

# Insights Direct Company Note

## Hang Seng Bank Ltd

Bloomberg : 11 HK Equity | Reuters : 0011.HK | TR PermID : 4295871575

DBS Group Research . Equity

23-Feb-2022 (View Latest Version )

### ANALYST

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**BUY**

Price	Mkt Cap	Target Price	Total Return
HKD 149.0	HKD 284.86 B	HKD 178.0	24.4%

### WHAT'S NEW

2022-02-22 17:47:07

- HSB (11 HK, BUY) FY21 result posted at HK\$14bn, down 16.3% y-o-y, and missing ours/consensus forecast by 25%/20%, respectively. This implies its 2H21 earnings landed only at HK\$5.2bn, or down 32%/41% y-o-y/h-o-h.
- The disappointing result was mainly attributed by a) higher than expected provisioning (ECL charges) on its China's real estate credit exposure, b) weaker net interest/non-interest income growth as impacted by consistently low interest rate/poor market sentiment in 2H, and c) continuous higher digital infrastructure investment leading to higher operating expenses.
- NIM further declined to 1.49% (-2bps h-o-h) while NPL ratio and credit cost moderately increased to 1.04% (+35bps h-o-h) and 0.49% (+42bp h-o-h).

## SEQUENTIAL IMPROVEMENT IN 1H21

### INVESTMENT THESIS

#### Key Arguments:

- **End of interest rate downtrend.** Hang Seng Bank ("HSB") is the main beneficiary of higher interest rates given its high exposure to HKD/USD assets.
- **Well positioned in Wealth Management Connect.** Helped by its strong presence in the stock market and investment funds, HSB has the highest branch productivity in terms of fee income among HK banks. HSB is better positioned to capture rising investment demand in GBA.
- **Easing credit costs to provide earnings upside.** HSB's prudent provisioning policy should help to ease the pressure from adjustments in ECL assumptions amid economic recovery expectations in FY21F.

### STOCK PRICE



### Valuation

We raised our target price to HK\$178 from HK\$173 by rolling over our valuation to FY22F and factoring in a higher dividend payout ratio of 69% from 66%. Our valuation is based on the Gordon Growth Model of 17% ROE, 3% growth, and an 11% cost of equity. Our TP implies 1.8x FY22 P/BV, which is its five-year average PB.

#### Where we differ

Our earnings forecasts for FY21/22/23F are 3%/5%/7% higher than consensus, as we expect HSB to deliver earnings growth of 7.5%/13.4%/11.6% y-o-y, thanks to strong financing demand, robust fee income growth from increasing investment demand, and easing provisioning pressure from adjustments in the ECL model.

#### Key Risks to Our View

Downside risk could emerge from weaker-than-expected HIBOR movements, leading to a lower NIM and asset quality deterioration.

### FORECASTS AND VALUATION (HKD, M)

FY Dec	FY2018A	FY2020A	FY2021F	FY2022F
Pre-prov. Profit	29,047	22,863	22,437	25,505
Net Profit	24,211	16,687	18,571	20,970
Net Pft (Pre Ex.)	24,037	17,323	18,571	20,970
Net Pft Gth (Pre-ex) (%)	20.9	(30.2)	7.2	12.9
EPS (HKD)	12.53	8.64	9.61	10.86
EPS Pre Ex. (HKD)	12.44	8.97	9.61	10.86
EPS Gth Pre Ex (%)	20.9	(30.2)	7.2	12.9
Diluted EPS (HKD)	12.44	8.97	9.61	10.86
PE Pre Ex. (x)	12.0	16.7	15.5	13.8
Net DPS (HKD)	7.42	5.44	6.38	7.24
Div Yield (%)	5.0	3.6	4.3	4.8
ROAE Pre Ex. (%)	15.3	9.6	10.0	10.9
ROAE (%)	15.4	9.2	10.0	10.9
ROA (%)	1.6	1.0	1.0	1.1
BV Per Share (HKD)	83.91	94.79	97.66	100.9
P/Book Value (x)	1.8	1.6	1.5	1.5

