Singapore Banks: What Now?

Three Survivors Try To Write The Second Act of Consolidation.

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- Return to a Neutral Weighting in Singapore Banks. After being Overweight in Singapore all year on expectations of consolidation, we have returned our market weighting to Neutral post the OUB and Keppel transactions. Valuations, while considerably lower than those of a year ago, are nonetheless not out of line with the rest of the market, or with fundamentals.

- Growth Will Be Slow Through 2003. The recent flurry of transactions is a reaction to an expectation of low growth over the next several years—as foreshadowed by the precipitous fall in GDP. We expect loan growth of only 0.8% in FY2002 and 3.2% in FY2003.

- In-market Consolidations Will Add Significant Value. Singapore stands in stark contrast to the typical consolidating market, where all gains go to the targets and none to the acquisitors. Due to the closed nature of the market and the presence of only two credible bidders for two targets, we calculate that substantial value remains for the acquisitors to take in the form of cost savings.

- Regional Ambitions Continue. Singaporeans continue to have regional ambitions, but values in the region are few and far between and growth in all markets ex-Korea is in at best a shallow upturn. DBS has already impaled itself upon the poison stake that is Dao Heng, and OCBC has been saved from itself only by higher bidders. All three survivors are now positioning themselves for the China market—but we think the payoff is likely to be far-off and centered around non-banking businesses.

- Buy UOB For Singapore Exposure. We are maintaining our views on the three remaining banks in Singapore. Currently, we recommend that investors buy UOB as the best way to leverage the extraction of value from in-market mergers. We see substantial gains from the OUB acquisition, with the potential for additional accretion as non-core assets are worked out.

- Maintain 3-Market Perform on DBS and OCBC. Although we have grown considerably more positive on OCBC on the back of the Keppel acquisition and strengthened management credibility, we are nevertheless maintaining our 3-Market Perform on the shares, pending some concrete indications of a turn-around in financial performance. Finally, DBS (also rated 3-Market Perform) continues as a laggard, having both missed out on in-market consolidation and destroyed value through its acquisition of Dao Heng Bank. Even after a 36% YTD fall, DBS is not yet cheap.

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Table of Contents

Investment Summary 3
Consolidation At Last—But Is It In Time? 6
Earnings Commentary and Projections 8
Rates, Margins, and Competition 11
Banking Liberalization and the Shape of Things to Come 14
Loan Growth 17
Asset Quality 21
Expense Control and Merger Cost Saves 24
Valuation 30
DBS BANK 32
OVERSEA-CHINESE BANKING CORP. 34
UNITED OVERSEAS BANK 36
Table of Figures 38

Except for the con men borrowing money they shouldn't get and the widows who have to visit with the handsome young men in the trust department, no sane person ever enjoyed visiting a bank.

—Martin Mayer, The Money Bazaars

Investment Summary

Neutral on Singapore

We are now NEUTRAL on the Singaporean banks, down from OVERWEIGHT at the beginning of the year. The bank sector is somewhat unexciting post-mergers, and we are positive only on UOB (1–Strong Buy), with DBS and OCBC remaining 3-Market Performers.

Grading Progress

We had looked for three main areas of progress from Singaporean banks this year: Consolidation, better capital management, and resumed growth. Here's how they stack up so far:

- Consolidation: Grade—A. Banks have done exactly as we hoped by buying each other.
- Capital Management: Grade—B-. Acquisitions have helped return capital to shareholders, but the banking sector as a whole still has too much capital and hence low returns.
- Growth: Grade—C+. Although consumer lending has continued to shine, overall loan growth is basically flat, with no improvement likely until FY2003.

Reasons For A Neutral Rating Now

Although Singapore has taken a big step with consolidation, larger issues remain which reduce the market's attractiveness. Keep in mind that "Neutral" means neutral; we have an Underweight category and are not afraid to use it (witness our current roster of five underweight markets).

Unfavorable Macro Environment

From a peak of 9.9% in 2000, Singapore's GDP growth has cratered, with the economy actually contracting 0.9% in 2Q. We now expect aggregate growth of only 0.2% in FY2001, and 6.1% in FY2002. In the industrial sector, production has been declining for six consecutive months, and export growth of -19.5% in July gives us no great hope that an uptick is coming.

In the consumer sector, uncertainty about the future, rising unemployment, and a reverse wealth effect from retail share and property exposure is causing consumers to rein in their spending.

Barring either a recovery in the US or a resurgence of Singapore's Southeast Asian trading partners, Singapore seems bound to suffer a further downturn. In the absence of the growth that this implies, banks will continue to be exposed to a weak manufacturing sector, stagnant property market, and potentially slumping consumer spending/borrowing.

Poor Loan Growth

In a trend which is directly related to the fall in GDP, loan growth has been close to flat since 1998, despite several interest rate cuts and excess liquidity. Although loan growth typically lags behind GDP, we don't foresee any future benefits from the fast growth experienced last year, but anticipate that we will be hit by a decline in loans later in 2001 and 2002 as the current slowdown shows its full effects.

Our lending forecast for Singapore currently projects growth of 2.8% in FY2001 and 0.8% in FY2002, with a pick-up to 5.7% by FY2004. Keep in mind that the Singaporean banks will have to fight for this growth in their home market with increasingly aggressive foreign competitors, but may be able to offset any share loss here with gains in foreign operations such as Malaysia.

Returns Are Still Low

Although better leverage is helping lift core ROEs (*see Figure 6*), the sector return will still only marginally exceed the cost of capital. Returns on assets are perfectly fine despite declining margins—what the banks must do is off-load non-core assets and return capital. Note that DBS is in a somewhat different trap, having used its excess capital to make dilutive acquisitions the bank is more locked-in to a low return in the near term.

DBS: 3—Market Perform

DBS started the competitive game with a host of advantages—government backing, management transparency, a no-bid merger with POS Bank—but has been a value destroyer for shareholders nonetheless. As we have cried in vain for some time, the regional expansion strategy used by DBS has been a device for diluting returns as the bank consistently overpays.

The Dao Heng (DHB) transaction was a poor one; we calculate the IRR of the purchase at 6.5%, or slightly more than half of the cost of capital for DBS. Furthermore, we believe that the market positioning and profitability of mid-sized Hong Kong banks will come under increasing pressure in the future, and this will affect DHB negatively. Finally, as an institution in another geographic market, DHB does not offer the same cost savings as would an in-market merger, limiting DBS' return.

It is somewhat ironic that executing the DHB acquisition probably cost DBS the chance to acquire OUB, which would have brought in-market cost savings, added consumer lending heft, and allowed DBS to penetrate Malaysia.

On 1.4x book (3.4x ABV) and 12.1x 2001 EPS (versus index average of only 9.4x) for a sub-12% ROE, DBS is fairly priced.

OCBC: 3—Market Perform

OCBC has been rebuilding both its performance and its credibility, and is now on an upswing. However, OCBC continues to suffer from fundamental problems including

over-capitalization and its failure to unload non-core assets. While the pending acquisition of Keppel Capital (KEPC) is a good one and will address the leverage issue to some extent, more work remains to be done to keep core ROE moving ahead. We now project a 2002 core ROE of only 9.8%, a significant improvement over the 6.6% lever of FY1999 but still low.

OCBC is also the most dependent of the banks on pure spread income to meet its profit targets, which makes the bank vulnerable to margin compression. That said, OCBC's margins have held up quite well so far. The KEPC acquisition will also help to address OCBC's Achilles' heel, which is that consumer lending has been an area of weakness for some time—this is a sector that management needs to get right, but the task will be more and more difficult as growth slows.

Management is doing a good job of meeting its commitments and targets, which gives us hope that these issues will be addressed. Until then, on 14.1x FY2001 EPS and 1.1x book value (1.7x ABV), OCBC also has little headroom for advancement.

UOB: 1—Strong Buy

UOB is the sleeper of the lot, and the only bank we are currently recommending buying. The institution has consistently had higher returns than its competitors, but has been branded by some as a stodgy family bank. While some of the reputation is due to management's lower transparency versus its competitors, we believe that UOB is misperceived and that its shares have over 30% upside.

UOB has concluded the best of the Singaporean acquisitions. While OUB and Keppel are similar in terms of their Singaporean banking books, both having concentrations in SME and consumer loans, OUB also has substantial non-Singaporean banking assets including a Malaysian bank which will be merged with UOB Malaysia, broking operations (which we expect to be merged into Uob-Kay Hian), corporate finance and investment banking (which will augment UOB's scandal-tarred operation), and asset management with an emphasis on institutional funds rather than retail unit trusts. This deal is both strategically right and financially accretive.

Looking deeper, UOB even pre-merger had the best franchise of the surviving banks, with concentrations in consumer and SME lending and retail asset management. UOB has also been able to consistently outgrow the industry, especially in high-margin retail lending.

With earnings set to move ahead smartly beginning in FY2002, UOB deserves a premium valuation for its higher ROE (reaching 15.9% in 2004) and better growth prospects. While price-to-book is in line with that of DBS at 1.3x, on an adjusted book basis UOB will be well below its competitors at 1.7x as of YE2001.

Consolidation At Last—But Is It In Time?

Banks face a new set of challenges.

Now that the dust is settling from the recent hostile tenders and takeover battles, what do the three remaining Singaporean banks—UOB, OCBC, and DBS—do for an encore? While the strategies of banks in the Lion City have long been essentially identical, the survivors now have fairly distinct portfolios of current business and future options.

The challenge for Singaporean banks will be to find profitable growth opportunities so as to be able to deploy their excess capital—be these inside or outside Singapore. Key business issues to be addressed include:

Excess Capital Remains

While the banks have all taken major steps towards reducing capital by making acquisitions, OCBC and UOB continue to have significant excess capital, particularly when off-balance-sheet assets (reported at over S$4.4 billion, or 52% of reported equity) are taken into account. These banks can not let themselves be put into a position where they are forced to either make regular acquisitions (whether or not the environment or pricing are favorable) or risk lowered ROEs.

An ROE focus will require divestment of non-core assets by OCBC and UOB (DBS has done a quite credible job already) in a less dilatory manner than has thus far been the case. UOB's job will be complicated by the addition of OUB's affiliates and property holdings—even though this should add substantial value to the transaction if properly handled .

In the very near term, Singapore will also need to reconsider its 12% CAR and 10% Tier 1 requirements, which are well above the global benchmarks of 8% and 4%, respectively. With bankers reporting informal pressure to keep their ratios well above this statutory minimum, Singaporean banks must clear a considerably higher profit hurdle than their Asian and global peers. If Singaporean banks are to expand in the region, they will need to do so on even terms.

Where To Find Growth?

Barring a dramatic economic turnaround, credit growth in Singapore will be fairly low through at least 2003. This corresponds well with the period during which all three banks will be occupied with taking profit growth through acquisitions, so it's not an immediate problem for bottom line returns. However, looking at 2004 and beyond, banks will need either to find areas for new growth or to consolidate further—or be bought by foreigners if this becomes allowable.

So far, banks have focused on South Asia (DBS: BPI, TDB; UOB: Radanasin, Westmont), Malaysia (OCBC, UOB) and Hong Kong (DBS: DHB; OCBC: unsuccessful bids for Manhattan Card and FPB) as areas for incremental growth. While the relative rankings may change in the future, it does not now appear that growth prospects in Thailand, the Philippines, and Indonesia are superior enough to earn the Singaporean banks return on

capital. Keep in mind that each of these markets already has many strong local players, and is overbanked to begin with, so that taking appreciable share would seem a difficult task.

Malaysia is somewhat attractive given the poor condition of many of the domestic banks, but foreigners are limited in their ability to open branches (all Singaporeans are at their limits already), so that the ability to exploit this opportunity is limited.

The China Syndrome

China is the wild card in the growth deck—all banks in the region are salivating over the prospects for access to this huge and rapidly industrializing market. In particular, the historically-Chinese Singaporean banks believe that they have a cultural advantage in servicing the mainland market, as well as a network of contacts with ethnic-Chinese diaspora SMEs which are expected to do increased trading business as the country opens up.

In large part, the desire to be in Hong Kong has been predicated not on the SAR's innate attractiveness as a banking market, but on the positioning of Hong Kong as a means of entry into China. We don't think that this makes sense, with the following rationale: China has every incentive to keep its banking market closed (as, we must point out, Singapore is doing) until it is able to list its major banks and use the profits to fund a clean up of bad assets in the system. This will likely take at least five years.

After the state banks are listed, China will probably open up somewhat, but we think that the government will then be very selective in inviting banks with world-class capabilities in various areas to enter the market. This will serve two purposes: first, to promote technology transfer to local banks; and second, to increase the sophistication of the Chinese financial economy and thus benefit local corporates.

This first wave of banks will include the best-of-breed players like Citibank, HSBC, JPMorgan, et cetera. To be included in this category it will take high status within the banking industry and the ability to deliver benefits to China rather than existing Hong Kong exposure. So far, none of the Singaporean banks seem likely to make the grade, and so will have to wait for a further opening of the market.

We do see good prospects for banks to expand in China with non-banking businesses such as insurance and unit trusts, where their cultural advantages can be monetized without requiring retail banking licenses or tremendous balance sheet exposure. Investors should favor this strategy as well, as it is far from a closed issue that banking growth in China will translate into profits for foreign banks, given the dearth of credit-worthy companies, poor disclosure standards, and weak legal and foreclosure proceedings.

Earnings Commentary and Projections

First half earnings season was a disappointment even given low expectations, with only UOB among the major banks hitting analysts reduced estimates. The impetus for consolidation or foreign acquisitions is evident, as the Singaporean market became significantly less favorable this half in almost every area.

Earnings will be driven over the next two years by cost savings (or the lack thereof) from M&A, primarily the in-market transactions at UOB and OCBC. Note also that for the first time we have a material difference between our projected core and net income figures, due mainly to the write-down of goodwill incurred in the various acquisitions.

Figure 1: Bank and Pro-Forma Net Income 1996–2004

	Net Income								
S$, MM	**1996**	**1997**	**1998**	**1999**	**2000**	**2001E**	**2002E**	**2003E**	**2004E**
DBS	669.5	436.4	222.7	1,071.8	1,389.1	1,357.4	1,396.5	1,310.7	1,322.8
OCBC	708.9	581.1	425.3	689.5	840.1	1,011.8	1,199.2	1,319.2	1,381.3
OUB	663.1	255.0	180.4	409.1	545.5	N/M	N/M	N/M	N/M
UOB	715.5	502.0	367.8	760.2	913.4	987.8	1,280.8	1,569.6	1,773.3
KEPC	92.2	73.3	430.1	259.7	301.5	N/M	N/M	N/M	N/M
Pro-Forma:									
OCBC-KEF	801.0	654.4	855.4	949.2	1,141.6	1,011.8	1,199.2	1,319.2	1,381.3
UOB-OUB	1,378.6	757.0	548.2	1,169.3	1,458.9	987.8	1,280.8	1,569.6	1,773.3
DBS-DHB	1,117.3	869.5	354.1	1,392.2	1,822.2	1,357.4	1,396.5	1,310.7	1,322.8
Aggregate	2,849.1	1,847.7	1,626.4	3,190.3	3,989.6	3,356.9	3,876.5	4,199.5	4,477.3
% Increase		-35%	-12%	96%	25%	-16%	15%	8%	7%

Source: Company reports; Lehman Brothers estimates.

