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Standard Chartered 09/08/2012 **FAT-UK-449**

STAN GBP £13.63 Core **MED.** **B**

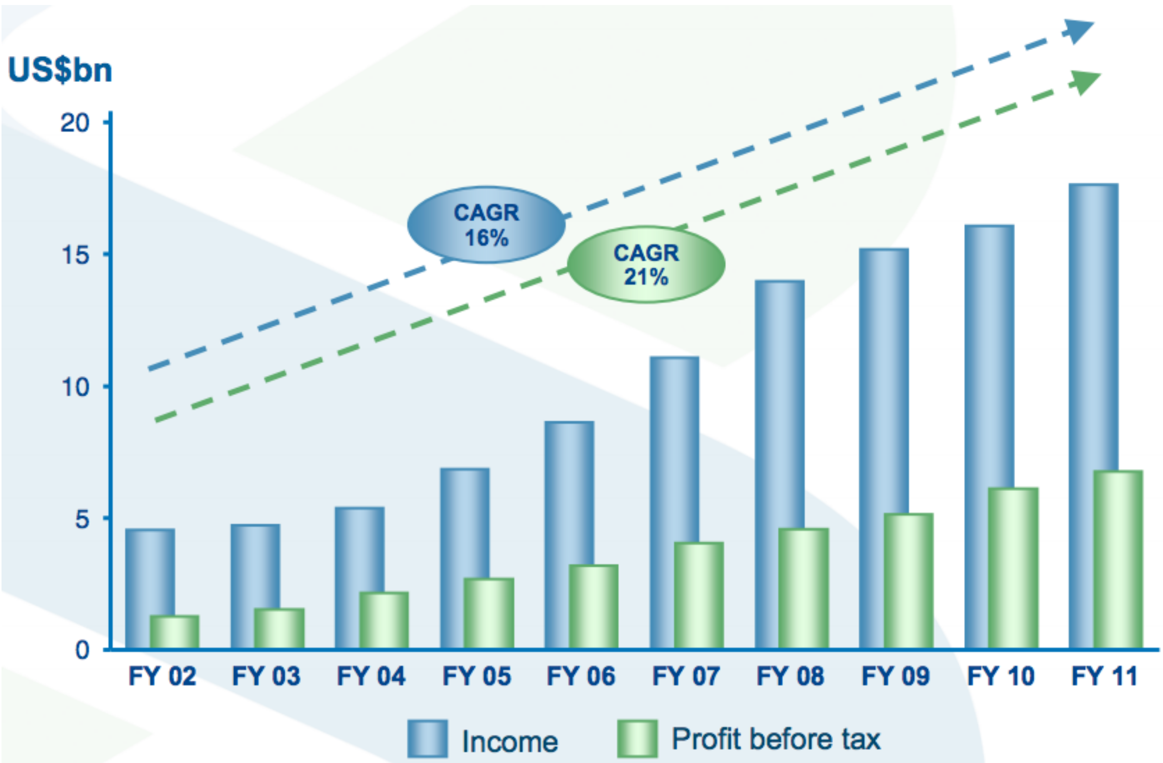
No standard bank; US regulatory battle

The practice of regulators becoming politicians in the US makes for colorful oversight. Standard Chartered Bank is the latest victim with a robust attack from the New York Department of Financial Services (DFS). This looks politically motivated and with good long-term growth prospects we rate the stock a buy.

Standard Chartered's position in Asia and Africa ensures solid long-term growth prospects and ensured that the group was resilient in the global financial crisis. In fact it is the only London listed bank which has increased its dividends in every year from 2007 (a rights issue was conducted in Oct 2010).

