

ACTION

Sell

Bank of East Asia (0023.HK)

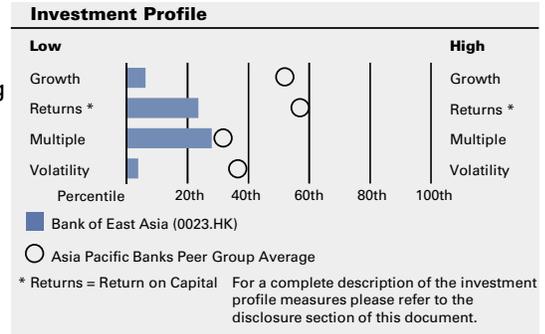
Return Potential: (6%)

Equity Research

Reinstate at Sell post share issuance; see NIM/asset quality pressure

Source of opportunity

We remove the Not Rated designation from BEA and reinstate at Sell with a 12m TP of K\$29.1. BEA has issued 222.6mn shares to Sumitomo Mitsui Banking Corporation (SMBC) pursuant to the MoU entered between the two banks on Sep 5, 2014, increasing SMBC's stake to 17.4%. We believe BEA continues to face NIM and asset quality pressures given its relatively outsized China exposure (43%/49% of loans/deposits) and a relatively weaker deposit franchise (~70% time deposits) vs. peers. We expect BEA to deliver the slowest top- and bottom-line growth within our coverage this year and forecast 15% EPS decline (2015E EPS is 10% below Bloomberg consensus).



Catalyst

(1) Estimates: We reduce 2015E/16E/17E EPS estimates by 6%/7%/7% as we factor in the 9.3% share count dilution slightly offset by the use of proceeds (which we estimate to earn 2% rate of return). **(2) Balance Sheet:** CT1 CAR strengthens by 150bp 13.3% (from 11.8%) at YE14 on a pro forma basis. The proceeds should fund BEA's organic balance sheet growth for the next 3-4 years as we estimate an average c.40bp annual capital consumption from growing the balance sheet at a high single digit percent pace despite low returns (~8% ROE) on top of around 40% dividend payout. **(3) Shareholder interests:** Various media sources, including WSJ (Feb 19, 2014), have discussed in the past that Guoco Group may be interested in acquiring BEA. We note that, post SMBC's increased stake, control consolidates with the Li family and associates, which together with CaixaBank, SMBC and other directors, hold 44% of shares vs. 13% held by Guoco, and that CaixaBank and SMBC have historically supported management's strategy.

Valuation

BEA trades at 13X 2015E P/E, 1.0X 2015E P/B vs. 7.9% ROE. Our 12m TP is based on RIM methodology (9.6% COE, 9.6% LT ROE); implies 0.95X 2015E P/B.

Key risks

Better China credit quality or cost control; potential takeover of BEA

INVESTMENT LIST MEMBERSHIP

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Coverage View: Neutral

Gurpreet Singh Sahi, CFA
+852-2978-1287 gurpreet.s.sahi@gs.com Goldman Sachs (Asia) L.L.C.
Vincent Chang
+852-2978-6681 vincent.chang@gs.com Goldman Sachs (Asia) L.L.C.
Jonathan Lim
+65-6654-5437 jonathan.lim@gs.com Goldman Sachs (Singapore) Pte

| Key data | Current |
|--------------------------------|---------------------|
| Price (HK\$) | 30.80 |
| 12 month price target (HK\$) | 29.10 |
| Market cap (HK\$ mn / US\$ mn) | 80,486.6 / 10,380.1 |
| Foreign ownership (%) | -- |

| | 12/14 | 12/15E | 12/16E | 12/17E |
|-----------------------|-------------|-------------|-------------|-------------|
| EPS (HK\$) New | 2.72 | 2.32 | 2.29 | 2.92 |
| EPS revision (%) | 0.0 | (5.7) | (7.0) | (7.1) |
| P/B (X) | 1.1 | 1.0 | 1.0 | 0.9 |
| P/E (X) | 11.7 | 13.3 | 13.4 | 10.5 |
| Dividend yield (%) | 3.5 | 3.0 | 3.0 | 3.9 |
| P/POP (X) | 9.6 | 9.4 | 9.1 | 7.1 |
| PPOP growth (%) | 9.3 | 2.2 | 3.4 | 27.4 |
| Preprovision ROA (%) | 1.1 | 1.0 | 1.0 | 1.1 |
| Credit cost (%) | 0.2 | 0.3 | 0.3 | 0.3 |
| ROA (%) | 0.82 | 0.71 | 0.67 | 0.78 |
| ROE (%) | 9.6 | 7.9 | 7.3 | 8.9 |



| Share price performance (%) | 3 month | 6 month | 12 month |
|-----------------------------|---------|---------|----------|
| Absolute | (0.3) | (2.1) | 1.0 |
| Rel. to MSCI Hong Kong | (5.1) | (5.5) | (10.0) |

