

Hong Kong Banks

2014 Outlook – a New Growth Strategy

- **The new growth strategy for 2014: quality over quantity** - Hong Kong banks registered another year of strong loan growth in 2013, up 16% YTD to November. Sector loan growth in the four years from 2010-13 reached 97% and asset growth reached 57%, both substantially exceeded Hong Kong's nominal GDP growth. We believe the volume-centric strategy will evolve into a quality-centric strategy in 2014.
- **Quality-centric strategy is positive medium term** – A quality-centric strategy focuses on NIM and non-interest income instead of volume. And this strategy is more sustainable by avoiding over-leverage and avoiding unexpected regulatory tightening. As this strategy develops, a key point to watch is loan pricing. We see a 50% chance for loan pricing to increase in 2014.
- **Three push factors for the new growth strategy** – (i) Overall financing demand from China continues to be strong and mortgage growth may bottom out, (ii) HKMA's tightened regulations will be likely to reduce price competition, particularly affecting some China banks' HK subsidiaries with fast loan growth but limited deposit franchises, and (iii) product sophistication develop through RMB initiatives can offer structural upside to non-interest income.
- **Loan growth to be more rational** - Our base-case loan growth estimate of 8-12% is slower than 2013's and, in our view, represents the lower-end of market estimates. Hong Kong's banking sector is supported by solid customer demand (China & mortgages) and strong capital sufficiency (Tier 1 ratio at 10-13%), but has a conservative liquidity outlook (LDR rising, macro/regulatory tightening) in our view. With these dynamics, banks may slow down volume growth, be selective about lending, and put additional effort to manage pricing.
- **Non-consensus concern: slower deposit growth on property price drop** – We are less worried about the negative impact of property-related asset quality (due to low LTV and large accumulated gains). However, a drop in property prices may also negatively affect deposit growth, and we believe this risk is insufficiently understood by the market. This concern also reaffirmed our conservative stance on liquidity.
- **Investment thesis: stable near term; positive mid-term** – The market may remain conservative near term in order to price in more moderate loan growth and risks of having slower deposit growth; but, as loan pricing improves, the quality over volume-centric strategy is favorable for the mid/long-term. We prefer **BoCHK** (positioned to improve service sophistication), **HSB** (non-consensus ROE re-rating) and **DahSing** (rising scarcity value as a family bank).

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See Appendix A-1 for Analyst Certification, Important Disclosures and non-US research analyst disclosures.

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Investment Thesis

Hong Kong banks registered another year of strong loan growth in 2013, up 16% YTD to November. Sector loan growth in the four years from 2010-2013 reached 97% and asset growth reached 57%; both exceeded Hong Kong's nominal GDP growth substantially. We believe this volume-centric strategy will end in 2014 and evolve into a quality-focused growth strategy.

We establish a positive view on customer demand and capital sufficiency, but a conservative view on sector liquidity outlook for 2014. Against this backdrop, we see three push factors for the sector to evolve into the new growth strategy: (i) overall financing demand strong from China, (ii) tightened liquidity regulations may reduce price competition from China banks' HK subsidiaries, and (iii) RMB banking to support banks to enhance product sophistication and offer structural upside to non-interest income.

Our base-case is for loan growth of 8-12% (slower than 2013's and in our view representing the lower-end of Street estimates). We see HK's banking sector being influenced by solid loan demand (China & mortgages), and strong capital sufficiency (Tier 1 ratio at 10-13%), but with a conservative liquidity outlook (LDR rising, macro/regulatory tightening). With these dynamics, banks may keep volume growth slow but be selective on lending; loan pricing power may increase.

Near-term risks exist as the market may need to price in (i) an overall slower loan growth estimate for 2014E and (ii) the increased risk that sector deposit growth may slow due to the impact from declining property prices.

We are positive medium term as we believe a quality-centric strategy (focus on margin, non-interest income over volume) is structurally positive for banks' share prices; growth appears more *sustainable*; and banks should be able to avoid over-leverage and avoid knee-jerk regulatory tightening.

Upward adjustment of loan pricing is a key catalyst to watch both in corporate and the mortgage lending space. We believe a lending rate increase is NOT much expected by the market; currently, we see a 50% chance for loan pricing to increase within 2014.

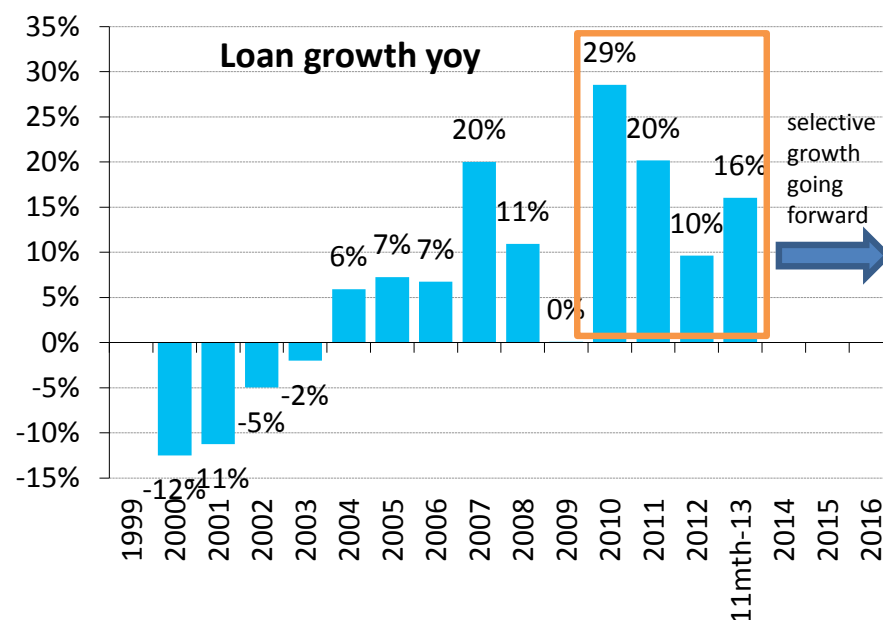
Among listed Hong Kong banks, we prefer **BoCHK** (best positioned for building service sophistication) and **HSB** (non-consensus ROE re-rating).

A New and Favorable Growth Strategy

A Volume-Centric Strategy from 2010-2013 - Over the four-year period from 2010 to 2013, HK banks achieved a substantial loan growth CAGR of 19%, substantially faster than the CAGR nominal GDP growth of c5%. We believe this volume-centric growth strategy will end in 2014 and, instead, banks will focus on margin expansion and non-interest income growth.

A Quality-Centric Strategy Should Be Sustainable – The transition toward a quality-centric strategy means that banks should be less worried about having excess liquidity, and turn selective in asset deployment. Banks will probably put increasing focus on margin and non-interest income, both of which are capital and liquidity friendly. In addition to ROA and ROE expansion, this strategy can help avoid over-leverage and avoid knee-jerk regulatory tightening. Share prices are likely to react positively as the increase of profitability is deemed *sustainable*.

Figure 1. Sector loan growth (2010-2013 CAGR at 19%, be selective going forward)



Source: Citi Research, HKMA

3+1 Sector Dynamics

We acknowledge that achieving the new growth is favorable but NOT easy; but we see HK banks having such potential after considering multiple factors.

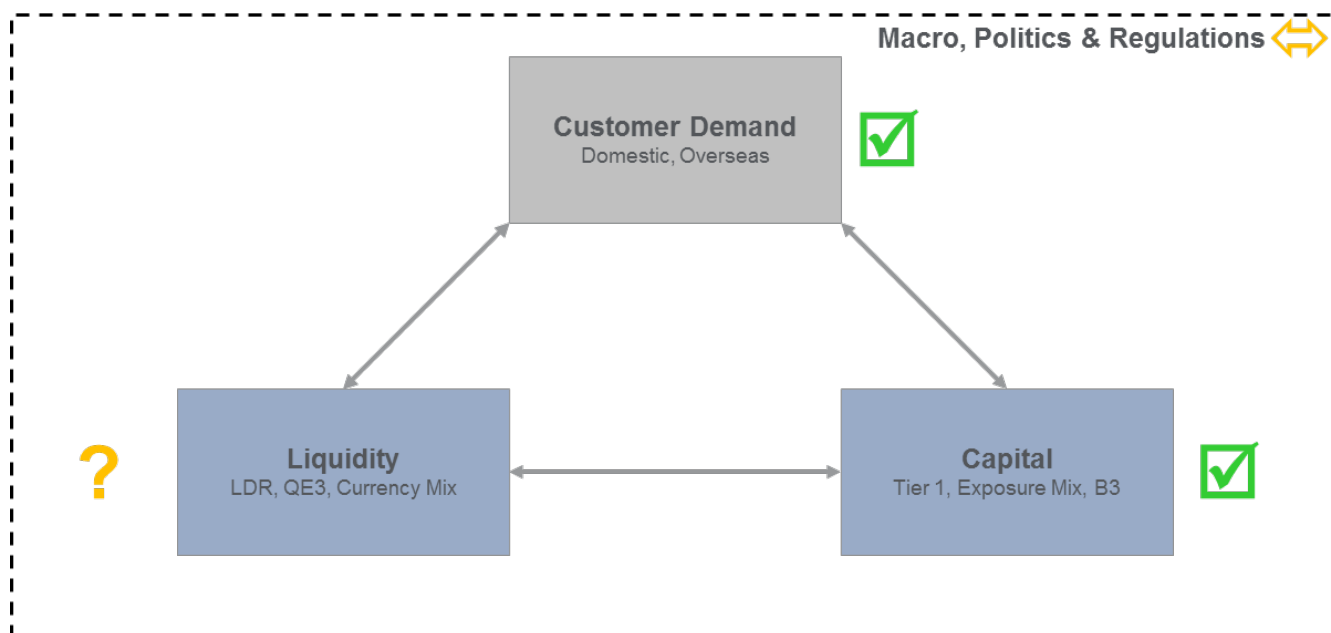
3 core sector dynamics

- **Customer demand** will remain solid (China loan demand continues to be strong; mortgage loan growth pick up from a low base in 2013)
- **Capital** base appears sufficient [low risk for equity fund raising, certainty for dividends (with upside), clarity in meeting Basel III with current Tier 1 ratio at c.10-13%]
- **Liquidity** outlook is conservative (LDR increased for consecutive years with limited upside, HKMA introduced multiple tightening requirements)

+1 evolving catalyst

- **RMB banking** offers opportunities to enhance service/product sophistication (leading offshore deposit base, dim sum bond market, FX transactions; solid China operating experience and potential synergy with onshore branches)

Figure 2. Our sector framework: solid Customer Demand, sufficient capital, conservative liquidity outlook, and mixed macro/regulations



Source: Citi Research

Solid customer demand

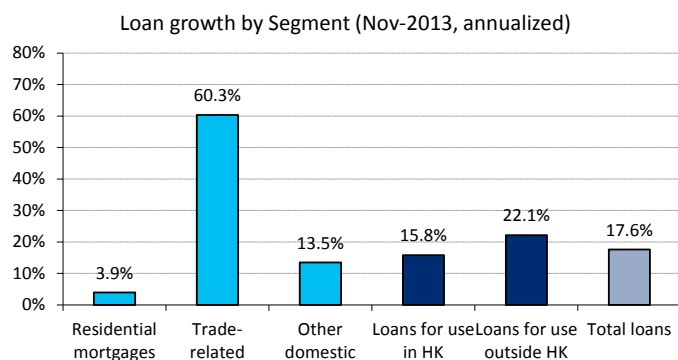
Loan demand in HK is expected to exceed nominal GDP growth. We expect customer demand to be solid for 2014 due to China-related lending and domestic mortgages. Mortgage growth may normalize from a low base in 2013.

HK/China rate differentials remain substantial. This offers an economic incentive for a China borrower to finance through HK and overseas markets. The mainland China one-year benchmark borrowing rate remains at 6%. Premium borrowers may borrow at slightly below benchmark¹ but the majority of loans were priced at or above benchmark. In contrast, HKD/USD borrowing rates in Hong Kong range from 1.5% to 2.5% for high-quality borrowers and CNH borrowing ranges c.2.5-3.5%. Additional demand may arise from (i) China pilot zones (Shanghai FTZ, Qianhai, Henqin), (ii) referrals from Hong Kong banks' growing China presence, and (iii) advances in cross-border infrastructure that accept cross-guarantees.

On mortgages, loan growth may pick up in 2014 after the lackluster growth experienced in 2013. The YTD growth for 2013 to November was at 3.9%; this is compared to annual growth of 7.4%/14.0%/6.9%/7.6% for 2009 to 2012, respectively. Any normalization of property transactions in 2014 are likely to point mortgage growth in 2014 to exceed that of 2013.

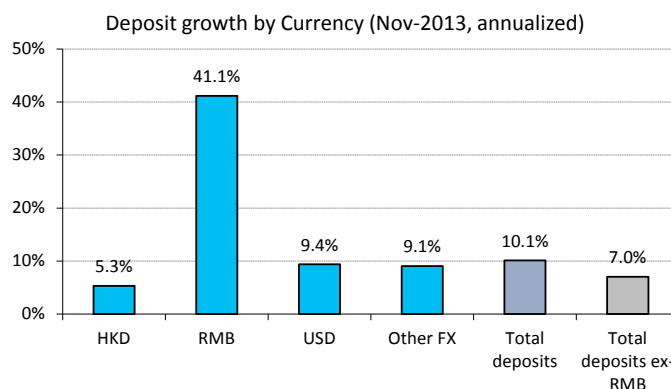
In 2013, loan growth was driven by trade finance, domestic corporate loans, and loans for use outside Hong Kong (Figure 3). The annualized loan growth of 17.6% to Nov-2013 was noticeably higher than the 10.1% deposit growth.

Figure 3. HK - Loan growth by Segment



Source: Citi Research, HKMA

Figure 4. HK - Deposit growth by Currency

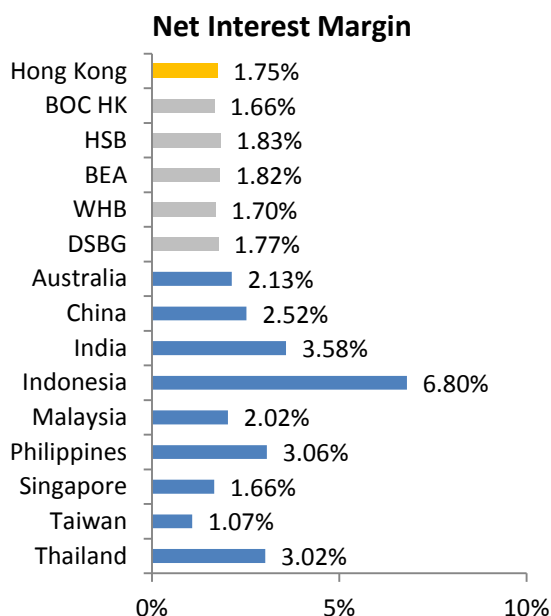


Source: Citi Research, HKMA

From a regional perspective, Hong Kong banks NIM was the third-lowest among Asia ex Japan (Figure 5). The market cap-weighted averaged NIM for 2013E is 1.75%. We believe the recovery of demand may induce additional flexibility for banks to be selective in lending, potentially leading to NIM expansion.

