Issuer Profile:

Positive (2)

Ticker:

UOBSP

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United Overseas Bank Ltd ("UOB")

Recommendation

- **Broad based performance has contributed to record income momentum for UOB while a fall in allowances has translated to solid earnings growth.**
- **Loans growth and a geographic focus on South East Asia should keep earnings resilient although lower interest rates will likely suppress 2H2019 performance against a strong 1H2019.**
- **We maintain our Positive (2) issuer profile on UOB. Across the UOB curve, we see the UOB 4.0% PERPc21s as better value but continue to like other Positive (2) issuers under our coverage which offer better yield for a broadly comparable credit profile.**

Relative Value:

Bond	Maturity / Call date	CET1 Ratio	Ask YTW	Spread
UOBSP 3.5 26c20	22/05/2020	13.9%	2.31%	65bps
UOBSP 3.5 29c24	27/02/2024	13.9%	2.65%	107bps
UOBSP 4.75 PERPc19	19/11/2019	13.9%	2.40%	64bps
UOBSP 4.0 PERPc21	18/05/2021	13.9%	2.99%	138bps
UOBSP 3.58 PERPc26	17/07/2026	13.9%	3.50%	185bps
ANZ 3.75 27c22	23/03/2022	11.5%	3.24%	165bps
HSBC 4.7 PERPc22	08/06/2022	14.3%	4.13%	256bps

Indicative prices as at 06 August 2019 Source: Bloomberg
Common Equity Tier 1 (CET1) Ratio based on latest available quarter

Background

- United Overseas Bank Limited ('UOB') is Singapore's third largest consolidated banking group with total assets of SGD406.4bn as at 30 June 2019. Wee Investments Pte Ltd and Wah Hin & co Pte Ltd have an 8.0% and 5.15% stake in UOB, respectively, as of 6th August 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.

Key Considerations

- **Record income momentum**: UOB announced robust 2Q2019 and 1H2019 results with net profit before tax up 9% and 7% respectively to SGD1.4bn and SGD2.7bn. This was driven by solid total income growth of 10% and 9% y/y respectively while allowances for credit and other losses fell 44% and 15% over the same periods. Of note is that the movements in allowances for credit and other losses contrast with those of DBS Group Holdings Ltd. On a q/q basis, net profit before tax rose 12% from 1Q2019 due to similar trends. Total income performance came from net interest income improvement from volume growth which offset y/y net interest margin compression (1.80% in 1H2019 against 1.83% in 1H2018; 1.81% in 2Q2019 against 1.83% in 2Q2018). 1H2019 net fee and commission income was broadly stable as higher loans related and credit card income were offset by lower fund management fees. Other non-interest income for 1H2019 showed solid growth (+36% y/y) on trading and investment gains. 2Q2019 income performance was driven by a mix of loans growth and loan repricing on a y/y and q/q basis (the net interest margin rising 2bps q/q) as well as a recovery in wealth management performance and higher investment gains and dividend income.

- **Faster growth in expenses balanced by lower allowances**: In line with income growth, operating expenses also grew (+10% y/y for 1H2019; +11% y/y and +5% q/q for 2Q2019) due to higher personnel and IT related expenditure given the bank's ongoing investment in staff and technology. As such, UOB's cost to income ratio rose to 44.1% for 1H2019 and 43.7% for

2Q2019 against 43.9% and 43.6% for 1H2018 and 2Q2018. With regards to allowances for credit and other losses, management indicated that the credit environment was stable leading to a lower allowance for non-impaired assets (or general provisions) y/y and a writeback in allowances while there were also recoveries in 2Q2019. Elsewhere, allowances for impaired loans was up 17% and 16% y/y for 1H2019 and 2Q2019 indicating some stress still in existing impaired loan exposures, particularly in Singapore but also in Malaysia. Other notable trends include a material y/y reduction in 1H2019 allowances for Indonesia and a q/q pick up in allowances for exposures in Thailand. Otherwise, management's view on overall loan quality trends is somewhat reflected in the non-performing loan ratio as at 30 June 2019 which improved by 20bps y/y at 1.5% with absolute numbers of non-performing loans down 0.6% q/q and falling 4.2% y/y although this was due to higher upgrades/recoveries and write-offs that offset higher new non-performing asset formation. The nonperforming asset coverage ratio was 84% or 191% including collateral as at 30 June 2019, weaker than 89%/203% as at 31 March 2019 and 89%/190% as at 30 June 2018.

- **Loans growth outpacing deposit growth:** The fall in the non-performing loan ratio was also due to balance sheet trends, with total assets up 5.8% y/y and 1.5% q/q. This was driven entirely by growth in net customer loans, which came mainly from growth in loans to building and construction and financial institutions, investment and holding companies. These two segments have the lowest non-performing loan ratio excluding housing loans and loans to professionals and private individuals. By geography, most of the y/y loans growth was in Singapore followed by Thailand and Greater China. Customer deposit growth was lower at 6% y/y and -1% q/q translating to the loan to deposit ratio rising to 88.5% as at 30 June 2019 against 85.7% as at 30 June 2018 and 86.6% as at 31 March 2019. The net stable funding ratio dipped slightly to 108% (110% as at 30 June 2018, 109% as at 31 March 2019) but still remains above the 100% minimum requirement.

- **Broad based segment performance**: UOB's y/y segment performance for 1H2019 and 2Q2019 was balanced with all operating segments delivering growth. Group Retail profit before tax rose 4.5% y/y and 7.8% y/y due to better volumes and higher wealth management fees respectively. Group Wholesale Banking profit before tax rose 1.3% and 6.2% on loans growth and investment banking and treasury customer income for 1H2019 and loans growth, better fee based income and lower allowance for credit and other losses in 2Q2019. Finally, Global Markets improvement for 1H2019 and 2Q2019 was due to higher trading and investment income. Group Wholesale Banking continues to contribute the bulk of consolidated profit before tax at ~55% followed by Group Retail (~36%) and Global Markets (~6%).

- **Fall in capital ratios but could be temporary:** Capital ratios remain solid although stable or reduced against prior periods with CET1/CAR ratios of 13.9%%/17.2% as at 30 June 2019 against 13.9%%/17.0% as at 31 March 2019 and 31 December 2018 and 14.5%/18.4% as at 30 June 2018. The y/y fall in ratios is due to risk weighted assets growth above the growth in capital from earnings. Ratio movement was also impacted by the call of SGD850mn in Additional Tier 1 capital which was balanced somewhat by the issue of USD600mn in Tier 2 capital in April 2019. UOB has another SGD500mn in Additional Tier 1 capital due to call later in 2019 although this should be compensated for by the recent SGD750mn AT1 issue in July 2019. Ratios continue to remain above minimum CET1/CAR capital requirements of 9.0%/12.5%. Given balanced performance across segments, we expect UOB's capital position and earnings to remain solid against potential economic headwinds.

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 scale ("IPS").

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

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. We may also suspend our issuer rating and bond level recommendation in the ordinary course of business if (1) we believe the current issuer profile is incorrect and we have incomplete information to complete a review; or (2) where evolving circumstances and increasingly divergent outcomes for different investors results in less conviction on providing a bond level recommendation.

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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