Singapore Industry Focus

Singapore Banks

Refer to important disclosures at the end of this report

DBS Group Research . Equity

6 Jul 2018

Property cooling measures strikes again!

- New property cooling measures (wef 6 Jul 2018) will dampen loan growth; downside to 2018-19 loan growth
- Previous property cooling measures caused loan growth to half from a high of 16% after a year; banks' share prices did not correct sharply as business loans stayed strong
- Downgrade banks to HOLD; TPs for UOB and OCBC lowered to S$28.30 and S$12.20 respectively on earnings revision of c. -1% to -5% over FY18-19F

From peak to trough. The Singapore government has raised the Additional Buyer's Stamp Duty (ABSD) and Loan-to-Value (LTV) limits on residential property purchases, to cool the property market and keep price increases in check. ABSD rates for Singapore citizens and Singapore permanent residents purchasing their first property will be retained at 0% and 5% respectively, raised by 10% (from 15%) for entities, and ABSD of 5% has been introduced for developers purchasing residential properties for housing development. Separately, LTV limits will be tightened by 5% (refer to table for details) for all housing loans granted by financial institutions (not applicable to HDB loans). Changes will be effective from 6 Jul 2018. With rising interest rates, we gather that the government is trying to instill caution to property buyers to avoid over-leveraging. Property prices started to rebound after the government relaxed the Seller's Stamp Duty (SSD) in Mar 2017, and prices have increased by 8-9% while transaction volumes rose by 40% since then.

2Q18 earnings should still be positive; potential profit taking risk post results. Singapore banks are over-owned by investors' vs other ASEAN Banks based on our checks, at least since the middle of 2017. The slightest negative news, would easily prompt a sell down. We saw the first leg of sell down post 1Q18 results where we believe investors started to take profit. Newsflow on weakness in the power and water sector had led to some degree of cautiousness. We believe investors could hold on a little longer for the upcoming higher interim dividends. We expect 2Q18 earnings to remain positive, supported by sustained NIM uptrends and low credit costs. But 2H18 might see the tide turn, especially in loan growth.

Turning cautious. Loan growth sentiment will be dampened from here as this is currently driven largely by property development companies. Mortgage growth might still stay relatively stable over the next few quarters from existing drawdowns. The property cooling measures would likely take a hit on UOB, which is most exposed to property-related lending. We cut 2018 loan growth to 7% (from 8%), and to 6% (from 7%) in 2019. We downgrade both OCBC and UOB with revised TP of S$12.20 and S$28.30 respectively, with earnings revision of c. -1% to -5% through FY18-19F. We expect NIM to stay on an uptrend, in line with SIBOR/SOR although re-pricing effect remains a risk. Near term, we expect wealth management income to remain a key driver. Banks remain vigilant in controlling costs. Post SFRS9, banks' credit cost levels are expected to normalise (lower) in the absence of the oil & gas woes. However, should property sales decline significantly leading up to completion, there may be downside risks on loans to developers' bank loans in 2 to 3 years' time.

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STOCKS

	Price S$	Mkt US$m	12-mth Target S$	Performance (%) 3 mth	12 mth	Rating
DBS	26.03	48,885	NA	(4.6)	25.8	NR
OCBC	11.50	35,252	12.20	(8.4)	8.4	HOLD
UOB	27.09	33,138	28.30	0.4	18.3	HOLD

Source: DBS Bank, Bloomberg Finance L.P.
Closing price as of 5 Jul 2018

Summary of ABSD changes

Range of ABSD	Type	Rates on/ before 5 Jul 2018	Rates on/after 6 Jul 2018
Singapore Citizen (SCs) buying first residential property	Individual	0%	0% (no change)
SCs buying second residential property	Individual	7%	12% (revised)
SCs buying third and subsequent residential property	Individual	10%	15% (revised)
Singapore Permanent Resident (SPRs) buying first residential property	Individual	5%	5% (no change
SPRs buying second and subsequent resident property	Individual	10%	15% (revised)
Foreigners buying any residential property	Individual	15%	20% (revised)
Entities buying any residential property	Companies	15%	25% (revised); 5% additional for developers (non-remittable)

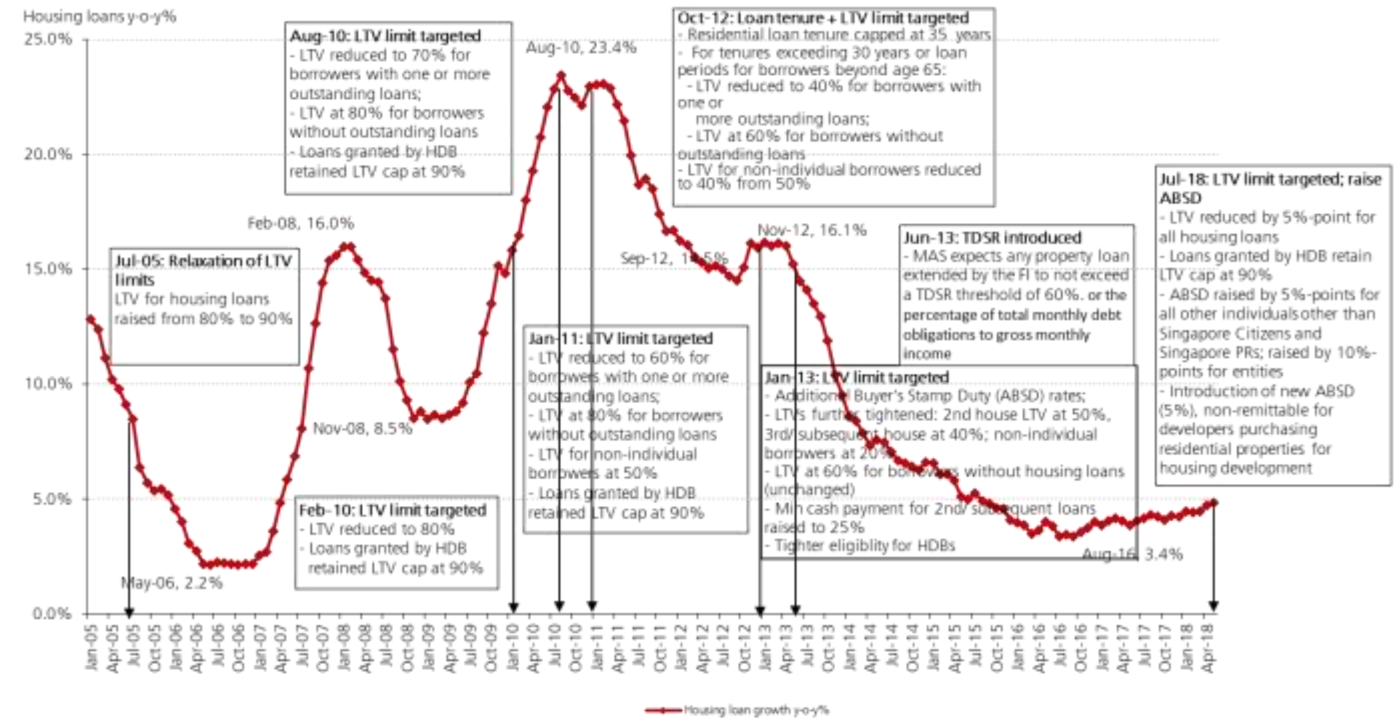
Source: MOF, DBS Bank

Summary of changes in loan-to-value (LTV) limits

Range of ABSD	1st Housing Loan	2nd Housing Loan	3rd Housing Loan
Individual			
LTV Limit	Existing Rules 80% or 60% if loan tenure >30 years or extends past age 65 Revised Rules 75% or 55% if loan tenure >30 years or extends past age 65	Existing Rules 50% or 30% if loan tenure >30 years or extends past age 65 Revised Rules 45% or 25% if loan tenure >30 years or extends past age 65	Existing Rules 40% or 20% if loan tenure >30 years or extends past age 65 Revised Rules 35% or 15% if loan tenure >30 years or extends past age 65
Cash down-payment	No change to existing rules 5% or 10% if tenure > 30 years or extends past age 65	25%	25%
Non-Individual			
LTV Limit	Existing Rules : 20% Revised Rules: 15%		

Source: MOF, DBS Bank

Singapore banks: Mortgage loan growth (y-o-y %) and property cooling measures



Source: MAS, DBS Bank

Singapore banks: Loan growth profile (1Q18)

