OCBC Bank

May 6, 2019

Credit Headlines: Société Générale, HSBC Holdings PLC, Westpac Banking Corporation, Starhub Ltd

Market Commentary

- The SGD swap curve steepened last Friday, with most tenors trading 1bps higher, exception being the 12-year swap rates trading 2bps higher.
- The Bloomberg Barclays Asia USD IG Bond Index average OAS and the Bloomberg Barclays Asia USD HY Bond Index average OAS traded little change at 128bps and 462bps respectively.
- Flows in SGD corporates were heavy, with large flows from SOCGEN 6.125%-PERPs. The other flows seen were CNQCHK 4.9%'20s, FPLSP 4.98%-PERPs, KEPSP 3.66%'29s, PREHSP 5.95%'20s, OLAMSP 5.5%-PERPs and CMZB 4.2%'28s.
- 10Y UST yields fell 2bps to 2.53%, as jobs data released on Friday showed strong growth in April, which however still came in lower than the bullish job gains priced in by the market. Wage inflation was muted in April, as inflation remains a focus in the market for future interest rate movements by the Fed.

Credit Headlines

Société Générale ("SocGen") | Issuer Profile: Neutral (4)

- SocGen reported 1Q2019 results with underlying gross operating income down 10.8% y/y. This was due to a 1.6% y/y fall in underlying net banking income driven by French Retail Banking while underlying operating expenses rose 2.9% y/y due to investment in digitisation in French Retail Banking and growth expenditure in International Retail Banking & Financial Services.
- Underlying net cost of risk rose 26.9% y/y from a low base in 1Q2018 and higher risk costs in International Retail Banking & Financial Services and Global Banking & Investor Solutions (cost of risk remains low in French Retail Banking) and as a result, underlying operating income (or profit before tax) fell 15.0% y/y.
- Segment wise, French Retail Banking continues to struggle due to low interest rates with net banking income down 3.2% y/y. Offsetting this was better performance in Global Banking & Investor Solutions' with net banking income up 1.1% y/y as better financing and advisory revenues were 18.5% higher y/y offset weaker performance in Global Markets and Investor Services (-7.2% y/y). Similar to BNP Paribas SA's recent results, overall results were helped by solid performance in International Retail Banking & Financial Services with net banking income up 4.4% y/y from business growth across retail banking, insurance and services to corporates.
- Loan quality indicators remain solid with the gross doubtful outstandings to total outstandings at 3.5% as at 31 March 2019 against 4.2% as at 31 March 2018 (3.6% as at 31 December 2018). The coverage ratio for doubtful outstandings was stable at 55% over the same period (54% as at 31 December 2018).
- Despite customer loan outstandings rising marginally by 1.2% q/q, risk weighted assets fell 2.6% q/q due to SocGen's restructuring activities (Global Markets, asset refocusing and organic risk weighted asset growth). This translated to a 55bps positive impact to capital ratios with SocGen's CET1 ratio as at 31 March 2019 of 11.7% against 11.2% as at 31 December 2018. SocGen is targeting to reach a CET1 ratio of 12% by 2020. It's TLAC ratio of 25.2% continues to exceed the Financial Stability Board's 2019 and 2022 minimum requirements of 19.5% and 21.5% respectively. We continue to review the numbers. (Company, OCBC)

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Credit Headlines (cont'd)

HSBC Holdings PLC ("HSBC") | Issuer Profile: Positive (2)

