Banks | HONG KONG

FINANCIALS

NOMURA

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NEW THEME

Action

We are negative on HK banks' earnings progress in FY11F, yet we see value in some banks on diverging valuation. We resume sector coverage with a Neutral view. Our top BUYs are BOCHK and DSF on scope for ROE expansion and inexpensive valuation, respectively. We have a REDUCE rating on BEA, which looks expensive at 1.5x book with just 9% ROE for FY11F. We are NEUTRAL on HSB and WHB, both of which look fully valued.

Catalysts

The 2H10F results could provide better earnings visibility for FY11F and FY12F.

Anchor themes

Earnings progress is likely to be muted in FY11F, driven by compressing margins and slow asset growth. We believe margins for HK banks will remain under pressure until the US starts tightening aggressively.

Stocks for action

Top BUYs: BOCHK and DSF owing to scope for ROE expansion and inexpensive valuation, respectively.

Top REDUCE: BEA looks expensive at 1.5x book with ROE of just 9% for FY11F.

Stock	Ticker	Rating	Price (lc)	Price target
BOCHK	2388 HK	BUY	24.7	30.0
DSF	440 HK	BUY	52.0	65.0
HSB	11 HK	NEUTRAL	124.8	130.0
WHB	302 HK	NEUTRAL	99.4	104.0
BEA	23 HK	REDUCE	33.6	28.0

Note: Prices as of 3 March, 2010

Headwinds in 2011

① Resuming sector coverage with a Neutral view: top BUYs BOCHK and DSF; top REDUCE BEA

We are negative on the earnings progress for HK banks this year, as margins remain under pressure and asset growth momentum is slow. However, from a risk-reward perspective, we believe BOCHK and DSF will offer upside potential owing to scope for ROE expansion and inexpensive valuation, respectively; hence our BUY ratings. We believe BEA is expensive at 1.5x book with just 9% ROE for FY11F; hence our REDUCE call. We are NEUTRAL on HSB and WHB.

② Margins pressure from loan, treasury and free-fund operations

Loan margins are still under pressure owing to continued re-pricing of mortgage loans downwards and impaired corporate loan pricing power. The Treasuries spread is still heading south, with the US maintaining a low interest-rate environment. Free-fund contribution is limited in a low HIBOR environment. A strong pick-up in loan growth in 2010 may have eased part of the margin pressure, but we believe overall margins will remain under pressure in FY11F.

③ Muted asset and deposit outlook

Deposits dictate balance sheet growth, which, in turn, is driven by GDP growth. Our HK economist, Robert Subbaraman, forecasts HK real GDP growth will be 5.8% y-y in 2011. We forecast deposit growth only in high single-digits in 2011F. Deposit progress has been the weakest since 2005. We believe the weak asset trend will continue into 2011.

④ Slow earnings progression

We look for 9% earnings growth in FY11F, driven mainly by slow asset growth. The key upside risk is a sharp pick-up of US interest rates, which we do not see until 2012, since US unemployment remains high and the overall economy is only recovering at a slow pace. The key downside risk is a rise of credit charges should major economies see double dips.

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Executive summary

Resuming coverage with a Neutral industry view: BUY BOCHK and DSF; REDUCE BEA

Buy BOCHK and DSF; REDUCE BEA

Earnings progression for HK banks is likely to be muted in 2011, driven by compressing margins and slow asset growth. We are resuming coverage of BOCHK and DSF with BUY ratings as there is scope for ROE expansion since BOCHK is well capitalised and under-leveraged, in our view. DSF's undemanding valuation and the theme of M&A are likely to keep the stock strong, we believe.

We have NEUTRAL ratings on Hang Seng and WHB. We believe the shares are fully valued at 3.0x and 1.9x book in FY11F with ROE at 22% and 13%, respectively.

We have a REDUCE rating on BEA since we believe the bank is expensive at 1.5x book for FY11F on 9% ROE. We believe a significant growth premium has already been priced into the stock.

Margins still under pressure

Margin pressure from: 1) mortgage re-pricing; 2) impaired loan pricing power; and 3) compressing treasury spread

Data from HKMA and news reports showed that 4Q10 margin was 1.13%, a compression of 18bps q-q or 26bps y-y. The compression was mainly owing to excess liquidity in a low interest-rate environment. For the sector as a whole, we believe margins will remain under pressure, owing to: 1) re-pricing of mortgage portfolios downwards; 2) negatives from Treasuries owing to a compressing yield spread; and 3) limited free-fund contribution in a low HIBOR environment. The margin outlook for smaller banks such as BEA, WHB and DSF should be slightly better, in our view, since they carry less liquidity and a pick-up of loan growth in FY10F could help them report stable margins. We think large banks HSB and BOCHK will see margins remain under pressure in FY11F.

Muted assets growth

Slow asset growth due to weak GDP outlook

Deposits dictate balance sheet growth, which, in turn, is driven by GDP growth. Our HK economist, Robert Subbaraman, forecasts real GDP growth in HK will be 5.8% y-y in 2011. We forecast deposit growth of only high single digits this year. Deposit progress has been the weakest since 2005. We believe this weak trend will continue through this year.

Slow earnings growth in FY11F

Earnings growth of just 9% y-y seen in FY11F

Putting all things together, with compressing margins and muted asset growth, we believe HK banks will likely report 9% earnings growth in FY11F. Unless the US Fed increases interest rates sharply, we believe the upside risks to earnings will be limited. Given high unemployment in the US, we see the Fed maintaining a low interest-rate environment for some time to come, which in turn caps upside for HK banks' margins and earnings.

RMB business: limited contribution short-term; long-term gain

Recently there has been a lot of discussion on the subject of renminbi liberalisation.

RMB short term: small volume and low margin

In the near term, we believe renminbi business is likely to be a drag on banks' margins since there is a lack of renminbi investment vehicles and the PBOC is paying 0.99% on offshore renminbi deposits. Currently, the renminbi deposits business is starting from a low base with these deposits comprising just 6% of HK banks' total deposits, according to latest data from HKMA.

Renminbi long term: key driver for asset growth and margins to expand

However, in the long run, we believe renminbi liberalisation is fundamentally positive for the HK bank sector, as renminbi deposits should continue to grow at a fast pace and thus become a driver for asset growth. It also opens up new opportunities for high-margin business, such as renminbi lending, and investment in China's bond market.

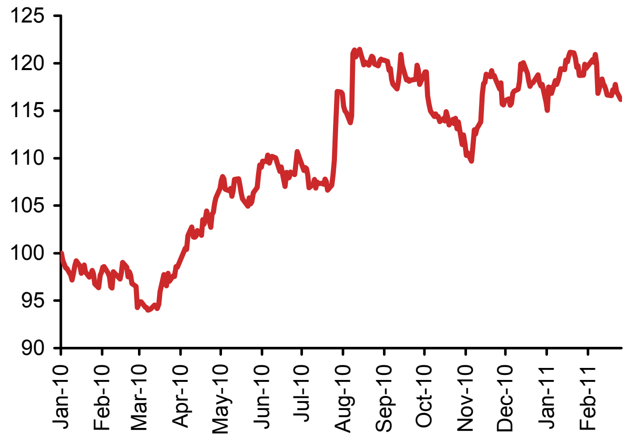
We have conducted a sensitivity analysis on the potential earnings contribution from RMB liberalisation. The results show that BOCHK and DSF are the biggest beneficiaries (both rated BUY). However, we believe renminbi liberalisation is not going to materialise in a meaningful way until China lifts capital controls. As such, we have not built in the potential benefits of the renminbi business in our base case.

Our sensitivity analysis shows that BOCHK and DSF are the biggest beneficiaries of potential RMB liberalisation

Key stock picks

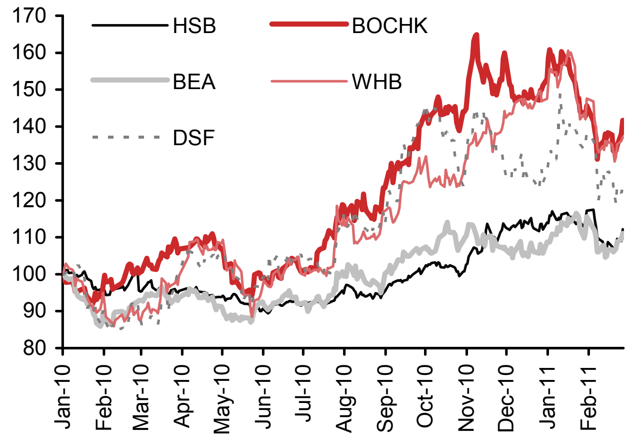
HK banks have outperformed the broad market in 2010, with MSCI HK Banks up 41%, outperforming MSCI HK Index by 21%. The best performers in the sector were BOCHK and WHB, as renminbi liberalisation and M&A activity propelled the stocks higher.

Exhibit 1. MSCI HK Banks relative performance vs MSCI HK Index, 2010-2011 (YTD)



Source: Bloomberg, Nomura research

Exhibit 2. HK Banks absolute performance, 2010-2011 to (YTD)



Source: Bloomberg, Nomura research

We would be selective in stock picks given diverging valuations and earnings outlooks. Our key ratings are as follows:

BOCHK (2388 HK, BUY, Price Target HK$30): We believe there is scope for ROE expansion, although earnings progress is under pressure in FY11F. This is because the bank is well capitalised and under-leveraged. Our back-of-the-envelope calculation indicates that the tier-1 ratio at BOCHK can rise to 17% when we benchmark BOCHK's capital calculation methodology against HSB's. Further renminbi liberalisation should prove beneficial to margins and asset growth in the long run. We believe BOCHK can achieve normalised ROE of 18%. Coupled with a strong long-term growth outlook owing to renminbi liberalisation, we believe the stock can trade up to 3x book. On an FY11F P/E of 16x, P/BV of 2.2x, we believe there is more upside for the stock.

BOCHK: upside from ROE expansion as tier 1 could potentially go to 17%; downside protection from 4% dividend yield;

DSF (440 HK, BUY, Price Target HK$65): The stock is the least expensive in our universe of HK banks, at 1.1x book for FY11F. We see the fundamentals of the company as improving with stable NIMs, slow asset growth and benign credit cost. The potential listing of Bank of Chongqing in 2011 (source: Bloomberg (24 September, 2010, *Bank Of Chongqing Seeks Hong Kong Listing In 2011 Oriental Daily Reports*), if it materialised, would, we think, be likely to trigger a re-rating of the stock. In addition, we believe the theme of M&A could keep the stock buoyant, as shares are tightly held, with the Wong Family holding a 40% stake.

DSF: Inexpensive at 1.1x book; Downside protection from M&A them; upside catalyst from potential listing of Bank of Chongqing

HSB (11 HK, NEUTRAL, Price Target HK$130): We believe earnings progress is going to be weak owing to compressing margins and muted asset growth. The bank is already highly leveraged, so further ROE expansion seems unlikely at HSB and hence

HSB & WHB: Risk-reward balanced; NEUTRAL

limited upside. However, the stock is offering dividend yield of 4%, which we think will lend a floor to the stock price. Trading at 14.9x reported earnings and 3.0x book for FY11F, we believe the shares are fully valued; hence we are NEUTRAL on HSB.

WHB (302 HK, NEUTRAL, Price Target HK$104): We think the fundamentals of the company are improving. However, trading on 1.9x book with an ROE 13% for FY11F, we believe valuation is full and hence are NEUTRAL on the stock.

BEA: Risk-reward skewing downward; REDUCE

BEA (23 HK, REDUCE, Price Target HK$28): the stock looks expensive at 1.5x book with an ROE of 9% for FY11F. Rapid expansion in China should remain a drag on its profitability in the coming 1-2 years. We think that M&A is unlikely since the shares are diffusely held, with the Li's Family holding just 8%.

Valuation

Valuation comparison

Exhibit 3. HK banks: valuation snapshot

	Rating	Mkt cap (US$bn)	Current price	Price Target	P/E FY10F	P/E FY11F	P/E FY12F	P/B FY10F	P/B FY11F	P/B FY12F	P/PPP FY10F	P/PPP FY11F	P/PPP FY12F
HSB	NEUTRAL	30.6	124.8	130.0	16.0	14.9	13.5	3.4	3.0	2.8	16.5	15.5	14.0
BOCHK	BUY	33.5	24.7	30.0	18.0	16.1	12.8	2.3	2.2	2.1	15.9	12.8	10.2
BEA	REDUCE	8.8	33.6	28.0	16.1	16.6	14.5	1.5	1.5	1.4	16.1	14.6	11.9
WHB	NEUTRAL	3.8	99.4	104.0	18.0	15.7	14.1	2.1	1.9	1.8	16.2	13.1	11.8
DSF	BUY	2.0	52.0	65.0	14.9	11.6	10.4	1.1	1.1	1.0	11.5	9.3	8.3
Sector Mean					**16.6**	**15.0**	**13.0**	**2.1**	**1.9**	**1.8**	**15.2**	**13.1**	**11.2**

	Bloomberg ticker	EPS FY10F	EPS FY11F	EPS FY12F	Div yield (%) FY10F	Div yield (%) FY11F	Div yield (%) FY12F	ROE (%) FY10F	ROE (%) FY11F	ROE (%) FY12F	ROA (%) FY10F	ROA (%) FY11F	ROA (%) FY12F
HSB	11 HK	7.80	8.39	9.23	4.2	4.4	4.8	22.6	21.6	21.5	1.7	1.7	1.7
BOCHK	2388 HK	1.38	1.54	1.93	3.6	4.0	5.1	13.6	14.1	16.7	1.1	1.1	1.3
BEA	23 HK	2.08	2.03	2.32	2.8	3.0	3.5	10.6	9.1	9.9	0.9	0.7	0.8
WHB	302 HK	5.52	6.33	7.07	1.2	1.7	2.3	12.5	12.8	13.1	1.1	1.2	1.2
DSF	440 HK	3.48	4.48	5.00	1.7	3.0	3.4	8.2	9.4	9.8	0.8	0.9	1.0
Sector Mean		**4.05**	**4.55**	**5.11**	**2.7**	**3.2**	**3.8**	**13.5**	**13.4**	**14.2**	**1.1**	**1.1**	**1.2**

Note: on a reported basis

Source: Nomura estimates

Exhibit 4. HK Banks: key ratios

	NIM (%) FY09	NIM (%) FY10F	NIM (%) FY11F	Deposits growth (%) FY09	Deposits growth (%) FY10F	Deposits growth (%) FY11F	Loans growth (%) FY09	Loans growth (%) FY10F	Loans growth (%) FY11F
HSB	1.91	1.78	1.79	13.2	7.4	8.0	4.7	37.1	15.0
BOCHK	1.69	1.55	1.52	5.0	18.0	10.0	11.9	20.1	15.0
BEA	1.80	1.78	1.69	5.8	22.6	11.9	7.4	20.2	11.8
WHB	1.82	1.85	1.83	9.6	7.0	5.0	0.5	25.1	9.0
DSF	1.95	1.87	1.88	9.9	8.0	6.0	-6.1	30.4	8.0
Average	**1.83**	**1.77**	**1.74**	**8.7**	**12.6**	**8.2**	**3.7**	**26.6**	**11.7**

	Cost/income (%) FY09	Cost/income (%) FY10F	Cost/income (%) FY11F	Credit cost (bps) FY09	Credit cost (bps) FY10F	Credit cost (bps) FY11F	Tier 1 (%) FY09	Tier 1 (%) FY10F	Tier 1 (%) FY11F
HSB	32.6	33.7	33.9	24	10	15	12.8	10.8	10.1
BOCHK	34.0	35.8	32.6	2	0	9	11.6	10.4	9.9
BEA	60.2	62.1	62.7	46	11	10	9.4	9.8	9.3
WHB	55.1	46.0	42.6	7	0	8	10.7	11.1	11.4
DSF	68.6	52.3	48.1	70	10	10	10.2	10.6	10.7
Average	**50.1**	**46.0**	**44.0**	**30**	**6**	**10**	**10.9**	**10.5**	**10.3**

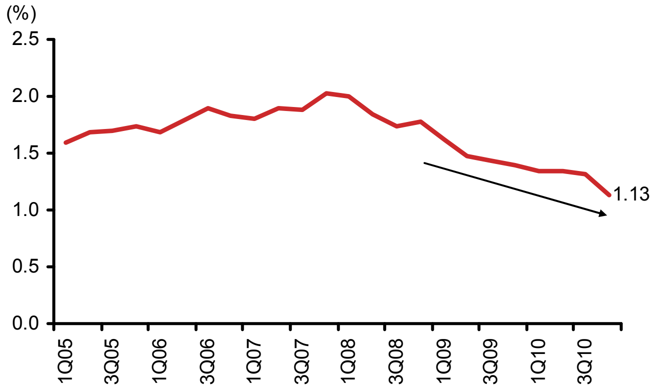
Note: on a reported basis

Source: Nomura estimates

Chart suite

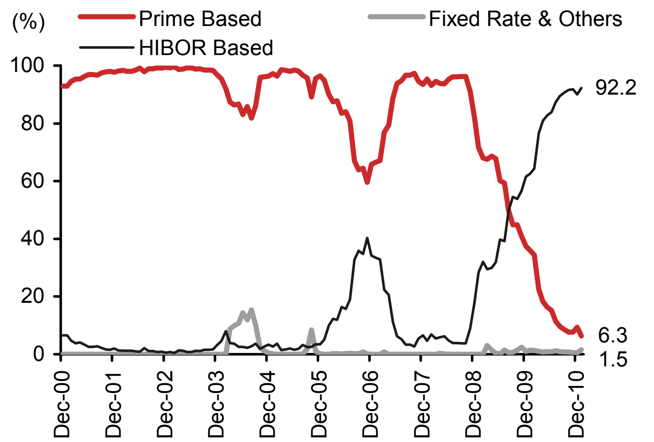
Key charts

Exhibit 5. Quarterly NIM … on a downward trend



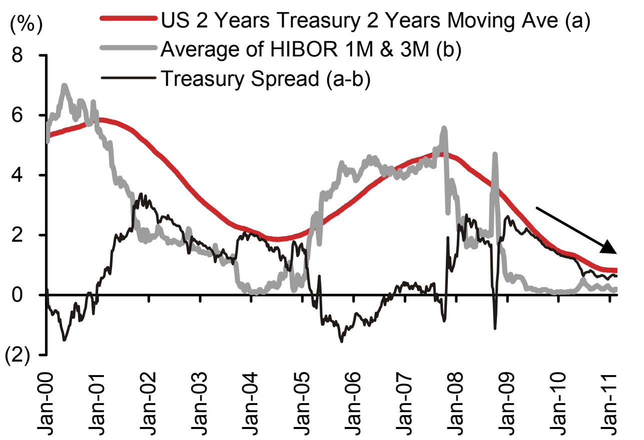
Source: HKMA, Nomura research

Exhibit 6. HK new mortgage loan type … negative for loan yield as HIBOR-based type picked up



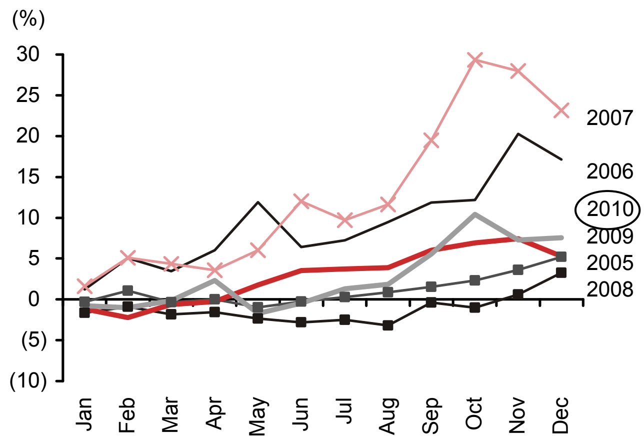
Source: CEIC, Nomura research

Exhibit 7. Treasury spread … still heading south



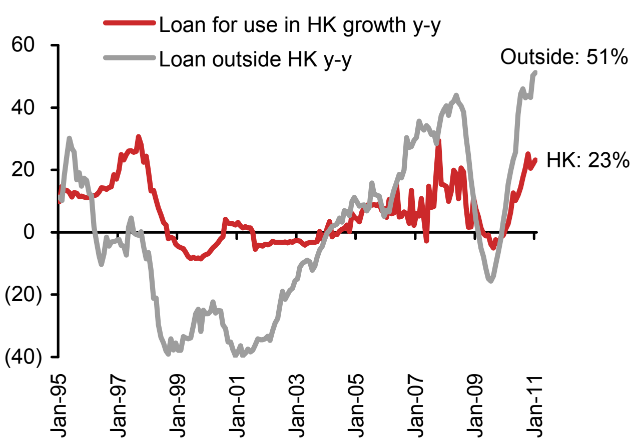
Source: CEIC, Nomura research

Exhibit 8. Deposit Growth YTD … slow progress in recent years



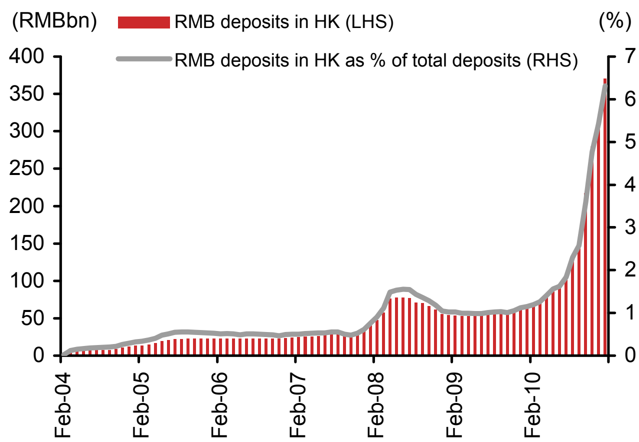
Source: CEIC, Nomura research

Exhibit 9. HK loan growth y-y … strong loan growth helps ease NIM pressure



Source: CEIC, Nomura research

Exhibit 10. RMB deposits in HK … growing strongly from low base



Source: CEIC, Nomura research

Margins

Margins still under pressure

Margins are expected to be compressed by another 10bps in FY11F, or until the US Fed increases interest rate aggressively, which we see as more of a 2012 theme.

We see another 10bps in margin compression in FY11F

Data from the HKMA and a local newspaper (source: Oriental Daily, http://orientaldaily.on.cc/cnt/finance/20110225/00202_027.html , 25 Feb 2011) showed that 4Q10 margin was 1.13%, a compression of 18bps q-q or 26 bps y-y. The compression here is mainly owing to excess liquidity in a low interest-rate environment. We think HK banks are highly liquid and they invest ~30% of interest earning assets in the treasury market and ~20% in the interbank market, whose returns have been kept abnormally low due to Quantitative Easing in the US.

Excess liquidity in a low interest-rate environment caused NIM compression in FY10

Exhibit 11. NIM … on a downward trend

Source: CEIC, Nomura research

We believe there are several reasons why NIM will remain under pressure:

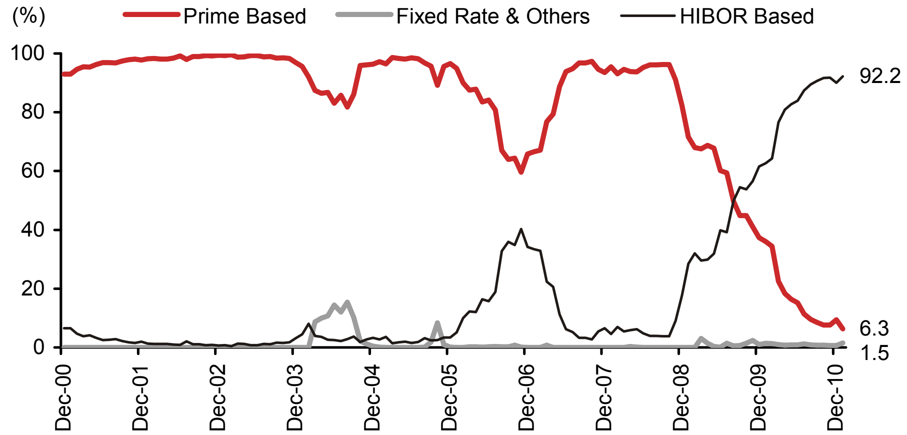
Compressing mortgage loan yield due to pick-up of HIBOR-based loans

The mortgage loan book comprises around 20% of the total loan book. There are mainly two types of mortgage loans in HK: HIBOR-based and Prime-based. Historically, most of the mortgage loans are Prime-based (over 90%) when HIBOR is relatively high. However, we have seen a reverse of this trend since December 2008. Since that time, HIBOR has been held at an abnormally low level due to US Quantitative Easing, resulting in a surge of HIBOR-based mortgage lending. According to the latest data from the HKMA, more than 90% of new mortgage loans are now HIBOR-based since effective HIBOR-based lending (~1%) is much lower than Prime-based lending (~2.25%). For HK mortgage loans, the duration is around 4-5 years. Therefore, we believe re-pricing of mortgage loans from Prime-based to HIBOR-based is still taking place at a rapid pace given the large interest rate differential between Prime- and HIBOR-based loans. As a result, we believe mortgage loan margins will be under pressure in 2011.

Home buyers are shifting from prime-based (current 2.25%) to HIBOR-based (current 1%) mortgage products

Exhibit 12. HK: new mortgage loan by type

Pick-up of HIBOR-based mortgage loans is negative for mortgage loan yield



Source: CEIC, Nomura research

Exhibit 13. HK: system loan mix and growth, December 2010

Mortgage loans comprise some 20% of the total loan book

(HK$bn)	Dec-10	Mix (%)	y-y (%)	q-q (%)
SME	**851**	**20**	**38**	**3**
- Manufacturing	170	4	26	2
- Transportation	171	4	14	2
- Wholesale & Retail	236	6	52	1
- Trade Finance	274	6	57	7
Mortgages	**795**	**19**	**14**	**3**
- HOS	51	1	0	4
- Private Residential	744	18	15	3
Consumers	**246**	**6**	**18**	**10**
- Credit Card	80	2	17	12
- Other Private	166	4	19	8
Corporates	**1,424**	**34**	**24**	**(4)**
- Electricity, Gas and Tel	89	2	20	19
- Bldg, Construction	845	20	24	4
- Hotels &Catering	40	1	9	4
- Financial Concerns	246	6	27	0
- Stockbrokers	18	0	49	(83)
- Other Corporates	11	0	(2)	(6)
Loan for use in HK	**3,316**	**78**	**24**	**0**
Outside HK	911	22	48	11
Total loans	**4,227**	**100**	**29**	**2**

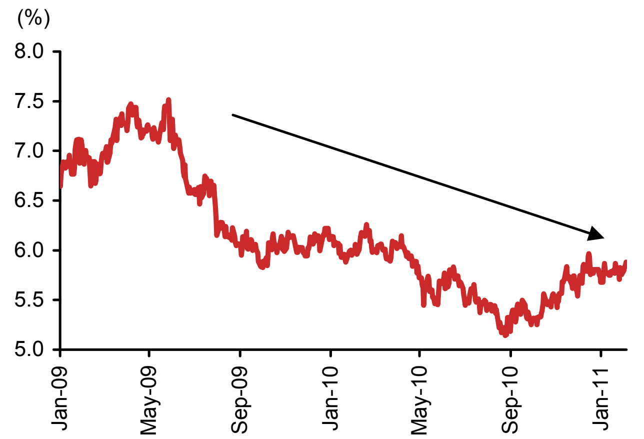
Source: CEIC, Nomura research

Competition is driving down loan pricing power

Loan pricing power is impaired in a low interest-rate environment

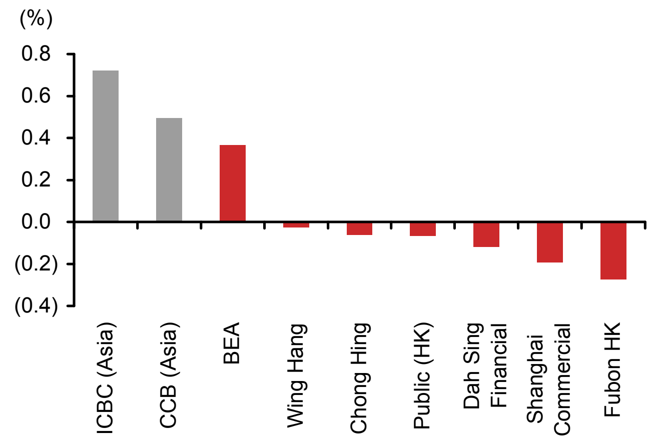
Corporate loans made up around 34% of the total loan book as at December 2010. We believe loan pricing power is impaired in a low interest-rate environment. A good proxy of corporate loan spread would be Moody's Corporate Bond Yield minus LIBOR 3M (Exhibit below). We have seen a general decline in corporate loan spread since 2009. In addition, local HK banks are not just competing with foreign banks such as Citi and DBS, but also facing serve competition from China banks. We have already seen a significant decrease in local HK banks' loan market share in recent years (see Exhibit below). Therefore, we believe corporate loan yields should be heading south in 2011F.

Exhibit 14. Moody's Seasoned Baa corporate bond yield … proxy for HK corp loan spread; on way down



Source: US St. Louis Fed, CEIC, Nomura research

Exhibit 15. Chinese peers gaining loan market share in HK at expense of mid-cap banks, Dec 08- Jun 10



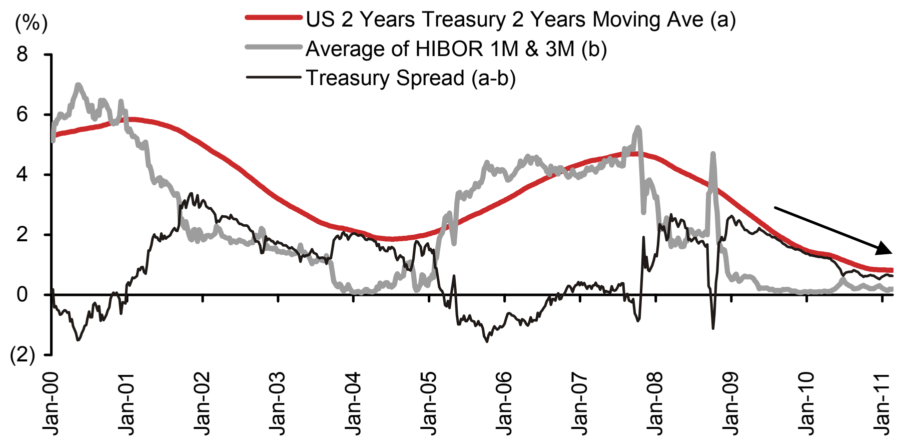
Source: Company data, Nomura research

Treasury spread running down

Treasury asset yield is running down while cost of funding is already at bottom, resulting in further treasury spread compression

HK banks are highly liquid and invest around 30% of free funds in the Treasury market. Treasury takes the form of deploying excess liquidity at yields above money-market rates rather than booking trading gains. To minimise credit and currency risk, HK banks deploy most liquidity in the US treasury market (since the currency spread makes this a very low-risk move). For HK banks, the duration of Treasury investment is around 1-2 years. Returns from Treasuries have been trending down in the past two years as Treasury investments mature, the principal has to be re-invested at a lower rate owing to the flat yield curve. At the same time, the funding cost HIBOR is already at a very low level so there is limited room for funding cost to fall further. We believe US interest rates will remain at a low level in 2011; therefore, we believe Treasury spreads will continue to trend down this year.

Exhibit 16. Treasury spread … still heading south



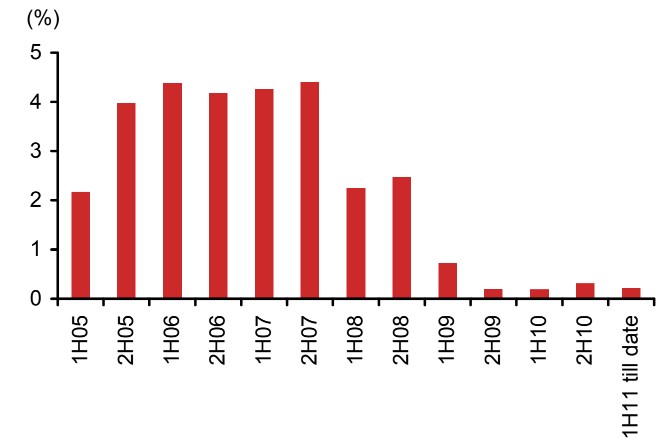
Source: CEIC, Nomura research

Limited contribution from free-funds

Low free fund contribution because of low HIBOR

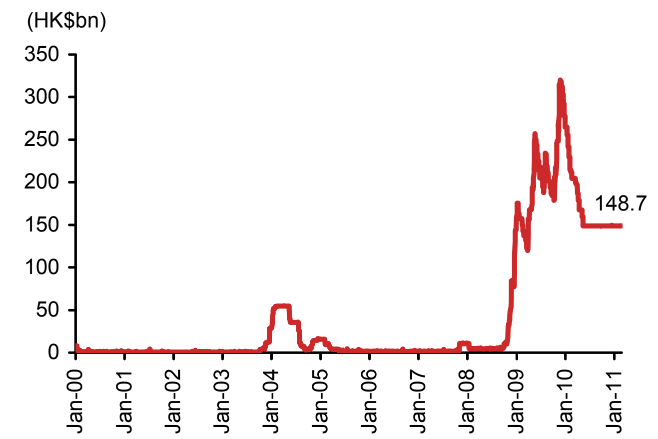
HK banks also invest about 20% of interest-earning assets in the interbank market, earning HIBOR. Since HIBOR is at a historically low level and there is still an abundant supply of interbank liquidity, we believe HIBOR will remain low in FY11.

Exhibit 17. HIBOR 3M … staying at a low level



Source: Bloomberg, Nomura research

Exhibit 18. HK interbank balance … flooded with liquidity



Source: CEIC, Nomura research

Margin estimates for FY11F

We have developed a comprehensive model to take into account the above factors. Our simulation predicts that the negatives in the form of mortgage re-pricing, compressing Treasury returns and lower free-fund contribution will outweigh the positives of strong loan growth. For HK banks as a whole, we predict margins will be down another 10bps in FY11F.

NIM to fall another 10bps in FY11F

Exhibit 19. HK bank system: NIM simulation, FY11-12F

(%)	FY04	FY05	FY06	FY07	FY08	FY09	FY10	FY11F	FY12F
Free fund contribution									
Mix %	12	13	13	13	17	13	13	13	13
Return = HIBOR 3M	0.47	3.09	4.27	4.33	2.36	0.45	0.25	0.20	0.60
Contribution	0.06	0.41	0.54	0.57	0.39	0.06	0.03	0.03	0.08
Change y-y		**0.35**	**0.13**	**0.03**	**(0.17)**	**(0.33)**	**(0.02)**	**(0.01)**	**0.05**
Deposit spread									
Mix %	33	30	32	35	27	26	23	21	20
Return = HIBOR 3M - Deposit Rates	0.42	1.74	1.41	1.98	1.86	(0.05)	(0.04)	(0.10)	0.20
Contribution	0.14	0.52	0.46	0.69	0.50	(0.01)	(0.01)	(0.02)	0.04
Change y-y		**0.38**	**(0.07)**	**0.24**	**(0.20)**	**(0.51)**	**0.00**	**(0.01)**	**0.06**
Treasury spread									
Mix %	22	23	23	20	22	27	26	25	25
Return = US Treasury 2Y - Deposits	1.97	1.77	1.47	2.23	2.68	0.98	0.53	0.21	0.50
Contribution	0.44	0.40	0.34	0.46	0.58	0.26	0.14	0.05	0.13
Change y-y		**(0.04)**	**(0.06)**	**0.12**	**0.12**	**(0.31)**	**(0.12)**	**(0.09)**	**0.07**
Loan spread									
Mix %	32	34	32	31	35	34	37	40	42
Pricing premium/ (discount)	0.00	0.00	0.00	0.00	0.50	0.80	(0.50)	(0.90)	(0.70)
Return = Prime - Cost of Funding	4.58	3.42	3.90	3.69	4.41	5.33	4.24	3.86	4.29
Contribution	1.48	1.17	1.25	1.16	1.55	1.82	1.59	1.56	1.80
Change y-y		**(0.30)**	**0.07**	**(0.09)**	**0.39**	**0.27**	**(0.23)**	**(0.03)**	**0.24**
Estimated NIM change		**0.4**	**0.1**	**0.3**	**0.1**	**(0.9)**	**(0.4)**	**(0.1)**	**0.4**
Actual NIM change		**0.0**	**0.1**	**0.1**	**(0.1)**	**(0.4)**	**(0.2)**		
HKMA NIM	1.66	1.68	1.80	1.90	1.84	1.48	1.28*		

* Source of the 1.28% NIM data is *The Oriental Daily*

Source: CEIC, Nomura estimates

NIM pressure is larger at large-sized banks

In summary, we believe large banks such as HSB and BOCHK will be the most negatively affected since they have more excess liquidity, we forecast that their NIMs will be compressed by another 5-10bps in FY11F.

However, smaller banks such as BEA, WHB and DSF, have less excess liquidity and the recent strong pick-up of loan growth should help them to report stable margins. Hence we believe mid-size banks such as BEA, WHB and DSF will report flattish margins in FY11F.

Exhibit 20. NIM outlook

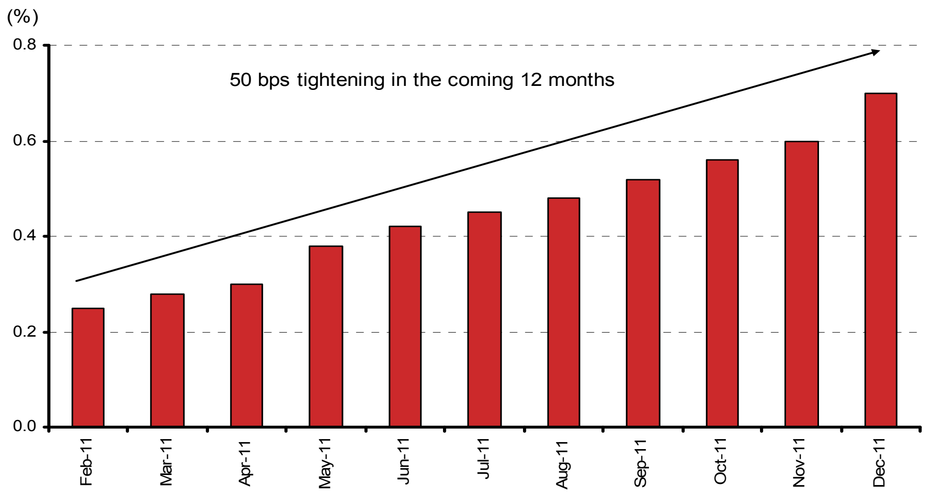
(%)	FY08	FY09	1H10	2H10F	FY10F	FY11F
HSB	2.36	1.91	1.77	1.79	1.78	1.79
BOCHK	2.00	1.69	1.58	1.52	1.55	1.52
BEA	1.85	1.80	1.84	1.72	1.78	1.69
WHB	1.84	1.82	1.91	1.79	1.85	1.83
DSF	2.11	1.95	1.87	1.87	1.87	1.88
Average	**2.03**	**1.83**	**1.79**	**1.74**	**1.77**	**1.74**

Source: Nomura research

Upside risk to our forecast if US Fed hikes earlier than expected

We believe that there are upside risks to our forecast for margins if the US Fed increases rates more aggressively than we expect. Fed fund futures from Bloomberg indicate the market is assigning a low probability the Fed will increase interest rates aggressively in 2011. In our earnings model we assume a flat interest rate environment in 2011. However, if the US economy recovers faster-than-expected, rates could rise faster, hence our margin estimates for FY11F might prove conservative.

