Singapore Industry Focus

Singapore Banks

Refer to important disclosures at the end of this report

DBS Group Research . Equity

10 Sep 2020

Life after moratoriums

- Moratoriums offered by Singapore banks expire towards year-end; restructuring and rescheduling are key
- Extension of moratoriums likely on a targeted basis going forward, if any
- Extension of dividend cap beyond FY20F a possibility
- Singapore banks' valuations remain inexpensive

Moratoriums offered by Singapore banks expire towards year-end; restructuring and rescheduling are key. As of 2Q20, c.5-16% of Singapore banks' total loans were under moratorium, of which an estimated c.4-10% of Singapore loans were under moratorium. Moratoriums for SMEs and mortgages, which form the bulk of moratorium loans locally, will end on 31 December 2020. As the various moratoriums come to an end towards year-end, we believe the key to preventing a "cliff effect" is proactive loan restructuring and rescheduling.

Extension of moratoriums likely on a targeted basis going forward, if any; asset quality uncertainty to weigh on. We believe there may be a case for extension of mortgage moratoriums minimally against increasingly weak employment outlook into 2H20 and see further room for extension of mortgage moratoriums on a targeted basis, say for example, households which have lost a substantial part of income or jobs, even as likelihood for large loan losses for mortgages remains low due to low loan-to-value (LTV) alongside a resilient property market. But, if a vaccine remains elusive, we believe asset quality uncertainties are likely to weigh on Singapore banks through FY21F as central banks regionally balance between providing support to industries affected by the pandemic and ensuring banking system stability.

Extension of dividend cap beyond FY20F a possibility. Post the Fed's updates to its statement on longer-run goals and monetary policy strategy aiming to achieve inflation moderately above 2% after a period of undershoot, short-term rates have priced in no hikes for several years as the hurdle to hike rates are now set much higher. Lower-for-longer rates are likely to weigh on net interest margins (NIMs) and return on equity recovery. In our opinion, lower net interest income, coupled with relatively soft credit demand and asset quality uncertainty, opens the possibility of extension of dividend cap into FY21F.

Singapore banks' valuations remain inexpensive. Regionally, Singapore banks' valuations remain inexpensive at c.0.8x FY21F P/BV, trading near -2s.d. valuations. We continue to prefer UOB to OCBC as a more defensive pick due to its larger domestic exposure, higher ROE and dividend yield.

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STOCKS

	Price S$	Mkt Cap US$m	12-mth Target Price S$	Performance (%) 3 mth	12 mth	Rating
DBS	20.54	38,168	NA	(11.0)	(17.2)	NR
OCBC Bank	8.58	27,661	9.30	(11.9)	(20.8)	HOLD
UOB	19.39	23,690	22.20	(16.5)	(24.5)	BUY

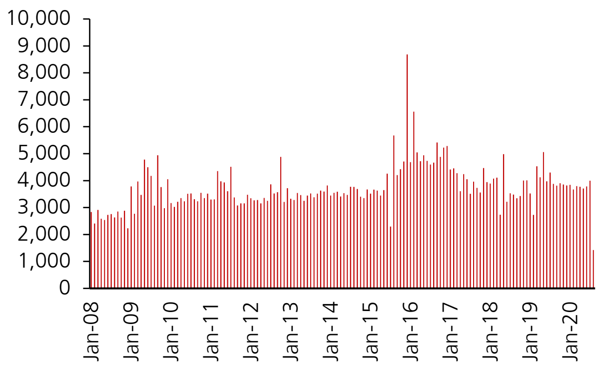
Source: DBS Bank, Bloomberg Finance L.P.
Closing price as of 10 Sep 2020

Various moratorium expirations coming up. An earlier measure introduced at end-March 2020 allowed SMEs to defer principal payments on secured term loans till 31 December 2020 subject to banks' assessment, and also to extend the loan tenures by up to the principal deferment period. Individuals, on the other hand, are also allowed to defer premium payments for life and health insurance till 30 September 2020, while homeowners can also apply to defer either the principal repayment or both principal and interest repayments on property loans till 31 December 2020.

Government measures have kept businesses and jobs afloat, though a worsening employment outlook may happen in 2H20. Gradual normalisation of business and trade activities, albeit from a low base in 2Q20 (which coincided with global supply chain disruptions and Singapore's Circuit Breaker measures), is incrementally positive for the economy. To date, the government's support in terms of Jobs Support Scheme (JSS) which heavily subsidises wages through the pandemic, as well as various loan moratoriums and reliefs, on top of various financing schemes offered by the banks, has helped keep jobs across sectors afloat.

Going forward, as JSS gradually rolls off, some businesses may still be unable to churn sufficient cashflow to survive eventually due to structural changes in their respective industries. We continue to monitor the credit health of SMEs locally as cessations of business entities slowed in Aug 2020, as we expect some loan losses arising from businesses that become unviable.

Cessation of business entities in Singapore (monthly) has slowed in Aug 2020



Source: Singstat, DBS Bank

Government's risk-sharing schemes limit some downside for Singapore banks. As of May 2020, various financing schemes such as the Temporary Bridging Loan Programme and the Enterprise Financing Scheme in the past Budgets had seen a high take-up, catalysing S$4.5bn of loans so far, and benefitting 5,000 businesses which is >3x the amount in 2019. With the government's higher risk-share of 90% (prior: 80%) for loans made under Temporary Bridging Loan Programme; the Enterprise Financing Scheme – SME Working Capital Loan; and Enterprise Financing Scheme – Trade Loan for loans initiated from 8 April 2020 until 31 March 2021, this helps to limit some downside for Singapore banks.

Extension of moratoriums likely on a targeted basis going forward, if any. If a vaccine remains elusive, we believe asset quality uncertainties are likely to weigh on Singapore banks through FY21F as central banks regionally balance between providing support to industries affected by the pandemic and ensuring banking system stability.

Accordingly, ~S$15bn of mortgage deferments, which account for ~7.5% of outstanding mortgages in the system, have been approved. This accounts for nearly 80% of mortgage debt relief applications. We believe there may be a case for extension of mortgage moratoriums minimally against increasingly weak employment outlook into 2H20. While we believe the likelihood for large loan losses for mortgages remains low due to low loan-to-values alongside a resilient property market, we see further room for extension of mortgage moratoriums on a targeted basis, for instance, for households which have lost a substantial part of income or jobs.

Breakdown of Singapore banks' moratorium loans. As of 2Q20, c.5%/10%/16% of DBS/OCBC/UOB total loans were under moratorium. Accordingly, it appears that a large portion of loans under moratorium are secured to some extent. We believe that UOB's Singapore loans under moratorium may be higher as the bank typically has more SME customers compared to its peers.

As shared in DBS 2Q20 analyst briefing (and the transcript available on DBS website), c.5% of its total loan book are under moratorium, comprising S$12.6bn of SME book and S$5.7bn of consumer book, where 90% of the SME book is secured mostly against property and LTV is generally below 70%.

c.10% of OCBC's total loan book are under moratorium, as its Malaysia loans which account for half of the loans under moratorium are on automatic inclusion basis as of June 2020. Of c.S$27bn of loans under moratorium, S$13.7bn pertains to Malaysia exposure, of which 86% are secured, and >50% of the exposure pertains to housing loans with LTV of ~56% and the remaining exposures are to emerging SMEs with low LTVs and mostly secured. In Singapore, 6.8% of its loans are under moratorium (i.e. S$7.4bn exposure).c.16% (S$28bn) of UOB's total loan book are under moratorium, where Singapore/Malaysia/Thailand's moratorium loans account for 10%/60%/30% respectively, due to Malaysia and Thailand's automatic inclusion basis. Singapore's moratorium loans are estimated to be ~S$13bn. According to management, most loans under moratorium are heavily secured.

Banks likely to continue booking provisions in anticipation of further loan losses. Credit cost guidance is maintained with DBS/OCBC/UOB guiding for 80-130bps (S$3-5bn), 100-130bps, and 120-130bps (S$2-3bn) of credit costs cumulatively over the next two years respectively (previously 50-60bps per year for next two years). During 1H20, DBS/OCBC/UOB booked S$1.9bn/S$1.4bn/S$0.7bn of provisions. Note that OCBC estimates its gross NPL ratio to increase to 2.5% to 3.5% while UOB sees its NPL ratio possibly doubling to 3.2%.

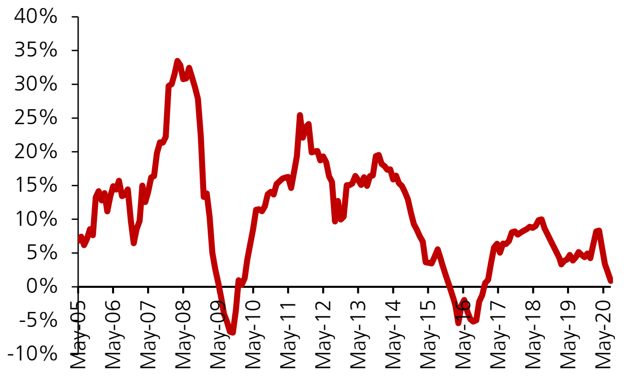
2Q20 saw net interest margins (NIMs) collapse on the back of rate cut; Fed's latest statement prolongs Singapore banks' recovery path. Following March's two Fed rate cuts in response to the spread of COVID-19 in the US, which resulted in the repricing of loans on lower benchmark rates through most of 2Q20. During 2Q20, average 3MSIBOR and average 3MLIBOR declined 83bps and 93bps respectively, a multi-fold increase from the previous quarter (25bps and 41 bps respectively). NIM saw a record decline of 16-24bps q-o-q in 2Q20. 1H20 NIMs for DBS/OCBC/UOB came in at 1.74%/1.68%/1.60%, while that for 2Q20 were 1.62%/1.60%/1.48%. DBS/OCBC are guiding for full-year NIM at 1.60%/mid-to-high 1.50% range.

Post the Fed's updates to its statement on longer-run goals and monetary policy strategy aiming to achieve inflation moderately above 2% after a period of undershoot, short-term rates have priced in no hikes for several years as the hurdle to hike rates are now set much higher. Lower-for-longer rates are likely to weigh on NIMs and return on equity recovery.

