

Singapore Banks

Has the tide turned?

Equities

Singapore
Banks

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One of the worst trading days in history for the Singapore banks

Looking back 25 years, we could find only 4 days ("normal" periods) when the Singapore banks performed worse than 12th August (Figure 1). Three of these were heading into a crisis/recession and one was during the Soviet Union collapse (1991). There doesn't appear to be a striking similarity with any of these episodes today. Two of the three Singapore banks are trading below their "normal" trough valuations.

Let's keep a few things in context

All of this year we have argued that rising rates in late stages of credit cycles was not a positive for bank share prices (see Figure 2 & [this](#)). We also expected ROE compression for the sector owing to the weak balance sheet momentum (see [link](#)). We expected earnings to normalize in the next 12-18 months and consensus estimates looked 6-7% too high, even without accounting for higher credit costs (see [link](#)). While there is little direct impact from RMB "devaluation", it adds to all these challenges through second-order effects. We also highlighted recently that valuations appeared to be pricing in a lot of the bad news. The case for that looks even more compelling now.

Trough valuations – a case for a short term rebound

With two of the three banks (UOB & OCBC) trading at levels where they generally trough in "non-crisis" periods, it appears that a lot of bad news might be priced in (Figure 14). We would still be cautious of arguing in favour of a fundamentally bullish case for the sector though. Little balance sheet momentum, hardly exciting NIM improvement and low levels of provisioning and credit costs present a strong case for earnings downgrades in the coming months. A short term rebound is possible but rerating in an environment of negative revisions and rising risks looks highly unlikely.

Early signs of the NPL cycle turning?

We have also argued that rising rates might raise the debt service burden for SMEs potentially causing challenges (see [link](#)). Especially alongside deteriorating economic fundamentals in Singapore (see [this](#)). With the Brent below US\$50, commodity exposures are once again an area of concern. We discussed our estimates of the risks (using syndicate loans as a proxy) [here](#). More recently, a pickup in "past due but not impaired" loans for the sector looks interesting and a potential red flag (see [this](#)).

Singapore banks valuation summary

	Price S\$	Mkt Cap S\$ mn	Target price	Rating	15E P/E	2014-15E RoTE	FY 15E Adj.P/BV	FY 15E yield
DBS	18.64	46,848	20.8	Neutral	11.0x	12.4%	1.37x	3.2%
OCBC	9.50	39,112	11.3	Buy	10.1x	13.6%	1.06x	4.2%
UOB	19.98	32,259	23.8	Neutral	10.4x	12.5%	1.11x	3.8%
Total sector		118,218			10.6x	14.2%	1.18x	3.7%

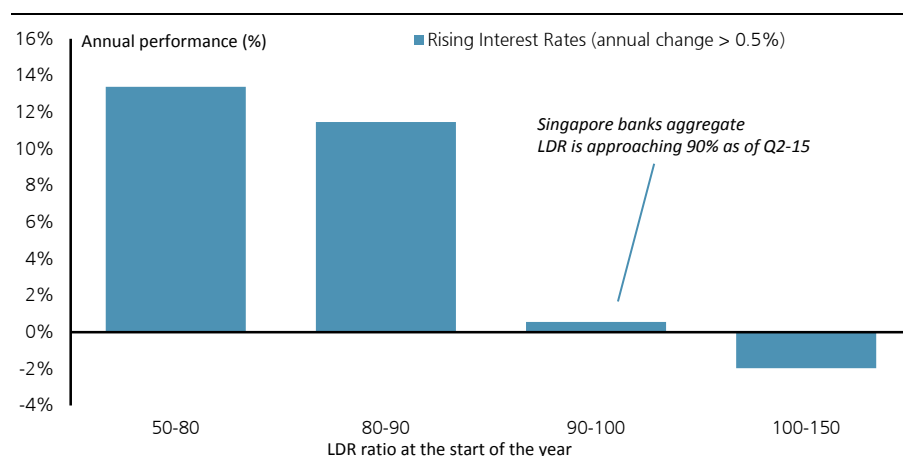
Source: Company data, UBS estimates (prices as of 12th August close)

Figure 1: Worst average performance (on a single trading day) for the Singapore banks in the last 25 years

