APEX SECURITIES BERHAD

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Hong Leong Bank Berhad

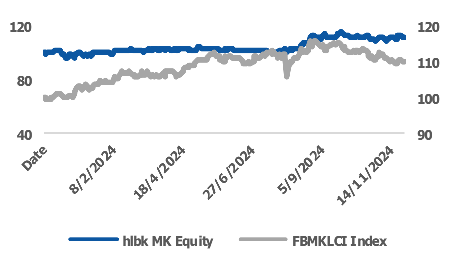
Rising Regional Contributions

Recommendation:	**BUY**
Current Price:	**RM 20.48**
Previous Target Price:	**-**
Target Price:	**RM 24.79**
Upside/Downside:	**21.0%**

Stock information	
Board	MAIN
Sector	Financial Services
Bursa / Bloomberg Code	5819 / HLBK MK
Syariah Compliant	No
FTSE4Good Index	Yes
FTSE ESG Rating	★★★★
Bloomberg ESG Rating	N/A
Shares issued (m)	2,167.7
Market Cap (RM' m)	44,394.9
52-Week Price Range (RM)	21.88-18.46
Beta (x)	0.8
Free float (%)	33.5
3M Average Volume (m)	1.8
3M Average Value (RM' m)	37.1

Top 3 Shareholders	**(%)**
Hong Leong Financial Group Bhd	61.8
Employees Provident Fund Board	8.2
Amanah Saham Nasional Bhd	3.3

Share Price Performance



	1M	**3M**	**12M**
Absolute (%)	1.4	-2.9	7.0
Relative (%)	2.0	0.9	-3.4

Summary

- **HLBK is one of the most profitable banks in the industry and appears to be very undervalued, premised to its ROE level.**
- **We like HLBK for several reasons: (i) Its high ROE of 11-12%, (ii) Excellent asset quality and low provisions, making it a suitable defensive pick, (iii) Significant BOCD-related Associate income, and (iv) Rising regional contributions, notably from its fast-growing Singapore segment.**
- **We initiate coverage on HLBK with a BUY recommendation with a TP of RM24.79 based on FY26F GGM-PBV of 1.17x.**

Company Background

- Hong Leong Bank Berhad (HLBK) is a regional financial services bank based in Malaysia, with a presence in Singapore, Hong Kong, Vietnam, Cambodia and China. The Bank is technology-focused and emphasises the development of financial capabilities to serve its clients across these five geographies.

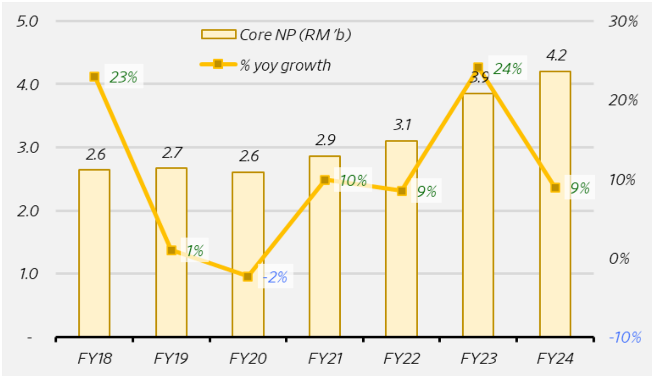
- HLBK was originally incorporated as Kwong Lee Mortgage and Remittance Company in 1905 in Kuching, Sarawak and later as Kwong Lee Bank Limited in 1934, bearing the heritage of Malaysia's oldest local financial institution. Kwong Lee Bank Berhad was acquired by the MUI Group in May 1982 and renamed Malayan United Bank Berhad on 2 February 1983. In 1989, it was renamed as MUI Bank. Under the MUI Bank banner, it grew from 11 to 35 branches nationwide.

- On the regional front, HLBK was the first Malaysian bank to enter the Chinese banking sector in 2008 with a strategic investment in Bank of Chengdu Co., Ltd (BOCD) with an 18% stake. HLB became the first Malaysian and South East Asian bank to be granted a license to incorporate and operate a 100% wholly-owned commercial bank in Vietnam, which commenced operations in October 2009 with a branch located in Ho Chi Minh City and Hanoi.

Income Statement

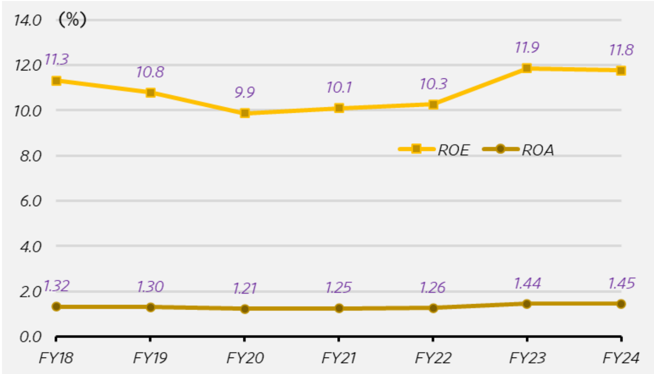
- **Earnings and ROE.** A steady earnings CAGR in recent years has been difficult to determine due to earnings distortions caused by the Covid-19 pandemic. Regardless, HLBK has posted very strong Core NP growth in recent years, mainly due to the rapid growth of Bank of Chengdu (BOCD) contributions. Its steady ROE of 11-12% is always among the highest in the industry, attributable also to its strict cost control and low provisioning.

