Singapore Sector Update

23 December 2020

Financial Services | Banks

Banks

Neutral (Maintained)

Expect Lacklustre Toplines In 2021; NEUTRAL

Stocks Covered	3
Rating (Buy/Neutral/Sell):	1 / 2 / 0
Last 12m Earnings Revision Trend:	Negative

- **Stay NEUTRAL, BUY DBS.** Singapore (SG) banks are expected to post a 19% recovery in FY21F earnings, with ROE edging up to 8.4%. COVID-19 vaccine-induced optimism saw bank stocks rally to reduce the YTD fall to 8%, outperforming the market's -12% YTD. The increasing availability of vaccines, we believe, will support further rotation into cyclical stocks. Still, risks from an uneven economic recovery point to a need to stick with banks with high provision buffers and robust capital. DBS is our only BUY.
- **Asset quality remains the priority.** Varying loan moratorium and repayment assistance programmes across the region led to low visibility on asset quality. We have conservatively forecasted NPLs to rise by a sharper 15% YoY by end-2020 (Sep 2020: +7.8% YTD) and increase by a further 19% YoY in FY21F. Still, NPL ratio should remain benign, at 1.64% in FY20F (FY19: 1.49%) and 1.87% in FY21F. With provisions taken in 9M20, LLR was boosted to a high of 104.7%, and will stay comfortable at 99.7% in FY21F.
- **NIM to stay low.** For 9M20, SG banks' average NIM compressed by c.20bps YoY to 1.63%, on the 137bps YTD decline in the Singapore Interbank Offered Rate (SIBOR) and the Swap Offer Rate (SOR). With short-term rates expected to be stable, banks indicated that 3Q20 exit NIM can be sustained. To support NIM, banks have been gradually lowering deposit rates and reducing excess liquidity built up from the robust deposit growth in 2020. We believe these efforts will help buffer NIM from declining further 2021.
- **Topline outlook subdued.** The recovery in economic activities, we believe, would help sustain loan growth in 2021 (FY20F: +5% YoY). However, with the lingering NIM pressures, the resulting sector net interest income growth would be a modest 2.5% YoY. Banks are more upbeat about fee income outlook, particularly from wealth management and transaction banking operations. Still, non-interest income growth is expected to be a mild 2.2% YoY, dampened by lower trading and investment gains. All in, sector operating income is projected to rise by a subdued 2.4% YoY.
- **Lower credit costs to lift earnings.** We expect the pick-up in 3Q20 operating income to be sustained into 2021, with economic activities regaining momentum. Our forecasts point to a 19% YoY rise in FY21 sector net profit, with the recovery led mainly by the 36% YoY decrease in net impairment charges. Credit cost is projected to decline to 44bps from 74bps in FY20F, but should remain elevated against the 17-22bps in FY18-19. PIOP is anticipated to be flattish, with the modest operating income growth negated by the normalisation in overhead expenses. For FY20F, earnings are projected to contract by 31% YoY.
- **Stock recommendations.** DBS is our pick for SG banks. Aggressive frontloading of provisions has bumped up LLR to 117%, providing comfortable headroom and engendering a sustained ROE recovery in FY21F-22F. We are NEUTRAL on Oversea-Chinese Banking Corp (OCBC) (on lingering asset quality concerns) and United Overseas Bank (UOB) (higher exposure to ASEAN, where asset quality risks are greater, risk-reward ratio is balanced).
- **Key risks.** Delays in the general availability of COVID-19 vaccines and a resurgence in new cases could derail economic recovery in 2021 and exert pressure on asset quality. Conversely, upside risks will likely come from stronger-than-expected GDP growth and a pick-up in SIBOR and SOR. Digital banks are expected to commence operations in early 2022. We believe these new entrants will not pose a significant threat, as SG banks have been investing to digitalise their operations and offerings.