By sector (S$m)	DBS	%	y-o-y%	q-o-q%	UOB	%	y-o-y%	q-o-q%	OCBC	%	y-o-y%	q-o-q%	Dom bks	%	y-o-y%	q-o-q%
Manufacturing	33,449	10%	9.0%	2.5%	19,993	8%	17.5%	7.4%	14,055	6%	6.6%	12.4%	67,497	8%	10.8%	5.9%
Building & Construction	66,447	20%	15.4%	3.0%	54,883	23%	4.0%	2.3%	38,476	16%	7.6%	8.6%	159,806	19%	9.4%	4.0%
Housing loans	73,500	22%	13.7%	0.3%	66,545	28%	7.3%	1.5%	65,087	26%	8.4%	0.8%	205,132	25%	9.9%	0.8%
General commerce	51,947	16%	11.0%	1.6%	31,307	13%	1.1%	2.1%	30,198	12%	14.5%	4.1%	113,452	14%	8.9%	2.4%
Transportation, storage & communications	29,374	9%	-5.9%	-3.6%	9,235	4%	-4.8%	-1.6%	10,530	4%	-12.4%	-9.0%	49,139	6%	-7.2%	-4.5%
Financial institutions, investment & holdings companies	19,937	6%	20.1%	15.8%	19,303	8%	15.4%	1.1%	41,590	17%	25.2%	9.9%	80,830	10%	21.5%	9.0%
Professionals & individuals	30,180	9%	22.2%	2.7%	28,360	12%	5.8%	0.6%	30,182	12%	12.0%	5.1%	88,722	11%	13.1%	2.8%
Others	28,034	8%	-8.9%	-3.7%	11,162	5%	-14.5%	2.6%	16,544	7%	-4.3%	-6.6%	55,740	7%	-8.8%	-3.4%
Total	332,868	100%	9.9%	1.6%	240,788	100%	5.1%	2.0%	246,662	100%	9.7%	3.9%	820,318	100%	8.4%	2.4%

Source: Companies, DBS Bank

Singapore banks' peer table

	Market cap (US$m)	Price (S$/s)	Target Price (S$/s)	Rating	PE (x) FY17A	PE (x) FY18F	PE (x) FY19F	CAGR ^ (%)	PBV (X) FY17A	PBV (X) FY18F	PBV (X) FY19F	ROE (%) FY12F	Net div (%) FY12F
DBS*	48,885	26.03	NA	NA	16.9x	12.0x	11.5x	17.7	1.4x	1.4x	1.3x	13.0%	4.1%
OCBC	35.252	11.50	12.20	Hold	13.3x	11.2x	10.2x	17.0	1.3x	1.2x	1.1x	12.2%	2.9%
UOB	33,138	27.09	28.30	Hold	13.2x	11.3x	10.3x	14.9	1.3x	1.2x	1.1x	11.4%	3.6%
Simple average					13.3x	10.7x	9.8x		1.3x	1.2x	1.2x	12.2%	3.6%
Weighted average					14.3x	11.2x	10.1x		1.3x	1.3x	1.2x	12.4%	3.9%

^ Refers to 2-year EPS CAGR for FY16-18F

*Based on Bloomberg consensus

Source: Companies, Bloomberg Finance L.P., DBS Bank

Singapore Company Guide
OCBC

Version 13 | Bloomberg: OCBC SP | Reuters: OCBC.SI

Refer to important disclosures at the end of this report

DBS Group Research . Equity

6 Jul 2018

HOLD (Downgrade from BUY)

Last Traded Price (5 Jul 2018): S$11.50 (STI : 3,256.71)
Price Target 12-mth: S$12.20 (6% upside) (Prev S$15.30)

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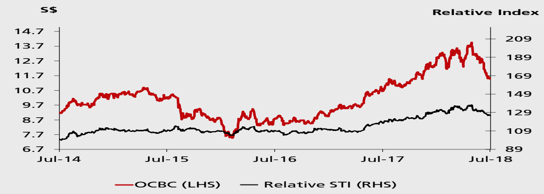
What's New

- Newly introduced property cooling measures a dampener to loan growth
- FY18-20F earnings lowered by 5% on lower loan growth, higher cost of funds, and lower non-interest income
- Unlikely to raise dividends; yield at c.3%
- Downgrade to HOLD, TP revised to S$12.20

Price Relative



Forecasts and Valuation

FY Dec (S$ m)	2017A	2018F	2019F	2020F
Pre-prov. Profit	5,498	6,221	6,830	7,180
Net Profit	4,106	4,812	5,266	5,527
Net Pft (Pre Ex.)	4,106	4,812	5,266	5,527
Net Pft Gth (Pre-ex) (%)	19.6	17.2	9.4	5.0
EPS (S cts)	98.2	115	126	132
EPS Pre Ex. (S cts)	98.2	115	126	132
EPS Gth Pre Ex (%)	17	17	9	5
Diluted EPS (S cts)	98.2	115	126	132
PE Pre Ex. (X)	11.7	10.0	9.1	8.7
Net DPS (S cts)	37.0	38.0	38.1	38.5
Div Yield (%)	3.2	3.3	3.3	3.3
ROAE Pre Ex. (%)	11.1	12.1	12.2	11.8
ROAE (%)	11.1	12.1	12.2	11.8
ROA (%)	1.0	1.1	1.1	1.1
BV Per Share (S cts)	909	986	1,074	1,167
P/Book Value (x)	1.3	1.2	1.1	1.0
Earnings Rev (%):		(5)	(5)	(7)
Consensus EPS (S cts):		111.9	123.7	134.5
Other Broker Recs:		B: 13	S: 0	H: 10

Source of all data on this page: Company, DBS Bank, Bloomberg Finance L.P.

Staying cautious

Staying cautious; downgrade to HOLD. We believe that the newly introduced property cooling measures are a dampener to loan growth and have hence revised our loan growth forecast from 8% to 7% for FY18. We lowered our NIM assumptions by c. 6bps for FY18 on slower loan repricing amid higher cost of funds. However, we believe that the NIM uptrend should continue in this current operating environment. We have also lowered OCBC's insurance income contribution from 5% y-o-y to 2% y-o-y as 1Q18 saw both total new weighted business premiums and new business embedded value decline y-o-y due to shifts in product mix. At this juncture, we have conservatively assumed credit cost will hover around 21-22bps over FY18-20F. Further earnings upside may be possible. What remains an overhang would be the much anticipated higher dividend payout. OCBC was the only bank that did not raise dividends substantially in FY17 and has stated that it does not have excess capital.

Where we differ: Our credit cost of 21-22bps could be lower than consensus. Management indicated that credit cost would remain benign in this current operating environment and possibly reflect pre-oil & gas crisis levels.

Potential catalyst: Sustained positive deliveries, minimal surprise in insurance income trends, higher dividends. Asset quality issues are a thing of the past. Lower-than-expected credit cost could further boost earnings. In the meantime, sustained positive deliveries from NIM and loan growth should support valuations. We remain hopeful that the change in accounting rules would not dampen insurance income contribution too much. A much anticipated catalyst would be higher dividends, which we think would be announced as early as its 1H18 results. However, **in the event that trade war escalates, it might trigger further risks to loan growth.**

Valuation:

Downgrade to HOLD, TP S$12.20. Our TP of S$12.20 (11% ROE, 3% growth, 9.4% cost of equity) following our earnings adjustments is equivalent to 1.3x FY18 BV, at its 10-year mean P/BV multiple.

Key Risks to Our View:

Faltering NIM and non-interest income traction. Inability to see revenue generation from improved NIM as well as better wealth management and insurance income contribution could pose downside to our earnings forecasts.

At A Glance

Issued Capital (m shrs)	4,185
Mkt. Cap (Sm/USm)	48,127 / 35,260
Major Shareholders (%)	
Selat Pte Ltd	11.1
Free Float (%)	88.9
3m Avg. Daily Val (US$m)	58.3
ICB Industry : Financials / Banks	

CRITICAL DATA POINTS TO WATCH

Critical Factors

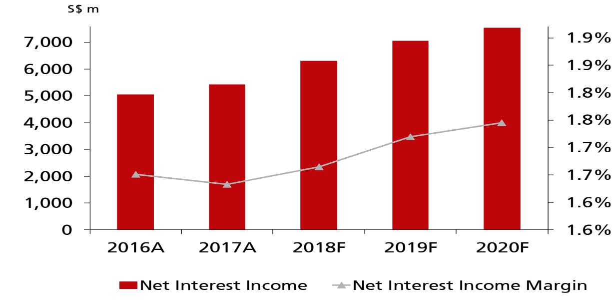
NIM uplift more visible in FY18. It is possible for the Fed rate hike pass-through to eventually spill over to SIBOR, hence positively repricing loans but the caveat to this is that competitive pressures are there and credit spreads are unlikely to widen, therefore limiting any significant positive impact on NIM. OCBC's loan profile is largely variable rate based at 90%, with one-third prime-rate based, one-third SIBOR based and 25% SOR based. Our sensitivity analysis implies that for every 25-bps increase in SIBOR/SOR, HK$ and US$ loan rates (collectively), OCBC's NIM could rise by 2bps with an accompanying 1.4% impact on net profit, holding everything else constant. The bonus to its NIM uplift could lie in its treasury operations, where in a rising rate environment, there would be more opportunities to rebalance its securities portfolio given the steepened yield curve.

