

THE BANK OF EAST ASIA, LIMITED (東亞銀行)

Sector	: Banking
HKSE Code	: 0023
Market Price	: HK\$24.70 (10/02/2006)
Shares Issued	: 1,510.229 million
Mkt. Cap.	: HK\$37,302.67 million
52 weeks Hi/Lo	: HK\$24.80 / HK\$22.30
HSI	: 15,425.95 (10/02/2006)
Main Business	: Banking and related financial services

Chairman & Chief Executive : Dr. David Li Kwok-po

 Executive Directors &
 Deputy Chief Executives : Mr. Joseph Pang Yuk-wing
 Mr. Chan Kay-cheung

SUMMARY OF THE FINAL RESULTS FOR THE YEAR ENDED 31ST DECEMBER 2005
Final Results Highlights

	HK\$ million	Vs FY2004 (%)	Vs 30/06/2005 (%)
• Net interest income	3,760.3	+4.0%	
• Non-interest income	2,192.3	+16.5%	
• Total operating income	5,952.5	+8.3%	
• Operating expenses	(2,988.0)	+8.2%	
• Operating profit before impairment losses	2,964.5	+8.4%	
• Impairment losses on loans and advances	(141.5)	N/A	
• Attributable profit to equity holders	2,748.7	+17.1%	
• Total loans	138,744	+18.3%	+8.0%
• Total deposits	182,326	+8.6%	+9.2%
• Total assets	238,799	+13.5%	+12.5%
• Basic EPS (HK\$)	HK\$1.83	+15.1%	
• Final DPS (HK\$)	HK\$0.93	+16.3%	
• Total DPS (HK\$)	HK\$1.26	+16.7%	

Selected Ratios

	FY2005	FY2004	6 months ended 30/06/2005
• Net interest margin	1.85%	1.95%	1.76%
• Impaired loan ratio (<i>NPL ratio</i> *)	0.91%	1.35% (*)	1.17%
• Impaired advances coverage (<i>NPL coverage</i> *)	54.0%	104.6% (*)	46.9%
• Return on average assets	1.28%	1.19%	1.14%
• Return on average equity	12.22%	11.51%	10.91%
• Loan-deposit ratio	76.1%	69.8%	76.9%
• Cost-income ratio	50.2%	50.3%	51.2%
• Capital adequacy ratio	17.4%	16.2%	15.6%
• Average liquidity ratio	39.3%	44.4%	39.5%

- **FY2005 results beat forecast** The Bank of East Asia ("BEA") reported a 17.1% y-o-y rise in net attributable profit to HK\$2.75 billion for the year ended 31/12/2005 from a revised HK\$2.35 billion a year earlier, beating market expectations of HK\$2.5 billion. Earnings growth in FY2005 was driven by trading gains, lower bad loan charges and disposal gains on properties.
- **Dividend payout at 69%** Basic earnings per share for FY2005 was HK\$1.83, while the Bank proposed a final dividend of HK\$0.93 per share, bringing the full-year payout ratio to 68.85% (FY2004: 67.92%).

