

China / Hong Kong Company Update

Bank of China Hong Kong

Bloomberg: 2388 HK EQUITY | Reuters: 2388.HK

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DBS Group Research . Equity

29 Jun 2022

BUY (Reinstating coverage)

Last Traded Price (28 Jun 2022): HK\$31.55 (HSI : 22,419)

Price Target 12-mth: HK\$37.40 (19% upside)

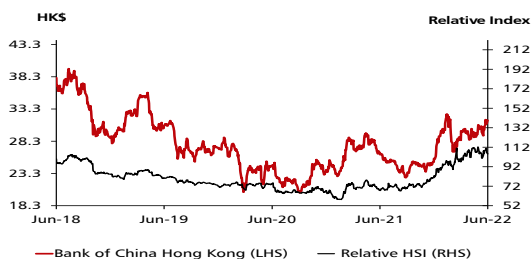
Analyst

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What's New

- Expect 8% loan growth CAGR in FY21-24F with steady loan pipeline with large corporate clients
- Stable and benign asset quality expected ahead with small exposure to concerned segments
- More upside in fee income to be unlocked, despite short-term volatilities
- Reinstate coverage with BUY; TP at HK\$ 37.4

Price Relative



Forecasts and Valuation

| FY Dec (HK\$ m) | 2021A | 2022F | 2023F | 2024F |
|---------------------------|--------|--------|--------|--------|
| Pre-prov. Profit | 32,575 | 37,190 | 46,271 | 53,705 |
| Pre-prov. Profit Gth | (15) | 14 | 24 | 16 |
| Pretax Profit | 29,968 | 34,426 | 43,435 | 51,031 |
| Net Profit | 22,970 | 26,852 | 34,239 | 40,467 |
| EPS (HK\$) | 2.17 | 2.54 | 3.24 | 3.83 |
| EPS Gth (%) | (13) | 17 | 28 | 18 |
| PE (X) | 14.5 | 12.4 | 9.7 | 8.2 |
| DPS (HK\$) | 1.13 | 1.32 | 1.68 | 1.99 |
| Div Yield (%) | 3.6 | 4.2 | 5.3 | 6.3 |
| BV Per Share (HK\$) | 28.19 | 29.40 | 30.96 | 32.80 |
| P/Book Value (x) | 1.1 | 1.1 | 1.0 | 1.0 |
| ROAE (%) | 7.8 | 8.8 | 10.7 | 12.0 |
| ROAE (ex-exceptional) (%) | 7.9 | 8.8 | 10.7 | 12.0 |
| ROA (%) | 0.72 | 0.77 | 0.90 | 0.99 |

| | | | | |
|----------------------|--|------|------|------|
| Earnings Rev (%) | | (10) | 2 | New |
| Consensus EPS (HK\$) | | 2.57 | 3.23 | 3.75 |
| Other Broker Recs: | | B:13 | S:0 | H:1 |

Source of all data on this page: Company, DBS Bank (Hong Kong) Limited ("DBS HK"), Thomson Reuters

Steady growth ahead with better asset quality

Investment Thesis

Better asset quality than peers. We expect BOCHK's NPL ratio to continue to be better than its peers' as it has higher bargaining power to select good-quality borrowers, such as China SOEs in HK.

Solid loan growth. BOCHK reported a higher-than-peers loan growth rate in the past few years with solid demand from large corporate clients. We expect a mid to high single-digit loan growth in FY22/23F.

Leveraging on BOC for emerging markets' opportunities. With its broad branch network leveraging its parent company BOC, BOCHK has a strong position in GBA and ASEAN, which will serve as the next revenue growth engine in the long run.

Valuation:

We reinstate coverage with BUY and TP at HK\$ 37.4, based on the Gordon Growth Model (14% ROE, 3% growth, and 12% cost of equity). Our TP implies a 1.2x FY23F P/BV, on par with its five-year P/BV average, supported by its ROE expansion.

Where we differ:

We have a higher earnings projection for FY23/24F. This is mainly driven by our positive outlook on its asset quality and credit cost. We expect lower-than-consensus provisions as we see the asset quality showing an improving trend in FY23/24F, with the expectation of regional economy recovery and the China property sector set to show a turnaround.

Key Risks to Our View:

Lower-than-expected HK GDP recovery; and weak synergies from its acquisitions in ASEAN, and GBA expansion.

