Transcript of Analyst Briefing for 2022 Annual Results

Question and answer session of analyst briefing

Winnie Wu from BOA Merrill Lynch: Recently, there has been market concern that if the risk problem of the US regional banks and Credit Suisse Group will spread to Asia. Has the valuation of BOCHK's bond investments affected the capital or balance sheet? Amid an interest rate hike environment, will asset quality problem arise in Hong Kong or Southeast Asian businesses?

Chief Risk Officer Jiang Xin: A prolonged high interest rate environment has triggered volatility in asset prices in the international financial markets and increasing uncertainty of capital movements. After the introduction of savings protection and liquidity assurance measures by regulators, the market order was gradually restored. Banks in Hong Kong have been pursuing prudent operations principle and maintaining solid capital and liquidity while fulfilling the minimum capital requirement set by the regulator. They also keep necessary operating buffer and have established sophisticated risk management mechanisms. Adhering to the controllable risk principle, BOCHK continued to maintain a good interbank lending business and asset deployment. Currently, most of our exposure are concentrated in Asia region. Major counterparts are large institutions with strong financial strength, solid operations and healthy overall conditions. Therefore, the overall risk is controllable. Moving forward, we will continue to monitor the relevant development and identify any potential risk stemming from a high interest rate environment so as to ensure our solid operations.

Southeast Asian business accounted for a limited proportion of the Group's exposure. Currently, our concern on Southeast Asian asset quality was whether a small number of customers will suffer volatility after the withdrawal of relief measures. Based on our current assessment, individual customers may be subject to asset quality downgrade, but the overall situation is controllable. For 2023, we expect our Southeast Asian asset quality may still face pressure from credit rating downgrade but overall risk is manageable.

Chief Financial Officer Liu Chenggang: Interest rate hike is a double-edged sword. On one hand, it can improve banks' net interest margin (NIM) and net interest income. On the other hand, it may create mark-to-market pressure on the existing asset valuation, which has been shown in the recent risk incidents of the US and European banks. Since early 2022, our bond investment valuation came under pressure due to the rapid increase in market interest rates. Our Board and senior management took it very seriously and implemented a series of forward-looking actions to reduce risk and volatility. In particular, we reduced the size of bond investment portfolio and the scale of credit related bonds. The government bonds accounted for about 3/4 of the total bond investment portfolio. In addition, we also deployed interest rate swap (IRS) instrument. Overall, we effectively managed the interest rate risk and credit risk of our bond investments. As of end of 2022, the overall size of our investments was about HK$1 trillion, accounting for less than 30% of our total assets. The interest income generated from bond investments in the year was HK$21.8 billion, up 58% year-on-year, with investment yield increasing by 73 basis points. The overall duration was further reduced to a level of more than one year including money market investments. At the end of the year, our total capital ratio was 21.56%, up 12 basis points. Overall speaking, we managed to cope with the risk of rapid interest rate hike and at the same time achieved good growth in net interest income.

Looking into 2023, the market is expecting that the interest rate hike cycle of US is nearing the end. We expect that the valuation changes of our bond investment portfolio will stabilize while a high interest rate environment will be favorable to our bond reinvestment returns. In the future, we will continue to match our assets and liabilities and continue to fully leverage our good corporate governance mechanism. While properly managing risk and increase returns, we expect that our bond investment income will continue to grow.

Gary Lam from HSBC: BOCHK reported a dividend payout ratio of 53% for 2022, which was higher than comparable local peers and globally systematically important banks, how will you deploy the capital going forward and how much room is there for higher dividend payout ratio in the future? Separately, Hong Kong has reopened its border with the Mainland and other places around the world, with people flow resuming, how will it help the capital flow, loan demand and wealth management business?

