

Oversea-Chinese Banking Corp

Meet Expectations

Bloomberg | Reuters | POEMS
OCBC SP | OCBC SI | OCBC SG
Industry: Regional Banks

Phillip Securities Research Pte Ltd

21 February 2012

Report type: Quarterly Results

Company Overview

OCBC, together with its subsidiaries, provides a range of services including banking, life assurance, general insurance, private banking, and asset management. Its main operations are in Singapore and Malaysia, with representative offices in 15 countries and territories.

- FY11 NPAT was within our expectations, but higher than street's consensus.
- Group reported 4Q11 revenue of S\$1.497 billion (+12.6% y-y; +14.3% q-q)
- Net Interest Income increased to S\$925 million (+20.3% y-y; +5.8% q-q)
- Fees and Commission amounted to S\$257 million (+0.4% y-y; -16.3% q-q)
- Profits from Insurance declined to S\$85 million (-19.8% y-y; -20.6% q-q)
- Net profit attributable to shareholders amounted to S\$594 million (+17.6% y-y; 15.8% q-q)
- Maintain Hold with new target price of S\$8.00.

What is the news?

OCBC FY11 earnings were within our expectations. Net interest income beat expectations due to higher loans growth while 4Q11 NIMs was maintained at 1.85%. Net profit was within our expectations. Non interest income beat 4Q11 expectations due to strong net trading gains. The net trading gains had rebounded from poorer performances in previous 3 quarters. However, fees and commission reported its first significant negative q-q growth since 3Q09.

Income Statement				
(Extract)	FY10	FY11	y-y (%)	Comments
(S\$'mn)				
NII	2,947	3,410	15.7%	High loans growth
Fees & Comm	987	1,137	15.2%	
Others	1,391	1,114	-19.9%	Weaker trading income
Revenue	5,325	5,661	6.3%	
Expenses	2,254	2,430	7.8%	Opex well managed
Net Income	2,254	2,312	2.6%	Meet expectations

Source: Company, PSR

How do we view this?

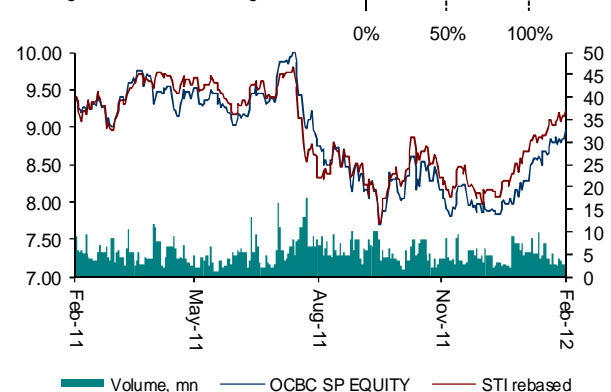
Although 4Q11 earnings improved q-q from weak 3Q11 earnings, we have our doubts on OCBC's ability to deliver strong earnings in the next few quarters. NIMs may face further compressions, while Profits from insurance, which has been decreasing the last 4 quarters, may continue to underperform.

Investment Actions?

Although OCBC met expectations, there is no clear catalyst for stronger growth in the next few quarters. We peg P/B of 1.25X to our forecasted NBV of S\$6.43 to attain a new fair valuation of S\$8.00.

Oversea-Chinese Banking Corp

Rating	3	Neutral
- Previous Rating	3	Neutral
Target Price (SGD)	8.0	
- Previous Target Price (SGD)	7.3	
Closing Price (SGD)	8.95	
Expected Capital Gains (%)	-10.6%	
Expected Dividend Yield (%)	3.1%	
Expected Total Return (%)	-7.5%	
Raw Beta (Past 2yrs w weekly data)	0.97	
Market Cap. (USD mn / SGD mn)	24503 / 30673	
Enterprise Value (USD mn / SGD mn)	20759 / 25796	
3M Average Daily T/O (mn)	4.5	
52 w week range (SGD)	7.68 - 10.09	
Closing Price in 52 w week range		



Major Shareholders	(%)
1. Selat Pte Ltd	10.7
2. Aberdeen Asset Management PLC	7.0
3. Singapore Investment Pte Ltd	3.4

Key Financial Summary

FYE	12/10	12/11	12/12F	12/13F
Revenue (SGD mn)	5,325	5,661	6,140	6,514
Net Profit, adj. (SGD mn)	2,254	2,312	2,545	2,716
EPS, adj. (SGD)	0.66	0.66	0.71	0.76
P/E (X), adj.	13.5	13.7	12.5	11.7
BVPS (SGD)	5.66	6.02	6.43	6.87
P/B (X)	1.6	1.5	1.4	1.3
DPS (SGD)	0.30	0.30	0.32	0.34
Div. Yield (%)	3.4%	3.4%	3.6%	3.8%

Source: Bloomberg, PSR est.

