

DBS Group (DBS SP)

Green Evolution

Balancing ESG risks and opportunities

As ASEAN's largest bank, DBS is exposed to multiple ESG risks. These include contagion risks from clients due to the nature of its business of lending & investments as well as internal governance risks. In our view, DBS' ESG risks are not un-typical for a regional bank of its size. We also note DBS has been leading regionally in establishing frameworks and policies to mitigate these risks. It is also been materially expanding its asset allocation towards sustainability-linked transactions. At the same time the group's strong capital levels, deep balance sheet liquidity, should present market share opportunities in the medium term. Maintain BUY.

Mitigating governance risks

DBS' large regional footprint (54% of loans outside SG) exposes it to significant governance risks especially for fair dealing across product categories including wealth management and insurance. Money laundering is a material day to day operational risk. Data privacy and cyber security issues are significant given the sizable scale of DBS' platforms. The group has had no material controversies under these risk categories in the past few years. It has put in place detailed and transparent policies for mitigating risks benchmarked to best practice standards, in our view. More details are available in the ESG Tear Sheet in page 2.

Expanding environmental, social footprint

The group has committed to not funding new coal mining & energy related segments, while nearly 40% of incremental loan funding in 2019 was towards sustainability-linked segments. DBS has also raised green bond funding to provide ring-fenced investments to sustainable segments. It has also started incorporating ESG scoring on its wealth management products.

Strong balance sheet

DBS' progressive dividend policy offers medium term dividend certainty. Strong CET1 ratio of 13.9% along with a liquid balance sheet (USD LD ratio 77%) provides significant opportunities for regional market share growth as corporates look to bulk up liquidity and diversify funding risks, especially as supply chains shift out of China to ASEAN. Maintain BUY.

FYE Dec (SGD m)	FY18A	FY19A	FY20E	FY21E	FY22E
Operating income	13,183	14,544	14,750	15,334	16,471
Pre-provision profit	7,385	8,286	7,935	8,160	8,746
Core net profit	5,625	6,391	5,130	5,363	6,223
Core EPS (SGD)	2.2	2.5	2.0	2.1	2.4
Core EPS growth (%)	38.3	14.1	(19.7)	4.6	16.0
Net DPS (SGD)	1.2	1.2	1.3	1.3	1.3
Core P/E (x)	10.8	10.3	10.5	10.0	8.6
P/BV (x)	1.2	1.3	1.0	1.0	1.0
Net dividend yield (%)	5.1	4.8	6.2	6.3	6.3
Book value (SGD)	19.13	19.96	20.51	21.14	22.10
ROAE (%)	12.2	13.4	10.3	10.5	11.7
ROAA (%)	1.1	1.1	0.9	0.8	0.9
Consensus net profit	-	-	4,601	5,016	6,091
MKE vs. Consensus (%)	-	-	11.5	6.9	2.2

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BUY

Share Price SGD 21.05

12m Price Target SGD 22.10 (+5%)

Previous Price Target SGD 22.10

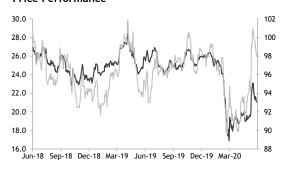
Statistics

52w high/low (SGD)	26.91/16.88
3m avg turnover (USDm)	107.3
Free float (%)	70.3
Issued shares (m)	2,564
Market capitalisation	SGD54.0B
	USD38.7B

Major shareholders:

,	
Temasek Holdings	29.09
Capital Research	2.19
The Vanguard Group	2.19
•	

Price Performance



	-1M	-3M	-12M
Absolute (%)	10	16	(19)
Relative to index (%)	4	6	2

Source: FactSet





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Business Model & Industry Issues

