

Upgrade on Cheap valuations, Strong fundamentals

Bloomberg | Reuters | POEMS
UOB SP | UOBH SI | UOB SG
Industry: Regional Banks

Phillip Securities Research Pte Ltd

8 November 2012

Report type: Quarterly Results

Company Overview

UOB Ltd provides a wide range of financial services including banking, insurance, and asset management. Its main operations are in Southeast Asia, including Singapore and Malaysia, with more than 500 offices in 19 countries and territories.

- 3Q12 results beat expectations on strong non-trading income, one-off dividends.
- Upgrade to "Accumulate" on cheap valuations, strong fundamentals, with new target price of S\$18.00, based on unchanged P/B multiple of 1.25X.

What is the news?

UOB's 2Q12 earnings were above our expectations, due largely to high non-trading income and a one-off dividend income from a subsidiary. NIMs declined -8bps q-q, leading to weaker q-q net interest income performances. Fees and commission income declined marginally q-q. Provision was made for a specific loan, leading to an increase in NPL ratio. Overall portfolio however remains healthy.

Income Statement				
(Extract)	3Q11	3Q12	y-y (%)	Comments
(S\$'mn)				
NII	916	970	5.9%	NIMs down 5bps y-y
Fees & Comm	323	372	15.2%	Strong performance
Others	122	321	163.1%	Non-trading inc up
Revenue	1,361	1,663	22.2%	
Expenses	632	687	8.7%	Within expectations
Net Income	522	706	35.2%	Beat expectations

Source: Company, PSR

How do we view this?

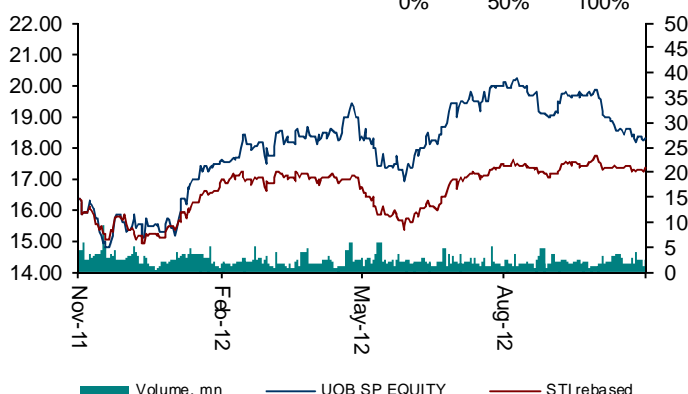
On the overall, UOB posted a decent set of 3Q12 results. Although downward NIMs pressure remain while the earnings beat was of low quality, growth of fees and commission was relatively resilient, loans growth was healthy, and non-interest income this year has been strong, both likely due to selling of assets with European exposure at a smaller loss y-y, while increase in customer flow and cross selling likely decreased the q-q volatility of its non-interest income.

Investment Actions?

While the decline in NIMs may be mitigated by a healthy loans growth and increased pricing power, we think that there are potential upsides from sustained strong fees and commission, with increasing contribution from its regional offices. We adjust our forecast to include 3Q12's results, deriving a higher BVPS of S\$14.42. Based on our unchanged P/B multiple of 1.25X, we obtain a new target price of S\$18.00. We upgrade UOB to "Accumulate", based on its current cheap valuations, strong fundamentals, and potential increase in dividend for FY2012. We encourage investors to buy on the dip, as we expect UOB's share price to fall initially on expectations of continued NIMs pressure.

United Overseas Bank Ltd

Rating	2	Accumulate
- Previous Rating	4	Reduce
Target Price (SGD)	18.0	
- Previous Target Price (SGD)	17.9	
Closing Price (SGD)	18.30	
Expected Capital Gains (%)	-1.6%	
Expected Dividend Yield (%)	3.6%	
Expected Total Return (%)	1.9%	
Raw Beta (Past 2yrs weekly data)	1.04	
Market Cap. (USD mn / SGD mn)	23568 / 28801	
3M Average Daily T/O (mn)	1.9	
52 week range (SGD)	14.77 - 20.23	
Closing Price in 52 week range		



Major Shareholders

	(%)
1. Wee Investments Pte Ltd	7.6
2. Wah Hin & Co Pte Ltd	5.2
3. Harbor Capital Advisors Inc	1.7

Key Financial Summary

FYE	12/10	12/11	12/12F	12/13F
Revenue (SGD mn)	5,800	5,700	6,444	6,612
Net Profit, adj. (SGD mn)	2,696	2,325	2,725	2,857
EPS, adj. (SGD)	1.56	1.42	1.65	1.73
P/E (X),adj.	11.7	12.9	11.1	10.6
BVPS (SGD)	12.51	13.23	14.42	15.52
P/B (X)	1.5	1.4	1.3	1.2
DPS (SGD)	0.70	0.60	0.65	0.65
Div. Yield (%)	3.8%	3.3%	3.6%	3.6%

Source: Bloomberg, PSR est.