Source: Company data, Goldman Sachs Research estimates, FactSet. Price as of 3/30/2015 close.

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Bank of East Asia: 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 | 12,653.0 | 12,987.6 | 13,248.2 | 16,114.1 | Gross loans | 443,287.0 | 473,758.2 | 515,644.1 | 571,501.3 |
| Non-interest income | 5,579.0 | 5,664.4 | 6,058.9 | 6,488.5 | NPLs | 2,736.0 | 3,185.7 | 3,763.6 | 4,513.9 |
| Operating revenue | 18,232.0 | 18,652.1 | 19,307.1 | 22,602.6 | Loan loss reserves | 1,354.0 | 2,230.0 | 2,634.5 | 3,159.7 |
| Non-interest expense | (9,849.0) | (10,082.3) | (10,449.6) | (11,315.1) | Total interest earning assets | 646,940.0 | 686,458.8 | 739,457.7 | 808,034.0 |
| Preprovision operating profit | 8,383.0 | 8,569.7 | 8,857.5 | 11,287.5 | Other non-interest earning assets | 148,951.0 | 184,823.7 | 223,303.0 | 267,871.6 |
| Total provision charge | (1,001.0) | (1,421.2) | (1,530.8) | (1,679.0) | Total assets | 795,891.0 | 871,282.5 | 962,760.7 | 1,075,905.6 |
| Associates | 645.0 | 723.2 | 797.4 | 879.1 | Customer deposits | 548,184.0 | 584,070.3 | 637,286.5 | 703,862.6 |
| Pretax profit | 8,424.0 | 8,071.7 | 8,324.0 | 10,687.9 | Total interest-bearing liabilities | 648,084.0 | 695,819.8 | 763,017.9 | 846,132.2 |
| Tax | (1,650.0) | (1,705.0) | (1,759.6) | (2,271.5) | Total equity | 73,444.0 | 85,483.5 | 90,868.0 | 98,034.8 |
| Minorities | (443.0) | (452.0) | (452.0) | (452.0) | CAMEL ratios (%) | 12/14 | 12/15E | 12/16E | 12/17E |
| Net profit | 6,331.0 | 5,914.8 | 6,112.4 | 7,964.4 | C: Tier 1 capital ratio | 12.5 | 13.6 | 13.1 | 12.6 |
| Dividends | 2,597.0 | 2,397.4 | 2,478.0 | 3,296.7 | C: Equity/loans | 15.6 | 17.2 | 16.8 | 16.4 |
| Dividends payout (%) | 40.6 | 39.3 | 40.2 | 41.0 | C: Equity/assets | 8.7 | 9.3 | 9.0 | 8.7 |
| Earnings growth drivers (%) | 12/14 | 12/15E | 12/16E | 12/17E | A: NPL ratio | 0.6 | 0.7 | 0.7 | 0.8 |
| Net interest margin | 1.77 | 1.70 | 1.57 | 1.72 | A: Loan loss reserves/NPLs | 49.5 | 70.0 | 70.0 | 70.0 |
| Provision charge/total loans | 0.23 | 0.30 | 0.30 | 0.30 | E: Net interest margin | 1.77 | 1.70 | 1.57 | 1.72 |
| YoY Growth (%) | | | | | E: Non int inc/oper revenues | 30.60 | 30.37 | 31.38 | 28.71 |
| Customer deposits | 2.5 | 6.5 | 9.1 | 10.4 | E: Cost-income ratio | 53.8 | 53.9 | 54.0 | 49.9 |
| Loans | 9.3 | 6.7 | 8.8 | 10.8 | E: ROAA | 0.82 | 0.71 | 0.67 | 0.78 |
