

# DBS GROUP HOLDINGS LTD

Profit before Allowance remains Weak as Coverage Ratio Deteriorates



## SINGAPORE | BANKING | 2Q17 RESULTS

- 2Q17 PATMI of S\$1.13bn missed our estimate by 12.4%.
- The downside surprise came from higher-than-expected provisions.
- Maintain "Reduce" rating with a higher target price of S\$17.92 (previous TP S\$17.24)** based on Gordon Growth Model (previously 0.95x FY17F PBR, excluding preference shares).

### Results at a glance

(SGD mn)	2Q17	2Q16	YoY (%)	1Q17	QoQ (%)	Comments
NII	1,888	1,833	3.0%	1,831	3.1%	NIMs -13bps YoY, loans +6.6% YoY
Net Fees & Comm	636	628	1.3%	665	-4.4%	Higher WM and Cards YoY. Lower Loan-related and Investment Banking fees YoY
Other Non-II	400	458	-12.7%	740	-45.9%	Lower net income from investment securities, trading income YoY
<b>Total Income</b>	<b>2,924</b>	<b>2,919</b>	<b>0.2%</b>	<b>3,236</b>	<b>-9.6%</b>	
Expenses	1,268	1,285	-1.3%	1,248	1.6%	Cost savings from tech and digital initiatives
Allowance	304	366	-16.9%	550	-44.7%	SP remains elevated because of O&G exposure
<b>Net Profit</b>	<b>1,175</b>	<b>1,079</b>	<b>8.9%</b>	<b>1,288</b>	<b>-8.8%</b>	

Source: Company, PSR

### The Positives

+ **Strong WM.** 2Q17 WM income was S\$511mn (+21% YoY) supported by investment products (+12% YoY) and loans and deposit (+4% YoY). The strong WM income helped offset the weak 2Q17 Retail income (-2.8% YoY) to bring 2Q17 CBG income 6.5% higher YoY.

+ **Trade loans 6% higher YoY; IBG Cash/SFS income 35% higher YoY.** We believe the trade loans are boosted by the offshore RMB trade loans as the spread between the onshore SHIBOR and the offshore CNH HIBOR narrowed in recent months. 2Q17 IBG Cash/SFS income showed strong growth as Non-trade corporate (+8% YoY), and Trade loans (+6% YoY) grew.

+ **Stronger Net Interest Income growth was due to higher volumes of interest-bearing assets.** Stronger NII YoY was led by loans growth (6.6% higher YoY) offset by lower NIM. Stronger NII QoQ was supported by pass through of higher rates in Singapore market offset by unfavourable rates for HIBOR pegged loans in Hong Kong and higher LDR of 88% (2Q17: 87%).

+ **Recovering Singapore property market.** DBS experienced strong pick up in resale and refinancing mortgage activities in 2Q17 as it has 28.7% market share in Singapore housing mortgage.

### The Negatives

- **Unfavourable rate and volume dynamics could remain a challenge.** Despite positive non-trade corporate loans growth, IBG NII fell 5.8% YoY from S\$721mn in 2Q16 to S\$679mn in 2Q17. We estimate the IBG NII make up c.22% of Total Income (c.30% of Total NII). IBG Treasury income fell 16.7% YoY from S\$204mn in 2Q16 to S\$170mn in 2Q17. On the CBG business, the unfavourable HIBOR has mainly affected the HIBOR pegged housing mortgage loans thus causing Hong Kong NIM to decline 9 basis points QoQ.

- **Treasury customer income fell 8% YoY** because of lower RMB hedging activities from customers and continuing poor performance in the interest rate activities in Treasury Markets.

7 August 2017

### Reduce (Maintain)

LAST TRADED PRICE	SGD 21.49
FORECAST DIV	SGD 0.63
TARGET PRICE	SGD 17.92
<b>TOTAL RETURN</b>	<b>-13.68%</b>

### COMPANY DATA

BLOOMBERG TICKER	DBS SP
O/S SHARES (MN) :	2,556
MARKET CAP (USD mn / SGD mn) :	40355 / 54923
52 - WK HI/LO (SGD) :	22.25 / 14.72
3M Average Daily T/O (mn) :	4.22

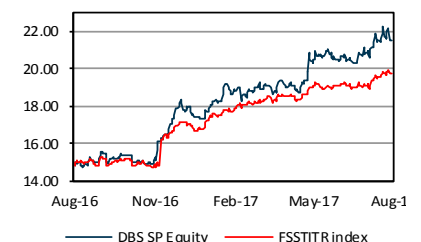
### MAJOR SHAREHOLDERS (%)

