Equity Markets
Banks

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Hong Kong

Paul Sheehan
Hong Kong (852) 2848 8580
paul.sheehan@asia.ing.com

Christina Fok
Hong Kong (852) 2913 8042
christina.fok@asia.ing.com

Clash of the Titans

HSBC and STAN vie for Asian growth

Standard Chartered is well positioned to capture Asian emerging markets expansion due to its high-growth mix of markets. We are upgrading StanChart to BUY from Hold and recommend switching from HSBC to StanChart.

HSBC is now a developed market play. 75% of the group's loan portfolio is in the US and Europe. We believe that HSBC's acquisitions of Household, Republic and CCF (as well as its growing size) have tied the bank's fortunes firmly to GDP growth in these markets – and the immediate prognosis is poor.

Standard's emerging portfolio is attractive. StanChart retains good market positions in Singapore and Hong Kong, but its growth prospects come increasingly from India, Malaysia, the Middle East and Africa. These markets are growing faster, and StanChart is simultaneously increasing its market share.

Returns are diverging. HSBC has out-earned StanChart on both an ROE and an ROA basis since the Asian financial crisis, but our projections give StanChart a clear edge in EPS growth, which will put its returns back on top.

Valuation will follow. The fair value multiples of HSBC and StanChart are moving in opposite directions. StanChart's higher growth and ROE should lift its fair value P/BV even as HSBC's higher beta and slower organic growth argue for a de-rating. Maintain HOLD on HSBC and upgrade StanChart to BUY from Hold.

Standard Chartered (HK$83)

Target price: 12 months

HK$92 (+11%)

Share data	
Market cap (US$m)	12,452
No of shares (m)	1,170
Daily turnover (US$m)	1.11
Free float (%)	88
52-week hi/lo (HK$)	95-80.5

Price performance (%)	Absolute	Relative to HSI
1m	-1.8	1.3
3m	-7.0	4.2
6m	6.0	10.1

HSBC (HK$82.75)

Target price: 12 months

HK$78 (-6%)

Share data	
Market cap (US$m)	114,102
No of shares (m)	10,755
Daily turnover (US$m)	100.53
Free float (%)	100
52-week hi/lo (HK$)	97.5-78.75

Price performance (%)	Absolute	Relative to HSI
1m	0.0	3.1
3m	-6.5	4.7
6m	-6.2	16.5

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Executive summary

Return gap is reversing.

Standard Chartered has underperformed HSBC on an ROE and an ROA basis since the 1997-98 Asian financial crisis, in contrast to its emerging markets heyday. We project that StanChart will return to outperformance in 2003-04, and that valuations should follow suit.

Growth markets to the fore.

StanChart's basket of markets is growing substantially faster than that of HSBC, which is now overwhelmingly a US and UK bank. Our forecasts call for emerging markets to continue to perform better than the developed world in terms of GDP and loan growth.

Standard Chartered: Balance sheet solidification.

StanChart's books have been cleaned up markedly over the past two years, with NPLs falling and high-cost debt redeemed. Although HSBC's fortress-like balance sheet is still without compare in Asia, SCB has eliminated many of its historic negative traits.

HSBC: Tied to the US cycle.

HSBC's purchase of Household International (HI) has left the group vulnerable to the US credit cycle, which appears to be entering a downturn. Even though accretive, this raises HSBC's risk and our projected cost of capital, thus lowering the bank's trading multiple.

Asset quality.

HSBC and StanChart are about even in terms of balance sheet NPLs after the consolidation of HI, but HSBC's actual credit costs are still much lower than StanChart's. We do see some scope for StanChart's provisions to come down in future years, although it should be assumed that its bad debt charges will always remain substantially higher due to the bank's emerging market loan book.

Upgrade STAN to BUY.

We are upgrading StanChart from Hold to BUY with this report, and assigning a new 12-month price target of 757p (equivalent to HK$92), based on our cost-of-capital methodology (see *Valuation* section for details).

Maintain HOLD on HSBC.

We maintain our HOLD rating on HSBC shares, with price targets of 647p and HK$78.

The old switcheroo.

We recommend that investors looking to take broad Asian exposure switch from HSBC into StanChart, while investors with a specific Hong Kong focus are additionally advised to switch from Hang Seng Bank (HK$79, SELL, Target HK$70) into StanChart.

Returns

HSBC's returns have outperformed, but StanChart is ready to turn the tables

HSBC has outperformed StanChart on both an ROE and an ROA basis in three of the past four years, and for the period as a whole. However, HSBC's increasing reliance on mature markets, along with its larger size and commensurately deliberate pace, indicate that this long period of outperformance is drawing rapidly to an end.

Fig 1 ROA and ROE gap: 1996-2004F (%)

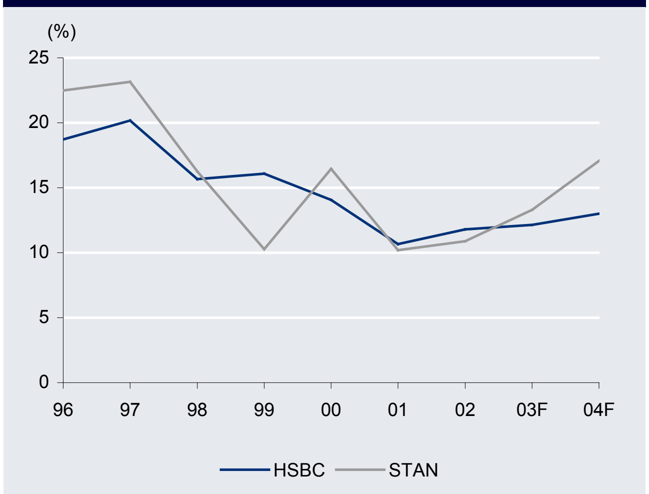
	96	97	98	99	00	01	02	03F	04F
ROA: HSBC	1.27	1.26	0.90	1.03	1.04	0.73	0.86	0.96	0.98
ROA: STAN	1.36	1.31	0.98	0.64	1.06	0.60	0.67	0.82	1.06
Gap	-0.09	-0.05	-0.07	0.39	-0.02	0.13	0.19	0.14	-0.08
ROE: HSBC	18.82	20.26	15.76	16.19	14.17	10.76	11.91	12.25	13.11
ROE: STAN	22.60	23.26	16.36	10.37	16.55	10.31	10.99	13.40	17.17
Gap	-3.78	-3.00	-0.61	5.82	-2.38	0.46	0.91	-1.16	-4.06

Source: Company data, ING estimates

From a peak ROE of 20.2%, HSBC's shareholder returns have dwindled to under 12% in the just-ended fiscal year on slower growth (particularly in the once-core Hong Kong business), diversification into lower-spread markets, and higher credit costs. Even allowing for somewhat decreased leverage (equity/assets has risen from 5.7% at end-1997 to 6.9% at end-2002), ROA has fallen well under 1% despite the best efforts of the Hong Kong operations, which maintain an ROA of above 2%.

