

DBS GROUP HOLDINGS LTD

This leader in digital banking is about to fly even higher



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SINGAPORE | BANKING | UPDATE

- Digital capabilities continue to improve cost to income ratios in established markets.
- Digitally engaged clients have higher transaction volumes and therefore more profitable than non-digitally engaged clients.
- Expect stronger than expected performance at digibank India in 2018.
- We increase FY18e PATMI by 8.4% to S\$6.2bn
- **Maintain “BUY” rating with a higher target price of S\$29.30 (previous TP S\$26.83) as we raise our ROE assumptions to 13.1% (previous 12.1%) .**

What were the key takeaways from DBS Investor Day?

DBS' Investor Day main theme was digital strategy and how it is applied to different markets to drive the bank forward.

Digital strategy 1: Consumer/SME banking in Singapore and Hong Kong. DBS is adopting the digital platform approach to engage their customers and digitising their banking processes. The aim is to pre-empt new digital disruptors in the legacy markets where DBS is an incumbent. The digital process reduced the cost to income ratio from 49% in 2015 to 43% in 2017 as income growth outpaced cost growth and ROE improved from 22% in 2015 to 24% in 2017. DBS aspires to improve the cost-income ratio further to less than 40%.

Digital strategy 2: Consumer/SME banking in growth markets including India and Indonesia. DBS is using the digital approach to acquire clients at a low cost and achieve scale in product distribution. The aim is to disrupt the banking incumbents in the growth markets that have large swathes of physical branches. Fighting head on with physical branches in these growth markets would be uneconomical and less effective. Income from Consumer & SME banking in growth markets including India and Indonesia is expected to grow 20% CAGR.

Digital strategy 3: Corporate banking, Private banking, Markets and Others at group level. Private banking and cash management have experienced higher transaction turnover as digital platforms keep clients engaged and client-initiated transactions increase.

What is our outlook?

We have increased our DBS ROE expectation for FY18e from previous estimate of 12.1% to 13.1% as the economies in DBS' main markets of Hong Kong and Singapore remain vibrant. In particular, Singapore 3Q GDP growth surpassed expectations with a 5.2% increase YoY. Our revised ROE estimate is due to our expectation that the strong economy continues to be supportive of stronger pass-through of higher interest rates. As a result we increased our FY18e total income estimate by 4.5% and PATMI estimate by 8.4%. The high double digit growth in FY18e PATMI is mainly due to absence of lumpy provision expense in FY17

Investment Actions

Maintain “BUY” rating with a higher target price of S\$29.30 (previous TP S\$26.83) based on Gordon Growth Model

27 November 2017

Buy (Maintain)

LAST TRADED PRICE	SGD 24.93
FORECAST DIV	SGD 0.66
TARGET PRICE	SGD 29.30
TOTAL RETURN	20.18%

COMPANY DATA

BLOOMBERG TICKER	DBS SP
O/S SHARES (MN) :	2,558
MARKET CAP (USD mn / SGD mn) :	47354 / 63762
52 - WK HI/LO (SGD) :	25 / 16.55
3M Average Daily T/O (mn) :	4.41

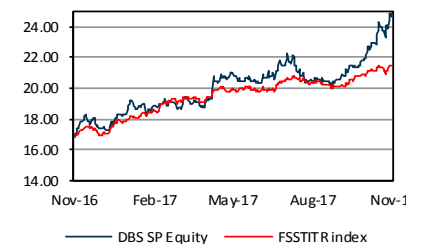
MAJOR SHAREHOLDERS (%)

Temasek Holdings Pte Ltd	29.35%
Vanguard Group	2.12%
Norges Bank Investment Management	2.02%
BlackRock	1.30%

PRICE PERFORMANCE (%)

