

Main Board H-share Listing – Research

交通銀行股份有限公司

BANK OF COMMUNICATIONS CO., LTD. [Stock Code: 3328]

Joint Global Coordinators, Joint Bookrunners, and Joint Lead Managers : Goldman Sachs (Asia) L.L.C.
The Hongkong and Shanghai Banking Corporation Limited

Sector : Banking
Business : Banking and related services

Total share offer: <u>5,855,626,000</u> H shares (13.03% of the enlarged share capital) Public Offer: 292,782,000 H shares (5%) Placing: 5,562,844,000 H shares (95%) Greenshoe: 878,344,000 H shares	<u>Business of Bank of Communications (BoCom)</u> Bank of Communication is the 5 th largest commercial bank in the mainland China in terms of total assets as of 31 st December 2004. As of 31 st December 2004, the total assets and shareholders' equity of BoCom stood at RMB1,145 billion and RMB53.6 billion respectively. BoCom offers a broad range of financial products and services to corporate and retail customers covering corporate banking, retail banking and treasury operations. Since establishment, BoCom has developed an extensive distribution network, including 92 branches, 2,413 sub-branches, 87 outlets, 1,486 self-service centres and 4,545 ATMs across 137 cities in the mainland, focusing on the Yangtze River Delta, the Bohai Rim Economic Zone and the Pearl River Delta.
Price: HK\$1.95 – HK\$2.55 per H share Market Cap.: HK\$87.6 billion – HK\$114.6 billion FY2005 P/E: 11.83x – 15.47x (pro forma) Adjusted NTA per H share: RMB1.45 – RMB1.53 Staffing: 54,408 (as of 31 st December 2004)	
Book opens: 6 th June 2005 Book closes: 17 th June 2005 HK Public Offer period: 13 th June 2005 – 16 th June 2005 noon Receiving banks: Bank of Communications Hong Kong Branch, Bank of East Asia HSBC, BOC Hong Kong and ICBC (Asia) Share registrar: Computershare Hong Kong Investor Service Limited Listing date: 23 rd June 2005	

Major Shareholders after Listing (Assuming the over-allotment option is not exercised)

Ministry of Finance	22.20%
HSBC (*)	19.90%
National Council for Social Security Fund	12.37%
China SAFE Investments Ltd.	6.68%
Capital Airports Holding (Group) Company	2.19%
Others – each accounts for less than 1% of the enlarged share capital	26.22%
	89.56%

Remark (): HSBC agrees to subscribe an additional number of H shares in the Global Offering to maintain its interest in the Bank at 19.90%.*

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Use of Proceeds

Net proceeds from the offer are estimated to be HK\$12,643 million

(Assuming the over-allotment option is not exercised, no new shares are issued pursuant to the HSBC Price Adjustment Top-Up, and at an issue price of HK\$2.25 each, which is the mid-point of the indicative price range)

BoCom intends to use the net proceeds to strengthen its capital base and to support ongoing growth of its business, which includes:

1. Strengthen and expand core corporate banking business
2. Enhance retail banking business
3. Strengthen non-interest business
4. Strengthen distribution network
5. Enhancing marketing ability
6. Leverage cooperation with HSBC to enhance management and competitiveness
7. Improve risk management and internal controls
8. Implement and optimize cost control system

Financial Highlights

	Year ended 31 st December		
	2002	2003	2004
	RMB million	RMB million	RMB million
Net interest income	16,608	19,674	25,192
Non-interest income	1,564	2,266	2,765
Total operating income	18,172	21,940	27,957
Operating profit / (loss)	6,490	4,135	7,750
Net profit / (loss)	4,429	4,376	1,604

Breakdown of Revenue by Business Segments

	Year ended 31 st December					
	2002		2003		2004	
	RMB (million)	%	RMB (million)	%	RMB (million)	%
Corporate banking	19,393	70	22,143	68	26,226	63
Retail banking	1,265	5	2,492	8	4,187	10
Treasury operations	6,752	24	7,348	23	10,324	25
Others	286	1	523	2	701	2
Total revenue	<u>27,696</u>	100	<u>32,506</u>	100	<u>41,438</u>	100