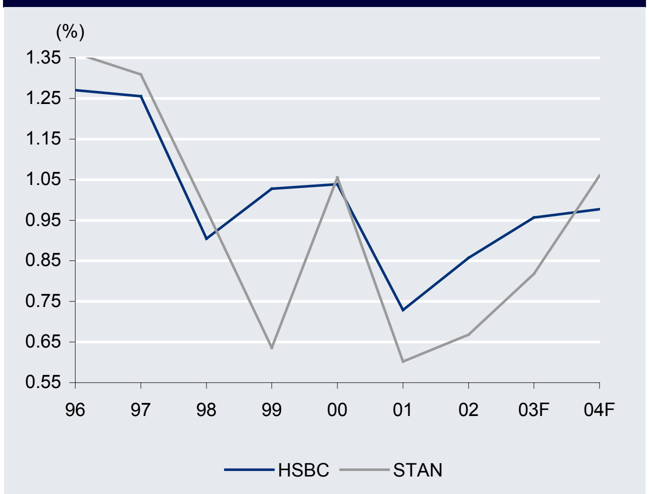
Although StanChart has lowered its gearing as well (most recently by redeeming preferred shares) and its equity/assets is a full percentage point lower than that of HSBC at 5.9%, our projections show the bank accelerating both its ROE and ROA in 2003-04 to surpass those of HSBC.

Fig 2 ROE: 1996-2004



Source: Company data, ING estimates

Fig 3 ROA: 1996-2004



Source: Company data, ING estimates

Although HSBC's EPS CAGR was higher from 1997 to 2002, StanChart will have superior EPS growth in 2003 and 2004, on our estimates

We calculate that this will translate into superior EPS growth for StanChart after a period of serious underperformance: an EPS CAGR of 77% in 2003-04F versus 22% for HSBC. Note that substantially all of the HSBC EPS growth comes from the acquisition of Household International (HI); given that these earnings are lower-quality (as evidenced by the low PER trading ranges of HI's competitors), we would also argue for multiple contraction as well.

Fig 5 HSBC and StanChart's EPS CAGRs: 1997-2004 (%)

	CAGR 1997-2002	03F	04F
HSBC	-0.1	10	11
STAN	-8.5	29	38

Source: Company data, ING estimates

Forward earnings comparisons are, by necessity, predicated on our own forecasts for the companies, and so may tend to reinforce our existing prejudices; however, using consensus forecasts for both companies yields a similar result – ie, StanChart shows higher projected earnings growth – although we are more bearish than the consensus on HSBC in 2003 and more bullish on StanChart in 2004.

Fig 6 HSBC and StanChart consensus EPS CAGRs: 1997-2004 (%)

	CAGR 1997-2002	03F	04F
HSBC	-0.1	13	11
STAN	-8.5	35	15

Source: Company data, I/B/E/S, ING estimates

Why is StanChart returning to outperformance? We see three key reasons:

- **Better markets.** StanChart has a higher-growth mix of markets vis-a-vis HSBC, which is no longer an emerging market bank. On the back of better observed and forecast performance from StanChart's main markets (as well as our call on an Asia-US de-linking), the bank will have a tailwind for the next two to three years, while HSBC will have to cope with tighter economic conditions in the UK, France and the US.

- **Focused consumer model.** StanChart has been very clear on its ambition to become a consistent consumer brand across Asia and the Subcontinent. We believe that this strategy is already beginning to pay dividends, although the fully valued Manhattan Card acquisition and truly terrible Hong Kong banking environment have retarded progress.

- **Operating leverage.** StanChart's cost base is out of line with HSBC's and with its local market competitors. Management has made substantial efforts to standardise product (eg, extending the Manhattan Card brand and service globally) and systems, and is centralising back-office operations in low-cost markets. As emerging markets return to growth, StanChart will be able to continue to grow assets without proportional growth in costs.

Market positioning

StanChart's emerging market focus will yield higher growth than HSBC's franchise

StanChart is much more a pure Asian and emerging markets bank than is HSBC. Although its historical roots are in China, and the Hong Kong business is still the group's most profitable, 70% of HSBC's loan book is based in Europe and the Americas, and this rises to 75% on a pro-forma basis after the acquisition of HI.

In contrast, StanChart has 69% of its loan book in Asia-Pacific (mainly Hong Kong and ASEAN), plus another 15% in India, Africa and the Middle East/South Asia (MESA); the remaining 15% at its head office or in Europe and the Americas has been shrinking steadily in importance since the sale of Chartered Trust in the UK – we expect this trend to continue.

Fig 7 Loan book distribution: end-2002

	STAN		HSBC		HSBC/HI*	
US$m	Loans	% of total	Loans	% of total	Loans	% of total
Customer loans, gross	58,165	100	361,929	100	444,491	100
Hong Kong	21,313	37	71,207	20	71,207	16
Singapore	8,060	14	6,204	2	6,204	1
Malaysia	4,201	7	4,865	1	4,865	1
Other Asia-Pacific	6,390	11	19,716	5	19,716	4
India	2,458	4	1,758	0	1,758	0
Middle East and South Asia	4,883	8	6,184	2	6,184	1
Africa	1,168	2	N/A	0	N/A	0
Americas, Europe, and LatAm	9,004	15	251,995	70	334,557	75

* Pro-forma

Source: Company data, ING estimates

Figure 8 shows that both the US and UK have been growing quite well over the last 12 months (FY02 figures for both), mainly in mortgages and other consumer lending. In contrast, Hong Kong and Singapore have experienced negative growth – a major reason why HSBC outperformed StanChart in aggregate loan volumes during 2002.

Better overall growth has been seen in Malaysia (+5%), Thailand (+7.8%), MESA (+8.0%), India (+22.3%) and Africa (+34.0%)

Fig 8 Aggregate loan growth by market

Market	Loan growth over last 12 months (%)
US	5.5
Euro area	1.8
UK	6.7
France	3.9
Hong Kong	-5.0
Singapore	-1.3
Malaysia	5.0
Thailand	7.8
India	22.3
MESA	8.0
Africa	34.0

Source: Central banks, African Development Bank, ING estimates

ING's 2003 forecasts for GDP call for slowing growth in the US, UK and the Eurozone, while ASEAN, India, and Hong Kong will pick up. This should result in stronger loan growth for StanChart's key markets, even as HSBC increases its weighting in slow-growth countries.

