

Oversea-Chinese Banking Corp

Firing On All Cylinders as Economy Improves Steadily



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SINGAPORE | BANKING | 2Q17 RESULTS

- 2Q17 PATMI of S\$1,083mn exceeded our estimate by 12.6%. Insurance and Net Interest Income growth exceeded expectation.
- Wealth Management fee income growth of 45% YoY was boosted by the acquisition of Barclay's WM.
- Upgrade "Neutral" with a higher target price of S\$10.81**, based on Gordon Growth Model, (previously 0.95x book value, excluding preference shares).

Results at a glance

(SGD mn)	2Q17	2Q16	YoY (%)	1Q17	QoQ (%)	Comments
Net interest income	1,345	1,260	7%	1,272	6%	NIMs -3bps y-o-y. Loans +11% y-o-y
Fees & Comm	492	417	18%	481	2%	Higher WM fee income y-o-y
Insurance	278	146	90%	211	32%	Higher Life Assurance profit q-o-q & y-o-y
Other NII	283	225	26%	285	-1%	Higher net trading income y-o-y
Total income	2,398	2,048	17%	2,249	7%	
Expenses	-992	-932	6%	-973	2%	Inclusion of Barclays WM staff costs y-o-y
Allowances	-169	-88	92%	-168	1%	
PATMI	1,083	885	22%	973	11%	

Source: Company, PSR

The Positives

+ Strong Insurance and Wealth Management. Profit from life assurance almost doubled YoY due to a positive performance from Great Eastern Holdings' investment portfolio as a result of narrowing credit spreads and gains from favourable interest rate movements. Wealth management fee income grew 45% y-o-y as OCBC's Bank of Singapore ("BOS") AUM rose 46% y-o-y from US\$61bn to US\$89bn. Two-thirds of BOS' AUM growth came from net new money.

+ NPL ratio stable and Oil and Gas exposures have declined. NPL ratio is stable at 1.3%, stable QoQ but higher than 1.1% in 2Q16. OCBC's exposure to oil and gas loans have declined 9% QoQ as oil majors, and offshore support vessel ("OSV") operators have deleveraged.

+ Stronger Net Interest Income ("NII") was due to higher Loan-to-deposits ratio ("LDR"), gaping income and higher yields on customer loans. In our [Banking Sector Report](#) published in January 2017, we explained how the expansion of LDR would help boost net interest income growth. Management has indicated that they are comfortable to bring the LDR higher from the current 85% to increase NII in the near term. OCBC was able to find opportunities to place out interbank loans at a higher rate to achieve higher gaping income. OCBC was able to enjoy better yields on customer loans by charging a higher spread on loans to customers' overseas expansion projects.

The Negatives

- Unfavourable rate dynamics could remain a challenge. OCBC Wing Hang's Net Interest Margin ("NIM") continues to languish as the three-month HIBOR rate, which housing loans are pegged to, remain subdued despite the Fed rate hike. Similarly, in Singapore, the Fed rate hike cycle has not translated into a meaningful increase in SIBOR and SOR, therefore, delaying the pass through of higher rates to customer loans.

- Oil and Gas Sector is stable but not improving. The lack of commitment to long term charter for OSV operators has impacted their cash flow and their ability to service loan payments. We believe that oil price should settle at US\$60 per barrel sustainably before we can see commitment to long term charter rates. And given OCBC bad loans coverage ratio is at 100%, we expect OCBC's provision expenses be volatile when it is required to respond to a sudden deterioration in quality of loans related to the OSV sector.

28 July 2017

Neutral (Upgrade)

LAST TRADED PRICE	SGD 11.47
FORECAST DIV	SGD 0.36
TARGET PRICE	SGD 10.81
TOTAL RETURN	-2.62%

COMPANY DATA

BLOOMBERG TICKER	OCBC SP
O/S SHARES (MN) :	4,187
MARKET CAP (USD mn / SGD mn) :	34970 / 47570
52 - WK HI/LO (SGD) :	1149 / 8.27
3M Average Daily T/O (mn) :	5.85

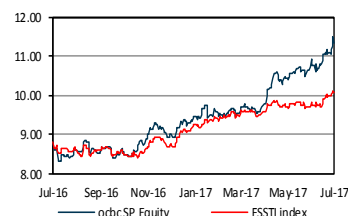
MAJOR SHAREHOLDERS (%)

