

20 March 2020

Financial Services | Banks

United Overseas Bank (UOB SP)

Neutral (Maintained)

Macro Concerns To Weaken Earnings

- **Stay NEUTRAL with a new GGM-derived SGD20.00 TP from SGD25.20, 9% upside with c.6% yield**, based on 0.85x 2020F P/NBV. We lowered our sustainable ROE assumption to 10.3% from 11.2%, as we cut FY20F earnings on lower NIM and higher provision assumptions. Our NIM forecast was lowered due to the 15 Mar cut in the federal fund rate (FFR). Travel restrictions globally due to COVID-19 would slow economies and raise provisioning requirements. However, given UOB's more conservative lending, it is our preferred pick within the banking sector.
- **FFR cut on 15 Mar will lower the SIBOR going forward.** The US Federal Reserve cut the FFR twice in March (150bps in total) to the current upper bound of 0.25%. The 3-month SIBOR has fallen to the current 0.995% vs February's 1.69% average. There may be more downside for the 3-month SIBOR. We cut our FY20F NIM to 1.68% from 1.73% to factor in the two FFR cuts – note that UOB recorded NIM of c.1.71% in FY13 and FY14 when the FFR was close to zero.
- **We forecast a FY20 loan contraction.** Given the global travel restrictions and sharp fall in crude oil price, investments are likely to be scaled back sharply. Malaysia accounts for 11% of UOB's FY19 global loans, and we may see soft loans from there. We assume an overall loan contraction of 2% in FY20 for the bank.
- **Provisions to move up.** UOB de-risked by reducing its North Asia loans in 4Q19, and this should lead to less deterioration in asset quality. Its O&G loans which have weaker asset quality have already been largely provided for. However, its ASEAN loans could see asset quality deterioration as economic growth stalls. As a result, we raise our FY20F NPL ratio to 1.9% (from 1.8%) and increase our provisions for this period by 19% to SGD990m, or 39bps credit cost.
- **We cut FY20F net profit by 9% to SGD3.53bn.** We cut earnings forecasts further to factor in the recent developments. Even based on our revised numbers, there is further downside to earnings if the COVID-19 pandemic worsens globally.
- **UOB's FY20F yield of c.6% may be high, but the risk of falling dividends cannot be ruled out.** Based on our SGD1.10/share dividend for FY20F (c.50% payout ratio), UOB's yield is c.6%. However, there is a risk that a prolonged economic disruption could lead to dividends coming in lower than our expectations. Our TP is based on 2020F P/NBV of 0.85x, which is lower than the 5-year average of 1.17x. Our target P/NBV is close to the low of 0.92x recorded during the Global Financial Crisis. We believe UOB could see short-term price downsides (due to the headwinds mentioned above) before rebounding.

Target Price (Return): SGD20.00 (9%)
 Price: SGD18.40
 Market Cap: USD21,011m
 Avg Daily Turnover (SGD/USD): 80.3m/58.0m

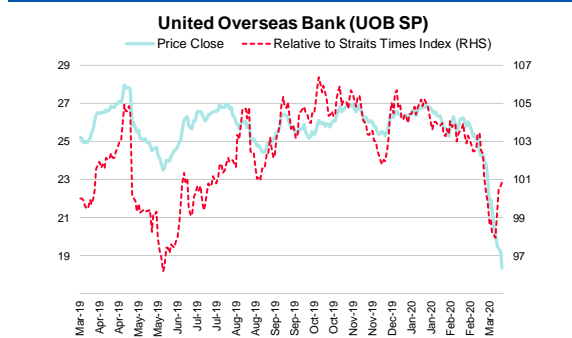
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Share Performance (%)

	YTD	1m	3m	6m	12m
Absolute	(30.5)	(29.6)	(31.0)	(28.6)	(28.2)
Relative	(2.2)	(1.5)	(3.0)	(1.8)	0.1
52-wk Price low/high (SGD)	18.4 – 28.0				



Source: Bloomberg

Forecasts and Valuation	Dec-18	Dec-19	Dec-20F	Dec-21F	Dec-22F
Reported net profit (SGDm)	4,009	4,342	3,527	4,041	4,395
Net profit growth (%)	18.2	8.3	(18.8)	14.6	8.8
Recurring net profit (SGDm)	4,009	4,342	3,527	4,041	4,395
Recurring EPS (SGD)	2.41	2.60	2.11	2.42	2.63
BVPS (SGD)	22.59	23.76	24.74	25.84	27.09
DPS (SGD)	1.20	1.30	1.10	1.30	1.35
Recurring P/E (x)	7.62	7.05	8.68	7.58	6.97
P/B (x)	0.81	0.77	0.74	0.71	0.68
Dividend Yield (%)	6.5	7.1	6.0	7.1	7.4
Return on average equity (%)	10.8	11.2	8.7	9.6	10.0