Fig 1: Core Net Profit



Source: HLBK

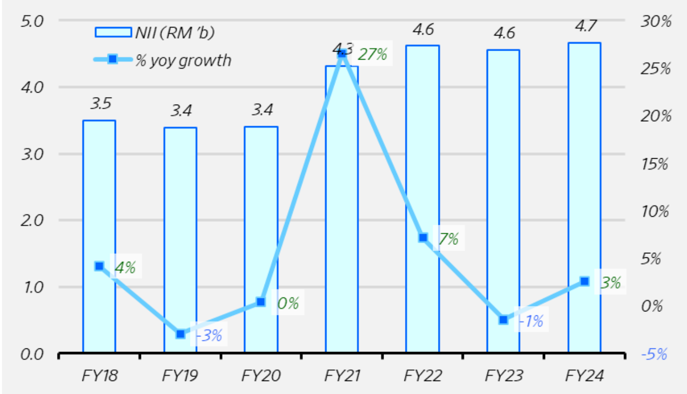
Fig 2: Return on Equity and Return on Assets



Source: HLBK

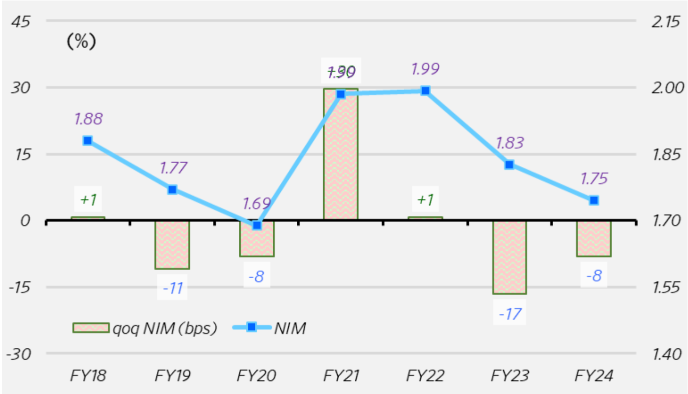
- **Management NII and NIM.** HLBK's NIM is moving roughly in line with the rest of the industry. Its NII has stagnated in recent years. However, the Group is making several efforts to rectify this: (i) Switching towards higher-yielding business loans, (ii) Increasing its loan/deposit ratio to a more optimal level (from 85% to 87-88% level), and (iii) Growing its CASA ratio.

Fig 3: Net Interest Income



Source: HLBK

Fig 4: Net Interest Margins

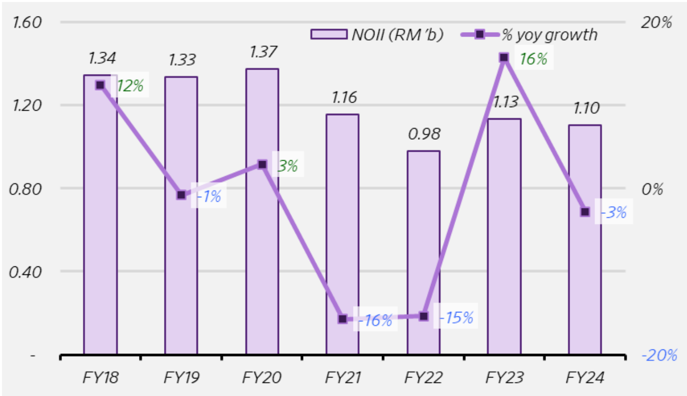


Source: HLBK

- **NOII.** HLBK's NOII makes up a relatively small component of topline. This is because HLBK lacks the contributions of several core NOII business lines. Segmental contributions from traditional NOII business lines, such as insurance and stockbroking, are only recognized as part of Hong Leong Financial Group's (HLBK's parent company) earnings.

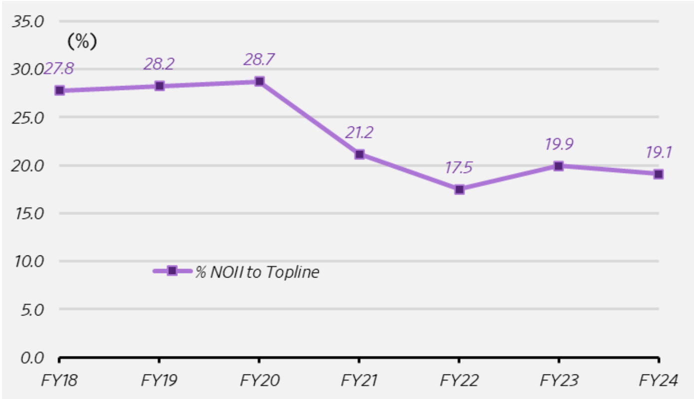
- Regardless, the Group reckons "low-hanging fruit" still exists. HLBK is growing its client franchise rapidly – its close relationship with SMEs is the main driver. Most notable are the wealth management, bancassurance income segments, and Global Market franchise sales. These are reporting strong double-digit level annual growth. While most of the growth comes from Malaysia, HLBK's burgeoning Singaporean segment is starting to pull in serious weight.

