



CHINA
DEVELOPMENT
FINANCIAL

DBS Group Holdings

(DBS SP/DBS.SI)

Geared for Wealth

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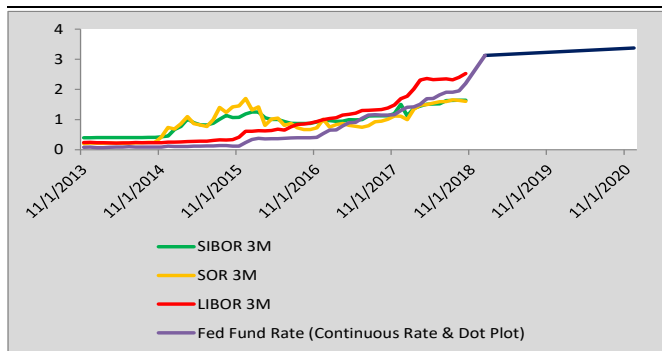
- We re-initiate coverage on DBS Group (SSG) with a **BUY** at a fair value of S\$27.70, based on a Residual Income Model. As Singapore's largest bank, DBS is well-positioned to benefit from rising interest rates, as well as Singapore's continued growth as a private banking hub.

Financials & Key Operating Statistics					
YE Dec SGD bn	2016	2017	2018F	2019F	2020F
Net interest income	9.7	10.8	12.7	14.7	15.6
Non interest income	4.2	4.5	4.4	4.7	5.0
Profit before Tax & Allowances	6.5	7.1	7.6	8.6	9.2
PATMI	4.2	4.4	5.9	6.7	7.2
Total Assets	481.6	517.7	548.0	580.2	614.6
Total Liabilities	434.6	467.9	497.2	526.4	556.6
P/B (x)	1.35	1.28	1.26	1.19	1.10
DPS	0.60	1.43	1.19	1.24	1.31
EPS	1.66	1.69	2.25	2.58	2.76
Net Interest Margin (%)	1.80	1.75	1.85	1.96	1.96
Cost/Income Ratio (%)	43.28	42.41	42.37	40.87	40.52
Tier 1 Capital Ratio (%)	14.68	15.10	14.86	15.08	15.36

Source: Company Data, KGI Research

Rising interest rates. As the bank with the highest CASA composition among its peers, funding cost for DBS will likely remain low. As the rate hike cycle continues, we expect SIBOR and SOR to trend upwards, driving interest income growth.

Figure 1: Dot Plot indicates continued hikes from 2018 to 2020



Source: Bloomberg, KGI Research

From this trend, we expect DBS's NIM to expand faster than OCBC and UOB due to their cost of funding. We forecast net interest margins to increase from 1.75% in 2017 to 1.85% for 2018 and 1.96% for 2019.

Buy (Re-Initiation)		Performance (Absolute)	
Price as of 1 Nov 18 (SGD)	23.9	1 Month (%)	-7.9
12M TP (\$)	27.7	3 Month (%)	-10.3
Previous TP (\$)	-	12 Month (%)	10.5
Upside, incl div (%)	19.1		
Trading data		Perf. vs STI Index (Red)	
Mkt Cap (\$mn)	61,113		
Issued Shares (mn)	2,554		
Vol - 3M Daily avg (mn)	4.6		
Val - 3M Daily avg (\$mn)	116.5		
Free Float (%)	69.9%		
Major Shareholders		Previous Recommendations	
Temasek Holdings	30.1%	-	-
		-	-
		-	-

Private banking growth. The bank's acquisition of ANZ and Societe Generale has greatly enhanced DBS's private banking footprints in the region. Among the largest private banks in Asia Pacific, DBS has been the only Singapore bank to break into the top six since 2014. In our view, we believe the wealth management sector will continue to benefit from the growth of the private banking sector in Asia and we forecast total income from wealth management to grow at ~10% per annum from 2018-2020.