What's new

WHAT'S NEW

Date

2022-02-22 17:47:07

Title

[News Alert] Hang Seng Bank (11 HK, BUY) FY21 result missed consensus by 20% on higher provisioning and weaker revenue growth, -ve to share price

- HSB (11 HK, BUY) FY21 result posted at HK\$14bn, down 16.3% y-o-y, and missing ours/consensus forecast by 25%/20%, respectively. This implies its 2H21 earnings landed only at HK\$5.2bn, or down 32%/41% y-o-y/h-o-h.
- The disappointing result was mainly attributed by a) higher than expected provisioning (ECL charges) on its China's real estate credit exposure, b) weaker net interest/non-interest income growth as impacted by consistently low interest rate/poor market sentiment in 2H, and c) continuous higher digital infrastructure investment leading to higher operating expenses.
- NIM further declined to 1.49% (-2bps h-o-h) while NPL ratio and credit cost moderately increased to 1.04% (+35bps h-o-h) and 0.49% (+42bp h-o-h).
- With the expectation of US interest rate hike, management indicated every 25bps parallel shift in interest rate (accounting for full year) will lead to a 10bps NIM expansion. As current interest rate is at low ground, NM is expected to benefit more from the widening of deposit spread at the initial stage of rate hike. However, management also indicated given the abundant liquidity in HK, it only expect the pass-through from higher US interest rate to be felt in 2H22F.
- We expect market to revise down HSB FY22/23F earnings on the back of the disappointing FY21 result, hence, -ve to HSB near-term share price.
- We are reviewing our model forecast.

HSB FY21 result summary

P&L (HKD m)	2H20	1H21	2H21	yoy %	hoh %	FY21F DBS est.	% of DBS FY21 est.	FY21F Cons. Est.	% of Cons. FY21 est.
Net Interest Income	12,114	11,883	11,939	-1%	0%	25,263	94%		
Non-interest Income	4,767	5,443	3,917	-18%	-28%	10,737	87%		
Income Bef Opg Exp	16,881	17,326	15,856	-6%	-8%	36,000	92%	34,981	95%
Operating expenses	(6,912)	(6,754)	(7,380)	7%	9%	(13,564)	104%		
Pre-provisioning operating profit	9,969	10,572	8,476	-15%	-20%	22,437	85%		
Provisions	(978)	(349)	(2,458)	151%	604%	(831)	338%		
Other income	(196)	75	69	-135%	-8%				
Profit before tax	8,795	10,298	6,087	-31%	-41%	21,606	76%	19,980	82%
Tax expenses	(1,260)	(1,537)	(902)	-28%	-41%	(3,054)	80%		
Minority interest	9	6	8	-11%	33%	19	73%		
Profit after tax and minority interest	7,544	8,767	5,193	-31%	-41%	18,571	75%	17,454	80%
Key balance sheet items (HKD m)									
Loan	944,774	1,013,463	997,397	6%	-2%				
Deposit	1,209,472	1,190,438	1,230,216	2%	3%				
Asset	1,759,787	1,800,215	1,820,185	3%	1%				
Shareholders' equity	183,100	183,677	184,416	1%	0%				
Key financial ratios (%)									
Cost to income	40.9%	39.0%	46.5%	560 bps	756 bps				
NIM	1.52%	1.51%	1.49%	-3 bps	-2 bps				
Credit cost	0.21%	0.07%	0.49%	29 bps	42 bps				
ROE	8.5%	9.9%	7.7%	-78 bps	-220 bps				
NPL ratio	0.61%	0.69%	1.04%	43 bps	35 bps				
Core tier 1 CAR	16.8%	15.80%	15.90%	-91 bps	10 bps				
Tier 1 CAR	18.5%	17.40%	17.50%	-98 bps	10 bps				
CAR	20.0%	18.90%	18.90%	-109 bps	0 bps				

Source: Company, DBS HK

## CRITICAL EQUITY FACTORS (CF)

### CF 1: HK system loan growth

HSB's share price has strong correlation with system loan growth.

