Event | Initiation | Preview | **Results** | Strategy | Update

OCBC (OCBC SP)

Buy (Maintained)

Financial Services - Banks

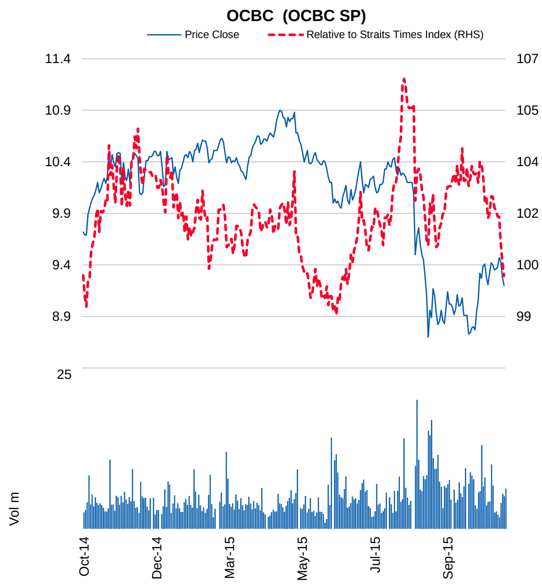
Market Cap: USD27,154m

Target Price: SGD10.70

Price: SGD9.20

Proactive Restructuring Of Oil & Gas Loans

Macro ◆
Risks ◆◆
Growth ◆◆
Value ◆◆



Source: Bloomberg

Avg Turnover (SGD/USD)	64.2m/45.8m
Cons. Upside (%)	19.6
Upside (%)	16.3
52-wk Price low/high (SGD)	8.70 - 10.9
Free float (%)	75
Share outstanding (m)	4,117
Shareholders (%)	
Selat	10.6
Aberdeen	5.9

Share Performance (%)

	YTD	1m	3m	6m	12m
Absolute	(12.1)	5.4	(10.4)	(15.0)	(5.4)
Relative	(2.4)	(3.5)	(3.1)	(2.0)	(0.1)

3Q15 core net profit fell 14% QoQ mainly on lower non-interest income and higher provisions. Maintain BUY, with a lower TP of SGD10.70 TP (from SGD10.90, 16% upside). Our TP implies a FY16F P/BV of 1.25x vs the historical mean of 1.35x. OCBC's asset quality remains resilient despite the sharp 28% QoQ rise in NPLs. Proactive restructuring of oil & gas loans would help keep its credit cost in check.

- **9M15 earnings in line.** OCBC posted core net profit of SGD902m (-14% QoQ/+7% YoY) for 3Q15 and SGD2,943m for 9M15 (+11% YoY). 9M15 earnings were at 78% of consensus' 2015 forecast of SGD3,786m. The sequential drop in earnings was mainly due to lower non-interest income (-17% QoQ) and higher impairment charges (+68% QoQ).
- **Key positives for 3Q15** were: i) stable net interest margin (NIM) of 1.66% as the drop in asset yields was compensated by lower funding costs, ii) operating expenses were well-controlled (-2% QoQ), iii) deposits grew 2% QoQ with demand deposits up 8% QoQ, and iv) fully-loaded Common Equity Tier 1 (CET1) ratio strengthened further to 11.4% (June: 11.2%, Dec 2014: 10.6%). The negatives were: i) a sharp 28% QoQ rise in gross non-performing loans (NPLs) that led to a higher credit cost of 33bps (2Q15: 20bps) and lower loan loss coverage (LLC) of 125.8% (June: 156.4%), and (ii) still-weak loan demand. Gross loans were up 1% QoQ, but stayed flat on constant currency terms.
- **Asset quality.** The spike in NPLs was largely due to proactive action to restructure accounts in the oil & gas support services sector, given the prolonged slump in oil prices. OCBC is seeing almost zero NPLs in its commodity exposure while its China NPL ratio is a low 0.3%.
- **Maintain BUY.** Although loan growth would be softer than expected, management expects OCBC's underlying operations to be supported by growth in its wealth management business. It believes NIM can be sustained at 3Q15 levels while credit cost would likely be maintained at current levels. We lower our GGM-based TP to SGD10.70 (from SGD10.90) after fine-tuning of our ROE forecasts, implying a 1.25x FY16F P/BV (historical mean: 1.35x). Maintain BUY, as pre-emptive restructuring of oil & gas loans would help keep credit costs in check. OCBC's gross NPL ratio of 0.88% remains the lowest among peers, while its LLC is at a comfortable level.

