

EARNINGS REVIEW

BOC Hong Kong (Holdings) (2388.HK)

Buy

Equity Research

In line with expectations, no NCB announcement; maintain CL-Buy

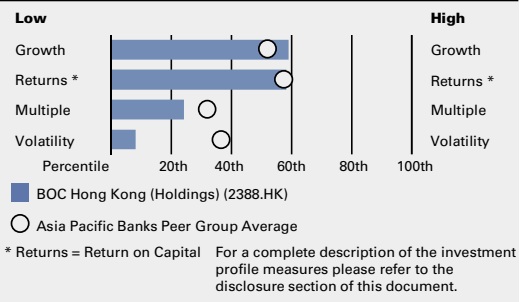
What surprised us

2H14 EPS, operating profit were 4%, 2% above GSe led by higher NII, better fee income and tighter cost management. Weaker trading income and lower insurance profitability partly offset the positives and were driven by a weaker RMB. **Positives: (1)** NIM: was 5bp lower hoh as guided but FY14 NIM was 4bp higher. Higher funding costs and lower SHIBOR drove the decline hoh. **(2)** CT1 CAR: at 12.3% was 50bp, 170bp higher hoh, yoy on RoRWA focus. **(3)** Fee: had a broad based beat, +9% vs GSe. **(4)** Costs: were 3% below GSe with FY14 cost growth tightly managed at 7.4% (vs. 9.8% revenue growth). **Negative:** Insurance premium income fell 82% hoh/72% yoy on lower RMB policy sales. On top of that, a fall in long-term interest rates prompted relatively higher increases in policyholders reserves (with the benefits and claims to premium income ratio rising to 165% from 112%/113% at 2H14/1H14), thereby further pressuring insurance earnings. There was no further announcement on Nanyang Commercial Bank (NCB) and the management review has not been completed.

What to do with the stock

We fine tune our 2015E-16E EPS and our RIM-based 12m TP to HK\$31.1 (1.72X 2015E P/B from prior 1.73X, from HK\$30.8) on slightly higher forward BVPS. We also introduce 2017E EPS. We now forecast 5bp NIM contraction this year on lower SHIBOR and higher HK funding costs. But, we expect NIM to improve in 2016E on positive leverage to rising \$ interest rate environment. We retain CL-Buy and view the stock as offering the best available combination of value (11X 2015E P/E) and growth (6%/14% 2015E/16E EPS growth) in the HK banks space. Risks: worse than expected minimum CT1 CAR, China asset quality or HK liquidity.

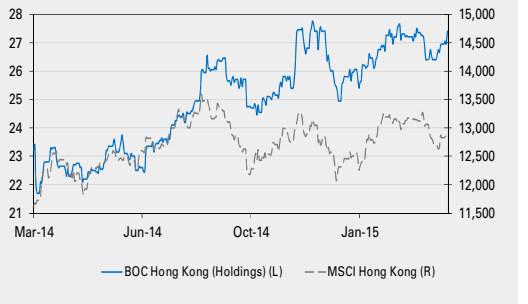
Investment Profile



Key data	Current
Price (HK\$)	27.40
12 month price target (HK\$)	31.10
Market cap (HK\$ mn / US\$ mn)	289,694.2 / 37,353.4
Foreign ownership (%)	--

	12/14	12/15E	12/16E	12/17E
EPS (HK\$) New	2.32	2.46	2.80	3.27
EPS revision (%)	2.1	0.0	(1.3)	--
P/B (X)	1.5	1.5	1.4	1.3
P/E (X)	10.5	11.1	9.8	8.4
Dividend yield (%)	4.6	4.3	4.9	5.7
P/POP (X)	9.3	8.6	7.6	6.6
PPOP growth (%)	10.9	7.0	13.1	16.0
Preprovision ROA (%)	1.5	1.5	1.5	1.6
Credit cost (%)	0.1	0.1	0.1	0.1
ROA (%)	1.16	1.14	1.20	1.29
ROE (%)	14.6	14.2	14.9	16.0

Price performance chart



Share price performance (%)	3 month	6 month	12 month
Absolute	6.2	7.7	18.1
Rel. to MSCI Hong Kong	2.9	6.1	6.8

Source: Company data, Goldman Sachs Research estimates, FactSet. Price as of 3/25/2015 close.

