

HSBC

Performed well supported by capital return, sector rotation, Chinese buying; Downgrade to Neutral

HSBC's shares are up with events now...

HSBC's share price is up 17% in Sterling since early August results, adding US\$25bn to market cap and prompting increased investor interest in the stock and, given large benchmark weights, FTSE100, Hang Seng and European banks too. This puts HSBC's forward P/E at its highest level since 2010, a healthy premium to relevant peers such as the Eurobanks sector and Citi. We see little in the operating environment and conversations with investors to justify a further re-rating of the stock in the near term.

...assisted by strong flows from mainland China

Part of HSBC's re-rating is likely down to a recent surge in demand for the bank's stock in Hong Kong from mainland Chinese investors via the Shanghai and Shenzhen Stock Connect facilities. Last week, southbound demand made up an average 38% of Hong Kong volumes, peaking on Thursday at 56% of shares traded. As a firm we are not negative on the outlook for a continuation of growth in Connect volumes in future. But this week [our China strategists turned more cautious](#) on H-shares given the sector's move and a number of near-term constraining issues.

We don't think HSBC is a Sell, however

We don't think HSBC is a Sell. Recent results confirmed progress on costs and sufficient confidence on capital to confirm plans to pay a 51cps future dividend – a running yield of ~5% net of scrip – and launch a US\$2.5bn share buyback paid from the proceeds of the Brazilian disposal. On the analyst call management suggested, we think, that another buyback may be forthcoming if HSBC succeeds in releasing capital trapped in the US since the Capital One sale in 2012. In a world of low yields and capital concerns, we view decent income and non-UK exposure as attractive features of the stock.

Valuation: 11.3x 2017E PE, 5.1% net yield, downgrade to Neutral

Despite the rally we see no basis at this stage to change our assumed cost of equity or earnings estimates. This leaves HSBC at 11.3x 2017E EPS and with a 5.1% net yield. At 1.0x TNAV, HSBC is trading a touch ahead of our 9% forward ROTE. Our target prices move only from FX changes to 540p / HK\$56 from 535p / HK\$54.6. With modest capital downside offset by dividend yield we downgrade from Buy to Neutral.

Equities

United Kingdom
Banks, Ex-S&L

12-month rating **Neutral**
Prior: Buy

12m price target **540p**
Prior: 535p

Price **566p**

RIC: HSBA.L **BBG:** HSBA LN

Trading data and key metrics

52-wk range	582p-416
Market cap.	£113bn/US\$150bn
Shares o/s	19,924m (ORD)
Free float	100%
Avg. daily volume ('000)	34,812
Avg. daily value (m)	£172.2
Common s/h equity (12/16E)	US\$172bn
P/BV (12/16E)	0.9x
Tier 1 ratio	14%

EPS (UBS, diluted) (US\$)

	UBS	Cons.
12/16E	0.63	0.58
12/17E	0.66	0.60
12/18E	0.73	0.66

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Highlights (US\$m)	12/13	12/14	12/15	12/16E	12/17E	12/18E	12/19E	12/20E
Revenues	63,733	62,001	57,955	52,600	51,272	53,566	56,814	59,811
Profit before tax	22,565	18,680	18,867	13,000	16,719	22,599	25,964	28,593
Net earnings (local GAAP)	15,631	13,115	12,572	7,797	10,368	14,720	17,154	19,024
Net earnings (UBS)	15,835	16,673	13,962	12,534	13,453	15,145	17,580	19,450
Tier 1 ratio %	13.0	11.6	12.7	13.7	13.9	14.3	15.0	15.5
EPS (UBS, diluted) (US\$)	0.85	0.87	0.72	0.63	0.66	0.73	0.83	0.89
Profitability/valuation	12/13	12/14	12/15	12/16E	12/17E	12/18E	12/19E	12/20E
ROE (UBS) %	9.2	9.4	7.9	7.3	7.7	8.5	9.4	9.8
P/POP (diluted)	7.8	8.2	7.8	7.0	6.9	6.5	6.0	5.7
P/BV x	1.2	1.1	1.0	0.9	0.9	0.9	0.8	0.8
P/BV (UBS) x	1.4	1.3	1.1	1.0	1.0	1.0	0.9	0.9
P/E (UBS, diluted)	12.9	11.8	12.1	12.0	11.3	10.3	9.1	8.4
Net dividend yield %	4.5	4.8	5.9	6.8	6.8	5.3	6.0	6.6

Source: Company accounts, Thomson Reuters, UBS estimates. Metrics marked as (UBS) have had analyst adjustments applied. Valuations: based on an average share price that year, (E): based on a share price of 566p on 12 Sep 2016 21:41 BST

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UBS Research THESIS MAP a guide to our thinking and what's where in this report**PIVOTAL QUESTIONS****Q: Should you own HSBC for US\$-rate gearing?**

For the medium term, yes. All else equal, HSBC's rate gearing looks considerable – we estimate worth 20% of market cap if three hikes were retained by the banking industry. But given market concerns on the rate outlook and an industry track record of fairly consistent margin decline, we include only modest margin expansion in our numbers from 2018E.

Q: Would credibility on costs deliver a re-rating?

Yes, we think so. If HSBC hits its cost targets we would expect our fair value to rise by ~10% of market cap. Despite outperforming market expectations again on costs in 2Q16, we and consensus assume a miss to plan: possible upside in the event of successful delivery in line with targets.

UBS VIEW

Thanks to capital strength, c.7% headline dividend yield and significant non-Sterling earnings, HSBC has outperformed UK peers since the EU referendum. But, with a 69% loan deposit ratio and US\$400bn in excess deposits, the flattening of world yield curves and weaker medium-term outlook for UK and US official rates after the EU referendum leaves the outlook for revenues less positive than before. Management remains under pressure to deliver the US\$29.2bn 2017 cost target, despite having confirmed that the 10% ROE target will not be achieved in that year. With a commitment to a flat dividend and potential upside from deal / restructuring-driven buybacks in 2017, HSBC continues to offer stability and income.

EVIDENCE

A new company earnings model gives us greater clarity on the drivers of the business, we think. 2Q16 results saw another quarter of progress on costs and revenue momentum which justified a 2-4% EPS upgrade.

WHAT'S PRICED IN?

Trading at a net dividend yield of 5.1% and 1.0x TNAV for a forecast ROTE of 9%, we think the share discounts near-term delivery on the dividend. This is a change that has taken place over the last month, we think. Though buying from mainland China and underweight European investors create risks that the valuation could overshoot, we think the stock price is now up with events.

UPSIDE / DOWNSIDE SPECTRUM

Value drivers	NIM delta	Cost delta	Cost of risk	Adj. net profit	17E EPS	17E P/E	16E P/TNAV
690p upside	0.20%	1,500	0.42%	17,211	0.86	10.6	1.2
540p base	0.00%	0	0.42%	13,453	0.67	10.6	0.9
455p downside	0.00%	-1,000	0.62%	11,307	0.57	10.6	0.8

Source: UBS estimates

[more →](#)**COMPANY DESCRIPTION**

HSBC employs 255,000 staff members operating in 6,000 offices in 71 countries and territories. A global universal bank, HSBC is managed across a matrix of four global businesses...

[more →](#)

COMMENTARY

[return](#) ↑

We think the HSBC shares are up with events

HSBC has performed well this year in a difficult market, up 5% in absolute terms, bettered only by StanChart amongst the UK majors, which has risen 10% in Sterling (Figure 1). Factoring in HSBC's decent running yield, the performance gap to StanChart narrows to ~1% for a lower-risk bank – a decent outcome, we think.