At A Glance

| | |
|-----------------------------------|------------------|
| Issued Capital (m shrs) | 10,573 |
| Mkt Cap (HKm/US\$m) | 333,578 / 42,507 |
| Major Shareholders (%) | |
| Bank of China Ltd | 66.1 |
| Free Float (%) | 33.9 |
| 3m Avg. Daily Val. (US\$m) | 42.53 |
| GICS Industry: Financials / Banks | |



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Bank of China Hong Kong

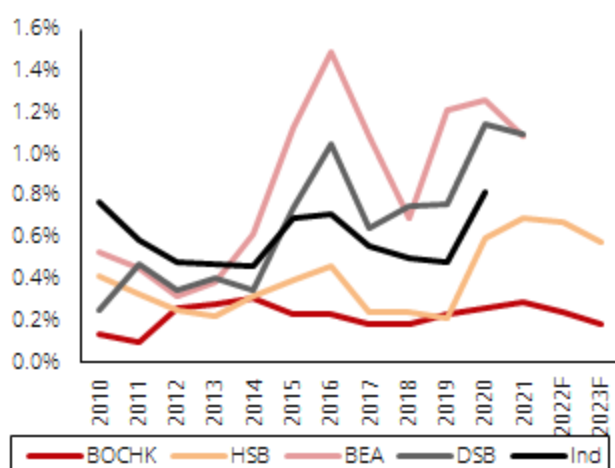
WHAT'S NEW

Strong loan growth and good asset quality from large clients' exposures

Exposure to large corporate clients brings steady loan growth. BOCHK benefits from exposure to large corporate clients. The SME clients are less than 5% of its total clients. With the relatively stable loan demand from larger corporates in a volatile environment, BOCHK reported a 4.5% y-o-y loan growth in 1Q22, exceeding the overall HK loan growth of 2.2% y-o-y. This was mainly driven by the steady corporate loan growth of c.6-7% y-o-y, while retail loan growth was weak. Looking ahead, we expect BOCHK to achieve a mid to high single-digit loan growth in FY22-24F.

Better asset quality compared to peers, and positive outlook. Again, as BOCHK's focus is on large corporate clients, its NPL ratio and credit cost remain significantly lower than peers. Its NPL ratio was 0.27% in 1Q22, an equal level with FY21. It also has a more resilient profile with a high impairment coverage ratio of higher than 200%, while peers' is usually lower than 100%. Its loan to riskier sectors, such as property-related, wholesale, and retail and manufacturing accounts for 54.3% of total loans in FY21, lower than the majority of peers' c.65-70%.

Fig 1: NPL ratio comparison



Source: Corporates, DBS HK

Key concerned areas are 1) ASEAN exposure and 2) China property sector exposure. Looking ahead, we expect the asset quality to be largely stable in FY22F as the concerned areas as of total loan was relatively small. We expect more

improvement in FY23/24F with assumptions of a better COVID situation and a property market turnaround.

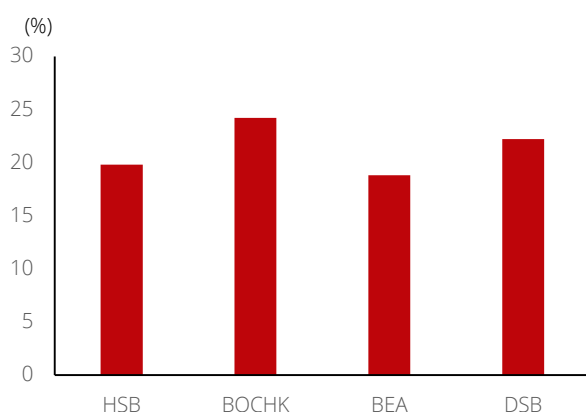
NPL in ASEAN was 2.39% in FY21, significantly higher than the group level. This was mainly due to many loans being issued to SMEs before COVID-19, which was negatively impacted by the pandemic. By the end of FY21, ASEAN loans accounted for c.3.45% of total loans. The overall impact would be small. By 1Q22, BOCHK's exposure to the China property market was c.Rmb 105bn, or 6.3% of total loans. Around 77% of the exposure was to SOE.

Expect strong NII growth despite NIM being lower than peers. The high exposure to large clients also led to a lower NIM. What's more, it has more pressure on deposit costs with a relatively lower CASA ratio. However, the negative impact from a lower NIM could be offset by the strong loan growth and low credit cost. Driven by the NIM increment in the interest rate upward cycle and strong loan growth, we expect over 15-25% y-o-y NII in FY22/23F.

High fee income proportion. BOCHK's fee income accounted for c.24% of total revenue in FY21, the highest among its peers. Despite 1Q22 fee income declining by 22% y-o-y due to market volatility, we expect a better performance in 2H22. In the longer run, we expect Wealth Connect to be another major growth driver, especially after the China-HK border reopens. BOCHK was well prepared for the WMC services leveraging on BOC's presence in GBA.