Top Picks	Target Price
DBS Group (DBS SP) - BUY	SGD30.00

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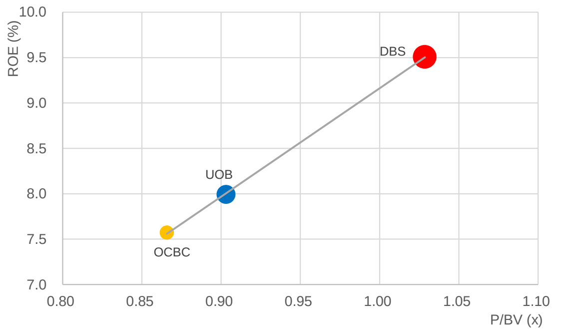
SG banks' P/BV vs ROE



Source: Company data, RHB

Company Name	Rating	Target Price(SGD)	% Upside (Downside)	P/E (x) Dec-21F	P/B (x) Dec-21F	Yield (%) Dec-21F
DBS	BUY	SGD30.00	19.8	11.2	1.0	3.6
Oversea-Chinese Banking Corp	NEUTRAL	SGD9.50	(5.2)	11.7	0.9	3.6
United Overseas Bank	NEUTRAL	SGD21.00	(7.0)	11.6	0.9	4.2

Source: Company data, RHB

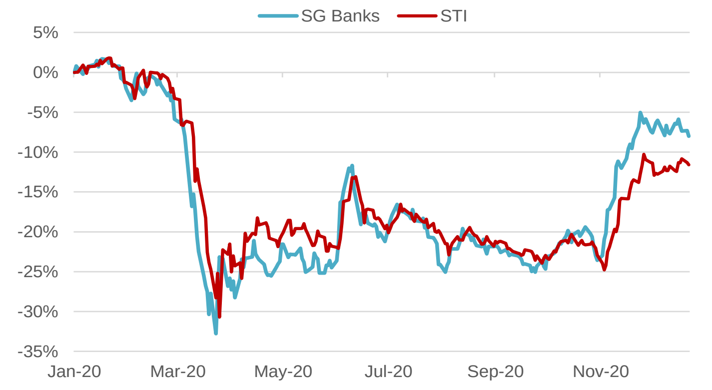
2021 Outlook & Strategy

Maintain NEUTRAL rating; Top Pick – DBS

Stay NEUTRAL on SG banks. SG banks are expected to emerge from a challenging year in 2020 with a 19% recovery in aggregate net profit, lifting sector ROE to 8.4% in FY21F (FY20F: 7.5%). NPLs are expected to rise further in 2021 as relief programmes expire, but frontloading of provisions in 2020 should mean lower credit costs in the year ahead. Positive news on COVID-19 vaccines saw SG banks rise a sharp 13% between 9 Nov and 24 Nov, with the sector's P/BV reverting to 1.1x from a low of 0.8x in Apr 2020. Vaccine-induced optimism will likely support a further rotation into cyclical stocks, but risks from an uneven economic recovery and lingering impact from the pandemic point to a need to stick with banks with high provision buffers and robust capital.

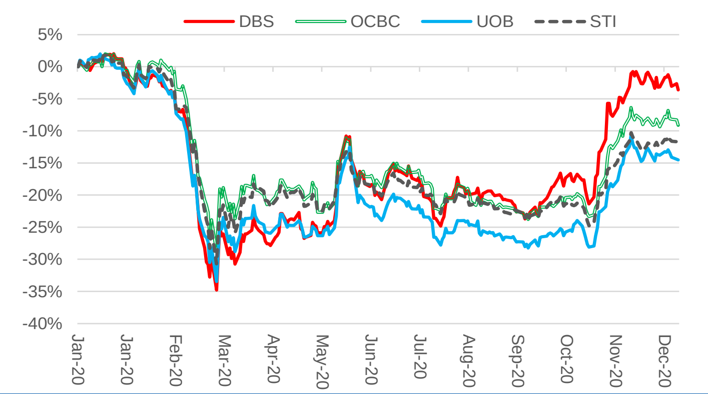
Top Pick: DBS. DBS (DBS SP, BUY, TP: SGD30.00) is our pick for SG banks. Aggressive frontloading of provisions has bumped up LLR to 117%, providing comfortable headroom and sustained ROE recovery in FY21F-22F. Our GGM-derived TP of SGD30.00 is based on a GGM-derived P/BV of 1.25x, near +1SD from its historical mean.

