HSBC’s Acquisition of KEB

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“2007 was a year when large parts of the international financial system came under extraordinary strain. For HSBC to achieve another new high in earnings, despite these conditions and the exceptionally weak performance of our US business, underscores the value of the strategic focus we announced early last year to drive sustainable growth by concentrating on the faster growing markets of the world.”

--S K Green, Group Chairman
The banking sector emerging from the Credit card crisis in 2003.

Strong loan growth, low NPL, strong profitability and BIS.


4.5% GDP growth expected in 2008.
Korea Country Risk

Sovereign
- Korea rated Aa3 (78 on Institutional Investor Country Credit rating)
- Unfriendly relations with North Korea (raises political tensions between world superpowers)

Operating
- HSBC has little experience in the Korean market, which is dominated by local banking groups
- Bank unions
- Restrictive regulations

Financial
- Volatile currency market
- Heavy indebtedness of the households (136% debt to disposable income) and SMEs (200% debt to equity)
KEB as the Target

- **Right candidate for HSBC because:**
  - Only Korean bank up for sale – Lone Star desperate to exit after 4 years
  - Only bank in Korea that focused on quality asset growth (low delinquency)
  - One of the highest Net Interest Margin (3.42%)
  - 17% ROE (vs. 15% normalized) and 1.5% ROA (vs. 1% normalized)
  - Most global bank of Korea with maximum no. of overseas branches
  - Lone Star has introduced global banking standards
  - For HSBC, this acquisition will cement their presence in a fast growing economy

- **Not a right candidate because:**
  - Multiple court cases against Lone Star’s qualification as a major shareholder
  - Regulatory hurdles involving acquisition by a foreign bank
  - Strong union
Should HSBC go ahead with the deal?

- Closing price on the day before deal was announced (Aug 31, 2007): 14,600 won
- Offer price (agreed between Lone Star and HSBC): 18,045 won per share. The deal should be executed by April 2008, subject to regulatory approval.
- Analyst’s fair value assessment: 15,500 won (16.4% control premium)
- Is HSBC paying too much?
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- Our “preliminary” valuation for end of 2007 using Equity method (Abnormal Earnings): 12,769 won; Relative Valuation (P/BV): 13,274 won
- Similar valuation using Equity method for the end of 2008: 10,907 won
- Is HSBC paying too much? Have they estimated all the risks properly?
What is the probability of regulators approving the deal?
What actually happened

- In Feb 2008 lower court finds Lone Star guilty of stock price manipulation.
- Regulators deferred approval citing legal issues.
- Jun 2008 High Court overturns the lower court’s ruling. Prosecutor’s appeal sends the case to Supreme court.
- Contract extended until Sep 2008 and subsequently HSBC dropped their bid same month.
- “In the light of developments around the world, not least changes in asset values in world markets, we do not believe it would be in the best interests of shareholders to continue to pursue this acquisition on the terms negotiated last year”
  --HSBC Asia’s chief executive, Sandy Flockhart
Thank You!
Korean Won value against USD

HSBC submitted bid
- KRW 923
- KRW 1,106
- KRW 1,544

HSBC dropped bid
- KRW 1,122