

Far East Horizon (3360 HK)

Hold

Target price (HKD)	6.80
Share price (HKD)	6.71
Upside/Downside (%)	-1.3

	2014 a	2015 e	2016 e
HSBC EPS	0.70	0.81	1.01
HSBC PE	7.8	6.8	5.4
Performance	1M	3M	12M
Absolute (%)	-8.6	-10.9	23.1
Relative ^A (%)	-8.3	-14.2	-0.6

26 March 2015

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the Disclosure appendix,
and with the Disclaimer,
which forms part of it

Hold: Earnings missed on continuing challenges

- **Profit grew 20% y-o-y in 2014, but was 6% below our forecast on the lower revenue and higher credit impairment**
- **It takes time for the company's business transformation to bear fruit; we see a capital need in the near term**
- **We establish a Hold rating with a fair value TP of HKD6.8**

Broad-based slowdown. Far East Horizon (FEH) reported that its net profit was up 20% y-o-y to RMB2.3bn in 2014, 6% below our forecast. We note revenue growth has slowed down on:

- Net interest income was up 8% y-o-y in 2014, down from 30% in 2013. Net interest spread (NIS) dropped 75bp y-o-y, offsetting the 25% leasing assets growth in 2014.
- Fee income (including brokerage) was up 24% y-o-y in 2014, down from up 51% in 2013.

Moreover, credit impairment charges were up 40% y-o-y in 2014 – a trend we expect to continue amid the challenging macro environment.

Transformation takes time. We note FEH has initiated a business transformation against the macro uncertainties and capital constraint (for details, please read our report about [N: Profit, growth and capital trilemma](#), published on 15 April 2014). FEH has made further progress during the year, but we think this remains a long path ahead, in view of the following:

- FEH has tried to enhance its capital efficiency through issuing perpetual bond and ABS. However, the cost-benefit profile doesn't seem favourable. With an 84.2% gearing ratio at end-2014 (which has included the impact of perpetual bond), we see a capital need.
- FEH has attempted to diversify its businesses in 2014, such as the hospital investment projects. Nonetheless, we think some of these investments will take a long time to generate return and may dilute the ROE in the near term.

We establish a Hold rating. We reduce our profit forecasts by 18% in 2015e and 20% in 2016e to reflect our expectations of lower margin and slower leasing assets expansion. We set our fair value target price at HKD6.8, based on 1x 2015e PB (unchanged) and a lower FX rate assumption. Under our previous rating system, we had a Neutral rating and a TP of HKD7.

Key upside and downside risks. Clarity on the expected change in shareholding structure could positively affect the company. Other key risks include favourable or unfavourable changes in macro conditions, industry regulations and liquidity conditions, and its strategy in business diversification.

Index ^A	HSCEI
Index level	12,005
RIC	3360.HK
Bloomberg	3360 HK

Source: HSBC

Enterprise value	NA
Free float (%)	72
Market cap (USDm)	2,848
Market cap (HKDm)	22,092

Source: HSBC

Financials & valuation: Far East Horizon

Hold

P&L summary (RMBm)				
Year	12/14a	12/15e	12/16e	12/17e
Interest income	6,458	7,117	7,967	8,929
Interest expense	(3,423)	(3,959)	(4,468)	(4,994)
Net interest income	3,035	3,158	3,499	3,934
Fees & commissions & others	3,260	4,265	5,643	7,502
Sales of goods and others	458	481	505	531
Business tax and surcharges	(116)	(56)	-	-
Cost of sales	(684)	(958)	(1,245)	(1,494)
Net revenue	5,953	6,891	8,402	10,473
Selling and distribution	(1,356)	(1,559)	(1,871)	(2,339)
Administrative expenses	(910)	(1,087)	(1,299)	(1,552)
Other expenses	(251)	(257)	(263)	(269)
PPOP	3,437	3,988	4,969	6,313
Impairments	(750)	(930)	(1,001)	(1,131)
Non-operating income/loss	524	550	577	606
Profit before tax	3,210	3,608	4,545	5,788
Taxation	(869)	(902)	(1,136)	(1,447)
Minorities	(46)	(54)	(75)	(104)
Attributable profit	2,295	2,652	3,334	4,237
HSBC attributable profit	2,295	2,652	3,334	4,237

