

22 August 2024

Financial Services | Banks

United Overseas Bank (UOB SP)

Neutral (Maintained)

Aiming To Sustain ROEs Through a Rate Cut Cycle

Target Price (Return): SGD32 (+4%)
 Price (Market Cap): SGD30.70 (USD39,250m)
 ESG score: 3.2 (out of 4)
 Avg Daily Turnover (SGD/USD) 79.5m/59.7m

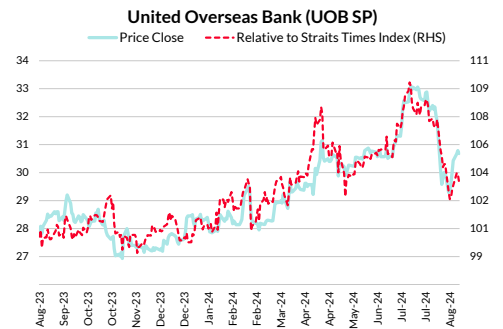
- Maintain NEUTRAL and SGD32 TP, 4% upside.** United Overseas Bank held its Corporate Day 2024 last week, with the key financial highlight being its 2026 medium-term ROE target of 14%. Compared to its core FY23 ROE of 14.2%, UOB essentially thinks this level can be sustained through the rate cut cycle. We keep our more conservative earnings forecasts, for now. In a rates downcycle, we think the focus should be on dividend yields and DPS growth – and UOB’s preference for capital retention means yields and DPS growth are relatively more muted.
- Sustaining ROE through a rates downcycle.** Several broad key assumptions UOB has made in deriving the above 14% ROE target include: i) 4% revenue CAGR on the back of low single-digit NII growth (10 rate cuts expected all the way through end-2026) and mid-teens fee income growth. UOB intends to pivot away to trade and capital-light non-ll growth from the traditional asset-based, capital-intensive balance sheet growth; ii) 3% opex CAGR from improved cost efficiency and productivity; iii) credit cost of 25-30bps (FY23: 25bps) – potentially lower should economies in its major markets continue to improve; and iv) 50% dividend payout ratio. UOB thinks this is an optimal mix as it believes its main markets continue to offer good growth opportunities and the capital retained should be able to support volume growth of 7-8%.
- Income growth – pivoting to an asset-light business model.** UOB is positioning its wholesale banking business towards trade, cash and treasury to capitalise on the rise in connectivity flows (eg shift of value chain, China+1 strategy) and its digital banking platform for wholesale. Outcomes expected include a doubling of trade loans and ASEAN-4 (Indonesia, Malaysia, Thailand and Vietnam) wholesale banking loan mix rising to 20% by 2026 (2023: 14%). As for its enlarged retail franchise, its focus will predominantly be on fee income from wealth and cards with the aim of raising this to 50% in 2026 from 38% in 2023. Similarly, this rise is expected to be tilted towards ASEAN-4, whose contribution is projected to rise to 40% from 33% in 2023.
- Improved cost efficiencies through cost optimisation and productivity.** This includes optimising its channels (digital and physical infrastructure), offshoring some of its more labour-intensive operations out of Singapore and leveraging off technology to improve productivity. Its end-financial metric is to reduce CIR to 40% by 2026 (2023: 41.5% core CIR, ie ex-Citi integration costs).
- Execution is key; stick to our forecasts, for now.** We maintain our more conservative forecasts for now, where we project 2023-2026 operating income and opex CAGR at 3% and 2%. A major variance in our projected growth vs UOB’s target is fees, where we project a CAGR of 7%. We pencilled in credit cost of 25-26bps and an annual dividend payout ratio of 50%. We set out the highlights from its other key business lines in the pages ahead.

Analyst

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Share Performance (%)

	YTD	1m	3m	6m	12m
Absolute	7.8	(6.0)	1.5	4.9	10.4
Relative	3.7	(3.8)	(0.5)	0.0	3.4
52-wk Price low/high (SGD)				26.9	–33.1



