Transcript of Analyst Briefing for Annual Results 2018

Part 1: 2018 Annual results presentation

Chief Executive Gao Yingxin

Good afternoon, ladies and gentlemen. Before we start, I am pleased to introduce our new Deputy Chief Executives. They are Madam Wang Qi, our DCE overseeing Legal, Compliance and Operational Risk Management, as well as Economics and Strategic Planning, and Mr. Wang Bing, our DCE overseeing the Corporate Banking. Both of them have worked with BOC for many years, and have strong banking experiences. I believe that they will make a great contribution to promote our long-term sustainable growth. Now, I will give our strategic review for 2018.

In 2018, the global economy continued a mild recovery, but regional economies became more diverged. Against this backdrop, we continued to pursue our strategic goal of building a top-class, full-service and internationalised regional bank. We actively responded to market changes, and firmly pushed forward our business priorities, therefore enhancing our high-quality development and achieving a healthy financial performance.

In 2018, our profit attributable to equity holders grew to HK$32 billion, up 12% compared with profits from continuing operations in 2017. Our ROE improved by 73 basis points to 12.83%. The Board recommended a final dividend of HK$0.923 per share for 2018. Including the interim dividend, our full year dividend would be HK$1.468 per share, an increase of HK$7 cents per share from the previous year. Our dividend payout ratio is 48.5%.

In 2018, we continued to maintain our edge in key areas, and further strengthened our market position. Our personal customer structure was optimised, with 27.3% growth in private banking clients, and 17.5% growth in mid-to-high end customers. The number of small enterprise customers with Business Integrated Accounts increased by 15.7%. We also maintained our leading market position in the residential mortgage business.

We remained the top mandated arranger in the Hong Kong and Macao syndicated loan market for the 14th consecutive year and maintained our top ranking in IPO receiving bank business for eighth years in a row. Leveraging Hong Kong SAR Government's tax policy for corporate treasury centres, as well as our own competitive advantages, we retained our market leadership in cross-border cash pooling business. We strengthened our institutional business and maintained strong relationships with major central banks, national treasuries and sovereign funds around the globe.

We sharpened our competitive advantage in RMB business. Our RMB clearing volumes accounted for about 75% of the total global offshore RMB clearing volumes in 2018. We were appointed by China Securities Depository and Clearing Company Limited as the sole clearing bank in Hong Kong for H-share full convertibility. We provided 90% of wholesale forex banknotes in Hong Kong and also are a major wholesale forex banknote supplier in the Chinese Mainland. We helped our customers issue green bonds in US dollar, Euro and RMB, accounting for nearly 30% of that issued in Hong Kong in 2018.

Our integrated service capabilities continued to improve. We remained leader in the UnionPay banking card business in Hong Kong. Our custody business achieved an asset size of HK$1.1 trillion. The size of MPF assets managed by BOCI Prudential Trustee increased by 11.6% year on year, while the standard new insurance premium of our BOC Life grew by 8.2% year-on-year.

In February, the "Development Plan for the Greater Bay Area" was unveiled with a clear positioning of the Greater Bay Area.

Hong Kong is one of the most competitive economies in the world. Through opening-up and pursuing system innovation, it can play a valuable role in the Greater Bay Area construction, which will instill new growth impetus in Hong Kong. There will be more opportunities for Hong Kong people and business sectors. In the future, the flow of goods, people, capital and information within the region will become even smoother, creating huge demand for corporate investment, financing, wealth management and cross-border payment. This will bring massive upside for us in the areas of livelihood finance, technology finance and green finance.

BOCHK has fully aligned itself with national strategies, and continued to facilitate Hong Kong's integration into the national development plan. Our role is not just as a player, but also a promoter and an enabler. Focused on resolving the major key obstacles in account opening, payment and wealth management for Hong Kong residents going to the Chinese mainland, we launched compelling products and services, including BOC Dual Currency Card, mutual brand recognition for wealth management customers, cross-border e-payment App, and smart terminal for merchant payment collection. Recently we launched the first Greater Bay Area themed fund product for distribution in Hong Kong and Macao markets. We also obtained regulatory approval and became the first bank in Hong Kong to offer remote account opening service on pilot basis, for customers who need to open a Mainland bank account. Customers can now complete the account opening procedure all in Hong Kong, saving the trouble for them to show up in a BOC mainland branch. This will facilitate greater convenience for Hong Kong people's mobile payment and consumption in the Chinese Mainland.

