



HSBC Q1 2010 IMS LOOKS GOOD ON CREDIT QUALITY

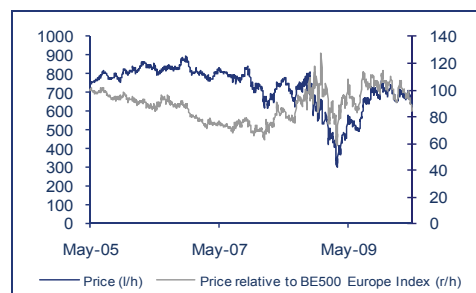
Management notes the first pre-tax profit in the US since 2007. NIM appears to be still weakening, but the reduction in loan losses is ahead of schedule, falling to the lowest quarterly level for more than two years, implying that profits will be ahead of our own and consensus forecasts for H1 2010. We rate the stock a SELL. Given its strong deposit base, HSBC has obvious defensive attractions in a market concerned with sovereign indebtedness and the contagion effect to bank borrowing costs. However, in our opinion, Standard Chartered is equally well funded from customer deposits, should benefit more from expanding liability margins as base rates in Asia rise, has much better growth and much stronger capitalisation under Basel III. We see Lloyds (HOLD) as having greater upside as a restructuring play. (We do not cover RBS or Barclays).

- “Credit quality improved faster than we anticipated in US consumer finance, and more generally across the Group. As a result, loan impairment charges fell to the lowest quarterly level for more than two years, reducing in every customer group and in all regions except the Middle East.” This is a positive statement. We forecast H1 2010 loan losses of £10.8bn (which we believe is similar to consensus). This compares to H1 2008 loan losses of £10.1bn. If the Q1 2010 run-rate management is alluding to is maintained, this would imply an upgrade in earnings of some £0.8-1.0bn for H1 2010.
- As per the Standard Chartered IMS, HSBC management alludes to weaker deposit spreads and likely weaker NIM compared to that achieved in H2 2009.
- “For the Group as a whole, revenues were lower than in Q1 2009 but were higher than in Q4 2009.” This is positive. We have forecasted H1 2010 revenues to be slightly lower than in H2 2009, given an expectation of NIM weakening further. The statement suggests to us that either volumes or other core operating revenues are more than compensating for this.
- The Tier 1 ratio strengthened to 11.1% from 10.8% over the quarter and the Core Tier 1 ratio improved to 9.7% from 9.4%. This is ahead of our expectations of a Core Tier 1 ratio of 9.4% in H1 2010, although we continue to think that HSBC has relatively weak capital adequacy versus the peer group under Basel III. RWA fell slightly in the quarter.

Rating	SELL
Target price (p)	650.00
Yesterday's closing price (p)	628.40
Upside / Downside	3%
Market cap (£bn)	110.5
Market cap (€bn)	126.5
Sector	Pan-Euro Banks

Research

Andrew Lim +44 20 3206 7347 andrew.lim@matrixgroup.co.uk



Matrix Corporate Capital LLP is authorised and regulated in the United Kingdom by the Financial Services Authority. This document must be treated as a marketing communication as it has not been prepared in accordance with legal requirements designed to promote the independence of investment research.

