Issuer Profile:
Positive (2)

Ticker:
HSBC

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HSBC Holdings PLC ("HSBC")

Recommendation

- **Despite solid results in 1H2019, HSBC's outlook is clouded from event risk in its major markets and changing expectations for the operating outlook. This has necessitated a rethink of current strategy and prompted a change in CEO.**
- **Buffering challenging conditions is HSBC's size and operating diversity as well as its capital position which has enabled the bank to announce a share buyback.**
- **We are overweight several European AT1s with shorter call dates given the carry and still decent fundamentals. While duration is attractive with the current rates outlook, we prefer to stay relatively short until there is more clarity around event risks and their impact on the economic outlook.**

Relative Value:

Bond	Maturity / Call date	CET1 Ratio	Ask YTW	Spread
HSBC 4.7 PERPc22	08/06/2022	14.3%	4.13%	256bps
HSBC 5.0 PERPc23	24/09/2023	14.3%	4.32%	277bps
BAERVX 5.90 PERPc22	18/11/2020	13.1%	3.64%	202bps
BAERVX 5.75 PERPc22	20/04/2022	13.1%	4.27%	270bps
UBS 5.875 PERPc23	28/11/2023	13.3%	4.50%	295bps
UOBSP 4.0 PERPc21	18/05/2021	13.9%	2.94%	135bps

Indicative prices as at 06 August 2019 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'). As at 30 June 2019, it had total assets of USD2,751.3bn.
- Based in London, it is the holding company for the HSBC Group which includes global banking operations across 65 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.

Key Considerations

- **Solid y/y growth impacted by adjustments**: HSBC reported solid 1H2019 results with reported profit before tax up 15.8% y/y to USD12.4bn. This was driven by a 7.6% y/y rise in reported revenue from better performance in both Retail Banking and Wealth Management segment and Commercial Banking segment while Global Banking and Markets segment performance was impacted by weaker market activity and lower spreads. At the same time, reported operating expenses were down 2.3% y/y while a noticeable 180% y/y rise in risk costs weakened the reported profit before tax growth. Excluding significant items (includes disposals, acquisitions and investments as well as customer redress programmes and restructuring and other related costs) which in 1H2019 included dilution gains from the merger of The Saudi British Bank with Alawwal bank in Saudi Arabia, provisions for mis-selling of payment protection insurance, and severance costs associated with restructuring, adjusted revenue growth was higher (+8.0% y/y) and adjusted operating expenses rose 3.5% y/y leading to adjusted profit before tax only rising 6.8% y/y to USD12.5bn.

- **Activity driving adjusted performance**: Revenue growth reflected solid momentum in Retail Banking from deposits and lending, mostly in Hong Kong and the UK. At the same time, higher insurance revenues offset lower investment distribution revenues in Wealth Management. Together with improved margins, adjusted revenues in Retail Banking and Wealth Management rose 12% y/y. Revenue growth of 9% y/y in Commercial Banking was broad based through a mix of volume growth (higher deposit balances in UK, Credit and

Lending) and improvement in Global Trade and Receivables Finance while Private Banking adjusted revenues grew 2% y/y from growth in Asia. Conversely, weaker market activity and volatility in Global Banking and Markets along with spread compression in Foreign Exchange and Equities led to a 3% y/y fall in adjusted segment revenues against 1H2018 which also included restructuring gains on corporate lending. On the expense front, adjusted operating expenses were higher y/y on investment in growth as well as digitalisation and absence of favourable foreign currency translation differences. While adjusted expected credit losses and other credit impairment charges were noticeably higher y/y, according to management this was due to a small number of Commercial Banking exposures in HSBC UK and increased charges in Hong Kong and mainland China. 1H2018 also included net releases in Asia and North America and higher net releases from HSBC's legacy credit portfolio. Otherwise, other loan quality metrics remain solid with the ratio of expected credit losses to average gross loans and advances of 22bps in 2Q2019 below previous quarters (23bps in 1Q2019, 34bps in 4Q2018) while the ratio of Stage 3 loans to total customer loans and advances of 1.3% has been stable over the same period. Given volume growth, HSBC's reported advances to deposit ratio has risen to 74.0% in 1H2019 which management hope will support earnings going forward.

