HSBC

HSBC Holdings plc – 2006 Interim Results
Transcript of the Webcast Presentation

Date: Monday, July 31, 2006

Speakers: Michael Geoghegan, Group Chief Executive

Douglas Flint, Group Finance Director

Stuart Gulliver, Chief Executive CIBM

Bobby Mehta, Chief Executive HSBC North America

Dyfrig John, Chief Executive, HSBC Bank plc

Peter Wong, Executive Director, Hong Kong and Mainland China

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Please note that there may be minor differences between this transcript and the words that were actually spoken.

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Event Date: 31 July 2006 – 10 :15 to 11 :30am (London time)
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Event Participants

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Questioners:

Alastair Ryan; UBS;Analyst
Simon Samuels; Citigroup;Analyst
Ian Smillie; ABN Amro;Analyst
Tom Rayner; Citigroup;Analyst
David Williams; Morgan Stanley;Analyst
John-Paul Crutchley; Merrill Lynch;Analyst
Mark Thomas, Keefe, Bruyette Analyst
Simon Willis; NCB;Analyst
Michael Helsby; Fox-Pitt, Kelton;Analyst
Derek Chambers, Standard & Poor's;;

Presentation

Mike Geoghegan: Good morning ladies and gentlemen, and welcome to Canary Wharf and those who are joining us on the Webcam, welcome as well. I'm Mike Geoghegan. This is the first time I'm presenting the results here in the UK, these interim results for 2006 for HSBC Holdings. For those of you who are regular attendees, you'll probably see a little bit difference in the format today. We want to broaden out the presentation so we give you a flavour of our team around the world. And I have on my left here Bobby Mehta, who is President of our North American Operations and beside him, Dyfrig John, our new CEO of HSBC Bank PLC and he is representing the UK and our European businesses; Peter Wong, Group General Manager, Hong Kong, representing Asia on behalf of Vincent Chang and Mike Smith who are with our Group Chairman in Hong Kong presenting the results at the same time. Stuart Gulliver, many of you know, a Group Managing Director, my colleague for the last 26 years and representing Global CIBM. And last but by no means least, my friend and award-winning CFO, Douglas Flint, who you all know so well. And in the front row we have David Hodgkinson, who has been our very successful Middle Eastern operations and is now our Chief Operating Officer. We have our Non-Executive directors, Sir Brian Moffat, Sharon Hintze, and Sir Bryan Williamson.

The presentation today will take about 40 minutes after which I will take your questions. But beforehand I think we need to reflect on an event that happened around the world. HSBC operates all over the world and certainly my colleagues are no strangers to disaster and tragedy. However we were deeply shocked at the terrorist atrocities in Mumbai earlier this month in which four of our colleagues were injured and one, Rasik Merchant, tragically lost his life. In his memory we have established a spirit of Mumbai initiative to support the people of Mumbai.

I think it's also necessary to say that our colleagues in Lebanon are having a difficult time at the present time. Our six branches in Beirut are open today; however, 85% of our staff are in attendance. But it is a difficult time for them.

Now before we start, I would ask that you turn off the blackberries, the phones, and for others who are looking in on hsbc.com, you can find our news release, are slide presentation and interim report which includes information which will be filed on the full 8-K.

Before we start the presentation I would draw your attention to the cautionary words from the forward-looking statements now on the screen. This is to comply with the regulatory environment. Our results for the first half show that we have grown our income strongly and faster than our costs in line with our Managing for Growth strategy. Virtually all of this business is organic. The impact of acquisitions has been small. Encouragingly we have grown revenues strongly in business which we have invested and in our emerging market operations. Our business in mature economies continue to perform well. We improved our return, our investment capital on a stronger capital base.

As part of our strategy, our targeted growth strategy, we grew our deposit base at a faster rate at 17% and customer lending at 15% in the last 12 months. At the same time, we are positioning the Group for further growth by strengthening the links between our global distribution channel, by investing in technology and re-engineering processes, and by focusing on making HSBC the most respected brand in financial services.

Let me now run through the headline figures for the first half of 2006 compared with the first half of 2005. Net operating income before loan impairment charges was up 15% to 32.2 billion US dollars. Net operating income increased by 14% to 28.3 billion US dollars. Total operating expenses were up 12% to 16.1 billion US dollars. Pretax profit was up 18% to 12.5 billion US dollars. Profits attributed to the shareholders was up 15% to 8.7 billion US dollars. Earnings per share increased 13% to 78 US cents . The directors have approved a second interim dividend of 15 US cents per share in line with our pattern of dividend payments set out in last year's annual reporting accounts.

This illustrates the movement and profit attributable to the shareholders. Over the first half of 2006, you can see the underlying growth which exceeded 1 billion US dollars was approximately 2.5 times the level of underlying growth from the first half of 2005. Against this first half of 2005, average invested capital increased by 9 billion US dollars and return on the capital improved by 0.7% to 17.2%. This implies a 24% annualized return on the incremental capital investment invested and evidences our focus on strong organic growth. This took place without leveraging our capital further; indeed our capital ratios strengthened with Tier 1 ratio at 9.4%.

The geographical shape of the Group's business has remained probably stable. Our core markets remain Hong Kong, the United States and the UK. But three other businesses, Mexico, France and the Middle East including Saudi Arabia, are now also generating pretax profit of 1 billion US dollars on an annualized basis with Canada not far behind.

Our emerging markets business continued to grow strongly with aggregate growth in 14 businesses listed here, up 23% to 2.3 billion US dollars. Mexico continues to show strong momentum with profits up 20% and is now the fourth largest contributor to our profits. Of particular note with the doubling of profits in India and the strong growth in Mainland China, the Middle East and Brazil. Overall we see good opportunities for growth in Central and South America and the agreed acquisition of Panama's Grupo Banistmo, will strengthen our presence in the region.

The distribution of profit by customer group remains broadly in line with the historic trends. Let me deal with each one of these in turn. The following commentary strips out the impact of exchange translation and acquisitions and investments to illustrate an underlying trend. In Personal Financial Services, which includes our Consumer Finance business, pretax profit increased on an underlying basis by 10% to 5.9 billion US dollars. The cost efficiency ratio was stable at 49%.

