Asia Credit Research

OCBC Bank

HSBC Holdings PLC: New Issue View

Monday, 17 September 2018

New Issue View: HSBC Holdings PLC ("HSBC") has announced a new SGD Additional Tier 1 ("AT1") capital instrument issue. The initial price guidance is around the 5.125% area. This is HSBC's second SGD AT1 following the HSBC 4.7% PerpC22s issued in June 2017.

We currently hold HSBC at a **Positive (2) Issuer Profile**. Peers with a comparable issuer profile that have also issued SGD AT1s include DBS Group Holdings Ltd and United Overseas Bank Ltd.

The initial price guidance in the 5.125% area implies a spread of around 280bps over 5 year swaps. Compared to the existing HSBC 4.7% PerpC22s which are currently trading at a yield to call of 4.55%, the new deal represents initially a 50bps pick up for a one year extension to call date. The relatively wide spread considering the current trading levels could be influenced by the reset spread for the existing HSBC 4.7% PerpC22s which is 2.87%.

Using the HSBC 4.7% PerpC22s as a reference, **we would see the new issue as better value if priced above ~4.8%**. At 4.8%, this would represent a 15bps pick up for the one year extension. That said, we would not be surprised if the deal prices wider considering the reset spread.

Although there may be some market indigestion from recent bank capital issues, there remains solid technical support for yields to tighten from the initial price guidance following recent sizeable maturities in the SGD capital instrument space and an overall lack of supply of rated high quality papers in the SGD space. YTD issuance[1] in the SGD corporate bond market (excluding government bonds, treasury bills and MAS bills) is down ~15% y/y as at 14th September 2018.

Figure 1: Relative Value

Bond	Maturity / Call date	CET1 Ratio	Ask Yield	Spread
HSBC 4.70 PERPc22	08/06/2022	14.2%	4.55%	230bps
DBSSP 3.98 PERPc25	12/09/2025	13.6%	4.05%	160bps
UOBSP 4.0 PERPc21	18/05/2021	14.5%	3.32%	115bps
BAERVX 5.90 PERPc20	18/11/2020	13.7%	3.89%	178bps
BAERVX 5.75 PERPc22	20/04/2022	13.7%	4.47%	223bps

Indicative prices as at 17 September 2018 Source: Bloomberg
Common Equity Tier 1 (CET1) Ratio based on latest available quarter

Background: HSBC Holdings PLC ('HSBC') is one of the world's largest banks by asset size and a global systemically important bank ('GSIB'). Based in London, it is the holding company for the HSBC Group which includes global banking operations across 67 countries and territories through major subsidiaries HSBC Bank PLC (in Europe and the UK) and The Hongkong and Shanghai Banking Corporation, Limited (in Asia) amongst others. As at 30 June 2018, it had total assets of USD2,607.3bn.

Key Credit considerations

- **Solid 2Q2018 results:** 2Q2018 reported revenues were up 3% y/y to USD13.6bn. Costs were up marginally by 1% y/y but together with a 44% fall in loan impairment charges and better performance from associates (+20% y/y), profit before tax for 2Q2018 rose 13% y/y to USD6.0bn. 1H2018 results were softer however with revenues up 4% y/y to USD27.3bn but higher loan impairment charges (+39% y/y) and higher expenses (+7% y/y) translated to a more moderate growth in profit before tax (+5% y/y) to USD10.7bn.

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[1] **For issuances above SGD50mn and excluding government bonds, treasury bills and MAS bills**

- **Rising expenses dent profits:** On an adjusted basis (adjusted for one-offs which were higher in prior periods), profit before tax for 2Q2018 and 1H2018 were down 1% and 2% y/y respectively primarily due to higher investment spending on growth and technology. As mentioned previously, elevated expenses are likely to continue as the bank continues to push into technology and the operating environment for HSBC remains supportive with decent underlying business and revenue growth in all business segments.