Lee Foundation	4.34%
Selat (Pte) Limited	11.03%
DBSN Services Pte Ltd	3.26%
Singapore Investments (Pte) Ltd	3.75%

PRICE PERFORMANCE (%)

	1M TH	3M TH	1YR
COMPANY	7.1	20.0	34.9
STIRETURN	4.36	6.78	16.33

PRICE VS. STI



Source: Bloomberg, PSR

KEY FINANCIALS

Y/E Dec	FY 15	FY 16	FY 17e	FY 18e
Total Operating Inc (SGD mn)	8,722	8,489	9,192	9,379
Operating Profit (SGD mn)	4,472	3,879	4,493	4,623
NPAT, adj.	4,108	3,646	4,200	4,310
EPS (SGD)	0.95	0.83	0.95	0.98
PER, adj. (x)	12.1	13.8	12.0	11.7
P/BV, x	11	11	13	12
ROE (%)	11.6%	9.6%	10.6%	10.5%

Source: Bloomberg, Company, PSR

Valuation Method: Gordon Growth Model (ERP: 7%, g: 2%)

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Outlook

We are revising our LDR forecast for OCBC from c.80% to c.85% as management indicated more flexibility to move the LDR higher. Therefore we increased our FY17e net interest income growth estimates from our previous 2% to 5%. Moreover, due to improving economic sentiment and low volatility at the start of 2017 and recovering Singapore housing market, we are revising our valuation to reflect these improvements. However, we are cautious of OCBC's sensitivity to competition in the loans market as slightly more than half of OCBC's loans are pegged to board rates which are influenced by market competition.

Valuation: Gordon Growth Model

Item	Description	Value
R _f	Risk-free rate	2.0%
E	Equity-risk premium	7.0%
B	Beta	1.02
COE	Cost of Equity	9.1%
ROE	FY17e Return on Equity	10.6%
g	Terminal growth rate	2.0%
$(\text{ROE}-g)$ FY17e Target Price to Book		1.20
$(\text{COE}-g)$ FY17e BVPS, S\$		8.98
FY17e Valuation, S\$		10.81

3-Year Historical Price-to-Book



Investment Actions

Upgrade "Neutral" with a higher target price of S\$10.81, based on Gordon Growth Model (previously 0.95x price to book, excluding preference shares).

Table 1. Fee and commission income

SGD mn	2Q17	2Q16	YoY (%)	1Q17	QoQ (%)
Brokerage	17	15	13.3%	18	-5.6%
Wealth management	215	150	43.3%	215	0.0%
Fund management	27	24	12.5%	25	8.0%
Credit card	44	41	7.3%	35	25.7%
Loan-related	79	78	1.3%	67	17.9%
Trade and remittances	53	51	3.9%	52	1.9%
Guarantees	5	7	-28.6%	4	25.0%
Investment Banking	24	15	60.0%	29	-17.2%
Service charges	19	29	-34.5%	27	-29.6%
Others	9	7	28.6%	9	0.0%
Total Fee and Comm	492	417	18.0%	481	2.3%

Table 2. Other non-interest income

SGD mn	2Q17	2Q16	YoY (%)	1Q17	QoQ (%)
Net trading income	140	123	13.8%	158	-11.4%
Net gain on Invst securities	54	44	22.7%	65	-16.9%
Disposal of properties	6	7	-14.3%	24	-75.0%
Others	16	21	-23.8%	2	700.0%
Total other non int Inc	236	176	34.1%	249	-5.2%

Table 3. Loans by Industries

SGD mn	2Q17	2Q16	YoY (%)	1Q17	QoQ (%)
Agri, mining & quarrying	7,855	7,838	0.2%	7,582	3.6%
Manufacturing	13,530	11,434	18.3%	13,185	2.6%
Building and construction	36,683	34,090	7.6%	35,742	2.6%
Housing loans	60,998	58,356	4.5%	60,027	1.6%
General commerce	27,247	22,294	22.2%	26,366	3.3%
Tpt, storage & comms	12,367	10,860	13.9%	12,016	2.9%
Fls, invt & holding co	32,736	26,856	21.9%	33,225	-1.5%
Professionals & Pri inv	27,573	24,319	13.4%	26,956	2.3%
Others	9,816	9,438	4.0%	9,704	1.2%
Total loans	228,805	205,485	11.3%	224,803	1.8%

