Edited transcript for DBS fourth-quarter 2019 results conference call for buy and sell sides, 13 February 2020

Danielle Yew Welcome to DBS 4Q19 results briefing.

Aakash Rawat (UBS) I have a few questions. First, what is the impact on revenue of the moratorium on principal repayments? It does not appear to be accounted for in the 2% impact?

Piyush Gupta There is no impact on earnings because it is only a moratorium on principal repayments. Interest is still payable so that will flow to the income line.

Aakash Rawat The second question is on NIM. Your guidance of a seven basis points drop is based on one Fed rate cut assumption. Is that still the case?

Piyush Gupta Yes, so we have not changed the guidance because it is hard to call. It was based on one Fed rate assumption in June 2020, though it looks like there might not be at this point in time. If we look at data in the last jobs report, the overall economy looks quite robust, so they might not have a rate cut. On the other hand, there is likely to be easing of monetary policy from countries in the region. So, it is a tough call what the net impact might be. Interestingly for the last couple of months, both Hong Kong and Singapore rates were robust. We did not see the drop we might normally have expected. So, at this point, I am maintaining the seven-basis-point guidance, but there might be a basis point or so of upside.

Aakash Rawat But there was a drop of around 11 basis points in your funding costs for deposits during the quarter. Could you help us understand what happened there? Was there any mix change that drove that?

Piyush Gupta Our costs of deposits are down, reflecting the reduction in the interest rate environment. There was no change in mix. Our Casa was robust.

Aakash Rawat Some investors were expecting a strong trading quarter given the environment we saw in other markets. Why do you think that did not come through?

Piyush Gupta Well, I think trading income was only strong in the US. It is partly the result of a base-year effect relative to the fourth quarter of the previous year; and partly because the repo market in the US spiked at the end of the year. We did not see the same in Asia. Our fourth quarter was fairly consistent with our previous fourth quarter.

Aakash Rawat On asset quality in Hong Kong, could you help us understand the $77 million write-back from Stage 1 and 2 allowances?

Chng Sok Hui Our model ensures that as a case becomes an NPL, the general allowances taken when it was in Stage 1 or 2 would be released into specific allowances, resulting in a reduction of general allowances. Sometimes such reductions are offset by other factors, such as additional general allowances for management overlays for the US-China trade war. But in the fourth quarter, the reduction in general allowances was purely due to transfers to specific allowances.

Aakash Rawat Lastly, given that Hong Kong has been in a recession for almost six months now, how is it that revenue is still resilient? If the combined effect of the protest and the virus leads to a deeper than expected recession in Hong Kong, what will happen to earnings?

Piyush Gupta A large part of our Hong Kong business is really related to China. While we have a domestic wealth management franchise in Hong Kong it is not as large as the corporate business. Irrespective of the protests, the China economy has been doing fine. You might see some impact with the virus, but I think that will be transient. Also Hibor has been firm because liquidity in Hong Kong has been tight, which supports earnings.

Harsh Modi (JP Morgan) A couple of questions. First, the cost of funds came off quite a bit. Is there more leeway for that to come off?

Piyush Gupta The cost of funds only reflects the cut in interest rates, that's all. The third cut came in October, so has not trickled through entirely.

Harsh Modi The second question is on SFRS(I) 9. With the Hong Kong protest and as you said, the bigger part of your book is in greater China, does that increase the risk of any kind of macroeconomic adjustment or is it already taken in the fourth quarter?

Chng Sok Hui We already took general allowances for the US-China trade tensions as well as the Hong Kong social unrest in the third quarter, not in the fourth quarter.

Harsh Modi If we do see sharper deceleration especially in mainland China, how will your ECL be impacted?

Chng Sok Hui There is some judgment involved in how much management overlay to take. For the virus situation, we could release some of the general allowances we had taken in the past.

Piyush Gupta We have built up a buffer for these uncertainties. If we do see portfolio deterioration, our buffer should be able to take care of most of that.