Temasek Holdings Pte Ltd	29.37%
Vanguard Group	2.04%
Norges Bank Investment Management	1.97%
BlackRock	1.27%

### PRICE PERFORMANCE (%)

	1M TH	3M TH	1Y R
COMPANY	3.9	5.1	47.9
STI RETURN	4.34	4.09	21.58

### 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	12,148	12,360
Op Profit (SGDmn)	5,280	5,083	5,869	6,335
NPAT (SGDmn)	4,567	4,360	5,122	5,503
EPS (SGD)	1.71	1.73	1.95	2.06
PER, (X)	11.7	10.3	11.0	10.4
P/BV, (X)	1.3	1.0	1.2	1.1
DPS (SGD)	0.60	0.60	0.63	0.63
ROE, (%)	11.4%	10.0%	11.0%	11.0%

Source: Bloomberg, Company, PSR

### Valuation Method:

**Gordon Growth Model (ERP: 6.5%, g: 2%)**

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- **Lumpy write offs in the offshore O&G sector has weighed on provision expense and coverage ratio.** Recall that DBS used the S\$350mn gain from the sale of PwC building in 1Q17 to bolster its general provisions and improve the coverage ratio from 97% to 103%. However, for the current quarter, the lumpy write-offs and new NPL formation in 2Q17 brought the coverage ratio back down to 100%. There are still ongoing concerns on offshore services vessel collateral values as charter rates continue to be low. Liquidity driven events such as bond maturities will be key risks to NPL formation in the near future. DBS' exposure to the O&G support services is S\$5.4bn.

### Outlook

Our FY17e total income growth estimate is 5.7% as we expect FY17e NII growth to be c.3%. Though the management has guided for FY17e provision expense of S\$1bn, we believe it is insufficient because 1H17 provision expense was already S\$854mn yet coverage ratio is 100%. Unless there is certainty of stable write-offs and net NPL formation, we think that S\$150mn provision expense for 2H17 could be insufficient. Therefore, we are revising our FY17e to S\$1.16bn from the previous estimate of S\$1.1bn.

The operations in the IBG segment appears to be challenged with a negative jaw of -2% YoY for 1H17. We continue to see unfavourable loan rate dynamics in non-trade corporate loans and a continuing poor performance in DBS' Treasury Markets in 2017. The retail segment in CBG appears to be sluggish (2Q17 Retail income -2.8% YoY). But the bright spots are – a) the WM segment continues to grow through product synergies between loans, deposits, investment products and cards b) Strong Cash/SFS income growth as trade and corporate loans increase.

The “larger than expected” specific allowance in 2Q17 was an immediate reaction to the lumpy write-off and net NPL formation in the same quarter. The situation corroborates with our longstanding argument that DBS has little bandwidth to manage its provision expense owing to low coverage ratio wherein too little provision expense would bring the coverage below 100%, but too much provision expense will eat into the PATMI growth. **Whilst a stronger growth in Total Income can support higher provision expense, we highlight that unfavourable conditions continue to impact total income growth** – a) DBS already has a [high LDR](#), so it does not have a wide headroom to stretch it further to raise NII b) As we have already observed; unfavourable loan volume and rate dynamics, benchmark rates and competition in mature markets can crimp NII growth. c) Hong Kong's funding costs may be more sensitive to capital flows as Hong Kong's CASA (cheap and sticky deposits) ratio is c.56% compared to Singapore's CASA ratio of c.91%.

In the near term, however, economic sentiments are improving, and volatility is low from the start of 2017. Singapore housing market has bottomed and recovering. Therefore we are revising our valuation to reflect these improvements.

### Valuation: Gordon Growth Model

Item	Description	Value
$R_f$	Risk-free rate	2.0%
E	Equity-risk premium	6.5%
B	Beta	1.289
COE	Cost of Equity	10.4%
ROE	FY17e Return on Equity	10.2%
g	Terminal growth rate	2.0%
(ROE-g) (COE-g)	FY17e Target Price to Book	0.98
	FY17e BVPS, S\$	18.26
	FY17e Valuation, S\$	17.92

**3-Year Historical Price-to-Book**



**Investment Actions**

**Maintain “Reduce” rating with a higher target price of S\$17.92 (previously S\$17.24)** based on Gordon Growth Model (previously 0.95x FY17F PBR, excluding preference shares).

