F·P·A FINANCIAL
Investment Perspectives

22 December 2022

FINANCIALS EQUITY RESEARCH

Hong Leong Finance Limited

SGX: S41
Bloomberg: HLF:SP
ISIN code: SG1M04001939

Country: Singapore
Industry: Banking & Investment Services

22 December 2022
RECOMMENDATION: BUY

Current price: S$2.390
Target price: S$2.718
Issued units: 448.123 million (30 June 2022)
Market capitalisation: S$1,071.02 million

52-week range: S$2.310-S$2.590

PRICE PERFORMANCE

COMPANY DESCRIPTION

Hong Leong Finance Limited and its subsidiaries (collectively defined herein as HLF) is a Singapore-based financial service company. HLF's core business involves taking deposits and savings from the public and providing financing solutions and services that include corporate and consumer loans, government assistance for SMEs, corporate finance and advisory services. Currently, HLF has a network of 28 branches and 12 SME Centres islandwide.

SUMMARY

For the half year ended 30 June 2022 (1H2022), HLF recorded a 3.1% yoy increase in interest income/ hiring charges to S$127.0 million. At the same time, interest expense also decreased by 9.9% yoy to S$30.5 million. Accordingly, the net interest income for 1H2022 increased by 8.1% to S$96.4 million owing to improved interest yield and lower funding cost sustained amidst elevated benchmark rates. Net allowances for loans and other financial assets for 1H2022 was a net allowance of $1.8 million arising from higher allowances for non-credit-impaired loans as compared to the corresponding period. Consequently, HLF reported a net attributable profit to owners of the company of S$45.1 million, translating to an annualized earnings per share of 20.14 cents. Meanwhile, the interim dividend remained unchanged at 3.75 cents per share for 1H2022 compared to a year ago.

RECOMMENDATION

HLF reported NAV per share of S$4.40 and annualised earnings per share of 20.14 cents as at 30 June 2022. Our peer comparison analysis results show that HLF's P/B of 0.54x is slightly lower compared to its peer average P/B of 0.55x. However, HLF's P/E of 11.87x is higher than its peer average P/E of 10.36x. Meanwhile, HLF is relatively attractive in terms of dividend yield. Considering HLF's higher market capitalisation, relatively attractive dividend yield and having a strong parent company together with the stable Singapore's economy outlook and a high interest rate environment, we believe there could be upside potential to HLF's share price. Hence, we estimated HLF's target price based on its P/B and dividend yield peer comparison analysis. Adopting a relative valuation approach, we estimate a target price of S$2.420 and S$3.015 based on the P/B and dividend yield peer comparison analysis respectively. Accordingly, we estimate a target price of S$2.718, which is the average of the target price derived from the peer average P/B and dividend yield peer comparison analysis. This target price represents a 13.72% upside from the current price of S$2.390. Given the above, we maintain our buy recommendation on HLF.

KEY FINANCIALS Year ended Dec 31	Revenue (S$ million)	Profit [(1)] (S$ million)	EPS (cents)	P/E (x)	DPS (cents)	Dividend yield (%)	NAV per unit (S$)	P/B (x)
2020 actual	310.8	63.9	14.28	16.74	9.00	3.8%	4.29	0.56
2021 actual	240.0	84.8	18.95	12.61	12.00	5.0%	4.38	0.55
2022 forecast [(2)]	323.0	90.4	20.18	11.85	12.00	5.0%	4.40	0.54
2023 forecast	394.2	96.0	21.43	11.15	13.00	5.4%	-	-

Figures have been rounded. P/E, P/B and dividend yield figures are based on current price of S$2.390

(1) Profit attributable to owners of the company

(2) NAV as at 30 June 2022

Source: Hong Leong Finance Limited, FPA Financial

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FINANCIAL REVIEW FOR 1H2022

(I) Financial performance

For the half year under review from 1 January 2022 to 30 June 2022 (1H2022), interest on loans and other interest income rose by 7.4% and 6.1% yoy respectively to S$98.5 million and S$8.9 million respectively. However, hiring charges fell by 15% yoy to S$19.6 million from S$23.0 million in 1H2021. Accordingly, the total interest income/ hiring charges amounted to S$127.0 million in 1H2022, representing an increase of 3.1% yoy compared to S$123.1 million in 1H2021.

Interest expense decreased by 9.9% yoy to S$30.5 million from S$33.9 million in 1H2021. Consequently, the net interest income for 1H2022 increased by 8.1% yoy to S$96.4 million compared to S$89.2 million the same period a year ago, owing to improved interest yield on the healthy asset growth and lower funding cost sustained amidst elevated benchmark rates driven by global interest rate hikes.

Meanwhile, fee and commission income, mainly comprise of fee income from lending and corporate finance activities increased by 73.6% yoy to S$8.1 million largely due to fee income from rebound lending activities.

Total staff expenses increased by 10.8% yoy to $36.1 million for 1H2022 on lower base in first half last year (offset of budget relief measures from Singapore Government) as well as cost associated with headcount growth in its drive to further enhance its risk & compliance management and technology transformation. Other operating expenses increased by 20.8% yoy to $8.4 million mainly attributed to higher business transactions and promotional cost linked to improved lending activities amidst competitive market costs coupled with higher energy price.

Net allowances for loans and other financial assets for first half-year 2022 was a net allowance of $1.8 million arising from higher allowances for non-credit-impaired loans as compared to the corresponding period which included a reversal of $2.7 million in allowances for non-credit-impaired loans on revised risk parameters. Asset quality remained sound as HLF continued to exercise prudence in its credit risk management and underwriting parameters with adequate loss allowances to cover the loan portfolio. The non-performing loan ratio has declined to 0.8% with proactive management of its loan portfolio.

As a result, HLF reported a profit before tax of S$54.3 million in 1H2022, improving by 1.3% yoy from 1H2021. The improvement was driven by the stronger interest income/ hiring charges and lower interest expense. For the period, income tax expense of S$9.2 million was recorded compared to S$8.9 million a year ago. After adjusting for income tax expense, the profit attributable to owners of the company amounted to S$45.1 million in 1H2022, which represents an increase of 1.0% compared to S$44.7 million in 1H2021. Accordingly, HLF reported an earnings per share of 10.07 cents for 1H2022.

HLF's 1H2022 and 1H2021 financial results are summarised in **Exhibit 1** on the next page.

Exhibit 1: HLF's 1H2022 and 1H2021 Financial Results

S$'000	1H2022	1H2021	y-o-y change
Interest on loans	98,458	91,659	7.4%
Hiring charges	19,584	23,035	-15.0%
Other interest income	8,920	8,408	6.1%
Interest income/hiring charges	**126,962**	**123,102**	**3.1%**
Less: Interest expense	(30,530)	(33,879)	-9.9%
Net Interest income/ hiring charges	**96,432**	**89,223**	**8.1%**
Fee and commission income	8,108	4,671	73.6%
Other operating income	76	157	-51.6%
Income before operating expenses	**104,616**	**94,051**	**11.2%**
Less: Staff costs	(36,086)	(32,558)	10.8%
Depreciation of property, plant and equipment	(3,992)	(3,991)	0.0%
Other operating expenses	(8,393)	(6,945)	20.8%
Total operating expenses	**(48,471)**	**(43,494)**	**11.4%**
Profit from operations before allowances	**56,145**	**50,557**	**11.1%**
Add/(less): (allowance for)/ reversal or recovery of doubtful debts and other financial assets	(1,833)	3,039	-160.3%
Profit before tax	**54,312**	**53,596**	**1.3%**
Less: Income tax expense	(9,196)	(8,911)	3.2%
Profit for the period attributable to owners of the company	**45,116**	**44,685**	**1.0%**
Number of issued shares	448,123,733	447,605,573	0.1%
Earnings per share (cents)	10.07	9.98	0.8%
Annualised earnings per share (cents)	**20.14**	**19.97**	**0.8%**

Source: HLF, FPA Financial

Dividends

For 1H2022, HLF also declared a dividend rate of 3.75 cents per share, which has been paid on 1 September 2022. Compared to the same period a year ago, the dividend rate remained unchanged at 3.75 cents as shown in **Exhibit 2**.

