

HSBC Holdings PLC (0005)

Attractive Valuation but uncertain prospect

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Industry: Banking

1 H 2012 Interim Result Review

Rating: Accumulate Close Price:\$65.60 Target Price: \$75

Summary of interim result	1 H 2012	2 H 2011	1 H 2011	Target
ROE	10.5	9.5	12.3	12-15%
Cost Efficiency Ratio	57.5	57.5	57.5	48-52%
EPS (USD)	0.45	0.41	0.51	N/A
Core tier 1 CAR	11.3	10.1	10.8	9.5-10.5%

Source: Company report. PSR

On May 11, 2011 the Group's strategy day, senior management published goals for the future as follows:

- 1) to maintain a 12-15% return on equity
- 2) by 2013, reduce costs, 2.5-3.5 billion USD, the cost-efficiency ratio achieve 48-52%
- 3) Keep the target payout ratio in 40-60%
- 4) Restructure the global business

Summary of 1H 2012 interim result

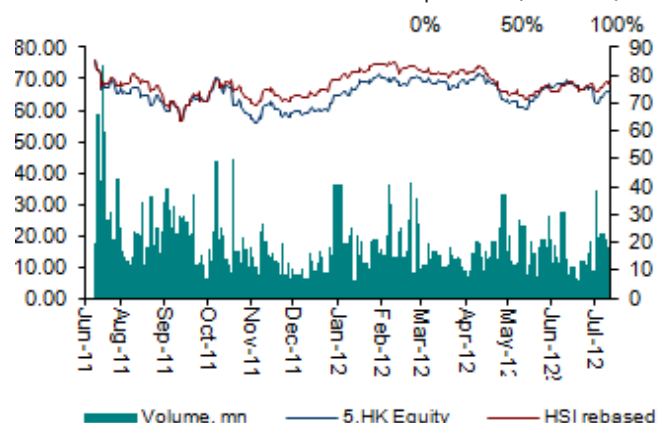
HSBC interim results in line with our expectation, basic earnings per share was \$ 0.45 the profit before tax (PBT) was \$ 12.7 billion USD (as below), an increase of 11% y/y, but excluding gains on disposal \$ 4.3 billion, and a negative changes in securities revaluation 2.2 billion, the actual revenue rose 4 % only, the actual profit before tax decreased by 3% to \$ 10.6 billion. As we predicted, the Asia-Pacific region, Hong Kong, and Latin America as the engine of growth, Hong Kong and the Asia-Pacific region's PBT increased by \$ 1.3 billion, Hong Kong and the Asia-Pacific region contributed about 66% of the group's PBT. The Group's core business recorded a comprehensive declining in net interest income, net fee income and trading income, fell by 4.2%, 5.6% and 6% y/y respectively. However, other operating income surged by 2.7 times, supporting group's income growth in 1 H 2012.

Group booked billions in provisions, in legal issues, increase nearly \$ 1.9 billion y/y, including 700 million provisions related to US anti – money laundering, 1.3 billion provisions for UK customers redress. As the related cases are processing, we expect the compensation and fine will be far more than this number, while the related provision for the coming year may be significant increased; investors should pay close attention to the news.

Since the final results of 2011, our target price has been maintained at \$75 HKD, as the EPS of interim result was in line our expectation (0.45 U.S. dollars / 3.5 million), we were more conservative than the market expected, the market consensus was 80 HKD, as the Group's core earnings fell, we believe the market will lowered the target price and earnings forecasts of HSBC, and closer to our target price, the Group is suffering form the legal cases, the amount of fines and compensation is uncertain, we will pay close attention to the operating performance.