Fig 5: Non-Interest Income



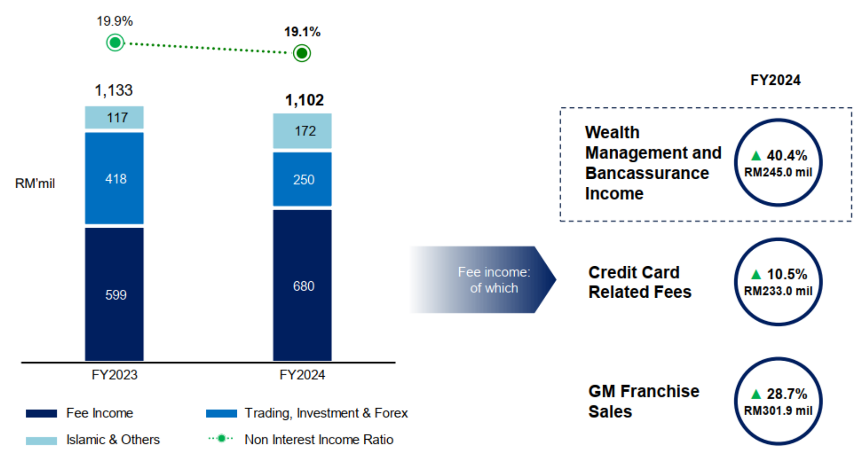
Source: HLBK

Fig 6: Non-Interest Income as % of Topline



Source: HLBK

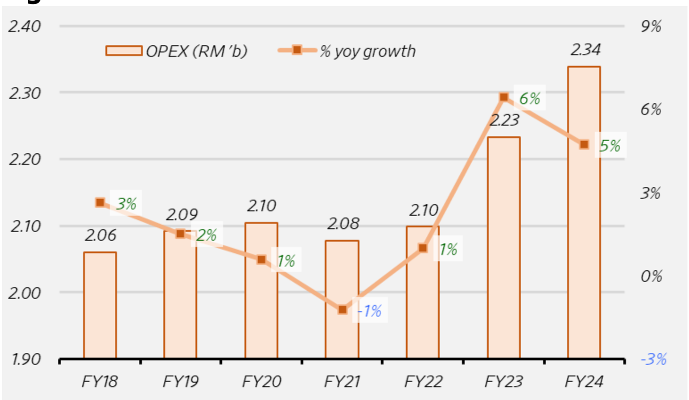
Fig 7: Fee Income Drivers



Source: HLBK

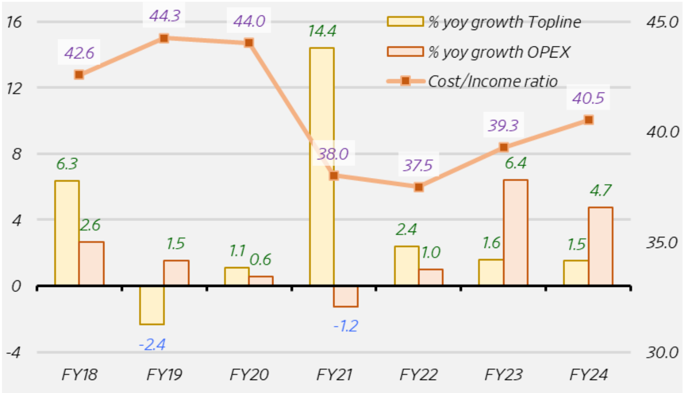
- **OPEX.** HLBK's cost/income ratio is among the most efficient in the industry. Historically, OPEX growth has been kept very low, though this has increased recently. Along with its peers, management has guided for elevated costs in the near term as the Group expands its sales force, revamps its NOII-related lines of business and develops its regional businesses.

Fig 8: OPEX



Source: HLBK

Fig 9: Cost/Income ratio

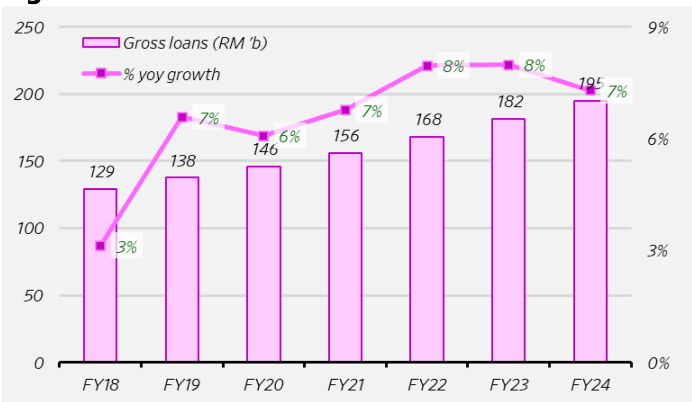


Source: HLBK

Balance Sheet

- **Loans.** Historically, HLBK was a retail-leaning bank but is now moving away from this to improve loan yields. HLBK has been slowing down growth in residential mortgages and aggressively expanding its SME base, driven by both local and overseas (Singapore and Vietnam) segments. The Group is also rebalancing its consumer portfolio, with an increased focus on taking up hire purchase loans and unsecured loans. Loan growth is always slightly above the industry average, helped by its sharp growth in SME and overseas segments.