Figure 1: SG banks underperformed the broader market YTD



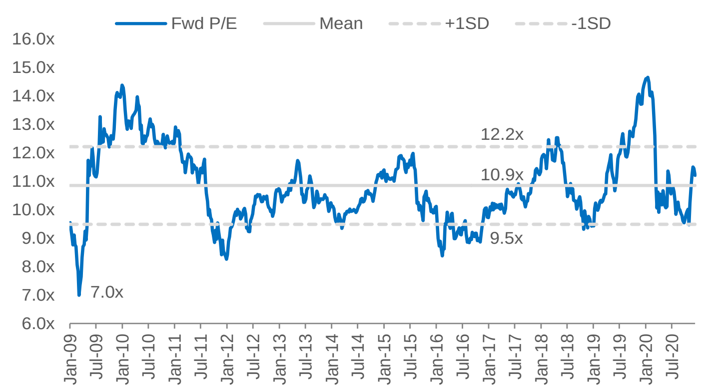
Source: Bloomberg, RHB

Figure 2: SG banks' comparative price performance in 2020



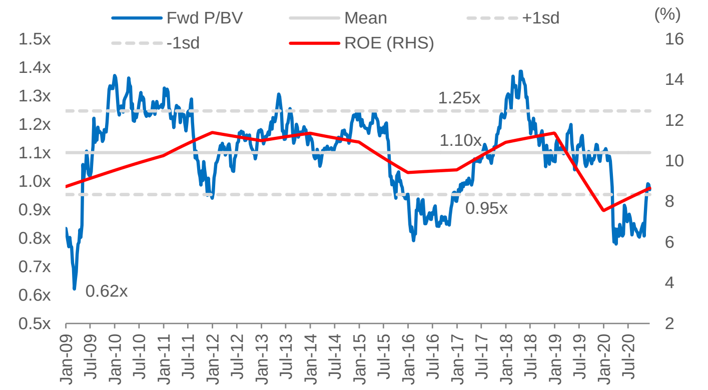
Source: Bloomberg, RHB

Figure 3: SG banks' 12-month forward P/E



Source: Bloomberg, RHB

Figure 4: SG banks' 12-month forward P/BV



Source: Bloomberg, RHB

Figure 5: Summary of SG banks' valuations

Company	Rating	Price (SGD)	TP (SGD)	Mkt Cap (SGD'bn)	EPS Chg (%) FY20	EPS Chg (%) FY21	PER (x) FY20	PER (x) FY21	P/BV (x) FY20	P/BV (x) FY21	ROE (%) FY20	ROE (%) FY21	NDY (%) FY20	NDY (%) FY21
DBS Group (DBS SP)	Buy	25.05	30.00	63.66	(24.4)	18.6	13.2	11.2	1.10	1.03	8.8	9.5	3.0	3.6
OCBC (OCBC SP)	Neutral	10.02	9.50	44.82	(36.3)	19.6	14.0	11.7	0.90	0.87	6.6	7.6	3.1	3.6
UOB (UOB SP)	Neutral	22.58	21.00	37.77	(37.5)	15.4	13.3	11.6	0.94	0.90	7.0	8.0	3.5	4.2
Weighted average - banks					**(31.5)**	**18.1**	**13.5**	**11.4**	**1.00**	**0.95**	**7.7**	**8.5**	**3.1**	**3.8**

