

Analyst: Paul Sham
BOC HONG KONG (HOLDINGS) LIMITED (中銀香港)

Sector	: Banking	Chairman	: Mr. Xiao Gang
HKSE Code	: 2388	Vice Chairman & Chief Executive	: Mr. He Guangbei
Market Price	: HK\$18.44 (25/03/2008)		
Shares Issued	: 10,572.8m		
Mkt. Cap.	: HK\$194,962.1m		
52 weeks Hi/ Lo	: HK\$24.10 / HK\$16.02		
HSI	: 22,464.52 (25/03/2008)		
Main Business	: Banking and related financial services		

SUMMARY OF THE FINAL RESULTS FOR THE YEAR ENDED 31ST DECEMBER 2007
Final Results Highlights

	HK\$ million	Vs FY2006 (%)	Vs 30/06/2007 (%)
• Net interest income	19,395	+22.5%	
• Non-interest income	7,859	+43.6%	
• Total operating income	27,254	+27.9%	
• Operating expenses	(7,773)	+18.5%	
• Operating profit before impairment losses	19,481	+32.1%	
• Impairment losses on loans and advances	(1,448)	NA	
• Profit before taxation	19,126	+11.6%	
• Taxation	(3,309)	+15.9%	
• Attributable profit to shareholders	15,446	+10.3%	
• Total loans	413,062	+19.0%	+5.2%
• Total deposits	801,519	+13.5%	-2.0%
• Total assets	1,067,637	+14.9%	+2.0%
• Basic EPS (HK\$)	1.4609	+10.3%	
• Final DPS (HK\$)	0.487	+8.9%	
• Total DPS (HK\$)	0.915	+7.9%	

Selected Ratios

	FY2007	FY2006	1H2007
• Net interest margin	2.07%	1.90%	2.03%
• Cost-income ratio	28.5%	30.8%	28.3%
• Return on average assets	1.53%	1.56%	1.57%
• Return on average equity	17.4%	17.0%	17.3%
• Impaired loan ratio	0.44%	0.57%	0.41%
• Impaired advances coverage	76.8%	55.5%	70.2%
• Loan-deposit ratio	51.5%	49.1%	48.0%
• Capital adequacy ratio	13.1%	15.7%	14.3%
• Average liquidity ratio	50.9%	50.5%	50.1%

- **FY2007 above market expectations** Bank of China (Hong Kong) (BOCHK) posted a net profit of HK\$15,446m for FY2007, up 10.3% y-o-y and was 7% above the market forecast of HK\$14,439m. Key earnings drivers include: strong loan growth, widening net interest margin and robust fee income. Similar to other local lenders, BOCHK's bottom line was dragged by the substantial impairment losses for its investment in US asset-backed securities (ABS).
- **NIM widened** Net-interest income rose by 22.5% y-o-y, on the back of a 17 bps y-o-y rise in the net interest margin to 2.07%, benefiting from a wider prime-HIBOR spread for 2H07 and more active asset liability management.

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- **Strong loan growth** Loans and advances were up 19% y-o-y, with domestic loans increasing 13.3% y-o-y, while overseas loans rose by 48.6%. The stronger growth in overseas loans was due principally to the loan growth of the Group's Mainland branches. For domestic loans, trade finance grew strongly by 43.9%, thanks to the Group's intense promotional efforts, and the robust import and export trade.
- **Non-interest income surged** Fee income recorded 64.0% y-o-y growth, driven by booming brokerage fees (+157% y-o-y) and asset-management income (+116%), benefiting from the robust stock market in FY07. Net insurance premium income from BOC Life (unlisted) also saw a 36.0% y-o-y growth due to its successful brand building, marketing and service enhancement.
- **Effective cost control** Operating expenses grew 18.5% y-o-y in 2007, mainly due to an increase in staff salaries which rose by 16.3% or HK\$652m after pay rise. With operating profit before impairment losses grew by 32% to HK\$19,481 million, cost-income ratio of BOCHK fell from 30.8% in 2006 to 28.5% in 2007, which was low by industry standards.
- **Reduction in subprime exposure** BOCHK made impairment losses of HK\$2,133m for its debt securities and substantially reduced its exposure (through disposals and repayments) to sub-prime ABS, which fell from HK\$15,809m at the end of 2006 to HK\$4,118m at the end of 2007. BOCHK's net-of-provision exposure to subprime ABS was reduced to 4.4% of shareholders' funds, compared with 18.7% a year earlier.
- **Contributions from PRC branches** Pre-provision operating profit of BOCHK's 15 PRC branches registered a 52.0% increase in FY2007. Pre-tax profit rose by a moderate 39.7% to HK\$584m, representing 3.1% of the bank's total.
- **Asset quality improved** BOCHK recorded lower bad-debt recoveries, resulting in a net credit of HK\$685m to the P&L account for loan-impairment allowances, compared with HK\$1,790m for 2006. The NPL ratio fell to 0.44% at the end of June 2007, from 0.57% at the end of 2006. We think that the recoveries from big accounts are now almost completed, and therefore expect much lower recoveries going forward.
- **Stable profitability and healthy financial position** ROA and ROE was 1.53% and 17.4% respectively in FY2007 (FY2006: 1.567% and 17.0%). Meanwhile, BOCHK's CAR declined to 13.1% as of 31/12/2007 due to the implementation of Basel II in 2007 as well as the direct capital deduction re. its some 4.9% interest in BEA shares.