Exhibit 2: HLF's Dividend Announcement for 1H2022

	Latest Period	Previous Period
Name of Dividend	Interim	Interim (paid on 8 September 2021)
Dividend Type	Cash	Cash
Dividend Rate	3.75 cents per share	3.75 cents per share
Total Dividend	$16,805,000*	$16,789,000
Tax Rate	Tax exempt one-tier	Tax exempt one-tier

Source: HLF, FPA Financial

(II) Capital Management

Review of Balance Sheet

HLF reported net loan assets of S$11,455 million as at 30 June 2022, compared to S$10,695 million as at 31 December 2021, representing an increase of 7.1% or S$760 million. Accordingly, total assets increased to S$13,953 million as at 30 June 2022 from S$12,952 million as at 31 December 2021.

In tandem with strong loan growth, deposits and balances of customers increased to $11,748 million as at 30 June 2022, representing an increase of 8.7% or $941 million over the previous year's base of $10,807 million as at 31 December 2021. The increase in total liabilities to S$11,982 million as at 30 June 2022 from S$10,990 million was mainly due to the increase in deposits.

Overall, we believe HLF balance sheet remained robust with strong liquidity and capital to support lending activities and well positioned to ride through current market uncertainties.

Consequently, HLF recorded total equity attributable to owners of the Company of S$1,972 million as at 30 June 2022 compared to S$1,963 million as at 31 December 2021. Accordingly, HLF's net asset value (NAV) per share increased slightly to S$4.40 as at 30 June 2022 from S$4.38 as at 31 December 2021.

HLF's balance sheet data is summarised in **Exhibit 3**.

Exhibit 3: Summary of HLF's Balance Sheet

S$'000	30-Jun-22	31-Dec-21
Loans net of allowance	11,454,800	10,695,494
Total assets	13,953,114	12,952,263
Deposits	11,748,382	10,806,871
Total liabilities	11,981,605	10,989,716
Equity attributable to owners of the Company	1,971,509	1,962,547
No. of shares in issue	448,123,733	447,817,233
Net asset value per share (S$)	4.40	4.38

Source: HLF

HLF's policy is to maintain a strong capital base so as to maintain investor, customer and market confidence and to sustain future development of the business. The Assets and Liabilities Committee reviews the adequacy of capital by monitoring the levels of major assets and liabilities taking into account the underlying risks of HLF's businesses and compliance with regulatory capital requirements.

HLF's eligible total capital includes share capital, accumulated profits, statutory reserve, capital reserve and share option reserve. Risk-weighted assets are determined according to regulatory requirements that reflect the varying levels of risk attached to assets and off-balance sheet exposures. Thus, the capital adequacy ratio, as computed by dividing eligible total capital over the total risk-weighted assets stood approximately at 16.9% as at the end of FY2021 compared to 16.4% as at the end of FY2020, higher than the prescribed requirement by MAS of 10%.

HLF's regulatory capital adequacy position is summarised in **Exhibit 4** on the next page.

Exhibit 4: Breakdown of HLF's Capital Adequacy Ratio

S$'000	FY2021	FY2020	y-o-y change
Share capital	889,771	889,117	0.1%
Accumulated profits	230,648	214,585	7.5%
Statutory reserve	744,744	728,766	2.2%
Capital reserve	2,307	2,307	0.0%
Share option reserve	2,397	3,279	-26.9%
Eligible total capital	**1,869,867**	**1,838,054**	**1.7%**
Risk-weighted assets	11,031,725	11,211,746	-1.6%
Capital adequacy ratio	**16.9%**	**16.4%**	**0.5 percentage points**

Source: HLF, FPA Financial

The carrying amounts of other financial assets and financial liabilities with a maturity of less than one year (including other receivables, other deposits, cash, trade payables and other payables) are estimated to approximate their fair values in view of the short period to maturity. The aggregate net fair values of these financial assets and financial liabilities are shown in **Exhibit 5**.

Exhibit 5: Carrying Amount of Net Financial Assets As at 30 June 2022

S$'000	Carrying amount	
	30-Jun-22	31-Dec-21
Financial assets		
Loans, advances and receivables	11,454,800	10,695,494
Singapore Government debt securities, MAS bills and MAS FRN	1,497,084	1,357,675
	12,951,884	12,053,169
Financial liabilities		
Deposits and balances of customers	(11,748,382)	(10,806,871)
Net financial assets	**1,203,502**	**1,246,298**

Source: HLF

OPERATIONAL UPDATE

Since our last initiation report on December 2021, there has been a new development announced by HLF. We will now provide an operational update on the development.

(I) Hong Leong Finance Launches HLF FASTPAY

HLF announced on 19 May 2022 that it will be launching HLF FASTPAY, a multi-currency e-wallet app that comes with a virtual Visa Prepaid Card for customers to enjoy more payment solutions safely and securely on 20 May 2022.

In collaboration with Nium, the global platform for modern money movement, HLF FASTPAY provides a seamless cross-border digital payment solution for small- and medium-sized enterprises (SMEs), corporates and consumers to manage and transfer funds in multiple currencies safely, quickly and cost-efficiently. It is an all-in-one payment solution incorporating remittance service locally and internationally, currency exchange, as well as Visa card payment. HLF highlighted four main benefits to its FASTPAY app:

1. Helping customers take charge of their spending locally and internationally

HLF FASTPAY facilitates payments for customers in an easy to use, secure mobile app. It allows customers to spend in Singapore and around the world at over 70 million Visa merchants, including online and e-commerce sites. Customers simply have to top up their e-wallet via direct fund transfer from an HLF account or any other bank. The card can also be added to Google Pay, offering more payment flexibility to consumers.

The multi-currency e-wallet can store more than 20 currencies, including Euros, US dollars and Japanese yen. Customers can enjoy the versatility and convenience of holding the currencies that they want and use them to pay in the currency of their choice. They also enjoy favourable exchange rates for over 100 supported currencies including Malaysian ringgit and Korean won that are not part of the currency e-wallet

2. Managing business payments conveniently with cost-efficiency

Similarly, corporate and SME customers can use HLF FASTPAY to pay to their suppliers or for company expenses locally and abroad. The remittance function allows customers to make fast transfers abroad at competitive rates, directly to the receiving party’s bank accounts. This makes it a more efficient and cost-effective option compared with traditional remittance methods.

3. Security features to ensure customer protection

HLF FASTPAY incorporates the latest security and digital encryption features to ensure customer funds are well-protected. The e-wallet offers settings that allow customers to have direct spend management and control of their funds. In cases of suspicious transactions, locking the card and blocking it from further use can be done directly via the mobile app, which is more convenient compared to the traditional process of reporting to customer service.

4. Enjoy hassle-free registration online

HLF FASTPAY is available to corporates, SMEs, and consumers. Corporate and SME customers can register online. Consumers can also download the mobile app via Apple App Store or Google Play Store and register for an account.

