

# DBS GROUP HOLDINGS LTD

Asset Quality is the Red Herring

## SINGAPORE | BANKING | RESULTS

- 3Q16 NPAT up y-o-y attributed to increase in Non-interest income and decrease in total expense.
- 3Q16 NIM decreased 10 bps q-o-q on the back of lower SIBOR/SOR.
- 3Q16 NPL was hit a high 1.32% as asset quality deteriorates.
- Ability to grow income is paramount to dealing with deteriorating asset quality.
- **Maintain “Accumulate” with a lower target price of S\$15.71 (previously S\$16.09), pegged at unchanged 0.95x FY16F book value (excluding perpetual capital securities).**

### Results at a glance

(SGD mn)	3Q16	3Q15	y-o-y (%)	2Q16	q-o-q (%)	Comments
Net interest income	1,815	1,813	0.1%	1,833	-1.0%	NIMs -1bps y-o-y, loans +1.8% yoy
Net Fees & Comm income	614	517	18.8%	628	-2.2%	Higher WM, Investment Banking fees and Cards
Other Non-interest income	500	382	30.9%	458	9.2%	Higher Net income from investment securities and Net trading Income
<b>Total Income</b>	<b>2,929</b>	<b>2,712</b>	<b>8.0%</b>	<b>2,919</b>	<b>0.3%</b>	
Expenses	1,199	1,259	-4.8%	1,285	-6.7%	
Credit Allowance	436	178	144.9%	366	19.1%	S\$169mn charged to general allowance for prudent measure
<b>Net Profit</b>	<b>1,102</b>	<b>1,093</b>	<b>0.8%</b>	<b>1,079</b>	<b>2.1%</b>	

Source: Company, PSR

**Loans grew 1.8% year-on-year (“y-o-y”).** Strong loans growth in *Housing loans*, up 10.2% y-o-y attributed by higher Singapore mortgage loans. Trade loans remained unchanged quarter-on-quarter (“q-o-q”) at S\$37bn but declined 14% y-o-y contributed by declines in Chinese trade loans. On a q-o-q basis, loans growth from *Rest of Greater China* and *South and Southeast Asia* regions offset decline in loans from *Singapore* where SME loans are experiencing weakness from slowing economy.

**DBS is vulnerable to NIM weakness in a low rates environment.** Average rates on interest earning assets declined 11bps q-o-q, tracking the declines in SOR and SIBOR, while average rates for interest bearing liabilities declined only 1bps q-o-q. We opine that DBS’ Loan-to-Deposit ratio which is pushing to a high of c.90% means it is already maximising the volume of loans it can maintain against its funding from deposits. Now, DBS has less room to optimise NIM further by growing loan volumes faster than deposits. In a low rates environment, DBS would seek to grow the loan volumes to offset the fall in rates on interest earning assets in order to maintain interest income. However, since it is already at a Loan-to-Deposit ratio of c.90% it has less room to grow loans without first taking care of the funding from the liability side. If it tries to grow deposits in tandem, it has to increase rates on deposits but that would run counter to low rates on the interest earning assets and compress NIMs further. Also it may not be able to reduce interest expense simply by cutting rates more aggressively on liability side lest funding drains out and pushes Loan-to-Deposits higher even as loan volumes remain unchanged. We believe the unfavourable rate and volume dynamics is corollary to its current high Loan-to-Deposit ratio and as a result, DBS would have less bandwidth to manage Net Interest Income higher in a low rates environment.

1 November 2016

### Accumulate (Maintain)

LAST TRADED PRICE	SGD 15.06
FORECAST DIV	SGD 0.60
TARGET PRICE	SGD 15.71
TOTAL RETURN	8.30%

### COMPANY DATA

O/S SHARES (MN) :	2,537
MARKET CAP (USD mn / SGD mn) :	27472 / 38211
52 - WK HI/LO (SGD) :	17.93 / 13.01
3M Average Daily T/O (mn) :	4.24

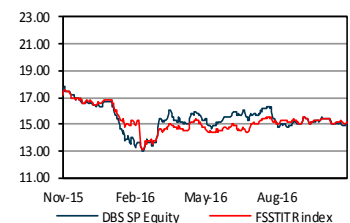
### MAJOR SHAREHOLDERS (%)

