

**Analyst: Paul Sham**

## **BANK OF CHINA LIMITED** (中國銀行)

Sector	: Banking
HKSE Code	: 03988
Market Price	: HK\$3.62 (27/03/2013)
Shares Issued	: 83,622m (H share)
Mkt. Cap.	: HK\$302,712m (H share)
52 weeks Hi/ Lo	: HK\$4.00 / HK\$2.61
HSI / HSCEI	: 22,464.82 / 11,033.61(27/03/2013)
Main Business	: Banking and related financial services

Vice Chairman & Head of Bank : Mr. Li Lihui

### **SUMMARY OF THE FINAL RESULTS FOR THE YEAR ENDED 31<sup>ST</sup> DECEMBER 2012**

#### **Final Results Highlights**

	<b>RMB million</b>	<b>Vs FY2011 (%)</b>	<b>Vs 30/06/2012 (%)</b>
• Net interest income	256,964	+12.7%	
• Non-interest income	109,212	+9.0%	
• Total operating income	366,176	+11.5%	
• Operating expenses	(160,022)	+13.6%	
• Operating profit before impairment losses	206,154	+10.0%	
• Impairment losses on loans and advances	(19,086)	-1.0%	
• Profit before taxation	187,380	+11.1%	
• Taxation	(41,858)	+9.7%	
• <b>Attributable profit to equity holders</b>	<b>139,432</b>	<b>+12.2%</b>	
• Total loans	6,864,696	+8.2%	+1.6%
• Total deposits	9,173,995	+4.0%	-3.3%
• Total assets	12,680,615	+7.2%	-1.1%
• Basic EPS (RMB)	0.50	+11.1%	
• Interim DPS (RMB)	0.00	+0.0%	
• Final DPS (RMB)	0.175	+12.9%	
• Total DPS (RMB)	0.175	+12.9%	
<b>Selected Ratios</b>	<b>FY2012</b>	<b>FY2011</b>	<b>1H2012</b>
• Net interest margin	2.15%	2.12%	2.10%
• Cost-income ratio	43.7%	42.9%	40.9%
• Return on average assets	1.19%	1.17%	1.22%
• Return on average equity	18.1%	18.3%	19.0%
• NPL ratio	0.95%	1.00%	0.94%
• NPL Coverage ratio	236.3%	220.8%	232.6%
• Loan-deposit ratio	74.8%	71.9%	71.2%
• Core capital adequacy ratio	10.5%	10.1%	10.2%
• Capital adequacy ratio	13.6%	13.0%	13.0%
• Liquidity ratio (RMB portion)	49.8%	47.0%	54.0%
• Liquidity ratio (Foreign currency portion)	65.2%	56.2%	66.8%

- **2012 results driven by low credit cost** Bank of China (BOC) reported a solid set of results, with its net profit rising 12.2% y-o-y to RMB139,432m, ahead of market forecast of RMB132,106m. The beat was largely attributable to lower-than-expected credit costs and better-than-expected NIM expansion in 4Q12. Nevertheless, earning momentum and profitability still lagged behind the other 3 big banks

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(ICBC, CCB, ABC & BOC, collectively the “Big 4 Banks”). BOC proposed a final dividend of RMB0.175 per share, implying a dividend payout ratio of 35%, same as that in 2011.

- **Net interest income** BOC's NIM expanded 3bps y-o-y to 2.15%. The NIM expansion was largely driven by domestic RMB business. NIM of domestic RMB business was 2.39%, an increase of 6bps y-o-y, while that of domestic foreign currency business was 1.11%, a decrease of 58bps as a result of interest rate cuts by overseas central banks. BOC's loan book grew by 8.2% y-o-y, lower than CCB's 15.6% and ABC's 14.1%. Since its deposit increased at a slower pace of 4.0% y-o-y in FY12, its loan-to-deposit ratio further stretched to 74.8% at end-2012, marginally below the regulatory requirement of 75%.
- **Non-interest income** BOC earned a net fee income of RMB69,923m, an increase of 8.14% y-o-y. Bank card revenues grew strongly by 39.13% as BOC substantially increased bank card issuance and grew transaction volumes. Agency commissions and settlement & clearing fees also recorded double-digit growth of 16.7% and 13.4% respectively. Nevertheless, BOC, like CCB, was required by the government to waive certain fee charges for customers, which capped the growth of overall net fee income. BOC also realised other non-interest income of RMB39,289m, up 10.4% y-o-y, mainly from more sales of precious metals products.
- **Cost efficiency** Total operating expenses in FY12 rose 13.6% y-o-y to RMB160,022m. Staff cost, the major component of expenses, increased 10.2% y-o-y to RMB66,994m. BOC's cost-to-income ratio was once again the highest among Big 4 banks, rising slightly to 43.7% in FY12 from 42.9% in FY11.
- **Asset quality** BOC's impairment charges on loans amounted to RMB19,086m, down 1% y-o-y. Its NPL amount was largely flat y-o-y at RMB65,448m, with the NPL ratio lowering 5bps to 0.95%. The coverage ratio also improved 15.6ppt y-o-y to 236.3% at end-2012. In respect of European debt issue, BOC continued to reduce its exposure to high-risk European debt. As at the end of 2012, the total carrying value of those debt securities was RMB45.6bn, down 44% y-o-y. BOC did not hold any debt securities issued by governments and institutions in Greece, Portugal, Ireland, Italy or Spain.
- **Capital position** Strengthened via self-generation from retained earnings, BOC's core CAR improved to 10.5% at end-2012, from 10.1% a year earlier. Total CAR also advanced to 13.6% from 13.0% during the same period, boosted by the issuance of CNY23bn subordinated bonds in November 2012.

