

**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\$16.26 (05/03/2008)		
Shares Issued	: 435m		
Mkt. Cap.	: HK\$7,073.1m		
52 weeks Hi/ Lo	: HK\$22.05 / HK\$16.00		
HSI	: 23,114.34 (05/03/2008)		
Main Business	: Banking and related financial services		

### SUMMARY OF THE FINAL RESULTS FOR THE YEAR ENDED 31<sup>ST</sup> DECEMBER 2007

#### Final Results Highlights

	HK\$ million	Vs FY2006 (%)	Vs 30/06/2007 (%)
• Net interest income	970.6	+17.2%	
• Non-interest income	450.1	+49.2%	
• Total operating income	1,420.7	+25.7%	
• Operating expenses	(642.9)	+8.7%	
• Operating profit before impairment losses	777.8	+44.4%	
• Impairment losses on loans and advances	(82.9)	+38.7%	
• <b>Impairment losses AFS securities</b>	<b>(369.6)</b>	N/A	
• Profit before taxation	570.0	-0.2%	
• Taxation	(65.0)	-4.2%	
• <b>Attributable profit to shareholders</b>	<b>505.0</b>	<b>+0.4%</b>	
• Total loans	31,721.9	+18.0%	+13.7%
• Total deposits	60,327.4	+10.3%	+5.0%
• Total assets	69,052.4	+9.6%	+3.9%
• Basic EPS (HK\$)	1.16	+0.0%	
• Final DPS (HK\$)	0.44	+0.0%	
• Total DPS (HK\$)	0.65	+3.2%	
<b>Selected Ratios</b>	<b>FY2007</b>	<b>FY2006</b>	<b>1H2007</b>
• Net interest margin	1.44%	1.51%	1.38%
• Cost-income ratio	45.3%	52.3%	48.1%
• Return on average assets	0.76%	0.89%	0.93%
• Return on average equity	8.20%	8.50%	9.70%
• Impaired loan ratio	0.68%	1.23%	0.96%
• Impaired advances coverage	62.4%	41.4%	50.0%
• Loan-deposit ratio	52.6%	49.2%	48.5%
• Capital adequacy ratio	14.2%	15.6%	15.6%
• Average liquidity ratio	55.8%	55.7%	55.9%

- **FY2007 results below market expectations** Results were just below the low end of market consensus (HK\$650m - HK\$512m). Net profit was flat at HK\$505m, up only 0.4% y-o-y. EPS was HK\$1.16/sh while dividend rose 3.2% y-o-y to HK\$0.65/sh.
- **Bottom line dragged by SIV provisions** CHB held HK\$568m in SIVs at the end of 2007 and required a provision of HK\$369.6m, representing 26% of total operating income. Despite the impairment losses were partly offset by a HK\$177.4m gain on AFS-security disposal, the SIV provisions still eliminated a large portion of the increment in total operating income.

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- **Higher net interest income, but shrinking NIM** Net interest income increased 17.2% y-o-y due to the satisfactory loan growth but net interest margin dropped from 1.51% to 1.44% in FY2007.
- **Property mortgage boosted the loan portfolios** Total loans rose 18.0% during the year as the new mortgage loans drawn down grew strongly by some 160%. In addition, newly approved personal loan increased by some 47% while the tax loan also recorded a twofold increase. As the loan growth outpaced the deposit expansion, the loan-to-deposit ratio rose to 52.6% as of 31/12/2007 from 49.2% as of 31/12/2006.
- **Solid increase in non-interest income** Non-interest income, which accounted for more than 30% of CHB's operating income, grew 49.2% y-o-y, thanks to the brilliant performance of the securities business whose fee income increased 156% y-o-y. Revenue from card business also jumped 38.7% y-o-y on continuous promotion campaigns held throughout the year.
- **Improving cost efficiency** After a jump in expenses in FY2006 due to the opening of new branches and the increasing headcount, total operating expenses recorded only a mild increase of 8.7% in FY2007, driving the cost-to-income ratio down significantly to 45.3% from 52.3% a year earlier.
- **Deteriorating profitability and financial position** Owing to the substantial provisions, CHB's profitability dropped in FY2007, with ROA and ROE down to 0.76% and 8.20% respectively, (FY2006: 0.89% and 8.50%) which is at the bottom of the league among other Hong Kong-based listed banks. The capital adequacy ratio was also lower to 14.2% (31/12/2006: 15.6%).