Note: Prices are as at 22 Dec 2020

Source: Bloomberg, RHB

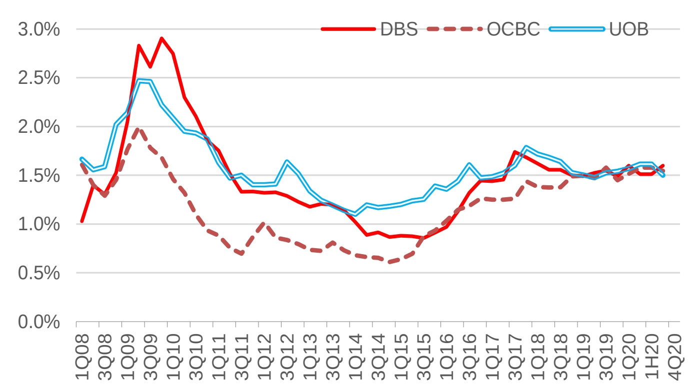
Managing asset quality remains the priority

Asset quality to hold up well. Varying loan moratorium and repayment assistance programmes across the region have resulted in low visibility on asset quality. Loans under relief programmes at DBS and OCBC (OCBC SP, NEUTRAL, TP: SGD9.50) stood at c.5% at end-Sep 2020, while UOB (UOB SP, NEUTRAL, TP: SGD21.00) had a higher 10% due to its bigger exposure to Malaysia.

With sector NPLs rising 7.8% YTD-Sep 2020 (2019: +2.2% YoY) due to the economic downturn, we have conservatively assumed NPLs would be up a sharper 15% YoY by end-2020 and increase a further 19% in FY21F. Still, NPL ratio would remain benign at 1.64% in FY20F (FY19: 1.49%) and 1.87% in FY21F. The additional provisions boosted LLR to a high of 104.7%, and will stay comfortable at 99.7% in FY21F.

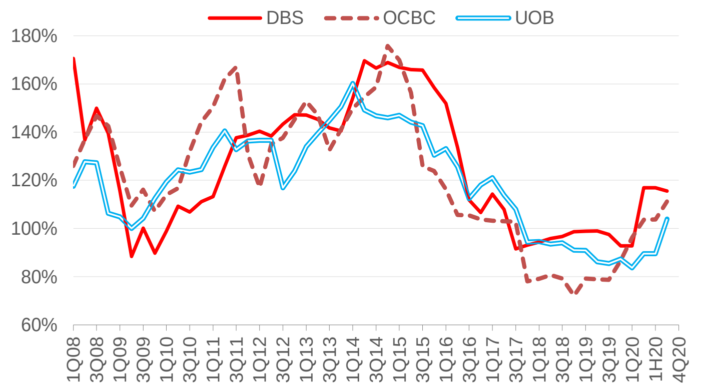
In the 3Q20 results season, UOB lowered its credit cost guidance to 30-40bps (from 60bps) for FY21F, citing optimism that asset quality will be better than anticipated. On the flipside, DBS and OCBC maintained their 2-year credit cost guidance – SGD3-5bn impairment charges for DBS and 100-130bps for OCBC (with lower end of range being the more likely outcome). DBS and OCBC remain cautious, concerned over recovery in the real economy and borrowers' repayment behaviour post-moratorium.

