November 22, 2016
Company Update

Oversea-Chinese Banking Corp. Ltd. (O39 SGX)

Cold Wind from the U.S.

Non-interest income benefit
We expect that Q4 will be OCBC's last good quarter in some time: the bank will benefit from non-interest income from the wealth management business of Barclay OCBC, acquired earlier this year.

Positive results mask a weakening
OCBC's strong Q3 was driven by 25% growth in non-interest income, offset by a 6.3% decline in primary loan income. But positive results in the insurance business hide what is actually a weakening.

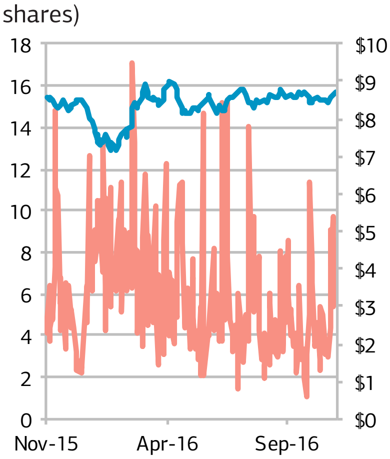
Great Eastern weakness
In the new year, poorer performance by Great Eastern Holdings, responsible for 17% of profit, will impair results. Meanwhile, the strong-USD environment generated by the Trump factor is likely to hurt OCBC's income from Ningbo Bank and AVIC Trust, which accounted for 10% of profit. OCBC will fail to benefit from USD appreciation against the Singapore Dollar.

Rating: Sell
We raise our price target to SGD 7.61, a 13% downside from the current price, and reiterate our SELL rating.

OCBC (O39 SGX)

Price	SGD 8.78
Rating	**SELL**
Price Target	**SGD 7.61**
Difference	13%
Market Cap	SGD 36.68 bln
P/E	8.39x

OCBC (O39 SGX) last share price in SGD (blue) and volume (pink, in mln shares)



Source: Bloomberg

Responsible for this report:
Anne Stevenson-Yang anne@jcapitalresearch.com +852 2534 7405

Headwinds Ahead

Nan Yiyi

Good times are ending for OCBC. After a great Q3 and what promises to be a good Q4, the bank faces all the headwinds of the smaller players in an unforgiving environment. The insurance and the wealth management businesses, now contributing an outsized portion of profit, are challenged by regulatory costs, currency, and slowing sales.

Private Banking Gets Tougher

Singapore is layering cost onto its private banking industry, making it hard for anyone but the largest banks to compete. Eight foreign banks have exited the market in the last two years, and two of the eight were closed by Singapore's Monetary Authority for anti-money laundering violations. Other banks have been acquired by larger local players like DBS or closed their Singapore businesses.

OCBC CEO Samuel Tsien said that the cost of complying with anti-money laundering, tax, and other regulatory requirements has increased by 35% annually for the bank. That creates an urgent need to expand in scale to spread out the fixed costs and puts pressure on OCBC in competing with rival DBS. In the effort to increase scale, OCBC acquired Barclay's wealth management business in Hong Kong and Singapore in April this year and DBS acquired ANZ wealth management business in October to cement its top position in the industry.

Germany's DZ Bank signed an agreement with OCBC under whichDZ wealth managers will refer their clients to OCBC. There is no financial exchange. We view this as a positive move but not significant in volume.

Insurance Challenges

Total weighted sales actually declined.

OCBC realized profit of SGD 164 mln from the insurance business of Great Eastern Holdings (GEH), a life insurance company, in Q3, up from SGD 62 mln a year earlier. But the growth came from an increase in net asset value, mainly in realized gain from investments. Unrealized mark-to-market gains in GEH's equity and bond investment portfolio contributed to the improvement in insurance earnings during the quarter. Total weighted sales actually declined. Furthermore, the uplift was mainly due to a low base in Q3 2015, when GEH realized a SGD 78.7 mln loss on its investments. In the first nine months of this year, operating profit declined by 5% YoY. Profit from the Shareholders' Fund was down by 65% YoY.

