

Oversea-Chinese Banking Corp

Provisions vanished this quarter



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8 May 2018

SINGAPORE | BANKING | 1Q18 RESULTS

- 1Q18 PATMI was within our expectations. Non-interest income was below our estimates but this was made up by a collapse in allowances for loans and assets.
- NIM was flat qoq due to Indonesia and trade loans.
- Excluding insurance and allowances, 1Q18 earnings was up 10% YoY.
- We raised our target price to S\$14.90 (previously S\$13.94) on a higher terminal growth rate assumption. Nevertheless, our rating has been downgraded to ACCUMULATE due to the share price performance.

Results at a glance

(SGD mn)	1Q18	1Q17	YoY	4Q17	QoQ	Comments
Net interest income	1,415	1,272	11%	1,424	-1%	NIMs +5bps YoY. Loans +9% YoY.
Fees & Comm	536	481	11%	491	9%	Higher WM fee income.
Insurance	206	84	145%	310	-34%	S\$1.7bn fall in fund contract liab.
Other NII	176	285	-38%	415	-58%	Trading and investment securities income fell S\$121mn YoY.
Total income	2,333	2,122	10%	2,640	-12%	
Expenses	(1,032)	(973)	6%	(1,067)	-3%	Staff cost +10% YoY, other opex flat.
Allowances	(12)	(168)	-93%	(178)	-93%	Collapsed due to over-provisions.
PATMI	1,112	861	29%	1,034	8%	

Source: Company, PSR

The Positives

+ The disappearance of allowances. Allowances for loans and assets declined 93% to S\$12mn. It almost disappeared. Singapore operations had no provisions. The rationale given was an overprovision in the prior quarter. Recall that in 4Q17, OCBC made specific allowances of S\$1bn, but managed to offset this with an S\$887mn write-back. The current underwhelming credit cost is expected to rise from this quarter 2 bps to 15-20 bps in FY18e.

+ Asset quality is getting better. After the horrible spike of S\$1.3bn of NPAs last quarter, no surprise that asset quality is improving. New gross NPAs was S\$297mn, the lowest in twelve quarters.

+ Loans growth is healthy. Loans grew 9.7% YoY in 1Q18. Growth was driven by general commerce, trade finance and financial intermediaries (property funds) loans. Hong Kong dollar loans grew 14%, but US dollar and ringgit loans grew at 3% YoY.

The Negatives

- Trading/Investment gains fell. OCBC generated around S\$240mn in trading and investment securities gains per quarter in FY17. 1Q18 saw this more than halved to S\$102mn. This excludes the S\$231mn investment loss in the comprehensive income from FVOCI. The mark to market weakness in equity and debt market was significant for the insurance business. Higher interest rates will result in bond portfolios losses, but this will be offset somewhat by lower life assurance contract liabilities.

- NIM was marginally softer than expected. NIM had been rising every QoQ for OCBC in FY17. However, in 1Q18, NIM was surprisingly flat, when other banks saw sequential improvement. The reason for weakness is a decline in Indonesia NIMs. There is price pressure on the middle market (SME) loan segment especially with the authorities advocating single digit lending interest rates. Hong Kong is also not capturing a much larger improvement in margins due to their weaker CASA of around 20%.

Accumulate (Downgrade)

LAST CLOSE PRICE	SGD 13.17
FORECAST DIV	SGD 0.37
TARGET PRICE	SGD 14.90
TOTAL RETURN	15.9%

COMPANY DATA

BLOOMBERG TICKER	OCBC SP
O/S SHARES (MN)	4,183
MARKET CAP (USD mn / SGD mn)	41117 / 54961
52 - WK HI/LO (SGD)	14.04 / 10.21
3M Average Daily T/O (mn)	6.74

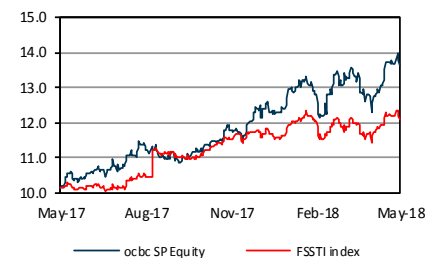
MAJOR SHAREHOLDERS (%)

Lee Foundation Singapore	4.3%
Selat Pte Limited	11.1%
Singapore Investments (Pte) Ltd	3.8%

PRICE PERFORMANCE (%)

