May 28, 2015

Standard Chartered

Asia Insight: Long quest to reclaim 'growth stock' crown

Industry View	Stock Rating	Price Target
Attractive	**Underweight**	**HK$100.00**

Reshaping the portfolio to drive returns ahead of the cost of capital is the next key debate. But our deep dive analysis indicates a more drawn out recovery process than most expect – we stay UW.

What's Changed?	From:	To:
Standard Chartered		
Price Target	HK$94.00	HK$100.00

In many respects it can be convincingly argued that StanChart could be on the cusp of a rebound. The stock is down c.45% from the 2013 peak; it trades at 1.0x 2015e tangible book vs its 2009-13 average of c.1.5x; and a well regarded CEO is about to take the helm with the express mandate of turning around the fortunes of this unique bank. If only it were that simple.

It is the contention of this report that the process of recovery is going to be more drawn out than is reflected in the share price. A process that essentially entails three steps. **1) restoring balance sheet confidence** on asset quality and capital levels. **2) restoring profitability**, namely, lifting returns to beat the cost of capital. **3) repositioning StanChart as a 'growth stock'**.

With the balance sheet question well aired in the market, and impairment charges starting to fall, we see Step 2) as the next key debate for the stock. We identify 3 key levers at management's disposal to lift ROE above COE:

- **i) Tackling the cost base:** Our DuPont analysis of returns (Exhibit 1) indicates that cost efficiency is the key area where StanChart lags its Asian peers, with a 2014 cost:assets ratio of 1.7% vs an Asian peer average of 1.2%. While there are structural reasons for its higher ratio (bank levy, mix and scale), cost still appears a ripe opportunity to improve returns.
- **ii) Streamlining the portfolio:** Our 'quadrant' analysis of 26 business cells reveals $160bn of RWAs (c.45% of group) with RoAE as low as c.2% and cost:income of c.70% as at 1H14, implying that exit/reshaping could unearth much higher 'core' returns.
- **iii) Redomiciling the bank:** Changing domicile to avoid the UK bank levy could take c.3ppt off the cost:income ratio and add c.10% to group earnings. However, we do not see this as a straightforward process and, instead, expect a focus on business improvements.

We raise our PT to HKD 100 as we now link valuation to 2018e (was 2017e) recovered returns. But we still only expect RoTE of c.10% in 2018, justifying 0.9x TNAV (on 11% COE), and so reiterate our UW.

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Hong Kong Financials / Hong Kong

Stock Rating	**Underweight**
Industry View	**Attractive**
Price target	HK$100.00
Up/downside to price target (%)	(21)
Shr price, close (May 27, 2015)	HK$125.90
52-Week Range	HK$175.70-102.60
Sh out, dil, curr (mn)	2,493
Mkt cap, curr (mn)	US$40,487
Avg daily trading value (mn)	HK$211

Fiscal Year Ending	12/14	12/15e	12/16e	12/17e
ModelWare EPS (US$)	1.40	1.09	1.25	1.51
Consensus EPS (US$)§	1.67	1.50	1.60	1.81
ModelWare net inc (US$ mn)	3,470	2,728	3,226	3,953
P/E	10.7	15.0	12.9	10.8
P/BV	0.8	0.9	0.9	0.8
ROE (%)	7.8	6.1	6.9	8.1
Div yld (%)	5.7	3.3	3.5	3.7
P/tang BV	0.9	1.0	1.0	0.9
Tang BVPS (US$)	15.9	16.4	16.7	17.5
Core tier 1 ratio (%)	10.7	10.8	11.4	12.2
Core tier 1 capital ratio, Basel 3 (%)	10.7	11.3	11.9	12.7
RWA (US$ bn)	342	338	336	337

Unless otherwise noted, all metrics are based on Morgan Stanley ModelWare framework
§ = Consensus data is provided by Thomson Reuters Estimates
e = Morgan Stanley Research estimates

Risk Reward

STAN: We expect earnings to disappoint as the bank prioritises capital build

Source: Thomson Reuters (historical share price data), Morgan Stanley Research estimates

Price Target HKD100	Weighted 15% bear, 70% base and 15% bull case.
Bull HKD139 1.2x Bull Case 2018e TNAV	**Asian Tiger.** The key Asian economies StanChart is exposed to grow faster than expected, allowing stronger system loan growth. Financial Markets revenue picks up. Impairments are more benign than feared. Control on costs and capital allocation pay dividends.
Base HKD98 0.9x Base Case 2018e TNAV	**Muddle Through (growth constrained by capital demands).** Economies improve in Asia but not back to historical growth rates. Asset and revenue growth are negative in 2015, and then constrained to low single digits by the need to preserve capital in the context of pro-cyclicality in RWAs and higher regulatory capital requirements (we expect 13% minimum CET1 Ratio). Impairment rates gradually improve.
Bear HKD70 0.7x Bear Case 2018e TNAV	**Malaise.** The Asian economies slow prompted by a weak patch for China/HK. This leads to lower revenue growth and higher impairments with LLPs rising towards the long-run average.

Investment Thesis

- **Consensus revenue / earnings expectations too bullish.** Due to the necessity to build capital towards a 13% CET1 ratio leading to rationing of asset growth, intense competition, tighter credit standards (especially commodities), exit of low return businesses (Korea/RWA hogs etc) and drag from FX.
- **Asset quality a wildcard risk.** Due to deteriorating conditions in commodities / China slowdown.
- **Dividend cut likely.** We model a c.30% cut for dividend declared in respect of 2015 given need to build capital.
- **Potential for capital raise** of c.$7-10bn, we calculate.
- **Valuation not yet compelling** given the capital challenge and economic backdrop – STAN trades at c.1.0x 2015 TNAV for only c.10% 2018e RoTE.

Key Value Drivers

- Asia/EM economic outlook
- Lower capital requirements or a longer implementation period
- Positive jaws (costs growing faster than revs) to protect profits
- Delivery of new management targets
- Trends in asset quality

Potential Catalysts

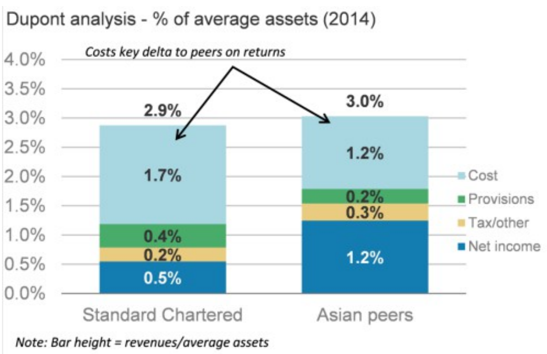
- New business plan / targets from new CEO potentially in 4Q15
- UK regulatory developments
- Macroeconomic indicators, particularly in Asia
- Renewed takeover speculation on SC could support the share price
- Data on India / commodity / China asset quality

Risks to Achieving Price Target

- Slower global economic growth
- Worsening impairment trends
- Higher-than-expected capital requirements

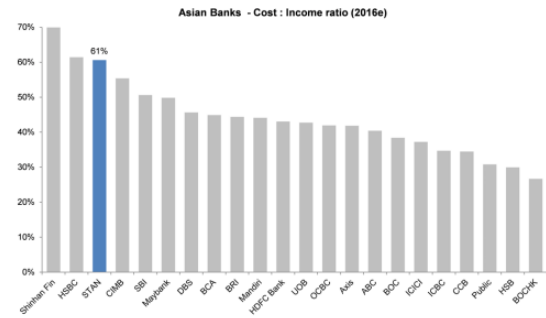
StanChart: We see improving returns as the next key debate

Exhibit 1: StanChart cost:assets well above peers: 1.7% vs 1.2%



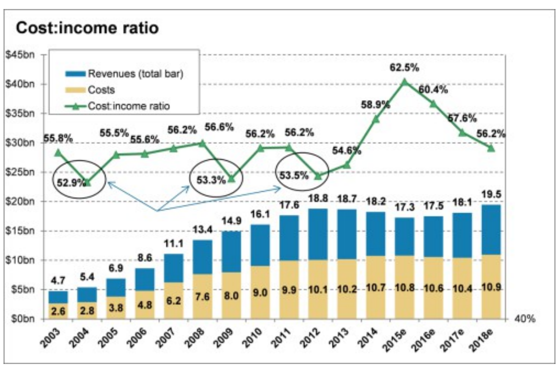
Source: Company data, Morgan Stanley Research estimates

Exhibit 2: Peer group avg cost:income ratio c.45%



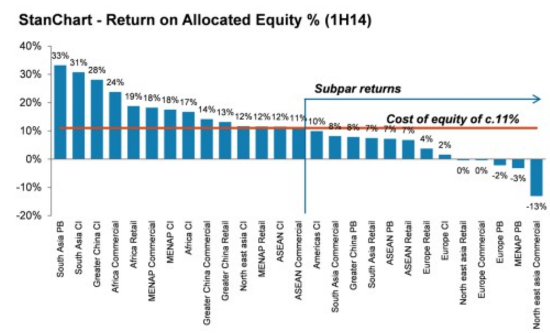
Source: Company data, Morgan Stanley Research estimates

Exhibit 3: StanChart's best-of-the-last-decade cost:income ratio: c.53%



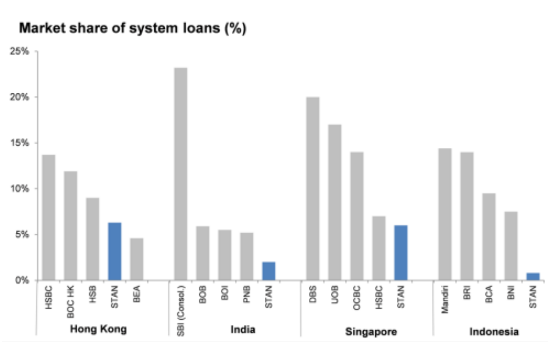
Source: Company data, Morgan Stanley Research estimates

Exhibit 4: Addressing low-returning tail could significantly boost group returns at SC



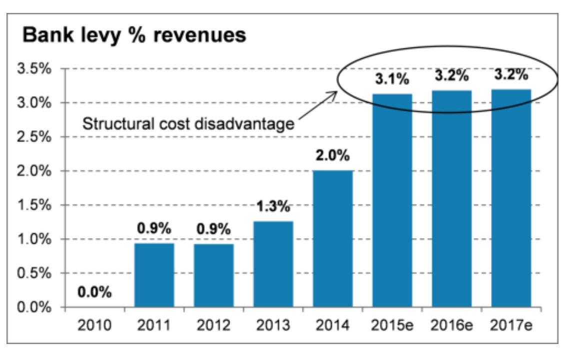
Source: Company data, Morgan Stanley Research

Exhibit 5: But StanChart lacks scale in key markets



Source: Company Data, CEIC, Local Central Banks, Morgan Stanley Research

Exhibit 6: And the UK bank levy drives a structurally higher cost/income ratio



Source: Company data, Morgan Stanley Research estimates

Investment Case

In this Insight note, we study in depth three key steps we expect incoming CEO Bill Winters to take to revitalise the Standard Chartered equity story when he outlines his vision for the group. Ostensibly, StanChart currently offers an exciting investment proposition with the stock off c.45% from its 2013 peak, materially trailing European and Asian peers. Further, at 1.0x 2015e TNAV and 11x 2017e EPS it looks cheap vs history. However, as explained below we do not yet see the case for re-rating.

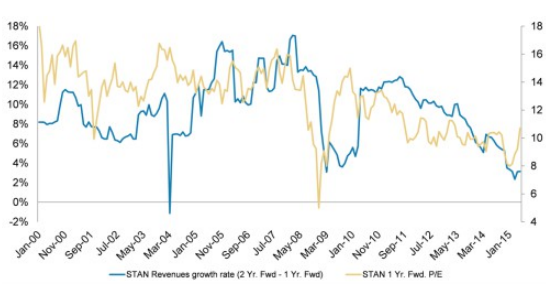
Our analysis suggests that StanChart is likely to miss consensus earnings estimates by c.15% (base case) on lower revenues driven by RWA rationing (ie muddle through); or, another option is to raise additional capital of c$7-10bn (c.15-25% of market cap) to quickly restore investor confidence in the balance sheet. We think it is more likely to opt to muddle through, and this is the reason we believe that it will take as far out as 2018e to deliver ROTE of just c.10%. And with cost of equity of 11%, we believe that StanChart should trade at c.0.9x TNAV. If we are correct in our analysis, we see 15% downside potential to our new price target of HKD 100 (was HKD 94), and so reiterate our Underweight rating.

What went wrong at Standard Chartered?

StanChart had an impressive run from 2002-12 reporting 10 consecutive years of record PBT, growing from $1.3bn to $6.9bn (18% CAGR) with a fivefold increase in balance sheet assets from $112bn to $630bn (19% CAGR). Success was predicated on asset and top-line growth, in two phases. From 2002 to 2007, Asia ex-Japan nominal GDP growth was running at 10%+, allowing all players to grow. Then, following the financial crisis, from 2008 to 2012, although Asia ex-Japan real GDP slowed to c.8-9%, StanChart's competitors faced significant challenges (eg Citi / HSBC battling losses on subprime, French banks with US$ funding difficulties), allowing SC to take share in a slower growing market and maintain 'double-digit' revenue growth.

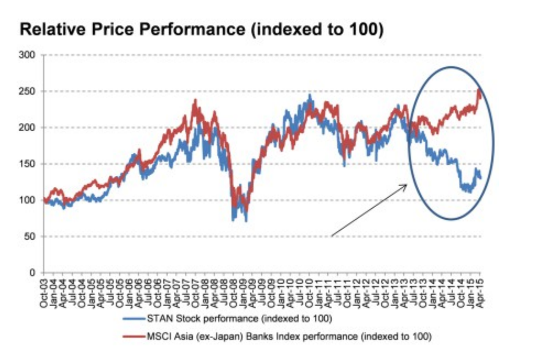
However, things changed from 2012, and StanChart's once-impressive financial engine began to stall with revenue growth lagging asset growth in a low rate environment and the reemergence of competition, and RWA growth outpacing asset growth due to negative credit migration and regulatory changes. This led to a squeeze on capital formation and revenue growth lower than peers. Further, cost inflation at StanChart has persisted despite falling revenues, and asset quality risks have come to the fore due to commodity price falls, Korean PDRS and certain corporate exposures. StanChart's premium rating disappeared as returns fell, and since November 2013 MSCI has even categorised SC as a 'value stock' rather than a 'growth stock'.

Exhibit 7: The stock has de-rated as return expectations have collapsed



Source: Thomson, Morgan Stanley research

Exhibit 8: Performance de-linked vs Asian peers



Source: Datastream, Morgan Stanley research

How can new management revitalise the equity story? – we see three key steps

Step 1: Restoring Balance Sheet Confidence

Investors have doubts about the balance sheet on two fronts; *asset quality* and *capital ratios*. Given the rapid balance sheet expansion in the last decade, the turn in the commodity cycle, macro slowdown in Asia, the rise in non-performing loans and coverage lower than peers, the market is still concerned on asset quality. StanChart has also fallen behind other banks in building capital and we expect it to run with a CET1 ratio of c.13%+ in a 'steady state' (vs 10.7% at Dec 14 and targets of 11-12%), a level that should lift it 'above the fray', and allay any investor concerns on its balance sheet.

Conclusion: So, what options does StanChart have to put these doubts to rest? First, it could opt to: **i) 'muddle through' by cutting the dividend and restructuring assets**, thus addressing concerns over time, but with a weaker revenue and earnings outlook. Another option is that new management could simply choose to **ii) 'grasp the nettle' and increase capital by $7-10bn** in an effort to restore confidence in one go, but at the expense of diluting returns nearer term. See **ii) in Step 1: Restoring balance sheet confidence**. We look forward to what new management would consider the right course of action when it takes the reins, ie asset disposals/cost cutting/restructuring are some of the several options available to it besides a capital raise, on which it has made no comment to the market.

Step 2: Restoring profitability – forging a clear path for ROE to beat COE

The financial 'engine' of StanChart has stalled with normalised return on equity a lowly 8% in 2014, which is not enough to both pay a dividend and capture growth opportunities in the markets where StanChart operates. We examine where it lags peers and could boost returns.