Singapore banks continue to manage cost of funds. OCBC expects both 3Q20 and 4Q20 NIM to see improvements of 2-3bps q-o-q. While loan books continue to reprice, this may be partially offset by reduction in flagship deposit accounts' interest rates during 3Q20. Excess CASA also continues to weigh on NIM amidst weaker credit demand.

Credit demand remains soft. DBS and UOB continue to see some credit demand, while OCBC is expecting muted loan growth for FY20F. We continue to observe some sustainability-linked/green loans and Sora-based loans being rolled out by the Singapore banks. However, as several major infrastructure projects are delayed due to the pandemic, we believe credit demand will remain soft for some time, as July 2020 continues to register a decline in system loans (DBU+ACU) of -1.0% m-o-m, the fourth monthly consecutive decline since March 2020. Year-to-date, system loans are largely flat at 0.3% (since December 2020).

Singapore: System loans (DBU+ACU) y-o-y growth momentum continues to weaken



Source: MAS, DBS Bank

Singapore banks issue subordinated bonds with attractive pricing. On 3 September 2020, OCBC issued a US$1bn tier-two subordinated note due 2030 at 1.832% until call date (September 2025) while UOB priced a US$600m tier-two subordinated note due 2031 at 1.75% until call date (March 2026) as banks leverage on the existing low interest rate environment to refinance maturing subordinated notes ahead of time and improve capital adequacy in the interim.

Extension of dividend cap beyond FY20F a possibility. The Monetary Authority of Singapore's call to cap FY20 dividends at 60% of FY19's was predicated on shoring up capital amid the uncertain economic climate. As of 2Q20, CET1 ratios for DBS/OCBC/UOB stood at 13.7%/14.2%/14.0%, which are strong. In our opinion, lower net interest income, coupled with relatively soft credit demand and asset quality uncertainty, opens the possibility of extension of dividend cap into FY21F from a prudent standpoint, given continued uncertainty amidst the pandemic and uneven recovery paths across countries, regions and industries.

Singapore banks' valuations remain inexpensive. Regionally, Singapore banks continue to be the best capitalised, and the valuations remain inexpensive at c.0.8x FY21F P/BV, trading near -2s.d. valuations. We continue to prefer UOB to OCBC as a more defensive pick due to its larger domestic exposure, higher ROE and dividend yield, though OCBC had provisioned ahead compared to UOB in 1H20.

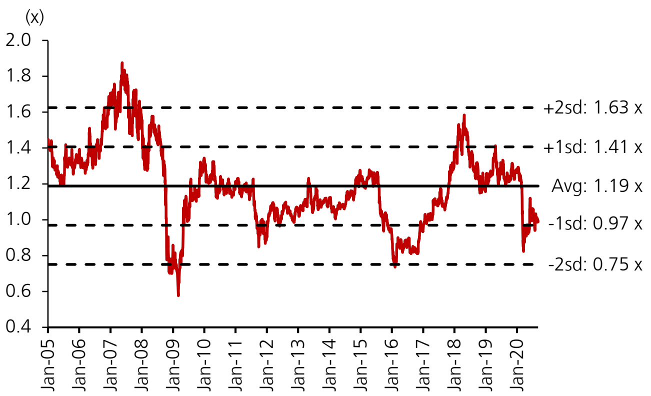
Singapore Banks: Peer comparison

	Mkt cap (US$m)	Price (S$/s)	TP (S$/s)	Rating	PE (x) FY19A	FY20F	FY21F	CAGR^ (%)	PBV (x) FY19A	FY20F	FY21F	ROE (%) FY21F	Net div (%) FY20F
DBS*	38,168	20.54	NA	NR	8.3x	11.8x	10.3x	-7%	1.0x	1.0x	1.0x	9.7%	3.6%
OCBC	27,661	8.58	9.30	HOLD	7.8x	12.4x	10.x	-8%	0.8x	0.8x	0.7x	7.9%	3.7%
UOB	23,690	19.39	22.20	BUY	7.4x	10.9x	9.6x	-8%	0.8x	0.8x	0.7x	8.3%	4.0%
Simple average					7.8x	11.7x	10.0x		0.9x	0.9x	0.8x	8.6%	3.8%
Weighted average					8.3x	7.9x	11.8x		0.9x	0.9x	0.9x	8.6%	3.8%

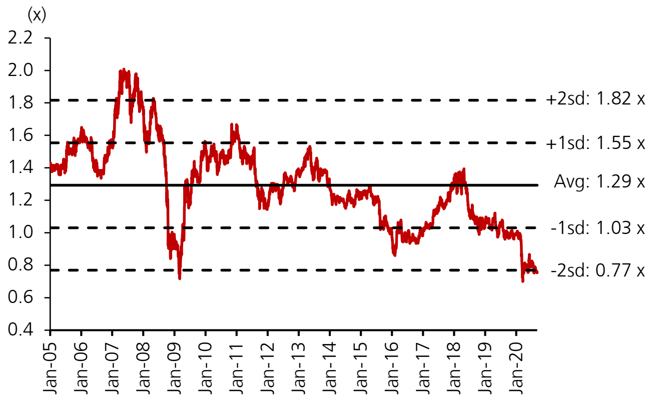
*^ Refers to 2-year EPS CAGR for FY19-21F   *Based on Bloomberg consensus*
Source: Companies, Bloomberg Finance L.P., DBS Bank

Singapore Banks: Valuation charts (15-year)

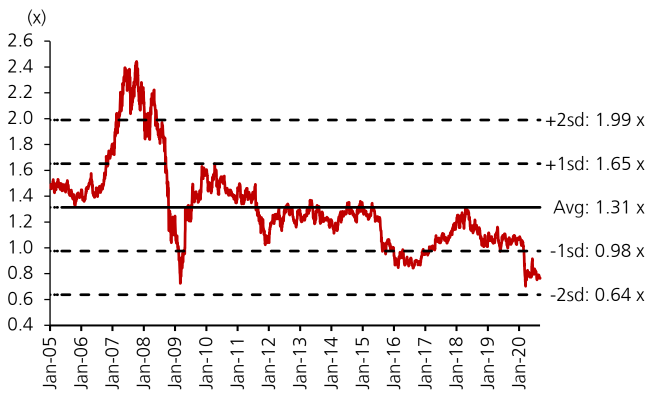
DBS



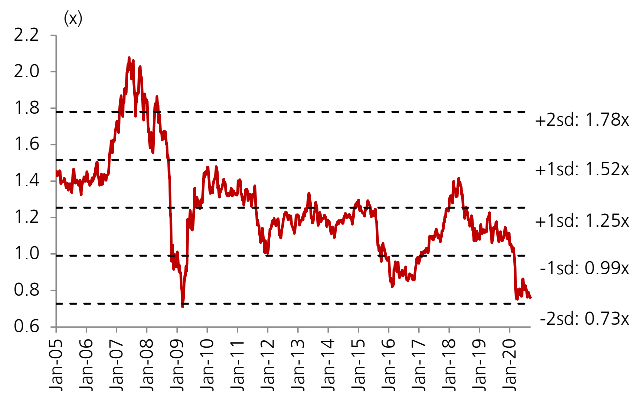
OCBC



UOB



Sector



Source: Thomson Reuters, Bloomberg Finance L.P., DBS Bank

Singapore Company Guide
OCBC

Version 26 | Bloomberg: OCBC SP | Reuters: OCBC.SI

Refer to important disclosures at the end of this report

DBS Group Research . Equity

7 Aug 2020

HOLD

Last Traded Price (7 Aug 2020): S$8.72 (STI : 2,545.51)
Price Target 12-mth: S$9.30 (7% upside)

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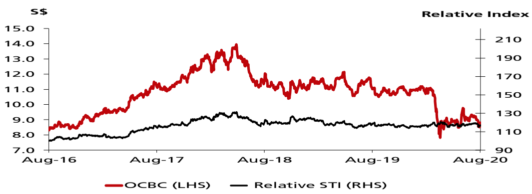
What's New

- 2Q20 net profit of S$730m (-42% y-o-y/+5% q-o-q) below expectations
- Continues to write provisions totalling S$750m (1Q20: S$657m)
- Declared dividend per share of 15.9 Scts (2Q20: 25 Scts) representing ~49% dividend payout ratio; scrip dividend with 10% discount
- Maintain HOLD and TP of S$9.30

Price Relative



Forecasts and Valuation

FY Dec (S$ m)	2019A	2020F	2021F	2022F
Pre-prov. Profit	6,124	5,174	5,375	5,518
Net Profit	4,869	3,044	3,768	4,263
Net Pft (Pre Ex.)	4,869	3,044	3,768	4,263
Net Pft Gth (Pre-ex) (%)	8.4	(37.5)	23.8	13.1
EPS (S cts)	110	69.0	85.5	96.7
EPS Pre Ex. (S cts)	110	69.0	85.5	96.7
EPS Gth Pre Ex (%)	4	(37)	24	13
Diluted EPS (S cts)	110	69.0	85.5	96.7
PE Pre Ex. (X)	7.9	12.6	10.2	9.0
Net DPS (S cts)	53.0	31.8	42.7	48.4
Div Yield (%)	6.1	3.6	4.9	5.5
ROAE Pre Ex. (%)	11.0	6.3	7.6	8.2
ROAE (%)	11.0	6.3	7.6	8.2
ROA (%)	1.0	0.6	0.8	0.8
BV Per Share (S cts)	1,070	1,107	1,150	1,198
P/Book Value (x)	0.8	0.8	0.8	0.7
Earnings Rev (%):		(14)	(4)	(6)
Consensus EPS (S cts):		81.5	88.3	109.1
Other Broker Recs:		B: 9	S: 1	H: 11

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

Brain Box

(Our NEW Pilot Research Platform) is available to Institutional Investors on Demand. Please contact your DBSV Institutional Sales contact for a demonstration.