Source: Bloomberg

Forecasts and Valuation	Dec-22	Dec-23	Dec-24F	Dec-25F	Dec-26F
Reported net profit (SGDm)	4,573	5,711	5,876	6,089	6,266
Net profit growth (%)	12.2	24.9	2.9	3.6	2.9
Recurring net profit (SGDm)	4,819	6,061	6,045	6,089	6,266
Recurring EPS (SGD)	2.88	3.62	3.61	3.64	3.75
BVPS (SGD)	25.86	27.64	29.43	31.24	33.16
DPS (SGD)	1.35	1.71	1.76	1.81	1.86
Recurring P/E (x)	10.66	8.48	8.49	8.43	8.19
P/B (x)	1.19	1.11	1.04	0.98	0.93
Dividend Yield (%)	4.4	5.6	5.8	5.9	6.1
Return on average equity (%)	10.6	12.7	12.3	12.0	11.6

Source: Company data, RHB

Overall ESG Score: 3.2 (out of 4)

E: GOOD

In 2023, UOB purchased and retired 20.5k carbon offsets to address its Scope 1, residual Scope 2 and Scope 3 (business air travel) emissions. It has made a net-zero commitment for six sectors by 2050 while aiming to build a sustainable finance portfolio of SGD30bn by 2025 (2023: SGD44.5bn). Meanwhile, about SGD10bn in total assets under management were in ESG-focused investments.

S: EXCELLENT

UOB embraces gender diversity, with women accounting for 62% of permanent staff at end-2023 – 38% in senior management roles. It launched TMRW, ASEAN’s first mobile-only digital bank, to improve financial inclusion in Thailand and Indonesia.

G: EXCELLENT

UOB has a comprehensive framework of policies, processes, methodologies and tools for effective risk management. There is a much-publicised ongoing money laundering case in Singapore, where UOB is one of several banks mentioned in relation to the case.

