BOC (3988 HK)

FY14 results better than expected; reiterate BUY rating

- **FY14 NPAT reported at RMB169.6bn, up 8.1% YoY and 0.9%/1.2% ahead of our and consensus forecasts. We expect its FY15/16E NPAT growth to reach 0.0% and 5.6% YoY given the headwinds.**
- **NIM stayed resilient at 2.22% (-2bps QoQ) in 4Q14 while fee income growth recovered to 14.7% YoY from merely 0.2% in 3Q14.**
- **Asset quality deteriorated at a milder pace with gross NPL formation of 0.90% in 4Q14 compared to well above 1% for all the H-share peers under our coverage who have released annual results.**

Resilient margin, a recovery in fee income growth and stable credit cost underpinned bottom line growth in 4Q

4Q14 NPAT came in at RMB38.5bn, up 4.8% YoY and slightly beat our and market expectations. PPOP grewbriskly by12.3% YoY in 4Q, largely driven by resilient NIM (-2bps QoQ to 2.22%) and a recovery in fee income growth to 14.7% YoY from 0.2% in 3Q.

Positives: (1) Fee incomes growth rebounded to 14.7% YoY in 4Q14 from 0.2% in 3Q despite the impact from NDRC'srequirement to reduce fee charges on SMEs; (2) NIM remained resilient at 2.22% in 4Q14, down 2bps QoQ, and full year NIM also reported at 2.25%, up 1bps YoY, thanks to the expanding margin in domestic FX business; (3) CAR improved by 0.10%/0.83%/0.80% QoQ to 10.61%/11.35%/13.87% in 4Q mainly on the adoption of advanced internal ratings-based approach and completion of RMB40bn offshore preference share and RMB32bn domestic preference share issuance.

Negatives: (1) total deposits decreased 1.5% QoQ due to the continued impact from deposit deviation indicator; (2) NPL balance increased 37.2% YoY, pushing NPL ratio up 11bps QoQ to 1.18% in 4Q; gross NPL formation rose from 0.67% in 3Q to 0.90% in 4Q, but still well below that for all the other H-share peers under our coverage who have reported annual result so far; (3) credit cost moderated to 0.44% in 4Q while coverage ratio dropped 20.10% QoQ to 187.60% in 4Q due to enhanced effort in NPL write-offs in the quarter.

Catalysts & valuation

A more resilient NIM thanks to better-than-expected global economy and further loosening of monetary policy could be positive catalysts. Trading at 0.79x FY15E P/B and 6.10x FY15E P/E, we believe the valuation is still undemanding compared to the historical average of 0.96x P/B.

Financials

RMB mn	FY12	FY13	FY14E	FY15E	FY16E
Revenue	366,176	407,509	449,005	473,562	504,946
Growth (%)	11.5%	11.3%	10.2%	5.5%	6.6%
Net profit	139,656	156,911	168,023	168,077	177,473
Growth (%)	12.5%	12.4%	7.1%	0.0%	5.6%
EPS (RMB)	0.50	0.56	0.59	0.58	0.61
DPS (RMB)	0.18	0.20	0.20	0.20	0.22
P/E (x)	7.10	6.32	6.00	6.10	5.78
P/B (x)	1.20	1.07	0.92	0.79	0.69
ROE (%)	18.0%	17.9%	16.5%	14.0%	12.8%

Note: Closing price as of 25 Mar 2015.
Sources: Bloomberg, Company data, CMS(HK) research

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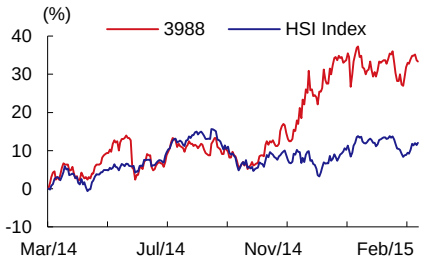
WHAT'S NEW

N.A.