Surprise discount on scrip dividend

Maintain HOLD and TP of S$9.30. We maintain our HOLD call, as we believe there are limited catalysts for the stock currently amid the zero-rate environment, and uncertain economic recovery path. For 1H20, ROE was 6.1%, the lowest among peers while OCBC continues to have the highest CET1 ratio at 14.2% among peers. As historical take-up for OCBC's scrip dividend has been high, this might weigh on OCBC's ROE in the near term. While OCBC has historically been viewed as a quality stock due to its lower credit costs through the cycle, we remain cautious over the SME books across Malaysia, Hong Kong and Indonesia in the near term. We believe there might be further pressures to NIM in 2H20 regionally amidst muted loan growth expected.

Where we differ: We remain cautious over OCBC's SME books across the region, in the face of a regional economic slowdown and recession in Singapore, arising from COVID-19.

Potential catalysts: Sustained business momentum. We believe sustained business momentum and broader recovery in macroeconomic sentiments would catalyse the share price.

Valuation:

Maintain HOLD; TP S$9.30. Our TP of S$9.30 is based on the Gordon Growth Model (8% ROE, 3% growth, 9% cost of equity). This is equivalent to c.0.8x FY21F P/BV, which is 2SD below its average 10-year forward P/BV multiple.

Key Risks to Our View:

Deteriorating asset quality. A larger-than-expected NPL arising from generic sectors and/or commodity-related exposure, as well as a worse-than-expected COVID-19 pandemic situation globally could unwind expectations of credit cost and NPL declines, could pose risks to earnings. Further, unemployment arising from recession could pose risks to mortgages and unsecured consumer lending, among others.

At A Glance

Issued Capital (m shrs)	4,405
Mkt. Cap (Sm/USm)	38,413 / 28,063
Major Shareholders (%)	
Selat Pte Ltd	12.0
Free Float (%)	88.0
3m Avg. Daily Val (US$m)	59.0
GIC Industry : Financial / Banks	

WHAT'S NEW

Earnings below expectations

Net profit declined to S$730m. OCBC reported revenues of S$2,625m (flat y-o-y/ +5% q-o-q) as weakness in net interest margin offset better showing in non-interest income weighs. With higher provisions of S$750m (+576% y-o-y/ +14% q-o-q), net profit declined 42% y-o-y/improved 5% q-o-q to S$730m, below expectations. Operating costs were well-maintained at -4% y-o-y/flat q-o-q, resulting in lower cost-to-income ratio of 42.2% (1Q20: 44.5%). Capital ratios remain strong with CET1 and total CAR at 14.2%/16.4% respectively.

Net interest income offset gains in non-interest income. Net interest income of S$1,483 declined 7% y-o-y/9% q-o-q, as net interest margin (NIM) declined 16bps q-o-q to 1.60% on lower interest rates and loans declined 1% q-o-q/grew 2% y-o-y due to low demand from consumers and trade. Non-interest income of S$1,142m improved 11% y-o-y/32% q-o-q as fee income declines due to reduced customer activity largely on the back of wealth management weakness. This was offset by strong mark-to-market trading income due to favourable market conditions. Assets under management at Bank of Singapore rose 8% q-o-q to US$113bn (1Q20 was impacted by market losses). According to management, wealth management's business momentum increased in May and June with June's activity levels similar to March's levels. Though momentum is strong, it may be a challenge to return to 1Q20 peak levels.

Total credit costs continue to rise, led by specific provisions. Total allowances of S$750m represents higher total credit costs at 97bps (1Q20: 86bps). Total credit costs for 1H20 stood at 91bps (1H19: 25bps). General allowances continued to be high at S$232m, representing 31-bp credit costs (1Q20: 50bps) as management continues to set aside general provisions. Special allowances was higher q-o-q at S$518m, representing 66bps credit costs (1Q20: 36bps) to write down remaining OSV NPLs (accounting for S$350m of special allowances).

NPL ratio ticked up slightly. NPL ratio increased to 1.6% (1Q20: 1.5%) during the quarter. There is a slight pick-up in NPLs in Malaysia, Indonesia and China. This largely relates to manufacturing and general commerce sectors, including one exposure in Malaysia relating to plantations**.** OCBC continues to expect near-term economic weakness and uncertainty to raise gross NPL ratio to between 2.5-3.5%, incorporating impact from withdrawal of government-sponsored relief programmes. Given increase in provisions, total NPA coverage increased to 101% (1Q20: 90%).

Key takeaways from analyst briefing

Guidances ahead. With 2Q20's exit NIM at 1.55%, management is guiding for FY20 NIM to be within mid-to-high 1.5% range (1H20: 1.68%) and believes there is room to reprice deposits further which should help stabilise NIMs further. Management notes that loan demand is likely to remain muted and maintains a flat loan growth guidance for FY20F.

Dividends and capital. Management has applied scrip dividend with 10% discount. Management believes that a 10% discount is in line with previous scrip dividend practices and also with MAS's guidance. It sees the need for a huge lump of capital due to uncertainties over the severity and length of the COVID-19 crisis. Should there be excess capital post OCBC Wing Hang Bank's IRAB migration at year-end (current timeline), there can be contemplations on returning excess capital post FY20F.

Thoughts on provisions. Maintain guidance of 100-130bps (~S$3 to 3.5bn) credit costs for FY20-21F. Management now has an extremely negative view on OSV as it does not see any increase in deployment of transportation vessels by major oil companies. Hence, the company has further written down the portfolios which are still performing (OSV with charter) where it is now uncertain if cash flows can be sustained. Excluding national oil companies and SG large corporates, remaining OSV portfolio on net basis (loan outstanding minus special provisions) is less than 0.2% of total loan book. No identifiable chunky portfolios in OSV on forward looking basis. As OSV special provisions taken this quarter was not part of management's intention in 1Q20, depending on COVID-19 recovery path, total credit credits across FY20-21F could end up at the higher range.

Moratorium details. Moratorium loans represent 10% of total loan book. Management believes a coordinated and orderly approach is needed to manage these loans upon expiry of moratoriums where approximately half of the amounts arise from Malaysia (automatic opt-in) and it remains to be seen if customers are able to service loans upon moratorium expiry. 86% of moratorium loans in Malaysia are secured where >50% are housing loans with 56% LTVs, the rest are emerging SMEs which are almost totally secured with low LTVs. In Singapore, S$1.6bn has been disbursed under the government programme. 96% of Singapore's moratorium is secured. Half of moratorium loans are to SMEs, 35% to individuals with the rest being loans to corporates.

Valuation and recommendation

Maintain HOLD, TP $9.30. Our TP of $9.30 is based on the Gordon Growth Model (8% ROE, 3% growth, 9% cost of equity). This is equivalent to c.0.8x FY21F P/BV, which is 2SD below its average 10-year forward P/BV multiple.

Quarterly / Interim Income Statement (S$m)

FY Dec	2Q2019	1Q2020	2Q2020	% chg yoy	% chg qoq
Net Interest Income	1,588	1,626	1,483	(6.6)	(8.8)
Non-Interest Income	1,030	864	1,142	10.9	32.2
Operating Income	2,618	2,490	2,625	0.3	5.4
Operating Expenses	(1,177)	(1,135)	(1,107)	(5.9)	(2.5)
Pre-Provision Profit	1,441	1,355	1,518	5.3	12.0
Provisions	(111)	(657)	(750)	575.7	14.2
Associates	146	165	163	11.6	(1.2)
Exceptionals	0.0	0.0	0.0	-	-
Pretax Profit	1,476	863	931	(36.9)	7.9
Taxation	(224)	(165)	(201)	(10.3)	21.8
Minority Interests	(29.0)	0.0	0.0	nm	-
Net Profit	1,223	698	730	(40.3)	4.6
Growth (%)					
Net Interest Income Gth	3.5	1.0	(8.8)		
Net Profit Gth	(0.6)	(43.8)	4.6		
Key ratio (%)					
NIM	1.8	1.8	1.6		
NPL ratio	1.5	1.5	1.6		
Loan-to deposit	87.6	0.0	0.0		
Cost-to-income	45.0	45.6	42.2		
Total CAR	16.8	16.4	16.4		

Source of all data: Company, DBS Bank

CRITICAL DATA POINTS TO WATCH

Critical Factors

NIM pressures ahead. We expect loan growth to slow down in FY20F on slower business activity. In 2Q20, average 3MSIBOR/3MLIBOR declined 83/93bps q-o-q (previous quarter: 25/41). We believe that lower loan yields will continue to weigh on NIM amidst muted loan growth expected throughout the rest of the year. 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.

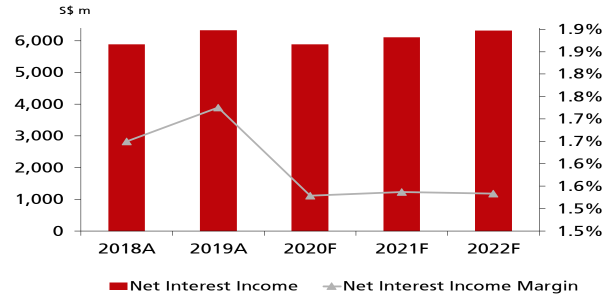
The bank's insurance business via c.88%-owned subsidiary, Great Eastern Holdings (GEH), remains a dominant contributor to its non-interest income. OCBC has no plans to sell its stake in GEH as the latter remains complementary to its non-interest income franchise. Management believes it is still logical 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.

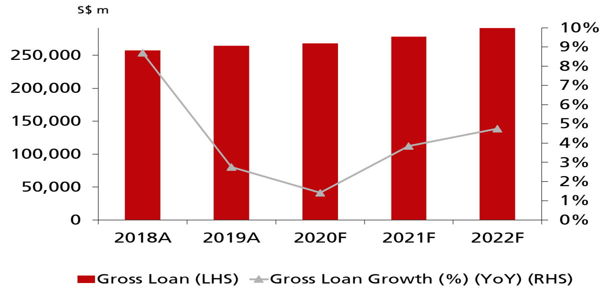
Asset quality. OCBC made provisions on its oil and gas portfolio through FY19 as c.65% of 4Q19 and FY19's elevated credit costs were oil and gas related (total provisions amounted to S$746m). As of 4Q19, OCBC had written down values of vessels to scrap value (3% of refreshed valuation) through FY19 for vessels with less than one year of charter. According to OCBC, oil and gas exposure accounts for c.5% of total loans, which includes oil majors, trading companies and OSV sector, with NPL ratio of 0.8% as of Dec 2019. We continue to keep watch on emerging risks from affected sectors from the fallout of COVID-19, oil and gas portfolio (due to low oil prices), as well as SME exposure.