Selected Financial Ratios

	Year ended 31 st December		
	2002	2003	2004
Net interest margin	2.55%	2.55%	2.59%
Non-performing loan ratio	18.53%	12.60%	2.91%
Return on average total assets	0.65%	0.53%	0.15%
Return on average shareholders' equity	59.19%	31.81%	4.48%
Cost-income ratio	59.07%	57.84%	60.78%
Capital adequacy ratio	8.83%	7.41%	9.72%
RMB current ratio (RMB assets / RMB liabilities)	51.42%	53.02%	66.30%
Foreign currency current ratio (FX assets / FX liabilities)	181.94%	98.02%	57.05%

Strengths/Opportunities

- ✓ HSBC's 19.9% strategic equity stake shows its strong commitment in the strategic cooperation with BoCom. A close tie-up with HSBC should not only help improve BoCom's corporate governance, risk management, asset and liability management, etc., but it should also help explore new business horizons by introducing HSBC's international expertise and knowledge. International exposure is vital to stand out in the fast growing and highly competitive banking sector in the Mainland.
- ✓ According to data from BoCom, its non-performing loan ratio was 2.91% as of 31st December 2004, which was lower than the industry average of 4.9% and the average of 15.6% among the Big Four specialised banks in the PRC, showing the healthy asset quality of BoCom.
- ✓ BoCom's non-interest income accounted for only 9.9% of the total operating income last year. With its extensive branch network located in major cities in China, BoCom should be able to leverage its distribution channels and further develop its fee & commission business.
- ✓ BoCom expects to report a 3.9x y-o-y surge in net profit to RMB7,874 million for the year ended 31st December 2005 from RMB1,604 million in 2004, mainly due to a low 2004 profit base as a result of a one-off tax expense in relation to disposal of impaired loans to Cinda last year.
- ✓ BoCom projects its ROAA to rise from 2004's 0.15% to 0.65% in 2005, the highest among its domestic banking peers. However, the FY2005E ROAA would remain well below international standard, while BoCom aims to eliminate the gap in the next three to five years. In order to achieve this goal, BoCom said it would shift its business focus to retail operations, improve its credit quality and lower the cost-income ratio. The bank said it would explore business opportunities with its retail client base, which was typically regarded only as a source of deposits, in promoting consumer lending and other banking products.
- ✓ To be priced at between 1.3x-1.8x FY2005E Price-to-book and 11.8x -15.5x FY2005E P/E, the valuations look attractive given a slight discount to HK-listed BOC Hong Kong (2388) (2.1x FY2005E P/B, 14.4x FY2005E P/E) and Bank of East Asia (0023) (1.5x FY2005E P/B, 13.5x FY2005E P/E), which have also substantial business exposure in the PRC's banking industry, as well as BoCom's positive business outlook (non-interest business) and a strong strategic tie with HSBC.

Weaknesses/Threats

- × As of 31/12/2004, property-related loans, including loans to real estate projects and construction companies as well as mortgage lending, accounted for 23.2% of BoCom's gross loans. The central government's austerity measures introduced over the past year to curb the red-hot property sector may slow down the respective loan growth. It was also reported that sales of homes under construction in Shanghai, Hangzhou and Beijing tumbled by more than 20% in May from April, showing a weaker demand for property purchase amid restrictive policies.
- × The ratio of foreign currency current assets to foreign currency current liability fell below the regulatory requirement of 60% to 57.05% as of 31st December 2004, as BoCom reallocated funds to longer-term investments in order to earn a higher return. BoCom may have to boost the ratio above the required level in the future, which may in turn have a negative impact on interest margins.
- × For FY2004, the ROE and ROA of BoCom was just 0.15% and 4.48% respectively, well below that of its listed peers in Hong Kong. In addition, its cost-to-income ratio still stayed high at more than 60%.

Recommendation: Subscribe