

UOB (UOB SP)

Financial Services - Banks

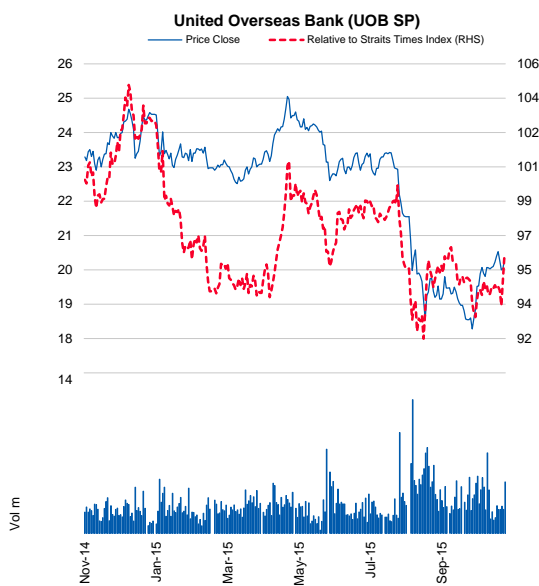
Market Cap: USD23,271m

Neutral (Maintained)

 Target Price: **SGD21.70**

 Price: **SGD20.30**

Asset Quality Benign, Special Dividend Declared

 Macro
 Risks
 Growth
 Value


Source: Bloomberg

Avg Turnover (SGD/USD)	71.6m/51.1m
Cons. Upside (%)	11.8
Upside (%)	-6.9
52-wk Price low/high (SGD)	18.3 - 25.1
Free float (%)	77
Share outstanding (m)	1,602
Shareholders (%)	
Wee Investments	7.8
Wah Hin & Co	5.1

Share Performance (%)

	YTD	1m	3m	6m	12m
Absolute	(17.1)	9.6	(11.3)	(17.0)	(9.5)
Relative	(6.2)	2.2	(3.6)	(3.0)	(2.2)

3Q15 earnings rose 13% QoQ mainly from a one-off SGD100m gain from the sale of securities. Maintain NEUTRAL and SGD21.70 TP (7% upside). Concerns over UOB's relatively higher exposure to ASEAN would linger until macroeconomic conditions improve while being challenged to sustain NIM in 2016. Still, a special dividend of 20 cents/share, declared to celebrate the bank's 80th anniversary, would provide some support to share price in the near term.

- ◆ **Results in line.** United Overseas Bank's (UOB) 3Q15 net profit of SGD858m was in line with consensus forecast, while 9M15 earnings of SGD2,421m was 76.5% of the street's 2015 forecast of SGD3,162m. The 13% QoQ rise in 3Q15 earnings was led mainly by net gains from sale of investment securities (c.SGD100m).
- ◆ **Key positives for 3Q15** were: i) stable net interest margin (NIM) of 1.77% helped mainly by lower funding costs, ii) steady 4% QoQ increase in fee income led by higher loan-related fees, and iii) moderate 2% QoQ rise in non-performing loans (NPLs) and relatively stable credit cost of 32bps (2Q15: 30bps). The main negative was the muted loan growth of 0.4% QoQ (mainly due to depreciation of MYR and IDR),
- ◆ **Asset quality healthy.** Gross NPLs rose 2% QoQ in 3Q15, resulting in moderate YTD increase of 8.2%. Gross NPL ratio was still low at 1.26% (Dec 2014: 1.18%) with the NPL ratio of its Singapore book at a low 0.9%, Greater China 0.7% and Indonesia 3.4%. UOB's exposure to the broad commodity sector stands at less than 8% of total loans, of which the oil and gas (O&G) sector made up 5%. Loan loss coverage (LLC) dipped slightly to 142.7% (June: 144.1%).
- ◆ **Management's guidance.** Excluding currency effects, loan growth target of 5% for 2015 stays within reach. NIM ought to be stable in 4Q15 but faces downside risks in 2016. Management remains comfortable with quality of its loan portfolio. While NPLs would grind higher in 2016, credit cost is expected to be relatively benign.
- ◆ **Maintain NEUTRAL.** No change in our NEUTRAL rating and GGM-based SGD21.70 TP, which implies 1.09x FY16F P/BV. We believe UOB's share price would continue to underperform peers on lingering concerns over its higher exposure to ASEAN. We see downside risks to 2016 NIM with pressures coming from its regional operations.