In 2018, we successfully acquired the business outlets of BOC in Vietnam and the Philippines. Together with the BOC operations we acquired in Laos in this January, our service coverage has now extended to eight Southeast Asian countries.

During the year, we adjusted our regional management model, and further clarified the management mechanism and organisational structure. We strengthened our collaboration and provided great support to our Southeast Asian entities in order to achieve solid and sustainable growth.

The net operating income before impairment allowances of our Southeast Asian entities was HK$2.287 billion, up 27.6% year-on-year. Customer deposits and loans grew by 17.1% and 20% respectively, maintaining relatively high growth pace. Their non-performing loan ratio was 1.14%, down 4 basis points from the end of 2017.

Guided by our customer-centric principle and technology-led strategy, we reshaped our organisational structure and further optimised our innovation mechanisms so as to pursue faster digitalisation.

We stepped up the payment service capability of our credit card business. For personal customers, we launched BoC Pay cross-border e-payment App. It can help satisfy the needs of Hong Kong residents in making small value, high frequency mobile payment both in Hong Kong and across the border. For local merchants, we provide BoC Bill integrated payment collection service that supports a wide range of payment methods including credit card, Alipay, WeChat Pay, UnionPay QR code and FPS. We simultaneously launched our Faster Payment System service with HKMA and have seen a steady increase in both the number of registered customers and transaction volumes.

We continued to deploy technologies such as AI, big data and blockchain in the building of our intelligent platform, data platform and open platform. As the vital part of digital bank strategy, our mobile banking saw an active user growth of 63.5% in the year.

After a year of preparation and diligence, we have officially obtained a virtual bank license. BOCHK, JDD, a subsidiary of Jingdong, and Jardine Matheson, will join hands to form a virtual bank. Its key strategic goal is to achieve “Fintech development, financial inclusion, and better customer experience”. The VB will employ the latest technologies, and integrate the online and offline ecosystem. It will provide user-friendly, convenient and secure financial services to deliver a brand-new customer experience.

In order to ensure our solid operations with customer-centric principle, we continued to enhance our bank culture. We have redefined our values and culture, which are cascaded throughout all aspects of our work, including operating management, customer services, staff relationship, risk management and others. Our values are to respect customers' interests, meet regulatory expectations and support the Group's development strategy.

During the period, we have further enhanced the standards of our risk management, compliance and internal controls, while upgrading our regional risk management system.

Based on our customer-first principle, we streamlined our personal banking structure to generate stronger support from product and channel units. We also further strengthened our capability and responsiveness to meet the diverse needs of customers whenever they visit our branches.

We established our Innovation and Optimisation Centre, which serves as a testing ground and incubator for new innovative projects. Driven by digitalization and using agile management methods, we have sought to speed up innovation of products, services and business, so as to meet the changing demands of customers and respond to a competitive environment.

We constantly adhered to our people-oriented principle, and care deeply about our employees' development. We continued to refine our long-term incentive and restrictive mechanism and pushed forward the implementation of our corporate culture. These efforts will serve as a good foundation across different stages of our long-term sustainable growth.

I will wrap up my strategy review for 2018 here and hand over the stage to Madam Sui Yang, our Chief Financial Officer, to introduce our financial performance in 2018 for you.

Chief Financial Officer Sui Yang

Thank you, Chief Executive Gao.

BOCHK realised satisfactory growth in 2018, with solid financial indicators.

Our profit attributable to equity holders increased 12% year-on-year to HK$32 billion. Our total assets increased 11.4% to HK$3 trillion while our total liabilities increased 11.1% to HK$2.7 trillion.

We maintained good ROA and ROE of 1.16% and 12.83% respectively. During the year, we optimised our capital structure by issuing US$3 billion AT1 capital securities, as well as redeeming US$877 million of our outstanding subordinated notes. Our total capital ratio was 23.1%, up 2.71 percentage points compared with the end of 2017.

As at the end of December, our total customer deposits reached HK$1.9 trillion, up 6.6% from the end of the previous year, notably faster than the market average. Our market share in Hong Kong rose by 0.13 percentage points to 14.21%.

We took various measures to drive deposit growth and optimise our deposit structure, including enhancement to our payroll services, wealth management and integrated payment solutions. Our personal deposits grew by 8.9%, with its proportion of total deposits increasing to 48.9%. We also grasped opportunities arising in the cash management, settlement and custody businesses, as well as from our role serving as the main receiving bank for IPOs, to attract corporate deposits to the Group.