Figure 6: SG banks' quarterly NPL ratios



Source: Company data, RHB

Figure 7: SG banks' quarterly LLR ratios

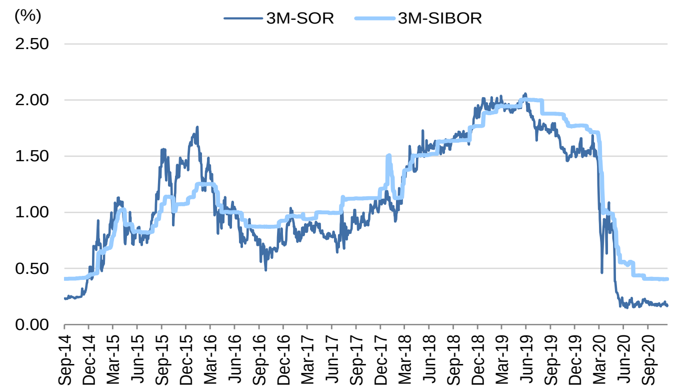


Source: Company data, RHB

NIM to stay low

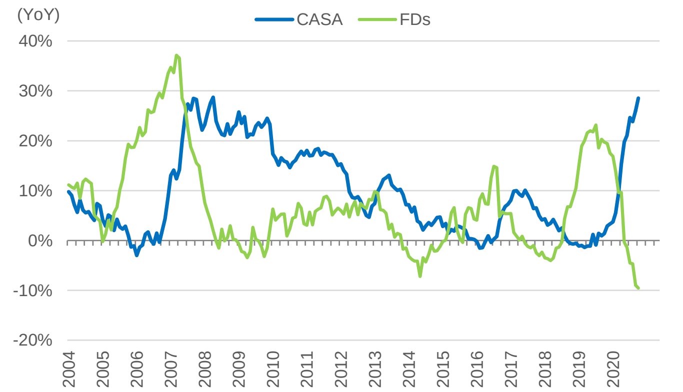
NIM has stabilised, no recovery in sight yet. Short-term rates in Singapore bottomed in mid-Jun 2020 and have stabilised since Sep 2020. Reflecting expectations that short-term rates would likely remain steady, banks indicated that 3Q20 exit NIM can be sustained in 4Q20. For 9M20, SG banks' average NIM compressed by c.20bps YoY to 1.63% on the 137bps YTD decline in the Singapore Interbank Offered Rate (SIBOR) and the Swap Offer Rate (SOR). To support NIM, banks have been gradually lowering deposit rates as well as working to reduce some of the excess liquidity built up from the robust deposit growth seen in 2020. We believe these efforts would help support NIM from a further decline in 2021.

Figure 8: Short term rates have stabilised



Source: Bloomberg, RHB

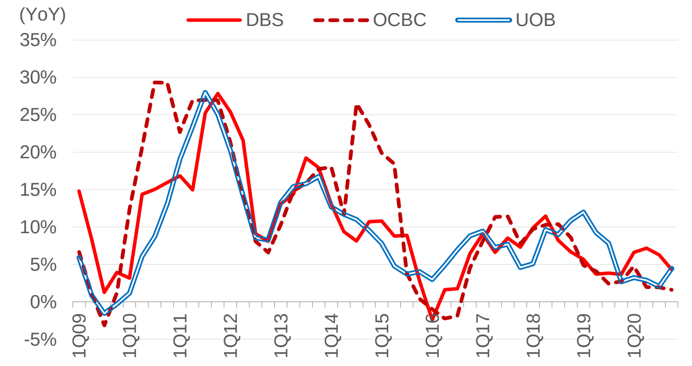
Figure 9: Robust CASA growth helped lower funding costs



Source: MAS, RHB

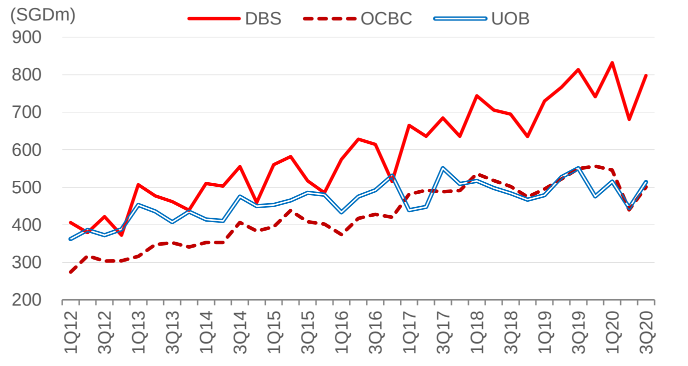
Loan growth stable. We expect sustained loan demand in 2021 underpinned by the recovery in economic activities. Sector loans are projected to expand by 4.7% in 2021F, relatively stable against the estimated growth of 5.0% for 2020F. We believe the increase would be led by lending to businesses while demand for mortgages remains soft. Of the three banks, DBS and UOB are expected to achieve loan growth of c.5% YoY, while OCBC is forecasted to grow its loans at a lower clip of 3.3% YoY.

