Deutsche Bank
Markets Research

Rating
Hold

Asia
Hong Kong

Banking / Finance
Banks

Company
HSBC Holdings Plc

Reuters	Bloomberg	Exchange	Ticker
0005.HK	5 HK	HSI	0005

ADR Ticker	ISIN
HBC	US4042804066

Date
19 June 2015

Company Update

Price at 18 Jun 2015 (HKD)	72.40
Price target - 12mth (HKD)	69.00
52-week range (HKD)	84.20 - 64.65
HANG SENG INDEX	26,695

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Key changes

Price target	68.00 to 69.00	↑	1.5%

Source: Deutsche Bank

Price/price relative

Performance (%)	1m	3m	12m
Absolute	-3.7	9.9	-10.5
HANG SENG INDEX	-3.2	10.7	15.2

Source: Deutsche Bank

Investor day 2015: Changing world, changing plan

Unpacking the detail from HSBC's investor day

HSBC held an investor day on June 9th 2015 which gave considerable detail on its strategy out to 2017. Key targets (RoE >10%, 2017 run rate exit costs flat on 2014, progressive dividend) were pre-announced, but the investor presentations laid out the management actions on business exits, redeployment, cost control and growth opportunities. This note takes a detailed look at HSBC's investor day disclosures, which we estimate imply $27.3bn of adjusted PBT for 2017 (7% higher than consensus, 2% below DBe). Our estimates are left unchanged at this stage, though our TP changes marginally from HK$68 to HK$69 on TVM / FX movements.

Much detail, but scepticism likely to remain in the near-term

- **Adjusting for business exits / RWA reductions** identified by mgmt, we estimate pro-forma 2014 RoRWA would already be above the 2.3% target.
- **Excess capital potential:** Hitting targets (and assuming $50bn reg. RWA inflation) we estimate should result in CET1 of 13.5% at 2017 / excess capital of $6bn-$18bn (on top of a progressive dividend, but before additional redress/litigation), which represents ~4-10% of mkt cap.
- **Implied shape of the P&L in 2017** is strikingly different to current consensus / DBe: 12% lower revenues, 26% lower costs vs consensus. Planned cost reductions are back-ended to 2017: we remain sceptical on costs due to past track-record, and a lack of interim targets.
- **Business mix change towards a far more capital efficient GBM:** mgmt are planning to reduce client facing GBM RWAs from the 2014 level (39%), targeting <1/3 for non-BSM GBM RWAs in 2017. GBM is still expected to deliver a similar proportion of group PBT though, effectively an additional $2bn of PBT from $130bn fewer RWAs – an ambitious target.
- **UK ring-fencing**: HSBC is advancing plans to set up a rebranded, Birmingham headquartered, UK retail bank. We estimate 'Basel 4 rules' could result in $20bn of additional RWAs due to low mortgage RWs here.

Valuation and Risks (TP HK$69 from HK$68)

At this stage we make no changes to our forecast estimates. HSBC is trading at 10.7x 2016 P/E, 1.2x TNAV, for a 5.5% dividend yield. We value HSBC using a sum-of-the-parts approach. Our TP changes marginally to HK$69 from HK$68 on FX and TVM movements. Forecast cash dividends in 2015/16 are worth around ~40p. With limited downside to the current shareprice, we retain our Hold rating. Key upside risks are an unexpected improvement in organic growth within the bank and lower than expected loan losses. Key downside risks relate to regulatory change and legacy liabilities.

Forecasts And Ratios

Year End Dec 31	2013A	2014A	2015E	2016E	2017E
EPS (USD)	0.84	0.69	0.69	0.75	0.98
PER (x)	12.9	13.8	13.5	12.5	9.6

Source: Deutsche Bank estimates, company data

Model updated:19 June 2015

Running the numbers

Asia

Hong Kong

Banks

HSBC Holdings Plc

Reuters: 0005.HK | Bloomberg: 5 HK

Hold

Price (18 Jun 15)	HKD 72.40
Target Price	HKD 69.00
52 Week range	HKD 64.65 - 84.20
Market Cap (m)	HKDm 1,419,211
	USDm 183,053

Company Profile

HSBC is one of the world's leading banking and financial institutions with c.6,600 offices and 58 million customers in 81 countries across Europe, Hong Kong, Asia-Pacific, Middle East, North Africa, North America and Latin America. At FY12 46% of its loan book was in Europe, 17% in Hong Kong, 17% in Asia & Middle East, 14% in North America and 5% in Latin America. HSBC has 4 main business divisions: Retail Banking & Wealth Management, Commercial Banking, Global Banking and Markets and Global Private Banking. At FY12 38% of loan balances

Fiscal year end 31-Dec	2012	2013	2014	2015E	2016E	2017E
Data Per Share						
EPS (stated)(USD)	0.75	0.84	0.69	0.69	0.75	0.98
EPS (DB) (USD)	0.93	0.78	0.86	0.82	0.87	0.97
Growth Rate - EPS (DB) (%)	17.8	-15.3	9.7	-4.9	6.3	11.7
DPS (USD)	0.45	0.49	0.50	0.51	0.51	0.52
BVPS (stated) (USD)	9.06	9.27	9.24	9.07	9.30	9.75
Tang. NAV p. sh. (USD)	7.44	7.68	7.80	7.72	8.02	8.54
Market Capitalisation	193,643	204,292	183,392	183,053	183,053	183,053
Shares in issue	18,271	18,654	19,056	19,511	19,904	20,305
Valuation Ratios & Profitability Measures						
P/E (stated)	14.0	12.9	13.8	13.5	12.5	9.6
P/E (DB)	11.3	13.8	11.1	11.4	10.7	9.6
P/B (stated)	1.2	1.2	1.0	1.0	1.0	1.0
P/Tangible equity (DB)	1.4	1.4	1.2	1.2	1.2	1.1
ROE(stated)(%)	8.5	9.1	7.4	7.5	8.1	10.3
ROTE (tangible equity) (%)	12.9	10.4	11.1	10.6	11.1	11.8
ROIC (invested capital) (%)	10.3	8.4	9.1	8.8	9.3	10.1
Dividend yield(%)	5.1	4.5	4.8	5.4	5.5	5.6
Dividend cover(x)	1.7	1.7	1.4	1.4	1.5	1.9
Profit & Loss (USDm)						
Net interest revenue	37,672	35,538	34,705	34,749	36,818	39,281
Non interest income	30,658	29,106	26,543	26,377	27,406	29,044
Commissions	16,430	16,434	15,957	14,660	15,441	16,825
Trading Revenue	7,091	8,690	6,760	9,464	9,843	10,236
Other revenue	7,137	3,982	3,826	2,253	2,122	1,983
Total revenue	68,330	64,644	61,248	61,126	64,224	68,326
Total Operating Costs	42,927	38,556	41,249	40,129	40,486	38,158
Employee Costs	20,491	19,196	20,366	19,681	19,805	18,448
Other costs	22,436	19,360	20,883	20,448	20,681	19,710
Pre-Provision profit/(loss)	25,403	26,088	19,999	20,997	23,737	30,168
Bad debt expense	8,311	5,849	3,851	3,276	3,463	3,557
Operating Profit	17,092	20,239	16,148	17,721	20,274	26,611
Pre-tax associates	3,557	2,325	2,532	1,784	1,094	1,151
Pre-tax profit	20,649	22,564	18,680	19,506	21,368	27,763
Tax	5,315	4,765	3,975	4,291	4,701	6,108
Other post tax items	-1,741	-2,169	-1,590	-1,808	-1,889	-1,927
Stated net profit	13,593	15,630	13,115	13,406	14,778	19,728
Goodwill	0	0	0	0	0	0
Extraordinary & Other items	3,336	-989	3,290	2,566	2,541	0
Bad Debt Provisioning	0	0	0	0	0	0
Investment reval, cap gains / losses	0	0	0	0	0	0
DB adj. core earnings	16,929	14,641	16,405	15,973	17,319	19,728
Key Balance Sheet Items (USDm) & Capital Ratios						
Risk-weighted assets	1,123,943	1,214,939	1,219,800	1,244,196	1,281,522	1,319,968
Interest-earning assets	1,657,569	1,702,755	1,822,267	1,805,735	1,905,293	2,006,248
Customer Loans	1,001,522	992,089	974,660	975,411	1,019,068	1,073,065
Total Deposits	1,340,014	1,361,297	1,350,642	1,351,682	1,412,180	1,487,007
Stated Shareholder Equity	167,360	174,615	177,510	177,877	186,034	198,867
Equals: Tangible Equity	137,507	144,697	149,933	151,236	160,329	174,098
Tier 1 capital	151,048	158,155	152,739	162,417	173,325	188,964
Tier 1 ratio (%)	13	13	13	13	14	14
o/w core tier 1 capital ratio (%)	12.3	12.3	10.9	11.3	11.7	12.4
Credit Quality						
Gross NPLs/Total Loans(%)	4.30	3.99	3.33	3.04	3.03	2.83
Risk Provisions/NPLs(%)	37	39	38	41	36	36
Bad debt / Avg loans (%)	0.84	0.59	0.39	0.34	0.35	0.34
Bad debt/Pre-Provision Profit(%)	32.7	22.4	19.3	15.6	14.6	11.8
Growth Rates & Key Ratios						
Growth in revenues (%)	-5	-5	-5	0	5	6
Growth in costs (%)	3	-10	7	-3	1	-6
Growth in bad debts (%)	-31	-30	-34	-15	6	3
Growth in RWA (%)	-7	8	0	2	3	3
Net int. margin (%)	2.32	2.13	1.94	1.96	1.97	2.00
Cap.-market rev. / Total revs (%)	32	32	32	33	33	33
Total loans / Total deposits (%)	75	73	72	72	72	72
ROTE Decomposition						
Revenue % ARWAs	5.86	5.53	5.03	4.96	5.09	5.25
Net interest revenue % ARWA	3.23	3.04	2.85	2.82	2.92	3.02
Non interest revenue % ARWA	2.63	2.49	2.18	2.14	2.17	2.23
Costs/income ratio (%)	62.8	59.6	67.3	65.6	63.0	55.8
Bad debts % ARWAs	0.71	0.50	0.32	0.27	0.27	0.27
Tax rate (%)	31.1	23.5	24.6	24.2	23.2	23.0
Adj. Attr. earnings % ARWA	1.15	1.05	1.14	1.15	1.28	1.43
Capital leverage (ARWA/Equity)	8.9	8.3	8.3	8.2	8.1	7.8
ROTE (Adj. earnings/Ave. equity)	10.2	8.7	9.4	9.4	10.4	11.1

Source: Company data, Deutsche Bank estimates

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Changing world, changing plan

Investor update 2015

HSBC held its Investor Update 2015 on June 9th 2015, which gave considerable additional detail behind previously announced targets for 2017 (laid out in Figure 1). Presentations from the company are available here.

Figure 1: HSBC targets for 2017

ROE	>10%
Cost	Positive jaws in 2015,2016,2017 2017 exit run rate costs flat vs 2014 (adjusted) Cost of achieve of $4.0-4.5bn
Dividend	Progressive

Source: Company data

CEO Gulliver announced 10 actions for changing the bank by 2017 (Figure 2), which include exiting Turkey and Brazil, reducing RWAs by $290bn (primarily in GBM), setting up a UK-ring-fenced bank headquartered in Birmingham, and reviewing the location of the Holding company for HSBC by the end of 2015.

