

HSBC

Reassuring numbers in a tough market

1Q16 results were 11% ahead of company-consensus expectations

HSBC's 1Q16 profit before tax and significant items of US\$5,434m was 11% above company consensus of US\$4,884m. Within this, revenues were 2% ahead (-10% YoY in constant FX), costs a significant 6% better (down 8% YoY) while loan losses were 16% above consensus at 50bps of loans, driven in part by commodity-related hits.

Costs are coming out, though we're prepared for the next quarters to be softer

For a company with a mixed track record of delivering on costs, the operating expense outcome is especially noteworthy. Though some of this is down to FX moves, both expenses and income beat market expectations, with HSBC reconfirming its target of delivering end-2017 run rate costs in line with 2014 levels of ~US\$29.2bn ex levy.

Softer capital down to lower scrip take-up, re-iterated dividend plans

Common equity tier 1 of 11.9% was 20bps below the market expectation of 12.1%, mostly driven by higher RWAs, with a surprising underlying increase in GBM capital demand particularly noteworthy. Important for a yield-driven stock like HSBC, a 10cps interim dividend was declared in line with last year and our forecast for a flat dividend in 2016. Management reiterated a progressive dividend policy on the analyst call.

Valuation: 9.2x 2017 EPS, 0.8x TNAV for 9% ROTE, 8.0% running yield

HSBC's numbers were better than market expectations and with a decent mix. Progress on costs is helpful but with 4Q15 results missing market numbers by 47% we expect cautious estimate revisions from the sell side. We have HSBC trading at 0.8x TNAV for a 9% forecast ROTE. At an 8.0% running yield we think the share discounts a cut to dividends in 2016 or 2017. Though we include a dividend reset for 2018 in our brand new model we still see decent income generation for investors thereafter. At 10.2x / 9.2x 2016 / 2017 EPS HSBC trades in line with the European average despite superior yield and significant upside gearing to rates. Our sum of the parts-derived target price falls to 480p (HK\$53.7) from 490p (HK\$54) on lower EPS estimates. With 10% capital upside and 8% yield, retain Buy.

Equities

United Kingdom
Banks, Ex-S&L

12-month rating **Buy**

12m price target **480p**
Prior: 490p

Price **437p**

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

Trading data and key metrics

52-wk range	641p-416
Market cap.	£86.0bn/US\$125bn
Shares o/s	19,686m (ORD)
Free float	100%
Avg. daily volume ('000)	33,519
Avg. daily value (m)	£149.7
Common s/h equity (12/16E)	US\$176bn
P/BV (12/16E)	0.7x
Tier 1 ratio	13%

EPS (UBS, diluted) (US\$)

	From	To	% ch	Cons.
12/16E	0.68	0.62	-8	0.62
12/17E	0.73	0.69	-6	0.66
12/18E	0.84	0.76	-9	0.72

Jason Napier, CFA

Analyst
jason.napier@ubs.com
+44-20-7568 5037

Ivan Jevremovic

Analyst
ivan.jevremovic@ubs.com
+44-20-756 76171

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	54,260	54,635	57,347	60,863	64,032
Profit before tax	22,565	18,680	18,867	14,995	17,544	23,802	26,961	29,665
Net earnings (local GAAP)	15,631	13,115	12,572	8,952	11,018	15,659	17,938	19,865
Net earnings (UBS)	15,835	16,673	13,962	12,496	14,104	16,084	18,363	20,291
Tier 1 ratio %	13.0	11.6	12.7	13.4	13.6	14.3	14.9	15.5
EPS (UBS, diluted) (US\$)	0.85	0.87	0.72	0.62	0.69	0.76	0.85	0.92
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	7.2	8.0	8.8	9.6	9.9
P/POP (diluted)	7.8	8.2	7.8	5.9	5.7	5.3	4.9	4.6
P/BV x	1.2	1.1	1.0	0.7	0.7	0.7	0.7	0.7
P/BV (UBS) x	1.4	1.3	1.1	0.8	0.8	0.8	0.8	0.7
P/E (UBS, diluted)	12.9	11.8	12.1	10.2	9.2	8.3	7.4	6.9
Net dividend yield %	4.5	4.8	5.9	8.1	8.1	6.3	7.1	7.9

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 437p on 04 May 2016 21:35 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 at HSBC looks considerable – we estimate worth 30% of market cap if three hikes were retained by the banking industry. But given market concerns on the rate outlook the industry track record of fairly consistent margin decline we only include some margin expansion in our numbers from 2018.

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 on costs in 1Q16 we and consensus assume a miss to plan: possible upside in the event of successful delivery in line with targets.

Q: What did we learn with the 1Q16 results?

1Q16 adj. profit before tax was 11% above company consensus, driven by costs 6% better and revenue 2% higher than market expectations. Market conditions largely dictate quarterly revenue swings whilst the focus on cost rationalisation and paying a handsome dividend remain intact.

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UBS VIEW

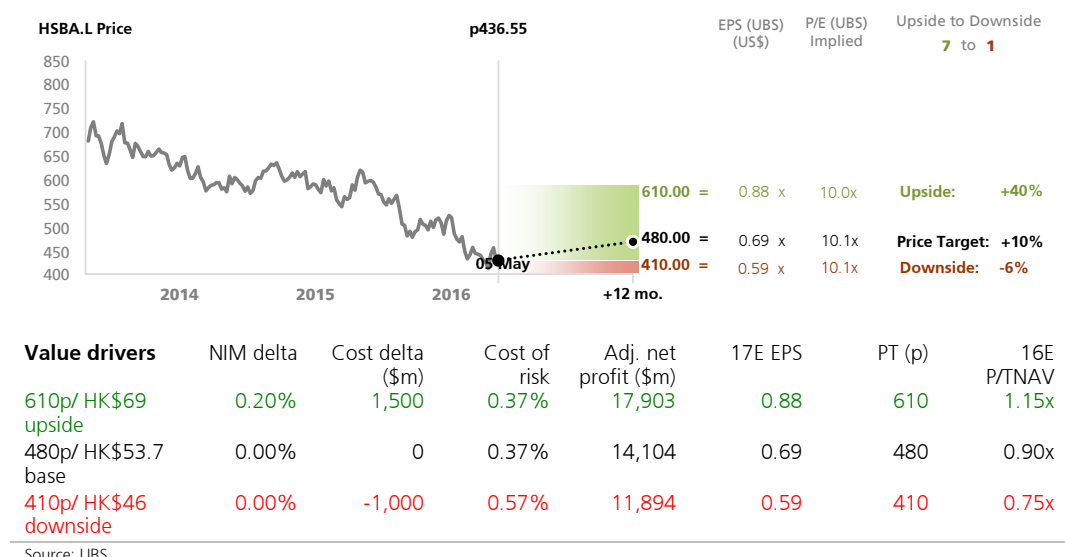
HSBC is performing better than market expectations despite difficult revenue conditions and a mixed track record when it comes to delivering on costs. With intentions to pay a progressive dividend re-iterated implying a yield of 8% we think the share offers decent risk-adjusted returns.

