Earnings Review: Standard Chartered PLC ("StanChart")

Asia Credit Research

Issuer Profile: Neutral (4)

Ticker: **STANLN**

Background

Formed almost 50 years ago, Standard Chartered PLC ('StanChart') is a universal bank, offering broad services aligned both globally and regionally. Although headquartered in the UK, StanChart's footprint is skewed towards emerging markets, mostly in Greater China & North Asia (Hong Kong), followed by ASEAN & South Asia. As at 31 December 2018, it had total assets of USD688.8bn.

Andrew Wong
+65 6530 4736
WongVKAM@ocbc.com

Recommendation

- Underlying performance in StanChart's FY2018 results continue to be constructive on solid earnings and an improved balance sheet. With its capital position sound, we retain StanChart's Neutral (4) Issuer Profile.
- With its 2015 strategic plan in the rear view mirror, the bank has announced its new 2019-2021 strategic plan focused on on-going transformation.
- With some potential event risk around Commerzbank AG, we tend to look to SOCGEN 4.3% '26c21s and LBBW 3.75% '27c22s given the STANLN 4.4 '26c21 looks tight in our view. We rate all of the below five issuers at Neutral (4) Issuer Profile.

Relative Value:

Bond	Maturity / Call date	CET1 Ratio	Ask Yield	Spread
STANLN 4.4 '26c21 (T2)	23/01/2021	14.2%	3.18%	120
SOCGEN 4.3 '26c21 (T2)	19/05/2021	11.2%	3.78%	180
CMZB 4.875 '27c22 (T2)	01/03/2022	12.9%	4.47%	248
LBBW 3.75 '27c22 (T2)	18/05/2022	14.9%	4.26%	226
CMZB 4.2 '28c23 (T2)	18/09/2023	12.9%	4.55%	252
BACR 3.75 '30c25 (T2)	23/05/2025	13.2%	5.66%	353

Indicative prices as at 27 February 2019 Source: Bloomberg
Common Equity Tier 1 (CET1) Ratio based on latest available quarter

Key Considerations

- **Ending on a positive note:** StanChart's FY2018 results represent the final year of the bank's 2015 Transformation plan and show fundamentals on an improving trend. Operating income was up 5% y/y due to an 8% y/y rise in net interest income (improved net interest margin as well as better performance in Cash Management and Deposits and Wealth Management) and 1% y/y rise in other income. Concurrently, overall operating expenses rose at a slower pace, up 3% y/y, as higher investment expenditure on technology was balanced by cost control. Management has indicated that the bank exceeded its 2015 Transformation plan with USD3.2bn in gross cost efficiencies to date and this cost performance likely contributed to the positive income-to-cost operating leverage (or "jaws"). Together with a 38% y/y fall in credit impairments from lower impairments in Corporate & Institutional Banking, underlying profit before tax ("uPBT") saw a noticeable y/y improvement, up 28% y/y to USD3.86bn. Growth in statutory profit was lower however up 6% y/y to USD2.5bn due to the setting aside of USD900mn in its 4Q2018 results to cover potential regulatory fines related to legacy financial crime control matters and FX trading issues. While the additional provisioning weakened the reported results, it may not necessarily signal a bad thing but rather a desire to face the future with a clean slate.

- **Growth through diversity:** By segment, operating income improvement was broad based with Corporate & Institutional Banking income up 6% y/y from a better quality client book as well as higher interest rates that drove a 22% y/y rise in Cash Management and Custody income that offset asset margin compression in Corporate Finance and Trade Finance. The Retail Banking and Commercial Banking segments both saw income up 4% y/y from better performance in Greater China & North Asia (in particular China and Hong Kong) and ASEAN & South Asia (mostly Singapore) that mitigated lower y/y operating income from Africa & Middle East on difficult macro-economic conditions. Trends are a little less broad based on a uPBT basis with Corporate & Institutional Banking up 64% y/y and Retail Banking up 18% y/y while Commercial Banking uPBT was down 21% y/y. This was due to this segments' higher exposure to Africa & Middle East and higher impairments. This lowered Commercial Banking's contribution to overall uPBT to 5.8% (9.4% in FYU2017) while Corporate & Institutional Banking contribution rose to 53.7% of overall uPBT (41.9% in FY2017) and Retail Banking contribution rose to 26.8% of overall uPBT (29.0% in FY2017). By geography, Greater China & North Asia continues to be the main contributor to uPBT at 61.4% followed by ASEAN & South Asia at 25.1% and Africa & Middle East at 13.8%.

- **Improved balance sheet quality from repositioning and reduction:** Loan quality continues to improve due partially to the bank's focus on high-quality origination (StanChart has stated that exposure to investment grade clients rose to 62% from 57%) and also from the reduction of exposures in the liquidation portfolio. The liquidation portfolio reduced by 39% y/y while loans from ongoing business rose 1.8%. Overall impaired loans fell by 13.7% y/y through lower new inflows as well as debt sales, write-offs and repayments. Overall coverage ratios for impaired loans remained constant as the fall in impaired loans was matched by the fall in provisions.

- **Positive impact on capital position:** StanChart's CET1 ratio improved to 14.2% as at 31 December 2018 from 13.6% as at 31 December 2017, well above StanChart's previous CET1 target range of 12-13% and slightly above the updated target CET1 range of 13-14% (see below). The improvement was driven by lower credit risk weighted assets ("RWA") from RWA efficiencies and net positive credit migration that reduced more than capital through the impact of regulatory adjustments. Overall, StanChart's capital position is in line with its constructive results from the Bank of England stress test in late 2018 in our view.

- **Setting a new path**: Aside from presenting the full year results, StanChart also announced its new 3-year strategic plan which is focused on further transformation following a focus on turnaround in the prior 3-year plan over 2015-2018. Key strategies include (1) digital transformation; (2) growing its affluent client business; (3) improving productivity; (4) optimising low-return markets of India, United Arab Emirates, Korea and Indonesia; and (5) continuing to deliver on its international network. Key financial targets accompanying these strategies include 5-7% CAGR in income, a CET1 target ratio of 13%-14%, USD700mn in gross cost reduction and greater than 10% return on tangible equity by 2021 (5.1% in FY2018). The market's lukewarm response to the plan is somewhat understandable as banks face a challenging and low return environment going forward, which will likely make successful execution of this new strategic plan more challenging going forward.

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 financial interests in the above-mentioned issuer or company as at the time of the publication of this report.

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