

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.

- 2Q12 NPAT of S\$648 million above both our and consensus's estimates.
- Downgrade to "Reduce" based on current high share price and slower loans growth, lower NIMs, with unchanged target price of S\$8.20.

What is the news?

OCBC 1Q12 earnings beat both our and consensus's estimates. Earnings surprise was largely due to lower allowances for loans. Management also announced an increased interim dividend of S\$0.16, of which may be maintained, leading to a potential final dividend of S\$0.16, and an increase in total dividends to S\$0.32 for FY12.

Income Statement				
(Extract)	2Q11	2Q12	y-y (%)	Comments
(S\$m)				
NII	827	931	12.6%	Below expectations
Fees & Comm	299	317	6.0%	Wealth Mgmt fees strong
Insurance	137	108	-21.2%	
Others	150	171	14.0%	
Revenue	1,413	1,527	8.1%	
Expenses	(618)	(661)	7.0%	
Net Income	577	648	12.3%	Lower Loan allowance

Source: Company, PSR

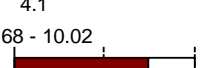
How do we view this?

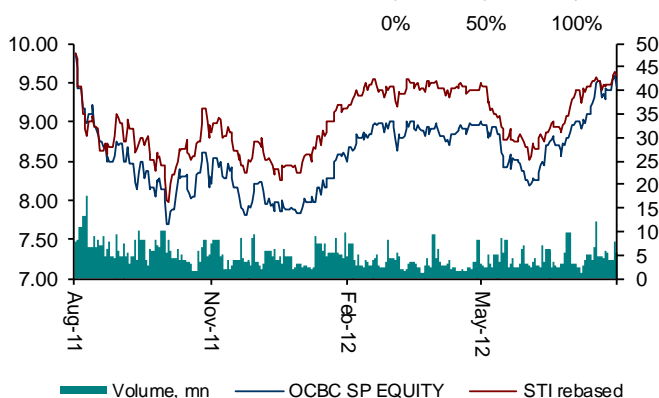
Although earnings were above estimates, management reduced their guidance on loans growth, while NIMs declined 9bps to 1.77%, and may decline slightly moving forward. Fees and commission improved, notably with sustained strong wealth management fee performance, while high improvements in investment banking fees may however be non-recurring. We are positive on the increase in interim dividend, and estimate a possible special dividend from the sale of APB and FNN, based on management's dividend payout policy of approximately 45% yearly.

Investment Actions?

We factor in the disappointing loans growth, lowered NIMs, positive improvements in Wealth management, and gains from sale of APB and FNN as the transaction is highly probable. We derive a lower core EPS of S\$0.69. Based on a higher BVPS to S\$6.57, due to potential gains from sale of APB and FNN, and an unchanged P/B multiple of 1.25X, we obtained an unchanged target price of S\$8.20. While core 2Q12 earnings were disappointing, OCBC's share price has rallied since Jun 12. Although we continue to expect OCBC to grow strongly y-y, we think that this may be a good time for investors to take profits, and therefore downgrade our call to "Reduce".

Oversea-Chinese Banking Corp

Rating	4	Reduce
- Previous Rating	3	Neutral
Target Price (SGD)	8.2	
- Previous Target Price (SGD)	8.2	
Closing Price (SGD)	9.44	
Expected Capital Gains (%)	-13.1%	
Expected Dividend Yield (%)	4.4%	
Expected Total Return (%)	-8.7%	
Raw Beta (Past 2yrs w weekly data)	1.00	
Market Cap. (USD mn / SGD mn)	26025 / 32421	
3M Average Daily T/O (mn)	4.1	
52 week range (SGD)	7.68 - 10.02	
Closing Price in 52 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	7,456	6,361
Net Profit, adj. (SGD mn)	2,254	2,312	3,616	2,571
EPS, adj. (SGD)	0.66	0.66	0.68	0.71
P/E (X),adj.	14.3	14.4	13.9	13.3
BVPS (SGD)	5.66	6.02	6.56	6.85
P/B (X)	1.7	1.6	1.4	1.4
DPS (SGD)	0.30	0.30	0.42	0.32
Div. Yield (%)	3.2%	3.2%	4.4%	3.4%

Source: Bloomberg, PSR est.

