



Rating
Buy

Asia
Hong Kong

Banking / Finance
Banks

Company
DSBG

Reuters 2356.HK Bloomberg 2356 HK Exchange HKG Ticker 2356

Date
25 March 2015

Results

Price at 25 Mar 2015 (HKD)	13.08
Price target - 12mth (HKD)	16.00
52-week range (HKD)	14.96 - 11.26
HANG SENG INDEX	24,400

Franco Lam

Research Analyst
(+852) 2203 6226
franco.lam@db.com

2H14 results: Becoming more steady

Solid earnings; core beat Deutsche Bank estimate by 5%

DSB reported 2H14 earnings of HKD985m (-6% HoH, +4% YoY), with 2014 earnings of HKD2bn (+16% YoY) beating the Bloomberg consensus and Deutsche Bank estimate by 15%/5% on better non-interest income (e.g., fees and higher FX gains) and associate income. Since the financial crisis in FY08, we continue to see a steady turnaround in DSB's fundamentals, with higher transparency and earnings becoming less volatile. Maintaining Buy.

2H14 Key highlights: Trends largely within expectations

The **positives**: Other non-interest income went up 17% HoH, helped by higher forex gains and trading income, helping offset the NIM weakness (-6bp HoH and 1% HoH loan growth). BCQ earnings accounted for 24% of DSB (1H14: 35%), with BCQ earnings tending to be front loaded. Net fee income grew 6% HoH, supported by insurance (+72% HoH). LDR was unchanged at 74%, while there was slight improvement in CASA. Capital further improved to 11.4% (+50bp HoH). **Negatives**: NIM was under pressure from higher cost of funds as NII grew 3% HoH. Loans grew only 1% HoH; weakness was seen in property-related lending. Credit costs continued to move up to ann. 43bp (+3bp HoH), with potentially half of the bad debt charges related to onshore exposures.

Management outlook: Slower growth ahead

Citing higher cost of funds and flight for quality loans, DSB sees pressure ahead but hopes to achieve a steady NIM run rate vs. 2H14. Loan growth is expected to slow in FY15 on weaker cross-border demand and caution in Mainland China. Overall capital looks adequate, and even if in need, it could source from AT1 (instead of equity rising). The asset quality of Macau lending (11% of book) remains solid, seeing no deterioration despite slowdown seen in the gaming industry. DSB remains open minded for any M&A opportunities.

Valuation undemanding; Steadier fundamentals with M&A option

DSB trades at 0.9x 2015E P/B and near 10% RoE (cheapest in our HK banks coverage). Our view on DSB as an M&A candidate remains unchanged, given structural change in the banking system by which medium-size banks will face stiff competition from larger peers in HK. We value DSBG via a GGM and combined M&A entities approach (see p. 5). Downside risks: severe asset quality deterioration, liquidity outflow and removal of M&A potential.

Price/price relative



Performance (%)	1m	3m	12m
Absolute	-0.5	5.0	9.0
HANG SENG INDEX	-1.5	4.5	12.3

Source: Deutsche Bank

Stock data

Market cap (HKDm)	18,332
Market cap (USDm)	2,364
Shares outstanding (m)	1,326.5
Major shareholders	Dah Sing Financial (74.23%)
Free float (%)	26
Avg daily value traded (USDm)	2.0

Source: Deutsche Bank

Figure 1: Forecasts and ratios

Year End Dec 31	2012A	2013A	2014A	2015E	2016E
Net profit (HKDm)	1,480	1,756	2,034	1,869	2,036
EPS (HKD)	1.2	1.3	1.5	1.3	1.5
EPS growth (%)	33.9	17.3	10.1	-10.4	9.0
PER (x)	6.3	8.0	8.4	9.6	8.8
Price/book (x)	0.68	1.00	0.87	0.86	0.8
Yield (net) (%)	3.7	2.9	2.9	2.6	2.6
ROE (%)	9.7	10.8	11.0	9.2	9.4

Source: Deutsche Bank estimates, company data (DB EPS is fully diluted and excludes non-recurring items. Multiples and yields calculations use average historical prices for past years and spot prices for current and future years, except P/B, which uses the year-end close)

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Figure 2: DSBG 2H14 results summary

