VOLUME XI No. 43 | F R I D A Y | March 6, 2009

HSBC HOLDINGS PLC:
OF GURUS AND GA-GAS

There are quite a number of self-proclaimed gurus on Wall Street and, more often than not, they are wrong in many, if not most, of their assessments of the majority of things, including which is the best stock to buy, sell or hold, at any one time.

In a bull market, of course, they are rarely wrong – they can hardly make a mistake.

But in this bear market, their ignorance is only too evident.

It was only about 3 months ago that one self-proclaimed, Wall Street guru said, during an interview on television with regard to the Dow Jones Industrial Average, having risen about one percent on the day:

> *'If you haven't become fully invested by now, you've missed the boat. I loaded up about 2 weeks ago.'*

He has not reappeared on that television show since then.

For the most part, the self-proclaimed gurus of Wall Street spew out their prognostications mainly because they like the idea of being quoted on television, on the radio, in the print media, and being known among the ignorant hoi-polloi.

In the Hongkong Special Administrative Region (HKSAR) of the People's Republic of China (PRC), there are, also, self-proclaimed gurus, most of whom are very well-heeled individuals, with some of them, holding high offices in publicly listed companies.

The main difference between these gurus and their counterparts on Wall Street is that they have ulterior motives when they make prognostications about this and that.

Of course, there are, also, those self-proclaimed, HKSAR gurus who are completely ga-ga.

Which brings **TARGET** () to the matter of the Rights Issue of HSBC Holdings plc (Code: 5, Main Board, The Stock Exchange of Hongkong Ltd).

Last Tuesday, one learned that Net Profit Attributable to Shareholders of HSBC Holdings plc for the Financial Year, ended December 31, 2008, was $US5,728 million (2007: $US19,133 million).

That result was a reduction of about 70.06 percent, Year-On-Year.

The announcement shocked the financial world and caused even more panic on equity markets, from Wall Street to Zanzibar.

Accompanying the announcement about this financial disaster, HSBC Holdings plc said that it would be pitching a 5-for-12 Rights Issue of 5,060,239,065 New Ordinary Shares at 254 pence per Share.

The bank stated, in its Circular to Shareholders, that it was desirous of raising £12.50 billion (about

$HK137.80 billion).

In explaining its reasoning in passing round its begging bowl, Management of HSBC Holdings plc said, in 9 paragraphs of its Circular to Shareholders, contained on Pages 10 and 11:

> *'HSBC has long maintained a culture of responsibility and conservative risk management which has combined to produce a strong financial position which has enabled it to create valued long-term relationships with customers. These fundamental beliefs are deeply rooted in our character. The key elements of financial strength are a strong capital base coupled with sustainable and stable funding sources, and in particular a strong and growing deposit base. Those strengths have served us well over the years. Today HSBC is well capitalised, liquid and profitable. Our capital strength is supported by a conservative balance sheet characterised by an advances to deposits ratio of 83.6 per cent as at 31 December 2008 and a core funding base that continues to grow.*

> *'We are however today facing unprecedented turmoil in the economic and financial environment, with major uncertainties ahead. The current global economic downturn, combined with extreme volatility in financial markets, means that the financial system remains under stress. Over the past 12 months, many of our competitors have received significant government capital injections or have raised capital from shareholders and other investors. Higher regulatory capital requirements, in part from the effect of the economic downturn on capital requirements under the Basel II regime, as well as changing market sentiment on appropriate levels of leverage, have also raised expectations regarding capital levels. While we have maintained strong capital ratios, we are now raising the top of our target range for the tier 1 ratio so that the range will be from 7.5 per cent to 10 per cent. The Rights Issue will add 150 basis points to our capital ratios, strengthening the core equity tier 1 ratio to 8.5 per cent and the tier 1 ratio to 9.8 per cent, in each case on a pro forma basis as at 31 December 2008. We are determined that HSBC should maintain its signature financial strength.*

> *'We are continuing to manage the capital allocation within the HSBC Group to concentrate on our core emerging markets and faster growing businesses. In light of continuing losses from our US consumer finance business, yesterday we announced further actions in the US to restructure our operations and to put into run off all of our branch-based consumer lending operations, which are branded "HFC" and "Beneficial". We have also closed down most of our structured credit and mortgage-backed securities distribution operations. Outside the US, during 2008 we have sold certain businesses that are not core to our strategy, such as our French regional banks.*