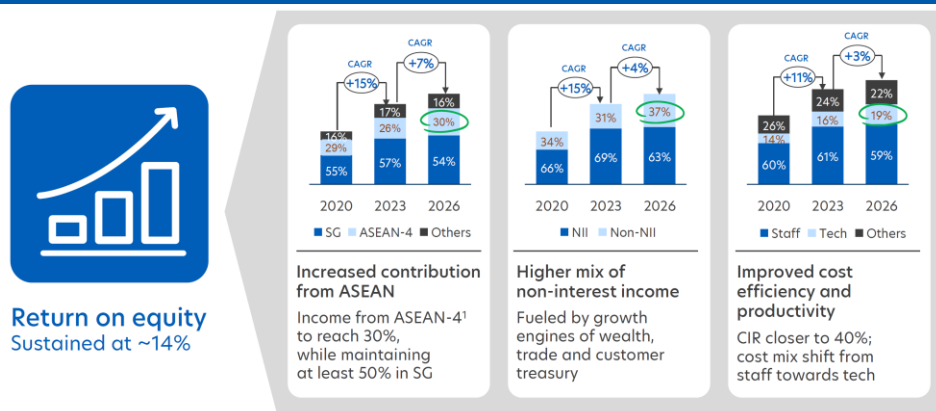
Financial Exhibits

Asia	Financial summary (SGD)	Dec-22	Dec-23	Dec-24F	Dec-25F	Dec-26F
Singapore	EPS	2.73	3.41	3.51	3.64	3.75
Financial Services	Recurring EPS	2.88	3.62	3.61	3.64	3.75
United Overseas Bank	DPS	1.35	1.71	1.76	1.81	1.86
UOB SP	BVPS	25.86	27.64	29.43	31.24	33.16
Neutral						
	Valuation metrics	Dec-22	Dec-23	Dec-24F	Dec-25F	Dec-26F
Valuation basis	Recurring P/E (x)	10.66	8.48	8.49	8.43	8.19
GGM-derived intrinsic value with an ESG overlay. Key GGM assumptions are:	P/B (x)	1.2	1.1	1.0	1.0	0.9
i. COE of 12.1%;	Dividend Yield (%)	4.4	5.6	5.8	5.9	6.1
ii. ROE of 12.5%;						
iii. 3.0% long-term growth.						
	Income statement (SGDm)	Dec-22	Dec-23	Dec-24F	Dec-25F	Dec-26F
Key drivers	Interest income	12,862	22,242	22,457	22,324	22,211
Our net profit forecasts is most sensitive to changes in:	Interest expense	(4,519)	(12,563)	(12,719)	(12,389)	(12,110)
i. Impairment charges;	Net interest income	8,343	9,679	9,738	9,936	10,100
ii. NIM;	Non interest income	3,232	4,253	4,428	4,722	5,054
iii. Non-II growth.	Total operating income	11,575	13,932	14,166	14,658	15,155
	Overheads	(4,971)	(5,797)	(5,987)	(6,431)	(6,678)
	Pre-provision operating profit	6,604	8,135	8,179	8,226	8,477
	Loan impairment allowances	(628)	(783)	(800)	(850)	(850)
	Other impairment allowances	22	(162)	(45)	(41)	(40)
	Income from associates	97	93	100	110	120
	Other exceptional items	(310)	(420)	(208)	-	-
	Pre-tax profit	5,785	6,863	7,226	7,445	7,707
	Taxation	(1,202)	(1,138)	(1,337)	(1,340)	(1,426)
	Minority interests	(10)	(14)	(14)	(16)	(15)
	Reported net profit	4,573	5,711	5,876	6,089	6,266
	Recurring net profit	4,819	6,061	6,045	6,089	6,266
	Profitability ratios	Dec-22	Dec-23	Dec-24F	Dec-25F	Dec-26F
	Return on average assets (%)	0.9	1.1	1.1	1.1	1.1
	Return on average equity (%)	10.6	12.7	12.3	12.0	11.6
	Return on IEAs (%)	3.0	5.0	4.9	4.7	4.5
	Cost of funds (%)	1.1	2.8	2.8	2.6	2.4
	Net interest spread (%)	2.0	2.2	2.2	2.1	2.1
	Net interest margin (%)	2.0	2.2	2.1	2.1	2.1
	Non-interest income / total income (%)	27.9	30.5	31.3	32.2	33.4
	Cost to income ratio (%)	42.9	41.6	42.3	43.9	44.1
	Credit cost (bps)	19.9	24.4	24.5	25.1	24.0
	Balance sheet (SGDm)	Dec-22	Dec-23	Dec-24F	Dec-25F	Dec-26F
	Total gross loans	319,663	321,150	330,785	347,324	361,217
	Other interest earning assets	116,707	125,723	130,670	135,313	139,868
	Total gross IEAs	436,370	446,873	461,455	482,637	501,084
	Total provisions	(4,308)	(4,145)	(4,317)	(4,469)	(4,546)
	Net loans to customers	315,355	317,005	326,468	342,855	356,671
	Total net IEAs	432,062	442,728	457,138	478,168	496,538
	Total non-IEAs	72,198	80,792	83,790	89,271	98,390
	Total assets	504,260	523,520	540,928	567,439	594,928
	Customer deposits	368,553	385,469	397,033	416,885	437,729
	Other interest-bearing liabilities	65,918	69,551	71,293	73,747	75,952
	Total IBLs	434,471	455,020	468,326	490,632	513,681
	Total non-IBLs	26,183	22,032	23,134	24,290	25,505
	Total liabilities	460,654	477,052	491,459	514,922	539,186
	Share capital	7,855	7,752	7,752	7,752	7,752
	Shareholders' equity	43,366	46,226	49,212	52,245	55,456
	Minority interests	240	242	256	272	287
	Asset quality and capital	Dec-22	Dec-23	Dec-24F	Dec-25F	Dec-26F
	Reported NPLs / gross cust loans (%)	1.6	1.5	1.5	1.5	1.5
	Total provisions / reported NPLs (%)	85.1	85.1	87.0	87.2	86.8
	CET-1 ratio (%)	14.4	14.4	15.0	15.1	15.3
	Tier-1 ratio (%)	14.4	14.4	15.0	15.1	15.3
	Total capital ratio (%)	16.7	16.6	17.0	17.1	17.2

Source: Company data, RHB

Highlights Of Corporate Day 2024

Figure 1: UOB's medium-term goals by 2026



Source: Company data, RHB

Group Wholesale Banking (GWB)

GWB's ambition is to be the top cross-border trade bank in the region by focusing on banking supply chains with and within ASEAN, Greater China and beyond. Its strategy will be supported through three strategic themes around connectivity, digitalisation and sustainability.

For the connectivity theme, UOB estimates annual trade flows within and with ASEAN to be at USD2trn. As its current trade assets of USD22bn only makes up 1% of market share, it sees potential to take market share, especially now that its digital platform for wholesale has been rolled out. UOB targets to achieve a market share of 5% by 2026.

UOB also highlighted the robust inward FDI inflows ASEAN is enjoying. According to ASEANstats, about USD230bn of inward FDI flowed into ASEAN in 2023. Of this amount, >90% went into UOB's key markets of Singapore (69%), Indonesia (9%), Vietnam (8%) Malaysia (4%) and Thailand (2%). UOB has a dedicated FDI advisory team to help customers diversify into the region.

