

SECTOR UPDATE

Banking – Singapore

3Q22 Results Preview: Series Of 75bp Hikes Propels Accelerated NIM Expansion

The Fed has accelerated the pace of rate hikes, leading to massive NIM expansion of 29bp for DBS and 20bp for OCBC in 3Q22. DBS and OCBC grew net interest income by a hefty 41% and 31% yoy respectively. We forecast net profit of S\$2,012m for DBS (+18% yoy and +11% qoq) and S\$1,417m for OCBC (+16% yoy and -4% qoq). BUY DBS (Target: S\$45.75) and OCBC (Target: S\$16.82) for 2023 dividend yields of 5.4% and 5.2% respectively. Maintain OVERWEIGHT.

WHAT'S NEW

- The three local banks will be announcing their 3Q22 results on 28 Oct 22 (UOB), 3 Nov 22 (DBS) and 4 Nov 22 (OCBC).
- DBS Group Holdings (DBS SP/BUY/S\$32.39/Target: S\$45.75)**
 - We forecast net profit to grow 18% yoy and 11% qoq to S\$2,012m in 3Q22. The strong growth was powered by accelerated NIM expansion.
 - Strong pass-through boosted NIM expansion.** We expect healthy loan growth of 5.8% yoy and 1.0% qoq, driven primarily by corporate loans in 3Q22. NIM expanded by a massive 29bp qoq to 1.87%. The US Fed hiked Fed Funds Rate by 50bp on 4 May 22 and 75bp on 15 Jun 22. There was strong pass-through to domestic interest rates with three-month compounded SORA and three-month SIBOR rising 121bp and 126bp qoq respectively to 1.97% and 3.17% in 3Q22. Net interest income grew by a hefty 41% yoy.
 - Fees & commission declined 12% yoy.** Contribution from wealth management held steady at S\$335m despite chopping financial markets and heightened risk aversion. Fees from transaction services are expected to be stable. Contribution from cards increased 12% yoy due to resumption of business and leisure travel.
 - Non-interest income lower yoy due to high base.** We expect other non-interest income to decline 19% yoy in 3Q22. Both net trading income and gains from investment securities are expected to be lower compared to last year.
 - We expect operating expenses to increase 4.2% yoy and cost-to-income ratio at 41.3%.
 - Asset quality remains benign.** We expect NPL ratio to be stable at 1.3%. DBS has ample management overlay for general provisions of S\$1.8b set aside previously due to the COVID-19 pandemic. We expect DBS to top up general provisions in 3Q22 due to deterioration in macroeconomic variables and the uncertain economic outlook. We expect credit cost of 16p in 3Q22, higher than 5bp in 1H22.
 - We expect DBS to maintain quarterly dividend at 36 S cents for 3Q22.
 - Our target price of S\$45.75** is based on 1.94x 2023F P/B, derived from Gordon growth model (ROE: 16.0%, COE: 8.5%, Growth: 1.5%).
- Oversea-Chinese Banking Corporation (OCBC SP/BUY/S\$11.53/Target: S\$16.82)**
 - We forecast net profit of S\$1,417m for 3Q22, representing growth of 16% yoy but a decline of 4% qoq. The strong growth was powered by accelerated NIM expansion.

PEER COMPARISON

Company	Ticker	Rec	Price @ 21 Oct 22 (\$)	Target Price (\$)	Market Cap (US\$m)	FY	PE 2022F	PE 2023F	P/B 2022F	P/B 2023F	P/POP 2022F	P/POP 2023F	Yield 2022F	Yield 2023F	ROE 2022F	ROE 2023F
DBS	DBS SP	BUY	32.39	45.75	58,335	12/2021	10.8	8.9	1.50	1.38	8.9	6.9	4.4	5.4	13.5	15.6
OCBC	OCBC SP	BUY	11.53	16.82	36,259	12/2021	9.0	8.4	0.98	0.92	8.2	7.4	4.9	5.2	10.7	11.0
UOB*	UOB SP	NR	25.99	n.a.	30,457	12/2021	9.8	8.2	1.00	0.94	7.8	6.9	5.0	5.9	10.6	12.0
Average							9.9	8.5	1.16	1.08	8.3	7.1	4.8	5.5	11.6	12.9

* Based on consensus estimate

Source: Bloomberg, UOB Kay Hian

OVERWEIGHT

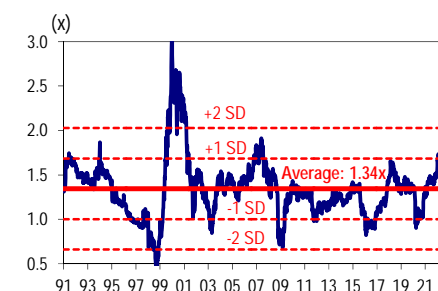
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TOP BUYS

