

Sector analysis

Asia

# The start of something big?

## Temasek's quest for a pan-Asian bank

### Banks

**Temasek's purchase of Danamon and bid for BII with Deutsche Bank and Kookmin, respectively, call into question the group's intentions with respect to DBS. Either outright competition or a sale could be in order.**

**Regional ambitions undimmed.** Recent conversations with Temasek officials have reaffirmed the government holding company's desire to create a pan-Asian banking group, and recent purchases in Indonesia are definitely part of this aim.

**But whither DBS?** A surprising result of our conversations was the insight that DBS is no longer a key part of Temasek's regional banking strategy, perhaps a reason why the bank did not participate in either the Danamon purchase or the pending BII bid.

**Parent or competitor?** If Temasek is really to build a regional bank under one roof as per their plan, it will be difficult to keep from encroaching on DBS' existing turf or future expansion plans. How should investors react to the thought that DBS' largest shareholder (and its primary regulator) may soon be in active competition with the bank?

**What's the end-game?** Temasek and the Ministry of Finance have recently reorganized their shareholdings in DBS to place them all in a single vehicle. This could be a prelude to a disposal of DBS altogether, or to M&A with another bank.

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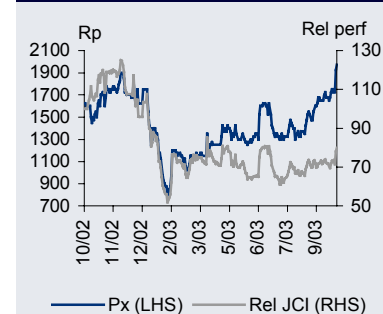
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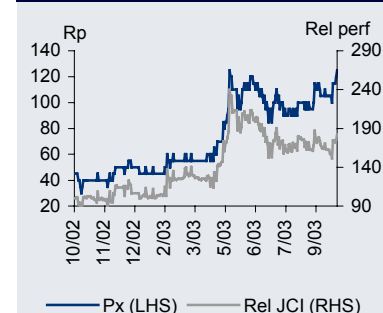
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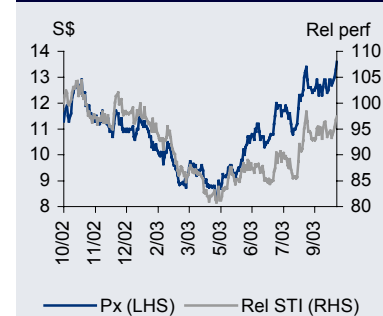
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**Bank Danamon price chart**


Source: Datastream, ING

**BII price chart**


Source: Datastream, ING

**DBS Group price chart**


Source: Datastream, ING

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## Spreading its wings

We have long heard from Temasek and from others in the Singaporean political sphere that one of the holding company's ambitions is to develop a pan-Asian bank, which would help in the development of Singapore as a regional financial centre. We have been confident for a long time that we knew how this would be accomplished—through the offices of DBS Group, Temasek's 30.6%-owned<sup>1</sup> banking affiliate.

However, Temasek's recent acquisition of Indonesia's Bank Danamon and bid for competitor Bank Internasional Indonesia with two separate partners—neither of which is DBS—calls into question the group's strategy going forward.

In fact, we were told by a senior official recently hired by Temasek that the holding company's plan for a pan-regional banking platform remains intact—but that shockingly DBS is no longer considered a part of this plan. It is not at all clear whether this represents an official or widespread view within Temasek, yet recent events would tend to indicate that DBS has become more independent of, and at the same time more peripheral to, Temasek's goals.

We are not in general sorry to see DBS free from governmental pressure to expand abroad by acquisition, given that the aggregate result of its previous deals has been a tremendous squandering of shareholders' money.

However, a potential danger to investors in DBS under the new Temasek strategy is that if Temasek does go about building a pan-Asian bank it will inevitably compete with DBS, and the potential conflict implicit in having DBS' largest shareholder (and primary regulator) as a competitor is not negligible.

This leads us to wonder if we will see divestment of Temasek's DBS shares—or potentially a sale of the bank to another party.

## What is Temasek?

Temasek is an investment and development arm of the Singaporean government, with all of its shares held by the Ministry of Finance. Temasek is charged with managing the government's stakes in both listed and unlisted companies on a long-term basis, with an emphasis on building international businesses headquartered in Singapore.

Major holdings include such leading listed companies as SIA, DBS, CapitaLand, and Chartered Semi, as well as extensive unlisted and property holdings.