- **i) More radical action on the cost base:** Our DuPont framework (see Exhibit 1) indicates that cost efficiency is the key area where StanChart lags its Asian peers, with a 2014 cost:assets ratio of 1.7% vs the Asian peer average of 1.2%. We calculate that if the cost:income ratio can be brought down to the best level of the last decade (53%), this would result in c.10% earnings upside. If the ratio could be brought in line with its Asian peers (45%+levy), this could add c.25% to earnings. However, we see structural reasons for a higher ratio vs peers due to such factors as the bank levy, mix (more skew to high cost:income wholesale banking) and scale (with StanChart outside the top 4 in all its key markets).
- **ii) Streamlining the portfolio:** In our 'quadrant' analysis we look at returns across 26 key business cells as at 1H14 (ex-levy). We have identified $160bn of RWAs (c.45% of group) allocated to businesses with a RoAE of 2% and cost:income ratio c.70%, including Korean Retail and Commercial, South Asian Retail, Asean Retail, MENAP Private Bank, Europe PB, Retail and CI. We acknowledge the use of booking centres distorts comparisons, however, we expect that the restructuring of low return businesses would generate higher 'core' returns.
- **iii) Redomicile to avoid the bank levy:** Changing domicile to avoid the UK bank levy could take c.3ppt off the cost:income ratio and add c.10% to group earnings. However, we do not see this as a straightforward process given the cost and complexity of such a move and that StanChart's assets to HK / Singapore GDP are >2x.

Conclusion: more **ambitious cost cutting**, **portfolio rationalisation** and **redomicile** are the key levers at management's disposal. That said, execution will likely be a long and drawn out process.

Step 3: Repositioning StanChart as a 'growth stock'

StanChart has lost its crown as the growth bank of choice for European investors with revenues having stalled since peaking in 2012. However, StanChart still has exposure to vibrant markets in Asia with high single-digit growth rates in their banking systems, and so over time StanChart should be able to recapture this growth opportunity. However, we think this is likely to be an uphill battle for the next 12 months or so, given **i) slowing Asian macro** indicators and **ii) a tough competitive environment** in the region, with both domestic and international banks vying for market share.

Conclusion: A slowing Asian macro backdrop is likely to limit system loan growth to high single digits in most markets and competition is likely to keep margins in check in the medium term. Over time, however, we expect growth will reemerge in the franchise.

Valuation only looks appealing if a long-term outlook is taken

On P/E, StanChart trades at a significant discount to its own history. We acknowledge this looks 'cheap' and in the long term may actually prove a good entry point. However, although multiples are 2 standard deviations lower than long-term average, ROE is also at decade-low levels. For the stock to re-rate requires investors to become more confident in the ability of the bank to beat its cost of equity, in our view.

What could make us more positive?

We identify a number of areas that would incline us to be more positive on the stock. i) A brighter Asian macro outlook; ii) Faster-than-expected US rate hikes boosting margins; iii) Rebound in Financial Markets activity; iv) More dovish tone on capital from UK policymakers, de-escalating the capital challenge v) Renewed takeover speculation.

Price target and EPS changes

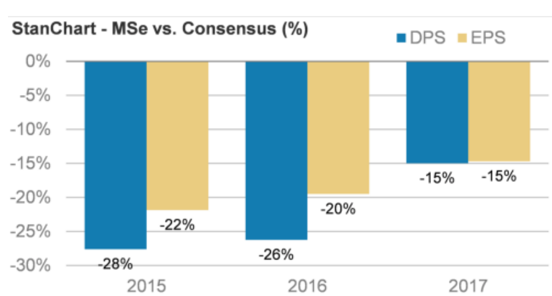
Given the challenges and the long road ahead, we have adopted a longer-term view on StanChart, and value the stock on 2018e earnings, as this is when we expect return on equity to recover to c.10%. Rolling forward our valuation, we raise our **price target to HKD 100** and make housekeeping changes of +/-c.5% on 2015-18e EPS. We see better value at **Lloyds, Intesa, Unicredit, ING and UBS (all OW) in Europe.** In Asia, we would own **Indian banks (HDFC Bank, Axis)** for growth, **HK banks (HSB, BOCHK)** for yield and **large cap Chinese banks (CCB)** for value.

Exhibit 9: Overview of earnings changes

Standered Chartered Estimates					TNAV/ share	Price Target
	2015e	2016e	2017e	2018e	2015e	12m fwd
New	**$1.09**	**$1.25**	**$1.51**	**$1.71**	**$16.51**	**HK$100**
Prior	$1.12	$1.30	$1.52	$1.63	$16.21	HK$94
New vs. prior	*-3%*	*-3%*	*-0%*	*+5%*	*2%*	*7%*
Consensus	$1.39	$1.56	$1.77	$1.94	-	-
New vs. consensus	*-22%*	*-20%*	*-15%*	*-12%*	-	-
Price/**New**	**15.2x**	**13.2x**	**11.0x**	**9.6x**	**1.01x**	-

Source: Morgan Stanley Research estimates

Exhibit 10: We are c.15 below consensus for 2017



Source: Thomson Reuters consensus, Morgan Stanley Research estimates

Exhibit 11: UK Banks Snapshot

Order of Pref	Company	Price 21 May 15		Consensus		Capital ratios/ Dividends		Valuation TNAV / Shr (basic)		EPS	2015e	2016e	2017e	Investment Case
1	**Lloyds**	Price	88p	Buy	52%	2016e CRD IV CET1	15.6%	2015e	58.7	MSe	8.2p	8.2p	8.3p	* Tail risk from funding / asset quality reduced enabling focus on core
	LLOY LN	L1m perf.	+12%	Hold	33%	16e CRD IV Lev.	5.6%	P/2015e	1.50x	Cons.	7.8p	8.2p	8.6p	* Solid + high return core franchise (MSe ~25% core RoAE)
OW	Market Cap	L3m perf.	+13%	Sell	15%	16e DPS	4.0p	17e RoTE	13.0%	MS v C.	+5%	+1%	-4%	* EPS revisions to support as better UK housing provides tailwind
	£62.8bn	YTD perf.	+16%			Divi yield	4.6%			P/MSe	10.7x	10.7x	10.6x	* Refocus on dividend yield as surplus capital builds
2	**Barclays**	Price	271p	Buy	71%	2016e CRD IV CET1	12.1%	2015e	285	MSe	20.4p	25.0p	27.4p	* Potential need to build capital to hamper revenue growth
	BARC LN	L1m perf.	+7%	Hold	25%	16e CRD IV Lev.	4.9%	P/2015e	0.95x	Cons.	24.4p	29.3p	32.1p	* Loss of FICC share to US competitors underestimated
OW	Market Cap	L3m perf.	+4%	Sell	4%	16e DPS	7.0p	17e RoTE	9.3%	MS v C.	-16%	-15%	-15%	* Consensus dividends look ambitious
	£45.4bn	YTD perf.	+11%			Divi yield	2.6%			P/MSe	13.3x	10.8x	9.9x	* Italy/Spain exposure improving
3	**TSB**	Price	338p	Buy	14%	2016e CRD IV CET1	19.7%	2015e	340	MSe	15.6p	22.4p	18.1p	* Strong UK macro outlook and growth in loan volumes
	TSB LN	L1m perf.	+1%	Hold	71%	16e CRD IV Lev.	5.8%	P/2015e	1.00x	Cons.	16.4p	19.9p	17.6p	* Conduct risk limited by indemnity from Lloyds & strong capital position
EW	Market Cap	L3m perf.	+31%	Sell	14%	16e DPS	0.0p	17e RoTE	4.8%	MS v C.	-5%	+13%	+3%	* Growth imperative to improve returns
	£1.7bn	YTD perf.	+22%			Divi yield	0.0%			P/MSe	21.7x	15.1x	18.7x	* Gaining share with return to intermediary channel
4	**RBS**	Price	355p	Buy	19%	2016e CRD IV CET1	17.6%	2015e	373	MSe	26.3p	16.7p	25.2p	* Opportunity to grow in UK Retail & Commercial banking
	RBS LN	L1m perf.	+2%	Hold	52%	16e CRD IV Lev.	5.7%	P/2015e	0.95x	Cons.	29.6p	26.8p	29.3p	* Capital build above peers likely by 2016e post disposals
EW	Market Cap	L3m perf.	-11%	Sell	30%	16e DPS	0.0p	17e RoTE	7.0%	MS v C.	-11%	-38%	-14%	* No dividend + overhang of c.80% UK government stake
	£41.0bn	YTD perf.	-10%			Divi yield	0.0%			P/MSe	13.5x	21.3x	14.1x	* Drag from RCR / restructurings charges / conduct costs on TNAV
5	**HSBC**	Price	615p	Buy	28%	2016e CRD IV CET1	12.4%	2015e	$8.0	MSe	$0.77	$0.79	$0.85	* Earnings may disappoint on weaker revenues
	HSBA LN	L1m perf.	+1%	Hold	45%	16e CRD IV Lev.	5.2%	P/2015e	1.21x	Cons.	$0.84	$0.89	$0.95	* Dividend expecations may be too high
EW	Market Cap	L3m perf.	+2%	Sell	28%	16e DPS	$0.52	17e RoTE	10.5%	MS v C.	-8%	-11%	-10%	* US subprime normalising impairment charges already anticpated
	£119.9bn	YTD perf.	+1%			Divi yield	5.4%			P/MSe	12.5x	12.1x	11.2x	* Asia / EM outlook to weigh
6	**Stan Chart**	Price	1057p	Buy	33%	2016e CRD IV CET1	11.9%	2015e	$16.5	MSe	$1.09	$1.25	$1.51	* Capital challenge to weigh on growth ambition / capital return
	STAN LN	L1m perf.	+1%	Hold	30%	16e CRD IV Lev.	5.6%	P/2015e	1.00x	Cons.	$1.39	$1.56	$1.77	* Asian/EM outlook still to weigh
UW	Market Cap	L3m perf.	+9%	Sell	37%	16e DPS	$0.57	17e RoTE	8.8%	MS v C.	-22%	-20%	-15%	* Asset quality deterioration a 'wildcard' risk
	£26.9bn	YTD perf.	+10%			Divi yield	3.5%			P/MSe	15.2x	13.2x	11.0x	

Source: Company data, Morgan Stanley Research, e = Morgan Stanley Research estimates Share prices for other stocks in this report: Intesa 3.40; Unicredit 6.75; UBS 22.70; HDFC 1350; AXIS 900; ING 16.10; HSB 183; BOCHK 7.94; CCB 4.80

Morgan Stanley is acting as financial advisor to Standard Chartered Bank (Hong Kong) Limited ("Standard Chartered") in relation to the proposed sale of PrimeCredit Limited and Shenzhen PrimeCredit Limited to a consortium led by China Travel Financial Holdings Co., Limited, together with Pepper Australia Pty Limited and York Capital Management Global Advisors, LLC as announced on 16 December 2014. The transaction is subject to certain conditions including regulatory approvals. Standard Chartered has agreed to pay fees to Morgan Stanley for its financial services. Please refer to the notes at the end of the report.

Step 1: Restoring balance sheet confidence

Investors have raised doubts on the balance sheet of Standard Chartered on two fronts; *asset quality* and *capital ratios*. The market is still concerned on asset quality at StanChart given its rapid balance sheet growth, the turn in the commodity cycle, the slowdown in Asia and the increase in non-performing loans along with a coverage level that is lower than its peers. In building capital, StanChart has fallen behind other banks. We expect it to address these concerns by raising its coverage ratio on NPLs to c.75% and showing c.13%+ CET1 print ' (vs 10.7% reported at Dec 14 and current targets of 11-12%). **We see two potential paths to solve this:**

- **i) Muddle through (our base case): Temper RWA growth and rebase the dividend.** Our base case is for StanChart to tightly ration risk-weighted assets, which stay broadly flat in 2014-18e despite RWA inflation from credit migration and rule changes. We also expect management to rebase the dividend by c.30%, allowing it to grow by c.5% per annum thereafter. Provisions would be recognised over an extended timeframe and coverage taken up to 75%, with $5.8bn recognised from 2015-17e. This approach would allow it build to c.13% CET1 ratio by 2017e, but at a cost to earnings power (MS 2018e revenues are 8% below consensus, EPS c.15% below). This would avoid a cash call which outgoing management have said is unnecessary.
- **ii) Grasp the nettle: and increase capital by $7-10bn.** While not our base case, the new management team could choose to grow the balance sheet rather than endure a prolonged period of retrenchment. We calculate that a c.$7-10bn capital raise would likely be sufficient to assuage investors' concerns in a much shorter time frame. This would allow the bank to top up its impaired loan provision coverage to 75% on the assumption that NPLs rise to 3% by 2017e (vs 2.6% as at end 2014), and still afford headroom to lift the CET1 ratio to 13%. Once again lifting it '*above the fray*', placing it among the top quartile of peers in Europe, and setting the stage for growth. Note that our capital raise is hypothetical, and not in our base case; and we note new management has several options available to address its capital needs, such as shedding low performing assets/cutting costs/exercising dividend restraint.

Conclusion: We think StanChart is likely to either miss consensus earnings estimates by c.15% on softer revenues, ie choose to muddle through. **Or it could hypothetically seek a capital raising to the tune of c.15-25% of market cap.** That said, our base case is that it opts to muddle through, seeking to address its capital over time, as discussed above.

Exhibit 12: Framing a potential capital raise in a 'grasp the nettle' scenario

Standard Chartered, US$m	Low	Central	High
Capital - top up to 13% CET1			
2015e RWA		338,430	
2015e CET1 ratio		11.3%	
Assumed CET1 ratio requirement		13.0%	
Implied capital required (A)		5,855	
Asset quality - top up to peer coverage			
2014 NPL ratio %	2.6%	2.6%	2.6%
2014 Coverage ratio %	53%	53%	53%
Assumed coverage ratio post top up %	64%	76%	113%
Implied capital required (B)	798	1,722	4,468
Total potential capital top up			
New equity US$ (A+B)	**6,653**	**7,577**	**10,323**
% market capitalisation	*16%*	*18%*	*25%*

Source: Company data, Morgan Stanley Research estimates

i) Muddle through (our base case)

For 2018e we model revenues that are c.8% below consensus and a c.30% dividend cut as we expect that StanChart will likely choose to **'muddle through'**, which is our base case. The last reported CET1 ratio of 10.7% is still well above the known 2019 minimum (set by the PRA) of 8.65%, and we expect that the bank can build towards 13% CET1 ratio over time without raising fresh equity from the market and diluting shareholders. However, in order to meet this higher capital threshold, we would expect asset growth to be tempered in order hold RWAs broadly flat in 2014-18e. Lowering its sights on asset growth should result in slower revenue growth and hence lower earnings than the market expects. We also assume its NPL coverage to build steadily to reach 75% by 2017e, providing reassurance to the market on asset quality. We expect a dividend cut in order to raise the pace of CET1 build from earnings, modelling a c.30% dividend reduction in 2015e and 5% dividend growth thereafter.