Fig 10: Gross loans

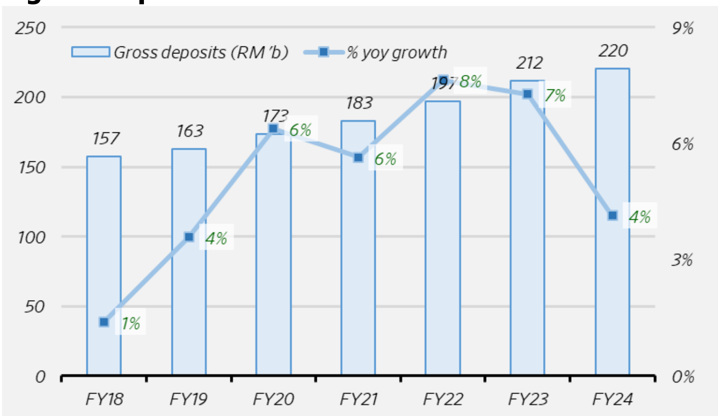


Source: HLBK

- **Deposits, CASA and Liquidity.** Historically, liquidity was never a huge issue for HLBK, given their strict loan/deposit ceiling requirements. While this has slightly loosened (from 85% to 87-88%), their loan/deposit ratio remains slightly lower compared to the rest of the industry. Generally, HLBK can grow deposits at a roughly similar rate to loans (FY24's growth was weak due to deposit mix optimisation).

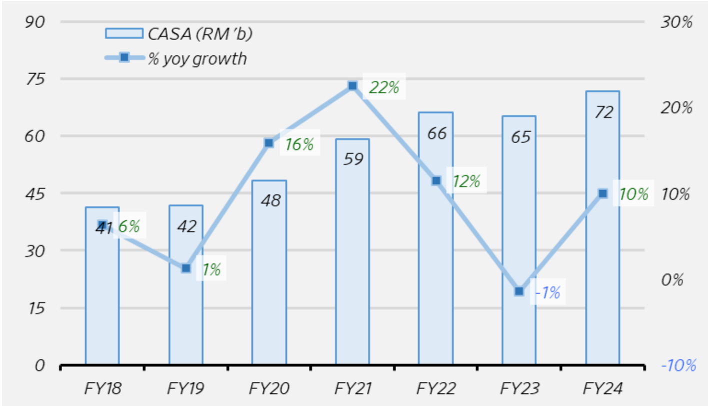
- So far, HLBK has perform well in growing CASA balances as it seeks to increase its CASA ratio. The Group prioritises good quality, cheap CASA instead of rapidly capturing of pricier non-retail CASA. Management remains optimistic about the overall funding outlook, as Singapore is beginning to net in valuable deposits amid its aggressive expansion.