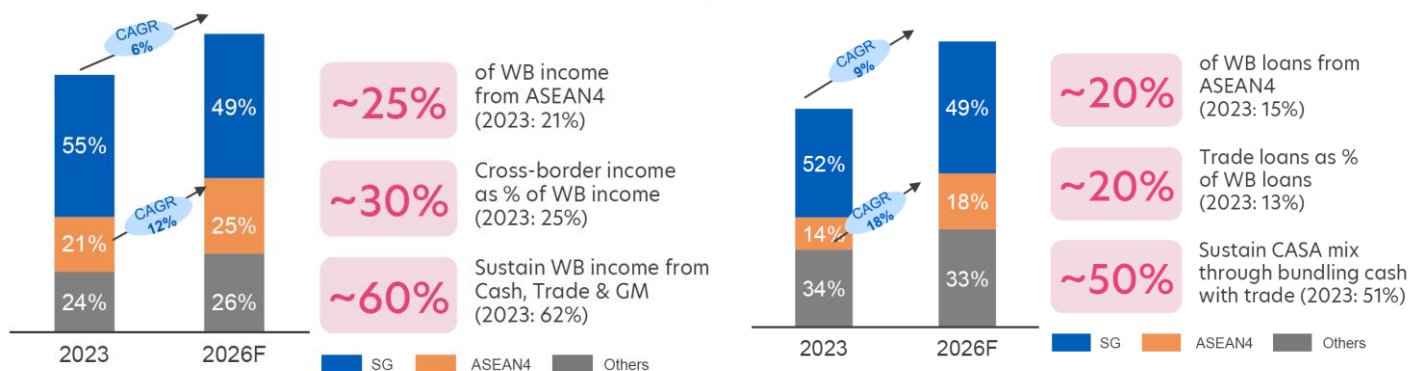
As for digitalisation, this relates to its Infinity platform, ie its digital banking platform for wholesale banking. First rolled out in Singapore (2020) and then China (2021), this was followed by its other ASEAN markets in the last 2-3 years. The platform allows for better management of cash flows with a range of payments and collection features, as well as enabling digital connection of suppliers, buyers and distributors to streamline trade and financial supply chain processes on top of facilitating financing. As a result:

- i. Transaction banking now makes up 54% of 2023 GWB revenue (2020: 38%) and is expected to rise to 60% by 2026 with cash management, trade and treasury;
- ii. CASA deposits now account for 51% of GWB deposits (2020: 41%); and
- iii. Loan and trade-related fees grew by 7% CAGR from 2020-2023.

UOB believes the effectiveness of its platform has been to be able to use digital to simplify the trade process. Apart from the financing of trade, this will allow the banking group to further enlarge its wallet share in areas such as cash management, CASA and FX. Also, by penetrating the trade financing business, UOB will have access to the cash flows of customers and be in a better position to assess credit worthiness.

Figure 2: ASEAN-4 is expected to drive GWB's income ...

Figure 3: ... as UOB leverages on its digital platform to increase customer stickiness in trade, cash and treasury ecosystem



Note: ASEAN-4 comprises Indonesia, Malaysia, Thailand and Vietnam
Source: Company data, RHB

Source: Company data, RHB

Sustainability. Based on data from the South-East Asia Green Economy 2024 report, it is estimated that South-East Asia holds about USD1.5trn in investment opportunities to fund the transition by 2030 (USD300bn in annual revenue potential). UOB's sustainable loans stood at SGD50bn as of Jun 2024 (21% of overall GWB portfolio), with 60% in Singapore, 10% in ASEAN-4, 17% in Greater China and the balance from rest of the world. UOB will continue to aid customers in their sustainability journey, with dedicated sector specialists across industries. UOB also highlighted its green deposit solutions, 97% of which comprise green term deposits. These deposits are ring-fenced to finance only green assets originated.

