Asian Banks: Double-Dipping

Looming Recessions Make For Unfavorable Markets

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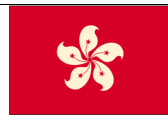
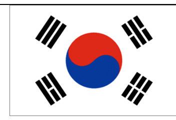
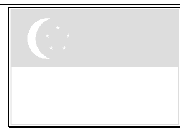
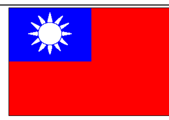
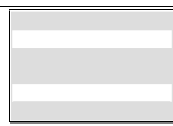
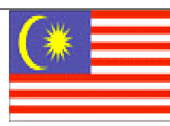
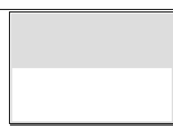
	Hong Kong HSBC ➨ HSB ➨ DSF ➨ DEA ➨ WLB ➨ WHB	Underweight
	South Korea Kookmin ➨ H&CB ➨ Shinhan ➨ Hana ➨ Koram	Overweight
	Singapore DBS ➨ UOB ➨ OCBC	Neutral
	Taiwan Chinatrust ➨ Sinopac ➨ Taishin ➨ UWCCB	Underweight
	Thailand BBL ➨ SCB ➨ TFB ➨ BAY ➨ KTB ➨ TMB ➨ IFCT	Underweight
	Malaysia Maybank ➨ Public Bank ➨ Commerce-Asset	Underweight
	Indonesia BCA ➨ Lippo ➨ Panin	Neutral
	Philippines BPI ➨ EBC ➨ MBT ➨ PNB	Underweight

- We remain UNDERWEIGHT Asian banks and financials as an asset class, despite a fairly severe downward re-rating in share prices over the past nine months. Asian banks continue to have structural problems which keep them from taking advantage of favorable sectors, and the macro-economic environment is becoming less and less supportive.

Inside: Regional Themes and Market Commentary on all Eight Countries

October 29, 2001

http://www.lehman.com

Table of Contents

Except for the con men borrowing money they shouldn't get and the widows who have to visit with the handsome young men in the trust department, no sane person ever enjoyed visiting a bank.

—Martin Mayer, The Money Bazaars

Asian Banks: Double-Dipping

Banking markets in Asia remain structurally challenged, and the current recessionary environment can only exacerbate their existing weakness as an industry. Growth is non-existent outside of Korea (and slowing there), margins are under pressure from competition all around, and banks are still carrying a heavy burden of impaired loans across the region.

Although share prices have come down, fundamentals have deteriorated even more sharply, and so we are maintaining our fundamental UNDERWEIGHT stance on the Asian financial sector.

Figure 1: Market Summary

Market	Weighting
Hong Kong	Underweight
Singapore	Neutral
Korea	Overweight
Taiwan	Underweight
Thailand	Underweight
Malaysia	Underweight
Philippines	Underweight
Indonesia	Neutral

Source: Lehman Brothers

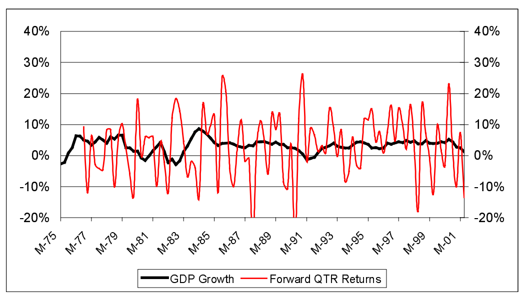
Of our individual covered markets, we remain Overweight only in Korea, albeit with a smaller universe of attractive banks than at the beginning of the year. We are Neutral in Singapore, with only an almost utter collapse in share prices after the summer's consolidation keeping us from an Underweight position, and we have recently lowered our investment recommendation on the Hong Kong banking sector to Underweight.

Of the smaller markets, we are Underweight all save for Indonesia, where we have a Neutral rating.

Wait For The Bottom

From a strategy perspective, the onset of a recession is a poor time to buy financial shares, in large part because the magnitude of the downturn is unknown.

Figure 2: US—GDP Growth versus Financial Sector Returns



Source: Lehman Brothers

Our analysis of GDP growth versus forward quarter financial share returns in the US shows that buying into the recession is a poor strategy, producing negative returns in each of the three downturns since 1980. We recommend that investors wait until the full extent of recession is apparent before overweighting Asian financials.

Figure 3: Universe by Market—Share Price Performance

	Rating	Closing Price	Target Price	Potential Upside	52-Week High	52-Week Low	Share Price Performance 1-Week	1-Month	3-Month	YTD	1-Year
Hong Kong:											
Bank of East Asia	4	15.55	13.00	-16%	22.20	14.45	2.64%	2.30%	-14.09%	-22.83%	-11.40%
Dah Sing Financial	3	33.30	34.00	2%	45.30	29.95	-8.01%	-2.06%	-13.28%	-20.71%	-1.19%
Hang Seng Bank	4	81.75	70.00	-14%	107.00	74.00	2.83%	7.92%	-2.97%	-22.14%	-11.62%
HSBC Holdings PLC	3	88.00	84.00	-5%	121.50	68.50	6.02%	16.56%	1.73%	-23.81%	-18.52%
Wing Hang Bank	4	24.00	21.00	-13%	33.30	21.80	1.05%	4.12%	-9.77%	-14.89%	0.84%
Wing Lung Bank	4	27.40	25.00	-9%	39.20	24.70	0.37%	8.30%	-16.97%	-13.29%	-4.53%
Hang Seng index		**10,405**			**16,164**	**8,934**	**5.89%**	**11.02%**	**-13.58%**	**-31.07%**	**-30.62%**
Hong Kong Dollar (HKD)		7.80			7.80	7.79	0.00%	0.00%	0.00%	0.00%	0.00%
South Korea:											
Kookmin Bank	1	20,000	23,700	19%	20,600	12,100	7.82%	21.95%	19.76%	34.23%	61.29%
H&CB	1	33,750	40,000	19%	34,050	19,000	7.83%	22.73%	20.97%	29.36%	43.90%
Hana Bank	2	10,250	11,500	12%	10,600	5,500	2.50%	20.59%	27.81%	73.14%	50.74%
Shinhan Financial Group	3	11,400	16,000	40%	14,700	9,400	6.54%	17.53%	-5.79%	9.62%	3.64%
KorAm Bank	2	7,990	7,800	-2%	8,900	4,900	1.78%	21.06%	11.90%	57.28%	37.76%
KOSPI		**543**			**632**	**469**	**2.91%**	**14.92%**	**2.68%**	**7.69%**	**3.77%**
Korean Won (KRW)		1,294			1,368	1,131	0.43%	0.62%	0.12%	-2.24%	-12.21%
Singapore:											
DBS Bank Group	2	10.70	12.50	17%	21.20	9.50	-1.83%	12.63%	-13.71%	-45.41%	-46.50%
Oversea-Chinese Banking Corp.	3	10.60	11.10	5%	13.50	8.80	0.95%	19.10%	-1.85%	-17.83%	-0.93%
United Overseas Bank	1	10.50	14.90	42%	14.00	9.05	2.94%	14.75%	-2.78%	-19.23%	-15.32%
STI		**1,411**			**2,062**	**1,241**	**1.62%**	**10.45%**	**-13.91%**	**-26.76%**	**-26.58%**
Singapore Dollar (SGD)		1.83			1.84	1.72	-0.22%	-3.45%	-1.81%	-5.09%	-3.94%
Taiwan:											
Bank SinoPac	2	13.85	20.00	44%	17.45	10.32	-3.82%	6.54%	10.36%	6.91%	2.25%
Chinatrust Commercial	1	18.00	30.00	67%	27.10	14.80	2.86%	14.90%	-3.96%	-5.89%	-17.13%
Taishin International	3	13.10	21.00	60%	19.10	10.25	2.34%	4.38%	19.01%	3.15%	-13.51%
United World Chinese Commercial	4	21.00	19.00	-10%	25.73	15.18	5.53%	3.96%	28.05%	-3.75%	4.05%
TWSE		**4,044**			**6,104**	**3,446**	**5.15%**	**11.53%**	**-5.97%**	**-14.76%**	**-31.95%**
New Taiwan Dollar (TWD)		34.54			35.13	31.98	0.00%	0.03%	0.61%	-4.22%	-6.58%
Thailand:											
Bangkok Bank (F)	4	43.50	25.00	-43%	64.00	32.50	-1.14%	9.43%	2.35%	26.09%	8.07%
Bangkok Bank (L)	3	33.50	25.00	-25%	42.00	24.75	-3.60%	8.94%	-3.60%	31.37%	27.62%
Siam Commercial Bank (F)	3	15.00	25.00	67%	31.25	14.50	-1.64%	1.69%	-9.09%	-23.08%	-16.67%
Siam Commercial Bank (P)	3	15.00	25.00	67%	29.50	14.50	0.00%	1.69%	-6.25%	-30.23%	-17.81%
Thai Farmers Bank (F)	3	17.50	22.00	26%	31.75	15.75	0.00%	9.38%	7.69%	-18.60%	-27.84%
Thai Farmers Bank (L)	3	15.00	22.00	47%	27.25	14.00	-1.64%	5.26%	-7.69%	-23.08%	-27.71%
Krung Thai Bank (F)	4	9.00	10.00	11%	15.25	8.20	0.00%	-3.23%	-16.28%	-18.18%	-20.00%
Bank of Ayudhya (F)	4	4.60	5.00	9%	9.60	4.30	0.00%	4.55%	-16.36%	-11.54%	-14.81%
Bank of Ayudhya (L)	4	4.70	5.00	6%	9.60	4.30	2.17%	4.44%	-16.07%	-11.32%	-14.55%
Thai Military Bank (F)	4	5.00	5.00	0%	9.60	4.50	0.00%	-3.85%	-12.28%	-10.71%	-12.28%
IFCT (F)	3	5.20	10.00	92%	10.25	4.90	-1.89%	6.12%	-14.75%	-5.45%	-13.33%
SET		**281**			**343**	**265**	**-1.45%**	**1.79%**	**-8.10%**	**4.24%**	**1.89%**
Thai Baht (THB)		44.88			45.97	41.90	-0.28%	-1.17%	1.74%	-3.32%	-2.50%
Malaysia:											
Commerce Asset Holding	3	6.75	8.00	19%	10.10	5.05	-4.26%	-1.46%	-9.40%	-17.18%	-34.47%
Maybank	2	7.30	16.00	119%	10.60	6.20	-5.19%	9.50%	0.46%	-18.89%	-31.56%
Public Bank (F)	2	2.68	3.80	42%	3.04	2.12	5.51%	7.20%	-3.94%	17.70%	-1.58%
MY Comp.		**612**			**791**	**553**	**-0.42%**	**1.64%**	**-4.73%**	**-9.89%**	**-23.09%**
Malaysian Ringgit (MYR)		3.80			3.80	3.80	0.00%	-0.03%	0.00%	-0.01%	-0.01%
Indonesia:											
Bank Central Asia	1	1,300	1,450	12%	1,450	788	10.64%	-1.89%	13.04%	55.22%	60.00%
Lippo Bank	2	35	-	-100%	70	35	0.00%	-12.50%	-30.00%	-36.36%	-50.00%
Panin Bank	4	200	260	30%	270	95	-2.44%	-9.09%	-16.67%	17.65%	-6.98%
JCI		**388**			**470**	**343**	**-0.01%**	**-3.29%**	**-12.59%**	**-6.85%**	**-6.36%**
Indonesia Rupiah (IDR)		10,265			12,200	8,280	-1.70%	-5.80%	-2.09%	-5.75%	-11.06%
The Philippines:											
Bank of the Philippine Islands	2	42.00	64.00	52%	79.50	41.00	-5.62%	-17.65%	-37.31%	-27.59%	-21.50%
Equitable-PCI	NR	18.75	na	na	70.00	16.00	5.63%	-23.47%	-47.92%	-68.22%	-66.52%
Metrobank	3	168.00	255.00	52%	241.00	167.00	-2.89%	-15.58%	-18.45%	-8.20%	0.00%
Philippine National Bank	4	47.50	55.00	16%	55.50	29.50	-1.04%	-5.00%	18.75%	25.00%	21.80%
Ph Comp.		**1,003**			**1,712**	**979**	**-1.66%**	**-12.39%**	**-26.43%**	**-32.92%**	**-22.50%**
Philippines Peso (PHP)		52.05			55.80	46.50	-0.53%	-1.25%	2.69%	-3.94%	-1.73%

Source: Lehman Brothers; Bloomberg

Key to Investment Rankings: This is a guide to expected total return (price performance plus dividend) relative to the total return of the stock's local market over the next 12 months. 1 = **Strong Buy** (expected to outperform the market by 15 or more percentage points); 2 = **Buy** (expected to outperform the market by 5-15 percentage points); 3 = **Market Perform** (expected to perform in line with the market, plus or minus 5 percentage points); 4 = **Market Underperform** (expected to underperform the market by 5-15 percentage points); 5 = **Sell** (expected to underperform the market by 15 or more percentage points); V = **Venture** (return over multiyear time frame consistent with venture capital; should only be held in a well-diversified portfolio).

Regional Valuation

What Happened?

In early August, we looked at Asian bank valuations, with an eye towards answering the following two questions:

- Are all banks cheap right now?
- If so, should I buy all banks?

At that time our answers were a qualified yes to question #1, and an emphatic no to question #2. Since then, valuations have come down by roughly 20% on a price-to-book basis, and the average stock in our universe is down approximately 4.2%, or 6.7% ex Korea, our only overweight market. Again we ask:

- Are all banks cheap right now?
- If so, should I buy all banks?

Cheap Is In The Eye Of The Beholder

All banks may not be cheap right now, but they are undeniably less expensive than they have been for some time. Regional banks in our universe are selling at 1.8x book value on a market cap-weighted basis (heavily influenced by HSBC and Hang Seng), and at 1.4x book value on an average basis. This is above the Asian Crisis lows, where almost all banks sold for less than 1x book value, but it stands out as at the low end of normal trading valuations.

Figure 4: Asian Markets Price/Book Multiples

	Average P/BV	
	10/27/01	8/8/01
Hong Kong	3.14	3.48
Singapore	1.07	1.39
South Korea	1.22	1.26
Thailand	1.57	2.68
Malaysia	1.59	2.10
Taiwan	0.97	1.08
Philippines	1.04	1.56
Indonesia	0.75	0.53
Region (Avg)	1.42	1.76
Region (Cap Wgted)	1.78	2.18

Source: Company Reports; Lehman Brothers

A major caveat to this analysis: Countries with significant amounts of distressed assets on the books of their banks (Thailand, the Philippines, Indonesia, Taiwan) are generally understating their valuations as book value is too high. The effect on some banks is considerable. For example, we think that most of the Thai banks would be expensive at an equity price of zero, because true BV is so negative.

How do we arrive at this hidden "true" book value in such cases? We calculate a required level of reserves based on stated loan classifications (or our own, higher, estimates in the case of Korea), and deduct any shortfall from equity. As an example, our analysis of Bangkok Bank shows that loan loss reserves should be THB159.7 billion—but the actual allowance is only THB75.7 billion. The differential of THB84 billion we subtract from equity, leaving a negative equity position of THB49.6 billion. Although we show BBL as having a stated price-to-book valuation of 1.9x based on the foreign share, it is in some sense more correct to consider the bank as having an infinite P/BV. While this is admittedly an extreme case, the principle is hard at work in Asia, where banks are still laboring under a burden of bad debts.

If Asian Banks Have Low P/BVs, Is This The Same Thing As Cheap?

So, adjustments aside, low P/BV banks are cheap, right? We mostly disagree with this statement, although there are definitely pockets of value in Asian banks. The reason: Asian banks historically have single-digit returns on capital, even ignoring the credit cycle and financial crisis years.

- e.g.: Singaporean banks earned an average ROE of 8.9% from 1997–1H01, despite having strong balance sheets and comparatively low NPLs throughout—and no bank had an average ROE higher than UOB's 9.1%. With our calculation of the cost of capital in Singapore running at just over 12%, every one of these banks has been destroying value for years. Think this can't go on forever? Just consider Japan...

Remember, price-to-book in isolation doesn't tell us anything about whether the bank is cheap or expensive—the measure has no inherent investment rigor as P/E does. We need to look at P/BV in conjunction with ROE and growth prospects (it can be argued that this is a shadow P/E).

A single-digit ROE, or one which doesn't meet the cost of capital, does not argue for a premium over net assets, and therefore probably should trade at 1x book or less—unless there is some reason for this to change in the (fairly near) future, either through increased returns or through liquidation. P/BV and ROE don't exactly have a linear relationship—it is actually a curve with a strong upward slope above 20% ROE—but the simplification is a useful if rough tool.

Most of the banks which look inexpensive on a P/BV basis either don't earn their cost of capital now, or may not in the future, and so are not actuality cheap.

If Asian Banks Have Low P/Es, Is *This* The Same Thing As Cheap?

Moving on to earnings-based valuations, we see that once again valuations have come down—in many cases (Singapore, for example) breaking through their Asian Crisis lows. On average, banks trade at 12.1x trailing and 11.8x forward EPS.

Figure 5: Asian Markets Price/Earning Multiples

	Average P/E	
	2000A	**2001E**
Hong Kong	20.02	14.25
Singapore	18.42	13.52
South Korea	9.22	7.13
Thailand	6.25	0.08
Malaysia	12.26	16.94
Taiwan	10.00	8.36
Philippines	17.55	13.98
Indonesia	3.06	3.12
Region (Avg*)	12.10	11.84
Region (Cap Wgted)	15.37	11.85

** ex loss-making banks*

Source: Company Reports; Lehman Brothers

Bottom-line earnings are of course notoriously easy to manipulate in the case of banks—discretionary provisions become the swing factor for a quarter...or more. Some banks in our universe have been taking cash out of the reserve for over a year—and were under-reserved to begin with.

Nevertheless, earnings are a better indicator of value than price-to-book alone, and similar to price-to-book in conjunction with ROE. But: earnings have to remain steady or increasing for a long time for investors to make their money back—and herein lies the catch.

Banks' Traditional Business Is Going Away

Asian banks were all corporate banks three years ago, and thirty years ago. All credit in Asia has historically been channeled to corporate borrowers as a part of industrial policy. In the short run, most corporates are over-leveraged, and have less demand for current lending, which is why loan growth lagged GDP for the first time in years coming out of the financial crisis.

In the long run, things look even worse. The corporate lending business is fundamentally flawed in a developed market, as spreads decline due to competition from the lower-cost fixed-income markets (note that even Thailand and Indonesia now have flourishing domestic bond markets). Global banks no longer make money on this business no matter how efficient they are, but they do use it as a loss-leader to get high-margin treasury, forex, cash management, derivatives and advisory business from their lending clients. Asian banks by and large don't have this option because a) the corporate market is not yet sophisticated enough to demand these products in volume; and b) the banks themselves (ex-HSBC and StanChart, plus DBS in some lines) are not savvy enough to produce and manage the products.

Herein lies the problem with earnings valuations in Asia: old line banks that stick to their knitting will find their profits increasingly marginalized in future years—witness the developing plight of the small Hong Kong banks.

What Will Replace Old Businesses?

Chances are pretty high that you have heard us say it: the business which will replace corporate is consumer. If you haven't heard it from us, you've surely heard it from the mouth of a banker.

The flip side of the policy which over-subsidized corporate lending is that consumers were denied credit. This policy has come home to roost in places like Korea, which finds it has no service or consumer sector to iron out swings in the industrial cycle. In order to fix this, you need to give consumers the ability to smooth out their consumption—which means that they will simultaneously demand both more credit and more investment products. These are the most profitable and the fastest growing areas of Asian banking.

Most Asian Banks Will Never Reach The New World

Retail banking and wealth management demands an entirely different skill set to corporate banking. Asian banks are used to taking in time deposits and making large business loans, or perhaps mortgages; a few have experience with SME lending, which has been more resilient. Moving to establish branded consumer products is a sea change for which most banks are not prepared, and a glance over current JVs meant to transfer this technology and mindset shows that banks are effectively selling access to their networks without keeping control of the clients or gaining much expertise.

Also, the nasty matter of asset quality is keeping banks from giving this matter their full attention. Sheehan's Iron Law of Banking: once NPLs reach 10% of assets, senior management must spend 90% of its time dealing with the problem. In a market like Thailand, bad assets are the only focus—it may be worthwhile to talk about consumer business and new products but there is no money for investment or training, and little management time. Meanwhile, global competitors like Citibank are in all of these markets doing consumer business (high net worth-oriented for the time being, but class will become mass in a flash when the markets pick up).

The Bottom Line

Some 90% of Asian banks will not make the jump, and will be left with low-yield legacy business. These franchises are worth at most 1x book. Many will be acquired in the end for their branches and customers, the rest will just limp along.

10% of banks will become efficient users of capital and will be mainly providers of consumer loans and wealth management products. With one or two exceptions, our recommendations match up well with a list of banks we think will make this transition, and which are attractively priced.

Figure 6: Coverage Universe Valuations

	Rating	Closing Price	Mkt Cap (US$, MM)	P/Book 1999A	P/Book 2000A	P/Book 2001E	P/E 1999A	P/E 2000A	P/E 2001E
Hong Kong:									
HSBC Holdings PLC	3	88.00	105,401.81	3.54	2.79	2.66	21.43	15.20	16.01
Bank of East Asia	4	15.55	2,857.41	1.99	1.28	1.23	20.07	11.67	11.15
Dah Sing Financial	3	33.30	1,052.69	1.85	1.76	1.57	11.98	10.11	9.02
Hang Seng Bank	4	81.75	20,037.42	4.29	4.95	4.17	20.43	20.05	16.21
Wing Hang Bank	4	24.00	902.85	1.61	1.30	1.13	11.08	7.82	7.62
Wing Lung Bank	4	27.40	815.63	0.83	1.13	1.02	6.58	6.29	6.58
South Korea:									
Kookmin Bank	1	20,000	4,690.39	1.82	1.56	1.27	0.00	7.54	4.34
H&CB	1	33,750	3,127.81	0.76	1.64	1.41	6.49	5.54	5.02
Hana Bank	2	10,250	984.72	0.76	0.89	0.76	6.75	41.43	2.94
Shinhan Financial Group	3	11,400	2,574.52	0.94	0.97	1.03	12.52	8.04	16.21
Koram Bank	2	7,990	1,006.49	1.06	1.63	1.39	16.69	0.00	7.51
Singapore:									
DBS Bank Group	2	10.70	7,121.07	1.94	1.08	1.03	22.20	9.07	9.31
Oversea-Chinese Banking Corp.	3	10.60	7,462.99	1.56	1.22	1.02	23.66	16.23	14.42
United Overseas Bank	1	10.50	8,978.42	1.42	1.33	1.15	14.53	12.10	11.05
Taiwan:									
Bank SinoPac	2	13.85	780.12	1.16	1.03	0.92	17.33	9.45	8.24
Chinatrust Commercial	1	18.00	2,401.44	1.35	1.17	1.01	21.74	8.73	7.33
Taishin International	3	13.10	680.67	0.99	0.86	0.80	17.94	13.65	8.12
United World Chinese Commercial	4	21.00	2,294.46	1.18	1.13	0.99	14.91	10.45	9.55
Thailand:									
Bangkok Bank (F)	4	43.50	1,420.77	3.08	1.88	1.75	-2.33	-3.39	11.51
Siam Commercial Bank (F)	3	15.00	283.57	2.69	0.77	0.74	-4.06	13.19	18.70
Thai Farmers Bank (F)	3	17.50	917.13	6.98	1.60	1.59	-2.63	32.63	-7.67
Bank of Ayudhya (F)	4	4.60	189.57	1.29	0.55	0.55	-1.35	-1.00	-5.81
Krung Thai Bank (F)	4	9.00	2,240.88	3.28	3.02	1.66	-3.68	2.59	54.22
Thai Military Bank (F)	4	5.00	223.93	1.74	1.54	1.74	-1.33	-0.80	-2.99
IFCT (F)	3	5.20	134.53	1.72	0.68	0.76	-2.72	-3.66	-6.36
Malaysia:									
Commerce Asset Holding	3	6.75	2,101.49	0.73	1.50	1.34	6.83	15.23	15.39
Maybank	2	7.30	4,532.02	3.99	1.65	1.71	26.95	12.53	20.34
Public Bank (F)	2	2.68	2,194.41	1.62	1.44	1.59	9.38	8.86	11.41
Indonesia:									
Bank Central Asia	1	1,300	746.04	0.00	0.55	0.82	0.00	2.12	4.62
Lippo Bank	2	35	87.46	6.77	0.54	0.49	-9.55	5.56	16.55
Panin Bank	4	200	116.09	0.00	0.45	0.43	0.00	7.22	-6.32
The Philippines:									
Bank of the Philippine Islands	2	42.00	1,236.53	1.30	1.32	1.18	22.95	21.11	17.83
Equitable-PCI	NR	18.75	261.85	0.30	0.29	0.28	22.50	6.61	5.28
Metrobank	3	168.00	1,054.57	1.11	1.11	1.11	22.05	23.24	19.90
Philippine National Bank	4	47.50	345.02	0.66	0.80	0.86	-0.56	-4.30	-11.28
COUNTRY AVERAGES			*Total Mkt Cap (US$m)*						
Hong Kong			25,666.00	4.19	4.08	3.14	24.45	20.02	14.25
South Korea			12,383.93	1.22	1.41	1.22	6.14	9.22	7.13
Singapore			23,562.48	2.10	1.78	1.07	25.45	18.34	11.59
Taiwan			6,156.69	1.22	1.11	0.97	18.22	10.00	8.36
Thailand			5,410.38	3.65	2.15	1.57	(2.97)	6.25	24.67
Malaysia			8,827.92	2.63	1.56	1.59	17.79	12.26	16.94
Indonesia			949.59	0.62	0.53	0.75	(0.88)	3.06	4.38
The Philippines			2,897.97	1.07	1.09	1.04	19.78	17.55	13.98
REGION			**85,854.96**	**2.64**	**2.33**	**1.78**	**18.79**	**15.35**	**12.89**

Source: Company Reports; Lehman Brothers; Bloomberg

Figure 7: Global Financial Institutions Valuations

	LB Rating	Closing Price	52-Week High	52-Week Low	Share Price Performance 1W	1M	3M	YTD	1Y	Mkt Cap ($, MM)	Price/ Book	P/E 2000A	P/E 2001E
United States:													
Bank One	3	34.27	39.85	28.00	4.58%	12.36%	-8.54%	-6.43%	3.26%	39,753.18	2.1	15.9	14.3
BankAmerica	2	60.65	65.00	38.00	6.35%	10.17%	-3.90%	32.21%	39.83%	97,248.81	2.0	12.8	12.5
BONY	1	35.98	59.25	30.62	7.15%	9.49%	-17.89%	-34.80%	-31.06%	26,503.11	4.4	18.6	1.7
Citigroup	1	48.58	56.30	36.36	5.95%	23.58%	-2.84%	-4.86%	-0.86%	244,413.19	3.7	17.7	16.9
First Union	3	30.31	36.38	24.00	7.06%	-0.30%	-13.35%	8.98%	7.53%	42,435.90	1.8	10.2	11.9
JP Morgan Chase & Co	1	37.55	55.98	30.82	10.87%	15.22%	-13.16%	-17.36%	-6.13%	74,544.50	1.8	12.7	17.5
US Average					6.99%	11.75%	-9.95%	-3.71%	2.10%		2.6	14.7	12.5
Europe:													
ABN-AMRO	2	17.37	28.15	15.78	10.08%	0.58%	-10.74%	-28.28%	-31.91%	23,594.57	2.2	8.5	9.6
Allied Irish Banks	2	11.00	13.80	9.31	0.36%	17.02%	-11.58%	-10.93%	-7.56%	8,694.05	2.5	12.4	9.4
Barclays	2	2,115.00	2,330.00	1,518.00	4.81%	16.34%	8.46%	2.08%	12.50%	50,357.59	4.0	14.2	13.8
BBVA	3	13.20	17.20	9.50	6.88%	20.55%	-2.94%	-16.72%	-14.84%	37,640.46	3.2	18.1	15.5
BNP-Paribas	2	93.35	105.10	75.90	2.41%	7.30%	-2.35%	-0.16%	-1.37%	36,897.66	1.9	9.9	9.6
BSCH	3	9.25	12.38	6.93	5.35%	16.21%	-2.73%	-18.86%	-16.37%	37,648.48	2.4	17.1	15.2
Commerzbank	3	18.00	33.90	15.70	7.78%	3.45%	-30.37%	-40.98%	-44.27%	8,702.21	0.8	18.4	19.6
Credit Lyonnais	3	39.10	45.75	34.05	7.12%	10.14%	-9.66%	5.11%	0.26%	12,006.21	1.8	14.6	13.4
Credit Suisse Group	3	60.05	87.00	44.80	7.42%	15.70%	-14.82%	-22.01%	-27.10%	43,508.54	3.9	12.5	14.8
Deutsche	2	63.75	104.95	46.55	6.87%	14.76%	-17.21%	-28.21%	-31.30%	35,362.51	2.3	8.0	11.9
Dresdner	3	41.10	54.45	35.60	1.99%	9.89%	-9.27%	-11.23%	-11.04%	20,251.24	2.0	12.3	19.2
HBOS	3	800.00	874.00	517.50	3.36%	6.67%	6.95%	20.57%	52.38%	41,115.76	3.0	16.5	na
Lloyds TSB	3	712.00	772.00	590.00	2.36%	11.83%	7.26%	0.54%	8.05%	56,859.34	5.5	13.4	14.0
Royal Bank of Scotland	2	1,713.00	1,782.00	1,256.00	7.40%	15.67%	15.28%	8.28%	16.61%	70,001.06	6.5	25.8	18.8
Societe Generale	3	57.30	74.60	45.89	3.90%	6.11%	-6.83%	-13.44%	-6.68%	22,019.46	5.6	9.0	10.5
Standard Chartered	3	716.00	1,128.00	566.00	6.87%	11.18%	-9.14%	-25.76%	-26.19%	11,576.27	2.2	8.9	9.8
UBS	2	79.05	96.83	62.10	5.75%	10.79%	3.27%	-10.34%	-1.39%	61,902.14	1.2	11.9	11.5
European Average					5.34%	11.42%	-5.08%	-11.20%	-7.66%		3.0	13.6	13.5
Latin America:													
Bancomer	2	7.40	9.15	5.00	4.23%	7.40%	-10.30%	39.10%	25.42%	7,358.21	0.9	na	7.6
Bradesco	2	10.90	14.01	9.36	1.87%	13.54%	-5.05%	-22.14%	9.46%	2,845.88	3.1	1.5	2.3
Latin American Average					3.05%	10.47%	-7.68%	8.48%	17.44%		2.0	1.5	4.9
Japan:													
Asahi	3	125	449	120	-0.79%	-4.58%	-42.13%	-67.87%	-69.06%	2,874	0.3	25.0	7.4
Chuo-Mitsui	3	170	378	158	5.59%	-1.73%	-14.14%	-51.70%	-49.25%	1,130	0.2	23.3	5.1
Daiwa	2	130	226	124	0.00%	-4.41%	-2.26%	-30.48%	-42.73%	2,168	0.7	10.3	-10.3
Mitsubishi-Tokyo	2	970,000	1,340,000	861,000	2.75%	1.68%	0.00%	na	na	45,242	na	-23.5	40.3
Mizuho	3	393,000	882,000	370,000	4.52%	-17.95%	-19.30%	-44.49%	na	29,385	0.6	15.9	8.7
Sumitomo Mitsui	3	796	1,380	710	11.33%	-10.66%	-11.56%	-32.14%	-38.67%	36,913	1.8	25.7	15.0
Sumitomo Trust	2	719	912	588	7.31%	8.94%	-5.89%	-7.46%	-14.30%	8,481	1.4	15.8	10.9
UFJ Holdings	3	560,000	970,000	484,000	12.45%	-8.35%	-2.61%	na	na	21,991	na	-14.0	19.4
Japanese Average					5.40%	-4.63%	-12.24%	-39.02%	-42.80%		0.8	9.8	12.1
Asian Coverage Averages:													
Hong Kong					1.63%	6.80%	-8.59%	-15.31%	0.02%		4.08	20.02	14.25
South Korea					5.29%	20.77%	14.93%	40.73%	39.47%		1.41	9.22	7.13
Singapore					0.69%	15.49%	-6.11%	-27.49%	-20.92%		1.78	18.34	11.59
Taiwan					1.73%	7.45%	13.37%	0.11%	-6.09%		1.11	10.00	8.36
Thailand					-0.23%	5.47%	-6.84%	1.38%	0.67%		2.15	6.25	24.67
Malaysia					-1.31%	5.08%	-4.29%	-6.12%	-22.54%		1.56	12.26	16.94
Indonesia					2.73%	-7.83%	-11.21%	12.17%	1.01%		0.53	3.06	4.38
The Philippines					-0.98%	-15.42%	-21.23%	-19.75%	-16.55%		1.09	17.55	13.98
Asian Average					1.19%	4.73%	-3.75%	-1.79%	-3.12%		1.7	12.1	12.7

Source: Company Reports; Lehman Brothers; Bloomberg

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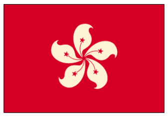
Hong Kong

Contracting Margins

Rating: Underweight ⇩



Covered Banks	Rating
HSBC	3 – Market Perform
Bank of East Asia	4-Mkt Underperform
Dah Sing Fin.	3 – Market Perform
Hang Seng	4-Mkt Underperform
Wing Hang Bank	4-Mkt Underperform
Wing Lung Bank	4-Mkt Underperform

We have recently lowered our investment recommendation on the Hong Kong banking sector to Underweight and believe that other sectors such as telecoms and conglomerates offer better value in Hong Kong. Meanwhile, across the region, Korea is the only country where we see value and represents our only Overweight position in our coverage of Asian banks.

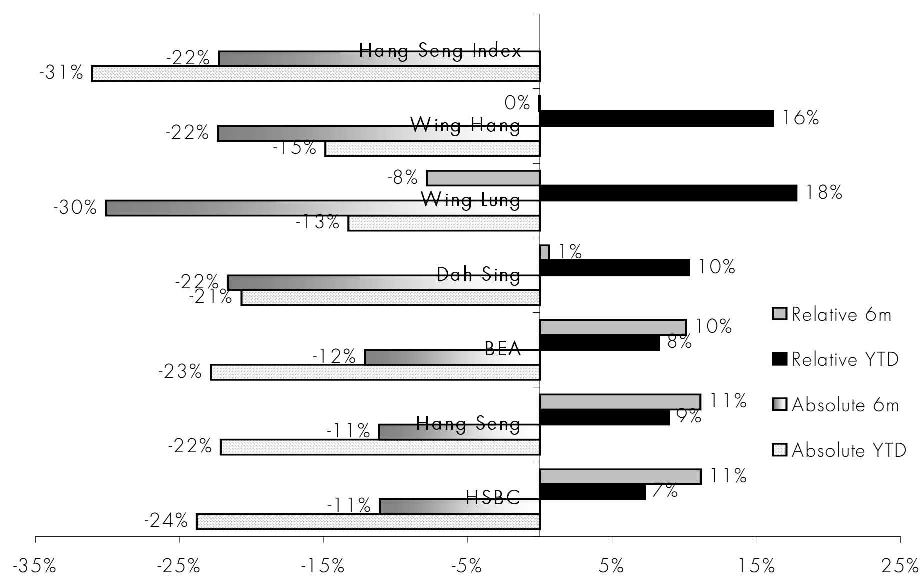
We have been negative on the earnings prospects of the Hong Kong banks since the beginning of the year but our positive view on Hang Seng Bank held us back from going Underweight the Hong Kong banking sector earlier. However, we have recently downgraded Hang Seng to a 4-Market Underperform with a HK$70 price target and this is the straw that broke the camel's back.

Mixed performance YTD…

absolute losses, but relative gains

Since the beginning of the year and from six months ago, the performance of the banking sector in Hong Kong has been mixed. Average share prices have declined a whopping 20% since the beginning of the year and are down an average of 18% from six months ago. However, relative to the Hang Seng Index, which has been dragged down by the telecom and property sectors, the banks outperformed by 11% year to date and 4% over the last six months. The prospects for the banking sector have not changed, but those for the telecom sector are expected to improve, thus our Underweight recommendation on the Hong Kong banks.

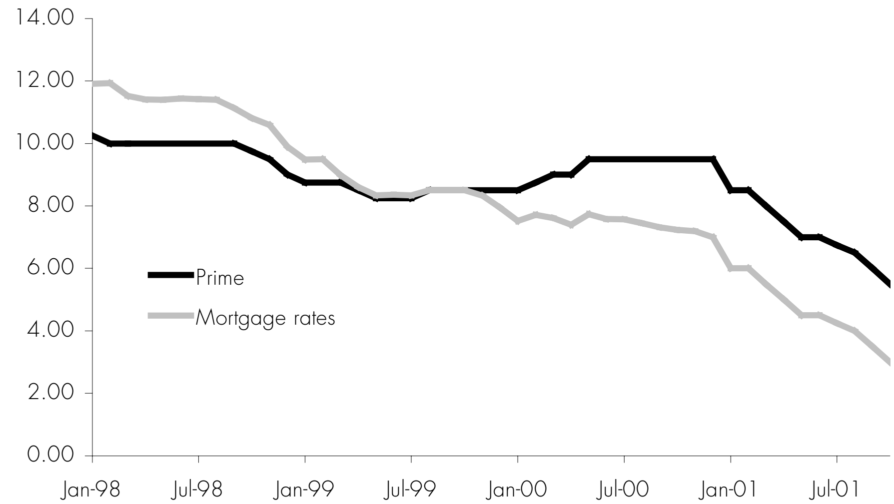
Figure 8: Hong Kong Banks YTD Share & 6 Month Price Performance



Source: Hong Kong Stock Exchange

Deteriorating earnings prospects

Figure 9: Hong Kong Mortgage Rate and Prime



Source: Datastream, Company data and Lehman Brothers estimates

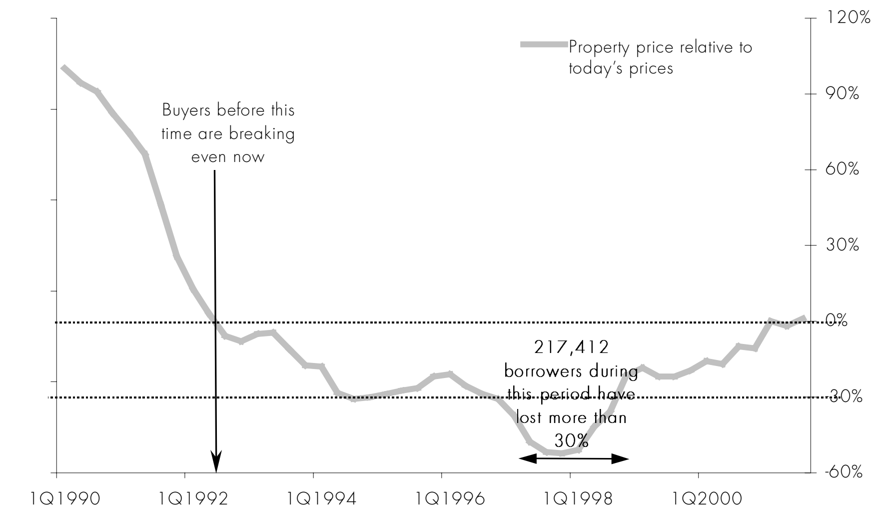
Significant loss of profitability on core mortgage product

The earnings prospects for the Hong Kong banks is deteriorating quickly and there is little that any of the banks can do to cope with the situation. Loans outstanding have been contracting since the onslaught of the Asian Financial Crisis and the outlook remains bleak, especially with the slowdown in the global economy. Domestically, to revert back to pre-crisis levels of loan growth, Hong Kong has to see a recovery in the property market, which accounted for two-thirds of 20%+ annual loan growth in the ten years prior to the crisis. Compounding the problems of lack of loan growth is the re-pricing of the mortgage book. Each bank has between 40-50% of their loan books exposed to this sector, which has lost over 400 basis points in spread over the last 24 months. This is obviously a hard pill to swallow for all the banks, but particularly hard for the smaller banks that are essentially "mortgage machines".

New government policy does little

The government has recently relaxed the 70% maximum loan-to-value ceiling for mortgages and is encouraging banks to offer more attractive rates to borrowers that have seen the value of their property decline significantly. This is aimed at helping those borrowers that purchased property between 1Q97 and 3Q98. There were 217, 412 mortgages lent during this period, equivalent to almost half of the estimated 465,000 outstanding mortgages in Hong Kong. However, the situation is not that bad — a HKMA survey revealed that there are approximately 65,000 mortgages, or 14% of total mortgages in negative equity positions, and most of these borrowers are paying rates below Prime already. We do not believe that this change in policy will have any significant impact on bank earnings because we do not believe that this policy will affect that many people. Given the poor economic outlook, borrowers who are currently in negative equity positions are not likely to top up mortgages to take advantage of slightly better rates. We believe that they would rather maintain their savings to cope with any 'rainy days'.

Figure 10: Property Values Relative to Today's Prices

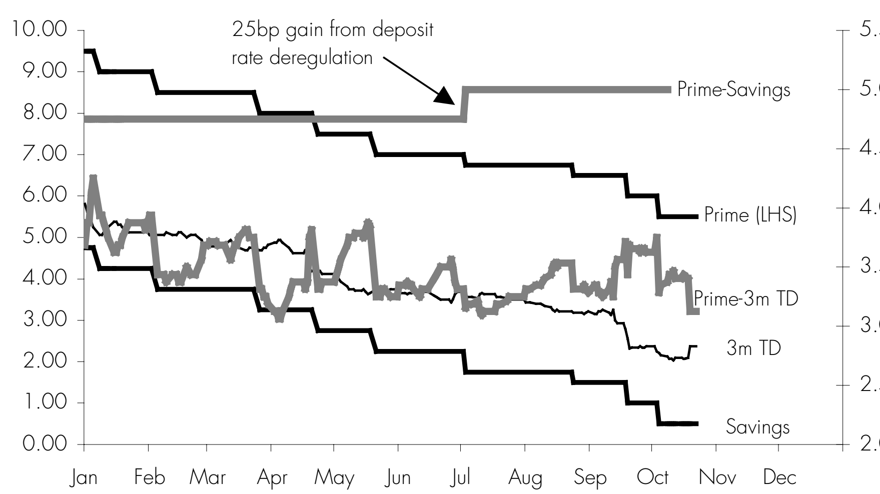


Source: Hong Kong Land Registry, HKMA and Lehman Brothers estimates

Gains from deposit rate deregulation

Deposit rate deregulation has given some respite to margin contraction, but the benefits have been wiped out by lower returns on free funds in this lower interest rate environment. Since the middle of the year, the large banks were able to lower savings deposit rates by 25 basis points—this was soon followed by the smaller banks which realized an additional 25 basis points on typically small deposits were not going to attract any meaningful amount of deposits. Once savings deposit rates were lowered, time deposit rates soon followed — the savings deposit rate is essentially acting as a floor in this environment of excess liquidity and no lending opportunities. Thus, banks have benefited from deregulation by being able to lower deposit costs more so than lending rates.

Figure 11: Hong Kong Interest Rates



Source: Datastream

Negative endowment

Figure 12: Estimated Free Funds

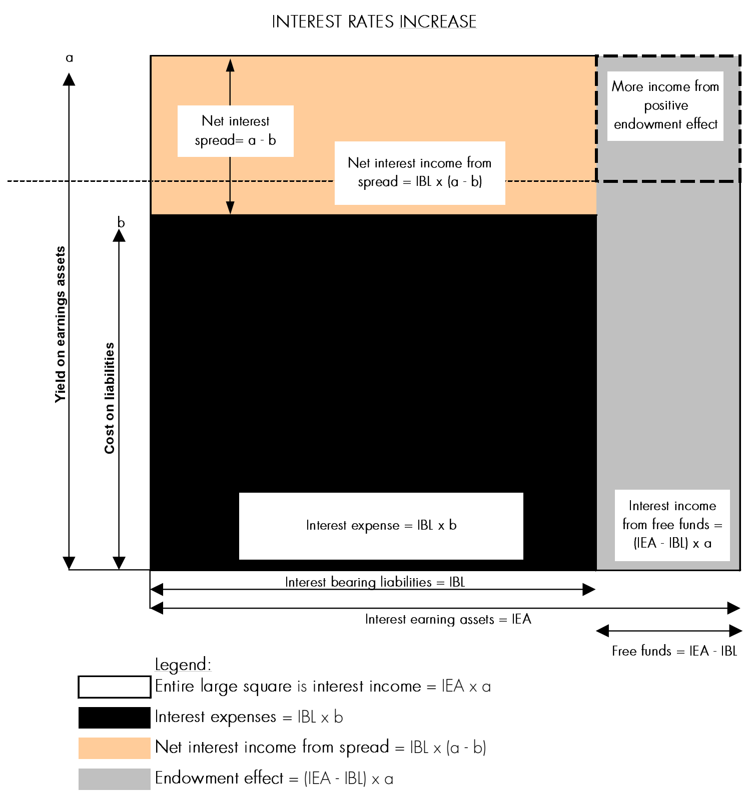
(HK$m)	Interest earning asset	Interest bearing liabilities	Free funds	% Interest earning assets	B/S leverage (Assets / equity)
HSBC (US$m)	575,774	511,787	63,987	11%	15.0
Hang Seng	450,857	384,143	66,713	15%	11.7
BEA	169,745	150,529	19,216	11%	10.3
Dah Sing	42,976	38,137	4,839	11%	10.5
Wing Lung	60,905	53,830	7,075	12%	9.1
Wing Hang	53,712	47,973	5,739	11%	9.4

Source: Company reports and Lehman Brothers estimates

Wiped out by negative endowment effect

However, interest rates have declined by 400 basis points since the beginning of the year. Theoretically, this should be beneficial for banks since it should spur loan growth and improve debt serviceability. However, none of these have occurred. What this has done however, is lower the return generated from free funds. With free funds accounting for an average of 11.8% of interest earning assets, banks are losing 400 basis points of "spread" on this component. The greatest impact will be on Hang Seng, which has a relatively un-levered balance sheet and an above average amount of checking accounts. We estimate that its free funds account for approximately 15% of total interest earning assets, which compares to an average of approximately 11% for the other banks. Thus, Hang Seng loses out in a declining interest rate environment but will benefit once the interest rate cycle turns.

Figure 13: Hang Seng Bank Interest Income and Expenses Breakdown



Source: Company reports and Lehman Brothers estimates

Non-interest income

Developing non-interest income to offset lost interest income

To offset the lost profitability on lending operations, the larger banks have been able to target the development of non-interest income, in particular, personal wealth management products such as unit trust sales and insurance operations—and this is one area that the small banks cannot compete in. Large banks have the large customer base, information technology platform and the wide product range that small banks do not have. Large banks' advantages stem from their access to their large customer bases—the customer is already in their database. The bank then must mine this customer database and turn it into a strategic weapon, identifying specific customer segments and particular needs for that segment—cross selling is the name of the game. Finally, access to a wide product range enables bundling, which de-commoditizes bank products and increases stickiness.

Helping unit trust sales is the low interest rate environment. Base savings deposit rates are currently 0.5% and with interest rates expected to be cut at least another 50 basis points before the end of the year, savings deposit rates could head down to zero. However, anecdotal evidence reveals that banks themselves do not think rates will go to zero, but rather to a nominal level like 0.1%.

With interest rates so low, depositors are looking for alternative savings vehicles, and capital guaranteed unit trusts are currently becoming a very popular item. HSBC and Hang Seng have indicated that unit trust sales are growing quickly and fees from these operations will help boost other lackluster earnings. Management fees are still approximately 1% and distribution fees can run as high as 3%, making unit trust sales very lucrative.

Figure 14: Non-interest Income (% of Total Operating Income)

	1998	1999	2000	2001	2002	2003
HSBC	43.1%	42.9%	44.2%	43.4%	44.1%	44.6%
Hang Seng	21.7%	21.2%	23.4%	25.1%	28.4%	28.4%
Bank of East Asia	23.4%	22.1%	25.8%	25.8%	28.2%	29.1%
BEA	32.7%	28.3%	24.7%	26.0%	27.9%	29.6%
Wing Lung	26.0%	22.0%	21.9%	22.4%	24.7%	22.3%
Wing Hang	21.4%	19.0%	17.5%	18.8%	21.1%	22.4%
	28.1%	25.9%	26.2%	26.9%	29.1%	29.4%

Source: Company reports and Lehman Brothers estimates

Asset quality a concern again

Figure 15: Loan book breakdown in Hong Kong

(HK$m)	HSB	BEA	DSF	WLB	WHB
Mortgages	114,875	44,148	10,534	11,159	12,008
Credit cards & individual	10,098	5,572	6,072	1,085	2,955
Property development	49,874	17,458	2,687	6,841	6,326
Others	48,894	40,427	10,489	8,360	14,258
	223,741	107,605	29,783	27,445	35,546

	HSB	BEA	DSF	WLB	WHB
Mortgages	51%	41%	35%	41%	34%
Credit cards & individual	5%	5%	20%	4%	8%
Property development	22%	16%	9%	25%	18%
Others	22%	38%	35%	30%	40%
	100%	100%	100%	100%	100%

Source: Company reports and Lehman Brothers estimates

Hang Seng and Dah Sing have the lowest exposure to coporates

Asset quality is expected to take a hit in the near term, but the problem will be nowhere near that experienced during the Asian Financial Crisis. In 1997/98, the key driver to the asset quality problem was China-related loans and corporate lending. However, since the crisis, banks have all scaled back their China-related loans so this should not pose a problem. Also, most coporates have de-leveraged their balance sheets since the financial crisis and are in a better position to service their debt.

What about SMEs? Asset quality concerns are rising again, especially at the SME level. There appears to be some concern regarding the asset quality of SME loans, which will have an impact on those banks that have exposure to this area. Although banks do not breakout SME lending, we can arrive at likely exposure levels by process of elimination.

HSB and DSF have the lowest corporate exposure. From reported loan books, we subtract mortgages, credit card and personal loans and the remainder is corporate loan book exposure. We find that HSB and DSF have the smallest exposure to corporate loans at 44% of their loan books. Meanwhile, the remaining banks are highly geared to coporates, with BEA at 54%, WLB at 55% and WHB at 58%.

SMEs exposure. To get a gauge of SME exposure, we have subtracted property development/investment loans from the corporate loans because SME are not likely to be using their loans for these purposes. The remaining corporate loans include trade finance, hire purchase as well as those classified for commercial and industrial. We believe that this is a good gauge for SME lending in Hong Kong. From this, we can see that HSB has the lowest exposure at 22% and BEA and WHB are the highest at 38% and 40% respectively.

SMEs defined

SMEs are defined as manufacturing enterprises with fewer than 100 employees and non-manufacturing enterprises with fewer than 50 employees are regarded as small and medium enterprises (SMEs) in Hong Kong. In March 2001, there were about 300,000 SMEs in Hong Kong. They accounted for over 98% of the total establishments and provided job opportunities to about 1.4 million people, about 60% of total employment (excluding civil service). Most of the SMEs were in the import and export trades followed by the wholesale and retail trades, restaurants and hotels. They accounted for more than 60% of the SMEs in Hong Kong and represented over half of SME employment.

New provisions for consumer-related loans

Therefore, the majority of new bad debt problems are expected to arise from the consumer sector, which is more predictable and more manageable. Apart from mortgages, these loans are typically smaller in size and the risk is diversified over a larger number of people. Banks are typically avoiding high-risk sectors such as restaurant and construction workers, *as well as equity research analysts*. Therefore, although these loans are unsecured, the significantly higher returns well justify the risk. Thus loan loss provisions are expected to remain high, rather than spike up.

Figure 16: Hong Kong Banks' Loan Loss Provisions

LOAN LOSS PROVISIONS							
(HK$m)	1997	1998	1999	2000	2001	2002	2003
HSBC (US$m)	-1,119	-2,866	-2,244	-1,039	-1,292	-1,474	-1,532
Hang Seng	-635	-2,476	-1,419	-196	-191	-288	-286
BEA	-292	-1,506	-2,215	-681	-320	-527	-510
Dah Sing	-67	-255	-407	-311	-303	-303	-304
Wing Lung	-56	-357	-258	-89	-97	-105	-76
Wing Hang	-167	-512	-439	-367	-356	-332	-274

LOAN LOSS PROVISION / LOANS							
(basis points)	1997	1998	1999	2000	2001	2002	2003
HSBC	47	122	88	36	43	46	45
Hang Seng	31	122	70	9	8	12	11
BEA	35	180	263	65	30	48	44
Dah Sing	24	103	149	106	101	97	94
Wing Lung	20	119	94	32	35	38	27
Wing Hang	51	160	136	109	99	89	71
Average	35	135	134	59	53	55	49

Source: Company reports and Lehman Brothers estimates

Valuation

Average 12x earnings and 2x book

Figure 17: Hong Kong Banks Valuation Summary

	Price	Market	PER (x)		PBR (x)	
	(HK$)	Cap (HK$m)	2001	2002	2000	2001
HSBC-stated	88.00	808.1	16.3	16.5	2.8	2.7
HSBC (cash)	88.00	808.1	14.5	14.7	3.4	3.2
Hang Seng	81.75	151.5	15.4	16.9	3.8	3.8
BEA	15.55	21.9	11.9	13.2	1.5	1.2
Dah Sing	33.30	8.4	8.7	8.5	1.9	1.6
Wing Lung	27.40	6.3	7.8	8.6	1.3	1.0
Wing Hang	24.00	7.0	8.7	9.1	1.5	1.1
		Average	*11.9*	*12.5*	*2.3*	*2.1*

Source: Company reports and Lehman Brothers estimates

Underweight Hong Kong banks…

The risks are on the downside

Hong Kong banks are currently trading on an average of approximately 12x earnings and 2x book value. However, given the poor earnings prospect and declining profitability, we believe that valuation multiples should contract, hence our Underweight recommendation on the Hong Kong banking sector. We also point out that the risk to earnings is more on the downside rather than for positive surprises. Loan growth may take longer to return, margins may face more pressure, especially if there is currency volatility and loan loss provisions may come in even higher than our estimate.

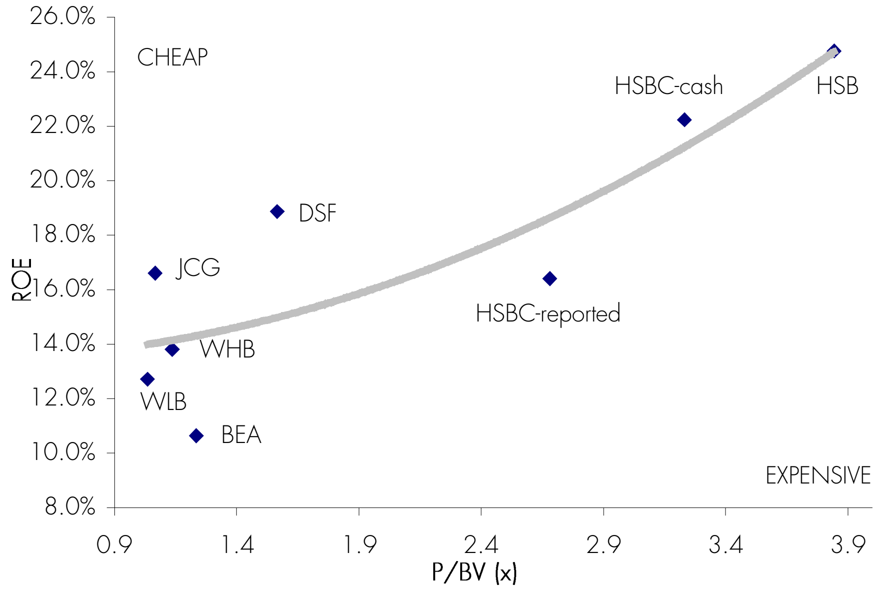
Declining profitability

Figure 18: Hong Kong Banks' Return on Equity

	1999A	2000A	2001E	2002E	2003E
HSBC-cash	17.5%	24.7%	22.2%	20.6%	21.1%
HSBC-reported	16.5%	18.6%	16.4%	15.7%	16.6%
Hang Seng	18.5%	25.0%	24.7%	22.5%	23.9%
BEA	10.1%	11.7%	10.6%	9.1%	9.0%
Financial	15.1%	18.6%	18.9%	17.4%	17.8%
Wing Lung	14.2%	16.3%	12.5%	11.6%	10.4%
Wing Hang	14.7%	17.4%	13.8%	11.9%	11.8%
Average	15.2%	18.9%	17.0%	15.5%	15.8%

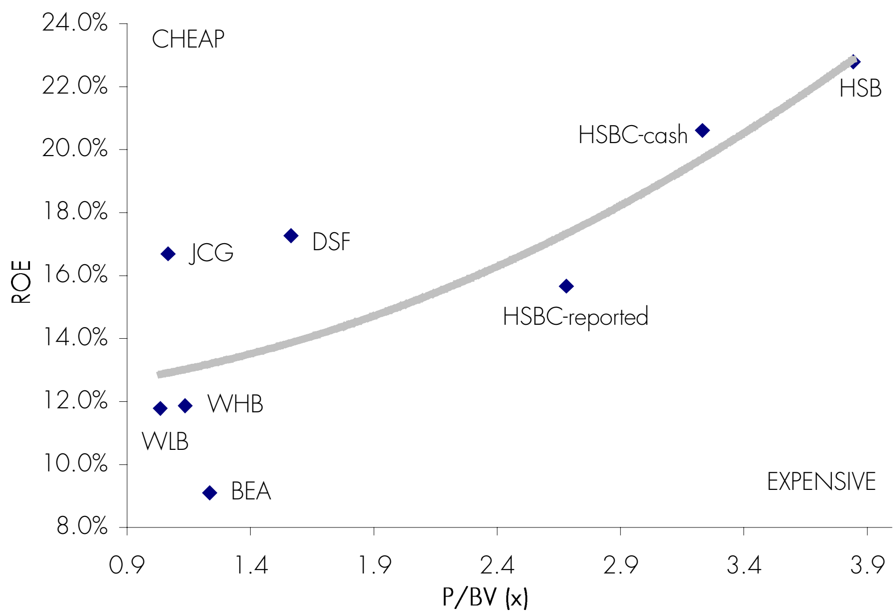
Source: Company reports and Lehman Brothers estimates

Figure 19: 2001 ROE versus P/BV



Source: Lehman Brothers estimates

Figure 20: 2002 ROE versus P/BV



Source: Lehman Brothers estimates

HSBC

Downside Risks Outweigh Potential Upside

Rating: 3-Market Perform

Ticker: 0005.HK
Market Cap: US$105,402 MM
Shares Outstanding: 9,332 MM

We are maintaining our 3-Market Perform rating and price target of HK$84 per share. On a reported basis, HSBC is trading at 14-16x earnings and 2.3-2.5x book value, which is only supported by a ROEs of 16-17% over the next three years. Meanwhile, stripping out goodwill, on a cash basis, HSBC is currently trading at 13-14x earnings and 2.7-3.0x tangible book, but is only supported by a declining ROE of 21-22%. Lower profitability hardly justifies any further multiple expansion and the risk to projected earnings is on the downside.

Increasing loan loss provisions in Europe.

In Europe, we recently increased our loan loss provisions to a more normalized 40 basis points of loans on an annualized basis. Provisions are not likely to increase to crisis levels. That said, we do not believe that charges will revert to levels seen in the previous economic downturn. In fact, we take quite a benign view of the UK credit cycle for the following reasons:

1. The economy in the U.K. still remains relatively stable.
2. U.K. operations are still relatively profitable at the pre-provision level and we are unlikely to revert to the depths of the U.K. recession of the early 1990s. Loan growth is in the neighborhood of 10% for both personal and corporate lending and margins remain buoyant;
3. Debt serviceability remains comfortable. Contrary to the early 1990s, this economic downturn is being accompanied by fiscal and monetary easing;
4. The banks themselves are optimistic and do not envision a sharp jump in provisions. Also, there does not appear to be any large problem loans;

Remain cautious on Asia prospects.

In Hong Kong, although deposit rate deregulation lowered funding costs, this has been offset by a lower return on free funds. However, NIM contraction will be limited to treasury operations. We already saw at the interim that management is increasing its investment in government paper, which now stand at approximately 14% of asset and yield in the neighborhood of over 5%, which is more attractive than new mortgages at 3%. The bank should also be able to maintain its net interest margin at 2.49% in the second half of the year.

Loan loss provision not likely to revert to crisis levels.

The key concern this time is consumer loans which should be hit by rising unemployment. However, management believes that Hong Kong households still have untapped resources that can be called upon if the need arises. This includes savings, friends and family. In 1997/98, the key driver to the asset quality problem was China-related loans and corporate lending, which is not a problem this time. Consequently, we are not expecting loan loss provisions to spike up in the near term.

HSBC

Share Price (HK$):	88.00	Index:	10,405
52 Week Price Range:	122.00 - 68.25	Current Yield:	4.24%
Reuters Code:	0005.HK		
Bloomberg Code:	0005 HK		

INCOME STATEMENT	1999A	2000A	2001E	2002E	2003E
(US$m)					
Interest income	29,204	31,225	30,000	26,500	21,509
Interest expense	-17,214	-17,502	-15,501	-11,305	-11,305
Net interest income	11,990	13,723	14,499	15,195	16,011
Ave. interest earnings assets	*419,231*	*496,335*	*514,709*	*548,165*	*583,796*
NIM (%)	2.86%	2.76%	2.74%	2.70%	#DIV/0!
Non-interest income	9,012	10,850	11,135	11,968	12,904
Total operating income	21,002	24,573	25,634	27,163	28,914
Non-interest expenses	-11,313	-13,577	-14,380	-15,072	-15,812
Pre provision profit	9,689	10,996	11,254	12,091	13,102
Loan loss provisions	-2,244	-1,039	-1,292	-1,474	-1,532
Non-operating income	609	838	1,580	1,138	1,130
Pre tax profit	8,054	10,795	11,542	11,755	12,701
Tax	2,038	2,238	2,416	2,660	2,896
Net profit	5,408	6,628	6,444	6,382	7,059

PER SHARE DATA	1999A	2000A	2001E	2002E	2003E
(US$m)					
Earnings per share	0.65	0.75	0.69	0.68	0.76
Dividends per share	0.34	0.44	0.48	0.53	0.58
Effective payout ratio (%)	*53%*	*61%*	*68%*	*76%*	*77%*
Book value per share	3.95	4.02	4.21	4.37	4.54
Adjusted book value per share	3.18	3.29	3.49	3.73	4.00

VALUATION (x)	1999A	2000A	2001E	2002E	2003E
Price to book value (%)	3.6	2.8	2.7	2.6	2.5
Price to adjusted book value (%)	4.4	3.4	3.2	3.0	2.8
Price to earnings (X)	21.8	15.1	16.3	16.5	14.9

PROFITABILITY RATIOS (%)	1999A	2000A	2001E	2002E	2003E
Net interest margin	2.86%	2.76%	2.74%	2.70%	#DIV/0!
Yield on interest earning assets	6.97%	6.29%	5.68%	4.71%	3.68%
Cost on interest bearing liabilities	-3.78%	-3.28%	-2.69%	-1.84%	-0.86%
Net interest spread	3.19%	3.01%	2.98%	2.86%	2.82%
Non-int. income (% Op income)	42.9%	44.2%	43.4%	44.1%	44.6%
Cost to income	53.9%	55.3%	56.1%	55.5%	54.7%
Overhead ratio	2.15%	2.19%	2.05%	2.06%	2.21%
Cost coverage	*79.7%*	*79.9%*	*77.4%*	*79.4%*	*81.6%*
ROA	95.02%	106.65%	108.16%	110.43%	0.92%
ROE	17.8%	16.8%	18.8%	19.1%	19.1%
ROE-cash	17.5%	24.7%	22.2%	20.6%	21.1%

DUPONT ANALYSIS	1999A	2000A	2001E	2002E	2003E
Lending operations					
Net interest margin	2.86%	2.76%	2.74%	2.70%	#DIV/0!
Interest earnings assets/assets	*73.7%*	*73.7%*	*75.6%*	*75.6%*	#DIV/0!
NIM contribution to ROA	2.11%	2.04%	2.07%	2.04%	2.02%
Non-interest operations					
Non-interest income/assets	1.58%	1.61%	1.59%	1.61%	1.63%
Overhead ratio	1.99%	2.01%	2.06%	2.03%	2.00%
Non-int. contribution to ROA	-0.40%	-0.40%	-0.46%	-0.42%	-0.37%
Asset quality analysis					
Provision/loans	0.86%	0.35%	0.42%	0.45%	0.44%
Loans/assets	46.0%	44.2%	44.4%	44.3%	44.3%
ROA effect from asset quality	0.39%	0.15%	0.18%	0.20%	0.19%
Core ROA	2.10%	1.79%	1.80%	1.82%	1.85%
Non-core contribution to ROA	0.1%	0.1%	0.2%	0.2%	0.1%
Pre-tax ROA	1.42%	1.60%	1.65%	1.58%	1.60%
Tax rate	25.5%	22.9%	24.3%	26.2%	26.1%
After tax ROA	1.05%	1.24%	1.25%	1.17%	1.18%
Balance sheet leverage (x)	16.9x	13.6x	15.1x	16.4x	16.1x
ROE	17.8%	16.8%	18.8%	19.1%	19.1%

BALANCE SHEET	1999A	2000A	2001E	2002E	2003E
(US$m)					
Gross loans	261,587	298,034	310,362	329,996	350,966
Total reserves	*-8,020*	*-8,197*	*-7,896*	*-7,870*	*-7,902*
Net loans	253,567	289,837	302,466	322,126	343,064
Other earning assets	222,181	275,530	297,034	295,462	322,701
Other assets	93,391	108,447	99,259	126,590	126,784
Total Assets	569,139	673,814	698,758	744,178	792,549
Deposits	359,972	427,069	450,558	475,338	466,030
Other paying liabilities	95,399	113,967	109,999	122,575	171,593
Other liabilities	80,360	87,208	98,230	103,345	112,522
Total Liabilities	535,731	628,244	658,787	701,259	750,145
Shareholders' funds	33,408	45,570	39,971	42,919	42,405

GEOGRAPHIC BREAKDOWN	1999A	2000A	2001E	2002E	2003E
Pre-tax profit (US$m)					
Europe	3,330	4,006	4,219	4,168	4,521
Hong Kong	3,054	3,692	3,993	4,175	4,420
Other Asian Countries	329	1,270	1,139	1,213	1,412
North America	959	991	1,015	965	1,069
Latin America	318	324	374	433	477
Total pre-tax profit	7,990	10,283	10,740	10,953	11,899

GEOGRAPHIC BREAKDOWN	1999A	2000A	2001E	2002E	2003E
Pre-tax profit (% of total)					
Europe	42%	39%	39%	38%	38%
Hong Kong	38%	36%	37%	38%	37%
Other Asian Countries	4%	12%	11%	11%	12%
North America	12%	10%	9%	9%	9%
Latin America	4%	3%	3%	4%	4%
Total pre-tax profit	100%	100%	100%	100%	100%

BALANCE SHEET RATIOS	1999A	2000A	2001E	2002E	2003E
(%)					
Loan-to-deposit	*70.4%*	*67.9%*	*68.5%*	*69.2%*	*72.9%*
Loan-to-deposit (incl. CDs)	n.a.	n.a.	n.a.	n.a.	n.a.
Equity to assets	5.9%	6.8%	5.7%	5.8%	5.4%
Tier 1 Capital	8.5%	9.0%	9.4%	9.4%	9.4%
Total reserves (% loans)	3.07%	2.75%	2.54%	2.38%	2.25%

ASSET QUALITY	1999A	2000A	2001E	2002E	2003E
Nonperforming loans	10,525	10,372	9,272	8,808	8,368
NPL ratio	4.0%	3.5%	3.1%	2.6%	2.4%
Total provisions/NPLs	*76.2%*	*79.0%*	*85.2%*	*89.3%*	*94.4%*

GROWTH RATES	1999A	2000A	2001E	2002E	2003E
(%)					
Income statement					
Net interest income	3.8%	14.5%	5.7%	4.8%	5.4%
Non-interest income	3.1%	20.4%	2.6%	7.5%	7.8%
Total operating income	3.5%	17.0%	4.3%	6.0%	6.4%
Operating expenses	0.7%	20.0%	5.9%	4.8%	4.9%
Pre-provision earnings	7.0%	13.5%	2.3%	7.4%	8.4%
Loan loss provisions	-21.7%	-53.7%	24.3%	14.1%	3.9%
Net profit	25.2%	22.6%	-2.8%	-1.0%	10.6%
Balance sheet					
Loan growth	8.1%	13.9%	4.1%	6.3%	6.4%
Interest earning assets	17.8%	18.6%	5.9%	3.0%	*7.7%*
Asset growth	#REF!	#REF!	#REF!	#REF!	#REF!
Deposit growth	#REF!	#REF!	#REF!	#REF!	#REF!
Shareholders funds	21.9%	36.4%	-12.3%	7.4%	-1.2%
Geogrphic					
Europe	15.5%	20.3%	5.3%	-1.2%	8.5%
Hong Kong	25.8%	20.9%	8.2%	4.5%	5.9%
Other Asian Countries	743.6%	286.0%	-10.3%	6.5%	16.4%
North America	-2.8%	3.3%	2.4%	-4.9%	10.8%
Latin America	35.9%	1.9%	15.4%	15.9%	10.0%
Total pre-tax profit	21.6%	28.7%	4.4%	2.0%	8.6%

Source: Company reports; Lehman Brothers estimates.

Bank of East Asia

Asset Quality Concerns

Rating: 4-Market Underperform

Ticker:	0023.HK
Market Cap:	US$2,857 MM
Shares Outstanding:	1,433 MM

Our share price target of HK$13.20 is equivalent to 1x book and 10-11x earnings, which is justifiable for a bank that does not even make its cost of capital, estimated at 12.5%. Net interest margin contraction and high loan loss provisions are likely to result in declining earnings. This results in a projected ROE of only 9% for 2002, the lowest in our Hong Kong universe. ROE and earnings growth are the key drivers to valuation and a decline in both of these metrics means that multiples should contract as well.

Sever margin contraction.

At over one-quarter of interest earnings assets, re-pricing of the mortgage book is likely to take its toll on margins in 2H01. At the interim, the average yield on the mortgage book was already Prime less 1.6% and we expect at least another 30-35 basis points decline in 2H01. Also, similar to the other banks, the contribution from its estimated HK$7 billion of "free funds" will decline by an average of 200 basis points in 2H01. These two factors combined, more than offset the benefits of deposit rate deregulation, which lowered the cost of deposits by an estimated 20 basis points. Consequently, we project the NIM to contract 12 basis points in 2H01 to 2.35% and then a further five basis points in 2002 to 2.30% due to a full year impact of lower returns on free funds.

Loan growth still non-existent.

We project 2H01 loan growth at less than 1%, for a full year figure of just over 4%. Thereafter, with the economy still in the doldrums, we are only projecting another 2.5% in 2002. This figure is at risk if the economy takes longer than expected to recover. In the past, BEA had the additional driver of Rmb-denominated lending to multinationals operating in China. However, we believe that the integration of FPB is diverting management time and effort from these core lending operations.

Loan loss provisions are the main concern.