Forecasts and Valuations	Dec-13	Dec-14	Dec-15F	Dec-16F	Dec-17F
Reported net profit (SGDm)	2,904	3,211	3,182	3,376	3,616
Net profit growth (%)	7.6	10.6	(0.9)	6.1	7.1
Recurring net profit (SGDm)	2,904	3,211	3,182	3,376	3,616
Recurring EPS (SGD)	1.84	2.03	2.00	2.12	2.27
BVPS (SGD)	16.8	18.6	19.4	20.5	21.9
DPS (SGD)	0.75	0.75	1.05	0.85	0.85
Recurring P/E (x)	11.0	10.0	10.2	9.6	8.9
P/B (x)	1.21	1.09	1.05	0.99	0.93
Dividend Yield (%)	3.7	3.7	5.2	4.2	4.2
Return on average equity (%)	11.3	11.5	10.5	10.6	10.7
Return on average assets (%)	1.1	1.1	1.0	1.0	1.0
Our vs consensus EPS (adjusted) (%)			0.6	1.8	1.8

Source: Company data, RHB

Results At A Glance

Figure 1: UOB's 3Q15 and 9M15 results summary

FYE Dec (SGD'm)	3Q14	2Q15	3Q15	QoQ (%)	YoY (%)	9M14	9M15	YoY (%)	Comments – 9M15 vs 9M14
Net interest income	1,156	1,212	1,235	2	7	3,390	3,648	8	Growth led by 4% loan growth and NIM expansion.
<i>Net interest margin</i>	1.71%	1.77%	1.77%			1.71%	1.77%		
Non-interest income	816	713	851	19	4	2,218	2,319	5	Lift came mainly from improved fee income (+8% YoY) and a 48% YoY rise in net gain from investment securities.
<i>Non-ll/total income</i>	41.4%	37.0%	40.8%			39.6%	38.9%		
Operating income	1,972	1,925	2,086	8	6	5,608	5,967	6	
Overhead expenses	(800)	(876)	(904)	3	13	(2,342)	(2,632)	12	Staff cost: +12% YoY, revenue-related expenses: +11% YoY and IT-related expenses: +33% YoY. There were also expenses of SGD28m incurred on a brand campaign and employee incentives for UOB's 80 th anniversary and Singapore's Golden Jubilee.
<i>Cost-income ratio</i>	40.6%	45.5%	43.3%			41.8%	44.1%		
Pre-impairment profit	1,172	1,049	1,182	13	1	3,266	3,335	2	
Impairment charges	(163)	(152)	(161)	6	(1)	(470)	(482)	3	Specific allowances on loans +67% to SGD277m led by increases from Indonesia (+2.1x) and Singapore (+3.6x). General allowances: -28% YoY.
<i>Credit cost - annualised (bps)</i>	34	30	32			33	32		
Operating profit	1,009	897	1,021	14	1	2,796	2,853	2	
Associates	37	40	28			107	72		
Pretax profit	1,046	937	1,049	12	0	2,903	2,925	1	
Tax	(176)	(173)	(189)			(426)	(495)		
<i>Effective tax rate</i>	16.8%	18.5%	18.0%			14.7%	16.9%		
Minority interest	(3)	(3)	(3)			(13)	(9)		
Net profit	867	761	858	13	(1)	2,463	2,421	(2)	
El/others	-	-	-			-	-		
Core net profit	867	761	858	13	(1)	2,463	2,421	(2)	9M15 earnings were 76.5% of consensus 2015F net profit.
Other key data and ratios									
Gross loans	195,943	202,406	203,228	0	4	195,943	203,228	4	Up 2% YTD with growth in Singapore (+4% YTD) offset by declines elsewhere due to depreciation of regional currencies.
Customer deposits	224,365	241,485	244,630	1	9	224,365	244,630	9	Up 5% YTD with fixed deposits: +4% YTD, savings: +5% and demand deposits: +7%.
Gross impaired loans	2,289	2,504	2,551	2	11	2,289	2,551	11	Up 8% YTD led by Singapore (+21% YTD), Indonesia (+25%), Malaysia (+10%) and Greater China (+34%).
Total assets	302,711	310,078	323,356	4	7	302,711	323,356	7	
Shareholders' funds	28,611	30,548	30,206	(1)	6	28,611	30,206	6	
ROAA (%)	1.16	0.98	1.08			1.16	1.08		
ROAE (%)	12.2	9.9	11.3			12.2	11.3		
LDR (%)	85.8	82.3	81.6			85.8	81.6		SGD LDR: 90.3% (Dec 2014: 94.8%) and USD LDR: 60.4% (Dec 2014: 68.2%). CASA ratio was 42%.
Gross impaired loans ratio (%)	1.17	1.24	1.26			1.17	1.26		
Loan loss reserves (%)	146.8	144.1	142.7			146.8	142.7		
CET-1 ratio (%)	14.0	14.0	13.6			14.0	13.6		Fully loaded CET-1 was 12.2%.
Total capital ratio (%)	17.0	16.8	16.4			17.0	16.4		