What is the Appropriate Measure of Earnings?

How should investors be measuring forward earnings and ROE? We believe that the answer is without goodwill charges.

A key question going forward is which of these earnings measures we should be looking to for guidance on operating performance and investment return. We acknowledge that goodwill is merely an accounting fiction, which in many cases distorts operating performance. Therefore, we are placing the greatest reliance on our measures of core earnings, core ROE, and core ROA, which are measured as follows:

Core Earnings

Our core earnings figure is net earnings plus goodwill charge-offs, less extraordinaries and tax-adjusted securities gains and other disposals. It is meant to give a comparable measure of profit from the underlying core business, with as little exposure as possible to managements' discretionary accounting choices and the timing of asset sales. Note, however, that core earnings *do* include provisions, despite the fact that these are one of the most easily manipulated accounts in the earnings release. This is because we strongly believe that credit provisions are a part of the core business.

Figure 2: Yearly EPS 1998–2004

	Earnings Per Share						% Chg (YoY)				
S$	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**	**2004E**	**2000A**	**2001E**	**2002E**	**2003E**	**2004E**
DBS	0.91	1.14	1.12	1.15	1.08	1.09	26%	-2%	3%	-6%	1%
OCBC	0.54	0.65	0.79	0.93	1.03	1.07	22%	20%	19%	10%	5%
OUB	0.41	0.55	0.60	N/M	N/M	N/M	33%	9%	N/M	N/M	N/M
UOB	0.72	0.87	0.63	0.82	1.00	1.13	20%	-27%	30%	23%	13%
KEPC	0.19	0.22	0.23	N/M	N/M	N/M	15%	7%	N/M	N/M	N/M
Pro-Forma:											
OCBC-KEPC	0.74	0.89	0.79	0.93	1.03	1.07	20%	-11%	19%	10%	5%
UOB-OUB	0.91	1.13	0.63	0.82	1.00	1.13	25%	-45%	30%	23%	13%
DBS-DHB	1.18	1.50	1.12	1.15	1.08	1.09	27%	-26%	3%	-6%	1%
Average							23%	1%	17%	9%	6%

Source: Company reports; Lehman Brothers estimates.

Figure 3: Yearly Core EPS 1998–2004

	Core Earnings Per Share						% Chg (YoY)				
S$	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**	**2004E**	**2000A**	**2001E**	**2002E**	**2003E**	**2004E**
DBS	0.83	1.11	1.16	1.42	1.35	1.36	34%	4%	23%	-5%	1%
OCBC	0.51	0.63	0.79	1.05	1.11	1.16	24%	26%	33%	6%	4%
OUB	0.41	0.55	0.59	N/M	N/M	N/M	33%	8%	N/M	N/M	N/M
UOB	0.71	0.79	0.68	0.95	1.11	1.24	12%	-15%	41%	16%	12%
KEPC	0.17	0.22	0.21	N/M	N/M	N/M	26%	-4%	N/M	N/M	N/M
Pro-Forma:											
OCBC-KEPC	0.69	0.86	0.79	1.05	1.11	1.16	25%	-8%	33%	6%	4%
UOB-OUB	0.90	1.07	0.68	0.95	1.11	1.24	20%	-37%	41%	16%	12%
DBS-DHB	1.07	1.44	1.16	1.42	1.35	1.36	34%	-19%	23%	-5%	1%
Average							26%	4%	32%	6%	6%

Source: Company reports; Lehman Brothers estimates.

Figure 4: Period EPS 1H00–1H02

S$	**1H00A**	**2H00A**	**1H01A**	**2H01E**	**1H02E**	**1H00A**	**2H00A**	**1H01A**	**2H01E**	**1H02E**
DBS	0.60	0.56	0.52	0.60	0.57	-9%	59%	-13%	6%	9%
OCBC	0.35	0.31	0.34	0.45	0.45	57%	-6%	-3%	47%	35%
OUB	0.29	0.25	0.32	0.28	N/M	23%	32%	8%	9%	N/M
UOB	0.39	0.48	0.43	0.34	0.39	22%	14%	11%	-29%	-11%
KEPC	0.10	0.12	0.13	0.11	N/M	18%	-10%	3%	-12%	N/M
Pro-Forma:										
OCBC-KEPC	0.45	0.44	0.47	0.45	0.45	57%	-6%	-3%	3%	-4%
UOB-OUB	0.55	0.59	0.60	0.34	0.39	22%	14%	11%	-42%	-36%
DBS-DHB	0.78	0.81	0.75	0.60	0.57	-9%	59%	-13%	-26%	-25%
Average						22%	18%	1%	4%	11%

Source: Company reports; Lehman Brothers estimates.

Figure 5: Period Core EPS 1H00–1H02

	Core Earnings Per Share					% Chg (YoY)				
S$	**1H00A**	**2H00A**	**1H01A**	**2H01E**	**1H02E**	**1H00A**	**2H00A**	**1H01A**	**2H01E**	**1H02E**
DBS	0.59	0.54	0.42	0.73	0.70	4%	56%	-29%	37%	68%
OCBC	0.35	0.28	0.28	0.51	0.51	58%	-6%	-18%	80%	82%
OUB	0.29	0.25	0.32	0.28	N/M	22%	32%	8%	9%	N/M
UOB	0.36	0.43	0.40	0.41	0.45	16%	5%	10%	-5%	14%
KEPC	0.10	0.12	0.11	0.11	N/M	18%	5%	-15%	-12%	N/M
Pro-Forma:										
OCBC-KEPC	0.45	0.41	0.40	0.51	0.51	58%	-6%	-18%	24%	30%
UOB-OUB	0.53	0.55	0.57	0.41	0.45	16%	5%	10%	-26%	-21%
DBS-DHB	0.76	0.76	0.63	0.73	0.70	4%	56%	-29%	-4%	11%
Average						24%	18%	-9%	22%	55%

Source: Company reports; Lehman Brothers estimates.

Core ROE

ROE in the underlying business should be measured by core earnings over average economic equity ("AEE"). AEE is higher than reported equity, and includes both goodwill and reported real estate revaluation and unrealized securities gains, neither of which are shown on the balance sheet in Singapore.

Figure 6: Core ROE: 1997–2004

	DBS	OCBC	UOB	AVG
Core ROE:				
1997	5.20%	7.16%	7.91%	6.76%
1998	2.43%	3.15%	5.51%	3.70%
1999	8.70%	6.64%	10.23%	8.52%
2000	11.25%	7.45%	10.27%	9.66%
2001	11.57%	8.27%	11.62%	10.49%
2002	13.21%	9.77%	14.65%	12.54%
2003	11.76%	9.79%	15.63%	12.39%
2004	11.17%	9.68%	15.90%	12.25%

Source: Company reports; Lehman Brothers estimates.

Note that on this basis we find UOB a clear leader post its integration of OUB (*see "Expense Control and Merger Cost Savings," on page 24*). Although OCBC also improves markedly, the company is coming off a lower base and has more off-balance-sheet revaluation (some S$4.4 billion) than any of its peers, holding down return. DBS peaks in FY2002 in large part due to the lag effect of AEE averaging in the Dao Heng acquisition.

Rates, Margins, and Competition

The key driver of Singaporean bank results over the past two reporting periods has been the unexpected softness of net interest income. While some of the responsibility for this can be laid at the doorstep of weak loan growth, a more favorable loan mix occasioned by well-above-average growth in the profitable consumer sector should have allowed banks to post better results on a volume basis.

Figure 7: Net Interest Margins: 1H98–1H01

	Net Interest Margin						
Annualized	1H98	2H98	1H99	2H99	1H00	2H00	1H01
DBS	1.87%	2.48%	2.23%	2.16%	2.15%	1.98%	1.76%
OCBC	2.68%	2.58%	2.46%	2.53%	2.42%	2.35%	2.31%
OUB	2.23%	2.06%	2.13%	2.28%	2.45%	2.30%	2.29%
UOB	2.89%	2.72%	2.39%	2.46%	2.25%	2.13%	1.93%
KEPC	1.68%	2.21%	2.30%	2.31%	2.28%	2.38%	2.20%
Average	2.27%	2.41%	2.30%	2.35%	2.31%	2.23%	2.10%
Pro-Forma:							
OCBC-KEPC	2.50%	2.50%	2.42%	2.46%	2.38%	2.36%	2.28%
UOB-OUB	2.57%	2.41%	2.27%	2.38%	2.34%	2.20%	2.08%
DBS-DHB	1.97%	2.39%	2.29%	2.25%	2.28%	2.26%	2.04%

Source: Company reports; Lehman Brothers estimates

The real culprit, then, is interest margins which have steadily trended downwards. The five banks have lost an average of 31bp in NIM since 2H98, despite steadily decreasing levels of foregone interest income on NPLs and more emphasis on high-margin consumer business. The three largest (and surviving) banks did even worse on this measure, dropping an average of 60bp over those 30 months, which can be attributed to the higher growth and retail focus of OUB and Keppel.

Figure 8: Yields on Interest-bearing Funds: 1H98–1H01

	Yield on Interest-bearing Funds				
Annualized	1H99	2H99	1H00	2H00	1H01
DBS	4.56%	4.96%	4.84%	4.95%	4.10%
OCBC	5.95%	5.73%	5.82%	5.83%	5.62%
OUB	5.00%	5.37%	5.16%	5.54%	5.22%
UOB	5.07%	5.17%	5.22%	5.36%	4.88%
KEPC	4.85%	4.96%	5.19%	5.41%	4.79%
Pro-Forma:					
OCBC-KEPC	5.64%	5.50%	5.63%	5.70%	5.38%
UOB-OUB	5.04%	5.25%	5.19%	5.44%	5.02%
DBS-DHB	5.04%	5.45%	5.52%	5.65%	4.59%
Average	5.09%	5.24%	5.24%	5.42%	4.92%

Source: Company reports; Lehman Brothers estimates

Figure 9: Cost of Interest-bearing Liabilities: 1H98–1H01

	Cost of Interest-bearing Liabilities				
Annualized	1H99	2H99	1H00	2H00	1H01
DBS	2.60%	2.81%	3.00%	3.08%	2.94%
OCBC	3.81%	3.59%	3.85%	4.12%	3.75%
OUB	3.15%	3.39%	3.19%	3.52%	3.31%
UOB	2.92%	2.78%	3.45%	3.49%	3.16%
KEPC	2.98%	3.11%	3.28%	3.41%	2.87%
Pro-Forma:					
OCBC-KEPC	3.58%	3.44%	3.68%	3.90%	3.49%
UOB-OUB	3.02%	3.03%	3.34%	3.50%	3.22%
DBS-DHB	3.04%	3.26%	3.48%	3.51%	3.13%
Average	3.09%	3.14%	3.36%	3.52%	3.20%

Source: Company reports; Lehman Brothers estimates

Most of the NIM compression has come on the asset side, although funding costs have increased marginally. A major reason for the higher cost of funds is the increased use of subordinated debt and preferred shares as a substitute for equity capital—a positive change as it leads to more optimal leverage. While equity capital counts as zero-cost funding under the net interest income model, this is clearly far from true in an economic sense.

Mortgage War Typifies Margin Squeeze

The mortgage market, with its highly-publicized rate changes, is a useful microcosm of Asian bank lending in general. Slow loan growth is seemingly leaving banks no option but to cut margins to capture share, although it does not appear that lowered rates have stimulated any additional demand from consumers. Banks are therefore slashing aggregate profitability.

As a consumer product with high informational content and a long average life, mortgages are particularly prized as a means of acquiring consumers, to whom banks hope to cross-sell more profitable credit cards and investment products. Additionally, the low capital requirement and minimal credit loss on residential mortages has made them especially cherished in the risk-averse post-crisis environment.

Figure 10: Singaporean Bank Mortgage Rates: September 2000–August 2001

		Mortgage Rate in Year:					
Bank	**Date**	**1**	**2**	**3**	**4**	**5**	**6+**
DBS	Sep-00	**4.00%**	**5.00%**	5.00%	5.00%	5.00%	5.75%
	Aug-01	**3.00%**	**3.25%**	3.50%	4.75%	4.75%	5.75%
OCBC	Sep-00	**3.75%**	**4.75%**	5.50%	5.50%	5.50%	5.50%
	Aug-01	**2.70%**	**3.80%**	3.50%	4.90%	4.90%	4.90%
OUB	Sep-00	**3.75%**	**4.75%**	5.00%	5.00%	5.00%	5.50%
	Aug-01	**3.00%**	**3.25%**	3.50%	4.75%	4.75%	5.50%
UOB	Sep-00	**3.75%**	**4.75%**	4.88%	4.88%	4.88%	5.50%
	Aug-01	**3.50%**	**3.50%**	**3.50%**	4.75%	4.75%	5.50%
KTLB	Sep-00	**3.50%**	**4.50%**	4.75%	4.75%	4.75%	5.75%
	Aug-01	**3.00%**	**3.25%**	3.50%	4.75%	4.75%	5.75%
StanChart	Sep-00	3.50%	4.50%	5.00%	5.00%	5.00%	5.00%
	Aug-01	2.88%	3.88%	4.25%	4.25%	4.25%	4.50%
ABN AMRO	Sep-00	3.50%	4.25%	4.75%	4.75%	4.75%	4.75%
	Aug-01	**3.25%**	**3.25%**	3.25%	3.75%	3.75%	4.50%
HSBC	Sep-00	**3.75%**	**4.75%**	5.00%	5.00%	5.00%	5.00%
	Aug-01	2.00%	3.65%	5.00%	5.00%	5.00%	5.00%

Rates in **bold** are fixed; others are variable.

Source: Company reports; Dollardex.com.

Regulatory Changes Permit Additional Growth

Amendments to the Banking Act have exempted owner-occupied housing loans from the definition of property loans, which were formerly limited to 30% of banks' deposits. This rule change allows room for further expansion in mortgages and home equity products, as the banking sector was at 90% of its permissible lending limit under the old definition.