Temasek Holdings Pte Ltd	29.96%
Vanguard Group	1.74%
Norges Bank Investment Management	1.73%
BlackRock	1.53%

### PRICE PERFORMANCE (%)

	1M TH	3M TH	1YR
COMPANY	(2.5)	(0.7)	(9.6)
STIRETURN	(1.39)	(1.96)	(3.62)

### PRICE VS. STI



Source: Bloomberg, PSR

### KEY FINANCIALS

Y/E Dec	FY 14	FY 15	FY 16 F	FY 17 F
Total Income (SGD mn)	9,816	10,923	11,558	11,458
Operating Profit (SGD mn)	4,819	5,280	5,165	5,129
NPAT (SGD mn)	4,186	4,567	4,422	4,412
EPS (SGD)	1.63	1.71	1.78	1.68
PER, (X)	11.8	11.7	8.4	10.0
ROE, (%)	11.2%	11.4%	10.2%	9.4%

Source: Bloomberg

Valuation Method: 0.95x P/B

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**Coverage ratio declined to 100% from 113% in 2Q16 and 161% in 3Q15** as a result of NPLs growing faster than allowance charged. We have alluded to DBS having less bandwidth to manage Net Interest Income higher in a low rates environment, therefore it also implies that it will have to be more cautious in charging higher allowance to the income statement lest it affects the overall profit performance. The situation today is worsened as asset quality is falling and more allowance is expected but the lack of it is leaving the market bamboozled. We believe that DBS had played its cards to drive efficiency too early; only to find itself in a quandary of low rates and falling asset quality happening together.

**Strong fee and commission income supports performance.** Net fee income rose 19% y-o-y to S\$614mn led by *Wealth Management*, up 47% y-o-y from higher bancassurance contributions; by *Investment Banking*, up 74% y-o-y from higher equity market, fixed income fees and increased advisory activities; by *Cards*, up 15% y-o-y from growth in credit and debit card transactions. With increased investments into digital and wealth management infrastructure, we believe DBS is seeking to improve the performance of fee income to provide a reliable and consistent boost of offset any potential lacklustre performance from Net interest income segment.

**Boost from ANZ acquisition.** We believe that the acquisition of ANZ wealth and retail business in five markets (Hong Kong, Singapore, China, Taiwan and Indonesia) is timely because DBS can bolt on the much needed loans and deposits growth. DBS will have access to S\$11bn worth of customer loans, representing 3.74% of DBS' customer loans and S\$17bn worth of customer deposits, representing 5.24% of DBS' customer deposits. DBS can also grow its *Cards* and *Wealth Management* franchise across this customer base.

#### Investment Actions

DBS' 3Q16 NPAT of S\$1.102bn was in line with our expectations of S\$1.1bn. The market is focused on the DBS' asset quality and whether sufficient measures are in place to ensure that. Whereas our view is inasmuch as taking on riskier loans is a concern, **the ability to generate higher net interest income is the prerogative to manage higher provisioning to buffer against deteriorating asset quality.** We view that the strong Non-interest income segment can help offset the near term weakness in Net interest income and the timely acquisition of ANZ wealth and retail business in five markets will provide the loans and deposit growth support. **Maintain to "Accumulate" with a lower target price of S\$15.71 (previously S\$16.09)**, pegged at unchanged 0.95x FY16F book value (excluding perpetual capital securities). The lower share price reflects dilution from scrip dividends.

Table 1. Fee and commission income

SGD mn	3Q16	3Q15	y-o-y (%)	2Q16	q-o-q (%)
Stockbroking	39	45	-13.3%	38	2.6%
Investment banking	54	31	74.2%	83	-34.9%
Trade and transaction svc	147	133	10.5%	148	-0.7%
Loan related	110	120	-8.3%	120	-8.3%
Credit card	123	107	15.0%	108	13.9%
Fund management	28	16	NM	24	NM
Wealth management	201	137	46.7%	179	12.3%
Fee and commission expense	88	72	22.2%	72	22.2%
<b>Total</b>	<b>790</b>	<b>661</b>	<b>19.5%</b>	<b>772</b>	<b>2.3%</b>

