

**Analyst: Paul Sham**
**CHONG HING BANK LIMITED (創興銀行)**

|                 |  |                         |                   |
|-----------------|--|-------------------------|-------------------|
| Sector          | : Banking                                | Executive Chairman      | : Mr. Liu Lit Man |
| HKSE Code       | : 1111                                   | Managing Director & CEO | : Mr. Liu Lit Chi |
| Market Price    | : HK\$19.20 (13/08/2008)                 |                         |                   |
| Shares Issued   | : 435m                                   |                         |                   |
| Mkt. Cap.       | : HK\$8,352m                             |                         |                   |
| 52 weeks Hi/ Lo | : HK\$23.40 / HK\$15.32                  |                         |                   |
| HSI             | : 21,304.52 (13/08/2008)                 |                         |                   |
| Main Business   | : Banking and related financial services |                         |                   |

**SUMMARY OF THE INTERIM RESULTS FOR THE SIX MONTHS ENDED 30<sup>TH</sup> JUNE 2008**
**Interim Results Highlights**

|  | HK\$ million   | Vs 1H2007 (%)  | Vs 31/12/2007 (%) |
|--|----------------|----------------|-------------------|
| • Net interest income                                    | 446.6          | +0.1%          |                   |
| • Non-interest income                                    | 201.2          | +2.6%          |                   |
| • Total operating income                                 | 647.8          | +0.9%          |                   |
| • Operating expenses                                     | (354.2)        | +14.6%         |                   |
| • Operating profit before impairment losses              | 293.7          | -11.9%         |                   |
| • Impairment losses on loans and advances                | (36.7)         | -10.7%         |                   |
| • <b>Impairment losses on SIVs</b>                       | <b>(153.2)</b> | <b>NA</b>      |                   |
| • <b>Share of results of jointly controlled entities</b> | <b>(38.3)</b>  | <b>-262.5%</b> |                   |
| • Profit before taxation                                 | 131.1          | -63.2%         |                   |
| • Taxation   | (26.3)         | -52.4%         |                   |
| • <b>Attributable profit to shareholders</b>             | <b>104.8</b>   | <b>-65.1%</b>  |                   |
| • Total loans  | 33,651.9       | +20.6%         | +6.1%             |
| • Total deposits   | 62,923.2       | +9.5%          | +4.3%             |
| • Total assets   | 73,818.5       | +11.1%         | +6.9%             |
| • Basic EPS (HK\$)                                       | 0.24           | -65.2%         |                   |
| • Interim DPS (HK\$)                                     | 0.15           | -28.6%         |                   |
| <b>Selected Ratios</b>                                   | <b>1H2008</b>  | <b>1H2007</b>  | <b>FY2007</b>     |
| • Net interest margin                                    | 1.30%          | 1.38%          | 1.44%             |
| • Cost-income ratio                                      | 54.7%          | 48.1%          | 45.3%             |
| • Return on average assets                               | 0.29%          | 0.93%          | 0.76%             |
| • Return on average equity                               | 3.42%          | 9.70%          | 8.20%             |
| • Impaired loan ratio                                    | 0.51%          | 0.96%          | 0.68%             |
| • Impaired advances coverage                             | 80.5%          | 50.0%          | 62.4%             |
| • Loan-deposit ratio                                     | 53.5%          | 48.5%          | 52.6%             |
| • Capital adequacy ratio                                 | 14.6%          | 15.6%          | 14.2%             |
| • Average liquidity ratio                                | 51.1%          | 55.9%          | 55.8%             |

- **Disappointing bottom-line result** Chong Hing Bank (CHB) announced a net profit of HK\$104.8m for 1H08, down 65.1% y-o-y. The disappointment came from the lower net-interest margin, slower fee-income growth, its impairment loss on SIV holdings and a net loss of HK\$38.3m from its jointly-controlled entities, Hong Kong Life.
- **Net interest income grew at a meagre 0.1%** Net interest margin was down 8 bps y-o-y due to an intentional de-risking move by the bank from debt securities to cash. The balance of cash and short-term funds surged 76.3% from HK\$14,764m at 31 Dec 2007 to HK\$26,028m at 30 June 2008. As a result, the decreased contribution from free funds amid the falling HIBOR, drove the gross interest income down 25.4% y-o-y. With lower deposit rate, the interest expense also fell by 35.8%.