Foreign Banks Are Increasingly Aggressive

While the sleepy domestic banking sector has been looking to foreign acquisitions for growth and domestic combinations for efficiency, global competitors are insinuating their way into the wallets of Singaporean consumers. Foreign banks including HSBC,

StanChart, and ABN-AMRO are matching domestic rates aggressively and putting pressure on margins.

Standard Chartered, long a top name in asset management, has amassed a mortgage portfolio of S$4.9 billion, putting it ahead of both OUB and Keppel. HSBC, with 11 branches, ABN, with three branches, and Citibank, with four branches, are also moving ahead swiftly to add balances as they expand their networks under QFB licenses.

Internet lending and phone banks have allowed foreign banks to amass assets without a cumbersome branch infrastructure, and plans underway to form a shared ATM network for foreign banks (led by Citibank and ABN) will add additional points for customer interaction without substantial incremental expense.

As consolidation inevitably leads to branch closures and some degree of customer attrition, foreign banks will no doubt be waiting to peel off dissatisfied customers. In a market without substantial growth, this will probably prevent domestic banks from regaining lost margins on the asset side—even after taking out two major competitors.

Banking Liberalization and the Shape of Things to Come

In a July policy address, MAS Chairman Lee Hsien Loong unveiled the clearest road map yet for banking sector liberalization in Singapore. The most important components of this change will involve the partial opening of Singapore's banking system to foreign banks, and the rationalization of the charter classification system.

While the announced changes take a far from laissez-faire attitude towards the admission of additional competitors, implicit is at least the realization that outside pressure on Singapore's remaining three banks will increase over the next few years. The government's plan appears to be to delay opening key segments of the market for as long as possible to allow domestic banks to become stronger.

In summary, Singapore's retail banking system will remain closed, and may even become more restrictive for foreign banks than it heretofore has been if subsidiarization is implemented. In contrast, the wholesale banking market will be liberalized substantially. However, it is open to question whether foreigners will find potential new regulations commensurate with the relatively low profit to be gained in Singapore.

Foreign Bank Presence — More QFBs, More Powers

Singapore is ready to take applications for two additional Qualifying Full Bank (QFB) licenses, in addition to the four issued in 1999 (to Citibank, Standard Chartered, BNP, and ABN-Amro). Speculation has been that these QFBs will be issued to HSBC (inexplicably overlooked in the last round, but now seen as a lock on grounds of reciprocity post the HKMA's approval of the DBS acquisition of Dao Heng Bank) and Maybank.

QFBs will be permitted to operate up to 10 branches (an increase from five), and up to 15 locations (branches plus ATMs). They will also be permitted to link their ATM networks with each other, although not with domestic banks' networks. With a theoretical maximum network of 90 branches and ATMs, foreign banks will for the first time be able to compete on a relatively even playing field as regards convenience; bear in mind that the just-acquired smaller local banks had only 33-34 branches and 110-150 ATMs.

Finally, QFBs are being granted extra privileges in offering most types of CPF accounts and access to point-of-sale EFT networks.

Wholesale Banking Liberalization

The existing offshore and restricted license banks will be migrated to a new Wholesale Banking License (WBL). WBLs will be able to offer Singapore dollar current accounts and large dollar savings and fixed accounts, mainly focused on the corporate and private banking markets. WBLs, like offshore and restricted banks, may have only a single branch, and no off-premise ATMs.

Twenty new WBLs will be granted over the next two years, beginning with the eight qualifying offshore banks chartered in 1999.

Still No Purchase of Domestic Banks

Mr. Lee confirmed that foreign banks will not be permitted to acquire or control any of the three remaining local banks. However, strategic stake-holdings and partnerships will be permitted as a means of gaining technology transfer, with the threshold for MAS approval set at 12%. It is questionable whether foreign banks will be interested in purchasing minority stakes in the remaining Singaporean banks simply to gain access to the retail market.

We believe that at least two foreign banks have expressed interest in acquired banks (HSBC for Keppel and BNP for OUB) only to be rebuffed by the MAS. Note that Singapore plans to maintain its protectionist attitude towards bank acquisitions even as it hypocritically pushes its domestic banks to purchase franchises in other countries.

Subsidiarization May Negate Liberalization

The MAS is also considering a major new change to its requirements of foreign banks which operate in Singapore. Currently, offices of foreign banks in Singapore operate as branches of the parent bank, with no distinct legal entity required within the country. Subsidiarization would require the chartering of a separate bank–not an unreasonable imposition in and of itself, and one which the MAS quite rightly points out is imposed by many other countries including the US on banks which wish to conduct retail business.

The problem with subsidiarization is that it would force the subsidiary banks to meet the minimum capital requirement of S$1.5 billion in capital and Singapore's minimum CAR of 12%. This means that banks without at least S$12.5 billion in risk-weighted assets (approximately two thirds the size of Keppel Capital Holdings) would be operating with excess capital and unable to manage their balance sheets effectively. On a continuing basis, banks which are required to meet the BIS standard CAR of 8% elsewhere would need to hold 12% against Singaporean risk assets, making the market significantly less attractive.

Although the MAS is well within its rights to insist on prudent regulation of foreign banks operating within its borders, we see this as an unnecessarily protectionist move which will work against the country's desire to become an international financial center.

Bank Consolidation

DPM Lee drove home the government's favorable stance on consolidation, emphasizing that the MAS and the government would not take sides in any bidding contests but reiterating that consolidation is necessary to create large banks which have enough scale for technology investments, et cetera. Comments on the advisability of Australia's "Four Pillars" policy appeared to indicate that the government would look favorably on a further round of consolidation post OCBC-KEPC and UOB-OUB.

Consumer Protection

Looking beyond efficiency, Mr. Lee reminded bankers that consumer service is important, promising to stop mergers which result in anti-competitive practices. Additionally, the prospect of an eventual requirement for banks to offer "lifeline" basic bank accounts to low-income customers without fees was floated; however, DBS is still seen to be fulfilling this social role by operating the POSB system.

Deposit Insurance

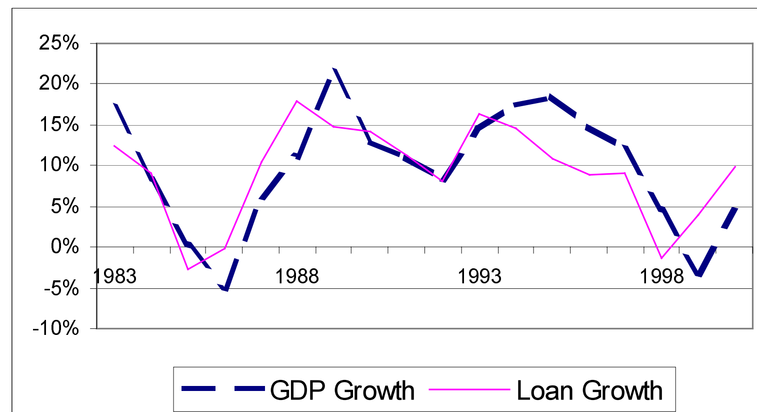
Singapore plans to study implementing a deposit insurance scheme, on the theory that its absence may imply unlimited government support for failing banks so as not to hurt consumers. We don't envision any near-term action on this point, but any implementation will presumably need to be funded by the banks, potentially hurting profits.

Loan Growth

Loan growth has continued at a low level coming out of the financial crisis, rising only 4.3% in 2000 and staying in a similar range in 1H01. Key categories like manufacturing and commerce lending are actually down year on year, with only strength in consumer lending keeping growth moving ahead.

This has been particularly puzzling given the strong GDP updraft experienced by Singapore last year, and the historic correlation between growth in GDP and lending. With economic growth now contracting at 0.9% in the last quarter versus an expansion of 9.9% in FY00, certainly prospects for the next 18 months do not seem promising.

Figure 11: Singaporean Loan Growth *vs.* GDP: 1983–2000

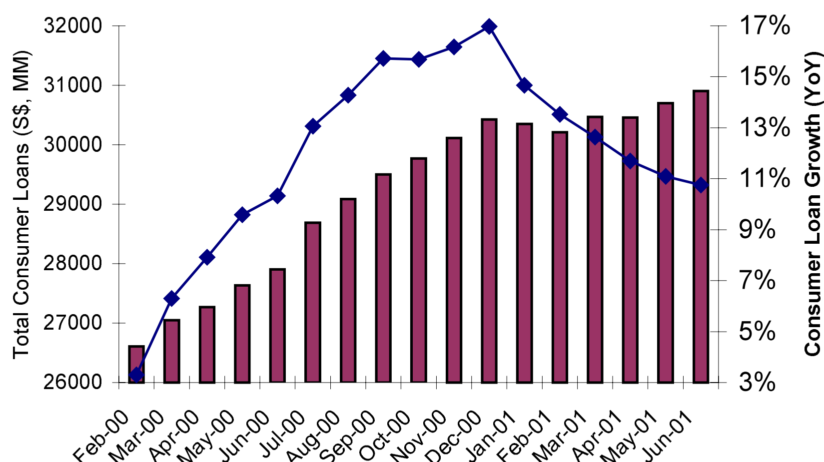


Source:MAS; Asian Development Bank; Lehman Brothers.

As expected given the plunge in GDP, loan growth has already weakened in key areas and been slack overall, despite interest rate cuts. Most notably, banks' consumer lending books are increasing at a declining rate, although they continue to outgrow the rest of the market. Mortgages have retained positive momentum only through a punishing series of margin cuts, which can not continue much further.

We recently revised our loan growth forecast for Singapore down to 2.8% in FY2001 and 0.8% in FY2002, with a pick-up to 5.7% by FY2004. Keep in mind that the Singaporean banks will have to fight for this growth in their home market with increasingly aggressive foreign competitors. However, they may to some extent be able to offset any share loss in Singapore with gains in foreign operations such as Malaysia.

Figure 12: Consumer Lending in Singapore



Source: MAS

Loan Growth: Winners and Losers

FY2000's loan growth was far from evenly distributed, with DBS sustaining a marked loss and OUB and Keppel significantly outperforming. While OCBC did well overall, consumer lending curiously fell by 5.5% in a buoyant market despite the introduction of several new products, making up most of its ground in lower-margin financial institution loans. Surprisingly, the most consistent performers over the past two years were OUB and KTLB, the only banks to post growth in both periods.

In 1H01, growth was more even with UOB, OCBC, and OUB gaining 3-4% and KEPC moderating to 1.15% on a slowdown in mortgage lending. DBS posted a 33% increase due to the consolidation of Dao Heng Bank on the last day of the first half; the company was unwilling to provide a balance sheet for DBS ex-DHB.

Figure 13: Outstanding Loans by Category

Bank and Finance Company Loans by Category (S$, billions)	Total	Manufacturing	Building & Construction	Mortgages	Commerce	Transport, Storage, & Communications	Financial Institutions	Consumer	Other
YE 1996	143.8	12.2	21.4	23.6	23.9	2.6	19.4	25.2	15.2
% of Total	100.0%	8.5%	14.9%	16.4%	16.6%	1.8%	13.5%	17.6%	10.6%
YE 1997	161.1	12.5	26.2	26.7	26.3	3.6	21.0	27.7	17.1
% of Total	100.0%	7.7%	16.3%	16.5%	16.4%	2.2%	13.0%	17.2%	10.6%
YE 1998	168.4	12.2	25.6	35.6	21.5	4.5	22.7	26.1	20.2
% of Total	100.0%	7.3%	15.2%	21.1%	12.8%	2.6%	13.5%	15.5%	12.0%
YE 1999	162.8	11.6	23.4	38.7	19.9	3.7	21.1	26.0	18.4
% of Total	100.0%	7.1%	14.4%	23.7%	12.3%	2.3%	12.9%	16.0%	11.3%
YE 2000	169.8	11.6	25.6	41.3	19.0	4.1	20.9	30.4	16.9
% of Total	100.0%	6.8%	15.1%	24.3%	11.2%	2.4%	12.3%	17.9%	9.9%
June 2001	173.1	12.1	25.6	42.3	18.8	5.1	22.3	30.9	15.9
% of Total	100.0%	7.0%	14.8%	24.5%	10.9%	3.0%	12.9%	17.9%	9.2%

Source: MAS

Figure 14: Loan Growth By Category, YoY

Loan Growth by Category Year on Year Change, %	Total	Manufacturing	Building & Construction	Mortgages	Commerce	Transport, Storage, & Communications	Financial Institutions	Consumer	Other
FY 1997	12.1%	1.8%	22.6%	12.8%	10.1%	36.5%	8.0%	9.9%	12.4%
FY 1998	4.5%	-1.8%	-2.5%	33.6%	-18.2%	24.7%	8.2%	-5.9%	17.7%
FY 1999	-3.3%	-5.5%	-8.4%	8.5%	-7.4%	-16.1%	-7.3%	-0.3%	-8.8%
FY 2000	4.3%	0.4%	9.4%	6.9%	-4.9%	10.2%	-0.9%	17.0%	-8.3%
June-00	0.8%	4.4%	-1.1%	7.5%	-5.1%	-12.0%	-0.4%	10.3%	-13.5%
July-00	2.3%	1.5%	-0.6%	7.5%	-4.2%	0.5%	4.1%	13.1%	-12.8%
August-00	2.9%	6.2%	2.0%	7.2%	-6.7%	2.2%	4.8%	14.3%	-12.7%
September-00	3.5%	7.3%	4.5%	6.7%	-5.1%	-1.4%	2.4%	15.7%	-11.8%
October-00	3.7%	-0.3%	4.9%	7.3%	-2.6%	-2.2%	2.3%	15.7%	-9.5%
November-00	3.5%	1.6%	6.8%	6.9%	-3.2%	-4.5%	-1.3%	16.2%	-9.7%
December-00	4.3%	0.4%	9.4%	6.9%	-4.9%	10.2%	-0.9%	17.0%	-8.3%
January-01	4.6%	6.8%	10.2%	7.4%	-3.1%	10.3%	0.2%	14.7%	-12.1%
February-01	4.3%	8.0%	10.6%	7.4%	-4.6%	7.3%	-0.8%	13.5%	-11.1%
March-01	4.3%	4.7%	13.3%	7.0%	-4.8%	16.7%	-1.9%	12.6%	-11.5%
April-01	4.4%	5.2%	13.0%	7.0%	-4.2%	17.1%	-1.1%	11.7%	-11.1%
May-01	4.2%	1.2%	10.2%	7.0%	-3.6%	17.3%	-1.2%	11.1%	-6.2%
June-01	4.5%	-1.1%	8.8%	6.2%	-1.4%	31.7%	0.2%	10.7%	-5.8%

