Transcript of Analyst Briefing for Interim Results 2018

Part 1: 2018 Interim results presentation

Chief Executive Gao Yingxin

Good afternoon, ladies and gentlemen. Here I am going to introduce our strategy review in the first half of this year.

During the first half, the global economy continued to recover. The Chinese economy was stable with improvement, while Hong Kong enjoyed a strong economic growth. However, there were still uncertainties within the global economy and financial markets.

Amid a complex and changing economic and financial environment, we earnestly followed BOC group's strategic plan, and worked towards our goal of "Building a Top-class, Full-service and Internationalised Regional Bank". We proactively pushed forward our business focus and made solid progress in our financial performance.

In the first half of 2018, our profit attributable to equity holders increased 17.7% year-on-year to HK$17.5 billion. Total assets and liabilities expanded to HK$2.8 trillion and HK$2.5 trillion respectively. Earnings per share were HK$1.6578. The Board has recommended an interim dividend of 54.5 HK cents per share.

We seized market opportunities, remained committed to the Hong Kong market, and further consolidated our market leadership. Solid progress was made in our regional expansion strategy, with steady growth in Southeast Asian business. Our efforts to achieve integrated development in the Greater Bay Area began to bear fruit. In order to enhance our full-service capabilities, we continued to develop our diversified business platforms. We also accelerated fintech innovation to pursue a digitalisation strategy.

At the same time, we stepped up our efforts to enhance comprehensive risk management and internal control, so as to ensure a balanced, sustainable and high quality growth.

In this January, we completed the acquisitions of the Philippines and Vietnam Businesses of BOC. In the first half, we promoted the integration of the Southeast Asian institutions and improved regional management model. We strengthened the function of business frontlines as SBUs, coordinated the mid-office professional management and local operations to effectively control risk, and centralised bank-wide back-office operations.

Meanwhile, we made steady progress in building our regional management system with respect to mechanisms, culture and staff, and realised stable and healthy growth.

The aggregate net operating income before impairment allowances of our seven Southeast Asian institutions was HK$1.07 billion, up 24.4% year-on-year. Deposits from customers amounted to HK$41.6 billion, up 7.2% from the end of 2017, and advances to customers grew by 11.3% to HK$36.4 billion.

We stuck to a prudent risk management principles and adopted proactive monitoring measures. The NPL ratios of our Southeast Asian institutions outperformed their market averages.

We leveraged our unique competitive advantages and actively developed RMB products and treasury business. Our Manila Branch helped the Central Bank of the Philippines to successfully issue RMB1.46 billion of Panda Bonds in China's interbank bond market.

In line with BOC's strategic plan, we will leverage BOC group's internationalised and diversified advantages, and fully perform our role as the chair of the integrated development committee, seeking to become the first-choice bank in the Greater Bay Area. We will strengthen collaboration with our sister companies and develop products in account management, wealth management and payment for Hong Kong and Macao residents residing in the Greater Bay Area.

We pushed forward cross-border payment to support people's livelihood and their mobile payment needs in the Greater Bay Area, by launching the mobile payment service of BOC PAY and a BOC dual currency card. In addition, we promoted cross-border two-way RMB cash pooling services and helped to enhance the competitiveness of our corporate customers.

We collaborated with BOC Guangdong Branch, Shenzhen Branch and Macau Branch, to provide a unified service and a consistent experience for Wealth Management customers in the Greater Bay Area.

We continued to invest in our diversified business platforms in order to enhance our comprehensive service capabilities. The operating profit of our eight key business platforms grew by 45.3% year-on-year with increased profit contribution to the group.

In our credit card business, cardholder spending and merchant acquiring volume increased by 13% and 19% year-on-year respectively, and we maintained our leading position in UnionPay business in Hong Kong.

In our private banking business, our customer base was up 15% from last year end, and the average AUM increased 41% year-on-year.

BOC Life achieved 35% year-on-year growth in net insurance premium income with its market ranking rising to fourth place in the Hong Kong market as of end of the first quarter.

BOCHK Asset Management proactively explored new markets and its average AUM grew 20% year-on-year.