*All multiples & yields based on current market price

Valuation Method

P/B

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Summary

OCBC reported improved 4Q11 earnings from previous quarter to S\$594 million. However, we have our doubts OCBC being able to maintain net interest margins due to a likely fall in interest income margins. Profit from Insurance have been on the decline, while the risk of higher NPLs may require more aggressive provisioning in future quarters, decreasing net profits.

Fig 2. Y-Y and Q-Q comparison of FY11 results

\$m	4Q11	4Q10	%y-y ch	3Q11	%q-q ch
NII	925	769	20.3%	874	5.8%
Fees & Comm	257	256	0.4%	307	-16.3%
Profits from insurance	85	106	-19.8%	107	-20.6%
Other non-interest inc	230	198	16.2%	22	945.5%
Total Reveue	1,497	1,329	12.6%	1,310	14.3%
Expenses	(620)	(620)	0.0%	(611)	1.5%
Net Profit	594	505	17.6%	513	15.8%

Source: Company, PSR

Conso' ending	Profits (SGM)	EPS (SG)	DPS (SG)	BV (SG)	ROE (%)	P/E (X)	Yield (%)	P/BV (X)
12/09 A	1,962	0.60	0.28	5.29	12.2%	14.95	3.1%	1.69
12/10 A	2,254	0.66	0.30	5.66	12.1%	13.55	3.4%	1.58
12/11 A	2,312	0.66	0.30	6.02	11.1%	13.65	3.4%	1.49
12/11 E	2,546	0.71	0.32	6.43	11.9%	12.54	3.6%	1.39
12/12 E	2,716	0.76	0.34	6.87	11.9%	11.73	3.8%	1.30

Source: Company, PSR

Net Interest Margins outlook (Poor)

Net interest margins registered a y-y decrease of 0.11% for 4Q11, while it was maintained at 1.85% q-q based on average assets and liabilities during the quarter. The y-y decrease is largely attributable to 11.1% higher average margins for "Customer deposits", which is an interest expense, coupled with the 8.5% decrease in average margins for "Customer loans", an interest income.

Fig 3. Interest bearing Asset & Liability (Selected items)

	4Q11	4Q10	%y-y ch	3Q11	%q-q ch
Average Balance (\$m)					
Customer loans ¹	130,340	102,093	27.7%	122,701	6.2%
Loans to banks ¹	36,599	25,101	45.8%	34,876	4.9%
Interest income (\$m)					
Customer loans ¹	992	850	16.7%	938	5.8%
Loans to banks ¹	263	124	112.1%	240	9.6%
Interest margins (%)					
Customer loans ¹	3.02	3.30	-8.5%	3.03	-0.3%
Loans to banks ¹	2.85	1.96	45.4%	2.73	4.4%
Customer deposits ²	1.10	0.99	11.1%	1.11	-0.9%
Deposits of banks ²	0.90	0.70	28.6%	0.81	11.1%
NIM	1.85	1.96	-5.6%	1.85	0.0%

Note: 1- Asset; 2--Liability

Source: Company, PSR

Fig 4. Proportion of Interest bearing Assets (Selected items)

	4Q11	4Q10	%y-y ch	3Q11	%q-q ch
Average Balance (%)					
Customer loans ¹	65.6%	65.5%	0.1%	65.5%	0.1%
Loans to banks ¹	18.4%	16.1%	14.3%	18.6%	-1.1%
Interest income (\$m)					
Customer loans ¹	67.8%	73.1%	-7.3%	67.9%	-0.2%
Loans to banks ¹	18.0%	10.7%	68.5%	17.4%	3.4%

Source: Company, PSR

Looking at the breakdown of interest margins, we see a significant increase in average margins in Loans to banks. With an average balance amounting to 18.4% of total interest bearing asset in 4Q11, there seems to be substantial reliance on this category in stabilizing NIMs q-q. Interest income from Loans to banks now makes up 18.0% of total interest income, while contributions from Customer loans have dropped to 67.8%. However, we expect that increase in this interest margin may not be sustainable, and favor interest income growth to be from Customer loans as these are likely more stable compared to the overnight lending that typically makes up loans to banks.

Although management has guided that they have been able to price up new mortgage loans, pricing pressures remain relatively strong. In Singapore, banks have indicated challenges in increasing loan pricing and interest rates remain low, while key regions such as Indonesia and China recently experienced policy rate and reserve ratio cuts respectively, adding further pressures to interest margins. Therefore, we expect NIMs to decrease due to likely decrease in interest income.