Loans growth across segments driven by corporate clients' overseas business expansion

Table 4. Loans by currencies

SGD mn	2Q17	2Q16	YoY (%)	1Q17	QoQ (%)
Singapore dollar	83,378	80,540	3.5%	83,069	0.4%
US dollar	59,685	45,645	30.8%	59,828	-0.2%
Malaysian ringgit	20,091	21,720	-7.5%	20,264	-0.9%
Indonesian rupiah	7,652	6,543	16.9%	7,350	4.1%
Others	21,435	17,466	22.7%	19,587	9.4%
Hong Kong Dollar	30,990	27,794	11.5%	29,561	4.8%
Renminbi	5,574	5,777	-3.5%	5,144	8.4%
Total loans	228,805	205,485	11.3%	224,803	1.8%

Loans growth from OCBC Wing Hang and OCBC NISP outpaced Singapore based loans in 2Q17

Table 5. Operating profit by Business segments

SGD mn	2Q17	2Q16	YoY (%)	1Q17	QoQ (%)
Global Consumer/ Private Banking	320	273	17.2%	313	2.2%
Global Corporate/ Investment Banking	429	468	-8.3%	356	20.5%
Global Treasury and Markets	134	101	32.7%	109	22.9%
Insurance	296	120	146.7%	237	24.9%
OCBC Wing Hang	91	94	-3.2%	85	7.1%
Others	(60)	(52)	nm	(18)	nm
Total Profit	1,210	1,004	20.5%	1,082	11.8%

Table 6. Profit before tax by Geographical segments

SGD mn	2Q17	2Q16	YoY (%)	1Q17	QoQ (%)
Singapore	767	507	51.3%	629	21.9%
Malaysia	323	340	-5.0%	311	3.9%
Indonesia	209	181	15.5%	197	6.1%
Greater China	344	301	14.3%	289	19.0%
Other Asia Pacific	41	37	10.8%	38	7.9%
Rest of the World	59	37	59.5%	47	25.5%
Total NPBT	1,743	1,403	24.2%	1,511	15.4%