### **Outlook & Prospects**

- **NIM less impacted by interest-rate liberation** Management guided stable NIM in 2013 by controlling its deposit costs and increasing exposure on high-yield SME loans. Despite the sector's NIM would face pressure due to gradual interest-rate liberation, we expect to see milder NIM contraction for BOC given its higher percentage of foreign currency business that has already liberalized. In addition, experience gained from overseas business may place BOC a better position for the interest rate de-regulation and RMB internationalization process.
- **Loan growth may slow down** BOC proactively trimmed its high-cost deposit from RMB669bn at end-June 2012 to only RMB158bn at end-2012. As a result, BOC's deposit balance has shrunk for three consecutive quarters, which pushed the loan-to-deposit ratio to a high level of 74.8%. The shift in deposit strategy can help reduce its interest expense but may also stall the future loan growth at the same time.
- **Solar loans at risk** According to Management, BOC's loan to local government financing vehicle (LGFV) amounted to RMB398bn, accounting for about 7.3% of its domestic loans, and 97% of which was cash-flow covered and 93% belonged to provincial level government. NPL ratio was 0.25% only. In respect of its exposure to solar sector, BOC did not disclose the exact loan amount. Nevertheless, the sector was definitely not in a good shape as 21% and 24% of its loans were classified as NPLs and special mention loans respectively. The NPL coverage ratio by BOC was as low as 51.5%.
- **Fund raising pressure still exists** BOC's core CAR is likely to see a drop of about 100bps upon the adoption of Basel III. Although BOC has no plan for equity raising at the moment, its higher-than-peer fund-raising pressure could be an overhang in the medium term.



- **Valuations** BOC was the best performer among the Big 4 banks in 2012, up 21%. A key reason for the outperformance was that BOC was relatively less impacted by the interest rate cuts and deregulation in China, due to its more diversified business mix. BOC is trading at 0.87 FY13E P/B, lagging behind CCB's 1.16x amid its weak fundamentals. Nevertheless, we still prefer CCB and ICBC due to their stronger profit momentum as well as better fundamentals. As such, we recommend "Neutral" rating on the counter.

**Recommendation: *Neutral***

## Appendix I

## I. Impaired loans and special-mention loans of Bank of China

As % of total customer advances	Impaired loans	Special mention loans
As of 31/12/2012	0.95%	3.02%
As of 30/06/2012	0.94%	2.84%
As of 31/12/2011	1.00%	3.03%

## II. Comparison of Bank of China's loan book: 31/12/2012 vs 31/12/2011

Pre-tax profit by businesses (RMB million)	FY2012	FY2011	y-o-y (%)	Breakdown FY2012	FY2011
Corporate banking	104,472	101,887	+2.5%	55.8%	60.4%
Personal banking	39,344	37,523	+4.9%	21.0%	22.2%
Treasury operations	37,143	19,166	+93.8%	19.8%	11.4%
Commercial banking	180,959	158,576	+14.1%	96.6%	94.0%
Investment banking	1,157	1,657	-30.2%	0.6%	1.0%
Insurance	830	1,017	-18.4%	0.4%	0.6%
Others	4,441	7,394	-39.9%	2.4%	4.4%
Total pre-tax profit	187,387	168,644	+11.1%	100.0%	100.0%