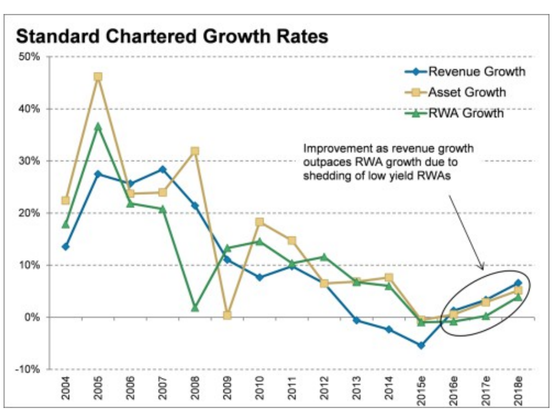
Exhibit 13: Our base case is for capital build to 13% CET1 by RWA rationing and dividend restraint

Standard Chartered, $m CRD IV transitional	2012	2013	2014	2015e	2016e	2017e	2018e
Starting CET1	28,297	33,108	35,123	36,494	38,141	40,090	42,675
Net profits	4,786	3,989	2,512	2,728	3,041	3,768	4,522
Dividend (net scrip)	(1,306)	(1,967)	(1,350)	(852)	(1,036)	(1,097)	(1,119)
FX/ Other	1,331	(7)	209	(229)	(56)	(87)	(99)
End CET1	**33,108**	**35,123**	**36,494**	**38,141**	**40,090**	**42,675**	**45,980**
y/y		*6%*	*4%*	*5%*	*5%*	*6%*	*8%*
Starting RWAs	285,120	310,311	331,296	341,648	338,430	335,754	336,645
Asset growth	16,897	17,688	9,968	(1,774)	1,840	9,738	17,365
Exit of low return RWAs			(8,500)	(9,167)	(9,167)	(9,167)	-
Credit migration	6,104	8,954	6,400	5,000	4,000	3,000	-
Model changes	7,337	2,195	14,895	8,000	8,000	6,000	-
RWA efficiencies	(3,800)	(3,916)	(12,166)	(8,000)	(8,000)	(8,000)	(4,000)
Other inc. op/market risk	(3,263)	2,102	5,693	2,723	651	(679)	(204)
FX	1,916	(6,038)	(5,938)	-	-	-	-
End RWAs	**310,311**	**331,296**	**341,648**	**338,430**	**335,754**	**336,645**	**349,806**
y/y		*7%*	*3%*	*-1%*	*-1%*	*0%*	*4%*
CRD IV CET1 ratio	***10.7%***	***10.6%***	***10.7%***	***11.3%***	***11.9%***	***12.7%***	***13.1%***
Gap to 13% CET1 ratio	*-2.3%*	*-2.4%*	*-2.3%*	*-1.7%*	*-1.1%*	*-0.3%*	*0.1%*
Capital gap vs 13%	**(7,232)**	**(7,945)**	**(7,920)**	**(5,855)**	**(3,558)**	**(1,089)**	**505**
Total assets (reported)	631,208	674,380	725,914	722,144	726,069	747,127	785,665
RWAs/Total Assets (%)	***49.2%***	***49.1%***	***47.1%***	***46.9%***	***46.2%***	***45.1%***	***44.5%***

Dividend restraint ***RWA rationing***

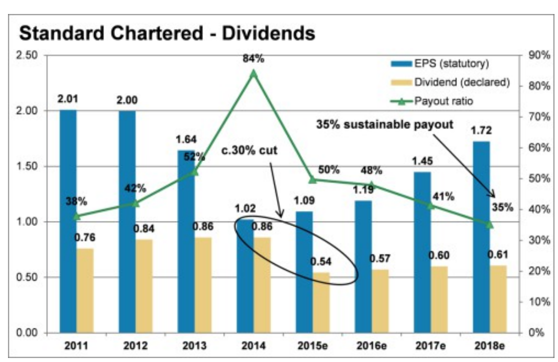
Source: Company data, Morgan Stanley Research estimates

Exhibit 14: We expect RWA rationing to weigh on revenue growth



Source: Company data, Morgan Stanley Research estimates

Exhibit 15: And a dividend cut to preserve capital



Source: Company data, Morgan Stanley Research estimates

Exhibit 16: We model 2018e revenues 8% below consensus

Standard Chartered revenues (US$mn)	2013	2014	2015e	2016e	2017e	2018e	CAGR 14-18e	Δ 14-18e
Core revenues	16,901	16,934	16,874	17,331	18,052	19,240	3%	2,306
Growth vs prior year		*0%*	*0%*	*3%*	*4%*	*7%*		
De-risking	600	300	-	-	-	-		
Exit businesses	450	450	100	-	-	-	-100%	(450)
Exit of low return RWAs	720	550	275	138	-	-	-100%	(550)
Total revenues (MS est.)	**18,671**	**18,234**	**17,249**	**17,468**	**18,052**	**19,240**	**1%**	**1,006**
Growth vs prior year			*-5%*	*1%*	*3%*	*7%*		
Consensus (Bloomberg)			**17,997**	**18,502**	**18,988**	**20,873**	**3%**	**2,639**
Growth vs prior year			*-1%*	*3%*	*3%*	*10%*		
MS est. vs consensus			***-4%***	***-6%***	***-5%***	***-8%***		

Source: Bloomberg consensus, Company data, Morgan Stanley Research estimates

ii) 'Grasp the nettle' – increase capital by c.$7-10bn

While not our base case, we run the numbers on a hypothetical capital raise for StanChart should the incoming management team opt to **'grasp the nettle'** from the outset, thereby addressing immediately the market's concerns on asset quality and capital ratios by Dec 2015. Such action should be sufficient to set the stage for returning the group to growth earlier, and thus may prove a tempting option for the new team. We await new management to update the market on how it will see to address the bank's level of capital, which we expect it will likely choose to do by streamlining its portfolio, among other options available to it as discussed elsewhere in this report.

Addressing asset quality: a $1-4bn provision top-up

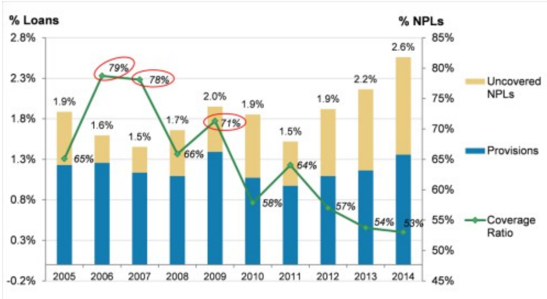
From 2011 the Asian economies started slowing down, leading in turn to increasing bad loans – initially in India, Korea and the Middle East and subsequently even in China. This has been compounded by the strength in the USD and the weakness in commodities, where StanChart has a substantial exposure ($50 billion). For more detail on why asset quality has deteriorated and the key areas of risk from here, see **Standard Chartered Bank: Capital challenge intensifying; no clear pathway back to double-digit RoTE (14 Jan 2015).**

Given that the bad loan cycle is still ongoing, it is difficult to assess the exact quantum of bad loans StanChart will need to take over the cycle. In our base case of 'muddle through', we build in ~70 bps of credit costs on average over 2015-2017. However, this will not remove the asset quality overhang from the stock in the near term, in our view.

StanChart has experienced worse losses than other banks in the same markets, and yet it also has lower coverage of NPLs and total loans (**Exhibit 17**), which has led to concern around its level of provisioning. Coverage on bad loans is running at a decade low of 53% – among the lowest in Asia and lower in each region than peers (**Exhibit 19**). While the bank believes that it has adequate collateral and highlights the short-term nature of much of its book, with Asian economies remaining relatively weak and given its commodity related exposures, we believe that it will be tough to achieve material recoveries. As such, we see a case for the new management taking coverage levels higher, reducing concerns around future provisioning levels.

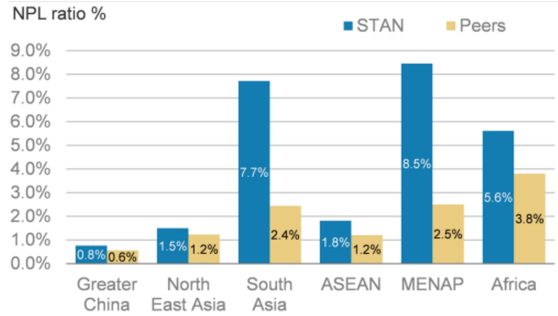
Our central case here is that 75% coverage would be sufficient to allay concerns, given this would close the gap with peers and return StanChart to the level of provisioning seen in 2006/07 and 2009. We estimate this level of coverage on 2014 bad loans would imply one time provisioning of ~USD1.7bn with lower provisioning thereafter vs our base case as illustrated in **Exhibit 22**as loan losses are brought forward. In a more benign scenario (Scenario 2 in Exhibit 22) we assume the percentage of loan loss provisions to loans is brought in line with peer banks, implying a c.USD800 million gap. A highly conservative Scenario 3 where coverage increases to be in line with peers in each region implies a gap of as much as $4.5 billion.

Exhibit 17: NPLs at 10-year highs, coverage at the lows



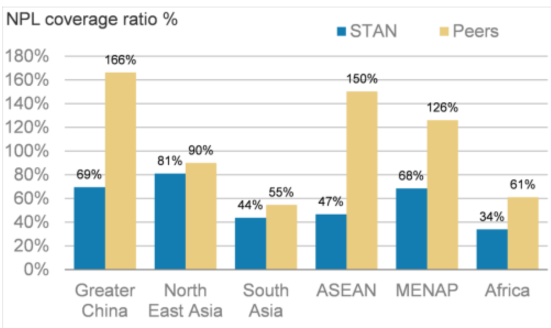
Source: Company data, Morgan Stanley Research

Exhibit 18: NPLs are also elevated vs peers...



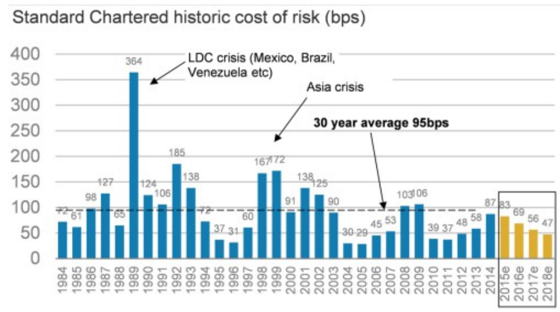
Source: Company data, Morgan Stanley Research

Exhibit 19: While coverage is lower across the board



Source: Company data, Morgan Stanley Research

Exhibit 20: We model gradual normalisation



Source: Company data, Morgan Stanley Research

Exhibit 21: Base case vs capital raise: implications for asset quality metrics

US$ mm	2012	2013	2014	2015e	2016e	2017e
Gross NPL start of period	4,112	5,538	6,479	7,492	8,642	8,832
Additions	2,367	2,965	3,118	3,105	2,144	1,745
% loans	*0.8%*	*1.0%*	*1.1%*	*1.1%*	*0.7%*	*0.6%*
Write offs	(331)	(622)	(771)	(771)	(771)	(771)
Other reductions	(571)	(1,232)	(1,184)	(1,184)	(1,184)	(1,184)
Other	(39)	(170)	(150)	-	-	-
Gross NPL end of period	5,538	6,479	7,492	8,642	8,832	8,621
% loans	*1.8%*	*2.2%*	*2.6%*	*3.0%*	*3.0%*	*2.9%*
Base case - *"Muddle through"*						
Provisions start of period	2,672	3,157	3,547	4,073	5,185	5,961
New provisions in P&L	1,195	1,612	2,134	2,258	1,921	1,650
% loans	*0.40%*	*0.54%*	*0.73%*	*0.78%*	*0.66%*	*0.55%*
Write offs	(935)	(1,173)	(1,517)	(1,146)	(1,146)	(1,146)
Other	225	(49)	(91)	-	-	-
Provisions end of period	3,157	3,547	4,073	5,185	5,961	6,466
% NPL	57%	55%	54%	60%	68%	75%
Capital raise case - *"Grasp the nettle"*						
Provisions start of period				4,073	6,482	6,624
One off top up				1,722	-	-
New provisions in course of year				1,832	1,287	988
% loans				*0.63%*	*0.44%*	*0.33%*
Write offs				(1,146)	(1,146)	(1,146)
Other				-	-	-
Provisions end of period				6,482	6,624	6,466
% coverage				75%	75%	75%

Source: Company data, Morgan Stanley Research estimates. note: peer banks include major comparable private banks in each county; please contact us for full data spreadsheet

Exhibit 22: Benchmarking vs. peers and history suggests a provision top-up of $0.8-$4.5 billion

2014, US$ mm	Net Loans (by borrower location)	Allocation	Net Loans (by booking centre)	Total provisions	Gross loans (by booking centre)	NPLs	NPL ratio	Coverage ratio	Provisions / Group loans
Greater China	89,646	(2,194)	87,452	464	87,916	668	0.8%	69%	0.5%
North East Asia	29,582	34	29,616	363	29,979	448	1.5%	81%	1.2%
South Asia	22,859	(8,347)	14,512	506	15,018	1,159	7.7%	44%	3.4%
ASEAN	78,541	(2,137)	76,404	651	77,055	1,396	1.8%	47%	0.8%
MENAP	22,775	(4,468)	18,307	1124	19,431	1,643	8.5%	68%	5.8%
Africa	13,103	(4,742)	8,361	162	8,523	478	5.6%	34%	1.9%
Americas	10,952	3	10,955	9	10,964	37	0.3%	24%	0.1%
Europe	21,141	21,851	42,992	693	43,685	1,663	3.8%	42%	1.6%
Group	**288,599**	**-**	**288,599**	**3,972**	**292,571**	**7,492**	**2.6%**	**53%**	**1.4%**

Scenario 1: Top up coverage to average of the past three peak coverage ratios (71%, 79%, 78%)

US$ mm	
Group loans	292,571
2014 NPLs	7,492
2014 provisions	3,972
2014 coverage	53%
Peak coverage	76%
Implied provisions	5,694
Δ vs current provisioning	**1,722**

Scenario 2: Top up provisions to a level in line with peer banks in each geography (based on borrower location)

US$ mm	Net Loans (by borrower location)	Provisions / loans for peers	Implied provision	Δ vs current provisioning	Implied Coverage ratio
Greater China	89,646	1.2%	1,053		
North East Asia	29,582	1.1%	330		
South Asia	22,859	1.3%	308		
ASEAN	78,541	1.8%	1,434		
MENAP	22,775	3.3%	752		
Africa	13,103	2.3%	301		
Americas*	10,952	1.8%	202		
Europe*	21,141	1.8%	390		
Group	**288,599**	**1.6%**	**4,770**	**798**	**64%**

Scenario 3: Top up provisions to bring NPL coverage in line with peer banks in each geography (based on booking centre)

US$ mm	Gross loans (by borrower location)	NPLs	NPL ratio	Coverage ratio	Provisions	Peer NPL ratio	Peer group coverage	Implied provision	Δ vs current provisioning
Greater China	87,916	668	0.8%	69.5%	464	0.6%	166%	1,110	646
North East Asia	29,979	448	1.5%	81.0%	363	1.2%	90%	403	40
South Asia	15,018	1,159	7.7%	43.7%	506	2.4%	55%	632	126
ASEAN	77,055	1,396	1.8%	46.6%	651	1.2%	150%	2,097	1,446
MENAP	19,431	1,643	8.5%	68.4%	1,124	2.5%	126%	2,070	946
Africa	8,523	478	5.6%	33.9%	162	3.8%	61%	292	130
Americas*	10,964	37	0.3%	24.3%	9		108%	40	31
Europe*	43,685	1,663	3.8%	41.7%	693		108%	1,796	1,103
Group	**292,571**	**7,492**	**2.6%**	**53.0%**	**3,972**		**113%**	**8,440**	**4,468**

* For Americas and Europe we apply the average of the other geographies. Source: Company data, Morgan Stanley Research

Addressing capital ratios: $6bn catial raise to get to a 13% CET1 ratio

What CET1 ratio does StanChart need to print to put doubts to rest? We expect 13% would be sufficient, in turn implying c.$6bn capital raised by Dec 2015. To put investor doubts to rest we believe StanChart would need to print a c13% CET1 ratio based on where its peer banks are headed and bearing in mind the upcoming PRA stress test. To hit this 13.0% hurdle rate at Dec 15 vs our baseline forecast CET1 ratio of 11.3% implies a need to raise capital equal to 1.7% of RWAs which we forecast at c.$340bn, implying c.$6bn incremental capital required in a **'grasp the nettle'** hypothetical scenario. Note that our base case is that it does not meet its cost of capital until 2018+, as discussed in the next section.

We increase our expectation for 'steady state' CET1 ratio for StanChart to 13% (from 12%) for two main reasons:

- **The large banks in StanChart's key geographies are now running with higher CET1 ratios:** This implies the 'bootstrapping' effect is likely to continue with laggard banks looking undercapitalised, regardless of absolute ratios. For instance, in Hong Kong – StanChart's largest market – large banks have been cutting dividends, selling assets and raising capital and are now well above 12% (and rising) CET1 ratios. Its unlikely in our view that the bank will be able to keep its CET1 ratio at the lower end of its peer group in these geographies.
- **Prudential Regulatory Authority stress test:** We expect that the tougher stress test which places more emphasis on Emerging Markets risk will result in a PRA buffer of c.100bps to be added to our previously expected stack of 12.0%. In the 2014 PRA stress test the regulator had not stressed banks aggressively for their EM exposures. But, it has now said that it will focus on banks' EM exposures in its 2015 stress tests. Against this backdrop, the focus on StanChart's capital ratios is likely to remain intense.

We also anticipate risk weight density to keep drifting higher for certain asset categories: We expect to see continued increases in risk weight density (ie risk-weighted assets / total assets) for two main reasons. **Credit migration** – we expect the slowdown in China and fall in commodity prices to drive negative credit migration, translating into more cautious modeling assumptions. **Regulatory actions** – we expect assets that have low risk weights to be identified by regulators and normalised upwards (eg CP12/14 proposing that AIRB (advanced internal ratings-based approach) permissions for certain exposures be replaced by FIRB (foundation internal ratings-based approach). Regulators are also taking action to cool certain market segments, eg Hong Kong residential property, for which the **HKMA announced** a 15% risk weight floor on all mortgages in Feb 2015.

