

Lack of growth highlights

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Industry: Banking



Phillip Securities (Hong Kong) Ltd

Phillip Securities Research

3 April 2013

FY 2012 Review

Rating: Neutral Closing:\$25.95 Target: \$27.05

FY 2012 Summary

Financial Summary %

Up to 31December 2012	2012	2011	2010
Return on average total assets	1.24%	1.14%	1.21%
Return on average shareholders' equity	14.91%	16.68%	14.77%
Cost to income ratio	31.88%	25.49%	34.84%
Loan to deposit ratio	63.32%	61%	59.69%
Average Liquidity ratio	41.20%	36.17%	38.77%
Capital adequacy ratio	16.80%	16.9%	16.14%
Core Capital Ratio	12.31%	12.51%	11.29%
Core operating expense (HKD\$ Mn)	11498	10,659	9,495

Source: Company, PSR

Growth in core business

BOC HK's FY 12 performance was in line with our expectation:

Net interest income achieved to HK \$ 24.708 billion (HKD as below), up 12.4 % yoy or 27.29 billion HKD, NIM improved to 1.6%

Net fees and commissions, rose 0.9 % yoy to 7.906 billion HKD,

Net trading income increased by 83% yoy to 3.129 billion HKD, mainly due to net trading income of the foreign exchange trading and related products, driven by an increase of 558 million HKD, or 39% yoy. The interest rate instruments and items under fair hedge rose by 74 times yoy to 900 millions. Accounted for the vast growth of the trading business.

Profit before tax reached 25.521 billion, an increase of 3.41% yoy.

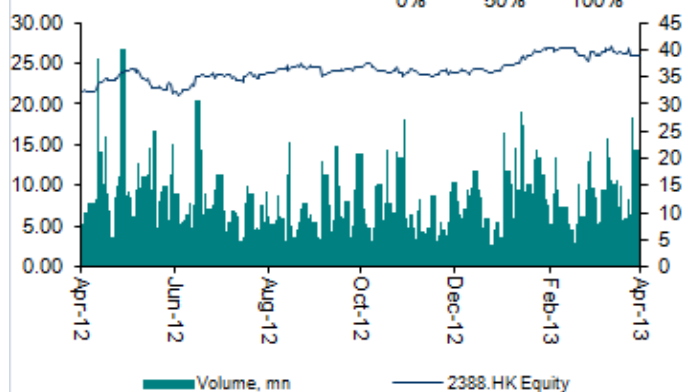
Due to the Lehman Brothers mini-bonds related expense, total operating expenses increased by 45% yoy to 11.402 billion, core operating expenses rose 7.9%, or 839 million.

In FY 12 basic earnings per share was HK \$ 1.9796, up 2.46 % yoy, dividend increased 4.2% yoy to \$ 1.238, to maintain a 62.5% payout ratio as past. However, the FY 12 result of BOCHK was not impressive, thus, we downgrade the investment rating to "Neutral" and rise target price to HK\$27.05.

Based on the development of RMB business and the Group's long-term advantages, coupled with stable dividend payout policy, investors can buy for long-term holding at lower price

BOC HK

Rating	3.00	Neutral
- Previous Rating	2.00	Accumulate
Target Price (HKD)	27.05	
- Previous Target Price (HKD)	26	
Closing Price (HKD)	25.95	
Expected Capital Gains (%)	4.2%	
Expected Dividend Yield (%)	5.0%	
Expected Total Return (%)	9.2%	
Market Cap. (HKD mn)	274,364	
3M Average Daily T/O (mn)	14.3	
52 week range (HKD)	20.85 - 27.1	
Closing Price in 52 week range		



