13 July 2018

Financial Services | Banks

Banks

Overweight On Wider NIM Offsetting Trade War Effects

Overweight (from Neutral)

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

Top Picks	Target Price
UOB (UOB SP) – BUY	SGD33.30
DBS (DBS SP) – BUY	SGD30.30

Upgrading sector call to OVERWEIGHT from Neutral. Whilst the US-China trade war and the Singapore Government's property cooling measures could slow loan growth, rising FFR and a firmer SIBOR will widen banks' NIM. Between 2003-2007 when the FFR surged, DBS' and UOB's P/BV escalated – this could potentially be repeated this time round, with market expecting two more rate hikes in 2H18, and more in 2019. UOB is our preferred pick, given its lower exposure to China and potential for higher dividends. DBS is also a BUY.

We upgrade the Singapore banking sector call to OVERWEIGHT from Neutral, largely premised on expectations of continued NIM widening which would drive earnings, and the fact that the recent share price correction has already factored in significant negatives from the Singapore Government's property cooling measures.

FY20 NIM forecast is lower than FY08's 2.19%. We forecast DBS and UOB to record FY20 average NIM of 1.96%, sharply wider than these two banks' 1Q18 average NIM of 1.84%. This is premised on further hikes in the US federal funds rate (FFR) and the SIBOR. We believe our NIM forecast for FY20 is conservative – this is as in the last cycle, after 4-5 years of FFR hikes (starting FY03), the three big banks recorded average NIM of 2.19% in FY08.

Dampening effect from slower housing loan growth. On a slightly negative note, the property cooling measures announced by the Singapore Government on 5 Jul 2018 to raise additional buyer's stamp duty (ABSD) and lowering the loan-to-value (LTV) ratio, could dampen housing loan growth ahead. Having said that, we are forecasting mid-to-high single digit loan growth pa during FY18-20, which we see as already conservative.

Rising SIBOR seen to offset adverse effects from property cooling measures. The 3-month SIBOR has risen to 1.63%. We did a sensitivity analysis which examined the likely impact on earnings from a 10bps rise in the SIBOR, as well as a 1ppt fall in loan growth. Our conclusion is that a 1ppt slowdown in loan growth would be offset by a 10bps rise in the SIBOR. In other words, the impact of the Singapore Government's property cooling measures would be offset by the expected increases in the SIBOR over the next few quarters.

UOB is our preferred pick. UOB is a beneficiary of rising FFR. We forecast its NIM to widen to 1.97% by FY20 (from 1Q18's 1.84%). Its ROE also improved to 11% in 1Q18 from 4Q17's 9.8%, and management is guiding for 12% ROE by end-2019. More importantly, UOB's management indicated its intention to lower CET1 CAR, and we see this translating into higher dividends, which could catalyse its share price higher. Our UOB TP is SGD33.30, equivalent to 1.43x 2019F book –similar to the P/BV level in 2007 after four years of FFR hikes.

DBS is also attractive. Amongst the Singapore banks, DBS' earnings will improve the most from every 1bp rise in the SIBOR. Whilst the ongoing trade war between the US and China could slow DBS' loan growth (more than peers), we believe the rise in the SIBOR could offset the negatives. Based on the previous FFR upcycle between mid-2003 and mid-2007, FFR rose to >5% from 1%. During that time, DBS' P/BV correspondingly rose to as high as 1.9x from 1.04x. Currently, the bank is trading at only 1.26x 2019F book and our target P/BV is set at 1.47x, yielding our TP of SGD30.30.

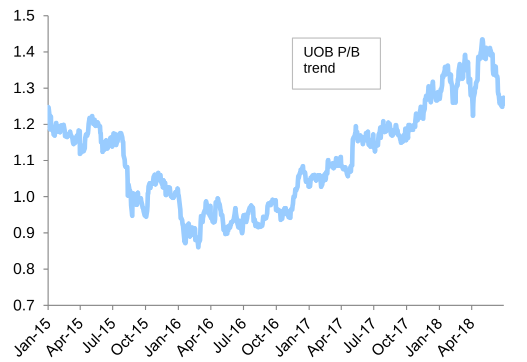
Downside risks to our forecasts include global macro uncertainties such as the US-China trade war, higher impairment charges, and weaker NIMs.