*All multiples & yields based on current market price

Valuation Method

P/B

Analyst

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Fig 1. Y-Y and Q-Q comparison of 1Q12 results

\$m	2Q12	2Q11	%y-y ch	1Q12	%q-q ch
NII	931	827	12.6%	951	-2.1%
Fees & Comm	317	299	6.0%	274	15.7%
Profits from insurance	108	137	-21.2%	253	-57.3%
Other non-interest inc	171	150	14.0%	319	-46.4%
Total Reveue	1,527	1,413	8.1%	1,797	-15.0%
Expenses	(661)	(618)	7.0%	(625)	5.8%
Net Profit	648	577	12.3%	832	-22.1%

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%	15.77	3.0%	1.79
12/10 A	2,254	0.66	0.30	5.66	12.1%	14.29	3.2%	1.67
12/11 A	2,312	0.66	0.30	6.02	11.1%	14.40	3.2%	1.57
12/12 E	3,617	0.68	0.42	6.56	16.7%	13.93	4.4%	1.44
12/13 E	2,571	0.71	0.32	6.85	11.2%	13.31	3.4%	1.38

Source: Company, PSR

Loans growth slow, management guidance lowered

Gross customer loans grew 2.8% q-q, rebounding from the -0.4% decline in 1Q12. This translates to YTD increase of 2.4%. In comparison, growth of total loans (ACU + DBU) based on MAS figures was 5.2%. On an absolute basis, growth was highest in the Housing loans, which likely contributed to a higher proportion of loans with maturity of over 3 years. On a positive note, loans growth was across most key regions except Greater China, reflecting well diversified growth.

A key takeaway was Management's lowered guidance on loans growth, which was from a low double-digit, to a high single-digit growth. Reasons given include a more conservative approach, and a slowing loans demand in line with the slowing economy. USD loans decreased for the second straight quarter, although management believes that USD loans demand will pick up moving forward.

NIMs decline disappointing

Although we expected NIMs to decline slightly, OCBC's 9bps drop to 1.77% was a negative surprise. The decline was also attributable to many areas, including NIMs in OCBC Malaysia declining 20bps to 2.01%, and OCBC NISP (Indonesia) declining 34bps to 4.04%. On OCBC Malaysia, management attributed this to lower yields on interbank placement, and higher funding cost. Higher interest rate fixed deposits were priced to attract new customers. Moving forward, management expects NIIMs to improve or stabilize, as deposits are priced down to previous levels, while housing loans that are currently experiencing downward pressure are priced back upwards. On OCBC NISP, lower asset yields due to increasing competition, and higher funding cost led to the decrease in NIMs. We attribute this partially to the interest rate cuts pushing loan prices down, while OCBC's funding costs increase from a lower proportionate increase in cheaper CASA deposits.

In Singapore, management guides that NIMs have declined due to downward pressure on housing loans as competition among the three local banks heat up, while senior debts that

were issued to improve longer maturity liquidity were booked in Singapore's books and therefore increasing interest expenses. On a positive note, loan spreads to corporations widened, resulting in higher interest income.

Interbank balances continue to increase, while the volatility of the interest rates saw a decrease in average interest rate of 24bps q-q to 2.44% for interest earning interbank balances. The average interest rate q-q decrease in interest earning interbank balances amounting to -\$27 million also contributed to the q-q decrease in total net interest income of -\$20 million. We prefer for OCBC to convert its assets to increasing loan balances, which has higher and less volatile interest yields, or other less volatile interest earning assets instead of interbank balances. This would reduce volatility and improve NIMs. Management has also guided that NIMs may slightly decrease moving forward, and we have priced this in our forecast for OCBC accordingly.

Non-provisioning loans, loan allowance lower

NPL ratios decreased 16bps q-q to 0.86%. Management guided that the decrease in NPLs was due to them identifying troubled accounts during their 1Q12 portfolio review, and improving their positions in these accounts. Management also guided that 3Q12's NPL is likely to remain similar. Loan allowances also decreased -60.0% q-q to S\$38 million. We had forecasted loan allowances to be much higher at S\$115. With the slowdown in the global economy, we continue to expect higher loan provisions to be made.

Fees and Commission – Wealth Mgmt a bright spot

Fees and Commission beat our estimates by 5.0%, with continued strong performance in Wealth management fees. Compared to 1H11, wealth management fees increased 19.0% in 1H12. Significant improvements were also noted in the increase in Investment-related fees, due to investment banking deals performed for a few of OCBC's core clients. The higher investment banking fees may however be non-recurring in 3Q12.

