

FIG
Diversified Financial Services
 Equity – Hong Kong

Overweight

Target price (HKD)	7.30
Share price (HKD)	6.64
Forecast dividend yield (%)	4.2
Potential return (%)	14.1

Note: Potential return equals the percentage difference between the current share price and the target price, plus the forecast dividend yield

Performance	1M	3M	12M
Absolute (%)	5	10	40
Relative ^A (%)	5	9	9

Index^A HSCEI

RIC 86.HK
 Bloomberg 86 HK

Market cap (USDbn) 1.9
 Market cap (HKDbn) 15.0

Free float (%) 13

Note: (V) = volatile (please see disclosure appendix)

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Sun Hung Kai & Co (86 HK)

OW: 3% profit beat from trading income, risk profile rising

- **SHKC reported 26% y-o-y profit growth in 2014, 3% ahead of our estimates. However, the slight beat to our numbers is mainly from trading income which is market driven**
- **We think the risk profile is rising as economy slows, UAF's overdue ratio rose by 3ppt h-o-h to 12% in 2H14, with a 1ppt rise in credit cost and charge-off ratio**
- **Remain OW with TP slightly raised 3% to HKD7.30 (from HKD7.10) as we roll over to use 2015e book value, earnings estimates fine-tuned <1% and introduce 2017e**

Profit beats 3% from trading income: Income from trading gain was 39% ahead of our estimates, contributing to 2.5% of total revenue of FY14 and was the key reason for the beat to our estimates. However, given the non-recurring nature and dependence on capital market performance this is not a very quality beat, in our view.

UAF a slower growth engine: Key subsidiary UA Finance's (UAF) revenue was 3% below our estimates, although it was still the key growth engine contributing to 70% of group revenue. In particular, China loan growth slowed to 32% y-o-y in 2H14 (we estimated 40%), slowing from 45-46% in 2H13 and 1H14. Overall loan growth is 3ppt below our estimates.

Risk profile is rising: The conservative loan growth could be a result of risk management as economic growth continues to remain slow and hit the low quality borrowers of UAF. Total overdue loan ratio rose by 3.3ppt y-o-y to 12% in 2014. Net charge-off ratio rose by 1.5ppt y-o-y or 0.9ppt h-o-h to 6.1% in 2H14. This is still within the company's comfort zone of 4-8% and way below the breakeven point of 10%. However, the risk profile is indeed higher as the asset quality indicators continue to worsen in trend.

Fine tune TP up 3% to HKD7.30, remain OW: We adjust earnings by under 1% for 2015-16e estimates and introduce 2017e. We fine tune our TP up 3% to HKD7.30 as we rollover the book value used in our simple growth model from 1H15e to 2015e. Company dividend payout is 43%, in line with previously years' 44-45%.

Analyst briefing to be held on 20 March 2015 at 9:30am in SHKC's Hong Kong head office: 21/F The Lee Gardens, 33 Hysan Avenue, Causeway Bay. We will follow up with more details.