Exhibit 21. US Fed Fund futures



Source: Bloomberg, Nomura research

Assets and deposits

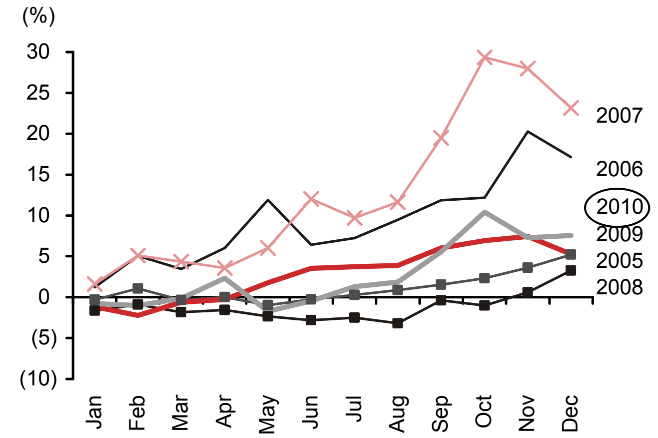
Muted asset and deposit growth

Deposit growth is a key determinant of asset growth since it is a proxy for interest-earning assets.

Slow deposit growth in 2010

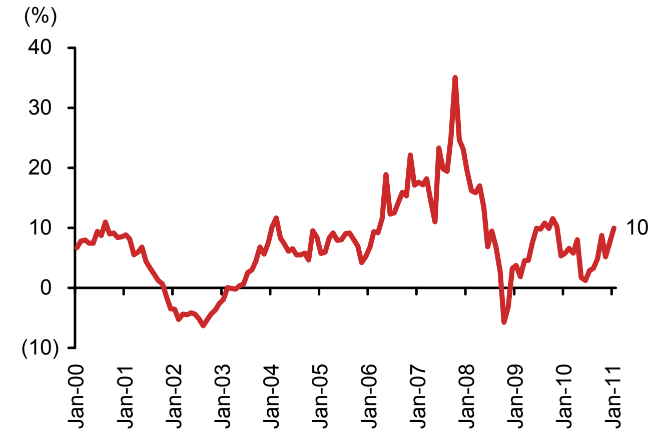
The progression of deposits has been the weakest since 2005. In our view, this is because nominal rates have fallen to close to zero as a result of repeated cuts by the US Federal Reserve. Banks chose to turn away deposits by lowering deposit rates to close to zero. In addition, excess system liquidity was close to the highest level in the past 20 years.

Exhibit 22. Deposit Growth YTD … recent slow progress



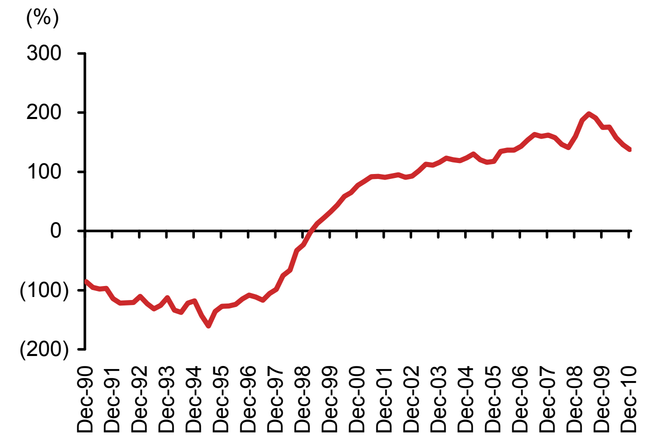
Source: CEIC, Nomura research

Exhibit 23. Year-on-year deposit growth



Source: CEIC, Nomura research

Exhibit 24. Hong Kong: excess Liquidity as % of GDP



Note: Excess Liquidity is defined as total deposits minus total loans

Source: CEIC, Nomura research

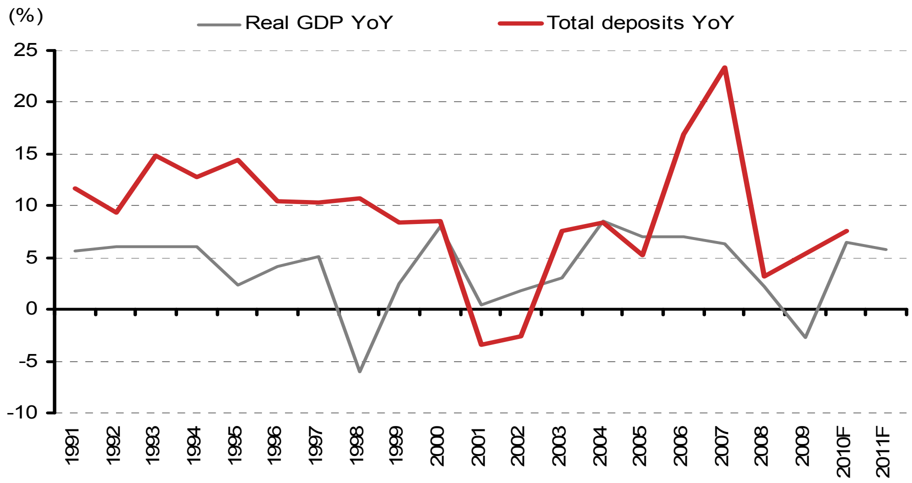
We believe deposit growth will be slow because:

Slow GDP growth in 2011F

Slow deposit growth driven by slow GDP growth

Deposit growth is essentially a function of GDP growth: historically the deposit multiplier is around 2x real GDP. Our HK economist Rob Subbaraman is forecasting that HK real GDP growth will be 5.8% in 2011F. Hence, we believe deposit growth in HK will most likely be in high single digits in 2011.

Exhibit 25. Hong Kong: real GDP growth vs deposit growth



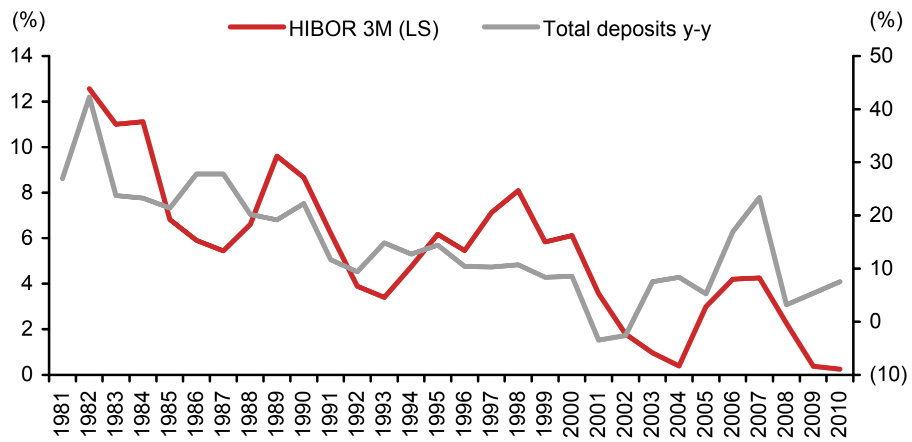
Source: CEIC, Nomura research

Low interest-rate environment to constrain deposit growth

Difficult to deploy excess liquidity in a low interest-rate environment

HK banks are very liquid, with the loan-to-deposit ratio standing at 63% as at January 2011. In a low rate environment, the incentive for banks to grow deposits is weak since it is difficult to deploy excess liquidity in a low interest-rate environment.

Exhibit 26. Hong Kong: HIBOR vs deposit growth



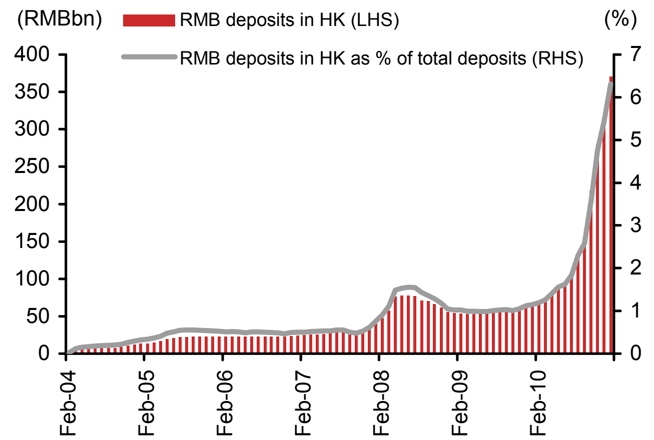
Source: CEIC, Nomura research

RMB deposits: limited ST contribution to deposit growth

Renminbi deposits not yet a key driver for asset growth in 2011

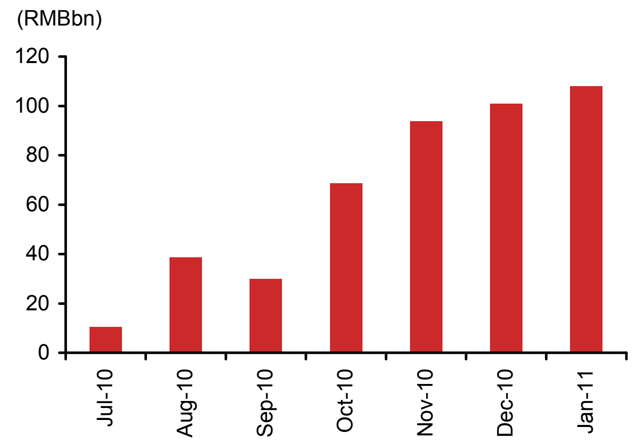
Renminbi deposits stood at RMB371bn as of January 2011, significant growth of 480% y-y, if from a low base. The significant growth is mainly due to renminbi appreciation and increasing flow of renminbi trade settlement. As at January 2011, renminbi deposits comprised 6% of total deposits. In the long run, we believe renminbi deposits will be a major source of deposit growth and make up a significant portion of total deposits in HK. However, we believe renminbi deposits will contribute but limited impact to system deposit growth in 2011, with renminbi deposits just a small part of the overall picture.

Exhibit 27. Renminbi deposits in HK



Source: CEIC, Nomura research

Exhibit 28. Renminbi trade settlement volume in HK



Source: HKMA, Nomura research

Deposit forecast

We expect average deposit growth of 9% y-y and 6% y-y for FY11F and FY12F within our universe of HK bank coverage. Deposit growth at BOCHK will be slightly higher owing to rapid growth pace of renminbi deposits and BOCHK has a disproportionately larger market share of renminbi deposits.

We expect single-digit deposit growth in FY11F

Exhibit 29. Deposit growth outlook

(HK$mn)	FY09	FY10F	FY11F	FY12F	10F y-y (%)	11F y-y (%)	12F y-y (%)
HSB	636,369	683,628	738,318	782,617	7	8	6
BOCHK	842,321	993,939	1,093,333	1,147,999	18	10	5
BEA	342,528	419,833	469,688	512,695	23	12	9
WHB	126,183	135,016	141,766	148,855	7	5	5
DSF	88,370	95,440	101,166	105,213	8	6	4
Total	**2,035,771**	**2,327,855**	**2,544,272**	**2,697,379**	**14**	**9**	**6**

Source: Nomura estimates

Loan growth and NIM

Strong loan growth eases some NIM pressure

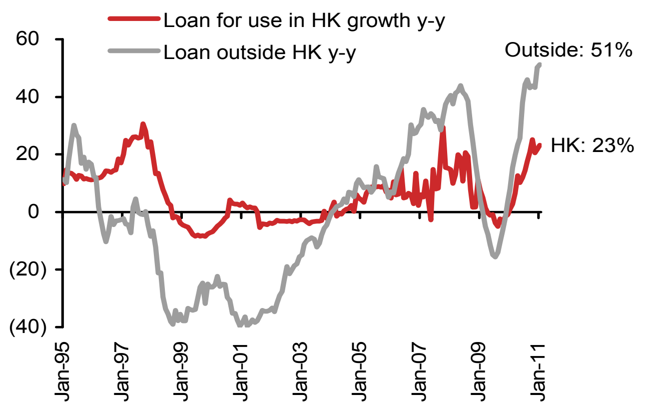
Loan growth is strong at 30% y-y as at January 2011. This growth was mainly owing to the low interest-rate environment in HK and continued renminbi appreciation in China.

Exhibit 30. HK Banks: earnings assets structure, 1H10

(HK$bn)	HSB	BOCHK	BEA	WHB	DSF	Sector
Cash	135	234	90	12	14	485
Investments	307	403	71	37	44	862
Loans	394	569	277	90	65	1,395
Total IEA	**836**	**1,206**	**438**	**140**	**122**	**2,742**
(Mix %)	**HSB**	**BOCHK**	**BEA**	**WHB**	**DSF**	**Sector**
Cash	16	19	21	9	12	18
Investments	37	33	16	27	36	31
Loans	47	47	63	64	53	51
Total IEA	**100**	**100**	**100**	**100**	**100**	**100**

Source: Company data, Nomura research

Exhibit 31. HK system loan growth y-y



Source: Company data, Nomura research

Strong loan growth offset by loan margin compression

For the broad sector, our model indicates that loan margin contribution is likely to be flattish (down 3bps y-y) in FY11F. This is in contrast with consensus that strong loan growth in 2010 will help HK banks expand margins. Our view is that strong loan growth is unlikely to fully offset the negatives from mortgage re-pricing and impaired loan pricing power. In our model, we build in further reduction of loan pricing power in 2011.

Exhibit 32. HK Banks system: NIM simulation, 2011-12F

(%)	FY04	FY05	FY06	FY07	FY08	FY09	FY10	FY11F	FY12F
Free fund contribution									
Mix %	12	13	13	13	17	13	13	13	13
Return = HIBOR 3M	0.47	3.09	4.27	4.33	2.36	0.45	0.25	0.20	0.60
Contribution	0.06	0.41	0.54	0.57	0.39	0.06	0.03	0.03	0.08
Change y-y		**0.35**	**0.13**	**0.03**	**(0.17)**	**(0.33)**	**(0.02)**	**(0.01)**	**0.05**
Deposit spread									
Mix %	33	30	32	35	27	26	23	21	20
Return = HIBOR 3M - Deposit Rates	0.42	1.74	1.41	1.98	1.86	(0.05)	(0.04)	(0.10)	0.20
Contribution	0.14	0.52	0.46	0.69	0.50	(0.01)	(0.01)	(0.020	0.04
Change y-y		**0.38**	**(0.07)**	**0.24**	**(0.20)**	**(0.51)**	**0.00**	**(0.01)**	**0.06**
Treasury spread									
Mix %	22	23	23	20	22	27	26	25	25
Return = US Treasury 2Y - Deposits	1.97	1.77	1.47	2.23	2.68	0.98	0.53	0.21	0.50
Contribution	0.44	0.40	0.34	0.46	0.58	0.26	0.14	0.05	0.13
Change y-y		**(0.04)**	**(0.06)**	**0.12**	**0.12**	**(0.31)**	**(0.12)**	**(0.09)**	**0.07**
Loan spread									
Mix %	32	34	32	31	35	34	37	40	42
Pricing premium/ (discount)	0.00	0.00	0.00	0.00	0.50	0.80	(0.50)	(0.90)	(0.70)
Return = Prime - Cost of Funding	4.58	3.42	3.90	3.69	4.41	5.33	4.24	3.86	4.29
Contribution	1.48	1.17	1.25	1.16	1.55	1.82	1.59	1.56	1.80
Change y-y		**(0.30)**	**0.07**	**(0.09)**	**0.39**	**0.27**	**(0.23)**	**(0.03)**	**0.24**
Estimated NIM change		**0.4**	**0.1**	**0.3**	**0.1**	**(0.9)**	**(0.4)**	**(0.1)**	**0.4**
Actual NIM change		**0.0**	**0.1**	**0.1**	**(0.1)**	**(0.4)**	**(0.2)**		
HKMA NIM	1.66	1.68	1.80	1.90	1.84	1.48	*1.28		

* Source of the 1.28% NIM data is *The Oriental Daily*

Source: CEIC, Nomura research estimates

We believe strong loan growth will help mid-sized banks, such as BEA, WHB and DSF, to report stable margins since they carry less excess liquidity.

However, at large banks such as HSB and BOCHK, strong loan growth may not help much since their Treasury operations are still a major part group operations, and margins here are hurt in a low interest-rate environment.

We believe loan growth will remain strong in FY11F as China has tightened liquidity. We have built in an average of 14% y-y loan growth in 2011F.

Exhibit 33. Loan growth outlook

(HK$mn)	FY09	FY10F	FY11F	FY12F	10F y-y (%)	11F y-y (%)	12F y-y (%)
HSB	344,621	472,637	543,394	591,700	37	15	9
BOCHK	512,703	615,873	708,061	750,225	20	15	6
BEA	246,309	295,943	330,765	367,606	20	12	11
WHB	80,249	100,420	109,419	114,832	25	9	5
DSF	56,490	73,672	79,566	83,544	30	8	5
Total	**1,240,372**	**1,558,545**	**1,771,205**	**1,907,907**	**26**	**14**	**8**

Source: Nomura estimates

Exhibit 34. HK loan mix, December 2010

(HK$bn)	Dec-10	Mix (%)	y-y (%)	q-q (%)
SME	**851**	**20**	**38**	**3**
- Manufacturing	170	4	26	2
- Transportation	171	4	14	2
- Wholesale & Retail	236	6	52	1
- Trade Finance	274	6	57	7
Mortgages	**795**	**19**	**14**	**3**
- HOS	51	1	0	4
- Private Residential	744	18	15	3
Consumers	**246**	**6**	**18**	**10**
- Credit Card	80	2	17	12
- Other Private	166	4	19	8
Corporates	**1,424**	**34**	**24**	**(4)**
- Electricity, Gas and Tel	89	2	20	19
- Bldg, Construction	845	20	24	4
- Hotels &Catering	40	1	9	4
- Financial Concerns	246	6	27	0
- Stockbrokers	18	0	49	(83)
- Other Corporates	11	0	(2)	(6)
Loans for use in HK	**3,316**	**78**	**24**	**0**
Outside HK	911	22	48	11
Total loans	**4,227**	**100**	**29**	**2**

Source: CEIC, Nomura research

Fee income

Reasonable fee growth

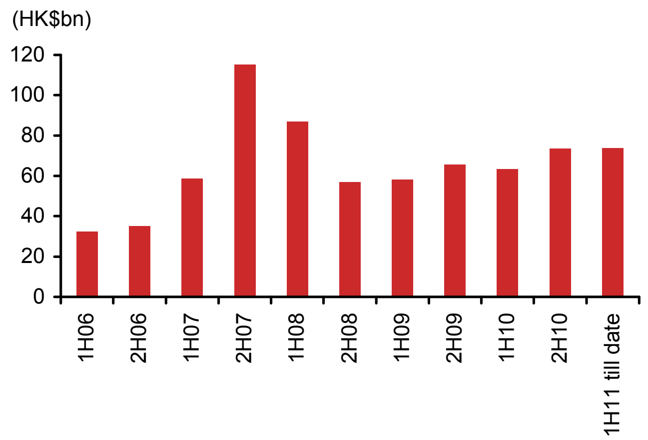
We expect HK banks to report reasonable fee growth in 2011 owing to: 1) pick-up of HK system turnover; 2) strong credit-related fees owing to strong loan growth, and; 3) recovery in the wealth management business. However, we believe mild growth of fee income will not contribute significant operating revenues growth in 2011 since non-interest income makes up only around 25% of total operating revenues.

Pick-up of stock market turnover

Market turnover is picking up in 1H11

Stock-broking is highly correlated to daily stock turnover, and we saw a pick-up of stock turnover in 1H11 from last year. Daily stock turnover is HK$74bn in 1H11 to date, representing an increase of 17 % y-y. In our earnings model, we are building in some pick-up of stock-broking in 2011, assuming market share of each bank remains more or less the same.

Exhibit 35. HKEx daily stock turnover



Source: Bloomberg, Nomura research

Exhibit 36. Stock broking income outlook, FY09-11F

(HK$mn)	FY09	FY10F	FY11F	10F y-y (%)	11F y-y (%)
HSB	1,566	1,450	1,740	(7)	20
BOCHK	3,677	3,300	3,960	(10)	20
BEA	320	456	502	43	10
WHB	189	180	200	(5)	11
DSF	47	40	44	(15)	10
Total	**5,799**	**5,426**	**6,446**	**(6)**	**19**

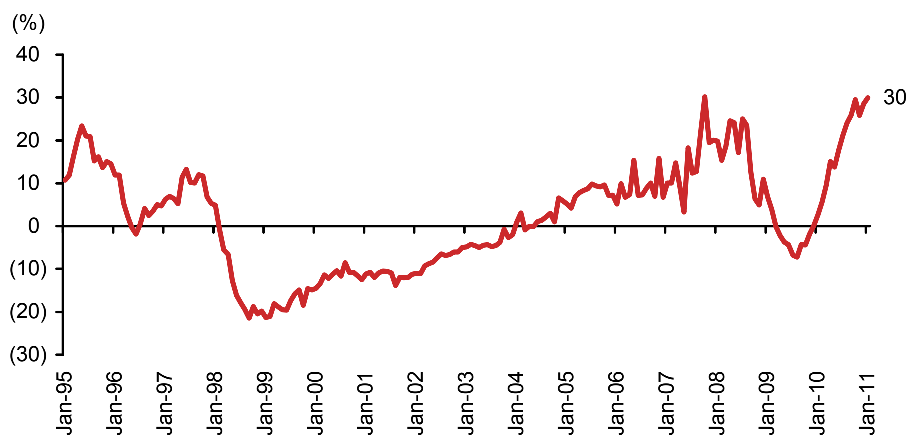
Source: Company data, Nomura estimates

Strong loan-related fees

Strong loan growth helps trade finance and loan-processing fees

Loan-related fees are generally linked to loan growth, and a pick-up of loan growth will lead to more loan arrangement and processing fees. In FY10, we saw a significant pick-up of loan growth, with loans up 30% y-y as of January 2011. We believe the loan pipeline will remain strong owing to increased renminbi appreciation expectation and HK's low interest-rate environment.

Exhibit 37. HK total loan growth y-y



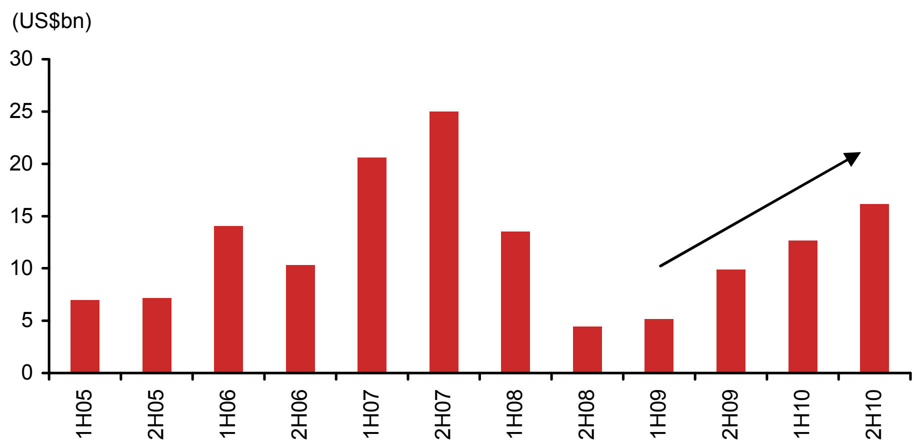
Source: CEIC, Nomura research

Wealth Management business…recovering

In Hong Kong, the sales of unit trust products are recovering after the Lehman minibond incident in 2008, per industry data. However, we believe the recovery momentum will be gradual rather than rapid owing to tighter SFC supervision.

Sale of unit trust products are bottoming out

Exhibit 38. Sales of Investments funds



Source: CEIC, Nomura research

Fee outlook

For the HK banking sector as a whole, we believe fee income growth will be around 14% in 2011, mainly owing to a pick-up in stock market turnover and loan-related fees.

Exhibit 39. Fee income outlook

(HK$mn)	FY09	FY10F	FY11F	10F y-y (%)	11F y-y (%)
HSB	4,321	4,897	5,402	13	10
BOCHK	6,508	7,080	8,456	9	19
BEA	2,262	2,942	3,152	30	7
WHB	662	711	791	8	11
DSF	327	367	389	12	6
Total	**14,080**	**15,998**	**18,190**	**14**	**14**

Source: Company data, Nomura estimates

Asset quality

Benign asset quality

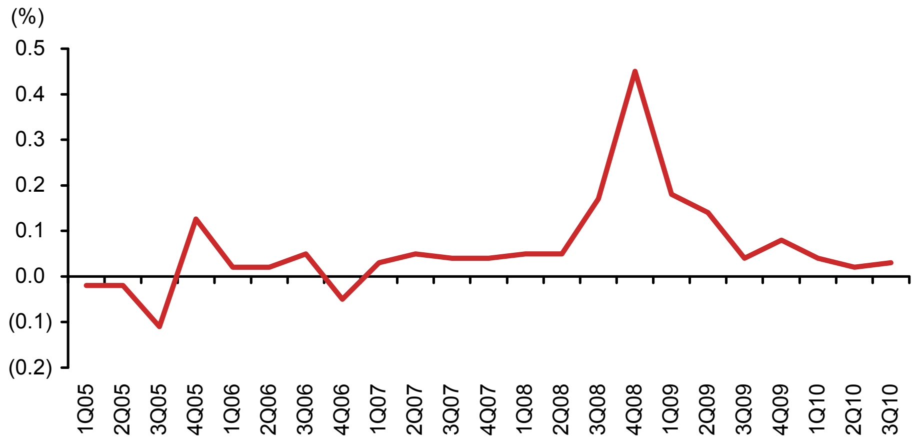
Asset quality is expected to remain benign in FY11F. Our credit cost assumption is 10-15bps in FY11-11F versus 21bps in FY09. Our expectation is premised on:

Clean loan portfolios

Loan portfolios were scrubbed clean after the 2008 financial crisis as the sector underwent stress-testing during the crisis. As a result, we believe the chance of large scale credit deterioration is remote.

Loan portfolios were scrubbed clean in 2008

Exhibit 40. HK banks: bad debt charges as % of average assets



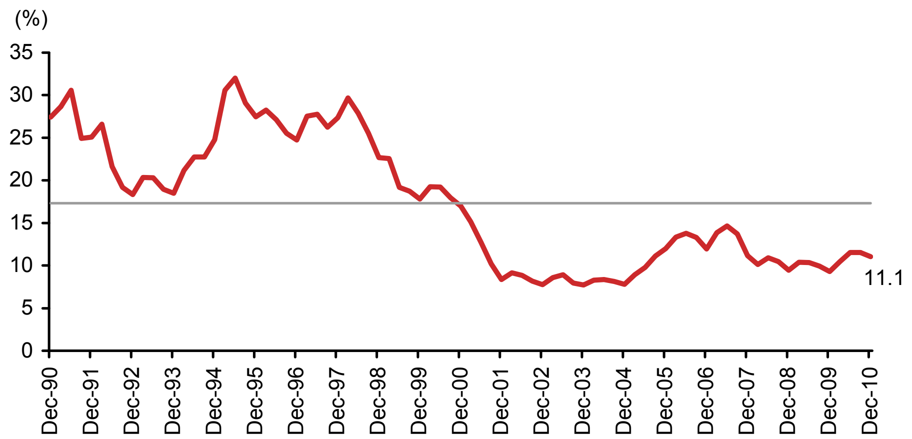
Source: CEIC, Nomura research

Stable debt-servicing burden

Debt-servicing burden remains stable because of a fall in interest rates in the past few years, in our view. We calculate that current debt servicing burden stands at about 11% of GDP versus a 17% average in the past 20 years.

Debt-servicing burden is close to historical low

Exhibit 41. Hong Kong: annualised debt service (% of GDP)



Note: The ratio is calculated as Prime Lending Rate * (Loans/GDP)

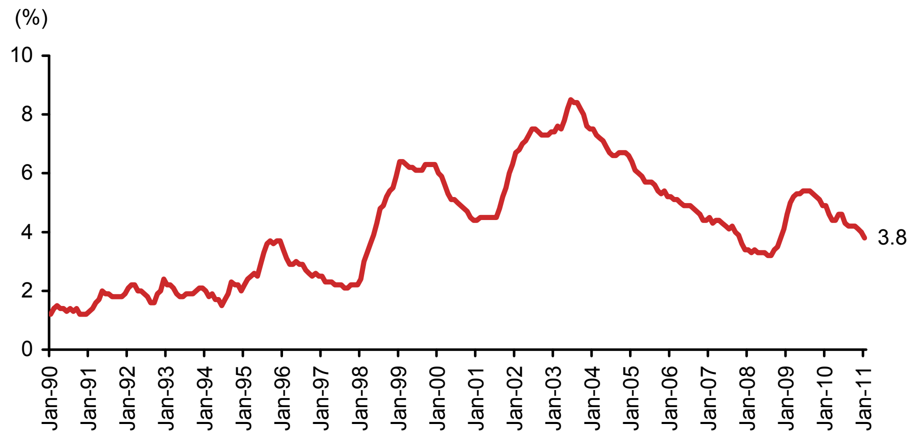
Source: CEIC, Nomura research

Unemployment rate on a downward trend

Hong Kong's unemployment rate stood at 3.8% as of January 2011, according to latest government figures. This compares with a peak of 5.4% during the 2008 financial crisis and our Hong Kong economist (Tomo Kinoshita) expects the unemployment rate to reach 3.2% by December 2012. Given the buoyant labour market we do not see any dramatic rise in loan-loss charges in 2011.

Unemployment rate seen trending down in 2011-12

Exhibit 42. Hong Kong: unemployment rate



Source: CEIC, Nomura research

Risk tendency of loan portfolio

We are positive on the credit environment in 2011. Nevertheless, we have conducted a risk tendency on current loan portfolios and examined the potential impact on earnings, should credit costs 'normalise'.

Most vulnerable: DSF, WHB & BEA;
Most defensive: BOCHK and HSB

In our view, DSF, WHB and BEA are the most vulnerable to a rise in credit costs owing to their larger exposure to SME and China loans. HSB and BOCHK are the most defensive should credit costs increase, since they have large exposure to mortgages and corporate loans, which are lower risk, in our opinion.

Exhibit 43. HK banks' risk tendencies

(Loan mix %)	HSB	BOCHK	BEA	WHB	DSF	Risk tendency (bps)
SME	15	21	7	12	14	150
Corporates	38	31	22	25	25	20
Mortgages	29	25	10	24	19	0
Personal	7	3	7	6	17	200
Loan for use in HK	**90**	**80**	**46**	**67**	**75**	
Outside HK	10	20	54	33	25	100
Total loans	**100**	**100**	**100**	**100**	**100**	
Normalised credit costs (bps)	54	64	81	68	85	
2011F credit costs (bps)	15	9	10	8	10	
Potential increase in credit costs (bps)	**39**	**55**	**71**	**60**	**74**	
PBT impact, 2011F (%)	**12**	**20**	**47**	**29**	**32**	

Source: Nomura estimates

Earnings

Earnings outlook

We are looking for muted earnings growth of 9% this year for companies under our coverage, assuming compressing margins, weak asset growth and benign credit assumptions.

Slow earnings growth of 9% in FY11F

Operating revenues

For operating revenues, we look for 13% growth in FY11F. This is a refection of muted net interest income as a result of compressing margins and weak asset growth. The growth in non-interest income should be driven by a pick-up of stock-broking business and credit-related fees. We expect the wealth management business to continue to bottom out from the trough in 2008. We believe the main upside risk is the US increasing interest rates faster and earlier than our expectation.

Slow revenue growth of 13% due to compressing margins and slow asset growth

Banks that can deliver superior top-line growth according to our models are DSF and WHB, since their margins are stable due to a pick-up in loan-deposit ratios. BOCHK is also likely to report higher revenue growth due to higher fee income.

Banks that are likely to report weaker top-line growth are HSB, as HSB has more excess liquidity and margins could be under pressure in a low interest rate environment.

Exhibit 44. Operating revenue outlook

(HK$mn)	FY09	FY10F	FY11F	FY12F	10F y-y (%)	11F y-y (%)	12F y-y (%)
HSB	20,812	21,830	23,200	25,271	5	6	9
BOCHK	26,055	25,583	30,258	36,170	(2)	18	20
BEA	10,188	11,126	12,470	13,995	9	12	12
WHB	2,853	3,382	3,922	4,273	19	16	9
DSF	2,724	2,772	3,163	3,465	2	14	10
Total	**62,632**	**64,693**	**73,012**	**83,174**	**3**	**13**	**14**

Source: Nomura research

Pre-provision profits

For pre-provision profits, we look for growth rates of 16% and 19% in 2011F and 2012F. We expect cost growth to track operating revenue growth. We are building some mild cost growth in line with inflation rates and for overseas expansion.

Exhibit 45. Pre-provision profits outlook

(HK$mn)	FY09	FY10F	FY11F	FY12F	10F y-y (%)	11F y-y (%)	12F y-y (%)
HSB	14,026	14,475	15,344	17,071	3	6	11
BOCHK	17,192	16,417	20,385	25,535	(5)	24	25
BEA	4,059	4,222	4,657	5,697	4	10	22
WHB	1,281	1,826	2,252	2,507	42	23	11
DSF	855	1,323	1,641	1,840	55	24	12
Total	**37,413**	**38,263**	**44,279**	**52,650**	**2**	**16**	**19**

Source: Nomura research

Net profit

Overall we forecast net income growth at 9% for 2011F, supported by a benign credit environment as we believe loan loss charges will be kept to a low level.

Exhibit 46. Earnings outlook

(HK$mn)	FY09	FY10F	FY11F	FY12F	10F y-y (%)	11F y-y (%)	12F y-y (%)
HSB	13,138	14,917	16,032	17,637	14	7	10
BOCHK	13,725	14,548	16,239	20,440	6	12	26
BEA	2,604	4,224	4,107	4,703	62	(3)	15
WHB	1,205	1,643	1,884	2,106	36	15	12
DSF	626	1,018	1,310	1,461	63	29	11
Total	**31,298**	**36,350**	**39,571**	**46,347**	**16**	**9**	**17**

Note: on a reported basis

Source: Nomura estimates

Nomura estimates versus consensus

Generally we are below consensus for 2011F and 2012F since we assume NIM compression and muted asset growth.

Exhibit 47. Nomura vs I/B/E/S EPS

	Nomura			I/B/E/S			Variance (%)		
	FY10F	FY11F	FY12F	FY10F	FY11F	FY12F	FY10F	FY11F	FY12F
HSB	NA	8.39	9.23	NA	8.72	10.09	NA	(4)	(9)
BOCHK	1.38	1.54	1.93	1.42	1.66	1.95	(3)	(8)	(1)
BEA	NA	2.03	2.32	NA	2.05	2.36	NA	(1)	(2)
WHB	5.52	6.33	7.07	5.39	6.41	7.41	2	(1)	(5)
DSF	3.48	4.48	5.00	3.73	4.44	5.20	(7)	1	(4)

Source: Bloomberg, Nomura estimates

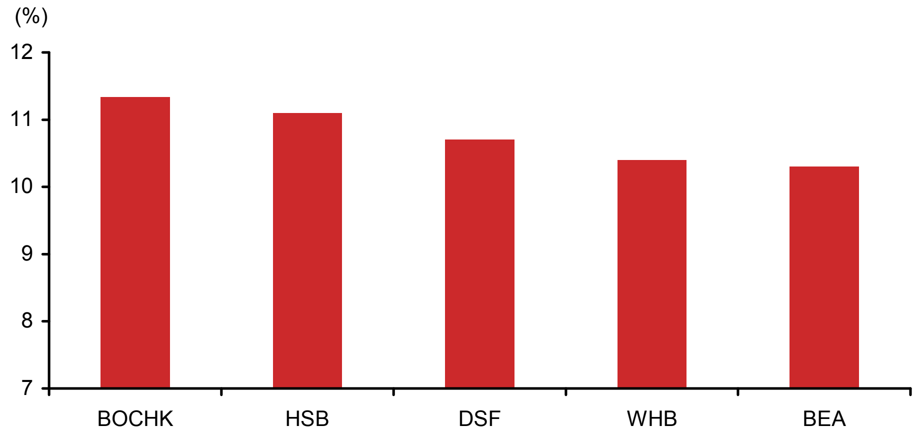
Capital

Capital sound

We think HK banks are well capitalised, with core tier 1 ratios all above 10% as of June 2010, as per company disclosures. Therefore, we believe all the HK banks are able to meet the new Basel III requirements.

Reported tier-1 ratios are all 10% or above

Exhibit 48. Core tier-1 ratios, June 2010



Source: Company data, Nomura research

However, there are two things we would like to draw to investors' attention:

Different capital calculation methodology

HK banks are using different capital calculation methodology. On a reported basis, HSB and BEA are using Advanced IRB. BOCHK, DSF and WHB are using the standardised approach, according to company disclosures.

HSB & BEA are adopting the AIRB approach, while others are using the standardised approach

The calculation of core capital is the same; the difference lies with the calculation of Risk-Weighted Assets (RWA). For instance, the risk-weighting of mortgage loans is 35% under the Standardised Approach, while it is 7-8% under the Advanced IRB approach. For other types of loans, risk weighting is generally under Advanced IRB since internal methodology is less stringent in risk-weighting. As a result, reported core tier-1 ratios are not directly comparable, in our view.

Exhibit 49. Current capital calculation methodology

	Methodology
HSB	Advanced IRB
BEA	Advanced IRB
BOCHK	Standardised Approach
DSF	Standardised Approach
WHB	Standardised Approach

Source: Company data, Nomura research

We have conducted an apples-to-apples comparison of core tier-1 ratios for HSB and BOCHK since they have better disclosure of their risk-weighted assets and their loan mix is similar in our view.

Our results show that BOCHK is much better capitalised due to a reduction of RWA. Our back-of-the-envelop calculation indicates that **tier-1 ratio of BOCHK could potentially go up to 17%** versus 11% at HSB. We believe the stronger capital position at BOCHK could enable it to leverage up its balance sheet, leading to ROE and a re-rating of the stock.

Pro-forma calculation shows that BOCHK is much better capitalised with a 17% tier 1 ratio, versus HSB at 11.1%

Exhibit 50. HSB and BOCHK: loan mix, June 2010 — similar loan mix

(Mix %)	HSB	BOCHK
SME	15	21
Corporates	38	31
Mortgages	29	25
Personal	7	3
Loan for Use in HK	**90**	**80**
Outside HK	10	20
Total Loans	**100**	**100**

Source: Company data, Nomura research

Exhibit 51. HSB & BOCHK: pro-forma core capital ratios under Advanced IRB

(HK$mn)	BOCHK - Standardised	BOCHK - AIRB pro-forma	Chg (%)
Core tier-1 capital	**75,297**	**75,297**	
Credit RWA	618,503	387,878	(37.3)
Market RWA	18,501	18,501	
Operational RWA	47,898	47,898	
Deductions	(20,126)	(20,126)	
Total RWA	664,776	434,151	(34.7)
Core tier 1 %	**11.3**	**17.3**	**6.0**
Total Loans	597,306	597,306	
Credit RWA as % of loans (%)	104	65	

(HK$mn)	Hang Seng - AIRB reported
Core tier-1 capital	32,678
Credit RWA	255,927
Market RWA	1,405
Operational RWA	37,576
Deductions	0
Total RWA	294,908
Core tier-1 %	**11.1**
Total Loans	394,110
Credit RWA as % of Loans (%)	65

Source: Company data, Nomura research

Potential Basel III impact on HK banks

Limited impact from Basel 3 as a whole

In our view, the most affected would be HSB, impacting HSB's core tier 1 ratio by around 2%. The new requirement under Basel 3 is to deduct all investment in associates from total core capital (current only 50%). HSB has a 12.80% stake in Industrial Bank totalling HK$13,841mn as of June 2010. If the deduction is one-off, the impact would be around 2% in our view. However, guidelines from the HKMA as of 26 January 2011 suggest that there would be a phase-in period of the deduction starting in 2014. Hence, we believe the actual impact on HSB is smaller in 2011 and 2012.