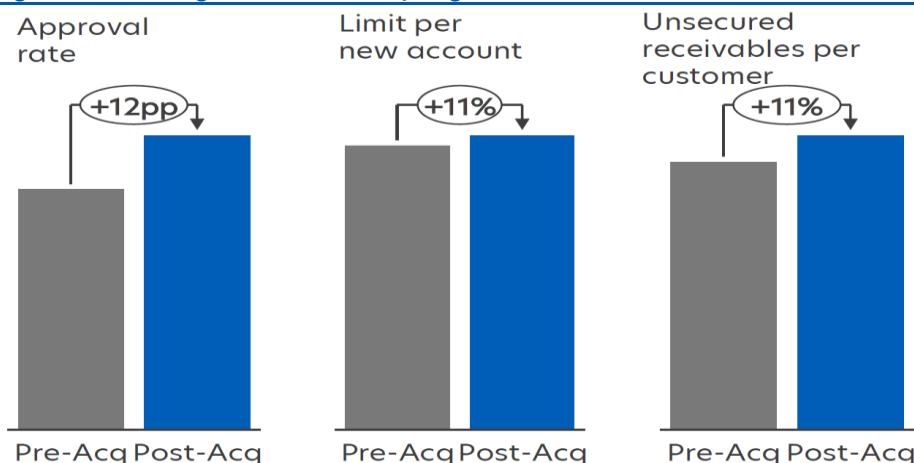
Retail

The Citi acquisition has allowed UOB to scale up its ASEAN franchise and advance its position as a leading regional bank and cards issuer. It has topped billings in ASEAN-4 for both Visa and Mastercard while, in Singapore, it is top in billings for Visa. The importance of card spending is the fee income opportunities that come along with it – interchange, FX and card fees.

With the key Citi markets of Malaysia, Indonesia and Thailand now on UOB's platform, the focus ahead is to generate revenue synergies via the following three levers:

- i. Cross-sell CASA and raise its ASEAN-4 penetration (ambition: 58% vs 2023: 48%);
- ii. Cross-sell wealth and mortgage (ASEAN-4 wealth penetration ambition of 45% vs 2023: 38%);
- iii. Reap synergies from credit harmonisation, and increasing card spend/balances.

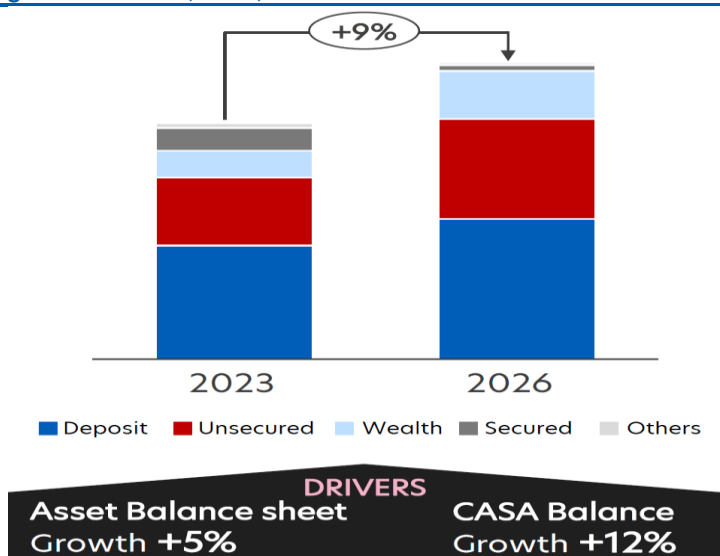
Figure 4: Levers to generate revenue synergies from cards



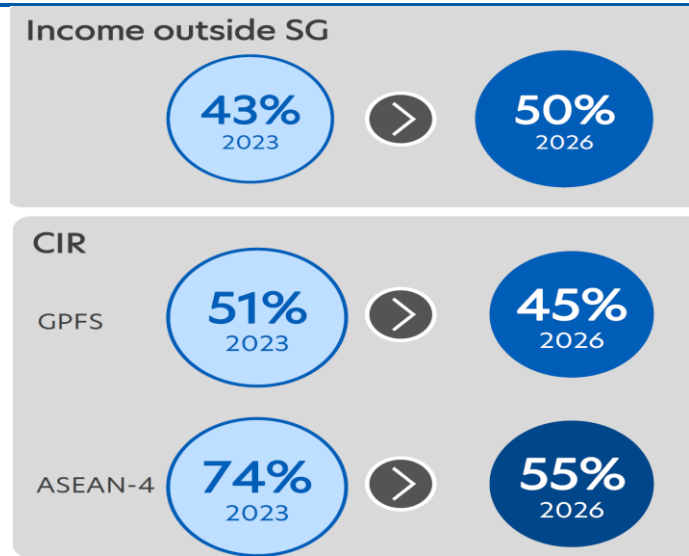
Source: Company data, RHB

Figure 5: UOB targets 9% CAGR for group PFS income, driven by growth in wealth, cards, CASA ...

