, AmlInvestment Bank Bhd

## EXHIBIT 2: RESULTS COMPARISON

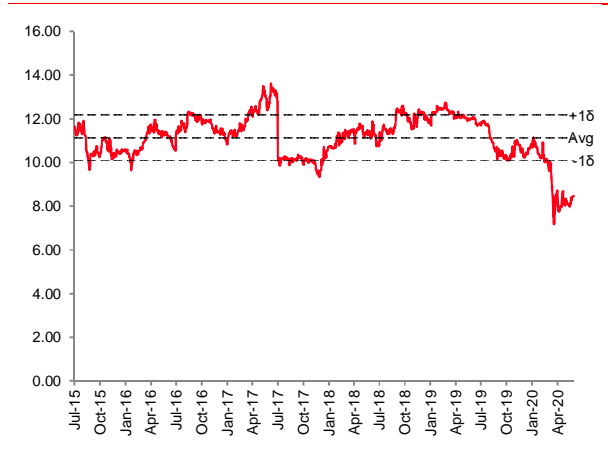
Income Statement (RM m, FYE 30 Jun)	3Q19	2Q20	3Q20	% QoQ	% Yoy	9M19	9M20	% Yoy
Interest income	1,785	1,726	1,657	-4.0%	-7.2%	5,354	5,099	-4.8%
Interest expense	-1,038	-939	-916	-2.5%	-11.7%	-3,103	-2,815	-9.3%
<b>Net interest income</b>	<b>747</b>	<b>787</b>	<b>740</b>	-5.9%	-0.9%	<b>2,251</b>	<b>2,283</b>	1.4%
Islamic banking income	188	206	206	-0.1%	9.5%	532	612	15.1%
Non interest income	372	367	196	-46.6%	-47.4%	1,153	933	-19.1%
<b>Total income</b>	<b>1,308</b>	<b>1,360</b>	<b>1,142</b>	-16.0%	-12.6%	<b>3,936</b>	<b>3,829</b>	-2.7%
Overhead expenses	-600	-601	-599	-0.3%	-0.2%	-1,765	-1,783	1.0%
Pre-provision profit	<b>707</b>	<b>759</b>	<b>543</b>	-28.4%	-23.2%	<b>2,171</b>	<b>2,046</b>	-5.8%
Loan impairment allowances	-5	-20	-129	562.0%	2687.3%	35	-140	-502.4%
Other allowances	1	-2	2	-227.8%	33.9%	0	0	-15.9%
Associates and JV income	155	187	188	0.4%	21.0%	460	535	16.5%
<b>Pretax profit</b>	<b>859</b>	<b>924</b>	<b>603</b>	-34.7%	-29.8%	<b>2,666</b>	<b>2,441</b>	-8.4%
Income tax	-157	-167	-91	-45.8%	-42.4%	-462	-428	-7.5%
Minority interest	-239	-254	-174	-31.7%	-27.2%	-753	-681	-9.5%
<b>Net profit</b>	<b>463</b>	<b>503</b>	<b>339</b>	-32.6%	-26.8%	<b>1,451</b>	<b>1,332</b>	-8.1%
<b>Core net profit</b>	<b>463</b>	<b>503</b>	<b>339</b>	-32.6%	-26.8%	<b>1,360</b>	<b>1,332</b>	-2.1%
Core EPS (sen)	40.5	44.3	46.1	4.1%	13.8%	118.9	117.3	-1.3%
<b>Segmental Analysis (RM m, FYE 30 Jun)</b>	<b>3Q19</b>	<b>2Q20</b>	<b>3Q20</b>	<b>% QoQ</b>	<b>% Yoy</b>	<b>9M19</b>	<b>9M20</b>	<b>% Yoy</b>
Commercial Banking	638	690	472	-31.6%	-26.0%	2,032	1,863	-8.3%
Investment Banking	18	23	11	-54.3%	-42.9%	56	58	3.8%
Insurance	70	45	-65	-243.4%	-193.1%	186	26	-86.1%
Others	194	538	201	-62.7%	3.8%	616	719	16.6%
Eliminations	-215	-559	-202	-63.8%	-6.1%	-684	-760	11.0%
Share of profit from associates	155	187	188	0.4%	21.0%	460	535	16.5%
Share of profit from JVs	0	0	0	na	na	0	0	na
<b>Pretax profit</b>	<b>859</b>	<b>924</b>	<b>603</b>	<b>-34.7%</b>	<b>-29.8%</b>	<b>2,666</b>	<b>2,441</b>	<b>-8.4%</b>

Source: Company, AmlInvestment Bank Bhd estimates.

