Asian Banks

Where's The Loan Growth?

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We have downgraded Hong Kong banks to NEUTRAL following their excellent performance in the past six months. We reiterate our OVERWEIGHT position on banks in Singapore and South Korea, while we remain negative on the remaining Asian banking sectors.

- While we agree that the US rate cuts will help improve investor sentiments, we are more cautious than the market in terms of the fundamental impact on Asian banks. Most banks in the region are facing country-specific problems such as deteriorating asset quality or political instability, which means that a lower interest rate environment does not necessarily translate to substantially higher credit demand.

- We have downgraded Hong Kong to NEUTRAL, given that the banks have rallied strongly in recent months in anticipation of interest rate cuts, and valuations are becoming increasingly stretched. Additionally, even after incorporating an additional 25bps reduction, we do not expect loans in Hong Kong to grow more than 5% in 2001 and 2002. Our view stems from the fact that the key driver for loan demand, the property-related sector, remains sluggish. We have downgraded Hang Seng Bank to 3-Market Perform.

- Given concerns of a "double-dip" recession in most Asian economies, Singaporean banks present good investment opportunities given the country's safe haven status. Loan demand has also picked up in recent months, especially among the consumer segment, while we expect capital management and rationalization to be addressed in 1Q01. We have recently upgraded Singaporean banks to OVERWEIGHT.

- We continue to recommend investors to OVERWEIGHT South Korean banks. The key drivers of the sector's price performance would be the successful and timely implementation of Round 2 of financial restructuring, which we expect in 1Q01, and a resilient consumer segment to support loan growth. Increased pace of mergers and acquisitions among the strong banks would be an added catalyst for share price performance.

- We recommend H&CB, Kookmin Bank, UOB and Bank Central Asia as our top picks for the Asian banking sector.

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Investment Summary

2000 has been a trying year for most bank stocks in Asia. With the exception of Hong Kong, other banks in the region ended the year down in absolute terms. In Hong Kong, the banks gained 10% in absolute terms on average and outstripped the local index by 21%. We would also highlight that the healthy South Korean retail banks have handsomely outperformed the KOSPI index by an average of 35% to 39%. For the coming year, while the declining US interest rate scenario will help to improve investor sentiment towards the banking sector, we are more cautious than the market in terms of the fundamental impact of lower interest rates on loan growth.

In particular, we would highlight that we expect loan growth in Hong Kong to remain below 5% for the next years, lower interest rates notwithstanding. Our view stems from the fact that the key driver for Hong Kong loan demand, the property-related sectors, remains very sluggish. Additionally, we believe that share prices of most of the big cap banks have already discounted the interest rate cuts given the strong rally we witnessed in the past two months and as such we have less optimistic views of further outperformance. We continue to rate HSBC a 3-Market Perform, given our view that ROE for the bank has peaked and valuations are stretched at this juncture. We have also downgraded Hang Seng Bank from 2-Buy to 3-Market Perform, following its 40% increase in its share price over the last six months. Indeed, trading at 4.8x PBR, Hang Sang Bank is the most expensive banking stock in our universe. Consequently, we now recommend investors to adopt a NEUTRAL position in the Hong Kong banking sector.

We upgraded Singapore banks to OVERWEIGHT in the last week of 2000, and we take the opportunity to reiterate this view. We expect the US interest rate loosening to benefit the banks given that investors will focus on the interest rate sensitive sectors in the market. While loan growth has been weak for most of last year, we have seen some improvements in the most recent MAS releases. Specifically, lending to the consumer sector has been increasingly strong, growing by 12.9% year on year in October. Mortgage lending has also improved, mitigating the effects of rate cuts. Given its large exposures to the consumer and SME segments, coupled with its asset management expertise, we continue to rate UOB 1- Strong Buy as our top pick in the sector.

We recommend investors to remain OVERWEIGHT in South Korean banks in 2001. we expect the key drivers of the sector's price performance to be the successful and timely implementation of Round 2 of financial restructuring, which we expect in 1Q01, and a resilient consumer segment to support loan growth. Increased pace of mergers and acquisitions among the strong banks will be an added catalyst for share price performance. Already, we have heard announcements by H&CB and Kookmin Bank to merge with each other to form a retail-banking powerhouse. These two banks are our top picks in the sector, with 1-Strong Buy ratings on both stocks.