Exhibit 52. Potential Impact of Basel 3 by excluding investments in associates

(HK$mn)	Reported Tier-1 Capital	Reported RWA	Reported Tier-1 (%)	Associates	Adjusted Tier-1 (%)	Change (%)
HSB	32,678	294,908	**11.1**	13,841	**8.7**	(2.3)
DSF	8,286	77,436	**10.7**	1,405.659	**9.8**	(0.9)
BEA	32,159	312,223	**10.3**	3,255	**9.8**	(0.5)
WHB	9,179	88,262	**10.4**	205.767	**10.3**	(0.1)
BOCHK	75,297	664,776	**11.3**	213	**11.3**	0.0

Source: Nomura research

Exhibit 53. Basel 3: Phase-in Arrangements

Phase-in arrangements

(shading indicates transition periods - all dates are as of 1 January)

	2011	2012	2013	2014	2015	2016	2017	2018	As of 1 January 2019
Leverage Ratio	Supervisory monitoring		Parallel run 1 Jan 2013 – 1 Jan 2017 Disclosure starts 1 Jan 2015					Migration to Pillar 1	
Minimum Common Equity Capital Ratio			3.5%	4.0%	4.5%	4.5%	4.5%	4.5%	4.5%
Capital Conservation Buffer						0.625%	1.25%	1.875%	2.50%
Minimum common equity plus capital conservation buffer			3.5%	4.0%	4.5%	5.125%	5.75%	6.375%	7.0%
Phase-in of deductions from CET1 (including amounts exceeding the limit for DTAs, MSRs and financials)				20%	40%	60%	80%	100%	100%
Minimum Tier 1 Capital			4.5%	5.5%	6.0%	6.0%	6.0%	6.0%	6.0%
Minimum Total Capital			8.0%	8.0%	8.0%	8.0%	8.0%	8.0%	8.0%
Minimum Total Capital plus conservation buffer			8.0%	8.0%	8.0%	8.625%	9.25%	9.875%	10.5%
Capital instruments that no longer qualify as non-core Tier 1 capital or Tier 2 capital			Phased out over 10 year horizon beginning 2013						
Liquidity coverage ratio	Observation period begins				Introduce minimum standard				
Net stable funding ratio	Observation period begins							Introduce minimum standard	

Source: HKMA

M&A

M&A opportunities

We believe consolidation is inevitable.

Demand matches supply => consolidation

Strong demand for mid-sized banks

- **Strong wealth management demand**: For political and risk management purposes, there is strong demand for wealth management in HK as wealthy Chinese people typically do not want to concentrate their personal wealth in China. Given the proximity and similar culture, we believe HK is the best wealth management centre for mainland tycoons. As a result, there is strong demand for the services of HK mid-sized banks since they can provide platforms for wealth management business.
- **China banks want bigger footprint in HK**: Some Chinese banks that are big in China have but relatively small operations in HK. For instance, BOC has BOCHK. ICBC has ICBC (Asia), CCB has CCB (Asia) and CMB has Wing Lung Bank. But for ABC and BoComm, their operation in HK is small compared with peers. Therefore, we believe demand for the services of HK mid-sized banks is high.

Supply of quality banks for acquisition is possible

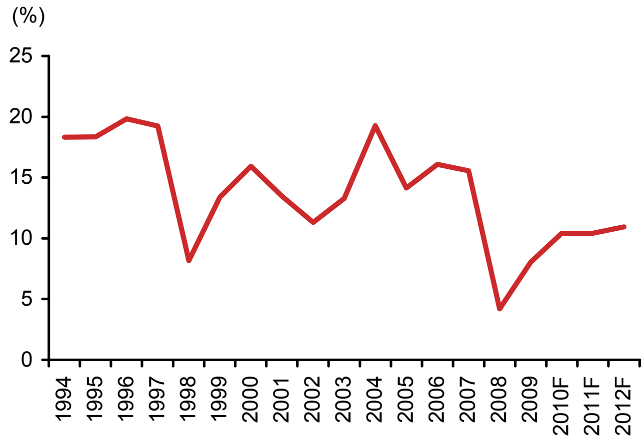
- **Structural decline in profitability due to low interest rate environment and competition**. Historically, the highest ROE that mid-sized banks can generate is close to 20%. However, competition and the low interest-rate environment is driving down the profitability of HK banks, in our view. In our models, we expect mid-sized banks to generate an average ROE of 11-12% in FY11F and FY12F. Given the difficult operating environment, we believe some HK mid-sized banks may be willing to sell off their shares.

Exhibit 54. HK banks' loan market share — small banks in HK are generally losing market share

	Dec 08	Jun 10	Change
BOCHK	13.9	15.1	1.1
HSBC HK ex Hang Seng	13.8	13.1	(0.6)
Hang Seng	10.0	10.4	0.4
BEA	7.0	7.3	0.4
STAN HK	6.5	7.2	0.7
ICBC (Asia)	4.2	4.9	0.7
Wing Hang	2.5	2.5	0.0
Citic Int'l	2.3	2.3	0.0
CCB (Asia)	1.2	1.7	0.5
Dah Sing Fina	1.8	1.7	(0.1)
Shanghai Commercial	1.5	1.3	(0.2)
Chong Hing	1.0	1.0	(0.1)
Fubon HK	1.0	0.7	(0.3)
Public (HK)	0.7	0.7	(0.1)
Others	32.5	30.0	(2.5)
Systems	**100.0**	**100.0**	

Source: Company data, Nomura research

Exhibit 55. ROE of mid-sized banks — structural decline in profitability — low rates, competition



Source: Company data, Nomura research

- **Mid-sized banks — shareholders seem open to M&A**: Some mid-banks have stated that they are open to M&A discussions. For instance, DSF and WHB mentioned that they are open-minded to M&A (First Financial Daily, 12 August, 2010). Therefore, we believe M&A activity is possible soon.

Likely M&A candidates

In our view, DSF and WHB are potential M&A candidates based on their public comments. The likelihood of M&A at BEA seems remote, in our view. We have not built in potential M&A into our base case valuation.

Exhibit 56. Current shareholding structure

Bank	Major shareholder	% Shareholding
Hang Seng Bank	HSBC	62.1
BOCHK	BOC Group	66.1
BEA	Criteria CaixaCorp	15.1
	Guoco	9.1
	Li Family	8.0
Wing Hang	Bank of New York	20.3
	Fung Family	23.6
Dah Sing Financial	Wong Family	40.0
	Mitsubishi UFJ	15.1

Source: Bloomberg, Company data, Nomura research

At DSF and WHB, major shareholdings are concentrated at the one or two largest shareholders, making M&A negotiation easier. Management mentioned before that they are open to M&A discussions (Hong Kong Commercial Newspapers, "*Dah Sing Bank is Open to M&A*", 10 August, 2010). Therefore, we attach a high probability of M&A activities at WHB and DSF.

BEA's shareholding structure is very diversified, with the largest shareholder holding being Criteria Caixa Corp at 15%. The Li family has an 8% shareholding. We believe the complex shareholding structure could make M&A negotiation less likely at BEA. Moreover, management has mentioned before (RTHK, *"David Li: BEA wishes to stay independent"*, 12 August, 2010) that it wants to stay independent. Therefore, we attach a low probability of M&A activities at BEA.

Exhibit 57. HK banks: M&A history

Date	Target	Acquirer	% Acquired	Tran value (US$mn)	P/B (x)	P/E (x)
1Q11	Fubon (HK)	Fubon Group	25.0	188	1.4	19.2
3Q10	ICBC (Asia)	ICBC Group	27.2	1387	2.1	15.8
2Q09	CIFH	CITIC Group	70.3	1739	1.4	20.2
2Q08	Wing Lung Bank	China Merchant Bank	53.1	2475	3.1	34.1
4Q07	Bank of East Asia	BOC (Hong Kong)	4.9	506	2.9	23.0
4Q06	CITIC Int'l Fina	BBVA	15.0	625	1.6	17.5
4Q06	Bank of America (HK)	China Construction Bank	100.0	1253	1.3	18.1
1Q06	Asia Commercial Bank	JCG	100.0	577	2.5	63.0
3Q05	Banco Comercial de Macau	Dah Sing Financial	100.0	214	2.6	22.6
2Q05	Pacific Finance	Dah Sing Financial	100.0	120	1.8	13.8
1Q04	Fortis Bank	ICBC (Asia)	100.0	324	1.1	17.7
4Q03	IBA (now Fubon)	Fubon Financial	75.0	415	1.2	16.0
3Q03	Chekiang First	Wing Hang	100.0	615	1.2	23.2
1Q02	HK Chinese	CITIC Ka Wah	70.0	538	1.3	46.1
2Q01	Dao Heng	DBS	55.0	5716	3.4	25.6
4Q00	First Pacific	Bank of East Asia	75.0	561	1.5	71.5
Average					**1.9**	**28.0**

Source: Company data, Nomura research

Renminbi business

RMB: short-term contribution limited; long-term gain

Since its inception in 2004, the renminbi business in HK has been growing rapidly. This has led to a significant pick-up in interest among investors on renminbi liberalisation. While we believe it is structurally positive in the long run, we see the earnings contribution as limited this year.

Exhibit 58. Renminbi developments in Hong Kong

Year	Month	Details
2004	Feb	HK banks were allowed to start RMB business including deposits, transfer & exchange
	Apr	HK banks were allowed to start RMB credit card business
2005	Dec	1) Allowing corporate from 7 industries (including retail, beverage, transport, hotels, telecom education & medical) to open RMB deposit accounts in HK banks. RMB deposits can be exchanged into HK dollars but not vice versa
		2) Cap of daily exchange amount is increased to RMB20,000
		3) Daily transfer from HK deposit accounts into China deposit accounts of the same depositor is increased to RMB80,000
		4) Abolishment of credit card limit of RMB10,000
2006	Mar	HK citizens were allowed to open RMB cheque accounts
2007	Jan	Chinese Government approved Chinese FI to issue RMB denominated bonds
	Jul	First issuance of RMB5bn bonds by China Development Bank in Hong Kong
2009	May	HK banks' subsidiaries in China were allowed to issue RMB bonds
	Jun	Signing of memorandum between PBOC and HKMA
	Jul	Cross-border RMB clearing was adopted. Chinese cities included 4 cities in Guangdong and Shanghai. Outside include HK, Macau and ASEAN
	Sep	Issuance of RMB6bn bonds by Department of Finance
2010	Feb	HKMA opened up RMB clearing pilot scheme to trade related industries
	Jun	Scope of cross-border RMB clearing scheme was enlarged. Number of Chinese cities were increased to 20. Outside was extend to the globe
	Jul	PBOC and HK clearing bank signed revised "Settlement Agreement", allowing retail RMB deposits to buy RMB-denominated investment products
	Jul	Hong Kong Renminbi Clearing Platform to Conduct Exchange, Supply and Repatriation of Renminbi cash notes for HK branches of eligible Taiwan commercial banks as determined by Taiwan
		Allowing corporate accounts to open RMB accounts
	Aug	PBOC allowed RMB Clearing Bank and other eligible institutions to make use of their RMB funds to invest in the Mainland's interbank bond market
	Oct	PBOC increased the number of Chinese enterprises that can settle exports in renminbi from 365 to 67,359

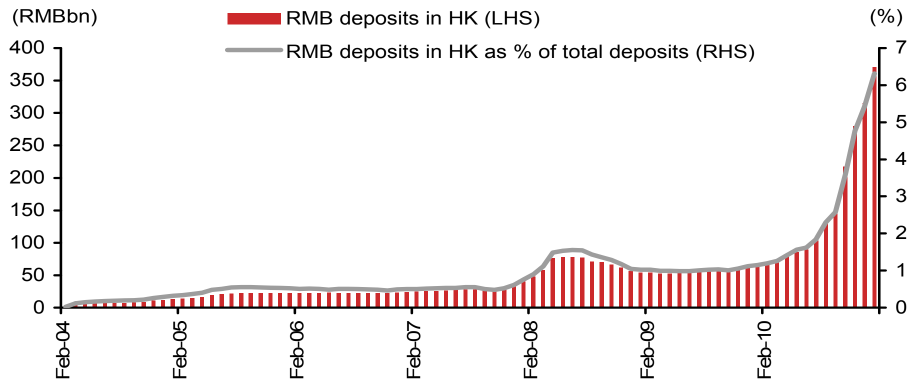
Source: HKMA, Nomura research

Short-term limited contribution

On volume, RMB deposits in HK reached RMB371bn as of January 2011, up 480% y-y. Despite the significant growth, renminbi deposits account for just 6% of HK's total deposits as of January 2011. Starting from a low base in 2011, we believe volume contribution from renminbi deposits will be limited.

RMB deposits account for 6% of total deposits in HK

Exhibit 59. Renminbi deposits in HK

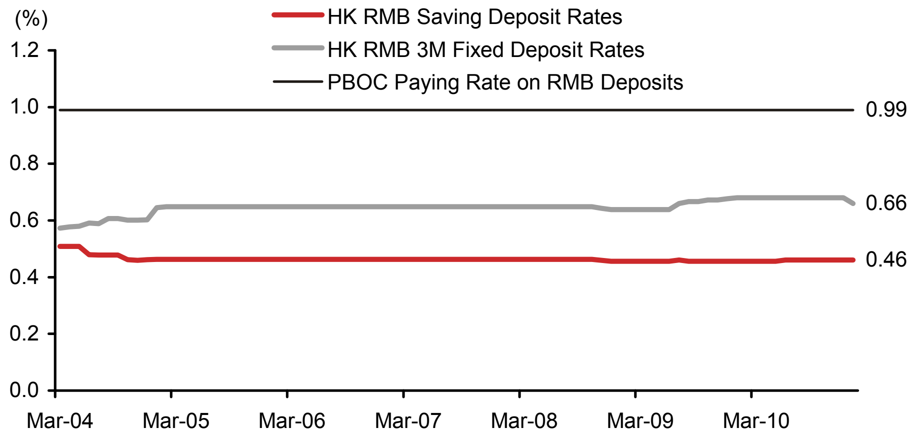


Source: CEIC, Nomura research

RMB business — low margin

On margins, we believe renminbi business is a drag on HK banks' margins. Growth of renminbi deposits is much faster than growth in renminbi investment vehicles, therefore most of the excess renminbi deposits are channelled back to Shenzhen PBOC via Clearing Bank BOCHK. Currently, the PBOC is offering 0.99% for renminbi deposits in HK, of which retail deposits get 40-50bps, deposit taking banks get 20bps and Clearing Bank BOCHK gets 12.5bps. Since margins on renminbi business (20bps for deposit-taking bank) are much lower than current bank margins of 1.31% in 3Q10 (as reported by HKMA), we believe renminbi business will remain a drag HK banks' margins.

Exhibit 60. Renminbi deposits rates in HK



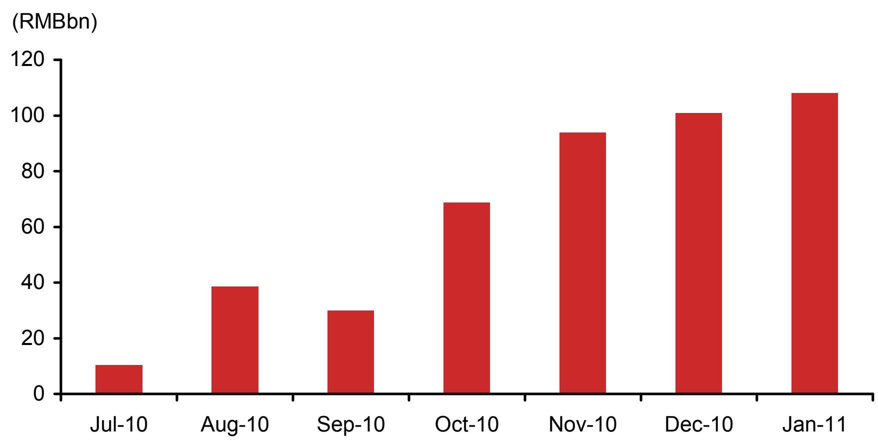
Source: CEIC, Nomura research

Long-term gain

RMB is a long-term asset growth driver

On volume, we believe renminbi liberalisation is positive for the HK bank sector. Recent data from the HKMA indicates that renminbi trade settlement volume is growing at a rapid pace (see Exhibit below). We estimate that renminbi deposits will make up 15% of HK's total deposits in 2012F and thus become a driver for asset growth for HK banks.

Exhibit 61. Renminbi trade settlement volume in HK



Source: HKMA, Nomura research

Long-term margin to expand should China lifts capital controls

On margin, there is room for expansion should China open up new opportunities for high-margin business such as renminbi lending and investment in China's bond market, in our view. However, we believe renminbi liberalisation is a long-term story until China lifts capital controls: note China still controls the flow of capital inside the nation.

Potential earnings impact from renminbi business in FY12F

We believe BOCHK is the biggest beneficiary should renminbi business continue to be liberalised. On our estimates, the potential impact of renminbi business on FY12F earnings would be 22% for BOCHK, 7% for HSB, 14% for BEA, 12% for WHB and 17% for DSF.

Our key assumptions:

- **Renminbi deposits will hit 15% of the HK total deposits in 2012F.**
- **Current market share of renminbi deposits remain unchanged:** BOCHK 35%; HSB 9%, BEA 5%, WHB 2% and DSF 2%.
- **Incremental net interest income yield of 100bps:** According to Nomura estimates, the loan yield in China will be around 5% in 2012F, this compares with just 1.5% in HK (assuming current HIBOR 3M + a 120bps premium). We assume part of the interbank investment should be shifted to China loan investments, earning an incremental asset yield of 100bps.
- **Incremental fee income = 25% of net interest income:** We assume additional fee income such as loan-arrangement fee as a result of additional net interest income.
- **Incremental operating expense is assumed to be zero:** As there is no change in the cost of funding.
- **Tax rate is assumed to remain at 17.5%.**

Exhibit 62. Sensitivity analysis of renminbi business (FY12F)

Total HK deposits as of Dec 2010 (HK$bn)	**6,862**				
RMB deposits as % of total deposits in FY12F (%)	15				
RMB deposits in HK, FY12F (HK$bn)	1,235				
(HK$mn)	**HSB**	**BOCHK**	**BEA**	**WHB**	**DSF**
Market share estimates of RMB deposits (%)	9	35	5	2	2
RMB deposits in FY12F	111,167	432,316	61,759	24,704	24,704
Net interest income @ 100bps	1,112	4,323	618	247	247
Non-interest income @ 25% of NII	278	1081	154	62	62
Revenue	**1,390**	**5,404**	**772**	**309**	**309**
Expenses	0	0	0	0	0
Operating profits	**1,390**	**5,404**	**772**	**309**	**309**
Tax @ 17.5%	243	946	135	54	54
Incremental profits	**1,146**	**4,458**	**637**	**255**	**255**
Impact as % of FY12F Earnings (%)	**7**	**22**	**14**	**12**	**17**
FY12F Earnings (Base case)	17,637	20,440	4,703	2,106	1,461

Source: Nomura research

We have not built in the above sensitivity results in our base-case models since it is difficult to predict whether the above assumptions will materialise in FY12F. We believe the renminbi business is a long-term positive. However, the short term, the contribution is likely to be small.

Valuation

Valuation methodology

Our valuation methodology is based on the Gordon Growth Model on normalised ROE, which helps us to better track the long-term profitability of HK banks and smooth out volatility throughout cycles. We use the following formula:

P/B = (ROE – g)/ (COE – g)

ROE = normalised return on equity; COE = cost of equity; g = long-term growth rate

Key assumptions:

- Normalised ROE based on normalised earnings excluding exceptional and non-recurring items such as property disposal gain/(losses), investment losses.
- Cost of equity is calculated based on risk-free rate plus risk premium.
- Risk-free rate of 4%, which is the long-term average of HK's 10-year exchange fund note yield.
- Beta to take into account the volatility of different bank stocks.
- Risk premium of 5%.
- Long-term growth rate of 4-7% for different banks, after factoring in different growth prospects since significant exposure outside HK deserves a higher long-term growth rate assumption in our view.

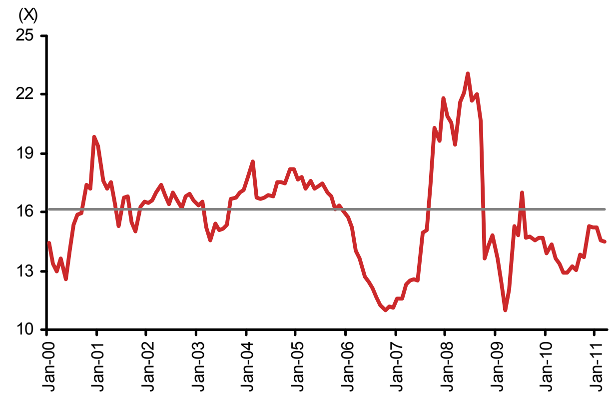
Exhibit 63. HK banks: price target calculation derived from normalised earnings

(As % of ave assets)	HSB	BOCHK	BEA	WHB	DSF
Net interest income (%)	1.7	1.6	1.6	1.9	1.7
Non-interest income (%)	1.0	0.9	0.7	0.7	0.7
Fee income (%)	0.6	0.7	0.6	0.5	0.3
Other non-interest income (%)	0.4	0.2	0.2	0.2	0.4
Operating revenues (%)	**2.7**	**2.5**	**2.3**	**2.6**	**2.4**
Operating expenses (%)	(0.9)	(0.7)	(1.3)	(1.1)	(1.1)
Pre-provision profits (%)	**1.8**	**1.7**	**1.0**	**1.5**	**1.3**
Loan loss provision (%)	(0.1)	(0.2)	(0.1)	(0.2)	(0.2)
Other provisions (%)	0.0	0.0	0.0	0.0	0.0
Operating profits (%)	**1.7**	**1.6**	**0.9**	**1.3**	**1.1**
Others (%)	0.3	0.0	0.1	0.0	0.3
Associates profits (%)	0.3	0.0	0.1	0.0	0.3
Other non-operating income (%)	0.0	0.0	0.1	0.0	0.0
Profit before tax (%)	**2.0**	**1.6**	**1.0**	**1.3**	**1.4**
Tax (%)	(0.3)	(0.2)	(0.2)	(0.2)	(0.2)
Profit after tax (%)	**1.7**	**1.3**	**0.8**	**1.1**	**1.2**
Minority interests (%)	0.0	0.0	0.0	0.0	(0.2)
ROA (%)	**1.6**	**1.3**	**0.8**	**1.1**	**1.0**
Leverage (x)	14.0	13.0	13.0	12.3	11.4
ROE (%)	**23.1**	**17.5**	**10.2**	**13.1**	**11.2**
Risk-free rate (%)	4.0	4.0	4.0	4.0	4.0
Risk premium (%)	5.0	5.0	5.0	5.0	5.0
Beta	1.0	1.0	1.1	0.9	1.1
COE (%)	9.0	9.0	9.5	8.7	9.4
Long-term growth rate (%)	3.5	4.5	7.0	5.0	5.0
Fair value PB (x)	3.6	2.9	1.3	2.2	1.4
FY10E book value per share (HK$)	36.5	10.6	22.0	47.4	46.2
Price target (HK$)	**130**	**30**	**28**	**104**	**65**

Source: Nomura research

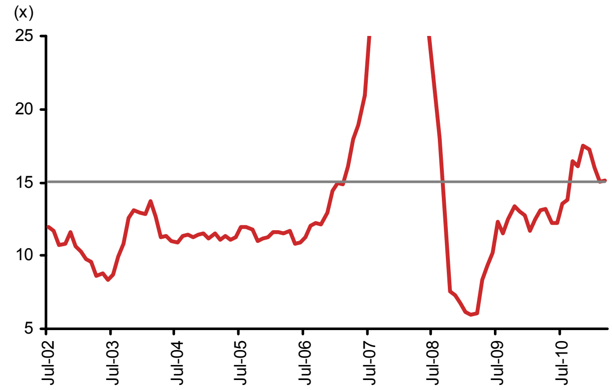
Prospective P/E charts

Exhibit 64. HSB: Prospective P/E



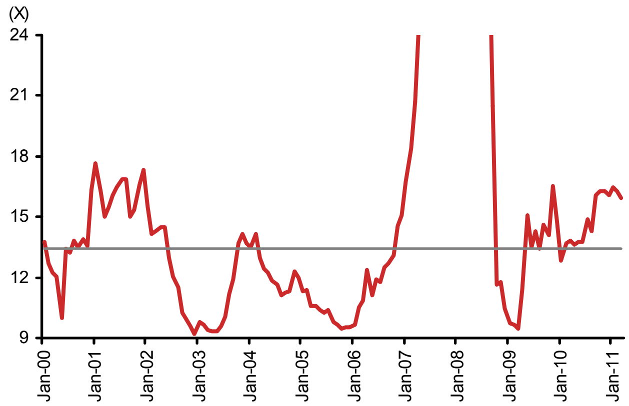
Source: Bloomberg, Company data, Nomura estimates

Exhibit 65. BOCHK: Prospective P/E



Source: Bloomberg, Company data, Nomura estimates

Exhibit 66. BEA: Prospective P/E

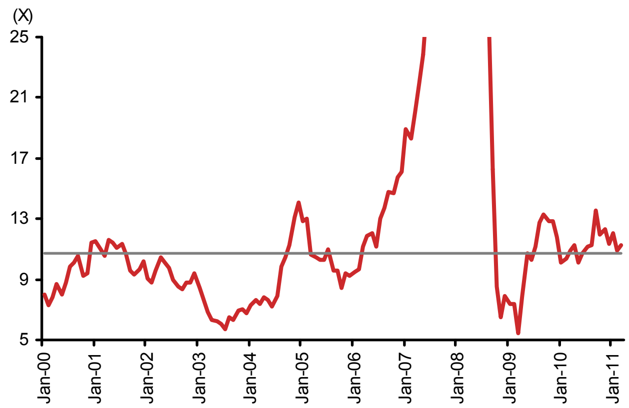


Source: Bloomberg, Company data, Nomura estimates

Exhibit 67. WHB: Prospective P/E

Source: Bloomberg, Company data, Nomura estimates

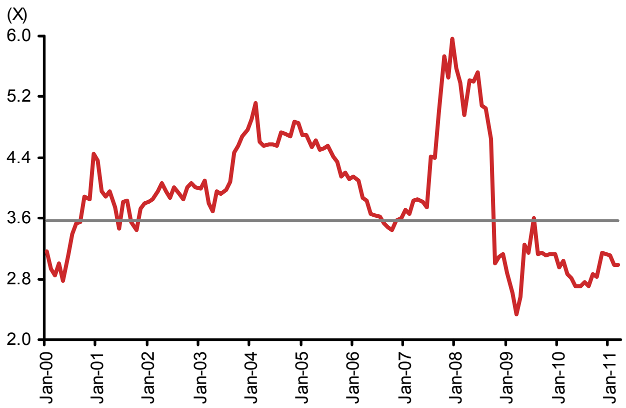
Exhibit 68. DSF: Prospective P/E



Source: Bloomberg, Company data, Nomura estimates

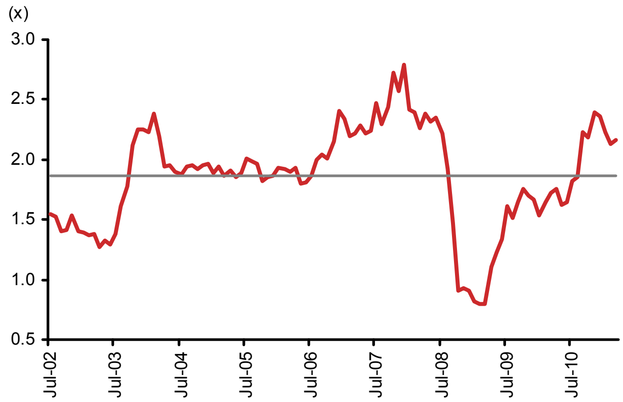
Prospective P/B charts

Exhibit 69. HSB: Prospective P/B



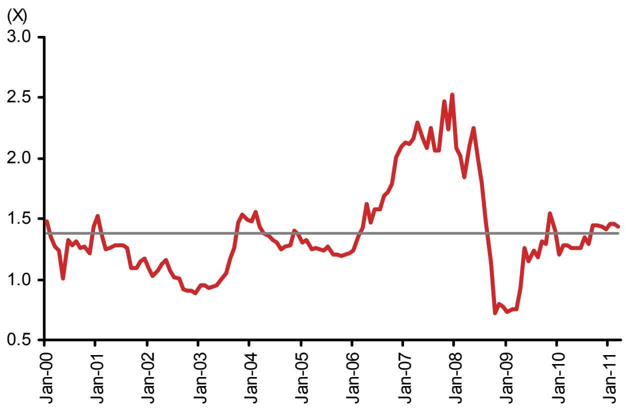
Source: Bloomberg, Company data, Nomura estimates

Exhibit 70. BOCHK: Prospective P/B



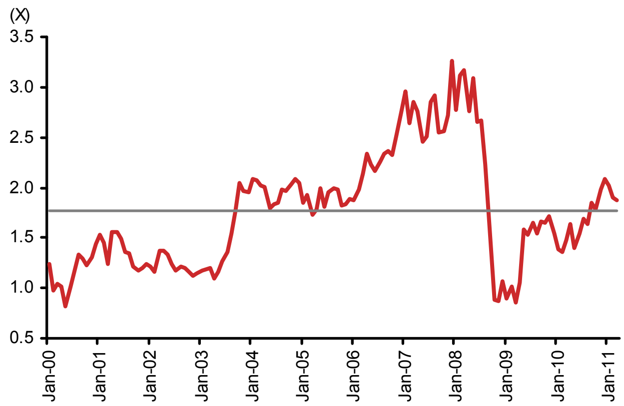
Source: Bloomberg, Company data, Nomura estimates

Exhibit 71. BEA: Prospective P/B



Source: Bloomberg, Company data, Nomura estimates

Exhibit 72. WHB: Prospective P/B



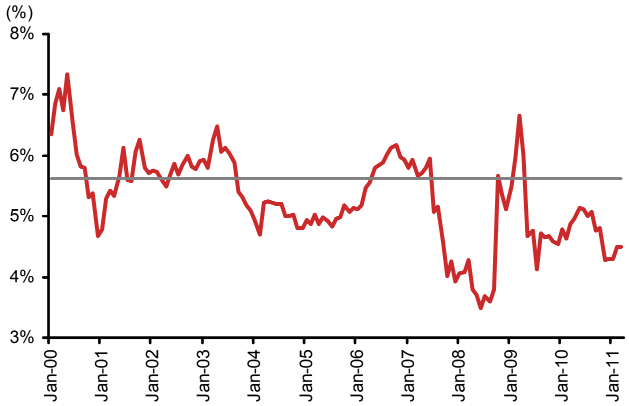
Source: Bloomberg, Company data, Nomura estimates

Exhibit 73. DSF: Prospective P/B

Source: Bloomberg, Company data, Nomura estimates

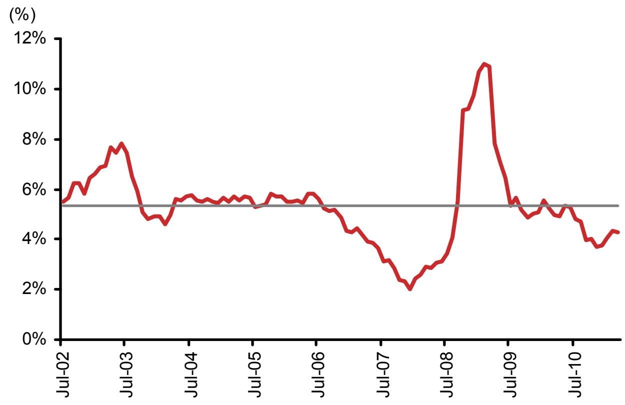
Prospective dividend yield

Exhibit 74. HSB: Prospective dividend yield



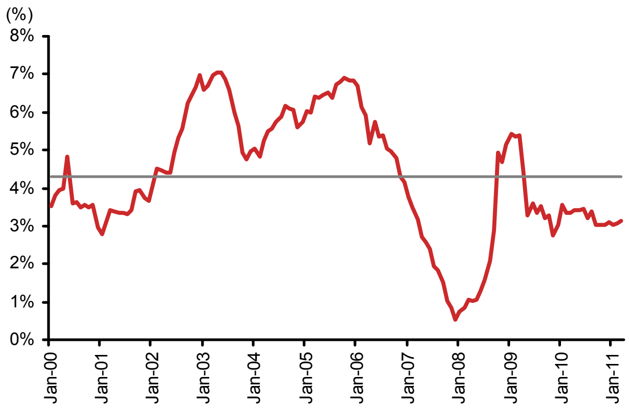
Source: Bloomberg, Company data, Nomura estimates

Exhibit 75. BOCHK: Prospective dividend yield



Source: Bloomberg, Company data, Nomura estimates

Exhibit 76. BEA: Prospective dividend yield



Source: Bloomberg, Company data, Nomura estimates

Exhibit 77. WHB: Prospective dividend yield

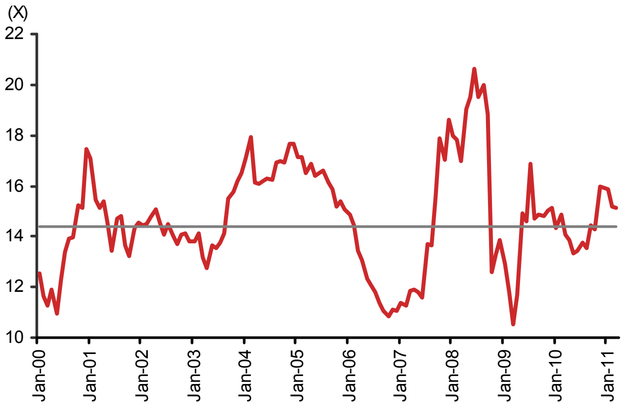
Source: Bloomberg, Company data, Nomura estimates

Exhibit 78. DSF: Prospective dividend yield

Source: Bloomberg, Company data, Nomura estimates

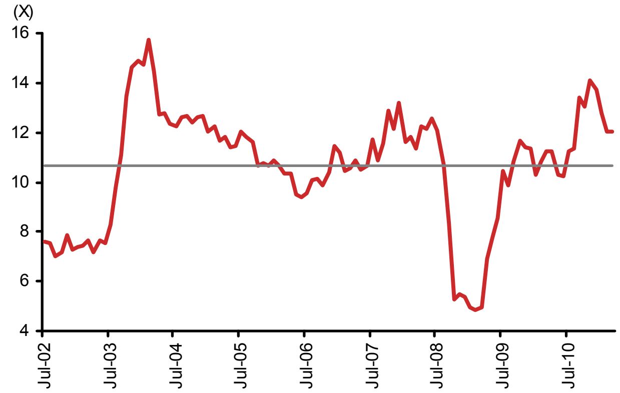
Prospective price to pre-provision profits

Exhibit 79. HSB: Prospective P/PPP



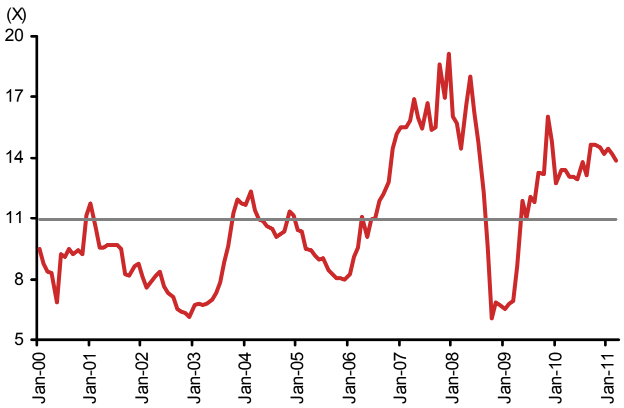
Source: Bloomberg, Company data, Nomura estimates

Exhibit 80. BOCHK: Prospective P/PPP



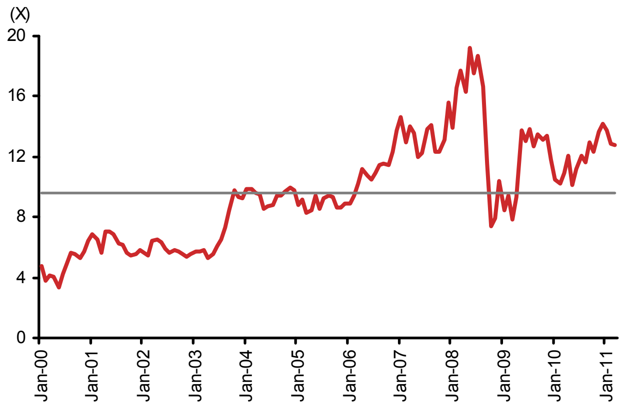
Source: Bloomberg, Company data, Nomura estimates

Exhibit 81. BEA: Prospective P/PPP



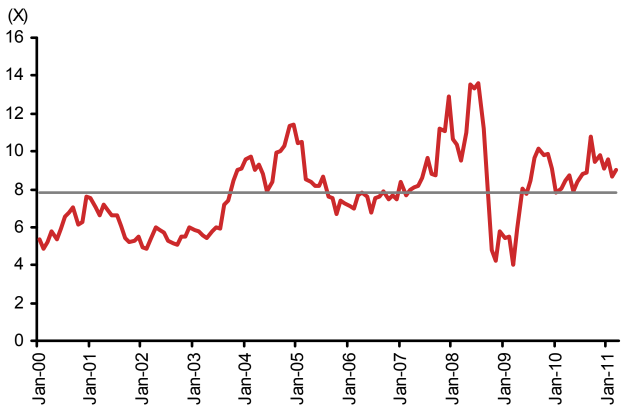
Source: Bloomberg, Company data, Nomura estimates

Exhibit 82. WHB: Prospective P/PPP



Source: Bloomberg, Company data, Nomura estimates

Exhibit 83. DSF: Prospective P/PPP



Source: Bloomberg, Company data, Nomura estimates

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From Rating Suspended

BUY

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Action

We resume coverage of BOCHK with a BUY rating and price target of HK$30, implying 22% potential upside from current levels. We believe there is scope for ROE expansion at BOCHK, as it is well capitalised and underleveraged compared with peers. In addition, the renminbi is a long-term positive for the bank, although short-term contributions here are likely to be limited in FY11F.

Catalysts

2H10 results could provide better earnings visibility for FY11F and FY12F.

Anchor themes

Earnings progression is likely to be muted in FY11F, due to compressing margins and slow asset growth. We believe margins for HK banks will remain under pressure until the US starts tightening aggressively, which we think is likely to occur only in 2012.

Closing price on 3 Mar	HK$24.70
Price target	**HK$30.00**
	(from HK$24.00)
Upside/downside	21.5%
Difference from consensus	**5.6%**
FY11F net profit (HK$mn)	16,239
Difference from consensus	**-8.5%**

Source: Nomura

Nomura vs consensus

Our PT is higher than consensus because we believe there is scope for ROE expansion despite earnings headwinds, as BOCHK is well capitalised and underleveraged compared with peers.

