

Analyst: Paul Sham

ICBC (ASIA) LIMITED (工銀亞洲)

Sector	: Banking	Chairman	: Dr. Jiang Jianqing
HKSE Code	: 00349		
Market Price	: HK\$28.80 (26/08/2010)	Managing Director & CEO	: Mr. Chen Aiping
Shares Issued	: 1,352.1m		
Mkt. Cap.	: HK\$38,940.5m		
52 weeks Hi/ Lo	: HK\$28.95 / HK\$14.43		
HSI	: 20,612.06 (26/08/2010)		
Main Business	: Banking and related financial services		

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	1,724.9	+15.8%	
• Non-interest income	553.4	+4.6%	
• Total operating income	2,278.3	+12.8%	
• Operating expenses	(679.8)	-2.2%	
• Operating profit before impairment losses	1,598.5	+20.7%	
• Impairment losses on loans and advances	(210.3)	-6.4%	
• Profit before taxation	1,478.8	+31.1%	
• Taxation	(249.6)	+26.0%	
• Attributable profit to shareholders	1,229.2	+32.1%	
• Total loans	155,266.5	+23.2%	+14.4%
• Total deposits	188,170.3	+16.6%	+14.9%
• Total assets	255,806.6	+17.3%	+18.6%
• Basic EPS (HK\$)	0.93	+29.2%	
• Interim EPS (HK\$)	0.37	+32.1%	

Selected Ratios	1H2010	1H2009	FY2009
• Net interest margin	1.51%	1.63%	1.56%
• Cost-income ratio	29.8%	34.4%	32.4%
• Return on average assets	1.00%	1.00%	1.23%
• Return on average equity	13.7%	13.0%	16.1%
• Impaired loan ratio	0.65%	0.71%	0.92%
• Impaired advances coverage	85.8%	89.5%	65.9%
• Loan-deposit ratio	82.5%	78.1%	82.9%
• Capital adequacy ratio	13.4%	14.4%	14.9%
• Average liquidity ratio	41.5%	38.0%	40.2%

- **Satisfactory 1H10 performance** ICBC(Asia)'s 1H10 net profit of HK\$1,229.2m was up 32.1% y-o-y and exceeded market expectation of HK\$1,199m. On h-o-h basis, the reported earnings fell 23% due to large gains in 2H09 from its sale of stake in China Taiping. The satisfactory 1H10 was primarily driven by higher loan volume and the decline in operating expense due to the absence of Lehman Mini-bonds provision. ICBC (Asia) lifted its dividend per share to HK\$0.37, up 32.1% y-o-y.

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- **Higher loan volume offset margin compression** Net interest income increased by 15.8% y-o-y, mainly attributable to a 14.4% h-o-h increase in its loan portfolio, reflecting stronger lending on property (+11.8% h-o-h) and wholesale business (+42.9% h-o-h). Loan outside HK also recorded strong h-o-h growth of 16.3%, driven by the bank's successful strategy on business referrals from its parent ICBC. But the bank's net interest margin shrank to 1.51% in 1H10 from 1.63% a year earlier as a low interest rate environment persisted in the first half of 2010.
- **Non-interest income increased 4.6% y-o-y** Net fee income rose 14% y-o-y with a big positive being seen in loans, overdrafts and guarantees, which was up 72.6% y-o-y and helped offset the fee-income decline in securities and brokerage fee amid weak turnover of the stock market. The weakness in the gains from fair value items which dropped to HK\$18m in 1H10 from 74m a year earlier, also dragged the overall non-interest income.
- **Expenses declined amid the absence of Lehman provisions** Operating expenses dropped slightly by 2.2% to HK\$679.8m as the provision charges of HK\$89m for Lehman Brothers Mini-bonds in 1H09 did not recur during 1H10. Excluding the provisions, the operating expenses would have increased by 11.9% y-o-y, on higher staff costs (+14.5% y-o-y) and depreciation expenses (+11.8% y-o-y).
- **Improving asset quality** The impairment losses on loans were HK\$210.3m, down 6.4% y-o-y while impaired loan ratio improved 27bps h-o-h to 0.65%. Provision coverage was maintained at 82.5%, down marginally from 82.9% at the end of 2009.
- **CAR remains the lowest in the sector** ICBC (Asia) reported its core CAR and total CAR at 8.4% and 13.4% respectively (end-2009: 9.0% and 14.9%). The decline was due to the higher risk-weighted assets which jumped 16.1% h-o-h. The ratios are the lowest among the listed local banks. If privatization fails, equity capital raising will be expected.