Source: MAS

Figure 15: Loan Growth by Category, MoM

Loan Growth by Category Month-on-Month Change, %	Total	Manufacturing	Building & Construction	Mortgages	Commerce	Transport, Storage, & Communications	Financial Institutions	Consumer	Other
May-99	(0.7%)	(1.0%)	(2.2%)	0.8%	(1.2%)	(2.8%)	0.7%	(0.2%)	(2.7%)
June-99	0.3%	(2.5%)	(2.2%)	1.1%	(1.4%)	4.9%	3.5%	0.3%	1.0%
July-99	(1.0%)	(3.6%)	3.1%	0.6%	(0.5%)	(11.5%)	(8.0%)	0.3%	0.4%
August-99	(0.1%)	0.0%	(0.5%)	0.8%	0.7%	(0.8%)	(1.8%)	0.3%	(0.9%)
September-99	(0.7%)	(3.2%)	(2.2%)	0.7%	(1.4%)	0.8%	1.5%	0.2%	(3.3%)
October-99	0.3%	3.0%	(0.1%)	0.0%	0.7%	(3.1%)	0.3%	0.9%	(0.9%)
November-99	0.6%	0.1%	(0.8%)	1.3%	0.6%	1.2%	2.6%	0.7%	(0.9%)
December-99	0.1%	2.5%	(0.8%)	0.7%	(0.8%)	(2.2%)	0.0%	0.3%	(0.2%)
January-00	0.3%	0.1%	(0.5%)	0.4%	(0.1%)	2.5%	0.5%	1.8%	(0.9%)
February-00	(0.2%)	(0.7%)	(0.8%)	0.4%	(0.9%)	2.7%	0.8%	0.5%	(2.3%)
March-00	(0.3%)	0.2%	(2.6%)	0.4%	(1.6%)	(5.4%)	1.2%	1.7%	(1.8%)
April-00	0.6%	(0.2%)	0.6%	0.3%	0.2%	(0.5%)	1.9%	0.8%	0.1%
May-00	1.1%	3.0%	1.8%	0.6%	(0.4%)	3.3%	3.4%	1.3%	(2.2%)
June-00	0.3%	3.4%	2.0%	0.9%	(1.5%)	1.4%	(2.3%)	1.0%	(1.4%)
July-00	0.3%	(6.4%)	3.5%	0.6%	0.4%	1.1%	(3.8%)	2.8%	1.2%
August-00	0.6%	4.7%	2.1%	0.5%	(1.9%)	0.9%	(1.1%)	1.4%	(0.8%)
September-00	(0.2%)	(2.2%)	0.2%	0.2%	0.3%	(2.8%)	(0.9%)	1.4%	(2.3%)
October-00	0.5%	(4.4%)	0.3%	0.6%	3.3%	(3.8%)	0.1%	0.9%	1.6%
November-00	0.4%	2.1%	0.9%	0.9%	(0.1%)	(1.3%)	(1.0%)	1.2%	(1.1%)
December-00	0.9%	1.2%	1.6%	0.7%	(2.5%)	12.8%	0.4%	1.0%	1.4%
January-01	0.6%	6.4%	0.3%	0.9%	1.8%	2.6%	1.6%	(0.2%)	(5.0%)
February-01	(0.5%)	0.4%	(0.4%)	0.3%	(2.5%)	(0.0%)	(0.1%)	(0.5%)	(1.3%)
March-01	(0.4%)	(2.8%)	(0.2%)	0.1%	(1.9%)	2.9%	0.1%	0.9%	(2.2%)
April-01	0.6%	0.3%	0.4%	0.4%	0.9%	(0.2%)	2.7%	(0.0%)	0.5%
May-01	0.9%	(0.9%)	(0.8%)	0.6%	0.3%	3.4%	3.2%	0.8%	3.2%
June-01	0.6%	1.1%	0.8%	0.1%	0.7%	13.8%	(0.9%)	0.7%	(1.0%)

Source: MAS

Figure 16: Singaporean Bank Loan Portfolios by Sector

% of Portfolio	DBS 1999	DBS 2000	DBS 2001	OCBC 1999	OCBC 2000	OCBC 2001	UOB 1999	UOB 2000	UOB 2001	OUB 1999	OUB 2000	KEPC 1999	KEPC 2000
Manufacturing	10.06%	10.70%	8.74%	8.28%	8.07%	7.50%	8.83%	9.33%	8.65%	7.85%	8.43%	6.60%	6.20%
Building and Construction	16.44%	16.11%	13.91%	16.83%	18.55%	17.47%	10.63%	11.26%	15.48%	22.27%	19.33%	18.75%	16.04%
Housing	28.39%	30.10%	34.53%	14.04%	16.83%	18.12%	25.28%	23.78%	19.43%	12.58%	14.58%	15.80%	19.61%
General Commerce	7.06%	6.83%	7.19%	11.17%	9.55%	7.61%	13.62%	12.16%	10.26%	7.55%	7.55%	10.80%	10.33%
Transport, Storage, and Communication	5.94%	6.44%	8.69%	2.61%	2.73%	3.13%	0.99%	2.24%	2.83%	3.59%	3.56%	4.72%	4.20%
Financial Institutions, Investment, and Holding Companies	8.63%	7.65%	6.48%	18.88%	22.00%	18.90%	15.09%	15.74%	16.65%	19.92%	20.19%	11.15%	9.99%
Consumer Loans	9.84%	11.66%	12.17%	14.79%	12.80%	16.80%	12.58%	13.32%	15.01%	14.20%	14.38%	21.76%	23.53%
Other	13.65%	10.51%	8.28%	13.42%	9.48%	10.47%	12.98%	12.18%	11.68%	12.03%	11.98%	10.42%	10.09%
Total	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%

Source: Company reports; Lehman Brothers estimates.

Figure 17: Singaporean Bank Loan Growth by Sector

Loan Growth by Sector	DBS 1999	DBS 2000	DBS 1H01	OCBC 1999	OCBC 2000	OCBC 1H01	OUB 1999	OUB 2000	OUB 1H01	UOB 1999	UOB 2000	UOB 1H01	KEPC 1999	KEPC 2000	KEPC 1H01
Manufacturing	-12.37%	-1.43%	8.06%	-9.02%	6.38%	0.49%	18.42%	21.41%	7.74%	-1.17%	15.32%	-7.00%	-9.30%	6.31%	2.44%
Building and Construction	8.35%	-9.17%	18.93%	-14.46%	20.32%	2.23%	-17.20%	-1.79%	5.91%	-4.32%	15.61%	9.95%	11.54%	-3.25%	0.29%
Housing	14.27%	-1.72%	51.00%	2.38%	30.87%	4.14%	35.06%	31.11%	1.27%	14.74%	2.74%	2.29%	29.57%	40.33%	0.37%
General Commerce	12.53%	-10.24%	42.72%	-12.54%	-6.63%	-28.25%	-32.30%	12.99%	5.61%	-3.43%	-2.50%	10.01%	-12.64%	8.20%	-1.15%
Transport, Storage, and Communication	-11.18%	0.46%	75.94%	-10.95%	14.30%	3.57%	36.69%	12.29%	10.28%	-23.24%	146.18%	-12.98%	80.91%	0.47%	-5.96%
Financial Institutions, Investment, and Holding Companies	-30.12%	-17.85%	14.87%	-11.90%	23.96%	8.46%	20.27%	17.64%	2.39%	-13.36%	12.06%	-2.17%	13.12%	1.51%	9.05%
Consumer Loans	13.37%	9.88%	33.45%	-15.81%	-5.54%	6.97%	11.75%	14.60%	4.04%	1.45%	15.64%	11.25%	4.99%	22.28%	4.44%
Other	-13.67%	-28.65%	9.12%	-0.29%	-22.86%	16.46%	26.22%	15.97%	3.43%	-1.41%	2.41%	2.25%	-19.39%	7.71%	-5.12%
Total	-1.28%	-7.31%	33.07%	-9.61%	9.15%	3.13%	4.79%	13.14%	3.99%	-0.45%	9.20%	3.36%	5.53%	13.08%	1.15%

Source: Company reports; Lehman Brothers estimates.

Figure 18: Industry Loan Growth by Sector: 2000–2004

	2000			2001			2002			2003			2004		
	1H Act.	2H Act.	Year Act.	1H Act.	2H Est.	Year Est.	1H Est.	2H Est.	Year Est.	1H Est.	2H Est.	Year Est.	1H Est.	2H Est.	Year Est.
Total Loan Growth	1.7%	2.5%	4.3%	1.9%	0.9%	2.8%	0.3%	0.6%	0.8%	1.2%	2.0%	3.2%	2.6%	3.0%	5.7%
By Sector:															
Manufacturing	5.9%	-5.2%	0.4%	4.4%	2.1%	6.5%	-1.5%	-3.0%	-4.5%	0.5%	3.0%	3.5%	3.0%	3.0%	6.0%
Building and Construction	0.5%	8.9%	9.4%	-0.1%	-0.5%	-0.6%	-0.2%	-0.5%	-0.7%	2.0%	2.5%	4.5%	2.0%	3.0%	5.0%
Housing	3.1%	3.7%	6.9%	2.4%	2.8%	5.2%	2.9%	3.5%	6.4%	3.0%	3.0%	6.0%	4.0%	4.0%	8.0%
General Commerce	-4.3%	-0.6%	-4.9%	-0.8%	-0.2%	-1.0%	-2.0%	-1.3%	-3.3%	-1.3%	0.5%	-0.8%	1.0%	2.0%	3.0%
Transport, Storage, and Communication	3.7%	6.2%	10.2%	23.9%	2.0%	25.9%	2.0%	1.5%	3.5%	1.5%	1.5%	3.0%	1.5%	1.5%	3.0%
Financial Institutions	5.6%	-6.2%	-0.9%	6.7%	-1.5%	5.2%	-3.0%	-3.0%	-6.0%	-3.0%	-3.0%	-6.0%	1.0%	1.0%	2.0%
Consumer Loans	7.3%	9.0%	17.0%	1.6%	2.1%	3.7%	1.8%	2.6%	4.4%	2.5%	4.5%	7.0%	4.0%	4.5%	8.5%
Other	-8.3%	0.0%	-8.3%	-5.8%	-1.0%	-6.8%	-1.0%	-1.0%	-2.0%	0.5%	0.5%	1.0%	0.5%	0.5%	1.0%

Source: MAS; Lehman Brothers estimates.

Asset Quality

Asset quality has not been a key problem at the Singaporean banks due to their relative protection from the Asian crisis, and to generally strong prudential standards for underwriting. However, classified loans as a percentage of customer loans are still very high by global standards, at an average of 8.0% as of 1H01. Note further that this figure is understated due to the consolidation of DHB into DBS at period-end, dropping the DBS ratio from 8.1% to 5.7%.

NPLs have been stubborn despite an estimated S$2.1 billion in net write-offs for the sector as a whole. In the latest period, NPLs fell only 2.1% on average from the previous half, although results have been satisfactory on a year-over-year basis. Excluding the extraordinary write-offs at DBS Thai Danu Bank, Singapore-domiciled credit quality appears to be gaining ground very slowly—even before the current economic slowdown.

Weighted Classified Assets Declining More Slowly

Although headline NPLs are declining, a more revealing mode of analysis concentrates not only on the volume of bad loans but also on their severity. The ratio of weighted classified assets to customer loans is calculated for Singaporean banks as follows:

Figure 19: Weighted Classification Ratio Calculation

$$WCR = \frac{[(\text{Substandard Loans} \times 0.2) + (\text{Doubtful Loans} \times 0.5) + (\text{Loss Loans} \times 1.0)]}{\text{Total Customer Loans}}$$

Source: Lehman Brothers.

Reserves Generally Adequate

Despite remaining NPLs, loan loss reserves at all five banks except for OUB meet our rather strict standards, with OCBC overshooting by a further 21%. OUB has persistently run with a lower coverage ratio than its peers, and this will pull the combined UOB-OUB entity into an under-reserved position by approximately 2.5% of capital. We don't consider this material, but it is the main reason why we forecast UOB's provisions to remain comparatively constant in 2001–2003.

Loan Loss Provisions Will Bottom-out in 2002

Given that NPLs are still fairly high by developed market standards, we estimate that loan loss provisions will bottom-out in FY2002 at an average of 0.04% of assets, down from 1.20% in FY1998. With our base-case estimate of charge-offs running at 50bp on the customer loan portfolio, it is difficult to see this low level persisting regardless of the economic condition.

Figure 20: Gross NPLs

	Gross NPLs					% Change, YoY			
S$, MM	1997	1998	1999	2000	1H01	1998	1999	2000	1H01
DBS	1,112	7,086	8,149	4,411	4,109	537.2%	15.0%	-45.9%	-46.4%
OCBC	1,845	4,059	4,335	4,092	3,921	120.0%	6.8%	-5.6%	-13.8%
OUB	613	2,888	2,991	2,829	3,020	371.1%	3.6%	-5.4%	7.2%
UOB	991	2,191	2,993	2,610	2,507	121.2%	36.6%	-12.8%	-14.9%
KEPC	169	2,213	1,777	1,774	1,733	1210.6%	-19.7%	-0.2%	-0.3%
Pro-Forma:									
OCBC-KEPC	2,014	6,272	6,102	5,866	5,654	211.5%	-2.7%	-3.9%	-0.3%
UOB-OUB	1,604	5,079	5,984	5,439	5,527	216.7%	17.8%	-9.1%	-0.3%
DBS-DHB	1,263	7,634	8,780	5,008	4,707	504.5%	15.0%	-43.0%	-0.3%
Average						472.0%	8.5%	-14.0%	-13.6%

Source: Company reports; Lehman Brothers estimates.

Figure 21: NPLs as a Percentage of Customer Loans

	NPLs, % of Customer Loans					
	1998	1999	2000	2001	2002	2003
DBS	12.0%	13.9%	8.1%	5.8%	4.5%	3.9%
OCBC	11.4%	13.4%	11.6%	10.3%	9.6%	8.6%
OUB	11.5%	11.4%	9.5%	N/M	N/M	N/M
UOB	7.5%	10.3%	8.2%	8.3%	6.6%	5.2%
KEPC	17.4%	13.2%	11.7%	N/M	N/M	N/M
Pro-Forma:						
OCBC-KEPC	12.9%	13.3%	11.6%	10.3%	9.6%	8.6%
UOB-OUB	9.4%	10.8%	8.9%	8.3%	6.6%	5.2%
DBS-DHB	10.3%	11.9%	7.1%	5.8%	4.5%	3.9%
Average	11.9%	12.5%	9.8%	8.1%	6.9%	5.9%

Source: Company reports; Lehman Brothers estimates.

