

Analyst: Paul Sham
BANK OF CHINA LIMITED (中國銀行)

Sector	: Banking	Chairman	: Mr. Xiao Gang
HKSE Code	: 3988	Vice Chairman & President	: Mr. Li Lihui
Market Price	: HK\$3.24 (25/03/2008)		
Shares Issued	: 76,020.3m (H share)		
Mkt. Cap.	: HK\$246,305.8m (H share)		
52 weeks Hi/ Lo	: HK\$5.27 / HK\$2.91		
HSI / HSCEI	: 22,464.52 / 11727.00 (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

	RMB million	Vs FY2006 (%)	Vs 30/06/2007 (%)
• Net interest income	152,745	+25.8%	
• Non-interest income	29,967	+11.0%	
• Total operating income	182,712	+23.1%	
• Operating expenses	(85,026)	+23.7%	
• Operating profit before impairment losses	97,686	+22.6%	
• Impairment losses on loans and advances	(8,252)	-33.1%	
• Profit before taxation	90,697	+33.5%	
• Taxation	(28,661)	+45.7%	
• Attributable profit to equity holders	56,248	+31.3%	
• Total loans	2,850,561	+17.2%	+6.7%
• Total deposits	4,400,111	+7.6%	+1.1%
• Total assets	5,991,217	+12.5%	+2.7%
• Basic EPS (RMB)	0.22	+22.2%	
• Final DPS (RMB)	0.10	+150.0%	
• Total DPS (RMB)	0.10	+150.0%	
Selected Ratios	FY2007	FY2006	1H2007
• Net interest margin	2.76%	2.45%	2.66%
• Cost-income ratio	46.5%	46.3%	37.3%
• Return on average assets	1.10%	0.96%	1.16%
• Return on average equity	14.0%	14.1%	15.2%
• NPL ratio	3.17%	4.24%	3.72%
• NPL coverage ratio	106.4%	91.3%	99.5%
• Loan-deposit ratio	64.8%	59.4%	61.4%
• Capital adequacy ratio	13.3%	13.6%	13.4%
• Liquidity ratio (RMB portion)	32.6%	37.7%	36.1%
• Liquidity ratio (Foreign currency portion)	75.9%	64.1%	68.6%

- **FY2007 results slightly above expectations** Bank of China (BOC) reported a growth in net profit of 31.3% y-o-y to RMB56,248 million for FY2007. The result was slightly higher than the market expectations of RMB53,461 million. The positive surprise came from widened net interest margin, strong fee income and lower credit cost. Its 65.77%-owned BOCHK (2388) contributed RMB9,917m (FY2006: RMB9,448m) or 17.6% (FY2006: 22.1%) of BOC's bottom line,
- **Non-interest income dragged by provisions for U.S. Sub-prime investments** BOC's investments in U.S. sub-prime asset-backed securities (ABS) and mortgage backed securities (MBS) recorded a combined impairment allowance of RMB11.6b, significantly dragging down its non-interest income and the overall earnings.

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- **Strong performance of net interest income** Net interest income rose 25.8% y-o-y to RMB152.7b in FY07, with net interest margin expanding significantly by 31 bps to 2.76%. Management attributed the better NIM to the improved yields on loans and investments on rising interest rates and migration of deposits from time deposits to demand deposits.
- **Healthy loan growth** Domestic loan growth was also encouraging, up 16.3% y-o-y in 2007. Domestic personal loan growth, which was primarily driven by personal mortgages, was also up 32%, outpacing the 11.9% growth in domestic corporate loan, and as a result, boosting the ratio of retail loans to total loans to 25.3% in FY07 Vs 22.3% in FY06. However, management expects loan growth would slow in 2008 as the government is determined to apply austerity measures to curb inflation.
- **Respectable increase in non-interest income** Net fee and commission income surged by 91.9%, driven by agency fees (up 211%), settlement and clearing fees (up 26%) and bankcard fees (up 26.7%). We believe the growth of agency fees should slow in 2008 on lower stock market turnover.
- **Cost efficiency improved** BOC's total expense grew 23.7%, resulting in a flat cost-to-income ratio of 46.5%. The staff cost and G&A expense increased by 17% and 33% respectively, accounting for a combined 68.2% of total operating expenses.
- **Sub-prime exposure in ABS and MBS** BOC's sub-prime ABS exposure was reduced to RMB36.5b as of 31/12/2007, accounting for about 8.7% of its year-end shareholders' equity, of which 71% was AAA rated. BOC recorded impairment allowances totalling RMB9.5 billion on its ABS investments in FY07. In addition, BOC made a RMB2.1 billion provision on its MBS securities and its carrying value amounted to RMB18.0 billion (98% was AAA rated) as of 31/12/2007.
- **Loan quality improved** Asset quality of BIC continued improving. Impaired loan balance was down 12.5% to RMB90.3 billion whilst impaired loan ratio was down to 3.17% from 4.24% at 2006 year end.
- **Sustainable profitability and capital position** The ROE and ROA of BOC was 14.0% and 1.10% respectively in FY2007 (2006: ROE 14.1%, ROA 0.96%). Meanwhile, the CAR of BOC also maintained at 13.3% as of 31/12/2007, compared with 13.6% as of 31/12/2006.

