

Analyst: Paul Sham
WING HANG BANK LIMITED (永亨銀行)

Sector	: Banking	Chairman & Chief Executive	: Dr. Patrick Y. B. Fung
HKSE Code	: 0302	Deputy Chief Executive	Mr. Frank J Wang
Market Price	: HK\$102.80 (14/08/2008)		
Shares Issued	: 295.0m		
Mkt. Cap.	: HK\$30,326m		
52 weeks Hi/ Lo	: HK\$121.60 / HK\$80.50		
HSI	: 21,392.71 (14/08/2008)		
Main Business	: Banking and related financial services		

SUMMARY OF THE INTERIM RESULTS FOR THE SIX MONTHS ENDED 30TH JUNE 2008
Interim Results Highlights

	HK\$ million	Vs 1H2007 (%)	Vs 31/12/2007 (%)
• Net interest income	1,310.3	+12.5%	
• Non-interest income	563.4	+15.9%	
• Net losses from financial instruments held for trading & designated at FV through P&L	(7.1)	-71.2%	
• Total operating income	1,873.7	+13.5%	
• Operating expenses	(726.8)	+19.0%	
• Operating profit before impairment losses	1,146.9	+10.3%	
• Impairment losses on loans and advances	(45.2)	-1890.0%	
• Profit before taxation	1,094.9	-1.6%	
• Taxation	(157.3)	+0.9%	
• Attributable profit to shareholders	938.1	-1.9%	
• Total loans	81,439.7	+14.8%	+9.2%
• Total deposits	119,890.4	+8.7%	+2.2%
• Total assets	140,264.8	+4.4%	+0.4%
• Basic EPS (HK\$)	3.18	-2.2%	
• Interim DPS (HK\$)	0.96	+0.0%	
Selected Ratios	1H2008	1H2007	FY2007
• Net interest margin	1.94%	1.92%	1.90%
• Cost-income ratio	38.8%	37.0%	39.7%
• Return on average assets	1.34%	1.52%	1.53%
• Return on average equity	17.7%	19.9%	20.5%
• Impaired loan ratio	0.50%	0.41%	0.44%
• Impaired advances coverage	63.4%	89.7%	74.4%
• Loan-deposit ratio	67.9%	64.3%	63.6%
• Capital adequacy ratio	16.1%	17.2%	16.7%
• Average liquidity ratio	45.1%	52.3%	50.4%

- **Solid 1H08 results helped by large Fair Value gains** Wing Hang Bank (“WHB”) reported 1H08 net profit of HK\$938m, down 1.9% y-o-y, mainly attributable to slower fee-income growth, higher loan impairment losses and a share of the net loss of its associate, Hong Kong Life. The bank also recorded HK\$247m MTM losses on CDOs but they were fully offset by the HK\$348m fair value gain on its own USD subordinated debt due to higher credit spread on credit crunch. DPS were HK\$0.96, representing a payout ratio of 30.2%.

This report has been prepared solely for information purposes and we are not soliciting any action based upon it. Neither this document nor its contents shall be construed as an offer, invitation, advertisement, inducement or representation of any kind or form whatsoever. The information is based upon information which we consider reliable, but accuracy or completeness is not guaranteed. Opinions expressed herein are subject to change without notice. At time of this report, East Asia Securities Company Limited has no position in securities of the company or companies mentioned herein.