	1M TH	3M TH	1YR
COMPANY	12.2	19.7	51.4
STIRETURN	2.34	5.21	24.62

PRICE VS. STI



Source: Bloomberg, PSR

KEY FINANCIALS

Y/E Dec	FY 15	FY 16	FY 17e	FY 18e
Total Inc (SGDmn)	10,923	11,489	12,200	13,544
Op Profit (SGDmn)	5,280	5,083	5,151	7,383
NPAT (SGDmn)	4,567	4,360	4,504	6,375
EPS (SGD)	1.71	1.73	1.52	2.42
PER, (X)	11.7	10.3	15.8	10.3
P/BV, (X)	13	10	14	13
DPS (SGD)	0.60	0.60	0.66	0.68
ROE, (%)	11.4%	10.4%	9.1%	13.1%

Source: Bloomberg, Company, PSR

Valuation Method:

Gordon Growth Model (ERP: 6.7%, g: 2%)

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Details on the key takeaways

Consumer & SME banking (Singapore and Hong Kong) income grew 11% CAGR from 2015 to 2017 because of the growth from digital channel. The digital channel grew 23% CAGR from 2015 to 2017 compared to the -2% CAGR growth at the traditional channel. The digital channel also produced a higher ROE of 27% than the 19% ROE at the traditional channel. By 2017, the digital channel contributed to 60% of the Consumer & SME banking (Singapore and Hong Kong) income, an increase from 49% contribution in 2015.

Consumer & SME banking (S'pore & HK) Key indicators	Total	Traditional channel	Digital channel	Digital channel strengths
Income per customer (S\$'000)	0.9	0.6	1.3	2X income per customer
Cost-income ratio (%)	43	55	34	21 percentage points lower CIR
Return on equity (%)	24	19	27	8 percentage points higher ROE

Source: DBS Investor Day Presentation, PSR

Consumer banking in India is gaining traction. Though it is still loss-making (losses undisclosed), we expect to see profit growth by end of 2018. Since the launch of digibank India in April 2016, DBS has been rolling out its phase 1 products which are savings accounts and time deposits and electronic payment services. By Oct 2017, the pace of client acquisition had almost trebled to a 3 month moving average of c.40,000 from c.15,000 in Aug 2016. Cumulatively, digibank India has 1.5 million customers as of Oct 2017. The value of transactions per month has increased 11 fold from Aug 2016 to reach c.S\$160mn in Oct 2017. However, the profit drivers will be coming from the phase 2 products. Phase 2 products will roll out gradually, starting as early as 1Q 2018. DBS launched the digibank Indonesia in Aug 2017 with the intention of replicating the digibank India strategy but with some changes tailored to the culture and social norms of the Indonesian people.

India Digibank Phase 2 products	Mutual Fund	Mortgages	Unsecured loans	Remittance	Insurance	Credit cards
Expected date of launch	Nil	Nil	1Q18	2Q18	4Q18	1Q19

Source: DBS Investor Day Presentation, PSR

DBS' SME banking in India has found a strong local partner. Presently, the number of small SME (valued at S\$1mn to S\$5mn) in DBS' India portfolio is 2.5mn. With the partnership with Tally, a leading ERP company in India, we expect DBS to gain access to customers in Tally's portfolio amounting to 8mn customers. Tally has 70% market share in India's SME space. DBS' value proposition to Tally is the provision of banking products and services to Tally's customers to create an integrated ERP plus banking platform. In return, DBS will be able to leverage on Tally's extensive distribution network of more than 2,000 certified channel partners and 30,000 sales agents to scale up client acquisition. DBS is also a leader in technology as it has developed standardised ERP API for easy integration, user-friendly mobile applications and has the highest encrypted security standards. Therefore even as the partnership is not exclusive, we believe DBS' value proposition is sufficiently robust to fend off competing banks.

List of Abbreviations

WM – Wealth Management
 NII – Net Interest Income
 NIM – Net Interest Margin
 LDR – Loan to Deposit Ratio
 CASA – Current Account, Savings Account
 AUM – Asset Under Management
 ERP – Enterprise Resource Planning
 SME – Small Medium Enterprise
 API – Application Programming Interface
 RFP – Request for Proposals
 RM – Relationship Manager

The digibank India profit drivers will be coming from the phase 2 products which will be rolled out gradually starting as early as 1Q2018.

Cash management transactions turnover increased because digital capabilities reduced duration of sales cycle, client onboarding, payment settlement & reconciliation and post sales services.