¹ As an example: Sun Hung Kai Properties (0016) has reportedly signed a three-year refinancing loans of RMB4.9 billion with eleven banks for the Shanghai IFC mall project. The interest rate reportedly was fixed at 95% of PBOC's benchmark interest rate. Sources said that the syndicate is led by Bank of China, and the rest includes Industrial Bank, Shanghai Pudong Development Bank, BNP Paribas, HSBC, ICBC, Standard Chartered, Sumitomo Mitsui, etc. (Apple Daily, 31-Dec-2013)

Figure 5. NIM - Hong Kong banks and regional peers (2013E)

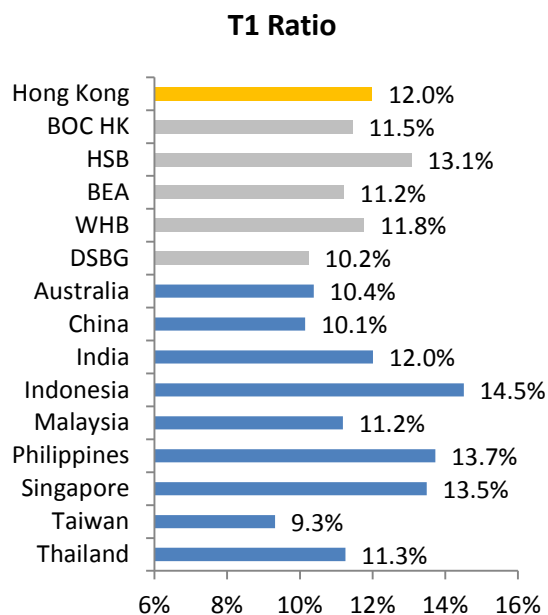


Source: Citi Research *2013E market cap weighted average of banks under Citi Research coverage

Sufficient Capital

HK banks announced their first Basel III compliant capital ratios in 1H13. Market cap-weighted average Tier 1 came in at 12% (Figure 6). This put Hong Kong banks among the markets with higher Tier 1 capital sufficiency. With the expectations that Basel III fully loaded capital requirements will be likely to range c.9.5%-11% by 2019, the sector looks capital sufficient even under a B3 fully loaded basis.

Figure 6. Tier 1 ratio - Hong Kong banks and regional peers (2013E)



Source: Citi Research *2013E market cap weighted average of banks under Citi Research coverage

Liquidity outlook conservative

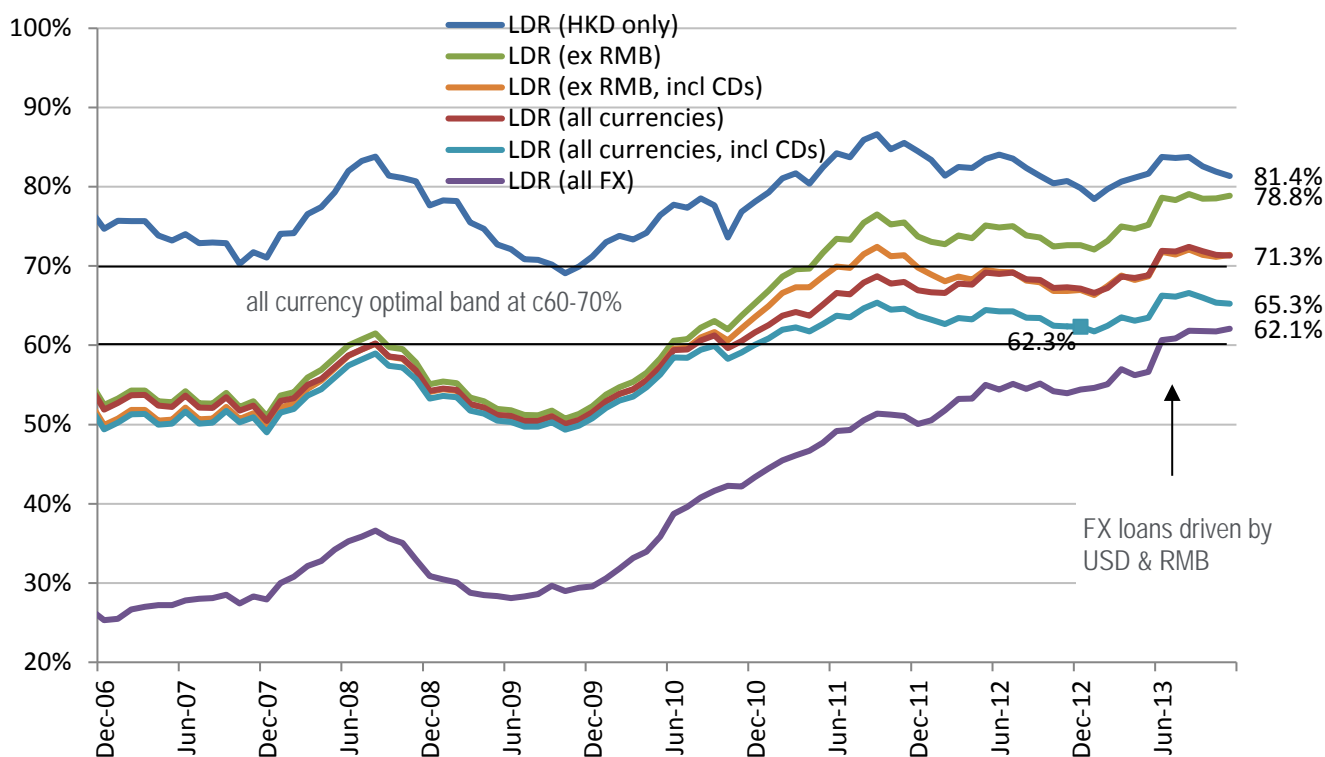
Loan-to-deposit ratio (LDR) noticeably increased, further upside limited -

Sector loan-to-deposit ratio (all currency, CD inclusive) increased to 65.3% in Nov-2013 (versus 50.8% by end-2009 and 62.4% by end-2012). While Hong Kong still has the second-lowest LDR in Asia, HKMA had shown various concerns about the sector, which resulted in regulatory tightening. We expect liquidity requirements may further tighten as Hong Kong phases in the implementation of liquidity coverage ratio (LCR) in 2015.

To gauge sector liquidity, we break down the loan-to-deposit ratio into multiple definitions according with reference to HKMA-detailed disclosures by currencies. At the current juncture, sector liquidity sufficiency may partly be gauged by all currency CD-inclusive LDR (Figure 9, second lowest line, at 65.6% in Nov-2013). And we established an expectation that the range of 60-70% will be optimal for all currency CD-inclusive LDR.

As sector LDR picked up, the ratio may continue to trend toward the higher end of our optimal range. Further upside of LDR will become limited. Given the backdrop of QE tapering expected in 2014 and the reaffirmed volatility in China's interbank market in late-2013, we believe Hong Kong banks' management and regulator are both set to be adopting an overall conservative stance in liquidity during 2014.

Figure 7. Hong Kong sector loan-to-deposit ratio



Source: Citi Research, HKMA

Regulatory tightening: avoiding high LDR and fast growth

HKMA announced in late Oct-2013 the top up stable funding requirements specifically applied to banks with fast loan growth and high loan-to-deposit ratios, a countercyclical move in regulating banks' loan growth and funding mix.

In this measure, HKMA require banks with fast loan growth (i.e. annualized to 20% or above) to meet additional stable funding ratio (Figure 8). Expressed in a formula, the stable funding to be obtained is calculated by:

$$\text{Stable funding to be obtained} = (\text{Total loans} - \text{total customer deposits} \times 70\%) \times \text{SFR} - \text{available stable funding}$$

Stable funding is defined to include long-term interbank funding/debt instruments or long-term parent group funding.

Figure 8. HKMA's matrix for Stable Funding Ratio requirement

Annualized loan growth	Stable funding ratio (SFR)
<20%	0%
20-30%	40%
30-40%	60%
40-50%	80%
>50%	100%

Source: Citi Research

The regulatory implications are twofold, in our view: (i) rival competition may abate from foreign/Mainland China banks' HK subsidiaries with limited deposit franchises – these banks were growing their balance sheets relatively faster than the domestic HK banks peers; (ii) overall customer deposit competition may edge up IF external liquidity inflow slows.

As a side note, the relatively stable funding costs in Hong Kong during 4Q13 were in line with Citi's expectations. We expected "slow down growth near end-2013, and year-end deposit competition may moderate" (reference: [It's Just Fast – Our Thoughts on Loan Growth and Implications](#), 11 Oct 2013) as the sector looked to benefit from strong deposit growth in Sep/Oct/Nov 2013, and we believe such liquidity inflow is partly related to the favorable equity market performance. However, looking into 2014, such favorable market-related flow may NOT repeat.

With overall rising liquidity cost increases with such tightening regulations, banks may consider raising lending prices to reflect the increased liquidity premium. Such policy direction is also in line with the future implementation of the Basel III liquidity coverage ratio (LCR).

On LCR, HKMA consultation released in July 2013 reflected HKMA's *general leading* toward adopting the BCBS phase-in timeline for LCR (i.e. requiring banks to meet only 60% LCR by Jan 2015, 70% by Jan 2016, and progressively to 100% by Jan 2019).

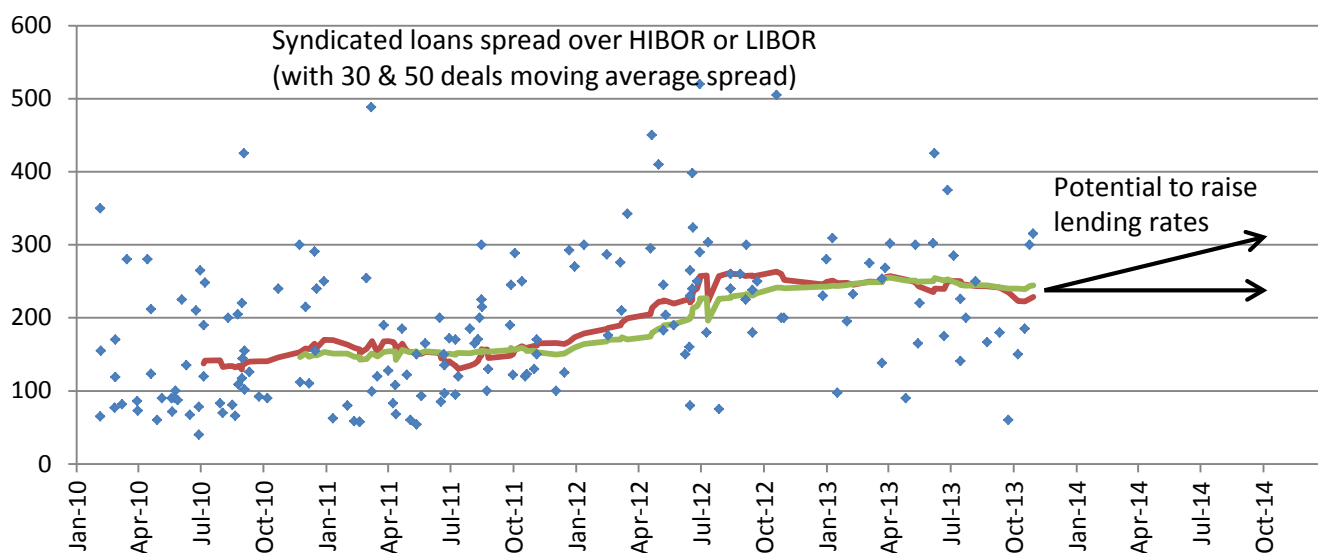
With Hong Kong being a small and open economy that can be noticeably influenced by external liquidity flow, the external dynamics as influenced by QE tapering in 2014 and the continuous volatility in the China interbank market may both cause regulators and banks managements to take a conservative stance on liquidity.

A Non-consensus View: estimate 50% probability for lending rates to increase in 2014

Despite the strong loan growth in 2013, banks are not yet pricing up new loans (Figure 9). We estimate a 50% probability that loan pricing will improve in 2014 from the current level; and this is in contrast with a largely stable loan pricing trend during the last 12-18 months.

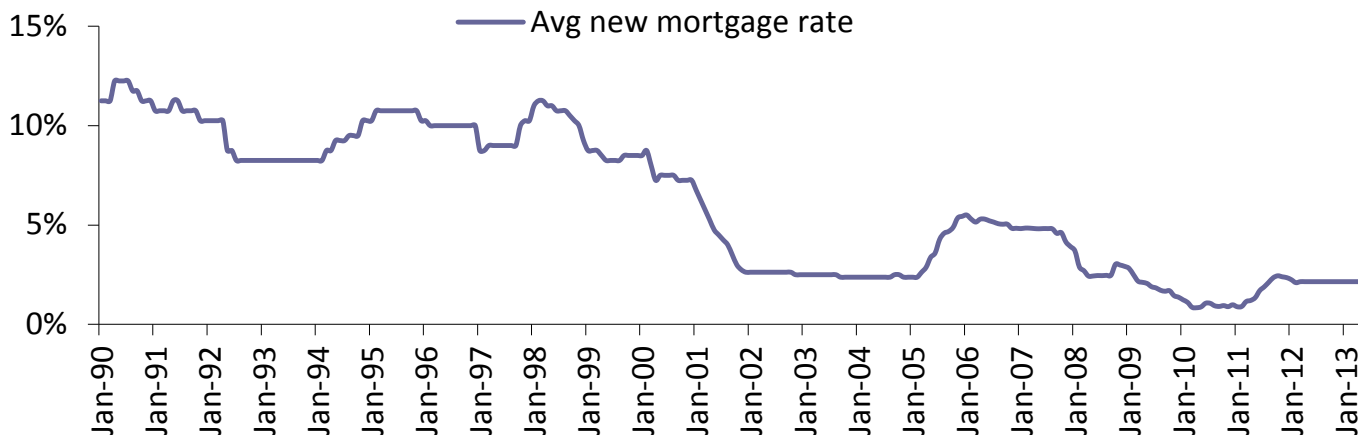
We believe upward adjustment of loan pricing is a key catalyst to watch for in both corporate and mortgage lending, and we also believe such pricing power improvement is NOT expected by the market. Thus, rising confidence or confirming evidence for a rising lending rate can offer share price upside to the sector.

Figure 9. Hong Kong syndicated loans spread over HIBOR/LIBOR for HKD/USD loans - banks are NOT raising syndicated loans pricing



Source: Citi Research, Dealogic

Figure 10. Average new mortgage rate



Source: Citi Research, CEIC *average new lending rate for mortgages referred by mortgage broker mReferral

Product Sophistication through RMB

The Hong Kong markets are typically perceived as well-developed and well-penetrated, but the rapid China-related growth in recent years and emerging RMB banking look to reveal banks' diversified product and service strategy.

And particularly due to certain first-comer-benefits from offshore RMB banking, Hong Kong banks' product sophistication improved and new client relationships were established.

In the medium term, the increase of product sophistication may structurally improve non-interest income and also be a supportive factor to drive overall balance sheet growth.

Among the listed Hong Kong banks, **BoCHK** stands out with the highest level of strategic clarity and understanding of China market.

Up-coming liberalization efforts: such initiatives may include: (i) streamlined regulations and increased support for cross-border lending, (ii) relaxation of the RMB20,000 daily conversion limit and subsequent development of wealth management products, and (iii) relaxation for onshore Mainland individuals to invest overseas and the subsequent investment inflow from mainland wealth.

Recap of key RMB initiatives & revenue drivers – A factual review of key RMB-related initiatives offered by Hong Kong banks could reveal that level of *product sophistication* has been increasing. In addition to traditional lending & deposit taking, we see rising diversity on the capability to deploy excess RMB funding and in offering non-interest income-related services.

The below lists of key initiatives announced over the last 12 months by local Hong Kong banks² again reveals the multiple line of efforts made

- (i) RMB Lending, Interbank Placement, Bond investment - RMB trade-related loans, syndicated loans, pilot zone cross border loans, working capital loans, entrusted loans, certain capability to access SHIBOR
- (ii) RMB Treasury – CNH CDs, CNH/USD Currency Swap, USD/CNH Futures
- (iii) RMB Investments – invest from RQFII quota, funds custodian, ETF issuance, commodities priced on RMB
- (iv) RMB Cash Management – fund pooling, trade settlement
- (v) RMB Bonds – issuances, underwriting, distribution, trading, benchmarking, liquidity swap with HKMA's RMB liquidity facility.
- (vi) RMB Insurance – life insurance
- (vii) RMB Credit card – China Union Pay network, dual currencies
- (viii) China Pilot zone initiatives – branch setup in Qianhai and Shanghai Free Trade Zone, cross-referral of businesses, corporate and retail services

Against the backdrop of the above bank-specific efforts, HKMA also complemented such development by reducing the currency-specific liquidity ratio requirements and improving its RMB liquidity facility that it *welcomed* banks to make use of. In our view, the regulatory preparation increases the readiness for the sector to absorb sudden and external driven on RMB.