Fig 9 GDP growth by market (%)

Market	01	02	03F
US	1.2	2.4	1.9
UK	2.2	1.7	1.7
France	2.0	1.1	0.7
Hong Kong	0.6	2.3	2.5
Singapore	-2.4	2.2	3.5
Malaysia	0.4	4.2	5.0
Thailand	2.0	5.2	4.5
India	3.9	5.5	6.0
MESA	2.6	3.9	N/A
Africa	1.7	3.5	N/A

Source: World Bank, ING estimates

Loan growth and portfolio mix

Both banks are taking share, but StanChart is winning in Singapore, Malaysia, India and the Middle East

In the markets where HSBC and StanChart go head to head for business, each side can lay claim to some important victories. While both banks are taking share across their markets, HSBC has outperformed in Hong Kong, mainly due to its strength in mortgage lending (+3.1%) and other personal lending (+10.4%). Although StanChart is the Hong Kong market leader in terms of credit cards, this segment has been hurt the most by the poor economy and rising bankruptcies.

However, StanChart handily beats HSBC in terms of both Singapore and Malaysia growth within ASEAN, and in the key India and MESA markets as well, despite having a larger footprint.

Fig 10 Actual loan growth by market: 2002 (%)

US$m	STAN	HSBC
Total loans	5.7	14.0
Hong Kong	0.8	3.2
Singapore	18.0	15.8
Malaysia	13.4	8.4
Other Asia-Pacific	9.4	22.2
India	27.8	12.8
Middle East and South Asia	18.6	16.7
Africa	20.5	N/A
US and Canada	N/A	8.3
Europe	N/A	23.4
LatAm	N/A	-31.3
Americas, UK, and head office	0.7	N/A

Source: Company data, ING estimates

Fig 11 HSBC/STAN growth vs market: 2002 (%)

Market	Market growth over last 12 months	HSBC growth 02	STAN growth 2002
US	5.5	8.3	{ 0.7
Euro area	1.8	23.4	
Hong Kong	-5.0	3.2	0.8
Singapore	-1.3	15.8	18.0
Malaysia	5.0	8.4	13.4
India	22.3	12.8	27.8
MESA	8.0	16.7	18.6
Africa	34.0	N/A	20.5

Source: Company data, ING estimates

China vs India

We like StanChart's emphasis on India more than HSBC's on China for near-term potential

We see a key divergence in the growth strategies of HSBC and StanChart. While StanChart has pared back to its roots as an emerging markets bank, HSBC has become progressively more dependent on large and stable economies. In addition, each bank is looking to a different large market for future growth.

HSBC is clearly the foreign bank to beat in mainland China. With a long history in the country, deep knowledge of the culture, and excellent *guanxi* in addition to its leading position in Hong Kong, HSBC hopes to become a global bank with Chinese characteristics. Management has already acquired an 8% stake in Bank of Shanghai, 10% of Ping An Insurance, and is reported by other Chinese bankers to be negotiating the purchase of an unprecedented majority control stake (up to 80%) in Guangzhou City Commercial Bank.

Although we agree that China's vast population makes it a potentially rich prize, we believe that it will prove much harder to make significant amounts of money on the mainland than is implicit in this idea of a "land rush" opportunity. China's state-owned banks carry a heavy burden of loans that will never be repaid; we estimate this at over US$500bn.

The best hope for recapitalising the financial system is for the large domestic banks to earn outsized returns over the next 10 years so as to be able to clear this unrealised loss. With the total market essentially a zero-sum game, every dollar earned by the foreign banks is a dollar not earned by the state banks, and hence, a dollar which the government must somehow provide in recapitalisation. Given this incentive on the part of the government, which regulates the activities of foreign banks, it should not be surprising that the foreign financial sector now runs at a loss.

Although StanChart is also publicly keen on China, and is building its own network of offices (15 at year-end) on the mainland, it has placed a much larger emphasis on another giant market – India. The purchase of Grindlay's from ANZ in July 2000 has brought StanChart's total presence in the country to 62 branches, integrated into a platform which is much more able to operate freely than are banks in China.

While we believe that China runs at a loss for both HSBC and StanChart, India generated US$166m of pre-tax profit for StanChart in 2002, just over 13% of total group EBT.

Efficiency

HSBC is still more efficient, but StanChart is closing the gap

HSBC is still more efficient than StanChart, although the difference has narrowed. HSBC's consistently better efficiency ratio is not just a measure of higher fee revenues, as the overhead comparison illustrates. However, since 1997, StanChart has managed to narrow the gap by half.

Fig 12 Comparative efficiency: 1996-2004F (%)

	96	97	98	99	00	01	02	03F	04F
Efficiency: HSBC	50.5	52.2	53.9	52.4	54.5	54.7	54.9	53.4	52.4
Efficiency: STAN	55.6	51.8	52.2	58.2	67.2	59.6	58.5	55.0	51.7
Gap	-5.1	0.3	1.6	-5.8	-12.7	-4.9	-3.5	-1.6	0.7
Cost/assets: HSBC	2.38	2.63	2.63	2.45	2.49	2.44	2.36	2.76	2.54
Cost/assets: STAN	2.93	2.86	2.98	3.02	3.25	2.82	2.66	2.51	2.42
Gap	-0.6	-0.2	-0.4	-0.6	-0.8	-0.4	-0.3	0.2	0.1

Source: Company data; ING estimates

Note that although HSBC's costs have increased almost directly in line with the bank's asset base, StanChart has an expense CAGR of 7.2% versus an asset CAGR of 7.9%, meaning that the bank has been able to demonstrate operational leverage as it standardises its product offerings across markets and outsources back-office functions to India and Shenzhen.

There is obviously still a way to go before StanChart equals HSBC in terms of operational efficiency, but the results could be substantial – lowering StanChart's 2002 cost-to-assets ratio to match HSBC's would have boosted net income by 30% after taxes.

Fig 13 Expense and asset CAGRs: 1996-2002 (US$m)

	96	97	98	99	00	01	02	Expense CAGR (%)	Asset CAGR (%)
Expenses:									
HSBC	7,917	10,056	10,994	11,313	13,577	14,605	14,954	11.2	11.2
STAN	1,694	1,857	2,036	2,226	2,714	2,585	2,557	7.1	7.9

Source: Company data, ING estimates

Non-interest income

Despite wealth management emphasis, StanChart lags HSBC in fee income

HSBC has been much more effective at generating fee income to boost its revenue base, one reason why we continue to believe that the bank deserves a PER premium to StanChart.

As a percentage of revenues, HSBC earned 43.2% of gross revenues (net interest income + non-interest income) from non-interest sources in 2002, with fees and commissions accounting for 66% of total non-interest income, or 28.7% of revenues. By comparison, StanChart derived only 33.7% of its revenues from sources other than interest spread.

