

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\$119.30 (03/03/2008)	Group Finance Director	: Douglas Flint
Shares Issued	: 11,865.6m		
Mkt. Cap.	: HK\$1,415,566.1m		
52 weeks Hi/ Lo	: HK\$153.50 / HK\$104.00		
HSI	: 23,584.97 (03/03/2008)		
Main Business	: Banking and related financial services		

SUMMARY OF THE FINAL RESULTS FOR THE YEAR ENDED 31ST DECEMBER 2007
Final Results Highlights

	US\$ million	Vs FY2006 (%)	Vs 30/06/2007 (%)
• Net interest income	37,795	+9.6%	
• Non-interest income	41,198	+33.4%	
• Total operating income	78,993	+20.8%	
• Operating expenses	(39,042)	+16.4%	
• Operating profit before impairment losses	39,951	+25.6%	
• Impairment losses on loans and advances	(17,242)	+63.1%	
• Profit before taxation	24,212	+9.6%	
• Taxation	(3,757)	-28.0%	
• Attributable profit to ordinary shareholders	19,133	+21.2%	
• Total loans	1,000,753	+13.5%	+6.2%
• Total deposits	1,096,140	+22.2%	+11.8%
• Total assets	2,354,266	+26.5%	+9.5%
• Basic EPS (US\$)	1.65	+17.9%	
• 3rd & 4th interim DPS (US\$)	0.56	+9.8%	
• Total DPS (US\$)	0.90	+11.1%	

Selected Ratios	FY2007	FY2006	1H2007
• Net interest margin	2.91%	3.10%	2.99%
• Cost-income ratio – basic	49.4%	51.3%	49.7%
• Return on average asset	0.97%	1.00%	1.19%
• Return on average equity	15.9%	15.7%	19.1%
• Impaired loan ratio	1.83%	1.56%	1.54%
• Impaired advances coverage	104.9%	98.5%	98.4%
• Loan-deposit ratio	91.3%	98.3%	96.1%
• Total capital ratio	13.6%	13.5%	13.2%
• Tier 1 ratio	9.3%	9.4%	9.3%

- **FY2007 results in line with market expectations** HSBC posted FY2007 net profit of US\$19,133m, up 21.2% y-o-y, largely in-line with market expectations. Total dividends declared re. FY2007 increased by 11%, to US\$0.90/sh.
- **Results helped by one-off items** Despite the Group recorded higher-than-expected impairment losses, the bottom line was helped by a few one-off items such as US\$3.1b fair value gain from its own debt, US\$1.1b dilution gains from Ping An Insurance, Bank of Communications and Industrial Bank and also lower effective tax rate due to a lack of earnings from North America and non-cash gains (not taxable). Excluding these, the overall pre-tax profit fell 9.4% in FY2007.

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- **Moderate growth in net interest income** Net interest income rose by US\$3,309m to US\$37,795m, an increase of 9.6% y-o-y. Overall net interest margin narrowed by 19 bps to 2.91% and accordingly net interest income growth was driven entirely by higher average interest-earning assets which increased 16.5% to US\$1,297bn. HSBC's loan book grew 13.5%, driven by strong growth in the Rest of Asia Pacific Region (+31.0%), Europe (+15.2%) and Latin America (+34.3%).
- **Stellar non-interest income growth** Non-interest income rose 33.4% with net fee and commission grew 28% y-o-y, representing 53.4% of non-interest income, driven by extremely good fee income in Hong Kong linked to buoyant equity markets. Regarding the net trading income, almost all the regions experienced strong growth, especially Europe with 53.3% y-o-y growth, but North America recorded a loss of US\$542m resulting mainly from deterioration of the US credit market.
- **Improving cost-income ratio** Operating expenses rose 16.4% y-o-y in FY2007, mainly driven by 15.3% increase in staff cost as well as 19.3% increase in general & administrative expenses. Owing to the outpaced operating income, cost-to-income ratio of the Group dropped slightly to 49.4%, compared with 51.3% a year earlier.
- **Jump in loan impairment losses** Loan impairment losses surged 63.1% y-o-y. Of the US\$6,669m increase, US\$5,360m was incurred by losses in US mortgage lending and credit card portfolios. US loan impairment charges rose by 78.8% to over US\$12bn, representing 70.5% of total impairment losses. Credit quality deteriorated subsequently because of higher impairment loans in North America. As a result, impaired loan ratio of the Group increased to 1.83% as of 31/12/2007, up from 1.56% at the end of 2006.
- **Capital indicators remain healthy** As of 31/12/2007, the Group's total capital ratio was 13.6% (31/12/2006: 13.7%) and the tier-1 CAR was 9.3% (31/12/2006: 9.4%). ROAE was 15.9% for FY2007.