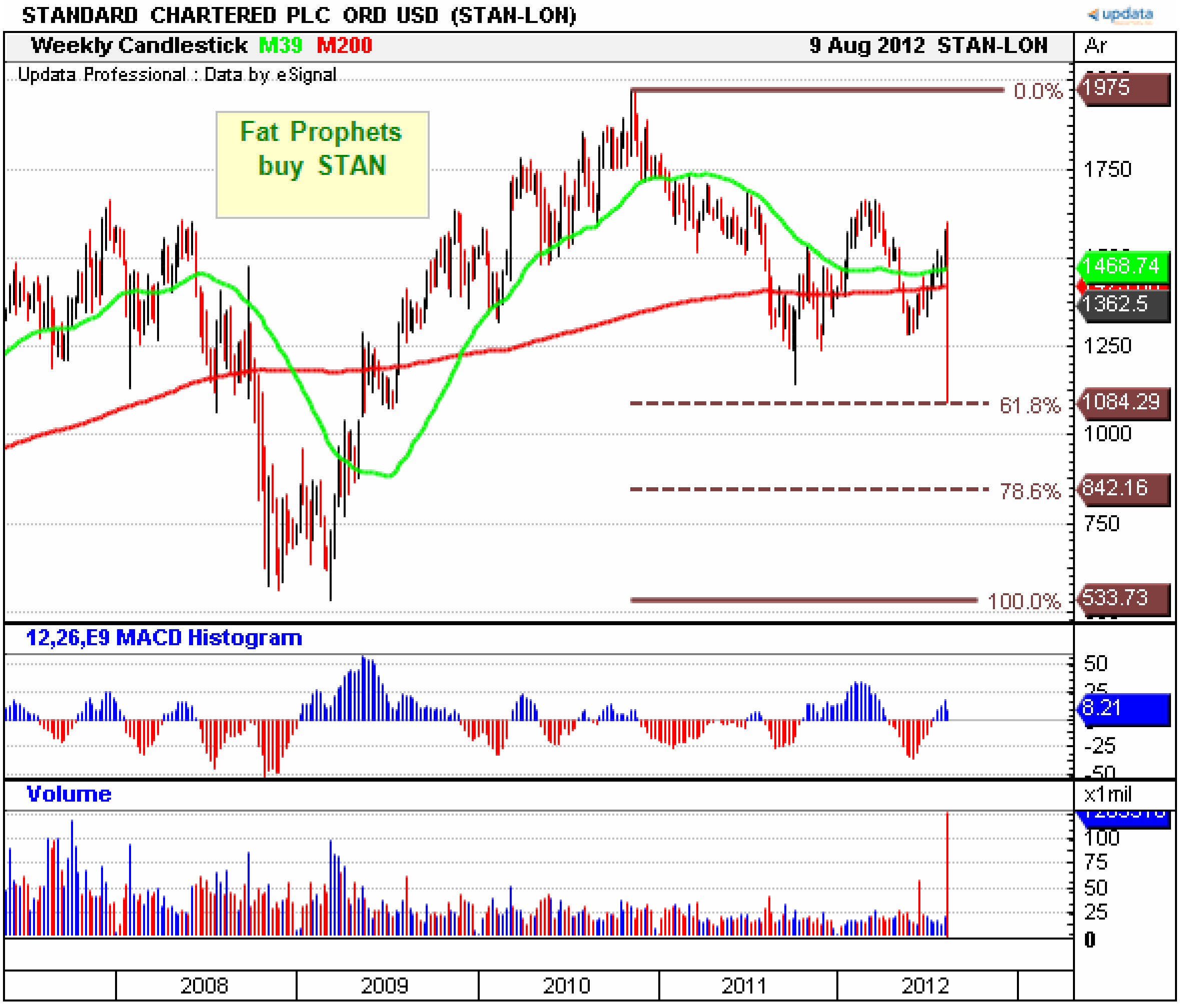
We have therefore long viewed the stock as a core holding candidate for the Fat Prophets portfolio. The recent sell-off looks like an opportunity, in our view, despite the additional risks the regulatory uncertainty creates. The below graphic illustrates the outstanding recent track record of the Standard Chartered:

No standard bank: 2011 is ninth year of record income & profit



Turning to the charts, and after respecting support at the 78.6% Fibonacci retracement region of 490/494p in May, prices have rotated sharply higher. Near term resistance is currently being tested at the 580/587p region. A sustained break above this level on increasing volume would spark a strong boost of upward momentum.