	Episode description	Day's average	Performance		P/BV	
			6m before	6m after	Historical	Forward
NOT in a crisis / recession ("Normal")	05-Jan-00 Heading into Global recession (dotcom)	-6.1%	32.9%	-14.2%	2.46	2.46
	06-Aug-07 Heading into the GFC	-5.3%	-2.7%	-11.6%	1.70	1.69
	19-Aug-91 Collapse of the Soviet Union	-5.0%	-5.0%	4.7%	1.62	
	28-Oct-97 Heading into the AFC	-7.5%	-8.9%	-5.2%	1.21	
	12-Aug-15 RMB devaluation	-5.2%	-9.4%		1.39	1.08
IN a Crisis / Recession	<i>Average</i>	<i>-6.0%</i>	<i>4.1%</i>	<i>-6.6%</i>	<i>1.75</i>	<i>2.07</i>
	17-Apr-00 Global recession (dotcom)	-8.9%	4.4%	1.7%	2.02	1.96
	07-Jan-98 AFC	-4.8%	-3.5%	-27.7%	1.07	
	08-Jan-98 AFC	-8.6%	-12.1%	-20.6%	1.42	1.46
	12-Sep-01 Global recession (dotcom) / 9-11	-5.2%	-17.7%	29.5%	0.96	
	09-Jan-98 AFC	-10.1%	-20.9%	-11.9%	1.12	1.05
	04-Oct-11 US debt downgrade	-5.1%	-22.0%	22.4%	1.43	1.20
	06-Oct-08 GFC	-5.8%	-22.8%	-25.0%	1.56	1.38
	21-Jan-08 GFC	-6.1%	-24.1%	13.7%	1.29	1.33
	17-Sep-01 Global recession (dotcom) / 9-11	-5.5%	-24.8%	41.6%	1.32	1.11
	10-Oct-08 GFC	-7.3%	-28.8%	-18.7%	0.85	
	12-Jan-98 AFC	-10.7%	-29.4%	-1.2%	1.14	1.16
	21-Sep-01 Global recession (dotcom) / 9-11	-7.3%	-33.9%	61.1%	1.24	1.03
	22-Oct-08 GFC	-6.0%	-34.4%	-11.7%	1.17	0.97
	23-Oct-08 GFC	-5.7%	-38.0%	-6.6%	0.63	
	31-Aug-98 AFC	-5.7%	-44.1%	91.7%	1.03	0.86
	24-Oct-08 GFC	-10.7%	-44.8%	4.9%	0.76	0.77
	02-Mar-09 GFC	-6.7%	-45.9%	82.1%	0.69	0.70
	09-Mar-09 GFC	-6.0%	-51.6%	103.8%	0.52	
	03-Sep-98 AFC	-7.4%	-54.4%	176.6%	0.52	
	<i>Average</i>	<i>-7.0%</i>	<i>-28.9%</i>	<i>26.6%</i>	<i>1.09</i>	<i>1.15</i>
OUT of a recession / crisis	25-Jan-99 Out of the AFC	-7.0%	36.5%	92.8%	1.07	
	11-May-09 Out of the GFC	-5.4%	21.1%	29.7%	1.18	1.29
	<i>Average</i>	<i>-6.2%</i>	<i>28.8%</i>	<i>61.2%</i>	<i>1.13</i>	<i>1.29</i>

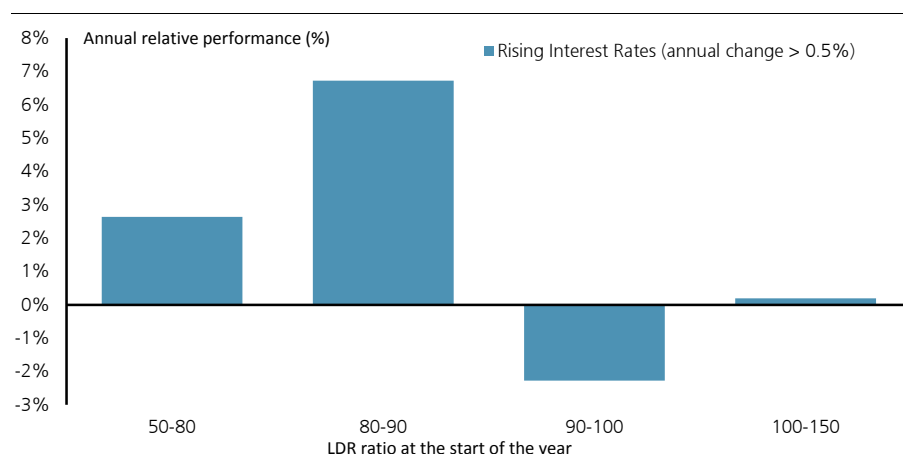
Source: Datastream, prices as of 12th August close

