

19 November 2020

Financial Services | Banks

DBS (DBS SP)

Buy (Maintained)

Rescue ≠ National Service; Maintain BUY

Target Price (Return): SGD25.20 (+2%)
 Price: SGD24.60
 Market Cap: USD46,676m
 Avg Daily Turnover (SGD/USD) 102m/74.9m

- **Maintain BUY with SGD25.20 TP, 2% upside and 3% yield.** DBS Bank India Ltd's (DBIL) potential amalgamation with Lakshmi Vilas Bank (LVB IN, NR), we believe, will be a positive for long term growth prospects. Although not a material boost to DBS group assets, LVB would provide DBIL with the opportunity to scale up its operations at a faster pace as well as boost digibank's franchise. Near term, key challenges will be management of asset quality and retention of customer deposits.

- **A proposed merger with LVB, a distressed Indian bank.** The Reserve Bank of India (RBI) announced on 17 Nov 2020 a draft scheme to amalgamate Lakshmi Vilas Bank (LVB) with DBIL, a wholly-owned subsidiary of DBS Bank. The RBI is stepping in due to the serious deterioration in LVB's financial position and measures had to be taken to protect depositors (more details on page 3). To support the amalgamation, DBS will inject INR25.0bn (SGD463m) into DBIL – fully funded from DBS' existing resources.

- **Rescue = opportunity to build scale.** In its announcement, DBS said that "the proposed amalgamation will allow DBIL to scale its customer base and network, particularly in South India, which has longstanding and close business ties with Singapore." It is no secret that DBS has identified India as one of the six core markets for the banking group. While the strategy is to have full service and diversified franchise across all customer segments and business lines in the core markets, DBS faced challenges in efforts to build the required scale in India. This led to the launch of its mobile-only offering, digibank, in 2016 and the establishment of DBIL in Mar 2019 as a locally incorporated wholly-owned subsidiary of DBS Bank.

- **Physical network to boost digital franchise.** DBS' digibank in India, while quick to garner new customers, did not attract the right ones in the initial years due to poor brand presence. With DBIL, which is present in 24 cities with 34 branches, management plans to accelerate its growth plans through a hybrid model – a physical overlay to boost its digital franchise. A merger with LVB, which has 563 branches, should enhance that strategy.

- **Not a major transaction.** LVB's total assets of INR244.2bn (SGD4.52bn) at as end-Mar 2020 is smaller than DBIL's (INR628.6bn or SGD11.64bn), and is only 0.9% of the banking group's total assets of SGD643.01bn (Mar 2020). The injection of SGD463m capital into DBIL would trim DBS' CET-1 ratio by a very manageable c.20bps. DBS' CET-1 ratio was a healthy 13.9% at end-Sep 2020.

- **Key risks – loan impairments and deposit run-offs.** According to news reports, LVB's shareholders' funds will be fully written off. If true, this would probably mean that DBIL would take over LVB at zero cost but bear the risks related to LVB's loans portfolio and potential deposit run-offs. The capital injection of SGD463m will be required to restore capital ratios.

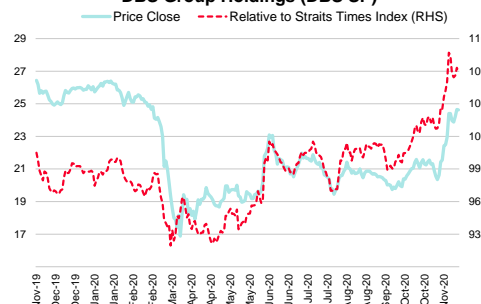
Analyst

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Share Performance (%)

	YTD	1m	3m	6m	12m
Absolute	(4.8)	15.1	18.8	29.1	(7.4)
Relative	8.7	5.0	10.0	19.3	7.0
52-wk Price low/high (SGD)				16.9 – 26.4	

DBS Group Holdings (DBS SP)