P&L account (HKD m)	2H13	1H14	2H14	HoH (%)	YoY (%)	Comments
Net interest income	1,454	1,471	1,519	3.3	4.5	NIM down 6 bps HoH to 1.73%; loan growth of 1.5% HoH
Non-interest income	545	540	634	17.5	16.4	HoH up on higher trading and FX gains
<i>o/w: Fees and commissions</i>	354	404	427	5.7	20.7	Broad-based improvement HoH
Total income	1,999	2,011	2,154	7.1	7.8	
Operating expenses	(1,067)	(1,003)	(1,125)	12.1	5.4	
Pre-provision profit	932	1,008	1,029	2.1	10.5	
Bad debt charges	(172)	(225)	(248)	10.6	44.2	Though credit costs inched up marginally, gross NPL ratio improved
Operating profit	760	784	781	(0.4)	2.8	
Associates	345	365	238	(34.9)	(31.1)	For BCO, the earnings tend to be front-loaded (e.g., 1H14). The drop YoY was due to the dilution of stake from 20% to 17%
Non-recurring items & exceptional	(28)	14	78	449.3	(382.1)	
Pre-tax profit	1,077	1,163	1,096	(5.7)	1.8	
Taxation & minority	(133)	(114)	(112)	(1.6)	(15.9)	
Net profit	944	1,049	985	(6.2)	4.3	
EPS (HKD)	0.63	0.79	0.70	-11.1	10.4	
DPS (HKD)	0.24	0.10	0.26	160.0	8.3	
BPS (HKD)	13.63	13.67	14.23	4.1	4.4	
Balance sheet (HKD m)						
Advances to customer	97,978	103,686	105,230	1.5	7.4	Primarily driven by loans for use outside HK +4% HoH
Deposits from customers	129,843	139,358	142,580	2.3	9.8	According to management, the CASA has improved to 36% in 2H14
Key ratios (%)	%	%	%	bps	bps	
Ann. Return on equity	11.5	11.6	10.1	(152)	(139)	
Ann. Return on assets	1.15	1.21	1.08	(13)	(7)	
Net interest margin	1.81	1.79	1.73	(6)	(8)	
Cost / Income	53.4	49.9	52.2	235	(117)	
Loan to deposit ratio	75.5	74.4	73.8	(60)	(165)	
Tier I capital	10.4	10.9	11.4	50	96	CET1 improved due to higher profits and lower credit growth
Total CAR	14.5	15.8	16.3	50	178	
Gross NPL ratio	0.40	0.47	0.35	(12)	(5)	
Annualized credit costs	0.32	0.40	0.43	3	11	

Source: Deutsche Bank, Company data



Key operating trends

Figure 3: DSB net interest margin

	2H13	1H14	2H14	HoH (%)	YoY (%)
Interest income	2,285	2,416	2,516	4.2	10.1
Interest expense	(832)	(945)	(997)	5.5	19.9
Net interest income	1,454	1,471	1,519	3.3	4.5
Average Interest Earning Assets	160,628	164,367	175,652	6.9	9.4
Net interest margin (%)	1.82	1.79	1.73	(6)	(8)

Source: Deutsche Bank, Company data

Figure 4: Non-interest income break-up

(HKD m)	2H13	1H14	2H14	HoH (%)	YoY (%)
Fees & commissions	477	518	543	4.7	13.8
Less: Fees & commissions expenses	(123)	(114)	(115)	1.2	(6.3)
Net fees & commissions	354	404	427	5.7	20.7
Foreign exchange gain - net	114	76	118	54.6	3.4
Rental income	14	17	17	(0.5)	22.4
Profit from dealing activities	42	27	61	125.8	46.4
Dividend income from investments	6	9	8	(10.5)	21.4
Others	15	6	3	(53.9)	(80.7)
Total	545	540	634	17.5	16.4

Source: Deutsche Bank, Company data

Figure 5: Gross fee income break-up

(HKD m)	2H13	1H14	2H14	HoH (%)	YoY (%)
Credit related fees and commissions	43	62	74	19.8	(1.3)
Trade finance	33	42	31	(24.7)	(5.8)
Credit card	161	152	160	5.4	(0.8)
Securities brokerage and investment services	56	39	49	26.7	40.9
Insurance distribution and others	72	35	60	72.4	29.3
Retail investment funds and fiduciary services	61	81	90	10.2	45.1
Bank services and handling fees	27	29	30	2.3	9.2
Other fees	23	79	49	(38.1)	31.6
Total	477	518	543	4.7	13.8

Source: Deutsche Bank, Company data

Figure 6: Operating expenses

(HKD m)	2H13	1H14	2H14	HoH %	YoY %
Total staff costs	(647)	(639)	(678)	6.1	4.7
Rental of premises	(140)	(136)	(150)	10.5	7.7
Depreciation	(60)	(67)	(73)	9.1	21.5
Others	(220)	(161)	(223)	38.6	1.6
Total	(1,067)	(1,003)	(1,125)	12.1	5.4
%					
Cost-to-income ratio	53.4	49.9	52.2		