The continuing principle of the group is that we are self-funding. In support of this, we focus particularly on growing our deposits in the first half with notable successes in the U.S. and the UK and the rest of Asia. Lending growth was the strongest in mortgages in the U.S. and UK, with growth and other personal lending and credit cards highest in percentage terms in emerging markets. Credit quality remained generally benign and where deterioration occurred it was largely offset by improved performance in other retail portfolios.

As you will hear from my colleagues later, we have invested heavily to improve our distribution channels both in physical and in the Internet infrastructure. Once again, Commercial Banking delivered an excellent performance with a 21% increase in profits before tax on an underlying basis. Revenue growth was driven both by deposits and lending and credit quality remained good. The cost to efficiency ratio fell a further 2 percentage points to 44.5%.

With profits growing at a faster rate than capital utilisation, our return on capital employed improved. Much of this reflects the good progress we are making and establishing HSBC as the international business bank. We established a cross-border business referral system connecting over 50 locations and 4000 relationship managers.

Facilities with aggregate value of over 1.4 billion of US dollars was included in the first half.

Returns of investment we have made in our CIBM business improved dramatically in our results for the first half. Profits before tax grew by 37% on an underlying basis with positive revenue trends and key areas of investment. Cost growth slowed as we moved into the execution phase of our five-year strategy and was concentrated in performance related pay and supporting the volume growth in Global Transaction Ganking. The cost efficiency ratio improved significantly from 61% to 55%. Stuart will give you some more detail on CIBM's performance shortly.

HSBC Private Bank has been one of a great success stories over the last few years. In the first half of 2006, we grew pretax profits for Private Banking by 35% to 600 million US dollars on in underlying basis driven by expansion in a number of products and services that we are offering our clients. This profit has more than doubled over the last three years.

Enhanced operational efficiency helped improve our cost efficiency ratio from 62% to 57%. Client assets increased by 22% to 305 billion US dollars, with net new money of 19 billion US dollars in the first half. We are managing the business in a joined up way with an increased number of cross-referrals from the rest of the Group which contributed more than 3 billion US dollars of net new money.

Let me say a few words about the huge rise in the use of direct channels which are an integral part of our approach to growing our business in both the developed and developing countries. HSBC.net, our Internet service for large and medium corporate clients is now used by 20,000 companies and 123 different counties. Our SME business has over 1 million registered Internet banking clients, 40% of which are based in Mexico, Brazil and Turkey. In our personal customer base there has been a dramatic increase in products purchased on line, up 60% from the first half of 2005. There was a strong increase in the number of active Internet banking customers and our experience with HSBC Direct in the USA, which Bobby will tell you about shortly, demonstrates our ability to attract new customers via the Net.

Let me now hand over to Douglas, who will take you through some of the financial details.

<u>Douglas Flint</u>: Thank you, Mike. This slide evidences the strong underlying growth and positive jaws we have achieved. Reading from the left, we have restated the first half of last year to a constant currency basis and then adjusted our reported figures for the first half of 2006 for acquisitions and investments. You can see from the slide that net operating income before loan impairment charges increased by 13.4% and total operating expenses increased by 10.9%.

If we look at the comparison on the same basis with the trailing six-month period on an underlying basis, we generated positive jaws. Net operating income before loan impairment charges increased by 6.1% compared to the 4.5% increase in total operating expenses. A significant reduction in loan impairment charges and the profit before tax was 18.3% higher.

I think we need to explain this slide. This slide deals with our businesses on a geographic basis and excludes CIBM. The vertical line shows the average revenue growth for the Group so everything to the right of the line is growing faster than average. The horizontal line shows the Group's average cost efficiency ratio surfacing below the line as a higher than average cost efficiency ratio, so the countries in the bottom right therefore have high cost efficiency ratios and generally that is because we're investing in them. And we're investing in them because they have higher than average growth. You can see from this familiar slide of the daily distribution of market risk revenues that revenues remain concentrated in a similar range to previous half years.

Looking at the loan portfolio, you can see from this slide that lending to personal customers continues to account for over half of all customer lending broadly in line with last year. If we exclude the impact of acquisitions on lending to financial institutions, which is volatile, lending growth over the last 12 months was 11% constant currency.

Turning to the composition of the loan impairment charge, this slide shows that the net charge as a percentage of average advances is stable against the first half of last year. Releases and recoveries have also been broadly stable. The new provisions in the first half of 2006 benefited in the United States from exceptionally low bankruptcy filings which along with Hurricane Katrina were the cause of the higher charges in the second half of last year.

In both the current period and the prior year period there were net recoveries for provisions in CIBM. You can also see from this slide that the impairment charges elsewhere in our major markets are broadly stable as a percentage of average advances.

In Personal Financial Services, the impairment charge as a percentage of average advantage was modestly up reflecting extremely low charges in deed recoveries in 2005 in parts of Asia; in 2006 these were not repeated. And we also felt the impact of a systemic issue in the credit card market in Taiwan.

The Commercial Banking book continues to exhibit low levels of impairment. And there are two areas we will come back to in more detail of position in the UK unsecured lending book and mortgage lending in the United States. Now let me hand you back to Mike.

Mike Geoghegan: Thank you, Douglas. I'm now going to invite my colleague to provide a brief summary of the performances of their businesses. Firstly, I'd like to ask Bobby Mehta to say a few words about the development of our businesses in the U.S. and Canada. Bobby?

Bobby Mehta: Thank you, Mike. Good morning everyone. The first slide shows the results of our personal financial services businesses in the U.S. and Canada which includes Consumer Finance. Personal Financial Services contributed approximately 3 billion US dollars in North American results, up 25% from the prior year period. We saw good loan growth across all businesses and all product lines. We've also seen some favorable trends in credit card fees which together with pricing initiatives have in part counteracted the impact of the rising cost of funds.

We launched in late 2005 a nationwide direct savings product under the HSBC brand. This not only gave us our increased nationwide brand recognition but it has also attracted about 5 billion dollars in deposits, most of which, 80% of which are new customers to the bank. Cost growth in our Personal Financial Services businesses was 17% driven by loan growth and also our investment in direct banking and branch expansion.

