

Analyst: Paul Sham
BOC HONG KONG (HOLDINGS) LIMITED (中銀香港)

Sector	: Banking
HKSE Code	: 02388
Market Price	: HK\$27.8 (26/03/2015)
Shares Issued	: 10,572.8m
Mkt. Cap.	: HK\$293,924m
52 weeks Hi/ Lo	: HK\$28.15 / HK\$21.50
HSI	: 24,497.08 (26/03/2015)
Main Business	: Banking and related financial services

Vice Chairman & Chief Executive : Mr. Yue Yi

SUMMARY OF THE FINAL RESULTS FOR THE YEAR ENDED 31ST DECEMBER 2014
Final Results Highlights

	HK\$ million	Vs FY2013 (%)	Vs 30/06/2014 (%)
• Net interest income	31,919	+14.3%	
• Non-interest income	12,363	-0.3%	
• Total operating income	44,282	+9.8%	
• Operating expenses	(12,972)	+7.4%	
• Operating profit before impairment losses	31,310	+10.9%	
• Allowances for credit and other losses	(1,050)	+42.5%	
• Profit before taxation and non-core items	30,260	+10.1%	
• Non-core items	403	+34.3%	
• Profit before taxation	30,663	+10.3%	
• Taxation	(5,558)	+17.8%	
• Attributable profit to shareholders	24,577	+10.4%	
• Total loans	960,989	+12.0%	+1.3%
• Total deposits	1,492,010	+12.2%	+3.6%
• Total assets	2,189,367	+7.0%	+5.0%
• Basic EPS (HK\$)	2.3246	+10.5%	
• Final DPS (HK\$)	0.5750	+23.7%	
• Total DPS (HK\$)	2.8996	+187.1%	
Selected Ratios	FY2014	FY2013	1H2014
• Net interest margin	1.72%	1.68%	1.74%
• Cost-income ratio	29.3%	30.0%	28.7%
• Return on average assets	1.19%	1.22%	1.20%
• Return on average equity	14.65%	14.37%	14.8%
• Impaired loan ratio	0.31%	0.28%	0.31%
• Impaired advances coverage	153.5%	174.1%	153.4%
• Loan-deposit ratio	64.4%	64.6%	65.9%
• Common Equity tier 1 CAR	12.3%	10.6%	11.8%
• Tier 1 CAR	12.4%	10.7%	11.8%
• Total CAR	17.51%	15.80%	16.9%

- **2014 results broadly in-line** BOCHK reported FY14 full-year net profit of HK\$24,577m, up 10.4% y-o-y, supported by mid-teen growth in interest income. The results were in-line with consensus estimates of HK\$24,401m. The rise in provisions (+42.5% y-o-y) and the lukewarm non-interest income (-0.6% y-o-y) were the weaknesses in the results. BOCHK declared final dividend of HK\$0.575, up 23.7% y-o-y, maintaining its full-year dividend payout ratio at 48% like last year.

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- **Net interest income** increased by 14.3% y-o-y to HK\$31,919m, due to a combination of the growth in average interest-earning assets and the widened net interest margin. Total loans of BOCHK increased by 12.0% y-o-y, thanks to strong demand from the transport sector (+19.4%), manufacturing sector (+26.6%) and overseas loans (+13.0%). On the other hand, the net interest margin expanded by 4bps to 1.72%, enhanced by higher fund allocation to customer advances, placements with banks and RMB bonds
- **Non-interest income** was flattish during 2014. The 12.9% y-o-y rise in net fee income on the back of higher income from insurance (+21.6%), funds distribution (+26.1%) and loan commission (+15.0%) was largely offset by 26.9% y-o-y decline in net trading income due to the net trading loss from forex swap contracts.
- **Operating expenses** grew modestly by 7.4% y-o-y to HK\$12,972m. BOC's staff costs increased by 6.6%, mainly due to annual salary increment and increases in headcount (+1.9% to 14,926 full-time employees at end-2014). With 9.8% increase in operating income and 7.3% growth in operating expenses, the cost-to-income ratio improved to 29.3%, the best among its local peers.
- **Asset quality** Impairment charges increased by 42.5% y-o-y as individually accessed impairment allowances jumped 139% y-o-y, caused by the downgrade of a few corporate advances in China. Overall asset quality of BOCHK remained sound, with its NPL staying low at 0.31% at end-2014, and continued to be one of the best in the industry. Coverage ratio also maintained at comfortable high level of 154%, among the best in the sector.
- **Capital position** Thanks to cut in dividend payout ratio from 62.5% in FY12 to 48.0% in both FY13 and FY14, BOCHK's capital position continued to improve. Its CET1 and total CAR went up 1.73ppts and 1.71ppts respectively to 12.3% and 17.5% during FY14. The potential deal of Nanyang Commercial Bank (NCB) will further boost its capital position.

