Edited transcript of DBS first-quarter 2024 conference call for buy and sell sides, 2 May 2024

Nicholas Teh Good morning and welcome to the analyst briefing. We can go straight to Q&A.

Tan Yong Hong (Citi) I have two questions. The first one is on loans. The non-trade corporate loan growth was great. Is it too early to take it as a sign that borrowers have accepted higher rates, which would mean upside to our the low-single-digit full-year outlook?

Piyush Gupta I think it is too early to say so. Our pipelines for the second quarter are solid, but nowhere near as strong as the first quarter. So, at this point in time, we are not changing our full-year guidance. If interest rates continue to stay high, it would also mean some headwinds for the Hong Kong book as well.

Tan Yong Hong My second question is on your guidance of 6-7% for income growth and low-40% for the cost-income ratio. They seem to imply some slowdown in your top line and a pick-up in expenses in the coming quarters.

Piyush Gupta The projected slowdown in the top line is due to uncertainty. Also, our first-quarter income tends to be stronger and the fourth quarter weaker because of seasonality. It would be unrealistic to multiply the first-quarter income by four. In terms of expenses, we are keeping full-year expense growth of high-single-digit. When you look at the income and expense projections, you wind up with the cost-income ratio in the very low-40% area.

Tan Yong Hong Could the slowdown in income potentially come from non-interest income, for example wealth management and treasury customer sales?

Piyush Gupta So far, the momentum in wealth management is continuing, but it is dependent on animal spirits. Going into January, the expectation was that rates were coming down, and people were more open to putting money to work. If rates do not come down and animal spirits recede, you wind up with headwinds. There is an element of uncertainty whether the first-quarter growth can be sustained.

Tan Yong Hong My final question is on capital. You continue to accrete capital, and if the MAS operational risk penalty is lifted it will add 70 basis points to the capital ratio. There is also the additional relief from the Basel 4 framework. How are you going to manage the excess capital in the short and medium term?

Piyush Gupta We have to keep looking for ways to return capital. Right now, we are accreting a lot more capital than we are paying out and it is obviously not sustainable.

Aakash Rawat (UBS) The first question is on loan growth. I think you are sounding a bit more optimistic even though you are not extrapolating from the first quarter's momentum. Is the growth coming from better demand or lower repayments compared to last year?

Piyush Gupta It is better demand. We are still seeing higher repayments in Hong Kong. The demand was from the commodity complex, both energy and soft commodities, and it was broad based, including from India.

Aakash Rawat Was there manufacturing or technology as well?

Piyush Gupta They were not a significant driver in the first quarter. In our pipeline, we are seeing some fairly decent demand in the energy complex, manufacturing, minerals and technology.

Aakash Rawat It is pretty clear you need to do more in terms of dividends. Last quarter when I asked this question, you said that while MAS was not restricting you, the optics were not suitable do a special dividend. Do you think with the MAS now lifting the pause on non-essential activities, it opens the door for you to do a special dividend, or would you still focus on an ordinary dividend increase, including an off-cycle one?

Piyush Gupta The truth is we not evaluated the options at the board. It would therefore be remiss for me to tell you how we might be thinking about it. We will evaluate it over the next few quarters.

Aakash Rawat This could happen in the second quarter, because the board meets every quarter?

Piyush Gupta There is nothing to prevent it from happening in the second quarter, but it is not something we have evaluated yet.

Aakash Rawat Third, some of my clients have pointed to chatter that you are going to retire this year. Can I ask you for any comments on that?

Piyush Gupta No, I am not retiring this year.

Aakash Rawat That is great. Very good to hear.

The fourth question is on the higher-rates-for-longer environment. It is good for the company, margins, and the stock, but at some point it will start becoming a concern for asset quality. In the scenario where rates do not rise, how long will it take before your non-performing assets start rising? If they do rise further, at what level of rates would NPA formation start accelerating from current levels?

Piyush Gupta I do not know the answer. I have said before that I had expected NPA to be higher already 12-18 months ago, which we girded up for by building up general allowance reserves and overlays. It has been one of the big unknowns to me why we are not seeing a greater increase in NPA anywhere in the world. There has been a lot of speculation. People initially thought it was the fiscal support provided by governments, but it would have had run its course by now. There is an element of excess money sloshing around, which has had a huge bearing on the availability of liquidity around the board.

In our forward-looking analysis, our corporate and individual customers are looking quite resilient. We are beginning to see a pick-up in unsecured consumer delinquencies. For the $115 million of specific allowances this quarter, almost nothing came from the corporate book and almost all of it was from the consumer book. While the consumer book delinquencies are nowhere near the levels of the GFC, higher interest rates are beginning to stress the consumer book. Similarly, for the SME and mid-cap, there has been a marginal pick-up in delinquencies but nothing to write home about.

If current rates continue for another one or two years, does the other shoe begin to drop? Like I said, I have been expecting it for a year, so I would not be surprised if there was more stress. It is why we are hanging on to our excess GP reserves.

