

2009 RESULTS HIGHLIGHT SUPERIORITY OVER HSBC

Standard Chartered's FY 2009 results demonstrate to us its clear structural superiority over HSBC in a number of respects. We believe this will be maintained for the foreseeable future, particularly as we expect the market will arrive at our conclusion that HSBC has a much lower Core Tier 1 ratio under Basel III, which should constrain earnings and dividend growth. In addition, we see Standard Chartered as some 13% cheaper than HSBC on 2011E P/E. We have increased our target price for Standard Chartered to 2050p from 1500p, indicating 22% upside from the current share price, and upgrade to BUY from HOLD. This compares to our decrease in target price to 750p from 800p for HSBC a few days ago, indicating only 7% upside. We rate HSBC a HOLD.

- Standard Chartered's 2009 results are of very high quality in our opinion. Key features are: much better than expected net interest income (driven by strong growth in interest-earning assets); the Consumer Banking division now taking on the mantle of growth; a strong Core Tier 1 ratio of 8.9%; and better-than-expected asset quality, with absolute loan losses lower in H2 2009 than in H1 2009 together with a falling NPL ratio and increasing coverage ratio.
- Net income missed our and consensus estimates by 7% due to a high tax charge. Pre-tax profit missed our expectation by 1% (but was in-line with consensus), with strength in NII offset by weaker-than-expected trading income and higher-than-expected costs. We do not believe this detracts from what is essentially a very robust, high-quality growth story.
- Management indicated that it expects the net impact from the Basel III regulations on its capital ratios to be about 125bps (including the expected increase in RWA). Factoring this in to our Basel III model leads to an estimated Core Tier 1 ratio of 8.8% by our calculations, making Standard Chartered one of the best capitalised banks in its peer group. This compares to the 6.4% Basel III Core Tier 1 ratio that we see at HSBC. Increasing this ratio to the peer average of 7.5% would require HSBC to raise about \$13bn of capital.
- Importantly, unlike HSBC, we expect strong capital adequacy to allow Standard Chartered to grow earnings and dividends in an unrestrained fashion. We have already seen Standard Chartered grow its 2009 dividend by 7% YoY to \$0.66, and this should increase further in 2010 as earnings grow and the payout ratio is maintained at the same level. We expect \$0.78 for 2010 (+18% YoY), representing a yield of 4.9%. At HSBC, however, management indicated that its fears about forthcoming regulatory changes were the main reason for maintaining a flat dividend YoY for Q1 2010 of \$0.08.

Research

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Rating	BUY
Target price (p)	2050
Yesterday's closing price (p)	1674
Upside / Downside (%)	22
Market cap (£m)	33.9
Market cap (€m)	37.3
Sector	Pan-European Banks

USD/(USDm)	2009A	2010E	2011E
Net interest income	7,623	8,385	9,070
Net fees & commissions	3,370	3,505	3,645
Trading profits/losses	2,890	2,138	1,965
Other revenue	1,301	1,260	1,512
Total operating revenues	15,184	15,289	16,191
Operating costs	-7,952	-7,939	-8,348
Operating profit	7,232	7,350	7,843
Total provisions	-2,000	-1,590	-1,246
Pre-tax profit	5,151	5,713	6,551
ROA	0.78%	0.84%	0.84%
ROE	13.66%	13.44%	13.52%
ROTNV	18.52%	17.48%	17.12%
Cost/Income	-52.37%	-51.93%	-51.56%
Net interest margin	2.32%	2.23%	2.23%
LLC % gross loans	-0.84%	-0.60%	-0.43%
NPL ratio	1.57%	1.50%	1.20%
NPL coverage ratio	71.31%	73.00%	73.00%
Loans % deposits	79%	76%	71%
Core tier 1 ratio	8.93%	9.37%	9.94%
EPS	1.68	1.91	2.20
DPS	0.66	0.78	0.90
Payout ratio	39.32%	40.00%	40.00%
P/TNAV	2.32	1.98	1.69
Div yield	4.16%	4.93%	5.65%