NIM surged during the 2003-2007 FFR upcycle

	DBS	OCBC	UOB
FY03	1.78%	1.90%	2.25%
FY04	1.87%	1.91%	2.10%
FY05	1.91%	1.84%	1.99%
FY06	2.20%	2.00%	1.99%
FY07	2.17%	2.10%	2.04%
FY08	2.04%	2.27%	2.27%

Source: Bloomberg

Recent UOB share price weakness has lowered P/BV



Source: Bloomberg

Company Name	Rating	Price	Target	% Upside (Downside)	P/E (x) Dec-18F	P/B (x) Dec-18F	Yield (%) Dec-18F
DBS	BUY	SGD26.00	SGD30.30	16.5	11.8	1.3	4.6
United Overseas Bank	BUY	SGD26.68	SGD33.30	24.8	11.3	1.1	4.3

Source: Company data, RHB

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Upgrading Sector To Overweight

Expect mildly slower housing loan growth from recent Singapore Government property cooling measures. The 5 Jul 2018 Singapore Government announcement to raise ABSD and lower LTV limits are expected to dampen demand for residential property, which will in turn slow housing loan growth.

We forecast a conservative mid-to-high single digit loan growth pa till FY20. Whilst the property cooling measures are negative for Singapore banks' earnings growth, we believe the impact will be relatively muted. We maintain our forecast for Singapore banks' loan growth of mid to high single digit pa for FY18-20 (Figure 1), which we see as relatively conservative. The banks' management teams are still guiding for mid-to-high single digit loan growth for FY18.

Figure 1: Loan growth (YoY%)

Loan Growth (YoY%)	DBS	OCBC	UOB
FY13	18.1%	17.9%	17.0%
FY14	10.8%	23.6%	9.5%
FY15	2.8%	0.3%	3.9%
FY16	6.4%	4.1%	8.9%
FY17	7.2%	8.0%	4.7%
1Q18	10.0%	10.1%	5.5%
FY18F	8.0%	NA	8.0%
FY19F	6.5%	NA	6.5%
FY20F	7.0%	NA	5.5%

Source: Respective companies data, RHB

Figure 2: QoQ non-bank loan growth

Loan QoQ% change	DBS	OCBC	UOB
1Q16	-3.2%	-1.5%	1.0%
2Q16	3.9%	-1.3%	1.4%
3Q16	1.9%	1.5%	2.4%
4Q16	3.9%	5.5%	3.9%
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%

Source: Respective companies data

1Q18 loan growth was mainly driven by non-housing loans. 1Q18 housing loan growth for the three banks averaged 0.9% QoQ (Figure 3), slower than the 2.5% average for overall loans. Singapore banks relied less on home mortgages for growth in 1Q18.

Figure 3: Sequential loan growth by sector

	DBS	OCBC	UOB
1Q18 L&A QoQ % change	1.6%	3.9%	2.0%
- Transportation, Storage & Comms	-3.6%	-9.0%	-1.6%
- Building & Construction	3.0%	8.6%	2.3%
- Manufacturing	2.5%	12.4%	7.4%
- Financial Institutions	15.8%	9.9%	1.1%
- General Commerce	1.6%	4.1%	2.1%
- Professionals & Pte Individuals	2.7%	5.1%	0.6%
- Housing	0.3%	0.8%	1.5%
- Others	-3.7%	-6.6%	2.6%

Source: Respective companies data

UOB has the largest portion of mortgage loans as percentage of total loans. 27.6% of UOB's loans are to the housing sector, higher than its peers (Figure 4). Given the recent property cooling measures, this is a mild negative for UOB.

