Transcript of DBS third-quarter 2017 results conference call for buy and sell sides, 6 November 2017

Michael Sia Hello, everybody, and thank you for joining us for the third-quarter call for the buy and sell sides. With me are Piyush, Sok Hui and the rest of the team here in Singapore and Hong Kong. We have gone through an extensive presentation at the media briefing, so we can start with questions.

Robert Kong (Citi) Hi, thanks for the presentation, and congratulations on taking the big decision on the provisions. I only have a few small questions. The first one is a clarification on the CEO slides on FRS 109 guidelines. [Can I confirm that] the 0.9% as shown on the peach block is based on MAS requirements, and is what you need for FRS 109 as opposed to you having a shortfall of 0.1%?

Piyush Gupta Yes, what the bar is saying is that when we build bottom up from our FRS 109 models, the actual number we come up to is short of the 1% MAS requirement. It's 0.9% and so under the MAS guidelines we would have to take another 0.1% into this account called RLAR [which is non-distributable].

Chng Sok Hui Basically as at 30 September we are above the 1% [MAS requirement]. So what [the accounting standards require us to] do on 1 January 2018 – we are working on refining the number and let's say it's 0.9% – is that [we will take] the 0.1% to retained earnings, and because MAS needs a minimum 1% [of asset base], we will [transfer from our] retained earnings that 0.1% [amount to RLAR, which] is not distributable as dividends. That's all it means.

Robert Kong If you were to make this adjustment to the September numbers, would there be a slight negative impact to your CET-1?

Chng Sok Hui GP is Tier-2. So you have to transfer part of that which today sits in Tier-2 to retained earnings which are Tier-1, and then you take it down back to Tier-2, so it should be neutral.

Piyush Gupta You'll be neutral. You won't see a negative impact of CET-1 because we have the excess general provisions. We take it into retained earnings first so that it bolsters up CET-1 and then we take it from there back into Tier-2.

Robert Kong Thank you. Could you also elaborate more on the line items of earnings that are going to benefit from Belt and Road initiatives? Because it's not really going to be loans as a lot of that is [either] done by the Chinese development banks [or have a] very fine spread, but clearly you're quite optimistic on the potential from Belt and Road initiatives.

Piyush Gupta It's actually very broad-based. So first, correcting your impression that it's not loans, that's not true because a large part of the BRI projects tends to be around M&A and project finance, as opposed to clean balance sheet lending which means you need to be able to structure, and we find that we're competitive and quite well-positioned to do that part of the lending business. It is also better priced if you do it that way.

Second, we continue to benefit from M&A fees; they're not big but they're helpful.

The third and larger impact is on the treasury, cash management, trade finance as well as hedging activities that BRI companies do when they come out. We've built a five-pronged strategy around this. We have five different task forces: one on strategic advisory, one on project finance, one on structured lending, one on treasury, one on capital markets and each of them have a very strong pipeline that we're working with.

Harsh Modi (JPM) Hi, a couple of questions. [First], on the secured book of the offshore marine sector, how much is deep water and how much is shallow water? For the deep water, what kind of markdowns have you taken, have you written off 100% and shifted the NPAs to unsecured, or have you taken a markdown to scrap value? I wanted to put into context [this collateral markdown to 25% of original values].

Second, [a clarification] on the revenue side of your double-digit growth [guidance]. Definitely there is some NIM pick-up, but on the non-interest income I just wanted to understand how much of wealth management growth in absolute terms are you taking into account given you had a really strong year, or are you looking at a sharp pick-up?

Piyush Gupta On the first, I don't have a specific breakdown between the deep sea and the shallow water, but the methodology we used is that if they were specialised in deep-sea vessels we looked to see if we had any bids, and we benchmarked the collateral down to known bids that we had from potential buyers of vessels. On the rest of the portfolio, we've looked at either scrap value or trades in the market for those kinds of ships. We've been very conservative in [arriving at] what we're calling liquidation value.