24 Feb 2021

HSB's share price has been displaying a strong correlation of 0.92x with loans and advances growth (y-o-y) in HK since 2015, as net interest income represents ~70% of the bank's total operating income. We believe lending demand is likely to slow on the back of the economic slowdown in HK. Thus, loan growth should come in at 6.1%/5.6% in FY21/22F, vs 0.2% in FY20, driven by strong financing demand post pandemic and cross-border under the GBA scheme.

**Hang Seng Bank Ltd - Share Price (0011.HK) vs. Total Loan Growth**



**Hang Seng Bank Ltd - Total Loan Growth vs. Hong Kong - Loans & Advances Growth**



### CF 2: USD LIBOR-3M

**As LIBOR and HIBOR have been trading at close to 0%, the downside risk for HSB's net interest margin will be minimised. Any potential upside for interest rate would be positive to HSB.**

24 Feb 2021

LIBOR has been trading close to 0% since May 2020, while HIBOR caught up in Nov 2020. HIBOR was once above LIBOR (by 20-40bps) during Sep to Nov 2020 due to a strong IPO pipeline that led to an increase in demand for HKD. We expect HIBOR to trade at the current level in 1H21, though we may see some fluctuations due to IPO deals. HIBOR should gradually rebound in 2H21/FY22F

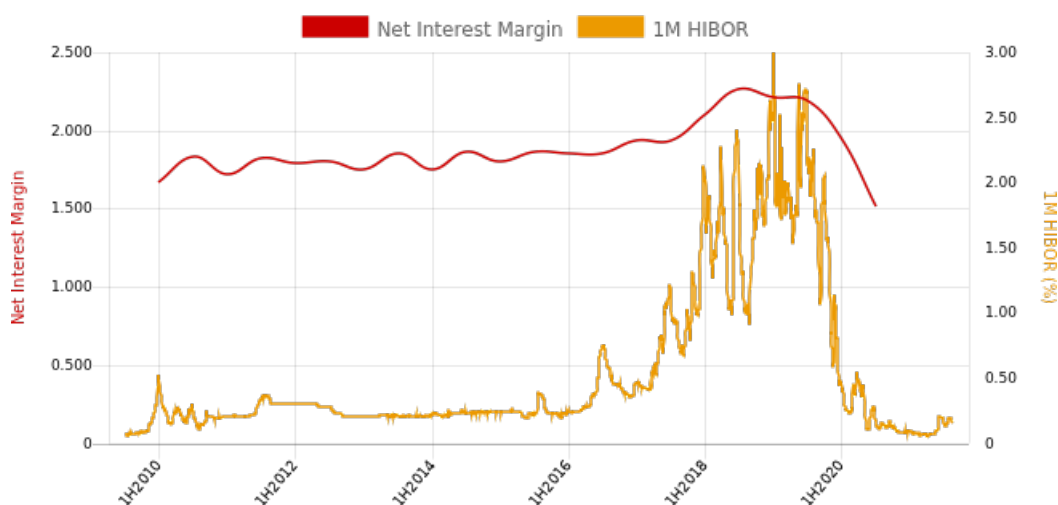
## Critical Equity Factors

when business activities signal better recovery ahead as more are inoculated with the COVID-19 vaccine. Due to HSB's large proportion of HKD and USD assets that are sensitive to HIBOR/LIBOR movements, we believe HSB's NIM will start to see stabilised in FY21F. We expect HSB's NIM to be 1.65%/1.69% in FY21/22F, vs 1.96%/1.52% in 1H20/2H20, helped by better asset allocation and funding cost structure.

