

Singapore Banking Sector Results Season Takeaways – 3Q12

Report type: Update

Sector Overview

The Singapore Banking Sector provides traditional lending and depository functions, as well as other services in the areas of commercial banking, financial advisory, asset management, insurance broking and capital market services.

Post Results Highlight

Net Interest Margins

- NIMs continue to decline 2-8bps q-q in 3Q12, with UOB's NIMs weakest at -8bps and OCBC strongest at -2bps
- 3Q12's cost of deposits generally increased, while margins on customer loans declined
- DBS guides NIMs to have bottomed, UOB and OCBC guide further marginal compression
- We expect NIMs to compress marginally q-q in 4Q12.

Loans growth outlook

- Loans growth largely stable q-q in 3Q12, driven by consumer loans while business loans growth was weaker
- DBS maintain 9%-10% loans growth guidance on constant currency basis for FY12 and FY13, UOB maintain FY12 guidance of high single digit growth, while OCBC guide FY13 to be mid to high single digit growth.

Non Interest income (Non II)

- Non II contributed to 3Q12 earnings surprise
- Y-y growth of Non II expected from higher customer flow
- OCBC's exceptional Non II performance due to gains from non-participating fund however likely non recurring

Fees and Commission

- Fees and commission, especially from Wealth management, Trade related and Loan related fees, expected to be revenue driver
- The strong brand name and high credit rating of the Singapore banks further puts them in a strong position to grow these contributions
- We note that UOB's Fees and commission has grown significantly over the past two years.

Investment actions

3Q12 results were broadly within our expectations, excluding one-off gains and DBS's lower loans provision. While the macroeconomic environment remains uncertain, NIMs remain under pressure and loans growth slow, the banks continue to be strong fundamentally, with expected y-y growth in net profits in FY13. We are "Neutral" on the banking sector. We maintain our "Accumulate" rating on UOB, "Neutral" on DBS, and "Reduce" on OCBC based on current valuations.

Singapore Banking Sector

Company	Rating	Price (\$)	TP (\$)	Upside (%)	M.Cap. (US\$m n)
DBS Group Holdings Ltd Overseas Chinese Banking Corp	Neutral	14.46	15.10	4.4%	28,915
United Overseas Bank	Reduce	9.47	8.30	-12.4%	26,658
	Accumulate	18.91	18.00	-4.8%	24,432

Source: Bloomberg, PSR

Analyst

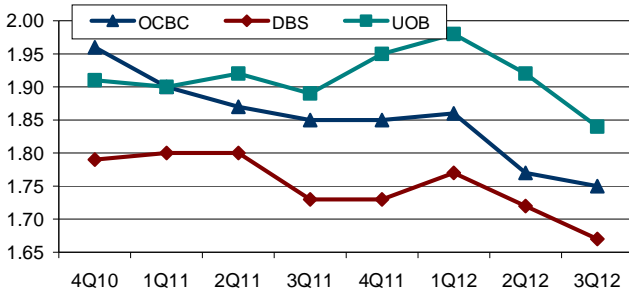
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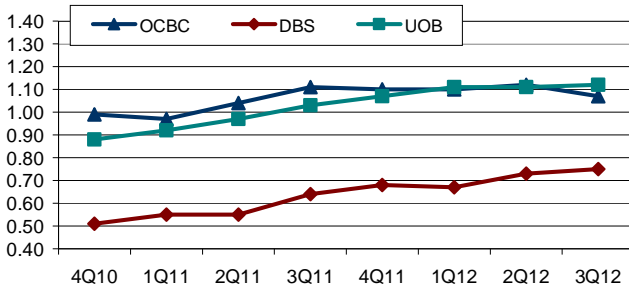
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NIMs down further, loans growth stable

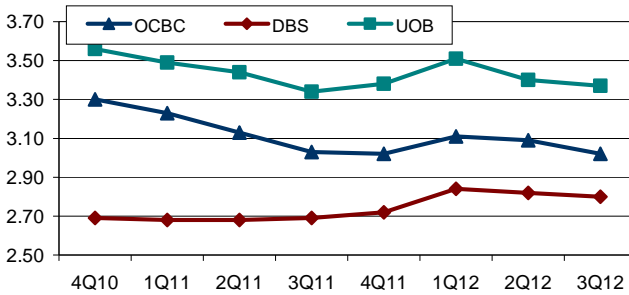
Fig 1: NIMs down q-q for all three banks due to...



