

Singapore Industry Focus

Singapore Banks

Refer to important disclosures at the end of this report

DBS Group Research . Equity

17 Mar 2020

Pressured by Fed's rate cut

- Fed announced 100bps rate cut; Net Interest Margin (NIM) to see more downside; further trim OCBC and UOB's NIM forecasts by another 5-8bps
- Raised credit costs further by 4-9bps through FY21F as increased travel restrictions will likely push recovery of global travel and consumption further out
- Dividends may be reduced on lower earnings
- Maintain HOLD on OCBC and UOB with reduced TP pegged to c.0.8x FY20F P/BV (-2SD below 10 year average)

Net interest margin (NIM) to see more downside from here; further trim OCBC and UOB's NIM by another 6-8bps. Following Fed's second emergency rate cut of 100bps with Fed funds target at 0-0.25%, back at the zerobound, where it was at the 2008 global financial crisis, we believe NIMs could see more downside from here. As a result, we further trim OCBC and UOB's NIM forecasts by another 5-8bps in FY20F to reflect lower cost of deposits which is unlikely to offset loan yields.

Raised credit costs further by 4-9bps through FY21F as increased travel restrictions will likely push recovery of global travel and consumption further out. Our revised assumptions brings OCBC and UOB's credit costs to 36bps and 33bps respectively, as we believe a deteriorating macroeconomic environment will see increased general provisions on top of specific provisions. Supply chain disruptions has evolved to be more a global than a regional one. While governments across the world are putting on emergency measures to arrest the COVID-19 situation, we believe increased travel restrictions could push recovery of global travel and consumption further out, on top of worsening domestic economy outlooks. We continue to be watchful for further downside risks.

Reduced earnings by 6-8% through FY21F on lower NIMs and higher credit costs; assumed dividends will be reduced on lower earnings. Given the headwinds expected on earnings due lower NIMs and higher credit costs, we now assume lower dividends on reduced earnings. We expect UOB to minimally pay S\$1.10 DPS (FY2019's base dividend level) and OCBC to continue paying c.50% of its underlying profit, which translates into c.\$0.48 DPS based on our estimates, representing c.5.5-5.7% dividend yield at current levels.

Maintain HOLD on OCBC and UOB with reduced TPs. Singapore banks have corrected 20-28% since start of the year. We maintain HOLD call at current prices, given the uncertain macroeconomic outlook and near-zero interest rates environment. We derive OCBC and UOB's revised TPs of S\$8.60 and S\$19, at c.0.8x FY20F P/BV, 2SD below its average 10-year forward P/BV multiple. Assuming GFC trough valuation of 0.7x P/BV, UOB and OCBC would work out to S\$17.40 and S\$7.80, respectively.

STI : 2,634.00

Analyst

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STOCKS

	Price S\$	Mkt Cap US\$m	12-mth		Rating
			Target Price S\$	Performance (%) 3 mth 12 mth	
DBS	18.58	33,540	n.a.	(27.7) (26.1)	NR
OCBC Bank	8.70	27,061	8.60	(20.3) (21.8)	HOLD
UOB	19.45	22,934	19.00	(26.4) (22.9)	HOLD

Source: DBS Bank, Bloomberg Finance L.P.

Closing price as of 16 Mar 2020



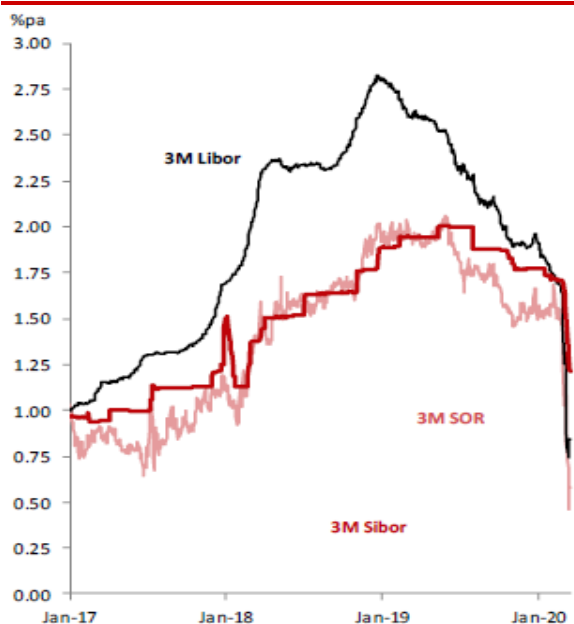
Live more, Bank less

Page 1

Further downside for 3MSIBOR. DBS Group Research economists believe that short-term SGD rates are likely to follow short-term USD rates lower, following Fed’s cut to zero. SGD interest rates are less susceptible to changes in MAS policy. Instead, the global issues – such as COVID-19, trade war and Brexit – have a much larger impact on USDSGD as well as SGD rates. Flush liquidity will cap a lid on SGD rates. DBS Group Research’s 3MSIBOR projections currently stand at 0.40% by 4Q20 (13 Mar 20: 1.22%).

More room for NIM to decline. We believe that NIM will decline as loan yields reprice on a lower benchmark rate, though repricing may not be immediate. Against a slower growth backdrop, we believe loan yields may continue to compress due to flight to quality loans. We further trim OCBC and UOB’s NIM forecasts by another 5-8bps in FY20F to reflect lower cost of deposits which is unlikely to offset loan yields. NIM sensitivity: Every 10bps decline in NIM has 6-8% impact on net profit. Our sensitivity analysis indicates that every 25- bp decline in interest rates that reprices the S\$, HK\$ and US\$ books collectively would result in NIM decline of c.1-3bps with a corresponding 1.0-2.5% decline in net profit across the Singapore banks.

3M LIBOR v 3M SIBOR v 3M SOR downtrend



Source: Bloomberg Finance L.P., DBS Bank

Worsened COVID-19 situation raises risks to asset quality. Since the start of March, COVID-19 situation globally has taken a turn for the worse. We believe the newly imposed travel restrictions by various countries, and recession fears, will further push out the recovery path for travel and consumption. There are heightened risks of third and fourth order impact to economy, in terms of unemployment risks and mortgages, on top of the first and second order impact to freight and other directly-hit industries such as hospitality and travel, aviation, tourism, retail, food and beverage, entertainment, on top of supply chain impacts. Higher than expected credit costs would translate into downside earnings risks; based on our sensitivity analysis, every 5bps uptick in credit costs may impact sector earnings by c.3%.

Singapore banks corrected 20-28% since Jan-20, valuations approaching/at -2SD low; limited catalysts ahead. Singapore banks have corrected 20-28% since Jan-20 and current valuations of the banks (see next page) are approaching/at -2SD levels (forward P/B), largely pricing in a substantial part of the negative outlook. With our estimates reduced, coupled with lower dividends, at current levels, OCBC and UOB still trades at c.5.5% dividend yield, which could provide some support to share prices

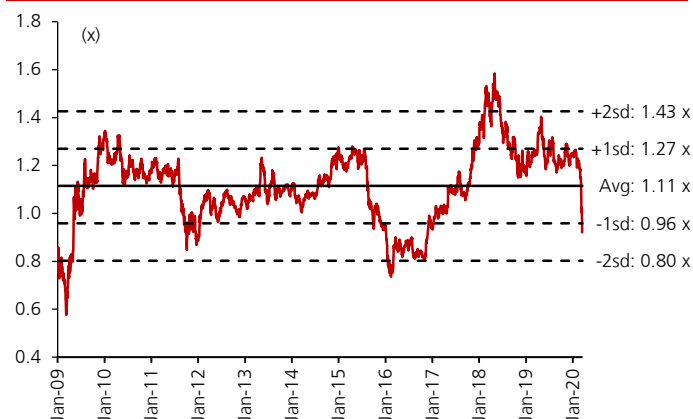
We derive OCBC and UOB’s revised TPs of S\$8.60 and S\$19, at c.0.8x FY20F P/BV, 2SD below its average 10-year forward P/BV multiple. Taking reference from Global Financial Crisis (GFC) trough valuation, at c.0.7x P/BV, the implied share prices are c.S\$7.80 and S\$17.40 respectively, representing c.10% downside from current prices. We believe there are limited catalysts for Singapore banks for now, given the current zero-rate environment, heightened risks to asset quality and volatile markets, though the above trough levels (at GFC) could be key levels to watch for, on assumption that the situation do not deteriorate further.

