

18 July 2018

Financial Services | Banks

## United Overseas Bank

**Buy** (Maintained)

### Still a Play On Rising Interest Rates

Target Price: SGD33.30  
 Price: SGD25.92  
 Market Cap: USD31,764m  
 Bloomberg Ticker: UOB SP

**Maintain BUY and SGD33.30 TP, 28% upside. UOB remains our Top Pick in the Singapore banking sector as future NIM widening would offset negative effects from the recently-announced government measures to cool Singapore's residential property market. Management's intention to lower its CAR could potentially provide investors with more dividends. We believe the surge in UOB's P/BV between 2003-2007 (during FFR upcycle) could be repeated in the current FFR upcycle. We expect 2Q18 earnings to be in line with our expectations, with loan expansion supporting net interest income growth.**

**2Q18 net interest income growth may be more volume driven.** For 2Q18, management indicated that more focus would be placed on the corporate segment, which generates lower margin on average. In addition, more high quality liquid assets (due to the riskier global environment) could keep yields subdued. However, the higher SIBOR will be a positive for NIM. Overall, we forecast 2Q18 NIM to be marginally wider than 1Q18's 1.84%, which was 3bps higher than 4Q17's. We believe 2Q18 loan expansion will be in tandem with management's guidance of high single-digit for FY18.

**NIM expected to expand over next few quarters.** On a longer term perspective, the gradual increases in the US' federal funds rate (FFR) – US Federal Reserve (Fed) Chair Jerome Powell reiterated gradual interest rate hikes on 17 Jul 2018 – will also translate into wider NIM. We are forecasting NIM to widen further in subsequent quarters, and are projecting FY20 NIM of 1.97%.

**Lending to property space to be supported near term.** The 5 Jul 2018 announcement by the Government on measures to cool Singapore's residential property market could slow loan growth more obviously by 2020 and beyond. Over the next 1-2 years, lending to the property segment is likely to be supported by loans already approved in 1H18 and earlier, as drawdown will be gradual over the next few quarters. We are forecasting loan expansion of 8% and 6.5% for FY18 and FY19 respectively at UOB.

The trade war between the US and China is expected to impact the wealth management business. Wealth management AUM is likely to be affected as well. However, loan growth in 2Q18 should lead to more loan-related fees.

**Maintain BUY and SGD33.30 TP.** Our GGM-derived TP of SGD33.30 assumes CoE of 9.8% and ROE of 12.8% (1Q18 ROE was 11%). This yields a target P/BV of 1.43x, which we apply to our forecast FY19 BV of SGD23.35. Over the past five years, UOB has traded at an average P/BV of 1.24x. We believe the higher P/BV target is reasonable given the improving NIM environment.

**Downside risks** to our forecasts include higher-than-expected impairment charges and weaker-than-expected NIMs.

#### Share Data

Avg Daily Turnover (SGD/USD) 75.8m/56.5m  
 52-wk Price low/high (SGD) 23.1 - 30.1  
 Free Float (%) 77  
 Shares outstanding (m) 1,670  
 Estimated Return 28%

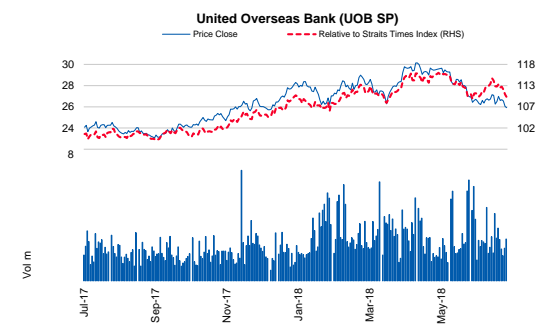
#### Shareholders (%)

Wee Cho Yaw 18.2  
 Estate of Lien Ying Chow, deceased 5.2

#### Share Performance (%)

	YTD	1m	3m	6m	12m
Absolute	(2.0)	(3.8)	(8.7)	(8.0)	8.0
Relative	2.8	(0.3)	(1.3)	0.5	9.8