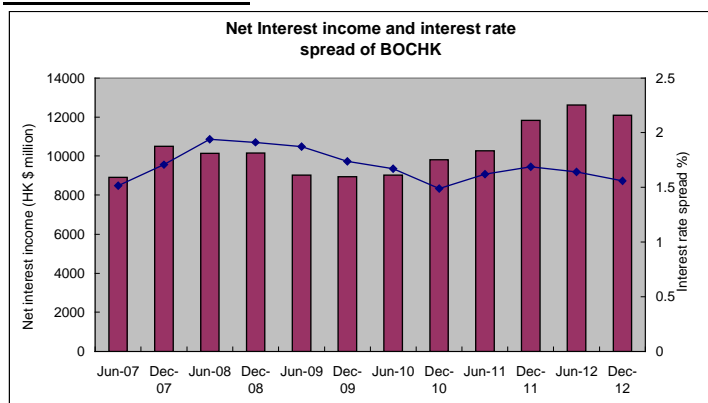
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Net Interest Income

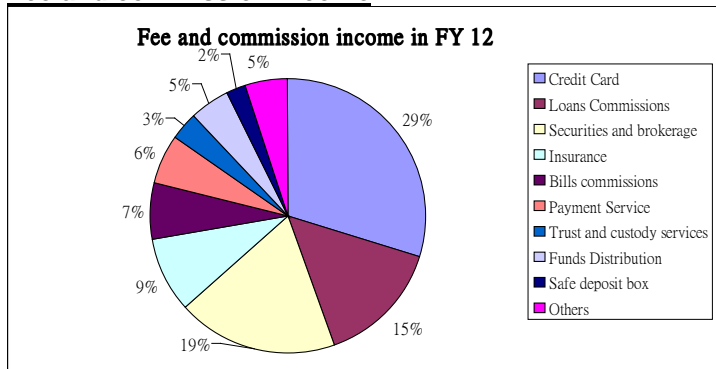


Source: Company, PSR, Bloomberg

Due to the dilutive effect of RMB business reduced, NIM rallied by 28bp in 2013

However the deposit market is increasingly competitive, the Group's loan to deposit ratio increased to 63.32%. Net interest income is still up to \$ 24.708 billion, up 12.4 % yoy or 2.729 billion. We expect a strong demand in offshore RMB lending, which let a keen competition in attracting deposit, negative effect to NIM.

Fee and commission income



Source: Company, PSR

Group's net fee and commission income also recorded a slight growth, up 0.9 % yoy to 7.906 billion, the growth momentum mainly driven by credit cards, insurance business, up 14.5% yoy. Securities brokerage income fell 24% yoy, due to the volatility market conditions in 2012. We expected the debt crisis in Europe will be released, market sentiments improved, and the market turnover rose, securities brokerage income is expected to rebound in 2013.

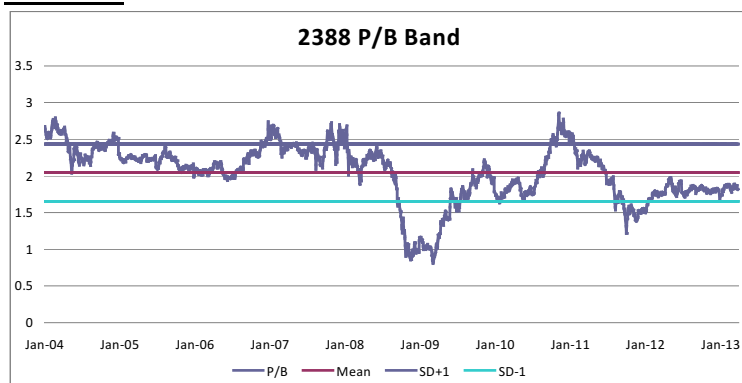
Major Risk

European sovereign debt crisis continues to worsen, affect global economy

Group's growth rate is slower than we expected

Chinese economic hard landing

Valuation



Source: Company, PSR, Bloomberg

BOC Hong Kong's nine-year average P/B is about 2 times, while the current price P/B is about 1.8 times. With Europe's debt crisis slightly eased, and the opportunities of Rmb internationalization, the Group's P/B is expected to back to 2 times which is near our target price \$27.05.