Outlook & Prospects

- **Targeting regional businesses** The new CEO Yue Yi (former head of BOC's international business, who took office in early March) commented that BOCHK will take advantage of opportunities that arise such as implementation of the national strategy on One Belt, One Road, RMB internationalization, the establishment of Free Trade Zones on the mainland, and the enhancement of Hong Kong's status as a major hub for international financial services, trade, shipping and offshore RMB business. Management also stressed the need to increase its exposure to South East Asia in an effort to make BOCHK a truly regional bank and improve its medium-term growth profile. This seems to be a marked shift from BOCHK's focus on cross-border opportunities between Hong Kong and China.
- **Stable dividend expected** HKMA categorised BOCHK as one of the D-SIBs (domestic systemically important banks) with level 2 systemic importance, which will add an additional CET1 requirement of 1.5% by 2019. However, BOCHK's CET1 has already stood at 12.3% at-end 2014, higher than the regulatory minimum requirement of 11% after the inclusion of the additional CET1 requirement. Therefore, we believe BOCHK is capable of maintaining its dividend payout ratio of 48% in the medium term.
- **Divestment of NCB** Bloomberg reported that three potential buyers, namely China Life, Bank of Beijing and China Cinda Asset Management are interested in bidding NCB, a 100% owned subsidiary of BOCHK, at around US\$5bn. If such a deal were to occur, BoCHK could redeploy the capital for overseas expansion or potentially pay a special dividend, both of which would be a positive near-term catalyst for the stock.
- **Valuations** BOCHK's FY14 results looked steady and the previous concern over the stability of dividend payout should be largely removed, given the strengthened capital position. Investors may start to focus on the potential changes in the bank's future strategy that new management may bring to BOCHK, e.g. the new capital redeployment following the sale of NCB and the business opportunity arising from One Belt, One Road. On the valuation front, BOCHK's FY15E P/BV of 1.5x is one of the highest in the sector but factors like improving capital position, decent dividend yields of 4.3% and potential business opportunity following divestment of NCB should be supportive for the share price. As such, we recommend an "outperform" rating on the counter.

Recommendation: *Outperform*

I. Impairment allowances, overdue and rescheduled advances of BOC Hong Kong

As % of total customer advances	Individual allowance	Portfolio Non-performing allowance	loans	Overdue and rescheduled advances
As of 31/12/2014	0.11%	0.37%	0.31%	0.14%
As of 30/06/2014	0.10%	0.37%	0.31%	0.15%
As of 31/12/2013	0.10%	0.40%	0.28%	0.20%

