

Company Update

HSBC

Hong Kong | Financials

Rating BUY (as at 7 December 2020)
 Last Close HKD 43.75
 Fair Value HKD 48.2

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Dividend debate

- **Update on potential dividend resumption by regulator**
- **Robust capital position**
- **Stabilizing outlook**

Investment thesis

HSBC, with its strong capital position, offers sustainable and relatively high dividends. The bank is set to redeploy and reposition its capital for high growth areas in Asia. While these markets could be exposed to economic slowdown, the Group's presence in growing trade corridors and economic zones could continue provide growth opportunities.

Investment summary

- **Update on potential dividend resumption by regulator** – The Bank of England (BOE) will publish its Financial Stability Report on 11th December. There are possibilities that BOE could provide an update on dividend suspensions on that date given the current dividend and buyback ban expires at the end of this calendar year. The Swiss and Nordic regulators are already allowing dividend. The ECB is also indicating moving towards “case-by-case” approach rather than a blanket ban. Given that the BOE supervises smaller number of banks when compared to the European Central Bank (ECB), it is expected that the BOE is likely to adopt a “case-by-case” and differentiated approach in dividend resumption.
- **Robust capital position** – HSBC's strength in its capital position with Common Equity Tier 1 (CET1) ratio at 15.6%, which is well above the company's target should support a potential return of dividends and buybacks. Management highlighted that they would restart dividend at a conservative level, subject to regulatory approval. Consensus is estimating a dividend of US11cents in 4Q20e.
- **Stabilizing outlook** – Management highlighted at its 3Q20 investor call that they were comfortable with the consensus net interest income estimates in 2021e, which is at around US\$25-26bn. Also, the credit

Security information

Ticker	5 HK
Market Cap (USD bn)	875.8
Daily turnover (HKD m)	1,493.8
Free Float	92%
Shares Outstanding (m)	20,313
Top Shareholder	PING AN INSURANCE GR 8.14%

Price performance chart



Financial summary

US\$bn	2019	2020E	2021E
Net interest income	30.5	27.4	26.1
Pre-provision profits	16.1	17.8	17.8
Distributable profits	6.0	5.1	8.5
EPS (US\$)	0.6	0.3	0.5
DPS (US\$)	0.5	0.1	0.3

Key ratios

%	2019	2020E	2021E
ROAA	1.6%	1.4%	1.8%
ROAE	4.0%	3.5%	5.3%
Net interest margin	1.6%	1.4%	1.3%
NPL ratio	1.3%	1.3%	1.3%
Core Tier-1 ratio	14.7%	15.1%	15.3%

Source: Bloomberg, Company, Internal estimates

charges for FY20e is likely to be at the low end of the guidance range of US\$8-13bn. We expect a new set of financial targets to be communicated at 4Q20 results announcement, including Return of Tangible Equity (with the current target of 10-12% appears aggressive amid Covid19 outbreak and the ultra-low interest rate environment). The potential dividend resumption in 2021e would be a positive catalyst for share price but would still depend on economic outlook and subject to regulatory approval. Key issue to watch out for would be the interplay of Brexit in the near-term. The stock is trading at 0.66x forward P/B and 4.4% FY21e dividend yield. We maintain our earnings estimates unchanged and raise our Fair Value estimate at HK\$48.2 which is set at -1 s.d. to historical average as (vs. previously at -2 s.d. to historical average) on the back of a stabilizing outlook.

