

**Analyst: Paul Sham**
**HSBC HOLDINGS PLC (匯豐控股)**

Sector	: Banking	Group Chairman	: Stephen Green
HKSE Code	: 0005	Group Chief Executive	: Michael Geoghegan
Market Price	: HK\$129.40 (04/08/2008)	Group Finance Director	: Douglas Flint
Shares Issued	: 11,737m		
Mkt. Cap.	: HK\$1,518,768m		
52 weeks Hi/ Lo	: HK\$153.50 / HK\$104.00		
HSI	: 22,514.92 (04/08/2008)		
Main Business	: Banking and related financial services		

**SUMMARY OF THE INTERIM RESULTS FOR THE SIX MONTHS ENDED 30<sup>TH</sup> JUNE 2008**
**Interim Results Highlights**

	US\$ million	Vs 1H2007 (%)	Vs 31/12/2007 (%)
• Net interest income	21,178	+16.2%	
• Non-interest income	18,297	-4.6%	
• Total operating income	39,475	+5.5%	
• Operating expenses	(20,140)	+8.2%	
• Operating profit before impairment losses	19,335	+2.8%	
• Impairment losses on loans and advances	(10,058)	+58.5%	
• Profit before taxation	10,247	-27.6%	
• Taxation	(1,941)	-26.6%	
• <b>Attributable profit to ordinary shareholders</b>	<b>7,722</b>	<b>-29.1%</b>	
• Total loans	1,069,780	+13.5%	+6.9%
• Total deposits	1,161,923	+18.5%	+6.0%
• Total assets	2,546,678	+18.4%	+8.2%
• Basic EPS (US\$)	0.65	-31.6%	
• 1st & 2nd interim EPS (US\$)	0.57	+7.5%	

**Selected Ratios**

	1H2008	1H2007	FY2007
• Net interest margin	3.00%	2.99%	2.91%
• Cost-income ratio – basic	51.0%	49.7%	49.4%
• Return on average asset	0.68%	1.19%	0.97%
• Return on average equity	12.1%	19.1%	15.9%
• Impaired loan ratio	2.04%	1.54%	1.83%
• Impaired advances coverage	108.1%	98.4%	104.9%
• Loan-deposit ratio	92.1%	96.1%	91.3%
• Total capital ratio	11.9%	13.2%	13.6%
• Tier 1 ratio	8.8%	9.3%	9.3%

- **1H08 net profit exceeded market expectations** HSBC reported a 29.1% y-o-y drop in net profit to US\$7,722m for 1H08, beating the market consensus of US\$7,439m. The drop was due to (i) absence of associates gains (US\$1,114m in 1H07), US\$3.9bn of asset write-offs in capital markets (none in 1H07), US\$6,952m of loan impairments in North American Personal Financial Services (PFS) (US\$3,774m in 1H07) and US\$524m goodwill impairment on the North American PFS business.
- **Net-interest income increased robustly by 16.2% y-o-y** Growth in net interest income of 16.5% was mainly driven by improved net interest margin to 3% from 2.85% in 2H07 and a 6.9% h-o-h growth in total loans. The key loan-growth areas included residential mortgages and commercial lending in Europe and Hong Kong, and personal lending and commercial lending in Asia Pacific and Latin

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America. The improvement in net-interest margin was due primarily to an increase in lower-cost customer deposits of 18.5% y-o-y for June 2008.

- **Disappointment in non-interest income growth** Non-interest income of HSBC fell by 4.6% y-o-y as card fee income decreased on substantial fall in income in the consumer finance business in the US. In addition, the negative movement in the financial instruments designated at fair value of US\$584m (+ US\$874m in 1H07) dragged down the overall performance of non-interest income.
- **Stable cost-to-income ratio** Operating expenses rose by 8.2% y-o-y, mainly due to increased headcount (particularly in emerging markets such as India, Mainland China and in the Middle East) and higher administrative costs as the branch network was extended. With increase in operating expense faster than operating income (+5.5% y-o-y), the Group's cost-to-income ratio was 51.0% in 1H08, up modestly from 49.7% in the same period last year.
- **Jump in loan impairment losses.** Loan impairment losses jumped 58.5% y-o-y, mainly driven by the significant rise in loan impairment charges in the US as credit quality worsened. For 1H08, loan impairment charges against the US PFS reached US\$6,952m, compared with US\$3,774m in 1H07. As of 30/06/2008, overall impaired loan ratio rose to 2.04% (31/12/2007: 1.83%) with a coverage ratio of 108.1% (31/12/2007: 104.9%).
- **Solid financial position** As of 30/06/2008, the tier 1 capital ratio of the Group was 8.8% and the total capital ratio was 11.9%, down from 9.3% and 13.2%, respectively, at the end of 2007. Despite this, the figures are still within the Group's target tier 1 range of 7.5% to 9%. ROE was 12.1% for 1H08, falling from 19.1% in 1H07. This was below the group's target range of 15% to 19% over the full cycle.