Figure 6: ... and ASEAN-4

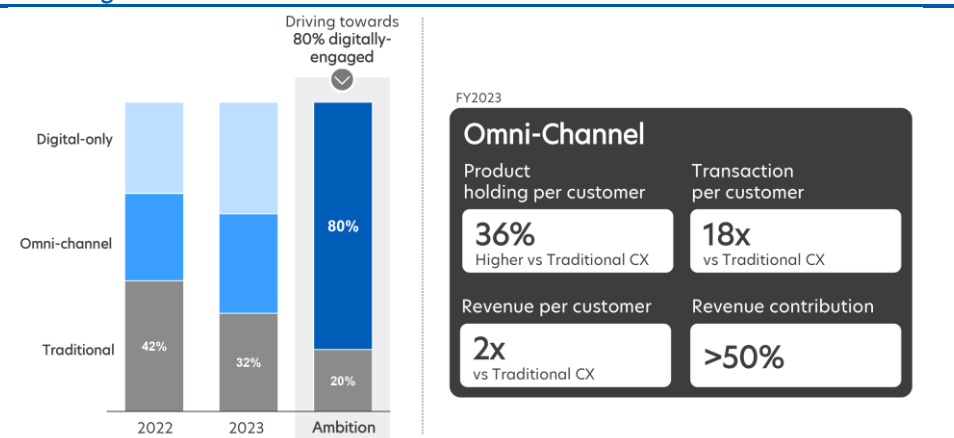


Source: Company data, RHB



Source: Company data, RHB

Figure 7: Cost synergies for PFS underpinned by better efficiencies aided by technology and UOB's omni-channel approach – Omni-channel customers typically are higher revenue generators



Source: Company data, RHB

UOB assessed that its income uplift achieved from the Citi acquisition is close to the SGD1bn incremental annual income it had initially guided. Thus far, it is comfortable with the quality of its credit card portfolio.

UOB also highlighted that its retail digital offering – UOB TMRW, uses both artificial intelligence and machine learning models to, among others, aid with real-time fraud detection, customer protection and to create greater customer engagement. As highlighted in Figure 7, digitally engaged customers tend to have higher spending, CASA balances, wealth products, etc. As for the balance of traditional customers, while these customers are not engaged digitally, UOB said these customers are still profitable to serve and would be comfortable with the mix of 20% of non-digitally engaged customers.

Wealth

BCG estimates Singapore captures SGD160bn in annual wealth flows, evenly split between Greater China (SGD80bn with 8% CAGR until 2030) and ASEAN (SGD80bn with 6% CAGR to 2030). Of this amount, c. 60% are wealth of business owners, with >50% of these being typically first-generation owners.

UOB's AUM amounted to SGD93bn in June. CIR for the business was a low <40% as it has been able to leverage on group resources on all fronts – front, middle and back, and as such, its return on average risk-weighted assets last year was an attractive 16%.

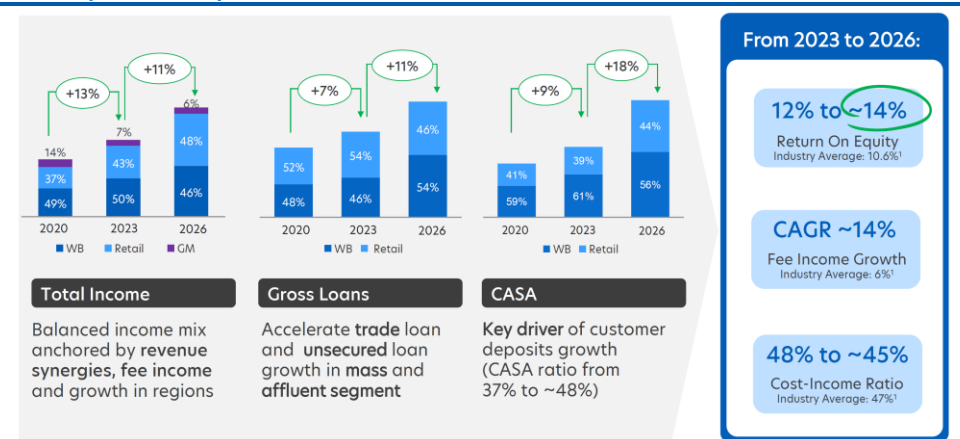
Going forward, UOB targets to grow AUM to SGD145bn by 2026. The target segment remains business owners and professionals while, by geography, the focus is on North Asia and ASEAN. It intends to grow AUM via a combination of: i) Increasing the headcount of relationship managers (RMs) - UOB plans to grow its RM number to 400 by 2026, from 278 at end-2023; ii) continue to scale with upgrading clients (offering more sophisticated products and solutions) and ONE bank proposition (leverage on group wide products and services); and iii) leverage on technology and data analytics to improve client engagement and RM productivity.