**Fig 1 Major Temasek holdings**

Company	Primary businesses
DBS Bank	Finance
Keppel Corp.	Marine/Diversified
Neptune Orient Lines	Shipping
SembCorp Industries	Engineering/Logistics
Singapore Airlines	Airline
SMRT Corp.	Mass transit
SingTel	Telecom
PSA Corporation	Ports
Singapore Technologies	Semiconductors/Electronics
Singapore Power	Gas/Electric utility

Source: Company data

<sup>1</sup> Including the conversion of preferred shares, which are technically held by the Ministry of Finance.

## Back to the beginning

Temsek's first banking platform was of course the then Development Bank of Singapore—now better known as DBS—which started off the entire pan-Asian strategy. After absorbing POSB in 1998, DBS (with no small measure of government urging) turned its sights abroad.

### Why build up DBS?

Our conversations with Singaporean government officials and public policy experts dating back to the early 1990s gave us very good and consistent insight into Singapore's major self-perceived competition in the Asian financial sector—Hong Kong.

In the Lion City's battle with Hong Kong for financial supremacy (note that no one was yet worried about Shanghai), Hong Kong's claim to HSBC—a major global bank even then—was seen as a dominating advantage, even though it can be convincingly claimed that post the movement of HSBC's headquarters to London and the investment of a majority of the bank's portfolio in Europe and the US made it no longer truly a Hong Kong bank.

Even in relatively recent meetings with the central bank officials have expressed concern that Hong Kong's companies enjoy better access to capital than do Singapore's; this is seen as a factor which will tend to inhibit overall economic growth and not just that of the financial sector.

We're not at all certain we agree with this, as both Singapore and Hong Kong now have oodles of excess liquidity that banks would be more than happy to lend out, but its possible that in either a crisis or a sustained boom Hong Kong could have an edge.

How to solve the problem of Hong Kong's structural advantage?

### From national champion to regional champion

The collective response of Singapore's governing community was to try and turn DBS—essentially controlled by government entities at that time—into a large regional powerhouse in the hopes of countering, if not exceeding, HSBC and making Singapore the financial hub of ASEAN.

DBS' bank acquisitions were as follows:

**Fig 2 DBS Group's bank acquisitions**

Bank	Market	Year Purchased
POSB	Singapore	1998
Thai Danu	Thailand	1998
Kwong On	Hong Kong	1998
Bank of SE Asia	Philippines	1998
BPI	Philippines	1999
Dao Heng	Hong Kong	2001

Source: Company data, ING estimates

**POSB**

DBS purchased POSB (the former Post Office Savings Bank) from the Singaporean government in July 1998 for S\$1.6 billion in preferred shares, or 1.37x tangible equity. POSB had assets of S\$26.9 billion<sup>2</sup> and tangible equity of S\$1.2 billion.

**Thai Danu**

DBS took control of Thai Danu Bank in 1998, injecting some THB6 billion (\$US151m) in new equity in return for a 51.7% stake. By mid-2000, the bank required additional capital, and DBS again subscribed for an estimated THB7bn (US\$177m) in new equity as well as THB7.5bn (US\$189m) in capital securities, bringing the total investment to THB20.5bn (US\$518m).

**Bank of Southeast Asia**

DBS purchased a majority stake in Bank of Southeast Asia ("BSA") in January 1998, buying 60% of the company for at least PHP1.2 billion (approx US\$29m at then-prevailing exchange rates). The bank, which had 18 branches and assets of approximately PHP11 billion (US\$266m) at acquisition, was merged with DBS' Manila branch and renamed DBS Bank Philippines.

Subsequently, DBS increased its stake in BSA to 72%, and then sold the entire company (including the former DBS assets) to affiliate BPI in August 2001 for PHP1.6bn (US\$30m at then-prevailing exchange rates).

**Kwong On Bank**

DBS purchased 87.3% of Hong Kong's Kwong On Bank in December 1998 for an initial cost of HK\$3.01bn (US\$386m) plus performance accelerators, a valuation of 0.75x stated book or 0.87x adjusted book. Kwong On had 31 branches and assets of HK\$28.6bn (US\$3.7bn) at acquisition<sup>3</sup>, with book equity of HK\$4.6bn (US\$590m) which was reduced by approximately HK\$648m (US\$83m) due to additional general provisioning required upon review of the bank's books.

The acquisition of 100% of KOB was completed in April 2002, when DBS purchased the remaining 12.7% for HK\$903.8m (US\$116m). KOB was merged with Dao Heng and DBS' other Hong Kong operations in July 2003 to form DBS Bank (Hong Kong).

**BPI**

During 1999, DBS executed several transactions to purchase a 19.7% stake in BPI for S\$1.2bn; the company now has a deemed 20.8% stake which is partially held through the group's 40% stake in Ayala-DBS Holdings, a joint venture with the controlling shareholders of BPI. BPI currently has assets of PHP400bn (US\$ 7.3bn).

