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Edited transcript of DBS second-quarter 2021 results conference call for buy and sell sides, 5 August 2021

Yeoh Hong Nam Good morning everyone, and thank you for joining us on our first-half results briefing.

Jayden Vantakaris (Macquarie) You are saying that provisions wouldn't be any more than $500 million for the full year, so that suggests up to $400 million for the second half. As your comments on credit quality sounded upbeat, is it possible that the guidance is too high. In the first quarter, the GP write-back was due to model adjustments. Was it also the case this quarter? And how much of the write-back had to do with repayments versus credit upgrades?

Piyush Gupta I am hedging my position on second-half allowances. It could be less than $0.4 billion because I am not seeing a pickup in delinquencies. It's just that the delta variant is causing some uncertainty on consumer portfolios in countries such as Indonesia and Taiwan. In addition, loans are coming off moratorium. While there hasn't been a pickup in delinquencies, it could be that it's still early and they will come in a few months. But if I had to make a bet it would be lower than $0.4 billion.

Chng Sok Hui A large part of the GP write-back of $275 million in the two quarters came from repayments and credit upgrades. About $80 million was from the retail portfolio as we had used conservative assumptions last year in determining the GP to set aside. For the institutional portfolio, repayments contributed $75 million and credit upgrades $37 million. The balance was due to the shortening of maturity and other modelling factors.

Piyush Gupta Our GP reserves are around $4 billion, including $1.5 billion of model overlays reflecting downside risks. The balance of $2.5 billion is based on our models, which takes into account probability of default, loss-given default and the risk rating of our portfolio.

Melissa Kuang (Goldman Sachs) Did I hear right that you still have $1 billion in GP model overlays? Will you consider releasing them next year if things are better? On net interest margin, can you explain the factors for the four basis point decline and indicate how it might trend in the second half?

Chng Sok Hui We are unlikely to write back the entire GP overlay because there is likely to be something that causes us concern – for example, prior to Covid, there were geopolitical tensions. A guidepost of GP write-back potential is the $0.8 billion surplus above MAS minimum requirements.

Melissa Kuang What would be likely credit costs next year taking into account potential GP write-backs?

Chng Sok Hui Any GP write-back will be gradual and in tandem with the outlook for the economy, in particular the lifting of travel restrictions. We are going to take a prudent approach and not release the entire amount.

Piyush Gupta In the past 22-25bp would have been the normalised cost of credit. Taking into account GP write-backs in the near term, it is likely to sub-20bp. That reflects the quality of our portfolio, our credit processes and the GP buffer we have built up. If things get better, we have the capacity to release some GP, but we are not going to release all of it because we you never know what might come along the road that is not reflected in the models.

We had guided for net interest margin to be 1.45-1.50% for the full year, and it will come in at the low end of the range. This means there will be a further drag of 2-3bp in the second half from second-quarter levels.

Terrence Chua (Phillip Securities) What is the percentage of loans coming off moratorium and which sectors are they in?

Piyush Gupta At the peak we had $17 billion in moratorium or about 4% of total loans. Currently we have less than 1%. We also have another $5 billion of ESG loans that are 90% government guaranteed.

Harsh Modi (JP Morgan) For 2022, is it reasonable to say provisions would be in line with or lower than 2021 after taking GP write-backs into account?

Piyush Gupta We are budgeting for next year's allowances to be at the through-cycle level rather than this year's low level due to macroeconomic uncertainties. Although many governments are still providing some form of fiscal and monetary stimulus, it is not certain they will continue. The other uncertainty is tapering, which could lead to some NPL pickup as liquidity is drained.

Harsh Modi On capital, how should we think about the path towards a CET-1 of 13%?

Piyush Gupta It might happen tomorrow if we do all the Citi deals we are looking at. On the other hand, if we wind up not doing any M&A, we will go back and take a more aggressive view of capital management.

Harsh Modi Let's say in the next 6-12 months, when we should see resolution to the Citi deals, would we have much better clarity on the dividend outlook?