Forecasts and Valuations	Dec-13	Dec-14	Dec-15F	Dec-16F	Dec-17F
Reported net profit (SGDm)	2,768	3,842	3,841	4,102	4,461
Net profit growth (%)	(30.7)	38.8	(0.0)	6.8	8.7
Recurring net profit (SGDm)	2,768	3,451	3,841	4,102	4,461
Recurring EPS (SGD)	0.78	0.92	0.95	1.00	1.08
BVPS (SGD)	7.10	7.79	8.27	8.87	9.55
DPS (SGD)	0.33	0.34	0.25	0.37	0.37
Recurring P/E (x)	11.8	10.0	9.7	9.2	8.5
P/B (x)	1.30	1.18	1.11	1.04	0.96
Dividend Yield (%)	3.6	3.7	2.8	4.0	4.0
Return on average equity (%)	10.9	13.7	11.8	11.6	11.8
Return on average assets (%)	0.9	1.0	1.0	1.0	1.0
Our vs consensus EPS (adjusted) (%)			3.1	1.5	1.7

Source: Company data, RHB

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Results At a Glance

Figure 1: OCBC's 3Q15 and 9M15 results summary

FYE Dec (SGDm)	3Q14	2Q15	3Q15	QoQ (%)	YoY (%)	9M14	9M15	YoY (%)	Comments – 9M15 vs 9M14
Net interest income	1,246	1,282	1,317	*3*	*6*	3,459	3,848	*11*	Growth underpinned mainly by a 14% YoY rise in interest-earning assets.
Net interest margin	*1.68%*	*1.67%*	*1.66%*	*-1bps*	*-2bps*	*1.69%*	*1.65%*	*-4bps*	Down 4bps YoY as a 3bps rise in asset yields was offset by an 8bps increase in total funding costs.
Non-interest income	1,192	939	775	*(17)*	*(35)*	2,842	2,573	*(9)*	Fee income rose 12% YoY on higher income from brokerage, wealth management and credit card fees. Profit from life insurance fell 32% YoY and net trading & investment income rose 41% YoY.
Non-II/Total income	*39.1%*	*42.3%*	*37.0%*			*41.2%*	*40.1%*		
Operating income	**2,438**	**2,221**	**2,092**	***(6)***	***(14)***	**6,301**	**6,421**	***2***	
Overhead expenses	(870)	(918)	(900)	*(2)*	*3*	(2,336)	(2,691)	*15*	The rise reflects the consolidation of OCBC WH. Ex-OCBC WH, opex rose 5% YoY.
Cost-Income Ratio	*42.5%*	*41.3%*	*43.0%*			*39.7%*	*41.9%*		
Pre-Impairment profit	**1,568**	**1,303**	**1,192**	***(9)***	***(24)***	**3,965**	**3,730**	***(6)***	
Impairment charges	(111)	(104)	(175)	*68*	*58*	(246)	(367)	*49*	Allowances for loan impairments rose 20% YoY to SGD259m while allowance for intangible assets was up 74% YoY to SGD73m.
Credit cost - annualised (bps)	*23*	*20*	*33*			*70*	*93*		
Operating profit	**1,457**	**1,199**	**1,017**	***(15)***	***(30)***	**3,719**	**3,363**	***(10)***	
Associates	14.0	102.0	99.0	*(3)*		49.0	290.0		Lifted by contributions from Bank of Ningbo, which became a 20%-owned associate at end-Sep 2014.
Pretax profit	**1,471**	**1,301**	**1,116**	***(14)***	***(24)***	**3,768**	**3,653**	***(3)***	
Tax	(184)	(191)	(181)			(541)	(557)		
Effective tax rate	*12.5%*	*14.7%*	*16.2%*			*14.4%*	*15.2%*		
Minority Interest	(55)	(62)	(33)	*(47)*	*(40)*	(175)	(153)	*(13)*	
Net Profit	**1,232**	**1,048**	**902**	***(14)***	***(27)***	**3,052**	**2,943**	***(4)***	OCBC WH contributed SGD232m to 9M15 earnings (9M14: SGD38m).
EI/Others	(392)	-	-			(392)	-		
Core Net Profit	**840**	**1,048**	**902**	***(14)***	***7***	**2,660**	**2,943**	***11***	1H15 earnings were 78% of consensus FY15F net profit of SGD3,786m.
Other Key Data and Ratios									
Gross loans	204,854	210,146	212,682	*1*	*4*	204,854	212,682	*4*	Up 1.4% compared to Dec 2014 with growth from Indonesia (+15% YTD) and China (7% YTD) negated by declines of 3% YTD in Malaysia and 24% YTD in other countries.
Customer deposits	237,172	246,424	251,884	*2*	*6*	237,172	251,884	*6*	Savings deposits: +7% YTD, time deposits: +1% YTD and demand deposits: +10.5% YTD.
Gross non-performing loans	1,338	1,460	1,862	*28*	*39*	1,338	1,862	*39*	
Total assets	391,588	399,014	399,815	*0*	*2*	391,588	399,815	*2*	
Shareholders' funds	29,771	32,948	33,939	*3*	*14*	29,771	33,939	*14*	
ROAA (%)	0.91	1.04	0.90			0.87	0.93		
ROAE (%)	11.9	12.8	10.8			11.6	12.8		
LDR (%)	85.5	84.3	83.5			85.5	83.5		
Gross NPL ratio (%)	0.65	0.69	0.88			0.65	0.88		
Loan loss reserves (%)	157.5	156.4	125.8			157.5	125.8		
CET-1 ratio (%)	13.20	14.10	14.50			13.20	14.50		
Total capital ratio (%)	15.5	16.1	16.6			15.5	16.6		