Figure 22: Weighted Classified Assets

	Weighted Classification Ratio			
	2H99	1H00	2H00	1H01
DBS	6.6%	6.1%	2.6%	1.8%
OCBC	4.3%	4.8%	4.0%	3.8%
OUB	4.2%	3.6%	3.4%	3.6%
UOB	4.5%	4.6%	3.9%	3.5%
KEPC	5.5%	5.0%	4.5%	4.4%
Pro-Forma:				
OCBC-KEPC	6.6%	7.1%	5.9%	5.6%
UOB-OUB	4.4%	4.2%	3.7%	3.6%
DBS-DHB	7.0%	6.5%	3.0%	2.1%
Average	5.0%	4.8%	3.7%	3.4%

Source: Company reports; Lehman Brothers estimates.

Figure 23: Loan Loss Provisions: 1996–2003

	Loan Loss Provisions								Change in LLP, %		
S$, MM	1996	1997	1998	1999	2000	2001E	2002E	2003E	2000, YoY	2001, YoY	2002, YoY
DBS	85	496	996	1,063	54	56	30	30	-95%	4%	-47%
OCBC	165	569	938	516	139	145	40	70	-73%	4%	-72%
OUB	83	317	474	211	123	N/M	N/M	N/M	-42%	N/M	N/M
UOB	83	335	654	253	93	86	70	70	-63%	-8%	-18%
KEPC	40	123	105	96	24	N/M	N/M	N/M	-75%	N/M	N/M
Pro-Forma:											
OCBC-KEPC	205	692	1,043	612	164	145	40	70	-73%	-11%	-72%
UOB-OUB	166	652	1,128	465	216	86	70	70	-53%	-60%	-18%
DBS-DHB	148	573	1,215	1,177	133	56	30	30	-89%	-58%	-47%
Average									-70%	0%	-46%

Source: Company reports; Lehman Brothers estimates.

Figure 24: Loan Loss Provisions to Average Assets: 1996–2003

	Loan Loss Provisions to Average Assets							
	1996	1997	1998	1999	2000	2001E	2002E	2003E
DBS	0.16%	0.82%	1.21%	1.04%	0.05%	0.05%	0.03%	0.02%
OCBC	0.34%	1.04%	1.66%	0.93%	0.24%	0.19%	0.04%	0.08%
OUB	0.28%	0.88%	1.16%	0.51%	0.29%	N/M	N/M	N/M
UOB	0.18%	0.70%	1.31%	0.50%	0.16%	0.09%	0.06%	0.05%
KEPC	0.74%	1.05%	0.64%	0.44%	0.10%	N/M	N/M	N/M
Pro-Forma:								
OCBC-KEPC	0.38%	1.05%	1.43%	0.78%	0.20%	0.19%	0.04%	0.08%
UOB-OUB	0.22%	0.78%	1.24%	0.50%	0.21%	0.09%	0.06%	0.05%
DBS-DHB	0.23%	0.65%	1.10%	0.89%	0.09%	0.05%	0.03%	0.02%
Average	0.34%	0.90%	1.20%	0.68%	0.17%	0.11%	0.04%	0.05%

Source: Company reports; Lehman Brothers estimates.

Figure 25: Loan Loss Reserve Adequacy at 1H01

1H2001 S$, MM	Loan Loss Reserves	Required Reserves*	Surplus (Deficit)	as a % of Capital
DBS	2,332	2,205	127	1.2%
OCBC	2,215	1,831	384	4.6%
OUB	1,184	1,481	(297)	-5.4%
UOB	1,674	1,703	(29)	-0.4%
KEPC	929	814	115	3.9%
Pro-Forma:				
OCBC-KEPC	3,144	2,645	499	4.4%
UOB-OUB	2,858	3,184	(326)	-2.5%
DBS-DHB	2,689	2,557	132	0.9%
Average				0.8%

* Per Lehman Brothers Model

Source: Company reports; Lehman Brothers estimates.

Expense Control and Merger Cost Saves

In a no-growth environment, nothing counts like efficiency. After a land rush period in 1999–2000 when banks fell all over themselves to make investments (note: an "investment" is defined as something management would prefer not to classify as an "expense" or "cost" in a bad year) in CRM, Internet banking, risk management systems, and other bank technology, the bills have come due—and it appears that the philosophy of investment has allowed the banks to do not much more than keep even with each other.

To be perfectly serious, banks *have* expanded their capabilities to a large extent—and are able to generate demand for new services (*viz.* DBS' expanded Treasury operations)—but profitability has lagged behind. Higher cost-to-income ratios should be expected as banks focus more on the retail market (which costs more to serve), but even so we have the feeling that a lot of investment dollars have been wasted (finatiQ, anyone?).

Figure 26: Overhead and Efficiency Ratios

	Overhead Ratio						Efficiency Ratio					
	1998	1999	2000	2001E	2002E	2003E	1998	1999	2000	2001E	2002E	2003E
DBS	1.11%	1.23%	1.28%	1.41%	1.41%	1.57%	39.58%	33.96%	41.93%	45.57%	45.26%	50.29%
OCBC	0.93%	1.03%	1.23%	1.23%	1.21%	1.15%	24.61%	27.20%	34.15%	35.60%	34.96%	32.53%
OUB	1.00%	1.23%	1.20%	N/M	N/M	N/M	35.14%	38.12%	36.54%	N/M	N/M	N/M
UOB	1.35%	1.26%	1.38%	1.19%	1.07%	0.97%	32.73%	31.21%	38.38%	39.22%	35.77%	31.84%
KEPC	1.08%	1.04%	1.03%	N/M	N/M	N/M	46.22%	32.24%	34.09%	N/M	N/M	N/M
Pro-Forma:												
OCBC-KEPC	0.96%	1.02%	1.17%	1.23%	1.21%	1.15%	27.89%	28.46%	34.14%	35.60%	34.96%	32.53%
UOB-OUB	1.18%	1.23%	1.31%	1.19%	1.07%	0.97%	33.67%	33.99%	37.63%	39.22%	35.77%	31.84%
DBS-DHB	1.17%	1.26%	1.30%	1.41%	1.41%	1.57%	41.75%	35.46%	41.44%	45.57%	45.26%	50.29%
Average	1.09%	1.16%	1.22%	1.28%	1.23%	1.23%	35.66%	32.55%	37.02%	40.13%	38.66%	38.22%

Source: Company reports; Lehman Brothers estimates.

M&A Makes Cost the Only Game in Town

Bank M&A is all about cost saves, with revenue synergies largely illusory. As each bank has just completed an acquisition, and with overall sector growth flat, execution success—and thus the driving force for bank profitability over the next three years—will be a function of extracting expense savings with minimum customer attrition.

There has been much public acrimony over which management teams are best positioned to do this, with DBS trumpeting its past successes and UOB responding by gestures towards its history of parsimonious expenditure.

Market consensus so far is that DBS as a professionally-run bank with a large network and more M&A experience will be faster to take out costs in its DHB acquisition, with this carrying over into the OUB battle, where DBS asserted that it would cut in-market costs more deeply than UOB.

UOB as a family-run bank is seen as likely to preserve more jobs, particularly given the friendly nature of its bid for OUB. Seemingly confirming this view is the UOB plan to incorporate all OUB Board members and much of management into its existing structure.

Significant In-Market Savings Are Not a Given

Although those of us in the analyst and corporate finance communities have rushed to predict cost savings from in-market mergers—and rightly, I would hope—it bears keeping in mind that these reductions are difficult to achieve and sometimes lacking.

At the heart of the DBS argument on superior integration is the conviction that DBS has valuable experience stemming from its absorption of POSBank and Thai Danu Bank in 1998, the group's most significant consolidated acquisitions (aside from the pending Dao Heng merger). As an in-market merger, the POSB transaction would seem to be directly on point as regards UOB-OUB and OCBC-KEPC, with the DBS management experience valuable in looking at DBS-DHB.

While we know that DBS did close a substantial number of overlapping branches (the count now stands at 106, versus approximately 170 at the date of merger announcement), it is difficult to find this reflected in DBS' overall costs.

In order to ascertain the expense changes post-merger, we have gone back and created a pro-forma merged DBS-POSB-TDB expense line for 1997, and adjusted reported consolidated 1998 expenses to allow for consolidation of a full year's expenses (POSB was consolidated from 7/1/98, while TDB was consolidated from 4/1/98).

Figure 27: DBS: Pro-Forma Expense Growth

	1997	1998	1999	2000	2001**
DBS Consolidated*	688.4	847.1	1,064.7	1,246.0	1,497.8
% Chg, YoY		23.1%	25.7%	17.0%	20.2%
DBS Standalone	492.9	625.1			
POSB Standalone	150.0	150.0			
TDB Standalone	45.5	72.0			

* Pro-forma for 1997-1998 **1H01 annualized

Source: Company reports; Lehman Brothers estimates.

Note that total DBS expenses continued to increase at a high rate, with no obvious benefits from POSB and TDB integration. Of course, it is possible that these benefits are present but simply outweighed by increased spending elsewhere, but this would make little difference to investors.

DBS' expenses rose at a 27.7% CAGR between 1996 and 2000, well above the rate of increase shown by its peers, some of whom also completed acquisitions during this period.

Figure 28: Singaporean Banks' Expense CAGRs

	1997	1998	1999	2000	CAGR
DBS	5.2%	53.1%	41.1%	17.0%	27.7%
OCBC	10.7%	-0.3%	9.0%	24.2%	10.5%
UOB	7.0%	-4.9%	2.5%	29.3%	7.7%
OUB	NA	2.1%	23.7%	1.6%	8.7%
Keppel	7.6%	46.4%	28.3%	12.7%	22.9%
Average	7.6%	19.3%	20.9%	16.9%	15.5%

* OUB CAGR is 1997-2000.

Source: Company reports; Lehman Brothers estimates.

For many reasons, looking at the absolute amount of expenses is somewhat misleading. With DBS as a group having grown dramatically in size during this period, some (perhaps significant) increase in expenses should be expected. In figure 29 below, we look at expenses relative to income (Cost to income, or Efficiency ratio) and to average earning assets (Overhead ratio), and at the changes between 1997 and 2000.

Figure 29: Cost-to-Income and Overhead Ratio Migrations 1997–2000

	1997	1998	1999	2000	Chg 97-00
Cost to Income Ratio					
DBS	32.6%	39.6%	34.0%	41.9%	+9.34%
OCBC	26.0%	24.6%	27.2%	34.2%	+8.16%
UOB	35.9%	32.7%	31.2%	38.4%	+2.49%
OUB	35.8%	35.1%	38.1%	36.5%	+0.73%
Keppel	33.7%	46.2%	32.2%	34.1%	+0.43%
Average	32.8%	35.7%	32.5%	37.0%	+4.23%
Overhead Ratio:					
DBS	0.90%	1.11%	1.23%	1.28%	+0.37%
OCBC	1.01%	0.93%	1.03%	1.23%	+0.22%
UOB	1.50%	1.35%	1.26%	1.38%	-0.12%
OUB	1.11%	1.00%	1.23%	1.20%	+0.09%
Keppel	1.02%	1.08%	1.04%	1.03%	+0.02%
Average	1.11%	1.09%	1.16%	1.22%	+0.12%

Source: Company reports; Lehman Brothers estimates.

Once again, DBS looks high in absolute terms compared to its peers, particularly on the cost-to-income measure. (Also note unfavorable trends in 1H01 for DBS, with efficiency slipping to 48.8% and overhead to 1.49%.) Even more revealing is the degree of change over the 1997–2000 period: DBS' cost-to-income rose by 9.34 percentage points against 2.49 percentage points for UOB, and overhead rose by 37bp against a 12bp drop for UOB.

Obviously we believe that cost savings in the latest round of mergers will be considerably higher.

In-market Cost Save Estimates—UOB/OUB

Market perception is that UOB, as a family-run bank, will be unwilling to cut costs at the merged bank. We believe that UOB's attitude towards cost-cutting has been mis-represented, and foresee savings amounting to 47.7% of OUB's existing cost base—some S$113 million per annum at equilibrium.

Figure 30: OUB Cost Saves by Business Line

Total OUB Spending on:	(S$, 000s)	% Cost Saves
Consumer	120,360	35%
Corporate	40,120	50%
Regional	40,120	70%
Treasury	16,520	60%
Stockbroking	18,880	65%
Others	-	40%
Total	236,000	47.7%

Source: Company reports; Lehman Brothers estimates.

Figure 31: OUB Cost Saves by Expense Category

% of savings on:	
Salaries and Benefits	50%
Premises and Equipment	35%
Taxes and Duties	0%
Other Expenses	15%

Source: Company reports; Lehman Brothers estimates.

Discussion

To begin with, UOB management in the past considered acquiring a competitor and eliminating all of the branches and staff. While we do not expect that this will happen in the OUB acquisition (nor should it), this bespeaks a materially more hard-nosed attitude on costs than is commonly supposed.

Group Chairman Wee Cho Yaw was very clear on his plans for the merged bank at the UOB shareholders' meeting in July, saying that the point of bank M&A is either to have "a bigger market share or cut a lot of operating costs," and that in this case his focus is "100% cut costs."

Specific targets were set out in the offer document for OUB, wherein UOB estimated cost savings of S$200–250 million per year, representing 41–51% of OUB's FY2000 cost base. As over 50% of OUB's costs are personnel related, this by definition will mean large job losses, and Mr. Wee has been forthright in stating that there may be over 2,000 layoffs (on an OUB employee base of 4,443 at 1H01). Note that these layoffs are included in our merger charge estimate of S$68 million.

Finally, there has been discussion of the cost effect of keeping on much of OUB's senior management team and the entire Board. To begin with, we consider the addition of many OUB managers (hopefully including CEO Peter Seah) a positive for UOB, in that their performance has been excellent even with OUB's fundamentally weaker franchise. In truth, the cost issue is moot in our opinion, as even managers dismissed as a result of a merger tend to leave with large golden parachutes and severance packages—the bottom line is that OUB's management will probably be paid whether they are retained or not!

Sources of cost savings include:

- Branch Rationalization: UOB intends to close 19 of the combined 93 UOB/OUB Singapore branches within two years, with further cuts to come. Note that this does not include the further rationalization expected to occur with the integration of OUB's finance subsidiary, Overseas Union Trust, which itself has seven branches[1]. In addition, UOB and OUB have overlapping foreign branches, representative offices, and other banking facilities which can be eliminated.

- Malaysia: The good news is that UOB appears to be confident that it can retain both UOB Malaysia and OUB Malaysia, while merging the branch networks for a total of 37 branches.[2] This will produce fairly minimal premises savings, but should still chop away at back office and processing functions.

- IT and Process Functions: UOB and OUB already use fairly similar core banking platforms, making integration—while never a trivial problem—relatively simple. UOB's secret weapon in this regard is EVP Susan Hwee, who has already been through one Singaporean bank merger (that of Keppel Bank and Tat Lee bank in 1998) and so has gained valuable integration experience. In addition, UOB plans to merge the settlement, clearing, credit administration, and treasury areas with substantial savings. In aggregate, management expects these savings alone to amount to some S$85–105 million on a yearly basis.

