Edited transcript of DBS fourth-quarter 2022 results conference call for buy and sell sides, 13 February 2023

Michael Sia Welcome to the conference call for the buy and sell sides.

Aakash Rawat (UBS) First, on loan growth, you mentioned some reasons why it declined in the fourth quarter. Why shouldn't we extrapolate these headwinds into this year and do you see any downside risk to the mid-single-digit loan growth guidance for the year? Second, you mentioned strong wealth management fund inflows and growth from family offices. It is surprising that these have not contributed to loan growth. Why?

Piyush Gupta The decline in the fourth quarter was partly due to refinancing which has tapered off in January. Our guidance of mid-single digit percentage growth is supported by our pipelines and recent bookings. There could be some upside from wealth management. The strong inflows have not resulted in much investment activity as customers have mostly stayed in deposits. There was weak margin financing activity. However, if markets turn around we could see a pickup in wealth management loans. We are already seeing stronger activity in North Asia. This was not factored into our mid-single digit percentage growth projection. Thus, I think there is little downside risk to the guidance.

Aakash Rawat There was a large increase in fourth quarter expenses. Is there upside risk to your guidance of 9-10% expense growth this year?

Piyush Gupta Several one-off items contributed to higher expenses in the fourth quarter. We took impairments on some tech-related assets which did not give us the value we anticipated. We also distributed a one-time $500 special award to each staff. In addition to these one-time items, we also recognised more bonus accruals in the fourth quarter given our strong financial performance. For this year, I am fairly confident that we can meet our guidance.

Aakash Rawat Your outlook is quite positive on credit costs. How confident are you of that guidance? In the previous quarters you were a bit more cautious. What has changed since then? Second, isn’t it a bit early to be taking a view on the impact from higher rates? Rates are still going up, and there is typically a six-to-twelve-month lag before asset quality issues materialise.

Piyush Gupta One big change is that China has opened up. The government has put in place heavy support for the economy. Thus, I think that idiosyncratic risk from China has reduced. For example, they have changed real estate financing rules and channelled more liquidity to the property sector. Second is the fact that we have been through another four months with rates at 4.5-4.75%, and we have not seen delinquencies go up. SME delinquencies are flattish. While we have seen delinquencies creep up in consumer in a couple of markets, by and large there is a tremendous degree of resiliency in the sectors that traditionally experience pain from higher rates.

SP were at eight basis points of loans for 2022 and we currently do not expect to see any material pick up in credit costs. The reason why we guided for 10-15 bps of credit costs is precisely because we do not know the extent of the lagged impact of higher interest rates.

We also have a sizable general allowance management overlay which remains untouched. We did not reverse it last year or the year before unlike many other banks. Therefore, even if some unexpected SPs materialise, we have the capacity to absorb it from our existing buffers.

Aakash Rawat On dividends, what is the reason behind a special dividend as opposed to an even higher core dividend? Notwithstanding the possible peaking of NIM, capital accretion from higher interest income will still be very strong and the quarterly ordinary dividend could have been higher than 42 cents. You also seem to be more inclined to distribute special dividends going forward.

Piyush Gupta That is not true. It is only the second time we have done a special dividend. We did one in our 50th anniversary in 2018 and we are doing one now in the 55th year. Our focus is on a sustainable core dividend that grows progressively with earnings. We certainly have the capacity to distribute a higher core dividend if earnings accretion continues.

Aakash Rawat On the transitional Basel IV impact of a 200 basis points benefit to CET-1, how likely will this materialise? Other Singapore banks are more conservative about the impact. Does the ongoing conversation with MAS suggest that there will be changes to the rules which will prevent Singapore banks from benefitting?

Piyush Gupta From our discussions with MAS, we do not expect further changes to the rules. Our core capital ratio benefits by two percentage points in the first year. This transitional benefit will reverse over the subsequent five years as the output floor phases in. During the transitional period, the benefit provides added capacity to support capital initiatives, such as redeeming Additional Tier 1 and Tier 2 capital instruments subject to MAS approval.

Aakash Rawat Lastly, on the funding costs, are you expecting time deposit rates to continue going up or do you see them flattening out?

Piyush Gupta They have already started flattening out because T-bill rates seem to have peaked and time deposit rates of our competitors have also plateaued.

Aakash Rawat This should translate into a slower pace of Casa outflow right?

