Edited transcript of DBS second-quarter 2020 results media briefing, 6 August 2020

Edna Koh Good morning, everyone, and welcome to our second-quarter results briefing.

Chng Sok Hui Thanks Edna and good morning everyone.

Overview. First-half 2020 was a story of two parts. The first quarter carried over the strong momentum of 2019's record performance but ended with the onset of the global pandemic. The second quarter saw a far more challenging business environment and sharply lower global interest rates.

Compared to a year ago net interest income rose 1% to $4.79 billion. Loans grew 5% but their positive impact was countered by a sharply lower net interest margin in the second quarter. Fee income rose 1% to $1.51 billion as a 14% increase in first quarter was offset by an 11% decline in the second quarter. Investment gains increased three-fold from the same period a year ago.

As a result, total income grew 7% to a record $7.75 billion. Expenses were stable and the positive jaw of seven percentage points lowered the cost-income ratio from 42% to 39%. Profit before allowances was 12% higher at a record $4.71 billion.

The strong performance enabled us to conservatively set aside $1.26 billion of general allowances in anticipation of a far more challenging environment in the quarters ahead. This boosted GP reserves by a half to $3.80 billion, 24% above MAS' minimum requirement.

Higher general allowances also contributed to a 25% increase in total allowance reserves to $6.72 billion. This lifted allowance coverage above 100% to 106%. After taking collateral into account, allowance coverage was 199%.

Excluding a significant exposure in the first quarter, underlying NPA formation was stable. The NPL rate at 1.5% was unchanged from its level in 2019. Specific allowances almost doubled to $672 million, or 30 basis points of loans, with all of the increase due to the significant exposure.

Liquidity was ample. Deposits grew 9% over the first half from $54 billion of current and savings account inflows. The LCR and NSFR ratios were 134% and 121% respectively, comfortably above regulatory requirements.

The CET-1 ratio was 13.7%, also well above regulatory requirements and even above the Group's target operating range of between 12.5% and 13.5%.

The Board declared a second quarter dividend of 18 cents per share, in line with MAS guidance.

First-half performance. Net interest income grew 1% or $46 million to $4.79 billion. Loans grew 5%, led by non-trade corporate loans. This was offset by a 16bp decline in net interest margin to 1.74%, with most of the decline occurring in the second quarter.

Fee income grew 1% or $16 million to $1.51 billion. Increases in wealth management and loan related fees as well as brokerage commissions were offset by a decline in cards fees. Second-quarter fee income was lower than the preceding quarter as business activity slowed from lockdowns across the region.

Other non-interest income rose 42% or $430 million to $1.45 billion as profits were realised on fixed income portfolios which had appreciated with lower interest rates. Trading income fell 6% to $752 million as a decline in the first quarter due to wider credit spreads was moderated by an increase in the second quarter. Treasury customer income was higher in both quarters.

Expenses were stable from the same period a year ago, and profit before allowances increased 12% to $4.71 billion.

Total allowances of $1.94 billion were taken in the first half, a five-fold increase from the same period a year ago. General allowances increased by $1.31 billion while specific allowances were $303 million higher due to the significant exposure in the first quarter.

Net profit declined 26% from a year ago to $2.41 billion.

Net interest income. First-half net interest income increased 1% from a year ago to $4.79 billion. Loan growth of 5% and deposit growth of 13% were offset by a 16 basis point tightening of net interest margin to 1.74%.

Net interest income fell from $2.48 billion in the first quarter to $2.30 billion in the second quarter, when most of the net interest margin decline occurred.

First-quarter net interest margin was little changed from previous quarters at 1.86% before falling to 1.62% in the second quarter. The decline was triggered by sharp cuts in global interest rates as central banks responded to the pandemic. A considerably more flush balance sheet with excess deposits deployed into low-risk liquid assets also contributed to the decline.

Loans. In constant currency terms, loans grew 3% or $12 billion in the first half to $381 billion. Non-trade corporate loans expanded $20 billion, led by drawdowns in Singapore and Hong Kong. The expansion was moderated by a $5 billion decline in trade loans and a $3 billion decline in consumer loans from lower wealth management borrowing.

Non-trade corporate loan growth was split evenly between the first and second quarters. Virtually all of the decline in trade loans and two-thirds of the decline in consumer loans occurred in the first quarter. Non-trade corporate loan growth is expected to normalize to previous-period levels in the second half.

$2 billion of first-half loan growth was associated with Singapore’s credit relief programmes where the government provided a 90% risk share.