Source: Company data, RHB

Key Highlights From Management Briefing

Rise in NPLs mainly from Malaysia and Singapore. Gross non-performing assets increased 29% QoQ to SGD1,932m, of which SGD1,862m (up SGD402m or 27.5% QoQ) consisted of NPLs. The balance of SGD70m includes debt securities and contingent liabilities. Overall, gross NPL ratio edged up to 0.88% from 0.69% in June.

The bulk of the increase in NPLs came from the bank's Singapore (up SGD131m or 34% QoQ) and Malaysia (up SGD177m or 34% QoQ) loan books. Indonesia NPLs increased by SGD59m or 24% QoQ, while Greater China impaired loans rose SGD48m or 30% QoQ.

Proactive restructuring and provisioning of loans. Management attributed the sharp increase in NPLs to proactive actions to restructure loans extended to borrowers in the oil & gas support services sector. Once restructured, these loans are classified as substandard loans, which are then deemed as non-performing. Hence, the 53% QoQ jump in substandard assets to SGD1,376m was the main driver of the rise in NPLs. Due to the proactive restructuring of loans, 46% of gross NPLs are non-overdue accounts. This partly explains the decline in LLC ratio to 125% from 156.4% in June.

The increase in its China NPLs came mainly from two accounts – a trading company with raw materials related to oil prices and a company that owns a shopping mall (loan-to-value is a low 30%).