*All multiples & yields based on current market price

Valuation Method

P/B

Analyst

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Fig 1. Y-Y and Q-Q comparison of 3Q12 results

\$m	3Q12	3Q11	%y-y ch	2Q12	%q-q ch
NII	970	916	5.9%	981	-1.1%
Fees & Comm	372	323	15.2%	386	-3.6%
Other non-interest inc	321	122	163.1%	243	32.1%
Total Revenue	1,663	1,361	22.2%	1,610	3.3%
Expenses	687	632	8.7%	666	3.2%
Net Profit	706	522	35.2%	713	-1.0%

Source: Company, PSR

Conso' ending	Profits (SGM)	EPS (SG)	DPS (SG)	BV (SG)	ROE (%)	P/E (X)	Yield (%)	P/BV (X)
12/09 A	1,902	1.19	0.60	11.17	11.9%	15.37	3.3%	1.64
12/10 A	2,696	1.56	0.70	12.51	14.3%	11.70	3.8%	1.46
12/11 A	2,325	1.42	0.60	13.23	11.1%	12.85	3.3%	1.38
12/12 E	2,725	1.65	0.65	14.42	12.0%	11.11	3.6%	1.27
12/13 E	2,857	1.73	0.65	15.52	11.7%	10.57	3.6%	1.18

Source: Company, PSR

Net Interest Margins down, may fall further

NIMS were down -8bp q-q, erasing all recent NIMs improvements made in 1Q12, and even beyond previous lows of 1.89% in 3Q11. Q-q, the decline in NIMs was largely attributable to the decrease in yields on interbank balances. Loan yields also declined, while cost of deposits saw a slight uptick on intense competition for deposits. Asset yields also declined due to changes in the asset mix to lower yielding assets, with a decrease to the bank's European exposure.

Management guided for possible further decline in NIMs moving forward. While Singapore's DBU NIMs have generally stabilized, pressure on ACU NIMs due to the increase in liquidity from QE3 may continue to add to the pressure on NIMs. We note the declining USD interbank rates, and believe this will be one of the factors causing further downward pressure on NIMs. In the overseas markets, management also continues to see downward pressure in Thailand, Indonesia, and China. However, NIMs pressure may be mitigated by increase in pricing power, as banks seek to pass the higher cost of funding to their borrowers.

Loans guidance maintained, high Deposits growth

Loans grew 1.75% q-q, 5.91% ytd to S\$152.4 billion. Growth was mainly from an increase in housing loans, other consumer loans, and loans to Financial Institutes. Management maintained its guidance of high single digit loans growth for FY2012 and FY2013. Geographically, Thailand and Malaysia experienced high loans growth q-q. We estimate this to be 5.53% and 2.78% respectively, based on constant currency terms. Indonesia grew by a slower 1.49% q-q, after adjusting for currency effects.

Deposits grew 2.98% q-q, with growth in all major currencies based on constant currency terms. The proportion of CASA deposits however declined by 0.45%, as the bank relies more heavily on the higher costing fixed deposits. This may have an adverse effect on funding cost as the cost of fixed deposits increases faster than those of CASA deposits.

With the q-q growth of deposits beating that of loans growth in 3Q12, LDR decreased to 86.0%. We think that this is a healthy level, with room for possibly higher LDR.

Fees and Commission, Non interest income strong

Fees and commission maintained its strong momentum, although registering a slightly q-q decline. Total fees and commission for 9M12 was 13.0% higher as compared to 9M11. Management continues to expect the retail portion, including the investment/wealth management, credit card, and loan related fees and commission to be the growth driver moving forward, driven by increasing contributions from its regional branches.

Other non-interest income was once again the biggest earnings surprise for the quarter, largely due to high non-trading income from available-for-sale assets. Income from AFS, which is volatile and of lower quality due to its non-recurring nature, did not decline as much as per our forecast. Fair value gains were recognised as UOB continued to reduce its European exposure, as the market value of some instruments rebounded, or due to the exercising of some of the instrument's callable option. Furthermore, there was a one-time dividend income gain of approximately S\$50 million from a subsidiary.

NPL ratio up mainly due to a specific loan

NPL ratio was up 23 bps to 1.64%, due to a transportation loan booked in one of UOB's overseas branch. Management guided that this loan had not defaulted, but was categorized as a NPL due to concerns over its cash flow. Ignoring this loan, management guided for the overall portfolio to be stable, and do not expect any further changes in FY2012.

Other matters

Basel III: Capital requirements – Management does not expect much impact from the capital requirements due to adequate preparation time. Although CAR are expected to decrease due to the higher RWA and lower eligible equity, management does not expect this to be significant. While management is also working on reducing its RWA, it does not expect reductions similar to the magnitude as indicated by DBS Group of approximately 60% of total assets.