Bank of China Hong Kong

Fig 2: Fee income as of total revenue



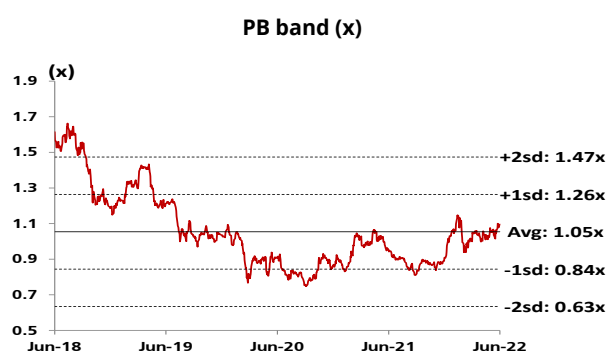
Source: Corporates, DBS HK

Company Background

BOCHK is the second-largest commercial bank in Hong Kong by total assets, and commands a strong market share in all major businesses. It is an indirectly owned subsidiary of Bank of China Limited (BOC). BOCHK is one of the three note-issuing banks in Hong Kong and is the PBOC-appointed clearing bank for Renminbi (RMB) businesses in Hong Kong.

Reinstate coverage with BUY and TP at HK\$ 37.4. The stock is currently trading at a c.1x forward P/B vs. its five-year average of a 1.2x P/B with dividend yield of 3.6%. We expect its ROE to gradually recover to 10-12% in FY23/24F (from 7.8% in FY21) and show a 20% earnings CAGR in FY21-24F. We thus expect a rerating of the stock with TP at HK\$ 37.4, or 1.2x P/B.

Historical PE and PB band



Source: Thomson Reuters, DBS HK

Bank of China Hong Kong

Key Assumptions

| FY Dec | 2020A | 2021A | 2022F | 2023F | 2024F |
|------------------------------|-------|-------|-------|-------|-------|
| NIM (%) | 1.27 | 1.06 | 1.12 | 1.34 | 1.48 |
| Loan growth (%) | 7 | 7 | 7 | 9 | 7 |
| Cost-to-income (%) | 30 | 33 | 31 | 28 | 26 |
| Credit cost (%) | 0.2 | 0.1 | 0.1 | 0.1 | 0.1 |
| Customer Deposits Growth (%) | | | | | |
| Growth (%) | 9 | 7 | 8 | 8 | 8 |
| Yld. On Earnings Assets (%) | 1.69 | 1.23 | 1.41 | 1.68 | 1.86 |
| Avg Cost Of Funds (%) | 0.66 | 0.34 | 0.41 | 0.46 | 0.51 |

Source: Company, DBS HK

Income Statement (HK\$ m)

| FY Dec | 2020A | 2021A | 2022F | 2023F | 2024F |
|-----------------------------|---------------|---------------|---------------|---------------|---------------|
| Net Interest Income | 34,738 | 31,941 | 36,813 | 46,123 | 54,320 |
| Non-Interest Income | 19,736 | 17,041 | 17,112 | 17,887 | 18,543 |
| Operating Income | 54,474 | 48,982 | 53,925 | 64,010 | 72,863 |
| Operating Expenses | (16,347) | (16,407) | (16,735) | (17,739) | (19,158) |
| Pre-provision Profit | 38,127 | 32,575 | 37,190 | 46,271 | 53,705 |
| Provisions | (2,707) | (2,145) | (2,508) | (2,529) | (2,306) |
| Associates | (152) | (213) | (256) | (307) | (368) |
| Exceptionals | (1,685) | (249) | 0 | 0 | 0 |
| Pre-tax Profit | 33,583 | 29,968 | 34,426 | 43,435 | 51,031 |
| Taxation | (5,115) | (4,969) | (5,508) | (6,950) | (8,165) |
| Minority Interests | (605) | (651) | (689) | (869) | (1,021) |
| Preference Dividend | (1,376) | (1,378) | (1,378) | (1,378) | (1,378) |
| Net Profit | 26,487 | 22,970 | 26,852 | 34,239 | 40,467 |
| Net Profit bef Except | 28,172 | 23,219 | 26,852 | 34,239 | 40,467 |

Growth (%)

| | | | | | |
|-------------------------|---------|---------|-------|-------|-------|
| Net Interest Income Gth | (14.28) | (8.05) | 15.25 | 25.29 | 17.77 |
| Net Profit Gth | (17.70) | (13.28) | 16.90 | 27.51 | 18.19 |

Margins, Costs & Efficiency (%)

| | | | | | |
|----------------------|------|------|------|------|------|
| Spread | 1.03 | 0.89 | 1.00 | 1.22 | 1.35 |
| Net Interest Margin | 1.17 | 0.98 | 1.06 | 1.28 | 1.41 |
| Cost-to-Income Ratio | 30.0 | 33.5 | 31.0 | 27.7 | 26.3 |