We are UNDERWEIGHT the banking sector for the remaining countries in Asia. Taiwan is besieged with rising non-performing assets, slow financial reforms and unstable political environment. We would only recommend Chinatrust for exposure to the sector. In Malaysia, continued merger pains weigh down bank share price performance, and Maybank is the only bank we would advise investors to hold in an otherwise unattractive sector. Banks in Thailand, Indonesia and the Philippines will be adversely affected, to varying degrees, by political and social turmoil. Coupled with the fact that most banks are still grappling with their non-performing asset portfolio, we believe investors would do well by staying away from these countries. We have included BCA, however, as one of our top picks given our strong belief that the potential return from this stock far outweighs the risk of investing in Indonesia.

Figure 1: Top Recommended Asian Bank Stocks

		EPS		Book value	PER		PBR
Bank	Price	2000	2001	2000	2000	2001	2000
H&CB	29,900	5,502	7,565	20,759	5.4x	4.0x	1.4x
Kookmin	17,800	2,073	3,124	11,501	8.6x	5.7x	1.3x
UOB	13.20	0.89	1.12	8.05	14.8x	11.7x	1.6x
BCA	1,625	351	474	2,109	4.6x	3.4x	0.8x

Source: Lehman Brothers

To Greenspan: Thanks for the cut

In a move that surprised the global markets, the US Fed announced a 50bps cut in the benchmark Fed Funds rate to 6.0% on January 3. The move came in-between the official FOMC meetings. The timing was four weeks earlier than most investors expected while the magnitude was also greater than most economists' forecasts. The Fed under Alan Greenspan's stewardship has traditionally been viewed as being partial to prescribing small doses and evaluating how the economy responds. Indeed, it is the first time that the Greenspan Fed initiated a 50bps change in what is expected to be a round of interest rate reductions. Our Lehman Brothers Global Economics team is forecasting an additional 25bps reduction in 1Q01. Any further reductions in the following quarters would largely depend on the how the US economy performs in the first three months of year.

The US interest rate cut is positive for sentiments in all Asian markets, and particularly so for the two big developed markets in Hong Kong and Singapore.

The Hong Kong market has factored in lower interest rates with bank stocks rising 15-20% over the last month. Bank stock have always been viewed as beneficiaries of lower interest rates, and the market has already factored this in. In fact we believe that current bank stock share prices have already factored in another 50-75 basis points decline in interest rates. Consequently, further multiple expansion will be difficult to achieve.

In Singapore, we likewise expect a US rate loosening to benefit loan volumes. We believe that one of the key drivers to overall loan growth will continue to be the consumer sector. In recent monthly MAS reports, consumer lending continues to advance at double-digit levels. We would highlight that personal income in Singapore is rising swiftly, which will help maintain this aggressive growth.

The US interest rate cut will have a less direct impact on the rest of Asia. The authorities in most of the rest of Asia have been contemplating rate cuts, not because of the US factor, but because of their rapidly deteriorating economies. In Taiwan, for example, the central bank cut its discount rate by 12.5bps to 4.625% in the last week of December 2000, a move that was widely viewed as necessary to boost the flagging economy. We would also point out that until December 2000, the Taiwanese authorities had not changed domestic interest rates for almost two years.

Nevertheless, lower US interest rates allow these countries to reduce interest rates without having to worry about the impact on their respective currencies. The overriding concern of the Taiwanese, Thai and the Philippine banks remains non-performing assets.

Wither loan growth?

Loan growth across the region was anemic in 2000, with the exception of loan growth in South Korea and Indonesia, despite strong rebounds in economic growth from 1999. Major economies like Hong Kong and Singapore are on track to register about 10%

GDP growth for 2000. These outstanding growth rates were achieved without any significant recovery in loan growth. As of November 2000, loan growth in Hong Kong inched up a feeble 2.8%, while loans in Singapore expanded by only 3.4% in the first ten months. This compares to more than 20% growth in the pre-crisis period for Hong Kong and Singapore. Indeed, this is one of the longest instances of a de-coupling of GDP/loan growth in recent memory.

