Issuer Profile:
Positive (2)

Positive (2)

Ticker:
DBSSP
UOBSP

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Singapore Banks – 3Q2020 Review

Recommendation

- **Economic re-openings and ongoing government support measures have stabilized fundamentals for a potential springboard to economic recovery in 2021. However, upside is likely limited given the gradual withdrawal of government relief measures and residing weakness in bank balance sheets not evident by current ratios.**
- **We maintain our Positive (2) issuer profiles for now on expected resilient earnings and existing capital buffers that will enable UOB and DBS to main solid balance sheets for potential future stress and the evolution of its business as a result of COVID-19. While uncertainty has reduced, a cautious outlook continues to predominate.**
- **The DBS and UOB curves look tight in our view despite the solid fundamentals and prevailing COVID-19 concerns. With a potential recovery on the cards and systemic importance for other banks under our coverage, we think European names make sense including BNP 4.35% 29c24s and the CS 5.625% PERPc24s with a yield to call of 2.75% and 4.74% respectively at time of writing (spread of 243bps and 438bps respectively).**

Relative Value:

Bond	Maturity / Call date	Ask YTC	Spread	Recommen-dation
DBSSP 3.8% '28c23s	20/01/2023	1.41%	115bps	UW
DBSSP 3.98% 'PERPc25s	12/09/2025	2.43%	194bps	N
UOBSP 3.5% '29c24s	27/02/2024	1.24%	91bps	UW
UOBSP 4.0% 'PERPc21s	18/05/2021	1.01%	83bps	UW
UOBSP 3.58% 'PERPc26s	17/07/2026	2.51%	195bps	UW

Indicative prices as at 19 November 2020 Source: Bloomberg

Background

- **DBS Group Holdings Limited ("DBS")** primarily operates in Singapore and Hong Kong and is a leading financial services group in Asia with a regional network across 18 markets. With total assets of SGD638.1bn as at 30 September 2020, it provides diversified services across consumer banking, wealth management institutional banking, and treasury. It is 30% indirectly owned by the Singapore government through Temasek Holdings Pte Ltd as of 18th November, 2020.

- **United Overseas Bank Limited ("UOB")** is Singapore's third largest consolidated banking group with total assets of SGD422.1bn as at 30 September 2020. It has a global network of around 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 an 8.0% and 5.14% stake in UOB, respectively, as of 18th November, 2020.

Key Considerations – DBS Group Holdings Limited ("DBS")

- **Past performance influencing the present:** Q/q performance for both DBS and UOB indicate decent business momentum on Singapore's economic re-opening in 3Q2020 although 2Q2020 performance clouded q/q trends. DBS's profit before allowances was down 9% q/q to SGD2.04bn due to a fall in 3Q2020 total income by 4% q/q on lower interest rates (net interest margins fell 9bps q/q to 1.53% while loan balances were stable) and lower trading income. That said, 2Q2020 was a strong quarter for trading income while net fee and commission income was higher in 3Q2020 and the third highest quarterly amount on record on growth in wealth management fees, investment banking fees and credit card fees on improved market conditions and consumer spending. Conversely, UOB's

3Q2020 performance saw a q/q recovery in margins (net interest margins up 5bps q/q to 1.53%) and business conditions with operating profit up 3% q/q to SGD1.25bn.

- **1H2020 provisioning could be telling for 2H2020 results:** Net profit after tax performance was the inverse of pre-provision performance with DBS profit before tax ("PBT") recovering 6% q/q for 3Q2020 to SGD1.48bn. At the same time, UOB's net profit after tax was down 5% q/q to SGD668mn. Driving the performance was a 35% q/q fall in allowances for credit and other losses for DBS to SGD554mn while UOB's impairments rose 20% q/q. Movements to an extent are not surprising given relative provisioning levels in 1H2020 with DBS being more pre-emptive in its 1H2020 allowance build-up compared to UOB with 3Q2020 looking like a catch up for UOB. 71% or SGD339mn of UOB's SGD477mn 3Q2020 impairment charges related to allowances for non-impaired assets. Supporting this to an extent is an improved non-performing loan ratio and non-performing asset coverage ratio q/q for UOB at 1.5% and 111% respectively as at 30 September 2020 (1.6% and 96% as at 30 June 2020) on higher upgrades and recoveries and lower non-performing asset formation in 3Q2020. That said, underlying loan quality trends indicate a potential continuation of elevated loan impairments in the future. Although allowances on impaired loans for UOB rose 48.9% q/q to SGD134mn, it remains slower than allowances on impaired loans recognized in 3Q2019 and 4Q2019 (SGD149mn and SGD161mn respectively). In addition, although allowances for credit and other losses fell 35% q/q for DBS, this was driven by a 58% q/q fall in allowances for performing assets (stage 1 and 2 or general provisions). Conversely, allowances for non-performing assets (stage 3 or specific provisions) rose 10% q/q. Total non-performing assets rose 2.6% q/q however within this was a ~370% q/q rise in new non-performing assets that was offset by higher write-offs. DBS loan quality metrics though are only slightly weaker with the non-performing loan ratio at 1.6% as at 30 September 2020 against 1.5% as at 30 June 2020 while coverage ratios remain sound (and improved on a y/y basis) with the ratio of total allowances and regulatory loss allowance reserves to non-performing assets at 107% as at 30 September 2020 (106% and 96% as at 30 June 2020 and 30 September 2019). All these ratios should be read with caution however with UOB's management noting that the stability in non-performing loan balances is due to loan moratorium reliefs.

