

Sun Hung Kai & Co Ltd

China Growth Still Impressive, But Risks Emerging

SHK&Co. reported operating earnings of HK\$1,328mm for FY14, up +26% Y/Y due to higher interest income (+17% Y/Y) and overall lower cost to income ratio (40bps improvement) partially offset by increased provisions (+35% Y/Y). Other income also doubled on the gains from the disposal of land and building (HK\$140mm). Consumer finance in China continues to see strong loan growth of +34% Y/Y, which in turn is driving higher onshore revenue (+36%) relative to HK (+7%). The China book now has 139 branches (+32 Y/Y) and HK\$5bn in loans (42% of total). With the first credit guarantee company branch launched in Oct-14, UAF is trying to position its expansion in a more capital-light model. More importantly, SHK has announced the sale of 70% its stake in Sun Hung Kai Financial Group Limited (SHKFGL) to Everbright Securities which will provide SHK access to Chinese markets through Everbright's strong customer base and branch network ([the note](#)). The one worrying note is that credit costs at UAF spiked from HK\$567mm to HK\$787mm Y/Y (and +37% H/H), largely due to the slowdown of China's economy – while HK saw benign asset quality. We fine tune our EPS forecast and roll over our PT to HK\$7.60; remain OW.

- **Top line:** SHK reported HK\$1,328mm operating earnings for FY14 driven by higher interest income and improved cost efficiency (CIR 42%). Consumer Finance revenue rose +20% Y/Y (HK: 9%, CH: 36%) and PBT +15% Y/Y due to strong loan growth (+34% Y/Y) in China as well as HK\$36mm FX gain from RMB depreciation (vs -30mm in 2013). UAF now makes up 65% of pre-tax.
- **Asset quality:** Asset quality deterioration continued in 2H14 with impaired loans increasing by 39% Y/Y to HK\$787mm. Credit cost rose from 4.1% to 5.1% Y/Y (1H: 5.1%), with China jumping from 4.8% to 7.0% (1H: 7.1%). Asset quality is much more stable in HK, with provisions up only +10bps to 3.8% (1H: 3.9%). Group overdue loans increased by +360bps Y/Y to 12.8% (1H: 9.9%), mostly on China-related stress.
- **China expansion:** The China book now has 139 branches (+32 Y/Y) and HK\$5bn in loans. The first credit guarantee company branch started to function in Oct-14, which allows UAF to expand custom reach in a more capital-light model. Apart from 58.com and Souyidai, SHK also has entered into partnership with Dianrong to develop P2P and online business.

Sun Hung Kai & Co Ltd (Reuters: 0086.HK, Bloomberg: 86 HK)

	FY12A	FY13A	FY14A	FY15E	FY16E
Operating Profit (HK\$ mn)	1,688	1,702	2,115	2,331	2,736
Net Profit (HK\$ mn)	1,036	1,052	1,328	1,436	1,726
EPS (HK\$)	0.49	0.49	0.62	0.66	0.79
DPS (HK\$)	0.22	0.22	0.24	0.29	0.35
EPS Growth	(0.6%)	1.1%	25.7%	6.6%	20.2%
ROE	8.3%	8.0%	9.4%	9.5%	11.1%
P/E (x)	13.6	13.5	10.7	10.1	8.4
BV per share (HK\$)	5.95	6.31	6.84	7.04	7.25
P/BV	1.1	1.0	1.0	0.9	0.9
Div. Yield	3.3%	3.3%	3.6%	4.4%	5.3%

Source: Company data, Bloomberg, J.P. Morgan estimates.

Overweight

0086.HK, 86 HK

Price: HK\$6.62

▲ Price Target: HK\$7.60

Previous: HK\$6.90

Hong Kong Asia Financials

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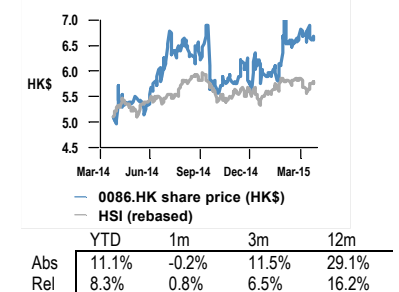
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J.P. Morgan Securities (Asia Pacific) Limited

Price Performance



Company Data	
52-week Range (HK\$)	7.60-4.94
Market Cap (HK\$ mn)	14,250
Market Cap (\$ mn)	1,837
Shares O/S (mn)	2,153
Fiscal Year End	Dec
Price (HK\$)	6.62
Date Of Price	26-Mar-15
3M - Avg daily val (HK\$ mn)	11.93
3M - Avg daily val (\$ mn)	1.5
3M - Avg daily vol (mn)	1.83
HSI	24,399.60
Exchange Rate	7.76
Price Target End Date	31-Dec-15

See page 7 for analyst certification and important disclosures, including non-US analyst disclosures.