HSBC's performance as a stock since 2Q16 results on 3 August is even better than these figures suggest, rising ~17%, a gain worth US\$21bn in market cap terms.

Figure 1: HSBC is up 17% since 2Q16 results, passing our target price

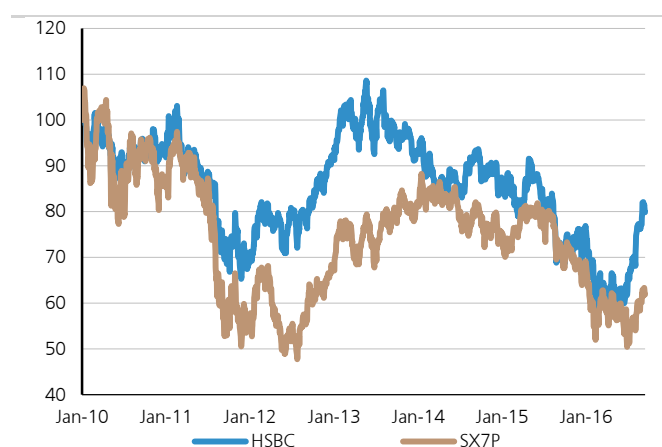
The referendum snap-back	Large Banks					UK Challengers				
	Barclays	HSBC	LBG	RBS	StanChart	Aldermore	Metro	Paragon	Shawbrook	Virgin
% day 1	-18%	-1%	-21%	-18%	-3%	-32%	-9%	-16%	-21%	-25%
% at worst	-32%	-4%	-34%	-41%	-9%	-49%	-23%	-27%	-55%	-44%
% from the bottom	34%	29%	20%	34%	17%	67%	70%	40%	83%	46%
% at 30 August 2016	-9%	24%	-21%	-20%	7%	-15%	31%	3%	-18%	-18%
Since HSBC 2Q16 results	16%	17%	8%	7%	5%	27%	35%	20%	32%	16%
YTD	-22%	5%	-22%	-34%	10%	-25%	38%	-10%	-31%	-21%

Source: Datastream; Priced to open on 12 September 2016; Note: Metro YTD performance is since March IPO.

A meaningful move relative to peers and relative to history

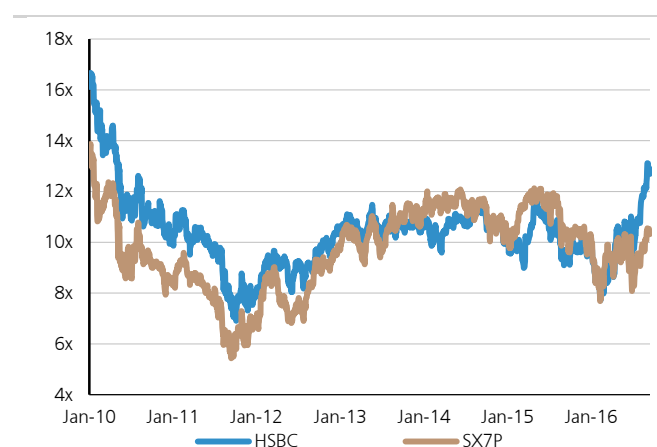
The move in HSBC's stock price has prompted a noticeable increase in investor interest in the stock. This interest appears to have been split almost equally between those looking at the relative charts below – which show a meaningful relative move – and arguing for a relative underweight, and those looking at the more recent steepening of global yield curves and the rally in other 'value' sectors and wondering whether covering a financials underweight via HSBC is the obvious low-risk move.

Figure 2: HSBC is +17% since 2Q results, Eurobanks +15%



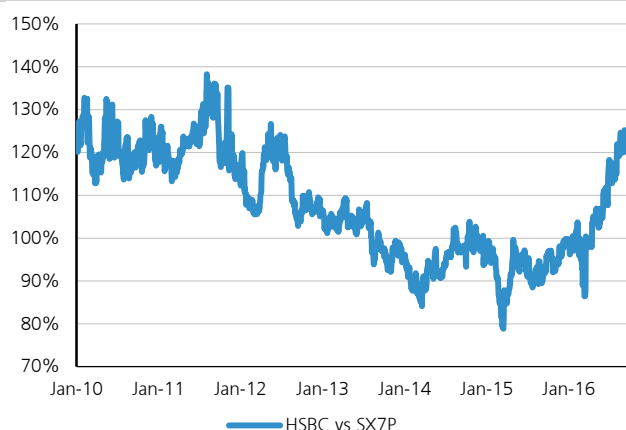
Source: Datastream. Note: rebased to 100 on 1/1/2010

Figure 3: ...which takes HSBC P/E to highest since 2010



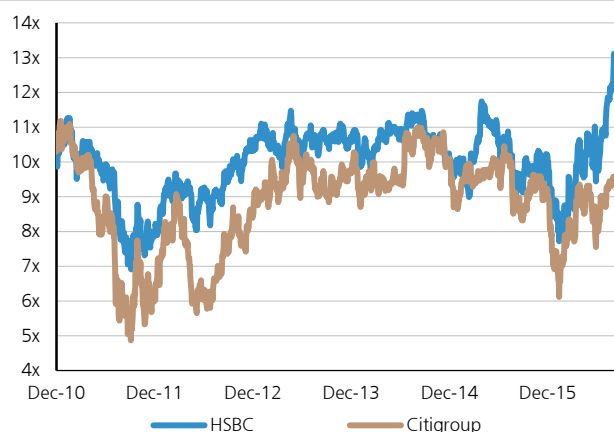
Source: Datastream

Figure 4: HSBC one year forward P/E relative to Eurobanks: back to the 2012 premium.... (latest 123%)



Source: Datastream

Figure 6: HSBC is at a meaningful premium to arguable peers like Citi... (one year forward P/E)



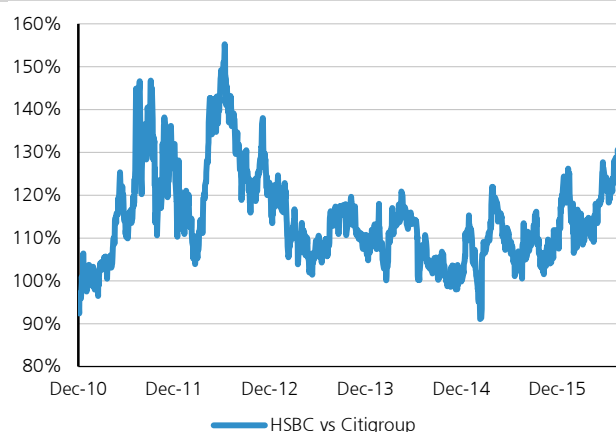
Source: Datastream

Figure 5: ...with the P/B relative to Eurobanks back to 2013 levels (125%)



Source: Datastream

Figure 7: ...which prompts the question as to whether the recent rally should be assumed to be about US\$ rate gearing (one year forward P/E relative)

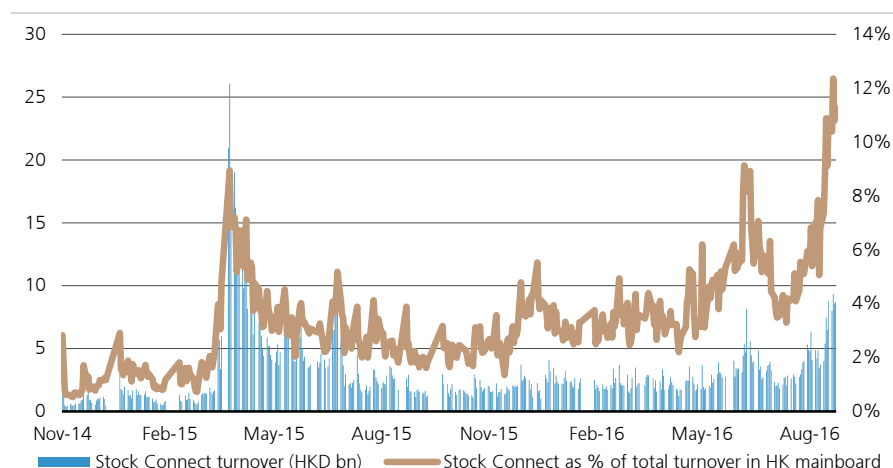


Source: Datastream

A rally partially supported by mainland Chinese buying

The role of mainland Chinese buyers of stock in Hong Kong via the Shanghai and Shenzhen Connect facilities appears to be supporting the HSBC share price, too. Southbound buying (from mainland China into Hong Kong) has been significant: Net southbound flow reached Rmb24.9bn last week, with last Friday seeing Rmb6.09bn, the highest daily volume since early April 2015, over 11% of the HK market volume (Figure 8).

