

United Overseas Bank Limited

Stable Outlook Despite NIM Contraction

SINGAPORE | BANKING | 3Q18 RESULTS

- 3Q18 PATMI and Revenue were in line with our expectations.
- NIM rose by 2bps YoY but contracted 2bps QoQ due to the intensive build-up of fixed deposits in the third quarter.
- Key earning drivers were loans growth and fee income. Loans grew 9% YoY, driven by broad-based growth across industries and countries.
- Credit costs improved to 18 bps (3Q17: 32bps) due to the absence of problematic O&G sector loans.
- Maintain BUY with target price of S\$32.50 (previous TP S\$33.70). We derived our revised target price following our earnings adjustments, based on the Gordon Growth Model.**

Results at a glance

(SGD mn)	3Q18	3Q17	YoY (%)	2Q18	QoQ (%)	Comments
Net interest income	1,599	1,408	14%	1,542	4%	Driven by loans growth of 9% YoY. NIM rose 2bps YoY to 1.81%.
Fees & Comm	484	477	1%	498	-3%	Higher fee income was driven by broad-based growth in Credit Card, Loan-related and Trade-related fees of 7%, 11% and 9% YoY respectively.
Other Non Int Income	243	279	-13%	302	-20%	Decrease was mainly due to 81% YoY decline in net gain from Investment Securities.
Total Revenue	2,327	2,164	8%	2,342	-1%	
Expenses	1,011	973	4%	1,022	-1%	Expenses increased due to Staff costs and IT investment costs rising 15% YoY and 18% YoY respectively.
Allowances	95	221	-57%	90	6%	Credit costs declined to 18 bps from 32 bps a year ago (Substantial allowances provided for impaired loans from the O&G sectors in 3Q17).
PATMI	1,037	883	17%	1,077	-4%	

Source: Company, PSR

Positives

+ Net interest income grew 14% YoY. Loans expanded 9% YoY, driven by loans to financial institutions (+25% YoY) and Greater China (+23% YoY). Property related loans remain the largest slice of pie at 50% of total loans, but growth is expected to slow in the next few quarters due to property cooling measures.

+ Lower credit costs at 18bps, as compared to 32 bps a year ago. This decrease is due to the absence of substantial allowances for impaired O&G sector loans in 3Q17. New NPA formation remained around c.S\$400m per quarter this year. NPL rose 12% YoY while NPL ratio remained stable at 1.6% (3Q17: 1.6%). Assuming the current benign environment remains unchanged, coupled with the possibility of recoveries, the management's credit cost guidance of 20-25 bps is reasonable, and we put in our credit cost assumption at 20bps.

+ Higher dividends still in the picture. UOB maintains its 50% payout guidance, subject to a minimum CET1 ratio of 13.5%. 3Q18 CET 1 ratio stands at 14.1%, giving UOB the capacity to award shareholders with higher dividends. We put in our dividend forecast at S\$1.20 per share, giving us a dividend yield of 4.8%.

+ Cost-to-income ratio remains stable at 43.4%. Operating expense grew 12% YoY due to higher staff costs (performance-related bonus) and IT-related expenses while operating income increased 8% YoY. CIR is in line with management's guidance of c.44%. To trend towards a c.40% CIR in the next few years, UOB indicated that it is a two-pronged approach: both interest margins and cost efficiency has to improve.