We have been uncomfortable with BEA's loan loss reserve levels for some time and have argued that it has a loan loss reserve shortfall of HK$1.4 billion or 8% of equity. Our methodology involves applying the HKMA's industry NPL profile of 35% in "sub-standard", 57% in "doubtful" and 8% in the "loss" category (for which the respective provisioning requirements are 20%, 50% and 100%). Meanwhile, we believe that BEA will be hit by a deterioration in both segments of the loan book– the corporate sector will require reserve top-ups and higher unemployment will result in higher consumer related loan provisions. A more realistic loan loss provision level for BEA should be 50 basis points of loans. Thus we are projecting another HK$271 million loan loss provisions in 2H01 for a full year charge of HK$320 million and then HK$527 million in 2002. Even with higher loan loss provisions, we are still concerned about asset quality.

Highest cost-to-income ratio among our Hong Kong universe.

Operating expenses increased by 36% in 1H01 due to integration costs and goodwill charges for FPB, generating a cost/income ratio of 50.4%. This is by far the highest among our coverage universe in Hong Kong and we expect expenses to remain high for a full year cost/income ratio of 51%. We remain skeptical about BEA's ability to extract high levels of cost savings from its acquisitions – FPB and United Chinese Bank.

Share Price:	15.55		Index:	10,405
52 Week Price Range:	22.30 - 14.15		Current Yield:	4.3%

Reuters Code:	0023.HK
Bloomberg Code:	0023 HK

INCOME STATEMENT (HK$m)	1999A	2000A	2001E	2002E	2003E
Interest income	9,879	10,666	9,436	6,291	6,518
Interest expense	-6,375	-6,971	-5,370	-2,360	-2,360
Net interest income	3,505	3,695	4,066	3,932	4,051
Ave. interest earnings assets	*130,280*	*138,922*	*169,062*	*170,882*	*174,296*
NIM (%)	2.69%	2.66%	2.41%	2.30%	2.32%
Non-interest income	992	1,287	1,412	1,543	1,664
Total operating income	4,496	4,983	5,478	5,474	5,715
Non-interest expenses	-1,803	-2,083	-2,714	-2,817	-2,986
Pre provision profit	2,694	2,900	2,764	2,658	2,728
Loan loss provisions	-2,215	-681	-320	-527	-510
Non-operating income	2	11	91	91	91
Pre tax profit	481	2,230	2,534	2,222	2,309
Tax	-126	-282	-374	-337	-351
Net profit	1,488	1,871	1,876	1,684	1,752

PER SHARE DATA (HK$)	1999A	2000A	2001E	2002E	2003E
Earnings per share	1.08	1.35	1.31	1.18	1.23
Dividends per share	0.53	0.66	0.60	0.59	0.61
Effective payout ratio (%)	*50%*	*49%*	*46%*	*50%*	*50%*
Book value per share	10.87	12.16	12.59	13.18	13.79
Adjusted book value per share	9.86	11.18	11.62	12.21	12.83

VALUATION (X)	1999A	2000A	2001E	2002E	2003E
Price to book value (x)	2.0	1.3	1.2	1.2	1.1
Price to adjusted book value (x)	2.2	1.4	1.3	1.3	1.2
Price to earnings (X)	20.1	11.5	11.9	13.2	12.7

PROFITABILITY RATIOS (%)	1999A	2000A	2001E	2002E	2003E
Net interest margin	2.69%	2.66%	2.41%	2.30%	2.32%
Yield on interest earning assets	7.84%	7.18%	5.72%	3.63%	3.63%
Cost on interest bearing liabilities	5.31%	4.99%	3.43%	1.47%	1.48%
Net interest spread	2.53%	2.19%	2.29%	2.16%	2.15%
Non-int. income (% Op income)	22.1%	25.8%	25.8%	28.2%	29.1%
Cost to income	40.1%	41.8%	49.5%	51.4%	52.3%
Overhead ratio	0.82%	0.93%	0.84%	0.90%	0.95%
Cost coverage	55.0%	61.8%	52.0%	54.8%	55.7%
ROA	1.08%	1.22%	1.03%	0.91%	0.92%
ROE	10.1%	11.7%	10.6%	9.1%	9.0%

DUPONT ANALYSIS	1999A	2000A	2001E	2002E	2003E
Lending operations					
Net interest margin	2.69%	2.66%	2.41%	2.30%	2.32%
Interest earnings assets/assets	94.5%	90.3%	93.2%	92.7%	91.2%
NIM contribution to ROA	2.54%	2.40%	2.24%	2.13%	2.12%
Non-interest operations					
Non-interest income/assets	0.72%	0.84%	0.78%	0.84%	0.87%
Overhead ratio	1.31%	1.35%	1.50%	1.53%	1.56%
Non-int. contribution to ROA	-0.59%	-0.52%	-0.72%	-0.69%	-0.69%
Asset quality analysis					
Provision/loans	-2.63%	-0.76%	-0.30%	-0.48%	-0.45%
Loans/assets	61.1%	58.3%	58.9%	59.4%	59.4%
ROA effect from asset quality	-1.61%	-0.44%	-0.18%	-0.29%	-0.27%
Core ROA	0.35%	1.44%	1.35%	1.16%	1.16%
Non-core contribution to ROA	0.00%	0.01%	-0.05%	-0.05%	-0.05%
Pre-tax ROA	0.35%	1.45%	1.30%	1.11%	1.11%
Tax rate	26.1%	12.7%	15.9%	16.5%	16.5%
After tax ROA	0.26%	1.27%	1.09%	0.92%	0.93%
Balance sheet leverage (x)	9.4x	9.6x	10.3x	10.0x	9.9x
ROE	2.4%	12.2%	11.2%	9.2%	9.2%

BALANCE SHEET (HK$m)	1999A	2000A	2001E	2002E	2003E
Gross loans	84,074	103,994	108,262	110,908	116,333
Specific loan loss reserves	*-2,399*	*-671*	*-1,044*	*-1,539*	*-1,983*
General loan loss reserves	*-1,200*	*-1,271*	*-1,323*	*-1,355*	*-1,421*
Net loans	80,475	102,052	105,895	108,014	112,929
Other earning assets	56,555	62,731	61,773	61,967	63,726
Other assets	8,311	14,159	14,995	17,180	19,707
Total Assets	145,341	178,942	182,664	187,161	196,362
Deposits	112,259	138,747	137,824	140,346	145,479
Other paying liabilities	5,935	9,003	16,714	17,527	20,115
Other liabilities	12,115	14,111	10,121	10,441	11,044
Total Liabilities	130,310	161,861	164,659	168,315	176,639
Minorities & other	0	0	0	0	0
Shareholders' funds	15,031	17,081	18,005	18,847	19,723

LOAN BOOK (HK$m)	1999A	2000A	2001E	2002E	2003E
Property development	12,158	15,811	17,458	17,809	18,167
Non-bank financials	2,844	2,815	1,999	1,744	1,522
Commercial and industrial	3,644	4,197	4,357	4,212	4,072
Hire purchase	878	3,388	3,464	3,370	3,618
Other commercial	3,906	7,565	8,760	8,760	8,760
Trade finance	2,487	3,111	3,015	2,442	1,978
Loans for use outside HK	18,059	17,996	19,144	20,114	23,244
HOS & PSPS loans	2,492	2,647	2,709	2,709	2,709
Residential mortgages	34,946	41,120	41,646	43,755	45,970
Credit cards	821	1,601	1,752	1,837	1,926
Individuals	1,837	3,742	3,957	4,157	4,368
Total loans	84,074	103,994	108,262	110,908	116,333

LOAN BOOK BREAKDOWN (%)	1999A	2000A	2001E	2002E	2003E
Property development	14%	15%	16%	16%	16%
Non-bank financials	3%	3%	2%	2%	1%
Commercial and industrial	4%	4%	4%	4%	3%
Hire purchase	1%	3%	3%	3%	3%
Other commercial	5%	7%	8%	8%	8%
Trade finance	3%	3%	3%	2%	2%
Loans for use outside HK	21%	17%	18%	18%	20%
HOS & PSPS loans	3%	3%	3%	2%	2%
Residential mortgages	42%	40%	38%	39%	40%
Credit cards	1%	2%	2%	2%	2%
Individuals	2%	4%	4%	4%	4%
Total loans	100%	100%	100%	100%	100%

BALANCE SHEET RATIOS (%)	1999A	2000A	2001E	2002E	2003E
Loan-to-deposit	74.9%	75.0%	78.6%	79.0%	80.0%
Loan-to-deposit (incl. CDs)	69.7%	70.6%	73.4%	73.9%	74.9%
Equity to assets	10.3%	9.5%	9.9%	10.1%	10.0%
Tier 1 Capital	16.4%	14.8%	14.0%	14.2%	14.1%
Total Capital adequacy	18.1%	16.1%	15.2%	15.4%	15.2%
General reserves (% loans)	-1.43%	-1.22%	-1.22%	-1.22%	-1.22%
Specific reserves (% loans)	-2.85%	-0.65%	-0.96%	-1.39%	-1.70%
Total loan provisions	-4.28%	-1.87%	-2.19%	-2.61%	-2.93%

ASSET QUALITY	1999A	2000A	2001E	2002E	2003E
Nonperforming loans	6,701	3,745	4,439	5,863	7,423
NPL ratio	8.0%	3.6%	4.1%	5.3%	6.4%
Total provisions/NPLs	53.7%	51.8%	53.3%	49.4%	45.9%

GROWTH RATES (%)	1999A	2000A	2001E	2002E	2003E
Income statement					
Net interest income	5.3%	5.4%	10.0%	-3.3%	3.0%
Non-interest income	-2.6%	29.8%	9.7%	9.3%	7.8%
Total operating income	3.5%	10.8%	9.9%	-0.1%	4.4%
Operating expenses	6.1%	15.5%	30.3%	3.8%	6.0%
Pre-provision earnings	1.8%	7.6%	-4.7%	-3.8%	2.7%
Loan loss provisions	47.1%	-69.3%	-52.9%	64.5%	-3.2%
Net profit	81.6%	25.7%	0.2%	-10.2%	4.1%
Balance sheet					
Loan growth	0.5%	23.7%	4.1%	2.4%	4.9%
Interest earning assets	7.7%	18.6%	2.0%	1.7%	4.2%
Asset growth	7.1%	23.1%	2.1%	2.5%	4.9%
Deposit growth	11.3%	23.6%	-0.7%	1.8%	3.7%
Shareholders funds	6.4%	13.6%	5.4%	4.7%	4.6%

Source: Company reports; Lehman Brothers estimates.

Dah Sing Financial

Consumer Banking Generates Higher Returns

Rating: 3-Market Perform

Our price target represents 1.6x BV and 9x earnings, which is reasonable for a bank that is going to exhibit lower ROEs and slower earnings growth. This bank is best suited to cope with a declining interest rate environment and lower returns on free funds will be offset by higher returns on the fixed-rate component of its loan book.

Ticker:	0440.HK
Market Cap:	US$1,053MM
Shares Outstanding:	247MM

Struggling for growth, but heavier emphasis on consumer loans.

We expect full year loan growth of 2% (1% in 1H01) and then 3% in 2002. This bank continues to re-configure its loan book composition to a heavier weighting of consumer banking. For the year, we expect consumer related loans (buoyed by more credit cards and personal loans) to be up approximately 10% while commercial loans are expected to decline approximately 7% due in no small part to the withdrawal from taxi license financing, which has already declined by over 30% in 1H01.

Fixed rate consumer loans offset lost yield on mortgages and lower return on free funds.

This concentration in high yielding, fixed-rate loans is helping Dah Sing cope with lost yield on the mortgage book (currently at Prime less 1.7%, compared to Prime less 1.3% at the interim and Prime less 1.0% at the end of 2000). However, combined with the expected lost yield on its estimated HK$4 billion "free funds", we expect net interest margin to only be maintained at the current level of 3.70% and then increase slightly to 3.75% in 2002. Dah Sing has an estimated HK$6 billion in fixed-rate loans, comprised credit card receivables and personal loans.

Management is still optimistic about credit cards.

Management has indicated that they are still optimistic about the prospects for credit card operations and is not too concerned about increasing competition, which is a part of any profitable business. Dah Sing has approximately 460,000 active cards, and over HK$2.5 billion in receivables. We estimate that credit card operations account for over one-quarter of group earnings and any reduction in yields is sure to hurt.

Loan loss provisions are likely to stay around the HK$300 million in 2001 and 2002.

Loan loss provisions are expected to remain high, at approximately the same level reported in 2000. However, the components of the provisions are changing, with a larger portion being for consumer loans and less for corporate loans—this is happening due in part to the contraction in the corporate book. Charge-offs on personal loans is running at about 1.3%, credit cards at 4% and mortgages at 0.2%, which means the charge-off on the corporate book is less than 1%.

Non-interest income to be boosted by better trading gains and recovery in insurance.

Management has indicated that it turned over a significant portion of its fixed income portfolio, likely generating trading gains (part of non-interest income) and disposal gains (below-line items). It realized HK$51 million in 1H01 and we have penciled in HK$65 million for 2H01. Meanwhile, fee income should show a recovery due to insurance operations, which we estimate will contribute HK$50 million, for a full year contribution of HK$86 million, just below the HK$87 million reported in 2000. Our main concern has been the volatility of investment earnings. Nonetheless, the underlying business is growing, with new sales up over 30% and persistency at over 75%.

Share Price:	33.30			Index:	10,405
52 Week Price Range:	46.00 -	28.85		Current Yield:	3.2%
Reuters Code:	0440.HK				
Bloomberg Code:	0440 HK				

INCOME STATEMENT (HK$m)	1999A	2000E	2001E	2002E	2003E
Interest income	3,489	3,817	3,109	2,337	2,233
Interest expense	-2,165	-2,283	-1,518	-674	-674
Net interest income	1,324	1,534	1,591	1,662	1,707
Ave. interest earnings assets	*39,293*	*40,481*	*43,147*	*44,082*	*45,627*
NIM (%)	3.37%	3.79%	3.69%	3.77%	3.74%
Non-interest income	521	503	559	644	717
Total operating income	1,846	2,037	2,150	2,306	2,424
Non-interest expenses	-744	-823	-898	-903	-858
Pre provision profit	1,102	1,214	1,252	1,403	1,566
Loan loss provisions	-407	-311	-303	-303	-304
Non-operating income	-35	25	120	5	5
Pre tax profit	661	928	1,069	1,105	1,267
Tax	-65	-105	-130	-138	-158
Net profit	587	810	936	964	1,106

PER SHARE DATA (HK$)	1999A	2000E	2001E	2002E	2003E
Earnings per share	2.40	3.29	3.81	3.92	4.50
Dividends per share	0.82	1.08	1.41	1.45	1.66
Effective payout ratio (%)	*34%*	*33%*	*37%*	*37%*	*37%*
Book value per share	16.75	18.96	21.28	23.75	26.58
Adjusted book value per share	15.34	17.48	19.80	22.27	25.10

VALUATION (X)	1999A	2000E	2001E	2002E	2003E
Price to book value (%)	1.9	1.8	1.6	1.4	1.3
Price to adjusted book value (%)	2.0	1.9	1.7	1.5	1.3
Price to earnings (X)	12.0	10.1	8.7	8.5	7.4

PROFITABILITY RATIOS (%)	1999A	2000E	2001E	2002E	2003E
Net interest margin	3.37%	3.79%	3.69%	3.77%	3.74%
Yield on interest earning assets	8.88%	9.43%	7.21%	5.30%	4.89%
Cost on interest bearing liabilities	5.95%	6.02%	3.95%	1.71%	1.31%
Net interest spread	2.93%	3.41%	3.26%	3.60%	3.58%
Non-int. income (% Op income)	28.3%	24.7%	26.0%	27.9%	29.6%
Cost to income	40.3%	40.4%	41.8%	39.1%	35.4%
Overhead ratio	1.33%	1.24%	1.30%	1.46%	1.57%
Cost coverage	70.1%	61.1%	62.3%	71.3%	83.6%
ROA	1.34%	1.71%	1.82%	1.82%	2.03%
ROE	15.1%	18.6%	18.9%	17.4%	17.8%

DUPONT ANALYSIS	1999A	2000E	2001E	2002E	2003E
Lending operations					
Net interest margin	3.37%	3.79%	3.69%	3.77%	3.74%
Interest earnings assets/assets	90.0%	85.6%	83.7%	83.0%	83.5%
NIM contribution to ROA	3.03%	3.25%	3.09%	3.13%	3.13%
Non-interest operations					
Non-interest income/assets	1.19%	1.06%	1.08%	1.21%	1.31%
Overhead ratio	1.70%	1.74%	1.74%	1.70%	1.57%
Non-int. contribution to ROA	-0.51%	-0.68%	-0.66%	-0.49%	-0.26%
Asset quality analysis					
Provision/loans	-1.54%	-1.12%	-1.02%	-0.99%	-0.96%
Loans/assets	60.4%	58.9%	57.8%	57.6%	58.2%
ROA effect from asset quality	-0.93%	-0.66%	-0.59%	-0.57%	-0.56%
Core ROA	1.59%	1.91%	1.84%	2.07%	2.31%
Non-core contribution to ROA	-0.08%	0.05%	0.23%	0.01%	0.01%
Pre-tax ROA	1.51%	1.96%	2.07%	2.08%	2.32%
Tax rate	9.9%	11.3%	12.2%	12.5%	12.5%
After tax ROA	1.36%	1.74%	1.82%	1.82%	2.03%
Balance sheet leverage (x)	11.3x	10.8x	10.4x	9.6x	8.8x
ROE	15.4%	18.9%	18.9%	17.4%	17.9%

BALANCE SHEET (HK$m)	1999A	2000E	2001E	2002E	2003E
Gross loans	27,245	29,495	30,068	31,155	32,494
Specific loan loss reserves	*-236*	*-236*	*-529*	*-823*	*-1,114*
General loan loss reserves	*-248*	*-268*	*-274*	*-284*	*-296*
Net loans	26,997	29,227	29,794	30,872	32,198
Other earning assets	10,951	12,252	13,267	13,561	13,926
Other assets	6,446	8,222	9,357	9,286	9,301
Total Assets	44,394	49,702	52,418	53,719	55,425
Deposits	32,607	31,385	32,346	33,221	34,289
Other paying liabilities	4,323	5,358	6,742	6,258	5,830
Other liabilities	3,365	8,296	8,097	8,399	8,770
Total Liabilities	40,295	45,040	47,185	47,878	48,888
Minorities & other	0	0	0	0	0
Shareholders' funds	4,099	4,662	5,233	5,841	6,537

LOAN BOOK (HK$m)	1999A	2000E	2001E	2002E	2003E
Property development	2,609	2,288	2,687	2,741	2,796
Non-bank financials	179	233	375	363	351
Commercial and industrial	2,999	3,403	3,525	3,547	3,570
Hire purchase	4,541	4,669	3,138	3,053	2,969
Other commercial	560	823	786	786	786
Trade finance	2,168	1,990	1,835	1,486	1,204
Loans for use outside HK	544	469	497	497	497
HOS & PSPS loans	1,902	1,835	2,115	2,115	2,115
Residential mortgages	7,613	8,460	8,461	8,890	9,340
Credit card receivables	1,759	2,276	2,800	3,230	3,725
Individuals	2,373	3,050	3,849	4,448	5,140
Total loans	27,245	29,495	30,068	31,155	32,494

LOAN BOOK BREAKDOWN (%)	1999A	2000E	2001E	2002E	2003E
Property development	10%	8%	9%	9%	9%
Non-bank financials	1%	1%	1%	1%	1%
Commercial and industrial	11%	12%	12%	11%	11%
Hire purchase	17%	16%	10%	10%	9%
Other commercial	2%	3%	3%	3%	2%
Trade finance	8%	7%	6%	5%	4%
Loans for use outside HK	2%	2%	2%	2%	2%
HOS & PSPS loans	7%	6%	7%	7%	7%
Residential mortgages	28%	29%	28%	29%	29%
Credit card receivables	6%	8%	9%	10%	11%
Individuals	9%	10%	13%	14%	16%
Total loans	100%	100%	100%	100%	100%

BALANCE SHEET RATIOS (%)	1999A	2000E	2001E	2002E	2003E
Loan-to-deposit	83.6%	94.0%	93.0%	93.8%	94.8%
Loan-to-deposit (incl. CDs)	73.5%	78.7%	78.1%	79.1%	80.3%
Equity to assets	9.2%	9.4%	10.0%	10.9%	11.8%
Tier 1 Capital	12.7%	13.1%	13.7%	15.0%	16.3%
Total Capital adequacy	13.9%	14.3%	14.1%	15.2%	16.3%
General reserves (% loans)	-0.91%	-0.91%	-0.91%	-0.91%	-0.91%
Specific reserves (% loans)	-0.87%	-0.80%	-1.76%	-2.64%	-3.43%
Total loan provisions	-1.78%	-1.71%	-2.67%	-3.55%	-4.34%

ASSET QUALITY	1999A	2000E	2001E	2002E	2003E
Nonperforming loans	935	667	617	513	428
NPL ratio	3.4%	2.3%	2.1%	1.6%	1.3%
Total provisions/NPLs	51.8%	75.7%	130.1%	215.5%	329.8%

GROWTH RATES (%)	1999A	2000E	2001E	2002E	2003E
Income statement					
Net interest income	37.7%	15.9%	3.7%	4.5%	2.7%
Non-interest income	11.5%	-3.6%	11.3%	15.1%	11.4%
Total operating income	29.1%	10.4%	5.6%	7.2%	5.1%
Operating expenses	0.6%	10.7%	9.1%	0.5%	-4.9%
Pre-provision earnings	59.8%	10.1%	3.1%	12.1%	11.6%
Loan loss provisions	59.3%	-23.5%	-2.6%	0.1%	0.3%
Net profit	132.7%	38.1%	15.5%	3.0%	14.7%
Balance sheet					
Loan growth	10.3%	8.3%	1.9%	3.6%	4.3%
Interest earning assets	8.3%	9.3%	3.8%	3.2%	3.8%
Asset growth	10.9%	12.0%	5.5%	2.5%	3.2%
Deposit growth	13.0%	-3.7%	3.1%	2.7%	3.2%
Shareholders funds	11.4%	13.7%	12.3%	11.6%	11.9%

Source: Company reports; Lehman Brothers estimates.

Hang Seng Bank

Squeezed

Rating: 4-Market UnderPerform

Ticker:	0011.HK
Market Cap:	US$20,037MM
Shares Outstanding:	1,192MM

We lowered our investment rating to 4-Market Underperform from 2-Buy and lowering our share price target to HK$70. We recently met with the management of Hang Seng Bank and discovered several negative surprises that have led to a change in our near term opinion on the stock to a more cautious and negative position. The biggest negative surprise for us was that the net interest margin is contracting and we believe that the market will take this news negatively. Benefits of deposit rate deregulation are being offset by lower returns on free funds. While we have the greatest respect for management and what they are doing, some things, such as interest rates, are out of their control and will offset the positive things that they have done.

Previous outperformance on expectations of better NIM after deposit rate deregulation…

The shares of Hang Seng Bank have been among the best performing large-cap stocks in Hong Kong since the beginning of March 2001, outperforming the Hang Seng Index by 18%. The key driver to the outperformance, in our opinion, has been expectations of a better net interest margin following deposit rate deregulation. This however, will not happen. Although the cost of funds has declined due to lower deposit rates, the lower interest rate environment has resulted in lower returns on free funds, which more than offsets the gains on the liability side. Consequently, the net interest margin is expected to contract in the second half of the year—we project eight basis point contraction to 2.50%. A full year impact of lower interest rates will result in further contraction in 2002 by another ten basis points to 2.40%. Thereafter, we expect a more stable interest rate environment, which will result in a more stable net interest margin.

…however, negative endowment effect on free funds in lower interest rate environment more than offsets above gains.

Lower earnings…

We are lowering our earnings estimates by 4% and 15% in 2001 and 2002 respectively. Consequently, profitability as measured by ROE is expected to decline to 23.2% in the second half of this year for a full year ROE of 24.9%. Then in 2002, further deterioration in profitability will result in an even lower ROE of 23.2%.

…and price target to HK$70

Consequently, we are lowering our price target to HK$70, which represents 12% downside from the current level. At this level, the shares of Hang Seng would be trading at 13.3x 2001 and 14.2x 2002 earnings. Meanwhile, this price target represents 3.3x 2001 and 3.2x 2002 projected book values. Although one could argue that Hang Seng's share price should be supported by its high dividend yield, we believe that there is risk that the dividend could be cut.

Risks are on the downside!

Looking ahead, we believe that further risks are on the downside:

- Dividend could be cut, resulting in a lower dividend yield;
- Loan loss provisions could be higher than expected;
- Even more severe contraction in net interest margin;
- Disposal gains are a wildcard.

Share Price:	81.75	Index:	10,405
52 Week Price Range:	108.00 - 72.00	rrent Yield:	5.9%
Reuters Code:			
Bloomberg Code:			

INCOME STATEMENT (HK$m)	1999A	2000E	2001E	2002E	2003E
Interest income	28,072	31,913	23,907	14,733	14,736
Interest expense	-16,405	-20,222	-12,388	-4,098	-4,098
Net interest income	11,667	11,691	11,519	10,635	11,347
Ave. interest earnings assets	*406,113*	*435,759*	*454,031*	*448,688*	*450,568*
NIM (%)	2.87%	2.68%	2.54%	2.37%	2.52%
Non-interest income	3,141	3,574	3,851	4,226	4,507
Total operating income	14,808	15,265	15,370	14,861	15,854
Non-interest expenses	-3,743	-3,725	-3,978	-4,109	-4,374
Pre provision profit	11,065	11,540	11,392	10,752	11,480
Loan loss provisions	-1,419	-196	-191	-288	-286
Non-operating income	138	331	463	257	262
Pre tax profit	9,784	11,675	11,664	10,720	11,457
Tax	-1,477	-1,661	-1,548	-1,447	-1,547
Net profit	8,307	10,014	10,116	9,273	9,910

PER SHARE DATA (HK$)	1999A	2000E	2001E	2002E	2003E
Earnings per share	4.35	5.24	5.29	4.85	5.18
Dividends per share	8.20	4.80	4.85	4.90	4.95
Effective payout ratio (%)	*189%*	*92%*	*92%*	*101%*	*95%*
Book value per share	20.70	21.23	21.27	21.22	21.82
Adjusted book value per share	16.40	16.66	17.49	18.39	19.36

VALUATION (X)	1999A	2000E	2001E	2002E	2003E
Price to book value (x)	4.3	3.9	3.8	3.9	3.7
Price to adjusted book value (x)	5.4	4.9	4.7	4.4	4.2
Price to earnings (X)	20.4	15.6	15.4	16.9	15.8

PROFITABILITY RATIOS (%)	1999A	2000E	2001E	2002E	2003E
Net interest margin	2.87%	2.68%	2.54%	2.37%	2.52%
Yield on interest earning assets	6.91%	7.32%	5.27%	3.28%	3.27%
Cost on interest bearing liabilities	4.77%	5.32%	3.20%	1.07%	0.88%
Net interest spread	2.14%	2.01%	2.07%	2.21%	2.39%
Non-int. income (% Op income)	21.2%	23.4%	25.1%	28.4%	28.4%
Cost to income	25.3%	24.4%	25.9%	27.7%	27.6%
Overhead ratio	0.77%	0.82%	0.89%	0.95%	0.97%
Cost coverage	83.9%	95.9%	96.8%	102.8%	103.1%
ROA	1.92%	2.11%	2.08%	1.93%	2.05%
ROE	18.5%	25.0%	24.7%	22.5%	23.9%

DUPONT ANALYSIS	1999A	2000E	2001E	2002E	2003E
Lending operations					
Net interest margin	2.87%	2.68%	2.54%	2.37%	2.52%
Interest earnings assets/assets	93.7%	91.9%	93.3%	93.4%	93.3%
NIM contribution to ROA	2.69%	2.46%	2.37%	2.21%	2.35%
Non-interest operations					
Non-interest income/assets	0.72%	0.75%	0.79%	0.88%	0.93%
Overhead ratio	0.86%	0.79%	0.82%	0.86%	0.91%
Non-int. contribution to ROA	-0.14%	-0.03%	-0.03%	0.02%	0.03%
Asset quality analysis					
Provision/loans	-0.70%	-0.09%	-0.08%	-0.12%	-0.11%
Loans/assets	46.6%	45.2%	46.3%	49.1%	52.1%
ROA effect from asset quality	-0.33%	-0.04%	-0.04%	-0.06%	-0.06%
Core ROA	2.23%	2.39%	2.30%	2.18%	2.32%
Non-core contribution to ROA	0.03%	0.07%	0.10%	0.05%	0.05%
Pre-tax ROA	2.26%	2.46%	2.40%	2.23%	2.37%
Tax rate	15.1%	14.2%	13.3%	13.5%	13.5%
After tax ROA	1.92%	2.11%	2.08%	1.93%	2.05%
Balance sheet leverage (x)	9.6x	11.9x	11.9x	11.7x	11.6x
ROE	18.5%	25.0%	24.7%	22.5%	23.9%

BALANCE SHEET (HK$m)	1999A	2000E	2001E	2002E	2003E
Gross loans	202,244	221,973	228,559	243,823	259,581
Specific loan loss reserves	*-3,522*	*-3,017*	*-2,560*	*-2,613*	*-2,676*
General loan loss reserves	*-1,441*	*-1,438*	*-1,432*	*-1,452*	*-1,475*
Net loans	200,803	220,535	227,127	242,371	258,106
Other earning assets	206,035	244,283	225,141	223,377	222,259
Other assets	35,232	35,966	27,704	15,705	3,892
Total Assets	442,070	500,784	479,971	481,453	484,256
Deposits	364,038	414,875	391,255	392,579	394,912
Other paying liabilities	(11,788)	(16,535)	(9,611)	(10,294)	(11,352)
Other liabilities	50,246	61,860	57,673	58,601	58,973
Total Liabilities	402,496	460,200	439,316	440,886	442,534
Minorities & other	0	0	0	0	0
Shareholders' funds	39,574	40,584	40,655	40,567	41,723

LOAN BOOK (HK$m)	1999A	2000E	2001E	2002E	2003E
Property development	39,739	48,658	50,623	54,753	59,221
Non-bank financials	4,055	3,076	3,076	3,076	3,076
Commercial and industrial	6,394	5,891	6,129	6,377	6,634
Hire purchase	8,411	8,471	9,518	10,694	12,016
Other commercial	17,443	19,073	19,454	20,240	20,240
Trade finance	8,787	9,013	9,238	9,238	9,238
Loans for use outside HK	3,276	4,195	4,195	4,195	4,195
HOS & PSPS loans	31,936	35,971	37,792	37,792	37,792
Residential mortgages	73,854	78,005	78,005	86,001	94,816
Credit cards	3,835	4,745	5,407	6,075	6,698
Individuals	4,514	4,875	5,122	5,381	5,654
Total loans	202,244	221,973	223,015	226,013	229,636

LOAN BOOK BREAKDOWN (%)	1999A	2000E	2001E	2002E	2003E
Property development	20%	22%	23%	24%	26%
Non-bank financials	2%	1%	1%	1%	1%
Commercial and industrial	3%	3%	3%	3%	3%
Hire purchase	4%	4%	4%	5%	5%
Other commercial	9%	9%	9%	9%	9%
Trade finance	4%	4%	4%	4%	4%
Loans for use outside HK	2%	2%	2%	2%	2%
HOS & PSPS loans	16%	16%	17%	17%	16%
Residential mortgages	37%	35%	35%	38%	41%
Credit cards	2%	2%	2%	3%	3%
Individuals	2%	2%	2%	2%	2%
Total loans	100%	100%	100%	100%	100%

BALANCE SHEET RATIOS (%)	1999A	2000E	2001E	2002E	2003E
Loan-to-deposit	55.6%	53.5%	55.1%	55.8%	56.5%
Loan-to-deposit (incl. CDs)	53.8%	51.7%	53.2%	54.0%	54.8%
Equity to assets	9.0%	8.1%	8.5%	8.4%	8.6%
Tier 1 Capital	13.3%	11.9%	12.3%	12.4%	12.5%
Total Capital adequacy	17.3%	15.2%	15.5%	15.2%	16.0%
General reserves (% loans)	-0.71%	-0.65%	-0.63%	-0.60%	-0.57%
Specific reserves (% loans)	-1.74%	-1.36%	-1.12%	-1.07%	-1.03%
Total loan provisions	-2.45%	-2.01%	-1.75%	-1.67%	-1.60%

ASSET QUALITY	1999A	2000E	2001E	2002E	2003E
Nonperforming loans	8,658	7,434	6,458	6,273	6,117
NPL ratio	4.3%	3.3%	2.9%	2.8%	2.7%
Total provisions/NPLs	57.3%	59.9%	61.8%	64.8%	67.9%

GROWTH RATES (%)	1999A	2000E	2001E	2002E	2003E
Income statement					
Net interest income	2.7%	0.2%	-1.5%	-7.7%	6.7%
Non-interest income	0.0%	13.8%	7.7%	9.7%	6.7%
Total operating income	2.1%	3.1%	0.7%	-3.3%	6.7%
Operating expenses	-3.2%	-0.5%	6.8%	3.3%	6.4%
Pre-provision earnings	4.1%	4.3%	-1.3%	-5.6%	6.8%
Loan loss provisions	-42.7%	-86.2%	-2.5%	50.8%	-0.7%
Net profit	22.4%	20.5%	1.0%	-8.3%	6.9%
Balance sheet					
Loan growth	-0.2%	9.8%	3.0%	6.7%	6.5%
Interest earning assets	4.5%	14.2%	-2.7%	3.0%	3.1%
Asset growth	5.2%	13.3%	2.8%	6.6%	6.4%
Deposit growth	6.6%	14.0%	-0.1%	5.3%	5.2%
Shareholders funds	-8.1%	2.6%	0.2%	-0.2%	2.8%

Source: Company reports; Lehman Brothers estimates.

Wing Hang Bank

Caught In a Tight Spot

Rating: 4-Market Underperform

Ticker:	0302.HK
Market Cap:	US$903MM
Shares Outstanding:	293MM

We are lowering our investment rating to 4-Market Underperform and are lowering our price target to HK$21, from HK$27 previously. At our new rice target Wing Hang would be trading at 1x prospective book value and approximately 8x earnings. Valuations on both book and earnings are being negatively impacted by the lower expected ROEs of 12% over the next two years. The outlook for this bank is similar to the rest of the sector—bleak. There is no loan growth, margins are under pressure and the deteriorating economy will likely lead to higher loan loss provisions.

1-2% loan growth expected in 2H01.

In 1H01, Wing Hang already exhibited the strongest loan growth in our Hong Kong universe at 5.6%, and we expect another 1.4% in 2H01, for a full year projection of 7.0%. Looking ahead to next year, we expect a sharp slowdown to only 3%. We must point out that the risks are still on the downside and the economic recovery may take even longer. All the loan growth has come from China, Hong Kong dollar-denominated mortgages (at Prime less 1%) and from personal and credit card loans.

Margins are under severe pressure.

In 1H01, the strong loan growth relative to the sector came at the expense of the net interest margin, which contracted 31 basis points to 2.85%. Looking ahead, we expect further margin contraction, particularly from the mortgage book, which is contracting at four to five basis points per month (slower than the six to seven basis points reported in 1H01). In addition, Wing Hang has approximately HK$5 billion in free funds which are now generating lower returns due to a negative endowment effect. Consequently, the net interest margin is expected to contract to 2.77% in 2H01 for a full year figure of 2.81% and then to 2.66% in 2002. Our assumption incorporates a slight increase in the deposit book, resulting in a loan-to-deposit ratio of 65%, the same as in 1H01.

Loan loss provisions to remain high.

At the guidance of management, we expect a 2H02 loan loss provision similar to that taken in 1H01. Thereafter, in 2002, we are projecting that NPLs remain high and are projecting a loan loss provision of HK$332 million. Management is not too concerned about asset quality and does not expect NPLs to spike up. They have indicated that problems are likely to come from the consumer space, particularly if unemployment increases sharply. Nonetheless, they do feel that this segment is more manageable than the corporate sector, which was the cause of the asset quality problems in 1997/98. NPLs on mortgages are likely to remain at the 1.3%-level and the overall NPL ratio is expected to increase slightly from the 3.73% reported at the interim.

Looking for better balance sheet management.

Management is concerned about declining asset yields and the lack of lending opportunities. Following the lead of some of the other local banks, management is looking to increase treasuries operations and has hired a bond trading team. Given management's low appetite for risk, exposure will be kept to a minimum for now, we would guess at approximately HK$5 billion, or one-third of its interbank loans or just under 10% of total assets.

Share Price:				Index:	10,405
52 Week Price Range:	24.00			Current Yield:	5.1%
	33.80 -	21.00			

Reuters Code:	0302.HK
Bloomberg Code:	0302 HK

INCOME STATEMENT	1999A	2000E	2001E	2002E	2003E
(HK$m)					
Interest income	3,834	4,314	3,154	2,022	2,068
Interest expense	-2,390	-2,654	-1,633	-565	-565
Net interest income	1,444	1,659	1,520	1,457	1,497
Ave. interest earnings assets	*49,452*	*52,514*	*54,227*	*55,128*	*56,812*
NIM (%)	2.92%	3.16%	2.80%	2.64%	2.63%
Non-interest income	338	351	352	389	431
Total operating income	1,782	2,011	1,872	1,846	1,928
Non-interest expenses	-517	-582	-597	-626	-659
Pre provision profit	1,265	1,429	1,275	1,220	1,269
Loan loss provisions	-439	-367	-356	-332	-274
Non-operating income	-5	3	5	0	0
Pre tax profit	821	1,064	924	888	995
Tax	-119	-163	-117	-111	-124
Net profit	683	901	807	777	870

PER SHARE DATA	1999A	2000E	2001E	2002E	2003E
(HK$)					
Earnings per share	2.32	3.07	2.75	2.65	2.97
Dividends per share	0.85	1.22	1.05	1.03	1.15
Effective payout ratio (%)	*37%*	*40%*	*38%*	*39%*	*39%*
Book value per share	16.55	18.51	21.14	23.82	26.81
Adjusted book value per share	15.46	17.42	19.99	22.62	25.55

VALUATION	1999A	2000E	2001E	2002E	2003E
(X)					
Price to book value (%)	1.6	1.3	1.1	1.0	0.9
Price to adjusted book value (%)	1.7	1.4	1.2	1.1	0.9
Price to earnings (X)	11.1	7.8	8.7	9.1	8.1

PROFITABILITY RATIOS	1999A	2000E	2001E	2002E	2003E
(%)					
Net interest margin	2.92%	3.16%	2.80%	2.64%	2.63%
Yield on interest earning assets	7.85%	8.37%	5.81%	3.67%	3.64%
Cost on interest bearing liabilities	5.50%	5.90%	3.44%	1.15%	1.15%
Net interest spread	2.35%	2.47%	2.38%	2.51%	2.49%
Non-int. income (% Op income)	19.0%	17.5%	18.8%	21.1%	22.4%
Cost to income	29.0%	29.0%	31.9%	33.9%	34.2%
Overhead ratio	0.68%	0.67%	0.65%	0.71%	0.76%
Cost coverage	65.3%	60.4%	59.0%	62.1%	65.4%
ROA	1.39%	1.73%	1.47%	1.38%	1.50%
ROE	14.7%	17.4%	13.8%	11.9%	11.8%

DUPONT ANALYSIS	1999A	2000E	2001E	2002E	2003E
Lending operations					
Net interest margin	2.92%	3.16%	2.80%	2.64%	2.63%
Interest earnings assets/assets	100.7%	100.7%	98.5%	98.1%	98.1%
NIM contribution to ROA	2.94%	3.18%	2.76%	2.59%	2.59%
Non-interest operations					
Non-interest income/assets	0.69%	0.67%	0.64%	0.69%	0.74%
Overhead ratio	1.05%	1.12%	1.09%	1.11%	1.14%
Non-int. contribution to ROA	-0.36%	-0.44%	-0.45%	-0.42%	-0.39%
Asset quality analysis					
Provision/loans	-1.36%	-1.11%	-1.01%	-0.91%	-0.73%
Loans/assets	65.6%	63.2%	64.0%	65.1%	65.3%
ROA effect from asset quality	-0.89%	-0.70%	-0.65%	-0.59%	-0.47%
Core ROA	1.68%	2.03%	1.67%	1.58%	1.72%
Non-core contribution to ROA	-0.01%	0.01%	0.01%	0.00%	0.00%
Pre-tax ROA	1.67%	2.04%	1.68%	1.58%	1.72%
Tax rate	14.5%	15.3%	12.6%	12.5%	12.5%
After tax ROA	1.43%	1.73%	1.47%	1.38%	1.50%
Balance sheet leverage (x)	10.6x	10.1x	9.4x	8.6x	7.8x
ROE	15.1%	17.4%	13.8%	11.9%	11.8%

BALANCE SHEET (HK$m)	1999A	2000E	2001E	2002E	2003E
Gross loans	32,331	33,676	36,047	37,170	38,471
Specific loan loss reserves	*-359*	*-286*	*-297*	*-337*	*-359*
General loan loss reserves	*-334*	*-349*	*-363*	*-380*	*-393*
Net loans	31,998	33,326	35,683	36,790	38,078
Other earning assets	17,052	19,743	18,422	18,848	19,356
Other assets	1,391	1,460	1,390	1,421	1,472
Total Assets	50,441	54,530	55,495	57,058	58,906
Deposits	41,774	45,933	45,846	48,600	51,149
Other paying liabilities	2,295	1,709	2,108	69	(1,583)
Other liabilities	1,506	1,446	1,338	1,399	1,473
Total Liabilities	45,576	49,088	49,293	50,068	51,039
Minorities & other	0	0	0	0	0
Shareholders' funds	4,865	5,441	6,203	6,990	7,867

LOAN BOOK (HK$m)	1999A	2000E	2001E	2002E	2003E
Property development	5,788	5,859	6,326	6,453	6,583
Non-bank financials	1,127	1,204	1,137	1,057	982
Commercial and industrial	2,396	2,049	1,981	1,915	1,852
Hire purchase	1,104	1,385	1,594	1,551	1,508
Other commercial	2,342	2,865	3,015	2,866	2,724
Trade finance	1,679	1,665	1,712	1,540	1,386
Loans for use outside HK	3,177	3,015	3,286	3,623	3,994
HOS & PSPS loans	727	461	674	674	674
Residential mortgages	10,616	11,152	11,390	11,967	12,573
Credit cards	307	480	765	802	841
Individuals	2,032	2,216	2,411	2,786	3,219
Total loans	32,331	33,676	36,047	37,170	38,471

LOAN BOOK BREAKDOWN (%)	1999A	2000E	2001E	2002E	2003E
Property development	18%	17%	18%	17%	17%
Non-bank financials	3%	4%	3%	3%	3%
Commercial and industrial	7%	6%	5%	5%	5%
Hire purchase	3%	4%	4%	4%	4%
Other commercial	7%	9%	8%	8%	7%
Trade finance	5%	5%	5%	4%	4%
Loans for use outside HK	10%	9%	9%	10%	10%
HOS & PSPS loans	2%	1%	2%	2%	2%
Residential mortgages	33%	33%	32%	32%	33%
Credit cards	1%	1%	2%	2%	2%
Individuals	6%	7%	7%	7%	8%
Total loans	100%	100%	100%	100%	100%

BALANCE SHEET RATIOS (%)	1999A	2000E	2001E	2002E	2003E
Loan-to-deposit	77.4%	73.3%	78.6%	76.5%	75.2%
Loan-to-deposit (incl. CDs)	73.1%	70.1%	74.4%	72.6%	71.6%
Equity to assets	9.6%	10.0%	11.2%	12.3%	13.4%
Tier 1 Capital	14.5%	14.9%	16.7%	18.3%	20.1%
Total Capital adequacy	16.0%	16.2%	17.6%	19.3%	21.1%
General reserves (% loans)	-1.03%	-1.04%	-1.01%	-1.02%	-1.02%
Specific reserves (% loans)	-1.11%	-0.85%	-0.82%	-0.91%	-0.93%
Total loan provisions	-2.14%	-1.89%	-1.83%	-1.93%	-1.95%

ASSET QUALITY	1999A	2000E	2001E	2002E	2003E
Nonperforming loans	1,508	1,334	1,569	1,376	1,208
NPL ratio	4.7%	4.0%	4.4%	3.7%	3.1%
Total provisions/NPLs	46.0%	47.6%	42.0%	52.1%	62.2%

GROWTH RATES (%)	1999A	2000E	2001E	2002E	2003E
Income statement					
Net interest income	11.8%	14.9%	-8.4%	-4.2%	2.7%
Non-interest income	-4.0%	4.0%	0.2%	10.4%	10.9%
Total operating income	8.4%	12.9%	-6.9%	-1.4%	4.4%
Operating expenses	-1.4%	12.6%	2.6%	4.8%	5.3%
Pre-provision earnings	13.0%	13.0%	-10.8%	-4.3%	4.0%
Loan loss provisions	-14.3%	-16.3%	-3.0%	-6.8%	-17.4%
Net profit	35.7%	32.0%	-10.4%	-3.8%	12.1%
Balance sheet					
Loan growth	1.3%	4.2%	7.0%	3.1%	3.5%
Interest earning assets	4.2%	8.2%	2.0%	2.8%	3.2%
Asset growth	4.1%	8.1%	1.8%	2.8%	3.2%
Deposit growth	8.6%	10.0%	-0.2%	6.0%	5.2%
Shareholders funds	9.9%	11.8%	14.0%	12.7%	12.6%

Source: Company reports; Lehman Brothers estimates.

Wing Lung Bank

Neither Here Nor There

Rating: 4-Market Underperform

Ticker:	0096.HK
Market Cap:	US$816MM
Shares Outstanding:	232MM

This bank does not have a precise strategy to cope with inherent changes in the industry, namely the lower profitability of lending operations and we believe that it will be hard-pressed to compete against the market leaders in the development of non-interest income. Our price target represents 0.94x book value and 8x earnings.

Minimal loan growth expected.

We expect loan growth of 0% in 2H01 for a full year figure of –2.8% and then to 1.7% in 2002. This bank experienced among the most severe loan book contraction in the first half of the year at –2.8% and we expect more of the same in 2H01. Management has indicated that they expect loan growth to return in 2H02, when the economy recovers. Although we agree that the economy is likely to recover at this time, we point out that the risk is on the downside that the economy will take longer to recover. Meanwhile, the loan-to-deposit ratio is expected to remain at 55% until at least the end of 2002.

Management remains optimistic on margins.

Management is expecting net interest margins to be maintained at the same level as that reported in 1H01—2.03%. However, we are more skeptical and expect margins to contract by three basis points in 2H01 and then another eight basis points in 2002, to 2.00% in 2H01 and then 2.92% in 2002. Management claims that they were offering high deposit rates in the first half of the year because they wanted to appease customers ahead of deposit rate deregulation.

Difficulty developing non-interest income operations.

Our main concern about this bank is its lack of a strategy to develop non-interest income, which accounts for a below average 21% of total income. Excluding rental income from its headquarters and from a building in Mongkok, non-interest income accounts for only 17% of total operating income, which is well below the 23% average exhibited by its peers. Looking ahead, similar to all the other banks in Hong Kong, we believe that development of non-interest income will continue to be slow as brokerage commissions, forex and rental income decline.

Higher cost-to-income ratio.

Wing Lung is the second most efficient bank in Hong Kong as measured by its cost-to-income ratio, behind only Hang Seng. However, the need to spend on technology combined with the slowdown in revenue growth, is expected to drive the cost-to-income ratio to 34% in 2H01 and then 36% in 2002. WLB recently signed a HK$100 million agreement with IBM to overhaul and re-engineer both its front and back office technology platforms.

Lower provisions remain high, but low relatively.

We expect 2H01 provisions to be similar to those in 1H01 and to remain at this level thereafter. In 1H01, NPLs increased by 9%, for a NPL ratio of 4.08%, up 44 basis points during the period. This surprise deterioration in asset quality is expected to continue. Nonetheless, this bank is the most conservative with regards to provisioning with a reserve coverage of 75%, highest in our Hong Kong universe.

Share Price:	27.40	Index:	10,405
52 Week Price Range:	39.60 - 24.40	Current Yield:	5.7%
Reuters Code:	0096.HK		
Bloomberg Code:	0096 HK		

INCOME STATEMENT (HK$m)	1999A	2000E	2001E	2002E	2003E
Interest income	3,965	4,187	2,941	1,734	1,801
Interest expense	-2,629	-2,802	-1,708	-559	-559
Net interest income	1,336	1,385	1,233	1,175	1,175
Ave. interest earnings assets	*53,437*	*56,774*	*62,087*	*62,247*	*64,044*
NIM (%)	2.50%	2.44%	1.99%	1.89%	1.84%
Non-interest income	377	388	356	385	338
Total operating income	1,713	1,774	1,588	1,561	1,514
Non-interest expenses	-466	-475	-518	-566	-587
Pre provision profit	1,247	1,299	1,070	994	927
Loan loss provisions	-258	-89	-97	-105	-76
Non-operating income	-50	-3	0	0	0
Pre tax profit	938	1,207	973	890	851
Tax	-165	-197	-159	-147	-140
Net profit	855	1,011	814	743	710

PER SHARE DATA (HK$)	1999A	2000E	2001E	2002E	2003E
Earnings per share	3.68	4.35	3.50	3.20	3.06
Dividends per share	1.33	1.57	1.40	1.28	1.22
Effective payout ratio (%)	*36%*	*36%*	*40%*	*40%*	*40%*
Book value per share	26.33	24.34	26.44	28.36	30.20
Adjusted book value per share	20.97	18.80	20.90	22.82	24.66

VALUATION (X)	1999A	2000E	2001E	2002E	2003E
Price to book value (%)	0.8	1.1	1.0	1.0	0.9
Price to adjusted book value (%)	1.0	1.5	1.3	1.2	1.1
Price to earnings (X)	6.6	6.3	7.8	8.6	9.0

PROFITABILITY RATIOS (%)	1999A	2000E	2001E	2002E	2003E
Net interest margin	2.50%	2.44%	1.99%	1.89%	1.84%
Yield on interest earning assets	7.07%	7.17%	4.70%	2.79%	2.81%
Cost on interest bearing liabilities	5.46%	5.61%	3.16%	0.98%	1.08%
Net interest spread	1.61%	1.56%	1.54%	1.80%	1.73%
Non-int. income (% Op income)	22.0%	21.9%	22.4%	24.7%	22.3%
Cost to income	27.2%	26.8%	32.6%	36.3%	38.8%
Overhead ratio	0.71%	0.68%	0.57%	0.62%	0.53%
Cost coverage	80.9%	81.9%	68.7%	68.0%	57.6%
ROA	1.49%	1.67%	1.26%	1.17%	1.09%
ROE	14.2%	16.3%	12.5%	11.6%	10.4%

DUPONT ANALYSIS	1999A	2000E	2001E	2002E	2003E
Lending operations					
Net interest margin	2.50%	2.44%	1.99%	1.89%	1.84%
Interest earnings assets/assets	93.4%	93.7%	95.9%	97.6%	98.7%
NIM contribution to ROA	2.33%	2.29%	1.90%	1.84%	1.81%
Non-interest operations					
Non-interest income/assets	0.66%	0.64%	0.55%	0.60%	0.52%
Overhead ratio	0.81%	0.78%	0.80%	0.89%	0.90%
Non-int. contribution to ROA	-0.16%	-0.14%	-0.25%	-0.28%	-0.38%
Asset quality analysis					
Provision/loans	-0.88%	-0.32%	-0.35%	-0.38%	-0.27%
Loans/assets	51.1%	45.8%	42.7%	43.4%	43.4%
ROA effect from asset quality	-0.45%	-0.15%	-0.15%	-0.16%	-0.12%
Core ROA	1.73%	2.00%	1.50%	1.40%	1.31%
Non-core contribution to ROA	-0.09%	0.00%	0.00%	0.00%	0.00%
Pre-tax ROA	1.64%	1.99%	1.50%	1.40%	1.31%
Tax rate	-17.6%	-16.3%	-16.4%	-16.5%	-16.5%
After tax ROA	1.93%	2.32%	1.75%	1.63%	1.53%
Balance sheet leverage (x)	9.5x	9.8x	9.9x	10.0x	9.5x
ROE	18.4%	22.6%	17.4%	16.2%	14.5%

BALANCE SHEET (HK$m)	1999A	2000E	2001E	2002E	2003E
Gross loans	27,382	28,246	27,444	27,908	28,418
Specific loan loss reserves	*-525*	*-378*	*-618*	*-715*	*-783*
General loan loss reserves	*-439*	*-447*	*-439*	*-447*	*-455*
Net loans	26,943	27,799	27,005	27,461	27,963
Other earning assets	28,658	33,219	31,910	33,322	34,838
Other assets	4,135	4,464	4,221	3,168	3,061
Total Assets	59,736	65,482	63,135	63,950	65,863
Deposits	45,480	49,718	50,095	50,729	51,424
Other paying liabilities	4,300	4,178	4,156	3,875	4,711
Other liabilities	3,841	5,935	2,745	2,762	2,717
Total Liabilities	53,621	59,831	56,996	57,365	58,852
Minorities & other	0	0	0	0	0
Shareholders' funds	6,115	5,651	6,139	6,585	7,011

LOAN BOOK (HK$m)	1999A	2000E	2001E	2002E	2003E
Property development	5,996	6,547	6,841	6,978	7,119
Non-bank financials	497	434	303	264	230
Commercial and industrial	1,783	1,666	1,563	1,527	1,476
Hire purchase	1,214	1,260	1,055	1,027	999
Other commercial	2,948	4,262	3,669	3,669	3,669
Trade finance	664	559	485	393	318
Loans for use outside HK	957	1,071	1,176	1,176	1,176
HOS & PSPS loans	3,790	3,336	3,293	3,293	3,293
Residential mortgages	8,713	8,199	7,906	8,306	8,727
Credit cards	279	328	399	483	579
Individuals	540	584	755	793	833
Total loans	27,382	28,246	27,444	27,908	28,418

LOAN BOOK BREAKDOWN (%)	1999A	2000E	2001E	2002E	2003E
Property development	22%	23%	25%	25%	25%
Non-bank financials	2%	2%	1%	1%	1%
Commercial and industrial	7%	6%	6%	5%	5%
Hire purchase	4%	4%	4%	4%	4%
Other commercial	11%	15%	13%	13%	13%
Trade finance	2%	2%	2%	1%	1%
Loans for use outside HK	3%	4%	4%	4%	4%
HOS & PSPS loans	14%	12%	12%	12%	12%
Residential mortgages	32%	29%	29%	30%	31%
Credit cards	1%	1%	1%	2%	2%
Individuals	2%	2%	3%	3%	3%
Total loans	100%	100%	100%	100%	100%

BALANCE SHEET RATIOS (%)	1999A	2000E	2001E	2002E	2003E
Loan-to-deposit	60.2%	56.8%	54.8%	55.0%	55.3%
Loan-to-deposit (incl. CDs)	57.1%	55.3%	53.3%	53.6%	53.8%
Equity to assets	10.2%	8.6%	9.7%	10.3%	10.6%
Tier 1 Capital	14.7%	11.6%	13.5%	14.9%	15.8%
Total Capital adequacy	21.0%	16.0%	17.9%	19.3%	20.1%
General reserves (% loans)	-1.60%	-1.58%	-1.60%	-1.60%	-1.60%
Specific reserves (% loans)	-1.92%	-1.34%	-2.25%	-2.56%	-2.75%
Total loan provisions	-3.52%	-2.92%	-3.85%	-4.16%	-4.35%

ASSET QUALITY	1999A	2000E	2001E	2002E	2003E
Nonperforming loans	1,303	1,029	1,413	1,147	930
NPL ratio	4.8%	3.6%	5.1%	4.1%	3.3%
Total provisions/NPLs	74.0%	80.2%	74.8%	101.3%	133.1%

GROWTH RATES (%)	1999A	2000E	2001E	2002E	2003E
Income statement					
Net interest income	16.2%	3.7%	-11.0%	-4.6%	0.0%
Non-interest income	-6.7%	3.0%	-8.4%	8.3%	-12.2%
Total operating income	10.2%	3.5%	-10.5%	-1.7%	-3.0%
Operating expenses	-1.8%	1.8%	9.2%	9.3%	3.7%
Pre-provision earnings	15.6%	4.2%	-17.6%	-7.1%	-6.8%
Loan loss provisions	-27.7%	-65.4%	8.7%	7.9%	-27.4%
Net profit	42.5%	18.2%	-19.5%	-8.7%	-4.4%
Balance sheet					
Loan growth	-8.4%	3.2%	-2.8%	1.7%	1.8%
Interest earning assets	11.7%	9.7%	-3.4%	3.2%	3.3%
Asset growth	12.1%	9.6%	-3.6%	1.3%	3.0%
Deposit growth	8.4%	9.3%	0.8%	1.3%	1.4%
Shareholders funds	0.3%	-7.6%	8.6%	7.3%	6.5%

Source: Company reports; Lehman Brothers estimates.

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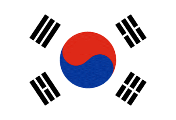
South Korea

Leading the Charge

Rating: Overweight ⇩



Covered Banks	Rating
Kookmin Bank	1-Strong Buy
H&CB	1-Strong Buy
"New" Kookmin	1-Strong Buy
Hana Bank	2-Buy
Shinhan Bank	3-Mkt Perform
KorAm Bank	2-Buy

Korean Banks: Doing What They Ought

Although Korea's banking crisis is undeniably severe, with repercussions and consequences still to be felt over a period of years, we believe that the difference between Korea and other markets with similar issues (Thailand, Japan) is one of reaction to crisis, and not so much the depth of crisis itself. Here, we think Korea is distinguishing itself—a view which has yet to be reflected in market valuations of healthy Korean banks.

Because of this opportunity, we continue to OVERWEIGHT Korean financials, now our only such position among our eight covered Asian markets. A quick review of some of the things we think banks are doing right—and wrong:

- Moving to Value-Added Sectors… Most Korean banks have realized that their primary lending market of old—large chaebol companies—does not generate an acceptable return through a full credit cycle (one leading institution estimated its risk-adjusted return on corporate lending at 7%). This has led banks to pursue the retail consumer more aggressively, with excellent results so far. The migration of assets from chunky low-margin corporate exposure to diversified consumer and SME lending has added stability to the industry and increased operating profits.

- ….And Value-Added Products. Korean banks are champing at the bit to move more fully into areas like bancassurance and wealth management, and international money managers and insurers have taken notice. With a number of partnerships already in place (Kookmin/ING, Hana/Allianz), we expect banks' fee income to rise in coming years, adding recurring profits to more sensitive interest spread income.

- Domestic M&A. One of the most beneficial measures in a recovering economy is the promotion of in-market bank mergers. Such mergers take capacity out of the system and minimize margin pressure, cut expenses, and result in stronger banks with the ability to move beyond their credit quality problems. This year has already seen the H&CB/Kookmin merger and the formation of Woori Holdings, and we expect several more banks to follow suit.

  Of the remaining un-merged good banks (Shinhan, KFB, Hana, Koram), we expect to see one or two transactions over the next 18 months, and among the remaining bad banks (Woori, KEB, Chohung, Seoul) we likewise expect further consolidation. Also keep an eye on major non-bank finance companies such as LG Card and Samsung Card—these would make excellent partners for banks.

- **Write-Offs.** Loan write-offs are hardly a positive event in isolation; however, in the context of recovery from a distressed situation they are a powerful signal that the worst is passed, and that management is able to confront its portfolio demons without shrinking.

Valuations Are Attractive

The investment opportunity in Korean banks is still attractive, even after good performance in 2001 YTD. On a headline basis, the sector is trading at just under 1.1x book value on an estimated FY2001 ROE of 21.3%—a steep discount to our theoretical valuation which prices in considerable downside.

On an earnings basis, Korean banks trade at under 8x forward earnings, with the leading bank in the sector available at under 9x trailing and 4.6x forward earnings. Unless you believe in a disaster scenario, these banks are still too cheap.

Figure 21: Korean Bank Valuations

	Kookmin	Shinhan	Koram	Hana	Average
Price/BV	1.34	0.86	1.31	0.77	1.07
Price/ABV	1.42	0.86	1.31	0.77	1.09
ROE 2000	19.65%	11.07%	-52.48%	0.90%	-5.2%
ROE 2001	32.07%	6.41%	19.04%	27.70%	21.3%
P/E 2000	8.70	8.82	(3.29)	71.73	21.49
P/E 2001	4.57	16.21	7.51	2.94	7.81

Source: Company reports; Lehman Brothers estimates.

Economic Outlook is Poor...

As with other export-driven countries in the region, Korea has been whipsawed by a sharp slowdown in US and world demand, particularly in capital goods and technology. This impact comes at a time when the Korean economy is already weakened by domestic corporate stagnation and the need to fundamentally change many of its business and government institutions.

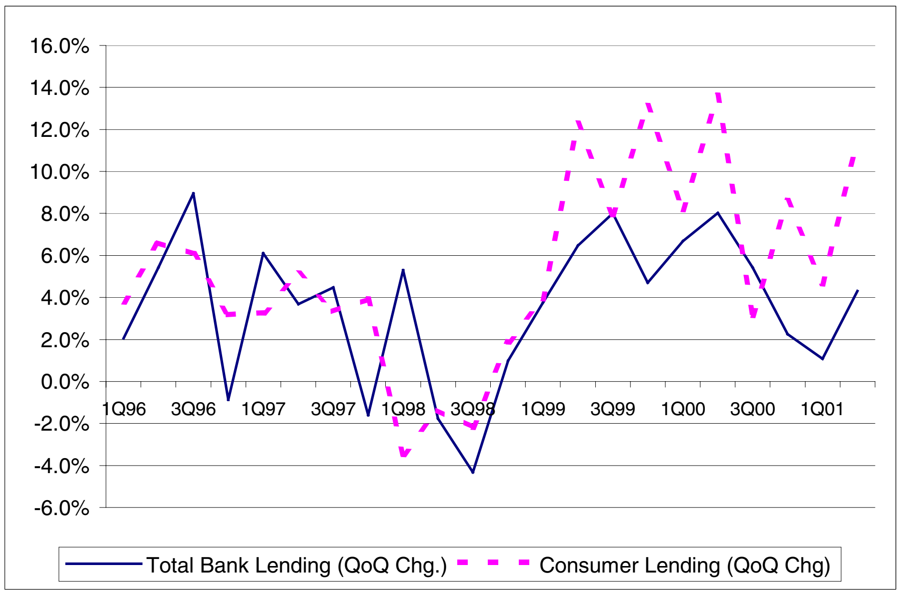
After growing real GDP at an 8.8% rate in FY2000, Korea slowed to 2.7% growth in 2Q01, and we project that the full year will come in up only 1.4%, with a modest increase to 2.6% in FY2002. Note however that the Lehman Brothers Global Economics team still expects positive US GDP growth in both 2001 (+0.9%) and 2002 (+0.3%). With deceleration still ongoing, there would seem to be downside risk to US and Global growth estimates, which could negatively affect Korea.

...But Growth Continues

Although the economy has probably moved into recession in 3Q01, total bank lending is still growing, albeit at a significantly reduced rate. Growth is a double-edged sword for banks in a distressed economy: on the one hand, robust growth in assets (Korean loans are +17.7% and +13.6% YoY in the first two quarters of 2001) can allow banks to grow out of past asset quality mis-steps by diluting the portfolio of bad loans and keeping spreads high. In truth, steady growth is the only way for a severely impaired banking system to right itself organically—all other paths involve either years of painful contraction and widespread failures or massive government intervention.

However, bankers know this too, and their need for growth sometimes leads to a "lend at any cost" strategy which generates new NPLs and makes the existing problem worse; this was the central lesson of the US savings and loan debacle. The worry for investors right now must be that Korean banks may head down this path.

Figure 22: Total and Consumer Loan Growth: 1Q96–2Q01



Source: Bank of Korea

Asset Quality: The Threat of Moral Hazard

We don't believe that our universe of Korean banks is engaged in loosening credit standards to finance growth, although we are fairly certain that reported NPLs will continue to rise throughout 2001 and 1H 2002. Moral hazard at the "good" Korean banks is minimal at this point, as all of these banks are solvent even under punitive asset quality scenarios. Note that in the past month all of these banks have refused to extend credit to Hynix, even though the lead banks and government are pressing hard for their support. Although we see a danger that some banks have become over-enamoured of the retail market (see below), we don't foresee any substantial losses here that would endanger banks.

Banks in the state sector are quite a different story, with moral hazard now a significant issue. We believe it is highly likely that banks like KEB, Hanvit, and Chohung are in danger of failing without additional government capital injections. As they struggle for life, these banks can not afford, as the good banks can, to realize losses on their existing bad loans, and so choose to paper over the problem by extending new credit. Although we do not believe that managements are under any illusions about the soundness of such loans, they have rightly concluded that to do so is their only chance of survival.

Asset Quality: NPLs Understated

We do not believe that reported Korean NPL figures, even after the advent of forward-looking criteria, accurately reflect the quality of banks' loan portfolios. This is a serious issue for investor transparency and tends to cast doubt on the quality of regulation and supervision of the banks, but the conclusion is inescapable. Note that until the third quarter of 2001, a majority of banks classified Hynix exposure as only Precautionary, while no bank had rated the credit lower than Substandard. This pattern has been repeated time and again, with Daewoo Corp continuing to be classified as Precautionary at many institutions even after studies showed that creditors would lose at least 90% of their investments.

For this reason we apply a stress test in the form of an upward adjustment of asset quality classifications to derive internal estimates of a more accurate level of bad debt to counteract Korean Banks' understatement of the level of impaired credits on their books. This estimate increases both the amount and severity of loan classifications in order to approximate international standards, and generally increases gross NPLs by 50–65%.

Figure 23: Korean NPL Adjustments

Korean Classification	Adjustment for International Standards
Pass	5% downgraded to S/M
Special Mention	85% downgraded to S/S
Substandard	40% downgraded to D
Doubtful	35% downgraded to L
Loss	No additional changes

Source: Lehman Brothers

Asset Quality: Some Positive Signs

Although the slow-motion collapse of the state banking sector continues to be a source of worry, we do see positive signs among our covered private banks:

- Profits Remain High: First, banks are earning robust profits—absolutely essential if they are to be able to take write-downs and rid themselves of bad assets.

- Banks Are Provisioning Aggressively: Secondly, we are seeing a steady increase in provisions and classifications, a heartening sign that managements believe that they have seen the worst and have the capital to take hits.

- Sales And Charge-Offs: Finally, banks are increasingly electing to write bad assets off the books entirely or sell them at (low) market prices rather than maintain them as NPLs with associated reserves. This is generally a sign that the credit cycle has already hit a bottom, as managers prefer to assess the full extent of potential damage to the balance sheet before limiting their flexibility to act in the future by writing off loans and reserves. Contrast this with the Thai or Japanese experiences, where bad loans remain on the books virtually forever.

Corporate Restructuring: Tyranny of the Majority?

Under the new Corporate Restructuring Promotion Law ("CRPL"), which took effect in September, if creditor banks representing 75% of the total debt of a troubled company agree to extend new financing, all financial institutions with exposure to the troubled borrower are bound by the resolution and must proportionately take up new funding commitments.

This is a bad law due to the perverse incentives already present for majority creditor banks of troubled companies (who are almost always the usual suspects: the state banks). If these banks do not agree to restructure the loans, they will have to mark them as delinquent, as CRPL will rarely be invoked unless borrowers can not either service their loans or pay them as they come due.

Using Hynix—the first major case under the CRPL—as an example, we can see why lead creditors KEB and Hanvit can not countenance such an outcome: their required reserves if Hynix losses were recognized would so deplete capital that the banks would be in danger of seizure. The largest creditors can not afford to recognize the loss which exists, so their only option is to double down and play for time—or hope for a miraculous recovery in the DRAM market.

The check on this destructive tendency in other markets is the refusal of healthier banks—which would rather take immediate write-downs than throw good money after bad—to go along with "restructurings" which only delay the day of reckoning. Note past decisions by Korea First Bank not to participate in new funding pools, and the recent actions by both foreign and domestic banks which precipitated the current Hynix liquidity crisis.

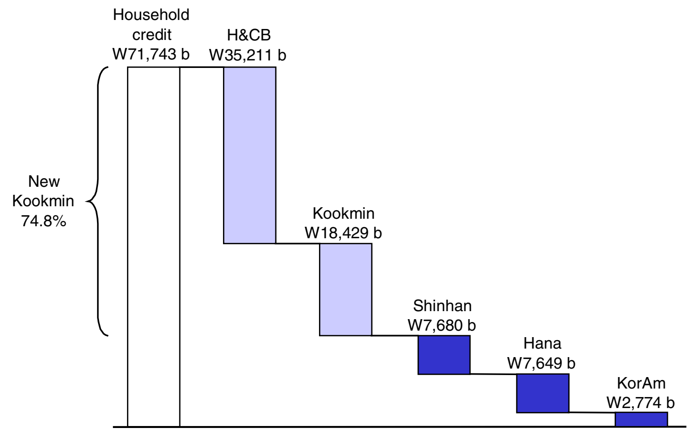
With the CRPL in full force, this brake may be removed. The only remaining mechanism to counteract the desire to restructure at all costs is the somewhat vague provision of the CRPL which holds that when dissenting creditors oppose a decision ratified by 75% of creditors, dissenting banks have the right to require the other lenders to purchase their loan claims at market value.

How will the market value be determined? No one has a ready answer, but it appears possible that we will see lead banks arguing on the one hand that a company is sound and should be given additional financing, and on the other hand that dissenting banks' claims on the same company have low value.

Lending Strategy: Which Sectors?

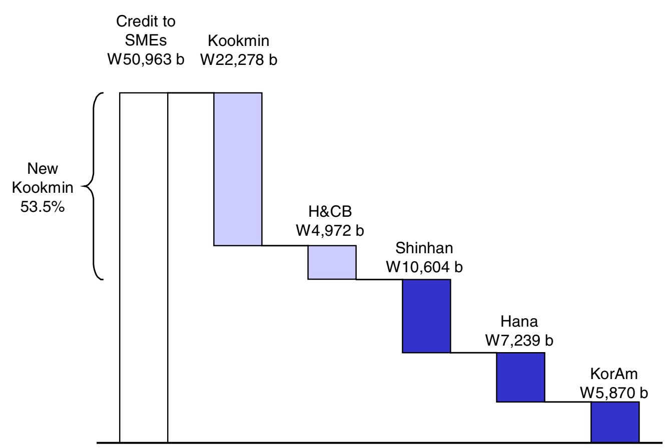
Success in Korea this year has largely been a function of positioning in the consumer and SME sectors, and we believe that this will continue. Although large corporate lending will never disappear, demand will remain slack for years as deleveraging proceeds, and spreads are unlikely to make the business attractive for most banks. Meanwhile, both consumers (until recently forbidden to borrow) and SMEs (once largely financed through their chaebol customers) have substantial unmet funding needs.

Figure 24: Korean Bank Universe: Share of Household Credit (2Q01)



Source: Company reports; Lehman Brothers estimates.

Figure 25: Korean Bank Universe: Share of SME Lending (2Q01)



Source: Company reports; Lehman Brothers estimates

Is the Consumer Rally Over?

So far, banks which cater to a retail clientele have seen a huge upturn in lending over the past two years, paced by triple-digit credit card growth and double-digit moves in all other household sectors. Credit losses on this business are negligible (anywhere from 1–3%) and margins are very high, with interest rates routinely topping 24% on credit cards.