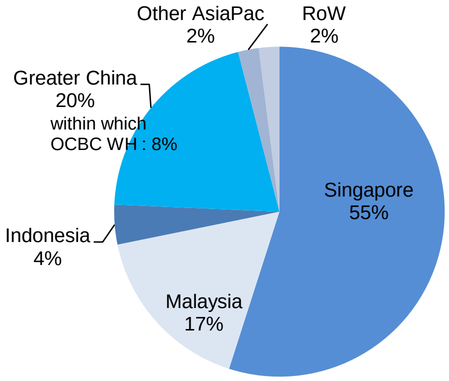
Exposure to oil & gas and commodity sectors. Lending to the oil & gas sector accounted for 6% of gross loans (June: 7%) while loans to the commodity sector made up 7% of total loans (June: 7%). Unlike the oil & gas loans, OCBC's commodity loans portfolio is solid, with almost zero NPLs.

Loan demand still soft. Gross loans grew a modest 1.4% YTD or 2% annualised. Given the domestic demand and moderating GDP growth in neighbouring countries, management expects low single-digit loan growth for 2015. Management believes that should regional economies regain momentum in 2016, Singapore banks would see some recovery in loan demand.

Expects stable NIM in 4Q15. OCBC managed to keep its NIM relatively stable at 1.66% in 3Q15 compared with 1.67% in 2Q15. A 4bps QoQ decline in funding costs cushioned the 5bps QoQ drop in asset yields. Management believes NIM can be maintained at 1.66% in 4Q15. Efforts are likely to be made to optimise funding as well as reduce expensive deposits, in particular USD deposits. As at end-September, its USD loan-to-deposit ratio (LDR) stood at a low 66%.

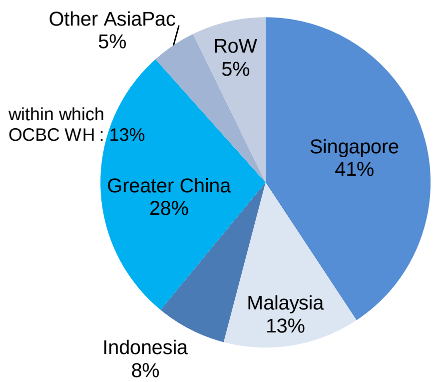
No plans to divest Great Eastern Holdings (GEH SP, NR) GEH. Although OCBC's fully-loaded CET1 ratio strengthened further to 11.4% (June: 11.2%, Dec 2014: 10.6%), it remains lower than its peers' 12.3-12.5%. For the near term, management would continue to use scrip dividend to improve OCBC's capital base. The sale of non-core assets remains an option, but timing is key. That said, management added that it has no intention to divest its 87% stake in GEH, as it forms part of OCBC's wealth management strategy.

Figure 2: OCBC's pre-tax profit by geography (9M15)



Source: Company data, RHB

Figure 3: OCBC's loans by geography (Sep 2015)



Source: Company data, RHB

Valuation And Risks

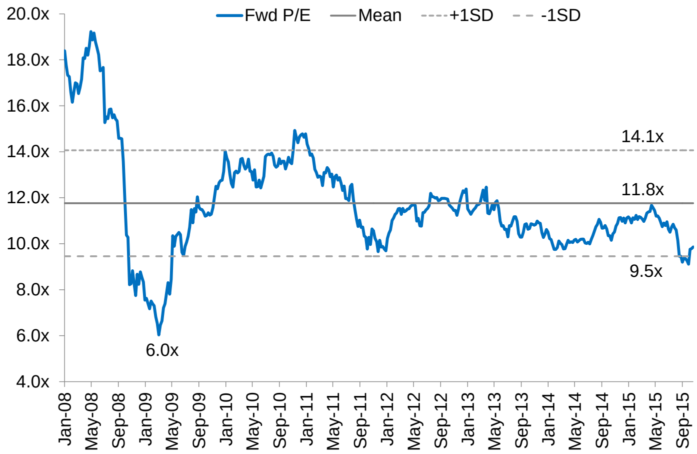
Valuation

Our GGM-derived TP is lowered to SGD10.70 (from SGD10.90) after we incorporated the latest changes in 3Q15 shareholders' funds. This resulted in a revised 3-year forward ROE of 12.15% (from 12.4%). Other assumptions are unchanged – cost of equity of 10.4% and long-term growth of 3.5%. Our revised TP implies a FY16F P/BV of 1.25x (historical mean: 1.35x) and P/E of 10.8x (historical mean: 11.8x).

