

United Overseas Bank Limited

Loans growth intact and least affected by trade war

SINGAPORE | BANKING | UPDATE

- In near-term, loans growth not expected to be affected by trade war and property cooling measures. High single-digit loans growth target for FY18 remains reasonable.
- Rising interest rate unlikely to have a significant impact on credit quality but cost of funds is expected to increase in tandem.
- Operating costs is expected to stay elevated with investments in technology for business expansion.
- We raise our dividend forecast to S\$1.19 per share in favour of a 50% pay-out ratio.
- **Maintain BUY with target price of S\$33.70 (previous TP S\$34.50) based on Gordon Growth Model.** The decrease in target price was due to our lower ROE assumption to 11.6% (previously 11.8%) and lower BV assumption to S\$21.30 (previously S\$21.6/share).

Expect loans growth to remain on target

Between 10-15% of UOB's loans book is trade related, with the bulk anchored out of South-East Asia. Hence we do not expect the trade war to pose significant risks to trade loans growth unless it escalates into an overall global slowdown. UOB has the largest proportion of property-related loans (50% of total loans) as compared to DBS (42%) and OCBC (42%). Mortgage-related loans at 27% of total loans, and building and construction at a further 23% of total loans. Due to drawdowns of previously approved loans, weakness in the property-related loan market may only be felt next year. Lending to the property developer market is expected to hold up in the short-term. To put things into context, for UOB to miss their full-year loans growth target by 1% point, housing loans and building and construction loans would have to contract 3-4% YoY. Taking into account near-term uncertainties in trade and expectation of a more moderate pace in property transaction volumes, we are forecasting loans growth of 8.4% and 5.9% for FY18e and FY19e respectively.

Rising interest rates not expected to have near-term impact on NPL

The rising interest rate environment is not expected to have a significant impact on NPL. Housing loans made up 22% of total loans with unemployment being the driving factor on defaults on housing loans, not interest rates. Housing loans were also assessed using a 3.5% rate on loan repayment, higher than the current interest rate level. Average LTV in mortgages is 60%.

Credit considerations used to monitor loans to property developers

Some examples of credit considerations include approval of loan only upon certain percentage of units sold, disbursements according to % sales and completion, ring-fencing of proceeds from project (for servicing bank loan), track record of sales history of past projects from same developer to assess potential demand of current project, haircuts on LTV to determine loan amount etc.

Loan book pegged mainly to floating rates

Around 80% of the loan book is pegged to floating rate (30% belongs to SIBOR and SOR; and 50% belongs to prime rates and board rates etc.), and the remaining 20% is pegged to fixed rates. Certain corporations prefer to use SOR because they perceive SOR as much more transparent. Board rates are pegged to the bank's own benchmark rate and differ from product to product and across different customers. Board rates are more popular as it is less volatile. The bank adjusts its board rates internally according to market conditions, cost of funding and the rates of its products to prevent product cannibalism.



26 September 2018

BUY (MAINTAINED)

LAST TRADED PRICE	SGD 27.01
FORECAST DIV	SGD 1.20
TARGET PRICE	SGD 33.69
TOTAL RETURN	29.18%

COMPANY DATA

BLOOMBERG TICKER	DBS SP
O/S SHARES (MN) :	1667
MARKET CAP (USD mn / SGD mn) :	32978 / 45038
52 - WK HI/LO (SGD) :	30.37 / 23.12
3M Average Daily T/O (mn) :	2.25

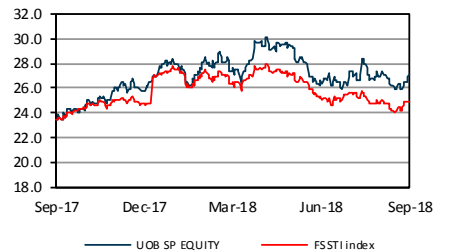
MAJOR SHAREHOLDERS (%)

Wee Investments	7.82%
Wah Hin & Co Pte Ltd	5.16%
Wee Chow Yaw	1.27%
Vanguard Group Inc/Wayne	1.08%

PRICE PERFORMANCE (%)

