

Analyst: Kevin Tam

## **Main Board H-share Listing – Research**

中國銀行股份有限公司  
Bank of China Limited [Stock Code: 3988]

**Joint Global Coordinators, Joint Bookrunners,** BOC International  
**Joint Sponsors and Joint Lead Managers** : Goldman Sachs  
 UBS Investment Bank

**Sector** : Banks  
**Business**: Commercial banking and related services

<p><b>Total share offer:</b> 25,568,590,000  <b>Public Offer:</b> 1,278,430,000 (5%)  <b>Placing:</b> 24,290,160,000 (95%)  <b>Greenshoe:</b> 3,835,288,000 (15% of initial total share offer)</p>	<p><b><u>Business of Bank of China (“BOC”)*</u></b>          Bank of China is the second largest commercial bank in the PRC in terms of total asset (RMB 4,740 billion). It has the most extensive international branch network among PRC commercial banks. In terms of domestic loans and deposits, BOC ranks 4<sup>th</sup> among PRC banks, commanding 7.6% and 8.8% market share respectively.</p> <p>Hong Kong and Macau operations together accounted for 19.8% of BOC’s total assets before inter-company balances and 41.1% of operating profit in FY05, mainly through its 65.79% stake in BOC (Hong Kong) (2388).</p> <p>Since 1998, the Chinese government had carried out a series of efforts to restructure BOC by means of two rounds of recapitalisation and NPL carve-outs. In August 2004, BOC formally converted itself into a joint stock bank, with strategic or pre-IPO investors including by RBS China, Temasek Holdings., UBS and Asia Development Bank.</p> <p><small>* All figures were as of 31<sup>st</sup> December 2005.</small></p>
<p><b>Price:</b> HK\$2.50 to HK\$3.00 per H share  <b>Market Cap:</b> HK\$608,776 million to 730,531million  <b>Forecast 2006 P/E:</b> 18.94X to 22.73X  <b>Adjusted NTA per share:</b> HK\$1.189 – HK\$1.242  <b>Staffing:</b> 190,828 (as of 31<sup>st</sup> December 2005)</p>	
<p><b>Book opens:</b> 11<sup>th</sup> May 2006  <b>Book closes:</b> 23<sup>rd</sup> May 2006  <b>HK Public Offer period:</b>          18<sup>th</sup> May 2006 to 23<sup>rd</sup> May 2006  <b>Receiving bank:</b> Bank of China (Hong Kong)          Bank of Communications (HK)  <b>H Share registrar:</b> Computershare Hong Kong          Investor Services Limited  <b>Listing date:</b> 1 June 2006</p>	

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

Asian Development Bank	0.208%
UBS AG	1.387%
Central SAFE Investments Ltd. (“Huijin”)	70.507%
Royal Bank of Scotland China	8.6%
Temasek	4.879%
PRC Social Security Fund	4.498%
Public Shareholders	9.921%
	100%

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**Use of Proceeds**

Net proceeds from the Global Offering are estimated to be HK\$68,071 million. (Based on HK\$1.00 = RMB1.0339, assuming the over-allotment option is not being exercised and an offer price of HK\$2.75 per H-share, being the mid-point of offer price range.) The Bank intended to use the net proceeds to strengthen its capital base to support the ongoing growth of the Bank's business.

**Selected Income Statement Data**

	<u>Year ended 31<sup>st</sup> December</u>		
	<b>2003</b>	<b>2004</b>	<b>2005</b>
	RMB million	RMB million	RMB million
Net Interest Income	76,597	88,435	101,008
Net fee and commission income	7,353	8,557	9,247
Operating Income	83,950	96,992	110,255
Pre-provision operating profit	55,516	60,934	65,122
Provision for impairment losses	(18,100)	(23,812)	(11,486)
Operating Profit	37,416	37,122	53,636
<b>Net profit</b>	<b>31,015</b>	<b>22,301</b>	<b>25,921</b>

**Selected Balance Sheet Data**

	<u>Year ended 31<sup>st</sup> December</u>		
	<b>2003</b>	<b>2004</b>	<b>2005</b>
	RMB billion	RMB billion	RMB billion
Gross Loans and advances	2,160,900	2,147,688	2,235,265
Total assets	3,973,280	4,265,221	4,740,048
Deposits from customers	3,190,607	3,479,535	3,912,090