Business Review by Business Lines

Pre-tax profit by businesses (US\$ million)	Breakdown				
	FY2007	FY2006	y-o-y (%)	FY2007	FY2006
Personal Financial Services	5,900	9,457	-37.6%	24.4%	42.8%
Commercial Banking	7,145	5,997	+19.1%	29.5%	27.2%
Global Banking & Markets	6,121	5,806	+5.4%	25.3%	26.3%
Private Banking	1,511	1,214	+24.5%	6.2%	5.5%
Other	3,535	(388)	-1011.1%	14.6%	(1.8%)
Total	24,212	22,086	+9.6%	100.00%	100.00%

- **Personal Financial Services (PFS) dragged by US sub-mortgage business** PFS division saw a 37.6% drop in pre-tax profit, due to a 62.5% jump in loan impairment losses, particularly in the US consumer finance business. Putting aside the substantial impairment losses, net operating income of PFS rose 15.7%, driven by strong growth in Hong Kong and the Rest of Asia-Pacific region.
- **Commercial Banking driven by emerging markets** The Commercial Banking unit grew 19.1% y-o-y in pre-tax profit, driven by strong results in Hong Kong (up by 23% on 2006), Mainland China (65%), Mexico (69%) and the UAE (29%). Both net interest income and net fee income recorded considerable increases of 20.5% and 23.9% respectively, reflecting a healthy growth across the board.
- **Global Banking & Markets dragged by write-downs** The division reported pre-tax profit of \$6.1bn, up 5.4% y-o-y only, dragged by a total of US\$2.1bn of write-downs of subprime investment, monoline insurers and other non-subprime assets. Pre-tax profits from Hong Kong and the Rest Asia-Pacific were particularly outstanding, rising 65% and 49% respectively.
- **Strong performance delivered by Private Banking** Private banking showed the best performance, with 24.5% y-o-y growth in pre-tax profit, on all round strength but specifically in HK, Switzerland and the Americas.

Business Review by Geographies

Pre-tax profit by geographic areas (US\$ million)	Breakdown			Impaired Loan Ratio			
	FY2007	FY2006	y-o-y (%)	FY2007	FY2006	31/12/2007	31/12/2006
Europe	8,595	6,974	+23.2%	35.5%	31.6%	1.37%	1.48%
Hong Kong	7,339	5,182	+41.6%	30.3%	23.5%	0.48%	0.54%
Rest of Asia Pacific	6,009	3,527	+70.4%	24.8%	16.0%	1.06%	1.51%
North America	91	4,668	-98.1%	0.4%	21.1%	2.78%	1.69%
Latin America	2,178	1,735	+25.5%	9.0%	7.9%	4.30%	3.98%
Total	24,212	22,086	+9.6%	100.00%	100.00%	1.83%	1.56%

- **Europe (35.5% pre-tax profit)** Pre-tax profit from Europe rose 23.2% in FY2007, mainly due to a moderate growth of Commercial Banking in UK market and especially, the fair value movement in HSBC's own debt resulting in gains of US\$1.3bn. But the overall pre-tax profit was dragged by the PFS in UK, which declined 18.4% y-o-y.