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- **Net interest margin slashed** Net interest income increased 4.0% y-o-y to HK\$3.76 billion in FY2005, despite a sharp 96.9% y-o-y jump in interest expense. As a result, BEA's net interest margin narrowed by 10bps y-o-y to 1.85% but up 9bps h-o-h from 1.76% in 1H2005. BEA experienced an interest margin squeeze in early 2005, amid unparallel rise in prime rate and interbank rates. However, margin squeeze was largely alleviated in 2H2005, after Hong Kong Monetary Authority's move to refine the linked exchange rate system and a streak of local rate hikes following the U.S.
- **Mainland loan portfolio kept growing strongly** As of 31/12/2005, BEA's loan portfolio amounted to HK\$138.7 billion, up 18.3% y-o-y from HK\$117.3 billion as of 31/12/2004, driven by robust loan growth in China. China business continued to grow, with its loan book (after transfer of risk) swelled up by 82.7% y-o-y. It represented 14.4% of BEA's total loan book, up from 9.3% a year earlier. In HK, residential mortgages HOS/PSPS, the integral part of BEA's loan portfolio, grew 5.6% y-o-y. In fact, the segment lost steam and fell 2.3% h-o-h in 2H2005, as the property market turned sluggish after faster-than-expected rate hikes by local lenders. With a higher 8.6% y-o-y growth in total deposits, BEA's loan-to-deposit ratio dropped slightly to 76.1% as of 31/12/2005 from 76.9% a year earlier.
- **Underlying growth in non-interest business persisted** Non-interest income jumped 16.5% y-o-y in FY2005 to HK\$2.19 billion, driven by a 13.2% y-o-y rise in net fee & commission and a 54.0% y-o-y jump in net trading profits. A 22.0% y-o-y surge in income from corporate services helped drive BEA's net fee & commission revenue in FY2005, thanks to the strong performance of Tricor Holdings – the Bank's business, corporate and investor services arm. Meanwhile, BEA's insurance division also performed well, as Blue Cross Insurance reported a 24% y-o-y rise in gross premium income and Bancassurance recorded a 30% increase in premium income in FY2005. Overall, non-interest income accounted for 36.8% of total operating income in FY2005, up from 34.2% in a year earlier.
- **Cost-to-income ratio stabilized** Operating expenses increased by 8.2% y-o-y last year, largely in line with the growth in operating income. Total staff costs surged 8.4% y-o-y in FY2005, mainly due to an increase in head count amid business expansion and a general rise in remuneration level in HK. Coupled with an 8.3% gain in operating income, cost-to-income ratio narrowed slightly to 50.2% in FY2005 from 50.3% in FY2004.
- **Gain on properties disposal** BEA reported a HK\$365 million disposal gain of fixed assets in FY2005, due to the sale of vacant bank premises. Management revealed that the Bank would continue to assess market conditions and look for opportunities to unload more vacant bank properties. Meanwhile, BEA also reported a HK\$210 million impairment charge on bank premises (value in use). Some write-back is expected in the future on subsequent determination of usage of the properties concerned.
- **Better asset quality and accounting changes lowered loan impairment charges** BEA reported an impairment loan loss of HK\$141.5 million in FY2005 when compared with a HK\$272.8 million charge for bad and doubtful debts a year earlier. It was mainly due to better credit quality and the adoption of new accounting standard HKAS 39. As a result, the Bank's impaired loan ratio fell to 0.91% as of 31/12/2005 (31/12/2004: 1.35%).
- **Sound financial position and better profitability** BEA's financial position was healthy, with its CAR at 17.4% as of 31/12/2005 and average liquidity ratio at 39.3% in FY2005. BEA issued a US\$550 million subordinated debt in December 2005 to refinance the old subordinated debt issued in Feb 2000, and matured on 1st Feb 2006. Management of BEA revealed that after the repayment of the old subordinated debt, BEA's CAR ratio has now returned to a more efficient level of some 15%. The Bank's profitability also improved with ROAA and ROAE at 1.28% and 12.22% respectively in FY2005, compared with 1.19% and 11.51% in FY2004.



Outlook & Prospects

- **Loan growth momentum remains intact** BEA's China loan book grows vigorously, as the Bank keeps its full strength in building up branch network in the Mainland. In Hong Kong, consumer lending is expected to expand amid better jobs security and sentiments, while mortgage loan business is seen picking up steam in latter part of FY2006 as the interest rate outlook turns a bit clearer.
- **Asset quality to stay at healthy levels** The number of residential mortgages in negative equity surged for two consecutive quarters in 2H2005, highlighting some concerns that any further drop in property prices may threaten the overall asset quality of banks in HK. However, as the local economy continues to grow favourably and the labour market remains sound, we expect the property market to stay in good shape and pose little threats to the HK banking sector. For BEA, the NPL ratio dropped further to 0.91% in FY2005 from 1.17% in 1H2005, which showed that the bank's asset quality stayed robust despite a minor surge in the number of negative equity mortgages in HK.
- **Cost efficiency continues to improve** BEA's cost-to-income ratio bucked its upward trend and dipped slightly in FY2005. The Bank's cost efficiency is expected to further improve this year, as the office relocation campaign would show a full-year cost-saving impact in FY2006.
- **NIM outlook improves but sector competition remains** The introduction of two-way trading bands for HK dollar against the greenback by the Hong Kong Monetary Authority to fine tune the linked exchange rate system in 2005 helped normalize interbank rates and eased interest rate margin pressure among banks in HK. Meanwhile, the recent launch of deposit-linked mortgage products by rival Hang Seng Bank (HKEx: 0011) may trigger another round of cut-throat competition, but we expect BEA could weather well such rivalry in view of its well diversified loan portfolio in both geographical and industry terms.
- **Transforming into an international bank** BEA has been investing actively in past years in setting up its branch network in the mainland China. As of the end of December 2005, the Bank has 11 branches, 6 sub-branches and 6 representative offices in mainland China. Along with its strong retail banking network in Hong Kong, 3 branches in Taiwan and Macau and its extensive worldwide reach (London, New York, Los Angeles, San Francisco, Singapore, Malaysia, BVI) targeting overseas Chinese people, BEA has successfully transformed itself from a pure local lender into a true international bank serving the Greater China market. In FY2005, profit contribution from China accounted for 11.6% of the Bank's total, up from 6.4% a year earlier. It is expected that the Mainland operations should continue to drive the Bank's earnings momentum in coming years.
- **A key beneficiary for restriction loosen-up in RMB business** It is foreseen that China will take further steps to allow HK banks to extend their RMB-related operations under CEPA. Leveraging on the strong network and early entry in the Mainland, BEA is better positioned to benefit from such market liberalization.
- **A better year seen for FY2006** Trading at 13.5x FY2006E P/E and 1.5x FY2006E P/B, valuations of BEA are not demanding, as we see China operations make a bigger contribution to the Bank's bottom line, while cost control measures throughout the past years is expected to show a greater impact in FY2006. With its descent dividend yield of more than 5%, we recommend a BUY rating on the banking counter.