Company	Rec	Share Price (\$)	Target Price (\$)
DBS	BUY	32.39	45.75
OCBC	BUY	11.53	16.82

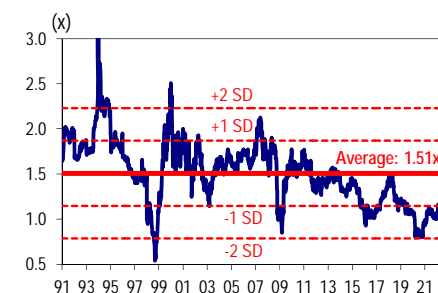
Source: UOB Kay Hian

P/B – DBS



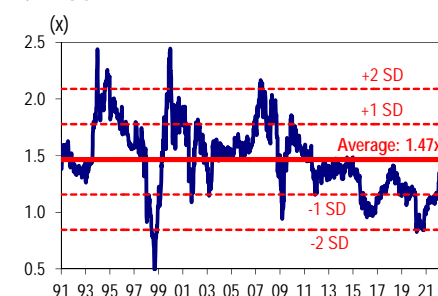
Source: UOB Kay Hian

P/B – OCBC



Source: UOB Kay Hian

P/B – UOB



Source: UOB Kay Hian

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- **On track to achieve mid-single digit loan growth.** We expect loan growth of 5.4% yoy and 0.8% qoq in 3Q22, driven mainly by network customers expanding overseas to acquire logistics, data centre and student accommodation properties and sustainable finance. We expect NIM to expand by 20bp qoq to 1.91%. Net interest income grew by a massive 31% yoy.
- **Fees affected by weakness in financial turmoil and economic slowdown.** We expect fee income to drop 13% yoy in 3Q22. Contribution from wealth management is expected to decline 23% yoy as investors' risk appetite was affected by the Russia-Ukraine war. Loans & trade related fees are expected to drop 11% yoy. We expect contributions from insurance to be stable at S\$300m. Bond markets were in the doldrums with 10-year government bond yield rising 50bp to 3.48% in Singapore and 11bp to 4.41% in Malaysia. We also expect net trading income to be healthy at S\$180m.
- **Asset quality remains stable.** We expect NPL ratio to be stable at 1.3%. OCBC has set aside management overlay of more than S\$400m, which is above the amount of general provisions required by its macro-economic variable (MEV) model. We have factored in higher credit costs of 20bp in 3Q22 (1H22: 7bp), in line with management's guidance of credit costs at 20-25bp for 2022.
- **Our target price of S\$16.82** is based on 1.34x 2023F P/B, derived from the Gordon growth model (ROE: 11.2%, COE: 8.5%, Growth: 0.5%).

ACTION

- **Ferocious rate hikes almost reaching a climax.** The Fed has maintained its disciplined and hawkish stance, hiking the Fed Funds Rate by a third consecutive 75bp to 3.00% after the FOMC meeting on 21 Sep 22. Based on the Fed's dot plot, the median projected path for Fed Funds Rate would hit 4.4% by end-22 and 4.6% by end-23. The projection is expected to lead to continued steep rate hikes on of 75bp on 2 Nov 22 and 50bp on 14 Dec 22, bringing the Fed Funds Rate to 4.25% by end-22. The rate hikes are front-loaded in 2022 and the intensity of rate hikes is expected to be modest in 2023.
- **Anticipating pain but striving to engineer a soft landing.** The Fed is concerned that inflation remains elevated, driven by imbalances between demand and supply. It prioritises quelling inflation and has promised to "keep at it until the job is done." Based on economic projections submitted by FOMC participants, US GDP growth is expected to slow to 1.2% and unemployment rate should rise to 4.4% in 2023.
- **Maintain OVERWEIGHT.** Banks benefit from NIM expansion as liquidity is tightened due to higher interest rates and QT. The Russia-Ukraine war exacerbates higher inflation, which could keep bond yields higher for longer. DBS is the most sensitive to higher interest rates. OCBC and UOB benefit from reorientation of supply chains towards ASEAN countries.
- **BUY DBS** (Target: S\$45.75) and **OCBC** (Target: S\$16.82) for their 2023 dividend yields of 5.4% and 5.2% respectively.

SECTOR CATALYSTS

- NIM expansion in 2022 and 2023, driven by upcycle in interest rates.
- Economic recovery driven by reopening and easing of COVID-19 restrictions.
- Banks pay more dividends as risks emanating from COVID-19 pandemic recede.