Source: Company data, RHB

Key Highlights From Management Briefing

Asset quality resilient

Gross NPLs rose 2% QoQ in 3Q15, resulting in moderate YTD increase of 8.2%. Bulk of the increase came from its Singapore loan book (+12% QoQ) while Indonesia and Greater China NPLs rose by 11%.

Overall, its asset quality remains resilient with gross NPL ratio still low at 1.26% (Dec 2014: 1.18%). NPL ratio of its Singapore book was at a low 0.9% (Dec 2014: 0.8%), Greater China 0.7% (Dec 2014: 0.5%) and Indonesia 3.4% (Dec 2014: 2.7%). UOB's exposure to the broad commodity sector stands at less than 8% of total loans, of which the oil and gas (O&G) sector comprised 5% consisting mainly of traders and downstream players.

Management is comfortable with its Malaysia loan portfolio and does not expect NPLs to spike. UOB has been very careful to not participate in the mass market and general economy. As a result, the bank does not have large NPLs in Malaysia.

Asset quality of its Indonesian book was relatively stable in 3Q15 although there were two loans that turned NPL. These were customers in the support industries for the commodity sector. Having taken the hit in 2Q15, management believes the worst is over and any increase in NPLs would be small.

In Thailand, UOB wrote-off one loan but its NPL base is not increasing. Quality of its loan portfolio is very stable and management believes it has over-provided for NPLs.

All in, management does not expect massive asset quality deterioration. It believes NPLs would rise further but rules out the possibility of sharp increases as seen during the Asian financial crisis.

Loan growth outlook

Despite the challenging environment, management believes UOB can achieve its 5% loan growth target for 2015, on constant currency terms.

The bank's lending business in Singapore is holding notwithstanding the slowdown in demand for mortgages. UOB's credit approvals increased in the last two quarters and management hopes this would result in an uptick in loan growth.

Over in Indonesia, UOB continues to see loan demand but the bank has stayed out of the market for some time as the general economy has weakened. Management believes that the bank can soon look to lending opportunities on a selective basis.

UOB is seeing slowing loan demand in Hong Kong but management is not worried. Having enjoyed healthy volume growth in the past few years, management believes a slower pace of expansion in its HK loan portfolio in challenging times would be good.

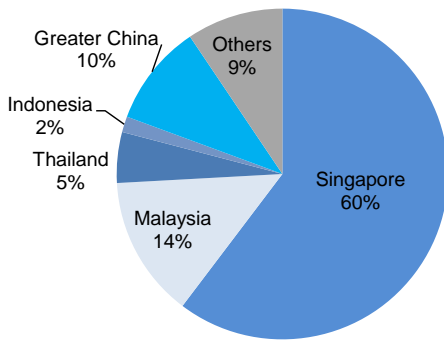
NIM would come under pressure

Management expects NIM to be stable for at least another quarter but sustaining margins would be a challenge in 2016.

Margins are holding well in Singapore, Malaysia and Indonesia but are under pressure in China. Management believes its strategy of pushing USD deposits to manage funding costs can sustain NIM in 4Q15.

