

26 February 2019

Financial Services | Banks

## Banks

**Overweight** (Maintained)

### More Room For NIM Expansion

Stocks Covered 2  
Ratings (Buy/Neutral/Sell): 2 / 0 / 0  
Last 12m Earnings Neutral

- **Keep OVERWEIGHT on banking sector.** Singapore banks should record further NIM expansion in 2019 – which will come from higher lending yields. In addition, over the longer term, we expect more cost efficiencies from digitisation efforts. All these will contribute to ROE expansion. Dividend yields are also attractive. We have BUY recommendations on both UOB and DBS. UOB is our preferred pick, partly due to its lower P/BV valuation.
- **1Q18 results were in line with expectations.** Singapore banks' 4Q18 earnings were generally in line with expectations. There was continued sequential expansion in NII as loans expanded, although the sequential NIM trend was mix. However, non-II performed poorly on weaker trading income and lower fees and commissions.
- **Higher lending yields ahead.** The 3-month SIBOR is now at 1.94%, higher than 4Q18's average of 1.73%. Repricing of loans will raise lending yields and contribute to wider 2019 NIM. DBS has guided for 4-5bps NIM expansion in 2019, assuming no further US Fed Fund Rate (FFR) hikes. UOB guided for flat 2019 NIM with an upward bias, and highlighted that home mortgage repricing will raise lending yields.
- **Mid-single-digit 2019 loan expansion.** Singapore banks' management teams are guiding for mid-single-digit 2019 loan growth, slower than the high-single-digit growth rates in 2018. After the Jul 2018 property cooling measures, home mortgages slowed in 4Q18, and are expected to remain soft in 2019.
- **Cost income ratio (CIR) to trend down over the longer term.** DBS guided for 2019 CIR of 43%, down from 2018's 44%. UOB guided for 2019 CIR to be similar to 2018's 43.9%. The digitisation efforts should contribute to lower CIR over the longer term.
- **Dividend payout to remain high.** Capital adequacy ratios (CAR) are at similar levels. DBS and UOB recorded CET1 CAR of 13.9%, whilst OCBC's was at 14%. UOB guided for a dividend payout ratio of 50% subject to CET1 CAR of at least 13.5% and good financials. Therefore, we believe dividends should expand for UOB. DBS should also report good dividends given its high CET1 CAR.
- **UOB is our preference.** Within the OVERWEIGHT banking sector, we believe UOB has the best potential for share price upside. Its 15% loan percentage exposure to Greater China, which is half of DBS', puts UOB less susceptible to China's economic uncertainties. UOB offers an attractive 2019 dividend yield of 5.1%, and trades at 1.15x 2019 book, below its historical average of 1.25x. Our SGD29.80 TP is based on 1.35x 2019 book.
- **DBS is also attractive.** Amongst the banks, DBS' earnings will gain most from FFR hikes, as evident from its 2018 NIM widening more than its peers. The lagged effect from FFR hikes on DBS' NIM should feature prominently in its 2019 results, and management has guided for 4-5bps NIM expansion in 2019. Our SGD28.80 TP is based on 1.5x 2019 book.

#### Top Picks

UOB (UOB SP) – BUY  
DBS (DBS SP) – BUY

#### Target Price

SGD29.80  
SGD28.80

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#### Moderating but still respectable loan growth

Loan Growth (YoY%)	DBS	OCBC	UOB
FY16	6.4%	4.1%	8.9%
FY17	7.2%	8.0%	4.7%
FY18	6.8%	9.0%	11.4%
FY19F	5.0%	NA	5.0%

Source: Company data, RHB

Company Name	Rating	TP (SGD)	% Upside (Downside)	P/E (x) Dec-19F	P/B (x) Dec-19F	Yield (%) Dec-19F
DBS	BUY	28.80	14.4	10.6	1.31	4.8
UOB	BUY	29.80	17.4	9.7	1.15	5.1

Source: Company data, RHB

**Stronger net interest income**

**DBS' NIM rose most in 2018.** DBS recorded 2018 NIM of 1.85%, up 10bps vs 2017. This is double the rate of expansion of 5bps for each of the other two banks. Looking ahead, banks' NIM are forecasted to widen on upward repricing of loan interest rates. The 4Q18 rise in SIBOR will translate to higher lending yields from 1H19 onwards, and widen NIM. Banks' management teams have generally guided for wider 2019 NIM.