BOC HK 2H14 review: in-line with expectations

BOC HK 2H14 results review						2H14	2H14	Actual vs. Gse
In HK\$mn, unless noted otherwise	1H13	2H13	1H14	2H14A	2H14E	HoH	YoY	
Net int income	13,331	14,585	15,656	16,263	15,649	4%	12%	4%
Net operating revenue	19,791	20,522	21,649	22,633	22,514	5%	10%	1%
PPOP	14,099	14,131	15,433	15,877	15,574	3%	12%	2%
Operating profit	13,728	13,765	15,054	15,206	14,846	1%	10%	2%
Attributable profits	11,252	11,000	12,083	12,494	11,988	3%	14%	4%

Source: Company data, Goldman Sachs Global Investment Research.

INVESTMENT LIST MEMBERSHIP

- Asia Pacific Buy List
- Asia Pacific Conviction Buy List

Coverage View: Neutral

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BOC Hong Kong (Holdings): Summary Financials

Profit model (HK\$ mn)	12/14	12/15E	12/16E	12/17E	Balance sheet (HK\$ mn)	12/14	12/15E	12/16E	12/17E
Net interest income	31,919.0	33,160.4	37,165.6	42,872.5	Gross loans	960,989.0	1,054,888.2	1,158,448.7	1,273,674.6
Non-interest income	12,363.0	14,261.3	15,715.1	17,293.6	NPLs	3,008.0	3,940.0	3,969.1	3,726.5
Operating revenue	44,282.0	47,421.7	52,880.7	60,166.2	Loan loss reserves	4,616.0	5,274.4	5,213.0	5,094.7
Non-interest expense	(12,972.0)	(13,920.4)	(15,001.5)	(16,232.3)	Total interest earning assets	1,604,494.0	1,731,684.0	1,871,646.2	2,025,922.9
Provision operating profit	31,310.0	33,501.4	37,879.2	43,933.9	Other non-interest earning assets	584,873.0	634,517.8	691,600.7	755,657.6
Total provision charge	(1,050.0)	(1,157.0)	(1,159.5)	(1,214.8)	Total assets	2,189,367.0	2,366,201.8	2,563,246.9	2,781,580.5
Associates	34.0	34.0	34.0	34.0	Customer deposits	1,480,109.0	1,615,049.6	1,763,566.0	1,925,535.8
Pretax profit	30,663.0	32,378.3	36,753.6	42,753.0	Total interest-bearing liabilities	1,759,726.0	1,894,905.8	2,043,666.2	2,205,884.9
Tax	(5,558.0)	(5,766.7)	(6,546.0)	(7,614.5)	Total equity	181,472.0	195,482.6	211,808.4	230,864.6
Minorities	(528.0)	(556.0)	(556.0)	(556.0)	CAMEL ratios (%)	12/14	12/15E	12/16E	12/17E
Net profit	24,577.0	26,055.6	29,651.6	34,582.5	C: Tier 1 capital ratio	12.4	12.9	13.4	14.0
Dividends	11,842.0	12,506.7	14,232.8	16,599.6	C: Equity/loans	18.5	18.2	18.0	17.8
Dividends payout (%)	48.2	48.0	48.0	48.0	C: Equity/assets	8.1	8.1	8.1	8.1