² relevant discussion & disclosure from banks recapped in the Appendix of this report

RMB loan-deposit spread represents the typical loan-to-deposit spread business. As of now, RMB lending is still more concentrated in short-tenure trade finance (or those with counterparty guarantees). As RMB lending matures, banks shall increasingly offer longer-tenure term loans, bilateral loans, and syndicated loans; credit spread on loans shall also increase as these exposures are of direct client risk instead of FI guarantees. Co-operation with Mainland China pilot / free-trade zone offers additional benefit for longer-tenure loan growth.

RMB interbank placement spread - this is where we believe the market consensus has mostly misunderstood (and also why the market has been focusing more on LDR increase). The special situation in China is that the yield curve is heavily inverted and onshore RMB interbank rate SHIBOR is at a substantial premium versus offshore CNH interbank rate. During 4Q13, 1 month-SHIBOR is hovering mostly between c5% and 8% and is substantially higher than 1 month-CN HIBOR of c2-3%. This means that for any excess RMB funding, if any HK bank is capable of deploying its excess into the SHIBOR market rather than CNH HIBOR market, the incremental spread would be large. Such spread benefit is also liquidity friendly, thanks again to the inverted yield curve of SHIBOR.

RMB QFII investments and dim sum bond investments – HK banks were able to apply and expand their respective onshore investment quota so as to deploy part of their excess funding into onshore China investment instruments (e.g. corporate bonds). Onshore China investments typically have a higher asset yield than offshore RMB instruments. For the additional surplus RMB liquidity, banks may deploy to purchase Dim Sum bonds.

RMB deposit mix – the sector's RMB time deposit mix is high at c80%. We believe such a higher time deposit mix reaffirms the view that the investment opportunity/deployment channel for corporate/individuals are both insufficient. As RMB markets mature, the time deposit mix may better proxy that in HKD/USD, which is at 40-50% of the sector total. Such a migration could mean a rising opportunity for wealth management product distribution, and overall lower RMB funding costs due to deposit mix improvement.

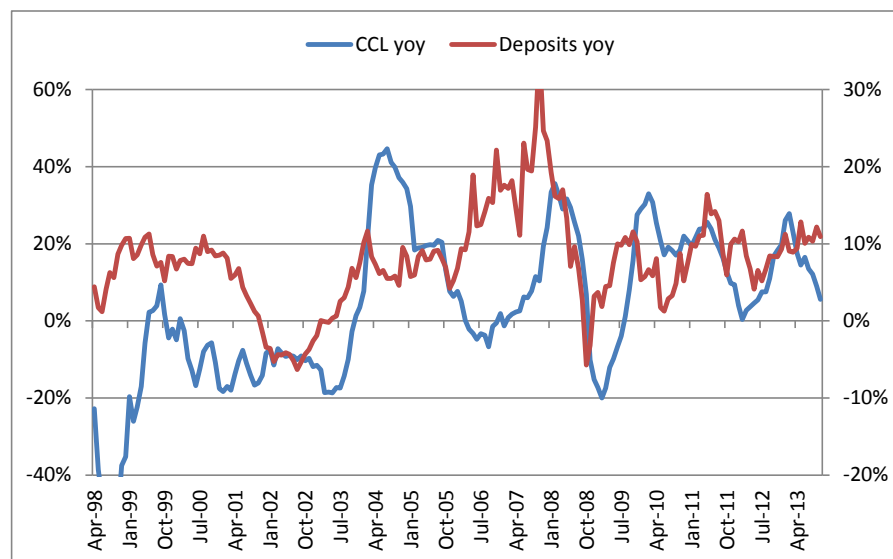
RMB earnings impact sensitivity - By sensitivity, a 10bp increase in the RMB asset-liability spread can increase BoCHK's interest income by HK\$355mn (proxy calculation: $0.1\% \times 20\% \times \text{total assets}$), which translates to c1.3% of 2014E pretax profit. The sensitivity to BoCHK is substantially larger than that to the other banks as BoCHK has c20% of total balance sheet in RMB (compared to sector RMB deposits accounting for c11% of sector deposits). From a fee income contribution perspective, any 5% of group fee income uplift by any non-interest income revenue stream can raise HK banks' profit by c3-4%.

A Non-Consensus Concern: Slower Deposit Growth

Contrasting with a common market worried that property price corrections may have an impact on asset quality and cause mark-to-market losses, we believe property-related asset quality will remain solid (due to low LTV and large accumulated gains over the last decade) and investment losses quantifiable (see Appendix – Three Tactical Risks).

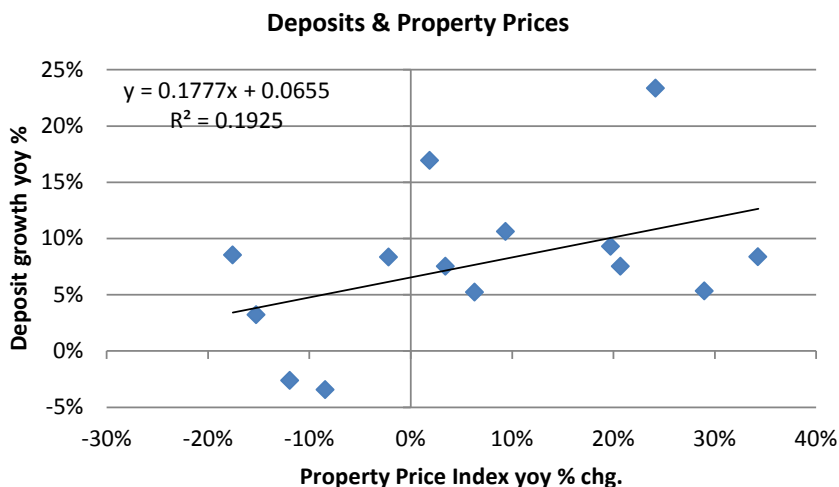
However, the market could have overlooked the risk that a property prices drop may negatively affect deposit growth. This view also reaffirmed our conservative stance on liquidity.

Figure 11. Deposit growth and Property Price Index -



Source: Citi Research, CEIC, HKMA

Figure 12. Deposit growth and Property Prices Changes yoy (1999 till 2012, yearly data)

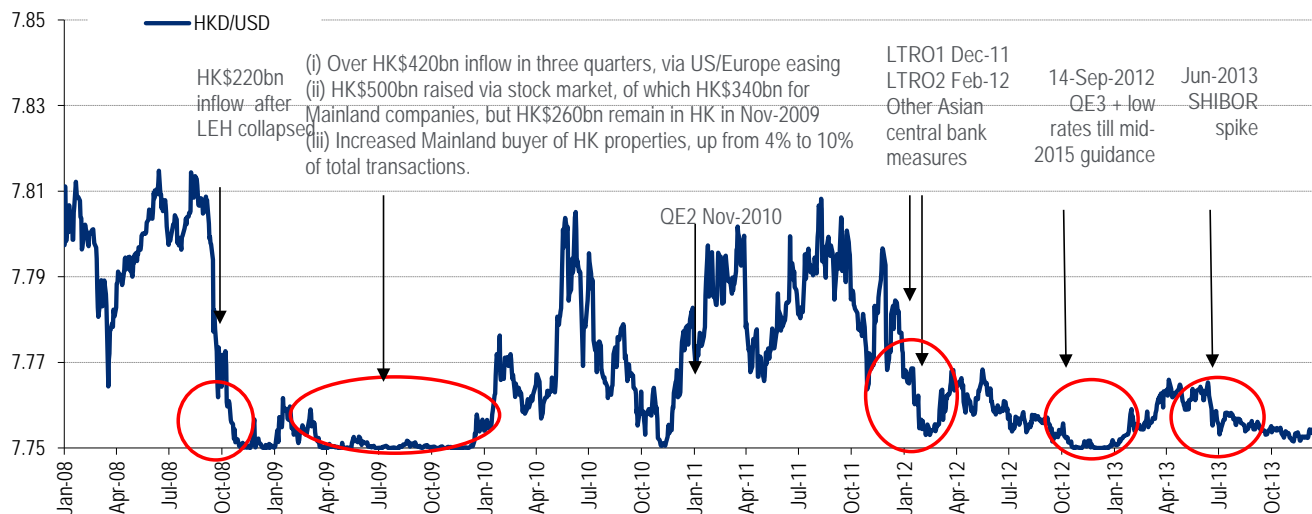


Source: Citi Research

Citi property analyst Ken Yeung expects property prices to drop by c10% yoy in 2014E (reference: [Hong Kong Property 2014 Outlook](#)); should the price drop occur, sector deposit growth could be negatively affected and come in lower than historical CAGR of c7.5% yoy. The correlation analysis between yearly deposit growth and property price change revealed positive relations with an R-square of 0.19 (Figure 12).

External inflow for property purchase may slow with regulations - Property sales, especially those to foreign buyers, may generate liquidity inflow. HKMA's previous analysis to explain post-GFC liquidity inflow attributed Mainland buyers' purchase of HK properties as a key driver for liquidity inflow (Figure 13, include quoted comments from HKMA during 2009). Given the tightening measures applied to curb overseas investments in Hong Kong property market, this driver of liquidity inflow may remain muted in 2014.

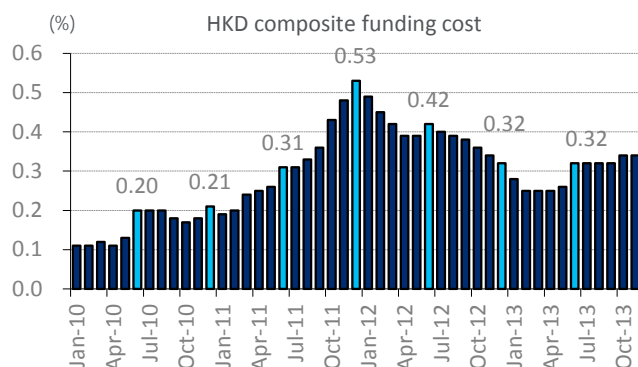
Figure 13. HKD vs USD



Source: Citi Research, HKMA

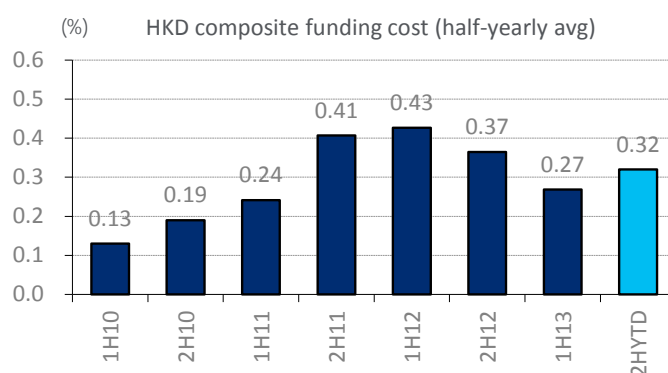
Composite funding cost is likely to be flat or increase moderately. While the liquidity outlook remains conservative, loan growth may NOT substantially exceed that of deposit growth. And the absence of a Fed Fund Rate increase suggests that local liquidity will be the key driver of funding costs.

Figure 14. HKD composite funding cost



Source: Citi Research, HKMA

Figure 15. HKD composite funding cost (half-yearly average)

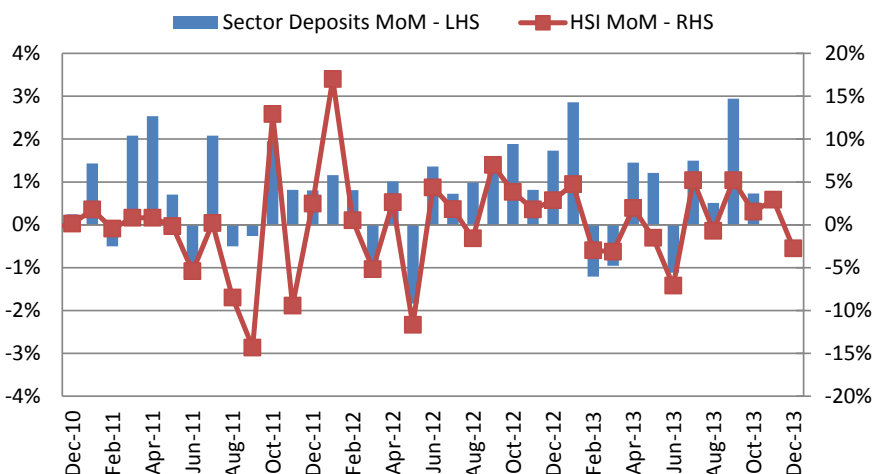


Source: Citi Research, HKMA

Near-term influence from equity market on deposit growth

We see strong correlation with the equity market and near-term deposit growth. As we anticipated, late-2013 deposit competition was moderate versus previous years. Deposit growth was particularly strong in Sep/Oct/Nov 2013 thanks to the favorable equity market performances. However, favorable equity market performance may or may not repeat in 2014.

Figure 16. Deposit growth and HSI – strong near term correlation

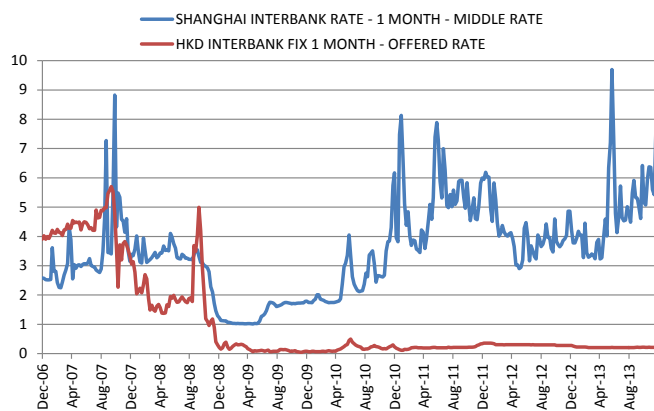


Source: Citi Research, HKMA

Widening interbank rates differences between China and Hong Kong

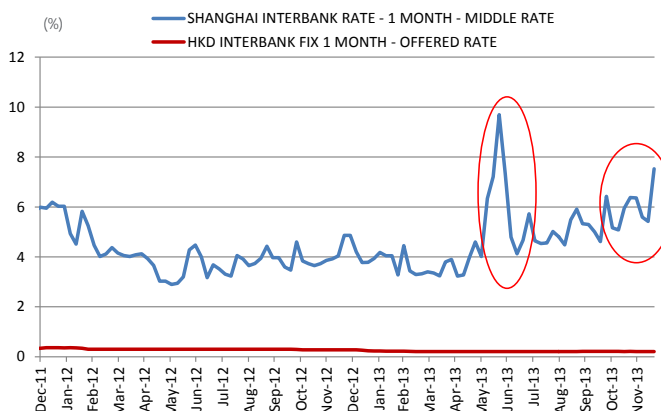
Despite the continued effort for China to liberalize its financial market and for HK to enhance cross-border financing capability for China corporates and individuals, the rate differential of SHIBOR and HIBOR continued to reach historical highs in late 2013. Such a substantial difference may influence lending rates and be another push factor for China's borrowing demand to be addressed outside of China when possible.

Figure 17. SHBIOR & HIBOR 1mth (long-term comparison)



Source: Citi Research, DataStream

Figure 18. SHBIOR & HIBOR 1mth (near-term comparison)



Source: Citi Research, DataStream

Share Price Performances

Hong Kong local banks' share prices were up 13.3% in 2H13, or 9.3% in full-year 2013, outperforming the HSI by 1.3ppt and 6.5ppt, respectively.