Source (tables 1-6): Company, Phillip Securities Research

Fig 1: Net interest margin

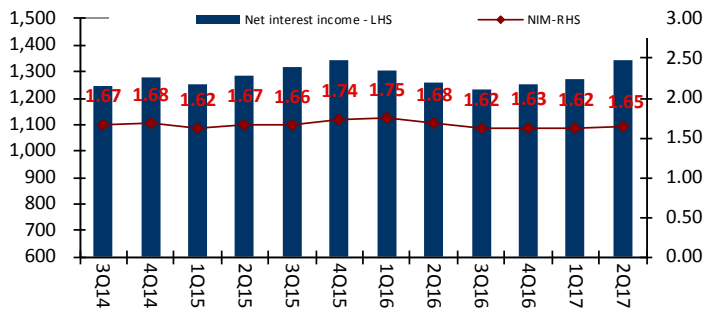


Fig 2: NonII/Total revenue

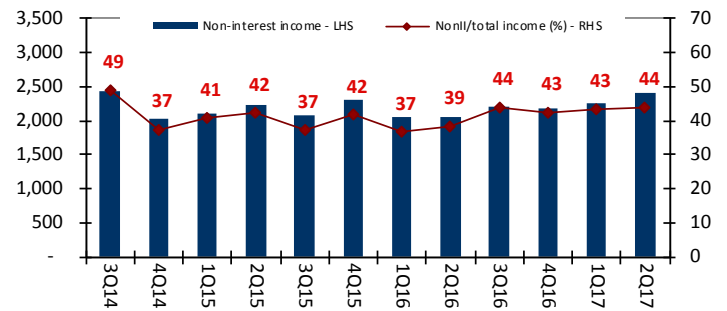


Fig 3: Efficiency ratio

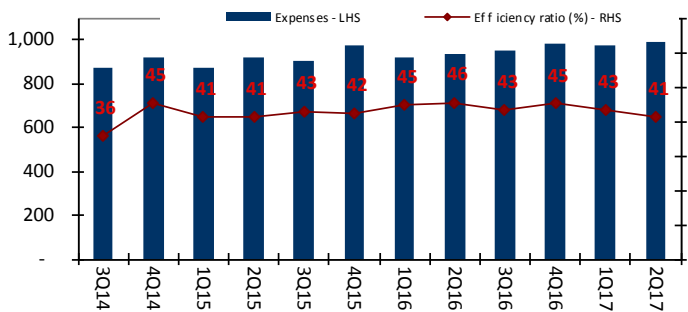


Fig 4: Net profit margin

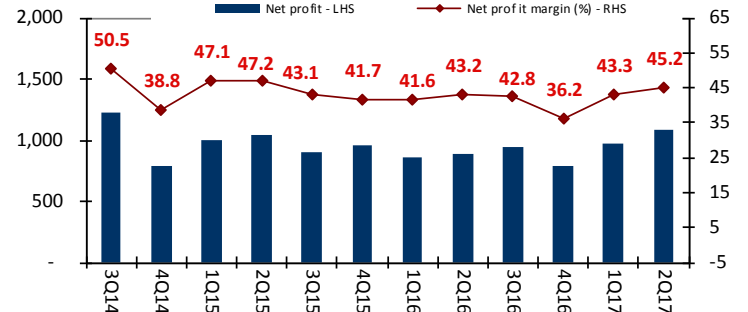


Fig 5: Deposits, Loans, LDR

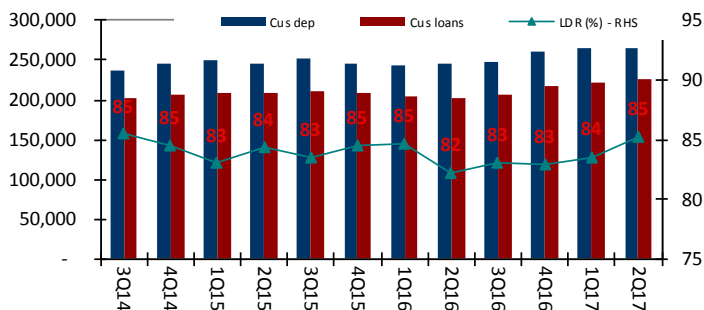


Fig 6: NPA, NPL

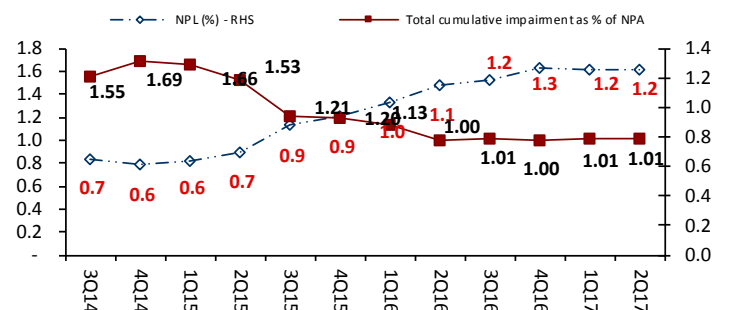


Fig 7: Growth in selected asset items

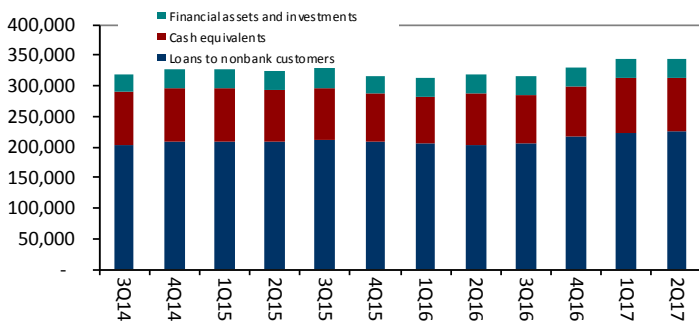


Fig 8: CAR

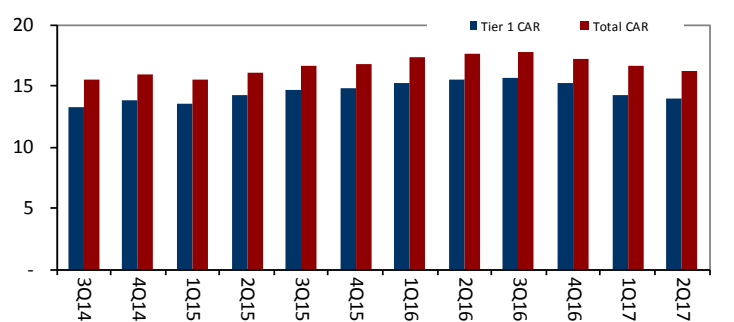


Fig 9: ROE and ROA

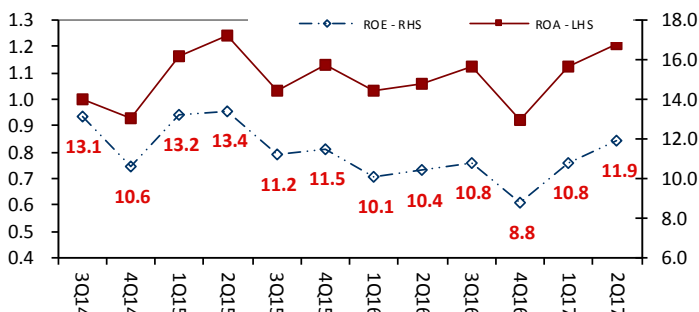


Fig 10: EPS and NBV

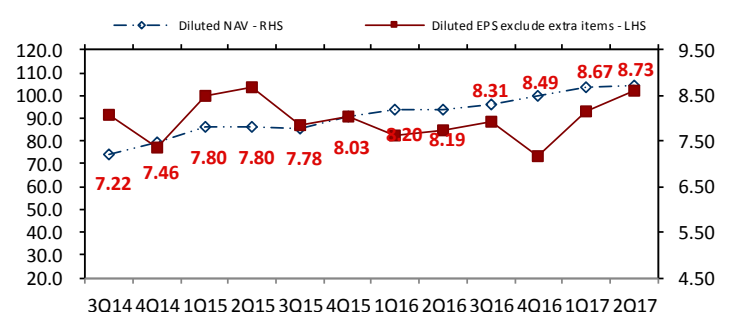


Fig 11: Profit before tax by geographical segment