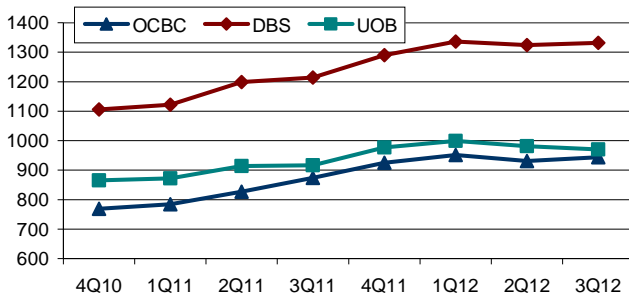
Higher cost of Customer Deposits and...



Lower margins on Customer loans...



Leading to lower increase/decrease in NII



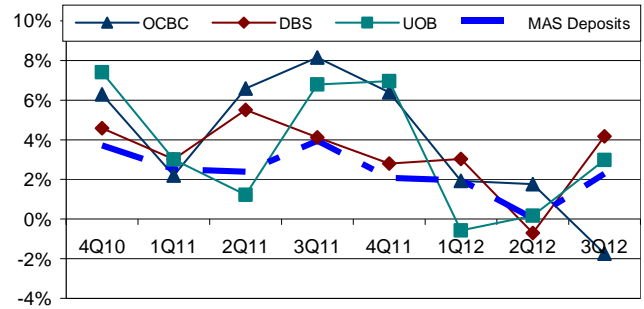
Source: Company data, Phillip Securities Research

NIMs pressure continued in 3Q12, declining 2bps-8bps q-q, with **UOB** the poorest performer. **UOB** was the only bank with net interest income declining q-q, despite its stronger 1.75% q-q loans growth. NIMs decline largely attributed to decrease in yields on interbank balances.

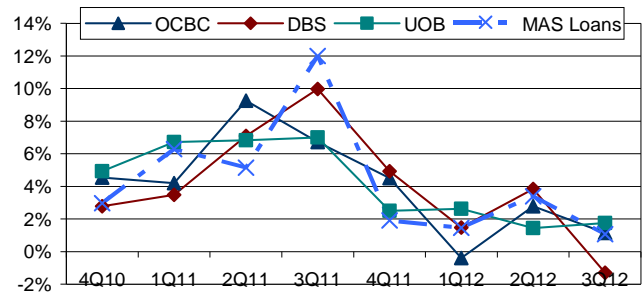
OCBC experienced the least q-q NIMs decline at 2bps, due to lower customer deposits as **OCBC** did not increase their pricing of fixed deposits. Moving forward, management expects to fund its operations from wholesale funding. Fixed deposits can also be raised through increasing interest rates at a later date should the need arise.

While **DBS** expects NIMs to have bottomed, **UOB** and **OCBC** expects further marginal NIMs compression. We forecast marginal q-q compression. A further compression of 2bps is estimated to reduce FY13 forecasted profit by 1% to 2% for all three banks. While **UOB** saw the steepest decline in NIMs YTD (UOB 11bps, OCBC 10bps, DBS 6 bps), the higher YTD growth of loans at 5.9% (DBS 4.0%, OCBC 3.5%) may mitigate the decline in Net interest income.

Fig 2: Q-Q change in deposits – OCBC contracts



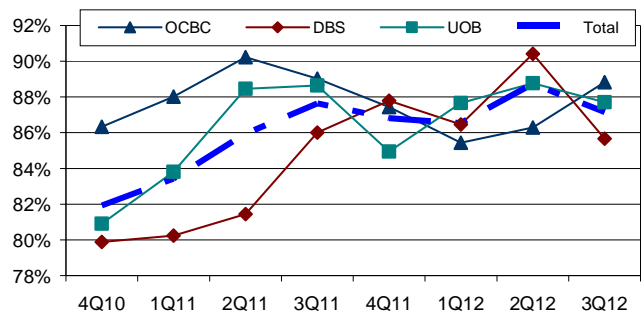
Q-Q loans growth slow – DBS loans contracts