**Selected Financial Ratios**

	<u>Year ended 31<sup>st</sup> December</u>		
	<b>2003</b>	<b>2004</b>	<b>2005</b>
<b>Profitability</b>			
Return on average assets	0.94%	0.66%	0.70%
Return on average equity	15.76%	11.22%	12.14%
Net interest margin	2.16%	2.24%	2.33%
Cost-to-income ratio (excluding business and other taxes)	41.45%	43.08%	43.41%
<b>Capital adequacy</b>			
Core capital adequacy ratio	N.A.	8.48%	8.08%
Capital adequacy ratio	N.A.	10.04%	10.42%
Total equity to total assets	5.58%	5.34%	5.39%
<b>Asset quality</b>			
Impaired loan ratio	16.58%	5.51%	4.9%
Impaired loss coverage	66.73%	63.16%	75.92%
Impaired allowance ratio	11.06%	3.48%	3.72%

**Strengths/Opportunities**

- ✓ Bank of China has dominant domestic market share in forex loans, domestic forex deposits, and international trade settlement, commanding market share of 43.3%, 40.9% and 32.6% respectively. BOC's domestic forex spread income has shown a 31% CAGR between FY03 and FY05 (accounting for 5% of operating income in FY05). BOC is better positioned to capitalize on China's policy to gradually liberalize RMB exchange rates and open up its capital accounts. Moreover, Bank of China's extensive global network, strong presence in Hong Kong and Macau enable it to take advantage of China's increasing globalization.
- ✓ Under Chinese Law, banks are prohibited from operating in securities and insurance. However, BOC has built a universal banking platform using Hong Kong subsidiaries BOC International (investment banking) and BOCG Insurance. Both these entities have also entered the domestic Chinese market through joint ventures and branches. Thus, BOC has a stronger cross-selling platform to its peers.
- ✓ Bank of China's recurring fee-related income accounts for 10.4% of total revenue of domestic operations, which is the highest among Chinese banks. BOC's ability to offer innovative financial solutions provides a competitive advantage.
- ✓ Bank of China has the highest proportion of consumer loans (21.1% in FY05 for domestic operations) among PRC banks. From FY03 to FY05, BOC recorded CAGR in mortgage loans of 34.2% and total consumer loans at 22.3%, which were the highest among PRC banks. BOC should be better placed to capitalize on government policy to encourage private consumption.
- ✓ It is estimated Bank of China will register 40%-50% growth in FY06 and some 20% growth in FY07 in net profit. The growth driver are: (i) return to double digit loan growth on cleaning up of its bad debts; (ii) margin gains from asset yield, mix and funding costs; (iii) rise in forex spreads and fee incomes; (iv) stable credit and operating cost trends; and (v) effective tax rate falls to a level in-line with its peers (For FY05: BOC: 41%; China Construction Bank (939): 30%; Bank of Communications (3328): 28%)
- ✓ Bank of China is priced at 2x to 2.3x FY06E book value and FY06E PER at 18.94X to 22.73X. China Construction Bank is trading at 2.48 times FY06E book value and 16.4X FY06PER. Bank of Communications is trading at 2.56 times FY06E book value and 19.6X FY06 PER. Bank of China's valuation is in-line with its peers.

**Weaknesses/Threats**

- × Despite showing significant progress of improvement, Bank of China's impaired loan ratio of 4.9% in FY05 is still higher than its peers. (China Construction Bank's NPL loan ratio: 3.84%; Bank of Communications impaired loan ratio: 2.8%) Even so, BOC's has a relatively high coverage ratio of 75.92% in FY05. (China Construction Bank: 66.78%; Bank of Communications: 58.39%) Many former employees of BOC in the past had involved in high-profile fraud cases, theft and misappropriation of funds. It remains to be seen whether the new credit and risk management systems are adequately instituted to prevent recurrence of such incidents.
- × Bank of China's earnings are vulnerable to the appreciation of the RMB. BOC's net foreign exchange position reaches US\$39.2 billion in FY05, equivalent to 124% of its total equity in FY05. It is estimated that an additional one-percentage point in the yuan exchange rate will reduce its FY06 profit by 3.3% and cut its book value by 0.6%.

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