	1M TH	3M TH	1YR
COMPANY	0.1	4.1	19.2
STIRETURN	0.30	(0.53)	3.71

PRICE VS. STI



Source: Bloomberg, PSR

KEY FINANCIALS

Y/E Dec	FY 16	FY 17	FY 18 e	FY 19 e
Total Inc (SGDmn)	8,060	8,783	9,637	10,334
Op Profit (SGDmn)	3,769	4,099	5,070	4,997
NPAT (SGDmn)	3,105	3,409	4,239	4,169
EPS (SGD)	1.83	1.96	2.39	2.31
PER, (X)	11.2	13.8	11.3	11.7
P/BV, (X)	1.1	1.3	1.3	1.2
DPS (SGD)	0.75	1.00	1.20	1.15
ROE, (%)	10.1%	10.2%	11.6%	10.8%

Source: Bloomberg, Company, PSR

Valuation Method:

Gordon Growth Model (ERP: 5.5%, g: 3%)

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O&G sector no longer a cause for asset quality concerns

The O&G sector has stabilised, but it is unlikely to see consistent recoveries every quarter. Any recoveries for the sector would be a bonus for the bank. O&G non-performing assets were brought down to 10% of its asset value as the collateral value for recovery. Non-performing loans that have bounced back from the brink will be moved to performing loans, but collateral values cannot be marked up once it is marked down. Any gains can only be recognized in P&L when the asset is sold. UOB's NPL ratio was 1.68% as of June-18, higher than DBS (1.56%) and OCBC (1.38%). We adjusted our NPL to be in line with management's guidance of NPL ratio of 1.7% for the full year (previously 1.3%).

Lower credit costs

Historically, the long-term credit cost averages around 28bps, factoring in the peaks and troughs. Given the new accounting standards, banks are no longer allowed to use general provisions as buffers. Credit cost is currently at a low of 11bps for 1H18. Hence in the current benign environment coupled with the possibility of recoveries, management's credit cost guidance of 20-25 bps is reasonable, and we put in our credit cost assumption at 20bps.

Funding pressure as UOB bulks up on time deposits

In anticipation of steeper interest rates, UOB has been strengthening its funding position. Total deposits rose S\$13.7bn QoQ in 2Q18, of which S\$10.8bn came from fixed deposits. In comparison, 1Q18 total deposits only rose S\$1bn QoQ. The aggressive sourcing of funds even resulted in lower LDR ratio in 2Q18 of 85.7% (1Q18 LDR: 86.7%). As the bulk of the deposits raised were pricier fixed deposit, it resulted in a squeeze in interest margins, albeit in the near term.

Expect operating costs to be slightly elevated

As UOB continues to invest in technology to enhance digital proficiencies in its business and the Digital Bank, we expect full year CIR to remain elevated at current levels (2Q18's CIR was 43.6%). We adjusted operating expenses upwards to bring full year CIR to 43% (previously 42%).

Potential for higher dividends remain a catalyst

Guidance for full-year dividend payout is at 50% payout ratio (special dividend is part of this payout ratio), subject to a minimum CET1 ratio of 13.5%. UOB's 2Q18 fully loaded CET1 was already higher than its peers at 14.5%, and by adhering to a 50% dividend pay-out guidance, we increase our dividend forecast to S\$1.20/share (previously S\$1.05/share) to give dividend yield of 4.5%.

Least exposed to China and trade war repercussion

UOB's exposure to trade war effects is relatively muted as compared to its peers. UOB has the largest percentage of Singapore loans (2Q18: 52% of total loans) as compared to DBS (47%) and OCBC (41%), and the least exposure to Greater China loans (2Q18: 15% of total loans) as compared to DBS (16%) and OCBC (26%).

Net trading income

UOB enjoys its net trading income from transaction spreads. Volatility has an influence on customer flows, as the need to hedge turns more acute. Between 60-70% of trading income comes from customer flows and the remaining 30-40% proprietary trading mainly belongs to derivatives to hedge structural positions. Every quarter's marked to market changes in trading assets will flow to net trading income.