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- **Loan growth remains healthy** Total loans grew 20.6% y-o-y amid continued branch expansion. However, the bank's deposit book expanded at a slower pace, up 9.5% y-o-y. Accordingly, CHB's loan-to-deposit ratio rose to 54.7% as of 30/06/2008 from 48.1% as of 30/06/2007.
- **Unexciting non-interest income growth** Net fees income grew moderately at 9.9% y-o-y. The slowdown in growth of securities-brokerage fees (up 0.5% y-o-y) was offset by strong growth of loan fees (up 19.6% y-o-y), credit-card fees (up 28.1% y-o-y) and agency services (up 53.1% y-o-y). However, net gains on financial assets at fair value through profit & loss narrowed to only HK\$4.5m (1H07: HK\$13.7m), dragging down the overall non-interest income growth to 2.6% y-o-y.
- **Cost-to-income increased amid weak revenue growth** This was largely a result of the full-year effect of the increase in staff costs and rental expenses following the opening of five new branches during 2007. Besides, the company increased its promotional spending on its wealth-management and credit-card businesses. As a result of the weak revenue growth, CHB's cost-income ratio rose from 45.3% for 2007 to 54.4% for 1H08.
- **Insignificant written down value of its SIVs** SIV losses were HK\$153.1m (none in 1H07 and HK\$369.6m in 2H07), taking the cumulative loss to 94%. After impairment provision, the net book value of SIVs was HK\$30m (or 0.04% of total assets).
- **Loss-making joint-venture life-insurance company** CHB's controlled entities for 1H08 decreased by 262.5% to losses of HK\$38.3m from gains of HK\$23.6m for the corresponding period in 2007. This was largely related to the negative investment return from Hong Kong Life.
- **Improvement in loan book quality** CHB's loan quality continued to improve, with its impaired loan ratio declined to 0.51% as of 30/06/2008 from 0.68% as of 31/12/2007. However, a concern arises as most of the new impaired loans came from trade finance, which has a low collateral-coverage ratio of 14.7%.
- **Very weak profitability** CHB's ROA and ROE were 0.29% and 3.42% respectively for 1H08, probably the worst interim results among Hong Kong-based listed banks. CAR remained stable at 14.6%.

### Outlook & Prospects

- **Weak core business but financial health remains** CHB posted a disappointing 1H08 results in almost all its business operations, despite management forecasted that performance in the second half would be better. We see CHB as a weak undifferentiated franchise with no particular strengths among the Hong Kong banks. The only merit remaining is that CHB still maintains a solid financial position, with CAR standing firm at 14.6%.
- **Slow expansion in China and Macau** CHB has only one branch in China, in Shantou, and one branch in Macau. The bank has no plans to set up a subsidiary bank in China or open new branches in Macau. We also see the loans outside HK as a % of total loans, dropped from 10.94% in 2005 to only 6.24% in 1H08, further confirming that the management is not keen on expanding the business in China or Macau.
- **No catalyst except M&A market talks** Management has hinted that the controlling shareholder would sell his stake if offered an attractive price. To pave the way for a stake sale, the bank had been renamed (formerly as Liu Chong Hing Bank) to remove its family-owned element. We see the bank lacks the ambition and clear strategies to differentiate and compete in the highly competitive Hong Kong market, implying that the controlling shareholder was not committed to the bank's development.
- **Unattractive valuations; M&A talks remain the only swinger.** Trading at FY08E P/B of 1.32x and FY08E P/E of 17.6x, the current valuations should have priced in some level of M&A premium. Given the unexciting business outlook and the uncertain M&A timeline, we therefore recommend a "Sell" rating on the counter.