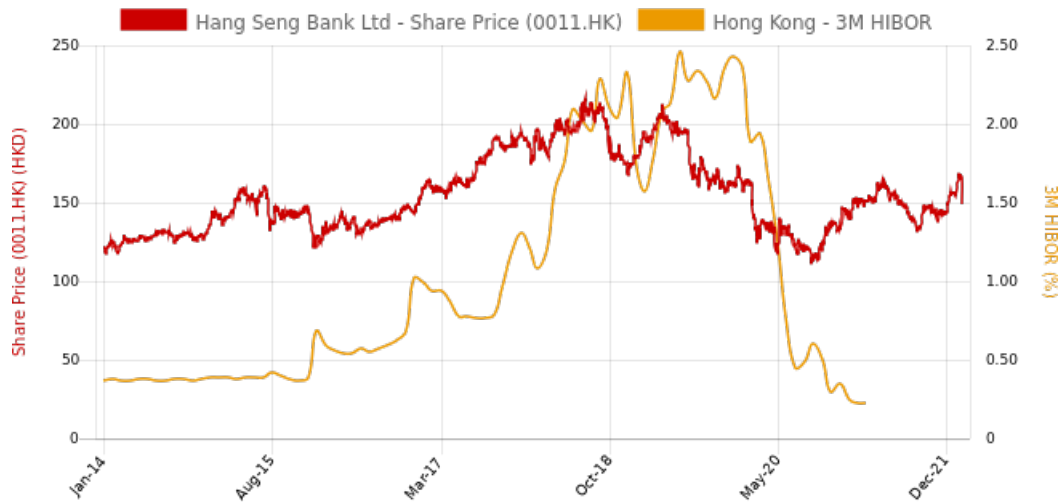
### Hang Seng Bank Ltd - Net Interest Margin vs. Share Price



### Hang Seng Bank Ltd - Net Interest Margin vs. 1M HIBOR



### Hang Seng Bank Ltd - Share Price (0011.HK) vs. Hong Kong - 3M HIBOR



### CF 3: Return on Total Equity

HSB's ROE has strong positive correlation with its share price

### Hang Seng Bank Ltd - Share Price (0011.HK) vs. Return on Total Equity (half-year)



### VALUATION

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#### Where we differ

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#### Key Risks to Our View

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### PROFILE

#### At A Glance

Issued Capital (m shares)	1,912
Major shareholders (%)	
HSBC	62.1
Free Float (%)	37.9
3m Avg. Daily Val. (US\$m)	30.26
GICS Industry: Financials / Banks	

#### Company description

Founded in 1933, Hang Seng Bank (HSB) is one of the largest banks in Hong Kong by asset size and is a principal member of the HSBC Group. Its subsidiary, Hang Seng Bank (China) Limited operates a network of 50 branches around China. As of 2020, HSB had HK\$1.76tr assets and HK\$944bn loans.

#### Business segment

- HSB derived 53.4% of profit before tax (PBT) from wealth and personal banking, 30.5% from commercial banking, 17.2% from global banking and markets, and -1.1% from others.
- Revenue breakdown – 72% of total revenue came from Interest income, 28% from fee income.
- Loans in HK contributed 76% of total loans, of which 56%/44% comes from corporate/individuals, respectively, while trade finance/loans for use outside HK represented 3%/21% of its loan mix.
- Savings/current/fixed deposit accounted for 67%/11%/22% of total deposits, respectively. Its CASA ratio stands at 80%.

#### Balance sheet

- As of the end of 2020, HSB's total assets amounted to HK\$1.76tr and gross loans reached HK\$945bn, while total liabilities amounted to HK\$1.58tr and deposits stood at HK\$1.21tr. Loan to deposit ratio reached 78.1%, down from 78.4% in FY19.
- HSB's CET1/AT1/CAR/ increased to 16.8%/18.5%/20.0% in 2020 vs 16.3%/18.0%/19.7% in 1H20, higher than the regulatory requirement of 16%/17.5%/19.5%.