II. Comparison of BOC Hong Kong's loan book: 31/12/2014 vs 31/12/2013

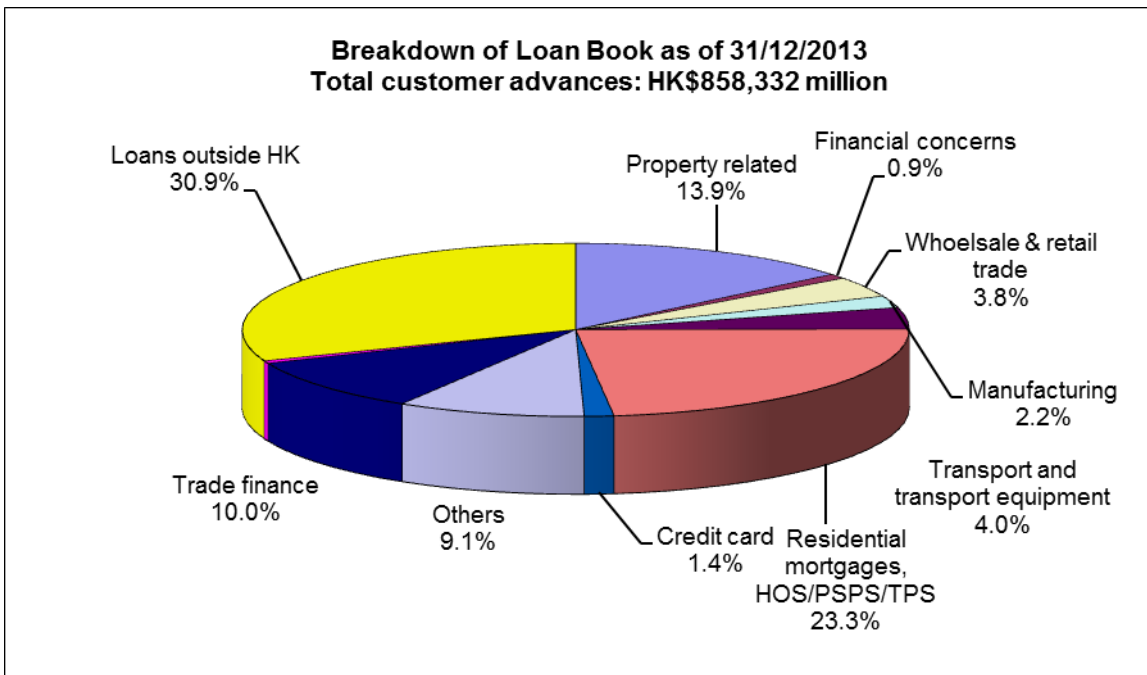
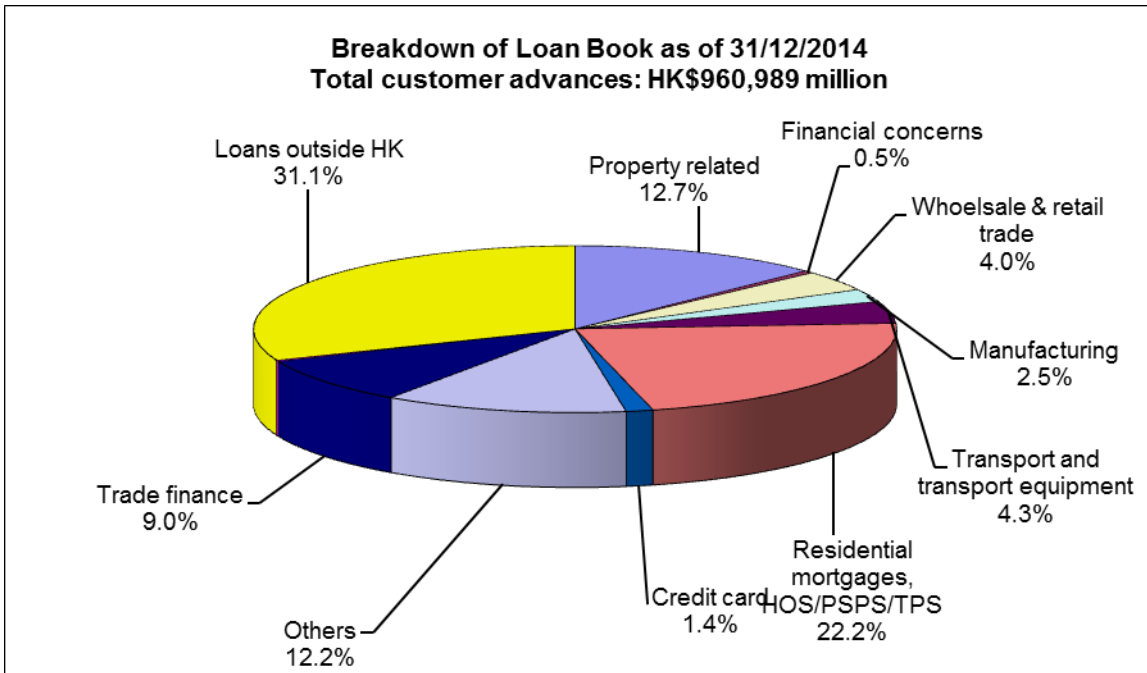
Loans-by industry	31 st Dec, 2014	Up/(down)	31 st Dec, 2013
	HK\$ million		HK\$ million
Property related	122,154	+2.1%	119,699
Financial concerns	4,758	-38.6%	7,748
Wholesale & retail trade	38,014	+15.7%	32,846
Manufacturing	24,097	+26.6%	19,031
Transport & transport equipment	40,999	+19.4%	34,327
Residential mortgages, HOS/PSPS	213,107	+6.7%	199,804
Credit card	13,021	+6.5%	12,223
Others	117,200	+50.1%	78,078
Trade finance	86,316	+1.1%	85,413
Stockbrokers	2,051	-51.3%	4,215
Loans outside HK	299,272	+13.0%	264,948
	<u>960,989</u>	<u>+12.0%</u>	<u>858,332</u>

III. Comparison of BOC Hong Kong's loan book: 31/12/2014 vs 30/06/2014

Loans-by industry	31 st Dec, 2014	Up/(down)	30 th June, 2014
	HK\$ million		HK\$ million
Property related	122,154	+0.3%	121,742
Financial concerns	4,758	-38.4%	7,725
Wholesale & retail trade	38,014	+2.1%	37,238
Manufacturing	24,097	-1.6%	24,479
Transport & transport equipment	40,999	+7.5%	38,124
Residential mortgages, HOS/PSPS	213,107	+4.8%	203,340
Credit card	13,021	+9.9%	11,845
Others	117,200	+3.5%	113,278
Trade finance	86,316	-6.9%	92,749
Stockbrokers	2,051	-55.9%	4,647
Loans outside HK	299,272	+2.0%	293,537
	<u>960,989</u>	<u>+1.3%</u>	<u>948,704</u>



Breakdown of loan book of BOC Hong Kong





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