

China / Hong Kong Company Update

HSBC Holdings

Bloomberg: 5 HK EQUITY | Reuters: 0005.HK

Refer to important disclosures at the end of this report

DBS Group Research . Equity

16 Oct 2023

BUY

Last Traded Price (16 Oct 2023): HK\$61.80 (HSI : 17,640)

Price Target 12-mth: HK\$71.70 (16% upside)

Analysts

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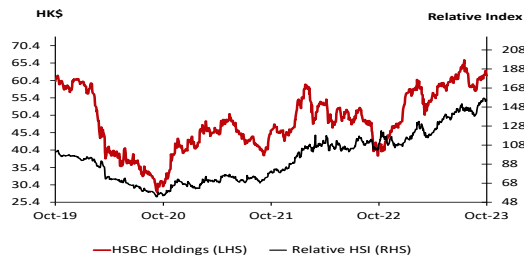
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What's New

- Revise up FY23/24F NIM by 3/11 bps to 1.72%/1.68% with expectation of higher-for-longer interest rates
- ECL charges might also be higher for 2H23F following higher uncertainties in China CRE sector
- Expect ROTe to be on track to meet mid-teen target in FY23-25F with attractive dividend yield of >8%
- Reiterate BUY with TP unchanged at HK\$71.7

Price Relative



Forecasts and Valuation

FY Dec (US\$ m)	2022A	2023F	2024F	2025F
Pre-prov. Profit	18,397	35,501	35,415	33,822
Pre-prov. Profit Gth	23	93	0	(4)
Pretax Profit	17,528	34,696	34,717	33,248
Net Profit	14,822	26,698	27,606	25,584
EPS (US\$)	0.75	1.36	1.46	1.45
EPS (HK\$)	5.84	10.61	11.43	11.37
EPS Gth (%)	20	82	8	(1)
PE (x)	10.6	5.8	5.4	5.4
DPS (HK\$)	2.50	5.25	6.86	4.94
Div Yield (%)	4.1	8.5	11.1	8.0
BV Per Share (HK\$)	70.10	74.07	80.67	88.61
P/Book Value (x)	0.9	0.8	0.8	0.7
ROAE (%)	10.9	13.6	11.8	12.8
ROAE (ex-exceptional)	10.9	13.6	11.8	12.8
ROA (%)	0.50	0.89	0.88	0.78

Earnings Rev (%)		0	4	3
Consensus EPS (US\$)		1.28	1.30	1.27
Other Broker Recs:		B:21	S:0	H:5

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

3Q23 preview: Further NIM upside

Investment Thesis

Higher NIM alongside higher ECL expectation. With the expectation of a higher-for-longer Fed Funds Rate, we expect HSBC's NIM to peak in 2H23F. Meanwhile, the high-interest rate environment may also keep loan demand subdued and add some pressure on asset quality from 2H23F to FY24F. We see higher uncertainty in the China CRE (commercial real estate) sector in 3Q23, and there might be a high possibility of ECL heading downward. Overall, we see a limited benefit to earnings from the higher interest rate environment.

Expect c.43% adjusted PBT y-o-y growth in FY23, mainly driven by 1) the expectation that NIM is to further expand to 1.72% in FY23 from 1.48% in FY22 and 2) continuous cost-saving efforts to improve operating efficiency. FY24/25F profit is expected to be largely flat vs FY23, as we expect interest rate cuts. Meanwhile, we expect ECL charges to be maintained at a relatively high level of c.40bps of average gross loans in FY23/24F, given the uncertainties in the global macroeconomic environment as well as the China CRE sector.

Improving returns is a positive share price driver. Return on Tangible Equity (ROTE) is one of HSBC's primary share price drivers, according to our empirical study. One of HSBC's key strategies is to shift capital and resources to areas that generate the highest returns and where it has competitive strength. We see HSBC is well on track to reach its mid-teen ROTe target and expect c.17%-18% ROTe to be reported in FY23/24F.