Fig 11: Deposits



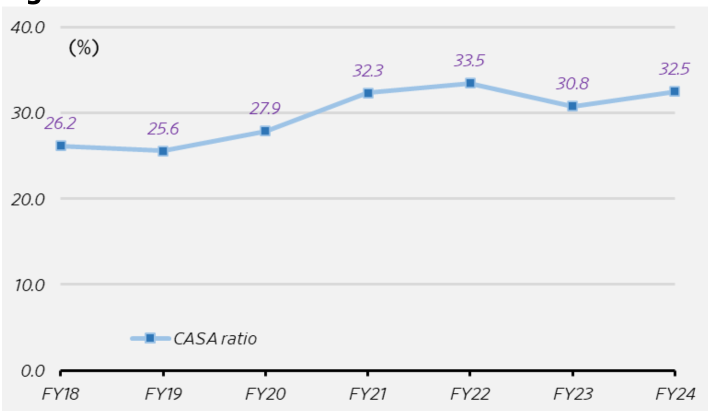
Source: HLBK

Fig 12: CASA



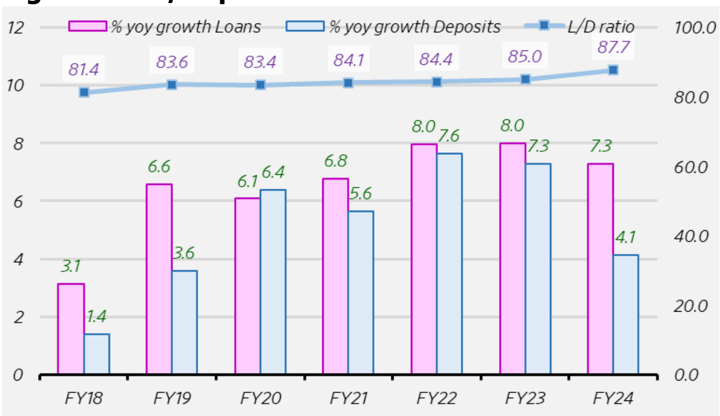
Source: HLBK

Fig 13: CASA ratio



Source: HLBK

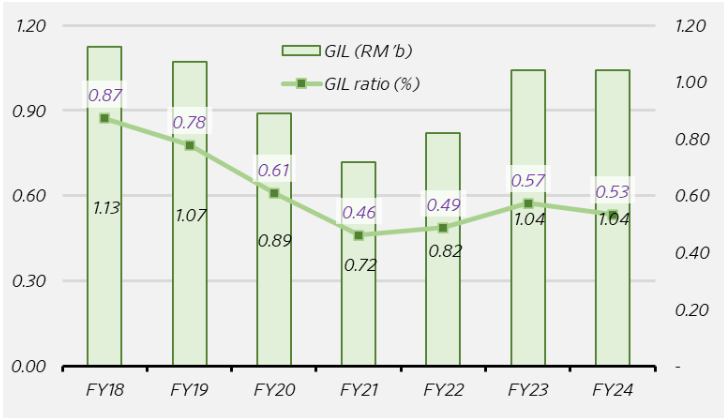
Fig 14: Loan/Deposit ratio



Source: HLBK

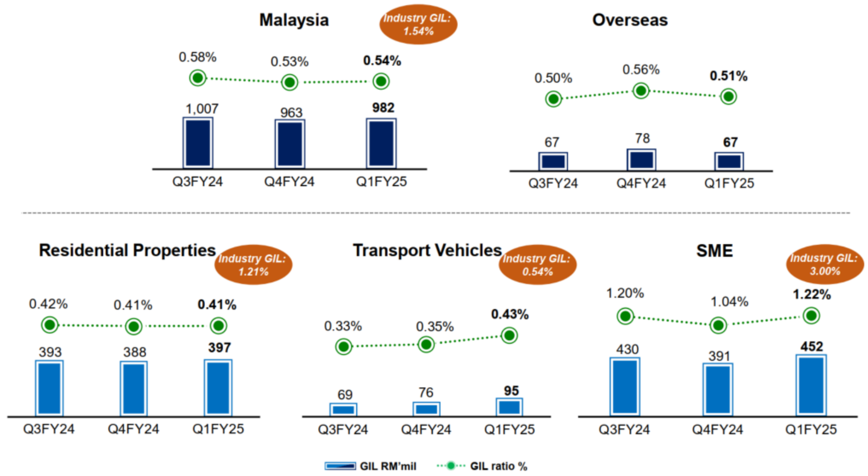
- **Asset quality and provisioning.** HLBK's asset quality is one of the best in the industry, boasting the lowest provisioning and GIL ratio. Note that asset quality is expected to worsen with the shift towards higher-risk business loans, but we doubt it will result in any serious deterioration.

Fig 15: Gross Impaired Loans



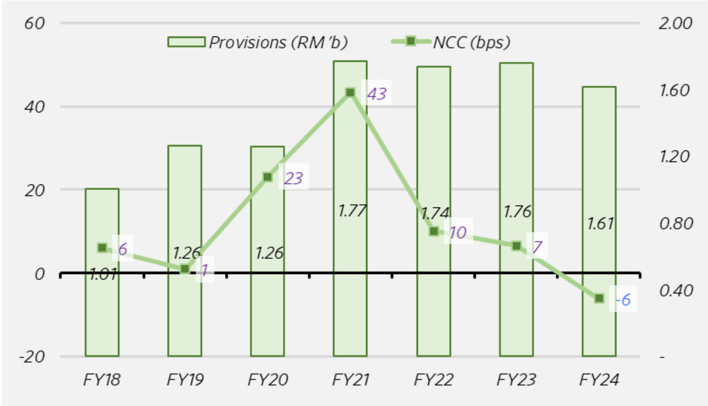
Source: HLBK

Fig 16: GILs by Segment



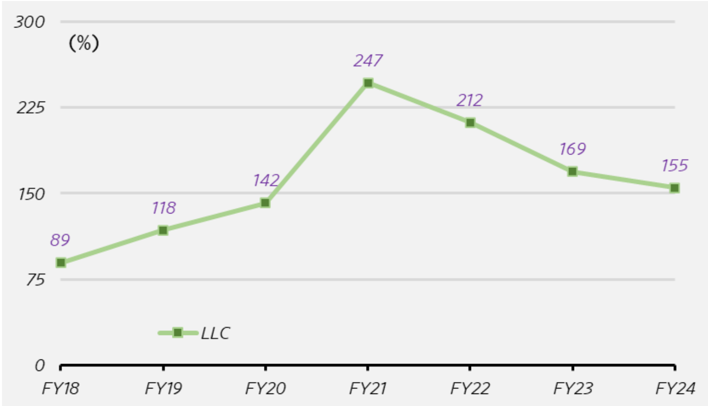
Source: HLBK

Fig 17: Provisioning and Net Credit Cost



Source: HLBK

Fig 18: Loan Loss Coverage

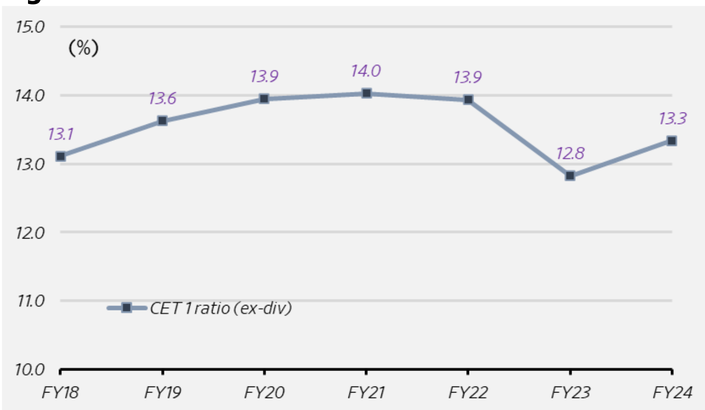


Source: HLBK

- **Capital and dividends.** HLBK has one of the industry's lowest dividend payouts (and yields). Part of this was due to HLBK's low CET 1 ratio, which was weakened by various capital injections to fuel BOCD's growth.

