

Analyst: Paul Sham
INDUSTRIAL AND COMMERCIAL BANK OF CHINA LIMITED (中國工商銀行)

Sector	: Banking	Chairman	: Mr. Jiang Jianqing
HKSE Code	: 1398	Vice Chairman & President	: Mr. Yang Kaisheng
Market Price	: HK\$5.12 (21/08/2008)		
Shares Issued	: 83,056.5m (H shares)		
Mkt. Cap.	: HK\$425,249.3m (H shares)		
52 weeks Hi/ Lo	: HK\$7.49 / HK\$4.24		
HSI / HSCEI	: 20,392.06 / 10,916.50 (21/08/2008)		
Main Business	: Banking and related financial services		

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

	RMB million	Vs 1H2007 (%)	Vs 31/12/2007 (%)
• Net interest income	131,785	+28.9%	
• Non-interest income	23,171	+50.7%	
• Total operating income	154,956	+31.8%	
• Operating expenses	(53,193)	+22.0%	
• Operating profit before impairment losses	101,763	+37.5%	
• Impairment losses on loans and advances	(13,648)	-7.6%	
• Profit before taxation	84,411	+44.0%	
• Taxation	(19,532)	+13.5%	
• Attributable profit to equity holders	64,531	+57.3%	
• Total loans	4,355,365	+11.2%	+6.9%
• Total deposits	7,538,748	+12.6%	+9.3%
• Total assets	9,399,384	+13.2%	+8.2%
• Basic EPS (RMB)	0.19	+58.3%	
• Interim DPS (RMB)	0.0	Unchanged	
Selected Ratios	1H2008	1H2007	FY2007
• Net interest margin	3.01%	2.65%	2.80%
• Cost-income ratio	34.3%	37.1%	40.3%
• Return on average assets	1.44%	1.05%	1.02%
• Return on average equity	22.8%	16.9%	16.2%
• NPL ratio	2.41%	3.29%	2.74%
• NPL coverage ratio	116.1%	81.30%	103.5%
• Loan-deposit ratio	57.8%	58.5%	59.0%
• Capital adequacy ratio	12.5%	13.7%	13.1%

- **Steady and solid 1H08 results** Industrial and Commercial Bank of China (“ICBC”) reported a 57.3% y-o-y jump in net profit to RMB 64,531million for 1H08. The result was driven by stable loan growth (+11.2% y-o-y), continuing expansion of NIM (3.01%), strong fee growth (+48% y-o-y) and improvement in asset quality. The application of new income tax rate also contributed to the increase in the profit after tax of ICBC.
- **Increase in net interest income** ICBC saw a 28.9% y-o-y jump in net interest income in 1H08, accounting for 85% of the operating income. NIM of 3.01% in 1H08 was 36bps higher than a year ago and 21 bps higher than 2.80% in FY07. Main drivers to stronger margin were the cumulative effect of upward re-pricing of loan assets, and the lagged impact of rate hikes on average cost of ICBC’s liability.

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- **Healthy loan growth** ICBC's loan book grew by 6.9% h-o-h during 1H08. All-rounded growth was seen in lending to transportation & logistics (+8.9%), power supplies (+13.6%), property development, (+11.4%) retail, wholesale & catering (+11.0%) and leasing & commercial services (+13.1%) sectors. Corporate loans increased by 8.3% h-o-h and accounted for 72.5% of total loans as of 30 June 2008 (31 Dec 2007: 71.6%). Meanwhile, ICBC further reduced its exposure to discounted bills by 21.4% and the lower-yield assets only represented 4.6% of total loans as of 30 June 2008 (31 Dec 2007: 6.2%). Along with a faster 9.3% y-o-y increase in total deposits, loan-to-deposit ratio dropped slightly to 57.8% as of 30 June 2008 from 59.0% as of 31 Dec 2007.
- **Stellar growth in net fee income partly offset by FX loss** Net fee and commission income jumped by 48.0% y-o-y. The businesses of investment banking (+105.6%), asset custody (+186.3%), settlement, clearing and cash management (+56.2%), and guarantees and commitments (+224.4%) maintained a rapid growth, whereas the income growth from wealth management (+2.6% h-o-h) slowed down due to the equity market downturn. On the other hand, ICBC recorded a net loss of RMB1,309m from other non-interest income in 1H08, due to a FX translation loss on accelerated RMB appreciation. As a result, non-interest income grew by 50.7% y-o-y, contributing 14.9% of the operating income.
- **Cost-to-income ratio improved** Total operating expenses rose 22.0% y-o-y in 1H08, primarily driven by a 30.7% increase in staff costs on rising staff compensations. Thanks to a higher 31.8% y-o-y jump in total operating income, cost-to-income ratio improved by 2.8% y-o-y to 34.3%.
- **Continual improvement in loan quality** NPLs and overdue loans fell 5.9% and 9.9%, respectively. NPL ratio fell to 2.41% with coverage ratio rising to 116.1%. Management expects both NPLs and NPL ratio to fall further in 2H08 and coverage ratio to rise moderately to increase its ability to counter potential increase in credit risk.
- **Limited exposure to troubled US mortgage assets** The bank's exposure to US sub-prime residential mortgage-backed securities (MBS), structured investment vehicles (SIVs), Alt-A mortgages, and Fannie Mae & Freddie Mac accounted for 5.7% of the bank's shareholders' equity for 1H08. The nominal values of the above securities investments were US\$1,214m, US\$55m, US\$651m and US\$2,716m, respectively. Without any write-downs on Fannie and Freddie bonds, ICBC made 36.6% provisioning in total for US sub-prime MBS, SIVs and Alt-A mortgages for 1H08.
- **Solid profitability and capital position** The bank's profitability was solid, with ROA and ROE of 1.44% and 22.8% respectively for 1H08. Its CAR stood at 12.5% as of 30 June 2008.