- **Underlying fundamentals supportive of margins and volumes:** On a segment basis, 1H2018 adjusted results were driven by weaker performance in the Corporate Centre (valuation differences on long term debt and associated swaps, higher interest expense from MREL costs, higher losses on disposal of legacy portfolios). This offset a 15% y/y improvement in Commercial Banking (better margins and loan volumes) and 7% y/y improvement in Retail Banking and Wealth Management (better deposit revenues). Adjusted profit before tax for Global Banking & Markets and Global Private Bank also rose by 1% (muted markets activity) and 32% (solid inflows in discretionary and advisory mandates) y/y respectively. Net interest margins ("NIMs") in 1H2018 rose 2bps y/y to 1.66% on better lending yields and higher deposit margins in Asia which offset a material fall in Europe NIMs (-17bps y/y) due to higher liquidity and funding costs connected to HSBC' regulatory restructuring and ringfencing. This somewhat drove geographical segment trends with adjusted profit before tax continuing to be supported by Asia (+14% y/y) and North America (+17% y/y) while Europe PBT was down 78% y/y. Reflecting business growth, loans grew 5% h/h and 3% q/q on a constant currency basis. Most of this growth was in Asia and primarily Hong Kong, in line with its recently announced strategy update. Non-performing loan ratio improved slightly q/q to 1.4% from 1.6% in 1Q2018.

- **Active capital management with an eye on the future position**: Despite a fall in risk weighted assets, HSBC's CET1 ratio at 14.2% was weaker as at 30 June 2018 compared to the 14.5% as at 31 March 2018 and 31 December 2017 due to dividend payments, share buy-back and foreign exchange differences. Share buy-backs are unlikely to continue however given management's focus on potential growth opportunities to improve returns, which could necessitate the need for additional capital.

OCBC Global Treasury	
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Explanation of Issuer Profile Rating ("IPR") / Issuer Profile Score ("IPS")

Positive ("Pos") – The issuer's credit profile is either strong on an absolute basis, or expected to improve to a strong position over the next six months.

Neutral ("N") – The issuer's credit profile is fair on an absolute basis, or expected to improve / deteriorate to a fair level over the next six months.

Negative ("Neg") – The issuer's credit profile is either weaker or highly geared on an absolute basis, or expected to deteriorate to a weak or highly geared position over the next six months.

To better differentiate relative credit quality of the issuers under our coverage, we have further sub-divided our Issuer Profile Ratings ("IPR") into a 7 point Issuer Profile Score ("IPS") scale.

IPR	Positive		Neutral			Negative	
IPS	1	2	3	4	5	6	7

Explanation of Bond Recommendation

Overweight ("OW") – The performance of the issuer's specific bond is expected to outperform the issuer's other bonds, or the bonds of other issuers either operating in the same sector or in a different sector but with similar tenor over the next six months.

Neutral ("N") – The performance of the issuer's specific bond is expected to perform in line with the issuer's other bonds, or the bonds of other issuers either operating in the same sector or in a different sector but with similar tenor over the next six months.

Underweight ("UW") – The performance of the issuer's specific bond is expected to underperform the issuer's other bonds, or the bonds of other issuers either operating in the same sector or in a different sector but with similar tenor over the next six months.

Other

Suspension – We may suspend our issuer rating and bond level recommendation on specific issuers from time to time when OCBC is engaged in other business activities with the issuer. Examples of such activities include acting as a joint lead manager or book runner in a new issue or as an agent in a consent solicitation exercise. We will resume our coverage once these activities are completed.

Withdrawal ("WD") – We may withdraw our issuer rating and bond level recommendation on specific issuers from time to time when corporate actions are announced but the outcome of these actions are highly uncertain. We will resume our coverage once there is sufficient clarity in our view on the impact of the proposed action.

Analyst Declaration

The analyst(s) who wrote this report and/or her or his respective connected persons did not hold securities in the above-mentioned issuer or company as at the time of the publication of this report.

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