In terms of the growth in our income next year – the double-digit income – part of it is obviously the benefit that we would get from the ANZ integration. That itself could give us a big lift and get us into the teens level. But outside of that it is also broad-based. It is from loan growth, it is from NIM increase. Our wealth business has been growing [in the] double digits, and we expect it to continue to grow [in the] double digits next year. We expect cash management to continue growing [in the] double digits next year as well, so it is again quite broad-based and diversified. Finally, I'm assuming that we will get some comeback on treasury and markets. We're down [more than] $200 million on trading and customer [income this year compared to last year], so if you assume some lift , [there could be] reversion [closer] to normal [levels] next year.

Harsh Modi Just clarifying the view on the markdowns – if I look at the breakdown of your NPLs [by days past due], they're not very different from the distribution we had 12 months ago (as at September 2016), and yet we had a very sharp transition down [thereafter] as the not-overdue was 20% of the portfolio and went down as low as 12%. Given your view on structural weakness on some of the assets, I'm just trying to figure out if we don't get cyclical pick-up as you said before 2019, is there a risk of negative transition and as a result would you have to take one more round of markdowns? That was the context [for my question on the deep-sea part of the sector].

Second, you had $300 million of new NPLs outside of offshore marine in this quarter which seems to be a bit higher than your run rate, where did they come from?

Piyush Gupta The short answer [to the first part of your follow-up question] is no. If you look at the names that we've not put into NPL, the largest chunk of them are names who are part of conglomerates or have very strong parent activity; parent activity which is very diversified. This means that they have multiple alternative lines of revenue and businesses to support the shipping business. They're also names who have contracts which they've been able to keep in place through the last three years of the down cycle.

Oil prices crashed in the middle of 2014, [when some of these names] were trying to figure out how to keep their heads above water through 2015, and the names who started getting damaged between 2015 and 2017, they've done that. [That's] one difference [from] a year ago – that [the remaining performing names have] had the resiliency to see through the last two, two and a half years. I think they have the wherewithal to continue to [stay in] the part of the business I'm saying is cyclical. You will see a pick-up. So, no, I don't think we're going to see another [round of] this. I think we've pretty much cleaned up the books.

On the NPA [for the rest of the portfolio], the [average] balance [of around] $300 million which you're talking about – it is in line with what we've been seeing in the last few quarters. Some of it is still India because the RBI is continuing to drive recognition of some of the big names; there are one or two residual names along with the rest of the industry we've got to recognise. But it's not very different from what we've seen in the last several quarters.

Ng Wee Siang (Fitch) I wanted to ask if assuming DBS had not transferred its excess general provisions to SP in the third quarter – your GP ratio would be at 1.4% as of September 2017 and you mentioned that you would have been allowed to transfer the excess 0.4% of GP to retained profit, would that transfer of 0.4% to retained profit be considered as part of CET-1?

Chng Sok Hui Yes.

Piyush Gupta Yes, it would be.

Ng Wee Siang I [ask this as after reading] through the [FRS 109] proposal, there was no mention that [excess GP] could be transferred to retained profit on day one. Can I just get [more] clarity, please?

Piyush Gupta Yes, I think it's pretty clear. If you don't take it, you have to transfer it to retained earnings on day one and that would be part of CET-1. Sok Hui, do you want to confirm that?

Chng Sok Hui The choices you have for the [GP amount] that is above the MAS requirement of 1%, you can do either one. You can take 0.4% all to retained earnings or take half to retained earnings half to RLAR, the choice is yours. Basically it means it goes back to either the distributable or the non-distributable part of [shareholders' funds].

Ng Wee Siang Do you have to do it before or on day one?

Piyush Gupta On 1 January 2018 you give up the option of moving it through P&L; you only have the option of taking it to [either] retained earnings or RLAR [without passing through the P&L]. So if you want to take it back through P&L, you have to do it before 31 December this year.