Figure 4: Loan breakdown by sector

	DBS	OCBC	UOB
1Q18 L&A Breakdown	100.0%	100.0%	100.0%
- Transportation, Storage & Comms	8.8%	4.3%	3.8%
- Building & Construction	20.0%	15.6%	22.8%
- Manufacturing	10.0%	5.7%	8.3%
- Financial Institutions	6.0%	16.9%	8.0%
- General Commerce	15.6%	12.2%	13.0%
- Professionals & Pte Individuals	9.1%	12.2%	11.8%
- Housing	22.1%	26.4%	27.6%
- Others	8.4%	6.7%	4.6%

Source: Respective companies ***data***

Risks from escalating trade war between the US and China. Amongst the three banks, DBS has the greatest loan percentage exposure to Greater China, at 31.9% (Figure 5). On the other hand, UOB has the smallest exposure, at only 14% of its total loan book. Consequently, we believe any further escalation in trade tensions between the US and China could slow DBS' loan growth more significantly. On the other hand, if the trade tensions were to stabilise, this would be relatively positive for DBS vs the other banks.

Figure 5: 1Q18 loan breakdown by geography

1Q18 Loan breakdown by geography (%)	DBS	OCBC	UOB
Singapore	47.1%	42.1%	53.4%
South & SEA	7.8%	NA	NA
South-east Asia	NA	NA	NA
- Malaysia	NA	11.8%	11.9%
- Thailand	NA	NA	6.5%
- Indonesia	NA	7.7%	4.4%
Greater China	31.9%	25.5%	14.0%
- HK	15.5%	NA	NA
Others	13.2%	12.9%	9.8%
Total	100.0%	100.0%	100.0%

Source: Respective companies ***data***

We are forecasting NIMs to widen ~12bps from 1Q18 to FY20. On a positive note, Singapore banks will benefit from wider margins over the next few quarters. A rising FFR should drive the SIBOR higher and contribute to wider NIMs. The banks have indicated that 2Q18 NIM should be slightly wider than 1Q18's level. We forecast gradually widening NIMs for Singapore banks over the next few years (Figure 6).

Figure 6: Net interest margins

Net Interest Margin	DBS	OCBC	UOB
FY15	1.77%	1.67%	1.77%
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%
FY18F	1.85%	NA	1.86%
FY19F	1.90%	NA	1.92%
FY20F	1.95%	NA	1.97%

Source: Respective companies ***data****, RHB*

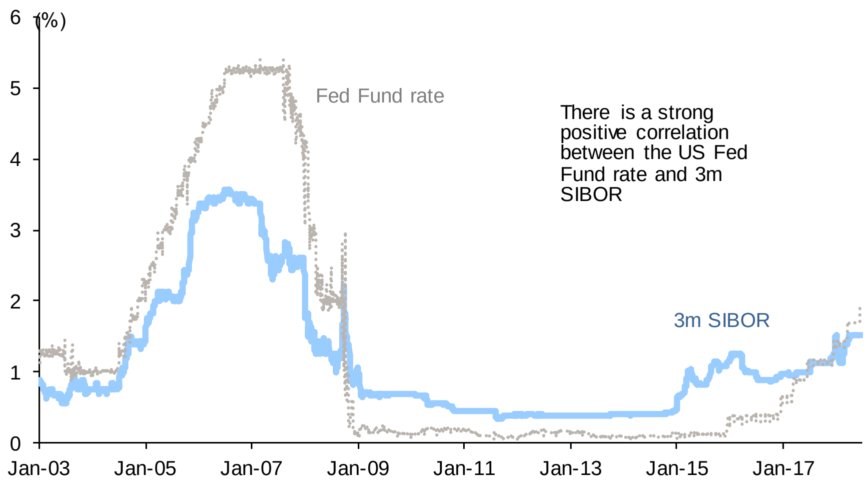
The three banks had an average NIM of 2.19% in FY08, whilst we forecast FY20 average NIM of 1.96%. When the FFR rose from 1% to >5% between mid-2003 and mid-2007, the three Singapore banks generally recorded wider NIMs – in FY08, the three banks had an average NIM of 2.19% (Figure 7), which was way higher than our FY20F of around 1.96% ie our NIM expectation is therefore not aggressive.