ASSUMPTION CHANGES

- We raised our DBS earnings forecast for 2023 by 4.7% due to steep hikes in interest rates in 4Q22 and the resultant positive impact of NIM expansion.

PROFIT & LOSS – FORECAST FOR DBS (3Q22)

Profit & Loss (\$m)	3Q22F	3Q21	yoy % Chg	2022	qoq % Chg
Net Interest Income	2,965	2,104	40.9	2,454	20.8
Fees & Commissions	784	888	-11.8	768	2.0
Other Operating Income	460	569	-19.2	570	-19.3
Total Income	4,209	3,561	18.2	3,792	11.0
Operating Expenses	(1,738)	(1,668)	4.2	(1,658)	4.8
PPoP	2,471	1,893	30.5	2,134	15.8
Provisions	(174)	70	-348.6	(46)	278.2
PBT	2,297	1,963	17.0	2,088	10.0
Net Profit	2,012	1,700	18.3	1,815	10.8
EPS (S cents)	77.2	64.5	19.7	70.0	10.3
DPS (S cents)	36.0	33.0	9.1	36.0	0.0
BVPS (S\$)	21.18	21.43	-1.1	20.78	1.9

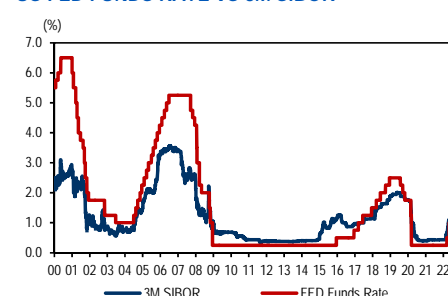
Source: UOB Kay Hian

PROFIT & LOSS – FORECAST FOR OCBC (3Q22)

Profit & Loss (\$m)	3Q22F	3Q21	yoy % Chg	2022	qoq % Chg
Net Interest Income	1,917	1,461	31.2	1,700	12.7
Fees & Commissions	495	569	-13.1	477	3.7
Insurance	300	311	-3.5	423	-29.1
Net Trading Income	180	83	116.9	267	-32.6
Other Non-Interest Income	72	136	-47.1	12	500.0
Total Income	2,963	2,560	15.8	2,879	2.9
Operating Expenses	(1,373)	(1,214)	13.1	(1,280)	7.3
PPOP	1,590	1,346	18.1	1,599	-0.6
Provisions	(150)	(163)	-7.9	(72)	108.5
Associates	224	204	10.0	245	-8.4
PBT	1,664	1,387	20.0	1,772	-6.1
Net Profit	1,417	1,224	15.7	1,481	-4.3
EPS (S cents)	31.5	26.8	17.8	32.8	-3.8
DPS (S cents)	0.0	0.0	n.m.	28.0	n.m.
BVPS (S\$)	11.41	11.28	1.1	11.37	0.3

Source: UOB Kay Hian

US FED FUNDS RATE VS 3M SIBOR



Source: Bloomberg

THREE-MONTH COMPOUNDED SORA



Source: Bloomberg

KEY ASSUMPTIONS – DBS

	2020	2021	2022F	2023F	2024F
Loan Growth (%)	4.2	9.9	5.8	6.7	4.9
NIM (%)	1.63	1.45	1.77	2.27	2.30
Fees, % Chg	0.2	15.2	(8.4)	13.2	8.8
NPL Ratio (%)	1.60	1.27	1.28	1.50	1.52
Credit Costs (bp)	79.7	1.3	10.6	27.5	27.2
Net Profit (\$m)	4,721	6,805	7,792	9,448	10,259
% Chg	(26.1)	44.1	14.5	21.3	8.6

Source: UOB Kay Hian

- We raised our OCBC earnings forecast for 2023 by 3.4% due to steep hikes in interest rates in 4Q22 and the resultant positive impact of NIM expansion.

KEY ASSUMPTIONS – OCBC

	2020	2021	2022F	2023F	2024F
Loan Growth (%)	0.6	8.6	4.5	4.4	5.2
NIM (%)	1.62	1.55	1.83	2.18	2.21
Fees, % Chg	(5.6)	12.0	(11.6)	2.9	6.2
NPL Ratio (%)	1.47	1.45	1.27	1.54	1.53
Credit Costs (bp)	76.7	31.3	14.1	27.1	27.7
Net Profit (\$m)	3,588	4,858	5,757	6,191	6,536
% Chg	(26.3)	35.4	18.5	7.6	5.6

Source: UOB Kay Hian

RISKS

- Escalation of the Russia-Ukraine war beyond Ukraine.
- Geopolitical tension and trade conflict between the US, China and Russia.

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