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<p>Key catalysts for the stock price:</p> <ul style="list-style-type: none"> • Mainland expansion • Strong performance in Consumer Finance Business 	<p>Upside risks to our view:</p> <ul style="list-style-type: none"> • Faster-than-expected China expansion • Cross-border business development 	<p>Downside risks to our view:</p> <ul style="list-style-type: none"> • Keen competition in brokerage • Change in consumer finance regulation • Credit quality deterioration in China
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Key financial metrics	FY13A	FY14E	FY15E	FY16E
Total revenue (LC)	4,683	5,592	6,056	6,794
Revenue growth (%)	14.7%	19.4%	8.3%	12.2%
Costs (LC)	(2,391)	(2,679)	(2,867)	(3,072)
PPOP (LC)	2,292	2,913	3,189	3,722
LLP (LC)	(590)	(798)	(857)	(986)
Net income (LC)	1,052	1,328	1,436	1,726
Non-IT/Revenue (%)	78.2%	80.9%	80.6%	81.3%
CIR (%)	51.1%	47.9%	47.3%	45.2%
Costs/Assets (%)	9.0%	8.8%	8.5%	8.5%
PPOP/Assets (%)	8.6%	9.6%	9.4%	10.3%
LLP/Loans (%)	6.4%	7.4%	7.0%	7.0%
ROA (%)	4.0%	4.4%	4.2%	4.8%
ROE (%)	8.0%	9.4%	9.5%	11.1%
EPS (LC)	0.49	0.62	0.66	0.79
Dividend (LC)	0.22	0.24	0.29	0.35
BVPS (LC)	6.31	6.84	7.04	7.25
NPL ratio (%)	9.3%	11.1%	12.5%	11.9%
NPL coverage (%)	65.2%	52.0%	49.1%	51.4%
Key model assumptions	FY13A	FY14E	FY15E	FY16E
Brokerage and wealth management	2%	-14%	10%	-11%
Corporate finance	-93%	23%	10%	10%
Consumer finance	7%	15%	22%	7%

Source: Company and J.P. Morgan estimates.

Sensitivity analysis	PPOP		EPS	
	FY15E	FY16E	FY15E	FY16E
Sensitivity to				
Brokerage and wealth mgmt(10%)	0.2%	0.2%	0.3%	0.3%
Corporate finance (10%)	0.0%	0.0%	0.0%	0.0%
Consumer finance (22%)	3.0%	3.1%	2.6%	2.9%
Principal investment (5%)	1.1%	1.0%	1.6%	1.5%

Source: J.P. Morgan estimates.

Valuation and price target basis

Our PT (Dec-15, DDM-derived) of HK\$7.5 implies a P/BV of 1.1x and P/E of 11.4x (FY15E).

PT Derivation

Risk free rate:	4.0%
Market risk premium	5.0%
Cost of equity	9.0%
Terminal "g":	4.0%
Fair P/NTA	1.32
PV of Terminal Value	6.7
PV of Dividend	0.9
Fair value	7.6

Source: Bloomberg, Company and J.P. Morgan estimates.

JPM vs. consensus, change in estimates

EPS (LC)	FY15E	FY16E
JPM old	0.67	n.a.
JPM new	0.66	0.79
% chg	-2%	n.a.
Consensus	0.70	0.84

Source: Bloomberg, J.P. Morgan estimates.