If the Group's core profitability does not significantly improve in Q3 as we expected, we may downgrade HSBC's investment rating, and cut the target price. As the earning of interim result is in line with our expectation, we maintain out target price at \$75 HKD, with the investment rating "accumulate"

HSBC		
Rating	2.00	Accumulate
- Previous Rating	2.00	Accumulate
Target Price (HKD)	75	
- Previous Target Price (HKD)	75	
Closing Price (HKD)	65.60	
Expected Capital Gains (%)	14.3%	
Expected Dividend Yield (%)	11.7%	
Expected Total Return (%)	26.1%	
Raw Beta (Past 2yrs weekly data)	-	
Market Cap. (HKD mn)	154,428	
3M Average Daily T/O (mn)	16.8	
52 week range (HKD)	56 - 77.05	
Closing Price in 52 week range		



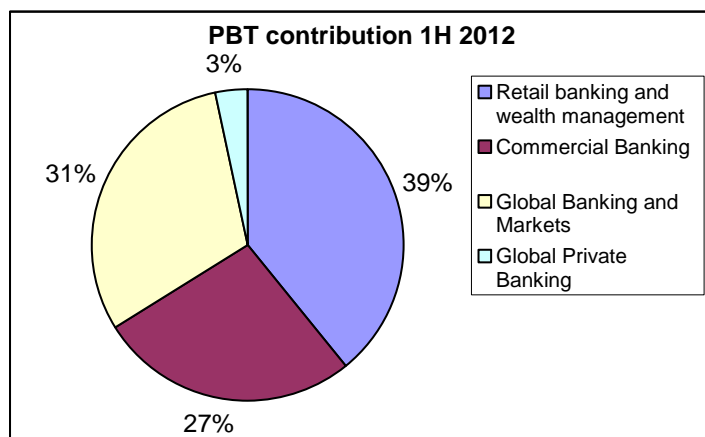
Source: PSHK Company report

Analyst
Phillip Research Team
+65 65311240
+65 63367607
research@phillip.com.sg

PBT Contribution in interim result

By Global Business (USD Mn)	1 H 2012	1 H 2011
Retail Banking & Wealth Management	6,410	3,126
Commercial Banking	4,429	4,189
Global Banking and Markets	5,047	4,811
Global Private Banking	527	552
Other	-3,676	-1,204
Profit Before Tax	12,737	11,474

Source: PSR, Company report



Source: PSR, Company report

By Geographical Regional (USD Mn)	1 H 2012	1 H 2011	2 H 2011	1 H 12/11 Change (%)
Europe	-667	2,147	2,524	-131%
Hong Kong	3,761	3,081	2,742	22%
Rest of Asia Pacific	4,372	3,742	3,729	17%
Middle East	772	747	745	3%
North America	3,354	606	-506	453%
Latin America	1,145	1,151	1,164	-1%
Total Profit before tax	12,737	11,474	10,398	11%

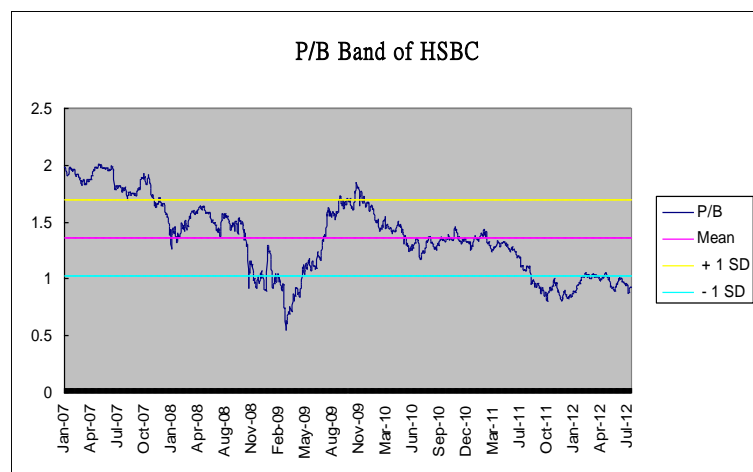
Source: PSR, Company report

Dividend Policy

Year	Dividend Per Share (HK\$)	Earning Per Share (HK\$)	Payout ratio
2000	3.39	5.92	57%
2001	3.74	4.59	81%
2002	4.12	5.22	79%
2003	4.67	6.54	71%
2004	5.14	5.22	98%
2005	5.68	10.5	54%
2006	6.3	10.74	59%
2007	7	12.76	55%
2008	4.98	3.66	136%
2009	2.65	2.65	100%
2010	2.808	5.6	50%
2011	3.19	7.16	45%
2012(E) 1 H	1.4	3.5	40%
2012(E) 2 H	2.05	4.2	49%