SHKC financial summary

(HKDm)	1H13	2H13	1H14	2H14	h-o-h	Y-o-y	2013	2014	y-o-y vs HSBCe	
P&L summary										
UAF – microfinance	1,487	1,650	1,788	1,976	11%	20%	3,137	3,764	20%	-3%
SHKF & others	682	757	724	763	5%	1%	1,439	1,488	3%	1%
Trading income	-118	122	87	46	-47%	-62%	4	132	3680%	39%
Revenue	2,051	2,528	2,598	2,785	7%	10%	4,579	5,384	18%	-1%
PPOP	926	1,262	1,340	1,364	2%	8%	2,188	2,704	24%	-1%
Att profit	376	676	610	718	18%	6%	1,052	1,328	26%	3%
Balance sheet items										
Assets	27,622	27,804	30,941	32,761	6%	18%	27,804	32,761	18%	5%
Micro loans	8,594	10,044	10,249	11,392	11%	13%	10,044	11,392	13%	-3%
Debt	8,817	8,583	11,764	10,738	-9%	25%	8,583	10,738	25%	4%
Att equity	12,881	13,402	13,593	14,927	10%	11%	13,402	14,927	11%	5%
Ratios										
Cost / income	50.4%	45.4%	43.6%	46.6%	3.0 ppt	1.2 ppt	47.6%	45.1%	-2.5 ppt	0.0 ppt
ROAA	2.8%	4.9%	4.2%	4.5%	0.4 ppt	-0.4 ppt	4.0%	4.4%	0.4 ppt	0.0 ppt
Leverage	2.1	2.1	2.2	2.2	0.1	0.1	2.0	2.1	0.1	0.0
ROAE	5.8%	10.3%	9.0%	10.1%	1.0 ppt	-0.2 ppt	8.0%	9.4%	1.4 ppt	0.1 ppt
Lending yield	34.4%	35.1%	34.7%	35.5%	0.8 ppt	0.3 ppt	34.7%	35.9%	1.2 ppt	-0.4 ppt
Funding cost	4.5%	5.0%	4.4%	4.1%	-0.3 ppt	-0.8 ppt	5.0%	4.7%	-0.3 ppt	-0.3 ppt
Estimated spread	29.9%	30.2%	30.3%	31.3%	1.0 ppt	1.2 ppt	29.8%	31.2%	1.5 ppt	0.0 ppt
Gross charge off ratio	5.6%	5.5%	6.1%	7.1%	1.0 ppt	1.6 ppt	5.4%	6.5%	1.1 ppt	0.4 ppt

Source: Company data, HSBC estimates

Valuation and risks

We slightly fine-tune up our target price by 3% to HKD7.30, based on 1.26x (previously 1.33x) 2015e tangible BPS of HKD5.80 (previously 1H15e of HKD5.32) using a simple growth model with the assumed ROE of 12.2% (previously 12.6%) and the cost of equity of 10.7% (unchanged) using beta of 1.20.

Under our research model, for stocks with a volatility indicator, the Neutral band is 5ppt above and below the hurdle rate for Hong Kong stocks of 8.5%. Our TP implies a potential return of 14.1%, including the forecast dividend yield of 4.2%, which is above the Neutral band; therefore, we maintain our OW rating on the stock. Potential return equals the percentage difference between the current share price and the target price, including the forecast dividend yield where indicated.

We do not have enough financial information and proceed usage details to model the sale of the HK brokerage subsidiary, which would also require shareholder approval for such substantial disposal. For more information of the proposed sale of HK brokerage business please refer to our report [OW: A good sale to focus on consumer finance](#), published on 4 February 2015.

Key risks: Failure of reform progress, more volatile asset quality in micro lending, and less policy support, more trading loss drag.

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Year	2014a	2015e	2016e	2017e
P&L summary (HKDm)				
UAF - microfinance	3,764	4,467	5,359	6,511
SHKF & others	1,488	1,681	1,848	1,990
Trading income	132	92	97	41
Revenue	5,384	6,241	7,304	8,541
Total expenses	-2,224	-2,533	-2,944	-3,453
Operating income	3,159	3,708	4,360	5,088
Finance costs	-455	-513	-538	-567
PPOP	2,704	3,195	3,822	4,521
Bad & doubtful debts	-798	-870	-996	-1,211
Non-operating Income	252	80	60	60
Profit before tax	2,157	2,405	2,886	3,370
Income Tax	-359	-372	-493	-635
Net profit	1,798	2,033	2,393	2,736
Minority Interest	-470	-545	-658	-772
Att profit	1,328	1,488	1,735	1,963

ROAA deconstruction				
Net interest income	12.4	13.2	14.8	16.8
Other income	0.9	0.3	0.2	0.2
Operating income	13.3	13.5	15.0	16.9
Operating expenses	-7.3	-7.5	-8.1	-8.9
PPOP	6.0	6.0	6.8	8.0
Bad & doubtful debts	-2.6	-2.6	-2.8	-3.1
Profit before tax	3.3	3.4	4.1	4.9
Taxation	-1.2	-1.1	-1.4	-1.6
Minorities	-1.6	-1.6	-1.8	-2.0
ROAA	4.4	4.4	4.8	5.1
Leverage (x)	2.1	2.2	2.2	2.2
ROAE	9.4	9.7	10.6	11.1