Figure 10: SG banks' loan growth trend



Source: Company data, RHB

Figure 11: SG banks' fee income trend



Source: Company data, RHB

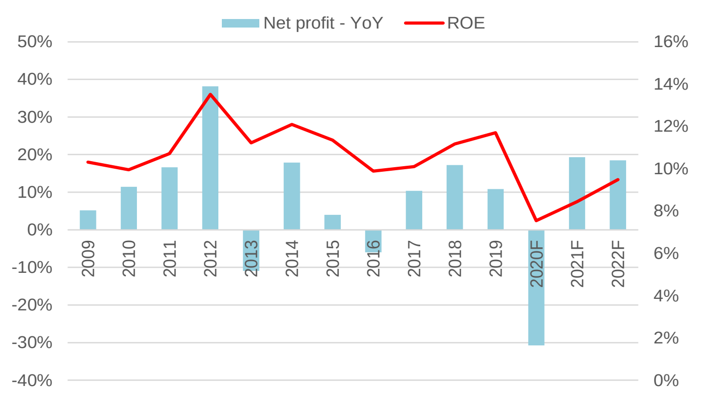
Healthy fee income growth, moderated by lower investment trading gains. Fee income is expected to grow at a healthy 9% YoY in 2021F driven by continued growth in fees from wealth management and transaction banking. Still, this will be moderated by lower investment and trading gains, resulting in a modest 2% YoY rise in non-II.

Lower credit cost to lift earnings

Bank earnings to recover 19%, ROE at 8%. The pick-up in 3Q20 operating income, we believe, can be sustained going into 2021. Economic activities are regaining momentum since the lifting of COVID-19 lockdown measures, while positive news on vaccine developments would help restore confidence. Our forecasts point to a 19% YoY rise in FY21F sector net profit with the recovery led mainly by the 36% YoY decline in net impairment charges. Credit cost is projected to decline to 44bps from 74bps in FY20F, but remains elevated against the 17-22bps in FY18-19. PIOP is expected to be flattish dampened mainly by the tail-end effect from interest rate cuts.

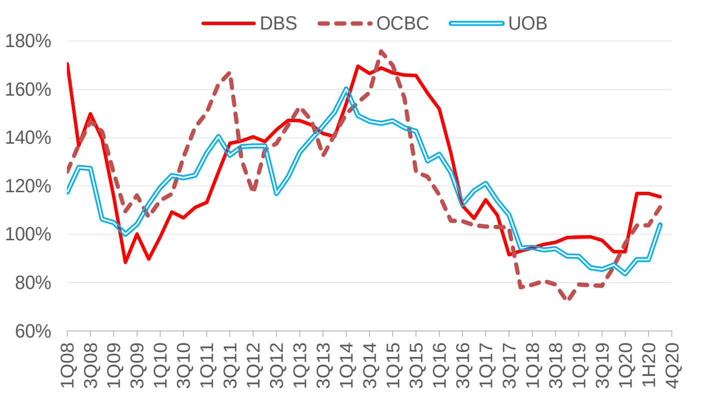
For FY20, sector earnings are estimated to fall 31% YoY, impacted mainly by the 226% YoY jump in net impairment charges as banks set aside additional provisions for adjustments of macroeconomic variables (MEV) used in the Expected Credit Loss (ECL) model and pre-emptive management overlay.