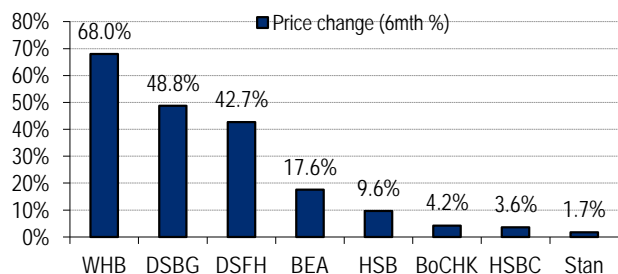
Hong Kong banks also ranked No.1 among the nine regions that Citi Research covers in Asia ex Japan during 2H13 (or ranked No.2 on a full-year basis).

The favorable share price performances were, in our view, attributable to (i) better-than-expected earnings - NIM expansion, strong China-related growth, moderate deposit competition, (ii) overall confidence on risks management – reduced worry about asset quality, improved clarity on capital, and sufficient liquidity, and (iii) rising M&A expectations with deals announced by Wing Hang and Chong Hing, benefiting particularly on mid-cap family owned banks.

On an individual bank basis, mid-cap banks DSBG/DSFH/WHB/BEA led the performance, thanks to positive surprises in 1H13 results, M&A speculation, and low valuation.

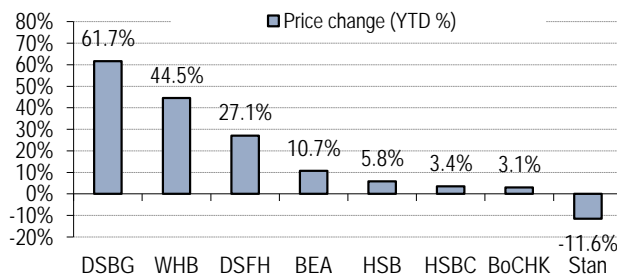
Among large banks, HSB moderately outperformed BoCHK both for 1H13 and 2H13, in our view due to improved clarity on capital (esp. on Industrial Bank impact), a larger benefit from a mid/long-term rate hike, and a catch-up allocation of being underweighted among HK banks.

Figure 19. HK Banks – banks' share price changes in 2H13



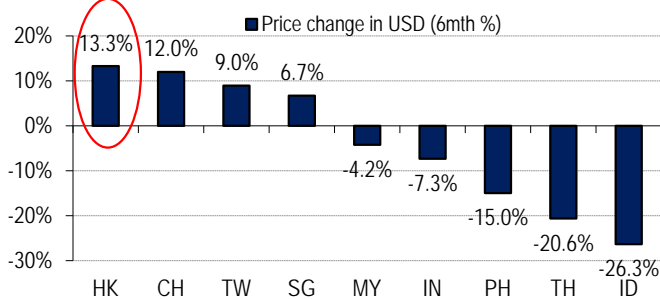
Source: Citi Research, DataStream *priced 31-December-2013

Figure 20. HK Banks – banks' share price changes in full-year 2013



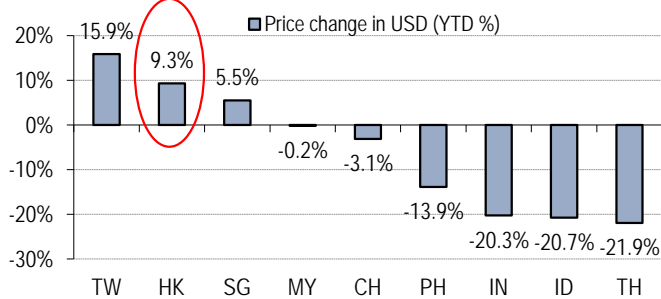
Source: Citi Research, DataStream *priced 31-December-2013

Figure 21. HK Banks – share price changes in USD in 2H13



Source: Citi Research, DataStream *priced 31-December-2013

Figure 22. HK Banks – share price changes in full-year 2013



Source: Citi Research, DataStream *priced 31-December-2013

Valuation Comp

Figure 23. HK banks valuation comp

	Stock	Rating	Target Px	Current*	Mkt Cap	TP Upside	PB			PE			ROE			Dividend Yield		
Bank	Code		(HK\$)	(HK\$)	(US\$ bn)		2012	2013E	2014E	2012	2013E	2014E	2012	2013E	2014E	2012	2013E	2014E
Large banks																		
BoCHK	2388.HK	Buy	30.00	24.15	32.90	24%	1.69x	1.64x	1.56x	12.2x	11.5x	11.3x	14.9%	14.5%	14.1%	5.1%	5.7%	5.7%
HSB	11.HK	Buy	140.00	123.10	30.33	14%	2.55x	2.28x	2.14x	12.1x	8.8x	13.9x	22.6%	27.3%	16.0%	4.3%	4.4%	4.5%
Mid/small banks																		
BEA	23.HK	Neutral	33.00	31.65	9.34	4%	1.23x	1.17x	1.10x	11.8x	12.0x	12.0x	10.9%	10.0%	9.5%	3.3%	3.7%	3.7%
WHB	302.HK	Buy	94.00	117.40	4.65	-20%	1.82x	1.69x	1.59x	19.6x	16.8x	16.7x	9.9%	10.5%	9.9%	1.8%	2.2%	2.4%
DSBG	2356.HK	Buy	13.60	13.76	2.22	-1%	1.12x	1.04x	0.97x	12.1x	10.9x	10.0x	9.3%	9.9%	10.0%	2.3%	2.5%	2.7%
DSFH	440.HK	Buy	49.00	42.80	4.67	14%	0.71x	0.68x	0.64x	10.2x	9.5x	8.5x	7.5%	7.3%	7.7%	2.8%	2.9%	3.2%
Mkt cap w. avg							1.98x	1.83x	1.73x	12.4x	10.7x	12.6x	17.2%	18.8%	14.1%	4.4%	4.8%	4.9%
Large banks							2.10x	1.94x	1.83x	12.2x	10.2x	12.5x	18.5%	20.5%	15.0%	4.7%	5.1%	5.2%
Mid/small banks							1.36x	1.28x	1.21x	13.8x	13.0x	12.9x	10.5%	10.1%	9.6%	2.8%	3.2%	3.3%

Source: Citi Research, Companies, DataStream *priced 7-January 2013

Financial Summary

Figure 24. BoCHK – Financial Summary

P&L (HK\$ m)	2011	2012	2013E	2014E	2015E	Change YoY (%)				
						2011	2012	2013E	2014E	2015E
Net interest income	21,979	24,708	27,384	28,713	30,935	17.3	12.4	10.8	4.9	7.7
Net fees and commission	7,833	7,906	9,468	10,383	11,332	11.2	0.9	19.8	9.7	9.1
Other income	1,034	3,146	3,160	2,339	2,528	-40.2	204.3	0.4	-26.0	8.1
Total operating income	30,846	35,760	40,011	41,434	44,795	12.1	15.9	11.9	3.6	8.1
Operating expenses	-10,659	-11,402	-12,264	-13,131	-14,061	12.3	7.0	7.6	7.1	7.1
Pre-provision operating profit	20,187	24,358	27,746	28,303	30,733	12.1	20.7	13.9	2.0	8.6
Loans impairment charge	-379	-859	-962	-1,234	-1,455	na	126.6	12.0	28.3	18.0
Operating profit	19,808	23,499	26,785	27,069	29,278	9.5	18.6	14.0	1.1	8.2
Exceptionals	4,859	1,995	475	578	530	192.5	-58.9	-76.2	21.6	-8.2
Associates	23	27	28	30	31	na	17.4	5.0	5.0	5.0
Pre-tax profit	24,690	25,521	27,288	27,677	29,840	25.1	3.4	6.9	1.4	7.8
Tax	-3,867	-3,974	-4,366	-4,428	-4,774	26.7	2.8	9.9	1.4	7.8
Minority interests	-383	-617	-648	-680	-714	-22.5	61.1	5.0	5.0	5.0
Attributable net profit	20,440	20,930	22,274	22,568	24,351	26.2	2.4	6.4	1.3	7.9
Balance Sheet (HK\$ m)										
	2011	2012	2013E	2014E	2015E	2011	2012	2013E	2014E	2015E
Cash and balance with banks	445,385	309,953	303,389	302,921	299,351	-9.1	-30.4	-2.1	-0.2	-1.2
Derivative financial instruments	26,787	31,339	32,279	34,862	37,650	12.3	17.0	3.0	8.0	8.0
HKSAR certificates of indebtedness	65,890	82,930	93,711	97,459	101,358	40.2	25.9	13.0	4.0	4.0
Total securities	425,600	531,696	494,477	514,256	534,827	-1.0	24.9	-7.0	4.0	4.0
Gross customer advances	699,379	778,264	854,779	929,234	1,011,452	14.1	11.3	9.8	8.7	8.8
Total loan provision	-2,830	-3,705	-4,342	-4,988	-5,664	22.5	30.9	17.2	14.9	13.6
Associates	234	259	272	286	300	10.4	10.7	5.0	5.0	5.0
Fixed assets	52,091	63,107	59,191	58,612	60,564	25.9	21.1	-6.2	-1.0	3.3
Other assets	25,974	36,920	38,766	40,704	42,740	45.9	42.1	5.0	5.0	5.0
Total assets	1,738,510	1,830,763	1,872,522	1,973,346	2,082,577	4.7	5.3	2.3	5.4	5.5
Interbank deposits	236,694	179,206	139,781	145,372	151,187	-24.6	-24.3	-22.0	4.0	4.0
Total customer deposits	1,146,590	1,229,131	1,299,236	1,377,190	1,459,822	11.6	7.2	5.7	6.0	6.0
HKSAR notes in circulation	65,890	82,930	93,711	97,459	101,358	40.2	25.9	13.0	4.0	4.0
FVPL, derivatives	24,879	38,545	36,618	38,449	40,371	-46.6	54.9	-5.0	5.0	5.0
Debt or Sub-debt	34,641	34,678	26,355	26,882	27,420	28.9	0.1	-24.0	2.0	2.0
Other liabilities	96,633	111,199	116,759	120,262	123,870	19.0	15.1	5.0	3.0	3.0
Minority interests	3,418	4,105	3,941	4,138	4,345	10.0	20.1	-4.0	5.0	5.0
Shareholders' funds	129,765	150,969	156,121	163,594	174,205	12.7	16.3	3.4	4.8	6.5
Total liabilities & equities	1,738,510	1,830,763	1,872,522	1,973,346	2,082,577	4.7	5.3	2.3	5.4	5.5
Ratios (%)										
	2011	2012	2013E	2014E	2015E	2011	2012	2013E	2014E	2015E
Net interest margin	1.32	1.55	1.67	1.69	1.72	-0.17	0.23	0.12	0.02	0.03
ROA	1.20	1.17	1.20	1.17	1.20	0.08	-0.03	0.03	-0.03	0.03
ROE	16.7	14.9	14.5	14.1	14.4	1.8	-1.8	-0.4	-0.4	0.3
Cost/income	34.6	31.9	30.7	31.7	31.4	0.0	-2.7	-1.2	1.0	-0.3
Non-interest/total op income	28.7	30.9	31.6	30.7	30.9	-3.2	2.2	0.7	-0.9	0.2
Impairment charge/avg loans	0.06	0.12	0.12	0.14	0.15	0.07	0.06	0.00	0.02	0.01
Gross loans/deposits	61.0	63.3	65.8	67.5	69.3	1.3	2.3	2.5	1.7	1.8
Loan growth	14.1	11.3	9.8	8.7	8.8	-5.0	-2.8	-1.4	-1.1	0.1
Customer deposit growth	11.6	7.0	5.5	6.0	6.0	-10.4	-4.6	-1.5	0.5	0.0
Impaired loan ratio	0.10	0.26	0.30	0.36	0.40	-0.04	0.16	0.04	0.06	0.04
Impaired loan coverage	398.6	180.4	169.3	149.1	140.0	132.0	-218.2	-11.0	-20.2	-9.1
Provision allowance/gross loans	0.40	0.48	0.51	0.54	0.56	0.03	0.07	0.03	0.03	0.02
Effective tax rate	15.7	15.8	16.0	16.0	16.0	0.2	0.1	0.2	0.0	0.0
Dividend payout	61.4	62.5	65.0	65.0	65.0	-2.0	1.1	2.5	0.0	0.0
Tier 1 capital	12.5	12.3	11.5	11.7	11.9	1.2	-0.2	-0.9	0.3	0.2
Total CAR	16.9	16.8	16.6	16.4	16.2	0.8	-0.1	-0.2	-0.2	-0.2

Source: Citi Research, Company

Figure 25. HSB – Financial Summary

P&L (HK\$ mn)	2011	2012	2013E	2014E	2015E	Change YoY (%)				
						2011	2012	2013E	2014E	2015E
Net interest income	15,736	16,946	18,233	19,850	22,011	10.0	7.7	7.6	8.9	10.9
Net fees and commission	4,836	5,086	5,979	6,439	6,939	-1.2	5.2	17.6	7.7	7.8
Other income	2,025	2,349	3,846	3,939	4,020	-23.1	16.0	63.7	2.4	2.1
Total operating income	22,597	24,381	28,058	30,229	32,970	3.5	7.9	15.1	7.7	9.1
Operating expenses	-7,898	-8,389	-8,985	-9,590	-10,304	7.4	6.2	7.1	6.7	7.4
Pre-provision operating profit	14,699	15,992	19,073	20,639	22,666	1.5	8.8	19.3	8.2	9.8
Impairment charge	-440	-386	-669	-1,121	-1,265	12.8	-12.3	73.3	67.5	12.9
Operating profit	14,181	15,606	18,404	19,518	21,401	0.7	10.0	17.9	6.1	9.6
Exceptionals	1,042	1,126	9,749	406	620	74.0	8.1	765.8	-95.8	52.8
Associates	3,990	5,381	408	420	430	49.9	34.9	-92.4	2.9	2.4
Pre-tax profit	19,213	22,113	28,561	20,344	22,451	10.8	15.1	29.2	-28.8	10.4
Tax	-2,533	-2,687	-1,871	-3,357	-3,704	4.3	6.1	-30.4	79.4	10.4
Attributable net profit	16,680	19,426	26,690	16,987	18,747	11.8	16.5	37.4	-36.4	10.4
Balance Sheet (HK\$ mn)	2011	2012	2013E	2014E	2015E	Change YoY (%)				
						2011	2012	2013E	2014E	2015E
Cash and short term funds	39,533	27,082	21,666	22,532	23,434	-11.0	-31.5	-20.0	4.0	4.0
Interbank placements, bills	107,742	140,382	145,535	150,487	160,353	-2.6	30.3	3.7	3.4	6.6
Investment securities	286,167	301,329	318,362	331,097	344,341	20.2	5.3	5.7	4.0	4.0
Gross customer advances	482,241	537,571	598,418	649,599	701,733	1.6	11.5	11.3	8.6	8.0
Impairment allowances	-1,667	-1,409	-1,556	-2,014	-2,421	-9.2	-15.5	10.4	29.4	20.2
Associates	19,627	24,655	2,850	2,993	3,142	25.3	25.6	-88.4	5.0	5.0
Intangible assets	5,962	6,783	6,919	7,057	7,198	10.5	13.8	2.0	2.0	2.0
Premises and equipment	17,983	19,262	20,289	20,764	21,257	23.5	7.1	5.3	2.3	2.4
Investment properties	4,314	4,860	4,909	5,014	5,334	32.7	12.7	1.0	2.1	6.4
Other assets	13,763	16,581	17,078	17,591	18,119	11.8	20.5	3.0	3.0	3.0
Total assets	975,665	1,077,096	1,134,470	1,205,120	1,282,489	6.4	10.4	5.3	6.2	6.4
Interbank deposits	14,004	19,845	16,868	17,206	17,550	-10.2	41.7	-15.0	2.0	2.0
Customer deposits	730,780	807,260	848,334	902,450	960,951	3.7	10.5	5.1	6.4	6.5
Trading liabilities (ex structured dep)	28,789	21,740	22,175	22,618	23,071	32.5	-24.5	2.0	2.0	2.0
Financial liabilities at FV via P&L	434	464	487	512	537	-5.0	6.9	5.0	5.0	5.0
Derivatives financial instruments	4,848	4,118	4,859	4,956	5,056	3.5	-15.1	18.0	2.0	2.0
CDs issued	9,284	11,291	11,856	13,634	15,679	200.0	21.6	5.0	15.0	15.0
Sub debt	11,846	11,821	12,057	12,299	12,545	0.0	-0.2	2.0	2.0	2.0
Customer insurance liabilities	72,225	81,670	86,570	91,764	97,270	12.1	13.1	6.0	6.0	6.0
Other accounts and provisions	23,821	26,564	28,158	29,847	31,638	15.7	11.5	6.0	6.0	6.0
Shareholders' funds	79,634	92,323	103,105	109,833	118,193	13.7	15.9	11.7	6.5	7.6
Total liabilities & equity	975,665	1,077,096	1,134,470	1,205,120	1,282,489	6.4	10.4	5.3	6.2	6.4
Ratios (%)	2011	2012	2013E	2014E	2015E	Change YoY (ppt)				
						2011	2012	2013E	2014E	2015E
Net interest margin	1.78	1.85	1.83	1.85	1.92	0.00	0.07	-0.02	0.02	0.07
ROA	1.76	1.89	2.41	1.45	1.51	0.06	0.13	0.52	-0.96	0.06
ROE	22.3	22.6	27.3	16.0	16.4	-0.3	0.3	4.7	-11.4	0.5
Cost/income	35.0	34.4	32.0	31.7	31.3	1.3	-0.5	-2.4	-0.3	-0.5
Non-interest/total op income	30.4	30.5	35.0	34.3	33.2	-4.1	0.1	4.5	-0.7	-1.1
Impairment chg/avg loans	0.09	0.08	0.12	0.18	0.19	0.00	-0.02	0.04	0.06	0.01
Gross loans/deposits (incl. CD)	65.2	65.7	69.6	70.9	71.9	-1.9	0.5	3.9	1.3	0.9
Loan growth	1.6	11.5	11.3	8.6	8.0	-35.3	9.8	-0.2	-2.8	-0.5
Customer deposit growth	3.7	10.5	5.1	6.4	6.5	-3.2	6.7	-5.4	1.3	0.1
Impaired loan ratio	0.33	0.25	0.25	0.30	0.35	-0.07	-0.08	0.00	0.05	0.05
Impaired loan coverage	111.7	104.8	104.0	103.3	98.6	14.3	-6.8	-0.8	-0.7	-4.8
Provision allowance/gross loans	0.35	0.26	0.26	0.31	0.35	-0.04	-0.08	0.00	0.05	0.03
Effective tax rate	16.6	16.0	16.5	16.5	16.5	0.1	-0.6	0.5	0.0	0.0
Dividend payout	59.6	52.2	38.7	63.0	59.2	-7.0	-7.4	-13.5	24.3	-3.9
Tier 1 capital	11.6	12.2	13.3	13.4	13.7	0.8	0.6	1.1	0.0	0.3
Total CAR	14.3	14.0	15.4	16.5	17.1	0.7	-0.3	1.4	1.1	0.6