#### **Outlook & Prospects**

- **Loan growth might slow down** CHB's strong growth in the mortgage loan business in FY2007 was mainly due to its small base number. As mortgage loans represent only a small portion (17% of the loan book, versus around 30% for market lenders such as BOC(HK) and Hang Seng Bank), CHB will not benefit greatly from the booming property market.
- **Limited exposure in the PRC** CHB has limited mainland exposure, with less than 1% of loan book generated from China and obviously, its development of China operations is comparatively slower than its peers. As we do not see any detail expansion plan in FY2007 results announcement, we believe that management's priority is now in Hong Kong, so we expect that CHB will at least take a few more years to bring in significant earning contributions from China.
- **M&As remain a key appeal** With an expanding branch network in Hong Kong to a target 50 outlets, CHB is undoubtedly an attractive potential target for Mainland banks to strengthen the war chest in the matured Hong Kong banking market before "going out". China Construction Bank, which has long been speculated as a possible buyer of Wing Lung Bank, might be also interested in CHB.
- **Unattractive valuations but upside potential remains** CHB is currently valued at 1.13x 2007 P/B and 14.0x 2007 P/E. From our viewpoint, its low ROE of 8.20% reflecting its low profitability could not justify the high P/E ratio. Therefore, we think the current stock prices should have factored the M&A premium and the takeover theme might continue support its share price.

**Recommendation: *Neutral***

**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 31/12/2007</b>	0.06%	0.37%	0.68%	1.52%
<b>As of 30/06/2007</b>	0.15%	0.34%	0.93%	3.00%
<b>As of 31/12/2006</b>	0.12%	0.39%	1.23%	2.62%