- The nature of DBS' business of lending and investments exposes it to multiple risks including environmental, social, money laundering, corruption through its clients. It has been increasing weightings towards green, sustainability linked lending along with clean energy (40% of incremental loans in 2019).
- Its extensive investments in digitisation and automation (7% CAGR 2010-2019) of banking processes & digital banking exposes it to data and cyber-security risks. No material lapses have been reported in the past 5-years
- DBS' significant private banking and wealth management business exposes it to product governance, business ethics risks. Its long term exclusive relationship with Manulife for insurance distribution also exposes DBS to similar risks
- The banking sector is being used as a transmission mechanism for government stimulus programs under COVID-19 relief schemes across the region, elevating social priorities over shareholder returns over the medium term
- DBS displays no exceptional risks not typical for a large, regional bank for ESG. In our view, it has a regionally above average track record of disclosure in terms of adhering to ESG standards (rated AA by MSCI). This is complemented by an overlay of a strong balance sheet (AA rated) and proactive regulatory oversight by MAS

Material E issues

- Potential contagion risks from lending & investment to sectors with ESG issues. Only 0.5% of loan book exposed to coal, palm oil, but 7% exposure to 0&G and aviation.
- Issued USD500m green bond for funding green assets
- Committed to no new coal mining, energy funding
- Increasing lending exposure to clean energy related lending with 13% of incremental lending in 2019
- 99.9% of new suppliers have signed on to DBS' sustainable sourcing principles
- 100% of Singapore branches BCA Green Mark certified with
 62% branches certified as Gold or above
- 14% of energy consumption sourced from renewable sources across key markets
- Adapted Equator Principles to guide large scale development and construction projects

Material S issues

- Potential financial inclusion risks from vulnerable sectors such as low income, elderly, migrant workers etc. DBS has launched multiple digital inclusion programs including robo-advisory for retail clients, co-lending partnerships and instant approval digital loans in Indonesia and appointing elderly digital ambassadors through their heartland POSB franchise in Singapore. DBS has also launched digital banking inclusion program for migrant workers
- Social impact risks from investing activities. DBS has been engaging its private banking and wealth management customers on sustainable investing and has adopted MSCI ESG ratings on its wealth and advisory products
- Employee diversity and equal opportunity risks. Female employees make up 52% of the workforce with a Board level diversity policy. It also has a whistleblowing program to escalate employee concerns

Key G metrics and issues

- DBS was fined by MAS in 2016 for due diligence and money laundering lapses in the 1MDB scandal. While the regulator did not find any material control weakness, it did find fault with specific employees discharging duties
- DBS has not had any material accounting & tax, lobbying & public policy, sanctions related, data privacy or security controversies in the past 5-yers
- Given the breadth of products offered and the large wealth and PB franchise, fair dealing risks cannot be ignored. This is addressed by the Group Fair Dealing and Conduct Committee (FDCC) - chaired by CEO - and the Board's Risk Management Committee. Employee incentives have been aligned with customer interests, according to Management. DBS has not had any material fair dealing controversies since its temporary product selling ban following mis-selling complex 'mini-bond' products to unqualified investors in 2008/9
- Significant investments in technology for systems and business integration as well as online banking opens it to material cyber-security risks. DBS was censured by MAS for an inadequate tech risk management in 2010 following a wide outage of its banking systems .The group has developed a cyber-security risk management framework and a Group information security policy. DBS is also working with MAS and banking associations to tackle industry-wide cyber-security risks. It has Data Governance and Data Privacy policies in place to deal with data governance risks.
- Corporate Governance Risks. 54% of Board composition is Independent Directors. This increases to 91% when non-executive directors are included. Gender diversity is lower with 18% of female Board representation. In the Management committee this is 29%
- DBS is a signatory to the UN Global Compact. It has been producing a detailed standalone sustainability report since 2018. The report has been prepared under the ESG standards of SGX, GRI, ABS and the recommendations of TCFD



Risk statement

There are several risk factors for our earnings estimates, price target, and rating for DBS. Higher than expected NPL formation as a result of weak economic conditions may have a material impact to earnings visibility. Higher credit charges and requirements to preserve capital may increase risks of lower dividend payout.