Piyush Gupta Yes. Casa outflows are beginning to level off. The biggest uncertainty is not from Casa switching to FD but outflows to T-bills as it depends on the extent of monetary policy sterilisation by MAS. MAS was sterilising through the domestic market, which was why domestic rates stayed high. However, in recent months MAS have strengthened the SGD. Thus, headwinds from T-bills should ease off as well.

Aakash Rawat Do you see any chance that the government might raise the interest rates paid to CPF members?

Piyush Gupta It is tough for us to call. It is a political decision.

Harsh Modi (JP Morgan) On wealth management, you have seen a large increase in net new money flows. What are the second- and third-order effects, such as increased fees from custody? Will they translate to a meaningful increase in revenues?

Piyush Gupta You should expect to see at least a percentage point in revenues from the incremental AUM inflows. As a large proportion of the increase in AUMs come from the ultra-high net worth and family offices, this benefits the ecosystem of services we provide. One is access to private equity deals, which our investment banking arm is able to facilitate. Currently, we have some 40 or 50 deals in the pipeline. Our deep connectivity across the region allows us to benefit from this.

Another is our digital asset ecosystem. While some may question the long-term viability of digital assets, I think that despite the crypto winter, tokenised assets do have a role to play in the future and clients are keen to participate in these kinds of opportunities.

Harsh Modi These are contingent on the state of markets. So, if there is a risk-on environment, you have a higher probability of making a better return from the AUMs because the size has increased?

Piyush Gupta Yes.

Harsh Modi On capital, can you please walk us through the thought process on determining the 42 cent ordinary dividend and the 50 cent special dividend?

Piyush Gupta It is anchored on our dividend policy to pay sustainable dividends that grow progressively with earnings. The ordinary dividend of 42 cents represents an increase of about 17%, which is in line with the 20% increase in our full-year net income. If earnings continue to increase this year, we can support even higher core dividend payment in line with the profit growth. That said, we may pace out the dividend increase to ensure that the trajectory is sustainable. And because we have surplus capital, we decided on a special dividend.

Harsh Modi Should we think of dividend distributions in terms of a payout ratio with the previous quarterly absolute dividend amount as a floor? Because the previous framework of paying out given a CET-1 target seems to have changed.

Piyush Gupta Our payout ratio has historically been between 48% and 54%. You can use that as a starting point for forecasting dividends. However, you need to also consider our CET-1. We have surplus capital even after considering the full transition to Basel IV, thus we have room to further increase dividends or consider other means of capital distribution.

Harsh Modi CET-1 is now at 14.6%. How will excess capital be used? Is there a glidepath to 13%?

Piyush Gupta After we pay the announced dividends, we would be at around 14% CET-1. The integration of Citi Taiwan this year will reduce CET-1 by around 0.6 to 0.7 percentage points. Organic activity for Lakshmi Vilas Bank will not consume a lot of capital, perhaps $300 million to $500 million over three to five years, which does not move the needle significantly. Any opportunistic inorganic deals will likely be bite-sized. If we set aside $1 billion for these, we will still end up with around $3 billion to $4 billion of surplus capital that we will have to return to shareholders.

Jayden Vantarakis (Macquarie) I would like to clarify the comments on credit cost guidance. At 10-15 basis points of loans, does this represent a new normal level of credit costs or are there cyclical factors that you have considered?

Piyush Gupta The short answer is that we are not completely certain. Our credit cost guidance used to be 20-25 basis points of loans several years ago. We then brought it down over recent years to 17-20 basis points as we got more confident with our credit processes, and now we are at eight basis points of loans. I am not certain that this represents a new normal. However, we have a good line of sight for this year, and I do not see how we will wind up with more than 10-15 basis points of loans. We will have to wait and see if this will be the new normal.

Jayden Vantarakis On general allowances, the write-back in the fourth quarter was due to model impact and not reversals of the management overlays, right? Can you confirm how much of the stock of GP is from management overlays?

Chng Sok Hui Yes, we did not touch the management overlays and they still stand at $2 billion.

Piyush Gupta Our total GP is at $3.7 billion of which $2 billion are management overlays. We topped up management overlays in the third quarter from $1.7 billion to $2 billion. The GP write-backs in the fourth quarter were due to upgrades and repayments from overall improvement in the portfolio. You can see from our NPL ratio, it has come down from 1.2% to 1.1%.

Jayden Vantarakis So modelled GPs reduced due to portfolio improvements but you took the opportunity to top up the management overlays from around $1.7 billion to $2 billion?