UOB Malaysia

UOB Malaysia is the largest foreign bank in the county. Including the local commercial banks, it is sixth in terms of total income and PBT, and in the seventh spot on loans and deposits. Going forward, it shared the following strategies and targets for key divisions:

- i. Wholesale banking – it intends to defend its core sectors in construction and infrastructure while shifting more towards growth sectors such as industrials, energy and chemicals, consumer goods and technology, media and telecommunications. Also, UOB expects to pivot its loan book towards trade loans, which accounted for 23% of the wholesale banking loan book in 2023 – it aims to increase the mix to 40% in 2026. With that, it expects cash, trade and treasury to lead low-income growth for the wholesale banking division.
- ii. Retail banking – the focus ahead will be to continue with cross-selling CASA to the Citi customer base absorbed, wealth management, and to continue with the card engagement with customers.

Figure 8: UOB Malaysia targets to lift ROE to 14% in 2026 from 12% in 2023, driven by both topline and improved cost efficiencies



Source: Company data, RHB

Valuation and TP

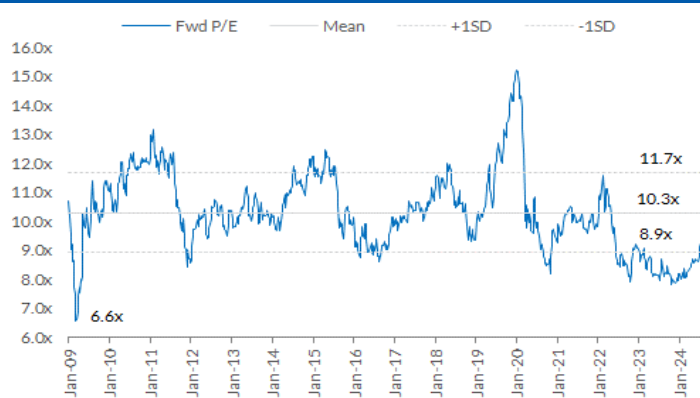
We make no change to our SGD32 TP, which is based on an intrinsic value of SGD31.38 with a 2% ESG premium applied, in accordance with RHB's in-house ESG methodology. The intrinsic value is premised on a GGM-derived P/BV of 1.04x – close to its historical mean.

Figure 9: UOB – GGM valuation with ESG overlay

Cost of equity (COE) computation:		Sustainable ROE (%)	12.5
Risk free rate (%)	3.0	COE (%)	12.1
Equity premium (%)	8.3	Long-term growth (g)	3.0
Beta (x)	1.1	Implied P/BV (x)	1.04
Cost of equity - CAPM (%)	12.1	BVPS – FY25F	SGD30.16
		Intrinsic value	SGD31.38
ESG premium/(discount) (%)	2.0	ESG premium/(discount)	SGD0.63
		TP (rounded up)	SGD32.00

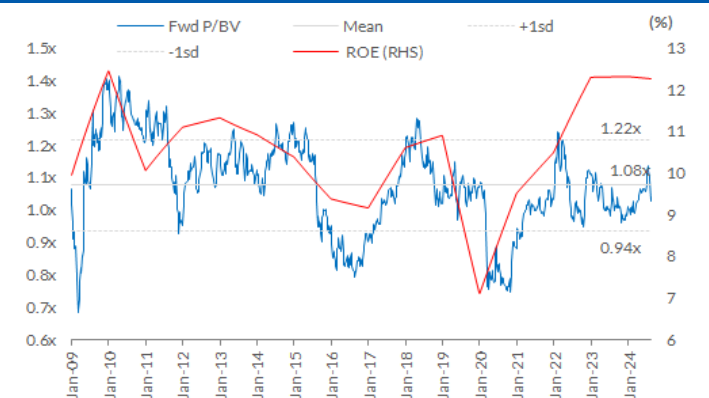
Source: Company data, RHB

Figure 10: UOB's 12-month forward consensus P/E



Source: Bloomberg, RHB

Figure 11: UOB's 12-month forward consensus P/BV



Source: Bloomberg, RHB

Emissions And ESG

Trend analysis

In 2023, UOB purchased and redeemed a total of 135k GWh in Renewable Energy Certificates (RECs) to address its electricity consumption in all key markets. UOB also purchased and retired 20.5k carbon offsets to address its Scope 1, residual Scope 2 and Scope 3 (business air travel) emissions.

