

DBS Group (DBS SP)

Solid Outlook But Fairly Valued

HOLD

Share Price SGD 30.84
 12m Price Target SGD 30.80 (-0%)
 Previous Price Target SGD 29.66

Growth story intact

The 1Q18 results demonstrate DBS's ability to generate earnings growth in the current business environment. However, following the 24% YTD increase, we find the shares fairly valued on our revised estimates. Reported 1Q18 earnings beat Bloomberg consensus, but were in-line after stripping out a SGD86m gain from the divestment of a Hong Kong property. 1Q18 core PATMI of SGD1.4b (+19.8% QoQ, +18.6% YoY) met our expectation at 22% of our previous FY18E forecast. Because of a higher interest rate outlook, we have lifted our net profit estimates for FY19/20E by 4%/5%, sustainable ROE by 14.7% from 14.3%, but left unchanged our COE at 10.5% and growth 3.5%. As a result, our TP is slightly raised to SGD30.80 based on 1.6x FY18E P/BV (unchanged), close to 2SD above its historical mean of 1.2x to reflect higher ROEs.

Active liability management, NIMs to expand

We raised net interest income by 2-5% for FY18-20E after factoring in a higher SIBOR forecast in FY18/19E of 1.65%/1.90% (from 1.55%/1.75% previously) per our Singapore economist. While interest rates have increased, DBS's funding cost for customer deposits has not significantly widened, reflecting its active liability management. Between 1Q15 and 1Q18, SIBOR/LIBOR/HIBOR increased 63/166/81bps respectively, but DBS's funding cost rose by 5bps. With repricing intervals working their way through and funding costs manageable, we estimate NIMs will expand to 1.85%/1.92%/1.96% for FY18-20E from 1.81%/1.84%/1.88% previously.

Benign credit environment

1Q's SP/loans fell to 20bps (4Q17: 25bps, 1Q17: 26bps). We raised allowances by 4-25% for FY18-20E assuming gradual rate hikes, and estimate credit costs at 17-20bps. We assume a benign credit environment with no significant asset quality deterioration given the improvement in FCF for corporates. For every 10bps increase in credit costs, we estimate net profit during FY18-20E may decline by ~5%.

Maintain HOLD; Shares fairly valued

Maintain HOLD as the shares are fairly valued. However, healthy dividend yields of ~4% should lend support to share price. Key risks to our call: 1) lower revenue; 2) higher costs; and 3) higher allowances.

FYE Dec (SGD m)	FY16A	FY17A	FY18E	FY19E	FY20E
Operating income	11,489	12,274	13,868	15,509	17,073
Pre-provision profit	6,517	7,069	8,250	9,880	11,170
Core net profit	4,200	4,277	6,338	7,715	8,694
Core EPS (SGD)	1.6	1.7	2.5	3.0	3.4
Core EPS growth (%)	(4.4)	1.2	48.2	21.7	12.7
Net DPS (SGD)	0.6	1.4	1.2	1.2	1.2
Core P/E (x)	18.7	18.5	12.5	10.2	9.1
P/BV (x)	1.8	1.7	1.6	1.5	1.3
Net dividend yield (%)	1.9	4.6	3.9	3.9	3.9
Book value (SGD)	17.02	17.80	19.11	20.86	22.99
ROAE (%)	10.2	9.7	13.4	15.1	15.5
ROAA (%)	0.9	0.9	1.2	1.3	1.4
Consensus net profit	-	-	5,830	6,585	7,143
MKE vs. Consensus (%)	-	-	10.9	17.7	22.3

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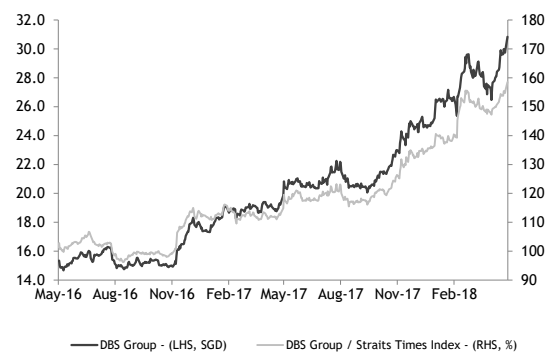
Statistics