Figure 32: UOB and OUB: Overlapping Foreign Branches

	UOB	OUB
Malaysia	Branch; Subsidiary (25 Branches)	2 Branches; Subsidiary (13 Branches)
Labuan	Branch	Branch
China:		
Hong Kong	4 Branches; Full License	2 Branches
Shanghai	Branch	Branch
Beijing	Rep. Office	Rep. Office
Shenzen	---	Branch
Guanhzhou	Branch	---
Xiamen	Branch	---
Chengdu	---	Rep. Office
Other Asia-Pacific:		
Tokyo	Branch	Branch
Seoul	Branch	Branch
Sydney	Branch	Branch
Taipei	Branch	Branch
Bangkok	IBF; Subsidiary (63 Branches)	IBF
Manila	Subsidiary (86 Branches)	Agency
Jakarta	Rep. Office; Subsidiary (7 Branches)	Rep. Office
Yangon	Rep. Office	Rep. Office
Ho Chi Minh City	Branch	Rep. Office
Other Global:		
New York	Agency	Agency
London	Branch	Branch
Los Angeles	Agency	Agency
Vancouver	Subsidiary (1 Branch)	---

Source: Company reports; Lehman Brothers estimates.

[1] *For full details please refer to our note of July 19, 2001, entitled: OUB: UOB Offer Will Promote Privatization Of Affiliates.*

[2] *For full details please refer to our note of July 9, 2001, entitled: United Overseas Bank and Overseas Union Bank: Combined Malaysian Operations Analysis.*

In-market Cost Save Estimates—OCBC/Keppel

By comparison, OCBC has done a good job of getting its expense plan out in the market, and projects per annum savings of S$80–100 million, or 33.8–42.2% of Keppel's existing cost base. Our estimate of S$107 million in savings (45.2%) is just past the high end, but we feel that OCBC management has been conservative in its estimation, as it was the only bidder for KEPC and shareholders of Keppel were not asked to take OCBC shares.

Management has also projected a charge of S$120 million for merger-related costs; we are likely to re-classify some of this as normal expense rather than as an extraordinary, and project extraordinaries of S$62 million.

Figure 33: Keppel Cost Saves by Business Line

Total Keppel Spending on:		% Cost Saves
Consumer	134,609	35%
Corporate	46,470	50%
Regional	17,573	70%
Treasury	18,661	60%
Stockbroking	18,208	65%
Others	1,178	40%
Total	236,699	45.2%

Source: Company reports; Lehman Brothers estimates.

Figure 34: Keppel Cost Saves by Expense Category

% of savings on:	
Salaries and Benefits	50%
Premises and Equipment	35%
Taxes and Duties	0%
Other Expenses	15%

Source: Company reports; Lehman Brothers estimates.

Valuation

Our usual value touchstones have been somwehat scrambled due to merger accounting, with current price-to-book ratios set to change drastically, and a looming disparity between book value and adjusted book figures. [A review: our ABV is total economic equity less revaluations, goodwill, and excess capitalized tax loss carry-forwards.]

Based on 1H01 figures, the sector is trading at only 1.38x book, with the three remaining banks averaging 1.25x—which seems fairly reasonable given the average trailing core ROE of 9.7% and low growth prospects. On a YE2001 basis, P/BV declines to only 1.16x despite the acquisitions, as we continue to include goodwill in economic equity.

Figure 35: Valuation Metrics: P/BV and P/ABV

	Book Value		Price / Book		ABV		Price / ABV	
	1H01A	2001E	1H01A	2001E	1H01A	2001E	1H01A	2001E
DBS	9.96	10.38	1.36	1.30	9.00	3.97	1.50	3.40
OCBC	9.99	10.44	1.11	1.06	6.55	5.13	1.69	2.16
OUB	6.27	N/M	1.54	N/M	5.56	N/M	1.74	N/M
UOB	8.31	6.23	1.31	1.75	6.90	2.70	1.58	4.04
KEPC	2.30	N/M	1.58	N/M	2.15	N/M	1.68	N/M
Average			1.38	1.37			1.64	3.20

Source: Company reports; Lehman Brothers estimates.

On an adjusted book basis, things look much different, with absolute ABV declining at all three banks due to goodwill and merger expenses. We project that banks are now trading at 3.2x YE2001 adjusted book value.

While it is perfectly proper to use either post- or pre- goodwill figures for ratios, investors should be careful when using company-provided figures to ascertain that all ratios are presented in a like manner—cash earnings over tangible equity will overstate ROE.

Earnings Relative to Market

On a net income basis, Singaporean banks are currently trading at 15.1x trailing earnings and 14.5x forward earnings, versus weighted index levels of 13.3x and 9.4x, respectively, for the Straits Times Index.

Based on historical trading ranges, the banks are not notably cheap compared with the index; however, both the sector and market are trading at very low multiples vis-a-vis their historic levels.

We would not look for an upward sector re-rating independent of the market based on this data, hence our Neutral view and selective ratings.

Figure 36: Valuation Metrics: Historical and Forward P/E; Share P/E to Index P/E

	Price to Earnings							Share P/E to Index P/E						
	1996A	1997A	1998A	1999A	2000A	2001E	2002E	1996A	1997A	1998A	1999A	2000A	2001E	2002E
DBS	18.16	30.43	60.00	16.37	11.81	12.09	11.75	101%	147%	154%	81%	89%	128%	155%
OCBC	19.52	30.27	28.05	20.87	16.99	14.10	11.90	109%	146%	72%	103%	127%	150%	157%
OUB	10.00	34.60	29.21	17.44	17.58	N/M	N/M	56%	167%	75%	86%	132%	N/M	N/M
UOB	17.87	30.91	25.29	14.67	12.56	17.32	13.35	100%	149%	65%	72%	94%	184%	176%
KEPC	27.55	32.03	6.83	12.14	16.57	N/M	N/M	154%	155%	18%	60%	124%	N/M	N/M
Average	18.62	31.65	29.88	16.30	15.10	14.50	12.33	104%	153%	77%	80%	113%	154%	162%
Straits Times	17.90	20.71	38.86	20.30	13.33	9.42	7.60	--	--	--	--	--	--	--

Source: Bloomberg; Lehman Brothers estimates.

Figure 37: Valuation Metrics: Deposit Premium Valuation: 1H01

SGD, MM	Market Cap	Total Equity	Market Cap Less Equity	Total Deposits	Deposit Premium	Customer Deposits	Deposit Premium
DBS	16,411	12,111	4,301	94,811	4.5%	82,395	5.2%
OCBC	14,274	12,843	1,431	50,769	2.8%	39,537	3.6%
OUB	9,588	6,225	3,363	39,247	8.6%	29,284	11.5%
UOB	11,469	8,749	2,720	58,589	4.6%	44,053	6.2%
KEPC	4,996	3,176	1,820	20,833	8.7%	15,509	11.7%
Average	11,348				5.9%		7.6%

Source: Company reports; Lehman Brothers estimates.

Figure 38: Valuation Metrics: Deposit Premium Valuation: 2H01 Pro-Forma

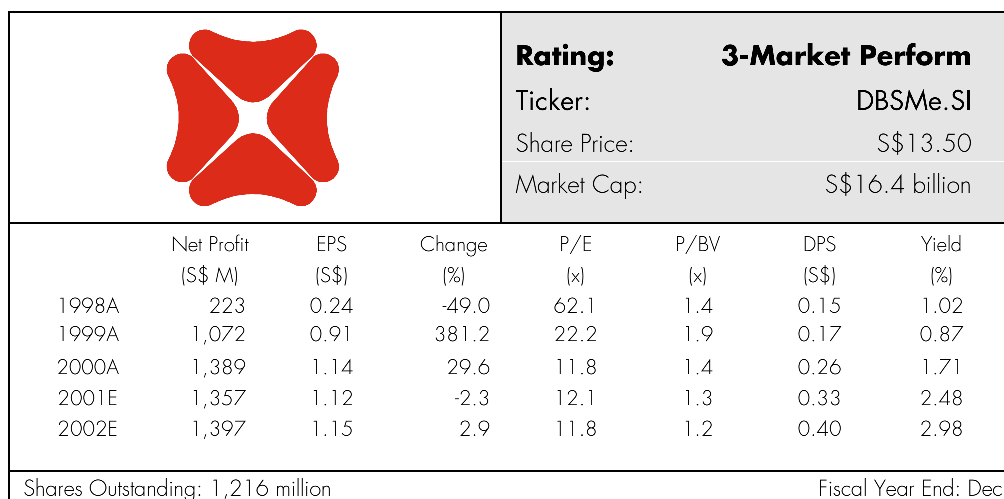
SGD, MM	Market Cap	Total Equity	Market Cap Less Equity	Total Deposits	Deposit Premium	Customer Deposits	Deposit Premium
DBS	16,411	12,620	3,791	96,895	3.9%	84,107	4.5%
OCBC	14,268	13,419	849	73,584	1.2%	56,856	1.5%
UOB*	17,104	15,354	1,750	97,836	1.8%	73,337	2.4%
Average	15,928				2.3%		2.8%

* Adjusted for OUB acquisition shares.

Source: Company reports; Lehman Brothers estimates.

DBS BANK

FEELING THE PAIN



Rating:	**3-Market Perform**
Ticker:	DBSMe.SI
Share Price:	S$13.50
Market Cap:	S$16.4 billion

	Net Profit (S$ M)	EPS (S$)	Change (%)	P/E (x)	P/BV (x)	DPS (S$)	Yield (%)
1998A	223	0.24	-49.0	62.1	1.4	0.15	1.02
1999A	1,072	0.91	381.2	22.2	1.9	0.17	0.87
2000A	1,389	1.14	29.6	11.8	1.4	0.26	1.71
2001E	1,357	1.12	-2.3	12.1	1.3	0.33	2.48
2002E	1,397	1.15	2.9	11.8	1.2	0.40	2.98

Shares Outstanding: 1,216 million — Fiscal Year End: Dec

Key Focus Areas for DBS:

Economic ROE Will Remain Low: While goodwill write-offs will help improve reported ROE, on an economic basis DBS has locked itself into a sub-12% core ROE through at least 2004 because of a series of overpriced acquisitions culminating in Dao Heng.

Strategy Lacks Cohesion: DBS will be the third-largest bank in Singapore, fifth-largest in Hong Kong, and twelfth-largest in Thailand, with a minority stake in the largest bank in the Philippines. This assemblage doesn't appear to have much synergy—and certainly has not produced revenue in proportion to its cost. As DBS no longer has oodles of excess capital, it can't keep on buying market access and will have to develop a better strategy to get value out of existing assets.

Dao Heng Squeeze: DBS has bought into a mid-sized Hong Kong bank just as times are getting rough for the sector—deposit rate deregulation is forcing consolidation of accounts into the large clearing banks even as depositors shift funds from traditional time deposits into unit trusts and other investment products. With 85% time deposit funding, DHB looks very vulnerable just now.

Public Disapproval: Don't underestimate the lingering effects of DBS' missteps in the OUB takeover battle and its closure of POSB branches. Our recent trips to Singapore have revealed an undercurrent of public anger at the bank, with an unscientific sample of citizens expressing their upset at DBS' apparent arrogance. This may prevent DBS from taking as much share during the consolidation of its rivals as it really should.

Figure 39: DBS Summary Sheet

DBS

Share Price:	13.50	**Index:**	1,640.00
52 Week Price Range:	12.40 - 23.10	**Current Yield:**	1.9%
Reuters Code:	DBSMe.SI		
Bloomberg Code:	DBS SP	**Shares Outstanding** (MM):	1,215.66

INCOME STATEMENT (S$m) *year ending Dec*	1998A	1999A	2000A	2001E	2002E
Interest income	4,931	4,608	4,897	5,551	6,144
Interest expense	3,501	2,573	2,858	3,211	3,415
Net interest income	**1,430**	**2,035**	**2,039**	**2,340**	**2,730**
Ave. int. earnings assets	*68,233*	*86,446*	*97,571*	*117,518*	*136,856*
NIM (%)	**2.10%**	**2.35%**	**2.09%**	**1.99%**	**1.99%**
Non-interest income	481	957	886	1,170	1,522
Total operating income	**1,911**	**2,992**	**2,925**	**3,509**	**4,252**
Non-interest expense	-754	-1,065	-1,246	-1,653	-1,925
Pre provision profit	**1,157**	**1,927**	**1,679**	**1,857**	**2,327**
Loan loss provisions	-996	-1,063	-54	-56	-30
Non-operating income	-5	143	50	-22	-331
Pre tax profit	**155**	**1,007**	**1,671**	**1,918**	**2,297**
Tax	-72	-345	-315	-430	-563
Net profit	**223**	**1,072**	**1,389**	**1,357**	**1,397**
Core earnings	**225**	**977**	**1,348**	**1,406**	**1,727**

PER SHARE DATA (S$)	1998A	1999A	2000A	2001E	2002E
EPS	0.24	0.91	1.14	1.12	1.15
DPS	0.15	0.17	0.26	0.33	0.40
Effective payout ratio (%)	*55%*	*19%*	*23%*	*30%*	*35%*
BVPS	10.98	10.44	9.60	10.38	11.13
ABVPS	9.84	9.23	8.63	3.97	4.99

VALUATION	1998A	1999A	2000A	2001E	2002E
Price to book value (x)	1.4	1.9	1.4	1.3	1.2
Price to adjusted book value (x)	1.5	2.2	1.6	3.4	2.7
Price to earnings (x)	62.1	22.2	11.8	12.1	11.8

PROFITABILITY RATIOS (%)	1998A	1999A	2000A	2001E	2002E
Net interest margin	2.10%	2.35%	2.09%	1.99%	1.99%
Yield on interest earning assets	6.31%	4.87%	4.88%	4.12%	4.42%
Cost on interest bearing liabilities	3.93%	2.78%	2.95%	3.13%	3.23%
Net interest spread	2.38%	2.09%	1.93%	0.99%	1.19%
Non-int. income (% Op income)	25.2%	32.0%	30.3%	33.3%	35.8%
Cost to income	39.6%	34.0%	41.9%	45.6%	45.3%
Overhead ratio	1.11%	1.23%	1.28%	1.41%	1.41%
Cost coverage	63.8%	89.9%	71.1%	70.8%	79.1%
ROA	0.27%	1.04%	1.28%	1.21%	1.21%
ROE	2.4%	9.5%	11.6%	11.2%	10.7%