Aakash Rawat You have some 70-80 basis points of excess allowance buffer, so why do you think credit costs can go from 10 basis points to 17-20? Why would they not stay at 10 basis points since you can use up the buffer to take care of any pick-up?

Regarding your comment on the credit cycle this time. Typically, there would be an increase in leverage in the early part of the cycle, which then causes higher NPA formation subsequently. It has been different this time because loan growth was negative for a while. Could it be a reason we will not see systemic problems this time, although there could be idiosyncratic ones such as CRE in Hong Kong or the US?

Piyush Gupta I have not thought about that. It could be one of the reasons. At the sovereign level, countries are much stronger, with more flexible exchange rate policies and stronger reserves. System leverage has also been lower.

Your other observation is also correct. We have four bites of the cherry. First, we are starting from a low base of SP at 10 basis points, which gives us a cushion to the baseline 17-20 basis points we have assumed in our guidance. Second, we have strong earnings – we generated $3 billion in the first quarter – so even if we had a few $100 million more in SP, we have the earnings capacity to take care of it. Third, we have built up $2 billion in GP overlays. Fourth, our capital is strong. We have very solid balance sheet and earnings generation, so we can absorb a lot of pain.

Aakash Rawat Finally, did you mention that you are now assuming two rate hikes this year versus five rate cuts previously?

Piyush Gupta I mistakenly said rate hike earlier, I meant rate cut. But with Powell's latest statement now, there could be even less likelihood they cut rates.

Jayden Vantarakis (Macquarie) On the outlook for net interest income, you said at the media briefing that there would be a lift of $100 million from your previous guidance assuming two rate cuts this year. If there are no rate cuts at all, would that number be higher? Second, is there a further potential lift if you can manage liabilities more proactively, since the domestic system is flush with liquidity and it sounds like there is not a huge loan pipeline?

Piyush Gupta If there are no rate cuts, there would be further upside to our current projection which is based on two rate cuts. On managing deposits, we have already been quite sensible about deposit pricing and I do not know if there are more opportunities to be sharper on it. We pay 15 basis points on a large part of our savings book, while Singapore government T-bills are yielding 3.5-3.7%. If we want to pick up any fixed deposits, we have to match the T-bill rates or at least keep them in mind.

Jayden Vantarakis Now that you are the largest foreign bank in Taiwan, how much of the wealth fee growth is from that franchise?

Piyush Gupta Our wealth fees grew 47% in the first quarter, with Taiwan accounting for 12 percentage points. We are finding a tremendous value both ways, as some Citi product capabilities are now available to the DBS customer base. For example, we did not have online equity trading, which Citi was providing to its customers. Citi also had much better and more robust foreign exchange products than we did, and we have been able to layer them on for our customers. In the first quarter, we already saw an improvement in AUM yield from our customers. On the other hand, Citi was not very strong in structured products, which we manufacture and is a mainstay of our wealth offering. We have also been able to offer bankassurance to the Citi customer base. I am therefore quite energised by the upside I am seeing on both ways of the franchise.

Melissa Kuang (Goldman Sachs) I have a few questions on NIM. How did the lower Hibor impact NIM during the quarter? How much fixed-rate asset repricing was there in the first quarter and how much will there be for the rest of the year? What do you expect for NIM trajectory next year? On NPA, can you provide more colour on what drove the increase in NPA formation?

Chng Sok Hui The average one-month Hibor declined about 55 basis points during the quarter and the impact on both the group and the commercial book NIM was about minus two basis points. Despite this, the commercial book NIM still expanded two basis points due to fixed-rate asset repricing.

Piyush Gupta Our total fixed-rate assets are $184 billion. It was $180 billion at the end of last year, of which $16 billion repriced during the first quarter, while we also added another $4 billion. The bulk of the duration we put on was between two-to-three-year tenors and gives us a decent two-percentage-point lift in yields for our fixed-rate assets.

This year, $40 billion of fixed-rate assets are repricing. Sixteen billion dollars happened in the first quarter, $11 billion will reprice in the second quarter and about $13 billion reprices in the third and fourth quarters. All this repricing gives us incremental yield. On the other hand, the headwinds on NIM come from two things. Firstly, potential rate cuts and, secondly, Casa repricing. Our deposit betas were about 40% in the first quarter and will keep edging up as rates stay high. When you put the headwinds and tailwinds together, our modelling suggests that we will see a marginal decline in NIM from last year's exit level. For next year, if you assume that there is no change to the rate outlook, I think the trajectory will probably be similar to this year.

On NPA, the drivers are idiosyncratic. For example, one of the NPA is in Myanmar where the underlying company is performing well, but the government has foreign exchange control regulations. Therefore, they are unable to remit the money out of Myanmar, so we had to move it into NPA. Another case is in India, where the joint venture between one of our clients and a UK-based firm decided to unwind the joint venture as they are going into a distribution agreement, leading to some challenges. The third is a residential project in Hong Kong, where we have not taken any SP as the loan-to-value is very low in the 20% range, but we had to move that to NPA because there was a default. So the drivers of NPA formation are quite widespread and there is no trend or trajectory.