Table 2. Other non-interest income

SGD mn	3Q16	3Q15	y-o-y (%)	2Q16	q-o-q (%)
Net Trading income	338	286	18.2%	307	10.1%
Net income on Fin Invt	103	39	164.1%	116	-11.2%
Net gain on fixed assets	41	43	NM	13	NM
Others (inc. rental and assoc)	18	14	28.6%	22	-18.2%
<b>Total other non int Inc</b>	<b>500</b>	<b>382</b>	<b>30.9%</b>	<b>458</b>	<b>9.2%</b>

Table 3. Loans by Industries

SGD mn	3Q16	3Q15	y-o-y (%)	2Q16	q-o-q (%)
Manufacturing	30,872	32,253	-4.3%	30,087	2.6%
Building and construction	55,881	54,913	1.8%	56,048	-0.3%
Housing loans	62,692	56,873	10.2%	60,913	2.9%
General commerce	45,559	52,914	-13.9%	45,206	0.8%
Tpt, storage & comms	28,591	24,723	15.6%	27,819	2.8%
Fls, invt & holding co	15,525	14,562	6.6%	15,254	1.8%
Professionals & Pri inv	24,663	24,630	0.1%	24,042	2.6%
Others	30,034	27,881	7.7%	28,975	3.7%
<b>Total loans</b>	<b>293,817</b>	<b>288,749</b>	<b>1.8%</b>	<b>288,344</b>	<b>1.9%</b>

Table 4. Loans by currencies

SGD mn	3Q16	3Q15	y-o-y (%)	2Q16	q-o-q (%)
Singapore dollar	121,203	114,122	6.2%	121,457	-0.2%
US dollar	95,509	91,913	3.9%	93,437	2.2%
Hong Kong dollar	33,415	34,760	-3.9%	32,825	1.8%
Chinese yuan	12,296	22,949	-46.4%	11,732	4.8%
Others	31,394	25,005	25.6%	28,893	8.7%
<b>Total loans</b>	<b>293,817</b>	<b>288,749</b>	<b>1.8%</b>	<b>288,344</b>	<b>1.9%</b>

Table 5. Revenue by Business segments

SGD mn	3Q16	3Q15	y-o-y (%)	2Q16	q-o-q (%)
Consumer/ Priv Banking	1106	880	25.7%	1070	3.4%
Institutional Banking	1310	1343	-2.5%	1340	-2.2%
Treasury	287	226	27.0%	271	5.9%
Others	226.00	263.00	-14.1%	238.00	-5.0%
<b>Total Revenue</b>	<b>2929</b>	<b>2712</b>	<b>8.0%</b>	<b>2919</b>	<b>0.3%</b>

Table 6. Revenue by Geographical segments

SGD mn	3Q16	3Q15	y-o-y (%)	2Q16	q-o-q (%)
Singapore	1,889.00	1,645.00	14.8%	1,956.00	-3.4%
Hong Kong	566.00	604.00	-6.3%	520.00	8.8%
Rest of Greater China	208.00	266.00	-21.8%	188.00	10.6%
South and Southeast Asia	188.00	130.00	44.6%	181.00	3.9%
Rest of the world	78.00	67.00	16.4%	74.00	5.4%
<b>Total Revenue</b>	<b>2,929</b>	<b>2,712</b>	<b>8.0%</b>	<b>2,919</b>	<b>0.3%</b>

