

Oversea-Chinese Banking Corp Ltd

NIM expansion yet to be unleashed



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SINGAPORE | BANKING | 2Q18 RESULTS

- 2Q18 PATMI exceeded our expectations by 4.6%.
- Loans grew 10% YoY, mainly driven by housing loans that recovered to 8% YoY.
- NIM's increase by only 2bps YoY to 1.67%. The higher NIM in Singapore and Malaysia was offset by lower NIM in Indonesia and Hong Kong.
- Allowances dropped 88% YoY. The worst is over for the O&G and shipping sectors.
- Our rating has been upgraded to BUY with an unchanged target price of S\$14.90.

Results at a glance

(SGD mn)	2Q18	2Q17	YoY (%)	1Q18	QoQ (%)	Comments
Net interest income	1,450	1,345	8%	1,415	2%	NIMs +2bps YoY. Loans +10.3% YoY.
Fees & Comm	518	492	5%	536	-3%	Double digit growth in investment related (29%) and trade-related (11%) fees were offset by a decrease in loan-related fees (-3.8%).
Insurance	234	233	0%	206	14%	
Other NII	272	281	-3%	176	55%	Net gain from sale of investment securities fell 96% YoY but offset by increase in net trading income by 37% YoY.
Total income	2,474	2,351	5%	2,333	6%	
Expenses	(1,035)	(993)	4%	(1,032)	0%	Other operating expenses increased 12% YoY.
Allowances	(21)	(169)	-88%	(12)	75%	Large decrease due to provisions set aside for O&G sector last year.
PATMI	1,209	1,041	16%	1,112	9%	

Source: Company, PSR

The Positives

+ Net interest income driven by loans growth and NIM expansion. Loans grew 10.3% YoY and NIM expanded by 2bps YoY to 1.67%. Loans expanded the most in Greater China (16.6% YoY), driven by loans to housing, building and construction and financial institution. Housing loans made up the largest proportion of total loans at 26% of total loans. Management reiterated the high-single-digit loans growth guidance for FY18e.

+ Improving asset quality. Allowances declined 88% YoY to S\$21m due to heavy provisioning made for the exposure to the O&G sector last year. New gross NPA was S\$277mn, the lowest in 3 years. Credit costs declined by 14 bps to 5bps YoY. The current underwhelming credit cost is expected to normalise from the current 5 bps to 15-20 bps. Despite the higher credit cost guidance, there are no new problematic loan portfolios right now. We pin our forecasted credit costs at 15bps for FY18e.

The Negatives

- NIM was softer than expected. NIM had been rising every quarter for OCBC in FY17. However, NIM was surprisingly flat for the past two quarters when other banks saw sequential improvement. The higher NIM in Singapore and Malaysia was offset by weaker NIM from Indonesia and Hong Kong. Hong Kong's NIM came down because the increase in the cost of funds due to rising HIBOR did not result in a proportionate increase in prime rates. In Indonesia, it was difficult to increase asset yield as well due to the increase in funding cost, especially with the authorities advocating single digit lending interest rates. We forecast FY18e NIM at 1.69% as we expect NIM to improve with more capital being directed to loans with higher yield and more rate hikes in FY18.

7 August 2018

BUY (Upgraded)

LAST CLOSE PRICE	SGD 11.58
FORECAST DIV	SGD 0.37
TARGET PRICE	SGD 14.90
TOTAL RETURN	31.9%

COMPANY DATA

BLOOMBERG TICKER	OCBC SP
O/S SHARES (MN)	4,191
MARKET CAP (USD mn / SGD mn)	36081 / 49370
52 - WK HI/LO (SGD)	14.04 / 10.83
3M Average Daily T/O (mn)	5.63

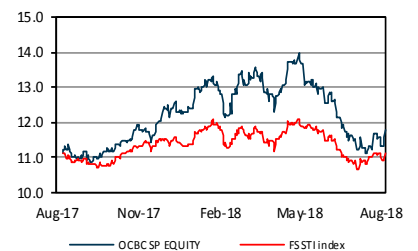
MAJOR SHAREHOLDERS (%)