Our cash management business accelerated the development of its cash pooling and treasury centre businesses. It also successfully launched a global cash management platform and is gradually becoming the first-choice bank for cross-border pooling services.

Our custody business grew its total assets under custody to HK$1.17 trillion and maintained its leading position in “Bond Connect” custody business.

BOCI-Prudential Trustee achieved a 13% year-on-year growth in its MPF-related AUM and a market share of 7.5%.

Po Sang Securities and Futures, our securities brokerage, saw total transaction volumes grow by 83% year-on-year, underpinned by a larger client base, and an expanded range of products and services.

We strived to advance our business through technological development and innovation, and persisted to enhance our fintech competitiveness as part of our wider effort to become a leading digital bank.

We launched brand new version of Smart Mobile Banking in March. It supports fingerprint authentication, facial recognition and mobile token, allowing for higher service efficiency and a better customer experience. The number of active customers using our mobile banking increased 25% compared with last year end with much faster growth seen in our youth customers.

We successfully introduced BOC Pay, the first e-wallet in the Hong Kong market that supports one-stop cross-border QR code payment. It takes care of your consumption payment, bill settlement, small value transfer, cross-border remittance and other simple financial services, offering a seamless, fast and simple mobile payment experience.

We accelerated innovation in online financial services that support people’s day-to-day life. A new generation of iService was introduced. The Science Park Banking Services Centre commenced operations featuring new 24-hour video banking services. These represented our efforts to explore the “bank branch of the future”.

On 1st of April, we completed the integration of core-banking systems of BOC's overseas operations, and ensured a smooth system switchover while maintaining daily normal operations and manageable risk. This further enhanced the technological foundations for our regional development.

We actively promoted the development and application of fintech in Hong Kong's banking sector. We hosted a competition with the title "Future Bank and AI", which was well received by all sectors of the society.

Now, let me end my review of the first half of 2018 here. Next, Madam Sui Yang, our CFO will walk you through our financial performance and numbers.

Chief Financial Officer Sui Yang

Thank you, Chief Executive Gao.

Bank of China Hong Kong further increased its profitability in the first half of 2018, with solid financial indicators.

Our profit attributable to equity holders increased 17.7% year-on-year to HK$17.5 billion. Compared with the end of 2017, total assets increased by 4.7% to HK$2.8 trillion while total liabilities increased 5.0% to HK$2.5 trillion.

We sustained good performance in ROA and ROE, which stood at 1.27% and 14.32% respectively. Our capital adequacy was sufficient, with CET1 capital ratio at 16.62% and total capital ratio at 20.12%.

We adopted a flexible strategy and took various measures to drive deposit growth and optimise our deposit structure. We enhanced our payroll account services and enriched our wealth management solutions. Our personal deposits grew by 5.8% with its proportion of total deposits increasing to 48.5%. We also effectively strengthened business relationships with major central banks, national treasuries and sovereign funds to expand deposit base. At the same time, we leveraged our unique competitive advantages and maintained our leading position as the main receiving bank for IPOs.

As at the end of June, our total customer deposits reached HK$1.9 trillion, up 4.4% from the end of the previous year. This growth rate was notably faster than the market average. Our market share in Hong Kong also rose by 0.37 percentage point to 14.45%.

We continued to deliver our commitment to the local market while collaborating within BOC group, to capture the opportunities arising from the Belt and Road, the Greater Bay Area and Southeast Asia. Our total customer loans increased to HK$1.2 trillion, up 7.3% from the end of 2017. Our market share in Hong Kong rose by 0.21 percentage point to 12.18%.

In terms of composition, our lending to the industrial, commercial and financial sectors in Hong Kong increased by 8.8%, with all key sectors showing favourable growth. We made further efforts to strengthen our services to local industrial and commercial corporates, as well as small business retail customers, resulting in a solid growth in SME loans.

Lending to individuals in Hong Kong increased by 4.0%. During the reporting period, we enhanced the professional services capability of our mortgage business by setting up 6 mortgage centres, therefore maintaining stable growth in residential mortgages.

Loans for use outside Hong Kong continued to grow at a relatively fast pace, increasing 13.1% from last year end.