As we look at prospects for the industry, two questions come to mind: 1) Is this a one-time event? and 2) Will the attractive return/risk characteristics of the business change?

The answer to 1) is unequivocally yes…and no. The "big bang" in credit cards is over, with the average bankable Korean already holding two or three in his/her wallet. While usage will go on increasing due to government promotion and convenience, gains here will likewise slow down. Other consumer lending will suffer in the short term due to rising unemployment.

However, the structurally-underlevered Korean consumer still has a long way to go, and we see a substantial wave of growth looking out over the next decade and a half. Consumer lending by banks accounts for only 24% of GDP in Korea, well below other developed economies worldwide, and closer to the level in Thailand than the level in Japan. Taiwan, Singapore and Japan all post levels of consumer lending more than twice as high as does Korea, with Hong Kong even higher.

Assuming that Korea returns to 6% GDP growth by 2006, it would take a 13.4% CAGR in consumer lending to bring the country up to the level of its top-ranked Asian peers by 2015. While the growth figures are speculation and thus illustrative only, the analysis argues for a long uptrend in consumer credit.

Turning to question 2), we expect Korea to follow the typical model of retail credit development in other markets. This means that margins will come under pressure as competition intensifies, particularly in mortgages and credit cards—but origination efficiencies will rise and the business will still be a high ROE one.

We do expect to see a rise in consumer delinquencies in 1Q02, an unattractive but unavoidable consequence of rapid growth in a country not used to managing consumer credit exposure. Although this may lessen the attraction of the business for marginal players without natural advantages in retail lending, it should have minimal continuing impact on the profitability of top consumer banks like Kookmin and H&CB.

Kookmin Bank

Big is Beautiful

Rating: 1-Strong Buy

Ticker:	02313.KS
Market Cap:	US$4,690 MM
Shares Outstanding:	304 MM

Kookmin's efforts to turn the bank into a dominant retail platform are paying off, although the bank has been beset by corporate loan losses. The most exciting news of the year is no doubt the sealing of Kookmin's merger agreement with Housing and Commercial Bank this month. As both banks continue to report separately until year-end, we are presenting merged Kookmin Bank figures independently in this report, following Kookmin and H&CB.

Even on a standalone basis Kookmin is the largest Korean bank, and has been able to use its heft well against competition. Expected higher provisions this year mask an otherwise robust set of operating numbers for the bank. Loan growth this year has been proceeding apace, driven by the Korean consumer, who continues to lever up and switch borrowing from traditional finance companies. Consumer lending in the first half is up 27% YoY. The other key area of growth has been SMEs, traditionally Kookmin's *forte*; SME loan growth in the first half was over 14%.

Net interest margins for the bank have been rising steadily since 4Q00, despite drooping asset yields. With 100bp of rate cuts during the third quarter, we expect full-year NIM of 2.60% on a lagged 100bp drop in funding costs and an 80bp drop in yields. Margins should continue to rise next year as loan growth continues apace.

We expect the actual NPL ratio for the bank to continue to drop as the Korean economy has been surprisingly resilient, and apart from evidence of rising personal bankruptcies, the most recent announcements of other indicators show positive movements; unemployment down to 3.3%, debt default ratio down to 0.11% and the number of corporate failures dropping month on month. While Kookmin is not as geared towards the consumer as H&CB, its loan book is skewed towards both the consumer and SME segments—this will provide some measure of protection against continuing defaults in the Korean corporate sector.

Kookmin management is vehemently against increasing the bank's exposure to Hynix; however, we fear that current exposure is likely to be a 100% loss. On a fully-provided-for basis under a loss scenario, Kookmin's pain would be bearable: on a reserve shortfall/equity basis, the merged bank provision shortfall for Hynix is only 4.1% of equity, second lowest only to Shinhan.

Kookmin is currently trading at 1.21x book (1.35x adjusted diluted book). Given its relatively low exposure to chaebols and its gearing towards SME and consumer loans the bank deserves to trade higher. Our price target of W23,700 reflects the merger ratio with H&CB and represents a multiple of 1.54x book and 1.73x adjusted diluted book. On an earnings basis this represents 5.14x prospective 2001 earnings and 4.53x prospective 2002 earnings.

Kookmin

Share Price (KRW):	20,000	**Index:**	543.41
52 Week Price Range (KRW):	20,600 - 12,100	**Current Yield:**	2.50%
Reuters Code:	02313.KS		
Bloomberg Code:	2313 KS	**Shares Outstanding (MM):**	303.59

INCOME STATEMENT	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
(W million) *year ending Dec*					
Interest income	6,853,045	6,788,556	7,285,794	7,513,181	8,001,105
Interest expense	-5,028,924	-4,947,070	-4,970,912	-4,679,404	-4,989,207
Net interest income	**1,824,121**	**1,841,486**	**2,314,883**	**2,833,777**	**3,011,898**
Ave. int. earnings assets	*64,078,716*	*75,038,282*	*89,058,037*	*97,443,255*	*104,613,306*
NIM (%)	**2.85%**	**2.45%**	**2.60%**	**2.91%**	**2.88%**
Non-interest income	1,449,660	1,996,700	2,400,421	2,163,556	2,227,113
Total operating income	**3,273,781**	**3,838,186**	**4,715,304**	**4,997,333**	**5,239,011**
Non-interest expenses	-1,670,541	-1,761,026	-1,717,056	-1,788,602	-1,883,422
Pre provision profit	**1,603,240**	**2,077,160**	**2,998,248**	**3,208,731**	**3,355,590**
Loan loss provisions	-1,380,426	-912,936	-852,075	-760,123	-1,101,598
Non-operating income	-129,137	-123,539	-78,737	-93,837	-93,837
Pre tax profit	**93,677**	**1,040,685**	**2,067,436**	**2,354,771**	**2,160,155**
Tax	-121,483	-448,269	-667,316	-765,304	-705,362
Net profit	**-27,806**	**592,416**	**1,400,120**	**1,589,467**	**1,454,793**

PER SHARE DATA (W)	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
EPS	-93	1,977	4,612	5,236	4,792
DPS	50	500	1,166	1,324	1,212
Effective payout ratio (%)	*-54%*	*25%*	*25%*	*25%*	*25%*
BVPS	10,974	12,805	15,768	19,151	22,202
ABVPS	10,358	12,179	15,152	18,535	21,586

VALUATION	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
Price to book value (x)	1.6	1.2	1.3	1.0	0.9
Price to adjusted book value (x)	1.7	1.2	1.3	1.1	0.9
Price to earnings (X)	NM	7.5	4.3	3.8	4.2

PROFITABILITY RATIOS	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
(%)					
Net interest margin	2.85%	2.45%	2.60%	2.91%	2.88%
Yield on interest earning assets	10.69%	9.05%	8.18%	7.71%	7.65%
Cost on interest bearing liabilities	7.63%	6.88%	5.90%	5.08%	5.05%
Net interest spread	3.07%	2.17%	2.28%	2.63%	2.60%
Non-int. income (% Op income)	44.3%	52.0%	50.9%	43.3%	42.5%
Cost to income	51.0%	45.9%	36.4%	35.8%	35.9%
Overhead ratio	2.29%	1.93%	1.68%	1.63%	1.60%
Cost coverage	86.8%	113.4%	139.8%	121.0%	118.2%
ROA	-0.04%	0.72%	1.45%	1.50%	2.46%
ROE	-1.0%	16.6%	32.4%	30.0%	23.2%

DUPONT ANALYSIS	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
Lending operations					
Net interest margin	2.85%	2.45%	2.60%	2.91%	2.88%
Interest earning assets/assets	86.01%	91.47%	92.01%	91.91%	177.19%
NIM contribution to ROA	**2.45%**	**2.24%**	**2.39%**	**2.67%**	**5.10%**
Non-interest operations					
Non-interest income/assets	1.95%	2.43%	2.48%	2.04%	3.77%
Overhead ratio	2.24%	2.15%	1.77%	1.69%	3.19%
Non-int. contribution to ROA	**-0.30%**	**0.29%**	**0.71%**	**0.35%**	**0.58%**
Asset quality analysis					
Provision/loans	-3.21%	-1.74%	-1.36%	-1.12%	-2.92%
Loans/assets	57.80%	63.89%	64.62%	64.21%	63.99%
ROA effect from asset quality	**-1.85%**	**-1.11%**	**-0.88%**	**-0.72%**	**-1.87%**
Core ROA	**0.30%**	**1.42%**	**2.22%**	**2.31%**	**3.82%**
Non-core contibution to ROA	-0.17%	-0.15%	-0.08%	-0.09%	-0.16%
Pre-tax ROA	**0.13%**	**1.27%**	**2.14%**	**2.22%**	**3.66%**
Tax rate	129.68%	43.07%	32.28%	32.50%	32.65%
After tax ROA	**-0.04%**	**0.72%**	**1.45%**	**1.50%**	**2.46%**
Balance sheet leverage (x)	24.6	23.0	22.4	20.0	9.4
ROE	**-0.9%**	**16.6%**	**32.5%**	**30.0%**	**23.2%**

BALANCE SHEET	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
(W million) *year ending Dec*					
Gross loans	48,003,191	61,444,463	68,100,855	72,623,633	78,422,932
Specific loan loss reserves	*0*	*0*	*0*	*0*	*0*
Loan loss reserves	*-2,367,392*	*-2,250,507*	*-2,191,953*	*-2,370,995*	*-2,868,609*
Net loans	45,635,799	59,193,956	65,908,902	70,252,639	75,554,322
Other earning assets	20,518,350	24,728,458	28,284,758	30,440,212	32,979,440
Other assets	6,825,521	4,078,889	8,296,228	8,862,134	9,544,867
Total Assets	**72,979,670**	**91,098,765**	**102,489,887**	**109,554,985**	**118,078,629**
Deposits	44,537,854	58,244,627	64,860,825	69,685,924	75,225,818
Other paying liabilities	19,827,526	21,231,865	24,262,353	25,588,562	27,152,993
Other liabilities	5,126,227	7,585,858	8,379,836	8,266,584	8,759,479
Total Liabilities	**69,491,607**	**87,062,350**	**97,503,014**	**103,541,069**	**111,138,290**
Minorities & other	200,000	200,000	200,000	200,000	200,000
Shareholders' funds	**3,488,063**	**4,036,415**	**4,986,873**	**6,013,915**	**6,940,339**

LOAN BOOK	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
(W billion)					
Corporate	21,262	27,557	28,016	27,880	28,751
Consumer	8,694	12,039	16,798	20,203	23,169
Mortgage	3,317	3,840	4,032	4,535	5,201
Credit Card	579	354	47	55	62
Foreign currency loans	3,389	2,971	3,062	3,254	3,527
Other	8,396	12,434	13,954	14,325	14,845
Total loans	**45,636**	**59,194**	**65,909**	**70,253**	**75,554**
(%)					
Corporate	47%	47%	43%	40%	38%
Consumer	19%	20%	25%	29%	31%
Mortgage	7%	6%	6%	6%	7%
Credit Card	1%	1%	0%	0%	0%
Foreign currency loans	7%	5%	5%	5%	5%
Other	18%	21%	21%	20%	20%
Total loans	**100%**	**100%**	**100%**	**100%**	**100%**

BALANCE SHEET RATIOS	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
(%)					
Loan to deposit	102.5%	101.6%	101.6%	100.8%	100.4%
Equity to assets	4.8%	4.4%	4.9%	5.5%	5.9%
Tier 1 Capital	7.3%	6.8%	7.6%	8.6%	9.2%
Total Capital adequacy	11.4%	11.2%	11.9%	12.9%	13.6%
General reserves (% loans)	4.93%	3.66%	3.22%	3.26%	3.66%
Specific reserves (% loans)	0.00%	0.00%	0.00%	0.00%	0.00%
Total loan provisions	4.93%	3.66%	3.22%	3.26%	3.66%

ASSET QUALITY	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
(W million)					
Pass	38,970,684	53,578,779	60,750,199	65,574,854	71,383,064
Special Mention	2,823,822	2,848,513	3,272,596	3,060,325	2,842,843
Substandard	3,486,589	2,556,201	1,598,696	1,494,999	1,388,757
Doubtful	888,908	1,166,487	1,270,867	1,188,434	1,103,978
Foreclosed assets	15,044	11,258	7,852	7,852	7,852
NPL ratio	17.4%	11.6%	10.6%	9.4%	8.2%
Total provisions/NPLs	32.8%	34.2%	35.6%	41.2%	53.7%

GROWTH RATES	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
(%)					
Income statement					
Net interest income	40.4%	1.0%	25.7%	22.4%	6.3%
Non-interest income	-5.6%	37.7%	20.2%	-9.9%	2.9%
Total operating income	15.5%	17.2%	22.9%	6.0%	4.8%
Operating expenses	-16.8%	5.4%	-2.5%	4.2%	5.3%
Pre-provision earnings	93.6%	29.6%	44.3%	7.0%	4.6%
Loan loss provisions	8.3%	-33.9%	-6.7%	-10.8%	44.9%
Net profit	**NM**	**NM**	**136.3%**	**13.5%**	**-8.5%**
Balance sheet					
Total Loans	12.7%	29.7%	11.3%	6.6%	7.5%
Interest earning assets	6.7%	26.9%	12.2%	6.9%	7.8%
Total Assets	-4.0%	24.8%	12.5%	6.9%	7.8%
Deposits	5.0%	30.8%	11.4%	7.4%	7.9%
Shareholders' funds	18.8%	16.7%	24.8%	21.5%	15.9%

Source: Company reports; Lehman Brothers estimates.

H&CB

Consumer Safe Haven

Rating: 1-Strong Buy

Ticker:	02746.KS
Market Cap:	US$3,128 MM
Shares Outstanding:	120 MM

Consumer loans still have a way to run before they approach the 50%+ level of total commercial bank lending that we see in mature markets.

H&CB has pinned its hopes squarely on the expanding consumer market, both for growth and quality. Remember that when these factors go wrong, they generally go hand-in-hand, for a double hit effect. While we do expect lower growth and higher consumer NPLs going forward, the changes will not be so strong as to change H&CB's business case. In fact, any downturn in this business will disproportionately hit marginal and opportunistic players in the consumer market—allowing H&CB and Kookmin to consolidate their market share dominance.

Unlike the rest of Asia, loan growth in Korea continues to be strong, mostly due to government stimulus of nascent demand for consumer credit. H&CB, and going forward, "New" Kookmin will dominate this segment through the power of its distribution channels and branding. We are unabashed fans of H&CB CEO Kim Jung Tae, and his appointment as CEO of the merger entity is a significant positive for the bank. We believe Kim Jung Tae will be able to quell union problems and successfully handle the integration of the banks.

With Hynix heightening sensitivity to large corporate risks, H&CB is an obvious safe haven due to the bank's mortgage credit monopoly heritage, 80% of the loan book consists of consumer credits—which are by nature smaller exposures and dispersed risks. Although reserves have dropped to 87% of our theoretical required reserve calculation based on reported classifications, we expect H&CB to hit 100% by the end of the year and don't consider the difference material.

Loan growth so far this year has been impressive with mortgages (which constitute 50% of the loan book) growing 7.3% year on year. Other consumer loans have grown in the first half from a low base by 53.9% year on year and 18.0% half on half. As economic growth slows, we believe the Korean consumer will continue to borrow, with our projections calling for a further 17.1% growth in consumer loans for the remainder of the year.

H&CB currently trades at 1.32x book (1.47x adjusted diluted book). Given its low chaebol exposure and imminent dominating position in the local market, the current price still represents 28% upside to our target price. On an earnings basis, the bank is trading at 4.24x prospective FY2001 earnings (5.08x core earnings) and just 2.75x prospective 2002 earnings.

H&CB

Share Price (KRW):	33,750			**Index:**	543.41
52 Week Price Range (KRW):	34,050 - 19,000			**Current Yield:**	0.44%

Reuters Code:	02746.KS				
Bloomberg Code:	2746 KS			**Shares Outstanding (MM):**	119.97

INCOME STATEMENT	1999A	2000A	2001E	2002E	2003E
(W million) *year ending Dec*					
Interest income	4,265,327	4,873,349	5,245,769	5,821,178	6,507,978
Interest expense	-3,029,834	-3,536,563	-3,627,541	-3,515,713	-3,883,376
Net interest income	**1,235,493**	**1,336,786**	**1,618,228**	**2,305,465**	**2,624,602**
Ave. int. earnings assets	*39,829,399*	*50,780,492*	*62,600,122*	*72,059,670*	*77,053,962*
NIM (%)	**3.10%**	**2.63%**	**2.59%**	**3.20%**	**3.41%**
Non-interest income	937,026	1,144,915	1,967,444	1,675,950	1,877,480
Total operating income	**2,172,519**	**2,481,701**	**3,585,672**	**3,981,415**	**4,502,082**
Non-interest expenses	-1,092,604	-1,213,178	-1,436,158	-1,720,079	-2,028,286
Pre provision profit	**1,079,915**	**1,268,523**	**2,149,514**	**2,261,336**	**2,473,796**
Loan loss provisions	-366,346	-588,648	-926,824	-410,459	-749,736
Non-operating income	-39,695	43,966	-55,292	-1,714	-1,714
Pre tax profit	**673,874**	**723,841**	**1,167,398**	**1,849,164**	**1,722,346**
Tax	-219,114	-210,274	-361,445	-552,655	-513,595
Net profit	**454,760**	**513,567**	**805,953**	**1,296,508**	**1,208,751**

PER SHARE DATA (W)	1999A	2000A	2001E	2002E	2003E
EPS	4,587	4,709	6,718	10,807	10,076
DPS	150	150	2,015	3,242	3,023
Effective payout ratio (%)	*3%*	*3%*	*30%*	*30%*	*30%*
BVPS	18,716	20,588	23,942	31,394	38,335
ABVPS	16,595	18,641	22,164	29,617	36,558

VALUATION	1999A	2000A	2001E	2002E	2003E
Price to book value (x)	1.6	1.3	1.4	1.1	0.9
Price to adjusted book value (x)	1.8	1.4	1.5	1.1	0.9
Price to earnings (X)	6.5	5.5	5.0	3.1	3.3

PROFITABILITY RATIOS	1999A	2000A	2001E	2002E	2003E
(%)					
Net interest margin	3.10%	2.63%	2.59%	3.20%	3.41%
Yield on interest earning assets	10.71%	9.60%	8.38%	8.08%	8.45%
Cost on interest bearing liabilities	7.69%	7.36%	6.14%	5.26%	5.21%
Net interest spread	3.02%	2.24%	2.24%	2.82%	3.23%
Non-int. income (% Op income)	43.1%	46.1%	54.9%	42.1%	41.7%
Cost to income	50.3%	48.9%	40.1%	43.2%	45.1%
Overhead ratio	2.24%	1.96%	2.00%	2.11%	2.21%
Cost coverage	85.8%	94.4%	137.0%	97.4%	92.6%
ROA	0.98%	0.93%	1.21%	1.69%	1.39%
ROE	31.3%	25.0%	31.5%	39.0%	28.9%

DUPONT ANALYSIS	1999A	2000A	2001E	2002E	2003E
<u>Lending operations</u>					
Net interest margin	3.10%	2.63%	2.59%	3.20%	3.41%
Interest earning assets/assets	85.59%	91.86%	93.75%	94.15%	88.88%
NIM contribution to ROA	**2.66%**	**2.42%**	**2.42%**	**3.01%**	**3.03%**
<u>Non-interest operations</u>					
Non-interest income/assets	2.01%	2.07%	2.95%	2.19%	2.17%
Overhead ratio	2.35%	2.19%	2.15%	2.25%	2.34%
Non-int. contribution to ROA	**-0.33%**	**-0.12%**	**0.80%**	**-0.06%**	**-0.17%**
<u>Asset quality analysis</u>					
Provision/loans	-1.24%	-1.48%	-1.87%	-0.73%	-1.25%
Loans/assets	63.59%	71.83%	74.16%	73.19%	69.09%
ROA effect from asset quality	**-0.79%**	**-1.06%**	**-1.39%**	**-0.54%**	**-0.86%**
Core ROA	**1.53%**	**1.23%**	**1.83%**	**2.42%**	**1.99%**
Non-core contibution to ROA	-0.09%	0.08%	-0.08%	0.00%	0.00%
Pre-tax ROA	**1.45%**	**1.31%**	**1.75%**	**2.42%**	**1.99%**
Tax rate	32.52%	29.05%	30.96%	29.89%	29.82%
After tax ROA	**0.98%**	**0.93%**	**1.21%**	**1.69%**	**1.39%**
Balance sheet leverage (x)	32.3	27.0	26.1	23.1	20.7
ROE	**31.5%**	**25.0%**	**31.5%**	**39.1%**	**28.9%**

BALANCE SHEET	1999A	2000A	2001E	2002E	2003E
(W million) *year ending Dec*					
Gross loans	34,524,817	47,984,845	53,852,391	60,931,510	69,045,976
Specific loan loss reserves	*0*	*0*	*0*	*0*	*0*
Loan loss reserves	*-1,649,893*	*-1,450,365*	*-1,354,247*	*-1,401,228*	*-1,749,857*
Net loans	32,874,924	46,534,480	52,498,144	59,530,281	67,296,119
Other earning assets	10,937,588	11,213,992	14,953,628	17,137,287	19,360,032
Other assets	4,859,506	4,078,889	4,204,838	4,742,031	5,324,271
Total Assets	**48,672,018**	**61,886,461**	**71,656,610**	**81,409,600**	**91,980,422**
Deposits	34,357,895	47,820,696	53,075,824	59,115,004	65,850,381
Other paying liabilities	6,872,339	7,113,217	10,073,723	11,330,860	12,729,457
Other liabilities	5,289,665	4,403,908	5,331,594	6,894,156	8,498,323
Total Liabilities	**46,519,899**	**59,337,821**	**68,481,141**	**77,340,020**	**87,078,160**
Minorities & other	296,501	303,221	303,221	303,221	303,221
Shareholders' funds	**2,152,119**	**2,548,640**	**3,175,468**	**4,069,581**	**4,902,262**

LOAN BOOK	1999A	2000A	2001E	2002E	2003E
(W billion)					
Corporate	4,604	7,144	6,323	6,292	6,488
Consumer	6,294	11,958	15,884	19,104	21,909
Mortgage	18,093	21,327	22,515	25,329	29,047
Credit Card	1,237	2,911	4,370	5,094	5,740
Foreign currency loans	1,075	1,299	1,293	1,420	1,597
Other	1,573	1,894	2,114	2,291	2,514
Total loans	**32,875**	**46,534**	**52,498**	**59,530**	**67,296**
(%)					
Corporate	14%	15%	12%	11%	10%
Consumer	19%	26%	30%	32%	33%
Mortgage	55%	46%	43%	43%	43%
Credit Card	4%	6%	8%	9%	9%
Foreign currency loans	3%	3%	2%	2%	2%
Other	5%	4%	4%	4%	4%
Total loans	**100%**	**100%**	**100%**	**100%**	**100%**

BALANCE SHEET RATIOS	1999A	2000A	2001E	2002E	2003E
(%)					
Loan to deposit	95.7%	97.3%	98.9%	100.7%	102.2%
Equity to assets	4.4%	4.1%	4.4%	5.0%	5.3%
Tier 1 Capital	6.9%	5.5%	6.1%	7.0%	7.5%
Total Capital adequacy	11.7%	9.9%	10.5%	11.3%	11.9%
General reserves (% loans)	4.78%	3.02%	2.51%	2.30%	2.53%
Specific reserves (% loans)	0.00%	0.00%	0.00%	0.00%	0.00%
Total loan provisions	4.78%	3.02%	2.51%	2.30%	2.53%

ASSET QUALITY	1999A	2000A	2001E	2002E	2003E
(W million)					
Pass	27,260,292	41,884,772	48,835,579	56,080,727	64,041,562
Special Mention	3,289,208	2,471,638	2,039,441	1,963,907	1,901,846
Substandard	1,375,452	1,524,489	1,229,908	1,184,356	1,146,930
Doubtful	518,522	413,994	467,199	449,895	435,678
Foreclosed assets	30,876	12,253	2,258	2,258	2,258
NPL ratio	17.2%	10.0%	7.3%	6.2%	5.3%
Total provisions/NPLs	31.6%	32.8%	36.2%	38.9%	50.2%

GROWTH RATES	1999A	2000A	2001E	2002E	2003E
(%)					
<u>Income statement</u>					
Net interest income	4.4%	8.2%	21.1%	42.5%	13.8%
Non-interest income	68.2%	22.2%	71.8%	-14.8%	12.0%
Total operating income	24.8%	14.2%	44.5%	11.0%	13.1%
Operating expenses	31.0%	11.0%	18.4%	19.8%	17.9%
Pre-provision earnings	19.2%	17.5%	69.5%	5.2%	9.4%
Loan loss provisions	-67.1%	60.7%	57.4%	-55.7%	82.7%
Net profit	**NM**	**12.9%**	**56.9%**	**60.9%**	**-6.8%**
<u>Balance sheet</u>					
Total Loans	25.0%	41.6%	12.8%	27.9%	28.2%
Interest earning assets	22.2%	31.8%	16.8%	32.8%	28.5%
Total Assets	9.6%	27.1%	15.8%	31.5%	28.4%
Deposits	15.2%	39.2%	11.0%	23.6%	24.1%
Shareholders' funds	80.5%	21.0%	27.9%	67.7%	60.1%

Source: Company reports; Lehman Brothers estimates.

"New" Kookmin Bank

Two's (a) Company

Rating: 1-Strong Buy

Ticker:	Listing on November 9
Market Cap:	pf US$5,906 MM
Shares Outstanding:	300 MM

The entity resulting from the merger between Kookmin and H&CB will enjoy a rare position of dominance over the domestic sector but will especially dominate the choicest customer segments—consumer lending (for high spreads), mortgages (for their safety and high information content), and SMEs (for growth and fee income). While we expect the new entity's market share based on outstanding balances to fall as other banks aggressively target the market, we believe that Kookmin can continue to control a 50% share of consumer banking—a tremendously valuable franchise. Such dominance will lead to improved economies of scale, enhanced fee income and greater pricing power

It is our usual practice not to factor in revenue synergies expected from a merger into our forecasts, preferring to see hard evidence of gains first. We have however adjusted our assumptions for costs at the merged entity going forward. We forecast a 15% reduction in salary and general expenses and a 10% reduction in premises and equipment over the next two years. These cuts are expected to add about 3.1% or W90 billion to FY2002 net income and about 13.3% or W376 billion to FY2003 net income.

While these gains seem modest in the first year, the bank will be less aggressive than banks in other markets due to the sensitivities with labor in South Korea. CEO J. T. Kim has already stated that the structure of the banks will be left separate and intact for a full year after the merger as banking information systems are integrated, with only a small number of branches slated for closure. Eventual staff reductions are likely to come in the form of voluntary retirement rather than layoffs.

The merged balance sheets will carry NPLs of 9.2% at the end of 2001. As both banks are former Government monopolies—H&CB for housing mortgages and Kookmin for SMEs—the resulting inherited loan books reflect a low weight of debt to the struggling corporate sector in Korea. Such a position will help to hedge the bank against continuing corporate defaults as the economy is restructured going forward.

While consumer banking has been a great success thus far for both H&CB and Kookmin Bank, we note the risks going forward as the US economy enters recession. The South Korean economy is one of the most open in the region and one of the most dependant upon direct exports to the USA. A slowdown in the domestic economy will mean higher unemployment and personal bankruptcies, and so we expect somewhat deteriorated consumer loan quality at New Kookmin.

New Kookmin is currently unlisted but an indicative market price can be inferred from current H&CB and Kookmin prices—investors are currently paying 1.2x *pro-forma* 2Q01 book, 4.1x FY2001 EEPS and 3.1x FY2002 EEPS—still not expensive for a franchise of this caliber. We expect the bank to earn an ROE of 33.1% in 2001 and 34.4% in 2002.

New Kookmin (entity created from merger between Kookmin Bank and H&CB)

Share Price (KRW):	na	**Index:**	543.41	**Reuters Code:**	na		
52 Week Price Range (KRW):	na - na	**Current Yield:**	na	**Bloomberg Code:**	na	**Shares Outstanding** (MM):	299.78

INCOME STATEMENT	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
(W million) *year ending Dec*					
Interest income	11,118,372	11,661,905	12,531,563	13,334,359	14,509,083
Interest expense	-8,058,758	-8,483,633	-8,598,453	-8,195,117	-8,872,583
Net interest income	**3,059,614**	**3,178,272**	**3,933,110**	**5,139,242**	**5,636,500**
Ave. int. earnings assets	*103,908,115*	*125,818,774*	*151,658,159*	*169,502,926*	*186,275,166*
NIM (%)	**2.94%**	**2.53%**	**2.59%**	**3.03%**	**3.03%**
Non-interest income	2,386,686	3,141,615	4,367,865	3,839,506	4,104,593
Total operating income	**5,446,300**	**6,319,887**	**8,300,975**	**8,978,748**	**9,741,093**
Non-interest expenses	-2,763,145	-2,974,204	-3,153,213	-3,414,163	-3,504,519
Pre provision profit	**2,683,155**	**3,345,683**	**5,147,762**	**5,564,585**	**6,236,574**
Loan loss provisions	-1,746,772	-1,501,584	-1,778,899	-1,170,582	-1,851,334
Non-operating income	-168,832	-79,573	-134,029	-95,551	-95,551
Pre tax profit	**767,551**	**1,764,526**	**3,234,834**	**4,298,452**	**4,289,690**
Tax	-340,597	-658,543	-1,028,761	-1,317,959	-1,218,957
Net profit	**426,954**	**1,105,983**	**2,206,072**	**2,980,493**	**3,070,732**

PER SHARE DATA (W)	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
EPS	1,544	3,860	7,359	9,942	10,243
DPS	200	650	2,208	2,983	3,073
Effective payout ratio (%)	*13%*	*17%*	*30%*	*30%*	*30%*
BVPS	18,596	21,226	25,549	31,958	37,825
ABVPS	17,168	19,831	24,214	30,622	36,490

VALUATION	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
Price to book value (x)	1.6	1.2	na	na	na
Price to adjusted book value (x)	1.7	1.3	na	na	na
Price to earnings (X)	19.4	6.6	na	na	na

PROFITABILITY RATIOS	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
(%)					
Net interest margin	2.94%	2.53%	2.59%	3.03%	3.03%
Yield on interest earning assets	10.70%	9.27%	8.26%	7.87%	7.79%
Cost on interest bearing liabilities	7.65%	7.07%	6.00%	5.15%	5.12%
Net interest spread	3.05%	2.20%	2.26%	2.71%	2.67%
Non-int. income (% Op income)	43.8%	49.7%	52.6%	42.8%	42.1%
Cost to income	50.7%	47.1%	38.0%	38.0%	36.0%
Overhead ratio	2.27%	1.94%	1.81%	1.79%	1.67%
Cost coverage	86.4%	105.6%	138.5%	112.5%	117.1%
ROA	0.35%	0.81%	1.35%	1.63%	1.53%
ROE	9.4%	19.7%	32.1%	34.5%	29.3%

DUPONT ANALYSIS	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
Lending operations					
Net interest margin	2.94%	2.53%	2.59%	3.03%	3.03%
Interest earning assets/assets	85.85%	91.63%	92.72%	92.85%	92.90%
NIM contribution to ROA	**2.53%**	**2.31%**	**2.40%**	**2.82%**	**2.81%**
Non-interest operations					
Non-interest income/assets	1.97%	2.29%	2.67%	2.10%	2.05%
Overhead ratio	2.28%	2.17%	1.93%	1.87%	1.75%
Non-int. contribution to ROA	**-0.31%**	**0.12%**	**0.74%**	**0.23%**	**0.30%**
Asset quality analysis					
Provision/loans	-2.40%	-1.63%	-1.59%	-0.94%	-1.90%
Loans/assets	60.03%	67.08%	68.52%	67.98%	48.71%
ROA effect from asset quality	**-1.44%**	**-1.09%**	**-1.09%**	**-0.64%**	**-0.92%**
Core ROA	**0.77%**	**1.34%**	**2.06%**	**2.41%**	**2.19%**
Non-core contibution to ROA	-0.14%	-0.06%	-0.08%	-0.05%	-0.05%
Pre-tax ROA	**0.63%**	**1.28%**	**1.98%**	**2.35%**	**2.14%**
Tax rate	44.37%	37.32%	31.80%	30.66%	28.42%
After tax ROA	**0.35%**	**0.81%**	**1.35%**	**1.63%**	**1.53%**
Balance sheet leverage (x)	27.1	24.5	23.8	21.2	19.2
ROE	**9.6%**	**19.7%**	**32.1%**	**34.6%**	**29.4%**

BALANCE SHEET	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
(W million) *year ending Dec*					
Gross loans	82,528,008	109,429,308	121,953,245	133,555,143	147,468,907
Specific loan loss reserves	*0*	*0*	*0*	*0*	*0*
Loan loss reserves	*-4,017,285*	*-3,700,872*	*-3,546,200*	*-3,772,223*	*-4,618,466*
Net loans	78,510,723	105,728,436	118,407,045	129,782,920	142,850,442
Other earning assets	31,455,938	35,942,450	43,238,386	47,577,500	52,339,472
Other assets	11,685,027	4,078,889	12,501,065	13,604,165	14,869,139
Total Assets	**121,651,688**	**152,985,226**	**174,146,497**	**190,964,585**	**210,059,052**
Deposits	78,895,749	106,065,323	117,936,649	128,800,927	141,076,199
Other paying liabilities	26,699,865	28,345,082	34,336,076	36,919,421	39,882,450
Other liabilities	10,912,393	12,492,987	14,214,651	15,663,962	17,761,023
Total Liabilities	**116,508,007**	**146,903,392**	**166,487,376**	**181,384,310**	**198,719,671**
Minorities & other	0	0	0	0	0
Shareholders' funds	**5,143,681**	**6,081,834**	**7,659,121**	**9,580,275**	**11,339,380**

LOAN BOOK	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
(W billion)					
Corporate	25,866	34,701	34,339	34,172	35,239
Consumer	14,988	23,997	32,682	39,307	45,077
Mortgage	21,410	25,167	26,546	29,865	34,249
Credit Card	1,816	3,265	4,417	5,149	5,802
Foreign currency loans	4,463	4,270	4,355	4,673	5,124
Other	9,968	14,328	16,067	16,617	17,359
Total loans	**78,511**	**105,728**	**118,407**	**129,783**	**142,850**
(%)					
Corporate	33%	33%	29%	26%	25%
Consumer	19%	23%	28%	30%	32%
Mortgage	27%	24%	22%	23%	24%
Credit Card	2%	3%	4%	4%	4%
Foreign currency loans	6%	4%	4%	4%	4%
Other	13%	14%	14%	13%	12%
Total loans	**100%**	**100%**	**100%**	**100%**	**100%**

BALANCE SHEET RATIOS	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
(%)					
Loan to deposit	99.5%	99.7%	100.4%	100.8%	101.3%
Equity to assets	4.2%	4.0%	4.4%	5.0%	5.4%
Tier 1 Capital	7.1%	6.3%	6.9%	7.9%	8.5%
Total Capital adequacy	11.5%	10.7%	11.4%	12.3%	12.9%
General reserves (% loans)	4.87%	3.38%	2.91%	2.82%	3.13%
Specific reserves (% loans)	0.00%	0.00%	0.00%	0.00%	0.00%
Total loan provisions	4.87%	3.38%	2.91%	2.82%	3.13%

ASSET QUALITY	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
(W million)					
Pass	66,230,976	95,463,551	109,585,779	121,655,582	135,424,626
Special Mention	6,113,030	5,320,151	5,312,037	5,024,232	4,744,689
Substandard	4,862,041	4,080,690	2,828,604	2,679,355	2,535,687
Doubtful	1,407,430	1,580,481	1,738,065	1,638,329	1,539,656
Foreclosed assets	45,920	23,511	10,110	10,110	10,110
NPL ratio	17.3%	10.9%	9.2%	7.9%	6.8%
Total provisions/NPLs	32.3%	33.6%	35.9%	40.3%	52.3%

GROWTH RATES	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
(%)					
Income statement					
Net interest income	23.2%	3.9%	23.7%	30.7%	9.7%
Non-interest income	14.0%	31.6%	39.0%	-12.1%	6.9%
Total operating income	19.0%	16.0%	31.3%	8.2%	8.5%
Operating expenses	-2.7%	7.6%	6.0%	8.3%	2.6%
Pre-provision earnings	54.7%	24.7%	53.9%	8.1%	12.1%
Loan loss provisions	-26.9%	-14.0%	18.5%	-34.2%	58.2%
Net profit	**NM**	**159.0%**	**99.5%**	**35.1%**	**3.0%**
Balance sheet					
Total Loans	17.5%	34.7%	12.0%	9.6%	10.1%
Interest earning assets	12.4%	28.8%	14.1%	9.7%	10.1%
Total Assets	1.0%	25.8%	13.8%	9.7%	10.0%
Deposits	9.2%	34.4%	11.2%	9.2%	9.5%
Shareholders' funds	35.5%	18.2%	25.9%	25.1%	18.4%

Source: Company reports; Lehman Brothers estimates.

Hana Bank

High Net Worth Clients = High Value

Rating: 2-Buy

Ticker:	07360.KS
Market Cap:	US$985 MM
Shares Outstanding:	124 MM

Hana has shown better performance than we had expected given the bank's high proportion of large corporate loans. While investors are justifiably skittish about potential future losses—and make no mistake: we do think there are more to come—even our very conservative adjustments to stated NPLs still show that Hana's franchise is being undervalued.

Hana's high net worth customer base is increasingly desirable as more banks chase the mass-market retail population. Even Kookmin bank has realized that its pending merger will not get the bank into the private banking segment. As well as this, as a smaller bank with manageable asset quality, Hana is a potential acquisition target for a domestic or foreign bank. We see substantial possibility of either beneficial domestic M&A or acquisition by a foreign player.

Hana's margins have been lifted by a reduced cost of funds; this is an instance of the institution's loyal high net worth depositor base allowing the bank to add substantial balances even as COF declines. A note of caution is sounded in that we would expect Hana's customers to be more rate sensitive than those of other banks, as their average funds on deposit are much larger.

We have been pleasantly surprised by Hana's asset quality performance in recent quarters, given that the bank has more large corporate lending exposure than any of the other sound banks in our universe, just ahead of Shinhan with 43%. Based on our estimates, Hana's impaired loans amount to some 11.2% of total loans, approximately equivalent to the level that the Singaporean banks experienced in late 1999 and early 2000—an easily survivable event if indeed our estimates have captured the full extent of the problem. Note that returns and growth in Korea are superior to those in Singapore, and so NPLs could come down more rapidly than was the experience for DBS and its compatriots.

Hana is trading at the low end of Korean bank valuations, slightly below Shinhan on a book value basis but well below peers on forward earnings. We surmise that this is due to the low predictability of forward earnings—but believe that there is substantial room for downward revisions which would not eliminate the value case for Hana.

On a price-to-book basis, Hana continues to trade well below 1x net assets, on investors' fears about asset quality. However, even after we increase weighted classified assets by 65% and subtract required reserves to obtain fully-adjusted book value (FABV), the bank is trading at 0.91x trailing book. Our deposit premium valuation calculations show negative values for Hana's liability franchise, even after including our estimate of reserve underfunding on adjusted NPLs. We believe that Hana's HNW franchise makes these accounts worth substantially more than nothing.

Hana

Share Price (KRW):	10,250	**Index:**	543.41	
52 Week Price Range (KRW):	10,600 - 5,500	**Current Yield:**	1.95%	
Reuters Code:	07360.KS			
Bloomberg Code:	0736 KS	**Shares Outstanding** (MM):	124.36	

INCOME STATEMENT	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
(W million) *year ending Dec*					
Interest income	2,842,229	3,265,757	3,333,364	3,385,747	3,583,052
Interest expense	-2,316,637	-2,561,543	-2,386,248	-2,130,554	-2,207,365
Net interest income	**525,592**	**704,214**	**947,115**	**1,255,193**	**1,375,686**
Ave. int. earnings assets	*27,489,230*	*38,982,804*	*42,845,076*	*45,407,286*	*49,071,994*
NIM (%)	**1.91%**	**1.81%**	**2.21%**	**2.76%**	**2.80%**
Non-interest income	845,195	747,440	975,896	913,185	1,100,963
Total operating income	**1,370,787**	**1,451,654**	**1,923,011**	**2,168,378**	**2,476,650**
Non-interest expenses	-608,449	-832,789	-1,019,714	-1,201,859	-1,284,189
Pre provision profit	**762,338**	**618,865**	**903,297**	**966,519**	**1,192,461**
Loan loss provisions	-488,529	-574,571	-304,920	-204,133	-215,216
Non-operating income	-61,364	-3,345	-15,595	-18,313	-18,313
Pre tax profit	**212,445**	**40,949**	**582,781**	**744,073**	**958,931**
Tax	-67,911	-23,178	-148,977	-234,815	-242,340
Net profit	**144,534**	**17,771**	**433,804**	**509,258**	**716,592**

PER SHARE DATA (W)	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
EPS	1,312	143	3,488	4,095	5,762
DPS	400	200	1,063	1,248	1,757
Effective payout ratio (%)	*30%*	*140%*	*30%*	*30%*	*30%*
BVPS	11,610	11,535	13,464	15,762	17,941
ABVPS	11,607	11,530	13,458	15,757	17,936

VALUATION	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
Price to book value (x)	0.8	0.5	0.8	0.7	0.6
Price to adjusted book value (x)	0.8	0.5	0.8	0.7	0.6
Price to earnings (X)	6.7	41.4	2.9	2.5	1.8

PROFITABILITY RATIOS	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
(%)					
Net interest margin	1.91%	1.81%	2.21%	2.76%	2.80%
Yield on interest earning assets	10.34%	8.38%	7.78%	7.46%	7.30%
Cost on interest bearing liabilities	9.25%	7.10%	6.16%	5.37%	5.17%
Net interest spread	1.09%	1.28%	1.62%	2.08%	2.13%
Non-int. income (% Op income)	61.7%	51.5%	50.7%	42.1%	44.5%
Cost to income	44.4%	57.4%	53.0%	55.4%	51.9%
Overhead ratio	1.65%	1.93%	2.25%	2.44%	2.41%
Cost coverage	138.9%	89.8%	95.7%	76.0%	85.7%
ROA	0.51%	0.04%	0.98%	1.08%	1.40%
ROE	12.7%	0.9%	27.7%	27.9%	34.1%

DUPONT ANALYSIS	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
Lending operations					
Net interest margin	1.91%	1.81%	2.21%	2.76%	2.80%
Interest earning assets/assets	97.08%	97.41%	96.84%	96.10%	95.80%
NIM contribution to ROA	**1.86%**	**1.76%**	**2.14%**	**2.66%**	**2.69%**
Non-interest operations					
Non-interest income/assets	2.98%	1.87%	2.21%	1.93%	2.15%
Overhead ratio	2.15%	2.08%	2.30%	2.54%	2.51%
Non-int. contribution to ROA	**0.84%**	**-0.21%**	**-0.10%**	**-0.61%**	**-0.36%**
Asset quality analysis					
Provision/loans	-3.63%	-2.53%	-1.15%	-0.72%	-0.70%
Loans/assets	47.49%	56.75%	59.99%	59.80%	59.75%
ROA effect from asset quality	**-1.73%**	**-1.44%**	**-0.69%**	**-0.43%**	**-0.42%**
Core ROA	**0.97%**	**0.11%**	**1.35%**	**1.61%**	**1.91%**
Non-core contibution to ROA	-0.22%	-0.01%	-0.04%	-0.04%	-0.04%
Pre-tax ROA	**0.75%**	**0.10%**	**1.32%**	**1.57%**	**1.87%**
Tax rate	31.97%	56.60%	25.56%	31.56%	25.27%
After tax ROA	**0.51%**	**0.04%**	**0.98%**	**1.08%**	**1.40%**
Balance sheet leverage (x)	26.3	29.5	28.5	26.0	24.4
ROE	**13.4%**	**1.3%**	**27.9%**	**28.0%**	**34.2%**

BALANCE SHEET	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
(W million) *year ending Dec*					
Gross loans	20,320,497	26,962,988	27,756,472	30,186,581	32,670,643
Specific loan loss reserves	*0*	*0*	*0*	*0*	*0*
Loan loss reserves	*-909,414*	*-953,975*	*-680,285*	*-748,530*	*-900,353*
Net loans	19,411,083	26,009,013	27,076,186	29,438,050	31,770,290
Other earning assets	16,426,142	16,119,370	16,485,583	17,814,754	19,120,895
Other assets	963,164	4,078,889	1,688,648	1,998,477	2,303,887
Total Assets	**36,800,389**	**43,236,669**	**45,250,417**	**49,251,281**	**53,195,072**
Deposits	26,620,895	30,375,271	31,245,889	33,496,175	35,800,762
Other paying liabilities	6,189,733	8,952,316	6,904,172	7,646,825	8,374,426
Other liabilities	2,237,976	2,139,115	5,090,539	5,812,610	6,453,218
Total Liabilities	**35,048,604**	**41,466,702**	**43,240,601**	**46,955,611**	**50,628,406**
Minorities & other	472,800	335,405	335,405	335,405	335,405
Shareholders' funds	**1,751,785**	**1,769,967**	**2,009,816**	**2,295,670**	**2,566,666**

LOAN BOOK	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
(W billion)					
Corporate	6,677	10,032	10,739	11,116	11,633
Consumer	2,374	4,047	5,844	6,912	7,788
Mortgage	906	1,291	1,400	1,547	1,743
Credit Card	118	440	748	872	982
Foreign currency loans	958	1,007	1,314	1,446	1,564
Other	8,378	9,191	7,031	7,546	8,060
Total loans	**19,411**	**26,009**	**27,076**	**29,438**	**31,770**
(%)					
Corporate	34%	39%	40%	38%	37%
Consumer	12%	16%	22%	23%	25%
Mortgage	5%	5%	5%	5%	5%
Credit Card	1%	2%	3%	3%	3%
Foreign currency loans	5%	4%	5%	5%	5%
Other	43%	35%	26%	26%	25%
Total loans	**100%**	**100%**	**100%**	**100%**	**100%**

BALANCE SHEET RATIOS	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
(%)					
Loan to deposit	72.9%	85.6%	86.7%	87.9%	88.7%
Equity to assets	4.8%	4.1%	4.4%	4.7%	4.8%
Tier 1 Capital	9.0%	6.5%	7.3%	7.8%	8.2%
Total Capital adequacy	12.3%	10.4%	10.9%	11.4%	11.8%
General reserves (% loans)	4.48%	3.54%	2.45%	2.48%	2.76%
Specific reserves (% loans)	0.00%	0.00%	0.00%	0.00%	0.00%
Total loan provisions	4.48%	3.54%	2.45%	2.48%	2.76%

ASSET QUALITY	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
(W million)					
Pass	16,633,189	23,966,448	25,482,085	27,705,127	29,899,357
Special Mention	1,420,200	899,100	742,598	807,359	871,640
Substandard	1,495,000	1,127,000	930,828	1,012,004	1,092,580
Doubtful	406,500	413,000	341,111	370,859	400,386
Foreclosed assets	-	-	-	-	-
NPL ratio	17.9%	9.6%	7.6%	7.6%	7.6%
Total provisions/NPLs	27.4%	39.1%	33.8%	34.2%	38.1%

GROWTH RATES	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
(%)					
Income statement					
Net interest income	35.0%	34.0%	34.5%	32.5%	9.6%
Non-interest income	317.7%	-11.6%	30.6%	-6.4%	20.6%
Total operating income	131.7%	5.9%	32.5%	12.8%	14.2%
Operating expenses	129.5%	36.9%	22.4%	17.9%	6.9%
Pre-provision earnings	133.6%	-18.8%	46.0%	7.0%	23.4%
Loan loss provisions	109.8%	17.6%	-46.9%	-33.1%	5.4%
Net profit	**95.1%**	**-87.7%**	**2341.1%**	**17.4%**	**40.7%**
Balance sheet					
Total Loans	159.4%	34.0%	4.1%	8.7%	7.9%
Interest earning assets	87.2%	17.6%	3.4%	8.5%	7.7%
Total Assets	85.5%	17.5%	4.7%	8.8%	8.0%
Deposits	92.3%	14.1%	2.9%	7.2%	6.9%
Shareholders' funds	46.8%	12.2%	16.7%	17.1%	13.8%

Source: Company reports; Lehman Brothers estimates.

Shinhan Financial Group

Regrouped

Rating: 3-Market Perform

Shinhan Bank

Ticker:	05555.KS
Market Cap:	US$2,575 MM
Shares Outstanding:	292 MM

Shinhan Financial Group listed and began trading on the KSE on September 10 following the de-listing of Shinhan Bank. The group is a holding company structure under which the bank, Shinhan Securities, Shinhan Capital, Cheju Bank and joint-ventures with various foreign banks are tucked.

We have become increasingly concerned about Shinhan recently on several unfavorable indicators. First, we believe that the holding company implementation does not offer easily-realized synergies, but may instead add costs and inhibit transparency. Secondly, we now believe that our old asset quality projections for Shinhan were too optimistic, as evidenced by continuing high provisions in 3Q01. Finally, although Shinhan's margins are improving, its earning asset growth lags well behind that of the industry leaders. Although valuations are not stretched, we see better opportunities elsewhere in the Korean bank sector.

Despite the touted maximization of synergies, we fail to see how the holding company will materially impact the revenue generating abilities or the costs of the bank going forward. The holding company structure may allow the group to better manage capital and reduce the inefficient holding of risk-weighted assets on the bank's balance sheet. However, in the absence of specific management plans to restructure the balance sheet we await evidence of signs of improved capital management in the company's results before factoring in any improvements into our forecast.

Since a huge drop in margin in the 3Q00 (due to a shift in the balance sheet from finance debentures and bonds into lower yielding inter-bank assets), better management of the balance sheet has yielded progressively better margins, rising to 2.15% in the second quarter. We expect margins for FY2001 of 2.24%, despite yields dropping a full 100 basis points, on growth of interest earning assets of 17% YoY.

Shinhan has a relatively high proportion of its loan book exposed to corporate and other debts. The higher corporate exposure indicates Shinhan may well suffer from relatively higher levels of NPLs as the Korean economy weakens into next year and we expect subsequently larger provisioning going forward.

Loan growth in Korea has been impressive in the first half of this year driving net interest margins upwards, however, the growth has been concentrated mainly in the consumer and SME segments. Shinhan has been able to grow earning assets at a respectable 12.6% YoY in the second quarter but this has clearly been a distant laggard to retail banking powerhouses Kookmin with 20% and H&CB with 19.5% second quarter YoY earning assets growth.

Shinhan currently trades at 0.78x first half 2001 book, 8.02x prospective FY2001 earnings and 4.69x prospective 2002 earnings. We expect the bank to earn a ROE of 12.01% in FY2001 and 18.44% in FY2002. Clearly it is the dismal ROE that is dragging down the valuation for this bank. On a comparative basis to other Korean banks in our universe, Shinhan even at a book multiple of 0.78x looks fully-priced.

Shinhan

Share Price (KRW):	11,400	**Index:**	543.41
52 Week Price Range (KRW):	14,700 - 9,400	**Current Yield:**	6.58%
Reuters Code:	1558.KS		
Bloomberg Code:	1558 KS	**Shares Outstanding** (MM):	292.34

INCOME STATEMENT	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
(W million) *year ending Dec*					
Interest income	3,350,808	3,660,915	3,786,599	3,813,367	3,882,263
Interest expense	-2,597,162	-2,746,758	-3,028,454	-3,272,919	-3,320,145
Net interest income	**753,646**	**914,157**	**758,145**	**540,448**	**562,118**
Ave. int. earnings assets	*34,876,883*	*43,176,180*	*50,182,021*	*54,767,614*	*56,889,013*
NIM (%)	**2.16%**	**2.12%**	**1.51%**	**0.99%**	**0.99%**
Non-interest income	1,134,471	893,480	1,089,568	1,220,081	1,266,137
Total operating income	**1,888,117**	**1,807,637**	**1,847,712**	**1,760,530**	**1,828,254**
Non-interest expenses	-817,858	-813,599	-1,003,409	-1,057,010	-1,008,410
Pre provision profit	**1,070,259**	**994,038**	**844,303**	**703,520**	**819,845**
Loan loss provisions	-804,324	-481,504	-535,550	-254,184	-316,784
Non-operating income	44,605	12,126	-3,534	12,126	12,126
Pre tax profit	**310,540**	**524,660**	**305,219**	**461,462**	**515,186**
Tax	-68,986	-186,827	-99,685	-157,081	-173,628
Net profit	**241,554**	**337,832**	**205,534**	**304,380**	**341,558**

PER SHARE DATA (W)	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
EPS	982	1,293	703	1,041	1,168
DPS	400	750	750	1,111	1,246
Effective payout ratio (%)	*41%*	*58%*	*107%*	*107%*	*107%*
BVPS	12,132	11,738	11,116	11,863	11,238
ABVPS	11,915	11,533	11,076	11,824	11,198

VALUATION	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
Price to book value (x)	1.0	0.9	1.0	1.0	1.0
Price to adjusted book value (x)	1.0	0.9	1.0	1.0	1.0
Price to earnings (X)	12.5	8.0	16.2	10.9	9.8

PROFITABILITY RATIOS	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
(%)					
Net interest margin	2.16%	2.12%	1.51%	0.99%	0.99%
Yield on interest earning assets	9.61%	8.48%	7.55%	6.96%	6.82%
Cost on interest bearing liabilities	7.42%	6.75%	6.51%	6.51%	6.29%
Net interest spread	2.19%	1.72%	1.04%	0.46%	0.53%
Non-int. income (% Op income)	60.1%	49.4%	59.0%	69.3%	69.3%
Cost to income	43.3%	45.0%	54.3%	60.0%	55.2%
Overhead ratio	1.89%	1.62%	1.73%	1.77%	1.62%
Cost coverage	138.7%	109.8%	108.6%	115.4%	125.6%
ROA	0.59%	0.72%	0.38%	0.52%	0.56%
ROE	9.4%	11.1%	6.4%	9.0%	10.0%

DUPONT ANALYSIS	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
Lending operations					
Net interest margin	2.16%	2.12%	1.51%	0.99%	0.99%
Interest earning assets/assets	84.89%	92.45%	92.98%	93.07%	93.07%
NIM contribution to ROA	**1.83%**	**1.96%**	**1.40%**	**0.92%**	**0.92%**
Non-interest operations					
Non-interest income/assets	2.76%	1.91%	2.02%	2.07%	2.07%
Overhead ratio	1.99%	1.74%	1.86%	1.80%	1.65%
Non-int. contribution to ROA	**0.77%**	**0.17%**	**0.16%**	**0.28%**	**0.42%**
Asset quality analysis					
Provision/loans	-3.80%	-1.77%	-1.64%	-0.70%	-0.85%
Loans/assets	51.52%	58.40%	60.51%	61.28%	61.31%
ROA effect from asset quality	**-1.96%**	**-1.03%**	**-0.99%**	**-0.43%**	**-0.52%**
Core ROA	**0.65%**	**1.10%**	**0.57%**	**0.76%**	**0.82%**
Non-core contibution to ROA	0.11%	0.03%	-0.01%	0.02%	0.02%
Pre-tax ROA	**0.76%**	**1.12%**	**0.57%**	**0.78%**	**0.84%**
Tax rate	22.21%	35.61%	32.66%	34.04%	33.70%
After tax ROA	**0.59%**	**0.72%**	**0.38%**	**0.52%**	**0.56%**
Balance sheet leverage (x)	16.2	15.4	17.1	17.5	18.1
ROE	**9.5%**	**11.2%**	**6.5%**	**9.1%**	**10.1%**

BALANCE SHEET	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
(W million) *year ending Dec*					
Gross loans	25,831,756	30,581,748	36,366,762	37,639,309	39,253,027
Specific loan loss reserves	*0*	*0*	*0*	*0*	*0*
Loan loss reserves	*-1,163,944*	*-700,329*	*-932,056*	*-953,336*	*-982,377*
Net loans	24,667,812	29,881,419	35,434,706	36,685,973	38,270,650
Other earning assets	15,182,813	16,620,317	18,427,600	18,986,949	19,834,455
Other assets	3,476,389	4,078,889	4,007,506	4,145,013	4,329,726
Total Assets	**43,327,014**	**50,076,050**	**57,869,812**	**59,817,936**	**62,434,830**
Deposits	23,167,642	29,809,333	32,283,257	33,252,273	34,447,987
Other paying liabilities	14,403,891	13,951,670	17,016,981	18,066,314	19,738,880
Other liabilities	2,001,036	1,948,083	4,020,180	3,731,333	3,662,716
Total Liabilities	**39,572,570**	**45,709,086**	**53,320,418**	**55,049,920**	**57,849,583**
Minorities & other	771,043	1,299,799	1,299,799	1,299,799	1,299,799
Shareholders' funds	**3,754,444**	**4,366,964**	**4,549,394**	**4,768,016**	**4,585,247**

LOAN BOOK	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
(W billion)					
Corporate	9,001	11,501	13,539	14,015	14,667
Consumer	2,547	4,154	5,939	7,024	7,914
Mortgage	1,146	1,562	1,713	1,893	2,133
Credit Card	1,143	1,586	1,991	2,321	2,615
Foreign currency loans	3,312	3,026	3,386	3,614	3,890
Other	7,519	8,053	8,867	7,820	7,052
Total loans	**24,668**	**29,881**	**35,435**	**36,686**	**38,271**
(%)					
Corporate	36%	38%	38%	38%	38%
Consumer	10%	14%	17%	19%	21%
Mortgage	5%	5%	5%	5%	6%
Credit Card	5%	5%	6%	6%	7%
Foreign currency loans	13%	10%	10%	10%	10%
Other	30%	27%	25%	21%	18%
Total loans	**100%**	**100%**	**100%**	**100%**	**100%**

BALANCE SHEET RATIOS	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
(%)					
Loan to deposit	106.5%	100.2%	109.8%	110.3%	111.1%
Equity to assets	8.7%	8.7%	7.9%	8.0%	7.3%
Tier 1 Capital	10.4%	9.2%	8.5%	8.7%	7.9%
Total Capital adequacy	13.9%	12.3%	11.5%	11.7%	11.0%
General reserves (% loans)	4.51%	2.29%	2.56%	2.53%	2.50%
Specific reserves (% loans)	0.00%	0.00%	0.00%	0.00%	0.00%
Total loan provisions	4.51%	2.29%	2.56%	2.53%	2.50%

ASSET QUALITY	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
(W million)					
Pass	20,312,966	27,677,470	33,229,753	34,373,052	35,857,379
Special Mention	2,947,000	1,632,000	1,614,594	1,687,007	1,758,569
Substandard	1,309,000	1,062,000	1,050,673	1,097,795	1,144,363
Doubtful	99,000	185,000	183,027	191,235	199,348
Foreclosed assets	-	-	-	-	-
NPL ratio	19.9%	9.9%	8.2%	8.3%	8.3%
Total provisions/NPLs	26.7%	24.3%	32.7%	32.0%	31.7%

GROWTH RATES	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
(%)					
Income statement					
Net interest income	33.5%	21.3%	-17.1%	-28.7%	4.0%
Non-interest income	-9.1%	-21.2%	21.9%	12.0%	3.8%
Total operating income	4.2%	-4.3%	2.2%	-4.7%	3.8%
Operating expenses	-41.0%	-0.5%	23.3%	5.3%	-4.6%
Pre-provision earnings	151.0%	-7.1%	-15.1%	-16.7%	16.5%
Loan loss provisions	107.7%	-40.1%	11.2%	-52.5%	24.6%
Net profit	**766.1%**	**39.9%**	**-39.2%**	**48.1%**	**12.2%**
Balance sheet					
Total Loans	39.6%	21.1%	18.6%	3.5%	4.3%
Interest earning assets	33.3%	16.7%	15.8%	3.4%	4.4%
Total Assets	11.5%	15.6%	15.6%	3.4%	4.4%
Deposits	5.4%	28.7%	8.3%	3.0%	3.6%
Shareholders' funds	41.8%	2.8%	5.9%	6.7%	-5.3%

Source: Company reports; Lehman Brothers estimates.

KorAm Bank

Small, but well formed

Rating: 2-Buy

Ticker:	01683.KS
Market Cap:	USD1,006MM
Shares Outstanding:	163 MM

KorAm has been vigorously cleaning house, selling NPLs worth W347.3 billion in the third quarter. These actions will position the bank well for improved profitability in future years but are depressing earning assets growth and hence placing a hold on margin expansion in the short-term. The bank has stated its intention to sell approximately the same amount of non-performing loans in the fourth quarter of this year.

Further, the bank has stated its intention to raise provisions against its Hynix debt to 80% by year end. We expect this action to reduce net income for the fourth quarter by a further W53 billion. As a measure of relative credit risk, on a reserve shortfall to equity basis, the bank is relatively highly exposed at around 7.1% of its existing equity. The bank has a slim equity base, with an equity to assets ratio of only 3.6% accounting for the high-level of exposure on a proportionate basis. The bank is unlikely to generate sufficient profits over the next few reporting periods to bolster capital sufficiently and in fact plans to issue additional Tier-II capital of W150 billion in November for this very purpose.

We expect full year margins of 1.79% for 2001 on a 20 basis point drop in yields and a 90 basis point drop in cost of funds. Margin growth is constrained by the lack of asset growth—we see earning assets contracting by 2% YoY for FY2001.

KorAm's loan book is highly geared towards SMEs, with over 50% exposure to this segment and relatively moderate exposure to large corporates. The bank however is actively seeking to restructure its loan portfolio, strategically seeking to grow consumer loans while passively maintaining corporate exposure and selling large corporate NPLs wherever possible. Despite being positioned towards one of the fastest growing segments in the SME market, the bank has refrained from growing the loan book here, preferring to maintain a balance of 50% SME lending, a limit it was already at in the beginning of the year. Absolute exposure to SME loans has actually shrunk over the first half of the year from W5,870 billion at year end 2000 to W5,854 billion in the middle of the year.

Where the bank has been gaining ground in loan growth is in the consumer and credit card segments. Consumer loan and credit card growth rates of 36% YoY and 110% YoY respectively in the second quarter compare favorably with the leading consumer franchises of Kookmin and H&CB.

At current levels, KorAm Bank is trading at approximately 1.27x first half 2001 book, 7.38x estimated FY2001 earnings and 4.07x estimated FY2002 earnings—reflecting a quality, albeit small, franchise.

KorAm

Share Price (KRW):	7,990	**Index:**	543.41
52 Week Price Range (KRW):	8,900 - 4,900	**Current Yield:**	0.00%
Reuters Code:	1683.KS		
Bloomberg Code:	1683 KS	**Shares Outstanding (MM):**	163.07

INCOME STATEMENT	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
(W million) *year ending Dec*					
Interest income	1,873,246	1,916,597	1,932,417	1,836,299	1,953,430
Interest expense	-1,471,647	-1,485,751	-1,427,844	-1,273,795	-1,322,525
Net interest income	**401,599**	**430,846**	**504,572**	**562,504**	**630,905**
Ave. int. earnings assets	*20,428,289*	*25,232,370*	*28,167,659*	*29,114,935*	*31,371,739*
NIM (%)	**1.97%**	**1.71%**	**1.79%**	**1.93%**	**2.01%**
Non-interest income	704,645	783,135	847,663	921,126	1,116,411
Total operating income	**1,106,244**	**1,213,981**	**1,352,235**	**1,483,631**	**1,747,316**
Non-interest expenses	-648,396	-758,290	-860,071	-904,467	-1,011,051
Pre provision profit	**457,848**	**455,691**	**492,164**	**579,164**	**736,265**
Loan loss provisions	-387,228	-1,025,049	-300,017	-162,443	-149,308
Non-operating income	0	0	14,443	0	0
Pre tax profit	**70,620**	**-569,358**	**206,590**	**416,721**	**586,957**
Tax	-20,284	173,310	-33,066	-101,911	-154,344
Net profit	**50,336**	**-396,048**	**173,525**	**314,810**	**432,613**

PER SHARE DATA (W)	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
EPS	515	-2,429	1,064	1,931	2,653
DPS	0	0	0	0	0
Effective payout ratio (%)	*0%*	*0%*	*0%*	*0%*	*0%*
BVPS	7,567	4,898	5,763	7,118	9,215
ABVPS	7,566	4,897	5,762	7,117	9,214

VALUATION	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
Price to book value (x)	1.1	1.0	1.4	1.1	0.9
Price to adjusted book value (x)	1.1	1.0	1.4	1.1	0.9
Price to earnings (X)	16.7	NM	7.5	4.1	3.0

PROFITABILITY RATIOS	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
(%)					
Net interest margin	1.97%	1.71%	1.79%	1.93%	2.01%
Yield on interest earning assets	9.17%	7.60%	6.86%	6.31%	6.23%
Cost on interest bearing liabilities	7.79%	6.46%	5.57%	4.85%	4.72%
Net interest spread	1.38%	1.13%	1.29%	1.45%	1.51%
Non-int. income (% Op income)	63.7%	64.5%	62.7%	62.1%	63.9%
Cost to income	58.6%	62.5%	63.6%	61.0%	57.9%
Overhead ratio	2.80%	2.65%	3.04%	2.94%	3.05%
Cost coverage	108.7%	103.3%	98.6%	101.8%	110.4%
ROA	0.23%	-1.53%	0.61%	1.07%	1.35%
ROE	6.6%	-52.5%	19.0%	29.2%	32.1%

DUPONT ANALYSIS	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
Lending operations					
Net interest margin	1.97%	1.71%	1.79%	1.93%	2.01%
Interest earning assets/assets	94.54%	97.42%	98.96%	98.59%	98.05%
NIM contribution to ROA	**1.86%**	**1.66%**	**1.77%**	**1.90%**	**1.97%**
Non-interest operations					
Non-interest income/assets	3.26%	3.02%	2.98%	3.12%	3.49%
Overhead ratio	3.00%	2.93%	3.02%	3.06%	3.16%
Non-int. contribution to ROA	**0.26%**	**0.10%**	**-0.04%**	**0.06%**	**0.33%**
Asset quality analysis					
Provision/loans	-3.54%	-6.93%	-1.87%	-1.01%	-1.66%
Loans/assets	50.66%	57.10%	56.50%	54.50%	28.16%
ROA effect from asset quality	**-1.79%**	**-3.96%**	**-1.05%**	**-0.55%**	**-0.47%**
Core ROA	**0.33%**	**-2.20%**	**0.68%**	**1.41%**	**1.83%**
Non-core contibution to ROA	0.00%	0.00%	0.05%	0.00%	0.00%
Pre-tax ROA	**0.33%**	**-2.20%**	**0.73%**	**1.41%**	**1.83%**
Tax rate	28.72%	30.44%	16.01%	24.46%	26.30%
After tax ROA	**0.23%**	**-1.53%**	**0.61%**	**1.07%**	**1.35%**
Balance sheet leverage (x)	29.7	33.7	32.7	28.1	24.0
ROE	**6.9%**	**-51.5%**	**20.0%**	**30.0%**	**32.5%**

BALANCE SHEET	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
(W million) *year ending Dec*					
Gross loans	13,624,078	18,121,303	16,213,840	17,506,485	18,751,367
Specific loan loss reserves	*0*	*0*	*0*	*0*	*0*
Loan loss reserves	*-763,356*	*-1,401,562*	*-769,218*	*-760,836*	*-732,949*
Net loans	12,860,722	16,719,741	15,444,622	16,745,649	18,018,418
Other earning assets	9,221,585	11,662,691	12,508,264	13,531,335	14,448,076
Other assets	1,057,018	4,078,889	310,031	524,062	725,699
Total Assets	**23,139,325**	**28,663,059**	**28,262,917**	**30,801,047**	**33,192,193**
Deposits	14,684,445	18,011,373	17,794,387	18,915,349	20,127,387
Other paying liabilities	5,405,927	7,861,986	7,599,660	8,192,917	8,820,167
Other liabilities	2,049,894	1,682,927	1,621,062	2,224,024	2,433,900
Total Liabilities	**22,140,266**	**27,556,286**	**27,015,110**	**29,332,291**	**31,381,454**
Minorities & other	260,000	308,000	308,000	308,000	308,000
Shareholders' funds	**999,059**	**1,106,773**	**1,247,808**	**1,468,757**	**1,810,739**

LOAN BOOK	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
(W billion)					
Corporate	5,094	7,566	7,516	7,780	8,142
Consumer	1,203	1,932	2,438	2,883	3,249
Mortgage	602	843	828	915	1,031
Credit Card	459	859	1,322	1,540	1,736
Foreign currency loans	976	601	653	699	750
Other	4,526	4,919	2,688	2,927	3,110
Total loans	**12,861**	**16,720**	**15,445**	**16,746**	**18,018**
(%)					
Corporate	40%	45%	49%	46%	45%
Consumer	9%	12%	16%	17%	18%
Mortgage	5%	5%	5%	5%	6%
Credit Card	4%	5%	9%	9%	10%
Foreign currency loans	8%	4%	4%	4%	4%
Other	35%	29%	17%	17%	17%
Total loans	**100%**	**100%**	**100%**	**100%**	**100%**

BALANCE SHEET RATIOS	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
(%)					
Loan to deposit	87.6%	92.8%	86.8%	88.5%	89.5%
Equity to assets	4.3%	3.9%	4.4%	4.8%	5.5%
Tier 1 Capital	8.3%	5.0%	5.9%	6.7%	8.1%
Total Capital adequacy	12.3%	8.8%	9.7%	10.4%	11.8%
General reserves (% loans)	5.60%	7.73%	4.74%	4.35%	3.91%
Specific reserves (% loans)	0.00%	0.00%	0.00%	0.00%	0.00%
Total loan provisions	5.60%	7.73%	4.74%	4.35%	3.91%

ASSET QUALITY	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
(W million)					
Pass	10,515,653	15,062,657	13,941,740	15,325,125	16,723,781
Special Mention	524,000	284,000	268,743	261,572	248,057
Substandard	1,248,000	121,000	114,500	111,445	105,686
Doubtful	796,000	1,499,000	1,418,472	1,380,623	1,309,287
Foreclosed assets	-	-	-	-	-
NPL ratio	20.6%	11.8%	12.1%	10.9%	9.6%
Total provisions/NPLs	29.7%	73.6%	42.7%	43.4%	44.1%

GROWTH RATES	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
(%)					
Income statement					
Net interest income	3.2%	7.3%	17.1%	11.5%	12.2%
Non-interest income	72.7%	11.1%	8.2%	8.7%	21.2%
Total operating income	38.8%	9.7%	11.4%	9.7%	17.8%
Operating expenses	35.2%	16.9%	13.4%	5.2%	11.8%
Pre-provision earnings	44.2%	-0.5%	8.0%	17.7%	27.1%
Loan loss provisions	40.3%	164.7%	-70.7%	-45.9%	-8.1%
Net profit	**113.2%**	**-886.8%**	**NM**	**81.4%**	**37.4%**
Balance sheet					
Total Loans	42.4%	30.0%	-7.6%	8.4%	7.6%
Interest earning assets	17.6%	28.5%	-1.5%	8.3%	7.2%
Total Assets	15.2%	23.9%	-1.4%	9.0%	7.8%
Deposits	20.4%	22.7%	-1.2%	6.3%	6.4%
Shareholders' funds	3.1%	8.1%	17.7%	23.5%	29.5%

Source: Company reports; Lehman Brothers estimates.