Balance sheet summary				
Loans and receivable	99,441	115,264	133,925	154,623
Total assets	110,726	128,499	148,798	171,172
Total borrowings	71,778	83,106	95,401	108,468
Total liabilities	93,276	109,007	126,730	145,822
Ordinary equity	16,113	18,102	20,602	23,780

ROA deconstruction (%)				
Net Interest Income	3.08	2.64	2.52	2.46
Net Fee & Commissions	3.31	3.57	4.07	4.69
Sales of goods and others	0.46	0.40	0.36	0.33
Net revenue	6.04	5.76	6.06	6.55
Selling and distribution costs	(1.38)	(1.30)	(1.35)	(1.46)
Other operating expenses	(1.18)	(1.12)	(1.13)	(1.14)
PPOP	3.48	3.33	3.58	3.95
Impairment losses on L&A	(0.76)	(0.78)	(0.72)	(0.71)
PBT	3.26	3.02	3.28	3.62
Other non-operating Items	0.53	0.46	0.42	0.38
Taxation	(0.88)	(0.75)	(0.82)	(0.90)
Minority Interest	(0.05)	(0.05)	(0.05)	(0.07)
Attributable profit	2.33	2.22	2.40	2.65

Per share data (RMB)				
EPS	0.70	0.81	1.01	1.29
DPS	0.18	0.20	0.25	0.32
Tangible NAV	4.89	5.50	6.26	7.22
NAV per share	4.89	5.50	6.26	7.22

Source: Company data, HSBC estimates

Ratios (%)				
Year to	12/14a	12/15e	12/16e	12/17e
Margin				
Gross yield	7.02	6.60	6.32	6.13
Cost of funds	5.01	4.80	4.70	4.60
Net interest spread	2.01	1.80	1.62	1.53
Net interest margin	3.30	2.93	2.78	2.70
Operating efficiency				
Non-int inc/total income	55.1	60.0	63.7	67.1
Cost/income ratio	42.3	42.1	40.9	39.7
Credit quality				
Write-off (% of NPA)	19.02	20.00	15.00	12.00
Credit costs	0.83	0.84	0.78	0.76
NPA ratio	0.91	1.04	1.15	1.26
NPA coverage	218.7	220.0	220.0	220.0
Capital and gearing				
Gearing	84.2	84.8	85.2	85.2
Profitability				
ROA (including goodwill)	2.3	2.2	2.4	2.6
ROE (including goodwill)	15.2	15.5	17.2	19.1

Growth (y-o-y, %)				
Loans and receivable	24.8	15.9	16.2	15.5
Total assets	28.0	16.1	15.8	15.0
Total borrowings	26.9	15.8	14.8	13.7
Net equity	14.1	12.3	13.8	15.4
Net interest income	12.2	4.0	10.8	12.4
Service fee income	33.1	30.8	32.3	32.9
Sales of goods	23.6	5.0	5.0	5.0
Total net revenue	19.6	15.8	21.9	24.6
Selling and distribution	20.5	15.0	20.0	25.0
Administrative expenses	19.8	19.5	19.5	19.5
Total operating expenses	16.5	15.4	18.2	21.2
PPOP	22.0	16.0	24.6	27.0
Impairment charges	40.3	24.0	7.7	12.9
Non-operating profit	64.6	5.0	5.0	5.0
Profit before tax	23.4	12.4	26.0	27.3
HSBC net profit	20.0	15.5	25.7	27.1