Source (tables 1-6): Company, Phillip Securities Research

Fig 1: Net interest margin

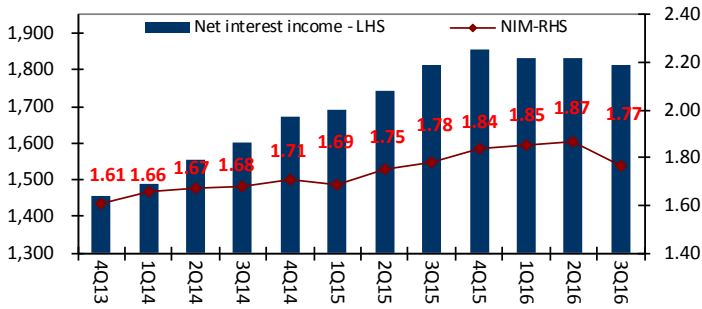


Fig 2: NonII/Total Income

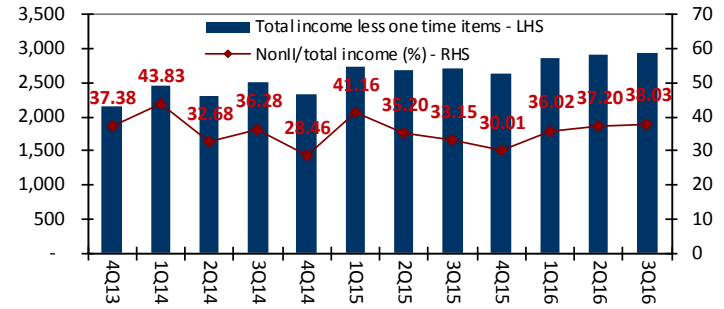


Fig 3: Efficiency ratio

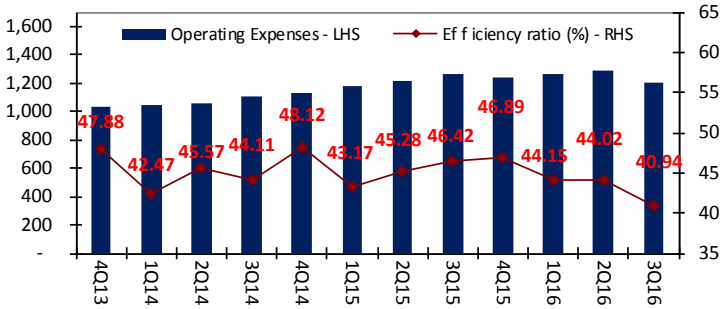


Fig 4: Net profit margin

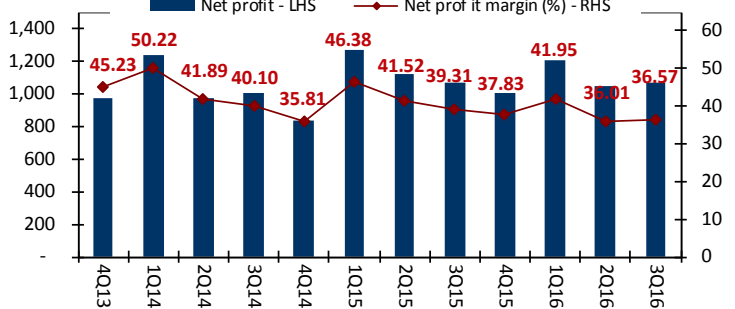


Fig 5: Deposits, Loans, LDR

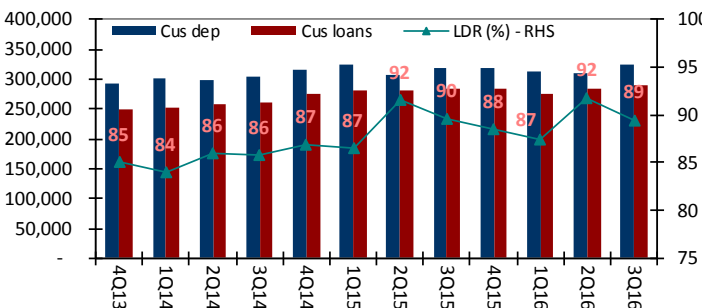