Asset Quality. Uncertainty about asset quality outlook has subsided after the bank accelerated recognition of non-performing assets in 2017. While mortgage growth might be muted after the latest Additional Buyer's Stamp Duty (ABSD) and Loan-to-Value (LTV) limits, we believe the loan book should be well cushioned due to existing drawdowns. For FY18, we expect NPL ratios to remain at 1.7%.

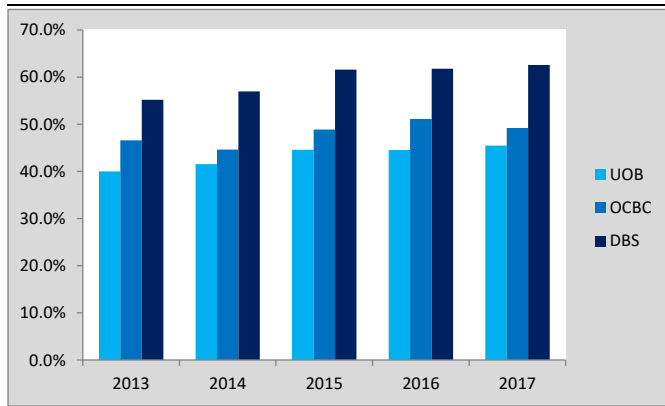
Valuation & Action: We re-initiate coverage on DBS with a **BUY** and a TP of \$27.70, based on a Residual Income Model with cost of equity at 9.9% and long-term growth rate at 1%.

Risks: Further slowdown in Singapore and global economy, no rate hike or slower than expected increase in US interest rates and domestic interest rates, sudden escalation or high increase in credit costs such as those in the oil & gas, shipping or real estate sectors, increase in funding costs due to intense deposits competition, potential changes to the monetary policy or capital requirements by MAS.

Investment Thesis

Main beneficiary of rising interest rate. Rising interest rates would benefit DBS the most among its peers due to its high CASA composition. As rates rise, there will be higher deposit competition for funds but we expect the impact to DBS to be relatively muted compared to OCBC and UOB due to their size and consumer outreach.

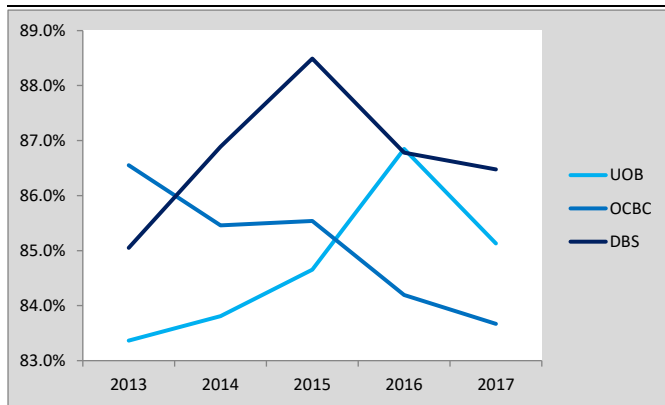
Figure 2: CASA Composition of customer deposits (%)



Source: Company Data, KGI Research

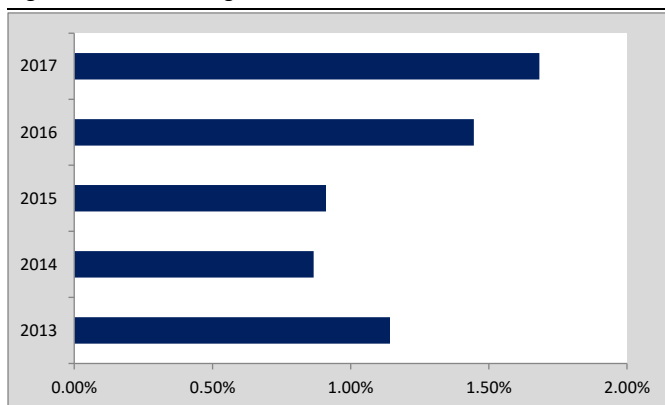
Additionally, we also expect credit costs to trend upwards as rising rates increases the probability of loan losses but net gains should be positive for the bank given management’s belief that its oil and gas loan book has been cleaned.

