Edited transcript of DBS first-quarter 2022 results conference call for buy and sell sides, 29 April 2022

Yeoh Hong Nam Good morning everyone, and welcome to the briefing.

Aakash Rawat (UBS) My first question is on the outlook for credit costs this year and next. There are a lot of uncertainties given geopolitical and other risks. Can credit costs still be minimal this year?

Piyush Gupta The first-order impact of the war in Ukraine on us is minimal. The second-order impact is through the commodities complex – the prices of gas and energy, metals, minerals and food – which could create some credit risks. There could be companies taking the wrong side of trading positions, which could create some vulnerability. I would call these risks idiosyncratic, you can't model for them.

The third-order impact is the macroeconomic flow-through, which theoretically is something that can be modelled although it's not easy. What impact does inflation have on a company's sales revenues – while volumes might come off, prices might go up. What can it do about pricing and what how will its profit margins be impacted? Higher interest rates will increase debt servicing, which can be modelled, but it's also not that easy to do, especially since we haven't seen a high-inflation environment in a long time. We have also done bottoms-up stress testing across impacted industries such as food and agriculture, metals and mining, and the energy complex. We have done stress tests around property and around consumer goods manufacturing to ascertain the size of margin squeezes.

In the short term, we are fairly confident we will not see any material pick-up in specific allowances relative to what we would normally assume, which I have said should be 15-20 basis points. The minimal total allowances we had guided for earlier assumed that these specific allowances would be offset by general allowance write-backs from the significant GP we had built up in earlier years, like what happened last year. How much GP we write back in the coming quarters is something we will be more thoughtful about. It will depend on how much line of sight we have of the future.

At the same time, we expect higher interest rates to give us tailwinds, so even if we decide not to write back GP, we will more than make up for it through higher net interest income.

It is harder to model what credit costs might be next year. On a two-year timeframe, the biggest impact is likely to be on SMEs. But our SME book has been well stress tested in the past four or five years, and it is mostly secured. So my expectation is that it will stay quite robust. We will make another assessment as the year progresses. The other major area is consumer finance. Again, our consumer finance book is largely secured. We will see what happens to wages and debt servicing ability in the second half of the year. So because of these longer-term uncertainties and the difficulty of modelling them, our current inclination is to be a little more careful about further GP writebacks. We have built up SGD1.8 billion of GP overlays above our models, so we are quite confident our buffers are solid.

Aakash Rawat My second question is on trading gains. They look surprisingly strong when other banks are reporting weakness. Can you explain what the difference is between DBS and other banks? And how will higher market volatility help?

Piyush Gupta I am not sure what our peer banks have reported, but the US and European banks had a very strong FICC quarter. Macro trading has done well in this environment. We saw the same across our desks, particularly interest rates. If you position well into market volatility, you can make reasonable money. I do think we are advantaged by the flow business we have built up through our digital distribution over the past two or three years, which subsequently gives us an advantage in warehousing and positioning.

Aakash Rawat The marked-to-market impact of the investment portfolio probably flows through other comprehensive income rather than the profit and loss directly.

Piyush Gupta That's correct. The increase in interest rates means that bond investments get marked down, and the negative marked-to-market goes through OCI, which is also what the US and European banks reported. Such impact goes directly to equity. If you look at our own numbers, there is a reduction in our shareholder funds for the quarter, but that didn't come through the profit and loss account.

Aakash Rawat My last question is on staff cost pressures. Why is there more pressure at DBS compared to peers? Can you still meet your cost guidance?

Piyush Gupta I haven't looked at peer staff costs. But if you check the market, technology talent is very scarce across the region and particularly in Singapore. Tech turnover rates are high in every market. I think the shortage has also been exacerbated by war in Ukraine. Somebody told me there were 300,000 engineers who are outside the market in Ukraine and another one million in Belarus and Russia. The big tech firms are hiring in our part of the world. Wage pressures have also affected other business segments, but turnover rates are highest in tech. Our cost guidance has already factored in such wage pressures, so we are maintaining the guidance.

Harsh Modi (JP Morgan) A couple of questions. First, does the slope change for Singapore's nominal effective exchange rate (Neer) affect net interest income sensitivity to US interest rates?