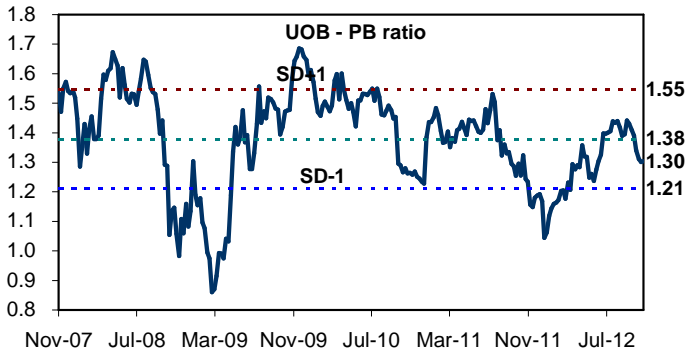
Liquidity requirements – Management expects the new liquidity requirements to have significant impact on UOB's balance sheet. For example, UOB may be required to hold more government securities. Competition for deposits may also increase as wholesale funding carries a lower weight for the NSFR and may decrease the LCR ratio. However, management expects that UOB would be able to fulfill the requirements within the time given. More clarification is also required from both MAS and the Basel Committee.

Strong performance of regional offices – We note the strong 9M12 performances of 20.4% increase in operating income, and 39.2% increase in profit before tax for UOB's main regional offices as compared to 9M11. This is significantly higher compared to Singapore's 13.7% and 15.1% growth respectively in the same period.

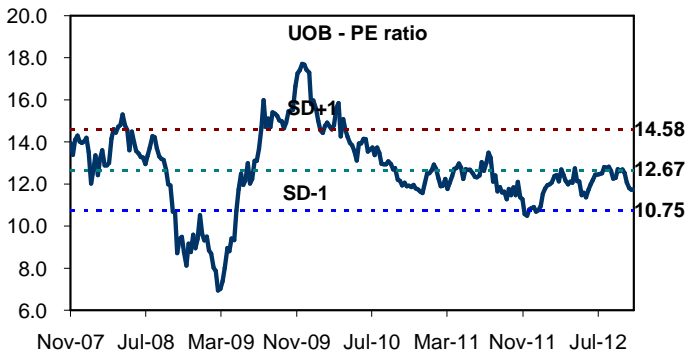
Potential increase in full year dividends – Based on our forecast, we think that management may give a special dividend of S\$0.05 – S\$0.10 for FY2012. This is based on a dividend payout ratio of 39.5% - 42.5%, which is at the low end of historical dividend payouts of 40% - 60%, while forecasting continued strong y-y growth momentum in 4Q12. However, management may decide on reducing payouts to retain capital to meet Basel III requirements, or for further investments in its current regional offices.

Key risks – Downside risk includes worsening credit quality. Loan allowances has been low, therefore credit cost will increase sharply should asset quality deteriorate. Significant changes to the macroeconomic environment, such as unexpected sharp worsening in the global economy, more than two countries leaving the Euro, or natural disasters such as severe floods in Thailand have also not been factored into our earnings forecast.

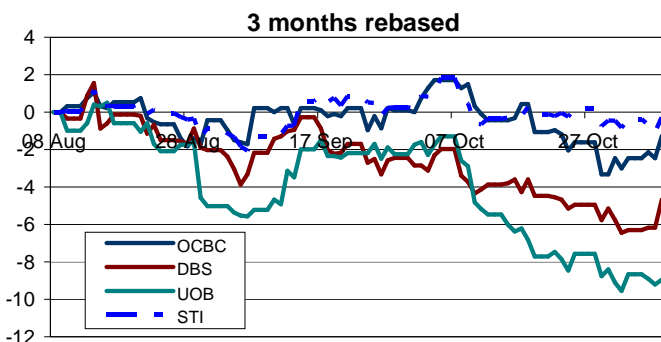
Fig 2. 5 Year Price to Book – Below historical mean



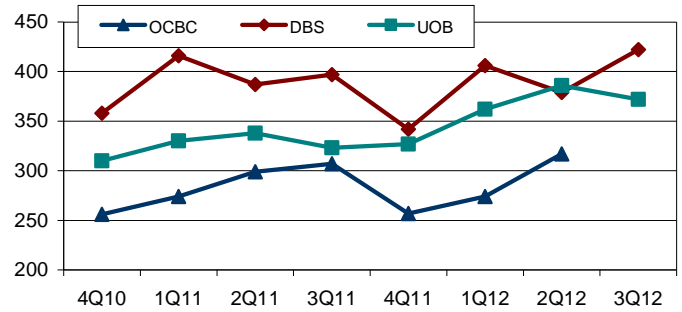
5 Year Price to Earnings – Below historical mean



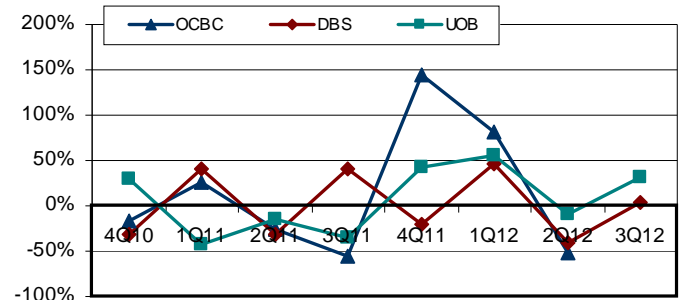
Recent share price trading below local peers and STI



Q-Q Fees and commission relatively resilient



Q-Q non-interest income momentum less volatile



Source: Company, PSR

Valuation

On the overall, UOB posted a decent set of 3Q12 results. Although downward NIMs pressure remain while the earnings beat was of low quality, growth of fees and commission was relatively resilient, loans growth was healthy, and non-interest income this year has been strong, both likely due to selling of assets with European exposure at a smaller loss y-y, while increase in customer flow and cross selling likely decreased the q-q volatility of its non-interest income.