Selat Pte Limited	11.0%
Lee Foundation Singapore	4.3%
Singapore Investments (Pte) Ltd	3.8%

PRICE PERFORMANCE (%)

	1M TH	3M TH	YTD
COMPANY	3.0	(13.9)	(5.2)
STIRETURN	3.4	(6.5)	(13)

PRICE VS. STI



Source: Bloomberg, PSR

KEY FINANCIALS

Y/E Dec (SGD mn)	FY 16	FY 17	FY 18e	FY 19e
Total Income	8,489	9,474	9,876	10,567
Op. Profit	3,879	4,657	5,482	5,979
NPAT, adj.	3,473	3,997	4,688	5,083
EPS (SGD)	0.83	0.95	1.12	1.22
PER, adj. (x)	10.9	12.1	10.3	9.5
P/BV, x	1.0	1.3	1.2	1.1
ROE	10.0%	10.8%	12.0%	12.3%

Source: Bloomberg, Company, PSR

Valuation Method:

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

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- **Other non-interest income fell 7.6% YoY.** The decline is mainly attributable to a fall of 96.3% YoY in net gain from investment securities. However, this decline was offset by a spike in net trading income where a 40% belongs to the marked to market portfolio in Great Eastern's account (1Q18 was negative and 2Q18 was positive). The rest came from structural capital positions and a small portion from trading activities.

Outlook

The flattish NIM this quarter is expected to improve as the majority of the mortgage repricing based on rising interest rates will likely to happen from 3Q18 onwards. The reluctance in repricing was to ensure that interest rate trends are sustainable before repricing mortgage loans and to provide stability to customers. However, we expect upside surprises to NIM expansion in the upcoming quarters and OCBC has not yet realised its NIM potential.

The recent property cooling measures are not expected to have a significant impact on the mortgage loans book for the rest of FY18. Loans growth guidance of high-single-digit is unchanged. Housing loans for the rest of FY18 are not expected to decline because of previous approvals for the drawdowns this year and management expects the slowdown of new origination of housing loans to begin only next year.

The management's trade war outlook at the moment is cautious and would be more concerned if the war starts to impact on a broader macroeconomic level with countries such as Vietnam and Thailand that play a more active role on a global value. If the trade war escalates, countries will begin to focus on their own domestic market growth and this will affect capital flow and investment flow which will shrink the global economy.

In conclusion, earnings were boosted by robust loans growth, NIM expansion and low allowance. Upside in NIMs may be capped by Indonesia and Hong Kong's inability to raise pricing.

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 1: 2018e Guidance vs. PSR estimates

Assumptions	2Q18	OCBC	PSR	Comments
NIM (%)	1.67%	1.70%	1.69%	PCBC guides 1.7% of full year NIM.
Loans growth	10.3%	HSD	10.6%	OCBC guides high single digit.
ROE	12.6%	> 11.2%	12.1%	OCBC guides a minimum of 11.2% ROE.
Credit cost (bps)	5	15-20	15	OCBC guides 15-20 bps in the long term.
CIR (%)	41.9%	43-45%	40.8%	OCBC guides 43-45%, with 43% as the sweet spot.
CET 1	13.1%	12.5-13.5%	13.5%	OCBC guides 12.5 - 13.5% CET 1 ratio.

Source: Company, PSR

Investment Actions

Our rating has been upgraded to BUY with an unchanged target price of S\$14.90.

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	1.5
	FY18e BVPS, S\$	9.6
	FY18e Valuation, S\$	14.8

Figure 2: Revenue breakdown

SGD mn	2Q18	2Q17	YoY (%)	1Q18	QoQ (%)
Net interest income	1,450	1,345	7.8%	1,415	2.5%
Net fee and comm inc	518	492	5.3%	536	-3.4%
Profits from insurance	234	233	0.4%	206	13.6%
Other non-interest inc	272	281	-3.2%	176	54.5%
Allowance	(21)	(169)	-87.6%	(12)	75.0%
Total	2,474	2,351	5.2%	2,333	6.0%

NII rose 8% YoY from increased loan volumes and higher NIM.