Singapore banks: Valuation range

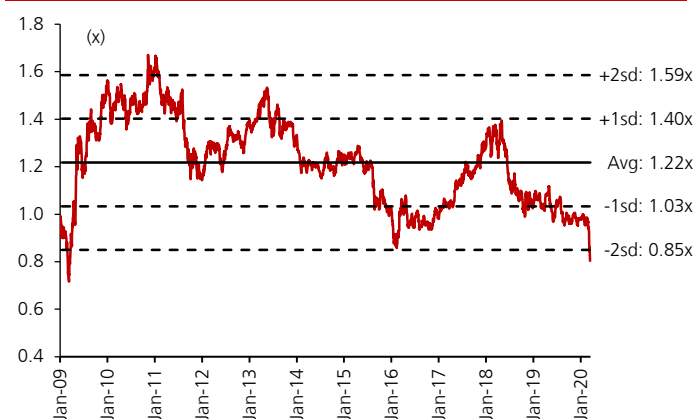
	Trough	-2 S.D.	-1 S.D.	Mean
DBS	0.58	0.80	0.96	1.11
OCBC	0.72	0.85	1.03	1.22
UOB	0.73	0.84	1.01	1.19

Source: Thomson Reuters, DBS Bank

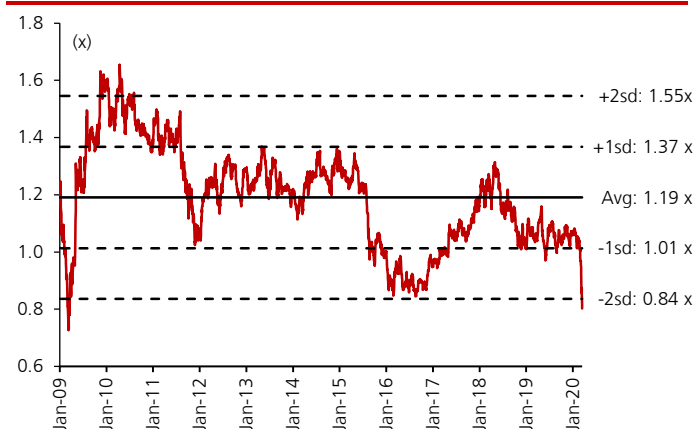
DBS: Rolling forward P/BV band



OCBC: Rolling forward P/BV band



UOB: Rolling forward P/BV band



Singapore Banks: Rolling forward P/BV band



Singapore Banks: Rolling forward P/E band



Source: Companies, Thomson Reuters Datastream, DBS Bank (Closing price as of 13 Mar 2020)

Singapore Banks: Peer Valuations

	Market cap (US\$m)	Price (\$\$/s)	Target Price (\$\$/s)	Rating	PE (x) FY19A	FY20F	CAGR [^] (%)	PBV (x) FY19A	FY20F	ROE (%) FY20F	Net div (%) FY20F
DBS	33,540	18.58	NA	NA	7.5x	8.3x	1%	1.0x	0.9x	11.6%	6.5%
OCBC	27,061	8.70	8.60	HOLD	7.9x	9.0x	-2%	0.8x	0.8x	8.8%	5.5%
UOB	22,934	19.45	19.00	HOLD	7.5x	8.8x	-2%	0.8x	0.8x	9.1%	5.7%
Simple average					7.6x	8.7x		0.9x	0.8x	10.4%	5.9%
Weighted average					7.6x	8.7x		0.8x	0.8x	10.7%	5.9%

[^] Refers to 2-year EPS CAGR for FY18-20F * Based on Bloomberg consensus
Source: Companies, Bloomberg Finance L.P., DBS Bank (Closing price as of 16 Mar 2020)

Singapore Company Guide

OCBC

Version 23 | Bloomberg: OCBC SP | Reuters: OCBC.SI

Refer to important disclosures at the end of this report

DBS Group Research . Equity

17 Mar 2020

HOLD

Last Traded Price (16 Mar 2020): S\$8.70 (STI : 2,495.77)
 Price Target 12-mth: S\$8.60 (1% downside) (Prev S\$11.00)

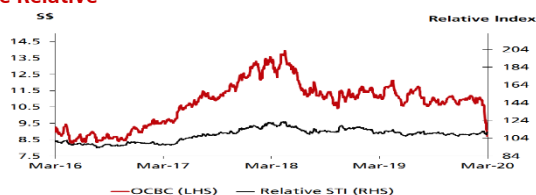
Analyst

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What's New

- Further pressures on NIM following Fed's 100-bp interest rate cut
- Cut NIM by c.8bps and increased credit costs of c.6bps results in negative earnings revision of c.8%
- Dividends may be reduced in FY20F due to earnings decline; expect 48 Scts DPS which represents 5.5% dividend yield at current price
- Maintain HOLD with revised TP of S\$8.60

Price Relative



Forecasts and Valuation

FY Dec (S\$ m)	2019A	2020F	2021F	2022F
Pre-prov. Profit	6,124	5,741	5,929	6,170
Net Profit	4,869	4,241	4,517	4,811
Net Pft (Pre Ex.)	4,869	4,241	4,517	4,811
Net Pft Gth (Pre-ex) (%)	8.4	(12.9)	6.5	6.5
EPS (S cts)	110	96.2	102	109
EPS Pre Ex. (S cts)	110	96.2	102	109
EPS Gth Pre Ex (%)	4	(13)	7	7
Diluted EPS (S cts)	110	96.2	102	109
PE Pre Ex. (X)	7.9	9.0	8.5	8.0
Net DPS (S cts)	53.0	48.0	51.0	54.0
Div Yield (%)	6.1	5.5	5.9	6.2
ROAE Pre Ex. (%)	11.0	8.8	9.0	9.1
ROAE (%)	11.0	8.8	9.0	9.1
ROA (%)	1.0	0.9	0.9	0.9
BV Per Share (S cts)	1,070	1,118	1,169	1,225
P/Book Value (x)	0.8	0.8	0.7	0.7
Earnings Rev (%)		(8)	(6)	(6)
Consensus EPS (S cts)		104.2	110.9	120.0
Other Broker Recs:		B: 10	S: 1	H: 6

Source of all data on this page: Company, DBS Bank, Thomson Reuters

Double whammy

Maintain HOLD, revised TP of S\$8.60. The Federal Reserve announced another 100-bp interest rate cut in an emergency move on 15 Mar 2020. We believe that there is further NIM downside for OCBC on the back of Hong Kong rate cut following Fed cut, as well as expected decline in SIBOR. We further revised FY20F NIM assumptions by c.-8bps. Together with increased credit costs assumptions of c.6bps to 36bps, this results in negative earnings revision of c.8%, with FY20F NIM and credit costs at 1.63% and 36bps respectively. We believe that absolute DPS will be reduced in FY20F due to earnings decline expected in FY20F.

We maintain our HOLD call with revised TP of S\$8.60 as we believe there are limited catalysts for the stock currently amidst the zero-rate environment. We continue to remain watchful for downside risks in credit costs, given that recovery of travel and consumption is likely to be pushed further out amidst current efforts to contain COVID-19 across the world. During the GFC, OCBC trades at c.0.7x P/BV implying c.S\$7.80 and could be interesting level to watch for, assuming the situation do not deteriorate further.

Where we differ: We remain cautious over OCBC's SME books across the region, in the face of a potential regional slowdown amidst the ongoing COVID-19 situation and Hong Kong protests. Our revised earnings are below consensus.

Potential catalysts: Sustained business momentum. OCBC currently trades at c.0.8x FY20F P/BV, 2SD below its average 10-year forward P/BV multiple. We believe sustained business momentum and broader recovery in macroeconomic sentiments should catalyse the share price.

Valuation:

Maintain HOLD; TP at S\$8.60. Our revised S\$8.60 TP is pegged to c.0.8x FY20F P/BV, which is at 10-year -2SD forward P/BV multiple. Current dividend yield is at c.5.5%, after our revised DPS assumption. Should the macroeconomic outlook continue to worsen, our bear case TP based on 2008 global financial crisis trough of c.0.7x P/BV multiple is c.\$7.80.