3Q12 Growth mainly from Consumer loans

Total loans q-q growth	4Q11	1Q12	2Q12	3Q12
Agriculture	18.2%	1.3%	19.2%	-3.6%
Manufacturing	7.2%	2.4%	3.6%	-2.6%
Building and construction	8.0%	1.8%	4.0%	1.0%
General commerce	1.9%	-1.2%	3.2%	-3.2%
Transport	4.4%	-2.5%	7.5%	-3.6%
Financial institutions	1.0%	4.9%	-0.1%	0.5%
Professional and private (b	7.5%	2.1%	4.0%	3.8%
Others	0.3%	-4.8%	-4.1%	0.2%
Housing	3.6%	3.1%	3.0%	3.0%
Total loans	4.2%	1.3%	2.8%	0.3%

Slow loans growth, higher deposits, healthy LDR



Source: Company data, MAS, Phillip Securities Research

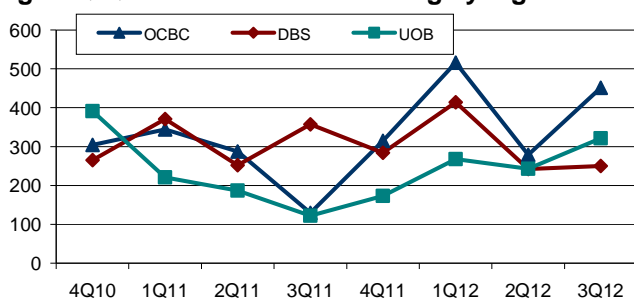
Loans growth was largely stable, with the Loans contraction in DBS due to SGD appreciation, higher proportion of

expired loan tenures and lower loans origination. Loans growth was also mainly from Consumer loans, driven by continued growth of housing loans. Business loans growth slowed in-line with the weaker global economy, and from the non-renewal of short term loan tenures. These are largely trade finance loans, which were not renewed as expectations of benefits from USD RMB carry-trade did not materialize. New trade finance loans were originated, but at a slower pace y-y.

Per managements' guidance, **DBS** expects loans growth of 9%-10% on constant currency terms for FY12 and FY13, **UOB** maintains guidance of high single digit growth for FY12, while **OCBC** guided mid-high single digit growth for FY13.

Non interest income main earnings surprise

Fig 4: Q-Q Non interest income largely higher



Source: Company data, Phillip Securities Research

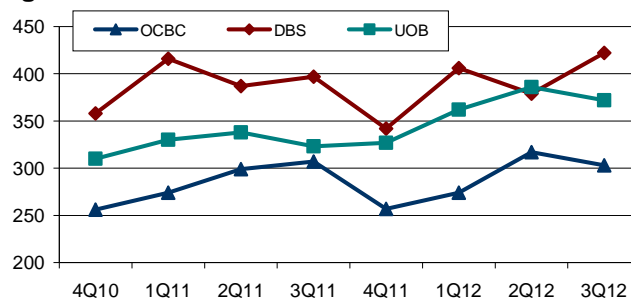
The volatile non interest income ("Non II") provided earnings beat for **UOB** and **OCBC**. UOB's 3Q12 Non II included a one-off dividend income of approximately S\$50 million from a subsidiary. We note **UOB's** 9M12 Non II to be significantly higher compared to 9M11. The poor Non II performance in FY11, which declined 36.5% y-y compared to FY10, was a major factor in its below par FY11 performance. This was likely due to losses recognised as **UOB** reduced its European exposure in FY11. We expect **UOB** to maintain current FY12 levels of Non II in FY13.

OCBC's strong Non II benefited from strong performances in its non-participating fund by its Great Eastern subsidiary. **OCBC's** trading income was also strong, driven by high customer flows and high quality of traders. However, the exceptionally strong performances in 1Q12 and 3Q12 may not be recurring in FY13, as the strong performances in the equity and bond markets may not be repeated.

We note positively that **DBS's** Non II to be stable in recent quarters, likely due to higher recurring contributions from customer flows. Similarly, with all three banks increasingly more focused on cross selling, we expect y-y increase in Non II from higher customer flow in FY13.