Potential catalysts

- A faster-than-expected US rate hike and a stronger global economy
- Better-than-expected cost controls
- A rebound in its Global Banking & Markets revenue
- Smooth execution of the new strategic plan

Investment risks

- Regulatory requirements and pressure could result in the bank holding more capital and incurring higher costs, potentially dampening future profitability
- Brexit could adversely affect economic growth, financial stability and asset prices in the UK - slower-than-expected growth and unexpected financial instability would dampen potential profitability
- Rising protectionism that could have a negative impact on the global trade and macroeconomic outlook

Valuation analysis

	Price/Earnings		Price/Book		Dividend Yield (%)		ROE (%)	
	2020E	2021E	2020E	2021E	2020E	2021E	2020E	2021E
HSBC HOLDINGS PLC (5 HK)	21.5	13.2	0.7	0.7	1.7	4.6	2.5	4.2
STANDARD CHARTERED PLC (2888 HK)	16.2	10.5	0.5	0.4	1.3	2.9	2.1	3.9
HANG SENG BANK LTD (11 HK)	15.1	14.5	1.5	1.4	3.8	4.4	10.0	10.4
BOC HONG KONG HOLDINGS LTD (2388 HK)	9.4	9.3	0.9	0.8	4.7	5.4	9.6	9.4

Source: Bloomberg

Price/Earnings chart



Source: Bloomberg

Price/Book chart



Source: Bloomberg

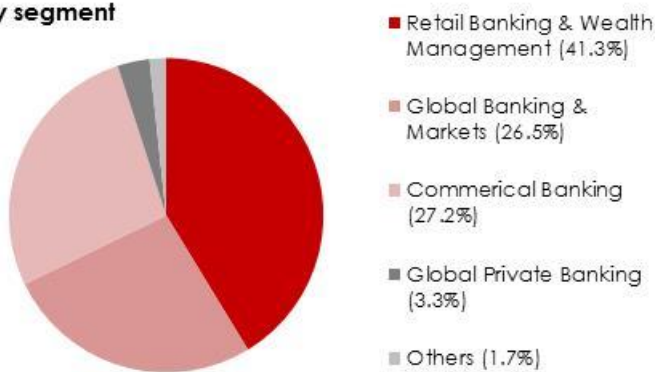
Company overview (as of 31 December 2019)

Company description

HSBC Holdings is a leading international financial services group headquartered in the UK that has a strong presence in the UK and Asia (ex-Japan). Its regional banking franchises are mainly focused on retail banking and business banking. The group's corporate and investment banking businesses offer unique trade financing that has pricing power and credit discipline. The group's key earnings drivers are its banking businesses in the UK and Hong Kong.

FY19 revenue breakdown

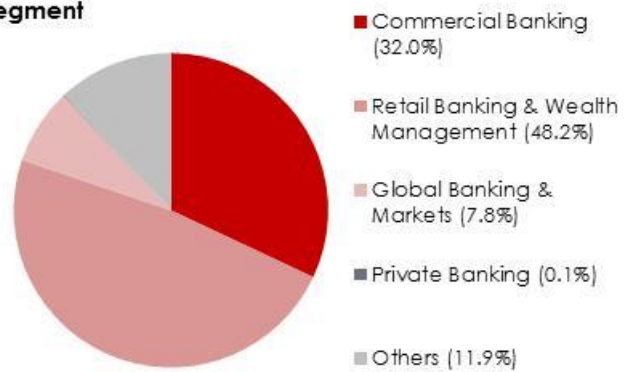
By segment



Source: Bloomberg

FY19 pretax income breakdown

By segment



Source: Bloomberg

Net interest margin

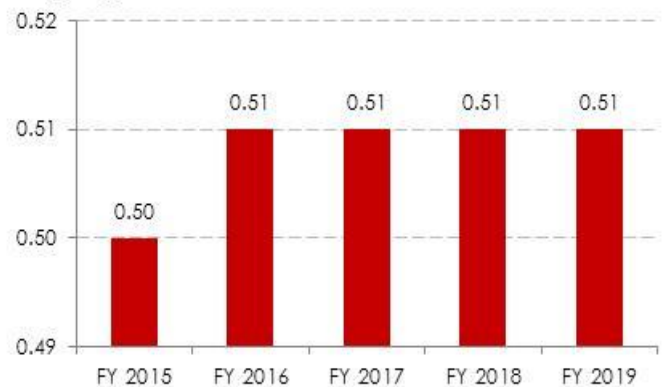
Net interest margin (%)