Source: Citi Research, Company

Figure 26. BEA – Financial Summary

P&L (HK\$ m)	2011	2012	2013E	2014E	2015E	Change YoY (%)				
						2011	2012	2013E	2014E	2015E
Net interest income	9,263	9,724	11,385	12,083	13,044	22.8	5.0	17.1	6.1	8.0
Net fees and commissions	3,050	3,379	4,023	4,415	4,824	3.7	10.8	19.1	9.7	9.3
Other income	402	2,006	1,458	1,460	1,547	-37.3	399.0	-27.3	0.2	5.9
Total operating income	12,715	15,109	16,866	17,958	19,415	14.3	18.8	11.6	6.5	8.1
Operating expenses	-7,992	-8,725	-9,408	-10,050	-10,737	15.8	9.2	7.8	6.8	6.8
Pre-provision profit	4,723	6,384	7,458	7,908	8,678	11.9	35.2	16.8	6.0	9.7
Impairment charge	-75	-213	-527	-719	-798	-73.7	184.0	147.3	36.4	11.0
Operating profit	4,648	6,171	6,931	7,189	7,879	18.1	32.8	12.3	3.7	9.6
Exceptionals	728	910	432	286	290	-16.5	25.0	-52.5	-33.8	1.4
Associates	435	536	760	798	794	27.6	23.2	41.8	5.0	-0.5
Pre-tax profit	5,751	7,565	8,123	8,273	8,964	11.7	31.5	7.4	1.8	8.3
Tax	-1,300	-1,411	-1,747	-1,820	-1,972	53.5	8.5	23.8	4.2	8.3
Minority interests	-93	-98	-108	-119	-130	17.7	5.4	10.0	10.0	10.0
Hybrid Tier 1	-328	-331	-330	-330	-330	-0.6	0.9	-0.4	0.0	0.0
Attributable profit	4,030	5,725	5,939	6,005	6,531	3.5	42.1	3.7	1.1	8.8
Balance Sheet (HK\$ m)	2011	2012	2013E	2014E	2015E	Change YoY (%)				
						2011	2012	2013E	2014E	2015E
Cash and short term funds	71,761	85,512	55,583	56,139	56,700	48.6	19.2	-35.0	1.0	1.0
Interbank placements, bills, CDs	105,489	106,358	113,716	117,405	120,449	37.5	0.8	6.9	3.2	2.6
Investment securities	71,760	91,558	91,100	98,388	106,259	4.7	27.6	-0.5	8.0	8.0
Gross customer advances	315,281	350,720	398,335	432,929	468,934	6.1	11.2	13.6	8.7	8.3
Impairment allowances	-968	-919	-1,203	-1,602	-1,988	-12.1	-5.1	30.9	33.2	24.1
Accrued interest, other loans	27,405	37,615	41,377	44,687	48,262	11.8	37.3	10.0	8.0	8.0
Associates	3,820	4,677	5,051	5,455	5,892	6.9	22.4	8.0	8.0	8.0
Fixed assets	12,639	12,552	13,556	14,641	15,812	1.8	-0.7	8.0	8.0	8.0
Goodwill	4,215	4,041	4,122	4,204	4,288	0.6	-4.1	2.0	2.0	2.0
Total assets	611,402	692,114	721,637	772,245	824,608	14.5	13.2	4.3	7.0	6.8
Interbank deposits	15,923	30,597	18,358	19,276	20,240	59.3	92.2	-40.0	5.0	5.0
Customer deposits	467,354	498,770	519,197	559,848	601,372	11.3	6.7	4.1	7.8	7.4
Loan capital, debt	23,134	22,920	20,806	20,756	20,756	31.1	-0.9	-9.2	-0.2	0.0
Trading liabilities	4,548	3,827	4,210	4,420	4,641	46.7	-15.9	10.0	5.0	5.0
CD issued	11,483	27,370	40,508	44,558	49,014	105.6	138.4	48.0	10.0	10.0
Others	36,916	46,991	52,630	53,156	53,688	25.6	27.3	12.0	1.0	1.0
Minority interest	4,428	4,486	4,621	4,759	4,902	0.6	1.3	3.0	3.0	3.0
Share capital	5,190	5,568	5,654	5,704	5,754	1.7	7.3	1.6	0.9	0.9
Reserves	42,426	51,585	55,653	59,767	64,241	8.4	21.6	7.9	7.4	7.5
Total liabilities & equity	611,402	692,114	721,637	772,245	824,608	14.5	13.2	4.3	7.0	6.8
Ratios (%)	2011	2012	2013E	2014E	2015E	Change YoY (ppt)				
						2011	2012	2013E	2014E	2015E
Net interest margin	1.75	1.67	1.82	1.81	1.83	-0.01	-0.08	0.15	-0.01	0.02
ROA	0.78	0.94	0.90	0.86	0.88	-0.11	0.17	-0.04	-0.04	0.01
ROE	8.8	10.9	10.0	9.5	9.6	-1.01	2.15	-0.90	-0.55	0.17
Cost/income	62.9	57.7	55.8	56.0	55.3	0.80	-5.11	-1.97	0.19	-0.66
Non-interest/total op income	27.1	35.6	32.5	32.7	32.8	-5.05	8.49	-3.14	0.22	0.10
Impairment charge/avg loans	0.02	0.06	0.14	0.17	0.18	-0.08	0.04	0.08	0.03	0.00
Gross loans/deposits (incl. CDs)	65.8	66.7	71.2	71.6	72.1	-3.98	0.82	4.51	0.46	0.47
Loan growth	6.1	11.2	13.6	8.7	8.3	-13.80	5.10	2.34	-4.89	-0.37
Customer deposit growth	11.3	6.7	4.1	7.8	7.4	-11.25	-4.60	-2.63	3.73	-0.41
Impaired loan ratio	0.47	0.32	0.46	0.60	0.70	-0.07	-0.14	0.14	0.14	0.10
Impaired loan coverage	65.6	80.8	65.7	61.7	60.6	-3.53	15.13	-15.10	-3.99	-1.10
Provision allowance/gross loans	0.31	0.26	0.30	0.37	0.42	-0.06	-0.04	0.04	0.07	0.05
Effective tax rate	22.6	18.7	21.5	22.0	22.0	6.16	-3.95	2.85	0.50	0.00
Dividend payout	49.0	40.3	45.0	45.0	45.0	-0.21	-8.77	4.72	0.00	0.00
Tier 1 capital	9.42	10.73	11.22	11.34	11.52	-0.38	1.31	0.48	0.13	0.18
Total CAR	13.70	14.30	15.12	14.79	14.57	0.50	0.60	0.82	-0.32	-0.22

Source: Citi Research, Company

Figure 27. WHB – Financial Summary

P&L (HK\$ m)	2011	2012	2013E	2014E	2015E	Change YoY (%)				
						2011	2012	2013E	2014E	2015E
Net interest income	2,871	2,954	3,291	3,593	3,797	8.6	2.9	11.4	9.2	5.7
Net fees and commission	681	630	678	734	795	0.2	-7.6	7.6	8.3	8.3
Other income	232	307	277	380	398	na	32.2	-9.9	37.1	4.7
Total operating income	3,785	3,891	4,246	4,707	4,989	14.8	2.8	9.1	10.9	6.0
Operating expenses	-1,735	-1,852	-2,044	-2,117	-2,232	7.7	6.8	10.4	3.5	5.4
Pre-provision profit	2,050	2,039	2,201	2,590	2,757	21.5	-0.6	8.0	17.6	6.5
Impairment charge	-30	-236	-163	-180	-219	na	691.0	-31.0	10.6	21.9
Operating profit	2,021	1,803	2,039	2,410	2,538	16.2	-10.8	13.1	18.2	5.3
Exceptional	450	276	422	71	72	149.4	-38.7	53.1	-83.1	0.5
Associate	50	41	45	50	56	79.6	-18.6	11.0	11.0	11.0
Pre-tax profit	2,521	2,120	2,506	2,531	2,665	29.4	-15.9	18.2	1.0	5.3
Tax	-372	-317	-388	-392	-413	15.6	-14.7	22.4	1.0	5.3
Attributable net profit	2,149	1,802	2,118	2,139	2,252	32.2	-16.1	17.5	1.0	5.3
Balance Sheet (HK\$ m)	2011	2012	2013E	2014E	2015E	Change YoY (%)				
						2011	2012	2013E	2014E	2015E
Cash and short term funds	9,161	7,211	7,572	7,951	8,348	8.8	-21.3	5.0	5.0	5.0
Interbank placements, bills, CDs	24,426	16,833	14,747	15,415	16,722	235.7	-31.1	-12.4	4.5	8.5
Investment securities	34,646	49,586	44,628	46,859	49,202	-11.3	43.1	-10.0	5.0	5.0
Gross customer advances	110,578	114,054	127,409	135,876	144,284	13.7	3.1	11.7	6.6	6.2
Impairment allowances	-193	-339	-401	-435	-482	-5.7	76.0	18.2	8.5	11.0
Accrued interest & others	2,166	2,910	3,055	3,208	3,368	-7.4	34.3	5.0	5.0	5.0
Associates	249	230	241	253	266	18.2	-7.8	5.0	5.0	5.0
Fixed assets	4,870	5,533	5,588	5,773	5,962	34.6	13.6	1.0	3.3	3.3
Goodwill	1,306	1,306	1,306	1,306	1,306	0.0	0.0	0.0	0.0	0.0
Others	39	39	39	40	41	173.1	-0.2	2.0	2.0	2.0
Total assets	187,249	197,363	204,186	216,247	229,017	17.5	5.4	3.5	5.9	5.9
Interbank deposits	808	1,091	1,135	1,198	1,263	-28.0	35.0	4.0	5.5	5.5
Customer deposits	157,754	165,935	172,573	182,927	193,903	16.3	5.2	4.0	6.0	6.0
CDs issued	2,757	2,564	2,948	3,125	3,312	731.3	-7.0	15.0	6.0	6.0
Trading liabilities	1,082	552	552	552	552	37.2	-49.0	0.0	0.0	0.0
Subordinated liabilities	4,686	4,950	3,205	3,205	3,205	-3.6	5.7	-35.3	0.0	0.0
Other accounts and provisions	3,257	2,737	2,792	2,848	2,905	42.3	-16.0	2.0	2.0	2.0
Share capital	299	302	302	302	302	1.2	1.1	0.0	0.0	0.0
Reserves	16,605	19,232	20,678	22,090	23,574	18.8	15.8	7.5	6.8	6.7
Total liabilities & equity	187,249	197,364	204,186	216,247	229,017	17.5	5.4	3.5	5.9	5.9
Ratios (%)	2011	2012	2013E	2014E	2015E	Change YoY (ppt)				
						2011	2012	2013E	2014E	2015E
Net interest margin	1.67	1.62	1.70	1.80	1.80	-0.17	-0.05	0.08	0.11	-0.01
ROA	1.24	0.94	1.05	1.02	1.01	0.18	-0.30	0.12	-0.04	-0.01
ROE	13.78	9.89	10.45	9.86	9.73	1.66	-3.89	0.56	-0.59	-0.13
Cost/income	45.83	47.60	48.15	44.98	44.74	-2.99	1.77	0.55	-3.17	-0.24
Non-interest/total op income	24.15	24.09	22.49	23.66	23.90	4.32	-0.06	-1.60	1.17	0.23
Impairment charge/avg loans	0.03	0.21	0.13	0.14	0.16	0.09	0.18	-0.08	0.00	0.02
Gross loans/deposits (incl CD)	68.89	67.69	72.59	73.03	73.16	-2.65	-1.20	4.90	0.44	0.13
Customer loan growth	13.70	3.14	11.71	6.64	6.19	-7.12	-10.56	8.57	-5.07	-0.46
Customer deposit growth	16.33	5.19	4.00	6.00	6.00	8.86	-11.15	-1.19	2.00	0.00
Impaired loans ratio	0.30	0.45	0.44	0.50	0.56	-0.01	0.14	-0.01	0.06	0.06
Impaired loans coverage	57.58	66.22	71.45	64.00	59.71	-10.49	8.64	5.23	-7.45	-4.29
Provision allowance/gross loans	0.17	0.30	0.31	0.32	0.33	-0.04	0.12	0.02	0.01	0.01
Effective tax rate	14.76	14.97	15.50	15.50	15.50	-1.77	0.21	0.53	0.00	0.00
Dividend payout	25.01	34.83	37.50	40.00	40.00	-0.07	9.83	2.67	2.50	0.00
Tier 1 capital	10.10	11.10	11.78	11.97	12.19	-0.20	1.00	0.68	0.20	0.22
Total capital	15.90	15.70	15.88	15.91	15.97	-0.70	-0.20	0.18	0.02	0.06

