18 May 2020

Financial Services | Banks

Banks

Neutral (Maintained)

Rowing Against The Rising Provisions Tide

Stocks Covered	3
Rating (Buy/Neutral/Sell):	0 / 3 / 0
Last 12m Earnings Revision Trend:	Downgrade

- **Staying NEUTRAL.** The three banks' recent 1Q20 results showed sharply high loan loss provisioning. Their management teams also guided for continued high FY20-21 credit costs on rising NPL ratios. Softer interest rates will lead to narrower NIM, and the full impact of US interest rate cuts will only be felt in subsequent quarters, as guided by management. We believe asset quality uncertainties are a major headwind. Within the sector, we prefer Oversea-Chinese Banking Corp (OCBC) the most, given its stronger capital ratio and high exposure to a recovering Greater China.
- **NIM squeeze to show up from 2Q20 onwards.** The US Federal Reserve cut the federal fund rate (FFR) twice in March by a total of 150bps to the current upper bound of 0.25%. The 3-month SIBOR correspondingly fell to 0.62% vs 1Q20's 1.55% average. The fall in the 3-month SIBOR will narrow the NIMs of the three banks. 1Q20 average NIM of these banks was 1.78%, and we forecast an FY20 average of 1.69% vs FY19's 1.81% (Figure 1).
- **Asset quality to see significant stress.** As of March, all three banks recorded NPL ratios of 1.5-1.6%. Loan loss coverage is a high 88-92%. However, as NPLs rise – we forecast a 2.2% average by end 2020 – provisions should increase. NPLs could exceed our assumptions, considering that, during the severe acute respiratory syndrome (SARS) outbreak in 2003, the three banks recorded NPL ratios as high as 8% (Figure 4). We forecast 2020 provisions for DBS, OCBC, and United Overseas Bank (UOB) to rise by 238%, 112%, and 220% YoY – in line with managements' guidance of a cumulative 80-130bps credit costs over two years. The increase will come from sectors affected by travel restrictions and supply chain disruptions, as well as those related to the oil industry.
- **OCBC has the highest CET1 CAR amongst peers.** OCBC's 1Q20 CET1 CAR is 14.3%, higher than DBS and UOB's 13.9% and 14.1% (Figure 7). This is a big positive for OCBC, given the tough economic circumstances.
- **We forecast SG Banks – the banks under our coverage – to record 2020 net profit falls of between 26% and 36% YoY.** The declines are primarily due to higher loan loss provisioning and narrower NIMs.
- **Short-term share price weakness is likely.** SG Banks' share prices fell by 20-27% YTD (Figure 8). We see further short-term share price downsides but, on a 12-month timeframe, we are NEUTRAL on SG Banks.
- **We have a GGM-derived SGD8.70 TP on OCBC (our preferred pick)** based on 0.81x 2020F P/NBV. We are NEUTRAL on OCBC, factoring in a sustainable 8.3% ROE assumption vs 1Q20's 6%. Capital strength is vital, and OCBC has the highest CET1 CAR. In addition, OCBC's high 25% loan share to Greater China is a positive, as this region is likely ahead of ASEAN in resuming economic activities post the COVID-19 shutdowns.

Top Picks	Target Price
Oversea-Chinese Banking Corp (OCBC SP) – NEUTRAL	SGD8.70

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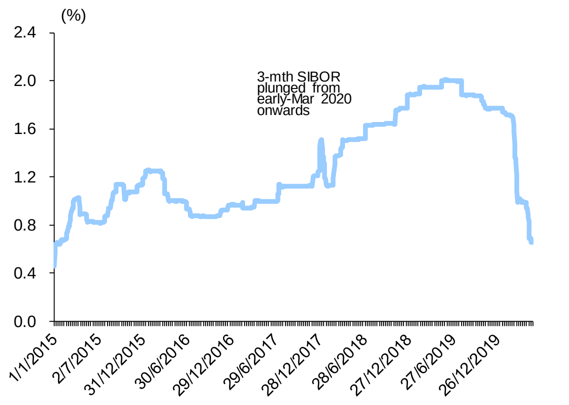
3-month SIBOR collapse will narrow NIMs



Source: Bloomberg

Company Name	Rating	Target Price(SGD)	% Upside (Downside)	P/E (x) Dec-20F	P/B (x) Dec-20F	Yield (%) Dec-20F
DBS	NEUTRAL	SGD18.70	(1.6)	10.3	0.9	5.3
Oversea-Chinese Banking Corp	NEUTRAL	SGD8.70	(0.3)	12.2	0.8	4.1
United Overseas Bank	NEUTRAL	SGD19.40	-	10.6	0.8	4.6