Outlook & Prospects

- **Best distribution network among peers** ICBC has the strongest distribution network of all the banks in China which is a crucial competitive edge in developing retail banking. ICBC has both the largest corporate-banking and retail-banking franchises in terms of assets and deposits, which provide a rich client base and strong client relationships.
- **Strategic relationships with leading foreign players** ICBC has established strategic relationships with leading foreign players in various business areas: Allianz on bancassurance, American Express on high-end retail cards, Goldman Sachs on investment banking and private banking, and Credit Suisse on asset management. We believe these partnerships should help it unlock the value of its distribution network and huge customer base in the long run.
- **Minimal impact on further write-downs** We believe subprime exposure should no longer be a very major issue for ICBC as the provision coverage for its subprime MBS, SIVs and Alt-A mortgage amounted to 37% by 1H08. The remaining net exposure of RMB8.5bn Alt-A, subprime and SIVs is only 5% of 2008 pre-tax profit. As such, further provisions on these exposures will not have any significant impact on ICBC's bottom line.



- **Asset quality is key risk, but ICBC is more protected on balanced loan portfolio** ICBC has a balanced loan portfolio, particularly with lower concentration of property loans, manufacturing loans and loans to southern China (where property prices are reported to be falling and export business concentration is higher), and is thus better downside protected than peers.
- **Building up diversified business model** ICBC is going to acquire a 43.5% stake in a joint venture that China Insurance International Holdings (00966.HK) and Fortis Group will establish. The JV is expected to acquire Tai Ping Insurance, but no details regarding the price consideration were disclosed so far. If the report proves to be true, we believe that it will be positive for ICBC. ICBC has also established a leasing entity and fund management companies. We believe the diversified business model should help ICBC improve its profitability over the long term.
- **Valuation** We continue to view ICBC as a stable play on the China banking sector given its size and market leadership in various categories and strong earnings capacity from retail and fee-based businesses in the long run. However, trading at 2.48x FY08E P/B and 12.3x FY08E P/E, valuations of ICBC is not particularly cheap when compared with China Construction Bank's 2.49x FY08 P/B & 11.8x FY08 P/E. As such, we recommend investors to "Accumulate" the counter on weakness.