- HSBC announced a solid set of results for 1Q2019 with profit before tax up 31% y/y to USD6.2bn. Driving the performance was a 5% y/y improvement in revenue (mostly in Asia) and a 12% y/y fall in operating expenses. Most of the reduction in expenses was due to the USD0.9bn in legal and regulatory settlements recognized in 1Q2018. That said, underlying expense performance was still solid despite on-going investment for growth and digitisation.
- Revenue growth was driven by balance sheet growth and better margins from higher interest rates in Retail Banking and Wealth Management while Commercial Banking performance continues to be supported by Global Liquidity and Cash Management as well as lending. Revenue also included non-recurring impacts including USD157mn in disposal gains. Global Private Banking revenue was down 4% y/y on repositioning as well as lower revenue in Switzerland that was partially offset by better performance in Asia.
- Revenue growth mitigated a significant rise in expected credit losses and other credit impairment charges to USD585mn (from USD170mn in 1Q2018). This was due to individual stresses within Commercial Banking in the UK, higher allowances to reflect the uncertain UK outlook from Brexit and inclusion of net releases in 1Q2018. Expected credit losses for other segments were stable y/y.
- Segment wise, the above translated to Commercial Banking adjusted profit before tax down 0.7% y/y as expected credit losses offset revenue growth (segment profit before tax rose 20.3% q/q from higher insurance and global markets product revenue in Asia). Global Banking & Markets performance was stable y/y as higher revenue was offset by business investment (up 133% q/q due to seasonal influence on client activity which was weak in 4Q2018) while Retail Banking and Wealth Management was up 18.9% y/y due to the aforementioned revenue growth (+64.8% q/q from insurance and investment distribution revenue growth).
- HSBC's balance grew with total assets up 3.9% q/q. This was driven by 2% q/q growth in lending within Asia, particularly in Global Private Banking in Hong Kong. This led to a similar growth in risk weighted assets q/q. Despite the risk weighted asset growth, HSBC's capital position improved due to strong capital generation with its CET1 ratio of 14.3% as at 31 March 2019 up from 14.0% as at 31 December 2018.
- We continue to see HSBC's size and operating diversity along with a solid capital position continues to be a key credit strength in our view and supports its Positive (2) issuer profile (OCBC, Company)

Credit Headlines (cont'd)

Westpac Banking Corporation ("WSTP") | Issuer Profile: Positive (2)

- WSTP announced its results for the 1HFY2019 ended 31 March 2019. As previously announced, results were heavily influenced by provisions for customer remediation with 1HFY2019 cash earnings down 14% h/h. Excluding provisions for customer remediation as well as other restructuring charges for Westpac's wealth business, cash earnings were down 1% h/h. Reported net profit was down 19% h/h to AUD3.2bn.
- Net interest income was stable h/h as (1) loan growth more than offset slightly lower net interest margins and (2) AUD330mn that was reclassified to interest income from net fee income was partially negated by AUD212mn in provisions for estimated customer refunds and payments. Net fee income fell 28% h/h from the aforementioned reclassification as well as the recognition of AUD165mn in provisions for estimated customer refunds and payments. Finally, net wealth management and insurance income fell 71% h/h due to AUD435mn in provisions for estimated customer refunds and payments, higher insurance claims and lower wealth management income. This drove net operating income down 9% h/h.
- Expense performance was challenging with operating expenses up 4% h/h (implementation costs for customer refunds, wealth business provisions and business investment) and impairment charges up 5% h/h, which also contributed to the weaker results.
- In line with the higher impairment charges, loan quality indicators appear on the downtrend. Gross impaired exposures to gross loans rose to 0.24% as at 31 March 2019 from 0.20% as at 30 September 2018 while the ratio of gross impaired exposures provisions to gross impaired exposures fell slightly to 45.74% from 46.12% over the same period. Similarly, mortgages and consumer loan 90+ delinquencies rose from 0.67% and 1.64% respectively as at 30 September 2018 to 0.75% and 1.80% respectively as at 31 March 2019. Overall mortgage growth has slowed according to management, in line with a general slowdown in the Australian economy. This is likely to have a larger impact on Westpac's future earnings compared to peers given the higher exposure to the consumer segment.
- While earnings challenges are expected to persist, Westpac's capital position remains solid. Its CET1 ratio as at 31 March 2019 at 10.64% continued to be above the Australian Prudential Regulatory Authority's ("APRA") 10.5% minimum requirement for 'unquestionably strong' capital ratios in Australia's banking sector (comes into force January 2020). The ratio was stable h/h as still solid underlying earnings generation offset dividend payments and the additional provisions for customer remediation and restructuring.
- We continue to look through the numbers. That said, despite weaker headline numbers we are unlikely to change our credit view on Westpac given earnings generation capacity continues to be solid and support its current capital position. (Company, OCBC)