Profit from Insurance outlook (Neutral)

Great Eastern, a subsidiary of OCBC, posted a decreased 4Q11 profit from life assurance of S\$50.8 million (-23% y-y, -33% q-q), largely attributable to S\$13.9 million loss for non-participating funds. For the full year, profit from life assurance fell to S\$382.5 million (2009: S\$437.2 million). Management indicated that the full year decrease was due to the widening of credit and swap spreads, and lower equity prices resulting in unrealized mark-to-market losses in valuation of assets.

On the bright side, in Singapore, sales of new regular premiums, which require periodic premium payments and increases new business embedded value, have increased to S\$98.3 million for 4Q11. This 27% y-y increase for 4Q11, and 41% overall increase for FY11, is significantly higher than the 19% y-y increase in 2011 for the sector based on figures from Life Insurance Association Singapore.

Unfortunately, sales of new regular premium have been dismal in the other regions, with emerging markets reporting a -35% y-y decrease to S\$24.8 million, and Malaysia reporting a weak 3% increase for FY11. We see a vast improvement in 4Q11 (Emerging markets: +27% q-q. Malaysia: +22% q-q), but we are skeptical on GE's ability to maintain sales momentum in FY12 until we see continued improvements in the next few quarters.

NPLs and Provisions outlook (Neutral)

NPL ratios were increased from 0.70% in 3Q11 to 0.87% for 4Q11 after recent reviews of the loan books. The sharpest increase was in the substandard category, while increases in the other two categories were more subtle. There was an approximate two fold increase in the "Current" category based on the ageing schedule, indicating that most of the new additions were not yet overdue.

Management has indicated that the loans belonged to a few large and middle sized corporations, and that the loans were well collateralized and had low probability of default. The ratio of specific loan allowances to average loans remain low at 7bps for FY2011, after recognizing of S\$48m of net specific allowances in 4Q11.

With the uncertainty in the economy, there is however a possibility for loans, especially consumer loans such as loans to SMEs and private individuals, to experience difficulties repaying their loans. A further slowdown in the global economy may also further affect businesses. Although management is cautiously optimistic, higher loan provisions, both specific and general, may be required to reflect a more accurate picture of the loan book in the next few quarters.

Future growth outlook (Neutral)

With a diverse business, there is potential for OCBC to achieve higher profits from greater synergies between the different businesses, namely banking services, life assurance, general insurance, asset management and private banking. Higher exposures in recent years through strategic acquisitions in neighboring South-east Asia countries, coupled with greater cross-selling of products through these increased touch points, together with the transfer of knowledge among business segments, could provide OCBC with an edge over its competitors. We maintain that its comparatively lower exposure to China, and

Hong Kong, may benefit OCBC, as geographical closeness and likely better understanding of key markets Malaysia and Indonesia may provide an edge over similar non-Asian competitors.

However, contributions by its subsidiary do not seem to be increasing significantly and benefiting from greater synergies. Based on figures from management, net profit contribution from Great Eastern, the largest contributor, has decreased 27% y-y from S\$405 million (18.0% of NPAT to shareholders) for FY2010 to S\$297 million (12.8% of NPAT to shareholders) for FY2011 due to volatile financial markets. Therefore, we are currently neutral on our outlook, until further improvements in contributions by these subsidiaries can be observed.

On a positive note, operating expenses have been well managed, with an improved cost to income ratio of 41.4% in 4Q11, compared to 46.6% in the previous quarter. Increase in operating expenses in 4Q11 was largely attributable to increase PPE, while staff costs remains unchanged. Continued management of operating expenses will lead to higher net interest profits, should revenue remains or increases.

Valuation

Taking into account the expected moderate growth of OCBC, together with a lower economic growth forecast for FY2012, we increase our EPS forecast to S\$0.71 for FY2012 from S\$0.69 for FY2011, EPS for FY2011 was S\$0.66. We expect dividend payouts for FY2012 to be 45%, which is similar to the actual payout ratio for FY2010. Although current P/B ratios are low, we do not see opportunities for an increase to historical means due to the sharp decreases in NIMs from historical year. We forecast P/B to increase from our previous forecast of 1.2X to 1.25X for 2012. Based on these assumptions, we obtain a new target price of S\$8.00.

