Transcript of DBS first quarter 2017 conference call for buy and sell sides, 2 May 2017

Michael Sia Hello everybody and welcome to the call for the buy and sell sides. This is Michael. With me are Piyush, Sok Hui and management teams here in Singapore and Hong Kong. We've gone through the media briefing and we can go straight into Q&A.

Robert Kong (Citi) Thank you for the update. Congratulations on a very solid result. Two questions from me. First, could you elaborate on the NIM sensitivities for Hong Kong? Previously we focused on Singapore rate repricing and largely ignored Hong Kong because we never felt it [was leveraged to interest rates]. Second, could you give more clarity on the migration of NPLs. You mentioned that Singapore NPLs were up because of oil and gas and that you sold some loans in India. [Would we be able to] say with confidence that NPL formation is likely to normalise [and that] SPs can hold at these levels [from here], aside from the issue about specialised vessels you mentioned? Thank you.

Piyush Gupta On Hong Kong, Sok Hui pointed out that current and savings accounts have gone up from 40% [of our Hong Kong deposit base] in 2014 to 60% now. That's a substantial shift. In the past, whenever US and Hong Kong interest rates went up, [we would have had] to pay market rates [for deposits] because we were largely funded by fixed deposits, so [we didn't see much of an] impact on NIM. But with 60% Casa funding, we do see the impact now. Hong Kong was quite material to the increase in overall NIMs in the first quarter. [Besides] the shift in the liability structure, [the increase in Hong Kong NIMs] was helped by the replacement of some lower-yielding trade loans with corporate loans. Our LDR also went up from 91% to 93%. But it's the structural change in the liabilities that drove the bulk [of the Hong Kong NIM improvement].

Your second question was on NPL formation, which was [$523] million [for the quarter], of which [$362] million came from [three names in the granular] oil and gas portfolio. The remainder of the NPL formation was [business-as-usual across the board]. The three [new oil and gas NPLs] were relatively chunky. Two of them were well north of $100 million each. It reflects what I had said before, that there are about 20 [exposures in the granular portfolio that are of relatively significant size], some of which might become NPLs in the course of the year.

[Of the total loans in the granular portfolio that have not been classified as NPLs yet, there are] about $1 billion that I would classify as weak. And it is quite possible that over the next few quarters some of them will slide into NPL. If you assume that half of them [become non-performing, it would translate into] another $500 million-600 million of NPLs from that [portfolio]. It would not be extraordinarily high and therefore I think it's safe to assume that the worst is behind us in terms of NPL formation.

Your third question was on provisions. For this quarter, they were $200 million, so if you assume that things stay benign, [our full-year provisions] should be $800 million [compared to our guidance of $1 billion]. It's just that the restructuring of our [oil and gas exposures involves], in some cases, specialised vessels and ships. And it's hard to figure out how much value you will get if you do need to sell them. In some cases, we could just restructure the debt with the existing owners. [But in other] cases, we do need to sell them. [Because of the] uncertainty we're keeping a $200 million [buffer in our guidance] for possible provisions [related to such] situations.

Robert Kong Thank you. Can you add any more [colour] on India?

Piyush Gupta [When we did the $170 million India NPL sale during the quarter,] we found that our collateral values were quite accurate. [The valuation from] the restructuring company [that bought the loan] was very consistent with [our valuation]. Could more [exposures become] NPL in India? Yes. There are some weak names but [the amounts are] not extraordinary.

Melissa Kuang (Goldman Sachs) Good morning. Just three questions. First, could you give us a rough guidance on what net interest margin did in the Singapore book this quarter, whether they were up.

Chng Sok Hui Yes. Of the three basis point NIM increase this quarter, two basis points came from Hong Kong and one basis point was from Singapore.

Melissa Kuang Thank you. Second, credit risk-weighted assets came down about 3% quarter-on-quarter. The loan book was flat so why did they come down?

Chng Sok Hui I mentioned [during the media briefing] that the decline was due to currency effects as US dollar assets were translated [into Singapore dollars] at lower rates. The other [factor] was the marked-to-market [value of derivative exposures] has come down quite substantially if you look at the balance sheet. So two factors contributed to the decline in risk weighted assets.

Melissa Kuang Thank you. Lastly, [slide 24 of the CFO presentation shows that SP for new NPLs] was $53 million while you mentioned that new NPLs for oil and gas were about $360 million. So [does it mean] that the SP coverage [for these NPLs] is about 13%?