Figure 7: Net interest margins from 2003-2008

	DBS	OCBC	UOB
FY03	1.78%	1.90%	2.25%
FY04	1.87%	1.91%	2.10%
FY05	1.91%	1.84%	1.99%
FY06	2.20%	2.00%	1.99%
FY07	2.17%	2.10%	2.04%
FY08	2.04%	2.27%	2.27%

*Source: Respective companies **data***

Figure 8: US FFR and 3-mth SIBOR



Source: Bloomberg

We did a sensitivity analysis which examined the likely impact on earnings from a 10bps rise in the SIBOR, as well as a 1ppt fall in loan growth. Our conclusion is that a 1ppt slowdown in loan growth would be offset by a 10bps rise in the SIBOR (Figure 9). In other words, the impact of the Singapore Government measures to cool the residential property market could be offset by expected increases in the SIBOR over the next few quarters.

Figure 9: Sensitivity of profit to SIBOR rise and weaker loan growth

	DBS	UOB
FY19F net int inc rise for 10bp rise in SIBOR (SGDm)	74.8	38.8
- net of tax & as % of net profit	1.0%	0.7%
FY19F net int inc rise for 1% rise in loan book (SGDm)	54.8	39.5
- net of tax & as % of net profit	0.8%	0.7%
FY19F net int inc change for 10bp SIBOR rise & 1% fall in loan (SGDm)	20.0	(0.7)
- net of tax & as % of net profit	0.3%	0.0%

Source: RHB

UOB is our preferred bank pick. UOB is a beneficiary of rising FFR. We forecast its NIM to widen to 1.97% by FY20 (from 1Q18's 1.84%). Its ROE also improved to 11% in 1Q18 from 4Q17's 9.8%,and management is guiding for 12% ROE by end-2019. More importantly, UOB's management indicated its intention to lower CET1 CAR, and we see this translating into higher dividends, which could catalyse its share price higher.

Over the past month, UOB's share price has fallen the least vs its peers – and we attribute this to UOB's potential of paying more dividends and its smaller China exposure. On a longer 12-month perspective, UOB has given investors a total return (TR) of 19%, lagging behind DBS' 33% (Figure 10). We believe wider NIMs will continue to drive UOB share price higher. Our TP for UOB is SGD33.30, which works out to 1.4x FY19 book – UOB traded at 1.4x P/BV in 2007, when the FFR was around its peak (Figure 11).