Table 1. Growth in revenue

\$m	4Q11	4Q10	%y-y ch	3Q11	%q-q ch
Net interest income	925	769	20.3%	874	5.8%
Net fee and comm	257	256	0.4%	307	-16.3%
Profits from insura	85	106	-19.8%	107	-20.6%
Other non-interest	230	198	16.2%	22	945.5%
Total	1,497	1,329	12.6%	1,310	14.3%

Table 2. Fee and commission income

\$m	4Q11	4Q10	%y-y ch	3Q11	%q-q ch
Brokerage	13	23	-43.5%	20	-35.0%
Wealth managemen	56	54	3.7%	65	-13.8%
Fund managemen	24	23	4.3%	26	-7.7%
Credit card	13	13	0.0%	15	-13.3%
Loan-related	57	49	16.3%	62	-8.1%
Trade and remittar	49	49	0.0%	53	-7.5%
Guarantees	5	5	0.0%	5	0.0%
Investment Bankin	12	12	0.0%	27	-55.6%
Service charges	18	16	12.5%	27	-33.3%
Others	10	12	-16.7%	7	42.9%
Total Fee and Corr	257	256	0.4%	307	-16.3%

Table 3. Other non-interest income

\$m	4Q11	4Q10	%y-y ch	3Q11	%q-q ch
Net trading income	163	114	43.0%	(68)	-339.7%
Net gain on Invt se	22	11	100.0%	44	-50.0%
Disposal of proper	2	1	100.0%	-	#DIV/0!
Others	17	13	30.8%	15	13.3%
Total other non int	204	174	17.2%	(9)	-2366.7%

Table 4. Loans by Industries

\$m	4Q11	4Q10	%y-y ch	3Q11	%q-q ch
Agri, mining & qua	4,042	2,909	38.9%	3,421	18.2%
Manufacturing	8,424	7,057	19.4%	8,030	4.9%
Building and cons	20,365	18,532	9.9%	18,889	7.8%
Housing loans	32,076	27,076	18.5%	30,646	4.7%
General commerc	20,347	11,793	72.5%	19,442	4.7%
Tpt, storage & com	9,208	6,447	42.8%	7,999	15.1%
Fis, invt & holding	15,150	12,887	17.6%	16,095	-5.9%
Professionals & Pi	13,952	10,954	27.4%	12,769	9.3%
Others	11,568	8,794	31.5%	12,015	-3.7%
Total loans	135,132	106,449	26.9%	129,306	4.5%

Table 5. Loans by currencies

\$m	4Q11	4Q10	%y-y ch	3Q11	%q-q ch
Singapore dollar	61,198	54,850	11.6%	59,411	3.0%
US dollar	35,716	18,937	88.6%	33,432	6.8%
Malaysian ringgit	16,724	14,885	12.4%	15,919	5.1%
Indonesian rupiah	4,465	3,551	25.7%	4,013	11.3%
Others	17,029	14,226	19.7%	16,531	3.0%
Total loans	135,132	106,449	26.9%	129,306	4.5%

Table 6. Operating profit by Business segments

\$m	4Q11	4Q10	%y-y ch	3Q11	%q-q ch
Global Consumer	126	141	-10.6%	116	8.6%
Global Corporate F	370	297	24.6%	409	-9.5%
Global Treasury	307	133	130.8%	130	136.2%
Insurance	85	104	-18.3%	52	63.5%
Others	(10)	71	-114.1%	65	-115.4%
Total Profit	878	746	17.7%	772	13.7%

Table 7. Profit before tax by Geographical segments

\$m	4Q11	4Q10	%y-y ch	3Q11	%q-q ch
Singapore	479	472	1.5%	350	36.9%
Malaysia	204	200	2.0%	177	15.3%
Rest of SEA	26	(6)	-533.3%	38	-31.6%
Greater China	47	(19)	-347.4%	50	-6.0%
Other Asia Pacific	20	(1)	-2100.0%	26	-23.1%
Rest of the World	(19)	(2)	850.0%	8	-337.5%
Total NPBT	757	644	17.5%	649	16.6%