**List of Abbreviations**

- WM – Wealth Management
- IBG – Institutional Banking Group
- CBG – Consumer Banking Group
- NII – Net Interest Income
- NIM – Net Interest Margin
- LDR – Loan to Deposit Ratio
- NPL – Non-performing Loans
- CASA – Current Account, Savings Account

Table 1. Fee and commission income

SGD mn	2Q17	2Q16	YoY (%)	1Q17	QoQ (%)
Brokerage	38	38	0.0%	38	0.0%
Investment banking	41	83	-50.6%	45	-8.9%
Transaction Services	154	148	4.1%	157	-1.9%
Loan related	104	120	-13.3%	128	-18.8%
Cards	130	108	20.4%	123	5.7%
Others	19	24	-20.8%	28	-32.1%
Wealth management	245	179	36.9%	222	10.4%
Fee and comm expense	(95)	(72)	NM	(76)	NM
<b>Total</b>	<b>636</b>	<b>628</b>	<b>1.3%</b>	<b>665</b>	<b>-4.4%</b>

Wealth management the stand-out performer

Table 2. Other non-interest income

SGD mn	2Q17	2Q16	YoY (%)	1Q17	QoQ (%)
Net trading income	295	307	-3.9%	270	9.3%
Net income on Fin Inv	95	116	-18.1%	102	-6.9%
Net gain on fixed assets	-	13	NM	1	NM
Others (inc. rental and assoc)	10	22	-54.5%	17	-41.2%
<b>Total other non int Inc</b>	<b>400</b>	<b>458</b>	<b>-12.7%</b>	<b>390</b>	<b>2.6%</b>

Less investment gains

Table 3. Loans by Industries

SGD mn	2Q17	2Q16	YoY (%)	1Q17	QoQ (%)
Manufacturing	32,771	30,087	8.9%	30,690	6.8%
Building & construction	60,546	56,048	8.0%	57,565	5.2%
Housing loans	64,850	60,913	6.5%	64,629	0.3%
General commerce	48,692	45,206	7.7%	46,796	4.1%
Tpt, storage & comms	30,411	27,819	9.3%	31,218	-2.6%
Fis, invt & holding co	14,768	15,254	-3.2%	16,594	-11.0%
Professionals & Pri inv	25,312	24,042	5.3%	24,692	2.5%
Others	30,072	28,975	3.8%	30,758	-2.2%
<b>Total loans</b>	<b>307,422</b>	<b>288,344</b>	<b>6.6%</b>	<b>302,942</b>	<b>1.5%</b>

Business and trade related loans leading the group

Table 4. Loans by currencies

SGD mn	2Q17	2Q16	YoY (%)	1Q17	QoQ (%)
Singapore dollar	126,378	121,457	4.1%	124,096	1.8%
US dollar	101,206	93,437	8.3%	100,487	0.7%
Hong Kong dollar	34,389	32,825	4.8%	33,502	2.6%
Chinese yuan	10,127	11,732	-13.7%	10,912	-7.2%
Others	35,322	28,893	22.3%	33,945	4.1%
<b>Total loans</b>	<b>307,422</b>	<b>288,344</b>	<b>6.6%</b>	<b>302,942</b>	<b>1.5%</b>

Table 5. Revenue by Business segments

SGD mn	2Q17	2Q16	YoY (%)	1Q17	QoQ (%)
Consumer/Priv Banking	1,140	1,070	6.5%	1,159	-1.6%
Institutional Banking	1,298	1,340	-3.1%	1,319	-1.6%
Treasury	258	271	-4.8%	187	38.0%
Others	228	238	-4.2%	221	3.2%
<b>Total Revenue</b>	<b>2,924</b>	<b>2,919</b>	<b>0.2%</b>	<b>2,886</b>	<b>1.3%</b>

Table 6. Revenue by Geographical segments

SGD mn	2Q17	2Q16	YoY (%)	1Q17	QoQ (%)
Singapore	1,923	1,956	-1.7%	1,870	2.8%
Hong Kong	536	520	3.1%	524	2.3%
Rest of Greater China	208	188	10.6%	208	0.0%
South and SE Asia	168	181	-7.2%	195	-13.8%
Rest of the world	89	74	20.3%	89	0.0%
<b>Total Revenue</b>	<b>2,924</b>	<b>2,919</b>	<b>0.2%</b>	<b>2,886</b>	<b>1.3%</b>