EVIDENCE

1Q16 PBT ex. significant items was 11% above consensus driven by revenues 2% ahead (down 10% YoY in constant FX), costs 6% better (down 8% YoY), partially offset by loan losses 16% above consensus at 50bps of loans. Common equity tier 1 of 11.9% was a touch below expectations but capital generation is sufficient to deliver the promised dividend, we think.

WHAT'S PRICED IN?

Trading at 0.8x TNAV for a 9% forecast ROTE and with a running dividend yield of 8.0% we think the share discounts a cut to payouts in the near term. We have HSBC trading at 10.2x and 9.2x 2016 / 2017 EPS, in line with the European average. We think at this level a cut in dividends is discounted.

UPSIDE / DOWNSIDE SPECTRUM
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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...

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PIVOTAL QUESTIONS

[return](#) ↑**Q: What did we learn with the 1Q16 results?****UBS VIEW**

HSBC is performing better than market expectations despite difficult market revenue conditions and a mixed track record when it comes to delivering on cost targets. With intentions reiterated to pay a progressive dividend implying a yield of 8% we think the share offers decent risk-adjusted returns.

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WHAT'S PRICED IN?

Trading at 0.8x TNAV for a 9% forecast ROTE and with a running dividend yield of 8.0% we think the share discounts a cut to dividends in 2016 or 2017. Even including a reduction in payout we assume for 2018, we still see decent income generation for investors thereafter. We have HSBC at 10.2x / 9.2x 2016 / 2017 EPS, in line with the European average despite superior yield.

11% better 1Q16 adj. PBT

1Q16 profit before tax excluding significant items of US\$5,434m was 11% above company consensus expectations of US\$4,884m driven by 2% higher revenues and 6% better costs, partially offset by 16% higher loan losses at 50bps, at least partially driven by commodity-lead hits (Figure 1).

Figure 1: HSBC's 1Q16 adjusted PBT was 11% ahead of consensus, capital 20bps light

Adjusted group (US\$m)	1Q15A	4Q15A	1Q16E	1Q16A	US\$m delta	v cons	YoY	QoQ
Income	15,406	12,949	13,679	13,914	235	2%	-10%	7%
Costs ex levy	-8,526	-8,536	-8,385	-7,874	511	-6%	-8%	-8%
Levy	0	-1,421	0	0	0	n/a	n/a	-100%
Pre-prov Profit	6,880	2,992	5,294	6,040	746	14%	-12%	102%
Impairments	-570	-1,644	-999	-1,161	-162	16%	104%	-29%
Op prof	6,310	1,348	4,295	4,879	584	14%	-23%	262%
JVs	582	556	589	555	-34	-6%	-5%	0%
PBT	6,892	1,904	4,884	5,434	550	11%	-21%	185%
CET1 (US\$'bn)	135.6	130.9	n/a	133	n/a	n/a	-2.0%	2%
RWA (US\$'bn)	1212.6	1,103.0	n/a	1,115	n/a	n/a	-8.0%	1%
CET1 ratio	11.2%	11.9%	12.10%	11.9%	-0.19%	-0.19%	0.7%	0.05%

Source: Company data; Consensus compiled by HSBC

Income: A little better, a tough market

A 2% income beat is better than a 2% miss, for sure, but despite expectations which were pretty beaten up into the result there isn't that much to get excited about in the revenue line. Sequentially, income was up 7% QoQ, improving across all geographies other than Latam (Figure 2). But the divisional breakdown in the second half of the table makes it clear that **GBM drove these gains**, coming off a terrible 4Q15: the rest of the vanilla divisions were flat or down QoQ.

It is also worth highlighting that **a significant proportion of sequential growth in income came from the "Other" division** which "contains the results of HSBC's holding company and financing operations, central support and functional costs with associated recoveries, unallocated investment activities, centrally held investment companies, certain property transactions and movements in fair value of own debt". Even excluding FVOD the income tally here is large at US\$5-6bn p.a.. It is hard to imagine much market confidence in forecasting this division.

Figure 2: Sequential improvement in revenue was driven by GBM recovering partially from a weak 4Q15 income print

	1Q15	4Q15	1Q16	YoY	QoQ
Europe	5,535	4,433	4,917	-11%	11%
Asia	6,181	5,516	5,889	-5%	7%
MENA	640	638	694	8%	9%
North America	1,981	1,809	1,942	-2%	7%
Latam	1,822	1,480	1,459	-20%	-1%
GBM inter-regional	-33	-23	-46		
Total	16,126	13,853	14,855	-8%	7%
RBWM	6,081	5,778	5,558	-9%	-4%
o/w - Ongoing	5,779	5,481	5,321	-8%	-3%
o/w Run-down	302	297	237	-22%	-20%
Commercial	3,785	3,651	3,623	-4%	-1%
GBM	5,152	3,646	4,316	-16%	18%
Private Bank	589	481	487	-17%	1%
Other	1,289	1,171	1,598	24%	36%
Inter-segment	-770	-874	-727	-6%	-17%
Total	16,126	13,853	14,855	-8%	7%

Source: Company data, UBS calculations

Within GBM the bounce was almost entirely in Markets, up 68% QoQ. Outside of markets, GBM product income was flat QoQ and down 12% YoY (Figure 3).

Figure 3: GBM income bounced in Markets – the rest of the division

Revenue by product	1Q14	4Q14	1Q15	4Q15	1Q16	YoY %	QoQ %
Legacy Credit	0	0	73	-29	-39	n/m	n/m
Credit	347	-208	262	91	159	-39%	75%
Rates	631	-79	477	265	546	14%	106%
Foreign Exchange	803	630	958	569	757	-21%	33%
Equities	444	201	477	134	303	-36%	126%
Markets	2,225	544	2,247	1,030	1,726	-23%	68%
Capital Financing	997	1,002	923	914	875	-5%	-4%
Payments and Cash Management	444	427	466	463	465	0%	0%
Securities Services	413	423	437	408	383	-12%	-6%
Global Trade and Receivables Finance	187	179	189	165	176	-7%	7%
Balance Sheet Management	750	779	942	638	703	-25%	10%
Principal Investments	94	67	19	66	1	n/m	n/m
Other	9	-63	-14	-38	-13	n/m	n/m
Total income (adjusted)	5,119	3,358	5,209	3,646	4,316	-17%	18%

Source: Company data, UBS calculations

The raw materials for future revenue growth – loan momentum – are still lacking, in our view. Though not surprising given slowing global growth and increased risk aversion, gross loans are down 1% QoQ and HoH (Figure 4). Though FX has a role to play, without loan growth or an optimistic view on markets revenues, modest income growth is a sensible presumption in our view.