As at the end of December, our total customer loans increased 10.5% to HK$1.3 trillion. Our market share in Hong Kong rose by 0.67 percentage points to 12.64%. Both loans for use in Hong Kong and loans for use outside Hong Kong grew at a relatively rapid pace.

We continued to deliver on our commitment to the local market, and improved our support to commercial customers and small retail enterprises in Hong Kong, by providing convenient and effective financial service solutions. We also enhanced our mortgage services capabilities and achieved steady growth in residential mortgages. By collaborating within BOC Group, we provided a diversified range of financial services to mainland and Hong Kong “Going Global” enterprises, as well as to corporates in Southeast Asia.

We proactively managed our assets and liabilities, and capitalised on the rising trend in market interest rates. As a result, we widened our loan-to-deposit spreads, and achieved a higher average yield on our debt securities investments. The scale of our average interest-earning assets increased steadily, and our asset-liability mix was further optimised. Our net interest income increased by 13.1% year-on-year while our adjusted net interest margin was 1.63%, up 19 basis points year-on-year.

Our net fee and commission income decreased 2.5% year-on-year to HK$11.3 billion, primarily due to lower loan commissions and volatility in capital markets. We focused on the development of mid-to-high-end as well as cross-border customers. Fee income from securities brokerage and insurance businesses increased by 5.5% and 16.6% year-on-year respectively.

Thanks to our integrated business platform, our fee income from traditional business grew by 10.1% year-on-year. We captured market opportunities and achieved steady growth in fee income in credit card, currency exchange, trust and custody, as well as payment services.

Our operating efficiency further improved. While our operating expenses rose by 9.6% year-on-year to HK$15.2 billion, our cost-to-income ratio dropped 0.4 percentage points to 27.9%, consistently lower than the local market average.

Within this, staff costs increased by 9.2%, mainly due to annual salary increment as well as increases in headcount and performance-related payment. Business expenses, including premises and equipment expenses as well as depreciation, increased by 6.8%, mainly due to an increase in expenses on optimisation of system platform and IT infrastructures.

We further enhanced the effectiveness and quality of our risk management, providing a solid bedrock for sustainable development.

The Group's classified or impaired loan ratio was 0.19%, better than the market average. Credit cost was stable. Provision remained sufficient, with our coverage ratio at 227%.

We consistently enhanced our liquidity position. Our average LCR in 2018 was 145.6%, and our net stable funding ratio was above 120%. Both were higher than the regulatory requirements.

This concludes my review of our financial performance. Now I would like to hand back to CE Gao for our key strategic priorities of 2019.

Chief Executive Gao Yingxin

Thank you, CFO SUI.

Looking into 2019, our operating environment remains challenging. At the same time, we also see signs of promise. Specifically, China will further push forward its opening-up policy and supply-side reform. The accelerated development of the Greater Bay Area provides fresh impetus to Hong Kong's economy. Moreover, Hong Kong market still has vast potential demand to be unlocked and served. The Southeast Asian market also has broad prospects for future growth. All of these will bring new business opportunities for us.

In 2019, we will strictly follow our strategic goal and strengthen our execution capability with a customer-centric philosophy.

We will focus on three strategic markets. First, our core market is Hong Kong. We will fully strengthen our foundation in Hong Kong for sustainable development in every aspect. Second, our key market is the Greater Bay Area. We will build up our integrated competitive advantage focusing on livelihood finance. Third, our growth market is Southeast Asia. We will increase our synergy and development quality by adopting differentiated positioning and bespoke strategy for each country.

We will strive to build three strategic capabilities. First, the technology-led capability. We will pursue digital bank transformation by promoting technology innovation, infrastructure construction and application capability. Second, the full service and internationalised service capability. We will strengthen our integrated business platform and leverage our RMB franchise to develop our capability to offer comprehensive and global financial services. Third, the regional management capability. We will further improve our matrix management model and regional management to provide full support to our regional development.

Furthermore, we will establish three cornerstones of our business development. First, we will reform our corporate culture that support our strategies and meet regulatory expectations. Second, we will further improve our risk management system and compliance controls that befit our position as a full-service, internationalised regional bank. Third, we will enhance our human resources management that is strategy-oriented, highly standardised, effective and also in line with market best practice.