Chief Financial Officer Liu Chenggang: For a long time, BOCHK has been adopting a prudent dividend payout policy and strived to provide long-term stability of shareholder returns. In 2022, we endeavored to grow our profit amid the interest rate hike cycle and reasonably controlled our risk-weighted assets (RWA) scale while enhancing RoRWA (Return on RWA). The Board has proposed a final dividend of HK$0.91. Including the interim dividend, it will take the full-year dividend to HK$1.357, up 20.1% year-on-year with a dividend payout ratio of 53.0%, up 1 percentage point, meeting our goal to create continuous growth in shareholder returns.

Currently, we maintain the dividend payout ratio between 40% and 60%. Going forward. We will consider a number of factors including regulatory requirement, changes in our capital structure, business opportunities and change in risk, so as to maintain an appropriate level of capital ratios. While maintaining a solid capital position to guard against risks, we will strive to increase our earnings and deliver a stable growth of shareholder returns.

Chief Executive Sun Yu: Facing a tough situation in 2022, we proactively made various preparations and captured the policy opportunities of “Interest Rate Swap Connect” and “ETF Connect”. Meanwhile we continued to optimize our products and services as well as basic infrastructure. For example, we successfully helped more than 14,000 Hong Kong customers to update their relevant identity documents and reactivate their mainland bank accounts through BOCHK's offline attestation service or "BOC at Home" WeChat mini-program. We continued to make progress in our Greater Bay Area business development amid a challenging environment. In early 2022, we captured the market opportunities of border reopening between the Mainland and Hong Kong, carried out a series of sales and marketing activities and adhered to a customer-centric principle to build financial service scenarios. Comparing the figures of the first two months of the year with that before the border reopening, we recorded 100% growth in the cross-border payment transaction volume using BoC Pay and 75% growth in the average daily spending volume with BOC Credit Card in the Mainland market. We also saw insurance policy sales to cross-border customers increase by 3 times compared with the first two months of the previous year. In February, the daily average numbers of accounts opened under "GBA Account Opening" service and by cross-border customers increased by 1.4 times and 1.3 times month-on-month, respectively, with cross-border account opening numbers in the first two months already restored to pre-pandemic level, reaching 126% of the base in 2019. These data showed that border reopening has positive impact on our business and brought us development opportunities. Going forward, we will further focus on "improve synergy, innovate products and service, and ensure resource allocation", continuously expand the business scale and market share to consolidate our position as the first-choice of cross-border bank.

For retail banking business, we will drive the development of high-end customers, product innovation, service journey and an integrated collaboration mechanism, focusing on “Wealth Management Connect”, “GBA Account Opening”, “GBA Loan” for mortgages, and three major service scenarios including transportation, shopping and F&B. We will boost cross-border business volume with our payment-service-first strategy and continuously enrich RMB product choices and supporting services so as to build a leading edge in the GBA.

For corporate banking business, we will focus on “cross-border finance” and “green finance” and proactively participate in the relevant construction projects in the region. We will build a one-stop integrated service platform combining our “debt financing, equity financing and capital market” service capabilities to support the development of innovative tech enterprises. We will build a “green plus” product system to meet the demand of GBA customers for green financing and green bond issuance, to expand our green financing business. We will capture business opportunities through various multi-dimensional means.

Deputy Chief Executive Chan Man: In the first two months of the year, we witnessed substantial growth of service demand driven by customer flow. Although we might still face some market challenges this year, overall market sentiment will improve compared with last year. In addition, due to the positive impact of the border reopening, our insurance, trade and settlement, credit card and currency exchange businesses should deliver favorable performance and support fee income growth. Since the beginning of the year, Hong Kong has implemented border reopening in an orderly manner. The number of inbound visitors has markedly increased and the economic and cross-border trade interactions have gradually normalized. We proactively embraced border reopening and achieved growth in the number of new accounts opened by cross-border customers and the cross-border business volume. We also provided comprehensive financial services to customers and assisted them to manage funds movements in and out for their commercial activities. Currently, our business volume growth is normal while we have not seen any abnormal large-sized capital inflows.