Credit Headlines (cont'd)

StarHub Ltd ("StarHub") | Issuer Profile: Neutral (3)

- Revenue rose 6.0% y/y to SGD596.8mn, though this is largely due to the increase in sale of equipment (+33.2% y/y to SGD152.5mn) which is a low margin business (cost of equipment: SGD140.2mn, which represents ~91.9% of the sale of equipment revenue).
- Mobile revenue fell 5.3% y/y to SGD192.3mn, which is also down on a q/q basis (4Q2018: SGD194.3mn). While the number of post-paid customers grew 5.3% y/y to 1.44mn, ARPU per month fell to SGD39 (4Q2018: SGD41, 1Q2018: SGD43) with fewer excess data usage while IDD and voice continued to decline. We think the mobile segment may remain challenging on the ARPU front.
- For Pay TV, similar to 4Q2018 trends, revenue fell 12.4% y/y to SGD70.7mn (4Q2018: SGD71.3mn) mainly due to the decline in residential pay TV customers to 394k (4Q2018: 409k, 1Q108: 449k). In addition, ARPU per month declined to SGD48 (1Q2018: SGD51) with promotional offers to drive existing cable subscribers to IPTV. The segment is expected to continue shrinking with piracy and alternative viewing options (e.g. Netflix) while we note that StarHub has ceased 11 channels from Discovery Networks from 31 Aug 2018.
- Meanwhile, Broadband was relatively stable at SGD47.1mn (1Q2018: SGD47.2mn). While subscribers picked up to 495k (4Q2018: 482k, 1Q2018: 468k), ARPU per month declined to SGD31 (4Q2018: SGD32, 1Q2018: SGD33), similarly driven by promotional offers to migrate existing cable subscribers to fibre broadband.
- Enterprise Business remains the only bright spot, which is up 14.1% y/y to SGD134.1mn, though down q/q (4Q2018: SGD146.1mn). This is mainly due to the growth of managed services (+44.1% y/y to SGD26.1mn) with higher demand for cloud, cryptographic and digital security solutions. Meanwhile, cyber security services (+41.1% y/y to SGD26.4mn) and voice services also grew (+22.9% y/y to SGD11.6mn).
- Going forward, StarHub continues to guide for service revenue to decline up to 2% y/y (FY2018: SGD2.36bn) and EBITDA margin to be between 30%-32%. Based on the guidance, we estimate that reported EBITDA may come in as low as ~SGD694mn. This looks sustainable as the EBITDA should be still sufficient to cover (1) capex (excluding spectrum), which is guided at around 11%-12% of total revenue (our estimate: ~SGD260mn), (2) SGD155.8mn dividends p.a. based on the dividend guidance of 2.25 cts per share per quarter, and (3) ~SGD40mn in interest expense and perpetuals distribution. However, we note that our calculation does not factor commitments for spectrum (outstanding: SGD282mn).
- Meanwhile, net debt/TTM reported EBITDA remained stable q/q at 1.49x (4Q2018: 1.52x). Although the industry outlook remains challenged, we note that StarHub has cut back on dividends (previously: 4 cts per share per quarter) while EBITDA appears to be stabilising. As such, we continue to hold StarHub Ltd at a Neutral (3) Issuer Profile. (Company, OCBC)

