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COMPANY PROFILE

HSBC Holdings Plc

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COMPANY OVERVIEW

HSBC Holdings Plc (HSBC) is a leading global provider of banking and financial solutions. It offers retail, commercial, and private banking; and wealth management services through its subsidiaries. The group's offerings include loans, deposit services, mortgages, cards, insurance, asset management, working capital and term loans, payment services, international trade facilitation, M&A advisory, transaction banking, capital markets and risk management, investment management, and trusts and estate planning. The group has a presence in Europe, Asia, MENA, North America, and Latin America. HSBC is headquartered in London, the UK.

The bank reported interest income of (US Dollars) US$40,995 million for the fiscal year ended December 2017 (FY2017), a decrease of 3.3% over FY2016. The net interest income after loan loss provision of the bank was US$26,407 million in FY2017, compared to net interest income after loan loss provision of US$26,413 million in FY2016. In FY2017, the bank recorded a net margin of 26.3%, compared to a net margin of 5.8% in FY2016.

The bank reported interest income of US$7,456.0 million for the first quarter ended March 2018, a decrease of 64.9% over the previous quarter.

KEY FACTS

Head Office	HSBC Holdings Plc 8 Canada Square LONDON England LONDON England GBR
Phone	44 20 79918888
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Web Address	www.hsbc.com
Revenue / turnover (USD Mn)	82,012.0
Financial Year End	December
Employees	228,899
London Stock Exchange (LON) Ticker	HSBA

SWOT ANALYSIS

HSBC Holdings Plc (HSBC) is one of the largest providers of banking and financial services in the world. Sound capital adequacy and market position; adequate liquidity; and improved asset quality, cost efficiency and non-interest income are the major strengths of the group; even as decrease in net-interest margin, and litigation and penalties could be causes for concern. Digital transformation, the emergence of Fintech, growing cards and payments channel in the UK, and expansion initiatives in China may offer new growth opportunities. However, risks related to regulatory changes in the EU and the UK, prolonged low-interest-rate environment, and concerns related to cryptocurrencies could pose challenges to the group.

Strength Capital Adequacy Adequate Liquidity Cost Efficiency Non-Interest Income Asset Quality International Market Position	**Weakness** Net Interest Margin Litigations and Penalties
Opportunity Digital Transformation Growing Cards and Payments Channel: The UK HSBC's China-Centric Initiatives Emergence of FinTech	**Threat** Regulatory Changes: The European Union and the UK Prolonged Low-Interest-Rate Environment Concerns Related to Cryptocurrencies

Strength

Capital Adequacy

HSBC has a sound capital base, ensuring capital adequacy to facilitate its organic and inorganic growth with the secured and unsecured nature of its lending. Sound capital management and moderate risk-weighted asset growth enabled the group to strengthen its capital base. In FY2017, the group reported common equity tier 1 (CET1) ratio of 14.5%, tier 1 ratio of 17.3%, and total capital ratio of 20.9%; as compared to 13.6%, 16.1%, and 20.1%, respectively, in the previous year. The improvement was due to capital generation through profits, favorable foreign exchange, share buy-back, regulatory netting of US$1.5 billion, decrease in deduction for excess expected loss, and increase in the value of minority interest. The ratios were well above the minimum requirements of 8%, 8.5%, and 10.5% respectively, set by financial authorities under Basel III. Its leverage ratio stood at 5.6% in FY2017, compared to 5.4% in FY2016, meeting the minimum requirements of 3.25%.

Adequate Liquidity

HSBC continued to report adequate liquidity in FY2017, which enabled it to carry out day-to-day operations with ease. During the year, its loan-to-deposit ratio was 70.58%, as compared to 67.71% in the previous year. Improvement was due to higher increase in net loans than the increase in customer deposits. The group's net loans grew 11.8% to US$963 billion; whereas its customer deposits increased 7.2%. Its liquidity coverage ratio (LCR) was 142.2%, as compared to 136% and in FY2016. It had high-quality liquid assets of US$512.6 million, reflecting an increase of 14.7% over US$447 billion. The LCR was well above the minimum requirement of 80% in FY2017, which will become 90% in FY2018, and 100% in FY2019.

Cost Efficiency

The group reported improvement in its cost efficiency in FY2017, which enhanced its profitability. It has been implementing various initiatives to improve it operational efficiency. Under its transformation program, the group reduced the number of branches by more than 20% in its major markets with the help of enhancing digital capabilities; automated and re-engineered operations, which enabled quick customer services; and adopted DevOps and Agile that resulted in reduced IT costs and enhanced security. During the year, the group concluded its cost-saving program and realized US$6.1 billion of annual run-rate savings, which helped offset increased costs due to regulatory programs and compliance. During the year, the group's efficiency ratio improved to 60.44% from 61.04% in the previous year. The ratio indicates operating expense as percentage of adjusted revenue. The group's operating expenses increased 3.5% to US$31,140 million from US$30,084 million in the previous year, owing to investment in growth initiatives and higher expenses from RBWM and CMB segments. Its adjusted revenue increased 4.5% to US$51,524 million from US$49,290 million in FY2016, as a result of higher adjusted revenue from RBWM, CMB, and GB&M segments. The group delivered over US$1 billion cost savings in Global Functions including Financial Crime Risk, Risk, Finance, and HR through process re-engineering and better use of near-shore and offshore operations.