Loan growth to pick up; guiding for 7-8% in FY18F. Management is guiding for loan growth of 7-8% for FY18. Loan demand appears apparent for Singapore companies investing abroad. Every 1-ppt rise in loan growth leads to 0.9% increase in net profit. We are forecasting loan growth at c.6% p.a. across FY18-20F.

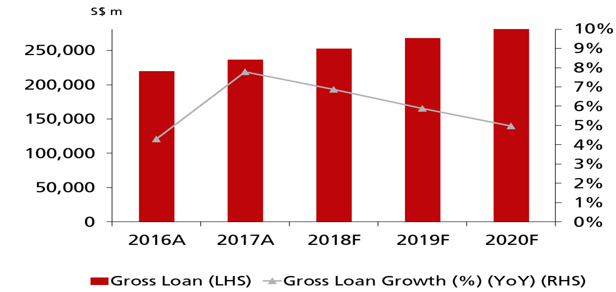
Non-interest income drivers remain its key differentiator, especially wealth management and insurance. OCBC differentiates itself from peers in terms of its non-interest income composition. Its focus is on growing its non-interest income franchise, especially its wealth management business. Its insurance business via 87.75%-owned subsidiary, Great Eastern Holdings (GEH), remains a dominant contributor to its non-interest income. OCBC has no plans to sell its stake in GEH as it remains complementary to its non-interest income franchise. Management believes it is still logical and beneficial to keep the insurance product manufacturing in-house. However, in view of the need to meet regulatory requirements in Malaysia, GEH may look to divest part of its operations in Malaysia. It is currently exploring options to meet this requirement. GEH tends to exhibit earnings volatility due to fluctuations of interest rates. It is best to track GEH's underlying business trends i.e. total weighted new sales and new business embedded values. These metrics have been growing robustly for GEH. Since the acquisition of Bank of Singapore in 2010, its wealth management income has been growing steadily; and this trend is expected to be sustainable. The acquisition of the wealth and investment business of Barclays Bank in Singapore and Hong Kong, completed in December 2016, added US$13bn to OCBC's AUM. In May 2017, OCBC further acquired National Bank of Australia's wealth business in Singapore and Hong Kong.

Regionalisation is a key item on its agenda. Malaysia remains OCBC's second largest contributor. Its business proposition in Malaysia has a track record of over 80 years and its added advantage lies in its Islamic banking franchise. Management feels bullish about its operations in Indonesia. While still a small contributor, opportunities are aplenty for further growth. We see the wealth management income line as the key indicator to watch for sustained synergies in OCBC-Wing Hang.

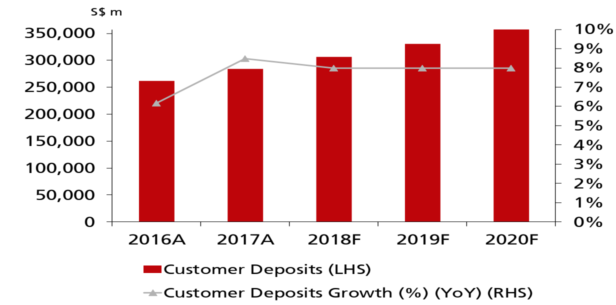
Margin Trends



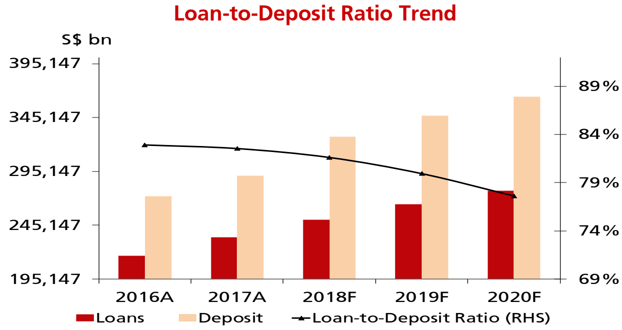
Gross Loan& Growth



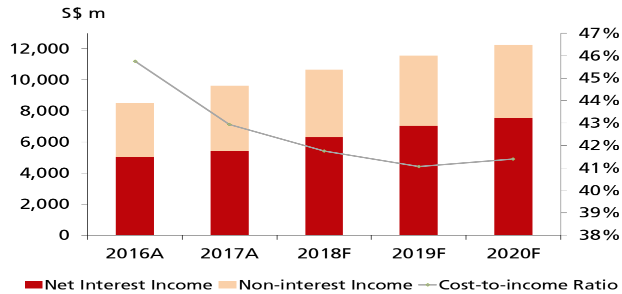
Customer Deposit & Growth



Loan-to-Deposit Ratio Trend



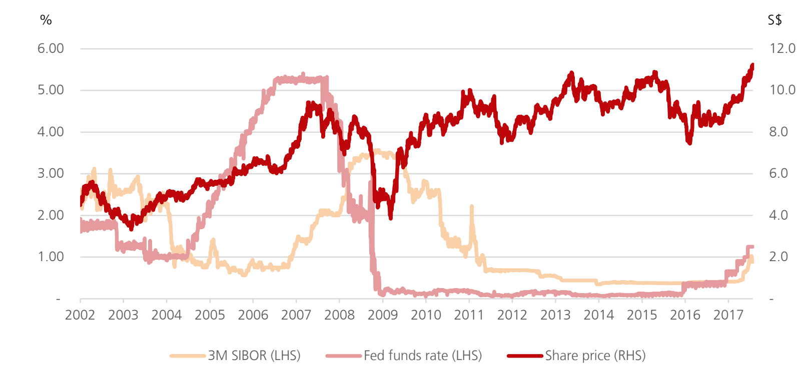
Cost & Income Structure



Source: Company, DBS Bank

Appendix 1: A look at Company's listed history – what drives its share price?

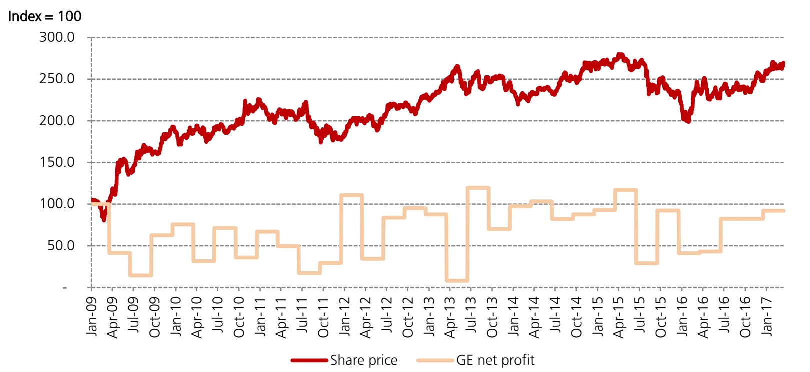
Interest rates as critical factor



Remarks

Interest rates, particularly SIBOR, is linked to loan pricing and hence NIM, which in turn drives earnings and share price performance. The Fed rate hikes which should lead to SIBOR uplift was historically 60% correlated. The relationship has somewhat broken down since late 2016 due to the relative strength of the SGD. Nevertheless, expectations of Fed rate hikes, which are expected to pass through to SIBOR does have a positive correlation to banks' share prices.

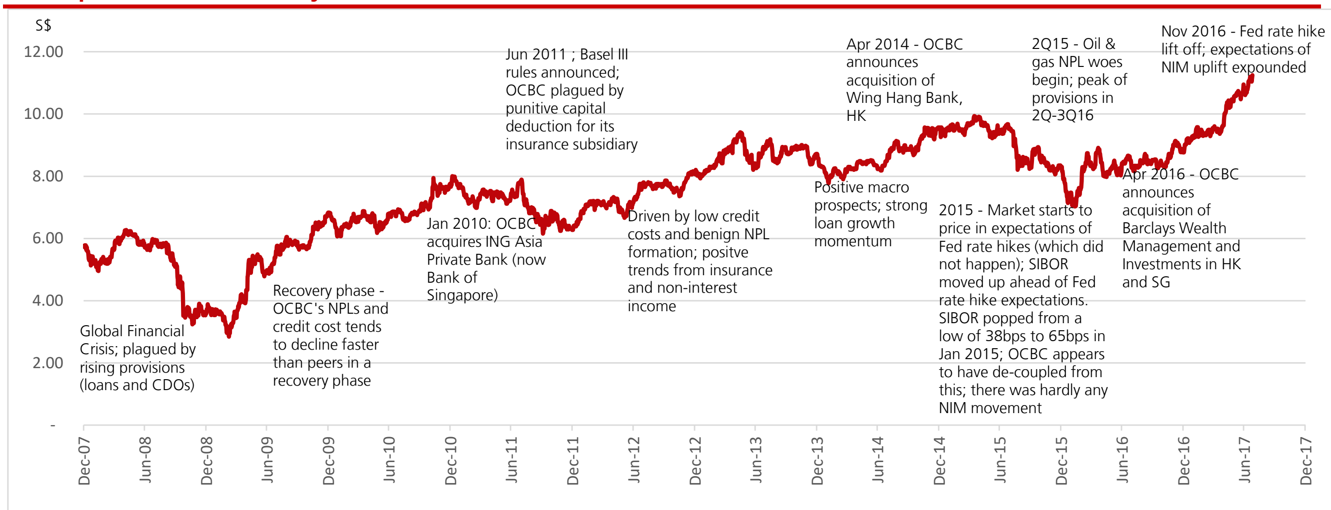
GEH's earnings as critical factor



Remarks

GEH's profit contributes approximately 20-25% of non-interest income, translating into 8-10% of OCBC's net profit. While not being directly correlated, GEH's profits do indicate OCBC's overall non-interest income trends. GEH also forms part of OCBC's wealth management offerings.