Source: Bloomberg

Forecasts and Valuation	Dec-18	Dec-19	Dec-20F	Dec-21F	Dec-22F
Reported net profit (SGDm)	5,577	6,391	4,819	5,703	6,959
Net profit growth (%)	27.6	14.6	(24.6)	18.3	22.0
Recurring net profit (SGDm)	5,625	6,391	4,819	5,703	6,959
Recurring EPS (SGD)	2.21	2.50	1.89	2.24	2.74
BVPS (SGD)	19.22	19.96	22.86	24.35	26.09
DPS (SGD)	1.20	1.23	0.74	0.90	1.15
Recurring P/E (x)	11.14	9.84	13.02	10.97	8.99
P/B (x)	1.28	1.23	1.08	1.01	0.94
Dividend Yield (%)	4.9	5.0	3.0	3.7	4.7
Return on average equity (%)	11.6	12.8	8.8	9.5	10.9

Source: Company data, RHB

Financial Exhibits

Asia	Financial summary (SGD)	Dec-18	Dec-19	Dec-20F	Dec-21F	Dec-22F
Singapore	EPS	2.19	2.50	1.89	2.24	2.74
Financial Services	Recurring EPS	2.21	2.50	1.89	2.24	2.74
DBS	DPS	1.20	1.23	0.74	0.90	1.15
DBS SP	BVPS	19.22	19.96	22.86	24.35	26.09
Buy						
Valuation basis	Valuation metrics	Dec-18	Dec-19	Dec-20F	Dec-21F	Dec-22F
Our TP is derived using the Gordon Growth Model with key assumptions being:	Recurring P/E (x)	11.14	9.84	13.02	10.97	8.99
i. 10.5% ROE;	P/B (x)	1.3	1.2	1.1	1.0	0.9
ii. 8.95% COE; and	Dividend Yield (%)	4.9	5.0	3.0	3.7	4.7
iii. 3.0% long term growth.						
Key drivers	Income statement (SGDm)	Dec-18	Dec-19	Dec-20F	Dec-21F	Dec-22F
Key earning drivers are:	Interest income	13,798	15,592	13,050	13,650	14,380
i. NIM;	Interest expense	(4,843)	(5,967)	(3,925)	(4,150)	(4,450)
ii. Credit cost;	Net interest income	8,955	9,625	9,125	9,500	9,930
iii. Loan growth;	Non interest income	4,276	4,919	5,570	5,550	5,930
iv. Fee income growth.	Total operating income	13,231	14,544	14,695	15,050	15,860
	Overheads	(5,814)	(6,258)	(6,155)	(6,485)	(6,815)
	Pre-provision operating profit	7,417	8,286	8,540	8,565	9,045
	Loan impairment allow ances	(708)	(704)	(2,980)	(1,960)	(900)
	Other impairment allow ances	(2)	1	-	-	-
	Other exceptional items	(48)	-	-	-	-
	Pre-tax profit	6,659	7,583	5,560	6,605	8,145
	Taxation	(1,006)	(1,154)	(701)	(859)	(1,140)
	Minority interests	(76)	(38)	(40)	(43)	(46)
	Reported net profit	5,577	6,391	4,819	5,703	6,959
	Recurring net profit	5,625	6,391	4,819	5,703	6,959
Key risks	Profitability ratios	Dec-18	Dec-19	Dec-20F	Dec-21F	Dec-22F
Key risks are:	Return on average assets (%)	1.0	1.1	0.8	0.8	1.0
i. Sharper-than-expected rise in NPLs;	Return on average equity (%)	11.6	12.8	8.8	9.5	10.9
ii. Weaker-than-expected NIM;	Return on IEAs (%)	2.8	2.9	2.3	2.2	2.2
iii. Prolong slowdown in economic growth.	Cost of funds (%)	1.1	1.3	0.8	0.8	0.8
	Net interest spread (%)	1.7	1.7	1.5	1.4	1.4
	Net interest margin (%)	1.8	1.8	1.6	1.5	1.5
	Non-interest income / total income (%)	32.3	33.8	37.9	36.9	37.4
	Cost to income ratio (%)	43.9	43.0	41.9	43.1	43.0
	Credit cost (bps)	20.9	19.8	80.4	50.5	22.2
Company Profile	Balance sheet (SGDm)	Dec-18	Dec-19	Dec-20F	Dec-21F	Dec-22F
DBS is the largest Singapore bank by assets. It also has significant exposure to Greater China.	Total gross loans	349,645	362,427	379,000	398,000	414,000
	Other interest earning assets	167,838	179,173	230,900	241,000	242,600
	Total gross IEAs	517,483	541,600	609,900	639,000	656,600
	Total provisions	(4,642)	(4,543)	(6,600)	(6,900)	(7,250)
	Net loans to customers	345,003	357,884	372,400	391,100	406,750
	Total net IEAs	512,841	537,057	603,300	632,100	649,350
	Total non-IEAs	37,910	41,889	61,419	58,301	66,937
	Total assets	550,751	578,946	664,719	690,401	716,287
	Customer deposits	393,785	404,289	457,000	480,000	497,000
	Other interest-bearing liabilities	71,959	84,439	84,807	83,586	86,200
	Total IBLs	465,744	488,728	541,807	563,586	583,200
	Total non-IBLs	35,132	38,419	64,000	64,100	65,950
	Total liabilities	500,876	527,147	605,807	627,686	649,150
	Share capital	2,441	2,441	2,441	2,441	2,441
	Shareholders' equity	49,045	50,981	58,092	61,890	66,307
	Minority interests	830	818	820	825	830
	Asset quality and capital	Dec-18	Dec-19	Dec-20F	Dec-21F	Dec-22F
	Reported NPLs / gross cust loans (%)	1.5	1.5	1.7	1.7	1.7
	Total provisions / reported NPLs (%)	88.4	84.1	105.5	103.2	104.2
	CET-1 ratio (%)	13.9	14.1	14.9	15.4	15.6
	Tier-1 ratio (%)	15.1	15.0	15.7	16.1	16.3
	Total capital ratio (%)	16.9	16.7	17.4	17.8	18.0