Figure 4: At a group level, consumer lending and some commercial lending is leading the charge, with a tentative stabilization in trade

\$'m	2Q15	3Q15	4Q15	1Q16	QoQ	HoH
First lien residential mortgages	284,753	277,245	274,511	269,291	-2%	-3%
Other personal	100,547	97,466	99,571	100,199	1%	3%
Total personal	385,300	374,711	374,082	369,490	-1%	-1%
Manufacturing	102,098	98,992	95,858	94,716	-1%	-4%
International trade and services	169,479	163,539	159,019	160,674	1%	-2%
Commercial real estate	70,757	70,357	67,926	65,948	-3%	-6%
Other property-related	59,109	57,330	53,464	54,555	2%	-5%
Government	6,040	6,362	7,455	6,526	-12%	3%
Other commercial*	116,724	112,840	115,791	118,783	3%	5%
Total corporate and commercial	524,207	509,420	499,513	501,202	0%	-2%
Total non-financial gross loans	909,507	884,131	873,595	870,692	0%	-2%
Non-bank financial institutions	54,218	52,293	60,414	58,715	-3%	12%
Total gross loans to customers	963,725	936,424	934,009	929,407	0%	-1%

Source: Company data, UBS estimates. *includes agriculture, transport, energy utilities and reclassified ABS

Evidence of the strategic pivot – though only a little under a year old – is hard to see in the headline numbers. In Figure 5 we see Asian loans have fallen over the last quarter, half year, and year. Corporate and commercial lending – the place we expected to see the bank grow – is notably weaker.

Figure 5: Regionally, capital reallocation to Asia is yet to bear fruit; but commercial lending in NAFTA seems to be

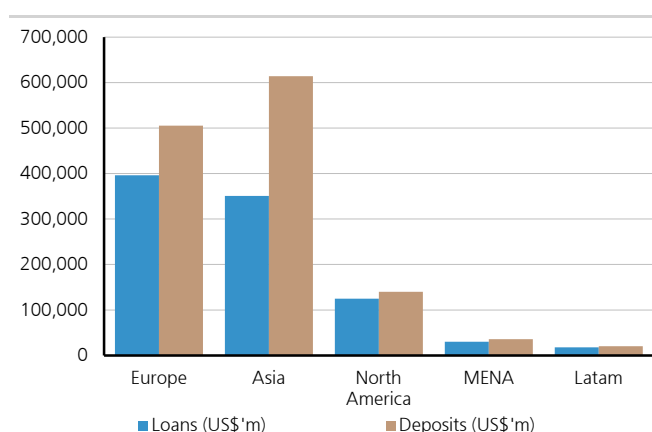
\$'m	2Q15	3Q15	4Q15	1Q16	QoQ	HoH	YoY
Personal	177,311	172,466	170,526	168,429	-1%	-2%	1%
Corporate and commercial	200,188	196,720	191,765	198,326	3%	1%	-1%
Europe total	377,499	369,186	362,291	366,755	1%	-1%	0%
Personal	132,375	130,277	132,707	134,105	1%	3%	0%
Corporate and commercial	225,249	216,793	211,224	204,101	-3%	-6%	-6%
Asia total	357,624	347,070	343,931	338,206	-2%	-3%	-4%
Personal	6,648	6,740	6,705	6,635	-1%	-2%	1%
Corporate and commercial	22,833	22,285	22,268	22,500	1%	1%	7%
MENA total	29,481	29,025	28,973	29,135	1%	0%	6%
Personal	62,990	59,242	58,186	54,199	-7%	-9%	-14%
Corporate and commercial	63,524	61,947	62,882	64,547	3%	4%	5%
North America total	126,514	121,189	121,068	118,746	-2%	-2%	-4%
Personal	5,976	5,986	5,958	6,122	3%	2%	
Corporate and commercial	12,413	11,675	11,374	11,728	3%	0%	
LatAm total	18,389	17,661	17,332	17,850	3%	1%	
Group total	909,507	884,131	873,595	870,692	0%	-2%	

Source: Company data, UBS estimates

Ludicrous Liquidity

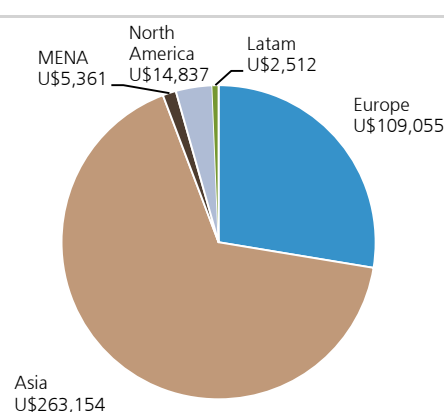
As is clear from the loan growth data above, HSBC operates in the same low growth world as the rest of the banking sector. Having built a new forecast model from scratch over the past few weeks we were again struck by the extraordinary excess liquidity held by this bank. Sure, Asian banks generally have low loan / deposit ratios in line with the saving and borrowing habits of the underlying markets. In contrast with peers, however, HSBC has significant excess deposits in Europe and the Americas as well. And the sums here are far from trivial: HSBC's excess deposits in Europe of US\$109bn at 1Q16, a shade under the size of the bank's entire UK first lien mortgage book.

Figure 6: Excess deposits in every region...



Source: Company data

Figure 7: ...concentrated in US\$-linked markets



Source: Company data

HSBC clearly has the liquidity to grow and bottom-up gearing to higher returns from higher interest rates. We have nothing in the model in 2016 and 2017 for higher rates but we think ignoring the potential revenue, efficiency and return upside from higher rates later is wrong *if only because at the current price we think this is a free option*. Similar logic

applies to applying a multiple to today's UK bank levy – which should fall on our numbers from US\$1.2bn a year at current run rates to US\$500m or below in 2021.