> *'We remain confident that HSBC is well-placed in today's environment and that our strength leads to opportunity. Our strategy has served HSBC well and positions it for long-term growth with attractive returns. We continue to combine our position as the world's leading emerging markets bank with an extensive international network across both developed and faster growing markets. At the same time, as the financial system exhibits stress, our competitive position is improving as the capacity and capabilities of financial institutions are constrained by lack of capital and funding; many of them are also focusing more on their respective domestic markets.*

> *'Planned internal capital generation remains strong and this capital raising will enhance our ability to deal with the impact of an uncertain economic environment and to respond to unforeseen events. Importantly, it will also give us options regarding opportunities which we believe will present themselves to those with superior financial strength. These may involve organic investment in the continued taking of market share from more capital constrained competitors. There may also be opportunities to grow through targeted acquisitions, by taking advantage of attractive valuations where the opportunities in question align with our*

strategy and the risks are understood.

'As explained below, the Directors have rebased the envisaged dividend per share, for the first three interim dividends in respect of 2009, to reflect the impact of the enlarged ordinary share capital resulting from the Rights Issue, prevailing business conditions and capital requirements. Until the end of 2007, HSBC had grown its dividend per share by 10 per cent or more every year for 15 years, reflecting the strong growth and shareholder returns that the Company has delivered. For 2009, the Directors have carefully considered HSBC's dividend payments in view of the Company's desire to retain its absolute and relative position of capital strength. The current challenges that have left much of the wider financial services sector unable to support cash returns to shareholders have also been factored into this consideration.

'The dividend payments envisaged remain substantial and reflect management's long-term confidence in the business. However, they also move the Company to a more conservative position to reflect the uncertain current environment and to retain more capital within the business. HSBC will continue to aim to pay progressive dividends in line with the long-term growth of the business.

'During a period of global financial turmoil, our business model, the broad base of our earnings, our distinctive character and our brand mean that we remain one of the strongest international banks.

'Your Board believes that the Rights Issue is in the best interests of Shareholders, helping us strengthen our competitive positioning so that we can better deliver sustained value over time …'.

The following day, Wednesday, March 4, 2009, one read in the HKSAR media that this self-proclaimed *'guru'* and that self-proclaimed *'guru'*, as well as one ga-ga after another, highly praised the Rights Issue of HSBC Holdings plc, stating, among other things, that this was an opportunity to obtain the shares of this bank on the cheap.

These intelligent gurus and ga-gas could not have read the Circular to Shareholders in respect of the Rights Issue because, at the time of their erudite utterances, the Circular had not been published on the website of HSBC Holdings plc.

Of course, in the HKSAR, it is possible, one supposes, to obtain an advanced copy of a highly sensitive, financial document to be issued by publicly listed companies, prior to the official release date.

The Entire Basis Of The Argument For Subscribing To The Rights

The entire basis of the gurus and ga-gas for picking up shares in HSBC Holdings plc at this time is that the share price is cheaper than it has been over the past 17 months.

According to **TOLFIN ()** (The Computerised, Online Financial Intelligence Service and Web-Based, Credit-Checking Provider), the share price of HSBC Holdings plc, as at October 15, 2007, was $HK152.80.

By last Tuesday, the share price of HSBC Holdings plc had fallen $HK106.55 from its high point on October 15, 2007, equivalent to about 70 percent of its entire Market Capitalisation, to $HK46.25.

It is true that, at about $HK45, the share price of HSBC Holdings plc is cheap, relative to its price as at October 15, 2007, of $HK152.80, that is.

In **TARGET**'s thinking, it would not be unfair to compare HSBC Holdings plc with Citigroup Incorporated and/or Bank of America Corporation because all 3 of these banks were, not very long ago, among the largest in the world.

Citigroup Incorporated was, at one time, the largest bank in the world and, at its zenith of popularity in 2007, the share price stood at $US55.25.

During 2007, however, its share price fell back to $US29.29 and, at the beginning of 2008, it had fallen back even further to $US29.09 – a 47-percent drop from its highest point of $US55.25.

By the close of 2008, its share price had fallen back to $US3.77.

Today, its share price is about $US1.13.