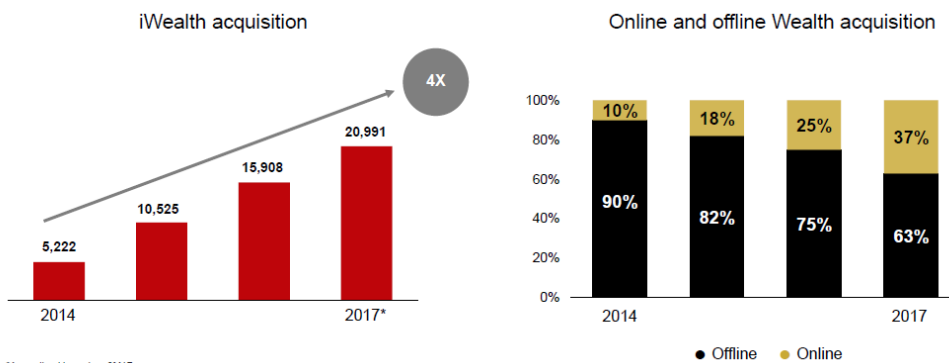
Process	Traditional	Digital
Consultative selling and RFPs	<ul style="list-style-type: none"> - 1 to 6 months of consultative selling - 1 to 2 months for RFPs 	<ul style="list-style-type: none"> - Real-time analytics based selling. - No RFPs
Account opening	7 to 8 days from form submission	Same day account opening
Payment settlement and reconciliation	<ul style="list-style-type: none"> - T+1 settlement - T+? reconciliation 	Instant
Post sales	<ul style="list-style-type: none"> - Call centre: 5 to 10 min response - Manual account planning and market analysis 	<ul style="list-style-type: none"> - Chatbots and AI: instant - Enterprise data analytics: instant origination and cross-sell leads

Source: DBS Investor Day Presentation, PSR

Digital capabilities improve WM client transaction turnover, client acquisition and client engagement. The digital capabilities allow clients to execute straight-through transactions especially in higher margin structured products. Time for client acquisition has shortened because of the digital onboarding process. Client engagement has also become more efficient as client’s data is integrated into the digital platform for easy access.

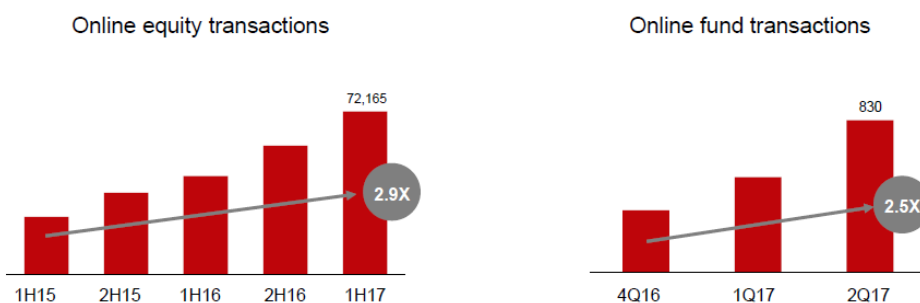
Treasures and Treasures Private Client cost-income ratio from the traditional client base is 53% compared to 43% for the digital client base was due to faster income growth from the digital channel.

Figure 1: WM client acquisition increased 4 times since 2014 with the online acquisition channel becoming more dominant.