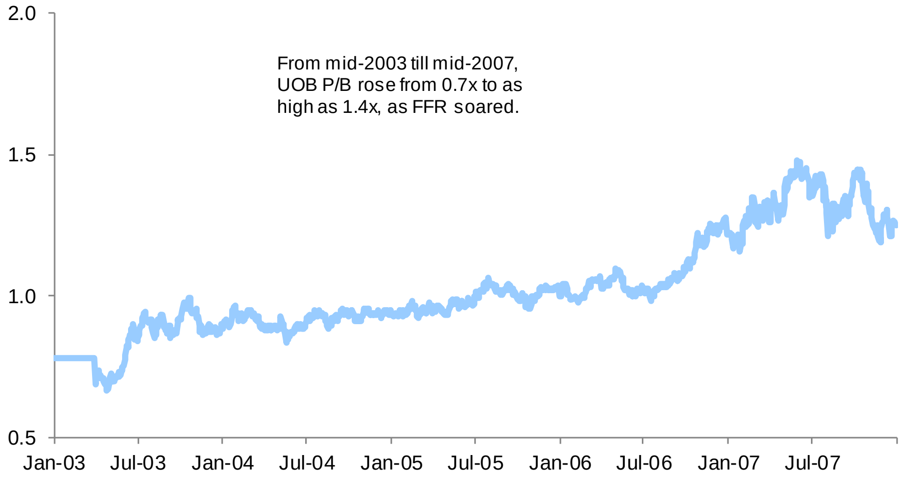
Figure 10: SG banks' valuations

Name		DBS GROUP HOLDINGS LTD	OVERSEA-CHINESE BANKING CORP	UNITED OVERSEAS BANK LTD
Price @	12-Jul-18	26.00	11.30	26.68
Local	Curr	SGD	SGD	SGD
Mkt Cap ($m)	(LC)	66,638	47,302	44,532
	(US$)	48,909	34,717	32,684
PE (x)	Hist	14.3	11.2	12.5
	Curr	11.3	10.1	11.2
	Fwd	10.1	9.2	10.1
PB	(x)	1.4	1.2	1.3
ROE	(%)	9.8	11.2	10.7
ROA	(%)	0.9	1.0	1.0
Yield	(%)	3.6	3.3	3.0
YTD TR	(%)	8.6	(7.5)	3.1
1-m TR	(%)	(8.7)	(9.9)	(4.2)
3-m TR	(%)	(3.9)	(10.7)	(2.4)
6-m TR	(%)	2.4	(11.7)	(2.2)
1-y TR	(%)	33.0	7.5	19.0

Note: TR – total return

Source: Bloomberg, forecasts are based on consensus expectations

Figure 11: UOB's P/BV surged between 2003-2007



Source: Bloomberg

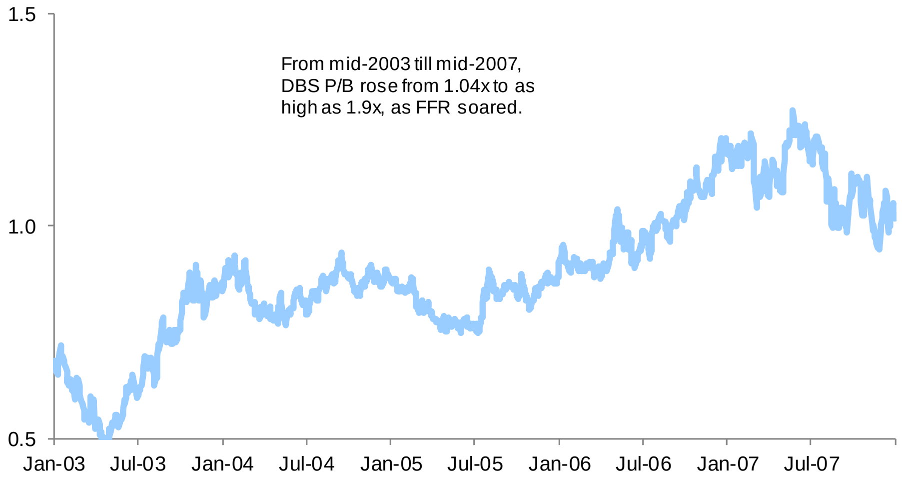
Figure 12: UOB's financial data

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)
Net Profit	**3,096**	**3,390**	**3,989**	**4,462**	**4,798**
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
P&L ratios (%)					
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
P&L YoY change (%)					
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
BS data (SGDm)					
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
Balance sheet ratios (%)					
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

DBS is also attractive. Amongst the Singapore banks, DBS' earnings will improve the most from every 1bp rise in the SIBOR. Whilst the ongoing trade war between the US and China could slow DBS' loan growth (more than peers), we believe the rise in the SIBOR could offset the negatives. For the previous FFR upcycle between mid-2003 and mid-2007, FFR rose to >5% from 1%. During that time, DBS' P/BV correspondingly rose to as high as 1.9x from 1.04x (Figure 13). Currently, the bank is trading at only 1.26x 2019F book and our target P/BV is set at 1.47x, giving a TP of SGD30.30.