BUY

Previous	BUY
Price	HKD4.40
12-month Target Price (Potential upside)	HKD4.79 (+8.9%)
Previous	HKD4.79

Price Performance



Source: Bigdata

%	1m	6m	12m
3988 HK	(0.5)	24.7	52.8
HSI	(1.4)	2.0	11.7

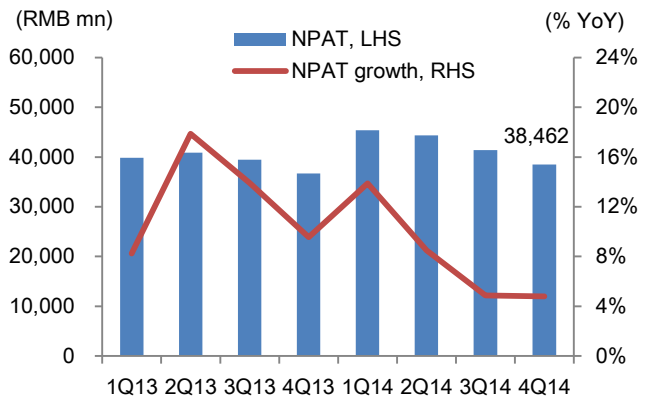
Bank	
Hang Seng Index	24528
HSCEI	11969
Key Data	
52-week range (HKD)	3.25-4.57
Market cap (US$bn)	193.3
Avg. daily volume (mn)	332.15
BVPS (RMB)	4.47
Shareholdings Structure	
Central Huijin Investment Ltd.	65.52%
HKSCC Nominees Limited	28.29%
The Bank of Tokyo-Mitsubishi UFJ Ltd.	0.18%
No. of shares outstanding	288.7bn
Free float	91.01%

Related Research

1. BOC (3988 HK) -Overseas business plays an increasingly important role; maintain BUY (BUY) 2015/03/17
2. BOC (3988 HK) - Full approval on issuance of RMB40bn offshore preference shares to remove capital overhang (BUY) 2014/09/15
3. BOC (3988 HK) - 1H14 result in line; further moderation expected for 2H (BUY) 2014/08/20

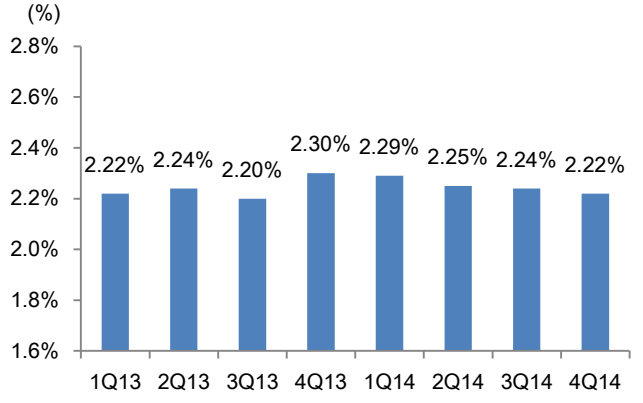
Focus charts

Figure 1: Quarterly NPAT & YoY growth



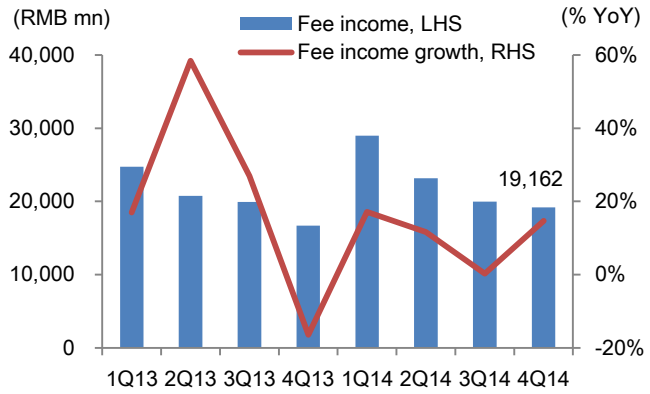
Sources: Company data, CMS (HK) research.