Deposits. In constant-currency terms, deposits grew 9% or $36 billion in the first half to $447 billion. During this period current accounts and savings accounts, or CASA for short, increased $54 billion. Consumer Banking and Wealth Management contributed three-fifths of the CASA increase.

This improved the proportion of CASA balances by seven percentage points over the half-year to 66% of the overall deposit base.

The loan-deposit ratio fell five percentage points to 84% as deposit growth out-stripped loan growth.

The liquidity coverage ratio of 134% and the net stable funding ratio of 121% were both comfortably above their respective regulatory requirements of 100%.

Fee income. First-half gross fee income was stable at $1.75 billion. The steady performance belied a strong first quarter that grew 13% from a year ago, only to be offset by a considerably weaker second quarter that saw a 12% contraction as regional lockdowns curtailed activity.

First-half wealth management fees grew 9% to $707 million as record investment product sales in the first quarter were moderated by lower bancassurance sales. Loan-related fees increased 10% to $226 million due to a higher number of transactions in the first quarter. Brokerage fees increased 25% to $74 million from higher equity market volumes during the half year. Cards fees fell 21% to $304 million as transactions slowed with lower consumer spending in the second quarter. Investment banking fees declined 19% to $63 million due to weaker market conditions. Transaction service fees were stable at $374 million.

Expenses. First-half expenses were stable from a year ago at $3.04 billion. Compared to a year ago, staff costs rose 2% to $1.75 billion as higher base salary costs from an increased headcount were moderated by lower bonus accruals and by government grants. Non-staff costs were 3% lower as general expenses such as for travel and advertising declined. The positive jaw of seven percentage points reduced the cost-income ratio by three percentage points to 39%.

Consumer Banking and Wealth Management. First-half Consumer Banking and Wealth Management income declined 3% from a year ago to $3.08 billion. Income from investment products increased 13% to $968 million. This was more than offset by a sharply lower net interest margin that reduced loans and deposits income by 8% to $1.73 billion. At the same time income from cards declined 13% to $349 million as transactions slowed when lockdowns were introduced across the region.

Retail customer segment income declined 5% to $1.53 billion while Wealth Management customer segment income was stable at $1.55 billion. Assets under management increased 7% to $251 billion from $234 billion a year ago. We maintained our domestic market share for savings deposits and housing loans at 52% and 31% respectively.

Institutional Banking. First-half Institutional Banking income declined 1% from a year ago to $3.01 billion. Cash management income fell 27% to $733 million. The impact of lower interest rates more than offset a 20% increase in GTS deposits to $158 billion. Loan-related income rose 12% to $1.49 billion from strong non-trade corporate loan growth. Treasury customer income rose 24% to $382 million from higher customer hedging activity.

Treasury Markets. First-half income increased 44% from a year ago to $714 million due to a strong trading performance across interest rates, FX and equity asset classes, which was partially offset by wider credit spreads. Treasury customer income increased 26% to $809 million. The most actively traded products were related to interest rates for corporate clients, and FX and equity for wealth management clients.

Hong Kong. In constant currency terms, Hong Kong's first-half net profit fell 24% from a year ago to $602 million. Total income declined 9% to $1.38 billion primarily from lower interest rates. Profit before allowances was 11% lower at $869 million. Total allowances increased six-fold due to higher GP.

Net interest income declined 13% to $897 million. Loans grew 8% mainly from large corporates. This was offset by a 36 basis point fall in net interest margin to 1.74%, with the first quarter at 1.96%

and the second quarter at 1.52%. The sharp decline in the second quarter was due to the full-period impact of lower interest rates.

Fee income declined 4% as higher wealth management investment sales were offset by declines in trade finance, cash management and bancassurance. Other non-interest income increased 8% from gains in investment securities.

Expenses declined 7% to $513 million and the cost-income ratio was one percentage point higher at 37%. Profit before allowances declined 11% to $869 million.

Total allowances rose to $157 million, including $124 million of general allowances conservatively taken for risks arising from the pandemic. Specific allowances were 27% lower at $33 million.

<u>Non-performing loans.</u> Non-performing assets rose 10% to $6.35 billion in the first half as new NPA formation was moderated by write-offs and recoveries. Most of the new NPA occurred in the first quarter, which included a significant oil trader exposure. New NPA formation in the second quarter was $115 million, below the run rate in 2019. The NPL rate at the end of first half was 1.5%, below the 1.6% in March and unchanged from the previous half.