29 October 2018

BUY (Maintained)

LAST TRADED PRICE	SGD 24.07
FORECAST DIV	SGD 1.15
TARGET PRICE	SGD 32.52
TOTAL RETURN	39.89%

COMPANY DATA

BLOOMBERG TICKER	DBS SP
O/S SHARES (MN):	1667
MARKET CAP (USD mn / SGD mn):	29080 / 40136
52 - WK HI/LO (SGD):	30.37 / 24.01
3M Average Daily T/O (mn):	2.29

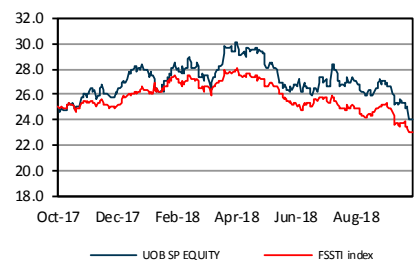
MAJOR SHAREHOLDERS (%)

Wee Investments	7.82%
Wah Hin & Co Pte Ltd	5.16%
Vanguard Group Inc/Wayme	2.09%
BlackRock Fund Advisors	152%

PRICE PERFORMANCE (%)

	1M TH	3M TH	1Y R
COMPANY	(11.3)	(10.4)	10
STI RETURN	(8.22)	(9.55)	(8.13)

PRICE VS. STI



Source: Bloomberg, PSR

KEY FINANCIALS

Y/E Dec	FY 16	FY 17	FY 18 e	FY 19 e
Total Inc (SGD mn)	8,060	8,778	9,310	10,344
Op Profit (SGD mn)	3,769	4,097	4,861	5,815
NPAT (SGD mn)	3,105	3,407	4,067	4,839
EPS (SGD)	1.82	1.94	2.32	2.78
PER, (X)	11.2	12.4	10.4	8.7
P/BV, (X)	1.1	1.2	1.1	1.0
DPS (SGD)	0.75	1.00	1.15	1.38
ROE, (%)	10.1%	10.1%	11.1%	12.5%

Source: Bloomberg, Company, PSR

Valuation Method:

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

Tin Min Ying (+65 6212 1853)

Negatives

- **Funding pressure as UOB bulks up on time deposits; NIM contracted 2bps QoQ.** In anticipation of higher interest rates, regional volatility and year-end competition for deposits, UOB has been strengthening its capital and funding position by bulking up on mainly SGD time deposits to meet projected business (SGD LDR lowered to 75.5% as compared to 76.9% a year ago). Total deposits rose S\$6.1bn QoQ in 3Q18, of which S\$7.0bn came from fixed deposits (other deposits decreased by S\$2.3bn). Fixed deposits spiked 4.7% QoQ as compared to the average fixed deposit growth in FY2017 of 1% QoQ. With the bulk of deposits raised being pricier fixed deposit, this could result in a squeeze in interest margins, albeit in the near term. NIM expanded 2bps YoY due to a favourable interest rate environment (Singapore's NIM expanded 8bps YoY, while Indonesia's and Greater China's NIM contracted 25 and 13 bps YoY respectively). Efficient utilisation of this war chest of funds remains to be seen in the next quarter.

- **Net fees and commission income was flat YoY.** Fee income improved slightly due to loan-related, trade finance and credit card fees which grew 7%, 11% and 9% YoY respectively. However, the improvement was offset by lower wealth management fees that fell 7% YoY as investors' appetite for financial products turned more cautious.

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
SEA – South East Asia

Outlook

Expect loans growth to remain on target. With the build-up of stronger funding base to lock in their funding position, UOB intends to deploy these funds up for loans growth. Furthermore, assuming the current trade war situation does not take a drastic turn for the worse, the trade war is not expected to pose significant risks to trade loans growth (however, slower transaction volumes is likely in the near term). This is because the bulk of UOB's loans book is anchored out of the SEA, with the majority of belonging to Singapore (52% of total loans). If the trade war escalates further, UOB might even benefit from an increase in regional trade as compared to the US and China (as companies turn to SEA as an alternative in their supply chain).

Rising interest rates still a key factor. Majority of UOB's loans book is pegged to floating rates, and as interest rates increase, UOB will be able to reprice its loans. Near-term competitive pricing might result in a squeeze in margins, but NIM should improve as UOB gains more pricing power with the rise in interest rates.