Harsh Modi Finally, if somebody applies for a loan moratorium, does that lead them to be classified as Stage 2 loans? For example, the $20 billion in F&B and retail, and $2 billion out of which may be at risk, would you need to classify them as Stage 2?

Chng Sok Hui We will not need to because we are talking about liquidity relief for clients rather than a significant deterioration in their creditworthiness.

Piyush Gupta The $2 billion is an estimate of companies that could see stress. It is still hypothetical. If any of these names do show signs of weakness, we will classify them as Stage 2, but we cannot merely classify any name we think could see stress. That is not how the process works.

Chng Sok Hui We have a process to place some of these names on our watchlist but they continue to remain in Stage 1. They do not go to Stage 2 unless the credit standing has actually deteriorated.

Harsh Modi Final question is on the $575 million of new NPA formation during the quarter. Which were the chunkier portions and how do we see that number in next three, six months?

Piyush Gupta The bulk of that is from a single name. The loan is collateralised with a commercial property in Singapore. It is not actually in default, just a covenant breach. Because of the overall stress in the environment, we moved it to non-performing. It is a precautionary move. We did not take any allowances against it because it is completely secured.

Jayden Vantarakis (Macquarie) I have a few questions. First, the local banks have good market shares of domestic mortgages in Singapore. If you give all customers a six-month moratorium on principal, does this add much to the loan growth and change the loan growth guidance?

Piyush Gupta We are not giving the moratorium to everybody, only those who ask. This is really a community relief effort. But you are right, it can extend the life of the loan. But it is not likely to be material. Besides, I do not know how many will take it up.

Jadyen Vantarakis What is the duration of the mortgage book?

Piyush Gupta The contractual duration is very long. The empirical duration is about four years because some refinance it about every four to five years.

Jayden Vantarakis Sok Hui mentioned during the media briefing that there was some re-profiling of institutional banking deposits. Have those higher-cost deposits all been re-profiled? Please give us more colour on what you could do on that front.

Chng Sok Hui Some of our deposits are high cost but are perfectly substitutable. Depending on the cost we can get on commercial papers, we can let the highest-cost deposits run off and replace them with capital market instruments if we need to. We continually monitor prices.

Piyush Gupta We have more capacity to borrow from the capital markets, but we prefer to drive Casa growth, which our cash management businesses is bringing in.

Jayden Vantarakis You mentioned that credit card transactions are coming down in the current environment. Do you have any sense of the size of decline during the first half? The banks are doing a good job on credit card fees and it has been growing consistently.

Piyush Gupta So far, we are not seeing any decline in Singapore yet. I do not have up-to-date data in Hong Kong but I think there is a decline of 5-7% in spending relative to what we expected.

Robert Kong (Citi) Thank you and I wish everybody well at DBS and hope you all stay safe. I have three questions. First, thank you for raising the dividend by 10%. Could you indicate some of the underlying assumptions that you made on the dividends? Is this something you intend to sustain? What are you thinking about, how stable are the levels and, what sort of on-going loan or RWA growth are you looking at?

Second, I have been surprised that Sibor has held up so well. I think there is still a 20-basis-point gap over Sor. MAS tried last week to talk the market down, and I believe if they need to, they can also inject liquidity. How do you think Sibor and Sor will go?

Finally, could you give more colour on the additional credit costs mentioned at the media briefing? You said the best case is an additional 4-5 basis points of specific allowances. I think you said worst case may be in the high single digits. What were you thinking within the 4-5 basis points – is it the initial stage, to be followed by a second or third stage?

Chng Sok Hui Prior to announcing the dividend increase, we did a lot of simulations and are confident that we can sustain the annualised $1.32 per share as long as our net profit grows and CET-1 is at 12.5-13.5%.

Piyush Gupta We are still accreting earnings. Even if we assume no profit growth, based on our $6.4 billion earnings last year, we have capacity to be able to maintain the dividend.