Ng Wee Siang The other question is [if] the FRS 109-compliant minimum regulatory loss allowances would be larger than that of MAS 612-compliant 1% GP reserves, in terms of absolute numbers?

Chng Sok Hui It's the same. The MAS has not changed their 1% requirement. The standard under MAS 612 today and under the FRS 109 going forward – they're identical. [There's no change to] the way the 1% is to be computed. All MAS is saying is that under the new accounting rules, if you don't have this amount up to 1%, then [you have] to earmark part of retained earnings so that they become non-distributable. That's the only change. The way you compute the 1% has not changed.

Ng Wee Siang I [ask] because if you look at the definition for the denominator under the FRS 109, [it] seems to have been widened to include certain non-credit securities and even undrawn facilities as well, so hasn't that been affected at all?

Chng Sok Hui Maybe [I should] say that the MAS did not spell out prior to this 19 October clarification how the industry would compute it, but DBS has always computed that 1% internally based on not just loans but also all the other credit exposures – on balance sheet, off balance sheet – and we have recognised part of the residential mortgages. [The way we calculate our asset base is] very consistent [with FRS 109]. It did not come as a surprise to us.

Piyush Gupta Correct. Our [computation of] the 1% is very consistent with this new MAS guideline, so for us there is no change.

Ng Wee Siang I see. So actually your current calculation is more conservative compared to MAS 612, correct?

Piyush Gupta The MAS 612 is not clear. It does not define what should go into that calculation and, in fact, we've been pushing MAS to give a consistent measure because we recognise that different banks [calculate the 1% requirement differently]. We have always chosen to take the most conservative interpretation of MAS 612. As a consequence, the new MAS guidelines are very consistent with what we've always done.

Melissa Kuang (Goldman Sachs) Hi there, I just have a quick question on your ANZ [integration]. We've seen the loan numbers come through, [as well as] the deposit numbers. Can you just give a little bit more insight [into its contribution] to the non-interest income numbers, as well as expenses? We've seen expenses [come] down quarter-on-quarter – does that already include the new headcounts from ANZ?

Piyush Gupta The headcount is also in this quarter. We added about 500 people I think, but Sok Hui will give you a more detailed response.

Chng Sok Hui We added income of $38 million because most of the integration happened over this quarter. China was in July, Singapore in August, Hong Kong in September – so they're all partial [contributions] during this quarter. For the expenses it's about $17 million, and the balance goes into net profit after tax. At the net profit after tax level it's not a very significant contribution. In terms of the loans we added $6 billion, and in terms of deposits we added $10 billion.

Melissa Kuang Thanks. Do you have any guidance on credit costs for next year given that you worked out your FRS 109 [provisions]? I just wanted to know if we can think about next year's credit cost.

Piyush Gupta I put in my outlook slide that I think it's safe to assume we should do better than our through-cycle average of 27 basis points. The other data point you could look at is what Sok Hui showed – that our provisions ex-oil and gas averaged about $100 million a quarter for the last three quarters, and we're not seeing anything that [leads] us to believe that the environment will become a lot worse in the course of the next few quarters.

Aakash Rawat (UBS) Hi, thanks for the call. A couple of questions from me. First, on the asset quality slide on the support services that you've shared in the past, the last quarter you said that if you look at the left side which is the five big names, two of them were already in NPAs and out of the three remaining you said that two were vulnerable which could possibly go into NPAs over the coming quarters. On the right-hand side [of the $1.8 billion that was weak] you said $1.0 billion [had not been classified as NPAs yet]. Out of the $1.7 billion new NPAs this quarter you said half is left and half is right. So there's still $200 million on the right side [that hasn't been classified as NPAs yet]. And on the left side there's $800 million – does that cover the two names or is that only one of them?

Piyush Gupta It's about half and half. The left side covers two of the names. The name which is not in NPA is the largest exposure – that's a large conglomerate that's well backed and supported. On the right-hand side, it's actually a tad below $900 million and once you do the half and half we have one or two names left which again have a lot of support from diversified parentage, and these are very small so we've pretty much cleaned up.