More room to shine

① Scope for ROE expansion

We believe there is room for ROE expansion at BOCHK, as the bank is well capitalised and underleveraged. As per our calculation, if BOCHK were to adopt the Advanced IRB approach like HSB then its core tier-1 ratio as of June 2010 could go up to 17%. BOCHK seems underleveraged at 12.2x its balance sheet vs HSB at 13.6x as of June 2010.

② Renminbi is a long-term positive, could contribute 22% of earnings in FY12F

Our sensitivity analysis indicates that renminbi offshoring could potentially contribute around 22% of total earnings in FY12F. Renminbi deposits are growing rapidly and could be a significant source of asset growth as BOCHK has a large market share in offshore renminbi deposits in Hong Kong. In addition, with greater availability of renminbi investment vehicles, BOCHK's margins could increase in the long run. However, we have not built in the impact of renminbi liberalisation in our base case estimate as the timing for this is difficult to ascertain.

③ Mild earnings growth outlook

On a fundamental basis, NIM is still under pressure due to negatives from mortgage re-pricing, lower treasury returns and limited free-fund contribution. Asset growth is slow owing to slow GDP growth. We look for earnings growth of 12% in the absence of significant credit costs in FY11F.

④ Valuation can trend up to 3x book; PT of HK$30

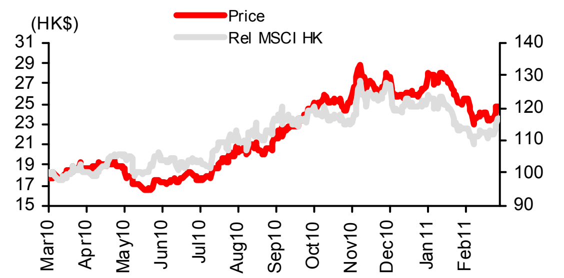
The stock is trading at 16x FY11F earnings and 2.2x book for earnings. Although not cheap, we believe ROE expansion and the theme of renminbi liberalisation can propel the stock to 3x book by 2012. We resume coverage of BOCHK with BUY rating, PT of HK$30.

Key financials & valuations

31 Dec (HK$mn)	FY09	FY10F	FY11F	FY12F
PPOP	17,192	16,417	20,385	25,535
Reported net profit	17,003	14,548	16,239	20,440
Normalised net profit	14,097	13,248	16,239	20,440
Normalised EPS (HK$)	1.33	1.25	1.54	1.93
Norm. EPS growth (%)	(12.6)	(6.0)	22.6	25.9
Norm. P/E (x)	18.5	19.7	16.1	12.8
Price/adj. book (x)	2.54	2.34	2.20	2.07
Price/book (x)	2.54	2.34	2.20	2.07
Dividend yield (%)	3.5	3.6	4.0	5.1
ROE (%)	18.3	13.6	14.1	16.7
ROA (%)	1.44	1.12	1.12	1.32
Earnings revisions				
Previous norm. net profit		16,592	18,650	21,946
Change from previous (%)		(20.2)	(12.9)	(6.9)
Previous norm. EPS (HK$)		1.57	1.76	2.08

Source: Company, Nomura estimates

Share price relative to MSCI HK



	1m	3m	6m
Absolute (HK$)	(3.1)	(10.7)	14.4
Absolute (US$)	(3.2)	(11.0)	14.1
Relative to Index	2.4	(8.0)	0.2
Market cap (US$mn)			33,522
Estimated free float (%)			33.9
52-week range (HK$)			28.85/16.50
3-mth avg daily turnover (US$mn)			66.6
Stock borrowability			Easy
Major shareholders (%)			
Bank of China Limited			66.1
			0.0

Source: Company, Nomura estimates

Drilling down

Investment highlights

BOCHK is better capitalised than Hang Seng

BOCHK tier-1 could potentially go to 17% (pro-forma as of June 2010) if BOCHK adopts Advanced IRB as has Hang Seng Bank

HK banks use different methods to calculate capital. For instance, HSB uses Advanced IRB, while BOCHK uses the Standardised Approach under Basel 2. While the calculation of core capital is the same for both methods, the calculation of risk-weighted assets (RWA) differs. For instance, risk-weighting of mortgage loan is 35% under the Standardised Approach, while it is only 7-8% under the Advanced IRB approach. As a result, reported core tier-1 ratios are not directly comparable.

We have conducted an apples-to-apples comparison of core tier-1 ratios for HSB and BOCHK, as they have better disclosure and their loan mix is similar. Our analysis showed that BOCHK is much better capitalised due to the reduction of RWA. The pro-forma core tier-1 ratios of BOCHK can go up from 11.3% to 17% as of June 2010 according to our calculations as against HSB's 11.1%. Therefore, we believe BOCHK is better positioned than Hang Seng Bank with regard to expanding its loanbook and ROE.

Exhibit 84. HSB and BOCHK: similar loan mix, June 2010

(Mix %)	HSB	BOCHK
SME	15	21
Corporates	38	31
Mortgages	29	25
Personal	7	3
Loan for use in HK	**90**	**80**
Outside HK	10	20
Total loans	**100**	**100**

Source: Company data, Nomura research

Exhibit 85. HSB & BOCHK: pro forma core capital ratios under advanced IRB, June 2010

(HK$mn)	BOCHK - Standardized	BOCHK - AIRB pro-forma	Change (%)
Core tier 1 capital	**75,297**	**75,297**	
Credit RWA	618,503	387,878	(37.3)
Market RWA	18,501	18,501	
Operational RWA	47,898	47,898	
Deductions	(20,126)	(20,126)	
Total RWA	664,776	434,151	(34.7)
Core tier 1 (%)	**11.3**	**17.3**	**6.0**
Total loans	597,306	597,306	
Credit RWA as % of loans (%)	104	65	

(HK$mn)	Hang Seng - AIRB reported
Core tier 1 capital	32,678
Credit RWA	255,927
Market RWA	1,405
Operational RWA	37,576
Deductions	0
Total RWA	294,908
Core tier 1 (%)	**11.1**
Total Loans	394,110
Credit RWA as % of loans (%)	65

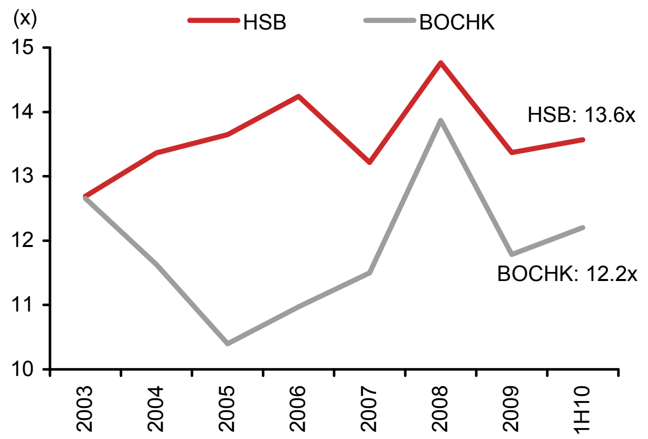
Source: Company data, Nomura research

BOCHK has more room to leverage up

BOCHK has been underleveraged since listing

Since its listing in 2002, BOCHK has consistently been underleveraged compared to HSB, as BOCHK has kept more excess capital by lowering its dividend payout ratios. Average payout ratios were 83% at HSB from 2003-09, vs. 64% at BOCHK for the same period (excluding 2008 due to investment loss in that year). We believe the excess capital can help BOCHK leverage up its balance sheet and thus provide room for ROE expansion. In our normalised-ROE price target calculation, we use a target leverage ratio of 13x to derive our price target of HK$30.

Exhibit 86. BOCHK and HSB: assets to equity ratios



Source: Company data, Nomura research

Exhibit 87. BOCHK and HSB: reported dividend payout ratios

(%)	2003	2004	2005	2006	2007	2008	2009	2010F
HSB	98	87	88	83	66	85	76	70
BOCHK	68	63	63	64	63	139	66	65

Source: Company data, Nomura research

Slow earnings outlook

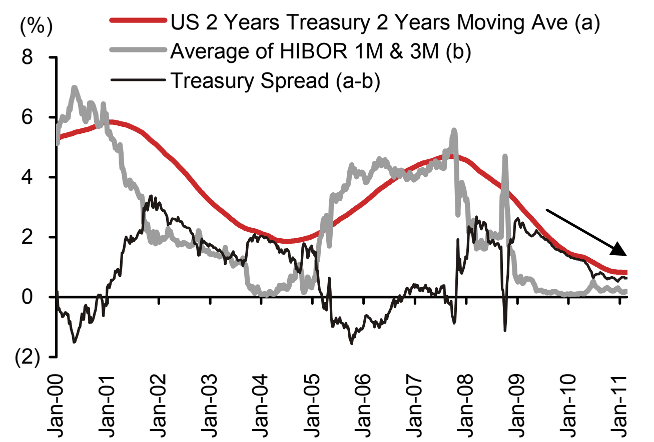
On a fundamental basis, earnings headwinds in FY11F

On a fundamental basis, NIM is still under pressure due to negatives from mortgage re-pricing, lower treasury returns and limited free-fund contribution. Asset growth is slow owing to slow GDP growth. We look for reported earnings growth of 12% in the absence of significant credit costs in FY11F.

For treasury, while cost of funding is already close to the bottom (based on HIBOR 3M & saving deposit rates), return from treasury investments is still decreasing, as treasury duration is 1-2 years. As a result, we believe treasury spread is still diminishing at BOCHK.

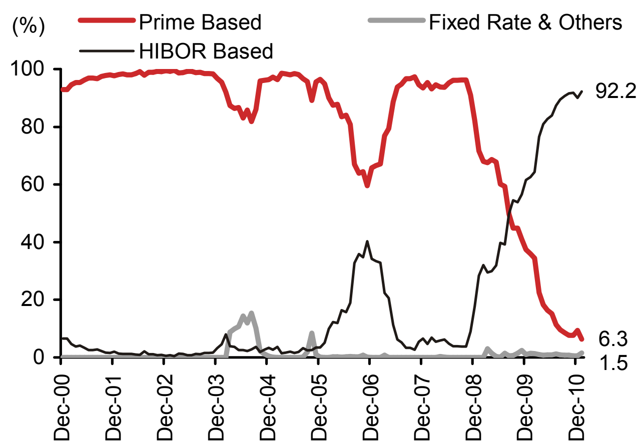
We believe loan pricing power is impaired in a low interest-rate environment. A good proxy of corporate loan spread would be Moody's Corporate Bond Yield minus LIBOR 3M. We have seen a general decline in corporate loan spread since 2009. In addition, mortgages are being re-priced at a rapid pace, with more than 90% of new mortgages HIBOR-based. Therefore, loan spread is expected to remain weak in FY11F.

Exhibit 88. HK: treasury spread heading south



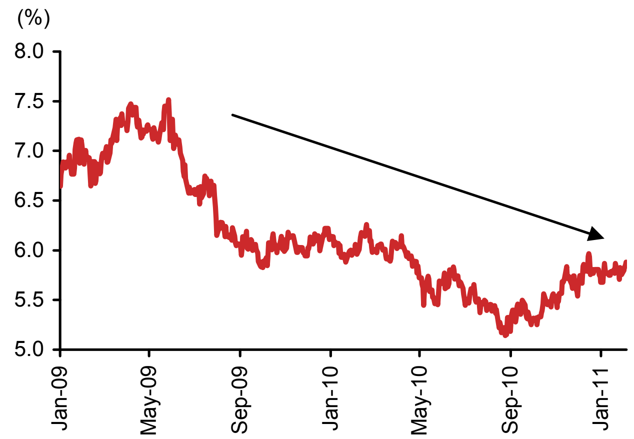
Source: CEIC, Nomura research

Exhibit 89. HK new mortgage loan type — pick-up of HIBOR-based mortgage type is negative for NIM



Source: CEIC, Nomura research

Exhibit 90. Moody's seasoned Baa Corporate Bond Yield… proxy of Corporate Loan Spread in HK



Source: US St. Louis Fed, CEIC, Nomura research

For asset growth, we believe the main driver could be deposit growth, which in turn is driven by GDP growth. Our HK economist, Robert Subbaraman, forecasts that HK real GDP growth will be 5.8% in 2011. We forecast 2011 deposit growth to be in the high single digits. Deposit growth has been weak since 2005. We believe the weak asset trend could continue into 2011.

We forecast 12% earnings growth for FY11F by incorporating our NIM compression and slow asset growth estimates. We forecast 26% earnings growth in FY12F as the US begins to increase interest rates slightly.

Exhibit 91. BOCHK: earnings outlook

						y-y			
(HK$mn)	**FY08**	**FY09**	**FY10F**	**FY11F**	**FY12F**	**09**	**10F**	**11F**	**12F**
Net interest income	20,157	17,932	17,815	19,655	23,916	(11)	(1)	10	22
Non-interest income	5,369	8,123	7,768	10,603	12,254	51	(4)	36	16
Fee income	5,179	6,508	7,080	8,456	10,009	26	9	19	18
Other non-interest income	190	1,615	688	2,146	2,245	750	(57)	212	5
Operating revenues	**25,526**	**26,055**	**25,583**	**30,258**	**36,170**	**2**	**(2)**	**18**	**20**
Operating expenses	(8,002)	(8,863)	(9,166)	(9,872)	(10,635)	11	3	8	8
Pre-Provision Profits	**17,524**	**17,192**	**16,417**	**20,385**	**25,535**	**(2)**	**(5)**	**24**	**25**
Loan loss provision	(661)	(103)	0	(609)	(639)	(84)	(100)	NA	5
Other provisions	(769)	(3,278)	0	0	0	326	(100)	NA	NA
Operating profits	**16,094**	**13,811**	**16,417**	**19,777**	**24,896**	**(14)**	**19**	**20**	**26**
Others	(12,016)	2,913	1,310	10	10	(124)	(55)	(99)	0
Associates profits	7	7	10	10	10	0	43	0	0
Other non-operating income	(12,023)	2,906	1,300	0	0	(124)	(55)	(100)	NA
Profit before tax	**4,078**	**16,724**	**17,727**	**19,787**	**24,906**	**310**	**6**	**12**	**26**
Tax	(1,071)	(2,678)	(2,839)	(3,168)	(3,988)	150	6	12	26
Profit after tax	**3,007**	**14,046**	**14,888**	**16,618**	**20,918**	**367**	**6**	**12**	**26**
Minority interests	336	(321)	(340)	(380)	(478)	(196)	6	12	26
Attributable profits	**3,343**	**13,725**	**14,548**	**16,239**	**20,440**	**311**	**6**	**12**	**26**

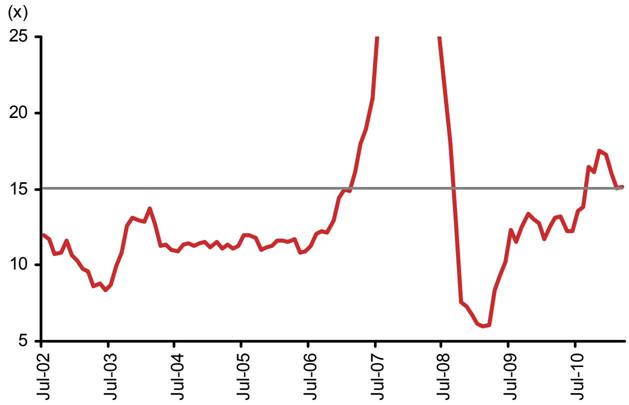
Source: Nomura research

Valuation

BOCHK is trading at 16x earnings and 2.2x book value for FY11F. While this valuation is not inexpensive, we believe there could be scope for multiple expansion as the bank could expand its ROE by leveraging up its balance sheet as the bank is well capitalised and underleveraged. In addition, the stock is offering a 4% dividend yield for FY11F, which could act as a share-price support.

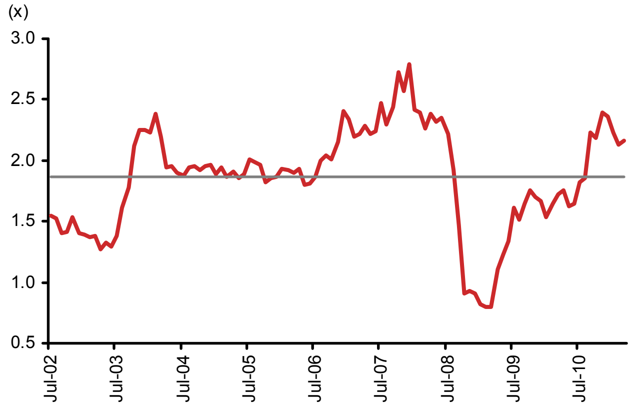
Our price target of HK$30 is based on normalised-ROE approach. Key assumptions are normalised ROE of 17.5%, COE 9% and long-term growth of 4.5%.

Exhibit 92. BOCHK: prospective P/E



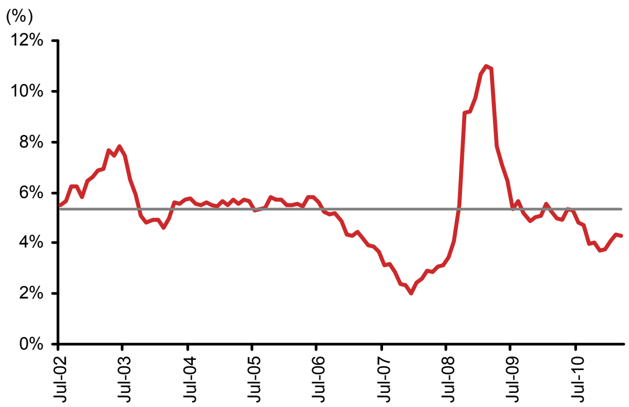
Source: Company data, Nomura research

Exhibit 93. BOCHK: prospective P/B



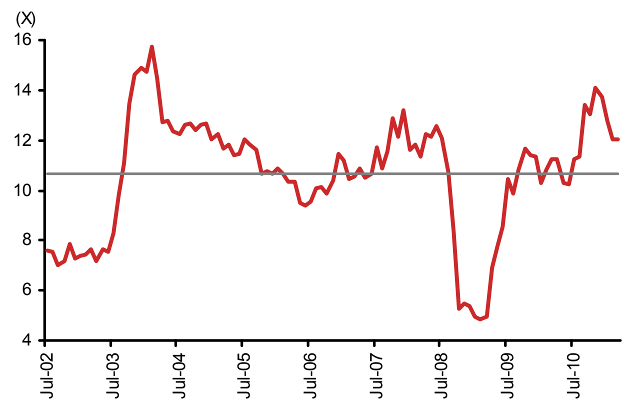
Source: Company data, Nomura research

Exhibit 94. BOCHK: prospective dividend yield



Source: Company data, Nomura research

Exhibit 95. BOCHK: prospective P/PPP



Source: Company data, Nomura research

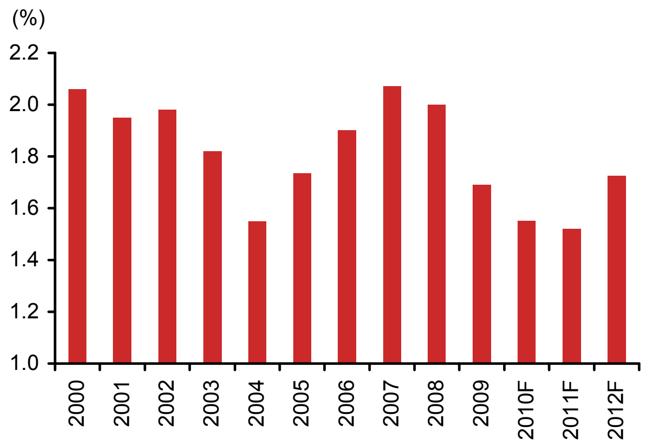
Risks

The key upside risk is the US increasing interest rates earlier and faster than our expectation, causing an expansion of NIM. In addition, any news of further renminbi liberalisation would likely cause multiple expansion owing to a better growth outlook.

Downside risks include a double-dip recession in the world economy, leading to a pick-up in credit costs.

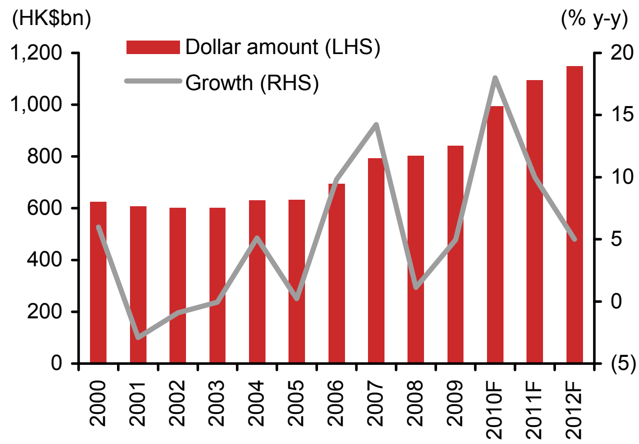
Operating metrics

Exhibit 96. BOCHK: NIM progression



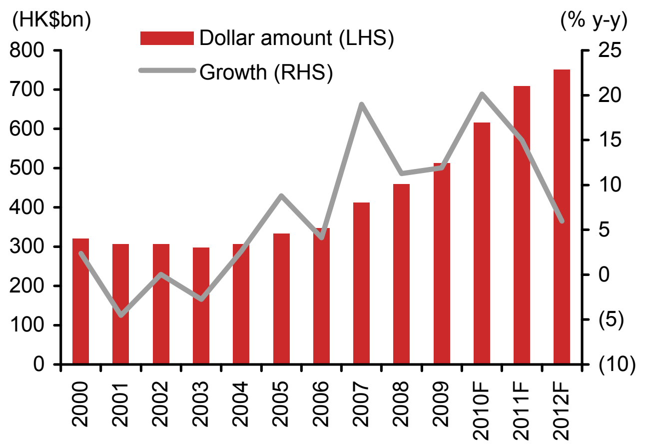
Source: Company data, Nomura research

Exhibit 97. BOCHK: deposit growth



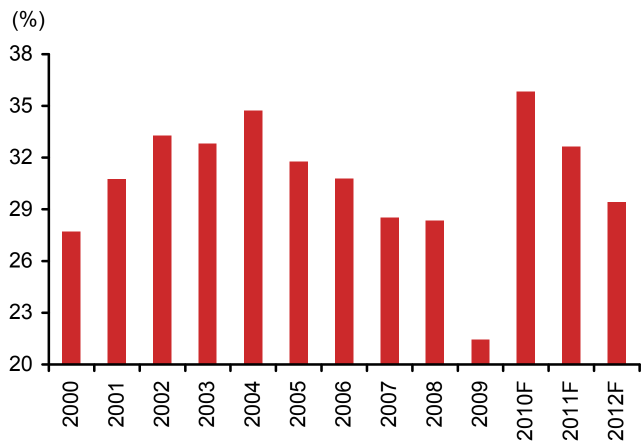
Source: Company data, Nomura research

Exhibit 98. BOCHK: loan growth



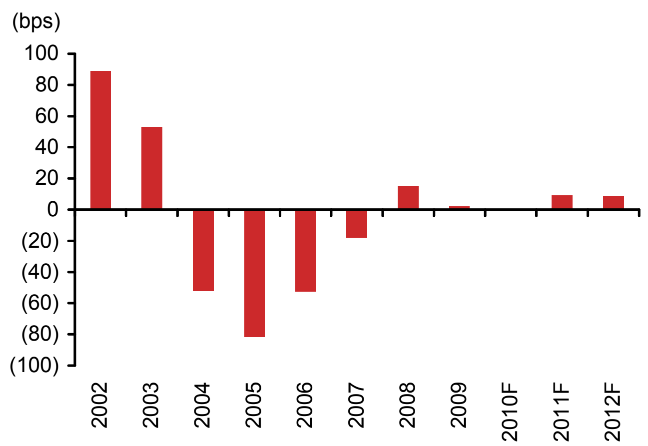
Source: Company data, Nomura research

Exhibit 99. BOCHK: cost income ratios



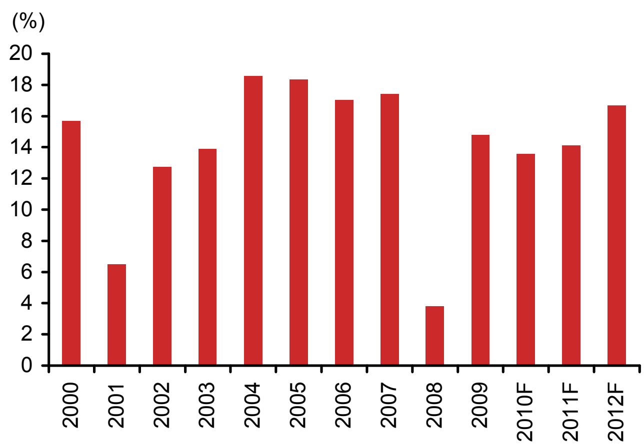
Source: Company data, Nomura research

Exhibit 100. BOCHK: loan loss provision as % of loans



Source: Company data, Nomura research

Exhibit 101. BOCHK: Return on Equity



Source: Company data, Nomura research

Exhibit 102. BOCHK: normalised ROE-based price target calculation

DuPont Analysis (As % of ave assets)	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010F	2011F	2012F	Ave 99-09	Normalised
Net interest income	**2.0%**	**1.9%**	**1.9%**	**1.7%**	**1.4%**	**1.6%**	**1.8%**	**1.9%**	**1.8%**	**1.5%**	**1.4%**	**1.4%**	**1.5%**	**1.8%**	**1.6%**
Non-interest income	**0.6%**	**0.5%**	**0.6%**	**0.6%**	**0.6%**	**0.6%**	**0.6%**	**0.8%**	**0.5%**	**0.7%**	**0.6%**	**0.7%**	**0.8%**	**0.6%**	**0.9%**
Fee income	0.4%	0.3%	0.4%	0.4%	0.4%	0.4%	0.4%	0.6%	0.5%	0.6%	0.5%	0.6%	0.6%	0.4%	0.7%
Other non-interest income	0.2%	0.2%	0.2%	0.2%	0.2%	0.3%	0.2%	0.2%	0.0%	0.1%	0.1%	0.1%	0.1%	0.2%	0.2%
Operating revenues	**2.6%**	**2.4%**	**2.4%**	**2.3%**	**2.0%**	**2.2%**	**2.4%**	**2.7%**	**2.3%**	**2.2%**	**2.0%**	**2.1%**	**2.3%**	**2.4%**	**2.5%**
Operating expenses	-0.7%	-0.7%	-0.8%	-0.8%	-0.7%	-0.7%	-0.7%	-0.8%	-0.7%	-0.8%	-0.7%	-0.7%	-0.7%	-0.7%	-0.7%
Pre-Provision Profits	**1.9%**	**1.6%**	**1.6%**	**1.5%**	**1.3%**	**1.5%**	**1.7%**	**2.0%**	**1.6%**	**1.5%**	**1.3%**	**1.4%**	**1.6%**	**1.6%**	**1.7%**
Loan loss provision	-1.1%	-0.9%	-0.4%	-0.2%	0.2%	0.3%	0.2%	0.1%	-0.1%	0.0%	0.0%	0.0%	0.0%	-0.3%	-0.2%
Other provisions	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Operating profits	**0.8%**	**0.7%**	**1.2%**	**1.3%**	**1.5%**	**1.8%**	**1.9%**	**2.0%**	**1.5%**	**1.4%**	**1.3%**	**1.4%**	**1.6%**	**1.3%**	**1.6%**
Others	0.0%	-0.3%	-0.2%	-0.2%	0.3%	0.2%	0.1%	-0.1%	-1.1%	0.2%	0.1%	0.0%	0.0%	-0.1%	0.0%
Associates profits	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Other non-operating income	0.0%	-0.3%	-0.1%	-0.2%	0.3%	0.2%	0.1%	-0.1%	-1.1%	0.2%	0.1%	0.0%	0.0%	-0.1%	0.0%
Profit before tax	**0.8%**	**0.5%**	**1.1%**	**1.2%**	**1.8%**	**2.0%**	**1.9%**	**1.9%**	**0.4%**	**1.7%**	**1.4%**	**1.4%**	**1.6%**	**1.3%**	**1.6%**
Tax	-0.1%	-0.1%	-0.2%	-0.1%	-0.3%	-0.3%	-0.3%	-0.3%	-0.1%	-0.2%	-0.2%	-0.2%	-0.3%	-0.2%	-0.2%
Profit after tax	**0.6%**	**0.4%**	**0.9%**	**1.1%**	**1.6%**	**1.7%**	**1.6%**	**1.6%**	**0.3%**	**1.5%**	**1.1%**	**1.1%**	**1.3%**	**1.1%**	**1.3%**
Minority interests	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
ROA	**0.6%**	**0.3%**	**0.9%**	**1.1%**	**1.5%**	**1.7%**	**1.6%**	**1.5%**	**0.4%**	**1.4%**	**1.1%**	**1.1%**	**1.3%**	**1.0%**	**1.3%**
Leverage	25.1	18.8	14.1	13.1	12.1	11.0	10.7	11.2	12.6	12.7	12.1	12.6	12.7	15.1	13.0
ROE	**15.7%**	**6.5%**	**12.7%**	**13.9%**	**18.6%**	**18.3%**	**17.0%**	**17.4%**	**4.7%**	**18.3%**	**13.6%**	**14.1%**	**16.7%**	**15.8%**	**17.5%**
Risk free rate															4.0%
Risk premium															5.0%
Beta															100%
COE															**9.0%**
Long term growth rate															4.5%
Fair value PB															**2.9**
2010E book value per share															10.6
Fair value (HK$)															**30**

Source: Company data, Nomura research

Financial statements

Profit and Loss (HK$mn)					
Year-end 31 Dec	**FY08**	**FY09**	**FY10F**	**FY11F**	**FY12F**
Interest income	35,281	21,684	21,262	23,541	29,115
Interest expense	(15,124)	(3,752)	(3,447)	(3,886)	(5,200)
Net interest income	**20,157**	**17,932**	**17,815**	**19,655**	**23,916**
Net fees and commissions	5,179	6,508	7,080	8,456	10,009
Trading related profits	1,447	675	1,700	1,620	1,686
Other operating revenue	(1,257)	940	(1,012)	526	559
Non-interest income	**5,369**	**8,123**	**7,768**	**10,603**	**12,254**
Operating income	**25,526**	**26,055**	**25,583**	**30,258**	**36,170**
Depreciation	(2,334)	(2,577)	(2,569)	(2,772)	(2,993)
Amortisation					
Operating expenses	(5,668)	(6,286)	(6,597)	(7,100)	(7,642)
Employee share expense					
Op. profit before provisions	**17,524**	**17,192**	**16,417**	**20,385**	**25,535**
Provisions for bad debt	(661)	(103)	-	(609)	(639)
Other provision charges					
Operating profit	**16,863**	**17,089**	**16,417**	**19,777**	**24,896**
Other non-operating income					
Associates & JCEs	7	7	10	10	10
Pre-tax profit	**16,870**	**17,096**	**16,427**	**19,787**	**24,906**
Income tax	(1,071)	(2,678)	(2,839)	(3,168)	(3,988)
Net profit after tax	**15,799**	**14,418**	**13,588**	**16,618**	**20,918**
Minority interests	336	(321)	(340)	(380)	(478)
Other items					
Preferred dividends					
Normalised NPAT	**16,135**	**14,097**	**13,248**	**16,239**	**20,440**
Extraordinary items	(12,023)	2,906	1,300	-	-
Reported NPAT	**4,112**	**17,003**	**14,548**	**16,239**	**20,440**
Dividends	(4,631)	(9,040)	(9,456)	(10,555)	(13,286)
Transfer to reserves	**(519)**	**7,963**	**5,092**	**5,683**	**7,154**
Valuation and ratio analysis					
FD normalised P/E (x)	16.2	18.5	19.7	16.1	12.8
FD normalised P/E at price target (x)	19.7	22.5	23.9	19.5	15.5
Reported P/E (x)	63.5	15.4	18.0	16.1	12.8
Dividend yield (%)	1.8	3.5	3.6	4.0	5.1
Price/book (x)	3.2	2.5	2.3	2.2	2.1
Price/adjusted book (x)	3.2	2.5	2.3	2.2	2.1
Net interest margin (%)	2.08	1.73	1.55	1.52	1.72
Yield on interest earning assets (%)	3.63	2.09	1.85	1.82	2.10
Cost of interest bearing liabilities (%)	1.68	0.39	0.32	0.32	0.40
Net interest spread (%)	1.96	1.71	1.53	1.50	1.70
Non-interest/operating income (%)	21.0	31.2	30.4	35.0	33.9
Cost to income (%)	31.3	34.0	35.8	32.6	29.4
Effective tax rate (%)	6.3	15.7	17.3	16.0	16.0
Dividend payout (%)	112.6	53.2	65.0	65.0	65.0
ROE (%)	4.7	18.3	13.6	14.1	16.7
ROA (%)	0.37	1.44	1.12	1.12	1.32
Operating ROE (%)	19.2	18.4	15.3	17.2	20.3
Operating ROA (%)	1.52	1.45	1.26	1.36	1.60
Growth (%)					
Net interest income	3.9	(11.0)	(0.7)	10.3	21.7
Non-interest income	(31.7)	51.3	(4.4)	36.5	15.6
Non-interest expenses	0.3	10.9	5.0	7.6	7.6
Pre-provision earnings	(10.0)	(1.9)	(4.5)	24.2	25.3
Net profit	(2.1)	(12.6)	(6.0)	22.6	25.9
Normalised EPS	(2.1)	(12.6)	(6.0)	22.6	25.9
Normalised FDEPS	(2.1)	(12.6)	(6.0)	22.6	25.9

Source: Nomura estimates

Margin under pressure in 2011F

Balance Sheet (HK$mn)					
As at 31 Dec	FY08	FY09	FY10F	FY11F	FY12F
Cash and equivalents	153,269	160,788	164,951	169,226	173,616
Inter-bank lending	93,456	65,614	118,498	129,155	139,148
Deposits with central bank					
Total securities	355,121	375,933	388,455	401,414	414,827
Other interest earning assets					
Gross loans	468,056	524,072	627,794	721,276	764,764
Less provisions	(2,301)	(2,269)	(2,094)	(2,600)	(3,076)
Net loans	**465,755**	**521,803**	**625,701**	**718,675**	**761,688**
Long-term investments	88	217	227	237	247
Fixed assets	30,522	35,650	37,433	39,304	41,269
Goodwill	-	-	-	-	-
Other intangible assets					
Other non IEAs	49,033	52,786	54,659	56,603	60,216
Total assets	**1,147,244**	**1,212,791**	**1,389,922**	**1,514,614**	**1,591,013**
Customer deposits	802,577	842,321	993,939	1,093,333	1,147,999
Bank deposits, CDs, debentures	88,779	99,647	110,786	121,865	127,958
Other interest bearing liabilities	62,397	65,086	66,651	67,835	69,054
Total interest bearing liabilities	**953,753**	**1,007,054**	**1,171,376**	**1,283,032**	**1,345,011**
Non interest bearing liabilities	108,959	100,102	104,006	109,764	116,486
Total liabilities	**1,062,712**	**1,107,156**	**1,275,382**	**1,392,797**	**1,461,498**
Minority interest	1,813	2,733	2,963	3,152	3,351
Common stock	52,864	52,864	52,864	52,864	52,864
Preferred stock	-	-	-	-	-
Retained earnings	21,037	32,334	37,426	43,109	50,263
Proposed dividends	-	6,027	5,227	6,047	7,583
Other equity	8,818	11,677	16,060	16,646	15,454
Shareholders' equity	**82,719**	**102,902**	**111,577**	**118,666**	**126,164**
Total liabilities and equity	**1,147,244**	**1,212,791**	**1,389,922**	**1,514,614**	**1,591,013**
Non-performing assets (HK$)	*2,138*	*1,769*	*1,681*	*1,882*	*2,108*
Balance sheet ratios (%)					
Loans to deposits	58.3	62.2	63.2	66.0	66.6
Equity to assets	7.2	8.5	8.0	7.8	7.9
Asset quality & capital					
NPAs/gross loans (%)	0.5	0.3	0.3	0.3	0.3
Bad debt charge/gross loans (%)	0.14	0.02	-	0.08	0.08
Loss reserves/assets (%)	0.20	0.19	0.15	0.17	0.19
Loss reserves/NPAs (%)	107.6	128.3	124.6	138.2	145.9
Tier 1 capital ratio (%)	10.9	11.6	10.4	9.9	10.0
Total capital ratio (%)	16.2	16.9	15.1	14.1	14.1
Growth (%)					
Loan growth	11.7	12.0	19.9	14.9	6.0
Interest earning assets	11.0	5.4	17.6	10.3	5.3
Interest bearing liabilities	7.3	5.6	16.3	9.5	4.8
Asset growth	7.5	5.7	14.6	9.0	5.0
Deposit growth	1.1	5.0	18.0	10.0	5.0
Per share					
Reported EPS (HK$)	0.39	1.61	1.38	1.54	1.93
Norm EPS (HK$)	1.53	1.33	1.25	1.54	1.93
Fully diluted norm EPS (HK$)	1.53	1.33	1.25	1.54	1.93
DPS (HK$)	0.44	0.86	0.89	1.00	1.26
PPOP PS (HK$)	1.66	1.63	1.55	1.93	2.42
BVPS (HK$)	7.82	9.73	10.55	11.22	11.93
ABVPS (HK$)	7.82	9.73	10.55	11.22	11.93
NTAPS (HK$)	7.82	9.73	10.55	11.22	11.93

Slow interest-earning asset growth

Source: Nomura estimates

Hang Seng Bank 11 HK

FINANCIALS/BANKS | HONG KONG

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From Rating Suspended

NEUTRAL

NOMURA
NOMURA INTERNATIONAL (HK) LIMITED

Action

We resume coverage of Hang Seng Bank (HSB) with a NEUTRAL rating and price target of HK$130. Earnings progression is likely to be challenging in 2011F owing to compressing margins and slow asset growth, which could cap HSB's upside potential. However, we see downside support as the stock is offering a 4.4% dividend yield.

Catalysts

1H11 results could provide better earnings visibility for FY11F and FY12F.

Anchor themes

Earnings progression likely will be muted in 2011F, due to compressing margins and slow asset growth. We think margins for HK banks will remain under pressure until the US starts tightening aggressively, which we believe is likely only in 2012.

Closing price on 3 Mar	HK$124.8
Price target	HK$130.0
	(from HK$126.0)
Upside/downside	4.2%
Difference from consensus	-5.7%
FY11F net profit (HK$mn)	16,032
Difference from consensus	-4.4%

Source: Nomura

Nomura vs consensus

Our FY11F forecast is 4% below consensus due to continued NIM compression and slow asset growth.

Lack of catalysts, but defensive

① Muted earnings growth

We foresee muted earnings growth for HSB in FY11F. NIMs will likely continue to face pressure from mortgage re-pricing, decreasing treasury returns and limited free-fund contribution. Asset growth is slow owing to slow GDP growth. We expect earnings to rise by only 7% in FY11F, despite the absence of significant credit costs.

② Lack of catalysts in 2011

A key upside catalyst to our earnings forecasts would be the US increasing interest rates aggressively, which we think is likely only in 2012, given the high unemployment rate of 8.9% in the US as per Bloomberg. HSB is a liquid bank with ~50% of interest-earning assets invested in the treasury and interbank markets. Should the US increase interest rates faster and earlier than expected, it would act as an upside risk to our earnings forecast for FY11F.

