

Standard Chartered Plc (HK) (2888 HK)

Neutral

Price: HK\$117.50

03 Mar 2015

Price Target: HK\$115.00

PT End Date: 31 Dec 2015

FY14 Results: Reducing Costs/RWAs is Step Two...

Following last week's announcement on key management changes ([the note](#)), **StanChart has followed up with a restructuring plan to:** (i) achieve \$1.8bn of cost saves over 3 years, or 17% of the cost base; (ii) reduce risk-weighted assets by \$25bn-\$30bn, or ~8% of total; and (iii) target CET1 of 11-12%, from a level of 10.7% at year-end. Indeed, the main positive this half was that end-point CET1 remained flat at 10.7%, with the Group holding the 2H dividend steady at \$0.572. All that said, earnings were disappointing, with FY14 adjusted pre-tax of \$5.2bn, down 25% Y/Y, and almost 7% below our estimates even after we cut by ~12% over the past 6 months. Moreover, while the restructuring plan may reduce dilution concerns, the new guidance also implies lower revenues & lower pre-provision profit from 2015, **which we put at ~\$0.5-1.0 billion, or downgrades of ~10-20% for 2015E pre-tax.** We intend to revisit our estimates & view post-conference call, but this is an important second step in rebasing expectations for the stock. On balance, we think markets will view these announcements as positive; whereas we had expected weak earnings (and/or dilution), capital was better, and the existing team is clearly not waiting for the new CEO to join to start paring costs & risk.

- **Asset Quality:** The key miss in the 2H14 results was asset quality, with impairments of \$1.5bn, up 47% from 1H14. That means total credit costs rose from 68bps to 101bps – the highest level since the GFC. *Most of the increase was due to Corporate & Inst'l clients, with mgmt noting commodity weakness as the culprit in a few key cases.* We previously increased our credit cost assumptions to 95bps in 2015E, and 87bps in 2016E, and see smaller increases on this line item. The good news is that: (i) NPLs rose more slowly, up +4% H/H, to \$7.5bn, after rising >10% the last two halves; and (ii) the Group reduced its Commodity exposure by \$6bn in 2H14, to \$55bn.
- **Capital & Balance Sheet:** As part of its de-risking, StanChart reduced total RWAs by \$21bn H/H (or -6%), to \$342 billion. This helped CET1 stay flat H/H at 10.7%, despite +\$14bn of RWA inflation due to model changes, *inclusive of anticipated changes in 2015.* Net loans were down -3% in the second half (to \$289bn), even as deposits rose another +6% (to \$414bn). The planned reduction of \$25-30bn in RWAs will be achieved via business exits and/or asset disposals.
- **Restructuring Plan:** StanChart's new cost savings plan of \$1.8bn over the next three years includes ~\$100m from the closure of the Equities business, and would partly offset inflationary cost increases and increased regulatory costs. We had expected 1-1.5% cost increases in each of the next two years. We estimate the revenue impact of the plan is ~\$450mm in 2015E, and the Group also indicates a further impact from the \$25-30bn RWA reduction target. The net impact of these measures would improve CET1 into the 11-12% range for 2015, but also lead to steeper cuts in consensus forecasts, given estimates still anticipate revenue growth of 2% in FY15, and 4% in FY16 – in-line with JPMe.
- **Results vs Expectations:** For FY14, topline revenues (\$18.2bn ex-Own Credit) and costs (\$10.5bn ex-restructuring) were inline with our estimates, with the miss almost entirely on impairments (\$2.5bn vs. JPMe of \$2.1bn). That left clean pre-tax of \$5.2bn, 7% below JPMe.

Investment Thesis

We believe that StanChart remains a unique franchise, spread across markets that we believe offer long-term growth but also some near-term challenges. While Standard Chartered's 3Q IMS showed some stabilization in revenues, we also witnessed a significant rise in impairments (commodity related) which creates a material headwind for profitability in our view especially with global commodity prices down c40% since the peak. Although valuation is inexpensive at 0.7x P/B 2015E, we believe that the shares are unlikely to re-rate until the pace of impairment rise moderates, which appears unlikely to us on a 12-month view. We remain Neutral.

