

## Bank of East Asia Ltd.

Monday, April 14, 2014

### New issue highlight

Bank of East Asia Ltd (“BEA”) announced a USD benchmark size 3-year senior unsecured bond issue with initial price guidance at T3+185bp. The Moody’s and S&P ratings of the proposed 2017 issue are expected to be A2/negative and A/stable, respectively.

Total order book is in excess of US\$1.25bn as of London open.

### New issue view

**At initial price talk of T3+185bp, the new BNKEA’17 offers a decent 44bp additional pickup over BCHINA 2.125% 2017, in our view. We see fair value around T3+160-170bp.** We believe an additional 20-30bp should be adequate for BEA’s smaller size and 1 notch lower rating than Bank of China Hong Kong (“BOCHK”), which is also observed in the outstanding 2020 LT2 bonds of BCHINA and BNKEA. Using the BCHINA’s senior 2017 to LT2 5.55% 2020 ASW spread multiple of c.1.52x as a very rough guide, we derived the fair value of the BNKEA 3-year senior bond to be about T3+167bp (154bp ASW/Z+157bp) with the indicative price of BNKEA 6.125% 2020 LT2 bond at 110.14 bid (234bp ASW/Z+230bp). Furthermore, we note that BEA’s FY2013 credit metrics is relatively at par with BOCHK with the former’s stable asset quality, good liquidity and satisfactory capital position and improving profitability.

**Compared to CCB Asia’s 2.375% 2017 senior bond, we believe the new BNKEA 2017 issue should trade flat with the former.** While a 5-10bp additional spread may compensate for the potential support from CCB Asia’s state-owned parent entity China Construction Bank at times of distress, we also take in account BEA’s better profitability, LDR and bigger presence in Hong Kong. (Please refer to Table 2 on page 4 for more details.)

Key risks to our pricing thoughts are significant price tightening and issue size.

Table 1: Summary of peers’ indicative pricing

Senior bonds	Issue Size (in mn)	S&P/Moody's/ Fitch	Bid price	T3 + spread (bid, bp)
BCHINA 2.125% 23/01/2017	US\$750	NR/A1/A	99.80	141
CCB 2.375% 01/04/2017	US\$300	NR/A2/A	99.95	160
BOCOM 2.125% 15/01/2017	US\$700	A-/NR/NR	99.90	137
ICBCAS 2.1% 03/03/2017	US\$750	A/A1/NR	99.39	153

Source: OCBC, Bloomberg Finance LP

### Neutral

S&P: A Outlook: Stable  
 Moody's: A2 Outlook: Neg  
 Fitch: NR Outlook: NR

Ticker: **BNKEA**

#### Treasury Advisory

#### Corporate FX & Structured Products

Tel: 6349-1888 / 1881

#### Fixed Income & Structured Products

Tel: 6349-1810

#### Interest Rate Derivatives

Tel: 6349-1899

#### Investments & Structured Products

Tel: 6349-1886

Marie-Anne Garcia

+65 6530 7348

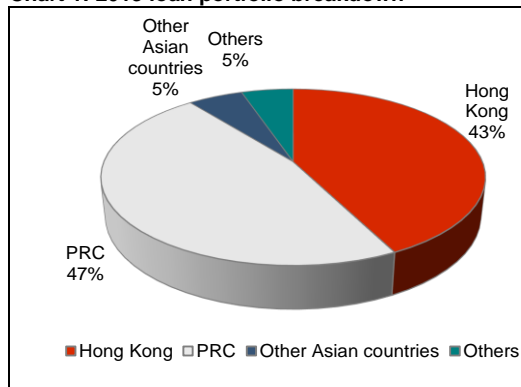
[MarieAnneGarcia@ocbc.com](mailto:MarieAnneGarcia@ocbc.com)

## Background

BEA is the 4<sup>th</sup> largest bank and the largest independent local bank in Hong Kong in terms of assets. BEA has one of the most extensive branch networks among foreign banks in China with a total of 128 outlets as of end-2013.

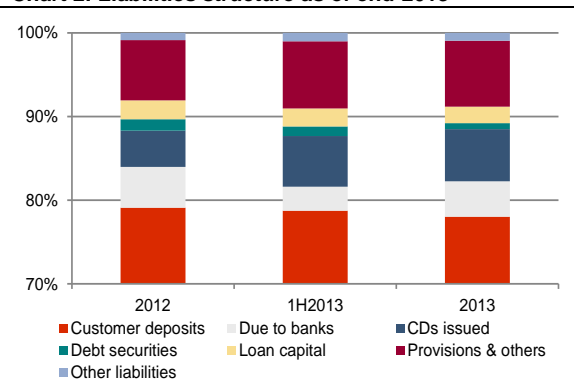
The bank has a market capitalization of HK\$76.2bn as of 14<sup>th</sup> April 2014. The 3 top shareholders of BEA are Caixabank (17.05% stake), Guoco Management Co Ltd (14.59%) and Sumitomo Mitsui Financial Group (9.09%) as of 2<sup>nd</sup> April 2014.