③ Defensive with 4.4% dividend yield

We think HSB's dividend of 4.4% for FY11F is attractive in a zero interest rate environment. We believe the dividend is secure since the payout ratio is only ~70% in FY11F, and HSB has a long history of paying stable and progressive dividends. We believe there is a remote likelihood of a capital call from Industrial Bank as it is well capitalised at 16.1% for FY10F.

④ Valuation fair at 3x book with 22% ROE

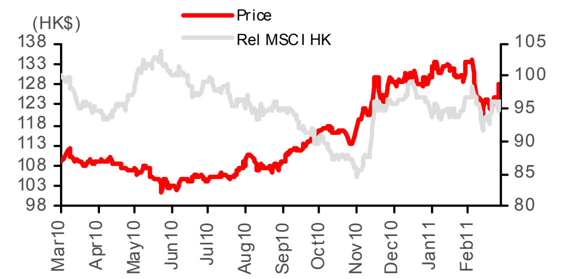
The stock is trading at a reported 14.9x P/E, 3.0x book and ROE of 22% for FY11F; we consider the valuation fair. Our price target of HK$130 is based on a Gordon Growth model normalised ROE approach. Our key assumptions are normalised ROE of 23%, cost of equity of 9% and long-term growth rate of 3.5%. We believe the risk-reward is balanced for HSB; hence, we resume coverage with a NEUTRAL rating.

Key financials & valuations

31 Dec (HK$mn)	FY09	FY10	FY11F	FY12F
PPOP	14,026	14,475	15,344	17,071
Reported net profit	13,138	14,917	16,032	17,637
Normalised net profit	12,700	14,318	15,732	17,437
Normalised EPS (HK$)	6.64	7.49	8.23	9.12
Norm. EPS growth (%)	(16.0)	12.7	9.9	10.8
Norm. P/E (x)	18.8	16.7	15.2	13.7
Price/adj. book (x)	3.84	3.41	3.05	2.79
Price/book (x)	3.84	3.41	3.05	2.79
Dividend yield (%)	4.2	4.2	4.4	4.8
ROE (%)	23.1	22.6	21.6	21.5
ROA (%)	1.65	1.71	1.69	1.74
Earnings revisions				
Previous norm. net profit		14,465	16,174	18,793
Change from previous (%)		(1.0)	(2.7)	(7.2)
Previous norm. EPS (HK$)		7.57	8.46	9.83

Source: Company, Nomura estimates

Share price relative to MSCI HK



	1m	3m	6m
Absolute (HK$)	(6.6)	(2.8)	14.7
Absolute (US$)	(6.7)	(3.1)	14.4
Relative to Index	(1.1)	(0.1)	0.6
Market cap (US$mn)			30,628
Estimated free float (%)			37.9
52-week range (HK$)			133.9/101.5
3-mth avg daily turnover (US$mn)			33.50
Stock borrowability			Easy
Major shareholders (%)			
HSBC			62.1

Source: Company, Nomura estimates

Drilling down

Investment highlights

NIM is still compressing

HSB's liquidity suffers in a low interest rate environment

HSB is a liquid bank, with more than 50% of interest-earning assets invested in the cash and treasury markets. We believe its margins are still under pressure because of negatives from treasury, impaired loan pricing and limited free-fund contribution.

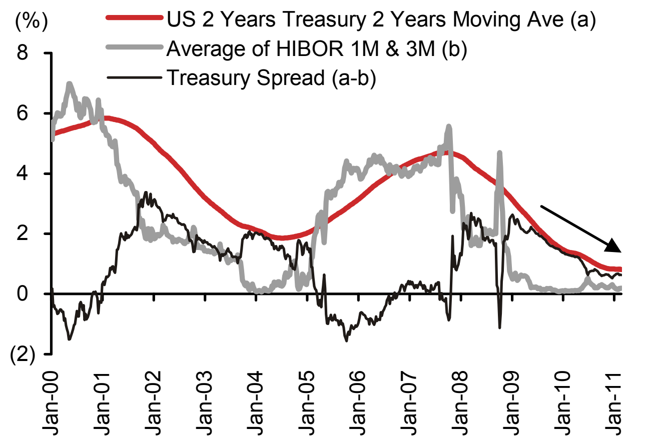
For treasury, while the cost of funding is already close to the bottom (read HIBOR 3M and saving deposit rates), returns from treasury investments are still compressing since the duration of treasury investments is 1-2 years. Hence, we believe the treasury spread is still compressing for HSB.

Exhibit 103. HSB: interest-earning asset mix, 1H10

(Mix %)	HSB
Cash	16
Treasury Investments	37
Loans	47
Total IEA	**100**

Source: Company data, Nomura research

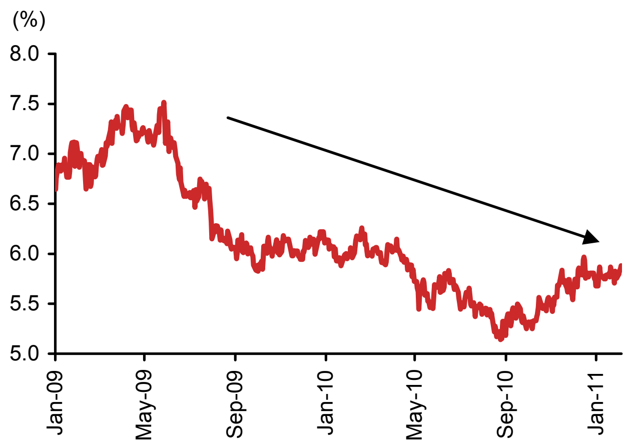
Exhibit 104. HK: treasury spread….heading south



Source: CEIC, Nomura research

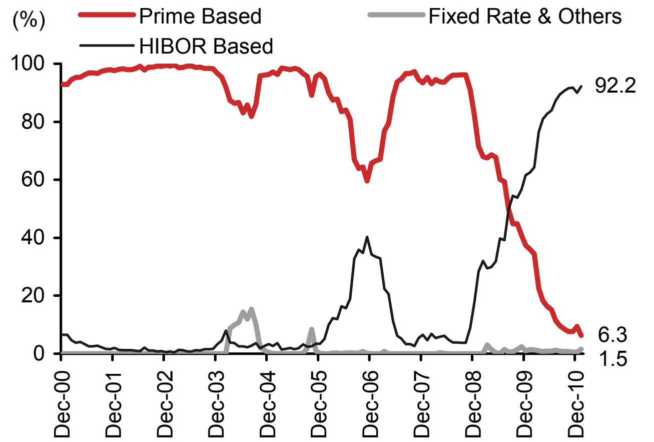
For loan pricing, we believe loan pricing power is impaired in a low-interest rate environment. Therefore, a good proxy for corporate loan spreads would be Moody's Corporate Bond Yield minus LIBOR 3M. We have seen a general decline in the corporate loan spread since 2009. In addition, mortgages are being re-priced at a rapid pace, with more than 90% of the new mortgages being HIBOR-based. Therefore, we expect the loan spread to remain weak in 2011F.

Exhibit 105. Moody's seasoned BAA corporate bond yield… proxy for corporate loan spread in HK



Source: US St. Louis Fed, CEIC, Nomura research

Exhibit 106. HK new mortgage loan type… pickup of HIBOR-based mortgage type is negative for NIMs



Source: CEIC, Nomura research

Slow asset growth

We expect HSB's deposits to grow in line with the system

Deposits dictate balance sheet growth, which in turn are driven by GDP growth. Nomura's economics team forecasts HK real GDP to grow 5.8% in 2011F. We forecast only high-single-digit deposit growth in FY11F at HSB. Deposit progression has been among the weakest in HK since 2005. We expect the weak asset trend will continue into FY11F.

Muted earnings outlook

We forecast HSB to report 7% earnings growth for FY11F on a reported basis, on the back of our NIM compression and slow asset growth estimates. We forecast 10% earnings growth for FY12F as we see the US beginning to raise interest rates slightly.

Exhibit 107. HSB: earnings outlook

						y-y			
(HK$mn)	**2008**	**2009**	**2010**	**2011F**	**2012F**	**09**	**10**	**11F**	**12F**
Net interest income	16,232	14,023	14,300	15,413	17,583	(14)	2	8	14
Non-interest income	7,064	6,789	7,530	7,788	7,688	(4)	11	3	(1)
Fee income	4,969	4,321	4,897	5,402	5,927	(13)	13	10	10
Other non-interest income	2,095	2,468	2,633	2,386	1,760	18	7	(9)	(26)
Operating revenues	**23,296**	**20,812**	**21,830**	**23,200**	**25,271**	**(11**	**5**	**6**	**9**
Operating expenses	(6,795)	(6,786)	(7,355)	(7,856)	(8,199)	0	8	7	4
Pre-provision profits	**16,501**	**14,026**	**14,475**	**15,344**	**17,071**	**(15)**	**3**	**6**	**11**
Loan loss provision	(1,401)	(812)	(390)	(765)	(1,140)	(42)	(52)	96	49
Operating profits	**15,100**	**13,214**	**14,085**	**14,579**	**15,931**	**(12**	**7**	**4**	**9**
Others	778	2,186	3,260	3,493	3,936	181	49	7	13
Associates profits	1,807	1,748	2,661	3,193	3,736	(3)	52	20	17
Other non-operating income	(1,029)	438	599	300	200	(143)	37	(50)	NA
Profit before tax	**15,878**	**15,400**	**17,345**	**18,072**	**19,867**	**(3)**	**13**	**4**	**10**
Tax	(1,779)	(2,262)	(2,428)	(2,041)	(2,230)	27	7	(16)	9
Attributable profits	**14,099**	**13,138**	**14,917**	**16,032**	**17,637**	**(7)**	**14**	**7**	**10**

Source: Nomura estimates

Limited impact of Basel-3

On our calculations, the full impact of Basel-3 on the core tier-1 ratio is around 2%. Basel-3 now requires that all (100%) investments in associates be deducted from total core capital (current only 50%). HSB has a 12.80% stake in Industrial Bank (601166 CH, RMB 27.14, BUY) which amounted to HK$13,841mn as of June 2010. If the deduction is one-off, the impact would be around 2%, on our reading. However, HKMA guidelines as of 26 January 2011 suggest that there will be a phase-in period for the deduction starting in 2014. Hence, we believe the actual impact on HSB will be smaller in 2011 and 2012.

Exhibit 108. Potential impact of Basel-3 after excluding investments in associates

Actual near-term impact on HSB is minimal as there will be a phase-in period starting in 2014

(HK$mn)	Reported Tier 1 capital	Reported RWA	Reported Tier 1 %	Associates	Adjusted Tier 1 %	Change %
HSB	**32,678**	**294,908**	**11.1**	**13,841**	**8.7**	**(2.3)**
DSF	8,286	77,436	10.7	1,405.659	9.8	(0.9)
BEA	32,159	312,223	10.3	3,255	9.8	(0.5)
WHB	9,179	88,262	10.4	205.767	10.3	(0.1)
BOCHK	75,297	664,776	11.3	213	11.3	0.0

Source: Nomura estimates

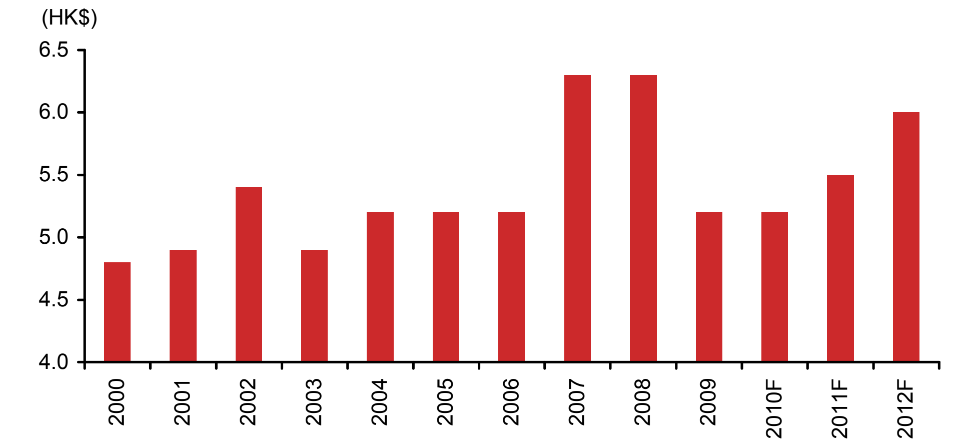
Dividend cut unlikely

In 2009, HSB surprised the market by cutting its dividend. The cut was mainly due to the rights issue of Industrial Bank amounting to RMB2.3bn. However, we believe another dividend cut is unlikely. First, with a payout ratio of only ~70% in FY11F it is affordable for HSB, in our view. Second, we see remote likelihood of a capital call from Industrial Bank as it is well capitalised at 16.1% for FY10F (per Nomura China Bank's estimates).

Contrary to some market estimates, we believe HSB will not cut its dividend in 2011-12F

We expect HSB to raise its dividend payment slowly

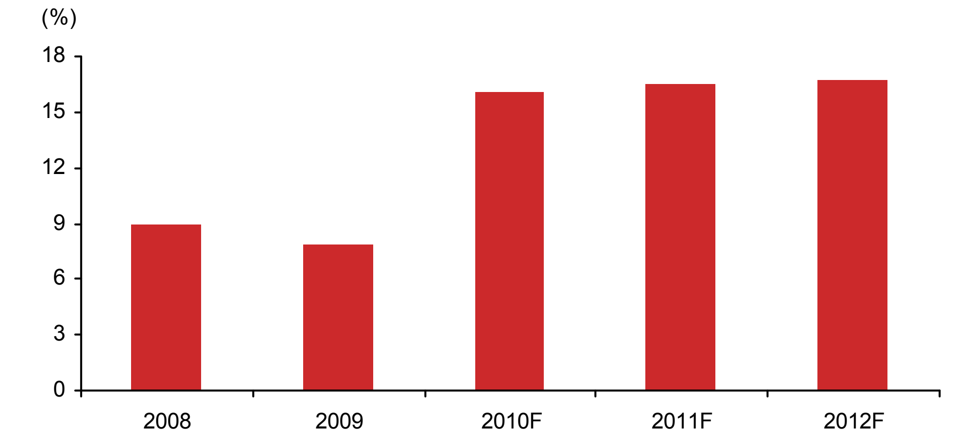
Exhibit 109. HSB: dividend per share



Source: Company data, Nomura estimates

Industrial Bank is well capitalised with a 16% Tier-1 ratio for 2010F… therefore, we see remote likelihood of a capital call

Exhibit 110. Industrial Bank: tier-1 ratios



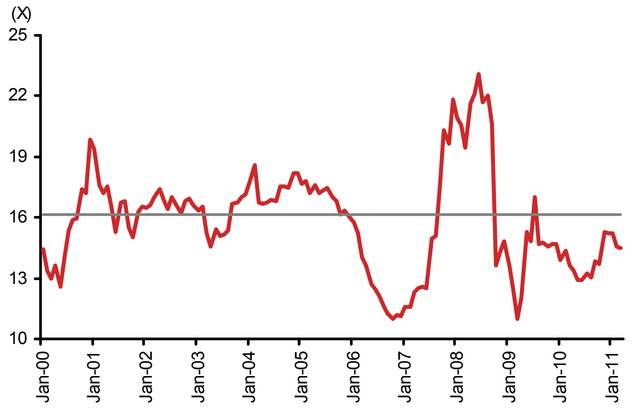
Source: Company data, Nomura estimates

Valuation full, but strong yield acts as support

The stock is trading at a reported 14.9x P/E, 3.0x book and ROE of 22% for FY11F. Further multiple expansion is unlikely given our view that the current low-interest rate environment will continue for a prolonged period. However, the stock's current 4.4% dividend yield could act as a share price support for the stock.

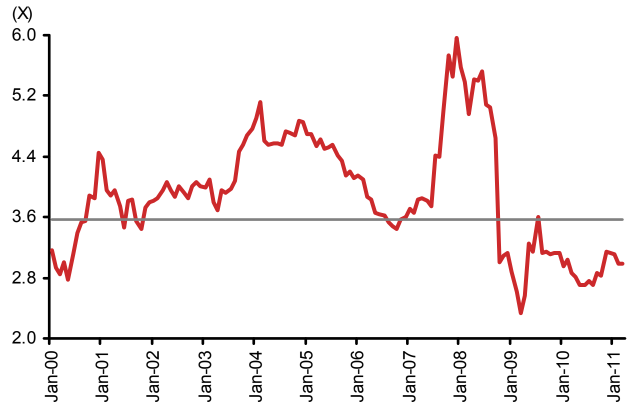
Our price target of HK$130 is based on a Gordon Growth model normalised ROE approach. Our key assumptions are normalised ROE of 23%, cost of equity of 9% and long-term growth rate of 3.5%.

Exhibit 111. HSB: prospective P/E



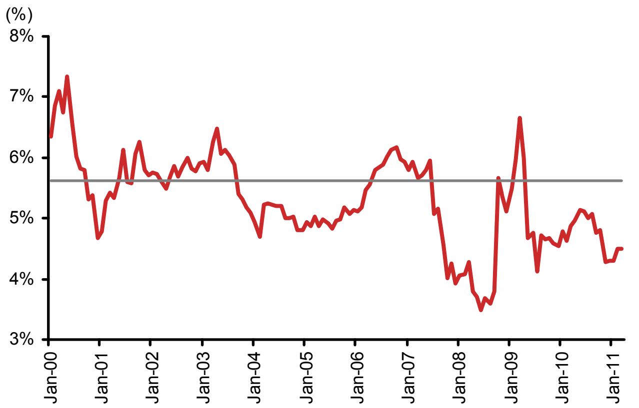
Source: Company data, Nomura research

Exhibit 112. HSB: prospective P/B



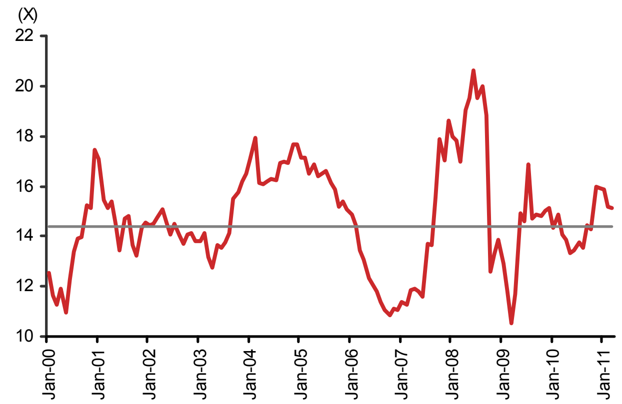
Source: Company data, Nomura research

Exhibit 113. HSB: prospective dividend yield



Source: Company data, Nomura research

Exhibit 114. HSB: prospective P/PPP



Source: Company data, Nomura research

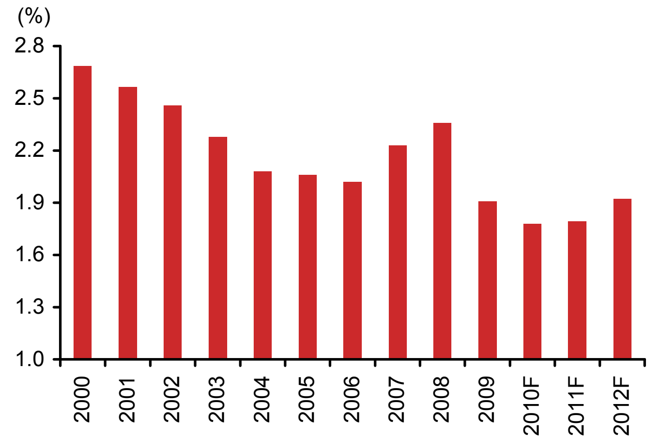
Risks

A key upside risk is the US increasing interest rates earlier and faster than our expectations, causing an expansion in NIMs.

Downside risks include a double-dip of the global economy, leading to a pick-up in credit costs.

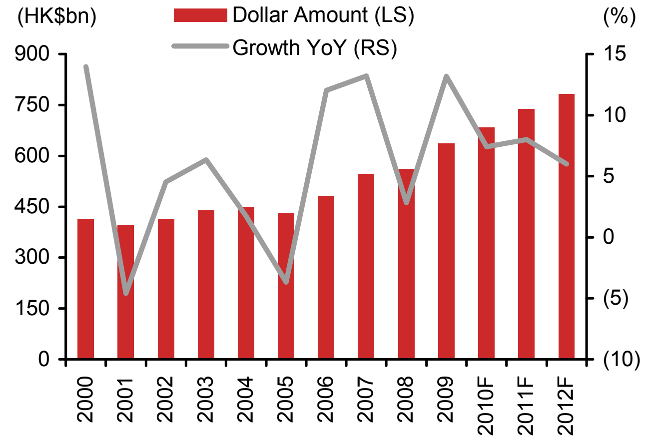
Operating metrics

Exhibit 115. HSB: NIM progression



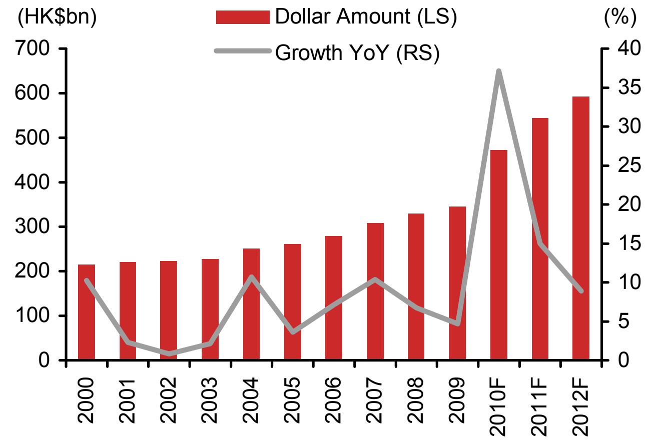
Source: Company data, Nomura estimates

Exhibit 116. HSB: deposit growth



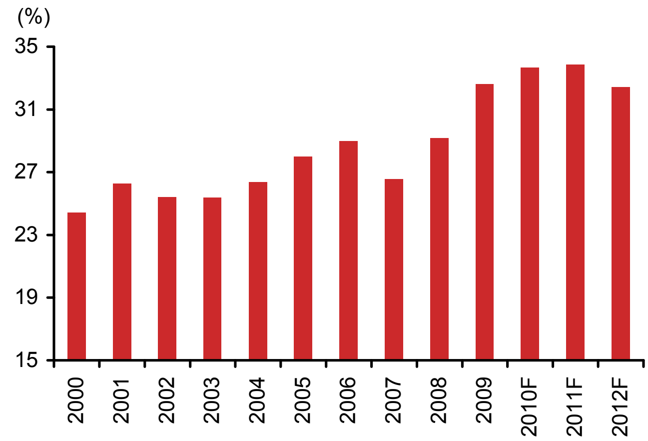
Source: Company data, Nomura estimates

Exhibit 117. HSB: loan growth



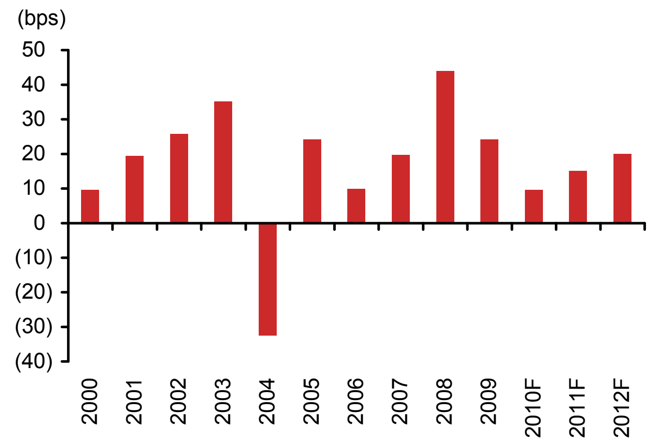
Source: Company data, Nomura estimates

Exhibit 118. HSB: cost-income ratios



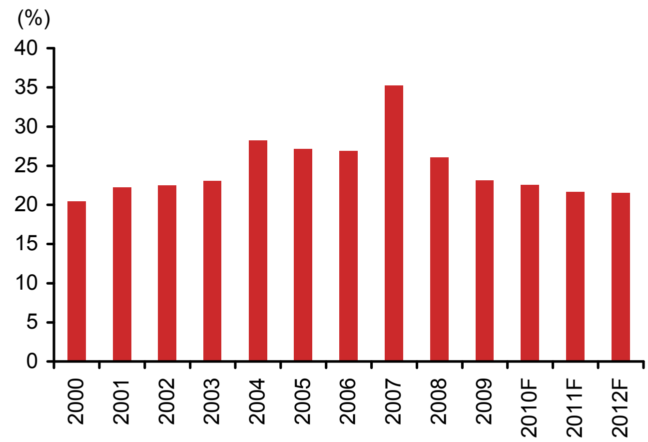
Source: Company data, Nomura estimates

Exhibit 119. HSB: loan loss provisions as % of loans



Source: Company data, Nomura estimates

Exhibit 120. HSB: return on equity



Source: Company data, Nomura estimates

Exhibit 121. HSB: normalised ROE-based price target calculation

DuPont Analysis															
(As % of ave assets)	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011F	2012F	Ave 94-10	Normalised
Net interest income	**2.5%**	**2.4%**	**2.3%**	**2.1%**	**1.9%**	**1.9%**	**1.9%**	**2.1%**	**2.2%**	**1.8%**	**1.6%**	**1.6%**	**1.7%**	**2.2%**	**1.7%**
Non-interest income	**0.8%**	**0.8%**	**0.9%**	**1.1%**	**1.2%**	**1.0%**	**1.0%**	**1.5%**	**0.9%**	**0.9%**	**0.9%**	**0.8%**	**0.8%**	**0.9%**	**1.0%**
Fee income	0.4%	0.5%	0.5%	0.5%	0.7%	0.5%	0.6%	1.0%	0.7%	0.5%	0.6%	0.6%	0.6%	0.5%	0.6%
Other non-interest income	0.3%	0.3%	0.4%	0.5%	0.5%	0.4%	0.5%	0.5%	0.3%	0.3%	0.3%	0.3%	0.2%	0.4%	0.4%
Operating revenues	**3.2%**	**3.2%**	**3.2%**	**3.1%**	**3.1%**	**2.9%**	**2.9%**	**3.5%**	**3.1%**	**2.6%**	**2.5%**	**2.4%**	**2.5%**	**3.2%**	**2.7%**
Operating expenses	-0.8%	-0.8%	-0.8%	-0.8%	-0.8%	-0.8%	-0.8%	-0.9%	-0.9%	-0.9%	-0.8%	-0.8%	-0.8%	-0.9%	-0.9%
Pre-Provision Profits	**2.4%**	**2.4%**	**2.4%**	**2.3%**	**2.3%**	**2.1%**	**2.1%**	**2.6%**	**2.2%**	**1.8%**	**1.7%**	**1.6%**	**1.7%**	**2.3%**	**1.8%**
Loan loss provision	0.0%	-0.1%	-0.1%	-0.2%	0.1%	-0.1%	0.0%	-0.1%	-0.2%	-0.1%	0.0%	-0.1%	-0.1%	-0.1%	-0.1%
Other provisions	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Operating profits	**2.4%**	**2.3%**	**2.3%**	**2.2%**	**2.4%**	**2.0%**	**2.0%**	**2.5%**	**2.0%**	**1.7%**	**1.6%**	**1.5%**	**1.6%**	**2.2%**	**1.7%**
Others	0.1%	0.1%	0.1%	0.1%	0.1%	0.4%	0.3%	0.5%	0.1%	0.3%	0.4%	0.4%	0.4%	0.2%	0.3%
Associates profits	0.0%	0.0%	0.0%	0.0%	0.0%	0.1%	0.1%	0.2%	0.2%	0.2%	0.3%	0.3%	0.4%	0.1%	0.3%
Other non-operating income	0.1%	0.1%	0.1%	0.1%	0.1%	0.3%	0.2%	0.4%	-0.1%	0.1%	0.1%	0.0%	0.0%	0.1%	0.0%
Profit before tax	**2.5%**	**2.4%**	**2.4%**	**2.3%**	**2.5%**	**2.4%**	**2.3%**	**3.0%**	**2.1%**	**1.9%**	**2.0%**	**1.9%**	**2.0%**	**2.4%**	**2.0%**
Tax	-0.4%	-0.3%	-0.3%	-0.3%	-0.3%	-0.3%	-0.3%	-0.4%	-0.2%	-0.3%	-0.3%	-0.2%	-0.2%	-0.3%	-0.3%
Profit after tax	**2.1%**	**2.1%**	**2.1%**	**2.0%**	**2.2%**	**2.1%**	**2.0%**	**2.6%**	**1.9%**	**1.6%**	**1.7%**	**1.7%**	**1.7%**	**2.0%**	**1.7%**
Minority interests	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	-0.1%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
ROA	**2.1%**	**2.1%**	**2.1%**	**2.0%**	**2.2%**	**2.0%**	**1.9%**	**2.6%**	**1.9%**	**1.6%**	**1.7%**	**1.7%**	**1.7%**	**2.0%**	**1.6%**
Leverage	9.6	10.7	10.8	11.8	13.0	13.5	14.0	13.7	14.0	14.0	13.2	12.8	12.4	11.3	14.0
ROE	**20.4%**	**22.2%**	**22.5%**	**23.1%**	**28.2%**	**27.2%**	**26.9%**	**35.3%**	**26.1%**	**23.1%**	**22.6%**	**21.6%**	**21.5%**	**22.9%**	**23.0%**
Risk free rate															4.0%
Risk premium															5.0%
Beta															100%
COE															**9%**
Long term growth rate															3.5%
Fair value PB															**3.5**
2010E book value per share															36.6
Fair value (HK$)															**130**

Source: Company data, Nomura estimates

Financial statements

Profit and Loss (HK$mn)					
Year-end 31 Dec	FY08	FY09	FY10	FY11F	FY12F
Interest income	26,172	16,390	16,507	18,706	21,750
Interest expense	(9,940)	(2,367)	(2,207)	(3,293)	(4,167)
Net interest income	**16,232**	**14,023**	**14,300**	**15,413**	**17,583**
Net fees and commissions	4,969	4,321	4,897	5,402	5,927
Trading related profits	424	1,848	2,341	2,103	1,473
Other operating revenue	1,671	620	292	283	288
Non-interest income	**7,064**	**6,789**	**7,530**	**7,788**	**7,688**
Operating income	**23,296**	**20,812**	**21,830**	**23,200**	**25,271**
Depreciation	(492)	(591)	(619)	(638)	(657)
Amortisation					
Operating expenses	(6,303)	(6,195)	(6,736)	(7,218)	(7,543)
Employee share expense					
Op. profit before provisions	**16,501**	**14,026**	**14,475**	**15,344**	**17,071**
Provisions for bad debt	(1,401)	(812)	(390)	(765)	(1,140)
Other provision charges					
Operating profit	**15,100**	**13,214**	**14,085**	**14,579**	**15,931**
Other non-operating income					
Associates & JCEs	1,807	1,748	2,661	3,193	3,736
Pre-tax profit	**16,907**	**14,962**	**16,746**	**17,772**	**19,667**
Income tax	(1,779)	(2,262)	(2,428)	(2,041)	(2,230)
Net profit after tax	**15,128**	**12,700**	**14,318**	**15,732**	**17,437**
Minority interests	-	-	-	-	-
Other items					
Preferred dividends					
Normalised NPAT	**15,128**	**12,700**	**14,318**	**15,732**	**17,437**
Extraordinary items	(1,029)	438	599	300	200
Reported NPAT	**14,099**	**13,138**	**14,917**	**16,032**	**17,637**
Dividends	(12,045)	(9,942)	(9,942)	(10,515)	(11,471)
Transfer to reserves	**2,054**	**3,196**	**4,975**	**5,516**	**6,166**

Strong earnings contribution from China's Industrial Bank

Valuation and ratio analysis					
FD normalised P/E (x)	15.8	18.8	16.7	15.2	13.7
FD normalised P/E at price target (x)	16.4	19.6	17.4	15.8	14.3
Reported P/E (x)	16.9	18.2	16.0	14.9	13.5
Dividend yield (%)	5.0	4.2	4.2	4.4	4.8
Price/book (x)	4.6	3.8	3.4	3.0	2.8
Price/adjusted book (x)	4.6	3.8	3.4	3.0	2.8
Net interest margin (%)	2.52	2.12	1.85	1.79	1.92
Yield on interest earning assets (%)	4.06	2.48	2.14	2.18	2.38
Cost of interest bearing liabilities (%)	1.57	0.36	0.30	0.42	0.50
Net interest spread (%)	2.48	2.12	1.83	1.76	1.88
Non-interest/operating income (%)	30.3	32.6	34.5	33.6	30.4
Cost to income (%)	29.2	32.6	33.7	33.9	32.4
Effective tax rate (%)	10.5	15.1	14.5	11.5	11.3
Dividend payout (%)	85.4	75.7	66.6	65.6	65.0
ROE (%)	26.1	23.1	22.6	21.6	21.5
ROA (%)	1.87	1.65	1.71	1.69	1.74
Operating ROE (%)	27.9	23.2	21.3	19.7	19.5
Operating ROA (%)	2.00	1.66	1.61	1.53	1.57

Growth (%)					
Net interest income	10.3	(13.6)	2.0	7.8	14.1
Non-interest income	(31.4)	(3.9)	10.9	3.4	(1.3)
Non-interest expenses	0.5	(1.7)	8.7	7.2	4.5
Pre-provision earnings	(10.1)	(15.0)	3.2	6.0	11.3
Net profit	(3.5)	(16.0)	12.7	9.9	10.8
Normalised EPS	(3.5)	(16.0)	12.7	9.9	10.8
Normalised FDEPS	(3.5)	(16.0)	12.7	9.9	10.8

Source: Nomura estimates

Balance Sheet (HK$mn)					
As at 31 Dec	**FY08**	**FY09**	**FY10**	**FY11F**	**FY12F**
Cash and equivalents	71,847	98,665	100,848	77,661	64,428
Inter-bank lending	22,554	27,972	54,127	56,833	59,675
Deposits with central bank					
Total securities	304,450	318,599	238,121	250,027	262,528
Other interest earning assets					
Gross loans	331,164	346,586	474,473	545,644	594,752
Less provisions	(2,043)	(1,965)	(1,836)	(2,250)	(3,051)
Net loans	**329,121**	**344,621**	**472,637**	**543,394**	**591,700**
Long-term investments	8,870	10,226	15,666	18,859	22,595
Fixed assets	9,683	12,414	14,561	14,998	15,448
Goodwill	-	-	-	-	-
Other intangible assets					
Other non IEAs	15,643	18,171	20,951	21,999	23,098
Total assets	**762,168**	**830,668**	**916,911**	**983,771**	**1,039,474**
Customer deposits	562,183	636,369	683,628	738,318	782,617
Bank deposits, CDs, debentures	11,556	4,870	15,586	16,365	17,184
Other interest bearing liabilities	60,363	49,537	57,524	56,672	55,838
Total interest bearing liabilities	**634,102**	**690,776**	**756,738**	**811,356**	**855,639**
Non interest bearing liabilities	76,440	77,744	90,161	94,154	98,332
Total liabilities	**710,542**	**768,520**	**846,899**	**905,510**	**953,971**
Minority interest	-	-	-	-	-
Common stock	9,559	9,559	9,559	9,559	9,559
Preferred stock	-	-	-	-	-
Retained earnings	-	-	-	-	-
Proposed dividends	5,736	3,633	3,633	6,309	7,265
Other equity	36,331	48,956	56,820	62,392	68,679
Shareholders' equity	**51,626**	**62,148**	**70,012**	**78,260**	**85,503**
Total liabilities and equity	**762,168**	**830,668**	**916,911**	**983,771**	**1,039,474**
Non-performing assets (HK$)	*3,404*	*2,508*	*1,990*	*1,891*	*1,985*
Balance sheet ratios (%)					
Loans to deposits	58.9	54.5	69.4	73.9	76.0
Equity to assets	6.8	7.5	7.6	8.0	8.2
Asset quality & capital					
NPAs/gross loans (%)	1.0	0.7	0.4	0.3	0.3
Bad debt charge/gross loans (%)	0.42	0.23	0.08	0.14	0.19
Loss reserves/assets (%)	0.27	0.24	0.20	0.23	0.29
Loss reserves/NPAs (%)	60.0	78.3	92.3	119.0	153.7
Tier 1 capital ratio (%)	9.5	12.8	10.8	10.1	10.2
Total capital ratio (%)	12.5	15.8	13.6	12.5	12.2
Growth (%)					
Loan growth	6.7	4.7	37.1	15.0	8.9
Interest earning assets	9.1	5.3	10.7	11.2	7.5
Interest bearing liabilities	0.7	8.9	9.5	7.2	5.5
Asset growth	2.2	9.0	10.4	7.3	5.7
Deposit growth	2.8	13.2	7.4	8.0	6.0
Per share					
Reported EPS (HK$)	7.37	6.87	7.80	8.39	9.23
Norm EPS (HK$)	7.91	6.64	7.49	8.23	9.12
Fully diluted norm EPS (HK$)	7.91	6.64	7.49	8.23	9.12
DPS (HK$)	6.30	5.20	5.20	5.50	6.00
PPOP PS (HK$)	8.63	7.34	7.57	8.03	8.93
BVPS (HK$)	27.00	32.51	36.62	40.93	44.72
ABVPS (HK$)	27.00	32.51	36.62	40.93	44.72
NTAPS (HK$)	27.00	32.51	36.62	40.93	44.72

Source: Nomura estimates

Slow asset growth

Bank of East Asia 23 HK

FINANCIALS/BANKS | HONG KONG

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NOMURA

NOMURA INTERNATIONAL (HK) LIMITED

From Rating Suspended

REDUCE

Closing price on 3 Mar	HK$33.55
Price target	**HK$28.00**
	(from HK$31.00)
Upside/downside	-16.5%
Difference from consensus	-15.2%
FY11F net profit (HK$mn)	4,107
Difference from consensus	-2.7%

Source: Nomura

Action

We resume coverage of BEA with a REDUCE rating and price target of HK$28, implying downside of 17%. Earnings growth will be challenging in 2011F, in our view, as NIM remains under pressure in China, where cost growth is high amid continued rapid expansion. Trading at an FY11F P/B of 1.5x with an ROE of 9%, the stock is overvalued, in our view.

Catalysts

US increasing interest rates leading to NIM and ROE expansion; and FY11 interim results should provide more insight into full-year FY11 and FY12.

Anchor themes

Earnings progression will likely be muted in 2011F, driven by compressing margins and slow asset growth. We think margins for HK banks will remain under pressure until the US starts tightening aggressively, which we believe is likely only in 2012.

Nomura vs consensus

We believe BEA's NIM will remain pressured in 2011 vs the consensus the view for a stable NIM amid a pick-up in loan growth.

China pressures NIM and costs

① Earnings expected to ease by 3% in FY11F

We expect BEA's earnings will decline 3% y-y in FY11F as expected NIM compression will offset forecast strong asset growth. Sharply higher costs related to continued expansion in China will likely lead to negative jaws and a drop in pre-provision profits. Also, exceptional items such as disposal gains and investment revaluation gains accounted for a significant portion of FY10 earnings and are unlikely to be matched in FY11F, in our view.

② NIM compression in China

2H10 results showed that China NIM shrank by 32bps h-h to 2.18% from 2.50% in 1H10. The compression was mainly due to significant growth of deposits in China in order to meet the 75% regulatory LDR requirements by December 2011. As of December 2010, China LDR stood at 78%. We believe deposit growth in China will continue to outpace loan growth, causing further NIM compression in China. China loan is 40% of total loan book. We expect the HK NIM to be stable as HK loan growth remains strong.