Share price movement (10-year historical trends)



Source: Bloomberg Finance L.P, DBS Bank

Balance Sheet:

Asset quality concerns a thing of the past. OCBC's NPL ratio stood at 1.5% as at end-December 2017 largely from the oil & gas segment (6% of total loans). We understand collaterals have been written down to 30% of market value. Its credit cost has stayed lower compared to peers. Despite concerns of an unsustainably low credit cost level, OCBC has successfully weathered through the storm as seen during several crises over the past ten years.

Capital ratios remain strong. OCBC halted its scrip dividend in 2Q16. It had previously used the scrip dividend to help shore up capital. Separately, while there are still some non-core assets the bank can divest, these are not large and not an immediate priority. There has been a continuous debate on whether OCBC should divest its insurance business, GEH, as it is perceived to be capital punitive once Basel III is fully enforced. But we believe that without majority control of the business, integrating it as part and parcel of its wealth management offerings would be challenging.

Share Price Drivers:

Rising interest rates lift NIM and possibly better insurance business revenues. Rising NIM and hence earnings will be key drivers to share price. Barring volatility in its insurance contribution due to accounting reasons, higher interest rates bode well for its life insurance business to build longer-term revenues. Successful credit costs and NPL containment could provide an added catalyst. Ability to demonstrate these should see the stock re-rate above its 5-year mean P/BV multiple.

Key Risks:

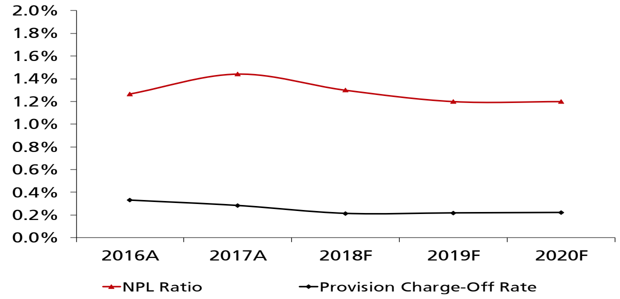
Inability to deliver NIM uplift. Expectations are rife that the Singapore banks will deliver strong NIM trends following sequential Fed rate hikes. Slower-than-expected SIBOR/SOR pass-through could upset NIM uplift trends.

Asset quality trend reversal. Banks are already on a recovery trend for their NPLs. A larger-than-expected NPL occurrence could unwind expectations of credit cost and NPL declines, posing risks to earnings.

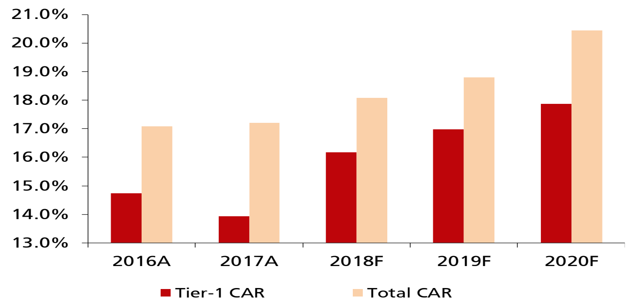
Company Background

The OCBC Bank group of businesses comprises a family of companies owned by Singapore's longest-established local bank. Its banking business franchise includes OCBC Bank, Bank OCBC NISP and Bank of Singapore, with branches in over 15 countries. OCBC has strategic stakes in other financial service businesses operating under independent brands such as Great Eastern, Bank of Singapore and Lion Global Investors.

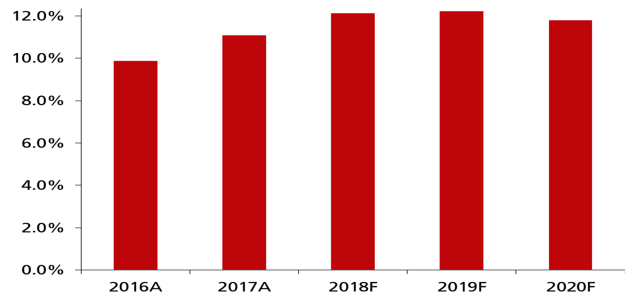
Asset Quality



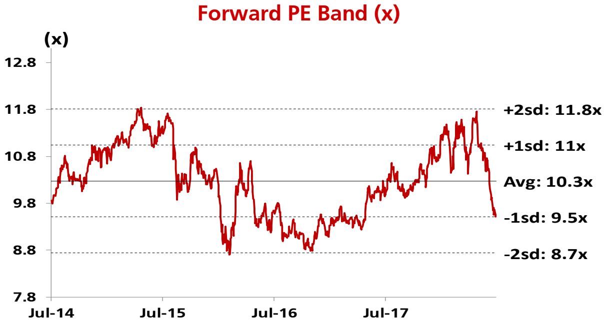
Capitalisation (%)



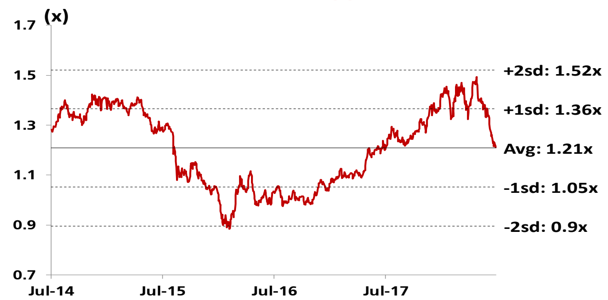
ROE (%)



Forward PE Band (x)



PB Band (x)



Source: Company, DBS Bank

Key Assumptions

FY Dec	2016A	2017A	2018F	2019F	2020F
Gross Loans Growth	4.3	7.8	6.9	5.9	5.0
Customer Deposits Growth	6.2	8.5	8.0	8.0	8.0
Yld. On Earnings Assets	2.8	2.8	2.9	3.0	3.0
Avg Cost Of Funds	1.2	1.2	1.3	1.3	1.4

Lowering loan growth assumptions

Income Statement (S$ m)

FY Dec	2016A	2017A	2018F	2019F	2020F
Net Interest Income	5,052	5,423	6,308	7,051	7,550
Non-Interest Income	3,437	4,213	4,374	4,535	4,702
Operating Income	**8,489**	**9,636**	**10,682**	**11,586**	**12,252**
Operating Expenses	(3,884)	(4,138)	(4,461)	(4,756)	(5,071)
Pre-provision Profit	**4,605**	**5,498**	**6,221**	**6,830**	**7,180**
Provisions	(726)	(671)	(542)	(585)	(625)
Associates	396	389	397	405	413
Exceptionals	0	0	0	0	0
Pre-tax Profit	**4,275**	**5,216**	**6,076**	**6,649**	**6,968**
Taxation	(629)	(803)	(913)	(1,003)	(1,045)
Minority Interests	(173)	(267)	(311)	(340)	(357)
Preference Dividend	(40)	(40)	(40)	(40)	(40)
Net Profit	**3,433**	**4,106**	**4,812**	**5,266**	**5,527**
Net Profit before Except.	3,433	4,106	4,812	5,266	5,527
Growth (%)					
Net Interest Income Gth	(2.6)	7.3	16.3	11.8	7.1
Net Profit Gth bef Except	(10.2)	19.6	17.2	9.4	5.0
Margins, Costs & Efficiency (%)					
Spread	1.6	1.6	1.5	1.6	1.6
Net Interest Margin	1.7	1.6	1.7	1.7	1.8
Cost-to-Income Ratio	45.8	42.9	41.8	41.1	41.4
Business Mix (%)					
Net Int. Inc / Opg Inc.	59.5	56.3	59.1	60.9	61.6
Non-Int. Inc / Opg inc.	40.5	43.7	40.9	39.1	38.4
Fee Inc / Opg Income	19.3	20.3	19.2	18.4	18.2
Oth Non-Int Inc/Opg Inc	21.2	23.5	21.8	20.7	20.2
Profitability (%)					
ROAE Pre Ex.	9.9	11.1	12.1	12.2	11.8
ROAE	9.9	11.1	12.1	12.2	11.8
ROA Pre Ex.	0.9	1.0	1.1	1.1	1.1
ROA	0.9	1.0	1.1	1.1	1.1