Table 1: SHK&Co: Earnings review

HK\$ in millions

	1H13	2H13	1H14	2H14	H/H	Y/Y
Income statement						
Gross revenue	2,301	2,549	2,658	2,874	8%	13%
Total revenue	2,079	2,604	2,628	2,965	13%	14%
Total operating expenses	1,125	1,266	1,258	1,421	13%	12%
Pre-provision Profit	954	1,338	1,369	1,544	13%	15%
Operating earnings before tax	731	971	1,041	1,074	3%	11%
Attributable profits	380	671	610	718	18%	7%
Balance sheet						
Loans to consumer finance	8,594	10,044	10,249	11,392	11%	13%
Total assets	27,622	27,804	32,114	32,761	2%	18%
Total liabilities	11,511	10,985	15,005	14,094	-6%	28%
Shareholders' funds	12,881	13,402	13,593	14,927	10%	11%
Per share data						
EPS (FD)	0.18	0.31	0.29	0.33	14%	5%
DPS (ord)	0.10	0.12	0.10	0.14	45%	21%
BVPS (FD)	5.96	6.31	6.40	6.84	7%	8%
NTAPS (FD)	4.40	4.72	4.82	5.30	10%	12%
Ratios						
TR/AA	15.7%	18.8%	17.5%	18.3%	1%	-1%
CIR	54.1%	48.6%	47.9%	47.9%	0%	-1%
PPPoA	7.21%	9.66%	9.14%	9.52%	0%	0%
Credit cost (prov / gross loans)	5.28%	7.88%	6.48%	8.68%	2%	1%
ROA	2.88%	4.85%	4.07%	4.43%	0%	0%
ROE	5.9%	10.2%	9.0%	10.1%	1%	0%
AE / AA	48.7%	47.4%	45.1%	44.0%	-1%	-3%
Loans / Assets (net, avg)	20.2%	21.7%	22.5%	23.0%	1%	1%

Source: Company reports and J.P. Morgan estimates.

Table 2: SHK&Co: Earnings Revisions

HK\$ in millions

	New	FY15E Old	chg	FY16E New
Income statement				
Gross revenue	6,350	6,126	4%	7,104
Total revenue	6,056	5,823	4%	6,794
Total operating expenses	2,867	2,723	5%	3,072
Pre-provision Profit	3,189	3,100	3%	3,722
Operating earnings before tax	2,331	2,305	1%	2,736
Attributable profits	1,436	1,430	0%	1,726
Balance sheet				
Loans to consumer finance	12,696	12,540	1%	14,156
Total assets	34,955	33,975	3%	37,159
Total liabilities	15,137	14,278	6%	16,266
Shareholders' funds	15,359	15,283	1%	15,822
Per share data				
EPS (FD)	0.66	0.67	-2%	0.79
DPS (ord)	0.29	0.30	-4%	0.35
BVPS (FD)	7.04	7.20	-2%	7.25
NTAPS (FD)	5.42	5.45	0%	5.55
Ratios				
TR/AA	17.8%	17.8%	0%	18.8%
CIR	47.3%	46.8%	1%	45.2%
PPPoA	9.40%	9.47%	-1%	10.32%
Credit cost (prov / gross loans)	7.00%	6.40%	9%	7.00%
ROA	4.23%	4.37%	-3%	4.79%
ROE	9.5%	9.7%	-2%	11.1%
AE / AA	44.6%	45.2%	-1%	43.2%
Loans / Assets (net, avg)	35.5%	36.3%	-2%	37.2%

Source: Company reports and J.P. Morgan estimates.

Investment Thesis, Valuation and Risks

Sun Hung Kai & Co Ltd (*Overweight; Price Target: HK\$7.60*)

Investment Thesis

Consumer finance growth and mainland China expansion will be the performance engine for the company.

Valuation

Our price target is based upon DDM methodology. We use a fair P/NTA based multiple of 1.3x, with a normalised RoNTA of 10.6%. Our PT (Dec-15, DDM-derived) of HK\$7.6 implies a P/BV of 1.1x and P/E of 11.4x (FY15E).

Risk free rate:	4.0%
Market risk premium:	5.0%
Cost of equity	9.0%
Terminal "g":	4.0%
Fair P/NTA	1.32
PV of Terminal Value	6.7
PV of Dividends	0.9
Fair value	7.6

Source: J.P. Morgan estimates

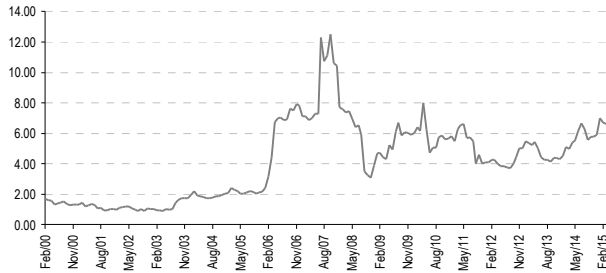
Risks to Rating and Price Target

Key downside risks to our rating and price target include keen competition in brokerage and changes in consumer finance regulation, and credit quality deterioration in China. Upside risks include faster-than-expected China expansion.