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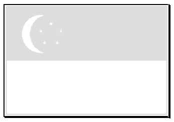
Singapore

What Now?

Rating: Neutral ⇔



Covered Banks	Rating
DBS	2-Buy
OCBC	3-Mkt Perform
UOB	1-Strong Buy

We are NEUTRAL on the Singaporean banks, down from OVERWEIGHT at the beginning of the year. The bank sector is somewhat unexciting post-mergers, and we are positive mainly on UOB. With low growth and weak margins, only significantly-reduced valuations keep Singapore from being underweight at this point.

Reasons For A Neutral Rating Now

We had looked for three main areas of progress from Singaporean banks this year: Consolidation, better capital management, and resumed growth. Here's how they stack up so far:

- Consolidation: Grade—A. Banks have done exactly as we hoped by buying each other.
- Capital Management: Grade—B-. Acquisitions have helped return capital to shareholders, but the banking sector as a whole still has too much capital and hence low returns.
- Growth: Grade—C+. Although consumer lending has continued to shine, overall loan growth is basically flat, with no improvement seen until FY2003.

Although Singapore has taken a big step with consolidation, larger issues remain which reduce the market's attractiveness. Keep in mind that "Neutral" means neutral; we have an Underweight category and are not afraid to use it (witness our current roster of five underweight markets.

Excess Capital Remains

While the banks have all taken major steps towards reducing capital by making acquisitions, OCBC and UOB continue to have significant excess capital, particularly when off-balance-sheet assets (reported at over S$4.4 billion, or 52% of reported equity) are taken into account. These banks can not let themselves be put into a position where they are forced to either make regular acquisitions (whether or not the environment or pricing are favorable) or risk lowered ROEs.

A ROE focus will require divestment of non-core assets by OCBC and UOB (DBS has done a quite credible job already) in a less dilatory manner than has thus far been the case. UOB's job will be complicated by the addition of OUB's affiliates and property holdings—even though this should add substantial value to the transaction if properly handled.

In the very near term, Singapore will also need to reconsider its 12% CAR and 10% Tier 1 requirements, which are well above the global benchmarks of 8% and 4%, respectively. With bankers reporting informal pressure to keep their ratios well above this statutory minimum, Singaporean banks must clear a considerably higher profit hurdle than their Asian and global peers. If Singaporean banks are to expand in the region, they will need to do so on even terms.

Poor Loan Growth

Unfavorable Macro Environment

From a peak of 9.9% in 2000, Singapore's GDP growth has cratered. In the industrial sector, production has been declining for six consecutive months, and export growth of -19.5% in July gives us no great hope that an uptick is coming. In the consumer sector, uncertainty about the future, rising unemployment, and a reverse wealth effect from retail share and property exposure is causing consumers to rein in their spending.

In a trend which is directly related to the fall in GDP, loan growth has been close to flat since 1998, despite several rate cuts and excess liquidity. Although loan growth typically lags GDP, we don't foresee any future benefits from the fast growth experienced last year, but expect that we will be hit by a decline in loans later in 2001 and 2002 as the current slowdown shows its full effects.

Our lending forecast for Singapore currently projects growth of 2.8% in FY2001 and 0.8% in FY2002, with a pick-up to 5.7% by FY2004. Keep in mind that the Singaporean banks will have to fight for this growth in their home market with increasingly aggressive foreign competitors, but may be able to offset any lost share here with gains in foreign operations such as Malaysia.

Where To Find Growth?

Barring a dramatic economic turnaround, credit growth in Singapore will be fairly low through at least 2003. This corresponds well with the period during which all three banks will be occupied with taking profit growth through acquisitions, so it's not an immediate problem for bottom line returns. However, looking at 2004 and beyond, banks will need either to find areas for new growth or to consolidate further—or be bought by foreigners if this becomes allowable.

So far, banks have focused on South Asia (DBS: BPI, TDB; UOB: Radanasin, Westmont), Malaysia (OCBC, UOB) and Hong Kong (DBS: DHB; OCBC: unsuccessful bids for Manhattan Card and FPB) as areas for incremental growth. While the relative rankings may change in the future, it does not now appear that growth prospects in Thailand, the Philippines, and Indonesia are superior enough to earn the Sing banks return on capital. Keep in mind that each of these markets already has many strong local players, and is overbanked to begin with, so that taking appreciable share would seem a difficult task.

Malaysia is somewhat attractive given the poor condition of many of the domestic banks, but foreigners are limited in their ability to open branches (all Singaporeans are at their limits already), so that the ability to exploit this opportunity is limited.

Loan Growth: Winners and Losers

FY2000's loan growth was far from evenly distributed, with DBS sustaining a marked loss and OUB and Keppel significantly outperforming. While OCBC did well overall, consumer lending curiously fell by 5.5% in a buoyant market despite the introduction of several new products, making up most of its ground in lower-margin financial institution loans. Surprisingly, the most consistent performers over the past two years were OUB and KTLB, the only banks to post growth in both periods.

In 1H01, growth was more even with UOB, OCBC and OUB gaining 3-4% and KEPC moderating to 1.15% on a slowdown in mortgage lending. DBS posted a 33% increase due to the consolidation of Dao Heng Bank on the last day of the first half; the company was unwilling to provide a balance sheet for DBS ex-DHB.

Earnings Commentary and Projections

First half earnings season was a disappointment even given low expectations, with only UOB among the major banks hitting analysts reduced estimates. The impetus for consolidation or foreign acquisitions is evident, as the Singaporean market became significantly less favorable this half in almost every area.

Earnings will be driven over the next two years by cost savings (or the lack thereof) from M&A, primarily the in-market transactions at UOB and OCBC. Note also that for the first time we have a material difference between our projected core and net income figures, due mainly to the write-down of goodwill incurred in the various acquisitions.

How should investors be measuring forward earnings and ROE? We believe that the answer is without goodwill charges.

A key question going forward is which of these earnings measures we should be looking to for guidance on operating performance and investment return. We acknowledge that goodwill is merely an accounting fiction, which in many cases distorts operating performance. Therefore, we are placing the greatest reliance on our measures of core earnings, core ROE and core ROA, which are measured as follows:

Our core earnings figure is net earnings plus goodwill charge-offs, less extraordinaries and tax-adjusted securities gains and other disposals. It is meant to give a comparable measure of profit from the underlying core business, with as little exposure as possible to managements' discretionary accounting choices and the timing of asset sales. Note, however, that core earnings *do* include provisions, despite the fact that these are one of the most easily manipulated accounts in the earnings release. This is because we strongly believe that credit provisions are a part of the core business.

ROE in the underlying business should be measured by core earnings over average economic equity ("AEE"). AEE is higher than reported equity, and includes both goodwill and reported real estate revaluation and unrealized securities gains, neither of which are shown on the balance sheet in Singapore.

Note that on this basis we find UOB a clear leader post its integration of OUB (*see "Expense Control and Merger Cost Savings," below*). Although OCBC also improves markedly, the company is coming off a lower base and has more off-balance-sheet revaluation (some S$4.4 billion) than any of its peers, holding down return. DBS peaks in FY2002 in large part due to the lag effect of AEE averaging in the Dao Heng acquisition.

Figure 26: Core ROE: 1997–2004

	DBS	OCBC	UOB	AVG
Core ROE:				
1997	5.20%	7.16%	7.91%	6.76%
1998	2.43%	3.15%	5.61%	3.70%
1999	8.70%	6.64%	10.23%	8.52%
2000	11.25%	7.45%	10.27%	9.66%
2001	11.57%	8.27%	11.62%	10.49%
2002	13.21%	9.77%	14.65%	12.54%
2003	11.76%	9.79%	15.63%	12.39%
2004	11.17%	9.68%	15.90%	12.25%

Source: Company Reports; Lehman Brothers estimates s

Rates, Margins, and Competition

The key driver of Singaporean bank results over the past two reporting periods has been the unexpected softness of net interest income. While some of the responsibility for this can be laid at the door of weak loan growth, a move favorable loan mix occasioned by well-above-average growth in the profitable consumer sector should have allowed banks to post better results on a volume basis.

The real culprit, then, is interest margins which have steadily trended downwards. The five banks have lost an average of 31bp in NIM since 2H98, despite steadily decreasing levels of foregone interest income on NPLs and more emphasis on high-margin consumer business. The three largest (and surviving) banks did even worse on this measure, dropping an average of 60bp over those 30 months, which can be attributed to the higher growth and retail focus of OUB and Keppel.

Most of the NIM compression has come on the asset side, although funding costs have increased marginally. A major reason for the higher cost of funds is the increased use of subordinated debt and preferred shares as a substitute for equity capital—a positive change as it leads to more optimal leverage. While equity capital counts as zero-cost funding under the net interest income model, this is clearly far from true in an economic sense.

The mortgage market, with its highly-publicized rate changes, is a useful microcosm of Asian bank lending in general. Slow loan growth is seemingly leaving banks no option but to cut margins to capture share, although it does not appear that lowered rates have stimulated any additional demand from consumers. Banks are therefore slashing aggregate profitability.

While the sleepy domestic banking sector has been looking to foreign acquisitions for growth and domestic combinations for efficiency, global competitors are insinuating their way into the wallets of Singaporean consumers. Foreign banks including HSBC, StanChart, and ABN-AMRO are matching domestic rates aggressively and putting pressure on margins.

Standard Chartered, long a top name in asset management, has amassed a mortgage portfolio of S$4.9 billion, putting it ahead of both OUB and Keppel. HSBC, with 11 branches, ABN AMRO, with three branches, and Citibank, with four branches, are also moving ahead swiftly to add balances as they expand their networks under QFB licenses.

As consolidation inevitably leads to branch closures and some degree of customer attrition, foreign banks will no doubt be waiting to peel off dissatisfied customers. In a market without substantial growth, this will probably prevent domestic banks from regaining lost margins on the asset side—even after taking out two major competitors.

Banking Liberalization and the Shape of Things to Come

In a July policy address, MAS Chairman Lee Hsien Loong unveiled the clearest road map yet for banking sector liberalization in Singapore. The most important components of this change will involve the partial opening of Singapore's banking system to foreign banks, and the rationalization of the charter classification system.

While the announced changes take a far from *laissez-faire* attitude towards the admission of additional competitors, implicit is at least the realization that outside pressure on Singapore's remaining three banks will increase over the next few years. The government's plan appears to be to delay opening key segments of the market for as long as possible to allow domestic banks to become stronger.

In summary, Singapore's retail banking system will remain closed, and may even become more restrictive for foreign banks than it heretofore has been if subsidiarization is implemented. In contrast, the wholesale banking market will be liberalized substantially. However, it is open to question whether foreigners will find potential new regulations commensurate with the relatively low profit to be gained in Singapore.

Asset Quality

Asset quality has not been a key problem at the Singaporean banks due to their relative protection from the Asian crisis, and to generally strong prudential standards for underwriting. However, classified loans as a percentage of customer loans are still very high by global standards, at an average of 8.0% as of 1H01. Note further that this figure is understated due to the consolidation of DHB into DBS at period-end, dropping the DBS ratio from 8.1% to 5.7%.

NPLs have been stubborn despite an estimated S$2.1 billion in net write-offs for the sector as a whole. In the latest period, NPLs fell only 2.1% on average from the previous half, although results have been satisfactory on a year-over-year basis. Excluding the extraordinary write-offs at DBS Thai Danu Bank, Singapore-domiciled credit quality appears to be gaining ground very slowly—even before the current economic slowdown.

Although headline NPLs are declining, a more revealing mode of analysis concentrates not only on the volume of bad loans but also on their severity. The ratio of weighted classified assets to customer loans is calculated for Singaporean banks as follows:

Figure 27: Weighted Classification Ratio Calculation

$$WCR = \frac{[(\text{Substandard Loans} \times 0.2) + (\text{Doubtful Loans} \times 0.5) + (\text{Loss Loans} \times 1.0)]}{\text{Total Customer Loans}}$$

Source: Lehman Brothers.

Reserves Generally Adequate

Despite remaining NPLs, loan loss reserves at all five banks except for OUB meet our rather strict standards, with OCBC overshooting by 21%. OUB has persistently run with a lower coverage ratio than its peers, and this will pull the combined UOB-OUB entity into an under-reserved position by approximately 2.5% of capital. We don't consider this material, but it is the main reason why we forecast UOB's provisions to remain comparatively constant in 2001–2003.

Given that NPLs are still fairly high by developed market standards, we estimate that loan loss provisions will bottom-out in FY2002 at an average of 0.04% of assets, down from 1.20% in FY1998. With our base-case estimate of charge-offs running at 50bp on the customer loan portfolio, it is difficult to see this low level persisting regardless of the economic condition.

Merger Cost Saves

Bank M&A is all about cost saves, with revenue synergies largely illusory. As each bank has just completed an acquisition, and with overall sector growth flat, execution success—and thus the driving force for bank profitability over the next three years—will be a function of extracting expense savings with minimum customer attrition.

There has been much public acrimony over which management teams are best positioned to do this, with DBS trumpeting its past successes and UOB responding by gestures towards its history of parsimonious expenditure.

Market consensus so far is that DBS as a professionally-run bank with a large network and more M&A experience will be faster to take out costs in its DHB acquisition, with this carrying over into the OUB battle, where DBS asserted that it would cut in-market costs more deeply than UOB. UOB as a family-run bank is seen as likely to preserve more jobs, particularly given the friendly nature of its bid for OUB. Seemingly confirming this view is the UOB plan to incorporate all OUB Board members and much of management into its existing structure.

In-market Cost Save Estimates—UOB/OUB

Market perception is that UOB, as a family-run bank, will be unwilling to cut costs at the merged bank. We believe that UOB's attitude towards cost-cutting has been misrepresented, and foresee savings amounting to 47.7% of OUB's existing cost base—some S$113 million per annum at equilibrium.

Figure 28: OUB Cost Saves by Business Line

Total OUB Spending on: (S$, 000s)		%ge Cost Saves
Consumer	120,360	35%
Corporate	40,120	50%
Regional	40,120	70%
Treasury	16,520	60%
Stockbroking	18,880	65%
Others	-	40%
Total	236,000	47.7%

Source: Lehman Brothers estimates

To begin with, UOB management in the past considered acquiring a competitor and eliminating all of the branches and staff. While we do not expect that this will happen in the OUB acquisition (nor should it), this bespeaks a materially more hard-nosed attitude on costs than is commonly supposed. Group Chairman Wee Cho Yaw was very clear on his plans for the merged bank at the UOB shareholders' meeting in July, saying that the point of bank M&A is either to have "a bigger market share or cut a lot of operating costs," and that in this case his focus is "100% cut costs."

Specific targets were set out in the offer document for OUB, wherein UOB estimated cost savings of S$200–250 million per year, representing 41–51% of OUB's FY2000 cost base. As over 50% of OUB's costs are personnel related, this by definition will mean large job losses, and Mr. Wee has been forthright in stating that there may be over 2,000 layoffs (on an OUB employee base of 4,443 at 1H01). Note that these layoffs are included in our merger charge estimate of S$68 million.

Finally, there has been discussion of the cost effect of keeping on much of OUB's senior management team and the entire Board. To begin with, we consider the addition of many OUB managers a positive for UOB, in that their performance has been excellent even with OUB's fundamentally weaker franchise (unfortunately the expanded management team will not include CEO Peter Seah). In truth, the cost issue is moot in our opinion, as even managers dismissed as a result of a merger tend to leave with large golden parachutes and severance packages—the bottom line is that OUB's management will probably be paid whether they are retained or not!

In-market Cost Save Estimates—OCBC/Keppel

By comparison, OCBC has done a good job of getting its expense plan out in the market, and projects per annum savings of S$80–100 million, or 33.8-42.2% of Keppel's existing cost base. Our estimate of S$107 million in savings (45.2%) is just past the high end, but we feel that OCBC management has been conservative in its estimation, as it was the only bidder for KEPC and shareholders of Keppel were not asked to take OCBC shares.

Management has also projected a charge of S$120 million for merger-related costs; we are likely to re-classify some of this as normal expense rather than as an extraordinary, and project extraordinaries of S$62 million.

Figure 29: Keppel Cost Saves by Business Line

Total Keppel Spending on:		%ge Cost Saves
Consumer	134,609	35%
Corporate	46,470	50%
Regional	17,573	70%
Treasury	18,661	60%
Stockbroking	18,208	65%
Others	1,178	40%
Total	236,699	45.2%

Source: Lehman Brothers estimates

Valuation

Our usual value touchstones have been somewhat scrambled due to merger accounting, with current price-to-book ratios set to change drastically, and a looming disparity between book value and adjusted book figures. [A review: our ABV is total economic equity less revaluations, goodwill, and excess capitalized tax loss carry-forwards.]

Based on 1H01 figures, the sector is trading at only 1.30x book, with the three remaining banks averaging 1.13x—which seems fairly reasonable given the average trailing core ROE of 9.7% and low growth prospects. On an adjusted book basis, things look much different, with absolute ABV declining at all three banks due to goodwill and merger expenses. We project that banks are now trading at 2.88x YE2001 P/ABV.

Figure 30: Valuation Metrics: P/BV and P/ABV

	Book Value		Price / Book		ABV		Price / ABV	
	1H01A	2001E	1H01A	2001E	1H01A	2001E	1H01A	2001E
DBS	9.96	10.38	1.07	1.03	9.00	3.97	1.19	2.69
OCBC	9.99	10.44	1.06	1.02	6.55	5.13	1.62	2.06
OUB	6.27	N/M	1.54	N/M	5.56	N/M	1.74	N/M
UOB	8.31	6.23	1.26	1.69	6.90	2.70	1.52	3.89
KEPC	2.30	N/M	1.58	N/M	2.15	N/M	1.68	N/M
Average			1.30	1.24			1.55	2.88

Source: Company Reports; Lehman Brothers estimates

While it is perfectly proper to use either post- or pre- goodwill figures for ratios, investors should be careful when using company-provided figures to ascertain that all ratios are presented in a like manner—cash earnings over tangible equity will overstate ROE.

Earnings Relative to Market

On a net income basis, Sing banks are currently trading at 14.4x trailing earnings and 13.2x forward earnings, versus weighted index levels of 11.8x and 11.8x, respectively, for the Straits Times.

Based on historical trading ranges, the banks are not notably cheap compared with the index; however, both the sector and market are trading at very low multiples vis-a-vis their historic levels.

We would not look for an upward sector re-rating independent of the market based on this data, hence our Neutral view and selective ratings.

Figure 31: Valuation Metrics: Historical and Forward P/E; Share P/E to Index P/E

	Price to Earnings							Share P/E to Index P/E						
	1996A	1997A	1998A	1999A	2000A	2001E	2002E	1996A	1997A	1998A	1999A	2000A	2001E	2002E
DBS	18.16	30.43	60.00	16.37	9.36	9.58	9.31	101%	147%	154%	81%	79%	81%	80%
OCBC	19.52	30.27	28.05	20.87	16.23	13.47	11.36	109%	146%	72%	103%	137%	115%	97%
OUB	10.00	34.60	29.21	17.44	17.58	N/M	N/M	56%	167%	75%	86%	149%	N/M	N/M
UOB	17.87	30.91	25.29	14.67	12.10	16.68	12.86	100%	149%	65%	72%	102%	142%	110%
KEPC	27.55	32.03	6.83	12.14	16.57	N/M	N/M	154%	155%	18%	60%	140%	N/M	N/M
Average	18.62	31.65	29.88	16.30	14.37	13.24	11.18	104%	153%	77%	80%	121%	113%	96%
Straits Times	17.90	20.71	38.86	20.30	11.83	11.76	11.70	--	--	--	--	--	--	--

Source: Company Reports; Lehman Brothers estimates

Figure 32: Valuation Metrics: Deposit Premium Valuation: 1H01

SGD, MM	Market Cap	Total Equity	Market Cap Less Equity	Total Deposits	Deposit Premium	Customer Deposits	Deposit Premium
DBS	13,008	12,111	897	94,811	0.9%	82,395	1.1%
OCBC	13,631	12,843	788	50,769	1.6%	39,537	2.0%
OUB	9,588	6,225	3,363	39,247	8.6%	29,284	11.5%
UOB	11,048	8,749	2,299	58,589	3.9%	44,053	5.2%
KEPC	4,996	3,176	1,820	20,833	8.7%	15,509	11.7%
Average	10,454				4.7%		6.3%

Source: Company Reports; Lehman Brothers estimates

Figure 33: Valuation Metrics: Deposit Premium Valuation: 2H01 Pro-Forma

SGD, MM	Market Cap	Total Equity	Market Cap Less Equity	Total Deposits	Deposit Premium	Customer Deposits	Deposit Premium
DBS	13,008	12,620	387	96,895	0.4%	84,107	0.5%
OCBC	13,625	13,419	206	73,584	0.3%	56,856	0.4%
UOB*	16,476	9,774	6,702	97,836	6.9%	73,337	9.1%
Average	14,370				2.5%		3.3%

Source: Company Reports; Lehman Brothers estimates

DBS BANK

Feeling The Pain

Rating: 2-Buy

Ticker:	DBSMe.SI
Market Cap:	US$7,121MM
Shares Outstanding:	1,216 MM

DBS will be the third-largest bank in Singapore, fifth-largest in Hong Kong, and twelfth-largest in Thailand, with a minority stake in the largest bank in the Philippines. This assemblage doesn't appear to have much synergy—and certainly has not produced revenue in proportion to its cost. As DBS no longer has oodles of excess capital, it can't keep on buying market access and will have to develop a better strategy to get value out of existing assets.

We've been as vocal as anyone in criticizing DBS management for what we see as mis-steps in the past, but history is no reason to ignore a good deal. DBS is now trading below its 1998 trough valuation on a P/E basis, at 9.4x trailing EPS. This earnings power will start to tell in out years; meanwhile it offers downside protection. On other valuation methods, DBS continues to show the same value.

On a dividend discount model, DBS has substantial headroom given its sustainable long-term growth rate of 7.07%. The DDM model gives an implied value of S$14.67. On a less frequently seen, although just as valid given DBS's numerous acquisitions, sum-of-parts basis; DBS' non-Singaporean banking assets and easily separable businesses such as DBS-Vickers Securities and DBS Asset Management, along with the group's real estate holdings, the stand-alone bank has an implied valuation of S$2.6 billion—a pittance compared with the benchmarks set by the recent KEPC and OUB transactions.

The Dao Heng transaction was a poor one; we calculate the IRR of the purchase at 6.5%, or slightly more than half of the cost of capital for DBS. Furthermore, we believe that the market positioning and profitability of mid-sized Hong Kong banks will come under increasing pressure in the future, and this will affect DHB negatively. However, we believe that DHB is already priced in. Although we continue to feel that this is a deal which never should have been done, as a sunk cost we feel it is more than priced in.

Economic ROE however will continue to remain low. While goodwill write-offs will help improve reported ROE, on an economic basis DBS has locked itself into a sub-12% core ROE through at least 2004 because of a series of overpriced acquisitions culminating in Dao Heng.

On a price-to-book basis, particularly using trailing figures, DBS is cheaper than our top pick UOB, a relationship which is in line with historical experience (and one commensurate with UOB's consistently higher ROE). However, looking at adjusted (or reported) book value for DBS, we expect a very high value beginning with 2H01 due to massive goodwill from the Dao Heng acquisition.

DBS

Share Price:	10.70	**Index:**	1,411.25
52 Week Price Range:	9.50 - 21.20	**Current Yield:**	3.2%
Reuters Code:	DBSMe.SI		
Bloomberg Code:	DBS SP	**Shares Outstanding** (MM):	1,215.66

INCOME STATEMENT	**1998A**	**1999A**	**2000A**	**2001E**	**2002E**
(S$m) *year ending Dec*					
Interest income	4,931	4,608	4,897	5,551	6,144
Interest expense	3,501	2,573	2,858	3,211	3,415
Net interest income	**1,430**	**2,035**	**2,039**	**2,340**	**2,730**
Ave. int. earnings assets	*68,233*	*86,446*	*97,571*	*117,518*	*136,856*
NIM (%)	**2.10%**	**2.35%**	**2.09%**	**1.99%**	**1.99%**
Non-interest income	481	957	886	1,170	1,522
Total operating income	**1,911**	**2,992**	**2,925**	**3,509**	**4,252**
Non-interest expense	-754	-1,065	-1,246	-1,653	-1,925
Pre provision profit	**1,157**	**1,927**	**1,679**	**1,857**	**2,327**
Loan loss provisions	-996	-1,063	-54	-56	-30
Non-operating income	-5	143	50	-22	-331
Pre tax profit	**155**	**1,007**	**1,671**	**1,918**	**2,297**
Tax	-72	-345	-315	-430	-563
Net profit	**223**	**1,072**	**1,389**	**1,357**	**1,397**
Core earnings	**225**	**977**	**1,348**	**1,406**	**1,727**

PER SHARE DATA (S$)	**1998A**	**1999A**	**2000A**	**2001E**	**2002E**
EPS	0.24	0.91	1.14	1.12	1.15
DPS	0.15	0.17	0.34	0.33	0.40
Effective payout ratio (%)	*55%*	*19%*	*30%*	*30%*	*35%*
BVPS	10.98	10.44	9.60	10.38	11.13
ABVPS	9.84	9.23	8.63	3.97	4.99

VALUATION	**1998A**	**1999A**	**2000A**	**2001E**	**2002E**
Price to book value (x)	1.4	1.9	1.1	1.0	1.0
Price to adjusted book value (x)	1.5	2.2	1.2	2.7	2.1
Price to earnings (x)	62.1	22.2	9.4	9.6	9.3

PROFITABILITY RATIOS	**1998A**	**1999A**	**2000A**	**2001E**	**2002E**
(%)					
Net interest margin	2.10%	2.35%	2.09%	1.99%	1.99%
Yield on interest earning assets	6.31%	4.87%	4.88%	4.12%	4.42%
Cost on interest bearing liabilities	3.93%	2.78%	2.95%	3.13%	3.23%
Net interest spread	2.38%	2.09%	1.93%	0.99%	1.19%
Non-int. income (% Op income)	25.2%	32.0%	30.3%	33.3%	35.8%
Cost to income	39.6%	34.0%	41.9%	45.6%	45.3%
Overhead ratio	1.11%	1.23%	1.28%	1.41%	1.41%
Cost coverage	63.8%	89.9%	71.1%	70.8%	79.1%
ROA	0.27%	1.04%	1.28%	1.21%	1.21%
ROE	2.4%	9.5%	11.6%	11.2%	10.7%

OROA ANALYSIS	**1998A**	**1999A**	**2000A**	**2001E**	**2002E**
Net interest margin	2.10%	2.35%	2.09%	1.99%	1.99%
Non-interest inc./gross inc.	24.98%	35.10%	31.37%	35.49%	35.80%
Efficiency ratio	39.58%	33.96%	41.93%	45.57%	45.26%
Provision/assets	1.01%	1.00%	0.05%	0.05%	0.03%
Operating return on assets	**0.68%**	**1.40%**	**1.72%**	**1.63%**	**1.68%**
Equity/assets	10.29%	11.55%	10.49%	11.10%	11.46%
Operating return on equity	**6.62%**	**12.09%**	**16.39%**	**14.70%**	**14.62%**

BALANCE SHEET	**1998A**	**1999A**	**2000A**	**2001E**	**2002E**
(S$m) *year ending Dec*					
Gross loans	76,741	84,439	89,826	126,279	129,772
Loan loss reserves	*2,265*	*4,069*	*2,286*	*2,501*	*2,087*
Net loans	73,609	79,463	86,592	122,590	126,463
Total earning assets	78,188	94,704	100,437	134,600	139,112
Other assets	20,788	11,761	10,791	-20,855	-21,066
Total Assets	**98,975**	**106,465**	**111,228**	**113,745**	**118,045**
Deposits	86,477	89,759	92,774	96,895	100,046
Customer deposits	-	82,268	80,720	84,107	86,742
Other deposits	-	7,491	12,054	12,788	13,305
Other paying liabilities	2,715	2,818	4,219	5,709	5,742
Other liabilities	655	3,012	3,740	6,313	6,192
Total Liabilities	**89,846**	**95,589**	**100,733**	**108,917**	**111,980**
Equity with revaluation	**10,188**	**12,292**	**11,670**	**12,620**	**13,528**
Adjusted equity	**9,129**	**10,876**	**10,495**	**4,827**	**6,066**

BALANCE SHEET RATIOS	**1998A**	**1999A**	**2000A**	**2001E**	**2002E**
(%)					
Loan-to-deposit	87.7%	93.1%	95.8%	129.1%	128.5%
Equity to assets	10.3%	11.5%	10.5%	11.1%	11.5%
Total loan loss provisions	2.99%	4.87%	2.57%	2.00%	1.62%

ASSET QUALITY	**1998A**	**1999A**	**2000A**	**2001E**	**2002E**
Nonperforming assets	7,086	8,149	4,411	4,203	3,332
Special mention	-	-	-	-	-
Substandard	-	4,952	3,508	3,270	2,514
Doubtful	-	621	358	448	472
Loss	-	2,576	546	484	346
ORE	-	-	-	-	-
NPAs/total loans	9.3%	9.8%	5.0%	3.4%	2.6%
Reserve coverage of NPAs	32.0%	49.9%	51.8%	59.5%	62.6%
Required reserves	n.a	4,640	2,280	2,583	2,349
Actual reserves	2,265	4,069	2,286	2,501	2,087
Shortfall (surplus)	n.a	571	(6)	82	262
Actual to required reserves	n.a	88%	100%	97%	89%
Shortfall to capital	n.a	5%	0%	1%	2%

GROWTH RATES	**1998A**	**1999A**	**2000A**	**2001E**	**2002E**
(%)					
Income statement					
Net interest income	42.7%	42.3%	0.2%	14.7%	16.7%
Non-interest income	-6.7%	131.1%	-15.3%	38.1%	18.2%
Total operating income	26.0%	64.5%	-5.2%	22.1%	17.2%
Non-interest expenses	53.1%	41.1%	17.0%	32.6%	16.4%
Pre-provision earnings	13.0%	79.8%	-16.7%	14.4%	17.9%
Loan loss provisions	101.1%	6.7%	-94.9%	4.0%	-46.9%
Core earnings	-47.4%	333.8%	37.9%	4.3%	22.9%
Net profit	**-49.0%**	**381.2%**	**29.6%**	**-2.3%**	**2.9%**
Balance sheet					
Loan growth	37.9%	8.0%	9.0%	41.6%	3.2%
Interest earning assets	34.2%	14.7%	7.4%	37.5%	3.3%
Asset growth	51.9%	7.6%	4.5%	2.3%	3.8%
Deposit growth	60.0%	3.8%	3.4%	4.4%	3.3%
Shareholders funds	21.8%	19.1%	-3.5%	-54.0%	25.7%

Source: Company reports; Lehman Brothers estimates.

Oversea-Chinese Banking Corp

The Long Road Back

Rating: 3-Market Perform

Ticker:	OCBC.SI
Market Cap:	US$7,463MM
Shares Outstanding:	1,285 MM

OCBC has been rebuilding both its performance and its credibility, and is now on an upswing. However, OCBC continues to suffer from fundamental problems including over-capitalization and its failure to unload non-core assets. In addition, a management vacuum arising from the imminent departure of CEO Alex Au has increased uncertainty about the future direction of the bank.

While the acquisition of Keppel Capital is a good one and will address the leverage issue to some extent, more work remains to be done to keep core ROE moving ahead. We now project a 2002 core ROE of only 9.8%, an improvement over the 6.6% level of FY1999 but still low.

After bidding threateningly on a variety of unsuitable or richly-priced opportunities, OCBC has in fact concluded the right kind of deal at an excellent price—a tribute to management's savvy. We estimate that cost savings from the Keppel transaction will be significant and the leverage impact will help raise core ROE by 235 bp over FY2000.

OCBC is also the most dependent of the banks on pure spread income to meet its profit targets, which makes the bank vulnerable to margin compression. That said, OCBC's margins have held up quite well so far. The KEPC acquisition will also help to address OCBC's Achilles heel of consumer lending—this is a sector that management needs to get right, but the task will be more and more difficult as growth slows.

Although the bank did have a good uptick (+7%) in consumer lending in 1H01, this follows two years of portfolio losses—even as the segment expanded rapidly. OCBC badly needs to become successful in the consumer market to preserve its spreads and develop fee income, where it lags behind peers. We believe that the Keppel acquisition will help here, boosting consumer lending (including mortgages) from under 30% of the portfolio to 35%.

OCBC's off-balance-sheet revaluation reserves primarily consist of property, which the bank was unable to unload near appraised value earlier in the year. Despite this, aggregate revaluation has actually been written up in the first half, due to gains in the bank's Great Eastern Life Holdings. We believe that there is a substantial risk that OCBC may not realize appraised value on its real estate, with the shortfall potentially amounting to S$300–900 million.

Management is doing a good job of meeting its commitments and targets, which gives us hope that these issues will be addressed. Until then, on 13.5x FY2001 EPS and 1.1x book value (1.6x ABV), OCBC also has little headroom for advancement.

OCBC

Share Price:	10.60	**Index:**	1,411.25	**Reuters Code:**	OCBC.SI
52 Week Price Range:	8.80 - 13.50	**Current Yield:**	2.8%	**Bloomberg Code:**	OCBC SP
				Shares Outstanding (MM):	1,285.36

INCOME STATEMENT	**1998A**	**1999A**	**2000A**	**2001E**	**2002E**
(S$m) *year ending Dec*					
Interest income	4,193	2,986	3,158	3,841	4,425
Interest expense	2,778	1,695	1,898	2,190	2,406
Net interest income	**1,415**	**1,291**	**1,260**	**1,651**	**2,019**
Ave. int. earnings assets	*52,183*	*51,087*	*53,295*	*69,370*	*82,752*
NIM (%)	**2.71%**	**2.53%**	**2.37%**	**2.38%**	**2.44%**
Non-interest income	373	607	653	730	847
Total operating income	**1,788**	**1,897**	**1,913**	**2,381**	**2,866**
Non-interest expense	-485	-528	-656	-852	-1,002
Pre provision profit	**1,303**	**1,369**	**1,258**	**1,529**	**1,864**
Loan loss provisions	-938	-516	-139	-145	-40
Non-operating income	181	48	34	-3	-150
Pre tax profit	**546**	**898**	**1,125**	**1,397**	**1,824**
Tax	-117	-206	-305	-355	-456
Net profit	**425**	**690**	**840**	**1,012**	**1,199**
Core earnings	**283**	**652**	**807**	**1,018**	**1,349**

PER SHARE DATA (S$)	**1998A**	**1999A**	**2000A**	**2001E**	**2002E**
EPS	0.35	0.54	0.65	0.79	0.93
DPS	0.12	0.25	0.30	0.20	0.33
Effective payout ratio (%)	*34%*	*46%*	*46%*	*25%*	*35%*
BVPS	7.51	8.17	8.71	10.44	11.05
ABVPS	5.51	5.74	6.34	5.13	5.83

VALUATION	**1998A**	**1999A**	**2000A**	**2001E**	**2002E**
Price to book value (x)	1.5	1.6	1.2	1.0	1.0
Price to adjusted book value (x)	2.0	2.2	1.7	2.1	1.8
Price to earnings (x)	32.1	23.7	16.2	13.5	11.4

PROFITABILITY RATIOS	**1998A**	**1999A**	**2000A**	**2001E**	**2002E**
(%)					
Net interest margin	2.71%	2.53%	2.37%	2.38%	2.44%
Yield on interest earning assets	7.86%	5.90%	5.64%	4.64%	5.35%
Cost on interest bearing liabilities	5.72%	3.78%	3.93%	2.82%	2.97%
Net interest spread	2.14%	2.12%	1.71%	1.82%	2.37%
Non-int. income (% Op income)	20.9%	32.0%	34.1%	30.7%	29.5%
Cost to income	24.6%	27.2%	34.2%	35.6%	35.0%
Overhead ratio	0.93%	1.03%	1.23%	1.23%	1.21%
Cost coverage	76.9%	114.9%	99.6%	85.6%	84.5%
ROA	0.75%	1.25%	1.47%	1.36%	1.34%
ROE	4.7%	7.0%	7.7%	8.2%	8.7%

OROA ANALYSIS	**1998A**	**1999A**	**2000A**	**2001E**	**2002E**
Net interest margin	2.71%	2.53%	2.37%	2.38%	2.44%
Non-interest inc./gross inc.	28.12%	33.52%	34.34%	31.03%	29.55%
Efficiency ratio	24.61%	27.20%	34.15%	35.60%	34.96%
Provision/assets	1.68%	0.95%	0.23%	0.16%	0.04%
Operating return on assets	**1.16%**	**1.82%**	**2.14%**	**2.06%**	**2.21%**
Equity/assets	16.41%	19.32%	18.75%	15.02%	15.89%
Operating return on equity	**7.08%**	**9.40%**	**11.41%**	**13.72%**	**13.90%**

BALANCE SHEET	**1998A**	**1999A**	**2000A**	**2001E**	**2002E**
(S$m) *year ending Dec*					
Gross loans	49,341	47,589	51,621	77,738	81,721
Loan loss reserves	*2,265*	*2,466*	*2,302*	*2,946*	*2,594*
Net loans	46,697	44,765	48,935	74,214	78,519
Total earning assets	53,334	50,599	55,992	82,749	82,756
Other assets	2,403	3,691	3,718	6,617	6,618
Total Assets	**55,737**	**54,290**	**59,710**	**89,366**	**89,374**
Deposits	46,917	43,330	48,035	73,584	76,968
Customer deposits	36,993	36,762	37,942	56,856	59,734
Other deposits	9,439	6,567	10,093	16,728	17,233
Other paying liabilities	1,666	1,539	218	4,165	3,900
Other liabilities	448	2,045	3,305	5,018	1,018
Total Liabilities	**49,031**	**46,914**	**51,558**	**82,767**	**81,886**
Equity with revaluation	**9,146**	**10,490**	**11,194**	**13,419**	**14,198**
Adjusted equity	**6,706**	**7,376**	**8,151**	**6,599**	**7,488**

BALANCE SHEET RATIOS	**1998A**	**1999A**	**2000A**	**2001E**	**2002E**
(%)					
Loan-to-deposit	104.4%	109.0%	106.7%	104.9%	105.4%
Equity to assets	16.4%	19.3%	18.7%	15.0%	15.9%
Total loan loss provisions	4.63%	5.22%	4.49%	3.82%	3.20%

ASSET QUALITY	**1998A**	**1999A**	**2000A**	**2001E**	**2002E**
Nonperforming assets	4,059	4,335	4,092	5,375	4,974
Special mention	-	-	-	-	-
Substandard	-	2,876	2,721	3,481	3,275
Doubtful	-	1,260	1,031	1,312	1,184
Loss	-	199	340	582	514
ORE	-	-	-	-	-
NPAs/total loans	8.3%	9.2%	8.0%	7.0%	6.1%
Reserve coverage of NPAs	55.8%	56.9%	56.3%	54.8%	52.2%
Required reserves	n.a	1,837	1,875	2,658	2,529
Actual reserves	2,265	2,466	2,302	2,946	2,594
Shortfall (surplus)	n.a	(629)	(427)	(288)	(65)
Actual to required reserves	n.a	134%	123%	111%	103%
Shortfall to capital	n.a	-6%	-4%	-2%	0%

GROWTH RATES	**1998A**	**1999A**	**2000A**	**2001E**	**2002E**
(%)					
Income statement					
Net interest income	16.4%	-8.8%	-2.3%	31.0%	22.3%
Non-interest income	-15.5%	17.5%	1.3%	12.7%	14.0%
Total operating income	5.3%	-1.4%	-1.1%	24.7%	19.7%
Non-interest expenses	-0.3%	9.0%	24.2%	30.0%	17.6%
Pre-provision earnings	7.2%	-4.8%	-10.6%	22.0%	20.9%
Loan loss provisions	64.8%	-45.0%	-73.0%	4.2%	-72.4%
Core earnings	-46.9%	130.0%	23.9%	26.0%	32.6%
Net profit	**-26.8%**	**62.1%**	**21.8%**	**20.4%**	**18.5%**
Balance sheet					
Loan growth	0.2%	-4.1%	9.3%	51.7%	5.8%
Interest earning assets	4.5%	-4.7%	10.0%	49.6%	2.7%
Asset growth	-3.1%	-2.6%	10.0%	49.7%	0.0%
Deposit growth	-2.9%	-7.6%	10.9%	53.2%	4.6%
Shareholders funds	3.5%	10.0%	10.5%	-19.0%	13.5%

Source: Company reports; Lehman Brothers estimates.

United Overseas Bank

Under-Appreciated

Rating: 1-Strong Buy

Ticker:	UOB.SI
Market Cap:	US$8,978MM
Shares Outstanding:	1,569 MM

UOB is the sleeper of the lot, and remains our favorite bank in Singapore. The institution has consistently had higher returns than its competitors, but has been branded by some as a stodgy family bank. While some of the reputation is due to management's lower transparency, we believe that UOB is misperceived and its shares have +30% upside.

UOB has concluded the best of the Singaporean acquisitions. While OUB and Keppel are similar in terms of their Singaporean banking books, both having concentrations in SME and consumer loans, OUB also has substantial non-Sing banking assets including a Malaysian bank which will be merged with UOB Malaysia, broking operations (which we expect to be merged into UOB-Kay Hian), corporate finance and investment banking (which will augment UOB's scandal-tarred operation), and asset management with an emphasis on institutional funds rather than retail unit trusts. This deal is both strategically right and financially accretive.

Like OCBC, UOB has made an excellent deal for OUB—although we would have preferred to see a little more cash up front to raise returns. But execution—taking out the cost saves—is critical if UOB is not to validate the worst fears of investors about its perceived inability as a family-run bank in a friendly merger to be ruthless about staff cuts. We think this fear is misplaced.

UOB has been slow to look at getting rid of its non-core assets, and now unfortunately has added OUB's to the pile. We believe that there is substantial value to be created by privatizing OUB's listed affiliates, swapping and consolidating assets, and finally selling or spinning-off the remaining entities—but time is of the essence for returns.

Looking deeper, UOB even pre-merger had the best franchise of the surviving banks, with concentrations in consumer and SME lending and retail asset management. UOB has also been able to outgrow the industry consistently, especially in high-margin retail lending.

Although we consider UOB as a standalone to be effectively fully-reserved against potential loan losses, OUB has been a perennial laggard by our methodology—albeit a methodology CEO Peter Seah has cheerfully disputed with us in the past. We believe that the merged bank will require approximately S$326 million in additional provisions, keeping bad debt charges near their 2001 level through at least FY2003.

With earnings set to move ahead smartly beginning in FY2002, UOB deserves a premium valuation for its higher ROE (reaching 15.9% in 2004) and better growth prospects.

UOB

Share Price:	10.50	**Index:**	1,411.25
52 Week Price Range:	9.05 - 14.00	**Current Yield:**	3.8%
Reuters Code:	UOB.SI		
Bloomberg Code:	UOB SP	**Shares Outstanding** (MM):	1,052.54

INCOME STATEMENT	1998A	1999A	2000A	2001E	2002E
(S$m) *year ending Dec*					
Interest income					
Interest expense					
Net interest income	**1,201**	**1,133**	**1,198**	**1,632**	**2,162**
Ave. int. earnings assets	*42,050*	*45,915*	*54,250*	*83,203*	*110,184*
NIM (%)	**2.86%**	**2.47%**	**2.21%**	**1.96%**	**1.96%**
Non-interest income	530	708	754	899	1,145
Total operating income	**1,731**	**1,840**	**1,952**	**2,531**	**3,307**
Non-interest expense	-567	-581	-751	-991	-1,183
Pre provision profit	**1,164**	**1,260**	**1,201**	**1,540**	**2,124**
Loan loss provisions	-654	-253	-93	-86	-70
Non-operating income	0	20	78	-76	-212
Pre tax profit	**511**	**1,026**	**1,112**	**1,449**	**2,054**
Tax	-137	-251	-273	-376	-524
Net profit	**368**	**760**	**913**	**988**	**1,305**
Core earnings	**368**	**745**	**836**	**1,062**	**1,517**

PER SHARE DATA (S$)	1998A	1999A	2000A	2001E	2002E
EPS	0.37	0.72	0.87	0.63	0.83
DPS	0.18	0.40	0.40	0.24	0.37
Effective payout ratio (%)	*49%*	*55%*	*46%*	*38%*	*45%*
BVPS	6.83	7.39	8.08	9.14	9.40
ABVPS	5.59	5.88	6.62	5.61	5.97

VALUATION	1998A	1999A	2000A	2001E	2002E
Price to book value (x)	1.6	1.4	1.3	1.1	1.1
Price to adjusted book value (x)	1.9	1.8	1.6	1.9	1.8
Price to earnings (x)	28.7	14.5	12.1	16.7	12.6

PROFITABILITY RATIOS	1998A	1999A	2000A	2001E	2002E
(%)					
Net interest margin	2.86%	2.47%	2.21%	1.96%	1.96%
Yield on interest earning assets		5.07%	5.09%	1.42%	0.00%
Cost on interest bearing liabilities		2.78%	3.26%	0.92%	0.00%
Net interest spread		2.29%	1.83%	0.50%	0.00%
Non-int. income (% Op income)	30.6%	38.4%	38.6%	35.5%	34.6%
Cost to income	32.7%	31.2%	38.4%	39.2%	35.8%
Overhead ratio	1.35%	1.26%	1.38%	1.19%	1.07%
Cost coverage	93.5%	121.9%	100.4%	90.7%	96.8%
ROA	0.74%	1.50%	1.56%	1.09%	1.10%
ROE	5.5%	10.4%	11.2%	8.6%	9.0%

OROA ANALYSIS	1998A	1999A	2000A	2001E	2002E
Net interest margin	2.86%	2.47%	2.21%	1.96%	1.96%
Non-interest inc./gross inc.	30.61%	39.11%	38.75%	35.39%	34.62%
Efficiency ratio	32.73%	31.21%	38.38%	39.22%	35.77%
Provision/assets	1.30%	0.50%	0.14%	0.07%	0.06%
Operating return on assets	**1.47%**	**2.29%**	**2.08%**	**1.77%**	**1.87%**
Equity/assets	13.45%	15.31%	12.83%	12.47%	11.97%
Operating return on equity	**10.96%**	**14.94%**	**16.23%**	**14.20%**	**15.62%**

BALANCE SHEET	1998A	1999A	2000A	2001E	2002E
(S$m) *year ending Dec*					
Gross loans	40,818	47,649	57,508	90,547	90,714
Loan loss reserves	*1,429*	*1,933*	*1,812*	*2,716*	*2,349*
Net loans	39,122	45,404	55,319	87,184	87,734
Total earning assets	43,340	48,489	60,011	106,395	113,973
Other assets	7,129	2,300	6,313	8,573	9,184
Total Assets	**50,469**	**50,789**	**66,324**	**114,968**	**123,157**
Deposits	42,598	47,180	56,837	97,836	101,290
Customer deposits	-	40,728	43,406	73,337	75,926
Other deposits	-	6,452	13,431	24,499	25,364
Other paying liabilities	-	430	129	2,669	2,763
Other liabilities	-	-	2,390	5,666	9,729
Total Liabilities	**44,911**	**44,598**	**59,356**	**106,170**	**113,782**
Equity with revaluation	**6,789**	**7,778**	**8,507**	**14,339**	**14,748**
Adjusted equity	**5,559**	**6,191**	**6,968**	**8,798**	**9,374**

BALANCE SHEET RATIOS	1998A	1999A	2000A	2001E	2002E
(%)					
Loan-to-deposit	95.2%	100.3%	100.5%	91.9%	88.9%
Equity to assets	13.5%	15.3%	12.8%	12.5%	12.0%
Total loan loss provisions	3.52%	4.08%	3.17%	3.02%	2.61%

ASSET QUALITY	1998A	1999A	2000A	2001E	2002E
Nonperforming assets	2,191	2,993	2,610	5,360	4,341
Special mention	-	-	-	-	-
Substandard		1,947	1,583	3,762	3,047
Doubtful		245	208	381	308
Loss		801	819	1,217	986
ORE	-	-	-	-	-
NPAs/total loans	5.4%	6.3%	4.6%	6.0%	4.8%
Reserve coverage of NPAs	65.2%	64.6%	69.4%	50.7%	54.1%
Required reserves	n.a	1,759	1,789	3,012	2,613
Actual reserves	1,429	1,933	1,812	2,716	2,349
Shortfall (surplus)	n.a	(174)	(23)	296	264
Actual to required reserves	n.a	110%	101%	90%	90%
Shortfall to capital	n.a	-2%	0%	2%	2%

GROWTH RATES	1998A	1999A	2000A	2001E	2002E
(%)					
Income statement					
Net interest income	8.4%	-5.7%	5.8%	36.2%	32.5%
Non-interest income	-4.1%	37.3%	4.2%	17.9%	28.1%
Total operating income	4.2%	7.5%	5.1%	29.1%	30.9%
Non-interest expenses	-4.9%	2.5%	29.3%	32.0%	19.4%
Pre-provision earnings	9.4%	9.9%	-5.8%	27.4%	38.3%
Loan loss provisions	95.0%	-61.2%	-63.3%	-7.7%	-18.5%
Core earnings	-26.7%	102.6%	12.3%	27.0%	42.8%
Net profit	**-26.7%**	**106.7%**	**20.2%**	**8.1%**	**32.1%**
Balance sheet					
Loan growth	1.8%	16.1%	21.8%	57.6%	0.6%
Interest earning assets	6.3%	13.9%	22.8%	67.8%	4.2%
Asset growth	2.2%	0.6%	30.6%	73.3%	7.1%
Deposit growth	2.4%	10.8%	20.5%	72.1%	3.5%
Shareholders funds	3.5%	11.4%	12.6%	26.3%	6.6%

Source: Company reports; Lehman Brothers estimates.

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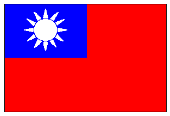
Taiwan

Teaming Up

Rating: Underweight ⇩



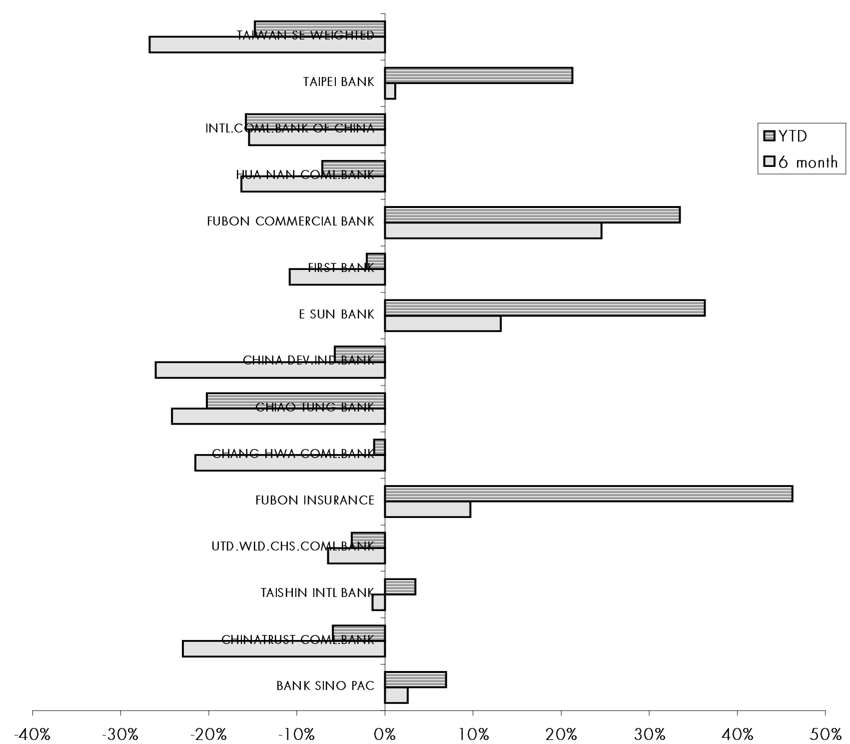
Covered Stocks	Rating
Bank SinoPac	2-Buy
Chinatrust Commercial	1-Strong Buy
Taishin International	3-Mkt Perform
Utd World Chinese	4-Mkt Underperform

We have recommended investors to remain Underweight the Taiwanese banking sector longer than any other recommendation and this investment opinion is not likely to change in the near term. The core fundamentals of the sector are deteriorating and will continue to do so in the near term and the foreseeable future. The country is in recession, which does not bode well for loan growth, asset quality and development of non-interest income. Lehman Brothers is projecting GDP contraction of 3% this year and then only a slight recovery in 2002, with growth of 0.9%. Meanwhile, consolidation is the top priority for all the banks, which appear to be in constant discussions, but no one is willing to pull the trigger.

Mixed share price performance

The share price performance of the Taiwanese banks has been mixed so far this year. On average, bank share prices are down 8% over the last six months and are pretty much flat since the beginning of the year. However, such uninspiring share price performance is rendered an outperformance as the technology sector has dragged down the Taiex by almost 30% over the last six months and down 15% since the beginning of the year. The star performers have been some of the smaller private banks along with Fubon Bank and Insurance. However, these companies only account for a miniscule percentage of the market and are not representative of the industry.

Figure 34: Taiwan Banks 6-month and YTD Share Price Performance



Source: Datastream

Investors are taking notice of Fubon

Meanwhile, the industry is sitting up and taking notice of the Fubon Group of companies, which is likely to become the leading financial holding company in Taiwan. It already has all the requisite components, namely a bank, insurance, brokerage and asset management, and has already been operating somewhat as a fully-integrated company, cross selling one another's products and leveraging off the group wide name. Looking ahead, we believe that this outperformance by Fubon will continue as management looks for ways to increase market share in each of its respective industries.

No catalyst to change our investment opinion

Nevertheless, we do not see any catalyst that will make us change our investment opinion on Taiwanese banks. At the macro level, including the problems of a slowing economy, higher unemployment will only add to the unstable political environment. The year-end election is crucial to establishing a majority government, otherwise Parliament will muddle through another term accomplishing very little.

Meanwhile, at the micro level, banks cannot find attractive lending opportunities, NPLs are rising, and banks are going to have to come to the market to raise capital. Most of these problems reside at the state-owned banks. Consequently, we believe that systemic risk is still too high and that the large market share controlled by the weaker state-owned banks represents a significant threat to the stability of the entire financial industry. Consequently, because of the high degree of fragmentation, there is no clear industry leader that is a head and shoulders above the rest and competition remains fierce.

Taiwan's banking sector is highly fragmented

Taiwan's banking sector is the third largest in Asia as measured by assets and loans, behind only Japan and Hong Kong. The banking sector consists of 53 domestic banks and over 45 credit cooperatives at the end of last year–the 53 banks can be broken down into 14 government-related banks, 22 old private banks and 17 new private banks. Meanwhile the sector is highly fragmented, with the largest controlling only 11% of deposits and 10% of loans–the top ten only account for 59.1% of deposits and 58.5% of total assets.

Figure 35: Market Share of the Deposit of Top Three Banks (%)

	# 1	# 2	# 3	Top 3
Singapore	40	28	25	93
Hong Kong	37	20	6	63
Korea	17	17	11	45
Philippines	16	14	10	40
Malaysia	17	11	7	35
Taiwan	11	8	8	27
Average	23	16	11	51

Source: Lehman Brothers estimates

Recent legislation

Recently passed laws appear to be a step in the right direction. The government realizes that there is a problem and is currently in the process of enacting six new laws that will allow banks to clean up their balance sheets and encourage mergers. However, we believe the key is implementation of the laws, which will require significant political funding and clout. We believe important steps for sector reform include merging institutions and eliminating excess capacity through staff retrenchment and branch closures. Also, recapitalization of surviving entities will require significant government funding, which may be difficult to extract from a weak ruling party. Identifying the problem is the easy part—implementation is the difficult part. In order to remove excess capacity, some banks will have to be closed, recapitalized and staff will have to be retrenched. Firstly, closing and recapitalizing weak banks will require a significant cash injection into the system—cash that the government is not likely to have in its coffers. Meanwhile, staff retrenchment will be difficult since we believe that the majority of asset quality problems lie with the government-related banks and lay-offs will not bode well for political reasons.

Systemic risk due to high concentration among government banks

Government-related banks represent a significant systemic risk. There are 53 domestic banks and 36 foreign banks in Taiwan. However, the industry is dominated by the state-owned banks, which account for 60-70% of total industry assets – we believe that this concentration among these poorly run banks represents a significant threat to the stability of the entire system. These banks can be typically characterized by high cost-to-income ratios, poor asset quality, low net interest margins and out-dated technology platforms. Although we believe that the government relationship has resulted in complacency among these banks, it also acts as a pillar of consumer confidence. Generally, these banks do not offer as wide a product offering or provide as good a quality of service as the new private banks. However, consumers are still confident that their deposits are safe within these large, government institutions. On the contrary, in line with bank sector reform, we are told by government officials that banks will be allowed to fail. However, we believe that this is unlikely.

Figure 36: Taiwanese Banking Industry Market Share Breakdown (end-2000)

	Number of banks	Branches	Depsoits (NT$b)	Market share (%)	Loans (NT$b)	Market share (%)
Government related banks	14	1,225	10,146	59%	8,627	61%
New priivate banks	17	567	2,803	16%	2,278	16%
Old private banks	22	900	3,507	20%	2,771	19%
Foreign bank	36	n.a.	791	5%	567	4%
Total	89		17,247	100%	14,243	100%

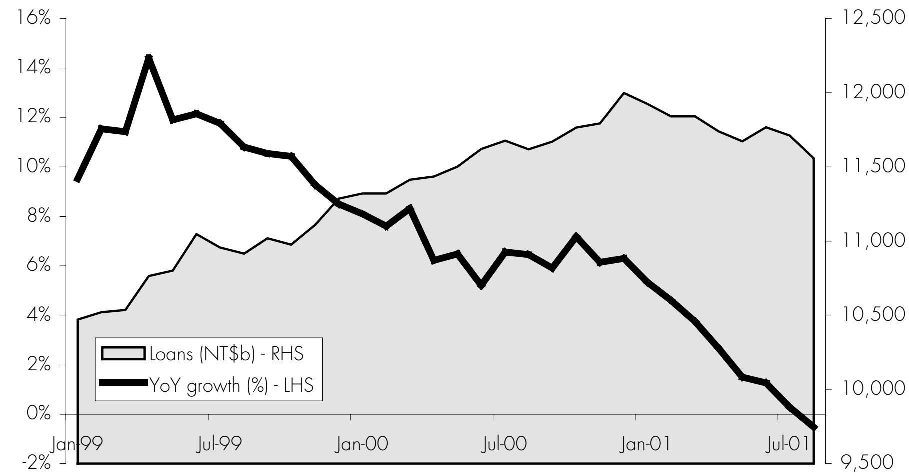
Source: Taiwan Economic Journal, Financial Statistics Monthly and Ministry of Finance

Loan growth slowing

At the end of August, industry loans contracted 3.7% YTD. Meanwhile, on a YoY basis, August was the first month to show a decline (-0.5%) in over a decade. We believe that the overall loan contraction can be attributed to both supply and demand. Loan demand has contracted due to the overall slowdown in the economy while on the supply side of the equation, banks are likely to be unwilling to take on more assets due to insufficient capital.

Looking ahead, given the state of the economy, we would expect this trend to continue and we project a full year loan contraction of 5% and then modest 1.5% loan growth in 2002. The story in Taiwan is the same as that around the region—consumer loans, especially credit cards, have exhibited healthy growth, but corporate loans are contracting.

Figure 37: Taiwan Loan Growth



Source: Datastream and Lehman Brothers estimates

Consolidation

Sector consolidation is inevitable and the government clearly believes that mergers will help its banks out of the current predicament, and has initiated the process. Despite announcing several mergers between government-related banks earlier in the year, the process has stalled over price negotiations.

Smaller private banks will be dragged down by the larger state-owned banks

More importantly will be what happens to the small private banks, which are clearly better-run and in better shape than the large state-owned banks. However, these smaller entities do not have enough of an impact on the market and will be dragged whichever way the larger, state-owned banks go. Nonetheless, some of these are prime acquisition targets for foreign banks looking for a way to enter the Taiwanese banking industry.

That said, Taiwan's banking sector is too crowded and fragmented, with the single largest bank controlling a market share of only 10%. The government is encouraging consolidation and is paving the way with the aforementioned laws as well as orchestrating mergers among the large state-owned banks. However, although several mergers have been announced, none have been completed yet. In addition, we are not convinced that these banks will be willing to implement the necessary staff cuts and branch rationalization schemes.

Asset quality

Asset quality deterioration expected to continue.

Industry NPLs increased to 6.47% at the end June, up from 5.34% at the end of 2000. However, we must bear in mind that Taiwan's definition of NPLs is more lax than international standards. Generally speaking, Taiwan banks classify loans as non-performing only after six months of missed interest/principal payments. This is less stringent than the three-month guideline that is widely followed by other banks in the region. In addition, some NPLs that have been renegotiated are not classified as NPLs, whereas under international standards, the suspect loan is not reclassified until after a pre-specified period of loan repayments (usually three to six months). A saving grace is that the regulator also requires banks to report their past due loans, which are defined as loans that have missed three months of payments, but less than six months. While not officially classified as NPLs, past due loans serve as a "watch-list" for both the banks and the MoF.

In our meetings with various banks, we learnt that the private banks generally follow a stricter internal policy of classifying their NPL portfolios by adhering to the three-month guideline. Additionally, the banks also closely monitor loan accounts that have not gone past due, but have weakening financials.

Figure 38: Non-performing Loan Criteria

Classification	Remarks
Past due loans	More than three months overdue in interest/principal
Non-performing loans	Non-installment loans: Three months principal; six months on interest Installment loans: six months past due Accounts in court litigation Accrual of interest income stopped after 180 days
Provisions	Specific: 50% for doubtful accounts; 100% for loss accounts General: None stipulated but 1% of loans is tax-deductible

Source: Ministry of Finance and Bank Data

Meanwhile, with a worsening economic backdrop, asset quality will continue to deteriorate. Government officials expect that NPLs will increase by approximately another two percentage points and peak at the end of this year at 8-9%. If we applied international standards to Taiwan, the actual NPL ratio would be significantly higher, at closer to 20% on our estimates. Consequently, because of the deterioration in asset quality, loan loss provisions are likely to remain high, thus creating a drag on earnings.

Removal of some NPLs

Earlier in the year, six banks with some degree of government ownership were called upon to support weaker financial institutions. The six banks, Bank of Taiwan, Land Bank of Taiwan, Chang Hwa Bank, First Commercial Bank, Hua Nan Bank and United Worlc Chinese Commercial Bank, are to absorb 36 local-level financial institutions (LLFI) at the request of the government. The LLFI sector comprises 382 institutions and accounts for only 10% of banking sector assets. Losses incurred by the acquiring banks will be compensated by the recently formed Resolution Trust Fund.

We view this as a positive move.

Eliminating over-capacity and weaker players should lead to healthier competition. Also, a reduction in the number of financial institutions, especially the smaller and weaker ones, will minimize the systemic risk caused by loss of depositor confidence, which ultimately eases the burden placed on regulators.

Although this is a positive move, we take it with a grain of salt—the interference of this symbolic of the problems already in the system. The government needs to play a less significant role in order to push ahead with the commercialization of government-invested banks. Although the acquiring banks are to be compensated for the economic loss incurred from these acquisitions, there are other costs as well. These involve integration and higher personnel expenses—unlikely that staff reductions can be achieved because this would be politically undesirable, especially in the current economic downturn.

Downward Earnings Revisions

Banks not expected to meet earnings targets.

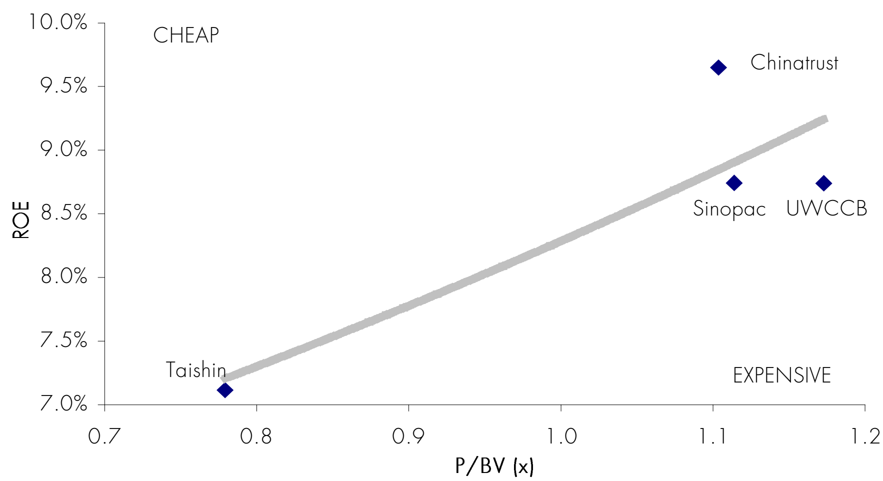
Due to the aforementioned slower-than-expected economic outlook, loan growth has come in under budget in the first half of the year and most banks are expected to miss their earnings projections. Contributing to the negative outlook for the sector is deteriorating asset quality, particularly at the large state-owned banks. We are likely to revise our earnings estimates down.

Core earnings will continue to be difficult to achieve as loan growth continues to be slow, margins coming under more pressure and operating expenses on the rise, particularly due to higher technology spending. Meanwhile, high levels of NPLs force management to spend considerable time managing these assets rather than focusing on lending operations. In addition, unlike in some of other Asian countries, net profit figures will not be boosted by lower loan loss provisions since NPLs are expected to continue to creep up.

Valuation

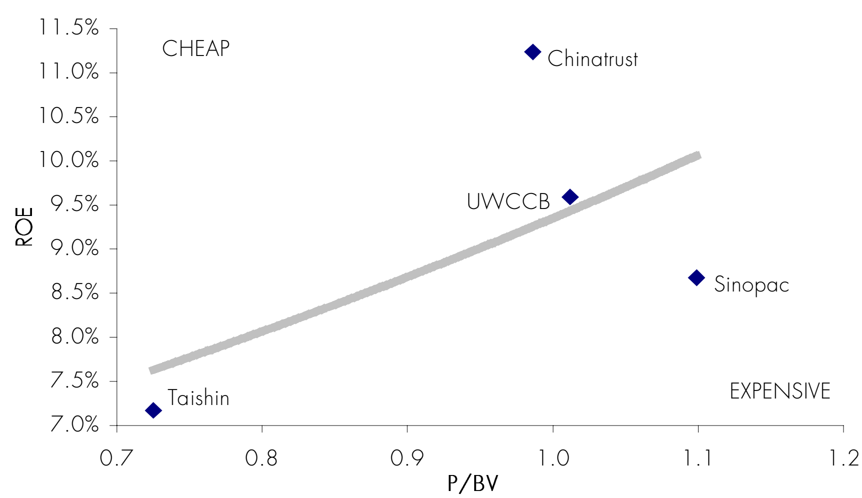
Earnings prospects are bleak and profitability as measured by ROE is declining—this is a recipe for lower valuation multiples. Also, none of these banks are even making their cost of capital, estimated at 12-13%. According to the text book, this means that management is destroying shareholder value! However, given the dire circumstances of the sector at the moment, we are giving management the benefit of the doubt—that they will be able to turn things around when the environment improves. Nonetheless, we are still staying away from Taiwan banks.

Figure 39: Taiwan Banks 2001 ROE versus P/BV



Source: Company reports and Lehman Brothers estimates

Figure 40: Taiwan Banks 2002 ROE versus P/BV



Source: Company reports and Lehman Brothers estimates

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Bank SinoPac

Size Does Matter

Rating: 2-Buy

Ticker:	2839.TW
Market Cap:	US$780MM
Shares Outstanding:	1,944MM

This bank is well run, but like Taishin Bank, lacks the size and scale to compete effectively. However, it does have a strong management team that is focusing on the all-important consumer space. With over half of its loan book lent for mortgages (the safest among loan assets), this bank has achieved the best asset quality in town. Thus, because it is a well-run bank with good asset quality, Sinopac is seen as an ideal acquisition target for a larger, foreign player that is looking to enter the Taiwanese banking industry.

However, this bank will suffer all the same problems endemic to the rest of the sector—the slowing economy and increasing unemployment will hinder loan growth resulting in the need for higher loan loss provisions. Consequently, earnings growth will be uninspiring until loan growth picks up some time by the end of 2002.

That said, similar to almost all the other banks, Sinopac is focusing on forming a financial holding company. In September, Sinopac already signed a memorandum of intention with its securities affiliate Sinapac Securities and National Securities of the International Group as a first step to setting up Sinopac Holding Company. Initial capitalization will be NT$35.3 billion. The proposed holding company will be 60% held by Sinopac; International Securities will hold 39% and Sinopac Securities will hold the remaining 1%.

Revenue enhancement and cost reduction

With the formation of a financial holding company, management expects a synergy benefit of NT$4.2 billion in three years. Revenue is expected to increase by NT$2.7 billion from cross selling while a cost savings (likely through the reduction of staff at the combined securities operations) are expected to amount to NT$1.4 billion. One of the key benefits cited by management is the 450,000 low-cost settlement accounts at National Securities that are likely to migrate to Sinopac.

More concerns on asset quality

Largely due to its exposure to the lower-credit risk mortgage segment, SinoPac boasts the best asset quality in the sector. However, this bank is not operating in a vacuum and its past due ratio did increase to 1.6%, from 1.0% at the end of the year, which is still remarkable given the industry figure of 6.5%. Corresponding to the rise in NPLs, the bank's NPL coverage ratio is expected to decline to approximately 50%, down from over 100% previously. Management has historically been aggressive with write-offs and loan loss provisioning and this will continue to be the case. Sinopac has already increased its loan loss provision to NT$561 million for the first nine months of this year, which is already higher than the NT$500.8 million charge taken in 2000. We expect a full year charge of NT$681 million, up 36% from the previous year.

