DNB Bank Strategy Update: Keen Focus on Achieving Higher Returns

On 16 November at its Capital Markets Day, DNB Bank provided investors with a strategy update. Now that the group's capital position has reached the desired level, we note management's renewed focus on achieving its greater than 12% ROE target. In addition, management reassured on the asset quality of the loan portfolio.

DNB's long-term ratings are A+ and short-term ratings are S-1, all with Stable Outlook. Following the strategy update, our opinion is that the ratings and their outlook remain well positioned.

As of end-September 2016, DNB had a CET1 ratio based on Basel I transitional rules of 15.7% and a leverage ratio of 6.9%. The bank has achieved these robust levels driven by the demands of its regulator. The Norwegian FSA has clarified that the bank should meet a 14.7% CET1 requirement, which includes a Pillar 2 component of 1.5% and various systemic buffers of 5%. In addition, the regulator expects the bank to maintain a management buffer of around 1%. Consequently, DNB has raised its CET1 capital target to around 15.7% for the years 2017-2019.

The Chief Risk Officer and the heads of the Energy and the Shipping, Offshore and Logistics divisions delivered reassuring messages on the loan portfolio. There have been no spillover effects across the loan portfolio from oil-related industries, with asset quality across the retail, general corporate and commercial real estate portfolios remaining stable. The probability of default for the entire loan portfolio continues to be low at just under 1%, excluding non-performing and doubtful loans.

The Oil & Gas and Oilfield Services sectors, which represent 4.7% of group exposure at default (EAD) have stabilized and management believes that the downside is limited. The Offshore sector (2.7% of EAD, NOK 53bn), however, is expected to remain challenged as low oil prices are not the only factor negatively impacting the industry. Encouragingly, the negative migration in credit quality appears to be levelling off and approximately 35% of Offshore EAD has been restructured and recapitalized. Meanwhile, the group also has 2.1% EAD to the dry bulk and container shipping sectors where some negative credit migration is still expected.

Management reiterated its guidance for up to NOK 18bn in total provisions over the 2016-2018 period, with the highest provisions to be incurred during the first part of the period. For 9M 2016, the bank incurred NOK 5.7bn in impairments.

The group is focused on achieving a ROE above 12% in 2019 while acknowledging the challenges posed by a high capital base, low interest rates and higher than normal loan-loss provisions. For 9M 2016, ROE was 9.9%. To achieve its target, management is planning on improved net interest income, higher fee and commission income, continued cost efficiency (below 40% cost/income ratio target), normalized loan loss provisions (about NOK 4bn annually) and the profitable and efficient use of capital.

Of note, DNB intends to increase lending to the personal customer and SME segments while rebalancing and decreasing credit exposure to the large corporates segment. There is already evidence of a reduction in exposures related to the oil sector. Consequently, RWAs and loan growth are expected to remain stable over the next couple of years. In addition, the group will aim to achieve higher weighted average combined spreads; which have been relatively stable over the last few years at around 1.3%. Management believes this is possible due to improving market conditions; competitors will need to adjust pricing in order to improve profitability and bolster capital positions.

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