Source: Bloomberg

Dividends per share

DPS (USD)



Source: Bloomberg

Company financials

Income Statement

In Millions of HKD except Per Share	FY 2015	FY 2016	FY 2017	FY 2018	FY 2019
12 Months Ending	12/31/2015	12/31/2016	12/31/2017	12/31/2018	12/31/2019
Net Revenue	602,913	492,595	524,496	598,196	656,170
Other Operating Income	—	—	—	—	—
Operating Expenses	308,306	309,006	271,841	271,643	331,810
Operating Income or Losses	126,453	36,934	115,270	136,013	86,132
Non-Operating (Income) Loss	—	—	—	—	—
Pretax Income	146,269	55,206	133,778	155,889	104,576
- Income Tax Expense (Benefit)	29,235	28,457	41,208	38,130	36,347
Income Before XO Items	117,033	26,749	92,570	117,760	68,228
- Minority/Non Controlling Interests (Credits)	12,203	7,506	8,424	10,173	10,382
Net Income/Net Profit (Losses)	104,831	19,243	84,146	107,586	57,847
Net Inc Avail to Common Shareholders	97,466	10,083	75,457	98,816	46,768
Abnormal Losses (Gains)	18,389	81,994	27,555	13,708	61,584
Tax Effect on Abnormal Items	-3,724	-11,369	4,733	-2,605	-761
Normalized Income	112,131	80,709	107,745	109,920	107,591
Basic Earnings per Share	5.0	0.5	3.7	4.9	2.4
Basic Weighted Avg Shares	19,380	19,753	19,972	19,896	20,158
Diluted EPS Before Abnormal Items	5.7	4.1	5.3	5.5	5.4
Diluted EPS Before XO Items	5.0	0.5	3.7	4.9	2.4
Diluted EPS	5.0	0.5	3.7	4.9	2.4
Diluted Weighted Avg Shares	19,517	19,845	20,072	19,983	20,233

Profitability Ratios

12 Months Ending	FY 2015	FY 2016	FY 2017	FY 2018	FY 2019
12/31/2015	12/31/2016	12/31/2017	12/31/2018	12/31/2019	
Returns					
Return on Common Equity	6.8	0.7	5.6	7.6	3.7
Return on Assets	0.5	0.1	0.4	0.5	0.3
Return on Capital	2.4	0.6	1.9	2.4	1.4
Return on Invested Capital	2.7	1.1	2.0	2.5	1.7
Margins					
Operating Margin	25.8	9.4	27.1	30.3	18.5
Incremental Operating Margin	—	-94.3	276.5	94.3	—
Pretax Margin	24.3	11.2	25.5	26.1	15.9
Income before XO Margin	23.9	6.8	21.8	26.3	14.6
Net Income Margin	21.4	4.9	19.8	24.0	12.4
Net Income to Common Margin	19.9	2.6	17.8	22.0	10.0
Additional					
Effective Tax Rate	20.0	51.5	30.8	24.5	34.8
Dividend Payout Ratio	77.2	780.1	105.3	80.8	172.0
Sustainable Growth Rate	1.6	-4.9	-0.3	1.5	-2.6

Credit Ratios

12 Months Ending	FY 2015	FY 2016	FY 2017	FY 2018	FY 2019
12/31/2015	12/31/2016	12/31/2017	12/31/2018	12/31/2019	
Total Debt/EBIT	23.8	81.9	31.7	23.9	37.5
Net Debt/EBIT	2.9	1.6	-0.7	-4.0	-5.2
EBIT to Interest Expense	—	—	—	—	—
Long-Term Debt/Total Assets	4.6	3.7	3.3	4.2	4.8
Net Debt/Equity	23.6	4.0	-5.3	-35.6	-29.8

Source: Bloomberg

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