Jemmy Huang from JP Morgan: Affected by the macro-environment last year, BOCHK grew loans by only 3.2%, which was slightly lower than the original target of mid-single digit. Witnessing volume rebound in some businesses after the border reopening, what is the loan growth target for this year? Will the drivers come from Hong Kong market, or other regions? Although NPL ratio increased last year, the overall asset quality was better than the local peers. Considering certain macro supportive measures already introduced by the mainland authorities as well as the improvement of the customers' own situation, shall we expect the credit cost to remain relatively stable compared with 2022?

Deputy Chief Executive Xu Haifeng: Global economies experienced downward pressure in 2022, which presented challenges to the operations of banking sector. Hong Kong market's loan balances dropped by 3% for the full year. Meanwhile we proactively coped with the market changes and leveraged our solid customer relationship, diversified business presence and professional service capability. Our customer loans increased by 3.2%, outperforming the market and further enhancing market share. New growth mainly came from quality corporate customers who are risk resilient and from personal mortgage loans, while overall asset quality was better than the market.

For 2023, there are still many uncertainties in the external environment. Nevertheless, China's favorable long-term economic fundamental remains unchanged. In addition, Hong Kong has orderly reopened its border with the world. Corporate investment and trade activities witnessed improvement. New government budget targets to attract investment and capital and strengthen infrastructure construction. All these factors will help speed up the economic recovery of Hong Kong and will also facilitate improvement to the external environment of banks.

In the first quarter of this year, we continued to achieve solid loan growth momentum. Moving forward, we will capture the opportunities in Hong Kong, cross-border GBA, Southeast Asian and other overseas markets. We will focus on market demand, choose quality deals and dynamically adjust our loan growth pace in accordance with the market development, ensuring our loan growth to continue to outperform the market and striving to achieve a mid-single digit expansion.

Specifically, we will continue to deepen our local market commitment, further our customer relationship with local blue chip and industry leading corporates, and provide with them diversified financing solutions. Meanwhile we will also support Hong Kong's development into an international hub for green technologies and finance by enriching our green finance products and services while driving the growth of our green finance. We will deeply participate in the integrated development of the GBA and fully capitalize on the opportunities arising from the financial market connectivity under the 30 financial measures to support Qianhai and meet the cross-border financing and investment demands of corporate and institutional customers with integrated solutions. We will proactively participate in the construction Hong Kong's Northern Metropolis to promote its coordinated development with Shenzhen. We will also actively follow the innovation-driven national development strategy, further enhance our service model by using financial technologies and provide financial support to key customers groups such as technological innovation and high-end manufacturing sectors. We will enthusiastically expand Southeast Asian and overseas markets and capture the RMB internationalization opportunities. By doing so, we strive to maintain a good development in the loan business for this year.

Chief Risk Officer Jiang Xin: As at the end of 2022, our NPL ratio was 0.53%, up 26 basis points from the end of the previous year, which was mainly due to the worsening financial status of individual mainland property customers and the withdrawal of relief policies in some Southeast Asian countries. As a result, we downgraded the relevant customer credit ratings accordingly. Our overall asset quality remained better than the market average in Hong Kong, while there was no systematic risk in our loan portfolio and the credit quality was controllable. Our credit cost for 2022 was 0.15%, up 3 basis points year-on-year. It was mainly attributable to our ECL model review and optimization, parameter updates, provision increases for customers with weak risk resistance ability and low credit rating and credit rating downgrades of certain customers.

For 2023, overall economic fundamental will see favorable changes due to the gradual economic recovery, border reopening and the positive policy signals. However, factors such as the high interest rate environment, geopolitical conflicts and global inflation, will present challenges to banks' risk management. In terms of asset quality, we will pay close attention to those stressful mainland property customers and see if they can recover as expected, and to certain Southeast Asian customers who may struggle to emerge from the post-pandemic environment. Overall, our asset quality risk remains stable and controllable while provisions will continue to be sufficient.