### Business Review by Business Lines

Pre-tax profit by businesses (US\$ million)	Breakdown				
	1H2008	1H2007	y-o-y (%)	1H2008	1H2007
Personal Financial Services	2,313	4,729	-51.1%	22.6%	33.4%
Commercial Banking	4,611	3,422	+34.7%	45.0%	24.2%
Global Banking & Markets	2,690	4,158	-35.3%	26.3%	29.4%
Private Banking	822	780	+5.4%	8.0%	5.5%
Other	-189	1,070	-117.7%	(1.8%)	7.6%
Total	10,247	14,159	-27.6%	100.00%	100.00%

- **Personal Financial Services** achieved pre-tax profit of US\$2.3bn, dropping 51% from 1H07. The decline was largely driven by higher loan impairment charges in the US consumer finance business. However, excluding US consumer finance, the business performed strongly with pre-tax profits up by 23%. Strong revenue momentum was seen in Rest of Asia-Pacific, Greater China, Middle East and Latin America. The US business registered a loss of US\$2.2bn. Loan impairment charges and other credit risk provisions rose by 85% to US\$6.8bn y-o-y, but declined by 15% compared with 2H07.
- **Commercial Banking** pre-tax profit increased by 35% to US\$4.6bn. About 70% of business growth came from emerging economies, which now account for 54% of Commercial Banking's global profit before tax. The growth has been powered by very strong results in Asia-Pacific, Brazil and the Middle East. In 1H08, Commercial Banking grew its small business customer base by 8% to 2.9m, with particular growth in Turkey, Taiwan, India and mainland China.
- **Global Banking and Markets** pre-tax profit was down 35% y-o-y to US\$2.7bn but it was 37% higher than in 2H07. The decline was due to the US\$3.9bn write-downs on credit trading, leveraged acquisition financing loans and monoline exposures, resulting from the continued deterioration in the credit markets. This compared with US\$2.1bn for 2H07 and nil for the 1H07. HSBC's exposure to illiquid markets and the consequent marked to market values remain modest with only 3% of its assets having to be valued with reference to significant unobservable price inputs. HSBC stressed that it does not have material exposure to CDO's backed by US sub-prime mortgages.

**Business Review by Geographies**

Pre-tax profit by geographic areas (US\$ million)				Breakdown		Impaired Loan Ratio	
	1H2008	1H2007	y-o-y (%)	1H2008	1H2007	30/6/2008	31/12/2007
Europe	5,177	4,050	+27.8%	50.5%	28.6%	1.35%	1.37%
Hong Kong	3,073	3,330	-7.7%	30.0%	23.5%	0.52%	0.48%
Rest of Asia Pacific	3,624	3,344	+8.4%	35.4%	23.6%	1.36%	1.06%
North America	-2,893	2,435	-218.8%	-28.2%	17.2%	1.81%	2.78%
South America	1,266	1,000	+26.6%	12.4%	7.1%	4.27%	4.30%
Total	10,247	14,159	-27.6%	100.00%	100.00%	1.54%	1.83%

- Europe (50.5% pre-tax profit)** The Group's European operations posted a solid 27.8% y-o-y increase in pre-tax profit in 1H08. PFS reported a pre-tax profit of US\$1.3bn, an increase of 97% compared with the first half of 2007. The good result was attributed to a reduction in loan impairment charges in UK, together with lower operating expenses and a one-off gain on the deemed disposal of MasterCard shares. Commercial Banking reported pre-tax profits of US\$1.9bn, an increase of 53% compared with 1H07. Revenues were boosted by gains of US\$425m on the sale of a UK business. Global Banking and Markets' profit before tax declined by 34% to US\$1.2bn, primarily due to US\$1.4bn of write-downs in credit-related trading exposures and leveraged and acquisition finance loans. Overall asset quality improved, with impaired loan ratio down to 1.1% from 1.4% as of the end of 2007.
- Hong Kong (30.0% pre-tax profit)** The Group's Hong Kong operations posted a 7.7% y-o-y decline in pre-tax profit.