52w high/low (SGD)	30.84/19.86
3m avg turnover (USDm)	126.0
Free float (%)	69.8
Issued shares (m)	2,479
Market capitalisation	SGD76.5B USD57.3B

Major shareholders:

Temasek	29.0%
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Price Performance



	-1M	-3M	-12M
Absolute (%)	12	16	59
Relative to index (%)	6	14	40

Source: FactSet

Fig 1: Revisions to estimates

DBS	Revised			Previous		
	2018E	2019E	2020E	2018E	2019E	2020E
(SGD m)						
Net interest income	9,210.2	10,315.7	11,370.9	9,021.1	9,838.3	10,856.6
Non-interest income	4,571.9*	5,192.8	5,702.0	4,737.7	5,213.1	5,701.9
Total income	13,782.1	15,508.5	17,073.0	13,758.9	15,051.4	16,558.6
Expenses	5,618.1	5,628.2	5,903.0	5,618.1	5,628.2	5,903.0
Allowances	567.2	684.3	821.2	455.5	590.2	786.5
Net profit^	6,337.6	7,715.4	8,694.4	6,427.7	7,403.2	8,281.9
Revisions (%)						
Net interest income	2.1	4.9	4.7			
Non-interest income	(3.5)	(0.4)	0.0			
Total income	0.2	3.0	3.1			
Expenses	0.0	0.0	0.0			
Allowances	24.5	15.9	4.4			
Net profit^	(1.4)	4.2	5.0			

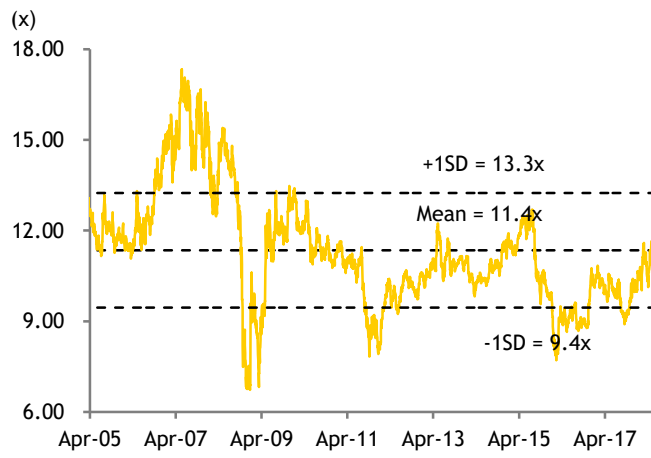
Source: Maybank Kim Eng. ^Net profit excludes one-offs and preference share dividends. *Excludes a one-off gain of SGD86m from divestment of a Hong Kong property.

Fig 1: Quarterly profit and loss summary

SGD m (FYE Dec)	1Q17 (SGD m)	4Q17 (SGD m)	1Q18 (SGD m)	QoQ %	YoY %	% of FY	FY18E (SGD m)	Comments
Net interest income	1,831	2,097	2,128	1.5	16.2	23	9,210	NIM rose 5bps QoQ/9bps YoY to 1.83%. Customer spreads now at 2.09%.
Non-interest income	1,055	958	1,146	19.6	8.6	25	4,572	Led by higher fee and commission income (+17% QoQ, +12% YoY) and trading income (+61% QoQ, +36% YoY). 1Q18 excludes a one-off gain of SGD86m from the divestment of a Hong Kong property related to the sale of one floor of the asset.
Total income	2,886	3,055	3,274	7.2	13.4	24	13,782	
Less: Overhead expenses	(1,258)	(1,387)	(1,410)	1.7	12.1	25	(5,618)	1Q17, 4Q17 and 1Q18 include ANZ integration costs of SGD10m, SGD30m and SGD12m, respectively.
Pre-provision profit	1,628	1,668	1,864	11.8	14.5	23	8,164	
Less: Allowances	(200)	(225)	(164)	(27.1)	(18.0)	29	(567)	
Operating profit	1,428	1,443	1,700	17.8	19.0	22	7,597	
Associates	-	-	-	n.a.	n.a.	n.a.	-	
Pre-tax profit	1,428	1,443	1,700	17.8	19.0	22	7,597	
Less: Tax	(195)	(224)	(247)	10.3	26.7	23	(1,078)	1Q17, 4Q17 and 1Q18 exclude tax on one-time items of SGD45m, SGD6m and SGD2m, respectively.
Effective tax rate (%)	(13)	(15)	(14)				(14)	
Profit after tax	1,233	1,219	1,453	19.2	17.8	22	6,519	
Minorities	(33)	(31)	(30)	(3.2)	(9.1)	21	(144)	
Core net profit^	1,200	1,188	1,423	19.8	18.6	22	6,376	It met 22% of our previous FY18E forecast.

