Singapore Banking Strategy

Cheaper than during Global Financial Crisis

SINGAPORE | BANKING & FINANCE | UPDATE

- Selling pressure drove prices of banking stocks below Global Financial Crisis (GFC) low Price-to-Book (P/B) ratios.
- Even under stressed scenario, banks can meet their dividend payout. Last dividend cut was during the 2008 GFC when Tier-1 capital ratio was 12.0% vs 15.3% currently (before CET-1 was introduced).
- Bank stocks now trading at above 6.5% dividend yield.
- **Maintain Singapore Banking Sector at Overweight.** Recent price weakness presents an opportune time for investors to enter with an attractive yield.

Selling pressure on banking stocks

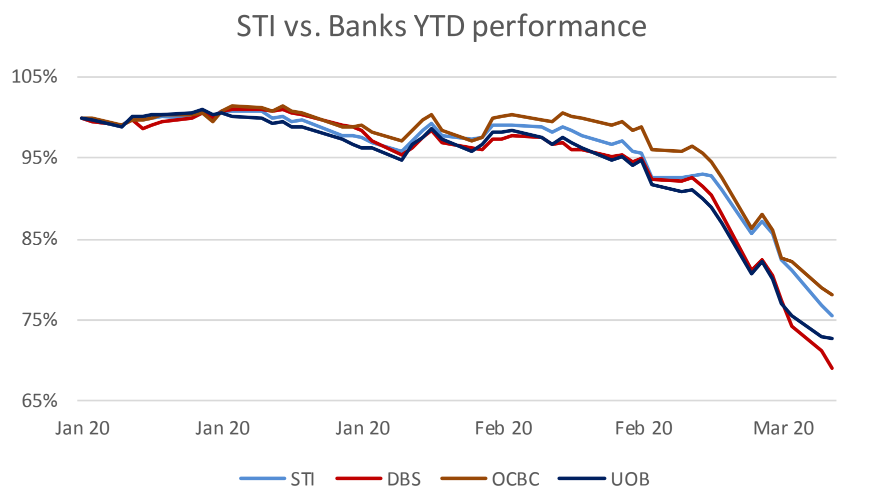
The Straits Times Index (STI) has nose-dove in recent days, falling off almost 25% YTD. The drop was led by banking stocks, who make up more than 30% of the benchmark index. The triple-threat combination of the COVID-19 pandemic, along with interest rate cuts as well as the oil price war continues to pile pressure on the prices of banking stocks, with prices of DBS and UOB falling more than the STI across the same period.

Figure 1: YTD performance of STI and banking stocks

	YTD Performance
STI	-24.5%
DBS	-31.1%
OCBC	-21.9%
UOB	-27.3%

Source: Bloomberg, PSR

Figure 2: Price weakness of banking stocks vs. STI



Source: Bloomberg, PSR

19 March 2020

Overweight (Maintained)

DBS Group Holdings

ACCUMULATE (Maintained)

BLOOMBERG CODE	DBS SP
LAST TRADED PRICE	SGD 17.90
FORECAST DIV	SGD 1.32
TARGET PRICE	SGD 27.30
HISTORICAL YIELD	6.87%
TOTAL RETURN	59.89%

Oversea-Chinese Banking Corp

ACCUMULATE (Maintained)

BLOOMBERG CODE	OCBC SP
LAST TRADED PRICE	SGD 8.49
FORECAST DIV	SGD 0.56
TARGET PRICE	SGD 12.10
HISTORICAL YIELD	6.24%
TOTAL RETURN	49.12%

United Overseas Bank Limited

ACCUMULATE (Maintained)

BLOOMBERG CODE	UOB SP
LAST TRADED PRICE	SGD 19.20
FORECAST DIV	SGD 1.30
TARGET PRICE	SGD 27.80
HISTORICAL YIELD	6.77%
TOTAL RETURN	51.56%

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Triple-threat impact on banks' earnings

The COVID-19 pandemic has weighed in on business sentiments with disruptions to global supply chains causing a liquidity crunch. Small and Medium Enterprises (SMEs) will be affected the most, followed by housing loans if employment levels fall. However, we are not observing a spontaneous deterioration in asset qualities within these sectors.