<u>Specific allowances.</u> First-half specific allowances nearly doubled to $672 million or 30 basis points of loans. The increase was due to the significant exposure in the first quarter.

<u>General allowances.</u> General allowance reserves rose 50% from a year ago to $3.80 billion as the balance sheet was conservatively fortified against risks arising from the pandemic. The GP reserves are $1 billion higher than the amount eligible as tier-2 capital. This surplus is thus available to absorb credit losses without impacting CET-1 levels should the business environment deteriorate. The GP reserves also exceed the regulator's minimum requirement by 24%. Allowance coverage was at 106%. When collateral valued at $2.97 billion was considered, allowance coverage was at 199%.

<u>Capital.</u> Capital continued to be healthy. The Common Equity Tier-1 ratio declined from 14.1% in December 2019 to 13.7% as risk-weighted assets increased from loan growth, credit exposures on derivatives, and market risk. The CET-1 ratio was above the group's target operating range as well as regulatory requirements. The leverage ratio of 6.8% was more than twice the regulatory requirement of 3%.

<u>Dividends.</u> The Board declared a dividend of SGD 18 cents per share for the second quarter. This is in line with MAS' guidance, issued on 29th July, for local banks to moderate dividends for the 2020 financial year. The scrip dividend scheme will be applicable to the second-quarter dividend. Scrip dividends will be issued at the average of the closing prices of 14 and 17 August 2020. Based on yesterday's closing share price, the annualised dividend yield is 3.6%.

<u>In summary.</u> The performance we reported amidst severe macroeconomic headwinds in the first half attests to the resilience of our franchise. Our strong operating earnings allowed us to conservatively take general allowances of $1.26 billion to fortify the balance sheet. This raised general allowance reserves to $3.80 billion, 24% above the MAS minimum requirement. Our capital and liquidity also remained strong. We are well positioned to continue supporting customers and the community through the difficult months ahead of us.

Piyush Gupta Thanks, Sok Hui. I'm going to make few comments on the business environment as well as provide an outlook on credit.

Business Outlook**.** It was a tough quarter principally because the full impact of the interest rate cuts flowed through our book. This is costing us about $80 million a month, and it may go up to $100 million by next year. That's obviously quite a big drag. This is compounded by the fact that in April and May, there were lockdowns in most of the countries we operate in, which slowed economic activity and reduced our non-interest income as well. Thus, the top line came in about $300 million below the first quarter.

We were fortunate to have had a few mitigating items. First, the balance sheet grew nicely. We raised deposits significantly. In fact, our Casa deposits in the second quarter went up by $38 billion, which allowed us to let about $32 billion of fixed deposits run off our books. On a net basis, the total deposit growth for the quarter was $6 billion.

Loan growth was also good. We grew non-trade loans by $10 billion in a fairly diversified way. Some of the loan growth in Singapore and Hong Kong was from government schemes, but a lot of it was from deal activity, some of which were from sectors such as TMT, where the digitisation of the world is helping our businesses.

Second, we had a strong trading quarter. In a normal quarter, we would expect about $225 million of Treasury Markets income, but the first quarter came in at more than $500 million. Third, we were appropriately positioned from an investment standpoint and were able to actively realise a lot of gains in investments as interest rates declined.

Due to these factors, our second-quarter total income was flat compared to last year. However, income between the first and second quarters decreased 7%.

Operating trends are in line with the guidance we gave in the first quarter. Total income increased 7% in the first half, but we will give that up in the second half due to the lower interest rates. Overall for the year, our top line should come in flat to last year, which is consistent with the our guidance.

On NIM, because we had so much excess deposits during the quarter, we put around $20 billion of Casa deposits with the central bank. We make about 50 basis points on this, which dilutes our NIM by about six basis points. However, this is income accretive, and because the placement of excess deposits with the central bank contributes nothing to risk-weighted assets, it is also accretive to ROE.

We expect NIM to continue to deteriorate because interest rates are trending down – rates in June were lower than in April – which means that average third-quarter rates will be lower. As a consequence, we expect a further decline in NIM in the second half to around 1.50%.

The other challenge is fee income. April was tough as cards were down because consumer activity fell. Wealth management fees declined as clients exited the market. The good news is that we are beginning to see a rebound across most categories. Cards and bancassurance came back in June. In April and May, they were about 30%-35% below pre-Covid levels. In June, they were about 15%-20% below pre-Covid levels. They're still below pre-Covid levels as we speak. On the other hand, wealth management fees rebounded more strongly. In July, we were back to pre-Covid levels, which is encouraging.