Source: Citi Research, Company

Figure 28. DSBG – Financial Summary

	Change YoY (%)									
Profit & Loss (HK\$ m)	2011	2012	2013E	2014E	2015E	2011	2012	2013E	2014E	2015E
Net interest income	1,919	2,204	2,737	2,878	3,067	-1.9	14.9	24.2	5.2	6.6
Net fees and commission	417	531	642	692	746	7.5	27.3	21.1	7.6	7.9
Other operating income	169	226	187	177	183	105.0	33.1	-17.1	-5.4	3.1
Total operating income	2,505	2,961	3,566	3,747	3,995	3.3	18.2	20.5	5.1	6.6
Operating expenses	-1,527	-1,833	-1,989	-2,145	-2,311	19.5	20.1	8.5	7.8	7.8
Pre-provision operating profit	978	1,127	1,577	1,602	1,684	-14.7	15.2	39.9	1.5	5.1
Impairment charge	-181	-144	-288	-307	-324	85.2	-20.7	100.5	6.7	5.2
Operating profit	797	984	1,289	1,294	1,360	-24.0	23.4	31.1	0.4	5.1
Exceptionals	64	77	-63	18	18	na	21.3	na	na	0.4
Associates	366	504	552	614	700	42.4	37.7	9.5	11.2	14.1
Pre-tax profit	1,227	1,565	1,778	1,926	2,078	-3.2	27.6	13.6	8.3	7.9
Tax	-135	-155	-192	-205	-216	-30.4	14.9	24.2	6.9	5.0
Minority interests	1	0	0	0	0	na	-96.7	10.0	10.0	10.0
Attributable net profit	1,093	1,411	1,586	1,721	1,863	1.8	29.0	12.4	8.5	8.3
Balance Sheet (HK\$ m)	2011	2012	2013E	2014E	2015E	2011	2012	2013E	2014E	2015E
Cash and balances with banks	17,070	17,464	16,885	17,387	17,802	42.4	2.3	-3.3	3.0	2.4
Inv securities & derivatives	31,513	35,433	35,610	38,102	40,770	-1.8	12.4	0.5	7.0	7.0
Gross customer advances	80,867	86,174	97,009	103,375	110,228	11.2	6.6	12.6	6.6	6.6
Loan provisions	-385	-261	-359	-457	-570	-2.8	-32.1	37.5	27.1	24.8
Accrued interest & trade bills	11,278	11,397	11,625	11,857	12,094	15.8	1.1	2.0	2.0	2.0
Associates & jointly controlled	2,030	2,491	3,036	3,640	4,330	25.4	22.7	21.9	19.9	19.0
Fixed assets	3,916	2,248	2,472	2,596	2,726	24.8	-42.6	10.0	5.0	5.0
Goodwill & intangibles	886	881	881	881	881	-1.6	-0.5	0.0	0.0	0.0
Other assets	13	14	15	16	17	130.8	5.0	10.0	5.0	5.0
Total assets	147,188	155,839	167,173	177,397	188,277	11.6	5.9	7.3	6.1	6.1
Bank deposits	2,385	2,646	2,857	3,086	3,333	56.5	11.0	8.0	8.0	8.0
Customer deposits	113,369	117,936	123,833	131,263	139,139	16.5	4.0	5.0	6.0	6.0
CDs issued	3,164	5,752	9,492	10,156	10,867	-33.3	81.8	65.0	7.0	7.0
Trading liabilities	4,587	3,777	3,966	4,164	4,372	-23.4	-17.7	5.0	5.0	5.0
Debt securities	2,718	2,713	2,849	2,991	3,141	39.9	-0.2	5.0	5.0	5.0
Sub-debt	3,698	3,979	3,702	3,702	3,702	-21.1	7.6	-7.0	0.0	0.0
Other accounts and provisions	2,311	3,617	3,906	4,219	4,556	8.6	56.5	8.0	8.0	8.0
Minority interests	16	15	16	16	16	-11.3	-0.2	2.0	2.0	2.0
Shareholders' funds	14,941	15,403	16,553	17,801	19,151	10.4	3.1	7.5	7.5	7.6
Total liabilities & equities	147,188	155,839	167,173	177,397	188,277	11.6	5.9	7.3	6.1	6.1
	Change YoY (ppt)									
Key Ratios (%)	2011	2012	2013E	2014E	2015E	2011	2012	2013E	2014E	2015E
Net interest margin	1.41	1.54	1.77	1.75	1.76	-0.27	0.13	0.23	-0.02	0.01
ROA	0.78	0.93	0.98	1.00	1.02	-0.06	0.15	0.05	0.02	0.02
ROE	7.68	9.30	9.93	10.02	10.08	-1.16	1.62	0.63	0.09	0.07
Cost/income	61.0	61.9	55.8	57.2	57.9	8.2	1.0	-6.2	1.5	0.6
Non-interest/total op income	23.4	25.5	23.3	23.2	23.2	4.0	2.1	-2.3	-0.08	0.06
Impairment charge/avg loans	0.24	0.17	0.31	0.31	0.30	0.09	-0.06	0.14	-0.01	0.00
Gross loans/deposits (incl CDs)	69.4	69.7	72.8	73.1	73.5	-1.9	0.3	3.1	0.34	0.38
Loan growth	11.2	6.6	12.6	6.6	6.6	-16.1	-4.6	6.0	-6.01	0.07
Customer deposit growth	16.5	4.0	5.0	6.0	6.0	7.9	-12.5	1.0	1.00	0.00
Impaired loan ratio	0.47	0.35	0.43	0.48	0.55	0.22	-0.13	0.08	0.05	0.07
Impaired loan coverage	100.5	87.2	86.2	92.1	94.1	-116.4	-13.3	-1.1	5.92	2.01
Provision allowance/gross loans	0.48	0.30	0.37	0.44	0.52	-0.07	-0.17	0.07	0.07	0.08
Effective tax rate	10.97	9.88	15.50	15.50	15.50	-4.30	-1.09	5.62	0.00	0.00
Dividend payout	31.32	27.50	27.50	27.50	27.50	1.30	-3.82	0.00	0.00	0.00
Tier 1 ratio	10.50	10.40	10.25	10.46	10.66	0.30	-0.10	-0.15	0.21	0.20
Total CAR	15.20	14.90	14.60	14.72	14.82	-1.10	-0.30	-0.30	0.12	0.10

Source: Citi Research, Company

Appendix – Structural Trends and Tactical Risks

We see three key structural trends to emerge for Hong Kong banks in the coming 2-3 year horizon: (i) NIM to bottom out, (ii) fee income growth, and (iii) credit cost growth. On the flip side, three tactical risks exist: (i) mark-to-market losses on bond portfolios, (ii) market-to-market losses on properties, and (iii) rising funding costs.

Structural Trends No.1 - NIM bottomed out

Average NIM for HK banks under our coverage improved to 1.74% in 1H13 from a trough of 1.49% in 1H11. BoCHK, BEA, WHB, and DahSing reported strong NIM expansion of 10-17bp hoh, while HSB was flat hoh. Net interest income increased by 8.5% hoh, thanks to margin (up 4.2% hoh) and B/S growth (up 4.1% hoh).

Figure 29. HK banks net interest income, NIM and AIEA trends

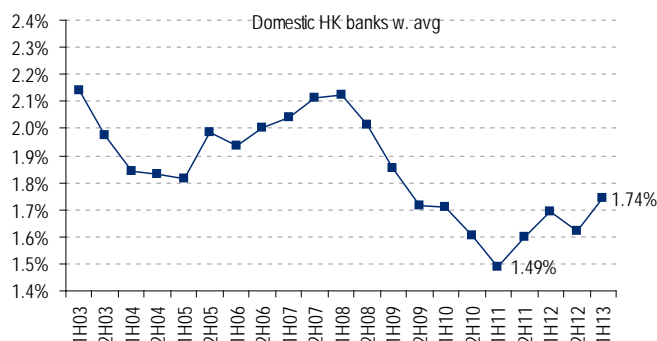
NIM	2H11	1H12	2H12	1H13	HoH % changes		
					1H12	2H12	1H13
BoCHK	1.44	1.64	1.56	1.67	13.9%	-4.9%	7.1%
HSB	1.80	1.85	1.84	1.84	2.8%	-0.5%	0.0%
BEA	1.76	1.63	1.70	1.83	-7.4%	4.3%	7.6%
WHB	1.63	1.67	1.58	1.69	2.5%	-5.4%	7.0%
DSBG	1.31	1.47	1.60	1.77	12.0%	8.8%	10.6%
Weighted Average	1.60	1.68	1.67	1.74	5.4%	-0.8%	4.2%

AIEA	2H11	1H12	2H12	1H13	HoH % changes		
					1H12	2H12	1H13
BoCHK	1,625,698	1,544,663	1,540,489	1,607,052	-5.0%	-0.3%	4.3%
HSB	893,673	898,862	935,610	981,814	0.6%	4.1%	4.9%
BEA	552,614	566,994	600,353	619,016	2.6%	5.9%	3.1%
WHB	180,606	178,691	185,009	189,418	-1.1%	3.5%	2.4%
DSBG	144,446	138,988	147,854	151,844	-3.8%	6.4%	2.7%
Total	3,397,037	3,328,198	3,409,314	3,549,144	-2.0%	2.4%	4.1%

Net interest income	2H11	1H12	2H12	1H13	HoH % changes		
					1H12	2H12	1H13
BoCHK	11,774	12,619	12,089	13,331	7.2%	-4.2%	10.3%
HSB	8,099	8,286	8,660	8,969	2.3%	4.5%	3.6%
BEA	4,863	4,621	5,103	5,664	-5.0%	10.4%	11.0%
WHB	1,472	1,492	1,462	1,601	1.4%	-2.0%	9.5%
DSBG	948	1,022	1,183	1,344	7.8%	15.8%	13.6%
Total	27,156	28,040	28,496	30,908	3.3%	1.6%	8.5%

Source: Citi Research, Companies

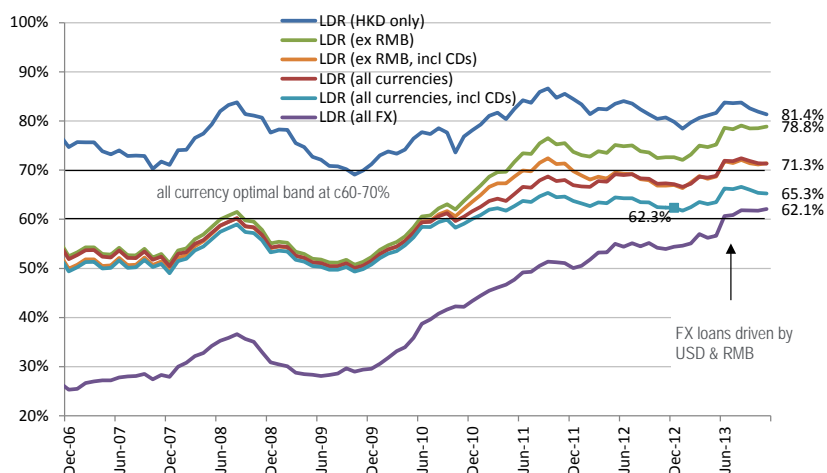
Figure 30. Domestic HK banks weighted average NIM



Source: Citi Research, Companies

The rise in interest income and NIM expansion came together with a rising loan-to-deposit ratio. We [held the view](#) that optimal sector-level LDR for HK banks would broadly be in the range of c60-70% (on an all currency, CD inclusive basis). In addition, when LDR increases from the low end to the high end of the optimal band, banks should benefit from NIM expansion and net interest income growth. We believe that this was partially realized in 1H13. The sector loan-to-deposit ratio increased from 62% to 66% hoh, and net interest income and NIM largely showed positive surprises to consensus. On individual banks, LDR increased by 2.4-4.8%, to the range of 66-73% during 1H13.

Figure 31. Sector loan-to-deposit ratio (incl CDs) within optimal range of 60-70%



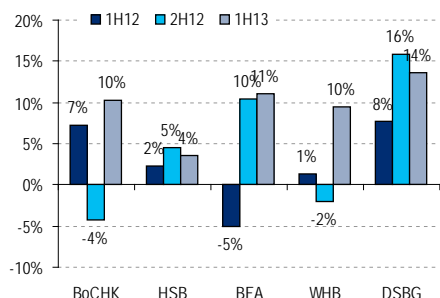
Source: Citi Research, HKMA

Figure 32. HK banks loan-to-deposit (including CDs) ratio up 2.4-4.8ppt hoh, to c66-73% in 1H

Loan-deposit ratio (LDR)	2H11	1H12	2H12	1H13	HoH % changes		
					1H12	2H12	1H13
BoCHK	61.0	63.0	63.3	65.7	2.0	0.3	2.4
HSB	65.2	65.7	65.7	69.9	0.6	0.0	4.3
BEA	65.8	67.2	66.7	71.4	1.4	-0.6	4.8
WHB	68.9	68.9	67.7	71.9	0.0	-1.2	4.2
DSBG	69.4	70.6	69.7	73.0	1.2	-0.9	3.3

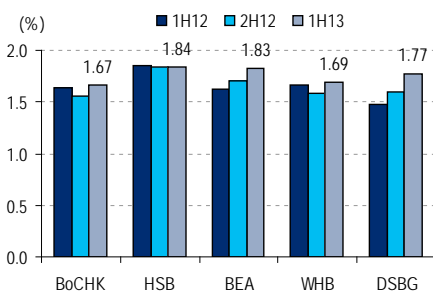
Source: Citi Research, Companies

Figure 33. Net Interest Income Growth (hoh)



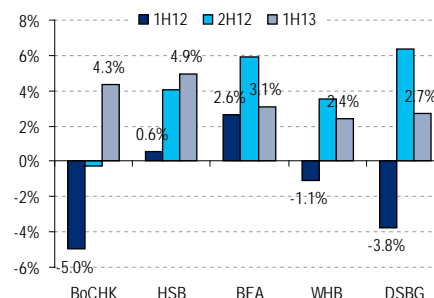
Source: Citi Research, Companies

Figure 34. NIM trends (hoh)



Source: Citi Research, Companies

Figure 35. AIEA growth (hoh)



Source: Citi Research, Companies

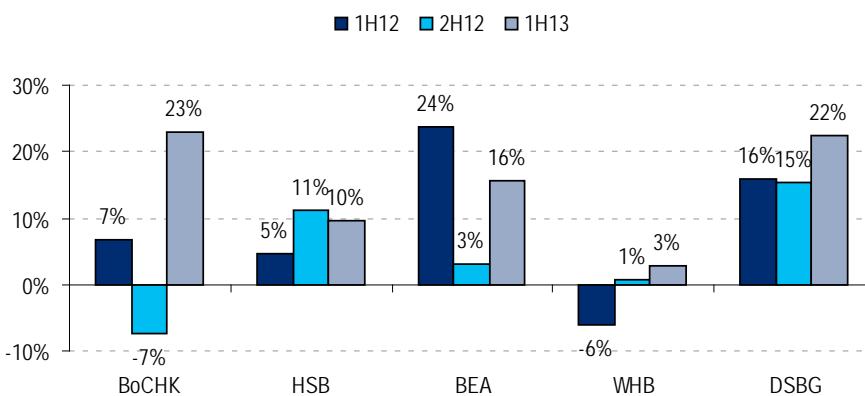
Structural Trends No.2 – Fee income contributions increased

Fee income growth was strong for BoCHK, DahSing, and BEA, led by wealth management, insurance, and trade/credit-related fees. Trade-related fees can be more seasonal but wealth management fees can be structural. We acknowledge particular progress on BoCHK's insurance income (both self-branded through BOC Life and also distribution on third-party insurance policies). We believe this was partly leveraged on the bank's more consistent strategy on RMB product development.