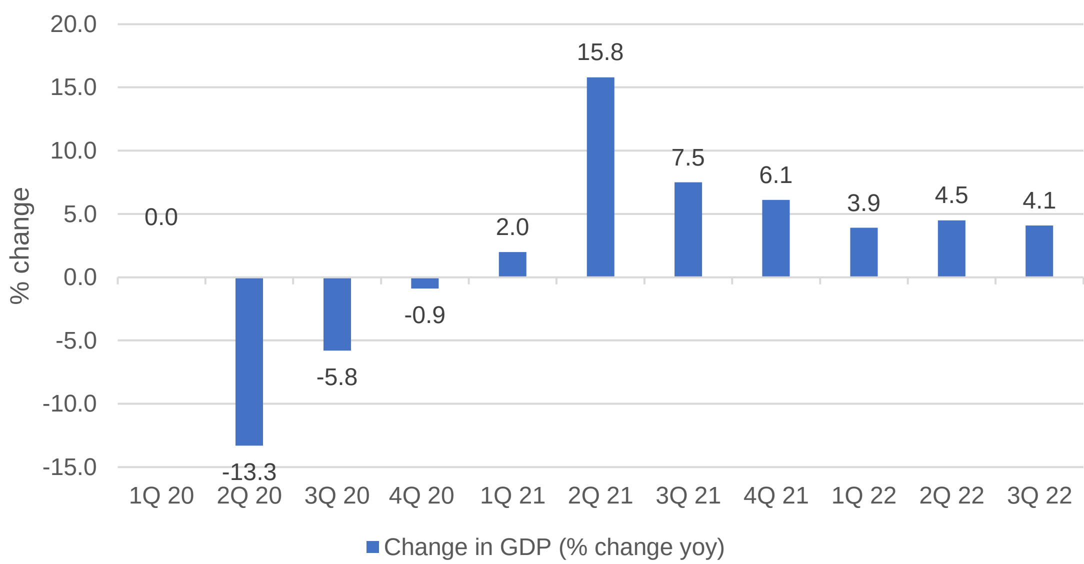
MARKET OUTLOOK

HLF's principal activities relate to financing business augmented by secondary non-lending activities such as provision of corporate advisory services and provision of nominee services. All activities are carried out in the Republic of Singapore. Hence, in this section, we will provide a review of Singapore's economic outlook.

(I) Singapore's Economy

The Ministry of Trade and Industry (MTI) reported that in the third quarter of 2022, Singapore economy grew by 4.1% on a year-on-year (yoy) basis, slower than the 4.5% expansion recorded in the previous quarter as shown in **Exhibit 6**. On a quarter-on-quarter (qoq) seasonally adjusted basis, the economy grew by 1.1%, reversing the 0.1% contraction in the second quarter.

Exhibit 6: Change in Singapore quarterly GDP (%, yoy)



Source: MTI

In Q3 2021, most sectors expanded from a year ago. Notable growth was seen in the food & beverage services (+30.5%), real estate (+11.7%), retail trade (+8.9%) and professional services (+8.3%). However, during the same period, contraction was seen in the accommodation sector (-1.9%) as shown in **Exhibit 7** on the next page.

Exhibit 7: Sectoral Growth Rates (% change yoy)

	3Q21	4Q21	2021	1Q22	2Q22	3Q22
	Year-on-Year % Change					
Total	7.5	6.1	7.6	3.9	4.5	4.1
Goods Producing Industries	11.7	13.6	13.4	5.0	5.3	1.6
Manufacturing	7.9	15.5	13.2	5.4	5.6	0.8
Construction	69.9	2.9	20.1	3.2	4.8	7.8
Services Producing Industries	6.8	4.4	5.6	4.9	5.0	5.8
Wholesale Trade	5.5	3.3	3.9	4.8	1.6	5.4
Retail Trade	0.9	4.3	10.2	5.0	12.3	8.9
Transportation & Storage	9.2	7.5	5.0	4.3	5.0	6.8
Accommodation	-5.7	-5.1	1.7	-8.7	-3.4	-1.9
Food & Beverage Services	-4.1	-1.5	3.0	2.1	23.4	30.5
Information & Communications	13.9	11.2	12.2	10.5	9.8	6.2
Finance & Insurance	8.5	5.6	7.4	3.6	2.4	0.4
Real Estate	19.9	1.6	10.7	10.5	11.1	11.7
Professional Services	5.9	4.9	4.4	9.4	8.2	8.3
Administrative & Support Services	0.2	2.5	-3.8	3.4	8.5	7.9
Other Services Industries	3.8	2.4	5.2	2.0	5.5	8.0

Source: MTI

Outlook

According to MTI, Singapore's external demand outlook has softened further due to the weaker outlook for the Eurozone economy amidst an energy crunch, as well as for China as it continues to grapple with recurring COVID-19 outbreaks and a property market downturn. For the rest of the year, the weaker external economic outlook will weigh on the growth of outward-oriented sectors in Singapore, including the electronics and chemicals clusters. On the other hand, the strong recovery in air travel and international visitor arrivals is expected to continue to benefit aviation- and tourism-related sectors such as air transport and arts, entertainment & recreation, as well as consumer-facing sectors like food & beverage services. The lifting of travel restrictions in Singapore and the region has also boosted the recovery of the professional services sector. Taking into account the performance of the Singapore economy in the first three quarters of the year, as well as the latest external and domestic developments, MTI expects the 2022 GDP growth for Singapore to be "around 3.5 per cent".

For 2023, MTI expects GDP growth rates in most major economies to moderate further from 2022 levels, with sharp slowdowns projected in the US and Eurozone. Meanwhile, global supply disruptions are likely to continue into 2023 as the war in Ukraine drags on, even though the extent and frequency of disruptions is expected to ease.

MTI also highlighted significant uncertainties and downside risks in the global economy. First, with many advanced economies raising interest rates simultaneously to combat high inflation, the impact of tightening financial conditions on global growth could be larger than expected. Second, financial stability risks could intensify if there are disorderly market adjustments to monetary policy tightening in the advanced economies. A sharp re-pricing of assets could trigger capital outflows from the region and increase debt servicing burdens, thereby dampening regional economies' growth outlook. Third, further escalations in the war in Ukraine and geopolitical tensions among major global powers could worsen supply disruptions, dampen consumer and business confidence, as well as weigh on global trade.

Considering the above, MTI expects the growth of outward-oriented sectors in Singapore to weaken in tandem with the deterioration in external demand conditions.

However, the growth prospects of several sectors remain positive. In particular, the continued recovery in air travel and international visitor arrivals will support the expansion of aviation- and tourism-related sectors. Taking these factors into account, and barring the materialisation of downside risks, MTI expects the Singapore economy to grow by "0.5 to 2.5 per cent" in 2023.

(II) Property Loans

In FY2021, HLF continues to focus on its key pillar business with mortgage loans from residential and commercial sectors making up 74% of total portfolio (2020: 73%). The housing and HDB loans component stood at 9% of the total (2020: 11%) of which HDB home loans made up of 6% (2020: 7%). HP Vehicles formed 13% of total loan portfolio as at 31 December 2021 (2020: 13%) with remaining portfolios supporting other corporate loans (HP Industrial/Equipment/TF) as shown in **Exhibit 8**.

Exhibit 8: Breakdown of HLF's Loans

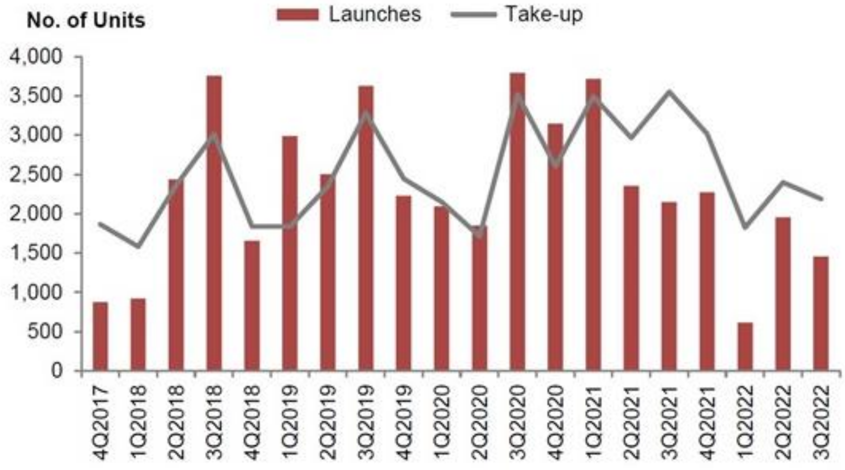
	2021		2020	
	$mil	%	$mil	%
Property Loans – Residential/Commercial	7,981	74	7,961	73
Housing and HDB Home Loans	1,001	9	1,186	11
HP Industrial/Vehicles	1,476	14	1,585	14
Share Loans	93	1	108	1
Others	171	2	135	1
Total	**10,722**	**100**	**10,975**	**100**

Source: HLF

Considering that property loans are a key pillar to HLF's portfolio, we would also review Singapore's private residential industry.

