

**Analyst: Paul Sham**
**BANK OF COMMUNICATIONS CO., LTD. (交通銀行)**

Sector	: Banking	Chairman	: Mr. Jiang Chaoliang
HKSE Code	: 3328	Vice Chairman & President	: Mr. Li Jun
Market Price	: HK\$9.16 (26/08/2008)		
Shares Issued	: 23,064.5 million (H shares)		
Mkt. Cap.	: HK\$211,270.8 million (H shares)		
52 weeks Hi/ Lo	: HK\$14.92 / HK\$7.60		
HSI / HSCEI	: 21,056.66 / 11,406.64 (26/08/2008)		
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**

	RMB million	Vs 1H2007 (%)	Vs 31/12/2007 (%)
• Net interest income	33,097	+40.6%	
• Non-interest income	4,710	+23.8%	
• Total operating income	37,807	+38.3%	
• Operating expenses	(13,529)	+33.8%	
• Operating profit before impairment losses	24,278	+40.9%	
• Impairment losses on loans and advances	(3,977)	+29.2%	
• Profit before taxation	20,301	+43.8%	
• Taxation	(4,734)	-14.5%	
• <b>Attributable profit to equity holders</b>	<b>15,508</b>	<b>+81.2%</b>	
• Total loans	1,242,297	+9.9%	+12.5%
• Total deposits	1,811,113	+9.6%	+16.4%
• Total assets	2,430,859	+13.8%	+15.2%
• Basic EPS (RMB)	0.32	+77.8%	
• Interim DPS (RMB)	0.10	NA	
<b>Selected Ratios</b>	<b>1H2008</b>	<b>1H2007</b>	<b>FY2007</b>
• Net interest margin	3.22%	2.73%	2.86%
• Cost-income ratio	35.8%	37.0%	40.3%
• Return on average assets	1.37%	0.89%	1.06%
• Return on average equity	22.8%	16.0%	18.2%
• NPL ratio	1.83%	2.06%	2.05%
• NPL coverage ratio	107.6%	85.3%	95.6%
• Loan-deposit ratio	68.6%	68.4%	71.0%
• Capital adequacy ratio	14.1%	14.2%	14.4%

- **1H08 results beat market consensus** First-half 2008 net earnings of Bank of Communications (BoCom), soared 81.2% from a year earlier to RMB15,508m, well ahead of analyst expectations. The increase in net profit was mainly attributable to net interest margin improvement, healthy loan growth and strong fee income growth. BoCom declared an interim dividend of RMB0.11 per share, the first ever among Mainland financials, as the management would like to develop the interim dividend as a norm in the future.
- **Net interest margin (NIM) widened** Net interest income grew by 40.6% y-o-y, thanks to the widened NIM. Compared to 2007, the NIM expanded by 36bps for 1H08, driven by strong pick-ups in both corporate and retail loan yields, due mainly to post-rate-hike re-pricing and strengthened bargaining power. During the same period, the funding costs rose by 32bps, slightly faster than its peers, but the average yield increased at a faster pace by 61bps, leading to an overall widening of NIM.

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- **Healthy loan growth** BoCom's loan book grew by 12.5% h-o-h during 1H08. Corporate loans increased by 11.8% h-o-h and accounted for 81.1% of total loans as of 30 June 2008 (31 Dec 2007: 81.5%). Personal loans rose by 11.2% h-o-h and accounted for 15.4% of total loans as of 30 June 2008 (31 Dec 2007: 15.6%). With a faster 16.4% growth in total deposits, loan-to-deposit ratio dropped a bit to 68.6% as of 30/06/2008.
- **Encouraging fee-income growth** Total fee and commission income grew 42.9% y-o-y. Broad-based growth was seen, with traditional bank fees (cards, settlements, guarantee and commitment) growing 71.4% y-o-y, offsetting the 5.5% fall in wealth management-related income (custodian, funds sales and funds management). The losses arising from trading activities expanded to RMB501m in 1H08 from RMB84m a year earlier, probably due to the adverse capital market condition. As a result, the overall non-interest income recorded a slower growth of 23.8% y-o-y.
- **Improved cost efficiency** Operating expenses rose by 33.8% y-o-y in 1H08. With a faster growth of total operating income (+38.3% y-o-y) outpaced that of operating expenses, cost-to-income ratio improved to 35.8% in 1H08 from 37.0% a year earlier.
- **Loan quality continued to improve** Similar to other China banks, BoCom reported a double decline in NPLs. As of 30 June 2008, NPLs stood at RMB22,684m, down from RMB22,694m at the end of 2007, of which RMB1.09bn were related to the earthquake in Sichuan province in May. The impaired loan ratio also dropped from 2.05% to 1.83% for the corresponding period, representing a decrease of 22bps. The coverage ratio also increased by 12bps from the beginning of the year to 107.6%.
- **Improving profitability** Meanwhile, the bank's profitability improved continuously, with ROA and ROE increasing to 1.37% and 22.8% respectively from 0.89% and 16.0% in 1H07. BoCom's CAR was relatively unchanged, standing firm at 14.1% as of 30 June 2008.