Figure 8: Stock Connect now more than 10% of HK main board volumes traded



Source: HKEX, WInd

Within this, mainland Chinese buyers *have* been significant bidders for HSBC (and ICBC and other large-cap Hong Kong names). Last Friday, Stock Connect buyers were 28% of Hong Kong shares traded in HSBC, down from a 45% and 56% in the preceding two days (Figure 9).

Figure 9: Stock Connect volumes have been up to 58% of recent HSBC trading volumes in Hong Kong

	Stock Connect volumes (HK\$'m)				Shares traded							
	Buy	Sell	Total	HK VWAP (HK\$)	HK shares traded (m's)	Connect: Buy (m's)	Connect: Sell (m's)	Connect: Total (m's)	Buys % of total	Sells % of total	Total % of total	
01-Aug-16	10	69	79	51	20	0	1	2	1%	7%	8%	
03-Aug-16	169	68	236	51	56	3	1	5	6%	2%	8%	
04-Aug-16	25	69	94	53	48	0	1	2	1%	3%	4%	
05-Aug-16	27	19	45	54	34	0	0	1	1%	1%	2%	
15-Aug-16	104	45	149	55	18	2	1	3	10%	4%	15%	
16-Aug-16	57	35	92	54	20	1	1	2	5%	3%	9%	
18-Aug-16	166	59	226	55	23	3	1	4	13%	5%	17%	
23-Aug-16	18	39	57	55	12	0	1	1	3%	6%	8%	
24-Aug-16	136	4	141	55	13	2	0	3	19%	1%	20%	
25-Aug-16	146	22	168	56	20	3	0	3	13%	2%	15%	
26-Aug-16	212	2	214	56	16	4	0	4	24%	0%	24%	
29-Aug-16	156	1	157	56	13	3	0	3	22%	0%	22%	
30-Aug-16	332	8	340	56	25	6	0	6	23%	1%	24%	
31-Aug-16	1,064	9	1,073	57	48	19	0	19	39%	0%	39%	
01-Sep-16	930	10	940	59	67	16	0	16	24%	0%	24%	
02-Sep-16	1,306	4	1,310	59	58	22	0	22	38%	0%	38%	
05-Sep-16	621	17	638	60	41	10	0	11	25%	1%	26%	
06-Sep-16	757	10	767	60	34	13	0	13	37%	0%	38%	
07-Sep-16	1,160	7	1,166	59	43	20	0	20	45%	0%	46%	
08-Sep-16	1,408	52	1,460	59	43	24	1	25	56%	2%	58%	
09-Sep-16	757	1	758	60	44	13	0	13	28%	0%	28%	

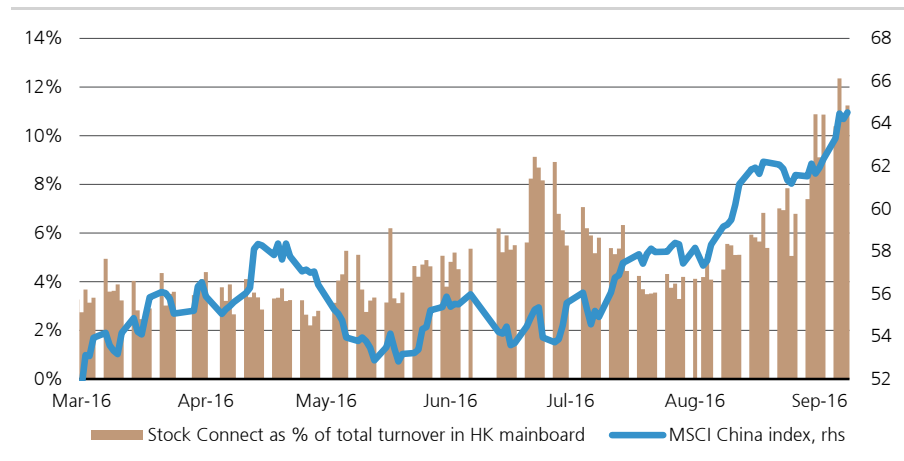
Source: HKEX; Note: Missing days are those in which HSBC was outside top ten shares traded by value via Connect

This increase in traded volume mirrors that of the broader market, visible in Figure 8 above. Our [recent research](#) highlights Connect facilities as a potential positive driver of the HK market for perhaps the next two to three years. Near term Connect volumes may also benefit from the CIRC giving approval for mainland insurers to begin trading via the same facility, covered in our research of [12 September](#). We understand that, while some large insurers have been investing in

the HK stock market via Connect, most small insurers are yet to open accounts for trading under the arrangement.

Overall, however, [this same work](#) suggests real risks to near-term performance given strength in the index, the potential near-term US\$ rate increase, a smaller price gap between mainland and HK stocks, and a rebound in the on-shore risk-free rate.

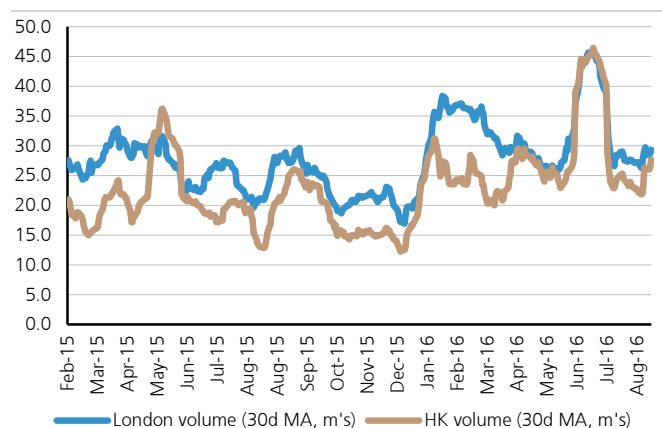
Figure 10: Stock Connect's share of HK market turnover, and MSCI China trend



Source: Bloomberg, Wind, UBSS

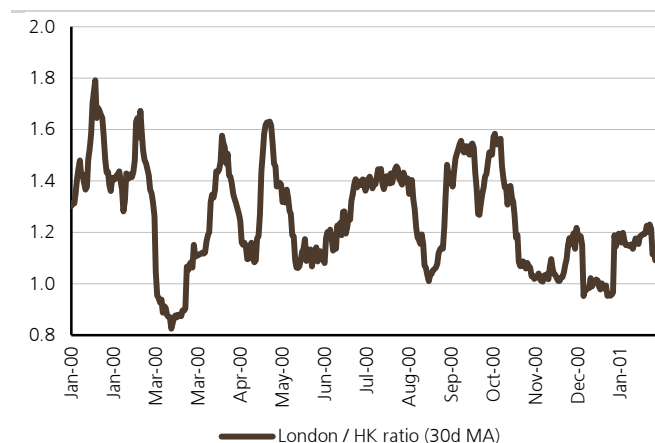
Focussing on HSBC specifically though, it is worth reflecting that, though Connect volumes are a significant proportion of HK-traded volumes, total shares traded are up just 10% MoM: how much do we want to assume that this volumes increase is what has driven a 13% rally in the share (Figure 11)?