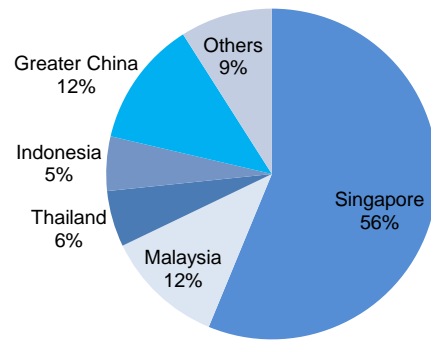
Management believes maintaining a margin in China would be a challenge given: i) economists expect further reduction in policy rates despite having seen six cuts so far this year, and ii) the removal of the 75% cap on loan-to-deposit ratio (LDR) of commercial banks in late-June 2015.

Figure 2: UOB's 9M15 pre-tax profit by geography



Source: Company data, RHB

Figure 3: UOB's gross loans by geography, Sept 2015



Source: Company data, RHB

Valuation and Risks

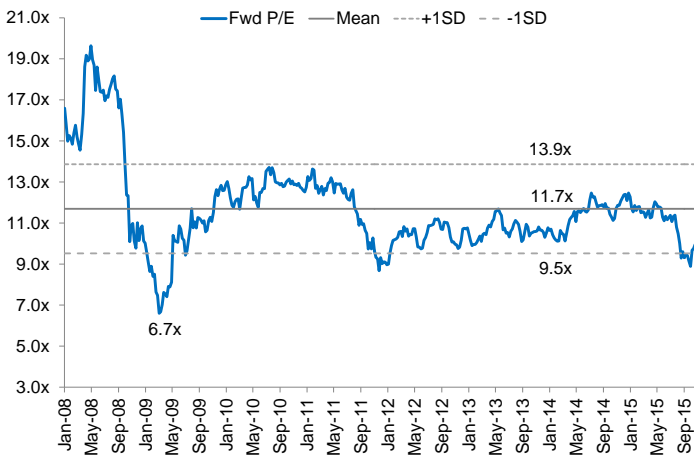
Valuation

Our GGM-derived SGD21.70 TP is based on 3-year forward ROE of 11.4%, cost of equity of 10.3% and long-term growth to 3%. Our TP implies a FY16F P/BV of 1.09x (historical mean: 1.35x, -1SD: 1.09x) and P/E of 10.2x (historical mean: 11.7x).

Risks

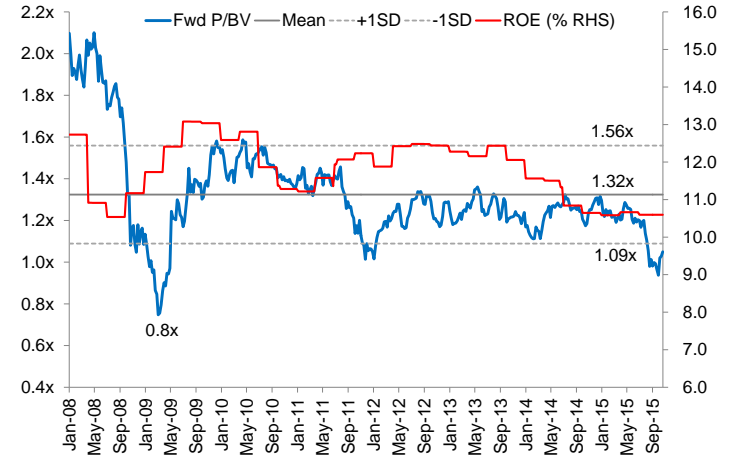
Factors that could cause the share price to rise above/fall below our TP are: i) sharper-than-expected NIM slippage or improvement that would impact revenue growth, ii) higher-than-expected credit cost, iii) a material slowdown or a pickup in its ASEAN operations, and iv) stronger-than-expected growth in fee income.