Source: Bloomberg



Source: Bloomberg

Forecasts and Valuations	Dec-16	Dec-17	Dec-18F	Dec-19F	Dec-20F
Reported net profit (SGDm)	3,097	3,391	3,989	4,462	4,798
Net profit growth (%)	(3.4)	9.5	17.6	11.9	7.5
Recurring net profit (SGDm)	3,097	3,391	3,989	4,462	4,798
Recurring EPS (SGD)	1.91	2.06	2.37	2.59	2.71
BVPS (SGD)	20.1	22.2	23.3	24.5	25.7
DPS (SGD)	0.70	1.00	1.15	1.25	1.35
Recurring P/E (x)	13.5	12.6	10.9	10.0	9.6
P/B (x)	1.29	1.17	1.11	1.06	1.01
Dividend Yield (%)	2.7	3.9	4.4	4.8	5.2
Return on average equity (%)	9.7	9.7	10.4	10.8	10.8
Return on average assets (%)	0.9	1.0	1.1	1.1	1.2
Our vs consensus EPS (adjusted) (%)			0.1	(1.3)	(5.5)

Source: Company data, RHB

#### Analyst

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## Financial Exhibits

Financial model updated on : 2018-07-18.

Asia  
Singapore  
Financial Services  
**United Overseas Bank**  
Bloomberg UOB SP  
Buy

### Valuation basis

Our GGM assumptions are:

- COE of 9.8%;
- ROE of 12.8%;
- Growth of 2.8%.

### Key drivers

Our net profit forecast is most sensitive to:

- Credit cost;
- Changes in NIM;
- Non-interest income growth.

### Key risks

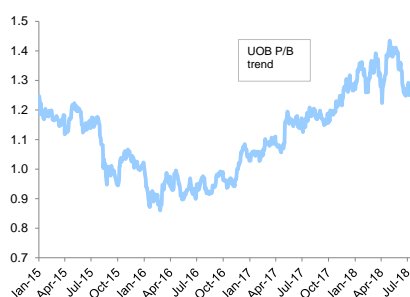
Risks include:

- Higher-than-expected impairment charges;
- Weaker-than-expected NIM;
- Softer-than-expected non-interest income.

### Company Profile

UOB is amongst the top three Singapore banks by loans. It also has significant operations in Malaysia, Thailand and Indonesia.

### UOB's P/BV trend



Financial summary (SGD)	Dec-16	Dec-17	Dec-18F	Dec-19F	Dec-20F
Recurring EPS	1.91	2.06	2.37	2.59	2.71
EPS	1.91	2.06	2.37	2.59	2.71
DPS	0.70	1.00	1.15	1.25	1.35
BVPS	20.1	22.2	23.3	24.5	25.7

Valuation metrics	Dec-16	Dec-17	Dec-18F	Dec-19F	Dec-20F
Recurring P/E (x)	13.5	12.6	10.9	10.0	9.6
P/B (x)	1.29	1.17	1.11	1.06	1.01
Dividend Yield (%)	2.7	3.9	4.4	4.8	5.2

Income statement (SGDm)	Dec-16	Dec-17	Dec-18F	Dec-19F	Dec-20F
Interest income	8,291	9,077	9,971	10,843	11,208
Interest expense	(3,300)	(3,548)	(3,945)	(4,256)	(4,312)
<b>Net interest income</b>	<b>4,991</b>	<b>5,529</b>	<b>6,026</b>	<b>6,587</b>	<b>6,896</b>
Non interest income	3,071	3,322	3,519	3,725	3,877
<b>Total operating income</b>	<b>8,062</b>	<b>8,851</b>	<b>9,545</b>	<b>10,312</b>	<b>10,773</b>
Overheads	(3,696)	(4,027)	(4,204)	(4,459)	(4,579)
<b>Pre-provision operating profit</b>	<b>4,366</b>	<b>4,824</b>	<b>5,341</b>	<b>5,853</b>	<b>6,194</b>
Loan impairment allowances	(594)	(727)	(600)	(580)	(520)
Income from associates	6	110	120	123	128
<b>Pre-tax profit</b>	<b>3,778</b>	<b>4,207</b>	<b>4,861</b>	<b>5,396</b>	<b>5,802</b>
Taxation	(669)	(800)	(856)	(917)	(986)
Minority interests	(12)	(16)	(16)	(17)	(18)
<b>Reported net profit</b>	<b>3,097</b>	<b>3,391</b>	<b>3,989</b>	<b>4,462</b>	<b>4,798</b>
<b>Recurring net profit</b>	<b>3,097</b>	<b>3,391</b>	<b>3,989</b>	<b>4,462</b>	<b>4,798</b>