Source (tables 1-6): Company, PSR

Fig 1: Net interest margin

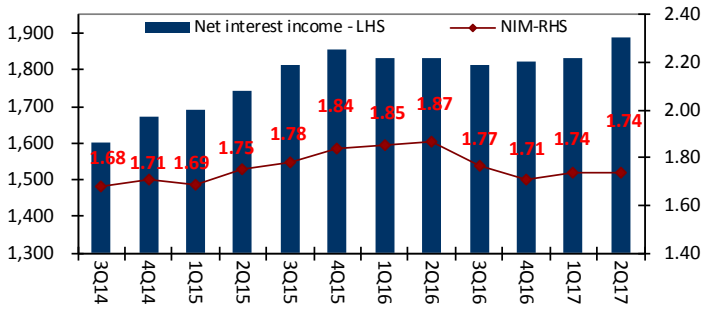


Fig 2: Nonll/Total Income

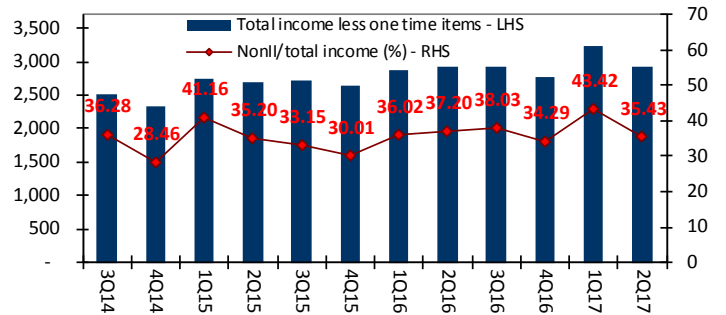


Fig 3: Efficiency ratio

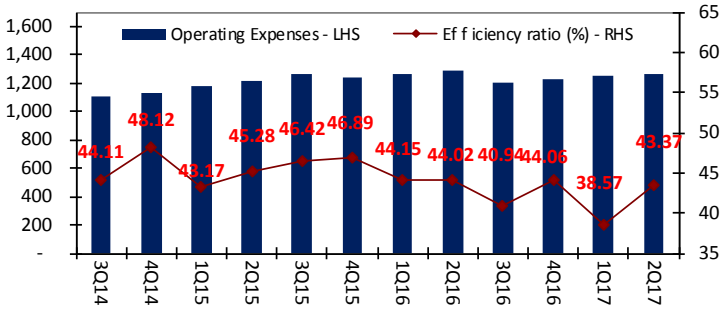


Fig 4: Net profit margin

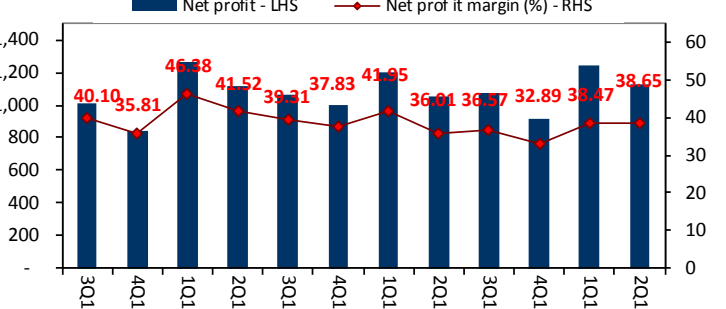


Fig 5: Deposits, Loans, LDR

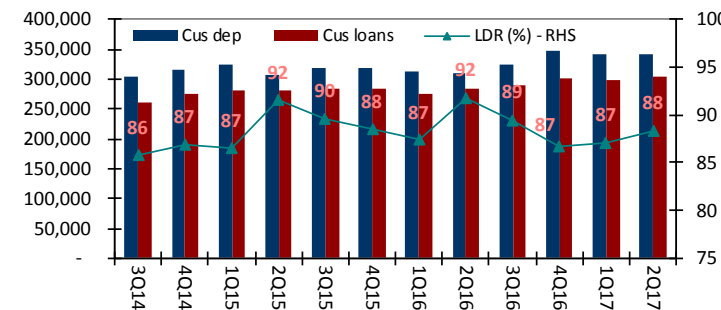


Fig 6: NPA, NPL

