

China / Hong Kong Company Update

Hang Seng Bank

Bloomberg: 11 HK EQUITY | Reuters: 0011.HK

Refer to important disclosures at the end of this report

DBS Group Research . Equity

29 Jun 2022

BUY (Reinstating coverage)

Last Traded Price (28 Jun 2022): HK\$138.20 (HSI : 22,419)

Price Target 12-mth: HK\$163 (18% upside)

Analysts

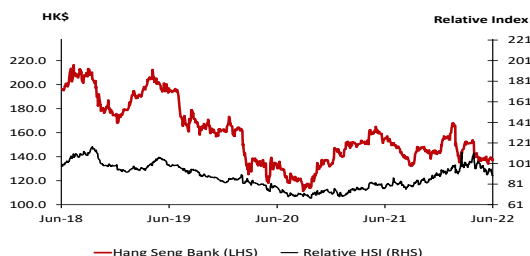
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What's New

- Highest NII sensitivity to interest rate hike
- ECL risk controllable with 7.5% of total loan exposure to China property sector
- Expect strong earnings growth of over 30% y-o-y in FY23F and ROE recovery
- Reinstate coverage with BUY and TP at HK\$163

Price Relative



Forecasts and Valuation

FY Dec (HK\$ m)	2021A	2022F	2023F	2024F
Pre-prov. Profit	19,048	21,270	27,156	31,429
Pre-prov. Profit Gth	(17)	12	28	16
Pretax Profit	16,385	18,167	24,279	28,834
Net Profit	13,960	15,478	20,685	24,566
EPS (HK\$)	7.23	8.01	10.71	12.72
EPS Gth (%)	(16)	11	34	19
PE (X)	19.1	17.2	12.9	10.9
DPS (HK\$)	5.05	5.63	7.61	9.09
Div Yield (%)	3.7	4.1	5.5	6.6
BV Per Share (HK\$)	95.43	97.45	100.19	103.46
P/Book Value (x)	1.4	1.4	1.4	1.3
ROAE (%)	7.6	8.3	10.8	12.5
ROAE (ex-exceptional)	7.6	8.3	10.8	12.5
ROA (%)	0.78	0.83	1.06	1.20

Earnings Rev (%)		(26)	(11)	New
Consensus EPS (HK\$)		7.80	10.71	12.80
Other Broker Recs:		B:5	S:1	H:5

Source of all data on this page: Company, DBS Bank (Hong Kong) Limited ("DBS HK"), Thomson Reuters

Main beneficiary of interest rate hike

Investment Thesis

Benefit from interest rate hike. In FY21, HSB had 81% of its assets in HKD and USD. With exposure that is higher than its major peers, HSB is the main beneficiary of the HK and US interest rate upward cycle.

Positioned for fee income growth in the long run. HSB has the highest branch productivity in terms of fee income among HK banks, which is helped by its strong presence in the stock market and investment funds.

Lower credit costs in FY23F to provide earnings upside. While credit costs would remain high this year due to a weak 1Q22, we expect more improvements in 2H22 and FY23F, with the economic recovery in HK.

Valuation:

Our target price of HK\$163 is based on the Gordon Growth Model of 16% ROE, 3% growth, and 11% cost of equity. Our TP implies a 1.65x FY23 P/BV, slightly lower than its five-year average PB of 1.8x.

Where we differ:

We have a higher NIM forecast in FY22-23F, based on our house view of the 1M HIBOR reaching 2.28% by the end of the year. We expect more interest rate upside as well as higher loan growth in HK in 2023 with the positive expectation of economic recovery.

Key Risks to Our View:

HK economy growth being weaker than expected and asset quality deterioration.

At A Glance

Issued Capital (m shrs)	1,912
Mkt Cap (HKm/US\$m)	264,238 / 33,671
Major Shareholders (%)	
HSBC Holdings PLC	62.1
Free Float (%)	37.9
3m Avg. Daily Val. (US\$m)	29.07
GICS Industry: Financials / Banks	



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WHAT'S NEW

Benefit from interest rate upward cycle

High sensitivity to interest rate hike. Compared with its major peers such as BOCHK, HSB has higher asset exposure to the HKD/USD, while its liability side exposure is not significantly higher (Fig 1). It also has a higher CASA ratio of 83% in FY21 compared with its peers' 40%-70% (Fig 2), which leads to lower funding costs. As a result, HSB has the highest NII (net interest income) sensitivity to HIBOR movements (Fig 3). Based on its FY21 number, we estimate a 100bps increase in the HIBOR to drive up its NII by c.24% if other conditions remain unchanged.