Non-interest income and Profit from insurance

As expected, net trading income declined after strong performances in 4Q11 and 1Q12, as the rally in the equity markets ended and went down. 3Q12 net trading income may improve q-q as equity markets has rallied on speculations of policy changes by US and ECB this quarter. Net trading income is however volatile as seen from historical trends, and remains hard to forecast. Profit from life assurance declined as expected after the sterling performance in 1Q12.

Other areas

Setting up China business office in Singapore

Management announced that it has plans to set up a China business office in Singapore, so as to allow businesses in China to expand to Singapore and the region. This is also expected to increase profits from Greater China. Q-q, Core income contribution from Greater China has improved from 6% to 8% of the Group's total core income.

Sale of OCBC's investment in APB and FNN

Management commented that they had entered into a binding agreement to sell these investments, although the sale is also dependent on the other conditions such as the buyer gaining approval. Management has also made plans on how the sales proceeds will be utilized. These include further building the Wealth Management, and deepening itself in the Singapore and Malaysia markets.

We note that as the investments are classified as Available-for-sale, most of the S\$1.15 billion gains are currently in the Balance Sheet under Equity, likely under FV reserve, as AFS mark to market (MTM) gains are recognized in the Other Comprehensive Income. We estimate OCBC bank's share of gains above MTM gains already recognized in OCBC Group's equity to be around S\$178 million as at 30 Jun. Current MTM gains already under OCBC's Equity is estimated to be S\$608 million. As the number of shares of FNN and APB attributable to GEH's shareholder is not available, we are unable to estimate the gains attributable to OCBC Group, which may be S\$67.5 million as at 30 Jun assuming current MTM gains being recognized in OCBC's equity to be S\$300 million.

More importantly, the real gain from the sale of investments is NOT S\$1.15 billion, but much less. OCBC could have sold these investments in the open market and realize most of these gains. Based on above estimated gains not yet recognized in OCBC's Equity, this amounts to an estimated S\$245 million, and would work out to S\$0.07 per share.

Higher interim dividends of S\$0.16 declared

Management also announced a higher interim dividend of S\$0.16 per share. Final dividend is also likely to be increased to S\$0.16 per share. Based on management's guidance of a payout ratio of 45%, we think that there may be a chance for a special dividend payout should the sale of FNN and APB materializes. We estimate this to be S\$0.10 per share based on our FY12 earnings forecast. As discussed above, this special dividend may partially be distributed from the reduction of OCBC's Equity.

Valuation

We factor in the disappointing loans growth, lowered NIMs, positive improvements in Wealth management, and gains from sale of APB and FNN as the transaction is highly probable. Base on these adjustments, we derive a lower core EPS of S\$0.69 from S\$0.73. Based on a higher BVPS to S\$6.57, due to potential gains from sale of APB and FNN, and an unchanged P/B multiple of 1.25X, we obtained an unchanged target price of S\$8.20. While core 2Q12 earnings were disappointing, OCBC's share price has rallied since Jun 12. Although we continue to expect OCBC to grow strongly y-y, we think that this may be a good time for investors to take profits, and therefore downgrade our call to "Reduce".

Table 1. Growth in revenue

SGD mn	2Q12	2Q11	%y-y ch	1Q12	%q-q ch
Net interest income	931	827	12.6%	951	-2.1%
Net fee and comm inc	317	299	6.0%	274	15.7%
Profits from insurance	108	137	-21.2%	253	-57.3%
Other non-interest inc	171	150	14.0%	319	-46.4%
Total	1,527	1,413	8.1%	1,797	-15.0%

Table 2. Fee and commission income

SGD mn	2Q12	2Q11	%y-y ch	1Q12	%q-q ch
Brokerage	13	16	-18.8%	17	-23.5%
Wealth management	76	64	18.8%	74	2.7%
Fund management	20	29	-31.0%	21	-4.8%
Credit card	13	10	30.0%	11	18.2%
Loan-related	62	52	19.2%	55	12.7%
Trade and remittances	59	58	1.7%	49	20.4%
Guarantees	4	5	-20.0%	4	0.0%
Investment Banking	42	27	55.6%	15	180.0%
Service charges	20	31	-35.5%	21	-4.8%
Others	8	7	14.3%	7	14.3%
Total Fee and Comm	317	299	6.0%	274	15.7%

Table 3. Other non-interest income

SGD mn	2Q12	2Q11	%y-y ch	1Q12	%q-q ch
Net trading income	75	41	82.9%	160	-53.1%
Net gain on Inv securities	21	31	-32.3%	43	-51.2%
Disposal of properties	1	1	0.0%	1	0.0%
Others	16	13	23.1%	12	33.3%
Total other non int inc	113	86	31.4%	216	-47.7%