With reference to the weekly chart, the bullish moving average cross in place is suggestive of broader term momentum to favour the upside. A retest of the 656p high is likely over the coming months.



US regulatory battle kicks off

In the short-run the stock will be driven by the regulatory battle which kicked into life this week. On Monday the New York Department of Financial Services (DFS) made a series of damaging accusations which include hiding money transfers from Iran by altering documentation.

The DFS states that the amount involved is US$250bn with the transfers over the 2001 to 2007 period. Standard Chartered refutes this and states that only US$14m or around 0.1% of transactions didn't comply with the regulations.

The DFS has nevertheless branded Standard Chartered a "rogue institution" and required it to explain its actions next week (15th August). A fine is the least concerning outcome as the New York regulator is threatening to take away the group's New York banking license.

Reputational damage could also be severe and it is notable that the DFS accuses Standard Chartered of also doing business with Burma, Libya and Sudan. However, Standard Chartered has come out fighting unlike Barclays and HSBC which chose to apologize for LIBOR manipulation and money laundering respectively.

A regulatory battle has therefore just begun and it is not certain whether Standard Chartered is in the wrong or what the likely outcome will be. We would note, though, that the loss of the New York banking license is the worst case scenario and the regulator involved looks to be politically motivated.

In the US, and New York in particular, regulators and public servants operate in a more politically biased way than in the UK and Europe. This is as regulators can also be politicians by background or harbour political ambitions.

Notable New York examples include Rudolph Giuliani and Elliot Spitzer who were both US attorney's before moving on to become New York Major and New York Governor respectively. Both prosecuted high profile Wall Street cases in their roles as attorneys which served to increase their political profiles.

The regulator which has attacked Standard Chartered is Benjamin Lawsky who was the former chief of staff for the Governor i.e. a political appointment who is likely to harbor political ambitions. Mr Lawsky heads up the newly formed (October 11) regulator the New York State Department of Financial Services (DFS).

Thus it is within this context that investors should consider the outspoken and headline grabbing public attack on Standard Chartered. Mr Lawsky acted has also broken ranks with other regulators and has previously stated that he was keen to make a "splash".

For Standard Chartered its US business isn't huge but having a presence in the country supports its trade finance business. It also means it is able to offer its clients dollar liquidity which is the currency of trade in much of Asia and Africa.

Standard Chartered profile

Looking at Standard Chartered's recent financial performance and from 2002 to 2011 the bank saw compound annual growth rate (CAGR) in income of 16% and in profits of 21%. In 2011 income rose by 10% and profits increasing 11% while in the first half of 2012 both figures increased by 9%.