List of Abbreviations

WM	–	Wealth Management
IBG	–	Institutional Banking Group
CBG	–	Consumer Banking Group
NII	–	Net Interest Income
Non-II	–	Non-Interest Income
NIM	–	Net Interest Margin
ECL	–	Expected credit loss
CIR	–	Cost-income ratio
LDR	–	Loan to Deposit Ratio
NPL	–	Non-performing Loans
CASA	–	Current Account, Savings Account
IB	–	Investment Banking
O&G	–	Oil and Gas
SP	–	specific provisions
GP	–	general provisions
AUM	–	Asset Under Management
CIR	–	Cost-to-income ratio

Table 1: UOB guidance vs. PSR estimates for FY18e

Assumptions	2Q18	UOB	PSR	Comment
NIM (%)	1.83	≥1.84	1.86	
Loans growth (%)	10%	HSD	8.4%	Lowered forecast (previously 10%).
Cost-income ratio (%)	43.6%	42-43%	43.0%	Increased forecast (previously 41.9%).
Credit Cost (bps)	13	20	20	Increased forecast (previously 19 bps).
CET 1 (%)	14.90%	> 13.5%	14.9%	
NPL ratio (%)	1.7%	1.7%	1.7%	Increased forecast (previously 1.3%).

Source: Company, PSR

Investment Actions

Maintain BUY with target price of S\$33.70 (previous TP S\$34.50) based on the Gordon Growth Model. The decrease in target price was due to our lower ROE assumption (previously 11.8%) and lower BVPS assumption (previously S\$21.6).

Valuation: Gordon Growth Model

Item	Description	Value
R _f	Risk-free rate	2.6%
E	Equity-risk premium	5.5%
B	Beta	1.1
COE	Cost of Equity	8.4%
ROE	FY18e Return on Equity	11.6%
g	Terminal growth rate	2.8%
$\frac{(ROE-g)}{(COE-g)}$	FY18e Target Price to Book	1.6
	FY18e BVPS, S\$	21.3
	FY18e Valuation, S\$	33.7