### Outlook & Prospects

- **Strategic cooperation with HSBC** BoCom is working closely with strategic shareholder HSBC (currently holding 18.6% stakes of BoCom) on developing fee-income products. With HSBC being its strategic shareholder, BoCom should have a competitive advantage in maintaining its earning momentum in non-interest income and BoCom's earning should be more resilient amid the unfavourable market condition.
- **Slower growth expected in 2H08 and FY09** During the analyst briefing session, management admitted the unprecedented high rate of profit growth and loan growth of BoCom in the previous years could not be sustained as the NIM is expected to reach the peak of the cycle and the fee-income growth is decelerating after the substantial growth in the past 2 years.
- **Nil exposure in worrisome debt investments** BOC, CNCB, CCB, ICBC and followed by CMB are in descending order of exposures to Freddie and Fannie and subprime-related securities. Meanwhile, BoCom is the only bank within the Chinese banking sector with no exposures on the aforesaid debt investment. Management disclosed that BoCom had holdings of US\$27m in Freddie and Fannie bonds but they have been sold in July 08 without losing money.
- **Premium valuations but lacking niche** BoCom's shares are currently trading at 2.58x FY08E P/B and 13.4x FY08E P/E. We consider valuation of BoCom pricey compared to its peer China CITIC Bank, which is trading at 1.64x FY08E P/B and 11.1x FY08E P/E. We see the premium on the high side given similar earnings growth outlook. As such, we prefer China CITIC Bank to BoCom in the China banking sector.

**Recommendation: Prefer China CITIC Bank**

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**I. Comparison of Bank of Communications' loan book: 30/06/2008 vs 31/12/2007**