Source: PSR, Company report

Valuation



Source: Company report, PSR, Bloomberg

Financial Status

Financial Report	2010	2011	2012 (E)	2013 (E)
US\$ Million				
Interest Income	58,345	63,005	65,525	68,474
Interest Expense	-18,904	-22,343	-23,460	-24,469
Net interest income	39,441	40,662	42,065	44,005
Fee Income	21,117	21,497	22,786	23,629
Fee Expense	-3,762	-4,337	-4,420	-4,597
Net Fee Expense	17,355	17,160	18,366	19,032
Trading income excluding net interest income	4,680	3,283	3,723	3,527
Net interest income on trading activities	2,530	3,223	3,520	3,320
Net Trading income	7,210	6,506	7,243	6,847
Changes in fair value of the long term debt issued and related derivatives	-258	4,161	3,121	2,103
Net income/(expense) from other financial instruments designated at fair value	1,478	-722	1,532	1,898
Net income/(expense) from financial instruments designated at fair value	1,220	3,439	4,653	4,001
Gains less losses from financial investment	968	907	982	982
Dividend income	112	149	153	153
Net earned insurance premiums	11,146	12,872	13,321	13,321
Other operating income	2,562	1,766	1,923	1,923
Total operating income	80,014	83,461	88,706	90,264
Net insurance claims incurred and movement in liabilities to policyholders	-11,767	-11,181	-12,322	-12,630
Net operating income before loan impairment charges and other credit risk provisions	68,247	72,280	76,384	77,634
Loan impairment charges and other credit risk provisions	-14,039	-12,127	-13,221	-13,672
Net operating income	54,208	60,153	63,163	63,962
Employee compensation and benefits	-19,836	-21,166	-21,344	-21,876
General and administrative expenses	-15,156	-17,459	-18,515	-18,790
Depreciation and impairment of intangible assets	-1,713	-1,570	-1,843	-1,590
Amortisation and impairment of intangible assets	-983	-1,350	-1,520	-1,590
Total operating expenses	-37,688	-41,545	-43,222	-43,846
Operating profit	16,520	18,608	19,941	20,116
share of profit in associates and joint ventures	2,517	3,264	3,523	3,763
Profit before tax	19,037	21,872	23,464	23,879
Tax expense	-4,846	-3,928	-4,213	-4,213
Profit for the year	14,191	17,944	19,251	19,666
Profit attributable to shareholders of the parent company	13,159	16,797	18,085	18,496
Profit attributable to non-controlling interests	1,032	1,147	1,154	1,170
	US \$	US \$	US \$	US \$
Basic earnings per ordinary share	0.73	0.92	0.987	1.01
Diluted earnings per ordinary share	0.72	0.91	0.977	1

Source: Reuters Company, PSR

Per Share Data \$	2010	2011	2012 (E)	2013 (E)
EPS	0.73	0.91	0.977	1.01
DPS	0.36	0.41	0.44	0.45
Payout ratio	0.49	0.45	0.45	0.45
Book Value	7.94	8.48	9.017	9.577

Source: Company, PSR

Balance Sheet	2010	2011	2012 (E)	2013 (E)
US\$ Million				
Cash & Interbanking Assets	1,166,087	1,266,762	1,355,435	1,409,653
Net Loans	1,166,637	1,121,416	1,188,701	1,239,815
Long Term Assets	121,965	167,401	205,903	214,139
Total Assets	2,454,689	2,555,579	2,750,040	2,863,607
Payables and Accrued Expenses	13,906	13,106	13,815	14,091
Deposits	1,338,309	1,366,747	1,499,252	1,532,332
Other Current Liabilities	410,729	485,138	531,262	592,037
Total Long Term Debt	33,387	30,606	32,025	34,328
Other Liabilities	510,691	501,257	509,081	517,397
Total Liabilities	2,307,022	2,396,854	2,585,435	2,690,185
Total Equity	147,667	158,725	164,605	173,422

Source: Reuters, Company, PSR

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Please contact Phillip Securities Research at [65 65311240] in respect of any matters arising from, or in connection with, this document.