Source: Company data, RHB

Potential Merger With LVB

A proposed merger with LVB,... The RBI announced on 17 Nov 2020 a draft scheme to amalgamate LVB with DBIL, a wholly-owned subsidiary of DBS Bank. To support the amalgamation, DBS will inject INR25.0bn (SGD463m) into DBIL – fully funded from DBS' existing resources.

... a distressed Indian bank. At the same, RBI has imposed a 30-day moratorium on LVB, with depositors restricted to a maximum withdrawal of INR25,000. The RBI is stepping in due to the serious deterioration in LVB's financial position and measures had to be taken to protect depositors. LVB has been loss-making for the past three years, with gross non-performing assets (NPA) at a high 25.4% in FY20 (Mar). As a result, its capital severely eroded, with CET-1 ratio at -0.88% and Capital Adequacy Ratio (CAR) at 1.12% in Mar 2020.

Figure 1: Key financial information of DBIL and LVB

	DBIL	DBIL	LVB	LVB
	31-Mar-19	31-Mar-20	31-Mar-19	31-Mar-20
Net profit				
INR'm	205	1,110	(8,941)	(8,360)
SGD'm	3.80	20.56	(165.59)	(154.83)
Net loans				
INR'm	181,079	191,307	219,560	166,730
SGD'm	3,354	3,543	4,066	3,088
Deposits				
INR'm	338,278	356,521	292,790	214,430
SGD'm	6,265	6,603	5,422	3,971
Gross NPA				
INR'm	5,11%	2.60%	15.30%	25.37%
INR'm	5,832	5,076	33,590	42,333
SGD'm	108	94	622	784
LLR				
INR'm	91.59%	88.0%	62.08%	71.25%
INR'm	5,341	4,467	20,853	30,162
Total Assets				
INR'm	579,205	628,644	330,462	244,215
SGD'm	10,727	11,643	6,120	4,523
CET-1	14.62%	13.12%	5.72%	-0.88%
CAR	19.69%	16.33%	7.72%	1.12%

