BEA securities

EAST ASIA SECURITIES COMPANY LIMITED
9/F, 10 Des Voeux Road Central, Hong Kong.
Dealing: 3608 8000 Research: 3608 8097 Facsimile: 3608 6113

HONG KONG RESEARCH
5th March 2015

Analyst: Paul Sham

STANDARD CHARTERED PLC (渣打集團)

Sector	: Banking	Chairman	: John Peace
HKSE Code	: 02888		
Market Price	: HK$121.00 (05/03/2015)	Group Chief Executive	: Peter Sands
Shares Issued	: 2,427m		
Mkt. Cap.	: HK$293,667.0m	Group Finance Director	: Richard Meddings
52 weeks Hi/ Lo	: HK$175.7/ HK$102.6		
HSI	: 24,193.04(05/03/2015)		
Main Business	: Banking and related financial services		

SUMMARY OF THE FINAL RESULTS FOR THE YEAR ENDED 31ST DECEMBER 2014

Final Results Highlights

	US$ million	Vs FY2013 (%)	Vs 30/06/2014 (%)
• Net interest income	11,003	-1.4%	
• Non-interest income	7,331	-3.8%	
• Total operating income	18,334	-2.4%	
• Operating expenses	(11,045)	+8.4%	
• Operating profit before impairment losses	7,289	-15.1%	
• Allowances for credit and other losses	(2,141)	+32.4%	
• Profit before taxation and non-core items	5,148	-26.1%	
• Non-core items	(913)	+1.1%	
• Profit before taxation	4,235	-30.2%	
• Taxation	(1,530)	-17.9%	
• **Attributable profit to equity holders**	**2,613**	-36.1%	
• Total loans	288,599	-2.5%	-5.4%
• Total deposits	434,063	+7.9%	+6.7%
• Total assets	725,914	+7.6%	+5.2%
• Basic EPS (US¢)	102.2	-37.8%	
• Final DPS (US¢)	57.20	+0.0%	
• Total DPS (US¢)	86.00	+0.0%	

Selected Ratios	**FY2014**	**FY2013**	**1H2014**
• Net interest margin	1.9%	2.1%	2.1%
• Cost-to-income ratio	60.2%	54.3%	54.9%
• Return on average equity	7.8%	11.2%	10.4%
• Impaired loan ratio	2.60%	2.19%	2.36%
• Impaired advances coverage	52.2%	53.7%	52.7%
• Loan-deposit ratio	66.5%	73.6%	75.0%
• Common Equity tier 1 CAR	10.5%	10.9%	10.5%
• Tier 1 CAR	11.4%	12.2%	11.8%
• Total CAR	16.7%	17.0%	17.3%

- ***Disappointing results but comforted by stable dividend*** Standard Chartered PLC ("StanChart") reported pre-tax profit of US$5,148m, down 26.1% y-o-y, hurt by higher regulatory costs and rising bad loans. The one-off items, namely impairment charge of US$403m due largely to the warehouse fraud in Qingdao China as well as goodwill impairment charge of US$758m for Korean and Corporate advisory businesses, dragged the bottom line further down by 36.1% y-o-y. Despite lower profit, StanChart maintained its full-year dividend at 86 cents per share, relieving fears the bank could cut its dividend to save capital.

- ***Net interest income*** fell slightly by 1.4% y-o-y to US$11,003m in 2014, as both margin and loan portfolio contracted during the year. StanChart's net interest margin shrank by 20bps y-o-y to 1.9% in FY14, while total loans shrank by 2.5% y-o-y, mainly due to the loan contraction in South Asia (-10.7% y-o-y), ASEAN (-5.2%) and North East Asia (-3.4%).
- ***Non-interest income*** fell by 3.8% y-o-y to US$7,331m, mainly dragged by 24.6% y-o-y fall in trading income as a result of weak forex gains. The higher rental income from operating lease assets (+15.9% y-o-y) and strong gains on disposal of AFS assets (+71.8%) helped partly offset the decline in trading income.
- ***Operating Expenses*** rose by 8.4% y-o-y to US$11,045m, of which US$300m arose from civil monetary penalty in relation to the settlement with the New York Department of Financial Services regarding deficiencies in its anti-money laundering transaction. Excluding such impact, the underlying expenses should have increased by 5.6% y-o-y. Since StanChart recorded negative growth in income during FY14, the normalized cost-to-income ratio worsened to 58.9% in FY14 from 54.4% a year earlier.
- ***Loan impairment charges*** were notably higher in 2014, up 32.4% y-o-y to US$2,141m, driven primarily by Corporate & Institutional and Commercial segment, as further weakness in commodity markets impacted a small number of StanChart's clients. Asset quality showed a deteriorating trend during 2014, with impaired loan ratio worsening to 2.60% at end-2014 (vs 2.19% at end-2013).
- ***Capital position*** CET1 and total CAR under Basel III were 10.5% and 16.7% respectively, compared with 10.9% and 17.0% a year earlier. The end point CET1 ratio of 10.7% was 200bps above the minimum regulatory requirement before taking into account of the countercyclical buffer.