Profitability ratios	Dec-16	Dec-17	Dec-18F	Dec-19F	Dec-20F
Return on average assets (%)	0.9	1.0	1.1	1.1	1.2
Return on average equity (%)	9.7	9.7	10.4	10.8	10.8
Return on IEAs (%)	2.8	2.8	2.9	3.0	3.0
Cost of funds (%)	1.3	1.3	1.3	1.4	1.3
Net interest spread (%)	1.5	1.6	1.6	1.7	1.6
Net interest margin (%)	1.7	1.7	1.8	1.8	1.8
Non-interest income / total income (%)	38.1	37.5	36.9	36.1	36.0
Cost to income ratio (%)	45.8	45.5	44.0	43.2	42.5
Credit cost (bps)	27.4	31.5	24.5	22.1	18.7

Balance sheet (SGDm)	Dec-16	Dec-17	Dec-18F	Dec-19F	Dec-20F
Total gross loans	225,780	236,202	254,520	270,923	285,874
Other interest earning assets	81,870	94,782	93,405	95,510	100,241
Total gross IEAs	307,650	330,984	347,925	366,433	386,115
Total provisions	(4,046)	(3,990)	(3,731)	(3,833)	(4,094)
Net loans to customers	221,734	232,212	250,789	267,090	281,780
Total net IEAs	303,604	326,994	344,194	362,600	382,021
Total non-IEAs	36,424	31,598	34,357	36,253	37,891
Total assets	340,028	358,592	378,551	398,853	419,912
Customer deposits	255,314	272,765	285,039	299,291	315,154
Other interest-bearing liabilities	11,855	11,440	15,419	17,207	16,720
Total IBLs	267,169	284,205	300,458	316,498	331,874
Total non-IBLs	39,817	37,350	38,205	39,345	41,729
Total liabilities	306,986	321,555	338,663	355,843	373,603
Share capital	6,351	7,766	7,780	7,872	8,012
Other reserves	26,522	29,084	31,839	34,851	38,010
Shareholders' equity	32,873	36,850	39,619	42,723	46,022
Minority interests	169	187	269	287	288

Asset quality and capital	Dec-16	Dec-17	Dec-18F	Dec-19F	Dec-20F
Reported NPLs / gross cust loans (%)	1.5	1.9	1.8	1.6	1.5
Total provisions / reported NPLs (%)	116.3	90.9	83.7	87.3	94.8
CET-1 ratio (%)	13.0	15.1	15.7	16.7	17.4
Tier-1 ratio (%)	13.1	16.2	16.7	17.3	18.0
Total capital ratio (%)	16.2	18.7	19.1	19.7	20.3

Source: Company data, RHB, Bloomberg

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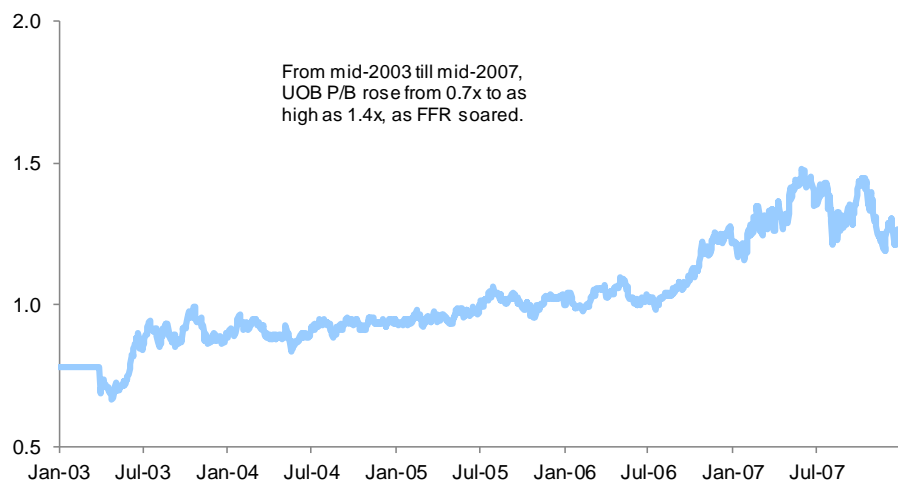
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Figure 1: UOB's financial data