Figure 2: HSBC 10 actions

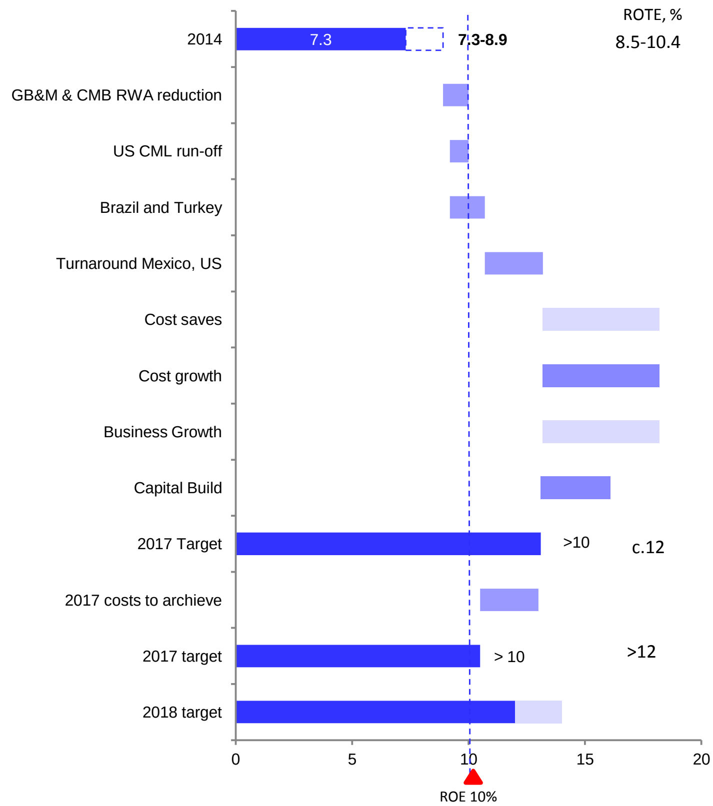
	Action	Targeted outcome by 2017
1	Reduce Group RWAs by US$290bn (at least 25% of RWAs) by reducing the size of GB&M by US$140bn, selling Brazil / Turkey, redeploying towards higher performing businesses	GBM to be <1/3 profitability
2	Sell operations in Turkey and Brazil, maintain a presence in Brazil for large corporate clients with international needs; continue to use the 6 filter process	Reduce footprint
3	Rebuild profitability in Mexico and North America	Targeting US PBT of US$2bn; Mexico PBT of US$0.6bn
4	Set up a UK ring-fenced bank headquartered in Birmingham	Completed by 2018
5	Deliver US$4.5-5bn of cost savings	2017 exit rate = operating expenses
6	Deliver revenue growth above GBP from international network	Revenue growth of international network > GDP
7	Capture growth opportunities in Asia, particularly in Pearl River Delta, ASEAN, Asset Management, Insurance	Market share gains c.10% growth per annum for AUM in Asia
8	Grow RMB business and extend global leadership position	US$ 2-2.5bn revenue
9	Complete implementation of Global Standards	Completed
10	Review location of Holding Company	Complete review by end of 2015

Source: Company presentation

These actions, shown in an RoE-walk in Figure 3 are designed to see the RoE rise from 7.3% in 2014 (8.9% ex significant items / FX translation) to over 10%

RoE / 12% RoTE (either when excluding or including the CTA / CML run off for 2017). Beyond that, 2018 is expected to build to a higher RoE.

Figure 3: Group RoE (%) walk from 2014 to 2017



Source: Company presentation

This note walks through the key changes announced and assesses the implied impact on profitability going forward.

Key conclusions

1. Targets imply US$25.5bn of pre-associate PBT

- **Adjusting for the sale of Brazil, Turkey, CMB, GBM, US CML run-off** and other management actions, we estimate adjusted PBT (ex-associates) of $19.3bn, around 1% lower than the adjusted 2014 ex-associates PBT (loss of GBM and US CML PBT partially offset by the removal of Brazil / Turkey losses). Rolling forward the changes and targets, we estimate $25.5bn of pre-associate PBT / $27.3bn PBT including associates.

2. Mgmt actions on exit businesses alone should deliver the RoRWA target

- Post-exits 2014 PBT of $19.3bn on $755bn of RWAs is **an RoRWA which is already above the 2.3% target**, even when adding in associate RWAs and PBT. In other words, the business exits and management actions alone should take HSBC's RoRWA above the target.

3. Implied shape of the P&L is strikingly different to consensus expectations

- Adjusted PBT (incl. associates) implied from the plan for 2017 is around $1.8bn / 7% ahead of pre-investor day consensus. But what is particularly striking **how significantly different the P&L mix is**: implied 2017 revenues are $7bn / 12% below consensus, and costs $8bn / 26% below.

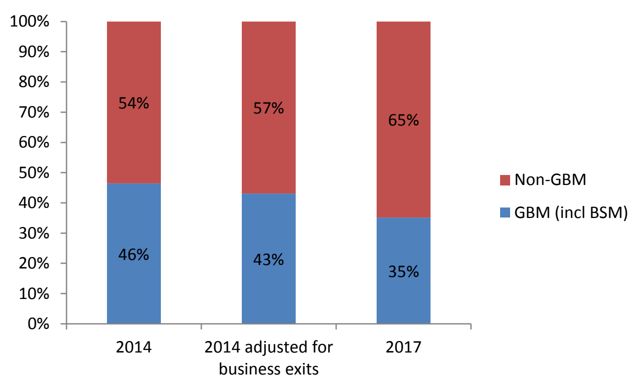
4. Hitting targets should mean excess capital

- Within this report we also estimate the roll forward on HSBC's capital stock. Taking into account losses on business exits (we assume it achieves 0.8x book value for Turkey / Brazil, worth ~60bps on 1Q15 CET1), CTA charges, planned RWA redeployment, and an assumed $50bn of regulatory RWA inflation we estimate implied CET1 of 13.5% at 2017.
- This represents $154bn of RWA buffer / $18bn of excess CET1 at the lower end of the 12-13% CET1 target, or $50bn RWAs / $6bn of excess CET1 at the higher end (in excess of a progressive dividend, but before any litigation / redress charges). This represents a potential additional yield of 4-10% if all returned to shareholders over time.

5. Business mix: GBM RWAs will shrink, but PBT mix broadly unchanged

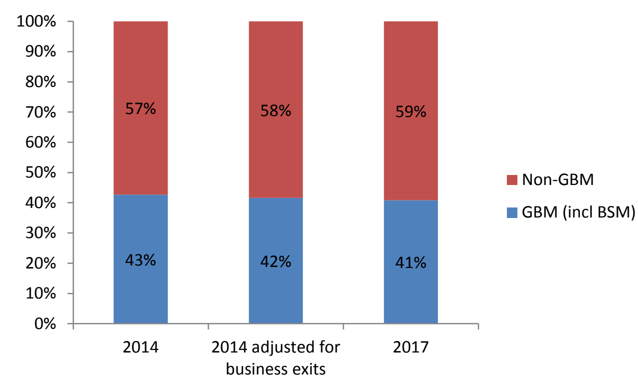
- Management are planning to reduce GBM RWAs from the 2014 level, targeting <1/3 for client-facing (non-BSM) GBM RWAs in 2017. We estimate this is around 35% when including BSM (Figure 4). This sees non-GBM become around 2/3 of the bank. However in terms of expected PBT, the targets set out do not, we think, imply a similar change in mix: GBM still represents ~41% of the implied 2017 PBT (ex associates) down from 43% in 2014 (Figure 5).

Figure 4: RWA (ex associates) mix change



Source: Deutsche Bank estimates, company data

Figure 5: Adjusted PBT (ex associates) mix change



Source: Deutsche Bank estimates, company data

- **We are sceptical as to how HSBC can generate an additional $2bn of PBT from lower RWAs** within GBM (expressed in terms of redeployed RWAs this implies incremental business at 6.5% RoRWA).

Figure 6: Increase vs. 2014 and 2014 adjusted for business exits

		RWAs	Income	Operating expenses	PPP	Loan losses	Adjusted PBT ex-associates
2017 implied vs. 2014	GBM	-27%	7%	-3%	18%	-19%	**20%**
	Non-GBM	17%	2%	-12%	27%	18%	**30%**
	Group	**-3%**	**3%**	**-10%**	**24%**	**14%**	**26%**
2017 implied vs. 2014 adj for business exits	GBM	9%	13%	2%	25%	79%	**24%**
	Non-GBM	52%	16%	2%	39%	95%	**28%**
	Group	**34%**	**15%**	**2%**	**34%**	**94%**	**27%**

Source: Deutsche Bank estimates

- Even adjusting for business exits this implies 13% additional income from 9% of new/redeployed RWAs. The reverse is true for non-GBM: RWA growth (~$175bn target) far exceeds income, and PBT growth (Figure 6).

6. Market likely to remain sceptical on costs

- Consensus and DBe estimates currently have costs well ahead of the targeted $32bn. Some may be swayed by the high level of helpful detail that HSBC provided in the presentation, but we expect the market to remain sceptical in the near term given 2 issues:
- Firstly, **HSBC's track record on cost control has not been strong.** Though part of it was out of their control (the UK bank levy) the previous cost plan failed to hit cost targets. On our analysis, HSBC was one of few banks in Europe that actually saw costs rise after launching a cost plan, with revenues lower than before. Nevertheless the level of new detail is impressive, and we expect that management will be extremely focused on curbing cost inflation in HSBC and changing perceptions around cost control.
- Secondly, though cost jaws are expected to be positive in 2015, 2016 and 2017, **costs will rise before they fall** – and are expected to peak in 2016. We lack interim targets for costs so at this stage it is not clear how the market will be able to track whether 2015 costs (which will be higher than 2014) are ahead or behind the new 2017 run rate cost target.

7. Regulation: 'Basel 4' and its implications for HSBC

- HSBC included an overview of a number of regulatory issues in its investor presentation, and highlighted an unquantified amount of potential RWA inflation on its slides as well as a management and regulatory buffer in CET1 of 1.5-2.5%. We assume these are offsetting to some degree (ie the management buffer has some conservatism for RWAs) and use $50bn of assumed regulatory RWA inflation in our analysis in this report. We estimate each $10bn of additional RWAs equates to around ~$230m of required additional revenues in order to maintain the same RoRWA.
- On 17/6/2015 we wrote a comprehensive report on new regulatory proposals called 'Basel 4: Truth and advertising'. The full report is available here. We estimate potential additional RWAs of $127bn, driven primarily by operational risk (though we note that the company thinks the operational increase will be manageable).
- One unclear issue at present is how the risk weighting rules will interact with the ring-fencing rules in the UK. HSBC currently has a very low IRB risk weight on UK mortgages (7% in 2013), and revealed at the investor day that the ring fenced bank will be ~$230bn (of which around half would be mortgages). Moving to a standardized floor of say 25% could see an additional ~$20bn of RWAs for the subsidiary vs. within the group at present.

Overall, we think that HSBC's investor day set out clear ambition for HSBC's strategy, particularly on costs (far lower than consensus expectations), and RWA allocation from GBM to non-GBM. However questions remain over whether this cost control can be achieved, how GBM profitability can sustainably rise whilst RWAs fall, and the overall phasing/timing of all of these changes announced. Capital should rise as Brazil / Turkey is sold, but costs will only peak in 2016, and meanwhile the bank will be exiting revenue generating businesses during 2015/16, with an implied downgrade to consensus revenue expectations of 11% / $7bn in 2017. Overall group revenue and cost improvements appear back-ended to 2017 in our view.

Forecast changes

At this stage we keep our forecasts unchanged, though we will keep these under review given the large difference in shape of P&L between the 2017 plan and our estimates (though overall implied PBT is broadly in line with our forecasts). This leaves the bank trading at 10.7x 2016 earnings, 1.2x TNAV for an 9.5% RoE and a 5.5% dividend yield. This is broadly in line with the European banking universe trading at 10.9x 2016 P/E, 1.1x TNAV for a 9.0% RoE and 4.6% dividend yield.