Loan growth in Hong Kong is expected to be less than 5% in the next two years

In Hong Kong, property-related lending was the key driver to overall loan growth in the first seven years of 1990, accounting for 68% of total growth. Unfortunately, all parties have to come to an end, and the property bubble burst with the onset of the Asian financial crisis. Hitherto, property prices have remained weak, resulting in smaller average mortgage sizes and the number of property transactions continues to slide as speculative demand has dried up. Furthermore, the lack of investment opportunities has resulted in increased loan pre-payments.

With the exception of some large syndicated loans to major blue-chip companies, Hong Kong banks have generally shied away from the corporate sector. This is due to the fact that this sector has been the source of the bulk of problem loans. Moreover, the healthier companies have been de-leveraging their balance sheets and have not indicated any desire to start borrowing again. Consequently the banks continue to rage a mortgage war, with rates hovering at Prime minus 225bps. Despite such competitive rates, however, outstanding mortgage loans have been flat over the past 18 months, illustrating that net demand for such loans is still extremely poor. While the recent interest rate cut in the U.S. and in domestic interest rates will help to stimulate some credit demand, we forecast overall loan growth in Hong Kong to remain below 5% for the next two years.

Consumer loans to boost loans in Singapore

In Singapore, consumer financing will continue to drive overall loan growth. In the first ten months of 2000, consumer lending jumped 12.9% year on year. This is especially notable given that overall loans grew by only 4%. The sector that dragged down overall loans was manufacturing, which declined 0.4% year on year. In an increasingly competitive environment, we expect the smaller banks (i.e. UOB and Keppel Tatlee) with niches in consumer and SME lending to steal market share. This year, on the back of a more interest rate friendly environment, we expect a healthy pick-up in overall loan growth to 9.4%, from an estimated 5.9% last year.

Buoyed by a resilient retail-banking segment, we expect loans in Korea to grow 16% this year

Korea exhibited one of the strongest loan growths in 2000. For the first nine months of the year, overall loans were up 27% year on year, largely driven by retail loans, which expanded by almost 50%. The key drivers were mortgages and other personal finance loans, underscoring the resilient private sector consumption. Loans to the corporate sector also grew by a healthy 22%, albeit significantly behind retail loans. Rather than lending to the large corporates (*chaebols*), most banks have focused on small and medium-sized enterprises (SMEs) for corporate exposure. This year we expect overall loan growth to decelerate a more sustainable 16% and 14% in 2001 and 2002 respectively, especially taking into account the high base effect.

For the remaining larger economies in Asia (Taiwan and Malaysia), we expect loan growth to remain in mid-single digits. In Taiwan, the sector is besieged with anemic consumer demand given a weak property and stock market. While corporate loans have performed relatively well, we expect credit demand to taper off, especially with signs of a slowing electronics industry, the main driver for the Taiwanese economy. Rising NPLs have also led to banks being much more cautious in extending credit. In Malaysia, we expect the opposite to happen. Loan growth in the past year was driven by mortgages, which increased 16%. On the other hand, manufacturing loans managed to eke out only 4% growth. Looking ahead, we expect loan growth to be weak and banks to struggle to achieve loan growth of 5%-8%.

Loan demand hurt by political woes in Thailand and the Philippines

In the rest of Asia, we do not expect banks to register double-digit growth rates given the generally weak operating environment. In some of these countries, political uncertainties will continue to plague investor and business confidence, while others are still struggling to recover from their asset quality problems. In the Philippines for example, the on-going impeachment of President Estrada has seriously damaged business sentiment, which has led to weak corporate demand. Coupled with the increasing of domestic interest rates to protect the sliding peso in 4Q00, banks would have to focus more on controlling their rising non-performing assets.

In Thailand, the recent senate elections suggest the election process is unlikely to run smoothly, despite the recent passage of stricter election laws aimed at speeding up the election process. Multiple rounds of voting may still be needed to weed out candidates guilty of unlawful vote buying, before the Election Commission ultimately endorses the result. In addition, an ongoing corruption inquiry may lead to the current opposition leader being banned from taking office. This opens the door for increased political unrest, which would inevitably hurt business sentiment and credit demand. High-quality loans remain disappointingly scarce.