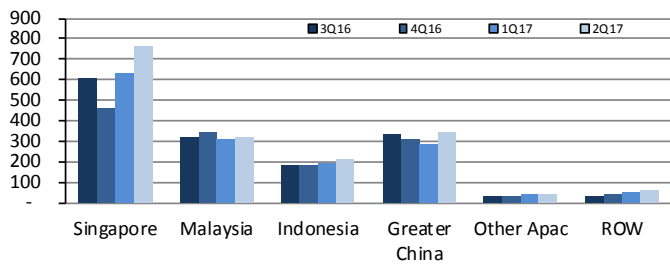


Fig 12: Geo segment breakdown

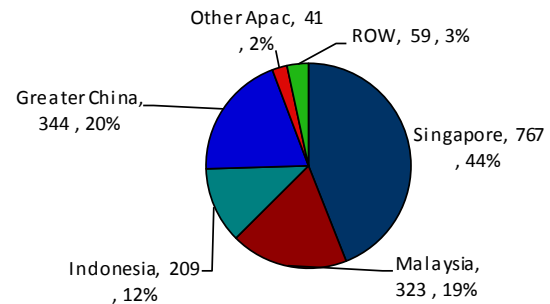


Fig 13: Operating profit by Business segment

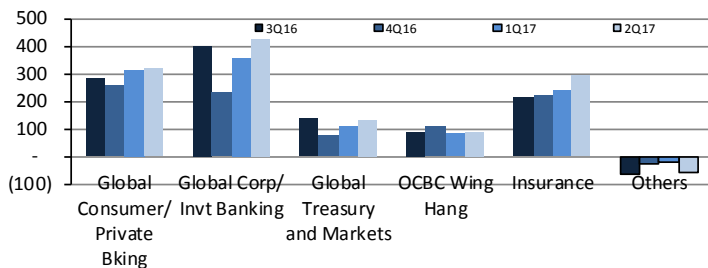


Fig 14: Net interest income trend

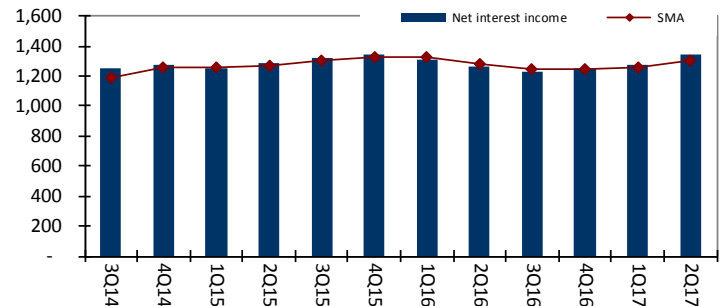


Fig 15: Fee and Commission trend

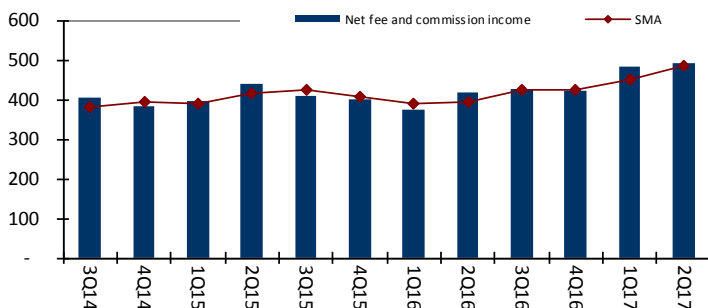


Fig 16: Other noninterest income trend

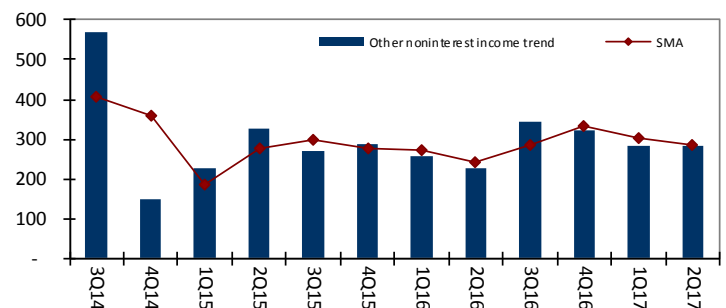
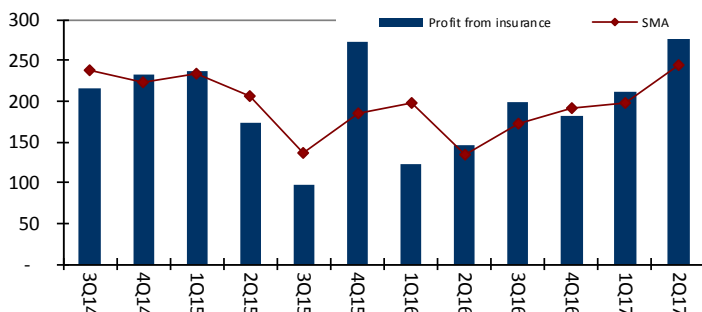


Fig 17: Profit from insurance



Financials

Income Statement

Y/E Dec, SGD mn	FY14	FY15	FY16	FY17e	FY18e
Net Interest Income	4,736	5,189	5,052	5,290	5,400
Fees and Commission	1,496	1,655	1,638	1,915	1,980
Other Non interest income	2,109	1,878	1,799	1,986	1,999
Total operating income	8,341	8,722	8,489	9,192	9,379