### **Recommendation: Sell**

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**I. Impairment allowances, overdue and rescheduled advances of Chong Hing Bank**

| As % of total customer advances | Individual allowance | Portfolio allowance | Non-performing loans | Overdue and rescheduled advances |
|---------------------------------|----------------------|---------------------|----------------------|----------------------------------|
| <b>As of 30/6/2008</b>          | 0.11%                | 0.30%               | 0.51%                | 1.24%                            |
| <b>As of 31/12/2007</b>         | 0.06%                | 0.37%               | 0.68%                | 1.52%                            |
| <b>As of 30/06/2007</b>         | 0.15%                | 0.34%               | 0.96%                | 3.00%                            |

**II. Comparison of Chong Hing Bank's loan book: 30/06/2008 vs 31/12/2007**

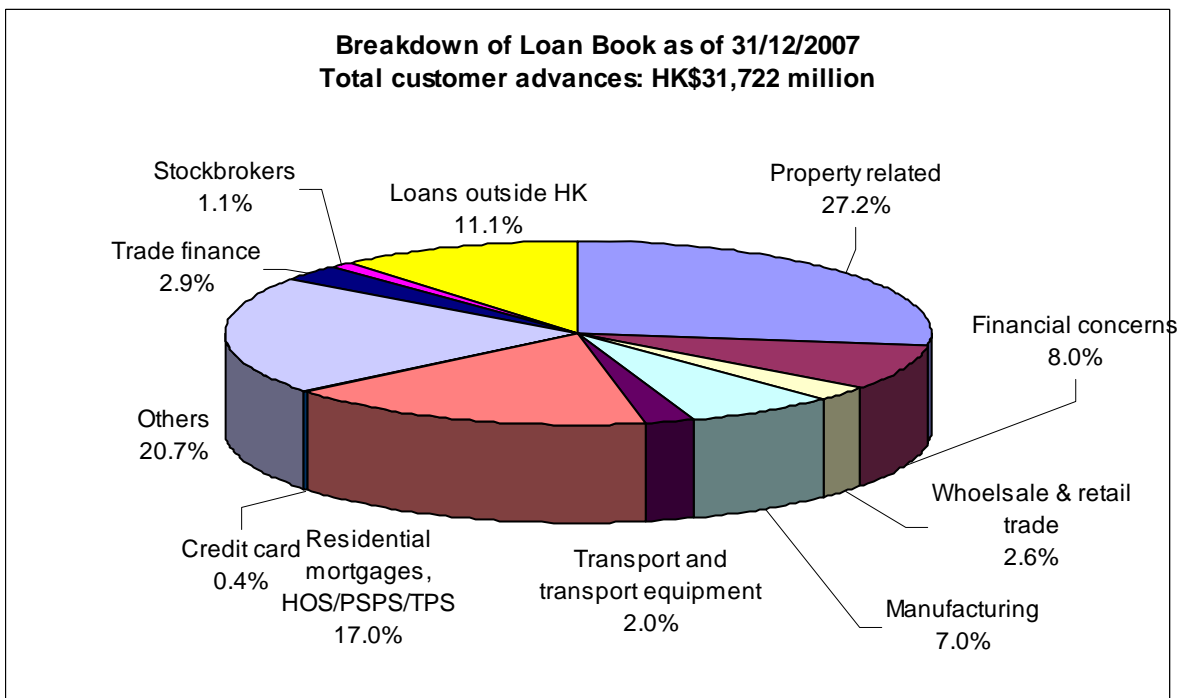
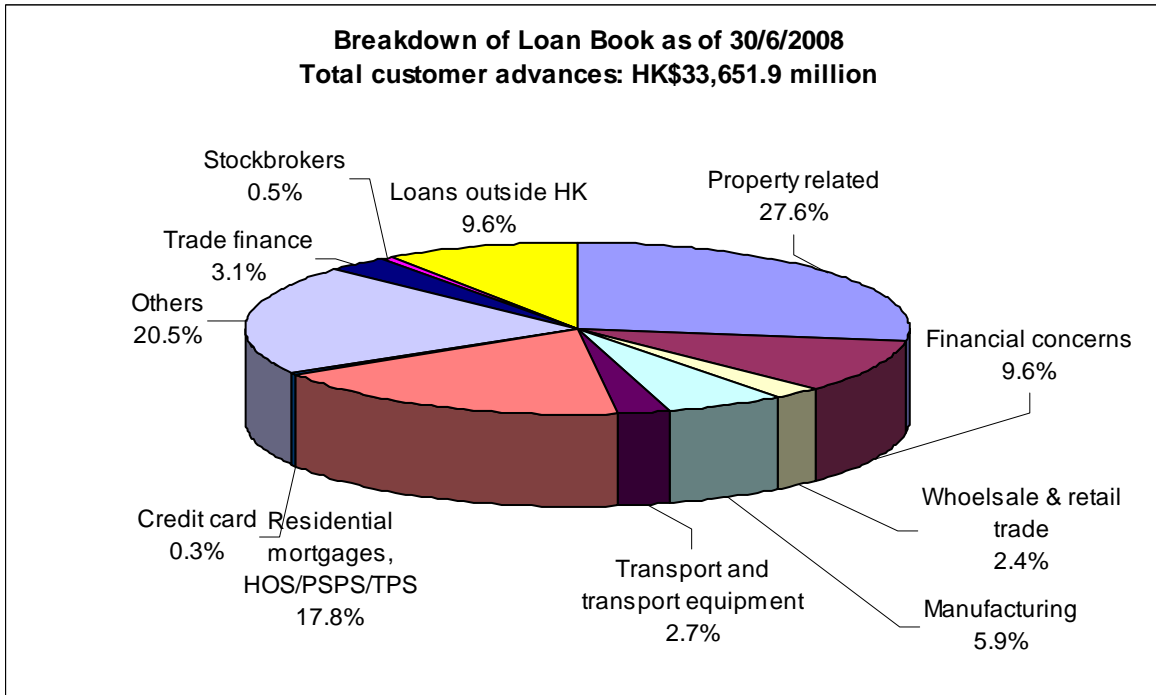
| Loans-by industry               | 30 <sup>th</sup> June, 2008 | Up/(down) | 31 <sup>st</sup> Dec, 2007 |
|---------------------------------|-----------------------------|-----------|----------------------------|
|                                 | HK\$ million                |           | HK\$ million               |
| Property related                | 9,297.0                     | +7.6%     | 8,641.5                    |
| Financial concerns              | 3,222.3                     | +27.7%    | 2,523.7                    |
| Wholesale & retail trade        | 814.1                       | -2.3%     | 833.6                      |
| Manufacturing                   | 1,972.3                     | -11.3%    | 2,224.8                    |
| Transport & transport equipment | 906.5                       | +43.8%    | 630.3                      |
| Residential mortgages, HOS/PSPS | 5,998.3                     | +11.4%    | 5,385.2                    |
| Credit card                     | 91.6                        | -31.4%    | 133.6                      |
| Others                          | 6,911.5                     | +5.5%     | 6,552.9                    |
| Trade finance                   | 1,047.6                     | +14.1%    | 918.5                      |
| Stockbrokers                    | 167.4                       | -51.8%    | 347.4                      |
| Loans outside HK                | 3,223.1                     | -8.7%     | 3,530.3                    |
|                                 | <u>33,651.9</u>             | +6.1%     | <u>31,721.9</u>            |