Piyush Gupta Yes. I would like to point out that the increase in management overlay was in the third quarter. Changes are also not purely discretionary, they go through auditor scrutiny. We must have a good justification for increasing the management overlay.

Jayden Vantarakis On wealth management, I note that net new money flows have been very encouraging. Last year, fee income was impacted from weakness in Chinese markets. Have you seen any meaningful pick up in wealth management fee activity so far this year?

Piyush Gupta Yes, we are seeing improvement in January after the Chinese New Year. Client conversations about putting money to work have been good.

Jayden Vantarakis Together with the normalisation of travel spend, that gives you the confidence for the double-digit percentage growth in fee income this year right?

Piyush Gupta Yes, that is correct. Another driver will be investment banking. Last year, we were impacted by weak ECM and DCM activity. We have seen stronger activity so far this year. We have done more DCM deals over the past six weeks than we did in the last several months. Our ECM pipeline is also beginning to get more active. We have a couple of deals which we are going to bring to the market soon.

Nicholas Teh (Credit Suisse) Why do you keep such a large GP management overlay? Are you retaining it as a buffer for a possible recession this year before looking to write back some of it? This would put you in an even larger surplus capital position which you would then have to distribute through higher dividends in order to bring CET-1 down to your targeted range of around 13%?

Also, has the operational risk charge from the digital bank outage been reversed? Can you please remind us of the impact to CET-1?

Chng Sok Hui A large part of the GP management overlay was set aside during Covid. Back then, we communicated that changes to the overlay, including any reversal, will depend on how the situation pans out. However, as economies started recovering from the pandemic, we had the Russia-Ukraine situation. Stress tests of our portfolio resulted in an estimated ECL figure that was consistent with what we had set aside at that point in time. If the external environment improves, we may be in the position to release some of these GPs.

Piyush Gupta I think it would be unwise to release it before we see the full impact of interest rates flow through by the tail end of this year. If we have unexpected credit losses, we will use the cushion that we have built up. If not, and once we are at the tail end of the cycle, we can start releasing some GPs. Whether it happens this year or next year is anybody's guess.

On capital management, it is pretty clear that even after the 92-cent payout for the fourth quarter, we are still extremely well-capitalised. So, we do have the opportunity to return more capital. Our preference is to do it through core dividends, not specials. Returning capital in excess of earnings growth is a possibility. We will review our capital management plans between now and year-end.

Chng Sok Hui The operational risk charge from the digital banking outage is 0.4 percentage points. It has not been reversed and we will continue to review it with the MAS.

Nick Lord My questions are on capital. First, can you quantify the impact on CET-1 from currency effects? Second, you need AGM approval for share buy-backs, but do you also need Board approval? Third, do changes to dividends require Board approval and does the Board sit every quarter or less frequently?

Chng Sok Hui CET-1 improved by 0.8 percentage points in the fourth quarter. Half of that came from the earnings accretion less the dividend paid out in the fourth quarter. The currency effect is about 0.15 percentage points, and we also benefited from a lower RWA charge from counterparty credit risk as well as lower market risk RWA.

Piyush Gupta The Board meets every quarter and can deliberate on capital management plans. For share buybacks, we need an enabling provision at the AGM. It also requires Board approval.

Chng Sok Hui For this year's AGM, we can buy back about 2% of total number of shares outstanding. So that is about 50 million.

Nick Lord On your cost guidance, is the base you are using an underlying cost base excluding the fourth-quarter one-offs or is it the full cost?

Chng Sok Hui It is based on the on the full-year numbers published in the performance summary.

Nick Lord Finally, can you remind us what the pricing split is for your Hong Kong and Singapore mortgage books? I assume that in Hong Kong it is pretty much all prime minus and Hibor. Given what has happened to Hibor in January, would that be one of the things that is adding to a little bit of margin pressure for this year?

Piyush Gupta Half of our outstanding Singapore mortgage book is fixed rate. 32% is priced off our fixed deposit rates and 10% is priced off Sora. Fixed-rate mortgages and those priced off our fixed deposit rates take time to reprice. Sora loans also take some time to reprice as it is backward looking. Only 5% is priced off Sibor which reprices more rapidly.

Our Hong Kong mortgage book is not big, at around $7 billion to $8 billion. You are right that the pricing is on prime minus. Most of our HK loan book are corporate loans priced off one-month Hibor. Hibor came off recently but over the last two weeks, it has reversed.