Source: Deutsche Bank, Company reports

The NIM contraction was due to a pick-up in funding costs, driven by competition in the market and flight for quality loans (e.g., slowdown in onshore China lending)

The improvement in non-interest income came primarily from higher trading (+126% HoH) and forex gain (+55% HoH)

Up HoH on higher insurance distribution (+72% HoH), securities (+27% HoH) and credit-related fees (+20% HoH)

The increase in cost-to-income ratio was seasonal; it stood at 52% and was lower than 2H13



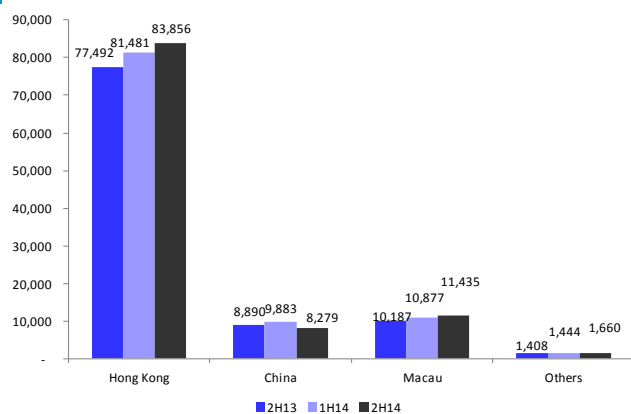
Figure 7: DSBG gross NPL and credit costs

(%)	2H13	1H14	2H14	bps HoH	bps YoY
Gross NPL ratio	0.40	0.47	0.35	(12)	(5)
Credit costs (Annualized)	0.32	0.40	0.43	3	11
NPL provision coverage	112.4	119.7	145.2	2,551	3,276

Source: Deutsche Bank, Company reports

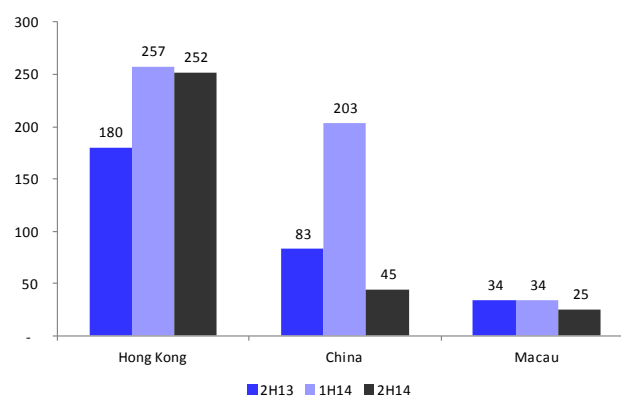
Despite improvement in NPL ratio, the bank continues to be cautious in Mainland China lending, as ~50% of bad debt provisions are related to the Mainland.

Figure 8: Gross loans and advances by geography (HKD m)



Source: Deutsche Bank, Company Report

Figure 9: Overdue advances by geography (HKD m)



Source: Deutsche Bank, Company Report

Figure 10: Loans and advances break-up

(HKD m)	2H13	1H14	2H14	HoH (%)	YoY (%)	Composition (%)
Industrial, commercial & financial sectors						
Property development	2,016	2,259	1,741	(22.9)	(13.6)	1.7
Property investments	15,122	15,667	15,753	0.5	4.2	15.0
Financial concerns	740	799	822	2.9	11.0	0.8
Stockbrokers	109	51	133	159.2	21.9	0.1
Wholesale and retail trade	4,007	4,304	4,497	4.5	12.2	4.3
Manufacturing	1,976	3,039	2,971	(2.2)	50.4	2.8
Transport, and transport equipment	5,051	5,135	4,612	(10.2)	(8.7)	4.4
Others	3,897	5,172	5,337	3.2	37.0	5.1
Sub-total	32,917	36,427	35,867	(1.5)	9.0	34.1
Individuals						
Loans for HOS/PSPS	1,081	1,030	963	(6.5)	(10.9)	0.9
Mortgages	18,041	19,106	19,452	1.8	7.8	18.5
Credit card advances	3,950	3,905	3,838	(1.7)	(2.8)	3.6
Others	6,880	7,891	8,355	5.9	21.4	7.9
Sub-total	29,952	31,932	32,608	2.1	8.9	31.0
Trade finance	5,918	6,300	6,517	3.5	10.1	6.2
Loans for use outside Hong Kong	29,191	29,028	30,238	4.2	3.6	28.7
Total Loans & Advances	97,978	103,686	105,230	1.5	7.4	100.0

Source: Deutsche Bank, Company data

Loan growth was up just 1.5% HoH, and it was flagged by management that it would trend down in 2H14. Loan growth was primarily driven by loans for use outside HK (+4.2% HoH), while corporate lending contracted (-1.5% HoH) and personal lending was up (+6% HoH). Property-related sectors saw tepid growth.