Figure 8: Reasonable sensitivity analysis suggests material earnings upside – if only rates would rise and industry would retain the gains

(US\$ mn)	2014	2015	2016E	2017E	2018E
Demand - non-interest bearing	194,299	198,029	201,666	205,475	211,015
Demand - interest bearing	746,242	770,649	784,805	799,626	821,183
Savings	255,649	228,042	232,231	236,616	242,996
Time	84,355	74,468	75,836	77,268	79,351
Other	2,247	2,743	2,793	2,846	2,923
Total (average)	1,282,792	1,273,931	1,297,331	1,321,831	1,357,467
Demand - non-interest bearing	15.1%	15.5%	15.5%	15.5%	15.5%
Demand - interest bearing	58.2%	60.5%	60.5%	60.5%	60.5%
Savings	19.9%	17.9%	17.9%	17.9%	17.9%
Time	6.6%	5.8%	5.8%	5.8%	5.8%
Other	0.2%	0.2%	0.2%	0.2%	0.2%
Total	100.0%	100.0%	100.0%	100.0%	100.0%
Assumed % US dollar/Sterling linked	70.9%	73.9%	73.9%	73.9%	73.9%
Adjusted equity	149,195	148,743	153,391	156,976	164,996
Assumed equity in HK\$/US\$/S\$/GBP	70.9%	73.9%	73.9%	73.9%	73.9%
Yield shift			0.25%	0.75%	1.25%
% shift retained by HSBC					
Demand - non-interest bearing			90%	90%	90%
Demand - interest bearing			15%	15%	15%
Savings			10%	10%	10%
Time			0%	0%	0%
Other			5%	5%	5%
Total deposits			18%	18%	18%
Equity			100%	100%	100%
Incremental interest income					
Demand - non-interest bearing			335	1,025	1,755
Demand - interest bearing			218	665	1,138
Savings			43	131	225
Time			0	0	0
Other			0	1	1
Total deposits			596	1,822	3,119
Equity			279	860	1,487
Total			875	2,682	4,606
NIM Impact			0.05%	0.15%	0.25%
Current NIM forecasts			1.81%	1.76%	1.78%
Aggregate NIM change vs FY15			-0.08%	-0.13%	-0.10%
Change Vs UBS forecasts			0.13%	0.28%	0.36%
Adjusted NIM			1.94%	2.04%	2.14%
NII delta			2,207	4,881	6,421
% of PBT			11.3%	22.7%	26.4%

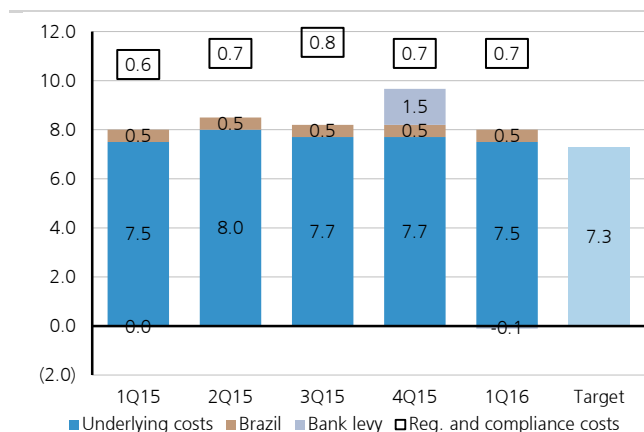
Source: UBS estimates

Don't extrapolate all the 1Q cost beat

1Q16 underlying costs were 6% better than consensus, down 8% QoQ (ex levy) and 8% YoY at US\$7.9bn (\$7.4bn ex Brazil). This is close to HSBC's target run-rate of US\$7.3bn for end-2017, despite which the company only managed an ROE of 9%, as compared with a target of beyond 10%. Revenue growth will be needed to achieve this target.

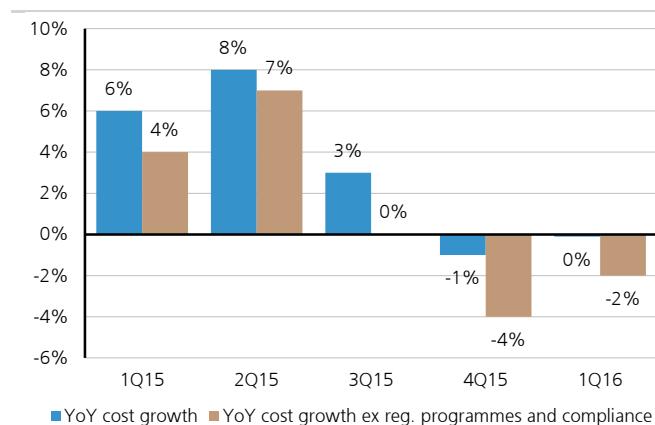
Moreover, **the company is guiding to increasing costs as 2016 progresses** due to still increasing compliance spend, before automation of some of these processes leads to declining costs through 2017. These costs are currently running at ~US\$0.7bn per quarter, broadly stable on recent quarters. Reduction in "core" employee numbers is being offset by increasing compliance staff (+536 FTEs QoQ) and restructuring staff (a really quite sobering +1,357 FTEs QoQ).

Figure 9: The underlying cost run-rate is getting close to target, with compliance costs moderating



Source: Company data

Figure 10: Excluding compliance costs, the business is already showing reasonable cost momentum y/y



Source: Company data

In our forecasts, we now see a quarterly run-rate of US\$7.7bn in 2017 and US\$7.8bn in 2018 – an average 5-6% above HSBC's end-17 target run-rate.

Capital – Lighter, mostly from lower scrip take-up for the FY15 dividend

HSBC's reported common equity tier 1 ratio of 11.9% was 20bps below market expectation of 12.1%. This was partly due to 10% take-up of the 4Q15 scrip option versus ~50% a year ago, worth over 10bps of capital (Figure 11).