	1M TH	3M TH	YTD
COMPANY	3.2	8.5	6.3
STIRETURN	3.6	5.7	5.2

PRICE VS. STI



Source: Bloomberg, PSR

KEY FINANCIALS

Y/E Dec (SGD mn)	FY 16	FY 17	FY 18 e	FY 19 e
Total Income	8,489	9,519	10,212	10,912
Op. Profit	3,879	4,702	5,494	6,066
NPAT, adj.	3,473	4,036	4,704	5,157
EPS (SGD)	0.83	0.96	1.12	1.23
PER, adj. (x)	10.9	13.7	11.7	10.7
P/BV, x	1.0	1.4	1.4	1.3
ROE	10.0%	10.9%	12.0%	12.5%

Source: Bloomberg, Company, PSR

Valuation Method:

Gordon Growth Model (ERP: 5.5%, g: 2.5%)

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Outlook

OCBC growth may be more timid than expected. 1Q18 earnings was boosted by an unsustainably low (or non-existent) allowance. This kept us from shaving our FY18e profit estimates. Unless we enter into a more vibrant capital market, investment income will remain a drag on earnings. Upside in NIMs will be capped by Indonesia (inability to raise pricing) and Hong Kong (lack of CASA franchise).

Figure 1: 2018e Guidance vs. PSR estimates

2018e	1Q18	OCBC	PSR
Loans growth	9.7%	HSD	8.6%
ROE	11.80%	> 11.2%	12.0%
Credit cost	2 bps	15-20 bps	15 bps
CET 1	13.1%	12.5-13.5%	13.7%

Source: Company, PSR

Investment Actions

We raised our target price to S\$14.90 (previously S\$13.94). Nevertheless, our rating has been downgraded to ACCUMULATE due to the share price performance. The improvement in target price was due to higher terminal growth rates. Our FY18e earnings was generally unchanged.

Valuation: Gordon Growth Model

Item	Description	Value
R_f	Risk-free rate	2.6%
E	Equity-risk premium	5.5%
B	Beta	1.1
COE	Cost of Equity	8.7%
ROE	FY18e Return on Equity	12.0%
g	Terminal growth rate	2.5%
$\frac{(ROE-g)}{(COE-g)}$	FY18e Target Price to Book	1.6
	FY18e BVPS, S\$	9.6
	FY18e Valuation, S\$	14.9

List of Abbreviations

WM – Wealth Management
 IBG – Institutional Banking Group
 CBG – Consumer Banking Group
 NII – Net Interest Income
 Non-II – Non-Interest Income
 NIM – Net Interest Margin
 LDR – Loan to Deposit Ratio
 NPL – Non-performing Loans
 CASA – Current Account, Savings Account
 IB – Investment Banking
 O&G – Oil and Gas
 SP – specific provisions
 GP – general provisions
 AUM – Asset Under Management
 Cost-to-income ratio – CIR

Figure 2: Revenue breakdown

SGD mn	1Q18	1Q17	YoY (%)	4Q17	QoQ (%)
Net interest income	1,415	1,272	11.2%	1,424	-0.6%
Net fee and comm inc	536	481	11.4%	491	9.2%
Profits from insurance	206	84	145.2%	310	-33.5%
Other non-interest inc	176	285	-38.2%	415	-57.6%
Allowance	(12)	(168)	-92.9%	(178)	-93.3%
Total	2,333	2,122	9.9%	2,640	-11.6%

Insurance revenue jumped on lower life assurance fund contract liabilities

Figure 3: Fee and commission income

SGD mn	1Q18	1Q17	YoY (%)	4Q17	QoQ (%)
Brokerage	25	18	38.9%	18	38.9%
Wealth management	255	215	18.6%	216	18.1%
Fund management	29	25	16.0%	28	3.6%
Credit card	35	35	0.0%	42	-16.7%
Loan-related	71	67	6.0%	70	1.4%
Trade and remittances	55	52	5.8%	56	-1.8%
Guarantees	4	4	0.0%	5	-20.0%
Investment Banking	22	29	-24.1%	26	-15.4%
Service charges	31	27	14.8%	21	47.6%
Others	9	9	0.0%	9	0.0%
Total Fee and Comm	536	481	11.4%	491	9.2%

Wealth management enjoyed consistent improvement from both Bank of Singapore and OCBC Premier Banking

Figure 4: Other non-interest income

SGD mn	1Q18	1Q17	YoY (%)	4Q17	QoQ (%)
Net trading income	94	158	-40.5%	99	-5.1%
Net gain on Invst securities	8	65	-87.7%	249	-96.8%
Disposal of properties	24	24	0.0%	1	2300.0%
Others	11	2	450.0%	11	0.0%
Total other non int Inc	137	249	-45.0%	381	-64.0%

Trading income and gain from investment securities collapsed due to weaker equity markets