Source (tables 1-7): Company, Phillip Securities Research

Fig 1: Net interest margin

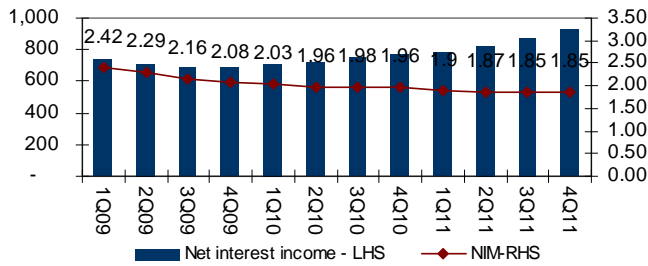


Fig 2: NonInt/Total revenue

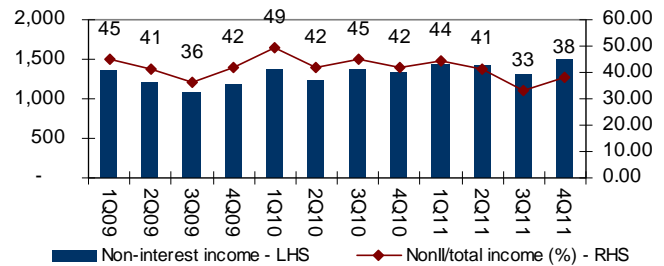


Fig 3: Efficiency ratio

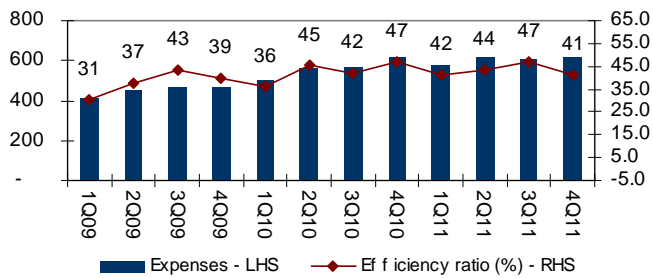


Fig 4: Net profit margin

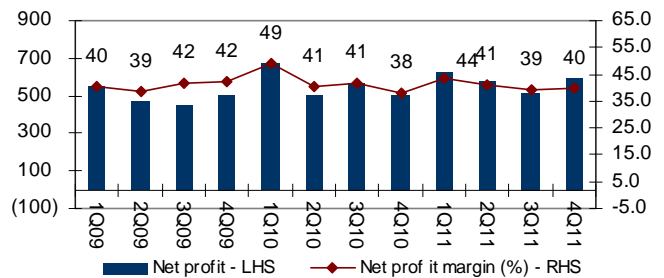


Fig 5: Deposits, Loans, LDR

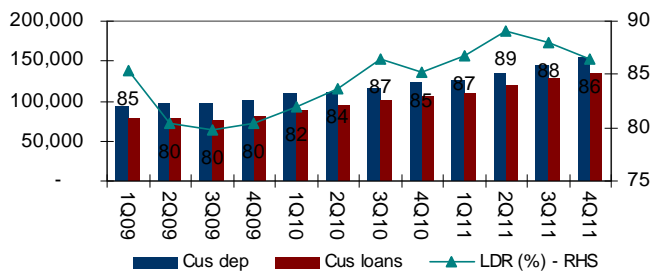


Fig 6: NPA, NPL

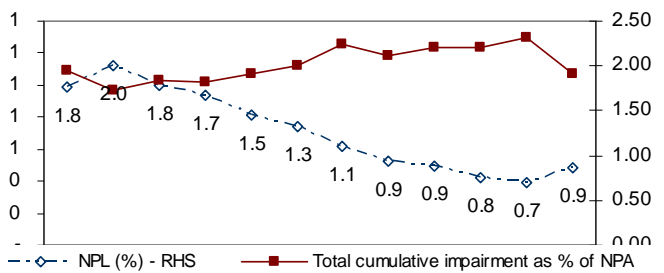


Fig 7: Growth in selected asset items

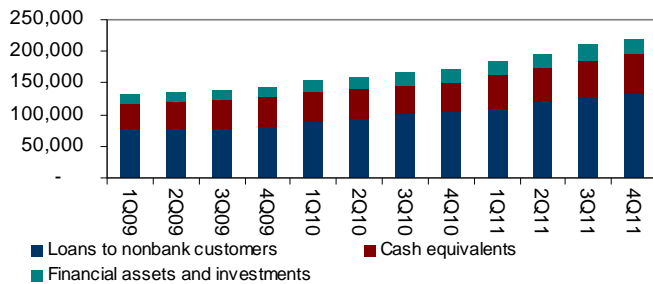


Fig 8: CAR

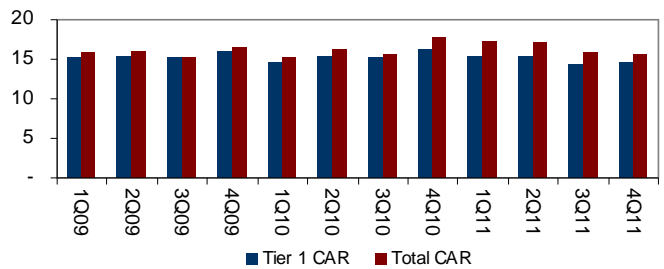


Fig 9: ROE and ROA