In 2019, we will make gradual steps towards our strategic goal supported by our confidence in achieving earnings growth, steady increase in loans and deposits, as well as healthy risk indicators, while always creating greater value for our stakeholders.

That ends our presentation. Thank you. We will now open the Q&A session.

Part 2: Question and answer session of analyst briefing

Gary Lam from HSBC: As you have a T1 capital ratio of 19.76% which is strong versus peers, can you elaborate on your capital deployment plan, in particular, the loan growth strategy or M&A opportunities?

Chief Financial Officer Sui Yang: Last year, we issued US$3 billion AT1 capital securities and redeemed also US$877 million of subordinate loans which were subject to gradual reduction in our capital calculation. Our CET1 ratio was further boosted to 19.8%. Our overall guidance remains unchanged, Given that the regulatory capital requirement continues to increase such as TLAC, and at the same time we see opportunities in our future loan growth and remain open to potential acquisition, we need to keep relatively higher capital level to meet the regulatory requirement and to support our own growth plan.

Chief Executive Gao Yingxin: Three years after BOC implemented its ASEAN integration strategy, BOCHK has made solid progress and will stick to the strategic direction unswervingly. At the same time, our capital strength is critical to support our future growth especially in loans. Southeast Asia sustains favourable economic growth momentum while China is also engaging in many major infrastructure projects there. Investment and trade activities involving Hong Kong customers in the Southeast Asia remain vibrant, implying promising prospects for us. In this connection, we expect to achieve relatively fast loan growth in the region. Therefore, it will also be necessary for us to keep a relatively strong capital position.

Gurpreet Sahi from Goldman Sachs: First, it is on asset quality which seems stable. Do you see any corporate downgrade with respect to your China exposure? And second, given the slowing economic outlook, how does it feed into your provision forecast for 2019?

Chief Credit Officer Stanley Yung: Referring to our non-bank mainland exposure information provided in the appendix of our presentation slides, our non-performing loan ratio was just 0.12%, which was lower than the

Group's average of 0.19%. In terms of credit cost, given the Sino-US trade clash seems easing, if there is no unexpected hiccup, we expect our credit cost to remain similar or close to that of last year.

Winnie WU from Merrill Lynch: Given the prospects for U.S interest rate hike is decreasing, and talks are on lowering rates now. Seeing your strong margins performance in 4Q18, and taking into account the limited upside in interest rates, and the low HIBOR level in January this year, what is your outlook for net interest margin for 2019? Can you shed some light on the recent loan pricing level or trend of time deposit migration?

Chief Financial Officer Sui Yang: The probability for U.S to raise interest rate in 2019 stands very low now. In terms of HIBOR-LIBOR gap, it is still quite large. However, you may also notice that under the normal operation of the HKD Currency Board System, HKMA recently undertook to buy Hong Kong dollar that reduced market liquidity. Our expectation is that the HIBOR-LIBOR gap should normalise but the pace and magnitude will depend on the liquidity condition of HKD.

Our margins increased by 19 basis points in 2018. In 2019, we strive to maintain a relatively stable NIM. In the face of lower possibility for U.S raising rates this year, and expectation of a consistently favourable capital market conditions, CASA deposits may reverse its downtrend shown in 2018. In the first quarter of this year, we took great efforts to grow our CASA deposits. Meanwhile, we will endeavour to maintain a relatively strong loan growth this year. We will proactively manage our asset and liabilities as well as liquidity risk, striving to achieve relatively good performance in our margins this year.

Tian Yafei from Citigroup: As you are the only bank which managed to grow margins in 4Q18 on a sequential basis, which was very difficult given the lower HIBOR levels in the quarter. What is the reason for such a strong margin performance? Another specific question is on the margins reporting. As shown in your 2018 interim and annual results, the gap between your adjusted margin and reported margin seems to be very small now, does it imply that going forward the swap activities will have minimum impact to your margins trend?

Chief Financial Officer Sui Yang: I would like to clarify that swap operations is part of our long-term asset and liability management strategy. We will continue to conduct swap activities in accordance with our asset and liability deployment as well as the deposit business development. We will retain the practice of reporting our margin on both bases. Regarding the sequential improvement in our NIM in 4Q18, we paid close attention to the asset and liability pricing, and strived to enhance margins by improving our loan-to-deposit spread and debt securities yield.