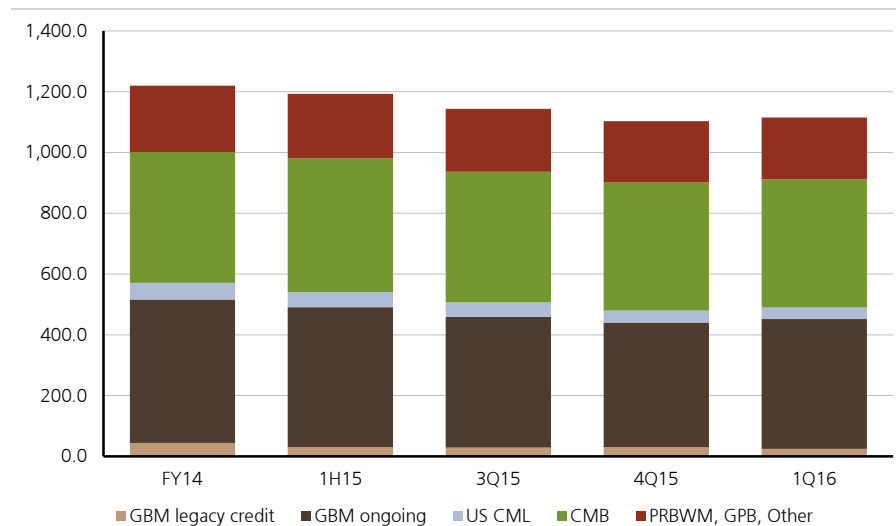
Figure 11: Low scrip take-up was worth 4bps off CT1 at 1Q16

	2014	2015
Q4 final dividend (\$ p.s.)	0.20	0.21
Q4 final dividend (\$'m)	3,823	4,160
Q4 dividend deduction net of planned scrip	3,362	3,717
Scrip assumption	461	443
Assumed scrip take-up (%)	12%	11%
Actual take up (%)	53%	10%
Q1 true-up to CET1	1,550	-35
Group RWA	1,212,600	1,152,000
% of RWA	+0.13%	-0.00%

Source: UBS estimates

The larger driver of the lower capital tally, however, was the 1% QoQ reported growth in RWAs. Though this is modest, this compares with 4% sequential declines in RWAs in the third and fourth quarters of last year, consistent with delivery under HSBC's capital reallocation plans.

Figure 12: RWAs were up 1% QoQ, versus 4% declines in the last two quarters



Source: Company data

As a reminder, HSBC announced plans at the June 2015 strategy event to reduce release US\$290bn of group RWAs to deploy to "higher performing" businesses, with a bent towards redeployment in Asia. Adjusting for FX movements this target fell to US\$279bn by 1Q16, half of which has already been achieved, according to the company, broadly consistent with RWA shifts since end 2014 (Figure 13).

Figure 13: The capital catch-and-release programme is half way through

Period-end RWA	FY14	1H15	3Q15	4Q15	1Q16	Since FY14 (US\$'bn)
GBM	516	491	459	441	452	-64
- Legacy credit	44	30	29	30	25	-19
- GBM ex legacy credit	472	461	430	411	427	-45
US CML	55	50	48	40	38	-17
CMB	430	440	430	421	422	-8
RBWM, GPB, Other	218	213	207	202	204	-15
Group total	1,220	1,193	1,144	1,103	1,115	-169

Source: Company data, UBS calculations

The higher RWAs at 1Q16 and redeployment initiatives which are more progressed than some appreciate means higher assumed capital demand for the bank in GBM in particular. At 1Q16 44% of the US\$290bn in planned redeployment was reported complete. A rough half of this took place in the ongoing GBM with US\$63bn in RWAs withdrawn.

But in 1Q16 only US\$6bn in ongoing GBM RWA efficiencies were achieved which were eclipsed fourfold by increased RWAs for growth and other factors (Figure 14). **Net RWAs in the lower-return Global Banking & Markets division are down far less than we had expect given the headline re-allocation programme: an issue worth monitoring closely in future quarters.**

Figure 14: The capital redeployment in the core GBM is worth monitoring – net slippage in 1Q16

	Legacy credit	US CML runoff	GBM ex Legacy	CMB	Rest of group	Group total
FY14 RWAs	44	55	472	430	218	1,220
Gross RWA initiatives	-14	-16	-57	-23	-14	-124
- as % of start	-32%	-28%	-12%	-5%	-6%	-10%
Growth & other movements	0	0	-4	14	-2	7
Net reduction	-14	-16	-61	-9	-16	-117
- as % of start	-32%	-28%	-13%	-2%	-8%	-10%
FY15 RWAs	30	40	411	421	202	1,103
Gross RWA initiatives	-5	-2	-6	-2	0	-15
- as % of start	-17%	-4%	-1%	-1%	0%	-1%
Growth & other movements	0	0	22	3	2	27
Net reduction	-5	-2	16	1	2	12
- as % of start	-17%	-4%	4%	0%	1%	1%
1Q16	25	38	427	422	204	1,115
RWA initiative target	-40	-40	-100	-30	0	-279
% complete	36%	39%	57%	77%	0%	44%
% change in RWAs from start	-44%	-31%	-10%	-2%	-7%	-9%

Source: Company data, UBS calculations

A 7% yield: Clear intentions

Crucial for supporting our positive recommendation, HSBC declared a 10cps interim dividend in line with last year. Management reiterated plans for a progressive dividend on the analyst call. Our revised estimates have HSBC trading at 10.2 / 9.2x 2016 / 2017 EPS and with an 8.0% dividend yield. We have the stock at 0.8x TNAV for a 9% ROTE.

Figure 15: HSBC forecast changes and key 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	8,952	11,018	15,659	17,938	19,865
UBS adj. net income	14,306	13,967	15,835	16,673	13,962	12,496	14,104	16,084	18,363	20,291
Stated EPS	0.92	0.74	0.84	0.69	0.65	0.45	0.54	0.75	0.84	0.90
UBS Adj. EPS (Prior, US\$)	0.80	0.76	0.85	0.87	0.72	0.62	0.69	0.76	0.85	0.92
UBS Adj. EPS (Current, US\$)	0.80	0.76	0.85	0.87	0.72	0.68	0.73	0.84	0.93	1.03
% change	0%	0%	0%	0%	0%	-8%	-6%	-9%	-9%	-11%
DPS (Current, 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	0.50	0.51	0.50	0.50	0.52	0.54	0.56
CET1 % (Fully Loaded)	10.1%	9.0%	10.9%	0%	0%	2%	2%	-23%	-17%	-11%
T1 lev ratio (Fully loaded)	4.67%	4.18%	4.38%	7.87	7.56	7.60	7.59	7.79	8.15	8.53
ROTE (Stated)	13.8%	10.2%	10.9%	11.1%	11.9%	12.1%	12.3%	12.9%	13.6%	14.1%
ROTE (Adj.)	12.1%	10.6%	11.1%	4.8%	5.0%	5.3%	5.5%	5.7%	5.9%	6.2%
Shares (m, EOP)	17,868	18,476	18,830	8.8%	8.4%	5.9%	7.1%	9.7%	10.5%	10.8%
Market Cap (£m)	104,623	101,673	128,329	11.2%	9.3%	8.3%	9.1%	10.0%	10.7%	11.1%
P/E (UBS Adj.) (x)	11.9	11.8	12.9	11.8	12.1	10.2	9.2	8.3	7.4	6.9
Div yield (%)	4.3	5.0	4.5	4.8	5.9	8.1	8.1	6.3	7.1	7.9
P/TNAV (x)	1.4	1.2	1.4	1.3	1.1	0.8	0.8	0.8	0.8	0.7
Excess cap over 13% as % MV	-21%	-32%	-13%	-12%	-7%	-11%	-9%	-1%	8%	16%