**Dao Heng Bank**

In April 2001 DBS acquired 100% of Dao Heng Bank from controlling owner Guoco and from public shareholders, paying HK\$42bn (US\$5.3bn) or 3.2x book value. The steep price bought DBS the #5 bank in Hong Kong (counting HSBC and Hang Seng separately) with 70 branches and HK\$135bn (US\$17bn) in assets.

Dao Heng was merged with DBS' other Hong Kong operations in July 2003 to form DBS Bank (Hong Kong).

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<sup>2</sup> At June 30, 1998.

<sup>3</sup> At June 30, 1998.

## Why not keep going?

Temasek has an admittedly long-term view on its investments, so that the fact that most of these acquisitions haven't really worked out for DBS in terms of generating shareholder value so far may not be dispositive. What is undeniable is that DBS has built the only home-grown Asian regional bank, with a decent brand name and pretty good core banking systems.

So why stop here? If you are looking to build a pan-Asian bank, you could do much worse than to begin with DBS. After all, it would be almost impossible to duplicate its position in Singapore and Hong Kong, two of the largest markets.

We suspect the issue has to do with the attitude of DBS' public shareholders towards further acquisition—they are decidedly not keen. It may be that Temasek is going to start over with a 100% owned vehicle and keep things private all the way.

## Indonesia

Indonesia is one of the natural markets for expansion by the Singaporean banks; the other—Malaysia—has long been off-limits to a frustrated DBS, although both OCBC and UOB have significant outposts there. Yet the Singaporean banks all passed up chances to buy BCA, Danamon, and Niaga, although UOB has finally gotten into the action by submitting a bid for BII.

In a bold move, Temasek has already acquired a controlling stake in one Indonesian bank (Danamon) and is now bidding for another (BII). We view this as a happy confluence of the holding company's desire to promote development of the region and help stimulate the Indonesian economy with the realization that banking assets in Indonesia are extremely cheap and represent a rare opportunity to generate cash flow for its pan-Asian strategy.

Somewhat curious, however, is the use of two different partners to bid for the banks, along with the contention that Temasek management has no intention of merging the two. This may be driven by a desire to avoid inflaming political sensibilities in Indonesia by minimizing the appearance of Singaporean government investment in the country.

Details of the two banks involved are as follows:

### Danamon

Bank Danamon is Indonesia's fifth-largest bank<sup>4</sup>, with a market share of approximately 4.7% of assets, 5.0% of loans and 4.3% of deposits as of March 2003. The Asia Finance Consortium acquired a 51% shareholding in Danamon for Rp1,202/share from the Indonesian Banking Restructuring Agency (IBRA) in June 2003. The split within the Asia Finance consortium is 85% Temasek Holdings of Singapore and 15% Deutsche Bank, translating to a 43.3% stake for Temasek and 7.6% stake for Deutsche.

We also learnt during a recent company visit that Temasek has further bought more shares from the market. Hence, the consortium now owns 61.9% of Danamon. We estimate that Temasek's ownership of Danamon has been increased to 54.3% while Deutsche Bank's ownership remains at 7.6%. Danamon's management indicates that Temasek plans to continue increasing its ownership in the bank.

### BII

BII is the sixth largest bank in Indonesia, with assets of Rp35tr as of June 2003. It was formerly owned by the Widjaya family's Sinar Mas group (which also owns the problematic Asia Pulp & Paper). BII had to undergo a second recapitalisation by IBRA as its related party loans owed by Sinar Mas group went into default.

BII's major assets are its branch network and strong credit card business, with 425 thousand cards in issue at year-end 2002. BII used to be the second largest credit card issuer (after Citibank); however, due to its recent problems, we believe that the bank's credit card ranking has now slipped to third or fourth.

The bank is well-capitalized, with a CAR of 25.9% as of June 2003, mainly due to a low LDR of 29.3%. BII's earning asset mix is 65% govt bonds, 27% loans, 3% marketable securities, 4% interbank placements, and 1% SBI.

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<sup>4</sup> For full details of our view on Bank Danamon, please refer to our recent research report "[Bank Danamon: The next blue chip](#)" dated September 10, 2003.

However, BII's net interest margin are the lowest in the sector (even lower than Bank Mandiri) at 1.92%. Its ROA and ROE in 1H03 were also lower than Mandiri's at 0.8% and 17.2% respectively.