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.

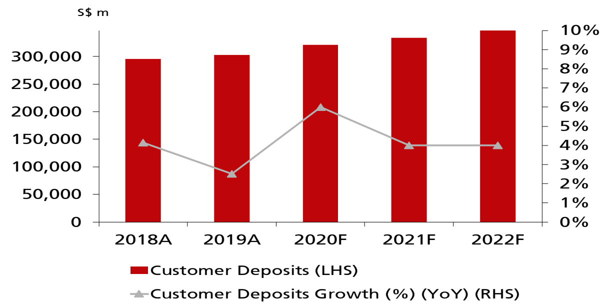
Margin Trends



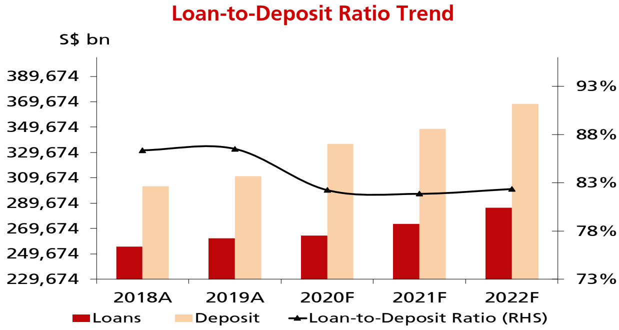
Gross Loan & Growth



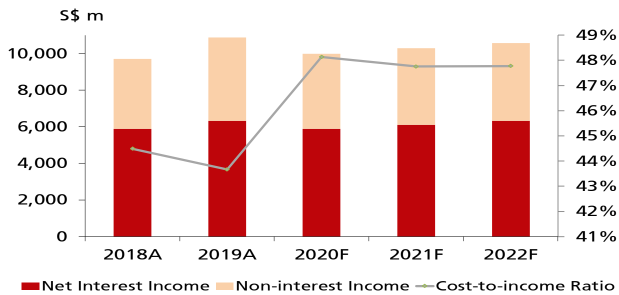
Customer Deposit & Growth



Loan-to-Deposit Ratio Trend



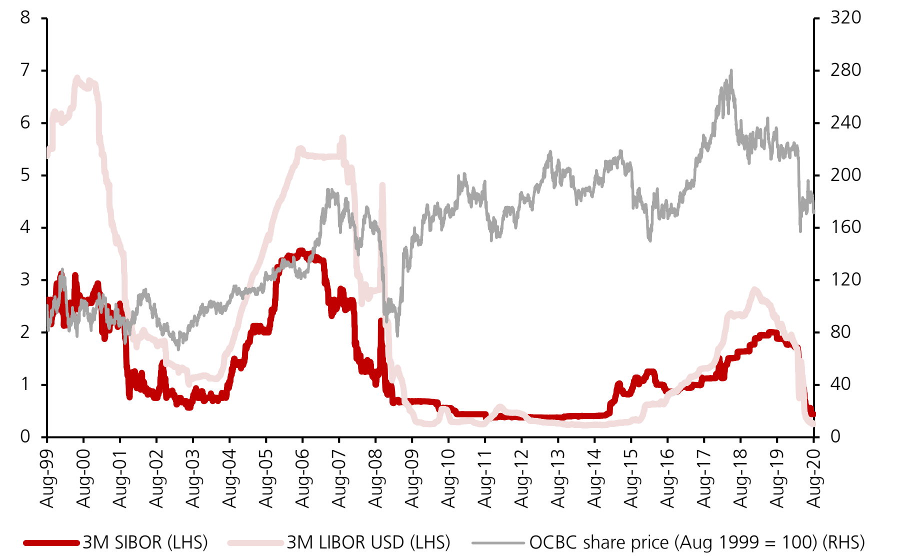
Cost & Income Structure



Source: Company, DBS Bank

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

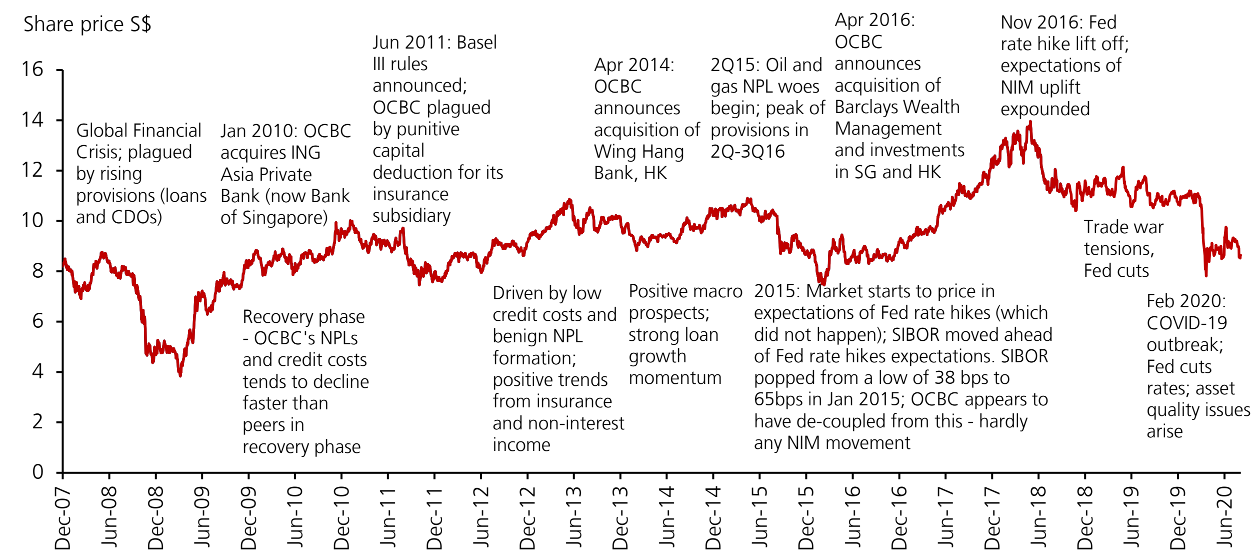
Interest rates as critical factor



Remarks

Interest rates, particularly SIBOR, are linked to loan pricing and hence NIM, which in turn drive 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 their peaks, 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

Balance Sheet:

Keep watch on asset quality. OCBC's NPL ratio stood at 1.6% as at 2Q20. 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.

Strong capital ratios. OCBC reintroduced its scrip dividend scheme in FY18 up to FY19's interim dividend after halting it in 2Q16, to help shore up capital. OCBC reintroduced scrip dividend in 2Q20 with 10% discount as it seeks to shore up capital amidst more uncertain times. Aside, OCBC-WHB is transitioning to IRAB which may provide some risk-weighted assets release towards end-FY20F/early FY21F upon Hong Kong Monetary Authority's approval.

Share Price Drivers:

Sustained ROE improvement. OCBC's ROE for 1H20 was 6.1%, compared to 11.4% in FY19. 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% in the medium term as it continues to manage costs into FY20F due to declines in revenue.

Key Risks:

Recession impact. A deeper-than-expected recession in Singapore, a worse-than-expected COVID-19 outbreak in Singapore and regionally and a less firm macroeconomic outlook going forward could temper our fee income and loan growth expectations. Although loan growth is less sensitive to earnings, any deceleration as a result of weaker sentiment would dent top-line prospects.

Deteriorating asset quality. A larger-than-expected NPL arising from generic sectors and/or commodity-related exposure, as well as a worse-than-expected COVID-19 pandemic situation globally could unwind expectations of credit cost and NPL declines, thus posing risks to earnings. Further, unemployment arising from recession could pose risks to mortgages and unsecured consumer lending, among others.

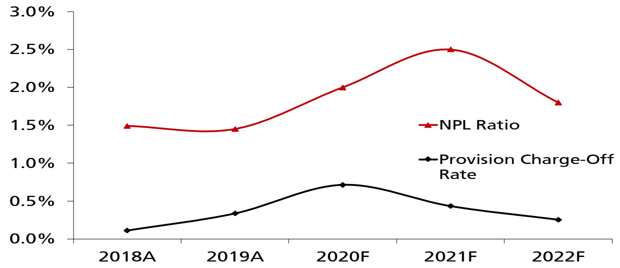
Environment, Social, Governance:

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. In FY19, OCBC committed to stop coal-fired power plant financing, on top of developing three additional sector-specific policies covering chemicals, infrastructure and waste management. OCBC added S$5bn in new commitments to sustainable finance during FY19.