Table 4. Loans by Industries

SGD mn	2Q12	2Q11	%y-y ch	1Q12	%q-q ch
Agri, mining & quarrying	4,880	3,135	55.7%	4,095	19.2%
Manufacturing	8,393	7,546	11.2%	8,543	-1.8%
Building and construction	21,183	17,902	18.3%	20,366	4.0%
Housing loans	34,974	28,957	20.8%	33,840	3.4%
General commerce	18,309	17,378	5.4%	18,967	-3.5%
Tpt, storage & comms	9,177	7,595	20.8%	8,756	4.8%
Fls, invt & holding co	19,918	14,968	33.1%	19,225	3.6%
Professionals & Pri inv	13,634	12,215	11.6%	13,547	0.6%
Others	7,876	11,480	-31.4%	7,265	8.4%
Total loans	138,344	121,176	14.2%	134,604	2.8%

Table 5. Loans by currencies

SGD mn	2Q12	2Q11	%y-y ch	1Q12	%q-q ch
Singapore dollar	65,249	58,429	11.7%	62,912	3.7%
US dollar	33,630	28,863	16.5%	33,843	-0.6%
Malaysian ringgit	17,265	15,371	12.3%	17,088	1.0%
Indonesian rupiah	4,810	3,746	28.4%	4,399	9.3%
Others	17,390	14,767	17.8%	16,362	6.3%
Total loans	138,344	121,176	14.2%	134,604	2.8%

Table 6. Operating profit by Business segments

SGD mn	2Q12	2Q11	%y-y ch	1Q12	%q-q ch
Global Consumer/ Private Banking	130	117	11.1%	154	-15.6%
Global Corporate/ Investment Bankin	488	358	36.3%	416	17.3%
Global Treasury and Markets	128	94	36.2%	182	-29.7%
Insurance	90	132	-31.8%	279	-67.7%
Others	(23)	22	-204.5%	(26)	-11.5%
Total Profit	813	723	12.4%	1,005	-19.1%

Table 7. Profit before tax by Geographical segments

SGD mn	2Q12	2Q11	%y-y ch	1Q12	%q-q ch
Singapore	481	418	15.1%	658	-26.9%
Malaysia	198	185	7.0%	207	-4.3%
Rest of SEA	27	29	-6.9%	34	-20.6%
Greater China	75	61	23.0%	73	2.7%
Other Asia Pacific	26	27	-3.7%	27	-3.7%
Rest of the World	18	22	-18.2%	12	50.0%
Total NPBT	825	742	11.2%	1,011	-18.4%