While the decline in NIMs may be mitigated by a healthy loans growth and increased pricing power, we think that there are potential upsides from sustained strong fees and commission, with increasing contribution from its regional offices. We also note that based on previous meetings, management is very optimistic on its regional offices, including expectations of 50% of NPAT contributions for Group Commercial Banking from its regional offices by 2015.

We adjust our forecast to include 3Q12's results, deriving a higher BVPS of S\$14.42. Based on our unchanged P/B multiple of 1.25X, we obtain a new target price of S\$18.00. We upgrade UOB to "Accumulate", based on its current cheap valuations, strong fundamentals, and potential increase in dividend for FY2012. We encourage investors to buy on the dip, as we expect UOB's share price to fall initially on expectations of continued NIMs pressure.

Table 1. Growth in revenue

\$m	3Q12	3Q11	%y-y ch	2Q12	%q-q ch
Net interest income	970	916	5.9%	981	-1.1%
Net fee and comm inc	372	323	15.2%	386	-3.6%
Other non-interest inc	321	122	163.1%	243	32.1%
Total	1,663	1,361	22.2%	1,610	3.3%

Table 2. Fee and commission income

\$m	3Q12	3Q11	%y-y ch	2Q12	%q-q ch
Credit card	60	58	3.4%	59	1.7%
Fund management	31	23	34.8%	24	29.2%
Investment-related	86	56	53.6%	78	10.3%
Loan-related	90	82	9.8%	114	-21.1%
Service charges	27	23	17.4%	27	0.0%
Trade-related	62	65	-4.6%	68	-8.8%
Other	16	16	0.0%	18	-11.1%
Dividend income	89	13	584.6%	34	161.8%
Rental income	27	28	-3.6%	27	0.0%
Total	488	364	34.1%	449	8.7%

Table 3. Other non-interest income

\$m	3Q12	3Q11	%y-y ch	2Q12	%q-q ch
Net trading income	173	56	208.9%	151	14.6%
Trading income/(loss)	17	5	240.0%	11	54.5%
Non-trading inc/(loss)	63	(37)	-270.3%	9	600.0%
AFS assets	93	88	5.7%	131	-29.0%
Other income	32	26	23.1%	31	3.2%
Total other non int inc	205	82	150.0%	182	12.6%

Table 4. Loans by Industries

\$m	3Q12	3Q11	%y-y ch	2Q12	%q-q ch
Tpt, storage & comms	7,452	6,825	9.2%	7,642	-2.5%
Building and construction	19,034	15,786	20.6%	18,939	0.5%
Manufacturing	11,475	10,393	10.4%	11,534	-0.5%
Financial institutions	24,078	22,971	4.8%	23,210	3.7%
General commerce	18,215	20,084	-9.3%	18,131	0.5%
Professionals & Pri inv	21,222	17,531	21.1%	20,262	4.7%
Housing loans	44,297	38,646	14.6%	42,997	3.0%
Others	6,674	8,196	-18.6%	7,114	-6.2%
Total loans	152,447	140,432	8.6%	149,829	1.7%

Table 5. Loans by currencies

\$m	3Q12	3Q11	%y-y ch	2Q12	%q-q ch
Singapore dollar	85,196	75,578	12.7%	82,942	2.7%
US dollar	18,553	21,328	-13.0%	19,190	-3.3%
Malaysian ringgit	21,026	17,336	21.3%	20,426	2.9%
Thai baht	7,838	7,340	6.8%	7,546	3.9%
Indonesian rupiah	4,502	4,335	3.9%	4,603	-2.2%
Others	15,332	14,515	5.6%	15,122	1.4%
Total loans	152,447	140,432	8.6%	149,829	1.7%

Table 6. Profit before tax by Business segments

\$m	3Q12	3Q11	%y-y ch	2Q12	%q-q ch
Group Retail	797	773	3.1%	257	210.1%
Grp Wholesale	1,331	1,193	11.6%	493	170.0%
Global Mkts and IM	494	317	55.8%	146	238.4%
Others	95	(14)	-778.6%	(27)	-451.9%
Total NPBT	2,717	2,269	19.7%	869	212.7%

Table 7. Profit before tax by Geographical segments

\$m	3Q12	3Q11	%y-y ch	2Q12	%q-q ch
Singapore	567	422	34.4%	523	8.4%
Malaysia	153	105	45.7%	154	-0.6%
Thailand	40	22	81.8%	26	53.8%
Indonesia	52	37	40.5%	53	-1.9%
Greater China	52	25	108.0%	46	13.0%
Others	16	39	-59.0%	70	-77.1%
Total NPBT	880	650	35.4%	872	0.9%