Fig 6: NPA, NPL

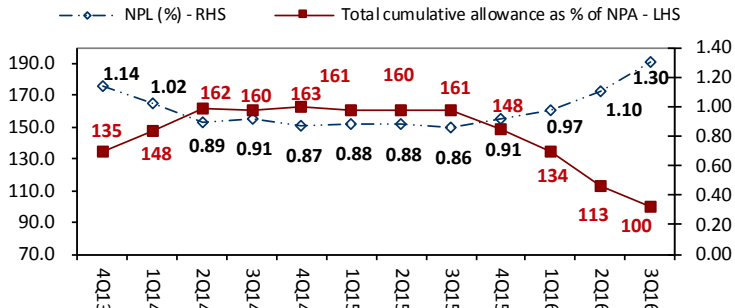


Fig 7: Growth in selected asset items

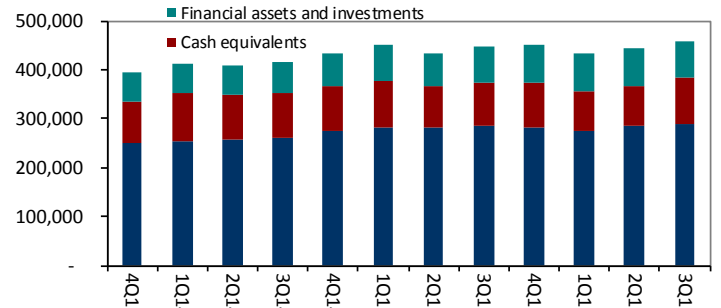


Fig 8: CAR

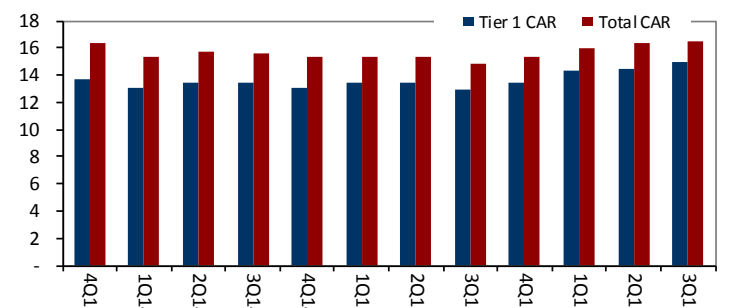


Fig 9: ROE and ROA

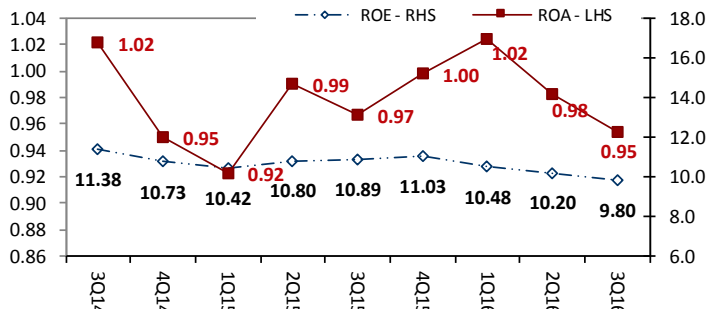


Fig 10: EPS and NBV

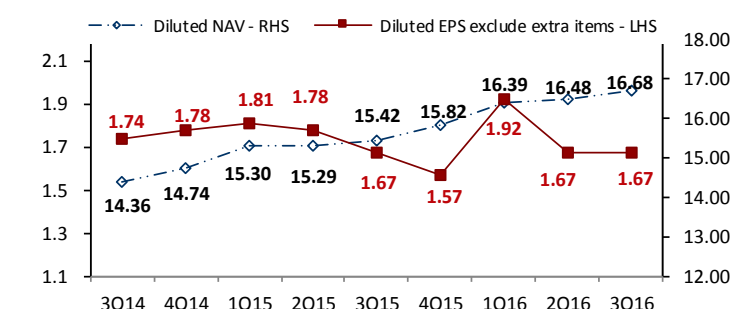


Fig 11: Profit before tax by geographical segment

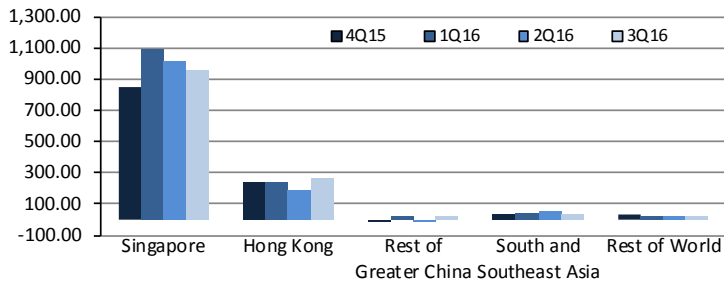