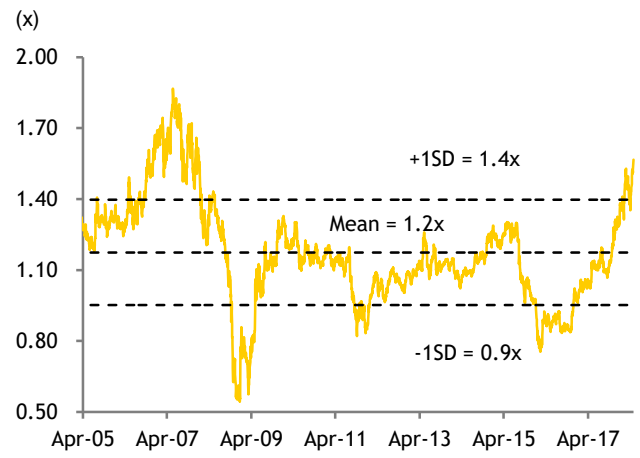
Source: Company, Maybank Kim Eng. ^Net profit excludes one-offs.

Fig 2: DBS's 12M forward rolling PER band



Source: Bloomberg, Maybank Kim Eng

Fig 3: DBS's 12M forward rolling P/BV band

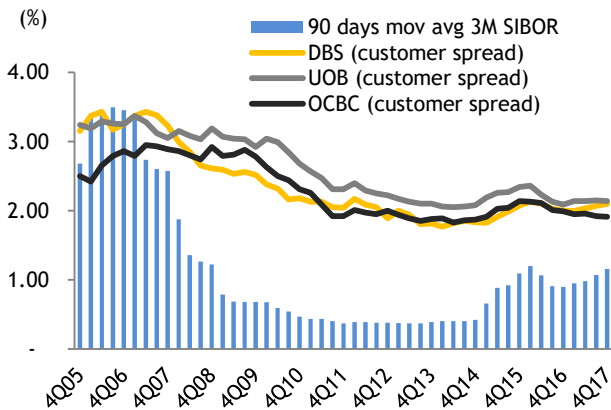


Source: Bloomberg, Maybank Kim Eng

Value Proposition

- Largest Singapore bank by assets, with strength in large corporate loans. Over 50% market share of SGD CASA deposits explains its low funding costs.
- Most aggressive of the three in regional expansion and wealth management; Helps strengthen market leadership.
- Trade loans, especially China-related, important in recent times. A 67% decline since Jun 2014 necessitates a switch to alternative sources of growth.
- Asset quality concerns on O&G exposure eased. Largest exposure of the three to O&G upstream/support services segment, at 3% of loans.