Looking into the 2H13, however, brokerage commissions may reduce hoh given the lower equity market run-rate vs 1H13. 2H13 average daily turnover of HK\$53bn in HK was 17% lower on a hoh basis. This could affect BoCHK and WHB more than peers due to the relatively higher brokerage mix among fee income.

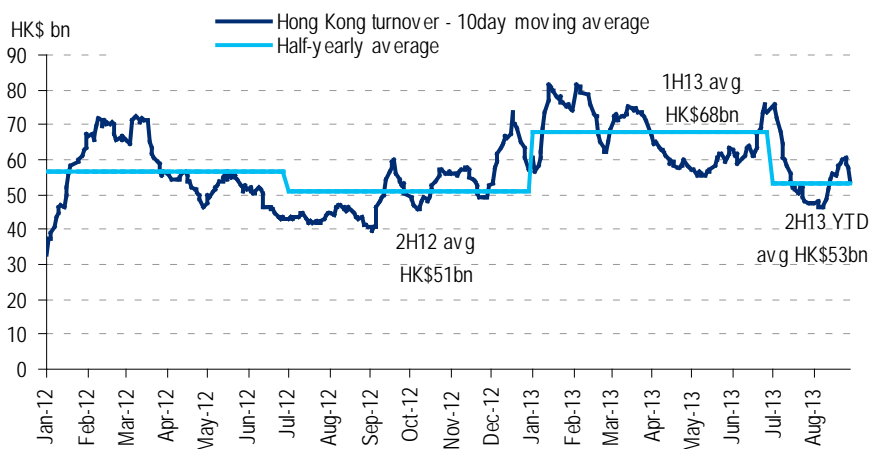
While turnover is by nature volatile, we do acknowledge structural progress on fund distribution (HSB a larger participant in this). According to industry figures, HK gross fund sales showed increased mix on equity and balanced funds over bond funds. This trend could benefit the average commission for banks as fund distributors.

Figure 36. Fee income growth hoh



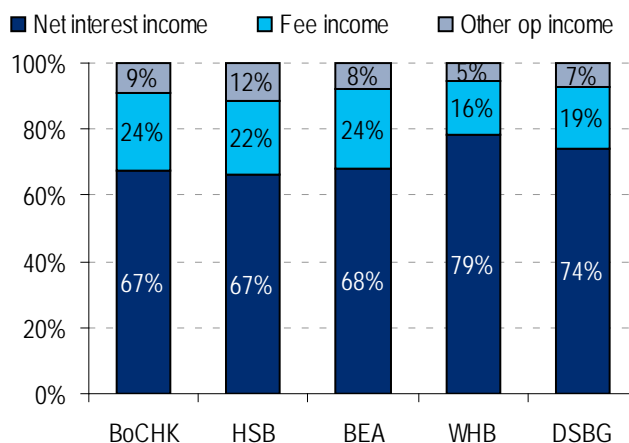
Source: Citi Research, Companies

Figure 37. HK equity market turnover



Source: Citi Research, Bloomberg

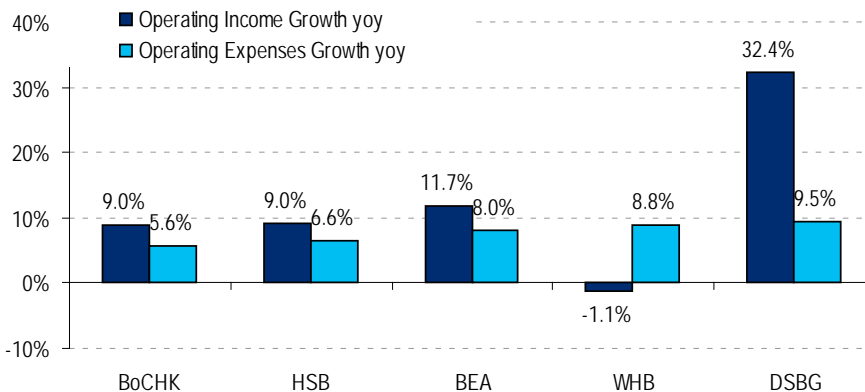
Figure 38. HK banks revenue mix (1H13)



Source: Citi Research, Companies

Operating expenses largely rose by 5.6-9.5% yoy in 1H13. The growth in expenses was mostly lower than operating income growth and resulted in positive operational JAW. Large HK banks continue to attain cost efficiency with BoCHK's cost-income ratio at 29% in 1H13, and HSB's at 32%.

Figure 39. HK banks, operating cost growth mostly faster than expense growth yoy 1H13



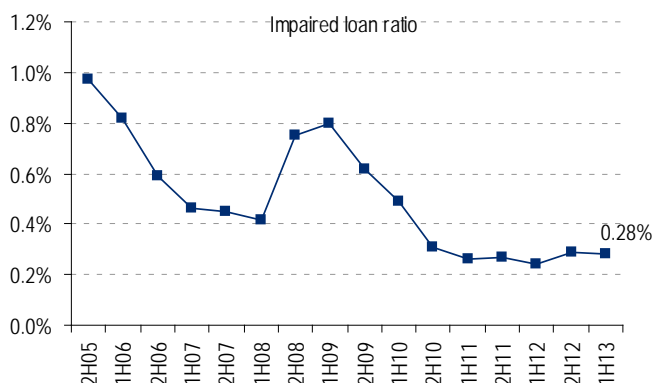
Source: Citi Research, Companies

Structural Trends No.3 – Credit costs bottom out

Annualized credit cost was only at 7-10bp for most banks in the last reported result in 1H13, except for DahSing, which came in higher at 31bp. The impaired loans ratio was mostly flat hoh. HSB and BoCHK have low-end impaired loans ratios of 0.22-0.26% and mid-cap banks at 0.36-0.40% by end-1H13. Banks' onshore China exposures were required to meet local minimum impaired loans coverage requirements of 150%: for these exposures, management would have an incentive to write off NPLs early. Thus, investors cannot purely rely on period-end impaired loans ratios but would have to reference credit costs or write-offs. In this regard, DahSing showed relatively higher credit costs of 31bp. As for the outlook, we expect future credit costs to bottom out from historical lows of c10-15bp in the 2010-11 period, but the increase was NOT expected to cause capital stress on banks.

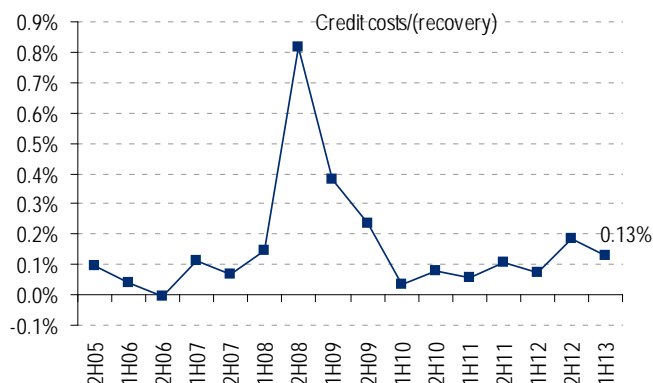
Bank managements mostly commented that asset quality remained benign in Hong Kong, thanks to resilient macro, low unemployment, and low loan-to-value ratios. However, China exposure looks to deserve a higher level of caution. With reference to [onshore China banks' 1H13 results](#), gross NPL formation was c20bp for big China banks and c60bp for smaller China banks. Foreign banks in China do have lower average NPL ratios, potentially due to more conservative underwriting standards, but broad NPL trends are still unlikely to fully decouple from those of domestic banks.

Figure 40. HK banks aggregate impaired loans ratios



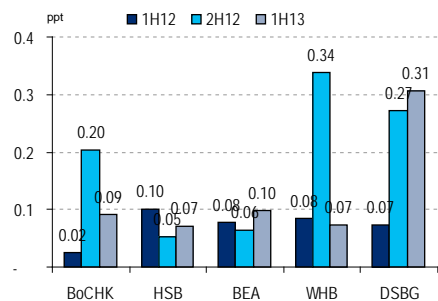
Source: Citi Research, Companies

Figure 41. HK banks aggregate credit costs



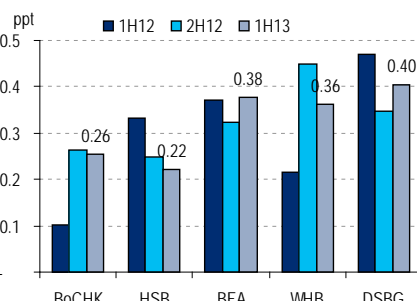
Source: Citi Research, Companies

Figure 42. Credit costs (annualized)



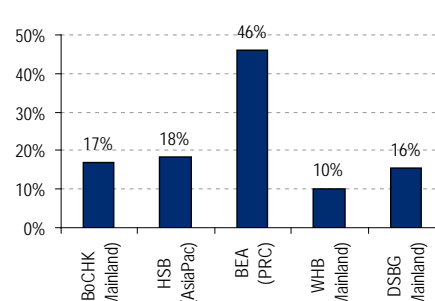
Source: Citi Research, Companies

Figure 43. Impaired loans ratio (hoh)



Source: Citi Research, Companies

Figure 44. Loans to China as % total



Source: Citi Research, Companies *BEA represents greater China exposure. *HSB represents Asiapac

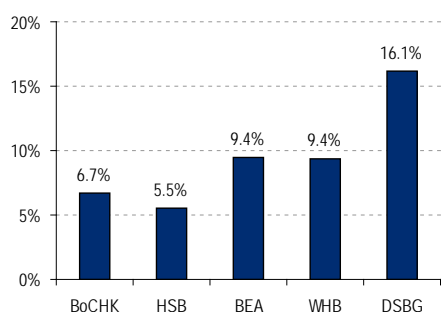
Sensitivity Analysis – NIM, Fee, Credit Costs

Some investors worried that higher credit costs would de-rate HK banks. We do expect credit costs to bottom out and normalize at higher levels. But we believe that they will also probably come with NIM expansion and fee income growth midterm. A fairer assessment is to consider all three key factors.

The above-highlighted three structural trends could further develop in the next 2-5 years. We expect the net result is for operational ROE to trend higher. But non-operational ROE may decline due to a reduced contribution from exceptional gains arising from property revaluations. Overall, we weight operational earnings over non-operational.

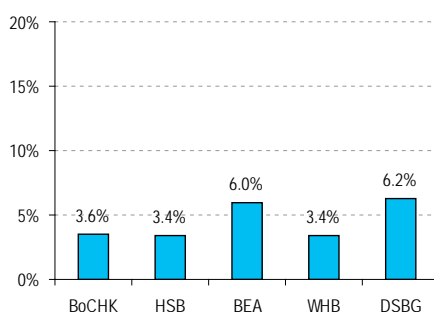
Below we present the sensitivity analysis on the above-mentioned three structural trends for the sector. NIM looks to have the highest sensitivity for earnings, whereas sensitivity to a 10% increase in fees looked similar to a 10bp increase in credit costs. As for the outlook, we largely expect NIM to first stay flat or moderate down in 2H13 hoh (due to the high base of NIM from a very low funding costs). But further down the time horizon, the steepening of the yield curve and rising rate environment should enhance all banks' NIM (particularly for the large-cap deposit franchise banks, HSB and BoCHK).

Figure 45. Sensitivity for 10bp NIM expansion on 2013E operating profit



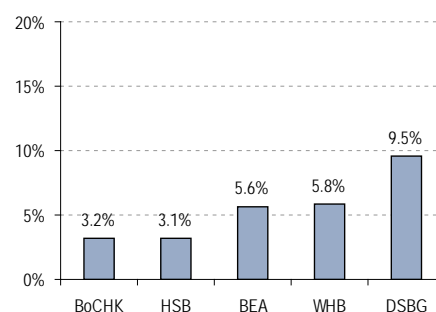
Source: Citi Research

Figure 46. Sensitivity for 10% increase in fee income on 2013E operating profit



Source: Citi Research

Figure 47. Sensitivity for 10bp credit costs increase on 2013E operating profit



Source: Citi Research

Three Tactical Risks

Risks on Bond, Properties, and Funding Costs

While the sector is supported by favorable structural drivers, we see three key tactical risks for earnings through bond book, property prices, and funding costs.

Figure 48. HK banks – sensitivity to (I) trading book & available-for-sale bond book, (II) property prices, and (III) funding costs