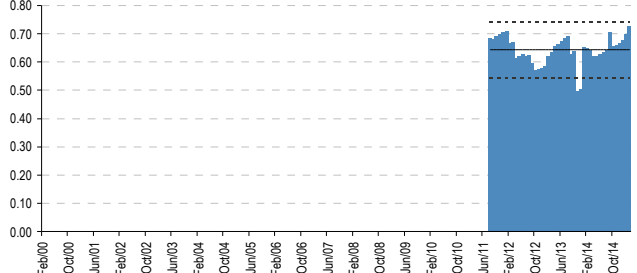
JPM Q-Profile
Sun Hung Kai & Co. Limited (HONG KONG / Financials)
 As Of: 23-Mar-2015

Global Equity Quantitative Analysis

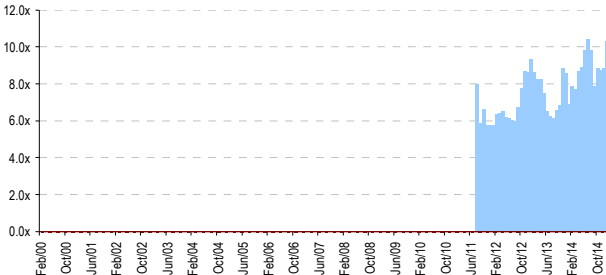
Local Share Price **Current: 6.61**



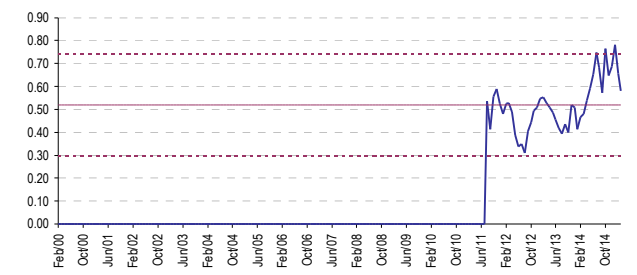
12 Mth Forward EPS **Current: 0.73**



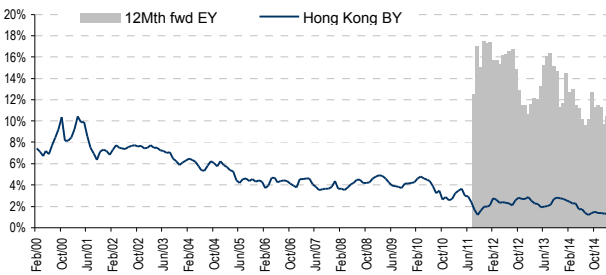
PE (1Yr Forward) **Current: 9.1x**



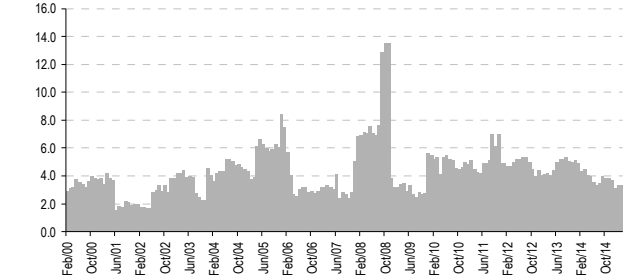
P/E Relative to Hong Kong Index **Current: 0.58**



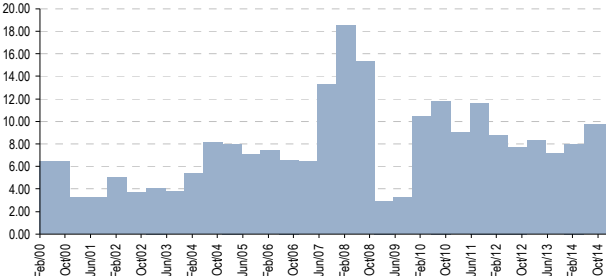
Earnings Yield (& Local Bond Yield) **Current: 11%**