Outlook & Prospects

- **ICBC(Asia) to be privatized at 2.14x P/B** ICBC proposes to privatize ICBC(Asia) in cash for HK\$29.45 per share. This is equivalent to 2.14x FY09 P/B, surpassing the bank's peak valuation of 2.07x in 2007. The deal is pending regulatory approval, and it also needs: (1) approval by at least 75% of minority shareholders vote in person or in proxy; and (2) no more than 10% of minority shareholders vote against the scheme. Since the offer price is well above ICBC(Asia)'s all-time high, and the respective P/B valuation is higher than its peak P/B as well as the average P/B of its peers, the proposed privatization is likely to be adopted by minority shareholders.
- **Lower profit contribution from China Mercantile Bank (CMB)** Profit before tax of its wholly owned subsidiary CMB fell 27.6% y-o-y to HK\$57.6m in FY10 due to additional provision made on doubtful loans granted in the past. Despite worsening profitability, CMB's operations continued to grow in a fast pace. Total asset of CMB amounted HK\$19,410m as at 30th June 2010, representing an increase of 52% over the end of 2009. Total customers' loan and deposit balance as at 30th June 2010 were HK\$14,591m and HK\$8,693m respectively, representing increases of 53% and 55% respectively y-o-y.
- **Support from parent ICBC group** ICBC(Asia) can keep receiving loan referrals from ICBC, offering sources of its loan growth. It also began collaborating with the ICBC Shenzhen branch in September 2009 to allow each other's retail customers to open cross border bank and securities brokerage accounts. We expect similar agreements with other ICBC branches to continue providing ICBC(Asia) with a steady source of new customers across China over time.
- **Stable share prices expected** Given that the bank is currently going through a privatization process, the stock is unlikely to react to the earnings release and stay in the current level until the completion of the privatization procedure. We accordingly recommend a "Hold" rating for the counter.