Valuation				
P/PPOP	5.2	4.5	3.6	2.8
PE	7.8	6.8	5.4	4.2
PB	1.1	1.0	0.9	0.8
Dividend yield	3.3%	3.7%	4.6%	5.9%

Source: Company data, HSBC estimates

Issuer information			
Share price (HKD)	6.71	Total shares (m)	3,292
Target price (HKD)	6.80	Market cap (HKDm)	22,092
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Note: Priced at close of 24 March 2015

FEH: Summary and comparison of the FY14 results (RMBm)

Income statement	2H13	1H14	2H14	YoY	HoH	FY13	FY14	YoY
Net interest income	1,331	1,506	1,354	2%	-10%	2,653	2,861	8%
Service fee income & brokerage	1,285	1,779	1,253	-2%	-30%	2,437	3,032	24%
Trading and others	260	338	524	102%	55%	435	862	98%
Gross revenue	2,875	3,623	3,132	9%	-14%	5,525	6,754	22%
Business tax and surcharges	(56)	(102)	(15)	-74%	-86%	(121)	(116)	-4%
Cost of trading and others	(246)	(324)	(360)	46%	11%	(425)	(684)	61%
Operating income	2,574	3,197	2,758	7%	-14%	4,978	5,954	20%
Selling and distribution costs	(612)	(643)	(713)	17%	11%	(1,125)	(1,356)	21%
Administrative expenses	(412)	(435)	(475)	15%	9%	(760)	(910)	20%
Others	(236)	(158)	(106)	-55%	-33%	(284)	(264)	-7%
Operating expenses	(1,261)	(1,236)	(1,294)	3%	5%	(2,169)	(2,530)	17%
PPOP	1,313	1,961	1,464	11%	-25%	2,809	3,424	22%
Impairment charges	(277)	(395)	(355)	28%	-10%	(535)	(750)	40%
Non-operating profit/loss	193	45	492	156%	1004%	326	537	65%
Profits before tax	1,228	1,611	1,601	30%	-1%	2,601	3,211	23%
Tax	(346)	(440)	(429)	24%	-2%	(685)	(869)	27%
Net profits	879	1,165	1,131	29%	-3%	1,913	2,296	20%
Balance sheet								
Loans and receivables	79,687	93,131	99,441	25%	7%	79,687	99,441	25%
Total assets	86,513	99,903	110,726	28%	11%	86,513	110,726	28%
Borrowings	56,554	65,905	71,778	27%	9%	56,554	71,778	27%
Total liabilities	72,348	83,890	93,276	29%	11%	72,348	93,276	29%
Total equity	14,125	14,717	16,113	14%	9%	14,125	16,113	14%
Key ratios								
Net interest spread	NA	2.35%	NA	NA	NA	2.76%	2.01%	NA
Net interest margin	NA	3.61%	NA	NA	NA	3.91%	3.30%	NA
Cost to income ratio	49.0%	38.7%	46.9%	NA	NA	43.6%	42.5%	NA
Special mention loans	14.0%	13.8%	13.7%	NA	NA	14.0%	13.7%	NA
NPA ratio	0.80%	0.89%	0.91%	NA	NA	0.80%	0.91%	NA
NPA coverage	219%	215%	219%	NA	NA	219%	219%	NA
30 days overdue	0.45%	0.70%	0.91%	NA	NA	0.45%	0.91%	NA
ROA	2.2%	2.5%	2.1%	NA	NA	2.6%	2.3%	NA
ROE	12.8%	16.2%	14.7%	NA	NA	14.2%	15.2%	NA
Gearing ratio	83.6%	84.0%	84.2%	NA	NA	83.6%	84.2%	NA

Source: Company data (FY13 financial data has been restated)