Figure 11: DSB investment portfolio break-up

(HKD m)	2H13	1H14	2H14	HoH %	YoY %
Trading Securities	6,336	6,534	6,850	4.8	8.1
Financial assets through P/L	56	80	130	62.0	131.5
Available for Sale	27,128	23,041	23,362	1.4	(13.9)
Held to maturity	5,669	9,657	10,833	12.2	91.1
Loan and receivable	1,063	0	0	-	-
Total Investment	40,252	39,312	41,175	4.7	2.3

Source: Deutsche Bank, Company data

More pick-up in HTM portfolio will lower hit to profits if rates start picking up

Valuation and risks

We value DSB based on a two-pronged fundamental GGM approach and combined M&A entities approach. The fundamental fair value is derived using the Gordon Growth Model ($P/B = ROE-g/COE-g$). For the sustainable ROE assumption, we use 9.5%, with cost of equity of 9.7% and long-term growth rate assumptions of 2.2%. Our long-term growth rate is derived from blended long-term ROE assumptions factoring in DSB's business mix in China (30%) and Hong Kong (70%). This provides us with a target price-to-book ratio of 0.97x P/B. The combined M&A entities approach is derived by applying a target P/B of 1.9x to average book value of FY2014E-15E. This fair value P/B multiple is based on current multiples of Dao Heng Bank and WLB after write-down in goodwill currently recognized in DBS and CMB. We have applied 25% and 75% weights to the combined M&A entities approach and fundamental fair value to derive our 12-month target price.

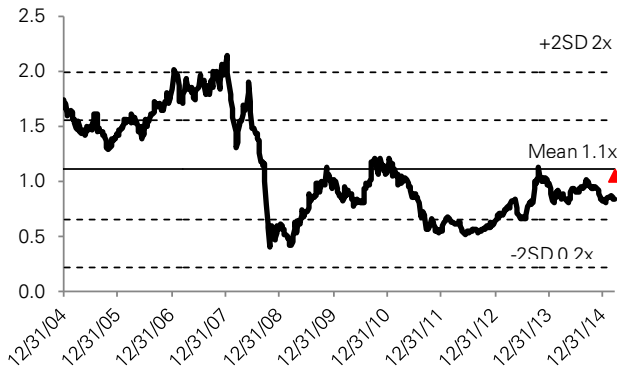
The key downside risks for DSBG are (1) severe deterioration in the export market, given its higher exposure to export-oriented small SMEs; (2) an asset quality issue in Chongqing, since DSBG has a 20% stake in Bank of Chongqing, which accounts for 14% of its book value; (3) a reversal in liquidity inflow and higher funding cost, given DSBG has greater reliance on time deposits, which account for 75% of its deposit base and (4) cancellation of M&A talks with WHB.

Valuation charts

DSB is currently trading at a significant discount to its historical P/B and P/E bands, due mainly to large investment provisions made since the global financial crisis in 2008. The unpredictability of these investment provisions has resulted in lower-than-consensus earnings results in the past few years. However, we believe this discount should start to narrow, as we expect fewer investment losses and more stable profits going forward.