Outlook & Prospects

- **Limited room for margin widening** Continuous cut in US\$ rate would likely hit the net interest margin of banks in HK, especially BOCHK, whose residential mortgages comprised over 30% of loan portfolio. Despite this negative factor will be partially offset by the continued diversification of the loan portfolio into SME and consumer loans, we expect BOCHK's net interest margin to decline in 2008.
- **Not very exciting outlook for non-interest income** One of the key drivers of earnings growth for BOCHK in FY07 was the strong fees income growth. The biggest driver was brokerage income, which was up 157% in FY2007 and made up 43.5% of gross fees. We expect continued strength in fees from other activities like insurance on BOCHK's extensive branch network, but we expect slowdown in brokerage revenues – which causes overall non-interest income to decline marginally in 2008.
- **Improving outlook for Mainland business** BOCHK's 15 mainland branches' pre-tax profit went up 39.7% to HK\$584m. Performance of these branches was disappointing in the past but the situation has improved. The incorporation of the 8 mainland branches under the "Nangyang Commercial Bank (China)" brand should further boost profits from mainland. Despite this, as of FY2007, these branches only contributed 3% to the Group's pre-tax profit. Competitors such as BEA and Hang Seng have already expanded at a much faster rate.
- **Share-price to be supported by decent yield** The counter has retreated by more than 20% from its peak in Jan 08 and is currently trading at 2.10x FY2007 P/B and 12.6x FY2007 P/E. We remain cautious on the sustainability of the underlying profits of BOCHK in the medium term. However, the close to 5% FY08 estimated dividend yield of the counter should give good support to its share price.

Recommendation: *Hold*

I. Impairment allowances, overdue and rescheduled advances of BOC Hong Kong

As % of total customer advances	Individual allowance	Portfolio allowance	Non-performing loans	Overdue and rescheduled advances
As of 31/12/2007	0.09%	0.24%	0.44%	0.30%
As of 30/06/2007	0.12%	0.17%	0.41%	0.31%
As of 31/12/2006	0.16%	0.16%	0.57%	0.45%