Figure 11: Volumes are up around 10% MoM over the last month in Hong Kong



Source: Datastream

Figure 12: London trades an average 130% of the volumes of shares traded in Hong Kong



Source: Datastream

Though up a little on the July volumes, the September figures are not wildly different from those seen over the past 18 months (Figure 11). London has traded around 10% more shares than Hong Kong over the past 30 days – again, lower than before, but not unprecedented (Figure 12).

The buyback, executed in London, won't have hurt

HSBC announced a \$2.5bn buyback programme with its H1 results following the completion of the Brazil sale. The buybacks conducted since then have on average constituted ~9% of daily trading by value increasing over that time; helpful but not decisive for performance in that period we think.

Figure 13: HSBC's buyback programme has constituted 9% of daily trading on average, and is only 20% done

Date	Number of shares	VWAP (£)	Value (£m)	Value (\$m)	Cumulative value (\$m)	% target	Daily trading (£m)	Buyback as % of daily trading	% cumulative trading
04-Aug-16	1,997,288	5.14	10.3	13.5	13.5	1%	270.3	4%	4%
09-Aug-16	886,944	5.39	4.8	6.2	19.7	1%	110.0	4%	4%
10-Aug-16	1,663,380	5.43	9.0	11.7	31.4	1%	147.1	6%	5%
11-Aug-16	1,828,535	5.42	9.9	12.8	44.3	2%	136.8	7%	5%
12-Aug-16	1,783,703	5.46	9.7	12.6	56.8	2%	95.4	10%	6%
15-Aug-16	1,450,013	5.47	7.9	10.2	67.0	3%	132.9	6%	6%
16-Aug-16	2,669,846	5.43	14.5	18.9	86.0	3%	150.9	10%	6%
17-Aug-16	3,019,977	5.44	16.4	21.4	107.4	4%	169.4	10%	7%
18-Aug-16	2,163,157	5.44	11.8	15.5	122.9	5%	107.6	11%	7%
19-Aug-16	1,774,619	5.42	9.6	12.6	135.4	5%	140.3	7%	7%
22-Aug-16	1,670,237	5.43	9.1	11.9	147.3	6%	89.3	10%	7%
23-Aug-16	2,158,718	5.42	11.7	15.4	162.8	7%	104.4	11%	8%
24-Aug-16	2,196,956	5.42	11.9	15.7	178.5	7%	105.8	11%	8%
25-Aug-16	2,462,519	5.42	13.3	17.6	196.1	8%	120.5	11%	8%
26-Aug-16	1,918,363	5.46	10.5	13.8	209.9	8%	98.4	11%	8%
30-Aug-16	3,406,568	5.57	19.0	24.8	234.7	9%	204.0	9%	8%
31-Aug-16	4,236,584	5.67	24.0	31.5	266.2	11%	266.5	9%	8%
01-Sep-16	5,397,828	5.74	31.0	41.1	307.3	12%	284.5	11%	9%
02-Sep-16	4,359,599	5.76	25.1	33.4	340.7	14%	350.9	7%	8%
05-Sep-16	2,684,847	5.80	15.6	20.7	361.4	14%	124.7	12%	9%
06-Sep-16	3,697,223	5.74	21.2	28.5	389.9	16%	218.9	10%	9%
07-Sep-16	4,125,298	5.68	23.4	31.3	421.2	17%	262.3	9%	9%
08-Sep-16	3,685,752	5.72	21.1	28.0	449.2	18%	192.8	11%	9%
09-Sep-16	3,886,383	5.79	22.5	29.8	479.0	19%	219.4	10%	9%
12-Sep-16	3,761,666	5.65	21.3	28.4	507.4	20%	189.9	11%	9%

Source: Company disclosure, UBS estimates

Nevertheless, HSBC is only one fifth of the way through its buyback programme, which is due to complete by the end of 2016 at the latest. With 78 working days left in the year, this leaves HSBC needing to complete ~\$26m per day, equivalent to ~12% of average daily trading YTD. This level of trading is in line with recent activity.

Figure 14: Buybacks left – 12% of average daily trading YTD

Target (\$m)	2,500
\$m completed	507
\$m left	1,993
Trading days left	78
\$m per day needed	25.5
YTD ADV (\$m)	217
% ADV	12%

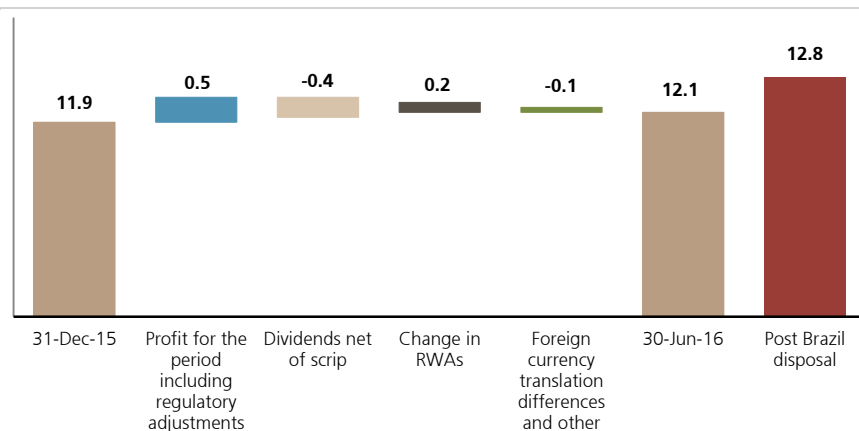
Source: UBS estimates

We don't think the stock is a Sell, either

Though HSBC has rallied significantly relative to its peers and its own valuation history, we don't see the re-rating as excessively overdone either. As discussed in our [results review](#) of 3 August we saw a number of attractive features to the 2Q16 results, including:

- **Better earnings.** 2Q16 adjusted EPS was 9% above consensus driven mostly by revenues, 3% ahead of market expectations.
- **Continued delivery on costs.** Continued signs of progress on the group's end-2017 cost target of flat expenses on the 2014 adjusted base of US\$29bn via US\$4.5bn-5.0bn gross cost savings. CEO Stuart Gulliver on the results call shared an expectation of another cost plan in the next strategy period (2018+).
- **Better capital ratio & share buyback.** HSBC's common equity tier 1 ratio of 12.1% was 10bps ahead of consensus. The real surprise, however, was the announced US\$2.5bn buyback, worth 23bps of CT1 and 2% of market cap, which the company has been executing over the last month or so. On the investor call management were clear that buyback capacity is driven by the 70bps gain to CT1 delivered by the sale of the business in Brazil to Bradesco which closed on 1 July. The gain on that deal took the 2Q16 CT1 ratio from 12.1% to 12.8%; net of the buyback – which the UK regulator approved – HSBC is managing to a ~12.5% CT1 ratio, the rough mid-point of the 12-13% longer-run group capital target.