Figure 2: UOB's 12-mth forward consensus P/E



Source: Bloomberg, RHB

Figure 3: UOB's 12-mth forward consensus P/BV



Source: Bloomberg, RHB

Financial Exhibits

Profit & Loss (SGDm)	Dec-13	Dec-14	Dec-15F	Dec-16F	Dec-17F
Interest income	6,508	7,189	7,780	8,230	8,900
Interest expense	(2,388)	(2,632)	(2,875)	(3,140)	(3,430)
Net interest income	4,120	4,557	4,905	5,090	5,470
Non interest income	2,600	2,899	3,066	2,990	3,185
- Fee income	1,731	1,749	1,880	1,970	2,090
Total operating income	6,720	7,456	7,971	8,080	8,655
Overheads	(2,898)	(3,146)	(3,510)	(3,530)	(3,820)
- Staff costs	(1,712)	(1,825)	(2,070)	(2,180)	(2,300)
Pre-provision operating profit	3,822	4,310	4,461	4,550	4,835
Loan impairment allowances	(408)	(572)	(567)	(480)	(490)
Other impairment allowances	(22)	(63)	(83)	(57)	(54)
Income from associates	191	149	107	118	130
Pre-tax profit	3,583	3,824	3,918	4,131	4,421
Taxation	(559)	(561)	(666)	(682)	(729)
Minority interests	(17)	(15)	(13)	(16)	(19)
Preferred dividends	(103)	(37)	(57)	(57)	(57)
Reported net profit	2,904	3,211	3,182	3,376	3,616
Recurring net profit	2,904	3,211	3,182	3,376	3,616

Source: Company data, RHB

	Dec-13	Dec-14	Dec-15F	Dec-16F	Dec-17F
Per Share Data					
EPS (SGD)	1.84	2.03	2.00	2.12	2.27
Recurring EPS (SGD)	1.84	2.03	2.00	2.12	2.27
DPS (SGD)	0.75	0.75	1.05	0.85	0.85
BVPS (SGD)	16.75	18.58	19.40	20.49	21.94
Growth Rates					
EPS growth (%)	8.1	10.0	(1.4)	6.1	7.1
Recurrent EPS growth (%)	8	10	(1)	6	7
DPS growth (%)	7	-	40	(19)	-
BVPS growth (%)	5.2	10.9	4.4	5.6	7.1
Gross cust loan growth (%)	16.8	9.5	3.5	5.0	5.5
Total asset growth (%)	12.4	7.9	5.9	4.1	4.8
Cust deposit growth (%)	17.9	8.9	5.6	5.8	5.3
Net interest income growth (%)	5.2	10.6	7.6	3.8	7.5
Non interest income growth (%)	0.9	11.5	5.8	(2.5)	6.5
Overhead growth (%)	5.5	8.6	11.6	0.6	8.2
Operating profit growth (%)	2.0	12.8	3.5	2.0	6.3
Loan impairment allowance growth (%)	(10.5)	40.2	(0.9)	(15.3)	2.1
Net profit growth (%)	7.6	10.6	(0.9)	6.1	7.1
Profitability					
Return on IEAs (%)	2.7	2.7	2.7	2.7	2.8
Cost of funds (%)	1.0	1.0	1.0	1.1	1.1
Net interest spread (%)	1.7	1.6	1.6	1.6	1.7
Net interest margin (%)	1.7	1.7	1.7	1.7	1.7
Non-interest income / total income (%)	38.7	38.9	38.5	37.0	36.8
Cost to income ratio (%)	43.1	42.2	44.0	43.7	44.1
Credit cost (bps)	24	30	28	23	22
Return on average assets (%)	1.1	1.1	1.0	1.0	1.0
Return on average equity (%)	11.3	11.5	10.5	10.6	10.7

