Daiwa Capital Markets

HSBC Holdings plc

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	Senior Preferred	Senior Non-Preferred	Outlook
Moody's	A2	A3	RUR*
S&P	A-	BBB	Stable
Fitch	A+	A-	Negative

*Source: Moody's, S&P and Fitch*Ratings Under Review*

Background and ownership

HSBC Holdings plc (HSBC) is one of the world's largest banking and financial services organisations with operations in 64 countries. The group provides a range of services to retail, commercial, corporate, institutional, investment and private banking clients through a global network of largely domestic banking operations. The group's main subsidiaries are HSBC Bank plc, which is the UK based non-ring fenced business, and its ring-fenced retail and commercial banking counterpart, HSBC UK Bank plc. The Hongkong and Shanghai Banking Corporation Limited is the group's main operating subsidiary based in Hong Kong, covering the group's business dealings in the Asia-Pacific region. In addition, the group runs its European operations via HSBC Continental Europe and its U.S. business via HSBC Bank USA N.A. HSBC is a public company with shares listed on London, Hong Kong, New York, Paris and Bermuda stock exchanges and with a widely distributed investor base.

2020-2022 strategy update

In February 2020, HSBC Holdings presented a strategic plan, outlining a path to upgrading its return performance by redeploying underperforming RWAs, reducing the group's cost base and streamlining the organisation. However, fundamental changes to operating environments worldwide caused by the pandemic led HSBC to revise some of its group targets in an updated plan published in February 2021. The plan included the following 2022 targets, among others:

- Adjusted cost base of ≤USD31bn (FY20: USD32.6bn) with adjusted costs savings of USD5bn-5.5bn to be achieved between 2020-2022 (vs USD4.5bn previously stated);
- RWA reduction of USD100bn; (61.1% already achieved, with asset disposal costs of USD1.2bn during 2020-2022);
- RoTE of 10-12% by 2022 revised in favour of 10% target over the medium term in recognition of the challenging operating environment and structural changes ahead. (Current annualised RoTE stands at 10.2%);
- CET1 ≥14%; (1Q21: 15.9%; Target range of 14-14.5% over the medium term); and
- Dividend payout ratio of 40-50% of reported earnings per ordinary share from 2022 onwards;

HSBC announced the reallocation of capital resources from its Global Banking and Markets business to the Wealth and Personal Banking unit and Asian operations in general. Revenue pressure has arguably contributed to its decision to increase its focus on Asian operations that accounted for 51% of the group's total revenues in 1Q21 (up from 27% back in 2010). In this context, HSBC has identified Greater China, Southeast Asia and India as key regions for future growth and is planning to invest some USD6bn of additional funds in its wealth management and international wholesale business. Another key element of the group's strategic overhaul is the reduction of its presence in North America and Europe. HSBC stated that it is negotiating the sale of its French retail banking branch network, which counts some 200 branches, and is likely to make a loss on the divestment. The group is also looking to exit its costly U.S. retail franchise, which is one of the largest for a non-U.S. bank. HSBC intends to continue investing in servicing internationally connected wholesale clients, maintain its position as USD clearer, conduct trading activities and enhance its wealth and asset management services in North America.

Main activities

HSBC's key operating segments are:

- **(WPB) - Wealth and Personal Banking (32% of 1Q21 pre-tax income)** – provides a range of services to retail clients and wealth management services, personal banking, mortgages, credit cards, loans and savings, as well as investments and insurance.
- **(GBM) - Global Banking and Markets (32%)** – provides large corporate and institutional banking, wholesale capital markets and transaction banking services. HSBC has a global franchise in FICC while equity trading is considered to be less developed.
- **(CB) - Commercial Banking (32%)** – provides lending and other products such as international trade and receivable finance, treasury management and liquidity solutions to SMEs and large corporates.
- **(CC) - Corporate Centre (4%)** – The results of Corporate Centre primarily comprise the share of profit from interests in HSBC's associates and joint ventures, together with central treasury revenue, stewardship costs and consolidation adjustments.

Financial strength indicators

Profitability – HSBC reported 1Q21 pre-tax profit of USD5.78bn (+80% yoy) helped by provision releases of USD400m. Top-line revenue performance was weaker than one year ago with earnings down 5% yoy to USD13bn, driven mostly by lower NII income (-14.4% yoy), which in turn was due to the low interest rate environment. NII remains the main revenue source, contributing just over half of all income during the period. Net fee income was stable or grew across the group's three main business lines to USD3.4bn (+16.7% yoy), reducing reliance on interest-bearing assets and underscoring the group's shift towards wealth and personal banking activities in Asia and elsewhere. Profitability is expected to remain under pressure for the remainder of 2021 due to persistently low interest rates and continued uncertainty caused by the ongoing pandemic. A further drag on bottom-line results comes from significant restructuring charges of some USD7bn until 2022, only partially offset by cost saving measures of USD5bn-5.5bn over the same period. Cost savings were implemented among other things by headcount reductions of 11,000 employees in 2020 with a view towards shedding a total of 35,000 by 2022. Furthermore, office space is expected to be reduced by 40% over the long term, explained by strong shifts in working patterns driven by the pandemic. Eventually, profitability should benefit from investments into high-growth regions and falling expected credit losses, making the 2022 RoTE target of 10% feasible.