③ Mild asset growth

Management guided for double-digit asset growth in FY11. In our model, we build in 12% deposit growth driven mainly by rising China deposits in order to comply with the 75% regulatory LDR requirement by year-end. HK deposit growth is likely to be muted, in our view, given the low HK GDP growth outlook in 2011F. As a result, we expect overall asset growth will likely be muted in FY11F at 12% y-y.

④ Valuation full; REDUCE rating with PT of HK$28

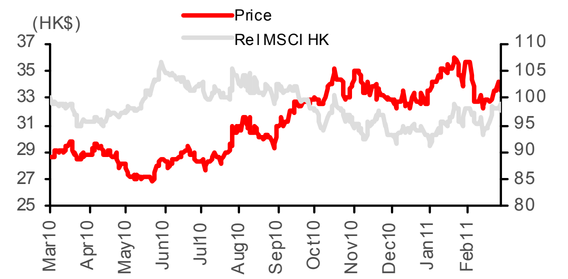
At 16.6x reported EPS and 1.5x book on forecast ROE of just 9% in FY11F, the shares look overvalued, in our view. Given the lack of a strong earnings outlook, we resume coverage with a REDUCE rating and PT of HK$28.

Key financials & valuations

31 Dec (HK$mn)	FY09	FY10	FY11F	FY12F
PPOP	4,059	4,222	4,657	5,697
Reported net profit	2,604	4,224	4,107	4,703
Normalised net profit	2,326	3,352	3,807	4,553
Normalised EPS (HK$)	1.26	1.65	1.88	2.25
Norm. EPS growth (%)	(43.9)	31.2	13.6	19.6
Norm. P/E (x)	26.6	20.3	17.8	14.9
Price/adj. book (x)	1.75	1.52	1.46	1.39
Price/book (x)	1.75	1.52	1.46	1.39
Dividend yield (%)	2.4	2.8	3.0	3.5
ROE (%)	7.7	10.6	9.1	9.9
ROA (%)	0.61	0.87	0.73	0.77
Earnings revisions				
Previous norm. net profit		3,387	3,978	4,387
Change from previous (%)		(1.0)	(4.3)	3.8
Previous norm. EPS (HK$)		1.56	1.97	2.18

Source: Company, Nomura estimates

Share price relative to MSCI HK



	1m	3m	6m
Absolute (HK$)	(5.8)	2.1	8.8
Absolute (US$)	(5.8)	1.8	8.5
Relative to Index	(0.3)	4.8	(5.4)
Market cap (US$mn)			8,794
Estimated free float (%)			67.8
52-week range (HK$)			35.90/26.80
3-mth avg daily turnover (US$mn)			11.85
Stock borrowability			Easy
Major shareholders (%)			
Criteria CaixaCorp			15.1
Guoco Group			9.1

Source: Company, Nomura estimates

Drilling down

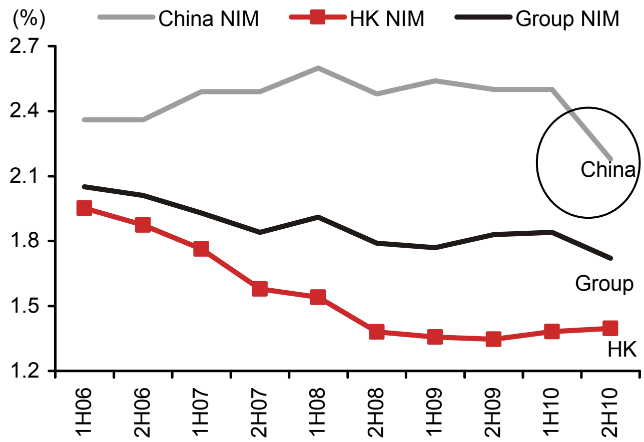
Investment highlights

NIM compression in China; stable in HK

China NIM is expected to decline by 24bps to 2.10% in FY11F

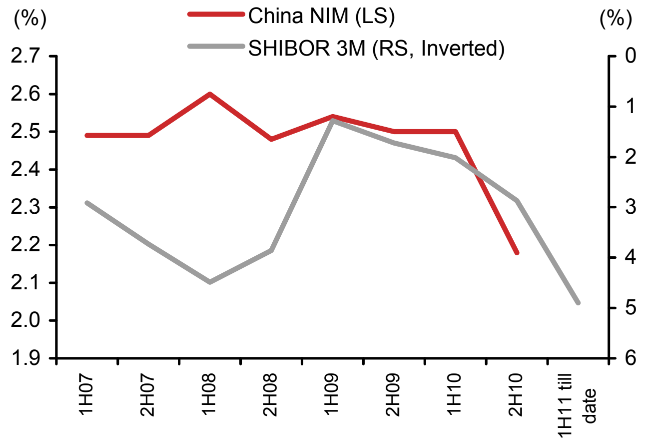
We expect China NIM to trend down further from FY10 levels, with HK NIM to remain stable in FY11F. For China, 2H10 results showed that the NIM compressed by 32bps to 2.18% from 2.50% in 1H10. The decline was mainly due to significant growth of deposits in China in order to meet the 75% regulatory LDR requirements by December 2011. As of December 2010, BEA's China LDR stood at 78% — still above the regulatory requirement of a 75% threshold, implying that BEA China needs to grow its deposit base faster than its loan book in 2011. Thus, we believe that will cause further pressure on the China NIM. In addition, a pick-up in SHIBOR in 1H11 suggested that funding costs in China are also rising. In our model, we forecast a China NIM of 2.10% in FY11F, representing y-y compression of 24bps from 2.34%.

Exhibit 122. BEA: NIM by geography … significant compression in China



Source: Company data, Nomura research

Exhibit 123. BEA China: NIM vs SHIBOR 3M … rising funding costs in China as BEA China grows deposits

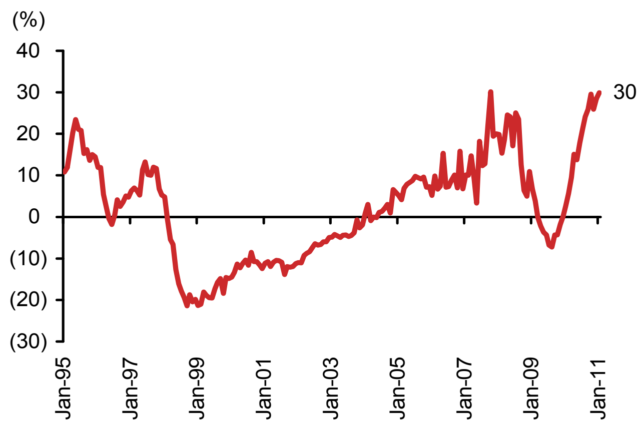


Source: CEIC, Company data, Nomura research

HK NIM should remain stable at 1.40% in FY11F

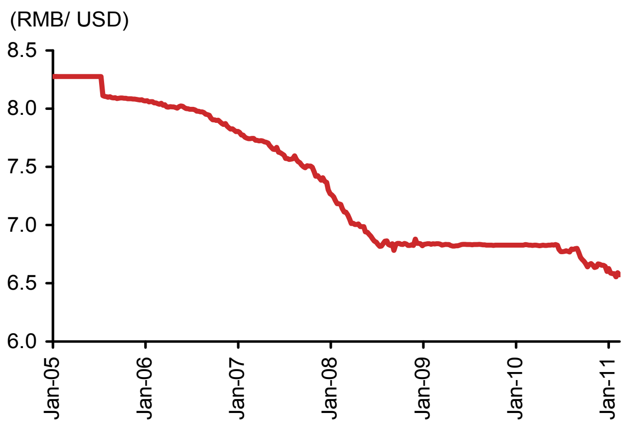
For Hong Kong, 2H10 results indicated that HK's margin was stable at 1.40% vs 1.35% in 2H09 and 1.38% in 1H10. Management was able to maintain the HK NIM in 2H10 as a pick-up in the LDR helped to offset declining loan pricing. We look for loan growth in HK to remain strong as China tightens liquidity and the RMB continues to appreciate. In our view, this should enable BEA to keep the HK NIM stable. We estimate an HK NIM of 1.40% in FY11F vs 1.39% in FY10.

Exhibit 124. HK System: total loan growth (y-y)… strong loan growth helped to keep HK NIM stable



Source: CEIC, Nomura research

Exhibit 125. RMB appreciation to continue… propelling HK loan growth in 2011



Source: CEIC, Nomura research

Overall NIM to trend down in FY11F

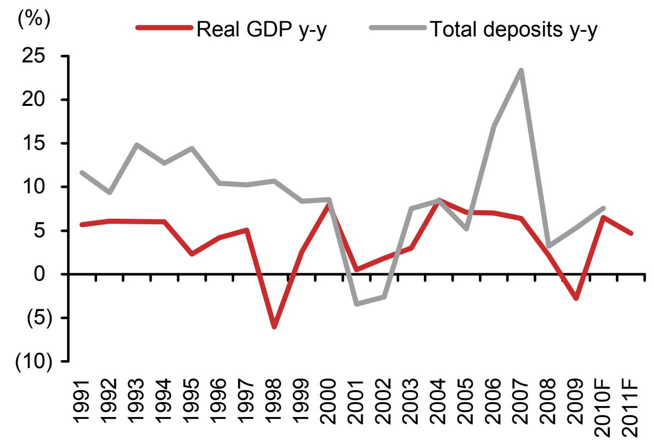
For the group as a whole, we forecast overall NIM compression of 10bps y-y to 1.68% in FY11F mainly due to the drag from China. Looking to FY12F, we forecast NIM will expand slightly to 1.73% as funding pressures likely ease.

Mild asset growth

Management guided double-digit growth

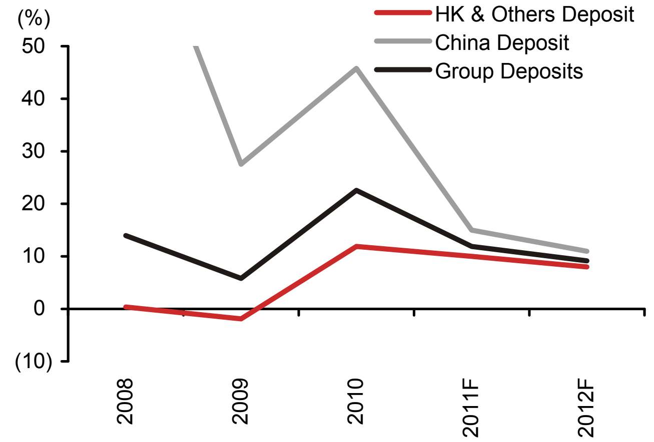
We forecast mild overall deposit growth of 12% in FY11F. Management guided for double-digit asset growth in 2011. In our model, we build in 12% deposit growth mainly due to a pick-up of China deposits in order to meet the 75% LDR regulatory requirements by December 2011. HK deposit growth is likely to be muted, we believe, given the low HK GDP growth outlook in 2011F. As a result, we expect overall asset growth to be muted in FY11F as well.

Exhibit 126. HK: system deposits vs real GDP growth… muted outlook



Source: CEIC, Nomura research

Exhibit 127. BEA: deposit growth y-y outlook… slowing down



Source: Company data, Nomura research

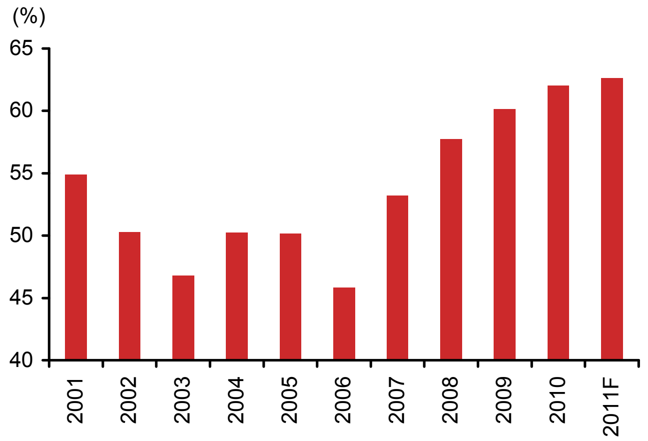
Expense growth to remain high

Cost-income ratio expected to remain strong

Growth in costs is expected to remain high as expansion in China continues, causing negative jaws and slower growth in pre-provision profits. As of December 2010, BEA has 94 branches in China and the number is likely to hit 100 by 2011, according to BEA management. We estimate that with headcount rising, inflation picking up and continued investment in China, BEA will see overall expense growth of 13% slightly outpacing forecast revenue growth of 12%, limiting the rise in pre-provision to 10% y-y in FY11F.

In addition, exceptional items such as disposal gains and investment revaluation gains, which made up 17% of PBT in FY10, are unlikely to recur in FY11, in our view. In 2010, BEA booked a HK$230mn gain from its disposal of BEA (Canada). It also recorded a property revaluation gain of HK$426mn. Our property research team expects HK office property prices to be up only 16% in 2011F (vs 43% in 2010). As a result, we do not expect a repeat of the FY10 disposal and revaluation gains in FY11.

Exhibit 128. BEA: cost-to-income ratio… staying high due to continued investments in china



Source: CEIC, Nomura estimates

Exhibit 129. Nomura property forecasts: slowdown of property growth rate to contribute smaller investment revaluation gains in 2011F

(%)	2010	2011F	2012F
Grade A Office Overall	43	16	7

Source: CEIC, Nomura property team estimates

Benign credit environment in 2011F

Credit costs are expected to remain low in 2011. The loan loss charge was only 9bps in 2H10 vs 53bps in 2H09 and 11bps in 1H10, reflecting China's growing economy and HK's low unemployment rate. We are expecting 10bps in credit charges in FY11F. However, our risk tendency analysis suggests that BEA's credit quality is most susceptible among HK banks to deterioration should the economy be weaker than expected, since BEA has a greater-than-peer average percentage of China loans, which are of higher inherent risk than those originating in HK.

BEA is the most susceptible to deterioration of asset quality should China's economy weaken

Exhibit 130. HK Banks — risk tendency

(Loan mix %)	HSB	BOCHK	BEA	WHB	DSF	Risk tendency (bps)
SME	15	21	7	12	14	150
Corporates	38	31	22	25	25	20
Mortgages	29	25	10	24	19	0
Personal	7	3	7	6	17	200
Loan for use in HK	**90**	**80**	**46**	**67**	**75**	
Outside HK	10	20	54	33	25	100
Total Loans	**100**	**100**	**100**	**100**	**100**	
Normalised credit costs (bps)	54	64	81	68	85	
FY11E credit costs (bps)	15	9	10	8	10	
Potential increase in credit costs (bps)	**39**	**55**	**71**	**60**	**74**	
PBT impact, FY11F (%)	**12**	**20**	**47**	**29**	**32**	

Source: Nomura estimates

Weak earnings outlook

We forecast an earnings decline of 3% y-y in FY11F as strong asset growth will likely be offset by NIM compression. In addition, exceptional items such as disposal gains and investment revaluation gains accounted for a significant portion of FY10 earnings and are unlikely to be matched in FY11F, in our view

Exhibit 131. BEA: earnings outlook

						y-y			
(HK$mn)	**2008**	**2009**	**2010**	**2011F**	**2012F**	**09**	**10**	**11F**	**12F**
Net interest income	6,793	6,747	7,543	8,395	9,550	(1)	12	11	14
Non-interest income	3,213	3,441	3,583	4,075	4,446	7	4	14	9
Fee income	2,145	2,262	2,942	3,152	3,373	5	30	7	7
Other non-interest income	1,068	1,179	641	923	1,073	10	(46)	44	16
Operating revenues	**10,006**	**10,188**	**11,126**	**12,470**	**13,995**	**2**	**9**	**12**	**12**
Operating expenses	(5,779)	(6,129)	(6,904)	(7,813)	(8,298)	6	13	13	6
Pre-provision profits	**4,227**	**4,059**	**4,222**	**4,657**	**5,697**	**(4)**	**4**	**10**	**22**
Loan loss provision	(558)	(1,105)	(285)	(315)	(526)	98	(74)	10	67
Other provisions	(3,549)	0	0	0	0	(100)	NA	NA	NA
Operating profits	**120**	**2,954**	**3,937**	**4,342**	**5,171**	**NA**	**33**	**10**	**19**
Others	(112)	542	1,213	675	563	(584)	124	(44)	(17)
Associates profits	53	264	341	375	413	398	29	10	10
Other non-operating income	(165)	278	872	300	150	(268)	214	(66)	NA
Profit before tax	**8**	**3,496**	**5,150**	**5,017**	**5,734**	**43,600**	**47**	**(3)**	**14**
Tax	96	(819)	(847)	(825)	(943)	(953)	3	(3)	14
Profit after tax	**104**	**2,677**	**4,303**	**4,192**	**4,791**	**2,474**	**61**	**(3)**	**14**
Minority interests	(65)	(73)	(79)	(85)	(88)	12	8	8	3
Attributable profits	**39**	**2,604**	**4,224**	**4,107**	**4,703**	**6577**	**62**	**(3)**	**15**

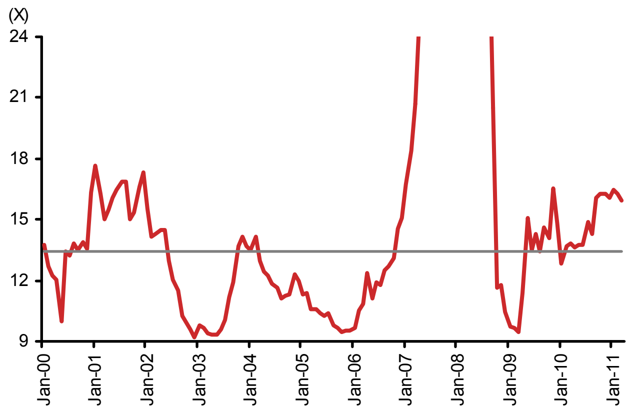
Source: Company data, Nomura estimates

Valuation

In our view, the stock is expensive at an FY11F P/E of 16.6x and P/B of 1.5x book with a forecast ROE just 9%. Given that the rich valuation of 16.6x is not accompanied by a strong earnings outlook, we resume coverage with a REDUCE rating and price target of HK$28.

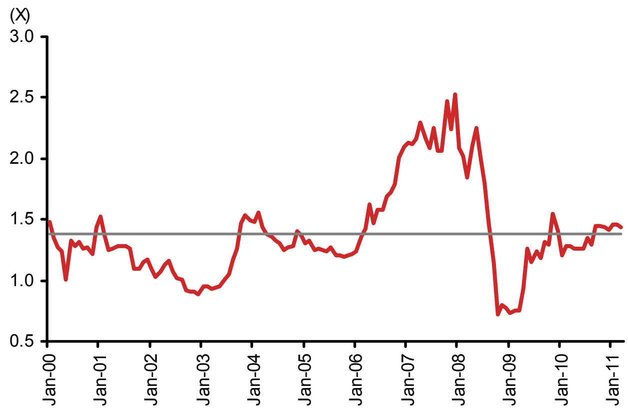
Our price target is based on the Gordon Growth model using a normalised ROE approach, with key assumptions of normalized ROE of 10%, COE of 9.5% and long-term growth of 7%.

Exhibit 132. BEA: prospective P/E



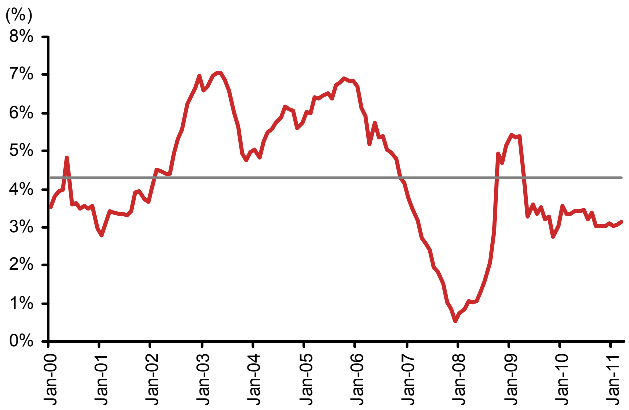
Source: Company data, Nomura research

Exhibit 133. BEA: Prospective P/B



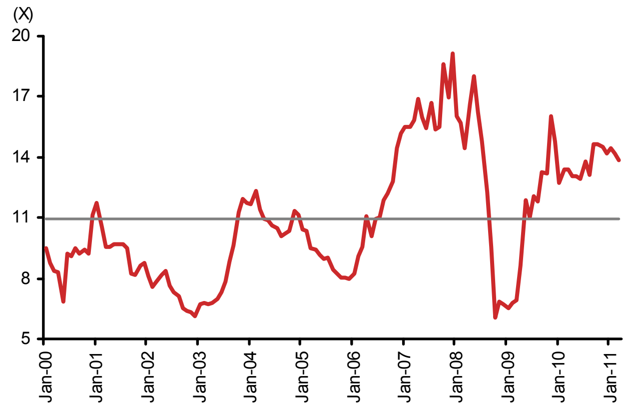
Source: Company data, Nomura research

Exhibit 134. BEA: prospective dividend yield



Source: Company data, Nomura research

Exhibit 135. BEA: prospective P/PPP



Source: Company data, Nomura research

Risks

Upside risk: Rising US interest rates could lead to reinstatement of treasury margins and loan margins, causing HK NIM and earnings expansion.

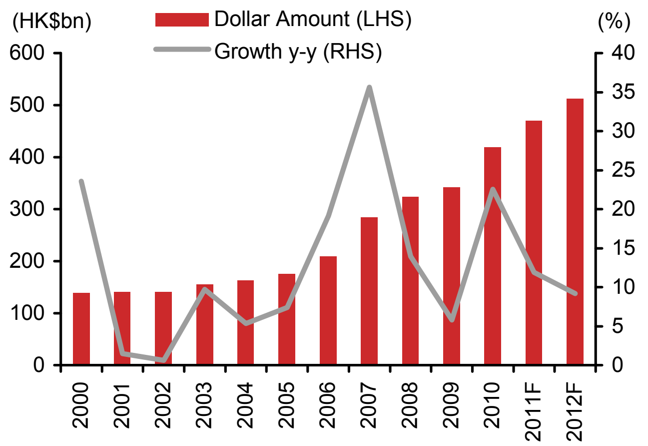
Downside risk: A slowdown of China's economy could lead to a sharp pick-up in credit costs as the bank has large exposure to China loan.

Operating metrics

Exhibit 136. BEA: NIM

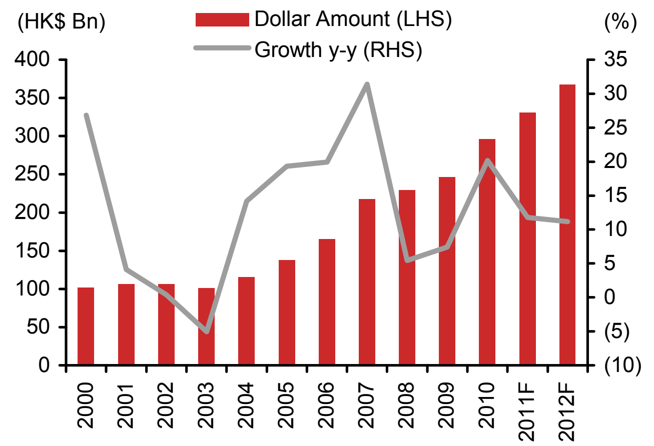
Source: Company data, Nomura estimates

Exhibit 137. BEA: deposit growth



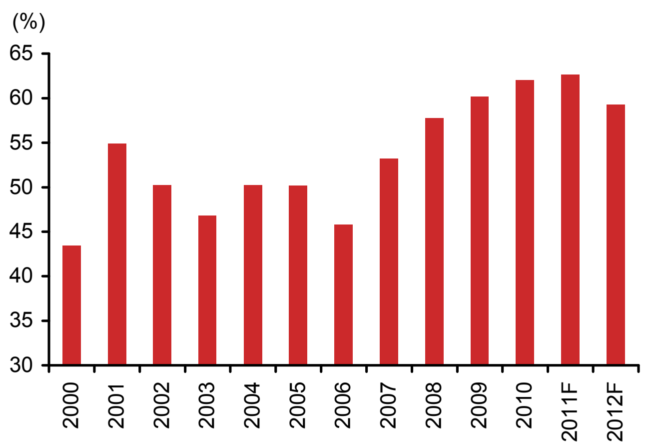
Source: Company data, Nomura estimates

Exhibit 138. BEA: loan growth



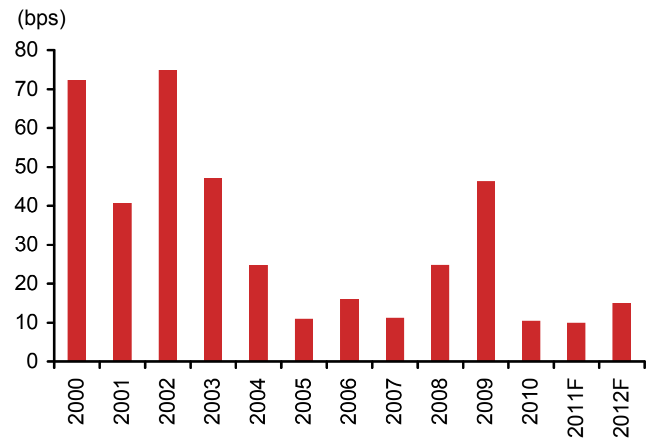
Source: Company data, Nomura estimates

Exhibit 139. BEA: cost-income ratio



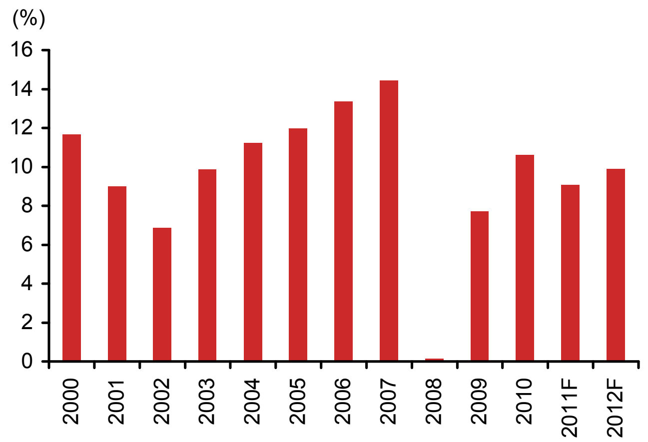
Source: Company data, Nomura estimates

Exhibit 140. BEA: loan loss provision as % of loans



Source: Company data, Nomura estimates

Exhibit 141. BEA: return on equity



Source: Company data, Nomura estimates

Exhibit 142. BEA: Nomralised ROE-based price target calculation

DuPont Analysis (As % of ave assets)	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011F	2012F	Ave 94-09	Normalised
Net interest income	**2.3%**	**2.2%**	**2.0%**	**1.9%**	**1.8%**	**1.7%**	**1.9%**	**1.7%**	**1.7%**	**1.6%**	**1.6%**	**1.5%**	**1.6%**	**2.1%**	**1.6%**
Non-interest income	**0.7%**	**0.7%**	**0.8%**	**0.9%**	**0.9%**	**1.0%**	**1.0%**	**0.8%**	**0.8%**	**0.8%**	**0.7%**	**0.7%**	**0.7%**	**0.8%**	**0.7%**
Fee income	0.5%	0.6%	0.5%	0.5%	0.6%	0.6%	0.6%	0.6%	0.5%	0.5%	0.6%	0.6%	0.6%	0.6%	0.6%
Other non-interest income	0.2%	0.1%	0.2%	0.4%	0.3%	0.4%	0.4%	0.2%	0.3%	0.3%	0.1%	0.2%	0.2%	0.3%	0.2%
Operating revenues	**3.0%**	**2.9%**	**2.8%**	**2.8%**	**2.7%**	**2.7%**	**2.8%**	**2.6%**	**2.5%**	**2.4%**	**2.3%**	**2.2%**	**2.3%**	**2.9%**	**2.3%**
Operating expenses	-1.3%	-1.6%	-1.4%	-1.3%	-1.4%	-1.3%	-1.3%	-1.4%	-1.4%	-1.4%	-1.4%	-1.4%	-1.4%	-1.4%	-1.3%
Pre-Provision Profits	**1.7%**	**1.3%**	**1.4%**	**1.5%**	**1.3%**	**1.3%**	**1.5%**	**1.2%**	**1.0%**	**1.0%**	**0.9%**	**0.8%**	**0.9%**	**1.5%**	**1.0%**
Loan loss provision	-0.4%	-0.2%	-0.4%	-0.3%	-0.1%	-0.1%	-0.1%	-0.1%	-0.1%	-0.3%	-0.1%	-0.1%	-0.1%	-0.4%	-0.1%
Other provisions	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	-0.3%	-0.9%	0.0%	0.0%	0.0%	0.0%	-0.1%	0.0%
Operating profits	**1.3%**	**1.1%**	**0.9%**	**1.2%**	**1.2%**	**1.3%**	**1.4%**	**0.8%**	**0.0%**	**0.7%**	**0.8%**	**0.8%**	**0.8%**	**1.1%**	**0.9%**
Others	0.1%	0.0%	-0.1%	0.0%	0.2%	0.2%	0.2%	0.7%	0.0%	0.1%	0.3%	0.1%	0.1%	0.1%	0.1%
Associates profits	0.0%	0.0%	0.0%	0.1%	0.0%	0.0%	0.1%	0.0%	0.0%	0.1%	0.1%	0.1%	0.1%	0.0%	0.1%
Other non-operating income	0.0%	0.0%	-0.1%	-0.1%	0.1%	0.2%	0.1%	0.7%	0.0%	0.1%	0.2%	0.1%	0.0%	0.1%	0.1%
Profit before tax	**1.3%**	**1.0%**	**0.9%**	**1.2%**	**1.4%**	**1.4%**	**1.6%**	**1.5%**	**0.0%**	**0.8%**	**1.1%**	**0.9%**	**0.9%**	**1.2%**	**1.0%**
Tax	-0.2%	-0.2%	-0.2%	-0.2%	-0.2%	-0.2%	-0.3%	-0.3%	0.0%	-0.2%	-0.2%	-0.1%	-0.2%	-0.2%	-0.2%
Profit after tax	**1.2%**	**0.9%**	**0.7%**	**1.0%**	**1.2%**	**1.2%**	**1.3%**	**1.2%**	**0.0%**	**0.6%**	**0.9%**	**0.7%**	**0.8%**	**1.0%**	**0.8%**
Minority interests	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
ROA	**1.2%**	**0.9%**	**0.7%**	**1.0%**	**1.1%**	**1.2%**	**1.3%**	**1.2%**	**0.0%**	**0.6%**	**0.9%**	**0.7%**	**0.8%**	**1.0%**	**0.8%**
Leverage	10.0	10.2	9.9	9.9	9.8	9.8	10.4	12.0	13.0	12.6	12.2	12.4	12.9	10.5	13.0
ROE	**11.7%**	**9.0%**	**6.9%**	**9.9%**	**11.2%**	**12.0%**	**13.3%**	**14.4%**	**0.1%**	**7.7%**	**10.6%**	**9.1%**	**9.9%**	**10.8%**	**10.2%**
Risk free rate															4.0%
Risk premium															5.0%
Beta															**1.1**
COE															**9.5%**
Long term growth rate															7.0%
Fair value PB															**1.3**
2010 book value per share															22.0
Fair value (HK$)															**28**

Source: Company data, Nomura research

Financial statements

Profit and Loss (HK$mn)					
Year-end 31 Dec	FY08	FY09	FY10	FY11F	FY12F
Interest income	17,465	12,121	13,626	15,666	17,524
Interest expense	(10,672)	(5,374)	(6,083)	(7,271)	(7,974)
Net interest income	**6,793**	**6,747**	**7,543**	**8,396**	**9,550**
Net fees and commissions	2,145	2,262	2,942	3,152	3,373
Trading related profits	602	642	81	300	370
Other operating revenue	466	537	560	623	703
Non-interest income	**3,213**	**3,441**	**3,583**	**4,075**	**4,446**
Operating income	**10,006**	**10,188**	**11,126**	**12,470**	**13,995**
Depreciation	(440)	(525)	(615)	(581)	(610)
Amortisation					
Operating expenses	(5,339)	(5,604)	(6,289)	(7,232)	(7,688)
Employee share expense					
Op. profit before provisions	**4,227**	**4,059**	**4,222**	**4,657**	**5,697**
Provisions for bad debt	(558)	(1,105)	(285)	(315)	(526)
Other provision charges					
Operating profit	**3,669**	**2,954**	**3,937**	**4,342**	**5,171**
Other non-operating income					
Associates & JCEs	53	264	341	375	413
Pre-tax profit	**3,722**	**3,218**	**4,278**	**4,717**	**5,584**
Income tax	96	(819)	(847)	(825)	(943)
Net profit after tax	**3,818**	**2,399**	**3,431**	**3,892**	**4,641**
Minority interests	(65)	(73)	(79)	(85)	(88)
Other items					
Preferred dividends					
Normalised NPAT	**3,753**	**2,326**	**3,352**	**3,807**	**4,553**
Extraordinary items	(165)	278	872	300	150
Reported NPAT	**3,588**	**2,604**	**4,224**	**4,107**	**4,703**
Dividends	(417)	(1,484)	(1,918)	(2,053)	(2,351)
Transfer to reserves	**3,171**	**1,120**	**2,306**	**2,053**	**2,351**
Valuation and ratio analysis					
FD normalised P/E (x)	14.9	26.6	20.3	17.8	14.9
FD normalised P/E at price target (x)	12.4	22.2	16.9	14.9	12.4
Reported P/E (x)	15.6	23.8	16.1	16.6	14.5
Dividend yield (%)	0.7	2.4	2.8	3.0	3.5
Price/book (x)	1.7	1.8	1.5	1.5	1.4
Price/adjusted book (x)	1.7	1.8	1.5	1.5	1.4
Net interest margin (%)	2.20	1.85	1.81	1.85	1.84
Yield on interest earning assets (%)	5.66	3.32	3.28	3.45	3.38
Cost of interest bearing liabilities (%)	3.42	1.46	1.46	1.61	1.55
Net interest spread (%)	2.24	1.86	1.82	1.84	1.83
Non-interest/operating income (%)	32.1	33.8	32.2	32.7	31.8
Cost to income (%)	57.8	60.2	62.1	62.7	59.3
Effective tax rate (%)	(2.6)	25.5	19.8	17.5	16.9
Dividend payout (%)	11.6	57.0	45.4	50.0	50.0
ROE (%)	11.5	7.7	10.6	9.1	9.9
ROA (%)	0.89	0.61	0.87	0.73	0.77
Operating ROE (%)	11.8	8.7	9.9	9.6	10.9
Operating ROA (%)	0.91	0.70	0.81	0.77	0.84
Growth (%)					
Net interest income	13.6	(0.7)	11.8	11.3	13.7
Non-interest income	13.3	7.1	4.1	13.7	9.1
Non-interest expenses	22.4	5.0	12.2	15.0	6.3
Pre-provision earnings	2.5	(4.0)	4.0	10.3	22.3
Net profit	27.0	(38.0)	44.1	13.6	19.6
Normalised EPS	18.9	(43.9)	31.2	13.6	19.6
Normalised FDEPS	18.9	(43.9)	31.2	13.6	19.6

Source: Nomura estimates

Balance Sheet (HK$mn)					
As at 31 Dec	**FY08**	**FY09**	**FY10**	**FY11F**	**FY12F**
Cash and equivalents	124,679	97,657	106,490	107,840	109,273
Inter-bank lending	850	678	1,320	14,381	18,241
Deposits with central bank					
Total securities	31,133	54,236	68,530	70,562	72,842
Other interest earning assets					
Gross loans	231,503	249,501	315,592	352,012	390,754
Less provisions	(1,047)	(1,345)	(1,101)	(1,216)	(1,514)
Net loans	**230,456**	**248,156**	**314,491**	**350,797**	**389,240**
Long-term investments	2,486	2,615	3,573	3,752	3,939
Fixed assets	9,146	11,467	12,414	13,035	13,686
Goodwill	2,734	4,135	4,188	4,188	4,188
Other intangible assets					
Other non IEAs	13,770	15,138	23,187	24,346	25,564
Total assets	**415,254**	**434,082**	**534,193**	**588,900**	**636,973**
Customer deposits	323,802	342,528	419,833	469,688	512,695
Bank deposits, CDs, debentures	27,045	11,886	9,994	11,181	12,205
Other interest bearing liabilities	16,527	19,517	23,229	23,229	23,229
Total interest bearing liabilities	**367,374**	**373,931**	**453,056**	**504,098**	**548,129**
Non interest bearing liabilities	15,395	20,416	32,494	34,062	35,707
Total liabilities	**382,769**	**394,347**	**485,550**	**538,160**	**583,836**
Minority interest	339	4,358	4,400	4,444	4,488
Common stock	4,183	4,623	5,105	5,105	5,105
Preferred stock	-	-	-	-	-
Retained earnings	14,634	14,866	15,453	15,453	15,453
Proposed dividends	33	968	1,144	1,144	1,144
Other equity	13,296	14,920	22,541	24,594	26,946
Shareholders' equity	**32,146**	**35,377**	**44,243**	**46,296**	**48,648**
Total liabilities and equity	**415,254**	**434,082**	**534,193**	**588,900**	**636,973**
Non-performing assets (HK$)	*1,586*	*2,448*	*1,592*	*1,751*	*1,891*
Balance sheet ratios (%)					
Loans to deposits	71.5	72.8	75.2	74.9	76.2
Equity to assets	7.7	8.1	8.3	7.9	7.6
Asset quality & capital					
NPAs/gross loans (%)	0.7	1.0	0.5	0.5	0.5
Bad debt charge/gross loans (%)	0.24	0.44	0.09	0.09	0.13
Loss reserves/assets (%)	0.25	0.31	0.21	0.21	0.24
Loss reserves/NPAs (%)	66.0	54.9	69.2	69.4	80.1
Tier 1 capital ratio (%)	9.1	9.4	9.8	9.3	8.9
Total capital ratio (%)	13.8	13.3	13.2	12.4	11.8
Growth (%)					
Loan growth	5.6	7.7	26.7	11.5	11.0
Interest earning assets	0.8	15.5	26.8	13.4	10.2
Interest bearing liabilities	5.2	1.8	21.2	11.3	8.7
Asset growth	5.4	4.5	23.1	10.2	8.2
Deposit growth	13.9	5.8	22.6	11.9	9.2
Per share					
Reported EPS (HK$)	2.15	1.41	2.08	2.03	2.32
Norm EPS (HK$)	2.25	1.26	1.65	1.88	2.25
Fully diluted norm EPS (HK$)	2.25	1.26	1.66	1.88	2.25
DPS (HK$)	0.25	0.80	0.95	1.02	1.17
PPOP PS (HK$)	2.53	2.20	2.08	2.30	2.81
BVPS (HK$)	19.21	19.13	22.00	23.02	24.19
ABVPS (HK$)	19.21	19.13	22.00	23.02	24.19
NTAPS (HK$)	17.58	16.89	19.92	20.94	22.11

Source: Nomura estimates

Dah Sing Financial 440 HK

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From Rating Suspended

BUY

Action

We are resuming coverage of DSF with a BUY rating and price target of HK$65, implying 25% potential upside. The stock is currently trading at 1.1x FY11F book value. In our view, the M&A theme can provide share price support for the company. In addition, earnings progression is recovering with a stable NIM and strong loan growth, leading to a slow recovery in ROE.