Figure 2: Quarterly NIM trend



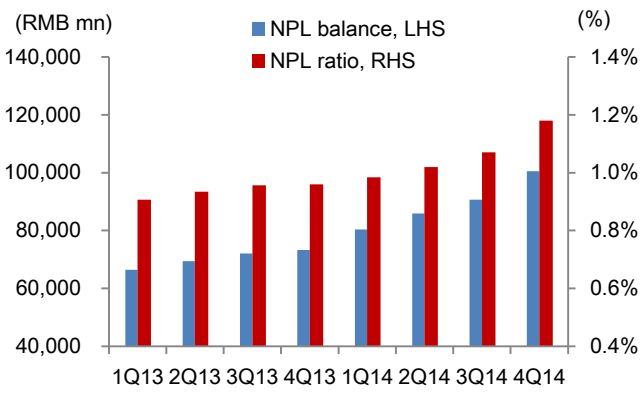
Sources: Company data, CMS (HK) research.

Figure 3: Fee income & YoY growth



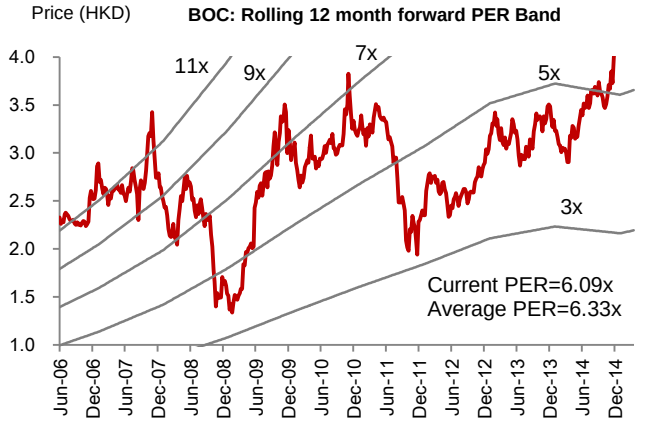
Sources: Company data, CMS (HK) research.

Figure 4: NPL balance & ratio



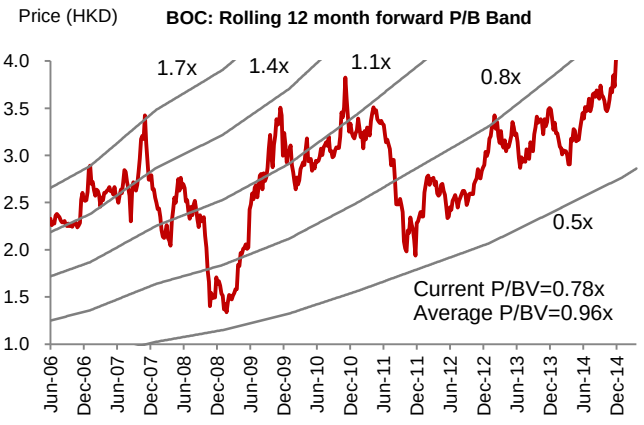
Sources: Company data, CMS (HK) research.

Figure 5: P/E Band



Note: Closing price as of 20 Mar 2015.
Sources: Bloomberg, Company data, CMS (HK) research.

Figure 6: P/B Band



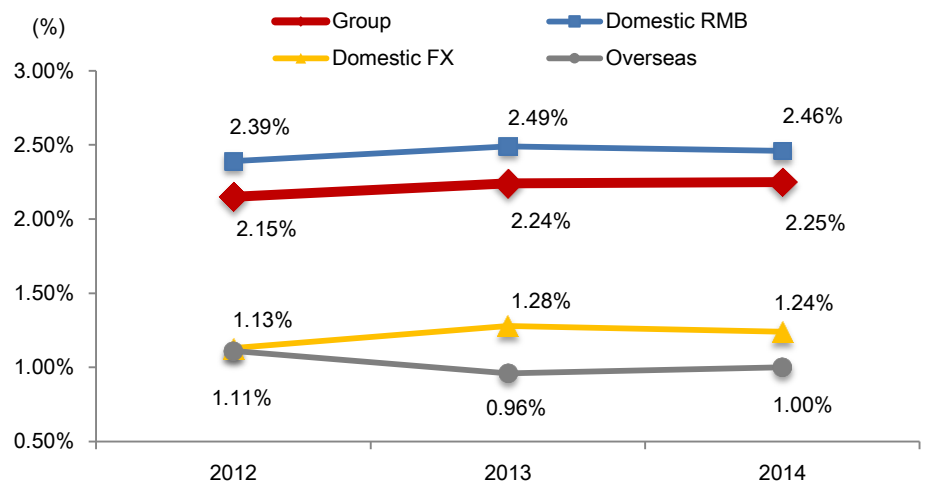
Note: Closing price as of 20 Mar 2015.
Sources: Bloomberg, Company data, CMS (HK) research.