Figure 3: Fee and commission income

SGD mn	2Q18	2Q17	YoY (%)	1Q18	QoQ (%)
Brokerage	16	17	-5.9%	25	-36.0%
Wealth management	225	215	4.7%	255	-11.8%
Fund management	29	27	7.4%	29	0.0%
Credit card	45	44	2.3%	35	28.6%
Loan-related	76	79	-3.8%	71	7.0%
Trade and remittances	59	53	11.3%	55	7.3%
Guarantees	5	5	0.0%	4	25.0%
Investment Banking	31	24	29.2%	22	40.9%
Service charges	23	19	21.1%	31	-25.8%
Others	9	9	0.0%	9	0.0%
Total Fee and Comm	518	492	5.3%	536	-3.4%

Wealth management business was surprisingly weak despite private banking AUM rising by 14% YoY.

Figure 4: Other non-interest income

SGD mn	2Q18	2Q17	YoY (%)	1Q18	QoQ (%)
Net trading income	192	140	37.1%	94	104.3%
Net gain on Inv securities	2	54	-96.3%	8	-75.0%
Disposal of properties	9	6	50.0%	24	-62.5%
Others	10	16	-37.5%	11	-9.1%
Total other non int inc	218	236	-7.6%	137	59.1%

The lower gain from investment securities pulled down non-interest income this quarter.

Figure 5: Loans by Industries

SGD mn	2Q18	2Q17	YoY (%)	1Q18	QoQ (%)
Agri, mining & quarrying	8,332	7,855	6.1%	7,140	16.7%
Manufacturing	15,176	13,530	12.2%	14,055	8.0%
Building and construction	40,931	36,683	11.6%	38,476	6.4%
Housing loans	65,885	60,998	8.0%	65,087	1.2%
General commerce	31,647	27,247	16.1%	30,198	4.8%
Tpt, storage & comms	11,122	12,367	-10.1%	10,530	5.6%
Fis, invt & holding co	38,718	32,736	18.3%	41,590	-6.9%
Professionals & Pri inv	30,925	27,573	12.2%	30,182	2.5%
Others	9,628	9,816	-1.9%	9,404	2.4%
Total loans	252,364	228,805	10.3%	246,662	2.3%

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

Figure 6: Loans by currencies

SGD mn	2Q18	2Q17	YoY (%)	1Q18	QoQ (%)
Singapore dollar	88,940	83,378	6.7%	89,008	-0.1%
US dollar	65,183	59,685	9.2%	61,439	6.1%
Malaysian ringgit	21,074	20,091	4.9%	20,877	0.9%
Indonesian rupiah	8,392	7,652	9.7%	7,840	7.0%
Others	27,717	21,435	29.3%	28,585	-3.0%
Hong Kong Dollar	35,996	30,990	16.2%	33,740	6.7%
Renminbi	5,062	5,574	-9.2%	5,173	-2.1%
Total loans	252,364	228,805	10.3%	246,662	2.3%

SG and HK dollar loans were the primary growth drivers.

Figure 7: Operating profit by Business segments

SGD mn	2Q18	2Q17	YoY (%)	1Q18	QoQ (%)
Global Consumer/ Private Banking	330	320	3.1%	369	-10.6%
Global Corporate/ Investment Banking	505	429	17.7%	506	-0.2%
Global Treasury and Markets	131	134	-2.2%	119	10.1%
Insurance	271	296	-8.4%	162	67.3%
OCBC Wing Hang	133	91	46.2%	99	34.3%
Others	22	(60)	nm	9	nm
Total Profit	1,392	1,210	15.0%	1,264	10.1%

Investment banking and OCBC Wing Hang were the main growth drivers.