Today's share price of this, once huge bank, has fallen by about 98 percent in a period of about 27 months.

Which might be something of a record.

Today, the largest, single shareholder of Citigroup Incorporated is the Government of the United States of America with a holding, equivalent to about 40 percent of the Issued and Fully Paid-Up Share Capital of this bank.

The US Government, effectively, *'nationalised'* Citigroup Incorporated, without the use of the *'n'* word – because it would have been unthinkable to allow this bank to file for bankruptcy: It is, just, too big.

Turning to Bank of America Corporation, its share price hit a high of $US54.05 in 2007 and sank to a low in that year of about $US41.10.

In 2008, however, the share price ranged from a high of $US45.03 to a low of $US11.25.

The price, today, of the largest bank in the US is about $US3.59.

And, there are fears in the US that Bank of America Corporation could go the way of Citigroup Incorporated, with the US Government, coming along with a bucket of cash to exchange for shares.

So, in summary, over a period of about 27 months, Citigroup Incorporated lost about 98 percent of its Market Capitalisation, Bank of America Corporation lost about 93 percent of its Market Capitalisation, and HSBC Holdings plc has lost about 70 percent of its Market Capitalisation in a period of about 17 months.

Clearly, if HSBC Holdings plc follows the path of Citigroup Incorporated and Bank of America Corporation, its share price still has a way to fall – about $HK40-odd, in fact.

TARGET is not suggesting that this will be the case (although it could be), but, at the same time, at least, this medium feels that the argument that the share price of HSBC Holdings plc is cheap at today's level is a fatuous one, to say the least.

How cheap is cheap?

In the case of Citigroup Incorporated, even at $US1.13 per share, it is difficult to find long-term investors.

People have lost confidence in the bank and its management.

The same could be said of Bank of America Corporation.

Will HSBC Holdings plc suffer similarly?

(**TARGET** has noted of late of the not insignificant number of high-level, management changes that have taken place at regional headquarters of various banking divisions of HSBC Holdings plc.)

<u>The Current Financial Year's Prospects</u>

It is usual that, when one subscribes for a share in a company or bank, one does so in the expectation that the company or bank will make a profit and that the market value of the share will reflect that happy state of affairs.

When subscribing for Rights Shares, this logic must hold water, too – unless one is a philanthropist, of course, and, in the world of high finance, they are few and far between.

What would be the logic in subscribing for the Rights Shares in, say, HSBC Holdings plc, in the certain knowledge that the profits of the bank would deteriorate in the Current Financial Year, ending December 31, 2009?

HSBC Holdings plc has stated, among other things, that it is going through a difficult stretch, a time of uncertainty, it has stated in not oblique terms.

In its 2008 Annual Report, HSBC Holdings plc has said, inter alia:

'Challenges and uncertainties
Current economic and market conditions
may adversely affect HSBC's results

> *'The global economy has entered the most severe downturn for 80 years, with the financial services industry facing extraordinary turbulence. A shortage of liquidity, lack of funding, pressure on capital and extreme price volatility across a wide range of asset classes are putting financial institutions under considerable pressure. This is leading governments and central banks to undertake unprecedented intervention designed to stabilise the global and domestic financial systems, to stimulate new lending and to support systemically important institutions at risk of failing. Many developed economies have entered recession and growth has slowed in many emerging countries, with serious adverse consequences for asset values, employment, consumer confidence and levels of economic activity. Commodity prices have significantly retrenched, in many cases from recent historical highs, interest rate yield curves have flattened, interest rates have fallen in absolute terms and trade flows have contracted. Global equity markets have experienced severe declines and various currencies, including sterling, have depreciated significantly against the US dollar. Emerging markets have suffered as portfolio investments have been repatriated and cross-border inter-bank funding has been withdrawn. Numerous governments and central banks have responded by proposing programmes to make substantial funds and guarantees available to boost liquidity and confidence in their financial systems, as well as cutting taxes and lowering interest rates. It is not known whether these responses will be effective in addressing the severe economic and market conditions or whether recently proposed measures will be implemented as initially proposed.*
>
> *'HSBC's earnings are affected by global and local economic and market conditions. Dramatic declines in 2007 and 2008 in the housing markets in the US, the UK and elsewhere have combined with increasing unemployment to affect negatively the credit performance of real estate-related exposures, resulting in significant write-downs of asset values by financial institutions, including HSBC. These write-downs, initially of asset-backed securities but spreading to other securities and loans, have caused many financial institutions to seek additional capital, to reduce or eliminate dividends, to merge with larger and stronger competitors or, in some cases, to fail.*
>
> *'A worsening of these conditions may exacerbate the impact of these difficult market conditions on HSBC and other financial institutions and could have an adverse effect on HSBC's operating results. In particular, the Group may face the following challenges in connection with these events:*