Provisions to stay relatively benign

Sustainable uplift to NIM

Source: Company, DBS Bank

Quarterly / Interim Income Statement (S$ m)

FY Dec	4Q2016	1Q2017	2Q2017	3Q2017	4Q2017
Net Interest Income	1,251	1,272	1,345	1,382	1,424
Non-Interest Income	926	977	1,053	978	1,205
Operating Income	**2,177**	**2,249**	**2,398**	**2,360**	**2,629**
Operating Expenses	(1,005)	(999)	(1,019)	(1,027)	(1,093)
Pre-Provision Profit	**1,172**	**1,250**	**1,379**	**1,333**	**1,536**
Provisions	(305)	(168)	(169)	(156)	(178)
Associates	82	114	119	127	28
Exceptionals	0	0	0	0	0
Pretax Profit	**949**	**1,196**	**1,329**	**1,304**	**1,386**
Taxation	(114)	(169)	(185)	(192)	(257)
Minority Interests	(46)	(54)	(61)	(55)	(96)
Net Profit	**789**	**973**	**1,083**	**1,057**	**1,033**
Growth (%)					
Net Interest Income Gth	1.4	1.7	5.7	2.8	3.0
Net Profit Gth	(16.3)	23.3	11.3	(2.4)	(2.3)

Balance Sheet (S$ m)

FY Dec	2016A	2017A	2018F	2019F	2020F
Cash/Bank Balance	16,559	19,594	30,633	33,084	35,731
Government Securities	24,364	27,471	28,845	30,287	31,801
Inter Bank Assets	39,801	49,377	55,008	58,188	61,016
Total Net Loans & Advs.	216,830	234,141	250,035	264,490	277,344
Investment	23,157	25,329	30,004	31,739	33,281
Associates	2,415	2,352	2,749	3,153	3,566
Fixed Assets	4,572	4,281	4,419	4,562	4,708
Goodwill	5,473	5,160	5,160	5,160	5,160
Other Assets	14,740	13,306	15,002	15,869	16,641
Life Ass Fund Inv Assets	61,973	73,927	73,927	73,927	73,927
Total Assets	**409,884**	**454,938**	**495,782**	**520,459**	**543,174**
Customer Deposits	261,486	283,642	306,333	330,840	357,307
Inter Bank Deposits	10,740	7,485	20,880	16,001	7,092
Debts/Borrowings	19,947	32,235	32,235	32,235	32,235
Others	16,107	16,045	17,268	18,304	19,186
Minorities	2,635	2,768	3,079	3,419	3,776
Shareholders' Funds	37,007	39,008	42,231	45,905	49,823
Life Ass Fund Liabs	61,962	73,755	73,755	73,755	73,755
Total Liab& S/H's Funds	**409,884**	**454,938**	**495,782**	**520,459**	**543,174**

Source: Company, DBS Bank

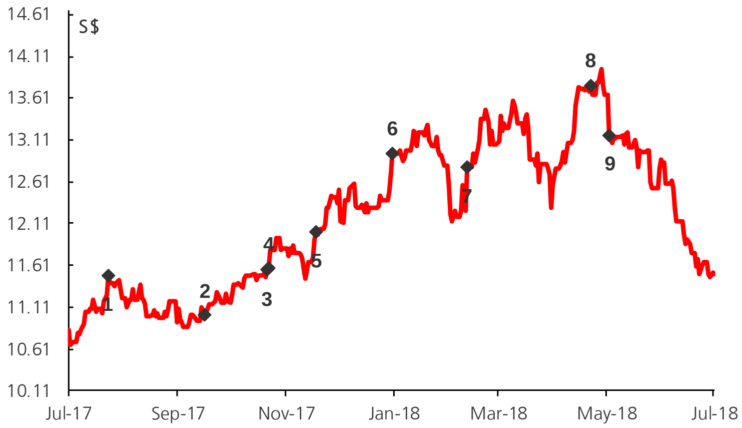
Financial Stability Measures (%)

FY Dec	2016A	2017A	2018F	2019F	2020F
Balance Sheet Structure					
Loan-to-Deposit Ratio	82.9	82.5	81.6	79.9	77.6
Net Loans / Total Assets	52.9	51.5	50.4	50.8	51.1
Investment / Total Assets	5.6	5.6	6.1	6.1	6.1
Cust . Dep./Int. Bear. Liab.	89.5	87.7	85.2	87.3	90.1
Interbank Dep / Int. Bear.	3.7	2.3	5.8	4.2	1.8
Asset Quality					
NPL / Total Gross Loans	1.3	1.4	1.3	1.2	1.2
NPL / Total Assets	0.7	0.8	0.7	0.6	0.6
Loan Loss Reserve Coverage	102.7	77.7	92.6	108.2	117.2
Provision Charge-Off Rate	0.3	0.3	0.2	0.2	0.2
Capital Strength					
Total CAR	17.1	17.2	18.1	18.8	20.4
Tier-1 CAR	14.7	13.9	16.2	17.0	17.9

Credit costs to go back to pre-provision levels

Source: Company, DBS Bank

Target Price & Ratings History



S.No.	Date of Report	Closing Price	12-mth Target Price	Rating
1:	27 Jul 17	11.49	12.80	BUY
2:	20 Sep 17	11.01	12.80	BUY
3:	25 Oct 17	11.55	12.80	BUY
4:	26 Oct 17	11.57	13.50	BUY
5:	22 Nov 17	12.01	13.50	BUY
6:	04 Jan 18	12.95	14.00	BUY
7:	15 Feb 18	12.78	14.00	BUY
8:	26 Apr 18	13.76	15.30	BUY
9:	07 May 18	13.17	15.30	BUY

***Note** : Share price and Target price are adjusted for corporate actions.*

Source: DBS Bank

Analyst: Sue Lin LIM
Rui Wen LIM

UOB

Version 15 | Bloomberg: UOB SP | Reuters: UOBH.SI

DBS Group Research . Equity

6 Jul 2018

HOLD (Downgrade from BUY)

Last Traded Price (5 Jul 2018): S$27.09 (STI : 3,256.71)
Price Target 12-mth: S$28.30 (4% upside) (Prev S$33.20)

Analyst
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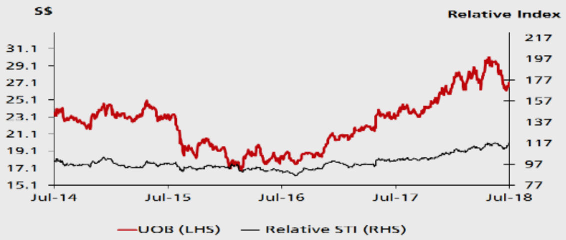
Rui Wen LIM +65 66823720 ruiwenlim@dbs.com

What's New

- Property-related loans would be affected by newly introduced cooling measures
- UOB, having the largest property-related loans exposure, may see slower than expected loans growth
- Stock price may be well-supported in the meantime as it offers c. 3.7% dividend yield; potential dividend upside may be a catalyst
- Downgrade to HOLD, TP S$28.30

Price Relative



Forecasts and Valuation

FY Dec (S$m)	2017A	2018F	2019F	2020F
Pre-prov. Profit	4,824	5,409	5,831	6,123
Net Profit	3,280	3,955	4,272	4,491
Net Pft (Pre Ex.)	3,280	3,955	4,272	4,491
Net Pft Gth (Pre-ex) (%)	9.8	20.6	8.0	5.1
EPS (S cts)	208	251	271	285
EPS Pre Ex. (S cts)	208	251	271	285
EPS Gth Pre Ex (%)	10	21	8	5
Diluted EPS (S cts)	197	238	257	270
PE Pre Ex. (X)	13.0	10.8	10.0	9.5
Net DPS (S cts)	100.0	100.0	100	100.0
Div Yield (%)	3.7	3.7	3.7	3.7
ROAE Pre Ex. (%)	10.1	11.3	11.4	11.1
ROAE (%)	10.1	11.3	11.4	11.1
ROA (%)	1.0	1.1	1.1	1.2
BV Per Share (S cts)	2,151	2,302	2,474	2,659
P/Book Value (x)	1.3	1.2	1.1	1.0
Earnings Rev (%):		(1)	(3)	(5)
Consensus EPS (S cts):		238	263	288
Other Broker Recs:		B: 16	S: 1	H: 5

Source of all data on this page: Company, DBS Bank, Bloomberg Finance L.P.