Key Risks to Our View:

Worsened asset quality. Supply chain disruptions arising from COVID-19 situation, ongoing Hong Kong protests, and further escalation of trade war may subject some companies to vulnerability. Should asset quality deteriorate, more specific provisions might be required, posing risks to earnings.

At A Glance

Issued Capital (m shrs)	4,401
Mkt. Cap (S\$m/US\$m)	39,917 / 28,212
Major Shareholders (%)	
Selat Pte Ltd	10.5
Free Float (%)	89.5
3m Avg. Daily Val (US\$m)	44.2
GIC Industry : Financial / Banks	



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OCBC

CRITICAL DATA POINTS TO WATCH

Critical Factors

NIM pressures ahead. In 4Q19, average 3MSIBOR declined c.12bps (3Q19: c. 5-bp decline) q-o-q as 3MLIBOR declined 27bps q-o-q (3Q19: 31-bp decline). We believe that loan yields will continue to decline on a lower reference rate. As economies in its key markets continue to slow, we believe net interest income growth will soften as loan growth weakens amidst NIM pressures.

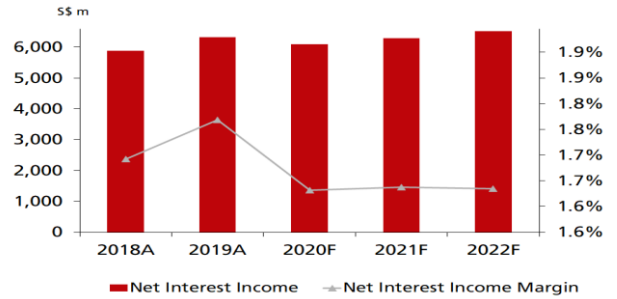
Non-interest income drivers remain its key differentiator, especially wealth management and insurance. OCBC differentiates itself from peers in terms of its non-interest income composition. Its focus is on growing its non-interest income franchise, especially its wealth management business.

The bank's insurance business via c.88%-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 the latter remains complementary to its non-interest income franchise. Management believes it is still logical and beneficial to keep the insurance product manufacturing in-house. GEH tends to exhibit earnings volatility due to fluctuations in 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.

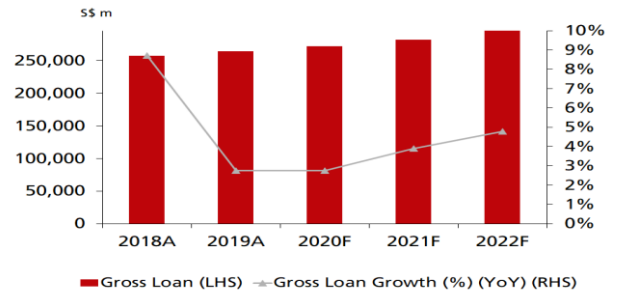
Since the acquisition of Bank of Singapore in 2010, its wealth management income has been growing steadily; and this trend is expected to be sustainable. The acquisition of the wealth and investment business of Barclays Bank in Singapore and Hong Kong, completed in Dec 2016, added US\$13bn to OCBC's 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. The bank has a track record of over 80 years in Malaysia, and its added advantage lies in its Islamic banking franchise. Elsewhere, 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.