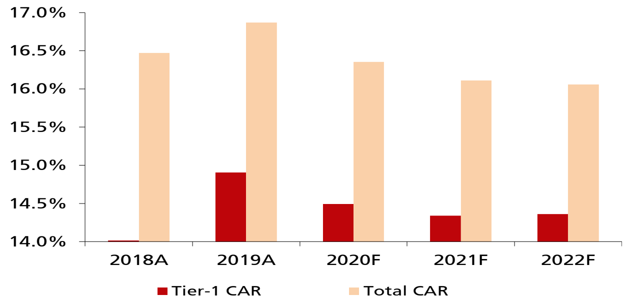
Company Background

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

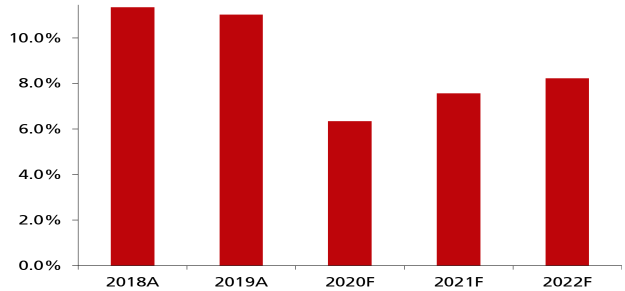
Asset Quality



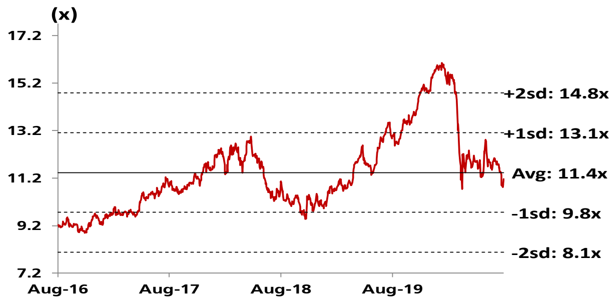
Capitalisation (%)



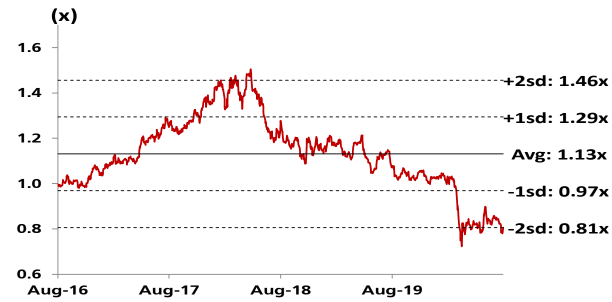
ROE (%)



Forward PE Band (x)



PB Band (x)



Source: Company, DBS Bank

Key Assumptions

FY Dec	2018A	2019A	2020F	2021F	2022F
Gross Loans Growth	8.7	2.7	1.4	3.9	4.8
Customer Deposits Growth	4.1	2.5	6.0	4.0	4.0
Yld. On Earnings Assets	3.2	3.4	2.7	2.7	2.7
Avg Cost Of Funds	1.6	1.7	1.2	1.1	1.2

Income Statement (S$ m)

FY Dec	2018A	2019A	2020F	2021F	2022F
Net Interest Income	5,890	6,331	5,882	6,107	6,315
Non-Interest Income	3,811	4,540	4,093	4,182	4,250
Operating Income	**9,701**	**10,871**	**9,975**	**10,289**	**10,566**
Operating Expenses	(4,316)	(4,747)	(4,801)	(4,914)	(5,048)
Pre-provision Profit	**5,385**	**6,124**	**5,174**	**5,375**	**5,518**
Provisions	(288)	(890)	(1,914)	(1,205)	(739)
Associates	455	566	583	600	618
Exceptionals	0	0	0	0	0
Pre-tax Profit	**5,552**	**5,800**	**3,843**	**4,770**	**5,397**
Taxation	(877)	(778)	(607)	(763)	(863)
Minority Interests	(183)	(153)	(192)	(239)	(270)
Preference Dividend	0	0	0	0	0
Net Profit	**4,492**	**4,869**	**3,044**	**3,768**	**4,263**
Net Profit before Except.	4,492	4,869	3,044	3,768	4,263
Growth (%)					
Net Interest Income Gth	8.6	7.5	(7.1)	3.8	3.4
Net Profit Gth bef Except	11.2	8.4	(37.5)	23.8	13.1
Margins, Costs & Efficiency (%)					
Spread	1.6	1.7	1.5	1.5	1.5
Net Interest Margin	1.7	1.8	1.6	1.6	1.6
Cost-to-Income Ratio	44.5	43.7	48.1	47.8	47.8
Business Mix (%)					
Net Int. Inc / Opg Inc.	60.7	58.2	59.0	59.4	59.8
Non-Int. Inc / Opg inc.	39.3	41.8	41.0	40.6	40.2
Fee Inc / Opg Income	20.9	19.5	20.2	20.6	21.2
Oth Non-Int Inc/Opg Inc	18.3	22.2	20.8	20.0	19.0
Profitability (%)					
ROAE Pre Ex.	11.4	11.0	6.3	7.6	8.2
ROAE	11.4	11.0	6.3	7.6	8.2
ROA Pre Ex.	1.0	1.0	0.6	0.8	0.8
ROA	1.0	1.0	0.6	0.8	0.8

Higher provisions expected through FY21F

Source: Company, DBS Bank

Quarterly / Interim Income Statement (S$ m)

FY Dec	2Q2019	3Q2019	4Q2019	1Q2020	2Q2020
Net Interest Income	1,588	1,600	1,610	1,626	1,483
Non-Interest Income	1,030	1,055	1,312	864	1,142
Operating Income	**2,618**	**2,655**	**2,922**	**2,490**	**2,625**
Operating Expenses	(1,177)	(1,158)	(1,292)	(1,135)	(1,107)
Pre-Provision Profit	**1,441**	**1,497**	**1,630**	**1,355**	**1,518**
Provisions	(111)	(323)	(207)	(657)	(750)
Associates	146	156	94	165	163
Exceptionals	0	0	0	0	0
Pretax Profit	**1,476**	**1,330**	**1,517**	**863**	**931**
Taxation	(224)	(139)	(220)	(165)	(201)
Minority Interests	(29)	(19)	(54)	0	0
Net Profit	**1,223**	**1,172**	**1,243**	**698**	**730**
Growth (%)					
Net Interest Income Gth	3.5	0.8	0.6	1.0	(8.8)
Net Profit Gth	(0.6)	(4.2)	6.1	(43.8)	4.6

Balance Sheet (S$ m)

FY Dec	2018A	2019A	2020F	2021F	2022F
Cash/Bank Balance	18,748	23,201	22,472	20,032	20,833
Government Securities	27,776	28,662	31,528	32,789	34,101
Inter Bank Assets	39,035	35,813	38,287	39,632	41,467
Total Net Loans & Advs.	255,193	262,045	264,045	273,325	285,980
Investment	25,542	28,533	36,966	38,266	40,037
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	13,113	13,574	14,203
Life Ass Fund Inv Assets	76,867	87,338	90,832	93,556	96,363
Total Assets	**467,543**	**491,691**	**511,314**	**526,081**	**548,755**
Customer Deposits	295,412	302,851	321,022	333,863	347,217
Inter Bank Deposits	7,576	8,250	15,468	14,562	20,626
Debts/Borrowings	30,272	29,388	23,596	23,596	23,596
Others	15,963	18,153	16,343	17,052	17,907
Minorities	1,255	1,441	1,633	1,872	2,141
Shareholders' Funds	42,137	47,162	48,806	50,690	52,821
Life Ass Fund Liabs	74,928	84,446	84,446	84,446	84,446
Total Liab& S/H's Funds	**467,543**	**491,691**	**511,314**	**526,081**	**548,755**

Source: Company, DBS Bank

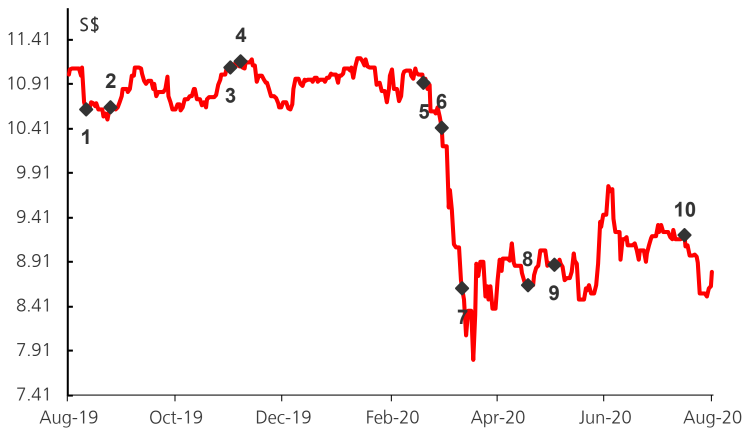
Financial Stability Measures (%)

FY Dec	2018A	2019A	2020F	2021F	2022F
Balance Sheet Structure					
Loan-to-Deposit Ratio	86.4	86.5	82.3	81.9	82.4
Net Loans / Total Assets	54.6	53.3	51.6	52.0	52.1
Investment / Total Assets	5.5	5.8	7.2	7.3	7.3
Cust . Dep./Int. Bear. Liab.	88.6	88.9	89.2	89.7	88.7
Interbank Dep / Int. Bear.	2.3	2.4	4.3	3.9	5.3
Asset Quality					
NPL / Total Gross Loans	1.5	1.5	2.0	2.5	1.8
NPL / Total Assets	0.8	0.8	1.0	1.3	1.0
Loan Loss Reserve Coverage	57.4	63.2	78.1	75.3	111.1
Provision Charge-Off Rate	0.1	0.3	0.7	0.4	0.3
Capital Strength					
Total CAR	16.5	16.9	16.4	16.1	16.1
Tier-1 CAR	14.0	14.9	14.5	14.3	14.4

Strong capital ratios

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:	16 Aug 19	10.63	11.50	HOLD
2:	30 Aug 19	10.65	11.50	HOLD
3:	06 Nov 19	11.10	11.50	HOLD
4:	12 Nov 19	11.17	11.50	HOLD
5:	24 Feb 20	10.92	11.50	HOLD
6:	05 Mar 20	10.42	11.00	HOLD
7:	17 Mar 20	8.61	8.60	HOLD
8:	23 Apr 20	8.65	7.90	HOLD
9:	08 May 20	8.88	7.90	HOLD
10:	21 Jul 20	9.21	9.30	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: 7 Aug 2020 19:05:59 (SGT)
Dissemination Date: 7 Aug 2020 19:45:09 (SGT)

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

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2. Neither DBS Bank Ltd nor DBS HK market makes in equity securities of the issuer(s) or company(ies) mentioned in this Research Report.