**II. Comparison of Chong Hing Bank's loan book: 31/12/2007 vs 31/12/2006**

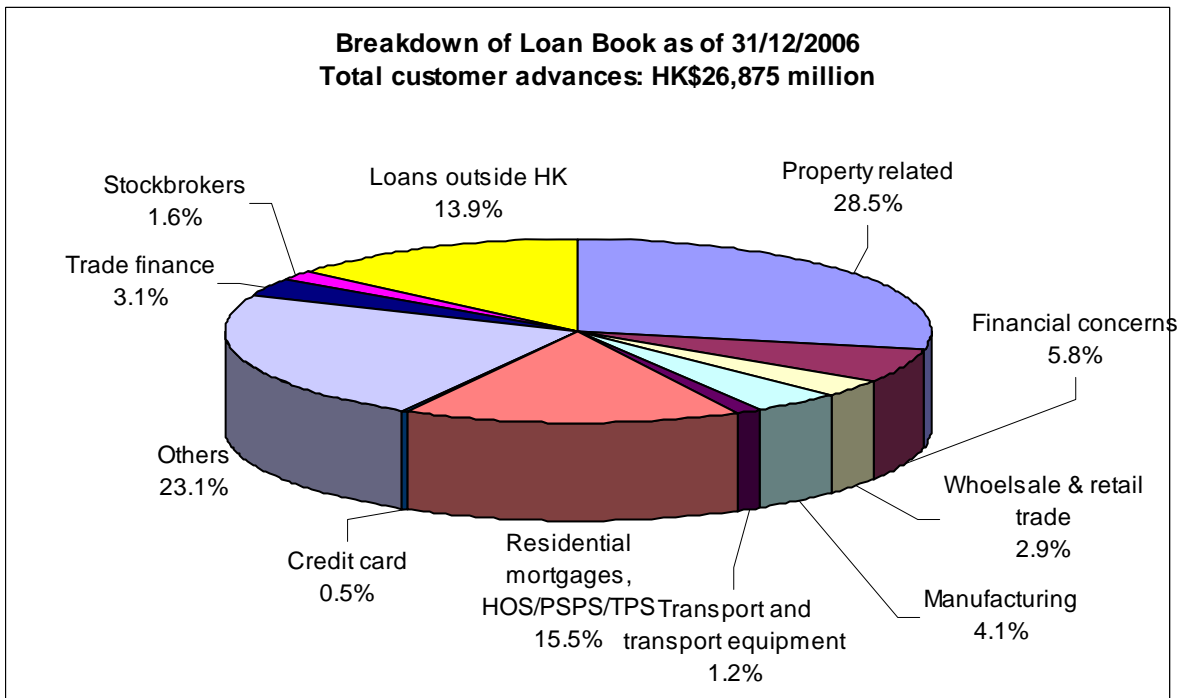
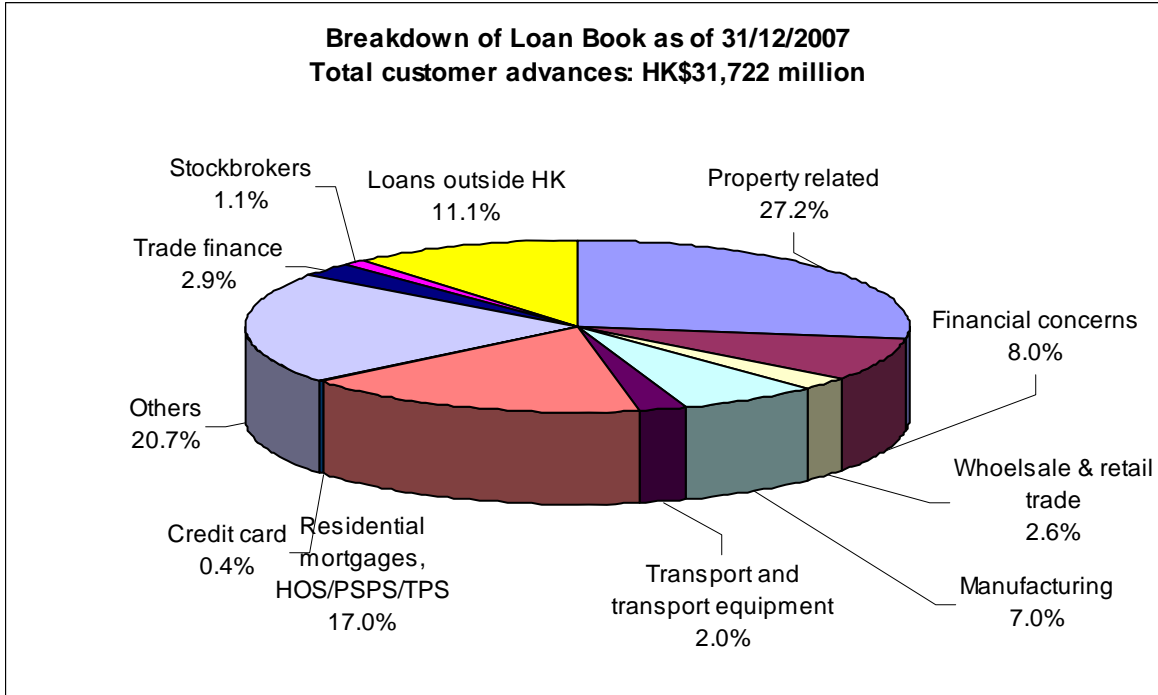
Loans-by industry	31 <sup>st</sup> Dec, 2007 HK\$ million	Up/(down)	31 <sup>st</sup> Dec, 2006 HK\$ million
Property related	8,641.5	+13.0%	7,649.6
Financial concerns	2,523.7	+62.2%	1,555.5
Wholesale & retail trade	833.6	+8.5%	768.4
Manufacturing	2,224.8	+99.6%	1,114.5
Transport & transport equipment	630.3	+93.0%	326.6
Residential mortgages, HOS/PSPS	5,385.2	+29.7%	4,153.0
Credit card	133.6	+4.8%	127.5
Others	6,552.9	+5.7%	6,198.6
Trade finance	918.5	+11.6%	823.2
Stockbrokers	347.4	-17.4%	420.9
Loans outside HK	3,530.3	-5.5%	3,737.0
	<u>31,721.9</u>	<u>+18.0%</u>	<u>26,874.5</u>

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

Loans-by industry	31 <sup>st</sup> Dec, 2007 HK\$ million	Up/(down)	30 <sup>th</sup> June, 2007 HK\$ million
Property related	8,641.5	+9.4%	7,900.2
Financial concerns	2,523.7	+35.4%	1,864.1
Wholesale & retail trade	833.6	+0.8%	826.6
Manufacturing	2,224.8	+39.1%	1,599.0
Transport & transport equipment	630.3	+132.8%	270.8
Residential mortgages, HOS/PSPS	5,385.2	+17.9%	4,568.3
Credit card	133.6	+33.3%	100.2
Others	6,552.9	+17.4%	5,584.0
Trade finance	918.5	-6.8%	985.1
Stockbrokers	347.4	-59.1%	850.1
Loans outside HK	3,530.3	+5.5%	3,344.9
	<u>31,721.9</u>	<u>+13.7%</u>	<u>27,893.4</u>



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





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