Asia Credit Research

Earnings Review: DBS Group Holdings Ltd ("DBS")

Recommendation

- Solid fundamentals for DBS continue to support earnings and capital strength against the prospect of lower rates and potentially lower demand for credit.
- We see 2Q2019 and 1H2019 results as consistent with our issuer profile for DBS at Positive (2) although expect results to moderate in 2H2019.
- While demand for the name will remain consistent, we continue to like other Positive (2) issuers under our coverage which offer better yield for a broadly comparable credit profile.

Relative Value:

Bond	Maturity / Call date	CET1 Ratio	Ask Yield	Spread
DBSSP 2.78 '21 (Snr)	11/01/2021	13.6%	2.16%	46
DBSSP 4.7 PERP (AT1)	22/11/2020	13.6%	2.67%	97
DBSSP 3.8 '28 (T2)	20/01/2023	13.6%	2.73%	108
HSBC 4.7 PERP (AT1)	08/06/2022	14.3%	4.13%	247
HSBC 5.0 PERP (AT1)	24/09/2023	14.3%	4.30%	264

Indicative prices as at 30 July 2019 Source: Bloomberg
*Common Equity Tier 1 (CET1) Ratio based on latest available quarter *APRA Compliant*

Issuer Profile: Positive (2)

Ticker: **DBSSP**

Background

DBS Group Holdings Limited ('DBS') primarily operates in Singapore and Hong Kong and is a leading financial services group in Asia with a regional network of more than 280 branches across 18 markets. With total assets of SGD566.6bn as at 30 June 2019, it provides diversified services across consumer banking, wealth management institutional banking, and treasury. It is 30% indirectly owned by the Singapore government through Temasek Holdings Pte Ltd as of 30th July, 2019.

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Key Considerations

- **Record earnings on strong income performance:** Record 1H2019 results with total income up 11% y/y was driven by continued strong net interest income growth of 9% y/y (net interest margin rose to 1.90% from 1.84% a year ago on higher rates as well as loans growth). Elsewhere, net fee and commission income was up 3% y/y due to growth in cards, wealth management and transaction services while other non-interest income was up 35% y/y due to higher trading income and net gains on investment securities that was partially offset by absence of net gain on fixed assets (divestment of a Hong Kong property in 1H2018). For 2Q2019, total income was up 16% y/y due to strong net interest income growth of 9% y/y and +5% q/q (net interest margin rose to 1.91% from 1.85% a year ago and 1.88% in 1Q2019 on higher rates charged to clients, while rates on interest bearing liabilities grew slower as well as y/y and q/q loans growth). Net fee and commission income was also up 9% y/y and +5% q/q on investment banking, wealth management and cards performance collectively, while other non-interest income was up 88% y/y (flat q/q) due to higher trading income and net gains on investment securities (fall in trading income was offset by higher gains on investment securities q/q). Performance overall continues to show broad-based strength through a mix of decent business volumes and margin management.

- **Expense trends to be watched**: Expense growth y/y was lower than total income growth and mostly related to higher staff, occupancy and computerisation costs for 1H2019 and 2Q2019. However allowances for credit and other losses rose 22% y/y for 1H2019 – this was due to a 23% y/y rise in stage 3 or specific provisions which were mostly in Singapore and a rise in stage 3 provisions for other credit exposures. These offset a writeback in general provisions in 1H2019. Overall 1H2019 performance was entirely due to a substantial rise in 2Q2019 provisions (+139% y/y and +230% q/q to SGD251mn) due to both a y/y rise in general and specific allowances (Singapore and South and Southeast Asia) and a q/q absence of writebacks for stage 1 and stage 2 expected credit losses (or general provisions) seen in 1Q2019. While the rise in allowances for credit and other losses will need to be monitored, they however did not moderate strong performance at the profit before tax level with SGD3.89bn for 1H2019 and SGD1.91bn for 2Q2019 up 12% and 14% respectively y/y. It did however drive a 3% q/q fall in net profit before tax for 2Q2019.

- **Reported loan quality indicators remain sound:** In line with the higher allowances, non-performing loans rose 3.3% q/q and 1.6% h/h due to growth in new non-performing asset formation that was offset by recoveries and write-offs. Combined however with growth in customer loans of 4% y/y and 1% q/q, the non-performing loan ratio was stable q/q and improved by 10bps h/h to 1.5%. Loans growth continues to be concentrated in non-trade corporate loans while consumer loans were stable as a fall in housing loans was offset by growth in other consumer loans. Similar growth trends were seen in non-performing loans and as such the relative non-performing loan ratio for Consumer Banking/Wealth Management and Institutional Banking and Others was stable q/q at 0.6% and 1.9% respectively. Due to noticeable rise in allowances, DBS's loss allowance coverage ratio (which includes non-performing assets (Debt securities, contingent liabilities & others) was stable q/q at 100% and 181% if only including unsecured exposures but improved y/y from 92% and 173% respectively as at 30 June 2018.