Aakash Rawat Understood. One more question on that. If I look at the NPLs in the professionals and private individuals category, that seemed pretty stable at $270 million to $280 million for the last several quarters, but this quarter that jumped up from $280 million to $404 million. What is driving that jump this quarter?

Piyush Gupta In that portfolio we have [additional] $123 million of NPAs from ANZ [this quarter]; that all relates to their consumer wealth and [it is classified under that professionals and private individuals category].

Aakash Rawat Okay, understood. The third quick question – on the credit cost guidance that you've given for next year, now that you've done this clean-up in Q3, should it also be applicable for Q4?

Piyush Gupta Yes, it is applicable for Q4 as well.

Diksha Gera (Bloomberg) A follow-up on the loan pipeline – it's interesting that we are seeing a fair bit of growth there – what I want to get your thoughts on is if you are able to bring back pricing power as well? I'm linking it with the margin as the two-basis-point uptick in Singapore doesn't really look that exciting, given that we've seen a little bit more flow-through to Sibor and Sor rates this quarter. What are you seeing right now in terms of pricing power and what do you expect going forward?

Piyush Gupta We've got at the moment a big uptick in Sor and Sibor [which] only happened only at the back end of the quarter – in the last couple of weeks, so you obviously don't see the impact of that on your entire pricing book. By and large, looking at our loan yields, we've been able to get them up by about three basis points for the quarter across lending and trade and so on. We've been able to pass on around 70-80% of the rate increases into the customer pricing. Some of that depends on [the] different markets in different countries. Some we can pass on more some less, but I'm fairly confident that we'll be able to pass on a large part of the rate increase to the customer over the next few coming periods.

Diksha Gera Sure, thank you. Just one more question on the regional demand. Domestically these markets are still seeing a little bit of a gloomy atmosphere in terms of the lending outlook. Are you seeing something outside of [domestic markets]? Is it more the cross-border [activity in the] Asean markets [where] you're able to see coming into your pipeline?

Piyush Gupta It depends on the timing, [some] of that growth is cross-border and is regional but, as I told you, we're seeing strong growth in the Singapore domestic market – in the consumer space as well. If you look at our book country by country, India continues to be slow, Indonesia is strong – we can see growth over there, Taiwan we're seeing growth in manufacturing; [the pick-up across] the electronic industry has helped. We're seeing growth in our domestic book in China and Hong Kong – so ex-India we're seeing growth across the region.

Anand Swaminathan (BAML) Hi, Piyush and Sok Hui, and thanks for the opportunity. Just a couple of questions from me. Your other two competitors mentioned that there was some uncertainty or confusion around the tax treatment for GP write-backs through P&L – can you provide some clarity on that?

Chng Sok Hui What we have clarity on is that GP for Singapore banks will continue to be tax-deductible, so that's actually very positive; not many countries have that as a policy. What is unclear and pending IRAS clarification is whether [you'll be able to have a tax deduction for] the amount that you are required to keep under RLAR. But written into regulation, [it is within] IRAS's powers to also treat the RLAR component as tax-deductible.

As far as doing your projection is concerned, you should assume that [all general provisions charged to P&L are] tax-deductible; same as the current situation.

Anand Swaminathan Okay, thank you. My second question is on capital. At 13.6% [final CET-1] do you still think you're in surplus [and that] there is some scope for capital management, or you're comfortable at this level?

Piyush Gupta We do think there is an opportunity for us to be more efficient with capital and as we project out over the next several years that continues to be the case. We increased our dividend pay-out ratio the last [quarter] and we will continue to look at that as we go forward.

Harsh Modi Sorry to belabour the point on one of the larger exposures that you have, but this comfort you have on them – is it mostly based on parent support, or are you [comfortable at the] [operating]-entity level? I'm just trying to figure out if there's a possibility of any strategic [decisions by] the parent [that] can lead to any issues and your thoughts around that.