Figure 15: 20bps of organic capital generation plus 70bps of disposal gains make room for US\$2.5bn buyback

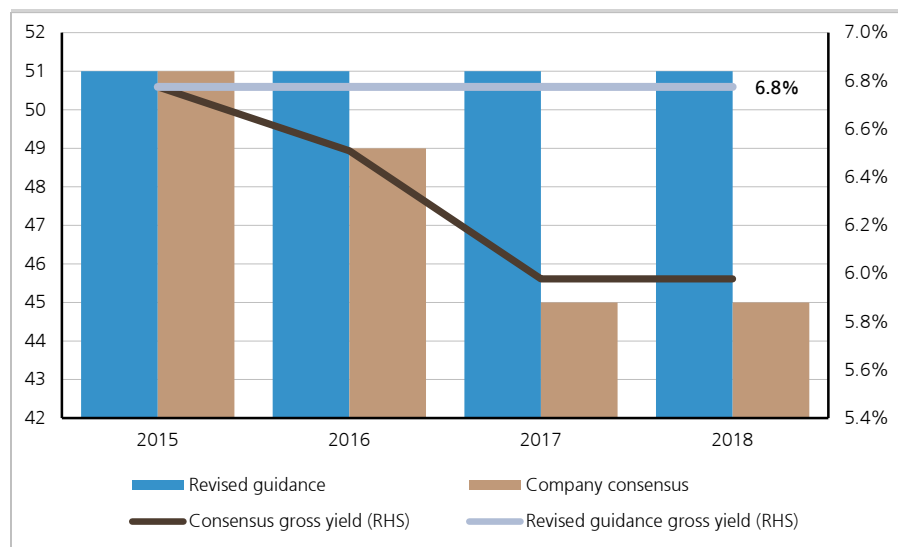


Source: Company data

- **Confidence on capital, additional excess capital returns to come.** We think HSBC was clear on the conference call that another buyback should follow similar future capital releases. Management cited capital trapped in the US since the card business sale to Capital One in 2012 for a US\$3.1bn capital gain. In the 2016 CCAR process the Fed did not object to a dividend from the US holdco to the Group being included in the plan for 1H17. This would be the first dividend out of the US entity since 2007 for HSBC.
- **Dividends to be kept flat at 51cps, superseding a previous ambition of delivering growth from 2015's 51cps.** Company consensus DPS for 2016 – 2018 pre-results was for a fall from 51cps to 45cps (Figure 16). The buyback and flat dividend plan under current management reassured many investors we

spoke to on the near-term outlook despite the near 100% stated payout ratio that the latter implies relative to our numbers (Figure 17).

Figure 16: Consensus already had a cut in dividends in estimates: There was reassurance in guidance of a flat payout at 51cps



Source: Company data, Company consensus; Note: Priced with HSBC at 566p and cable at 1.33.

We continue to model a lower payout ratio post 2018 on the assumption that potential new management will either see greater opportunities for growth or will wish to commit to a lower payout ratio. It is right to point out, though, that on our estimates a flat dividend is affordable – and that capital not returned isn't the same as capital not owned at all.

Figure 17: HSBC: DPS, payout ratios and capital formation

	FY15	FY16E	FY17E	FY18E	FY19E	FY20E
DPS (\$ p.s.)	0.51	0.51	0.51	0.40	0.45	0.50
Pay out ratio (Stated)	79%	130%	99%	56%	55%	57%
Pay out ratio (Adj.)	71%	81%	77%	55%	54%	56%
Scrip take-up	16%	25%	25%	25%	25%	25%
Scrip-adjusted payout ratio	60%	61%	58%	41%	41%	42%
CET1 %	11.9%	12.3%	12.5%	12.9%	13.5%	14.1%
Delta vs 13% CET1 (\$ p.s.)	-0.64	-0.36	-0.26	-0.04	0.28	0.57

Source: UBS estimates

Negatively, with 2Q16 results, HSBC management did remove the 2017 target date for the 10% ROE target. But, though abandoned targets are rarely good news, we estimated pre-results company consensus had underlying ROE at ~7.5% for 2017-18 respectively, making confirmation of a delay in double-digit returns a non-event in our view. Post results we modestly increased our EPS estimates – by 2-4% in each year.

Post the recent rally we see no basis to meaningfully change either cost of equity or earnings estimates at this juncture. This leaves HSBC trading at 11.3x 2017E EPS and with a running gross dividend yield of 6.8%. Allowing for a 25% scrip take-up, this yield falls to 5.1%. At 1.0x TNAV, HSBC is trading a touch ahead of our 9% forward ROTE estimate (Figure 18).

Figure 18: HSBC key forecasts and valuation metrics

US\$m	2011	2012	2013	2014	2015	2016e	2017e	2018e	2019e	2020e
Stated net income	16,224	13,454	15,631	13,115	12,572	7,797	10,368	14,720	17,154	19,024
UBS adj. net income	14,306	13,967	15,835	16,673	13,962	12,534	13,453	15,145	17,580	19,450
Stated EPS	0.92	0.74	0.84	0.69	0.65	0.39	0.52	0.71	0.81	0.88
UBS Adj. EPS (US\$)	0.80	0.76	0.85	0.87	0.72	0.63	0.66	0.73	0.83	0.89
DPS (US\$)	0.41	0.45	0.49	0.50	0.51	0.51	0.51	0.40	0.45	0.50
TNAV per share (US\$)	6.93	7.55	7.76	7.87	7.56	7.65	7.62	7.78	8.12	8.48
CET1 % (Fully Loaded)	10.1%	9.0%	10.9%	11.1%	11.9%	12.3%	12.5%	12.9%	13.5%	14.1%
T1 lev ratio (Fully loaded)	4.67%	4.18%	4.38%	4.8%	5.0%	5.2%	5.3%	5.5%	5.7%	6.0%
ROTE (Stated)	13.8%	10.2%	10.9%	8.8%	8.4%	5.2%	6.8%	9.3%	10.2%	10.6%
ROTE (Adj.)	12.1%	10.6%	11.1%	11.2%	9.3%	8.3%	8.8%	9.5%	10.5%	10.8%
Market Cap (£m)	104,623	101,673	128,329	118,535	109,373	112,690	112,690	112,690	112,690	112,690
P/E (UBS Adj.) (x)	11.9	11.8	12.9	11.8	12.1	12.0	11.3	10.3	9.1	8.4
Div yield (%)	4.3	5.0	4.5	4.8	5.9	6.8	6.8	5.3	6.0	6.6
P/TNAV (x)	1.4	1.2	1.4	1.3	1.1	1.0	1.0	1.0	0.9	0.9
Excess cap over 13% as % MV	-21%	-32%	-13%	-12%	-7%	-6%	-5%	-1%	5%	11%

Source: UBS estimates, Company data; Note: Priced with HSBC at 566p on 12 September 2016

Our target price is derived by the sum of the parts shown in Figure 19. The multiples applied are set with reference to growth and returns in the divisions concerned and multiples at which peers are trading. With estimates and cost of equity unchanged, our target prices move only by FX rate changes since our [August publication](#): Our UK target price rises to 540p from 535p and our HK\$ equivalent moves to HK\$56 from HK\$54.6. With modest downside to our target prices offset by running yield, we downgrade from Buy to Neutral.