**EXHIBIT 3: PB BAND CHART**



**EXHIBIT 4: PE BAND CHART**



## EXHIBIT 5: FINANCIAL DATA

Income Statement (RMmil, YE30 Jun)	FY18	FY19	FY20F	FY21F	FY22F
Net interest income	2,870.6	2,974.6	2,880.3	3,111.6	3,255.0
Non-interest income	1,834.3	1,596.2	1,326.2	1,231.7	1,392.5
<b>Islamic banking income</b>	<b>646.1</b>	<b>707.3</b>	<b>810.8</b>	<b>908.4</b>	<b>1,016.5</b>
Total income	5,351.0	5,278.0	5,017.4	5,251.7	5,664.0
Overhead expenses	(2,295.0)	(2,380.9)	(2,182.5)	(2,258.2)	(2,407.2)
Pre-provision profit	3,056.0	2,897.1	2,834.8	2,993.5	3,256.8
Loan loss provisions	(76.7)	(12.3)	(216.5)	(267.2)	(278.9)
Impairment & others	0.3	1.1	0.3	0.1	0.1
<b>Associates</b>	<b>599.7</b>	<b>619.7</b>	<b>677.3</b>	<b>739.8</b>	<b>808.4</b>
Pretax profit	3,579.3	3,505.6	3,295.9	3,466.1	3,786.5
Tax	(684.1)	(591.4)	(593.3)	(623.9)	(681.6)
<b>Minority interests</b>	<b>(987.1)</b>	<b>(994.9)</b>	<b>(891.9)</b>	<b>(937.9)</b>	<b>(1,024.6)</b>
Net profit	1,908.2	1,919.4	1,810.8	1,904.3	2,080.3
Core net profit	1,908.2	1,803.9	1,810.8	1,904.3	2,080.3
Balance Sheet (RMmil, YE30 Jun)	FY18	FY19	FY20F	FY21F	FY22F
Cash & deposits with FIs	9,890.1	8,613.5	10,444.7	13,143.4	17,828.2
<b>Marketable securities</b>	<b>76,151.4</b>	<b>75,909.4</b>	<b>81,148.2</b>	<b>85,605.7</b>	<b>90,435.9</b>
Total current assets	86,041.5	84,522.9	91,592.9	98,749.0	108,264.1
Net loans & advances	128,851.2	137,057.6	145,136.8	149,268.1	155,785.0
Statutory deposits	nm	nm	nm	nm	nm
Long-term investments	4,365.0	4,626.1	5,106.7	5,523.5	5,969.7
Fixed assets	2,068.0	2,030.0	1,882.4	1,799.9	1,723.0
Intangible assets	2,579.2	2,550.5	2,519.9	2,498.5	2,481.5
<b>Other long-term assets</b>	<b>6,196.2</b>	<b>6,613.0</b>	<b>7,777.3</b>	<b>11,054.4</b>	<b>11,345.0</b>
<b>Total LT assets</b>	<b>144,059.6</b>	<b>153,359.7</b>	<b>162,893.1</b>	<b>170,589.1</b>	<b>177,725.0</b>
Total assets	230,101.1	237,882.6	254,486.0	269,338.1	285,989.1
Customer deposits	156,882.9	161,887.9	169,172.8	176,447.3	184,034.5
Deposits of other FIs	9,296.4	9,780.5	10,998.4	11,963.0	13,001.1
Subordinated debts	3,460.7	2,160.4	1,845.8	1,348.0	987.6
Hybrid capital securities	1,829.5	1,381.3	1,206.8	1,043.9	947.9
<b>Other liabilities</b>	<b>31,951.8</b>	<b>34,071.4</b>	<b>40,731.0</b>	<b>45,610.9</b>	<b>51,481.6</b>
Total liabilities	203,421.4	209,281.6	223,954.9	236,413.0	250,452.6
Shareholders' funds	17,804.4	19,096.6	20,629.1	22,246.7	24,011.1
Minority interests	8,875.3	9,504.4	9,902.0	10,678.4	11,525.3
Key Ratios (YE30 Jun)	FY18	FY19	FY20F	FY21F	FY22F
Total income growth (%)	6.3	(1.4)	(4.9)	4.7	7.9
Pre-provision profit growth (%)	8.7	(5.2)	(2.2)	5.6	8.8
Core net profit growth (%)	26.6	(5.5)	0.4	5.2	9.2
Net interest margin (%)	1.7	1.7	1.6	1.7	1.7
Cost-to-income ratio (%)	42.9	45.1	43.5	43.0	42.5
Effective tax rate (%)	19.1	16.9	18.0	18.0	18.0
Dividend payout (%)	24.0	25.0	24.1	24.1	24.1
Key Assumptions (YE30 Jun)	FY18	FY19	FY20F	FY21F	FY22F
Loan growth (%)	3.1	6.5	6.0	3.0	4.5
Deposit growth (%)	1.6	3.2	4.5	4.3	4.3
Loan-deposit ratio (%)	82.8	85.4	86.7	85.6	85.8
Gross NPL (%)	0.9	0.8	0.9	1.0	1.0
Net NPL (%)	0.7	0.8	0.8	0.8	0.8
Credit charge-off rate (%)	-	-	0.1	0.1	0.1
Loan loss reserve (%)	89.0	117.3	112.3	115.8	128.5

Source: Company, AmInvestment Bank Bhd estimates

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