Bank SinoPac

Share Price (NT$):	13.85	**Index:**	4,043.57	**Reuters Code:**	2839.TW
52 Week Price Range (NT$):	10.32 - 17.45	**Current Yield:**	0.00%	**Bloomberg Code:**	2839 TT
				Shares Outstanding (MM):	1,944.40

INCOME STATEMENT	**1998A**	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
(NT$m) *year end Dec*						
Interest income	12,603	12,613	14,017	15,735	17,380	19,670
Interest expense	-9,721	-9,146	-9,746	-10,940	-12,225	-14,261
Net interest income	**2,882**	**3,468**	**4,271**	**4,796**	**5,154**	**5,409**
Ave. int. earnings assets	*172,625*	*187,186*	*205,449*	*234,855*	*259,786*	*293,584*
NIM (%)	**1.70%**	**1.90%**	**2.14%**	**2.04%**	**1.98%**	**1.84%**
Non-interest income	1,465	2,386	1,943	2,215	2,467	2,803
Total operating income	**4,347**	**5,854**	**6,214**	**7,010**	**7,621**	**8,212**
Non-interest expenses	-2,761	-3,090	-3,499	-3,748	-4,300	-4,825
Pre provision profit	**1,586**	**2,764**	**2,716**	**3,262**	**3,321**	**3,387**
Loan loss provisions	-288	-744	-501	-681	-565	-318
Non-operating income	12	0	42	-240	60	60
Pre tax profit	**1,299**	**2,020**	**2,215**	**2,581**	**2,756**	**3,069**
Tax	-305	-230	-556	-316	-380	-422
Net profit	**1,005**	**1,791**	**1,702**	**2,025**	**2,436**	**2,706**

PER SHARE DATA (NT$)	**1998A**	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
EPS	0.58	1.03	0.97	1.04	1.25	1.39
DPS	0.00	0.34	0.00	0.00	0.00	0.00
Effective payout ratio (%)	*0%*	*33%*	*0%*	*0%*	*0%*	*0%*
BVPS	11.20	11.93	12.62	12.43	13.69	15.08
ABVPS	11.20	10.62	13.31	14.86	16.90	16.90

VALUATION	**1998A**	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
Price to book value (x)	1.2	1.2	1.1	1.1	1.0	0.9
Price to adjusted book value (x)	1.2	1.3	1.0	0.9	0.8	0.8
Price to earnings (X)	24.0	13.5	14.3	13.3	11.1	10.0

PROFITABILITY RATIOS	**1998A**	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
(%)						
Net interest margin	1.70%	1.90%	2.14%	2.04%	1.98%	1.84%
Yield on interest earning assets	7.45%	6.92%	7.02%	6.70%	6.69%	6.70%
Cost on interest bearing liabilities	6.17%	5.38%	5.13%	5.13%	5.13%	5.20%
Net interest spread	1.28%	1.53%	1.88%	1.57%	1.56%	1.50%
Non-int. income (% Op income)	33.7%	40.8%	31.3%	31.6%	32.4%	34.1%
Cost to income	63.5%	52.8%	56.3%	53.5%	56.4%	58.8%
Overhead ratio	1.52%	1.56%	1.59%	1.48%	1.53%	1.52%
Cost coverage	53.1%	77.2%	55.5%	59.1%	57.4%	58.1%
ROA	0.55%	0.90%	0.77%	0.80%	0.87%	0.85%
ROE	5.9%	9.3%	7.9%	8.7%	9.6%	9.7%

DUPONT ANALYSIS	**1998A**	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
Lending operations						
Net interest margin	1.70%	1.90%	2.14%	2.04%	1.98%	1.84%
Interest earnings assets/assets	95.02%	94.60%	93.56%	92.91%	92.62%	92.73%
NIM contribution to ROA	**1.62%**	**1.80%**	**2.00%**	**1.90%**	**1.84%**	**1.71%**
Non-interest operations						
Non-interest income/assets	0.81%	1.21%	0.88%	0.88%	0.88%	0.89%
Overhead ratio	1.52%	1.56%	1.59%	1.48%	1.53%	1.52%
Non-int. contribution to ROA	**-0.71%**	**-0.36%**	**-0.71%**	**-0.61%**	**-0.65%**	**-0.64%**
Asset quality analysis						
Provision/loans	-0.25%	-0.58%	-0.34%	-0.40%	-0.30%	-0.15%
Loans/assets	64.05%	64.28%	66.14%	66.83%	66.57%	66.46%
ROA effect from asset quality	**-0.16%**	**-0.38%**	**-0.23%**	**-0.27%**	**-0.20%**	**-0.10%**
Core ROA	**0.75%**	**1.07%**	**1.06%**	**1.02%**	**0.98%**	**0.97%**
Non-core contibution to ROA	0.00%	0.00%	0.02%	-0.09%	0.02%	0.02%
Pre-tax ROA	**0.75%**	**1.07%**	**1.08%**	**0.93%**	**1.00%**	**0.99%**
Tax rate	23.29%	11.37%	24.61%	13.50%	13.50%	13.50%
After tax ROA	**0.57%**	**0.95%**	**0.82%**	**0.80%**	**0.87%**	**0.85%**
Balance sheet leverage (x)	10.3	9.8	10.2	10.9	11.0	11.3
ROE	**5.9%**	**9.3%**	**8.4%**	**8.7%**	**9.6%**	**9.7%**

BALANCE SHEET	**1998A**	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
(NT$m) *year end Dec*						
Gross loans	120,859	135,971	156,970	183,766	192,906	231,011
Specific loan loss reserves	*0*	*0*	*0*	*0*	*0*	*0*
Loan loss reserves	*-1,248*	*-1,195*	*-1,275*	*-1,603*	*-1,635*	*-1,486*
Net loans	119,611	134,776	155,695	182,163	191,271	229,525
Other earning assets	62,652	57,333	63,095	68,757	77,382	88,989
Other assets	9,341	12,021	16,267	19,589	21,785	24,235
Total Assets	**191,603**	**204,129**	**235,057**	**270,508**	**290,438**	**342,750**
Deposits	160,701	164,109	199,135	215,065	247,325	284,424
Other paying liabilities	4,564	10,534	5,856	6,442	7,795	8,964
Other liabilities	6,860	8,684	7,915	24,825	8,706	20,044
Total Liabilities	**172,125**	**183,327**	**212,906**	**246,332**	**263,826**	**313,432**
Minorities & other	0	0	0	0	0	0
Shareholders' funds	**19,479**	**20,802**	**22,151**	**24,176**	**26,612**	**29,318**

LOAN BOOK	**1998A**	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
(NT$m)						
Corporate loans	52,301	58,230	69,876	82,454	97,295	114,809
Mortgages	81,804	91,754	105,517	127,676	154,488	186,930
Personal loans	9,652	6,409	6,729	7,201	7,705	8,244
Car	1,049	667	734	785	840	899
Credit cards	2,553	3,407	4,770	6,201	8,061	10,479
Others	754	3,816	4,388	4,696	5,024	5,376
Total loans	**148,113**	**164,283**	**192,014**	**229,011**	**273,413**	**326,736**

LOAN BOOK BREAKDOWN	**1998A**	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
(%)						
Corporate loans	35%	35%	36%	36%	36%	35%
Mortgages	55%	56%	55%	56%	57%	57%
Personal loans	7%	4%	4%	3%	3%	3%
Car	1%	0%	0%	0%	0%	0%
Credit cards	2%	2%	2%	3%	3%	3%
Others	1%	2%	2%	2%	2%	2%
Total loans	**100%**	**100%**	**100%**	**100%**	**100%**	**100%**

BALANCE SHEET RATIOS	**1998A**	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
(%)						
Loan-to-deposit	74.4%	82.1%	78.2%	84.7%	77.3%	80.7%
Loan-to-deposit (incl. CDs)	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Equity to assets	10.2%	10.2%	9.4%	8.9%	9.2%	8.6%
Tier 1 Capital	15.5%	15.3%	14.3%	13.4%	14.0%	12.9%
Total Capital adequacy	15.5%	15.3%	14.3%	13.4%	14.0%	12.9%
General reserves (% loans)	-1.03%	-0.88%	-0.81%	-0.87%	-0.85%	-0.64%
Specific reserves (% loans)	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
Total loan provisions	-1.03%	-0.88%	-0.81%	-0.87%	-0.85%	-0.64%

ASSET QUALITY	**1998A**	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
Nonperforming loans	1,041	1,627	1,262	2,965	3,113	3,269
NPL ratio	0.9%	1.2%	0.8%	1.6%	1.6%	1.4%
Total provisions/NPLs	120.0%	73.5%	101.1%	54.1%	52.5%	45.5%

GROWTH RATES	**1998A**	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
(%)						
Income statement						
Net interest income		20.3%	23.2%	12.3%	7.5%	4.9%
Non-interest income		62.9%	-18.6%	14.0%	11.4%	13.6%
Total operating income		34.7%	6.2%	12.8%	8.7%	7.7%
Operating expenses		11.9%	13.2%	7.1%	14.7%	12.2%
Pre-provision earnings		74.3%	-1.8%	20.1%	1.8%	2.0%
Loan loss provisions		158.7%	-32.7%	36.1%	-17.1%	-43.7%
Net profit		**78.1%**	**-5.0%**	**19.0%**	**20.3%**	**11.1%**
Balance sheet						
Loan growth		12.7%	15.5%	17.0%	5.0%	20.0%
Interest earning assets		5.3%	13.8%	14.7%	7.0%	18.4%
Asset growth		6.5%	15.2%	15.1%	7.4%	18.0%
Deposit growth		2.1%	21.3%	8.0%	15.0%	15.0%
Shareholders funds		6.8%	6.5%	9.1%	10.1%	10.2%

Source: Company reports; Lehman Brothers estimates.

Chinatrust Commercial

Banking on the Consumer

Rating: 1-Strong Buy

Ticker:	2815.TW
Market Cap:	US$2,401MM
Shares Outstanding:	4,609MM

After the passage of Financial Holding Company Act in June, many financial institutions are in the process of establishing or becoming part of a financial conglomerate, which should enable them to meet increased competition head on once Taiwan enters the WTO in 2002. Chinatrust is no exception, it has already disclosed plans to combine with its securities arm, China Securities Co. Its board of directors has given the go-ahead, and Chinatrust is waiting to send its application to the Ministry of Finance in November. The proposed financial holding company will have an initial capitalization of over NT$50 billion. We believe this structure will not only increase the banks' capacity to raise capital, but more importantly, it will allow them to improve efficiency and enhance profitability through cross selling.

Meanwhile, Chinatrust is also evaluating strategic alliances with foreign players. We believe this will increase the competitiveness of the bank's technology as well product development. It will also provide Chinatrust a better premise to raise capital for expansion of the financial holding company in the future.

Chinatrust is also eyeing mainland China and is among the eight banks that the Ministry of Finance has given approval to set up representative offices to facilitate services for existing customers who have business dealings in China or have relocated to the mainland. These offices still need the approval of the Chinese government and subject to limitations set out by the People's Bank of China, Chinatrust will be able to better monitor customers to improve credit quality as well as gather intelligence on this vast market.

Remains profitable and strong in credit card business

Chinatrust remains among the most profitable of all commercial banks in Taiwan. It recently announced a nine-month pre-tax profit of NT$6.45 billion, representing a 15.8% decline over the previous year. The main reason for the decline was higher loan loss provisions as the NPL ratio increased to 2.8% from 2.0% at the end of 2000.

Going forward, this bank will continue to focus on its market leading credit card business, which currently accounts for 12% or NT$61.3 billion of its loan book and one third of its total profits. Chinatrust was one of the first banks to issue credit cards back in 1974 and has since managed to expand this business substantially. It is currently the largest credit issuer on the island with 3.75 million cards issued, representing a 17% market share and the target is to reach four million by the end of 2001. In addition to more cards, management is looking to increase spending and balances per card.

Chinatrust generates the highest profitability as measured by ROE at 10% this year and then expected to improve to 11% in 2002. However, the lead over its competitors has narrowed, despite its market leading position in the very lucrative credit card business.

Chinatrust

Share Price (NT$):	18.00	**Index:**	4,043.57
52 Week Price Range (NT$):	14.80 - 27.10	**Current Yield:**	0.00
Reuters Code:	2815.TW		
Bloomberg Code:	2815 TT	**Shares Outstanding** (MM):	4,608.55

INCOME STATEMENT	**1998A**	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
(NT$m) *year end Dec*						
Interest income	42,020	43,870	59,497	53,707	58,726	66,040
Interest expense	-29,862	-27,837	-39,130	-35,805	-41,208	-47,651
Net interest income	**12,158**	**16,033**	**20,367**	**17,902**	**17,518**	**18,389**
Ave. int. earnings assets	*534,290*	*571,950*	*639,599*	*708,535*	*781,970*	*886,447*
NIM (%)	**2.32%**	**2.88%**	**3.29%**	**2.53%**	**2.24%**	**0.00%**
Non-interest income	7,713	8,985	11,481	16,851	17,044	19,703
Total operating income	**19,871**	**25,018**	**31,848**	**34,752**	**34,562**	**38,093**
Non-interest expenses	-9,521	-10,902	-16,574	-16,307	-19,372	-21,840
Pre provision profit	**10,350**	**14,116**	**15,274**	**18,445**	**15,190**	**16,253**
Loan loss provisions	-5,036	-8,358	-6,599	-10,159	-4,388	-3,577
Non-operating income	342	369	346	363	381	400
Pre tax profit	**5,314**	**5,758**	**8,675**	**8,287**	**10,802**	**12,676**
Tax	-1,505	-1,266	-1,801	-1,730	-2,237	-2,615
Net profit	**4,151**	**4,861**	**7,220**	**6,920**	**8,947**	**10,461**

PER SHARE DATA (NT$)	**1998A**	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
EPS	1.05	1.23	1.83	1.47	1.91	2.24
DPS	0.00	0.00	0.00	0.00	0.00	0.00
Effective payout ratio (%)	*0%*	*0%*	*0%*	*0%*	*0%*	*0%*
BVPS	12.15	13.29	17.29	16.31	18.25	20.52
ABVPS	12.15	11.39	17.29	16.31	18.25	20.52

VALUATION	**1998A**	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
Price to book value (x)	1.5	1.4	1.0	1.1	1.0	0.9
Price to adjusted book value (x)	1.5	1.6	1.0	1.1	1.0	0.9
Price to earnings (X)	17.1	14.6	9.8	12.3	9.4	8.0

PROFITABILITY RATIOS	**1998A**	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
(%)						
Net interest margin	2.32%	2.88%	3.29%	2.53%	2.24%	2.07%
Yield on interest earning assets	8.03%	7.88%	9.61%	7.58%	7.51%	7.45%
Cost on interest bearing liabilities	5.78%	5.07%	6.41%	5.09%	5.08%	5.10%
Net interest spread	2.25%	2.82%	3.20%	2.49%	2.43%	2.35%
Non-int. income (% Op income)	38.8%	35.9%	36.0%	48.5%	49.3%	51.7%
Cost to income	47.9%	43.6%	52.0%	46.9%	56.0%	57.3%
Overhead ratio	1.69%	1.80%	2.45%	2.19%	2.35%	2.35%
Cost coverage	81.0%	82.4%	69.3%	103.3%	88.0%	90.2%
ROA	0.74%	0.80%	1.07%	0.93%	1.09%	1.12%
ROE	10.5%	10.4%	12.0%	9.7%	11.2%	11.7%

DUPONT ANALYSIS	**1998A**	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
Lending operations						
Net interest margin	2.32%	2.88%	3.29%	2.53%	2.24%	2.07%
Interest earnings assets/assets	94.92%	94.59%	94.74%	94.97%	95.05%	95.25%
NIM contribution to ROA	**2.21%**	**2.73%**	**3.12%**	**2.40%**	**2.13%**	**1.98%**
Non-interest operations						
Non-interest income/assets	1.37%	1.49%	1.70%	2.26%	2.07%	2.12%
Overhead ratio	1.69%	1.80%	2.45%	2.19%	2.35%	2.35%
Non-int. contribution to ROA	**-0.32%**	**-0.32%**	**-0.75%**	**0.07%**	**-0.28%**	**-0.23%**
Asset quality analysis						
Provision/loans	-1.29%	-1.90%	-1.30%	-1.80%	-0.71%	
Loans/assets	69.11%	72.63%	75.19%	75.66%	75.21%	
ROA effect from asset quality	**-0.89%**	**-1.38%**	**-0.98%**	**-1.36%**	**-0.53%**	
Core ROA	**0.99%**	**1.03%**	**1.39%**	**1.11%**	**1.31%**	
Non-core contibution to ROA	0.06%	0.06%	0.05%	0.05%	0.05%	
Pre-tax ROA	**1.05%**	**1.09%**	**1.44%**	**1.16%**	**1.36%**	
Tax rate	26.61%	20.67%	19.97%	20.00%	20.00%	
After tax ROA	**0.77%**	**0.86%**	**1.15%**	**0.93%**	**1.09%**	
Balance sheet leverage (x)	13.7	12.1	11.2	10.4	10.3	
ROE	**10.5%**	**10.4%**	**12.9%**	**9.7%**	**11.2%**	

BALANCE SHEET	**1998A**	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
(NT$m) *year end Dec*						
Gross loans	419,364	470,494	554,359	590,278	672,427	758,186
Specific loan loss reserves	*0*	*0*	*0*	*0*	*0*	*0*
Loan loss reserves	*-5,575*	*-5,995*	*-3,629*	*-12,012*	*-13,204*	*-13,264*
Net loans	413,789	464,499	550,729	578,266	659,223	744,922
Other earning assets	136,671	128,940	135,029	153,045	173,407	195,341
Other assets	30,401	34,970	36,108	39,014	42,397	46,091
Total Assets	**580,862**	**628,409**	**721,867**	**770,325**	**875,027**	**986,354**
Deposits	412,641	461,204	545,388	643,558	740,092	858,506
Other paying liabilities	114,935	110,255	104,281	113,666	125,033	145,038
Other liabilities	5,450	4,524	3,951	(62,066)	(74,211)	(111,765)
Total Liabilities	**533,026**	**575,984**	**653,620**	**695,158**	**790,913**	**891,779**
Shareholders' funds	**47,835**	**52,425**	**68,247**	**75,167**	**84,114**	**94,575**

LOAN BOOK (NT$ m)	**1998A**	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
Manufacturing	47,790	60,919	77,976	97,470	115,015	135,718
Trade and commerce	19,424	19,399	21,339	25,180	28,705	32,724
Communication	15,034	19,590	22,528	26,133	30,314	35,164
Business&social svcs	37,435	32,668	32,668	34,302	36,017	37,818
Real estate	27,240	34,725	39,934	47,521	53,224	59,611
Other corporate	51,377	70,180	77,543	86,810	95,802	105,747
Mortgage	112,474	114,447	120,169	130,985	142,773	155,623
Credit cards	42,827	48,690	60,863	76,078	95,098	118,872
Other retail	51,186	52,539	62,491	72,648	83,137	95,179
Total loans	**404,786**	**453,157**	**515,512**	**597,127**	**680,084**	**776,455**

LOAN BOOK BREAKDOWN (%)	**1998A**	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
Manufacturing	12%	13%	15%	16%	17%	17%
Trade and commerce	5%	4%	4%	4%	4%	4%
Communication	4%	4%	4%	4%	4%	5%
Financial services	9%	7%	6%	6%	5%	5%
Real estate	7%	8%	8%	8%	8%	8%
Other corporate	13%	15%	15%	15%	14%	14%
Mortgage	28%	25%	23%	22%	21%	20%
Credit cards	11%	11%	12%	13%	14%	15%
Other retail	13%	12%	12%	12%	12%	12%
Total loans	**100%**	**100%**	**100%**	**100%**	**100%**	**100%**

BALANCE SHEET RATIOS (%)	**1998A**	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
Loan-to-deposit	100.3%	100.7%	101.0%	89.9%	89.1%	86.8%
Loan-to-deposit (incl. CDs)	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Equity to assets	8.2%	8.3%	9.5%	9.8%	9.6%	9.6%
Tier 1 Capital	9.2%	9.2%	10.1%	10.6%	10.4%	10.3%
Total Capital adequacy	9.2%	9.2%	10.1%	10.6%	10.4%	10.3%
General reserves (% loans)	-1.33%	-1.27%	-0.65%	-2.03%	-1.96%	-1.75%
Specific reserves (% loans)	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
Total loan provisions	-1.33%	-1.27%	-0.65%	-2.03%	-1.96%	-1.75%

ASSET QUALITY	**1998A**	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
Nonperforming loans	6,210	9,136	8,879	15,981	17,579	19,337
NPL ratio	1.7%	1.9%	1.6%	2.7%	2.6%	2.6%
Total provisions/NPLs	89.8%	65.6%	40.9%	75.2%	75.1%	68.6%

GROWTH RATES (%)	**1998A**	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
Income statement						
Net interest income		31.9%	27.0%	-12.1%	-2.1%	5.0%
Non-interest income		16.5%	27.8%	46.8%	1.1%	15.6%
Total operating income		25.9%	27.3%	9.1%	-0.5%	10.2%
Operating expenses		14.5%	52.0%	-1.6%	18.8%	12.7%
Pre-provision earnings		36.4%	8.2%	20.8%	-17.6%	7.0%
Loan loss provisions		66.0%	-21.1%	54.0%	-56.8%	-18.5%
Net profit		**17.1%**	**48.5%**	**-4.2%**	**29.3%**	**16.9%**
Balance sheet						
Loan growth		12.3%	18.6%	5.0%	14.0%	13.0%
Interest earning assets		7.8%	15.0%	7.8%	13.8%	12.7%
Asset growth		8.2%	14.9%	6.7%	13.6%	12.7%
Deposit growth		11.8%	18.3%	18.0%	15.0%	16.0%
Shareholders funds		9.6%	30.2%	10.1%	11.9%	12.4%

Source: Company reports; Lehman Brothers estimates.

Taishin International

Everybody Wants To Be a Leader

Rating: 3-Market Perform

Ticker:	2844.TW
Market Cap:	US$681MM
Shares Outstanding:	1,789MM

Taishin International Bank is the commercial banking arm of Shin Kong Group, the fourth largest conglomerate in Taiwan. It is one of the 12 newly established private banks that were set up after the banking sector deregulation in 1992. Taishin focuses on consumer banking and is the second largest credit card issuer in Taiwan. With an overall deterioration in the banking sector's assets quality, Taishin is considered to be one of the better managed banks with a NPL ratio of just over 2%. However, lack of critical mass is limiting its growth. However, this could be remedied by the planned formation of a financial holding company or a potential merger with other domestic players—this will enable cross selling opportunities and revenue growth enhancement.

Possible domestic mergers to create critical mass

Taishin's parent, Shin Kong Group, has announced that it will create two financial holding companies, one led by Taishin and the other by the life insurance arm, Shing Kong Life Insurance. Taishin is reportedly in the process of taking over Dah An Commercial Bank for NT$10.4 billion. If this take over succeeds, the new entity will have a larger network of 77 branches. The combined total assets will amount to NT$515.3 billion and paid in capital to NT$39.2 billion. Total loan portfolio will increase to NT$340 billion and total deposits to NT$410 billion.

Expand on credit card operation

In terms of core operations, Taishin continues to concentrate on gaining market share in the retail consumer segment—Taishin is the second largest credit card issuer in Taiwan, after Chinatrust. Within plans to expand this high yielding product, Taishin has recently come to an agreement with China United Trust to purchase its credit card division. Taishin currently has about two million cards in circulation and outstanding balances of over NT$5 billion.

Overall, we view Taishin's desire to become larger positively. Potential cost savings and revenue enhancement are among the benefits of gaining critical mass, all of which will increase competitiveness of the bank. In addition, transforming into a financial holding company will facilitate cross selling opportunities among its parents' financial affiliates, especially between the insurance arm and the investment trust business. However, we are still skeptical about the bank's ability to successfully realize the real benefits of a cross-selling and joint marketing effort.

We are maintaining our 3-Market Perform rating on Taishin. The industry outlook is bleak, but Taishin should be able to outlast the downturn. Currently profit profile of single digit growth and single digit ROE are not attractive.

Taishin International

Share Price (NT$):	13.10	**Index:**	4,043.57
52 Week Price Range (NT$):	10.25 - 19.10	**Current Yield:**	0.00
Reuters Code:	2844.TW		
Bloomberg Code:	2844 TT	**Shares Outstanding** (MM):	1,788.64

INCOME STATEMENT	**1998A**	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
(NT$m) *year end Dec*						
Interest income	17,724	19,327	20,968	23,928	26,354	29,339
Interest expense	-11,799	-11,075	-11,170	-14,179	-16,334	-18,209
Net interest income	**5,925**	**8,253**	**9,799**	**9,749**	**10,020**	**11,130**
Ave. int. earnings assets	*201,374*	*227,622*	*245,031*	*275,352*	*308,956*	*345,160*
NIM (%)	**2.98%**	**3.68%**	**4.06%**	**3.54%**	**3.24%**	**0.00%**
Non-interest income	1,027	1,646	1,375	1,818	2,164	2,436
Total operating income	**6,952**	**9,899**	**11,174**	**11,567**	**12,184**	**13,565**
Non-interest expenses	-4,375	-4,904	-5,688	-6,514	-7,334	-8,253
Pre provision profit	**2,577**	**4,995**	**5,486**	**5,053**	**4,850**	**5,313**
Loan loss provisions	-905	-2,820	-3,186	-2,502	-2,088	-2,062
Non-operating income	138	78	208	0	0	0
Pre tax profit	**1,673**	**2,175**	**2,299**	**2,551**	**2,762**	**3,250**
Tax	-326	-436	-592	-485	-525	-618
Net profit	**1,485**	**1,816**	**1,916**	**2,066**	**2,237**	**2,633**

PER SHARE DATA (NT$)	**1998A**	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
EPS	0.95	0.97	0.79	1.06	1.18	1.47
DPS	0.00	0.00	0.00	0.00	0.00	0.00
Effective payout ratio (%)	*0%*	*0%*	*0%*	*0%*	*0%*	*0%*
BVPS	11.33	12.24	14.62	16.81	18.06	19.54
ABVPS	11.33	11.36	14.62	16.81	18.06	19.54

VALUATION	**1998A**	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
Price to book value (x)	1.2	1.1	0.9	0.8	0.7	0.7
Price to adjusted book value (x)	1.2	1.2	0.9	0.8	0.7	0.7
Price to earnings (X)	13.8	13.5	16.6	12.37	11.08	8.90

PROFITABILITY RATIOS	**1998A**	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
(%)						
Net interest margin	2.98%	3.68%	4.06%	3.54%	3.24%	3.22%
Yield on interest earning assets	8.91%	8.62%	8.69%	8.69%	8.53%	8.50%
Cost on interest bearing liabilities	6.06%	5.08%	4.80%	5.33%	5.39%	5.40%
Net interest spread	2.85%	3.54%	3.89%	3.36%	3.14%	3.10%
Non-int. income (% Op income)	14.8%	16.6%	12.3%	15.7%	17.8%	18.0%
Cost to income	62.9%	49.5%	50.9%	56.3%	60.2%	60.8%
Overhead ratio	2.08%	2.06%	2.20%	2.23%	2.22%	2.25%
Cost coverage	23.5%	33.6%	24.2%	27.9%	29.5%	29.5%
ROA	0.71%	0.76%	0.74%	0.71%	0.68%	0.72%
ROE	9.7%	9.1%	7.6%	7.1%	7.2%	7.8%

DUPONT ANALYSIS	**1998A**	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
Lending operations						
Net interest margin	2.98%	3.68%	4.06%	3.54%	3.24%	3.22%
Interest earnings assets/assets	95.61%	95.46%	94.74%	94.09%	93.71%	93.91%
NIM contribution to ROA	**2.85%**	**3.52%**	**3.85%**	**3.33%**	**3.04%**	**3.03%**
Non-interest operations						
Non-interest income/assets	0.49%	0.69%	0.53%	0.62%	0.66%	0.66%
Overhead ratio	2.08%	2.06%	2.20%	2.23%	2.22%	2.25%
Non-int. contribution to ROA	**-1.59%**	**-1.37%**	**-1.67%**	**-1.60%**	**-1.57%**	**-1.58%**
Asset quality analysis						
Provision/loans	-0.60%	-1.59%	-1.68%	-1.22%	-0.91%	-0.81%
Loans/assets	72.00%	74.27%	73.54%	70.36%	69.35%	69.02%
ROA effect from asset quality	**-0.43%**	**-1.18%**	**-1.23%**	**-0.85%**	**-0.63%**	**-0.56%**
Core ROA	**0.83%**	**0.97%**	**0.95%**	**0.87%**	**0.84%**	**0.88%**
Non-core contibution to ROA	0.02%	0.03%	0.08%	0.00%	0.00%	0.00%
Pre-tax ROA	**0.85%**	**1.00%**	**1.03%**	**0.87%**	**0.84%**	**0.88%**
Tax rate	17.98%	19.37%	23.61%	19.00%	19.00%	19.00%
After tax ROA	**0.70%**	**0.81%**	**0.79%**	**0.71%**	**0.68%**	**0.72%**
Balance sheet leverage (x)	13.7	11.9	10.3	10.1	10.6	10.9
ROE	**9.6%**	**9.6%**	**8.1%**	**7.1%**	**7.2%**	**7.8%**

BALANCE SHEET	**1998A**	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
(NT$m) *year end Dec*						
Gross loans	171,580	186,197	198,308	218,664	245,376	270,209
Specific loan loss reserves	*0*	*0*	*0*	*0*	*0*	*0*
Loan loss reserves	*-1,658*	*-1,928*	*-2,209*	*-2,955*	*-3,781*	*-4,456*
Net loans	169,922	184,268	196,099	215,709	241,594	265,753
Other earning assets	55,344	45,710	63,984	74,912	85,697	97,276
Other assets	10,255	11,409	15,777	18,809	22,680	22,120
Total Assets	**235,521**	**241,388**	**275,860**	**309,430**	**349,971**	**385,149**
Deposits	197,167	197,315	224,620	258,313	291,893	321,083
Other paying liabilities	20,095	21,265	22,634	26,482	29,395	32,040
Other liabilities	560	585	600	(5,438)	(3,627)	(2,917)
Total Liabilities	**217,821**	**219,165**	**247,853**	**279,357**	**317,661**	**350,206**
Minorities & other	0	0	0	0	0	0
Shareholders' funds	**17,700**	**22,223**	**28,007**	**30,073**	**32,310**	**34,943**

LOAN BOOK	**1998A**	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
(NT$m)						
Manufacturing	26,891	31,265	36,580	42,067	48,377	55,634
Construction	36,331	28,092	28,935	30,381	31,901	33,496
Trading	13,660	12,022	12,623	13,507	14,452	15,464
Financial institutions	21,329	23,316	25,881	28,469	32,739	37,650
Other corporate	12,196	11,522	11,868	12,461	13,707	15,078
Individuals	95,972	93,545	100,093	109,102	120,012	132,013
Credit cards	13,296	17,373	22,932	28,665	34,972	42,666
Total loans	**219,675**	**217,135**	**238,912**	**264,652**	**296,160**	**332,000**

LOAN BOOK BREAKDOWN	**1998A**	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
(%)						
Manufacturing	12%	14%	15%	16%	16%	17%
Construction	17%	13%	12%	11%	11%	10%
Trading	6%	6%	5%	5%	5%	5%
Financial institutions	10%	11%	11%	11%	11%	11%
Other corporate	6%	5%	5%	5%	5%	5%
Individuals	44%	43%	42%	41%	41%	40%
Credit cards	6%	8%	10%	11%	12%	13%
Total loans	**100%**	**100%**	**100%**	**100%**	**100%**	**100%**

BALANCE SHEET RATIOS (%)	**1998A**	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
Loan-to-deposit	86.2%	93.4%	87.3%	83.5%	82.8%	82.8%
Loan-to-deposit (incl. CDs)	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Equity to assets	7.5%	9.2%	10.2%	9.7%	9.2%	9.1%
Tier 1 Capital	8.6%	9.2%	11.2%	11.3%	11.4%	11.6%
Total Capital adequacy	0.0%	9.2%	11.2%	11.3%	11.4%	11.6%
General reserves (% loans)	-0.97%	-1.04%	-1.11%	-1.35%	-1.54%	-1.65%
Specific reserves (% loans)	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
Total loan provisions	-0.97%	-1.04%	-1.11%	-1.35%	-1.54%	-1.65%

ASSET QUALITY	**1998A**	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
Nonperforming loans	3,325	4,596	4,388	5,047	5,551	6,107
NPL ratio	1.9%	2.5%	2.2%	2.3%	2.3%	2.3%
Total provisions/NPLs	49.8%	49.9%	42.0%	50.3%	58.6%	68.1%

GROWTH RATES (%)	**1998A**	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
Income statement						
Net interest income		39.3%	18.7%	-0.5%	2.8%	11.1%
Non-interest income		60.3%	-16.5%	32.2%	19.1%	12.5%
Total operating income		42.4%	12.9%	3.5%	5.3%	11.3%
Operating expenses		12.1%	16.0%	14.5%	12.6%	12.5%
Pre-provision earnings		93.8%	9.8%	-7.9%	-4.0%	9.5%
Loan loss provisions		211.7%	13.0%	-21.5%	-16.5%	-1.2%
Net profit		**22.3%**	**5.5%**	**7.9%**	**8.3%**	**17.7%**
Balance sheet						
Loan growth		8.4%	6.4%	10.0%	12.0%	10.0%
Interest earning assets		2.2%	13.1%	11.9%	12.8%	11.0%
Asset growth		2.5%	14.3%	12.2%	13.1%	10.1%
Deposit growth		0.1%	13.8%	15.0%	13.0%	10.0%
Shareholders funds		25.6%	26.0%	7.4%	7.4%	8.1%

Source: Company reports; Lehman Brothers estimates.

United World Chinese Comm.

Many Suitors

Rating: 4-Market Underperform

Ticker:	2826.TW
Market Cap:	US$2,294MM
Shares Outstanding:	3,772MM

UWCCB's share price has been buoyed by competition between the Fubon Group and the Cathay Group—both of which would love to add its 22% market share of highly liquid and cheap securities settlement deposits and its branch network of 81 branches to their respective financial holding companies. That said though, similar to the other banks, UWCCB is looking into the merits of forming its own financial holding company and weighing that against the benefits of going it alone as a universal bank. UWCCB is 28%-owned by the government so the acquirers must get the buy-in of the government, which means limited staff retrenchments, before a deal can be consummated

This government influence is apparent as UWCCB was one of the six banks that absorbed 36 local level financial institutions back in August—although the government has guaranteed the assets, this type of acquisition will also incur indirect expenses related to staff and IT. Consequently, the NPL ratio increased significantly to 6.03% at the end of September from 3.4% nine months earlier. Another contributing factor is its real estate exposure, currently 58% of the loan book. Due to the deterioration in asset quality, management has already provided NT$3.9 billion in the first nine month of the year and we are projecting a full year figure of NT$4.2 billion, 15% higher than the charge taken in 2000. Given the state of the economy, NPLs are expected to continue to rise and peak by mid-2002.

Meanwhile, on a core operating basis, this bank is currently in transition mode, changing its focus from corporate to retail. Also, it is embracing technology and the Internet, which is ultimately a cheaper distribution network. Although we view this change in direction positively, we believe that it is still too early to determine the impact of these changes. Also, because every other bank in Taiwan is embarking on the same strategy, we are not convinced that this bank will be able to differentiate itself positively from its competitors.

Cheap funding costs vs high real estate exposure.

UWCCB has established a niche as the largest clearing bank for Taiwan's stock market. This lower cost of funds has enabled it to maintain a high level of profitability despite the fact that it used to focus on lower yielding corporate loans. Thus, here lies the opportunity for this bank—to deploy this base of low costing deposits into higher yielding consumer loans.

UWCCB

Share Price (NT$):	21.00	**Index:**	4,043.57
52 Week Price Range (NT$):	15.18 - 25.73	**Current Yield:**	4.54%

INCOME STATEMENT	**1998A**	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
(NT$m) *year end Dec*						
Interest income	36,175	35,850	40,224	41,492	47,255	51,939
Interest expense	-23,893	-22,078	-23,779	-26,272	-33,456	-37,440
Net interest income	**12,282**	**13,773**	**16,445**	**15,219**	**13,799**	**14,498**
Ave. int. earnings assets	*492,932*	*554,044*	*603,908*	*628,664*	*662,757*	*731,533*
NIM (%)	**2.56%**	**2.55%**	**2.77%**	**2.42%**	**2.08%**	**1.98%**
Non-interest income	3,078	3,375	3,130	3,627	4,060	4,605
Total operating income	**15,360**	**17,148**	**19,575**	**18,847**	**17,859**	**19,103**
Non-interest expenses	-7,107	-7,255	-7,373	-7,800	-8,474	-9,131
Pre provision profit	**8,253**	**9,892**	**12,202**	**11,047**	**9,385**	**9,973**
Loan loss provisions	-1,054	-2,320	-3,607	-4,242	-2,174	-1,418
Non-operating income	48	35	27	0	0	0
Pre tax profit	**7,199**	**7,573**	**8,595**	**6,805**	**7,210**	**8,555**
Tax	-1,208	-1,235	-1,764	-1,089	-1,154	-1,369
Net profit	**6,040**	**6,373**	**6,859**	**5,716**	**6,057**	**7,186**

PER SHARE DATA (NT$)	**1998A**	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
EPS	1.78	1.87	2.01	1.52	1.61	1.91
DPS	0.00	0.95	0.95	0.38	0.40	0.48
Effective payout ratio (%)	*0%*	*51%*	*47%*	*25%*	*25%*	*25%*
BVPS	17.06	17.82	18.57	17.91	19.11	20.54
ABVPS	17.06	10.52	18.57	17.91	19.11	20.54

VALUATION	**1998A**	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
Price to book value (x)	1.2	1.2	1.1	1.2	1.1	1.0
Price to adjusted book value (x)	1.2	2.0	1.1	1.2	1.1	1.0
Price to earnings (X)	11.8	11.2	10.4	13.9	13.1	11.0

PROFITABILITY RATIOS	**1998A**	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
(%)						
Net interest margin	2.56%	2.55%	2.77%	2.42%	2.08%	1.98%
Yield on interest earning assets	7.55%	6.63%	6.79%	6.60%	7.13%	7.10%
Cost on interest bearing liabilities	5.02%	4.19%	4.12%	4.25%	5.01%	5.10%
Net interest spread	2.52%	2.44%	2.67%	2.35%	2.12%	2.00%
Non-int. income (% Op income)	20.0%	19.7%	16.0%	19.2%	22.7%	24.1%
Cost to income	46.3%	42.3%	37.7%	41.4%	47.5%	47.8%
Overhead ratio	1.36%	1.23%	1.15%	1.17%	1.21%	1.18%
Cost coverage	43.3%	46.5%	42.5%	46.5%	47.9%	50.4%
ROA	1.15%	1.08%	1.07%	0.86%	0.86%	0.93%
ROE	13.1%	10.7%	11.1%	8.7%	8.7%	9.6%

DUPONT ANALYSIS	**1998A**	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
Lending operations						
Net interest margin	2.56%	2.55%	2.77%	2.42%	2.08%	1.98%
Interest earnings assets/assets	94.23%	94.25%	94.30%	94.30%	94.41%	94.74%
NIM contribution to ROA	**2.41%**	**2.40%**	**2.62%**	**2.28%**	**1.97%**	**1.88%**
Non-interest operations						
Non-interest income/assets	0.59%	0.57%	0.49%	0.54%	0.58%	0.60%
Overhead ratio	1.36%	1.23%	1.15%	1.17%	1.21%	1.18%
Non-int. contribution to ROA	**-0.77%**	**-0.66%**	**-0.66%**	**-0.63%**	**-0.63%**	**-0.59%**
Asset quality analysis						
Provision/loans	-0.33%	-0.65%	-0.90%	-1.01%	-0.51%	-0.30%
Loans/assets	61.67%	60.61%	62.43%	63.00%	61.27%	60.74%
ROA effect from asset quality	**-0.20%**	**-0.39%**	**-0.56%**	**-0.64%**	**-0.31%**	**-0.18%**
Core ROA	**1.44%**	**1.35%**	**1.39%**	**1.02%**	**1.03%**	**1.11%**
Non-core contibution to ROA	0.01%	0.01%	0.00%	0.00%	0.00%	0.00%
Pre-tax ROA	**1.45%**	**1.35%**	**1.40%**	**1.02%**	**1.03%**	**1.11%**
Tax rate	16.67%	16.23%	20.46%	16.00%	16.00%	16.00%
After tax ROA	**1.21%**	**1.13%**	**1.11%**	**0.86%**	**0.86%**	**0.93%**
Balance sheet leverage (x)	11.4	9.9	10.3	10.2	10.1	10.3
ROE	**13.7%**	**11.2%**	**11.5%**	**8.7%**	**8.7%**	**9.6%**

Reuters Code:	2826.TW		
Bloomberg Code:	2826 TT	**Shares Outstanding** (MM):	3,371.66

BALANCE SHEET	**1998A**	**1999A**	**2000A**	**2001E**	**2002E**	**2002E**
(NT$m) *year end Dec*						
Gross loans	342,817	376,896	429,981	418,512	451,142	494,333
Specific loan loss reserves	*0*	*0*	*0*	*0*	*0*	*0*
Loan loss reserves	*-3,456*	*-3,658*	*-3,621*	*-4,942*	*-4,487*	*-3,013*
Net loans	339,360	373,238	426,360	413,569	446,655	491,320
Other earning assets	184,815	210,676	197,542	219,856	245,435	279,656
Other assets	31,930	35,706	37,335	38,600	39,922	41,304
Total Assets	**556,105**	**619,620**	**661,237**	**672,025**	**732,011**	**812,280**
Deposits	421,646	494,490	531,555	568,764	614,265	681,834
Other paying liabilities	75,335	63,079	65,088	70,946	81,587	90,562
Other liabilities	1,224	1,369	1,348	(35,218)	(35,917)	(37,581)
Total Liabilities	**498,205**	**558,938**	**597,991**	**604,492**	**659,936**	**734,815**
Minorities & other	0	0	0	0	0	0
Shareholders' funds	**57,900**	**60,682**	**63,246**	**67,533**	**72,075**	**77,465**

LOAN BOOK	**1998A**	**1999A**	**2000A**	**2001E**	**2002E**	**2002E**
(NT$m)						
Manufacturing	23,997	30,152	34,399	38,182	42,764	47,896
Construction	6,856	7,538	8,600	9,288	10,123	11,035
Trading	17,141	15,076	17,199	18,403	19,875	21,465
Real estate	54,851	75,379	98,896	116,697	136,535	159,746
Commerce	17,141	22,614	24,079	25,042	26,044	27,086
Individuals	198,834	203,524	214,991	221,870	235,183	249,294
Gov't institutions	3,428	3,769	1,720	1,892	2,119	2,373
Others	20,569	18,845	30,099	34,614	39,806	45,776
Total loans	**342,817**	**376,896**	**429,981**	**465,988**	**512,450**	**564,671**

LOAN BOOK BREAKDOWN (%)	**1998A**	**1999A**	**2000A**	**2001E**	**2002E**	**2002E**
Manufacturing	7%	8%	8%	8%	8%	8%
Construction	2%	2%	2%	2%	2%	2%
Trading	5%	4%	4%	4%	4%	4%
Real estate	16%	20%	23%	25%	27%	28%
Commerce	5%	6%	6%	5%	5%	5%
Individuals	58%	54%	50%	48%	46%	44%
Gov't institutions	1%	1%	0%	0%	0%	0%
Others	6%	5%	7%	7%	8%	8%
Total loans	**100%**	**100%**	**100%**	**100%**	**100%**	**100%**

BALANCE SHEET RATIOS (%)	**1998A**	**1999A**	**2000A**	**2001E**	**2002E**	**2002E**
Loan-to-deposit	80.5%	75.5%	80.2%	72.7%	72.7%	72.1%
Loan-to-deposit (incl. CDs)	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Equity to assets	10.4%	9.8%	9.6%	10.0%	9.8%	9.5%
Tier 1 Capital	13.2%	13.2%	10.9%	13.2%	13.1%	12.8%
Total Capital adequacy	13.2%	13.2%	10.9%	13.2%	13.1%	12.8%
General reserves (% loans)	-1.01%	-0.97%	-0.84%	-1.18%	-0.99%	-0.61%
Specific reserves (% loans)	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
Total loan provisions	-1.01%	-0.97%	-0.84%	-1.18%	-0.99%	-0.61%

ASSET QUALITY	**1998A**	**1999A**	**2000A**	**2001E**	**2002E**	**2002E**
Nonperforming loans	8,944	10,459	14,608	26,294	28,923	31,237
NPL ratio	2.6%	2.8%	3.4%	6.3%	6.4%	6.3%
Total provisions/NPLs	38.6%	35.0%	24.8%	18.8%	15.5%	9.6%

GROWTH RATES (%)	**1998A**	**1999A**	**2000A**	**2001E**	**2002E**	**2002E**
Income statement						
Net interest income		12.1%	19.4%	-7.5%	-9.3%	5.1%
Non-interest income		9.6%	-7.3%	15.9%	11.9%	13.4%
Total operating income		11.6%	14.2%	-3.7%	-5.2%	7.0%
Operating expenses		2.1%	1.6%	5.8%	8.6%	7.7%
Pre-provision earnings		19.9%	23.3%	-9.5%	-15.0%	6.3%
Loan loss provisions		120.0%	55.5%	17.6%	-48.8%	-34.8%
Net profit		**5.5%**	**7.6%**	**-16.7%**	**6.0%**	**18.6%**
Balance sheet						
Loan growth		10.0%	14.2%	-3.0%	8.0%	10.0%
Interest earning assets		11.4%	6.8%	1.7%	9.1%	11.1%
Asset growth		11.4%	6.7%	1.6%	8.9%	11.0%
Deposit growth		17.3%	7.5%	7.0%	8.0%	11.0%
Shareholders funds		4.8%	4.2%	6.8%	6.7%	7.5%

Source: Company reports; Lehman Brothers estimates.

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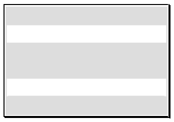
Thailand

Raising the Thai-tanic

Rating: Underweight ⇔



Covered Banks	Rating
Bangkok Bank	
/foreign	4 – Mkt Underperform
/local	3 – Market Perform
Thai Farmers Bank	
/foreign	3 – Market Perform
/local	3 – Market Perform
Siam Commercial Bank	
/foreign	3 – Market Perform
/preferred	3 – Market Perform
Krung Thai	4 – Mkt Underperform
Bank Ayudhya	4 – Mkt Underperform
Thai Military	4 – Mkt Underperform
IFCT	3 – Market Perform

We continue to be UNDERWEIGHT the Thai banking sector, with no exposure recommended for our clients who have broad global or regional mandates. Although fundamentals for the sector are undeniably improving, the underlying asset quality problems and reserve under-funding are persistent issues which make the equity of these banks highly speculative and very expensive relative to the franchise value of the institutions.

Our favorite of the large banks is still SCB, although the company has stumbled in recent quarters and no longer holds as large a lead over its compatriots as it once did.

The sector still has 31.4% non-performings/loans, more than three years into the financial crisis. Worse, after three years of increasingly serious restructuring, Thai banks have worked through most of the easy cases—what is left are hard-core NPLs which will probably cause higher rates of loss. The once-vaunted TAMC will only address 5–10% of the NPL issue at the listed banks; welcome to be sure, but hardly sufficient.

Remaining required reserves under our methodology are still 2.5x book equity of the banks, and without raising equity it will take 24–48 months for banks to top off the allowance such that additional profits may accrue to shareholders. All banks are insolvent save for Krung Thai.

Thailand still has a surfeit of commercial banks, including several propped up by the government which are hopelessly insolvent and serve only to ruin the margin environment for the other potentially salvageable banks. We must see consolidation and capacity reduction in order to cut costs and lift profits.

All banks would like to grow their way out of trouble, but the market is not cooperating. Loan growth was –5.2% in the first half, and total bank loans have declined by 24% since 1997. A recession forecast to begin in 4Q01 casts ample doubt on the prospects for reversal of this trend.

With all banks undercapitalized, managements will likely seize any opportunity to come to market for straight equity. Current investors should beware potential dilution from coercive rights offerings, new convertible structures, and the like.

Finally, even after steep declines in Thai bank share prices over the past two years, valuations remain high compared to the potential returns—even assuming a return to normalized asset quality. Remember that the high reserve shortfalls at these banks act like debt when evaluating franchise value, so that even a large cut in market cap has a minimal effect on EV.

M&A Is Necessary—As Are Bank Closures

Thailand continues to have too many banks for its shrinking pool of profitable lending; desperate for business they are competing away margins on many products, and possibly lowering credit standards again as well—we won't know for several years yet.

In order to clear their bad debt provisioning shortfalls, banks must return to high levels of profitability, and the best way to accomplish this would be to merge relatively healthy banks, closing branches and cutting employees in order to reduce the industry's cost base. In a static growth environment, these cost improvements would drop directly to the bottom line, and could be used to support a higher level of provisioning, as well as a permanently higher return on capital which might attract badly-needed new equity into the sector.

The less-healthy government banks should likewise be either closed or merged into one, perhaps using the now-stable Krung Thai as a base.

Market Share Trends

The Thai banking market is not as widely scattered as some (Taiwan, for example), with the top five banks accounting for some 71% of deposits. However, Thailand still has more significant commercial banks than Singapore, and a comparable number to Korea.

Since the advent of the crisis, large banks including the big three and KTB have increased their share of deposits, but are losing ground on the lending front to the smaller institutions. In part, this is a reflection of a shift from large corporate syndications to more SME and personal lending. Note that foreign banks have actually reduced their presence significantly as measured by market share, although four now own domestic banks: ABN AMRO (BOA); Standard Chartered (SCNB); DBS (DTDB); and UOB (UOBR).

Capital Raising Still An Issue

All of the Thai banks are undercapitalized relative to their risk books, and most are currently insolvent when marked to market. The sector will continue to require large amounts of additional equity capital over the next two years in order to cover past losses and move forward, even if consolidation and cutbacks are able to mitigate this to an extent.

Thai banks and finance companies have issued an aggregate of almost THB 1 trillion in Tier 1 and Tier 2 equity since year-end 1997, without managing to redeem their disastrous balance sheets. Although the situation has stabilized somewhat, the sector remains in a distressed state.

Equity Window Is Shut

Both Bangkok Bank and Bank of Ayudhya have attempted share offerings during the past 12 months, only to be met with indifference from investors. Most of their competitors also require additional capital, and would react to any successful offering by scheduling their own. Given the current attitude of investors, its is difficult to assume that even with a market upturn all banks would be able to access the required funding, and so we foresee several failures among the next round of attempted capital-raisings.

Bear in mind that some or all of the banks may take issuance in the form of coercive rights offerings priced well below the underlying equity, or of potentially-dilutive preferred classes of stock. This argues for caution in purchasing and holding any Thai bank shares.

Although we generally feel that current equity prices exceed the franchise value of Thai banks, there is a growing possibility of comprehensive transactions which will attempt to solve several problems at once; these could be attractive to investors. Combo deals will generally contain the following components:

- M&A or other consolidating activity. A merger between two distressed banks can help create a healthy one if it enables them to combine networks, cut branches and staff, and improve profitability. With overhead ratios averaging 1.9% (2.2% without IFCT), Thailand has substantial room to cut costs: we believe that the Thai banks should be able to approach the Singaporean overhead average level of 1.2%.
- Resolution of all distressed assets. Investors are rightly wary of buying into partial recap situations—any equity story must contain a comprehensive cleansing of the balance sheet, including real estate and "phantom equity."
- Recapitalization. Most of the Thai banks would like to jump directly to this phase of activity, but investors should stand firm in demanding contemporaneous action on the first two fronts before providing additional funds.

Rates and Margins

Margins have come up reasonably well over the last six quarters, adding an average of 19bp at the three major banks on a 20bp increase in spread. Asset yields continue to fall, giving up 73bp over the same period and are now standing at 5.17%, while cost of funds declined 94bp as banks cut deposit rates sharply.

Margins do continue to be stratified by institution, with the top three banks showing respectable spreads, KTB coming on strong post its recapitalization, and BAY, TMB and IFCT remaining deeply troubled.

The fall in asset yield is surprising—despite a prevailing fall in benchmark rates—as by our calculations foregone interest income on NPLs should have fallen considerably to offset this. Assuming that moving loans from NPL categories back into performing assets (or writing them off and replacing with the same) should yield incremental spread of 3–5.5% we find that although foregone interest income has fallen materially (by an average of 60bp), it has not offset other factors—either that or loans are being restructured to yield substantially less than performing loans.

We suspect the latter, meaning that banks have taken long-term impairment to their net interest income to lower NPL figures.

Because the effect of falling foregone interest will be limited in the future, and because we see less room to cut deposit rates going forward, we conclude that NIM improvements will become ever scarcer at the top banks. Second/third tier institutions will probably continue to make progress on this front through 1H02, but will still have margins below those of the big three.

Note that weak loan growth will also tend to arrest any tendency towards higher rates, as banks desperate for yield on performing assets are cutting lending rates.

Fierce competition for high-margin business is also coming from the non-viable state banks like BMB and SCIB, which have cut MLR by an average of 100bp so far this year, as opposed to 50bp at the large private banks. These "zombie banks" have almost no options other than to try to grow out of their problems, and with sectoral growth flat to negative this can only be accomplished by taking share from healthier institutions via pricing, looser credit standards, or both. For this reason alone, it is imperative that the Thai government act to shutter these banks and take capacity out of the system—Thailand can't afford a rate war now.

Asset Quality

Stated NPLs are well off their late 1998 highs, the result of countless restructurings, extraordinary provisions and in some cases government assistance. Real progress has been made, albeit at a high price—most of the billions of dollars in new equity raised by these banks in 1998 and 1999 went right out the door again to cover the asset quality nut.

Although we are somewhat tired of hearing about the problem, and so possibly inclined to take improvement as solution, we must keep on singing that old dirge: the Thai banks remain very seriously troubled by bad debts.

Non-performing assets (NPLs plus foreclosed property, or ORE) still account for 31.4% of total loans at our covered universe, and have actually increased since year-end as hastily-restructured loans come home to roost. Yet hope springs eternal. We project that bad loans will continue to come down—but any slide into deep recession for Thailand could scotch this progress.

Restructurings Are Getting Harder

In an effort to return loans to performing status, banks have restructured hundreds of billions of baht worth of loans over the past three years. In some cases, this restructuring amounts to nothing more than capitalizing unpaid interest, setting a new payment schedule, and perhaps lowering the interest rate a point or two. For some, it has involved haircutting the amount owed, swapping debt for equity stakes, dropping interest rates to as low as 0.1% per year, and even court proceedings.

The low-hanging fruit for loan restructurings has already been picked.

While some of these efforts have been reasonably successful given the economic backdrop (witness TFB's assertion that its yield on restructured loans is now 5–5.5%), we believe and banks concur that the easy restructurings have already taken place. With an average of 55% of all impaired assets in the loss category—denoting for the most part loans which have not paid interest for three years or more—what remains to be dealt with are more hard-core defaults or borrowers without readily accessible assets.

While banks point to collateral held against many of these loans, our methodology does not take it into account when looking at reserve adequacy (although we do think it a proper consideration for classification), as the valuation is subject to management's discretion, many of the properties are single-purpose or unfinished sites with no value, and banks' ability to actually seize collateral has been limited. Even under new, expedited procedures, bankers report that an average foreclosure will still take them three to five years to accomplish.

With a change in reporting over the past two quarters, banks have started to disclose the equity stakes they have booked from restructuring transactions, with somewhat disturbing results. Aside from marketable stakes, which are allegedly marked-to-market, banks have 15–60% of their capital tied up in non-marketable equity securities—which we consider a euphemistic term for securities of questionable value. BBL is the worst offender here, no surprise given its large corporate NPL portfolio and slim equity balance. Our position: these are not bankable assets, and should be written down to zero.

National AMC

After having been discussed for some time, Thailand's National AMC ("TAMC") is now a reality, and is ready to begin accepting loans as early as this week. However, the early promise of the TAMC as an entity which would solve the asset quality problem by assuming all bad loans a la IBRA has faded away, and the government company is now seen mainly as a solution for the state banks and AMCs like BMB, SCIB, and Sukumvit AMC—all institutions for which the government was already fully responsible.

Most of our covered institutions will shed 5–11% of their NPLs on a gross basis—certainly welcome, but hardly a panacea for bad debt woes. Remember as well that 20% of net value will eventually be charged back to the banks as the TAMC incurs losses, a bill which may be paid by issuing equity to the government if capital is insufficient.

Figure 41: TAMC Effect on NPLs

THB, Bil	BBL	TFB	SCB	KTB	BAY	TMB	IFCT*
Gross NPAs Before TAMC	237.5	164.8	165.7	117.5	99.3	101.0	38.0
Estimated Net Transfers	27.0	8.5	7.6	3.2	8.0	8.9	10.0
Gross NPAs After TAMC	210.5	156.3	158.1	114.3	91.3	92.1	28.0
Transfers as % of NPLs	11%	5%	5%	3%	8%	9%	26%

Source: Company reports; Lehman Brothers estimates.

Figure 42: Potential TAMC Loss Sharing

THB, Bil	BBL	TFB	SCB	KTB	BAY	TMB	IFCT*
TAMC Transfers	27.0	8.5	7.6	3.2	8.0	8.9	10.0
Potential Loss Sharing	5.4	1.7	1.5	0.6	1.6	1.8	2.0

Source: Company reports; Lehman Brothers estimates.

Although IFCT appears to be the greatest beneficiary of the TAMC, the company will require special approval in order to participate; hence the figure given above is a company estimate of its total TAMC-qualifying loans. *(See IFCT section for full details).*

Reserve Adequacy

Thai Banks are better reserved than they have been for some time, but the sector as a whole is only at 32% of our calculated required reserve, with no individual bank even reaching the 50% mark. Perhaps more importantly, banks' ability to make additional required provisions is low: the sector underfunding averages 249% of remaining capital, and no bank save for the post-recap Krung Thai is solvent by our methodology.

Loan Growth

Loan growth continues to be strongly and worrisomely negative, a key problem not only for the banks, but for the country. We do know that stimulating loan growth is one of the Thai Rak Thai administration's top priorities; however, we have some issues about the way in which it has heretofore been addressed.

Total loans at commercial banks have shrunk by a total of 24% since the end of 1997, even after the transformation of the assets of Krungthai Thanakit Finance and 12 other finance companies into Bank Thai in 1999. Loan growth continues to be weak in 1H01, with total loans falling 5.2% YoY despite strenuous efforts on the part of state banks to lead the recovery.

Note that financial institution lending has grown dramatically, and now accounts for some 20.2% of total commercial bank loans; this is generally short-term, low-margin business which is not as desirable as other types of lending.

Our covered universe of banks has declined basically in-line with the industry as a whole—unsurprising as they constitute over 70% of loan market share. However, note that performing loans—a more useful statistic as they represent interest-earning assets—have begun increasing. Yet, this mainly represents the restructuring of old NPLs into new performing loans (frequently at concessionary rates), and not new originations.

For the Thai banks to truly come back, organic loan originations and portfolio growth will have to come hand in hand. With our economic forecast calling for negative GDP growth by 4Q01, this seems unlikely.

The government's proposal to force bank lending to targeted sectors frankly concern us, although we can fully understand and share the motivation behind it. With a history of poor credit decisions still looming large in the rear view mirror, policy lending is a very long-shot solution.

Valuation

Thai bank valuations have come off quite significantly since the January rally, but are still expensive for the franchises on offer. We use two primary methods to value the banks: Price-to-book *vs.* ROE and deposit premium valuation.

In order to compare Thai banks with each other and with the rest of our universe of Asian institutions, we make a number of standard adjustments to the reported financial statements for valuation purposes.

First, we have deducted real estate revaluations from book value to arrive at adjusted book value. This account is not properly included in our calculation of adjusted book value for a number of reasons.

We generally deduct loan loss reserve underfunding from adjusted book value to arrive at fully adjusted book value (FABV), a more consistent measure of value as it is not affected by management's allocation of scarce capital between the reserve account and the equity account. However, FABV is negative for all of our covered Thai banks except for Krung Thai. As FABV is negative and thus a price-to-fully adjusted book measure not meaningful, we have presented only price-to-book and price-to-adjusted book here.

Figure 43: Price to Book and ROE

THB	Price 10/26/01	Book Value	Adj. Book Value	P/BV	P/ABV	ROE 2000A	ROE 2001E
BBL	43.50	23.43	11.92	1.86x	3.65x	-73.10%	29.81%
TFB	17.50	10.71	7.92	1.63x	2.21x	6.70%	4.65%
SCB	15.00	20.00	17.22	0.75x	0.87x	6.95%	4.02%
KTB	9.00	2.70	2.52	3.33x	3.57x	95.59%	-10.09%
BAY	4.60	9.21	7.15	0.50x	0.64x	-47.90%	-11.42%
TMB	5.00	2.98	2.73	1.68x	1.83x	-252.02%	-1.93%
IFCT	5.20	7.06	6.48	0.74x	0.80x	-16.55%	-2.32%
Average				1.50x	1.94x	-40.05%	1.82%

Source: Company reports; Lehman Brothers estimates.

Thai banks currently trade at an average of 1.50x book value and 1.94x adjusted book value, quite high compared with their trailing and forward average ROEs of –40.1% and 1.8% respectively.

Valuation on Premium Basis

With our normal value touchstones in distressed markets—price-to-book and price-to-adjusted book—rendered less-than-accurate by the dominating effect of reserve underfunding, we have been comparing the banks from a deposit premium standpoint.

Under this methodology, we subtract fully adjusted book value from market capitalization to determine the value in excess of net assets that the market is placing on the bank's franchise. When expressed as a percentage of total deposits, this valuation methodology confirms our view that the Thai market should still be avoided on valuation terms, with an average deposit premium of 15.1% down by 50% from June 2000 but still rich compared with less-distressed markets.

Figure 44: Deposit Franchise Premium Valuation

THB, MM	Market Cap	Adjusted Book	Reserve Underfunding	Franchise Premium	Total Deposits	Deposit Premium
BBL	63,793	17,478	(83,967)	130,282	1,066,148	12.2%
TFB	41,265	18,685	(64,373)	86,953	660,701	13.2%
SCB	46,967	53,918	(73,953)	67,002	606,259	11.1%
KTB	197,865	55,417	(40,616)	183,063	839,612	21.8%
BAY	8,511	13,230	(58,522)	53,803	362,632	14.8%
TMB	20,015	10,944	(55,120)	64,191	295,552	21.7%
IFCT	6,040	7,530	(21,061)	19,571	179,921	10.9%
Average						15.1%

Source: Company reports; Lehman Brothers estimates.

Even SCB, cheapest of the three large banks, is not cheap compared with some of our regional comps—unless of course you believe it comparable in quality to Hang Seng, which trades at a 30.1% premium. Banks in other distressed markets (Korea and Indonesia) with much better asset quality are available at 0–3% premium, with even DBS showing up at the high end of that scale.

Figure 45: Deposit Franchise Premium Valuation: Regional Comps

Bank	Country	Market Cap	Adjusted Book	Reserve Underfunding	Franchise Premium	Total Deposits	Deposit Premium
DBS	Singapore	13,007,573	10,935,627	(126,678)	2,198,624	94,810,775	2.3%
H&CB	Korea	4,048,947	2,638,007	528,025	882,915	50,058,564	1.8%
BCA	Indonesia	7,652	5,511	(513)	2,653	92,493	2.9%
Hang Seng	Hong Kong	156,293	31,270	1,226	123,797	415,484	29.8%
Regional Comps Average							9.2%

Source: Company reports; Lehman Brothers estimates.

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Bangkok Bank

Prestige at a Premium

Rating: 4 (Foreign) / 3 (Local)

Ticker:	BBL.BK
Market Cap:	US$1,421MM
Shares Outstanding:	1,466 billion

We remain negative on both BBL shares vis-à-vis those of competitors due to continued bad debt overhang and a parlous macroeconomic environment.

While net income at BBL appears to have settled at a sustainable maintenance level, we note that pre-provision profit has consistently fallen in past quarters, and remains well below last year's level, with the difference due largely to lower provisions which are imprudently small. ROA of 0.64% shows that the bank's slim equity cushion (2.7% of assets on a stated basis) is responsible for a high ROE of 42%. Remember though that property revaluation accounts for some 49% of book equity, so that on an adjusted basis, equity-to-assets totals only 1.4%—an unwise level of gearing by our standards.

Because of this, we expect that any opening of a market window for Thai Bank equity issuance will lead to a prompt rights issuance or other offering from BBL, which is likely to be dilutive for existing shareholders, giving us an additional reason to avoid the stock.

BBL continues to improve its net interest margin gradually, but the operating environment is making gains harder and harder to achieve. NIM increased as a lowered cost of funds once again outpaced the declining yield on assets. However, it will be fairly difficult to restore margins further without a return to performing asset growth and commensurate higher asset yields.

Asset quality continues to be poor, with NPLs comprising some 31% of total loans, almost unchanged from a year ago, but this measure ignores a marked increase in foreclosed property, which now accounts for almost 10% of non-performing assets. BBL will be the largest non-state bank beneficiary of the TAMC, due to the requirement that transferred loans be of large size and be shared by at least two bank creditors in order to qualify. BBL has publicly estimated that it will be able to transfer a net THB27 billion in problem loans (face value THB60 billion), comprising debts owed by some 1,100 borrowers.

Reserves for loan losses continue to be inadequate by our calculation methodology, with current reserves amounting to only 47% of our required amount, leaving a shortfall of THB84 billion, or 2.4x book equity. Note that this calculation does not explicitly include higher reserves for restructured loans which are considered to be performing, nor is it applied against equity stakes taken in debt-for-equity swaps —much of which we suspect is worthless.

Overall loan growth continues to be slack, with even performing loans down from YE2000. We forecast continued hard going for originations, with overall loan growth estimates at –2% for FY2002, flat for FY2003 and +2% for FY2004.

BBL/F shares trade at 1.9x book (3.8x adjusted book), still a high valuation given the poor economic outlook and potential for downward revision in book value as losses are recognized. On an earnings basis, BBL shares trade at 11.7x 2001 (9.3x 2002 EEPS) on a core basis, not lofty, but warranted by the risk weighing mainly on the downside.

BBL

Share Price:	43.50			**Index:**	284.97
52 Week Price Range:	32.50 - 64.00			**Current Yield:**	0.0%

Reuters Code:	BBL.BK			
Bloomberg Code:	BBL/F TB		**Shares Outstanding** (B):	1,466.50

INCOME STATEMENT	1999A	2000A	2001E	2002E	2003E
(THB mil) *year ending Dec*					
Interest income	65,621	67,114	62,697	64,351	68,100
Interest expense	57,772	43,765	37,370	36,747	41,139
Net interest income	**7,849**	**23,349**	**25,327**	**27,604**	**26,961**
Ave. int. earnings assets	*1,183,699*	*1,122,014*	*1,183,871*	*1,250,139*	*1,331,070*
NIM (%)	**0.66%**	**2.08%**	**2.14%**	**2.21%**	**2.03%**
Non-interest income	23,118	18,176	11,980	12,605	13,380
Total operating income	**30,967**	**41,526**	**37,307**	**40,209**	**40,341**
Non-interest expense	22,585	25,131	23,878	23,913	24,207
Pre provision profit	**8,382**	**16,395**	**13,430**	**16,296**	**16,134**
Loan loss provisions	68,210	35,082	6,917	6,000	4,000
Non-operating income	1	146	0	0	0
Pre tax profit	**-59,827**	**-18,541**	**6,513**	**10,295**	**12,134**
Tax	0	0	970	3,192	3,762
Net profit	**-59,829**	**-18,833**	**5,544**	**7,104**	**8,373**
Core earnings	**-71,082**	**-24,178**	**5,618**	**7,104**	**8,373**

PER SHARE DATA (THB)	1999A	2000A	2001E	2002E	2003E
EPS	(40.80)	(12.84)	3.78	4.84	5.71
DPS	0.00	0.00	0.00	0.00	0.00
Effective payout ratio (%)	*0%*	*0%*	*0%*	*0%*	*0%*
BVPS	30.87	23.15	24.91	29.75	35.46
ABVPS	23.62	11.52	13.85	19.55	26.05

VALUATION	1999A	2000A	2001E	2002E	2003E
Price to book value (x)	3.08	1.49	1.75	1.46	1.23
Price to adjusted book value (x)	4.02	3.00	3.14	2.23	1.67
Price to earnings (x)	(2.33)	(2.69)	11.51	8.98	7.62

PROFITABILITY RATIOS	1999A	2000A	2001E	2002E	2003E
(%)					
Net interest margin	0.66%	2.08%	2.14%	2.21%	2.03%
Yield on interest earning assets	6.02%	5.81%	5.17%	5.00%	4.95%
Cost on interest bearing liabilities	5.20%	3.73%	3.04%	2.82%	2.95%
Net interest spread	0.83%	2.08%	2.13%	2.18%	2.00%
Non-int. income (% Op income)	74.7%	43.8%	32.1%	31.3%	33.2%
Cost to income	72.9%	60.5%	64.0%	59.5%	60.0%
Overhead ratio	1.91%	2.24%	2.02%	1.91%	1.82%
Cost coverage	137.1%	165.2%	156.2%	168.1%	166.7%
ROA	-4.89%	-1.56%	0.44%	0.53%	0.59%
ROE	-95.0%	-73.1%	29.8%	29.0%	25.0%

OROA ANALYSIS	1999A	2000A	2001E	2002E	2003E
Net interest margin	0.66%	2.08%	2.14%	2.21%	2.03%
Non-interest inc./gross inc.	74.65%	43.77%	32.11%	31.35%	33.17%
Efficiency ratio	72.93%	60.52%	64.00%	59.47%	60.01%
Provision/assets	5.77%	2.83%	0.53%	0.44%	0.27%
Operating return on assets	**-5.06%**	**-1.37%**	**0.60%**	**0.87%**	**0.94%**
Equity/assets	3.83%	2.74%	2.81%	3.17%	3.53%
Operating return on equity	**-132.2%**	**-49.9%**	**21.4%**	**27.4%**	**26.6%**

BALANCE SHEET	1999A	2000A	2001E	2002E	2003E
(THB mil) *year ending Dec*					
Gross loans	926,490	793,690	771,047	755,741	753,837
Loan loss reserves	*170,417*	*61,537*	*77,781*	*79,974*	*80,214*
Net loans	756,072	732,153	693,265	675,767	673,623
Total earning assets	1,089,579	1,154,448	1,213,293	1,286,984	1,375,157
Other assets	92,106	85,952	84,782	89,931	96,092
Total Assets	**1,181,685**	**1,240,400**	**1,298,075**	**1,376,915**	**1,471,249**
Deposits	961,459	1,039,321	1,098,372	1,165,772	1,246,468
Customer deposits	NA	NA	NA	NA	NA
Other deposits	NA	NA	NA	NA	NA
Other paying liabilities	150,063	133,555	131,298	139,355	149,001
Interest-bearing Liabilities	**1,136,412**	**1,206,444**	**1,261,551**	**1,333,287**	**1,419,248**
Gross Equity	**45,273**	**33,957**	**36,524**	**43,628**	**52,001**
Adjusted equity	**34,637**	**16,889**	**20,304**	**28,668**	**38,202**

BALANCE SHEET RATIOS	1999A	2000A	2001E	2002E	2003E
(%)					
Loan-to-deposit	96.4%	76.4%	70.2%	64.8%	60.5%
Equity to assets	3.8%	2.7%	2.8%	3.2%	3.5%
Total loan loss provisions	14.42%	4.96%	5.99%	5.81%	5.45%

ASSET QUALITY	1999A	2000A	2001E	2002E	2003E
Nonperforming assets	486,093	228,977	219,878	188,593	158,469
Special mention	26,316	24,261	20,912	17,762	15,086
Substandard	16,171	19,719	41,994	43,690	40,299
Doubtful	27,121	15,125	22,768	18,545	15,105
Loss	406,264	153,215	114,266	91,127	72,673
ORE	10,220	16,657	19,938	17,470	15,307
NPAs/total loans	52.5%	28.8%	28.5%	25.0%	21.0%
Reserve coverage of NPAs	35.1%	26.9%	35.4%	42.4%	50.6%
Required reserves	428,900	171,769	144,794	119,365	98,208
Actual reserves	170,417	61,537	77,781	79,974	80,214
Shortfall (surplus)	258,483	110,232	67,012	39,392	17,993
Actual to required reserves	40%	36%	54%	67%	82%
Shortfall to capital	571%	325%	183%	90%	35%

GROWTH RATES	1999A	2000A	2001E	2002E	2003E
(%)					
Income statement					
Net interest income	-11.3%	197.5%	8.5%	9.0%	-2.3%
Non-interest income	14.9%	-21.4%	-34.1%	5.2%	6.1%
Total operating income	6.9%	34.1%	-10.2%	7.8%	0.3%
Non-interest expenses	-25.9%	11.3%	-5.0%	0.2%	1.2%
Pre-provision earnings	-659.6%	95.6%	-18.1%	21.3%	-1.0%
Loan loss provisions	42.1%	-48.6%	-80.3%	-13.3%	-33.3%
Core earnings	41.4%	-66.0%	-123.2%	26.5%	17.9%
Net profit	**20.9%**	**-68.5%**	**-129.4%**	**28.2%**	**17.9%**
Balance sheet					
Loan growth	-2.7%	-14.3%	-2.9%	-2.0%	-0.3%
Interest earning assets	-14.7%	6.0%	5.1%	6.1%	6.9%
Asset growth	-6.7%	5.0%	4.6%	6.1%	6.9%
Deposit growth	-0.9%	8.1%	5.7%	6.1%	6.9%
Shareholders funds	-55.2%	-25.0%	7.6%	19.5%	19.2%

Source: Company reports; Lehman Brothers estimates.