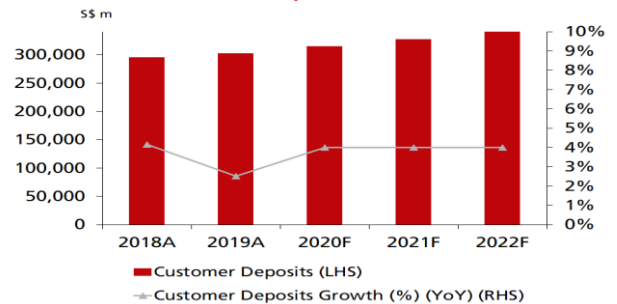
Margin Trends



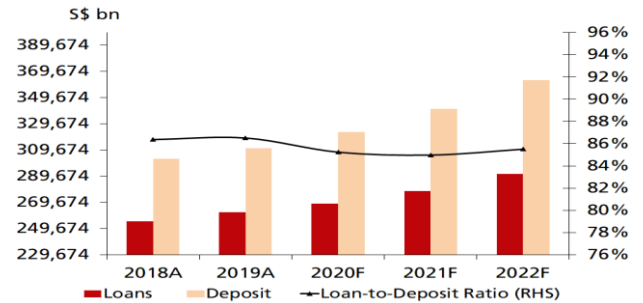
Gross Loan & Growth



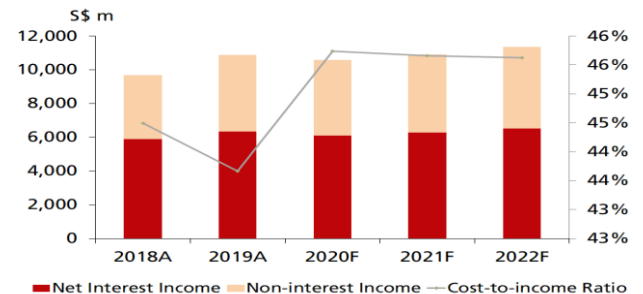
Customer Deposit & Growth



Loan-to-Deposit Ratio Trend



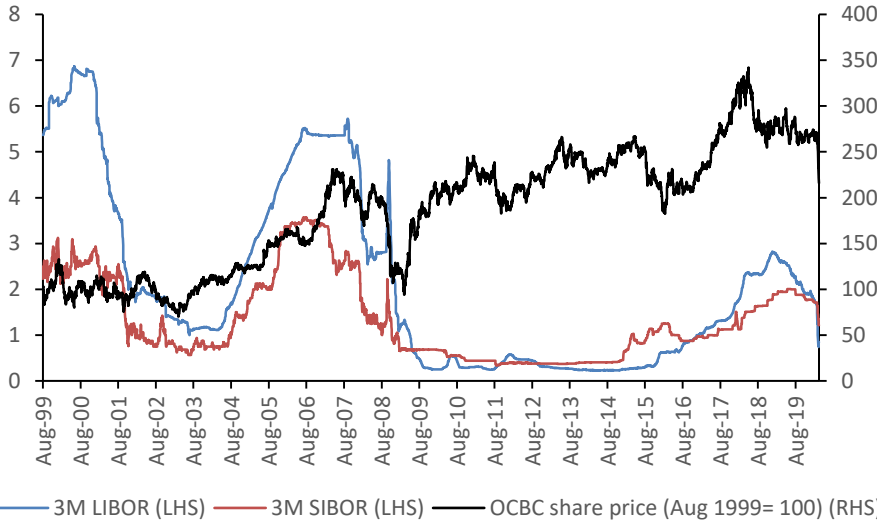
Cost & Income Structure



Source: Company, DBS Bank

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

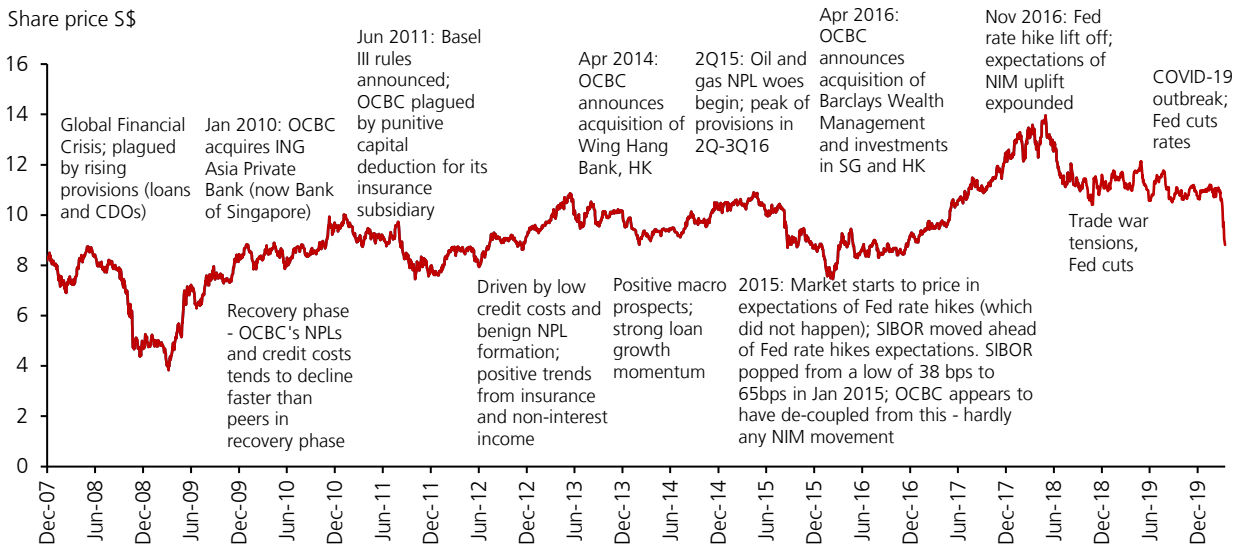
Interest rates as critical factor



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. As 3MSIBOR and 3MLIBOR have both declined from its peak, we expect NIM pressures to kick in, weighing on interest income growth.

Share price movement (10-year historical trends)



Source: Bloomberg Finance L.P., DBS Bank

OCBC

Balance Sheet:

Keep watch on asset quality. OCBC’s NPL ratio stood at 1.5% as at 4Q19. Over the last four quarters, OCBC has written special provisions for various stand-alone exposures. We remain cautious over OCBC’s exposure as the bank has larger SME-related exposure in Hong Kong compared to its peers.

Capital ratios strong, CET1 ratio highest among peers. OCBC reintroduced its scrip dividend scheme in FY18 after halting it in 2Q16, 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, in this event, without majority control of the business, integrating it as part and parcel of its wealth management offerings could be more challenging. We believe there is room for OCBC to raise its dividend payout ratio to be more in line with peers, while management has indicated the need for capital amid volatile markets and for market opportunities.

Share Price Drivers:

Sustained ROE improvement. OCBC’s ROE for FY19 was 11.4%, compared to 11.5% in FY18. Successful credit cost and NPL containment could provide an added catalyst. Ability to demonstrate these, coupled with higher dividend payout ratio, will continue to drive OCBC’s share price. OCBC has indicated a steady state CIR target of c.40% as it continues to manage costs into FY20F.

Key Risks:

Global slowdown; recession risks. A recession in Singapore, worse-than-expected macro indicators and a weaker macroeconomic outlook arising from COVID-19 infections, downside risks from US-China trade tensions, could temper our loan growth expectations. A sharper-than-expected slowdown in the Singapore property market will cause mortgage books to shrink faster.

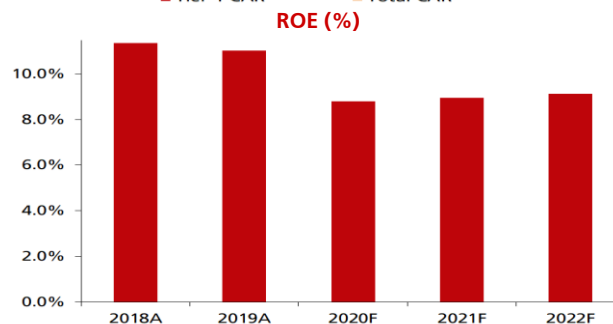
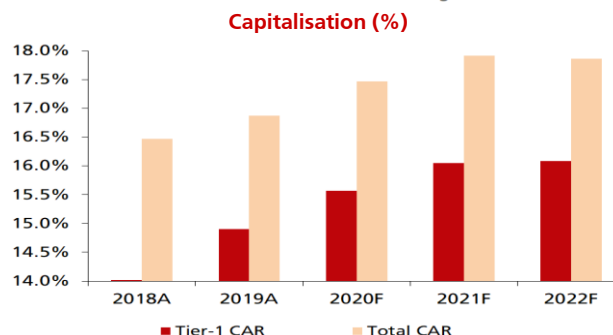
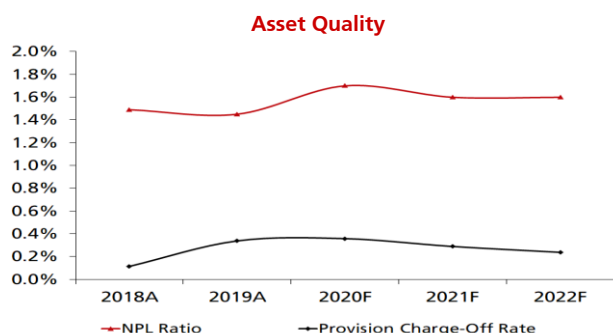
Asset quality trend reversal. Supply chain disruptions arising from COVID-19 situation, ongoing Hong Kong protests, and further escalation of trade war may subject some companies to vulnerability. Should asset quality deteriorate, more specific provisions might be required, posing risks to earnings.

Environment, Social, Governance:

In FY18, OCBC developed a Sustainability Framework, reinforcing the bank’s vision for sustainability. OCBC continues to implement its sustainability framework and monitors the progress via its KPIs.

Company Background

The OCBC Bank group of businesses (OCBC) comprises a family of companies owned by Singapore’s longest-established local bank.



Source: Company, DBS Bank

OCBC

Key Assumptions

FY Dec	2018A	2019A	2020F	2021F	2022F
Gross Loans Growth	8.7	2.7	2.8	3.9	4.8
Customer Deposits Growth	4.1	2.5	4.0	4.0	4.0
Yld. On Earnings Assets	3.2	3.4	3.0	2.9	2.9
Avg Cost Of Funds	1.6	1.7	1.4	1.4	1.3

Income Statement (\$\$ m)

FY Dec	2018A	2019A	2020F	2021F	2022F
Net Interest Income	5,890	6,331	6,099	6,285	6,517
Non-Interest Income	3,811	4,540	4,482	4,626	4,830
Operating Income	9,701	10,871	10,581	10,911	11,347
Operating Expenses	(4,316)	(4,747)	(4,840)	(4,982)	(5,177)
Pre-provision Profit	5,385	6,124	5,741	5,929	6,170
Provisions	(288)	(890)	(970)	(812)	(698)
Associates	455	566	583	600	618
Exceptionals	0	0	0	0	0
Pre-tax Profit	5,552	5,800	5,354	5,717	6,090
Taxation	(877)	(778)	(846)	(915)	(974)
Minority Interests	(183)	(153)	(268)	(286)	(304)
Preference Dividend	0	0	0	0	0
Net Profit	4,492	4,869	4,241	4,517	4,811
Net Profit before Except.	4,492	4,869	4,241	4,517	4,811
Growth (%)					
Net Interest Income Gth	8.6	7.5	(3.7)	3.1	3.7
Net Profit Gth bef Except	11.2	8.4	(12.9)	6.5	6.5
Margins, Costs & Efficiency (%)					
Spread	1.6	1.7	1.5	1.6	1.6
Net Interest Margin	1.7	1.8	1.6	1.6	1.6
Cost-to-Income Ratio	44.5	43.7	45.7	45.7	45.6
Business Mix (%)					
Net Int. Inc / Opg Inc.	60.7	58.2	57.6	57.6	57.4
Non-Int. Inc / Opg inc.	39.3	41.8	42.4	42.4	42.6
Fee Inc / Opg Income	20.9	19.5	20.8	21.3	21.6
Oth Non-Int Inc/Opg Inc	18.3	22.2	21.6	21.1	20.9
Profitability (%)					
ROAE Pre Ex.	11.4	11.0	8.8	9.0	9.1
ROAE	11.4	11.0	8.8	9.0	9.1
ROA Pre Ex.	1.0	1.0	0.9	0.9	0.9
ROA	1.0	1.0	0.9	0.9	0.9

Higher provisions expected

NIM to decline

Source: Company, DBS Bank

OCBC

Quarterly / Interim Income Statement (\$\$ m)