BII's low margins are caused by its high proportion of hedge bonds (paying only SIBOR plus 2% while its cost of funds is an estimated 7%), which account for 30% of total bonds. Another 24% are floating rate bonds while the balance (46%) are fixed rate bonds. Despite BII's large proportion of higher-yielding fixed rate bonds (paying coupons of 13-14% on average), this is offset by the extremely low yields on hedge bonds, while floating rate bonds are currently yielding only 8.6%.

BII has 250 branches and 600 ATMs, a good-sized network but far behind industry leader BCA (778 branches and 2,431 ATMs). While NPLs (category 3-5) are only 5% of gross loans, BII has another 18% of special mention loans (category 2). Similar to Bank Mandiri, BII's high category 2 loans give rise to concerns whether these loans could deteriorate into NPL.

Book value of BII stood at Rp67/share as at June 2003 (on an equity base of Rp3.2tr).

#### **Temasek again a bidder**

IBRA announced on September 27 that it had received three preliminary non-binding bids for the planned divestment of a controlling 51% stake of BII. The three consortia are:

- Sorak Financial Holdings, which consists of Korea's Kookmin Bank teamed up with Asia Financial Holdings of Singapore (a Temasek entity which previously won the bid for a 51% stake of Bank Danamon)
- The Panin Bank consortium, comprised of Bank Panin (PNBN IJ/JK, Rp325, BUY, Target: Rp380) and Australia's ANZ. ANZ currently has a 29% stake in Bank Panin.
- DBS rival UOB of Singapore, bidding alone.

Press reports indicate that Standard Chartered Bank submitted a bid as well but directly to ABN Amro (which acts as IBRA's advisor for the sale of a 51% stake of BII) and not to IBRA as the other three consortia did. IBRA has not yet decided whether Stanchart is following the correct procedure by submitting its bid directly to ABN Amro.

Bidders will submit their final bids in the 4th week of October followed by the announcement of a winner in the 1st or 2nd week of November.

## What does this mean for DBS?

### Potential divestment

Temasek may be planning to just let DBS go its own way, with eventual divestment of its remaining shares into the market. There are some signs of this apart from the comments about another regional platform—the MoF and Temasek have concentrated all of their holdings of DBS common within a single Temasek-controlled entity within the past month. This would make it easier to sell the shares in the market.

### Sale

The ownership reshuffling would also make it easier to sell Temasek's DBS stake to another bank, or to participate in a "merger of equals." Negotiations with Australia's Westpac came to naught a few years ago, but the Aussie banks are as hamstrung in their home market as ever, and might welcome a merger that would let them escape their home markets.

**Fig 3 DBS vs. potential suitors**

	Market Cap	P/BV	PER
Bank	(US\$m)	FYE02A	FY03F
<b>DBS</b>	<b>11,572</b>	<b>1.38</b>	<b>21.25</b>
ANZ	18,724	2.71	12.34
Westpac	19,975	2.89	14.29
NAB	31,980	2.34	12.23
CBA	23,800	1.91	13.52
StanChart	17,282	2.54	17.80

Source: Bloomberg, I/B/E/S, ING estimates.

We think that DBS would be best-off with Standard Chartered, with the following summary rationale:

- StanChart's branches in Singapore could be folded into the existing DBS network with virtually 100% cost savings.
- The merger of StanChart's Hong Kong operations with those of DBS would make Dao Heng a clearing bank—essential for getting salary payroll accounts and thus high-margin transaction deposits—and would give Standard a domestically-chartered bank thus enabling the group to qualify for additional China branches under CEPA.
- StanChart is one of the largest foreign banks in Malaysia, a market that DBS has tried unsuccessfully to penetrate for some time. There should be a significant overlap in customer base between Singapore and Malaysia, particularly on the business and SME side.
- Each bank now owns a small subsidiary in Thailand (Nakornthon and Thai Danu); these could be merged for cost savings.
- DBS' processing could be offloaded to existing StanChart back-office complexes in Chennai and Kuala Lumpur.



## Back to the fold

In the end, perhaps nothing will come of this speculation. DBS management have remarked before that they felt investors would punish the stock if the bank incurred Indonesian risk; while we tend to disagree this is a valid position.

Under this scenario, Temasek might eventually inject or sell Danamon and/or BII to DBS, once they have been rehabilitated and are no longer of concern to investors.

**Fig 4 Ratings and target price**

<b>Company</b>	<b>Closing price 10/3/03</b>	<b>ING rating</b>	<b>Price target</b>
DBS (S\$)	13.60	BUY	13.74
Standard Chartered (HK\$)	112.50	BUY	112.00
Bank Danamon (Rp)	1,975.00	BUY	2,100.00
BII (Rp)	125.00	Not Rated	N/A

Source: ING

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**Hold:** Share price movement of between -10% and +10% is expected on a 12-month view.

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