OROA ANALYSIS	1998A	1999A	2000A	2001E	2002E
Net interest margin	2.10%	2.35%	2.09%	1.99%	1.99%
Non-interest inc./gross inc.	24.98%	35.10%	31.37%	35.49%	35.80%
Efficiency ratio	39.58%	33.96%	41.93%	45.57%	45.26%
Provision/assets	1.01%	1.00%	0.05%	0.05%	0.03%
Operating return on assets	**0.68%**	**1.40%**	**1.72%**	**1.63%**	**1.68%**
Equity/assets	10.29%	11.55%	10.49%	11.10%	11.46%
Operating return on equity	**6.62%**	**12.09%**	**16.39%**	**14.70%**	**14.62%**

BALANCE SHEET (S$m) *year ending Dec*	1998A	1999A	2000A	2001E	2002E
Gross loans	76,741	84,439	89,826	126,279	129,772
Loan loss reserves	*2,265*	*4,069*	*2,286*	*2,501*	*2,087*
Net loans	73,609	79,463	86,592	122,590	126,463
Total earning assets	78,188	94,704	100,437	134,600	139,112
Other assets	20,788	11,761	10,791	-20,855	-21,066
Total Assets	**98,975**	**106,465**	**111,228**	**113,745**	**118,045**
Deposits	86,477	89,759	92,774	96,895	100,046
Customer deposits	-	82,268	80,720	84,107	86,742
Other deposits	-	7,491	12,054	12,788	13,305
Other paying liabilities	2,715	2,818	4,219	5,709	5,742
Other liabilities	655	3,012	3,740	6,313	6,192
Total Liabilities	**89,846**	**95,589**	**100,733**	**108,917**	**111,980**
Equity with revaluation	**10,188**	**12,292**	**11,670**	**12,620**	**13,528**
Adjusted equity	**9,129**	**10,876**	**10,495**	**4,827**	**6,066**

BALANCE SHEET RATIOS (%)	1998A	1999A	2000A	2001E	2002E
Loan-to-deposit	87.7%	93.1%	95.8%	129.1%	128.5%
Equity to assets	10.3%	11.5%	10.5%	11.1%	11.5%
Total loan loss provisions	2.99%	4.87%	2.57%	2.00%	1.62%

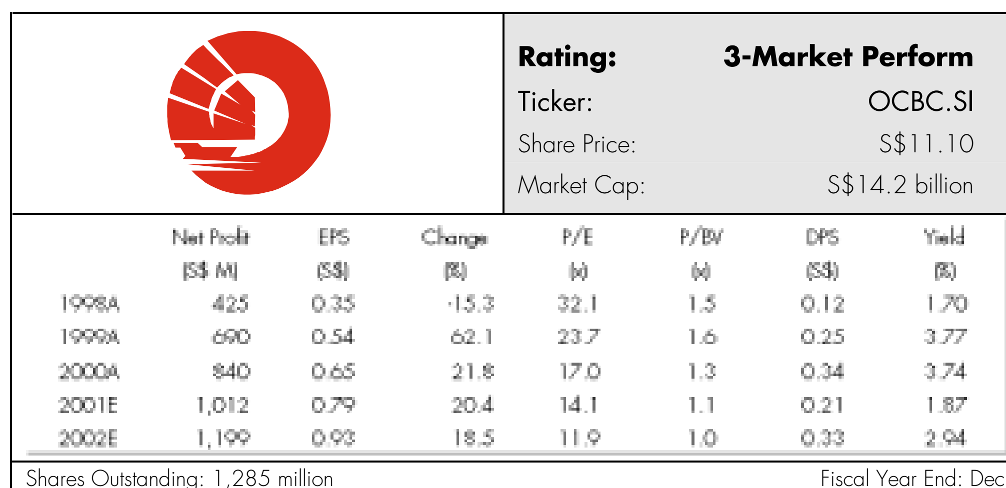
ASSET QUALITY	1998A	1999A	2000A	2001E	2002E
Nonperforming assets	7,086	8,149	4,411	4,203	3,332
Special mention	-	-	-	-	-
Substandard	-	4,952	3,508	3,270	2,514
Doubtful	-	621	358	448	472
Loss	-	2,576	546	484	346
ORE	-	-	-	-	-
NPAs/total loans	9.3%	9.8%	5.0%	3.4%	2.6%
Reserve coverage of NPAs	32.0%	49.9%	51.8%	59.5%	62.6%
Required reserves	n.a	4,640	2,280	2,583	2,349
Actual reserves	2,265	4,069	2,286	2,501	2,087
Shortfall (surplus)	n.a	571	(6)	82	262
Actual to required reserves	n.a	88%	100%	97%	89%
Shortfall to capital	n.a	5%	0%	1%	2%

GROWTH RATES (%)	1998A	1999A	2000A	2001E	2002E
Income statement					
Net interest income	42.7%	42.3%	0.2%	14.7%	16.7%
Non-interest income	-6.7%	131.1%	-15.3%	38.1%	18.2%
Total operating income	26.0%	64.5%	-5.2%	22.1%	17.2%
Non-interest expenses	53.1%	41.1%	17.0%	32.6%	16.4%
Pre-provision earnings	13.0%	79.8%	-16.7%	14.4%	17.9%
Loan loss provisions	101.1%	6.7%	-94.9%	4.0%	-46.9%
Core earnings	-47.4%	333.8%	37.9%	4.3%	22.9%
Net profit	**-49.0%**	**381.2%**	**29.6%**	**-2.3%**	**2.9%**
Balance sheet					
Loan growth	37.9%	8.0%	9.0%	41.6%	3.2%
Interest earning assets	34.2%	14.7%	7.4%	37.5%	3.3%
Asset growth	51.9%	7.6%	4.5%	2.3%	3.8%
Deposit growth	60.0%	3.8%	3.4%	4.4%	3.3%
Shareholders funds	21.8%	19.1%	-3.5%	-54.0%	25.7%

Source: Company reports; Lehman Brothers estimates.

OVERSEA-CHINESE BANKING CORP.

THE LONG ROAD BACK



Rating:	**3-Market Perform**
Ticker:	OCBC.SI
Share Price:	S$11.10
Market Cap:	S$14.2 billion

	Net Profit (S$ M)	EPS (S$)	Change (%)	P/E (x)	P/BV (x)	DPS (S$)	Yield (%)
1998A	425	0.35	-15.3	32.1	1.5	0.12	1.70
1999A	690	0.54	62.1	23.7	1.6	0.25	3.77
2000A	840	0.65	21.8	17.0	1.3	0.34	3.74
2001E	1,012	0.79	20.4	14.1	1.1	0.21	1.87
2002E	1,199	0.93	18.5	11.9	1.0	0.33	2.94

Shares Outstanding: 1,285 million — Fiscal Year End: Dec

Key Focus Areas for OCBC:

Keppel Transaction is Accretive: After bidding threateningly on a variety of unsuitable or richly-priced opportunities, OCBC has in fact concluded the right kind of deal at an excellent price—a tribute to management's savvy. We estimate that cost savings from the Keppel transaction will be significant (see details under "Expenses") and that the leverage impact will help raise OCBC's core ROE by 235 bp over FY2000.

Still Unproven in Consumer Lending: Although the bank did have a good uptick (+7%) in consumer lending in 1H01, this follows two years of portfolio losses—even as the segment expanded rapidly. OCBC badly needs to become successful in the consumer market to preserve its spreads and develop fee income, where it lags behind peers. We believe that the Keppel acquisition will help here, boosting consumer lending (including mortgages) from under 30% of the portfolio to 35%.

Excess Capital Remains: Although OC's CAR will decline close to the bank's 10% Tier 1 target post-Keppel, much of the bank's economic capital remains off-balance-sheet and is thus not counted—but does depress ROE under our methodology. Management needs to address this issue sooner rather than later in order to keep pressing its shareholder-friendly message.

Donwside Risk to Non-Core Asset Valuations: OCBC's off-balance-sheet revaluation reserves primarily consist of property, which the bank was unable to unload near appraised value earlier in the year. Despite this, aggregate revaluation has actually been written up in the first half, due to gains in the bank's Great Eastern Life holdings. We believe that there is a substantial risk that OCBC could not realize appraised value on its real estate, with the shortfall potentially amounting to S$300–900 million.

Figure 40: OCBC Summary Sheet

OCBC

Share Price:	11.10	**Index:**	1,640.00	
52 Week Price Range:	10.00 - 13.50	**Current Yield:**	3.1%	
Reuters Code:	OCBC.SI			
Bloomberg Code:	OCBC SP	**Shares Outstanding** (MM):	1,285.36	

INCOME STATEMENT (S$m) *year ending Dec*	1998A	1999A	2000A	2001E	2002E
Interest income	4,193	2,986	3,158	3,841	4,425
Interest expense	2,778	1,695	1,898	2,190	2,406
Net interest income	**1,415**	**1,291**	**1,260**	**1,651**	**2,019**
Ave. int. earnings assets	*52,183*	*51,087*	*53,295*	*69,370*	*82,752*
NIM (%)	**2.71%**	**2.53%**	**2.37%**	**2.38%**	**2.44%**
Non-interest income	373	607	653	730	847
Total operating income	**1,788**	**1,897**	**1,913**	**2,381**	**2,866**
Non-interest expense	-485	-528	-656	-852	-1,002
Pre provision profit	**1,303**	**1,369**	**1,258**	**1,529**	**1,864**
Loan loss provisions	-938	-516	-139	-145	-40
Non-operating income	181	48	34	-3	-150
Pre tax profit	**546**	**898**	**1,125**	**1,397**	**1,824**
Tax	-117	-206	-305	-355	-456
Net profit	**425**	**690**	**840**	**1,012**	**1,199**
Core earnings	**283**	**652**	**807**	**1,018**	**1,349**

PER SHARE DATA (S$)	1998A	1999A	2000A	2001E	2002E
EPS	0.35	0.54	0.65	0.79	0.93
DPS	0.12	0.25	0.34	0.21	0.33
Effective payout ratio (%)	*34%*	*46%*	*52%*	*26%*	*35%*
BVPS	7.51	8.17	8.71	10.44	11.05
ABVPS	5.51	5.74	6.34	5.13	5.83

VALUATION	1998A	1999A	2000A	2001E	2002E
Price to book value (x)	1.5	1.6	1.3	1.1	1.0
Price to adjusted book value (x)	2.0	2.2	1.8	2.2	1.9
Price to earnings (x)	32.1	23.7	17.0	14.1	11.9

PROFITABILITY RATIOS (%)	1998A	1999A	2000A	2001E	2002E
Net interest margin	2.71%	2.53%	2.37%	2.38%	2.44%
Yield on interest earning assets	7.86%	5.90%	5.64%	4.64%	5.35%
Cost on interest bearing liabilities	5.72%	3.78%	3.93%	2.82%	2.97%
Net interest spread	2.14%	2.12%	1.71%	1.82%	2.37%
Non-int. income (% Op income)	20.9%	32.0%	34.1%	30.7%	29.5%
Cost to income	24.6%	27.2%	34.2%	35.6%	35.0%
Overhead ratio	0.93%	1.03%	1.23%	1.23%	1.21%
Cost coverage	76.9%	114.9%	99.6%	85.6%	84.5%
ROA	0.75%	1.25%	1.47%	1.36%	1.34%
ROE	4.7%	7.0%	7.7%	8.2%	8.7%

OROA ANALYSIS	1998A	1999A	2000A	2001E	2002E
Net interest margin	2.71%	2.53%	2.37%	2.38%	2.44%
Non-interest inc./gross inc.	28.12%	33.52%	34.34%	31.03%	29.55%
Efficiency ratio	24.61%	27.20%	34.15%	35.60%	34.96%
Provision/assets	1.68%	0.95%	0.23%	0.16%	0.04%
Operating return on assets	**1.16%**	**1.82%**	**2.14%**	**2.06%**	**2.21%**
Equity/assets	16.41%	19.32%	18.75%	15.02%	15.89%
Operating return on equity	**7.08%**	**9.40%**	**11.41%**	**13.72%**	**13.90%**

BALANCE SHEET (S$m) *year ending Dec*	1998A	1999A	2000A	2001E	2002E
Gross loans	49,341	47,589	51,621	77,738	81,721
Loan loss reserves	*2,265*	*2,466*	*2,302*	*2,946*	*2,594*
Net loans	46,697	44,765	48,935	74,214	78,519
Total earning assets	53,334	50,599	55,992	82,749	82,756
Other assets	2,403	3,691	3,718	6,617	6,618
Total Assets	**55,737**	**54,290**	**59,710**	**89,366**	**89,374**
Deposits	46,917	43,330	48,035	73,584	76,968
Customer deposits	36,993	36,762	37,942	56,856	59,734
Other deposits	9,439	6,567	10,093	16,728	17,233
Other paying liabilities	1,666	1,539	218	4,165	3,900
Other liabilities	448	2,045	3,305	5,018	1,018
Total Liabilities	**49,031**	**46,914**	**51,558**	**82,767**	**81,886**
Equity with revaluation	**9,146**	**10,490**	**11,194**	**13,419**	**14,198**
Adjusted equity	**6,706**	**7,376**	**8,151**	**6,599**	**7,488**

BALANCE SHEET RATIOS (%)	1998A	1999A	2000A	2001E	2002E
Loan-to-deposit	104.4%	109.0%	106.7%	104.9%	105.4%
Equity to assets	16.4%	19.3%	18.7%	15.0%	15.9%
Total loan loss provisions	4.63%	5.22%	4.49%	3.82%	3.20%

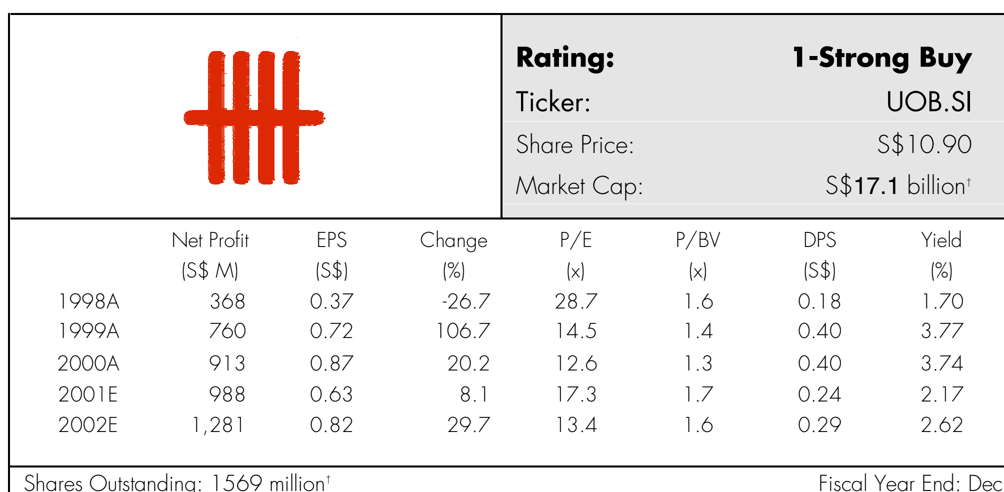
ASSET QUALITY	1998A	1999A	2000A	2001E	2002E
Nonperforming assets	4,059	4,335	4,092	5,375	4,974
Special mention	-	-	-	-	-
Substandard	-	2,876	2,721	3,481	3,275
Doubtful	-	1,260	1,031	1,312	1,184
Loss	-	199	340	582	514
ORE	-	-	-	-	-
NPAs/total loans	8.3%	9.2%	8.0%	7.0%	6.1%
Reserve coverage of NPAs	55.8%	56.9%	56.3%	54.8%	52.2%
Required reserves	n.a	1,837	1,875	2,658	2,529
Actual reserves	2,265	2,466	2,302	2,946	2,594
Shortfall (surplus)	n.a	(629)	(427)	(288)	(65)
Actual to required reserves	n.a	134%	123%	111%	103%
Shortfall to capital	n.a	-6%	-4%	-2%	0%