We acknowledge we are at the cautious end of the debate on capital and that the formal known minium CET1 ratio for Standard Chartered is 8.65% by 2019. However, our expectations are based on new buffers (eg countercyclical buffer) being introduced and a significant management buffer above the minimum.

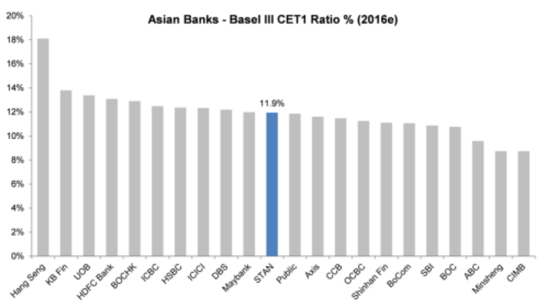
We have been cautious on the capital challenge confronting StanChart for some time – See our Feb 2014 note **Capital challenge to drag on EPS; dividend at risk – UW.**

Exhibit 23: On our baseline assumptions there is a $6bn capital gap as at Dec 2015e (which we expect will be resolved by 2018e)

Standard Chartered, $bn CRD IV end point	2013	2014	2015e	2016e	2017e	2018e
Starting CET1	33.1	35.1	36.5	38.1	40.1	42.7
Net profits	4.0	2.5	2.7	3.0	3.8	4.5
Dividend (net scrip)	(2.0)	(1.4)	(0.9)	(1.0)	(1.1)	(1.1)
FX/ Other	(0.0)	0.2	(0.2)	(0.1)	(0.1)	(0.1)
CET1 capital	**35.1**	**36.5**	**38.1**	**40.1**	**42.7**	**46.0**
RWAs	331.3	341.6	338.4	335.8	336.6	349.8
y/y		*3%*	*-1%*	*-1%*	*0%*	*4%*
CET1 ratio	*10.6%*	*10.7%*	*11.3%*	*11.9%*	*12.7%*	*13.1%*
Gap to 13% CET1 ratio	*-2.4%*	*-2.3%*	*-1.7%*	*-1.1%*	*-0.3%*	*0.1%*
Capital gap vs 13%	**(7.9)**	**(7.9)**	**(5.9)**	**(3.6)**	**(1.1)**	**0.5**

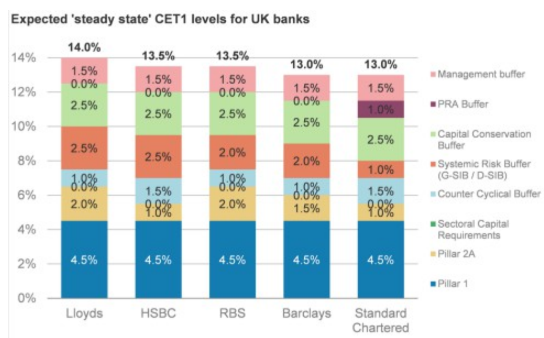
Source: Company data, Morgan Stanley Research estimates

Exhibit 24: We expect SC to build capital towards median of Asian peers over time



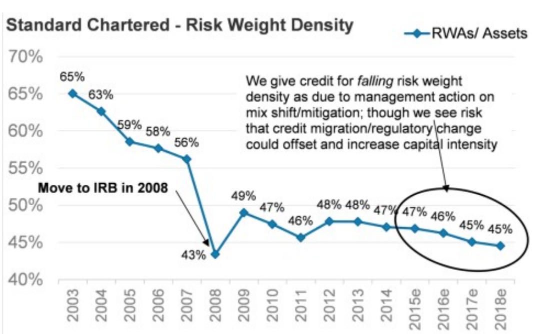
Source: Company data, Morgan Stanley Research estimates

Exhibit 25: We expect StanChart to run similar 'steady state' CET1 to other UK banks at c.13%+



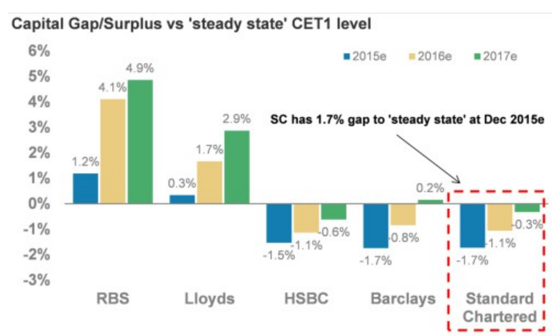
Source: Morgan Stanley Research estimates

Exhibit 27: We give credit for improving risk weight density



Source: Company data, Morgan Stanley Research e = Morgan Stanley Research estimates

Exhibit 26: We see a capital gap of 1.7% at Dec 15e but effectively closed by 2017



Source: Company data, Morgan Stanley Research e = Morgan Stanley Research estimates

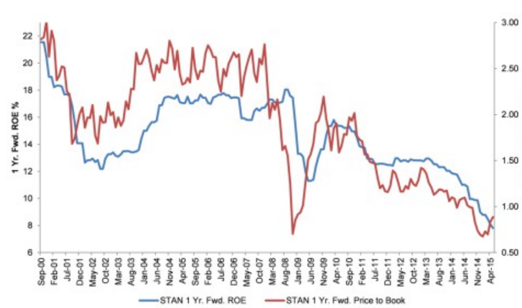
Step 2: Restoring profitability with ROE moving above COE

The **second step** we expect from new management is to reveal how it plans to lift returns above its cost of capital. Recent years have seen a stalling of StanChart's financial engine due to the effect of 'negative jaws' (costs growing faster than revenues), rising impairments and reduction in leverage, causing return on equity in 2014 to fall to 8%, well below the cost of capital (we use 11%). In our view, leverage will likely decline further as the bank builds capital ratios to bring it in line with peers, meaning that return on assets must be improved. We identify three key levers that management can pull in its bid to boost returns:

- **i) Tackling the cost base:** Our DuPont analysis of returns at StanChart indicates that costs are the key area the bank lags peers with cost:assets of 1.7% vs a blended average of Asia peers 1.2%. In our base case we factor in $1.8bn of gross costs savings 2014-18e (c.17% of 2014 cost base) as outlined by management and cost:income falling back to 57%, in line with 2004-14 average. We do see structural reasons why StanChart will have a higher cost income ratio than peers (bank levy/mix/scale), however, we run scenarios for what the benefit could might if more ambitious targets were set.
- **ii) Streamlining the portfolio:** We expect that exiting or reshaping low return businesses could yield significant benefits. Our granular analysis of the portfolio suggests that in 1H14 $160bn of RWAs (c.45% of group) was allocated to businesses which only delivered c.2% ROAE. We identify a 'core' of the bank with $200bn of RWAs generating 16% returns, though we acknowledge use of booking centres does muddy the waters.
- **iii) Redomiciling the bank:** Changing domicile to avoid the UK bank levy could take c.3ppt off the cost:income ratio and add c.10% to group earnings. However, we do not see this as a straightforward process.

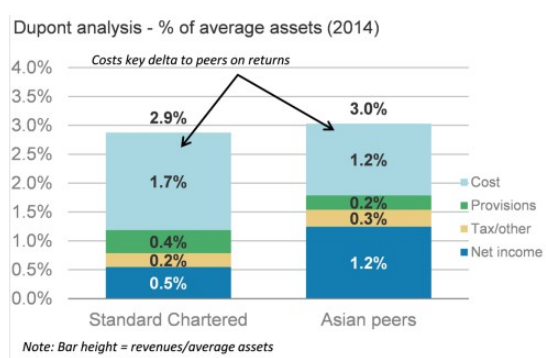
Conclusion: In our base case we don't expect StanChart to meet its cost of capital until 2018+, although there we believe are other options available to management should it wish to embark on a more dramatic course of action.

Exhibit 29: Return on equity has been under pressure as both leverage and RoA have come down



Source: Thomson, Morgan Stanley research

Exhibit 28: Return on assets lags peers due primarily to costs



Source: Company data, Morgan Stanley research; e = Morgan Stanley Research estimates

i) Tackling the cost base

We identify StanChart's higher cost:assets ratio as a key driver of its low return on equity when benchmarking against is Asian peers. Investigating further its performance on costs in recent years reveals that its ambitions to attain flat jaws (costs growing in line with revenues) with a positive bias was met in only 2 years of the past decade. The resulting rise in the cost:income ratio in 2013-15e presents opportunity for the new management to be more aggressive in addressing the cost base (while acknowledging there are cost headwinds, such as the UK bank levy and the rising burden on ongoing regulatory and compliance costs).

Exhibit 30: Our Dupont analysis highlights costs for StanChart being higher than peers

Dupont analysis % average assets, 2014	China	HK	Indo.	Korea	Sing.	India	MENA	Wtd avg	StanChart
Net Interest Income	2.6%	1.6%	6.0%	2.1%	1.4%	3.6%	2.6%	2.1%	1.7%
Non-Interest Income	0.7%	0.7%	1.7%	0.4%	0.9%	1.9%	1.1%	0.9%	1.1%
Total Revenues	**3.3%**	**2.2%**	**7.8%**	**2.5%**	**2.3%**	**5.4%**	**3.8%**	**3.0%**	**2.9%**
Total costs	**1.2%**	**0.7%**	**3.4%**	**1.4%**	**1.0%**	**2.2%**	**1.2%**	**1.2%**	**1.7%**
Pre-Provision Profit	**2.2%**	**1.6%**	**4.3%**	**1.1%**	**1.3%**	**3.2%**	**2.6%**	**1.8%**	**1.2%**
Total Provisions	0.3%	0.1%	0.7%	0.4%	0.1%	0.5%	0.6%	0.2%	0.4%
Exceptionals / Associates etc.	0.0%	0.0%	0.2%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
PBT	**1.8%**	**1.5%**	**3.8%**	**0.8%**	**1.2%**	**2.7%**	**2.0%**	**1.5%**	**0.8%**
Tax	0.4%	0.3%	0.8%	0.2%	0.2%	0.9%	0.0%	0.3%	0.2%
Minority Interest and Others	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
ROA	**1.4%**	**1.2%**	**3.0%**	**0.6%**	**1.0%**	**1.8%**	**2.0%**	**1.2%**	**0.5%**
Leverage	14.0x	11.4x	8.2x	11.5x	12.8x	9.1x	8.6x	11.5x	14.2x
ROE	**19.7%**	**13.8%**	**24.5%**	**6.5%**	**13.3%**	**16.7%**	**17.5%**	**14.3%**	**7.7%**

Costs appear to be the key issue vs asian peers

Source: Company Data, Morgan Stanley Research estimates, The Weighted Average Dupont is computed by a) Computing aggregate ROA for a sample of large banks in each country which constitute the peer group for StanChart in the respective country b) and by assigning weights to the ROA's thus arrived based on Stan's approximate geographical asset mix; also used Malaysia, Thailand, S.Africa in small weights. For a copy of full spreadsheet and bank by bank calculations please contact the team

Exhibit 31: We expect StanChart to keep costs broadly flat, 2014 to 2018e

Standard Chartered costs (US$mn)	2013	2014	2015e	2016e	2017e	2018e	CAGR 14-18e	Δ 14-18e
Underlying costs	7,958	8,161	8,401	8,793	9,258	9,739	5%	1,578
Growth vs prior year		*3%*	*3%*	*5%*	*5%*	*5%*		0
Exit businesses	*450*	*450*	*200*	*100*	-	-	*-100%*	*(450)*
Cost efficiency	*1,550*	*1,350*	*950*	*475*	-	-	*-100%*	*(1,350)*
Targeted saveable costs	2,000	1,800	1,150	575	-	-	-100%	(1,800)
Extra regulatory cost	-	237	387	487	587	587	25%	350
Bank levy	235	366	540	556	578	607	13%	241
Restructuring charges	-	181	300	150	-	-	-100%	(181)
Total costs (MS est.)	**10,193**	**10,745**	**10,778**	**10,561**	**10,424**	**10,933**	**0%**	**188**
Growth vs prior year		*5%*	*0%*	*-2%*	*-1%*	*5%*		
Consensus (Bloomberg)			**10,651**	**10,804**	**10,902**	**11,590**	**2%**	**845**
Growth vs prior year			*-1%*	*1%*	*1%*	*6%*		
MS est. vs consensus			***1%***	***-2%***	***-4%***	***-6%***		

$1.8 billion cost efficiencies as targeted by management

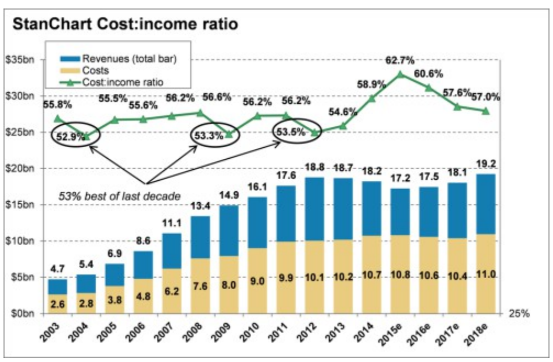
Source: Morgan Stanley research estimates, Bloomberg consensus, Company data

How much cost can StanChart cut?

We look at three scenarios to assess the degree to which StanChart can improve the cost:income ratio by 2018, which is where we now peg valuation for the bank given we estimate it will take this long for the RoTE to recover.

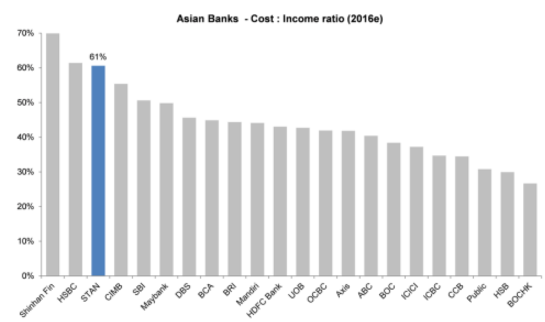
- ***i) Base case in line with last decade average* (57% cost:income):** We bake in the $1.8bn of cost savings that have been outlined by management, a drop-out of restructuring charges offset by 5% underlying cost CAGR (inflation etc) and higher bank levy / regulatory costs. This gives us costs c.5% below current Bloomberg consensus for 2018e.
- ***ii) Cut back to previous decade lows* (53% cost:income) would add c.10% to base case operating profit.** If management is able to act more decisively on cost, taking the cost:income ratio to the lows of the 2004-13 average, ie 53% by 2018e, this would imply c.$0.8bn lower costs and c.10% increase to PBT.
- ***iii) Cut back to Asian peer group average* (45% for peers + 3% bank levy) would add c.25% to base case operating profit.** In a more radical case in which Standard Chartered reins in its cost:income ratio to c.48% (45% for peers +3% for the bank levy)in line with the Asian peer group, this could lead to costs being some $1.7bn lower than our base case. However, this would clearly be a very significant operation and would be unlikely to be achieved without significant reorientation of the business model towards lower cost:income retail banking.