DBS's customer spreads at 2.09% in 1Q18

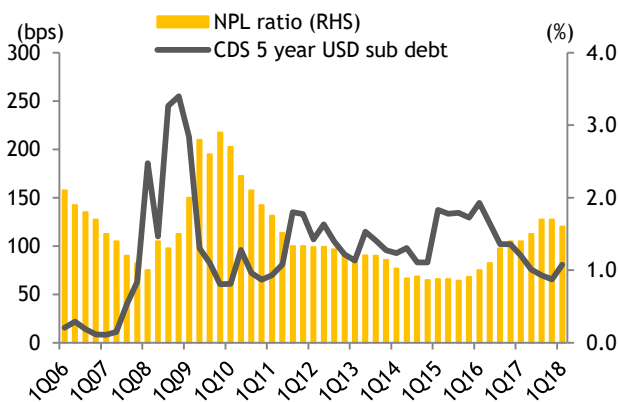


Source: Bloomberg, Companies

Financial Metrics

- Asset quality: Group NPL ratio at 1.6% in 1Q18.
- Fully-loaded CET1 ratio at 14% in 1Q18. With comfort level at 12.5%, there is scope for capital management and dividend upside.
- Expect -9% loan growth for FY18-20E.
- Expect NIMs to be 1.85%/1.92%/1.96% for FY18/19/20E.
- We forecast FY18/19/20E ROEs at ~13-15%.
- Cost of capital bears watching for the sector. Contagion risks may be reflected in corporate papers or CDS.

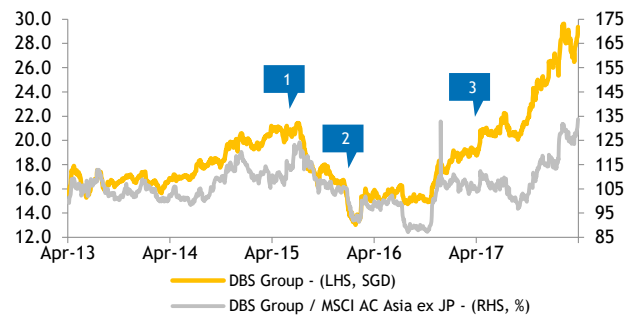
NPL ratio tracked CDS spreads after a 1-year lag during GFC



Source: Bloomberg, Company

Price Drivers

Historical share price



Source: FactSet, Maybank Kim Eng

1. Record earnings with robust lending and stable asset quality following strong 1Q15, despite declining trade loans.
2. Sharp CNY devaluation in August. O&G, commodities and China's NPL worries.
3. Share price rallied on positive sentiment from expectation of Fed rate hike, USD strength and oil.

Swing Factors

Upside

- Ability to reprice loans at higher interest rates and lower costs of funding from large pool of CASA deposits.
- Higher non-interest income from wealth-management and Manulife bancassurance businesses.
- Sharp and sustained rebound in commodity prices.
- Asset quality better than expected with no major credit slippages and proactive loan restructuring.
- Higher demand for domestic mortgages from easing of cooling measures.
- Translation benefits from appreciation of USD/HKD.

Downside

- Highest asset-quality risks from exposure to North and South Asia and O&G sector.
- Sharp decline in the value of securities and shocks in fixed-income portfolio.
- Job losses in Singapore become pervasive, hurting mortgage portfolio.
- Lack of liquidity of a funding currency.
- Emergence of dominant financial competitor in Singapore.
- Capital-raising by peers.