Turning now to CMB, our Commercial Banking business, we achieved a solid performance with profit growth of 7%. Investment in our branch network and in new products drove loan growth and operating income growth. We maintain strong momentum in commercial deposit growth and in transaction banking.

The U.S. and Canada continue to experience favorable economic conditions and credit costs remain low although as you will note, we had a net recovery in the first half of 2005 versus a modest charge in the first half of 2006.

Turning now to our Consumer Finance businesses, these trends that we've shown in the past are based on U.S. GAAP on a management basis which to remind everyone encompasses the legacy Household business and includes the Private-Label and certain mortgage loans that were transferred to the US Bank’s balance sheet.

Consumer Finance contributed 2.7 billion US dollars of total Personal Financial Services profits. Excluding derivatives volatility which occurred mainly in the first half of last year, profits before tax grew 38% helped by lower charge-offs. Net interest margin decreased to 6.66% due to a higher cost of funds and a greater proportion of residential mortgage lending with strong growth in the corresponding mortgage channel. There were some offsets to yields due to repricing efforts and higher market rates.

Charge-offs increased to 2.94% from the first quarter due to seasoning of the growing mortgage portfolio and higher-than-expected losses on certain 2005 mortgage originations. The first quarter also had the benefit from lower levels of bankruptcies which decreased from the fourth quarter of 2005 where we saw the introduction of new bankruptcy legislation in the United States and also the impact of Hurricane Katrina. Overall credit trends remain favorable as shown in the 2+ delinquency ratio of 3.57%.

Risk-adjusted revenue decreased from both the prior quarter and the prior year quarter partly due to the lower net interest margin. Also contributing to this decrease was the fact that the first quarter of 2006 benefited from the seasonal tax payer financial services revenue and the lower charge-offs.

I want to turn now to the U.S. residential mortgage market. We have a U.S. mortgage, first mortgage and second lien portfolio of approximately 126 billion US dollars held by the Bank and the Finance Corporation. This portfolio represents approximately 60% of U.S. personal lending. Geographically, as you can see, we have a well diversified portfolio with no state representing more than 16%; that state being California. California represents about 21% of the overall mortgage market, however. You can see the percentages represented by the other major states on this slide.

From a product concentration perspective, adjustable rate mortgages represented 77% of the Bank's portfolio and 27% of the Consumer Finance portfolio. Interest only mortgages represented 24% of our Bank and 7% of our Consumer Finance portfolio. We believe there is now evidence of a slowdown in the U.S. mortgage market. The impact of high interest rates on required payments on adjustable-rate mortgages that reach reset dates may put pressure on some borrowers. As a result, we have seen some deterioration leading to increased loan impairment charges in the first half of 2006. We are monitoring these aspects of our portfolio and taking actions to mitigate potential impacts.

In closing, however, I would like to emphasize that overall retail credit experience including our first lien mortgage book in the United States has shown favourable credit experience and has been favourable in the aggregate in the first half of 2006. Back to you, Mike.

Mike Geoghegan: Thanks, Bobby. Can I ask Dyfrig John now to take us through our UK and European operations? Dyfrig?

Dyfrig John: Thank you, Mike, and good morning to all of you. Personal Financial Services saw solid underlying growth across Europe with profits before tax up 8%. Our French Personal Financial Services operations, which were rebranded as HSBC France, from CCF last year, had an encouraging start to 2006. In Turkey, strong growth in credit cards, personal lending and savings products generated a strong rise in profits. In the UK, the benefits of strong balance sheet growth in both deposits and mortgage loans were offset by lower insurance revenues and increased loan impairment charges. We also wrote down the value of intangibles attributed to an acquired card portfolio. I'll return to the credit position in a moment.

Our Commercial Banking business grew both across the continent and here in the UK producing a strong 15% increase in pretax profits and on an underlying basis. Credit quality remained stable. In the UK, we had strong deposit growth and we attracted more net switchers than any other major High Street Bank. We successfully developed our SME business in Turkey which resulted in strong growth in loans and deposits. Strengthened relationship management in France helped support growth in lending and deposit balances.

Turning to credit quality in the UK personal and secured lending book, the chart shows that whilst credit losses have increased significantly since the first half of 2005, these have stabilised since the second half thanks to measures we have taken to protect ourselves and our customers against a weakening credit environment. The chart also shows the magnitude of the problem caused by bankruptcies and individual voluntary arrangements in the UK. Bankruptcies have trended up sharply and now account for around one-third of the delinquency in our unsecured consumer lending operation in the UK.

Excessive consumer indebtedness is increasingly an issue in the public domain and banks have an obligation here. We were the first major UK bank to share positive credit data. We think this is the only responsible action for a lender to take. We have also cut back on unsecured personal lending which has been reflected in a fall in our market share of new sales. On the plus side, our mortgage book continues to be extremely solid.

I'd like to finish by saying a few words about how we are re-engineering our distribution model in the UK. We believe we are seeing a genuine revolution in the way that banks relate to customers. We're investing over 400 million pounds in refurbishing our network that will make our branches more customer-friendly and we are extending opening hours in our top branches bringing them into alignment with retail hours.

During 2007, HSBC will establish the first of five megastores, huge, unique retail outlets that will add over 175,000 square feet of retail space to the network in the busiest streets in the UK. Let me hand you back to Mike.

Mike Geoghegan: Thanks, Dyfrig. Peter is here from Hong Kong. Hong Kong was our original home and it is still on of our three largest businesses. Peter is going to update us on things in Hong Kong and development of our business in the rest of Asia. Peter, over to you.

Peter Wong: Thank you, Mike. Good morning ladies and gentlemen. The continuing buoyancy of the Hong Kong economy we are forecasting GDP growth of 6.4% for 2006. And the growing and deepening links between Hong Kong and Mainland China have provided significant opportunities for growth. Market share of new residential mortgages in Hong Kong rose significantly following a successful promotional campaign. The marketing program by HSBC drove credit cards in circulation to a new high of the 3.1 million; including Hang Seng, total cards in force in Hong Kong totaled 4.4 million.