FY Dec	4Q2018	1Q2019	2Q2019	3Q2019	4Q2019
Net Interest Income	1,520	1,534	1,588	1,600	1,610
Non-Interest Income	830	1,142	1,030	1,055	1,312
Operating Income	2,350	2,676	2,618	2,655	2,922
Operating Expenses	(1,104)	(1,120)	(1,177)	(1,158)	(1,292)
Pre-Provision Profit	1,246	1,556	1,441	1,497	1,630
Provisions	(205)	(249)	(111)	(323)	(207)
Associates	85	170	146	156	94
Exceptionals	0	0	0	0	0
Pretax Profit	1,126	1,477	1,476	1,330	1,517
Taxation	(171)	(195)	(224)	(139)	(220)
Minority Interests	(29)	(51)	(29)	(19)	(54)
Net Profit	926	1,231	1,223	1,172	1,243

Growth (%)

Net Interest Income Gth	1.0	0.9	3.5	0.8	0.6
Net Profit Gth	(25.6)	32.9	(0.6)	(4.2)	6.1

Balance Sheet (\$\$ m)

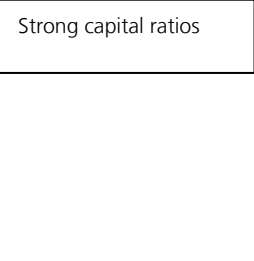
FY Dec	2018A	2019A	2020F	2021F	2022F
Cash/Bank Balance	18,748	23,201	24,129	25,094	26,098
Government Securities	27,776	28,662	28,662	28,662	28,662
Inter Bank Assets	39,035	35,813	34,908	36,193	37,875
Total Net Loans & Adv.	255,193	262,045	268,524	278,409	291,350
Investment	25,542	28,533	29,239	30,315	31,724
Associates	3,183	3,638	4,221	4,821	5,440
Fixed Assets	4,217	4,467	4,690	4,925	5,171
Goodwill	5,093	4,980	5,160	5,160	5,160
Other Assets	11,889	13,014	13,336	13,827	14,469
Life Ass Fund Inv Assets	76,867	87,338	93,452	99,993	106,993
Total Assets	467,543	491,691	506,321	527,399	552,942
Customer Deposits	295,412	302,851	314,965	327,564	340,666
Inter Bank Deposits	7,576	8,250	8,297	13,515	22,324
Debts/Borrowings	30,272	29,388	29,388	29,388	29,388
Others	15,963	18,153	18,229	18,938	19,835
Minorities	1,255	1,441	1,709	1,995	2,299
Shareholders' Funds	42,137	47,162	49,287	51,554	53,984
Life Ass Fund Liabs	74,928	84,446	84,446	84,446	84,446
Total Liab& S/H's Funds	467,543	491,691	506,321	527,399	552,942

Source: Company, DBS Bank

OCBC

Financial Stability Measures (%)

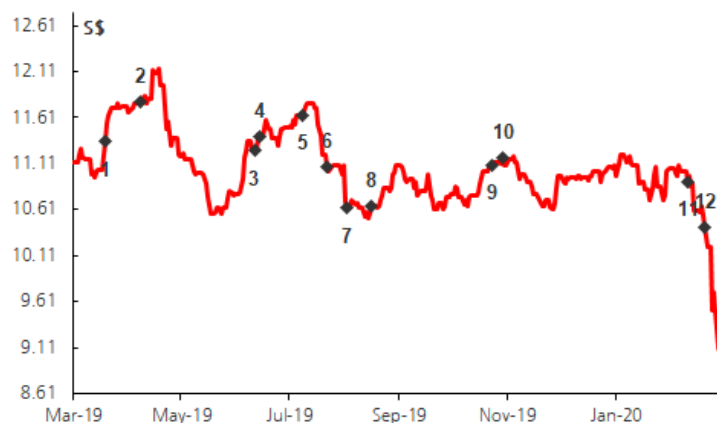
FY Dec	2018A	2019A	2020F	2021F	2022F
Balance Sheet Structure					
Loan-to-Deposit Ratio	86.4	86.5	85.3	85.0	85.5
Net Loans / Total Assets	54.6	53.3	53.0	52.8	52.7
Investment / Total Assets	5.5	5.8	5.8	5.7	5.7
Cust . Dep./Int. Bear. Liab.	88.6	88.9	89.3	88.4	86.8
Interbank Dep / Int. Bear.	2.3	2.4	2.4	3.6	5.7
Asset Quality					
NPL / Total Gross Loans	1.5	1.5	1.7	1.6	1.6
NPL / Total Assets	0.8	0.8	0.9	0.9	0.9
Loan Loss Reserve Coverage	57.4	63.2	70.2	86.5	94.1
Provision Charge-Off Rate	0.1	0.3	0.4	0.3	0.2
Capital Strength					
Total CAR	16.5	16.9	17.5	17.9	17.9
Tier-1 CAR	14.0	14.9	15.6	16.0	16.1



Strong capital ratios

Source: Company, DBS Bank

Target Price & Ratings History



S.No.	Date of Report	Closing Price	12-mth Target Price	Rating
1:	02 Apr 19	11.35	12.90	BUY
2:	22 Apr 19	11.78	12.90	BUY
3:	25 Jun 19	11.25	11.50	HOLD
4:	28 Jun 19	11.40	11.50	HOLD
5:	22 Jul 19	11.64	11.50	HOLD
6:	05 Aug 19	11.08	11.50	HOLD
7:	16 Aug 19	10.63	11.50	HOLD
8:	30 Aug 19	10.65	11.50	HOLD
9:	06 Nov 19	11.10	11.50	HOLD
10:	12 Nov 19	11.17	11.50	HOLD
11:	24 Feb 20	10.92	11.50	HOLD
12:	05 Mar 20	10.42	11.00	HOLD

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

Source: DBS Bank

Analyst: Rui Wen LIM

Singapore Company Guide

UOB

Version 24 | Bloomberg: UOB SP | Reuters: UOBH.SI

Refer to important disclosures at the end of this report

DBS Group Research . Equity

17 Mar 2020

HOLD

Last Traded Price (16 Mar 2020): S\$19.45 (STI : 2,495.77)
Price Target 12-mth: S\$19.00 (2% downside) (Prev S\$25.50)

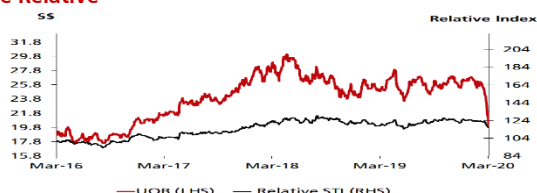
Analyst

Rui Wen LIM +65 66823720 ruiwenlim@dbs.com

What's New

- Further pressures on NIM following Fed's 100-bp interest rate cut
- Cut NIM by a further c.5bps and increased credit costs of c.7bps results in negative earnings revision of c.8%
- Dividends may be reduced in FY20F due to earnings decline; expected 110 Scts DPS (FY2019's base dividends) in FY20F which represents c.5.5% dividend yield at current price
- Maintain HOLD with revised TP of S\$19

Price Relative



Forecasts and Valuation

FY Dec (\$m)	2019A	2020F	2021F	2022F
Pre-prov. Profit	5,558	5,179	5,402	5,763
Net Profit	4,343	3,688	3,954	4,234
Net Pft (Pre Ex.)	4,343	3,688	3,954	4,234
Net Pft Gth (Pre-ex) (%)	8.4	(15.1)	7.2	7.1
EPS (S cts)	260	221	237	254
EPS Pre Ex. (S cts)	260	221	237	254
EPS Gth Pre Ex (%)	8	(15)	7	7
Diluted EPS (S cts)	258	219	235	252
PE Pre Ex. (X)	7.5	8.8	8.2	7.7
Net DPS (S cts)	130	111	116	123
Div Yield (%)	6.7	5.7	6.0	6.3
ROAE Pre Ex. (%)	11.2	9.1	9.3	9.5
ROAE (%)	11.2	9.1	9.3	9.5
ROA (%)	1.1	0.9	0.9	1.0
BV Per Share (S cts)	2,376	2,486	2,607	2,738
P/Book Value (x)	0.8	0.8	0.7	0.7
Earnings Rev (%):		(8)	(8)	(10)
Consensus EPS (S cts):		236	254	281
Other Broker Recs:		B: 8	S: 1	H: 7

Source of all data on this page: Company, DBS Bank, Thomson Reuters

Earnings shaved on lower NIM, higher credit costs

Maintain HOLD, revised TP of S\$19. The Federal Reserve announced another 100-bp interest rate cut in an emergency move on 15 Mar 2020. We believe that there is further NIM downside following the surprise Fed cut which will also impact SIBOR. We further trim our NIM assumptions by 5bps to 1.66% (FY19: 1.78%). Together with increased credit costs assumptions of c.7bps to 33bps, this results in negative earnings revision of c.8% along with lower absolute DPS in FY20F.