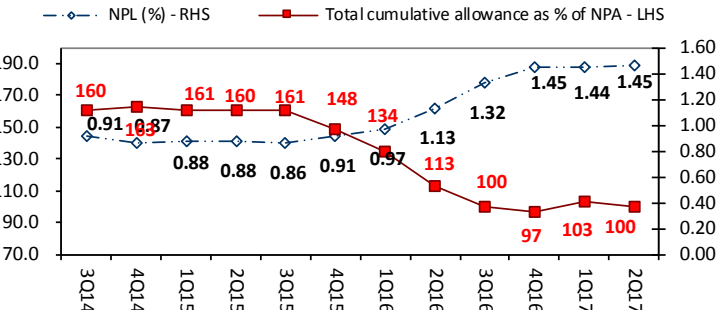


Fig 7: Growth in selected asset items

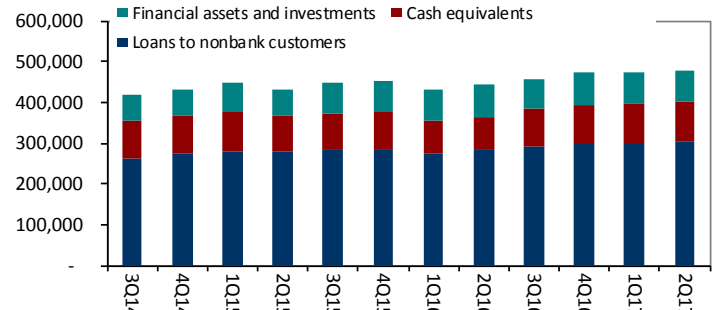


Fig 8: CAR

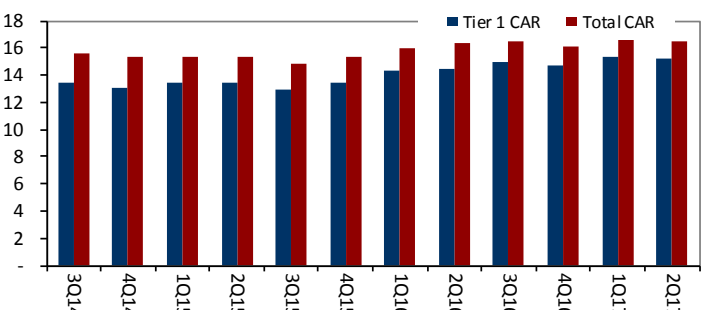


Fig 9: ROE and ROA

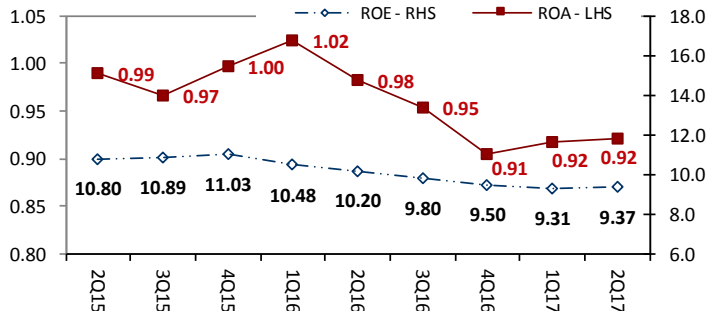


Fig 10: EPS and NBV

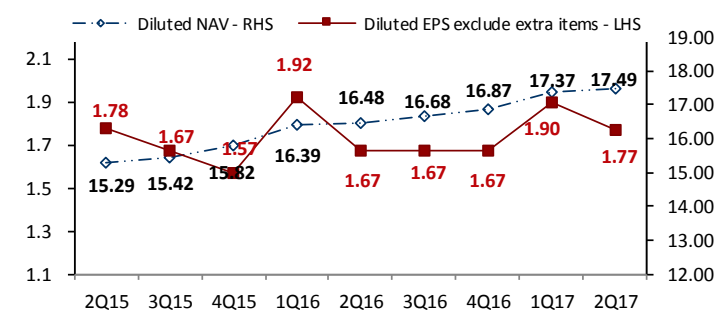


Fig 11: Profit before tax by geographical segment

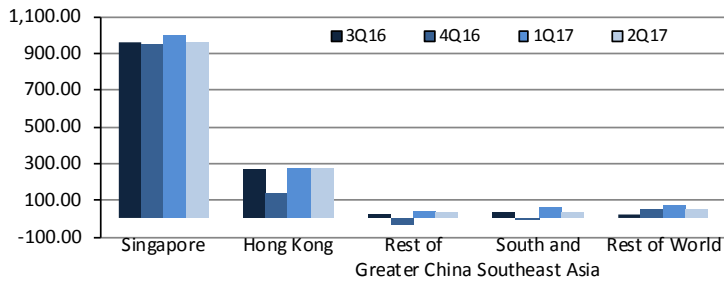