Figure 19: HSBC sum of the parts valuation

	PBT (2017e)	PAT (2017e)	TNAV (2016e)	ROTE (2017e)	P/TNAV (2017e)	P/E	Value (US\$m)	Value / Share	% of val.	% of earnings
RBWM	6,399	4,512	24,328	18.6%	2.2	12.0	54,146	2.71	37%	34%
CMB	8,084	5,211	62,213	8.2%	1.0	12.0	62,534	3.13	42%	39%
GBM	7,942	5,100	65,329	7.9%	0.8	10.2	52,263	2.61	35%	38%
GPB	380	246	2,868	8.5%	1.0	12.0	2,958	0.15	2%	2%
Operating divisions	22,805	15,070	154,738	9.7%	1.1	11.4	171,902	8.60	116%	112%
Other	-2,027	-1,617	5,256			11.4	-18,440	-0.92	-12%	-12%
Capital surplus (2017e)			-5,228		1.0		-5,228	-0.26	-4%	
Group	20,779	13,453	154,981	8.4%	1.0	11.0	148,234	7.41	100%	100%
							Discounted	7.17		
							Sterling	540p		
							HK\$	56		

Source: UBS estimates

UPSIDE / DOWNSIDE SPECTRUM

[return](#) ↑

HSBC is trading at
566p as of
12 September 2016

Value drivers	NIM delta	Cost delta	Cost of risk	Adj. net profit	17E EPS	17E P/E	16E P/TNAV
690p upside	0.20%	1,500	0.42%	17,211	0.86	10.6	1.2
540p base	0.00%	0	0.42%	13,453	0.67	10.6	0.9
455p downside	0.00%	-1,000	0.62%	11,307	0.57	10.6	0.8

Source: UBS estimates

Share price risks are equally skewed to the upside and downside

HSBC is trading at **566p** as of 12 September 2016.

Upside (690p/HK\$71): In an upside scenario, margins remain more resilient than our estimates expect and HSBC modestly beats its cost targets. At the same earnings multiple this leads to an upside fair value of 690p/HK\$71.

Base (540p/HK\$56): Our base case valuation uses a sum-of-the-parts model adjusted for target capital levels. We incorporate NIM contraction and a moderate cost miss in 2017/18. This yields a base case valuation of 540p/HK\$56.

Downside (455p/HK\$47): In a downside scenario, we assume HSBC misses its cost targets by a considerable amount and impairments prove worse than expected in Asia and the UK. At the same P/E multiple, this yields a downside fair value of 455p/HK\$47.

COMPANY DESCRIPTION

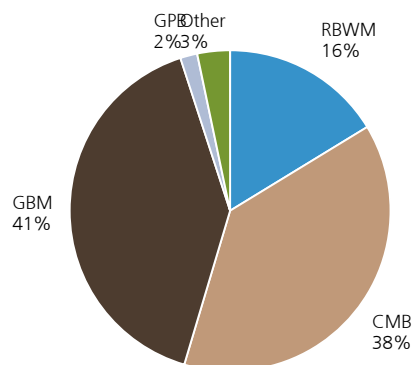
[return](#) ↑

Market Cap	£115bn
Shares Outstanding	19.6bn
Industry	Banks
Region	Europe
Website	www.hsbc.com

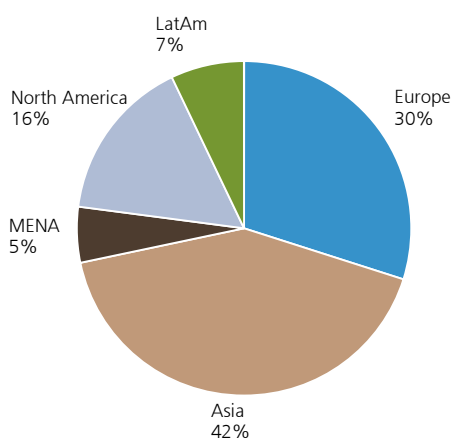
HSBC employs 255,000 staff members operating in 6,000 offices in 71 countries and territories. A global universal bank, HSBC is managed across a matrix of four global businesses (Retail Banking & Wealth Management, Commercial Banking, Global Banking & Markets, Private Banking) and five geographies (Europe, Asia, Middle East and North Africa, North America, Latin America). Breadth of operations, liquidity of balance sheet (with US\$400bn in excess deposits), strength in UK and Hong Kong retail banking, and investment banking reach are distinctive features of HSBC.

Industry outlook

HSBC's main "home" markets are the UK and Hong Kong with the investment bank the other main contributor to group earnings. We expect consistent profit and capital generation in the UK and Hong Kong, despite holding a cautious view on the outlook for property prices in Hong Kong. While the outlook for global investment banking revenues remains uncertain in the near term, we expect long-term growth in income for transaction banking, FX and large corporate banking in particular, all of which are meaningful businesses for HSBC.

Capital deployment by business (2Q16)

Source: UBS estimates

Capital deployment by geography (2Q16)

Source: UBS estimates

HSBC (HSBA.L)