#### Environmental, social and governance

HSB directly drives Hong Kong's economy by supporting SMEs and local businesses, and being one of the region's largest private sector employers. In 2020, HSB approved two green financing applications for mid-market enterprise customers of HK\$1bn. It also provided a syndicated loan for a major local developer with interest rates being indexed against the sustainability of hotels owned and operated by the borrower in Hong Kong. A Sustainability Margin Adjustment is applied to pricing, to encourage the borrower to think sustainably, which HSB hopes to bring about positive changes to the environment and hold borrowers accountable for their footprint on the environment.

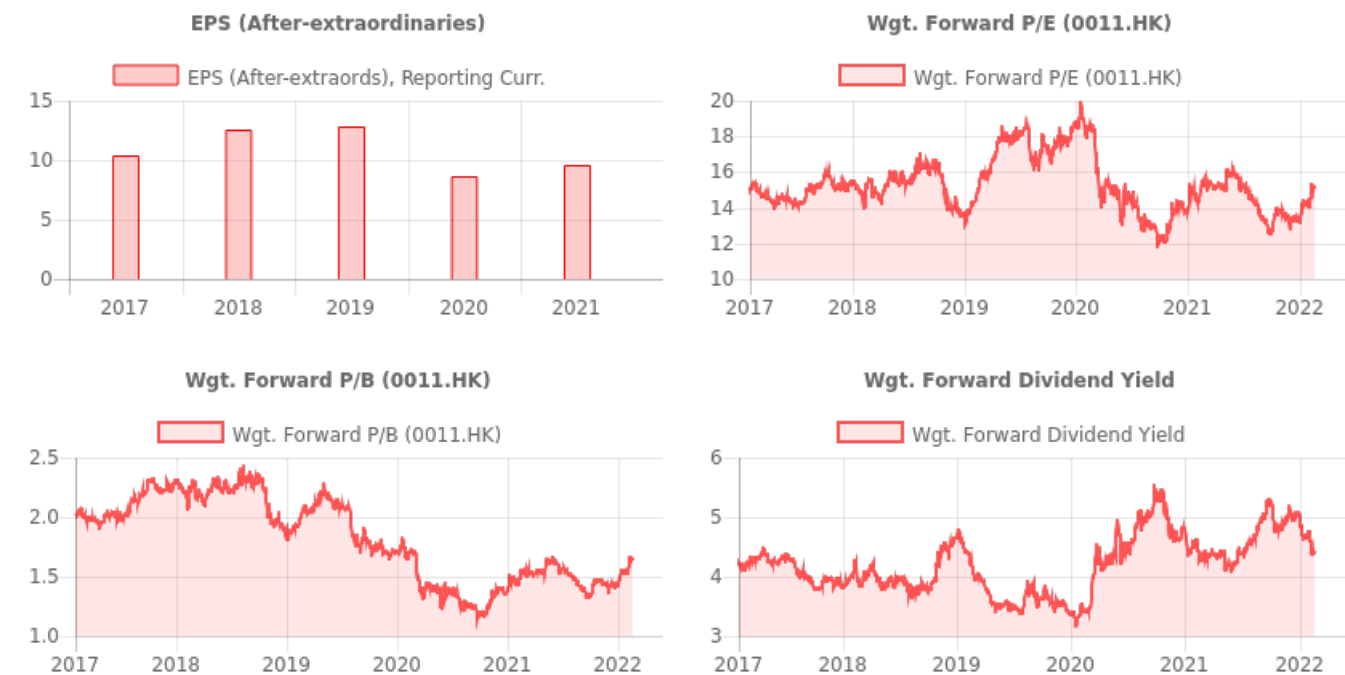
#### Key assumptions

<b>FY Dec</b>	<b>2019A</b>	<b>2020A</b>	<b>2021F</b>	<b>2022F</b>	<b>2023F</b>
NIM (%)	2.20	1.73	1.53	1.57	1.63
Loan growth (%)	8	0	9	7	5
Cost-to-income (%)	30	37	38	36	35
Credit cost (%)	0.2	0.3	0.1	0.1	0.1
Customer Deposits Growth (%) Growth (%)	4	0	5	5	5
Yld. On Earnings Assets (%)	2.92	2.23	1.78	1.92	2.07
Avg Cost Of Funds (%)	0.95	0.66	0.37	0.49	0.60