Fig 12: Profit before tax by Geographical segment breakdown

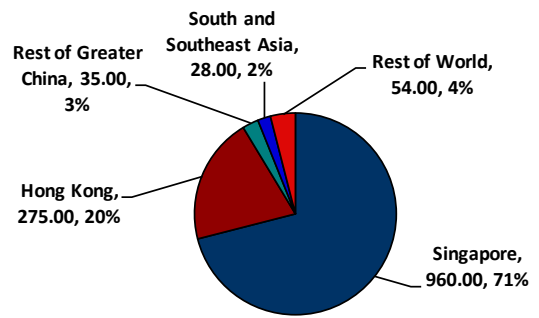


Fig 13: Profit before tax by business segment

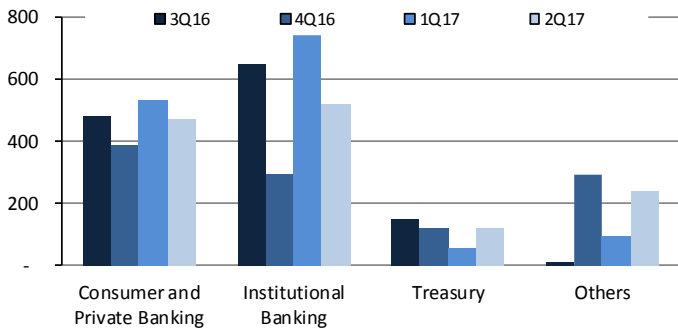


Fig 14: Net interest income trend

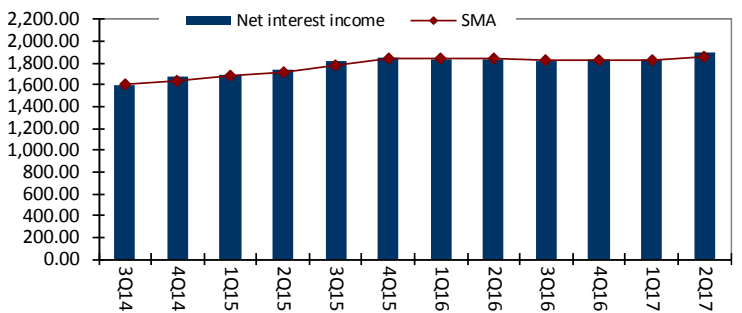


Fig 15: Fee and Commission trend

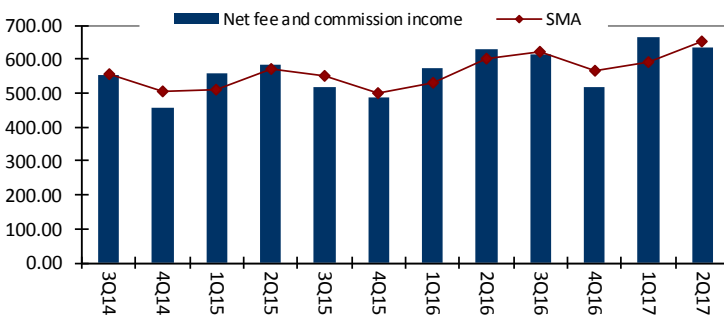
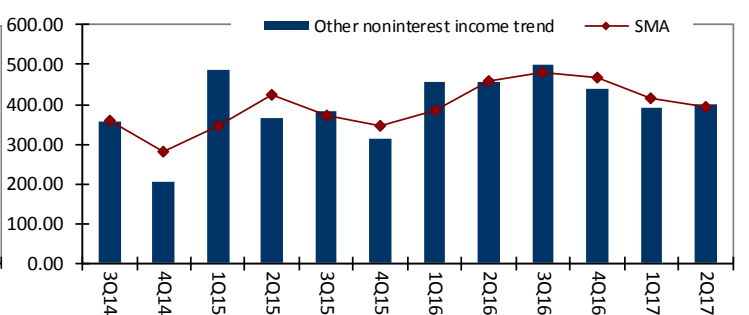