Risks

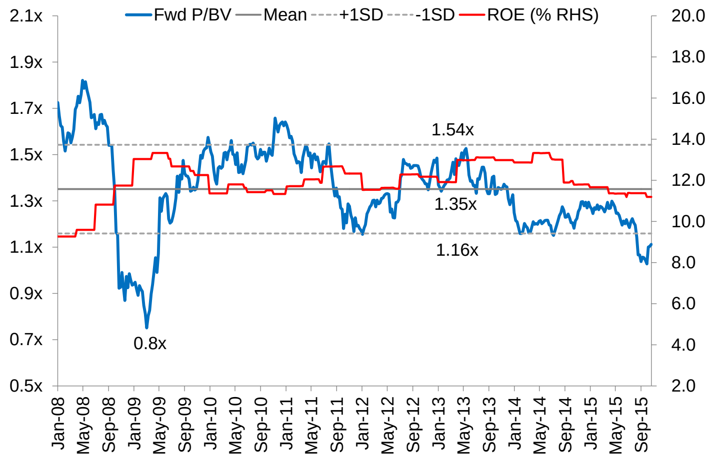
We believe key risks to share price performance are: i) a sharper-than-expected deterioration in asset quality, ii) weaker-than-expected improvement in wealth management income – which is one of management's key strategies for operating income growth in the face of weak loan demand, and iii) potential hiccups in the integration of OCBC Wing Hang Bank Ltd (OCBC-WH).

Figure 4: OCBC's 12-month forward consensus P/E



Source: Bloomberg, RHB

Figure 5: OCBC's 12-month forward consensus P/BV



Source: Bloomberg, RHB

Financial Exhibits

Profit & Loss (SGDm)	Dec-13	Dec-14	Dec-15F	Dec-16F	Dec-17F
Interest income	6,174	7,607	8,500	8,990	9,620
Interest expense	(2,291)	(2,871)	(3,378)	(3,582)	(3,840)
Net interest income	**3,883**	**4,736**	**5,122**	**5,408**	**5,780**
Non interest income	2,738	3,213	3,326	3,530	3,800
- Fee income	1,355	1,495	1,650	1,790	1,930
- Insurance income	756	930	781	850	930
Total operating income	**6,621**	**7,949**	**8,448**	**8,938**	**9,580**
Overheads	(2,842)	(3,332)	(3,686)	(3,870)	(4,080)
- Staff costs	(1,715)	(2,003)	(2,240)	(2,360)	(2,490)
Pre-provision operating profit	**3,779**	**4,617**	**4,762**	**5,068**	**5,500**
Loan impairment allowances	(264)	(359)	(365)	(395)	(420)
Other impairment allowances	(2)	2	(3)	(5)	(6)
Income from associates	54	112	385	420	465
Other exceptional items	-	391	-	-	-
Pre-tax profit	**3,567**	**4,763**	**4,779**	**5,088**	**5,539**
Taxation	(597)	(687)	(698)	(738)	(809)
Minority interests	(202)	(234)	(240)	(248)	(270)
Reported net profit	**2,768**	**3,842**	**3,841**	**4,102**	**4,461**
Recurring net profit	**2,768**	**3,451**	**3,841**	**4,102**	**4,461**