Outlook & Prospects

- **Not a pure China play** Even though austerity measures are likely to be pushed forward in 2008, we remain positive on the fundamentals and the performance of Chinese banks due to the strong economic growth of China. Comparatively speaking, BOC is not considered a pure China play because it has about 42% of its net profit from overseas (mainly Hong Kong and Macau). As a result, BOC should benefit in a lesser extent than its peers such as ICBC and CCB in the long run.
- **Momentum might slow down due to sub-prime exposure** Similar to its peers, we see the wealth management and fund custodian fees of BOC should decline in 2008 amid the weak A-share market. Furthermore, given the size of its US sub-prime exposure is still large (net exposure of RMB54.5b), we are concerned about the possibility of further provision required on those sub-prime exposures if the credit markets further deteriorate.
- **Reducing foreign exchange risk** BOC has reduced the net foreign currency open position from US\$15.7b at the end of 2006 to US\$4.1b at the end of 2007. We therefore expect foreign exchange loss would not constitute a concern for BOC in 2008.
- **Valuations reflected the negatives** BOC is currently trading at 1.96x FY2007 P/B and 14.7x FY07 P/E, which is at discount to H-share banks' average. We believe the aforesaid negative factors should have been reflected in the share price. We therefore recommend investors to "Accumulate" the counter.

Recommendation: Accumulate

I. Impaired loans and special-mention loans of Bank of China

As % of total customer advances	Impaired loans	Special mention loans
As of 31/12/2007	3.17%	5.08%
As of 30/06/2007	3.72%	6.47%
As of 31/12/2006	4.24%	8.15%

II. Comparison of Bank of China'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		RMB million
Manufacturing	629,327	+13.2%	556,032
Other corporate loans	1,100,845	+11.1%	990,788
Personal mortgage loans	454,984	+34.7%	337,834
Other personal loans	130,549	+23.5%	105,746
Loans for overseas operations	534,856	+21.1%	441,619
	2,850,561	+17.2%	2,432,019