Figure 7: Forecast changes

	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015e	2016e	2017e
EPS (Stated)	141	166	49	34	73	92	75	84	69	69	75	98
EPS (Adj.)	136	148	116	70	90	79	93	78	86	82	87	97
YoY % growth	n/a	9%	-21%	-39%	28%	-13%	18%	-15%	10%	-5%	6%	12%
DPS	81	90	64	34	36	41	45	49	50	51	51	52
Payout ratio (stated)	58%	54%	132%	99%	49%	45%	60%	58%	72%	73%	68%	53%
Payout ratio (adj.)	59%	61%	55%	48%	40%	52%	49%	62%	58%	62%	59%	54%
Period end share price (HKD)	88.4	85.7	51.2	70.0	64.5	49.8	71.8	77.7	71.6	72.4	72.4	72.4
Market cap (HK$ bn)	1,022	1,014	620	1,218	1,141	890	1,327	1,463	1,376	1,419	1,448	1,477
Shares	11,572	11,829	12,105	17,408	17,686	17,868	18,476	18,830	19,218	19,602	19,994	20,394
TNAV p.s.	614	748	533	565	675	700	744	768	780	772	802	854
NAV p.s.	936	1,083	758	737	802	863	906	927	924	907	930	975
P/E (Adjusted)	6.9	6.3	8.0	13.3	10.4	11.9	10.1	11.9	10.8	11.4	10.7	9.6
Dividend yield (%)	8.7%	9.6%	6.9%	3.6%	3.9%	4.4%	4.8%	5.2%	5.4%	5.4%	5.5%	5.6%
P/TBVPS	1.5	1.2	1.8	1.7	1.4	1.3	1.3	1.2	1.2	1.2	1.2	1.1
P/BVPS	1.0	0.9	1.2	1.3	1.2	1.1	1.0	1.0	1.0	1.0	1.0	1.0
ROE (Adj.)	15.4%	14.6%	12.6%	10.5%	11.8%	9.5%	10.5%	8.6%	9.3%	9.0%	9.5%	10.3%
ROTE	23.6%	21.6%	18.1%	14.2%	14.6%	11.5%	12.9%	10.4%	11.1%	10.6%	11.1%	11.8%
Basel 3 Core tier 1	n/a	n/a	n/a	n/a	9.3%	9.0%	9.0%	9.9%	11.1%	11.5%	11.9%	12.6%
Common equity t1 leverage	n/a	n/a	n/a	n/a	n/a	n/a	4.2%	4.4%	4.6%	4.9%	5.3%	5.6%
Tier 1 leverage	n/a	n/a	n/a	n/a	n/a	n/a	4.2%	4.4%	4.8%	5.2%	5.7%	6.0%

Source: Deutsche Bank estimates, company data, cable at 1.59, priced at 580p.

Valuation & Risks

Given the disparate earnings drivers, and varied growth and volatility of earnings of HSBC's divisions, we value the group using a sum-of-the-parts approach. In this valuation we apply fair P/E, or where the division is loss-making, P/B, multiples to our 2016 divisional forecasts. These multiples are set with reference to the current market valuations for pure-play peers, taking into account the expected differences in earnings growth and volatility - higher multiples for higher growth or lower volatility divisions (Private Banking, for example), lower multiples for lower growth and higher volatility divisions (Global Banking & Markets, for example).

Our TP changes marginally to HK$69 from HK$68 on FX and TVM movements. Forecast cash dividends in 2015/16 are worth around 40p. With limited downside to the current shareprice, we retain Hold.

Figure 8: HSBC Sum of the Parts

	2016 PBT (US$'m)	2016e Earnings (US$'m)	RWAs (US$'m)	TNAV (FY15, US$'m)	ROTE (%)	P/E (15e)	P/TBVPS Multiple	Value (US$'m)	Value / share (HK$)	% of valuation	% of earnings
Retail Banking & Wealth	7,975	6,577	218,407	26,666	25%	13.0x	3.2x	85,496	34	47%	42%
Commercial Banking	8,912	7,349	447,880	54,682	13%	12.0x	1.6x	88,190	35	48%	47%
GBM	6,691	5,517	550,193	67,174	8%	9.0x	0.7x	49,655	20	27%	35%
Private Banking	603	497	22,237	2,715	18%	12.0x	2.2x	5,968	2	3%	3%
Earnings before mins, prefs	24,181	19,940	1,238,717	151,236	13%	11.5x	1.5x	229,309	91	125%	127%
Other	-2,835	-2,338	42,804	5,226	-45%	11.5x	n/a	-26,889	-11	-15%	-15%
Mins & Prefs	n/a	-1,911	0	0	0%	10.0x	n/a	-19,111	-8	-10%	-12%
Total	**21,345**	**15,691**	**1,281,522**	**156,462**	**10%**	**11.7x**	**1.2x**	**183,308**	**72**	**100%**	**100%**
Discounted back									**69**		

Source: Deutsche Bank estimates, company data

Key upside risks are an unexpected improvement in organic growth within the bank and lower than expected loan losses. Key downside risks relate to regulatory change and legacy liabilities.

Unpacking the investor day

Step 1: Calculating 2014 pro-forma for exit businesses

Figure 11 shows our estimate for getting to underlying 2014 PBT after removing run off / exit businesses.

- **FX impact**: these figures were given at the presentation / slides / backed-out from 1Q15 disclosures. This reduces adjusted PBT by around $0.7bn.
- **Associates**: $160bn of RWAs, and $2,532m PBT, disclosed.

This gives us adjusted PBT of $19,575m for the group, a RoRWA which is unchanged at 1.87%.

- **Brazil / Turkey:** these represent c.$70bn of RWAs, and management disclosed the revenues and operating expenses at $4.7bn and $3.6bn respectively. Using subsidiary accounts we estimate that the FX-adjusted impairment for figure was $1.2bn for Brazil, $0.2bn for Turkey, US$1,475m in total (Figure 9).
- **CMB / other management actions:** The investor day slides included reductions to CMB of $30bn in RWAs and $10bn in other management actions. We have no details on the potential revenues / operating expenses / loan losses associated with these, but we expect that these will have limited impact on the overall PBT. We include US$1bn charge in the capital roll-forward, discussed later.

This gives us an adjusted PBT ex-new business exits of $19,950m.

- **GBM management actions**: mgmt expects to reduce RWAs by c.$140bn, made up of $40bn from legacy credit, $60bn from markets (ex legacy credit), and $40bn from capital financing / GTRF). Revenue impact here is disclosed as $400m (though this will include an element of GBM Brazil / Turkey), with $100-200m of costs to come out from business and client exits. We assume no change to loan losses, and so expect adjusted PBT impact of $200-300m.
- **US CML run-off:** The bank is planning to reduce RWAs here by $40bn. Last year the US run-off portfolio generated PBT of US$569m, up strongly YoY due to reduced impairments and costs. Year end RWAs were $55bn, so HSBC is effectively reducing ~70% of the RWAs in the US CML business. For the purposes of our analysis we have assumed the same proportion of revenues, costs and loan losses come out of the business by 2017, which represents $340m PBT.

Putting this all together in Figure 11 we get an adjusted P&L which excludes the run off and exit businesses. This has $755bn of RWAs (in line with guidance) $52.8bn of revenues, $31.4bn of costs, $2.1bn of loan loses and adjusted non-associated PBT of $19.3bn, or $21,835m if including Associates.

Importantly this is within >2.3% Group adjusted target for 2017 RoRWA. In other words, exiting the businesses and taking management actions identified would result in a RoRWA >2.3% *before* growth in revenues from investment areas.

Figure 9: Impairments in Brazil / Turkey

	Brazil	Turkey	Total
LCY	3,547	567	
Average FX 2014	2.35	2.19	
Average FX 1Q15	2.85	2.46	
US$ 31/12/14	1,511	259	1,771
US$ 31/3/15	**1,245**	**230**	**1,475**
Change	**-266**	**-29**	**-295**

Source: Deutsche Bank estimates, company data

Figure 10: US CML run off P&L

	2013	2014
NII	2,061	1,390
Net fee income	11	-4
Other income	-400	-49
Net operating income	**1,672**	**1,337**
Costs	-1,166	-738
PPP	**506**	**599**
Impairments	-705	-30
Associates	-1	0
PBT	**-200**	**569**
RoRWA	-0.20%	0.8%
RWAs	**78.6**	**55.1**

Source: Company annual report

Figure 11: Getting to underlying group

Group	RWAs bn	Income	Operating expenses	PPP	Loan losses	Associates	Adjusted PBT	RoRWAs
2014	**1,220**	**62,002**	**37,854**	**24,148**	**3,851**	**2,532**	**22,829**	**1.9%**
FX	-15	-3,300	-2,300	-1,000	-220	n/a	-722	4.8%
Associates	-160	0	0	0	0	-2,532	-2,532	1.6%
2014 FX adjusted ex-Associates	**1,045**	**58,702**	**35,554**	**23,148**	**3,631**	**0**	**19,575**	**1.9%**
Brazil & Turkey exit	70	4,700	3,600	1,100	1,445	0	-375	-0.5%
CMB / other management actions	40	n/a	n/a	n/a	n/a	n/a	n/a	n/a
2014 proforma ex-Brazil / Turkey	**935**	**54,002**	**31,954**	**22,048**	**2,156**	**0**	**19,950**	**2.1%**
GBM management actions	140	400	150	250	0	0	250	0.2%
US CML run-off	40	798	441	358	18	0	340	1.0%
2014 proforma ex-runoff/exit businesses	**755**	**52,804**	**31,363**	**21,440**	**2,138**	**0**	**19,303**	**2.6%**
Add back associates	**915**	**52,804**	**31,363**	**21,440**	**2,138**	**2,138**	**21,835**	**2.4%**

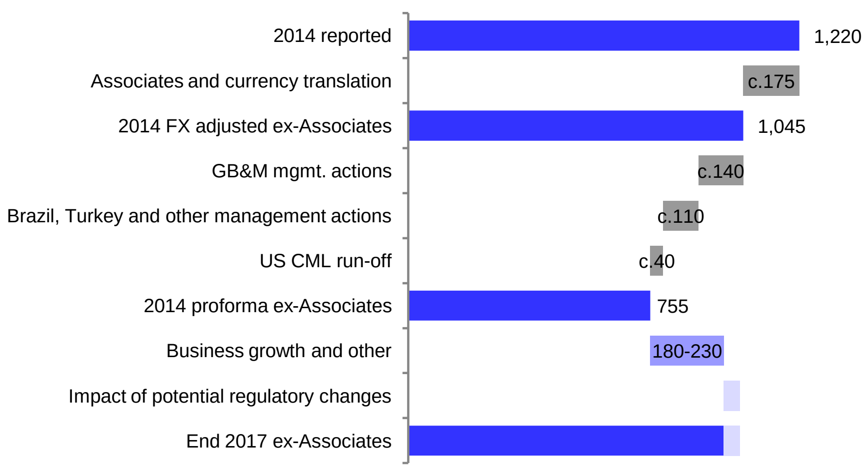
Source: Deutsche Bank estimates, company data. RoRWA calculated on static RWAs where not possible to estimate average

Step 2: Rolling forward for RWA growth and P&L guidance

Taking this 2014 pro-forma figure, we can now roll-forward for company guidance on costs, RWA growth and loan losses.

- **Costs**: Guidance is for to be flat vs. the 2014 FX/Brazil/Turkey adjusted level ($32bn).
- **RWA growth**: management are targeting US$180-230bn of additional RWA growth / redeployment mainly in non-GBM areas. The slides on GBM imply c.$30bn of additional RWAs here, so taking the midpoint ($205bn), this implies around $175bn of RWA growth in non-GBM businesses. We then assume $50bn of additional RWAs for regulatory increases (covered in more detail later). The RWA walk is represented graphically by the company in the presentation (Figure 12).