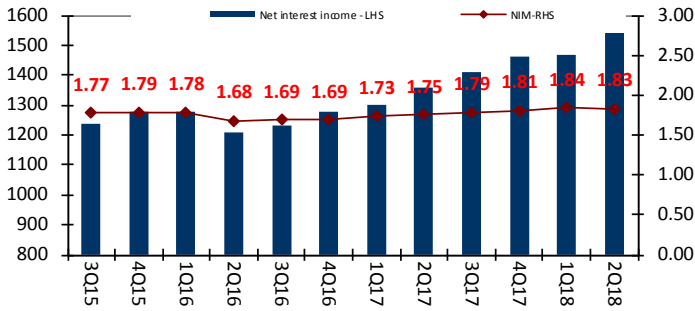
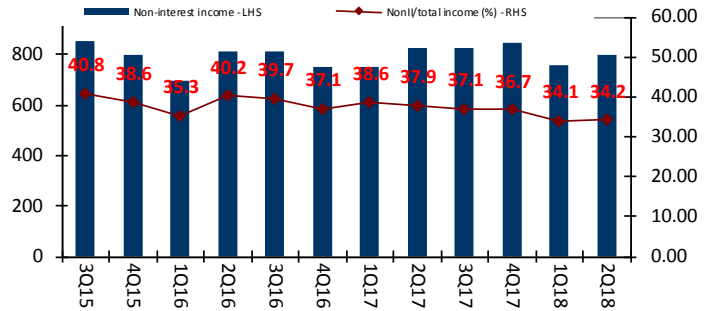
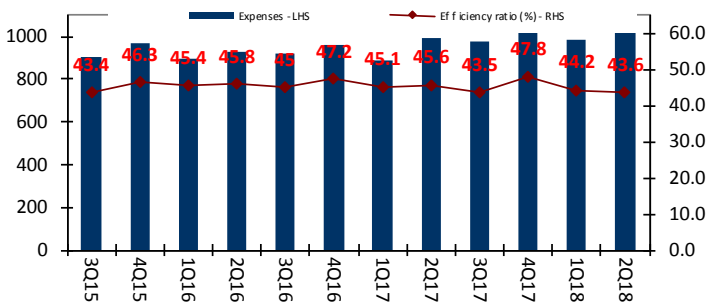
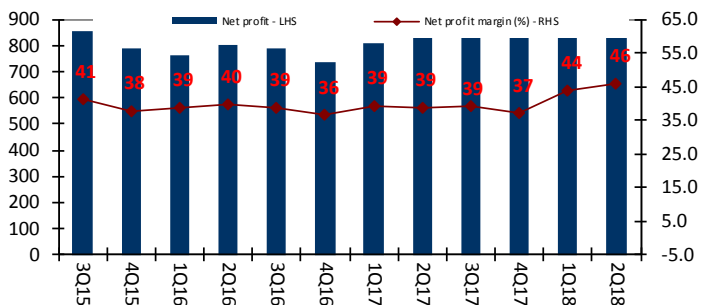
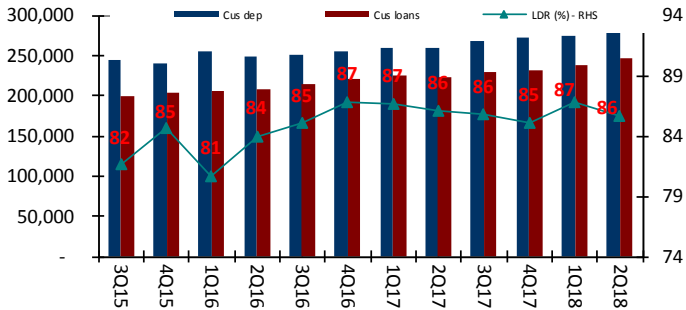
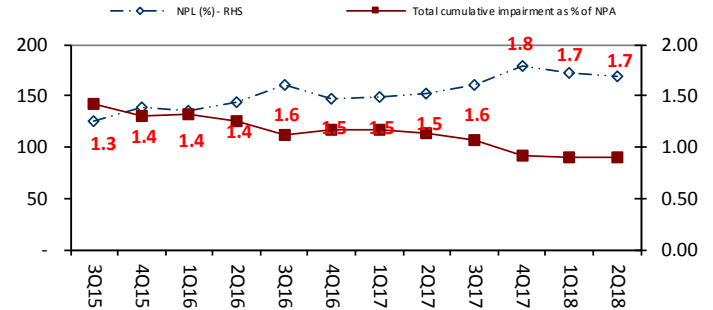
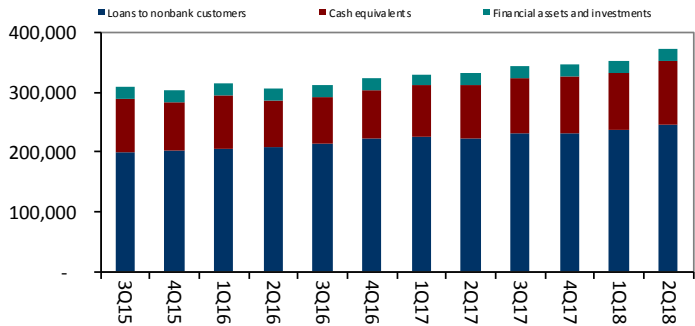
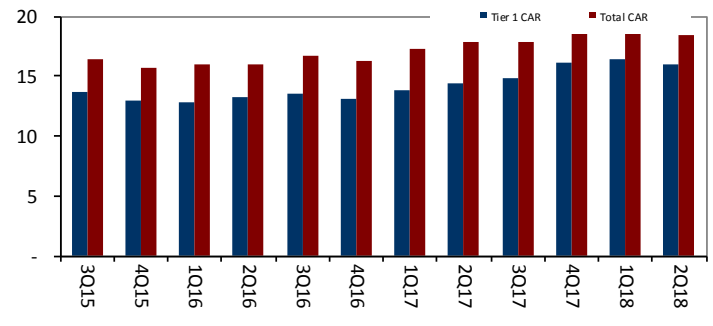