Recommendation: *Accumulate on Weakness*

I. Comparison of ICBC's loan book: 30/06/2008 vs 31/12/2007

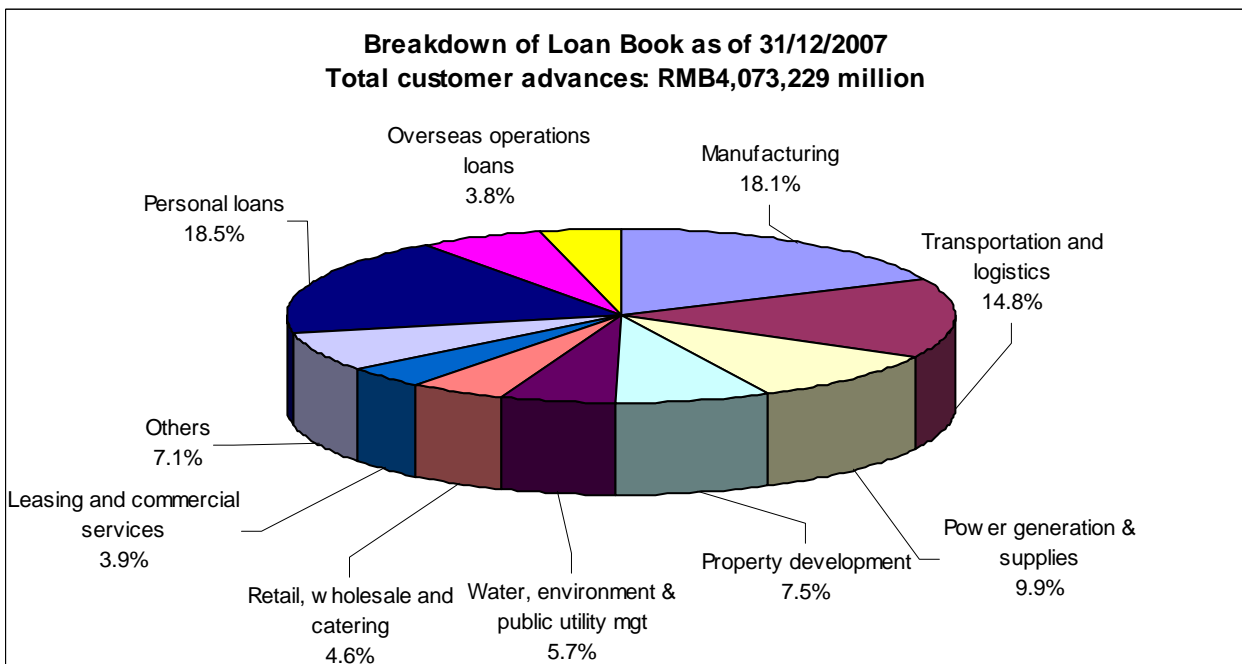
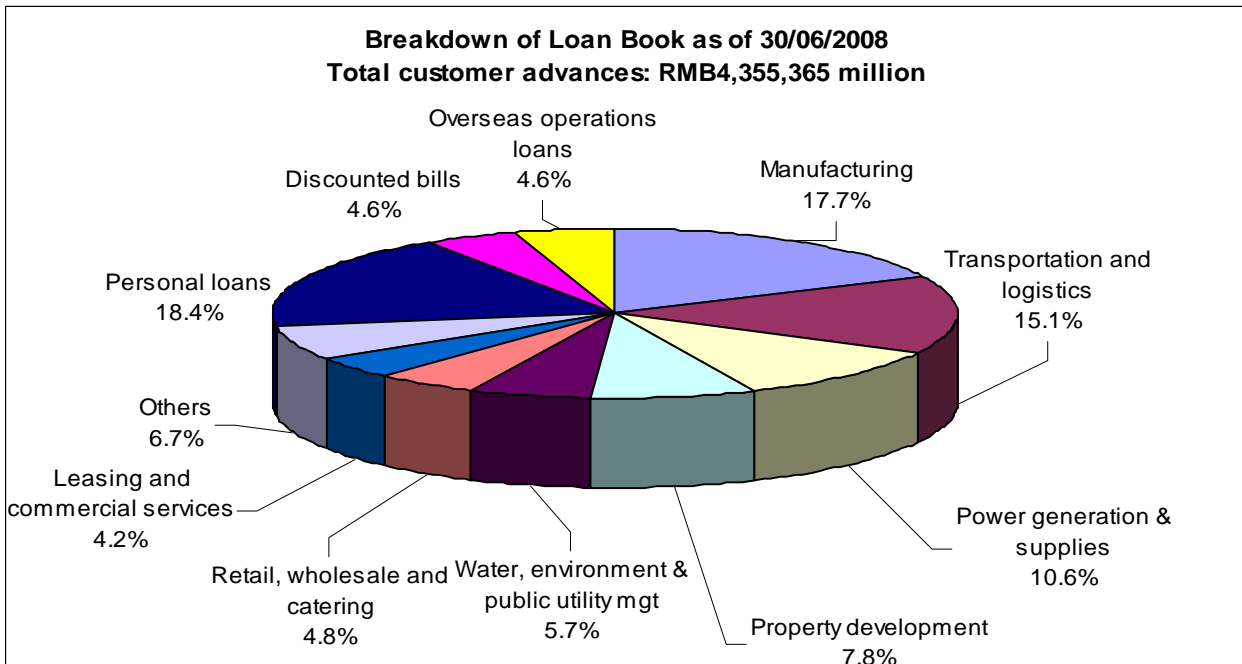
Loans-by industry	30 th Jun, 2008	<i>Up/(down)</i>	31 st Dec, 2007
	RMB million		RMB million
Corporate loans			
<i>Manufacturing</i>	770,770	+4.4%	738,121
<i>Transportation and logistics</i>	655,872	+8.9%	602,103
<i>Power generation & supplies</i>	459,843	+13.6%	404,873
<i>Property development</i>	338,684	+11.4%	303,984
<i>Water, environment & public utility mgt</i>	250,009	+8.6%	230,156
<i>Retail, wholesale and catering</i>	207,465	+11.0%	186,988
<i>Leasing and commercial services</i>	180,789	+13.1%	159,877
<i>Other corporate loans</i>	292,172	+1.1%	288,891
Personal loans	801,128	+6.5%	752,113
Discounted bills	198,208	-21.4%	252,103
Overseas operations loans	200,425	+30.1%	154,020
	4,355,365	+6.9%	4,073,229

II. ICBC's pre-tax profit breakdown by businesses

Pre-tax profit by businesses (RMB million)	Breakdown				
	1H2008	1H2007	<i>y-o-y (%)</i>	1H2008	1H2007
Corporate banking	34,684	24,439	+41.9%	41.1%	41.7%
Personal banking	32,243	21,115	+52.7%	38.2%	36.0%
Treasury operations	18,608	13,450	+38.3%	22.0%	23.0%
Others	(1,124)	(401)	+180.3%	(1.3%)	(0.7%)
Total pre-tax profit	84,411	58,603	+44.0%	100.00%	100.00%



Breakdown of loan book of ICBC





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