Figure 12: RWA forward walk (US$bn)



Source: Deutsche Bank estimates, company data

- **Loan losses**: loan losses for the group were $3.6bn, but around $1.5bn of this was in Brazil / Turkey. However, we think that loan losses are likely to be cyclically low, and so for conservatism we assume that these rise to around $4bn in 2017.

- **Other impacts**: TLAC costs are estimated to be US$200-300m per annum according to the company, for compliance at 21% level. We include the midpoint of this (US$250m).
- **Associates**: guidance is for these RWAs to increase from $160bn to $180bn in 2017. We assume the RoRWA in 2014 (1.6%) remains constant, leading to associate income of US$2.8bn.

Given end point RWAs of $1,190bn, and a target of >2.3% RoRWAs, we can back out that adjusted PBT is expected to be >US$27.3bn (we use an average RWAs for RoRWA calculation on our assumption of phasing of group RWA movement from 2014-17, Figure 13).

- Ex-associates this represents US$24.5bn PBT, an increase of US$5.2bn on 2014 pro-forma levels.
- Given our assumptions for LLPs, guidance for costs ($32bn), we can back out the implied revenue increase at US$8.1bn (US$7.8bn net of the TLAC issuance costs).
- Interestingly, on incremental RWAs of US$255bn this incremental PBT represents RoRWA of below target for the new business (i.e. new/redeployed business is dilutive to returns vs removing the old business altogether).

Figure 13: DB assumptions on RWA phasing

Year	GBM	Associates	Non-GBM	Total
2014	485	160	575	**1,220**
2015	433	167	503	**1,103**
2016	386	173	580	**1,139**
2017	355	180	655	**1,190**

Source: Deutsche Bank estimates, company data

Figure 14: Getting to 2017 estimates

Group	RWAs bn	Income	Operating expenses	PPP	Loan losses	Associates	Adjusted PBT	RoRWAs
2014 proforma ex-runoff/exit businesses	755	52,804	31,363	21,440	2,138	0	19,303	2.6%
Cost changes								
Productivity saves			-350					
Technology and operations			-550					
Digital / Automation / Productivity			-3,850					
Inflation			2,650					
Incremental growth			1,500					
Compliance			100					
Bank levy			500					
Net cost changes			0					
RWA growth								
RWA growth								
GBM RWA growth	30							
Non-GBM RWA growth	170							
Regulatory increases	50							
Other changes								
Normalisation of loan losses					2,000			
TLAC costs		-250						
Implied underlying growth	255	8,079	637	7,219	2,000	0	5,192	2.0%
2017 (ex-associates) exit-run rate	1,010	60,632	32,000	28,632	4,138	0	24,495	2.4%
Associates	180	0	0	0	0	2,796	2,796	1.6%
2017 implied exit-run rate	1,190	60,632	32,000	28,632	4,138	2,796	27,290	2.3%

Source: Deutsche Bank estimates, company data. Assumed RoRWA on static RWAs

How does this 2017 implied PBT compare to consensus and DBe?

We show in Figure 15 the company consensus (4/6/2015) and current DB estimates vs. the 2017 implied level. This reveals a consensus forecast for 2017 which is around 7% lower than that implied by the company targets (on a 2.3% RoRWA); whilst DB forecasts PBT for 2017 (US$27.8bn) which is around 2% ahead of target.

What is more interesting though, is just how significantly different the shape of the P&L is from consensus and DBe: **revenues are expected to be 12-13% / US$7-8bn lower, and costs 19-26% / US$6-8bn lower.** This is a fundamental realignment of operational mix.

Figure 15: How does this compare to consensus and DB estimates

Group	RWAs bn	Income	Operating expenses	PPP	Loan losses	Associates	Adjusted PBT	RoRWAs
2017 exit run-rate implied	**1,190**	**60,632**	**32,000**	**28,632**	**4,138**	**2,796**	**27,290**	**2.3%**
Consensus	**n/a**	**67,626**	**40,345**	**27,281**	**4,308**	**2,462**	**25,436**	
Consensus $ difference	n/a	6,994	8,345	-1,351	170	-334	-1,854	
Consensus % difference	n/a	12%	26%	-5%	4%	-12%	-7%	
DBe	**1,300**	**68,326**	**38,158**	**30,168**	**3,557**	**1,152**	**27,763**	**2.1%**
DBe $ difference	-110	7,694	6,158	1,536	-581	-1,644	473	
DBe % difference	-8%	13%	19%	5%	-14%	-59%	2%	

Source: Deutsche Bank estimates, company consensus 4/6/2015

What is the gearing to regulatory RWA inflation for RoRWA?

We show in Figure 16 the combination of different regulatory inflation estimates on RoRWA, and the required increase in revenues. This shows that on an assumption of zero regulatory inflation, US$6.9bn of additional revenues is needed. Each $10bn of additional RWAs equates to around $230m of additional revenues required to maintain the same RoRWAs (assuming everything else unchanged).

Figure 16: Computing the implications on revenue growth from higher RoRWA / regulatory RWA requirements

		Group RoRWA (>2.3% target)											
		1.8%	1.9%	2.0%	2.1%	2.2%	2.3%	2.4%	2.5%	2.6%	2.7%	2.8%	2.9%
Regulatory inflation (US$bn)	0	0.9	2.0	3.1	4.2	5.3	6.9	7.5	8.7	9.8	10.9	12.0	13.1
	10	1.0	2.2	3.3	4.4	5.5	7.1	7.8	8.9	10.0	11.2	12.3	13.4
	20	1.2	2.3	3.5	4.6	5.8	7.4	8.0	9.2	10.3	11.4	12.6	13.7
	30	1.4	2.5	3.7	4.8	6.0	7.6	8.3	9.4	10.5	11.7	12.8	14.0
	40	1.6	2.7	3.9	5.0	6.2	7.8	8.5	9.7	10.8	12.0	13.1	14.3
	50	1.8	2.9	4.1	5.2	6.4	8.1	8.7	9.9	11.1	12.2	13.4	14.6
	60	1.9	3.1	4.3	5.5	6.6	8.3	9.0	10.2	11.3	12.5	13.7	14.9
	70	2.1	3.3	4.5	5.7	6.9	8.5	9.2	10.4	11.6	12.8	14.0	15.1
	80	2.3	3.5	4.7	5.9	7.1	8.8	9.5	10.7	11.8	13.0	14.2	15.4
	90	2.5	3.7	4.9	6.1	7.3	9.0	9.7	10.9	12.1	13.3	14.5	15.7
	100	2.7	3.9	5.1	6.3	7.5	9.3	9.9	11.2	12.4	13.6	14.8	16.0
	110	2.8	4.1	5.3	6.5	7.7	9.5	10.2	11.4	12.6	13.9	15.1	16.3
	120	3.0	4.2	5.5	6.7	8.0	9.7	10.4	11.7	12.9	14.1	15.4	16.6
	130	3.2	4.4	5.7	6.9	8.2	10.0	10.7	11.9	13.1	14.4	15.6	16.9
	140	3.4	4.6	5.9	7.1	8.4	10.2	10.9	12.2	13.4	14.7	15.9	17.2

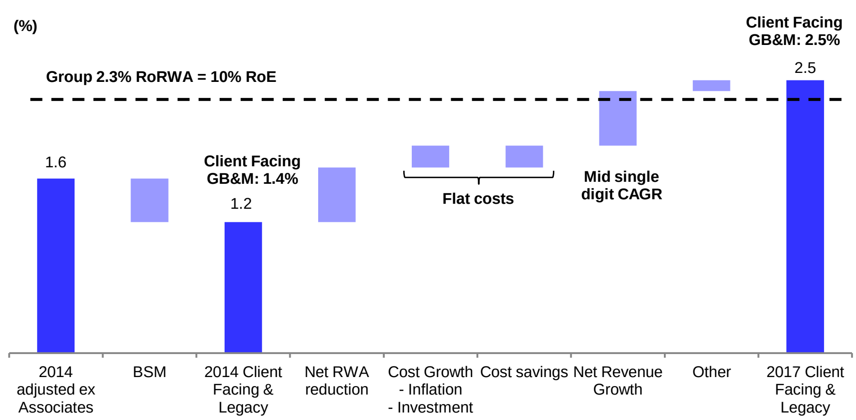
Source: Deutsche Bank estimates. Heighted cell corresponds to the incremental revenue calculated in Figure 14

Step 3: Backing out GBM from guidance

Now we have estimated the total group forecasts for 2016, we can back out the mix between GBM and non-GBM businesses. First, taking GBM:

- **Adjusted PBT:** 2.7% targeted RoRWA (including BSM, 2.5% excluding as shown in Figure 17) on guided average RWAs (US$316bn in 2016, US$285bn in 2017 = average $300bn + BSM of $70bn) gives $10bn of adjusted PBT.

Figure 17: HSBC Return on RWAs target for GBM



Source: Company presentation

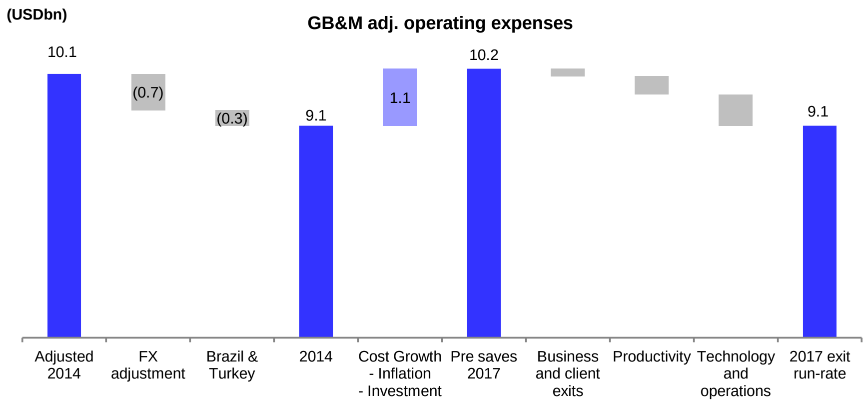
- **Income** was $18.1bn adjusted for FX at 2014. Guidance is for around $400m of revenue impact from the $140bn reduction in RWAs. We also know from looking at HSBC Brazil accounts (Figure 18) that the GBM segment made around US$0.5bn of revenue in 2014 (FX adjusted). If we assume all of this will be lost and that Turkey GBM income is negligible, then GBM revenue ex Brazil, Turkey and GBM management actions is US$17.2bn. Guidance of mid-single digit revenue growth (say 5%) from this base would put 2017 revenues at $19.4bn, an increase of 13% / $2.2bn on 2014 adjusted levels. The company is pointing to a revenue target in 2017 from RMBI of US$2-2.5bn which is around $0.3-0.8bn higher than current levels, which represents 14-30% of the GBM revenue increase.
- **Costs:** company guidance from the GBM presentation shows that operating expenses were US$9.4bn in 2014 after adjusting for FX (Figure 19). Management actions for 'Business and Client Exits' are expected to generate $100-200m of 2017 exit run rate savings. We use the mid-point $150m. Brazil/Turkey: guidance is that this represents US$0.3bn of costs – implying around US$60m for Turkey when compared with the Brazil P&L in Figure 18. Solving for US$9.1bn 2017 exit run-rate costs gives us $150m of cost increases from elsewhere (keeping costs flat on 2014).