Siam Commercial Bank

Racing For Solvency

Rating: 3-Market Perform

Ticker:	SCB.BK
Market Cap:	US$284MM
Shares Outstanding:	3,131 billion

We continue to favor SCB as the most financially strong Thai bank, which also has the lowest valuation; however, as the bank remains in poor condition our rating likewise remains.

SCB continues to be the only major Thai bank to consistently post positive core earnings by our methodology, showing a core ROAA of 0.38% on an annualized basis. SCB also has considerably more book equity than most of its competitors (8.6% of assets), which depresses ROE. As financial strength and stability are dominating traits in the current environment, we believe that SCB offers a more appropriate trade-off between risk and return.

SCB's net interest margin has slipped recently due to a rise in impaired assets, making the bank the only one of the big three to report such a shrinkage. While NIM of 2.42% is still comparatively high for the sector, declining NIM may be a harbinger of future problems in the bank's asset book. Asset quality, slack loan demand, and falling interest rates meant a falling asset yield, while cost of funds also came down, outpacing the decline in asset yield with a 27bp fall in the second quarter, meaning that interest spread actually increased after a fall in 1Q01. Adverse volume trends are however constraining NIM.

Management has attributed NPL backsliding to a slowdown in restructurings due to the TAMC; higher relapse rates in restructured NPLs; and the economy causing difficulties at a small number of major accounts. However, it is hard to see why these factors are affecting SCB disproportionately.

SCB's NPLs have begun to rise again, increasing in both 1Q01 and 2Q01, by a total of 11% from YE2000. This is not the result of a reduction in more-seriously distressed loans coupled with a rise in Special Mention of Substandard credits; weighted classified assets have also increased in each of the past two periods. SCB's poor margin experience on restructured loans (3.3%) seems to corroborate the theory that the bank is getting lower returns from its NPLs and restructured loans than is its competition.

SCB turns in one of the worst performances on our measure of actual reserves to required, having set aside only 26% of our theoretical figure; however, the bank turns in the best performance of any major Thai bank on our solvency measure, which measures the total reserve shortfall against total remaining equity. On this measure, SCB is close to solvency—as close to a victory in the sector as can be expected. Management currently plans to transfer a net THB7.6 billion in loans to the TAMC in two tranches; this figure is more likely to decline than to increase. The transfer will not materially change SCB's asset quality position; we anticipate based on current estimates that actual reserves would rise from 26% of required prior to the TAMC to 29% after.

Growth in performing loans has come to a halt over the past two quarters. Management currently projects a flat 2H01, excluding the impact of loans transferred to TAMC.

SCB currently trades at 0.76x book (0.89x adjusted book), on a trailing core ROE of 6.61%. On an earnings basis, SCB shares trade at 13.4x trailing and 22.1x 2001 EEPS (13.1x in FY2002). There is downside risk to these estimates, however, if criticized assets continue to rise as they have in 1H01. However, SCB is cheaper than its large Thai bank brethren.

SCB

Share Price:	15.00			**Index:**	284.97	**Reuters Code:**	SCB.BK			
52 Week Price Range:	14.50 - 31.25			**Current Yield:**	0.0%	**Bloomberg Code:**	SCB/F TB		**Shares Outstanding** (B):	3,131.15

INCOME STATEMENT	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
(THB mil) *year ending Dec*					
Interest income	40,892	36,667	33,702	34,138	36,889
Interest expense	31,104	21,442	17,251	16,700	19,081
Net interest income	**9,788**	**15,226**	**16,451**	**17,438**	**17,809**
Ave. int. earnings assets	*645,805*	*641,933*	*674,757*	*716,128*	*768,088*
NIM (%)	**1.52%**	**2.37%**	**2.44%**	**2.44%**	**2.32%**
Non-interest income	14,333	12,003	7,950	8,766	9,282
Total operating income	**24,121**	**27,229**	**24,401**	**26,204**	**27,091**
Non-interest expense	16,247	15,610	14,560	14,755	14,936
Pre provision profit	**7,874**	**11,619**	**9,841**	**11,448**	**12,155**
Loan loss provisions	43,285	6,577	7,017	6,000	6,000
Non-operating income	65	-1,216	108	103	102
Pre tax profit	**-35,346**	**3,825**	**2,931**	**5,551**	**6,258**
Tax	74	94	554	1,689	1,908
Net profit	**-35,550**	**3,560**	**2,162**	**3,656**	**4,145**
Core earnings	**-42,690**	**3,386**	**2,307**	**3,656**	**4,145**

PER SHARE DATA (THB)	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
EPS	(11.39)	1.14	0.69	1.17	1.32
DPS	0.00	0.00	0.00	0.00	0.00
Effective payout ratio (%)	*0%*	*0%*	*0%*	*0%*	*0%*
BVPS	17.21	19.50	20.34	21.51	22.83
ABVPS	16.09	16.67	17.67	19.04	20.56

VALUATION	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
Price to book value (x)	2.69	1.00	0.74	0.70	0.66
Price to adjusted book value (x)	2.87	1.17	0.85	0.79	0.73
Price to earnings (x)	(4.06)	17.15	21.73	12.85	11.33

PROFITABILITY RATIOS	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
(%)					
Net interest margin	1.52%	2.37%	2.44%	2.44%	2.32%
Yield on interest earning assets	6.52%	5.58%	4.87%	4.61%	4.63%
Cost on interest bearing liabilities	5.04%	3.35%	2.60%	2.35%	2.50%
Net interest spread	1.49%	2.23%	2.27%	2.26%	2.14%
Non-int. income (% Op income)	59.4%	44.1%	32.6%	33.5%	34.3%
Cost to income	67.4%	57.3%	59.7%	56.3%	55.1%
Overhead ratio	2.52%	2.43%	2.16%	2.06%	1.94%
Cost coverage	148.5%	174.4%	167.6%	177.6%	181.4%
ROA	-5.09%	0.50%	0.29%	0.47%	0.50%
ROE	-83.9%	7.0%	4.0%	6.4%	6.7%

OROA ANALYSIS	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
Net interest margin	1.52%	2.37%	2.44%	2.44%	2.32%
Non-interest inc./gross inc.	59.42%	44.08%	32.58%	33.45%	34.26%
Efficiency ratio	67.36%	57.33%	59.67%	56.31%	55.13%
Provision/assets	6.25%	0.92%	0.93%	0.75%	0.69%
Operating return on assets	**-5.04%**	**0.89%**	**0.52%**	**0.85%**	**0.89%**
Equity/assets	7.76%	8.49%	8.48%	8.39%	8.27%
Operating return on equity	**-64.9%**	**10.5%**	**6.2%**	**10.1%**	**10.7%**

BALANCE SHEET	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
(THB mil) *year ending Dec*					
Gross loans	494,119	491,212	472,226	469,865	474,582
Loan loss reserves	*23,325*	*25,548*	*28,931*	*32,582*	*36,218*
Net loans	470,794	465,664	443,295	437,283	438,364
Total earning assets	626,760	657,105	692,409	739,847	796,329
Other assets	65,290	61,684	59,006	63,048	67,862
Total Assets	**692,051**	**718,789**	**751,415**	**802,895**	**864,191**
Deposits	568,522	598,209	624,583	667,817	719,329
Customer deposits	NA	NA	NA	NA	NA
Other deposits	NA	NA	NA	NA	NA
Other paying liabilities	48,967	41,338	39,409	42,137	45,387
Interest-bearing Liabilities	**638,339**	**657,745**	**687,724**	**735,548**	**792,699**
Gross Equity	**53,711**	**61,043**	**63,691**	**67,347**	**71,492**
Adjusted equity	**50,212**	**52,201**	**55,321**	**59,627**	**64,371**

BALANCE SHEET RATIOS	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
(%)					
Loan-to-deposit	86.9%	82.1%	75.6%	70.4%	66.0%
Equity to assets	7.8%	8.5%	8.5%	8.4%	8.3%
Total loan loss provisions	3.37%	3.55%	3.85%	4.06%	4.19%

ASSET QUALITY	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
Nonperforming assets	185,152	149,553	154,052	133,260	112,565
Special mention	18,196	29,690	23,128	19,643	16,684
Substandard	31,720	22,482	33,446	34,798	32,096
Doubtful	23,926	14,872	19,103	15,560	12,674
Loss	102,107	72,703	68,768	54,842	43,736
ORE	9,203	9,806	9,606	8,417	7,375
NPAs/total loans	37.5%	30.4%	32.6%	28.4%	23.7%
Reserve coverage of NPAs	12.6%	17.1%	18.8%	24.4%	32.2%
Required reserves	126,385	91,626	91,364	75,697	62,495
Actual reserves	23,325	25,548	28,931	32,582	36,218
Shortfall (surplus)	103,060	66,078	62,433	43,115	26,278
Actual to required reserves	18%	28%	32%	43%	58%
Shortfall to capital	192%	108%	98%	64%	37%

GROWTH RATES	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
(%)					
Income statement					
Net interest income	-9.2%	55.6%	8.0%	6.0%	2.1%
Non-interest income	-2812.2%	-16.3%	-33.8%	10.3%	5.9%
Total operating income	135.2%	12.9%	-10.4%	7.4%	3.4%
Non-interest expenses	-6.1%	-3.9%	-6.7%	1.3%	1.2%
Pre-provision earnings	-211.6%	47.6%	-15.3%	16.3%	6.2%
Loan loss provisions	243.2%	-84.8%	6.7%	-14.5%	0.0%
Core earnings	430.8%	-107.9%	-31.9%	58.5%	13.4%
Net profit	**81.8%**	**-110.0%**	**-39.3%**	**69.1%**	**13.4%**
Balance sheet					
Loan growth	-9.2%	-0.6%	-3.9%	-0.5%	1.0%
Interest earning assets	-5.7%	4.8%	5.4%	6.9%	7.6%
Asset growth	-2.0%	3.9%	4.5%	6.9%	7.6%
Deposit growth	-3.8%	5.2%	4.4%	6.9%	7.7%
Shareholders funds	41.1%	13.7%	4.3%	5.7%	6.2%

Source: Company reports; Lehman Brothers estimates.

Thai Farmers Bank

What Price Quality?

Rating: 3-Market Perform

Ticker:	TFB.BK
Market Cap:	US$917MM
Shares Outstanding:	2,358 billion

TFB's underlying business is improving, but high expenses and the weight of NPLs argue against any near-term profit breakout.

TFB formed two AMCs in early 2000, Thonburi and Chantaburi, both fully-owned and hence consolidated, which took on approximately 39% of the bank's NPLs.

TFB came close to positive core income for the first time since 2Q00; although this shows signs of improvement, earnings increased mainly due to a fall-off in provisions. The large difference between pre-provision profit and net income is primarily due to write-downs on foreclosed property, which we treat as provisions.

TFB has been able to claw back some margin improvement by progressively reducing its deposit rates. Even though the yield on earning assets has fallen as well, the bank was thus able to increase both interest spread and NIM in 2Q01.

NPLs continue to move down, with gross criticized assets declining by 20% from a year ago and weighted classified assets at 24.8% of loans. However, NPLs of THB165 billion are still 33.8% of total loans. TFB has been able to outperform by virtue of its aggressive restructuring of loans through its two AMCs; management reports that the average yield on restructured loans is now 5–5.5%, as much as 200bp higher than the figures reported to us by other banks. Thonburi has resolved 27% of its transferred assets at an average of 73% of the transfer value, and expect a 50–60% total recovery on all assets. Chantaburi has resolved 53% of its transferred assets at an average recovery rate of 88%, but management expects this to fall as remaining NPLs are described as quite "sticky."

The bank expects to transfer THB8–9 billion in book value of loans to the TAMC, none of which will come from TFB's own AMCs (although the TAMC would accept them), as bank management feels that it is better placed to extract value than the government.

TFB's reserve is inadequate by our methodology, and required provisions would make the bank insolvent. Current ALLL is only 49% of our required metric, which leaves a shortfall of THB64.4 billion, or 2.6x equity. Loan growth continues to be poor on with management attributing this to the lack of credit-worthy borrowers (management will target loan sectors based on fee income growth potential rather than balance increases).

Expenses remain very high, forcing management to shed 2,000 staff via early retirement (target staffing of 8,000 by the end of 2003). TFB is also re-engineering its back-office operations, and projects total savings of 60% of present back-office costs (mid 2002 rollout). Finally, TFB is paring back its unprofitable rural office network, announcing that it will close 25 branches of its current 530. These branches will be replaced by 15–18 supermarket and department store branches which are significantly cheaper to operate.

TFB trades at 1.63x book (2.21x adjusted book), on a trailing core ROE of 3.95%. On an earnings basis, we expect most of TFB's income to go to provisions over the next three years; consequently the bank trades at 40.1x trailing (54.6x core) and 45.7x 2001 EEPS, falling to 16.8x in FY2002.

TFB

Share Price:	17.50	**Index:**	284.97
52 Week Price Range:	15.75 - 31.75	**Current Yield:**	0.0%
Reuters Code:	TFB.BK		
Bloomberg Code:	TFB/F TB	**Shares Outstanding** (B):	2,358.02

INCOME STATEMENT	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
(THB mil) *year ending Dec*					
Interest income	45,237	40,927	39,389	40,423	43,467
Interest expense	35,902	25,565	21,589	21,239	24,119
Net interest income	**9,336**	**15,362**	**17,800**	**19,184**	**19,347**
Ave. int. earnings assets	*686,810*	*692,729*	*734,259*	*782,256*	*839,014*
NIM (%)	**1.36%**	**2.22%**	**2.42%**	**2.45%**	**2.31%**
Non-interest income	3,416	8,054	9,831	8,800	9,395
Total operating income	**12,752**	**23,416**	**27,631**	**27,984**	**28,742**
Non-interest expense	17,775	20,560	20,574	20,374	20,590
Pre provision profit	**-5,023**	**2,856**	**7,057**	**7,610**	**8,152**
Loan loss provisions	50,646	712	5,649	4,000	4,000
Non-operating income	1,691	32	16	27	28
Pre tax profit	**-53,978**	**2,175**	**1,423**	**3,637**	**4,180**
Tax	2,634	847	488	1,119	1,287
Net profit	**-56,420**	**1,265**	**903**	**2,463**	**2,837**
Core earnings	**-54,836**	**746**	**22**	**2,463**	**2,837**

PER SHARE DATA (THB)	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
EPS	(23.93)	0.54	0.38	1.04	1.20
DPS	0.00	0.00	0.00	0.00	0.00
Effective payout ratio (%)	*0%*	*0%*	*0%*	*0%*	*0%*
BVPS	9.02	10.95	11.02	12.07	13.27
ABVPS	7.87	8.14	8.35	9.60	10.99

VALUATION	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
Price to book value (x)	6.98	1.96	1.59	1.45	1.32
Price to adjusted book value (x)	8.01	2.64	2.10	1.82	1.59
Price to earnings (x)	(2.63)	40.09	45.67	16.75	14.55

PROFITABILITY RATIOS	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
(%)					
Net interest margin	1.36%	2.22%	2.42%	2.45%	2.31%
Yield on interest earning assets	6.72%	5.75%	5.21%	5.00%	5.00%
Cost on interest bearing liabilities	5.20%	3.55%	2.86%	2.63%	2.77%
Net interest spread	1.52%	2.19%	2.35%	2.37%	2.23%
Non-int. income (% Op income)	26.8%	34.4%	35.6%	31.4%	32.7%
Cost to income	139.4%	87.8%	74.5%	72.8%	71.6%
Overhead ratio	2.59%	2.97%	2.80%	2.60%	2.45%
Cost coverage	71.7%	113.9%	134.3%	137.4%	139.6%
ROA	-7.62%	0.17%	0.11%	0.29%	0.32%
ROE	-168.3%	6.7%	4.6%	11.6%	11.7%

OROA ANALYSIS	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
Net interest margin	1.36%	2.22%	2.42%	2.45%	2.31%
Non-interest inc./gross inc.	26.79%	34.39%	35.58%	31.45%	32.69%
Efficiency ratio	139.39%	87.80%	74.46%	72.81%	71.64%
Provision/assets	6.99%	0.09%	0.70%	0.46%	0.43%
Operating return on assets	**-7.72%**	**0.32%**	**0.26%**	**0.51%**	**0.54%**
Equity/assets	2.94%	3.37%	3.20%	3.28%	3.35%
Operating return on equity	**-262.9%**	**9.5%**	**8.3%**	**15.6%**	**16.2%**

BALANCE SHEET	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
(THB mil) *year ending Dec*					
Gross loans	530,815	518,726	483,541	476,327	476,321
Loan loss reserves	*58,980*	*65,898*	*63,635*	*65,243*	*66,867*
Net loans	471,835	452,828	419,906	411,084	409,454
Total earning assets	673,288	712,171	756,347	808,165	869,863
Other assets	51,594	54,460	54,848	58,606	63,080
Total Assets	**724,882**	**766,630**	**811,195**	**866,771**	**932,943**
Deposits	608,554	646,997	680,670	727,787	783,925
Customer deposits	NA	NA	NA	NA	NA
Other deposits	NA	NA	NA	NA	NA
Other paying liabilities	81,466	72,662	75,302	80,515	86,725
Interest-bearing Liabilities	**703,602**	**740,810**	**785,203**	**838,316**	**901,651**
Gross Equity	**21,280**	**25,820**	**25,992**	**28,455**	**31,292**
Adjusted equity	**18,553**	**19,190**	**19,680**	**22,633**	**25,922**

BALANCE SHEET RATIOS	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
(%)					
Loan-to-deposit	87.2%	80.2%	71.0%	65.4%	60.8%
Equity to assets	2.9%	3.4%	3.2%	3.3%	3.4%
Total loan loss provisions	8.14%	8.60%	7.84%	7.53%	7.17%

ASSET QUALITY	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
Nonperforming assets	227,374	185,072	150,706	126,155	104,361
Special mention	9,178	9,835	10,142	8,614	7,317
Substandard	23,264	15,208	17,483	18,189	16,777
Doubtful	21,096	14,333	11,271	9,180	7,477
Loss	166,007	130,930	99,062	79,002	63,003
ORE	7,830	14,766	12,747	11,169	9,787
NPAs/total loans	42.8%	35.7%	31.2%	26.5%	21.9%
Reserve coverage of NPAs	25.9%	35.6%	42.2%	51.7%	64.1%
Required reserves	186,399	148,112	114,707	93,507	76,238
Actual reserves	58,980	65,898	63,635	65,243	66,867
Shortfall (surplus)	127,419	82,215	51,071	28,264	9,370
Actual to required reserves	32%	44%	55%	70%	88%
Shortfall to capital	599%	318%	196%	99%	30%

GROWTH RATES	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
(%)					
Income statement					
Net interest income	-27.3%	64.6%	15.9%	7.8%	0.9%
Non-interest income	-54.2%	135.7%	22.1%	-10.5%	6.8%
Total operating income	-37.2%	83.6%	18.0%	1.3%	2.7%
Non-interest expenses	-2.1%	15.7%	0.1%	-1.0%	1.1%
Pre-provision earnings	-334.5%	-156.9%	147.1%	7.8%	7.1%
Loan loss provisions	14.9%	-98.6%	692.9%	-29.2%	0.0%
Core earnings	44.0%	-101.4%	-97.1%	11313.4%	15.2%
Net profit	**40.6%**	**-102.2%**	**-28.6%**	**172.7%**	**15.2%**
Balance sheet					
Loan growth	-12.8%	-2.3%	-6.8%	-1.5%	0.0%
Interest earning assets	-3.9%	5.8%	6.2%	6.9%	7.6%
Asset growth	-4.2%	5.8%	5.8%	6.9%	7.6%
Deposit growth	-3.1%	6.3%	5.2%	6.9%	7.7%
Shareholders funds	-59.4%	21.3%	0.7%	9.5%	10.0%

Source: Company reports; Lehman Brothers estimates.

Krung Thai Bank

Balance Sheet Distress Clearing

Rating: 4-Market Underperform

Ticker:	KTB.BK
Market Cap:	US$2,241MM
Shares Outstanding:	21,985 billion

The government has recapitalized KTB to the point where it is now the only solvent Thai commercial bank by our methodology, however the bank continues to have weak earnings, high NPLs, and low efficiency.

Krung Thai swung back into the red in 2Q01, after posting only one quarter of profit since 1Q98, as provisions once again rose to crisis levels. However, all news is not bad, as we find that asset quality improved slightly despite the high bad debt charge—even net of write-offs. We do not see any risk at this point that KTB will be forced to discontinue its operations, but we are worried about the bank's apparent desire to make political hay through accelerated policy lending. The state-owned nature of the bank also makes it a potential candidate to rescue other state institutions which are not solvent, a potential which holds obvious risks for investors in KTB.

Net interest margin improved by 15bp in the second quarter to 2.09%, due to stable asset yields that are however well below those of the major banks. We attribute this in large part to the THB321 billion in special government notes given to KTB as part of the transfer of the bank's bad debts into SAM that pay only KTB's average savings. The bank continues to benefit from special government and SOE deposits on its liability side (~40% of total deposits), contributing to a cost of funds the lowest of the Thai banks.

Asset quality is poor, with NPLs/Loans falling below 30%—still an unacceptable level but in line with the industry—and weighted classifications at 15.6%, indicating that a substantial portion of KTB's remaining NPLs are in the less-severe Special Mention and Substandard categories. The danger for KTB now is that these non-Loss NPLs continue to worsen in quality with the faltering economy, and wind up migrating into more-severe categories with correspondingly higher reserve requirements and loss expectations.

An additional area of caution stems from KTB's close relationship with the government. Krung Thai has kicked lending into gear on the commitment and origination end, but this is not yet translating into sustained balance growth, particularly in terms of performing loans. So far this year, KTB has made large commitments to fund such political darlings as airport and commuter rail service projects in Bangkok.

KTB's reserve is inadequate along with those of all of its peers, but there is a substantial and positive distinction. By our calculations, KTB is the only Thai bank whose reserve underfunding is less than its equity—meaning that Krung Thai remains the only solvent commercial bank in Thailand.

A measure that adjusts for both equity and reserves, our "deposit franchise" calculation shows Krung Thai is still expensive at a 21.8% premium on deposits—well above the Thai average and that of other regional markets.

KTB is overstaffed and overbranched, and needs to cut back to a more sustainable level in order to get overhead costs down. Even at its sharply reduced trading price, KTB shares are still valued at 3.3x book and 3.6x adjusted book. Although the bank does deserve a premium to the rest of the sector given its solvency, this is still high by regional standards, especially as we project single-digit forward ROEs.

KTB

Share Price:	9.00	**Index:**	284.97
52 Week Price Range:	8.20 - 15.25	**Current Yield:**	0.0%
Reuters Code:	KTB.BK		
Bloomberg Code:	KTB/F TB	**Shares Outstanding** (B):	21,985.00

INCOME STATEMENT	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
(THB mil) *year ending Dec*					
Interest income	48,510	42,105	40,642	40,582	41,986
Interest expense	42,484	28,404	20,369	18,615	20,749
Net interest income	**6,026**	**13,701**	**20,274**	**21,967**	**21,237**
Ave. int. earnings assets	*883,233*	*932,727*	*938,466*	*959,395*	*994,354*
NIM (%)	**0.68%**	**1.47%**	**2.16%**	**2.29%**	**2.14%**
Non-interest income	6,483	4,410	6,162	6,235	6,403
Total operating income	**12,509**	**18,111**	**26,435**	**28,202**	**27,641**
Non-interest expense	19,145	19,202	19,391	20,190	20,439
Pre provision profit	**-6,636**	**-1,091**	**7,044**	**8,012**	**7,202**
Loan loss provisions	84,384	27,790	12,490	4,000	4,000
Non-operating income	0	108,000	0	0	0
Pre tax profit	**-91,019**	**79,119**	**-5,446**	**4,012**	**3,202**
Tax	2	2,858	517	1,244	993
Net profit	**-91,022**	**76,261**	**-5,963**	**2,768**	**2,209**
Core earnings	**-91,022**	**-29,442**	**-5,681**	**2,768**	**2,209**

PER SHARE DATA (THB)	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
EPS	(4.14)	3.47	(0.53)	0.25	0.20
DPS	0.00	0.00	0.00	0.00	0.00
Effective payout ratio (%)	*0%*	*0%*	*0%*	*0%*	*0%*
BVPS	4.65	2.98	5.41	5.66	5.85
ABVPS	4.46	2.80	5.07	5.34	5.56

VALUATION	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
Price to book value (x)	4.25	3.69	1.66	1.59	1.54
Price to adjusted book value (x)	4.43	3.93	1.78	1.69	1.62
Price to earnings (x)	(4.77)	3.17	-16.88	36.36	45.56

PROFITABILITY RATIOS	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
(%)					
Net interest margin	0.68%	1.47%	2.16%	2.29%	2.14%
Yield on interest earning assets	5.20%	4.51%	4.31%	4.16%	4.14%
Cost on interest bearing liabilities	4.86%	3.26%	2.27%	2.01%	2.15%
Net interest spread	0.35%	1.25%	2.03%	2.15%	1.99%
Non-int. income (% Op income)	51.8%	24.4%	23.3%	22.1%	23.2%
Cost to income	153.0%	106.0%	73.4%	71.6%	73.9%
Overhead ratio	2.17%	2.06%	2.07%	2.10%	2.06%
Cost coverage	65.3%	94.3%	136.3%	139.7%	135.2%
ROA	-8.84%	7.68%	-0.60%	0.27%	0.21%
ROE	-102.7%	95.6%	-10.1%	4.8%	3.6%

OROA ANALYSIS	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
Net interest margin	0.68%	1.47%	2.16%	2.29%	2.14%
Non-interest inc./gross inc.	51.83%	24.35%	23.31%	22.11%	23.17%
Efficiency ratio	153.05%	106.02%	73.35%	71.59%	73.94%
Provision/assets	8.48%	2.81%	1.25%	0.39%	0.37%
Operating return on assets	**-9.23%**	**-2.92%**	**-0.50%**	**0.45%**	**0.35%**
Equity/assets	10.27%	6.62%	6.07%	6.15%	6.12%
Operating return on equity	**-89.9%**	**-44.2%**	**-8.3%**	**7.3%**	**5.7%**

BALANCE SHEET	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
(THB mil) *year ending Dec*					
Gross loans	935,042	389,108	390,903	377,397	370,834
Loan loss reserves	*226,121*	*13,916*	*28,711*	*30,802*	*32,938*
Net loans	708,921	375,192	362,192	346,594	337,897
Total earning assets	932,546	932,908	944,025	974,765	1,013,943
Other assets	62,274	57,185	52,557	54,268	56,450
Total Assets	**994,819**	**990,093**	**996,582**	**1,029,033**	**1,070,392**
Deposits	802,102	818,977	852,253	880,289	916,032
Customer deposits	NA	NA	NA	NA	NA
Other deposits	NA	NA	NA	NA	NA
Other paying liabilities	72,839	51,417	43,853	45,296	47,135
Interest-bearing Liabilities	**892,634**	**924,531**	**936,085**	**965,768**	**1,004,918**
Gross Equity	**102,185**	**65,561**	**60,497**	**63,265**	**65,475**
Adjusted equity	**98,004**	**61,556**	**56,659**	**59,725**	**62,209**

BALANCE SHEET RATIOS	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
(%)					
Loan-to-deposit	116.6%	47.5%	45.9%	42.9%	40.5%
Equity to assets	10.3%	6.6%	6.1%	6.1%	6.1%
Total loan loss provisions	22.73%	1.41%	2.88%	2.99%	3.08%

ASSET QUALITY	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
Nonperforming assets	427,782	110,050	109,232	94,411	79,921
Special mention	19,578	17,074	19,719	16,749	14,225
Substandard	29,745	14,647	20,886	21,729	20,043
Doubtful	10,390	7,151	7,498	6,107	4,974
Loss	598,710	57,347	47,459	37,848	30,184
ORE	7,013	13,833	13,671	11,978	10,495
NPAs/total loans	45.7%	28.3%	27.9%	25.0%	21.6%
Reserve coverage of NPAs	52.9%	12.6%	26.3%	32.6%	41.2%
Required reserves	615,417	70,446	62,058	51,430	42,504
Actual reserves	226,121	13,916	28,711	30,802	32,938
Shortfall (surplus)	389,297	56,531	33,347	20,628	9,566
Actual to required reserves	37%	20%	46%	60%	77%
Shortfall to capital	381%	86%	55%	33%	15%

GROWTH RATES	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
(%)					
Income statement					
Net interest income	-100.0%	127.4%	48.0%	8.4%	-3.3%
Non-interest income	-11.3%	-32.0%	39.7%	1.2%	2.7%
Total operating income	-37.6%	44.8%	46.0%	6.7%	-2.0%
Non-interest expenses	16.4%	0.3%	1.0%	4.1%	1.2%
Pre-provision earnings	-284.9%	-83.6%	-745.7%	13.7%	-10.1%
Loan loss provisions	29.8%	-67.1%	-55.1%	-68.0%	0.0%
Core earnings	52.7%	-67.7%	-80.7%	-148.7%	-20.2%
Net profit	**47.8%**	**-183.8%**	**-107.8%**	**-146.4%**	**-20.2%**
Balance sheet					
Loan growth	-2.3%	-58.4%	0.5%	-3.5%	-1.7%
Interest earning assets	-100.0%	0.0%	1.2%	3.3%	4.0%
Asset growth	-100.0%	-0.5%	0.7%	3.3%	4.0%
Deposit growth	-100.0%	2.1%	4.1%	3.3%	4.1%
Shareholders funds	-100.0%	-35.8%	-7.7%	4.6%	3.5%

Source: Company reports; Lehman Brothers estimates.

Bank of Ayudhya

Proud Franchise, Hard Times

Rating: 4-Market Underperform

Ticker:	BAY.BK
Market Cap:	US$190MM
Shares Outstanding:	1,850 billion

Though doing well in certain aspects of its operating performance—reserve under-funding continues to be a dominating factor for the bank, even after transfers to the TAMC.

While some operating trends have improved, BAY has taken money out of its loan loss reserve via negative provisioning for four consecutive quarters. This action is unequivocally unwarranted as BAY's reserve remains direly under-funded by our standards. However, the bank has made progress on lowering its expense base as promised, and overhead costs are falling. Specifically, management implemented a plan to reduce staff by 10% from the April level of 9,731 via early retirement incentives.

Net interest margin declined by 13bp in 2Q01, from an already anemic 1.38%. BAY's problem is not so much its asset yield—but its cost of funds, which remains quite elevated due to a high level of non-deposit funding, including long-term borrowings and a 1999 issue of SLIPs (Stapled Limited Interest Preferred Shares) that pay a minimum rate of 11%. Unfortunately, it will be difficult for the bank to eliminate this disadvantage without growing the balance sheet to dilute existing high-yield liabilities.

Asset quality at BAY is basically in line with the industry—the bank lags, however, in provisions, which are markedly insufficient. NPLs though have resumed their downward trend after a worrisome upward blip in 1Q01 and the severity of the NPL mix is also declining, with weighted classifications dropping from 20.0% at YE2000 to 18.6%. Management disclosed the bank is making strides in selling ORE, offloading THB2 billion in foreclosed property since the close of 2Q for a profit of THB200 million..

Management believes that there will be another tranche of transfers to the TAMC within 12–18 months.

BAY plans to transfer all acceptable loans (face value of THB12 billion and net book value of THB8 billion) to the TAMC. This is approximately 10% of NPLs. Once the TAMC transfer is completed, BAY plans to transfer an additional THB8 billion in NPLs to its own AMC, primarily for the benefits of the longer holding period on real estate afforded such entities.

BAY's reserves against known bad loans are insufficient, with the bank's actual provisions accounting for only 13% of our required reserve amount and the difference amounting to some 3.4x equity. The bank has done well on loan growth, although figures remain close to zero. BAY's renewed focus on housing loans and credit cards (via a joint venture with GE Capital, which has doubled BAY's previous card base since its inception in March 2001) has paid dividends.

Our deposit franchise calculation shows that BAY continues to be expensive, at a 14.8% premium on deposits—well above the average for other Asian markets.

BAY trades at 0.50x book value (0.64x adjusted book value)—however, book value is significantly negative after subtracting reserve underfunding, making this measure a bad touchstone for industry comparison. As we expect losses through FY2004 (assuming provisioning sufficient to reach 50% of YE2004 reserve adequacy by our methodology), BAY can not be measured on earnings.

BAY

Share Price:	4.60	**Index:**	284.97	
52 Week Price Range:	4.30 - 9.60	**Current Yield:**	0.0%	
Reuters Code:	BAY.BK			
Bloomberg Code:	BAY/F TB	**Shares Outstanding** (B):	1,850.33	

INCOME STATEMENT	1999A	2000A	2001E	2002E	2003E
(THB mil) *year ending Dec*					
Interest income	26,934	22,688	19,546	19,456	20,250
Interest expense	23,747	16,638	14,015	13,420	14,395
Net interest income	**3,187**	**6,050**	**5,531**	**6,036**	**5,854**
Ave. int. earnings assets	*435,518*	*404,528*	*403,547*	*409,761*	*419,487*
NIM (%)	**0.73%**	**1.50%**	**1.37%**	**1.47%**	**1.40%**
Non-interest income	2,676	1,540	1,836	1,977	2,186
Total operating income	**5,863**	**7,590**	**7,367**	**8,014**	**8,041**
Non-interest expense	10,616	9,900	8,458	8,402	8,503
Pre provision profit	**-4,753**	**-2,310**	**-1,091**	**-388**	**-463**
Loan loss provisions	17,713	6,788	860	4,000	4,000
Non-operating income	-520	-579	-207	23	23
Pre tax profit	**-22,986**	**-9,678**	**-2,159**	**-4,365**	**-4,440**
Tax	27	10	-744	-1,360	-1,383
Net profit	**-21,973**	**-8,530**	**-1,464**	**-3,051**	**-3,102**
Core earnings	**-22,384**	**-8,561**	**-1,143**	**-3,051**	**-3,102**

PER SHARE DATA (THB)	1999A	2000A	2001E	2002E	2003E
EPS	(11.88)	(4.61)	(0.79)	(1.65)	(1.68)
DPS	0.00	0.00	0.00	0.00	0.00
Effective payout ratio (%)	*0%*	*0%*	*0%*	*0%*	*0%*
BVPS	12.39	8.36	8.31	6.66	4.99
ABVPS	11.72	7.53	6.33	4.83	3.30

VALUATION	1999A	2000A	2001E	2002E	2003E
Price to book value (x)	1.29	0.62	0.55	0.69	0.92
Price to adjusted book value (x)	1.37	0.69	0.73	0.95	1.39
Price to earnings (x)	(1.35)	(1.13)	-5.81	-2.79	-2.74

PROFITABILITY RATIOS	1999A	2000A	2001E	2002E	2003E
(%)					
Net interest margin	0.73%	1.50%	1.37%	1.47%	1.40%
Yield on interest earning assets	6.61%	5.65%	4.82%	4.70%	4.77%
Cost on interest bearing liabilities	5.71%	4.05%	3.38%	3.17%	3.31%
Net interest spread	0.91%	1.60%	1.44%	1.53%	1.46%
Non-int. income (% Op income)	45.6%	20.3%	24.9%	24.7%	27.2%
Cost to income	181.1%	130.4%	114.8%	104.8%	105.8%
Overhead ratio	2.44%	2.45%	2.10%	2.05%	2.03%
Cost coverage	55.2%	76.7%	87.1%	95.4%	94.6%
ROA	-4.72%	-1.93%	-0.33%	-0.68%	-0.68%
ROE	-93.0%	-47.9%	-11.4%	-29.5%	-41.2%

OROA ANALYSIS	1999A	2000A	2001E	2002E	2003E
Net interest margin	0.73%	1.50%	1.37%	1.47%	1.40%
Non-interest inc./gross inc.	45.65%	20.29%	24.92%	24.67%	27.19%
Efficiency ratio	181.06%	130.44%	114.82%	104.84%	105.75%
Provision/assets	3.97%	1.56%	0.19%	0.89%	0.86%
Operating return on assets	**-5.06%**	**-2.13%**	**-0.47%**	**-0.98%**	**-0.98%**
Equity/assets	5.13%	3.56%	3.48%	2.73%	1.99%
Operating return on equity	**-98.5%**	**-59.9%**	**-13.4%**	**-35.9%**	**-48.9%**

BALANCE SHEET	1999A	2000A	2001E	2002E	2003E
(THB mil) *year ending Dec*					
Gross loans	361,340	329,094	331,953	328,645	331,944
Loan loss reserves	*30,078*	*8,584*	*10,255*	*12,605*	*14,952*
Net loans	331,262	320,510	321,698	316,040	316,993
Total earning assets	407,172	401,885	405,210	414,312	424,662
Other assets	39,360	33,228	36,155	36,967	37,891
Total Assets	**446,532**	**435,112**	**441,366**	**451,279**	**462,552**
Deposits	361,178	361,631	366,268	374,578	384,031
Customer deposits	NA	NA	NA	NA	NA
Other deposits	NA	NA	NA	NA	NA
Other paying liabilities	55,056	49,230	(366,268)	(374,578)	(384,031)
Interest-bearing Liabilities	**423,603**	**419,640**	**425,989**	**438,953**	**453,328**
Gross Equity	**22,929**	**15,472**	**15,377**	**12,326**	**9,225**
Adjusted equity	**21,682**	**13,934**	**11,711**	**8,945**	**6,106**

BALANCE SHEET RATIOS	1999A	2000A	2001E	2002E	2003E
(%)					
Loan-to-deposit	100.0%	91.0%	90.6%	87.7%	86.4%
Equity to assets	5.1%	3.6%	3.5%	2.7%	2.0%
Total loan loss provisions	6.74%	1.97%	2.32%	2.79%	3.23%

ASSET QUALITY	1999A	2000A	2001E	2002E	2003E
Nonperforming assets	125,218	97,705	91,779	78,550	66,011
Special mention	8,136	9,565	8,349	7,091	6,023
Substandard	14,776	11,346	15,806	16,444	15,168
Doubtful	8,153	4,305	4,489	3,656	2,978
Loss	96,460	61,047	50,321	40,131	32,004
ORE	7,750	11,442	12,815	11,229	9,838
NPAs/total loans	34.7%	29.7%	27.6%	23.9%	19.9%
Reserve coverage of NPAs	24.0%	8.8%	11.2%	16.0%	22.7%
Required reserves	106,237	68,375	61,237	50,461	41,553
Actual reserves	30,078	8,584	10,255	12,605	14,952
Shortfall (surplus)	76,158	59,791	50,982	37,856	26,601
Actual to required reserves	28%	13%	17%	25%	36%
Shortfall to capital	332%	386%	332%	307%	288%

GROWTH RATES	1999A	2000A	2001E	2002E	2003E
(%)					
Income statement					
Net interest income	-30.9%	89.8%	-8.6%	9.1%	-3.0%
Non-interest income	219.9%	-42.5%	19.2%	7.7%	10.6%
Total operating income	7.5%	29.4%	-2.9%	8.8%	0.3%
Non-interest expenses	4.6%	-6.7%	-14.6%	-0.7%	1.2%
Pre-provision earnings	1.2%	-51.4%	-52.8%	-64.4%	19.2%
Loan loss provisions	284.6%	-61.7%	-87.3%	365.2%	0.0%
Core earnings	267.8%	-61.8%	-86.7%	166.9%	1.7%
Net profit	**129.5%**	**-61.2%**	**-82.8%**	**108.4%**	**1.7%**
Balance sheet					
Loan growth	-1.3%	-8.9%	0.9%	-1.0%	1.0%
Interest earning assets	-12.2%	-1.3%	0.8%	2.2%	2.5%
Asset growth	-7.7%	-2.6%	1.4%	2.2%	2.5%
Deposit growth	-10.6%	0.1%	1.3%	2.3%	2.5%
Shareholders funds	-14.7%	-32.5%	-0.6%	-19.8%	-25.2%

Source: Company reports; Lehman Brothers estimates.

Thai Military Bank

Trench Warfare

Rating: 4-Market Underperform

Ticker:	TMB.BK
Market Cap:	US$224MM
Shares Outstanding:	4,002 million

While operating measures are improving somewhat, structural insolvency due to bad debts is the dominating factor—it will be difficult if not impossible for operating income to pull the bank out of its deep financial hole in any reasonable amount of time.

The bank returned to positive net income in 1Q01 for the first time following 13 consecutive quarters of losses, and increased this profit in 2Q01. Pre-provision earnings have also been positive for two quarters, and core income also turned positive in 2Q01. The main problem though is that TMB's net asset quality position has not improved in the past year—even though gross NPLs are down by 11% YoY and weighted classifications have fallen from 9.89% to 8.91% over the same period.

TMB's net interest margin remains low at 1.49%, but has come up sharply since the beginning of the year. In part this is due to a rise in asset yield—an anomaly among the Thai banks in our universe. As foregone interest from classified loans has not changed materially, we believe that the increase has come primarily from growth in performing loans—another mark of distinction in Thailand. On the liability side, TMB has been reducing its cost of funds; we believe that the bank will continue to have an elevated COF due to high-cost debt instruments on the balance sheet. Spread improvements are outpacing margin gains as deposits expand quickly: we are curious as to whether this indicates liquidity issues or is just an opportunity for better balance sheet management.

TMB has posted QoQ growth in performing loans during five of the past six quarters, indicating that the bank is taking market share. In 1H01, management reports that total originations were approximately THB12 billion, which resulted in balance increases of THB6 billion. The bank is targeting total originations of THB30 billion for the full year, implying 8.2% growth in performing loans in 2H01.

Note that the implied loss ratio assumes that no loans were upgraded to performing status during this period (*i.e.*, there were zero restructurings), and that no recoveries on past write-downs were taken. Even under these heroic assumptions the actual loss sustained was 25.9%, or almost 3x TMB's reserve coverage of remaining NPLs. Furthermore, we believe based on consistent reports from other bankers that the "easy" NPLs have already been restructured, and that what remains will be considerably more difficult to cure.

Our standard model for predicting future losses and reserve adequacy shows a required allowance of THB64 billion for TMB, against which the bank holds just THB9 billion in actual reserves, or 14% of required. The shortfall of THB55 billion is 4.6x book equity. This ratio has been rising for some time. While the TAMC was once expected to remove the bulk of TMB's NPLs, the bank now expects to transfer at most THB8.9 billion in bad loans to the government corporation.

TMB trades at 1.7x stated book (1.8x adjusted book), but reserve underfunding makes this measure moot. On a deposit franchise basis, the bank trades at a 21.7% premium on its deposit base—far too high.

TMB

Share Price:	5.00	**Index:**	284.97	**Reuters Code:**	TMB.BK			
52 Week Price Range:	4.50 - 9.60	**Current Yield:**	0.0%	**Bloomberg Code:**	TMB/F TB	**Shares Outstanding** (B):	4,002.97	

INCOME STATEMENT	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
(THB mil) *year ending Dec*					
Interest income	19,239	14,888	16,485	17,300	18,410
Interest expense	17,313	12,942	11,683	11,609	12,918
Net interest income	**1,925**	**1,946**	**4,802**	**5,691**	**5,493**
Ave. int. earnings assets	*339,635*	*314,640*	*328,600*	*353,443*	*376,324*
NIM (%)	**0.57%**	**0.62%**	**1.46%**	**1.61%**	**1.46%**
Non-interest income	2,206	2,353	3,717	3,546	3,738
Total operating income	**4,131**	**4,299**	**8,518**	**9,237**	**9,230**
Non-interest expense	6,617	6,112	6,095	6,150	6,225
Pre provision profit	**-2,487**	**-1,813**	**2,424**	**3,087**	**3,005**
Loan loss provisions	9,110	23,220	2,808	4,000	4,000
Non-operating income	0	0	0	0	0
Pre tax profit	**-11,597**	**-25,033**	**-385**	**-913**	**-995**
Tax	27	31	-166	-283	-308
Net profit	**-11,624**	**-25,064**	**-218**	**-630**	**-687**
Core earnings	**-11,624**	**-25,037**	**-545**	**-630**	**-687**

PER SHARE DATA (THB)	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
EPS	(11.45)	(6.26)	(0.05)	(0.16)	(0.17)
DPS	0.00	0.00	0.00	0.00	0.00
Effective payout ratio (%)	*0%*	*0%*	*0%*	*0%*	*0%*
BVPS	8.73	3.26	2.87	2.72	2.54
ABVPS	7.73	3.01	2.64	2.50	2.35

VALUATION	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
Price to book value (x)	1.83	1.60	1.74	1.84	1.96
Price to adjusted book value (x)	2.07	1.73	1.89	2.00	2.13
Price to earnings (x)	(1.40)	(0.83)	-91.67	-31.76	-29.15

PROFITABILITY RATIOS	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
(%)					
Net interest margin	0.57%	0.62%	1.46%	1.61%	1.46%
Yield on interest earning assets	6.11%	4.74%	4.81%	4.75%	4.74%
Cost on interest bearing liabilities	5.43%	4.22%	3.43%	3.21%	3.34%
Net interest spread	0.67%	0.52%	1.37%	1.54%	1.39%
Non-int. income (% Op income)	53.4%	54.7%	43.6%	38.4%	40.5%
Cost to income	160.2%	142.2%	71.5%	66.6%	67.4%
Overhead ratio	1.95%	1.94%	1.85%	1.74%	1.65%
Cost coverage	62.4%	70.3%	139.8%	150.2%	148.3%
ROA	-3.37%	-7.46%	-0.06%	-0.17%	-0.17%
ROE	-105.1%	-252.0%	-1.9%	-6.1%	-7.1%

OROA ANALYSIS	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
Net interest margin	0.57%	0.62%	1.46%	1.61%	1.46%
Non-interest inc./gross inc.	53.39%	54.73%	43.63%	38.39%	40.49%
Efficiency ratio	160.20%	142.17%	71.55%	66.58%	67.45%
Provision/assets	2.72%	6.90%	0.76%	1.02%	0.95%
Operating return on assets	**-3.45%**	**-7.48%**	**-0.02%**	**-0.15%**	**-0.16%**
Equity/assets	2.64%	3.87%	3.11%	2.77%	2.43%
Operating return on equity	**-130.5%**	**-193.0%**	**-0.7%**	**-5.3%**	**-6.4%**

BALANCE SHEET	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
(THB mil) *year ending Dec*					
Gross loans	282,342	264,022	268,919	263,581	266,227
Loan loss reserves	*21,261*	*10,907*	*10,329*	*13,001*	*15,675*
Net loans	261,081	253,115	258,591	250,580	250,552
Total earning assets	315,106	314,175	343,026	363,860	388,788
Other assets	19,897	22,382	26,937	28,573	30,531
Total Assets	**335,002**	**336,557**	**369,963**	**392,433**	**419,319**
Deposits	259,843	268,490	304,485	323,169	345,539
Customer deposits	NA	NA	NA	NA	NA
Other deposits	NA	NA	NA	NA	NA
Other paying liabilities	58,825	38,481	35,909	38,112	40,750
Interest-bearing Liabilities	**326,143**	**323,524**	**358,459**	**381,559**	**409,132**
Gross Equity	**8,859**	**13,033**	**11,504**	**10,874**	**10,187**
Adjusted equity	**7,846**	**12,044**	**10,566**	**10,009**	**9,389**

BALANCE SHEET RATIOS	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
(%)					
Loan-to-deposit	108.7%	98.3%	88.3%	81.6%	77.0%
Equity to assets	2.6%	3.9%	3.1%	2.8%	2.4%
Total loan loss provisions	6.35%	3.24%	2.79%	3.31%	3.74%

ASSET QUALITY	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
Nonperforming assets	142,104	112,423	96,193	87,641	80,473
Special mention	26,500	16,094	14,054	12,442	11,015
Substandard	14,600	27,185	17,296	18,722	20,265
Doubtful	11,800	11,733	9,942	8,802	7,792
Loss	84,900	52,833	47,538	41,224	35,748
ORE	4,304	4,577	7,364	6,452	5,653
NPAs/total loans	50.3%	42.6%	35.8%	33.3%	30.2%
Reserve coverage of NPAs	15.0%	9.7%	10.7%	14.8%	19.5%
Required reserves	97,450	67,476	59,944	53,105	47,293
Actual reserves	21,261	10,907	10,329	13,001	15,675
Shortfall (surplus)	76,189	56,570	49,615	40,104	31,618
Actual to required reserves	22%	16%	17%	24%	33%
Shortfall to capital	860%	434%	431%	369%	310%

GROWTH RATES	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
(%)					
Income statement					
Net interest income	-35.2%	1.1%	146.7%	18.5%	-3.5%
Non-interest income	115.1%	6.7%	57.9%	-4.6%	5.4%
Total operating income	3.3%	4.1%	98.1%	8.4%	-0.1%
Non-interest expenses	-4.7%	-7.6%	-0.3%	0.9%	1.2%
Pre-provision earnings	-15.5%	-27.1%	-233.7%	27.4%	-2.7%
Loan loss provisions	-7.6%	154.9%	-87.9%	42.4%	0.0%
Core earnings	7.0%	115.4%	-97.8%	15.7%	9.0%
Net profit	**-9.5%**	**115.6%**	**-99.1%**	**188.6%**	**9.0%**
Balance sheet					
Loan growth	-2.7%	-6.5%	1.9%	-2.0%	1.0%
Interest earning assets	-13.5%	-0.3%	9.2%	6.1%	6.9%
Asset growth	-5.5%	0.5%	9.9%	6.1%	6.9%
Deposit growth	-11.5%	3.3%	13.4%	6.1%	6.9%
Shareholders funds	-42.2%	47.1%	-11.7%	-5.5%	-6.3%

Source: Company reports; Lehman Brothers estimates.

IFCT

Closer To Banks, But Still Distinct

Rating: 3-Market Perform

Ticker:	IFCT.BK
Market Cap:	US$135MM
Shares Outstanding:	1,162 million

IFCT does not wish to become a commercial bank and is not seeking the issuance of a new charter. Management however has petitioned the Ministry of Finance for permission to offer additional products: deposit accounts and foreign exchange facilities.

New deposit products will be offered and management plans to use its deposit license to attract additional funding rather than to replace existing debenture sales. The main rationale is to lower IFCT's cost of funds, a perennial problem. Additionally, these new products are intended to help IFCT hang on to its "upper-end SME" clientele now that commercial banks are hungry enough for loan growth to begin encroaching on the bank's historic turf.

Due to its special status, IFCT is not covered under the existing bill establishing the TAMC, but may request permission to be included. However, based on the current criteria, IFCT would have approximately THB10 billion in gross eligible assets, or 29% of total criticized assets; the net figure is not known but is estimated at THB6 billion.

IFCT's net interest margin and spreads remain negative, with NIM improving by 5bp to –0.20% in the second quarter. Asset yields have seen a precipitous fall in recent quarters, declining by almost 70bp in 2Q01 alone. Although funding costs are more than keeping pace, IFCT continues to pay considerably more for its funding than do other major commercial banks. During 1Q01, the corporation took advantage of low interest rates to refinance Bt11 billion of debentures with a coupon rate of 9% or higher, issuing new 4% one-year and 5% three-year notes, which should help continue to reduce funding costs going forward, but improvements elsewhere will be slow going.

The bank has received approval from the MOF to study raising capital via an equity offering or Tier 2 issue—we suspect neither is practicable— equity because the markets would not be receptive and Tier 2 because it is too expensive.

Asset quality remains worse than at year-end, but shows some signs of improvement from 1Q01. Management reports that restructured NPL relapses are now around 10%, up from 5–6% in FY2000, which may lead to bad assets re-entering the bank's books at a faster rate than they can be restructured in the future. Reserve coverage also continues to be low; by our model of required reserves the bank has provisioned only 30% of its required level, with the remaining shortfall equal to over 2.6x equity.

IFCT has bucked the tide on loan growth, managing to show increases in both total loans and performing loans on a fairly consistent basis—making it somewhat odd that asset yields have come off so sharply. We do note that the IFCT has largely continued in its development role, providing loans to projects at concessionary interest rates. We believe that IFCT, like other government run banks, has experienced pressure to take part in the government's directed lending initiatives aimed at spurring on the economy—a tricky business in the best of times.

IFCT currently trades at 0.74x book (0.80x adjusted book value). Book value is negative after subtracting reserve underfunding however, and with losses expected into next year, IFCT is also unsusceptible to earnings valuation measures. Using our deposit franchise calculation, an acquisitor would pay a 10.9% premium on IFCT's debenture funding base.

IFCT

Share Price:	5.20	**Index:**	284.97
52 Week Price Range:	4.90 - 10.25	**Current Yield:**	0.0%

Reuters Code:	IFCT.BK		
Bloomberg Code:	IFCT/F TB	**Shares Outstanding** (B):	1,161.62

INCOME STATEMENT	1999A	2000A	2001E	2002E	2003E
(THB mil) *year ending Dec*					
Interest income	9,525	8,633	8,486	8,384	8,914
Interest expense	11,614	10,531	8,891	8,672	8,997
Net interest income	**-2,089**	**-1,898**	**-405**	**-288**	**-84**
Ave. int. earnings assets	*168,155*	*162,406*	*174,608*	*190,105*	*203,153*
NIM (%)	**-1.24%**	**-1.17%**	**-0.23%**	**-0.15%**	**-0.04%**
Non-interest income	820	1,230	831	677	712
Total operating income	**-1,269**	**-668**	**426**	**389**	**628**
Non-interest expense	556	722	658	640	646
Pre provision profit	**-1,825**	**-1,390**	**-232**	**-251**	**-18**
Loan loss provisions	6,046	280	205	400	400
Non-operating income	37	-22	-131	-130	-129
Pre tax profit	**-7,834**	**-1,693**	**-568**	**-781**	**-547**
Tax	0	0	-126	-202	-129
Net profit	**-7,908**	**-1,649**	**-180**	**-320**	**-159**
Core earnings	**-7,208**	**-1,656**	**-344**	**-320**	**-159**

PER SHARE DATA (THB)	1999A	2000A	2001E	2002E	2003E
EPS	(6.81)	(1.42)	(0.15)	(0.28)	(0.14)
DPS	0.00	0.00	0.00	0.00	0.00
Effective payout ratio (%)	*0%*	*0%*	*0%*	*0%*	*0%*
BVPS	10.73	7.64	6.87	6.59	6.46
ABVPS	10.11	7.04	6.31	6.08	5.98

VALUATION	1999A	2000A	2001E	2002E	2003E
Price to book value (x)	1.72	0.72	0.76	0.79	0.81
Price to adjusted book value (x)	1.83	0.78	0.82	0.86	0.87
Price to earnings (x)	(2.72)	(3.88)	-33.59	-18.90	-37.91

PROFITABILITY RATIOS	1999A	2000A	2001E	2002E	2003E
(%)					
Net interest margin	-1.24%	-1.17%	-0.23%	-0.15%	-0.04%
Yield on interest earning assets	5.96%	5.23%	4.61%	4.28%	4.24%
Cost on interest bearing liabilities	7.43%	6.29%	4.77%	4.37%	4.23%
Net interest spread	-1.47%	-1.06%	-0.17%	-0.09%	0.01%
Non-int. income (% Op income)	-64.6%	-184.1%	195.1%	174.1%	113.3%
Cost to income	-43.8%	-108.1%	154.4%	164.6%	102.8%
Overhead ratio	0.33%	0.44%	0.38%	0.34%	0.32%
Cost coverage	-228.5%	-92.5%	64.8%	60.8%	97.3%
ROA	-4.43%	-0.94%	-0.10%	-0.16%	-0.07%
ROE	-73.7%	-16.5%	-2.3%	-4.4%	-2.3%

OROA ANALYSIS	1999A	2000A	2001E	2002E	2003E
Net interest margin	-1.24%	-1.17%	-0.23%	-0.15%	-0.04%
Non-interest inc./gross inc.	-64.57%	-184.07%	195.10%	174.11%	113.31%
Efficiency ratio	-43.76%	-108.07%	154.40%	164.57%	102.82%
Provision/assets	3.52%	0.16%	0.10%	0.19%	0.18%
Operating return on assets	**-4.60%**	**-1.01%**	**-0.24%**	**-0.32%**	**-0.19%**
Equity/assets	7.25%	4.94%	4.03%	3.63%	3.32%
Operating return on equity	**-63.5%**	**-20.5%**	**-5.9%**	**-8.9%**	**-5.6%**

BALANCE SHEET	1999A	2000A	2001E	2002E	2003E
(THB mil) *year ending Dec*					
Gross loans	135,972	154,777	158,666	157,873	159,855
Loan loss reserves	*10,252*	*10,052*	*9,171*	*8,782*	*8,387*
Net loans	125,721	144,726	149,495	149,091	151,468
Total earning assets	159,751	165,061	184,155	196,054	210,253
Other assets	12,163	14,652	13,998	14,902	15,982
Total Assets	**171,914**	**179,714**	**198,153**	**210,957**	**226,234**
Deposits	152,978	166,424	186,044	198,190	212,691
Customer deposits	NA	NA	NA	NA	NA
Other deposits	NA	NA	NA	NA	NA
Other paying liabilities	3,281	1,098	207	220	236
Interest-bearing Liabilities	**159,447**	**170,842**	**190,174**	**203,298**	**218,734**
Gross Equity	**12,468**	**8,872**	**7,979**	**7,659**	**7,500**
Adjusted equity	**11,748**	**8,181**	**7,330**	**7,061**	**6,948**

BALANCE SHEET RATIOS	1999A	2000A	2001E	2002E	2003E
(%)					
Loan-to-deposit	88.9%	93.0%	85.3%	79.7%	75.2%
Equity to assets	7.3%	4.9%	4.0%	3.6%	3.3%
Total loan loss provisions	5.96%	5.59%	4.63%	4.16%	3.71%

ASSET QUALITY	1999A	2000A	2001E	2002E	2003E
Nonperforming assets	49,072	35,638	34,392	28,185	23,040
Special mention	5,843	4,923	4,024	3,418	2,903
Substandard	646	2,046	1,123	1,168	1,077
Doubtful	6,118	3,842	2,336	1,902	1,550
Loss	34,277	22,273	23,905	19,064	15,204
ORE	2,188	2,554	3,005	2,633	2,307
NPAs/total loans	36.1%	23.0%	21.7%	17.9%	14.4%
Reserve coverage of NPAs	20.9%	28.2%	26.7%	31.2%	36.4%
Required reserves	39,152	26,636	27,373	22,270	18,192
Actual reserves	10,252	10,052	9,171	8,782	8,387
Shortfall (surplus)	28,900	16,585	18,202	13,488	9,805
Actual to required reserves	26%	38%	34%	39%	46%
Shortfall to capital	232%	187%	228%	176%	131%

GROWTH RATES	1999A	2000A	2001E	2002E	2003E
(%)					
Income statement					
Net interest income	-288.7%	-9.1%	-78.7%	-28.9%	-71.0%
Non-interest income	-141.1%	50.1%	-32.4%	-18.5%	5.1%
Total operating income	42.9%	-47.4%	-163.8%	-8.7%	61.4%
Non-interest expenses	-16.4%	30.0%	-8.9%	-2.7%	0.9%
Pre-provision earnings	17.5%	-23.8%	-83.3%	8.4%	-92.9%
Loan loss provisions	92.5%	-95.4%	-26.8%	95.0%	0.0%
Core earnings	121.6%	-77.0%	-79.2%	-7.1%	-50.1%
Net profit	**68.5%**	**-79.2%**	**-89.1%**	**77.7%**	**-50.1%**
Balance sheet					
Loan growth	3.2%	13.8%	2.5%	-0.5%	1.3%
Interest earning assets	-9.5%	3.3%	11.6%	6.5%	7.2%
Asset growth	-7.1%	4.5%	10.3%	6.5%	7.2%
Deposit growth	-10.4%	8.8%	11.8%	6.5%	7.3%
Shareholders funds	20.8%	-28.8%	-10.1%	-4.0%	-2.1%

Source: Company reports; Lehman Brothers estimates.

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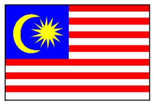
Malaysia

Too Many Risks Still

Rating: Underweight ⇔



Covered Banks	Rating
Commerce Asset	3-Mkt Perform
MayBank	2-Buy
Public Bank	2-Buy

We have been Underweight the Malaysian banking sector since last year and are unlikely to change this view given the return to rising NPLs, slowdown in lending and continued dysfunctional interest rate environment that continues to hurt those banks with strong, un-levered balance sheets. We do not see any of these factors changing in the near term. Meanwhile, the country is still in the process of one of the most aggressive consolidation exercises in the region, which is likely to have disrupted core lending operations—the government has merged the countries 58 financial institutions into ten anchor banks.

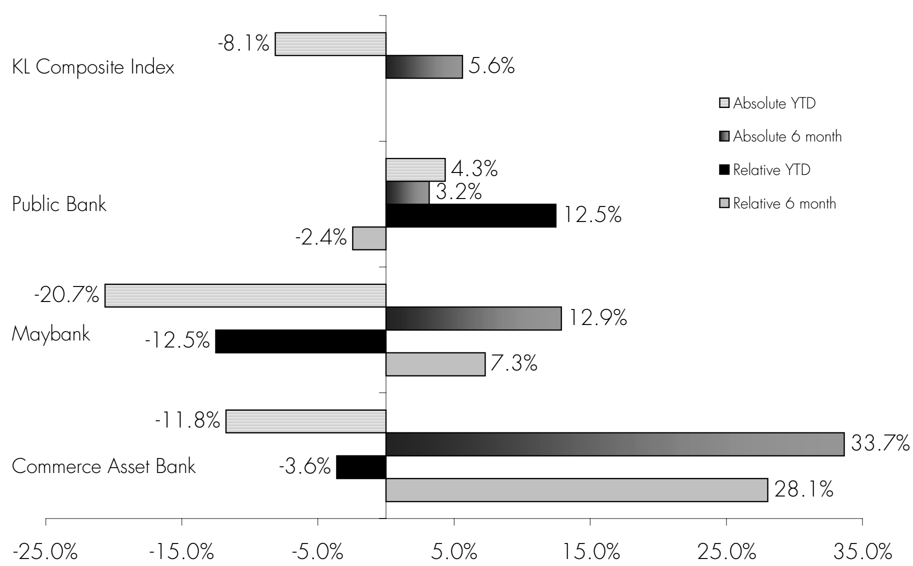
Volatile share prices

The share prices of the Malaysian banks in our universe have been quite volatile—down an average of 9% since the beginning of the year, but up an average of 17% over the last six months. These banks have underperformed the KL Composite Index YTD, but outperformed over the last six months—the index has declined 8% YTD, but is up 6% over the last six months.

Commerce has outperformed, but is ahead of itself, in our opinion

The star performer however, is Commerce Asset, which has increased 34% over the last six months on the back of strong interim earnings that exhibited margin expansion and increasing leverage of its balance sheet. However, we believe that this stock has run ahead of itself and outperformance is not likely to continue as it is now the most expensive, trading at 15x 2001 earnings and 14x 2002 earnings, which is relatively more expensive than both Maybank and Public.

Figure 46: Malaysian Banks



Source: Lehman Brothers

Potential merger related problems.

The government has taken a pre-emptive move to strengthen the local banks and prepare the sector for foreign competition. As part of its bid for entry into the World Trade Organization, the financial sector is to be liberalized and opened up to foreign competition. Ultimately, the ideal number of local banks should be four to six, which would be on par with the number of foreign banks—that means we will likely see another round of consolidation.

Are the mergers just going to create larger entities, or are these banks going to be better and more efficient entities? In the near term, cost savings will be minimal since BNM is against staff retrenchment and branch rationalization–it has recently indicated that it will allow voluntary separation schemes, which will add to staff expenses in the near term. In addition, revenue enhancement and organizational synergy will also be limited given the current weak demand for credit.

Now that the mergers are largely completed, the next hurdle is the RM2 billion capital minimum requirements by the end of 2001 that the central bank has imposed. Of the ten anchor banks, only Maybank, Bumiputra-Commerce Bank, RHB Bank and Public Bank meet this requirement. Therefore, this would imply that there might be a lot of capital raising efforts in the market this year, which should put pressure on share prices.

The aftermath of the mergers is likely to be more headaches, particularly integration problems on both the IT side as well as the product and staff side. The result will likely be higher operating expenses. Cost savings from the mergers are not likely to accrue until at least two to three years later.

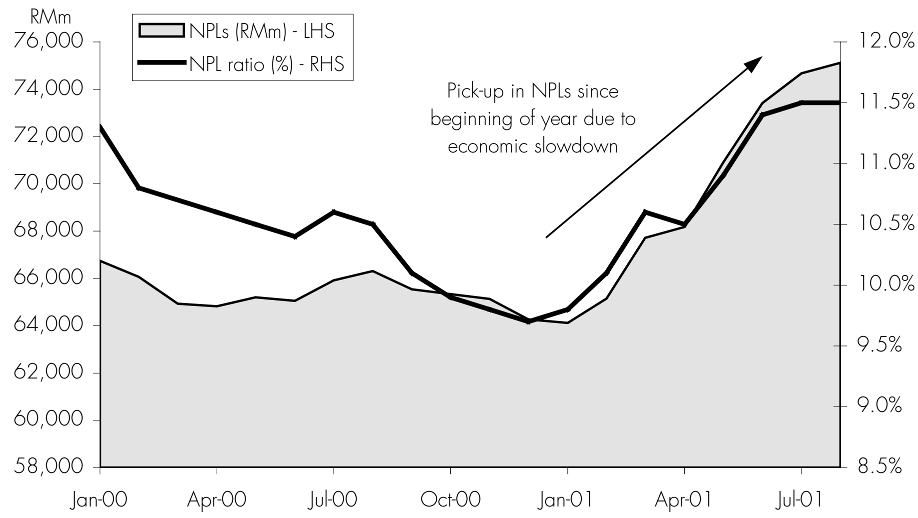
NPLs still on the rise.

Since the beginning of the year, system-wide NPLs (3-month basis) have increased by 17% between January and July to RM75.1 billion and the NPL ratio has increased to 11.5% from 9.6%. For the commercial banks, a lot of the problems stem from manufacturing and construction loans, which now account for close to 40% of NPLs.

Looking ahead, with Malaysia now technically in recession following two quarters of negative GDP growth, we believe the economic backdrop is not conducive to the bank operating environment. We have recently lowered our 2001 GDP growth rate to 0% and expect a recovery in 2002 to 2.3% growth, which is largely dependent on a recovery in the US. That said, with a deteriorating economy, NPLs are expected to continue to increase. We expect NPLs to peak by the end of this year–a sentiment shared by the management of the major banks as well.

Consequently, loan loss provisions are expected to remain high at least over the next two to three quarters, creating a drag on profitability.

Figure 47:



Source: Bank Negara Malaysia

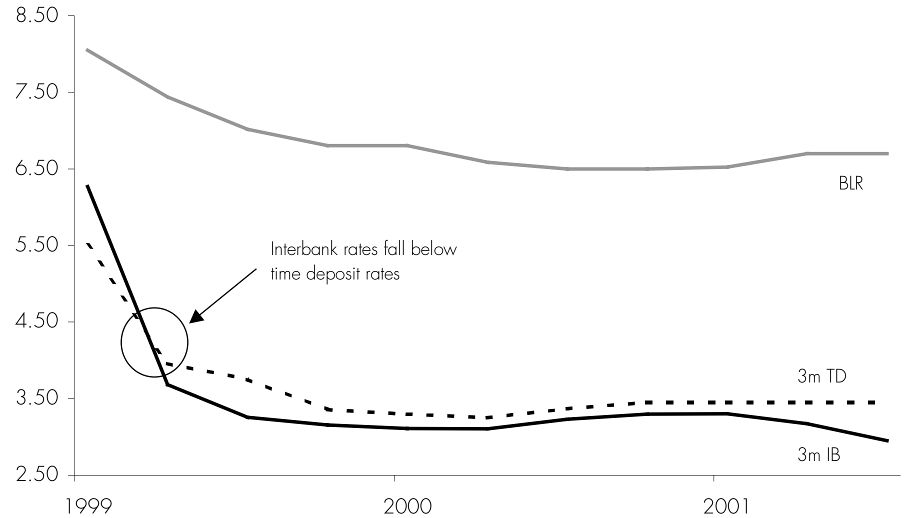
Dysfunctional interest rates. The direction of interest rates in the U.S. have little impact on local rates due primarily to the capital controls that were put in place in 1998. The key determinant to interest rates in Malaysia is the government, which effectively controls both the base lending rate (by way of the intervention rate and statutory reserve requirement) as well as deposit rates (by way of moral suasion).

Malaysia has coped with a dysfunctional interest rate environment for close to 18 months now, whereby deposit rates are 15bp higher than the corresponding interbank rates. Under normal market conditions where liquidity in the system is high and there is lack of meaningful loan growth, banks would set customer deposit rates below that of their corresponding interbank rates. However moral suasion from the central bank to maintain positive "real interest rates' on deposits has resulted in this dysfunctional interest rate environment, which penalizes banks that have highly liquid balance sheets with low loan to deposit ratios.

We expect the central bank to continue with its policy of maintaining positive "real interest rates". We project inflation to remain benign at 1.8% in 2001 and only 3.0% in 2002 and as a result, we expect the central bank to maintain a neutral stance on interest rates.

Looking ahead, interest rates are expected to remain low as the economy is not relying on interest rate sensitive capital flows to support liquidity. Also, there is no need to slow the economy, which is still operating at well below full employment and inflation is still benign.

Figure 48: Malaysian Interest Rates



Source: Datastream

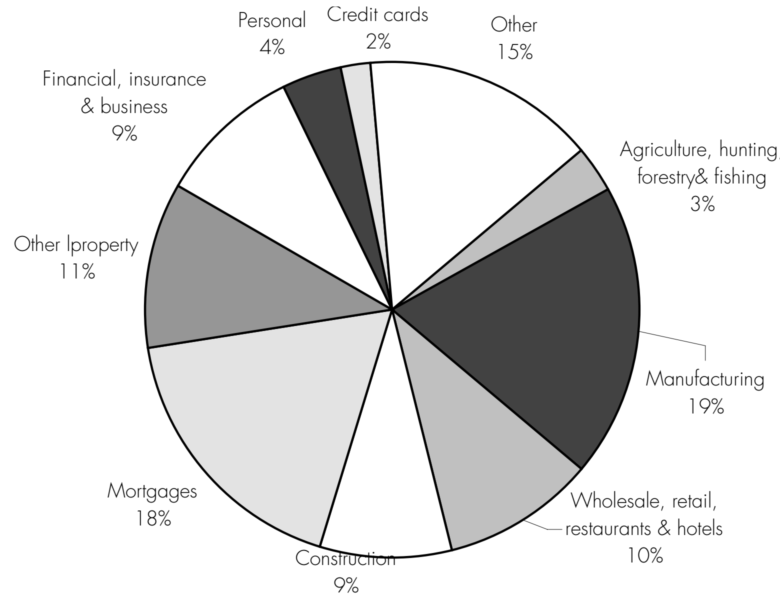
No meaningful loan growth.