Figure 1: HSBC Earnings Table

HSBC HLDGS PLC	H1 2009	H2 2009	FY 2009	H1 2010E	FY 2010E	FY 2011E	FY 2012E
Income statement (US\$m)							
Net interest income	20,538	20,192	40,730	19,924	39,845	40,462	41,454
Net fees & commissions	8,428	9,236	17,664	8,849	18,703	19,816	21,008
Trading profits/losses	6,255	3,608	9,863	4,115	7,217	6,815	6,454
Other revenue	64	-879	-815	733	2,544	4,738	4,329
Total operating revenues	35,285	32,157	67,442	33,620	68,309	71,831	73,245
Operating costs	-16,658	-17,738	-34,395	-17,088	-33,614	-33,140	-32,990
Operating profit	18,627	14,419	33,047	16,533	34,695	38,691	40,255
Total provisions	-13,931	-12,557	-26,488	-10,775	-21,048	-17,658	-14,227
Investment income	323	197	520	192	384	384	384
Impairments on other assets	0	0	0	0	0	0	0
Goodwill impairment	0	0	0	0	0	0	0
Pre-tax profit	5,019	2,059	7,079	5,950	14,031	21,417	26,412
Taxes	-1,286	901	-385	-1,487	-3,508	-5,354	-6,603
Minorities	-386	-474	-860	-469	-1,105	-1,687	-2,080
Other non-operating items	-4	-2	0	1	0	0	0
Net profit	3,343	2,484	5,834	3,995	9,418	14,376	17,729
Assets (US\$m)							
Loans to customers	924,683	896,231	896,231	897,187	907,977	931,363	954,643
Interbank loans	182,266	179,781	179,781	181,579	183,395	187,081	190,841
Total securities	801,163	845,183	845,183	853,659	862,305	897,142	933,386
Intangible assets	29,105	29,994	29,994	30,594	31,206	32,466	33,778
Total assets	2,421,843	2,364,452	2,364,452	2,398,512	2,434,195	2,511,111	2,593,673
Net interest-earning assets	1,516,761	1,529,683	1,529,683	1,541,511	1,563,371	1,609,512	1,656,392
Liabilities (US\$m)							
Interbank borrowings	129,151	130,606	130,606	133,218	135,882	141,372	147,084
Customer deposits	1,319,542	1,323,393	1,323,393	1,338,271	1,353,330	1,384,003	1,415,433
Total shareholders' equity	118,355	128,299	128,299	129,374	131,527	139,714	151,253
Tangible net asset value	89,250	98,305	98,305	98,780	100,322	107,247	117,475
Important financial ratios							
ROA	0.27%	0.21%	0.24%	0.34%	0.39%	0.58%	0.69%
ROE	6.32%	4.03%	5.26%	6.20%	7.25%	10.60%	12.19%
ROTNV	8.61%	5.30%	7.09%	8.11%	9.48%	13.85%	15.78%
Cost/income	-46.78%	-54.82%	-50.61%	-50.54%	-48.93%	-45.89%	-44.81%
Tax rate	-25.62%	43.76%	-5.44%	-25.00%	-25.00%	-25.00%	-25.00%
Payout ratio	82.70%	126.04%	101.16%	69.74%	62.84%	41.17%	33.38%
Net interest margin	3.05%	2.83%	2.94%	2.78%	2.76%	2.73%	2.72%
LLC % gross loans	-2.92%	-2.68%	-2.82%	-2.33%	-2.27%	-1.88%	-1.48%
Non-performing loans % gross loans	3.34%	3.32%	3.32%	3.30%	3.00%	2.25%	1.60%
NPL coverage ratio	87.04%	83.45%	83.45%	85.00%	87.00%	92.00%	100.00%
Loans % deposits	79.48%	77.33%	77.33%	76.64%	76.80%	77.22%	77.59%
Tier 1 ratio	10.12%	10.78%	10.78%	10.78%	10.87%	11.37%	12.13%
Core tier 1 ratio (Basel II)	8.77%	9.38%	9.38%	9.40%	9.50%	10.03%	10.82%
Est. Core tier 1 ratio (Basel III)	4.45%	5.05%	5.05%	5.08%	5.18%	5.71%	6.49%
RWA % total assets	47.87%	47.93%	47.93%	47.72%	47.49%	46.96%	46.38%

Source: Matrix Research

IMPORTANT DISCLOSURES

General Disclosures

MCC is committed to publishing accurate but non-independent research reports. MCC may provide financial advice to, and undertake corporate finance and other transactions on behalf of, companies on which it publishes research. Therefore, research reports published by MCC have not been prepared in accordance with legal requirements designed to promote the independence of investment research; nor is MCC subject to any prohibition on dealing ahead of the dissemination of investment research. Accordingly, this research report should be treated as a marketing communication.

This report was first released on 07 May 2010.

Unless otherwise noted, the securities prices noted in this report were market prices on 06 May 2010.