Source: Company data, RHB

Financial Exhibits

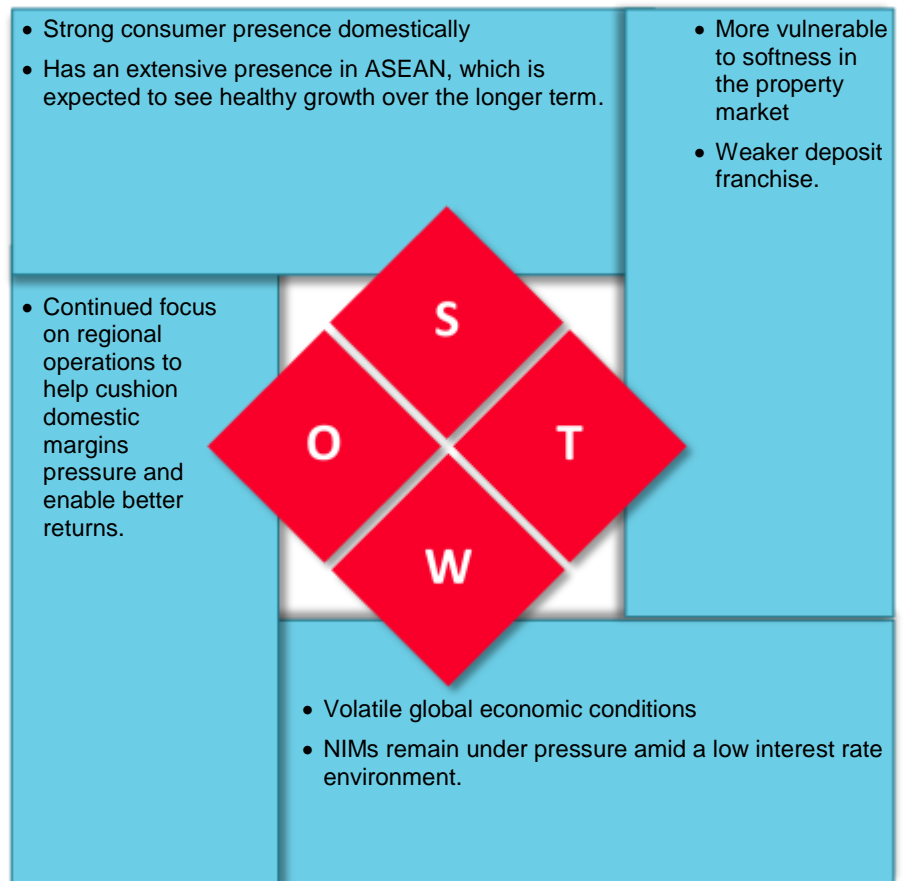
Balance Sheet (SGDm)	Dec-13	Dec-14	Dec-15F	Dec-16F	Dec-17F
Total gross loans	181,978	199,343	206,350	216,700	228,600
Other interest earning assets	76,178	81,962	90,035	92,900	96,896
Total gross IEAs	258,156	281,305	296,385	309,600	325,496
Total provisions	(3,408)	(3,729)	(4,070)	(4,300)	(4,496)
Net loans to customers	178,857	195,903	202,565	212,700	224,400
Total net IEAs	254,748	277,576	292,315	305,300	321,000
Tangible fixed assets	1,308	1,428	1,490	1,560	1,650
Intangible assets	4,144	4,149	4,140	4,116	4,092
Total non-IEAs	29,482	29,160	32,631	32,907	33,423
Total assets	284,230	306,736	324,946	338,207	354,423
Customer deposits	214,548	233,750	246,800	261,000	274,800
Other interest-bearing liabilities	33,722	33,130	34,085	33,880	33,960
Total IBLs	248,270	266,880	280,885	294,880	308,760
Total non-IBLs	9,382	10,084	13,028	10,556	10,582
Total liabilities	257,652	276,964	293,913	305,436	319,342
Share capital	5,333	5,892	5,892	5,892	5,892
Retained earnings reserve	12,003	14,064	15,682	17,420	19,720
Other reserves	9,053	9,613	9,299	9,299	9,299
Shareholders' equity	26,389	29,569	30,873	32,611	34,911
Minority interests	189	203	160	160	170