Table 1: UOB guidance vs PSR estimates for FY18e. (Management made no change to their guidance)

Assumptions	2Q18	3Q18	UOB	PSR
NIM (%)	1.83	1.81	≥1.84	1.80
Loans growth (%)	9.7%	9.0%	HSD	9.1%
Cost-income ratio (%)	43.6%	43.4%	44.0%	43.6%
Credit Cost (bps)	13	18	20	20
CET 1 (%)	14.5%	14.1%	> 13.5%	14.6%
NPL ratio (%)	1.7%	1.6%	1.7%	1.7%

Source: Company, PSR

Investment Actions

Maintain BUY with target price of S\$32.50 (previous TP S\$33.70). We derived our revised target price following our earnings adjustments based on the Gordon Growth Model. TP revised to account for AFS movements. Potential re-rating catalyst: (i) higher impairments and (ii) continuous NIM contraction.

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	9.0%
ROE	FY18e Return on Equity	11.8%
g	Terminal growth rate	3%
$\frac{(ROE-g)}{(COE-g)}$	FY19e Target Price to Book	1.4
	FY19e BVPS, S\$	23
	FY19e Valuation, S\$	32.5

Table 2: Growth in revenue

SGD mn	3Q18	3Q17	YoY (%)	2Q18	QoQ (%)
Net interest income	1,599	1,408	13.6%	1,542	3.7%
Net fee and comm inc	484	477	1.5%	498	-2.8%
Other non-interest inc	243	279	-12.9%	302	-19.5%
Total	2,326	2,164	7.5%	2,342	-0.7%

Strong loans growth and YoY NIM expansion supported net interest income growth.

Table 3: Fee and commission income

SGD mn	3Q18	3Q17	YoY (%)	2Q18	QoQ (%)
Credit card	110	103	6.8%	108	1.9%
Fund management	65	62	4.8%	68	-4.4%
Wealth management	133	143	-7.0%	132	0.8%
Loan-related	135	122	10.7%	148	-8.8%
Service charges	37	35	5.7%	37	0.0%
Trade-related	74	68	8.8%	74	0.0%
Other	15	(56)	-126.8%	15	0.0%
Total	569	477	19.3%	582	-2.2%

Loan-related fees maintained double-digit growth but wealth management fees declined for 2 consecutive quarters due to risk aversion.

Table 4: Other non-interest income

SGD mn	3Q18	3Q17	YoY (%)	2Q18	QoQ (%)
Net trading income	174	164	6.1%	215	-19.1%
Other income	23	26	-11.5%	36	-36.1%
Net gain/(loss) from inv. securities	11	57	-80.7%	1	1000.0%
Dividend income	5	3	66.7%	20	-75.0%
Rental income	30	29	3.4%	30	0.0%
Total other non int inc	243	279	-12.9%	302	-19.5%

3Q17 recorded stronger gains from investment securities.

Table 5: Loans by Industries

SGD mn	3Q18	3Q17	YoY (%)	2Q18	QoQ (%)
Tpt, storage & comms	9,996	9,704	3.0%	9,575	4.4%
Building and construction	60,174	53,688	12.1%	57,861	4.0%
Manufacturing	21,507	18,949	13.5%	21,809	-1.4%
Financial institutions	22,698	18,131	25.2%	21,558	5.3%
General commerce	32,365	30,317	6.8%	31,470	2.8%
Professionals & Pri inv	28,934	27,812	4.0%	28,851	0.3%
Housing loans	67,631	63,918	5.8%	66,983	1.0%
Others	11,816	11,594	1.9%	11,633	1.6%
Total loans	255,121	234,113	9.0%	249,740	2.2%

Loans growth was fairly broad-based. Building and Construction, Manufacturing and Financial Institution loans sustained double-digit loans growth.