We maintain our HOLD call with revised TP of S\$19 as we believe there are limited catalysts for the stock currently amidst the zero-rate environment. We continue to remain watchful for downside risks in credit costs, given that recovery of travel and consumption is likely to be pushed further out amidst current efforts to contain COVID-19 across the world. During the GFC, UOB trades at c.0.7x P/BV or S\$17.40, an interesting level to watch for, assuming the situation do not deteriorate further.

Where we differ: We remain cautious over the impact of asset quality on UOB's books, given the current COVID-19 situation. Our revised earnings are below consensus.

Potential catalyst: Sustained positive deliveries. Lower-than-expected credit costs could drive earnings. Sustained ROE improvement will continue to drive UOB's share price.

Valuation:

Maintain HOLD, revised TP of S\$19. Our revised S\$19 TP is pegged to c.0.8x FY20F P/BV, which is at 10-year -2SD forward P/BV multiple. Current dividend yield is at c.5.5%.

Key Risks to Our View:

Worsened asset quality. Supply chain disruptions arising from COVID-19 situation, ongoing Hong Kong protests, further escalation of trade war may subject some companies to vulnerability. Should asset quality deteriorate, more specific provisions might be required, posing risks to earnings.

At A Glance

Issued Capital (m shrs)	1,668
Mkt. Cap (\$m/US\$m)	33,600 / 23,747
Major Shareholders (%)	
Wee Investment Pte Ltd	7.9
Wah Hin & Co Pte Ltd	5.1
Free Float (%)	87.0
3m Avg. Daily Val (US\$m)	55.0
GIC Industry : Financial / Banks	



Live more, Bank less
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UOB

CRITICAL DATA POINTS TO WATCH

Critical Factors

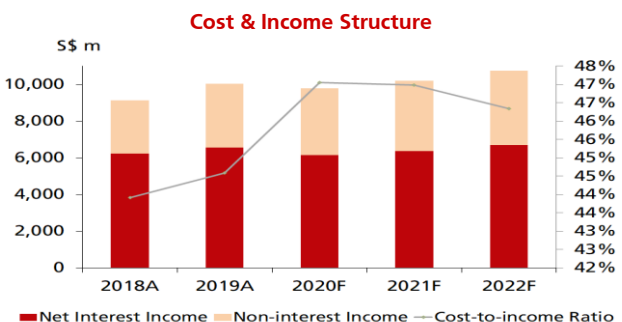
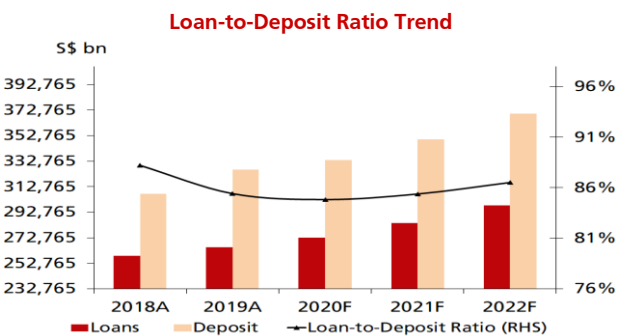
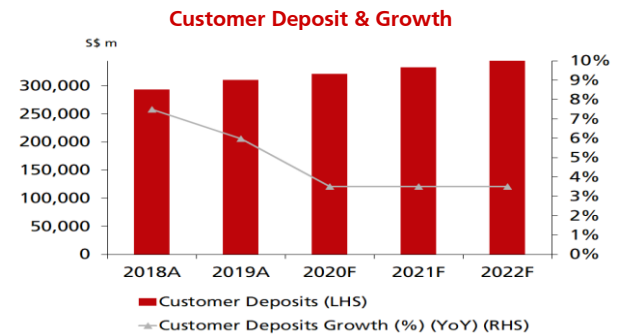
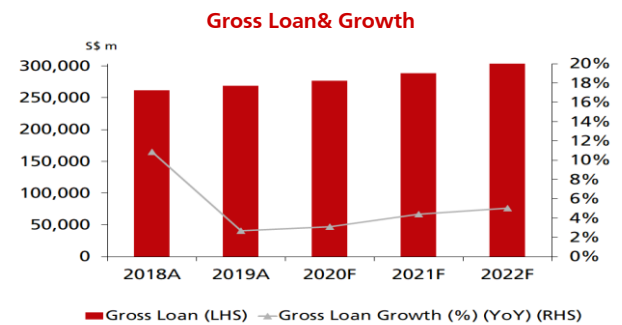
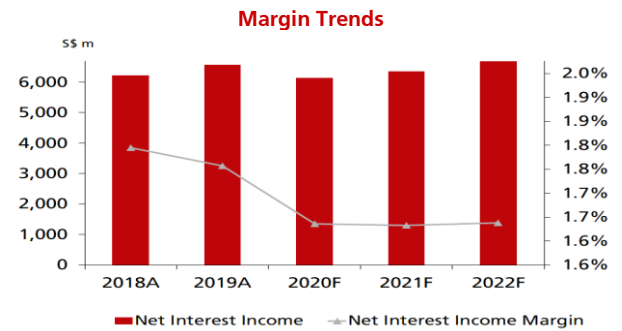
NIM pressures ahead. While loan growth is expected to still be at a high single digit in FY19 against a strong loan pipeline, higher than that of peers, we expect loan growth to show signs of slowdown into FY20F. In 4Q19, average 3MSIBOR declined c.12bps q-o-q (3Q19: c.5-bp decline) as 3MLIBOR declined 27bps q-o-q (3Q19: 31-bp decline). We believe that loan yields will continue to decline on a lower reference rate.

Non-interest income driven more by loan activities. Contrary to peers, UOB's non-interest income is focused 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. While UOB's wealth management business makes up a smaller proportion of non-interest income vs its peers, the bank has increasingly built up its wealth AUM which currently stands at S\$127bn (4Q19), of which ~61% comes from overseas customers.

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 businesses, but the target is 40% over the longer term. We forecast a higher c.45% cost-to-income ratio for FY20F due to lower expected revenues.

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. With its existing strong regional franchise within ASEAN and Greater China, and continued focus to tap intra-regional flows, UOB has a target to grow ex-Singapore revenues to ~50% (currently ~40%) by 2021. Currently, close to 40% of UOB's operating profit is derived outside of Singapore, primarily ASEAN and Greater China. UOB has opened its second branch in Vietnam in Jun 19 as testament to its efforts to grow its regional network.

Digital banking adds to its regionalisation strategy. UOB has announced its Digital Bank efforts for ASEAN's "mobile first" and "mobile only" customers in Singapore, Malaysia, Indonesia, Thailand and Vietnam as part of its efforts to scale up its regional franchise over the next few years. Its digital-only bank, TMRW, has since been launched in Thailand and has achieved reasonable success. UOB's end goal in its Digital Bank agenda would be to establish itself in five markets and have 3-5m customers with a steady-state CIR of ~35% as it seeks to serve the mobile-first and mobile-only generation. UOB plans to launch its digital bank in a second country, after TMRW's initial launch in Thailand.