Fees and commission revenue driver for FY13

Fig 5: Fees and commission



Source: Company data, Phillip Securities Research

As observed from Fig 5, **UOB's** Fees and commission has grown significantly over the past two years. Investment related fees, including fees from Wealth management, and Loan related fees were the key drivers for **UOB**. Fees and commission from Credit cards and Trade-related activities also contributed to the growth. Key drivers for **OCBC** and **DBS** include Wealth management and Trade related fees and commission. **DBS** also benefited from improved Investment Banking fees in 3Q12, while contributions from Credit cards have been relatively strong. Fees and commission may however decrease q-q in 4Q12 due to seasonal decline in business activities during the year-end holiday season.

With continued threats of NIMs compression, we expect more focus to be placed on growth of Fees and commission in FY13. While Net interest income remains the main source of revenue for banks, banks are expected to further grow their Fees and commission through cross selling of capabilities, such as Cash management and Trade financing, while providing Wealth management services to the owners of these businesses. The strong brand name and high credit rating of the Singapore banks further puts them in a strong position to grow these contributions to Fees and commission.

Key risks for the Sector

A worsening global economy may result in rise of NPLs and credit costs, as affected customers, especially SMEs and unsecured consumer loans, default on loan repayments. This may result in reduced net profits.

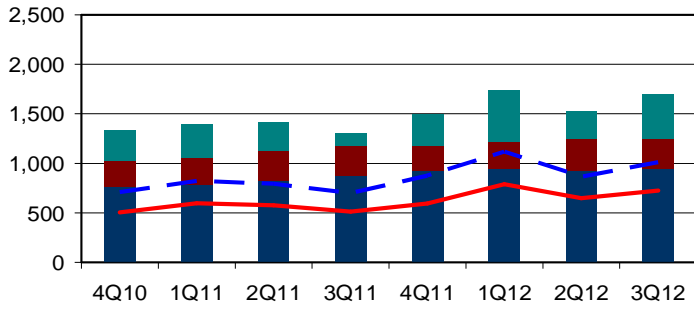
Unfavorable Basel III liquidity requirements, such as requiring much higher holdings of government securities, may lead to balance sheet changes that reduce ROE and ROA. Similarly, favorable requirements would allow banks to efficiently deploy their balance sheet and increase returns.

Irrational pricing of loans and deposits, especially in the foreign markets, would also lead to further NIMs compression or loss of market share.

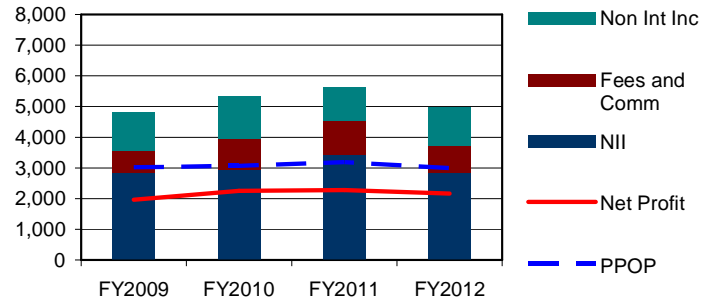
Company	Rating	FYE	Price	TP	Upside (%)	Market Cap. (\$'mn)	Market Cap. (US\$'mn)	Equity Multiple (X)						Dividend Yield (%)		
								Net Income			Book Value			FY10	FY11	FY12E
Market price as of: 4-Dec-12																
DBS Group Holdings Ltd	Neutral	Dec	14.46	15.10	4.4%	35,233	28,915	13.3	11.6	10.8	1.4	1.3	1.1	3.9%	3.9%	3.9%
Overseas Chinese Banking Corp	Reduce	Dec	9.47	8.30	-12.4%	32,483	26,658	14.4	14.2	12.0	1.7	1.6	1.4	3.2%	3.2%	3.4%
United Overseas Bank	Accumulate	Dec	18.91	18.00	-4.8%	29,770	24,432	11.9	12.8	10.9	1.5	1.4	1.3	3.7%	3.2%	3.4%

Source: Bloomberg, PSR est.