Following the 6.5% increase recorded in 2000, the pace of loan growth is slowing—loans are up only 4.1% since the beginning of the year. This compares to 5% contraction in 1999 and 2% contraction in 1998. Although this is commendable by regional standards, it still falls short of the 8-10% target that most banks set at the beginning of the year.

The main driver to loan growth has been mortgages, which have increased by 17% or close to RM5.4 billion, since the beginning of the year to account for over half of total loan growth. The key beneficiary of the strong mortgage lending were Public Bank, which has mortgage exposure of over 20% of its loan book and 8% market share. Meanwhile, CAHB and Maybank control 10% and 15% respectively. Elsewhere, corporate loans have been weak, despite the capacity utilization rate hovering at 85% over the last 12-18 months–this is the level when corporates are likely to look at investing in machinery and equipment. Manufacturing loans, which account for 15% of total loans, increased by only 3% during the year and 7% since the beginning of 2000.

Looking ahead, we expect loan growth to continue to be weak and banks to struggle to achieve loan growth of 5-8%. However, those banks that are able to complete their mergers and the integration processes quickly will be well positioned to take market share in loans. Thus we believe that Maybank and Public Bank will benefit in this environment.

Figure 49: Malaysia Loan Breakdown



Source: Bank Negara Malaysia

Valuation

Our only exposure in Malaysia is Maybank.

While the mergers have re-shaped the landscape, Maybank will still continue to dominate the sector and remain among the most profitable and safest—as a result, it will continue to trade at a premium to its peers and is our only exposure in a sector that exhibits too many risks. The key to the success of Public Bank, is the willingness and ability to leverage the strong deposit franchise through above average loan growth. The bank has been managed conservatively in the past, but the confidence afforded by the leading role played in the consolidation should help loosen the tie. It is still being hurt by its strong balance sheet and we are not keen buyers until we see a more normal interest rate environment. Commerce Asset on the other hand, is in the midst of the largest bank merger in Malaysia's history. Although it will eventually become a formidable player in the country with the full backing of the government, difficulties may arise in getting the larger institution to adopt the smaller one's culture. We remain cautious on this institution until we see hard evidence of progress.

Figure 50: Malaysian Banks Valuation Summary

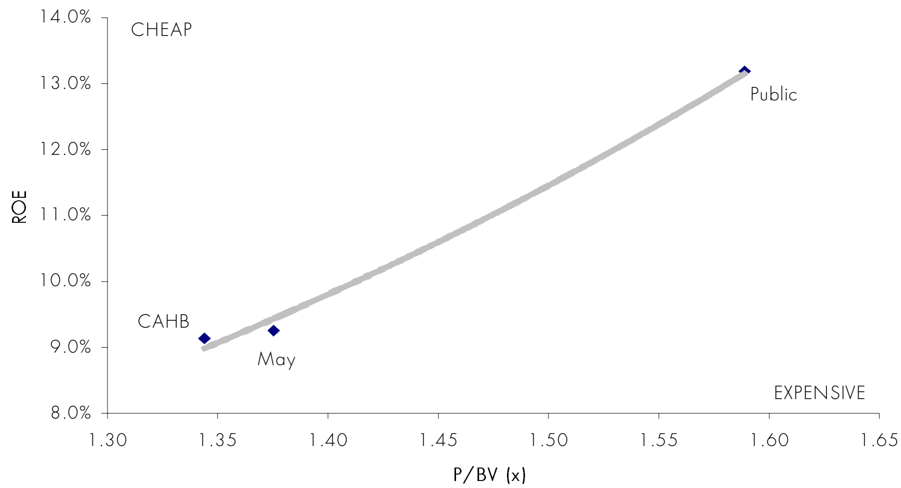
		Price	Mkt Cap	Price-to-Book (x)		Price-to-Earnings (x)		ROE	
Bank	Rating	(RM)	RM (Bil)	2000A	2001E	2001E	2002E	2000A	2001E
Maybank*	2	7.30	28,965	1.7	1.4	15.7	12.4	8.0%	9.3%
Commerce	3	6.75	9,283	1.5	1.3	15.4	13.7	10.2%	9.1%
Public	2	2.68	8,961	1.4	1.6	11.4	9.8	17.2%	13.2%

* Maybank's figures are most recent actual and one year forward

Source: Lehman Brothers estimates

On a fundamental basis, the only bank that is expected to show improving ROE and thus should justify a valuation multiple expansion is Maybank. That said, though, we are only expecting it to recover from unusually depressed levels in 2001 to only 9%, well below its historic pre-crisis levels of 20%+.

Figure 51: Malaysia Banks 2001 ROE versus P/BV



Source: Lehman Brothers estimates

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Commerce Asset Holding

Still Much to Prove

Rating: 3-Market Perform

Ticker:	CAHB.MK
Market Cap:	US$2,101MM
Shares Outstanding:	1,185MM

We are maintaining our 3-Market Perform rating on the shares of Commerce Asset Holdings. We believe that these shares have run ahead of themselves and are likely to come back to more normalized levels. This bank is still in the middle of the country's largest merger and further integration problems will continue to suppress sentiment of this stock. In addition, there is also a negative overhang of stock being placed at a discount by Renong (since purchased by UEM) and *New Straits Times*, which together own 25% of shares outstanding.

Although Commerce Asset was first out of the blocks with its merger, it still has not been able to complete its merger. The key problem is trying to integrate the larger bank into the small one–Bumiputra Bank is twice as large as Bank of Commerce. The combined entity is the second largest bank in Malaysia, controlling approximately 15% of assets, loans and deposits.

It would appear that this bank is well ahead of its peers with regards to its merger plan since it had a full eight-month head start. However, we have yet to see strong signs that it will emerge ahead of the pack. Problems still revolve around staff retrenchment and payments for voluntary retirement. The cost-to-income ratio is still high at 41% and this is one area that needs significant improvement. Public has improved its cost-to-income ratio to 41%, from 48% at the end of 2000. Management has indicated that the voluntary separation scheme is expected to shed some 20% of staff, lowering the staff headcount from 9,700 to approximately 7,800.

CAHB reported a NPL ratio of 13.4% at the end of June, equivalent to RM5 billion. Meanwhile, we are concerned about the bank's reserve coverage of NPLs, which is expected at only 32% by the end of 2000.

Core operations are expected to be weak. Commerce Asset already announced a first half profit of RM130 million, or RM0.11 per share, representing an 8% decline over the previous quarter. Combined with the first quarter results, profit in the first half of the year was RM288 million, or RM0.245 per share. This was a good set of results, exhibiting margin expansion and loan growth. It managed this by increasing the loan-to-deposit ratio, from 89% to 91% and increasing loans to 57% of assets. Because of the high loan-to-deposit ratio, this bank is not being hurt by the interest rate structure in Malaysia.

Meanwhile, NPLs (on a six-month basis) increased by almost 40% to 10.2% and we estimate that on a three-month basis, the NPL ratio was 12.8%. This bank has adequate loan loss reserves, with a general loan loss policy equal to 1.6% of total loan and a total reserve coverage of NPLs at 33%. Similar to the other banks, we expect further deterioration in asset quality and that NPLs will peak at the end of this year.

Share Price:	6.75	Index:	612.41
52 Week Price Range:	10.30 - 4.98	Current Yield:	0.01

Reuters Code:	CAHB.MK
Bloomberg Code:	CAHB MK

INCOME STATEMENT (RM m)	1998A	1999A	2000A	2001E	2002E	2003E
Interest income	2,247	2,181	3,939	4,124	4,493	4,811
Interest expense	-1,525	-1,378	-2,084	-2,087	-2,320	-2,464
Net interest income	722	803	1,855	2,038	2,173	2,347
Ave. interest earnings assets	*20,025*	*36,627*	*56,295*	*62,658*	*67,905*	*72,713*
NIM (%)	3.23%	1.97%	3.29%	3.25%	3.20%	3.23%
Non-interest income	254	518	594	770	766	812
Total operating income	975	1,321	2,449	2,808	2,939	3,159
Non-interest expenses	-422	-456	-1,179	-1,345	-1,498	-1,585
Pre provision profit	553	865	1,270	1,463	1,441	1,574
Loan loss provisions	-438	-423	-474	-704	-551	-500
Non-operating income	-9	12	5	17	21	25
Pre tax profit	106	454	801	776	910	1,099
Tax	-54	-10	-275	-225	-290	-353
After tax profit	52	444	525	550	620	746
Minority interest	31	-49	-7	-34	-39	-47
Net profit	84	394	519	516	581	699

PER SHARE DATA	1998A	1999A	2000A	2001E	2002E	2003E
(RM m)						
Earnings per share	0.10	0.43	0.44	0.44	0.49	0.59
Dividends per share	0.05	0.06	0.04	0.05	0.10	0.12
Effective payout ratio (%)	0.48	0.14	0.10	0.11	0.20	0.21
Book value per share	4.13	4.05	4.49	5.02	5.50	6.05
Adjusted book value per share	4.13	1.82	2.17	3.51	4.67	5.66

VALUATION (X)	1998A	1999A	2000A	2001E	2002E	2003E
Price to book value (x)	0.7	0.7	1.8	1.3	1.2	1.1
Price to adjusted book value (x)	0.7	1.6	3.8	1.9	1.4	1.2
Price to earnings (X)	28.1	6.8	18.4	15.4	13.7	11.4

PROFITABILITY RATIOS (%)	1998A	1999A	2000A	2001E	2002E	2003E
Net interest margin	3.23%	1.97%	3.29%	3.25%	3.20%	3.23%
Yield on interest earning assets	11.2%	6.0%	7.5%	6.6%	6.6%	6.6%
Cost on interest bearing liabilities	8.2%	3.8%	4.2%	3.4%	3.7%	3.7%
Net interest spread	3.03%	2.11%	3.21%	3.21%	2.90%	2.90%
Non-int. income (% Op income)	26.0%	39.2%	24.3%	27.4%	26.1%	25.7%
Cost to income	43.30%	34.53%	48.14%	47.90%	50.98%	50.18%
Overhead ratio	2.11%	1.25%	2.30%	2.27%	2.21%	2.18%
Cost coverage	60%	114%	50%	57%	51%	51%
ROA	0.35%	0.88%	0.75%	0.71%	0.73%	0.83%
ROE	2.6%	9.9%	10.2%	9.1%	9.4%	10.3%

DUPONT ANALYSIS	1998A	1999A	2000A	2001E	2002E	2003E
Lending operations						
Net interest margin	3.23%	1.97%	3.29%	3.25%	3.20%	3.23%
Interest earnings assets/assets	83%	97%	97%	97%	97%	97%
NIM contribution to ROA	2.68%	1.91%	3.19%	3.14%	3.09%	3.12%
Non-interest operations						
Non-interest income/assets	1.05%	1.15%	0.86%	1.06%	0.97%	0.96%
Overhead ratio	1.75%	1.01%	1.71%	1.84%	1.89%	1.87%
Non-int. contribution to ROA	-0.70%	0.14%	-0.85%	-0.79%	-0.92%	-0.91%
Asset quality analysis						
Provision/loans	-2.78%	-1.23%	-1.19%	-1.60%	-1.17%	-0.99%
Loans/assets	65.39%	76.45%	58.12%	60.34%	59.49%	59.64%
ROA effect from asset quality	-1.82%	-0.94%	-0.69%	-0.97%	-0.70%	-0.59%
Core ROA	0.17%	1.11%	1.65%	1.39%	1.47%	1.62%
Non-core contribution to ROA	0.1%	-0.1%	0.0%	0.0%	0.0%	0.0%
Pre-tax ROA	0.44%	1.03%	1.65%	1.36%	1.45%	1.59%
Tax rate	50.9%	2.2%	34.4%	29.1%	31.9%	32.1%
After tax ROA	0.3%	0.9%	0.8%	0.7%	0.7%	0.8%
Balance sheet leverage (x)	7.6	11.3	13.5	12.9	12.8	12.4
ROE	2.6%	9.9%	10.2%	9.1%	9.4%	10.3%

BALANCE SHEET (RM m)	1998A	1999A	2000A	2001E	2002E	2003E
Gross loans	15,758	34,410	39,961	44,038	47,136	50,495
Specific loan loss reserves	*-245*	*-1,012*	*-870*	*-1,122*	*-1,321*	*-1,526*
General loan loss reserves	*-290*	*-602*	*-653*	*-793*	*-848*	*-909*
Net loans	15,224	32,796	38,438	42,123	44,966	48,060
Other earning assets	7,967	31,658	27,734	29,984	31,973	34,141
Other assets	1,226	3,581	3,709	4,577	4,945	5,345
Total Assets	24,417	68,035	69,882	76,684	81,883	87,546
Deposits	13,249	43,865	46,121	48,653	52,076	55,787
Other paying liabilities	6,865	15,973	14,251	17,555	18,367	19,239
Other liabilities	1,080	3,501	4,210	4,582	4,983	5,421
Total Liabilities	21,194	63,339	64,583	70,790	75,425	80,447
Shareholders' funds	3,223	4,695	5,299	5,894	6,458	7,099

LOAN BOOK (RM m)	1998A	1999A	2000A	2001E	2002E	2003E
Manufacturing	3,714	6,351	7,174	7,938	8,425	8,942
Construction & real estate	3,706	6,037	6,469	7,207	7,649	8,119
Purchase of landed property	2,426	8,039	10,050	10,987	12,075	13,271
Fin. insur. & bus. service	1,648	1,532	2,770	2,980	3,101	3,227
Other Commercial	3,288	7,308	7,931	8,940	9,342	9,763
Purchase of securities	1,441	2,014	2,308	2,244	2,335	2,430
Purchase of transp. vehicles	15	1,281	1,241	1,596	1,761	1,944
Consumption credit	228	1,657	1,837	1,579	1,848	2,162
Others	436	1,864	2,337	2,842	2,958	3,078
Total domestic loans	15,758	34,410	39,961	44,038	47,136	50,495
Loans outside Malaysia	0	0	0	0	0	0
Total loans	15,758	34,410	39,961	44,038	47,136	50,495

LOAN BOOK BREAKDOWN (%)	1998A	1999A	2000A	2001E	2002E	2003E
Manufacturing	24%	18%	18%	18%	18%	18%
Construction & real estate	24%	18%	16%	16%	16%	16%
Purchase of landed property	15%	23%	25%	25%	26%	26%
Fin. insur. & bus. service	10%	4%	7%	7%	7%	6%
Other Commercial	21%	21%	20%	20%	20%	19%
Purchase of securities	9%	6%	6%	5%	5%	5%
Purchase of transp. vehicles	0%	4%	3%	4%	4%	4%
Consumption credit	1%	5%	5%	4%	4%	4%
Others	3%	5%	6%	6%	6%	6%
Total domestic loans	100%	100%	100%	100%	100%	100%
Loans outside Malaysia	0%	0%	0%	0%	0%	0%
Total loans	100%	100%	100%	100%	100%	100%

BALANCE SHEET RATIOS (%)	1998A	1999A	2000A	2001E	2002E	2003E
Loan-to-deposit	118.9%	78.4%	86.6%	90.5%	90.5%	90.5%
Equity to assets	13.2%	6.9%	7.6%	7.7%	7.9%	8.1%
Tier 1 Capital	10.7%	13.8%	10.0%	9.2%	9.4%	9.7%
Total Capital adequacy	14.2%	15.4%	12.7%	11.8%	12.0%	12.3%
General reserves (% loans)	-1.8%	-1.7%	-1.6%	-1.8%	-1.8%	-1.8%
Specific reserves (% loans)	-1.55%	-2.94%	-2.18%	-2.55%	-2.80%	-3.02%
Total loan provisions	-3.39%	-4.69%	-3.81%	-4.35%	-4.60%	-4.82%

ASSET QUALITY	1998A	1999A	2000A	2001E	2002E	2003E
Nonperforming loans	1,677	5,194	5,194	4,932	4,467	3,879
NPL ratio	10.6%	15.1%	13.0%	11.2%	9.5%	7.7%
Total provisions/NPLs	31.9%	31.1%	29.3%	38.8%	48.6%	62.8%

GROWTH RATES (%)	1998A	1999A	2000A	2001E	2002E	2003E
Income statement						
Net interest income	25.7%	11.3%	130.9%	9.9%	6.6%	8.0%
Non-interest income	-21.1%	103.9%	14.7%	29.7%	-0.6%	6.0%
Total operating income	8.9%	35.4%	85.4%	14.7%	4.7%	7.5%
Operating expenses	107.9%	8.0%	158.5%	14.1%	11.4%	5.8%
Pre-provision earnings	42.0%	56.4%	46.8%	15.2%	-1.5%	9.2%
Loan loss provisions	103.7%	-3.3%	12.0%	48.5%	-21.7%	-9.3%
Net profit	-45.1%	752.3%	18.4%	4.7%	12.7%	20.3%
Balance sheet						
Loan growth	5.4%	118.4%	16.1%	10.2%	7.0%	7.1%
Interest earning assets	8.7%	178.5%	2.5%	9.3%	6.9%	7.0%
Asset growth	2.7%	178.6%	2.7%	9.7%	6.8%	6.9%
Deposit growth	-0.5%	231.1%	5.1%	5.5%	7.0%	7.1%
Shareholders funds	2.0%	45.7%	12.9%	11.2%	9.6%	9.9%

Source: Company reports; Lehman Brothers estimates.

MayBank

Steady As She Goes

Rating: 2-Buy

Ticker:	MAY.MK
Market Cap:	US$4,532MM
Shares Outstanding:	3,540MM

Maybank's most recent results came in well below our projection, as well as that of the market, due to a significantly higher-than-expected loan loss provision in the last quarter. Although not a problem yet, we do note that Maybank's loan loss reserve levels, which was once its bastion of strength, have declined to a level more in line with the industry. This large provision taken in the last quarter of 2001 can be seen as a prelude for more. Maybank was likely bringing loan loss reserve levels at Pacific Bank and PhileoAllied up to the same level as itself.

Higher NPLs due to new acquisitions.

Asset quality continues to deteriorate and this is not likely the end of this trend. Gross NPLs were RM15.8 billion, or 15.2% of total loans at June, up sharply likely due to the acquisition of Pacific Bank and PhileoAllied, as well as reclassification of Corporate Debt Restructuring Committee (CDRC) related loans. Looking ahead, with the country now technically in recession, we believe that we are not at the end of the credit quality cycle. NPLs are expected to rise further and likely to peak by the start of 2002, at which time the economic recovery should start picking up steam.

Asset quality is not a problem.

Although NPLs and loan loss provisions are still on the uptrend, we do not believe that asset quality will become a problem since Maybank maintains a general loan loss reserve policy at 2.9% and has an internal target of 2.5%. This means that there is potentially RM360 million to be released–but this is unlikely given the conservative nature of management. That said, management already wrote back RM340 million this period, which is very uncharacteristic. Even at the target level, Maybank is still more conservative than the other large banks such as Public and Commerce Asset, which maintain general loan loss reserves close to 1.5%.

But provisions should remain high.

Looking ahead, we expect Maybank to bring its general loan loss reserve levels back to more normalized levels (by its standards) and that total reserves will increase to 70% of NPLs by the end of 2002 (from the current level of 55%) and that the general loan loss reserve will be increased back to 3.1%. Consequently, loan loss provisions will remain high in 2002, at RM1.5 billion.

Core lending operations will remain benign in the near term and we expect loan growth to remain weak and are projecting 5% in 2002 and 6% in 2003. Meanwhile, we calculate that the net interest margin contracted to 2.8% in the last quarter for a full year NIM of 3.1%, down from 3.3% the year before. Looking ahead, margins are expected to come under pressure as funding costs are likely to rise. The central bank wants banks to offer consumers a positive real deposit rate. With inflation likely to increase in the second half of 2001, deposit rates are likely to rise as well. However, the base lending rate is likely to remain the same, thus, resulting in a squeeze in margins.

Share Price:	7.3	Index:	612.41
52 Week Price Range:	10.67 - 6.13	Current Yield:	1.8%

INCOME STATEMENT (RM m)	1998A	1999A	2000A	2001E	2002E	2003E
Interest income	11,755	9,609	7,566	7,921	7,938	8,293
Interest expense	-7,715	-6,148	-3,769	-3,926	-3,921	-4,267
Net interest income	4,040	3,460	3,797	3,995	4,018	4,026
Ave. interest earnings assets	*109,425*	*117,040*	*127,029*	*138,811*	*149,807*	*158,061*
NIM (%)	4.08%	3.23%	2.99%	2.88%	2.68%	2.55%
Non-interest income	973	1,152	1,265	1,321	1,125	1,164
Total operating income	5,013	4,612	5,062	5,316	5,143	5,190
Non-interest expenses	-1,627	-1,437	-1,594	-2,118	-2,350	-2,459
Pre provision profit	3,386	3,175	3,468	3,198	2,793	2,730
Loan loss provisions	-2,909	-2,274	-1,520	-1,995	-1,643	-1,226
Non-operating income	76	110	190	308	410	498
Pre tax profit	553	1,011	2,137	1,510	1,560	2,003
Tax	-442	-59	-764	-711	-546	-701
After tax profit	111	952	1,374	799	1,014	1,302
Minority interest	18	18	-14	41	74	78
Net profit	130	970	1,360	840	1,088	1,379

PER SHARE DATA (RM)	1998A	1999A	2000A	2001E	2002E	2003E
Earnings per share	0.06	0.42	0.58	0.36	0.46	0.59
Dividends per share	0.05	0.09	0.13	0.09	0.12	0.11
Effective payout ratio (%)	0.95	0.20	0.22	0.24	0.25	0.18
Book value per share	3.68	3.99	4.44	4.27	5.31	5.83
Adjusted book value per share	3.68	3.59	4.44	2.78	5.25	5.83

VALUATION (X)	1998A	1999A	2000A	2001E	2002E	2003E
Price to book value (x)	1.1	2.9	1.6	1.7	1.4	1.3
Price to adjusted book value (x)	1.1	3.2	1.6	2.6	1.4	1.3
Price to earnings (X)	73.7	26.9	12.5	20.3	15.7	12.4

PROFITABILITY RATIOS (%)	1998A	1999A	2000A	2001E	2002E	2003E
Net interest margin	4.08%	3.23%	2.99%	2.88%	2.68%	2.55%
Yield on interest earning assets	10.7%	8.2%	6.0%	5.7%	5.3%	5.2%
Cost on interest bearing liabilities	8.3%	6.3%	3.7%	3.5%	3.2%	3.3%
Net interest spread	2.46%	1.89%	2.30%	2.23%	2.11%	1.94%
Non-int. income (% Op income)	19.4%	25.0%	25.0%	24.8%	21.9%	22.4%
Cost to income	32.45%	31.17%	31.49%	39.84%	45.69%	47.39%
Overhead ratio	1.49%	1.23%	1.25%	1.51%	1.57%	1.56%
Cost coverage	60%	80%	79%	62%	48%	47%
ROA	0.12%	0.84%	1.10%	0.63%	0.76%	0.91%
ROE	1.5%	11.0%	13.8%	8.0%	9.3%	10.7%

DUPONT ANALYSIS	1998A	1999A	2000A	2001E	2002E	2003E
Lending operations						
Net interest margin	4.08%	3.23%	2.99%	2.88%	2.68%	2.55%
Interest earnings assets/assets	97%	101%	103%	103%	104%	105%
NIM contribution to ROA	3.97%	3.26%	3.08%	2.98%	2.80%	2.66%
Non-interest operations						
Non-interest income/assets	0.87%	0.99%	1.03%	0.98%	0.78%	0.77%
Overhead ratio	1.45%	1.24%	1.29%	1.58%	1.64%	1.63%
Non-int. contribution to ROA	-0.58%	-0.25%	-0.27%	-0.59%	-0.85%	-0.86%
Asset quality analysis						
Provision/loans	-3.47%	-2.72%	-1.75%	-1.93%	-1.51%	-1.06%
Loans/assets	74.49%	72.06%	70.52%	77.20%	75.99%	76.25%
ROA effect from asset quality	-2.59%	-1.96%	-1.23%	-1.49%	-1.14%	-0.81%
Core ROA	0.80%	1.05%	1.58%	0.90%	0.80%	1.00%
Non-core contribution to ROA	0.1%	0.1%	0.1%	0.3%	0.3%	0.4%
Pre-tax ROA	0.49%	1.16%	1.72%	1.16%	1.14%	1.38%
Tax rate	79.9%	5.8%	35.7%	47.1%	35.0%	35.0%
After tax ROA	0.1%	0.8%	1.1%	0.6%	0.8%	0.9%
Balance sheet leverage (x)	13.2	13.2	12.5	12.7	12.2	11.7
ROE	1.5%	11.0%	13.8%	8.0%	9.3%	10.7%

Reuters Code:	MAY.MK
Bloomberg Code:	MAY MK

BALANCE SHEET (RM m)	1998A	1999A	2000A	2001E	2002E	2003E
Gross loans	83,786	83,585	86,983	103,551	109,081	115,248
Specific loan loss reserves	*-2,740*	*-3,593*	*-3,512*	*-5,728*	*-6,590*	*-7,501*
General loan loss reserves	*-2,671*	*-2,728*	*-3,076*	*-2,947*	*-3,328*	*-3,463*
Net loans	78,376	77,264	80,395	94,876	99,163	104,285
Other earning assets	16,348	19,985	19,471	18,889	19,700	20,699
Other assets	19,791	20,230	27,206	27,132	28,259	30,341
Total Assets	114,514	117,479	127,072	140,897	147,122	155,325
Deposits	70,025	77,551	81,867	96,485	99,615	103,152
Other paying liabilities	32,406	26,999	30,423	28,925	30,375	33,525
Other liabilities	3,676	3,711	4,423	5,448	4,651	4,928
Total Liabilities	106,107	108,261	116,712	130,857	134,640	141,606
Shareholders' funds	8,408	9,217	10,360	10,040	12,482	13,719

LOAN BOOK (RM m)	1998A	1999A	2000A	2001E	2002E	2003E
Manufacturing	10,233	10,082	10,970	13,771	14,616	15,513
Construction & real estate	11,687	12,990	11,726	13,413	13,413	13,413
Purchase of landed property	9,666	11,806	14,169	17,625	19,416	21,389
Fin. insur. & bus. service	7,235	10,512	10,488	11,960	12,446	12,951
Other Commercial	9,360	10,039	10,491	13,411	14,004	14,624
Purchase of securities	9,781	7,075	6,922	7,410	7,711	8,024
Purchase of transp. vehicles	4,782	5,281	5,854	6,455	7,125	7,864
Consumption credit	2,293	2,266	2,743	3,414	3,994	4,673
Others	2,966	2,082	2,647	4,233	4,405	4,583
Total domestic loans	63,742	66,912	71,360	87,291	92,967	99,137
Loans outside Malaysia	20,043	16,673	15,624	16,260	16,114	16,111
Total loans	83,786	83,585	86,983	103,551	109,081	115,248

LOAN BOOK BREAKDOWN (%)	1998A	1999A	2000A	2001E	2002E	2003E
Manufacturing	12%	12%	13%	13%	13%	13%
Construction & real estate	14%	16%	13%	13%	12%	12%
Purchase of landed property	12%	14%	16%	17%	18%	19%
Fin. insur. & bus. service	9%	13%	12%	12%	11%	11%
Other Commercial	11%	12%	12%	13%	13%	13%
Purchase of securities	12%	8%	8%	7%	7%	7%
Purchase of transp. vehicles	6%	6%	7%	6%	7%	7%
Consumption credit	3%	3%	3%	3%	4%	4%
Others	4%	2%	3%	4%	4%	4%
Total domestic loans	76%	80%	82%	84%	85%	86%
Loans outside Malaysia	24%	20%	18%	16%	15%	14%
Total loans	100%	100%	100%	100%	100%	100%

BALANCE SHEET RATIOS (%)	1998A	1999A	2000A	2001E	2002E	2003E
Loan-to-deposit	119.7%	107.8%	106.3%	107.3%	109.5%	111.7%
Equity to assets	7.3%	7.8%	8.2%	7.1%	8.5%	8.8%
Tier 1 Capital	11.2%	10.2%	11.0%	9.2%	10.7%	11.1%
Total Capital adequacy	14.5%	14.8%	15.2%	13.1%	13.4%	13.7%
General reserves (% loans)	-3.2%	-3.3%	-3.5%	-2.8%	-3.1%	-3.0%
Specific reserves (% loans)	-3.27%	-4.30%	-4.04%	-5.53%	-6.04%	-6.51%
Total loan provisions	-6.46%	-7.56%	-7.57%	-8.38%	-9.09%	-9.51%

ASSET QUALITY	1998A	1999A	2000A	2001E	2002E	2003E
Nonperforming loans	7,024	8,885	8,628	15,775	14,381	13,426
NPL ratio	8.4%	10.6%	9.9%	15.2%	13.2%	11.6%
Total provisions/NPLs	77.0%	71.1%	76.4%	55.0%	69.0%	81.7%

GROWTH RATES (%)	1998A	1999A	2000A	2001E	2002E	2003E
Income statement						
Net interest income	24.6%	-14.3%	9.7%	5.2%	0.6%	0.2%
Non-interest income	-3.1%	18.4%	9.8%	4.4%	-14.8%	3.4%
Total operating income	18.0%	-8.0%	9.7%	5.0%	-3.3%	0.9%
Operating expenses	114.8%	-11.6%	10.9%	32.9%	10.9%	4.7%
Pre-provision earnings	-16.7%	-6.3%	9.2%	-7.8%	-12.7%	-2.2%
Loan loss provisions	337.9%	-21.8%	-33.1%	31.3%	-17.7%	-25.4%
Net profit	-95.7%	755.0%	44.3%	-41.9%	26.9%	28.4%
Balance sheet						
Loan growth	22.9%	-0.2%	4.1%	19.0%	5.3%	5.7%
Interest earning assets	13.1%	3.4%	2.8%	15.0%	5.2%	5.6%
Asset growth	3.7%	2.6%	8.2%	10.9%	4.4%	5.6%
Deposit growth	7.6%	10.7%	5.6%	17.9%	3.2%	3.6%
Shareholders funds	-2.0%	9.6%	12.4%	-3.1%	24.3%	9.9%

Source: Company reports; Lehman Brothers estimates.

Public Bank

Leveraging Up and Taking Market Share

Rating: 2-Buy

PUBLIC BANK

Ticker:	PBKF.MK
Market Cap:	US$2,194MM
Shares Outstanding:	3,666MM

We are maintaining our 2-Buy rating on the shares of Public Bank and believe that its share price will continue to hold up. Public Bank had among the easiest mergers and should be able to concentrate on core lending operations ahead of other banks. The integration of Hock Hua is proceeding smoothly and the latter made a first time contribution to the group—earnings were consolidated on March 31, 2001. Public is the third largest bank in Malaysia, behind only Maybank and Commerce Asset.

Public Bank has been able to take market share, increasing is loan book by another 2.5% in 1H01 following a 10% increase in 2000—both well ahead of the market. The growth appears to be coming across the board and it looks like this bank is diversifying away from mortgages, which account for 20% of total loans.

Public Bank has the strongest balance sheet in the sector with a tier 1 ratio of 22%...but this is a drag on profitability.

Public has a tier 1 ratio of 22%, which is easily enough to carry out its merger as well as fund organic growth. However, its high level of capital is a drag on profitability as measured by ROE. Public has among the highest ROA's in the sector at 1.3-1.4%, yet its ROE only averages 14%. Public Bank is proactively trying to gear up its loan book given the dysfunctional interest rate environment in Malaysia. Deposit rates are currently higher than their corresponding interbank rates. This means a liquid bank like Public Bank, which has a loan-to-deposit ratio of only 78% is penalized. Public Bank has to put a portion of its deposit base into the interbank market and generate a negative spread. Loans account for 63% of assets and the loan-to-deposit has been increased to 82%. This means that there is excess liquidity being placed in the interbank market, which is generating yields lower than its corresponding deposit rates. With almost RM12 billion in cash and placements with other banks, Public is losing RM18 million per annum as interbank rates are 15 basis points lower than deposit rates.

And best asset quality

Public has always employed stringent lending criteria. For example, it only sold RM162 million in NPLs to Danaharta, which means that the peak level would have only been 12.6%, well below the industry peak of 30% (18% after sales to Danaharta). The bank is employing a more aggressive write-off policy, a luxury it can afford due to its high level of capital.

Public reported a NPL ratio of 7.9% on a six month basis and we estimate that on a three month basis, this ratio will increase to 11.6%, much higher than the 5.7% and 9.7% levels respectively at the end of 2000. The increase is attributed to higher NPLs at Hock Hua Bank. Similar to Maybank, we are not too concerned about the rising NPLs yet, given Public's strong balance sheet. This bank has a general loan loss policy equivalent to 1.9% of total loans and including specific loan loss provisions, total reserves cover 36% of gross NPLs on a three month basis.

Share Price:	2.68	Index:	612.41
52 Week Price Range:	3.12 - 2.12	Current Yield:	0.02
Reuters Code:	PBKF.MK		
Bloomberg Code:	PBKF MK		

INCOME STATEMENT (RM m)	1998A	1999A	2000A	2001E	2002E	2003E
Interest income	4,363	3,142	2,917	3,183	3,576	3,874
Interest expense	-2,895	-1,662	-1,203	-1,262	-1,489	-1,608
Net interest income	1,468	1,480	1,714	1,921	2,087	2,266
Ave. interest earnings assets	*40,302*	*43,020*	*43,242*	*48,272*	*52,985*	*57,394*
NIM (%)	3.64%	3.44%	3.96%	3.98%	3.94%	3.95%
Non-interest income	394	434	463	555	571	630
Total operating income	1,862	1,914	2,177	2,476	2,658	2,896
Non-interest expenses	-794	-695	-810	-934	-921	-973
Pre provision profit	1,068	1,219	1,367	1,542	1,737	1,923
Loan loss provisions	-887	-413	-161	-285	-238	-214
Non-operating income	18	32	54	128	158	192
Pre tax profit	199	838	1,260	1,385	1,657	1,901
Tax	-112	-51	-341	-390	-497	-570
After tax profit	87	787	919	995	1,160	1,330
Minority interest	-36	-171	-202	-233	-276	-336
Net profit	51	616	717	762	884	995

PER SHARE DATA (RM)	1998A	1999A	2000A	2001E	2002E	2003E
Earnings per share	0.05	0.26	0.30	0.23	0.27	0.31
Dividends per share	0.02	0.00	0.06	0.03	0.04	0.05
Effective payout ratio (%)	0.44	0.00	0.21	0.12	0.16	0.16
Book value per share	1.40	1.62	1.86	1.69	1.88	2.11
Adjusted book value per share	1.40	1.39	1.65	1.41	1.75	2.07

VALUATION (X)	1998A	1999A	2000A	2001E	2002E	2003E
Price to book value (x)	1.4	1.5	1.6	1.6	1.4	1.3
Price to adjusted book value (x)	1.4	1.8	1.8	1.9	1.5	1.3
Price to earnings (X)	44.3	9.4	9.8	11.4	9.8	8.7

PROFITABILITY RATIOS (%)	1998A	1999A	2000A	2001E	2002E	2003E
Net interest margin	3.64%	3.44%	3.96%	3.98%	3.94%	3.95%
Yield on interest earning assets	10.8%	7.3%	7.1%	6.7%	6.7%	6.7%
Cost on interest bearing liabilities	8.1%	4.6%	3.3%	3.0%	3.3%	3.3%
Net interest spread	2.74%	2.75%	3.81%	3.76%	3.44%	3.44%
Non-int. income (% Op income)	21.2%	22.7%	21.3%	22.4%	21.5%	21.8%
Cost to income	42.64%	36.31%	37.22%	37.73%	34.66%	33.61%
Overhead ratio	1.97%	1.62%	1.87%	1.93%	1.74%	1.70%
Cost coverage	50%	62%	57%	59%	62%	65%
ROA	0.12%	1.43%	1.66%	1.56%	1.64%	1.70%
ROE	1.7%	17.3%	17.2%	13.2%	13.4%	13.5%

DUPONT ANALYSIS	1998A	1999A	2000A	2001E	2002E	2003E
Lending operations						
Net interest margin	3.64%	3.44%	3.96%	3.98%	3.94%	3.95%
Interest earnings assets/assets	96%	100%	100%	99%	98%	98%
NIM contribution to ROA	3.50%	3.43%	3.96%	3.93%	3.87%	3.87%
Non-interest operations						
Non-interest income/assets	0.94%	1.01%	1.07%	1.14%	1.06%	1.08%
Overhead ratio	1.89%	1.61%	1.87%	1.91%	1.71%	1.66%
Non-int. contribution to ROA	-0.95%	-0.60%	-0.80%	-0.78%	-0.65%	-0.59%
Asset quality analysis						
Provision/loans	-3.98%	-1.78%	-0.63%	-0.89%	-0.69%	-0.57%
Loans/assets	53.17%	53.76%	59.53%	65.65%	64.26%	64.05%
ROA effect from asset quality	-2.12%	-0.96%	-0.37%	-0.58%	-0.44%	-0.37%
Core ROA	0.43%	1.87%	2.78%	2.57%	2.78%	2.92%
Non-core contribution to ROA	0.0%	-0.3%	-0.3%	-0.2%	-0.2%	-0.2%
Pre-tax ROA	0.47%	1.54%	2.44%	2.36%	2.56%	2.67%
Tax rate	56.2%	6.1%	27.1%	28.2%	30.0%	30.0%
After tax ROA	0.1%	1.4%	1.7%	1.6%	1.6%	1.7%
Balance sheet leverage (x)	13.7	12.1	10.4	8.5	8.2	8.0
ROE	1.7%	17.3%	17.2%	13.2%	13.4%	13.5%

BALANCE SHEET (RM m)	1998A	1999A	2000A	2001E	2002E	2003E
Gross loans	22,287	23,208	25,772	32,082	34,652	37,488
Specific loan loss reserves	*-800*	*-770*	*-792*	*-657*	*-618*	*-630*
General loan loss reserves	*-431*	*-436*	*-475*	*-598*	*-647*	*-701*
Net loans	21,057	22,001	24,505	30,827	33,387	36,157
Other earning assets	19,334	19,830	18,103	18,837	20,463	22,258
Other assets	1,562	1,496	1,493	2,104	2,348	2,535
Total Assets	41,952	43,328	44,101	51,769	56,198	60,949
Deposits	32,500	33,044	33,877	38,371	40,182	42,094
Other paying liabilities	4,015	5,349	4,580	5,821	7,569	9,431
Other liabilities	2,206	1,092	1,227	1,394	1,539	1,699
Total Liabilities	38,721	39,485	39,684	45,586	49,290	53,225
Shareholders' funds	3,231	3,843	4,417	6,183	6,907	7,724

LOAN BOOK (RM m)	1998A	1999A	2000A	2001E	2002E	2003E
Manufacturing	1,529	1,661	1,698	2,077	2,205	2,340
Construction & real estate	3,066	2,628	2,923	3,836	3,836	3,836
Purchase of landed property	4,674	5,553	6,788	8,727	9,583	10,525
Fin. insur. & bus. service	1,725	1,751	1,442	2,090	2,175	2,264
Other Commercial	3,786	3,833	4,565	5,909	6,158	6,417
Purchase of securities	1,171	749	718	876	912	949
Purchase of transp. vehicles	4,622	4,344	4,453	4,931	5,443	6,008
Consumption credit	1,935	2,019	2,445	3,100	3,627	4,243
Others	612	948	1,201	1,212	1,262	1,313
Total domestic loans	22,287	23,208	25,772	32,082	34,652	37,488
Loans outside Malaysia	0	0	0	0	0	0
Total loans	22,287	23,208	25,772	32,082	34,652	37,488

LOAN BOOK BREAKDOWN (%)	1998A	1999A	2000A	2001E	2002E	2003E
Manufacturing	7%	7%	7%	6%	6%	6%
Construction & real estate	14%	11%	11%	12%	11%	10%
Purchase of landed property	21%	24%	26%	27%	28%	28%
Fin. insur. & bus. service	8%	8%	6%	7%	6%	6%
Other Commercial	17%	17%	18%	18%	18%	17%
Purchase of securities	5%	3%	3%	3%	3%	3%
Purchase of transp. vehicles	21%	19%	17%	15%	16%	16%
Consumption credit	9%	9%	9%	10%	10%	11%
Others	3%	4%	5%	4%	4%	4%
Total domestic loans	100%	100%	100%	100%	100%	100%
Loans outside Malaysia	0%	0%	0%	0%	0%	0%
Total loans	100%	100%	100%	100%	100%	100%

BALANCE SHEET RATIOS (%)	1998A	1999A	2000A	2001E	2002E	2003E
Loan-to-deposit	68.6%	70.2%	76.1%	83.6%	86.2%	89.1%
Equity to assets	7.7%	8.9%	10.0%	11.9%	12.3%	12.7%
Tier 1 Capital	16.2%	19.8%	21.8%	23.1%	23.9%	24.8%
Total Capital adequacy	17.9%	21.9%	23.7%	26.5%	27.4%	28.4%
General reserves (% loans)	-1.9%	-1.9%	-1.8%	-1.9%	-1.9%	-1.9%
Specific reserves (% loans)	-3.59%	-3.32%	-3.07%	-2.05%	-1.78%	-1.68%
Total loan provisions	-5.52%	-5.20%	-4.92%	-3.91%	-3.65%	-3.55%

ASSET QUALITY	1998A	1999A	2000A	2001E	2002E	2003E
Nonperforming loans	2,642	2,360	2,399	2,949	2,255	1,855
NPL ratio	12.5%	10.4%	9.7%	9.5%	6.7%	5.1%
Total provisions/NPLs	46.6%	51.1%	52.8%	42.5%	56.1%	71.8%

GROWTH RATES (%)	1998A	1999A	2000A	2001E	2002E	2003E
Income statement						
Net interest income	-4.8%	0.8%	15.8%	12.1%	8.7%	8.5%
Non-interest income	-13.3%	10.1%	6.7%	19.8%	2.9%	10.4%
Total operating income	-6.8%	2.8%	13.7%	13.7%	7.4%	8.9%
Operating expenses	91.1%	-12.5%	16.6%	15.3%	-1.3%	5.6%
Pre-provision earnings	20.0%	14.1%	12.1%	12.8%	12.7%	10.7%
Loan loss provisions	74.9%	-53.4%	-61.0%	76.6%	-16.2%	-10.3%
Net profit	-81.4%	804.6%	16.7%	8.2%	16.6%	14.7%
Balance sheet						
Loan growth	-1.3%	4.1%	11.1%	24.5%	8.0%	8.2%
Interest earning assets	6.8%	3.4%	1.9%	16.1%	8.2%	8.4%
Asset growth	0.2%	3.3%	1.8%	17.4%	8.6%	8.5%
Deposit growth	1.0%	1.7%	2.5%	13.3%	4.7%	4.8%
Shareholders funds	12.4%	18.9%	14.9%	40.0%	11.7%	11.8%

Source: Company reports; Lehman Brothers estimates.

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Indonesia

Accidental Stars

Rating: Neutral ⇧

Covered Banks	Rating
BCA	1-Strong Buy
Lippo Bank	2-Buy
Panin Bank	4-Mkt Underperform

We are now NEUTRAL on Indonesian banks, up from UNDERWEIGHT at the beginning of the year. Although our universe of traded banks is small, fundamentals for the sector are good and the financial performance of our covered institutions has been strong.

As a consequence, even as Indonesia has been quietly outperforming other Asian markets, the bank sector has outperformed the broader Indonesian market. Our covered universe of stocks has risen by an average of 23% YTD, but the sector does not yet look expensive.

Our favorite bank in Indonesia remains BCA, with Lippo Bank also beginning to look attractive at these levels. Although the remaining bank we cover, Panin, is financially sound and will be a long-term survivor, we believe that shareholders will suffer further pain in the short run, as the bank works through its asset quality problems.

Indonesian banks are earning the highest interest margins of any group in our Asian banking universe, with average NIM of 5.19%. This robust underlying profitability has helped banks pull themselves out of difficulty—a feature still missing in markets like Thailand.

In part because banks have earned enough money to take write-offs, and in part due to IBRA's removal of bad loans, asset quality at those Indonesian banks we cover is recovering quickly, with some banks, like BCA , almost completely clean at this point.

After write-offs and workouts, Indonesia has commercial bank credit outstanding amounting to only 21% of GDP, down from an average level of 45% between 1993 and 1997 and a peak of over 70% in 1998. In terms of leaving room for growth, the credit to GDP level in Indonesia compares quite favorably with 41% in the Philippines, 61% in Korea, and 91% in Thailand.

What Has Been Done

- Capacity Taken Out: Indonesia has closed or merged 87 banks, and is forcing many other financially sound but small institutions to seek merger partners or increase their capital.

- NPLs Removed: Indonesia's listed banks have been forced to recognize their bad assets, and the worst of these have been removed by the government, leaving the banks cleaner than those in Thailand or Korea.

- Remaining Banks Recapitalized: Of the remaining banks, the majority have been effectively recapitalized with government bonds, and IBRA has demonstrated a commitment to ensure that banks still under its charge are safe and sound before removing them from administration. This has eliminated a major source of systemic risk.

- Bank/Corporate Structures Broken: The cozy relationships between Indonesia's corporate groups and their bank affiliates have been largely broken through shareholder settlements and use of the 'fit and proper' test, although insidious influences have not vanished entirely from the market.

What Remains to be Done

- Continue Bank Privatization: IBRA has been slow to sell its stakes in banks, although poor market conditions have not helped. Apart from the initiation of a tortuous sale process (in several tranches) for BCA, the government has yet to float or otherwise dispose of any banks. Bank Mandiri is scheduled to be listed next, but its cumbersome structure and recent integration of BII make this an uncertain prospect. IBRA should offer remaining banks (even at fire-sale prices) in order to put productive assets back to work in the private economy.

- Sell Remaining Assets: Although IBRA's recapitalization of banks and preservation of the banking system has been quite effective, its disposal of assets taken from liquidated and recapitalized banks has been far too slow. The longer these assets are held, the less value they have.

- Re-Think State Banks: It has been proven time and time again that governments should not be in the business of lending—and Indonesia is no exception. The former state banks were generally worse lenders than the private banks, and are significantly less efficient to boot. Indonesia's new administration needs to either devise a compelling rationale for keeping the government in the banking business, or find a clear and swift exit strategy.

- Effectively Regulate Going Forward: Bank Indonesia, the Central Bank, still needs to be recapitalized and cleaned up; this should be a priority of the new finance policy staff. In addition, an unambiguously professional supervisory staff must be institutionalized to ensure that banks stay on the straight and narrow. IBRA should also work to implement privately funded deposit insurance to replace the blanket government guarantee as soon as practicable.

The Indonesian Banking Scene: Who's Left?

Indonesia has closed 87 commercial banks and consolidated the industry

Indonesia's banking sector has consolidated quite significantly over the past two years, but remains more fragmented than in other Asian markets. However, the merger and liquidation process has reduced the number of banks by 37%, with some 87 commercial banks no longer in existence. Of these, 70 have been frozen or liquidated, with the remainder merged in an attempt to create viable institutions. In some cases, such as the eight-way merger which begot Bank Danamon, this strategy appears to have worked; in others such as the combination of four state banks (and now BII) into Bank Mandiri, the jury is still out.

Figure 52: Indonesia's Banks by Category: 1997—2000

	Oct-97	Dec-00	Change	%
State Banks	7	5	(2)	-29%
Private National Banks:				
Foreign Exchange Banks	115	67	(48)	-42%
Category A Banks		28		
Recapitalized Banks		6		
Taken Over (BTO) Banks		4		
JV Banks and Other		29		
Domestic Only Banks	79	43	(36)	-46%
Regional Development Banks	27	26	(1)	-4%
Foreign Banks	10	10	-	0%
Total Commercial Banks	238	151	(87)	-37%
Total Commercial Bank Branches	7,781	6,509	(1,272)	-16%

Source: Bank Indonesia

Although many of the liquidated banks were small (and indeed some banks like BCA were rescued only because they were "too big to fail"), the total number of bank branches has declined by 16%, and we expect a further fall as remaining large banks prune their low-performing branches.

Figure 53: Bank Market Share by Category: June 2001

		Deposits		
As of June, 2001	Assets	All	Demand	Time and Savings
State Banks	50.1%	46.6%	32.0%	49.5%
Private Banks	34.6%	43.5%	39.3%	44.3%
Foreign Banks	10.5%	3.6%	6.3%	3.1%
Joint Venture Banks	4.7%	1.0%	1.7%	0.9%
Regional Development Banks	3.4%	5.3%	20.7%	2.3%

Source: Bank Indonesia

Who's Better, Who's Best?

At this point there are only a handful of significant Indonesian banks remaining, although there is a possibility that IBRA may create several more through mergers of its remaining portfolio of banks.

Of the top ten banks in our estimation, six are full state banks, and the government owns a majority stake in two of the remaining four. We divide these banks into those concentrating on a mass retail and SME business (BCA, Danamon, Lippo, Panin, NISP), and those still operating in a traditional manner while waiting to be listed (Mandiri, BNI) or sold (Niaga, Universal, Bali). Only those in the first category can be of interest to investors in listed shares.

Figure 54: Major Indonesian Banks

	Total Assets	Status	Market Share	Branches
Mandiri	261,285	State Owned	24.7%	623
BNI	117,880	State Owned	11.1%	636
BCA	104,573	Public	9.9%	795
Danamon	56,093	State Owned	5.3%	497
Lippo	24,070	Public	2.3%	390
Niaga	18,699	State Owned	1.8%	95
Panin	15,881	Public	1.5%	113
Universal	11,320	State Owned	1.1%	69
NISP	5,686	Public	0.5%	73
Bali	5,652	State Owned	0.5%	265
Total	621,139		58.7%	3,556

Source: Bank Indonesia, company reports, Lehman Brothers estimates.

We believe that BCA, Lippo, and Danamon will survive as the major national retail banks, and also garner a fair share of the corporate business in the years ahead, as they begin with all of the advantages—clean balance sheets, large branch and ATM networks, good brand names, and voluminous existing customer bases on the deposit side. While no Indonesian bank has yet made a go of the consumer lending sector (pre-crisis this having been the purview of finance companies), it stands to reason that these banks will have the best ability to do so in the future.

Panin and NISP have good potential futures as niche banks in high-margin sectors, and may be able to grow substantially over time as the top banks have less than 60% market share. The large state banks (BNI and Mandiri) will remain afloat as a matter of policy, but are long shots to generate value and return on invested capital over a full cycle, dependent as they are on high-cost liabilities and corporate/SOE lending. Universal and Bali have valuable, although tarnished, franchises, and may conceivably find new life under foreign bank purchasers; otherwise we look for them to be consolidated with other banks in the top ten within 12 months. Neither of the two appears to be viable as a stand-alone bank.

Loan Growth Has Begun To Recover…

Loan growth has returned to positive territory, although the banking system is considerably smaller in terms of total assets than it was pre-crisis. However, the listed private banks are moving ahead smartly with the business of extending credit. Importantly, we see no signs as yet that banks are lending imprudently or failing to properly classify new loans as necessary—although we advise continued vigilance as this is the major risk of investing in the financially strong Indonesian banks.

Note that total or gross loans are not a good indicator of real growth, as they are subject to the distorting effects of loan write-offs—which we generally consider beneficial. Looking only at our statistic of performing (Category 1) loans, we see that growth at the more distressed banks in our coverage universe improves markedly.

Figure 55: Loan Growth: Lehman Brothers Covered Universe

	BCA	Lippo	Panin	AVG
Loan Growth FY2000				
Total Loans	95%	-3%	15%	35%
Performing Loans	130%	-4%	145%	90%
Loan Growth 1Q01 (YoY)				
Total Loans	129%	-2%	8%	45%
Performing Loans	140%	18%	95%	84%
Loan Growth 2Q01 (YoY)				
Total Loans	105%	-7%	-29%	23%
Performing Loans	97%	20%	-26%	30%
Loan-to-deposit Ratio	12%	20%	53%	28%

Source: Company reports; Lehman Brothers estimates

...As Interest Rates Have Stabilized

Generally declining and stable interest rates over the past two years have contributed to the industry's increased vigor. Although rates have crept up over the past two quarters on political uncertainty, this issue appears to be resolved satisfactorily, at least for the moment. We project a decline in benchmark SBI rates of 500-600 bp by 2004, which should stimulate loan growth further.

Figure 56: Aggregate Loan Growth and Loan to Deposit Ratio: 1991-2001

	Loan Growth		
	IDR Bil, YoY	%, YoY	Loans to Deposits
1991	15,847	16.34%	163%
1992	10,093	8.95%	145%
1993	27,353	22.25%	143%
1994	38,609	25.69%	151%
1995	45,731	24.21%	144%
1996	58,310	24.85%	136%
1997	85,213	29.09%	160%
1998	109,292	28.90%	117%
1999	(262,293)	-53.81%	48%
2000	43,867	19.48%	51%
Jun-01	66,198	27.57%	55%

Source: Bank Indonesia

We anticipate that loan growth will continue to be strong for our universe of banks, mainly due to them gaining market share and the normalization of the economy, rather than because of strong economic growth. After write-offs and workouts, Indonesia has commercial bank credit outstanding of only 21% of GDP, well below the average level in the region, leaving plenty of room for expansion, even despite low economic growth. We project average growth in performing loans of 33% in FY2001, 13% in FY2002, 20% in FY2003, and 18% in FY2004.

Figure 57: Total Commercial Bank Credit to GDP: Regional and Global Comparison

	Total credit as a % of GDP	Consumer credit as a % of GDP	Consumer loans as a % of Total loans
Indonesia	21.2%	5.6%	26.2%
Philippines	41.2%	1.4%	3.2%
South Korea	61.8%	24.0%	38.8%
Thailand	91.4%	9.6%	10.5%
Australia	111.1%	57.6%	51.8%
Singapore	116.0%	48.2%	41.6%
Taiwan	121.7%	48.1%	39.5%
Japan	125.0%	48.4%	38.7%
Malaysia	137.1%	42.2%	30.8%
Hong Kong	144.8%	62.1%	42.9%
USA	182.0%	64.6%	35.5%

Source: Central banks; CEIC; Lehman Brothers estimates.

Financial Performance

Our Indonesian bank universe has largely returned to pre-crisis levels of profitability, due both to the removal of NPLs from banks' balance sheets and to consolidation, which has favored the best surviving institutions. Overall return on assets has increased from 0.96% in 1997 to a healthy 1.22%. Note that Panin bank skews the average in both periods, having reported high profits through 1997 but very depressed levels since. Panin did not receive government funds and was not able to take a one-time write-off, but is now spreading its pain over several years—a major reason to avoid its shares at the current time in favor of those of either of its competitors.

Figure 58: Coverage Universe ROA: 1996—2Q01

	1996	1997	1998	1999	2000	1Q01	2Q01
BCA	0.54%	0.34%	-49.59%	0.79%	1.87%	1.81%	2.59%
Lippo	1.31%	1.02%	-54.94%	-8.44%	1.06%	0.57%	0.97%
Panin	2.98%	1.53%	0.04%	0.33%	0.21%	0.15%	0.10%
Average	1.61%	0.96%	-34.83%	-2.44%	1.05%	0.84%	1.22%

Source: Company reports; Lehman Brothers estimates

Margins Have Recovered

Indonesian Banks' net interest margins are on average the highest in Asia—a positive signal for the underlying business

Interest margins are quite healthy across the board, and appear set to increase smartly in FY2001 compared with FY2000. Banks have been able to lag deposit rate rises or actually lower liability costs, even as SBI rates have risen in 1H01. Margins at those banks in our universe are wide, even though 58% of BCA's balance sheet and 24% of Lippo's are comprised of government bonds yielding SBI at best.

Redeployment of these securities into loans at current rates would add an additional 400-500 bp to interest yields on this portion of these banks' assets. While we don't expect these banks to be loaned-up any time in the next three years, shifts to higher-margin assets could magnify the importance of the strong deposit franchises held by all three banks, and mitigate the impact of declining rates.

Margins will come off—but stability and falling rates will increase the value of deposit franchises nonetheless

We forecast that margins will decline throughout 4Q04 due to more normalized competition and a falling rate bias throughout the period. As the majority of banks' assets re-price quickly, while deposit rates are more sticky, this should have the effect of reducing spreads as SBI declines. However, with excess liquidity in the system and low loan growth, there is no reason why deposit margins should not recover as rates stabilize.

In truth, as we expect further consolidation, which will limit the number of convenient and safe banks, consumers may have fewer choices, and thus actually accept even lower deposit rates.

Increased Spreads + Lower Rates = Evidence of Deposit Pricing Power

Managements at Indonesian banks tell us that their customer surveys show retail depositors to be relatively rate insensitive. They first and foremost consider convenience when choosing where to bank. Financial data supports this view: even as rates have been lowered YTD, deposits have grown at the banks with large networks and good service, particularly in the more coveted demand and savings deposit categories.

Valuation

Banks have become religious about transparency—but are not yet getting credit.

Indonesian bank valuations are low across the board, in part due to an understandable reluctance on the part of investors to accept the reported figures at face value. Given the fraudulent accounting of the past, this is a reasonable "once bitten, twice shy" position—but we believe that standards and transparency have truly changed.

On a price-to-book basis, all banks in our universe trade below book value, despite an average sector ROE in the low to mid 20% range. Adjustments we make to our book value calculation to derive ABV include taking out property revaluation and capitalized tax loss carry-forwards. While these assets have real value, they don't fit our strict definition of ABV as a liquidation figure, and so we prefer to see their effects recognized through income. On this basis, the sector still trades at 1.1x.

Figure 59: Price to Book Valuations

	BCA	Lippo	Panin	Average
Book Value	1,395.2	67.2	446.3	
Price/Book	0.93	0.52	0.45	0.63
Adjusted Book Value	936.4	30.2	443.6	
Price/Adjusted Book	1.39	1.16	0.45	1.00
Trailing ROE	47.6%	29.4%	1.3%	26.1%
Forward ROE	42.5%	18.6%	4.8%	22.0%

Source: Company reports; Lehman Brothers estimate

Earnings valuations are likewise low: all banks have FY2002 P/E ratios in the low single digits, and the sector as a whole trades on 4.4x FY2002E EPS.

Figure 60: Price to Earnings Valuations

	BCA	Lippo	Panin	Average
EPS:				
2000A	306.2	3.1	2.4	
2001E	428.5	6.0	21.8	
2002E	406.9	6.4	66.3	
2003E	396.7	5.4	64.1	
2004E	400.2	6.0	63.1	
Price/EPS				
2000A	4.25	11.12	82.55	32.64
2001E	3.03	5.84	9.15	6.01
2002E	3.19	5.43	3.02	3.88
2003E	3.28	6.49	3.12	4.30
2004E	3.25	5.82	3.17	4.08

Source: Company reports; Lehman Brothers estimate

Our final valuation method for emerging market banks is a measure of the cost of the deposit franchise to an investor—particularly appropriate in the case of Indonesia as most banks are making returns on the liability front rather than on the asset side.

Under this methodology, we subtract adjusted book value from market capitalization to determine the value in excess of net assets that the market is placing on the bank's franchise. When expressed as a percentage of total deposits, this valuation methodology confirms our view that the Indonesian market is attractive, with an average deposit premium of –2.3%, the lowest in our universe.

Figure 61: Deposit Premium Valuations

	BCA	Lippo	Panin	Average
Market Capitalization	7,651.8	1,370.5	1,191.1	
Less: Adjusted Book Value	(5,511.5)	(1,183.0)	(2,642.2)	
Franchise Premium (FP)	2,140.3	187.5	(1,451.1)	
FP/Deposits	2.3%	0.9%	-13.6%	-3.5%
FP/Demand+Savings Deposits	3.6%	1.3%	-31.3%	-8.8%

Source: Company reports; Lehman Brothers estimate

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Bank Central Asia

Crown Jewel in Motion

Rating: 1-Strong Buy

Ticker:	BBCA.JK
Market Cap:	US$746MM
Shares Outstanding:	5.9 billion

We believe BCA is the most attractive way of taking emerging market exposure in Asian banks, and it has delivered so consistently that, in our opinion, it should be considered as an alternative investment to banks in many developed Asian markets.

We expect BCA's net income to decline through 2004, as interest rates fall, the company uses up its tax loss carry-forwards, and competition grows stronger, but the economic conditions and foreign entrants which will permit this scenario to unfold should raise BCA's valuation nonetheless.

BCA's net interest margin has been buoyed by rising benchmark rates and by the bank's shift of high-cost time deposits into transactions and savings accounts. Margins have been aided by a number of factors, including: 1) rising interest rates; 2) better leverage; 3) improved spread from the foregoing; and 4) a more favorable deposit mix. We forecast that margins will come down as rates return to more normal conditions and as competition increases, and project that BCA will give up 67bp of margin by YE2002.

Asset quality remains strong. NPLs to assets rose from 1.3% to 1.5% in the period, but management has signaled that this was due primarily to the purchase of a portfolio of restructured loans from IBRA. We should see these loans come out of NPL before year-end. BCA is considerably over-reserved by our strict methodology, with a surplus of IDR513 billion or 87% over and above the required amount.

BCA is delivering on its loan growth targets, with total credits rising 19% QoQ and 105% YoY in 2Q01, off an admittedly low base (the loan to deposit ratio is only 12%), even as management frets about poor utilization of approved lines. Growth has been accomplished in part by purchasing loans from IBRA: BCA won the bidding for two pools of loans during FY2000 and both have since been transferred.

The company executed a two-for-one share split as of May 15 in order to increase liquidity, and has also undergone a capital restructuring to eliminate the bank's accumulated deficit. This technical change permits the bank to pay dividends under Indonesian securities regulations; however, any dividend payment has been postponed at IBRA's request pending the strategic stake sale.

Any deterioration in confidence in the government should only strengthen BCA's hand relative to its state bank competitors, as a flight to quality will lower comparative funding costs while raising income on floating-rate government bonds.

IBRA recently concluded an agreement with the IMF under which it plans to offer 51% of BCA to a strategic partner, a more attractive offer as it comes with management control and the ability to consolidate. Most banks with regional ambitions should be potential bidders for BCA, and we would look favorably on such an acquisition from both the perspective of the acquisitor and the remaining minority shareholders in BCA.

BCA trades at 0.93x book (1.39x adjusted book after deduction of all capitalized tax-loss carry forwards and real estate revaluation) on BCA's trailing and projected ROE of 48% and 43%, respectively—far too low a valuation in our view, even after discount for country risk. On an earnings basis, BCA shares trade at 4.3x trailing core EPS and 3.0x FY2001E core EEPS. This will widen slightly to 3.2x for FY2002.

BCA

Share Price:	1,300.00	**Index:**	388.00	
52 Week Price Range:	1,450.00 - 788.00	**Current Yield:**	0.0%	
Reuters Code:	BBCA.JK			
Bloomberg Code:	BBCA IJ	**Shares Outstanding** (B):	5.89	

INCOME STATEMENT	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
(IDR bil) *year ending Dec*					
Interest income	13,933	10,431	12,821	13,379	13,635
Interest expense	18,311	8,299	8,606	9,169	9,334
Net interest income	**-4,379**	**2,132**	**4,214**	**4,210**	**4,301**
Ave. int. earnings assets	*65,760*	*84,765*	*90,040*	*96,493*	*100,065*
NIM (%)	**-6.66%**	**2.51%**	**4.68%**	**4.36%**	**4.30%**
Non-interest income	6,237	1,177	1,425	1,480	1,559
Total operating income	**1,858**	**3,309**	**5,639**	**5,690**	**5,860**
Non-interest expense	1,242	1,649	2,091	2,197	2,317
Pre provision profit	**616**	**1,660**	**3,548**	**3,494**	**3,543**
Loan loss provisions	382	56	547	300	300
Non-operating income	0	0	0	0	0
Pre tax profit	**234**	**1,605**	**3,001**	**3,194**	**3,243**
Tax	-407	-198	479	798	908
Net profit	**641**	**1,802**	**2,522**	**2,395**	**2,335**
Core earnings	**641**	**1,802**	**2,522**	**2,395**	**2,335**

PER SHARE DATA (IDR)	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
EPS	217.90	612.30	428.49	406.92	396.69
DPS	0.00	0.00	60.24	101.73	138.84
Effective payout ratio (%)	*0%*	*0%*	*14%*	*25%*	*35%*
BVPS	1,740.07	2,380.31	1,575.91	1,881.10	2,138.95
ABVPS	823.84	1,749.40	1,141.94	1,535.41	1,851.17

VALUATION	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
Price to book value (x)	NA	0.35	0.82	0.69	0.61
Price to adjusted book value (x)	NA	0.47	1.14	0.85	0.70
Price to earnings (x)	NA	1.35	3.03	3.19	3.28

PROFITABILITY RATIOS	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
(%)					
Net interest margin	-6.66%	2.51%	4.68%	4.36%	4.30%
Yield on interest earning assets	16.60%	12.18%	13.57%	13.58%	13.42%
Cost on interest bearing liabilities	20.37%	9.36%	9.06%	9.32%	9.30%
Net interest spread	-3.77%	2.82%	4.51%	4.26%	4.12%
Non-int. income (% Op income)	335.6%	35.6%	25.3%	26.0%	26.6%
Cost to income	66.8%	49.8%	37.1%	38.6%	39.5%
Overhead ratio	1.89%	1.95%	2.32%	2.28%	2.32%
Cost coverage	149.6%	200.7%	269.7%	259.0%	252.9%
ROA	0.79%	1.87%	2.50%	2.25%	2.15%
ROE	-5.3%	47.6%	42.5%	30.4%	23.4%

OROA ANALYSIS	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
Net interest margin	-6.66%	2.51%	4.68%	4.36%	4.30%
Non-interest inc./gross inc.	335.62%	35.58%	25.26%	26.02%	26.61%
Efficiency ratio	66.83%	49.83%	37.08%	38.61%	39.54%
Provision/assets	0.40%	0.06%	0.52%	0.28%	0.27%
Operating return on assets	**0.54%**	**1.90%**	**3.42%**	**3.34%**	**3.27%**
Equity/assets	5.31%	7.28%	8.78%	10.28%	11.45%
Operating return on equity	**10.19%**	**26.10%**	**38.98%**	**32.52%**	**28.53%**

BALANCE SHEET	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
(IDR bil) *year ending Dec*					
Gross loans	4,101	7,985	12,772	13,825	14,965
Loan loss reserves	*320*	*409*	*1,143*	*1,309*	*1,464*
Net loans	3,781	7,576	11,629	12,516	13,501
Total earning assets	83,915	85,616	94,464	98,523	101,607
Other assets	12,535	10,573	11,157	9,227	8,313
Total Assets	**96,450**	**96,188**	**105,621**	**107,749**	**109,920**
Deposits	86,803	86,869	93,143	96,445	98,388
Customer deposits					
Other deposits					
Other paying liabilities	3,080	1,797	1,863	1,929	1,967
Interest-bearing Liabilities	**91,329**	**89,183**	**96,345**	**96,677**	**97,331**
Gross Equity	**5,121**	**7,005**	**9,276**	**11,072**	**12,590**
Adjusted equity	**2,425**	**5,148**	**6,721**	**9,037**	**10,896**

BALANCE SHEET RATIOS	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
(%)					
Loan-to-deposit	4.7%	9.2%	13.7%	14.3%	15.2%
Equity to assets	5.3%	7.3%	8.8%	10.3%	11.5%
Total loan loss provisions	0.33%	0.43%	1.08%	1.22%	1.33%

ASSET QUALITY	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
Nonperforming assets	948	598	1,684	1,740	1,791
Special mention	460	88	881	877	877
Substandard	93	120	346	353	362
Doubtful	179	298	8	18	29
Loss	167	87	388	383	379
ORE	49	4	6	7	7
NPAs/total loans	23.1%	7.5%	13.2%	12.6%	12.0%
Reserve coverage of NPAs	33.7%	68.4%	67.9%	75.3%	81.7%
Required reserves	340	340	619	631	646
Actual reserves	320	409	1,143	1,309	1,464
Shortfall (surplus)	21	(69)	(524)	(678)	(818)
Actual to required reserves	94%	120%	185%	207%	227%
Shortfall to capital	0%	-1%	-6%	-6%	-6%

GROWTH RATES	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
(%)					
Income statement					
Net interest income	-71.0%	-148.7%	97.7%	-0.1%	2.2%
Non-interest income	-279.2%	-81.1%	21.0%	3.9%	5.3%
Total operating income	NM	78.1%	70.4%	0.9%	3.0%
Non-interest expenses	12.5%	32.8%	26.8%	5.1%	5.5%
Pre-provision earnings	NM	169.3%	113.7%	-1.5%	1.4%
Loan loss provisions	-96.2%	-85.4%	883.8%	-45.2%	0.0%
Core earnings	NM	181.0%	40.0%	-5.0%	-2.5%
Net profit	**NM**	**181.0%**	**40.0%**	**-5.0%**	**-2.5%**
Balance sheet					
Loan growth	-91.8%	94.7%	60.0%	8.2%	8.2%
Interest earning assets	76.3%	2.0%	10.3%	4.3%	3.1%
Asset growth	44.6%	-0.3%	9.8%	2.0%	2.0%
Deposit growth	50.7%	0.1%	7.2%	3.5%	2.0%
Shareholders funds	NM	36.8%	32.4%	19.4%	13.7%

Source: Company reports; Lehman Brothers estimates.

LippoBank

Riady for Action

Rating: 2- Buy

Ticker:	LPBN.JK
Market Cap:	US$87MM
Shares Outstanding:	39.6 billion

Lippo, although small compared to the pre-crisis state banks and BCA, has an enviable franchise base among both consumers and corporate borrowers.

Consumer lending, given Lippo's brand image, customer base, and excellent marketing ability, is a natural goal, and the bank has been working to broaden its product line with innovative structures. Mortgages, still a fairly new product for Indonesian banks, offer tiered interest rates based on loan-to-value, exactly the type of explicit credit-risk pricing that Asia has been conspicuously lacking. Lippo has also scaled up to over 1.5 million Visa debit cards through the Electron program. As approximately half of debit card accounts represent new customers, it is evident that Lippo's product differentiation in this area is paying dividends.

Lippo has continued to widen its margins, with NIM increasing by 22bp QoQ and 205bp YoY. Margins, at 5.75%, are now approximately 80bp higher than those of BCA, on a spread advantage of 196bp. Margin expansion is taking place on the liability side of the balance sheet, giving the bank a marked funding cost advantage. The bank is working to lower its cost of funds by reducing time deposits, aggressively targeting transaction and savings deposits, and attracting customers with fee-free accounts and low minimum balance requirements—deposits are increasing at approximately 12% per year, and funding costs are declining even as benchmark rates have risen.

Lippo has a CAR of 22.67%, due to the large amount of zero-weighted government bonds on the books—the bank could add Rp10 trillion in fully weighted loans while maintaining a CAR of 12%.