- **Diversity in segments supporting performance**: Segment trends show some divergence compared to prior periods with contribution from Retail Banking and Wealth Management rising to 35.5% of total adjusted profit before tax (30.6% in 1H2018) while Global Banking and Markets contribution fell to 22.6% in 1H2019 (29.3% in 1H2018). Commercial Banking and Global Private Banking contributions were relatively stable y/y (32.1% and 1.6% respectively) while Corporate Centre (intra-Group elimination items, Central Treasury, UK bank levy, legacy businesses, associates and joint ventures interests) contribution rose to 8.2%. From a geographic perspective, Europe performance on a reported profit before tax basis was notably weaker (loss of USD520mn in 1H2019 against profit of USD110mn in 1H2018 on stable revenues and a 7.6% y/y rise in operating expenses from USD888mn in the aforementioned significant items) in 1H2019 and, although stronger Asia performance partially mitigated this (+4.3% y/y from Hong Kong, the Pearl River Delta and Singapore), the consolidated reported profit before tax growth y/y was mostly driven by better performance in Middle East and North Africa and a recovery in performance from North America. This resulted in a higher contribution from Middle East and North Africa and North America to 1H2019 consolidated reported profit before tax (14% and 6% respectively) while Asia's contribution (while still dominant) fell to 78.8% in 1H2019 from 87.6% in 1H2018. Performance of HSBC's other geographic segments will be important given potential challenges to Asia performance given recent geopolitical developments in China and Hong Kong. Asia will continue to be a focus given HSBC's strategic priority on, and pivot towards, its strong Asia franchise. HSBC's US segment will also be a focus as part of its desire to turnaround low return businesses. Management have indicated that the turnaround of HSBC's US business remains the most challenging strategic priority.

- **Capital position adequate for buybacks**: HSBC's capital position improved due to strong capital generation which offset dividends and risk weighted asset growth with its CET1 ratio of 14.3% as at 30 June 2019 stable q/q and up 30bps from 14.0% as at 31 December 2018. This remains well above disclosed CET1 minimum capital requirements of 11.4% and is above HSBC's assumed range of above 14.0% through 2020. Its total loss absorbing capacity ratio of 29.3% as at 30 June 2019 is also above 2019 indicative requirements. Given HSBC's solid capital position, management intends to initiate a USD1bn share buyback, while at the same time proceeding with issuance plans that involve issuing hold co senior and additional tier 1 instruments. The exact quantum of issuance however depends on further balance sheet growth and the future operating environment.

- **Times are changing as are people**: HSBC's results reflect its current strategy that is centered on eight strategic priorities. Three of the eight priorities are targeted for growth while two are aimed at improving profitability to create capacity to fulfill a further two priorities that deal with increasing investment. Despite solid progress to date, a strategic rethink has been flagged given the current strategic plan is targeted to end in 2020, but more so given the operating environment and outlook has now changed to one of lower interest rates and ongoing geopolitical uncertainty from Brexit, US trade wars, and unrest in Hong Kong which all look to impact future earnings growth potential. As such, HSBC is expected to focus now on managing operating expenses and investment spend, already indicating plans to reduce headcount. As part of these changes, current CEO John Flint will also leave the bank after an 18-month tenure. According to HSBC, his departure does not indicate that its direction has changed but that someone different is required to take that direction forward.

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 scale ("IPS").

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.

Please note that Bond Recommendations are dependent on a bond's price, underlying risk free rates and an implied credit spread that reflects the strength of the issuer's credit profile. Bond Recommendations may not be relied upon if one or more of these factors change.

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. We may also suspend our issuer rating and bond level recommendation in the ordinary course of business if (1) we believe the current issuer profile is incorrect and we have incomplete information to complete a review; or (2) where evolving circumstances and increasingly divergent outcomes for different investors results in less conviction on providing a bond level recommendation.

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.

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