Per share data (HKD)				
EPS (diluted)	0.62	0.69	0.81	0.91
EPS (basic)	0.62	0.69	0.81	0.91
DPS	0.26	0.28	0.32	0.36
BPS (tangible)	5.37	5.80	6.33	6.92
BPS	6.93	7.36	7.89	8.48

Valuation multiple (x)				
P/E (diluted)	10.6	9.5	8.2	7.2
P/E (basic)	10.6	9.5	8.2	7.2
P/B (tangible)	1.2	1.1	1.0	0.9
P/B	0.9	0.9	0.8	0.8
Dividend yield%	4.0	4.2	4.9	5.6

Year	2014a	2015e	2016e	2017e
BS summary (HKDm)				
Microfinance loans	12,148	14,205	16,894	20,432
Other receivables	9,151	9,686	10,080	10,493
Cash and equivalents	5,045	4,486	3,793	2,520
Intangibles & goodwill	3,367	3,367	3,367	3,367
Total Assets	32,761	34,922	37,420	40,175
Debt and borrowings	10,738	11,441	12,215	13,065
Due to fellow subsidiary	9	9	9	9
Payables	2,820	2,961	3,109	3,264
Total liabilities	14,094	14,962	15,909	16,942
Share capital	8,752	8,752	8,752	8,752
Reserves	6,175	7,093	8,233	9,502
Att equity	14,927	15,846	16,985	18,255
Minority Interest	3,740	4,114	4,526	4,978

Growth rate (YoY %)				
Revenue	17.6	15.9	17.0	16.9
PPOP	23.6	18.2	19.6	18.3
Expenses	11.7	13.9	16.2	17.3
Profit before tax	25.4	11.5	20.0	16.8
Att profit	26.3	12.0	16.6	13.2
Loan receivables	14.1	16.9	18.9	20.9
Total assets	17.8	6.6	7.2	7.4
Debt and borrowings	25.1	6.5	6.8	7.0
Total liabilities	28.3	6.2	6.3	6.5

Key ratios (%)				
Cost / income	41.3	40.6	40.3	40.4
Effective tax rate	16.6	15.5	17.1	18.8
ROAA	4.4	4.4	4.8	5.1
Leverage	2.1	2.2	2.2	2.2
ROAE	9.4	9.7	10.6	11.1

Issuer information				
Share price (HKD)				6.64
Target price (HKD)				7.30
Pot'l return incl div yield				14%
Number of shares (bn)				2.3
Market cap (USDbn)				1.9
Market cap (HKDbn)				15.0
Free float				13%
USD/HKD assumed				7.80

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Note: Price at close 19 March 2015
Source: Company data, HSBC estimates

Disclosure appendix

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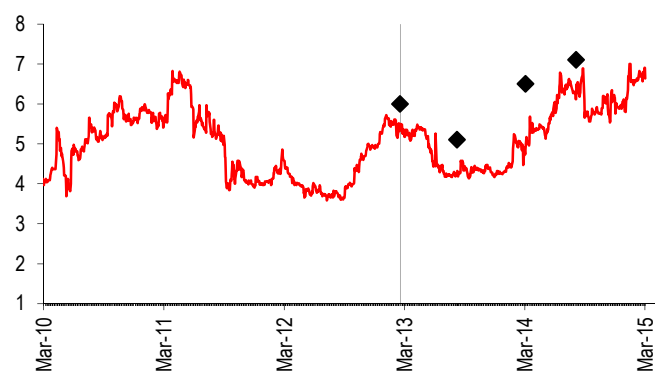
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Share price and rating changes for long-term investment opportunities

Sun Hung Kai & Co (0086.HK) Share Price performance HKD Vs HSBC rating history



Source: HSBC

Recommendation & price target history

From	To	Date
N/A	Overweight	05 March 2013
Target Price	Value	Date
Price 1	6.00	05 March 2013
Price 2	5.10	25 August 2013
Price 3	6.50	21 March 2014
Price 4	7.10	22 August 2014

Source: HSBC

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Disclosure checklist

Company	Ticker	Recent price	Price Date	Disclosure
SUN HUNG KAI CO	0086.HK	6.64	19-Mar-2015	6, 11

Source: HSBC

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