II. Comparison of BOC Hong Kong's loan book: 31/12/2007 vs 31/12/2006

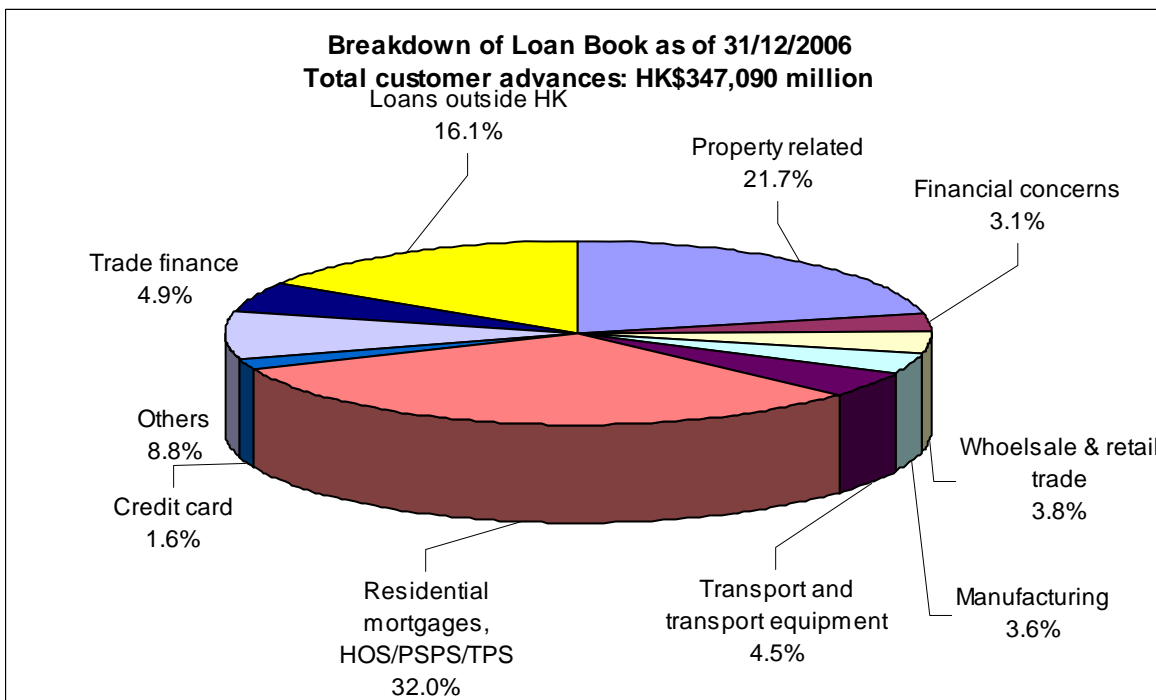
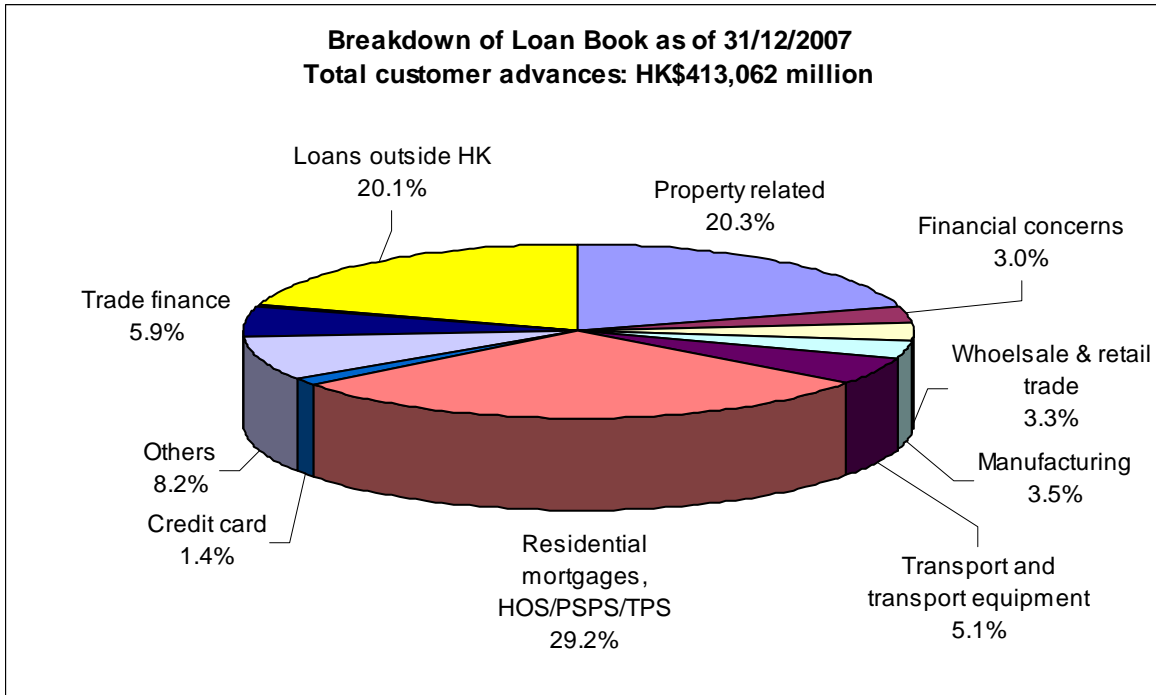
Loans-by industry	31 st Dec, 2007	Up/(down)	31 st Dec, 2006
	HK\$ million		HK\$ million
Property related	83,942	+11.6%	75,233
Financial concerns	12,346	+15.2%	10,721
Wholesale & retail trade	13,572	+4.2%	13,019
Manufacturing	14,468	+16.5%	12,417
Transport & transport equipment	21,001	+35.1%	15,548
Residential mortgages, HOS/PSPS	120,552	+8.4%	111,189
Credit card	5,761	+4.9%	5,490
Others	33,793	+10.4%	30,608
Trade finance	24,275	+43.9%	16,865
Stockbrokers	242	+272.3%	65
Loans outside HK	83,110	+48.6%	55,935
	<u>413,062</u>	<u>+19.0%</u>	<u>347,090</u>

III. Comparison of BOC Hong Kong's loan book: 31/12/2007 vs 30/06/2007

Loans-by industry	31 st Dec, 2007	Up/(down)	30 th June, 2007
	HK\$ million		HK\$ million
Property related	83,942	+3.8%	80,890
Financial concerns	12,346	+6.8%	11,565
Wholesale & retail trade	13,572	+5.3%	12,891
Manufacturing	14,468	+4.8%	13,801
Transport & transport equipment	21,001	+4.8%	20,030
Residential mortgages, HOS/PSPS	120,552	+5.5%	114,232
Credit card	5,761	+3.3%	5,578
Others	33,793	-10.9%	37,944
Trade finance	24,275	+12.4%	21,598
Stockbrokers	242	-97.0%	8,192
Loans outside HK	83,110	+25.8%	66,090
	<u>413,062</u>	<u>+5.2%</u>	<u>392,811</u>



Breakdown of loan book of BOC Hong Kong





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