Fig 12: Profit before tax by Geographical segment breakdown

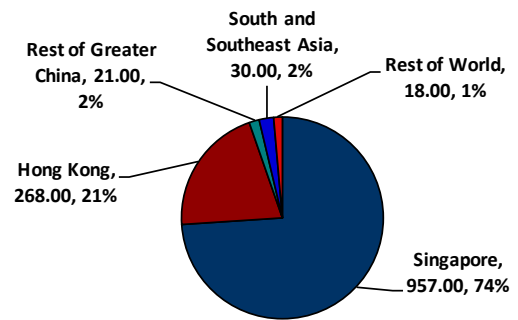


Fig 13: Profit before tax by business segment

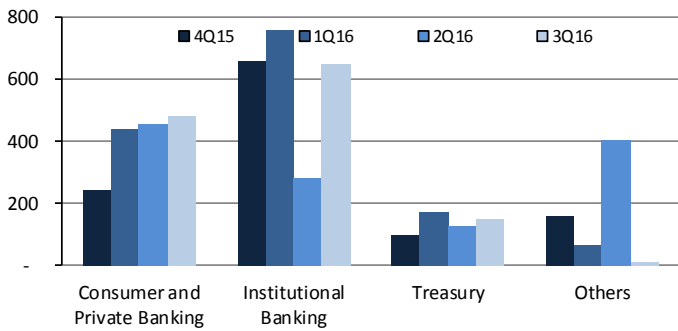


Fig 14: Net interest income trend

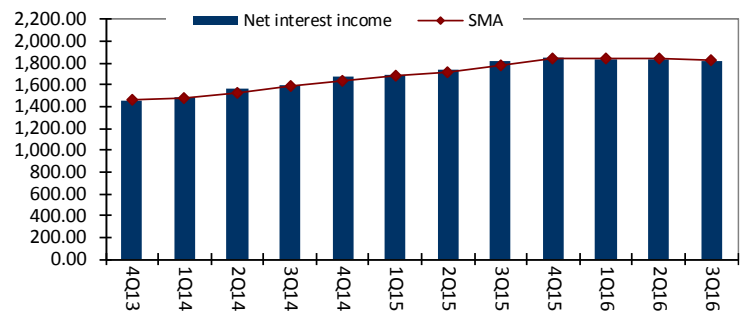


Fig 15: Fee and Commission trend

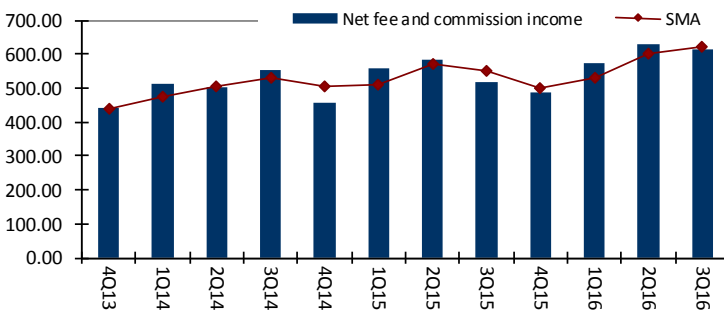
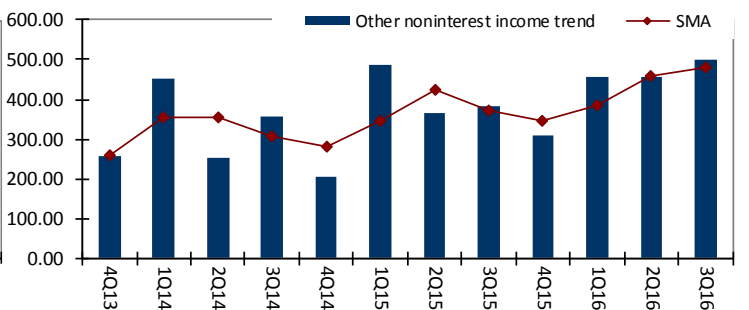