Exhibit 32: Best of the last decade cost:income ratio was c.53%



Source: Company data, Morgan Stanley Research estimates

Exhibit 33: The peer group average cost:income ratio is c.45%



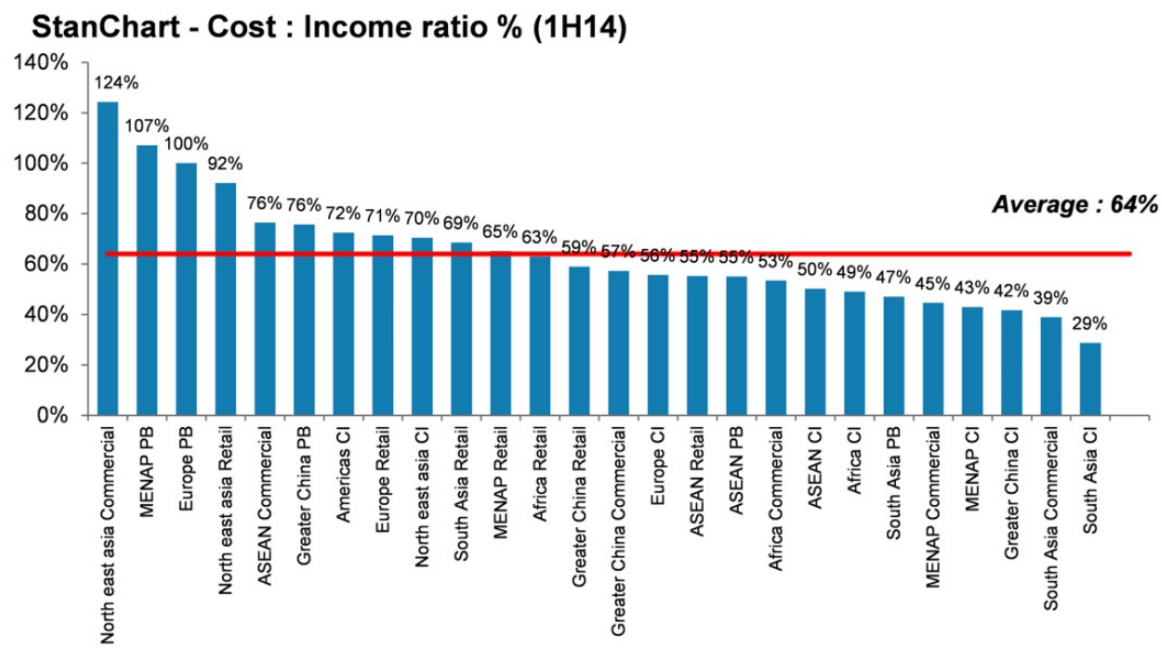
Source: Morgan Stanley Research estimates

Exhibit 34: Operating profit upside scenarios if better execution on costs

Standard Chartered, $m 2018e cost scenarios	Asian median	Best last decade	Base Case
Revenues	**19,240**	**19,240**	**19,240**
Operating costs	(9,235)	(10,197)	(10,959)
Cost:income	***48%***	***53%***	*57%*
Impairments	(1,514)	(1,514)	(1,514)
Equity method earnings	291	291	291
Operating profit	**8,782**	**7,820**	**7,059**
vs base case	***24%***	***11%***	

Source: Company data, Morgan Stanley Research estimates

Exhibit 35: Cost efficiency could be improved in many businesses

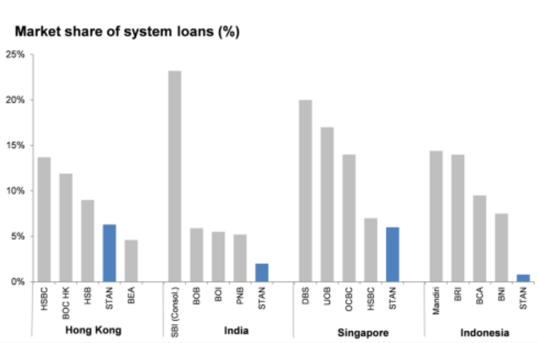


Source: Company data, Morgan Stanley Research

We see structural impediments due to scale/mix/bank levy

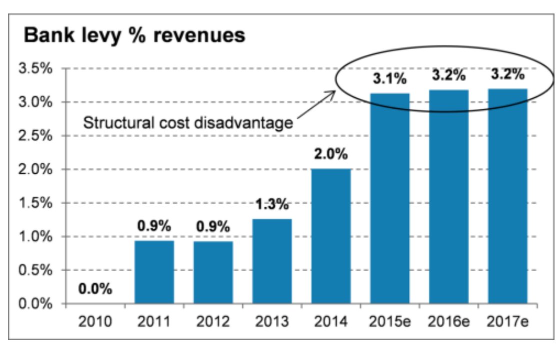
Standard Chartered is unlikely to be able to deliver a cost:income ratio in line with its Asian peers due to a number of structural reasons, in our view. First, in terms of scale, StanChart is outside the top 4 by market share of loans in all of its key geographies, indicating that it does not have as much economies of scale as the domestic players in those markets, and thus it operates at a higher cost:income ratio on a structural basis. Second, in terms of mix, StanChart has a higher proportion of wholesale banking than most Asian banks, which typically has a higher cost:income ratio due to higher compensation to staff. Third, the UK bank levy. We estimate this adds c.3ppt to the cost:income ratio. Asian domiciled banks are not subject to this levy (of course StanChart could theoretically remedy this if it left the UK, but this is not our base case).

Exhibit 36: Standard Chartered lacks scale in key markets



Source: Company Data, CEIC, Local Central Banks, Morgan Stanley Research

Exhibit 37: The UK bank levy drives a structurally higher cost:income ratio



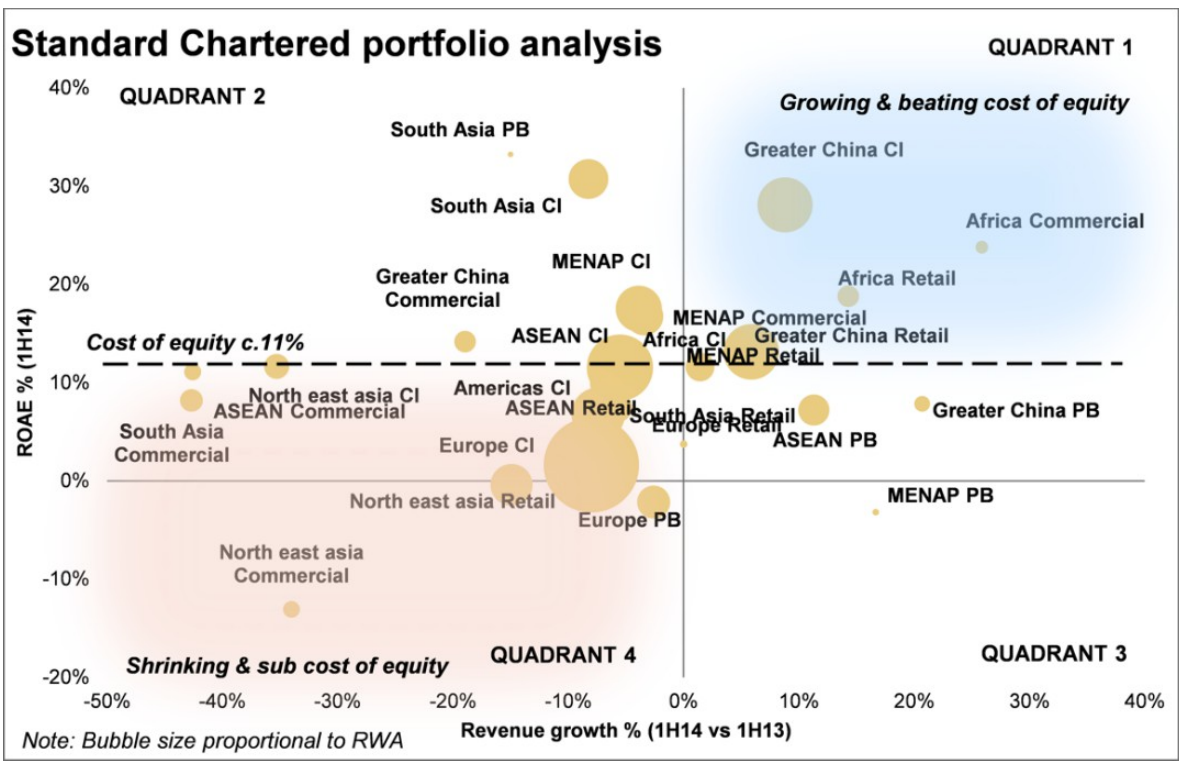
Source: Company data, Morgan Stanley Research

ii) Streamlining the portfolio

We see significant potential to boost returns by streamlining the portfolio at StanChart. We look at returns and growth across the 26 business cells using 1H14 data (the last time that this granular information was given). We split the business into four 'quadrants' based on their characteristics (similar to how Barclays has done this in the past).

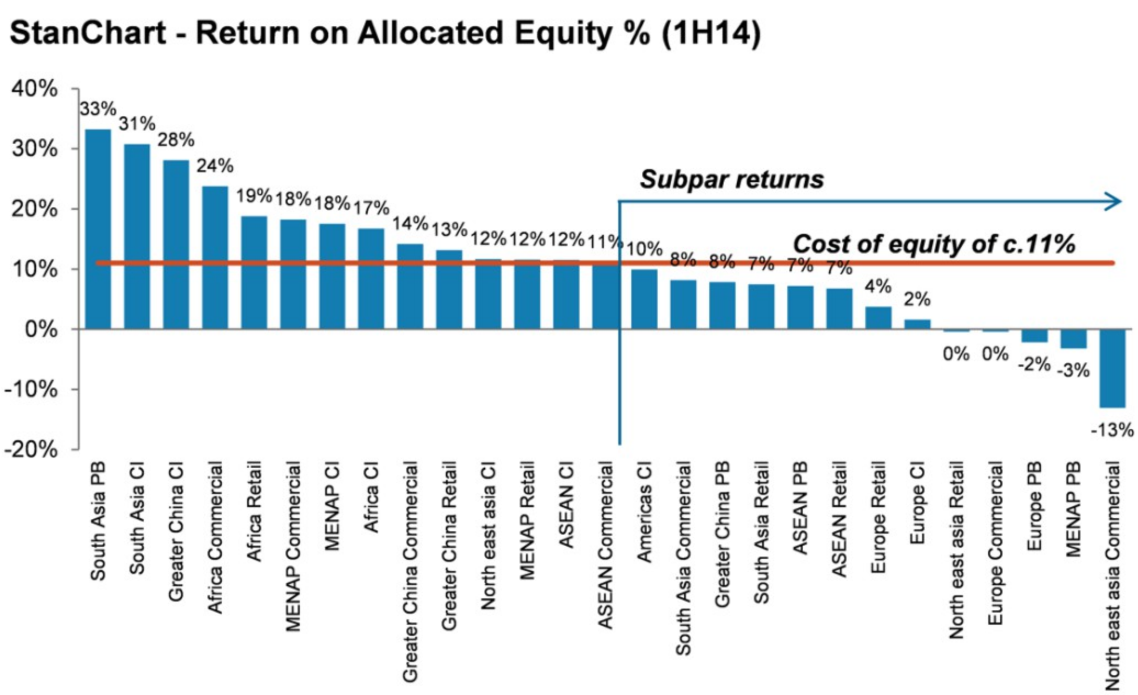
- ***Quadrant 1* High return and growing:** These appear ripe opportunities for more capital allocation to capture growth opportunities. These include Africa Retail and Commercial, Greater China CI / retail.
- ***Quadrant 2* High return and shrinking:** These either need to be repositioned to grow share or could be kept ticking over as cash cows to build capital, eg South Asia PB and CI, Greater China Commercial, MENAP CI.
- ***Quadrant 3* Low return and growing:** Propects need to be examined if there is potential for returns to beat COE over a reasonable timeframe (eg in certain PB areas) and whether growth should be pursued or other options for restructuring considered.
- ***Quadrant 4* Low return and shrinking:** Meaningful reshaping/consolidation of these businesses is likely to be necessary. Korean Retail and Commercial, South Asian Retail, Asean Retail, MENAP Private Bank, Europe PB, Retail and CI fall into this bucket.

Exhibit 38: Overview of business cells – many appear to be underperforming



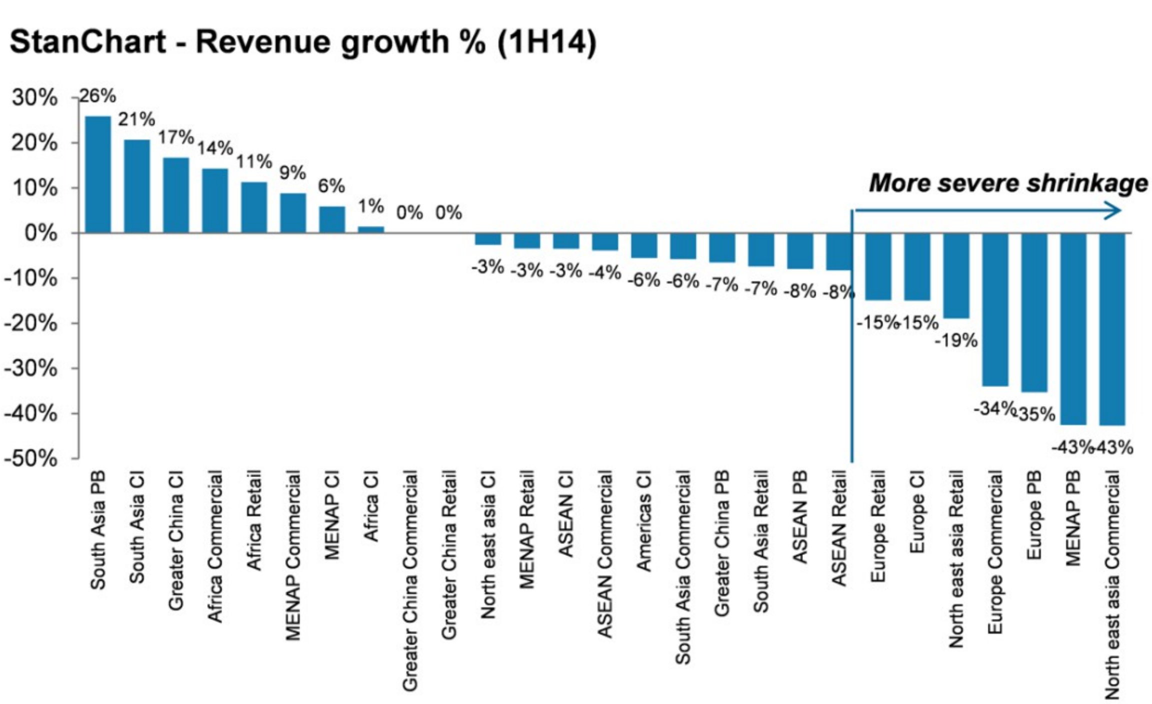
Source: Company data, Morgan Stanley Research estimates, We also acknowledging the use of booking centres distorts comparison

Exhibit 39: Addressing the low returning tail could significantly boost group returns



Source: Company data, Morgan Stanley Research

Exhibit 40: Some business lines are have seen a big contraction in revenue



Source: Company data, Morgan Stanley Research

In **Exhibit 41**below we 'heatmap' the underperforming areas of the bank in a granular analysis of its portfolio. Blue represents businesses that are delivering well on cost:income / growth / returns; red highlights underperforming businesses. In looking at underperformers, we take Quadrant 4 (excluding Americas CI which at 10% ROAE is very close to its cost of capital) and add MENAP PB, as it is loss making. Together they represent c.45% of group RWAs indicating significant room for improvement.

Our work suggests that in 1H14 the 'core' Rest of Group with $200bn of RWAs would have delivered a c.17% RoAE and a cost:income ratio of c.51%, much closer to Asian peers. Although, given the use of booking centres and linkages between business lines in the wholesale bank, we acknowledge that the analysis is by its nature somewhat simplistic. Nevertheless, we believe it is instructive.

The analysis below is also arguably generous as it does not take account of the bank levy (booked in 2H14) or the deterioration in credit quality in 2H14 (impairment +50% h/h) but we believe at least it gives a relative picture of where the different business lines sit, based on the information available.

Exhibit 41: Our heatmap highlights underperforming business areas at StanChart

Sub division	Return on allocated Eq.	Cost: Income	Revenue growth	Revenues (Ann. $bn)	Net income (Ann. $bn)	RWA ($bn)	RWA (%)
South Asia PB	33%	47%	-15%	0.03	0.01	0.3	0%
South Asia CI	31%	29%	-8%	1.25	0.61	15.2	4%
Greater China CI	28%	42%	9%	2.77	1.06	29.1	8%
Africa Commercial	24%	53%	26%	0.15	0.05	1.6	0%
Africa Retail	19%	63%	14%	0.48	0.11	4.4	1%
MENAP Commercial	18%	45%	-3%	0.17	0.06	2.4	1%
MENAP CI	18%	43%	-4%	1.14	0.46	20.4	6%
Africa CI	17%	49%	-3%	1.13	0.30	13.9	4%
Greater China Commercial	14%	57%	-19%	0.50	0.08	4.5	1%
Greater China Retail	13%	59%	6%	2.16	0.50	29.4	8%
North east asia CI	12%	70%	-35%	0.44	0.09	6.0	2%
MENAP Retail	12%	65%	1%	0.57	0.12	7.8	2%
ASEAN CI	12%	50%	-6%	1.99	0.63	41.9	11%
ASEAN Commercial	11%	76%	-43%	0.18	0.04	2.8	1%
Americas CI	10%	72%	-7%	0.83	0.16	12.6	3%
South Asia Retail	7%	69%	-6%	**0.46**	**0.08**	**8.3**	**2%**
Greater China PB	8%	76%	21%	0.14	0.02	2.3	1%
South Asia Retail	**7%**	**69%**	**-6%**	**0.46**	**0.08**	**8.3**	**2%**
ASEAN PB	7%	55%	11%	0.28	0.09	9.3	3%
ASEAN Retail	**7%**	**55%**	**-7%**	**1.40**	**0.24**	**27.2**	**7%**
Europe Retail	**4%**	**71%**	**0%**	**0.03**	**0.00**	**0.5**	**0%**
Europe CI	**2%**	**56%**	**-8%**	**1.13**	**0.18**	**86.2**	**24%**
North east asia Retail	**0%**	**92%**	**-15%**	**0.91**	**-0.01**	**16.8**	**5%**
Europe PB	**-2%**	**100%**	**-3%**	**0.15**	**-0.03**	**10.4**	**3%**
MENAP PB	**-3%**	**107%**	**17%**	**0.03**	**0.00**	**0.4**	**0%**
North east asia Commercial	**-13%**	**124%**	**-34%**	**0.07**	**-0.05**	**2.7**	**1%**
Group	**10.3%**	**55%**	**-4%**	**18.82**	**4.90**	**364.6**	**100%**
ow/ Underperformers	2.4%	68%	-9%	4.63	0.50	160.8	44%
ow/ 'core' Rest of group	16.6%	51%	-3%	14.19	4.40	203.8	56%

Source: Company data, Morgan Stanley research estimates; note: i) Capital allocated at 13% of RWAs ii) Group RWA pre diversification benefit iii) RWAs allocated based on loan split iv) Revenue growth in US$ terms

We draw readers attention to the fact that StanChart has already run a 'five tests' analysis (Clients, Activities, Here for Good, Geographies and Economics) and earmarked businesses for disposal/exit (see list below). However, taken at face value, these do not appear to be bold enough to move the dial and we would expect that more action will be forthcoming from new management.