Reiterate BUY with TP unchanged at HK\$71.7 with the earnings assumption largely unchanged for FY23/24F. Our TP is based on the DDM model, assuming a 12.6% COE, 15% ROTe (prev. 14%), and 0% terminal growth. Our TP implies 0.9x FY24F P/B, which is +1SD above its five-year average of 0.7x with a better outlook on dividends and ROTe compared with previous years, while the stock is currently trading at c.0.7x FY24F P/B and >8% dividend yield in FY23/24F.

Key Risks

Geopolitical risks, global economic slowdown, and operational efficiency being lower than expected.

At A Glance

Issued Capital (m shrs)	19,968
Mkt Cap (HKm/US\$m)	1,248,000 / 159,500
Major Shareholders (%)	
Ping An Asset Management Co., Ltd.	8.5
BlackRock Institutional Trust Company, N.A.	7.6
Free Float (%)	84.0
3m Avg. Daily Val. (US\$m)	139.99
GICS Industry: Financials / Banks	

HSBC Holdings

WHAT'S NEW

Expect 3Q23F results largely in line

We expect HSBC to deliver its 3Q23F and 2H23F results largely in line with market expectation. What we have changed in 3Q23 is 1) a higher expectation for the US Fed Funds Rate and 2) higher uncertainty in the China property sector. We expect the two factors to offset each other in 2H23F and our expectation for FY23F earnings is largely unchanged, at c.US\$26.7m. We have revised up our earnings assumptions for FY24/25F by 3%-4% each year, driven mainly by higher NII assumptions.

Further upside on NIM in 2H23F. We continue to see a higher interest rate environment in 3Q23 q-o-q. We expect HSBC to continue to see significant y-o-y growth in NII in 3Q23F and 4Q23F, though the q-o-q change from 2Q23's level might be marginal. We have revised up our FY23/24/25F NIM assumptions by 3/9/10bps to reflect the higher-for-longer US rate expectation. Still, we expect HSBC to see NIM peak in 2H23F, and room is limited for NIM upside in FY24F from FY23's level, given 1) NII sensitivity tends to be lower when the rate level gets higher and 2) we expect the high-HIBOR volatility to carry on in 4Q23 and FY24, as loan demand in HK is likely to remain subdued when China onshore rates remain low.

Interest rate change in 3Q and our NIM assumptions

Interest rate (%)	2022	1Q23	2Q23	3Q23
1M HIBOR (avg)	1.46	3.03	4.00	4.82
Fed effective rate (avg)	1.69	4.52	4.99	5.26
BOE bank rate (avg)	1.46	3.85	4.45	5.16
DBS NIM forecast (%)	2022	2023F	2024F	2025F
Old	1.42	1.69	1.59	1.52
New	1.42	1.72	1.68	1.62

Source: Bloomberg Finance L.P., DBS HK

Higher expectation for ECL charges. In 3Q23, we see higher uncertainty in the China CRE sector, as some major POE names had difficulties in their bond repayment. We expect 3Q and 4Q to each see more than US\$1.1-1.3bn in ECL charges, vs. US\$1.3bn in 1H23. Looking ahead, we have higher assumptions for ECL charges for FY23/24F and expect a c.38-40bps credit charge for FY23/24F, which would reflect 1) the continuously cautious attitude towards China CRE and 2) the higher possibility of a downside scenario when global economic growth is faced with more pressure in the high-interest rate environment. DBS house view has cut its China/HK economic growth forecast for FY24F to 4.5%/2.0% in 3Q, which is below HSBC's central ECL scenario of 4.9%/3.2% in its interim report.

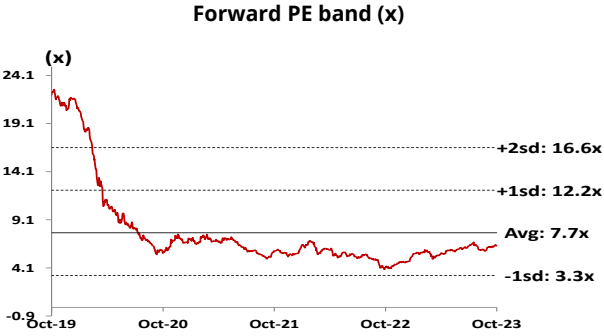
Returns improvement on track. Overall, we expect HSBC to be on track to achieve its mid-teen ROTE target and expect it to report 15%-17% in underlying ROTE for FY23/24F (or 16-18% for the reported number), driven by high NII, cost discipline, and more resources being allocated to higher return regions and segments. We expect a further share price upside along with the ROTE improvement. Also, it provides an attractive dividend yield of >8% for FY23/24F.