The buoyant equity market early in the year led to greater income from securities broking and related activity which was up 71%. World management income was boosted by the sale of unit trusts; insurance income rose with continued focus on the Group's retirement planning proposition.

Commercial Banking also saw higher insurance revenues resulting from the creation of a dedicated Commercial Banking insurance division last year. The rest of Asia-Pacific is already showing the results of our investments. There has been a significant increase in gross revenues across the region and we've added 900,000 new Personal Financial Services customers in the first half of the year.

In India, we are piloting 23 Consumer Finance centers and we will continue to extend this project in line with planned branch openings. In Malaysia, we recently opened our 37th branch and have approval to open three more before the end of the year. We also rank number three in credit cards with 980,000 cards in circulation. In Commercial Banking, corporate lending and trade finance grew strongly in India. Our cash management and trade finance business grew in Singapore. Trade finance revenues rose notably in Japan and Korea.

Now let me update you on our operations in Mainland China. In the first half of 2006, our investments performed well. As you know, our principal partner in Commercial Banking is Bank of Communications. We have continued to develop this relationship with more than 70 cooperation initiatives in place including a three-year technical support and assistance agreement; joint product development and co-branding for QDII propositions; a joint three-year strategic business plan for 2006 through 2008; and a staff exchange program with 80 to 100 Bank of Communications staff to be trained in HSBC in the next three years. And in the first half, we have issued more than one million of our jointly branded credit cards.

HSBC's own business operations have continued to grow. There was a strong performance by CIBM. Commercial Banking has signed a referral agreement with Ping An, China's second largest life insurer in which we have a 19.9% stake. We continue to invest in our branch network, which is growing rapidly. In the last twelve months, we have increased our branch presence by 50% to 34 branches. Thank you very much.

Mike Geoghegan: Peter, thanks very much. I've now got Stuart coming up to tell us about CIBM. I know lots of you have shown lots of interest in the past and Stuart will take us through the results today. Stuart?

Stuart Gulliver: Thanks, Mike. The next two slides review the key aspects of performance in our Corporate, Investment Banking and Markets business. And as we told you previously, we largely completed the investment phase of our five-year CIBM development programme in 2005 and in 2006, we are fully engaged in the execution phase of this strategy. CIBM has a broad mix of revenues whether measured by geography or business line. This reflects the diversity, sophistication and the scale of both our own client base and now our product capabilities.

As the pie chart here makes clear, we are not dependent on any particular product including either lending or balance sheet management. Taken together these two business lines account for just 14% of CIBM revenue. We believe this diversity is a terrific strength.

As demonstrated by the numbers you see here, business momentum is strong in the areas we have invested to enhance our product offerings. Of particular note is the 85% increase in revenues constructed derivative products, as well as the strong growth in our foreign exchange, credit and rates and investment management businesses. The convincing progress in our client-driven Global Markets business is especially pleasing because this is an area in which we made significant investment in 2004 and 2005 and that investment is now bearing fruit.

Our Transaction Banking businesses also experienced strong growth in volumes especially in emerging markets and revenue growth reflects this and the increased income on higher balances. Balance sheet management revenues remain constrained by the conditions in the global interest rate market with yield curves remaining flat and short-term rates continuing to rise in most major markets.

Our Investment Banking revenues rose modestly but business volumes were very strong in both financing and advisory areas and we captured a growing number of headline investment banking deal positions including four of the five largest deals announced in Europe during this period. During the first half of the year, we took advantage of this momentum to streamline the management structure of the business into four principal product lines: Global Markets, Global Banking, Group Investment Businesses and Global Transaction Banking.

CIBM's development strategy is focused on leveraging the group's unique strengths in emerging markets. This slide shows that this strategy has also already gained considerable traction in our Global Markets and global banking businesses. Revenues rose 31% in emerging markets as we continue to deliver products developed in London, Paris and New York through CIBM's extensive distribution network. Furthermore, a proportion of the revenue flows in New York, Hong Kong and London relate to emerging markets.

As we have demonstrated over the last two years, top-quality product expertise can actually be developed relatively quickly and it's not a significant barrier to entry in the wholesale banking market. However, the global footprint of the Group in our distribution network, which has been built up with within CIBM over many years, are powerful competitive advantages which are not easily replicated.

As we promised at the annual results presentation in March, we present in this slide league tables taken directly from Bloomberg. The tables show that HSBC's top tier position in the debt capital markets is now well entrenched. Our share of international bond issuance rose to 5.5%, placing HSBC fourth in global market share.

In the first half of 2006, we moved from the build phase in this business into full execution mode. Our overall investment spend was considerably lower and most encouragingly, cost growth was largely in performance and volume related expenses as revenue growth increased. These results show we've established our credentials in delivering profitable organic growth in key targeted businesses following a period of investment. We will continue to invest in CIBM over time but we will only invest in those businesses where we have a clear view of expected returns. Mike?

Mike Geoghegan: Thank you very much. I'd like to conclude by with a few words about the outlook. The world economy remains fundamentally strong. China continues to grow at an intense pace, attracting massive investment flows and providing massive opportunities for the world exporters. However, we remain alert to the possibility of rising interest rates, high energy prices and slowing housing markets may constrain economic growth. In this environment, HSBC's well diversified business is both a strength and a protection. We will continue to position HSBC to take best advantage of the changing nature of the world's economy.

Ladies and gentlemen, this completes the formal part of the presentation. However, before I take questions I think it would be fair to give you a flavour on how I and the management team propose to run the Group in the coming years. Clearly today's results speak for themselves both in their geography and their business makeup. They also demonstrate that following our investment in CIBM and in Personal Financial Services, these businesses are really now coming-of-age and they are picking up momentum.

So on the first question, would I change the strategy, and the answer obviously is no bearing in mind the results we've had today. The growth strategy was developed by the top team and is an integral part of our going forward. Now obviously as you roll out a strategy, there are many things you can do to enhance it to improve it. I think one of the things that I am struck by is the strength of this brand. In eight years, this is the 27th most valuable brand in the world. But to be realistic, take that brand across 76 countries, one wouldn't expect it to be really joined up at this stage. Not management's challenge is really to join it up and to make it a customer experience of note across all locations. And we intend to do that in the coming years.