Chart 1: 2013 loan portfolio breakdown



Source: Company

Chart 2: Liabilities structure as of end-2013



Source: Company

## Key credit highlights

- Solid 2013 results on NIM expansion:** BEA posted a net profit of HK\$6.7bn (up 9% y/y). PPOP grew a 20.1% y/y as net interest income grew 25.1% y/y on NIM expansion to 1.90% (+23bp y/y) following better funding costs and satisfactory loan growth. The bank's non-interest income modestly dropped (-5.5% y/y) as lower trading income and weaker investment portfolio performance had offset robust fee income growth (+18.1% y/y). Nonetheless, efficiency improved with cost-income ratio declining from 57.7% in FY2012 to 55.5% in 2013 amidst a modest branch expansion in China. Although impairment losses related to loans more than doubled y/y to HK\$458mn, credit costs remained low at 14bp for 2013. For 2014, Mainland China has been and will remain a key focus for the group. Management intends to continue its growth strategy by focusing on its cross-border business. Leveraging on its China and international network, BEA intends to capture opportunities arising from RMB internationalization policy developments. The group also maintains its optimistic outlook for offshore financing demand from Mainland China enterprises. We note that the group's China operations reported a profit before tax of HK\$2.8bn (BEA China's 2013 net profit: HK\$1.9bn), contributing roughly 30% of the group's total profit before tax.
- Steady funding and liquidity position:** The bank continues to fund its assets mostly by customer deposits (c.70.9% of 2013 total assets) given the BEA's solid retail base. Despite posting a higher LDR of 75.6% in 2013 following the 15.6% y/y loan growth, liquid assets remained adequate to cover its short-term liquidity needs with average liquidity ratio steady at 47%. The bank has a relatively smaller branch network in China compared to other large banks, which in turn limits its retail deposit base. Nonetheless, BEA China's LDR stood at 68.1%, lower than the 73% previously reported as of end-2012. Apart from deposits, the bank's funding is further diversified by CDs, debt securities and subordinated debt.

- **Manageable asset quality but remains vulnerable due to loan book exposure to China:** Total NPL grew 38.9% in 2013, mainly driven by the impaired loans in China. Nonetheless, the bank's overall NPL ratio stood at a low level of 0.4%. NPL coverage ratio also declined from 80.8% in FY2012 to 64.6% in 2013 as total impairment allowance only increased by 11.2%. BEA China's loan book continued its pace of growth in FY2013, growing 25.3% y/y, and comprised 47% of the bank's total loans. Meanwhile, China's total NPL, accounted for 53.1% of the bank's total NPL. Amidst the growing pressures due to slowing growth, over-capacity and excessive lending in some sectors, BEA China's NPL ratio remained low at 0.4% while its coverage ratio slipped lower to 56.5% from 77.5% in FY2012. We note that China's loan book is largely skewed towards large and mid-sized corporate lending (i.e., local private enterprises account for 49% of total). In terms of industry breakdown, BEA China's loan portfolio is mainly exposed to property development and investment and wholesale and retail trading segments (i.e., aggregate 52% of total). That said, BEA's asset quality may be adversely affected should local environment and global demand conditions severely deteriorate, in our view.
- **Adequate capital buffer:** Under the newly implemented Basel III capital rules and using the IRB approach, BEA reported a CET1 ratio of 11.4% while total CAR and Tier 1 ratio improved by 140bp and 160bp, respectively, respectively. As of end- 2013, outstanding capital instruments amounted to HK\$13.6bn with maturity dates still in 2020 and 2022. While current capitalization appears sufficient, a rapid growth/higher risks undertaken and/or any severe asset quality deterioration may ensue the need to prudently provide additional capital.