Operating expenses	3,258	3,665	3,789	3,954	4,001
Provisions	432	585	821	745	755
Operating profit	4,651	4,472	3,879	4,493	4,623
Associates & JVs	113	353	396	396	396
Profit Before Tax	4,764	4,825	4,275	4,889	5,019
Taxation	687	717	629	689	708
Profit After Tax	4,077	4,108	3,646	4,200	4,310
Non-controlling Interest	233	205	173	224	230
Net Income, reported	3,844	3,903	3,473	3,976	4,081
Net Income, adj.	3,844	3,903	3,473	3,973	4,081

Per share data (SGD)

Y/E Dec, SGD mn	FY14	FY15	FY16	FY17e	FY18e
EPS, reported	1.02	1.00	0.87	1.01	1.03
EPS, adj.	0.96	0.95	0.83	0.95	0.98
DPS	0.36	0.36	0.36	0.36	0.36
BVPS	7.46	8.15	8.61	8.98	9.34

Supplementary items

Y/E Dec, SGD mn	FY14	FY15	FY16	FY17e	FY18e
CET1 CAR (%)	13.8%	14.8%	14.7%	14.3%	14.5%
Tier 1 CAR (%)	13.8%	14.8%	15.2%	15.1%	15.3%
Total CAR (%)	15.9%	16.8%	17.2%	17.3%	17.5%