Source (tables 1-7): Company, Phillip Securities Research

Fig 1: Net interest margin

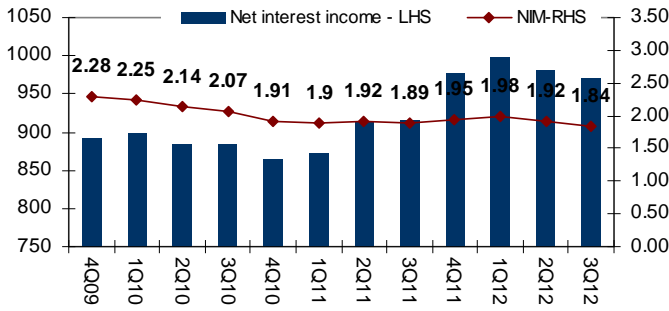


Fig 2: NonInt/Total revenue

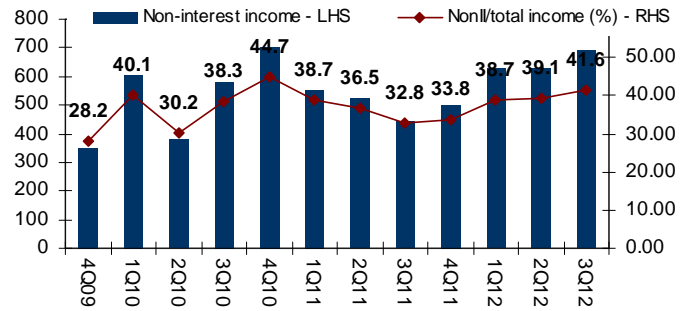


Fig 3: Efficiency ratio

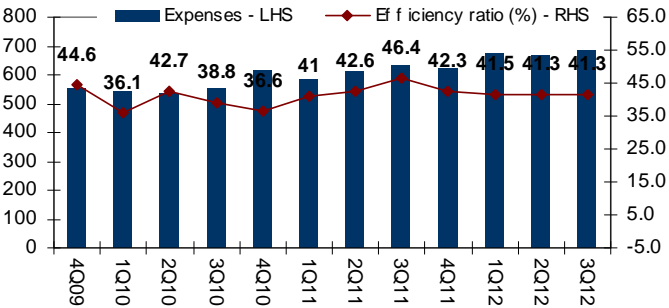


Fig 4: Net profit margin

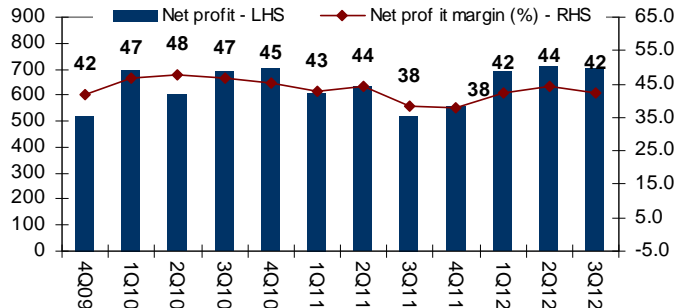


Fig 5: Deposits, Loans, LDR

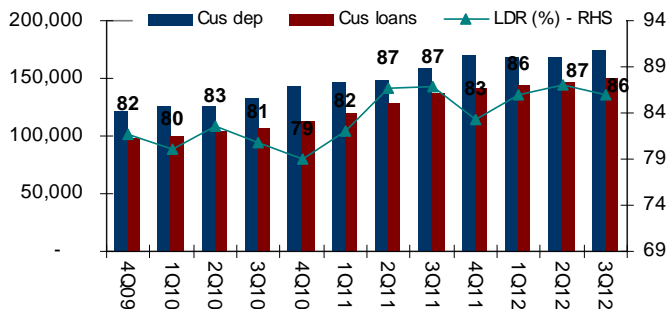


Fig 6: NPA, NPL

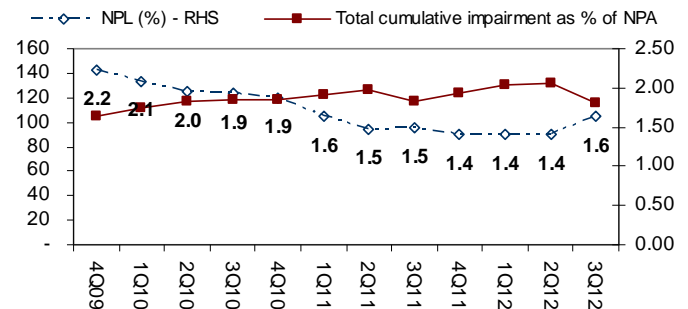