Catalysts

Potential listing of Bank of Chongqing; return of the M&A theme; and 2010 annual results to provide more visibility for 2011.

Anchor themes

Earnings progression likely will be muted in 2011F, due to compressing margins and slow asset growth. We think margins for HK banks will remain under pressure until the US starts tightening aggressively, which we believe is likely only in 2012.

Closing price on 3 Mar	HK$52.0
Price target	**HK$65.0**
	(from HK$45.00)
Upside/downside	25.0%
Difference from consensus	**0.8%**
FY11F net profit (HK$mn)	1,310
Difference from consensus	**-0.8%**

Source: Nomura

Nomura vs consensus

We have factored in Bank of Chongqing in our sum-of-the-parts analysis, and consensus has not.

Risk-reward skewing upward

① Trading close to book; strong potential M&A support

DSF is trading at 1.1x FY11F P/B, with ROE recovering slowly. In our view, a stable NIM and strong loan growth are driving the ongoing recovery in ROE. In addition, the return of the M&A theme in Hong Kong as a result of the recent privatisation of ICBC (Asia) and Fubon (HK) could provide share price floor support for DSF, in our view.

② Possible Bank of Chongqing listing a potential catalyst

DSF currently holds a 20% stake in Bank of Chongqing (BOCQ). BOCQ generated solid and stable ROE of 20-24% in 2007-10. We believe any news with respect to a possible listing of BOCQ would lead to a re-rating of DSF shares. DSF management has raised such a listing as a possibility. Our sum-of-the-parts analysis indicates that DSF is trading at a 23% discount to its fair value.

③ Solid earnings growth

We look for 29% y-y earnings growth in FY11F, driven by expectations of a stable NIM, strong loan growth and a growing contribution from BOCQ. The recent pick-up in loans in HK also should contribute to NIM stabilisation and asset growth as DSF has a higher LDR ratio relative to its peers. Credit cost is expected to remain low in FY11-12F, amid low unemployment and a growing economy, although DSF has the highest SME and consumer lending exposure.

④ Valuation is attractive; BUY with PT of HK$65

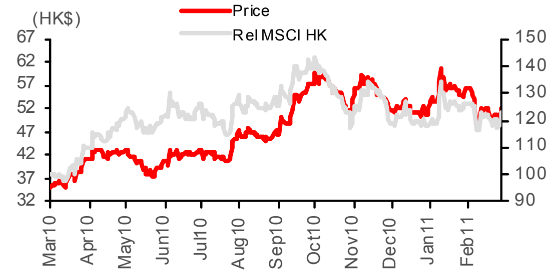
DSF is trading at 11.6x earnings and 1.1x book value, with an ROE of 9.4% in FY11F. We believe the risk-reward profile looks favourable as downside should be somewhat limited with the return of the M&A theme to the HK bank sector. We think upside catalysts could be continued ROE recovery and the possible listing of BOCQ.

Key financials & valuations

31 Dec (HK$mn)	FY09	FY10F	FY11F	FY12F
PPOP	856	1,323	1,641	1,840
Reported net profit	627	1,018	1,310	1,461
Normalised net profit	387	1,071	1,310	1,461
Normalised EPS (HK$)	1.49	3.66	4.48	5.00
Norm. EPS growth (%)	(55.6)	146.0	22.4	11.5
Norm. P/E (x)	34.9	14.2	11.6	10.4
Price/adj. book (x)	1.19	1.12	1.06	0.99
Price/book (x)	1.19	1.12	1.06	0.99
Dividend yield (%)	0.0	1.7	3.0	3.4
ROE (%)	5.9	8.2	9.4	9.8
ROA (%)	0.52	0.78	0.91	0.97
Earnings revisions				
Previous norm. net profit		1,070	1,221	1,366
Change from previous (%)		0.1	7.3	7.0
Previous norm. EPS (HK$)		4.11	4.69	5.25

Source: Company, Nomura estimates

Share price relative to MSCI HK



	1m	3m	6m
Absolute (HK$)	(7.8)	0.8	12.2
Absolute (US$)	(7.9)	0.4	12.0
Relative to Index	(2.3)	3.4	(1.9)
Market cap (US$mn)			1,954
Estimated free float (%)			46.0
52-week range (HK$)			60.7/35.18
3-mth avg daily turnover (US$mn)			1.41
Stock borrowability			Hard
Major shareholders (%)			
Wong's Family			38.9
Mitsubishi UFJ			15.1

Source: Company, Nomura estimates

Drilling down

Investment highlights

Trading close to book; strong M&A support

DSF is inexpensive at 1.1x book

DSF is trading at an FY11F P/B of 1.1x with ROE recovering slowly. The historical average M&A multiple for the HK bank sector is around 1.9x book, based on transactions completed over the past 10 years. We believe the recent privatisation of ICBC (Asia) and Fubon (HK) could provide implicit downside support for DSF. Moreover, given the recent sector trends, we think DSF could be a possible M&A candidate, given that it has a concentrated shareholding pattern making M&A negotiation easier and management has an open mind towards M&A. Management has stated publicly — as recently as 12 Aug 2010 (First Financial Daily, dated 12 Aug 2010) — that it has an open mind towards M&A. Nonetheless, we have not built an M&A theme into our base-case valuation, as it is difficult to ascertain timing.

Exhibit 143. HK banks: M&A transactions since 2000

Date	Target	Acquiror	% acquired	Tran value (US$mn)	P/BV	P/E
1Q11	Fubon (HK)	Fubon Group	25.0	188	1.4	19.2
3Q10	ICBC (Asia)	ICBC Group	27.2	1,387	2.1	15.8
2Q09	CIFH	CITIC Group	70.3	1,739	1.4	20.2
2Q08	Wing Lung Bank	China Merchant Bank	53.1	2,475	3.1	34.1
4Q07	Bank of East Asia	BOC (Hong Kong)	4.9	506	2.9	23.0
4Q06	CITIC Int'l Fina	BBVA	15.0	625	1.6	17.5
4Q06	Bank of America (HK)	China Construction Bank	100.0	1,253	1.3	18.1
1Q06	Asia Commercial Bank	JCG	100.0	577	2.5	63.0
3Q05	Banco Comercial de Macau	Dah Sing Financial	100.0	214	2.6	22.6
2Q05	Pacific Finance	Dah Sing Financial	100.0	120	1.8	13.8
1Q04	Fortis Bank	ICBC (Asia)	100.0	324	1.1	17.7
4Q03	IBA (now Fubon)	Fubon Financial	75.0	415	1.2	16.0
3Q03	Chekiang First	Wing Hang	100.0	615	1.2	23.2
1Q02	HK Chinese	CITIC Ka Wah	70.0	538	1.3	46.1
2Q01	Dao Heng	DBS	55.0	5,716	3.4	25.6
4Q00	First Pacific	Bank of East Asia	75.0	561	1.5	71.5
Average					**1.9**	**28.0**

Source: Company data, Nomura research

Exhibit 144. DSF: shareholding structure

Major shareholder	% Shareholding
Wong's Family	38.9
Mitsubishi UFJ	15.1

Source: Bloomberg, Company data, Nomura research

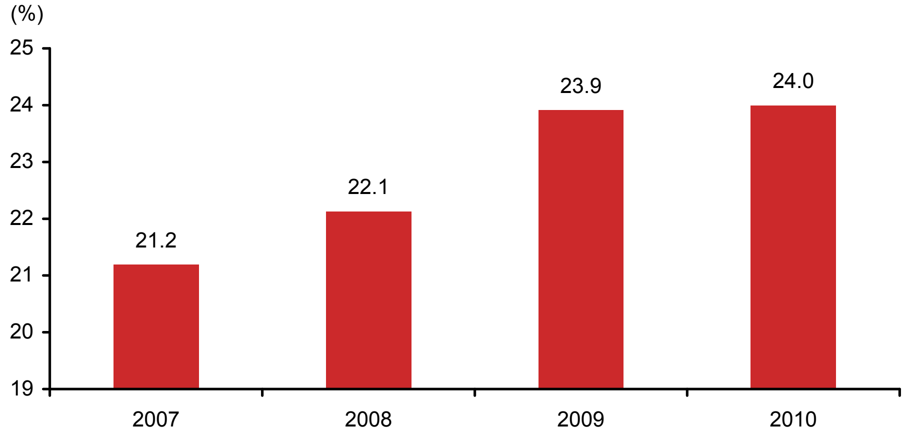
Potential listing of Bank of Chongqing as a catalyst

DSF currently holds a 20% stake in Bank of Chongqing (BOCQ). DSF first acquired a 17% BOCQ stake at around 1.55x book in April 2007, for a total consideration of RMB694mn. It then purchased another 3% in October 2008. Over the past three years, BOCQ was able to generate ROE of around 20-24%.

We believe the potential listing of BOCQ (as reported by Bloomberg news, *Bank of Chongqing Seeks Hong Kong Listing in 2011, Oriental Daily Reports*, 24 Sep 2010) could help to unlock the value of DSF. Our sum-of-the-parts analysis indicates that DSF is trading at 23% discount to its fair value.

Exhibit 145. Bank of Chongqing: return on equity

Strong ROE at Bank of Chongqing



Source: Company data, Nomura research

Exhibit 146. DSF: sum-of-the-parts analysis, FY10F

DSF trading at 23% discount to its fair value

(HK$mn)	2010 Book	Comparable P/BV	Fair value	Comparables
HK core banking	10,322	1.46	15,070	Chong Hing Bank IBES P/B FY10F
China's BOCQ	1,621	1.88	3,048	Average of China banks' P/B with ROE ~20%
Insurance	1,575	1.00	1,575	Fair value at 1x book
Total	**13,518**		**19,693**	
Current market value			**15,241**	
Discount (%)			**(23)**	

Note: Chong Hing Bank (1111.HK, not rated) is chosen for comparable since it is a pure HK play

Source: IBES, Nomura estimates

Solid earnings progression

We look for 29% earnings growth in FY11F, driven by an expected stable NIM, strong loan growth and a larger contribution from BOCQ. The recent loan pickup in HK should benefit DSF's NIM stabilisation and asset growth as DSF has a higher LDR ratio. Credit cost is expected to remain low in FY11-12F due to low unemployment and the growing economy, although DSF has the highest SME and consumer lending exposure. Our risk tendency analysis indicates that DSF's earnings are highly sensitive to changes of loan loss provision estimates due to the bank's larger portion of personal unsecured and overseas loans.

Exhibit 147. HK Banks' risk tendency

DSF's loan book is of higher inherent risk by nature

(Loan mix %)	HSB	BOCHK	BEA	WHB	DSF	Risk tendency (bps)
SME	15	21	7	12	14	150
Corporates	38	31	22	25	25	20
Mortgages	29	25	10	24	19	0
Personal	7	3	7	6	17	200
Loan for use in HK	**90**	**80**	**46**	**67**	**75**	
Outside HK	10	20	54	33	25	100
Total loans	**100**	**100**	**100**	**100**	**100**	
Normalised credit costs (bps)	54	64	81	68	85	
FY11F credit costs (bps)	15	9	10	8	10	
Potential increase in credit costs (bps)	**39**	**55**	**71**	**60**	**74**	
PBT impact, FY11F (%)	**12**	**20**	**47**	**29**	**32**	

Source: Nomura estimates

Exhibit 148. DSF: earnings outlook

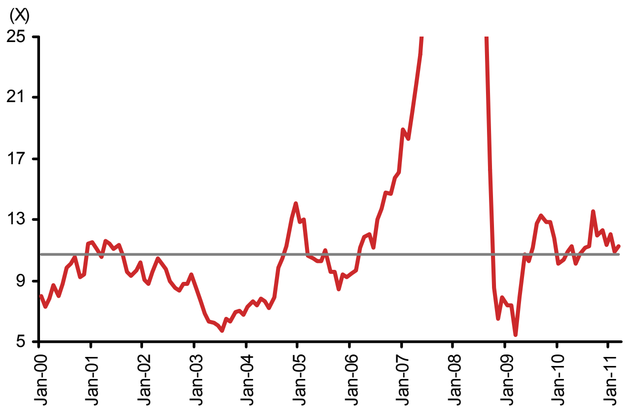
						y-y			
(HK$mn)	**FY08**	**FY09**	**FY10F**	**FY11F**	**FY12F**	**FY09**	**FY10F**	**FY11F**	**FY12F**
Net interest income	2,369	2,344	2,115	2,337	2,536	(1)	(10)	11	9
Non-interest income	801	381	657	826	929	(52)	73	26	12
Fee income	504	327	367	389	413	(35)	12	6	6
Other non-interest income	297	53	290	437	516	(82)	443	51	18
Operating revenues	**3,170**	**2,724**	**2,772**	**3,163**	**3,465**	**(14)**	**2**	**14**	**10**
Operating expenses	(1,703)	(1,869)	(1,449)	(1,522)	(1,625)	10	(22)	5	7
Pre-provision profits	**1,467**	**855**	**1,323**	**1,641**	**1,840**	**(42)**	**55**	**24**	**12**
Loan loss provision	(659)	(410)	(66)	(77)	(123)	(38)	(84)	18	60
Operating profits	**809**	**445**	**1,257**	**1,564**	**1,717**	**(45)**	**182**	**24**	**10**
Others	(626)	440	208	313	376	(170)	(53)	51	20
Associates profits	126	201	261	313	376	59	30	20	20
Other non-operating income	(752)	239	(53)	0	0	(132)	(122)	(100)	NA
Profit before tax	**183**	**886**	**1,465**	**1,877**	**2,093**	**384**	**65**	**28**	**11**
Tax	(29)	(96)	(182)	(225)	(251)	228	89	24	11
Profit after tax	**154**	**789**	**1,283**	**1,652**	**1,842**	**414**	**63**	**29**	**11**
Minority interests	(47)	(163)	(265)	(342)	(381)	244	63	29	11
Attributable profits	**106**	**626**	**1,018**	**1,310**	**1,461**	**490**	**63**	**29**	**11**

Source: Company data, Nomura estimates

Valuation

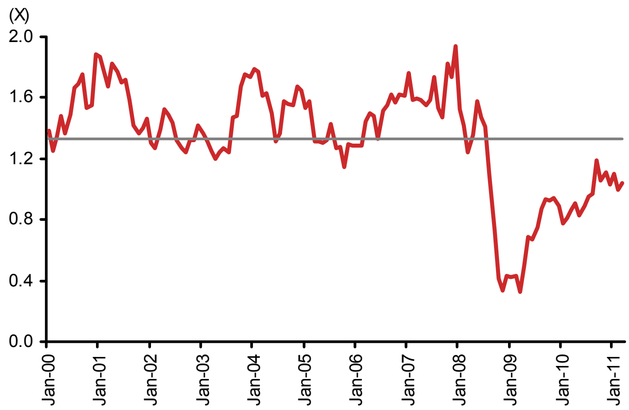
DSF is trading at an FY11F P/E of 11.6x and P/B of 1.1x, with ROE at 9.4%. We believe the current valuation is attractive given our view that downside is limited with the M&A theme. Upside potential is significant, in our view, amid improving bank fundamentals and the potential listing of BOCQ. Our price target of HK$65 is based on the Gordon Growth method using a normalised ROE approach. Key assumptions are normalised ROE of 11%, cost of equity 9.4% and long-term growth of 5%.

Exhibit 149. DSF: prospective P/E



Source: Company data, Nomura estimates

Exhibit 150. DSF: prospective P/BV

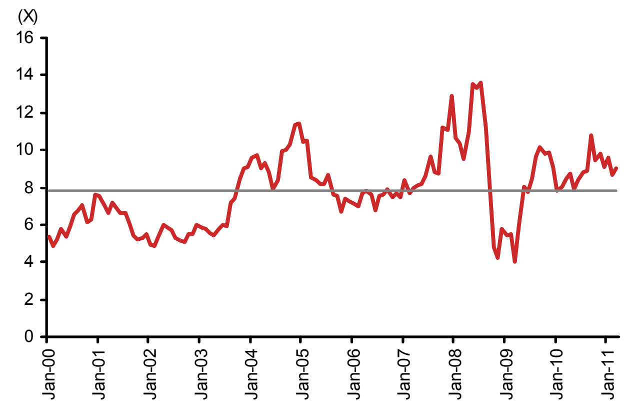


Source: Company data, Nomura estimates

Exhibit 151. DSF: prospective dividend yield

Source: Company data, Nomura estimates

Exhibit 152. DSF: prospective P/PPP



Source: Company data, Nomura estimates

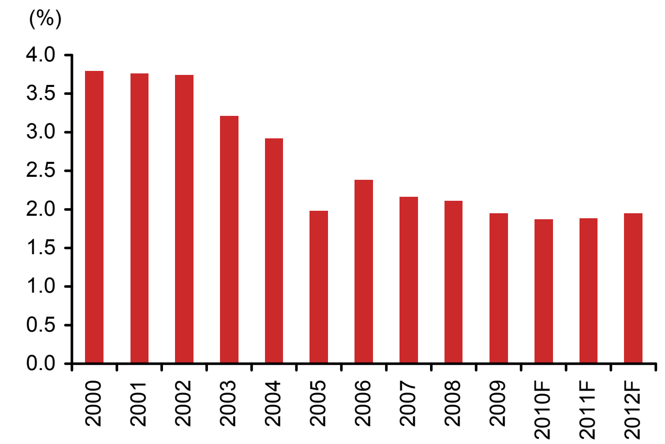
Risks

Downside risk: A slowdown in the HK and China economies would lead to sharp deterioration of asset quality since DSF has significant exposure to SME and unsecured personal loans.

Upside risk: Rising US interest rates earlier than our expectation would lead to NIM expansion and better earning growth.

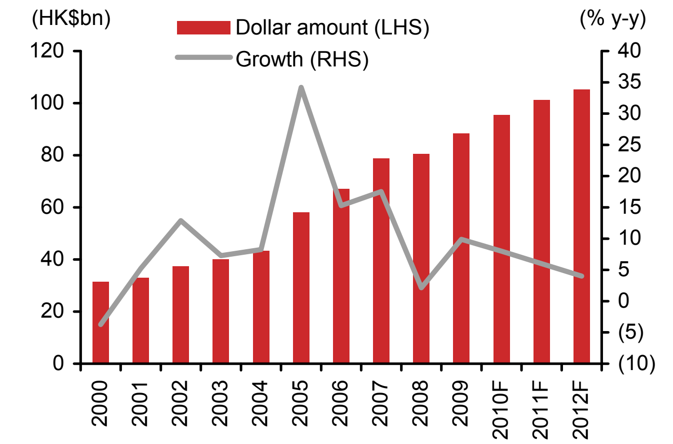
Operating metrics

Exhibit 153. DSF: NIM progression



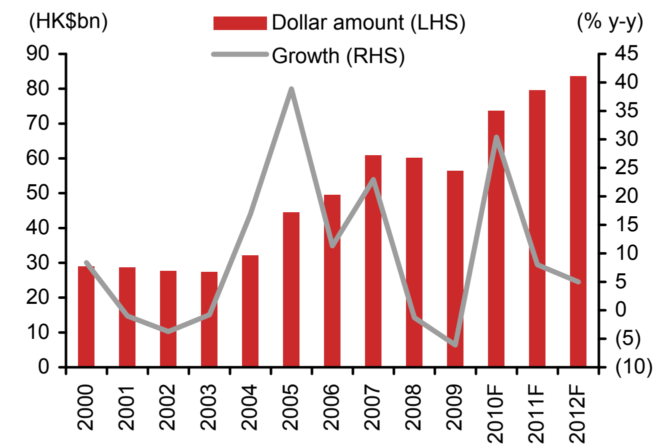
Source: Company data, Nomura estimates

Exhibit 154. DSF: deposit growth



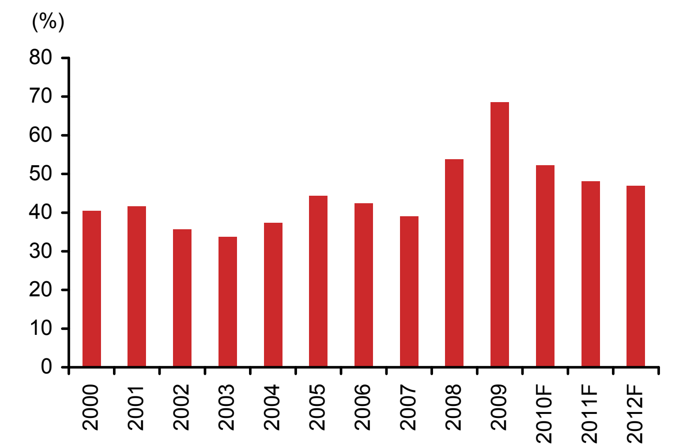
Source: Company data, Nomura estimates

Exhibit 155. DSF: loan growth



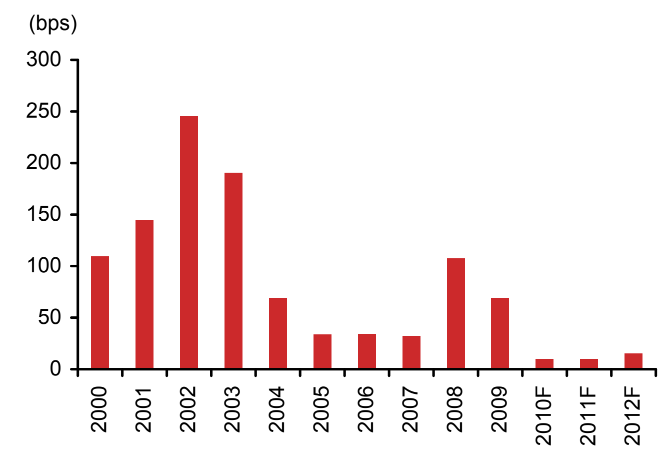
Source: Company data, Nomura estimates

Exhibit 156. DSF: cost income ratios



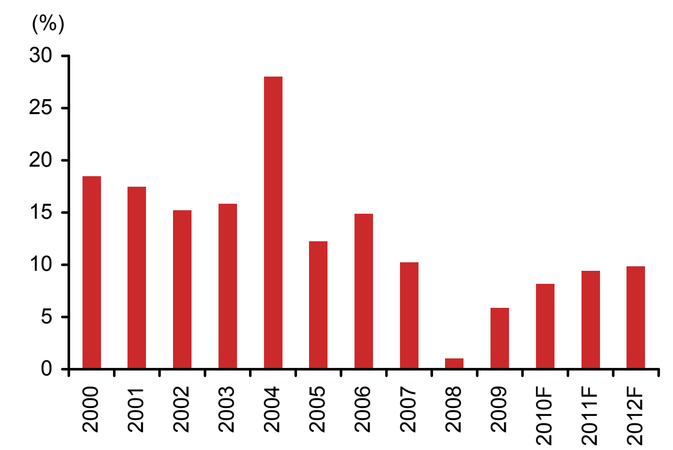
Source: Company data, Nomura estimates

Exhibit 157. DSF: Loan loss provision as % of Loans



Source: Company data, Nomura estimates

Exhibit 158. DSF: return on equity



Source: Company data, Nomura estimates

Exhibit 159. DSF: normalised ROE-based price target calculation

DuPont (As % of ave assets)	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010F	2011F	2012F	Ave 94-09	Normalised
Net interest income	3.3	3.2	3.2	2.7	2.4	1.7	2.1	1.9	1.9	1.9	1.6	1.6	1.7	2.6	1.7
Non-interest income	**1.1**	**1.1**	**1.1**	**1.1**	**1.0**	**1.0**	**1.0**	**1.3**	**0.7**	**0.3**	**0.5**	**0.6**	**0.6**	**1.0**	**0.7**
Fee income	0.6	0.6	0.7	0.7	0.5	0.4	0.5	0.5	0.4	0.3	0.3	0.3	0.3	0.5	0.3
Other non-interest income	0.4	0.4	0.4	0.4	0.5	0.6	0.5	0.7	0.2	0	0.2	0.3	0.3	0.5	0.4
Operating revenues	**4.3**	**4.3**	**4.3**	**3.8**	**3.5**	**2.7**	**3.0**	**3.2**	**2.6**	**2.2**	**2.1**	**2.2**	**2.3**	**3.5**	**2.4**
Operating expenses	(1.7)	(1.8)	(1.5)	(1.3)	(1.3)	(1.2)	(1.3)	(1.2)	(1.4)	(1.5)	(1.1)	(1.1)	(1.1)	(1.5)	(1.1)
Pre-Provision Profits	**2.6**	**2.5**	**2.8**	**2.5**	**2.2**	**1.5**	**1.8**	**1.9**	**1.2**	**0.7**	**1.0**	**1.1**	**1.2**	**2.0**	**1.3**
Loan loss provision	(0.7)	(0.8)	(1.2)	(0.9)	(0.3)	(0.2)	(0.2)	(0.2)	(0.5)	(0.3)	(0.1)	(0.1)	(0.1)	(0.5)	(0.2)
Other provisions	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Operating profits	**1.9**	**1.7**	**1.5**	**1.7**	**1.9**	**1.3**	**1.6**	**1.8**	**0.7**	**0.4**	**1.0**	**1.1**	**1.1**	**1.5**	**1.1**
Others	0.1	0.2	0.1	0.2	1.4	0.4	0.3	(0.6)	(0.5)	0.4	0.2	0.2	0.2	0.1	0.3
Associates profits	0	0	0	0	0	0	0	0	0.1	0.2	0.2	0.2	0.2	0	0.3
Other non-operating income	0	0.2	0.1	0.2	1.4	0.4	0.4	(0.7)	(0.6)	0.2	0	0	0	0.1	0
Profit before tax	**2.0**	**1.9**	**1.6**	**1.8**	**3.3**	**1.7**	**1.9**	**1.2**	**0.1**	**0.7**	**1.1**	**1.3**	**1.4**	**1.6**	**1.4**
Tax	(0.2)	(0.2)	(0.1)	(0.2)	(0.2)	(0.2)	(0.3)	(0.1)	0.0	(0.1)	(0.1)	(0.2)	(0.2)	(0.2)	(0.2)
Profit after tax	**1.7**	**1.7**	**1.5**	**1.6**	**3.1**	**1.5**	**1.7**	**1.1**	**0.1**	**0.7**	**1.0**	**1.2**	**1.2**	**1.4**	**1.2**
Minority interests	0	0	0	0	(0.2)	(0.3)	(0.3)	(0.2)	0	(0.1)	(0.2)	(0.2)	(0.3)	(0.1)	(0.2)
ROA	1.7	1.7	1.5	1.6	2.9	1.2	1.4	0.9	0.1	0.5	0.8	0.9	1.0	1.3	1.0
Leverage	10.7	10.5	10.2	9.9	9.6	10.1	10.8	11.4	12.0	11.4	10.5	10.3	10.2	10.8	11.4
ROE	**18.5**	**17.5**	**15.2**	**15.8**	**28**	**12.2**	**14.9**	**10.2**	**1.0**	**5.9**	**8.2**	**9.4**	**9.8**	**14.5**	**11.2**
Risk free rate															4.0
Risk premium															5.0
Beta															1.1
COE															**9.4**
Long term growth rate															5.0
Fair value PB															**1.4**
2010E book value per share															46.2
Fair value (HK$)															**65**

Source: Company data, Nomura estimates

Financial statements

Profit and Loss (HK$mn)					
Year-end 31 Dec	**FY08**	**FY09**	**FY10F**	**FY11F**	**FY12F**
Interest income	4,739	3,177	2,825	3,103	3,911
Interest expense	(2,369)	(833)	(710)	(766)	(1,375)
Net interest income	**2,369**	**2,344**	**2,115**	**2,337**	**2,536**
Net fees and commissions	504	327	367	389	413
Trading related profits	(116)	(60)	77	206	265
Other operating revenue	413	113	213	231	251
Non-interest income	**801**	**381**	**657**	**826**	**929**
Operating income	**3,170**	**2,725**	**2,772**	**3,163**	**3,465**
Depreciation	(134)	(133)	(135)	(138)	(141)
Amortisation					
Operating expenses	(1,570)	(1,737)	(1,314)	(1,384)	(1,484)
Employee share expense					
Op. profit before provisions	**1,467**	**856**	**1,323**	**1,641**	**1,840**
Provisions for bad debt	(659)	(410)	(66)	(77)	(123)
Other provision charges					
Operating profit	**809**	**446**	**1,257**	**1,564**	**1,717**
Other non-operating income					
Associates & JCEs	126	201	261	313	376
Pre-tax profit	**935**	**647**	**1,518**	**1,877**	**2,093**
Income tax	(29)	(96)	(182)	(225)	(251)
Net profit after tax	**906**	**551**	**1,336**	**1,652**	**1,842**
Minority interests	(47)	(163)	(265)	(342)	(381)
Other items					
Preferred dividends					
Normalised NPAT	**858**	**387**	**1,071**	**1,310**	**1,461**
Extraordinary items	(752)	239	(53)	-	-
Reported NPAT	**106**	**627**	**1,018**	**1,310**	**1,461**
Dividends	(176)	-	(254)	(459)	(511)
Transfer to reserves	**(70)**	**627**	**763**	**852**	**949**
Valuation and ratio analysis					
FD normalised P/E (x)	15.5	34.9	14.2	11.6	10.4
FD normalised P/E at price target (x)	19.4	43.7	17.7	14.5	13.0
Reported P/E (x)	125.3	21.6	14.9	11.6	10.4
Dividend yield (%)	1.3	-	1.7	3.0	3.4
Price/book (x)	1.4	1.2	1.1	1.1	1.0
Price/adjusted book (x)	1.4	1.2	1.1	1.1	1.0
Net interest margin (%)	2.18	2.21	1.87	1.88	1.95
Yield on interest earning assets (%)	4.36	2.99	2.50	2.50	3.00
Cost of interest bearing liabilities (%)	2.45	0.87	0.70	0.70	1.20
Net interest spread (%)	1.91	2.12	1.80	1.80	1.80
Non-interest/operating income (%)	25.3	14.0	23.7	26.1	26.8
Cost to income (%)	53.7	68.6	52.3	48.1	46.9
Effective tax rate (%)	3.1	14.9	12.0	12.0	12.0
Dividend payout (%)	165.6	-	25.0	35.0	35.0
ROE (%)	1.0	5.9	8.2	9.4	9.8
ROA (%)	0.09	0.52	0.78	0.91	0.97
Operating ROE (%)	7.9	4.2	10.1	11.2	11.6
Operating ROA (%)	0.66	0.37	0.96	1.09	1.14
Growth (%)					
Net interest income	7.0	(1.1)	(9.8)	10.5	8.5
Non-interest income	(46.0)	(52.5)	72.6	25.7	12.4
Non-interest expenses	18.6	10.6	(24.4)	5.4	7.2
Pre-provision earnings	(34.9)	(41.7)	54.6	24.0	12.1
Net profit	(52.9)	(54.8)	176.3	22.4	11.5
Normalised EPS	(53.9)	(55.6)	146.0	22.4	11.5
Normalised FDEPS	(53.9)	(55.6)	146.0	22.4	11.5

Source: Nomura estimates

Balance Sheet (HK$mn)					
As at 31 Dec	FY08	FY09	FY10F	FY11F	FY12F
Cash and equivalents	12,809	10,742	11,114	11,500	12,021
Inter-bank lending	1,836	4,433	1,246	1,320	1,388
Deposits with central bank					
Total securities	38,974	44,097	45,819	47,367	48,783
Other interest earning assets					
Gross loans	60,999	57,165	74,315	80,260	84,273
Less provisions	(850)	(675)	(642)	(694)	(728)
Net loans	**60,150**	**56,490**	**73,672**	**79,566**	**83,544**
Long-term investments	1,192	1,360	1,621	1,935	2,311
Fixed assets	2,529	2,995	3,055	3,116	3,179
Goodwill	1,274	1,226	1,575	1,669	1,769
Other intangible assets					
Other non IEAs	1,416	1,233	1,270	1,334	1,534
Total assets	**120,180**	**122,576**	**139,373**	**147,807**	**154,529**
Customer deposits	80,418	88,370	95,440	101,166	105,213
Bank deposits, CDs, debentures	2,444	1,435	3,500	3,710	3,858
Other interest bearing liabilities	12,727	6,662	7,417	7,552	7,693
Total interest bearing liabilities	**95,589**	**96,467**	**106,357**	**112,428**	**116,764**
Non interest bearing liabilities	12,654	11,930	16,196	17,500	18,704
Total liabilities	**108,243**	**108,397**	**122,553**	**129,928**	**135,468**
Minority interest	2,045	2,783	3,302	3,510	3,741
Common stock	521	521	586	586	586
Preferred stock	-	-	-	-	-
Retained earnings	7,719	8,381	9,144	9,996	10,945
Proposed dividends	-	-	196	400	419
Other equity	1,653	2,494	3,592	3,388	3,369
Shareholders' equity	**9,892**	**11,396**	**13,518**	**14,370**	**15,319**
Total liabilities and equity	**120,180**	**122,576**	**139,373**	**147,807**	**154,529**
Non-performing assets (HK$)	*1,037*	*547*	*383*	*306*	*331*
Balance sheet ratios (%)					
Loans to deposits	75.9	64.7	77.9	79.3	80.1
Equity to assets	8.2	9.3	9.7	9.7	9.9
Asset quality & capital					
NPAs/gross loans (%)	1.7	1.0	0.5	0.4	0.4
Bad debt charge/gross loans (%)	1.08	0.72	0.09	0.10	0.15
Loss reserves/assets (%)	0.71	0.55	0.46	0.47	0.47
Loss reserves/NPAs (%)	81.9	123.5	167.7	226.4	220.1
Tier 1 capital ratio (%)	6.8	10.2	10.6	10.7	10.6
Total capital ratio (%)	13.6	16.8	15.7	15.5	15.2
Growth (%)					
Loan growth	(1.3)	(6.1)	30.4	8.0	5.0
Interest earning assets	(5.1)	4.0	15.0	6.2	4.3
Interest bearing liabilities	(2.6)	0.9	10.3	5.7	3.9
Asset growth	(3.2)	2.0	13.7	6.1	4.5
Deposit growth	2.1	9.9	8.0	6.0	4.0
Per share					
Reported EPS (HK$)	0.4	2.4	3.5	4.5	5.0
Norm EPS (HK$)	3.4	1.5	3.7	4.5	5.0
Fully diluted norm EPS (HK$)	3.4	1.5	3.7	4.5	5.0
DPS (HK$)	0.7	-	0.9	1.6	1.7
PPOP PS (HK$)	5.7	3.3	4.5	5.6	6.3
BVPS (HK$)	38.0	43.8	46.2	49.2	52.4
ABVPS (HK$)	38.0	43.8	46.2	49.2	52.4
NTAPS (HK$)	33.1	39.1	40.9	43.4	46.4

Source: Nomura estimates

Wing Hang Bank 302 HK

FINANCIALS/BANKS | HONG KONG

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From Rating Suspended

NEUTRAL

Action

We resume coverage of WHB with a NEUTRAL rating and price target of HK$104. WHB is fairly valued at 1.9x book with 13% ROE for 2011F. Upside risk is limited, as we believe it will be difficult for WHB to go back to its historically high 22% ROE in a low interest rate environment. Downside is also limited, as the M&A theme should provide floor support. Risk-reward profile is balanced at WHB, in our view.

Catalysts

1) Return of M&A theme propelling the stock to its historical P/B of 3x; 2) 2010 annual results to provide more visibility for the stock in 2011 and 2012.

Anchor themes

Earnings progression is likely to be muted in 2011F, driven by shrinking margins and slow asset growth. We believe margins for HK banks will remain under pressure until the US starts tightening aggressively, which we think is likely only in 2012.

Closing price on 3 Mar	HK$99.4
Price target	**HK$104.0**
	(from HK$90.0)
Upside/downside	4.6%
Difference from consensus	-6.3%
FY11F net profit (HK$mn)	1,884
Difference from consensus	-2.4%

Source: Nomura

Nomura vs consensus

Our price target is 6% below consensus due to our perception of continued NIM pressure in HK.

Fairly valued, positive surprise limited

① Strong management and ROE track record in the price

We view WHB as one of the best-managed mid-cap banks in HK, since it has managed to deliver double-digit ROE even during financial crises. However, WHB is trading at 1.9x book with 13% ROE in 2011F and 2012F; we believe the valuation is fair because there is limited room for upside or downside, given the low interest rate environment and the support provided by the M&A theme.

② M&A theme to provide floor support

While WHB has long been regarded as a potential M&A candidate, given both its strong ROE record and franchise; its relative full valuation at 1.9x book is the key hurdle. Current WHB valuation is close to HK's historical M&A acquisition multiple of 1.9x book; we believe the M&A theme will provide floor support for the stock.

③ Slow earnings recovery

We look for earnings growth of 15% and 12% in 2011-12F, driven by stable NIM, strong loan growth in China and Macau and absence of loan loss provisions in a benign credit environment. We forecast WHB will generate an ROE of 13% in 2011-12F, which is well below its historical high of 22%, as profitability would be impaired in a low interest rate environment, in our view.

④ Valuation fair; NEUTRAL rating and PT of HK$104

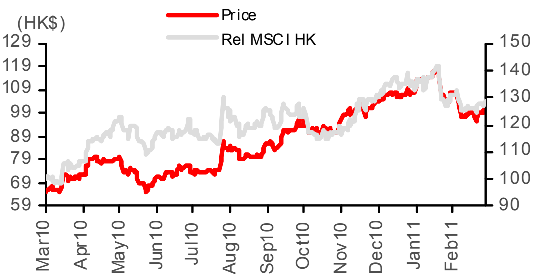
The stock is trading at 15.7x reported earnings, 1.9x book and ROE of 13% for 2011F; we consider the valuation fair. Our price target of HK$104 is based on a normalised-ROE approach. Our key assumptions are normalised ROE of 13%, cost of equity of 8.7% and long-term growth rate of 5%.

Key financials & valuations

31 Dec (HK$mn)	FY09	FY10F	FY11F	FY12F
PPOP	1,281	1,826	2,252	2,507
Reported net profit	1,205	1,643	1,884	2,106
Normalised net profit	1,037	1,533	1,834	2,056
Normalised EPS (HK$)	3.49	5.15	6.16	6.91
Norm. EPS growth (%)	(27.1)	47.6	19.6	12.2
Norm. P/E (x)	28.5	19.1	16.0	14.3
Price/adj. book (x)	2.37	2.09	1.91	1.74
Price/book (x)	2.37	2.09	1.91	1.74
Dividend yield (%)	0.7	1.2	1.7	2.3
ROE (%)	10.5	12.5	12.8	13.1
ROA (%)	0.86	1.08	1.16	1.23
Earnings revisions				
Previous norm. net profit		1,638	2,018	2,255
Change from previous (%)		(6.4)	(9.1)	(8.8)
Previous norm. EPS (HK$)		5.55	6.86	7.67

Source: Company, Nomura estimates

Share price relative to MSCI HK



	1m	3m	6m
Absolute (HK$)	(7.9)	(4.5)	16.1
Absolute (US$)	(8.0)	(4.8)	15.8
Relative to Index	(2.4)	(1.8)	1.9
Market cap (US$mn)			3,768
Estimated free float (%)			56.1
52-week range (HK$)			117.4/64.7
3-mth avg daily turnover (US$mn)			5.10
Stock borrowability			Easy
Major shareholders (%)			
Fung's Family			23.6
Bank of New York Mellon			20.3

Source: Company, Nomura estimates

Drilling down

Investment highlights

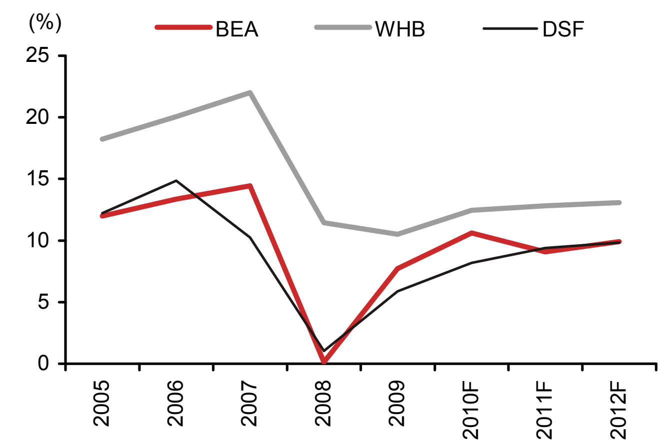
Strong management and ROE track record in the price

Fairly priced at 1.9x book for 13% ROE in 2011F

We view WHB as one of the best managed mid-cap banks in HK, since it has managed to deliver double-digit ROE even during financial crises. During the 2008 financial crisis, WHB generated 11% ROE vs. 0.1% at BEA and 1.0% at DSF.