**Figure 1: FY18 NIM was wider than FY17's**

Net interest margin	DBS	OCBC	UOB
FY16	1.80%	1.67%	1.71%
1Q17	1.74%	1.62%	1.73%
2Q17	1.74%	1.65%	1.75%
3Q17	1.73%	1.66%	1.79%
4Q17	1.78%	1.67%	1.81%
FY17	1.75%	1.65%	1.77%
1Q18	1.83%	1.67%	1.84%
2Q18	1.85%	1.67%	1.83%
3Q18	1.86%	1.72%	1.81%
4Q18	1.87%	1.72%	1.80%
FY18	1.85%	1.70%	1.82%
FY19F	1.90%	NA	1.84%
FY20F	1.93%	NA	1.87%

Source: Company data, RHB

**Banks continued to record 4Q18 sequential loan growth**, although the growth rates were slower vs the period before the Jul 2018 property cooling measures. Banks' management teams are guiding for mid-single-digit 2019 loan growth.

**Figure 2: UOB recorded strongest 4Q18 sequential loan expansion**

Loan QoQ% change	DBS	OCBC	UOB
1Q17	-1.0%	2.1%	1.5%
2Q17	1.5%	1.8%	-0.6%
3Q17	3.7%	1.6%	2.8%
4Q17	2.9%	2.3%	0.9%
1Q18	1.6%	4.1%	2.3%
2Q18	3.0%	2.3%	3.8%
3Q18	0.7%	1.7%	2.2%
4Q18	1.4%	0.5%	2.7%

Source: Company data

**Figure 3: NII continued to expand**

Net Interest Income QoQ % change	DBS	OCBC	UOB
1Q17	0.4%	1.7%	2.2%
2Q17	3.1%	5.7%	4.1%
3Q17	4.6%	2.8%	3.8%
4Q17	6.2%	3.0%	3.8%
1Q18	1.5%	-0.6%	0.6%
2Q18	4.5%	2.5%	5.0%
3Q18	2.2%	3.8%	3.6%
4Q18	2.5%	1.0%	0.6%

Source: Company data

### Weak fees and commissions

**Banks recorded weak 4Q18 non-II.** Besides the poor performance for trading income, fees and commissions were also weak.

**Figure 4: Weak showing for fees and commissions**

Fee & commissions QoQ % change	DBS	OCBC	UOB
1Q17	29.1%	14.5%	-17.3%
2Q17	-4.4%	2.3%	2.1%
3Q17	7.7%	-0.8%	6.5%
4Q17	-7.2%	0.6%	6.7%
1Q18	17.0%	9.2%	1.6%
2Q18	-5.1%	-3.4%	-3.7%
3Q18	-1.6%	-3.1%	-2.8%
4Q18	-8.6%	-5.4%	-3.3%

Source: Company data

### Trend in expenses

**CIR to be lower over the longer term.** Banks recorded higher 2018 CIR vs levels seen in 2017. This was partly due to weaker non-II. Looking ahead, DBS guided for 2019 CIR of 43%, and UOB guided for its 2019 CIR to be close to 2018's level. We are forecasting 2019 CIR levels that are lower than managements' guidance, as we believe NII could be slightly stronger.

**Figure 5: 2018 CIR higher than 2017 partly due to weak non-II**

Cost income ratio (%)	DBS	OCBC	UOB
4Q17	44.4%	40.8%	46.0%
FY17	43.0%	42.4%	43.7%
1Q18	41.6%	44.2%	44.2%
2Q18	44.3%	41.9%	43.6%
3Q18	43.9%	42.0%	43.4%
4Q18	46.3%	45.9%	44.4%
FY18	44.0%	43.4%	43.9%
FY19F	42.7%	NA	43.3%

Source: Company data, RHB

### Highlights on loan trend

**Property cooling measures have led to weaker mortgage expansion.** Following the property cooling measures in Jul 2018, Singapore banks started to record weaker mortgage loan expansion in 2H18. This was evident from 4Q18's housing loan sequential expansion being weaker than overall loan growth for individual banks.

**Figure 6: Housing mortgage sequential loan growth slower than overall**

	DBS	OCBC	UOB
4Q18 L&A QoQ % change	1.3%	0.4%	2.6%
- Transportation, Storage & Comms	0.2%	0.6%	1.9%
- Building & Construction	4.8%	4.1%	4.9%
- Manufacturing	4.0%	1.9%	-1.8%
- Financial Institutions	16.3%	6.5%	2.2%
- General Commerce	-6.5%	-0.8%	1.7%
- Professionals & Pte Individuals	-2.4%	-1.1%	1.2%
- Housing	0.7%	-1.2%	1.1%
- Others	-1.6%	-5.6%	14.0%