Source: Company data, RHB

	Dec-13	Dec-14	Dec-15F	Dec-16F	Dec-17F
Per Share Data					
EPS (SGD)	0.78	1.02	0.95	1.00	1.08
Recurring EPS (SGD)	0.78	0.92	0.95	1.00	1.08
DPS (SGD)	0.33	0.34	0.25	0.37	0.37
BVPS (SGD)	7.10	7.79	8.27	8.87	9.55
Growth Rates					
EPS growth (%)	(30.7)	30.4	(7.2)	5.1	8.7
Recurrent EPS growth (%)	(2)	17	3	5	9
DPS growth (%)	3	3	(25)	46	0
BVPS growth (%)	(2.7)	9.7	6.2	7.2	7.7
Gross cust loan growth (%)	17.8	23.7	2.9	3.3	5.0
Total asset growth (%)	14.4	18.5	1.1	3.6	5.3
Cust deposit growth (%)	18.7	25.3	2.9	3.4	5.4
Net interest income growth (%)	3.6	22.0	8.2	5.6	6.9
Non interest income growth (%)	(10.1)	17.3	3.5	6.1	7.6
Overhead growth (%)	3.2	17.2	10.6	5.0	5.4
Operating profit growth (%)	(6.4)	22.2	3.1	6.4	8.5
Loan impairment allowance growth (%)	0.4	36.0	1.7	8.2	6.3
Net profit growth (%)	(30.7)	38.8	(0.0)	6.8	8.7
Profitability					
Return on IEAs (%)	2.7	2.8	2.9	3.0	3.0
Cost of funds (%)	1.1	1.2	1.3	1.3	1.3
Net interest spread (%)	1.6	1.6	1.6	1.6	1.7
Net interest margin (%)	1.7	1.7	1.7	1.8	1.8
Non-interest income / total income (%)	41.4	40.4	39.4	39.5	39.7
Cost to income ratio (%)	42.9	41.9	43.6	43.3	42.6
Credit cost (bps)	17	19	17	18	18
Return on average assets (%)	0.9	1.0	1.0	1.0	1.0
Return on average equity (%)	10.9	13.7	11.8	11.6	11.8

Source: Company data, RHB

Financial Exhibits

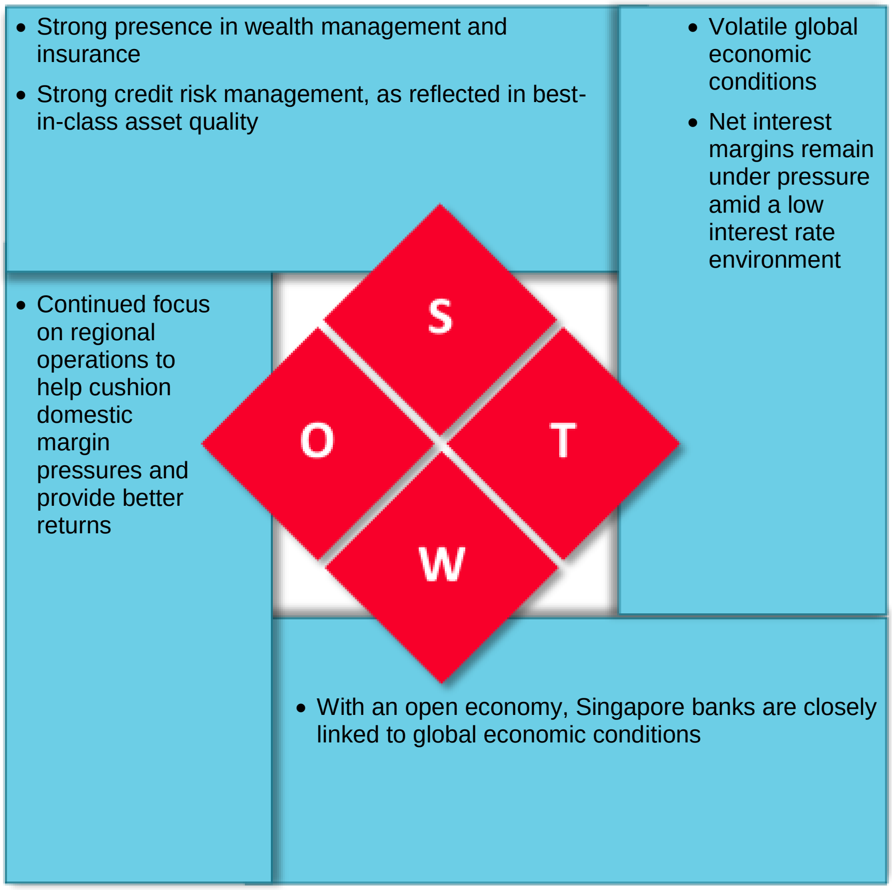
Balance Sheet (SGDm)	Dec-13	Dec-14	Dec-15F	Dec-16F	Dec-17F
Total gross loans	169,620	209,822	215,875	223,000	234,200
Other interest earning assets	77,758	86,496	83,685	86,520	91,482
Total gross IEAs	247,378	296,318	299,560	309,520	325,682
Total provisions	(1,775)	(2,305)	(2,530)	(2,695)	(2,733)
Net loans to customers	167,854	207,535	213,360	220,320	231,482
Total net IEAs	245,603	294,013	297,030	306,825	322,949
Tangible fixed assets	1,898	3,409	3,510	3,650	3,810
Intangible assets	3,460	4,802	4,610	4,430	4,250
Total non-IEAs	92,845	107,213	108,481	113,406	119,584
Total assets	338,448	401,226	405,511	420,231	442,533
Customer deposits	195,974	245,519	252,600	261,200	275,300
Other interest-bearing liabilities	21,549	20,503	18,000	17,500	18,600
Total IBLs	217,523	266,022	270,600	278,700	293,900
Total non-IBLs	92,846	101,019	98,030	102,197	106,488
Total liabilities	310,369	367,041	368,630	380,897	400,388
Share capital	9,448	13,752	15,452	15,452	15,452
Retained earnings reserve	14,756	16,461	18,011	20,464	23,275
Other reserves	911	884	638	638	638
Shareholders' equity	25,115	31,097	34,101	36,554	39,365
Minority interests	2,964	3,088	2,780	2,780	2,780