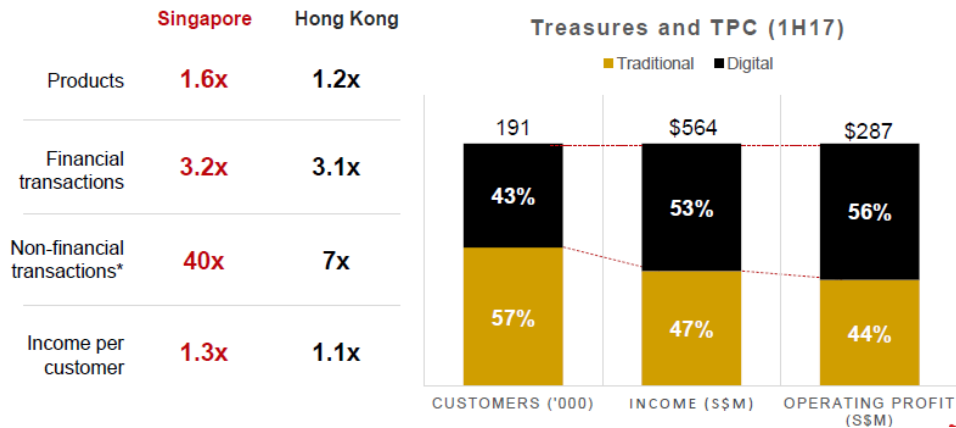
Source: DBS Investor Day presentation

Figure 2: WM digital transactions growth has accelerated in the last 2 years



Source: DBS Investor Day presentation

Figure 3: Digitally engaged WM clients are multiple times more profitable and more active compared to non-digitally engaged clients.



Source: DBS Investor Day presentation

What do we think of the digibank strategy?

We are excited about the digital push into the growth markets (namely in India and Indonesia) and also because the execution of phase 2 projects in India is imminent. Presently, the growth markets are still loss-making at the net profit line but the expectation is for growth market’s total income to grow more than 20% CAGR in the next 5 years. Growth markets total income as of 1H17 is about 4% of group total income so it has the potential to contribute up to 10% of DBS group total income and its ROE is also expected to exceed 10% in 5 years.

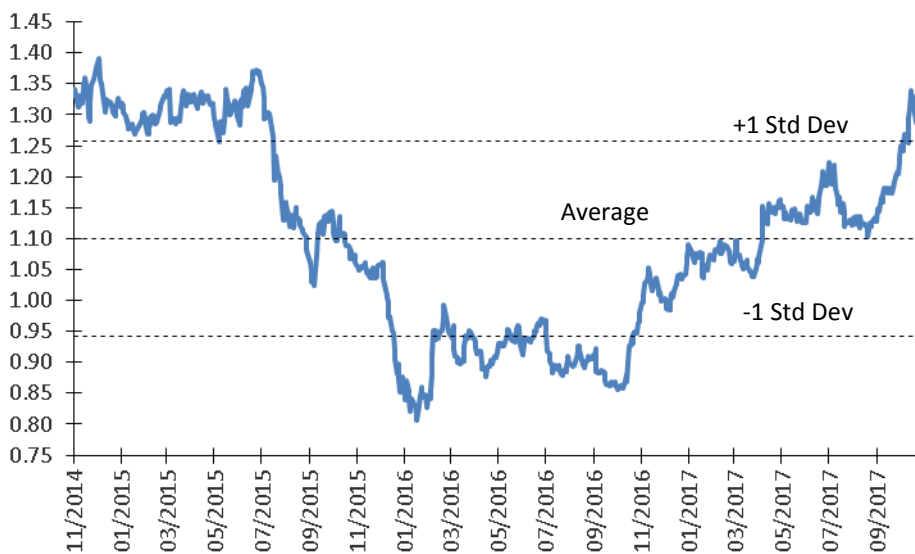
We think that the conditions are particularly favourable for digital push into India because of the mandatory Aadhaar system to all the residents of India and the ongoing banknote de-monetisation in India. The Aadhaar system is a 12-digit unique identification number that is linked to the resident’s basic demographic and biometric information such as photograph, fingerprints, iris scans which are stored in a centralised database. With the advanced and comprehensive digital identification infrastructure and expected increase in digital payments as a result of the banknote de-monetisation, it is highly plausible for DBS to successfully acquire clients digitally at partnering retail outlets where consumers make purchases of goods and services – [a strategy that DBS is already carrying out](#).

We are also cautiously optimistic that digibank India could outperform management’s expectations because DBS, being a leader in digital banking technology, has a first mover advantage into a large Indian population that is young and IT savvy.