Property-related loans take a hit

Cooling measures a dampener; downgrade to HOLD. For UOB, cooling measures are set to be a dampener as it may see slower than expected loan growth arising from the recent set of property cooling measures effective 6 July 2018. UOB has the largest property-related loans exposure among the Singapore banks with its mortgage loans accounting for c.28% of total loans in 1Q18. We lower our loan growth forecast for FY18 to c.6% (previously 7.5%) on slowing demand, with earnings cuts of 1-5% through to FY2020F on lower loan growth outlook. However, we believe that NIM uptrend remains in sight alongside lower credit costs assumption of c. 25bps over FY18-20F (from 26-28bps previously). Capital levels remain strong with fully loaded CET1 ratio at 14.9% as at Mar 18. Although scrip dividends will prevail, the shares would be issued without a discount. We believe a full year dividend of S$1.00 per share is sustainable and that higher dividends are possible on its higher capital levels.

Where we differ. We believe that UOB will be more affected by the newly introduced cooling measures as it has the largest property-related loans exposure among the banks.

Potential catalyst: Sustained positive deliveries. Further improvement in NIM should support earnings strongly. Lower credit cost is a new trend for UOB and should be viewed positively. Potential dividend upside may also be a catalyst should higher dividends be effected.

Valuation:

Downgrade to HOLD, TP S$28.30. Our revised TP of S$28.30 following our earnings adjustment is based on the Gordon Growth Model (11% ROE, 3% growth and 9.4% cost of equity), equivalent to 1.3x FY18 P/BV, which is at its 10-year average P/BV multiple.

Key Risks to Our View:

Relapse in NIM and asset quality trends. A relapse in SIBOR movement could also pose risks to our NIM forecast. If NPL issues start to spread further from here, more specific provisions might be required. **In the event that trade war escalates, it might trigger further risks to loan growth.**

At A Glance

Issued Capital (m shrs)	1,670
Mkt. Cap (Sm/USm)	45,240 / 33,145
Major Shareholders (%)	
Wee Investment Pte Ltd	7.7
Wah Hin & Co Pte Ltd	5.0
Free Float (%)	87.2
3m Avg. Daily Val (US$m)	60.7
ICB Industry : Financials / Banks	

CRITICAL DATA POINTS TO WATCH

Critical Factors

Lowering loan growth against rising NIM. Our FY18-19F loan growth forecast is now lowered to 5-6% p.a. from 7-8% as we expect the new cooling measures to impact UOB's large portion of property-related loans. Meanwhile, we expect UOB's NIM to rise by 9bps in FY18F and another 5bps in FY19F, taking into account some element of competition. Our sensitivity analysis indicates that for every additional 25 bps increase in SIBOR, UOB's NIM will rise by 1bp, holding other variables constant, and this would lead to a further 1.1% uplift to earnings. We note that UOB's S$ loan-to-deposit ratio remains the highest among peers and that itself could pressure S$ funding cost; S$ deposits forms close to half of UOB's total deposit base.

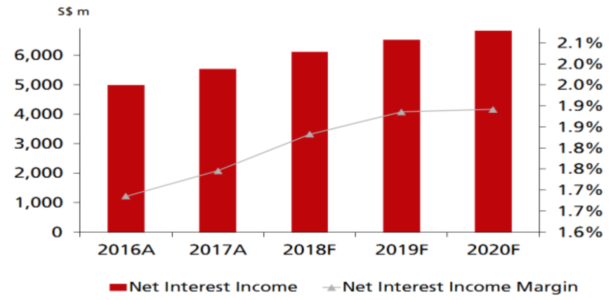
Non-interest income driven more by loan activities. Contrary to peers, UOB's non-interest income focuses more on loan activities, which is its core business. While there is increasing traction from wealth management income, it remains small vs peers. Fee income should be consumer-business driven from credit cards and private banking rather than from capital markets. UOB's wealth management business continues to pick up albeit makes up a smaller proportion of non-interest income vs its peers.

Costs skewed to business growth. We expect operating expenses to stay high with costs skewed towards business expansion and technology which is required particularly for digital banking and cyber security. Other investments to further enhance regional operations are still ongoing but the increase should not be high. Cost-to-income ratio may ease with stronger revenue growth amid its tight cost control strategies despite having to invest to grow its business but the target is 40% over the longer term. We forecast a 44% cost-to-income ratio in FY18F.

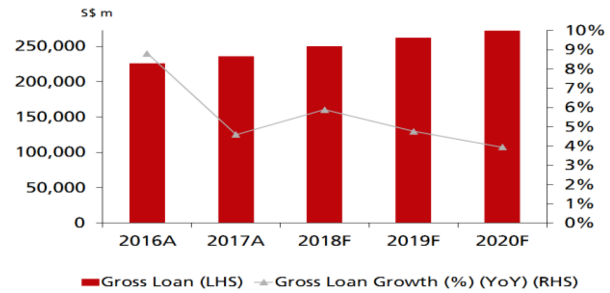
Expect lower credit costs; reversal in trends with IFRS9. Compared to peers, UOB's credit costs tend to hover at higher levels largely due to its conservative stance towards setting aside higher general provisions (1.2% of total loans). With IFRS9 implemented, banks will no longer be allowed to build general provision buffers. This is a new positive for UOB. Management is guiding for 20-25bps credit cost at the moment. We are assuming 25bps credit cost over FY18-20F (previously 26-28bps), which is at the higher end of guidance.

Regionalisation remains core to UOB's strategy. UOB's regionalisation agenda remains intact. The bank is relooking at its operations in Indonesia, given the current challenging operating environment. In Malaysia, growth remains cautious but asset quality is at a comfortable position. Its Thai operations remain small, while its Greater China operations are still smaller than peers. UOB has not been aggressively acquiring to add new revenue streams but has chosen to grow organically.

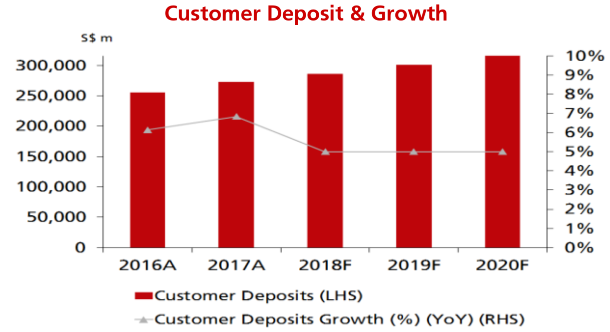
Margin Trends



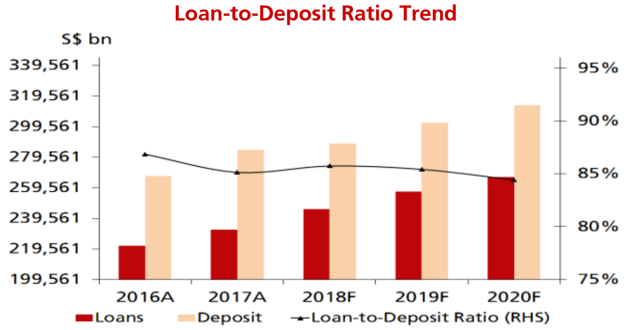
Gross Loan& Growth



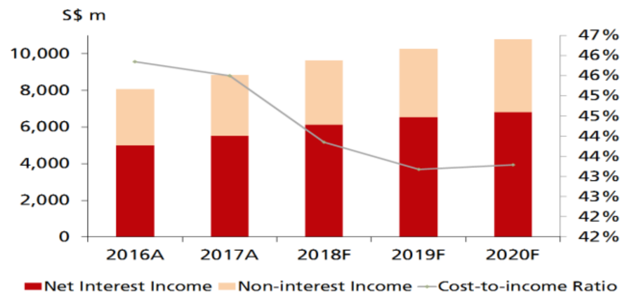
Customer Deposit & Growth



Loan-to-Deposit Ratio Trend



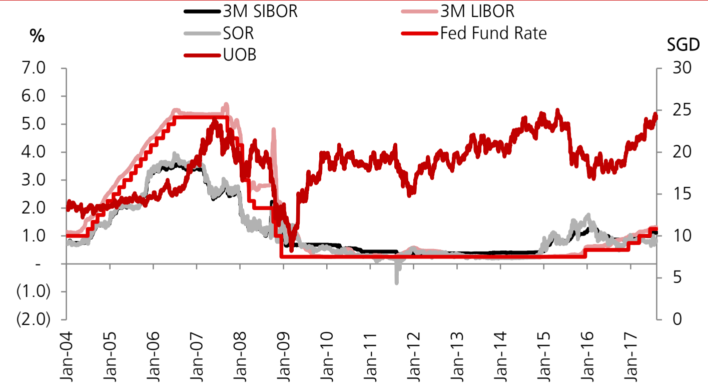
Cost & Income Structure



Source: Company, DBS Bank

Appendix 1: A look at Company's listed history – what drives its share price?