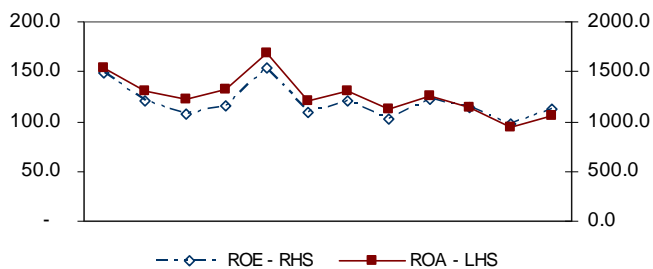


Fig 10: EPS and NBV

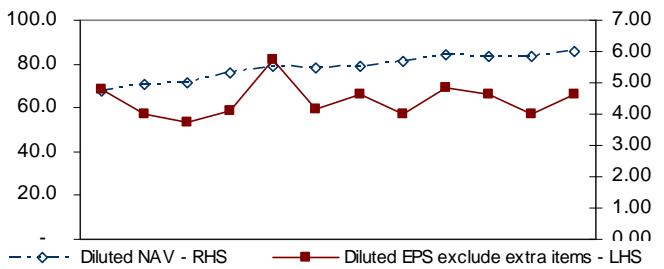


Fig 11: Profit before tax by geographical segment

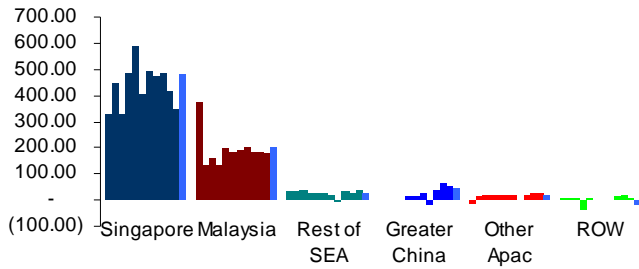


Fig 12: Geo segment breakdown

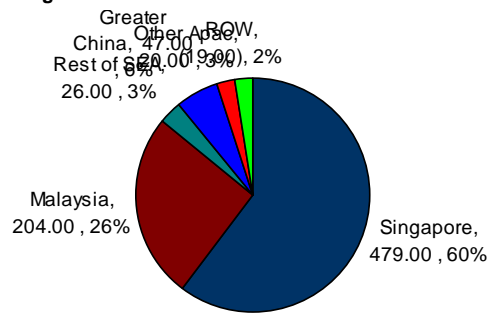
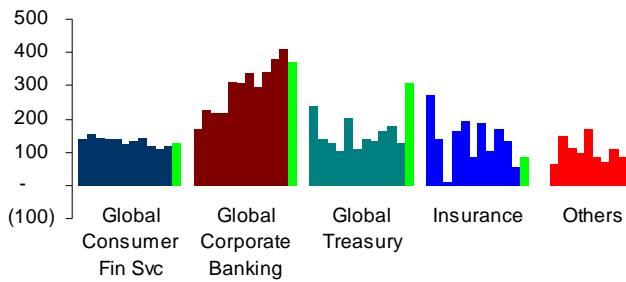


Fig 13: Operating profit by Business segment



Growth trend

Fig 14: Net interest income trend

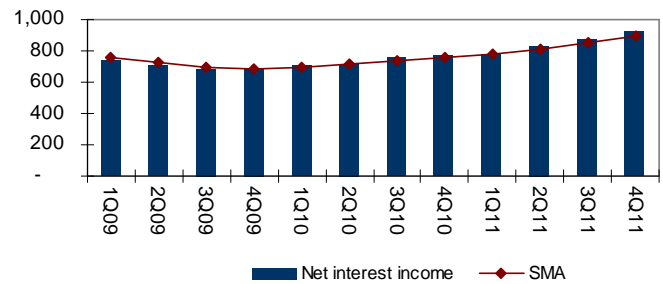


Fig 15: Fee and Commission trend

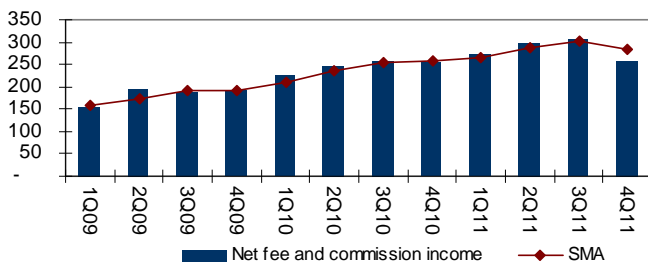


Fig 16: Other noninterest income trend

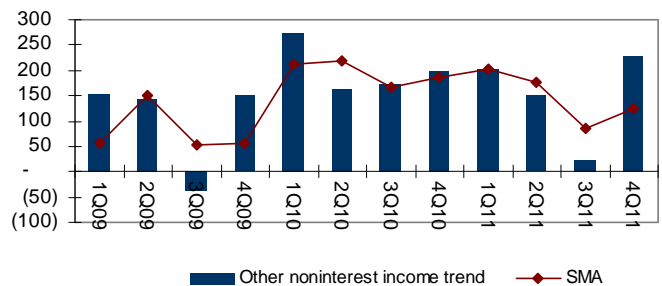
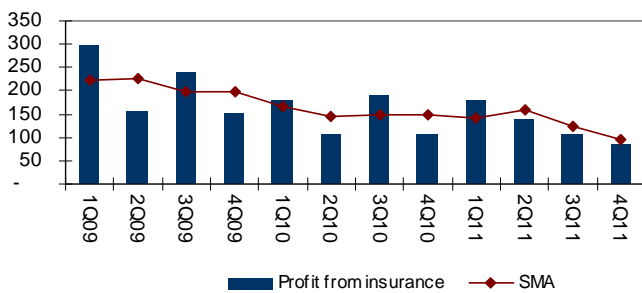