Piyush Gupta The policy of steadily increasing the dividend over time remains. On M&A, besides Citi, we will look out for other bolt-on opportunities over the next 12 months that may become available in the current macro environment. They could be banking or non-banking deals. Remember the two deals we recently did – Soc-Gen and ANZ – were the result of opportunities. So I am keeping some powder dry for something that might come along. If it doesn't, we will take a fresh look at dividends. We will make sure that any deals become earnings accretive within three years.

Harsh Modi Finally, how is progress on Lakshmi Vilas. What are the milestones you are aiming for by year-end?

Piyush Gupta There's good news and bad news. The good news is that things are proceeding on plan in terms of integration and credit quality. Integration is smooth – deposits are up, cost of funding is down 60bp, loans are up for the year. We are getting repayments of NPLs. The bad news is that because of the pandemic, we are behind schedule in sweating the franchise. And that's deliberate as I am reluctant to push the pedal on the consumer and SME franchise until I am more confident about the macroeconomic situation. We would probably have better line of sight on what to expect next year rather than in the next quarter or two.

Harsh Modi By the end of next year, would you get to a point of becoming comfortable enough to inject more capital for growth capital rather than precautionary capital? When do you sense a steady state there?

Piyush Gupta Over the next five years, we will put a lot more capital into India because the expanded franchise gives us very significant growth opportunities. We have an ambitious growth agenda for India on the back of this acquisition, which will require capital for at least two, three, four years before it starts levelling off.

Harsh Modi In terms of timeline, when do you get enough confidence to go to the board and say this is the amount of capital we are going to commit?

Piyush Gupta We have already done the work, so our plans are in place. We will formally take it to the board in the next couple of months. But informally, the board is fully supportive of it. It took the line of sight to that when they approved the deal.

Nicholas Teh (Credit Suisse) Just a couple of questions. First, with the rising cases in China and the lockdowns there, have you started to see any impact yet? Second, how should we think about whether the strong deposit growth in the past year is sticky and can be deployed into higher-yielding assets than with MAS?

Piyush Gupta The increased cases in China have not created incremental downside. We already went through stresses for three years before the pandemic from China-US tensions and the technology supply chain. As I had said at the media briefing, if you, like us, don't have a large consumer book or SME portfolio in China, there is unlikely to be any material impact.

I fully expect some of the massive deposit growth to run off when tapering happens and when interest rates start rising. Looking back at the GFC, it’s not clear to me that central banks will be able to eliminate this liquidity anytime soon. But when the liquidity starts going, I think that 30-40% of the surplus will remain for us, but it is only a guess. A significant amount of what we have got is Casa operating accounts as a result of digitisation, API connectivity, supply chain integration and other work we have done.

How do you use that money? You have to have a view on the risk. That's part of the earlier question from Harsh. I think eventually we will put money on growing the SME and consumer franchises. But you have to be thoughtful about the time to start doing so. We will get there when the economy stabilises further. For the time being, we are growing our business with large corporates.

Aakash Rawat (UBS) What are the expenses associated with the $350m of new income opportunities? What would be the cost-income ratio for these businesses?

Piyush Gupta The expenses associated with everything other than Lakshmi Vilas Bank is not material. After costs and allowances are considered, Lakshmi Vilas Bank is breakeven. Over time, its cost-income ratio will decline from rationalisation. We have already reduced its original headcount of 4,000 by 600.

Aakash Rawat What is the impact of the new initiative on your long-term ROE target?

Piyush Gupta ROE will keep improving structurally, but it will take time to trickle through. Wealth management and cash management have contributed significantly to the improvement from 8.5% a decade ago to 13.5% pre-pandemic, but in a given year we would be lucky to see 0.1-0.2%pt from these activities.

Aakash Rawat On a related note, what is the progress towards a 40% cost-income ratio that was discussed in 2017?

Piyush Gupta We continue to work at this. But interest rates have had an impact – the lower rates have set us back close to $3 billion in annual net interest income, making it harder to get to 40%. While we have clawed back some of it from business growth, we are still down on a net basis.

Aakash Rawat Finally, how is progress in the crypto business? On the recent crypto licence granted by the MAS, how critical is that for your business? Is it positive for the ecosystem?