Fig 7: Growth in selected asset items

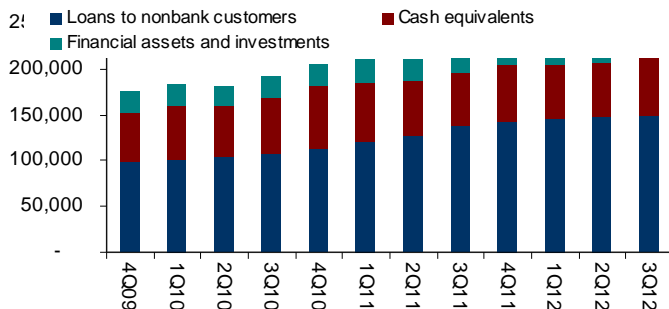


Fig 8: CAR

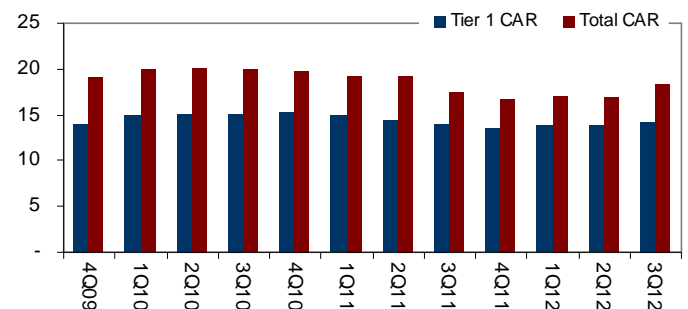


Fig 9: ROE and ROA

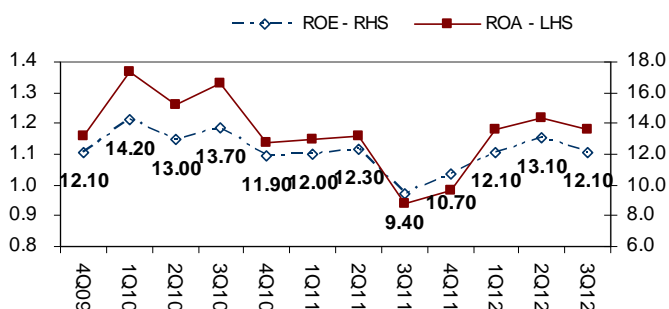


Fig 10: EPS and NBV

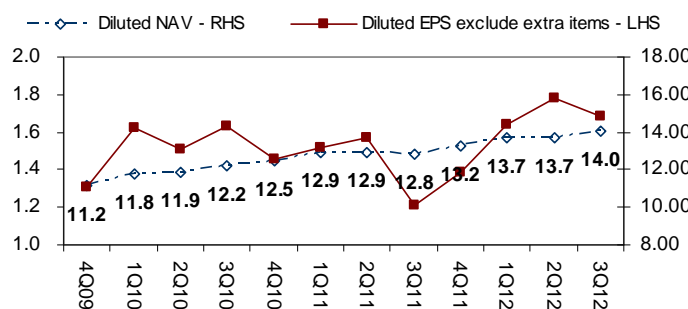


Fig 11: Revenue by geographical segment

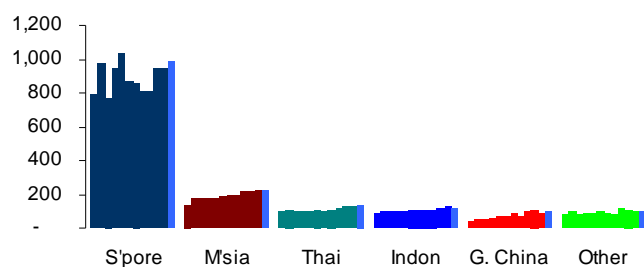


Fig 12: Geo segment breakdown

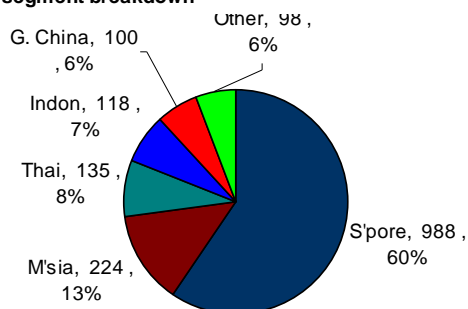
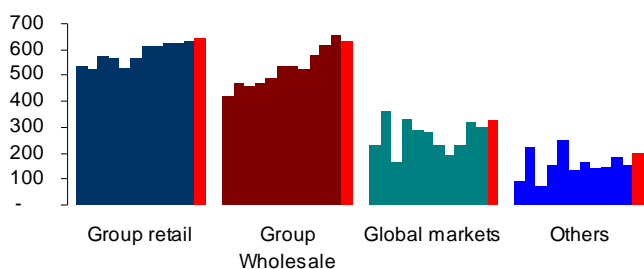