Figure 2: Average absolute performance of Asian banks in the same year as rising interest rates (based on a sample of more than 750 "bank years" in the last two decades)



Source: Datastream, UBS estimates

Figure 3: Average relative performance of Asian banks in the same year as rising interest rates (based on a sample of more than 750 "bank years" in the last two decades)



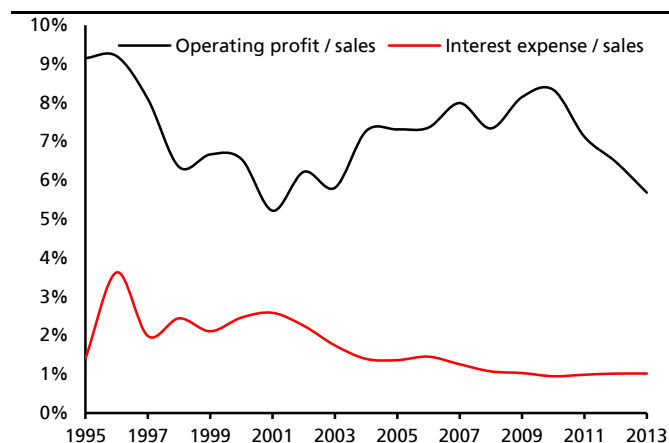
Source: Datastream, UBS estimates

Figure 4: EPS growth surprises using normalized earnings estimates

EPS growth under the normalized framework	DBS	OCBC	UOB
A. Normalized EPS growth - 12m forward vs. trailing (assuming 0% asset growth)	-1.2%	-5.6%	-4.1%
B. Normalized EPS growth - 12m forward vs. trailing (assuming 4-5% asset growth)	3.3%	-1.1%	0.4%
C. Consensus EPS growth - 12m forward vs. trailing	9.1%	5.9%	7.0%
Potential surprise (B-C)	-5.7%	-7.0%	-6.6%

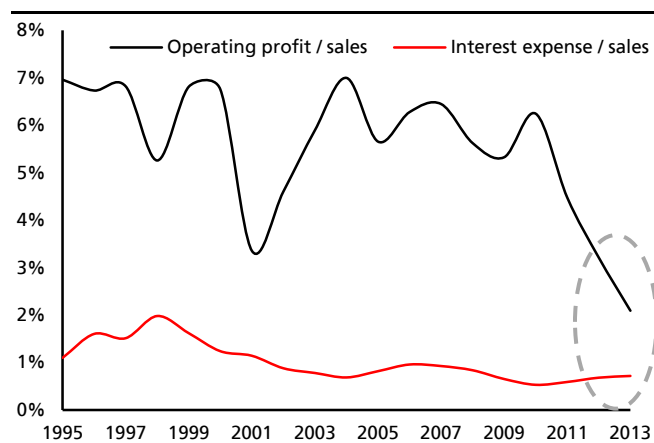
Source: Company data, Datastream, UBS estimates

Figure 5: Aggregate operating profit margins versus interest expense (% of sales) for Singapore listed corporates*



Source: Worldscope, Datastream; * we exclude companies listed on the SGX that do not have any banking relationships in Singapore e.g. most S-chips

Figure 6: Median operating profit margins versus interest expense (% of sales) for Singapore listed corporates*



Source: Worldscope, Datastream; * we exclude companies listed on the SGX that do not have any banking relationships in Singapore e.g. most S-chips

Figure 7: Small caps (sales <\$ 100mn, ~200 cos, median)