Table 2: Creditstats

Year ended 31 <sup>st</sup> December	BEA				BOCHK	CCB Asia
	FY2011	FY2012	1HFY2013	FY2013	FY2013	1HFY2013
<b>Income Statement (HK\$ mn)</b>						
Net interest Income	9,263.0	9,724.0	5,664.0	12,167.0	26,002.0	1,238.8
Non-interest Income	3,452.0	5,385.0	2,656.0	5,086.0	12,826.0	408.5
Operating expense	7,992.0	8,725.0	4,507.0	9,583.0	11,845.0	869.5
PPOP	4,723.0	6,384.0	3,813.0	7,670.0	26,983.0	777.8
Provisions	135.0	265.0	183.0	527.0	737.0	12.0
Other Income	1,163.0	1,446.0	756.0	1,343.0	299.0	11.5
Pre-tax income	5,751.0	7,565.0	4,386.0	8,486.0	26,545.0	777.4
Income taxes	1,300.0	1,411.0	956.0	1,779.0	4,630.0	132.0
Net income	4,451.0	6,154.0	3,430.0	6,707.0	21,915.0	645.4
<b>Balance Sheet (HK\$ bn)</b>						
Total Assets	611.4	692.1	697.4	754.0	1,969.8	220.5
Total Loans (net)	314.3	349.8	382.3	404.3	924.9	170.0
Total Loans (gross)	315.3	350.7	383.2	405.4	929.1	170.4
Total NPLs	1.5	1.1	1.4	1.6	2.4	0.2
Overdue over 3 months	0.3	0.7	0.9	0.9	0.7	0.1
Total Allowance	1.0	0.9	1.0	1.0	4.2	0.5
Total Deposits	467.4	498.8	498.0	535.0	1,329.4	122.3
Total Equity	52.0	61.6	64.9	68.2	145.9	18.6
<b>Key ratios</b>						
NIM	1.75%	1.67%	1.83%	1.90%	1.68%	1.34%
Cost-income ratio	62.9%	57.7%	54.2%	55.5%	30.5%	52.8%
LDR	67.3%	70.1%	76.8%	75.6%	69.6%	139.0%
LDR (reported)	67.2%	66.7%	71.4%	70.1%	64.6%	98.4%
Average liquidity ratio	42.8%	46.6%	46.6%	47.0%	37.9%	50.2%
NPL ratio	0.5%	0.3%	0.4%	0.4%	0.3%	0.1%
Allowance/NPLs	65.6%	80.8%	68.4%	64.6%	174.1%	267.0%
Credit costs	0.0%	0.1%	0.1%	0.1%	0.1%	0.0%
Total Equity/Total Assets	8.5%	8.9%	9.3%	9.1%	7.4%	8.4%
CE Tier 1 capital ratio	na	na	10.4%	11.4%	10.6%	13.3%
Tier 1 capital ratio	9.4%	10.7%	11.1%	12.1%	10.7%	13.3%
Total CAR	13.7%	14.3%	14.8%	15.9%	15.8%	14.5%
ROE	8.6%	10.0%	10.6%	9.8%	15.0%	3.5%
ROA	0.7%	0.9%	1.0%	0.9%	1.1%	0.3%

Source: Company, OCBC estimates

This publication is solely for information purposes only and may not be published, circulated, reproduced or distributed in whole or in part to any other person without our prior written consent. This publication should not be construed as an offer or solicitation for the subscription, purchase or sale of the securities/instruments mentioned herein. Any forecast on the economy, stock market, bond market and economic trends of the markets provided is not necessarily indicative of the future or likely performance of the securities/instruments. Whilst the information contained herein has been compiled from sources believed to be reliable and we have taken all reasonable care to ensure that the information contained in this publication is not untrue or misleading at the time of publication, we cannot guarantee and we make no representation as to its accuracy or completeness, and you should not act on it without first independently verifying its contents. The securities/instruments mentioned in this publication may not be suitable for investment by all investors. Any opinion or estimate contained in this report is subject to change without notice. We have not given any consideration to and we have not made any investigation of the investment objectives, financial situation or particular needs of the recipient or any class of persons, and accordingly, no warranty whatsoever is given and no liability whatsoever is accepted for any loss arising whether directly or indirectly as a result of the recipient or any class of persons acting on such information or opinion or estimate. This publication may cover a wide range of topics and is not intended to be a comprehensive study or to provide any recommendation or advice on personal investing or financial planning. Accordingly, they should not be relied on or treated as a substitute for specific advice concerning individual situations. Please seek advice from a financial adviser regarding the suitability of any investment product taking into account your specific investment objectives, financial situation or particular needs before you make a commitment to purchase the investment product.

OCBC and/or its related and affiliated corporations may at any time make markets in the securities/instruments mentioned in this publication and together with their respective directors and officers, may have or take positions in the securities/instruments mentioned in this publication and may be engaged in purchasing or selling the same for themselves or their clients, and may also perform or seek to perform broking and other investment or securities-related services for the corporations whose securities are mentioned in this publication as well as other parties generally.

Co.Reg.no.:193200032W