Source: UBS estimates, Company data;

Our target price is derived by the sum of the parts shown in Figure 16. The multiples applied in this calculation are set with reference to growth and returns in the divisions concerned as well as multiples at which peer group institutions are

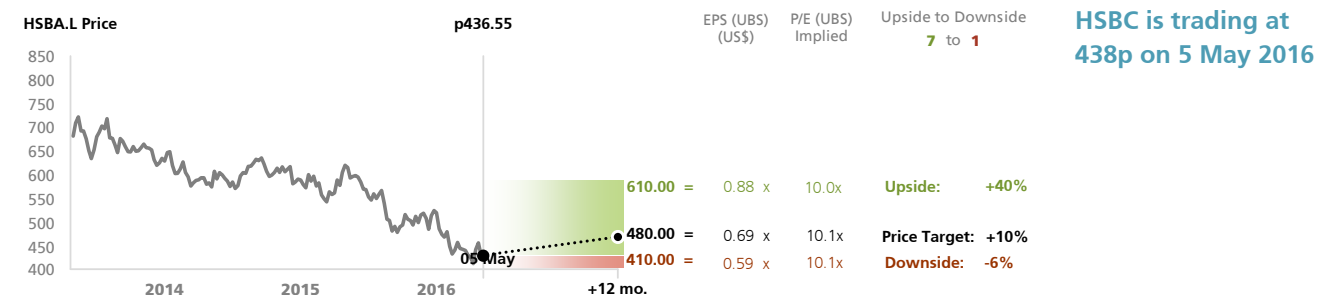
trading. Our target price falls marginally to 480p from 490p on lower forecast estimates in our new model.

Figure 16: 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	7,157	5,068	27,013	18.9%	2.3	12.0	60,821	2.99	40%	36%
CMB	8,544	5,554	64,406	8.4%	1.0	12.0	66,645	3.28	44%	39%
GBM	8,137	5,296	64,440	8.3%	0.8	9.7	51,552	2.54	34%	38%
GPB	462	307	3,112	9.7%	1.2	12.0	3,681	0.18	2%	2%
Operating divisions	24,300	16,225	158,971	10.2%	1.1	11.3	182,699	8.99	121%	115%
Other	-2,696	-2,121	5,185			11.3	-23,885	-1.18	-16%	-15%
Capital surplus (2017e)			-7,600		1.0		-7,600	-0.37	-5%	
Group	21,604	14,104	157,037	8.6%	1.0	10.7	151,213	7.44	100%	100%
Discounted								6.99		
							GBP	4.80		
							HKD	53.7		

Source: UBS estimates

UPSIDE / DOWNSIDE SPECTRUM

[return](#) ↑

Value drivers	NIM delta	Cost delta (\$m)	Cost of risk	Adj. net profit (\$m)	17E EPS	PT (p)	16E P/TNAV
610p/ HK\$69 upside	0.20%	1,500	0.37%	17,903	0.88	610	1.15x
480p/ HK\$53.7 base	0.00%	0	0.37%	14,104	0.69	480	0.90x
410p/ HK\$46 downside	0.00%	-1,000	0.57%	11,894	0.59	410	0.75x

Source: UBS

Risk to the current share price are skewed (7:1) to the upside

Upside (610p/KH\$69): In an upside case, we assume HSBC retains more NIM benefit from rate rises and closes in on its end-17 cost target. This adds c25% to 2017 earnings, and drives an upside fair value share price of 610p or HK\$69.

Base (480p/HK\$53.7): Our base case assumes a difficult 2016 with later years benefiting from modest revenue growth and progress on costs. Our forecasts assume that the lion's share of increased loan losses in Asia and Europe are offset by impairment reductions in Latam due to business disposals in Brazil.

Downside (410p/HK\$46): In a downside case, we assume US\$1bn higher costs from unintended cost inflation, and impairments rising to 57bps (vs 37bps in the base case) amidst an Asian and global slowdown. This leads us to a downside fair value share price of 410p or HK\$46.

COMPANY DESCRIPTION

[return](#) ↑

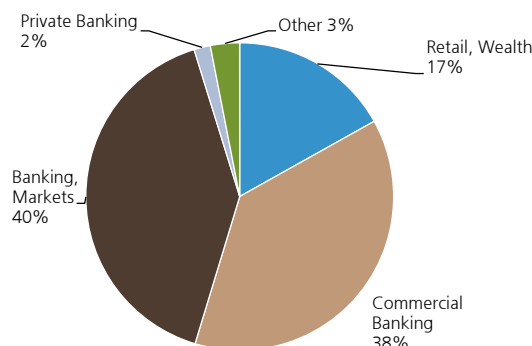
Market Cap	£89bn
Shares Outstanding	19.5bn
Industry	Banks
Region	Europe
Website	www.hsbc.com

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

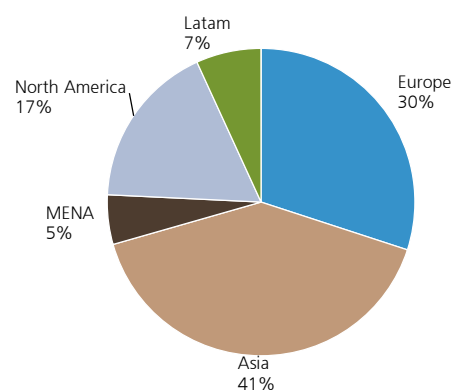
HSBC's main "home" markets are the UK and Hong Kong with the investment bank the other main contributor to group earnings. We expect consistent profit and capital generation in the UK and Hong Kong, despite holding a cautious view on the outlook for property prices in Hong Kong. While the outlook for 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 (1Q16)



Source: Company reports, UBS

Capital deployment by geography (1Q16)