#### Segment breakdown

<b>FY Dec</b>	<b>2019A</b>	<b>2020A</b>	<b>2021F</b>	<b>2022F</b>	<b>2022F</b>
<b>Revenues (HK\$ m)</b>					
Net interest income	32,255.0	26,906.0	25,263.4	27,461.5	29,456.4
Net fee and commission income	6,453.0	6,367.0	7,464.8	8,605.5	9,671.6
Other operating income	4,806.0	2,795.0	3,272.3	3,801.5	4,387.3
<b>Total</b>	<b>43,514.0</b>	<b>36,068.0</b>	<b>36,000.4</b>	<b>39,868.6</b>	<b>43,515.2</b>
<b>% of revenue (%)</b>	<b>2019A</b>	<b>2020A</b>	<b>2021F</b>	<b>2022F</b>	<b>2022F</b>
Net interest income	74.1%	74.6%	70.2%	68.9%	67.7%
Net fee and commission income	14.8%	17.7%	20.7%	21.6%	22.2%
Other operating income	11.0%	7.7%	9.1%	9.5%	10.1%
<b>Total</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>
<b>FY Dec</b>	<b>2016A</b>	<b>2017A</b>	<b>2018A</b>	<b>2019A</b>	<b>2020A</b>
<b>Loan (%)</b>					
Property development	7.4	7.8	7.7	7.7	7.6
Property investment	17.1	16.9	16.6	16.6	16.2
Financial concerns	0.7	1.1	1.0	0.8	0.3
Stockbrokers	0.0	0.0	0.0	0.0	0.0
Wholesale and retail trade	3.8	3.4	3.5	3.1	3.4
Manufacturing	3.3	2.9	2.6	2.5	2.5
Transport and transport equipment	1.3	1.8	1.5	1.5	1.5
Other corporate loans	7.6	8.9	10.7	10.5	10.9
<b>Total corporate loans</b>	<b>41.3</b>	<b>42.7</b>	<b>43.6</b>	<b>42.8</b>	<b>42.5</b>
Mortgage loans	25.5	24.3	25.1	26.0	27.5
Credit card	3.9	3.6	3.4	3.1	2.7
Other personal loans	2.9	3.1	3.5	3.3	3.2
<b>Total personal loans</b>	<b>32.3</b>	<b>31.0</b>	<b>32.0</b>	<b>32.3</b>	<b>33.4</b>
<b>Total loans used in HK</b>	<b>73.6</b>	<b>73.7</b>	<b>75.6</b>	<b>75.1</b>	<b>75.9</b>
Trade finance	6.2	5.8	4.1	3.5	2.8
Loans for use outside HK	20.3	20.5	20.3	21.4	21.3
<b>Total</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>