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

Fig 1: Net interest margin

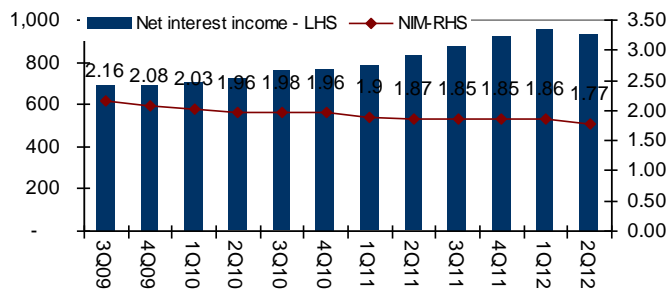


Fig 2: NonInt/Total revenue

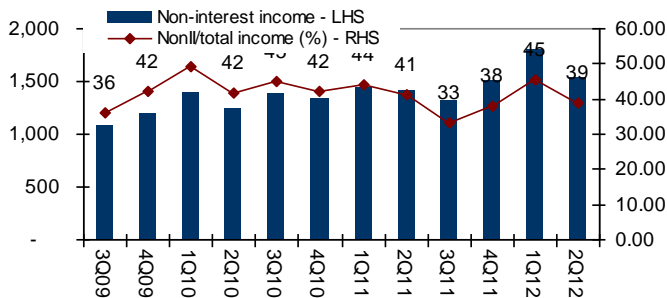


Fig 3: Efficiency ratio

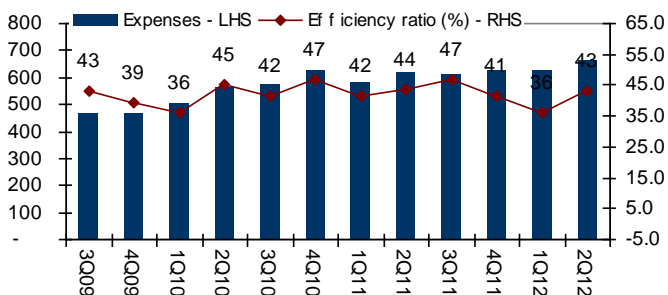


Fig 4: Net profit margin

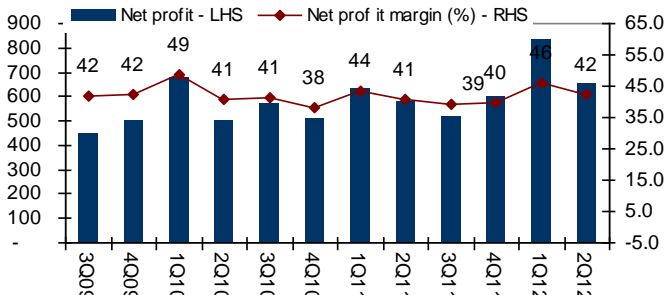


Fig 5: Deposits, Loans, LDR

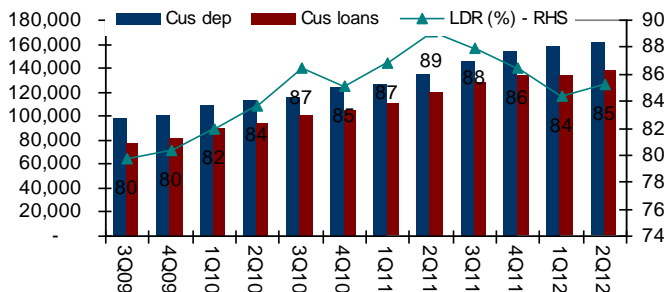


Fig 6: NPA, NPL

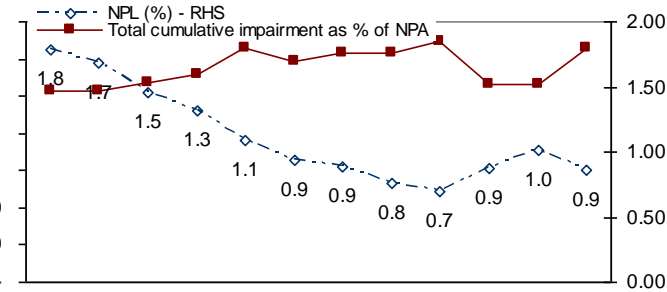