Business Mix (%)

| | | | | | |
|-------------------------|------|------|------|------|------|
| Net Int. Inc / Opg Inc. | 63.8 | 65.2 | 68.3 | 72.1 | 74.6 |
| Non-Int. Inc / Opg inc. | 36.2 | 34.8 | 31.7 | 27.9 | 25.4 |
| Fee Inc / Opg Income | 19.9 | 24.2 | 22.4 | 19.8 | 18.1 |
| Oth Non-Int Inc/Opg Inc | 16.3 | 10.6 | 9.3 | 8.1 | 7.3 |

Profitability (%)

| | | | | | |
|--------------|-----|-----|-----|------|------|
| ROAE Pre Ex. | 9.9 | 7.9 | 8.8 | 10.7 | 12.0 |
| ROAE | 9.3 | 7.8 | 8.8 | 10.7 | 12.0 |
| ROA Pre Ex. | 0.9 | 0.7 | 0.8 | 0.9 | 1.0 |
| ROA | 0.9 | 0.7 | 0.8 | 0.9 | 1.0 |

Source: Company, DBS HK

Bank of China Hong Kong
Balance Sheet (HK\$ m)

| FY Dec | 2020A | 2021A | 2022F | 2023F | 2024F |
|------------------------------------|------------------|------------------|------------------|------------------|------------------|
| Cash/Bank Balance | 653,261 | 669,345 | 542,980 | 586,418 | 633,332 |
| Government Securities | 0 | 0 | 0 | 0 | 0 |
| Inter Bank Assets | 0 | 0 | 0 | 0 | 0 |
| Total Net Loans & Adv. | 1,500,416 | 1,597,194 | 1,708,356 | 1,856,093 | 1,991,833 |
| Investment | 940,699 | 1,167,770 | 1,229,835 | 1,291,327 | 1,355,893 |
| Associates | 1,485 | 1,215 | 959 | 653 | 285 |
| Fixed Assets | 65,296 | 64,163 | 64,163 | 64,163 | 64,163 |
| Goodwill | 0 | 0 | 0 | 0 | 0 |
| Other Assets | 159,824 | 139,743 | 366,033 | 384,552 | 430,440 |
| Total Assets | 3,320,981 | 3,639,430 | 3,912,328 | 4,183,206 | 4,475,946 |
| Customer Deposits | 2,183,709 | 2,331,155 | 2,517,647 | 2,719,059 | 2,936,584 |
| Inter Bank Deposits | 326,495 | 486,062 | 534,668 | 561,402 | 589,472 |
| Debts/Borrowings | 426 | 2,423 | 2,496 | 2,571 | 2,648 |
| Others | 490,696 | 492,329 | 516,481 | 541,840 | 568,468 |
| Minorities | 5,877 | 5,986 | 6,675 | 7,543 | 8,564 |
| Shareholders' Funds | 313,778 | 321,475 | 334,361 | 350,791 | 370,211 |
| Total Liab& S/H's Funds | 3,320,981 | 3,639,430 | 3,912,328 | 4,183,206 | 4,475,946 |

Source: Company, DBS HK

Financial Stability Measures (%)

| FY Dec | 2020A | 2021A | 2022F | 2023F | 2024F |
|--------------------------------|-------|-------|-------|-------|-------|
| Balance Sheet Structure | | | | | |
| Loan-to-Deposit Ratio | 69.1 | 68.9 | 68.3 | 68.7 | 68.3 |
| Net Loans / Total Assets | 45.2 | 43.9 | 43.7 | 44.4 | 44.5 |
| Investment / Total Assets | 28.3 | 32.1 | 31.4 | 30.9 | 30.3 |
| Cust. Dep./Int. Bear. Liab. | 94.5 | 94.8 | 85.7 | 85.8 | 86.2 |
| Interbank Dep / Int. Bear. | 14.1 | 19.8 | 18.2 | 17.7 | 17.3 |
| Asset Quality | | | | | |
| NPL / Total Gross Loans | 0.3 | 0.3 | 0.3 | 0.2 | 0.2 |
| NPL / Total Assets | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 |
| Loan Loss Reserve Coverage | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Provision Charge-Off Rate | 0.2 | 0.1 | 0.1 | 0.1 | 0.1 |
| Capital Strength | | | | | |
| Total CAR | 22.1 | 21.4 | 20.9 | 20.6 | 20.5 |
| Tier-1 CAR | 19.7 | 19.1 | 18.7 | 18.6 | 18.6 |

Source: Company, DBS HK

DBS HK recommendations are based on an Absolute Total Return* Rating system, defined as follows:

STRONG BUY (>20% total return over the next 3 months, with identifiable share price catalysts within this time frame)

BUY (>15% total return over the next 12 months for small caps, >10% for large caps)

HOLD (-10% to +15% total return over the next 12 months for small caps, -10% to +10% for large caps)

FULLY VALUED (negative total return, i.e., > -10% over the next 12 months)

SELL (negative total return of > -20% over the next 3 months, with identifiable share price catalysts within this time frame)

*Share price appreciation + dividends

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