Fig 16: Other noninterest income trend



## Financials

### Income Statement

Y/E Dec, SGD mn	FY14	FY15	FY16	FY17e	FY18e
Net Interest Income	6,321	7,100	7,305	7,546	7,745
Fees and Commission	2,027	2,144	2,331	2,426	2,770
Other Non interest income	1,468	1,679	1,853	2,176	1,845
<b>Total income</b>	<b>9,816</b>	<b>10,923</b>	<b>11,489</b>	<b>12,148</b>	<b>12,360</b>
Operating expenses	4,330	4,900	4,972	5,121	5,312
Provisions	667	743	1,434	1,159	713
<b>Operating profit</b>	<b>4,819</b>	<b>5,280</b>	<b>5,083</b>	<b>5,869</b>	<b>6,335</b>
Associates & JVs	79	14	0	0	0
<b>Profit Before Tax</b>	<b>4,898</b>	<b>5,294</b>	<b>5,083</b>	<b>5,869</b>	<b>6,335</b>
Taxation	713	727	723	747	832
<b>Profit After Tax</b>	<b>4,185</b>	<b>4,567</b>	<b>4,360</b>	<b>5,122</b>	<b>5,503</b>
Non-controlling Interest	139	113	122	128	127
<b>Net Income, reported</b>	<b>4,046</b>	<b>4,454</b>	<b>4,238</b>	<b>4,994</b>	<b>5,376</b>
<b>Net Income, adj.</b>	<b>3,848</b>	<b>4,318</b>	<b>4,238</b>	<b>4,644</b>	<b>5,376</b>

### Per share data (SGD)

Y/E Dec, SGD mn	FY14	FY15	FY16	FY17e	FY18e
EPS, reported	1.63	1.71	1.73	1.95	2.06
DPS	0.58	0.60	0.60	0.63	0.63
BVPS	14.44	15.49	16.61	18.26	19.47

### Supplementary items

Y/E Dec, SGD mn	FY14	FY15	FY16	FY17e	FY18e
CET1 CAR (%)	13.1%	13.5%	14.1%	14.7%	14.8%
Tier 1 CAR (%)	13.1%	13.5%	14.7%	15.2%	15.4%
Total CAR (%)	15.3%	15.4%	16.2%	16.7%	16.9%

### Balance Sheet

Y/E Dec, SGD mn	FY14	FY15	FY16	FY17e	FY18e
Cash and bal with central banks	19,517	18,829	26,840	19,291	20,976
Due from banks	42,263	38,285	30,018	33,127	33,127
Govt, Bank & Corp Sec & T Bills	67,457	74,574	78,818	90,471	96,868
Derivatives	16,995	23,631	25,757	15,336	10,207
Goodwill and intangibles	5,117	5,117	5,117	5,115	5,115
Property and other fixed assets	1,485	1,547	1,572	1,332	1,853
Loans to non-bank customers	275,588	283,289	301,516	310,964	319,299
JV and Associates	995	1,000	890	896	933
Other assets	11,249	11,562	11,042	11,881	10,785
<b>Total Assets</b>	<b>440,666</b>	<b>457,834</b>	<b>481,570</b>	<b>488,415</b>	<b>499,163</b>
Due to banks	16,176	18,251	15,915	22,709	22,709
Deposits from customers	317,173	320,134	347,446	346,498	358,135
Derivatives	18,755	22,145	24,497	15,336	10,207
Other liabilities	11,728	12,404	15,895	18,961	19,034
Other debt securities	31,963	38,078	27,745	34,099	34,593
Subordinated term debts	4,665	4,026	3,102	2,186	2,186
<b>Total liabilities</b>	<b>400,460</b>	<b>415,038</b>	<b>434,600</b>	<b>439,789</b>	<b>446,863</b>
Shareholder's equity	37,708	40,374	44,609	46,275	49,973
Non-controlling interest	2,498	2,422	2,361	2,350	2,328
<b>Total Equity</b>	<b>40,206</b>	<b>42,796</b>	<b>46,970</b>	<b>48,626</b>	<b>52,300</b>

### Valuation Ratios

Y/E Dec, SGD mn	FY14	FY15	FY16	FY17e	FY18e
P/E (X), avg	11.8	11.7	10.3	11.0	10.4
P/B (X), avg	1.3	1.3	1.0	1.2	1.1
Dividend Yield (%)	3.3%	3.1%	3.5%	3.6%	3.4%