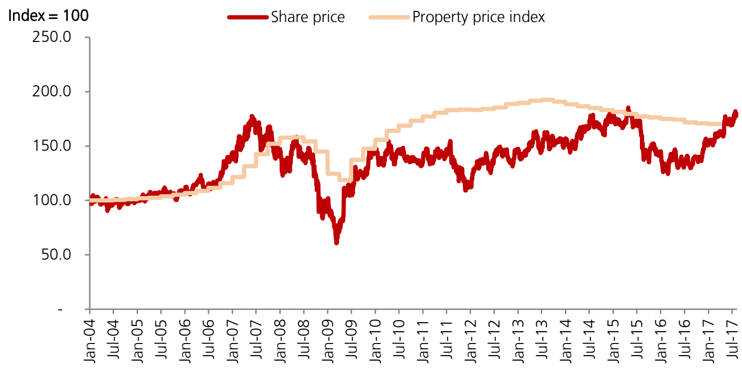
Interest rates as critical factor



Remarks

Interest rates, particularly SIBOR, are linked to loan pricing and hence NIM, which in turn drives earnings and share price performance. The Fed rate hikes, which should lead to SIBOR uplift, has been 60% correlated historically. The relationship has somewhat broken down since late 2016 due to the relative strength of the SGD. Nevertheless, expectations of Fed rate hikes, which are expected to pass through to SIBOR, do have a positive correlation to banks' share prices.

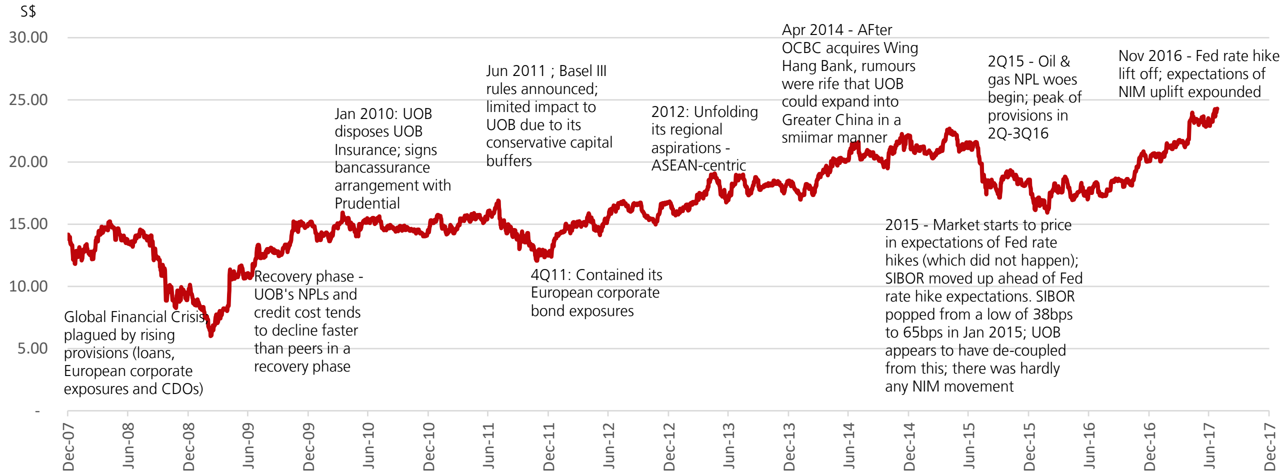
Property price index as critical factor



Remarks

UOB has the largest proportion of its loans related to mortgages, at 27% of total loans. Inclusive of building and construction loans at another 23%, UOB's total property-related loans make up 50% of total loans. Historically, UOB's share price has been correlating well with the property price index. The deviation in 2017 is due to the stronger influence of interest rate movements (the critical factor highlighted above).

Share price movement (10-year historical trends)



Source: Bloomberg Finance L.P, DBS Bank

Balance Sheet:

Asset quality concerns are a thing of the past. UOB's NPL ratio is higher vs peers, sitting at 1.8% as at end-Dec 2017. Issues pertaining to the oil & gas exposure have largely been taken care of. UOB's exposure to oil & gas comprises 5% of total loans while other commodity segments make up another 3%. Collectively, these account for 8% of total loans. These accounts are mostly secured; hence the impact on P/L should be limited. UOB is the only bank that has disclosed that it has taken a 70-80% haircut to the value of its oil & gas collateral. Other commodity segments include metal, mining and agriculture. There is little concern on these.

Strong capital position. Its CET1 ratio's comfort zone is 12.5%. We expect absolute DPS to be sustainable at S$1.00. UOB will likely keep its scrip dividend programme but new shares will be issued without a discount. The take-up of its scrip dividend has been relatively low. With its strong capital position (fully loaded CET1 ratio at 14.7% as at end Dec 2017), we would not discount a further uplift in dividends going forward.

Share Price Drivers:

Strong property market recovery met with cooling measures. The strong property market recovery from 2017 to 2018 has met with cooling measures. UOB's share price may be affected as it is seen as the proxy to the property market, having the largest proportion of property-related loans vs peers.

Sustained NIM. With asset quality issues largely to be dealt with by end-FY17, all eyes are on topline growth. With a sustained SOR/SIBOR uptrend, NIM uplift is here to stay. Sustained strong loan growth also adds to a boost in net interest income, though we believe it might be dampened should the cooling measures successfully arrest the strong property market recovery.

Key Risks:

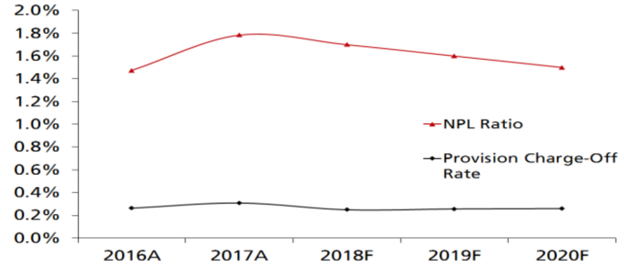
NIM trend reversal. Hopes on NIM improvement could dissipate if SIBOR/SOR movements turn south from here. NIM movements are more sensitive to earnings compared to loan growth. If NIM trends stop improving, earnings growth would be at risk.

Asset quality upsets. While unlikely at this juncture, any NPL formation above the normal levels of S$300-400m could upset trends and raise provisions, which could lead to earnings disappointment.

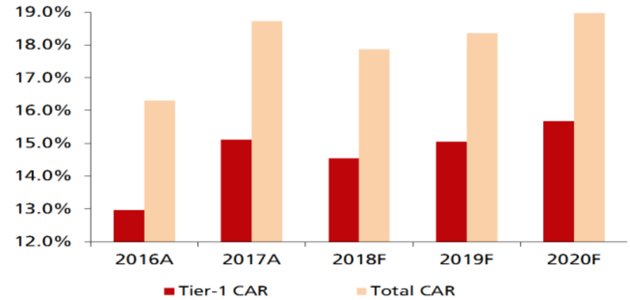
Company Background

UOB provides a wide range of financial services through its global network of branches, offices, subsidiaries and associates: personal financial services, private banking, commercial and corporate banking, investment banking, corporate finance, capital market activities, treasury services, futures broking, asset management, venture capital management, insurance and stockbroking services.