Outlook & Prospects

- ***New targets and outlook*** StanChart's end-point CET1 ratio of 10.7% was 200bps above the current minimum requirement and is the top among UK banks. Management said it would cut US$25bn to US$30bn in risk-weighted assets from current US$342bn in the next two years, to help address concerns about the bank's capital strength, with a CET1 target of 11%-12% to be achieved in 2015. As the targeted contraction of risk weighted assets would lead to some loss of its revenue, StanChart lowered its return on equity target to above 10%, from the mid-teens percentage it previously aimed for. In another word, the rapid expansion of StanChart in the past decade has been halted officially, at least for the coming few years.
- ***Ambitious cost saving plan*** StanChart said it was on track to save US$600m in headline costs this year, beyond its target of US$400m. StanChart targets gross cost savings of US$1.8bn over the next 3 years. Two-third of the cost savings come from the underlying cost savings per annum such as continued digitization & automation of processes, headcount reductions and branch rationalizations while the remaining one-third will be achieved by the exit of non-core businesses. Nevertheless, the target cost saving is expected to be offset by rising compliance/conduct costs and inflation.
- ***Change of Management*** StanChart's CEO Peter Sands, one of the few bank bosses to survive the 2008 banking crisis and once tipped to become governor of the Bank of England, will leave StanChart in June. He will be replaced by Bill Winters, a former investment banker at JPMorgan, who has not worked in Asia or Africa and lacks experience in commercial or retail banking. His appointment creates discussion over his suitability to run StanChart, a traditional bank focusing on emerging market. In addition to Peter Sands, Chairman Sir John Peace will also leave next year, and StanChart has not had a replacement lined up yet.

- ***Valuation*** StanChart shares rose 3.6% on the day after the result announcement, largely on relief that StanChart ruled out the need of rights issue and maintained the dividend payout. Following share underperformance in 2014, StanChart's current valuations of 0.75x FY15E P/B and 9.0x FY15E P/E should have factored in the headwinds such as challenging outlook in deteriorating asset quaity, slower growth momentum in emerging markets as well as potential fine from the US regulator. With its sustainable 5% yield, we believe investors are being paid to wait for better times. We accordingly recommended a "Neutral" rating on StanChart.

Recommendation: *Neutral*

- Appendix I

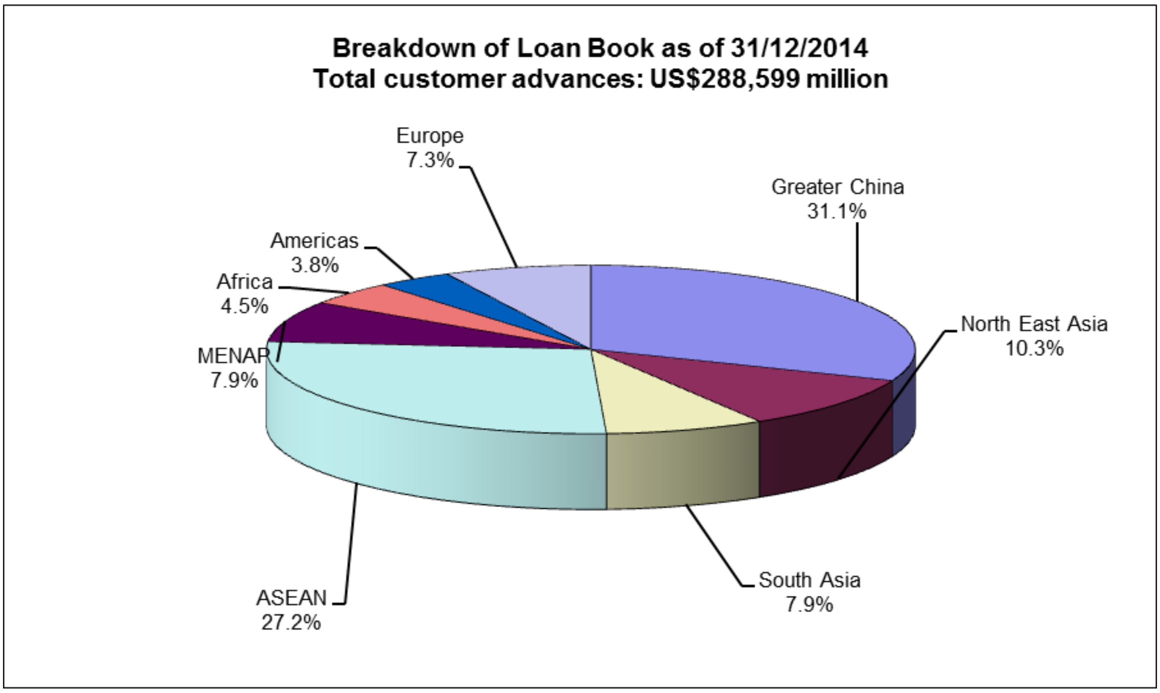
I. Impairment provisions of Standard Chartered