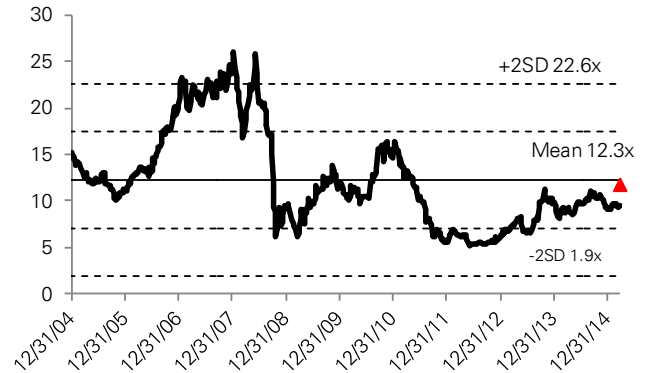


Figure 12: DSB – forward P/B valuation



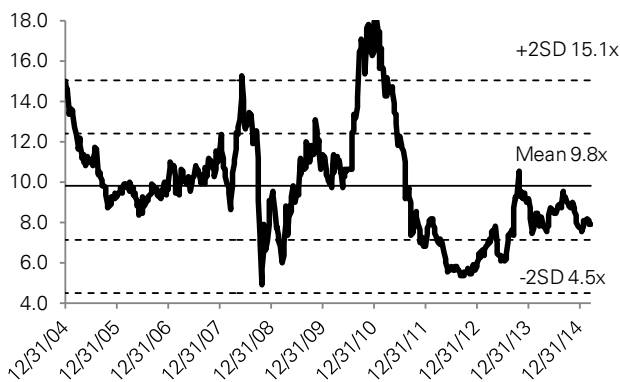
Source: Deutsche Bank

Figure 13: DSB – forward P/E valuation



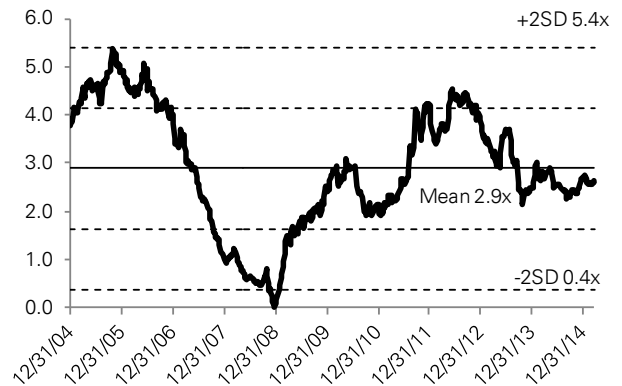
Source: Deutsche Bank

Figure 14: DSB – forward PPOP valuation



Source: Deutsche Bank

Figure 15: DSB – forward dividend yield valuation



Source: Deutsche Bank



Appendix 1

Important Disclosures

Additional information available upon request

Disclosure checklist

Company	Ticker	Recent price*	Disclosure
DSBG	2356.HK	13.08 (HKD) 25 Mar 15	7,14,15

*Prices are current as of the end of the previous trading session unless otherwise indicated and are sourced from local exchanges via Reuters, Bloomberg and other vendors. Data is sourced from Deutsche Bank and subject companies.

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Historical recommendations and target price: DSBG (2356.HK)

(as of 3/25/2015)



Previous Recommendations

- Strong Buy
- Buy
- Market Perform
- Underperform
- Not Rated
- Suspended Rating

Current Recommendations

- Buy
- Hold
- Sell
- Not Rated
- Suspended Rating

*New Recommendation Structure as of September 9,2002

1. 26/04/2013:	No Recommendation, Target Price Change HKD0.00	5. 30/03/2014:	Buy, Target Price Change HKD15.00
2. 21/07/2013:	Upgrade to Buy, Target Price Change HKD11.50	6. 30/07/2014:	Buy, Target Price Change HKD15.30
3. 16/09/2013:	Buy, Target Price Change HKD13.00	7. 28/09/2014:	Buy, Target Price Change HKD16.00
4. 22/10/2013:	Buy, Target Price Change HKD16.00		

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Notes:

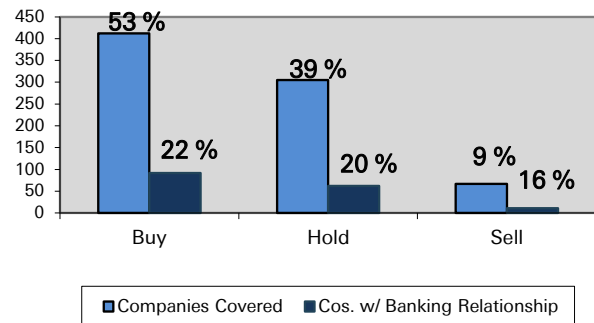
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Asia-Pacific Universe



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International locations

Deutsche Bank AG

Deutsche Bank Place
Level 16
Corner of Hunter & Phillip Streets
Sydney, NSW 2000
Australia
Tel: (61) 2 8258 1234

Deutsche Bank AG

Große Gallusstraße 10-14
60272 Frankfurt am Main
Germany
Tel: (49) 69 910 00

Deutsche Bank AG

Filiale Hongkong
International Commerce Centre,
1 Austin Road West, Kowloon,
Hong Kong
Tel: (852) 2203 8888

Deutsche Securities Inc.

2-11-1 Nagatacho
Sanno Park Tower
Chiyoda-ku, Tokyo 100-6171
Japan
Tel: (81) 3 5156 6770

Deutsche Bank AG London

1 Great Winchester Street
London EC2N 2EQ
United Kingdom
Tel: (44) 20 7545 8000

Deutsche Bank Securities Inc.

60 Wall Street
New York, NY 10005
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