Treasury Markets activity continues to benefit from conducive market conditions. We've been doing a lot of business both on trading and on customer flows. This momentum looks like it is continuing into the third quarter.

Finally, on our balance sheet, we still have unrealised mark-to-market gains in our investment portfolio, which will provide a cushion for the lower NIM. How much gains we realise in the short term against holding it into the future will be a tactical call.

On expenses, we've been quite prudent. We have been careful about non-staff expenses. We've also been cutting back on variable staff compensation. At the margin, we benefitted from the government grants as well.

As we go into the rest of the year, there will be some upward pressure on the cost-income ratio even as we hold expenses flat, as income will be lower in the second half. However, we think we'll be able to hold full-year cost-income ratio flat to last year at 43%. We are reviewing our cost structure given the challenging environment. But it is also important to point out that we are cognisant of our responsibility as a corporate citizen. Hence, we don't intend to cut jobs through the course of this year.

Credit Outlook. At this stage we are not seeing anything that will cause us to change our guidance that we gave in the first quarter. We said that we expect total credit cost to be between $3 billion and $5 billion and at this point in time we are holding to that estimate.

We didn't see any major non-performing loan formation in the second quarter and the NPL rate is still at 1.5%. Specific provisions did not increase materially. The portfolio for large corporates and SMEs is not showing significant deterioration, although for SMEs this may have been helped by loan moratoriums.

We did see increase in delinquencies for the unsecured consumer book across Singapore, Hong Kong, Taiwan and Indonesia. However, our unsecured consumer book is not very large. Interestingly, in Singapore and Hong Kong, delinquencies levelled off by June. Delinquency rates are still around 25% to 30% higher than they were pre-Covid, but we're not seeing continued deterioration in these two markets. In Taiwan, we saw further deterioration in June. Indonesia was more challenging, partly because social distancing measures have prevented us from carrying out our normal collection activities, and so it might improve in the next few months.

Overall, we're not seeing anything that would cause us to re-think the assessments we made three months ago. As a matter of prudence, we increased general allowances again this quarter, taking our GP reserves to $3.8 billion. We've taken allowances of just under $2 billion in the first half of the year. Given that our credit costs are estimated at between $3 billion and $5 billion over two years, it means that we've already taken a substantial portion over just six months. We will continue to build up allowances in the coming quarters as a prudential measure.

Finally, a comment on the loan relief measures. We currently have about $12.6 billion of the SME loan portfolio under moratorium, equally split between Singapore and Hong Kong. These are mostly well-secured with relatively low LTVs. We should note that the moratoriums only apply to the principal amount, so these loans are still servicing interest. So far, this portion of the loan book looks fine.

On the consumer side, we have $5.7 billion of loans in moratorium, most of which are in the Singapore housing loan portfolio. Eighty-six percent of our Singapore housing loan accounts are for properties that are owner-occupied. The LTVs on these loans are well below the regulatory maximum, with the average LTV at about 55%. The reason I'm pointing all these out is that while these loans are under moratorium, they are well-collateralised with low LTVs, and we don't expect that they will become NPL at the end of the year.

MAS is working together with the banks on a plan to minimise cliff effects that may materialise when the moratoriums end, and we are actively participating in this.

Chanyaporn Chanjaroen (Bloomberg) First, what would have been your second quarter NPL rate without the moratoriums? Second, could you share any colour about foreign currency deposits during the first half? Third, what's the percentage of employees working in the office currently and what are your thoughts about workspace requirements post-Covid?

Piyush Gupta On the first question, frankly I don't know the answer. I would guess that the NPL rate would likely not have changed much because it takes 90 days of delinquency for a loan to go into NPL. But the reality is nobody really knows how much of moratorium loans would eventually wind up as NPL. And this is exactly why we're building up substantial general allowances ahead of time. I have to say though that from talking with clients, I sense most of them are fairly resilient. We've seen few companies shut down so far.

Chng Sok Hui On deposits, most of the growth in the first half has been in Singapore dollars.

Piyush Gupta In the first quarter, when we were anticipating a sudden squeeze in liquidity, we raised $30 billion of deposits rapidly, half of which were fixed deposits. In the second quarter, we had large Casa inflows and were able to let a large part of the fixed deposits run off. So overall, the easy liquidity conditions are conducive for deposit growth around the world, including in Singapore.