Fig 14 Non-interest income by category as percentage of revenues: 1996-2004F (%)

	96	97	98	99	00	01	02	03F	04F
HSBC									
Fees and commissions	27.4	28.4	28.1	27.9	29.4	28.0	28.7	26.3	26.0
Dealing profit	5.1	5.1	5.6	6.0	6.5	6.3	4.8	3.1	3.5
Securities gains	3.5	2.9	1.1	2.1	1.2	2.8	2.0	0.0	0.0
Dividends and affiliates	1.9	1.4	1.4	1.3	0.9	1.0	1.4	1.1	1.1
Others	4.0	5.4	7.2	7.1	6.9	6.8	6.3	9.9	9.6
STAN									
Fees and commissions	21.7	20.3	17.2	18.6	22.0	22.5	22.7	23.1	22.6
Dealing profit	10.9	16.1	17.8	10.4	9.3	10.8	9.6	9.5	8.4
Securities gains	0.4	0.0	0.0	0.0	0.0	0.5	0.4	0.0	0.0
Dividends and affiliates	0.6	0.0	0.0	0.0	0.0	0.1	0.1	0.0	0.0
Others	1.1	1.6	0.8	2.5	2.9	0.7	1.0	1.5	1.4

Source: Company data, ING estimates

HSBC has been making better progress in converting its consumer business to a wealth management model, which is helping to replace slumping broking revenues with income from bancassurance, capital guarantee funds, and asset management. Credit card fees and charges already account for approximately 16% of net fees; this rises to approximately 30.6% after HI is included. Note that we do project that changes in HI's sales practices will reduce fee income from the US sub-prime business going forward, but HSBC will nevertheless extend its lead over StanChart.

StanChart has good fee income from its credit card business (primarily Hong Kong and India), but lags elsewhere – much of what is termed the "wealth management" sector in business line breakdowns is actually deposit-taking and the associated spread income. As you would expect from a more pure emerging markets bank, dealing and FX revenue is higher as a percentage of the total, at 9.6% to HSBC's 4.8%.

As StanChart increases its focus on the consumer business and standardises channels, we expect its wealth management revenue to rise, but we do not anticipate that its portfolio of primarily lesser-developed markets will allow it to compete seriously with HSBC for non-interest income any time in the next five years.

Asset quality

StanChart's asset quality is similar to HSBC's, but charge-offs are higher

Asset quality at both banks has improved only slightly from the crisis year of 1998, although on-balance-sheet criticised assets actually peaked for HSBC in 1999 and for StanChart in 2001.

We are somewhat leery of head-to-head comparisons on the asset quality front, as StanChart's disclosure is shockingly poor in this area; however, it certainly appears that HSBC retains its advantage as of the last results. However, StanChart has made credible strides in reducing its bad debt burden. HSBC still has far superior credit costs – but these are set to almost quadruple when HI is included.

Fig 15 Asset quality comparison: 1996-2002 (%)

	96	97	98	99	00	01	02	HSBC/HI pro-forma 02
NPLs/loans: HSBC	2.2	1.8	2.9	3.2	2.7	2.5	2.6	2.8
NPLs/loans: STAN	2.3	1.4	2.8	3.7	2.8	4.2	3.0	3.0
Gap	-0.1	0.4	0.1	-0.6	-0.1	-1.7	-0.4	-0.2
Reserves/loans: HSBC	1.7	1.6	2.0	2.2	1.9	1.9	2.0	2.5
Reserves/loans: STAN	2.3	2.1	3.3	4.0	3.0	2.5	2.0	2.0
Gap	-0.6	-0.5	-1.3	-1.8	-1.1	-0.6	0.0	0.5
Reserves/NPLs: HSBC	76.0	87.0	70.1	70.4	71.5	77.4	76.0	88.2
Reserves/NPLs: STAN	100.1	145.9	116.6	107.4	105.2	60.6	65.8	65.8
Gap	-24.1	-58.9	-46.4	-37.0	-33.7	16.8	10.2	22.4

Note: HSBC/HI pro-forma is presented on a managed basis as of 31/12/02
Source: Company data, ING estimates

Fig 16 Credit cost comparison: 1997-2002

bp on average loans	97	98	99	00	01	02	HSBC/HI pro-forma 02
Provisions: HSBC	36.41	86.93	65.14	26.45	78.79	39.89	105.37
Provisions: STAN	64.66	163.79	170.60	91.83	135.53	127.94	127.94
Gap	(28.25)	(76.86)	(105.46)	(65.38)	(56.74)	(88.05)	(22.57)
Net charge-offs: HSBC	22.74	42.04	25.60	21.94	79.12	18.10	74.12
Net charge-offs: STAN	47.27	30.72	68.25	161.71	176.32	168.10	168.10
Gap	(24.53)	11.32	(42.64)	(139.77)	(97.20)	(150.00)	(93.98)
Provisions less charge-offs: HSBC	13.67	44.89	39.54	4.51	(0.33)	21.79	31.25
Provisions less charge-offs: STAN	17.39	133.07	102.36	(69.88)	(40.79)	(40.16)	(40.16)
Gap	(3.72)	(88.18)	(62.82)	74.38	40.46	61.95	71.41
Accumulated reserves: HSBC	168.47	201.94	232.82	208.65	193.56	208.09	239.65
Accumulated reserves: STAN	225.21	335.07	417.38	313.01	256.23	205.42	205.42
Gap	(56.74)	(133.13)	(184.56)	(104.36)	(62.67)	2.68	34.24

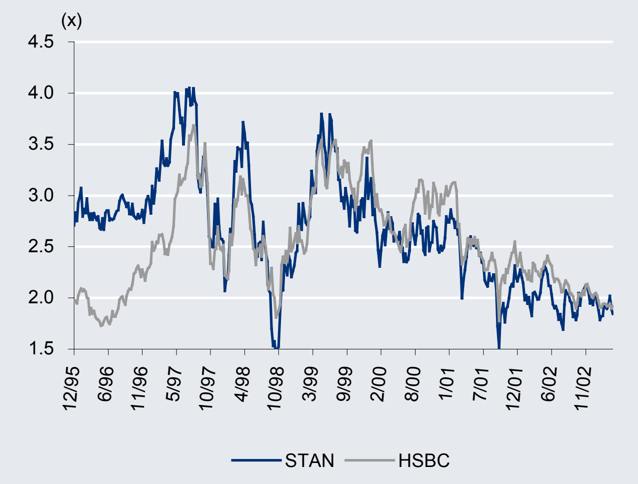
Note: HSBC/HI pro-forma is presented on an owned basis for FY02
Source: Company data, ING estimates