According to Urban Redevelopment Authority (URA), developers launched 1,455 uncompleted private residential units (excluding ECs) for sale in 3rd Quarter 2022, compared with the 1,956 units in the previous quarter. At the same time, 2,187 private residential units (excluding ECs) were sold in 3rd Quarter 2022, compared with the 2,397 units sold in the previous quarter, representing a decrease of 8.8% qoq as shown in **Exhibit 9**.

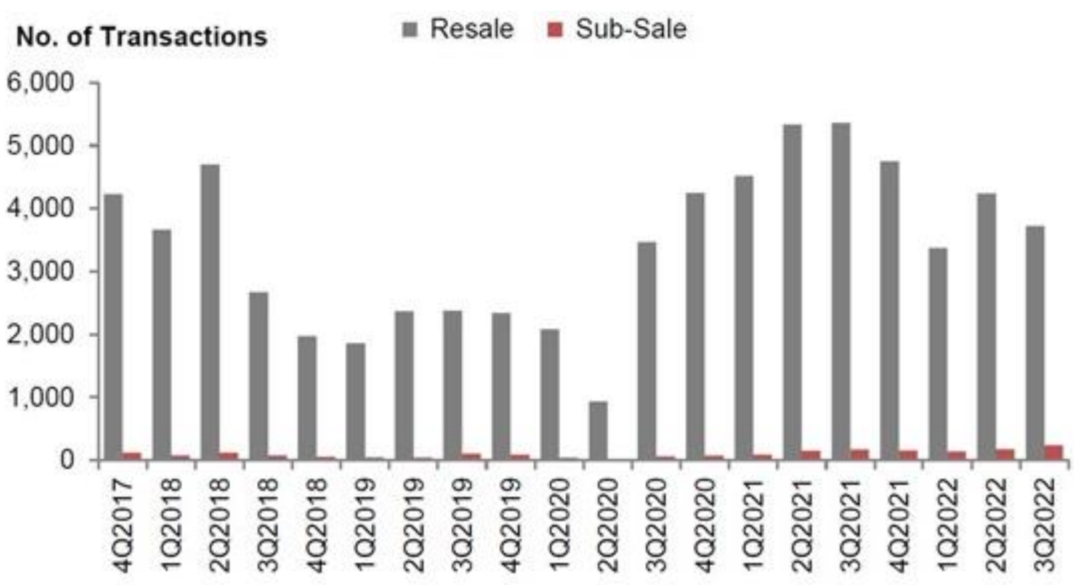
Exhibit 9: Number Of Private Housing Units Launched And Sold By Developers (excluding ECs)



Source: URA

We also noted from URA that there were 3,719 resale transactions in 3rd Quarter 2022, compared with the 4,236 units transacted in the previous quarter. Resale transactions accounted for 60.5% of all sale transactions in 3rd Quarter 2022, compared with 62.2% in the previous quarter. There were also 242 sub-sale transactions in 3rd Quarter 2022, compared with the 178 units transacted in the previous quarter. Sub-sales accounted for 3.9% of all sale transactions in 3rd Quarter 2022, compared with 2.6% in the previous quarter. The total number of resale and sub-sale transactions for private residential units (excluding ECs) is shown in **Exhibit 10**.

Exhibit 10: Number of resale and sub-sale transactions for private residential units (excluding ECs)



Source: URA

Thus, with sustained consumer spending for big-ticket items such as private residences, the demand for loans would increase and could potentially improve HLF's interest income.

However, it was recently reported on Business Times that sales of new private homes slid to an eight-year low in November on dwindling unsold stock and as developers held back on major new launches amid the seasonal year-end slowdown and the latest round of cooling measures. Including ECs, 445 units were sold in November, down from the 811 units sold in October, and a 72.4% plunge from the previous year. Looking ahead, ERA Realty believes the residential property market will remain muted for what is left of this year, with homebuyers away for the holidays and most major projects already launched. Meanwhile, OrangeTee and Tie pointed out that with the recent announcement of the 1H2023 Government Land Sales programme, there could be a bumper crop of more than 4,000 new homes, including 700 EC units, in the first half of 2023. OrangeTee and Tie noted that the increase in supply may alleviate some of the supply-demand imbalance facing the market and help to stabilise price growth next year.

SHARE PRICE DEVELOPMENT REVIEW

Since our initiation report issued on 28 December 2021, when HLF's share price closed at S$2.410, we note that the share price has fallen. From then till present, the share price is down by about 1% to the current price of S$2.390 as shown in **Exhibit 11**.

Exhibit 11: HLF's Share Price

Source: Yahoo Finance, FPA Financial

Over the past one year, the share price traded between S$2.310 to S$2.590. The 52-week low of S$2.310 was reached on 26 October 2022 and the 52-week high of S$2.590 was reached on 5 June 2022.

On 23 February 2022, HLF announced revenue of S$240.0 million and profit of S$84.8 million for full year ended 31 December 2022 (FY2021), representing a 22.8% yoy decrease and 32.7% yoy increase respectively. HLF also declared a final dividend of 8.75 cents per share to be paid on 27 May 2022. According to HLF's Chairman, there are signs of economic recovery based on external economic recovery and domestic demand. However, the market remains susceptible to economic and geopolitical uncertainties. He added that HLF will remain cautiously optimistic about what lies ahead. Upon the release of its financial result and the outlook from its Chairman, HLF's share price fell by 1.18% to S$2.51 on the next day.

On 4 August 2022, HLF announced revenue of S$127.0 million and profit of S$45.1 million for the half year ended 30 June 2022 (1H2022), representing an increase of 3.1% yoy and 1.0% yoy respectively. In addition, HLF also declared an interim dividend of 3.75 cents per share to be paid on 1 September 2022. HLF's share price rose by 0.40% to S$2.49 after the announcement.

POTENTIAL CATALYSTS

(I) High Interest Rates

Singapore's inflation unexpectedly eased across the board in October, from decade-high levels in the previous month, as prices rose more slowly across almost all broad categories. Headline inflation fell to 6.7% yoy in October, from 7.5% previously, with most categories seeing lower price increases other than accommodation and food. Core inflation, which excludes accommodation and private transport, was 5.1% yoy in October, easing from September's 5.3 yoy. The authorities said this was driven by smaller increases in the prices of electricity and gas, retail and other goods and services. Both sets of figures are lower than what private-sector economists polled by Bloomberg have predicted; they were expecting headline inflation to come in at 7%, and core inflation at 5.3%. It is also the first time both figures have dipped since February this year. Still, MAS and MTI kept their inflation outlook the same as the previous month and are sticking to a full-year forecast of 6% for headline inflation and 4% for core inflation. They are also maintaining their 2023 outlook at 5.5% to 6.5%for headline inflation, and 3.5% to 4.5% for core inflation.

In addition, in its December meeting, the Federal Reserve (Fed) officials approved an interest-rate increase of 0.5 percentage point and signaled plans to lift rates through the spring, though likely in smaller increments, to combat high inflation. As a result, the benchmark federal funds rate was raised to a range of between 4.25% and 4.5%, a 15-year high. Furthermore, in the newly released economic projections, most Fed officials penciled in plans to raise the fed-funds rate to a peak level between 5% and 5.5% in 2023 and is expected to maintain that in 2024.

According to MAS, Singapore's domestic interest rates are largely influenced by global market movements and especially by US rates. Hence, a further upside implication on Singapore benchmark rate could be expected which could provide more upside to HLF.

(II) Car Demand and Sales

According to Automobile Association of Singapore (AAS), the Certificate of Entitlement (COE) premiums prices fell for most categories in the latest bidding exercise on 21 December 2022. In the latest tender, the COE for cars with engines up to 1,600cc and 130bhp, as well as electric vehicles (EVs) with up to 110 kilowatts of power (Cat A), ended at $88,007, which is 0.6% lower than the previous tender exercise on 7 December 2022. In the category for larger cars and more powerful EVs (Cat B), the premium rose from $105,501 to $108,006 – an increase of 2.4%. The motorcycle COE (Cat D) prices ended lower at $11,690, a drop of 3.4% from $12,100 posted in the previous round. Commercial vehicle COE premiums (Cat C) fell by 4.1%, from $81,501 to $78,200, posting the biggest drop among the categories. Open category COEs, which can be used to register any type of vehicle other than motorcycles (Cat E), ended at $109,600, which is 0.8% below the $110,524 in the previous tender exercise. In addition, a total of 2,249 bids were received, with a quota of 1,562 COEs available. The summary of the COE prices is shown in **Exhibit 12**.