Company Background

HSBC first introduced local banking services in 1865 in Hong Kong and Shanghai. With various acquisitions, the bank conceived its "three-legged stool" strategy, representing its presence in the Asia-Pacific, the US, and the UK. It has dual listings on the Hong Kong Stock Exchange and London Stock Exchange. HSBC is one of the world's largest banking and financial service institutions with about US\$3tn in assets (as at end-Dec 2022). It operates three global businesses and a corporate centre: 1) Retail Banking and Wealth Management, 2) Commercial Banking, 3) Global Banking and Markets. It has 11 global functions, including for risk, finance, compliance, marketing, and legal.

HSBC Holdings

Historical PE and PB band



Source: Thomson Reuters, DBS HK

HSBC Holdings

Key Assumptions

FY Dec	2021A	2022A	2023F	2024F	2025F
NIM (%)	1.20	1.48	1.72	1.68	1.62
Loan growth (%)	1	(12)	3	1	3
Cost-to-income (%)	69	64	47	48	48
Credit cost (%)	(0.1)	0.3	0.4	0.4	0.4
Customer Deposits Growth (%)	4	(8)	2	2	5
Yld. On Earnings Assets (%)	1.66	2.63	2.90	2.84	2.74
Avg Cost Of Funds (%)	0.52	1.23	1.44	1.42	1.34

Source: Company, DBS HK

Income Statement (US\$ m)

FY Dec	2021A	2022A	2023F	2024F	2025F
Net Interest Income	26,489	32,610	37,020	37,561	37,150
Non-Interest Income	23,063	19,117	29,899	30,314	28,359
Operating Income	49,552	51,727	66,919	67,875	65,509
Operating Expenses	(34,620)	(33,330)	(31,418)	(32,460)	(31,687)
Pre-provision Profit	14,932	18,397	35,501	35,415	33,822
Provisions	928	(3,592)	(3,813)	(3,706)	(3,581)
Associates	3,046	2,723	3,008	3,008	3,008
Exceptionals	(3,010)	(6,482)	1,027	4,500	0
Pre-tax Profit	18,906	17,528	34,696	34,717	33,248
Taxation	(4,213)	(858)	(6,060)	(5,137)	(5,652)
Minority Interests	(776)	(635)	(725)	(761)	(799)
Preference Dividend	(1,310)	(1,213)	(1,213)	(1,213)	(1,213)
Net Profit	12,607	14,822	26,698	27,606	25,584
Net Profit bef Except	15,617	21,304	25,671	23,106	25,584

Growth (%)

Net Interest Income Gth	(3.95)	23.11	13.52	1.46	(1.09)
Net Profit Gth	223.42	17.57	80.12	3.40	(7.32)

Margins, Costs & Efficiency (%)

Spread	1.14	1.40	1.46	1.43	1.40
Net Interest Margin	1.21	1.56	1.72	1.68	1.62
Cost-to-Income Ratio	69.9	64.4	46.9	47.8	48.4

Business Mix (%)

Net Int. Inc / Opg Inc.	53.5	63.0	55.3	55.3	56.7
Non-Int. Inc / Opg inc.	46.5	37.0	44.7	44.7	43.3
Fee Inc / Opg Income	87.7	62.2	34.5	36.3	39.3
Oth Non-Int Inc/Opg Inc	0.0	0.0	0.0	0.0	0.0

Profitability (%)

ROAE Pre Ex.	7.6	10.9	13.6	11.8	12.8
ROAE	7.6	10.9	13.6	11.8	12.8
ROA Pre Ex.	0.5	0.7	0.9	0.7	0.8
ROA	0.4	0.5	0.9	0.9	0.8