Source: Company data

**Figure 7: Building & construction and housing loans account for close to half of loan book**

	DBS	OCBC	UOB
FY18 L&A Breakdown	100.0%	100.0%	100.0%
- Transportation, Storage & Comms	8.7%	5.4%	3.9%
- Building & Construction	21.9%	20.8%	24.1%
- Manufacturing	10.5%	6.5%	8.1%
- Financial Institutions	7.2%	8.6%	8.9%
- General Commerce	13.6%	13.5%	12.6%
- Professionals & Pte Individuals	8.7%	11.8%	11.2%
- Housing	21.5%	25.1%	26.1%
- Others	7.9%	8.4%	5.1%

Source: Company data

Amongst the three banks, UOB has lowest loan percentage exposure to Greater China. Given lingering concerns over the Chinese economy, UOB is seen to be more insulated. On the other hand, positive progress on trade talks between the US and China could lead to investors taking a more optimistic outlook on China.

**Figure 8: UOB has lowest percentage loan exposure to Greater China**

<b>FY18 Loan breakdown by geography (%)</b>	DBS	OCBC	UOB
Singapore	46.7%	42.0%	52.4%
South & SEA	8.1%	NA	NA
South-east Asia	NA	NA	NA
- Malaysia	NA	11.5%	11.2%
- Thailand	NA	NA	6.4%
- Indonesia	NA	7.6%	4.3%
Greater China	30.1%	25.0%	15.3%
- HK	15.5%	NA	NA
Others	15.0%	13.9%	10.3%
Total	100.0%	100.0%	100.0%

Source: Company data

**Figure 9: Singapore banks are well diversified in terms of loan currency**

<b>FY18 Loan breakdown by currency (%)</b>	DBS	OCBC	UOB
Singapore dollar	40.6%	35.6%	47.1%
US dollar	31.5%	26.1%	19.4%
HK dollar	11.7%	13.7%	NA
China Yuan	3.6%	1.7%	NA
Malaysian Ringgit	NA	8.1%	9.7%
Indonesia Rupiah	NA	3.4%	2.0%
Thai Baht	NA	NA	6.0%
Others	12.7%	11.5%	15.8%
Total	100.0%	100.0%	100.0%

Source: Company data

### Capital adequacy ratio

**Similar CET1 CARs for the banks.** Whilst UOB's 3Q18 CET1 CAR was clearly ahead of its peers, the playing field was levelled in 4Q18. UOB recorded a 3.8% QoQ rise in 4Q18 risk-weighted assets, whereas its peers such as DBS recorded a 1.7% sequential reduction in risk-weighted assets, thereby narrowing the gap in CET1 CAR.

**Figure 10: All three banks have very similar CET1 CAR currently**

	DBS	OCBC	UOB
FY17 CET1 CAR	14.3%	13.9%	15.1%
FY17 Tier 1 CAR	15.1%	15.0%	16.2%
1Q18 CET1 CAR	14.0%	13.1%	14.9%
1Q18 Tier 1 CAR	15.0%	14.2%	16.4%
2Q18 CET1 CAR	13.6%	13.2%	14.5%
2Q18 Tier 1 CAR	14.4%	14.3%	16.0%
3Q18 CET1 CAR	13.3%	13.6%	14.1%
3Q18 Tier 1 CAR	14.4%	14.5%	15.1%
FY18 CET1 CAR	13.9%	14.0%	13.9%
FY18 Tier 1 CAR	15.1%	14.8%	14.9%

Source: Company data

### Sector valuations

Whilst UOB outperformed its peers in terms of total returns on a 12-month time horizon, DBS' share price did well after the release of its 4Q18 results. Besides macro developments such as widening NIM, steady loan growth, and good asset quality, we prefer UOB given its lower P/BV, and high 2019 dividend yield of 5.1%.

**Figure 11: DBS' share price has outperformed since its recent results release**

Name		DBS	OCBC	UOB
Price @	25-Feb-19	25.18	11.33	25.39
Local	Current	SGD	SGD	SGD
Mkt Cap	(SGDm)	64,417	48,143	42,292
	(USDm)	47,731	35,672	31,337
P/E (x)	Historical	11.6	10.6	10.6
	Current	10.6	10.0	10.1
	Forward	9.7	9.5	9.5
P/BV	(x)	1.3	1.1	1.2
ROE	(%)	11.6	11.2	11.5
ROA	(%)	1.0	1.0	1.1
Yield	(%)	4.8	3.8	3.9
YTD TR	(%)	6.3	0.6	3.3
1-m TR	(%)	4.0	(1.2)	(1.9)
3-m TR	(%)	9.1	4.0	5.7
6-m TR	(%)	0.2	1.5	(5.5)
1-y TR	(%)	(9.7)	(12.5)	(5.8)

Note: TR = Total Return

Source: Bloomberg

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