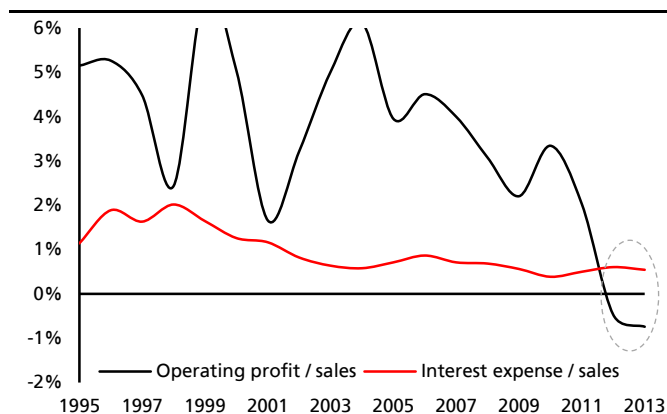


Figure 8: Mid caps (sales ~\$ 100-500mn, ~90 cos, median)

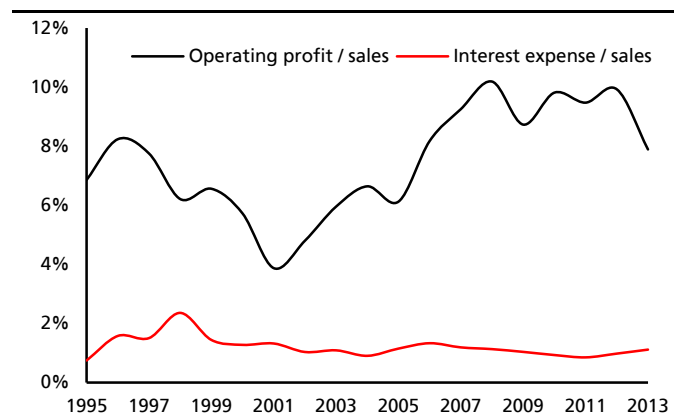


Figure 9: Large caps (sales \$ 500-1000mn, ~15 cos, median)

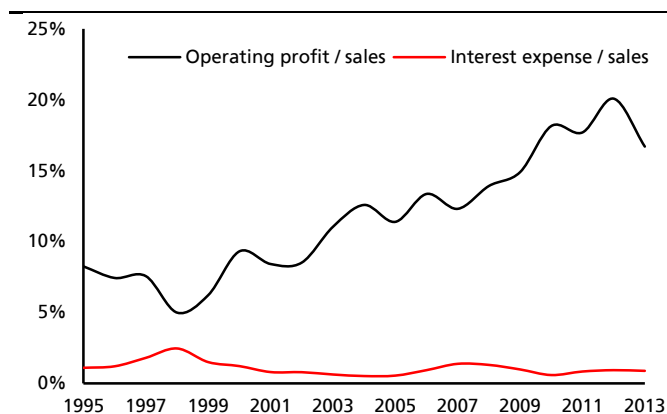


Figure 10: Mega caps (sales >\$ 1000mn, ~30 cos, median)

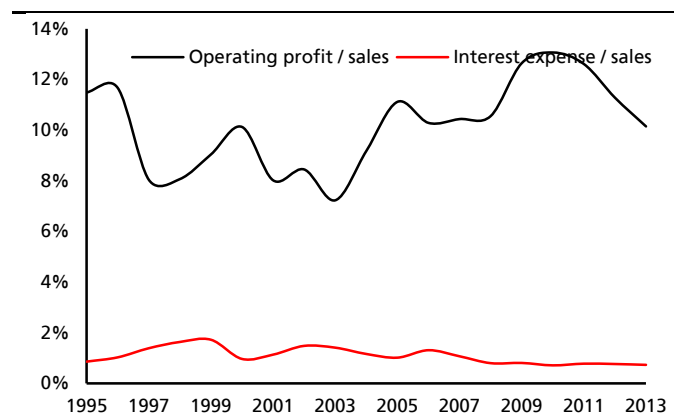
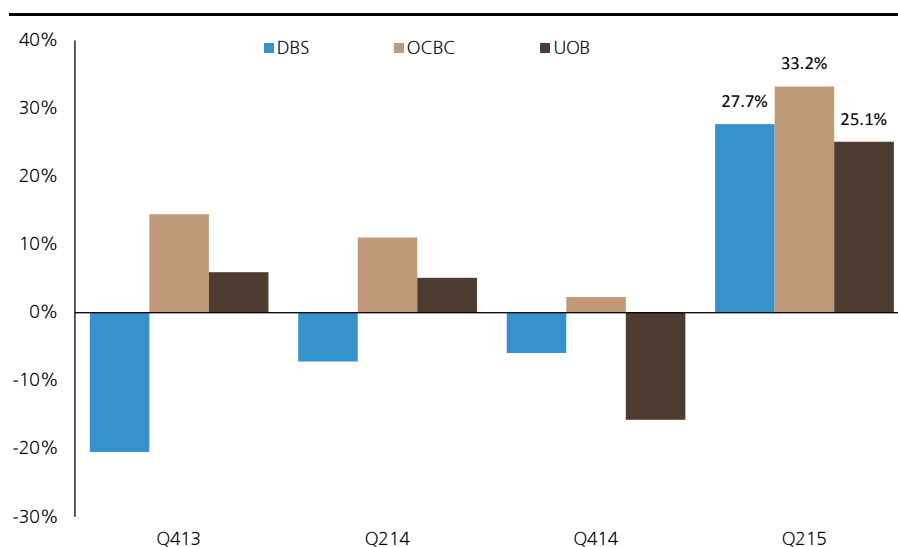