	12/13	12/14	12/15	12/16E	% ch	12/17E	% ch	12/18E	12/19E	12/20E
Profit & Loss (US\$m)										
Net income interest	35,539	35,337	32,541	30,004	-7.8	28,910	-3.6	30,128	32,288	34,162
Total non interest income	28,194	26,664	25,414	22,596	-11.1	22,362	-1.0	23,437	24,526	25,648
Total income	63,733	62,001	57,955	52,600	-9.2	51,272	-2.5	53,566	56,814	59,811
Total cash expenses	(36,261)	(36,471)	(34,913)	(29,726)	14.9	(27,845)	6.3	(28,057)	(28,770)	(29,517)
Pre-depreciation operating profit	27,472	25,530	23,042	22,874	-0.7	23,426	2.4	25,509	28,044	30,294
Depreciation & amort (excl. goodwill)	(1,364)	(1,382)	(1,269)	(1,269)	0.0	(1,269)	0.0	(1,269)	(1,269)	(1,269)
Operating profit pre provisions	26,108	24,148	21,773	21,605	-0.8	22,157	2.6	24,240	26,775	29,025
Total provisions	(5,849)	(3,851)	(3,721)	(4,164)	-11.9	(3,804)	8.7	(3,600)	(2,867)	(2,587)
Operating profit post provisions	20,259	20,297	18,052	17,440	-3.4	18,353	5.2	20,640	23,908	26,438
Income from associates & JVs (pre-tax)	2,325	2,532	2,556	2,373	-7.1	2,425	2.2	2,518	2,615	2,716
Other pre-tax items	0	0	0	0	-	0	-	0	0	0
Profit before tax (UBS)	22,584	22,829	20,608	19,814	-3.9	20,779	4.9	23,159	26,524	29,153
Exceptionals (incl goodwill)	(19)	(4,149)	(1,741)	(6,814)	-291.4	(4,060)	40.4	(560)	(560)	(560)
Profit before tax	22,565	18,680	18,867	13,000	-31.1	16,719	28.6	22,599	25,964	28,593
Tax	(4,765)	(3,975)	(3,771)	(2,976)	21.1	(4,012)	-34.8	(5,424)	(6,231)	(6,862)
Profit after tax	17,800	14,705	15,096	10,024	-33.6	12,706	26.8	17,175	19,732	21,731
Other post-tax items	0	0	0	0	-	0	-	0	0	0
Preference dividends	(573)	(573)	(950)	(1,216)	-28.0	(1,277)	-5.0	(1,341)	(1,408)	(1,478)
Minorities	(1,596)	(1,017)	(1,574)	(1,011)	35.8	(1,062)	-5.0	(1,115)	(1,170)	(1,229)
Net earnings (local GAAP)	15,631	13,115	12,572	7,797	-38.0	10,368	33.0	14,720	17,154	19,024
Net earnings (before pref divs)	16,204	13,688	13,522	9,013	-33.3	11,645	29.2	16,061	18,562	20,502
Net earnings (UBS)	15,835	16,673	13,962	12,534	-10.2	13,453	7.3	15,145	17,580	19,450
Per share (US\$)										
EPS (local GAAP, basic)	0.84	0.69	0.65	0.39	-39.3	0.52	31.0	0.71	0.81	0.88
EPS (UBS, diluted)	0.85	0.87	0.72	0.63	-12.2	0.66	5.8	0.73	0.83	0.89
PPOP (diluted)	1.40	1.27	1.12	1.08	-2.9	1.09	1.1	1.17	1.26	1.33
Net DPS	0.49	0.50	0.51	0.51	0.0	0.51	0.0	0.40	0.45	0.50
BVPS	9.45	9.38	8.88	8.68	-2.3	8.60	-0.9	8.72	9.02	9.33
BVPS (UBS)	7.84	7.94	7.62	7.65	0.3	7.62	-0.4	7.78	8.12	8.48
Balance sheet (US\$m)										
Banking assets (year end)	2,671,318	2,634,139	2,409,656	2,530,139	5.0	2,530,139	0.0	2,606,043	2,684,224	2,764,751
Banking assets (average)	2,681,928	2,652,729	2,521,898	2,469,897	-2.1	2,530,139	2.4	2,568,091	2,645,134	2,724,488
Total assets (year end)	2,671,318	2,634,139	2,409,656	2,530,139	5.0	2,530,139	0.0	2,606,043	2,684,224	2,764,751
Risk weighted assets (RWA) (year end)	1,214,939	1,219,800	1,103,000	1,065,339	-3.4	1,074,706	0.9	1,112,832	1,138,550	1,174,393
Risk weighted assets (RWA) (average)	1,252,075	1,217,370	1,161,400	1,084,170	-6.6	1,070,022	-1.3	1,093,769	1,125,691	1,156,472
Customer loans	1,080,304	974,660	924,454	899,207	-2.7	924,421	2.8	953,175	987,294	1,023,334
Customer loans (average)	1,038,964	1,027,482	949,557	911,831	-4.0	911,814	0.0	938,798	970,235	1,005,314
Interest earning assets (average)	1,669,368	1,786,536	1,726,949	1,721,881	-0.3	1,721,850	0.0	1,772,806	1,832,171	1,898,413
Customer deposits	1,482,812	1,350,642	1,289,586	1,273,465	-1.3	1,304,706	2.5	1,338,532	1,376,638	1,415,949
Common s/h equity (year end)	176,020	178,915	173,348	172,249	-0.6	174,995	1.6	181,901	192,787	204,572
Common s/h equity (average)	172,706	177,468	176,132	172,798	-1.9	173,622	0.5	178,448	187,344	198,679
Total SHF (equity, pref & MI) (year end)	190,459	199,978	197,518	200,498	1.5	203,944	1.7	211,585	223,243	235,838
Total SHF (equity, pref & MI) (average)	186,794	195,219	198,748	199,008	0.1	202,221	1.6	207,765	217,414	229,541
Net tangible assets	160,541	172,401	172,913	180,076	4.1	183,931	2.1	191,972	204,022	217,002
Balance sheet structure (%)										
Loans / banking assets (year end)	40.4	37.0	38.4	35.5	-7.4	36.5	2.8	36.6	36.8	37.0
Deposits / banking assets (year end)	55.5	51.3	53.5	50.3	-6.0	51.6	2.5	51.4	51.3	51.2
Loans / deposits	72.9	72.2	71.7	70.6	-1.5	70.9	0.3	71.2	71.7	72.3
Total SHF / banking assets (year end)	7.1	7.6	8.2	7.9	-3.3	8.1	1.7	8.1	8.3	8.5

Source: Company accounts, UBS estimates. (UBS) metrics use reported figures which have been adjusted by UBS analysts.

HSBC (HSBA.L)

	12/13	12/14	12/15	12/16E	12/17E	12/18E	12/19E	12/20E
Capital adequacy (US\$m)								
Tier 1 capital	158,155	142,031	140,233	145,424	149,184	159,194	170,235	182,157
Total capital	194,009	156,299	155,688	161,866	165,626	175,636	186,677	198,599
Risk weighted assets (RWA) (year end)	1,214,939	1,219,800	1,103,000	1,065,339	1,074,706	1,112,832	1,138,550	1,174,393
Core tier 1 ratio %	10.9	11.1	11.9	12.3	12.5	12.9	13.5	14.1
Tier 1 ratio %	13.0	11.6	12.7	13.7	13.9	14.3	15.0	15.5
Total capital ratio %	16.0	12.8	14.1	15.2	15.4	15.8	16.4	16.9
Tangible equity	146,102	151,338	148,743	151,827	154,981	162,287	173,565	185,735
Equity / assets %	6.6	6.8	7.2	6.8	6.9	7.0	7.2	7.4
Tangible equity to tangible assets %	5.5	5.8	6.2	6.0	6.2	6.3	6.5	6.8
Asset quality (US\$m)								
Non performing assets	36,503	29,283	23,758	24,660	27,214	24,822	19,855	19,147
Total risk reserves	15,201	12,337	9,555	10,578	12,298	11,699	9,413	9,254
NPLs / loans %	3.3	3.0	2.5	2.7	2.9	2.6	2.0	1.9
NPL coverage %	41.6	42.1	40.2	42.9	45.2	47.1	47.4	48.3
Provision charge / average loans %	0.6	0.4	0.4	0.5	0.4	0.4	0.3	0.3
Net NPAs / shareholders funds %	11.2	8.5	7.2	7.0	7.3	6.2	4.7	4.2
Profitability (%)								
Net interest margin (avg assets)	1.33	1.33	1.29	1.21	1.14	1.17	1.22	1.25
Provisions / operating profit	22.4	15.9	17.1	19.3	17.2	14.8	10.7	8.9
ROE (UBS earnings)	9.2	9.4	7.9	7.3	7.7	8.5	9.4	9.8
RoAdjE (UBS earnings & equity)	11.1	11.2	9.3	8.3	8.8	9.5	10.5	10.8
RoRWA (UBS)	1.39	1.45	1.34	1.25	1.36	1.49	1.67	1.79
RoA (UBS earnings)	0.66	0.55	0.60	0.41	0.50	0.67	0.75	0.80
Productivity (%)								
Cost income ratio	60.5	61.1	62.4	58.9	56.8	54.7	52.9	51.5
Cost / average assets	1.40	1.43	1.43	1.25	1.15	1.14	1.14	1.13
Compensation expense ratio	42.4	45.8	47.8	47.3	45.9	43.4	41.6	40.3
Growth (%)								
Revenue	-4.2	-2.7	-6.5	-9.2	-2.5	4.5	6.1	5.3
Operating profit pre provisions	6.3	-7.5	-9.8	-0.8	2.6	9.4	10.5	8.4
Net earnings (UBS)	13.4	5.3	-16.3	-10.2	7.3	12.6	16.1	10.6
Net DPS	8.9	2.0	2.0	0.0	0.0	-21.6	12.5	11.1
Total assets (year end)	-0.8	-1.4	-8.5	5.0	0.0	3.0	3.0	3.0
Customer loans	8.3	-9.8	-5.2	-2.7	2.8	3.1	3.6	3.7
Customer deposits	10.7	-8.9	-4.5	-1.3	2.5	2.6	2.8	2.9
Value (x)								
Market cap/revenues	3.1	3.1	2.9	2.9	2.9	2.8	2.6	2.5
Market cap/deposits	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
P/PPOP (diluted)	7.8	8.2	7.8	7.0	6.9	6.5	6.0	5.7
P/E (local GAAP, basic)	13.0	14.9	13.4	19.2	14.6	10.6	9.3	8.6
P/E (UBS, diluted)	12.9	11.8	12.1	12.0	11.3	10.3	9.1	8.4
Net dividend yield %	4.5	4.8	5.9	6.8	6.8	5.3	6.0	6.6
P/BV x	1.2	1.1	1.0	0.9	0.9	0.9	0.8	0.8
P/BV (UBS) x	1.4	1.3	1.1	1.0	1.0	1.0	0.9	0.9

Source: Company accounts, UBS estimates. (UBS) metrics use reported figures which have been adjusted by UBS analysts.