Fig 17: Profit from insurance



FYE Dec	FY09	FY10	FY11	FY12F	FY13F
Valuation Ratios					
P/E (X), adj.	14.9	13.5	13.7	12.5	11.7
P/B (X)	1.7	1.6	1.5	1.4	1.3
Dividend Yield (%)	3.1%	3.4%	3.4%	3.6%	3.8%
Per share data (SGD)					
EPS, reported	0.60	0.66	0.66	0.71	0.76
EPS, adj.	0.60	0.66	0.66	0.71	0.76
DPS	0.28	0.30	0.30	0.32	0.34
BVPS	5.29	5.66	6.02	6.43	6.87
Growth & Margins (%)					
Growth					
Net interest income	1.5%	4.3%	15.7%	13.1%	8.1%
Non interest income	21.1%	19.5%	-5.3%	1.4%	2.6%
Pre provision operating profit	8.8%	10.6%	6.3%	8.5%	6.1%
Operating income	22.3%	13.3%	2.3%	9.2%	6.7%
Net income, reported	12.2%	14.9%	2.6%	10.1%	6.7%
Margins					
Net interest margin	2.23%	1.98%	1.87%	1.83%	1.82%
Key Ratios (%)					
ROE	12.2%	12.1%	11.1%	11.9%	11.9%
ROA (exclude life assurance fund invt)	1.35%	1.32%	1.09%	1.02%	1.00%
RORWA	2.0%	2.2%	2.0%	1.9%	2.0%
Non-interest/total income ratio	41.3%	44.7%	39.8%	37.2%	35.9%
Cost/income ratio	37.3%	42.3%	42.9%	41.9%	41.9%
Loan/deposit ratio	80.4%	85.1%	86.4%	84.8%	83.8%
NPL ratio	1.68	0.93	0.87	0.87	0.87
Income Statement (SGD mn)					
Net Interest Income	2,826	2,947	3,410	3,858	4,173
Fees and Commission	730	987	1,137	1,199	1,244
Other Non interest income	1,260	1,391	1,114	1,083	1,097
Non Interest Income	1,990	2,378	2,251	2,282	2,341
Total operating income	4,816	5,325	5,661	6,140	6,514
Operating expenses	1,796	2,254	2,430	2,572	2,728
Provisions	478	189	283	349	351
Operating profit	2,542	2,882	2,948	3,219	3,435
Associates & JVs	1	(2)	8	5	5
Profit Before Tax	2,543	2,880	2,956	3,224	3,440
Taxation	389	433	478	516	550
Profit After Tax	2,154	2,447	2,478	2,708	2,889
Non-controlling Interest	192	193	166	162	173
Net Income, reported	1,962	2,254	2,312	2,545	2,716

Source: PSR

FYE Dec	FY9	FY10	FY11	FY12F	FY13F
Balance Sheet (SGD mn)					
Cash, balances and placements with central bank	13,171	11,493	12,897	22,209	27,038
Singapore Government treasury bills and securities	10,922	11,156	13,250	12,018	12,502
Other government treasury bills and securities	5,564	5,944	7,397	6,092	6,082
Placements and balances with banks	15,821	18,569	28,615	28,688	29,689
Debt and equity securities	11,680	14,255	15,081	14,817	15,205
Assets pledged	279	746	1,839	1,839	1,839
Assets held for sale	0	4	6	6	6
Derivative receivables	3,973	4,837	5,899	6,503	6,730
Other assets	2,911	3,116	3,191	3,060	3,167
Loans and bills receivable	80,876	104,989	133,557	148,226	163,829
Deferred tax	64	79	44	44	44
Associates and JV	226	255	361	361	361
PPE	1,609	1,625	1,664	1,773	1,862
Investment property	765	733	922	955	1,003
Goodwill and intangible assets	3,362	3,996	3,947	3,902	3,856
Life assurance fund investment assets	43,077	47,486	49,088	50,561	52,077
Total Assets	194,300	229,283	277,758	301,053	325,290
Deposits of non-bank customers	100,633	123,300	154,555	174,818	195,462
Deposits and balances of banks	10,958	16,508	21,653	21,628	22,006
Due to associates	119	139	178	178	178
Trading Portfolio liabilities	2,016	1,734	1,655	1,655	1,655
Derivative payables	3,918	4,563	6,113	6,113	6,113
Other liabilities	3,215	3,187	4,024	4,024	4,024
Current tax	607	745	800	800	800
Deferred tax	946	1,127	1,123	1,123	1,123
Debts issued	6,863	6,854	13,063	13,063	13,063
Life assurance fund liabilities	43,246	47,481	49,204	50,680	52,201
Total liabilities	172,521	205,638	252,368	274,083	296,625
Share Capital	5,480	6,315	7,127	7,127	7,127
Preference shares	1,896	1,896	1,896	1,896	1,896
Retained earnings	9,103	10,592	12,144	13,562	15,083
Capital reserves	986	613	279	279	279
FV reserves	1,506	1,374	1,125	1,125	1,125
Shareholder's equity	18,971	20,790	22,571	23,989	25,510
Non-controlling interest	2,808	2,855	2,819	2,981	3,155
Total Equity	21,779	23,645	25,390	26,971	28,665