Piyush Gupta Yes. They have low coverage because we don't expect to take losses on them. We're still in active dialogue and sticking with them. We've just been conservative about moving them to NPL.

Nick Lord (Morgan Stanley) Hi. First, did you do anything to the duration of your securities book during the quarter which would've helped NIM? Second, for the $170 million [India NPL sale, in which lines of slide 14 of the CFO presentation is it reflected]?

Piyush Gupta We haven't done very much [to the duration of the securities book, which remains] very heavily in the short term. The bulk of our securities book is in the one- to three-years [bucket]. We also have a chunk in the three- to five-year [bucket. Overall, duration] didn't change materially during the quarter.

Chng Sok Hui [The India NPL sale] is reflected as write-offs and recoveries. The write-offs are $141 million and the recoveries are $29 million.

Nick Lord [Coming back to] the securities portfolio, is it a policy to keep it short? Would you at some stage begin to push up the securities duration?

Piyush Gupta We will have to figure out what we want to do. There have been ups and downs [in bond yields]. You know, the ten-year went up and then came down. We're not entirely sure about our outlook. I was a lot more optimistic about the US [economic] scenario, which is why I expected rates to go up and my bias was to keep duration short. But the data in the past couple of weeks have been mixed, so I think we need to watch a bit before we can form a view on whether it makes sense to increase duration or not.

Aakash Rawat (UBS) A few questions from me. First, on a year-on-year basis the balance sheet grew 7-8% but on a quarter-on-quarter basis it shrank slightly. How do you think about balance sheet growth going forward? Second, 73% of specific provisions [during the quarter] was for existing NPLs. What is the [reason] for that? Is it collateral shortfall? Is it further deterioration in [collateral] quality? Third, the bulk of NPLs are now sitting in the 180 days past due bucket – [which is] more than 60% [of total NPLs compared to] 46% last quarter. Does this mean you might need more SP for them in the coming quarters? [Could you provide] some more colour on where [the increase] is coming from. Lastly, you talked about standard versus non-standard vessels. Do you have a rough split of the collateral for the standard bucket versus the non-standard bucket?

Piyush Gupta First, the balance sheet is down because of currency. If you look at it in constant currency terms, [loans] grew by 1% for the quarter. We think the guidance of mid-single-digit loan growth for the year is pretty much on track. The first quarter was slow, both for corporate non-trade as well as for [housing loans]. [Housing loan growth in the first quarter was] consistent with last year: we [had also] started off slow [last] year. [More of] our bookings [this year] were for [homes] under construction [which take longer to draw down], but our pipeline looks decent. Similarly, for the non-trade corporate loans, our loan pipeline is looking quite healthy. So I'm quite confident of being able to get mid-single-digit balance sheet growth.

[On your second question that 73% of SP was for existing NPLs,] that's because we continually revisit [what] realistic values [are for] collateral. As I mentioned earlier, particularly for the offshore marine and the shipping sector, it's now getting extremely hard to get a good assessment of collateral values because there are not many [transactions]. So we really have to go case-by-case, looking at the nature of the vessel, asking people for a value. We [might] figure that this [vessel isn't] going to sell, or we [might] find a comparable [transaction], or [we might say] this sold for less than we thought, and then we top up the SP accordingly.

[On your] third question, [there is] a larger chunk of NPLs greater than 180 days because NPLs continue to age, so they will move from one bucket to the next bucket. The thing that you should focus on is whether provisions are adequate. And that is why I took some time to explain that so far, as best as I can tell anecdotally, the proceeds [of collateral sales enable us] to recover our [net] loans. I gave two examples earlier [of companies] that went into judicial management where the collateral is going to pay off our net loans. And therefore it seems to me our collateral values seem to be reasonably accurate.

[On your fourth question,] actually, they're not that many [non-standard vessels]. There are two or three non-standard vessels, but they're chunky and they're big. Standard vessels can be in the $30 million to $80 million range, while the non-standard vessels can be in the $300 million to $500 million range. So there are only two or three of them, but they are big.

Marcus Chua (Nomura) Two questions from me. The first is on tax. The effective tax has dropped to about 10%. May I know if there is any driver for this and what is the guidance for the normalised tax rate for the full year. And the second is that full-loaded CET-1 ended at 14.2%. Are there any capital ratios that you would be looking at before the bank will increase dividends going forward? Thank you.