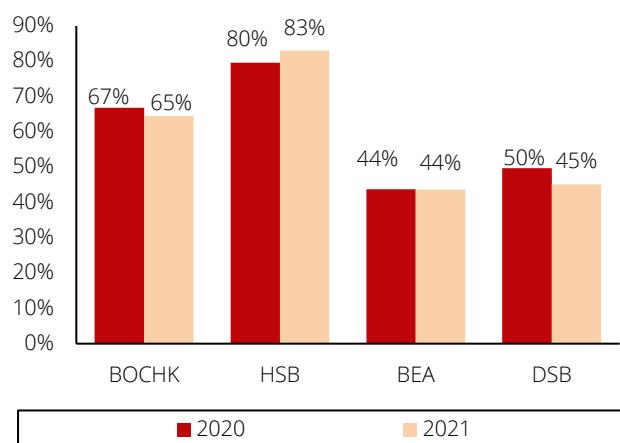
As our house view expects the 1M-HIBOR to reach 2.28% by the end of 2022, from the current level of c.0.87%, and the interest upward cycle is likely to carry into 1H23, we have a positive outlook on HSB's NII in 2H22 and FY23. We expect its NIM to increase to 1.65%/1.96% in FY22/23F from 1.49% in FY21, and NII to increase by 14%/23% y-o-y.

Fig 1: HKD/USD asset and liability exposure

2021	BOCHK	HSB	BEA	DSB
% of HKD assets	46%	69%	36%	57%
% of USD assets	30%	12%	28%	30%
% of HKD + USD assets	76%	81%	63%	87%
% of HKD liabilities	47%	64%	31%	59%
% of USD liabilities	30%	12%	29%	25%
% of HKD + USD liabilities	77%	77%	60%	83%

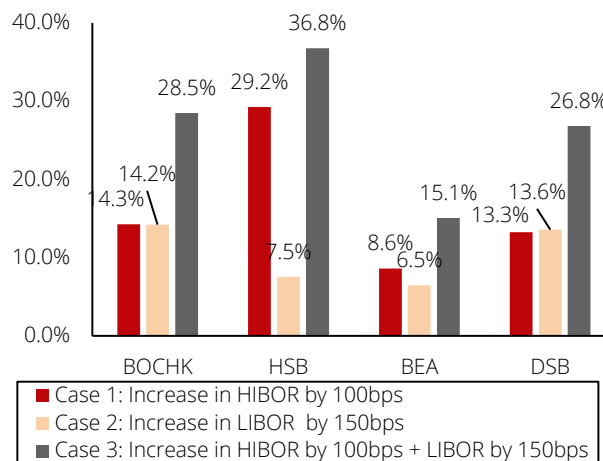
Source: Corporates, DBS HK

Fig 2: CASA ratios



Source: Corporates, DBS HK

Fig 3: HSB has the highest NII sensitivity to HIBOR movements



Source: Corporates, DBS HK

ECL risk to increase, but controllable. By the end of FY21, the central scenario used for the ECL (expected credit loss) model is 3.1% y-o-y growth in HK GDP and 5.3% y-o-y growth in mainland China GDP. While we think it's unlikely to face a downside scenario, the central scenario assumption might be revised down in 1H22 due to a weak performance in 1H22 in HK and mainland China. ECL is likely to increase in FY22F, especially in the China property sector. Thus, we expect a slight increase in its credit cost in FY22F.

While it may take some time for the property sector to stabilise, we see the overall risk as controllable. By the end of FY21, HSB has c.HK\$75bn in exposure to the China property sector, which accounts for 7.5% of its FY21 loan outstanding balance. Among its China real estate exposure, HK\$12.5bn bears a higher risk but c.HK\$9bn of it is secured. We remain confident in its overall asset quality.