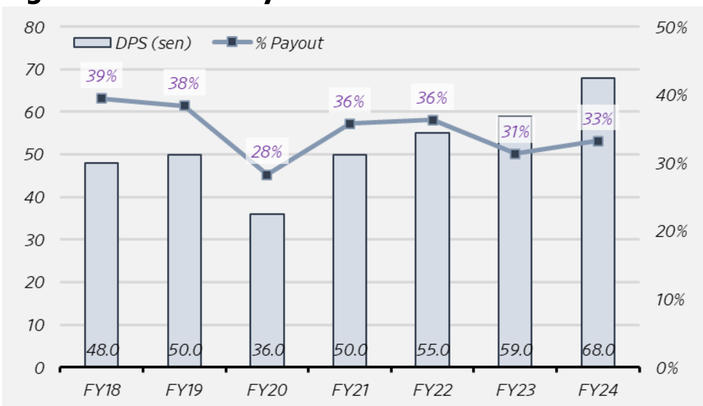
- Management intends to continue increasing dividend payout (currently 30-35%). Some difficulty is attached: HLBK's loan growth is quite high, and HLBK's dividend payout on profit before associate contributions is already at a high >50% level. Hence, further room for increased payouts may be limited.

Fig 19: CET 1 ratio



Source: HLBK

Fig 20: Dividend Payout



Source: HLBK

Investment Highlights

- **Industry-leading ROE.** HLBK's 11-12% ROE is among the top in within the industry. There are three main factors: (i) Excellent cost control, (ii) Low provisioning charges due to excellent asset quality, and (iii) Strong contributions from BOCD.

- Moving forward, the Group is optimising several central components of its income statement to maintain its high level of profitability. These include (i) Reshaping its loan portfolio to include a larger component of higher-yielding business loans, which should improve loan yields, (ii) Increasing its CASA balances and other forms of liability management as a form of COF optimisation, (iii) Improving NOII contributions by building up client-based income-contributing services, such as wealth management and Global Markets business.

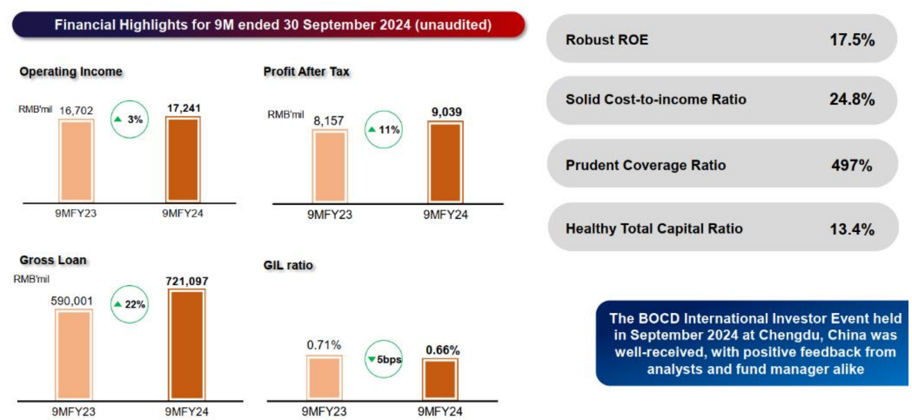
- This is a good move, given that ROE sees a couple of possible downsides: (i) The coming pare-down of BOCD shareholdings (which should in turn reduce BOCD contributions) and (ii) Increased spending to remain competitive.

- **Defensive pick, given high asset quality and low NCC.** HLBK's GIL ratio of 0.53% is currently the lowest in the industry. As a result, its NCC is also very low, often reaching <10bps. FY24, given a slew of solid recoveries, saw a net writeback of 6bps NCC. Its LLC of 155% is also among the highest in the industry, implying that there is room for a few more writeback instances.

- Note that base GIL ratio may creep up as the Group increases the proportion of business loans making up its total loanbook. This is not expected to affect the GIL ratio or NCC significantly – we doubt GIL ratio will reach anywhere close to the 1.0% mark.

- **Solid Bank of Chengdu contributions.** BOCD contributions make up roughly a third of PBT. The bank continues to boast exceptional growth and performance above the industry average. Despite this, the Group intends to reduce reliance on BOCD's contributions, as Associate performance increasingly affects quarterly results. HLBK has a c.19.6% stake in the company. This stake is expected to reduce to 17.8% within a year.