- **Hong Kong (30.3% pre-tax profit)**

	US\$ million	Vs FY2006 (%)
• Net interest income	5,483	+17.0%
• Non-interest income	5,839	+49.0%
• Total operating income	11,322	+31.6%
• Operating expenses	(3,780)	+15.6%
• Operating profit before provisions	7,542	+41.4%
• Impairment losses on loans & advances	(231)	+34.3%
• Pre-tax profit	7,339	+41.6%
• Total loans	90,014	+6.3%
• Total deposits	234,488	+19.2%
• Total assets	332,691	+22.1%

Selected Ratios	FY2007	FY2006
• Net interest margin	2.27%	2.29%
• Cost-income ratio	33.4%	38.0%
• Average liquidity ratio *	57.0%	49.3%

	31/12/2007	31/12/2006
• Impaired loan ratio	0.48%	0.54%
• Impaired advances coverage	86.84%	80.40%
• Loan-deposit ratio	38.39%	43.04%

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

- Net interest income from HK operations grew 17.0% y-o-y while net fee income rose by an impressive 63.5% y-o-y, particularly driven by increased fee income such as brokerage services and investment products within PFS and Global Banking & Markets on buoyant stock markets. Total operating expenses rose 15.6% for FY2007, reflecting the rise in premises costs, higher performance-related pay and higher IT costs. Cost-to-income ratio for the Hong Kong operations was 33.4% in FY2007, down notably from 38.0% a year earlier as net operating income growth (+31.6%) outpaced operating expenses.

- **North American operations (0.4% pre-tax profit)** North American operations saw pre-tax profit down 98.1%, overwhelmed by substantial loan impairment charges amounting to US\$12,156m. PFS recorded losses in the consumer finance business while Global Banking and Markets registered write-downs in credit and structured derivatives. In order to deal with the difficult situation faced in US mortgage market, HSBC has significantly reduced its mortgage portfolios from US\$49.5bn to US\$36.2bn, terminated its “Decision One Mortgage Corporation” and tightened underwriting in consumer lending business so as to control risks and reduce HSBC’s mortgage exposure in US.
- **Rest of Asia Pacific operations (24.8% pre-tax profit)** Rest of Asia-Pacific region reported pre-tax profit of \$6,009m, up 70.4% y-o-y. Excluding the exceptional profit of \$1,076m generated from the dilution of interests in HSBC’s associates in the region (Ping An, Bank of Communications and Industrial Bank) the pre-tax profit rose by 39.9% to \$4,933m. Within the region, China was the best-performed country, showing strong growth of pre-tax earnings in PFS (+80.0% y-o-y), Commercial Banking (+64.7%) and Global Banking & Markets (+121.0%).
- **Latin America (9.0% pre-tax profit)** HSBC’s Latin American operations saw a 25.5% rise in pre-tax profit on strong performance of its Commercial Banking segment (+64.1%), thanks to the notable contributions from Mexico and Brazil. The net operating income grew 28.3% but was offset by a surge in loan impairment charges of 80.9%, largely from Mexico. Impaired loan ratio also rose to 4.30% from 3.98% a year earlier, suggesting deterioration in credit quality.

Outlook & Prospects

- Emerging market businesses of HSBC performed well in FY2007 whilst its US operations registered depressed profitability. Income from emerging markets currently accounts for some 64% of the Group’s profits and we are seeing continuous robust performance in those markets in 2008. However, the strong market-related income such as net fee income might not be sustainable given the negative sentiment is still prevailing globally.
- Regarding the troubled North America region, management also admitted that it would “get worse before it gets better” during the result presentation, reflecting their pessimistic view to the US market. At this stage, we continue to see the US as a drag and the worst has not yet come.
- As of 31/12/2007, the Group held a combination of subprime mortgage related assets, credit trading & leveraged loans and derivative transactions with monolines, totalling US\$24.1bn, but only US\$2.13bn was written down for impairment losses in 2007. Despite management guided that there is no material investment was backed by US subprime assets, further write-downs may still be required if the credit market further gets worse.
- The stock looks attractively valued at 9.3x FY2007 P/E and 1.42x FY2007 P/B. In addition, HSBC’s dividend has increased by 10% or more each year for 15 years and the current dividend yield is over 5%, making HSBC a good defensive play. We expect HSBC to be able to benefit from its geographic reach and strong capital and liquidity positions going forward. We believe the Group’s exposure in fast growing emerging markets should be able to overshadow its subprime mistakes in the US and we accordingly recommend a ‘Hold’ or “Buy on weakness” rating on the banking counter.