Sor is not driven by MAS policy but is a function of the weak Sing dollar against the US dollar. That potentially results in a strong Sor, which anchors the rest of the rate spectrum in Singapore. So unless the Sing dollar starts strengthening relative to the US, you might see support for Sing dollar rates.

On credit costs, we expect that specific allowances in two of the four categories I spoke about in the call will be minimal. For the manufacturing sector, we think that the names we looked at should have the resilience to last a three- to four-month postponement in production, so no additional allowances will be needed.

The other factor arises from macroeconomic factors such as if oil prices come off. Based on our current reading of the portfolio, given that our customers are the oil majors, we do not expect any incremental allowances. That leaves the consumer services sector (which includes F&B, aviation and tourism) and the retail sector (including shopping malls). I do not expect major names in these two sectors to wind up requiring allowances. It is the remaining $2 billion of the portfolio to the smaller names that may see some stress.

The final aspect of credit costs involves consumer delinquencies for credit card and unsecured loans. While we are not seeing anything right now, if people are temporarily laid off, we should expect to see some pick-up in delinquencies. We benchmarked to SARS to estimate how much that could be.

Putting all these components together, the additional specific allowances are in the region of $150 million. It is not an entirely scientific estimate and we may be wrong. But even if we doubled the estimate, we can take the additional specific allowances by writing back some general allowances.

Nick Lord (Morgan Stanley) I also have three questions. First, on Hong Kong margin, it was down 10 basis points on quarter. Is it just related to the movement in rates? Second, for moratorium loans, on what basis would you consider them as performing or non-performing? Finally, on loan growth, has the virus situation affected demand?

Chng Sok Hui Hong Kong has 60% of deposits in low-cost Casa. As interest rates come off, the interest margin we earn from deploying them into assets goes down. In the fourth quarter, Libor rates declined.

Piyush Gupta On loans put on moratorium, there is no need to put them either into Stage 2 or NPL. On loan growth, the loan pipeline continues to look relatively robust and momentum was healthy. Housing loans in Singapore turned around in the fourth. So I think our original guidance of mid-single-digit loan growth for this year is for now intact.

Sebastian Paredes What Sok Hui said is right. The net interest margin decline is largely due to the interest rate environment, partly offset by IPO activities that drained some liquidity.

With respect to the question of why our revenues are resilient through the year, I would add that there was very strong capital market activity in the fourth quarter in Hong Kong on equities, M&A and debt, and demand for insurance products arising from the social unrest. So, fees were very strong in the fourth quarter in Hong Kong.

David Wong (Aletheia Capital) I have three questions. On costs, assuming full-year revenue grows around 1% or 2%, how are you thinking about cost growth? On capital, your CET-1 is at 14.1%. Should we expect that to increase further into 2020? And if not, what do you intend to do? Third, on asset quality, aside from sectors vulnerable to the virus-related slowdown, are there any areas of the portfolio you are keeping a closer eye on for idiosyncratic risks?

Piyush Gupta On costs, we have capacity to tighten our belts. Last year, our total cost grew 8%. We think we can cut that by two or three percentage points without compromising our investment agenda. We will continue to invest in our growth countries and our digital offering. In Singapore, with the impending entry of digital banks, we need to invest to defend against that. If there is a deterioration in our cost-income ratio this year, we will live with it given the bigger concerns.

Our dividend policy is consistent. We want to reward shareholders, but it in a steady way without having to cut future dividends. We never had to do it so far and that is the last thing I want. It is a graduated increase which we can maintain.

Finally, on asset quality. We are watching China bond defaults carefully. With the new stimulus measures, they might be reduced this year. Nevertheless, we have been struck by the Chinese government's discipline in letting companies default if they need to. We have been unscathed the past year or so. But that is obviously an area to watch on a continuous basis.

David Wong Your operating CET-1 range is 12.5-13.5%, but your current level of 14.1%, is that merely a buffer against economic uncertainty? Or are you thinking of inorganic growth?

Piyush Gupta We are open to bolt-on deals if they come along. Both the ANZ and Soc-Gen deals were very good. We got very quick paybacks. If we find appropriate bolt-on deals that could allow us to accelerate growth in businesses we see as strategic, we would be open. That is not a change, we have maintained that stand for some time.