FYE 31 Dec	FY16A	FY17A	FY18E	FY19E	FY20E
Key Metrics					
Core P/E (x)	18.7	18.5	12.5	10.2	9.1
Core FD P/E (x)	18.7	18.5	12.5	10.2	9.1
P/BV (x)	1.8	1.7	1.6	1.5	1.3
P/NTA (x)	2.1	2.0	1.8	1.6	1.5
Net dividend yield (%)	1.9	4.6	3.9	3.9	3.9
INCOME STATEMENT (SGD m)					
Interest income	9,748.0	10,833.0	13,063.3	14,863.5	16,689.0
Interest expense	(2,443.0)	(3,042.0)	(3,853.0)	(4,547.8)	(5,318.0)
Net interest income	7,305.0	7,791.0	9,210.2	10,315.7	11,370.9
Net insurance income	0.0	0.0	0.0	0.0	0.0
Net fees and commission	2,331.0	2,622.0	3,176.3	3,615.9	4,023.3
Other income	1,853.0	1,861.0	1,481.6	1,577.0	1,678.8
Total non-interest income	4,184.0	4,483.0	4,657.9	5,192.8	5,702.0
Operating income	11,489.0	12,274.0	13,868.1	15,508.5	17,073.0
Staff costs	(2,725.0)	(2,825.0)	(2,915.7)	(3,030.9)	(3,150.6)
Other operating expenses	(2,247.0)	(2,380.0)	(2,702.3)	(2,597.4)	(2,752.4)
Operating expenses	(4,972.0)	(5,205.0)	(5,618.1)	(5,628.2)	(5,903.0)
Pre-provision profit	6,517.0	7,069.0	8,250.1	9,880.3	11,170.0
Loan impairment allowances	(1,434.0)	(1,894.0)	(567.2)	(684.3)	(821.2)
Other allowances	0.0	0.0	0.0	0.0	0.0
Associates & JV income	0.0	0.0	0.0	0.0	0.0
Pretax profit	5,083.0	5,175.0	7,682.8	9,196.0	10,348.8
Income tax	(723.0)	(671.0)	(1,075.6)	(1,287.4)	(1,448.8)
Minorities	(122.0)	(133.0)	(143.6)	(155.1)	(167.5)
Discontinued operations	0.0	0.0	0.0	0.0	0.0
Reported net profit	4,238.0	4,371.0	6,463.6	7,753.4	8,732.4
Core net profit	4,200.0	4,277.0	6,337.6	7,715.4	8,694.4
Preferred Dividends	38.0	38.0	38.0	38.0	38.0
BALANCE SHEET (SGD m)					
Cash & deposits with banks	30,018.0	35,975.0	36,874.4	37,796.2	38,741.1
Sec. under resale agreements	0.0	0.0	0.0	0.0	0.0
Derivatives financial assets	25,757.0	17,585.0	17,936.7	18,295.4	18,661.3
Dealing securities	10,020.3	11,925.9	12,522.2	13,148.3	13,805.7
Available-for-sale securities	23,380.7	27,827.1	29,218.5	30,679.4	32,213.3
Investment securities	45,417.0	55,589.0	58,368.5	61,286.9	64,351.2
Loans & advances	301,516.0	323,099.0	351,790.2	382,255.2	417,957.9
Central bank deposits	26,840.0	26,463.0	28,335.7	30,585.5	38,310.5
Investment in associates/JVs	890.0	783.0	783.0	783.0	783.0
Insurance assets	0.0	0.0	0.0	0.0	0.0
Fixed assets	1,572.0	1,233.0	1,245.3	1,257.8	1,270.4
Intangible assets	5,117.0	5,165.0	5,165.0	5,165.0	5,165.0
Other assets	11,042.0	12,066.0	12,246.8	12,604.5	13,105.0
Total assets	481,570.0	517,711.0	554,486.2	593,857.2	644,364.5
Deposits from customers	347,446.0	373,634.0	404,795.1	436,935.8	478,881.6
Deposits from banks & FIs	15,915.0	17,803.0	18,693.2	20,001.7	21,601.8
Derivatives financial instruments	24,497.0	18,003.0	18,543.1	19,099.4	19,672.4
Subordinated debt	3,102.0	1,138.0	1,138.0	1,138.0	1,138.0
Other securities in issue	27,745.0	40,716.0	40,716.0	40,716.0	40,716.0
Other borrowings	4,115.0	3,773.0	3,058.1	3,120.4	3,185.9
Insurance liabilities	0.0	0.0	0.0	0.0	0.0
Other liabilities	13,592.0	14,654.0	16,189.5	16,988.5	17,827.0
Total liabilities	436,412.0	469,721.0	503,133.0	537,999.8	583,022.6
Share capital	2,549.0	2,563.9	2,563.9	2,563.9	2,563.9
Reserves	40,248.0	43,082.1	46,430.9	50,919.7	56,387.3
Shareholders' funds	42,797.0	45,646.0	48,994.9	53,483.6	58,951.3
Preference shares	0.0	0.0	0.0	0.0	0.0
Minority interest	2,361.0	2,344.0	2,358.4	2,373.9	2,390.6
Total equity	45,158.0	47,990.0	51,353.2	55,857.5	61,341.9
Total liabilities & equity	481,570.0	517,711.0	554,486.2	593,857.2	644,364.5