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Further Detail

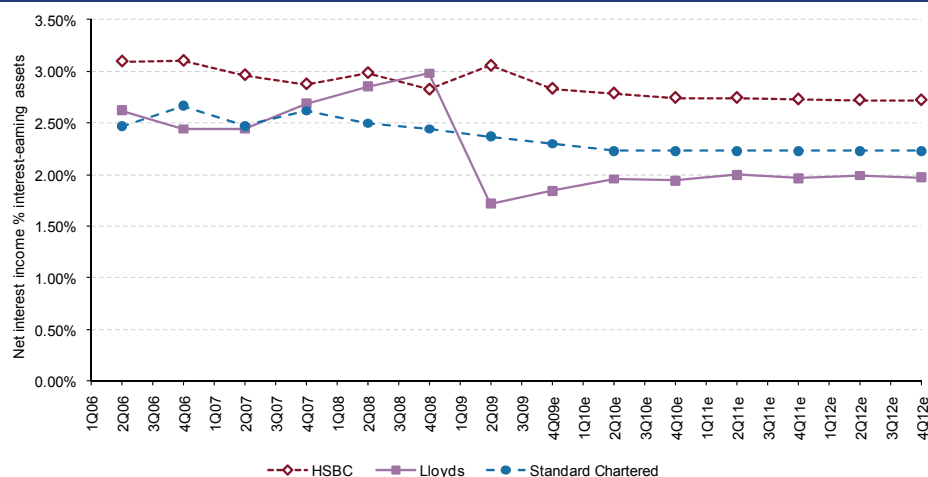
Net Interest Income Supported by Strong Loan Growth

Net interest income in H2 2009 was 8% higher than our estimate, representing growth of 6% HoH. This was driven by greater-than-expected growth in interest-earning assets of 11% HoH. The net interest margin, disappointingly, fell to 2.27% in H2 2009 from 2.37% in H1 2009, although not by the same magnitude as that seen at HSBC, where the NIM fell to 2.83% from 3.05% HoH and where the NII contracted HoH in absolute terms.

The main reason for the NIM contraction was the continued negative impact from falling base rates in Standard Chartered's key markets. Management indicates that there may be one or two more quarters of modest declines in the NIM as the negative pressure continues to have an impact, but that there should be stabilisation thereafter in the absence of rate increases. We have factored a flat NIM into our model, although concede that rising rates may mean that we have been too conservative.

More importantly, unlike at HSBC, we expect NIM contraction to be more than compensated by strong loan growth, resulting in growing, not declining NII.

Figure 1: NIM of UK Lending Banks



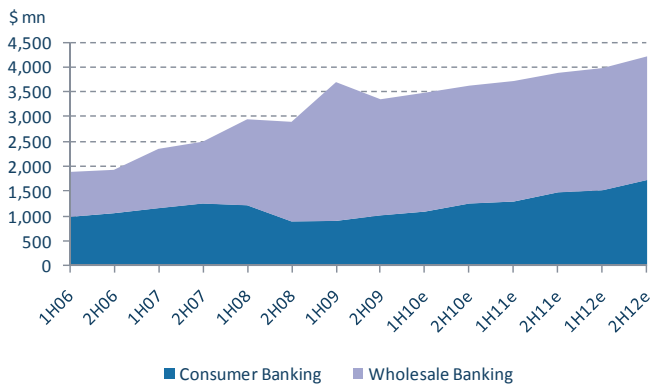
Source: Matrix Corporate Capital Research

Consumer Banking Division Now Taking on the Mantle of Growth

After a prolonged period of weak revenues and pre-tax profits from the Consumer Banking division (due to declining liability spreads and weaker volumes over the course of the credit crisis), it was very reassuring to see a rebound in H2 2009. This should be taken well by the market, particularly given the simultaneous fall in Own Account income in the Wholesale Banking division (due to lower volatility and volumes), which is perceived to be of low quality.