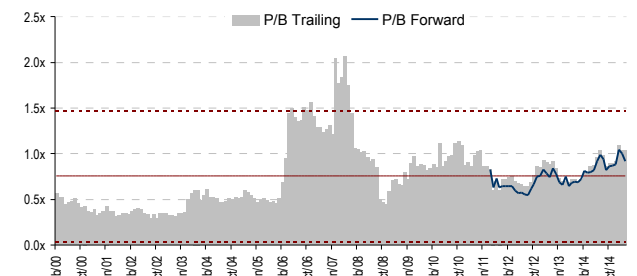
Dividend Yield (Trailing) **Current: 3.29**



ROE (Trailing) **Current: 9.68**



Price/Book (Value) **Current: 1.0x**



Summary

Sun Hung Kai & Co. Limited		TICKER 86 HK		As Of: 23-Mar-15							
HONG KONG				Local Price: 6.61							
Financials				EPS: 0.73							
	Latest	Min	Max	Median	Average	2 S.D.+	2 S.D. -	% to Min	% to Max	% to Med	% to Avg
12mth Forward PE	9.10x										
P/BV (Trailing)	1.03	0.30	2.07	0.70	0.75	1.47	0.04	-71%	101%	-32%	-27%
Dividend Yield (Trailing)	3.29x	1.59	13.51	4.07	4.32	7.90	0.73	-52%	310%	24%	31%
ROE (Trailing)	9.68	2.94	18.52	7.41	7.76	15.06	0.45	-70%	91%	-23%	-20%

Source: Bloomberg, Reuters Global Fundamentals, IBES CONSENSUS, JPMorgan Quantitative & Derivative Strategy

Sun Hung Kai & Co Ltd: Summary of Financials

Income Statement				AUM flows					
HK\$ in millions, year end Dec	FY13	FY14	FY15E	FY16E	HK\$ in millions, year end Dec	FY13	FY14	FY15E	FY16E
WM, brokerage revenue	939	1,012	1,113	1,202	EPS (HKD)	49.077%	61.711%	65.813%	79.109%
Corporate finance revenue	83	57	63	69	Dividend (HKD)	0.22	0.24	0.29	0.35
Asset management revenue	0	0	0	0	Payout ratio	44.8%	39.1%	44.0%	44.0%
Other revenue	3,661	4,523	4,880	5,523	BVPS (HKD)	6.31	6.84	7.04	7.25
Total revenue	4,683	5,592	6,056	6,794	NTA per share (HKD)	4.72	5.30	5.42	5.55
Brokerage and commission expenses	(260)	(283)	(303)	(324)	Avg. Shares issued (mn)	2,143	2,153	2,182	2,182
Direct cost and operating expenses	(80)	(61)	(64)	(67)					
Administrative expenses	(1,470)	(1,730)	(1,817)	(1,907)	Growth rates				
Other operating expenses	(581)	(606)	(684)	(774)	Total assets	10.1%	18.4%	6.2%	6.3%
Finance cost	(401)	(455)	(523)	(602)	Shareholders' funds	4.2%	11.4%	2.9%	3.0%
Total operating expenses	(2,391)	(2,679)	(2,867)	(3,072)	Total revenue	14.7%	19.4%	8.3%	12.2%
Pre-provision Profit	2,292	2,913	3,189	3,722	Attributable profits	1.5%	26.3%	8.1%	20.2%
Total provisioning charge/(writeback)	(590)	(798)	(857)	(986)	Operating earnings before tax	1.1%	25.7%	6.6%	20.2%
Operating earnings before tax	1,702	2,115	2,331	2,736	Associates profit	1.6%	9.7%	19.9%	20.2%
Associates profit	19	43	45	47	DPS (ord)	6.1%	8.4%	2.9%	3.0%
Exceptionals	0	0	0	0	BVPS (FD)				
Pretax income	1,720	2,157	2,376	2,784					
Net profit after tax	1,460	1,798	2,008	2,338	Balance Sheet Gearing				
Attributable profits	1,052	1,328	1,436	1,726	AE / AA	-	-	-	-
					NTA/AA	-	-	-	-
Balance sheet				DuPont analysis					
Cash & ST funds	3,739	5,045	4,958	4,657	TR/AA	17.7%	18.4%	17.8%	18.8%
Trade & other receivables	6,530	7,683	8,067	8,470	Credit cost (prov / gross loans)	6.4%	7.4%	7.0%	7.0%
Loans to consumer finance	10,044	11,392	12,696	14,156	ROA	4.0%	4.4%	4.2%	4.8%
Goodwill	3,370	3,367	3,535	3,712	ROE	8.0%	9.4%	9.5%	11.1%
Current assets	10,269	12,727	13,025	13,128	RoNTA	10.8%	12.3%	12.3%	14.4%
Total assets	27,804	32,908	34,955	37,159					
Bank borrowings (current)	2,435	3,834	4,217	4,639					
Trade and other payables (current)	1,867	2,820	3,102	3,412					
Bank borrowings (non current)	2,449	3,196	3,356	3,524					
Current liabilities	4,576	6,976	7,669	8,432					
Total liabilities	10,985	14,094	15,137	16,266					
Shareholders' funds	13,402	14,927	15,359	15,822					
Minority interest balance	3,417	3,887	4,459	5,071					