Figure 3: Group LDR for individual bank (%)



Source: Company Data, KGI Research

Figure 4: Non Performing Loans

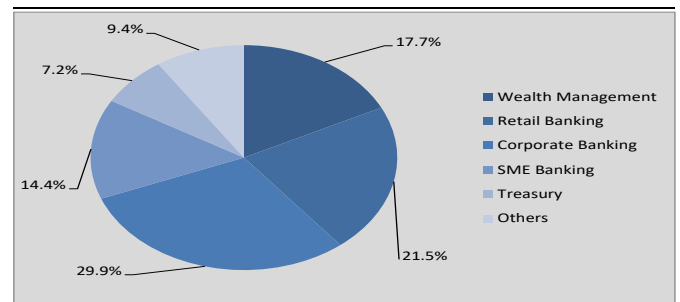


Source: Company Data, KGI Research

Private banking growth. DBS’s private banking business has delivered consistent, robust growth over the past few years. From 2014 to 2017, the bank’s assets under management grew at a CAGR of 15% from S\$134 bn to S\$206bn, boosted by Asia’s private banking boom, as well as acquisitions of Societe Generale and ANZ’s wealth management units.

Among DBS’s business units, wealth management is now the 3rd largest revenue driver with revenue contribution at 17.7% and the fastest growing segment for the group, with total income from wealth management rising 25% YoY to S\$2.11 bn.

Figure 5: DBS Total Income Business Unit Breakdown



Source: Company Data, KGI Research

According to Asian Private Banker, DBS has been the only Singapore bank to break into the top six largest private banks in Asia-Pacific since 2014.

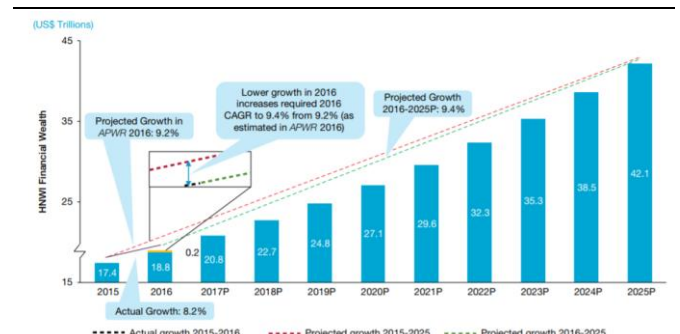
Figure 6: Asian Private Banker AUM Rankings

RANK	BANK	YOY % CHANGE	2017	2016	2015	2014	2013	2012
1	UBS Wealth Management	33.6%	382.7	286.4	274	272	245	207
2	Citi	17.4%	256.0	218	210	255	238	210
3	Credit Suisse Private Banking	23.4%	202.1	163.8	150.4	154	131	120.8
4	HSBC Private Banking	19.4%	129.0	108	112	112	108	91
5	Julius Baer	39.6%	115.0	82.4	75.1	78.7	72	43
6	DBS	33.6%	108.5	81.2	75	73.2	54.6	46

Source: Asian Private Banker, KGI Research

In our view, the private banking business will continue to experience strong growth due to the growth of financial wealth in Asia Pacific. According to Cap Gemini, wealth for high net worth individuals in Asia-Pacific excluding Japan, is expected to grow at 9.4% from 2016 – 2025.