Piyush Gupta On your second question, frankly I don't know the answer. I have just asked my people this morning to understand why the crypto licence is different from the one we have since we certainly have a license to everything. So I am going to find out.

On the first question, I am quite pleased. We now have just under 400 customers, did $170 million-180 million of trading volume in the second quarter, and have $130 million-140 million of assets under custody. We have been selective rather than going mass market because of the noise around it. My target is to get to 1,000 customers by year-end. One of the things we need to do is operate 24/7 rather than in only the Asian time zone. When that happens, I expect activity to pick up further.

Robert Kong (Citi Research) I have got some bits and pieces but will start with my main question about the math around capital. Let's start with a 13% CET-1 ratio, a return on risk-weighted assets of 1.9% and sustainable RWA growth in the mid- to high-single digits. With these parameters, what would be the neutral payout ratio?

Piyush Gupta I can leave Sok Hui to answer that question. I haven't done the math. But part of the answer goes back to what I told Harsh on M&A. If we need to keep a capital buffer for bolt-on acquisitions, we have to cater for that. In the past we have been able to get to a payout ratio in the high 50% range, although we do not commit to a specified ratio.

Chng Sok Hui The payout ratio currently is close to 50%. The next timeline to watch is a slew of changes in 2023 when the Basel 3 reforms kick in, and we can see how to calibrate the CET-1 ratio and assess the surplus capital.

Piyush Gupta Another reason we are not being more specific is that regulators are still wary about how much capital banks return as dividend restrictions are removed.

Robert Kong For the bits and pieces. Adjusting for the $30 billion of surplus deposit placements, could I argue that your adjusted net interest margin is closer to 1.50%?

Piyush Gupta It’s a 7bp impact.

Robert Kong Next, are there any interesting wealth portfolios for sale? Is there any more consolidation that you could see in the industry?

Piyush Gupta I am not seeing anything imminently. You will see people who want to exit the region now and then, but not anything imminent.

Robert Kong Finally, a slightly tongue-in-cheek question. In Indonesia, the traditional banks are getting jealous because the digital banks, which do not make any money, are being traded almost at the same market cap. Is there a way to split out your digital business and give it a slightly different valuation?

Piyush Gupta Robert, this is music to my ears. This has been my big bugbear for the longest time. The only way you can do that is to look at the bank from the lens of your technology colleagues, who are more willing than bank analysts and investors to accept a valuation of 80 times revenue. Bill Winters said the same yesterday – we have got fantastic digital revenue-generating businesses but your models don't pick it up. When we did our digital day in 2017, we precisely unbundled the bank into the digital and traditional segments in terms of growth and ROE.

One of the things we are considering is unbundling some of these activities from the mothership. And if there is private equity interest in these activities, they will start getting covered by your tech colleagues. Let me give you an example. We have a product called Remit, which is like Wise. We do instant transfers to 60 countries around the world. Our total volume of business is meaningful, let's say 15-20% of Wise based on what I last saw. But our profitability is massive, $60 million-70 million to the bottom line. If I could unbundle the business, there's no reason in my mind why it should not get a valuation of anything of $5 billion-10 billion. It's hidden inside DBS. Our market cap is $55 billion, nobody is riding the fact that I have got an embedded $5 billion-10 billion business. If I could spin it out into a separate entity, and then get some SoftBank kind of investor, maybe somebody starts valuing the business. And it is not the only one. We have got a whole slew of businesses where we think we have the capacity to spin out at some stage. It's something we are going to be looking at over the next year or two.

Robert Kong So we’re thinking of the same direction. I was just trying to think how to do this. I mean you have got your consumer bank, if I could separate out the digital customers, put a separate ROE and a separate valuation on it.

Piyush Gupta Robert, we have disclosed that. It's in the annual report. We started disclosing that in 2017 based on a very rigorous framework with a complete P&L for the digital customer with fully-allocated expenses and credit costs. We show the cost-income ratio and ROE of the segment, which is material.

Robert Kong What kind of ROE can we attach to the wealth business? Again, we have the revenue number in your consumer disclosure, but I am just trying to think, is it like a 30% ROE business?