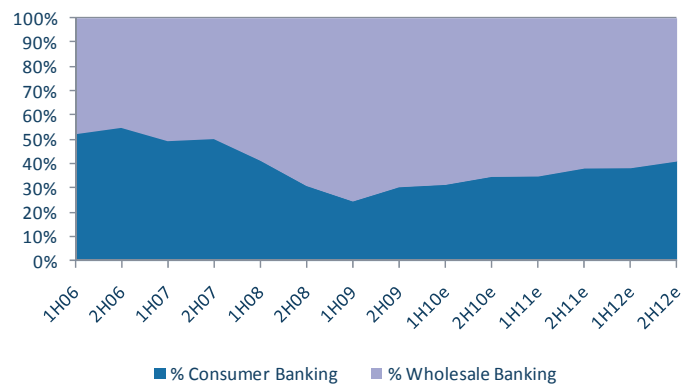
Management's efforts to restructure the Consumer Banking division into a more client-focussed business are now bearing fruit, although it is only half-way through the 18-month restructuring programme. We anticipate that the division will continue to post better revenue and pre-tax profit growth than the Wholesale Banking division over the course of 2010 and 2011, to the extent that it will account for closer to 40% of the group pre-tax profit rather than 25%, as at H1 2009.

Figure 2: Pre-tax Profit Derived From Consumer and Wholesale Banking Divisions



Source: Matrix Corporate Capital Research

Figure 3: Proportion of Group Pre-tax Profit Derived From Consumer and Wholesale Banking Divisions