Figure 7: Fee income breakdown

	2H13	2H14	2H14 h-h	2H14 y-y	2013	2014	2014 y-y
Agency commissions	6,644	9,066	-16.9%	36.5%	17,546	19,973	13.8%
Bank card fees	8,874	11,335	10.8%	27.7%	17,312	21,567	24.6%
Settlement and clearing fees	7,167	6,178	-28.5%	-13.8%	15,196	14,815	-2.5%
Credit commitment fees	5,920	7,678	-9.0%	29.7%	13,294	16,112	21.2%
Consultancy and advisory fees	3,784	531	-93.6%	-86.0%	9,574	8,835	-7.7%
Spread income from foreign exchange business	3,608	3,915	6.0%	8.5%	7,147	7,610	6.5%
Custodian and other fiduciary service fees	1,329	1,501	-22.0%	12.9%	2,874	3,426	19.2%
Others	2,786	2,759	-19.8%	-1.0%	5,642	6,200	9.9%
Fee and commission income	**40,112**	**42,963**	**-22.7%**	**7.1%**	**88,585**	**98,538**	**11.2%**
Fee and commission expense	(3,501)	(3,854)	11.9%	10.1%	(6,493)	(7,298)	12.4%
Net fee and commission income	**36,611**	**39,109**	**-25.0%**	**6.8%**	**82,092**	**91,240**	**11.1%**

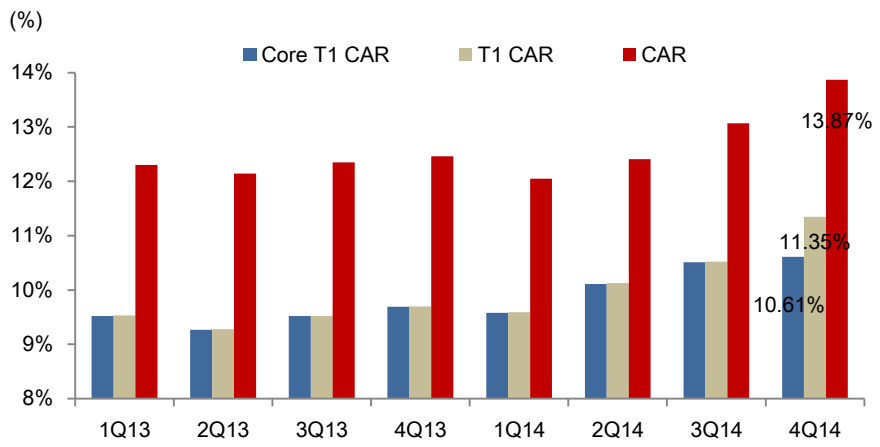
Sources: Company data, CMS (HK) research.

Figure 8: NIM performance breakdown



Sources: Company data, CMS (HK) research.

Figure 9: CAR



Sources: Company data, CMS (HK) research.