Figure 7: Asia Pacific High Net Worth Individuals Financial Wealth

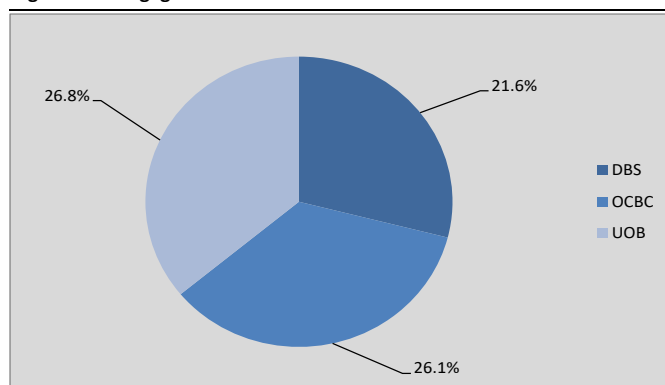


Note: 2025 data was projected by applying the market-level annualized growth rate from 2006-2015 for the 2015-2025 period. Projected data is for illustrative purposes; Chart numbers may not add up due to rounding.

Source: Capgemini Financial Services, KGI Research

Asset Quality. While loan growth sentiment might be affected after the Singapore government raised the Additional Buyer's Stamp Duty (ABSD) and Loan-to-Value (LTV) limits on residential property purchases to cool the property market, we expect mortgage growth to be well cushioned due to existing drawdowns. Should mortgage growth decline, we believe DBS will be less impacted from ABSD measures compared to its peers, given that the bank has the least exposure to the housing loan market in Singapore among the 3 local banks.

Figure 8: Mortgage Loans % of Gross Loans



Source: Company Data, KGI Research

Valuation. We re-initiate a BUY rating on DBS with a target price of S\$27.7, using a Residual Income Model. The RI model combines the book value of capital and the present value of future residual income. We derived residual income for each period by subtracting capital charges from net income and assume the cost of equity stays constant at 9.9% (risk free rate 2.7%, risk premium 6%, beta 1.2).

We also assume a conservative long-term growth rate of 1% to derive our target price of S\$27.70 which translates into a 2018F implied P/B multiple of 1.26x.

Key Risk. Slowdown in Singapore and global economy, no rate hikes or slower than expected increase in US interest rates and domestic interest rates, sudden escalation or high increase in credit costs such as those in the oil & gas, shipping or real estate sectors, increase in funding costs due to intense deposits competition, potential changes to the monetary policy or capital requirements by MAS.

Figure 9: Residual Income Model

Residual Income Model					
	2016A	2017A	2018F	2019F	2020F
Net Income	4,360.0	4,504.2	5,983.3	6,809.6	7,293.7
Equity	46,970.0	49,802.0	50,802.8	53,772.5	57,960.9
Return on Equity	9.8%	9.5%	12.3%	13.2%	13.1%
Cost of Equity (Bloomberg)		9.9%	9.9%	9.9%	9.9%
Spread		-0.4%	2.5%	3.4%	3.3%
Equity Charge		4,631.2	4,910.5	5,009.2	5,302.0
Residual Income		(127.0)	1,072.8	1,800.4	1,991.7
Current Book Value		49,802.0			
Discounted RI		3,970.4			
Terminal Value		17,123.5			
Growth Rate		1.00%			
Implied Equity Value		70,895.8			
Weighted Shares					
Basic		2562.8			
DBS Price Now		23.9			
Implied Price in SGD		27.7			

Source: KGI Research

Financials/Comparables

Figure 10: Singapore Banks Comparison

Company Name	Currency	Last Price	Currency Adj. Market Cap (\$ mn)	P/E (x)		P/B (x)		ROE (%)		Dividend Yield (%)
				FY17	FY18F	FY17	FY18F	FY17	FY18F	FY18F
DBS GROUP HOLDINGS LTD	SGD	23.94	44,290	12.7x	10.6x	1.3x	1.3x	10.3%	12.3%	5.0%
UNITED OVERSEAS BANK LTD	SGD	24.57	29,679	10.4x	10.2x	1.2x	1.1x	11.7%	11.3%	5.0%
OVERSEA-CHINESE BANKING CORP	SGD	11.16	34,377	10.3x	10.1x	1.2x	1.2x	11.5%	11.8%	3.8%
Singapore Banks Average				11.1x	10.3x	1.2x	1.2x	11.2%	11.8%	4.6%