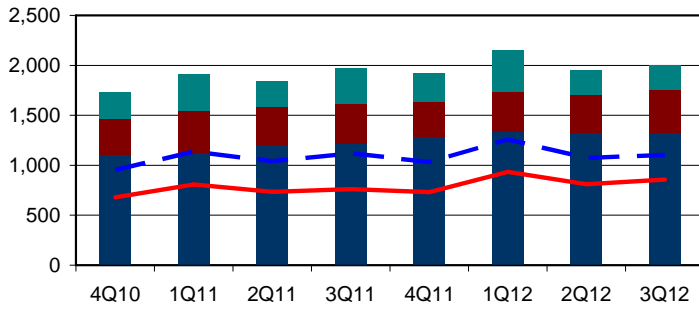
Oversea-Chinese Banking Corp – Insurance “wildcard”



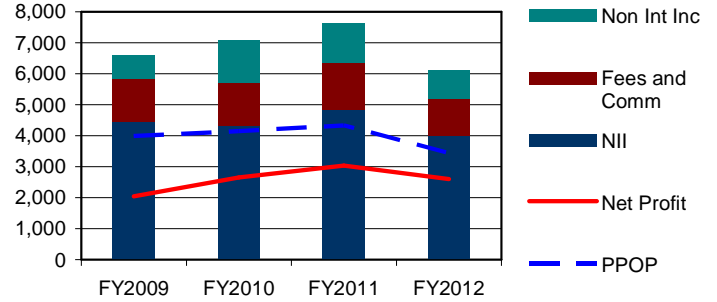
- Higher y-y growth of Non interest income



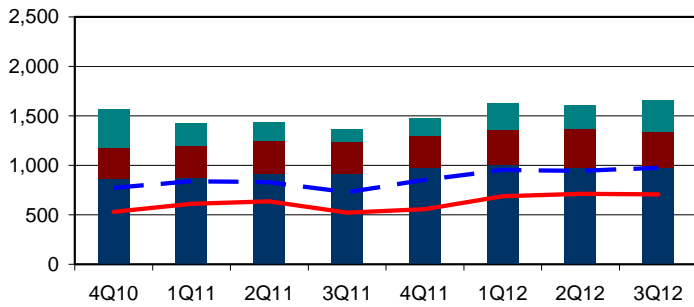
DBS Group Holdings – Most stable Non II earnings



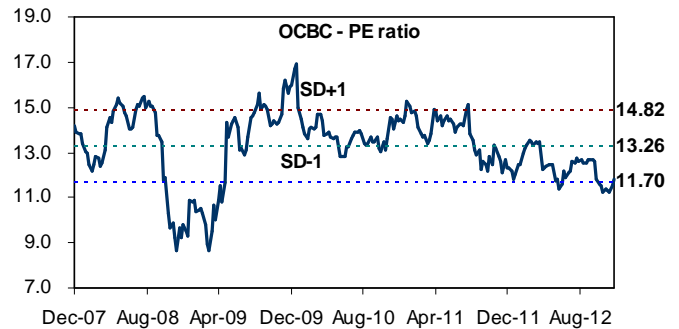
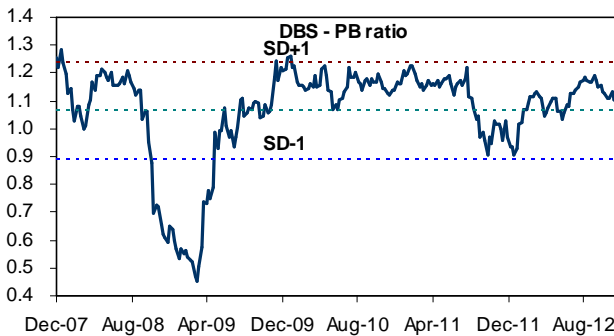
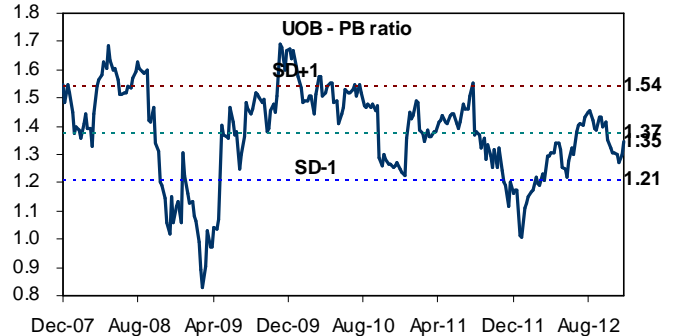
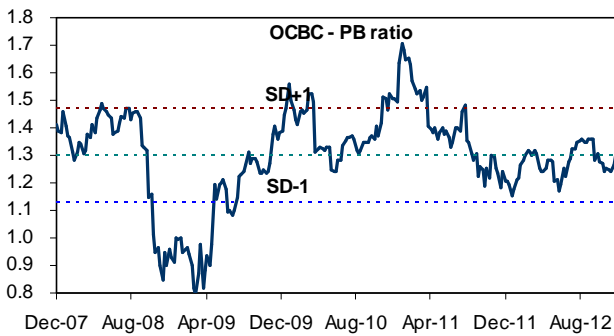
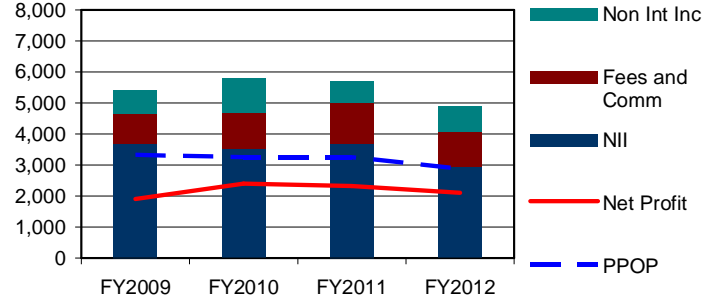
- Increasing y-y earnings from Net II, High net profit growth