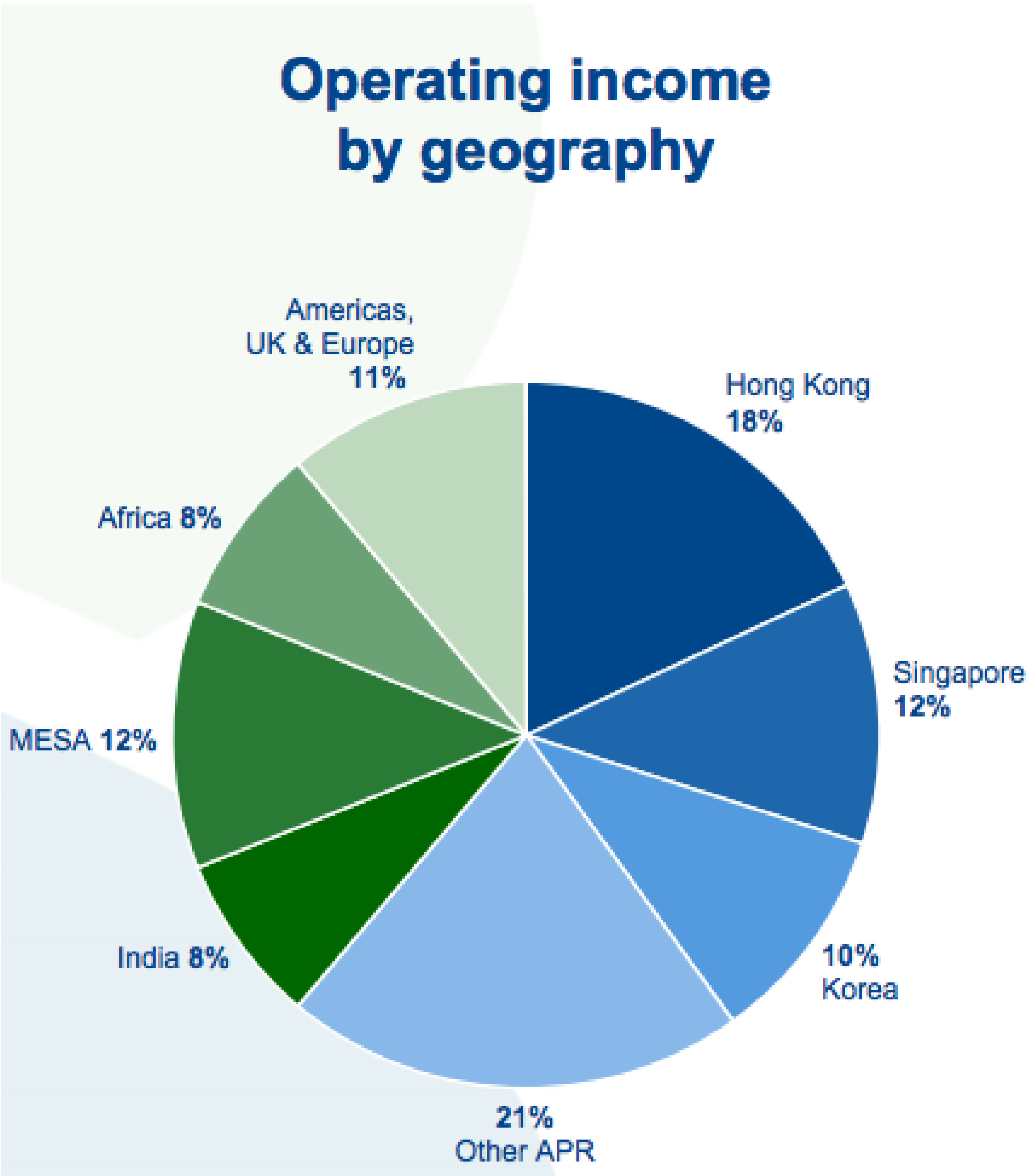
2011 profits performance

US$m	2010	2011	YOY %
Income	16,062	17,637	10
Net interest income	8,470	10,153	20
Non interest income	7,592	7,484	(1)
Expenses	(9,023)	(9,917)	10
Operating profit before impairment	7,039	7,720	10
Loan impairment	(883)	(908)	3
Other impairment	(76)	(111)	46
Profit from associates	42	74	76
Profit before tax	**6,122**	**6,775**	**11**
Profit attributable to ordinary shareholders	**4,231**	**4,748**	**12**

So growth has been slowing but for a bank these are still robust increases. We may also see growth rebound as the key economies for the group – i.e. Hong Kong and Singapore were 30% of H1 operating income – are forecast to see economic growth rebound next year.

Longer-term Standard Chartered is looking to expand in China – Chinese income grew 22% in the first half – and facilitate trade between China and Africa which has grown 20X since 2001. Its consumer business will also benefit from deposit and loan growth in Asia and Africa.