Source: Company data, RHB

Figure 1: Expect 2020 NIMs squeeze due to FFR cuts

NIM	DBS	OCBC	UOB
FY17	1.75%	1.65%	1.77%
FY18	1.85%	1.70%	1.82%
1Q19	1.88%	1.76%	1.79%
2Q19	1.91%	1.79%	1.81%
3Q19	1.90%	1.77%	1.77%
4Q19	1.86%	1.77%	1.76%
FY19	1.89%	1.77%	1.78%
1Q20	1.86%	1.76%	1.71%
FY20F	1.75%	1.67%	1.66%
FY21F	1.71%	1.63%	1.62%
FY22F	1.76%	1.69%	1.68%

Source: Company data, RHB

Figure 2: DBS' earnings is most sensitive to SIBOR changes – hence DBS is attractive when interest rates start to rise

Net profit change for 10bps rise in SIBOR	DBS	OCBC	UOB
FY21F NII increase for 10bp rise in SIBOR (SGDm)	72.3	44.3	44.2
- net of tax & as % of net profit	1.2%	1.0%	1.1%

Source: RHB

Figure 3: More Greater China exposure is a positive, as this area's economics are recovering from COVID-19 ahead of ASEAN

FY19 loans breakdown by geography (%)	DBS	OCBC	UOB
Singapore	46.5%	41.2%	51.6%
South and South-East Asia	8.1%	N/A	N/A
South-East Asia	N/A	N/A	N/A
- Malaysia	N/A	10.8%	11.0%
- Thailand	N/A	N/A	7.3%
- Indonesia	N/A	7.4%	4.3%
Greater China	29.8%	24.7%	15.4%
- Hong Kong	15.2%	13.2%	N/A
Others	15.5%	15.9%	10.4%
Total	100.0%	100.0%	100.0%

Source: Company data

Figure 4: NPL ratios were in high single-digits during 2003's SARS

Non-bank NPLs to non-bank loans	DBS	OCBC	UOB
FY02	6.1%	8.1%	9.0%
FY03	5.2%	6.9%	8.1%
FY04	2.5%	5.0%	8.0%
FY05	2.1%	4.1%	5.6%

Source: Company data

Figure 5: NPL ratios will trend up

Non-bank NPLs to non-bank loans	DBS	OCBC	UOB
FY19	1.5%	1.5%	1.5%
1Q20	1.6%	1.5%	1.6%
FY20F	2.0%	2.6%	2.0%
FY21F	1.9%	2.4%	1.9%
FY22F	1.7%	1.7%	1.8%

Note: Working to further raise NPL expectations above the levels shown above
Source: Company data, RHB

Figure 6: Loan loss coverages are sufficiently high

Coverage Ratios	DBS	OCBC	UOB
FY19 Loan loss coverage (including RLAR)	94.0%	85.5%	86.7%
1Q20 Loan loss coverage (including RLAR)	92.0%	90.1%	87.8%

Note: RLAR – Regulatory Loss Allowance Reserve
Source: Company data

Figure 7: OCBC has the highest CET1 CAR

Non-bank NPLs to non-bank loans	DBS	OCBC	UOB
FY19 CET1 CAR	14.1%	14.9%	14.3%
FY19 Tier 1 CAR	15.0%	15.6%	15.4%
1Q20 CET1 CAR	13.9%	14.3%	14.1%

Source: Company data

Figure 8: Banks recorded sharp YTD price falls, and weakness may persist

Name		DBS	OCBC	UOB
Price @	15-May-20	19.00	8.73	19.40
Market cap	(SGDm)	48,242	38,367	32,387
P/E (x)	Historical	8.2	6.0	7.9
	Current	9.9	10.5	10.5
	Forward	9.3	9.9	9.9
P/BV	(x)	0.90	0.81	0.87
ROE	(%)	11.3	10.9	11.9
ROA	(%)	1.0	0.9	1.0
Yield	(%)	6.6	6.1	5.7
YTD TR	(%)	(24.2)	(20.8)	(26.5)
1-month TR	(%)	(1.3)	(4.6)	(6.3)
3-month TR	(%)	(23.3)	(21.3)	(26.1)
6-month TR	(%)	(25.3)	(21.6)	(27.0)
1-year TR	(%)	(22.2)	(20.4)	(21.1)

Note: P/E ratio forecasts are based on consensus expectations
Source: Bloomberg

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