| Net interest income | 4.0 | 2.6 | 2.0 | 21.6 | L: Loan/deposit ratio | 80.6 | 80.7 | 80.5 | 80.7 |
| Fee income | 3.9 | 2.0 | 6.2 | 6.5 | Loan portfolio (%) | 12/14 | 12/15E | 12/16E | 12/17E |
| Non-interest income | 9.7 | 1.5 | 7.0 | 7.1 | Commercial & corporate | 86.8 | 87.0 | 87.4 | 88.0 |
| Operating revenue | 5.7 | 2.3 | 3.5 | 17.1 | Mortgages/home loans | 7.7 | 7.5 | 7.1 | 6.7 |
| Operating expenses | (2.8) | (2.4) | (3.6) | (8.3) | Consumer | 13.2 | 13.0 | 12.6 | 12.0 |
| Preprovision operating profit | 9.3 | 2.2 | 3.4 | 27.4 | Valuation (current price) | 12/14 | 12/15E | 12/16E | 12/17E |
| Provision charges | 116.2 | 40.7 | 7.9 | 9.9 | P/E basic (X) | 11.7 | 13.3 | 13.4 | 10.5 |
| Pretax profit | (0.7) | (4.2) | 3.1 | 28.4 | P/B (X) | 1.08 | 1.00 | 0.96 | 0.91 |
| Net profit | 0.8 | (6.6) | 3.3 | 30.3 | P/PPOP (X) | 9.6 | 9.4 | 9.1 | 7.1 |
| EPS | (2.0) | (14.9) | (1.1) | 27.5 | Dividend yield (%) | 3.5 | 3.0 | 3.0 | 3.9 |
| DPS | 0.1 | (17.7) | 1.2 | 30.0 | EPS, basic (HK\$) | 2.72 | 2.32 | 2.29 | 2.92 |
| Market dimensions | 12/14 | 12/15E | 12/16E | 12/17E | EPS, fully-diluted (HK\$) | 2.72 | 2.32 | 2.29 | 2.92 |
| No of branches | -- | -- | -- | -- | EPS, basic growth (%) | (2.0) | (14.9) | (1.1) | 27.5 |
| No of staff (000) | -- | -- | -- | -- | EPS, fully diluted growth (%) | (2.0) | (14.9) | (1.1) | 27.5 |
| Revenues/staff (US\$) | NM | NM | NM | NM | BVPS (HK\$) | 29.35 | 30.72 | 32.08 | 33.96 |
| Net profit/staff (US\$) | NM | NM | NM | NM | DPS (HK\$) | 1.11 | 0.91 | 0.92 | 1.20 |
| DuPont analysis (%) | 12/14 | 12/15E | 12/16E | 12/17E | | | | | |
| ROE | 9.6 | 7.9 | 7.3 | 8.9 | | | | | |
| x leverage | 8.6 | 9.0 | 9.1 | 8.8 | | | | | |
| =ROA | 0.82 | 0.71 | 0.67 | 0.78 | | | | | |
| % of assets | 12/14 | 12/15E | 12/16E | 12/17E | | | | | |
| Net interest income | 1.63 | 1.56 | 1.44 | 1.58 | | | | | |
| Fee income | 0.54 | 0.51 | 0.49 | 0.47 | | | | | |
| Non-interest income | 0.72 | 0.68 | 0.66 | 0.64 | | | | | |
| Operating revenue | 2.35 | 2.24 | 2.11 | 2.22 | | | | | |
| Operating expenses | 1.27 | 1.21 | 1.14 | 1.11 | | | | | |
| Preprovision operating profit | 1.08 | 1.03 | 0.97 | 1.11 | | | | | |
| Loan loss provisions | 0.13 | 0.17 | 0.16 | 0.16 | | | | | |
| Pretax profits | 1.09 | 0.97 | 0.91 | 1.05 | | | | | |
| Taxes | 0.21 | 0.20 | 0.19 | 0.22 | | | | | |

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

Source: Company data, Goldman Sachs Research estimates.