The rate cut undertaken by the Federal Reserve to combat economic impacts of the COVID-19 will put pressure on NIMs but cascading effects are expected to be felt in 1 to 2 quarters.

The oil price war reminiscent of the 2016 oil price meltdown will see muted impact on asset quality as all 3 banks have taken turns to clean up their oil and gas loan books in prior periods by reducing exposures to the industry and accounting for necessary provisions. Banks' exposure to oil and gas sector has dwindled to below 2% of their loan books.

We conducted a stress test on the banks' earnings by: (i) Doubling expected allowances or credit cost from 25 bps to 50 bps; (ii) Shaving 20 bps off forecasted NIM, we can observe PATMI deteriorate by up to 33%, which will take us back to PATMI levels last seen 4 years ago (FY16).

Figure 3: Stress test on NPAT

S$mn	DBS	OCBC	UOB
NPAT (FY20e)	6,789	4,835	4,462
NPAT (stressed)	5,489	3,231	3,154
Change	-19.1%	-33.2%	-29.3%

Source: PSR

Attractive valuations

With the sharp fall in prices, the local banks are currently trading at very attractive price-to-book (P/B) valuations. Both OCBC and UOB are trading at historical lows since 2002, while DBS has only traded below current levels in the 2008 Global Financial Crisis for 6 months, when it was directly involved in the Lehmann Brothers Minibond saga.

Figure 4: Historical P/B ratio of banks

Source: Bloomberg, PSR

Figure 5: Most banks are touching 2008 GFC low valuations

Price-to-Book Value	DBS	OCBC	UOB
Current	0.97	0.85	0.90
Average	1.28	1.47	1.44
Min	0.53	0.85	0.90

Source: Bloomberg, PSR

As such, we are entering an unchartered territory where banking stocks are highly undervalued trading against their respective book values.

Trim in dividends unlikely

Apart from appealing valuations, the banks are offering investors attractive dividend yields. The 3 local banks have increased dividend payout in FY19 compared to FY18 on the back of a good set of 4Q19 and FY19 results. The improvement in CET-1 ratios also bolsters investors from the likelihood of a trim in dividends.

Figure 6: FY19 dividend payout vs. FY18 dividend payout

	FY19	FY18	YoY
DBS	1.23	1.20	+2.5%
OCBC	0.53	0.43	+23.33%
UOB	1.30	1.20	+8.33%

The last dividend cut undertaken by the banks was during the GFC. However, the current situation is not comparable to the GFC, where the global financial system collapsed when credit quality of the banks came under pressure.

All 3 local banks are currently maintaining a CET-1 ratio of above 14.0%, well above regulatory requirements of 10.5% set out in the Basel III accord. Current CET-1 ratios are even higher than Tier-1 capital ratios from the 2008 GFC, where CET-1 ratios were yet to be introduced.

Figure 7: Historical CET-1 Ratio

CET-1 Ratio	DBS	OCBC	UOB
FY19	14.1%	14.9%	14.3%
FY18	13.9%	14.0%	13.9%
FY17	13.9%	13.9%	14.7%
FY08 Tier-1 Ratio (pre-CET-1)	10.1%	14.9%	10.9%

Figure 8: FY20e dividend and information

Dividends	Price	FY20e	Yield	Comments
DBS	18.00	1.32	7.3%	CET-1 ratio of 14.0% well below bank's comfortable operating levels between 12.5% to 13.5%.
OCBC	8.61	0.56	6.5%	Targets payout ratio range between 40-50% and revised payout of $0.28 every 6 months puts payout ratio closer to 50% than 40% in FY18.
UOB	19.39	1.30	6.7%	Healthy CET-1 ratio allowed the bank provide for special dividend amounting to $0.20 per year for the past 3 years to maintain a 50% payout ratio.

Conclusion

Maintain the Singapore Banking Sector at Overweight. While the Singapore economy seems bleak, the banks are well-poised to weather the headwinds as the integrity of the local banking system remains intact. The recent price weakness have provided investors with an opportunity to gain exposure to the banking industry while providing an attractive yield.

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