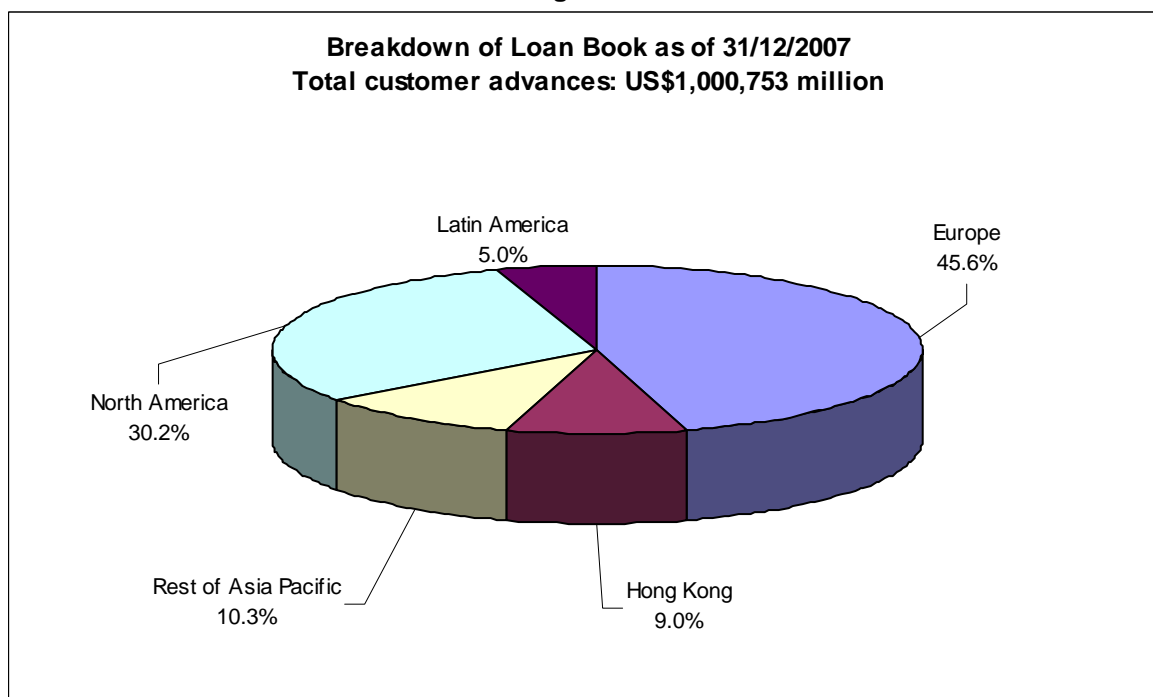
Recommendation: Hold / Buy on Weakness

I. Impairment provisions of HSBC Holdings

As % of total customer advances	Individual allowance	Portfolio allowance	Non-performing loans
As of 31/12/2007	0.27%	1.65%	1.83%
As of 30/06/2007	0.28%	1.24%	1.54%
As of 31/12/2006	0.29%	1.25%	1.56%

II. Comparison of HSBC Holdings' loan book: 31/12/2007 vs 31/12/2006

Loans-by economies	31 st Dec, 2007	Up/(down)	31 st Dec, 2006
	US\$ million		US\$ million
Europe	456,206	+15.2%	396,175
Hong Kong	90,014	+6.3%	84,647
Rest of Asia Pacific	102,778	+31.0%	78,475
North America	301,840	+5.8%	285,234
Latin America	49,915	+34.3%	37,180
	1,000,753	+13.5%	881,711

III. Breakdown of loan book of HSBC Holdings




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