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Contact Information (Singapore Research Team)

Chan Wai Chee
CEO, Research
Special Opportunities
+65 6531 1231
yebo@phillip.com.sg

Lee Kok Joo, CFA
Head of Research
S-Chips, Strategy
+65 6531 1685
leekj@phillip.com.sg

Joshua Tan
Macro Strategist
Global Macro, Asset Strategy
+65 6531 1249
joshuatan@phillip.com.sg

Magdalene Choong, CFA
Investment Analyst
Gaming, US
+65 6531 1791
magdalenechoongss@phillip.com.sg

Go Choon Koay, Bryan
Investment Analyst
Property
+65 6531 1792
gock@phillip.com.sg

Derrick Heng
Investment Analyst
Transportation, Telecom.
+65 6531 1221
derrickhengch@phillip.com.sg

Ken Ang
Investment Analyst
Financials
+65 6531 1793
kenangwy@phillip.com.sg

Travis Seah
Investment Analyst
REITS
+65 6531 1229
travisseahhk@phillip.com.sg

Research Assistant
General Enquiries
+65 6531 1240 (Phone)
+65 6336 7607 (Fax)
research@phillip.com.sg

Ng Weiwen
Macro Analyst
Global Macro, Asset Strategy
+65 6531 1735
ngww@phillip.com.sg

Contact Information (Regional Member Companies)

SINGAPORE

Phillip Securities Pte Ltd
Raffles City Tower
250, North Bridge Road #06-00
Singapore 179101
Tel : (65) 6533 6001
Fax : (65) 6535 6631
Website: www.poems.com.sg

MALAYSIA

Phillip Capital Management Sdn Bhd
B-3-6 Block B Level 3 Megan Avenue II,
No. 12, Jalan Yap Kwan Seng, 50450
Kuala Lumpur
Tel (603) 21628841
Fax (603) 21665099
Website: www.poems.com.my

HONG KONG

Phillip Securities (HK) Ltd
Exchange Participant of the Stock Exchange of Hong Kong
11/F United Centre 95 Queensway
Hong Kong
Tel (852) 22776600
Fax (852) 28685307
Websites: www.phillip.com.hk

JAPAN

Phillip Securities Japan, Ltd.
4-2 Nihonbashi Kabuto-cho Chuo-ku,
Tokyo 103-0026
Tel: (81-3) 3666-2101
Fax: (81-3) 3666-6090
Website: www.phillip.co.jp

INDONESIA

PT Phillip Securities Indonesia
ANZ Tower Level 23B,
Jl Jend Sudirman Kav 33A
Jakarta 10220 – Indonesia
Tel (62-21) 57900800
Fax (62-21) 57900809
Website: www.phillip.co.id

CHINA

Phillip Financial Advisory (Shanghai) Co. Ltd
No 550 Yan An East Road,
Ocean Tower Unit 2318,
Postal code 200001
Tel (86-21) 51699200
Fax (86-21) 63512940
Website: www.phillip.com.cn

THAILAND

Phillip Securities (Thailand) Public Co. Ltd
15th Floor, Vorawat Building,
849 Silom Road, Silom, Bangrak,
Bangkok 10500 Thailand
Tel (66-2) 6351700 / 22680999
Fax (66-2) 22680921
Website www.phillip.co.th

FRANCE

King & Shaxson Capital Limited
3rd Floor, 35 Rue de la Bienfaisance 75008
Paris France
Tel (33-1) 45633100
Fax (33-1) 45636017
Website: www.kingandshaxson.com

UNITED KINGDOM

King & Shaxson Capital Limited
6th Floor, Candlewick House,
120 Cannon Street,
London, EC4N 6AS
Tel (44-20) 7426 5950
Fax (44-20) 7626 1757
Website: www.kingandshaxson.com

UNITED STATES

Phillip Futures Inc
141 W Jackson Blvd Ste 3050
The Chicago Board of Trade Building
Chicago, IL 60604 USA
Tel +1.312.356.9000
Fax +1.312.356.9005

AUSTRALIA

Octa Phillip Securities Ltd
Level 12, 15 William Street,
Melbourne, Victoria 3000, Australia
Tel (03) 9629 8288
Fax (03) 9629 8882
Website: www.octaphillip.com