Non-Interest Income

The group's non-interest income (NII) increased in FY2017, which enhanced its revenue. During the year, NII increased 2% to US$41,017 million from US$40,215 million in FY2016. NII is an important source of revenue for entities providing banking and other financial solutions. In FY2017, it constituted 50.01% of the group's total revenue, as compared to 48.67% in FY2016. The improvement was due to 1.2% increase in fee income from funds under management, cards, unit trusts, underwriting, global custody, broking, and other activities.

Asset Quality

HSBC reported improvement in its asset quality in FY2017, which ensured interest income from outstanding loans and leases. During the year, the group reported impaired loans (NPL) of US$15,470 million, a substantial decline of 15.1% over US$18,228 million in FY2016. NPLs as percentage of gross loans and advances improved to 1.46%, from 1.90% in the previous year. There was substantial improvement in North American business, which led to decline in NPL of 46.2% due to improved conditions in oil and gas sector; followed by MENA (12.6%); Asia (10%); Latin America (4.9%); and Europe (0.2%). Asia was the most benign region in terms of quality of assets with NPL ratio at 0.5%, followed by Europe (2%), North America (2.2%), Latin America (2.6%), and MENA (5.4%). Due to the improved quality of assets, the group’s impairment allowance declined 4.7% to US$7,484 million from US$7,850 million in FY2016. Consequently, its NPL coverage ratio improved to 48.38% from 43.07% in the previous year.

International Market Position

HSBC continued to enhance its international market position, which provides it competitive advantage. Its business mix is more oriented towards Asia. In FY2017, its international client revenue was 53%, as compared to 50% in FY2015. The group was ranked first in trade finance operations, with a market share of 13.8% in Hong Kong and 10% in Singapore. Its market share in International commercial payments stood at 10.8% and 26.3% in Hong Kong liquidity and cash management. During the year, in foreign exchange operations, the group was ranked first among FX corporates, and third among FX institutions. It was ranked sixth in cross-border transactions.

Weakness

Net Interest Margin

HSBC has been reporting decrease in its net interest margin (NIM) in FY2017, which has been affecting its net interest income. During the year, NIM declined to 1.63% from 1.73% in the previous year. The decline was due to contraction in net interest spread, which decreased to 1.49% from 1.59% in the previous year, which resulted from increase in the cost of funds and decline in yield on average interest-earning assets. The group’s yield on average earning assets stood at 2.37%, as compared to 2.46% in FY2016; whereas its cost of funds increased to 0.88%, from 0.87% in the previous year. Lower customer lending yields due to the impact of consumer and mortgage lending run-off in the US; margin compression in Europe and Asia; higher MREL issuance; and unfavorable currency translation were the major factors, which led to decrease in NIM.

Litigations and Penalties

Involvement in litigations and regulatory issues could lead to the group incurring increased costs. In January 2018, the group entered into a deferred prosecution agreement with the Department of Justice, Criminal Division, Fraud Section, under which, it is required to pay US$101.5 million to resolve two wire fraud cases under 18 U.S.C. 1343, as criminal penalties and disgorgement. The charges were related to price manipulation in two foreign exchange transactions in 2011. In December 2017, it agreed to pay EUR300 million to settle a tax investigation in France. In September 2017, HSBC was fined a penalty of US$175 million by the Federal Reserve in a case related to improper trading.

Opportunity

Digital Transformation

The group invested over US$2.3 billion in digital transformation between 2015 and 2017. In FY2017, HSBC launched voice recognition and fingerprint technology in nine markets, which expands its biometrics reach to more than 1.5 million customers. During the year, it introduced voice biometrics in the UK, which simplifies its offerings and attracts new customers. Similarly, it enhanced its key digital channels, such as HSBCnet and HSBC Connect, for corporate clients. The initiative could enable the group to attract more corporate customers. The group introduced a new payment app in Hong Kong (PayMe) and rolled out Voice and Touch ID in 37 markets, reflecting its commitment to digital transformation. The group improved customer service and clients' ability to self-serve through digital multi-channel capabilities such as Live Sign, Live Chat, and Live Connect; mobile payment services; and revamped mobile banking apps in the UK, Hong Kong, and China.