Source: Company reports, UBS

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	30,865	-5.2	30,768	-0.3	32,249	34,562	36,510
Total non interest income	28,194	26,664	25,414	23,395	-7.9	23,867	2.0	25,098	26,301	27,522
Total income	63,733	62,001	57,955	54,260	-6.4	54,635	0.7	57,347	60,863	64,032
Total cash expenses	(36,261)	(36,471)	(34,913)	(31,589)	9.5	(30,518)	3.4	(30,954)	(31,682)	(32,412)
Pre-depreciation operating profit	27,472	25,530	23,042	22,671	-1.6	24,117	6.4	26,393	29,181	31,621
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	21,402	-1.7	22,848	6.8	25,124	27,912	30,352
Total provisions	(5,849)	(3,851)	(3,721)	(3,964)	-6.5	(3,560)	10.2	(3,168)	(2,890)	(2,722)
Operating profit post provisions	20,259	20,297	18,052	17,437	-3.4	19,288	10.6	21,957	25,022	27,630
Income from associates & JVs (pre-tax)	2,325	2,532	2,556	2,295	-10.2	2,316	0.9	2,405	2,499	2,596
Other pre-tax items	0	0	0	0	-	0	-	0	0	0
Profit before tax (UBS)	22,584	22,829	20,608	19,733	-4.2	21,604	9.5	24,362	27,521	30,225
Exceptionals (incl goodwill)	(19)	(4,149)	(1,741)	(4,738)	-172.1	(4,060)	14.3	(560)	(560)	(560)
Profit before tax	22,565	18,680	18,867	14,995	-20.5	17,544	17.0	23,802	26,961	29,665
Tax	(4,765)	(3,975)	(3,771)	(3,838)	-1.8	(4,211)	-9.7	(5,712)	(6,471)	(7,120)
Profit after tax	17,800	14,705	15,096	11,157	-26.1	13,333	19.5	18,090	20,490	22,546
Other post-tax items	0	0	0	0	-	0	-	0	0	0
Preference dividends	(573)	(573)	(950)	(1,221)	-28.5	(1,282)	-5.0	(1,346)	(1,413)	(1,484)
Minorities	(1,596)	(1,017)	(1,574)	(984)	37.5	(1,033)	-5.0	(1,085)	(1,139)	(1,196)
Net earnings (local GAAP)	15,631	13,115	12,572	8,952	-28.8	11,018	23.1	15,659	17,938	19,865
Net earnings (before pref divs)	16,204	13,688	13,522	10,173	-24.8	12,300	20.9	17,005	19,351	21,350
Net earnings (UBS)	15,835	16,673	13,962	12,496	-10.5	14,104	12.9	16,084	18,363	20,291
Per share (US\$)										
EPS (local GAAP, basic)	0.84	0.69	0.65	0.45	-30.8	0.54	20.1	0.75	0.84	0.90
EPS (UBS, diluted)	0.85	0.87	0.72	0.62	-13.0	0.69	10.1	0.76	0.85	0.92
PPOP (diluted)	1.40	1.27	1.12	1.07	-4.4	1.11	4.2	1.19	1.29	1.37
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	8.70	-2.1	8.64	-0.7	8.79	9.11	9.44
BVPS (UBS)	7.84	7.94	7.62	7.60	-0.3	7.59	-0.1	7.79	8.15	8.53
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	1,108,130	0.5	1,121,243	1.2	1,146,681	1,173,629	1,210,808
Risk weighted assets (RWA) (average)	1,252,075	1,217,370	1,161,400	1,105,565	-4.8	1,114,687	0.8	1,133,962	1,160,155	1,192,218
Customer loans	1,080,304	974,660	924,454	938,809	1.6	969,012	3.2	1,002,285	1,038,349	1,076,409
Customer loans (average)	1,038,964	1,027,482	949,557	931,632	-1.9	953,910	2.4	985,648	1,020,317	1,057,379
Interest earning assets (average)	1,669,368	1,786,536	1,726,949	1,708,677	-1.1	1,749,538	2.4	1,807,748	1,871,332	1,939,307
Customer deposits	1,482,812	1,350,642	1,289,586	1,305,076	1.2	1,338,586	2.6	1,376,349	1,415,269	1,455,411
Common s/h equity (year end)	176,020	178,915	173,348	175,535	1.3	178,739	1.8	186,388	197,887	210,327
Common s/h equity (average)	172,706	177,468	176,132	174,442	-1.0	177,137	1.5	182,564	192,137	204,107
Total SHF (equity, pref & MI) (year end)	190,459	199,978	197,518	203,787	3.2	207,691	1.9	216,075	228,345	241,596
Total SHF (equity, pref & MI) (average)	186,794	195,219	198,748	200,652	1.0	205,739	2.5	211,883	222,210	234,970
Net tangible assets	160,541	172,401	172,913	181,642	5.0	185,989	2.4	194,807	207,503	221,170
Balance sheet structure (%)										
Loans / banking assets (year end)	40.4	37.0	38.4	37.1	-3.3	38.3	3.2	38.5	38.7	38.9
Deposits / banking assets (year end)	55.5	51.3	53.5	51.6	-3.6	52.9	2.6	52.8	52.7	52.6
Loans / deposits	72.9	72.2	71.7	71.9	0.3	72.4	0.6	72.8	73.4	74.0
Total SHF / banking assets (year end)	7.1	7.6	8.2	8.1	-1.7	8.2	1.9	8.3	8.5	8.7