Source: Company data and J.P. Morgan estimates

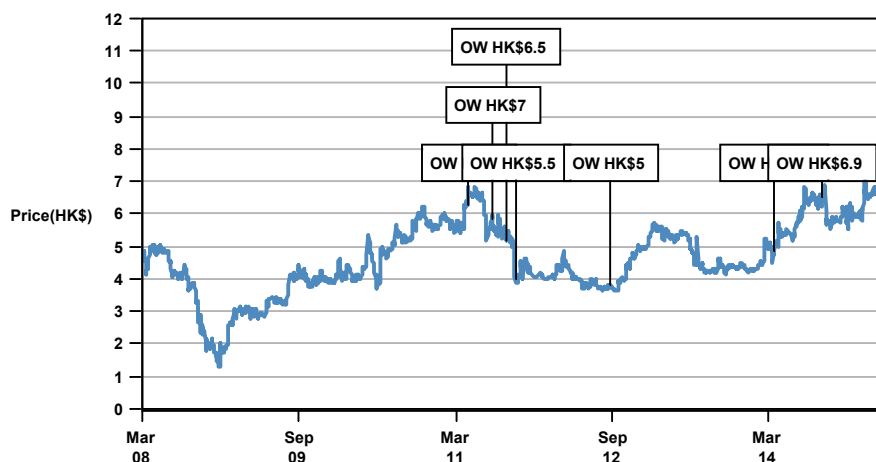
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Sun Hung Kai & Co Ltd (0086.HK, 86 HK) Price Chart



Date	Rating	Share Price (HK\$)	Price Target (HK\$)
12-Apr-11	OW	6.30	8.00
04-Jul-11	OW	5.82	7.00
25-Aug-11	OW	5.15	6.50
01-Oct-11	OW	4.00	5.50
24-Aug-12	OW	3.81	5.00
21-Mar-14	OW	4.89	5.50
05-Sep-14	OW	6.54	6.90

Source: Bloomberg and J.P. Morgan; price data adjusted for stock splits and dividends.
 Initiated coverage Apr 12, 2011.

The chart(s) show J.P. Morgan's continuing coverage of the stocks; the current analysts may or may not have covered it over the entire period.

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Coverage Universe: Klaczek, Josh A: Aozora Bank (8304) (8304.T), HSBC Holdings plc (0005.HK), Mitsubishi UFJ Financial Group (8306) (8306.T), Mizuho Financial Group (8411) (8411.T), Noah Holdings Ltd (NOAH), Resona Holdings (8308) (8308.T), Shinsei Bank (8303) (8303.T), Standard Chartered Plc (HK) (2888.HK), Sumitomo Mitsui Financial Group (8316) (8316.T), Sun Hung Kai & Co Ltd (0086.HK), Value Partners Group Limited (0806.HK)

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	Overweight (buy)	Neutral (hold)	Underweight (sell)
J.P. Morgan Global Equity Research Coverage	45%	43%	12%
IB clients*	56%	49%	33%
JPMS Equity Research Coverage	45%	48%	7%
IB clients*	75%	67%	52%

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