As % of total customer advances	Individual allowance	Portfolio allowance	Non-performing loans
As of 31/12/2014	1.11%	0.24%	2.60%
As of 30/6/2014	1.00%	0.24%	2.36%
As of 31/12/2013	0.94%	0.24%	2.19%

II. Comparison of Standard Chartered's loan book: 31/12/2014 vs 31/12/2013

Loans-by economies	31st Dec, 2014	*Up/(down)*	31st Dec, 2013
	US$ million		**US$ million**
Greater China	89,646	*(0.2%)*	89,846
North East Asia	29,582	*(3.4%)*	30,618
South Asia	22,859	*(10.7%)*	25,608
ASEAN	78,541	*(5.2%)*	82,852
MENAP	22,775	*(3.2%)*	23,535
Africa	13,103	*(0.1%)*	13,122
Americas	10,952	*+5.0%*	10,429
Europe	21,141	*+5.7%*	20,005
	288,599	*(2.5%)*	296,015

III. Breakdown of loan book of Standard Chartered



Important Disclosure / Analyst Certification / Disclaimer

This document is published by East Asia Securities Company Limited, a wholly-owned subsidiary of The Bank of East Asia, Limited (BEA).

The research analyst primarily responsible for the content of this report, in part or in whole certifies that the views on the companies and their securities mentioned in this report accurately reflect his/her personal views. The analyst also certifies that no part of his/her compensation was, is, or will be, directly, or indirectly, related to specific recommendations or views expressed in this report.

This report has been prepared solely for information purposes and has no intention whatsoever to solicit any action based upon it. Neither this report nor its contents shall be construed as an offer, invitation, advertisement, inducement or representation of any kind or form whatsoever. The information is based upon information, which East Asia Securities Company Limited considers reliable, but accuracy or completeness is not guaranteed. Information and opinions expressed herein reflect a judgment as of the date of this document and are subject to change without notice. Any recommendation contained in this report does not have regard to the specific investment objectives, financial situation and the particular needs of any specific addressee. This report is not to be taken in substitution for the exercise of judgment by respective readers of this report, who should obtain separate legal or financial advice. East Asia Securities Company Limited and / or The BEA Group accepts no liability whatsoever for any direct or consequential loss arising from any use of this report or further communication given in relation to this report.

At time of this report, East Asia Securities Company Limited has no position in securities of the company or companies mentioned herein the report, while BEA along with its affiliates and/or persons associated with any of them may from time to time have interests in the securities mentioned in this report. BEA and its associates, its directors, and/or employees may have positions in, and may effect transactions in securities mentioned herein and may also perform or seek to perform broking, investment banking and other banking services for these companies.

BEA and/or any of its affiliates may beneficially own a total of 1% or more of any class of common equity securities of the subject company or companies mentioned in this report and may, within the past 12 months, have received compensation and/or within the next 3 months seek to obtain compensation for investment banking services from the subject company or companies mentioned in the report.

This document is not directed to, or intended for distribution to or use by, any person or entity who is a citizen or resident of, or located in, any locality, state, country or other jurisdiction, publication, availability or use would be contrary to law and regulation.