Balance Sheet

Y/E Dec, SGD mn	FY14	FY15	FY16	FY17e	FY18e
Cash bal with central banks	25,314	21,180	16,559	16,650	19,606
Due from banks	41,220	35,791	39,801	44,221	42,693
Debt and equity securities	23,466	22,786	23,157	23,946	24,187
Loans and bills receivable	207,535	208,218	216,830	227,802	234,688
Life Assur. Fund Inv. Assets	57,286	56,983	61,973	63,832	65,747
Others	46,405	45,232	51,564	51,336	51,975
Total Assets	401,226	390,190	409,884	427,788	438,897
Due to banks	20,503	12,048	10,740	13,182	13,314
Due to non-bank customers	245,519	246,277	261,486	263,414	270,051
Life Assur. Fund Liabilities	57,224	56,994	61,962	63,821	65,735
Debts issued	28,859	23,479	19,947	29,436	29,730
Others	14,936	14,282	16,107	16,584	17,075
Total liabilities	367,041	353,080	370,242	386,437	395,906
Shareholder's equity	31,097	34,553	37,007	38,492	39,903
Non-controlling interest	3,088	2,558	2,635	2,859	3,088
Total Equity	34,185	37,111	39,642	41,351	42,991

Valuation Ratios

Y/E Dec, SGD mn	FY14	FY15	FY16	FY17e	FY18e
P/E (X), adj.	10.1	12.1	13.8	12.0	11.7
P/B (X)	1.3	1.1	1.05	1.27	1.23
Dividend Yield (%)	3.7%	4.1%	4.0%	3.8%	3.8%

Growth & Margins (%)

Growth					
Net interest income	22.0%	9.6%	-2.6%	4.7%	2.1%
Non interest income	31.6%	-2.0%	-2.7%	13.5%	2.0%
Pre provision operating profit	26.0%	4.6%	-2.7%	8.3%	2.0%
Operating income	32.4%	-3.8%	-13.3%	15.8%	2.9%
Net income, reported	38.9%	1.5%	-11.0%	14.4%	2.7%
Net income, adj	38.9%	1.5%	-11.0%	14.4%	2.7%

Margins

Net interest margin	1.68%	1.67%	1.67%	1.62%	1.60%
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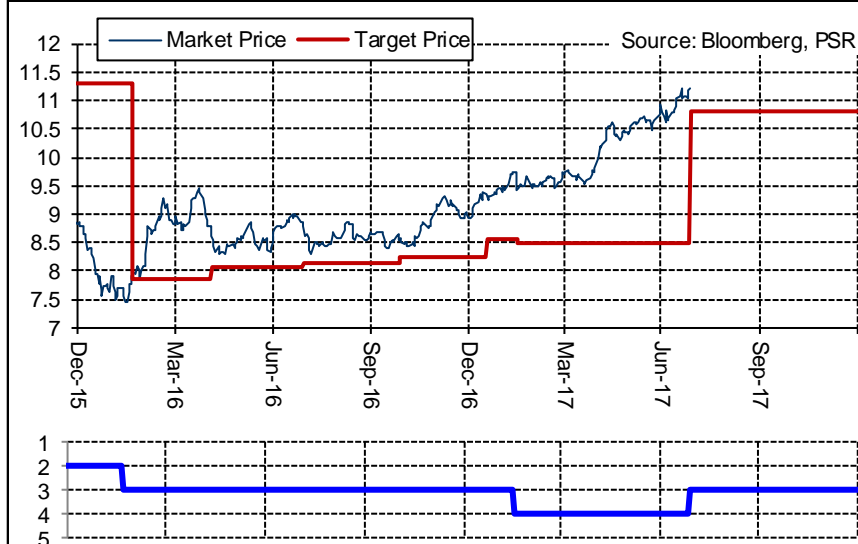
Key Ratios (%)

ROE	12.9%	11.6%	9.6%	10.6%	10.5%
ROA	1.1%	1.2%	1.0%	1.1%	1.1%
RORWA	2.0%	2.0%	1.8%	1.8%	1.8%
Non-interest/total income ratio	43.2%	40.5%	40.5%	42.4%	42.4%
Cost/income ratio	39.1%	42.0%	44.6%	43.0%	42.7%
Loan/deposit ratio	84.5%	84.5%	82.9%	86.5%	86.9%
NPL ratio	0.61	0.93	1.26	1.21	1.21

Source: Company, Phillip Securities Research (Singapore) Estimates

*Forward multiples & yields based on current market price; historical multiples & yields based on historical market price.

Ratings History



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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