Dividend Policy

Year	Interest per share (HK\$)	Growth rate	Earning per share (HK\$)	Payout ratio
2002	0.21	-	0.64	33%
2003	0.52	148%	0.75	69%
2004	0.71	37%	1.13	63%
2005	0.81	14%	1.29	63%
2006	0.85	5%	1.32	64%
2007	0.91	7%	1.46	62%
2008	0.44	-52%	0.32	138%
2009	0.86	9%	1.3175	65%
2010	0.972	13.02%	1.5319	63%
2011	1.19	19%	1.93	62%
2012	1.24	4%	1.98	63%
2013(E)	1.29	4%	2.05	63%
2014(E)	1.31	2%	2.12	62%
2015(E)	1.40	6%	2.18	64%

Source: Company, PSR

DDM Model

Assumption

Risk free rate	5%
Market risk premium	6%
Average Growth rate	4%
PV of Dividend	3.97
PV of Terminal	23.08
Fair Value	27.05
Fair P/B	1.73 X
13 (E) Fair P/E	13.19

Source: PSR

Due to the trend of Rmb internationalization, we expect that the Group will grow steadily, dividend per share will be HKD \$ 1.29 in 2013. Assume the growth rate will be 4%, we use dividend discount model calculated the fair value per share is HK \$ 27.05. The corresponding estimated P/B is about 1.73 times and P/E is 13.19 times.

Peers Comparison

	Estimate				Total Loan to total deposit (%)	NIM	Efficiency ratio(%)	Market Cap (HKD Mn)	Dividend Yield (%)
	P/E	P/E	P/B	ROE					
2388	13.10	13.11	1.82	14.91	63.32	1.60	31.88	274,363.66	4.77
11	11.37	12.31	2.59	22.59	65.67	1.68	55.31	239,171.53	4.24
23	13.70	10.85	1.21	11.56	77.25	1.54	59.43	69,408.85	3.40
5	10.96	13.82	1.15	8.37	75.65	N/A	52.96	1,540,844.10	4.21
1111	20.351	16.72	1.23	7.63	57.49	1.12	59.16	9,091.50	2.20
2356	9.824	9.82	0.78	8.59	73.1703	1.54	62.83	13,965.30	2.78

Source: PSR, Bloomberg

All based on the closing price and data of 2nd April 2013

Financial Status

Income statement End Dec (HKD Million)	2011 A	2012 (A)	2013 (E)	2014 (E)	2015 (E)
Interest Income	31,931	35,413	36,529	38,356	39,506
Interest Expense	-9,952	-10,705	-11,071	-11,403	-11,973
Net interest income	<u>21,979</u>	<u>24,708</u>	<u>25,458</u>	<u>26,953</u>	<u>27,533</u>
Fee and commission Income	10,858	11,110	11,857	12,213	12,823
Fee and commission Expense	-3,025	-3,204	-3,287	-3,419	-3,624
Net Fee and commission Expense	<u>7,833</u>	<u>7,906</u>	<u>8,570</u>	<u>8,794</u>	<u>9,199</u>
Gross earned premiums	12,927	11,881	15,609	16,234	16,721
Gross earned premiums ceded to reinsurers	-7,244	-5,430	-8,600	-9,030	-9,211
Net insurance premium income	<u>5,683</u>	<u>6,451</u>	<u>7,009</u>	<u>7,204</u>	<u>7,510</u>
Net trading gain	1,710	3,129	1,643	1,359	1,462
Net (loss)/ gain on financial instruments designated at fair value through profit or loss	-340	747	-323	-352	-415
Net gain on other financial assets	308	750	453	253	351
Other operating Income	<u>525</u>	<u>589</u>	<u>354</u>	<u>462</u>	<u>427</u>
Total Operating income	<u>37,698</u>	<u>44,280</u>	<u>43,164</u>	<u>44,672</u>	<u>46,068</u>
Net insurance benefits and claims	-6,852	-8,520	-9,792	-10,086	-10,590.1
Net Operating income before impairment allowan	30,846	35,760	35,372	34,586	35,477
Impairment allowances	-506	-859	-551	-476	-357
Net Operating income	<u>30,340</u>	<u>34,901</u>	<u>34,821</u>	<u>34,110</u>	<u>35,120</u>
Operating expense	-7,862	-11,402	-10,513	-9,089	-9,361.67
Other Operating profit	<u>2,202</u>	<u>2,022</u>	<u>2,058</u>	<u>2,051</u>	<u>2,157</u>
Profit before tax	<u>24,680</u>	<u>25,521</u>	<u>26,366</u>	<u>27,072</u>	<u>27,916</u>
Tax expense	-3,867	-3,974	-4,329	-4,242	-4,374
Profit for the year	20,813	21,547	22,037	22,830	23,541
Profit attributable to non-controlling interests	383	617	362	420	450
Profit attributable to shareholders	<u>20,430</u>	<u>20,930</u>	<u>21,675</u>	<u>22,410</u>	<u>23,091</u>