UOB (SGDm)	FY16	FY17	FY18F	FY19F	FY20F
Net Interest Income	4,991	5,528	6,026	6,587	6,896
Non-interest Income	3,071	3,322	3,519	3,725	3,877
- Dividends	31	23	33	35	36
- Fee & Commission Income	1,931	2,161	2,264	2,378	2,468
- Rental Income	118	119	120	123	125
- Other Operating Income	991	1,019	1,102	1,189	1,248
Total operating income	8,061	8,851	9,545	10,312	10,773
Operating Expenses	(3,696)	(4,027)	(4,204)	(4,459)	(4,579)
Operating Profit	4,365	4,824	5,341	5,853	6,194
Provisions	(594)	(727)	(600)	(580)	(520)
Associates	6	110	120	123	128
Pre-tax profit	3,777	4,207	4,861	5,396	5,802
Taxation	(669)	(800)	(856)	(917)	(986)
Profit after tax	3,108	3,407	4,005	4,479	4,816
Minorities	(12)	(16)	(16)	(17)	(18)
<b>Net Profit</b>	<b>3,096</b>	<b>3,390</b>	<b>3,989</b>	<b>4,462</b>	<b>4,798</b>
EPS (SGD¢)	186.0	199.0	234.4	256.1	268.6
Book value (SGD)	18.88	20.96	22.12	23.35	24.57
Revalued book (SGD)	21.60	23.78	24.87	26.03	27.18
NTA (SGD)	16.34	18.47	19.68	20.98	22.26
Revalued NTA (SGD)	19.07	21.29	22.43	23.66	24.87
<b>P&amp;L ratios (%)</b>					
ROE (Avg)	10.2	10.2	10.9	11.3	11.3
Net Interest Margin	1.71	1.77	1.86	1.92	1.97
Net interest income / income	61.9	62.5	63.1	63.9	64.0
Operating Expenses / income	45.9	45.5	44.0	43.2	42.5
<b>P&amp;L YoY change (%)</b>					
Net Interest Income	1.3	10.8	9.0	9.3	4.7
Non-interest income	(1.6)	8.2	5.9	5.9	4.1
Fee & commission income	2.5	11.9	4.8	5.0	3.8
Total income	0.2	9.8	7.8	8.0	4.5
Operating expenses	2.8	9.0	4.4	6.1	2.7
Operating profit	(1.9)	10.5	10.7	9.6	5.8
Provisions	(11.6)	22.4	(17.5)	(3.3)	(10.3)
Pre-tax Profit	(2.4)	11.4	15.5	11.0	7.5
Net Profit	(3.6)	9.7	17.8	11.9	7.6
<b>BS data (SGDm)</b>					
Assets	340,028	358,592	378,551	398,853	419,912
Non-bank loans	221,734	232,212	250,789	267,090	281,780
Customer deposit	255,314	272,765	285,039	299,291	315,154
Non-performing assets	3,480	4,389	4,458	4,389	4,320
Cumulative loan loss provisions	4,046	3,990	3,731	3,833	4,094
<b>Balance sheet ratios (%)</b>					
Loans deposit ratio	86.8	85.1	88.0	89.2	89.4
Non-bank loans growth (YoY%)	8.9	4.7	8.0	6.5	5.5
Customer deposit growth (YoY%)	6.1	6.8	4.5	5.0	5.3
NPL / Non-bank loans	1.5	1.8	1.7	1.6	1.5
Loan loss coverage	116.3	90.9	83.7	87.3	94.8
Total CAR	16.2	18.7	19.1	19.7	20.3
Tier 1 CAR	13.1	16.2	16.7	17.3	18.0