Figure 5: Loans by Industries

SGD mn	1Q18	1Q17	YoY (%)	4Q17	QoQ (%)
Agri, mining & quarrying	7,140	7,582	-5.8%	8,073	-11.6%
Manufacturing	14,055	13,185	6.6%	12,501	12.4%
Building and construction	38,476	35,742	7.6%	35,436	8.6%
Housing loans	65,087	60,027	8.4%	64,542	0.8%
General commerce	30,198	26,366	14.5%	29,010	4.1%
Tpt, storage & comms	10,530	12,016	-12.4%	11,568	-9.0%
Fls, invt & holding co	41,590	33,225	25.2%	37,838	9.9%
Professionals & Pri inv	30,182	26,956	12.0%	28,704	5.1%
Others	9,404	9,704	-3.1%	9,649	-2.5%
Total loans	246,662	224,803	9.7%	237,321	3.9%

Loans to FI, investment and holding companies category are predominantly to property funds

Figure 6: Loans by currencies

SGD mn	1Q18	1Q17	YoY (%)	4Q17	QoQ (%)
Singapore dollar	89,008	83,069	7.1%	85,485	4.1%
US dollar	61,439	59,828	2.7%	61,445	0.0%
Malaysian ringgit	20,877	20,264	3.0%	20,481	1.9%
Indonesian rupiah	7,840	7,350	6.7%	7,795	0.6%
Others	28,585	19,587	45.9%	24,478	16.8%
Hong Kong Dollar	33,740	29,561	14.1%	33,011	2.2%
Renminbi	5,173	5,144	0.6%	4,626	11.8%
Total loans	246,662	224,803	9.7%	237,321	3.9%

Others and HK dollar loans were the primary growth drivers

Figure 7: Operating profit by Business segments

SGD mn	1Q18	1Q17	YoY (%)	4Q17	QoQ (%)
Global Consumer/ Private Banking	369	314	17.5%	285	29.5%
Global Corporate/ Investment Banking	506	350	44.6%	258	96.1%
Global Treasury and Markets	119	109	9.2%	95	25.3%
Insurance	162	110	47.3%	482	-66.4%
OCBC Wing Hang	99	85	16.5%	83	19.3%
Others	9	(13)	nm	156	nm
Total Profit	1,264	955	32.4%	1,359	-7.0%

Investment and global corporate rebounded strongly due to trade loans

Figure 8: Profit before tax by Geographical segments

SGD mn	1Q18	1Q17	YoY (%)	4Q17	QoQ (%)
Singapore	697	504	38.3%	798	-12.7%
Malaysia	207	196	5.6%	111	86.5%
Indonesia	106	82	29.3%	221	-52.0%
Greater China	291	234	24.4%	216	34.7%
Other Asia Pacific	56	26	115.4%	44	27.3%
Rest of the World	32	27	18.5%	(3)	-1166.7%
Total NPBT	1,389	1,069	29.9%	1,387	0.1%

Singapore drove earnings growth, helped by zero provisions

Source (Figure 2-8): Company, Phillip Securities Research

Financials

Income Statement

Y/E Dec, SGD mn	FY15	FY16	FY17	FY18e	FY19e
Net Int Income	5,189	5,052	5,423	6,025	6,648
Fees and Commission	1,655	1,638	1,952	2,060	2,118
Other Non int income	1,878	1,799	2,144	2,127	2,146
Total operating income	8,722	8,489	9,519	10,212	10,912
Operating expenses	3,665	3,789	4,041	4,330	4,377
Provisions	585	821	776	389	469
Operating profit	4,472	3,879	4,702	5,494	6,066
Associates & JVs	353	396	388	388	388
Profit Before Tax	4,825	4,275	5,090	5,882	6,454
Taxation	717	629	803	885	976
Profit After Tax	4,108	3,646	4,287	4,997	5,478
Non-controlling Interest	205	173	251	293	321
Net Income, reported	3,903	3,473	4,037	4,704	5,157
Net Income, adj.	3,903	3,473	4,036	4,704	5,157

Per share data (SGD)

Y/E Dec, SGD mn	FY15	FY16	FY17	FY18e	FY19e
EPS, reported	0.95	0.83	0.96	1.12	1.23
EPS, adj.	0.95	0.83	0.96	1.12	1.23
DPS	0.36	0.36	0.37	0.37	0.37
BVPS	8.15	8.61	9.08	9.59	10.19

Supplementary items

Y/E Dec, SGD mn	FY15	FY16	FY17	FY18e	FY19e
CET1 CAR (%)	14.8%	14.7%	13.9%	13.7%	13.7%
Tier 1 CAR (%)	14.8%	15.2%	15.0%	14.6%	14.6%
Total CAR (%)	16.8%	17.2%	17.2%	16.6%	16.5%

