OCBC Bank

Asia Credit Research

Earnings Review: United Overseas Bank Ltd ("UOB")

Issuer Profile: Positive (2)

Ticker: **UOBSP**

Background

United Overseas Bank Limited ('UOB') is Singapore's third largest consolidated banking group with a global network of more than 500 offices in 19 countries in Asia Pacific, Europe and North America. Business segments comprise Group Retail, Group Wholesale Banking, Global Markets and Others. Wee Investments Pte Ltd and Wah Hin & co Pte Ltd have a 7.71% and 5.05% stake in UOB, respectively, as of 3rd May 2018.

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Recommendation

- Record earnings in 1Q2018 highlight the positive environment for banks in 2018. With expectations of higher interest rates and solid economic growth, our constructive sector outlook for financial institutions remains.
- This supports the continuation of our Positive (2) Issuer Profile on UOB.
- We tend to look to other names and lower in the capital structure for higher yield. This means looking at Aussie Tier 2 paper, in particular the ANZ 3.75% '27c22s. We currently rate the Australian banks also at a Positive (2) Issuer Profile.

Relative Value:

Bond	Maturity / Call date	CET1 Ratio	Ask Yield	Spread
UOBSP 3.50 '26c21 (T2)	16/09/2021	14.9%	2.87%	78
UOBSP 3.50 '29c24 (T2)	27/02/2024	14.9%	3.07%	61
UOBSP 4.75 PERPc19 (AT1)	19/11/2019	14.9%	2.68%	67
UOBSP 4.0 PERPc21 (AT1)	18/05/2021	14.9%	3.32%	109
ANZ 3.75 '27c22 (T2)	23/03/2022	16.3%	3.27%	97

Indicative prices as at 3 May 2018 Source: Bloomberg
Common Equity Tier 1 (CET1) Ratio based on latest available quarter

Key Considerations

- **Solid environment translates to record earnings:** UOB's 1Q2018 results were strong with total income up 9% y/y to SGD2.2bn. Net interest income grew 13% y/y to a new record high on customer loans growth of +5% y/y and net interest margin growth of +9bps y/y to 1.84%. Net fee and commission income performance was also strong, up 18% y/y with growth due to strong wealth management and fund management performance. Loan-related fee income increased sharply as well by 24% while credit card fees rose 11% y/y. These results were balanced by a 22% y/y fall in other non-interest income mainly from lower net trading income. Evidencing a broadly solid operating environment, all business segments delivered improved performance y/y. Group Retail reported y/y income growth of 6%, mainly from wealth management and fee based products. Group Wholesale Banking income grew 4% supported by higher cash management, trade and investment banking activities while Global Markets net income grew 20% y/y, benefitting from favourable foreign exchange movements.

- **Also supports overall expenses:** Operating expense growth for UOB was similarly higher due to growth-related staff and IT expenses. As expense growth of 11% y/y was higher than total income growth, the improvement in operating profit was slightly more moderate at 7% y/y than growth in total income while the expense to income ratio weakened slightly to 44.2% (43.2 in 1Q2017). This was mitigated however by credit loss allowances falling 57% y/y due to improved macro environments and lower additional stress in UOB's oil and gas and shipping sectors. Combined, overall expenses including credit loss allowances were stable and this translated to net profit before tax improving 18% y/y. In essence, operating expense trends are not necessarily negative in our view given that they appear to support current and future business growth.

- **Balance sheet expansion in kind:** UOB's solid loan growth is an indication of supportive operating conditions, with loan growth continuing to occur q/q (+2% q/q). Loan growth was broad-based across most territories (except Indonesia) and industries (except transport, storage and communication and others). The fall in loans within Indonesia and transport, storage and communication and others seems positive given these locations/sectors have the highest non-performing loan ratios within UOB's overall portfolio. Overall non-performing loans remain higher y/y due to the one-off recognition of stressed exposures although it fell slightly q/q. With operating conditions supportive, total allowances have been on a declining trend since March 2017. With this decline faster than the fall in non-performing loans ('NPL'), non-performing asset ('NPA') coverage ratios have been falling (91% as at 1Q2018; 117% as at 1Q2017). Coverage ratios including only unsecured NPA's have also fallen although it remained solid at 190% as at 1Q2018. Given current operating conditions, the fall in coverage is not a concern in our view.

- **Bumper growth in capital ratios:** Capital ratio improvement on a y/y basis was noticeable with UOB's CET1 ratio up 170bps to 14.9% due to earnings performance and a y/y fall in risk weighted assets from changes to the risk weighted asset computation methodology. The CET1 ratio was however down 20bps q/q due to a higher rise in risk weighted assets from loans growth. On a fully loaded basis, the CET1 ratio was also 14.9% as at 31 March 2018, well above the CET1 regulatory minimum requirement of 8.7%. Tier 1 and total capital ratios had also improved due to the issuance of USD650mn in AT1 securities in October 2017. This also assisted in the y/y improvement in UOB's leverage ratio, which was at 8.2% as at 31 March 2018 (7.6% as at 31 March 2017), well above the minimum Basel III requirement of 3%. As we mentioned in the earnings review for DBS Group Holdings Ltd, these strong positions against regulatory requirements should support further potential balance sheet growth in 2018.

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Explanation of Issuer Profile Rating / Issuer Profile Score

Positive ("Pos") – The issuer's credit profile is either strong on an absolute basis, or expected to improve to a strong position over the next six months.

Neutral ("N") – The issuer's credit profile is fair on an absolute basis, or expected to improve / deteriorate to a fair level over the next six months.

Negative ("Neg") – The issuer's credit profile is either weaker or highly geared on an absolute basis, or expected to deteriorate to a weak or highly geared position over the next six months.

To better differentiate relative credit quality of the issuers under our coverage, we have further sub-divided our Issuer Profile Ratings into a 7 point Issuer Profile Score scale.

IPR	Positive		Neutral			Negative	
IPS	1	2	3	4	5	6	7

Explanation of Bond Recommendation

Overweight ("OW") – The performance of the issuer's specific bond is expected to outperform the issuer's other bonds, or the bonds of other issuers either operating in the same sector or in a different sector but with similar tenor over the next six months.

Neutral ("N") – The performance of the issuer's specific bond is expected to perform in line with the issuer's other bonds, or the bonds of other issuers either operating in the same sector or in a different sector but with similar tenor over the next six months.

Underweight ("UW") – The performance of the issuer's specific bond is expected to underperform the issuer's other bonds, or the bonds of other issuers either operating in the same sector or in a different sector but with similar tenor over the next six months.

Other

Suspension – We may suspend our issuer rating and bond level recommendation on specific issuers from time to time when OCBC is engaged in other business activities with the issuer. Examples of such activities include acting as a joint lead manager or book runner in a new issue or as an agent in a consent solicitation exercise. We will resume our coverage once these activities are completed.

Withdrawal ("WD") – We may withdraw our issuer rating and bond level recommendation on specific issuers from time to time when corporate actions are announced but the outcome of these actions are highly uncertain. We will resume our coverage once there is sufficient clarity in our view on the impact of the proposed action.

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