Exhibit 42: Many business are already earmarked for disposal

Business line	Status
Retail Securities in Taiwan	Signed and completed in 2014
Savings Bank in Korea	Signed in June 2014. Completed in Jan 2015
Retail Clients in Germany	Signed in June 2014. Completed in November 2014
Run-down of SME in UAE	Completed in 2014
Exit stake in Fleming Family Partners	Signed in 2014. Completed in 2015
Sale of minority stake in Travelex	Signed in 2014
Exit institutional cash equities	Announced Jan 2015
Retail Clients in Lebanon	Signed in June 2014. Completed Mar 2015
Private Banking in Geneva	Signed Jan 2015
CF / Capital company in Korea	Signed Jun 2014
PrimeCredit in HK and China	Signed in Dec 2014

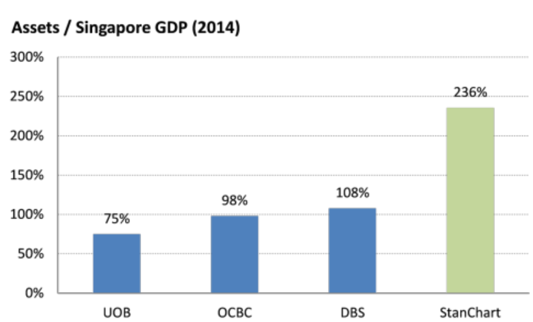
Source: Company data, Morgan Stanley Research

iii) Redomicile the bank

We do see potential upside to returns if the bank were to move its domicile out of the UK, a step that is under consideration from the board. The key driver of this is the UK bank levy which is a clear drag on returns (as shown above), and which we think adds c.3% structurally to the cost:income ratio. This burden could also increase if HSBC redomiciled, which we considered in our note of April 24, 2015 **Can HSBC Move HQ to Hong Kong?** Our base case is that StanChart stays in the UK given historical ties and difficulty of choosing a new domicile but expect this debate to remain live with significant potential for earnings upside if the levy can be avoided.

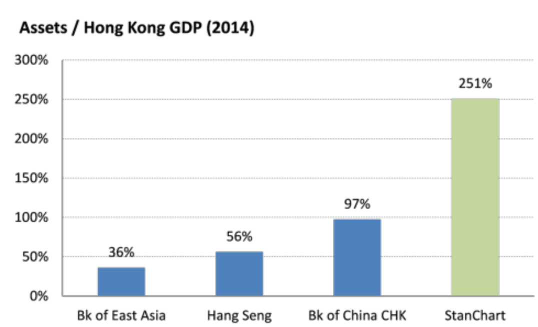
"At the moment it's something we're watching, we're looking at, we're thinking about, but at this point in time there's no change in our position," Andy Halford, Finance Director, speaking on the topic of moving domicile on 28 April 2015, reported by Reuters.

Exhibit 43: StanChart is large vs Singapore GDP...



Source: IMF, Company data, Morgan Stanley Research

Exhibit 44: ..and versus Hong Kong GDP



Source: IMF, Company data, Morgan Stanley Research

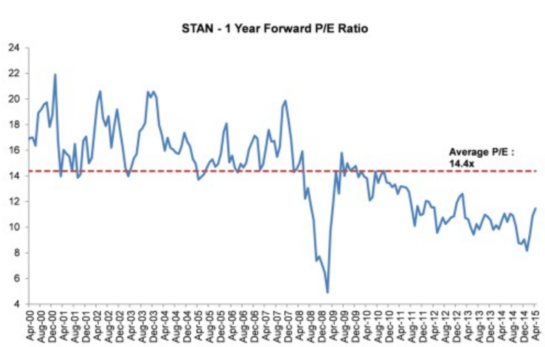
Step 3: Repositioning StanChart as a 'growth stock'

The **third step** to revitalise the StanChart equity story is for it to reclaim its crown as the growth bank of choice for European investors and in so doing restore its premium rating. Back in November 2013, MSCI reclassified StanChart as a 'value stock' (rather than a 'growth stock'), and we see it as mission critical to reverse this perception in due course. European investors were historically drawn to StanChart on account of its exposure to the Asian growth story – the bank grew its PBT and balance sheet c.5x in USD terms in 2002-2012, compounding at 18% / annum – and offering a differentiated proposition to that of the European banks. This meant that since 2000 StanChart traded at an average c.33% premium to European banks on a 1-year forward P/E primarily, we believe, due to the superior growth dynamics. Fast forward to today and the premium has vanished. StanChart currently trades at a c.5% discount and its growth prospects are much diminished. However, for the stock to become an attractive structural story once again (something that a new CEO would want to achieve), it would again have to start growing the balance sheet. We believe it is too early for this to be priced in over the next 12 months (which is the scope of our price target), for two key reasons, as outlined below, but acknowledge that the bank offers exposure to vibrant markets as well as a good long-term growth story.

- **i) Potential for system asset growth – less than recent years.** We expect that the system assets/loan/revenue growth for the geographies that StanChart is exposed to should be around 7-9% over the next couple of years, ie broadly in line with nominal GDP. This is less than the last decade but still appealing vs Europe. However, we expect that StanChart will struggle to deliver growth rates at these levels given the need to reshape the business model in order to focus on higher RoE business and shed 'off strategy' businesses.
- **ii) Competitive environment to remain intense – crimping share/margin.** We expect stiff competition in Asia from international banks who are refocussing on the region and domestic banks who have built capability and are now more ambitious. This is likely to see StanChart lose market share and keep margins in check. Though we do see potential for (eventual) rate rises to boost margins in cash management.

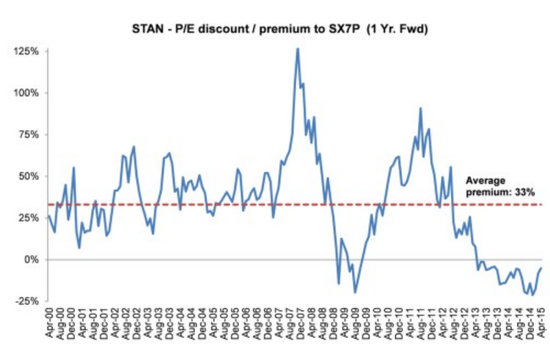
Conclusion: While StanChart has a number of exciting growth opportunities, **slowing Asian macro** and a **tough competitive environment** will likely constrain 'core' revenue growth to mid/high single digits, with group revenues not surpassing 2012 levels until 2018+.

Exhibit 45: StanChart's P/E ratio has de-rated...



Source: Thomson, Morgan Stanley Research

Exhibit 46: ... and it trades at a discount to EU banks



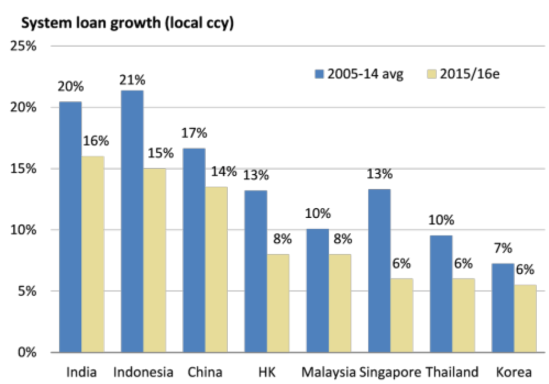
Source: Thomson, Morgan Stanley Research

i) Potential for system asset growth – less than recent years

We envisage system loan growth in the next decade being more muted than in the last decade, although we still anticipate growth of 7-9% in key Asian markets (broadly in line with nominal GDP). Over time, we expect StanChart growth to re-link with the blended average of the geographies that it is exposed to. However, on a group basis, due to our expectation of a 'muddle through' scenario we expect balance sheet growth to undershoot peers nearer term.

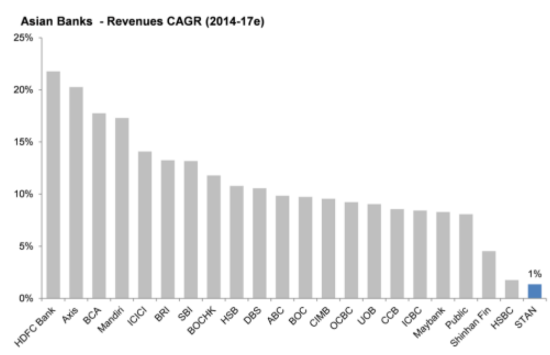
Macro environment unexciting vs history in Asia ex-JP but still growing: Our economics team forecasts +6.3%/+6.5% GDP growth in AXJ for 2015/16e with only +2.0% growth in Hong Kong and +3.2% growth in Singapore. See the April 13, 2015 note **Spring Asia Economic Outlook: Mind the Entrenched Disinflationary Trend** for more detail on our Economics team's views across the region.

Exhibit 47: We expect slower system loan growth 2015/16e vs last decade



Source: CEIC, Local Central Banks, Morgan Stanley Research estimates

Exhibit 48: And for StanChart revenues to lag peers



Source: Company data, Morgan Stanley Research estimates

Current trends point to a further slowing: Our economics team flags that domestic demand is still subdued and that external demand weakened further recently. Overall growth momentum in the region, led by China, weakened further towards the end of 1Q15. On the domestic demand front, headwinds from high debt, elevated levels of real rates and sluggish wage growth have all continued to weigh on domestic demand. On the external demand front, export growth in the region declined by 1.4% YoY in 1Q15 compared to a growth of 3.8% YoY in 4Q14, due to a combination of weaker global demand, lower commodity prices, and still elevated real effective exchange rate. See the April 29, 2015 note **Asia Pacific Economics Your Comprehensive Update on Asia's Growth Story – April 2015** for more detail recent trends.

Exhibit 49: Our economists expect little in the way of growth pick-up in AXJP

AXJP Real GDP forecasts (%)	2014A	2015e	2016e
Australia	2.7	2.1	2.4
China	7.4	7.0	7.0
Hong Kong	2.3	2.0	2.3
India	7.2	7.7	8.2
Indonesia	5.0	5.3	5.5
Korea	3.3	3.3	3.7
Malaysia	6.0	4.5	4.8
Phillipines	6.1	6.3	6.3
Singapore	2.9	3.2	3.4
Taiwan	3.7	3.7	4.0
Thailand	0.7	3.6	4.0
APXJ	**6.4**	**6.3**	**6.5**

Source: CEIC, Morgan Stanley Research

Exhibit 50: Tracking APXJ Growth Trend (on 3-Month Trailing Basis)

Legend: ↑↑ - up, ↑ - slightly up, ↔ - neutral, ↓ - slightly down, ↓↓ - down (on YoY 3MMA basis)

	Overall	Consumption	Investment	Government Spending	External Demand
Australia	↓	↑	↓	N.A.*	↓↓
China	↓↓	↓↓	↓↓	↑	↓↓
Hong Kong	↓	↓↓	↑	↓↓	↓
India	↓	↓↓	↑	↓↓	↓↓
Indonesia	↑	↓	↑	↓↓	↑
Korea	↓↓	↓	↓↓	↓	↓↓
Malaysia	↓↓	↓	↔	↓↓	↓↓
Philippines	↓	↔	↓	N.A.*	↓↓
Singapore	↓	↓	↓↓	N.A.*	↑↑
Taiwan	↓	↑	↓	↑↑	↓↓
Thailand	↔	↑	↓	↔	↓↓

Source: CEIC, Haver, Morgan Stanley Research.Note: The summary table above measures changes in the 3-month trailing average growth.

ii) Competition to remain intense – crimping share/margin

Competition in Asia from both domestic as well as international banks has been fairly intense:

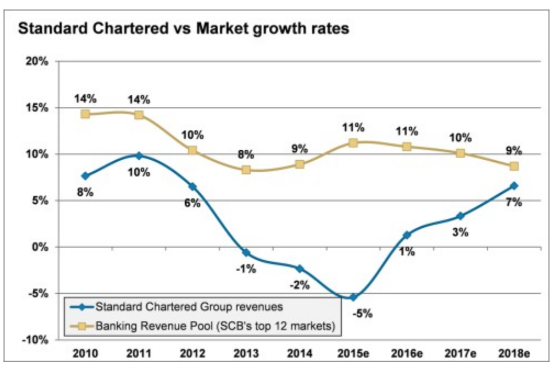
The markets that Standard Chartered operate in are becoming increasingly competitive: This is because formerly impaired banks that were undergoing retrenchment have started focusing on the region again. Japanese banks have also entered the fray, and there is a new class of super-regional banks, eg DBS / ANZ, also attempting to grow share.

1. Regional banks – Many Asian banks are better capitalised than StanChart and increasingly looking beyond domestic borders. For these banks, StanChart's share in cross border business is in their cross-hairs. For instance, DBS and ANZ have been building cross border businesses and have been successful in growing their balance sheet.

2. International banks – Banks that were formerly weighed down by impairments, and that had been pulling in their horns post the financial crisis (eg Citi) / US$ funding difficulties in Europe in 2011/12 (eg BNP / Soc Gen), are now retraining their sights on the region. Furthermore, Japanese banks are looking for regional opportunities post QE, and for HSBC Asia is also the one big growth market.

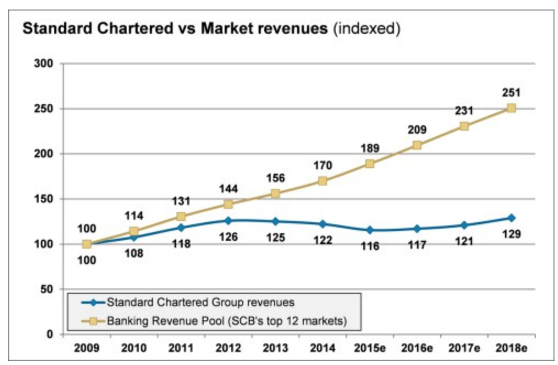
All of which drives us to the sobering conclusion that StanChart may lose share vs peers : We look at the banking revenue pool growth expectations StanChart used in its 1H14 results presentation last August (sourced from McKinsey). We then compare StanChart's growth vs the pool growth since 2009, and we observed that there has been a significant loss of share from 2010-14e, which we expect to continue into 2015+. This can only be avoided, in our view, if the bank starts to grow again. However, for that it will need to be adequately capitalised, so that it can in turn consider growing underlying RWAs, yet again.