Fig 16: Other noninterest income trend



## Income Statement

Y/E Dec, SGD mn	FY13	FY14	FY15	FY16F	FY17F
Net Interest Income	5,569	6,321	7,100	7,254	6,977
Fees and Commission	1,885	2,027	2,144	2,408	2,554
Other Non interest income	1,644	1,468	1,679	1,895	1,928
<b>Total income</b>	<b>9,098</b>	<b>9,816</b>	<b>10,923</b>	<b>11,558</b>	<b>11,458</b>
Operating expenses	3,918	4,330	4,900	4,954	4,843
Provisions	770	667	743	1,439	1,486
<b>Operating profit</b>	<b>4,410</b>	<b>4,819</b>	<b>5,280</b>	<b>5,165</b>	<b>5,129</b>
Associates & JVs	79	79	14	0	0
<b>Profit Before Tax</b>	<b>4,489</b>	<b>4,898</b>	<b>5,294</b>	<b>5,165</b>	<b>5,129</b>
Taxation	615	713	727	742	717
<b>Profit After Tax</b>	<b>3,874</b>	<b>4,185</b>	<b>4,567</b>	<b>4,422</b>	<b>4,412</b>
Non-controlling Interest	202	139	113	119	118
<b>Net Income, reported</b>	<b>3,672</b>	<b>4,046</b>	<b>4,454</b>	<b>4,304</b>	<b>4,293</b>
<b>Net Income, adj. for one time item</b>	<b>3,501</b>	<b>3,848</b>	<b>4,318</b>	<b>4,304</b>	<b>4,293</b>

## Per share data (SGD)

Y/E Dec, SGD mn	FY13	FY14	FY15	FY16F	FY17F
EPS, reported	1.17	1.63	1.71	1.78	1.68
DPS	0.58	0.58	0.60	0.60	0.60
BVPS	13.36	14.44	15.49	16.54	17.16

## Supplementary items

Y/E Dec, SGD mn	FY13	FY14	FY15	FY16F	FY17F
CET1 CAR (%)	13.7%	13.1%	13.5%	12.9%	13.3%
Tier 1 CAR (%)	13.7%	13.1%	13.5%	13.4%	13.5%
Total CAR (%)	16.3%	15.3%	15.4%	14.7%	14.9%

Source: Company Data, PSR est

## Balance Sheet

Y/E Dec, SGD mn	FY13	FY14	FY15	FY16F	FY17F
Cash and bal with central banks	18,726	19,517	18,829	28,022	28,201
Due from banks	39,817	42,263	38,285	31,157	26,875
Govt, Bank and Corporate Securities and Treasury Bills	61,043	67,457	74,574	80,211	80,794
Derivatives	17,426	16,995	23,631	20,273	19,134
Goodwill and intangibles	4,802	5,117	5,117	5,115	5,115
Property and other fixed assets	1,449	1,485	1,547	1,532	1,559
Loans to non-bank customers	248,654	275,588	283,289	289,730	301,626
JV and Associates	1,166	995	1,000	861	698
Other assets	8,925	11,249	11,562	10,362	9,156
<b>Total Assets</b>	<b>402,008</b>	<b>440,666</b>	<b>457,834</b>	<b>467,262</b>	<b>473,158</b>
Due to banks	13,572	16,176	18,251	24,916	24,916
Deposits and balances from customers	292,365	317,173	320,134	325,122	330,781
Derivatives	18,132	18,755	22,145	20,273	19,134
Other liabilities	11,594	11,728	12,404	18,784	17,633
Other debt securities	23,115	31,963	38,078	28,804	28,218
Subordinated term debts	5,544	4,665	4,026	3,064	2,765
<b>Total liabilities</b>	<b>364,322</b>	<b>400,460</b>	<b>415,038</b>	<b>420,962</b>	<b>423,448</b>
Shareholder's equity	34,233	37,708	40,374	43,911	47,321
Non-controlling interest	3,453	2,498	2,422	2,389	2,389
<b>Total Equity</b>	<b>37,686</b>	<b>40,206</b>	<b>42,796</b>	<b>46,300</b>	<b>49,710</b>

## Valuation Ratios

Y/E Dec, SGD mn	FY13	FY14	FY15	FY16F	FY17F
P/E (X), avg	10.3	11.8	11.7	8.4	10.0
P/B (X), avg	1.3	1.3	1.3	0.95	0.95
Dividend Yield (%)	3.5%	3.3%	3.1%	3.8%	3.5%