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Fig 4: ECL assumptions by end-FY21

HK

	Weighting	Assumption for 2022
Central scenario	70%	GDP 3.1%, unemployment 4.1%, house price 3.4%
Upside	5%	GDP 10.3% (4Q22), unemployment rate 2.7% (4Q23), house price 11.9% (4Q22)
Downside-1	20%	GDP -1% (4Q22), unemployment rate 5.6% (4Q23), house price -7.9% (4Q22)
Alternative downside - scenario 2	5%	GDP -8.2% (4Q22), unemployment rate 6.1% (4Q23), house price -17.7% (4Q22)

China

	Weighting	Assumption for 2022
Central scenario	80%	GDP 5.3%, unemployment 3.8%, house price 0.3%
Upside	5%	GDP 11.8% (4Q22), unemployment rate 3.5% (4Q23), house price 8.2% (4Q22)
Downside	10%	GDP 2.3% (4Q22), unemployment rate 4.0% (4Q23), house price -3.7% (4Q22)
Alternative downside - scenario 2	5%	GDP -4.8% (4Q22), unemployment rate 5.4% (4Q23), house price -24.8% (4Q22)

Source: Corporates, DBS HK

Expect more expansion in 2023. With the expected HK economy recovery in 2H22 and potential China-HK border reopening in 2023, we expect HSB to see a higher positive impact on loan growth, fee income growth, and asset quality improvement in FY23. We expect higher NIM improvement in FY23 of c.30bps and a 7% y-o-y loan growth in FY23F, given the HK interests rate hike lags US pace and recovering loan demand will need time for documentation.

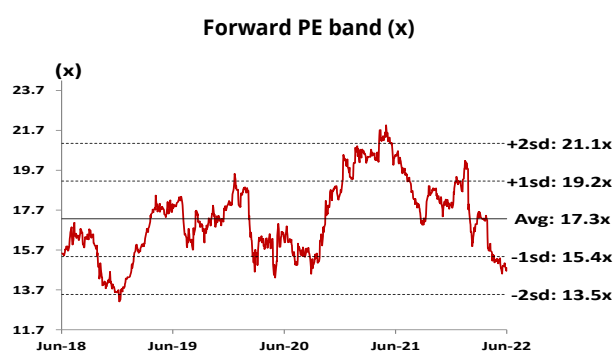
HSB is well positioned with the highest branch productivity in terms of fee income among HK banks, and is helped by its strong presence in the stock market and investment funds. Overall, we expect a strong rebound of c.35% y-o-y in its core net profit growth in FY23F.

BUY with attractive valuation. HSB is now trading at an attractive valuation of its five-year average -1SD PB level. With the positive catalysts mentioned above, we expect higher earnings growth and faster ROE recovery in FY23/24F. The company maintains a 50%-70% dividend payout ratio and a dividend yield of c.4%. We expect a further re-rating to take place in 2H22.

Company Background

Founded in 1922, 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 46 branches around China. As of FY21, HSB had HK\$1.82tn in assets and HK\$997bn in loans.

Historical PE and PB band



Source: Thomson Reuters, DBS HK

Hang Seng Bank

Key Assumptions

FY Dec	2020A	2021A	2022F	2023F	2024F
NIM (%)	1.73	1.49	1.65	1.96	2.16
Loan growth (%)	0	6	3	7	7
Cost-to-income (%)	37	43	41	37	36
Credit cost (%)	0.3	0.3	0.3	0.3	0.2
Customer Deposits Growth (%)					
Growth (%)	0	2	5	5	5
Yld. On Earnings Assets (%)	2.23	1.71	1.95	2.35	2.64
Avg Cost Of Funds (%)	0.66	0.34	0.44	0.54	0.63

Source: Company, DBS HK

Income Statement (HK\$ m)

FY Dec	2020A	2021A	2022F	2023F	2024F
Net Interest Income	26,906	23,822	27,153	33,358	38,531
Non-Interest Income	9,162	9,360	8,959	9,641	10,326
Operating Income	36,068	33,182	36,112	43,000	48,857
Operating Expenses	(13,205)	(14,134)	(14,841)	(15,844)	(17,428)
Pre-provision Profit	22,863	19,048	21,270	27,156	31,429
Provisions	(2,738)	(2,817)	(3,103)	(2,877)	(2,595)
Associates	(75)	72	0	0	0
Exceptionals	(636)	82	0	0	0
Pre-tax Profit	19,414	16,385	18,167	24,279	28,834
Taxation	(2,744)	(2,439)	(2,704)	(3,614)	(4,292)
Minority Interests	17	14	16	21	25
Preference Dividend	0	0	0	0	0
Net Profit	16,687	13,960	15,478	20,685	24,566
Net Profit bef Except	17,323	13,878	15,478	20,685	24,566