Secondly, as the map behind us probably demonstrates the unique advantage that HSBC has over virtually any other financial services industry. That distribution channel is second to none. We want to prioritise it and focus it in specific products in all areas because we want to automate it; we want to use the best technology we have. You've heard us talking about our direct channels but we want to grow those much more, growing up channels and business and geographies. I think we're only at the foothills in this regard.

Fourth, our people. An organization is only as good as its people and I reckon that we have the best. We have a maturity of people who work for us from graduates to retirement. And they are fundamental to us for everything we do. But I want to recognise this and grow it, staff engagement is key to me. You know and I know companies with high staff engagement generally have much higher profits. And it's the culture and the organisation that we have that makes us different. When we talk about acquisitions, we acquire with confidence; we execute together. We've done this and we will continue to do this.

So to the question, will we be doing acquisitions? Yes we will do acquisitions when they suit us, when the price is right but we will continue with our organic growth first.

Now I'm going to take your questions but can I ask you to wait until the mic comes to you. And we will also be taking some e-mails today as well. Please address your questions to me. I will take the easy ones and pass the hard ones onto my colleagues. So who would like to start? I think the gentleman here in the front.

Questions & Answers

Alastair Ryan: Alastair Ryan at UBS. After that sort of discussion of the Group strategy for the next several years like that, I feel a bad with the parochial question, but I'll ask it anyway. On the first lien and the second-lien mortgage portfolio in the U.S., clearly that was one of the areas you grew fastest last year. I think reasonably significantly more rapidly than the market as a whole and the emergence of credit problems has been fairly rapid. So two questions. One, do you feel that you have gained more than your fair share of impairments on that business? And if so, were you compensated for it?

And then secondly, how long does it take for that to flow through? I know the 73 million dollar additional impairment taken I guess in the second quarter, but typically how would you expect that to take? And then finally, probably just add -- it's all the same question really. Is there likely in your view to be read through of second lien sort of the canary in the coal mine or is it a particular issue on a particular tranche of lending?

Mike Geoghegan: Before I ask Bobby to reply to that, I think being realistic after 16 interest rate hikes if there wasn't a slowdown of some format, I would be quite worried in that interest rate hikes weren't taking their impact. So Bobby will answer the question now to the specifics.

Bobby Mehta: Sure. I think there were a number of questions in the specifics. One is we did grow the second lien book but we probably were underweight in second lien relative to the market. So in terms of the overall makeup, it is not by any means the predominant part of the book today.

Number two, you asked a question I think about how long does it take to flow through? Second liens flow through more quickly than first liens. With respect to exactly how many months it takes to flow through, I don't want to hazard a guess at this point.

The third point I think was is this a more widespread issue than simply in particular parts of our mortgage book? And I would simply want to reiterate the point that overall our mortgage book is stable from a credit quality perspective. And certainly overall, our credit book in Consumer Finance portfolio is stable as you can see from the 2+ delinquency ratio which really is a precursor of what is to come from a charge-off perspective. So we think we've sized the issue as best we can and dealt with it and we are very much focused on it.

Simon Samuels: Simon Samuels from Citigroup. I've got actually three questions if I can. The first is just following on the second lien issue. It is obviously interesting that you've given a priority in your sort of outlook, comments, etc., which suggested it might have a degree of materiality which on the face of it seems a bit out of step with the size. And if I understood Bobby's slide correctly, it's about 12 billion dollars or so of second lien mortgages that you've got outstanding. Your bad debt charge is annualising at about 7.5 billion dollars per year, your profits are annualising 25 billion dollars. So I mean, what I'm really trying to get a sense of is you've given a very high profile -- is that the comment on its potential materiality?

Mike Geoghegan: No. I think Simon what you always see with us is we tell it as it where we see it. Are we calling the top of these the mortgage market in the United States? Well maybe not. What we've been through here many, many times and when we see the rates tick up and then profits slows down and then goes back up again. We do believe that in the 2005 vintage, there were trends being seen there. We wanted to alert you to them. We don't see any major underlying problem in the book as a whole.

Simon Samuels: The second question is I was interested -- I can't actually remember the last time I saw this in an HSBC presentation, a lot of talk about marginal return on marginal capital. It looks like you did about a 15% return in invested capital last year and 24 or so, so far this year. And indeed a comment on I think on the PFS division about its marginal return going up as well. Is there something you want to tell us about a change in the way the Group is managed? Is that just because it happens to be good numbers in the first half that profiled it? My question is it there a change in sort of the focus on marginal return?

Mike Geoghegan: No, but I think there is a very clear wish to join the Company up and make sure we make the most out of our customer portfolios that we have. And that in itself gives us that organic growth that you are seeing in the first half. I mean, the reality is we have been at this for about 2.5 years now and possibly you're only beginning to see this coming through. I think we are at the foothills of where we will see across sales, with relationship banking going as we segment out our customer base.

It's interesting if we go back two decades, Personal Financial services in this group represented about 2% of our contribution. Today, as you saw the slides, they were 50%. So we have spread the risk of this Group across the personal financial service and I think that is giving us the organic growth and giving the return on the invested capital that you saw today.

Simon Samuels: Thank you. And last question is for Stuart which is the cost income ratio in CIBM obviously has been up a lot and come down a lot in the first half. Can you give us a sense of how you are managing that business in terms of the brand, sort of an acceptable cost income for our spreadsheets so to speak?

Stuart Gulliver: Yes, Simon, I think it is somewhere between the two numbers that you've actually just outlined. Which would again put it actually quite competitive compared to that peer group that we would measure ourselves against which is obviously a peer group of universal banks, yourselves included.

Ian Smillie: Ian Smillie from ABN. Three quick questions please. The first one comes back to marginal profitability. Your earnings grew faster than your risk risk-rated assets. Your risk-rated assets grew faster than your capital generation. And I understand there is a technicality of the dividend growth in the first half of the year but the headline payout ratio is now down to below 40%. Now you have mentioned potential appetite for deals hasn't gone away. But how high can the Tier 1 ratio go before you have to start to think about a, the dividend growing in line with the earnings? And then b, even possibly growing faster than earnings for a period of time?