Analyst Contributors

Gurpreet Singh Sahi, CFA

gurpreet.s.sahi@gs.com

Vincent Chang

vincent.chang@gs.com

Jonathan Lim

jonathan.lim@gs.com

BEA has issued 222.6mn (8.5%/9.3% of enlarged/before event share count) shares to Sumitomo Mitsui Banking Corporation (SMBC) pursuant to the MoU entered between the two banks on Sep 5, 2014, increasing SMBC's stake to 17.4%. The shares were issued at HK\$29.5576/share, a slight premium to the close on the announcement date (Mar 18, 2015, HK\$29.4) but c.11% discount to the close on Sep 5, 2014. We reduce 2015E/16E/17E EPS estimates by 6%/7%/7% as we factor in the 9.3% share count dilution slightly offset by the use of proceeds (which we estimate to earn 2% rate of return).

Exhibit 1: Estimate changes for BEA

| | 2015E | | 2016E | | 2017E | | % change | | |
|---------------------------------------|--------|--------|--------|--------|--------|--------|----------|-------|-------|
| | Old | New | Old | New | Old | New | 2015E | 2016E | 2017E |
| Key items (HK\$mn) | | | | | | | | | |
| Net interest income | 12,899 | 12,988 | 13,096 | 13,248 | 15,924 | 16,114 | 1 | 1 | 1 |
| Non-interest income | 5,664 | 5,664 | 6,059 | 6,059 | 6,488 | 6,488 | 0 | 0 | 0 |
| Operating revenues | 18,563 | 18,652 | 19,155 | 19,307 | 22,412 | 22,603 | 0 | 1 | 1 |
| Operating expenses | 10,082 | 10,082 | 10,450 | 10,450 | 11,315 | 11,315 | 0 | 0 | 0 |
| PPOP | 8,481 | 8,570 | 8,705 | 8,857 | 11,097 | 11,288 | 1 | 2 | 2 |
| Provisions & other impairment charges | 1,421 | 1,421 | 1,531 | 1,531 | 1,679 | 1,679 | 0 | 0 | 0 |
| Operating profits | 7,060 | 7,149 | 7,175 | 7,327 | 9,418 | 9,609 | 1 | 2 | 2 |
| Pretax profits | 7,983 | 8,072 | 8,172 | 8,324 | 10,497 | 10,688 | 1 | 2 | 2 |
| Taxes | 1,686 | 1,705 | 1,727 | 1,760 | 2,230 | 2,272 | 1 | 2 | 2 |
| Net profits | 5,845 | 5,915 | 5,993 | 6,112 | 7,815 | 7,964 | 1 | 2 | 2 |
| EPS (HK\$) | 2.46 | 2.32 | 2.47 | 2.29 | 3.15 | 2.92 | (6) | (7) | (7) |
| DPS (HK\$) | 0.99 | 0.91 | 0.99 | 0.92 | 1.29 | 1.20 | (8) | (7) | (7) |
| BVPS (HK\$) | 30.81 | 30.72 | 32.31 | 32.08 | 34.38 | 33.96 | (0) | (1) | (1) |
| Key assumptions (%) | | | | | | | | | |
| Net interest margins | 1.70 | 1.70 | 1.57 | 1.57 | 1.71 | 1.72 | | | |
| Loan growth | 6.9 | 6.9 | 8.8 | 8.8 | 10.8 | 10.8 | | | |
| Non int inc gwth | 1.5 | 1.5 | 7.0 | 7.0 | 7.1 | 7.1 | | | |
| Op exp gwth | 2.4 | 2.4 | 3.6 | 3.6 | 8.3 | 8.3 | | | |
| Cost-to-income ratio | 54.3 | 54.1 | 54.6 | 54.1 | 50.5 | 50.1 | | | |
| ROA | 0.70 | 0.71 | 0.66 | 0.67 | 0.77 | 0.78 | | | |
| ROE | 8.2 | 7.9 | 7.8 | 7.3 | 9.4 | 8.9 | | | |

Source: Company data, Goldman Sachs Global Investment Research.

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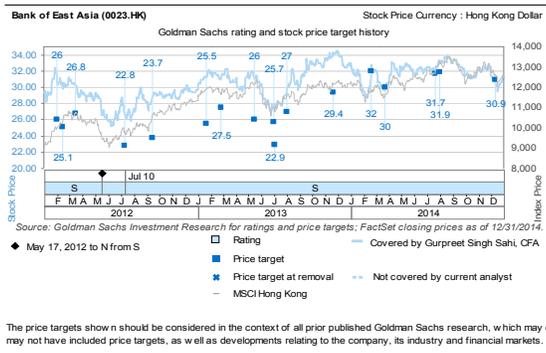
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