Figure 10: 2014 results table

P&L (RMB mn)	4Q13	3Q14	4Q14	4Q14 q-q	4Q14 y-y	2H13	2H14	2H14 h-h	2H14 y-y	2013	2014	2014 y-y
Interest Income	137,384	155,152	153,335	-1.2%	11.6%	269,125	308,487	4.9%	14.6%	518,995	602,680	16.1%
Interest Expense	(62,004)	(73,052)	(71,008)	-2.8%	14.5%	(122,828)	(144,060)	4.8%	17.3%	(235,410)	(281,578)	19.6%
Net Interest Income (NII)	**75,380**	**82,100**	**82,327**	**0.3%**	**9.2%**	**146,297**	**164,427**	**4.9%**	**12.4%**	**283,585**	**321,102**	**13.2%**
Non-Interest Income	**26,678**	**29,178**	**27,851**	**-4.5%**	**4.4%**	**54,961**	**57,029**	**-27.1%**	**3.8%**	**123,924**	**135,226**	**9.1%**
Dealing gain/loss - trading	1,957	2,406	1,374	-42.9%	-29.8%	3,265	3,780	-48.4%	15.8%	7,183	11,099	54.5%
Net fee and commission income	**16,707**	**19,947**	**19,162**	**-3.9%**	**14.7%**	**36,611**	**39,109**	**-25.0%**	**6.8%**	**82,092**	**91,240**	**11.1%**
Gain/(loss) on investment securities	1	815	662	-18.8%	na	180	1,477	364.5%	720.6%	594	1,795	202.2%
Others	8,013	6,010	6,653	10.7%	-17.0%	14,905	12,663	-31.3%	-15.0%	34,055	31,092	-8.7%
Operating Income	**102,058**	**111,278**	**110,178**	**-1.0%**	**8.0%**	**201,258**	**221,456**	**-5.7%**	**10.0%**	**407,509**	**456,328**	**12.0%**
Operating Expenses	(46,912)	(43,667)	(48,224)	10.4%	2.8%	(90,105)	(91,891)	7.0%	2.0%	(172,314)	(177,788)	3.2%
Pre-provision Profits	**55,146**	**67,611**	**61,954**	**-8.4%**	**12.3%**	**111,153**	**129,565**	**-13.0%**	**16.6%**	**235,195**	**278,540**	**18.4%**
Provisions	(4,858)	(11,296)	(9,303)	-17.6%	91.5%	(9,368)	(20,599)	-25.9%	119.9%	(23,510)	(48,381)	105.8%
Incl: loan loss provisions	(4,703)	na	na	na	na	(9,055)	(19,104)	-30.5%	111.0%	(22,938)	(46,606)	103.2%
Associated Companies	263	70	492	602.9%	87.1%	741	562	-25.8%	-24.2%	1,092	1,319	20.8%
Pre-tax Profits	**50,551**	**56,385**	**53,143**	**-5.7%**	**5.1%**	**102,526**	**109,528**	**-10.2%**	**6.8%**	**212,777**	**231,478**	**8.8%**
Taxes	(12,125)	(12,996)	(12,743)	-1.9%	5.1%	(22,957)	(25,739)	-9.8%	12.1%	(49,036)	(54,280)	10.7%
Net Profit	**38,426**	**43,389**	**40,400**	**-6.9%**	**5.1%**	**79,569**	**83,789**	**-10.3%**	**5.3%**	**163,741**	**177,198**	**8.2%**
Minority interest	1,725	1,980	1,938	-2.1%	12.3%	3,379	3,918	6.3%	16.0%	6,830	7,603	11.3%
Profits attributable to shareholders	**36,701**	**41,409**	**38,462**	**-7.1%**	**4.8%**	**76,190**	**79,871**	**-11.0%**	**4.8%**	**156,911**	**169,595**	**8.1%**