Table 6: Loans by currencies

SGD mn	3Q18	3Q17	YoY (%)	2Q18	QoQ (%)
Singapore dollar	119,752	114,823	4.3%	118,168	1.3%
US dollar	50,377	45,409	10.9%	49,367	2.0%
Malaysian ringgit	24,929	23,296	7.0%	25,100	-0.7%
Thai baht	15,161	13,385	13.3%	14,487	4.7%
Indonesian rupiah	5,014	5,162	-2.9%	5,044	-0.6%
Others	39,888	32,039	24.5%	37,572	6.2%
Total loans	255,121	234,114	9.0%	249,738	2.2%

SGD loans growth accelerated mildly while USD, THB and trade loans via Hong Kong (under others) grew the fastest.

Table 7: Profit before tax by Business segments

SGD mn	3Q18	3Q17	YoY (%)	2Q18	QoQ (%)
Group Retail	443	452	-2.0%	457	-3.1%
Grp Wholesale	738	503	46.7%	743	-0.7%
Global Mkts and IM	29	28	3.6%	72	59.7%
Others	35	90	-61.1%	10	250.0%
Total NPBT	1,245	1,073	16.0%	1,282	-2.9%

The Group Wholesale business continues to be the best-performing.

Table 8: Profit before tax by Geographical segments

SGD mn	3Q18	3Q17	YoY (%)	2Q18	QoQ (%)
Singapore	734	668	9.9%	770	-4.7%
Malaysia	144	144	0.0%	145	-0.7%
Thailand	79	63	25.4%	60	31.7%
Indonesia	5	(12)	-141.7%	11	-54.5%
Greater China	145	102	42.2%	124	16.9%
Others	140	107	30.8%	172	-18.6%
Total NPBT	1,247	1,072	16.3%	1,282	-2.7%

In 3Q18, Singapore and Greater China contributed 59% and 12% of total earnings respectively.