Figure 8: Profit before tax by Geographical segments

SGD mn	2Q18	2Q17	YoY (%)	1Q18	QoQ (%)
Singapore	874	767	14.0%	697	25.4%
Malaysia	263	182	44.5%	207	27.1%
Indonesia	8	75	-89.3%	106	-92.5%
Greater China	308	256	20.3%	291	5.8%
Other Asia Pacific	32	19	68.4%	56	-42.9%
Rest of the World	19	30	-36.7%	32	-40.6%
Total NPBT	1,504	1,329	13.2%	1,389	8.3%

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	5,948	6,562
Fees and Commission	1,655	1,638	1,952	2,087	2,145
Other Non int income	1,878	1,799	2,099	1,841	1,860
Total operating income	8,722	8,489	9,474	9,876	10,567
Operating expenses	3,665	3,789	4,041	4,051	4,065
Provisions	585	821	776	343	523
Operating profit	4,472	3,879	4,657	5,482	5,979
Associates & JVs	353	396	388	388	388
Profit Before Tax	4,825	4,275	5,045	5,870	6,367
Taxation	717	629	803	892	972
Profit After Tax	4,108	3,646	4,242	4,978	5,395
Non-controlling Interest	205	173	245	287	312
Net Income, reported	3,903	3,473	3,998	4,690	5,083
Net Income, adj.	3,903	3,473	3,997	4,688	5,083

Balance Sheet

Y/E Dec, SGD mn	FY15	FY16	FY17	FY18e	FY19e
Cash bal with central banks	21,180	16,559	19,594	20,948	16,348
Due from banks	35,791	39,801	49,377	39,751	40,100
Debt and equity securities	22,786	23,157	25,329	23,808	24,017
Loans and bills receivable	208,218	216,830	234,141	261,419	279,584
Life Assur. Fund Inv. Assets	56,983	61,973	73,927	76,145	78,429
Others	45,232	51,564	52,527	48,950	49,182
Total Assets	390,190	409,884	454,895	471,021	487,659
Due to banks	12,048	10,740	7,485	8,765	8,842
Due to non-bank customers	246,277	261,486	283,642	294,473	305,276
Life Assur. Fund Liabilities	56,994	61,962	73,755	75,968	78,247
Debts issued	23,479	19,947	32,235	31,143	31,454
Others	14,282	16,107	15,985	16,458	16,945
Total liabilities	353,080	370,242	413,102	426,807	440,764
Shareholder's equity	34,553	37,007	39,028	41,063	43,433
Non-controlling interest	2,558	2,635	2,863	3,150	3,462
Total Equity	37,111	39,642	41,891	44,214	46,895

Per share data (SGD)

Y/E Dec, SGD mn	FY15	FY16	FY17	FY18e	FY19e
EPS, reported	0.95	0.83	0.95	1.12	1.22
EPS, adj.	0.95	0.83	0.95	1.12	1.22
DPS	0.36	0.36	0.37	0.37	0.37
BVPS	8.15	8.61	9.08	9.58	10.18

Supplementary items

Y/E Dec, SGD mn	FY15	FY16	FY17	FY18e	FY19e
CET1 CAR (%)	14.8%	14.7%	13.9%	13.4%	13.6%
Tier 1 CAR (%)	14.8%	15.2%	15.0%	14.4%	14.5%
Total CAR (%)	16.8%	17.2%	17.2%	16.4%	16.3%

Valuation Ratios

Y/E Dec, SGD mn	FY15	FY16	FY17	FY18e	FY19e
P/E (X), adj.	9.3	10.9	12.1	10.3	9.5
P/B (X)	1.1	1.0	1.3	1.2	1.1
Dividend Yield (%)	4.1%	4.0%	3.2%	3.2%	3.2%

Growth & Margins (%)

Growth					
Net int income	9.6%	-2.6%	7.3%	9.7%	10.3%
Non int income	-2.0%	-2.7%	17.9%	-3.0%	2.0%
Pre provision operating profit	4.6%	-2.7%	11.6%	4.2%	7.0%
Operating income	-3.8%	-13.3%	20.1%	17.7%	9.1%
Net income, reported	1.5%	-11.0%	15.1%	17.3%	8.4%
Net income, adj	1.5%	-11.0%	15.1%	17.3%	8.4%