	US\$ million	Vs 1H2007 (%)
• Net interest income	2,835	+10.4%
• Non-interest income	2,273	-8.9%
• Total operating income	5,108	+0.9%
• Operating expenses	(1,975)	+18.6%
• Operating profit before provisions	3,133	-7.8%
• Impairment losses on loans & advances	(81)	+1.3%
• Pre-tax profit	3,073	-7.7%
		<b>Vs 31/12/2007</b>
• Total loans	100,114	+11.2%
• Total deposits	231,709	-1.2%
• Total assets	325,692	-2.1%
<b>Selected Ratios</b>	<b>1H2008</b>	<b>1H2007</b>
• Net interest margin*	2.31%	2.27%
• Cost-income ratio	38.7%	32.9%
	<b>30/6/2008</b>	<b>31/12/2007</b>
• Impaired loan ratio	0.44%	0.48%
• Impaired advances coverage	85.16%	86.84%
• Loan-deposit ratio	43.21%	38.39%

\* For the Hong Kong operations of The Hongkong and Shanghai Banking Corp only.

**HSBC's Hong Kong operations**

- HSBC's Hong Kong operations recorded a 10.4% y-o-y increase in net interest income. For The Hongkong and Shanghai Banking Corp in Hong Kong, its net interest margin widened by 4 bps y-o-y to 2.31%, reflecting a 24-bp increase in net interest spread partially offset by 21-bp decrease in contribution from net free funds.

- Non-interest income for the HSBC's Hong Kong operations dropped 8.9% y-o-y due to a net trading income decline caused by write-downs on exposures to monoline insurers and a negative movement in the fair value of assets driven by declining equity market performance.
- Operating expenses increased by 18.6%, compared with growth of 0.9% in total operating income, lifting the cost-income ratio to 38.7%, up from 32.9% in 1H07. Inflation and business growth were the main drivers behind the increase in staff, rental and IT costs.
- For Hong Kong operations, loan grew 11.2% h-o-h. Impaired loan ratio stood at 0.44% as of 30/06/2008, little changed from 0.48% as of 31/12/2007. Impaired loans were flat at US\$438m, reflecting favourable credit conditions on better local economy.
- **Rest of Asia Pacific (35.4% pre-tax profit)** Rest of Asia Pacific recorded an 8.4% y-o-y rise in pre-tax profit. Excluding the dilution gains made by HSBC's associates Ping An Insurance, Bank of Communications and Industrial Bank in 1H07, profit before tax increased by 49% on an underlying basis.
- **North American (-28.2% pre-tax profit)** HSBC's North America operations reported a pre-tax loss of US\$2.9bn in 1H08, compared with a pre-tax profit of US\$2.4bn in 1H07, a decline of 219%. The turmoil in the global credit markets persisted into 2008 and became more pronounced, lifting the loan impairment charges in US to rise by 88%. Personal Financial Services business recorded a pre-tax loss of US\$2.1bn while Global Banking and Markets reported a loss before tax of US\$1.6bn.
- **Latin America (12.4% pre-tax profit)** HSBC's operations in Latin America reported a pre-tax profit of US\$1.3bn compared with US\$1.0bn in 1H07, representing an increase of 27%. Increased revenues were partly offset by higher loan impairment charges, mainly driven by the cards business in Mexico, and increased operating costs across the region.

### Outlook & Prospects

- **Uncertain US credit market outlook** HSBC took a MTM loss of US\$3.9bn through the P&L but there are still US\$23.4bn net exposures of trading securities remaining. Management said the "near-term" outlook remained challenging, expecting the global economy to get worse before getting better. Despite the pace of deterioration was at a less marked rate than in previous quarters, it is still not clear whether this reflects the beginning of a turning point or simply the impact of seasonality. Further write-downs may still be required if the credit market further gets worse.
- **Continues to benefit from a high level of diversification** Despite the high level of US impairments may still has some way to run, nevertheless, outside of the US, emerging markets remain the key growth drivers for HSBC, and pre-tax profits were up in all major emerging markets in Asia-Pacific, the Middle East and Latin America in 1H08. Meanwhile, HSBC continues to step up investments in mainland China by adding outlets, while it has just completed its M&A in Taiwan and has significantly grown its presence there. In this environment, we expect HSBC's strong balance sheet and high diversification should continue to deliver out-performance.
- **Uncertainties about the company deal in Korea** HSBC announced that it has entered into a conditional agreement to acquire a 51.02% stake in Korea Exchange Bank (KEB). However, the Korean Financial Services Commission has not yet approved the deal as one of its shareholders is still dealing with the lawsuit over controlling KEB's share price when it acquired the bank in 2003. It is still not sure whether HSBC will extend the agreement or give up on acquiring KEB. This may result in the slower growth of HSBC in Korea compared with the growth of Standard Chartered and Citigroup.
- **Positives outweigh uncertainties** There is still a high degree of unpredictability to HSBC's future earnings. In particular, it is difficult to forecast further asset write-downs, although the details of HSBC's holdings have been disclosed. Despite the cautious comments, HSBC continues to post a solid earnings profile, and capital ratios are strong compared to many of its peers. The dividend also appears safe and is growing, and the yield of over 5% looks attractive. We accordingly recommend a 'Hold' or "Buy on weakness" rating on the banking counter.