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Singapore Company Guide
UOB

Version 28 | Bloomberg: UOB SP | Reuters: UOBH.SI

Refer to important disclosures at the end of this report

DBS Group Research . Equity

6 Aug 2020

BUY (Upgrade from HOLD)

Last Traded Price (6 Aug 2020): S$19.76 (STI : 2,559.10)

Price Target 12-mth: S$22.20 (12% upside) (Prev S$20.90)

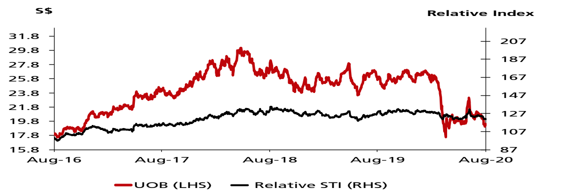
Analyst

Rui Wen LIM +65 66823720 ruiwenlim@dbs.com

What's New

- Net profit of S$703m was below expectations (-40% y-o-y, -18% q-o-q)
- Expect some asset deterioration in 2H20 and 1H21
- Dividend per share of 39 Scts declared (1H20: 55 Scts) due to dividend cap imposed by MAS
- Upgrade to BUY; TP of S$22.20 on undemanding valuations of c.0.8x FY21F P/BV

Price Relative



Forecasts and Valuation

FY Dec (S$m)	2019A	2020F	2021F	2022F
Pre-prov. Profit	5,558	5,136	5,330	5,587
Net Profit	4,343	2,957	3,361	3,991
Net Pft (Pre Ex.)	4,343	2,957	3,361	3,991
Net Pft Gth (Pre-ex) (%)	8.4	(31.9)	13.6	18.8
EPS (S cts)	260	177	201	239
EPS Pre Ex. (S cts)	260	177	201	239
EPS Gth Pre Ex (%)	8	(32)	14	19
Diluted EPS (S cts)	258	176	200	237
PE Pre Ex. (X)	7.6	11.1	9.8	8.3
Net DPS (S cts)	130	78.0	101	120
Div Yield (%)	6.6	3.9	5.1	6.1
ROAE Pre Ex. (%)	11.2	7.3	8.0	9.1
ROAE (%)	11.2	7.3	8.0	9.1
ROA (%)	1.1	0.7	0.8	0.9
BV Per Share (S cts)	2,376	2,475	2,576	2,695
P/Book Value (x)	0.8	0.8	0.8	0.7
Earnings Rev (%):		1	(2)	(1)
Consensus EPS (S cts):		177	194	244
Other Broker Recs:		B: 8	S: 3	H: 9

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

Brain Box

(Our NEW Pilot Research Platform) is available to Institutional Investors on Demand. Please contact your DBSV Institutional Sales contact for a demonstration.

Upgrade on undemanding valuations

Upgrade to BUY, higher TP of S$22.20. We upgrade our HOLD call with a TP of S$22.20, as we believe overhanging risks including lower net interest margins (NIM), as well as dividend cuts are already priced in. While ROEs are unlikely to return to pre-COVID 19 levels in the medium term due to lower-for-longer interest rates, we believe that UOB's strong NPA coverage of 96% (1Q20: 88%) and ongoing provisioning (management guides for S$2-3bn of provisioning through FY21F) will limit downside risks. Despite the dividend cut, yield of c.4% remains relatively attractive. As we expect some asset quality deterioration into 2H20 and 1H21, especially when the various moratoriums and reliefs expire, we believe the upside is capped below 1.0x P/BV.

Where we differ: We remain cautious over the impact of asset quality on UOB's books, given the current COVID-19 situation and likelihood of a deep recession in Singapore, as well as in Malaysia and Thailand.

Potential catalyst: Sustained positive deliveries. Lower–than-expected credit costs could drive earnings. Recovery in ROE post COVID will drive UOB's share price.

Valuation:

Upgrade to BUY, TP of S$22.20. Our revised TP of S$22.20 is based on the Gordon Growth Model (9% ROE [previously 8%], 3% growth, 10% cost of equity). This is equivalent to c.0.9x FY21F P/BV that is near 1SD below its average 15-year forward P/BV multiple. Our earnings revisions are due to lower NIM and higher expense and provision assumptions.

Key Risks to Our View:

Deteriorating asset quality. A larger-than-expected NPL arising from generic sectors and/or commodity-related exposure, as well as a worse-than-expected COVID-19 pandemic situation globally could unwind expectations of credit cost and NPL declines, thus posing risks to earnings. Further, unemployment arising from recession could pose risks to mortgages and unsecured consumer lending, among others.

At A Glance

Issued Capital (m shrs)	1,669
Mkt. Cap (Sm/USm)	32,988 / 24,082
Major Shareholders (%)	
Wee Investment Pte Ltd	8.0
Wah Hin & Co Pte Ltd	5.2
Free Float (%)	86.8
3m Avg. Daily Val (US$m)	61.1
GIC Industry : Financial / Banks	

Look forward to 2H20

Earnings were below expectations. 2Q20 net profit of S$703m declined 12% y-o-y/6% q-o-q, below expectations. Net interest income of S$1.5bn declined 12% y-o-y/ 9% q-o-q as NIM declined 23bps q-o-q to 1.48% (1Q20: 1.71%) on lower interest rates, on top of excess liquidity that weighed on NIM as UOB deliberately built up excess liquidity during April and May. NIM was worse than what we had previously expected. Geographically, Singapore and Southeast Asia revenues declined c.15%/8% y-o-y due to Circuit Breaker/movement restrictions amidst lower interest rates. Operating costs decreased slightly by 8% y-o-y/4% q-o-q on broad-based decline in expenses, resulting in cost-to-income ratio of 46.0% (1Q20: 45.1%) due to lower revenues. Capital ratios stood strong with CET1 ratio at 14.0% amidst a lower ROE of 7.1% (FY19: 11.6%).

Weaker fee income offset by trading income. Fee income declined 15% y-o-y/14% q-o-q due to lower business activities across the board due to Circuit Breaker/movement restrictions with credit card fees leading the biggest decline of 37% y-o-y/28% q-o-q. This was partially offset by good trading income during the quarter which led to non-interest income variance of -11% y-o-y/+20% q-o-q. Overall, non-interest income of S$804m declined 14% y-o-y/1% q-o-q. According to management, June and July's fee income activity levels were strong due to resumption of economic activities across the broad from the low base in 2Q20. However, as travelling accounts for a substantial portion of card fees, this is unlikely to recover to pre-COVID 19 levels in the near term.

Loan book grew 4% y-o-y/1% q-o-q, driven by loans in Thailand and Indonesia. Year-to-date (since Jan 2020), loans have grown 4.5%. UOB continues to see some new credit demand coming from selected corporates into 2H20. As of 2Q20, oil and gas exposure was largely flat, accounting for 3.5% of total loans (1Q20: 3.6%). UOB continues to target quality loan growth for the next 6-12 months.

Deposits grew 6% y-o-y/was flat q-o-q, in line with loans, resulting in a slight increase in loan-to-deposit ratio of 87.0% (1Q20: 86.3%). During 2Q20, CASA increased to account for ~50% of total deposits (1Q20: 47%).

More general allowances written during the quarter. Total allowances increased to S$468m, representing total credit costs of 67bps (1Q20: 35bps); on the back of higher general allowances of 54bps (1Q20: 4bps, excluding regulatory loan loss reserve [RLAR] taken), to reflect deteriorating macroeconomic conditions. For 1H20, total credit costs stood at 52bps, in line with management's full-year guidance. During the quarter, there were no significant new NPA formations (S$131m compared to average of S$398m for the last six quarters). We believe this is largely due to various loan moratoriums in place. NPA coverage ratio stood at 96% as of 1Q20 (1Q20: 88%).

Takeaways from analyst briefing

NIM expected to improve over next two quarters. Management indicated that there may be 2-3bps improvement every quarter over the next two quarters. Should rates remain around today's levels, management is confident that net interest income will improve q-o-q in 3Q20. Management is looking to price up credit spreads in coming quarters, which may support NIM.

Exposure breakdown. 51/15/34% of UOB's loan book are to large corporates/SMEs/individuals. Building and construction loans make up 25% of loans with average loan-to-value (LTV) of 50%, of which 80% are in Singapore and Hong Kong. SME loans are mostly in Malaysia and Singapore, where SMEs have a turnover of S$10-100m (not micro SMEs). About 90% of SME loans under relief are secured/mitigated by the government's risk-sharing schemes. Mortgages had an average LTV of 60% as of 2Q20 and are mostly for owner-occupied properties. Unsecured individual loans and credit card loans are ~2% of total loans.

16% of loans in moratorium; most of the loans are heavily securitised. About 10% of loans in Singapore are under moratorium, with the remainder in Malaysia and Thailand which have automatic opt-in moratoriums. Management estimates that ~10% of these loans may become NPLs. Based on observations, loans under moratorium have largely stabilised at current levels. Of the Enterprise Singapore loans, ~60% have been drawn down during the quarter.

Credit cost guidance. During 1Q20, management guided for 50-60bps credit costs each year through FY21F. Assuming the pandemic is largely under control, credit cost guidance cumulatively for the next two years is c.120-130bps/S$2-3bn, of which S$682m of loan provisions had been taken in 1H20. Peak NPL ratio may double from existing levels and this is likely to happen within the next 1.5 years.

CET1 ratio and dividends outlook. CET1 ratio is likely to decline from here (14.0%) but management believes it should remain above the bank's comfortable CET1 level of ~12.5%. Looking ahead, FY21F dividends are subject to MAS's deliberation.

Valuation and recommendation

Upgrade to BUY, TP of S$22.20. Our revised TP of S$22.20 is based on the Gordon Growth Model (9% ROE [previously 8%], 3% growth, 10% cost of equity). This is equivalent to c.0.9x FY21F P/BV that is near 1SD below its average 15-year forward P/BV multiple. Our earnings revisions are due to lower NIM and higher expense and provision assumptions.

Quarterly / Interim Income Statement (S$m)

FY Dec	2Q2019	1Q2020	2Q2020	% chg yoy	% chg qoq
Net Interest Income	1,653	1,593	1,456	(11.9)	(8.6)
Non-Interest Income	930	814	804	(13.5)	(1.2)
Operating Income	2,583	2,407	2,260	(12.5)	(6.1)
Operating Expenses	(1,130)	(1,087)	(1,040)	(8.0)	(4.3)
Pre-Provision Profit	1,453	1,320	1,220	(16.0)	(7.6)
Provisions	(51.0)	(286)	(396)	676.5	38.5
Associates	0.0	18.0	22.0	nm	22.2
Exceptionals	0.0	0.0	0.0	-	-
Pretax Profit	1,402	1,052	846	(39.7)	(19.6)
Taxation	(231)	(195)	(141)	(39.0)	(27.7)
Minority Interests	(4.0)	(2.0)	(2.0)	50.0	0.0
Net Profit	1,168	855	703	(39.8)	(17.8)
Growth (%)					
Net Interest Income Gth	4.2	(2.6)	(8.6)		
Net Profit Gth	11.0	(15.0)	(17.8)		
Key ratio (%)					
NIM	1.81	1.7	1.4		
NPL ratio	1.5	1.	1.		
Loan-to deposit	89.5	86.	87.		
Cost-to-income	43.7	45.	46.		
CET1 ratio	13.9	14.	14.		