Growing Cards and Payments Channel: The UK

The growing cards and payments channel in the UK may provide growth opportunities to the bank. According to in-house report, the number of cards in circulation in the country is projected to reach 165.2 million in 2021, including 101.6 million debit cards, 60.2 million credit cards, and 3.4 million charge cards. The transaction value of the channel is forecast to grow to GBP1,056.2 billion in 2021, including GBP855 billion for debit cards, GBP178.6 billion for credit cards, and GBP22.6 billion for charge cards. The growth could be augmented by the launch of pan-European instant credit transfer scheme by the European Payments Council, increasing proliferation of digital-only banks and the growing prominence of alternative payments.

HSBC's China-Centric Initiatives

HSBC has been undertaking several expansion initiatives with focus on China, which could open new growth avenues. In this direction, in December 2017, the group established HSBC Qianhai Securities, the first securities joint venture in China, majority-owned by an international bank. The initiative will enhance the group's access to the expanding Chinese capital market and enable it to grow its securities business in the country. It will also strengthen HSBC's position as the leading international bank in the country. During the year, the group also opened new Chinese desks in Luxembourg, Poland, Macau, and Thailand to capture new business. It increased the total number of China desks to 24, focusing on providing support to Chinese businesses. The group also expanded its presence in the country with the launch of new retail banking products and increased lending in the Pearl River Delta.

Emergence of FinTech

The group could benefit by venturing into FinTech arena as it is fast changing the way banking is done and challenging the regulatory structure. FinTech innovations such as crowd-funding, mobile payments, distributed ledgers, peer-to-peer lending, and online marketplace lending are cost effective and giving tough competition to banking institutions. In response, banks are increasingly pursuing opportunities to establish FinTech capabilities through partnerships or strategic collaborations, venture funding, developing in-house capabilities, setting up business accelerators, and/or acquisitions. One of the prime examples illustrating the FinTech focus is the collective initiative of the world's leading 22 banks in developing blockchain-based international payments system in 2017. FinTech offers cost savings to banks facing margin pressures from low interest rates. They also have the potential to expand intermediation services to the underserved.

Threat

Regulatory Changes: The European Union and the UK

Implementation of and compliance with regulatory changes could lead to the group incurring increased costs. For instance, banks in the UK, with an average 3-year core deposits of more than GBP25 billion, are required to separate or ring-fence their core banking activities such as deposit-taking from their riskier investment banking units by January 1, 2019. The ring-fencing legislation is likely to protect customers using essential banking services such as current accounts, savings accounts and payments from risks due to failure in another part of the business, such as investment banking. It is the biggest structural reform ever imposed on the UK banks with the treasury anticipating total set up cost of about GBP3 billion and annual running cost of about GBP4 billion.

Similarly, in May 2018, the EU's General Data Protection Regulation (GDPR) will come into force. The regulation aims at giving citizens and residents control of their personal data, simplifying the regulatory environment for global business, and pushing companies to minimize data collection. It is applicable to all businesses, regardless of geographic location, collecting or processing EU citizens' personal data such as name, location, ID numbers, and even their IP addresses. GDPR requires all data from collecting and processing companies to designate a Data Protection Officer to be fully compliant. One of the most challenging requirements of the legislation for banks is that customers can ask them to delete their personal data that may be available publicly. Banks need to develop IT mechanisms to ensure that personal data are processed only when necessary. Penalties for non-compliance include fines of up to EUR20 million or 4% of global revenue, whichever is higher.

Prolonged Low-Interest-Rate Environment

Prolonged low-interest-rate environment could pose significant challenges to a banking institution. According to IMF research, lower interest rates may increase banks' earnings in the short-term. However, they affect profitability in the steady state once they fall below a particular positive threshold. With flattened yield curves, if bank deposit rates cannot fall below zero, profitability would contract further. In such a scenario, regional and deposit-funded banks are likely to be most affected. In order to enhance yield, larger banks would increase their risk exposures in other countries that offer higher returns and rely more on wholesale funding, whereas their smaller counterparts would take more interest rate risk by increasing the duration of bond portfolios. Prolonged interest rate environment would result in consolidation of smaller banks.

Concerns Related to Cryptocurrencies

Growth of cryptocurrencies such as Bitcoins and Ethereum raised several concerns among central banks as it challenges their exclusivity of managing and recording digital transactions. The disruptive economic innovation has the capacity to drastically change the current economic structure, and the way banks and financial institutions function. Central banks across the world are very cautious about cryptocurrencies due to their uncontrollable and unpredictable form, which have the potential to create loopholes in banks' data related to financial transactions that could hamper their ability to track economic activities. Technology enables and records digital transactions between two parties without the need of a facilitator and without revealing the identity of concerning parties, which could lead to increased money laundering and cyber crimes. This public way of managing transactions has the potential to create huge disruption in the banking sector across the world. Due to high price volatility, cryptocurrencies can lead to considerable speculation.