Figure 2: Regional loan growth comparison

	1998	1999	2000E	2001E	2002E
Hong Kong	-5.2	-7.4	3.2	4.7	4.8
Singapore*	27.1	2.5	5.9	9.4	7.5
South Korea	-0.1	24.9	27.5	16.0	14.0
Taiwan	12.0	8.5	6.5	5.0	6.8
Malaysia	-2.0	-5.0	5.0	5.0	8.0
Thailand*	-0.8	-4.0	-6.2	4.5	5.2
Indonesia*	12.6	-54.7	54.8	30.5	25.9
Philippines	-4.8	0.4	3.5	6.0	7.3

* average for banks under LB coverage

Source: Lehman Brothers

Consolidation Brewing

Consolidation in the banking sector is a theme that has been brewing for some time, but with few results. However, there is significant evidence that all Asian countries are over-banked. For example, banks below the top five control only small market shares, usually less than one percent, and cannot develop the economies of scale or don't have the balance sheet capacity or customer base to diversify their earnings bases. Such a structure is obviously not efficient and does not create economies of scale as well as provide for lower funding costs. Thus, the writing is on the wall– all Asian countries are over-banks and there is definitely a need to get bigger and better. However, what is the catalyst, other than government intervention?

In stable countries like Hong Kong and Singapore, the catalyst is likely to be declining profitability and the need for economies of scale to improve operating efficiencies. Developments in each of these countries point to consolidation picking up steam in 2001 and beyond. However, in distressed countries, the catalyst is likely to be either the government taking a bank over of orchestrating a deal.

The little consolidation that has occurred has primarily been in distressed countries, and have largely been government induced, both where the government plays the consolidator as well as the facilitator. Countries where the government has taken significant ownership stakes in the banking sector are Thailand and Indonesia. Meanwhile, the government has played the facilitator in Malaysia by "forcing" the country's 54 financial institutions to merge into ten anchor banks as well as Korea by merging four weak banks under a single holding company.

However, we prefer market driven mergers, whereby the goal is to achieve cost savings and/or revenue enhancement. This has been more the case in Hong Kong and Singapore, where the goal is to improve profitability rather than simply to survive.

Nevertheless, no matter which route is taken, the goal is to create larger and better institutions that will be better equipped to compete against foreign competition as the local markets open up to foreign banks.

Figure 3: Deposit Market Share in Asia

	No.1	No. 2	No. 3	No. 4	No. 5	*Top 5*	Other Banks	Remaining Market share	Share / Bank
Hong Kong	38	17	6	3	3	*67*	148	33	0.2
Singapore	39	16	14	15	6	*90*	26	10	0.4
Thailand	20	17	12	12	9	*70*	26	30	1.2
Malaysia	21	13	9	9	5	*57*	16	43	2.7
Korea	15	14	8	8	7	*52*	51	48	0.9
Indonesia	14	12	9	9	9	*53*	152	47	0.3
Philippines	12	10	9	6	5	*42*	46	58	1.3
China	23	17	15	15	4	*73*	938	27	0.0
Taiwan	11.3	8.8	7.3	6.2	5.8	*39*	88	61	0.7

Source: Lehman Brothers

Figure 4: Comparative population/branch

	No. of Commercial banks	No. of Branches	Population (million)	Population / Branch
Hong Kong	153	1,715	7.0	4,083
Singapore	31	276	4.0	14,496
Taiwan	48	2,408	22.3	9,243
South Korea	56	4,900	47.3	9,648
China	943	200,000	1,264.5	6,323
Malaysia	21	1,888	23.3	12,316
Indonesia	157	2,296	212.2	92,425
Philippines	51	4,200	80.3	19,119
Thailand	13	3,832	62.0	16,191
US	8,375	71,142	275.6	3,874

Source: Lehman Brothers

Hong Kong: Still too profitable

In Hong Kong, although there is a compelling argument that the territory is over-banked, there are few catalysts to encourage further consolidation in the industry in the near term. Banks are profitable, currently generating ROEs of 10-15%. In addition, many banks are owned and controlled by family interests, who are unwilling to give up the prestige of ownership as well as the strong recurrent cash flow generated from these banks. Two transactions occurred in 2000– BEA acquired FPB Bank and Standard Chartered acquired Chase's retail operations. Both transactions were driven by the fact that the major shareholders wanted to exit the banking business and focus on their own core operations, namely telecommunications and property for First Pacific and wholesale and corporate banking for Chase.

