

Bank of China (3988 HK)

Better-than-expected profit performance

CHINA | BANKING | COMPANY REPORT

13 January 2015

Summary

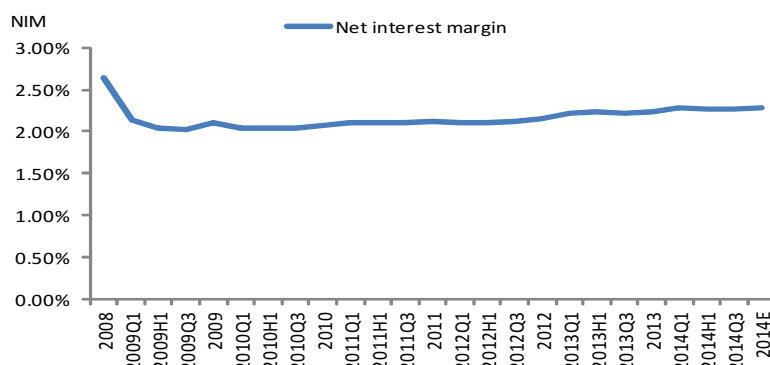
- According to BOC's (or the Group) 3Q2014 results, as at the end of Sep 2014, net interest income was RMB238.775 billion, up 14.68% y-y, which maintained stable growth. BOC's after-tax incomes reached to RMB136.798 billion, increased by 9.16% y-y, and net profit recorded RMB131.133 billion, up 9.09% y-y;
- The Group's total assets was RMB15.43 trillion, and total liabilities amounted to RMB14.38 trillion, with net assets of RMB101 million, increased by 11.20%, 11.38% and 8.82% respectively compared to the end of 2013. ROAA and ROAE were 1.24% and 18.03% respectively;
- BOC's asset quality trends to go down, NPLs amounted to RMB90.695 billion, with the NPL ratio of 1.07%, up 0.11ppts compared to the end of 2013, while the coverage ratio decreased to 207.70%;
- As at the end of Sep 2014, the Core Tier-1 Ratio and CAR of BOC increased obviously by 1.15ppts and 1.29ppts to 10.51% and 13.07% respectively compared with the end of 1H2014. Meanwhile, in 4Q2014, the Group issued the preferred stock with the amount of USD6.5 billion successfully, the first domestic listed company to issue the preferred stock, which would be helpful for increasing the CAR in future;
- Considering the better-than-expected performance, and the positive outlook of the market in 2015, we believe BOC's profit would maintain stable growth, and based on 3-stage DDM, we increase BOC's 12-month target price to HK\$5.50, around 25.3% higher than the latest closing price, equivalent to 6.5xP/E and 1.1xP/B in 2015 respectively, the valuation is reasonable. We maintain BOC at Buy.

Better-than-expected profit performance

By the end of Sep 2014, net interest income was RMB238.775 billion, up 14.68% y-y, which maintained stable growth. BOC's after-tax incomes reached to RMB136.798 billion, increased by 9.16% y-y, and net profit recorded RMB131.133 billion, up 9.09% y-y.

The Group's profit performance was better than our previous expectation slightly, mainly due to the sustainable growth of net interest incomes benefited from the stable increase of NIM, as at the end of 3Q, NIM recorded 2.26%, although it was lower than that of 1H, 0.02ppts higher than the of end of 2013.

The growth of BOC's NIM



Source: Company, Phillip Securities (HK) Research

Buy (Maintain)

CMP HK\$4.39

TARGET HK\$5.50 (+25%)

COMPANY DATA

O/S SHARES (MN) :	83,622
MARKET CAP (HK\$ MN) :	367,102
52 - WK HI/LO (HK\$) :	4.52/ 3.03

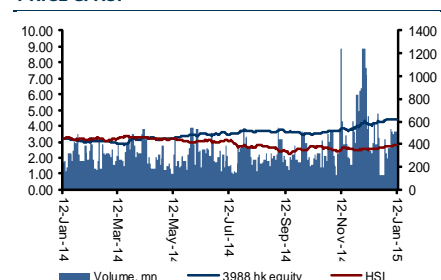
SHARE HOLDING PATTERN, %

Central Huijin Investment	67.68
HKSCC Nominees	29.20
The Bank of Tokyo-Mitsubishi UFJ Ltd.	0.19

PRICE PERFORMANCE, %

	1MTH	3MTH	1YR
HTS	7.66	18.13	25.27
HSI	-1.17	1.74	4.57

PRICE & HSI



Source: Phillip Securities (HK) Research

KEY FINANCIALS

Key Financial Summary				
FYE	12/13	12/14F	12/15F	12/16F
Operating Profit (RMB mn)	211,685	232,285	255,326	285,831
Net Profit, adj. (RMB mn)	156,911	172,306	189,498	211,816
EPS, adj. (RMB)	0.56	0.62	0.68	0.76
P/E (X)	6.2	5.7	5.2	4.6
BVPS (RMB)	3.31	3.71	4.07	4.48
P/B (X)	1.1	0.9	0.9	0.8
DPS (RMB)	0.20	0.22	0.24	0.27
Div. Yield	5.6%	6.2%	6.8%	7.7%

Source: Bloomberg, PSR est.