HSBC Holding – Key Data			
Key Ratios (%)	1Q21	1Q20	1Q19
CET1	15.9	14.6	14.3
Total Capital	21.6	20.3	20.2
NPL	1.8	1.4	1.3
NPL Coverage	69.6	70.6	64.0
LCR	143	156	143
Cost to Income	65.7	57.4	56.9
Balance Sheet (USDbn)			
Total assets	2,959	2,918	2,659
Loans to customers	1,054	1,051	1,014
Customer deposits	1,650	1,441	1,357
Debt securities	96	99	99
Total Equity	208	198	196
Income Statement (USDbn)			
Revenues	12.9	13.6	13.3
o/w NII	6.5	7.6	7.6
Operating Expenses	8.5	7.8	8.2
Impairment charge	-0.4	3.0	0.6
Net Income	4.6	2.5	4.9

Source: Company earnings reports, Bloomberg

Asset quality – HSBC reported total assets of USD2.96tr as at 1Q21, comprised of customer loans (35% of total), financial investments held mainly for liquidity purposes (15%), cash and equivalents at central banks (13%), trading assets (8%) and others. Customer loans were primarily extended in Asia (46% of total) and Europe (39%). HSBC's loan book of USD1.05tr is skewed towards corporate and commercial lending activities (50% of total) followed by residential mortgages (33%) and other personal lending - incl. credit cards and car finance - (10%). Within the corporate and commercial lending portfolio, the three largest sectoral exposures are towards real estate & construction (27%), trade (18%) and manufacturing (17%). Asset quality has worsened since the onset of the pandemic, albeit from very low levels. HSBC entered the pandemic from a position of relative strength with an NPL ratio of just 1.4% at 1Q20, which has risen to 1.8% as at 1Q21. We expect to see a further increase in impairments over the short term as stage 2 loan volumes have built up over the past year while government support and regulatory forbearance is expected to roll-off. The 2020 cost of risk (CoR) was 81bps, substantially higher than 2019 levels (25bps).

Capitalisation – The reported CET1 ratio 15.9%, up 130bps against the same period last year, holding a significant ~500bps over MDA requirements. The regulatory ratio was above the bank's own target range of 14-15.5% and was supported by retained earnings (+40bps) and a quarterly drop in RWAs (+10bps), now standing at USD846.8bn (-USD10.7bn qoq). HSBC's strong capital position gives the group operational flexibility and could easily absorb any unforeseen expenses that may arise from its ongoing restructuring and strategic shift towards Asian operations. HSBC expects RWA inflation of some 5% between 2022-2023 due to regulatory headwinds from Basel 3, amendments to CRR and changes to internal models under the IRB approach. The FY20 MREL position of the group is deemed adequate with an RWA MREL ratio of 30.9% above minimum requirements of 27.5% (incl. 6.75% leverage exposures). As such, additional financing of senior HoldCo bonds will likely be limited to refinance existing issuance and maintenance of requirements.

Funding & Liquidity – HSBC has a wide, diversified funding base that benefits from a granular customer deposit base. Total non-equity funding of USD2.75tr comprised primarily of customer deposits (60%) while USD96bn of debt securities issued only contributed 3.5% to funding. The group's loan to deposit ratio of just 64% is one of the lowest for a G-SIB. There is no reliance on intragroup funding, as HSBC is one of the few European banks to follow the multiple point of entry (MPE) resolution strategy, which means subsidiaries are self-sufficient in this regard. The holding company identified three separate resolution groups that comprise of the U.S. resolution group, the Europe resolution group (incl. HSBC Holdings) and the Asia resolution group, which together form the preliminary 2022 MREL requirement of 27.5%. In its fixed-income investor presentation from end-2020, HSBC stated that for 2021 it expects to issue USD15bn of senior HoldCo paper on a gross basis, which on a net basis would contribute ~USD10bn towards its MREL stack. From 2022 onwards, HSBC expects its issuance at holding and operating company levels to address refinancing, asset growth or liquidity requirements. Group liquidity indicators were strong with an LCR ratio of 143% supported by HQLA of some USD695bn (+12.6% yoy).