Asset quality remains poor by any standard, in particular owing to the loan book. Criticized assets amount to some 96% of gross loans—but note that this figure is misleading due to the low level of loan assets. The loan to deposit ratio stands at only 20%. Provisions have totaled only Rp13.5 billion in the first half, down from Rp38.7 billion in 1H00. We believe that this is low, particularly after what we consider an unwarranted write-back of Rp247 billion from reserves in 4Q00. After the write-back of reserves in 4Q00, we now once again consider Lippo under-reserved, with a required loss allowance of Rp1,049 billion under our methodology only 75% met. The shortfall amounts to some 10% of total equity—hence our expectation of higher provisions to come.

Loan growth has weakened in the first half, with 2Q01 showing a 7% drop in gross loans. However, some of this is due to write-offs of NPLs, with Pass loans actually rising year on year. Lippo is looking mainly to SMEs in the retail, tobacco, and pharmaceuticals industries for future growth.

Lippo currently trades at 0.52x book (1.16x adjusted book after subtracting real estate revaluation and capitalized tax loss carry-forwards). On an earnings basis, Lippo trades at 11.12x trailing EPS, and at 5.84x our FY2001 estimates. While this is a fairly low level for the region as a whole, BCA, with a clean book and considerably higher safety margin is still less expensive.

Lippo Bank

Share Price:	35.00	**Index:**	388.00	**Reuters Code:**	LPBN.JK
52 Week Price Range:	35.00 - 70.00	**Current Yield:**	0.0%	**Bloomberg Code:**	LPBN IJ
				Shares Outstanding (B):	39.16

INCOME STATEMENT	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
(IDR bil) *year ending Dec*					
Interest income	2,481	2,022	2,393	2,597	2,790
Interest expense	3,589	1,392	1,460	1,631	1,809
Net interest income	**-1,108**	**630**	**933**	**966**	**981**
Ave. int. earnings assets	*12,828*	*15,877*	*16,380*	*18,570*	*20,243*
NIM (%)	**-8.64%**	**3.97%**	**5.69%**	**5.20%**	**4.84%**
Non-interest income	196	171	326	330	338
Total operating income	**-913**	**802**	**1,258**	**1,295**	**1,319**
Non-interest expense	801	771	909	948	992
Pre provision profit	**-1,713**	**31**	**350**	**347**	**326**
Loan loss provisions	114	-182	38	50	33
Non-operating income	0	0	0	0	0
Pre tax profit	**-1,827**	**212**	**311**	**297**	**293**
Tax	-187	-34	76	45	82
Net profit	**-1,640**	**246**	**235**	**252**	**211**
Core earnings	**-1,640**	**246**	**235**	**252**	**211**

PER SHARE DATA (IDR)	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
EPS	(41.88)	6.29	6.00	6.45	5.39
DPS	0.00	0.00	0.00	0.00	0.81
Effective payout ratio (%)	*0%*	*0%*	*0%*	*0%*	*15%*
BVPS	59.08	64.69	70.90	77.35	82.74
ABVPS	13.19	29.63	34.72	42.69	49.49

VALUATION	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
Price to book value (x)	4.2	0.85	0.49	0.45	0.42
Price to adjusted book value (x)	19.0	1.86	1.01	0.82	0.71
Price to earnings (x)	NM	8.74	5.84	5.43	6.49

PROFITABILITY RATIOS	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
(%)					
Net interest margin	-8.64%	3.97%	5.69%	5.20%	4.84%
Yield on interest earning assets	14.72%	13.56%	13.40%	13.47%	13.16%
Cost on interest bearing liabilities	19.25%	7.33%	6.88%	7.21%	7.35%
Net interest spread	-4.52%	6.23%	6.52%	6.26%	5.81%
Non-int. income (% Op income)	-21.5%	21.4%	25.9%	25.4%	25.6%
Cost to income	-87.7%	96.2%	72.2%	73.2%	75.3%
Overhead ratio	6.24%	4.86%	5.55%	5.11%	4.90%
Cost coverage	-114.0%	104.0%	138.5%	136.6%	132.9%
ROA	-8.44%	1.06%	0.98%	0.96%	0.74%
ROE	56.5%	29.4%	18.6%	16.7%	11.7%

OROA ANALYSIS	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
Net interest margin	-8.64%	3.97%	5.69%	5.20%	4.84%
Non-interest inc./gross inc.	-21.47%	21.37%	25.88%	25.44%	25.64%
Efficiency ratio	-87.74%	96.19%	72.21%	73.21%	75.26%
Provision/assets	0.48%	-0.80%	0.15%	0.18%	0.11%
Operating return on assets	**-13.84%**	**1.00%**	**1.98%**	**1.68%**	**1.50%**
Equity/assets	9.73%	11.19%	11.02%	11.13%	10.83%
Operating return on equity	**-142.2%**	**8.90%**	**17.98%**	**15.14%**	**13.86%**

BALANCE SHEET	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
(IDR bil) *year ending Dec*					
Gross loans	4,086	3,963	4,013	4,228	4,644
Loan loss reserves	*1,068*	*707*	*802*	*832*	*842*
Net loans	3,018	3,256	3,211	3,397	3,802
Total earning assets	16,847	14,907	17,854	19,286	21,199
Other assets	6,932	7,720	7,341	7,931	8,717
Total Assets	**23,779**	**22,627**	**25,195**	**27,217**	**29,916**
Deposits	18,066	18,692	21,067	22,470	24,442
Customer deposits					
Other deposits					
Other paying liabilities	(18,066)	(18,692)	(21,067)	(22,470)	(24,442)
Interest-bearing Liabilities	**21,466**	**20,094**	**22,419**	**24,188**	**26,676**
Gross Equity	**2,313**	**2,533**	**2,776**	**3,029**	**3,240**
Adjusted equity	**517**	**1,160**	**1,360**	**1,672**	**1,938**

BALANCE SHEET RATIOS	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
(%)					
Loan-to-deposit	22.6%	21.2%	19.1%	18.8%	19.0%
Equity to assets	9.7%	11.2%	11.0%	11.1%	10.8%
Total loan loss provisions	4.49%	3.12%	3.18%	3.06%	2.82%

ASSET QUALITY	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
Nonperforming assets	5,453	2,665	4,073	3,935	3,337
Special mention	856	1,385	1,139	1,093	988
Substandard	647	644	651	600	489
Doubtful	1,147	229	106	97	79
Loss	99	407	509	484	429
ORE	2,704	1,552	1,669	1,660	1,352
NPAs/total loans	133.5%	67.3%	101.5%	93.1%	71.9%
Reserve coverage of NPAs	19.6%	26.5%	19.7%	21.1%	25.2%
Required reserves	1,400	1,044	1,101	1,061	914
Actual reserves	1,068	707	802	832	842
Shortfall (surplus)	332	338	298	229	72
Actual to required reserves	76%	68%	73%	78%	92%
Shortfall to capital	14%	13%	11%	8%	2%

GROWTH RATES	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
(%)					
Income statement					
Net interest income	-12.6%	-156.9%	48.0%	3.6%	1.5%
Non-interest income	-67.1%	-12.6%	90.1%	1.2%	2.6%
Total operating income	NM	-187.8%	57.0%	2.9%	1.8%
Non-interest expenses	-9.0%	-3.7%	17.8%	4.4%	4.7%
Pre-provision earnings	NM	-101.8%	1043.7%	-0.8%	-6.0%
Loan loss provisions	-98.3%	-259.2%	-121.2%	29.9%	-34.0%
Core earnings	NM	-115.0%	-4.7%	7.5%	-16.3%
Net profit	**NM**	**-115.0%**	**-4.7%**	**7.5%**	**-16.3%**
Balance sheet					
Loan growth	-56.7%	-3.0%	1.3%	5.4%	9.8%
Interest earning assets	91.2%	-11.5%	19.8%	8.0%	9.9%
Asset growth	57.7%	-4.8%	11.3%	8.0%	9.9%
Deposit growth	-2.6%	3.5%	12.7%	6.7%	8.8%
Shareholders funds	NM	9.5%	9.6%	9.1%	7.0%

Source: Company reports; Lehman Brothers estimates.

Panin Bank

Self-reliance and Selectivity

Rating: 4-Market Underperform

Ticker:	PNBN.JK
Market Cap:	US$116MM
Shares Outstanding:	5.96 billion

Panin was the only significant bank in Indonesia to be rated a Category A bank under the bank recapitalization program and as such received no government funds. Ironically Panin's competitors are now relatively healthy due to infusions of recap bonds and the removal of their category 5 (Loss) loans.

We have doubts about Panin's strategic plan, which calls for turning what was a small corporate lender into one of the top five or six retail banks. Although we agree that the consumer lending space is an attractive one, we note that Panin has little experience in the sector, which is becoming more competitive by the day. On the positive side, Panin does have a strong foreign partner and beefy capital base, and trades at a fairly cheap valuation.

Panin has significantly worse asset quality than does BCA, and is similar to Lippo in terms of NPLs/Assets, although its reserve coverage is considerably better. What this masks is that the severity of Lippo's NPLs is not as great, so that it is able to come closer to our required reserve calculation. We estimate that Panin is under-reserved by 16% of capital, versus 10% for Lippo.

Panin Bank did extremely well with margins in the second quarter, expanding NIM by 82bp in a relatively even split between the funding and asset sides. The bank has done some very shrewd work here, including using its recap bonds (purchased in the market at a discount) to create an off-balance-sheet money market product for customers thus removing excess deposits from its balance sheet while preserving a 3-4% spread. We project that spreads will come down, however, as stable or falling interest rates make it more difficult for Panin to maintain margins against a loan and securities book which will adjust downward quickly.

Loan growth has been uneven, with growth in performing assets coming down rapidly over the past four quarters. Although the environment is becoming more conducive to lending—with rates falling and economic activity surprisingly strong—we expect Panin to have difficulty continuing to outpace its competition. Panin management is concentrating on the bank's distribution channels, which they see as the bank's weakness.

Panin has a fairly deep relationship with Australia's ANZ Bank, which encompasses an equity stake, joint venture, and management support. ANZ now owns approximately 10% of Panin, with options to purchase 18% more from the controlling family interests.

Panin has a high CAR of 40% due to its relatively unlevered balance sheet and high book equity of 17% of assets. We note that book value no longer includes any material asset revaluation; the revaluation on computer equipment which was taken in 1999 has been reversed, and there are no capitalized tax loss carry-forwards on the balance sheet either. Therefore, our major adjustment to book value is for reserve under funding.

Panin is relatively cheap on a price-to-book basis, trading at only 0.45x 2Q01 BV. The adjusted book multiple is almost the same, including reserve underfunding the P/ABV would be 0.45x. However, Panin has a fairly low ROE (projected to peak in 2003 at 13.3%), and trades at 28.5x FY2000 core EPS (82.5x actual EPS). On a forward basis, the bank trades at 9.1x core FY2001 EEPS and 3.0x core FY2002E EPS, somewhat expensive compared with its peers.

Panin Bank

Share Price:	200.00	**Index:**	388.00	**Reuters Code:**	PNBN.JK				
52 Week Price Range:	95.00 - 270.00	**Current Yield:**	0.0%	**Bloomberg Code:**	PNBNIJ	**Shares Outstanding** (B):	5.96		

INCOME STATEMENT (IDR bil) *year ending Dec*	1999A	2000A	2001E	2002E	2003E
Interest income	1,652	1,450	2,157	2,265	2,386
Interest expense	1,130	969	1,458	1,568	1,697
Net interest income	**522**	**481**	**698**	**697**	**690**
Ave. int. earnings assets	*9,755*	*12,720*	*15,209*	*15,801*	*17,101*
NIM (%)	**5.35%**	**3.78%**	**4.59%**	**4.41%**	**4.03%**
Non-interest income	154	95	339	327	331
Total operating income	**676**	**576**	**1,037**	**1,024**	**1,020**
Non-interest expense	188	215	284	297	311
Pre provision profit	**488**	**361**	**753**	**727**	**709**
Loan loss provisions	451	341	600	200	200
Non-operating income	1	0	0	0	0
Pre tax profit	**38**	**20**	**153**	**527**	**509**
Tax	2	-9	23	132	127
Net profit	**35**	**29**	**130**	**395**	**382**
Core earnings	**-43**	**50**	**130**	**395**	**382**

PER SHARE DATA (IDR)	1999A	2000A	2001E	2002E	2003E
EPS	5.93	4.85	21.85	66.33	64.13
DPS	0.00	0.00	0.00	0.00	0.00
Effective payout ratio (%)	*0%*	*0%*	*0%*	*0%*	*0%*
BVPS	482.45	447.79	466.35	532.68	596.80
ABVPS	325.44	444.83	463.82	530.32	594.61

VALUATION	1999A	2000A	2001E	2002E	2003E
Price to book value (x)	1.3991124	0.38	0.51	0.45	0.40
Price to adjusted book value (x)	2.0741147	0.38	0.52	0.45	0.40
Price to earnings (x)	113.75187	35.08	10.98	3.62	3.74

PROFITABILITY RATIOS (%)	1999A	2000A	2001E	2002E	2003E
Net interest margin	5.35%	3.78%	4.59%	4.41%	4.03%
Yield on interest earning assets	16.23%	9.50%	14.23%	13.77%	13.44%
Cost on interest bearing liabilities	13.61%	7.33%	10.92%	11.00%	11.22%
Net interest spread	2.62%	2.18%	3.32%	2.77%	2.22%
Non-int. income (% Op income)	22.8%	16.5%	32.7%	31.9%	32.4%
Cost to income	27.8%	37.3%	27.4%	29.0%	30.5%
Overhead ratio	1.93%	1.69%	1.87%	1.88%	1.82%
Cost coverage	359.3%	267.8%	364.7%	344.6%	328.0%
ROA	0.33%	0.21%	0.79%	2.29%	2.05%
ROE	2.1%	1.3%	4.8%	13.3%	11.4%

OROA ANALYSIS	1999A	2000A	2001E	2002E	2003E
Net interest margin	5.35%	3.78%	4.59%	4.41%	4.03%
Non-interest inc./gross inc.	22.75%	16.51%	32.67%	31.89%	32.40%
Efficiency ratio	27.84%	37.34%	27.42%	29.02%	30.49%
Provision/assets	3.98%	2.06%	3.63%	1.11%	1.03%
Operating return on assets	**1.02%**	**0.78%**	**1.32%**	**3.48%**	**3.11%**
Equity/assets	25.35%	16.08%	16.81%	17.68%	18.36%
Operating return on equity	**4.0%**	**4.88%**	**7.87%**	**19.70%**	**16.96%**

BALANCE SHEET (IDR bil) *year ending Dec*	1999A	2000A	2001E	2002E	2003E
Gross loans	4,278	4,912	5,702	5,993	6,455
Loan loss reserves	*848*	*620*	*1,084*	*1,213*	*1,338*
Net loans	3,430	4,292	4,619	4,780	5,117
Total earning assets	10,175	15,264	15,153	16,449	17,753
Other assets	1,160	1,324	1,372	1,490	1,608
Total Assets	**11,335**	**16,588**	**16,525**	**17,939**	**19,360**
Deposits	6,578	10,894	11,065	11,802	12,526
Customer deposits					
Other deposits					
Other paying liabilities	1,722	2,333	2,294	2,447	2,597
Interest-bearing Liabilities	**8,461**	**13,921**	**13,748**	**14,766**	**15,806**
Gross Equity	**2,873**	**2,667**	**2,777**	**3,172**	**3,554**
Adjusted equity	**1,938**	**2,649**	**2,762**	**3,158**	**3,541**

BALANCE SHEET RATIOS (%)	1999A	2000A	2001E	2002E	2003E
Loan-to-deposit	65.0%	45.1%	51.5%	50.8%	51.5%
Equity to assets	25.3%	16.1%	16.8%	17.7%	18.4%
Total loan loss provisions	7.48%	3.74%	6.56%	6.76%	6.91%

ASSET QUALITY	1999A	2000A	2001E	2002E	2003E
Nonperforming assets	3,329	2,304	2,144	1,957	1,645
Special mention	814	304	229	202	165
Substandard	487	677	462	409	333
Doubtful	515	180	192	170	138
Loss	1,338	916	995	899	764
ORE	175	227	267	277	245
NPAs/total loans	77.8%	46.9%	37.6%	32.7%	25.5%
Reserve coverage of NPAs	25.5%	26.9%	50.5%	62.0%	81.3%
Required reserves	1,782	1,234	1,289	1,177	1,009
Actual reserves	848	620	1,084	1,213	1,338
Shortfall (surplus)	933	614	205	(37)	(329)
Actual to required reserves	48%	50%	84%	103%	133%
Shortfall to capital	32%	23%	7%	-1%	-9%

GROWTH RATES (%)	1999A	2000A	2001E	2002E	2003E
Income statement					
Net interest income	13.7%	-7.8%	45.1%	-0.2%	-1.1%
Non-interest income	-12.4%	-38.1%	256.1%	-3.7%	1.2%
Total operating income	NM	-14.7%	80.0%	-1.3%	-0.3%
Non-interest expenses	4.5%	14.5%	32.1%	4.5%	4.7%
Pre-provision earnings	NM	-25.9%	108.5%	-3.5%	-2.4%
Loan loss provisions	1.1%	-24.4%	75.9%	-66.6%	0.0%
Core earnings	NM	-217.6%	159.8%	203.6%	-3.3%
Net profit	NM	**-18.3%**	**350.9%**	**203.6%**	**-3.3%**
Balance sheet					
Loan growth	-15.5%	14.8%	16.1%	5.1%	7.7%
Interest earning assets	9.0%	50.0%	-0.7%	8.6%	7.9%
Asset growth	8.9%	46.4%	-0.4%	8.6%	7.9%
Deposit growth	3.6%	65.6%	1.6%	6.7%	6.1%
Shareholders funds	NM	-7.2%	4.1%	14.2%	12.0%

Source: Company reports; Lehman Brothers estimates.

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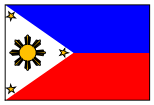
The Philippines

Still The Same, Not The Best

Rating: Underweight ⇧



Covered Banks	Rating
Bank Philippine Is.	2-Buy
Equitable PCI	Not Rated
MetroBank	3-Mkt Perform
Philippine Nat.	4-Mkt Underperform

Banks in the Philippines continue to be troubled, with the primary issues remaining NPLs and foreclosed property (ORE or ROPOA) and a poor macroeconomic environment. Since our last regional report in January, we have seen a new government and considerable progress on the government policy front, but deteriorating exports are negating these gains. We remain UNDERWEIGHT the market, unsurprisingly naming BPI as the bank of choice for investors wishing or needing to take Philippine bank exposure.

Asset Quality

Asset quality is still deteriorating, with the sector reporting approximately 20% of total loans delinquent. Excluding PNB, our covered universe reports a total of 27% non-performing assets once ROPOA is included. Banks' balance sheets are weighted down with bad loans and ORE, causing poor performance despite high interest spreads. Although banks in our universe are relatively well-capitalized, they have been thus far resistant to off-loading NPLs and property on the theory that holding assets through the worst of the downturn will result in higher sale prices. While we believe that this is likely to be true, we also believe that banks would be better off selling earlier, as their high cost of capital and investors' unwillingness to purchase bad assets inside an operating bank make holding until fair value is realized a losing game.

AMCs and Asset Sales

Most banks are now in the process of considering or forming asset management companies, or AMCs, as a way to deal with bad assets. As in Thailand and Taiwan, we consider AMCs a boon only if there is outside investment or management; in other cases AMC formation is only a balance sheet exercise which does not change the health of the promoting bank.

If, however, banks can attract outside investment (potentially from property companies or investment banks) for their AMCs and in effect sell their distressed credits, possibly retaining some participation in future gains, managements can turn their attention once more to the business of new lending and operations.

At the current time, we don't see any significant chance of government participation in such an AMC plan, or of capital injections into the banks, as Philippine fiscal policy is mainly concerned with dealing with a high deficit to begin with.

Mergers and Efficiency

The Philippine banking market has been fairly effectively consolidated over the past several years, in part due to the pursuit of efficiencies and in part a function of central bank pressure to increase capital bases. Most recently among the large banks, BPI acquired Far East Bank and Trust, Metrobank bought Solidbank, and Equitable acquired PCI Bank. While these mergers seem to spring from sensible ideas, neither one has yet proven to be a winner.

Figure 62: Philippine Bank Efficiency Ratios

	FY1999	FY2000	FY2001
BPI	62.2%	67.4%	62.8%
EBC	63.8%	74.2%	80.9%
MBT	63.8%	74.4%	71.4%
PNB	87.0%	85.7%	110.3%
Average	69.2%	75.4%	81.3%

Source: Company reports; Lehman Brothers estimates.

Although one of the espoused purposes of these bank mergers has been cost savings, so far it is difficult to detect any major progress: average efficiency ratios are still rising from FY2000, and no bank is turning in a stellar performance. The most efficient bank, BPI, still pays out 63% of revenues in non-interest expenses.

Figure 63: Philippine Bank Overhead Ratios

	FY1999	FY2000	FY2001
BPI	5.0%	4.1%	4.1%
EBC	6.8%	5.1%	5.3%
MBT	3.3%	4.0%	4.0%
PNB	5.3%	5.3%	7.0%
Average	5.1%	4.6%	5.1%

Source: Company reports; Lehman Brothers estimates.

While no doubt the bad lending environment has led to lower fee income and thus depressed revenues, it is very clear that the Philippine banks have a cost problem. Looking at the overhead ratio, a measure of expenses to assets which is not subject to revenue distortions, we can see that Philippine banks paid out an average of 4.6% of assets in expenses last year, and will pay out 5.1% this year. To put this in perspective, while Singaporean banks have been beaten down this year for poor expense control, they still have an average overhead ratio of 1.3%—so the average Philippine bank spends *3.5–4 times as much* money per dollar of assets as does the average Singaporean bank.

In order for the sector to become attractive, we need to see very substantial progress on costs, which will mean staff layoffs, closure of underperforming or unprofitable branches (of which we believe there are a good number), product and systems rationalization, and of course a solution to the expensive administration of NPLs and ROPOA.

Growth is Low

Total loan growth in the sector has slowed to 2.2% (YoY) in the most recent BSP reporting period. Overall expansion has masked significant declines in the manufacturing, construction, real estate, and communication sectors. In the past, a key driver for the economy and loan growth has been the manufacturing sector, which accounted for almost 30% of total loan demand in FY2000. Within this sector, electronics-related manufacturing had been especially robust.

Given the poor state of the US economy and other electronics-sensitive regions, we don't expect anything other than nominal growth in loans out through YE2002, with any pickup from there heavily dependent on the tech sector and thus a US recovery.

Interest Rates and Inflation

Real interest rates in the Philippines remain quite high, and the BSP would seem to have little room to stimulate loan demand without spurring inflation. The benchmark rate stands at 8.75%, down only 25bp in 3Q01 *vs.* 100bp for the Fed. As inflation is still running at 6.1%, monetary authorities would run the risk of a return to runaway inflation and/or currency depreciation should rates be lowered in line with those in other Asian market.

The artificially high real rate environment is likely to depress loan growth going forward, as well as to produce marginally higher NPLs due to the high cost of servicing existing loans. Ideally, we would like to see negative real interest rates at this point in the economic cycle in order to produce the best environment for banks.

Bank of the Philippine Islands

Providing Shelter

Rating: 2-Buy

Ticker:	BPM.PM
Market Cap:	US$1,237 MM
Shares Outstanding:	1,537 MM

In contrast to the general Philippine merger story, BPI has made some progress in integrating last year's acquisition of Far East Bank, reducing headcount and rationalizing the combined branch networks. The bank has reduced its efficiency ratio to 56% for the second quarter compared to last year's second quarter 70% level and 67% year end level. Savings have dropped directly to the bottom line with the bank recording first and second quarter results up well ahead of last year's depressed profits. While still high, these ratios do show some progress—but much remains to be done.

The bank started the year with a refreshingly different strategy of increasing market share to large corporates and in the middle market segment. Loans, however, have come off about 4% since the beginning of the year, reflecting the poor macro-economic environment leading to compounding stagnant loan growth and increasing non-performance.

The bank continues to be active on the acquisition and restructuring side—successfully acquiring DBS Bank Philippines and intending to merge it with their BPI Family Bank thrift subsidiary. We await evidence of cost-savings before ascribing any benefits to the deal.

NPLs have climbed from the year end level of 19.1% to 21.4% at mid-year. We expect the level of NPLs to further deteriorate to 22% by year end—bad, but still better than any of its competitors. The bank is also substantially better than its peers on the provisioning aspect, maintaining reserves at 84% of our estimated required levels. The shortfall on provisioning equates to just 6% of equity—a consequence of the high level of capital which will depress ROE to an estimated 9.70% in FY2001. In the current environment, this stability is on balance a welcome asset.

With the tumultuous political environment and increasingly shaky economic prospects going forward, the bank has seen deposits swell by 10% over the first half as depositors seek a safe haven to weather the storm. This enviable position has allowed the bank to reduce its COF by 230 basis points over year-end levels, well ahead of its rivals (with the exception of the distressed PNB). Unfortunately the bank's yields have also been dropping ahead of its competitors, although it still maintains superiority at 9.4% in the second quarter, allowing it to maintain receding but still high NIM of 4.61%. We expect full year margins to expand to 4.74% for the full year.

The bank has only marginally outperformed this year and is subsequently down around 20% from levels at the start of the year. Current prices however value the bank at 1.26x trailing first half 2001 book (1.26x adjusted book) on expected ROE of 9.7% for FY2001 (8.9% FY2002)—not cheap on a comparative basis to other Philippine bank stocks or other less distressed markets. On an earnings basis the bank trades at 13.1x FY2001 EEPS and 13.1x FY2002 EEPS.

Bank of the Philippine Islands

Share Price (PHP):	42.00		**Index:**	1,002.52	
52 Week Price Range (PHP):	79.50 - 41.00		**Current Yield:**	2.08%	
Reuters Code:	BPI.PM				
Bloomberg Code:	BPI PM		**Shares Outstanding (MM):**	1,537.16	

INCOME STATEMENT	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
(P million) year ending Dec					
Interest income	31,572	30,094	35,188	35,785	38,758
Interest expense	-15,913	-14,992	-18,069	-18,060	-19,452
Net interest income	**15,660**	**15,102**	**17,119**	**17,724**	**19,306**
Ave. int. earnings assets	*270,806*	*336,863*	*361,525*	*392,853*	*427,404*
NIM (%)	**5.78%**	**4.48%**	**4.74%**	**4.51%**	**4.52%**
Non-interest income	6,134	5,413	6,474	6,571	6,670
Total operating income	**21,793**	**20,515**	**23,593**	**24,296**	**25,976**
Non-interest expenses	-13,566	-13,825	-14,806	-15,028	-15,254
Pre provision profit	**8,227**	**6,690**	**8,786**	**9,267**	**10,722**
Loan loss provisions	-2,726	-3,587	-2,151	-2,000	-2,000
Non-operating income	-22	21	8	0	0
Pre tax profit	**5,479**	**3,125**	**6,644**	**7,267**	**8,722**
Tax	-800	-73	-1,704	-2,325	-2,791
Net profit	**4,679**	**3,052**	**4,940**	**4,942**	**5,931**

PER SHARE DATA (W)	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
EPS	3.80	1.99	3.21	3.21	3.86
DPS	1.48	0.88	0.00	0.00	0.00
Effective payout ratio (%)	*39%*	*44%*	*0%*	*0%*	*0%*
BVPS	38.21	31.93	34.35	37.57	41.43
ABVPS	38.21	31.93	34.35	37.57	41.43

VALUATION	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
Price to book value (x)	2.4	1.8	1.2	1.1	1.0
Price to adjusted book value (x)	2.4	1.8	1.2	1.1	1.0
Price to earnings (X)	24.4	29.2	13.1	13.1	10.9

PROFITABILITY RATIOS	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
(%)					
Net interest margin	5.78%	4.48%	4.74%	4.51%	4.52%
Yield on interest earning assets	11.66%	8.93%	9.33%	8.76%	8.68%
Cost on interest bearing liabilities	6.55%	4.78%	5.07%	4.68%	4.61%
Net interest spread	5.10%	4.15%	4.26%	4.08%	4.07%
Non-int. income (% Op income)	28.1%	26.4%	27.4%	27.0%	25.7%
Cost to income	62.2%	67.4%	62.8%	61.9%	58.7%
Overhead ratio	3.61%	3.51%	3.48%	3.26%	3.03%
Cost coverage	45.2%	39.2%	43.7%	43.7%	43.7%
ROA	1.52%	0.79%	1.21%	1.11%	1.23%
ROE	9.9%	6.4%	9.7%	8.9%	9.8%

DUPONT ANALYSIS	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
Lending operations					
Net interest margin	5.78%	4.48%	4.74%	4.51%	4.52%
Interest earning assets/assets	88.13%	87.63%	88.24%	88.57%	88.57%
NIM contribution to ROA	**5.10%**	**3.93%**	**4.18%**	**4.00%**	**4.00%**
Non-interest operations					
Non-interest income/assets	2.00%	1.41%	1.58%	1.48%	1.38%
Overhead ratio	4.41%	3.60%	3.61%	3.39%	3.16%
Non-int. contribution to ROA	**-2.42%**	**-2.19%**	**-2.03%**	**-1.91%**	**-1.78%**
Asset quality analysis					
Provision/loans	-2.03%	-2.07%	-1.23%	-1.17%	-1.14%
Loans/assets	43.67%	45.07%	42.65%	38.70%	36.38%
ROA effect from asset quality	**-0.89%**	**-0.93%**	**-0.52%**	**-0.45%**	**-0.41%**
Core ROA	**1.79%**	**0.81%**	**1.62%**	**1.64%**	**1.81%**
Non-core contibution to ROA	-0.01%	0.01%	0.00%	0.00%	0.00%
Pre-tax ROA	**1.78%**	**0.81%**	**1.62%**	**1.64%**	**1.81%**
Tax rate	14.60%	2.34%	25.64%	32.00%	32.00%
After tax ROA	**1.52%**	**0.79%**	**1.21%**	**1.11%**	**1.23%**
Balance sheet leverage (x)	6.5	8.0	8.0	8.0	7.9
ROE	**9.9%**	**6.4%**	**9.7%**	**8.9%**	**9.8%**

BALANCE SHEET	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
(P million) year ending Dec					
Gross loans	180,869	195,158	188,194	191,902	198,268
Specific loan loss reserves	*0*	*0*	*0*	*0*	*0*
Loan loss reserves	*-13,423*	*-16,083*	*-17,807*	*-18,950*	*-20,069*
Net loans	167,446	179,076	170,387	172,952	178,200
Other earning assets	160,539	166,666	206,922	235,444	268,212
Other assets	47,439	4,078,889	48,689	52,701	57,606
Total Assets	**375,424**	**393,429**	**425,998**	**461,098**	**504,018**
Deposits	271,289	295,754	334,970	362,570	396,319
Other paying liabilities	34,234	25,605	21,770	23,564	25,758
Other liabilities	22,909	22,989	16,451	17,216	18,262
Total Liabilities	**328,433**	**344,348**	**373,192**	**403,350**	**440,339**
Minorities & other	0	0	0	0	0
Shareholders' funds	**46,992**	**49,081**	**52,806**	**57,748**	**63,679**

LOAN BOOK	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
(P million)					
Manufacturing	51,741	53,365	58,237	63,035	68,903
Wholesale and retail trade	28,298	34,562	37,717	40,825	44,625
Consumer loans	25,117	24,533	26,773	28,979	31,677
Financial institutions	7,368	17,908	19,543	21,153	23,122
Real estate, renting and other busi	17,080	17,728	19,347	20,941	22,891
Others	37,843	30,980	8,770	-1,981	-13,017
Total loans	**167,446**	**179,076**	**170,387**	**172,952**	**178,200**
(%)					
Manufacturing	31%	30%	34%	36%	39%
Wholesale and retail trade	17%	19%	22%	24%	25%
Consumer loans	15%	14%	16%	17%	18%
Financial institutions	4%	10%	11%	12%	13%
Real estate, renting and other busi	10%	10%	11%	12%	13%
Others	23%	17%	5%	-1%	-7%
Total loans	**100%**	**100%**	**100%**	**100%**	**100%**

BALANCE SHEET RATIOS	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
(%)					
Loan to deposit	61.7%	60.5%	50.9%	47.7%	45.0%
Equity to assets	12.5%	12.5%	12.4%	12.5%	12.6%
Tier 1 Capital	na	na	na	na	na
Total Capital adequacy	25.0%	22.3%	22.2%	22.4%	22.6%
General reserves (% loans)	7.42%	8.24%	9.46%	9.87%	10.12%
Specific reserves (% loans)	0.00%	0.00%	0.00%	0.00%	0.00%
Total loan provisions	7.42%	8.24%	9.46%	9.87%	10.12%

ASSET QUALITY	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
(P million)					
Pass	148,572	157,805	143,980	147,705	155,002
Special Mention	2,291	2,579	3,121	2,998	2,880
Substandard	3,395	3,821	4,141	4,138	3,816
Doubtful	5,769	6,494	7,038	7,171	6,614
Foreclosed assets	8,313	10,093	11,093	9,417	8,510
NPL ratio	17.7%	19.1%	22.0%	20.0%	17.8%
Total provisions/NPLs	67.9%	70.0%	70.1%	79.9%	92.0%

GROWTH RATES	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
(%)					
Income statement					
Net interest income	-22.5%	-3.6%	13.4%	3.5%	8.9%
Non-interest income	-10.6%	-11.8%	19.6%	0.0%	0.0%
Total operating income	-19.5%	-5.9%	15.0%	3.0%	6.9%
Operating expenses	-2.0%	1.9%	7.1%	0.0%	0.0%
Pre-provision earnings	-37.8%	-18.7%	31.3%	5.5%	15.7%
Loan loss provisions	-38.7%	31.6%	-40.0%	-7.0%	0.0%
Net profit	**-30.9%**	**-34.8%**	**61.9%**	**0.0%**	**20.0%**
Balance sheet					
Total Loans	65.9%	6.9%	-4.9%	1.5%	3.0%
Interest earning assets	53.5%	5.4%	9.1%	8.2%	9.3%
Total Assets	57.0%	4.8%	8.3%	8.2%	9.3%
Deposits	54.1%	9.0%	13.3%	8.2%	9.3%
Shareholders' funds	-1.8%	4.4%	7.6%	9.4%	10.3%

Source: Company reports; Lehman Brothers estimates.

Equitable PCI Bank

Thrilla in Manila

Not Rated

Ticker:	EBC.PM
Market Cap:	US$262 MM
Shares Outstanding:	727 MM

Equitable-PCI has seen its fair share of troubles this year, with the dominating issue that of repayment of P30 billion in emergency government loans continually threatening the liquidity of the bank. The loans were originally extended to the bank to help it cope with a run on its deposits after the bank was drawn into the vortex surrounding the impeachment of former President Estrada. The bank has in fact made good progress on eliminating this Damoclean sword; although deposits remain below last year's levels, the bank has managed to prepay a substantial proportion of its debts, reducing the outstanding amount to P9 billion.

Aside from these difficulties the bank has installed a new management team following the resignation of bank president Vergara earlier in the year. Continuing squabbling between directors and 30% shareholders the Go family and 25% Social Security System center over the need to raise additional capital and dilution of existing shareholders. While the bank's total capital is sufficient at around 14% of weighted assets, EBC requires additional capital to fund an expected higher level of provisioning going forward. One upside from the Go family connection, however, is that holders of the shares are less likely to have their value diluted, a risk that holders of distressed market banks constantly face.

Surprisingly for all its woes, the bank has managed to maintain a healthy NIM as of the end of the first half of 3.00%, increasing from 2.40% from year end 2000. We expect full-year NIM to drop to 2.87% however on lower business volume in the second half. The loan book has contracted 15% over the first half, reflecting the bank's need to liquidate assets to meet its short-term funding requirements. (Deposits also slipped 14% over the first half.) EBC slipped into loss in the second quarter, due primarily to a one-off drop in non-interest income, down 30% YoY.

As the loan book contracts in the second half (although at a diminishing rate), we expect the proportion of non-performing loans to increase. We see the NPL ratio of 26.9% at the beginning of the year deteriorating to 32.1% by year end. Under our estimate of required reserves against NPLs, EBC remains relatively exposed with actual reserves around 59% of our stringent estimates. The shortfall in required reserves represents approximately 18% of the bank's capital, a significant portion but not as high as other banks.

Unsurprisingly, the bank trades at only 0.31x first half 2001 book (0.51x adjusted book) on an expected ROE of 0.52%. We expect the bank to be only marginally profitable this year. On our deposit premium franchise valuation, the bank is currently valued at a 4% discount on deposits, even after taking into account reserve shortfalls.

Equitable PCI Bank

Share Price (PHP):	18.75	**Index:**	1,002.52
52 Week Price Range (PHP):	70.00 - 16.00	**Current Yield:**	6.40%
Reuters Code:	EBC.PM		
Bloomberg Code:	EBC PM	**Shares Outstanding (MM):**	727.00

INCOME STATEMENT	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
(P million) year ending Dec					
Interest income	19,013	18,498	16,141	14,399	15,174
Interest expense	-10,764	-11,813	-10,493	-9,072	-9,535
Net interest income	**8,248**	**6,685**	**5,648**	**5,327**	**5,639**
Ave. int. earnings assets	*145,662*	*203,387*	*196,580*	*180,974*	*190,792*
NIM (%)	**5.66%**	**3.29%**	**2.87%**	**2.94%**	**2.96%**
Non-interest income	7,347	7,165	7,209	7,281	7,380
Total operating income	**15,595**	**13,850**	**12,856**	**12,607**	**13,019**
Non-interest expenses	-9,951	-10,273	-10,401	-10,349	-10,297
Pre provision profit	**5,645**	**3,577**	**2,456**	**2,259**	**2,722**
Loan loss provisions	-3,782	-3,755	-2,449	-2,050	-1,600
Non-operating income	-949	-88	-50	0	0
Pre tax profit	**914**	**-266**	**-44**	**209**	**1,122**
Tax	336	904	187	-67	-359
Net profit	**1,251**	**638**	**143**	**142**	**763**

PER SHARE DATA (W)	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
EPS	1.72	0.88	0.20	0.20	1.05
DPS	1.16	1.20	0.00	0.00	0.00
Effective payout ratio (%)	*67%*	*137%*	*0%*	*0%*	*0%*
BVPS	62.55	61.81	60.46	60.65	61.70
ABVPS	36.17	36.05	37.37	38.15	39.78

VALUATION	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
Price to book value (x)	1.4	1.0	0.3	0.3	0.3
Price to adjusted book value (x)	2.5	1.6	0.5	0.5	0.5
Price to earnings (X)	52.0	67.2	95.1	96.1	17.9

PROFITABILITY RATIOS	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
(%)					
Net interest margin	5.66%	3.29%	2.87%	2.94%	2.96%
Yield on interest earning assets	13.05%	9.09%	8.99%	7.90%	7.61%
Cost on interest bearing liabilities	7.64%	5.86%	6.03%	5.14%	4.94%
Net interest spread	5.41%	3.24%	2.95%	2.76%	2.67%
Non-int. income (% Op income)	47.1%	51.7%	56.1%	57.7%	56.7%
Cost to income	63.8%	74.2%	80.9%	82.1%	79.1%
Overhead ratio	3.90%	3.66%	4.18%	4.10%	3.73%
Cost coverage	73.8%	69.7%	69.3%	70.4%	71.7%
ROA	0.69%	0.24%	0.05%	0.06%	0.29%
ROE	4.1%	1.4%	0.5%	0.5%	2.7%

DUPONT ANALYSIS	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
Lending operations					
Net interest margin	5.66%	3.29%	2.87%	2.94%	2.96%
Interest earning assets/assets	80.05%	76.01%	74.28%	72.14%	72.14%
NIM contribution to ROA	**4.53%**	**2.50%**	**2.13%**	**2.12%**	**2.13%**
Non-interest operations					
Non-interest income/assets	4.04%	2.68%	2.72%	2.90%	2.79%
Overhead ratio	5.47%	3.84%	3.93%	4.13%	3.89%
Non-int. contribution to ROA	**-1.43%**	**-1.16%**	**-1.21%**	**-1.22%**	**-1.10%**
Asset quality analysis					
Provision/loans	-4.95%	-3.06%	-2.01%	-1.82%	-1.39%
Loans/assets	41.97%	45.82%	46.09%	45.00%	43.66%
ROA effect from asset quality	**-2.08%**	**-1.40%**	**-0.93%**	**-0.82%**	**-0.60%**
Core ROA	**1.02%**	**-0.07%**	**0.00%**	**0.08%**	**0.42%**
Non-core contibution to ROA	-0.52%	-0.03%	-0.02%	0.00%	0.00%
Pre-tax ROA	**0.50%**	**-0.10%**	**-0.02%**	**0.08%**	**0.42%**
Tax rate	-36.80%	340.18%	428.82%	32.00%	32.00%
After tax ROA	**0.69%**	**0.24%**	**0.05%**	**0.06%**	**0.29%**
Balance sheet leverage (x)	5.9	5.9	6.0	5.7	5.9
ROE	**4.1%**	**1.4%**	**0.3%**	**0.3%**	**1.7%**

BALANCE SHEET	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
(P million) year ending Dec					
Gross loans	121,515	141,949	123,987	127,160	131,631
Specific loan loss reserves	*0*	*0*	*0*	*0*	*0*
Loan loss reserves	*-8,199*	*-10,050*	*-11,942*	*-13,428*	*-14,449*
Net loans	113,315	131,899	112,045	113,732	117,183
Other earning assets	79,939	81,620	67,595	68,575	82,095
Other assets	61,571	4,078,889	69,368	70,398	76,951
Total Assets	**254,825**	**280,302**	**249,009**	**252,706**	**276,228**
Deposits	159,529	156,678	130,397	132,333	144,651
Other paying liabilities	35,510	51,620	43,536	44,183	48,295
Other liabilities	14,315	27,065	31,122	32,095	38,425
Total Liabilities	**209,354**	**235,364**	**205,055**	**208,610**	**231,370**
Minorities & other	0	0	0	0	0
Shareholders' funds	**45,471**	**44,938**	**43,954**	**44,095**	**44,858**

LOAN BOOK	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
(P million)					
Manufacturing	42,051	46,186	38,858	39,435	43,105
Wholesale and retail trade	19,254	23,868	20,081	20,379	22,276
Other community, social and persc	17,886	8,038	6,763	6,863	7,502
Financial institutions	8,361	12,192	10,258	10,410	11,379
Real estate, renting and other busi	12,038	11,776	9,907	10,054	10,990
Others	13,726	29,840	26,179	26,591	21,930
Total loans	**113,315**	**131,899**	**112,045**	**113,732**	**117,183**
(%)					
Manufacturing	37%	35%	35%	35%	37%
Wholesale and retail trade	17%	18%	18%	18%	19%
Other community, social and persc	16%	6%	6%	6%	6%
Financial institutions	7%	9%	9%	9%	10%
Real estate, renting and other busi	11%	9%	9%	9%	9%
Others	12%	23%	23%	23%	19%
Total loans	**100%**	**100%**	**100%**	**100%**	**100%**

BALANCE SHEET RATIOS	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
(%)					
Loan to deposit	71.0%	84.2%	85.9%	85.9%	81.0%
Equity to assets	17.8%	16.0%	17.7%	17.4%	16.2%
Tier 1 Capital	na	na	na	na	na
Total Capital adequacy	11.9%	11.8%	13.0%	12.9%	12.0%
General reserves (% loans)	6.75%	7.08%	9.63%	10.56%	10.98%
Specific reserves (% loans)	0.00%	0.00%	0.00%	0.00%	0.00%
Total loan provisions	6.75%	7.08%	9.63%	10.56%	10.98%

ASSET QUALITY	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
(P million)					
Pass	95,705	108,919	86,590	89,395	94,821
Special Mention	2,088	2,784	3,008	2,890	2,776
Substandard	3,094	4,126	3,992	3,989	3,679
Doubtful	5,259	7,012	6,784	6,912	6,375
Foreclosed assets	6,462	9,472	10,542	8,407	6,705
NPL ratio	22.9%	26.9%	32.1%	28.8%	24.8%
Total provisions/NPLs	48.5%	43.0%	49.1%	60.5%	74.0%

GROWTH RATES	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
(%)					
Income statement					
Net interest income	103.2%	-19.0%	-15.5%	-5.7%	5.9%
Non-interest income	193.5%	-2.5%	0.6%	0.0%	0.0%
Total operating income	137.7%	-11.2%	-7.2%	-1.9%	3.3%
Operating expenses	204.6%	3.2%	1.2%	0.0%	0.0%
Pre-provision earnings	71.3%	-36.6%	-31.4%	-8.0%	20.5%
Loan loss provisions	161.0%	-0.7%	-34.8%	-16.3%	-22.0%
Net profit	**-21.1%**	**-49.0%**	**-77.5%**	**-1.0%**	**437.6%**
Balance sheet					
Total Loans	187.4%	16.4%	-15.1%	1.5%	3.0%
Interest earning assets	97.1%	10.5%	-15.9%	1.5%	9.3%
Total Assets	133.6%	10.0%	-11.2%	1.5%	9.3%
Deposits	141.2%	-1.8%	-16.8%	1.5%	9.3%
Shareholders' funds	184.7%	-1.2%	-2.2%	0.3%	1.7%

Source: Company reports; Lehman Brothers estimates.

Metrobank

Indigestion

Rating: 3-Market Perform

Ticker:	MBT PM
Market Cap:	US$1,055 MM
Shares Outstanding:	327 MM

Metrobank is still digesting the consolidations it undertook last year. While we view consolidations in any overbanked markets as ultimately beneficial, we have yet to see any evidence of merger benefits accruing to the bank in either cost saves or efficiency gains.

Expenses at Metrobank have historically been high, however, the year end 2000 efficiency ratio of 74% and overhead ratio of 4% are significantly higher than 1999 figures (almost double 1998 ratios) and belie the effects of incorporating merged SolidBank results. While one could reasonably expect the efficiency ratio to drop, we see it has actually deteriorated to over 80% in the interim reporting periods this year. Some of the increase in costs may be due to merger-related expenses, but 18 months after the acquisition of SolidBank was announced we are surprised to see that no benefits at all have begun to accrue.

The acquisition of SolidBank also meant that MBT consolidated more bad loans onto its books, with the year end NPL ratio increasing to over 30%. Despite (or perhaps because of) much discussion on the pros and cons of a national AMC similar to Thailand's model (which looks likely to have minimal impact), banks have made little progress on year end figures in cleaning their books of the heavy burden of ROPOA weighing down their balance sheets. We expect NPL levels to remain appallingly high as management continue to dance around the horns of this dilemma.

Based on mid-year stated NPL classifications, we estimate that Metrobank is 50% under-provisioned by our loan loss reserve methodology, with the shortfall amounting to approximately 35% of equity. The level of provisioning compares unfavorably to other Philippine banks under our coverage; in fact Metro has always been known for aggressively low provisions.

Margins have held up well at 3.03% over the first half of the year, but we expect a decline beginning in 2H01 under the weight of a stagnant loan portfolio. We expect full-year NIM will decline to 2.89% in FY2002.

Despite a stated loan growth target of 10% for the year, mostly in the increasingly competitive consumer segment, loans have remained level over the first half. We estimate that loans will actually decline this year on an absolute level. Compounding already negative loan growth, we expect to see larger decreases in the level of performing loans due to Metrobank's relatively high exposure to the precarious SME segment.

The stock has been a relative out-performer this year and currently trades at 1.15x trailing first half book (1.42x adjusted book due to the effect of goodwill) on an expected 2001 ROCE of 8.5% (7.6% FY2002)and 16.5x FY2001 EEPS (16.8x FY2002 EEPS).

Metropolitan Bank and Trust Company

Share Price (PHP):	168.00	**Index:**	1,002.52
52 Week Price Range (PHP):	241.00 - 167.00	**Current Yield:**	0.00%
Reuters Code:	MBT.PM		
Bloomberg Code:	MBT PM	**Shares Outstanding** (MM):	326.73

INCOME STATEMENT (P million) year ending Dec	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
Interest income	25,498	33,984	38,232	38,442	41,625
Interest expense	-14,983	-23,591	-26,072	-25,823	-27,901
Net interest income	**10,515**	**10,393**	**12,160**	**12,618**	**13,725**
Ave. int. earnings assets	*304,134*	*367,575*	*401,747*	*435,905*	*474,243*
NIM (%)	**3.46%**	**2.83%**	**3.03%**	**2.89%**	**2.89%**
Non-interest income	5,335	9,609	10,083	10,234	10,388
Total operating income	**15,850**	**20,002**	**22,243**	**22,853**	**24,113**
Non-interest expenses	-10,108	-14,876	-15,891	-15,812	-15,733
Pre provision profit	**5,742**	**5,126**	**6,351**	**7,041**	**8,380**
Loan loss provisions	-1,802	-3,075	-1,778	-2,250	-2,250
Non-operating income	-156	-53	-150	0	0
Pre tax profit	**3,784**	**1,998**	**4,424**	**4,791**	**6,130**
Tax	-658	-494	-1,086	-1,533	-1,961
Net profit	**3,126**	**1,504**	**3,337**	**3,258**	**4,168**

PER SHARE DATA (W)	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
EPS	10.52	4.60	10.21	9.97	12.76
DPS	3.57	0.00	0.00	0.00	0.00
Effective payout ratio (%)	*34%*	*0%*	*0%*	*0%*	*0%*
BVPS	151.55	145.22	152.95	162.93	175.68
ABVPS	125.61	115.19	125.70	136.33	149.75

VALUATION	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
Price to book value (x)	1.9	1.3	1.1	1.0	1.0
Price to adjusted book value (x)	2.3	1.6	1.3	1.2	1.1
Price to earnings (X)	27.0	39.8	16.4	16.8	13.2

PROFITABILITY RATIOS (%)	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
Net interest margin	3.46%	2.83%	3.03%	2.89%	2.89%
Yield on interest earning assets	8.38%	9.25%	9.13%	8.48%	8.40%
Cost on interest bearing liabilities	5.32%	6.71%	6.64%	6.08%	6.01%
Net interest spread	3.06%	2.54%	2.49%	2.41%	2.40%
Non-int. income (% Op income)	33.7%	48.0%	45.3%	44.8%	43.1%
Cost to income	63.8%	74.4%	71.4%	69.2%	65.2%
Overhead ratio	2.50%	3.37%	3.38%	3.10%	2.82%
Cost coverage	52.8%	64.6%	63.4%	64.7%	66.0%
ROA	0.90%	0.36%	0.73%	0.66%	0.78%
ROE	7.1%	3.3%	8.5%	7.6%	8.9%

DUPONT ANALYSIS	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
Lending operations					
Net interest margin	3.46%	2.83%	3.03%	2.89%	2.89%
Interest earning assets/assets	87.63%	86.91%	88.02%	88.92%	88.92%
NIM contribution to ROA	**3.03%**	**2.46%**	**2.66%**	**2.57%**	**2.57%**
Non-interest operations					
Non-interest income/assets	1.54%	2.27%	2.21%	2.09%	1.95%
Overhead ratio	2.91%	3.52%	3.48%	3.23%	2.95%
Non-int. contribution to ROA	**-1.38%**	**-1.25%**	**-1.27%**	**-1.14%**	**-1.00%**
Asset quality analysis					
Provision/loans	-0.97%	-1.44%	-0.80%	-1.01%	-0.99%
Loans/assets	53.78%	50.61%	48.53%	45.35%	42.63%
ROA effect from asset quality	**-0.52%**	**-0.73%**	**-0.39%**	**-0.46%**	**-0.42%**
Core ROA	**1.14%**	**0.48%**	**1.00%**	**0.98%**	**1.15%**
Non-core contibution to ROA	-0.04%	-0.01%	-0.03%	0.00%	0.00%
Pre-tax ROA	**1.09%**	**0.47%**	**0.97%**	**0.98%**	**1.15%**
Tax rate	17.40%	24.72%	24.56%	32.00%	32.00%
After tax ROA	**0.90%**	**0.36%**	**0.73%**	**0.66%**	**0.78%**
Balance sheet leverage (x)	7.9	9.1	9.4	9.5	9.6
ROE	**7.1%**	**3.3%**	**6.9%**	**6.3%**	**7.5%**

BALANCE SHEET (P million) year ending Dec	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
Gross loans	219,598	238,197	237,884	242,346	250,250
Specific loan loss reserves	*0*	*0*	*0*	*0*	*0*
Loan loss reserves	*-13,884*	*-15,861*	*-17,234*	*-18,374*	*-19,483*
Net loans	205,714	222,336	220,650	223,972	230,767
Other earning assets	144,601	162,499	198,008	229,181	264,567
Other assets	53,536	4,078,889	52,191	56,492	61,750
Total Assets	**403,851**	**442,011**	**470,850**	**509,644**	**557,084**
Deposits	305,650	347,506	374,518	405,376	443,110
Other paying liabilities	28,415	22,093	18,111	19,603	21,428
Other liabilities	24,770	24,963	28,245	31,433	35,145
Total Liabilities	**358,836**	**394,563**	**420,875**	**456,412**	**499,683**
Minorities & other	0	0	0	0	0
Shareholders' funds	**45,015**	**47,449**	**49,975**	**53,233**	**57,401**

LOAN BOOK (P million)	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
Manufacturing	56,992	62,460	67,949	73,548	80,394
Wholesale and retail trade	43,154	42,188	45,896	49,678	54,302
Other community, social and persc	21,141	20,459	22,257	24,091	26,333
Financial institutions	11,753	6,824	7,424	8,036	8,784
Real estate, renting and other busi	32,046	44,399	48,302	52,281	57,148
Others	40,629	46,006	28,822	16,339	3,807
Total loans	**205,714**	**222,336**	**220,650**	**223,972**	**230,767**
(%)					
Manufacturing	28%	28%	31%	33%	35%
Wholesale and retail trade	21%	19%	21%	22%	24%
Other community, social and persc	10%	9%	10%	11%	11%
Financial institutions	6%	3%	3%	4%	4%
Real estate, renting and other busi	16%	20%	22%	23%	25%
Others	20%	21%	13%	7%	2%
Total loans	**100%**	**100%**	**100%**	**100%**	**100%**

BALANCE SHEET RATIOS (%)	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
Loan to deposit	67.3%	64.0%	58.9%	55.3%	52.1%
Equity to assets	11.1%	10.7%	10.6%	10.4%	10.3%
Tier 1 Capital	na	na	na	na	na
Total Capital adequacy	16.4%	13.0%	12.8%	12.6%	12.4%
General reserves (% loans)	6.32%	6.66%	7.24%	7.58%	7.79%
Specific reserves (% loans)	0.00%	0.00%	0.00%	0.00%	0.00%
Total loan provisions	6.32%	6.66%	7.24%	7.58%	7.79%

ASSET QUALITY (P million)	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
Pass	171,776	179,124	178,343	183,818	193,745
Special Mention	7,738	9,650	8,851	8,502	8,167
Substandard	5,477	6,831	5,921	5,916	5,457
Doubtful	6,849	8,542	7,404	7,544	6,958
Foreclosed assets	16,691	23,568	27,344	21,807	17,391
NPL ratio	26.9%	32.3%	31.6%	27.7%	23.6%
Total provisions/NPLs	37.8%	32.6%	34.8%	42.0%	51.3%

GROWTH RATES (%)	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
Income statement					
Net interest income	-15.6%	-1.2%	17.0%	3.8%	8.8%
Non-interest income	-2.3%	80.1%	4.9%	0.0%	0.0%
Total operating income	-11.5%	26.2%	11.2%	2.7%	5.5%
Operating expenses	16.1%	47.2%	6.8%	0.0%	0.0%
Pre-provision earnings	-37.7%	-10.7%	23.9%	10.9%	19.0%
Loan loss provisions	-33.1%	70.7%	-42.2%	26.6%	0.0%
Net profit	**-33.5%**	**-51.9%**	**121.9%**	**-2.4%**	**27.9%**
Balance sheet					
Total Loans	22.7%	8.1%	-0.8%	1.5%	3.0%
Interest earning assets	35.8%	9.9%	8.8%	8.2%	9.3%
Total Assets	39.1%	9.4%	6.5%	8.2%	9.3%
Deposits	46.8%	13.7%	7.8%	8.2%	9.3%
Shareholders' funds	5.0%	5.4%	5.3%	6.5%	7.8%

Source: Company reports; Lehman Brothers estimates.

Philippine National Bank

Not Seeing Eye to Eye

Rating: 4-Market UnderPerform

Ticker:	PNB.PM
Market Cap:	US$345.02 MM
Shares Outstanding:	378 MM

This stock is a relative (+62.2%) and absolute (+31.9%) out-performer so far this year, reflecting more perhaps how thinly traded the stock is rather than any progress. Indeed, the bank has been mired in an ownership battle between two-thirds owner Lucio Tan and the government (16% owners) over the future direction of the bank—with the government keen to wrest control from Tan and looking likely to succeed at its latest attempt. Majority shareholder Lucio Tan has agreed to allow the government to convert P7.8 billion of emergency loans extended to the bank at P40 per share, or around a 15% discount to market.

The conversion will give both the government and Tan 45% control over the bank and over future rehabilitation plans. With increased government influence, rehabilitation plans are more likely to include an early confrontation with the bank's massive non-performing asset burden—most beneficially this should include a sell-off and write-down of large chunks of debt to an AMC—an idea the government has been vociferously in favor of.

Operationally the bank is still in recovery mode following the run on deposits last year. This year as an indication that confidence is returning, deposits have increased 9% over the first half, although are still at levels lower than a year ago. Most of the growth has come in the form of relatively liquid, although lower cost, demand and savings deposits.

After dipping into a negative NIM in the first quarter, the bank has returned to slight positive margins of 0.09% on a normalized COF level of 6.9%. We expect full year negative NIM of –0.15% showing the bank is far from rehabilitation and an operating turnaround must await more drastic measures.

As with all other Philippine Banks we have seen an absolute drop-off in the loan book, with PNB losing 1.6% over the first half (although down 10% YoY). We see no pick up in loan growth for the sector as a whole until the end of FY2002 at the earliest. This will place a greater emphasis on operating efficiency – the bank has astronomical operating costs of around 90% of total income.

PNB turns in an incredibly high NPL ratio of 91%, and is seriously underprovisioned. Actual reserves meet only 48% of our estimated required loan loss allowance, and the resulting reserve shortfall is equivalent to over 1.21x equity—making the bank technically insolvent.

Surprisingly, the bank trades (rather infrequently) at 1.06x first half 2001 book (1.10x adjusted book)—although we believe book values are largely illusory for this bank. On our deposit premium franchise valuation, the bank is the most expensive of the Philippine banks, with a theoretical acquisitor paying a 17% premium over the value of deposits for PNB compared with an average of around 7% for our four covered banks.

Philippine National Bank

Share Price (PHP):	47.50	**Index:**	1002.52	**Reuters Code:**	PNB.PM
52 Week Price Range (PHP):	55.50 - 29.50	**Current Yield:**	0.00%	**Bloomberg Code:**	PNB PM
				Shares Outstanding (MM):	378.07

INCOME STATEMENT	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
(P million) year ending Dec					
Interest income	16,248	15,145	11,581	11,747	12,819
Interest expense	-12,580	-12,359	-11,793	-11,618	-12,559
Net interest income	**3,668**	**2,786**	**-212**	**129**	**260**
Ave. int. earnings assets	*154,639*	*141,895*	*139,053*	*148,347*	*161,394*
NIM (%)	**2.37%**	**1.96%**	**-0.15%**	**0.09%**	**0.16%**
Non-interest income	5,834	6,013	8,992	9,127	9,264
Total operating income	**9,502**	**8,799**	**8,780**	**9,256**	**9,524**
Non-interest expenses	-8,264	-7,540	-9,681	-9,633	-9,585
Pre provision profit	**1,238**	**1,259**	**-902**	**-377**	**-61**
Loan loss provisions	-13,858	-4,982	-3,265	-2,500	-2,000
Non-operating income	0	0	0	0	0
Pre tax profit	**-12,620**	**-3,723**	**-4,167**	**-2,877**	**-2,061**
Tax	-1,233	-2,251	-169	921	660
Net profit	**-13,853**	**-5,974**	**-4,336**	**-1,957**	**-1,402**

PER SHARE DATA (W)	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
EPS	-67.18	-15.80	-11.47	-5.18	-3.71
DPS	0.00	0.00	0.00	0.00	0.00
Effective payout ratio (%)	*0%*	*0%*	*0%*	*0%*	*0%*
BVPS	52.36	54.15	43.78	38.61	34.90
ABVPS	38.10	52.56	42.20	37.02	33.31

VALUATION	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
Price to book value (x)	1.8	0.7	1.1	1.2	1.4
Price to adjusted book value (x)	2.5	0.7	1.1	1.3	1.4
Price to earnings (X)	-1.4	-2.4	-4.1	-9.2	-12.8

PROFITABILITY RATIOS	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
(%)					
Net interest margin	2.37%	1.96%	-0.15%	0.09%	0.16%
Yield on interest earning assets	10.51%	10.67%	8.13%	7.62%	7.60%
Cost on interest bearing liabilities	7.10%	7.33%	7.00%	6.37%	6.30%
Net interest spread	3.40%	3.34%	1.13%	1.25%	1.31%
Non-int. income (% Op income)	61.4%	68.3%	102.4%	98.6%	97.3%
Cost to income	87.0%	85.7%	110.3%	104.1%	100.6%
Overhead ratio	4.19%	3.92%	4.89%	4.50%	4.09%
Cost coverage	70.6%	79.8%	92.9%	94.7%	96.6%
ROA	-6.97%	-3.07%	-2.22%	-0.95%	-0.63%
ROE	-108.2%	-38.2%	-24.2%	-13.1%	-10.5%

DUPONT ANALYSIS	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
Lending operations					
Net interest margin	2.37%	1.96%	-0.15%	0.09%	0.16%
Interest earning assets/assets	77.78%	72.87%	71.26%	72.02%	72.02%
NIM contribution to ROA	**1.85%**	**1.43%**	**-0.11%**	**0.06%**	**0.12%**
Non-interest operations					
Non-interest income/assets	2.93%	3.09%	4.61%	4.43%	4.13%
Overhead ratio	4.16%	3.87%	4.96%	4.68%	4.28%
Non-int. contribution to ROA	**-1.22%**	**-0.78%**	**-0.35%**	**-0.25%**	**-0.14%**
Asset quality analysis					
Provision/loans	-13.28%	-5.84%	-4.07%	-3.13%	-2.45%
Loans/assets	52.51%	43.83%	41.10%	38.80%	36.47%
ROA effect from asset quality	**-6.97%**	**-2.56%**	**-1.67%**	**-1.21%**	**-0.89%**
Core ROA	**-6.35%**	**-1.91%**	**-2.14%**	**-1.40%**	**-0.92%**
Non-core contibution to ROA	0.00%	0.00%	0.00%	0.00%	0.00%
Pre-tax ROA	**-6.35%**	**-1.91%**	**-2.14%**	**-1.40%**	**-0.92%**
Tax rate	-9.77%	-60.46%	-4.06%	32.00%	32.00%
After tax ROA	**-6.97%**	**-3.07%**	**-2.22%**	**-0.95%**	**-0.63%**
Balance sheet leverage (x)	15.5	12.5	10.5	13.2	16.1
ROE	**-108.2%**	**-38.2%**	**-23.4%**	**-12.6%**	**-10.1%**

BALANCE SHEET	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
(P million) year ending Dec					
Gross loans	106,380	98,348	99,457	102,752	106,785
Specific loan loss reserves	*0*	*0*	*0*	*0*	*0*
Loan loss reserves	*-16,791*	*-17,268*	*-20,135*	*-22,236*	*-23,826*
Net loans	89,589	81,080	79,322	80,516	82,959
Other earning assets	58,572	54,548	63,155	73,700	85,612
Other assets	48,838	4,078,889	55,355	59,916	65,493
Total Assets	**197,000**	**192,430**	**197,833**	**214,133**	**234,065**
Deposits	164,708	119,130	133,639	144,650	158,115
Other paying liabilities	12,607	40,835	34,948	37,828	41,349
Other liabilities	8,888	11,994	12,693	17,059	21,407
Total Liabilities	**186,203**	**171,959**	**181,280**	**199,537**	**220,871**
Minorities & other	0	0	0	0	0
Shareholders' funds	**10,797**	**20,471**	**16,552**	**14,596**	**13,194**

LOAN BOOK	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
(P million)					
Manufacturing	26,040	24,408	25,641	27,753	30,337
Wholesale and retail trade	18,349	16,572	17,409	18,843	20,597
Other community, social and persc	9,248	9,938	10,440	11,300	12,352
Financial institutions	3,746	3,485	3,661	3,963	4,331
Real estate, renting and other busi	20,254	17,171	18,038	19,524	21,342
Others	11,952	9,506	4,134	-867	-6,000
Total loans	**89,589**	**81,080**	**79,322**	**80,516**	**82,959**
(%)					
Manufacturing	29%	30%	32%	34%	37%
Wholesale and retail trade	20%	20%	22%	23%	25%
Other community, social and persc	10%	12%	13%	14%	15%
Financial institutions	4%	4%	5%	5%	5%
Real estate, renting and other busi	23%	21%	23%	24%	26%
Other	13%	12%	5%	-1%	-7%
Total loans	**100%**	**100%**	**100%**	**100%**	**100%**

BALANCE SHEET RATIOS	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
(%)					
Loan to deposit	54.4%	68.1%	59.4%	55.7%	52.5%
Equity to assets	5.5%	10.6%	8.4%	6.8%	5.6%
Tier 1 Capital	na	na	na	na	na
Total Capital adequacy	2.0%	11.9%	9.4%	7.6%	6.3%
General reserves (% loans)	15.78%	17.56%	20.24%	21.64%	22.31%
Specific reserves (% loans)	0.00%	0.00%	0.00%	0.00%	0.00%
Total loan provisions	15.78%	17.56%	20.24%	21.64%	22.31%

ASSET QUALITY	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
(P million)					
Pass	60,779	45,909	29,354	33,230	39,565
Special Mention	4,515	5,715	6,412	6,160	5,917
Substandard	4,597	5,819	6,652	6,647	6,131
Doubtful	6,781	8,583	9,812	9,997	9,221
Foreclosed assets	21,194	21,558	22,648	18,062	14,404
NPL ratio	62.3%	80.6%	91.5%	81.2%	69.7%
Total provisions/NPLs	45.3%	41.4%	44.2%	54.4%	66.8%

GROWTH RATES	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
(%)					
Income statement					
Net interest income	-30.8%	-24.1%	-107.6%	-160.6%	102.1%
Non-interest income	34.5%	3.1%	49.5%	0.0%	0.0%
Total operating income	-1.4%	-7.4%	-0.2%	5.4%	2.9%
Operating expenses	-7.8%	-8.8%	28.4%	0.0%	0.0%
Pre-provision earnings	82.7%	1.7%	-171.6%	-58.1%	-83.8%
Loan loss provisions	56.0%	-64.1%	-34.5%	-23.4%	-20.0%
Net profit	**NM**	**-56.9%**	**-27.4%**	**-54.9%**	**-28.4%**
Balance sheet					
Total Loans	-24.8%	-9.5%	-2.2%	1.5%	3.0%
Interest earning assets	-8.0%	-8.5%	5.0%	8.2%	9.3%
Total Assets	-1.8%	-2.3%	2.8%	8.2%	9.3%
Deposits	4.1%	-27.7%	12.2%	8.2%	9.3%
Shareholders' funds	-27.1%	89.6%	-19.1%	-11.8%	-9.6%

Source: Company reports; Lehman Brothers estimates.

Table of Figures

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HK-1431	Asian Bank Briefing	Asia Pacific Bank Team	10/15/01	60
HK-1425	Asian Bank Briefing	Asia Pacific Bank Team	10/08/01	36
HK-1423	**Fubon Insurance: Creating Value from Capital**	Grant Chan	10/04/01	48
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HK-1415	**Indonesian Banks: Accidental Stars**	Paul Sheehan	09/27/01	48
HK-1410	Asian Bank Briefing	Asia Pacific Bank Team	09/24/01	31
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HK-1364	Asian Bank Briefing	Asia Pacific Bank Team	08/06/01	44
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HK-1336	Asian Bank Briefing	Asia Pacific Bank Team	07/03/01	32
HK-1332	Asian Bank Briefing	Asia Pacific Bank Team	06/26/01	36
HK-1325	Asian Bank Briefing	Asia Pacific Bank Team	06/18/01	32
HK-1319	Asian Bank Briefing	Asia Pacific Bank Team	06/11/01	28
HK-1314	Asian Bank Briefing	Asia Pacific Bank Team	06/04/01	24
HK-1308	Asian Bank Briefing	Asia Pacific Bank Team	05/28/01	28
HK-1302	Asian Bank Briefing	Asia Pacific Bank Team	05/21/01	20
HK-1296	Asian Bank Briefing	Asia Pacific Bank Team	05/14/01	16
HK-1290	Asian Bank Briefing	Asia Pacific Bank Team	05/07/01	68
HK-1284	**2001 Asian Banks Tour**	Asia Pacific Bank Team	04/28/01	84
HK-1279	**Dao Heng Bank Group: DBS Offer Generates Attractive Return**	Grant Chan	04/23/01	16
HK-1277	Asian Bank Briefing	Asia Pacific Bank Team	04/23/01	40
HK-1272	Asian Bank Briefing	Asia Pacific Bank Team	04/17/01	20
HK-1267	Asian Bank Briefing	Asia Pacific Bank Team	04/09/01	28
HK-1264	Asian Bank Briefing	Asia Pacific Bank Team	04/02/01	32
HK-1255	Asian Bank Briefing	Asia Pacific Bank Team	03/19/01	36
HK-1247	Asian Bank Briefing	Asia Pacific Bank Team	03/12/01	32
HK-1241	Asian Bank Briefing	Asia Pacific Bank Team	03/05/01	28
HK-1232	Asian Bank Briefing	Asia Pacific Bank Team	02/26/01	32
HK-1229	Asian Bank Briefing	Asia Pacific Bank Team	02/19/01	24
HK-1222	Asian Bank Briefing	Asia Pacific Bank Team	02/12/01	28
HK-1216	Asian Bank Briefing	Asia Pacific Bank Team	02/05/01	32
HK-1209	Asian Bank Briefing	Asia Pacific Bank Team	01/22/01	40
HK-1207	**The End of Capital as We Know It**	Paul Sheehan	01/18/01	16
HK-1200	**Asian Banks Regional Outlook 2001: Where's The Loan Growth?**	Asia Pacific Bank Team	01/08/01	164
HK-1194	Asian Bank Briefing	Asia Pacific Bank Team	12/18/00	24
HK-1189	Asian Bank Briefing	Asia Pacific Bank Team	12/11/00	20
HK-1183	Asian Bank Briefing	Asia Pacific Bank Team	12/04/00	32
HK-1180	**Bangkok Bank Hits the Rocks: Should Investors Abandon Ship?**	Paul Sheehan	11/29/00	16
HK-1178	Asian Bank Briefing	Asia Pacific Bank Team	11/27/00	24
HK-1150	Asian Bank Briefing	Asia Pacific Bank Team	10/30/00	20
HK-1084	**Slice and Dice: A Cutting Analysis of Asian Bank Profitability**	Maughan/Pang	08/21/00	76

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