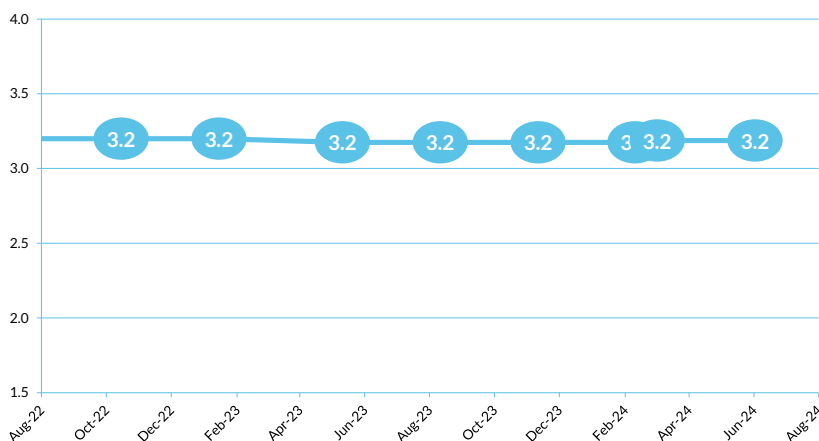
Emissions (tCO2e)	Dec-21	Dec-22	Dec-23
Scope 1	4,300	5,800	4,800
Scope 2	1,000	1,100	1,600
Scope 3	600	4,000	14,100
Total emissions	5,900	10,900	20,500

Source: Company data, RHB

Latest ESG-Related Developments

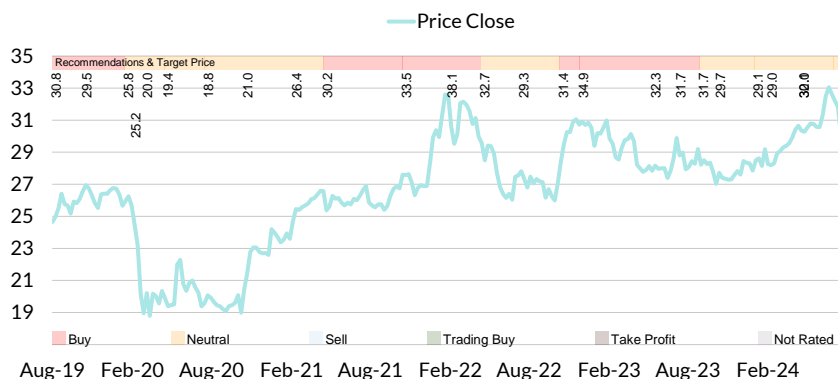
- **UOB Transition Finance Framework:** This was launched in 2022 to help companies in carbon-intensive sectors with their net-zero transition plans.
- **Sustainable targets:** UOB aims to have a sustainable finance portfolio of SGD30bn by 2025, and record net zero for six sectors (currently 60% of its corporate lending portfolio) by 2050.
- **Signatory to Equator Principles (EP):** EP requirements are integrated into UOB's Responsible Financing Policy.

ESG Rating History



Source: RHB

Recommendation Chart



Source: RHB, Bloomberg

Date	Recommendation	Target Price	Price
2024-07-22	Neutral	32.0	32.6
2024-05-09	Neutral	30.1	30.4
2024-03-21	Neutral	29.0	29.2
2024-02-22	Neutral	29.0	28.5
2024-01-21	Neutral	29.1	27.9
2023-10-26	Neutral	29.7	27.3
2023-09-17	Neutral	31.7	29.2
2023-07-27	Buy	31.7	28.9
2023-05-30	Buy	32.3	28.1
2023-02-23	Buy	34.9	29.6
2022-12-16	Buy	34.9	30.7
2022-10-30	Buy	31.4	27.1
2022-07-31	Neutral	29.3	27.6
2022-05-03	Neutral	32.7	30.0
2022-02-16	Buy	38.1	32.8

Source: RHB, Bloomberg

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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