Source (Table 2-8): Company, PSR

Figure 1: Net interest margin

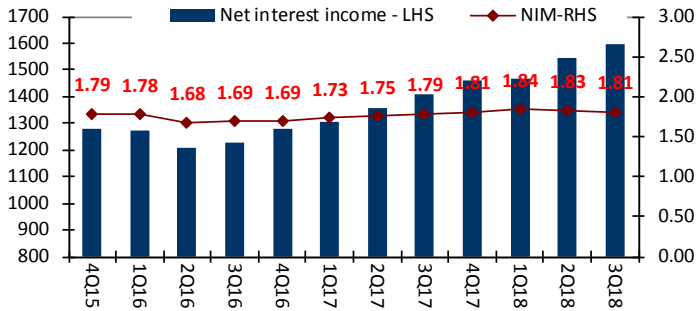


Figure 2: NonInt/Total revenue

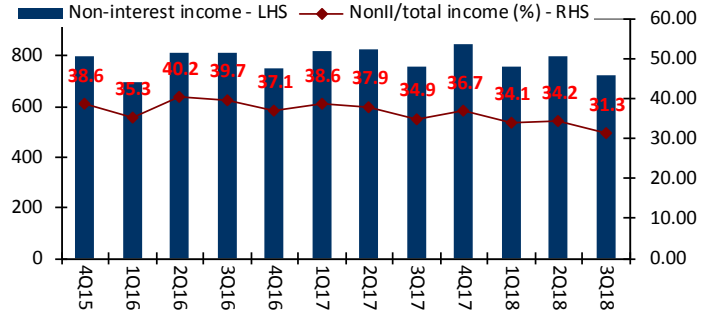


Figure 3: Efficiency ratio

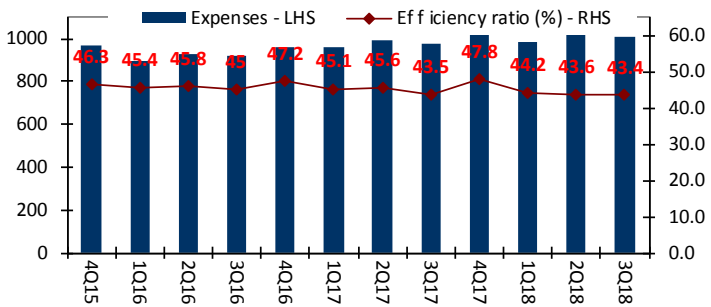


Figure 4: Net profit margin

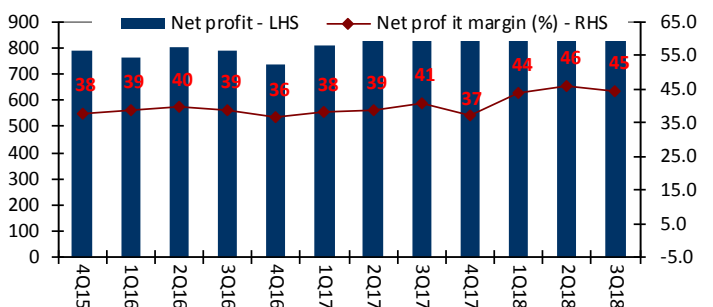


Figure 5: Deposits, Loans, LDR

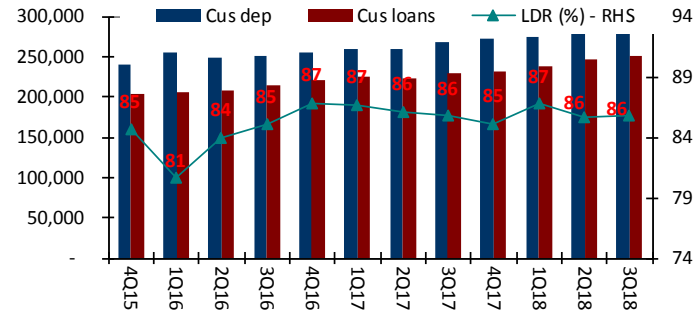


Figure 6: NPA, NPL

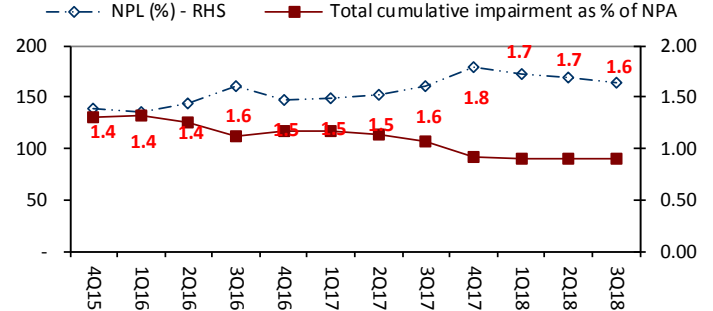


Figure 7: Growth in selected asset items

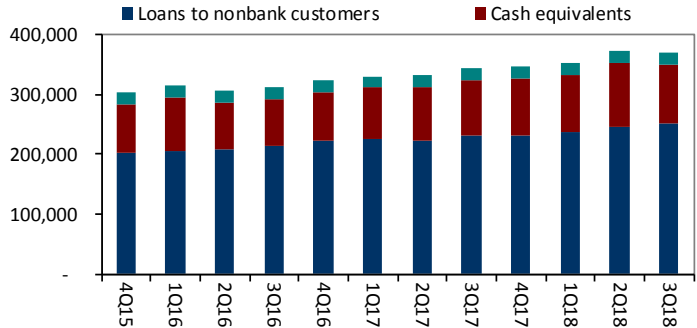
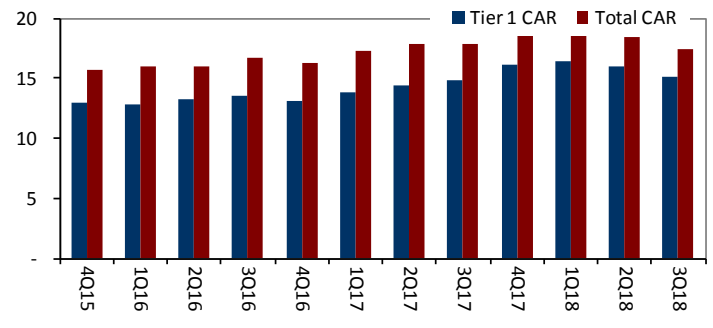