We proactively managed our assets and liabilities, achieving stable loans-to-deposit spreads, and higher average yield on our debt securities investments. Our net interest income increased by 7.5% year-on-year. Average interest earnings assets grew 14.4% year-on-year to HK$2.4

trillion, with further optimised asset-liability mix. Including the funding income or cost of FX swap contracts, our net interest margin was 1.56%, up 10 basis points year-on-year.

We actively captured market opportunities and diversified our income sources. Net fee and commission income grew steadily by 12% year-on-year to HK$6.5 billion.

Within this, the investment and insurance-related net fee income increased by 46% year-on-year. We intensified our efforts to expand our mid-to-high end and cross-border customer bases while also strengthening products and services. Net fee income from securities brokerage, funds distribution, and insurance increased 62%, 26% and 27% year-on-year, respectively.

Net fee and commission income from traditional business fell 6.2% year-on-year, mainly due to lower loan commissions income on the backdrop of slower loan growth compared with the same period in the previous year. Other fee income businesses largely delivered good performance. Credit card income increased by 5.3% year-on-year, while income from currency exchange, trust and custody services realised notable growth.

Our operating efficiency consistently improved. While our operating expenses did increase by 12.2% year-on-year to HK$7 billion, our cost-to-income ratio stood at 25.4%, thus remaining lower than the local market average.

Within this, staff costs increased by 9.6% mainly due to annual salary increment as well as increases in staff headcount and performance-related remuneration. Business expenses including premises and equipment expenses as well as depreciation, increased by 5.3%, as we kept our investment in enhancing our service capabilities as well as business systems and platforms to support the long term business development.

We continued to strengthen our comprehensive risk management and maintained solid performance in our key risk indicators. The classified or impaired loan ratio was 0.22%, better than the market average. Provision remained sufficient, with our coverage ratio standing at 193%.

We consistently enhanced our liquidity position. Our average LCR in the first half of 2018 was 140.4%, and our net stable funding ratio was above 118%. Both were above regulatory requirements.

This concludes my review of our financial performance. Now I will hand back to Chief Executive Gao.

Chief Executive Gao Yingxin

Thank you, CFO Sui.

Looking into the second half of 2018, we expect the global economy to continue its recovery in a steady manner, despite various uncertainties in the background. In particular, the United States is changing its external trade and investment policies. The threat of de-globalisation has become more severe. The China-U.S. trade dispute may escalate further. At the same time, major developed economies are normalising their monetary policies. This will create more uncertainties in the direction of global capital movements, adding pressure to Hong Kong dollar interest rates.

On the bright side, despite all these uncertainties, the major trend towards economic globalisation remains unchanged. The Chinese economy will continue its growth momentum and Hong Kong is also expected to maintain solid growth. Just as we reach the 40th anniversary of China's national reform and open-up, the Greater Bay Area will kick-start a new stage of development. This will bring about new growth drivers for the Hong Kong economy and huge business opportunities for the banking sector in terms of financial needs related to people's livelihood, innovation, Silkroad area and environmental protection.

In the second half of 2018, we will continue to adhere to our strategic goal of “Building a Top-class, Full-service and Internationalised Regional Bank”.

We will speed up technology innovation and product R&D to pursue digitalisation. We will continue to enhance our growth quality by deepening local market commitment, with focus on enhancing our services for local industrial and commercial customers, as well as individual customers. We will also strengthen our regional development to ensure sustainable growth in our Southeast Asian business, and to make ourselves the first choice for banking customers in the Greater Bay Area. In addition, we will closely monitor the changes in the global economy and financial markets, and continuously enhance our risk management and internal control. We will strive for a stronger bank culture to support balanced and long-term sustainable development. At the same time, we will adhere to a people-oriented principle, reinforce staff support and talent building, undertake our corporate social responsibilities and elevate our brand image.

With the commitment of our entire staff, we are fully confident to achieve stable growth for the whole year, striving to reward our investors, customers, employees and society with outstanding operating results.

This is the end of our presentation. Thank you. We will now open the Q&A session.

Part 2: Question and answer session of analyst briefing

Vincent Gu from CICC

What is the management's view on net interest margin in the second half of 2018 as HIBOR dropped since third quarter? Has RMB depreciation created any negative impact on your offshore loans growth?