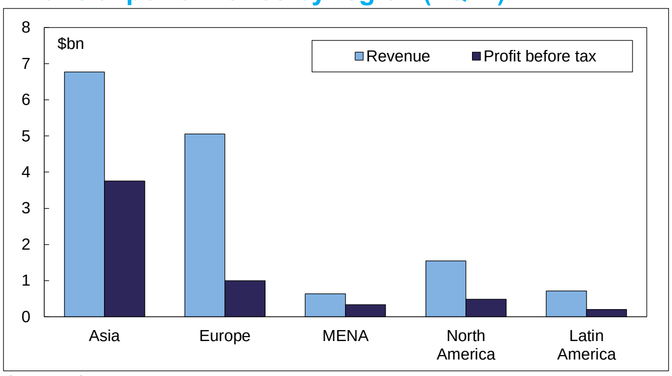
Rating agencies' views

Moody's: HSBC's ratings reflect the group's strong capital and liquidity, and lower reliance on market funding compared with its peers, but also strained profitability. HSBC is geographically diverse, operating across three main business lines, including retail and wealth, commercial and investment banking. Given the size and scale of the business, this heightens operational, governance and succession risks compared with smaller, less complex banks. HSBC maintains a global footprint and concentrated exposure to Asia, which presents unique political risks not present at most banks. The ratings were placed under review for possible downgrade on March 9 2021.

S&P: In May 2020, S&P downgraded the issuer credit ratings of HSBC Holdings and its selected operating subsidiaries principally in Europe and North America on muted earnings prospects and extensive restructuring. The group expects to complete an ambitious restructuring plan over the next three years. In the agency's view, the group will not be fully shielded from the global economic downturn resulting from the measures taken against the spread of COVID-19. Furthermore, weaker earnings arising from higher credit charges will be exacerbated by low interest rates, according to the agency. The stable outlook reflects the agency's expectation that HSBC's relatively strong balance sheet profile and diversified exposures will leave it resilient even if economic risks rise across several of its key geographies.

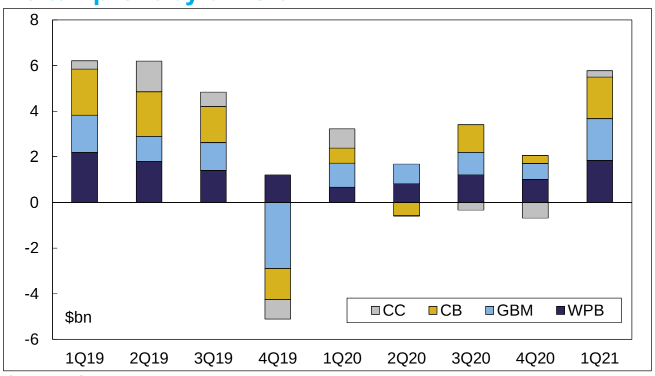
Fitch: The May 2020 rating action reflects HSBC's ability, as the group's ultimate holding company, to allocate financial resources across the operating subsidiaries. The ratings reflect Fitch's view that the group's international network remains a key strength in terms of franchise and business model, despite the weak earnings in some of the group's activities, particularly in the European non-ring-fenced bank and the US, which HSBC is addressing under its revised strategy. The ratings also reflect Fitch's expectation that the group's conservative risk appetite will mitigate the deterioration in asset quality resulting from the current crisis, and that the group will be able to maintain sound capital ratios despite pressure on earnings.

Financial performance by region (1Q21)



Source: Company reports

Pre-tax profit by division



Source: Company reports

Recent Benchmark Transactions

Issue Date	Security	Maturity/Call	Currency	Size (m)	Type	Coupon	Yield	Final Spread (bps)
17/03/2021	Sr. Unsecured (HoldCo)	6NC5	GBP	1,000	Fixed	1.75%	1.779%	G + 135
02/03/2021	AT1	PNC5	USD	1,000	Fixed	4.00%	4.00%	n.a.
02/03/2021	AT1	PNC10	USD	1,000	Fixed	4.70%	4.70%	n.a.
10/12/2020	AT1	PNC10	USD	1,500	Fixed	4.60%	4.60%	T + 364.9
17/11/2020	Sr. Unsecured (HoldCo)	6.5NC5.5	USD	2,000	Fixed	1.589%	1.589%	T + 120

Source: BondRadar

This is an issuer profile and contains factual statements only. All statements are sourced from HSBC financial reports, which can be found at https://www.hsbc.com/investors/investor-events-and-presentations?page=1&take=20

Daiwa Capital Markets

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In order to ensure the fairness and transparency in the markets, Credit Rating Agencies became subject to the Credit Rating Agencies' registration system based on the Financial Instruments and Exchange Act. In accordance with this Act, in soliciting customers, Financial Instruments Business Operators, etc. shall not use the credit ratings provided by unregistered Credit Rating Agencies without informing customers of the fact that those Credit Rating Agencies are not registered, and shall also inform customers of the significance and limitations of credit ratings, etc.