Result review and outlook

- **Interest spread:** FEH's interest spread dropped 75bp y-o-y in 2014, which is attributable to its risk aversion, the value-added tax impact (which reduced the yield by around 10bp), the rate reduction from PBOC as well as the increased funding cost. We expect some of these factors to continue, and the company's liability management measures (ie, extending borrowing duration and increase portion of unsecured borrowings) could add further pressure.
- **Fee income:** FEH's fee income (including brokerage) increased by 24% y-o-y, driven by the healthcare, infrastructure and electronic information sectors. But on an h-o-h basis, this income stream declined 30% in 2H14, affected by the deterioration of the economy. This could remain a volatile income stream ahead.
- **Credit quality:** NPA ratio increased 11bp y-o-y at end-2014, reflecting the economic slowdown. The upward trend was spear-headed by the transportation sector. We think deterioration in credit is likely to last, continuing to elevate impairment charges.
- **Capital:** FEH's gearing ratio reached 84.2% at end-2014; it is worth noting that this is partly supported by the USD200m perpetual bond issued during the year (which is callable in 2017). Since it takes time for the company to transform its business and reduce its reliance toward the asset-expansion mode, we continue to see near-term capital needs for the company.

FEH: Summary of change in forecasts (RMBm)

Income statement	Previous forecasts		Revised forecasts		New forecast	% Change	
	2015e	2016e	2015e	2016e	2017e	2015e	2016e
Net interest income	3,883	4,593	3,158	3,499	3,934	-19%	-24%
Service fee income & others	5,232	7,221	4,265	5,643	7,502	-18%	-22%
Trading & others	296	266	481	505	531	63%	90%
Gross revenue	9,410	12,079	7,905	9,647	11,967	-16%	-20%
Business tax and surcharges	(68)	0	(56)	0	0	-19%	NA
Cost of trading and others	(345)	(310)	(958)	(1,245)	(1,494)	178%	301%
Operating income	8,997	11,769	6,891	8,402	10,473	-23%	-29%
Selling and distribution costs	(2,616)	(3,793)	(1,559)	(1,871)	(2,339)	-40%	-51%
Administrative expenses	(1,293)	(1,600)	(1,087)	(1,299)	(1,552)	-16%	-19%
Others	(137)	(141)	(257)	(263)	(269)	88%	86%
Operating expenses	(4,045)	(5,534)	(2,904)	(3,433)	(4,161)	-28%	-38%
PPOP	4,952	6,235	3,988	4,969	6,313	-19%	-20%
Impairment charges	(734)	(792)	(930)	(1,001)	(1,131)	27%	26%
Non-operating profit/loss	117	123	550	577	606	370%	370%
Profits before tax	4,335	5,566	3,608	4,545	5,788	-17%	-18%
Tax	(1,084)	(1,392)	(902)	(1,136)	(1,447)	-17%	-18%
Net profits	3,245	4,166	2,652	3,334	4,237	-18%	-20%
Balance sheet							
Loans and receivables	116,912	137,766	115,264	133,925	154,623	-1%	-3%
Total assets	124,221	145,985	128,499	148,798	171,172	3%	2%
Borrowings	84,402	99,279	83,106	95,401	108,468	-2%	-4%
Total liabilities	105,774	124,404	109,007	126,730	145,822	3%	2%
Total equity	18,397	21,521	18,102	20,602	23,780	-2%	-4%
Key ratios							
Net interest spread	2.88%	2.90%	1.80%	1.62%	1.53%	-108	-128
Net interest margin	3.67%	3.66%	2.93%	2.78%	2.70%	-75	-89
Cost to income ratio	45.0%	47.0%	42.1%	40.9%	39.7%	-282	-616
NPA ratio	1.06%	1.18%	1.04%	1.15%	1.26%	-3	-2
NPA coverage	225%	220%	220%	220%	220%	-500	0
Gearing ratio	85.1%	85.2%	84.8%	85.2%	85.2%	-32	-5
ROA	2.8%	3.1%	2.2%	2.4%	2.6%	-62	-68
ROE	18.9%	20.9%	15.5%	17.2%	19.1%	-339	-365

Source: HSBC estimates

Revised forecasts

We have revised our forecasts for FEH to reflect the following considerations:

- ▶ We have reduced our net interest spread forecasts to take into account the interest rate cut, which we believe will negatively affect FEH given the asset-liability mismatch plus a high percentage share of overseas funding. We have also reduced the leasing assets growth. These combined lead us to lower our net interest income forecasts by 19% in 2015e and 24% in 2016e.
- ▶ We have also lowered our fee income forecasts by 18% in 2015e and 22% in 2016e, reflecting both the slower leasing assets expansion and a challenging economic backdrop. These are partly offset by the higher forecasts in trading and other income.
- ▶ We cut our forecasts for operating expenses to reflect the slower business growth.
- ▶ Nonetheless, we raise impairment charges by 27% in 2015e and 26% in 2016e to reflect the challenging macro conditions.

Overall, we have trimmed our profit forecast by 18% in 2015e, followed by a 20% reduction in 2016e.

Revised valuation

We continue to use a PB-based approach to value FEH with our assumptions based on a simple growth model. Our key assumptions, including 16% ROE, 16% COE and 5.5% medium-term growth rate, remain unchanged. These parameters give a target PB of 1x (unchanged) and we derive a new fair value target price of HKD6.8, after factoring our revised BVPS of RMB5.5 and the FX rate (RMB:HKD) of 1.23 (down from 1.25 before). We establish a Hold rating on FEH under our new rating system.

Key upside / downside risks to our view

- ▶ **Shareholding change:** We expect Sinochem, currently the largest shareholder of FEH, will continue to divest its shareholding in the company but the means and timing are uncertain. Depending on the form of its divestment, we believe the share price of FEH could react positively or negatively.
- ▶ **Regulations:** There are two regulators, namely MOFCOM and CBRC in the leasing industry and they have different requirements in terms of capital, liquidity, and business operations. It is uncertain whether the dual-regulatory model will change, but if it does, FEH might be positively or negatively affected.
- ▶ **Credit quality:** We have forecasted FEH's NPA ratio to rise modestly. But the SME customers of FEH are more vulnerable to deterioration in macro conditions, which could be worse than we are forecasting.
- ▶ **Funding:** FEH relies heavily on banking borrowing to fund its asset expansion. This creates liquidity and interest rate risks to FEH, although we note it has been diversifying the funding sources.
- ▶ **Business diversification:** FEH has been actively exploring the industry chain of the medical and healthcare industry and has acquired a hospital in 2014. Although we believe its experience in doing leasing business with this industry helps, failure in integration and unfavourable M&A could adversely affect the company.

Disclosure appendix

Analyst Certification

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Important disclosures

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From 23rd March 2015 HSBC has assigned ratings on the following basis:

The target price is based on the analyst's assessment of the stock's actual current value, although we expect it to take six to 12 months for the market price to reflect this. When the target price is more than 20% above the current share price, the stock will be classified as a Buy; when it is between 5% and 20% above the current share price, the stock may be classified as a Buy or a Hold; when it is between 5% below and 5% above the current share price, the stock will be classified as a Hold; when it is between 5% and 20% below the current share price, the stock may be classified as a Hold or a Reduce; and when it is more than 20% below the current share price, the stock will be classified as a Reduce.

Our ratings are re-calibrated against these bands at the time of any 'material change' (initiation or resumption of coverage, change in target price or estimates).

Upside/Downside is the percentage difference between the target price and the share price.

Prior to this date, HSBC's rating structure was applied on the following basis:

For each stock we set a required rate of return calculated from the cost of equity for that stock's domestic or, as appropriate, regional market established by our strategy team. The target price for a stock represented the value the analyst expected the stock to reach over our performance horizon. The performance horizon was 12 months. For a stock to be classified as Overweight, the potential return, which equals the percentage difference between the current share price and the target price, including the forecast dividend yield when indicated, had to exceed the required return by at least 5 percentage points over the succeeding 12 months (or 10 percentage points for a stock classified as Volatile*). For a stock to be classified as Underweight, the stock was expected to underperform its required return by at least 5 percentage points over the succeeding 12 months (or 10 percentage points for a stock classified as Volatile*). Stocks between these bands were classified as Neutral.