United Overseas Bank Ltd – Strong Fees and Commission

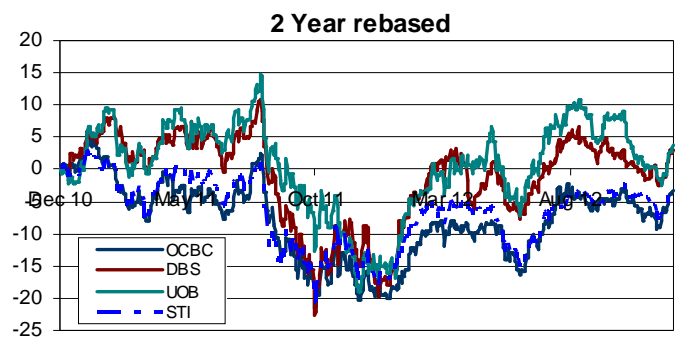
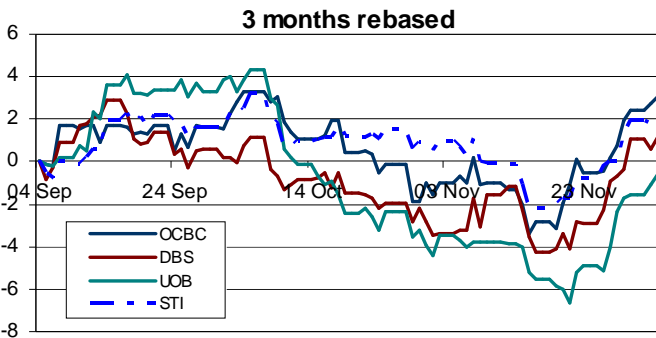
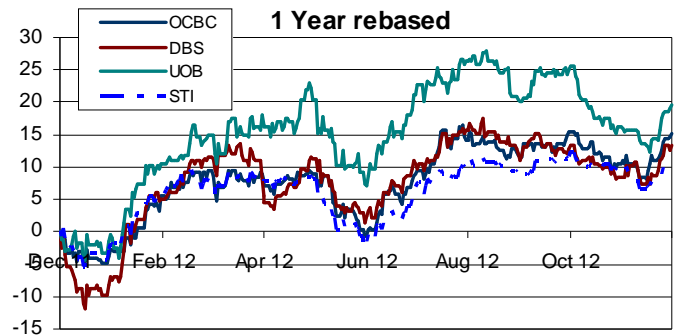
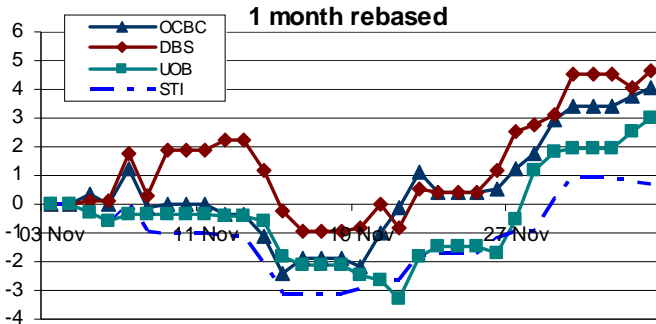
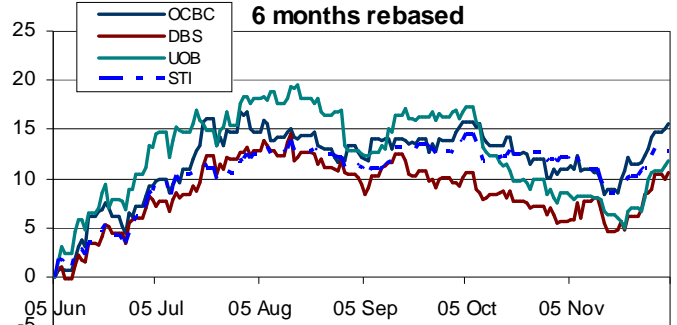
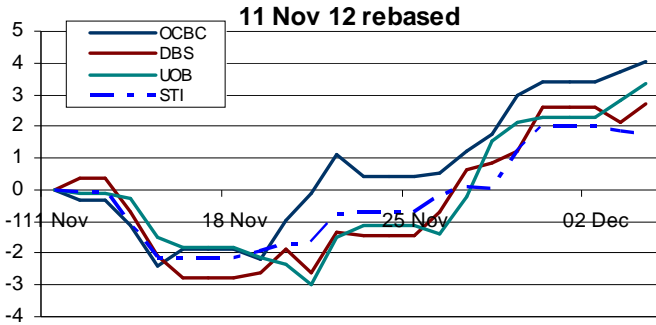