Fig 21: Bank of Chengdu performance



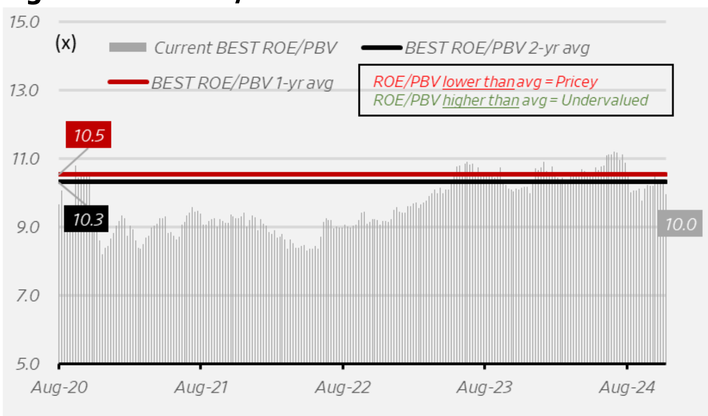
Source: HLBK

- **Rising regional contribution.** Management is working on its pre-BOCD contributions via a stronger regional presence to compensate for reduced Associate contributions. Standouts are the Singaporean and Vietnam geographical segments, which see excellent loan and deposit growth. In particular, Singapore is a solid driver in developing its fee-income-related franchise. Pre-BOCD contributions translate to roughly 10% of ROE, which is still slightly lower than HLBK's standard 11-12% range.

Valuation & Recommendation

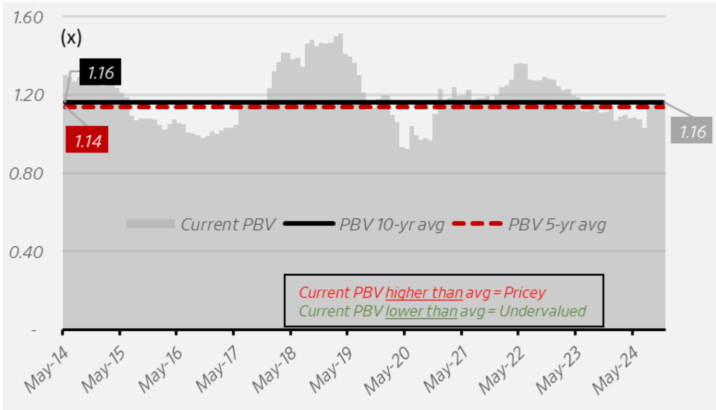
- We initiate coverage on HLBK with a **BUY** recommendation and a target price of **RM24.79** based on an FY26F PBV of 1.17x GGM-PBV valuation. (GGM Assumptions: FY26F ROE of 11.6%, LTG of 4.0%, & COE of 10.5%.)

Fig 22: BEST ROE/PBV



Source: HLBK

Fig 23: PBV



Source: HLBK

- We favour HLBK for its (i) Industry-leading ROE, (ii) Excellent asset quality, and low provisioning, (iii) Solid BOCD contributions, and (iv) Rising regional contributions.

Key Risks

- **Exposed to pressure in a volatile China environment.** Via BOCD, HLBK is exposed to China's economic, political and pressures – which has weighed heavily on valuations. Because of BOCD's large contribution to the bottom line, downside pressures significantly affect the earning outlook.

- **Weak dividend payouts.** HLBK's dividend payouts are some of the weakest in the industry. While management is guiding higher dividend payouts, we feel room for higher payouts may be limited due to HLBK's high asset growth. The dividend payout for pre-BOCD contributions already makes up 55%, which is already fairly high.

- **The base GIL ratio may tick up.** Traditionally a retail bank, HLBK is now reprioritising business loans (due to their higher loan yields) in its portfolio. We are wary that this may negatively impact asset quality, which may, in turn, lead to higher provisions.

Financial Highlights

Income Statement

FYE Jun (RM m)	FY23	FY24	FY25F	FY26F	FY27F
Net interest income	**3,684**	**3,822**	**4,183**	**4,516**	**4,768**
Islamic banking inc.	963	986	1,141	1,232	1,301
Other operating inc.	1,038	963	1,117	1,122	1,155
Net income	**5,686**	**5,771**	**6,441**	**6,870**	**7,224**
OPEX	(2,233)	(2,339)	(2,641)	(2,817)	(2,962)
PPOP	**3,452**	**3,432**	**3,800**	**4,053**	**4,262**
Loan allowances	(115)	114	(202)	(215)	(229)
Other allowances	0	(1)	(0)	(0)	(0)
JV & Associates	1,289	1,589	1,827	2,047	2,272
PBT	**4,627**	**5,134**	**5,426**	**5,884**	**6,304**
Tax & zakat	(808)	(938)	(949)	(1,030)	(1,103)
NCI	-	-	-	-	-
Reported NP	**3,818**	**4,196**	**4,476**	**4,855**	**5,201**
Core NP	**3,852**	**4,196**	**4,476**	**4,855**	**5,201**
Total NII	4,552	4,669	5,164	5,575	5,887
Total NOII	1,134	1,102	1,277	1,294	1,337