Source: Company, PSR

Per Share Data HKD \$	FY 11 A	FY 12 A	FY 13 E	FY 14 E	FY 15 E
EPS	1.93	1.98	2.05	2.12	2.18
DPS	1.19	1.24	1.29	1.31	1.40
Payout ratio	62%	63%	63%	62%	64%
BVPS	12.26	14.28	15.68	16.80	17.28

Source: Company, PSR

Balance Sheet					
End Dec HK\$ Mn	2011 A	2012 (E)	2013 (E)	2014 (E)	2015 (E)
Cash	278,795	198,748	288,131	280,837	297,687
Placing with banks	107,910	66,025	83,407	87,578	91,081
Trading assets	48,602	49,332	53,736	55,886	60,562
Derivatives	26,787	31,339	33,642	34,651	36,384
Cert of indebt (HKSAR)	65,890	82,930	76,871	79,945	82,344
Loans	755,229	819,739	852,773	903,939	913,231
Financial Investment	376,998	482,364	434,107	468,836	487,589
Others	78,299	100,286	112,310	120,172	136,280
Total Assets	<u>1,738,510</u>	<u>1,830,763</u>	<u>1,934,976</u>	<u>2,031,843</u>	<u>2,105,158</u>
Currency notes	65,890	82,930	75,824	82,135	83,320
Bank Deposits	236,694	179,206	184,662	207,143	211,052
Trading	3,237	20,172	23,636	24,413	25,217
Derivatives	22,281	21,214	27,655	30,385	33,384
Customer Deposits	1,145,951	1,226,290	1,300,358	1,342,563	1,387,432
CD	5,985	5,923	6,982	7,381	7,802
Others	125,289	139,954	145,792	155,794	169,796
Total Liabilities	<u>1,605,327</u>	<u>1,675,689</u>	<u>1,764,909</u>	<u>1,849,814</u>	<u>1,918,003</u>
Paid in Capital	52,864	52,864	52,864	52,864	52,864
Reserves	76,901	102,210	117,204	129,165	134,291
Shareholder's Fund	<u>129,765</u>	<u>155,074</u>	<u>170,068</u>	<u>182,029</u>	<u>187,155</u>
Minority interest	3,418	4,105	4,350	4,410	4,521
Total Liabilities and equity	1,738,510	1,834,868	1,939,326	2,036,253	2,109,679

Source: Company, PSR

PHILLIP RESEARCH STOCK SELECTION SYSTEMS

Total Return	Recommendation	Rating	Remarks
>+20%	Buy	1	>20% upside from the current price
+5% to +20%	Accumulate	2	+5% to +20% upside from the current price
-5% to +5%	Neutral	3	Trade within \pm 5% from the current price
-5% to -20%	Reduce	4	-5% to -20% downside from the current price
<-20%	Sell	5	>20% downside from the current price

quantitative return bands. We consider qualitative factors like (but not limited to) a stock's risk reward profile, market sentiment, recent rate of share price appreciation, presence or absence of stock price catalysts, and speculative undertones surrounding the stock, before making our final recommendation.

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