Valuation

Upgrading StanChart to BUY, maintain HOLD on HSBC

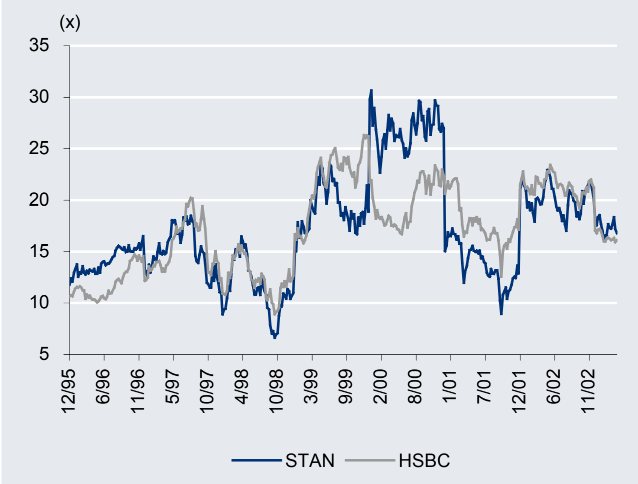
Although we think of the stocks as having been quite defensive in an Asian context, both StanChart and HSBC are trading near historic lows on a price-to-book basis, albeit with still-high PERs that show their ROE is not what it once was. We do believe that StanChart is poised to recapture some of its former glory on faster growth, although far from enough to send the stock back to its 4x book pre-crisis level.

Fig 17 HSBC and StanChart's historical P/BV



Source: Company data, Bloomberg, ING estimates

Fig 18 HSBC and StanChart's historical PER



Source: Company data, Bloomberg, ING estimates

Standard Chartered

StanChart is currently trading at 1.85x trailing book value per share (2.7x tangible book), and at 16.9x trailing earnings – rich given an unspectacular trailing ROE. However, due to the strong earnings momentum, these multiples decline to 1.75x and 13.1x, respectively, on a forward basis.

Fig 19 Valuation at current price: StanChart

	01	02	03F	04F
Share price (GBP)	677			
Share price (HK$)	83.00			
PER (x)	19.12	16.87	13.08	9.51
Core PER (x)	19.19	17.78	12.76	9.32
PUP (x)	6.88	6.83	5.99	5.09
P/BV (x)	1.97	1.85	1.75	1.63
P/ABV (x)	3.13	2.71	2.42	2.13

Source: Company data, ING estimates

Looking at our cost of capital methodology for determining target price/book, we peg StanChart's sustainable core ROE at 18.5%. Note that this is well below its pre-crisis peak levels, as we do not see either growth or margins returning to those lofty heights across the board.

StanChart's risk-free rate is a weighted average of the five-year government bonds in its four key markets: Hong Kong, Singapore, Malaysia and India, while the equity risk premium is a composite of the UK and Hong Kong levels (StanChart's two listing markets). You will see on the following page that both HSBC's risk-free rate and equity premium are lower, as befits a developed market institution.

Fig 20 Cost of capital valuation: StanChart

Sustainable ROE (%)	18.50
Cost of capital (%)	9.56
Risk-free rate (%)	3.38
Equity risk premium (%)	6.95
Beta	0.89
Target book multiple (x)	1.93
BVPS (YE03F, US$)	6.08
Implied target price (US$)	11.8
Implied target price (HK$)	92
Implied target price (GBP)	757

Source: Company data, ING estimates

Based on this calculation, StanChart should trade at 1.93x one-year forward BVPS, or 757p (HK$92). At this level, STAN will be valued at 14.4x 2003F and 10.5x 2004F EEPS. Consequently, we are upgrading the shares of StanChart from Hold to BUY, with a new target price of 757p, or HK$92.

Fig 21 Valuation at target price: StanChart

	01	02	03F	04F
Share price (GBP)	757			
Share price (HK$)	92			
PER (x)	21.09	18.62	14.44	10.50
Core PER (x)	21.18	19.62	14.08	10.28
PUP (x)	7.60	7.54	6.61	5.62
P/BV (x)	2.17	2.05	1.93	1.80
P/ABV (x)	3.45	2.99	2.67	2.35

Source: Company data, ING estimates

HSBC

HSBC trades at 16.1x 2002 actual EPS (the large difference in core earnings is due to goodwill amortisation) and 1.9x BVPS (3.1x adjusted BVPS), coming down to 14.7x earnings in 2003F (but falling only to 1.8x P/BV due to the issuance of new shares for HI).

Fig 22 Valuation at current price: HSBC

	2001	2002	2003F	2004F
Share price (GBP)	684			
Share price (HK$)	82.87			
PER (x)	19.94	16.17	14.71	13.30
Core PER (x)	16.03	13.29	11.94	10.79
PUP (x)	8.22	8.21	6.69	6.40
P/BV (x)	2.15	1.92	1.78	1.70
P/ABV (x)	3.50	3.14	2.78	2.52

Source: Company data, ING estimates

We peg the company's sustainable ROE at 14.5%, which will still require significant earnings growth from current levels. As noted previously, both HSBC's risk-free rate and equity risk premium are lower than those of StanChart, as is its beta. Although HSBC's calculated beta is currently .68, we have increased it to .83 on a prospective basis to account for the addition of HI's businesses; on a weighted basis, this gives the former HI an equivalent beta of 1.5.

Fig 23 Cost of capital valuation: HSBC

Sustainable core ROE (%)	14.50
Cost of capital (%)	8.62
Risk-free rate (%)	3.46
Equity risk premium (%)	6.21
Beta	0.83
Target book multiple (x)	1.68
BVPS (YE03F, US$)	5.98
Implied target price (US$)	10.1
Implied target price (HK$)	78
Implied target price (GBP)	647

Source: Company data, ING estimates

HSBC's target book multiple of 1.68x means that our target price remains HK$78 (647p), which is equivalent to 15.2x trailing and 13.9x forward EPS and 1.8x trailing book value. We maintain our HOLD rating on the shares of HSBC, and recommend that investors switch to StanChart.