Source: Company data, RHB

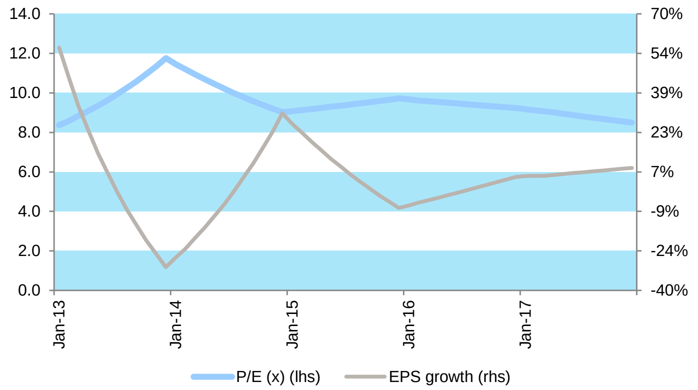
	Dec-13	Dec-14	Dec-15F	Dec-16F	Dec-17F
Balance Sheet Structure					
Net cust loans/cust deposits (%)	85.7	84.5	84.5	84.3	84.1
CASA deposits / customer deposits (%)	46.6	44.6	44.6	44.6	44.6
Total assets / shareholders' funds (x)	13.5	12.9	11.9	11.5	11.2
Asset Quality and Capital					
Reported NPLs / gross cust loans (%)	0.7	0.6	0.9	0.9	0.9
Net impaired loans / loans (%)	(0.3)	(0.5)	(0.2)	(0.2)	(0.3)
Collective allowance / net loans (%)	0.9	0.9	1.0	1.0	1.0
Total provisions / reported NPLs (%)	140.5	174.3	126.0	125.8	131.7
CET-1 ratio (%)	14.6	13.8	15.4	16.2	16.7
Tier-1 ratio (%)	14.6	13.8	15.4	16.2	16.7
Total capital ratio (%)	16.3	15.9	17.6	18.5	19.2
Du-Pont (as % of avg assets)					
Net interest income (%)	1.2	1.3	1.3	1.3	1.3
Non-interest income (%)	0.9	0.9	0.8	0.9	0.9
Operating expenses (%)	0.9	0.9	0.9	0.9	0.9
Pre-provision ROAA (%)	1.2	1.2	1.2	1.2	1.3
Loan & other impairment allowance (%)	0.1	0.1	0.1	0.1	0.1
Associates (%)	0.0	0.0	0.1	0.1	0.1
Pre tax ROAA (%)	1.1	1.3	1.2	1.2	1.3
Return on average assets (%)	0.9	1.0	1.0	1.0	1.0
Leverage (x)	12.5	13.2	12.4	11.7	11.4
Return on average equity (%)	10.9	13.7	11.8	11.6	11.8