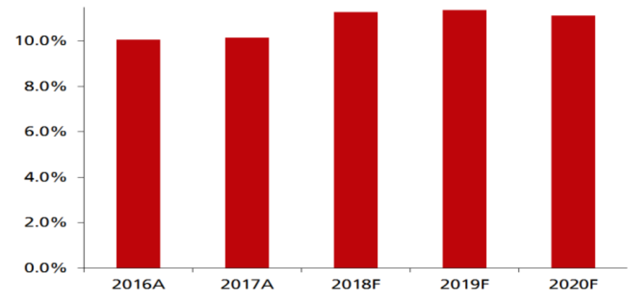
Asset Quality



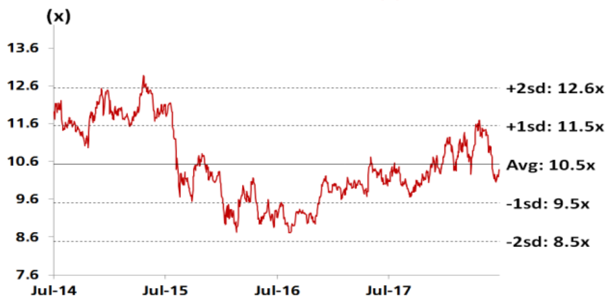
Capitalisation (%)



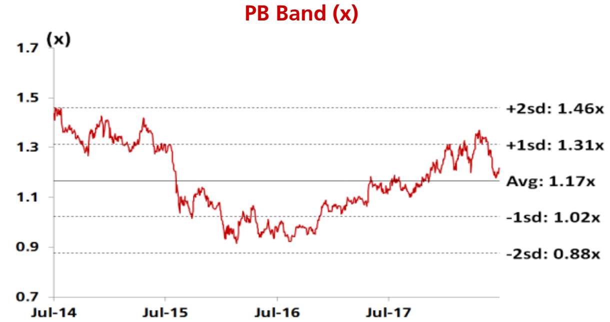
ROE (%)



Forward PE Band (x)



PB Band (x)



Source: Company, DBS Bank

Key Assumptions

FY Dec	2016A	2017A	2018F	2019F	2020F
Gross Loans Growth	8.8	4.6	5.9	4.8	3.9
Customer Deposits Growth	6.1	6.8	5.0	5.0	5.0
Yld. On Earnings Assets	2.8	2.9	3.0	3.0	3.0
Avg Cost Of Funds	1.2	1.2	1.2	1.2	1.2

Lowered loan growth assumptions

Income Statement (S$m)

FY Dec	2016A	2017A	2018F	2019F	2020F
Net Interest Income	4,991	5,528	6,109	6,521	6,823
Non-Interest Income	3,071	3,323	3,523	3,741	3,974
Operating Income	**8,061**	**8,851**	**9,633**	**10,262**	**10,796**
Operating Expenses	(3,696)	(4,027)	(4,224)	(4,431)	(4,673)
Pre-provision Profit	**4,365**	**4,824**	**5,409**	**5,831**	**6,123**
Provisions	(593)	(727)	(621)	(671)	(705)
Associates	6.00	110	129	139	145
Exceptionals	0.0	0.0	0.0	0.0	0.0
Pre-tax Profit	**3,778**	**4,207**	**4,916**	**5,298**	**5,563**
Taxation	(669)	(800)	(836)	(901)	(946)
Minority Interests	(12.0)	(16.0)	(14.8)	(15.9)	(16.7)
Preference Dividend	(110)	(110)	(110)	(110)	(110)
Net Profit	**2,986**	**3,280**	**3,955**	**4,272**	**4,491**
Net Profit bef Except	2,987	3,281	3,955	4,272	4,491
Growth (%)					
Net Interest Income Gth	1.3	10.8	10.5	6.7	4.6
Net Profit Gth	(3.6)	9.8	20.6	8.0	5.1
Margins, Costs & Efficiency (%)					
Spread	1.7	1.7	1.8	1.8	1.8
Net Interest Margin	1.7	1.8	1.9	1.9	1.9
Cost-to-Income Ratio	45.9	45.5	43.9	43.2	43.3
Business Mix (%)					
Net Int. Inc / Opg Inc.	61.9	62.5	63.4	63.5	63.2
Non-Int. Inc / Opg inc.	38.1	37.5	36.6	36.5	36.8
Fee Inc / Opg Income	24.0	24.4	23.9	24.0	24.4
Oth Non-Int Inc/Opg Inc	14.1	13.1	12.6	12.4	12.4
Profitability (%)					
ROAE Pre Ex.	10.1	10.1	11.3	11.4	11.1
ROAE	10.1	10.1	11.3	11.4	11.1
ROA Pre Ex.	0.9	1.0	1.1	1.1	1.2
ROA	0.9	1.0	1.1	1.1	1.2

Source: Company, DBS Bank

Lower provisions from FY18F in the absence of general provision buffers

NIM uptrend intact with rate hike expectations

Quarterly / Interim Income Statement (S$m)

FY Dec	4Q2016	1Q2017	2Q2017	3Q2017	4Q2017
Net Interest Income	1,276	1,303	1,355	1,408	1,460
Non-Interest Income	752	819	828	829	846
Operating Income	**2,028**	**2,123**	**2,184**	**2,238**	**2,307**
Operating Expenses	(957)	(957)	(995)	(973)	(1,102)
Pre-Provision Profit	**1,071**	**1,166**	**1,189**	**1,265**	**1,205**
Provisions	(131)	(187)	(180)	(221)	(140)
Associates	(21.0)	34.0	24.0	29.0	22.0
Exceptionals	0.0	0.0	0.0	0.0	0.0
Pretax Profit	**919**	**1,013**	**1,033**	**1,073**	**1,087**
Taxation	(177)	(203)	(184)	(187)	(226)
Minority Interests	(3.0)	(3.0)	(4.0)	(3.0)	(6.0)
Net Profit	**739**	**807**	**845**	**883**	**855**
Growth (%)					
Net Interest Income Gth	3.7	2.1	4.0	3.9	3.7
Net Profit Gth	(6.5)	9.2	4.8	4.4	(3.2)

Balance Sheet (S$m)

FY Dec	2016A	2017A	2018F	2019F	2020F
Cash/Bank Balance	24,322	26,625	34,368	36,087	37,891
Government Securities	17,515	15,976	16,775	17,614	18,494
Inter Bank Assets	40,033	52,181	36,832	38,530	39,983
Total Net Loans & Advs.	221,734	232,212	245,549	256,866	266,554
Investment	14,767	13,039	14,132	14,790	15,372
Associates	1,109	1,194	1,323	1,461	1,607
Fixed Assets	2,990	1,971	1,823	1,667	1,667
Goodwill	4,151	4,142	4,142	4,142	4,142
Other Assets	13,407	11,252	19,644	20,549	21,324
Total Assets	**340,028**	**358,592**	**374,587**	**391,706**	**407,035**
Customer Deposits	255,314	272,765	286,403	300,723	315,760
Inter Bank Deposits	11,855	11,440	2,011	1,109	(2,367)
Debts/Borrowings	26,143	25,178	25,178	25,178	25,178
Others	13,674	12,172	21,562	22,550	23,385
Minorities	169	187	202	218	234
Shareholders' Funds	32,873	36,850	39,231	41,928	44,845
Total Liab& S/H's Funds	**340,028**	**358,592**	**374,587**	**391,706**	**407,035**

Source: Company, DBS Bank

Financial Stability Measures (%)

FY Dec	2016A	2017A	2018F	2019F	2020F
Balance Sheet Structure					
Loan-to-Deposit Ratio	86.8	85.1	85.7	85.4	84.4
Net Loans / Total Assets	65.2	64.8	65.6	65.6	65.5
Investment / Total Assets	4.3	3.6	3.8	3.8	3.8
Cust . Dep./Int. Bear. Liab.	87.0	88.2	91.3	92.0	93.3
Interbank Dep / Int. Bear.	4.0	3.7	0.6	0.3	(0.7)
Asset Quality					
NPL / Total Gross Loans	1.5	1.8	1.7	1.6	1.5
NPL / Total Assets	1.0	1.2	1.1	1.1	1.0
Loan Loss Reserve Coverage	118.0	90.6	102.9	118.7	137.5
Provision Charge-Off Rate	0.3	0.3	0.2	0.3	0.3
Capital Strength					
Total CAR	16.3	18.7	17.9	18.4	19.0
Tier-1 CAR	13.0	15.1	14.5	15.1	15.7

Strong capital levels could hint towards higher dividends

Source: Company, DBS Bank

Target Price & Ratings History

***Note**: Share price and Target price are adjusted for corporate actions.*

S.No.	Date of Report	Closing Price	12-mth Target Price	Rating
1:	28 Jul 17	24.05	24.80	HOLD
2:	24 Oct 17	24.25	26.90	BUY
3:	03 Nov 17	24.77	27.50	BUY
4:	22 Nov 17	25.77	27.50	BUY
5:	04 Jan 18	27.02	29.50	BUY
6:	15 Feb 18	27.04	29.50	BUY
7:	26 Apr 18	29.39	33.20	BUY
8:	03 May 18	29.58	33.20	BUY

Source: DBS Bank
Analyst: Sue Lin LIM
Rui Wen LIM

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STRONG BUY (>20% total return over the next 3 months, with identifiable share price catalysts within this time frame)
BUY (>15% total return over the next 12 months for small caps, >10% for large caps)
HOLD (-10% to +15% total return over the next 12 months for small caps, -10% to +10% for large caps)
FULLY VALUED (negative total return i.e. > -10% over the next 12 months)
SELL (negative total return of > -20% over the next 3 months, with identifiable catalysts within this time frame)

Share price appreciation + dividends

Completed Date: 6 Jul 2018 07:00:57 (SGT)
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