Piyush Gupta About half of the interest rate sensitivity comes from the USD book, which flows straight through and does not get impacted by Neer. Around 90% of our USD loan book is Casa-funded and the loan book is mostly floating rate. The other half of the sensitivity comes from the SGD book, which is impacted by the pass-through of USD rates into SGD rates. Historically, when the SGD is strengthening the flow through tends to be lower, and vice-versa. On a through-cycle average, there tends to be a 60% pass-through. Our model takes a pass-through assumption based on where we see the SGD going, the likelihood of Casa outflows and the need to pay up for deposits. We take a conservative view. The outcome is what we have indicated to you.

Harsh Modi Okay. So I should not then slice down the SGD 18 million-20 million sensitivity?

Piyush Gupta Yes, you should not.

Harsh Modi Second, the CET-1 is quite comfortable. What does it mean for dividends or share buybacks?

Piyush Gupta There's the 0.4 percentage point impact from the digital disruption. I don't know how long MAS is going to keep that, so that's one thing to bear keep an eye on. The second thing to keep an eye on is as rates go up, there will be some pressure from the bond investment impact through OCI.

Chng Sok Hui The third factor is the Citi Taiwan transaction, which we expect to complete after June next year. It will have another 0.7 percentage point impact.

Piyush Gupta Obviously when rates go up, we make a lot more money, and that will be beneficial to CET-1. But we have to put all these factors together. We are not planning any unusual share buyback and we are sticking to our policy of steady incremental dividend growth in line with profit growth.

Harsh Modi Let’s say you find your CET-1 is 100 basis points above your target, would you increase the payout ratio then?

Piyush Gupta Our dividend policy is not based on payout ratios. We don't start with a payout ratio and then determine what dividend to pay. We try to figure out the growth rate, and then see what dividend we can pay out.

Harsh Modi You have done various transactions to expand the franchise over the past two years. These include the setting up of new business lines through the DBS Digital Exchange and Partior. You also acquired Lakshmi Vilas Bank (LVB), purchased of a stake in Shenzhen Rural Commercial Bank (SZRCB), and most recently you did the Citi Taiwan deal. At what point in time do you see making a more meaningful capital allocation to one or more of these businesses, and what is the incremental impact to your capital position and to profits?

Piyush Gupta The deals you mentioned such as LVB and SZRCB were inorganic ones and had a sizable capital impact when they were closed. LVB’s integration is going well and over the next four years, we plan to allocate more capital to our India operations in order to grow the book. India has been outperforming over the last two years and it is continuing to perform well. It will take about three or four years before it will be capital accretive. For SZRCB, we currently do not need to commit more capital. The bank is doing well, and a public listing is probably three to five years away. If there are further capital calls over the next few years, we will be happy meet them. These businesses are already contributing to our bottom line.

Chng Sok Hui Currently we put associate contributions within the other income line because they are not material yet. For this quarter, associate contributions are SGD 66 million compared to around SGD 40 million in the previous quarter, when we had two months’ impact from Shenzhen Rural Commercial Bank.

Piyush Gupta The Citi Taiwan business, which will be integrated by the middle of next year, will also contribute meaningfully to our bottom line. I would like to point out that this is separate from our digital businesses such as DBS Digital Exchange and Partior, or the software monetisation that we mentioned before. These businesses are not capital intensive. We might allocate incrementally more capital to these businesses to meet increased expenses and to build scale, but this would not have a material impact on our capital position. It is a slow burn.

Nicholas Teh (Credit Suisse) On credit cost guidance, 15-20 basis points of SP would be the normalised level and you are being more conservative on GP writebacks because of the uncertain environment. But since NPA formation would result in some amount of GP reversals, what would overall credit cost be, barring unforeseen circumstances?

Chng Sok Hui The GP reversals vary, depending on the case and how fast we pick it up. I would say that in a good scenario, the GP released should be about half the SP.

Nicholas Teh I remember you were talking last year about monetising some of your digital assets. Obviously, the market has changed quite a bit. Have you given further thought on the digital assets that could be monetised, or is it something that doesn't look likely in near term given market conditions?