Fig 7: Growth in selected asset items

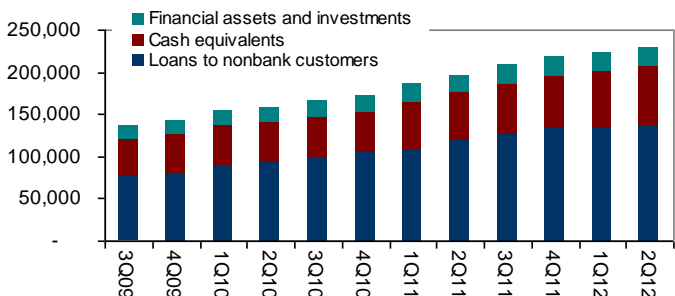


Fig 8: CAR

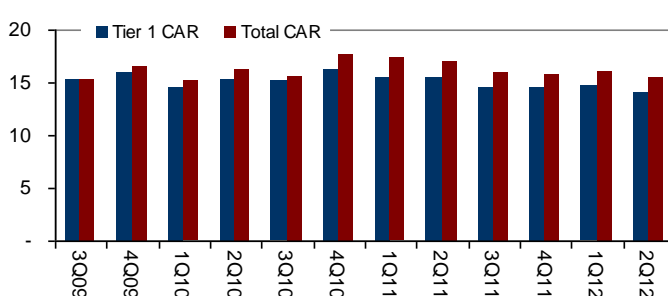


Fig 9: ROE and ROA

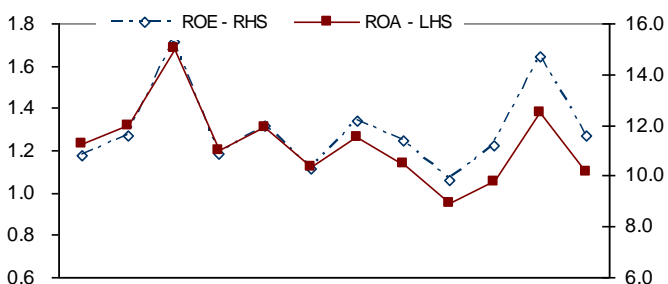


Fig 10: EPS and NBV

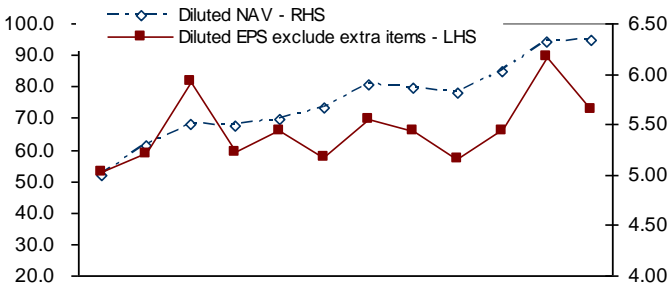


Fig 11: Profit before tax by geographical segment

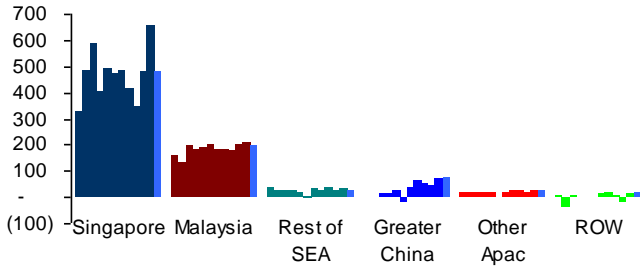


Fig 12: Geo segment breakdown

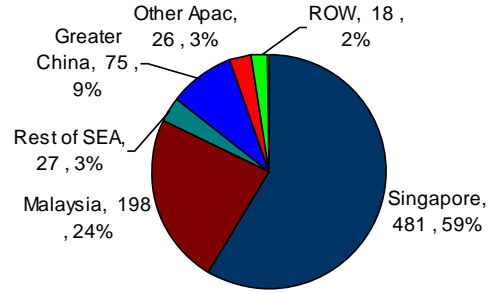
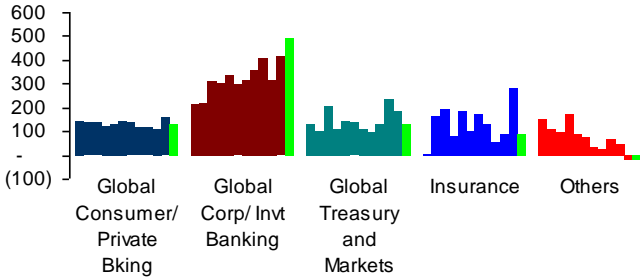