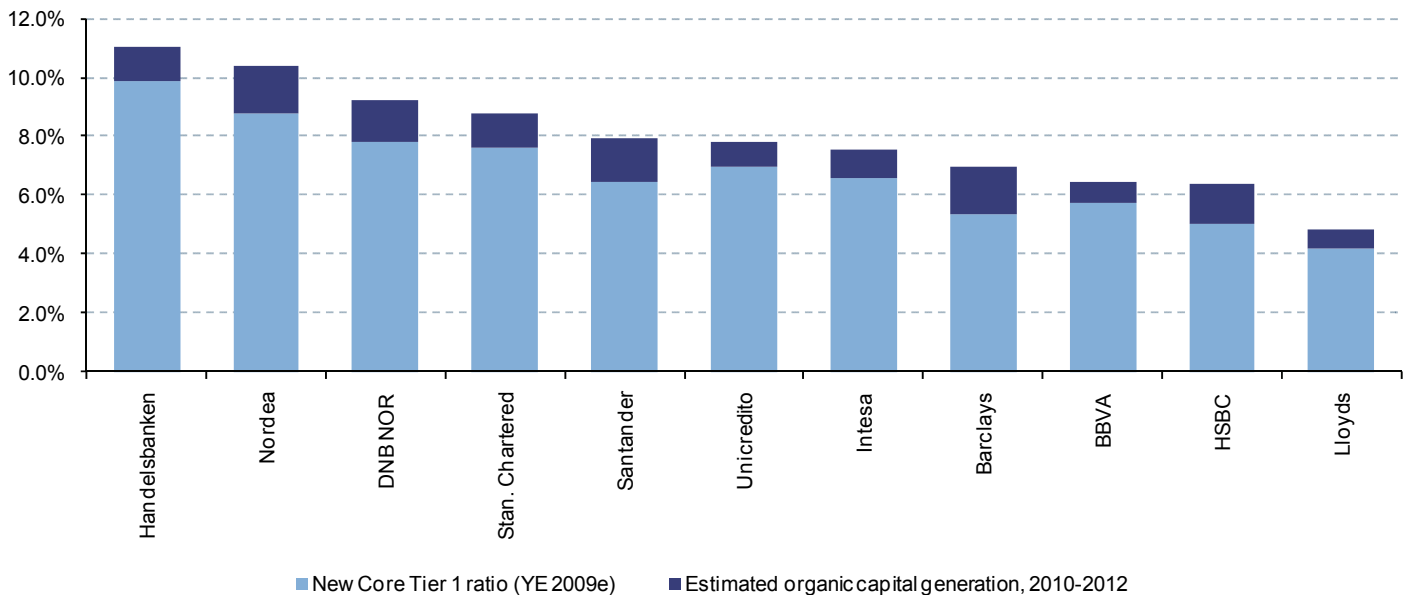


Source: Matrix Corporate Capital Research

Capital Adequacy Very Strong Under Basel III

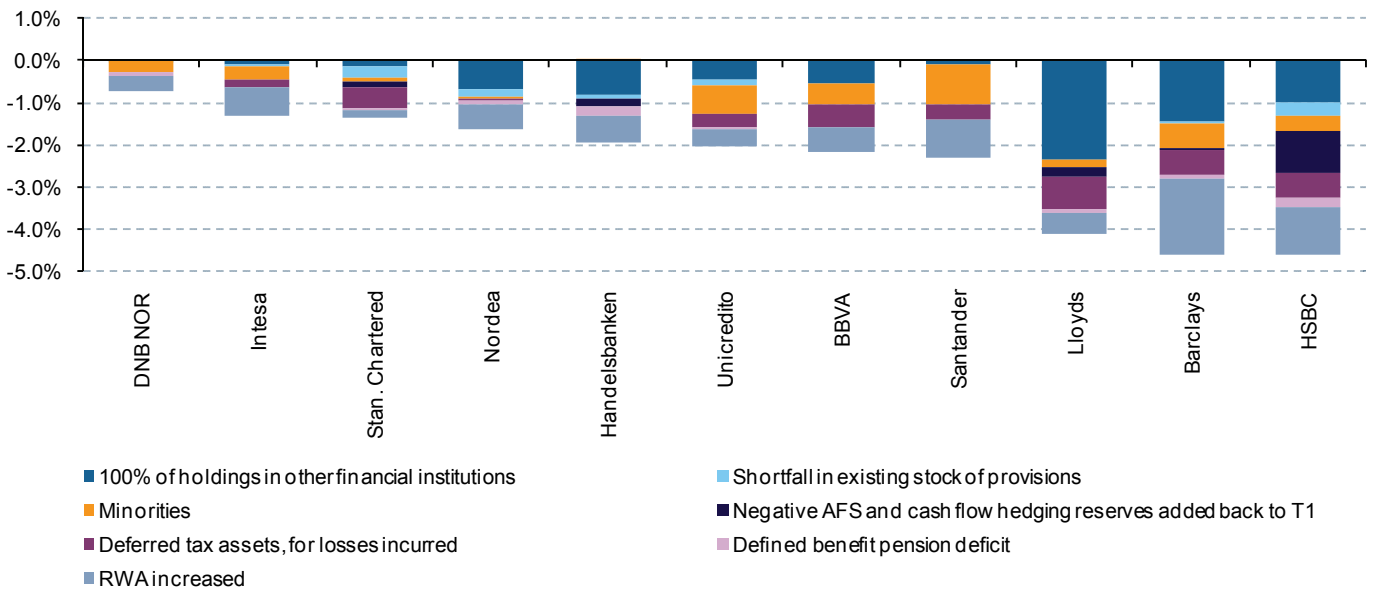
Management disclosed at the analyst presentation that it estimates the impact from the Basel III regulations to be only 125bps (this includes the expected increase in RWA). This is quite a bit less than our previous estimated impact of 314bps. The necessary deductions against common equity are quite transparent, leading us to conclude that our forecast of a threefold increase in the Market Risk component of RWA is somewhat harsh. 'Reverse-engineering' the increase in RWA from management's estimated impact on the Core Tier 1 ratio of 125bps leads us to conclude that the RWA should only increase by 10-20% under Basel III. We have assumed a 20% increase in our revised Basel III model, leading to a new Basel III Core Tier 1 ratio of 8.8%. This estimate also includes the £1.7bn capital increase undertaken in August 2009, which was not included before.