Source: Company data, RHB

20 March 2020

Financial Services | Banks

Financial Exhibits

Asia	Financial summary (SGD)	Dec-18	Dec-19	Dec-20F	Dec-21F	Dec-22F
Singapore	EPS	2.41	2.60	2.11	2.42	2.63
Financial Services	Recurring EPS	2.41	2.60	2.11	2.42	2.63
United Overseas Bank	DPS	1.20	1.30	1.10	1.30	1.35
UOB SP	BVPS	22.59	23.76	24.74	25.84	27.09
Neutral						
Valuation basis	Valuation metrics	Dec-18	Dec-19	Dec-20F	Dec-21F	Dec-22F
Our GGM assumptions are:	Recurring P/E (x)	7.62	7.05	8.68	7.58	6.97
i. COE of 11.8%;	P/B (x)	0.8	0.8	0.7	0.7	0.7
ii. ROE of 10.3%; and	Dividend Yield (%)	6.5	7.1	6.0	7.1	7.4
iii. growth of 1.2%						
Key drivers	Income statement (SGDm)	Dec-18	Dec-19	Dec-20F	Dec-21F	Dec-22F
Our net profit forecast is most sensitive to:	Interest income	11,141	12,557	12,024	12,586	13,256
i. Credit cost;	Interest expense	(4,921)	(5,994)	(5,757)	(6,142)	(6,534)
ii. changes in NIM; and	Net interest income	6,220	6,563	6,267	6,444	6,722
iii. non-interest income growth	Non interest income	2,897	3,467	3,409	3,813	4,214
	Total operating income	9,117	10,030	9,676	10,257	10,936
	Overheads	(4,003)	(4,473)	(4,487)	(4,809)	(5,085)
	Pre-provision operating profit	5,114	5,557	5,189	5,448	5,851
	Loan impairment allowances	(393)	(435)	(990)	(620)	(600)
	Income from associates	106	51	52	61	67
	Pre-tax profit	4,827	5,173	4,251	4,889	5,318
	Taxation	(805)	(813)	(708)	(831)	(904)
	Minority interests	(13)	(18)	(16)	(17)	(19)
	Reported net profit	4,009	4,342	3,527	4,041	4,395
	Recurring net profit	4,009	4,342	3,527	4,041	4,395
	Profitability ratios	Dec-18	Dec-19	Dec-20F	Dec-21F	Dec-22F
	Return on average assets (%)	1.1	1.1	0.9	1.0	1.1
	Return on average equity (%)	10.8	11.2	8.7	9.6	10.0
	Return on IEAs (%)	3.2	3.5	3.3	3.4	3.5
	Cost of funds (%)	1.7	1.9	1.8	1.9	2.0
	Net interest spread (%)	1.6	1.6	1.5	1.5	1.5
	Net interest margin (%)	1.8	1.8	1.7	1.7	1.8
	Non-interest income / total income (%)	31.8	34.6	35.2	37.2	38.5
	Cost to income ratio (%)	43.9	44.6	46.4	46.9	46.5
	Credit cost (bps)	15.8	16.4	37.1	23.1	21.5
	Balance sheet (SGDm)	Dec-18	Dec-19	Dec-20F	Dec-21F	Dec-22F
	Total gross loans	262,263	269,069	264,151	271,997	286,776
	Other interest earning assets	94,867	100,069	99,487	101,585	104,166
	Total gross IEAs	357,130	369,138	363,638	373,582	390,942
	Total provisions	(3,635)	(3,611)	(4,002)	(4,044)	(4,085)
	Net loans to customers	258,628	265,458	260,149	267,953	282,691
	Total net IEAs	353,495	365,527	359,636	369,538	386,857
	Total non-IEAs	34,598	38,882	38,622	39,769	40,900
	Total assets	388,093	404,409	398,258	409,307	427,757
	Customer deposits	293,186	310,726	313,833	324,817	341,058
	Other interest-bearing liabilities	13,800	15,302	4,116	1,508	1,076
	Total IBLs	306,986	326,028	317,950	326,325	342,135
	Total non-IBLs	43,294	38,517	38,789	39,627	40,154
	Total liabilities	350,280	364,545	356,739	365,952	382,289
	Share capital	7,014	7,325	7,400	7,460	7,510
	Shareholders' equity	37,623	39,637	41,281	43,105	45,201
	Minority interests	190	227	238	250	267
	Asset quality and capital	Dec-18	Dec-19	Dec-20F	Dec-21F	Dec-22F
	Reported NPLs / gross cust loans (%)	1.6	1.6	2.0	1.9	1.8
	Total provisions / reported NPLs (%)	87.3	84.0	74.9	80.0	78.5
	CET-1 ratio (%)	13.9	14.3	15.8	16.8	17.0
	Tier-1 ratio (%)	14.9	15.4	16.6	17.5	17.6
	Total capital ratio (%)	17.0	17.4	18.7	19.6	19.7