*All multiples & yields based on current market price

Source: Company reports, Phillip Securities Est.

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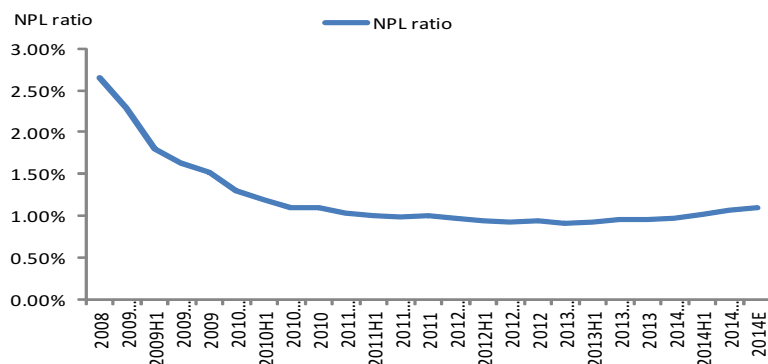
Stable growth of assets with the deterioration of the quality

BOC's total assets was RMB15.43 trillion, and total liabilities amounted to RMB14.38 trillion, with net assets of RMB101 million, increased by 11.20%, 11.38% and 8.82% respectively compared to the end of 2013. Total customer loans increased by RMB836.612 billion or 11% to RMB8.44 trillion compared with the end of 2013.

Due to the large growth of loans and under the downward trend of macroeconomic environment, BOC's asset quality faces the risk of the deterioration. By the end of Sep 2014, the Group's NPLs amounted to RMB90.695 billion, with the NPL ratio of 1.07%, up 0.11ppts compared to the end of 2013, of which special-mentioned loans decreased by 0.20ppts to 2.29%, but doubtful and loss loans should increase obviously. Meanwhile, the coverage ratio decreased to 207.70%, and allowance for loan impairment losses to total loans of domestic institutions was 2.72%, up 0.1ppts. In future, BOC will control the loans for the local government financial vehicles (LGFVs), and strengthen the risk control of industries with excess capacity, property, wealth management and other new businesses.

However, we expect BOC's NPL ratio and amount will increase continually, and the NPL ratio would reach to 1.10% approximately in 2014.

BOC's NPL ratio

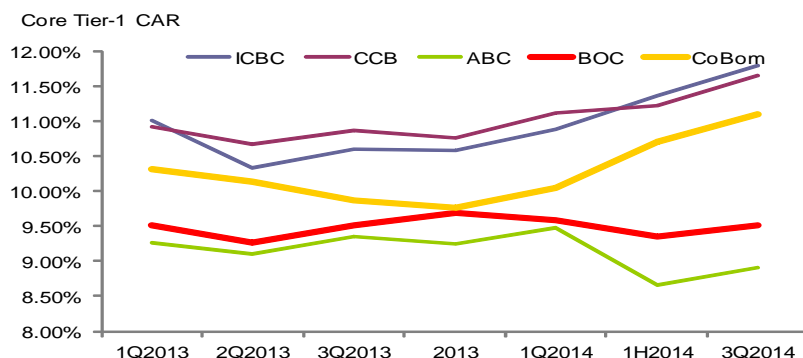


Source: Company, Phillip Securities (HK) Research

Capital pressures decreased

As at the end of Sep 2014, the Core Tier-1 Ratio and CAR of BOC increased obviously by 1.15ppts and 1.29ppts to 10.51% and 13.07% respectively compared with the end of 1H2014. Meanwhile, in 4Q2014, the Group issued the preferred stock with the amount of USD6.5 billion successfully, the first domestic listed company to issue the preferred stock, which would be helpful for increasing the CAR in future, representing the decrease of the capital pressure, however, it was still lower compared with the peers.

CARs of Big-5 in 3Q2014



Source: Company, Phillip Securities (HK) Research

Risk

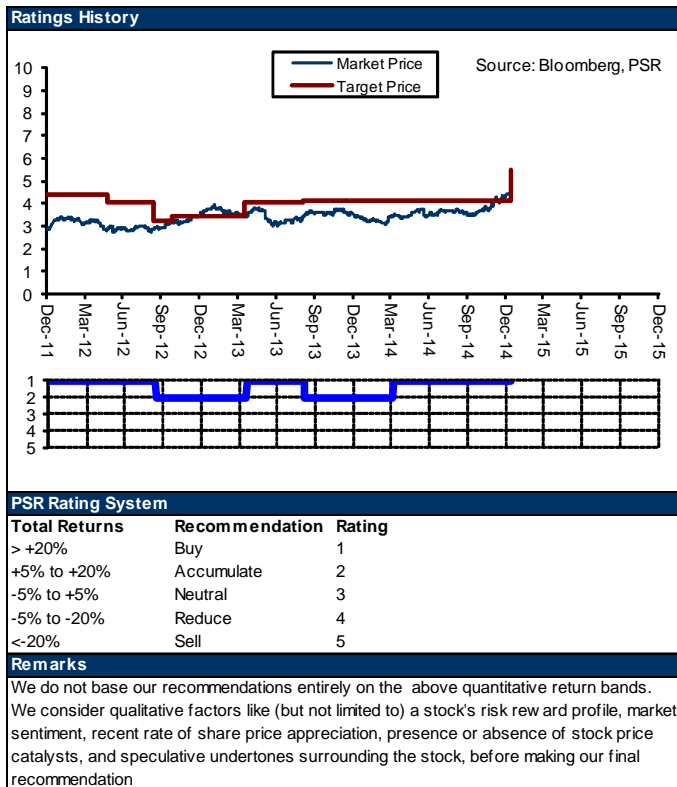
Lower-than-expected growth of main business incomes;
The deterioration of the asset quality due to the sharp growth of the NPLs;
Share price goes down largely in the short run.