Figure 18: HSBC GBM Brazil

millions	BRL	US$ 1Q15 FX rates
Net interest income	629	221
Net fee income	152	53
Net trading income	625	220
Other income	117	41
Net operating income	**1,524**	**535**
Costs	-687	-241
PPP	**837**	**294**
Loan impairments	-573	-201
PBT	**264**	**93**

Source: Deutsche Bank estimates, company data

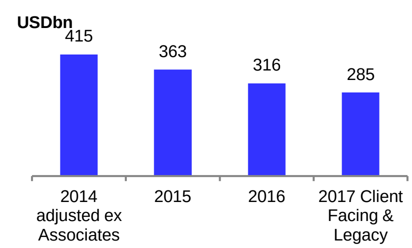
Figure 19: GBM adj operating expenses



Source: Company presentation

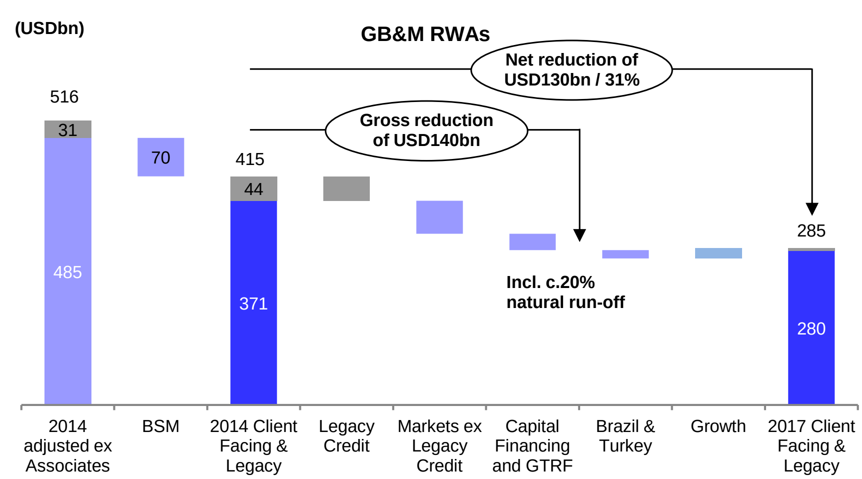
- **Loan losses:** last year Brazil GBM had US$201m of loan impairments (Figure 18). Backing this out would take the implied loan losses to around $0.3bn with an increase of around $130m.
- **Risk weighted assets:** Figure 21 and Figure 20 show the guidance given in the GBM presentation for RWAs going forward. $415bn of client facing RWAs fall by $140bn gross, a further $20bn when including Brazil / Turkey, but end at $285bn, which implies $30bn of RWA growth. Phasing of RWAs over time is shown in Figure 20. We have used the average of 2016 and 2017 RWAs to estimate the PBT from RoRWA at 2.7%.

Figure 20: RWA phasing



Source: Company presentation

Figure 21: GBM RWAs



Source: Company presentation

As with the group figures, the GBM adjusted PBT forecast is not hugely out of line with DB forecasts, but the shape of the P&L is again difference: with revenues implied 9% lower, and costs 15% lower.

Figure 22: GBM 2017 implied (ex-associates)

US$m	RWAs bn	Income	Operating expenses	PPP	Loan losses	Adjusted PBT	RoRWAs
2014 adjusted	**485**	**18,100**	**9,400**	**8,700**	**365**	**8,335**	**1.7%**
GBM management actions	140	400	150	250	0	250	0.2%
Brazil / Turkey	20	535	300	294	201	53	0.3%
2014 ex GBM run off	**325**	**17,165**	**8,950**	**8,156**	**164**	**8,032**	**2.5%**
Mid-digit revenue growth (assume 5%)		2,233					
Net cost / LLP movement			150		130		
Net RWA changes	30						
2017 exit run-rate implied	**355**	**19,398**	**9,100**	**10,298**	**294**	**10,004**	**2.7%**
% change	9%	13%	2%	25%	79%	24%	
$ change	30	2,233	150	2,083	130	1,953	
DB 2017 estimate	**n/a**	**21,073**	**10,423**	**10,650**	**343**	**10,307**	**n/a**
DB vs. 2017 implied	n/a	9%	15%	3%	17%	3%	

Source: Deutsche Bank estimates, company data

Step 4: Backing out non-GBM guidance

Now we have the group and the GBM estimate, we can back out the non-GBM element. Again we back out the non-GBM Brazil / Turkey elements, and the US CML lost revenue. This gives us implied revenues of $41.3bn, costs of $22.9bn, and loan losses of $3.8bn.

Figure 23: Non-GBM 2017 implied (ex-associates)

US$m	RWAs bn	Income	Operating expenses	PPP	Loan losses	Adjusted PBT	RoRWAs
2014 adjusted	**560**	**40,602**	**26,154**	**14,448**	**3,266**	**11,240**	**2.0%**
Brazil / Turkey non-GBM	50	4,165	3,300	865	1,274	-409	-0.8%
US CML	40	798	441	358	18	340	0.8%
CMB / other management actions	40	n/a	n/a	n/a	n/a	n/a	n/a
2014 proforma ex-Brazil / Turkey	**430**	**35,639**	**22,413**	**13,225**	**1,974**	**11,310**	**2.4%**
RWA growth (growth + regulation)	225						
2017 exit run-rate implied	**655**	**41,235**	**22,900**	**18,335**	**3,843**	**14,491**	**2.3%**
% change	39%	16%	2%	39%	95%	28%	
$ change	225	5,596	487	5,109	1,870	3,181	1.8%

Source: Deutsche Bank estimates, company data, 2017 uses an average for RWA roll forward from Figure 13

Adjusted PBT of $14.5bn implies 2.3% of return on average risk weighted assets. The incremental RWA growth of $225bn is at around 1.8% (but this has been deflated by the US$50bn of regulatory RWAs we assume in our figures). The company gave a matrix of expected adjusted RoRWA returns in 2017 by division (Figure 24). Interestingly, all of these different divisions have a higher RoRWA target for 2017 than the 2.3% average we have backed out from the disclosures.

Figure 24: HSBC investment and returns matrix

		2014 RoRWA	2014-17 RoRWA drivers: Revenue	Operating expenses (exit run rate)	RWA impact	Continued application of 6 filters	2017E RoRWA
Global Business adjusted returns	**RBWM** ex US CML run-off ex Associates	4.8%	Grow	Maintain	Invest	Positive impact	6.3%
	CMB ex Associates	2.3%		Invest	Invest	Positive impact	2.7%
	GB&M ex Legacy ex Associates	1.7% (1.4% excl. BSM)		Maintain	Reduce	Limited	2.7% (2.5% excl. BSM)
	GPB ex Associates	3.4%		Maintain	Reduce	Limited	4.3%
Associates, run-off portfolios and "Other" Global Business							
Group, adjusted		1.9%	Grow	Maintain	Reduce	Positive impact	>2.3%

Source: Company presentation

Some of the performance may be lost in the run off CMB business ($30bn RWAs) other management actions ($10bn RWAs). We estimate that the HSBC 'Other' business line (which lost an underlying $1.6bn PBT last year), is a drag of around 50bps on RoRWAs (1Q15 RWAs were $37bn). But even excluding this, we have RoRWA at 2.8% for non-GBM business – which looks low vs. Figure 24.

Figure 25: 'Other' division is about 40bps drag on the non-GBM divisions

	RWAs bn	Income	Operating expenses	PPP	Loan losses	Adjusted PBT	RoRWAs
Non-GBM 2017 implied	655	41,235	22,900	18,335	3,843	14,491	2.3%
'Other' division (1Q15 RWAs, 2014 PBT)	36.7	5,863	7,429	-1,566	0	-1,560	-4.3%
'Non-other non-GBM' approximation	618	35,372	15,471	19,901	3,843	16,051	2.8%

Source: Deutsche Bank estimates, company data

The implication appears to be that if the divisions produce close to targeted RoRWAs, then the group adjusted RoRWA should be well above the 2.3% target. Below we show the combinations and outcomes from a given GBM RoRWA (2.7% target including BSM), and Group RoRWA target (>2.3% target) upon the non-GBM (and adjusted to exclude effects of 'other' division) RoRWA.

The gearing to RoRWA in the non-GBM business: each 20bps of improved non-GBM RoRWA performance is worth about 10bps at the group level.

Figure 26: Computing the implications for RoRWA from non-GBM business (adjusting for 'other division')

		Group RoRWA (>2.3% target)											
US$m		1.80%	1.90%	2.00%	2.10%	2.20%	2.30%	2.40%	2.50%	2.60%	2.70%	2.80%	2.90%
GBM RoRWA (2.7% target)	1.8%	2.2%	2.4%	2.6%	2.9%	3.1%	3.3%	3.5%	3.7%	3.9%	4.1%	4.3%	4.5%
	1.9%	2.2%	2.4%	2.6%	2.8%	3.0%	3.3%	3.4%	3.6%	3.8%	4.0%	4.2%	4.4%
	2.0%	2.1%	2.3%	2.5%	2.7%	2.9%	3.2%	3.3%	3.5%	3.7%	3.9%	4.1%	4.3%
	2.1%	2.1%	2.3%	2.5%	2.7%	2.9%	3.1%	3.3%	3.5%	3.7%	3.9%	4.1%	4.3%
	2.2%	2.0%	2.2%	2.4%	2.6%	2.8%	3.1%	3.2%	3.4%	3.6%	3.8%	4.0%	4.2%
	2.3%	1.9%	2.1%	2.3%	2.5%	2.7%	3.0%	3.1%	3.3%	3.5%	3.7%	3.9%	4.1%
	2.4%	1.9%	2.1%	2.3%	2.5%	2.7%	3.0%	3.1%	3.3%	3.5%	3.7%	3.9%	4.1%
	2.5%	1.8%	2.0%	2.2%	2.4%	2.6%	2.9%	3.0%	3.2%	3.4%	3.6%	3.8%	4.0%
	2.6%	1.7%	1.9%	2.1%	2.3%	2.5%	2.8%	2.9%	3.1%	3.3%	3.5%	3.7%	3.9%
	2.7%	1.7%	1.9%	2.1%	2.3%	2.5%	2.8%	2.9%	3.1%	3.3%	3.5%	3.7%	3.9%
	2.8%	1.6%	1.8%	2.0%	2.2%	2.4%	2.7%	2.8%	3.0%	3.2%	3.4%	3.6%	3.8%
	2.9%	1.5%	1.7%	1.9%	2.1%	2.3%	2.6%	2.7%	3.0%	3.2%	3.4%	3.6%	3.8%
	3.0%	1.5%	1.7%	1.9%	2.1%	2.3%	2.6%	2.7%	2.9%	3.1%	3.3%	3.5%	3.7%
	3.1%	1.4%	1.6%	1.8%	2.0%	2.2%	2.5%	2.6%	2.8%	3.0%	3.2%	3.4%	3.6%
	3.2%	1.4%	1.6%	1.8%	2.0%	2.2%	2.4%	2.6%	2.8%	3.0%	3.2%	3.4%	3.6%
	3.3%	1.3%	1.5%	1.7%	1.9%	2.1%	2.4%	2.5%	2.7%	2.9%	3.1%	3.3%	3.5%

Source: Deutsche Bank estimates. Highlighted cell corresponds to the incremental revenue calculated in Figure 14

Step 5: rolling forward the capital base

Now we can roll forward the capital base of HSBC to take into account the various impacts highlighted in the investor day. Firstly there is the sale of Turkey and Brazil. Last year both were loss making but they may have a strategic value to an acquirer (press reports suggest ING, BNPP and Arab Banking Corp have submitted bids for the Turkish business)[1]

The businesses combined had around $70bn of RWAs at the group level (though subsidiary accounts appear ~$25bn lower likely to a group level add-on). Equity, on 1Q15 FX rates was $3.3bn in HSBC Brazil, and $1.6bn for HSBC Turkey at 2014. From this we can compute an estimated impact on HSBC's CET1 ratio of the sale. Given the size of the business and RWAs, the CET1 improvement is more geared to Brazil. We show a combination of outcomes in Figure 27.