We seek to update our research as appropriate, but various regulations may prevent us from doing so. Our reports are published at irregular intervals as appropriate in the analyst's judgement.

MCC's price targets are based on several methodologies, which may include, but are not restricted to, analyses of market risk, growth rate, revenue stream, discounted cash flow, EBITDA, EPS, cash flow (CF), free cash flow (FCF), EV/EBITDA, P/E, PE/growth, P/CF, premium (discount)/average group EV/EBITDA, premium (discount)/average group P/E, sum of the parts, net asset value, dividend returns, and return on equity over the next 12 months.

This report has been prepared by the individual(s) whose name(s) appear(s) on the front cover. Unless it has been otherwise specified, the preparers are employed by MCC as research analysts. Research analysts are paid in part based on the profitability of MCC, which includes remuneration received from investment banking transactions.

Specific Disclosures

Company	Disclosure
HSBC Holdings (HSBA)	None

1. Matrix Corporate Capital acts as broker
2. Matrix Corporate Capital acts as NOMAD
3. Matrix Corporate Capital acts as market maker

MCC, its partners, employees and any affiliated undertaking may have a position or holding in any of the securities mentioned in this report or in a related instrument.

Disclaimer

This report is issued by Matrix Corporate Capital LLP ("MCC") which is authorised and regulated in the United Kingdom by the Financial Services Authority (FSA) and is a member of the London Stock Exchange.

This report is not directed to, or intended for distribution to, or use by, any person or entity who is a citizen or resident of, or located in any locality, state, country or other jurisdiction where such distribution, publication, availability or use would be contrary to law or regulation or which would subject MCC to any registration or licensing requirement within such jurisdiction.

This report is for the use of the addressees only and is intended for use only by a person or entity that qualifies as an authorised person or exempt person within the meaning of section 19 of the Financial Services and Markets Act 2000 (the "Act") or qualifies as a person to whom the financial promotion restrictions imposed by the Act do not apply by virtue of the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005, or is a person classified as an "professional client" for the purposes of the Conduct of Business Sourcebook of the FSA. Consequently, this report is intended for use only by high net worth entities or by persons having professional experience in matters relating to investments. This report is not intended for use by other persons, in particular, "retail clients" as defined by the rules of the FSA. Any such person who receives this report should not act upon the contents of this report.

The information and materials presented in this report have been obtained or derived from sources believed by MCC to be reliable. Such information and materials have not been independently verified and MCC makes no representation as to their accuracy or completeness. Neither MCC, nor any of its directors or employees accepts liability for any loss arising from the use of material presented in this report.

Any forecasts or target prices shown for companies or securities noted in this report may not be achieved due to multiple risk factors including, without limitation, market volatility, sector volatility, corporate actions, the unavailability of complete and accurate information or assumptions made by MCC or other sources relied on in the report subsequently transpiring to be inapposite.

The information and materials presented in this report are provided to you for information purposes only and are not to be used or considered as an offer, or the solicitation of an offer, to sell or buy or subscribe for securities or other financial instruments. This report was prepared for general circulation and does not give investment advice or personal recommendations specific to individual investors. As such, the companies and securities discussed in this report may not be suitable for all investors who must make their own investment decisions based on their specific investment objectives and financial situation utilising their own financial advisors as they deem necessary. MCC will not treat recipients of this report as clients by virtue of their receiving it.

Past performance should not be taken as an indication or guarantee of future performance, and no representation or warranty, express or implied, is made regarding future performance. Information, opinions and estimates contained in this report reflect the preparer's best judgement at the date of publication and are subject to change without notice. The price, value of, and income from any of the securities or financial instruments mentioned in this report can fall as well as rise. You may not get back as much as you invest. Fluctuations in exchange rates could have adverse effects on the value or price of, or income derived from, certain investments.

None of the material presented in this report, nor its content, nor any copy of it, may be altered in any way, transmitted, copied or distributed to, any other party, without the express prior written permission of MCC.

Matrix Corporate Capital LLP

One Vine Street

London, W1J 0AH

+44 (0) 20 3206 7000