Over the longer term, the main catalyst for consolidation will be diminishing profitability, particularly due to increasing competition. BOC is aggressively increasing its retail banking operations, particularly in the mortgage market, resulting in lower profit margins on this core product. The inability to adapt and expand income sources will force small bank owners to sell to larger banks that can benefit from economies of scale.

Singapore: No catalyst yet

In Singapore, the economic case for industry consolidation is overwhelming. Profitability is poor, banks are overcapitalized and the capacity to increase earnings is limited. The most effective way to improve performance is to consolidate the industry, rationalize branch networks and technology platforms and take capital out of the sector. Meanwhile, the sector concentration is similar to Hong Kong, whereby the top bank is well ahead of its nearest competitor.

Korea: Grouping bad banks together

The government has been trying to kick-start consolidation in the banking sector by placing weak banks under a state-run financial holding company structure, targeted to be launched in 1Q01. We would highlight, however, that such a structure does not reduce the number of banks as the four banks are still allowed to operate as separate entities to minimize staff retrenchment and appease labor unions. We are advocates of this structure as it allows the government to restructure the business operations of the banks under the holding company.

And allowing good banks to merge to become even better

The placement of the weak banks under the holding company structure is also positive news for the good banks because the government will not force them to take over the weaker banks, which is good news for foreign strategic investors in both Kookmin and H&CB. In fact, Kookmin and H&CB have already announced that they are merging, which will create a retail banking powerhouse.

Indonesia: Total government intervention

Indonesia had the most unwieldy banking system in Asia, with 239 banks in operation prior to the crisis. The large number of banks in Indonesia put competitive pressure on managers to make riskier loans, which have not paid off. Consequently, 75 have since been closed, leaving 164 banks, which is still too many given the level of economic development in Indonesia as well as the amount of banking assets. The concentration among the top five banks remains high at 56% of deposits.

Even after the closures and rationalizations already orchestrated by IBRA, we believe that consolidation has barely begun. With government entities making no secret of their desire for fewer larger banks, we expect to see minimum capital requirements rise sharply in the next few years, similar to the path taken in the Philippines, whereby the government instituted higher minimum paid-up capital requirement to force the smaller banks to consolidate. This, along with an initially low loan growth environment, will provoke more strategic mergers, with the market eventually making room from 10-15 large banks and a similar number of niche banks.

Thailand: Selling off to foreign players

Consolidation in Thailand has largely been government driven, whereby the government-run Financial Restructuring Agency seized and sold the asset of over 50 finance companies. The government is also in the process of selling off several seized banks, which include Bangkok Metropolitan Bank and Nakorthon Bank. Some of the hurdles include the inability to retrench staff. In Thailand, it is considered poor business practice to lay employees off. Reducing the heavy overhead burden, in our opinion, is one of the many areas the sector critically needs to address, as it would enable the banks to free up some costs to make the necessary provisioning.

Taiwan: Moving at a standstill

There are 52 domestic banks and 41 foreign banks in Taiwan with over 2,400 branches – this is too many for a population of 22 million, which the authorities realize and have been discussing sector consolidation since 1998, with little result. The slow pace of mergers can be attributed to three factors: (i) layoffs which usually accompany mergers are socially unacceptable, especially among state-owned/controlled banks; (ii) the private banks are generally still profitable, which reduces the urgency to merge and (iii) MoF's inability to introduce merger incentives quickly. The authorities only managed finally to offer tax incentives to merging banks in November 2000.

Malaysia: The Iron Hand

Malaysia is embarking on one of the most aggressive consolidation plans in the region, whereby the government has "forced" its 54 financial institutions to merge into ten anchor banks. Most mergers met the December 2000 deadline, but integration problems will prevent merged entities from operating as one.