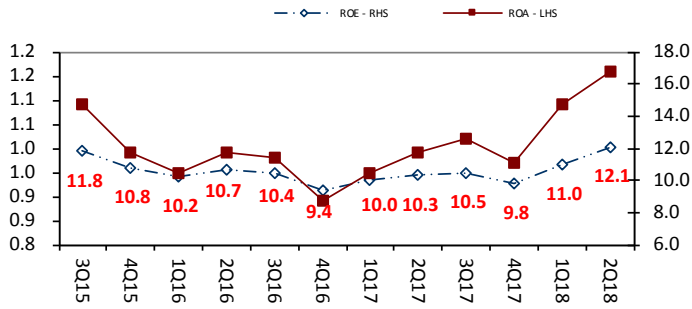
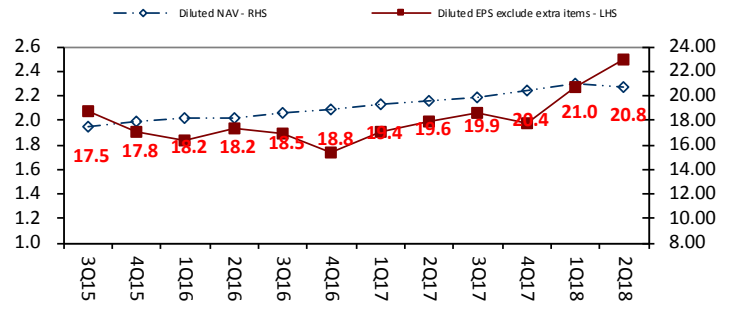
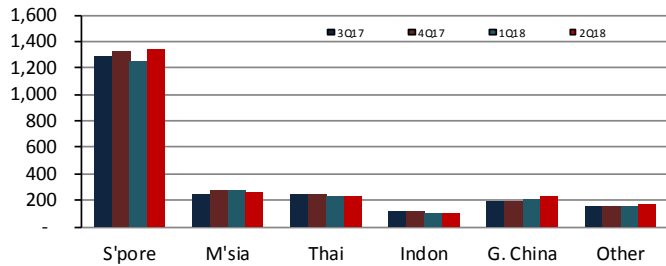
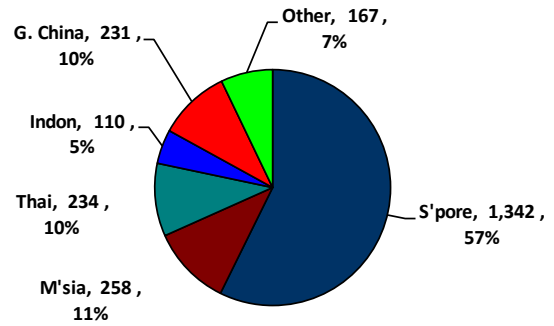
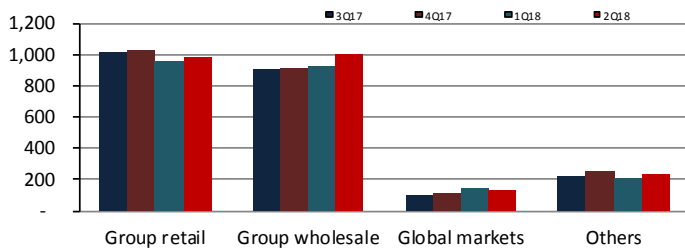
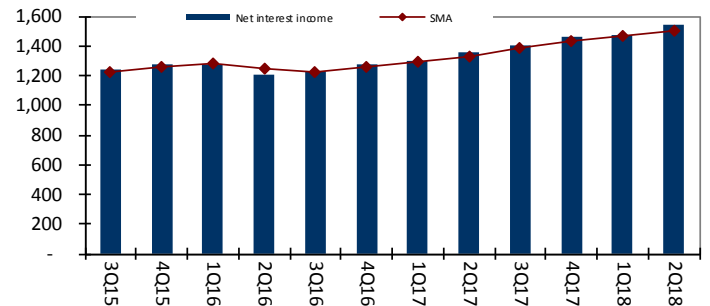
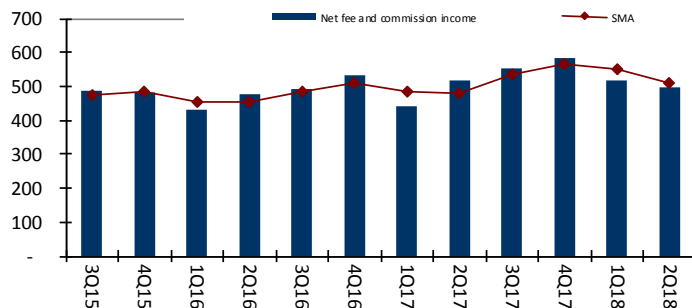
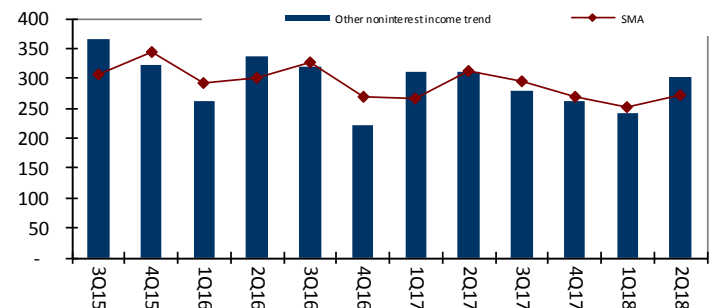
Figure 1: Net interest margin