Source of all data: Company, DBS Bank

CRITICAL DATA POINTS TO WATCH

Critical Factors

2Q20 NIM likely to be trough. We expect loan growth to slow down in FY20F on slower business activity. In 2Q20, average 3MSIBOR 3MLIBOR declined 83/93bps bps q-o-q (previous quarter: 25/41). We believe that loan yields will continue to decline on a lower reference rate as UOB actively seeks to let go of excess deposits/liquidity in 3Q20 to manage cost of funds.

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$129bn (2Q20), of which >50% comes from overseas customers. Amidst COVID-19, we expect some pressures on non-interest income such as cards, trading income going forward.

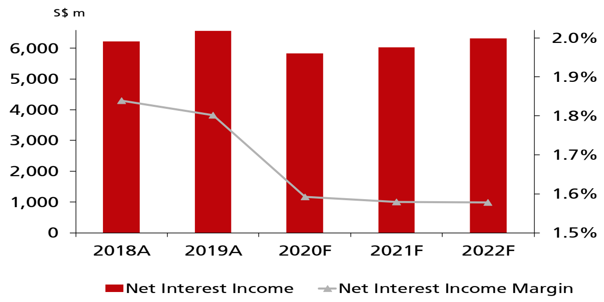
Costs skewed to business growth. We expect operating expenses to stay high with costs skewed towards business expansion and technology which is required particularly for digital banking and cyber security. Other investments to further enhance regional operations are still ongoing but the increase should not be high. Cost-to-income (CIR) target is 40% over the longer term. Management is guiding for stable CIR on the back on tight cost control in FY20F/FY21F.

Asset quality. We continue to keep watch on emerging risks from affected sectors from the fallout arising from COVID-19, oil and gas portfolio (due to low oil prices), as well as SME exposure. UOB's oil and gas book made up 3.5% of total loan book as of 2Q20 (2Q18: 4.7%). For vulnerable upstream exposures, they have been previously classified as NPLs and collateral values had been marked down by as much as 90% by end-2017.

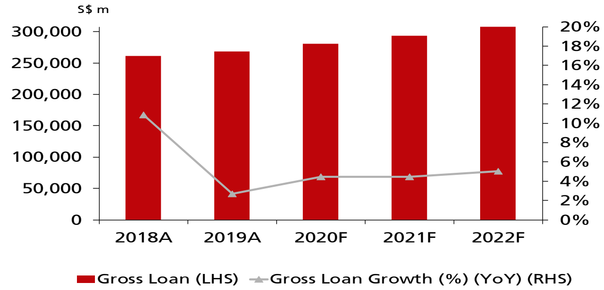
Regionalisation remains core to UOB's strategy. UOB's regionalisation agenda remains intact. The bank is relooking at its operations in Indonesia, given the current challenging operating environment. In Malaysia, growth remains cautious, but asset quality is at a comfortable position. Its Thai operations 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 from ASEAN and Greater China. UOB opened its second branch in Vietnam in June 2019 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.

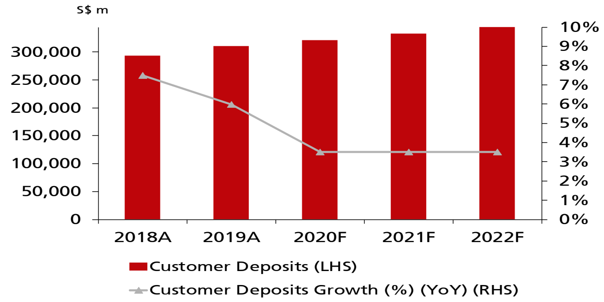
Margin Trends



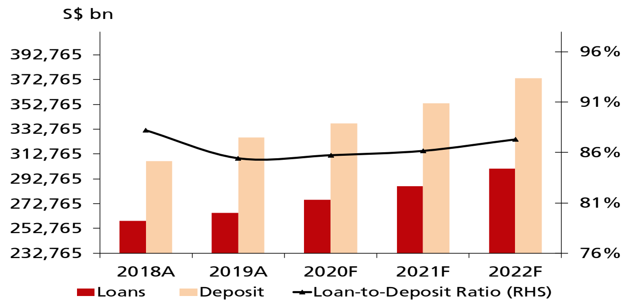
Gross Loan & Growth



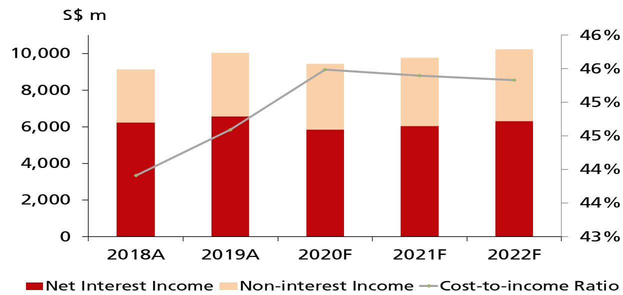
Customer Deposit & Growth



Loan-to-Deposit Ratio Trend



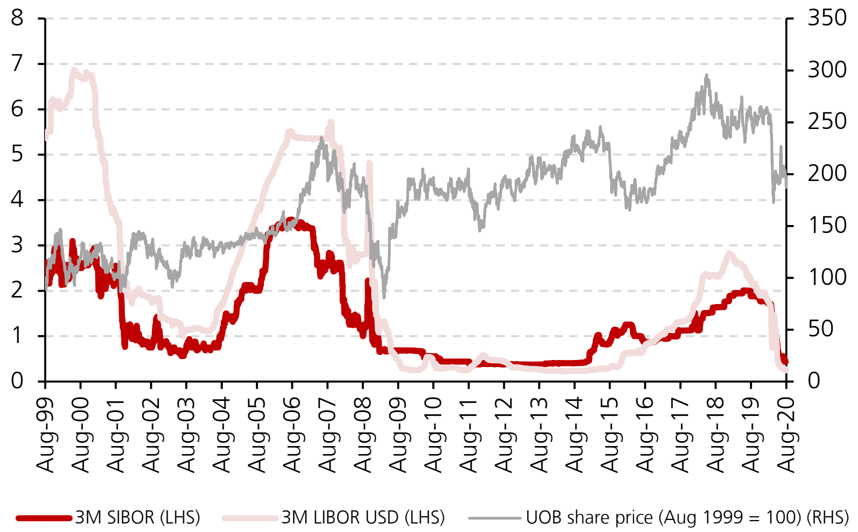
Cost & Income Structure



Source: Company, DBS Bank

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

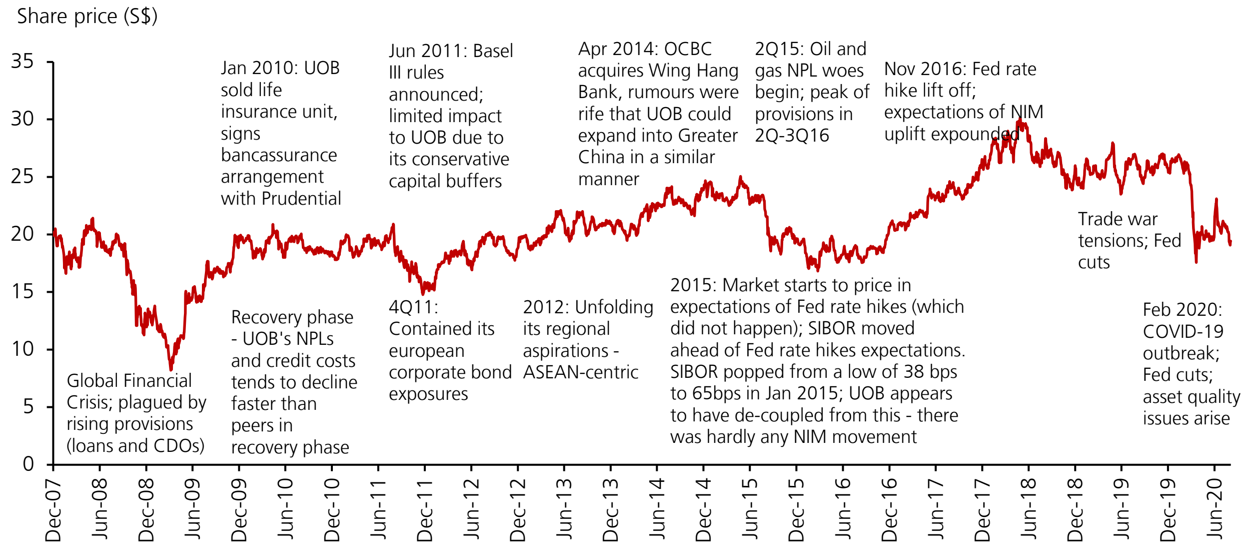
Interest rates as critical factor



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

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 12.5-13.5% and UOB announced the suspension of its scrip dividend programme together with its 2Q18 results. A lower dividend of 39 Scts (1H19: 55 Scts) was declared in 1H20 due to dividend cap imposed by MAS, which will see FY20F total dividends per share of 78 Scts.

Share Price Drivers:

Sustained ROE improvement. Sustained ROE improvement will continue to drive UOB's share price on the back of strong net interest income (post zero-rate environment) 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:

Recession impact. A deeper-than-expected recession in Singapore, a worse-than-expected COVID-19 outbreak in Singapore and regionally and a less firm macroeconomic outlook going forward could temper our fee income and loan growth expectations. Although loan growth is less sensitive to earnings, any deceleration as a result of weaker sentiment would dent top-line prospects.

Worsened asset quality. A larger-than-expected NPL arising from generic sectors and/or commodity-related exposure, as well as a worse-than-expected COVID-19 pandemic situation globally could unwind expectations of credit cost and NPL declines, thus posing risks to earnings. Further, unemployment arising from recession could pose risks to mortgages and unsecured consumer lending, among others.