- **Moderate growth in net interest income driven by widened NIM & strong loan growth** WHB reported net interest income growth of 12.5% y-o-y. This was partly driven by the 6bps NIM expansion, helped by the expansion in Prime-HIBOR gap in 1H08 and also re-pricing of mortgages. WHB's overall loan portfolio also grew by 9.2% h-o-h during 1H08, particularly in China loans (up 14.9% h-o-h), property-related lending (up 24.7% h-o-h) and transport loans (up 7.3% h-o-h).
- **Mild increase in non-interest income** Net fee income grew at a meagre 2.0% y-o-y, on lower stock-broking fees. WHB also took a MTM loss of HK\$247m on its CDO book and HK\$18m on SIVs, taking the total coverage to 49.1% and 100%, respectively. However, that was almost entirely offset by a MTM gain of HK\$348m on its own subordinated liabilities arising from a change of credit spread, lifting the overall non-interest income up by 15.2%. Despite this, the MTM gain should be just an accounting entry – it will be amortized over the life of the subordinated debt in issue.
- **Cost growth driven by staff costs and expansion** Total operating expenses increased by 19.0% y-o-y due to staff expansion in China & Macau, and mounting wage inflation in Macau. Total headcount was also up 6.5% YTD. Consequently the bank's cost-to-income ratio increased slight from 37.0% a year earlier, to 38.8%.
- **Losses recorded by associated company** Loss from associate of HK\$74m was arisen from Hong Kong Life's poor investment returns, reversing from a share of a net profit of HK\$29.6m in 1H07. Fortunately, revaluation gain on fixed assets of HK\$23.2m partially offset the loss from Hong Kong Life.
- **Mixed pictures in Macau and China** Banco Weng Hang in Macau contributed HK\$170.6m in net profit in 1H08, up 6.0% y-o-y and accounting for 18.2% of WHB's total (1H07: 16.8%). The loan growth in Macau only recorded a muted growth of 1.6% h-o-h. Its strong performance in the previous years seems to be slowing down. In contrast, loans for use in the Mainland increased 14.9% due to continued strong demand. Mainland operation recorded 32.9% y-o-y pre-tax profit growth and contributed 9% of the Group's profit (1H07: 7%).
- **Loan quality deteriorating** WHB reversed from a net write-back in loan loss provisions for 1H07 to a loan impairment charge of HK\$45.2m for 1H08. There was an increase in total impaired advance of 40% y-o-y for 1H08, due mainly to an increase in impaired loans from trade finance and China loans. As a result, the bank's impaired loan ratio increased to 0.50% as of 30 June 2008 and 0.41% as of 31 Dec 2007.
- **Maintained strong profitability among local banks** The bank continued to deliver solid return to shareholders, with ROE of 17.7% 1H08, one of the best among local banks. Meanwhile, CAR stood at 16.1% as of 30 June 2008.

Outlook & Prospects

- **Progressive expansion in China** WHB opened one sub-branch in Shenzhen in 1H08, making a total of three branches and two sub-branches in China at the end of June 2008. Management intends to open one sub-branch in both Shanghai and Guangzhou, and one branch in Zhuhai in 2H08 or 1H09. In the future, WHB will maintain a progressive expansion plan in China, by opening two-to-three outlets per year. We believe this business model fits WHB given its medium-sized operating scale and its focus on expanding its RMB corporate banking business in the Pearl River Delta and key cities in the Yangtze River Delta in the near term. Therefore, we expect WHB to maintain strong China loan growth, contributing larger portion of total net profit for the Group.
- **M&A speculation** It was reported that China Life had approached WHB's controlling shareholders, the Fung family, regarding a potential acquisition. Therefore, M&A cannot be totally ruled out. WHB has strategic appeal given its positioning in Hong Kong, Macau and Guangdong, and the combined stakes of Bank of New York (20%) and the Fung family (estimated at 30%) make it a relatively simple target.
- **Write-downs of CDOs and SIVs largely over** After making an additional provision of HK\$265m for 1H08, WHB's net exposure to CDOs and SIVs was reduced to HK\$267m as at 30 June 2008, accounting for 2.5% of its shareholders' funds. WHB's cumulative provisioning on CDO and SIV were 49.1% and 100% respectively, with all its CDOs being in investment grades. We therefore do not expect further significant MTM losses in 2H08.
- **Slightly over-valued but M&A theme holds** Trading at 14.6x FY08E P/E and 2.67x FY08E P/B, WHB should be one of the most expensive local banks, in terms of valuations, after Hang Seng Bank (superior profitability) and Wing Lung Bank (pending acquired by China Merchants Bank). Given its slowing Macau operations and the uncertain earnings outlook on its HK businesses, we believe that valuation is rich. The only key upside catalysts in the near term would be the possibility of M&A as management of the Bank showed an open-minded attitude towards M&A talks. As such, we maintain our "Neutral" rating for the counter.

Recommendation: *Neutral*

I. Impairment allowances, overdue and rescheduled advances of Wing Hang Bank

As % of total customer advances	Individual allowance	Portfolio allowance	Non-performing loans	Overdue and rescheduled advances
As of 30/6/2008	0.15%	0.16%	0.50%	0.42%
As of 31/12/2007	0.14%	0.18%	0.44%	0.35%
As of 30/6/2007	0.11%	0.26%	0.41%	0.36%