Figure 8: CAR



Source (Figure 1-8): Company, PSR

Financials

Income Statement

Y/E Dec, SGD mn	FY15	FY16	FY17	FY18e	FY19e
Net Int Income	4,925	4,991	5,528	6,156	6,894
Fees and Commission	1,884	1,931	2,087	2,114	2,390
Other Non-int income	1,239	1,138	1,163	1,040	1,060
Total operating income	8,048	8,060	8,778	9,310	10,344
Operating expenses	3,596	3,697	4,027	4,059	4,216
Provisions	671	594	727	390	314
Operating profit	3,781	3,769	4,024	4,861	5,815
Associates & JVs	90	5	110	90	90
Profit Before Tax	3,871	3,774	4,134	4,951	5,905
Taxation	649	669	800	888	1,072
Profit After Tax	3,222	3,105	3,334	4,063	4,833
Non-controlling Interest	12	12	16	20	19
Net Income, reported	3,210	3,093	3,318	4,044	4,814
Net Income, adj.	3,210	3,093	3,318	4,044	4,814

Per share data

Y/E Dec, SGD mn	FY15	FY16	FY17	FY18e	FY19e
EPS, reported	1.94	1.82	1.90	2.32	2.78
EPS, adj.	1.94	1.82	1.90	2.32	2.78
DPS	0.9	0.8	1.0	1.2	1.4
BVPS (less pref shares)	17.84	18.82	20.37	21.29	23.08

Supplementary items

Y/E Dec, SGD mn	FY15	FY16	FY17	FY18e	FY19e
CET1 CAR (%)	13.0%	13.0%	14.7%	14.6%	15.1%
Tier 1 CAR (%)	13.0%	13.1%	16.2%	14.6%	15.1%
Total CAR (%)	15.6%	16.2%	18.7%	17.3%	18.4%

Balance Sheet

Y/E Dec, SGD mn	FY15	FY16	FY17	FY18e	FY19e
Cash bal w central banks	32,306	24,322	26,625	28,999	31,435
Due from banks	28,646	40,033	52,181	49,127	51,767
Investment securities	10,562	11,640	11,273	11,093	11,121
Loans to non-bank cust	203,611	221,734	232,212	253,901	268,437
Others	40,886	42,287	36,294	43,854	44,053
Total Assets	316,011	340,016	358,585	386,974	406,815
Due to banks	11,986	11,855	11,440	12,403	12,527
Due to non-bank cust	240,524	255,314	272,765	295,689	311,740
Debts issued	20,288	26,143	25,178	27,580	27,856
Others	12,289	13,674	12,171	12,536	12,912
Total liabilities	285,087	306,986	321,554	348,208	365,035
Shareholder's equity	30,771	32,876	36,852	38,560	41,555
Non-controlling interest	156	169	187	207	225
Total Equity	30,927	33,045	37,039	38,766	41,780

Valuation Ratios

Y/E Dec, SGD mn	FY15	FY16	FY17	FY18e	FY19e
P/E (X), adj.	10.1	11.2	12.7	10.4	8.7
P/B (X)	1.1	1.1	1.2	1.1	1.0
Dividend Yield (%)	3.7%	3.1%	4.2%	4.8%	5.7%

Growth & Margins (%)