Figure 4: Lending Banks Ranked by Estimated Core Tier 1 Ratio Under Basel III



Source: Matrix Corporate Capital Research

Figure 5: Banks Ranked by Estimated Impact on Core Tier 1 Ratio From Basel III



Source: Matrix Corporate Capital Research

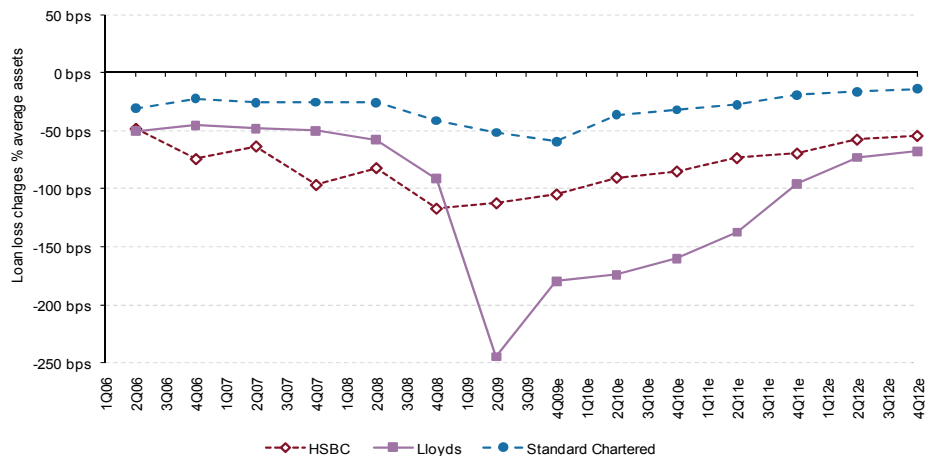
Dividend Policy – Progressive, Not Stagnant

We believe that, unlike HSBC, Standard Chartered’s strong capitalisation should allow it to grow earnings and dividends in an unrestrained fashion. We have already seen Standard Chartered grow its 2009 dividend by 7% YoY to \$0.66, and this should increase further in 2010 as earnings grow and the payout ratio is maintained at the same level. We expect \$0.78 for 2010. At HSBC, however, management indicated that its fears about the forthcoming regulatory changes were the main reason for maintaining a flat dividend YoY for Q1 2010 of \$0.08.

Asset Quality Improving Better Than Expected

Loan losses in H2 2009 were some 27% lower than expected, representing a loan loss ratio of only 0.75% compared to 0.96% in H1 2009. The improvement in credit quality is occurring more quickly than anticipated. In addition to faster-than-expected loan growth, we believe this will be the key driver of upgrades to consensus earnings estimates. It is also positive that the NPL ratio fell to 1.6% in H2 2009 from 1.8% in H1 2009 and the loan loss reserve coverage ratio improved to 71% from 64%.