Balance Sheet (RMB mn)	4Q13	3Q14	4Q14	4Q14 q-q	4Q14 y-y	2H13	2H14	2H14 h-h	2H14 y-y	2013	2014	2014 y-y
Total Assets	13,874,299	15,427,957	15,251,382	-1.1%	9.9%	13,874,299	15,251,382	-1.4%	9.9%	13,874,299	15,251,382	9.9%
Gross Loans	7,607,791	8,444,403	8,483,275	0.5%	11.5%	7,607,791	8,483,275	0.7%	11.5%	7,607,791	8,483,275	11.5%
Non-performing loans	73,271	90,695	100,494	10.8%	37.2%	73,271	100,494	17.0%	37.2%	73,271	100,494	37.2%
Loan loss reserves	168,049	188,374	188,531	0.1%	12.2%	168,049	188,531	1.2%	12.2%	168,049	188,531	12.2%
Total deposits	10,097,786	11,047,285	10,885,223	-1.5%	7.8%	10,097,786	10,885,223	-2.7%	7.8%	10,097,786	10,885,223	7.8%
Shareholder's Funds	923,916	1,005,374	1,069,114	6.3%	15.7%	923,916	1,069,114	10.7%	15.7%	923,916	1,069,114	15.7%
Per share data (RMB)												
Issued shares (mn)	279,365	279,535	288,731	3.3%	3.4%	279,365	288,731	3.4%	3.4%	279,365	288,731	3.4%
BVPS	3.31	3.60	3.70	3.0%	12.0%	3.31	3.70	7.1%	12.0%	3.31	3.70	12.0%
EPS	0.13	0.15	0.14	-6.7%	7.7%	0.27	0.29	-9.4%	7.4%	0.56	0.61	8.9%
DPS	0.20	0.00	0.19	na	-3.1%	0.20	0.19	na	-3.1%	0.20	0.19	-3.1%
PPOP	0.20	0.24	0.21	-11.3%	8.7%	0.40	0.45	-15.9%	12.8%	0.84	0.96	14.6%

Ratios (%)	4Q13	3Q14	4Q14	4Q14 q-q	4Q14 y-y	2H13	2H14	2H14 h-h	2H14 y-y	2013	2014	2014 y-y
1. CIR	45.97%	39.24%	43.77%	4.53pp	-2.20pp	44.77%	41.49%	4.92pp	-3.28pp	42.28%	38.96%	-3.32pp
2. Effective tax rate	23.99%	23.05%	23.98%	0.93pp	-0.01pp	22.39%	23.50%	0.10pp	1.11pp	23.05%	23.45%	0.40pp
3. ROA	1.12%	1.12%	1.05%	-0.07pp	-0.06pp	1.17%	1.09%	-0.18pp	-0.08pp	1.23%	1.22%	-0.02pp
4. ROE	16.19%	16.81%	14.83%	-1.97pp	-1.36pp	17.18%	15.70%	-3.29pp	-1.48pp	17.95%	17.02%	-0.93pp
5. Customer LDR	75.34%	76.44%	77.93%	1.50pp	2.59pp	75.34%	77.93%	2.65pp	2.59pp	75.34%	77.93%	2.59pp
6. NPL ratio	0.96%	1.07%	1.18%	11bps	22bps	0.96%	1.18%	16bps	22bps	0.96%	1.18%	22bps
7. NPL coverage	229.35%	207.70%	187.60%	-20.10pp	-41.75pp	229.35%	187.60%	-29.42pp	-41.75pp	229.35%	187.60%	-41.75pp
8. Loan-loss provision ratio	2.21%	2.23%	2.22%	-1bps	1bps	2.21%	2.22%	1bps	1bps	2.21%	2.22%	1bps
9. NIM	2.30%	2.24%	2.22%	-2bps	-8bps	2.25%	2.23%	-4bps	-2bps	2.24%	2.25%	1bps
10. Credit cost	0.26%	0.54%	0.44%	-10bps	18bps	0.24%	0.45%	-23bps	21bps	0.32%	0.58%	26bps
11. Non-interest income as % total income	26.14%	26.22%	25.28%	-0.94pp	-0.86pp	27.31%	25.75%	-7.54pp	-1.56pp	30.41%	29.63%	-0.78pp
12. Fee income as % total income	16.37%	17.93%	17.39%	-0.53pp	1.02pp	18.19%	17.66%	-4.54pp	-0.53pp	20.14%	19.99%	-0.15pp
13. Core Tier 1 CAR	9.69%	10.51%	10.61%	0.10pp	0.92pp	9.69%	10.61%	0.50pp	0.92pp	9.69%	10.61%	0.92pp
14. Tier 1 CAR	9.70%	10.52%	11.35%	0.83pp	1.65pp	9.70%	11.35%	1.22pp	1.65pp	9.70%	11.35%	1.65pp
15. CAR	12.46%	13.07%	13.87%	0.80pp	1.41pp	12.46%	13.87%	1.46pp	1.41pp	12.46%	13.87%	1.41pp

Sources: Company data, CMS (HK) research.