Figure 11: Pickup in "past due but not impaired" loans (H/H)



Consensus long term valuations (P/BV)

Figure 12: DBS - 12m forward P/BV (consensus)



Source: Datastream; prices as of 12th August close

Figure 13: OCBC - 12m forward P/BV (consensus)



Source: Datastream; prices as of 12th August close

Figure 14: UOB - 12m forward P/BV (consensus)



Source: Datastream; prices as of 12th August close

Statement of Risk

The risk to our earnings estimates and ratings is primarily from the macro front. Should economic projections change drastically, we would have to revisit our assumptions and this might lead to a change in our forecasts and recommendations.

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Buy	FSR is > 6% above the MRA.	45%	36%
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Sell	FSR is > 6% below the MRA.	13%	20%
Short-Term Rating	Definition	Coverage ³	IB Services ⁴
Buy	Stock price expected to rise within three months from the time the rating was assigned because of a specific catalyst or event.	less than 1%	less than 1%
Sell	Stock price expected to fall within three months from the time the rating was assigned because of a specific catalyst or event.	less than 1%	less than 1%

Source: UBS. Rating allocations are as of 30 June 2015.

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Company Name	Reuters	12-month rating	Short-term rating	Price	Price date
DBS Group Holdings ²²	DBSM.SI	Neutral	N/A	S\$18.64	12 Aug 2015
OCBC	OCBC.SI	Buy	N/A	S\$9.50	12 Aug 2015
United Overseas Bank ^{2, 4, 5}	UOBH.SI	Neutral	N/A	S\$19.98	12 Aug 2015