Fig 13: Operating profit by Business segment



Growth trend

Fig 14: Net interest income trend

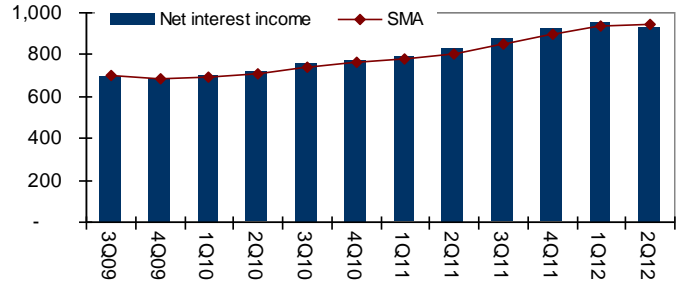


Fig 15: Fee and Commission trend

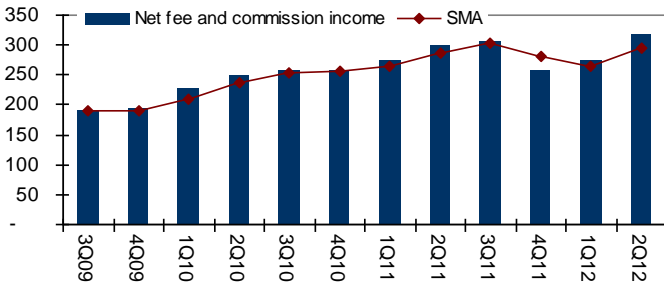


Fig 16: Other noninterest income trend

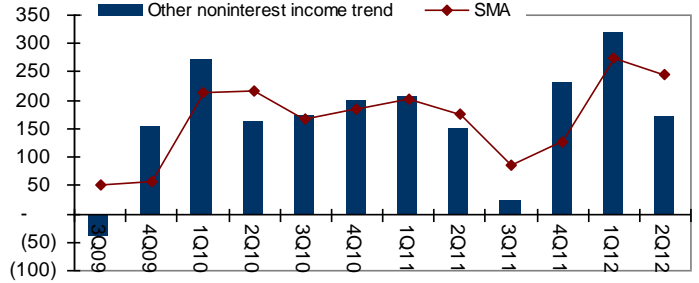
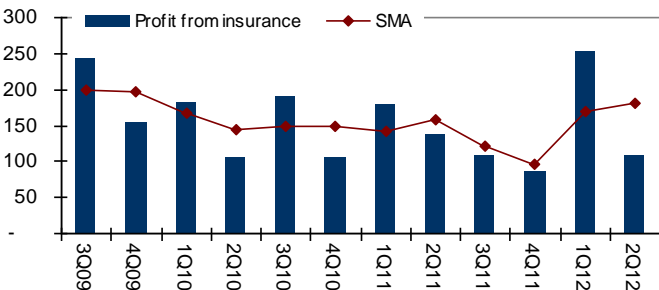


Fig 17: Profit from insurance

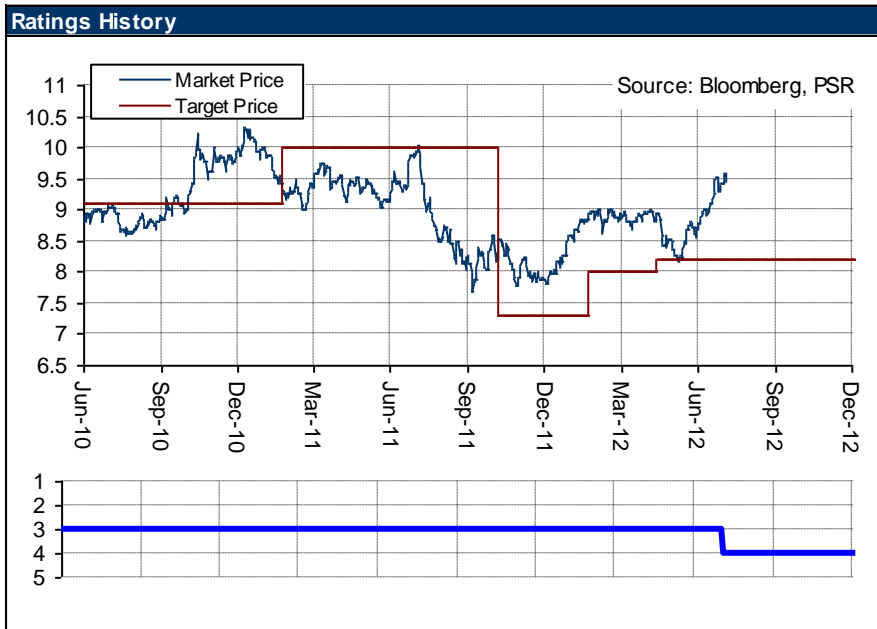


FYE Dec	FY09	FY10	FY11	FY12F	FY13F
Valuation Ratios					
P/E (X), adj.	15.8	14.3	14.4	13.9	13.3
P/B (X)	1.8	1.7	1.6	1.4	1.4
Dividend Yield (%)	3.0%	3.2%	3.2%	4.4%	3.4%
Per share data (SGD)					
EPS, reported	0.60	0.66	0.66	1.02	0.71
EPS, adj.	0.60	0.66	0.66	0.68	0.71
DPS	0.28	0.30	0.30	0.42	0.32
BVPS	5.29	5.66	6.02	6.56	6.85
Growth & Margins (%)					
Growth					
Net interest income	1.5%	4.3%	15.7%	10.7%	6.7%
Non interest income	21.1%	19.5%	-5.3%	63.5%	-36.6%
Pre provision operating profit	8.8%	10.6%	6.3%	31.7%	-14.7%
Operating income	22.3%	13.3%	2.3%	52.0%	-27.5%
Net income, reported	12.2%	14.9%	2.6%	56.4%	-28.9%
Margins					
Net interest margin	2.23%	1.98%	1.87%	1.77%	1.76%
Key Ratios (%)					
ROE	12.2%	12.1%	11.1%	16.7%	11.2%
ROA (exclude life assurance fund invt)	1.35%	1.32%	1.09%	1.47%	0.94%
RORWA	2.0%	2.2%	2.0%	2.8%	1.9%
Non-interest/total income ratio	41.3%	44.7%	39.8%	49.4%	36.7%
Cost/income ratio	37.3%	42.3%	42.9%	35.2%	43.9%
Loan/deposit ratio	80.4%	85.1%	86.4%	85.0%	81.4%
NPL ratio	1.68	0.93	0.87	1.03	1.03
Income Statement (SGD mn)					
Net Interest Income	2,826	2,947	3,410	3,776	4,029
Fees and Commission	730	987	1,137	1,189	1,232
Other Non interest income	1,260	1,391	1,114	2,490	1,100
Total operating income	4,816	5,325	5,661	7,456	6,361
Operating expenses	1,796	2,254	2,430	2,627	2,790
Provisions	478	189	283	348	322
Operating profit	2,542	2,882	2,948	4,480	3,248
Associates & JVs	1	(2)	8	8	8
Profit Before Tax	2,543	2,880	2,956	4,488	3,256
Taxation	389	433	478	584	521
Profit After Tax	2,154	2,447	2,478	3,905	2,735
Non-controlling Interest	192	193	166	288	164
Net Income, reported	1,962	2,254	2,312	3,616	2,571
Net Income, adj.	1,962	2,254	2,280	2,421	2,571