Forecast returns

Forecast price appreciation	-4.5%
Forecast dividend yield	6.8%
Forecast stock return	+2.3%
Market return assumption	5.2%
Forecast excess return	-2.9%

Valuation Method and Risk Statement

HSBC operates globally. This exposes it to considerable financial risk from macroeconomic changes, as well as moves in interest rates and credit quality. Our valuation method is based on a sum-of-the-parts using peer multiples and a 10% cost of equity.

Required Disclosures

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UBS Investment Research: Global Equity Rating Definitions

12-Month Rating	Definition	Coverage ¹	IB Services ²
Buy	FSR is > 6% above the MRA.	47%	32%
Neutral	FSR is between -6% and 6% of the MRA.	38%	25%
Sell	FSR is > 6% below the MRA.	15%	21%
Short-Term Rating	Definition	Coverage ³	IB Services ⁴
Buy	Stock price expected to rise within three months from the time the rating was assigned because of a specific catalyst or event.	<1%	<1%
Sell	Stock price expected to fall within three months from the time the rating was assigned because of a specific catalyst or event.	<1%	<1%

Source: UBS. Rating allocations are as of 30 June 2016.

1:Percentage of companies under coverage globally within the 12-month rating category.

2:Percentage of companies within the 12-month rating category for which investment banking (IB) services were provided within the past 12 months.

3:Percentage of companies under coverage globally within the Short-Term rating category.

4:Percentage of companies within the Short-Term rating category for which investment banking (IB) services were provided within the past 12 months.

KEY DEFINITIONS: **Forecast Stock Return (FSR)** is defined as expected percentage price appreciation plus gross dividend yield over the next 12 months. **Market Return Assumption (MRA)** is defined as the one-year local market interest rate plus 5% (a proxy for, and not a forecast of, the equity risk premium). **Under Review (UR)** Stocks may be flagged as UR by the analyst, indicating that the stock's price target and/or rating are subject to possible change in the near term, usually in response to an event that may affect the investment case or valuation. **Short-Term Ratings** reflect the expected near-term (up to three months) performance of the stock and do not reflect any change in the fundamental view or investment case. **Equity Price Targets** have an investment horizon of 12 months.

EXCEPTIONS AND SPECIAL CASES: **UK and European Investment Fund ratings and definitions are:** **Buy:** Positive on factors such as structure, management, performance record, discount; **Neutral:** Neutral on factors such as structure, management, performance record, discount; **Sell:** Negative on factors such as structure, management, performance record, discount. **Core Banding Exceptions (CBE):** Exceptions to the standard +/-6% bands may be granted by the Investment Review Committee (IRC). Factors considered by the IRC include the stock's volatility and the credit spread of the respective company's debt. As a result, stocks deemed to be very high or low risk may be subject to higher or lower bands as they relate to the rating. When such exceptions apply, they will be identified in the Company Disclosures table in the relevant research piece.

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UBS Limited: Jason Napier, CFA; Ivan Jevremovic.

Company Disclosures

Company Name	Reuters	12-month rating	Short-term rating	Price	Price date
HSBC ^{2, 4, 5, 6, 7, 16a, 16b}	HSBA.L	Buy	N/A	566p	12 Sep 2016
HSBC Holdings ^{2, 4, 5, 6, 7, 16a, 16b}	0005.HK	Buy	N/A	HK\$58.25	12 Sep 2016

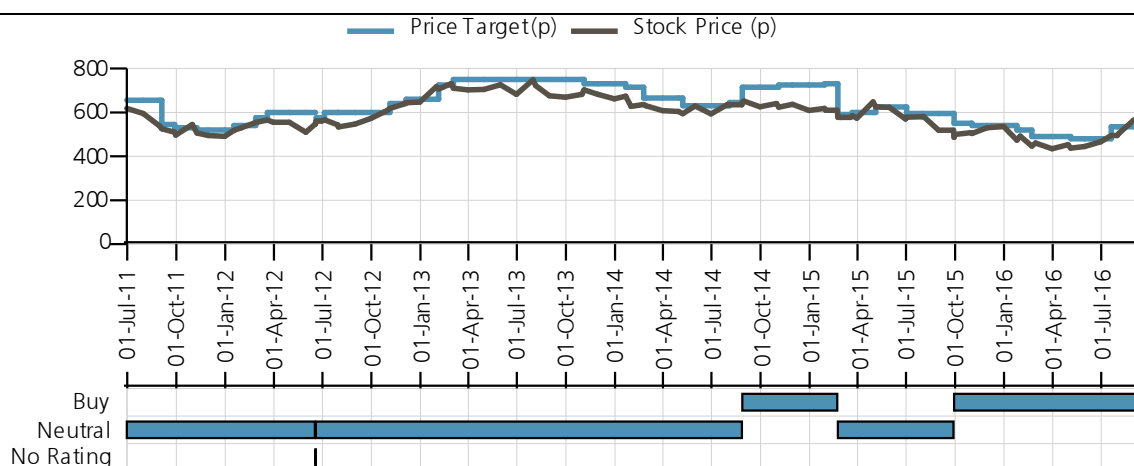
Source: UBS. All prices as of local market close.

Ratings in this table are the most current published ratings prior to this report. They may be more recent than the stock pricing date

2. UBS AG, its affiliates or subsidiaries has acted as manager/co-manager in the underwriting or placement of securities of this company/entity or one of its affiliates within the past 12 months.
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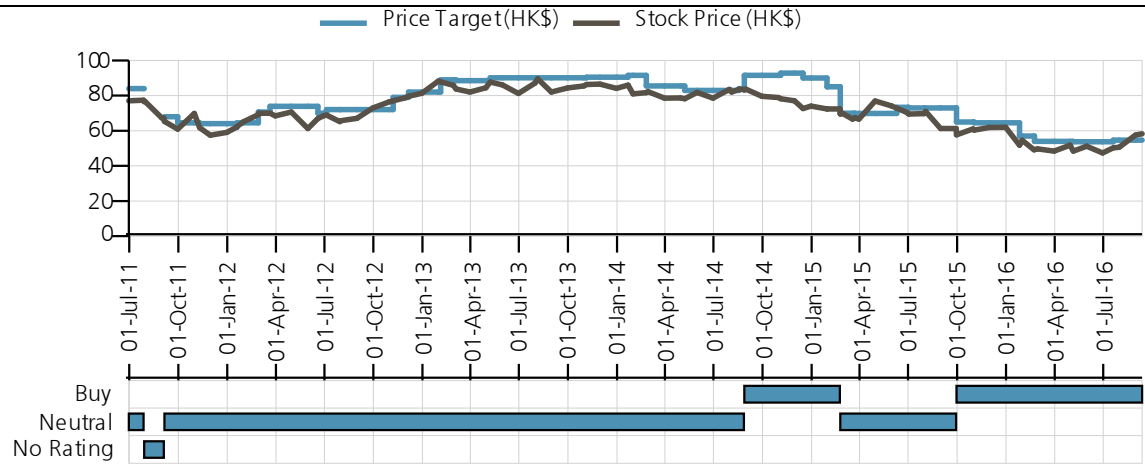
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HSBC (p)



Source: UBS; as of 12 Sep 2016

HSBC Holdings (HK\$)



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