Source: Company data, RHB

SWOT Analysis

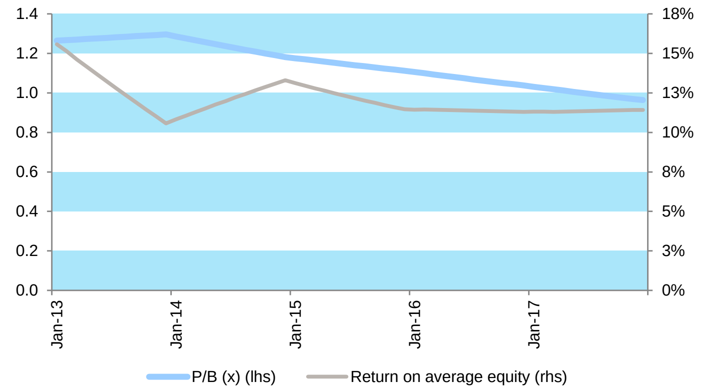


P/E (x) vs EPS growth



Source: Company data, RHB

P/BV (x) vs ROAE

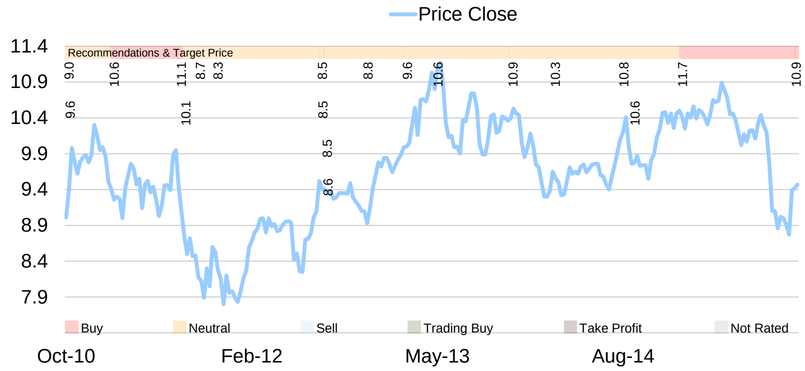


Source: Company data, RHB

Company Profile

OCBC is the second largest banking group in Singapore by asset size. It derives the bulk of its pre-tax profits from Singapore (1H15: 60%), Malaysia (19%), Greater China (17%) and Indonesia (5%).

Recommendation Chart



Source: RHB, Bloomberg

Date	Recommendation	Target Price	Price
2015-10-15	Buy	10.9	9.3
2015-08-02	Buy	11.7	10.3
2015-05-03	Buy	11.7	10.7
2015-02-11	Buy	11.7	10.6
2014-12-30	Buy	11.7	10.5
2014-10-31	Neutral	10.6	9.9
2014-09-03	Neutral	10.6	9.8
2014-08-19	Neutral	10.8	10.3
2014-08-06	Neutral	10.8	10.1
2014-05-02	Neutral	10.3	9.7

Source: RHB, Bloomberg

RHB Guide to Investment Ratings

Buy: Share price may exceed 10% over the next 12 months
Trading Buy: Share price may exceed 15% over the next 3 months, however longer-term outlook remains uncertain
Neutral: Share price may fall within the range of +/- 10% over the next 12 months
Take Profit: Target price has been attained. Look to accumulate at lower levels
Sell: Share price may fall by more than 10% over the next 12 months
Not Rated: Stock is not within regular research coverage

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