STANLN 4.4% 01/23/26

(STANLN)

Intermediate-Term Carry (SGD)

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Company Background: Standard Chartered is a retail and commercial bank with a trading business, mainly operating in Asia, Africa and the Middle East. The bank has more than 86,000 employees and serves customers in close to 150 markets worldwide. As of 30th Sep 2018, the bank has more than $685 bn in assets and is listed on the London and Hong Kong Stock Exchanges as well as the Bombay and National Stock Exchanges in India.

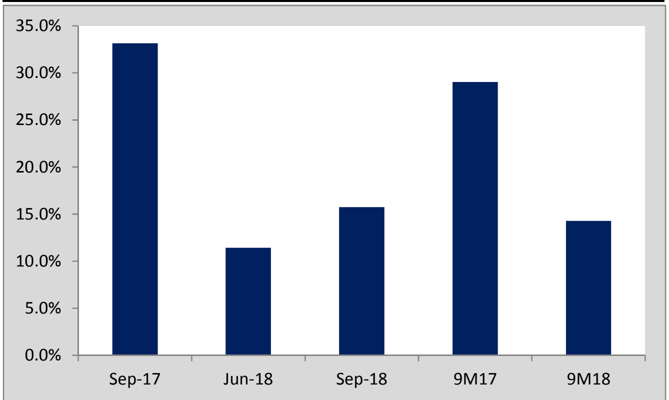
Credit Considerations:

Improvement in returns continues but interest rate margins falls as competitive pressure results in lower asset yields. For 9M18, underlying profits before tax grew 5% YoY to $11.4bn, driven by broad-based income growth with all growth across most client segments (Corporate & Institutional Banking +5%, Retail Banking +7%, Commercial Banking +5%, Private Banking +8%, Central & Others -1%) with particular strength in the Greater China and North Asia (GCNA) region (+11%).

Net interest income rose 10% YoY to $6.58bn as net interest margins grew 5bps to 1.58%. QoQ however, net interest margins declined 1bps from 1.59% due to more clients switching to higher rate time deposits as interest rates rise.

Asset quality improves with lower impairments but investment into digital capabilities continues with operating expenses growing 5% YoY to $7.63bn, driven by regulatory costs (+1%) and other operating expenses (+6%). Credit and other impairments came in at $535mn (-50%) as credit quality of the group's balance sheet continues to improve. For 2H18, the group expects operating expenses excluding bank levy ($310m) to be similar to 1H18.

Figure 1: Credit Impairment Charges % of Operating Profit



Source: Company Data, KGI Research

Completed stress test with strong capital adequacy. For 9M18, the group's capital adequacy continues to remain strong at 14.5%, well above the minimum 2019 requirement of 10%. QoQ, the group's CET1 ratio rose 28bps from 14.2% in 2Q18, driven by profit generation and a decline in risk weighted assets to $265.2bn (-2.4%).

Based on the bank's balance sheet at the end of 2017, the group also passed the Bank of England's 2018 stress tests with an adverse CET1 ratio at 7.5%, above the hurdle rate of 6.7%. With CET1 capital and Tier 1 leverage ratios at 14.5% and 5.8% respectively, the bank is not required to submit a revised capital plan.

Figure 2: Projected consolidated solvency ratios in stress scenario

	Actual (end-2017)[i]	Minimum stressed ratio (before 'strategic' management actions or AT1 conversions)	Non-dividend 'strategic' management actions only[i]	All 'strategic' management actions including CRD IV related restrictions	Minimum stressed ratio (after the impact of 'strategic' management actions and conversion of AT1)	Hurdle rate	Actual (2018 Q3)	Submit revised capital plan?
IFRS 9 Transitional								
Common equity Tier 1 ratio[a][b]	13.6%	7.1%	7.1%	7.9%	7.9%	6.7%	14.5%	Not required
Tier 1 capital ratio[c]	16.0%	8.9%[d]	8.9%[d]	9.7%[d]	9.7%[d]		17.0%	
Total capital ratio[f]	21.0%	11.7%[d]	11.7%[d]	12.5%[d]	12.5%[d]		21.7%	
Memo: risk-weighted assets (US$ billions)	280	369[d]	367[d]	367[d]	367[d]		265	
Memo: CET1 (US$ billions)	38	26[d]	26[d]	29[d]	29[d]		38	
Tier 1 leverage ratio[a][e]	6.0%	4.1%	4.3%	4.9%	4.9%	3.48%	5.8%	
Memo: leverage exposure (US$ billions)	717	709[h]	709[h]	709[h]	709[h]		743	
IFRS 9 non-transitional								
Common equity Tier 1 ratio[f]	13.5%	6.8%	6.7%	7.5%	7.5%	6.4%	14.3%	
Tier 1 leverage ratio[f]	6.0%	4.4%	4.4%	4.6%	4.6%	3.25%	5.8%	

Source: Bank of England, KGI Research

Credit Recommendations:

While STANLN's 2026 have been rated investment grade by S&P (BBB-), Moody's (Baa2) and Fitch (A-), the bond is a subordinated issue which may be subject to mandatory write-down or conversion to equity if the issuer becomes subject to a resolution procedure.

Additionally, the issue has an optional redemption date on 23 January 2021 and a coupon reset at the 5-year SGD Swap Offer Rate + 2.095% on 23 January 2021, which can help to mitigate interest rate risks.

Despite improvements in asset quality, the group's profitability remains weak with an ROE of 6.1% as at 9M18, dragged by low revenue growth and a high cost to income ratio. For FY18, we expect profitability to remain weak after the bank announced 900m provision from regulatory investigations in the US and UK. However, we expect the group's credit outlook to be well supported by improving asset quality and strong capital adequacy and we add ANZ 3.75% 2027 to our defensive portfolio. The bond is currently trading at 102.0 with a YTW of 3.3%.

Financials

INCOME STATEMENT (AUD mn)	2016A	2017A	1H18A
Net Interest Income	7,794	8,181	4,361
Net Fee and Commission Income	3,231	3,512	1,869
Other Operating Income	3,035	2,732	1,397
Operating expenses	(10,211)	(10,417)	(5,185)
Operating Income	3,849	4,008	2,442
Provisions	2,791	1,362	214
Profit Before Tax	409	2,415	2,346
Net Income	(191)	1,268	1,593
BALANCE SHEET (AUD mn)	**2016A**	**2017A**	**1H18A**
Total Assets	646,692	663,501	694,874
Total Customer Loans	255,896	285,553	296,719
Total Allowances	6,354	5,702	5,304
Total NPLs	9,687	8,679	7,728
Total Liabilities	598,034	611,694	643,386
Total Deposits	338,185	370,509	382,107
Total Equity	48,658	51,807	51,488
KEY RATIOS	**2016A**	**2017A**	**1H18A**
Net Interest Margin (%)	1.50	1.60	1.60
Cost/Income Ratio (%)	72.6	72.2	66.9
Loan/Deposit Ratio (%)	75.7	77.1	77.7
Non Performing Loans (%)	3.69	2.98	2.56
Equity/Assets (%)	7.52	7.81	7.41
CET1 (%)	13.60	13.60	14.20
CAR (%)	21.30	21.00	21.30
ROE (%)	(1.1)	1.7	6.1

Source: Company Data, KGI Research

KGI's Ratings

Rating	Definition
	KGI Securities Research's recommendations are based on an Absolute Return rating system.
BUY	>10% total return over the next 12 months
HOLD	-10% to +10% total return over the next 12 months
SELL	<-10% total return over the next 12 months

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