- **Capital continues to be the cushion:** Other credit metrics for DBS remain sound given earnings and stable loan quality performance. DBS' CET1 ratio improved q/q and y/y by 20bps and 10bps respectively to 13.9% as at 30 September 2020 although was down compared to 14.1% as at 31 December 2019. This was due to earnings and stable risk-weighted assets. The ratio remains well above the 9.1% minimum CET1 requirement. Its leverage ratio, liquidity ratio and net stable funding ratio was 6.9%, 135%, and 123% respectively as at 30 September 2020, stable or improved on a q/q basis and above regulatory minimum requirements. Similarly, UOB's capital position remained stable q/q at 14.0% as at 30 September 2020 and above its 9.1% minimum requirement while its liquidity coverage ratio and net stable funding ratio remained well above the minimum regulatory requirements (127% and 122% respectively). Regulatory buffers are somewhat improved given delays in implementation of capital strengthening rules due to COVID-19 although the previously mentioned loan moratoriums balance out any fundamental benefit from this in our view.

- **Cautious optimism heading into 2021:** Management at DBS have indicated an expectation of improved business conditions in 2021 and some supportive trends in underlying loan demand with stable loan balances driven by repayment of short-term facilities made in 1H2020, drawdown of non-trade corporate loans and a recovery in demand for Singapore housing loans. That said, with accelerated non-performing asset formation in 3Q2020 and 30% of 3Q2020 allowances for credit and other losses allocated for new non-performing loans, management have kept their total allowance guidance over 2020-2021 unchanged at SGD3-5bn (with SGD2.5bn recognized to date) given likely ongoing non-performing asset formation as government relief programs wind down. Of note is that loan moratoriums to

Corporates increased to SGD13.5bn in 3Q2020 against SGD12.6bn in 2Q2020 while Consumer moratoriums were unchanged at SGD5.7bn. For UOB, the tale is also supportive with loans under moratoriums reduced to 10% of total loans in October 2020 compared to 16% in July 2020 with the resumption of business activity and as loan moratorium schemes are extended in various countries albeit on a more conditional basis. According to UOB management, around 90% of loans under moratoriums are secured by collateral or government guarantees.

- **Diverging developments in DBS's growth markets:** India and Greater China were bright spots in FY2019 in terms of growth with DBS's strategy of expansion in these markets to counter the dependence on Singapore. Expansion in India looks set to continue through wholly owned subsidiary DBS Bank India Ltd ("DBIL") with the proposed scheme to amalgamate Lakshmi Vilas Bank with DBIL. Organized together with the Reserve Bank of India ("RBI"), DBS will inject SGD463mn into DBIL to help it recapitalise Lakshmi Vilas Bank on scheme approval given Lakshmi Vilas Bank has been under increasing financial pressure recently and had pursued other transactions for fresh capital before RBI placed it under a 30-day moratorium and appointed an administrator to halt further pressure on the bank which recently reported losses on rising bad loans and impairment provisions and drove a decline of depositors. Lakshmi Vilas Bank has an established retail and SME customer base in South India, areas previously identified for expansion by DBS in India back in 2019. Given Lakshmi Vilas Bank's recently stressed position, of importance will be understanding the ongoing capital commitments for such an acquisition. Conversely is recent news on Bloomberg that DBS is seeking to freeze assets of Brilliance Auto Group Holdings Co. ("Brilliance Auto") to resolve a legal dispute on overdue loans that have been provided. Brilliance Auto had recently announced a default on CNY6.5bn in debt on liquidity pressures. Developments on this exposure will need to be monitored given the negative impact that unexpected loan losses can have on provisioning levels and earnings.

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 bond represents **better relative value** compared to other bonds from the same issuer, or bonds of other issuers with similar tenor and comparable risk profile.

Neutral ("N") – The represents **fair relative value** compared to other bonds from the same issuer, or bonds of other issuers with similar tenor and comparable risk profile.

Underweight ("UW") – The represents **weaker relative value** compared to other bonds from the same issuer, or bonds of other issuers with similar tenor and comparable risk profile.

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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