

New Issue View: United Overseas Bank Ltd

Recommendation

- United Overseas Bank Limited (“UOB”) is proposing a **Perpetual non-call 7yrs Additional Tier 1 instrument at an initial price guidance of 3.875% area** (+208bps above swaps).
- Proceeds could be used to refinance the upcoming UOBSP 4.75% PERPc19s with call date on 19 November 2019. As we mentioned in our [Mid-Year 2019 Credit Outlook](#), we would not be surprised to see more capital issuance from UOB to buffer against future balance sheet growth and given the conducive technical environment and UOB’s solid fundamentals.
- Size is indicated as benchmark – benchmark sizes for financial institutions are typically larger than that of corporates recognizing the different purpose of bank capital instruments and the larger balance sheets. Average issue sizes for other recent Bank AT1s have been above SGD700mn. These include:
 - i) SGD750mn CS 5.625% PERPc24s (reset SDSW5 + 3.767%)
 - ii) SGD750mn HSBC 5.0% PERPc23s (SDSW5 + 2.665%)
 - iii) SGD750mn SOCGEN 6.125% PERPc24s (SDSW5 + 4.207%)
 - iv) SGD700mn UBS 5.875% PERPc23s (SDSW5 +3.605%)
 - v) SGD750mn STANLN 5.375% PERPc24s (SDSW5 +3.683%)
- We expect solid demand for the name and initial pricing guidance appears in line with the existing UOBSP 4.0% PERPc21s which offers better value within the UOB curve. That said, we do see the proposed pricing levels as tight considering the longer call date and compared to other recent SGD AT1s issued.
- In our [Monthly Credit View for July](#), we are overweight the HSBC Holdings PLC (HSBC 4.7% PERPc22s and HSBC 5.0% PERPc23s) and Julius Baer Group Ltd (BAERVX 5.9% PERPc20s and BAERVX 5.75% PERPc22s) AT1s. We also like the UBS 5.875% PERPc23s amongst the most recent European bank AT1s issued including CS 5.625% PERPc24s.

Issuer Profile:
Positive (2)

Ticker: **UOBSP**

Background

United Overseas Bank Limited (‘UOB’) is Singapore’s third largest consolidated banking group with total assets of SGD400.5bn as at 31 March 2019. It has 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 8.0% and 5.15% stake in UOB, respectively, as of 10th July 2019.m

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Key Considerations

- **Robust performance continues:** 1Q2019 results for UOB were robust on a y/y and q/q basis. Net profit before tax was up 5% y/y on solid operating profit performance (+7% y/y to SGD1.33bn), which was partially offset by higher allowances for credit and other losses and lower share of profit of associates and joint ventures. Operating profit was driven by growth in net interest income (+8% y/y due to strong y/y growth in loans which mitigated a 5bps fall in net interest margins to 1.79%) and other non-interest income (+40% y/y due to higher trading income and better customer-related income). This offset a 7% y/y fall in net fee and commission income from a fall in wealth management and fund management fees and a 9% y/y increase in operating expenses (higher staff and technology costs). Q/q trends were overall better with net profit before tax up 14% q/q on an 8% q/q rise in operating profit from total income growth (+9% q/q on trading and investment income growth) and a 27% q/q fall in allowances for credit and other losses which offset operating expense growth (+9 q/q). As in y/y trends, a material rise in other non-interest income drove the total income growth q/q. Net interest income however was marginally weaker q/q (-1%) despite only a 1bps q/q fall in net interest margin and a 3% q/q rise in net customer loans due to the lower amount of days q/q.
- **Balanced segment performance:** UOB’s segments continue to show balanced performance. Group Retail profit before tax had consistent growth (+1.3% q/q and +1.1% y/y) on volume growth and higher deposit margins while expenses grew y/y and fell q/q on seasonality. Global Markets profit before tax was up 42.9% q/q and 31.1% y/y on the aforementioned trading and investment income performance and lower allowances. While Group Wholesale Banking profit before tax performance was divergent (+9.9% q/q and -4.0% y/y), this was due mostly to a significant y/y rise in credit allowances (1Q2018 had a net write-back). Excluding this, Group Wholesale Banking profit before tax and allowances was up 8.9% q/q and up 11.9% y/y on volume and margin growth as well as stronger treasury and fee based income. Group Wholesale Banking continues to

be the largest contributor to UOB's consolidated profit before tax (53.9% for 1Q2019) with Group Retail contributing 37.5% to 1Q2019 consolidated profit before tax.

- **Watching credit costs:** The 16.3% y/y rise in allowances for credit and other losses was due to higher net customer loans (+12% y/y) with credit costs as a proportion of impaired loans relatively stable at 13 bps in 1Q2019 (12bps in 1Q2018). Otherwise, UOB's non-performing loan ratio fell to 1.5% as at 31 March 2019 from 1.7% as at 31 March 2018 (stable against 31 December 2018). This was due however more to the loans growth which was mostly in the building and construction segment (the building and construction segment represents the lowest industry segment non-performing loan ratio of UOB's major industry segment at 0.8%). The better non-performing loan ratio was also due to non-performing loan balances falling 2.0% y/y (stable q/q). The coverage for non-performing assets was broadly stable q/q and y/y at 89%, or 203% after taking collateral into account as at 31 March 2019. That said, we do note that movements in total allowances have not exactly matched the movements in non-performing loans, slightly exposing UOB to higher potential future allowances.
- **Capital needs to rise?** Capital ratios remain solid albeit stable or reduced against prior periods with CET1/CAR ratios of 13.9%/17.0% as at 31 March 2019 (unchanged q/q) against 14.9%/18.8% as at 31 March 2018. While ratios remain above minimum capital requirements, the stable to lower ratios were due to risk weighted assets growth above growth in capital from earnings as well as the call of SGD850mn in AT1. UOB has another SGD500mn in AT1 due to call later in 2019.

Relative Value:

Comparative AT1s	CET1 Ratio / CAR Ratio	Call date	Reset Spread	Ask Price	Ask Yield	Spread
UOBSP 3.875% Area PERPc'26 (proposed)	13.9%/17.0%	TBC	2.078%	100.00	3.875%	208bps
CS 5.625% PERPc24	12.6%/17.4%	06/06/24	3.767%	101.88	5.19%	348bps
UBS 5.875% PERPc23	13.0%/20.7%	28/11/23	3.605%	103.20	5.05%	338bps
HSBC 4.7% PERPc22	14.3%/20.2%	08/06/22	2.870%	101.55	4.13%	248bps
BAERVX 5.9% PERPc20	12.8%/18.7%	18/11/20	3.320%	102.30	4.15%	249bps

*Indicative prices as at 10 July 2019
Source: Bloomberg*

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Explanation of Issuer Profile Rating (“IPR”) / Issuer Profile Score (“IPS”)

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 (“IPR”) into a 7 point Issuer Profile Score (“IPS”) 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.

Please note that Bond Recommendations are dependent on a bond’s price, underlying risk free rates and an implied credit spread that reflects the strength of the issuer’s credit profile. Bond Recommendations may not be relied upon if one or more of these factors change.

Other

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Analyst Declaration

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