II. Comparison of Wing Hang Bank's loan book: 30/06/2008 vs 31/12/2007

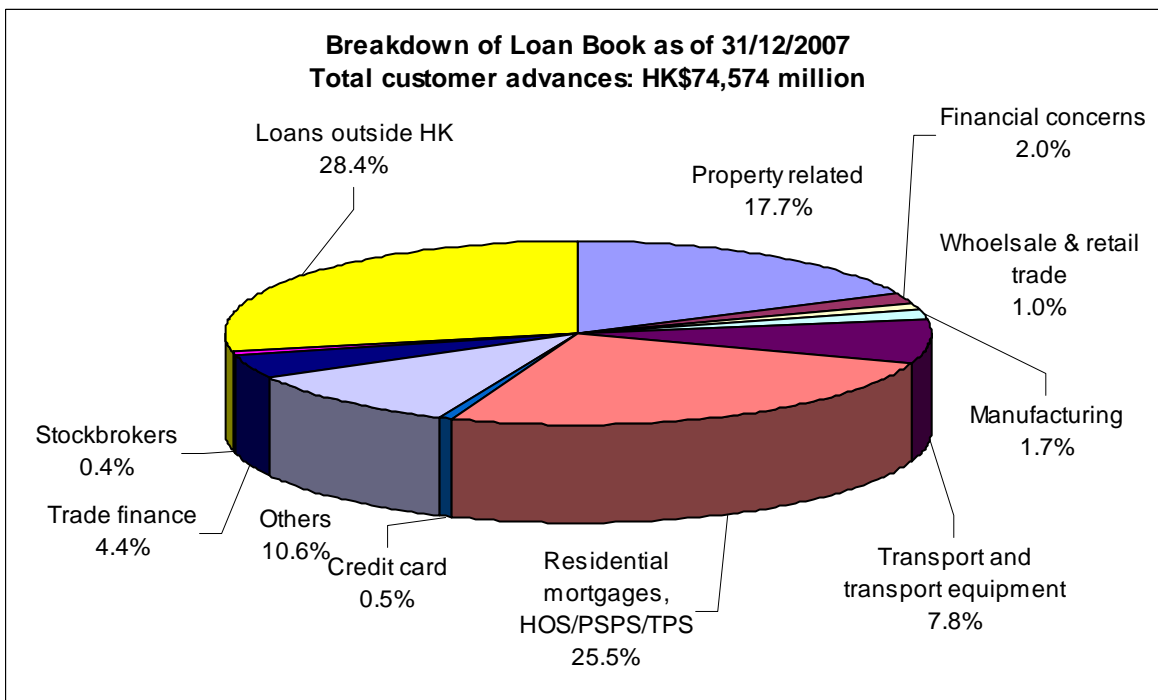
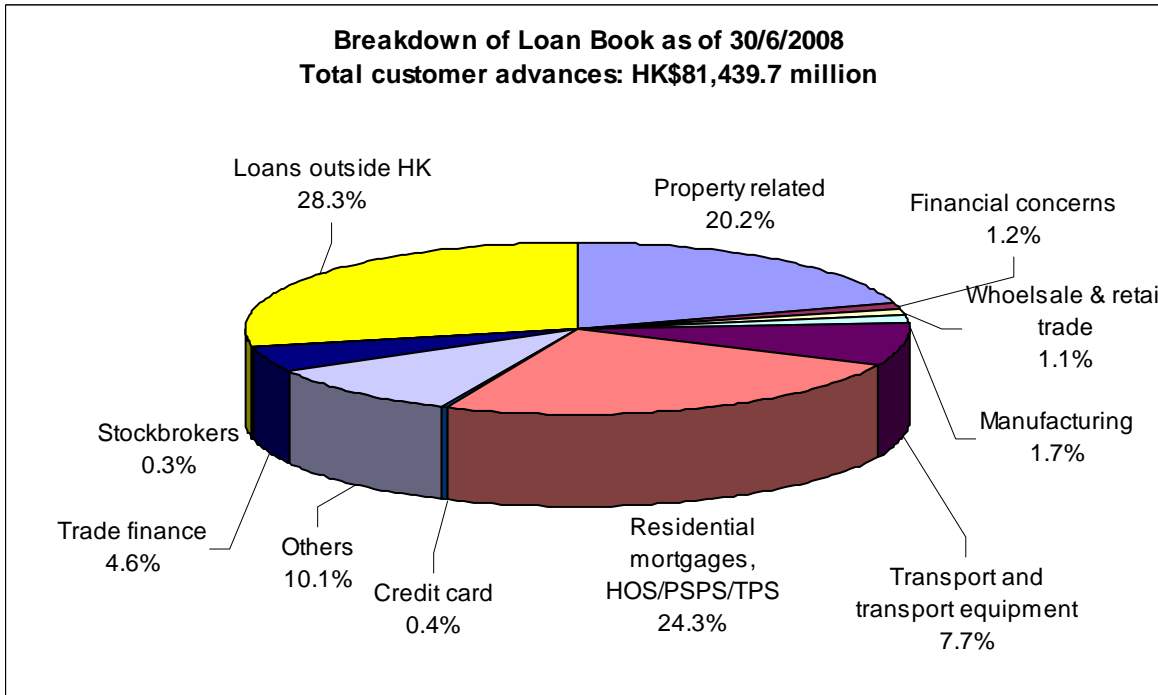
Loans-by industry	30 th June, 2008	Up/(down)	31 st Dec, 2007
	HK\$ million		HK\$ million
Property related	16,485.7	+24.7%	13,219.9
Financial concerns	963.2	-35.4%	1,491.1
Wholesale & retail trade	904.5	+19.4%	757.6
Manufacturing	1,394.6	+10.9%	1,257.8
Transport & transport equipment	6,266.3	+7.3%	5,837.4
Residential mortgages, HOS/PSPS	19,828.6	+4.3%	19,012.6
Credit card	330.7	-11.5%	373.6
Others	8,209.2	+4.3%	7,872.7
Trade finance	3,774.1	+14.9%	3,283.3
Stockbrokers	235.1	-27.2%	323.0
Loans outside HK	23,047.8	+9.0%	21,144.6
	<u>81,439.7</u>	<u>+9.2%</u>	<u>74,573.8</u>