Exhibit 12: Singapore's COE Premium as at 15 December 2022

Category	Current COE premium (S$)	Previous COE premium (S$)	Change (S$)	% change
A - Car (1,600cc & below)	88,007	88,503	(496)	-0.6%
B- Car (above 1,600cc)	108,006	105,501	2,505	2.4%
C - Goods vehicle & bus	78,200	81,501	(3,301)	-4.1%
D - Motorcycle	11,690	12,100	(410)	-3.4%
E- Open	109,600	110,524	(924)	-0.8%

Source: Automobile Association of Singapore

We note that while the prices for most categories have dropped, the number of bids still exceeded the quota. This means that there is still a demand for motor vehicles in Singapore. With COE premiums decreasing, dealers could revise its prices and drum up sales in the remaining weeks of 2022 and in the early part of 2023. Furthermore, there will be a Singapore Motorshow in January 2023. This could also be a catalyst for the increase in sales of motor vehicles and the increase in demand for such loans.

FINANCIAL PROJECTION

In this section, we will be providing our projections for HLF's revenue, earnings and dividend distribution in FY2022 and FY2023.

(I) Revenue Projection

In our revenue projections, we would consider HLF's historical interest income as a percentage of interest-bearing assets. With reference to **Exhibit 13**, HLF's half year interest income as a percentage of interest-bearing assets was between 0.91% and 1.41% from 1H2019 to 1H2022.

Exhibit 13: HLF's Historical Interest Income as a Percentage of Interest-Bearing Assets (Half year)

	FY2019		FY2020		FY2021		FY2022
S$'000	1H2019	2H2019	1H2020	2H2020	1H2021	2H2021	1H2022
Interest income/ hiring charges	193,231	203,125	178,169	132,616	123,102	116,875	126,962
Interest bearing assets (1)	13,974,963	14,394,048	13,877,691	13,303,809	12,950,284	12,896,938	13,900,603
Interest income as a percentage of interest bearing assets	1.38%	1.41%	1.28%	1.00%	0.95%	0.91%	0.91%

Source: HLF, FPA Financial

FY2022

As noted on page 3, in the first half of 2022, HLF's total interest income/ hiring charges increased by 3.1% yoy to S$127.0 million. For FY2022, according to Singapore's Ministry of Trade and Industry (MTI), Singapore's GDP grew by 4.1% in the third quarter and is expected to maintain a growth of around 3.5% in 2022. In addition, there is also a possibility that consumer spending on large ticket items could increase, which could increase the interest-bearing assets of HLF. Further, as noted on page 13, the Fed officials have raised fed fund rate in its December meeting by 50 basis points to a range between 4.25% and 4.5%, a 15-year high. The high interest rate environment would be beneficial to HLF and increase its interest income/ hiring charges.

Given the above, we expect HLF's collection of interest income/ hiring charges to increase. With reference to **Exhibit 13**, HLF's interest income as percentage of interest-bearing assets was between 0.91% and 1.41% from 1H2019 to 1H2022. Hence, for 2H2022, we would assume 2H2019's interest income as percentage of interest-bearing assets of 1.41% as a proxy for interest income/ hiring charges. We would also assume the interest-bearing assets to remain unchanged in 2H2022 at S$13,900.6 million as recorded in 1H2022.

Accordingly, the projected interest income/ hiring charges in 2H2022 and FY2022 would be as follows:

- Projected interest income/ hiring charges in 2H2022 = 1.41% (projected percentage of interest-bearing assets) x S$13,900.6 million (projected interest-bearing assets in 2H2022) = S$196.0 million

- Projected interest income/ hiring charges in FY2022 = S$127.0 million (actual 1H2022) + S$196 million (projected 2H2021) = S$323.0 million

FY2023

Looking ahead towards FY2023, we would expect a stronger interest income/ hiring charges performance for HLF. As mentioned on page 13, the Fed plans to continue raising the fed-funds rate from between 4.25% and 4.5% to a peak level of between 5% and 5.5% in 2023 and maintain that level until sometime in 2024. Amid the high inflation and a hawkish Fed, there is a possibility that interest rates could continue to rise in Singapore. This could potentially increase interest income/ hiring charges for HLF.

In addition, as mentioned on page 11, with the recent announcement of the 1H2023 Government Land Sales programme from Singapore's government, there would be an increase in supply of new homes. This could also help to increase the demand of property loans, which represents approximately 74% of HLF's total loans as at FY2021.

Considering the above, we would expect both the interest-bearing assets and the interest income/ hiring charges to increase. We would assume a 1.5% yoy growth for HLF's interest-bearing assets in FY2023, which is the mid-point mark of MTI's Singapore GDP growth projection for FY2023. Further, with elevated inflation, we believe there is a possibility that interest rates could continue to increase. We also noted that between FY2019 and FY2021, the full year estimated interest income as a percentage of interest-bearing assets was the highest in FY2019 at 2.79% = [1.38% (actual 1H2019) +1.41% (actual 2H2019)] as shown in **Exhibit 14**. As we are expecting interest rates to remain elevated in FY2023, we would assume the interest income as a percentage of interest-bearing assets for FY2023 to increase to 2.79% as recorded in FY2019.

Exhibit 14: HLF's Historical Interest Income as a Percentage of Interest-Bearing Assets (Full year)

	FY2019		FY2020		FY2021	
%	1H2019	2H2019	1H2020	2H2020	1H2021	2H2021
Interest income as a percentage of interest bearing assets	1.38%	1.41%	1.28%	1.00%	0.95%	0.91%
Estimated total (Full year)	2.79%		2.28%		1.86%	

Source: HLF, FPA Financial

Accordingly, the projected interest-bearing assets and interest income/ hiring charges in FY2023 would be as follows:

- Projected interest-bearing assets in FY2023 = S$13,900.6 million (projected FY2022) x 101.5% = S$14,109.1 million
- Projected interest income/ hiring charges in FY2023 = 2.79% x S$14,109.1 million (projected FY2023) = S$394.2 million

Our projected interest income/ hiring charges for FY2022 and FY2023 are summarized in **Exhibit 15.**

Exhibit 15: Projected Interest Income/ Hiring Charges for FY2022 And FY2023

	FY2019		FY2020		FY2021		FY2022	Forecast		
S$'000	1H2019	2H2019	1H2020	2H2020	1H2021	2H2021	1H2022	2H2022	FY2022	FY2023
Interest income/ hiring charges	193,231	203,125	178,169	132,616	123,102	116,875	126,962	195,999	322,961	394,190
Interest bearing assets (1)	13,974,963	14,394,048	13,877,691	13,303,809	12,950,284	12,896,938	13,900,603	13,900,603	13,900,603	14,109,112
Interest income as a percentage of interest bearing assets	**1.38%**	**1.41%**	**1.28%**	**1.00%**	**0.95%**	**0.91%**	**0.91%**	**1.41%**	**2.32%**	**2.79%**
Interest income as a percentage of interest bearing assets (full year)	**2.79%**		**2.28%**		**1.86%**		**2.32%**			**2.79%**

Source: HLF, FPA Financial

(II) Earnings Projection

Given our projected revenue figures for FY2022 and FY2023, we will now estimate HLF's earnings for these periods.

Net Interest Income

For our net interest income projections, we will consider HLF's historical interest expense as a percentage of total deposits. We note that between 1H2019 and 1H2022, the half year interest expense as a percentage of total deposits varies between 0.57% and 0.84% as shown in **Exhibit 16**.