Figure 2: NonInt/Total revenue

Figure 3: Efficiency ratio

Figure 4: Net profit margin

Figure 5: Deposits, Loans, LDR

Figure 6: NPA, NPL

Figure 7: Growth in selected asset items

Figure 8: CAR


Figure 9: ROE and ROA

Figure 10: EPS and NBV

Figure 11: Revenue by geographical segment

Figure 12: Geo segment breakdown

Figure 13: Revenue by Business segment

Figure 14: Net interest income trend

Figure 15: Fee and Commission trend

Figure 16: Other noninterest income trend


Financials

Income Statement

Y/E Dec, SGD mn	FY15	FY16	FY17	FY18e	FY19e
Net Int Income	4,925	4,991	5,528	6,291	6,698
Fees and Commission	1,884	1,931	2,092	2,209	2,401
Other Non-int income	1,239	1,138	1,163	1,138	1,238
Total operating income	8,048	8,060	8,783	9,637	10,337
Operating expenses	3,596	3,697	3,957	4,142	4,393
Provisions	671	594	727	425	310
Operating profit	3,781	3,769	4,099	5,070	5,633
Associates & JVs	90	5	110	90	90
Profit Before Tax	3,871	3,774	4,209	5,160	5,723
Taxation	649	669	800	921	1,033
Profit After Tax	3,222	3,105	3,409	4,239	4,690
Non-controlling Interest	12	12	16	20	18
Net Income, reported	3,210	3,093	3,393	4,219	4,672
Net Income, adj.	3,210	3,093	3,393	4,219	4,672

Per share data

Y/E Dec, SGD mn	FY15	FY16	FY17	FY18e	FY19e
EPS, reported	1.94	1.83	1.96	2.39	2.61
EPS, adj.	1.94	1.83	1.96	2.39	2.61
DPS	0.90	0.75	1.00	1.20	1.30
BVPS (less pref shares)	17.84	18.82	20.37	21.35	22.50

Supplementary items

Y/E Dec, SGD mn	FY15	FY16	FY17	FY18e	FY19e
CET1 CAR (%)	13.0%	13.0%	14.7%	14.9%	15.3%
Tier 1 CAR (%)	13.0%	13.1%	16.2%	14.9%	15.3%
Total CAR (%)	15.6%	16.2%	18.7%	17.7%	18.6%