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	18,882	29,004
Singapore Government treasury bills and securities	10,922	11,156	13,250	11,875	12,143
Other government treasury bills and securities	5,564	5,944	7,397	6,019	5,907
Placements and balances with banks	15,821	18,569	28,615	33,985	34,579
Debt and equity securities	11,680	14,255	15,081	14,640	14,768
Assets pledged	279	746	1,839	2,072	2,072
Assets held for sale	0	4	6	5	5
Derivative receivables	3,973	4,837	5,899	7,703	7,838
Other assets	2,911	3,116	3,191	3,625	3,688
Loans and bills receivable	80,876	104,989	133,557	144,294	154,571
Deferred tax	64	79	44	34	34
Associates and JV	226	255	361	369	369
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	300,694	323,776
Deposits of non-bank customers	100,633	123,300	154,555	169,742	189,883
Deposits and balances of banks	10,958	16,508	21,653	21,322	21,602
Due to associates	119	139	178	174	174
Trading Portfolio liabilities	2,016	1,734	1,655	1,113	1,113
Derivative payables	3,918	4,563	6,113	5,316	5,316
Other liabilities	3,215	3,187	4,024	4,497	4,497
Current tax	607	745	800	837	837
Deferred tax	946	1,127	1,123	1,196	1,196
Debts issued	6,863	6,854	13,063	18,253	18,253
Life assurance fund liabilities	43,246	47,481	49,204	49,720	51,212
Total liabilities	172,521	205,638	252,368	272,170	294,083
Share Capital	5,480	6,315	7,127	7,095	7,095
Preference shares	1,896	1,896	1,896	2,896	2,896
Retained earnings	9,103	10,592	12,144	14,588	15,594
Capital reserves	986	613	279	329	329
FV reserves	1,506	1,374	1,125	508	508
Shareholder's equity	18,971	20,790	22,571	25,416	26,422
Non-controlling interest	2,808	2,855	2,819	3,107	3,272
Total Equity	21,779	23,645	25,390	28,524	29,693
Cashflow Statements (SGD mn)					
CFO					
PBT	2,543	2,880	2,956	4,489	3,256
Adjustments	537	353	507	529	513
Cash from ops before WC changes	3,080	3,233	3,463	5,018	3,769
WC changes	2,668	54	(5,639)	(2,637)	8,782
Cash generated from ops	5,748	3,287	(2,176)	2,381	12,551
Taxes paid, net	(342)	(420)	(409)	(584)	(521)
Cashflow from ops	5,406	2,867	(2,585)	1,797	12,030
Cashflow from investments	0	(4,523)	(1,895)	(339)	(343)
Cashflow from financing	684	(44)	5,883	4,526	(1,566)
Net change in cash	6,143	(1,679)	1,404	5,984	10,122
CCE, end	13,172	11,494	12,898	18,882	29,004
Supplementary items					
Risk-weighted assets (SGD mn)	100,013	105,062	128,507	131,896	134,225
Tier 1 capital (SGD mn)	15,962	17,148	18,612	21,068	22,074
Total capital (SGD mn)	16,492	18,508	20,186	22,975	23,981
Core Tier 1 CAR (%)	12.0%	12.6%	11.4%	12.2%	12.8%
Tier 1 CAR (%)	15.9%	16.3%	14.5%	16.0%	16.4%
Total CAR (%)	16.4%	17.6%	15.7%	17.4%	17.9%

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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