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2) Establishment of control systems (fairness of the rating process, and prevention of conflicts of interest, etc.).
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4) Duty to disclose information (preparation and publication of rating policies, etc. and public disclosure of explanatory documents).

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■ Credit Rating Agencies

[Standard & Poor's]

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[Moody's]

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Based on the information received from issuers or from public sources, the credit risks of the issuers or obligations are assessed. MIS adopts all necessary measures so that the information it uses in assigning a credit rating is of sufficient quality and from sources MIS considers to be reliable. However, MIS is not an auditor and cannot in every instance independently verify or validate information received in the rating process.

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[Fitch]

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February 2020

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Daiwa Securities Co. Ltd. and Daiwa Securities Group Inc.: Daiwa Securities Co. Ltd. is a subsidiary of Daiwa Securities Group Inc.

Other Disclosures Concerning Individual Issues:
1) As of 26 April 2016, Daiwa Securities Co. Ltd., its parent company Daiwa Securities Group Inc., GMO Financial Holdings, Inc., and its subsidiary GMO CLICK Securities, Inc. concluded a basic agreement for the establishment of a business alliance between the four companies.
As of end-December 2017, Daiwa Securities Group Inc. owned shares in GMO Financial Holdings, Inc. equivalent to approximately 9.3% of the latter's outstanding shares. Given future developments in and benefits from the prospective business alliance, Daiwa Securities Group Inc. could boost its stake in GMO Financial Holdings, Inc. to up to 20% of outstanding shares.

2) Daiwa Real Estate Asset Management is a subsidiary of Daiwa Securities Group Inc. and serves as the asset management company for the following J-REITS: Daiwa Office Investment Corporation (8976), Daiwa Securities Living Investment Corporation (8986).

3) Samty Residential Investment became a consolidated subsidiary of Daiwa Securities Group Inc. effective 10 September 2019.

4) On 30 May 2019, Daiwa Securities Group Inc. formalized an equity/business alliance with Samty, and as of 14 June 2019 it owned 16.95% of shares outstanding in Samty along with convertible bonds with a par value of Y10bn. Conversion of all of said convertible bonds into common shares would bring the stake of Daiwa Securities Group Inc. in Samty to 27.28%.

5) Daiwa Securities Group Inc. and Credit Saison Co., Ltd. entered into a capital and business alliance, effective 5 September 2019. In line with this alliance, Daiwa Securities Group Inc. is to acquire up to 5.01% of Credit Saison's total common shares outstanding (excl. treasury shares; as of 31 Jul 2019).

Notification items pursuant to Article 37 of the Financial Instruments and Exchange Law
(This Notification is only applicable to where report is distributed by Daiwa Securities Co. Ltd.)
If you decide to enter into a business arrangement with our company based on the information described in this report, we ask you to pay close attention to the following items.

- In addition to the purchase price of a financial instrument, our company will collect a trading commission* for each transaction as agreed beforehand with you. Since commissions may be included in the purchase price or may not be charged for certain transactions, we recommend that you confirm the commission for each transaction. In some cases, our company also may charge a maximum of ¥2 million per year as a standing proxy fee for our deposit of your securities, if you are a non-resident.
- For derivative and margin transactions etc., our company may require collateral or margin requirements in accordance with an agreement made beforehand with you. Ordinarily in such cases, the amount of the transaction will be in excess of the required collateral or margin requirements**.
- There is a risk that you will incur losses on your transactions due to changes in the market price of financial instruments based on fluctuations in interest rates, exchange rates, stock prices, real estate prices, commodity prices, and others. In addition, depending on the content of the transaction, the loss could exceed the amount of the collateral or margin requirements.
- There may be a difference between bid price etc. and ask price etc. of OTC derivatives handled by our company.
- Before engaging in any trading, please thoroughly confirm accounting and tax treatments regarding your trading in financial instruments with such experts as certified public accountants.

* The amount of the trading commission cannot be stated here in advance because it will be determined between our company and you based on current market conditions and the content of each transaction etc.
** The ratio of margin requirements etc. to the amount of the transaction cannot be stated here in advance because it will be determined between our company and you based on current market conditions and the content of each transaction etc.

When making an actual transaction, please be sure to carefully read the materials presented to you prior to the execution of agreement, and to take responsibility for your own decisions regarding the signing of the agreement with our company.

Corporate Name: Daiwa Securities Co. Ltd.
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Memberships: Japan Securities Dealers Association, The Financial Futures Association of Japan, Japan Investment Advisers Association, Type II Financial Instruments Firms Association