Exhibit 16: HLF's Historical Net Interest Income (Half year)

	FY2019		FY2020		FY2021		FY2022
S$'000	1H2019	2H2019	1H2020	2H2020	1H2021	2H2021	1H2022
Interest income/ hiring charges (1)	193,231	203,125	178,169	132,616	123,102	116,875	126,962
Interest expense (2)	(90,865)	(103,787)	(96,001)	(67,936)	(33,879)	(28,132)	(30,530)
Total deposits	11,936,947	12,307,049	11,758,410	11,194,359	10,830,293	10,806,871	11,748,382
Interest expense as a percentage of total deposits	0.76%	0.84%	0.82%	0.61%	0.31%	0.26%	0.26%
Net interest income (1) + (2)	**102,366**	**99,338**	**82,168**	**64,680**	**89,223**	**88,743**	**96,432**

Source: HLF, FPA Financial

As we are expecting the interest income as a percentage of interest-bearing assets for 2H2022 and FY2023 to increase to the levels recorded in 2H2019 and FY2019 respectively, we would adopt the same assumptions for our projections for interest expense as a percentage of total deposits. We would assume the interest expense as a percentage of total deposits for 2H2022 to be 0.84% (2H2019) and for FY2023 to be 1.60% (FY2019) =[0.76% (actual 1H2019) + 0.84% (actual 2H2019)] as shown in **Exhibit 17**.

Exhibit 17: HLF's Historical Net Interest Income (Full year)

	FY2019		FY2020		FY2021	
%	1H2019	2H2019	1H2020	2H2020	1H2021	2H2021
Interest expense as a percentage of total deposits	0.76%	0.84%	0.82%	0.61%	0.31%	0.26%
Estimated total (Full year)	1.60%		1.42%		0.57%	

Source: HLF, FPA Financial

Similarly, in terms of total deposits, we would assume the total deposit to remain unchanged in 2H2022 at S$11,748.4 million as recorded in 1H2022. For FY2023, as we are projecting a 1.5% increase in interest-bearing assets, we would assume the total deposits to also increase by 1.5%.

Accordingly, the projected total deposits and interest expense for FY2022 and FY2023 would be as follows:

FY2022

- Projected total deposits in 2H2022 = S$11,748.4 million (actual 1H2022) (remain unchanged)
- Projected interest expense in 2H2022 = 0.84% x S$11,748.4 million (projected 2H2022) = S$99.1 million
- Projected interest expense in FY2022 = S$30.5 million (actual 1H2022) + S$99.1 million (projected 2H2022) = S$129.6 million

FY2023

- Projected total deposits in FY2023 = S$11,748.4 million (projected FY2022) x 101.5% = S$11,924.6 million

- Projected interest expense in FY2023 = 1.60% (projected FY2023) % x S$11,924.6 million (projected FY2023) = S$191.3 million

Consequently, net interest income for FY2022 and FY2023 would be S$193.4 million and S$202.9 million respectively as shown in **Exhibit 18**.

Exhibit 18: Projected Net Interest Income for FY2022 and FY2023

	FY2019		FY2020		FY2021		FY2022	Forecast		
S$'000	1H2019	2H2019	1H2020	2H2020	1H2021	2H2021	1H2022	2H2022	FY2022	FY2023
Interest income/ hiring charges (1)	193,231	203,125	178,169	132,616	123,102	116,875	126,962	195,999	322,961	394,190
Interest expense (2)	(90,865)	(103,787)	(96,001)	(67,936)	(33,879)	(28,132)	(30,530)	(99,076)	(129,606)	(191,333)
Total deposits	11,936,947	12,307,049	11,758,410	11,194,359	10,830,293	10,806,871	11,748,382	11,748,382	11,748,382	11,924,608
Interest expense as a percentage of total deposits	0.76%	0.84%	0.82%	0.61%	0.31%	0.26%	0.26%	0.84%	1.10%	1.60%
Interest expense as a percentage of total deposits (full year)	1.60%		1.42%		0.57%		1.10%			1.60%
Net interest income (1) + (2)	**102,366**	**99,338**	**82,168**	**64,680**	**89,223**	**88,743**	**96,432**	**96,923**	**193,355**	**202,857**

Source: HLF, FPA Financial

Fee and Commission Income

Fee and commission income mainly comprise of fee income from lending and corporate finance activities. It increased by 73.6% yoy to S$8.1 million in 1H2022 largely due to fee income from rebound lending activities. For 2H2022 and FY2023, we would expect the lending activities to remain high. Hence, for 2H2022, we would assume the same fee and commission income of S$8.1 million recorded in 1H2022. For FY2023, we would assume the same half year contribution of S$8.1 million. Consequently, the projected fee and commission income for FY2023 would amount to S$16.2 million =[S$8.1 million (projected 2H2022) x 2] as shown in **Exhibit 19**.

Exhibit 19: Projected Fee and Commission Income for FY2022 and FY2023

	Actual				Forecast		
S$'000	FY2019	FY2020	FY2021	1H2022	2H2022	FY2022	FY2023
Fee and commission income	13,714	10,229	11,181	8,108	8,108	16,216	16,216

Source: HLF, FPA Financial

Other Operating Income

Other operating income mainly comprises of gain on disposal of plant and equipment and "other operating income". We note that in FY2020, other operating income was significantly higher due to the gain on disposal of plant and equipment of S$1.4 million. For 2H2022, we would assume the same other operating income of S$76,000 as recorded in 1H2022 and for the other operating income to remain unchanged in FY2023 from FY2022, as shown in **Exhibit 20**.

Exhibit 20: Projected Other Operating Income for FY2022 and FY2023

	Actual				Forecast		
S$'000	FY2019	FY2020	FY2021	1H2022	2H2022	FY2022	FY2023
Other operating income	324	1,714	270	76	76	152	152

Source: HLF, FPA Financial

Total Operating Expenses

Total operating expenses comprise of staff cost, depreciation of property, plant & equipment and other operating expenses. As noted on page 3, staff cost increased by 10.8% yoy to $36.1 million for 1H2022 due to lower base in first half last year (offset of budget relief measures from Singapore Government) as well as cost associated with the expansion of its risk & compliance management and technology transformation. For 2H2022 and FY2023, as we are projecting an increase in interest income/ hiring charges, we would expect the staff cost to increase. Hence, we would assume a 5% increase in staff cost for 2H2022 and FY2023. Accordingly, the projected staff cost for 2H2022 would be S$37.9 million =[S$36.1 million (actual 1H2022) x 105% (projected growth)] and for FY2023 would be S$77.7 million =[(S$36.1 million (actual 1H2022) + S$37.9 million (projected 2H2022) x 105% (projected growth)].

For depreciation of property, plant & equipment, we note that it has remained relatively stable between S$7.7 million and S$8.1 million between FY2019 and FY2021. We also note that the depreciation expense was S$4.0 million in 1H2022. For 2H2022, we would assume the same amount of depreciation expense of S$4.0 million. This would imply that the depreciation of property, plant & equipment would be S$8.0 million. We would assume the same amount for FY2023.

As noted on page 3, other operating expenses increased by 20.8% yoy to $8.4 million in 1H2022 mainly attributed to higher business transactions and promotional cost linked to improved lending activities amidst competitive market costs coupled with higher energy price. For 2H2022, we would assume other operating expense to remain unchanged. Accordingly, other operating expenses would amount to S$16.8 million for FY2022. For FY2023, with the projected increase in interest income/ hiring charges, we also expect other operating expenses to increase. Hence, we would assume a 5% increase in other operating expenses for FY2023. Accordingly, the projected other operating expense for FY2023 would amount to S$17.6 million =[S$16.8 million (projected FY2022) x 105% (projected growth)].