Financial Summary

Statement of financial position

RMB mn	FY12	FY13	FY14E	FY15E	FY16E
Cash and due from banks	775,574	702,584	737,713	774,599	813,329
Balances with central banks	1,934,297	2,132,001	2,345,201	2,579,721	2,837,693
Placements with other banks	447,299	660,049	792,059	950,471	1,140,565
Government certificates of indebtedness	70,554	82,069	90,276	99,303	109,234
Precious metals	150,534	193,208	208,665	225,358	243,386
Trading assets	71,590	75,200	78,960	82,908	87,053
Loans and advances to customers	6,710,040	7,439,742	8,343,620	9,197,972	10,056,452
Investment securities	2,138,934	2,181,270	2,269,298	2,361,306	2,457,485
Investment in associates	12,382	13,368	14,036	14,738	15,475
Property and equipment	150,324	158,968	166,916	175,262	184,025
Deferred income tax assets	21,292	22,928	24,533	26,005	27,305
Other assets	197,795	212,912	456,532	463,898	460,955
Total assets	**12,680,615**	**13,874,299**	**15,527,809**	**16,951,541**	**18,432,959**
Due to central banks	130,022	200,939	221,033	243,136	267,450
Due to other banks	1,553,192	1,551,624	1,706,786	1,877,465	2,065,212
Customer Deposits	9,173,995	10,097,786	11,192,038	12,156,230	13,128,085
Current tax	34,994	40,031	46,036	52,941	60,882
Bank notes in circulation	70,733	82,212	92,077	103,127	115,502
Placements from banks	313,004	339,265	366,406	395,719	427,376
Bonds issued	199,133	224,704	273,154	244,704	254,704
Special purpose borrowings	34,045	29,570	29,570	29,570	29,570
Other liabilities	309,955	346,691	381,360	419,496	461,446
Total liabilities	**11,819,073**	**12,912,822**	**14,308,461**	**15,522,387**	**16,810,227**
Share Capital	279,147	279,365	288,731	288,731	288,731
Capital reserve	115,451	116,121	116,121	116,121	116,121
Other reserves	204,547	226,327	258,388	292,443	329,284
Undistributed profits	242,899	323,673	466,288	612,250	767,234
Currency translation	(17,352)	(21,542)	(20,465)	(19,442)	(18,470)
Treasury shares	(15)	(28)	(28)	(28)	(28)
Preferred shares	0	0	72,000	100,000	100,000
Minority interests	36,865	37,561	38,312	39,078	39,860
Total equity	**861,542**	**961,477**	**1,219,348**	**1,429,154**	**1,622,732**

Growth rate (% YoY)

	FY12	FY13	FY14E	FY15E	FY16E
Net interest income	12.7%	10.4%	6.8%	1.2%	4.0%
Non-interest income	9.0%	13.5%	18.0%	14.3%	11.4%
Operating income	**11.5%**	**11.3%**	**10.2%**	**5.5%**	**6.6%**
Operating expense	**13.4%**	**7.9%**	**2.4%**	**7.5%**	**7.2%**
PPOP	**10.1%**	**13.9%**	**15.9%**	**4.1%**	**6.2%**
Provisions	0.2%	21.3%	113.2%	3.0%	5.0%
Pre-tax profit	**11.3%**	**13.4%**	**5.1%**	**4.4%**	**6.6%**
After-tax profit	**11.8%**	**12.3%**	**6.6%**	**3.1%**	**6.6%**
NP to Parents	**12.5%**	**12.4%**	**7.1%**	**0.0%**	**5.6%**
Gross loans	8.2%	10.8%	12.2%	10.3%	9.5%
Total assets	**7.2%**	**9.4%**	**11.9%**	**9.2%**	**8.7%**
RWA	9.0%	29.9%	11.0%	11.9%	11.9%
Customer deposits	11.1%	10.1%	10.8%	8.6%	8.0%
Total liabilities	**6.7%**	**9.3%**	**10.8%**	**8.5%**	**8.3%**

Note: Closing price as of 25 Mar 2015.
Sources: Company data, CMS(HK) research.

