

Analyst: Paul Sham
WING HANG BANK LIMITED (永亨銀行)

Sector	: Banking
HKSE Code	: 00302
Market Price	: HK\$79.25 (13/08/2010)
Shares Issued	: 295.0m
Mkt. Cap.	: HK\$23,378.8m
52 weeks Hi/ Lo	: HK\$87.00 / HK\$61.95
HSI	: 21,071.57 (13/08/2010)
Main Business	: Banking and related financial services

Chairman & Chief Executive : Dr. Patrick Y. B. Fung

Deputy Chief Executive : Mr. Frank J Wang

SUMMARY OF THE INTERIM RESULTS FOR THE SIX MONTHS ENDED 30TH JUNE 2010
Interim Results Highlights

	HK\$ million	Vs 1H2009 (%)	Vs 31/12/2009 (%)
• Net interest income	1,320.4	+13.6%	
• Other operating income	269.5	-18.8%	
• Total operating income	1,589.9	+6.4%	
• Operating expenses	(775.8)	-2.7%	
• Operating profit before impairment losses	814.1	+16.9%	
• Impairment losses on loans and advances	50.2	-159.8%	
• Profit before taxation	927.4	+54.8%	
• Taxation	(165.7)	+95.9%	
• Attributable profit to shareholders	761.4	+48.5%	
• Total loans	90,165.5	+14.5%	+12.0%
• Total deposits	124,510.2	+1.9%	-1.6%
• Total assets	146,434.8	+3.5%	-0.5%
• Basic EPS (HK\$)	2.58	+48.3%	
• Interim DPS (HK\$)	0.30	+50.0%	
Selected Ratios	1H2010	1H2009	FY2009
• Net interest margin	1.91%	1.79%	1.82%
• Cost-income ratio	48.8%	53.4%	55.1%
• Return on average assets	1.04%	0.74%	0.83%
• Return on average equity	12.0%	9.4%	10.6%
• Impaired loan ratio	0.37%	0.63%	0.51%
• Impaired advances coverage	65.2%	61.5%	60.4%
• Loan-deposit ratio	72.4%	64.4%	63.6%
• Capital adequacy ratio	17.0%	17.7%	17.8%
• Average liquidity ratio	46.1%	52.2%	53.6%

- **1H10 results missed expectation** Wing Hang Bank ("WHB") reported net profit of HK\$761.4m, up 49% y-o-y. The results were 5% below market consensus of HK\$802m mainly due to the sub-debt revaluation loss of HK\$166m and a sizeable increase in banks staff costs. Absence of Lehman Brothers Minibond provisions helped offset some of the aforementioned expenses. Asset quality was the key positive during 1H10 as the bank wrote back HK\$50m impairment loss with NPL ratio falling to 0.37%. DPS was HK\$0.30, up 50% y-o-y, representing a payout ratio of 11.6%.

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- **Net interest income outperformed peers** Net interest income increased by 13.6% supported by better net interest margin (NIM) and an increase in loan volume. WHB's NIM widened to 1.91% in 1H10 from 1.79% a year earlier. On the other hand, loan portfolio increased by 12.0% h-o-h, with exceptional strong growth in overseas lending (+22.5% h-o-h) and to a lesser extent, residential mortgages (+5.1% h-o-h) and property-related lending (+7.1% h-o-h). Given a shrinkage of deposit in 1H10, loan-to-deposit edged up higher to 72.4% as of 30th June 2010 from 63.6% at the end of 2009.
- **Higher fee income dragged by sub-debt loss** Fee income was up 9.6% y-o-y to HK\$325m. Loan fees and credit card fees registered satisfactory y-o-y growth of 33% and 17% respectively, but other items such as stock brokerage, insurance commission and trade fees were largely flat. Meanwhile, net losses from financial instruments held for trading and designated at fair value increased to HK\$166m (1H09: 65m) following an increase in the fair value of its perpetual subordinated debt.
- **Higher staff costs** Total expenses decreased slightly by 2.7% partly due to a reduction in the provision for Lehman Brothers Minibonds. Nevertheless, staff cost unexpectedly jumped 19% y-o-y despite headcounts increased by only 2% during the same period. Consequently, WHB's cost-to-income ratio decreased from 53.4% to 48.8%. If the net losses from financial instruments were excluded, WHB's cost-to-income ratio would stand at 44.2%.
- **Superior asset quality** Asset quality is the key positive for WHB's 1H10 results. The continued rise in asset prices led to a release of loan impairment allowances for HK\$50.2m. Impaired loans also stabilised at HK\$336m, equivalent to 0.37% of total loans.
- **Strong China operation, sluggish business in Macau** Pre-tax profit from WHB's China jumped 53.8% y-o-y. Loan growth for use in Mainland China recorded a 26.4% growth h-o-h because of strong demand for credit as China's economic recovery gathered pace. However, with the measures taken by the Chinese Government to tighten loan growth and the implementation of new regulations to stabilise property prices, Management expect loan growth to slow down in the second half of the year. On the other hand, it was surprising to see the pre-tax profit from Macau decline by 6% y-o-y to HK\$123m given 1Q10 GDP growth of 30% in Macau.
- **Strong profitability and financial position among local banks** WHB delivered better return to shareholders, with ROAE of 12.0% in 1H10 but still far below the 1H07's peak at 19.9%. With risk-weighted asset expanding on higher loan volume, total CAR was lowered to 17.0% as of 30th June 2010, but remained at a strong level.