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	148,610	152,861	163,680	175,350	187,942
Total capital	194,009	156,299	155,688	164,349	168,600	179,419	191,089	203,681
Risk weighted assets (RWA) (year end)	1,214,939	1,219,800	1,103,000	1,108,130	1,121,243	1,146,681	1,173,629	1,210,808
Core tier 1 ratio %	10.9	11.1	11.9	12.1	12.3	12.9	13.6	14.1
Tier 1 ratio %	13.0	11.6	12.7	13.4	13.6	14.3	14.9	15.5
Total capital ratio %	16.0	12.8	14.1	14.8	15.0	15.6	16.3	16.8
Tangible equity	146,102	151,338	148,743	153,391	157,037	165,120	177,044	189,902
Equity / assets %	6.6	6.8	7.2	6.9	7.1	7.2	7.4	7.6
Tangible equity to tangible assets %	5.5	5.8	6.2	6.1	6.3	6.4	6.6	6.9
Asset quality (US\$m)								
Non performing assets	36,503	29,283	23,758	25,556	25,320	22,305	20,734	20,061
Total risk reserves	15,201	12,337	9,555	11,115	11,133	10,055	9,792	9,650
NPLs / loans %	3.3	3.0	2.5	2.7	2.6	2.2	2.0	1.8
NPL coverage %	41.6	42.1	40.2	43.5	44.0	45.1	47.2	48.1
Provision charge / average loans %	0.6	0.4	0.4	0.4	0.4	0.3	0.3	0.3
Net NPAs / shareholders funds %	11.2	8.5	7.2	7.1	6.8	5.7	4.8	4.3
Profitability (%)								
Net interest margin (avg assets)	1.33	1.33	1.29	1.25	1.22	1.26	1.31	1.34
Provisions / operating profit	22.4	15.9	17.1	18.5	15.6	12.6	10.4	9.0
ROE (UBS earnings)	9.2	9.4	7.9	7.2	8.0	8.8	9.6	9.9
RoAdjE (UBS earnings & equity)	11.1	11.2	9.3	8.3	9.1	10.0	10.7	11.1
RoRWA (UBS)	1.39	1.45	1.34	1.22	1.36	1.51	1.68	1.80
RoA (UBS earnings)	0.66	0.55	0.60	0.45	0.53	0.70	0.77	0.83
Productivity (%)								
Cost income ratio	60.5	61.1	62.4	60.6	58.2	56.2	54.1	52.6
Cost / average assets	1.40	1.43	1.43	1.33	1.26	1.25	1.25	1.24
Compensation expense ratio	42.4	45.8	47.8	47.5	45.1	42.5	40.6	39.3
Growth (%)								
Revenue	-4.2	-2.7	-6.5	-6.4	0.7	5.0	6.1	5.2
Operating profit pre provisions	6.3	-7.5	-9.8	-1.7	6.8	10.0	11.1	8.7
Net earnings (UBS)	13.4	5.3	-16.3	-10.5	12.9	14.0	14.2	10.5
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	1.6	3.2	3.4	3.6	3.7
Customer deposits	10.7	-8.9	-4.5	1.2	2.6	2.8	2.8	2.8
Value (x)								
Market cap/revenues	3.1	3.1	2.9	2.3	2.3	2.2	2.0	1.9
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	5.9	5.7	5.3	4.9	4.6
P/E (local GAAP, basic)	13.0	14.9	13.4	14.1	11.7	8.5	7.6	7.0
P/E (UBS, diluted)	12.9	11.8	12.1	10.2	9.2	8.3	7.4	6.9
Net dividend yield %	4.5	4.8	5.9	8.1	8.1	6.3	7.1	7.9
P/BV x	1.2	1.1	1.0	0.7	0.7	0.7	0.7	0.7
P/BV (UBS) x	1.4	1.3	1.1	0.8	0.8	0.8	0.8	0.7

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

Forecast returns

Forecast price appreciation	+9.9%
Forecast dividend yield	8.1%
Forecast stock return	+18.0%
Market return assumption	5.4%
Forecast excess return	+12.6%

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 for HSBC and HSBC Holdings 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.	49%	32%
Neutral	FSR is between -6% and 6% of the MRA.	38%	26%
Sell	FSR is > 6% below the MRA.	14%	19%
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 31 March 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.

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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 ^{4, 5, 6, 7, 16a, 16b}	HSBA.L	Buy	N/A	437p	04 May 2016
HSBC Holdings ^{4, 5, 6, 7, 16a, 16b}	0005.HK	Buy	N/A	HK\$49.45	05 May 2016

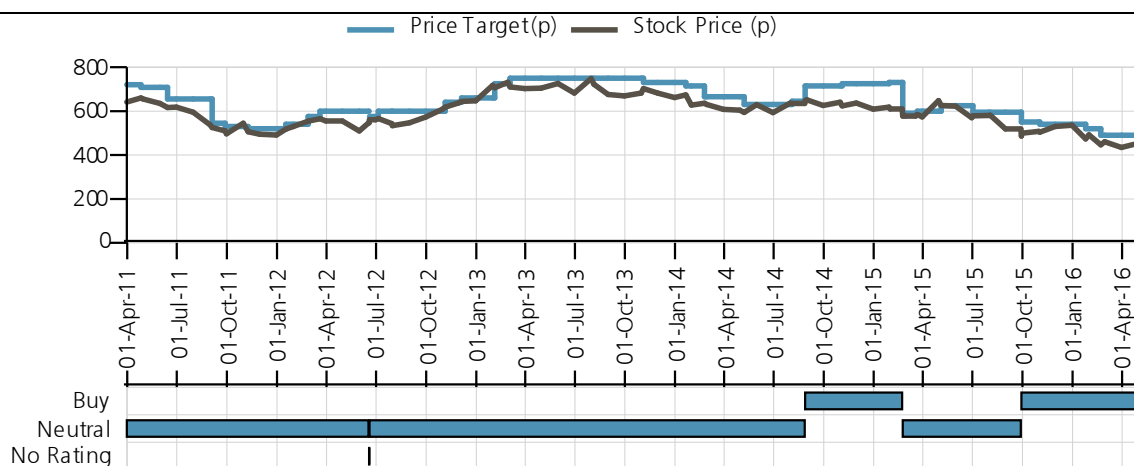
Source: UBS. All prices as of local market close.

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

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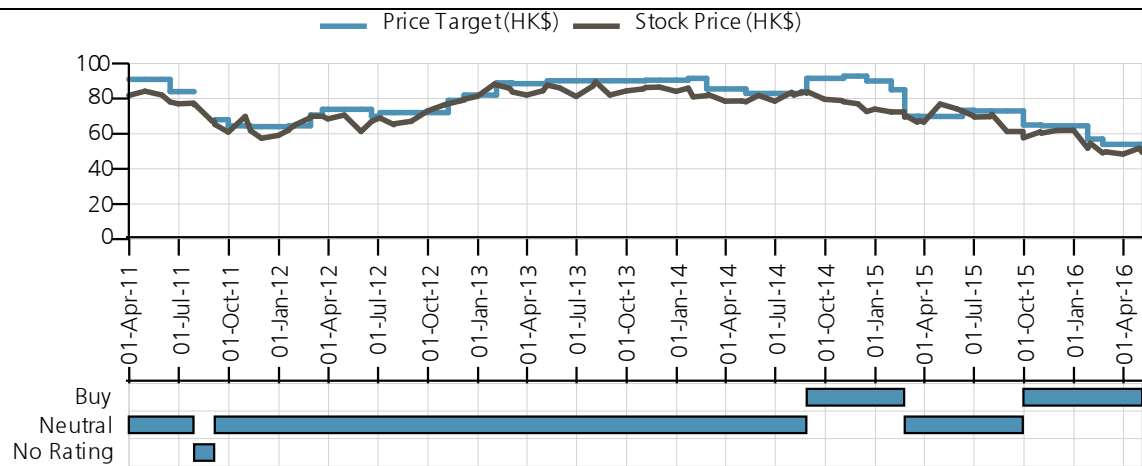
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HSBC (p)



Source: UBS; as of 04 May 2016

HSBC Holdings (HK\$)



Source: UBS; as of 05 May 2016

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