Source: Company data, RHB

Rescue = opportunity to build scale. In its announcement, DBS said that “the proposed amalgamation will allow DBIL to scale its customer base and network, particularly in South India, which has longstanding and close business ties with Singapore.” It is no secret that DBS has identified India as one of the six core markets for the banking group. While the strategy is to have full service and diversified franchise across all customer segments and business lines in the core markets, DBS faced challenges in efforts to build the required scale in India. This led to the launch of its mobile-only offering, digibank, in 2016 and the establishment of DBIL in Mar 2019 as a locally incorporated wholly-owned subsidiary of DBS Bank.

Physical network to boost digital franchise. DBS' digibank in India, while quick to garner new customers, did not attract the right ones in the initial years due to poor brand presence. With DBIL, which is now present in 24 cities with 34 branches, management plans to accelerate its growth plans through a hybrid model – a physical overlay to boost its digital franchise. A merger with LVB, which has 563 branches, will enhance that strategy.

Not a major transaction. The proposed amalgamation will not be a major transaction for DBS. LVB's total assets of INR244.2bn (SGD4.52bn) at as end-Mar 2020 is smaller than DBIL's (INR628.6bn or SGD11.64bn), and is only 0.9% of the banking group's total assets of SGD643.01bn (Mar 2020). The injection of SGD463m capital into DBIL would trim DBS' CET-1 ratio by a very manageable c.20bps. DBS' CET-1 ratio was a healthy 13.9% at end-Sep 2020.

Key risks – loan impairments and deposit run-offs. According to various news reports, the draft amalgamation scheme put out by RBI will result in LVB's entire shareholders' funds being written-off. LVB's shares and debentures on any stock exchange will be delisted without any further action. If true, this would probably mean that DBS would take over LVB at zero cost but bear the risks related to LVB's loans portfolio and potential deposit run-offs. Capital injection of will be required to restore capital ratios.

Based on LLR of 71.25% as at end-Mar 2020, a full write-off of NPAs would mean additional provisions of INR12.17m (SGD225.4m). This is equivalent to c.4% of our projected FY21F net profit of SGD5,703m for DBS. There is also the risk that DBIL may have to kitchen-sink to clean up LVB's loan portfolio.

Past rescue experience. DBS is not entirely new to rescuing a distressed bank. Back in 2008, DBS successfully bid for the takeover of Bowa Commercial Bank, a failed Taiwanese bank. Then, the acquisition was part of management's strategy to bolster DBS' expansion beyond its core markets in Singapore and Hong Kong.

Recommendation Chart



Source: RHB, Bloomberg

Date	Recommendation	Target Price	Price
2020-11-05	Buy	25.2	22.4
2020-08-07	Neutral	18.5	20.6
2020-04-30	Neutral	18.7	20.0
2020-03-12	Neutral	21.5	20.2
2020-02-13	Neutral	24.8	25.4
2020-02-13	Neutral	25.8	25.4
2020-02-13	Neutral	24.8	25.4
2019-11-12	Neutral	25.8	26.7
2019-09-06	Neutral	25.3	24.8
2019-07-12	Buy	30.3	25.8
2019-04-10	Buy	29.6	27.0

Source: RHB, Bloomberg

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Trading Buy:	Share price may exceed 15% over the next 3 months, however longer-term outlook remains uncertain
Neutral:	Share price may fall within the range of +/- 10% over the next 12 months
Take Profit:	Target price has been attained. Look to accumulate at lower levels
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Analyst	Company
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