Figure 6: Loan Loss Charges as a Percentage of Average Assets



Source: Matrix Corporate Capital Research

Figure 7: Standard Chartered Earnings table

	FY2008	H2 2009E	H2 2009	FY 2009E	FY 2009	FY 2010E	FY 2011E	FY 2012E
INCOME STATEMENT (US\$m)								
Net interest income	7,387	3,634	3,923	7,334	7,623	8,385	9,070	9,810
Net fees & commissions	2,941	1,701	1,685	3,386	3,370	3,505	3,645	3,791
Trading profits/losses	2,405	1,505	1,150	3,245	2,890	2,138	1,965	1,993
Other revenue	1,235	666	466	1,501	1,301	1,260	1,512	1,562
Total operating revenues	13,968	7,506	7,224	15,466	15,184	15,289	16,191	17,156
Operating costs	-7,611	-3,809	-3,925	-7,836	-7,952	-7,939	-8,348	-8,725
Operating profit	6,357	3,697	3,299	7,630	7,232	7,350	7,843	8,431
Total provisions	-1,321	-1,249	-912	-2,337	-2,000	-1,590	-1,246	-928
Impairments on other assets	-469	-36	-87	-51	-102	-67	-67	-67
Goodwill impairment	0	0	0	0	0	0	0	0
Other income	234	11	13	19	21	21	21	21
Pre-tax profit	4,801	2,423	2,313	5,261	5,151	5,713	6,551	7,457
Taxes	-1,290	-654	-827	-1,501	-1,674	-1,657	-1,900	-2,163
Minorities	-103	-53	-39	-111	-97	-122	-140	-159
Other non-operating items	0	-3	-2	-1	0	0	0	0
Net profit	3,408	1,713	1,445	3,648	3,380	3,935	4,511	5,136
ASSETS (US\$m)								
Loans to customers	174,178	182,330	198,292	182,330	198,292	221,620	242,454	264,419
Interbank loans	46,583	45,366	50,885	45,366	50,885	50,885	52,941	55,080
Total securities	145,477	131,905	136,367	131,905	136,367	144,129	152,687	162,122
Intangible assets	6,361	6,532	6,620	6,532	6,620	6,887	7,166	7,455
Total assets	435,068	430,405	436,653	430,405	436,653	501,918	577,144	663,912
Net interest-earning assets	390,399	370,812	403,675	370,812	403,675	435,498	467,707	502,039
LIABILITIES (US\$m)								
Interbank borrowings	31,909	35,652	38,461	35,652	38,461	44,034	50,415	57,720
Customer deposits	257,455	260,630	280,516	260,630	280,516	325,941	378,770	440,216
Total shareholders' equity	22,140	25,699	27,340	25,699	27,340	31,192	35,566	40,566
Tangible net asset value	15,779	19,166	20,720	19,166	20,720	24,305	28,401	33,111
IMPORTANT FINANCIAL RATIOS								
ROA	0.89%	0.82%	0.68%	0.84%	0.78%	0.84%	0.84%	0.83%
ROE	15.85%	14.00%	11.42%	15.25%	13.66%	13.44%	13.52%	13.49%
ROTNV	22.53%	19.01%	15.38%	20.88%	18.52%	17.48%	17.12%	16.70%
Cost/income	-54.49%	-50.75%	-54.33%	-50.67%	-52.37%	-51.93%	-51.56%	-50.86%
Tax rate	-26.87%	-27.00%	-35.75%	-28.53%	-32.50%	-29.00%	-29.00%	-29.00%
Payout ratio	34.18%	50.60%	62.47%	35.00%	39.32%	40.00%	40.00%	40.00%
Net interest margin	2.47%	2.30%	2.27%	2.33%	2.32%	2.23%	2.23%	2.23%
LLC % gross loans	-0.64%	-1.08%	-0.75%	-1.03%	-0.84%	-0.60%	-0.43%	-0.30%
Non-performing loans % gross loans	1.35%	1.80%	1.57%	1.80%	1.57%	1.50%	1.20%	1.20%
NPL coverage ratio	65.88%	73.00%	71.31%	73.00%	71.31%	73.00%	73.00%	73.00%
Loans % deposits	74.43%	76.18%	78.92%	76.18%	78.92%	75.63%	70.93%	66.32%
Tier 1 ratio	9.92%	10.69%	11.49%	10.69%	11.49%	11.76%	12.20%	12.69%
Core tier 1 ratio	7.51%	7.86%	8.93%	7.86%	8.93%	9.37%	9.94%	10.57%
Equity % total assets	5.09%	5.97%	6.26%	5.97%	6.26%	6.21%	6.16%	6.11%
RWA % total assets	43.40%	48.59%	48.99%	48.59%	48.99%	45.66%	42.12%	38.85%

Source: Matrix Corporate Capital Research

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Company	Disclosure
Standard Chartered (STAN)	None

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