Source: Company data, RHB

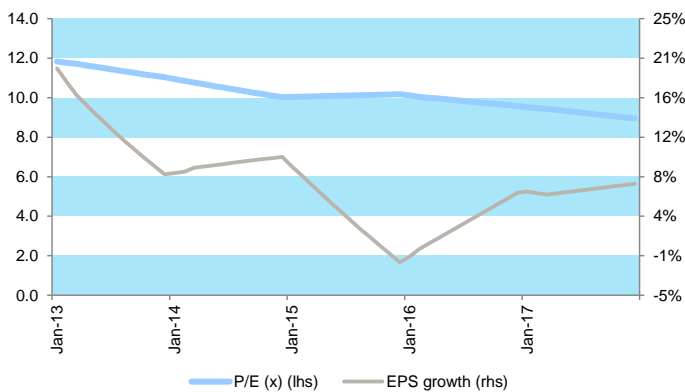
	Dec-13	Dec-14	Dec-15F	Dec-16F	Dec-17F
Balance Sheet Structure					
Net cust loans/cust deposits (%)	83.4	83.8	82.1	81.5	81.7
Total assets / shareholders' funds (x)	10.8	10.4	10.5	10.4	10.2
Asset Quality and Capital					
Reported NPLs / gross cust loans (%)	1.1	1.2	1.3	1.3	1.3
Net impaired loans / loans (%)	(0.6)	(0.5)	(0.6)	(0.6)	(0.6)
Collective allowance / net loans (%)	1.3	1.4	1.5	1.5	1.5
Total provisions / reported NPLs (%)	150.5	145.9	142.8	143.4	144.8
CET-1 ratio (%)	13.2	13.9	13.7	13.8	14.2
Tier-1 ratio (%)	13.2	13.9	13.7	13.8	14.2
Total capital ratio (%)	16.6	16.9	16.4	16.5	17.2
Du-Pont (as % of avg assets)					
Net interest income (%)	1.5	1.5	1.6	1.5	1.6
Non-interest income (%)	1.0	1.0	1.0	0.9	0.9
Operating expenses (%)	1.1	1.1	1.1	1.1	1.1
Pre-provision ROAA (%)	1.4	1.5	1.4	1.4	1.4
Loan & other impairment allowance (%)	0.2	0.2	0.2	0.2	0.2
Associates (%)	0.1	0.1	0.0	0.0	0.0
Pre tax ROAA (%)	1.3	1.3	1.2	1.2	1.3
Return on average assets (%)	1.1	1.1	1.0	1.0	1.0
Leverage (x)	10.4	10.6	10.5	10.4	10.3
Return on average equity (%)	11.3	11.5	10.5	10.6	10.7

Source: Company data, RHB

SWOT Analysis

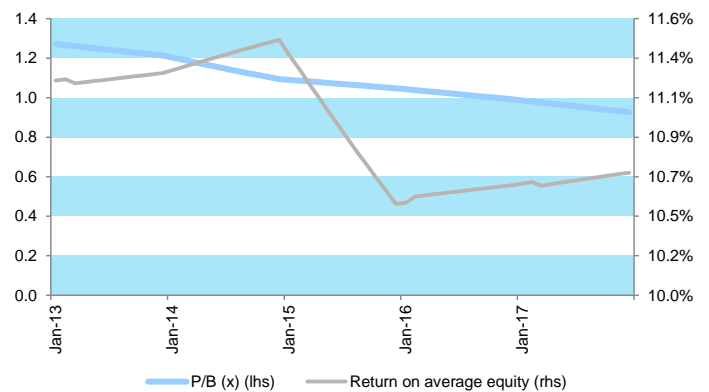


P/E (x) vs EPS growth



Source: Company data, RHB

P/BV (x) vs ROAE

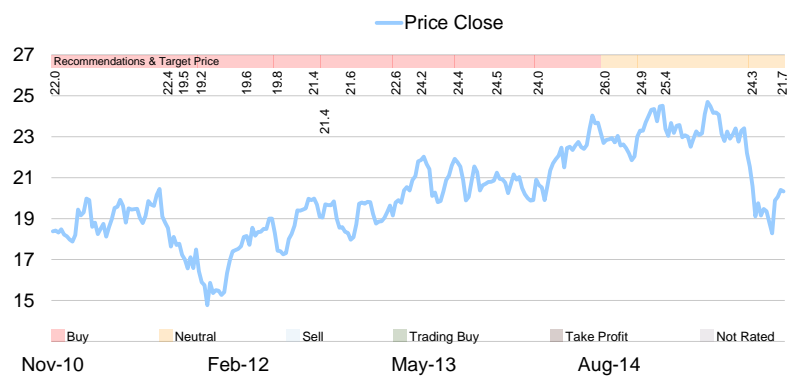


Source: Company data, RHB

Company Profile

UOB is the third largest Singapore bank by assets. It also has significant operations in Malaysia, Thailand & Indonesia.

Recommendation Chart



Source: RHB, Bloomberg

Date	Recommendation	Target Price	Price
2015-10-15	Neutral	21.7	20.1
2015-08-02	Neutral	24.3	22.2
2015-05-03	Neutral	25.4	24.5
2015-02-16	Neutral	25.4	23.2
2014-12-30	Neutral	25.4	24.5
2014-10-31	Neutral	24.9	23.0
2014-08-01	Neutral	26.0	23.2
2014-05-02	Buy	24.0	21.5
2014-02-17	Buy	24.0	20.4
2013-11-06	Buy	24.5	21.0

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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