Chng Sok Hui On the effective tax rate, [you have to realise that the one-time property disposal gain of $350 million] is not going to be taxable but the general allowance [charge of $350 million has a tax impact]. So the normalised tax rate for our first quarter is the usual 13-14% rate. You probably haven't factored in the fact that the property gain is not taxable.

Piyush Gupta [On the dividend,] as we indicated before, we think that capital ratio is already quite high. The reason we've not reviewed our dividend [so far] is that we've been waiting for Basel IV to land so that we have a better sense for what the capital requirements might be. Now, they keep pushing Basel IV [finalisation] back. It was supposed to be last September, then they pushed it to the first quarter, and I'm told it's going to be after this summer. And so, it seems to me, given the extent of capital we have, we will probably review our dividend. We can't just keep waiting for the Basel IV, so we'll take a look at it this year.

Harsh Modi (JPM) A few questions. First, there has been renewed talk about the US dollar being repatriated or Trump putting in some measures. The last time we discussed this you said you were reasonably comfortable with [your position based on a poll of client intentions]. Any change in that stance? If that happens, does it improve your loan pricing power at all?

Piyush Gupta We don't really have a change in the view. I haven't done a fresh poll. We did a poll in November with our clients to see how many of them were likely to suck dollars out of Asia and the answer was pretty small. [Then I asked whether] there might be some knock-on impact [on Asia] if dollars were to leave Europe but it doesn't look like it would be extraordinary. And so our general assessment at this stage is we're not overly worried about that phenomenon still.

If it were to happen, would it improve pricing power? If there's a general liquidity squeeze, then it does help you to improve pricing. So [like the situation in Hong Kong I described earlier,] in the past, because our Hong Kong book was mostly fixed-deposit funded, if loan pricing went up, we would also pay more [for deposits]. Now, with the liability restructure having shifted to 60% Casa, we actually get some benefit [from higher rates].

Harsh Modi The second question is on margin guidance: it is still at 1.80%, but if there is one [fewer US rate increase than expected] then maybe three basis points lower [than 1.80%]. What is your assumption on pass-through from US dollar to Singapore dollar rates, because as we have discussed in the past, despite two US Fed hikes, currently three-month Singapore dollar interbank rates are exactly where they were on 10th or 12th of December. So what is the key assumption here on pass-through?

Piyush Gupta If you are looking at Sor and Sibor, you should track it from [the time they went up in] November [in anticipation of] the Fed hike [in December]. Sibor is up about 15 basis points, Sor about 30 basis points, so on a blended basis, it's about 20-22 basis points up relative to the 50-basis point increase in Fed rates. So roughly there's been a pass-through of around 40% if you take it from the October, November levels to now.

The pass-through is low compared to historical trends because, for the past couple of years, we have had this anomaly where Singapore dollar rates were higher than US dollar rates. Historically, Singapore dollar rates had always been lower than US dollar rates. Now, after the [latest] two hikes, we've come back to conventional form – the Singapore dollar rates have once again fallen below US dollar rates. Therefore, our assessment is that if there are further US rate hikes from here, you will get the 60-70% pass-through that you've traditionally got.

Harsh Modi So the current guidance rests on the assumption of about 60-70% pass-through from US dollar to Sing dollar rates?

Piyush Gupta Correct.

Harsh Modi The final question is on oil price sensitivities. Let's say, for whatever reason, oil goes to US$60 and stays there for the rest of the year, or it goes to US$40 and stays there for the rest of the year, how will that impact your NPL or credit cost guidance?

Piyush Gupta I think if oil goes to US$40 or [below], there will be more pain in our [granular] portfolio for sure. I told you that we have classified $1 billion of that portfolio as weak, and therefore [if oil prices are at US$40, a larger proportion] of that $1 billion will become NPL than we are currently assessing. And then we'd have to take more provisions. If oil stays range-bound between US$50 and US$60, then [the outcome] will be pretty much what we're guiding. Oil would have to go above US$60 for us to see some upside. [Based on our stress tests, even] if it gets to the high US$50s and US$60s, you would still not see a lot of deep-sea investments. I think oil would have to go over US$60 for more deep-sea investments to create some upside. [We've factored in oil prices around] US$50, even US$40-50. But if it went substantially below that, you would start seeing [additional] pain.