## Growth &amp; Margins (%)

Growth					
Net interest income	5.4%	13.5%	12.3%	2.2%	-3.8%
Net Fee and Commission Income	19.4%	7.5%	5.8%	12.3%	6.0%
Total income	6.9%	7.9%	11.3%	5.8%	-0.9%
Profit before tax	-3.0%	9.3%	9.6%	-2.2%	-0.7%
Net income, reported	-4.0%	10.2%	10.1%	-3.4%	-0.2%
Net income, adj. for one time item	-4.0%	9.9%	12.2%	-0.3%	-0.2%

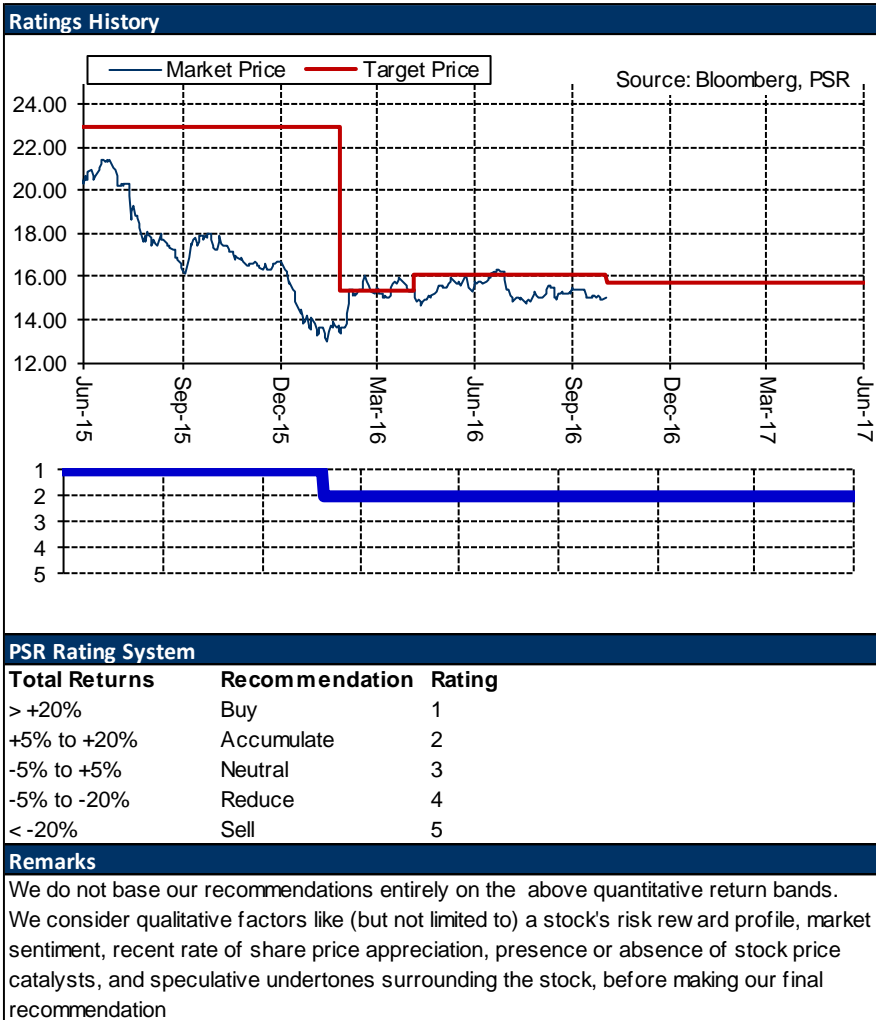
## Margins

Net interest margin	1.61%	1.71%	1.84%	1.75%	1.71%
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## Key Ratios (%)

ROE	10.7%	11.2%	11.4%	10.2%	9.4%
ROA	1.0%	1.0%	1.0%	0.9%	0.9%
RORWA	1.5%	1.5%	1.6%	1.4%	1.3%
Non-interest/total income ratio	38.8%	35.6%	35.0%	37.2%	39.1%
Cost/income ratio	43.1%	44.1%	44.9%	42.9%	42.3%
Loan/deposit ratio	85.0%	86.9%	88.5%	89.1%	91.2%
NPL ratio	1.14	0.87	0.91	1.32	1.27

Source: Company Data, PSR est



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