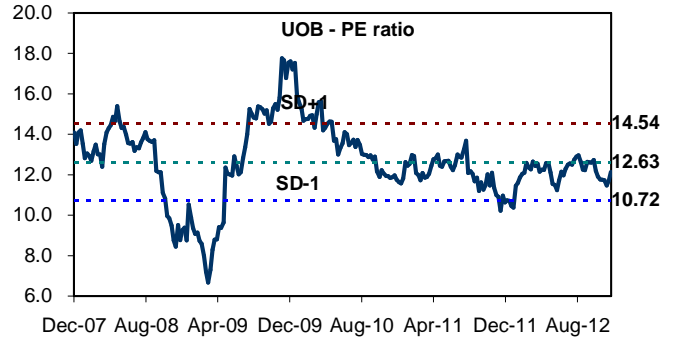
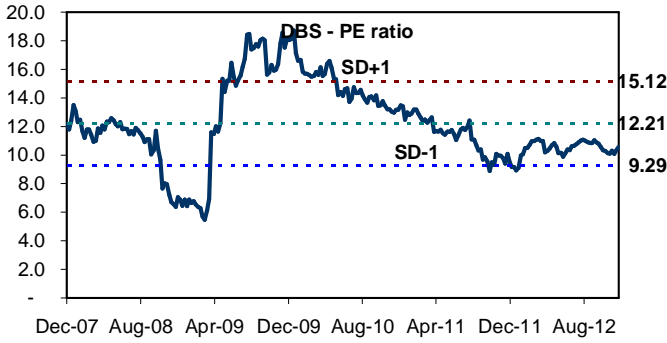


- Strong y-y rebound in Non Interest inc. from weaker FY11



Source: Company data, Bloomberg, Phillip Securities Research

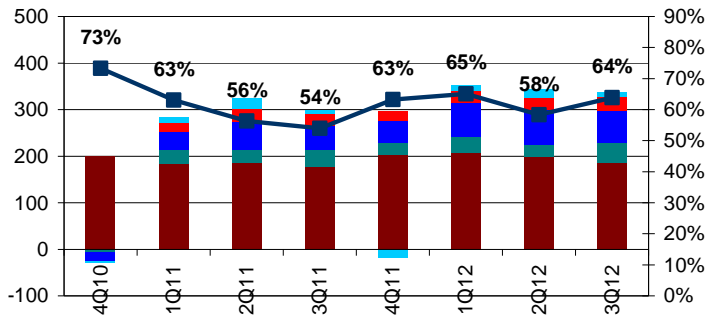
Source: Company data, Bloomberg, Phillip Securities Research