Valuation: Gordon Growth Model

Item	Description	Value
R _f	Risk-free rate	2.0%
E	Equity-risk premium	6.7%
B	Beta	1.098
COE	Cost of Equity	9.3%
ROE	FY18e Return on Equity	13.1%
g	Terminal growth rate	2.0%
(ROE-g)	FY18e Target Price to Book	1.51
(COE-g)	FY18e BVPS, S\$	19.40
	FY18e Valuation, S\$	29.30

3-Year Historical Price-to-Book



Financials

Income Statement

Y/E Dec, SGD mn	FY14	FY15	FY16	FY17e	FY18e
Net Interest Income	6,321	7,100	7,305	7,715	8,975
Fees and Commission	2,027	2,144	2,331	2,533	2,898
Other Non interest income	1,468	1,679	1,853	1,952	1,671
Total income	9,816	10,923	11,489	12,200	13,544
Operating expenses	4,330	4,900	4,972	5,084	5,317
Provisions	667	743	1,434	1,965	845
Operating profit	4,819	5,280	5,083	5,151	7,383
Associates & JVs	79	14	0	0	0
Profit Before Tax	4,898	5,294	5,083	5,151	7,383
Taxation	713	727	723	647	1,008
Profit After Tax	4,185	4,567	4,360	4,504	6,375
Non-controlling Interest	139	113	122	136	137
Net Income, reported	4,046	4,454	4,238	4,368	6,238
Net Income, adj.	3,848	4,318	4,238	4,018	6,238

Per share data (SGD)

Y/E Dec, SGD mn	FY14	FY15	FY16	FY17e	FY18e
EPS, reported	1.63	1.71	1.73	1.52	2.42
DPS	0.58	0.60	0.60	0.66	0.68
BVPS	14.44	15.49	16.61	17.69	19.40

Supplementary items

Y/E Dec, SGD mn	FY14	FY15	FY16	FY17e	FY18e
CET1 CAR (%)	13.1%	13.5%	14.1%	13.6%	13.7%
Tier 1 CAR (%)	13.1%	13.5%	14.7%	14.1%	14.2%
Total CAR (%)	15.3%	15.4%	16.2%	15.5%	15.6%

Balance Sheet

Y/E Dec, SGD mn	FY14	FY15	FY16	FY17e	FY18e
Cash and bal with central banks	19,517	18,829	26,840	22,661	20,332
Due from banks	42,263	38,285	30,018	33,020	33,020
Govt, Bank & Corp Sec & T Bills	67,457	74,574	78,818	98,936	105,955
Derivatives	16,995	23,631	25,757	16,651	11,082
Goodwill and intangibles	5,117	5,117	5,117	5,166	5,166
Property and other fixed assets	1,485	1,547	1,572	1,263	1,758
Loans to non-bank customers	275,588	283,289	301,516	319,701	343,151
JV and Associates	995	1,000	890	882	919
Other assets	11,249	11,562	11,042	12,268	11,135
Total Assets	440,666	457,834	481,570	510,548	532,518
Due to banks	16,176	18,251	15,915	22,920	22,920
Deposits from customers	317,173	320,134	347,446	365,132	387,848
Derivatives	18,755	22,145	24,497	16,651	11,082
Other liabilities	11,728	12,404	15,895	19,753	19,829
Other debt securities	31,963	38,078	27,745	35,514	35,514
Subordinated term debts	4,665	4,026	3,102	1,147	1,147
Total liabilities	400,460	415,038	434,600	461,117	478,340
Shareholder's equity	37,708	40,374	44,609	47,056	51,816
Non-controlling interest	2,498	2,422	2,361	2,375	2,362
Total Equity	40,206	42,796	46,970	49,431	54,178

Valuation Ratios

Y/E Dec, SGD mn	FY14	FY15	FY16	FY17e	FY18e
P/E (X), avg	11.8	11.7	10.3	15.8	10.3
P/B (X), avg	1.3	1.3	1.0	1.4	1.3
Dividend Yield (%)	3.3%	3.1%	3.5%	2.6%	2.7%

Growth & Margins (%)