**Recommendation: Hold / Buy on Weakness**

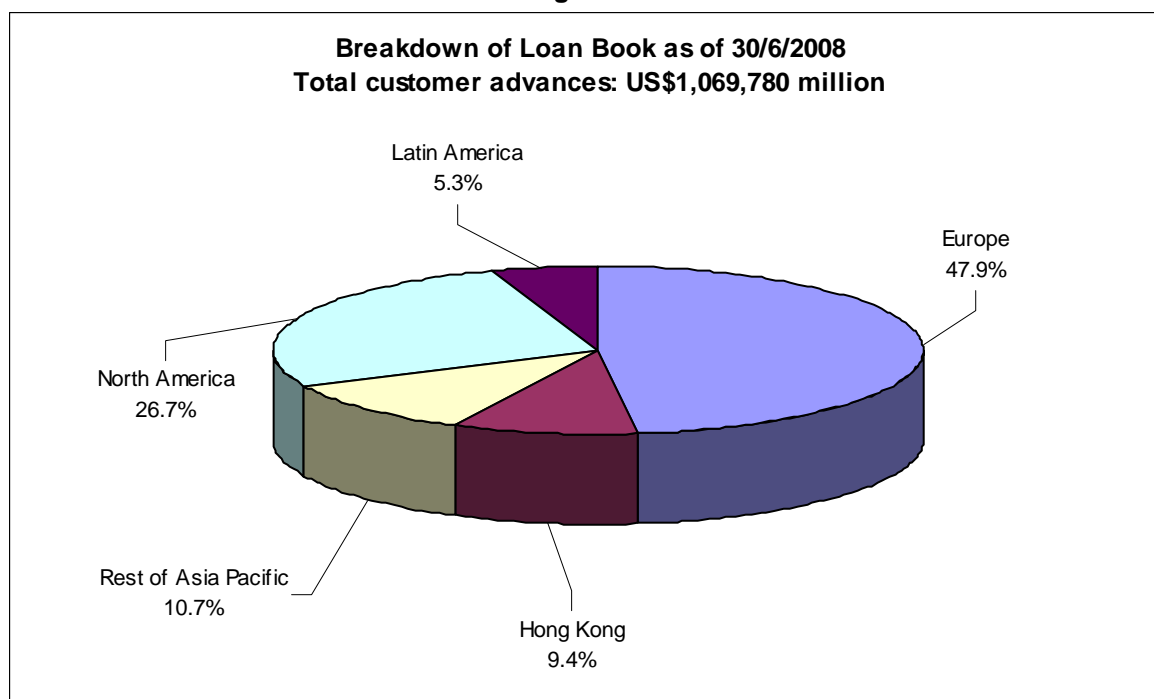
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**I. Impairment provisions of HSBC Holdings**

As % of total customer advances	Individual allowance	Portfolio allowance	Non-performing loans
<b>As of 30/6/2008</b>	0.22%	1.70%	1.78%
<b>As of 31/12/2007</b>	0.27%	1.65%	1.83%
<b>As of 30/06/2007</b>	0.28%	1.24%	1.54%

**II. Comparison of HSBC Holdings' loan book: 30/06/2008 vs 31/12/2007**

Loans-by economies	30 <sup>th</sup> Jun, 2008 US\$ million	Up/(down)	31 <sup>st</sup> Dec, 2007 US\$ million
Europe	512,699	+12.4%	456,206
Hong Kong	100,114	+11.2%	90,014
Rest of Asia Pacific	114,722	+11.6%	102,778
North America	285,677	-5.4%	301,840
Latin America	56,568	+13.3%	49,915
	<b>1,069,780</b>	<b>+6.9%</b>	<b>1,000,753</b>

**III. Breakdown of loan book of HSBC Holdings**




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