Mike Geoghegan: Well, I'm going to hand it to Douglas for all of those lovely questions. But before I do, I just wanted to say what we did say was we haven't ruled out acquisitions. We didn't say acquisitions are our strategy, organic growth is our strategy. But as we proved with the recent proposed investment in Banistmo, we will make acquisitions when it suits us, when they fill in. And then we are actually able to use the capital better than if it was less at the center. And that is always our challenge is to find places to take the capital up. But it's not going to be done in haste. Douglas, over to you.

Douglas Flint: Just a couple of quickies. I think there is an increasing focus on capital utilisation. Mike is challenging everybody to demonstrate to him why they are using the capital they've got and how they can improve returns and why they should deserve a better allocation. So I think there is a real message out there in terms of what capital is being used in the incremental returns. I think there is a seasonal impact. The first half of the year tends to be a slower growth in risk assets because the utilisation at the end of the year is high because of personal lending credit cards in December.

As you know we moved to a pattern a couple of years ago of three fixed quarterlies which makes this discussion easier at this stage. And clearly in light of the year-end results we will reflect on what an appropriate payout proportion will be. But I think as we've said for sometime that the important thing to assist and manage the returns and then look at our long-term sustainable and progressive dividend policy and that is what we will continue to do.

Ian Smillie: Thank you. The second question was you talked a lot about growth again today. When you look across the Group, which part in particular stand out for further investment and possibly acceleration in cost growth particular given that the track record of you have invested and delivered particularly in CIBM over the last couple of years? So as you look forward, where should we be thinking about you doing the same thing?

Mike Geoghegan: Well, there are a number of areas and the presentation alludes to some of them. But let's just take the rest of Asia. We've only just started, we've added 900,000 Personal Financial Services customers in the first half of the year. And that is a pretty impressive number. But the reality is there was more to go for. Our direct channel of opportunities that we want to launch in Taiwan, that is coming up soon. In the USA, where we've done HSBC direct and got about 4.8 billion dollars worth of deposits in the first half of the year, we want to go further. That is helping our brand as well, getting our brand nationally across the country.

We are opening branches in certain states of the United States and you've heard Dyfrig talking about our refurbishment plan in the UK, broadening out those hours of our opening, using the direct channels, Understanding segmentation. And I would say that we are late going into Eastern Europe. I'm not saying it is the right place to go in and do an acquisition. I think it is the right place to organically grow cogniant of the fact that those economies will have to adjust for the EU alignment. We'll see expansion in branches in Russia. In various places.

That's on the personal financial services, but I would say on the insurance side we want to a lot more and the retirement side we would like to see development. We approach that subject with care and caution as we go forward but we'd like to make that now more of an emphasis going forward. And Clive Bannister has just been appointed Group Managing Director with that job to do and he is in the audience there smiling so he must be happy.

But there are a number of areas. I think there's a lot of engine power and as Douglas alluded to, I've come from 33 years of running different parts of this group. I've worked in most segments of it. I think joining it up is the challenge. We've talked about private banking where we saw $3 billion worth of net new funds coming in from totally different segments. We saw $1.4 billion worth of new business coming from referrals in commercial banking. So I'm pretty optimistic on this that there's growth in virtually every segment we are looking at. And as you have seen on the CIBM side, the investment side is virtually done. Obviously improving systems, working things through there. I think there's a lot of opportunities still to come from that area as well. At the back.

Tom Rayner: Tom Rayner with Citigroup. Can I have a couple of questions please? The first on Hong Kong. I'm just wondering if the 6% profit growth in the PFS business perhaps understates the underlying performances coming through there now? I think as you ignore the normalisation of the impairment line, it looks like 15% pre-provision. Is that a sort of rate of growth that we should expect to be continued throughout this year and into next year?

Mike Geoghegan: I think before I ask Peter to take the question, I think we've got to recognize that we're taking a write-back in the first half of 2005. We had very low provisioning there so there had to be a kick up in the second half. But, Peter, you might want to expand on this.

Peter Wong: Yes. If you look at the GDP growth in Hong Kong it is 6.4% led by very strong domestic consumption. That gives us an opportunity in terms of the PFS side therefore we have hired people and also at the same time upfront our marketing costs in terms of gathering customers and market share. So we can see that our marketshare growth in mortgages, in credit cards, in unit trusts as well as in insurance.

Tom Rayner: Can I have a second question just coming back to U.S. credit quality in the Consumer Finance. Listening to what you've said on the mortgage issue etc., your view on the risk-adjusted margins now going forward I think previously we've talked about stabilisation possibly even a gentle rise. Is that something you are still happy with given what's been said on the mortgage side today?

Mike Geoghegan: Bobby?

Bobby Mehta: Thanks, Mike. I think our perspective on the risk-adjusted revenues in the Consumer Finance business really stay consistent with what we've said in the past. Obviously the rate increases continue to put pressure on net interest margin. And that obviously feeds through to the risk-adjusted revenue. But we are seeing -- we've been able to increase yield selectively. We've been able to reprice. We've been able to grow fee income which you can see from the 8-K, Finance Company 8-K that was published. And all of those factors we believe will continue to keep risk-adjusted revenues at a consistent level. Obviously there will be some cyclical ups-and-downs as the interest rate cycles.

Tom Rayner: Thank you.

David Williams: David Williams from Morgan Stanley. I have a question on your value at risk within your investment bank. I see it went down very substantially in the first half by $198 million last year to at about $92 million this year. You have a the strong performance in your trading revenues. Just wondering how you managed to get the value risk down so much and yet have such a strong performance on that trading line?

Mike Geoghegan: Well noted but Stuart, the answer.

Stuart Gulliver: This is going to enable me to answer the balance sheet question which one of you are undoubtedly going to ask. The derisking is because we completely flattened out our exposure to U.S. dollar, Hong Kong dollar and Euro interest rates within our balance sheet. So the BSM line which undoubtedly someone is going to ask the question about what the outlook for that is. The outlook for it actually is now pretty much protected against both rising and falling interest rates. In other words we derisked a chunk of it.