Harsh Modi (JP Morgan) A few questions. First on margins, is it fair to say that you would give up higher short-term NIM for longer-term NIM stability?

Piyush Gupta The short answer is yes. I am not managing to NIM; I am managing to interest income and making sure that we have stability in that income over the next two to three years. We could deploy fixed-rate assets into short-term paper issued by central banks and get a return which is 30-40 basis points higher than two to three-year paper. But the problem in doing that is you only get that return for one to two months. So, we are compromising, and we are trading-off short-term interest income and NIM, to lock in rates over the longer term. We do not go too long on the yield curve as it is inverted and there is uncertainty on its shape moving forward. The mid-tenors are more sensible and protects our income in 2025-26 without giving up too much income in 2024. A related question you had asked before was about mortgage pricing, and we have remained quite disciplined on that front.

Harsh Modi How many rate cuts can we have and still maintain flattish NIM over the next one to two years?

Piyush Gupta I do not have a specific answer. The way to think about it is that our fixed-rate asset book is about $184 billion, which is about one-third of our total commercial book assets of $530 billion. So, about one third of the commercial book is locked-in for two to three years.

Harsh Modi On capital, how do you think about the pros and cons of special dividends, regular dividends and potentially M&A? Is there guidance on payout ratio?

Piyush Gupta They are all good uses of capital. As you know, the M&A we have done are bolt-on, so the capital for M&A is small. Our capital surpluses run into several billions of dollars while we continue to accrete more, so we are looking at returning capital and all options are on the table. For the first quarter, even with the enlarged post bonus share base, our payout ratio was still in the low 50% range. In order to return all the surplus capital, the payout needs to be much higher. At the same time, our policy is architected on making sure that we can pay sustainably growing dividend over time.

Harsh Modi Over the next three years, what are the challenges that you are personally setting yourself for? Will you still be at DBS three years from now?

Piyush Gupta The way to look at it is we have a robust succession planning process at every step and in every level of the organisation. You should take assurance in the fact that we have had stability in our senior management and wherever we have had vacancies, we have been able to fill it internally. Our management committee is all home-grown as we groom and grow our own talent. We move them around and we give them relevant exposure. We have achieved our record performance because we have collectively worked towards it for a large number of years. So, the defining questions to me are do we have enough momentum in the business, is our strategy sound, is our execution capability robust and is the culture in the company long lasting? I think the answer to all of those is yes.

Jonathan Koh (UOB Kay Hian) What drove the 19% year-on-year decline in share of profits of associates and JV?

Chng Sok Hui It was driven by lower profits for NETS.

Tan Yong Hong A follow up question on rates, If the US Fed were to hike by 25-50 basis points, would this be net positive or negative to your earnings, considering factors beyond net interest income?

Piyush Gupta It is hard to say but I mentioned last quarter that there is a trade-off. If rates go up it helps our NIM, but further rate hikes could also result in more cost of credit. If it causes market sentiment to worsen, then it will also impact our investment banking and wealth management fees.

Tan Yong Hong The second follow-up question is on ROE. Given the potential impact of unrealised losses on your equity if the rates stay higher-for-longer, is there a view on where ROE can be this year?

Piyush Gupta There will be some mark-to-mark losses from higher-for-longer rates, and in the first quarter it was about $200 million, so it is not big. Our long-term ROE guidance is 15-17% and assumes a normalised interest rate environment. I think we could exceed that range this year, but I do not have a specific number.

Aakash Rawat I wanted to understand the drivers of the quarter-on-quarter strength in wealth management. Was it coming on the back of certain products or markets that might be hard to sustain even if the rates and macro environment remains unchanged?

Piyush Gupta There is seasonality quarter on quarter as the first quarter is usually more robust than the fourth. The other factor to consider is the growth in AUM. The momentum in net new money reached $24 billion in the last two years and was $6 billion this quarter, and there has also been a shift from deposits to investments. On products and markets, the strength is across the board and there is no pattern in the lift in activity.

Aakash Rawat On the net new money, have you seen any attrition, or does it continue to stay with the bank?

Piyush Gupta It continues to stay with the bank. Typically, the money that comes in is 50% in deposits and 50% in investments, and we try and gradually convert more of that into investments. Additionally, our AUM has continued grow and has reached $382 billion. Some of the growth is from mark-to-market gains, but a lot of that represents the new money that comes in and has stuck with us.

Aakash Rawat DBS's wealth management has gained critical mass and is ranked top three in Asia. Are you setting any target in terms of AUM?

Piyush Gupta We do not operate that way. The key thing is to focus on the fundamentals – how to continue bringing in new customers and how to get a greater share of wallet. The net growth in AUM is an outcome of that. We are number three in Asia in terms of AUM but there is a big gap to the top two, so there is still a lot of upside.

Nicholas Teh We do not have any more questions so that is it for the call. Thank you.