Second, cost has been very solid, your [performance] has been tracking [to guidance]. Getting into next year, the cost-income ratio improvement guidance – is it more based on revenue-strength expectations, or [is it] on an absolute basis at cost level [that] you think there is more to go in terms of taking out some efficiencies?

Piyush Gupta On the first, their underlying business is also doing relatively well compared to the competition. To be fair, the whole industry is still challenged but they've been able to create operating margins which allow them to do some debt servicing and interest payments at this point in time so that's positive. On top of that, they have very strong parental support and in several of our conversations at every level of the group there is no indication that they want to change the strategic view on the business that they do. They don't do deep sea and therefore they're not part of the sector that I think might [have a secular] problem going forward.

On the cost-income ratio, obviously revenue improvement will help but we continue to see a reduction in our overall costs. The headcount is still coming off at the margin and we're continuing to see benefits from technology. However, we think there's an opportunity for us to make some substantial increased investments in businesses like wealth management as we convert the ANZ piece of the business and in some digitalisation, so next year absolute costs will probably go up, but the cost-income ratio will continue to come down.

Nick Lord (Morgan Stanley) A question about deposits – obviously ANZ boosted your deposit number and in particular your fixed deposit number. My first question is – next year is the strategy to try and dilute that down, switch some of those into cash or [savings] deposits. How are you going to manage your deposit base next year?

I'm [also] interested [about] what you said on margin in the call. Could you clarify how many rate hikes you're looking at in justifying your double-digit revenue increase and maybe talk about what benefit you might be able to get from integrating that ANZ deposit base a bit better into your book?

Piyush Gupta So a lot of moving parts in that, Nick, but first of all the ANZ deposit base does come with a quantum of fixed deposits. Over the next couple of quarters we have to manage that transition because, frankly, it's high-cost money which we really don't need. On the other hand, there is a customer attached to the money so if we are smart and we can convert that money from a fixed deposit to other forms of more productive investments, that'll be helpful. If it means staying with the extra deposits for a few months while we can work on the customer and get the customer to do different activities, it is probably a good thing. I'm going to let Su Shan make a couple of comments on that in a minute.

The second thing is we've been quite conservative in our double-digit growth rate. We only factored in one rate hike. The market is pricing in almost two and the Fed is still calling for three, so if we actually get a couple of rate hikes more than we factored in we should have even stronger top-line growth.

Su Shan, you want to talk a little bit about the ANZ integration?

Tan Su Shan So three out of five countries done so far and, as Piyush alluded [to], we have started to let some of the higher-priced fixed deposits drip off. The RMs that came over [have] together with our product team come up with plans to convert that into either wealth management products, insurance products or other kinds of longer-term stickier products. The mortgage book has been quite sticky. The biggest book that came over was the Singapore book and it was quite complementary. There was a fair [number] of offshore clients in the wealth segment that we didn't have before and so that's been quite helpful. I think at the end of the day our wealth platform is quite a lot bigger and deeper than theirs was, so it's been quite a complementary fit and I'm quite confident that the RMs that have come over will end up being more productive as they get used to our systems and our product offering.

Piyush Gupta Nick, if you remember [in the case of] SocGen, we were able to lift within 18 months the productivity of the SocGen RMs by over 50% – almost double in several cases, because [DBS offered them] a much richer and deeper platform of products to sell to their clients. Our early read is we think we can achieve the same thing with the [RMs and the] client base that's coming [over] from ANZ, which is why in my outlook when I said that I'm optimistic about the ANZ integration, I think there is upside on the revenue side in terms of our synergies. There is also upside on the expense side. It turns out that we can drive greater expense efficiencies than we'd originally projected. Overall, I think it's going to be quite helpful to our business next year.

Michael Sia Okay. Thank you everybody for joining us. We'll see you again next quarter.