

FIG
Commercial Banks
Equity – Hong Kong

BOCHK (2388 HK)

Hold

Target price (HKD)	27.00
Share price (HKD)	26.95
Upside/Downside (%)	0.2

Performance	1M	3M	12M
Absolute (%)	-1.3	4.3	17.7
Relative ^A (%)	0.1	-0.2	5.4

Index^A Hang Seng Index

RIC 2388.HK
Bloomberg 2388 HK

Market cap (USDm) 36,739
Market cap (HKDm) 284,936
Free float (%) 34

Hold: Expect changes, but uneventful to near-term ROE

- ▶ **The 2014 profit is in-line with our forecast, underlying resilient operation and sound capital management**
- ▶ **Near-term outlook remains lukewarm; we expect to see some strategy changes and corporate activities ahead**
- ▶ **Establish Hold rating and set fair value target price of HKD27**

New management team made the debut. BOCHK has reported its net profit up 10% y-o-y to HKD24.6bn in 2014, in-line with our forecast. Growth was led by higher revenue as net interest income and fee income increased, more than offsetting the lower trading gain and insurance return. Moreover, the company's CET1 ratio has improved 170bp y-o-y to 12.3%; BOCHK maintains a dividend pay-out ratio of around 48%. It is also worth noting BOCHK has introduced its new management team – led by the CEO and CFO – in the results briefing.

Changes are on the way. In the results briefing, we have the impression that the new management team has emphasised about the offshore RMB business and collaboration with parent group to capture China's new policy initiatives (such as the "one belt, one road" policy). This could signal BOCHK might – leveraging on its solid balance sheet and as the leading Asia-Pacific syndication loan centre of BOC Group – to accelerate loan growth and offshore RMB business development. In our report *Banking on the RMB*, published on 20 March 2015, we discussed the large growth prospect related to China's outward investment. Nonetheless, it will take time to see how BOCHK might position itself to capture the growth opportunities arising from these areas. Perhaps inter-related, we may also see more corporate activities ahead, such as a possible asset disposal, reported by Bloomberg on 25 March 2015.

Near-term outlook remains lacklustre. Despite possible strategy changes ahead, we believe the company's near-term ROE is capped. Particularly, we don't think the net interest margin will benefit immediately even with a US rate hike, and credit cost should continue to trend up amid the challenging macro conditions in China.

We establish a Hold rating on BOCHK. We haven't revised our forecast and valuation. Our fair value target price of HKD27 is based on 1.5x PB (unchanged), which is derived from Gordon's growth model with assumptions of 15% ROE, 10.6% COE and 2.5% growth rate (all unchanged). **Catalysts and risks:** Further liberalisation in China's capital account or cross-border RMB reforms could drive BOCHK's share price momentum. Corporate activities are also potential swing factors to the share price. Favorable capital and liquidity movements may also be positive. On the other hand, unexpected deterioration in macro or capital market conditions may lead to higher credit costs and lower profits.

26 March 2015

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BOCHK: Summary and comparison of 2H14/FY14 results (HKDm unless otherwise specified)

Income statement	2H13	1H14	2H14	YoY g	HoH g	2013	2014	YoY g
Net interest income	14,585	15,656	16,263	12%	4%	27,916	31,919	14%
Net fee income	4,284	4,815	5,307	24%	10%	8,965	10,122	13%
Other operating income	1,653	1,178	1,063	-36%	-10%	3,432	2,241	-35%
Total operating income	20,522	21,649	22,633	10%	5%	40,313	44,282	10%
Operating expenses	(6,391)	(6,216)	(6,756)	6%	9%	(12,083)	(12,972)	7%
PPOP	14,131	15,433	15,877	12%	3%	28,230	31,310	11%
Loan impairment	(362)	(377)	(654)	81%	73%	(730)	(1,031)	41%
Investment impairments	(4)	(2)	(17)	325%	750%	(7)	(19)	171%
Non-operating income	80	125	278	248%	122%	300	403	34%
Pre-tax earnings	13,845	15,179	15,484	12%	2%	27,793	30,663	10%
Tax expenses	(2,427)	(2,846)	(2,712)	12%	-5%	(4,718)	(5,558)	18%
Net profits	11,000	12,083	12,494	14%	3%	22,252	24,577	10%
Balance sheet								
Customer loans	854,097	944,210	956,373	12%	1%	854,097	956,373	12%
Customer deposits	1,324,148	1,436,362	1,480,109	12%	3%	1,324,148	1,480,109	12%
Total assets	2,046,936	2,085,236	2,189,367	7%	5%	2,046,936	2,189,367	7%
Net asset values	158,183	168,865	176,714	12%	5%	158,183	176,714	12%
Key performance ratios				(bp)				
Net interest margin	1.69%	1.74%	1.69%	0	(5)	1.68%	1.72%	4
Gross loan to deposits ratio	64.5%	65.7%	64.6%	11	(112)	64.5%	64.6%	11
Cost to income ratio	31.1%	28.7%	29.9%	(129)	114	30.0%	29.3%	(68)
Impaired loans ratio	0.28%	0.31%	0.31%	3	0	0.28%	0.31%	3
ROE (annualized)	14.2%	14.8%	14.5%	27	(32)	14.4%	14.7%	28
CET1	10.6%	11.8%	12.3%	170	54	10.6%	12.3%	170
Total CAR	15.8%	16.9%	17.5%	171	61	15.8%	17.5%	171