Balance Sheet

Y/E Dec, SGD mn	FY15	FY16	FY17	FY18e	FY19e
Cash bal with central banks	21,180	16,559	19,594	17,438	10,972
Due from banks	35,791	39,801	49,377	42,926	43,302
Debt and equity securities	22,786	23,157	25,329	24,516	24,732
Loans and bills receivable	208,218	216,830	234,141	257,287	278,048
Life Assur. Fund Inv. Assets	56,983	61,973	73,927	76,145	78,429
Others	45,232	51,564	52,527	50,537	50,783
Total Assets	390,190	409,884	454,895	468,849	486,266
Due to banks	12,048	10,740	7,485	8,836	8,914
Due to non-bank customers	246,277	261,486	283,642	291,496	302,988
Life Assur. Fund Liabilities	56,994	61,962	73,755	75,968	78,247
Debts issued	23,479	19,947	32,235	31,811	32,129
Others	14,282	16,107	15,985	16,458	16,945
Total liabilities	353,080	370,242	413,102	424,569	439,222
Shareholder's equity	34,553	37,007	39,028	41,119	43,561
Non-controlling interest	2,558	2,635	2,869	3,162	3,482
Total Equity	37,111	39,642	41,897	44,280	47,043

Valuation Ratios

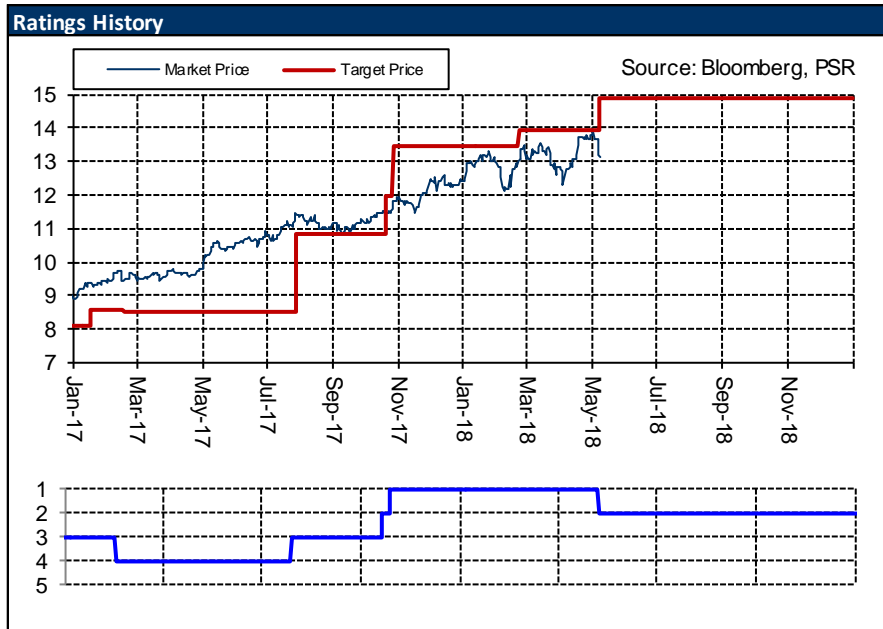
Y/E Dec, SGD mn	FY15	FY16	FY17	FY18e	FY19e
P/E (X), adj.	9.3	10.9	13.7	11.7	10.7
P/B (X)	1.1	1.0	1.4	1.4	1.3
Dividend Yield (%)	4.1%	4.0%	3.9%	3.9%	3.9%

Growth & Margins (%)

	FY15	FY16	FY17	FY18e	FY19e
Growth					
Net int income	9.6%	-2.6%	7.3%	11.1%	10.3%
Non int income	-2.0%	-2.7%	19.2%	2.2%	1.8%
Pre provision operating profit	4.6%	-2.7%	12.1%	7.3%	6.9%
Operating income	-3.8%	-13.3%	21.2%	16.8%	10.4%
Net income, reported	1.5%	-11.0%	16.2%	16.6%	9.6%
Net income, adj	1.5%	-11.0%	16.2%	16.6%	9.6%
Margins					
Net interest margin	1.67%	1.67%	1.65%	1.70%	1.76%
Key Ratios (%)					
ROE	12.3%	10.0%	10.9%	12.0%	12.5%
ROA	1.2%	1.0%	1.0%	1.2%	1.3%
RORWA	2.0%	1.8%	2.1%	2.2%	2.2%
Non-int/total income ratio	40.5%	40.5%	43.0%	41.0%	39.1%
Cost/income ratio	42.0%	44.6%	42.5%	42.4%	40.1%
Loan/deposit ratio	84.5%	82.9%	82.5%	88.3%	91.8%
NPL ratio	0.93	1.26	1.44	0.80	0.79

Source: Company, Phillip Securities Research (Singapore) Estimates

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



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

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