Growth					
Net interest income	13.5%	12.3%	2.9%	5.6%	16.3%
Net Fee and Comm Inc	7.5%	5.8%	8.7%	8.7%	14.4%
Total income	7.9%	11.3%	5.2%	6.2%	11.0%
Profit before tax	9.3%	9.6%	-3.7%	1.3%	43.3%
Net income, reported	10.2%	10.1%	-4.8%	3.1%	42.8%
Net income, adj.	9.9%	12.2%	-1.9%	-5.2%	55.2%

Margins

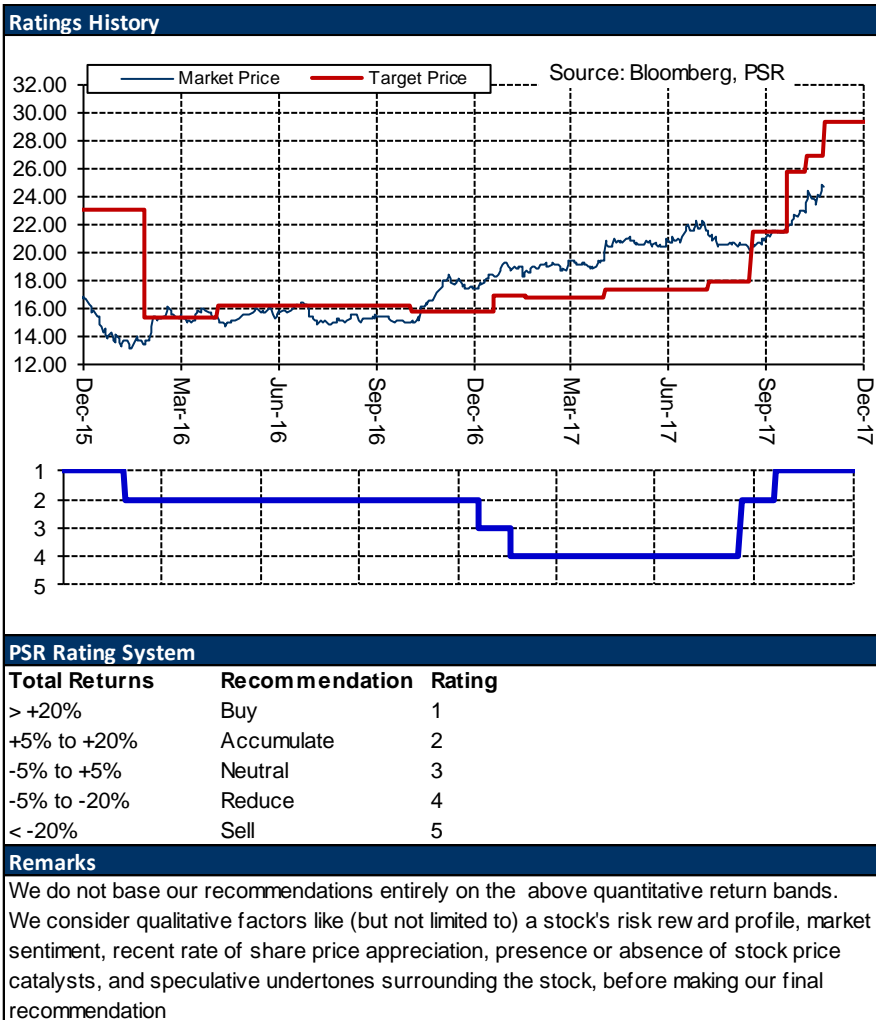
Net interest margin	1.71%	1.84%	1.71%	1.77%	1.93%
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Key Ratios (%)

ROE	10.9%	11.3%	10.4%	9.1%	13.1%
ROA	0.9%	1.0%	0.9%	0.8%	1.2%
RORWA	1.5%	1.6%	1.5%	1.4%	1.9%
Non-interest/total income ratio	35.6%	35.0%	36.4%	36.8%	33.7%
Cost/income ratio	44.1%	44.9%	43.3%	41.7%	39.3%
Loan/deposit ratio	86.9%	88.5%	86.8%	87.6%	88.5%
NPL ratio	0.87	0.91	1.45	1.71	1.53

Source: Company, PSR

*Forward multiples & yields based on current market price; historical multiples & yields based on historical market price.



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