Chief Financial Officer Sui Yang

After adjusting for the swap related impacts, our net interest margin for the first half of this year increased by 10 basis points year-on-year. Overall speaking, Hong Kong dollar interest rate is showing a reasonable trend for normalisation, though HIBOR had a moderate correction in third quarter. Higher market interest rates should benefit the net interest margins of banks, but there is still some headwind. Firstly, time deposit migration is increasingly noticeable especially in the U.S. dollar deposit market. This will increase funding cost. Secondly, loan pricing remains under pressure as competition for high quality lending is still keen. In general, our net interest margin will have some pressure in the second half, but we will strive to maintain it at a stable level compared with that of the first half of this year.

We experienced relatively fast loan growth during the first quarter of the year. Taking into account risk appetites and return on risk-weighted assets (RORWA), we adjusted our growth pace during the second quarter. In the second half, our lending strategy will become more selective with a view to growing our income while ensuring quality. We are maintaining our full year loan growth target at high single digit.

Chief Executive Gao Yingxin

The market demand for loans has remained strong so far. There is also a certain level of credit demand from the Mainland. However in light of the uncertainties in the external market, we will pay additional attention on risk control and will properly manage client screening. We will strive to enhance our loan yields amid rising deposit costs. Overall speaking, we do not think demand side is an issue while our growth pace will depend on our own credit expansion strategy.

Tian Yafei from Citigroup

Can the management explain how your margins were impacted by swap business? Besides as Malaysian government has recently suspended some infrastructure projects, how does this affect BOCHK's strategies in "Belt and Road" and Southeast Asian business? Does BOCHK have credit exposure to Country Garden?

Chief Financial Officer Sui Yang

Our business is mainly denominated in U.S. Dollar, HK Dollar and RMB. In our daily liquidity management, when we have excessive liquidity in one currency and shortage in another, we will conduct swap transactions to exchange them for appropriate deployment with a prerequisite that no net currency exposures are created. Based on the relevant accounting standard, the income derived from the assets deployed is booked as interest income and the relevant funding cost as interest expense. The swap income or cost is recognised in net trading income line. In the first half of 2018, our swap income was relatively high while in the first half of 2017, we had a relatively large amount of swap cost. In order to enable easier understanding of the relevant business dynamics, we will continue to disclose the net interest margin on an adjusted basis and wish analysts could help us to explain this when communicating with your clients.

Chief Executive Gao Yingxin

BOCHK proactively supports the Belt and Road initiative while sticking to our prudent principle in risk management and project selection, especially for those large-scale infrastructure projects that require long-term financing and offer lower yield. Usually we are not the major funding provider for those projects, but we do provide a wide range of financial services such as exchange rate value protection, and helping evaluate the legal environment and country risk, etc. At this stage the suspension of the relevant projects has not posed substantial direct impact on us. We will continue to keep a close eye on the development. As to our risk exposure to the real estate enterprises on the Mainland, it is very small.

Anthony Lam from HSBC Securities

As mentioned earlier in this session, time deposit migration is increasingly apparent. If such trend persists, how will it affect your funding cost? As Hong Kong dollar interest rate normalisation has started, when do you expect to raise Hong Kong dollar prime rate? At the same time, will there be any upward pressure on CASA deposit rates, and how will it affect margin trend?

Chief Executive Officer Sui Yang

Time deposit migration trend has become very clear, and it is the major driver for the increase of deposit costs. However as large banks enjoy higher CASA ratios, their margins will stand to benefit from interest rate hikes. We will continue to closely observe market changes and conduct in-depth analysis on the competition strategies with respect to deposit taking of currency types and tenors. Despite time deposit has expanded, as the increase was more supported by personal deposits, this would help us to maintain our liquidity indicators at a stable level.

Deputy Chief Executive Kung Yung Ann Yun Chi

For mortgage, you see that interest rate normalised for the past two years, HIBOR continued to climb steadily, this should have reflected all through the mortgage pricing but except for the Prime cap. So in the middle of August, you noticed that we have increased the Prime cap and also for the Prime rate mortgages, this does not fully reflect the increase in interest rate, but did help pass along some of the increase in cost to the customers. This would help with the continuous growth of our mortgage business in a healthy way. Looking forward, as the Fed rate might have a good chance of increasing in September, the pressure to increase Prime rate in Hong Kong might increase. This would transfer to the entire mortgage base as the Prime cap increases only apply to the new mortgages.