Figure 13: DBS' P/BV soared as FFR rose between 2003-2007



Source: Bloomberg

Figure 14: DBS' financial data

DBS (SGDm)	FY16	FY17	FY18F	FY19F	FY20F
Net Interest Income	7,305	7,791	8,466	9,131	9,803
Non-interest Income	4,184	4,483	4,991	5,211	5,734
- Fee & Commission Income	2,331	2,622	3,088	3,179	3,426
- Other Operating Income	1,853	1,861	1,903	2,032	2,308
Total Operating Income	11,489	12,274	13,457	14,342	15,537
Operating Expenses	(4,972)	(5,205)	(5,725)	(6,028)	(6,501)
Operating Profit	6,517	7,069	7,732	8,314	9,036
Provisions	(1,434)	(1,894)	(880)	(950)	(987)
Pre-tax profit	5,083	5,175	6,852	7,364	8,049
Taxation	(723)	(671)	(1,051)	(1,198)	(1,314)
Profit after tax	4,360	4,504	5,801	6,166	6,735
Minorities	(122)	(133)	(135)	(139)	(147)
Net Profit	**4,238**	**4,371**	**5,666**	**6,027**	**6,588**
EPS (SGD¢)	167.7	170.8	218.8	229.9	248.2
Book value (SGD)	17.58	18.56	19.55	20.63	21.89
Revalued book (SGD)	17.94	19.13	20.11	21.19	22.44
NTA (SGD)	15.56	16.54	17.55	18.66	19.95
Revalued NTA (SGD)	15.92	17.11	18.11	19.22	20.49
P&L ratios (%)					
ROE (Avg)	10.1	9.7	12.0	11.9	12.1
Net Interest Margin	1.80	1.75	1.85	1.90	1.95
Net interest income / income	63.6	63.5	62.9	63.7	63.1
Operating expenses / income	43.3	42.4	42.5	42.0	41.8
P&L YoY change (%)					
Net Interest Income	2.9	6.7	8.7	7.9	7.4
Non-interest Income	9.0	7.1	11.3	4.4	10.0
Fee & Commission Income	8.7	12.5	17.8	2.9	7.8
Total Income	5.0	6.8	9.6	6.6	8.3
Operating expenses	1.5	4.7	10.0	5.3	7.8
Operating profit	8.0	8.5	9.4	7.5	8.7
Provisions	93.0	32.1	(53.5)	8.0	3.9
Pre-tax Profit	(4.0)	1.8	32.4	7.5	9.3
Net Profit	(4.8)	3.1	29.6	6.4	9.3
BS data (SGDm)					
Assets	481,570	517,711	544,057	563,587	576,390
Non-bank loans	301,516	323,099	348,947	371,628	397,642
Customer deposit	347,446	373,634	394,184	415,076	437,075
Non-performing assets	4,856	6,070	6,016	5,510	5,004
Cumulative loan loss provisions	4,707	5,139	4,823	4,513	4,840
Balance sheet ratios (%)					
Loans Deposit Ratio	86.8	86.5	88.5	89.6	91.0
Non-bank loans growth (YoY%)	6.4	7.2	8.0	6.5	7.0
Customer deposit growth (YoY%)	8.5	7.5	5.5	5.3	5.3
Non-bank NPL / Non-bank loans	1.4	1.7	1.5	1.3	1.1
Loan loss coverage	96.9	84.7	80.2	81.9	96.7
Total CAR	16.2	15.9	15.8	16.1	16.4
Tier 1 CAR	14.7	15.1	15.1	15.5	15.8

Source: Company data, RHB

RHB Guide to Investment Ratings

Buy: Share price may exceed 10% over the next 12 months
Trading Buy: Share price may exceed 15% over the next 3 months, however longer-term outlook remains uncertain
Neutral: Share price may fall within the range of +/- 10% over the next 12 months
Take Profit: Target price has been attained. Look to accumulate at lower levels
Sell: Share price may fall by more than 10% over the next 12 months
Not Rated: Stock is not within regular research coverage

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