Piyush Gupta The intent to monetise the digital assets did not have a specific timeframe. We were exploring the idea in terms of three categories. The first was businesses within the bank. The most obvious candidates were the remittance and mass market wealth businesses. We have teams working on that, and we have to make sure we have line of sight on cash flow and how the businesses can be scaled. The second category is the businesses I spoke to Harsh about – the carbon exchange, Partior, the digital exchange and the fixed income marketplace. Each of them has possibilities but there will be a lead time before they scaled up. The third category is the distribution of technology solutions built in-house to third parties. Given the market sell-off, I don't expect to see any monetisation this year.

Jayden Vantarakis (Macquarie) On wealth management, there has obviously been a slowdown but can you provide any colour on assets under management and inflows. Should we still expect to see 10% growth this year?

Piyush Gupta Our AUMs were up by SGD 2 billion to SGD 294 billion during the quarter. Our net new money also rose, by SGD 3 billion. Wealth management fees were 20% lower than a year ago, which was exceptionally strong. As we are go into the second quarter, I think we are tracking more closely to year-ago levels. Given that the first quarter already had a 20% drop, it will be challenging to get double-digit growth this year. Whether we eke out single-digit growth will depend on market sentiment for the balance of the year. The positive thing is that customers still have dry powder – non-invested cash AUMs rose during the quarter. If there is a turnaround in market sentiment, I can see the money being put to work.

Jayden Vantarakis So it sounds like it's just a short-term cyclical rather than structural slowdown. Is there any sort of colour you can provide on new customer acquisition to demonstrate structural growth?

Piyush Gupta As you can imagine, there has been customer growth from north Asia into Singapore due to macroeconomic and Covid-related factors. This has been a consistent phenomenon over the past two to three years.

Krishna Guha (Jefferies) Could you give more of colour on loan growth. You mentioned a potential second-half slowdown. Are you seeing any shift to fixed deposits, especially for USD? On the general allowance writeback, how much was related to oil and gas?

Piyush Gupta On loan growth, our corporate pipeline is quite robust. The slower second-half growth I mentioned was predicated on expectations of a GDP slowdown. The statement was cautionary. Also, trade loans grew in the first quarter because of higher commodity prices, so if prices correct in the second half the growth could reverse. Other challenges are housing and wealth management loans. We had expected to grow housing loans this year by SGD 3 billion, but given the additional cooling measures enacted in December, we would be lucky to get SGD 1 billion of growth this year. If the market environment is not conducive, wealth management margin financing will also be impacted. While it's possible to continue getting 2% growth a quarter, it is also possible to get a slowdown in the second half as well.

On fixed deposits, we are not seeing anything yet. I am encouraged that a large part of our Casa deposits, including for USD, are driven by transactional activity, based on the APIs and the cash management system in place. Of course, as interest rates go up, some shift can be expected, which is what we have modelled into out assumptions but are not seeing yet.

On GP writebacks, we don't have anything particularly related to oil and gas. We are not expecting any large recoveries from the sector at the present time.

Melissa Kuang (Goldman Sachs) Given the faster pace of interest rate increases now expected this year, could you give us a revised guidance on NIM? And how is your Indonesia digibank doing?

Piyush Gupta On NIM, it all depends on how many rate hikes you assume, and at what pace. You can come up with your own NIM forecast, depending on the number of 50-basis-point increases and how early you assume they occur. On digibank, we are focused on getting quality customers and monetising them. We are not growing the customer base to get the numbers. It has been our strategy for the past two or three years. It's a slow, steady growth, and we are still losing money. Our annual digibank expenses, both in India and Indonesia, are not being covered by their revenues, although revenues are improving. We have some optimism about breaking even on a cash flow basis over the next few years.

Melissa Kuang Were there other factors for the CET-1 movement this quarter, other than the 0.4% percentage point impact that MAS imposed for the digital disruption?

Chng Sok Hui There were a few other drivers. The implementation of the standardised approach for counterparty risk rating, which the US banks also saw, had a 0.2 percentage point impact. The decline in fair value taken to OCI from bond investments had another 0.2 percentage point impact. Offsetting them was the approval from MAS for the advanced model for wealth management, which had a 0.4 percentage point impact. The details are in the Pillar 3 disclosure.

Yeoh Hong Nam: Thank you, everyone. We will speak again next quarter.