Growth (%)

Net Interest Income Gth	(16.58)	(11.46)	13.98	22.85	15.51
Net Profit Gth	(32.82)	(16.34)	10.88	33.64	18.76

Margins, Costs & Efficiency (%)

Spread	1.56	1.37	1.52	1.81	2.01
Net Interest Margin	1.73	1.49	1.65	1.96	2.16
Cost-to-Income Ratio	36.6	42.6	41.1	36.8	35.7

Business Mix (%)

Net Int. Inc / Opg Inc.	74.6	71.8	75.2	77.6	78.9
Non-Int. Inc / Opg inc.	25.4	28.2	24.8	22.4	21.1
Fee Inc / Opg Income	17.7	19.8	17.8	16.0	14.8
Oth Non-Int Inc/Opg Inc	7.7	8.4	7.0	6.4	6.3

Profitability (%)

ROAE Pre Ex.	9.6	7.6	8.3	10.8	12.5
ROAE	9.2	7.6	8.3	10.8	12.5
ROA Pre Ex.	1.0	0.8	0.8	1.1	1.2
ROA	1.0	0.8	0.8	1.1	1.2

Source: Company, DBS HK

Hang Seng Bank

Balance Sheet (HK\$ m)

FY Dec	2020A	2021A	2022F	2023F	2024F
Cash/Bank Balance	11,226	16,896	17,741	18,628	19,559
Government Securities	0	0	0	0	0
Inter Bank Assets	57,717	91,314	73,453	56,616	36,938
Total Net Loans & Adv.	944,774	997,397	1,026,567	1,098,215	1,170,682
Investment	629,713	592,369	609,352	626,830	644,815
Associates	2,358	2,341	2,341	2,341	2,341
Fixed Assets	40,340	40,750	42,788	44,927	47,173
Goodwill	24,733	25,486	27,525	29,727	32,105
Other Assets	48,926	53,632	103,202	113,864	130,968
Total Assets	1,759,787	1,820,185	1,902,969	1,991,147	2,084,582
Customer Deposits	1,209,472	1,230,216	1,291,727	1,356,313	1,424,129
Inter Bank Deposits	19,213	21,925	23,021	24,172	25,381
Debts/Borrowings	62,500	81,567	83,198	84,862	86,560
Others	142,727	147,510	154,419	161,796	169,677
Minorities	95	84	84	84	84
Shareholders' Funds	183,100	184,332	188,241	193,527	199,840
Total Liab& S/H's Funds	1,759,787	1,820,185	1,902,969	1,991,147	2,084,582

Source: Company, DBS HK

Financial Stability Measures (%)

FY Dec	2020A	2021A	2022F	2023F	2024F
Balance Sheet Structure					
Loan-to-Deposit Ratio	78.5	81.6	80.1	81.6	82.8
Net Loans / Total Assets	53.7	54.8	53.9	55.2	56.2
Investment / Total Assets	35.8	32.5	32.0	31.5	30.9
Cust. Dep./Int. Bear. Liab.	91.3	89.3	89.8	90.1	90.4
Interbank Dep / Int. Bear.	1.4	1.6	1.6	1.6	1.6
Asset Quality					
NPL / Total Gross Loans	0.6	0.7	0.7	0.6	0.5
NPL / Total Assets	0.3	0.4	0.4	0.3	0.3
Loan Loss Reserve Coverage	90.5	98.8	110.7	131.1	158.2
Provision Charge-Off Rate	0.3	0.3	0.3	0.3	0.2
Capital Strength					
Total CAR	20.0	18.9	19.0	19.2	19.4
Tier-1 CAR	18.5	17.5	17.2	17.1	17.1

Source: Company, DBS HK

DBS HK recommendations are based on an Absolute Total Return* Rating system, defined as follows:

STRONG BUY (>20% total return over the next 3 months, with identifiable share price catalysts within this time frame)

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)

FULLY VALUED (negative total return, i.e., > -10% over the next 12 months)

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*Share price appreciation + dividends

Completed Date: 29 Jun 2022 09:29:38 (HKT)

Dissemination Date: 29 Jun 2022 14:48:49 (HKT)

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