Source: Bloomberg, KGI Research

Figure 11: Financials

INCOME STATEMENT (SGD mn)	2016A	2017A	2018F	2019F	2020F
Net interest income	9,748.0	10,833.0	12,702.7	14,742.0	15,624.3
Non interest income	4,184.0	4,483.2	4,401.6	4,693.4	5,006.1
Total Revenue	11,489.0	12,274.2	13,172.5	14,524.9	15,450.1
Operating Expenses	4,972.0	5,205.0	5,581.5	5,936.9	6,260.2
Profit before Tax, Goodwill and Provisions	6,517.0	7,069.2	7,591.0	8,588.1	9,189.8
Allowances for credit and other losses	1,434.0	1,894.0	666.4	707.1	748.6
Profit before Tax	5,083.0	5,175.2	6,924.7	7,881.0	8,441.2
Tax	723.0	671.0	941.4	1,071.4	1,147.6
Profit After Tax	4,360.0	4,504.2	5,983.3	6,809.6	7,293.7
PATMI	4,238.0	4,371.2	5,850.3	6,676.6	7,160.7
BALANCE SHEET (SGD mn)	2016A	2017A	2018F	2019F	2020F
Cash/Due from Banks	56,858.0	62,438.0	64,584.5	66,912.6	69,434.4
Securities	78,818.0	95,342.0	102,015.9	109,157.1	116,798.0
Gross Loans	305,415.0	327,769.0	348,818.6	370,190.9	391,764.2
Provisions	3,899.0	4,670.0	4,600.0	4,600.0	4,600.0
Goodwill	5,117.0	5,165.0	5,175.0	5,175.0	5,175.0
Other assets	11,042.0	12,066.0	12,605.8	13,169.7	13,758.8
Total Assets	481,570.0	517,711.0	547,996.0	580,216.0	614,573.7
Due to banks	15,915.0	17,803.0	19,583.3	21,541.6	23,695.8
Deposits	347,446.0	373,634.0	394,069.0	415,674.5	438,520.1
Debt	30,847.0	41,854.0	47,984.2	52,689.7	56,833.9
Other Liabilities	15,895.0	16,615.0	17,445.8	18,318.0	19,233.9
Total Liabilities	434,600.1	467,909.1	497,193.3	526,443.6	556,612.8
Shareholders' Equity	44,609.0	47,458.0	48,458.8	51,428.5	55,616.9
Non-controlling interests	2,361.0	2,344.0	2,344.0	2,344.0	2,344.0
Total liabilities and equity	481,570.1	517,711.1	547,996.0	580,216.0	614,573.7
KEY RATIOS	2016A	2017A	2018F	2019F	2020F
P/NTA	1.52	1.44	1.41	1.32	1.21
ROE (%)	9.8%	9.5%	12.3%	13.2%	13.1%
P/B (x)	1.35	1.28	1.26	1.19	1.10
DPS	0.60	1.43	1.19	1.24	1.31
EPS	1.66	1.69	2.25	2.58	2.76
Growth (%)					
Total Operating Income	6.5	6.8	7.3	10.3	6.4
Pre-Provision Profit	8.0	8.5	7.4	13.1	7.0
Net Profit	(4.5)	3.3	32.8	13.8	7.1
Gross Loan Growth	6.5	7.3	6.4	6.1	5.8
Deposit Growth	8.5	7.5	5.5	5.5	5.5
Profitability (%)					
Net Interest Margin	1.80	1.75	1.85	1.96	1.96
Cost/Income Ratio	43.3	42.4	42.4	40.9	40.5
Loans/Deposit Ratio	87.9	87.7	88.5	89.1	89.3
Tier 1 Capital Ratio	14.7	15.1	14.9	15.1	15.4
Capital Adequacy Ratio	16.2	15.9	16.4	16.5	16.7

Source: Bloomberg, KGI Research

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Rating	Definition
	KGI Securities Research's recommendations are based on an Absolute Return rating system.
BUY	>10% total return over the next 12 months
HOLD	-10% to +10% total return over the next 12 months
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