So that volume number covers both the balance sheet and trading. So actually if you flick over from page 107 I think to page 108 or thereabouts you'll see the breakdown of the trading bar. The trading bar is actually more or less where it was previously. How do we make great results out of that? Because this is a client led Global Markets business not necessarily a prop led Global Markets business so you can hold your bar more or less the same and make more money. But the overall bar declines because we've taken a chunk of the risk out of the balance sheets in order to make sure that the continuous decline in the balance sheet is effectively arrested and we're fully now insulated from further rises in interest rates. That also means because we derisked it, we won't make money when rates fall again unless we put more risk back on. And clearly the timing for that remains as opaque as it has always been.

John-Paul Crutchley: John-Paul Crutchley from Merrill Lynch. Two questions if I can. The first one on investment bank and particularly on the UK business. Maybe just to clarify that last point, Stuart, do we therefore assume that the balance sheet revenue number that you talked about in the discussion here should be a fairly stable number given a fairly normal interest rate from here on out?

Stuart Gulliver: You can fairly assume it is a fairly stable number compared to its unfairly moves over the last couple of years, yes.

John-Paul Crutchley: I had a broader question actually on the investment bank as well. When I *look at* the size and shape of your business, again, it's obviously sort of global peers, you are obviously a very different type of business given where you make your money from etc. I guess are you broadly happy with that now? When you look forward in this business should we expect to see pretty much more of a similar fast and stronger contributions in places like Asia and the like? And the more mature more stable contribution from the U.S. etc. which in some ways obviously is complete mirror opposite of where the global investment banking revenues always are. Or do you see broad opportunities longer term to get more money?

Stuart Gulliver: I think we are quite pleased with the way the business is shaping up. We delivered 30% PBT growth, 12% positive jaws, got big gains in our Global Markets business, great gains in Global Banking. You know four out of the five largest European advisory deals we're working on which I think is proof of concept in those mature markets. But actually HSBC isn't like Goldman Sachs or Morgan Stanley. And we've never set out to build a business to look like that. We set out to build a business that if you think about it is an emerging market led wholesale bank that is very focused on financing. And you can see that coming through in those results.

So albeit the size of wallet is clearly bigger in the United States than anywhere else in the world, we think these results demonstrate that in the geographies we are focused on actually we can make quite material returns for our shareholders. So, yes, you can expect to see more of the same.

John-Paul Crutchley: The question on the UK business, when you showed slide 20 when you showed invest vs growth. It looked like the UK business is very much into re-engineering, restructuring quadrant if you like whereas the commentary which came out hinges on Dyfrig's comment on where the business is going and taking much more to invest style strategy. So I'm just trying to reconcile those two things or whether you actually see those if there is another scope for severe cost restructuring in that business to take it where you want to be?

Mike Geoghegan: As you know, prior to disappointment I was running the UK Bank and so some of the things I am going to say I hope Dyfrig will support. I believe retail banking is all about re-engineering. Because people's lifestyles are changing, how they interface with a financial service is changing with them. But it's an investment and a reengineering. Just to give you an example, I think there are 400 million pounds we're spending on the branches and 200 branches being totally refurbished move out of these megastores we're talking about, 175,000 square foot, that is a totally new concept in retail banking. We don't know how that is going to work out but we're bold enough to have it a very good go.

On the reengineering side, certainly we believe post it needs to be paid for -- actually think our industry is not very good at understanding costs of production and volumetrics of production. And we wish to lead in that area. And correct, the UK Bank is at the forefront of that and many at the initiatives established in the UK are being rolled out across the world and visa versa, there are best ideas coming across. So it is a growth strategy and it's an investment strategy. I think we took over one million customers in the first half of this year. The number one bank in switches and the commercial growth in this business but by doing that in a reengineering format that we have centered outside of branches so our colleagues are focused all the time on the customer. And this is the type of thing you will see more and more of HSBC both in the branch network and in the alternative channels as well.

Mark Thomas: Mark Thomas at Keefe, Bruyette: One for Douglas I suspect, and then in a second. Just in terms of the performance management fees on asset management, you highlight particularly the emerging markets and the BRIC fees. Can we take that was actually effectively period and year end and first quarter and that volatility that we're seeing in the emerging markets in May and June isn't actually a reflection of performance fees reported in this period?

Mike Geoghegan: Douglas, I'm definitely going to give you that one.

Douglas Flint: Thank you Mike, happily I know the answer. Most of the BRIC fees were in fact on a calendar basis and annual basis and the period of measurement was to March. So therefore, the annual fees to March and then March the BRIC funds that we do were doing very well so we had the annual fees and then we reset for another annual review. So there is no impact coming through thereafter. It's an annual review.

Mark Thomas: I guess strategic question is really around -- and we've heard for a number of years about the unique franchise, getting unique opportunities. What I'm really trying to get a feel for is how much do you think HSBC can add to its profit by being HSBC Group rather than being HSBC Holdings?

Michael Geoghegan: Well, so you wouldn't expect me to give you a profit forecast. But I think being around eight years during this it would be a bit of an understatement for us or an overstatement for us. I don't think the brand -- we changed the brand just under eight years ago -- it takes a long time to join up a company. You can change a brand overnight anywhere but the people are the same people that were of the previous brand. My desire and my team's desire is to make that cross referral business work and there was a number of intentions to make that happen. But you've got to communicate that strategy.

We have quite a unique management structure in that we have country managers and global businesses. Pulling those together and making sure they are seamless is what makes the bottom line work for us. I think there is a lot to go in that. As I said, I'm not going to give you a forecast of what it is going to come to. But it is certainly going to roll going and I believe when you talk to our customers, I think 10 out of 12 customers in the UK would recommend HSBC to their friends. That is a pretty powerful statement from a brand and we want to push that forward further in other parts of the world and making it absolutely seamless from someone who's doing business today in London, doing business in Sydney or doing it in Shanghai. That is the challenge and I think there's a lot to go for and nobody else can do it but us.