Exhibit 51: We expect StanChart to grow less than the available revenue pool



Source: IMF, WTO, McKinsey Global Banking Pools (Based on July 29 2014 version) MS estimates for SC

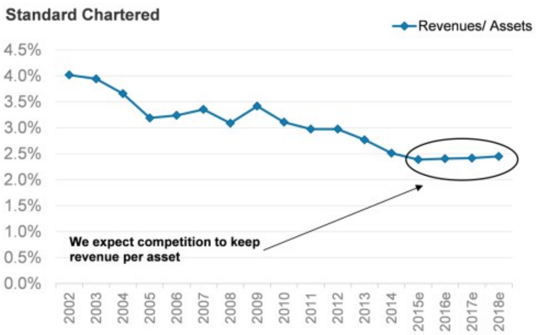
Exhibit 52: Leading to significant market share loss over time



Source: IMF, WTO, McKinsey Global Banking Pools (Based on July 29 2014 version) MS estimates for SC

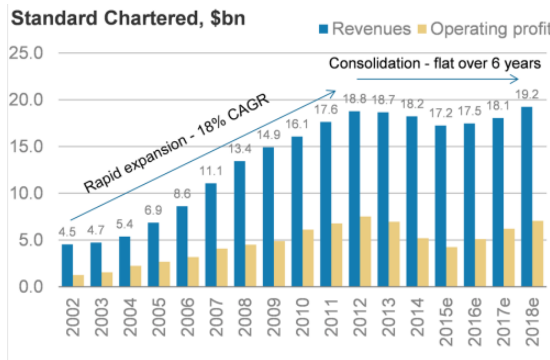
Competitive environment to keep margins in check – but US rate rises could give margins a boost: We see a tough competitive environment ahead, with traditional rivals having recovered from their difficulties in 2008-12 (eg Citi, French banks) and aforementioned regional challengers stepping up to the plate. Our base case is for a stable net interest margin from here, although this could prove optimistic. We also note that while acknowledging a strong surplus deposit position, it is likely that Standard Chartered has a higher marginal wholesale funding cost than its peers (using CDS as a crude proxy).

Exhibit 53: SC: We expect revenues / assets to remain flat due to competition...



Source: Company data, Morgan Stanley Research estimates

Exhibit 54: ...overall we expect revenues to stall



Source: Company data, Morgan Stanley Research estimates

What would make us more positive on the equity story?

Standard Chartered's stock price has fallen c.45% from the 2013 peak and significantly underperformed the wider MSCI AxJ Banks index. Furthermore, valuation appears cheap relative to its history. So what are the factors that could lead the stock price to recover / outperform? We see several potential external factors that would lift sentiment on the stock:

i) Brighter Asian macro outlook: This could lead to better revenues as increased demand leads to either better volumes or firmer pricing if Standard Chartered rations credit extension. Also, the impairment charges would likely be lower if trends in unemployment/collateral values improve.

ii) Faster-than-expected US rate hikes: We looked at this in our note from September 18, 2014 **Asian Banks (g)Rate Expectations?** Our analysis suggests that a 100bps increase in rates leads to a c.5% increase in profit before tax for StanChart as a first order impact. However, there could be second order impacts on asset prices, increased impairment charges, higher cost of equity, lower GDP growth, etc.

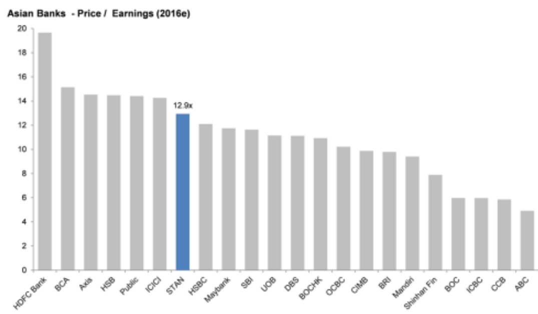
***iii) Rebound in Financial Markets activity*:** Financial Markets revenues have been weak as forward guidance from central banks has depressed volatility in macro products; a pick-up would be welcomed by the bank.

iv) More dovish tone on capital from UK policymakers: While not our base case, if the Bank of England was softer in tone on banks' capital requirements and StanChart was able to run with the current c.10.5% CET1 ratio, then the deleveraging pressure we anticipate would be less acute.

v) Renewed takeover speculation: This could also support the share price (cited in the *FT* Jan 21, 2014: ‘Standard Chartered back atop takeover target list’).

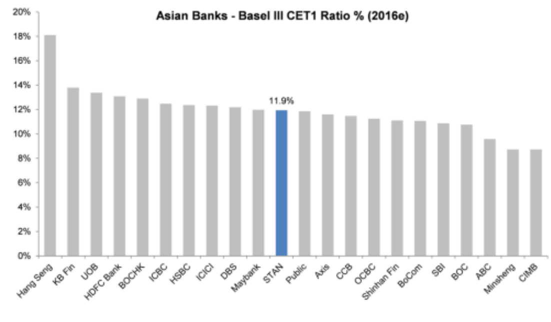
Valuation – Asian context

Exhibit 55: Standard Chartered does not screen as cheap vs Asian banks



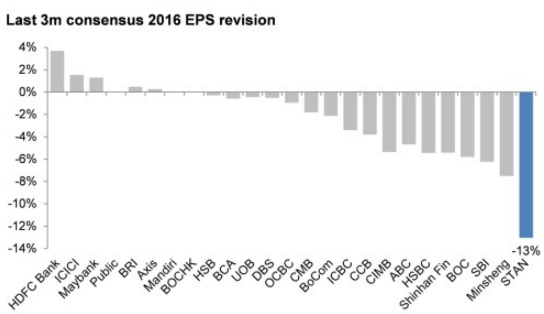
Source: Morgan Stanley Research estimates

Exhibit 56: Basel III CET1 Ratio



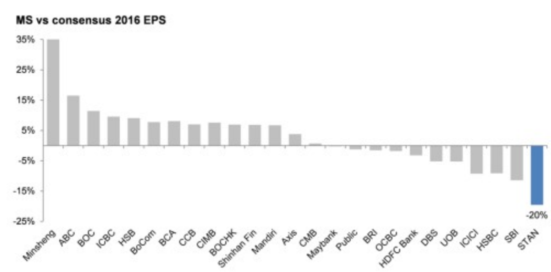
Source: Morgan Stanley Research estimates

Exhibit 57: 3M Consensus 2016 EPS revisions



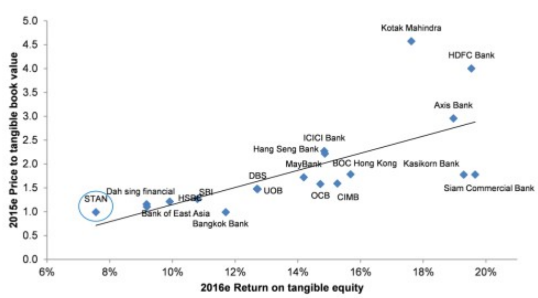
Source: Thomson Reuters

Exhibit 58: MS EPS vs. consensus (2016e)



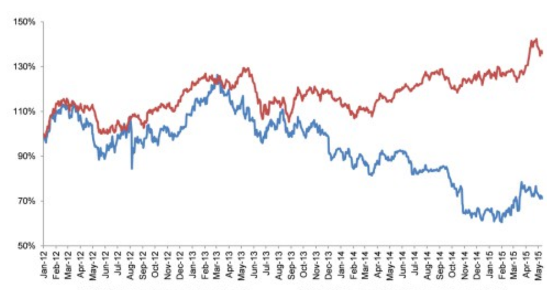
Source: Thomson Reuters, Morgan Stanley Research stimates

Exhibit 59: P/TNAV vs ROTE



Source: Morgan Stanley Research estimates

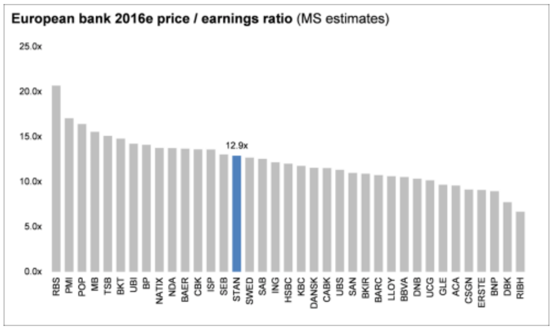
Exhibit 60: STAN performance vs. MSCI AxJ Banks Index



Source: Morgan Stanley Research estimates

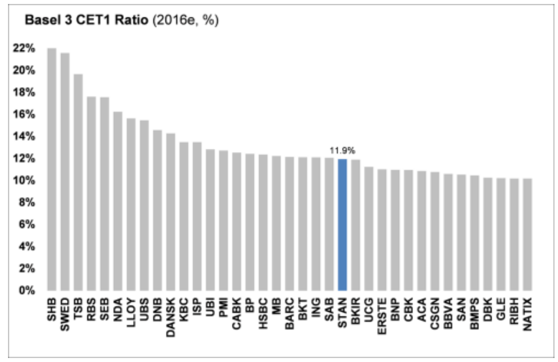
Valuation – European context

Exhibit 61: Standard Chartered does not screen as cheap vs European banks



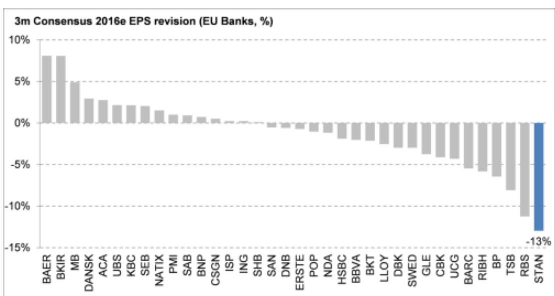
Source: Morgan Stanley Research estimates

Exhibit 62: Basel III CET1 Ratio 2016e



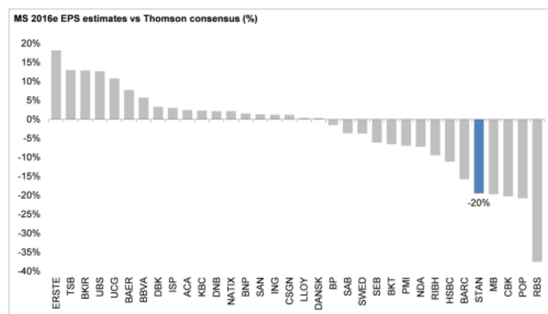
Source: Morgan Stanley Research estimates

Exhibit 63: 3M Consensus 2016 EPS revision



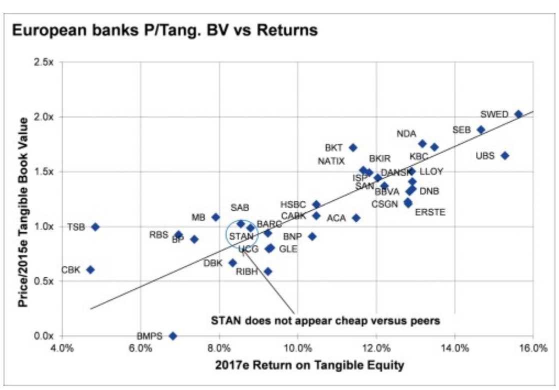
Source: Thomson Reuters, Morgan Stanley Research estimates

Exhibit 64: MS EPS vs. consensus (2016e)



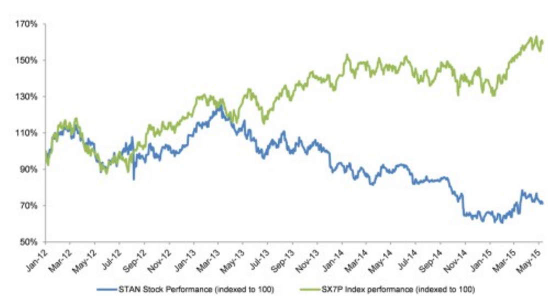
Source: Thomson Reuters, Morgan Stanley Research estimates

Exhibit 65: P/TNAV vs. ROTE



Source: Morgan Stanley Research estimates

Exhibit 66: STAN performance vs. SX7P Index



Source: Thomson Reuters, Morgan Stanley research

Valuation methodology and risks to price target

Valuation methodology: Our valuation approach is to model the group return on equity for 2018e, and then to derive a warranted valuation for the group as at Dec 2017 using a Gordon Growth Model derived multiple. For the cost of equity, we use 11% (10% bull, 12% bear) and growth of 3% (4% bull, 2% bear). This value is discounted at the cost of equity to get the value one year from now. We then add on the net present value of the dividends and any surplus/deficit capital. We derive our price target from an average of our bull, base and bear cases, applying weights to each potential outcome, reflecting our view of the balance of risks. We weight our base case at 70%, bear at 15% and bull at 15%.

Changes in this note: We now link valuation to 2018e returns (was 2017e) as we expect that this is when they will start to normalise.

Key risks to price target include: Upside risks to our view are that macroeconomic growth is faster than we expect and economic resilience causes stronger-than-expected asset quality. The key downside risk would be if the world double-dips, including most notably for StanChart a harder landing for China/Asia, and weaker-than-expected economic growth in its countries of operation.

Exhibit 67: Price Target Derivation

Standard Chartered valuation 2018, $m	Scenario Bear	 Base	 Bull
Revenues	**18,538**	**19,240**	**19,931**
Operating costs	(10,599)	(10,959)	(11,320)
Pre-provision operating profit	**7,939**	**8,282**	**8,611**
Loan loss provisions	(1,833)	(1,514)	(1,356)
Associates	291	291	291
Profit before tax	**6,396**	**7,059**	**7,546**
Tax	(1,821)	(1,993)	(2,120)
Minorities	(112)	(112)	(112)
Preference shares & AT1	(431)	(431)	(431)
Net income	**4,032**	**4,522**	**4,883**
Share count (bn)	2.62	2.62	2.62
Adj. EPS ($c)	$1.54	$1.73	$1.87
2018e Risk Weighted Assets	334,031	349,806	359,812
Steady state CET1 / RWAs (MSe)	14.0%	13.0%	12.0%
Allocated equity	46,764	45,475	43,177
Return on allocated equity	**8.6%**	**9.9%**	**11.3%**
Cost of equity	*12.0%*	*11.0%*	*10.0%*
Terminal Growth	*2.0%*	*3.0%*	*4.0%*
Multiple of book value	***0.66x***	***0.87x***	***1.22x***
Implied p/e ratio	*7.7x*	*8.7x*	*10.8x*
Dec 2017 valuation based on 18e returns	**30,970**	**39,477**	**52,598**
Dec 17 Core franchise value per share (A)	**$11.83**	**$15.08**	**$20.09**
2018e CET1 capital	45,365	45,980	45,060
2018e CET1 ratio	13.6%	13.1%	12.5%
Surplus (deficit) vs. steady state	(1,399)	505	1,882
Dec 17 capital surplus/deficit per share (B)	**-$0.53**	**$0.19**	**$0.72**
Cumulative dividends until Dec 17 (C)	**$0.86**	**$1.31**	**$1.82**
Dec 17 valuation (A) + (B) + (C)	**$12.15**	**$16.59**	**$22.63**
Scenario Weighting	*15%*	*70%*	*15%*
1 yr fwd value of bank + cum. Divis (HKD)	70	98	139
Blended Price Target (HKD)		**100**	