Standard chartered operating income by geography in H1 2012



The Asian and African focus is a result of the group's history as the business results from a merger of Asian focused Chartered Bank and African focused Standard Bank in 1969. In 2011 nearly 90% of earnings were outside of the UK and Europe and two-thirds of profits came from Asia.

2011 Profits growth by region

US$m	Income			Profit		
	2010	2011	YOY %	2010	2011	YOY %
Hong Kong	2,500	3,049	22	1,103	1,551	41
Singapore	1,738	2,186	26	718	1,002	40
Korea	1,698	1,718	1	388	172	(56)
Other APR	3,165	3,553	12	1,083	1,447	34
India	2,028	1,805	(11)	1,197	804	(33)
MESA	2,167	2,219	2	841	834	(1)
Africa	1,246	1,340	8	559	596	7
Americas, UK & Europe	1,520	1,767	16	233	369	58
Total	**16,062**	**17,637**	**10**	**6,122**	**6,775**	**11**

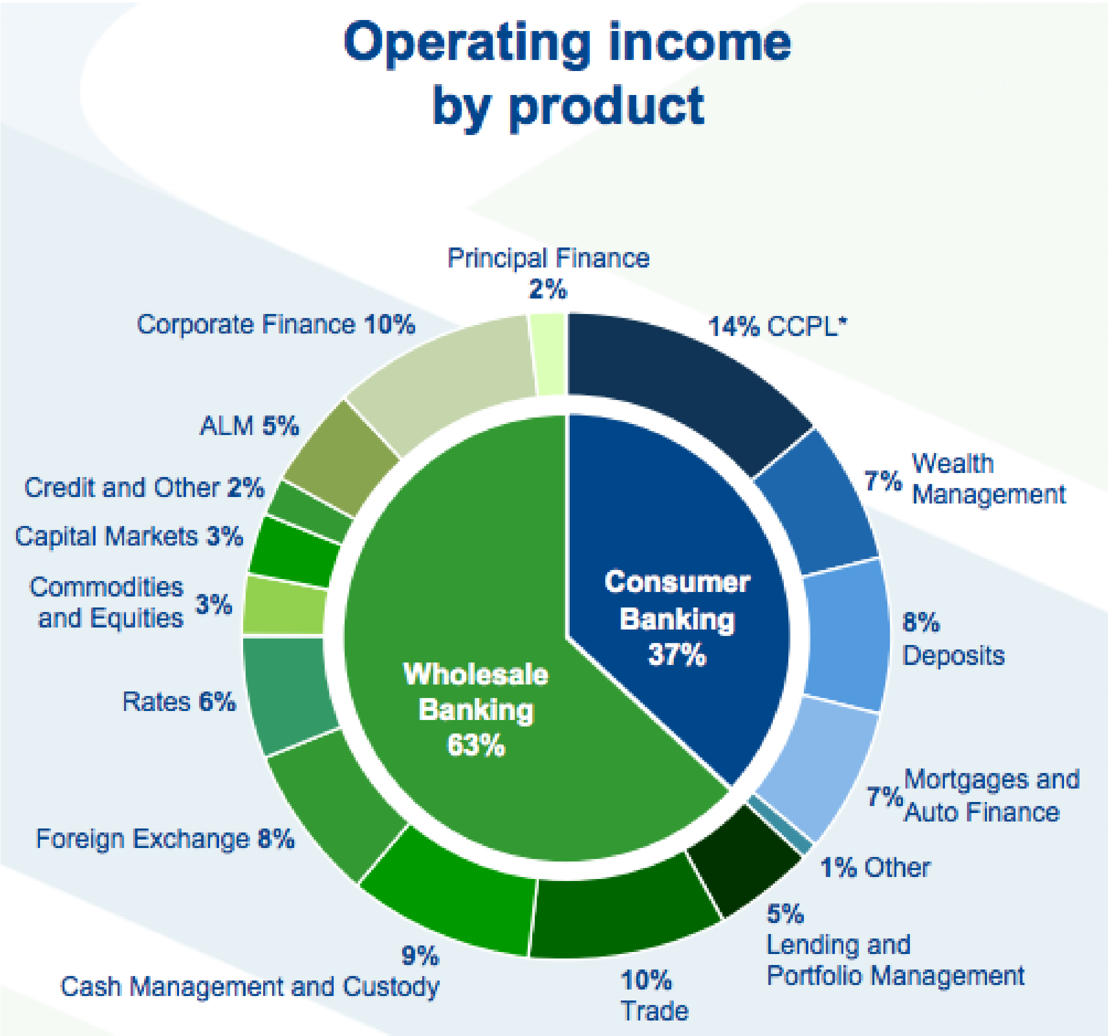
The above graphic shows that Standard Chartered benefited from a good performance in its key markets of Hong Kong, Singapore and Other APR (Asia Pacific Region). Weak areas were India, Korea and MESA (Middle East & South Asia).