Company Ratios





**FORECASTS AND VALUATION (HKD, M)**

<b>FY Dec</b>	<b>FY2018A</b>	<b>FY2019A</b>	<b>FY2020A</b>	<b>FY2021F</b>	<b>FY2022F</b>
Pre-prov. Profit	29,047	30,457	22,863	22,437	25,505
Net Profit	24,211	24,840	16,687	18,571	20,970
Net Pft (Pre Ex.)	24,037	24,805	17,323	18,571	20,970
Net Pft Gth (Pre-ex) (%)	20.9	3.2	(30.2)	7.2	12.9
EPS (HKD)	12.53	12.86	8.64	9.61	10.86
EPS Pre Ex. (HKD)	12.44	12.84	8.97	9.61	10.86
EPS Gth Pre Ex (%)	20.9	3.2	(30.2)	7.2	12.9
Diluted EPS (HKD)	12.44	12.84	8.97	9.61	10.86
PE Pre Ex. (x)	12.0	11.6	16.7	15.5	13.8
Net DPS (HKD)	7.42	8.12	5.44	6.38	7.24
Div Yield (%)	5.0	5.4	3.6	4.3	4.8
ROAE Pre Ex. (%)	15.3	14.6	9.6	10.0	10.9
ROAE (%)	15.4	14.6	9.2	10.0	10.9
ROA (%)	1.6	1.5	1.0	1.0	1.1
BV Per Share (HKD)	83.91	92.57	94.79	97.66	100.9
P/Book Value (x)	1.8	1.6	1.6	1.5	1.5

**INCOME STATEMENT (HKD, M)**

<b>FY Dec</b>	<b>FY2018A</b>	<b>FY2019A</b>	<b>FY2020A</b>	<b>FY2021F</b>	<b>FY2022F</b>
Net Interest Income	30,047	32,255	26,906	25,263	27,462
Non-Interest Income	11,168	11,259	9,162	10,737	12,407
<b>Operating Income</b>	<b>41,215</b>	<b>43,514</b>	<b>36,068</b>	<b>36,000</b>	<b>39,869</b>
Operating Expenses	(12,168)	(13,057)	(13,205)	(13,564)	(14,363)
<b>Pre-provision Profit</b>	<b>29,047</b>	<b>30,457</b>	<b>22,863</b>	<b>22,437</b>	<b>25,505</b>
Provisions	(996.0)	(1,847)	(2,738)	(831.2)	(1,109)
Associates	207.0	168.0	(75.00)	0.000	0.000
Exceptionals	174.0	35.00	(636.0)	0.000	0.000
<b>Pre-tax Profit</b>	<b>28,432</b>	<b>28,813</b>	<b>19,414</b>	<b>21,606</b>	<b>24,397</b>
Taxation	(4,244)	(3,991)	(2,744)	(3,054)	(3,448)
Minority Interests	23.00	18.00	17.00	18.92	21.36
Preference Dividend	0.000	0.000	0.000	0.000	0.000
<b>Net Profit</b>	<b>24,211</b>	<b>24,840</b>	<b>16,687</b>	<b>18,571</b>	<b>20,970</b>
Net Profit bef Except	24,037	24,805	17,323	18,571	20,970
<b>Growth (%)</b>					
Net Interest Income Gth	22.26	7.35	(16.58)	(6.11)	8.70
Net Profit Gth	20.95	2.60	(32.82)	11.29	12.92
<b>Margins, Costs &amp; Efficiency (%)</b>					
Spread	2.01	1.97	1.56	1.41	1.43
Net Interest Margin	2.18	2.20	1.73	1.53	1.57
Cost-to-Income Ratio	29.52	30.01	36.61	37.68	36.03
<b>Business Mix (%)</b>					
Net Int. Inc / Opg Inc.	72.90	74.13	74.60	70.18	68.88
Non-Int. Inc / Opg inc.	27.10	25.87	25.40	29.82	31.12
Fee Inc / Opg Income	17.15	14.83	17.65	20.74	21.58
Oth Non-Int Inc/Opg Inc	9.95	11.04	7.75	9.09	9.54
<b>Profitability (%)</b>					
ROAE Pre Ex.	15.30	14.55	9.57	9.99	10.93
ROAE	15.42	14.57	9.22	9.99	10.93
ROA Pre Ex.	1.58	1.53	1.00	1.03	1.10
ROA	1.59	1.53	0.970	1.03	1.10