Accordingly, total operating expenses amounted to S$98.7 million and S$103.3 million for FY2022 and FY2023 respectively as shown in **Exhibit 21.**

Exhibit 21: Projected Total Operating Expenses for FY2022 and FY2023

	Actual				Forecast		
S$'000	FY2019	FY2020	FY2021	1H2022	2H2022	FY2022	FY2023
Staff cost	(67,675)	(54,678)	(64,506)	(36,086)	(37,890)	(73,976)	(77,675)
Depreciation of property, plant and equipment	(8,071)	(7,922)	(8,011)	(3,992)	(3,992)	(7,984)	(7,984)
Other operating expenses	(14,460)	(13,739)	(14,896)	(8,393)	(8,393)	(16,786)	(17,625)
Total operating expenses	**(90,206)**	**(76,339)**	**(87,413)**	**(48,471)**	**(50,275)**	**(98,746)**	**(103,284)**

Source: HLF, FPA Financial

Allowance for Doubtful Debts and Other Financial Assets

As noted on page 3, the net allowance of S$1.8 million in 1H2022 was due to a higher allowance for non-credit-impaired loans. However, given the uncertainties in the allowance for/ recovery of doubtful debts, we would assume it to be zero for both 2H2022 and FY2023, as shown in **Exhibit 22**.

Exhibit 22: Allowance for Doubtful Debts and Other Financial Assets for FY2022 and FY2023

	Actual				Forecast		
S$'000	FY2019	FY2020	FY2021	1H2022	2H2022	FY2022	FY2023
(Less): allowance for recovery of doubtful debts and other financial assets	(1,578)	(7,733)	(60)	(1,833)	-	(1,833)	-

Source: HLF, FPA Financial

Profit before Tax

Given the above projections, we would estimate a profit before tax of S$109.1 million in FY2022 and S$115.9 million in FY2023 as shown in **Exhibit 23**.

Exhibit 23: Projected Profit Before Taxation for FY2022 and FY2023

S$'000	Actual	Forecast		
	1H2022	2H2022	FY2022	FY2023
Interest income/hiring charges	126,962	195,999	322,961	394,190
Less: Interest expense	(30,530)	(99,076)	(129,606)	(191,333)
Net Interest income/ hiring charges	**96,432**	**96,923**	**193,355**	**202,857**
Fee and commission income	8,108	8,108	16,216	16,216
Other operating income	76	76	152	152
Income before operating expenses	**104,616**	**105,107**	**209,723**	**219,225**
Less: Staff costs	(36,086)	(37,890)	(73,976)	(77,675)
Depreciation of property, plant and equipment	(3,992)	(3,992)	(7,984)	(7,984)
Other operating expenses	(8,393)	(8,393)	(16,786)	(17,625)
Total operating expenses	**(48,471)**	**(50,275)**	**(98,746)**	**(103,284)**
Profit from operations before allowances	**56,145**	**54,832**	**110,977**	**115,941**
Add/(less): (allowance for)/ reversal or recovery of doubtful debts and other financial assets	(1,833)	-	(1,833)	-
Profit before tax	**54,312**	**54,832**	**109,144**	**115,941**

Source: HLF, FPA Financial

Income tax expense

We note that excluding FY2020, HLF's effective tax rate has remained at 17%. The lower effective tax rate in FY2020 was mainly due to tax effect of exempt income not taxable for tax purposes, including Jobs Support Scheme. Considering the above, we would assume an effective tax rate of 17% to derive the income tax expense for FY2022 and FY2023. Accordingly, the income tax expense in FY2022 and FY2023 would amount to S$18.7 million and S$19.9 million as shown in **Exhibit 24**.

Exhibit 24: Projected Income Tax Expense for FY2022 and FY2023

	Actual				Forecast		
S$'000	FY2019	FY2020	FY2021	1H2022	2H2022	FY2022	FY2023
Profit before tax	123,958	74,719	101,944	53,596	54,832	109,144	115,941
Income tax expense	(20,873)	(10,810)	(17,123)	(9,196)	(9,531)	(18,727)	(19,893)
Effective tax rate	17%	14%	17%	17%	17%	17%	17%

Source: HLF, FPA Financial

Profit after Tax

Adjusting for income tax expense, the projected profit after tax for FY2022 and FY2023 would be S$90.4 million and S$96.0 million respectively. Assuming the same number of issued shares in 1H2022 for FY2022 and FY2023, we projected an earnings per share of 20.18 cents and 21.43 cents for FY2022 and FY2023 respectively. We have summarized our projected earnings in **Exhibit 25**.

Exhibit 25: Earnings Projections for FY2022 and FY2023

S$'000	Actual	Forecast		
	1H2022	2H2022	FY2022	FY2023
Interest income/hiring charges	126,962	195,999	322,961	394,190
Less: Interest expense	(30,530)	(99,076)	(129,606)	(191,333)
Net Interest income/ hiring charges	**96,432**	**96,923**	**193,355**	**202,857**
Fee and commission income	8,108	8,108	16,216	16,216
Other operating income	76	76	152	152
Income before operating expenses	**104,616**	**105,107**	**209,723**	**219,225**
Less: Staff costs	(36,086)	(37,890)	(73,976)	(77,675)
Depreciation of property, plant and equipment	(3,992)	(3,992)	(7,984)	(7,984)
Other operating expenses	(8,393)	(8,393)	(16,786)	(17,625)
Total operating expenses	**(48,471)**	**(50,275)**	**(98,746)**	**(103,284)**
Profit from operations before allowances	**56,145**	**54,832**	**110,977**	**115,941**
Add/(less): (allowance for)/ reversal or recovery of doubtful debts and other financial assets	(1,833)	-	(1,833)	-
Profit before tax	**54,312**	**54,832**	**109,144**	**115,941**
Less: Income tax expense	(9,196)	(9,531)	(18,727)	(19,893)
Profit after tax	**45,116**	**45,301**	**90,417**	**96,048**
Number of issued shares	448,123,733	448,123,733	448,123,733	448,123,733
Earnings per share (cents)	**10.07**	**10.11**	**20.18**	**21.43**

Source: HLF, FPA Financial

(III) Dividends Projection

With our projected profit after tax, we would now estimate HLF's dividend payment to the owners of the company. We note that the dividend payout ratio remained relatively stable between 63% and 65% between FY2019 and FY2021. In addition, we also noted on page 4 that in both 1H2021 and 1H2022, HLF declared a dividend of 3.75 cents. As the total dividend for FY2021 was 12.00 cents, the dividend distribution for 2H2021 would amount to 8.25 cents = [12.00 cents (actual FY2021) – 3.75 cents (actual 1H2021)].

Considering the above, we would assume the dividend distribution for 2H2022 to be similar to 2H2021 at 8.25 cents. Hence, the dividend distribution for FY2022 would be 12.00 cents =[3.75 cents (actual 1H2022) + 8.25 cents (projected 2H2022)]. For FY2023, as we are projecting an increase in profit after tax, we would assume the dividend distribution to increase by 1.00 cents to 13.00 cents as shown in **Exhibit 26**.

Exhibit 26: Projected Dividend Distribution for FY2022 and FY2023

	Actual				Forecast		
S$'000	**FY2019**	**FY2020**	**FY2021**	**1H2022**	**2H2022**	**FY2022**	**FY2023**
Profit after tax	103,085	63,909	84,821	45,116	45,301	90,417	96,048
EPS	23.10	14.28	18.95	10.07	10.11	20.18	21.43
Dividend (cents)	15.00	9.00	12.00	3.75	8.25	12.00	13.00
Dividend payout ratio (%)	65%	63%	63%	37%	82%	59%	61%

Source: HLF, FPA Financial

VALUATION ANALYSIS

(I) Peer Comparison Analysis

We performed a peer comparison analysis to review how HLF is faring against industry peers in terms of valuation metrics. We selected peer companies that are similar to HLF in terms of industry and business operations and did a comparison by considering the peer's P/E, dividend yield and P/B as shown in **Exhibit 27**.