### Growth & Margins (%)

	FY14	FY15	FY16	FY17e	FY18e
<b>Growth</b>					
Net interest income	13.5%	12.3%	2.9%	3.3%	0.5%
Net Fee and Comm Inc	7.5%	5.8%	8.7%	4.1%	2.6%
Total income	7.9%	11.3%	5.2%	5.7%	0.9%
Profit before tax	9.3%	9.6%	-3.7%	15.5%	0.6%
Net income, reported	10.2%	10.1%	-4.8%	17.8%	0.8%
Net income, adj.	9.9%	12.2%	-1.9%	9.6%	0.8%

### Margins

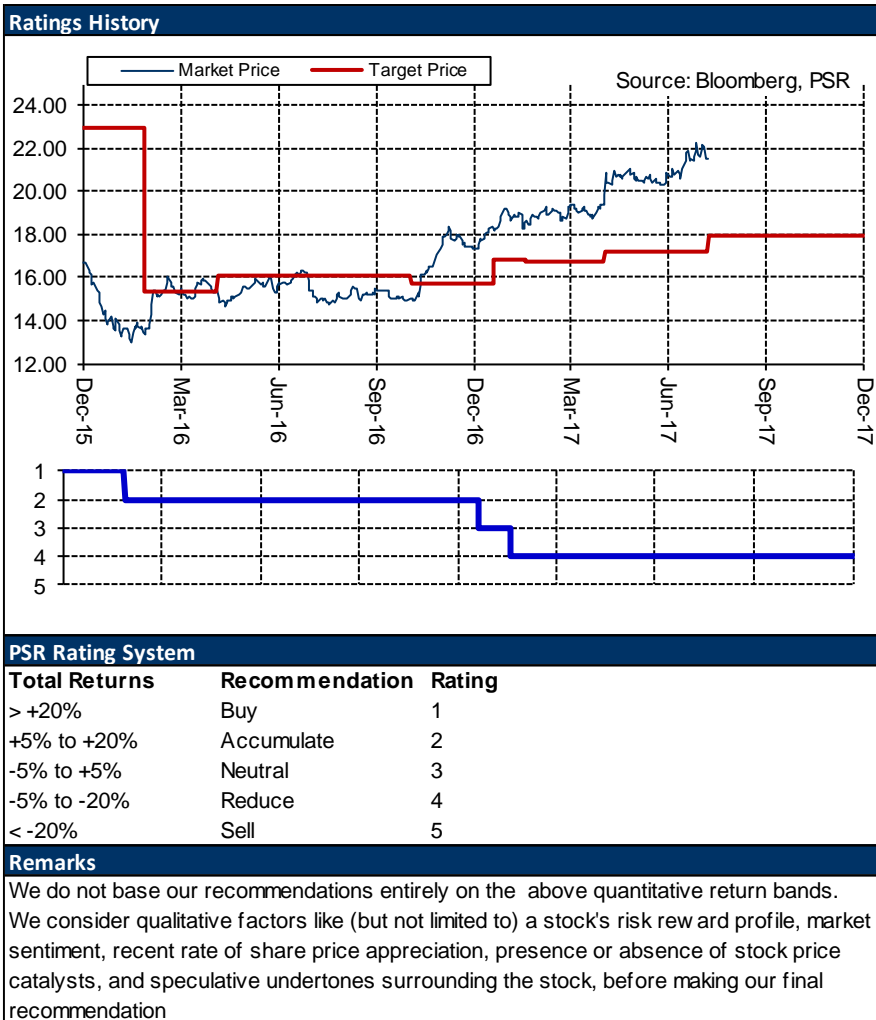
	FY14	FY15	FY16	FY17e	FY18e
Net interest margin	1.71%	1.84%	1.71%	1.75%	1.73%

### Key Ratios (%)

	FY14	FY15	FY16	FY17e	FY18e
ROE	11.2%	11.4%	10.0%	11.0%	11.0%
ROA	1.0%	1.0%	0.9%	1.0%	1.1%
RORWA	1.5%	1.6%	1.5%	1.7%	1.7%
Non-interest/total income ratio	35.6%	35.0%	36.4%	37.9%	37.3%
Cost/income ratio	44.1%	44.9%	43.3%	42.2%	43.0%
Loan/deposit ratio	86.9%	88.5%	86.8%	89.7%	89.2%
NPL ratio	0.87	0.91	1.45	1.44	1.32

Source: Company, Phillip Securities Research (Singapore) Estimates

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





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