Fig 24 Valuation at target price: HSBC

	01	02	03F	04F
Share price (GBP)	647			
Share price (HK$)	78			
PER (x)	18.79	15.24	13.86	12.53
Core PER (x)	15.11	12.52	11.25	10.17
PUP (x)	7.74	7.74	6.31	6.03
P/BV (x)	2.02	1.81	1.68	1.60
P/ABV (x)	3.30	2.96	2.62	2.38

Source: Company data, ING estimates

Hong Kong bank universe – Relative valuations

Fig 25 Hong Kong banks

	BBG code	Price (HK$)	Mkt cap (US$m)	ING rating	Px target (HK$)	BVPS (HK$)	YE2002 PBV (x)	PER (x) 01	02	03F
HSBC	5 HK	82.75	100,311.25	HOLD	78.00	43.02	1.92	20.1	16.1	15.0
HSB	11 HK	79.00	19,413.32	SELL	70.00	22.79	3.47	14.9	15.2	18.1
STAN	2888 HK	83.00	12,478.75	BUY	92	44.74	1.86	19.1	16.9	13.0
BOCHK	2388 HK	8.05	10,939.70	HOLD	8.90	5.39	1.49	12.8	10.3	9.3
BEA	23 HK	13.85	2,582.79	SELL	11.50	10.06	1.38	12.4	15.6	14.9
DSF	440 HK	33.90	1,074.86	BUY	42.85	24.70	1.37	9.6	10.1	7.8
WHB	302 HK	27.00	1,018.43	NR	N/A	21.66	1.25	10.2	11.6	10.0
WLB	96 HK	30.60	913.24	NR	N/A	34.29	0.89	8.4	9.4	8.9
IBA	636 HK	2.45	369.12	NR	N/A	3.21	0.76	9.7	12.8	13.0
CKW	183 HK	1.98	772.48	NR	N/A	2.45	0.81	8.5	9.8	8.0
ICBC (Asia)	349 HK	6.45	517.64	NR	N/A	7.10	0.91	11.5	9.2	8.7
LCH	1111 HK	7.35	410.96	NR	N/A	13.50	0.54	9.2	10.4	9.1
HKEx	388 HK	8.55	1,146.87	BUY	12.00	5.28	1.62	12.0	15.0	16.1
AEON	900 HK	2.65	142.64	BUY	2.94	2.52	1.05	5.3	5.3	7.8
JCG	626 HK	3.45	313.85	HOLD	3.75	4.63	0.75	5.7	10.1	7.0
Average							1.34	11.29	11.85	11.11

Source: Company data, ING estimates, IBES

Financial statements

Fig 26 StanChart financial summary

Yr to Dec	01	02	03F	04F	05F
Income statement (US$m)					
Interest income	6,419	5,231	5,493	5,805	6,301
Interest expense	3,587	2,333	2,452	2,391	2,606
Net interest income	**2,832**	**2,898**	**3,042**	**3,414**	**3,695**
Avg int earning assets	*91,660*	*96,133*	*101,145*	*107,911*	*116,472*
NIM (%)	**3.09**	**3.01**	**3.01**	**3.16**	**3.17**
Non-interest income	1,505	1,476	1,571	1,639	1,747
Total operating income	**4,337**	**4,374**	**4,613**	**5,053**	**5,442**
Non-interest expense	2,585	2,557	2,539	2,613	2,705
Pre provision profit	**1,752**	**1,817**	**2,074**	**2,440**	**2,737**
Loan loss provisions	731	720	600	450	450
Non-operating income	(12)	26	(24)	(28)	(27)
Pre tax profit	**1,009**	**1,123**	**1,450**	**1,962**	**2,260**
Tax	378	387	501	657	755
Net profit	**631**	**736**	**949**	**1,305**	**1,505**
Core earnings	**629**	**698**	**973**	**1,333**	**1,532**
Per share data (HK$)					
EPS	0.56	0.63	0.82	1.12	1.29
DPS	0.42	0.47	0.48	0.67	0.78
Effective payout ratio (%)	*75*	*74*	*59*	*60*	*60*
BVPS	5.42	5.75	6.08	6.53	7.05
ABVPS	3.41	3.93	4.41	5.00	5.67
Valuation (x)					
Price to book value	2.0	1.9	1.8	1.6	1.5
Price to adjusted book value	3.1	2.7	2.4	2.1	1.9
Price to earnings	19.2	16.9	13.1	9.5	8.3
Profitability ratios (%)					
Net interest margin	3.09	3.01	3.01	3.16	3.17
Yield on interest earning assets	6.85	5.31	5.29	5.18	5.21
Cost on interest bearing liabilities	4.12	2.56	2.58	2.42	2.53
Net interest spread	2.72	2.75	2.71	2.76	2.68
Non-interest income (% op income)	34.70	33.74	34.06	32.43	32.11
Cost to income	59.60	58.46	55.04	51.72	49.71
Overhead ratio	2.82	2.66	2.51	2.42	2.32
Cost coverage	167.78	171.06	181.69	193.35	201.17
ROA	0.60	0.67	0.82	1.06	1.14
ROE	10.31	10.99	13.40	17.17	18.34
Oroa analysis (%)					
Net interest margin	3.09	3.01	3.01	3.16	3.17
Non-interest income/gross income	34.70	33.74	34.06	32.43	32.11
Efficiency ratio	59.60	58.46	55.04	51.72	49.71
Provisions/assets	0.68	0.64	0.50	0.35	0.33
Operating return on assets	**1.23**	**1.25**	**1.55**	**1.91**	**2.02**
Equity/assets	5.70	5.92	5.95	5.98	6.03
Operating return on equity	**21.58**	**21.15**	**26.01**	**31.92**	**33.46**

Source: Company data, ING estimates

Fig 26 StanChart financial summary (cont'd)

As at Dec	01	02	03F	04F	05F
Balance sheet (US$m)					
Gross loans	54,387	58,165	61,108	65,777	69,783
Loan loss reserves	*1,382*	*1,156*	*1,334*	*1,332*	*1,439*
Net loans	53,005	57,009	59,774	64,445	68,345
Total earning assets	93,768	98,497	103,793	112,028	120,916
Other assets	13,611	14,513	15,293	15,231	15,076
Total assets	**107,379**	**113,010**	**119,087**	**127,259**	**135,992**
Deposits	79,543	82,476	85,890	90,480	95,359
Customer deposits	67,855	71,626	75,040	79,630	84,509
Other deposits	11,688	10,850	10,850	10,850	10,850
Other paying liabilities	21,134	21,814	-	-	-
Other liabilities	13,526	13,507	-	-	-
Total liabilities	101,256	106,315	112,005	119,655	127,786
Equity with revaluation	**6,123**	**6,695**	**7,082**	**7,604**	**8,206**
Adjusted equity	**3,854**	**4,577**	**5,133**	**5,825**	**6,596**
Balance sheet ratios (%)					
Loans-to-deposits	68.4	70.5	71.1	72.7	73.2
Equity to assets	5.7	5.9	5.9	6.0	6.0
Total loan loss reserves to assets	1.29	1.02	1.12	1.05	1.06
Asset quality					
Nonperforming assets	2,279	1,756	1,772	1,816	1,860
Special mention	444	343	350	455	560
Substandard	1,113	859	876	854	831
Doubtful	448	344	339	303	268
Loss	274	210	207	204	202
ORE	-	-	-	-	-
NPAs/total loans (%)	4.2	3.0	2.9	2.8	2.7
Reserve coverage of NPAs (%)	60.6	65.8	75.3	73.4	77.3
Required reserves	1,264	1,135	1,163	1,189	1,209
Actual reserves	1,382	1,156	1,334	1,332	1,439
Shortfall (surplus)	(118)	(21)	(172)	(143)	(230)
Actual to required reserves (%)	109.3	101.8	114.8	112.0	119.0
Shortfall to capital (%)	-1.9	-0.3	-2.4	-1.9	-2.8
Growth rates (%, YoY)					
Income statement					
Net interest income	7	2	5	12	8
Non-interest income	9	-2	6	4	7
Non-interest expenses	-5	-1	-1	3	4
Pre-provision earnings	32	4	14	18	12
Loan loss provisions	56	-2	-17	-25	0
Core earnings	32	11	39	37	15
Net profit	**-37**	**17**	**29**	**38**	**15**
Balance sheet					
Loan growth	2	7	5	8	6
Interest earning assets	5	5	5	8	8
Asset growth	5	5	5	7	7
Deposit growth	4	4	4	5	5
Shareholders' funds	1	9	6	7	8