Source: Company data, RHB

20 March 2020

Financial Services | Banks

Figure 1: UOB financial data

UOB (SGDm)	FY18	FY19	FY20F	FY21F	FY22F
Net interest income	6,220	6,562	6,267	6,444	6,722
Non-interest income	2,896	3,467	3,409	3,813	4,214
- Dividends	27	51	35	37	39
- Fee & commission income	1,967	2,032	2,105	2,260	2,562
- Rental income	119	110	119	121	124
- Other operating income	784	1,274	1,150	1,395	1,489
Total operating income	9,116	10,030	9,676	10,257	10,936
Operating expenses	(4,003)	(4,472)	(4,487)	(4,809)	(5,085)
Operating profit	5,113	5,558	5,189	5,448	5,851
Provisions	(393)	(435)	(990)	(620)	(600)
Associates	106	51	52	61	67
Pre-tax profit	4,826	5,174	4,251	4,889	5,318
Taxation	(805)	(813)	(708)	(831)	(904)
Profit after tax	4,021	4,362	3,543	4,058	4,414
Minorities	(13)	(18)	(16)	(17)	(19)
Net Profit	4,008	4,343	3,527	4,041	4,395
EPS (SGD¢)	234.0	255.0	208.6	239.3	260.6
Net book value/sh (SGD)	21.31	22.48	23.46	24.56	25.81
Revalued book (SGD)	24.19	25.54	26.53	27.62	28.88
P&L ratios (%)					
ROE (Avg)	11.3	11.6	9.5	10.7	11.5
Net interest margin	1.82	1.78	1.68	1.72	1.73
Net interest income / income	68.2	65.4	64.8	62.8	61.5
Operating expenses / income	43.9	44.6	46.4	46.9	46.5
P&L YoY change (%)					
Net interest income	12.5	5.5	(4.5)	2.8	4.3
Non-interest income	(4.5)	19.7	(1.7)	11.9	10.5
Fee & commission income	5.0	3.3	3.6	7.4	13.4
Total income	6.5	10.0	(3.5)	6.0	6.6
Operating expenses	7.1	11.7	0.3	7.2	5.7
Operating profit	6.0	8.7	(6.6)	5.0	7.4
Provisions	(45.9)	10.7	127.6	(37.4)	(3.2)
Pre-tax profit	14.7	7.2	(17.8)	15.0	8.8
Net profit	18.4	8.4	(19.0)	14.8	8.9
BS data (SGDm)					
Assets	388,093	404,409	398,258	409,307	427,757
Non-bank loans	258,627	265,458	260,149	267,953	282,691
Customer deposit	293,186	310,726	313,833	324,817	341,058
Non-performing assets	4,166	4,297	5,343	5,058	5,201
Cumulative loan loss provisions	3,636	3,611	4,002	4,044	4,085
Balance sheet ratios (%)					
Loans deposit ratio	88.2	85.4	82.9	82.5	82.9
Non-bank loans growth (YoY%)	11.4	2.6	(2.0)	3.0	5.5
Customer deposit growth (YoY%)	7.5	6.0	1.0	3.5	5.0
NPL / Non-bank loans	1.5	1.5	1.9	1.8	1.7
Loan loss coverage	87.3	84.0	74.9	80.0	78.5
Total CAR	17.0	17.4	18.7	19.6	19.7
Tier 1 CAR	14.9	15.4	16.6	17.5	17.6

Source: Company data, RHB

20 March 2020

Financial Services | Banks

Recommendation Chart



Source: RHB, Bloomberg

Date	Recommendation	Target Price	Price
2020-02-21	Neutral	25.2	25.7
2020-02-04	Neutral	25.8	25.8
2020-02-04	Neutral	25.8	25.8
2019-11-01	Buy	29.5	26.6
2019-08-02	Buy	30.8	26.0
2019-05-03	Buy	30.8	27.8
2019-04-24	Buy	30.8	27.1
2019-02-22	Buy	29.8	25.6
2019-01-29	Buy	29.8	25.5

Source: RHB, Bloomberg

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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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Analyst	Company
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