Weldon Sng (HSBC) You said that for the same level of NIM, the current ROE of 17% is four percentage points higher than in the past. What are the drivers of this? Is it mainly due to leverage or has there been a structural improvement in ROE? What is the medium-term ROE which you can achieve after this rate hike cycle?

Piyush Gupta The first significant structural improvement is a change in the mix of our business. High-return businesses such as cash management, transaction banking and wealth management now comprise a larger proportion of total income, doubling from 20% more than a decade ago to around 40% currently. This is aided by our digitalisation transformation agenda which we have been implementing for several years.

The second is that digital transformation in Singapore and Hong Kong in the SME and consumer space has given us clear benefits as well. We pointed out before that our wallet share and customer penetration rates have improved. Our digital customer base gives us in the region of 10 to 12 percentage points higher ROE than the non-digital customer base. And the income share of the digital customer base is increasingly quite material compared to the non-digital customer base.

The third structural shift is the improvement in our treasury market and transaction banking business. These used to be single-digit ROE businesses and with the digitalisation that we have done, ROE is now in the double-digits.

In fact, we have an Investor Day scheduled for May this year and our focus will be on how our digital strategy has led to pervasive transformation across the bank including in the corporate banking and treasury markets business, and not just in the retail and SME space like we did in our first Investor Day in 2017.

On your question of long-term sustainable ROE, I think ROE for this year will be north of 17%. What the normalised level of rates we return to is the question, but as long as it does not go back to unusually low levels, we are pretty confident that we can attain a ROE north of 15% on a sustainable basis.

Weldon Sng NIM was last at current levels around a decade ago. The cost-income ratio is also similar to a decade ago. Which metric reflects the digital improvement?

Piyush Gupta It is reflected in the ROE. We are able to generate a lot more non-asset-based income from wealth management or transaction banking.

Shane Mathews (WhiteOak Capital) I have two questions. First, given the recent developments in 2022 about the Regional Comprehensive Economic Partnership (RCEP), does that make you a bit more bullish about the trade volume which can benefit the bank? My second question is regarding your exposure outside Singapore. Can you remind us of your medium-term three- to five-year revenue targets in the different markets like Taiwan, ASEAN and India?

Piyush Gupta I think the RCEP reform is not the principal driver of trade. Intra-Asian trade continues to grow quite strongly and faster than global trade, despite geopolitical problems. It is a result of the China Plus One strategy and countries are diversifying away from China to other parts of Asia. Another key driver is that Asia is no longer just producing but also consuming. This supports the steady growth in regional trade. Our trade business has also evolved. We do not just do cross-border documentary trades now but also supply-chain financing. This is the fastest growing part of the business.

On your second question, we do not set explicit targets and we invest in these markets based on the opportunities they provide. For Taiwan, after the integration of Citi Taiwan's operations, annual revenues will be between $1.3 billion and $1.5 billion. The size of India's business is expected to triple over the next four to five years. These markets comprise a small proportion of overall revenues given our large presence in Singapore and Hong Kong.

Harsh Modi I have a follow-up question on NIM. We have visibility on the path of asset yields this year. For cost of funds, can you quantify the delta? How much of the increase is from the switch to FDs and the Casa mix change? There is deposit competition for corporate Casa. How does this impact the cost of funds?

Piyush Gupta One way to think about it is to look at deposit betas. Our overall deposit beta for the year was about 32%. As SGD deposit beta is much lower at 7%, the bulk of the Group deposit beta is from the USD book. Deposit beta was 60% for USD and 22% for other currencies. Deposit betas accelerated in the fourth quarter. For SGD, it increased to low double digits. For USD, it was at close to 80%. However, it has stabilised more recently.

Harsh Modi So your current guidance now is for an overall deposit beta of around 50%?

Piyush Gupta Mid-40s, actually.

Harsh Modi Does this guidance consider where SGD and USD rates will be in 12 months' time?

Piyush Gupta Our assumption is that the Fed raise rates to about 5.25% and do not cut rates this year. Similarly, we assume that SGD rates remain at current levels. We have not modelled for 2024 at this point in time.

Harsh Modi If Fed raises rates to around 6%, do you expect deposit betas increase or stay at the mid-40s range that you are guiding for?

Piyush Gupta I think that it will increase. As rates go up beyond 5.25%, deposit betas will likely climb more sharply.

Michael Sia Thank you for joining us.