Fig 13: Revenue by Business segment



Growth trend

Fig 14: Net interest income trend

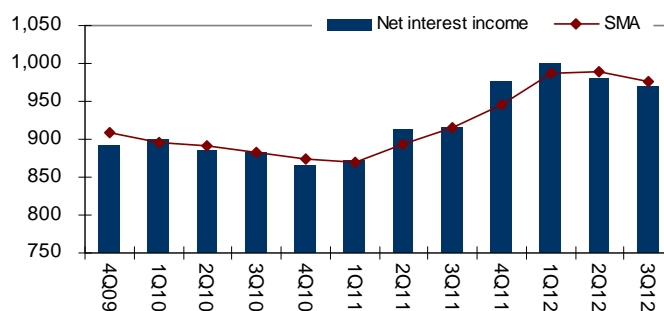


Fig 15: Fee and Commission trend

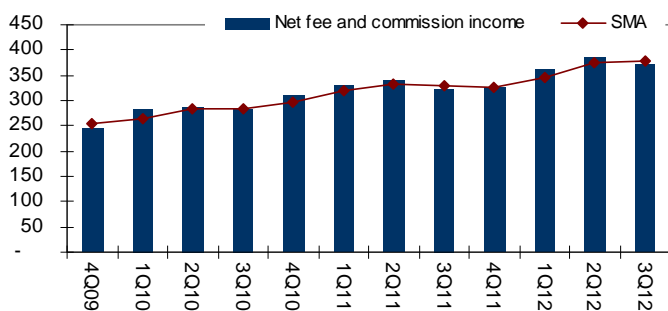


Fig 16: Other noninterest income trend

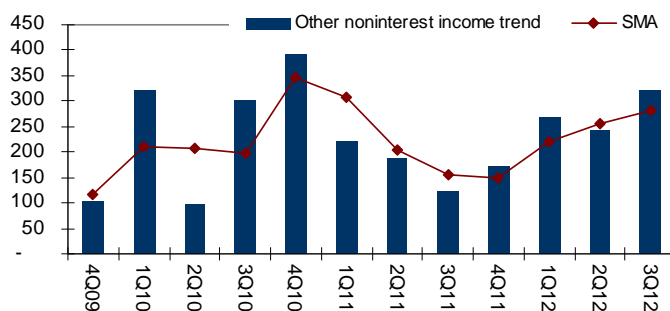


Table 8: Actual vs Forecast of 3Q12 results

Income Statement					
(Extract)	3Q12 F	3Q12 A	Diff	Diff (%)	Comments
Int Income	1,555	1,551	(4)	0%	
Int Expense	573	581	8	1%	
Net Int Inc	982	970	(12)	-1%	NIMs compression
Fees & Comm	362	372	10	3%	Higher fees
Other Int inc	190	321	131	69%	Volatile item &
Non Int inc	552	693	141	26%	One-off dividend
Revenue	1,534	1,663	129	8%	
Expenses	693	687	(6)	-1%	Within expectations
Amor/Imp chg	111	121	10	9%	Higher NPLs
Tax	136	166	30	22%	Higher PBT
Net income	615	706	91	15%	

Source: Company, PSR

FYE Dec	FY09	FY10	FY11	FY12F	FY13F
Valuation Ratios					
P/E (X), adj.	15.4	11.7	12.9	11.1	10.6
P/B (X)	1.6	1.5	1.4	1.3	1.2
Dividend Yield (%)	3.3%	3.8%	3.3%	3.6%	3.6%
Per share data (SGD)					
EPS, reported	1.19	1.70	1.43	1.65	1.73
EPS, adj.	1.19	1.56	1.42	1.65	1.73
DPS	0.60	0.70	0.60	0.65	0.65
BVPS	11.17	12.51	13.23	14.42	15.52
Growth & Margins (%)					
Growth					
Net interest income	2.7%	-3.9%	4.2%	6.8%	4.4%
Non interest income	3.3%	31.1%	-10.9%	24.5%	-0.2%
Pre provision operating profit	2.9%	7.3%	-1.7%	13.1%	2.6%
Operating income	-7.6%	39.1%	-11.2%	20.6%	4.0%
Net income, reported	-1.6%	41.7%	-13.8%	17.2%	4.9%
Margins					
Net interest margin	2.36%	2.09%	1.92%	1.89%	1.85%
Key Ratios (%)					
ROE	11.9%	14.3%	11.1%	12.0%	11.7%
ROA	1.06%	1.38%	1.06%	1.12%	1.09%
RORWA	1.76%	2.59%	1.93%	2.01%	2.07%
Non-interest/total income ratio	32.0%	39.1%	35.5%	39.0%	38.0%
Cost/income ratio	38.4%	38.9%	43.0%	42.2%	43.5%
Loan/deposit ratio	81.6%	79.0%	83.3%	86.5%	87.3%
NPL ratio	2.22	1.87	1.40	1.64	1.60
Income Statement (SGD mn)					
Net Interest Income	3,674	3,531	3,679	3,929	4,101
Fees and Commission	976	1,163	1,318	1,492	1,562
Other Non interest income	755	1,106	703	1,024	950
Total operating income	5,405	5,800	5,700	6,444	6,612
Operating expenses	2,074	2,256	2,452	2,722	2,875
Provisions	1,132	485	533	446	332
Operating profit	2,199	3,059	2,715	3,275	3,406
Associates & JVs	107	139	92	90	100
Profit Before Tax	2,306	3,198	2,807	3,365	3,506
Taxation	385	480	467	623	631
Profit After Tax	1,921	2,718	2,340	2,743	2,875
Non-controlling Interest	19	22	15	18	17
Net Income, reported	1,902	2,696	2,325	2,725	2,857
Net Income, adj.	1,902	2,493	2,325	2,724	2,857