Figure 12: SG banks' net profit vs ROE



Source: Company data, RHB

Figure 13: SG banks' ROE trend



Source: Company data, RHB

Figure 14: SG banks' earnings forecasts and key assumptions

(SGDm)	2018	2019	2020F	2021F	2022F
Net interest income	**21,065**	**22,519**	**21,084**	**21,620**	**22,760**
NII growth (%)	*12.4%*	*6.9%*	*-6.4%*	*2.5%*	*5.3%*
Loan growth (%)	*8.5%*	*3.1%*	*5.0%*	*4.7%*	*4.4%*
Net interest margin (%)	*1.80%*	*1.83%*	*1.62%*	*1.56%*	*1.59%*
Fee income	6,778	7,207	7,134	7,795	8,285
Other income	4,158	5,719	5,693	5,309	5,639
Non-interest income	**10,936**	**12,926**	**12,827**	**13,104**	**13,924**
Non-II growth (%)	*-5.9%*	*18.2%*	*-0.8%*	*2.2%*	*6.3%*
Total operating income	**32,001**	**35,445**	**33,911**	**34,724**	**36,684**
Operating income growth (%)	*5.4%*	*10.8%*	*-4.3%*	*2.4%*	*5.6%*
Non-II/Total income (%)	*34.2%*	*36.5%*	*37.8%*	*37.7%*	*38.0%*
Operating expenses	**(14,031)**	**(15,374)**	**(14,800)**	**(15,580)**	**(16,280)**
Operating expense growth (%)	*9.8%*	*9.6%*	*-3.7%*	*5.3%*	*4.5%*
CIR (%)	*43.8%*	*43.4%*	*43.6%*	*44.9%*	*44.4%*
PIOP	**17,970**	**20,071**	**19,111**	**19,144**	**20,404**
PIOP growth (%)	*2.2%*	*11.7%*	*-4.8%*	*0.2%*	*6.6%*
Loan impairment charges	(1,410)	(1,902)	(6,800)	(4,260)	(2,710)
Other impairment charges	(84)	(229)	(140)	(213)	(184)
Total impairment charges	**(1,494)**	**(2,131)**	**(6,940)**	**(4,473)**	**(2,894)**
Credit charge-off (bps)	*17*	*22*	*74*	*44*	*27*
GIL ratio (%)	*1.51%*	*1.49%*	*1.64%*	*1.87%*	*1.81%*
Loan loss coverage (%)	*84.4%*	*85.8%*	*104.7%*	*99.7%*	*100.2%*
Associates & others	561	617	715	775	825
Pre-tax profit	**17,037**	**18,557**	**12,886**	**15,446**	**18,335**
Taxation	(2,688)	(2,745)	(1,909)	(2,360)	(2,835)
Minority interests	(272)	(209)	(168)	(191)	(218)
Net profit	**14,077**	**15,603**	**10,809**	**12,895**	**15,282**
Net profit growth (%)	*17.2%*	*10.8%*	*-30.7%*	*19.3%*	*18.5%*

Source: Company data, RHB

Key risks

Entry of digital banks. On 4 Dec 2020, the Monetary Authority of Singapore (MAS) announced the award of four licences for digital banks. For the Digital Full Bank – a consortium comprising Grab Holdings Inc, Singtel (ST SP, BUY, TP: SGD3.10), and Sea Ltd. For Digital Wholesale Bank (DWB) – a consortium comprising Greenland Financial Holdings Group, Linklogis Hong Kong, Beijing Co-operative Equity Investment Fund Management, and Ant Group. MAS expects the new digital banks to commence operations from early 2022. We believe these new entrants will not pose a significant threat to incumbent banks. Over the past few years, SG banks have been investing to digitalise their operations and roll out digital offerings. Furthermore, the digital banks are to deliver financial services for the currently underserved businesses and individuals such as small medium enterprises, start-ups, gig workers and millennials.

Key risks to our sector view. Delays in the general availability of COVID-19 vaccines and a resurgence in new cases could derail economic recovery in 2021. A prolonged period of slow business activities would exert pressure on asset quality. Conversely, upside risks will likely come from a stronger-than-expected GDP growth and a pick-up in SIBOR and SOR.

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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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