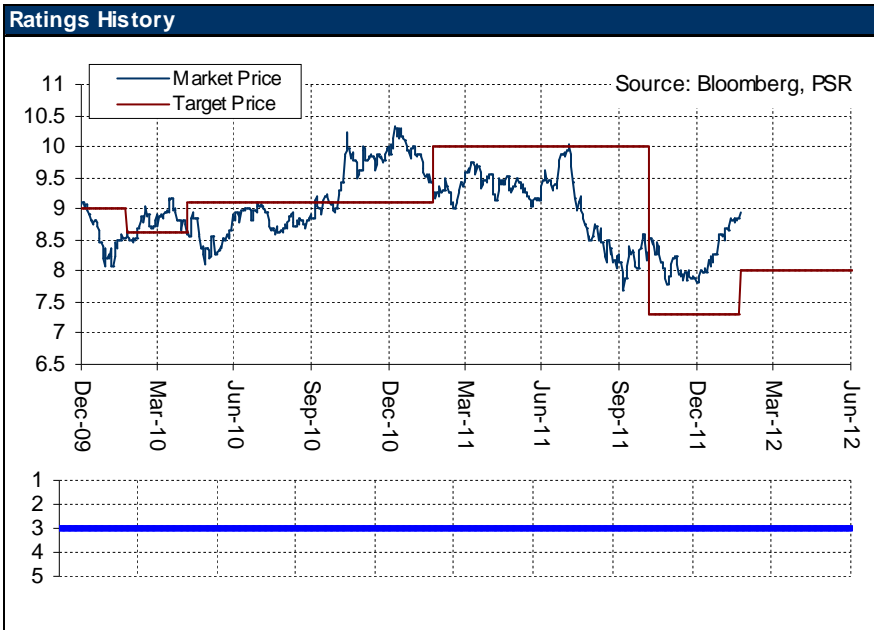
Cashflow Statements (SGD mn)

CFO					
PBT	2,543	2,880	2,956	3,224	3,440
Adjustments	537	353	507	530	542
Cash from ops before WC changes	3,080	3,233	3,463	3,754	3,982
WC changes	2,668	54	(5,639)	7,540	2,936
Cash generated from ops	5,748	3,287	(2,176)	11,294	6,918
Taxes paid, net	(342)	(420)	(409)	(516)	(550)
Cashflow from ops	5,406	2,867	(2,585)	10,778	6,367
Cashflow from investments	0	(4,523)	(1,895)	(339)	(343)
Cashflow from financing	684	(44)	5,883	(1,127)	(1,195)
Net change in cash	6,143	(1,679)	1,404	9,312	4,829
CCE, end	13,172	11,494	12,898	22,210	27,039

Supplementary items

Risk-weighted assets (SGD mn)	100,013	105,062	128,507	135,490	142,265
Tier 1 capital (SGD mn)	15,962	17,148	18,612	20,030	21,551
Total capital (SGD mn)	16,492	18,508	20,186	21,604	23,125
Core Tier 1 CAR (%)	12.0%	12.6%	11.4%	11.9%	12.4%
Tier 1 CAR (%)	15.9%	16.3%	14.5%	14.8%	15.1%
Total CAR (%)	16.4%	17.6%	15.7%	15.9%	16.3%

Source: PSR



PSR Rating System

Total Returns	Recommendation	Rating
> +20%	Buy	1
+5% to +20%	Accumulate	2
-5% to +5%	Neutral	3
-5% to -20%	Reduce	4
< -20%	Sell	5

Remarks

We do not base our recommendations entirely on the above quantitative return bands. We consider qualitative factors like (but not limited to) a stock's risk reward profile, market sentiment, recent rate of share price appreciation, presence or absence of stock price catalysts, and speculative undertones surrounding the stock, before making our final recommendation

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