GROWTH RATES (%)	1998A	1999A	2000A	2001E	2002E
Income statement					
Net interest income	16.4%	-8.8%	-2.3%	31.0%	22.3%
Non-interest income	-15.5%	17.5%	1.3%	12.7%	14.0%
Total operating income	5.3%	-1.4%	-1.1%	24.7%	19.7%
Non-interest expenses	-0.3%	9.0%	24.2%	30.0%	17.6%
Pre-provision earnings	7.2%	-4.8%	-10.6%	22.0%	20.9%
Loan loss provisions	64.8%	-45.0%	-73.0%	4.2%	-72.4%
Core earnings	-46.9%	130.0%	23.9%	26.0%	32.6%
Net profit	**-26.8%**	**62.1%**	**21.8%**	**20.4%**	**18.5%**
Balance sheet					
Loan growth	0.2%	-4.1%	9.3%	51.7%	5.8%
Interest earning assets	4.5%	-4.7%	10.0%	49.6%	2.7%
Asset growth	-3.1%	-2.6%	10.0%	49.7%	0.0%
Deposit growth	-2.9%	-7.6%	10.9%	53.2%	4.6%
Shareholders funds	3.5%	10.0%	10.5%	-19.0%	13.5%

Source: Company reports; Lehman Brothers estimates.

UNITED OVERSEAS BANK

UNDER-APPRECIATED



Rating:	**1-Strong Buy**
Ticker:	UOB.SI
Share Price:	S$10.90
Market Cap:	S$**17.1** billion†

	Net Profit (S$ M)	EPS (S$)	Change (%)	P/E (x)	P/BV (x)	DPS (S$)	Yield (%)
1998A	368	0.37	-26.7	28.7	1.6	0.18	1.70
1999A	760	0.72	106.7	14.5	1.4	0.40	3.77
2000A	913	0.87	20.2	12.6	1.3	0.40	3.74
2001E	988	0.63	8.1	17.3	1.7	0.24	2.17
2002E	1,281	0.82	29.7	13.4	1.6	0.29	2.62

Shares Outstanding: 1569 million† | Fiscal Year End: Dec

† Adjusted for OUB acquisition shares.

Key Focus Areas for UOB:

Execution is Critical: Like OCBC, UOB has made an excellent deal for OUB—although we would have preferred to see a little more cash up front to raise returns. But execution—taking out the cost saves—is critical if UOB is not to validate the worst fears of investors about its perceived inability as a family-run bank in a friendly merger to be ruthless about staff cuts. We think this fear is misplaced, but if we're wrong UOB could wind up vulnerable to takeover itself.

Non-Core Assets: UOB has been slow to look at getting rid of its non-core assets, and now has added OUB's to the pile. We believe that there is substantial value to be created by privatizing OUB's listed affiliates, swapping and consolidating assets, and finally selling or spinning-off the remaining entities—but time is of the essence for returns.

Provisions Lag on Pro-Forma Basis: Although we consider UOB as a standalone to be effectively fully-reserved against potential loan losses, OUB has been a perennial laggard by our methodology—albeit a methodology CEO Peter Seah has cheerfully disputed with us in the past. We believe that the merged bank will require approximately S$326 million in additional provisions, keeping bad debt charges near their 2001 level through a least FY2003.

Figure 41: UOB Summary Sheet

UOB

Share Price:	10.90	**Index:**	1,640.00
52 Week Price Range:	10.30 - 14.00	**Current Yield:**	3.7%
Reuters Code:	UOB.SI		
Bloomberg Code:	UOB SP	**Shares Outstanding** (MM):	1,052.54

INCOME STATEMENT	**1998A**	**1999A**	**2000A**	**2001E**	**2002E**
(S$m) *year ending Dec*					
Interest income					
Interest expense					
Net interest income	**1,201**	**1,133**	**1,198**	**1,632**	**2,162**
Ave. int. earnings assets	*42,050*	*45,915*	*54,250*	*83,203*	*110,184*
NIM (%)	**2.86%**	**2.47%**	**2.21%**	**1.96%**	**1.96%**
Non-interest income	530	708	754	899	1,145
Total operating income	**1,731**	**1,840**	**1,952**	**2,531**	**3,307**
Non-interest expense	-567	-581	-751	-991	-1,183
Pre provision profit	**1,164**	**1,260**	**1,201**	**1,540**	**2,124**
Loan loss provisions	-654	-253	-93	-86	-70
Non-operating income	0	20	78	-76	-212
Pre tax profit	**511**	**1,026**	**1,112**	**1,449**	**2,054**
Tax	-137	-251	-273	-376	-524
Net profit	**368**	**760**	**913**	**988**	**1,281**
Core earnings	**368**	**745**	**836**	**1,062**	**1,493**

PER SHARE DATA (S$)	**1998A**	**1999A**	**2000A**	**2001E**	**2002E**
EPS	0.37	0.72	0.87	0.63	0.82
DPS	0.18	0.40	0.40	0.24	0.29
Effective payout ratio (%)	*49%*	*55%*	*46%*	*38%*	*35%*
BVPS	6.83	7.39	8.08	6.23	6.76
ABVPS	5.59	5.88	6.62	2.70	3.33

VALUATION	**1998A**	**1999A**	**2000A**	**2001E**	**2002E**
Price to book value (x)	1.6	1.4	1.3	1.7	1.6
Price to adjusted book value (x)	1.9	1.8	1.6	4.0	3.3
Price to earnings (x)	28.7	14.5	12.6	17.3	13.4

PROFITABILITY RATIOS	**1998A**	**1999A**	**2000A**	**2001E**	**2002E**
(%)					
Net interest margin	2.86%	2.47%	2.21%	1.96%	1.96%
Yield on interest earning assets		5.07%	5.09%	1.42%	0.00%
Cost on interest bearing liabilities		2.78%	3.26%	0.92%	0.00%
Net interest spread		2.29%	1.83%	0.50%	0.00%
Non-int. income (% Op income)	30.6%	38.4%	38.6%	35.5%	34.6%
Cost to income	32.7%	31.2%	38.4%	39.2%	35.8%
Overhead ratio	1.35%	1.26%	1.38%	1.19%	1.07%
Cost coverage	93.5%	121.9%	100.4%	90.7%	96.8%
ROA	0.74%	1.50%	1.56%	1.09%	1.08%
ROE	5.5%	10.4%	11.2%	10.8%	12.6%

OROA ANALYSIS	**1998A**	**1999A**	**2000A**	**2001E**	**2002E**
Net interest margin	2.86%	2.47%	2.21%	1.96%	1.96%
Non-interest inc./gross inc.	30.61%	39.11%	38.75%	35.39%	34.62%
Efficiency ratio	32.73%	31.21%	38.38%	39.22%	35.77%
Provision/assets	1.30%	0.50%	0.14%	0.07%	0.06%
Operating return on assets	**1.47%**	**2.29%**	**2.08%**	**1.77%**	**1.87%**
Equity/assets	13.45%	15.31%	12.83%	8.50%	8.61%
Operating return on equity	**10.96%**	**14.94%**	**16.23%**	**20.83%**	**21.72%**

BALANCE SHEET	**1998A**	**1999A**	**2000A**	**2001E**	**2002E**
(S$m) *year ending Dec*					
Gross loans	40,818	47,649	57,508	90,547	90,714
Loan loss reserves	*1,429*	*1,933*	*1,812*	*2,716*	*2,349*
Net loans	39,122	45,404	55,319	87,184	87,734
Total earning assets	43,340	48,489	60,011	106,395	113,973
Other assets	7,129	2,300	6,313	8,573	9,184
Total Assets	**50,469**	**50,789**	**66,324**	**114,968**	**123,157**
Deposits	42,598	47,180	56,837	97,836	101,290
Customer deposits	-	40,728	43,406	73,337	75,926
Other deposits	-	6,452	13,431	24,499	25,364
Other paying liabilities	-	430	129	2,669	2,763
Other liabilities	-	-	2,390	10,230	13,871
Total Liabilities	**44,911**	**44,598**	**59,356**	**110,735**	**117,924**
Equity with revaluation	**6,789**	**7,778**	**8,507**	**9,774**	**10,606**
Adjusted equity	**5,559**	**6,191**	**6,968**	**4,233**	**5,233**

BALANCE SHEET RATIOS	**1998A**	**1999A**	**2000A**	**2001E**	**2002E**
(%)					
Loan-to-deposit	95.2%	100.3%	100.5%	91.9%	88.9%
Equity to assets	13.5%	15.3%	12.8%	8.5%	8.6%
Total loan loss provisions	3.52%	4.08%	3.17%	3.02%	2.61%

ASSET QUALITY	**1998A**	**1999A**	**2000A**	**2001E**	**2002E**
Nonperforming assets	2,191	2,993	2,610	5,360	4,341
Special mention	-	-	-	-	-
Substandard		1,947	1,583	3,762	3,047
Doubtful		245	208	381	308
Loss		801	819	1,217	986
ORE	-	-	-	-	-
NPAs/total loans	5.4%	6.3%	4.6%	6.0%	4.8%
Reserve coverage of NPAs	65.2%	64.6%	69.4%	50.7%	54.1%
Required reserves	n.a	1,759	1,789	3,012	2,613
Actual reserves	1,429	1,933	1,812	2,716	2,349
Shortfall (surplus)	n.a	(174)	(23)	296	264
Actual to required reserves	n.a	110%	101%	90%	90%
Shortfall to capital	n.a	-2%	0%	3%	2%

GROWTH RATES	**1998A**	**1999A**	**2000A**	**2001E**	**2002E**
(%)					
Income statement					
Net interest income	8.4%	-5.7%	5.8%	36.2%	32.5%
Non-interest income	-4.1%	37.3%	4.2%	17.9%	28.1%
Total operating income	4.2%	7.5%	5.1%	29.1%	30.9%
Non-interest expenses	-4.9%	2.5%	29.3%	32.0%	19.4%
Pre-provision earnings	9.4%	9.9%	-5.8%	27.4%	38.3%
Loan loss provisions	95.0%	-61.2%	-63.3%	-7.7%	-18.5%
Core earnings	-26.7%	102.6%	12.3%	27.0%	40.5%
Net profit	**-26.7%**	**106.7%**	**20.2%**	**8.1%**	**29.7%**
Balance sheet					
Loan growth	1.8%	16.1%	21.8%	57.6%	0.6%
Interest earning assets	6.3%	13.9%	22.8%	67.8%	4.2%
Asset growth	2.2%	0.6%	30.6%	73.3%	7.1%
Deposit growth	2.4%	10.8%	20.5%	72.1%	3.5%
Shareholders funds	3.5%	11.4%	12.6%	-39.3%	23.6%

Source: Company reports; Lehman Brothers estimates.

Table of Figures

Figure 1: Bank and Pro-Forma Net Income 1996–2004 8
Figure 2: Yearly EPS 1998–2004 9
Figure 3: Yearly Core EPS 1998–2004 9
Figure 4: Period EPS 1H00–1H02 9
Figure 5: Period Core EPS 1H00–1H02.. 9
Figure 6: Core ROE: 1997–2004... 10
Figure 7: Net Interest Margins: 1H98–1H01 11
Figure 8: Yields on Interest-bearing Funds: 1H98–1H01 11
Figure 9: Cost of Interest-bearing Liabilities: 1H98–1H01...................................... 11
Figure 10: Singaporean Bank Mortgage Rates: September 2000–August 2001 12
Figure 11: Singaporean Loan Growth *vs.* GDP: 1983–2000 17
Figure 12: Consumer Lending in Singapore 18
Figure 13: Outstanding Loans by Category 18
Figure 14: Loan Growth By Category, YoY 19
Figure 15: Loan Growth by Category, MoM 19
Figure 16: Singaporean Bank Loan Portfolios by Sector 20
Figure 17: Singaporean Bank Loan Growth by Sector... 20
Figure 18: Industry Loan Growth by Sector: 2000–2004 20
Figure 19: Weighted Classification Ratio Calculation.. 21
Figure 20: Gross NPLs 22
Figure 21: NPLs as a Percentage of Customer Loans 22
Figure 22: Weighted Classified Assets 22
Figure 23: Loan Loss Provisions: 1996–2003 23
Figure 24: Loan Loss Provisions to Average Assets: 1996–2003 23
Figure 25: Loan Loss Reserve Adequacy at 1H01... 23
Figure 26: Overhead and Efficiency Ratios.. 24
Figure 27: DBS: Pro-Forma Expense Growth 25
Figure 28: Singaporean Banks' Expense CAGRs 26
Figure 29: Cost-to-Income and Overhead Ratio Migrations 1997–2000................. 26
Figure 30: OUB Cost Saves by Business Line 27
Figure 31: OUB Cost Saves by Expense Category 27
Figure 32: UOB and OUB: Overlapping Foreign Branches.................................... 28
Figure 33: Keppel Cost Saves by Business Line 29
Figure 34: Keppel Cost Saves by Expense Category... 29
Figure 35: Valuation Metrics: P/BV and P/ABV 30
Figure 36: Valuation Metrics: Historical and Forward P/E; Share P/E to Index P/E ... 31
Figure 37: Valuation Metrics: Deposit Premium Valuation: 1H01............................ 31
Figure 38: Valuation Metrics: Deposit Premium Valuation: 2H01 Pro-Forma 31
Figure 39: DBS Summary Sheet 33
Figure 40: OCBC Summary Sheet 35
Figure 41: UOB Summary Sheet 37

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HK-1137	Asian Bank Briefing	Asia Pacific Bank Team	10/16/00	24
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