Simon Willis: Simon Willis from NCB. My question relates to the impairment charge in the rest of Asia Pacific in PFS that rose by around $200 million or so. And Douglas, I think you referred to Taiwan and the credit card issue. Could you say what you are seeing there at the moment? And then what you think the outlook is like for the next six to 12 months? And then also maybe add a comment about the outlook for the impairment charge around in Commercial in the rest of Asia Pacific and also in Hong Kong given that the other three saw some offsetting benefits?

Mike Geoghegan: Well, firstly if we take the Taiwanese situation. That is a government lead change in how consumers will pay for their credit card outstandings. And hence, it's not something we can project. Will that follow in other areas? We certainly saw it in Indonesia. We haven't seen it in other areas other than those two countries.

The impairment charge obviously as you're going your business and Personal Financial Services will always climb up until you get to that sort of level [A]. I use it a bit like a speedboat. It's always going up like that. The minute you stop growing the water comes over the back of the speedboat. But the reality is we are nowhere near there. We are still very much growing in the economies in Asia and they are growing. I think we're realizing a picture of what these economies are.

In regard to Commercial Banking, the 0.36% loss rate is a very low. There's no doubt about it and we've been sort of saying it must be coming, it must be coming. It certainly isn't coming in Asia at the moment and in Hong Kong in particular because of exports being so strong, etc. But I suspect in other parts of the world there must be a slowdown if rates were continue to increase but we are not seeing it at the present time.

Douglas Flint: Just one thing in Taiwan. The issue I think has substantially been dealt with in the first half. I mean there was a government program at that negotiation mechanism which people had to subscribe to. That has essentially been done and that gave people deferred terms and ability to discount debt. Now that has all been reflected in the charges which was just over $150 million we took in the first half. So in terms of the Taiwan issue there is defined impairment that has been debt with and I think going forward it would be a more normalised relationship to income. So that is a one-off.

Mike Geoghegan: And I would say actually even though the rules have changed, I think 92% of our customers are actually paying so that's a very unique situation. Next question.

Michael Helsby: Michael Helsby from Fox-Pitt. I was just looking at the UK profit performance in PFS on page 39 and it's interesting to note it has dropped back a fair way since the second half of last year. And that is despite the chart you showed, the bad debt actually falling since the second half of last year. I was just wondering if you could let us know what is going on there? If there is any particular trends driving that?

Mike Geoghegan: Well there are two things. Obviously the bankruptcy rules have changed where in the U.S. the bankruptcy rules change back the other way making it much harder to declare bankruptcy. In the UK it became very easy to declare bankruptcy and the IVAs in that voluntary agreement have also increased the losses on the unsecured but mainly the personal loans and the cards. The great thing about that is you've actually rolled through it in about 180 days, it goes through your provisioning level -- it gets through. And we've somewhat been out of that business for the first six months of this year and kept a very low position and we are actually seeing the maturities and the buckets much better this first half.

Dyfrig , do you want to add anything on that?

Dyfrig John: Yes I think I can add a few things. First of all, I'd caution against a direct comparison because there are some anomalies for instance the card portfolio we acquired suddenly appearing the cost of it only appearing now. But if you look at the underlying growth we're still in double-digit growth in the personal side in the first half. And you look at the Commercial Banking side that is also showing double-digit growth in PBT. So in overall terms, it is a period of investment. But with regard to that investment if you look at how that investment is tracking, there is 35% more contact with customers in those outlets we have changed we've invested in. And sales are broadly up over 20% in those.

So we now have proof that this concept is working. It's a case now of getting the right sites, the right planning commission in the high street. We have a model which is working and that will continue to roll out. So it is an investment phase and we have allowed costs to increase in certain areas but at least broadly, this is very, very generated in terms of bottom line but actually in product sales and cross sales as well - face to face.

Michael Helsby: Just one more follow-up if I may just on South America. You have not really mentioned about that today. And that was the one area where your profits fell. I was just wondering what is going on there in terms of trends and how you see that going forward? And if you could talk about the experience you've had because that's been a big area from the Household push through whether that is -- your bad debt has gone up whether there has been any problems there?

Mike Geoghegan: Well, since I led the investment into South America with the purchase of Bank of Bamerindus I'm happy to talk about it. Clearly we bought different banks in different places. In Mexico, we bought a bank that had a strong deposit base and needed to go out and fill relationships and that is what it has been doing. As I mentioned in the presentation this morning, we're virtually heading toward $1 billion business on that business going forward. And I think in the second half we should see that growth continue.

On Brazil, yes we bought the Losango business. It's a very cyclic business, the Consumer Finance business in Latin America. There was some volatility in the numbers in the first half but that generally has been seen through the systems there and the knowledge that we've got out of South America for nonpositive data management. It's been actually vital to us in other parts of the world.

In Argentina what you were seeing and of course there was a big recovery in the first half of 2005 coming out of the restructuring of the government debt position there and that obviously won't come again in the second half. But those, all those businesses are joined together and Banistmo is going to give us that whole lying down through the continent and I think it's a very exciting challenge for us. Those teams are working very, very closely and taking their knowledge into places like Turkey, into places like Egypt, into other places with similar demographics and similar opportunities for HSBC.

Can I take this as the last question?

Derek Chambers: Derek Chambers of Standard & Poor's Research. Can I ask a question about your comments on page 116 about Basel II? You are referring there to the complexities of implementing this for a many country basis. Has your thinking on the impact changed since you contributed to QIS-5?

Mike Geoghegan: All that sounds complicated.

Douglas Flint: I think if we had a magic wand, we would love there to be an overnight global agreement among all the contributory bodies regarding definitive final rules and so on. No, we continue to see a fairly similar picture in aggregate from the impact of Basel II. But yes, there are winners and losers within businesses and geographies and the biggest issue we have in dealing with the complexity of inconsistent rules across the whole piece and that's a burden to us in building and populating systems. But it is something we have to do.

Mike Geoghegan: I think at the same time there's lots of benefit coming out of it in managing portfolios and understanding portfolios better and that will obviously work its way through the system as it is implemented.

If there are no more questions, then I would just like to thank you very much for coming this morning. And wish you every success in the second half with us. And we will see you at the end of the year. Thank you very much.