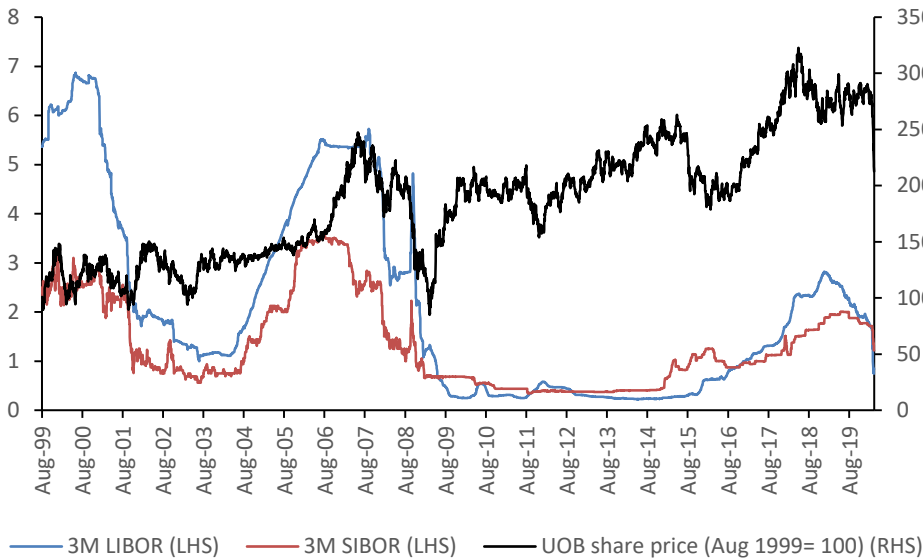


Source: Company, DBS Bank

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

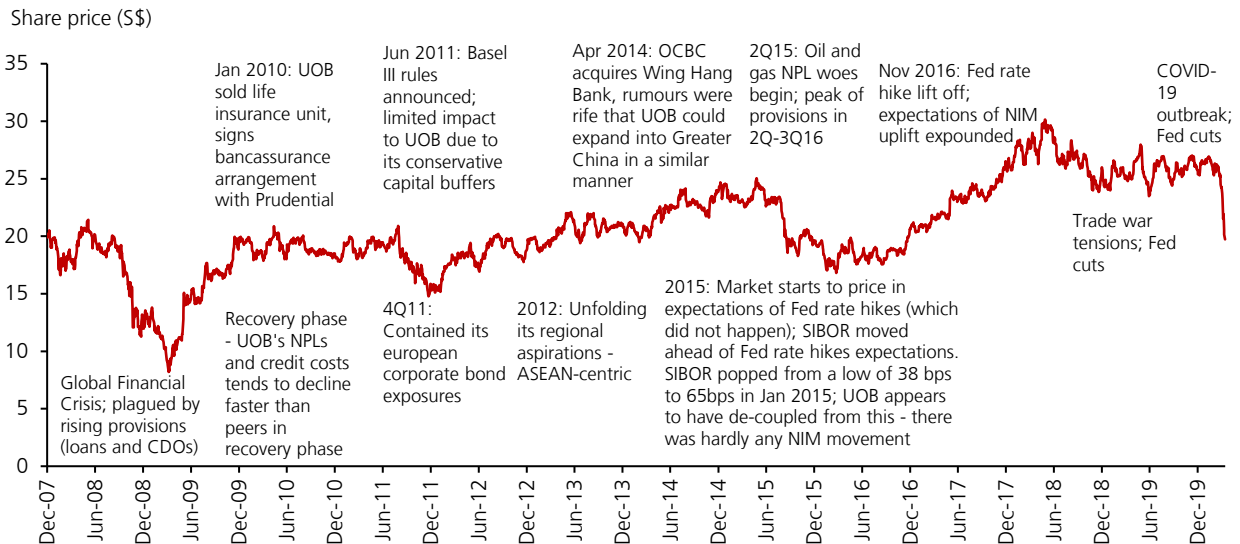
Interest rates as critical factor

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. As 3MSIBOR and 3MLIBOR have both declined from its peak, we expect NIM pressures to kick in, weighing on interest income growth.

Share price movement (10-year historical trends)



Source: Bloomberg Finance L.P., DBS Bank

UOB

Balance Sheet:

Keep watch on asset quality. While issues pertaining to the oil & gas exposure have largely been taken care of, we continue to keep watch on UOB's asset quality, especially in the SME space as higher credit costs could be indicators of an acceleration in economic slowdown. UOB had in the past built up general provisions as a prudent measure, but is no longer able to do so under IFRS9.

Strong capital position. Its CET1 ratio's comfort zone is 13.5% and UOB announced the suspension of its scrip dividend programme together with its 2Q18 results. With its strong capital position (CET1 ratio of 14.3% as at end-Dec 2019), we believe a sustained dividend payout of at least S\$1.30/share through FY19F will provide support to its share price.

Share Price Drivers:

Sustained ROE improvement. UOB's ROE for 9M19 was 11.9%, improving from FY18's 11.3%, on the back of strong net interest income and non-interest income growth on top of its efforts to digitalise internal processes to boost revenues. Sustained ROE improvement will continue to drive UOB's share price.

Key Risks:

Global slowdown; recession risks. A technical recession in Singapore, breakdown in US-China trade talks, disappointing macro indicators and a less firm macroeconomic outlook going forward could temper our loan growth expectations, though we argue that several large infrastructure projects in the pipeline would support loan growth. Although loan growth is less sensitive to earnings, any deceleration as a result of weaker sentiment would dent top-line prospects. A sharper-than-expected slowdown in the Singapore property market will cause mortgage books to shrink faster.

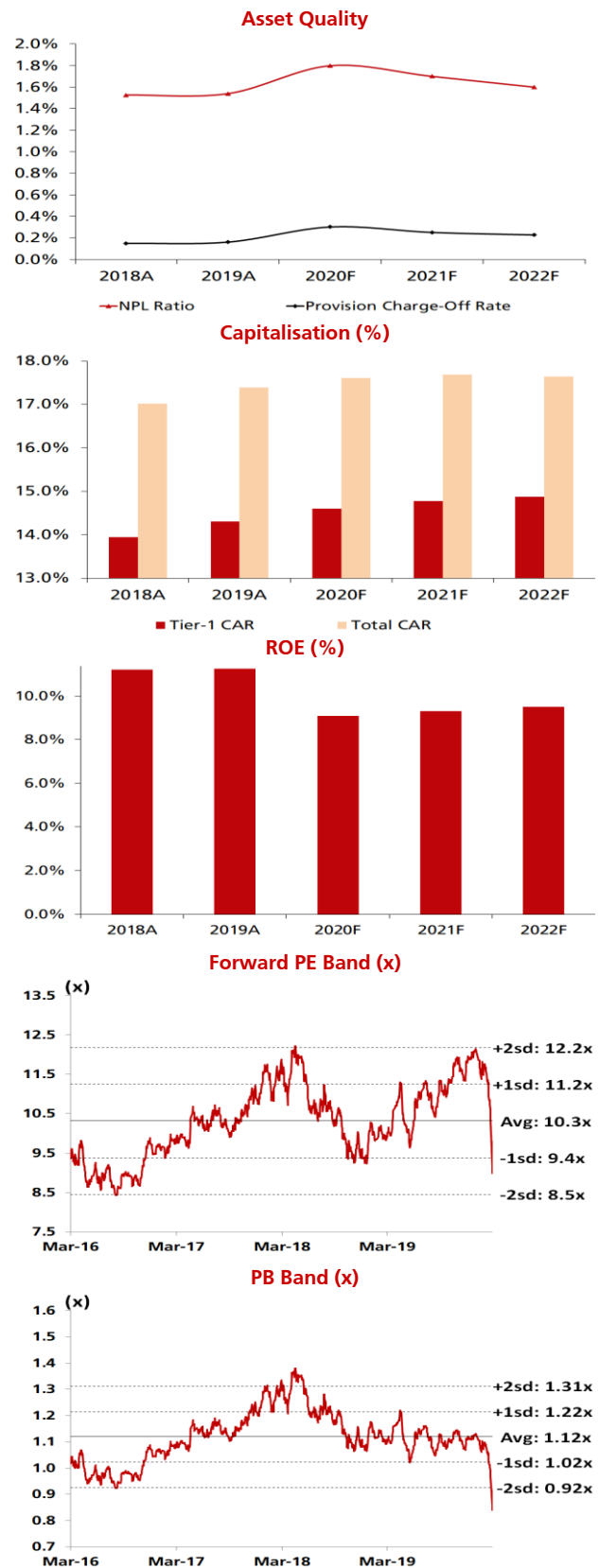
Worsening asset quality. Supply chain disruptions arising from COVID-19 situation, ongoing Hong Kong protests, and further escalation of trade war may subject some companies to vulnerability. Should asset quality deteriorate, more specific provisions might be required, posing risks to earnings.