Source: Company data, HSBC

Key upside/downside risks

- ▶ Changes in economic and monetary conditions are the largest risks to our forecasts. While we are looking for modest economic growth and benign liquidity conditions in Hong Kong, conditions can change rapidly depending on fund flows and policy actions. Unexpected and adverse change to these factors could affect our forecast negatively. Property price declines and bond market volatility are other key risks, but look contained at present.
- ▶ We believe the offshore RMB business and outward expansion of Chinese enterprises are two key drivers for BOCHK. However, these drivers are affected by China's policies, especially financial liberalisation and capital flows. These can change rapidly and have a positive or negative impact on our forecasts.
- ▶ We believe the company could see some strategy changes ahead and the possibility of asset disposal should be dismissed. Depending on the pricing, scale and strategy, these may positively or negatively affect BOCHK. We haven't built such event into our forecast and valuation, due to the uncertainties about the timing, scale and impact.

Disclosure appendix

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From 23rd March 2015 HSBC has assigned ratings on the following basis:

The target price is based on the analyst's assessment of the stock's actual current value, although we expect it to take six to 12 months for the market price to reflect this. When the target price is more than 20% above the current share price, the stock will be classified as a Buy; when it is between 5% and 20% above the current share price, the stock may be classified as a Buy or a Hold; when it is between 5% below and 5% above the current share price, the stock will be classified as a Hold; when it is between 5% and 20% below the current share price, the stock may be classified as a Hold or a Reduce; and when it is more than 20% below the current share price, the stock will be classified as a Reduce.

Our ratings are re-calibrated against these bands at the time of any 'material change' (initiation or resumption of coverage, change in target price or estimates).

Upside/Downside is the percentage difference between the target price and the share price.

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For each stock we set a required rate of return calculated from the cost of equity for that stock's domestic or, as appropriate, regional market established by our strategy team. The target price for a stock represented the value the analyst expected the stock to reach over our performance horizon. The performance horizon was 12 months. For a stock to be classified as Overweight, the potential return, which equals the percentage difference between the current share price and the target price, including the forecast dividend yield when indicated, had to exceed the required return by at least 5 percentage points over the succeeding 12 months (or 10 percentage points for a stock classified as Volatile*). For a stock to be classified as Underweight, the stock was expected to underperform its required return by at least 5 percentage points over the succeeding 12 months (or 10 percentage points for a stock classified as Volatile*). Stocks between these bands were classified as Neutral.

*A stock was classified as volatile if its historical volatility had exceeded 40%, if the stock had been listed for less than 12 months (unless it was in an industry or sector where volatility is low) or if the analyst expected significant volatility. However, stocks which we did not consider volatile may in fact also have behaved in such a way. Historical volatility was defined as the past month's average of the daily 365-day moving average volatilities. In order to avoid misleadingly frequent changes in rating, however, volatility had to move 2.5 percentage points past the 40% benchmark in either direction for a stock's status to change.

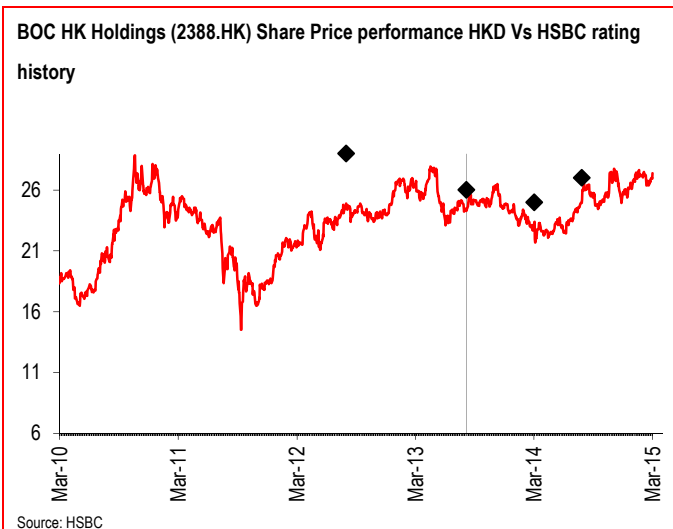
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As of 25 March 2015, the distribution of all ratings published is as follows:

Buy	41%	(30% of these provided with Investment Banking Services)
Hold	39%	(28% of these provided with Investment Banking Services)
Sell	20%	(20% of these provided with Investment Banking Services)

For the purposes of the distribution above the following mapping structure is used during the transition from the previous to current rating models: under our previous model, Overweight = Buy, Neutral = Hold and Underweight = Sell; under our current model Buy = Buy, Hold = Hold and Reduce = Sell. For rating definitions under both models, please see “Stock ratings and basis for financial analysis” above.

Share price and rating changes for long-term investment opportunities



Recommendation & price target history

From	To	Date
Overweight	Neutral	29 August 2013
Target Price	Value	Date
Price 1	29.00	23 August 2012
Price 2	26.00	29 August 2013
Price 3	25.00	26 March 2014
Price 4	27.00	19 August 2014

Source: HSBC

HSBC & Analyst disclosures

Disclosure checklist

Company	Ticker	Recent price	Price Date	Disclosure
BOC HK HOLDINGS	2388.HK	27.40	25-Mar-2015	1, 4, 5, 6, 7, 11

Source: HSBC

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