Victor Wang from CICC: My first question is related to your loan growth strategy for Mainland business. Since the disposal of NCB and Chiyu, BOCHK's loan exposure to Mainland has decreased to below 15% in terms of percentage of its total exposure. Given the future development of Greater Bay Area, do you expect any change to your Mainland loan exposure and capital allocation? My second question is on your virtual bank. Given Hong Kong traditionally has been a stable market, what impacts do you see from virtual banks on deposits, products and payment?

Chief Executive Gao Yingxin: Historically our loan exposure to the Chinese Mainland was a small portion of our book, whatever corporate loans or interbank loans, especially given the recent changes in the onshore and offshore interest rate differential, and also due to the capital control. After the unveiling of the Greater Bay Area Development plan, we noticed that the market was actively generating new ideas and proposals on how to support personal and corporate financing, especially for SME. It also includes how to conduct business such as two-way cash pooling and long lending, in particular, the northbound flows from Hong Kong. In the Chinese Mainland, there have been a lot of discussion on how financial service to support real economy, and how to resolve the difficulties of accessing to financing as well as expensive financing.

Despite the liquidity is relatively abundant in the Chinese Mainland, Hong Kong continue to be well positioned given its strong capital base and relatively lower interest rate environment. Therefore in the context of the Greater Bay Area, how to let Hong Kong banks through a well-designed system, to support the real economy of the Chinese Mainland, and satisfy resident's financing needs such as residential mortgage, there are now many ideas and many relevant parties are conducting their study with high hope on it.

Chief Operating Officer Zhong Xiangqun: We are very pleasured to be granted a virtual bank license in the first batch by the HKMA. Simply speaking, virtual bank means financial servicing provided through digital channels, and it has a clear positioning of financial inclusion for retail customers and SME. Due to arrival of the internet era and the rapid growth of e-payment these two trends combined to give rise to the birth of virtual banking services. To this end, HKMA has set three major objectives for virtual bank in Hong Kong: financial inclusion, fintech innovation and enhancing customer experience.

Virtual bank will play a more important role in satisfying financial inclusion needs by offering refined solutions to resolve the major obstacles in banking services. Our virtual bank will adopt a different approach in product, customer, channel, and operation.

As to its operating model, it will be backed by digitalised IT system and risk management structures. Its banking service will be offered totally on line. Target customers will be focused on young customers and small enterprises who will receive better attention and financial services, such as small value lending, small payment and installed payment services tailored for personal customers and the small value financing for online stores. These will require more refined services. We will focus our products to satisfy these scenarios, improve our product model with refined services and enhance customer experience. In terms of customer services, we will expand our scope and provide around the clock service with an internet based model, which will offer more convenient, fun and better customer experience. The differentiated model of our virtual bank will be a good complement to existing banking services, and will remain our development direction in a considerable time period.

Jemmy Huang from JP Morgan: the size of your risk-weight assets was relatively stable while the balances of your average interest earning assets increased by nearly 10%. Were there any model changes or just simply because of a better client loan exposure structure? Your credit cost in 4Q18 actually fell sharply from 3Q18 level, was there any change to your ECL assumptions or just slower loan growth? Can you also provide some color on the Southeast Asian entities in terms of margins and credit cost?

Chief Credit Officer Stanley Yung: The risk-weighted asset calculation is under strict guidance under HKMA, and is not easy for us to change. Simply speaking, the low risk-weighted asset growth was due to our selection of client base with our focus to control RWA growth pace. And this also led to a better ECL charge. Looking back the provision charges in 4Q18 and 3Q18, the major difference lies in the substantially different macroeconomic outlook during 1H18 and 2H18 because of the China-US trade tension issue. The reason for the significant increase in the provision charge in 3Q18 compared with 1H18 was mainly the China-U.S trade friction as well as the update of macro-economic parameters. The relevant impact has been fully reflected in our 3Q18 results, and we did not change the macro-economic parameters of our ECL model in the 4Q18. Unless there is substantial and adverse change, there should not be more implication to our provision charge for 2019.

We did not disclose the credit cost of our Southeast Asian entities. The NPL ratio of our Southeast Asian entities decreased by 4 basis points to 1.14% based on local reporting standards in 2018. Given that we have also made enhancement to their risk management policy, system, credit assessment skills and tools over the last two years during the integration process, we are confident that their asset quality will have room for further improvement in the future.

Chief Financial Officer Sui Yang: The margins of our Southeast Asian entities were higher than the Group's average, and the expansion was also better.