Earnings growth drivers (%)	12/14	12/15E	12/16E	12/17E	A: NPL ratio	0.3	0.4	0.3	0.3
Net interest margin	1.72	1.67	1.72	1.83	A: Loan loss reserves/NPLs	153.5	133.9	131.3	136.7
Provision charge/total loans	0.11	0.11	0.10	0.10	E: Net interest margin	1.72	1.67	1.72	1.83
YoY Growth (%)					E: Non int inc/oper revenues	27.92	30.07	29.72	28.74
Customer deposits	11.6	8.7	9.2	9.2	E: Cost-income ratio	29.3	29.4	28.4	27.0
Loans	12.0	9.7	9.9	10.0	E: ROAA	1.16	1.14	1.20	1.29
Net interest income	14.3	3.9	12.1	15.4	L: Loan/deposit ratio	64.6	65.0	65.4	65.9
Fee income	12.9	10.4	8.8	8.4	Loan portfolio (%)	12/14	12/15E	12/16E	12/17E
Non-interest income	(0.3)	15.4	10.2	10.0	Commercial & corporate	72.2	73.1	74.0	75.1
Operating revenue	9.8	7.1	11.5	13.8	Mortgages/home loans	22.2	20.9	19.8	18.7
Operating expenses	(7.4)	(7.3)	(7.8)	(8.2)	Consumer	27.8	26.9	26.0	24.9
Provision operating profit	10.9	7.0	13.1	16.0	Valuation (current price)	12/14	12/15E	12/16E	12/17E
Provision charges	42.5	10.2	0.2	4.8	P/E basic (X)	10.5	11.1	9.8	8.4
Pretax profit	10.3	5.6	13.5	16.3	P/B (X)	1.46	1.52	1.40	1.28
Net profit	10.4	6.0	13.8	16.6	P/PPOP (X)	9.3	8.6	7.6	6.6
EPS	10.4	6.0	13.8	16.6	Dividend yield (%)	4.6	4.3	4.9	5.7
DPS	10.9	5.6	13.8	16.6	EPS, basic (HK\$)	2.32	2.46	2.80	3.27
Market dimensions	12/14	12/15E	12/16E	12/17E	EPS, fully-diluted (HK\$)	2.32	2.46	2.80	3.27
No of branches	0.0	0.0	0.0	0.0	EPS, basic growth (%)	10.4	6.0	13.8	16.6
No of staff (000)	0.0	0.0	0.0	0.0	EPS, fully diluted growth (%)	10.4	6.0	13.8	16.6
Revenues/staff (US\$)	NM	NM	NM	NM	BVPS (HK\$)	16.71	18.04	19.58	21.39
Net profit/staff (US\$)	NM	NM	NM	NM	DPS (HK\$)	1.12	1.18	1.35	1.57
DuPont analysis (%)	12/14	12/15E	12/16E	12/17E					
ROE	14.6	14.2	14.9	16.0					
x leverage	7.9	8.1	8.1	8.1					
=ROA	1.16	1.14	1.20	1.29					
% of assets	12/14	12/15E	12/16E	12/17E					
Net interest income	1.51	1.46	1.51	1.60					
Fee income	0.48	0.49	0.49	0.49					
Non-interest income	0.58	0.63	0.64	0.65					
Operating revenue	2.09	2.08	2.15	2.25					
Operating expenses	0.61	0.61	0.61	0.61					
Provision operating profit	1.48	1.47	1.54	1.64					
Loan loss provisions	0.05	0.05	0.05	0.05					
Pretax profits	1.45	1.42	1.49	1.60					
Taxes	0.26	0.25	0.27	0.28					