Margins

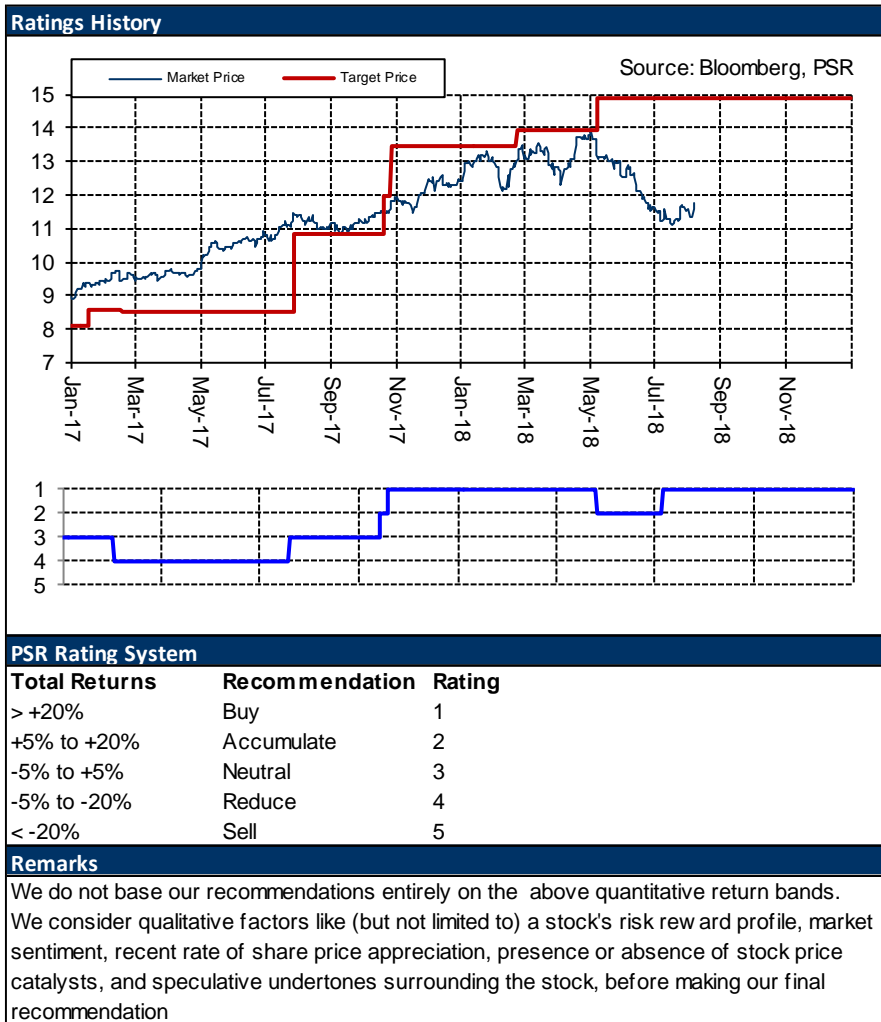
Net interest margin	1.67%	1.67%	1.65%	1.69%	1.76%
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Key Ratios (%)

ROE	12.3%	10.0%	10.8%	12.0%	12.3%
ROA	1.2%	1.0%	1.0%	1.2%	1.2%
RORWA	2.0%	1.8%	2.1%	2.2%	2.2%
Non-int/total income ratio	40.5%	40.5%	42.8%	39.8%	37.9%
Cost/income ratio	42.0%	44.6%	42.7%	41.0%	38.5%
Loan/deposit ratio	84.5%	82.9%	82.5%	88.8%	91.6%
NPL ratio	0.93	1.26	1.44	0.80	0.82

Source: Company, Phillip Securities Research (Singapore) Estimates

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



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