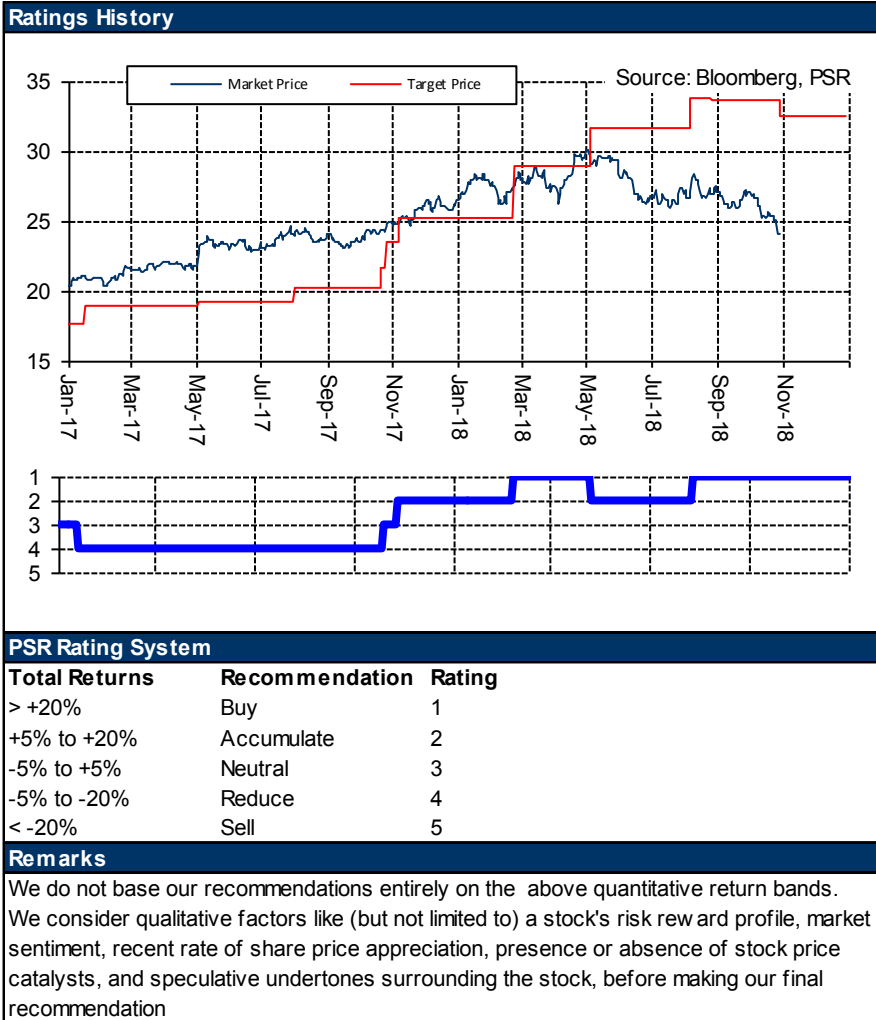
Growth					
Net interest income	8.1%	1.3%	10.8%	11.4%	12.0%
Non interest income	7.7%	-1.7%	5.9%	-3.0%	9.4%
Pre provision op profit	7.9%	0.1%	8.9%	6.1%	11.1%
Operating income	2.9%	-0.3%	6.8%	20.8%	19.6%
Net income, reported	-1.2%	-3.6%	7.3%	21.9%	19.1%
Margins					
Net interest margin	1.77%	1.71%	1.77%	1.80%	1.90%

Key Ratios (%)

ROE	11.9%	10.1%	9.9%	11.1%	12.5%
ROA	1.0%	0.9%	0.9%	1.1%	1.2%
RORWA	1.6%	1.4%	1.7%	1.7%	2.0%
Non-int/total income ratio	38.8%	38.1%	37.0%	33.9%	33.4%
Cost/income ratio	44.7%	45.9%	45.9%	43.6%	40.8%
Loan/deposit ratio	84.7%	86.8%	85.1%	85.9%	86.1%
NPL ratio	1.39	1.47	1.78	1.69	1.57

Source: Company, PSR

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



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