On your third question, about 30% of our total workforce is in the in office. We are still working through how much office space we need post-Covid. My view is while there will be a greater degree of work flexibility, there would still be a lot of merit in having people working physically together. We're hearing that from employees as well. Some are beginning to suffer fatigue and are quite desirous to return to the office. So there might be some marginal efficiency benefits but I'm not sure if they're going to be significant.

Chanyaporn Chanjaroen When do you expect to see the full workforce returning to office?

Piyush Gupta The guidance from the authorities is that anybody who can work from home should do so. In banking, other than for a handful of functions, almost everybody can theoretically keep working from home for extended periods. There's value in having people coming back in but we have been guided by national policy.

Chris Wright (Euromoney) We've seen a number of emerging markets where the lockdown has forced many people to use digital channels. I'm wondering what have you seen on the uptake of digital channels from new customers and whether you expect that to stick when we return to a more normal environment?

Piyush Gupta Digital activity has gone up dramatically across all of our markets, from setting up new accounts to payments. Depending on the product line and the country, digital activity is up 30%-40% across the board. The interesting thing is that it is now being embraced by people who have so far been reluctant, including the elderly.

One of the things we have done during this period is to stitch up the last-mile digitisation. When you have to cater for 100% working from home, you discover gaps that weren't apparent earlier because either transaction volumes were low or it was not an imperative to close them. This last-mile stitching will bring an opportunity to digitalise transactions that could not be done previously, such as trade finance.

How much of the new-found digital activity will stick is unclear. During the de-monetisation episode in India, people didn't have a choice but use digital. Once that ended, some went back to cash. A lot will depend on the extent of convenience that digitalisation brings to the people that adopt it.

Chris Wright For a regionally active bank, how much does it matter that people are not traveling at the moment?

Piyush Gupta It matters in two ways. First, credit cards. Travel typically accounts for 15% of card spending. We've got to make up for that from domestic spending and e-commerce. Second, the lack of travel has affected certain sectors of the economy inordinately: airlines, hotels, tourism, even food and beverage. The lack of travel has caused these sectors to be incrementally weaker. So while there are some pockets of compensating business at the top line, border closures could be potentially more consequential in terms of credit losses.

Chanyaporn Chanjaroen Where would your CET-1 settle at? And could you give some colour about your wealth management AUM.

Chng Sok Hui The main drivers of CET-1 are likely to be the amount of total allowances we take and RWA migration. They are not easy to forecast with precision.

Piyush Gupta As we take general allowances we're also keeping an eye on CET-1 to make sure it is within our operating range of 12.5-13.5%.

Wealth management AUMs went up in the second quarter due to higher market valuations. We also benefited from net new money in both quarters, which totalled $4.5 billion.

Goola Warden (The Edge) Can you identify any new megatrends post-Covid?

Piyush Gupta The principal trend for us is interest rates. Given the size of the ongoing monetary and fiscal stimulus, we are going to have a low interest rate environment for much longer, with consequences for areas other than banking, such as tax policy. Geopolitically, China-US tensions have been exacerbated by Covid. There will be an impact on supply chains, though any movements could be less quick than what people think. On social politics, income inequality is going to be at the forefront of political debate. What does that mean for our role as companies? What kind of contributions do we make to the community and society? And consumption and production patterns would digitalise even more rapidly that they have. Five to ten years' worth of digitalisation has happened in three months and a lot of that will stick. There will also be significant changes in the way business is done, including the agenda around sustainability.

Goola Warden (The Edge) Would DBS benefit from any of these changes?

Piyush Gupta I think we will benefit from many of the changes because we're well positioned. We're already seeing the benefits of digitalisation. And that reflects the strides we have made. Over the three-month period, our business volumes are up in absolute and market share terms. There will also be new business opportunities. There are going to be new areas in sustainability as well, such as carbon trading or digitally tracking the provenance of supply chains. All of these opportunities will be helpful for mitigating the interest rate headwinds facing us.

Anshuman Daga (Reuters) There is a lot of uncertainty from second-wave infections. Could you give some colour on the industries most affected?

Piyush Gupta We covered it extensively in our first-quarter update. I gave a detailed analysis of our exposure to the more vulnerable sectors. On the general outlook, demand will be constrained for the rest of the year and global economic activity is not going to return to previous levels. But once you pass the trough, economic activity starts coming back. China is back to 80-90% of where it was before. Taiwan and Hong Kong saw a bit of setback in July but overall economic activity is returning. The main issue is going to be cross-border flows.

Edna Koh Thank you everyone for tuning in.