**BALANCE SHEET (HKD, M)**

<b>FY Dec</b>	<b>FY2018A</b>	<b>FY2019A</b>	<b>FY2020A</b>	<b>FY2021F</b>	<b>FY2022F</b>
Cash/Bank Balance	16,421	13,038	11,226	11,787	12,377
Government Securities	0.000	0.000	0.000	0.000	0.000
Inter Bank Assets	79,400	72,466	57,717	63,212	45,399
Total Net Loans & Adv.	874,456	942,930	944,774	1,034,724	1,104,851
Investment	496,907	535,170	629,713	659,464	678,659
Associates	2,444	2,520	2,358	2,358	2,358
Fixed Assets	40,618	42,483	40,340	42,357	44,475
Goodwill	16,751	21,954	24,733	26,712	28,849
Other Assets	44,300	46,430	48,926	12,763	23,659
<b>Total Assets</b>	<b>1,571,297</b>	<b>1,676,991</b>	<b>1,759,787</b>	<b>1,853,377</b>	<b>1,940,625</b>
Customer Deposits	1,154,415	1,203,458	1,209,472	1,269,946	1,333,443
Inter Bank Deposits	3,122	4,369	19,213	20,174	21,182
Debts/Borrowings	3,748	17,190	62,500	75,000	76,500
Others	127,710	140,937	142,727	149,708	157,176
Minorities	25.00	107.0	95.00	95.00	95.00
Shareholders Funds'	162,082	178,810	183,100	188,640	194,924
<b>Total Liab&amp; S/H's Funds</b>	<b>1,571,297</b>	<b>1,676,991</b>	<b>1,759,787</b>	<b>1,853,377</b>	<b>1,940,625</b>

**FINANCIAL STABILITY MEASURES (HKD, M)**

<b>FY Dec</b>	<b>FY2018A</b>	<b>FY2019A</b>	<b>FY2020A</b>	<b>FY2021F</b>	<b>FY2022F</b>
<b>Balance Sheet Structure</b>					
Loan-to-Deposit Ratio	75.75	78.35	78.11	81.48	82.86
Net Loans / Total Assets	55.65	56.23	53.69	55.83	56.93
Investment / Total Assets	31.62	31.91	35.78	35.58	34.97
Cust . Dep./Int. Bear. Liab.	94.95	95.62	91.27	91.23	91.14
Interbank Dep / Int. Bear.	0.257	0.347	1.45	1.45	1.45
<b>Asset Quality</b>					
NPL / Total Gross Loans	0.246	0.219	0.603	0.450	0.350
NPL / Total Assets	0.137	0.124	0.325	0.252	0.200
Loan Loss Reserve Coverage	124.0	169.5	90.50	91.84	103.1
Provision Charge-Off Rate	0	0	0	0	0
<b>Capital Strength</b>					
Total CAR	20.15	20.83	19.99	19.84	19.90
Tier-1 CAR	17.77	18.71	18.48	18.29	18.27

Disclaimer

**RECOMMENDATION DEFINITION**

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**BUY** (>15% total return over the next 12 months for small caps, >10% for large caps)

**HOLD** (-10% to +15% total return over the next 12 months for small caps, -10% to +10% for large caps)

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\*Share price appreciation + dividends

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# Target Price & Ratings History



#	Date of Report	Closing Price	12-m Target Price	Rating
1	21 Feb'21	152.50	173.00	BUY
2	21 Feb'21	146.00	173.00	BUY
3	21 Feb'21	119.40	120.00	HOLD
4	21 Feb'21	119.00	120.00	HOLD
5	21 Feb'21	133.20	145.00	HOLD
6	21 Feb'21	163.20	166.00	HOLD
7	21 Feb'21	163.70	166.00	HOLD
8	21 Feb'21	165.20	172.00	HOLD
9	21 Feb'21	149.50	178.00	BUY
10	21 Feb'21	150.00	178.00	BUY
11	21 Feb'21	151.60	173.00	BUY
12	21 Feb'21	149.10	173.00	BUY

Analysts: Ken Shih

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