Table 1: Key Financial Indicators

	6-May	1W chg (bps)	1M chg (bps)
iTraxx Asiax IG	65	1	-2
iTraxx SovX APAC	43	0	-2
iTraxx Japan	55	0	-3
iTraxx Australia	67	1	-5
CDX NA IG	58	0	-2
CDX NA HY	108	0	1
iTraxx Eur Main	58	1	-3
iTraxx Eur XO	252	5	-8
iTraxx Eur Snr Fin	70	1	-6
iTraxx Sovx WE	16	-1	-2
AUD/USD	0.697	-1.16%	-2.15%
EUR/USD	1.119	0.02%	-0.67%
USD/SGD	1.365	-0.23%	-0.75%
China 5Y CDS	41	0	-2
Malaysia 5Y CDS	57	3	0
Indonesia 5Y CDS	96	2	-3
Thailand 5Y CDS	36	0	-5

	6-May	1W chg	1M chg
Brent Crude Spot ($/bbl)	69.36	-3.72%	-1.39%
Gold Spot ($/oz)	1,282.70	0.22%	-1.14%
CRB	181.77	-1.56%	-3.15%
GSCI	440.83	-0.90%	-1.44%
VIX	12.87	1.10%	0.39%
CT10 (bp)	2.525%	2.68	0.09
USD Swap Spread 10Y (bp)	-1	0	1
USD Swap Spread 30Y (bp)	-24	0	2
US Libor-OIS Spread (bp)	16	-1	-2
Euro Libor-OIS Spread (bp)	6	0	0
DJIA	26,505	-0.14%	0.30%
SPX	2,946	0.20%	1.83%
MSCI Asiax	680	0.24%	0.06%
HSI	29,156	-1.52%	-2.61%
STI	3,289	-2.02%	-1.01%
KLCI	1,628	-0.64%	-0.84%
JCI	6,245	-2.43%	-3.53%

New issues

- Tavan Bogh Trade LLC has scheduled investor meetings from 6 May for its potential USD bond issuance.
- Zeus Energy Holdings has scheduled investor meetings from 6 May for its potential USD Green bond issuance.

Date	Issuer	Size	Tenor	Pricing
2-May-19	Medco Oak Tree Pte Ltd	USD650mn	7NC4	7.70%
2-May-19	SD International Sukuk Ltd	USD300mn	3-year	6.30%
2-May-19	Alam Synergy Pte Ltd	USD125mn	ASRIIJ 6.625%'22s	95.176+accrued
29-Apr-19	Ronshine China Holdings Ltd	USD200mn	RONXIN 10.5%'22s	104.897+accrued
29-Apr-19	Mirae Asset Daewoo Co Ltd	USD300mn USD300mn	3-year 5-year	T3+95bps T5+112.5bps
29-Apr-19	Keppel Corp Ltd	SGD150mn SGD350mn	5-year 10-year	3.0% 3.66%
29-Apr-19	CDL Properties Ltd	SGD400mn	5-year	2.958%
26-Apr-19	Hanrui Overseas Investment Co Ltd	USD280mn	3-year	7.95%
25-Apr-19	Chengdu Tianfu New Area Investment Group Co Ltd	USD300mn	5-year	4.65%
25-Apr-19	Yango Justice International Ltd	USD150mn	SUNSHI 9.5%'21s	99.770+accrued
25-Apr-19	CICC Hong Kong Finance 2016 MTN Ltd	USD300mn USD700mn	3-year 3-year	T+115bps 3M-US LIBOR+117.5bps
25-Apr-19	Xinyuan Real Estate Co Ltd	USD100mn	XIN 14.2%'21s	103.932+accrued
24-Apr-19	Credit Agricole S.A.	SGD325mn	12NC7	3.8%

Source: OCBC, Bloomberg

Andrew Wong
Treasury Research & Strategy
Global Treasury, OCBC Bank
(65) 6530 4736
wongVKAM@ocbc.com

Ezien Hoo, CFA
Treasury Research & Strategy
Global Treasury, OCBC Bank
(65) 6722 2215
EzienHoo@ocbc.com

Wong Hong Wei, CFA
Treasury Research & Strategy
Global Treasury, OCBC Bank
(65) 6722 2533
WongHongWei@ocbc.com

Seow Zhi Qi
Treasury Research & Strategy
Global Treasury, OCBC Bank
(65) 6530 7348
zhiqiseow@ocbc.com