- **Consumers still leading the way**: By segment, Consumer Banking / Wealth Management continues to show growth across all periods with 2Q2019 total income in the segment up 15% y/y and 3% q/q due to higher loan and deposit volumes, improved net interest margins and growth in investment product and card fees. Institutional Banking also continues to perform up 8% y/y and 3% q/q as weaker trade finance was offset by cash management, loan related activities, treasury customer flows and investment banking. By comparison, Treasury Markets continues to be volatile with 2Q2019 total income up 89% y/y but down 31% q/q. Consumer Banking / Wealth Management was also the main driver for the 11% y/y improvement in 1H2019 total income up 15% y/y. Consumer Banking / Wealth Management and Institutional Banking continues to contribute around 85% of total consolidated income for 2Q2019 and 1H2019 (~44% and ~42% respectively). Institutional Banking however is the largest contributor to consolidated profit before tax (~51% in 2Q2019 and 1H2019) due to its lower cost to income ratio of around 32% compared to around 51% for Consumer Banking / Wealth Management.

- **Geographic split a sign of the times**: Country performance is showing the signs of both macro-economic and geo-political developments. While Singapore continues to generate the bulk of consolidated profit before tax (~70% in 2Q2019), results were stable q/q and up 17% y/y indicating possibly the effects of slowing economic growth through both moderating total income performance and higher allowances for credit and other losses. China on the other hand saw 2Q2019 profit before tax fall 48% y/y and 47% q/q from a mix of lower volumes, net interest margins and trading income. Of note was that Hong Kong showed solid performance (up 26% y/y and 2% q/q) on loan growth and net interest margin improvement although the current turmoil is likely to be a drag on Hong Kong performance in 2H2019 depending on how prolonged the disruptions will be.

- **Foundations remain solid:** Despite the strong earnings performance, DBS's capital ratios were stable y/y and fell q/q with a fully phased in CET1/CAR ratio as at 30 June 2019 of 13.6%/16.2% (similar levels to 30 June 2018; 14.1%/17.0% as at 31 March 2019). This was due to dividend payments for 2018 and 1Q2019 totalling $2.3 billion; risk-weighted assets growth on higher credit and market risk-weighted assets; and redemption of SGD$805 million in Additional Tier 1 capital. That said, the ratios continue to remain above the minimum CET1/ CAR ratio requirements of 9.4%/12.9% as at 30 June 2019. DBS' leverage ratio of 6.9% as at 30 June 2019 also remains well above the 3% minimum requirement.

OCBC Global Treasury

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Positive (“Pos”) – The issuer’s credit profile is either strong on an absolute basis, or expected to improve to a strong position over the next six months.

Neutral (“N”) – The issuer’s credit profile is fair on an absolute basis, or expected to improve / deteriorate to a fair level over the next six months.

Negative (“Neg”) – The issuer’s credit profile is either weaker or highly geared on an absolute basis, or expected to deteriorate to a weak or highly geared position over the next six months.

To better differentiate relative credit quality of the issuers under our coverage, we have further sub-divided our Issuer Profile Ratings (“IPR”) into a 7 point Issuer Profile Score (“IPS”) scale.

IPR	Positive		Neutral			Negative	
IPS	1	2	3	4	5	6	7

Please note that Bond Recommendations are dependent on a bond’s price, underlying risk free rates and an implied credit spread that reflects the strength of the issuer’s credit profile. Bond Recommendations may not be relied upon if one or more of these factors change.

Explanation of Bond Recommendation

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Other

Suspension – We may suspend our issuer rating and bond level recommendation on specific issuers from time to time when OCBC is engaged in other business activities with the issuer. Examples of such activities include acting as a joint lead manager or book runner in a new issue or as an agent in a consent solicitation exercise. We will resume our coverage once these activities are completed.

We may also suspend our issuer rating and bond level recommendation in the ordinary course of business if (1) we believe the current issuer profile is incorrect and we have incomplete information to complete a review; or (2) where evolving circumstances and increasingly divergent outcomes for different investors results in less conviction on providing a bond level recommendation.

Withdrawal ("WD") – We may withdraw our issuer rating and bond level recommendation on specific issuers from time to time when corporate actions are announced but the outcome of these actions are highly uncertain. We will resume our coverage once there is sufficient clarity in our view on the impact of the proposed action.

Analyst Declaration

The analyst(s) who wrote this report and/or her or his respective connected persons did not hold securities in the above-mentioned issuer or company as at the time of the publication of this report.

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