Stanley Cheung from BOCI Prudential

In the context of the Greater Bay Area development, what is the relationship between BOCHK and its parent bank? Is it competitive or collaborative? Besides, does BOCHK have exposure to Turkey?

Chief Executive Gao Yingxin

As to the Greater Bay Area development, BOCHK will fully leverage its role as the chair of BOC's integrated development committee for Guangdong, Hong Kong and Macao, and step up collaboration with its sister companies in the region for better alignment. BOCHK will not set up any operating entity in Guangdong Province, and will cooperate with different BOC's branches within the province. We have recently launched BOC Pay that allows customers to use QR code payment services, and also promoted a unified brand for wealth management business. We will continue to pursue all-round collaboration with BOC, in providing integrated cross-border financial services to customers.

Chief Risk Officer Li Jiuzhong

We have no investment exposure to Turkey. We do have business interactions with some European banks, yet the direct impact on us is immaterial and the risk is manageable.

Cao Zhu from Guotai Junan

What was the impact of RMB depreciation on your business? With the outbreak of trade war, what impact do you expect on Hong Kong's economy and on BOCHK?

Chief Financial Officer Sui Yang

The RMB currency exchange rate was relatively steady amid a volatile trend in the period, which was mild compared to the massive fluctuations after the adjustment made since 11th August 2015. We remain optimistic on the long-term development of RMB business. Currently, we do not have any net position in RMB while our RMB deposits experienced healthy growth in the first half of this year.

Chief Risk Officer Li Jiuzhong

Economic influences of the China-U.S. trade disputes are not only limited to the Chinese export products. The dispute has also undermined investment confidence and created knock-on effects on supply chain and value chain, exacerbating economic volatility and financial market fluctuations. Based on governmental data, the impact of trade dispute on Hong Kong's economy and exports is still controllable at the current stage. Hong Kong is a small open economy and is highly connected with financial markets around the globe. Therefore, we should keep a close eye on the long-term impact arising from it. With respect to its impact on the banking sector, China-U.S trade dispute will create volatility in stocks, commodities, currencies and interest rates. Banks will face challenges in business development and market risk management. According to our stress test, we do not see a material and adverse impact on us at this stage, and risks are still controllable. We will pay close attention to how the trade war evolves and continuously prepare contingency plans so as to minimise its impact.

Alex Zhou from UBS

What are the impacts on BOCHK caused by the change of monetary policies in the Mainland? Do you see any spillover demand from Mainland enterprises? Was your RMB investment affected by lower market interest rates onshore? Moreover what is BOCHK's expectation for loan growth in the long run? What are your strategies or logics to achieve that growth? Lastly, is there any update on the acquisition of BOC's Singapore Branch?

Chief Executive Gao Yingxin

Since the beginning of this year, the Mainland has been stepping up its financial regulations and deleveraging. It has caused a tightening in the credit environment when compared with the previous years. While bank lending increased during the first half of the year, the growth of Total Social Financing moderated. Recently adjustments have been made to Mainland's monetary policy. It has a very clear policy direction with the major objective to support SMEs while guiding bank lending towards real economy. Currently we do not profoundly feel the spillover effect of Mainland's credit demand in Hong Kong. The loan demand remains very strong in Hong Kong but it is mainly driven by local factors.

Chief Financial Officer Sui Yang

Our RMB deposits mainly come from offshore markets and are partially deployed onshore. During the first half of the year, the cost of RMB funding in both offshore and onshore markets were relatively low. It is believed that the spread between onshore and offshore interest rates will not suddenly invert. Under the current circumstances, there will be some impact on the interest spreads between two sides however the degree is insignificant.

Chief Executive Gao Yingxin

Regarding the possibility of BOC Singapore branch acquisition, it involves BOC and BOCHK who are two listed companies, and there is no information for disclosure purpose. We will stick to the relevant Listing Rules and make timely announcement to the public if necessary.