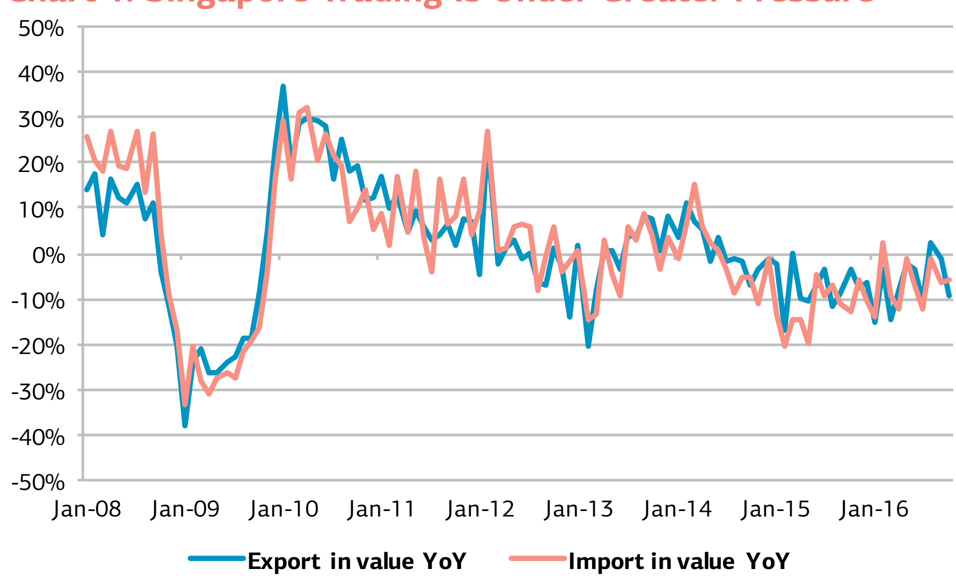
The slowdown in the insurance business can be laid at the door of Singapore's weakening trade with China. For the first nine months of 2016, OCBC operating profit fell by 6% compared with the same period of 2015 due to the lower contribution from the Singapore business in the first half of the year. Less business for GEH is as a result of a worsening macro economy in Singapore, as trade with its biggest partner, China is challenging.

Looking ahead, we believe that trade with China will only deteriorate further.

Not So Great Eastern Holdings

The recent sale of half of Great Eastern Holdings' Chinese business to is a red flag to us, suggesting that GEH is pursuing short-term asset inflation over quality of assets. In August, GEH sold a 50% equity stake in Great Eastern Life Assurance (China) Company Limited to Evergrande Insurance. Great Eastern China was founded by Great Eastern Holdings and Chongqing Land Group in May 2006. The sale was made under a Valuation Adjustment Mechanism, an agreement conditioned on a future, targeted valuation requiring that the JV assets reach RMB 10 mln, or 26 times the value of the assets as of the end of June 2015. As soon as the deal closed, Evergrande insurance started to aggressively increase its assets by selling short-term investment products with terms of under three years and promised return rates of as high as 8%. Evergrande Insurance made losses of RMB 1.2 bln in the first three quarters of the year.

Chart 1. Singapore Trading Is Under Greater Pressure



Source: Department of Singapore Statistics

With weakening demand in Singapore amid slowing growth in China and aggressive asset expansion, we believe that relying on Great Eastern Holding as profit driver is not sustainable.

Q3 Results

OCBC had a good Q3, with 5% income growth YoY and 8% improvement on the previous quarter, mainly driven by non-interest income. Non-interest income increased 25%, to SGD 970 mln, from SGD 775 mln a year ago and up by 23% QoQ. Wealth management contributions were 28% for the quarter, as compared to 22% in the prior year. Fee and commission income increased 5%, to SGD 428 million, boosted by continued growth in wealth management fee income. OCBC's private banking business registered a growth of 20% YoY in assets under management ("AUM") through its private banking arm, Bank of Singapore, by 30 September 2016 to USD 62 bln. This does not include the AUM contributions from the acquisition of the Barclays Wealth and Investment Management business in Singapore and Hong Kong, which is scheduled for completion later this year.

Table 1. Financial Information

	9M16	9M15	YoY %	3Q16	3Q15	YoY %	2Q16	QoQ %
Net interest income	3,801	3,848	-1.2%	1,234	1,317	-6.3%	1,260	-2%
Non-interest income	2,511	2,573	-2.4%	970	775	25.2%	788	23%
Total income	6,312	6,421	-1.7%	2,204	2,092	5.4%	2,048	8%
Operating expenses	-2,807	-2,691	4.3%	-953	-900	5.9%	-932	2%
Operating profit before allowances and amortization	3,505	3,730	-6.0%	1,251	1,192	4.9%	1,116	12%
Amortization of intangible assets	-72	-73	-1.4%	-23	-25	-8.0%	-24	-4%
Allowances for loans and impairment for other assets	-421	-294	43.2%	-166	-150	10.7%	-88	89%
Operating profit after allowances and amortization	3,012	3,363	-10.4%	1,062	1,017	4.4%	1,004	6%
Share of results of associates	314	289	8.7%	105	99	6.1%	103	2%
Profit before income tax	3,326	3,652	-8.9%	1,167	1,116	4.6%	1,107	5%

	9M16	9M15	YoY %	3Q16	3Q15	YoY %	2Q16	QoQ %
Net profit attributable to shareholders	2,684	2,943	-8.8%	943	902	4.5%	885	7%
Cash basis net profit attributable to shareholders	2,756	3,016	-8.6%	966	927	4.2%	909	6%
Cash basis net profit attributable to shareholders	2,756	3,016	-8.6%	966	927	4.2%	909	6%

Source: Company reports

Disclaimer

Nan Yiyi +852 2534 7405 yiyi@jcapitalresearch.com