Exhibit 27: Peer Comparison

Company	Stock code	Price (S$) as at initiation report [1]	Price (S$) as at 22 December 2022	Market cap (S$ million)	EPS [2] (cents)	P/E (x)	DPU [3] (cents)	Dividend yield (%)	NAV per share [4] (S$)	P/B (x)
Hong Leong Finance Limited	S41	2.410	2.390	1,071.02	20.14	11.87	12.00	5.02	4.40	0.54
Peer companies:										
Sing Investments & Finance Limited	S35	1.500	1.470	231.71	24.98	5.88	8.00	5.44	2.52	0.58
Singapura Finance Ltd	S23	0.815	0.795	126.16	5.36	14.83	2.00	2.52	1.54	0.52
Peer average	-	-		**178.93**	-	**10.36**	-	**3.98**	-	**0.55**

Figures have been rounded.
(1) As at 28 December 2021
(2) Annualised earnings per share
(3) Trailing 12-month data
(4) NAV as at 30 Jun 22
Source: Respective company data, FPA Financial

Based on our peer comparison results in **Exhibit 27**, we note that HLF is trading near its peer average P/B of 0.55x and is trading above its peer average P/E of 10.36x. In terms of dividend yield, HLF is relatively more attractive compared to its peer average dividend yield of 3.98%

(II) Factors for Higher Valuation

However, we believe there could be three reasons why HLF could be trading at a P/E and P/B of 11.87x and 0.54x respectively.

Market Capitalization

As shown in **Exhibit 27**, HLF's market cap of S$1,071.02 million is significantly higher than its peer average market cap of S$178.93 million. With a higher market cap, it may suggest that investors are valuing HLF at a higher valuation compared to its peers. A higher market cap may also represent the market's perception of its financial stability, because it reflects what investors are willing to pay for its stock. Hence, with a higher market cap, we believe it could potentially justify HLF's high P/B and P/E multiples as compared to its peers.

Dividend Yield

Another potential reason for HLF's high P/B and P/E multiples could be due to its dividend yield. As noted above, HLF is relatively more attractive in terms of dividend yield as compared to its peers. In general, dividend-paying stocks allow investors to profit in two ways: through the stock's price appreciation and through the company's distributions. In addition, dividend yield can also be a useful tool to help with valuation. Hence, with a higher dividend yield, HLF may be deemed to be more attractive, especially during periods of economic uncertainty arising from the Covid-19 pandemic, which may justify higher P/B and P/E multiples.

Strong Parent Company

HLF is the financial services arm of the Hong Leong Group. The Hong Leong Group is a globally-diversified company with gross assets of over S$40billion. It employs over 20,000 people across Asia-Pacific, the Middle East, Europe and North America. The Group's four core businesses are property development, hotels, financial services and trade & industry. With a strong parent company, it could provide confidence to investors that the parent company could step in to help manage or alleviate any potential problems. For example, should HLF face any financial difficulty, there is a possibility that Hong Leong Group would provide support to help HLF repay its debts.

(III) Valuation Summary

Considering HLF's higher market capitalisation, relatively attractive dividend yield and having a strong parent company together with the stable Singapore's economy outlook and a high interest rate environment, we believe there could be upside potential to HLF's share price. Hence, we would estimate HLF's target price based on its P/B and dividend yield peer comparison analysis.

(a) P/B Multiple

Based on the results in **Exhibit 27** on the previous page, we note that HLF is currently trading at a P/B multiple of 0.54x, which is slightly lower than the peer average P/B of 0.55x. Adopting a relative valuation approach, we estimate a target price of S$2.420 if HLF were to trade at the peer average P/B multiple of 0.55x as follows:

- Estimated target price = [peer average P/B] x [HLF's NAV per share] = 0.55 x S$4.40 = S$2.420

The estimated target price of S$2.420 would imply a upside potential of 1.26% from the current price of S$2.390.

(b) Dividend Yield

In addition, based on the results in **Exhibit 27** on the previous page, we note that HLF's dividend yield of 5.02% is relatively more attractive than the peer average dividend yield of 3.98%. Adopting a relative valuation approach, we estimate a target price of S$3.015 as follows:

- Estimated target price = [(HLF's dividend yield/ peer average dividend yield) x HLF's current price] = (5.02% / 3.98%) x S$2.390 = S$3.015

The estimated target price of S$3.015 would imply an upside potential of 26.15% from the current price of S$2.390.

(c) Estimated Target Price

Considering the above, by adopting a relative valuation approach, we estimate a target price of S$2.420 and S$3.015 based on the peer average P/B and dividend yield comparison analysis respectively. Accordingly, we derived a target price of S$2.718, which is the average of our estimated target price based on the peer P/B and dividend yield analysis as follows:

- Estimated target price = [(Estimated target price from P/B analysis + Estimated target price from dividend yield analysis) / 2] = (S$2.420 + SS$3.015) / 2 = S$2.718

The estimated target price of S$2.718 would imply a upside potential of 13.72% from the current price of S$2.390

INVESTMENT RECOMMENDATION

Based on HLF's reported book value of S$4.40 as at 30 June 2022, it currently has a P/B multiple of 0.54x and is trading at a discount of approximately 46% to NAV. Our peer comparison analysis results show that HLF's P/B of 0.54x is slightly lower than the peer average P/B of 0.55x. We adopted a relative valuation approach to derive an estimated target price of S$2.420 if HLF were to trade at its peer average P/B of 0.55x.

Further, our peer comparison analysis results also show that HLF's dividend yield of 5.02% is relatively more attractive than the peer average dividend yield of 3.98%. Adopting a relative valuation approach, we estimate a target price of S$3.015.

Meanwhile, our evaluation of the peer comparison analysis lead us to believe that HLF's significantly higher market capitalisation as compared to its peers could justify its higher P/B and P/E multiples. HLF's attractive dividend yield could also boost investors sentiment amid the uncertainties arising from the Covid-19 pandemic. In addition, having a strong parent company could further provide confidence to investors.

Considering the stable Singapore's economy outlook and a high interest rate environment, we are expecting an improvement in HLF's revenue, earnings & distribution for FY2022 and FY2023. Hence, we believe there could be upside potential to HLF's share price. Accordingly, we derived a target price of S$2.718, which is the average of our estimated target price based on the P/B and dividend yield peer comparison analysis = [(S$2.420 + S$3.015) / 2].

Given the above, we will maintain our buy recommendation on HLF. Our target price of S$2.718 implies an upside potential of 13.72% from the current share price of S$2.390. However, there are still risks to our target price which we will highlight in the next section.

RISKS TO THE TARGET PRICE

In this section, we highlight below risk factors that may limit the potential upside to HLF's target price.

(I) Weak Economic Recovery in Singapore

High vaccination rates, the loosening of safe management measures (SMM) and the reopening of international borders have largely contributed to a gradual recovery in Singapore's economy. However, the relaxation of Covid-19 related measures has caused the number of Covid cases in Singapore to increase. According to the Ministry of Health (MOH), the weekly growth rate of Covid-19 infections in Singapore was 0.91 as at 19 December 2022 as shown in **Exhibit 28**. The rate refers to the ratio of community cases for the past week over those of the week before.

We note that since the start of December, the weekly growth rate has increased and has hovered between 0.9 and 1.0 for the past month. This increased the uncertainty about how quickly the pandemic can be overcome. The uncertainties could cause consumers and corporations to cut back on spending and capital expenditures, reducing the demand for loans. Further, Health Minister Ong Ye Kung also mentioned that the Ministry of Health (MOH) is closely monitoring the Covid situation and does not rule out reimposing safe management measures if the situation worsen. This could derail Singapore's economic recovery and negatively impact HLF's financial performance.

Exhibit 28: Singapore's Covid-19 Weekly Infection Growth Rate

Source: Data.gov.sg

(II) Risk Of Default of Loans

Owing to elevated inflation, central banks in the US and Eurozone have raised interest rates. Amidst a high interest rate environment, it is important for HLF to manage the interest rate volatility and asset quality amid the global economic headwinds. In FY2020 and FY2021 when the interest rate was low, consumers took on a high amount of debt. This could be a problem when the interest rate rises and remains at elevated levels. This could increase the default risk and the amount of non-performing loans for HLF, which could potentially negatively affect HLF financial performance.

(III) Slowing Home Sales

As mentioned on page 10, property loans are a key pillar to HLF's portfolio and represent approximately 74% of its loans as at FY2021. We also noted on page 11 that in November 2022, the sales of new private homes slid to an eight year low. ERA Realty also added that the residential property market is expected to remain muted, with homebuyers away for the holidays and most major projects already launched. Hence, if the lower home sales trend were to continue into 2023, it could potentially lower HLF's loans growth and its interest income/ hiring charges which could in turn negatively affect its financial performance.

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