Source: Company data, ING estimates

Fig 27 HSBC financial summary

Yr to Dec	01	02	03F	04F
Income statement (US$m)				
Interest income	35,261	28,595		
Interest expense	20,536	13,135		
Net interest income	**14,725**	**15,460**	**21,760**	**22,358**
Avg int earning assets	*598,325*	*633,952*	*708,193*	*772,157*
NIM (%)	**2.46**	**2.44**	**3.07**	**2.90**
Non-interest income	11,990	11,774	14,818	15,074
Total operating income	**26,715**	**27,234**	**36,578**	**37,432**
Non-interest expense	14,605	14,954	19,544	19,631
Pre provision profit	**12,110**	**12,280**	**17,035**	**17,801**
Loan loss provisions	3,331	1,752	4,552	4,000
Non-operating income	(1,799)	(1,755)	(1,799)	(1,987)
Pre tax profit	**6,980**	**8,773**	**10,683**	**11,814**
Tax	1,988	2,534	2,933	3,243
Net profit	**4,992**	**6,239**	**7,750**	**8,571**
Core earnings	**6,208**	**7,590**	**9,549**	**10,558**
Per share data (HK$)				
EPS	0.53	0.66	0.72	0.80
DPS	0.48	0.53	0.57	0.60
Effective payout ratio (%)	*89*	*80*	*79*	*75*
BVPS	4.96	5.53	5.91	6.10
ABVPS	3.04	3.39	3.76	4.06
Valuation (x)				
Price to book value	2.1	1.9	1.8	1.7
Price to adjusted book value	3.5	3.1	2.8	2.6
Price to earnings	19.9	16.2	14.7	13.3
Profitability ratios (%)				
Net interest margin	2.46	2.44	3.07	2.90
Yield on interest earning assets	5.79	4.34		
Cost on interest bearing liabilities	3.21	1.94		
Net interest spread	2.58	2.40		
Non-interest income (% operating income)	44.88	43.23	40.51	40.27
Cost to income	54.67	54.91	53.43	52.44
Overhead ratio	2.44	2.36	2.76	2.54
Cost coverage	182.92	182.12	187.16	190.68
ROA	0.73	0.86	0.96	0.98
ROE	10.76	11.91	12.25	13.11
Oroa analysis (%)				
Net interest margin	2.46	2.44	3.07	2.90
Non-interest income/gross income	44.88	43.23	40.51	40.27
Efficiency ratio	54.67	54.91	53.43	52.44
Provision/assets	0.48	0.23	0.53	0.45
Operating return on assets	**1.55**	**1.71**	**1.88**	**1.86**
Equity/assets	6.66	6.90	7.36	7.31
Operating return on equity	**23.20**	**24.72**	**25.51**	**25.43**

Source: Company data, ING estimates

Fig 27 HSBC financial summary (cont'd)

As at Dec	01	02	03F	04F
Balance sheet (US$m)				
Gross loans	421,473	456,980	540,137	572,545
Loan loss reserves	*8,183*	*9,140*	*10,126*	*8,170*
Net loans	413,290	447,840	530,011	564,375
Total earning assets	608,534	659,369	757,016	787,297
Other assets	87,711	99,877	103,230	107,359
Total assets	**696,245**	**759,246**	**860,246**	**894,656**
Deposits	503,631	548,371		
Customer deposits	449,991	495,438		
Other deposits	53,640	52,933		
Other paying liabilities	71,330	73,426		
Other liabilities	128,536	137,976		
Total liabilities	649,857	706,840	796,971	829,280
Equity with revaluation	**46,388**	**52,406**	**63,275**	**65,376**
Adjusted equity	**28,438**	**32,154**	**40,255**	**43,508**
Balance sheet ratios (%)				
Loans-to-deposits	83.7	83.3		
Equity to assets	6.7	6.9	7.4	7.3
Total loan loss reserves to assets	1.18	1.20	1.18	0.91
Required reserves	4,215	4,570	5,401	5,725
Actual reserves	8,183	9,140	10,126	8,170
Shortfall (surplus)	(3,968)	(4,570)	(4,725)	(2,444)
Actual to required reserves	194.2	200.0	187.5	142.7
Shortfall to capital	-8.6	-8.7	-7.5	-3.7
Growth rates (%, YoY)				
Income statement				
Net interest income	7	5	41	3
Non-interest income	7	-2	26	2
Non-interest expenses	8	2	31	0
Pre-provision earnings	7	1	39	5
Loan loss provisions	221	-47	160	-12
Core earnings	-19	22	26	11
Net profit	-23	25	24	11
Balance sheet				
Loan growth	-1	8	18	6
Interest earning assets	3	8	15	4
Asset growth	3	9	13	4
Deposit growth	3	9		
Shareholders' funds	2	13	21	3