III. Bank of China's operating profit breakdown by businesses

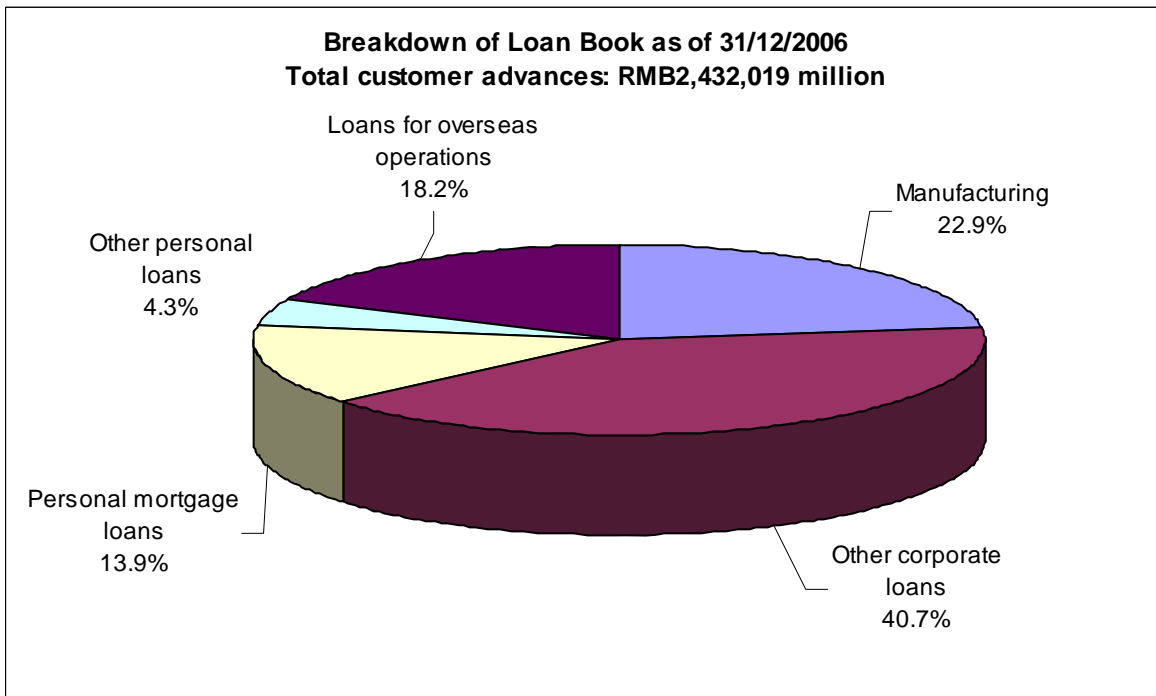
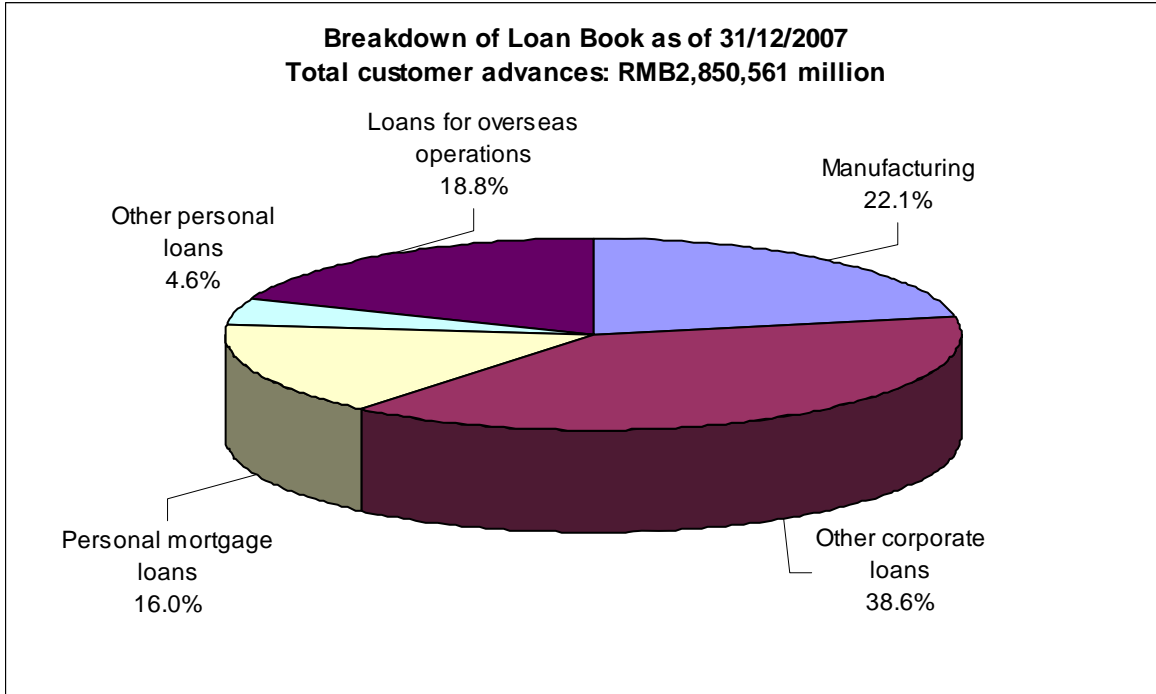
Operating profit by businesses (RMB million)				Breakdown	
	FY2007	FY2006	y-o-y (%)	FY2007	FY2006
Corporate banking	47,620	29,084	+63.7%	53.2%	43.2%
Personal banking	26,707	20,590	+29.7%	29.9%	30.6%
Treasury operations	5,995	13,718	-56.3%	6.7%	20.4%
Commercial banking	80,322	63,392	+26.7%	89.8%	94.2%
Investment banking	1,384	1,055	+31.2%	1.5%	1.6%
Insurance	233	581	-59.9%	0.3%	0.9%
Others	7,495	2,277	+229.2%	8.4%	3.4%
Total operating profit	89,434	67,305	+32.9%	100.0%	100.0%

IV. Bank of China's pre-tax profit breakdown by businesses

Pre-tax profit (RMB million)				Breakdown	
	FY2007	FY2006	y-o-y (%)	FY2007	FY2006
Domestic	60,408	42,607	+41.8%	66.6%	62.7%
HK & Macau	28,316	24,388	+16.1%	31.2%	35.9%
Other overseas	1,973	942	+109.4%	2.2%	1.4%
Total pre-tax profit	90,697	67,937	+33.5%	100.0%	100.0%



Breakdown of loan book of Bank of China





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