[1] http://www.reuters.com/article/2015/05/29/hsbc-ma-turkey-idUSL5N0YK1Y420150529

Figure 27: Impact on HSBC group CET1 ratio from combination of Turkey and Brazil sale multiples

		Turkey multiple of book (2014 FX adj)												
		0.2x	0.3x	0.4x	0.5x	0.6x	0.7x	0.8x	0.9x	1.0x	1.1x	1.2x	1.3x	1.4x
Brazil multiple of book	0.2x	0.33%	0.35%	0.36%	0.37%	0.39%	0.40%	0.42%	0.43%	0.44%	0.46%	0.47%	0.48%	0.50%
(2014 FX adj)	0.3x	0.36%	0.38%	0.39%	0.40%	0.42%	0.43%	0.44%	0.46%	0.47%	0.49%	0.50%	0.51%	0.53%
	0.4x	0.39%	0.40%	0.42%	0.43%	0.45%	0.46%	0.47%	0.49%	0.50%	0.51%	0.53%	0.54%	0.55%
	0.5x	0.42%	0.43%	0.45%	0.46%	0.47%	0.49%	0.50%	0.51%	0.53%	0.54%	0.56%	0.57%	0.58%
	0.6x	0.45%	0.46%	0.47%	0.49%	0.50%	0.52%	0.53%	0.54%	0.56%	0.57%	0.58%	0.60%	0.61%
	0.7x	0.48%	0.49%	0.50%	0.52%	0.53%	0.54%	0.56%	0.57%	0.59%	0.60%	0.61%	0.63%	0.64%
	0.8x	0.50%	0.52%	0.53%	0.55%	0.56%	0.57%	0.59%	0.60%	0.61%	0.63%	0.64%	0.65%	0.67%
	0.9x	0.53%	0.55%	0.56%	0.57%	0.59%	0.60%	0.61%	0.63%	0.64%	0.66%	0.67%	0.68%	0.70%
	1.0x	0.56%	0.57%	0.59%	0.60%	0.62%	0.63%	0.64%	0.66%	0.67%	0.68%	0.70%	0.71%	0.73%
	1.1x	0.59%	0.60%	0.62%	0.63%	0.64%	0.66%	0.67%	0.69%	0.70%	0.71%	0.73%	0.74%	0.75%
	1.2x	0.62%	0.63%	0.65%	0.66%	0.67%	0.69%	0.70%	0.71%	0.73%	0.74%	0.76%	0.77%	0.78%
	1.3x	0.65%	0.66%	0.67%	0.69%	0.70%	0.72%	0.73%	0.74%	0.76%	0.77%	0.78%	0.80%	0.81%
	1.4x	0.68%	0.69%	0.70%	0.72%	0.73%	0.74%	0.76%	0.77%	0.78%	0.80%	0.81%	0.83%	0.84%

Source: Deutsche Bank estimates, company data

From here we can now roll forward the remaining known items in the capital build.

- **Brazil and Turkey:** for the purposes of this analysis we assume 0.8x book valuation for both. It could be higher or lower than this, but this is the rough midpoint of the table in Figure 27 which shows the full sensitivities.
- **CMB / other management actions**: these are designed to reduce RWAs by \$40bn. We haven't included any revenue / cost impact in our previous tables estimating implied 2017 PBT, but for conservatism we assume a post-tax \$1bn hit to CET1 over the course of 2015-17 for reducing these RWAs.
- **GBM management actions**: at the investor day GBM CEO Samir Asaf mentioned that the cost of breaking long-dated swaps would be \$200-300m. We understand this is not included in the CTA charge, so we include the midpoint, taxed.
- **US CML**: this was profit making last year, is in run off, and we did not expect a capital hit from the exit over time.
- **CTA charges**: guidance is for US\$4-4.5bn of charges phased over 2015, 2016 and 2017. We use the mid-point, and adjust for tax shield.
- **Additional associate RWAs**: guidance is for \$20bn of additional by 2017.
- **Business growth:** guidance is for \$180-230bn. We use the mid-point \$205bn as with our earlier analysis.
- **Regulatory increase**: we assume \$50bn of RWA increases.
- **Straight line PBT growth**: we take the average of 2014 PBT and the implied 2017 run rate PBT, and take a straight line assumption on growth, which represents ~\$75bn of PBT over the 3 years. Taxed at 22%, and with minorities in each year of \$1.85bn.
- **Dividends**: cash dividends last year were \$6.6bn. We assume this grows at 3% per annum in 2015,16,17 sums to \$21bn.

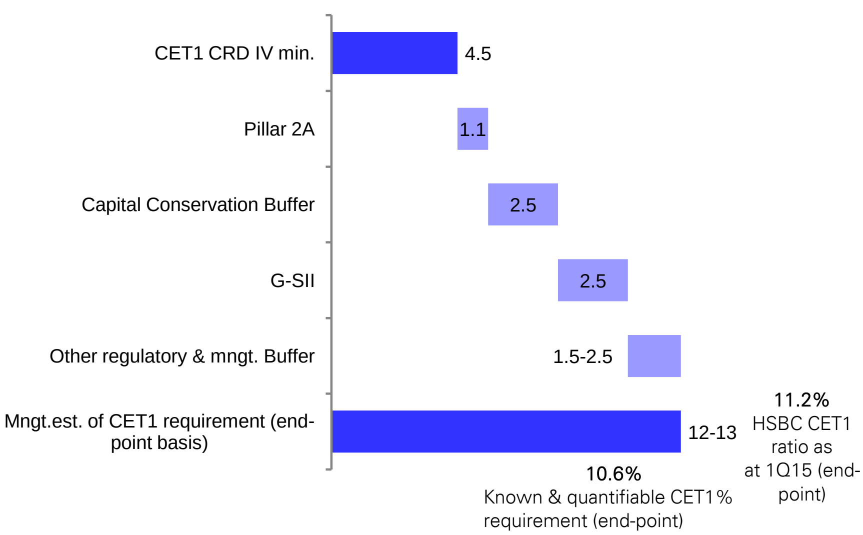
Figure 28: HSBC capital roll

	RWAs	CET1	CET1
1Q15	**1,213**	**135.6**	**11.2%**
Brazil / Turkey	-70	-1.0	
CMB	-30	-1.0	
Other management actions	-10		
1Q15 ex-business sales	**1,103**	**133.6**	**12.1%**
GBM management actions	-140	-0.3	
US CML run-off	-40	0	
CTA charges (4.0-4.5)	0	-3.3	
1Q15 pro-forma for changes	**923**	**130.1**	**14.1%**
Additional Associate RWAs (guidance)	20		
Business growth (180-230)	205		
Regulation	50		
Roll forward for RWA growth	**1,198**	**130.1**	**10.9%**
Straight line PBT growth 2014-17		75.2	
Tax @ 22%		-16.5	
Minorities @ US$1.85bn		-5.6	
Progressive dividend (cash) US$6.6bn grown 3% per annum		-21.0	
Roll forward for PBT growth	**1,198**	**162.2**	**13.5%**

Source: Deutsche Bank estimates, company data

The result is a capital position, after rolling forward CET1 and RWA impacts, of 13.5% at 2017 (Figure 28). The capital requirement for HSBC is shown in Figure 29.

Figure 29: Capital requirement for HSBC



Source: Company presentation

Compared with the 12-13% target requirement of HSBC for fully loaded CET1 in 2018 (Figure 30) this represents a buffer of $50-150bn of RWAs (ie if regulatory requirements came in harsher), or put another way, potential excess capital of $6-18bn (4-10% of market cap) before regulatory settlement / litigation costs.

13.5% CET1 ratio is also ahead of the DB forecast in 2017 (12.6%).

Figure 30: Potential excess capital in 2017?

	12% CET1 requirement	13% CET1 requirement
Gap in RWAs	154	50
Gap in CET1	18	6
Market cap	180	180
% of market cap	10%	4%

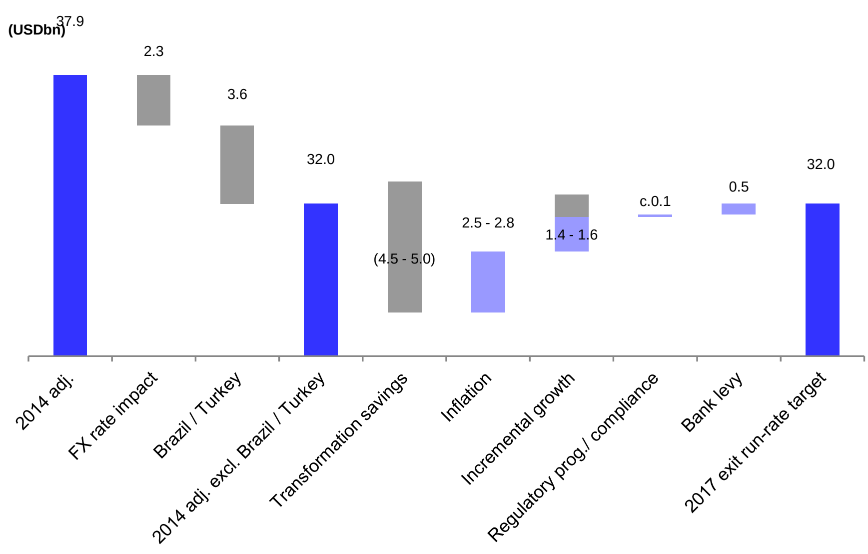
Source: Deutsche Bank estimates company data.

Key issue 1: Cost control: evidence required

The 2017 plan is clearly very much dependent on the cost target being hit. Going into the strategy day there was already much scepticism around the cost target (announced ahead of the strategy day) of keeping exit run-rate costs in 2017 at the same level as 2014. The mix difference between consensus (and DBe) estimates and the implied 2017 P&L is significant: revenues for consensus are $7bn higher, whilst costs $8bn / 26% higher.

The new 2015 plan is ambitious (Figure 31): transformation savings are around 15% of the cost base, and include an expectation that the bank levy rises by a further $0.5bn (we wait to see if the Chancellor will review this policy in the Budget). The inflation assumption is lower than the last plan (we are in a lower inflation world than in 2010), though HSBC says it has the flexibility to increase savings if investment or inflation exceeds the current estimate. Importantly regulatory and compliance spend is assumed to be almost fully complete (just $100m).

Figure 31: 2014-17 cost reductions



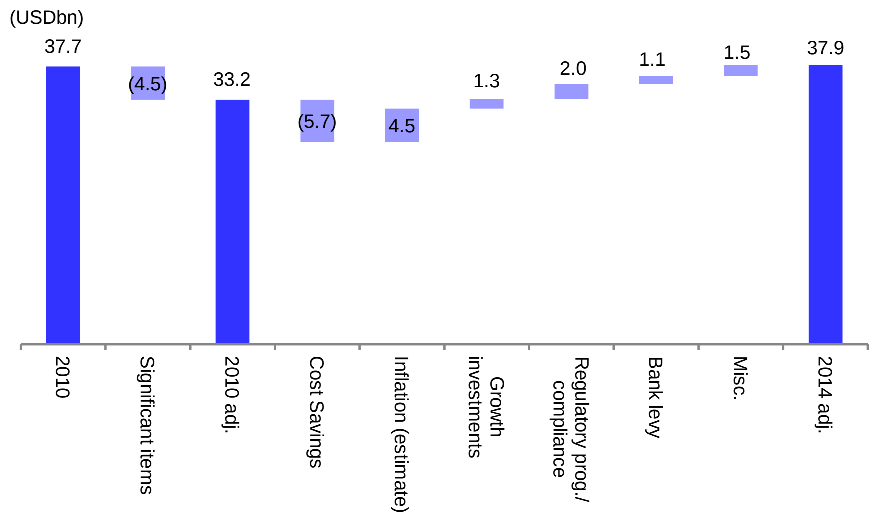
Source: Company presentation

The detail provided in the investor day presentation may help persuade some, but scepticism is likely to remain over how achievable the plan is, particularly until evidence is seen in the reported numbers. There are 2 reasons for this:

Firstly, the 2010 plan was insufficient

As shown in Figure 32 the last cost plan, announced in 2010, was a failure. Putting aside the bank levy (which is outside of HSBC's control), cost saves of $5.7bn almost matched inflation and growth investments ($5.8bn); but regulatory and compliance of $2bn, and $1.5bn of 'miscellaneous' pushed costs even higher in 2014 than before the plan.