Valuation

Our December 2015 PT of HK\$115 derives from a combination of: (i) a sum-of-the-parts valuation based on fair values of each of the six markets, which we think is in line with how European investors look at the stock (implied value of HK\$114); and (ii) a DDM analysis, where we forecast normalized ROEs of 8.0% and a cost of capital of 11.0%, in line with how we think Asia investors will look at the stock (implied value of HK\$118).

Risks to Rating and Price Target

The key upside and downside risks that could prevent our rating and price target from being achieved include the following:

- Macro economic risks (both upside and downside): Being an EM-focused bank, StanChart is exposed to general macroeconomic variables in EM, such as a slowdown or a quicker-than-expected recovery in GDP growth, inflationary pressures, depreciation of EM currencies & cross border & political risks.
- China hard landing (downside): Standard Chartered has direct and indirect exposure to Mainland China and a China hard-landing scenario poses downside risk to our investment thesis.
- Pick-up in growth (upside): Standard Chartered remains geared to growth in Asia and a material pick-up in growth in Asia poses upside risk to our estimates.
- Regulatory uncertainty (downside): Standard Chartered remains exposed to the uncertain regulatory environment in the UK.

Asia Financials

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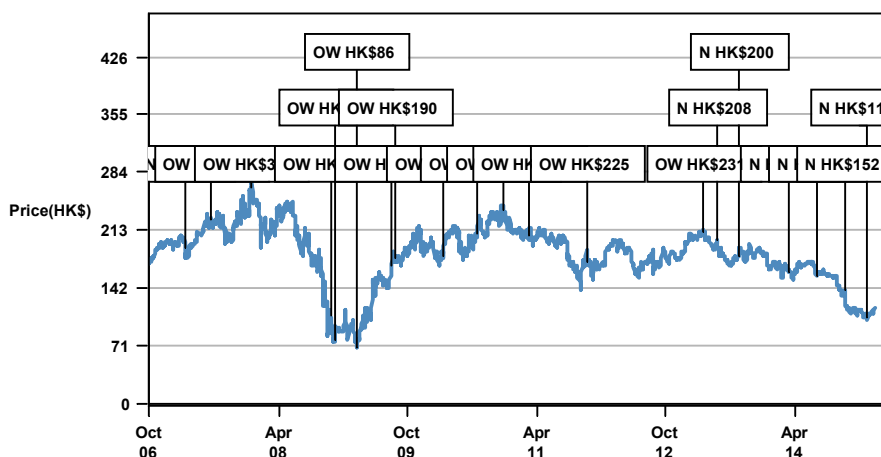
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Standard Chartered Plc (HK) (2888.HK, 2888 HK) Price Chart



Date	Rating	Share Price (HK\$)	Price Target (HK\$)
28-Feb-07	N	191.84	205.00
21-Jun-07	OW	226.40	308.00
06-Dec-07	OW	265.12	320.00
07-Nov-08	OW	107.58	150.00
25-Nov-08	OW	78.03	100.00
04-Mar-09	OW	67.75	86.00
27-Jul-09	OW	170.10	185.00
05-Aug-09	OW	178.80	190.00
03-Mar-10	OW	183.00	210.00
23-Jul-10	OW	209.40	225.00
12-Nov-10	OW	238.00	250.00
02-Mar-11	OW	206.60	240.00
28-Oct-11	OW	175.30	225.00
06-Mar-13	OW	210.80	231.00
08-May-13	N	201.00	208.00
07-Aug-13	N	182.80	200.00
09-Mar-14	N	163.30	181.00
02-Jul-14	N	157.70	169.00
28-Oct-14	N	139.00	152.00

Source: Bloomberg and J.P. Morgan; price data adjusted for stock splits and dividends. Initiated coverage Feb 28, 2007.

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