Source: Company data, Morgan Stanley Research estimates

Financials

Exhibit 68: Annual Forecasts, 2011-18e

				Forecasts							Change vs prior year				
Standard Chartered	2011	2012	2013	2014	2015e	2016e	2017e	2018e	2012	2013	2014	2015e	2016e	2017e	2018e
P&L Account (US $bn)															
Net Interest Income	10.15	10.78	11.16	11.00	10.66	10.72	11.32	12.22	6%	3%	-1%	-3%	1%	6%	8%
Non-interest income	7.48	8.00	7.52	7.23	6.59	6.75	6.73	7.02	7%	-6%	-4%	-9%	2%	0%	4%
Operating income	**17.64**	**18.78**	**18.67**	**18.23**	**17.25**	**17.47**	**18.05**	**19.24**	**6%**	**-1%**	**-2%**	**-5%**	**1%**	**3%**	**7%**
Operating costs	-9.92	-10.06	-10.19	-10.75	-10.82	-10.59	-10.40	-10.96	1%	1%	5%	1%	-2%	-2%	5%
Pre-provision op profit	**7.72**	**8.73**	**8.48**	**7.49**	**6.43**	**6.88**	**7.65**	**8.28**	**13%**	**-3%**	**-12%**	**-14%**	**7%**	**11%**	**8%**
Provisions	-1.02	-1.39	-1.75	-2.54	-2.42	-2.04	-1.72	-1.51	37%	25%	46%	-5%	-16%	-16%	-12%
Equity Method Earnings	0.07	0.18	0.23	0.25	0.25	0.26	0.27	0.29	146%	24%	10%	-1%	6%	6%	6%
Operating Profit	**6.78**	**7.52**	**6.96**	**5.19**	**4.25**	**5.10**	**6.21**	**7.06**	**11%**	**-7%**	**-25%**	**-18%**	**20%**	**22%**	**14%**
Goodwill writeoffs	0.00	0.00	-1.00	-0.76	0.00	0.00	0.00	0.00							
Conduct costs	0.00	-0.67	0.00	-0.30	0.00	-0.25	-0.25	0.00							
Own credit adjustment	0.00	0.00	0.11	0.10	0.00	0.00	0.00	0.00							
Other exceptionals	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00							
Reported operating profit	**6.78**	**6.85**	**6.06**	**4.24**	**4.25**	**4.85**	**5.96**	**7.06**	**1%**	**-11%**	**-30%**	**0%**	**14%**	**23%**	**18%**
Tax	-1.84	-1.87	-1.86	-1.53	-1.25	-1.41	-1.70	-1.99	1%	0%	-18%	-19%	13%	21%	17%
Minorities	-0.08	-0.10	-0.11	-0.09	-0.10	-0.10	-0.11	-0.11	17%	12%	-16%	5%	5%	5%	5%
Preference shares & AT1	-0.10	-0.10	-0.10	-0.10	-0.18	-0.30	-0.38	-0.43	0%	0%	0%	81%	66%	27%	12%
Net Attributable Income	**4.75**	**4.79**	**3.99**	**2.51**	**2.73**	**3.04**	**3.77**	**4.52**	**1%**	**-17%**	**-37%**	**9%**	**12%**	**24%**	**20%**
Modelware Net Income	4.75	5.46	4.91	3.47	2.73	3.23	3.95	4.52	15%	-10%	-29%	-21%	18%	23%	
Key metrics															
Number of shares (avg, fd)	2.40	2.42	2.45	2.47	2.51	2.57	2.62	2.64	1%	1%	1%	2%	2%	2%	1%
Reported EPS ($)	2.01	2.00	1.64	1.02	1.09	1.19	1.45	1.72	-1%	-18%	-38%	7%	9%	22%	19%
Modelware EPS ($)	**1.98**	**2.25**	**2.01**	**1.40**	**1.09**	**1.25**	**1.51**	**1.71**	**14%**	**-11%**	**-30%**	**-23%**	**16%**	**20%**	**13%**
DPS ($)	0.76	0.84	0.86	0.86	0.54	0.57	0.60	0.61	11%	2%	0%	-37%	5%	5%	1%
Payout ratio (declared)	38%	42%	52%	84%	50%	48%	41%	35%							
Basic Tang. NAV/share ($)	**13.6**	**15.2**	**16.0**	**16.0**	**16.5**	**16.8**	**17.6**	**18.7**	**12%**	**5%**	**0%**	**3%**	**2%**	**5%**	**6%**
Return on avg tangible eq. (%)	15.3%	15.9%	13.1%	8.8%	6.7%	7.6%	8.8%	9.5%	3%	-18%	-32%	-24%	13%	16%	8%
Cost:income ratio	56%	54%	55%	59%	63%	61%	58%	57%	-5%	2%	8%	6%	-3%	-5%	-1%
Cost of risk (bps)	37	48	58	87	83	69	56	47	30%	21%	49%	-5%	-17%	-18%	-16%
Advances:deposits ratio	77%	75%	76%	70%	70%	70%	69%	70%	-3%	2%	-8%	0%	0%	-1%	1%
Average interest earning assets	442	483	521	579	576	579	596	627	9%	8%	11%	-1%	1%	3%	5%
Net interest margin	2.30%	2.23%	2.14%	1.90%	1.85%	1.85%	1.90%	1.95%	-3%	-4%	-11%	-3%	0%	3%	3%
Balance sheet ($)bn															
Net Customer Loans	267	280	291	285	285	289	297	313	5%	4%	-2%	0%	1%	3%	5%
Customer Depositis	346	373	381	405	406	412	428	445	8%	2%	6%	0%	1%	4%	4%
Tangible Equity	32.2	36.6	38.7	39.7	41.7	43.7	46.2	49.3	14%	6%	3%	5%	5%	6%	7%
Total Assets	593	631	674	726	722	726	747	786	6%	7%	8%	-1%	1%	3%	5%
CRD IV CET1 Capital		33.1	33.2	36.5	38.1	40.1	42.7	46.0		0%	10%	5%	5%	6%	8%
CRD IV Risk Weighted Assets		310	331	342	338	336	337	350		7%	3%	-1%	-1%	0%	4%
CRD IV CET1 ratio %		**10.7%**	**10.6%**	**10.7%**	**11.3%**	**11.9%**	**12.7%**	**13.1%**		**-1%**	**1%**	**6%**	**6%**	**6%**	**4%**
CRD IV Tier 1 Capital		33.1	33.2	36.5	41.5	45.1	49.4	53.0		0%	10%	14%	9%	9%	7%
CRD IV Leverage Exposure		736	743	803	800	803	825	863		1%	8%	0%	0%	3%	5%
CRD IV CET1 Leverage Ratio		**4.5%**	**4.5%**	**4.5%**	**5.2%**	**5.6%**	**6.0%**	**6.1%**		-1%	2%	14%	8%	7%	2%

Source: Company data, Morgan Stanley Research, e = Morgan Stanley Research estimates

Exhibit 69: Semi-annual Forecasts

Standard Chartered	1H13	2H13	1H14	2H14	1H15e	2H15e	Change vs prior year 1H14	2H14	1H15e	2H15e
P&L Account (US $bn)										
Net Interest Income	5.60	5.56	5.60	5.40	5.44	5.22	0%	-3%	-3%	-3%
Non-interest income	4.15	3.36	3.67	3.57	3.29	3.30	-12%	6%	-10%	-7%
Operating income	**9.75**	**8.92**	**9.27**	**8.97**	**8.72**	**8.52**	**-5%**	**1%**	**-6%**	**-5%**
Operating costs	-5.03	-5.16	-5.08	-5.66	-5.14	-5.70	1%	10%	1%	1%
Gross Operating Profit	**4.72**	**3.76**	**4.19**	**3.30**	**3.59**	**2.83**	**-11%**	**-12%**	**-14%**	**-14%**
Provisions	-0.74	-1.01	-1.03	-1.51	-1.09	-1.33	39%	51%	6%	-12%
Equity Method Earnings	0.11	0.11	0.11	0.14	0.12	0.12	1%	18%	8%	-9%
Operating Profit	**4.09**	**2.87**	**3.27**	**1.93**	**2.62**	**1.62**	**-20%**	**-33%**	**-20%**	**-16%**
Goodwill writeoffs	-1.00	0.00	0.00	-0.76	0.00	0.00				
Conduct costs	0.00	0.00	0.00	-0.30	0.00	0.00				
Own credit adjustment	0.24	-0.13	-0.02	0.12	0.00	0.00				
Other exceptionals	0.00	0.00	0.00	0.00	0.00	0.00				
Reported operating profit	**3.33**	**2.74**	**3.25**	**0.98**	**2.62**	**1.62**	**-2%**	**-64%**	**-20%**	**65%**
Tax	-1.09	-0.78	-0.85	-0.68	-0.68	-0.57	-22%	-12%	-20%	-17%
Minorities	-0.06	-0.06	-0.04	-0.05	-0.05	-0.05	-20%	-13%	10%	1%
Preference shares & AT1	-0.05	-0.05	-0.05	-0.05	-0.09	-0.09	0%	0%	82%	79%
Net Attributable Income	**2.13**	**1.86**	**2.31**	**0.20**	**1.80**	**0.91**	**8%**	**-89%**	**-22%**	**352%**
Key metrics										
Number of shares (avg, fd)	2.44	2.45	2.46	2.47	2.49	2.51	1%	1%	1%	2%
DPS ($)	1.17	0.81	0.94	0.46	0.72	0.36	-19%	-43%	-24%	-22%
Modelware EPS ($)	**1.17**	**0.81**	**0.94**	**0.46**	**0.72**	**0.36**	**-19%**	**-43%**	**-24%**	**-22%**
DPS ($)	0.29	0.57	0.29	0.57	0.27	0.27	0%	0%	-6%	-53%
Basic Tang. NAV/share ($)	15.33	15.94	16.47	16.04	16.95	17.85	7%	1%	3%	11%
Return on avg tangible eq. (%)	11.6%	9.8%	11.7%	1.0%	8.8%	4.2%	1%	-90%	-25%	316%
Cost:income ratio	52%	58%	55%	63%	59%	67%	6%	9%	7%	6%
Cost of risk (bps)	50	67	70	104	75	91	39%	54%	7%	-12%
Advances:deposits ratio	77%	76%	79%	70%	70%	70%	2%	-8%	-11%	0%
Average interest earning assets	512	522	543	579	578	576	6%	11%	6%	-1%
Net interest margin	2.19%	2.10%	2.06%	1.86%	1.88%	1.81%	-6%	-11%	-9%	-3%
Balance sheet ($)bn										
Net Customer Loans	285	291	299	285	285	285	5%	-2%	-5%	0%
Customer Depositis	371	381	381	405	406	406	3%	6%	7%	0%
Tangible Equity	37.2	38.7	40.6	39.7	42.4	45.1	9%	3%	4%	13%
Total Assets	650	674	690	726	724	722	6%	8%	5%	-1%
CRD IV CET1 Capital	35.0	33.2	37.0	36.5	37.3	38.1	6%	10%	1%	5%
CRD IV Risk Weighted Assets	330	331	352	342	340	338	6%	3%	-3%	-1%
CRD IV CET1 ratio %	10.6%	10.6%	10.5%	10.7%	11.0%	11.3%	-1%	1%	4%	6%

Source: Company data, Morgan Stanley Research, e = Morgan Stanley Research estimates

Exhibit 70: Annual Forecasts by Division

Standard Chartered ($bn)	2013	2014	2015e	2016e	2017e	% change vs prior year 2014	2015e	2016e	2017e
Corporate and Institutional									
Total income	**10.66**	**10.43**	**9.72**	**9.90**	**10.20**	***-2%***	***-7%***	***2%***	***3%***
Expenses	(4.95)	(5.19)	(5.14)	(4.93)	(4.74)	*5%*	*-1%*	*-4%*	*-4%*
Pre-Provision Op Profit	**5.70**	**5.24**	**4.58**	**4.97**	**5.46**	***-8%***	***-13%***	***9%***	***10%***
Impairment losses	(0.60)	(1.30)	(1.36)	(1.10)	(0.92)	*116%*	*5%*	*-19%*	*-17%*
Associates	0.16	0.20	0.19	0.20	0.22	*27%*	*-3%*	*6%*	*6%*
Operating profit	**5.26**	**4.14**	**3.40**	**4.07**	**4.77**	***-21%***	***-18%***	***20%***	***17%***
Commercial									
Total income	**1.51**	**1.18**	**1.04**	**1.04**	**1.09**	***-22%***	***-12%***	***0%***	***5%***
Expenses	(0.73)	(0.74)	(0.72)	(0.70)	(0.72)	*1%*	*-3%*	*-2%*	*2%*
Pre-Provision Op Profit	**0.78**	**0.44**	**0.32**	**0.34**	**0.38**	***-43%***	***-27%***	***4%***	***12%***
Impairment losses	(0.17)	(0.25)	(0.25)	(0.19)	(0.14)	*45%*	*1%*	*-24%*	*-24%*
Associates	0.04	0.02	0.02	0.02	0.02	*-41%*	*2%*	*5%*	*5%*
Operating profit	**0.65**	**0.22**	**0.10**	**0.17**	**0.26**	***-66%***	***-56%***	***79%***	***50%***
Private Banking									
Total income	**0.59**	**0.61**	**0.62**	**0.64**	**0.67**	***4%***	***1%***	***3%***	***6%***
Expenses	(0.41)	(0.45)	(0.46)	(0.47)	(0.49)	*10%*	*3%*	*3%*	*3%*
Pre-Provision Op Profit	**0.18**	**0.17**	**0.16**	**0.16**	**0.19**	***-8%***	***-4%***	***3%***	***15%***
Impairment losses	(0.01)	(0.02)	(0.00)	(0.00)	(0.00)	*100%*	*-95%*	*10%*	*10%*
Associates	0.00	-	0.00	0.00	0.00	*-100%*	*nm*	*0%*	*0%*
Operating profit	**0.17**	**0.15**	**0.16**	**0.16**	**0.19**	***-14%***	***6%***	***3%***	***15%***
Retail									
Total income	**5.92**	**6.01**	**5.88**	**5.89**	**6.08**	***2%***	***-2%***	***0%***	***3%***
Expenses	(3.87)	(4.00)	(3.96)	(3.92)	(3.88)	*4%*	*-1%*	*-1%*	*-1%*
Pre-Provision Op Profit	**2.05**	**2.01**	**1.91**	**1.96**	**2.20**	***-2%***	***-5%***	***3%***	***12%***
Impairment losses	(0.97)	(0.98)	(0.81)	(0.75)	(0.65)	*2%*	*-18%*	*-8%*	*-12%*
Associates	0.03	0.03	0.03	0.03	0.03	*-10%*	*5%*	*3%*	*3%*
Operating profit	**1.12**	**1.05**	**1.13**	**1.25**	**1.58**	***-6%***	***8%***	***10%***	***26%***
Group									
Total income	**18.67**	**18.23**	**17.25**	**17.47**	**18.05**	***-2%***	***-5%***	***1%***	***3%***
Expenses	(9.96)	(10.38)	(10.28)	(10.03)	(9.82)	*4%*	*-1%*	*-2%*	*-2%*
Bank levy	(0.24)	(0.37)	(0.54)	(0.56)	(0.58)	*56%*	*48%*	*3%*	*4%*
Pre-Provision Op Profit	**8.48**	**7.49**	**6.43**	**6.88**	**7.65**	***-12%***	***-14%***	***7%***	***11%***
Impairment losses	(1.75)	(2.54)	(2.42)	(2.04)	(1.72)	*46%*	*-5%*	*-16%*	*-16%*
Associates	0.23	0.25	0.25	0.26	0.27	*10%*	*-1%*	*6%*	*6%*
Operating profit	**6.96**	**5.19**	**4.25**	**5.10**	**6.21**	***-25%***	***-18%***	***20%***	***22%***

Source: Company data, Morgan Stanley Research, e = Morgan Stanley Research estimates

Exhibit 71: Quarterly estimates

Standard Chartered ($mn)	1Q14	2Q14	3Q14	4Q14	1Q15	2Q15e	3Q15e	4Q15e	% change vs prior year 1Q15	2Q15e	3Q15e	4Q15e
Corporate and Institutional	2,656	2,663	2,562	2,650	2,515	2,443	2,379	2,379	-5%	-8%	-7%	-10%
Commercial	312	304	294	272	259	261	260	260	-17%	-14%	-12%	-4%
Private Banking	158	156	155	143	152	157	155	155	-4%	1%	0%	8%
Retail	1,446	1,559	1,503	1,501	1,469	1,469	1,469	1,469	2%	-6%	-2%	-2%
Operating Income	**4,572**	**4,682**	**4,514**	**4,566**	**4,395**	**4,329**	**4,262**	**4,262**	**-4%**	**-8%**	**-6%**	**-7%**
Operating Expenses	(2,483)	(2,600)	(2,523)	(3,139)	(2,502)	(2,637)	(2,578)	(3,118)	1%	1%	2%	-1%
Pre-provision Op. Profit	**2,089**	**2,082**	**1,991**	**1,427**	**1,893**	**1,692**	**1,685**	**1,145**	**-9%**	**-19%**	**-15%**	**-20%**
Impairment Losses	(263)	(768)	(539)	(974)	(474)	(616)	(666)	(666)	80%	-20%	24%	-32%
Profit from Associates & JV's	49	64	78	57	48	75	61	61	-2%	16%	-21%	7%
Operating profit	**1,875**	**1,378**	**1,530**	**510**	**1,467**	**1,150**	**1,079**	**539**	**-22%**	**-17%**	**-29%**	**6%**

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INDUSTRY COVERAGE: Hong Kong Financials

COMPANY (TICKER)	RATING (AS OF)	PRICE* (05/27/2015)
Agarwal, Anil		
Bank of East Asia (0023.HK)	E (12/01/2014)	HK$35.40
BOC Hong Kong (2388.HK)	O (03/11/2013)	HK$32.95
Dah Sing Financial (0440.HK)	O (05/22/2009)	HK$58.40
Hang Seng Bank (0011.HK)	O (04/22/2015)	HK$159.70
HK Exchanges & Clearing (0388.HK)	O (04/11/2014)	HK$305.80
HSBC Holdings (0005.HK)	E (04/12/2015)	HK$74.15
Standard Chartered (2888.HK)	U (01/13/2014)	HK$125.90
Fun CFA, Silvia		
Value Partners Group Limited (0806.HK)	O (04/09/2015)	HK$16.00

Stock Ratings are subject to change. Please see latest research for each company.
* Historical prices are not split adjusted.