Outlook & Prospects

- **Progressive expansion in China and Macau** WHB currently owns 12 branches in Macau and 10 branches and sub-branches on the Mainland (four in Shenzhen, three in Guangzhou, two in Shanghai and one in Zhuhai). Approval was obtained to open another branch in Beijing, which is expected to become operational in the first quarter of 2011. Management also revealed that they will continue to open more sub-branches in the Pearl River Delta. The combined pre-tax profit contribution from China and Macau accounted for 15% and 12% respectively, of the group's total for 1H10.

- **Interest income sets to slow down in 2H10** While WHB delivered a solid result in 1H10, Management expected to see stable-to-mild contraction in NIM, mainly coming from loan competition as well as higher deposit pricing and slower lending growth in 2H10. Meanwhile, WHB's China loans grew 26.4% h-o-h. However, with RMB loan to deposit ratio at above 100%, China loan growth may slow down in 2011 to meet the RMB loan-to-deposit ratio requirement of 75%.
- **M&A speculation** Compared with other small Hong Kong banks, WHB is a good acquisition target for Chinese banks and insurers given its better-than-peer asset quality and high ROE. Also, WHB owns a respectable branch network in Hong Kong and Macau and a growing presence in Guangdong province. Moreover, the combined stakes of Bank of New York (20%) and the Fung family (estimated at 30%) make WHB a relatively simple target to acquire. Therefore, M&A speculation should continue to support WHB's share prices in the near term. Nonetheless, we believe Fung family is likely to request a high premium for the acquisition, which makes Chong Hing Bank or Dah Sing Financial a better target from a potential bidder's point of view.
- **Over-valued on M&A theme** Currently trading at 1.71x FY10E P/B and 14.3x FY10E P/E, WHB remains one of the most expensive HK banks as it demonstrates a good ROE track record and superior asset quality. The near-term share price rally has been largely driven by M&A speculation and less by fundamentals. Given M&A is not an imminent event for WHB, its premium valuation against peer mid-cap Hong Kong banks should not be justified. As such, we recommend our "Underperform" rating for the counter.

Recommendation: *Underperform*

I. Impairment allowances, overdue and rescheduled advances of Wing Hang Bank

As % of total customer advances	Individual allowance	Portfolio allowance	Non-performing loans	Overdue and rescheduled advances
As of 30/6/2010	0.08%	0.16%	0.37%	0.33%
As of 31/12/2009	0.11%	0.20%	0.51%	0.42%
As of 30/6/2009	0.14%	0.24%	0.63%	0.51%