Recommendation: Buy

I. Allowances, impaired advances, overdue and rescheduled advances of the Bank of East Asia

As % of total customer advances	Individual impairment loss allowances	Collective impairment loss allowances	Impaired advances	Overdue and rescheduled advances
As of 31/12/05	0.21%	0.35%	1.03%	0.77%
As of 30/06/05	0.28%	0.36%	1.17%	0.91%
	Specific provisions	General provisions	NPLs	Overdue and rescheduled advances
As of 31/12/04	0.26%	1.13%	1.32%	1.12%

II. Comparison of the Bank of East Asia's loan book : 31/12/2005 Vs 30/06/2005

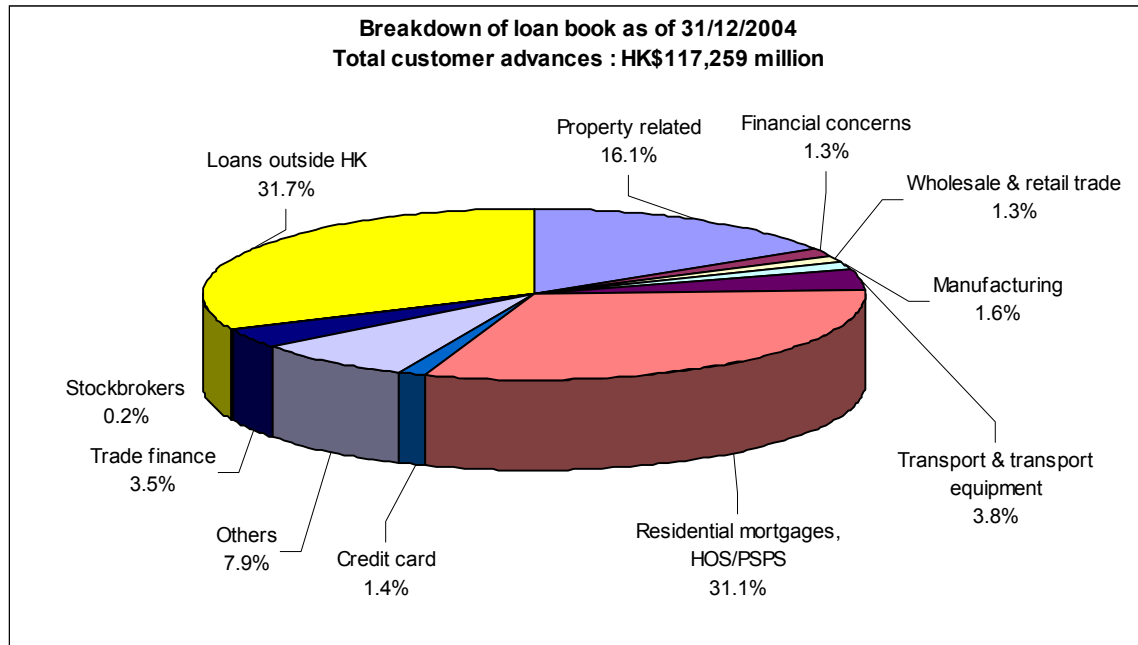
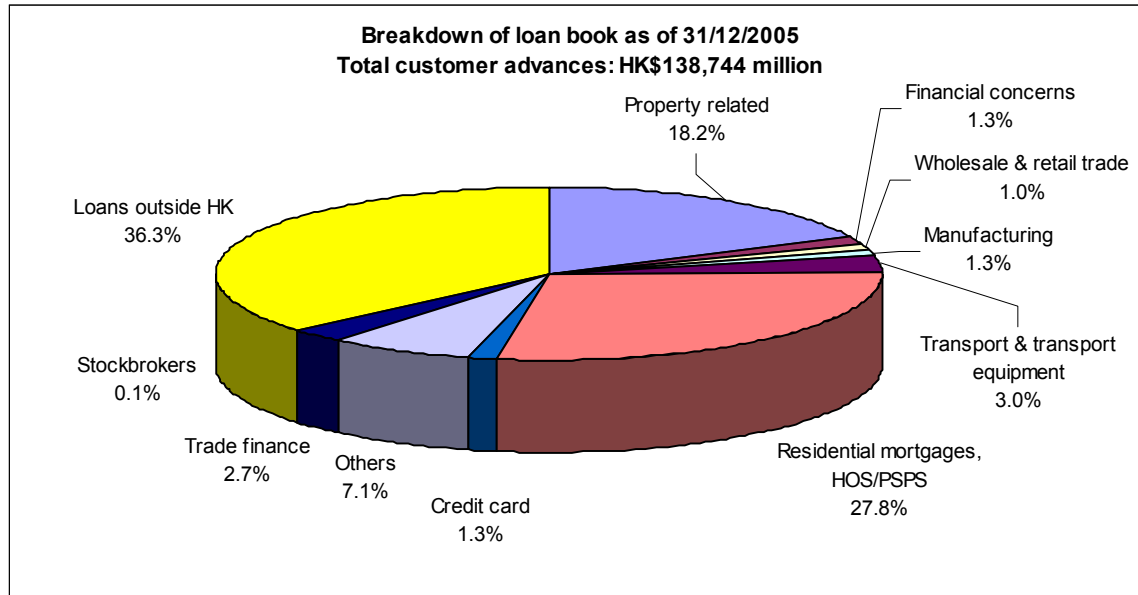
Loans-by industry	31 st Dec, 2005	Up/(down)	30 th Jun, 2005
	HK\$ million		HK\$ million
Property related	25,187	+18.7%	21,213
Financial concerns	1,868	+25.7%	1,486
Wholesale & retail trade	1,400	-16.9%	1,684
Manufacturing	1,744	-6.2%	1,860
Transport & transport equipment	4,133	-1.6%	4,198
Residential mortgages, HOS/PSPS	38,509	-2.3%	39,414
Credit card	1,770	+29.1%	1,371
Others	9,867	+5.6%	9,343
Trade finance	3,754	-10.1%	4,175
Stockbrokers	205	+15.7%	177
Loans outside HK	50,309	+15.7%	43,497
	<u>138,744</u>	+8.0%	<u>128,418</u>
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III. Comparison of the Bank of East Asia's loan book : 31/12/2005 Vs 31/12/2004

Loans-by industry	31 st Dec, 2005	Up/(down)	31 st Dec, 2004
	HK\$ million		HK\$ million
Property related	25,187	+33.0%	18,935
Financial concerns	1,868	+23.9%	1,507
Wholesale & retail trade	1,400	-10.8%	1,570
Manufacturing	1,744	-4.3%	1,823
Transport & transport equipment	4,133	-8.3%	4,507
Residential mortgages, HOS/PSPS	38,509	+5.6%	36,450
Credit card	1,770	+7.3%	1,649
Others	9,867	+6.5%	9,263
Trade finance	3,754	-8.3%	4,092
Stockbrokers	205	-26.3%	278
Loans outside HK	50,309	+35.3%	37,184
	<u>138,744</u>	+18.3%	<u>117,259</u>
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Breakdown of loan book of the Bank of East Asia





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