## III. Bank of China's pre-tax profit breakdown by businesses

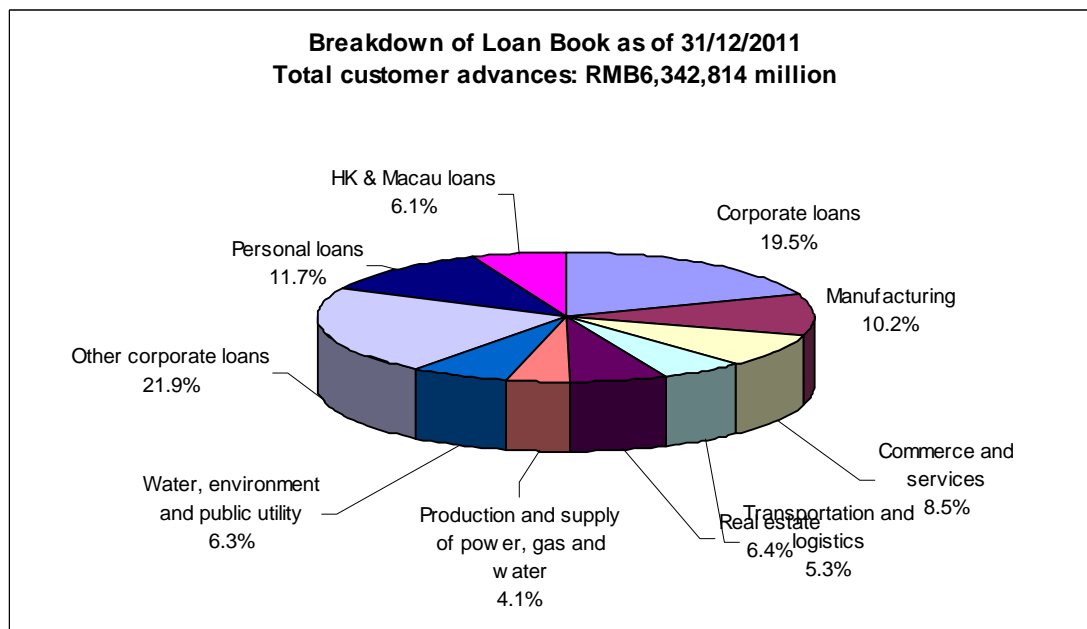
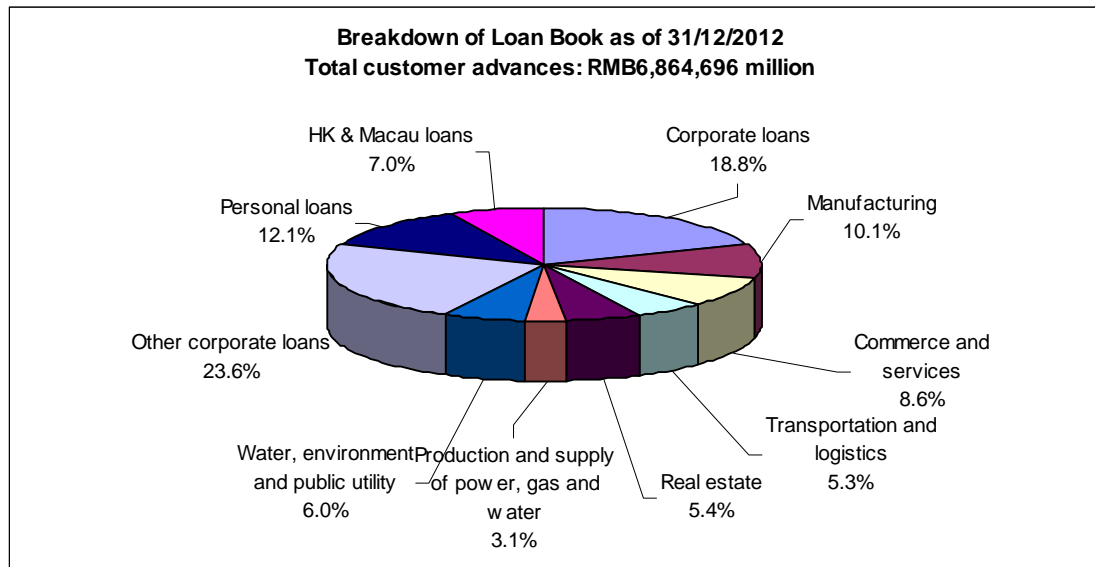
Loans-by industry	31st Dec, 2012 HK\$ million	Up/(down)	31st Dec, 2011 HK\$ million
Corporate loans			
Manufacturing	1,293,806	+4.5%	1,237,694
Commerce and services	693,405	+7.5%	645,276
Transportation and logistics	590,014	+9.7%	537,908
Real estate	362,212	+8.6%	333,434
Production and supply of power, gas and water	372,558	-7.8%	404,103
Water, environment and public utility	215,658	-17.5%	261,377
Other corporate loans	412,869	+3.6%	398,663
Personal loans	1,618,160	+16.3%	1,391,239
HK & Macau loans	828,844	+11.5%	743,233
Overseas operations loans	477,170	+22.4%	389,887
	6,864,696	+8.2%	6,342,814

## IV. Bank of China's pre-tax profit breakdown by regions

Pre-tax profit (RMB million)	FY2012	FY2011	y-o-y (%)	Breakdown FY2012	FY2011
Domestic	152,497	133,421	+14.3%	81.4%	79.1%
HK & Macau	26,696	29,287	-8.8%	14.2%	17.4%
Others	8,187	5,936	+37.9%	4.4%	3.5%
Total pre-tax profit	187,380	168,644	+11.1%	100.0%	100.0%



**Breakdown of loan book of Bank of China**



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