June 23, 2020



FYE 31 Dec	FY18A	FY19A	FY20E	FY21E	FY22E
Key Metrics					
Core P/E (x)	10.8	10.3	10.5	10.0	8.6
Core FD P/E (x)	10.8	10.3	10.5	10.0	8.6
P/BV (x)	1.2	1.3	1.0	1.0	1.0
P/NTA (x)	1.4	1.4	1.1	1.1	1.0
Net dividend yield (%)	5.1	4.8	6.2	6.3	6.3
INCOME STATEMENT (SGD m)					
Interest income	13,798.0	15,592.0	13,522.4	13,258.1	14,583.4
Interest expense	(4,843.0)	(5,967.0)	(4,233.2)	(3,874.7)	(4,597.1)
Net interest income	8,955.0	9,625.0	9,289.2	9,383.4	9,986.3
Net insurance income	0.0	0.0	0.0	0.0	0.0
Net fees and commission	2,780.0	3,052.0	3,357.2	3,692.9	4,062.2
Other income	1,448.0	1,867.0	2,104.1	2,257.4	2,422.3
Total non-interest income	4,228.0	4,919.0	5,461.3	5,950.3	6,484.5
Operating income	13,183.0	14,544.0	14,750.4	15,333.7	16,470.9
Staff costs	(3,185.0)	(3,514.0)	(3,689.7)	(3,874.2)	(4,261.6)
Other operating expenses	(2,613.0)	(2,744.0)	(3,125.4)	(3,299.1)	(3,462.8)
Operating expenses	(5,798.0)	(6,258.0)	(6,815.1)	(7,173.3)	(7,724.4)
Pre-provision profit	7,385.0	8,286.0	7,935.3	8,160.3	8,746.5
Loan impairment allowances	(710.0)	(703.0)	(1,840.0)	(1,789.7)	(1,361.8)
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	6,627.0	7,583.0	6,095.3	6,370.7	7,384.7
Income tax	(974.0)	(1,154.0)	(927.6)	(969.5)	(1,123.8)
Minorities	(76.0)	(38.0)	(38.0)	(38.0)	(38.0)
Discontinued operations	0.0	0.0	0.0	0.0	0.0
Reported net profit	5,577.0	6,391.0	5,129.7	5,363.2	6,222.8
Core net profit	5,625.0	6,391.0	5,129.7	5,363.2	6,222.8
Preferred Dividends	(38.0)	(38.0)	(38.0)	(38.0)	(38.0)
BALANCE SHEET (SGD m)					
Cash & deposits with banks	62,363.0	65,698.0	95,048.5	98,698.4	105,439.2
Sec. under resale agreements	0.0	0.0	0.0	0.0	0.0
Derivatives financial assets	17,029.0	17,235.0	18,958.5	20,854.4	22,939.8
Dealing securities	0.0	0.0	0.0	0.0	0.0
Available-for-sale securities	58,197.0	63,746.0	65,658.4	67,628.1	73,038.4
Investment securities	47,278.0	49,729.0	53,098.0	55,834.3	43,814.2
Loans & advances	345,003.0	357,884.0	361,833.2	376,634.9	398,969.1
Central bank deposits	0.0	0.0	0.0	0.0	0.0
Investment in associates/JVs	838.0	835.0	835.0	835.0	835.0
Insurance assets	0.0	0.0	0.0	0.0	0.0
Fixed assets	1,450.0	3,225.0	3,289.5	3,355.3	3,422.4
Intangible assets	5,175.0	5,170.0	5,170.0	5,170.0	5,170.0
Other assets	13,418.0	15,424.0	16,966.4	18,663.0	20,529.3
Total assets	550,751.0	578,946.0	620,857.5	647,673.5	674,157.4
Deposits from customers	393,785.0	404,289.0	442,483.3	465,286.0	486,824.7
Deposits from banks & FIs	22,648.0	23,773.0	24,953.9	26,193.4	27,494.5
Derivatives financial instruments	16,692.0	17,512.0	17,512.0	17,512.0	17,512.0
Subordinated debt	3,599.0	3,538.0	3,538.0	3,538.0	3,538.0
Other securities in issue	0.0	0.0	0.0	0.0	0.0
Other borrowings	45,712.0	57,128.0	58,270.6	59,436.0	60,624.7
Insurance liabilities	0.0	0.0	0.0	0.0	0.0
Other liabilities	18,440.0	20,907.0	20,907.0	20,907.0	20,907.0
Total liabilities	500,876.0	527,147.0	567,664.8	592,872.3	616,900.9
Share capital	10,898.0	10,948.0	10,948.0	10,948.0	10,948.0
Reserves	35,335.0	38,024.0	39,417.8	41,026.1	43,481.5
Shareholders' funds	46,233.0	48,972.0	50,365.8	51,974.1	54,429.5
Preference shares	2,812.0	2,009.0	2,009.0	2,009.0	2,009.0
			818.0	818.0	818.0
Minority interest	830.0	818.0			
Minority interest Total equity	830.0 49,875.0	818.0 51,799.0	53,192.8	54,801.1	57,256.5