Harsh Modi So your current guidance of $800 million to $1 billion of specific provisions is based on oil at $50-60?

Piyush Gupta Correct. And it seems oil will be range-bound. I think [prices] over US$60 are hard to [sustain] to because shale would turn on at those levels. There seems to be price support [around US$50]. Certainly, OPEC and the Saudis will work very hard to support oil prices at that level. So oil prices seem to be range-bound [around those levels] right now.

Viacheslav Shilin (Deutsche Bank) Good morning. The first question relates to slide 23 [of the CFO presentation. Could] you disclose the amount of overdue but not impaired loans? And of your NPLs, what amount is related to China and to the oil and gas sector? Second, what impact do you expect from the introduction of IFRS 9 on your P&L or capital? Third, can we expect an issuance of Tier 2 or AT-1 hybrid capital securities this year in currencies other than Singapore dollars. Thank you.

Michael Sia China NPLs are $240 million. It's 5% of the total.

Piyush Gupta It's [$1.8] billion for oil and gas and [$240] million for China. [On the past due but not impaired loans,] somebody's looking to see if we can find this number for you. In the meantime, [on your question of] AT-1 and Tier 2 securities in [other currencies] …

Chng Sok Hui We are unlikely to do any this year as we have more than adequate coverage.

[On your earlier question regarding past due by not impaired loans,] our [2016] annual report [shows that] there are about $60 million between 60 to 90 days [past due but not impaired]. It's a small number.

[On IFRS 9], MAS is about to issue its consultation paper. We will have to review the consultation paper before we can assess the impact on capital as well as on provisioning levels. At this stage, our assessment is that we have more than enough provisions under IFRS 9 so we are not likely to take any hit to P&L or to capital. So the [more pertinent] question is – how much excess provisions do we have under the guidelines, and do we or do we not write some of them back.

Stephen Andrews (Deutsche Bank) Good morning. Two questions for me. The first [concerns] the ongoing shift in the business mix we're seeing at the group, where Consumer Banking / Wealth Management is becoming a bigger part of earnings – I think it's up to 35-40% of pretax profit from just 15-20% just three or four years ago. It's a technical question: as rates rise in the management accounts, [is there any] transfer of treasury income into consumer banking for some reason? Treasury income has been glide-pathing down while consumer income has been going up. Or is it that [the consumer business] has been very good and treasury has just been weak?

Second, coming back to capital again because you're in a position where you're overcapitalised. You said that Basel IV is being kicked into the long grass and that IFRS 9 [does not cause] any drag [on capital] – there might even be a positive. With a 14.2% CET-1, what is the right level? I know you sort of danced around this, but if we assume you need a 13% CET-1, you've now probably have got $2 billion-3 billion of excess capital, which is really starting to drag on returns. Can you give more specific guidance on where you think the CET-1 should be? Thank you.

Piyush Gupta Your assessment on the consumer business is correct – it benefits from the increase in rates, but that doesn't come from treasury. Transfer pricing is done in the CFO's office, not in treasury. When you look at our business segment [disclosure, there is a category] called Others. The net impact of transfer pricing sits in that Others category, not in the treasury category. The consumer business benefits from rising rates because it benefits from the fund transfer pricing of the rising rate. But the offset is reflected in Others and not in treasury.

Chng Sok Hui Just to clarify, we behaviouralise consumer banking deposits, which [effectively] have a longer-term duration. We pay [the consumer business] a longer-term rate, so you find that the net interest margin for deposits of [the consumer business] is actually more gradual, more stable because of the stickiness of the deposits.

Stephen Andrews Can I ask what rough duration do you use to behaviouralise deposits so we have an idea of where we should be looking along the curve?

Chng Sok Hui For the consumer business, we characterise [deposit stickiness] of about one-and-a-half years.

Piyush Gupta The other question was on dividends. We said before that we would like to retain CET-1 at between 12.5% and 13.5%, so call it 13%. We are [currently] substantially ahead of that [because, as] I said, we've been waiting for Basel IV. I don't see that we can continue to wait for Basel IV so we'll take a look at [dividends] this year.

Michael Sia Okay, those are all the questions that we have. Thank you everybody for dialling in. See you next quarter.