Source: PSR

FYE Dec	FY09	FY10	FY11	FY12F	FY13F
Balance Sheet (SGD mn)					
Cash, balances and placements w ith central banks	18,885	30,743	26,786	36,373	37,066
Singapore Government treasury bills and securities	12,787	12,814	9,710	9,201	10,213
Other government treasury bills and securities	7,704	11,575	8,253	8,643	8,795
Trading securities	118	138	271	279	284
Placements and balances w ith banks	14,116	13,458	18,770	21,232	21,603
Investment securities	16,177	15,926	14,354	9,759	9,078
Other assets	8,994	9,132	10,157	14,155	14,402
Loans to non-bank customers	99,201	112,440	141,191	152,897	161,817
Investment in associates	1,212	1,198	1,092	1,095	1,095
Investment properties	1,134	1,125	1,126	976	976
Fixed assets	1,040	1,019	1,050	1,050	1,045
Intangible assets	4,229	4,210	4,196	4,183	4,171
Total Assets	185,597	213,778	236,956	259,842	270,544
Deposits and balances of banks	27,751	31,862	19,750	33,412	33,705
Deposits and balances of non-bank customers	121,502	142,299	169,460	176,678	185,354
Bills and drafts payable	1,438	1,288	1,730	1,927	1,927
Other liabilities	9,688	10,412	11,087	10,150	10,150
Debts issued	6,044	6,263	11,786	12,630	12,630
Total liabilities	166,423	192,124	213,813	234,798	243,765
Share capital	1,902	2,537	3,104	3,104	3,104
Preference shares	2,149	2,149	2,149	2,149	2,149
Retained earnings	6,324	7,687	8,499	10,173	11,890
Other reserves	8,611	9,101	9,215	9,424	9,424
Shareholder Equity	18,986	21,474	22,967	24,850	26,567
Non-controlling interest	169	180	177	195	212
Total Equity	19,155	21,654	23,144	25,044	26,779

Cashflow Statements (SGD mn)

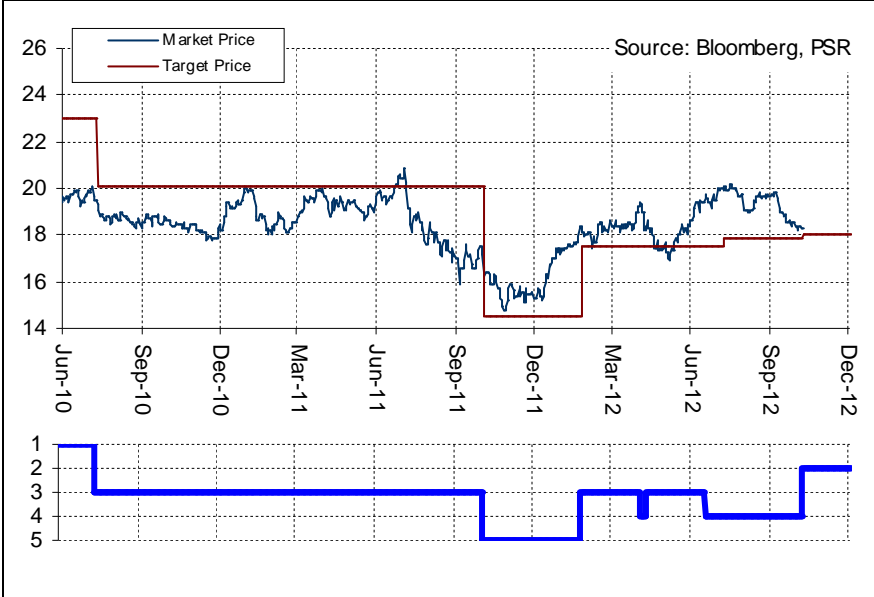
CFO					
PBT	3,331	3,542	3,248	3,365	3,506
Adjustments	124	(205)	163	135	134
Cash from ops before WC changes	3,455	3,337	3,411	3,500	3,640
WC changes	(3,003)	7,558	(12,369)	6,681	(1,059)
Cash generated from ops	452	10,895	(8,958)	10,182	2,581
Taxes paid, net	(423)	(488)	(601)	(623)	(631)
Cashflow from ops	29	10,407	(9,559)	9,559	1,950
Cashflow from investments	(132)	489	(17)	38	(99)
Cashflow from financing	(1,217)	(182)	6,163	(207)	(1,140)
Net change in cash	(1,197)	10,598	(4,747)	9,390	689
CCE, end	16,546	27,142	22,396	31,786	32,475

Supplementary items

Risk-weighted assets (SGD mn)	100,908	106,889	133,578	137,420	138,165
Tier 1 capital (SGD mn)	14,127	16,362	18,014	19,913	21,630
Total capital (SGD mn)	19,183	21,206	22,337	24,035	25,752
Core Tier 1 CAR (%)	11.9%	13.3%	11.9%	12.9%	14.1%
Tier 1 CAR (%)	14.0%	15.3%	13.5%	14.5%	15.7%
Total CAR (%)	19.0%	19.8%	16.7%	17.5%	18.6%

Source: PSR

Ratings History



PSR Rating System

Total Returns	Recommendation	Rating
> +20%	Buy	1
+5% to +20%	Accumulate	2
-5% to +5%	Neutral	3
-5% to -20%	Reduce	4
< -20%	Sell	5

Remarks

We do not base our recommendations entirely on the above quantitative return bands. We consider qualitative factors like (but not limited to) a stock's risk reward profile, market sentiment, recent rate of share price appreciation, presence or absence of stock price catalysts, and speculative undertones surrounding the stock, before making our final recommendation

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