Source: Company data, ING estimates

Asian Contacts List

RESEARCH

Asia	Adrian Faure	(852) 2848 8559	adrian.faure@asia.ing.com
Bangkok	Kenneth Ng	(662) 694 7722	kenneth.ng@asia.ing.com
China	Peter So	(852) 2848 8547	peter.so@asia.ing.com
Hong Kong/China	Kingston Lee	(852) 2913 8576	kingston.lee@asia.ing.com
Jakarta	Laksono Widodo	(62) 21 515 7334	laksono.widodo@asia.ing.com
Kuala Lumpur	Uday Jayaram	(603) 2165 3221	uday.jayaram@asia.ing.com
Manila	Gilbert Lopez	(632) 840 8937	gilbert.lopez@asia.ing.com
Seoul	Eugene Ha	(822) 317 1517	eugene.ha@asia.ing.com
Taipei	James P. Carroll	(886) 2 2734 7526	james.p.carroll@asia.ing.com
Sectors			
Autos	Corinna Cheah	(603) 2165 3222	corinna.cheah@asia.ing.com
Banking	Paul Sheehan	(852) 2848 8580	paul.sheehan@asia.ing.com
Basic Materials	Simon Francis	(852) 2913 8586	simon.francis@asia.ing.com
Conglomerates	Cusson Leung	(852) 2848 8544	cusson.leung@asia.ing.com
Consumer	Amelia Mehta	(65) 6539 5519	amelia.mehta@asia.ing.com
Convertibles	Shui-Yee Leung	(852) 2913 8851	shui-yee.leung@asia.ing.com
Economics	Tim Condon	(852) 2913 8133	tim.condon@asia.ing.com
Small Cap	Andrew Kuet	(852) 2913 8576	andrew.kuet@asia.ing.com
Strategy	Markus Rosgen	(852) 2848 8535	markus.rosgen@asia.ing.com
Technology	Eugene Ha	(822) 317 1517	eugene.ha@asia.ing.com
Telecoms	Leon Chik	(852) 2913 8546	leon.chik@asia.ing.com
Transport	Philip Wickham	(852) 2848 8053	philip.wickham@asia.ing.com
Utilities	Rohan Dalziell	(852) 2848 8530	rohan.dalziell@asia.ing.com

SALES

Asia	Stephen Hill	(852) 2913 8899	stephen.hill@asia.ing.com
Bangkok	John Thompson	(662) 694 7705	j.thompson@asia.ing.com
China	Derek Chong	(8621) 6841 1794	derek.chong@asia.ing.com
Geneva	Daniel Fust	(41) 22 818 7777	daniel.fust@ing-barings.com
Hong Kong	Jenkin Leung	(852) 2913 8840	jenkin.leung@asia.ing.com
Jakarta	Darwin Sutanto	(62) 21 515 7321	darwin.sutanto@asia.ing.com
London	Carl Strutt	(44) 20 7767 8183	carl.strutt@uk.ing.com
London (N Asia)	Derek Wilson	(44) 20 7767 8130	derek.wilson@uk.ing.com
Manila	Louie Bate	(632) 840 8877	louie.bate@asia.ing.com
New York	John T. Sullivan	(1) 646 424 7774	john.t.sullivan@americas.ing.com
Paris	Dari Ing	(331) 5568 4544	dari.ing@ing-barings-fr.com
San Francisco	Sheila Schroeder	(1) 415 925 2281	sheila.schroeder@americas.ing.com
Seoul	Sang Kim	(822) 317 1563	sang.kim@asia.ing.com
Singapore	Giles Heyring	(65) 6539 5555	giles.heyring@asia.ing.com
Taiwan	Mark Duncan	(886) 2 2734 7510	mark.duncan@asia.ing.com

SALES TRADING

Asia	Robert Lacey	(852) 2913 8814	robert.lacey@asia.ing.com
Hong Kong	Mona Lee	(852) 2913 8873	mona.lee@asia.ing.com
Korea	Stephen Cho	(822) 317 1559	stephen.cho@asia.ing.com
Singapore	Lim Lay Koon	(65) 6539 5555	lim.lay.koon@asia.ing.com
London	Alex Foster	(44) 20 7767 1000	alex.foster@uk.ing.com
New York	Richard Hopkins	(1) 646 424 7715	richard.hopkins@americas.ing.com

HEDGE FUND SALES

Hong Kong	Daren Riley	(852) 2913 8801	daren.riley@asia.ing.com

HEADS OF EQUITY RESEARCH

Asia	Adrian Faure	(852) 2848 8559	adrian.faure@asia.ing.com
Japan	Robert Burghart	(813) 5210 1556	robert.burghart@asia.ing.com
Latin America, Middle East, Emerging Europe, Africa	William Vincent	(44) 20 7767 5858	william.vincent@uk.ing.com
Western Europe	John Donald	(44) 20 7767 6527	john.donald@uk.ing.com
Convertibles	Lorraine Lodge	(44) 20 7767 8864	lorraine.lodge@uk.ing.com

ECONOMICS & STRATEGY RESEARCH

Chief Economist			
Head of Economics & Strategy	Mark Cliffe	(44) 20 7767 6283	mark.cliffe@uk.ing.com
Emerging Europe & Africa	Philip Poole	(44) 20 7767 6970	philip.poole@uk.ing.com
Latin America	Larry Krohn	(1) 646 424 7815	lawrence.krohn@americas.ing.com
Asia	Tim Condon	(852) 2913 8133	tim.condon@asia.ing.com
Japan	Richard Jerram	(813) 5210 1519	richard.jerram@asia.ing.com

ING Financial Markets

AMSTERDAM	LONDON	NEW YORK	HONG KONG	TOKYO
Tel: 31 20 563 87 98 Fax: 31 20 563 87 66	Tel: 44 20 7767 1000 Fax: 44 20 7767 7777	Tel: 1 646 424 6000 Fax: 1 646 424 6060	Tel: 852 2848 8488 Fax: 852 2522 8640	Tel: 813 5210 1500 Fax: 813 5210 1555
Bangkok Tel: 662 263 2888-9	**Edinburgh** Tel: 44 131 527 3000	**Madrid** Tel: 34 91 789 0030	**Santiago** Tel: 562 330 0600	**Warsaw** Tel: 48 22 820 5018
Bratislava Tel: 421 2 5934 61 11	**Frankfurt** Tel: 49 69 718 2701	**Manila** Tel: 632 840 8888	**Sao Paulo** Tel: 55 11 3847 6000	
Brussels Tel: 32 2 547 70 60	**Geneva** Tel: 41 22 818 77 77	**Mexico City** Tel: 52 55 5258 2000	**Seoul** Tel: 822 317 1500	
Bucharest Tel: 401 222 1600	**Istanbul** Tel: 90 212 258 8770	**Milan** Tel: 39 02 4762 1	**Shanghai** Tel: 86 21 6841 3355	
Budapest Tel: 36 1 268 0140	**Jakarta** Tel: 62 21 515 1818	**Moscow** Tel: 7095 755 5400	**Singapore** Tel: 65 6535 3688	
Buenos Aires Tel: 54 11 4310 4700	**Kiev** Tel: 380 44 230 3030	**Paris** Tel: 33 1 56 39 31 41	**Sofia** Tel: 359 2 917 6400	
Dublin Tel: 353 1 638 4000	**Kuala Lumpur** Tel: 603 2166 8803	**Prague** Tel: 420 2 232 0000	**Taipei** Tel: 886 2 2734 7500	

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