Piyush Gupta The wealth business is not a 30% ROE business because other than some leverage, there is only operating risk and no other risks. Another business that is doing well is retail wealth, where we offer everything from budgeting to financial planning. Two million people have downloaded the budgeting tool and one million are using it actively. I have got $1 billion now from it in regular savings and digital portfolios, all managed digitally. Now, if I unbundle it and compare it to others in the space, I think we have better capability, we have the revenue and the customers.

Anand Swaminathan (Bank of America) I wanted to get more colour on the slide you put out on the acceleration businesses. What is driving the growth?

Piyush Gupta There are three initiatives. One is the China securities JV. The opening up of China's capital markets is big, which is why everybody is trying to get in. We have a 51% stake with the option to buy the balance over the next few years. That business has got off to a flying start because of an active pipeline of mandates across DCM and BCM.

The second initiative is retail wealth, which I just spoke about. In the past year, retail investor activity has been picking up around the world. Our timing has been good, we are offering a complete end-to-end process that is fully digital and driven by AI and context.

The third initiative is supply chain, and there is a macro aspect and a digital aspect. The macro aspect is the alarm in the past year over supply chain resilience and transparency several levels down. Because we have built up APIs with corporates, we have been able to plug ourselves seamlessly into various supply chains and go for a land grab over the past 12-18 months. We went to several industries and said, We have the tools, you can plug them in and you can get digital visibility in the supply chain. We are seeing a significant pickup in volumes across logistics, auto and TMT.

Anand Swaminathan Is the API connectivity with your customer, your ecosystem players or FinTech players in the sector?

Piyush Gupta It's at three levels. One is anchor customers, which lead the effort to digitise their supply chain, and we plug into that. Another is platforms. We are plugged into some of the biggest in the region, such as the China and India platforms. The third is at the industry level. A lot of it is in Singapore where we have digitised and plugged into the construction and logistics industry supply chains.

We are seeing three things. First, we are getting a lot of the operating accounts from across the supply chain, which gives us cash. While it's not worth that much today because rates are low, it eventually will be worth a lot. Second, the financing spread is better than our traditional spreads. It depends on whether we take anchor rates or spoke rates, but they are definitely better. Third, some of the supply chains are cross-border, which adds an FX component to revenue.

Wilson Wong (Janchor Partners) Recently you said that normalised ROE was at 10.5-11%, and if interest rates rise then it would be 11-12%. You also just mentioned that your normalised credit cost normalisation would be closer to 20bp than to 25bp. And your mix is shifting towards higher-ROE businesses like the digital bank and wealth management business. Do you have any updated view on the normalised ROE?

Piyush Gupta We should be able to get 13% ROE in a normalised interest rate environment. Over time, with further structural improvements, we could get closer to 14%, but that would take a lot of time to reach.

Nick Lord (Morgan Stanley) Two questions from me. First, are you changing your cost guidance for this year, which was 4% above 2019 levels?

Piyush Gupta The guidance is still the same.

Nick Lord Second, given what you know today about the pipeline and the economic outlook, do you think the high-single digit loan growth for 2021 can be repeated for 2022 as well?

Piyush Gupta There are a few components to the loan book. For non-trade corporate loans, I think you will see a repeat because the momentum is strong. We are already talking to clients about next year's activity, the investment cycle, the M&A activity and so on. For trade loans, they are impacted by commodity prices and by our own decisions over whether pricing is attractive. Supply chain financing will grow but more opportunistic transactions may not. For housing loans, which we expect to grow $3 billion this year, we should be able to get to somewhere similar unless markets change dramatically. Finally, for wealth management loans, growth depends on market conditions. Given my outlook on rates, which I don't see going up dramatically next year, I think wealth management loan growth can be repeated.

Kevin Kwek (Bernstein) When you spoke about dividends, did you indicate a higher payout ratio?

Piyush Gupta No, we don't give a payout ratio. All we said is that we will continue to pay consistently higher dividends over time in line with our earnings. That's all.

Yeoh Hong Nam Thank you for joining us. See you next quarter.