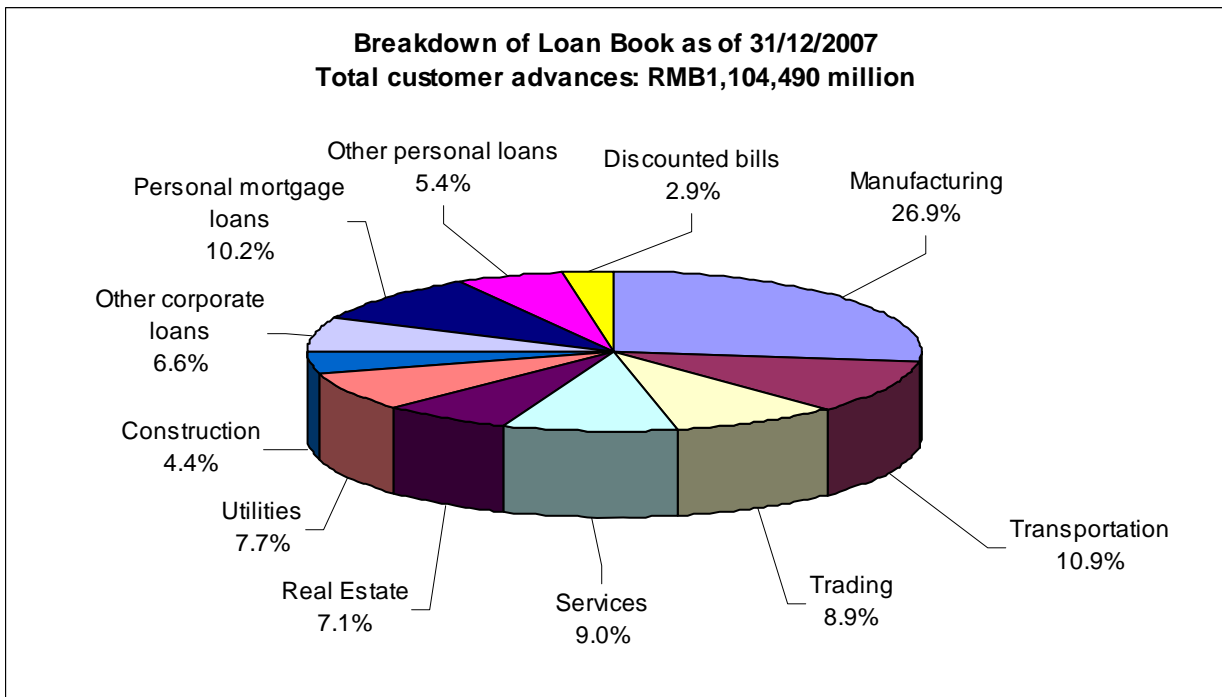
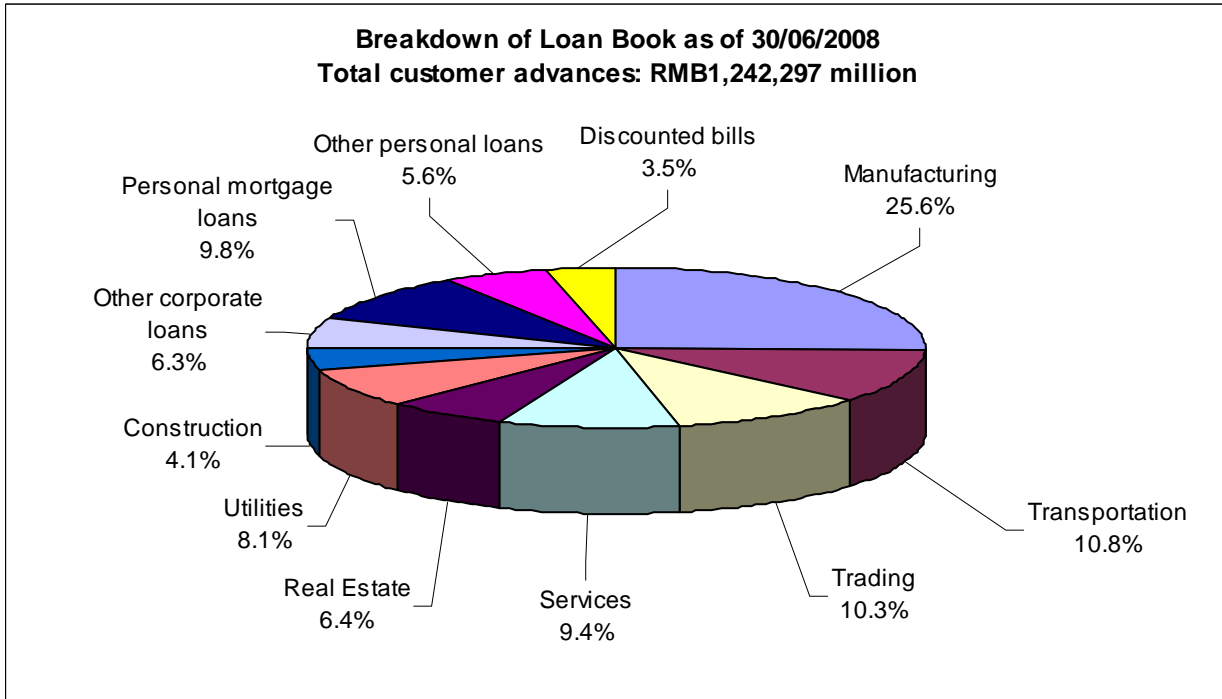
Loans-by sectors	30 <sup>th</sup> Jun, 2008	Up/(down)	31 <sup>st</sup> Dec, 2007
	RMB million		RMB million
Corporate loans			
<i>Manufacturing</i>	318,329	+7.1%	297,168
<i>Transportation</i>	134,265	+11.4%	120,484
<i>Trading</i>	128,267	+30.7%	98,172
<i>Services</i>	116,865	+17.3%	99,617
<i>Real Estate</i>	79,313	+1.6%	78,080
<i>Utilities</i>	100,650	+17.8%	85,457
<i>Construction</i>	51,426	+5.4%	48,805
<i>Other corporate loans</i>	77,982	+7.2%	72,753
Personal mortgage loans	121,645	+7.7%	112,941
Other personal loans	70,118	+17.8%	59,533
Discounted bills	43,437	+38.0%	31,480
	<u>1,242,297</u>	+12.5%	<u>1,104,490</u>

**II. Comparison of Bank of Communications' loan book (by geographies): 30/06/2008 vs 31/12/2007**

Loans-by geographies	30 <sup>th</sup> Jun, 2008	Up/(down)	31 <sup>st</sup> Dec, 2007
	RMB million		RMB million
Northern China	235,102	+12.0%	209,844
Northeastern China	67,712	+5.6%	64,102
Eastern China	503,725	+12.0%	449,780
Central and Southern China	239,562	+7.6%	222,589
Western China	101,057	+7.9%	93,660
Overseas	95,139	+47.5%	64,515
	<u>1,242,297</u>	+12.5%	<u>1,104,490</u>



**Breakdown of loan book of Bank of Communications**





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