FYE 31 Dec	FY16A	FY17A	FY18E	FY19E	FY20E
Key Ratios					
Growth (%)					
Net interest income	2.9	6.7	18.2	12.0	10.2
Non-interest income	9.4	7.1	3.9	11.5	9.8
Operating expenses	1.5	4.7	7.9	0.2	4.9
Pre-provision profit	8.2	8.5	16.7	19.8	13.1
Core net profit	(1.9)	1.8	48.2	21.7	12.7
Gross loans	6.5	7.3	8.8	8.6	9.3
Customer deposits	8.5	7.5	8.3	7.9	9.6
Total assets	5.2	7.5	7.1	7.1	8.5
Profitability (%)					
Non-int. income/Total income	36.4	36.5	33.6	33.5	33.4
Average lending yields	2.40	2.43	2.62	2.77	2.87
Average cost of funds	0.65	0.74	0.85	0.94	1.02
Net interest margin	1.80	1.75	1.85	1.92	1.96
Cost/income	43.3	42.4	40.5	36.3	34.6
Liquidity (%)					
Loans/customer deposits	86.8	86.5	86.9	87.5	87.3
Asset quality (%)					
Net NPL	1.6	1.9	1.3	1.4	1.5
Gross NPL	1.6	1.9	1.3	1.4	1.5
(SP+GP)/average gross loans	0.3	0.5	0.2	0.2	0.2
Loan loss coverage	96.9	84.7	115.7	93.9	82.4
Capital adequacy (%)					
CET1	14.1	14.3	13.5	13.7	14.0
Tier 1 capital	14.7	15.1	14.2	14.4	14.6
Risk-weighted capital	16.2	15.9	15.0	15.1	15.4
Returns (%)					
ROAE	10.2	9.7	13.4	15.1	15.5
ROAA	0.9	0.9	1.2	1.3	1.4
Shareholders equity/assets	8.9	8.8	8.8	9.0	9.1

Source: Company; Maybank

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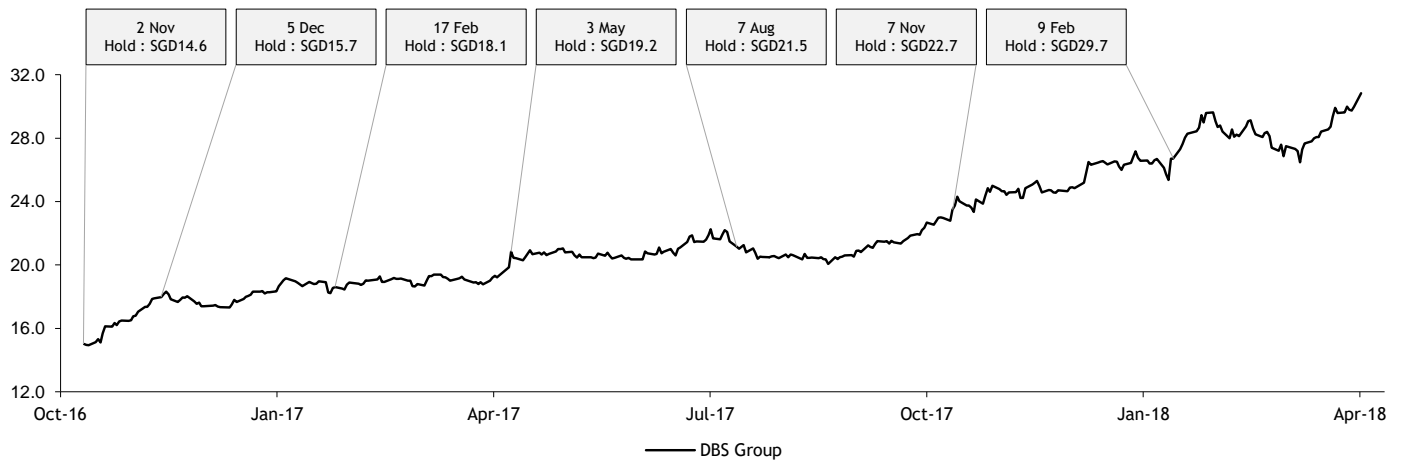
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