Source: Company, DBS HK

HSBC Holdings

Balance Sheet (US\$ m)

FY Dec	2021A	2022A	2023F	2024F	2025F
Cash/Bank Balance	403,018	327,002	350,265	383,168	451,177
Government Securities	0	0	0	0	0
Inter Bank Assets	83,136	104,475	110,744	116,281	122,095
Total Net Loans & Adv.	1,045,814	923,561	952,600	962,126	990,989
Investment	446,274	364,726	353,784	353,784	353,784
Associates	29,609	29,254	31,953	34,900	38,120
Fixed Assets	0	0	0	0	0
Goodwill	20,622	11,419	11,419	11,419	11,419
Other Assets	0	0	0	0	0
Total Assets	2,957,939	2,949,286	3,068,610	3,198,035	3,393,436
Customer Deposits	1,710,574	1,570,303	1,601,709	1,633,743	1,715,430
Inter Bank Deposits	106,366	74,586	77,773	81,113	84,612
Debts/Borrowings	99,044	100,439	118,033	139,587	165,994
Others	0	0	0	0	0
Minorities	8,527	7,364	8,089	8,849	9,648
Shareholders' Funds	0	0	0	0	0
Total Liab& S/H's Funds	2,957,939	2,949,286	3,068,610	3,198,035	3,393,436

Source: Company, DBS HK

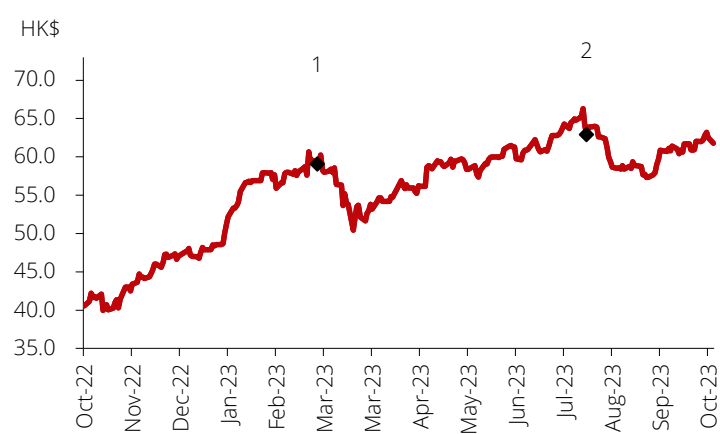
Financial Stability Measures (%)

FY Dec	2021A	2022A	2023F	2024F	2025F
Balance Sheet Structure					
Loan-to-Deposit Ratio	61.8	59.6	60.6	60.0	58.8
Net Loans / Total Assets	35.4	31.3	31.0	30.1	29.2
Investment / Total Assets	15.1	12.4	11.5	11.1	10.4
Cust. Dep./Int. Bear. Liab.	89.3	90.0	89.1	88.1	87.3
Interbank Dep / Int. Bear.	5.6	4.3	4.3	4.4	4.3
Asset Quality					
NPL / Total Gross Loans	1.8	2.1	2.4	2.1	1.9
NPL / Total Assets	0.6	0.7	0.8	0.6	0.6
Loan Loss Reserve Coverage	60.7	65.3	76.3	87.2	96.4
Provision Charge-Off Rate	(0.1)	0.4	0.4	0.4	0.4
Capital Strength					
Total CAR	21.2	19.3	19.4	19.3	19.0
Tier-1 CAR	18.5	16.6	16.7	16.6	16.4

Source: Company, DBS HK

HSBC Holdings

Target Price & Ratings 12-mth History



S.No.	Date	Closing Price	12-mth Target Price	Rating
1:	27-Feb-23	HK\$59.55	HK\$64.80	Buy
2:	3-Aug-23	HK\$64.20	HK\$71.70	Buy

Source: DBS HK

Analyst: Manyi Lu

Ken Shih

Iris GAO

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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)

SELL (negative total return of > -20% over the next 3 months, with identifiable share price catalysts within this time frame)

*Share price appreciation + dividends

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HSBC Holdings

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