Krishna Guha (Jefferies) My first question is on costs. Your staff cost has been growing in double digits while staff count shows about 6% growth. In terms of staff retention, are you seeing any competition from the new digital licensees or the various e-wallet players? Is that leading you to pay more? Second, your card income basically flattened in the fourth quarter. Given that it was before the impact of the virus and people travel during year-end, did you see any impact from YouTrip and TransferWise having launched their own cards?

Piyush Gupta A large part of the staff cost growth is due to line shift, as we continue to hire more engineers and tech people, and as we build our Hyderabad shop. That stems from skillsets we need to insource. On retaining staff, yes, we have had to do so both in Hong Kong last year with the launch of the digital banks and in Singapore this year. We have been pre-emptive. But it is not significant in the overall scheme of things. We do not expect to see significant growth in staff costs from that.

On cards, we are not seeing pressure. There may be a lot of other players in the market but our overall fees and market share have been growing. There was a $9 million charge on fees in the fourth quarter due to some adjustments.

Sanjay Jain (Aletheia Capital) One quick question on the $419 million NPA write-off in the fourth quarter. What drove that? Was there discretion or was it formulaic? Second, can you give us an update on the digital initiative in India?

Piyush Gupta The write-off number is discretionary. We make a judgment from time to time on which NPLs may not be recoverable. In the fourth quarter, the write-offs related to oil and gas exposures we recognised as NPLs in 2017.

In India, we slowed down digibank customer acquisitions to about 40,000 a month, but the quality is proving to be much better. We expect to break even on acquisition costs in a year and on variable cost in two. It is a much better customer profile than we had before. We are also getting some decent unsecured consumer loan volumes, although it is early days yet. We also have a small affluent business, which we have digitised and is turning out well.

The other area we have been working on is SMEs. We have a digital offering which allows onboarding and instant account opening. We embedded our digital product into Tally, which is a software package widely used in India. We get a lot of customer acquisitions through that. Last year, we launched algorithmic underwriting on SMEs, to enable us to do instant underwriting based on additional data, not just backward-looking financial data. We are getting good momentum. With the subsidiarisation, we are now in 22 cities and 30 locations, so the SME build-up is good.

And the last area where we have done digital work is transaction banking, particularly cash management. We offer API connectivity into two supply chains, including the payment function.

Sanjay Jain So, for both the SME and the consumer sides especially if you are doing unsecured lending, you must be getting better demand conditions?

Piyush Gupta That is true. Not just on those two though. Even for large corporates, we have been able to improve margins in India.

Sanjay Jain Overall, would you say in this fiscal year, would the bank break even or take another year?

Piyush Gupta Overall, the bank makes money because the corporate business is profitable. The consumer business has not broken even yet. It will take years. But overall, we made money last year, and the profitability this year should be stronger.

Aakash Rawat On bolt-on acquisitions, you had said in the past, anything less than 5% of the market cap would be comfortable. Is the thinking still the same despite stretching your dividend payout ratio to 55% of earnings?

Piyush Gupta We can still afford to do deals up to that amount. To re-emphasise, our conditions are still the same. A transaction has to be a strategic business in a country that is important to us. The numbers must work. And we must have the management bandwidth to do it without distracting us from our digital agenda. That is why we consider small-ticket deals.

Krishna Guha To follow up on Aakash's question: will you be interested in looking at some of the platforms which can help you with SME lending? You may not get the full ownership of the company but just a stake?

Piyush Gupta First of all, it has to make economic sense. I have two challenges with taking minority stakes. First, as a passive investor, it is hard to leverage on the holding and grow. Second, the economics is sometimes very hard to make work. Having said that, we did buy a small stake in Carousell. It does not move the needle but it gives us a way to source payment business and so on. For small exposures like that, we are open to look at.

Danielle Yew Thank you for joining us today. We will speak again at the next results release.