Hou Dekai from CICC: After the risk incidents in the US and European banking sectors, the market increasingly expects the US to stop raising rates or cut interest rates in the second half of this year. How do you see the net interest margin (NIM) performance for 2023 and 2024? With strong deposit competition in the fourth quarter of 2022 which increased deposit cost, where did you see the biggest increase in deposit tenors? In the first quarter of this year, did the deposit competition moderate? How do you see CASA ratio trend going forward?

Chief Financial Officer Liu Chenggang: Generally speaking, interest rate rise is positive to banks. For 2022, our NIM widened by 27 basis points year-on-year with 46 basis point expansion half-on-half in the second half and 11 basis point increase in the fourth quarter comparing with the third quarter. The impact of interest rate rise is very distinctive. Our NIM expansions were driven by market outperformance in terms of loan and deposit growths, a 73 basis point increase in our bond investment yield and 31 basis point increase in our loan-to-deposit spread.

In the fourth quarter of last year, our NIM expanded less due to the market impact as our loan growth slowed while time deposit migration intensified with our CASA ratio falling to 51.7%. However, it was still better than the market in terms of the overall trend.

Currently, the market is having a mixed view on whether the Federal Reserve will increase or decrease interest rate ahead. Although we see some headwinds on our NIM in the first quarter and the first half of this year, it is still difficult to predict if there will be a NIM decline or not in the second half. Since the beginning of this year, Hong Kong dollar interest rate rapidly fell ahead of the US dollar interest rate, which widened the USD-HKD interest rate gap further and created a relatively large impact on our NIM in January and in the first quarter. In addition, time deposit migration continued to strengthen and pushed down our CASA deposits. Meanwhile time deposits increased and tenors lengthened with most increases in 3-month term deposits. It will delay the deposit cost improvement. As Hong Kong market saw loan balances fall by seven consecutive months last year, it will take time to observe the loan demand recovery for this year. On the bright side, the marginal pricing of new deposits fell alongside the market interest rate in January this year, while the market loan growth also rebounded by 1.3%. Both will help generate positive momentum to NIM trend.

Overall speaking, our NIM level will depend on the external environment and the market interest rate movements. It will also be affected by our asset-liability deployment, such as the changes in our loan and deposit mixes. Currently our CASA ratio stood at 51.7% which can positively support our NIM performance. For 2023, we will proactively manage our asset and liability structure, delay the tipping point of net interest margin, and strive to achieve steady growth in net interest income and NIM for the full year.

Sam Wong from Jefferies: BOCHK reported a notable growth in operating expense in the second half of last year, what was the reason? Also, as the Mainland is pushing for SOE on market-cap management and encouraged more dividend payouts and share buyback, what is the view of BOCHK on that?

Chief Financial Officer Liu Chenggang: Effective operating expense management and cost-to-income ratio are always our advantages. Our cost-to-income ratio for 2022 was 31.3%, down 2.16 percentage points, keeping at a level better than local peers. We allocated resources with priority to key projects and business development, such as IT-related investment. Meanwhile we also pursued low-carbon operations, refined branch network layout and adopted refined management to exploit internal resources to support growth. For example, through branch network transformation and streamlined branch expenses, we saved nearly HK$30 million through rental and other expenses. We vigorously promoted the use of e-statements, which now accounted for 75% of all bank statements. At the same time, we managed to save HK$7 million through low-carbon operations efforts. In the second half, the operating expenses increased as we grasped the opportunities from economic recovery, and tailored business layout to prepare ahead of border reopening. These drove up our expenses in human resources, IT investments, publicity and promotions, virus prevention as well as other one-off business expenses.

Looking into 2023, we will adhere to our cost management principle, optimize resource allocation mechanism and enhance the input-output efficiency through digital transformation and smart operation. We will strive to maintain a relatively stable cost-income ratio at the current level and better than local peers. In the long run, we will keep our cost-to-income ratio below 35%.

We will maintain stable dividend payout policy and capital management policy. For the interim dividend of 2023, we will strive to increase earnings capability and balance between shareholder interest maximization and our own long-term development needs, while continuously providing better returns to shareholders.