Statement of comprehensive income

RMB mn	FY12	FY13	FY14E	FY15E	FY16E
Interest income	506,528	518,995	563,127	555,511	584,857
Interest expense	(249,564)	(235,410)	(260,396)	(249,185)	(266,258)
Net interest income	**256,964**	**283,585**	**302,731**	**306,327**	**318,599**
Net fees and commissions	69,923	82,092	90,480	98,276	105,818
Trading related profits	8,451	7,183	8,718	9,645	10,917
Other operating revenue	30,838	34,649	47,077	59,313	69,612
Non-interest income	**109,212**	**123,924**	**146,274**	**167,235**	**186,347**
Operating income	**366,176**	**407,509**	**449,005**	**473,562**	**504,946**
Operating expense	(159,729)	(172,314)	(176,453)	(189,745)	(203,454)
PPOP	**206,447**	**235,195**	**272,552**	**283,817**	**301,492**
Provisions	(19,387)	(23,510)	(50,130)	(51,655)	(54,226)
Other non-OP items	613	1,092	1,310	1,389	1,597
Pre-tax Profit	**187,673**	**212,777**	**223,733**	**233,551**	**248,863**
Taxes	(41,927)	(49,036)	(49,221)	(53,717)	(57,239)
After-tax Profit	**145,746**	**163,741**	**174,512**	**179,834**	**191,625**
NCI	(6,090)	(6,830)	(6,489)	(7,137)	(7,851)
NP to Parents	**139,656**	**156,911**	**168,023**	**168,077**	**177,473**

Ratios

	FY12	FY13	FY14E	FY15E	FY16E
NIM	2.15%	2.24%	2.24%	2.13%	2.09%
Net interest spread	2.03%	2.12%	2.09%	2.00%	1.98%
Asset yield	4.23%	4.11%	4.16%	3.86%	3.84%
Funding cost	2.21%	1.98%	2.07%	1.86%	1.86%
Effective tax rate	22.34%	23.05%	22.00%	23.00%	23.00%
Cost-to-income ratio	43.62%	42.28%	39.30%	40.07%	40.29%
Non-interest income/ operating income	29.83%	30.41%	32.58%	35.31%	36.90%
LDR	74.83%	75.34%	76.28%	77.49%	78.58%
NPL ratio	0.95%	0.96%	1.15%	1.37%	1.48%
Coverage ratio	236.30%	229.35%	196.65%	172.44%	169.85%
Allowance/total loans	2.25%	2.21%	2.27%	2.36%	2.51%
Credit cost	0.29%	0.32%	0.62%	0.58%	0.55%
Payout ratio	34.98%	34.88%	35.00%	35.00%	35.00%
ROA	1.19%	1.23%	1.19%	1.11%	1.08%
ROE	18.05%	17.95%	16.53%	14.01%	12.80%
Core tier-1 CAR	n.a.	9.69%	10.35%	10.64%	10.82%
Tier-1 CAR	10.54%	9.70%	11.05%	11.50%	11.59%
Total CAR	13.63%	12.46%	14.13%	14.15%	14.12%

Per share ratios & Valuations

	FY12	FY13	FY14E	FY15E	FY16E
BVPS (RMB)	2.95	3.31	3.84	4.47	5.14
EPS (RMB)	0.50	0.56	0.59	0.58	0.61
DPS (RMB)	0.18	0.20	0.20	0.20	0.22
P/E (x)	7.10	6.32	6.00	6.10	5.78
P/B (x)	1.20	1.07	0.92	0.79	0.69
Dividend yield (%)	4.93	5.52	5.73	5.74	6.06

Investment Ratings

Rating	Definition
BUY	Expected to outperform the market index by >10% over the next 12 months
NEUTRAL	Expected to outperform or underperform the market index by 10% or less over the next 12 months
SELL	Expected to underperform the market index by >10% over the next 12 months

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