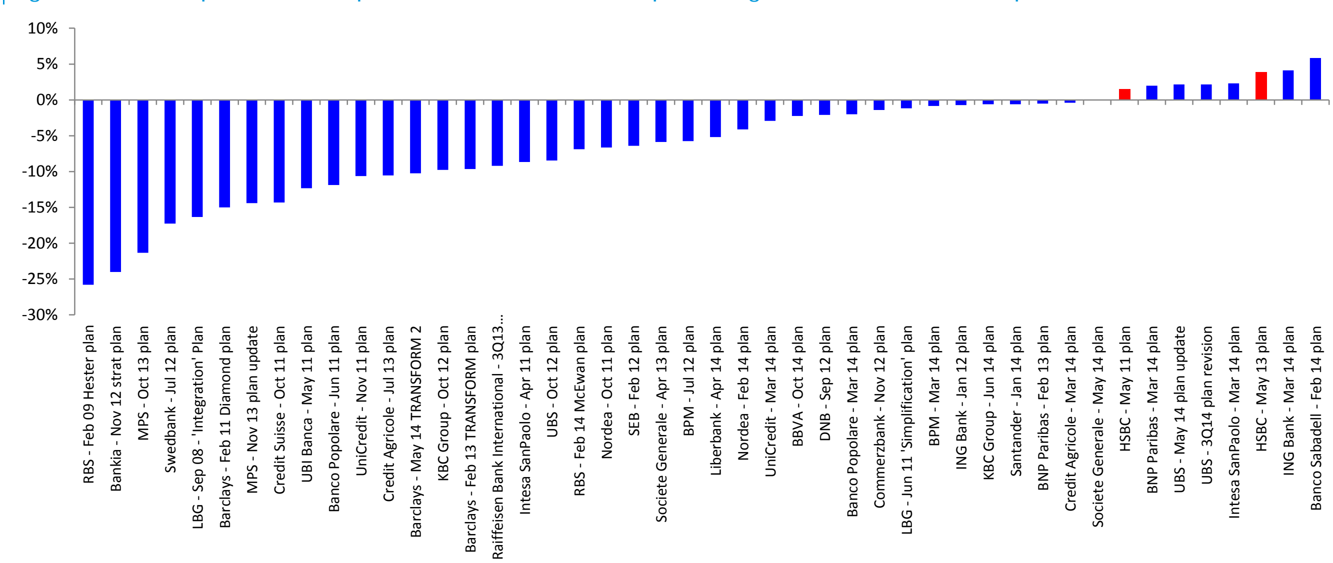
Figure 32: 2010-14 cost reductions



Source: Company presentation

Of the cost plans we track for European, banks HSBC was one of few banks to see costs actually rise over the course of a cost plan (Figure 33).

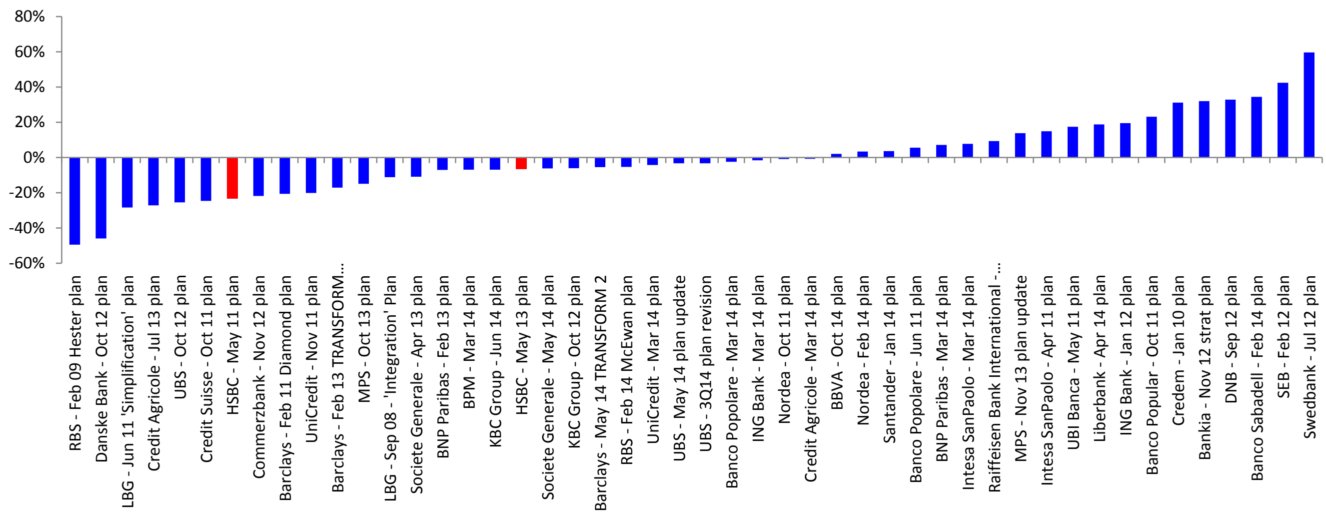
Figure 33: HSBC previous cost plan in the context of Europe: change in costs from before plan to 2014



Source: Deutsche Bank estimates, all converted to Euros and adjusted to underlying where possible.

...and the last plan did not see revenue growth to offset the cost plan disappointment. Ranked by pre-provision profit change from pre-plan to 2014, HSBC's May 2011 plan is again towards the lower end when compared with European banks.

Figure 34: HSBC previous cost plan in the context of Europe: change in Pre provision profit

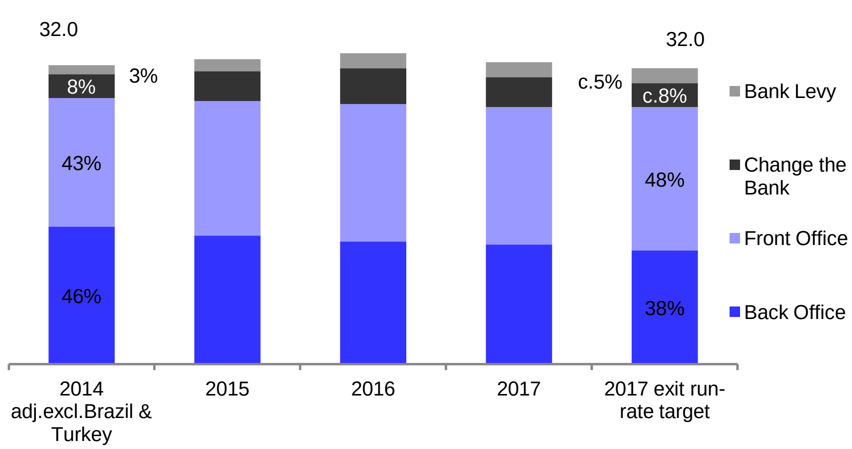


Source: Deutsche Bank estimates, all converted to Euros and adjusted to underlying where possible.

Secondly: costs will rise before they fall

What has also been made clear is that whilst HSBC is targeting positive jaws in each year (2015-17), <u>costs will rise before they fall</u> – and the 2017 target is exit-run rate (i.e. 2018) so 2017 full year costs are expected to be above 2014 levels. We lack interim cost targets for 2015, 16 and 2017: even if management thinks it is 'on track' to achieve its plan (Figure 35) it is difficult to see how the market can confirm whether HSBC is ahead of behind schedule before seeing costs fall in 2017 vs. the 2016 peak. We think the market is likely to remain cautious in the interim: it is being asked to pay for a cost plan where the benefits are back-ended.

Figure 35: Cost phasing – interim not specified



Source: Company presentation

Key issue 2: RWA growth

'Basel 4' and its implications for HSBC

HSBC included an overview of a number of regulatory issues in its investor presentation, and highlighted an unquantified amount of potential RWA inflation on its slides as well as a management and regulatory buffer in CET1 of 1.5-2.5%. We assume these are offsetting to some degree (ie the management buffer has some conservatism for RWAs).

On 17/6/2015 we wrote a comprehensive report on new regulatory proposals called 'Basel 4: Truth and advertising'. The full report is available here: http://pull.db-gmresearch.com/cgi-bin/pull/DocPull/1590-FEB4/60618873/0900b8c089904038.pdf

With this we screened HSBC (and all other European banks) for the potential impact from RWA inflation. Full details of the calculations used for HSBC are on the pages overleaf.

We estimate risk weight inflation risk for HSBC is mainly from operational risk:

- For **credit RWAs**, we estimate the key areas of higher risk weight requirements under IRB will come from corporate, mortgages and 'other retail'. Risk weights here are currently 53% for corporate 25% for mortgages, 27% for other retail. Moving these to an estimated 84% for corporate (taking into account the mix of EM and non-EM), 35% for mortgages, and 75% for other retail, and then flooring at 75% leads to an additional $72bn of RWAs (an increase of around 12% on IRB RWAs). However, for standardised risk weights, HSBC is already using risk weights that are higher than our expectation of new standardised rules. This means that whilst there is in increase in the IRB risk weights, our framework would suggest that standardised RWAs fall. We therefore estimate credit risk inflation to be zero.

- For **Operational risk** we estimate a near doubling of risk weights driven by the new business indicator calculation, leading to $114bn of additional RWAs. HSBC is effectively penalised under the framework for having a higher revenue base.

- For **Market risk** (incorporating FRTB) we estimate $13bn of additional RWAs. In total this represents $127bn of additional RWAs, an increase of 10%, and an impact of around 100bps on CET1.

In total this is $127bn of additional RWAs – <u>though this is on the 2014 balance sheet (which will change) and is before management mitigating actions</u>.

At the investor update HSBC said that though the FRTB was one of the bigger uncertainties, the QIS had suggested it wasn't a big impact for them. Management think the operational risk increase will be manageable. The biggest area of uncertainty is around potential changes in standardised credit risk weightings.

UK ring-fencing raises additional questions

As with other UK domestic banks, one of the key unknown issues at present is how the new risk weight rules will be applied to ring-fenced bank subsidiaries. HSBC's IRB risk weighting on UK mortgages specifically is just 7% (2013 data). At its investor day HSBC revealed that it expected the Ring fenced bank in the UK to be ~US$230bn, and of that we estimate around half would be mortgages. Moving risk weights to floored standardised of say 25% (HSBC's LTV distribution is low vs. UK peers) could see these attract materially higher risk weights (~$20bn) than they do within the overall group at present. On the other hand, the operational risk weight impact may be lower given that lower revenue banks attract a lower operating risk weight under the new rules. How this RWA increase could affect management's strategy for the (soon-to-be rebranded) UK retail banking business remains unclear.

Details and data on HSBC's potential RWA inflation (taken from our report) are shown overleaf

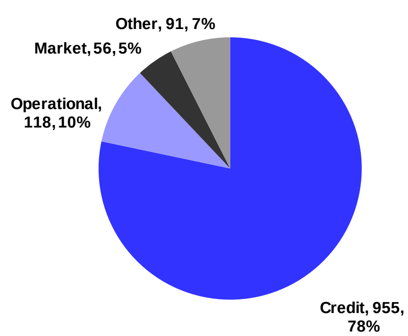
Under our framework, HSBC will experience RWA inflation of 10%.