FINANCIALS

FYE	FY12	FY13	FY14F	FY15F	FY16F
Valuation Ratios					
P/E (X)	7.0	6.2	5.7	5.2	4.6
P/B (X)	1.2	1.1	0.9	0.9	0.8
Dividend Payout ratio	35.04%	34.90%	35.00%	35.00%	35.58%
Dividend Yield	4.98%	5.58%	6.15%	6.76%	7.69%
Per share data (RMB)					
EPS, reported	0.50	0.56	0.62	0.68	0.76
EPS, adj.	0.50	0.56	0.62	0.68	0.76
DPS	0.18	0.20	0.22	0.24	0.27
BVPS	2.95	3.31	3.71	4.07	4.48
Growth					
Net interest income	12.7%	10.4%	6.5%	7.4%	10.0%
Net fee and commission income(exp.)	8.1%	17.4%	20.0%	21.0%	22.0%
Operating income	11.1%	13.3%	9.7%	9.9%	11.9%
Net Income, adj.	12.3%	12.5%	9.8%	10.0%	11.8%
Key Ratios					
ROAA	1.19%	1.23%	1.20%	1.17%	1.19%
ROAE	18.01%	17.95%	17.59%	17.44%	17.73%
Net interest margin	2.15%	2.24%	2.28%	2.33%	2.38%
Loan to deposit	71.99%	72.52%	71.90%	72.10%	72.80%
Cost to income ratio	31.81%	30.61%	31.17%	30.73%	29.84%
NPL ratio	0.95%	0.96%	1.10%	1.23%	1.34%
Core capital adequacy ratio	10.54%	9.69%	10.90%	11.30%	12.20%
CAR	13.63%	12.46%	13.25%	13.40%	13.94%
Income Statement (RMB mn)					
Net interest income	256,964	283,585	301,991	324,223	356,620
Net fee and commission income	69,923	82,092	98,510	119,198	145,421
Operating income	366,176	407,509	447,771	497,309	563,473
Operating expenses	(160,022)	(172,314)	(186,099)	(203,779)	(224,156)
Impairment losses	(19,387)	(23,510)	(29,388)	(38,204)	(53,485)
Operating profit	186,767	211,685	232,285	255,326	285,831
Profit before tax	187,380	212,777	233,759	257,095	287,954
Income tax	(41,858)	(49,036)	(53,940)	(59,334)	(67,047)
Effective income tax rate	22.34%	23.05%	23.07%	23.08%	23.28%
Net profit for the period	145,522	163,741	179,819	197,762	220,907
Minority interest	6,090	6,830	7,513	8,264	9,091
Net profit attributable to equity holders of the Bank	139,432	156,911	172,306	189,498	211,816
Declared and paid Dividends	48,851	54,755	60,307	66,324	74,136
Balance Sheet (RMB mn)					
Cash and balances w ith banks and other financial institutions	775,574	702,584	948,488	1,005,398	1,065,722
Balances w ith central bank	1,934,297	2,132,001	2,558,401	2,686,321	2,820,637
Placements w ith banks and other financial institutions	447,299	660,049	615,466	646,239	678,551
Loans and advances to customers	6,710,040	7,439,742	8,406,908	9,499,807	10,753,781
Investments	2,138,934	2,181,270	2,653,158	2,867,961	3,100,847
Total Assets	12,680,615	13,874,299	16,023,949	17,663,983	19,507,137
Deposits from banks and other financial Institutions	1,553,192	1,551,624	1,861,949	1,917,807	1,956,163
Deposits from customers	9,009,978	9,941,288	11,074,595	12,270,651	13,620,423
Other liabilities	268,018	302,279	356,689	428,027	522,193
Total Liabilities	11,819,073	12,912,822	14,945,346	16,481,972	18,207,499
Share capital	279,147	279,365	279,365	279,365	279,365
Equity	824,497	923,916	1,035,198	1,138,011	1,251,366
Minority interest	36,865	37,561	43,405	44,000	48,272
Total shareholders' equity	861,542	961,477	1,078,603	1,182,011	1,299,638
Total shareholders' equity and liabilities	12,680,615	13,874,299	16,023,949	17,663,983	19,507,137

Source: PSR

Source: Company, Phillip Securities (HK) Research Estimates



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

We do not base our recommendations entirely on the above 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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