III. Comparison of Wing Hang Bank's loan book: 30/06/2008 vs 30/06/2007

Loans-by industry	30 th June, 2008	Up/(down)	30 th June, 2007
	HK\$ million		HK\$ million
Property related	16,485.7	+33.6%	12,344.2
Financial concerns	963.2	-12.6%	1,101.7
Wholesale & retail trade	904.5	+15.1%	785.7
Manufacturing	1,394.6	-26.6%	1,900.6
Transport & transport equipment	6,266.3	+13.1%	5,541.8
Residential mortgages, HOS/PSPS	19,828.6	+8.7%	18,247.9
Credit card	330.7	+6.9%	309.3
Others	8,209.2	-9.9%	9,115.0
Trade finance	3,774.1	+13.4%	3,327.4
Stockbrokers	235.1	-80.1%	1,179.9
Loans outside HK	23,047.8	+34.9%	17,088.8
	<u>81,439.7</u>	<u>+14.8%</u>	<u>70,942.3</u>



Breakdown of loan book of Wing Hang Bank





Important Disclosure / Analyst Certification / Disclaimer

This document is published by East Asia Securities Company Limited, a wholly-owned subsidiary of The Bank of East Asia, Limited (BEA).

The research analyst primarily responsible for the content of this report, in part or in whole certifies that the views on the companies and their securities mentioned in this report accurately reflect his/her personal views. The analyst also certifies that no part of his/her compensation was, is, or will be, directly, or indirectly, related to specific recommendations or views expressed in this report.

This report has been prepared solely for information purposes and has no intention whatsoever to solicit any action based upon it. Neither this report nor its contents shall be construed as an offer, invitation, advertisement, inducement or representation of any kind or form whatsoever. The information is based upon information, which East Asia Securities Company Limited considers reliable, but accuracy or completeness is not guaranteed. Information and opinions expressed herein reflect a judgment as of the date of this document and are subject to change without notice. Any recommendation contained in this report does not have regard to the specific investment objectives, financial situation and the particular needs of any specific addressee. This report is not to be taken in substitution for the exercise of judgment by respective readers of this report, who should obtain separate legal or financial advice. East Asia Securities Company Limited and / or The BEA Group accepts no liability whatsoever for any direct or consequential loss arising from any use of this report or further communication given in relation to this report.

At time of this report, East Asia Securities Company Limited has no position in securities of the company or companies mentioned herein the report, while BEA along with its affiliates and/or persons associated with any of them may from time to time have interests in the securities mentioned in this report. BEA and its associates, its directors, and/or employees may have positions in, and may effect transactions in securities mentioned herein and may also perform or seek to perform broking, investment banking and other banking services for these companies.

BEA and/or any of its affiliates may beneficially own a total of 1% or more of any class of common equity securities of the subject company or companies mentioned in this report and may, within the past 12 months, have received compensation and/or within the next 3 months seek to obtain compensation for investment banking services from the subject company or companies mentioned in the report.

This document is not directed to, or intended for distribution to or use by, any person or entity who is a citizen or resident of, or located in, any locality, state, country or other jurisdiction, publication, availability or use would be contrary to law and regulation.