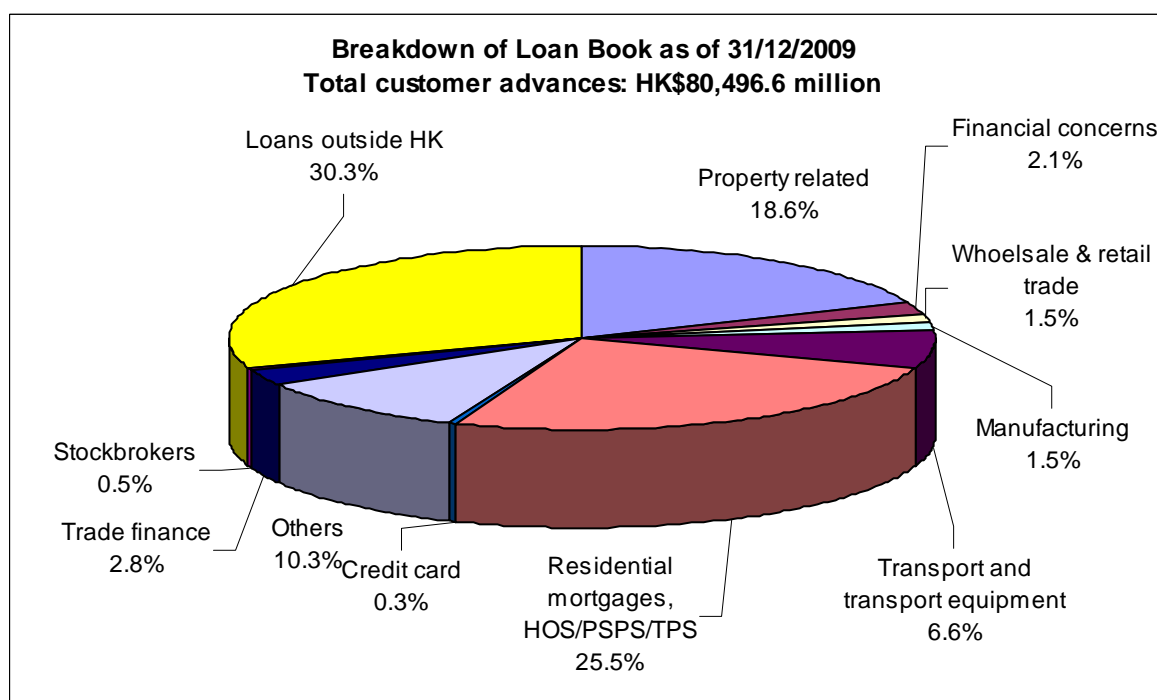
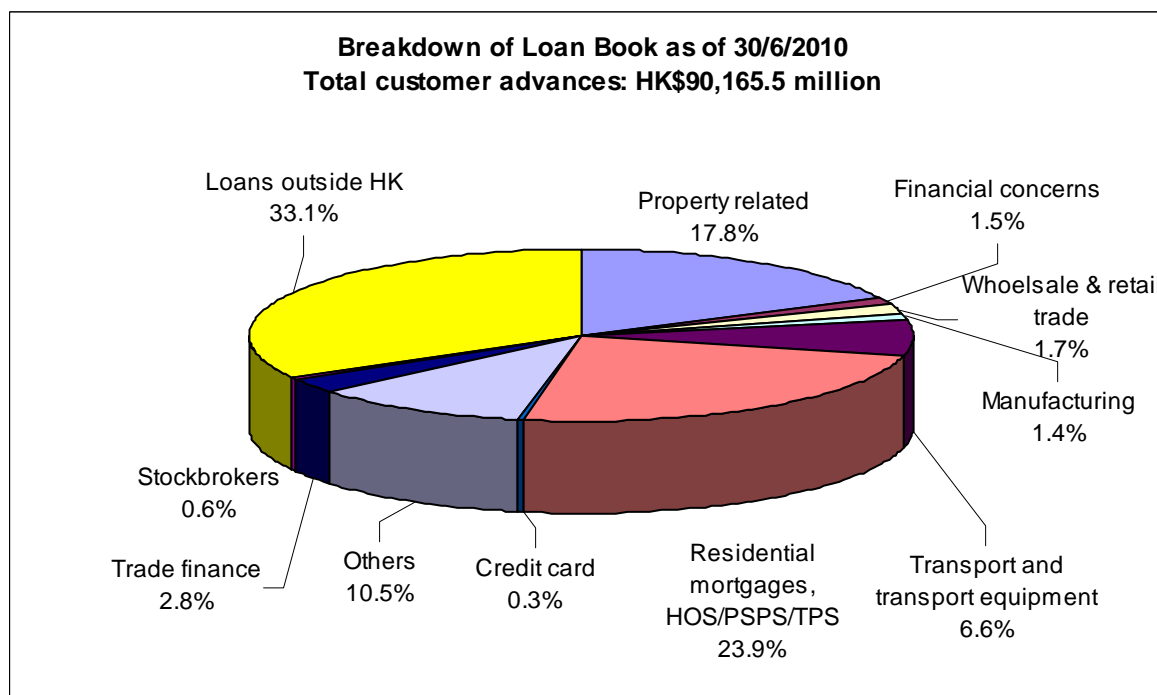
II. Comparison of Wing Hang Bank's loan book: 30/06/2010 vs 31/12/2009

Loans-by industry	30 th Jun, 2010 HK\$ million	Up/(down)	31 st Dec, 2009 HK\$ million
Property related	16,017.8	+7.1%	14,961
Financial concerns	1,326.7	-22.6%	1,713
Wholesale & retail trade	1,497.8	+25.1%	1,197
Manufacturing	1,288.0	+6.4%	1,210
Transport & transport equipment	5,924.0	+11.1%	5,334
Residential mortgages, HOS/PSPS	21,544.5	+5.1%	20,494
Credit card	229.3	+0.4%	228
Others	9,437.2	+13.8%	8,296
Trade finance	2,507.4	+9.8%	2,284
Stockbrokers	559.8	+33.2%	420
Loans outside HK	29,833.1	+22.5%	24,359
	<u>90,165.5</u>	<u>+12.0%</u>	<u>80,496.6</u>

III. Comparison of Wing Hang Bank's loan book: 30/06/2010 vs 30/06/2009

Loans-by industry	30 th Jun, 2010 HK\$ million	Up/(down)	30 th Jun, 2009 HK\$ million
Property related	16,017.8	+7.0%	14,964.8
Financial concerns	1,326.7	-11.7%	1,502.3
Wholesale & retail trade	1,497.8	+33.5%	1,121.7
Manufacturing	1,288.0	+1.6%	1,267.6
Transport & transport equipment	5,924.0	+5.0%	5,640.2
Residential mortgages, HOS/PSPS	21,544.5	+8.3%	19,901.8
Credit card	229.3	+1.1%	226.7
Others	9,437.2	+25.3%	7,533.0
Trade finance	2,507.4	+13.3%	2,213.5
Stockbrokers	559.8	-71.2%	1,945.2
Loans outside HK	29,833.1	+33.1%	22,407.1
	<u>90,165.5</u>	<u>+14.5%</u>	<u>78,723.9</u>

Breakdown of loan book of Wing Hang Bank



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