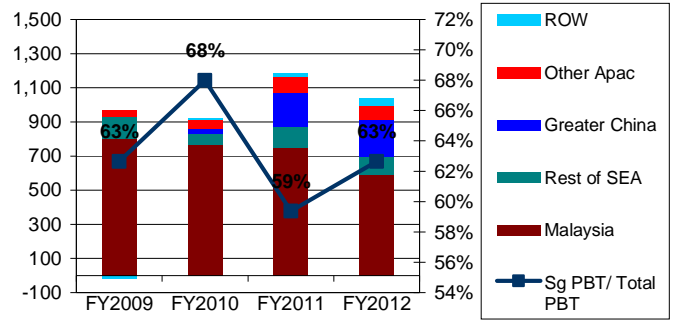
Source: Company data, Bloomberg, Phillip Securities Research

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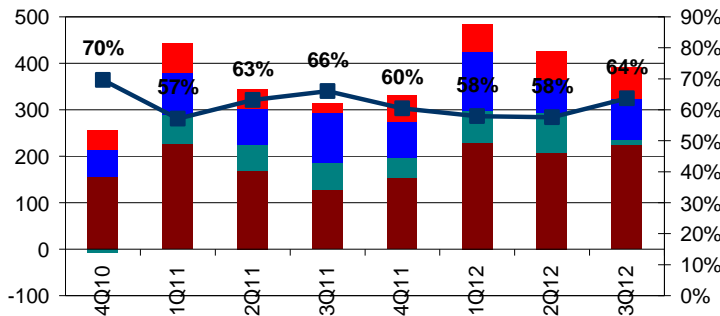
**By Geographical location – Profit before Tax
Oversea-Chinese Banking Corp**



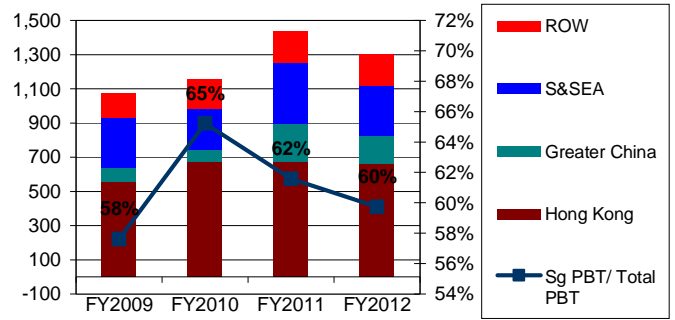
- Lower contributions from Malaysia



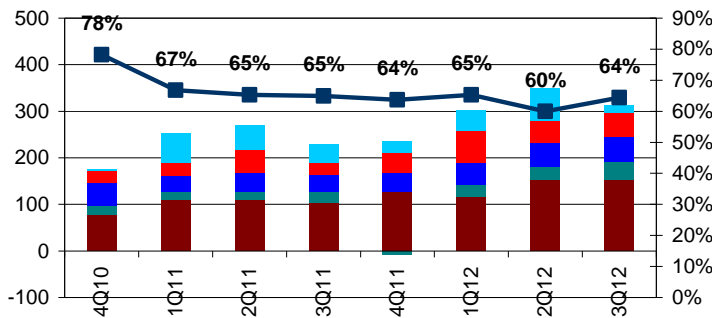
DBS Group Holdings



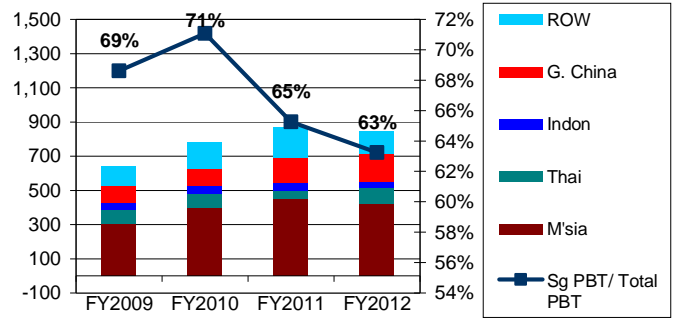
- Volatile contributions from HK



United Overseas Bank Ltd



- Stable contributions from all regional markets



Source: Company data, Bloomberg, Phillip Securities Research

Source: Company data, Bloomberg, Phillip Securities Research

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