Balance Sheet

FYE Jun (RM m)	FY23	FY24	FY25F	FY26F	FY27F
Cash & ST funds	8,644	6,452	7,408	7,716	7,864
Investment securities	70,736	75,667	74,126	72,968	72,166
Net loans	179,903	193,304	207,103	220,676	235,052
Other IEAs	0	297	0	0	0
Non-IEAs	20,568	22,069	21,305	26,265	33,386
Total assets	**279,850**	**297,789**	**309,942**	**327,624**	**348,468**
Customer deposits	211,652	220,433	236,084	251,193	267,269
Other IBLs	22,677	26,863	27,081	27,554	28,062
Non-IBLs	11,535	13,199	6,567	5,461	5,581
Total liabilities	**245,864**	**260,495**	**269,732**	**284,208**	**300,912**
Share capital	7,739	7,739	7,739	7,739	7,739
Reserves	26,248	29,555	32,471	35,677	39,816
Shareholders' funds	**33,987**	**37,294**	**40,210**	**43,417**	**47,555**
NCI	0	0	0	0	0
Total equity	**33,987**	**37,294**	**40,210**	**43,417**	**47,555**
Total L&E	**279,850**	**297,789**	**309,942**	**327,624**	**348,468**
Total IEAs	259,282	275,720	288,637	301,360	315,082
Total IBLs	234,328	247,296	263,165	278,747	295,331
Gross loans	181,677	194,927	208,572	222,130	236,568
CASA	65,097	71,617	75,547	82,894	90,872

Key Ratios

FYE Jun (RM m)	FY23	FY24	FY25F	FY26F	FY27F
Interest (%)					
NIM	1.83	1.75	1.83	1.89	1.91
Return on IEAs	3.02	3.28	3.25	3.26	3.23
Cost of funds	1.72	2.06	1.96	1.88	1.81
Net interest spread	1.30	1.22	1.30	1.38	1.42
Profitability (%)					
ROE	**11.9**	**11.8**	**11.6**	**11.6**	**11.4**
ROA	1.4	1.5	1.5	1.5	1.5
NOII/Net income	19.9	19.1	19.8	18.8	18.5
Effective tax rate	17.5	18.3	17.5	17.5	17.5
Cost/Income	39.3	40.5	41.0	41.0	41.0
Liquidity (%)					
Loan/Deposit	85.0	87.7	87.7	87.9	87.9
CASA ratio	30.8	32.5	32.0	33.0	34.0
Asset Quality (%)					
GIL ratio	0.57	0.53	0.50	0.50	0.49
LLC ratio	169	155	140	130	130
LLC (w. reserves)	265	276	199	186	183
Net CC (bps)	7	-6	10	10	10
Capital (%)					
CET 1	12.8	13.3	13.9	14.0	14.0
Tier 1 capital	13.9	14.3	14.9	14.9	14.8
Total capital	15.9	16.3	16.8	16.8	16.7
Growth (%)					
Total NII	-1.4	2.6	10.6	8.0	5.6
Total NOII	15.7	-2.8	15.9	1.4	3.3
Net income	1.6	1.5	11.6	6.7	5.2
OPEX	6.4	4.7	12.9	6.7	5.2
Core NP	24.1	8.9	6.7	8.5	7.1
Gross loans	8.0	7.3	7.0	6.5	6.5
Customer deposits	7.3	4.1	7.1	6.4	6.4
CASA	-1.4	10.0	5.5	9.7	9.6
Valuation metrics					
Core EPS (sen)	188.0	204.8	218.4	236.9	253.8
Gross DPS (sen)	59.0	68.0	76.4	82.9	88.8
Div payout (%)	31	33	35	35	35
BVPS (RM)	16.6	18.2	19.6	21.2	23.2
Core P/E (x)	10.9	10.0	9.4	8.6	8.0
Div yield (%)	**2.9**	**3.3**	**3.7**	**4.1**	**4.3**
P/BV (x)	1.2	1.1	1.0	1.0	0.9

APEX SECURITIES BERHAD – CONTACT LIST

APEX SECURITIES BHD

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Selangor Darul Ehsan, Malaysia

General Line: (603) 7620 1118

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Ahmad Mujib (ext 2028)
Azfar Bin Abdul Aziz (ext 2031)
Aizzat Bin Mohd Daud (ext 2030)

Institutional Dealing Team:
Low Jin Wu (ext 2109)

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Jayden Tan (ext 2069)
Chelsea Chew (ext 2070)
Tan Sue Wen (ext 2095)
Ong Tze Hern (ext 2113)
Samuel Woo (ext 2121)
Amir Hamdan (ext 2112)

RESEARCH RECOMMENDATION FRAMEWORK

STOCK RECOMMENDATIONS
BUY: Total returns* are expected to exceed 10% within the next 12 months.
HOLD: Total returns* are expected to be within +10% to – 10% within the next 12 months.
SELL: Total returns* are expected to be below -10% within the next 12 months.
TRADING BUY: Total returns* are expected to exceed 10% within the next 3 months.
TRADING SELL: Total returns* are expected to be below -10% within the next 3 months.
*Capital gain

SECTOR RECOMMENDATIONS
OVERWEIGHT: The industry defined by the analyst is expected to exceed 10% within the next 12 months.
NEUTRAL: The industry defined by the analyst is expected to be within +10% to – 10% within the next 12 months.
UNDERWEIGHT: The industry defined by the analyst, is expected to be below -10% within the next 12 months.

DISCLAIMER