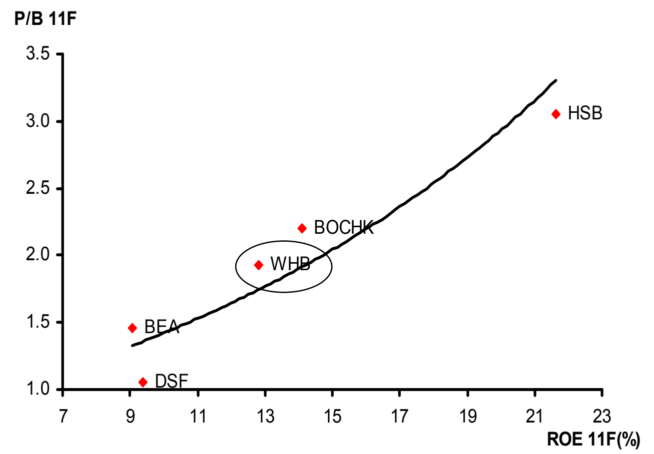
However, WHB is trading at 1.9x book with 13% ROE in 2011 and 2012; we believe the valuation is fair. Upside is limited in our view, as profitability should be impaired in a low interest rate environment and we believe it will be difficult for WHB to achieve its historically high ROE of 22% (achieved in 2007). Therefore, we believe multiple expansion seems unlikely at WHB.

Exhibit 160. WHB ROE consistently higher than mid-sized banking peers



Source: Company data, Nomura estimates

Exhibit 161. HK banks: P/B vs ROE, 2011F; WHB fairly valued



Source: Nomura estimates

M&A theme to provide floor support

WHB is currently valued at 1.9x FY11F book, which is in line with HK's historical M&A average of 1.9x. We see a high probability of M&A at WHB, since shareholding is concentrated among a few, making M&A negotiations easier, in our view.

Exhibit 162. HK banks: M&A history

Date	Target	Acquirer	% acquired	Tran value (US$mn)	P/BV	P/E
1Q11	Fubon (HK)	Fubon Group	25.0	188	1.4	19.2
3Q10	ICBC (Asia)	ICBC Group	27.2	1387	2.1	15.8
2Q09	CIFH	CITIC Group	70.3	1739	1.4	20.2
2Q08	Wing Lung Bank	China Merchant Bank	53.1	2475	3.1	34.1
4Q07	Bank of East Asia	BOC (Hong Kong)	4.9	506	2.9	23.0
4Q06	CITIC Int'l Fina	BBVA	15.0	625	1.6	17.5
4Q06	Bank of America (HK)	China Construction Bank	100.0	1253	1.3	18.1
1Q06	Asia Commercial Bank	JCG	100.0	577	2.5	63.0
3Q05	Banco Comercial de Macau	Dah Sing Financial	100.0	214	2.6	22.6
2Q05	Pacific Finance	Dah Sing Financial	100.0	120	1.8	13.8
1Q04	Fortis Bank	ICBC (Asia)	100.0	324	1.1	17.7
4Q03	IBA (now Fubon)	Fubon Financial	75.0	415	1.2	16.0
3Q03	Chekiang First	Wing Hang	100.0	615	1.2	23.2
1Q02	HK Chinese	CITIC Ka Wah	70.0	538	1.3	46.1
2Q01	Dao Heng	DBS	55.0	5716	3.4	25.6
4Q00	First Pacific	Bank of East Asia	75.0	561	1.5	71.5
Average					**1.9**	**28.0**

Source: Company data, Nomura research

Exhibit 163. WHB: shareholding structure — concentrated

Major shareholder	% Shareholding
Bank of New York	20.3
Fung's Family	23.6

Source: Bloomberg, Company data, Nomura research

Slow earnings recovery

We look for reported earnings growth of 15% and 12% in 2011-12F, driven by stable NIM, strong loan growth in China and Macau and absence of loan-loss provisions in a benign credit environment. We forecast WHB will generate an ROE of 13% in 2011-12F, which is well below its historical high of 22%, due to the low interest rate environment.

Exhibit 164. WHB: Earnings outlook

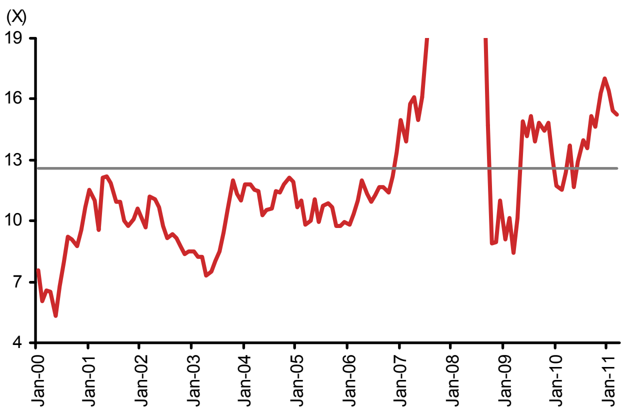
						y-y			
(HK$mn)	**2008**	**2009**	**2010F**	**2011F**	**2012F**	**2009**	**2010F**	**2011F**	**2012F**
Net interest income	2,445	2,460	2,712	2,851	3,085	1	10	5	8
Non-interest income	1,340	393	670	1,070	1,188	(71)	71	60	11
Fee income	706	662	711	791	887	(6)	8	11	12
Other non-interest income	634	(269)	(42)	279	301	(142)	(85)	(772)	8
Operating revenues	**3,785**	**2,853**	**3,382**	**3,922**	**4,273**	**(25)**	**19**	**16**	**9**
Operating expenses	(1,561)	(1,571)	(1,557)	(1,670)	(1,766)	1	(1)	7	6
Pre-provision profits	**2,224**	**1,281**	**1,826**	**2,252**	**2,507**	**(42)**	**42**	**23**	**11**
Loan loss provision	(444)	(53)	0	(84)	(79)	(88)	(100)	NA	(6)
Operating profits	**1,780**	**1,228**	**1,826**	**2,168**	**2,428**	**(31)**	**49**	**19**	**12**
Others	(417)	206	130	74	79	(149)	(37)	(43)	6
Associates profits	(156)	38	20	24	29	(125)	(48)	20	20
Other non-operating income	(261)	167	110	50	50	(164)	(34)	(55)	0
Profit before tax	**1,362**	**1,434**	**1,956**	**2,242**	**2,507**	**5**	**36**	**15**	**12**
Tax	(201)	(227)	(309)	(355)	(396)	13	36	15	12
Profit after tax	**1,161**	**1,207**	**1,646**	**1,887**	**2,110**	**4**	**36**	**15**	**12**
Minority interests	1	(2)	(3)	(4)	(4)	NA	36	15	3
Attributable profits	**1,162**	**1,205**	**1,643**	**1,884**	**2,106**	**4**	**36**	**15**	**12**

Source: Company data, Nomura estimates

Valuation

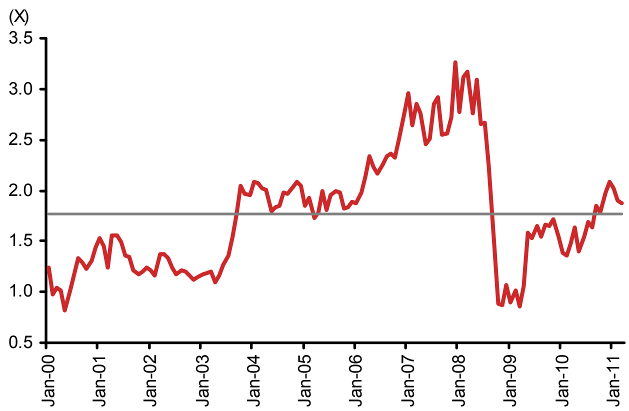
Our price target of HK$104 is based on a normalised-ROE approach. Our key assumptions are normalised ROE of 13%, cost of equity of 8.7% and long-term growth rate of 5%.

Exhibit 165. WHB: prospective P/E



Source: Company data, Nomura research

Exhibit 166. WHB: prospective P/B

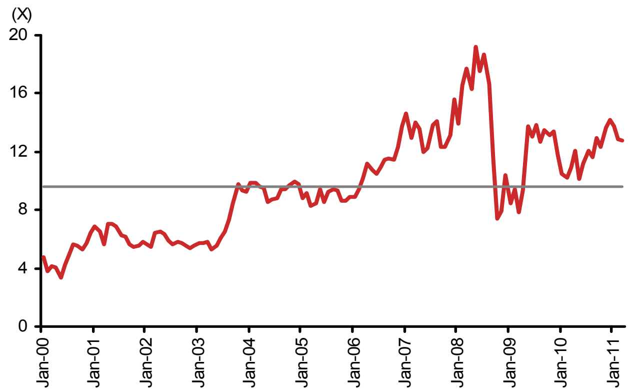


Source: Company data, Nomura research

Exhibit 167. WHB: prospective dividend yield

Source: Company data, Nomura research

Exhibit 168. WHB: prospective P/PPP



Source: Company data, Nomura research

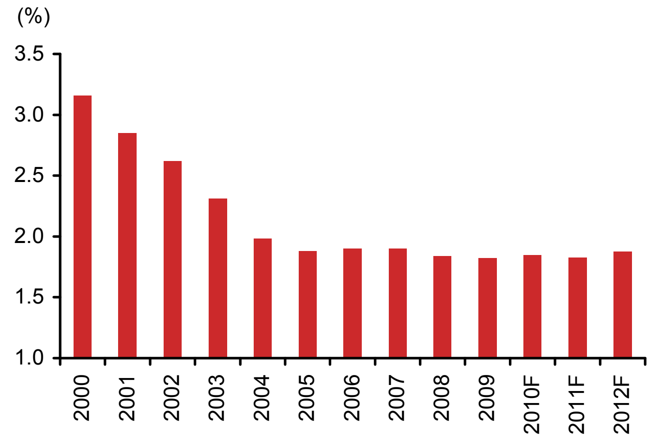
Risks

Upside risk: US increasing interest rates earlier than expected, leading to expansion of net interest margins.

Downside risk: Significant deterioration in Macau and China and SME loans leading to a pick-up of credit costs. Given WHB's large exposure to China and Macau, a worse-than-expected deterioration in these economies would pose downside risks to our earnings and price target.

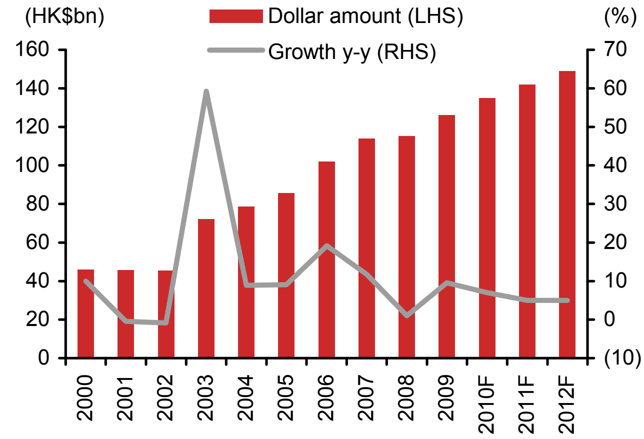
Operating metrics

Exhibit 169. WHB: NIM progression



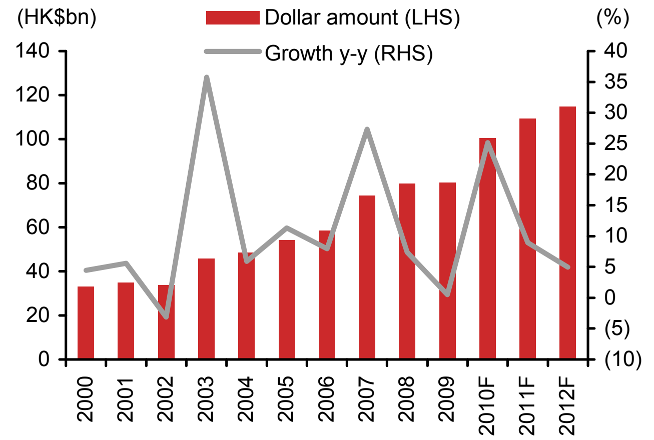
Source: Company data, Nomura estimates

Exhibit 170. WHB: deposit growth



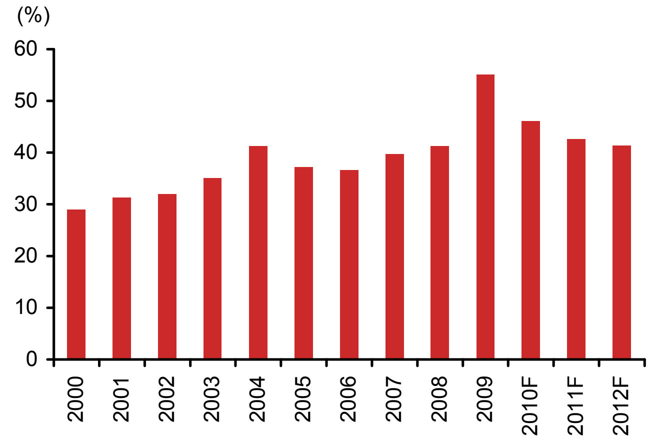
Source: Company data, Nomura estimates

Exhibit 171. WHB: loan growth



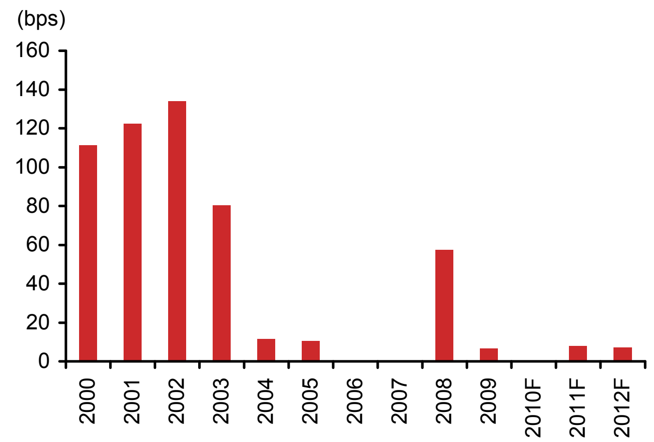
Source: Company data, Nomura estimates

Exhibit 172. WHB: cost income ratios



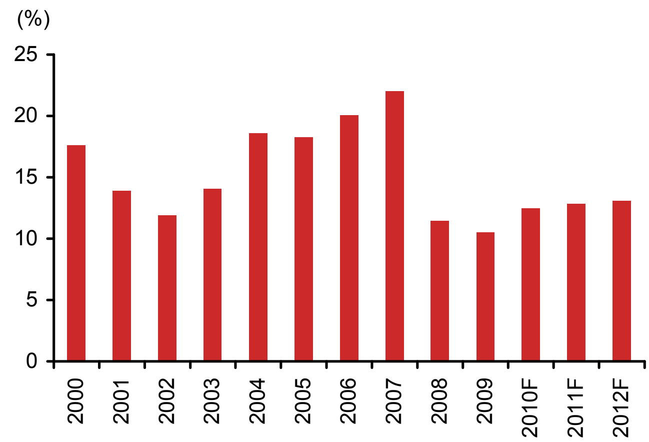
Source: Company data, Nomura estimates

Exhibit 173. WHB: loan loss provision as % of loans



Source: Company data, Nomura estimates

Exhibit 174. WHB: return on equity



Source: Company data, Nomura estimates

Exhibit 175. WHB: Normalised ROE-based price target calculation

DuPont (As % of ave assets)	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010F	2011F	2012F	Ave 94-09	Normalised
Net interest income	**3.2%**	**2.8%**	**2.6%**	**2.2%**	**1.9%**	**1.7%**	**1.9%**	**1.8%**	**1.8%**	**1.7%**	**1.8%**	**1.8%**	**1.8%**	**2.4%**	**1.9%**
Non-interest income	**0.7%**	**0.7%**	**0.7%**	**0.6%**	**0.8%**	**0.9%**	**0.7%**	**0.7%**	**1.0%**	**0.3%**	**0.4%**	**0.7%**	**0.7%**	**0.7%**	**0.7%**
Fee income	0.4%	0.5%	0.5%	0.4%	0.5%	0.5%	0.5%	0.6%	0.5%	0.5%	0.5%	0.5%	0.5%	0.5%	0.5%
Other non-interest income	0.3%	0.2%	0.2%	0.2%	0.3%	0.4%	0.2%	0.1%	0.5%	-0.2%	0.0%	0.2%	0.2%	0.2%	0.2%
Operating revenues	**3.8%**	**3.4%**	**3.3%**	**2.8%**	**2.7%**	**2.6%**	**2.6%**	**2.5%**	**2.8%**	**2.0%**	**2.2%**	**2.4%**	**2.5%**	**3.1%**	**2.6%**
Operating expenses	-1.1%	-1.1%	-1.1%	-1.0%	-1.1%	-1.0%	-0.9%	-1.0%	-1.1%	-1.1%	-1.0%	-1.0%	-1.0%	-1.1%	-1.1%
Pre-Provision Profits	**2.7%**	**2.4%**	**2.3%**	**1.8%**	**1.6%**	**1.6%**	**1.6%**	**1.5%**	**1.6%**	**0.9%**	**1.2%**	**1.4%**	**1.5%**	**2.1%**	**1.5%**
Loan loss provision	-0.7%	-0.8%	-0.8%	-0.4%	-0.1%	-0.1%	0.0%	0.0%	-0.3%	0.0%	0.0%	-0.1%	0.0%	-0.4%	-0.2%
Other provisions	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Operating profits	**2.0%**	**1.6%**	**1.4%**	**1.4%**	**1.5%**	**1.6%**	**1.6%**	**1.5%**	**1.3%**	**0.9%**	**1.2%**	**1.3%**	**1.4%**	**1.6%**	**1.3%**
Others	0.0%	0.0%	0.0%	0.0%	0.1%	0.0%	0.1%	0.3%	-0.3%	0.1%	0.1%	0.0%	0.0%	0.0%	0.0%
Associates profits	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.1%	-0.1%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Other non-operating income	0.0%	0.1%	0.0%	0.0%	0.1%	0.0%	0.1%	0.2%	-0.2%	0.1%	0.1%	0.0%	0.0%	0.0%	0.0%
Profit before tax	**2.0%**	**1.6%**	**1.4%**	**1.4%**	**1.6%**	**1.6%**	**1.7%**	**1.8%**	**1.0%**	**1.0%**	**1.3%**	**1.4%**	**1.5%**	**1.7%**	**1.3%**
Tax	-0.3%	-0.2%	-0.2%	-0.2%	-0.3%	-0.3%	-0.3%	-0.2%	-0.1%	-0.2%	-0.2%	-0.2%	-0.2%	-0.2%	-0.2%
Profit after tax	**1.7%**	**1.4%**	**1.2%**	**1.2%**	**1.3%**	**1.4%**	**1.5%**	**1.6%**	**0.8%**	**0.9%**	**1.1%**	**1.2%**	**1.2%**	**1.4%**	**1.1%**
Minority interests	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
ROA	**1.7%**	**1.4%**	**1.2%**	**1.2%**	**1.3%**	**1.4%**	**1.5%**	**1.6%**	**0.8%**	**0.9%**	**1.1%**	**1.2%**	**1.2%**	**1.4%**	**1.1%**
Leverage	10.2	9.8	9.6	11.9	13.8	13.5	13.7	14.2	13.5	12.3	11.6	11.1	10.6	11.8	12.3
ROE	**17.6%**	**13.9%**	**11.9%**	**14.1%**	**18.6%**	**18.2%**	**20.1%**	**22.0%**	**11.4%**	**10.5%**	**12.5%**	**12.8%**	**13.1%**	**16.7%**	**13.1%**
Risk free rate															4%
Risk premium															5%
Beta															0.94
COE															**8.7%**
Long term growth rate															5%
Fair value PB															**2.2**
2010E book value per share															47.1
Fair value (HK$)															**104**

Source: Company data, Nomura research

Financial statements

Profit and Loss (HK$mn)					
Year-end 31 Dec	FY08	FY09	FY10F	FY11F	FY12F
Interest income	5,829	3,933	4,279	4,650	5,121
Interest expense	(3,385)	(1,473)	(1,567)	(1,799)	(2,036)
Net interest income	**2,445**	**2,460**	**2,712**	**2,851**	**3,085**
Net fees and commissions	706	662	711	791	887
Trading related profits	602	(300)	(65)	254	274
Other operating revenue	32	31	23	25	28
Non-interest income	**1,340**	**393**	**670**	**1,070**	**1,188**
Operating income	**3,785**	**2,853**	**3,382**	**3,922**	**4,273**
Depreciation	(105)	(127)	(134)	(140)	(147)
Amortisation					
Operating expenses	(1,456)	(1,444)	(1,423)	(1,530)	(1,619)
Employee share expense					
Op. profit before provisions	**2,224**	**1,281**	**1,826**	**2,252**	**2,507**
Provisions for bad debt					
Other provision charges					
Operating profit	**1,780**	**1,228**	**1,826**	**2,168**	**2,428**
Other non-operating income					
Associates & JCEs	(156)	38	20	24	29
Pre-tax profit	**1,624**	**1,267**	**1,846**	**2,192**	**2,457**
Income tax	(201)	(227)	(309)	(355)	(396)
Net profit after tax	**1,422**	**1,040**	**1,536**	**1,837**	**2,060**
Minority interests	1	(2)	(3)	(4)	(4)
Other items					
Preferred dividends					
Normalised NPAT	**1,423**	**1,037**	**1,533**	**1,834**	**2,056**
Extraordinary items	(261)	167	110	50	50
Reported NPAT	**1,162**	**1,205**	**1,643**	**1,884**	**2,106**
Dividends	(313)	(207)	(357)	(507)	(679)
Transfer to reserves	**849**	**998**	**1,286**	**1,376**	**1,427**
Valuation and ratio analysis					
FD normalised P/E (x)	20.8	28.5	19.1	16.0	14.3
FD normalised P/E at price target (x)	21.8	29.8	20.0	16.7	14.9
Reported P/E (x)	25.5	24.5	18.0	15.7	14.1
Dividend yield (%)	1.1	0.7	1.2	1.7	2.3
Price/book (x)	2.8	2.4	2.1	1.9	1.7
Price/adjusted book (x)	2.8	2.4	2.1	1.9	1.7
Net interest margin (%)	1.94	1.94	2.03	1.99	2.05
Yield on interest earning assets (%)	4.64	3.11	3.20	3.25	3.40
Cost of interest bearing liabilities (%)	2.74	1.17	1.15	1.25	1.35
Net interest spread (%)	1.89	1.94	2.05	2.00	2.05
Non-interest/operating income (%)	35.4	13.8	19.8	27.3	27.8
Cost to income (%)	41.2	55.1	46.0	42.6	41.3
Effective tax rate (%)	12.4	17.9	16.8	16.2	16.1
Dividend payout (%)	26.9	17.1	21.7	26.9	32.2
ROE (%)	11.4	10.5	12.5	12.8	13.1
ROA (%)	0.85	0.86	1.08	1.16	1.23
Operating ROE (%)	17.5	10.7	13.8	14.7	15.1
Operating ROA (%)	1.30	0.87	1.20	1.33	1.42
Growth (%)					
Net interest income	1.1	0.6	10.3	5.1	8.2
Non-interest income	53.3	(70.7)	70.6	59.8	11.1
Non-interest expenses	19.8	(0.8)	(1.5)	7.5	5.8
Pre-provision earnings	12.0	(42.4)	42.5	23.3	11.3
Net profit	(20.3)	(27.1)	47.8	19.6	12.2
Normalised EPS	(20.4)	(27.1)	47.6	19.6	12.2
Normalised FDEPS	(21.2)	(27.1)	49.0	19.6	12.2

Source: Nomura estimates

Balance Sheet (HK$mn)					
As at 31 Dec	FY08	FY09	FY10F	FY11F	FY12F
Cash and equivalents	26,760	5,412	4,388	1,087	1,632
Inter-bank lending	5,751	6,326	6,959	7,167	7,382
Deposits with central bank					
Total securities	16,588	48,315	39,217	41,184	43,250
Other interest earning assets					
Gross loans	80,477	80,707	100,848	109,922	115,426
Less provisions	(428)	(248)	(201)	(257)	(329)
Net loans	**80,049**	**80,460**	**100,648**	**109,665**	**115,097**
Long-term investments	190	203	213	224	235
Fixed assets	2,179	2,914	3,200	3,360	3,528
Goodwill	-	-	-	-	-
Other intangible assets					
Other non IEAs	2,884	3,494	3,713	3,954	4,218
Total assets	**134,400**	**147,124**	**158,337**	**166,641**	**175,343**
Customer deposits	115,168	126,183	135,016	141,766	148,855
Bank deposits, CDs, debentures	309	832	478	478	478
Other interest bearing liabilities	5,430	4,939	5,039	5,039	5,039
Total interest bearing liabilities	**120,908**	**131,953**	**140,532**	**147,283**	**154,371**
Non interest bearing liabilities	2,917	2,778	3,769	3,944	4,128
Total liabilities	**123,825**	**134,731**	**144,301**	**151,227**	**158,499**
Minority interest	18	20	22	25	27
Common stock	295	295	295	295	295
Preferred stock	-	-	-	-	-
Retained earnings	7,158	8,133	9,418	10,794	12,222
Proposed dividends	30	148	269	269	269
Other equity	3,074	3,798	4,032	4,032	4,032
Shareholders' equity	**10,557**	**12,374**	**14,014**	**15,390**	**16,817**
Total liabilities and equity	**134,400**	**147,124**	**158,337**	**166,641**	**175,343**
Non-performing assets (HK$)	*567*	*410*	*390*	*429*	*493*
Balance sheet ratios (%)					
Loans to deposits	69.9	64.0	74.7	77.5	77.5
Equity to assets	7.9	8.4	8.9	9.2	9.6
Asset quality & capital					
NPAs/gross loans (%)	0.7	0.5	0.4	0.4	0.4
Bad debt charge/gross loans (%)	0.55	0.07	-	0.08	0.07
Loss reserves/assets (%)	0.32	0.17	0.13	0.15	0.19
Loss reserves/NPAs (%)	75.6	60.4	51.5	60.0	66.7
Tier 1 capital ratio (%)	8.4	10.7	11.1	11.4	11.7
Total capital ratio (%)	15.4	17.8	18.0	17.7	17.6
Growth (%)					
Loan growth	7.2	0.5	25.1	9.0	5.0
Interest earning assets	(2.0)	31.9	8.7	7.6	4.9
Interest bearing liabilities	(3.9)	9.1	6.5	4.8	4.8
Asset growth	(3.8)	9.5	7.6	5.2	5.2
Deposit growth	1.1	9.6	7.0	5.0	5.0
Per share					
Reported EPS (HK$)	3.9	4.0	5.5	6.3	7.1
Norm EPS (HK$)	4.8	3.5	5.1	6.2	6.9
Fully diluted norm EPS (HK$)	4.8	3.5	5.2	6.2	7.0
DPS (HK$)	1.1	0.7	1.2	1.7	2.3
PPOP PS (HK$)	7.5	4.3	6.1	7.6	8.4
BVPS (HK$)	35.8	41.9	47.5	52.2	57.0
ABVPS (HK$)	35.8	41.9	47.5	52.2	57.0
NTAPS (HK$)	35.8	41.9	47.5	52.2	57.0

Source: Nomura estimates

Analyst Certification

We, Lucy Feng and Daniel Shum, hereby certify (1) that the views expressed in this Research report accurately reflect our personal views about any or all of the subject securities or issuers referred to in this Research report, (2) no part of our compensation was, is or will be directly or indirectly related to the specific recommendations or views expressed in this Research report and (3) no part of our compensation is tied to any specific investment banking transactions performed by Nomura Securities International, Inc., Nomura International plc or any other Nomura Group company.

Issuer Specific Regulatory Disclosures

Mentioned companies

Issuer name	Ticker	Price	Price date	Stock rating	Sector rating	Disclosures
Bank of East Asia	23 HK	33.55 HKD	03-Mar-2011	Suspended		
BOC Hong Kong (Holdings)	2388 HK	24.70 HKD	03-Mar-2011	Suspended		4,58
Dah Sing Financial	440 HK	52.00 HKD	03-Mar-2011	Suspended		
Hang Seng Bank	11 HK	124.80 HKD	03-Mar-2011	Suspended		8,48
Wing Hang Bank	302 HK	99.4 HKD	03-Mar-2011	Suspended		

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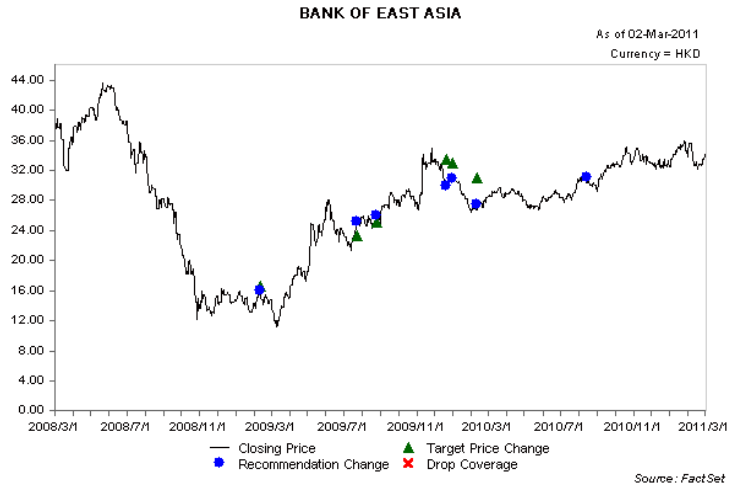
Previous Rating

Issuer name	Previous Rating	Date of change
Bank of East Asia	Neutral	17-Aug-2010
BOC Hong Kong (Holdings)	Buy	17-Aug-2010
Dah Sing Financial	Buy	17-Aug-2010
Hang Seng Bank	Neutral	17-Aug-2010
Wing Hang Bank	Buy	17-Aug-2010

Bank of East Asia (23 HK) **34.00 HKD (04-Mar-2011)** Suspended

Rating and target price chart (three year history)

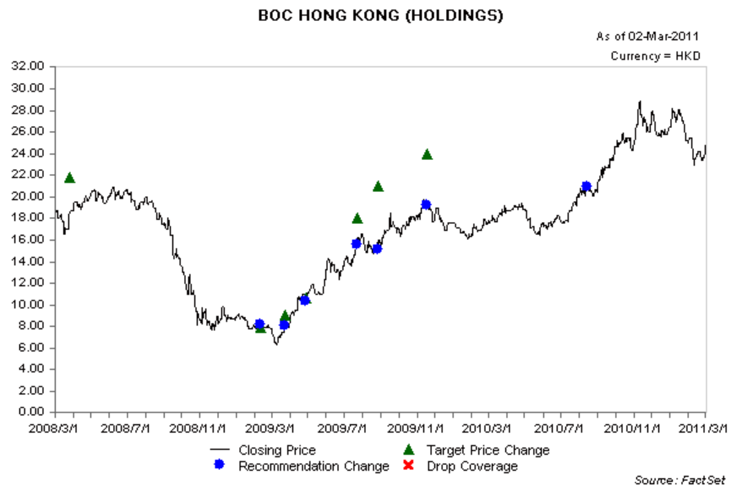


Date	Rating	Target price	Closing price
16-Aug-2010	Suspended		31.00
11-Feb-2010		31.00	27.50
31-Dec-2009		33.00	30.85
21-Dec-2009		33.55	29.90
26-Aug-2009		25.15	26.00
23-Jul-2009		23.35	25.10
11-Feb-2009		16.60	15.96
11-Feb-2009	Neutral		15.96

For explanation of ratings refer to the stock rating keys located after chart(s)

BOC Hong Kong (Holdings) (2388 HK) **24.90 HKD (04-Mar-2011)** Suspended

Rating and target price chart (three year history)

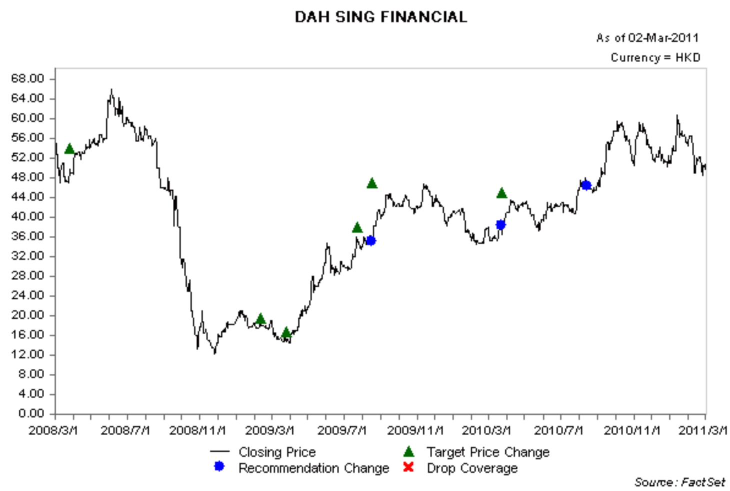


Date	Rating	Target price	Closing price
16-Aug-2010	Suspended		20.85
19-Nov-2009		24.00	19.14
27-Aug-2009		21.00	15.12
23-Jul-2009		18.00	15.54
23-Jul-2009	Buy		15.54
28-Apr-2009		10.65	10.36
25-Mar-2009		9.00	8.08
11-Feb-2009		7.95	8.17
11-Feb-2009	Neutral		8.17
26-Mar-2008		21.83	18.54

For explanation of ratings refer to the stock rating keys located after chart(s)

Dah Sing Financial (440 HK) **50.70 HKD (04-Mar-2011)** Suspended

Rating and target price chart (three year history)

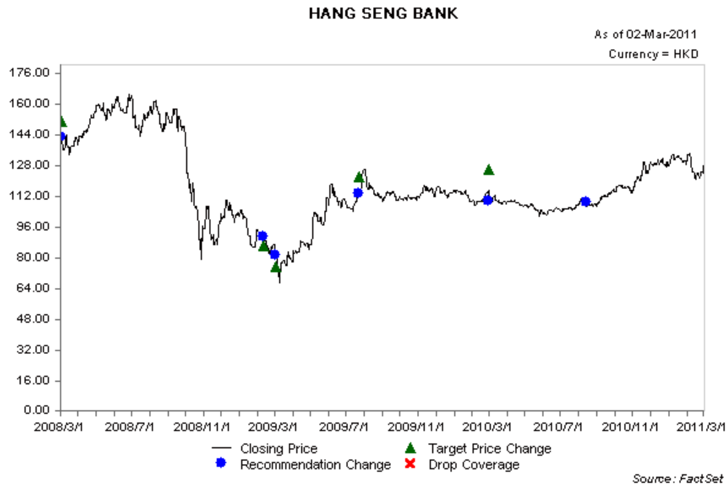


Date	Rating	Target price	Closing price
16-Aug-2010	Suspended		46.33
25-Mar-2010		45.00	38.29
17-Aug-2009		47.00	35.03
17-Aug-2009	Buy		35.03
23-Jul-2009		38.00	35.18
26-Mar-2009		16.85	14.72
11-Feb-2009		19.50	18.36
26-Mar-2008		53.90	49.58

For explanation of ratings refer to the stock rating keys located after chart(s)

Hang Seng Bank (11 HK) **126.10 HKD (04-Mar-2011)** Suspended

Rating and target price chart (three year history)



Date	Rating	Target price	Closing price
16-Aug-2010	Suspended		108.50
02-Mar-2010		126.00	109.00
23-Jul-2009		122.00	113.20
23-Jul-2009	Neutral		113.20
03-Mar-2009		75.00	81.30
11-Feb-2009		86.00	90.95
11-Feb-2009	Reduce		90.95
04-Mar-2008		150.60	142.30

For explanation of ratings refer to the stock rating keys located after chart(s)

Wing Hang Bank (302 HK) **100.60 HKD (04-Mar-2011)** Suspended

Rating and target price chart (three year history)

Date	Rating	Target price	Closing price
16-Aug-2010	Suspended		80.15
23-Jul-2009		90.00	70.40
13-Mar-2009		50.00	35.65
11-Feb-2009		52.00	40.85
18-Mar-2008		116.20	104.60
18-Mar-2008	Buy		104.60

For explanation of ratings refer to the stock rating keys located after chart(s)

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Conflict-of-interest disclosures

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As at 31 December 2010.
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STOCKS

A rating of '**Buy'**, indicates that the analyst expects the stock to outperform the Benchmark over the next 12 months.
A rating of '**Neutral'**, indicates that the analyst expects the stock to perform in line with the Benchmark over the next 12 months.
A rating of '**Reduce'**, indicates that the analyst expects the stock to underperform the Benchmark over the next 12 months.
A rating of '**Suspended'**, indicates that the rating and target price have been suspended temporarily to comply with applicable regulations and/or firm policies in certain circumstances including when Nomura is acting in an advisory capacity in a merger or strategic transaction involving the company.
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Explanation of Nomura's equity research rating system for Asian companies under coverage ex Japan published from 30 October 2008 and in Japan from 6 January 2009

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Explanation of Nomura's equity research rating system for Asian companies under coverage ex Japan published prior to 30 October 2008

STOCKS

Stock recommendations are based on absolute valuation upside (downside), which is defined as (Fair Value - Current Price)/Current Price, subject to limited management discretion. In most cases, the Fair Value will equal the analyst's assessment of the current intrinsic fair value of the stock using an appropriate valuation methodology such as Discounted Cash Flow or Multiple analysis etc. However, if the analyst doesn't think the market will revalue the stock over the specified time horizon due to a lack of events or catalysts, then the fair value may differ from the intrinsic fair value. In most cases, therefore, our recommendation is an assessment of the difference between current market price and our estimate of current intrinsic fair value. Recommendations are set with a 6-12 month horizon unless specified otherwise. Accordingly, within this horizon, price volatility may cause the actual upside or downside based on the prevailing market price to differ from the upside or downside implied by the recommendation.
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A '**Buy'** recommendation indicates that upside is between 10% and 20%.
A '**Neutral'** recommendation indicates that upside or downside is less than 10%.
A '**Reduce'** recommendation indicates that downside is between 10% and 20%.
A '**Sell'** recommendation indicates that downside is more than 20%.

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A '**Bullish'** rating means most stocks in the sector have (or the weighted average recommendation of the stocks under coverage is) a positive absolute recommendation.
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