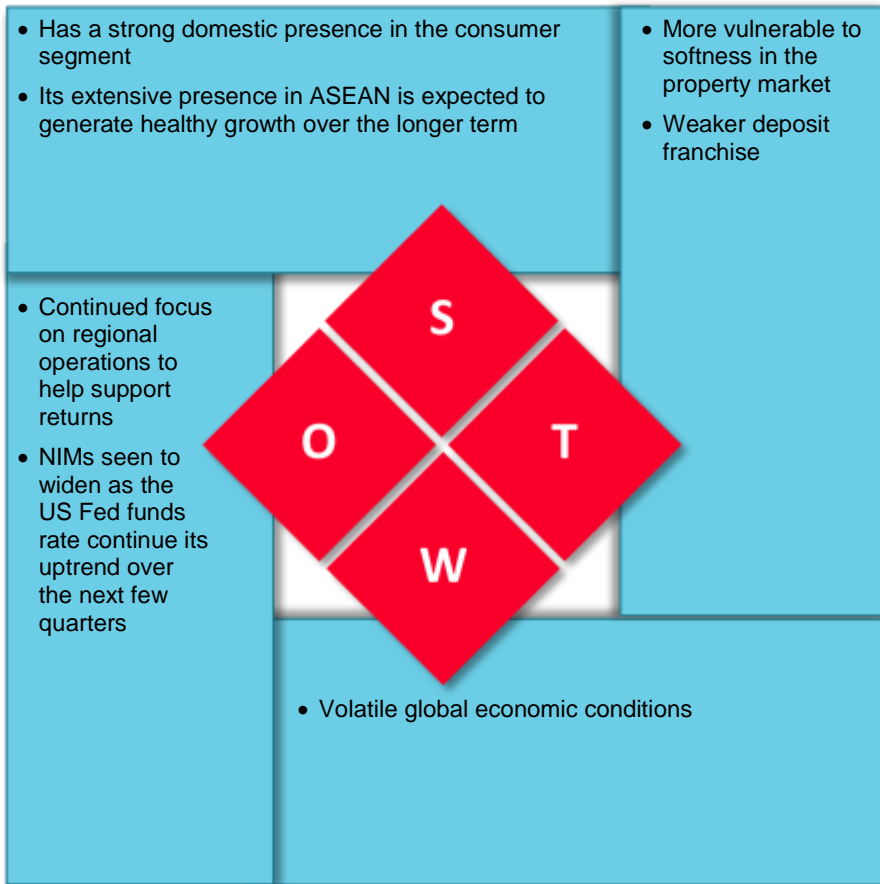
Source: Company data, RHB

Figure 2: UOB's P/BV surged between 2003-2007

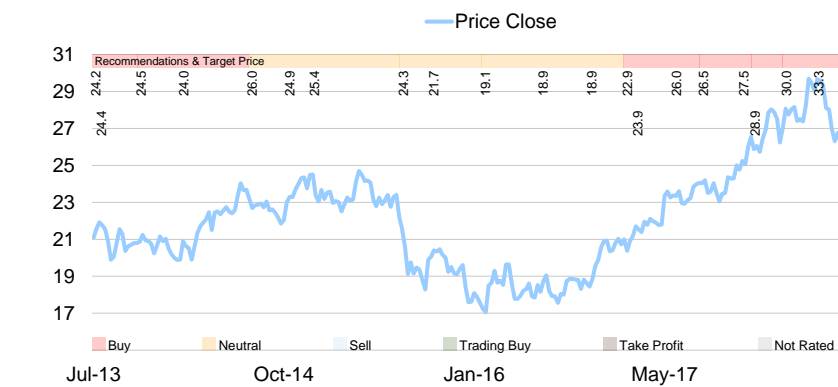


Source: Bloomberg

## SWOT Analysis



## Recommendation Chart



Source: RHB, Bloomberg

Date	Recommendation	Target Price	Price
2018-05-03	Buy	33.3	29.6
2018-02-14	Buy	30.0	26.2
2018-02-14	Buy	28.9	26.2
2017-11-30	Buy	28.9	26.2
2017-11-03	Buy	27.5	24.8
2017-11-03	Buy	26.5	24.8
2017-07-28	Buy	26.5	24.1
2017-07-28	Buy	26.0	24.1
2017-05-24	Buy	26.0	23.5
2017-05-01	Buy	23.9	21.8

Source: RHB, Bloomberg

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