**III. Comparison of Chong Hing Bank's loan book: 30/06/2008 vs 30/06/2007**

| Loans-by industry               | 30 <sup>th</sup> June, 2008 | Up/(down) | 30 <sup>th</sup> June, 2007 |
|---------------------------------|-----------------------------|-----------|-----------------------------|
|                                 | HK\$ million                |           | HK\$ million                |
| Property related                | 9,297.0                     | +17.7%    | 7,900.2                     |
| Financial concerns              | 3,222.3                     | +72.9%    | 1,864.1                     |
| Wholesale & retail trade        | 814.1                       | -1.5%     | 826.6                       |
| Manufacturing                   | 1,972.3                     | +23.3%    | 1,599.0                     |
| Transport & transport equipment | 906.5                       | +234.8%   | 270.8                       |
| Residential mortgages, HOS/PSPS | 5,998.3                     | +31.3%    | 4,568.3                     |
| Credit card                     | 91.6                        | -8.5%     | 100.2                       |
| Others                          | 6,911.5                     | +23.8%    | 5,584.0                     |
| Trade finance                   | 1,047.6                     | +6.3%     | 985.1                       |
| Stockbrokers                    | 167.4                       | -80.3%    | 850.1                       |
| Loans outside HK                | 3,223.1                     | -3.6%     | 3,344.9                     |
|                                 | <u>33,651.9</u>             | +20.6%    | <u>27,893.4</u>             |



**Breakdown of loan book of Chong Hing Bank**





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