Recommendation: *Hold*

I. Impairment allowances, overdue and rescheduled advances of ICBC (Asia)

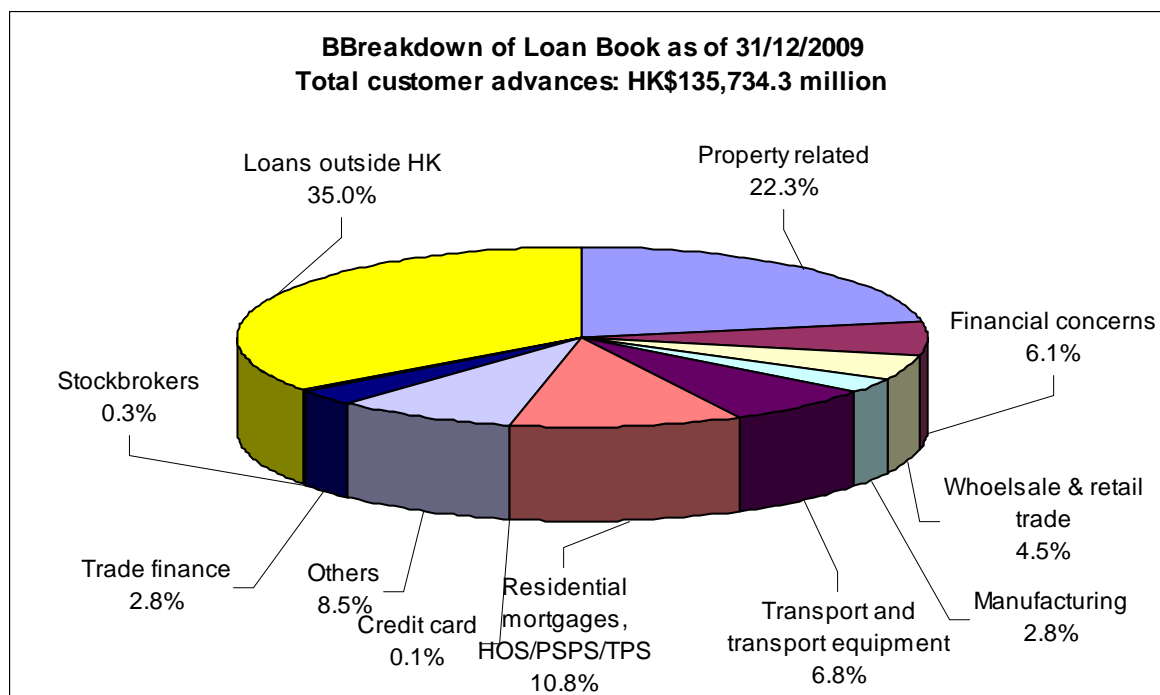
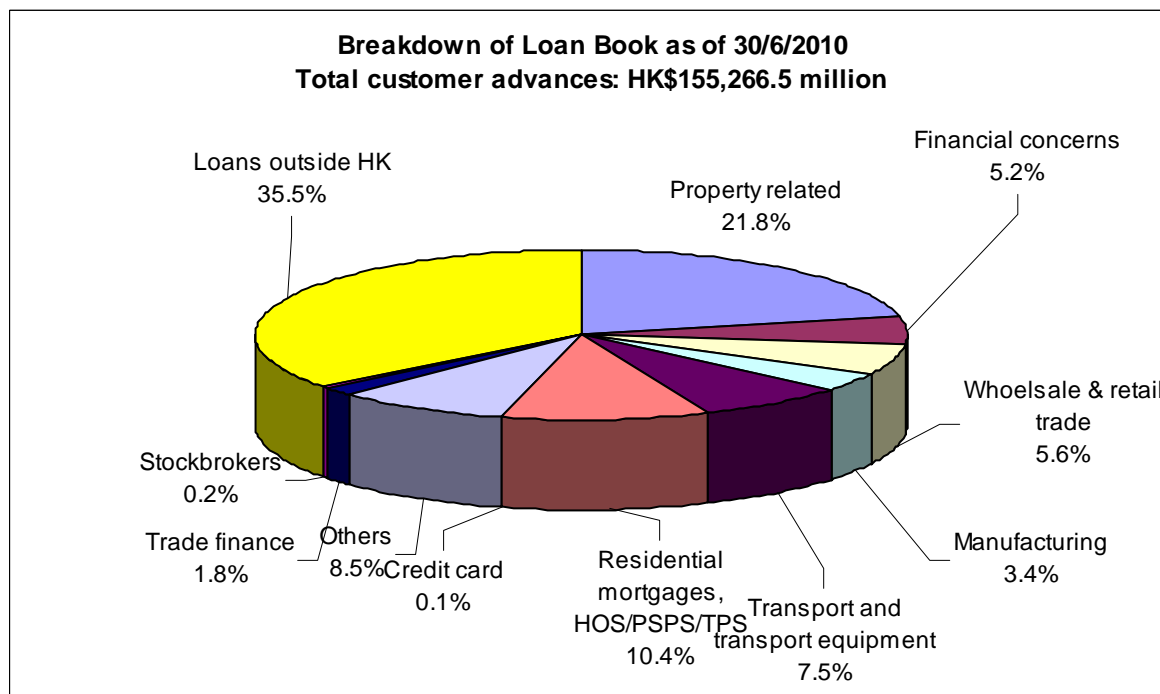
As % of total customer advances	Individual allowance	Portfolio allowance	Non-performing loans	Overdue and rescheduled advances
As of 30/6/2010	0.30%	0.37%	0.65%	0.72%
As of 31/12/2009	0.33%	0.33%	0.92%	0.47%
As of 30/6/2009	0.34%	0.31%	0.71%	0.53%

II. Comparison of ICBC (Asia)'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	33,772.9	+11.8%	30,219.0
Financial concerns	8,123.5	-2.3%	8,315.0
Wholesale & retail trade	8,715.6	+42.9%	6,100.3
Manufacturing	5,345.7	+40.2%	3,814.1
Transport & transport equipment	11,593.2	+25.7%	9,224.8
Residential mortgages, HOS/PSPS	16,115.9	+10.0%	14,650.3
Credit card	91.8	-2.5%	94.2
Others	13,175.0	+13.6%	11,596.0
Trade finance	2,805.0	-27.1%	3,846.7
Stockbrokers	342.1	-20.3%	429.4
Loans outside HK	55,185.8	+16.3%	47,444.5
	<u>155,266.5</u>	<u>+14.4%</u>	<u>135,734.3</u>

III. Comparison of ICBC (Asia)'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	33,772.9	+3.5%	32,637.1
Financial concerns	8,123.5	+2.2%	7,945.0
Wholesale & retail trade	8,715.6	+55.2%	5,615.5
Manufacturing	5,345.7	+34.5%	3,975.9
Transport & transport equipment	11,593.2	+42.1%	8,156.5
Residential mortgages, HOS/PSPS	16,115.9	+27.6%	12,634.4
Credit card	91.8	+14.6%	80.1
Others	13,175.0	+36.0%	9,687.7
Trade finance	2,805.0	-12.0%	3,185.8
Stockbrokers	342.1	-91.7%	4,114.4
Loans outside HK	55,185.8	+45.3%	37,972.1
	<u>155,266.5</u>	<u>+23.2%</u>	<u>126,004.5</u>

Breakdown of loan book of ICBC (Asia)


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