Figure 36: Capital sensitivities

Reporting FXbn	2014	2015E	2016E	2017E
RWA B3	1,220	1,244	1,282	1,320
RWA capital floors	1,347	1,374	1,415	1,458
RWA standardised	1,618	1,651	1,700	1,751
Leverage assets	2,953	2,923	2,865	2,951
RW density B3	41%	43%	45%	45%
RW density B4 capital floors	46%	47%	49%	49%
RW density B4 on fully standardised	55%	56%	59%	59%
CT1 B3	136	143	152	166
AT1	6	8	10	10
CT1 B4	11.1%	11.5%	11.9%	12.6%
CT1 B4 capital floors	**10.1%**	**10.4%**	**10.8%**	**11.4%**
CT1 B4 on standardised	8.4%	8.7%	9.0%	9.5%
Leverage ratio	4.8%	5.2%	5.7%	6.0%

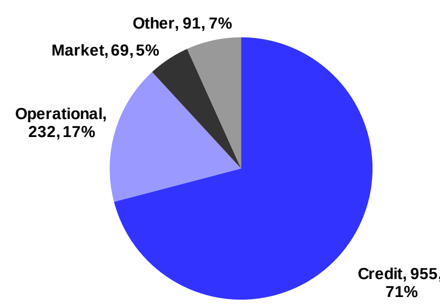
Source: Deutsche Bank, Company data

Figure 37: RWA B3 2014



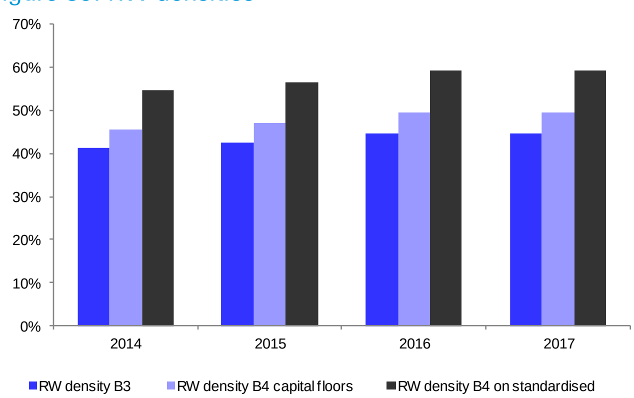
Source: Deutsche Bank, Company data

Figure 38: RWA B4 2014E



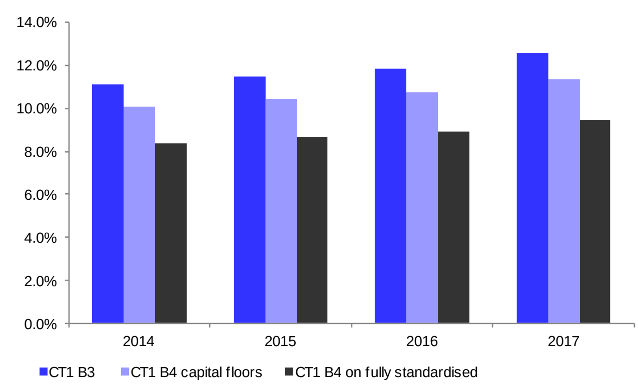
Source: Deutsche Bank, Company data

Figure 39: RW densities



Source: Deutsche Bank, Company data *Future data are forecasts*

Figure 40: CT1 capital ratios



Source: Deutsche Bank, Company data *Future data are forecasts*

Figure 41: HSBC – modelling pro-forma 2014 RWA inflation by category before management action

HSBA.L

2014 (reporting FXm)	EAD	RW	RWA	RW (new Standardised)	RWA (new Standardised)	RW (capital floor)	Floored RWAs	Increase
Sovereign	327,500	17%	54,100	17%	54,100	17%	54,100	0
Institution	130,500	30%	38,700	30%	39,150	30%	38,700	0
Corporate	651,400	53%	345,300	84%	548,930	63%	411,697	66,397
Retail	419,400	25%	106,100	47%	197,750	35%	148,313	42,213
o/w mortgage	292,000	25%	72,200	35%	102,200	26%	76,650	4,450
o/w Lombard or collateralised				0%	0	0%	0	0
o/w other	127,400	27%	33,900	75%	95,550	56%	71,663	37,763
Other	90,800	60%	54,200	60%	54,200	60%	54,200	0
IRB	1,619,600	37%	598,400	55%	894,130	41%	670,597	72,197
Sovereign	193,900	10%	19,700	10%	19,700	10%	19,700	0
Institution	30,100	37%	11,200	30%	9,030	37%	11,200	0
Corporate	240,100	94%	224,700	84%	202,330	94%	224,700	0
Retail	86,500	57%	49,000	57%	49,000	57%	49,000	0
Other	39,900	131%	52,300	131%	52,300	131%	52,300	0
Standardised	590,500	60%	356,900	56%	332,360	42%	249,270	0
Other	0	na	0	na	0	na	0	0
Credit Risk	**2,210,100**	**43%**	**955,300**	**55%**	**1,226,490**	**42%**	**919,868**	**0**
Operational Risk		**na**	**117,800**	**na**	**232,374**	**na**	**174,280**	**114,574**
Other risk (settlement, failed trades, equity risk outside trading book)		na	90,700	na	90,700	na	90,700	0
Market Risk		**na**	**56,000**	**na**	**68,797**	**na**	**68,797**	**12,797**
Net insurance		na		na	0	na	0	na
Deductions		na		na	0	na	0	na
RWA Basel III	2,210,100	55%	1,219,800	73%	1,618,361	57%	1,253,645	127,371
RWA inflation								10%

Source: Deutsche Bank, Company data

Appendix 1

Important Disclosures

Additional information available upon request

Disclosure checklist

Company	Ticker	Recent price*	Disclosure
HSBC Holdings Plc	0005.HK	72.45 (HKD) 18 Jun 15	1,7,14

*Prices are current as of the end of the previous trading session unless otherwise indicated and are sourced from local exchanges via Reuters, Bloomberg and other vendors . Other information is sourced from Deutsche Bank, subject companies, and other sources. For disclosures pertaining to recommendations or estimates made on securities other than the primary subject of this research, please see the most recently published company report or visit our global disclosure look-up page on our website at http://gm.db.com/ger/disclosure/DisclosureDirectory.eqsr.

Important Disclosures Required by U.S. Regulators

Disclosures marked with an asterisk may also be required by at least one jurisdiction in addition to the United States. See Important Disclosures Required by Non-US Regulators and Explanatory Notes.

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1. Within the past year, Deutsche Bank and/or its affiliate(s) has managed or co-managed a public or private offering for this company, for which it received fees.

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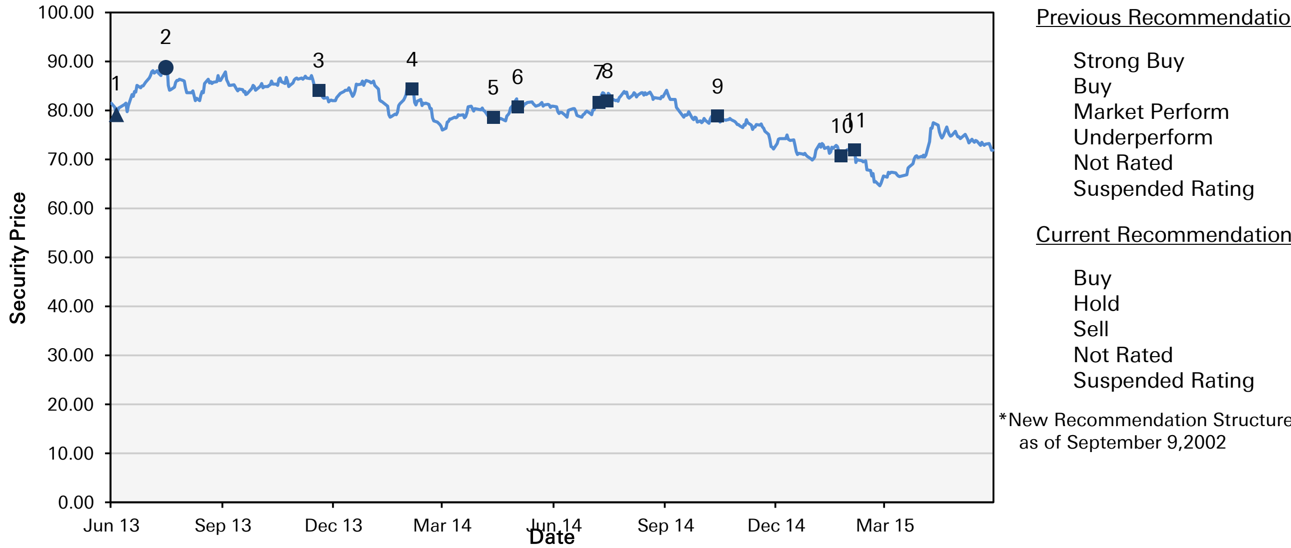
Analyst Certification

The views expressed in this report accurately reflect the personal views of the undersigned lead analyst(s) about the subject issuer and the securities of the issuer. In addition, the undersigned lead analyst(s) has not and will not receive any compensation for providing a specific recommendation or view in this report. David Lock

Historical recommendations and target price: HSBC Holdings Plc (0005.HK)

(as of 6/18/2015)



1.	25/06/2013:	Upgrade to Buy, HKD90.00	7.	28/07/2014:	Hold, Target Price Change HKD78.00
2.	05/08/2013:	Downgrade to Hold, Target Price Change HKD87.00	8.	04/08/2014:	Hold, Target Price Change HKD83.00
3.	09/12/2013:	Hold, Target Price Change HKD90.00	9.	03/11/2014:	Hold, Target Price Change HKD80.00
4.	24/02/2014:	Hold, Target Price Change HKD88.00	10.	13/02/2015:	Hold, Target Price Change HKD73.00
5.	02/05/2014:	Hold, Target Price Change HKD87.00	11.	24/02/2015:	Hold, Target Price Change HKD68.00
6.	22/05/2014:	Hold, Target Price Change HKD84.00			

Equity rating key

Buy: Based on a current 12- month view of total share-holder return (TSR = percentage change in share price from current price to projected target price plus pro-jected dividend yield) , we recommend that investors buy the stock.

Sell: Based on a current 12-month view of total share-holder return, we recommend that investors sell the stock

Hold: We take a neutral view on the stock 12-months out and, based on this time horizon, do not recommend either a Buy or Sell.

Notes:

1. Newly issued research recommendations and target prices always supersede previously published research.

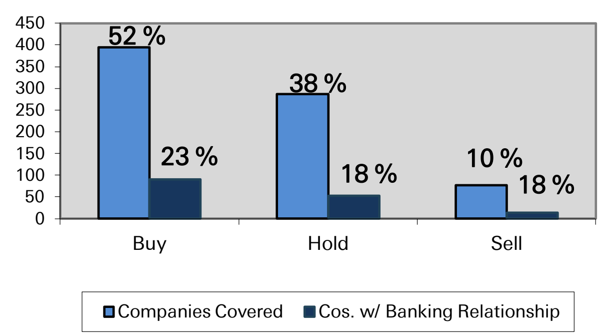
2. Ratings definitions prior to 27 January, 2007 were:

 Buy: Expected total return (including dividends) of 10% or more over a 12-month period

 Hold: Expected total return (including dividends) between -10% and 10% over a 12-month period

 Sell: Expected total return (including dividends) of -10% or worse over a 12-month period

Equity rating dispersion and banking relationships



Asia-Pacific Universe

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