We are encouraged that the group is forecasting rebounding growth in Hong Kong and Singapore although the forecasts were made in February:

GDP growth (%)	2011	2012F	2013F	2014F
China	9.2	8.1	8.7	7.0
India*	7.0	7.4	8.0	8.0
Hong Kong	5.0	2.9	5.6	4.5
Indonesia	6.5	5.8	6.5	6.8
Singapore	4.9	1.9	7.8	4.4
Eurozone	1.5	-1.5	1.5	2.4
US	1.7	1.7	2.5	3.0

In terms of the business mix and 37% of the business is focused on the relatively stable consumer banking arena. This benefits from mortgage, loan and deposit growth as the middle class increases in size in developing economies.

Operating income by product in H1 2012



Wholesale banking serves corporate finance, trade finance, cash management, FX, rates and a host of other areas. It is this area which is under investigation but the consumer franchise the group has should hold up well.

2012 first half

Looking at first half results and the 9% increase in income and profits before tax drove up earnings per share by 11%. The group's return on equity was a respectable 13.8% and the dividend was increased by 10%.

The bulk of the group's loan portfolio was in Asia and in particular Hong Kong, Singapore, Korea and Asia Pacific Region – over two thirds of the total. Standard Chartered notes that it has no direct sovereign exposure to Greece, Ireland, Italy, Portugal or Spain and that the loan to value ratio on its mortgages was 48%.

Moody's recently maintained Standard Chartered's credit rating at A1 which is only one notch behind HSBC. Of the fifteen global banks that were downgraded by Moody's in June the group's A1 rating is ahead of twelve of them.

Summary and valuation

Standard Chartered is now engaged in a regulatory battle whose outcome is uncertain. The political nature of the regulator in question, though, suggests that the accusations towards the group were played up as much as possible - perhaps as it is an election year in the US.

The worst case scenario of losing the New York banking license looks unlikely but could be manageable if the group can operate elsewhere in the US. The reputation risks are high whatever the operational impact as Iran is the political nemesis of the US but we are encouraged that Standard Chartered has come out fighting.

On the valuation front the group trades at just over 10X earnings for the current year with a yield of around 3.8%. The consistent earnings record, strong diversification and long-term growth prospects make this attractive.

Accordingly, we recommend Standard Chartered as a buy for all members. With the stock volatile investors with a low risk profile should look to accumulate it over time. Alternatively half of a full position could be purchased now and the other half after the regulatory situation is clear.

Snapshot STAN

Standard Chartered

The Company operates globally and is principally engaged in the business of retail and commercial banking. Around a third of profits come from consumer banking and two thirds on wholesale banking. The historical roots of the bank are in Asia and Africa and around two-thirds of profits currently come from Asia. The profits generated from Europe and the Americas are not a significant part of total profits.

Market Capitalisation:£31.5bn

	FY1	FY2
Price to Earnings	10	9
Dividend Yield (%)	4	4.2
Price to Book	1.1	1.1
Return on Equity (%)	12.6	12.9