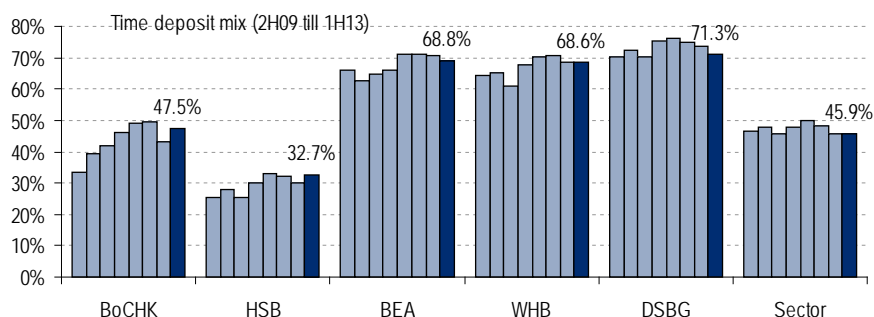
Company data	BoCHK			HSB			BEA			WHB			DSBG		
	2011	2012	1H13	2011	2012	1H13	2011	2012	1H13	2011	2012	1H13	2011	2012	1H13
Interest income	31,931	35,413	18,459	19,845	21,861	11,459	20,868	22,635	11,915	5,285	5,741	2,877	3,313	3,872	2,078
Interest expenses	-9,952	-10,705	-5,128	-4,109	-4,915	-2,490	-11,605	-12,911	-6,251	-2,414	-2,787	-1,276	-1,394	-1,667	-734
Total assets	1,738,510	1,830,763	1,834,661	975,665	1,077,096	1,106,657	611,402	692,114	697,433	187,249	197,364	201,104	147,229	158,586	161,159
Tier 1 capital	84,600	89,096	92,098	35,357	41,002	53,437	35,418	41,831	50,400	10,943	11,893	na	9,363	10,510	na
Total capital	114,254	121,548	135,307	43,624	47,135	61,882	51,517	55,733	66,600	17,135	18,572	na	13,615	15,175	na
FVTPL securities	48,602	49,332	48,564	72,267	42,742	44,659	22,263	22,507	21,130	7,901	18,297	16,789	5,415	5,821	6,223
AFS debt securities	274,123	407,947	362,894	105,080	145,308	126,153	42,897	62,333	61,882	24,406	24,640	19,889	16,941	21,587	24,788
AFS as % assets	15.8%	22.3%	19.8%	10.8%	13.5%	11.4%	7.0%	9.0%	8.9%	13.0%	12.5%	9.9%	11.5%	13.6%	15.4%
Tier 1 ratio	12.51%	12.31%	11.17%	11.6%	12.2%	13.6%	9.4%	10.7%	11.2%	10.0%	10.1%	10.8%	10.5%	10.3%	10.0%
CAR	16.90%	16.80%	16.40%	14.3%	14.0%	15.8%	13.7%	14.3%	14.8%	15.9%	15.7%	16.5%	15.2%	14.9%	14.2%
Book value	129,765	150,969	151,806	79,634	92,323	102,081	47,616	57,153	60,413	17,256	19,534	20,410	15,003	15,403	15,872
Investment properties	12,441	14,364	14,572	4,314	4,860	10,547	2,940	3,100	4,610	590	899	942	749	773	791
Premises	37,049	46,178	47,258	17,370	18,748	19,586	8,991	9,054	8,776	4,280	4,466	4,607	1,034	1,164	1,234
Pretax profit	24,680	25,521	13,948	15,223	16,732	10,319	5,751	7,565	4,386	2,521	2,120	1,369	874	1,074	698
Net profit	20,440	20,930	11,252	16,680	19,426	18,468	4,030	5,725	3,213	2,149	1,802	1,193	1,093	1,411	813
No. of shr outstanding (latest)	10,573	10,573	10,573	1,912	1,912	1,912	2,262	2,262	2,264	307	307	307	1,251	1,251	1,251
Share price (latest)	24.65	24.65	24.65	122.50	122.50	122.50	30.35	30.35	30.35	77.85	77.85	77.85	11.42	11.42	11.42
EPS (annualized)	2.33	2.41	2.64	7.96	8.75	10.79	2.54	3.34	3.88	8.20	6.90	8.90	0.70	0.86	1.12
Quantifying exposures															
AFS debt as % assets	15.8%	22.3%	19.8%	10.8%	13.5%	11.4%	7.0%	9.0%	8.9%	13.0%	12.5%	9.9%	11.5%	13.6%	15.4%
Trading securities as % assets	2.8%	2.7%	2.6%	7.4%	4.0%	4.0%	3.6%	3.3%	3.0%	4.2%	9.3%	8.3%	3.7%	3.7%	3.9%
Premises as % assets	2.1%	2.5%	2.6%	1.8%	1.7%	1.8%	1.5%	1.3%	1.3%	2.3%	2.3%	2.3%	0.7%	0.7%	0.8%
Inv properties as % assets	0.7%	0.8%	0.8%	0.4%	0.5%	1.0%	0.5%	0.4%	0.7%	0.3%	0.5%	0.5%	0.5%	0.5%	0.5%
RWA as % Tier 1 capital	7.99	8.12	8.95	8.62	8.20	7.35	10.64	9.35	8.93	10.00	9.90	9.26	9.52	9.71	10.00
Asset/equity gearing	13.40	12.13	12.09	12.25	11.67	10.84	12.84	12.11	11.54	10.85	10.10	9.85	9.81	10.30	10.15
(1A) 1% down in trading book															
impact on income in HK\$ mn	486	493	486	723	427	447	223	225	211	79	183	168	54	58	62
impact on income as % PBT	2.0%	1.9%	1.7%	4.7%	2.6%	2.2%	3.9%	3.0%	2.4%	3.1%	8.6%	6.1%	6.2%	5.4%	4.5%
(1B) 1% down in AFS bonds															
impact on AFS resrv (HK\$ mn)	2,741	4,079	3,629	1,051	1,453	1,262	429	623	619	244	246	199	169	216	248
impact on T1 capital (HK\$ mn)	2,741	4,079	3,629	1,051	1,453	1,262	429	623	619	244	246	199	169	216	248
impact on T1 ratio (bp)	40.5	56.4	44.0	34.5	43.2	32.1	11.4	15.9	13.8	22.3	20.9	na	19.0	21.2	na
impact as % of book value	2.1%	2.7%	2.4%	1.3%	1.6%	1.2%	0.9%	1.1%	1.0%	1.4%	1.3%	1.0%	1.1%	1.4%	1.6%
(2) 10% down in properties															
impact on book value (HK\$ mn)	3,705	4,618	4,726	1,737	1,875	1,959	899	905	878	428	447	461	103	116	123
impact on total capital (HK\$ mn)	1,667	2,078	2,127	782	844	881	405	407	395	193	201	207	47	52	56
impact on P&L (HK\$ mn)	1,244	1,436	1,457	431	486	1,055	294	310	461	59	90	94	75	77	79
impact on total CAR (bp)	24.7	28.7	25.8	25.6	25.1	22.5	10.8	10.5	8.8	17.9	17.0	na	5.2	5.1	NA
impact on book value (%)	2.9%	3.1%	3.1%	2.2%	2.0%	1.9%	1.9%	1.6%	1.5%	2.5%	2.3%	2.3%	0.7%	0.8%	NA
impact on PBT (%)	5.0%	5.6%	5.2%	2.8%	2.9%	5.1%	5.1%	4.1%	5.3%	2.3%	4.2%	3.4%	8.6%	7.2%	5.7%
(3) 10% up in funding costs															
impact on int. exp. (annualized)	995	1,071	1,026	411	492	498	1,161	1,291	1,250	241	279	255	139	167	147
impact on PBT (%)	4.0%	4.2%	3.7%	2.7%	2.9%	2.4%	20.2%	17.1%	14.3%	9.6%	13.1%	9.3%	16.0%	15.5%	10.5%

Source: Citi Research, Companies

Sensitivity to Bonds, Property and Funding Costs

- **Volatility in the trading book** should have a direct impact on P&Ls. **DahSing** and **Wing Hang** possess a relatively higher mix of trading securities and thus result in higher sensitivity on trading book value volatility.
- **Volatility in available-for-sale bond book** should NOT have direct P&L impact but should affect book value and the Tier 1 ratio. **BoCHK** is more exposed to available-for-sale securities value volatility.
- **Volatility in property values** should have a noticeable impact for **BoCHK/HSB/BEA**. In contrast, **WHB** has lower sensitivity due to reduced exposure; the bank also completed the sale of its WanChai office building in early 2H13. **DahSing** still demonstrates P&L sensitivity to properties, but the bank should NOT have significant book value effect as premises were reclassified to cost-based accounting in 1H13.
- **Volatility in funding costs** should have noticeable impact on mid-cap banks **BEA/WHB/DahSing**. Large banks are less sensitive due to the higher current and saving account deposit mix. Funding costs increase could be triggered by (i) rising broader interest rate, especially short-term rates, or (ii) increased competition for deposits due to liquidity tightness. While rising funding costs could later on be matched or offset by rising asset yields, there could be a noticeable re-pricing time gap and the match-up of asset yield is conditional on price competitions.

Figure 49. HK banks – time deposit mix



Source: Citi Research, Companies

Appendix – Recent RMB initiatives announced by banks

BoCHK Aug-2013 interim report

"The Group has been a major player in the offshore RMB market. After rigorous efforts over the years, we have further enhanced our market influence. This is attributable to our integrated RMB business platform, professional service team and continuous innovation in products with enhanced business functions. Furthermore, our proactive exploration of new customers in foreign enterprises and financial institutions has been on the back of collaboration with the overseas branches of our parent bank. Our RMB business grew healthily with significant developments in various business areas so far this year. Firstly, we completed the **first loan transaction under the Qianhai pilot scheme**. Secondly, we launched several pioneering products in the treasury market, including the first **Certificate of Deposit with the CNH HIBOR, the first CNH/USD Cross-Currency Swap and the first USD/CNH Futures contract**. Concurrently, our efforts in innovation and driving development of RMB investment products recorded outstanding results. This was illustrated by the overwhelming market response to the newly launched **"BOCHK All Weather RMB High Yield Bond Fund"**. We partnered with FTSE Group to develop a new series of **offshore RMB bond indices**, enabling investors to gain access to an array of quality benchmarks. It will help foster the development of **offshore RMB bond markets** worldwide."

"Continued enhancement in offshore RMB business platform. The scope of the offshore RMB business expanded on the back of further policy relaxation. The Group maintained its market leadership with steady development of its business. Leveraging the opportunities from the "Cross-border RMB Loan Trial Scheme in Qianhai", the Group acted swiftly and signed agreements with five enterprises registered in Qianhai to provide them with cross-border RMB direct loans. BOCHK was also designated as a market maker for USD/CNH (offshore RMB) futures by the Chicago Mercantile Exchange Group, being the sole bank among the first group of market makers. With the introduction of the CNH HIBOR in Hong Kong, we pioneered the launch of new treasury products using CNH HIBOR as the pricing benchmark. Our asset management company partnered with FTSE Group to develop a new "FTSE-BOCHK Offshore RMB Bond Index Series". This landmark partnership combines BOCHK's unique competitive position in the offshore RMB business with FTSE's leading index expertise. "

"Strong cross-border banking capabilities. In view of the growing demand for cross-border banking services, the Group strives to provide its customers with comprehensive solutions. Together with BOC, we strengthened our **cross-border RMB entrusted payments and entrusted loans businesses** and established business relationships with our target customers. In custody services, we expanded our client base and successfully secured mandates to provide **custody services for RQFII-ETFs, RQFII funds and Qualified Domestic Institutional Investors**. In recognition of its outstanding QFII performance, BOCHK was awarded the "Best QFII Custodian" under Regional Specialist in the "Asset Servicing Awards 2013" by The Asset Magazine. In cash management business, we further strengthened our competitive edge as a **crossborder fund centre for corporates in Hong Kong through close collaboration with BOC**. BOCHK was granted the "Achievement Award for Best Cash Management Bank in Hong Kong" from the "Asian Banker Transaction Banking Awards 2013" organised by Asian Banker. As for our **individual customers**, we continued to offer a wide range of banking services to bring them **added convenience in financial management across the border**."

“The Group maintained its leading position in the RMB insurance market. We continued to receive positive customer response for our RMB insurance products. The Group also actively explored new distribution channels and established partnerships with brokerage houses to promote insurance products. In recognition of its outstanding performance in RMB services, BOC Life was granted the honour of “Outstanding Insurance Business” under the “2013 RMB Business Outstanding Awards” organised by local media.”

“At the end of June 2013, excluding the RMB fiduciary account for participating banks, total assets under the Group’s custody were valued at HK\$617 billion.”

A number of initiatives were introduced to foster further development of the offshore RMB business in Hong Kong. These included the further relaxation of investment restrictions relating to the RMB Qualified Foreign Institutional Investors (“RQFII”) scheme and the announcement of the special funding arrangement to encourage certain industries to operate in the Qianhai Shenzhen-Hong Kong Modern Service Industry Cooperation Zone (“Qianhai”). The HKMA also removed the limits on RMB net open position and RMB liquidity ratio calculation. In July 2013, operating procedures for cross-border RMB business was simplified. These initiatives gave banks more flexibility to conduct RMB business.

However, the sector is also exposed to rising sector sophistication. Due to the developments of RMB-related products and the rising cross-border financing services demand from China (a large and regulated market).

Added to the fee income was the increase of RMB-related services and treasury product distributions. With incremental RMB products and the establishment of offshore RMB yield curve, both hedging and speculative needs on RMB-related product increased in 2013.

“By the end of June 2013, over 2,300 Platinum personal RMB CUP credit cards were issued. The SME business platform was further enhanced with the launch of the “Small Micro- Enterprise Loan Programme” and streamlining of processes to provide more efficient services to SME customers.”

HSB Oct-2013 announcement

“Hang Seng Bank announced that Hang Seng Bank (China) Limited (‘Hang Seng China’) has received approval from the Shanghai Office of the China Banking Regulatory Commission to establish a sub-branch in the China (Shanghai) Pilot Free Trade Zone (‘Shanghai Free Trade Zone’). “

HSB Nov-2013 announcement

“The Hang Seng China A Industry Top Index ETF(RMB Counter stock code: 83128 / HKD Counter stock code: 03128) — the first Renminbi Qualified Foreign Institutional Investor (RQFII) exchange-traded fund (ETF) issued by a local financial institution in Hong Kong — was today (26 November) listed on The Stock Exchange of Hong Kong (SEHK). “

HSB Jun-2013 announcement

HSB China obtained approval from CSRC for distributing investment funds in China. HSB China was one of the first foreign banks to receive such approval.

HSB Jun-2013 announcement

HSB China's Shenzhen Qianhai sub-branch officially started operation and is one of the first Qianhai-focused branch opened by a foreign bank. The Qianhai sub-branch will provide corporate and commercial banking services, including lending, depositing taking, trade finance and cash management. Businesses also include RMB and FX deposits, investments and insurance for individuals.

HSB Jun-2013 announcement

"Hang Seng Investment Management Limited, a wholly owned subsidiary of Hang Seng Bank, has received approval from the China Securities Regulatory Commission to become an RMB Qualified Foreign Institutional Investor (RQFII). With the approval, Hang Seng will be allowed to invest RMB capital raised in Hong Kong into Mainland domestic securities within an approved RMB investment quota."

HSB Mar-2013, 2012 annual report

"As part of our initiatives to help more people achieve their home ownership dreams, in March we launched the Hang Seng **RMB/HKD Mortgage-Link Account** – Hong Kong's first such dual-currency mortgage plan. RMB/HKD Mortgage-Link Account customers enjoy a preferential interest rate on renminbi and Hong Kong dollar savings that is equal to their mortgage loan interest rate, helping them to more easily offset their mortgage interest expenses. Offering instant access to savings for greater financial flexibility, the account also addresses the growing demand for renminbi-denominated wealth management solutions and further enriches our value-added residential mortgage service."

"We continue to blend innovation and integrity in expanding our portfolio of wealth management products to meet customer needs. Uniting recent rising demand for renminbi-related investments with the long-established investor interest in gold, in February we launched the **Hang Seng RMB Gold Exchange traded Fund (ETF)** – the first fund of its kind to be launched to the market and the first renminbi-denominated ETF of any kind in Hong Kong. Leveraging the strength of our trusted brand, we introduced Dragon themed 10oz and 100g Hang Seng Gold Bars in January to enhance choice for customers interested in physical gold. In early 2013, we further extended our offerings with God of Wealth-themed bars in the same weights."

BEA Dec-2013 announcement

Hong Kong, 16th December, 2013 – The Bank of East Asia ("BEA") today announces the launch of the 2-Year ValueRaiser Insurance plan (the "Plan") by BEA Life Limited ("BEA Life"), BEA's wholly-owned life insurance arm. Customers may apply for the Plan during the application period from now until 11th January, 2014 to receive life protection while enjoying a guaranteed annual return as high as 2.4%.

BEA Aug-2013 announcement

Hong Kong, 20th August, 2013 — The Bank of East Asia ("BEA") today announces that it has been approved as a Renminbi ("RMB") Qualified Foreign Institutional Investor ("RQFII") by the China Securities Regulatory Commission (the "CSRC"). With this approval, BEA is allowed to invest in China's fixed income and A-share markets. BEA will use the RQFII quota for its own investment to enhance return on its RMB funds.

BEA Jun-2013 announcement

Hong Kong, 26th June, 2013 — The Bank of East Asia (“BEA”) today announces that its wholly-owned subsidiary, The Bank of East Asia (China) Limited (“BEA China”) is among the first batch of foreign banks to have been granted a local mutual fund distribution licence in Mainland China.

BEA Feb-2013 announcement

Hong Kong, 25th February, 2013 — The Bank of East Asia (“BEA”) announces that its wholly-owned subsidiary on the Mainland, The Bank of East Asia (China) Limited (“BEA China”), has today opened a new “cross-location” sub-branch in Qingyuan City, Guangdong Province.

Appendix A-1

Analyst Certification

The research analyst(s) primarily responsible for the preparation and content of this research report are named in bold text in the author block at the front of the product except for those sections where an analyst's name appears in bold alongside content which is attributable to that analyst. Each of these analyst(s) certify, with respect to the section(s) of the report for which they are responsible, that the views expressed therein accurately reflect their personal views about each issuer and security referenced and were prepared in an independent manner, including with respect to Citigroup Global Markets Inc and its affiliates. No part of the research analyst's compensation was, is, or will be, directly or indirectly, related to the specific recommendation(s) or view(s) expressed by that research analyst in this report.

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Citigroup Global Markets Inc. or its affiliates expects to receive or intends to seek, within the next three months, compensation for investment banking services from Bank of China (Hong Kong), Wing Hang Bank, Hang Seng Bank.

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Citigroup Global Markets Inc. currently has, or had within the past 12 months, the following as clients, and the services provided were non-investment-banking, securities-related: Bank of China (Hong Kong), Wing Hang Bank, Dah Sing Financial, Bank of East Asia, Hang Seng Bank, Dah Sing Banking.

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The Firm is a market maker in the publicly traded equity securities of Bank of China (Hong Kong), Bank of East Asia, Hang Seng Bank.

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<i>Data current as of 31 Dec 2013</i>	12 Month Rating			Relative Rating		
	Buy	Hold	Sell	Buy	Hold	Sell
Citi Research Global Fundamental Coverage	49%	40%	12%	6%	88%	6%
% of companies in each rating category that are investment banking clients	55%	52%	44%	62%	52%	49%

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