- *HSBC's ability to assess the creditworthiness of its customers or to estimate the values of its assets may be impaired if the models and techniques it uses become less accurate in their predictions of future behaviour, valuations or estimates. The process HSBC uses to estimate losses inherent in its credit exposure or assess the value of certain assets requires difficult, subjective and complex judgements. These include forecasts of economic conditions and how predicted economic scenarios might impair the ability of HSBC's borrowers to repay their loans or might affect the value of assets. As a consequence, this process may be less capable of making accurate estimates which, in turn, may undermine the reliability of the process.*
- *The demand for borrowing from creditworthy customers may diminish as economic activity slows.*
- *Lower interest rates will reduce net interest income earned by HSBC on its excess deposits.*
- *HSBC's ability to borrow from other financial institutions or to engage in funding transactions on favourable terms, or at all, could be adversely affected by further disruption in the capital markets or deteriorating investor sentiment.*
- *Market developments may affect consumer confidence and may cause declines in credit card usage and adverse changes in payment patterns, leading to increases in delinquencies and default rates, write-offs and loan*
- *impairment charges beyond HSBC's expectations.*
- *Loan impairment allowances and write-offs are likely to rise as a result of a deterioration in payment patterns and increased delinquencies and default rates caused by weakening consumer confidence and increased business failures. A worsening of these economic factors may exacerbate the adverse effects of these difficult market conditions on HSBC and others in the financial services industry.*
- *HSBC expects to face increased regulation and supervision of the financial services industry, following new or proposed regulatory measures in countries in which it operates.*
- *Trade and capital flows may further contract as a result of protectionist measures being introduced in certain markets.*
- *Increased government ownership and control over financial institutions and further consolidation in the financial industry, which could significantly alter the competitive landscape.*

'As a worldwide financial institution, HSBC is exposed to these developments across all its businesses, both directly and through their impact on its customers and clients. Local variations exist, however, reflecting regional circumstances and presenting challenges to HSBC which are specific to those areas.'

On scanning the above, it must appear that the future earnings' potential of HSBC Holdings plc, during the next 9 months, at least, are going to be trying and there is no suggestion that the 2010-Year will be any better than the remainder of the 2009-Year.

In fact, at this early stage in the Financial Year of HSBC Holdings plc, the bank cannot know how badly or well it will perform in Fiscal 2009.

How could it?

It is unlikely that even Nostradamus (1503-1566), a guru of his day, would have been able for foretell what financial events could unfold between today and the end of this calendar year if he could shine down from the Heavens to deliver his prophesies.

HSBC Holdings plc, also, stated in its 2008 Annual Report that it would be sacking some 6,100 employees in the US and closing 800 retail, consumer-credit branches, which operate under the name of HSBC

Financial Corporation Ltd.

At this point, one is not apprised as to whether or not the bank has made provisions in its 2008 accounts for compensation for loss of office for those 6,100 employees who are about to get their pink slips if they have not received them yet.

Also, what will be the charge on the 2009 Bottom Line on closing down those 800 retail, consumer-credit branches in the US?

At a cost of just $US10,000 per sacked, junior employee, there will be a charge of not less than $US61million ($HK475.80 million) in the 2009-Year, it seems to **TARGET**.

And that would be an extremely cheap way out for the bank.

Double that amount of money would, probably, be closer to the truth at the end of the day.

As for the cost of closing down those 800 retail, consumer-credit branches, it is anybody's guess.

But nobody is uttering a dickey bird about these little matters.

In view of the above, one has to ponder:

> *Is an investment in HSBC Holdings plc, at today's share price of about $HK45, cheap or expensive?*

Gurus and ga-gas seem to have made their determinations without even looking at any of the facts.

Then, again, perhaps they have other (financial) considerations.

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