Environment, Social, Governance:

In FY18, UOB issued its third annual report which included Global Reporting Initiative (GRI) disclosures, highlighting the group's sustainability efforts. UOB continues to sustain growth responsibly and has integrated its Responsible Financing Policy into its business model.

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.



Source: Company, DBS Bank

UOB

Key Assumptions

FY Dec	2018A	2019A	2020F	2021F	2022F
Gross Loans Growth	10.9	2.7	3.1	4.4	5.0
Customer Deposits Growth	7.5	6.0	3.5	3.5	3.5
Yld. On Earnings Assets	3.3	3.4	3.1	3.0	3.0
Avg Cost Of Funds	1.5	1.7	1.4	1.4	1.4

Income Statement (\$m)

FY Dec	2018A	2019A	2020F	2021F	2022F
Net Interest Income	6,220	6,562	6,133	6,352	6,689
Non-Interest Income	2,896	3,468	3,648	3,836	4,051
Operating Income	9,116	10,030	9,780	10,188	10,740
Operating Expenses	(4,003)	(4,472)	(4,602)	(4,786)	(4,977)
Pre-provision Profit	5,113	5,558	5,179	5,402	5,763
Provisions	(393)	(435)	(838)	(728)	(694)
Associates	106	51.0	51.0	51.0	51.0
Exceptionals	0.0	0.0	0.0	0.0	0.0
Pre-tax Profit	4,826	5,174	4,391	4,724	5,119
Taxation	(805)	(813)	(690)	(756)	(870)
Minority Interests	(13.0)	(18.0)	(13.2)	(14.2)	(15.4)
Preference Dividend	0.0	0.0	0.0	0.0	0.0
Net Profit	4,008	4,343	3,688	3,954	4,234
Net Profit bef Except	4,008	4,343	3,688	3,954	4,234
Growth (%)					
Net Interest Income Gth	12.5	5.5	(6.5)	3.6	5.3
Net Profit Gth	18.2	8.4	(15.1)	7.2	7.1
Margins, Costs & Efficiency (%)					
Spread	1.8	1.7	1.6	1.6	1.6
Net Interest Margin	1.8	1.8	1.7	1.7	1.7
Cost-to-Income Ratio	43.9	44.6	47.0	47.0	46.3
Business Mix (%)					
Net Int. Inc / Opg Inc.	68.2	65.4	62.7	62.3	62.3
Non-Int. Inc / Opg inc.	31.8	34.6	37.3	37.7	37.7
Fee Inc / Opg Income	21.6	20.3	21.9	22.2	22.4
Oth Non-Int Inc/Opg Inc	10.2	14.3	15.4	15.5	15.3
Profitability (%)					
ROAE Pre Ex.	11.2	11.2	9.1	9.3	9.5
ROAE	11.2	11.2	9.1	9.3	9.5
ROA Pre Ex.	1.1	1.1	0.9	0.9	1.0
ROA	1.1	1.1	0.9	0.9	1.0

Higher provisions expected

NIM to decline

Source: Company, DBS Bank

UOB
Quarterly / Interim Income Statement (\$5m)

FY Dec	4Q2018	1Q2019	2Q2019	3Q2019	4Q2019
Net Interest Income	1,608	1,587	1,653	1,687	1,635
Non-Interest Income	608	819	930	922	797
Operating Income	2,216	2,406	2,583	2,609	2,432
Operating Expenses	(984)	(1,073)	(1,130)	(1,154)	(1,116)
Pre-Provision Profit	1,232	1,333	1,453	1,455	1,316
Provisions	(128)	(93.0)	(51.0)	(145)	(146)
Associates	0.0	17.0	0.0	14.0	20.0
Exceptionals	0.0	0.0	0.0	0.0	0.0
Pretax Profit	1,104	1,257	1,402	1,324	1,190
Taxation	(185)	(200)	(231)	(202)	(178)
Minority Interests	(3.0)	(5.0)	(4.0)	(4.0)	(6.0)
Net Profit	916	1,052	1,168	1,118	1,006

Growth (%)

Net Interest Income Gth	0.6	(1.3)	4.2	2.1	(3.1)
Net Profit Gth	(11.7)	14.8	11.0	(4.3)	(10.0)

Balance Sheet (\$5m)

FY Dec	2018A	2019A	2020F	2021F	2022F
Cash/Bank Balance	25,252	25,864	26,769	27,706	28,676
Government Securities	18,816	21,365	24,259	27,546	31,277
Inter Bank Assets	50,800	52,840	54,314	56,579	59,338
Total Net Loans & Adv.	258,628	265,458	272,862	284,241	298,104
Investment	15,482	18,243	16,572	17,287	18,134
Associates	1,170	1,182	1,233	1,284	1,335
Fixed Assets	2,266	2,760	1,667	1,667	1,667
Goodwill	4,138	4,148	4,142	4,142	4,142
Other Assets	11,541	12,549	12,899	13,437	14,092
Total Assets	388,092	404,409	414,717	433,888	456,766
Customer Deposits	293,186	310,726	321,601	332,857	344,507
Inter Bank Deposits	13,801	15,301	11,833	17,109	25,365
Debts/Borrowings	30,606	25,209	25,209	25,209	25,209
Others	12,688	13,309	14,352	14,961	15,737
Minorities	189	227	240	254	270
Shareholders' Funds	37,623	39,637	41,481	43,498	45,678
Total Liab& S/H's Funds	388,093	404,409	414,717	433,888	456,766

Source: Company, DBS Bank

UOB

Financial Stability Measures (%)

FY Dec	2018A	2019A	2020F	2021F	2022F
Balance Sheet Structure					
Loan-to-Deposit Ratio	88.2	85.4	84.8	85.4	86.5
Net Loans / Total Assets	66.6	65.6	65.8	65.5	65.3
Investment / Total Assets	4.0	4.5	4.0	4.0	4.0
Cust. Dep./Int. Bear. Liab.	86.8	88.5	89.7	88.7	87.2
Interbank Dep / Int. Bear.	4.1	4.4	3.3	4.6	6.4
Asset Quality					
NPL / Total Gross Loans	1.5	1.5	1.8	1.7	1.6
NPL / Total Assets	1.0	1.0	1.2	1.1	1.1
Loan Loss Reserve Coverage	77.1	77.8	81.7	98.0	113.7
Provision Charge-Off Rate	0.2	0.2	0.3	0.3	0.2
Capital Strength					
Total CAR	17.0	17.4	17.6	17.7	17.6
Tier-1 CAR	13.9	14.3	14.6	14.8	14.9



Strong capital levels

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:	02 Apr 19	25.74	29.20	BUY
2:	22 Apr 19	26.96	29.20	BUY
3:	02 May 19	27.85	29.20	BUY
4:	06 May 19	25.85	29.20	BUY
5:	16 May 19	25.16	29.20	BUY
6:	25 Jun 19	25.70	29.20	BUY
7:	28 Jun 19	26.13	29.20	BUY
8:	22 Jul 19	26.80	29.20	BUY
9:	05 Aug 19	25.91	29.20	BUY
10:	30 Aug 19	24.96	29.20	BUY
11:	01 Nov 19	26.57	29.20	BUY
12:	12 Nov 19	27.02	29.20	BUY
13:	24 Feb 20	25.28	27.20	BUY
14:	05 Mar 20	23.74	25.50	HOLD

Source: DBS Bank

Analyst: Rui Wen LIM

DBS Bank recommendations are based on an Absolute Total Return* Rating system, defined as follows:

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 share price catalysts within this time frame)

**Share price appreciation + dividends*

Completed Date: 17 Mar 2020 08:29:52 (SGT)

Dissemination Date: 17 Mar 2020 08:36:28 (SGT)

Sources for all charts and tables are DBS Bank unless otherwise specified.

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