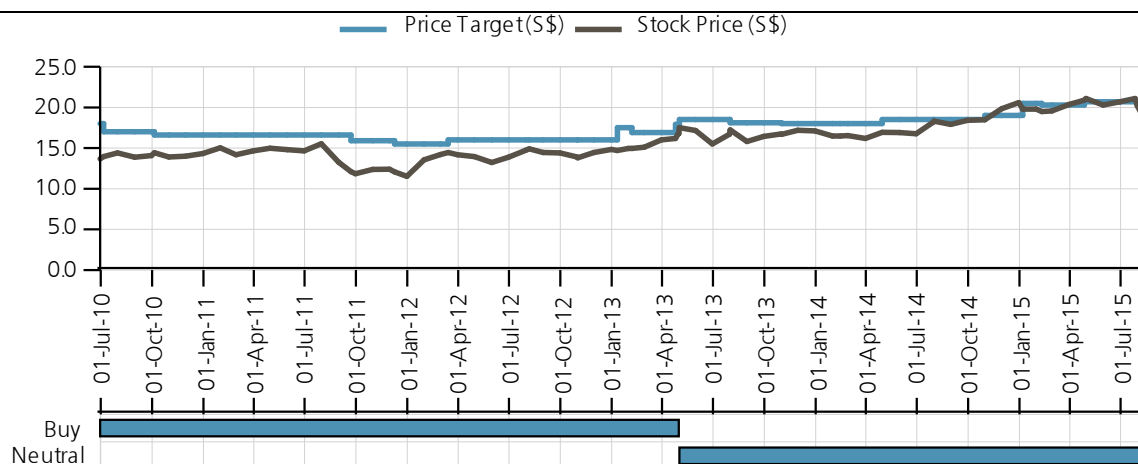
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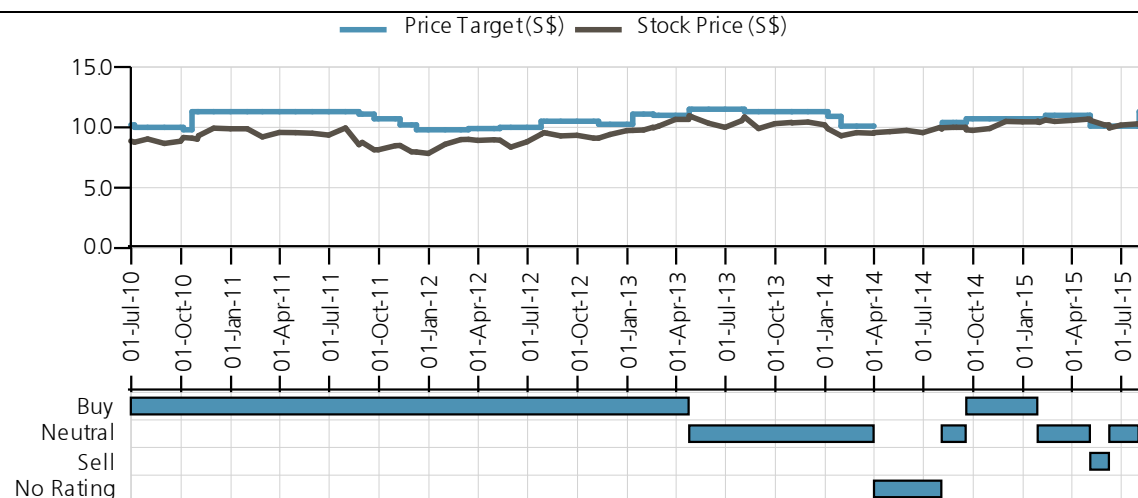
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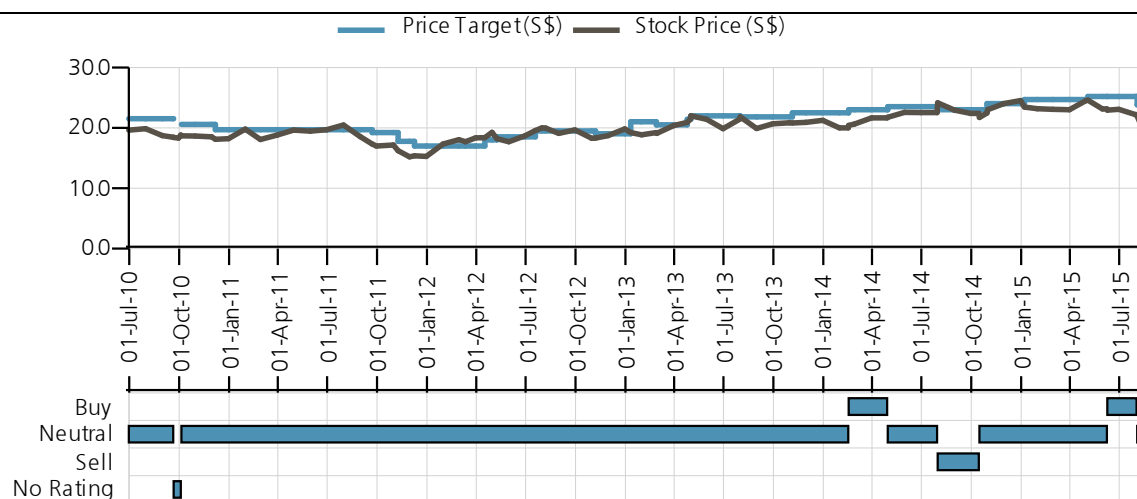
Source: UBS; as of 12 Aug 2015

OCBC (S\$)



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United Overseas Bank (S\$)



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