*A stock was classified as volatile if its historical volatility had exceeded 40%, if the stock had been listed for less than 12 months (unless it was in an industry or sector where volatility is low) or if the analyst expected significant volatility. However, stocks which we did not consider volatile may in fact also have behaved in such a way. Historical volatility was defined as the past month's average of the daily 365-day moving average volatilities. In order to avoid misleadingly frequent changes in rating, however, volatility had to move 2.5 percentage points past the 40% benchmark in either direction for a stock's status to change.

Rating distribution for long-term investment opportunities

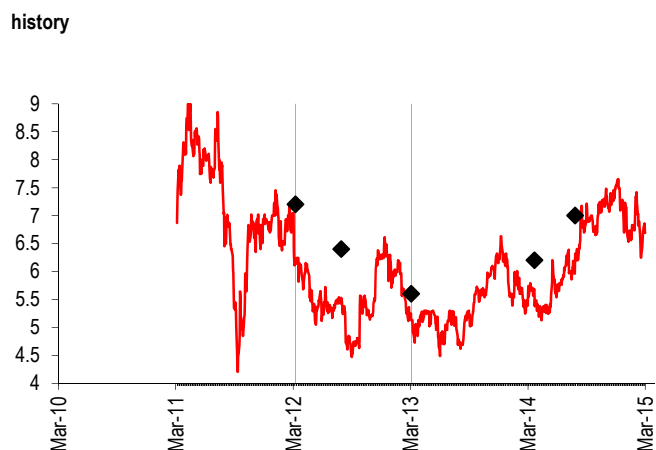
As of 26 March 2015, the distribution of all ratings published is as follows:

Buy	41%	(29% of these provided with Investment Banking Services)
Hold	40%	(28% of these provided with Investment Banking Services)
Sell	19%	(20% of these provided with Investment Banking Services)

For the purposes of the distribution above the following mapping structure is used during the transition from the previous to current rating models: under our previous model, Overweight = Buy, Neutral = Hold and Underweight = Sell; under our current model Buy = Buy, Hold = Hold and Reduce = Sell. For rating definitions under both models, please see “Stock ratings and basis for financial analysis” above.

Share price and rating changes for long-term investment opportunities

Far East Horizon (3360.HK) Share Price performance HKD Vs HSBC rating history



Source: HSBC

Recommendation & price target history

From	To	Date
Overweight (V)	Neutral (V)	02 April 2012
Neutral (V)	Neutral	28 March 2013
Target Price	Value	Date
Price 1	7.20	02 April 2012
Price 2	6.40	22 August 2012
Price 3	5.60	28 March 2013
Price 4	6.20	15 April 2014
Price 5	7.00	20 August 2014

Source: HSBC

HSBC & Analyst disclosures

Disclosure checklist

Company	Ticker	Recent price	Price Date	Disclosure
FAR EAST HORIZON	3360.HK	6.69	25-Mar-2015	1, 5, 6

Source: HSBC

- 1 HSBC has managed or co-managed a public offering of securities for this company within the past 12 months.
- 2 HSBC expects to receive or intends to seek compensation for investment banking services from this company in the next 3 months.
- 3 At the time of publication of this report, HSBC Securities (USA) Inc. is a Market Maker in securities issued by this company.
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- 9 A covering analyst/s or a member of his/her household has a financial interest in the securities of this company, as detailed below.
- 10 A covering analyst/s or a member of his/her household is an officer, director or supervisory board member of this company, as detailed below.
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Additional disclosures

- 1 This report is dated as at 26 March 2015.
- 2 All market data included in this report are dated as at close 24 March 2015, unless otherwise indicated in the report.
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