Note: Last actual year may include reported and estimated data.

Source: Company data, Goldman Sachs Research estimates.

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Exhibit 1: BOC HK 2H14 review: in line with expectations

OC HK 2H14 results review						2H14	2H14	Actual vs. Gse
i HK\$mn, unless noted otherwise	1H13	2H13	1H14	2H14A	2H14E	HoH	YoY	2H14
Net int income	13,331	14,585	15,656	16,263	15,648	4%	12%	4%
Non-interest income	10,994	10,676	13,234	8,297	12,461	-37%	-22%	-33%
Net fee income and commissions	4,681	4,284	4,815	5,307	4,869	10%	24%	9%
Gross fee income	6,509	6,207	6,715	7,290	6,790	9%	17%	7%
Securities brokerage commissions	1,224	1,208	1,180	1,496	1,450	27%	24%	
Credit card fees	1,734	1,782	1,792	1,881	1,835	5%	6%	
Loan and bills commissions	1,465	1,254	1,547	1,448	1,379	-6%	15%	
Payment services	322	343	300	304	343	1%	-11%	
Insurance commissions	708	577	677	885	577	31%	53%	
Other	1,056	1,043	1,219	1,276	1,205	5%	22%	
Fee expense	1,828	1,923	1,900	1,983	1,921	4%	3%	
Trading income	921	1,877	1,347	840	1,812	-38%	-55%	-54%
Forex profits	1,019	933	829	575	912	-31%	-38%	
Other dealing activities	-98	944	518	265	900			
Net gain from other invest in securities	106	-23	175	671	175	283%	3017%	283%
Net insurance premium income	4,971	4,199	6,489	1,166	5,249	-82%	-72%	-78%
Total operating revenue	24,325	25,261	28,890	24,560	28,109	-15%	-3%	-13%
Net Insurance benefits & claims	4,534	4,739	7,241	1,927	5,595	-73%	-59%	-66%
Net operating revenue	19,791	20,522	21,649	22,633	22,514	5%	10%	1%
Operating expenses	5,692	6,391	6,216	6,756	6,940	9%	6%	-3%
Staff costs	3,234	3,585	3,489	3,779	3,872	8%	5%	
PPOP	14,099	14,131	15,433	15,877	15,574	3%	12%	2%
Provision charges/(writebacks)	371	366	379	671	728	77%	83%	-8%
Operating profit	13,728	13,765	15,054	15,206	14,846	1%	10%	2%
Profit on reval and disposal of assets	207	58	112	257	0			
Pretax profits	13,948	13,845	15,179	15,484	14,868	2%	12%	
Attributable profits	11,252	11,000	12,083	12,494	11,988	3%	14%	4%
EPS (HK\$)	1.06	1.04	1.14	1.18	1.13	3%	14%	4%
DPS (HK\$)	0.54	0.47	0.54	0.58	0.59	6%	24%	-3%
ALANCE SHEET								
Total assets	1,834,661	2,046,936	2,085,236	2,189,367	2,173,129	5%	7%	1%
Gross loans	830,743	858,332	948,704	960,989	993,769	1%	12%	-3%
Ppty dev & invmt	117,282	119,699	121,742	122,154	124,177	0%	2%	-2%
Industrial, commercial, financial	152,766	147,933	188,599	185,987	205,589	-1%	26%	-10%
Mortgages	201,631	199,804	203,340	213,107	207,024	5%	7%	3%
Cards & other unsecured	33,786	40,535	48,737	54,153	57,300	11%	34%	-5%
Trade finance	76,494	85,413	92,749	86,316	98,314	-7%	1%	-12%
Loans for use outside HK	248,784	264,948	293,537	299,272	301,365	2%	13%	-1%
of which: China loans	139,524	153,201	195,711	200,208	203,539	2%	31%	-2%
of which: OECD syndication, others	109,260	111,747	97,826	99,064	97,826	1%	-11%	1%
Non-performing loans	2,120	2,433	2,930	3,008	3,233	3%	24%	-7%
Loan loss reserves	4,120	4,235	4,494	4,616	5,168	3%	9%	-11%
Customer deposits	1,259,756	1,324,148	1,436,362	1,480,109	1,504,801	3%	12%	-2%
Equity	151,806	158,813	168,865	176,714	175,091	5%	11%	1%
BVPS (HK\$)	14.4	15.0	16.0	16.7	16.6	5%	11%	1%
RWA	824,850	871,618	892,942	897,812	929,780	1%	3%	-3%
AMEL RATIOS								
Core Tier 1 CAR	11.0%	10.6%	11.8%	12.3%	11.9%			
Tier 1 CAR	11.2%	10.7%	11.8%	12.4%	12.0%			
NPL ratio	0.26%	0.28%	0.31%	0.31%	0.33%			
LLR/NPLs	194%	174%	153%	153%	160%			
Credit costs	0.09%	0.09%	0.08%	0.14%	0.15%			
NIM - reported	1.67%	1.70%	1.74%	1.69%	1.68%			
Cost-income ratio	28.8%	31.1%	28.7%	29.9%	30.8%			
ROA	1.23%	1.13%	1.17%	1.17%	1.13%			
ROE	14.9%	14.2%	14.7%	14.5%	13.9%			
Loan/deposits	66%	65%	66%	65%	66%			

Source: Company data, Goldman Sachs Global Investment Research.

Disclosure Appendix

Reg AC

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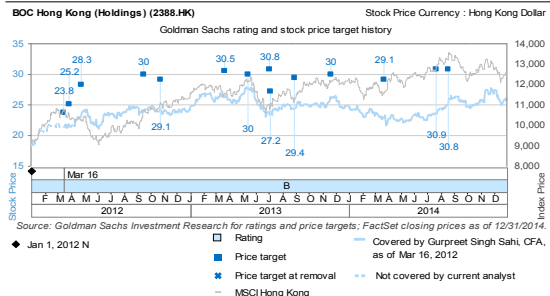
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	Buy	Hold	Sell	Buy	Hold	Sell
Global	33%	54%	13%	44%	38%	32%

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