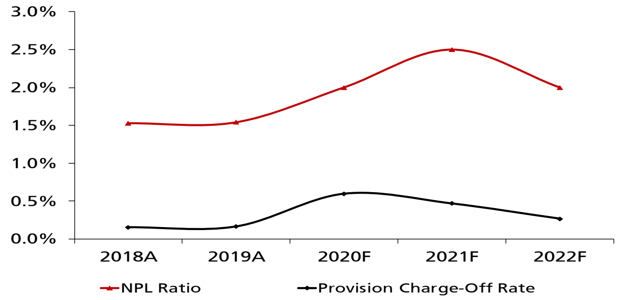
Environment, Social, Governance:

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. In FY19, UOB extended S$6bn of sustainable financing to corporates and completed its alignment of strategy to all United Nations Sustainable Development Goals.

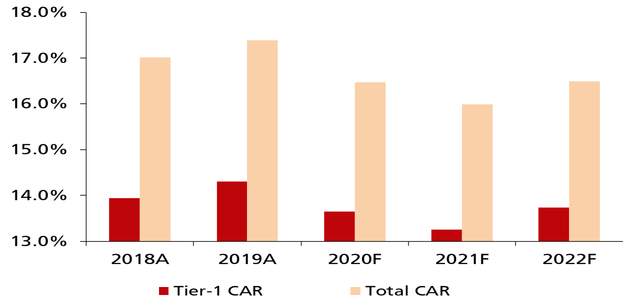
Company Background

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.

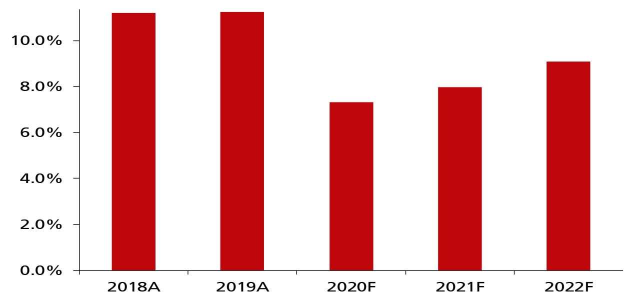
Asset Quality



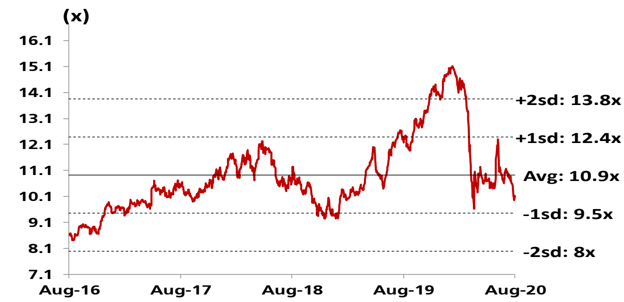
Capitalisation (%)



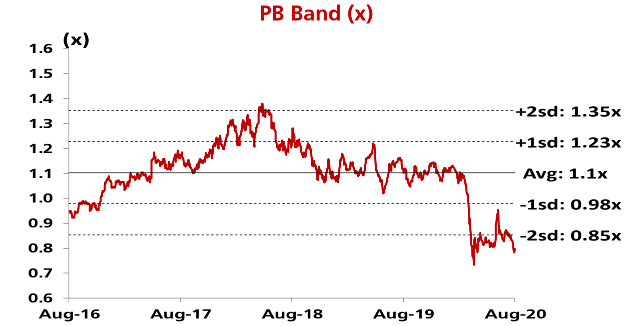
ROE (%)



Forward PE Band (x)



PB Band (x)



Source: Company, DBS Bank

Key Assumptions

FY Dec	2018A	2019A	2020F	2021F	2022F
Gross Loans Growth	10.9	2.7	4.4	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	2.6	2.6	2.6
Avg Cost Of Funds	1.5	1.7	1.1	1.1	1.1

Income Statement (S$m)

FY Dec	2018A	2019A	2020F	2021F	2022F
Net Interest Income	6,220	6,562	5,833	6,027	6,319
Non-Interest Income	2,896	3,468	3,588	3,733	3,901
Operating Income	9,116	10,030	9,422	9,760	10,221
Operating Expenses	(4,003)	(4,472)	(4,285)	(4,430)	(4,633)
Pre-provision Profit	5,113	5,558	5,136	5,330	5,587
Provisions	(393)	(435)	(1,666)	(1,365)	(812)
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	3,521	4,015	4,826
Taxation	(805)	(813)	(553)	(642)	(820)
Minority Interests	(13.0)	(18.0)	(10.6)	(12.1)	(14.5)
Preference Dividend	0.0	0.0	0.0	0.0	0.0
Net Profit	4,008	4,343	2,957	3,361	3,991
Net Profit bef Except	4,008	4,343	2,957	3,361	3,991
Growth (%)					
Net Interest Income Gth	12.5	5.5	(11.1)	3.3	4.9
Net Profit Gth	18.2	8.4	(31.9)	13.6	18.8
Margins, Costs & Efficiency (%)					
Spread	1.8	1.7	1.5	1.5	1.5
Net Interest Margin	1.8	1.8	1.6	1.6	1.6
Cost-to-Income Ratio	43.9	44.6	45.5	45.4	45.3
Business Mix (%)					
Net Int. Inc / Opg Inc.	68.2	65.4	61.9	61.7	61.8
Non-Int. Inc / Opg inc.	31.8	34.6	38.1	38.3	38.2
Fee Inc / Opg Income	21.6	20.3	22.5	23.0	23.3
Oth Non-Int Inc/Opg Inc	10.2	14.3	15.5	15.3	14.9
Profitability (%)					
ROAE Pre Ex.	11.2	11.2	7.3	8.0	9.1
ROAE	11.2	11.2	7.3	8.0	9.1
ROA Pre Ex.	1.1	1.1	0.7	0.8	0.9
ROA	1.1	1.1	0.7	0.8	0.9

Higher provisions expected through FY21F

Source: Company, DBS Bank

Quarterly / Interim Income Statement (S$m)

FY Dec	2Q2019	3Q2019	4Q2019	1Q2020	2Q2020
Net Interest Income	1,653	1,687	1,635	1,593	1,456
Non-Interest Income	930	922	797	814	804
Operating Income	**2,583**	**2,609**	**2,432**	**2,407**	**2,260**
Operating Expenses	(1,130)	(1,154)	(1,116)	(1,087)	(1,040)
Pre-Provision Profit	**1,453**	**1,455**	**1,316**	**1,320**	**1,220**
Provisions	(51.0)	(145)	(146)	(286)	(396)
Associates	0.0	14.0	20.0	18.0	22.0
Exceptionals	0.0	0.0	0.0	0.0	0.0
Pretax Profit	**1,402**	**1,324**	**1,190**	**1,052**	**846**
Taxation	(231)	(202)	(178)	(195)	(141)
Minority Interests	(4.0)	(4.0)	(6.0)	(2.0)	(2.0)
Net Profit	**1,168**	**1,118**	**1,006**	**855**	**703**
Growth (%)					
Net Interest Income Gth	4.2	2.1	(3.1)	(2.6)	(8.6)
Net Profit Gth	11.0	(4.3)	(10.0)	(15.0)	(17.8)

Balance Sheet (S$m)

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	54,881	57,086	59,866
Total Net Loans & Advs.	258,628	265,458	275,711	286,790	300,754
Investment	15,482	18,243	16,714	17,414	18,266
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	13,034	13,557	14,218
Total Assets	**388,092**	**404,409**	**418,411**	**437,194**	**460,202**
Customer Deposits	293,186	310,726	321,601	332,857	344,507
Inter Bank Deposits	13,801	15,301	15,718	20,935	29,439
Debts/Borrowings	30,606	25,209	25,209	25,209	25,209
Others	12,688	13,309	14,351	14,969	15,813
Minorities	189	227	238	250	264
Shareholders' Funds	37,623	39,637	41,293	42,974	44,969
Total Liab& S/H's Funds	**388,093**	**404,409**	**418,411**	**437,194**	**460,202**

Source: Company, DBS Bank

Financial Stability Measures (%)

FY Dec	2018A	2019A	2020F	2021F	2022F
Balance Sheet Structure					
Loan-to-Deposit Ratio	88.2	85.4	85.7	86.2	87.3
Net Loans / Total Assets	66.6	65.6	65.9	65.6	65.4
Investment / Total Assets	4.0	4.5	4.0	4.0	4.0
Cust . Dep./Int. Bear. Liab.	86.8	88.5	88.7	87.8	86.3
Interbank Dep / Int. Bear.	4.1	4.4	4.3	5.5	7.4
Asset Quality					
NPL / Total Gross Loans	1.5	1.5	2.0	2.5	2.0
NPL / Total Assets	1.0	1.0	1.3	1.7	1.3
Loan Loss Reserve Coverage	77.1	77.8	87.3	85.7	115.4
Provision Charge-Off Rate	0.2	0.2	0.6	0.5	0.3
Capital Strength					
Total CAR	17.0	17.4	16.5	16.0	16.5
Tier-1 CAR	13.9	14.3	13.6	13.3	13.7

Strong capital levels

Source: Company, DBS Bank

Target Price & Ratings History

S.No.	Date of Report	Closing Price	12-mth Target Price	Rating
1:	05 Aug 19	25.91	29.20	BUY
2:	30 Aug 19	24.96	29.20	BUY
3:	01 Nov 19	26.57	29.20	BUY
4:	12 Nov 19	27.02	29.20	BUY
5:	24 Feb 20	25.28	27.20	BUY
6:	05 Mar 20	23.74	25.50	HOLD
7:	17 Mar 20	19.39	19.00	HOLD
8:	23 Apr 20	19.57	17.50	HOLD
9:	06 May 20	19.88	17.50	HOLD
10:	21 Jul 20	20.70	20.90	HOLD

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

Source: DBS Bank

Analyst: Rui Wen LIM

DBS Bank recommendations are based on on 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: 6 Aug 2020 19:11:41 (SGT)
Dissemination Date: 6 Aug 2020 19:49:21 (SGT)

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**Share price appreciation + dividends*

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