Balance Sheet

Y/E Dec, SGD mn	FY15	FY16	FY17	FY18e	FY19e
Cash bal w central banks	32,306	24,322	26,625	29,305	31,563
Due from banks	28,646	40,033	52,181	47,133	49,667
Investment securities	10,562	11,640	11,273	10,727	10,754
Loans to non-bank cust	203,611	221,734	232,212	252,120	266,607
Others	40,886	42,287	36,294	42,556	42,753
Total Assets	316,011	340,016	358,585	381,841	401,344
Due to banks	11,986	11,855	11,440	12,184	12,306
Due to non-bank cust	240,524	255,314	272,765	290,969	306,938
Debts issued	20,288	26,143	25,178	27,095	27,365
Others	12,289	13,674	12,171	12,536	12,912
Total liabilities	285,087	306,986	321,554	342,784	359,521
Shareholder's equity	30,771	32,876	36,852	38,850	41,598
Non-controlling interest	156	169	187	207	225
Total Equity	30,927	33,045	37,039	39,057	41,823

Valuation Ratios

Y/E Dec, SGD mn	FY15	FY16	FY17	FY18e	FY19e
P/E (X), adj.	10.1	11.2	13.8	11.3	10.4
P/B (X)	1.1	1.1	1.3	1.3	1.2
Dividend Yield (%)	4.6%	3.7%	3.7%	4.4%	4.8%

Growth & Margins (%)

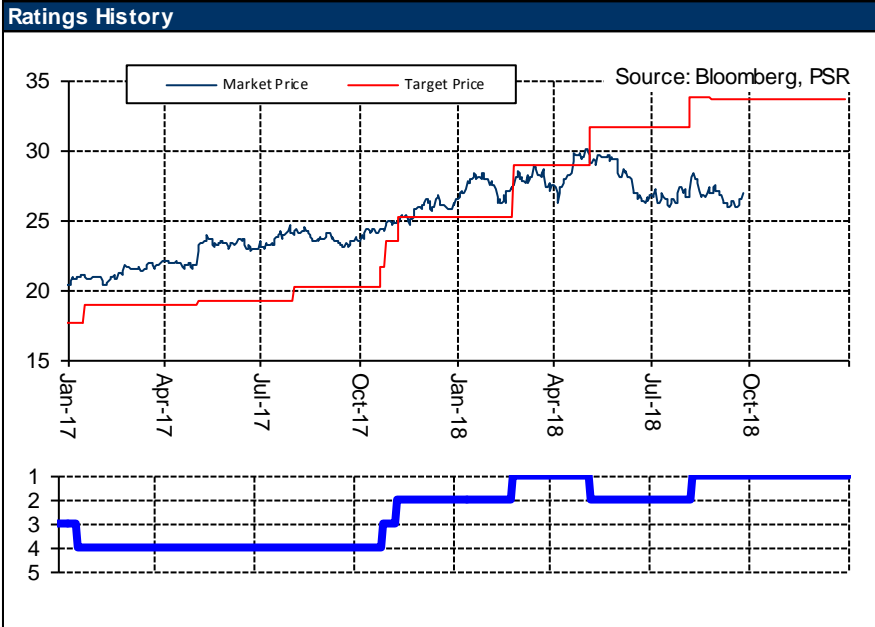
Growth					
Net interest income	8.1%	1.3%	10.8%	13.8%	6.5%
Non interest income	7.7%	-1.7%	6.1%	2.8%	8.7%
Pre provision op profit	7.9%	0.1%	9.0%	9.7%	7.3%
Operating income	2.9%	-0.3%	8.8%	23.7%	11.1%
Net income, reported	-1.2%	-3.6%	9.7%	24.3%	10.7%
Margins					
Net interest margin	1.77%	1.71%	1.77%	1.86%	1.88%

Key Ratios (%)

ROE	11.9%	10.1%	10.2%	11.6%	12.1%
ROA	1.0%	0.9%	1.0%	1.1%	1.2%
RORWA	1.6%	1.4%	1.7%	1.8%	1.9%
Non-int/total income ratio	38.8%	38.1%	37.1%	34.7%	35.2%
Cost/income ratio	44.7%	45.9%	45.1%	43.0%	42.5%
Loan/deposit ratio	84.7%	86.8%	85.1%	86.6%	86.9%
NPL ratio	1.39	1.47	1.78	1.68	1.56

Source: Company, PSR

*Forward multiples & yields based on current market price; historical multiples & yields based on historical market price.



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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