FYE 31 Dec	FY18A	FY19A	FY20E	FY21E	FY22E
Key Ratios					
Growth (%)					
Net interest income	14.9	7.5	(3.5)	1.0	6.4
Non-interest income	2.3	16.3	11.0	9.0	9.0
Operating expenses	11.4	7.9	8.9	5.3	7.7
Pre-provision profit	9.9	12.2	(4.2)	2.8	7.2
Core net profit	38.3	13.6	(19.7)	4.6	16.0
Gross loans	6.7	3.7	1.4	4.3	5.9
Customer deposits	5.4	2.7	9.4	5.2	4.6
Total assets	6.4	5.1	7.2	4.3	4.1
Profitability (%)					
Non-int. income/Total income	32.1	33.8	37.0	38.8	39.4
Average lending yields	2.78	2.97	2.43	2.26	2.39
Average financing yields	0.00	0.00	0.00	0.00	0.00
Average cost of funds	1.08	1.25	0.83	0.72	0.81
Net interest margin	1.80	1.83	1.67	1.60	1.64
Net income margin	42.67	43.94	34.78	34.98	37.78
Cost/income	44.0	43.0	46.2	46.8	46.9
Liquidity (%) Loans/customer deposits	87.6	88.5	81.8	80.9	82.0
Asset quality (%)					
Net NPL	0.2	0.2	0.4	1.1	0.8
Gross NPL	1.5	1.5	2.0	2.8	2.5
Net NPF	0.0	0.0	0.0	0.0	0.0
Gross NPF	0.0	0.0	0.0	0.0	0.0
(SP+GP)/average gross loans	0.2	0.2	0.5	0.5	0.3
(SP+GP)/average gross financing	0.0	0.0	0.0	0.0	0.0
Loan loss coverage	97.8	93.8	87.2	68.1	75.8
Capital adequacy (%)					
CET1	13.9	14.1	13.2	12.7	12.5
Tier 1 capital	15.1	15.0	14.0	13.5	13.3
Risk-weighted capital	16.9	16.7	15.5	15.0	14.7
Returns (%)					
ROAE	12.2	13.4	10.3	10.5	11.7
ROAA	1.1	1.1	0.9	0.8	0.9
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Source: Company; Maybank



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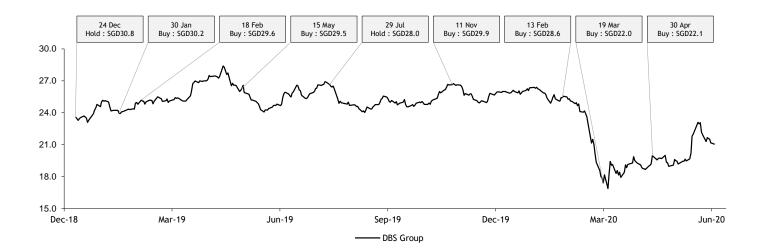
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