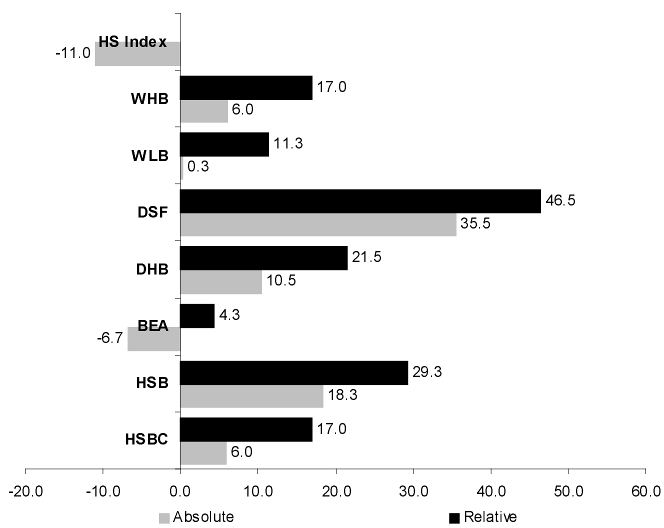
HONG KONG BANKS

Downgrading Hong Kong after a good run in 2000

We have downgraded the Hong Kong banking sector to Neutral following a an excellent run in 2000. Of the 42 bank stocks in our coverage universe throughout Asia (ex-Japan), only five posted positive share price gains in 2000, and all were in Hong Kong. Following the meltdown of the technology, media and telecommunications sector, investors flocked back to banks and the rest of the old economy. The key drivers for the banking sector were stabilizing asset quality and lower funding costs – both of which are unlikely to drive bank stocks further. Looking ahead, although lower interest rates help support high valuation multiples, further multiple expansion will not be possible without strong top line growth in the form of loan growth and non-interest income growth.

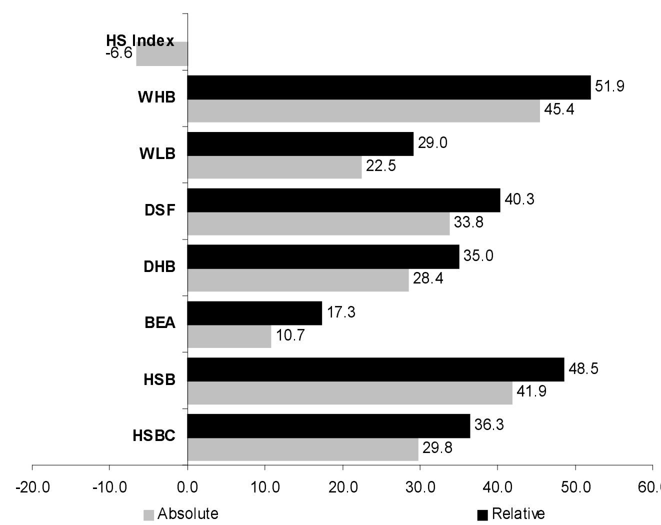
On average, Hong Kong banks in our coverage universe posted a 10% gain in share price in 2000, outperforming the Hang Seng Index by an average of 21%. This performance was even more impressive over the last six months of the year. Over this period, Hong Kong bank shares in our coverage universe increased by an average 30%, outperforming the Hang Seng Index by 37%. As a result, most Hong Kong bank stocks ended the year at or near their twelve month highs.

Figure 5: 12-Month Price Performance



Source: Lehman Brothers

Figure 6: 6-Month Price Performance



Source: Lehman Brothers

Operating environment will be difficult

Looking ahead, we believe that the operating environment will continue to be difficult for banks in Hong Kong. Key concerns are the following:

1) Lack of loan growth means top line growth will be difficult to achieve.

2) Pressure on net interest margins, particularly from the mortgage war. Lower mortgage yields were offset by lower deposit rates in 2000, but this will not be the case in 2001.

3) Investor perception that banks are overcapitalized and destroying shareholder value by not returning excess capital.

4) A more aggressive Bank of China, particularly for mortgages and other consumer lending, will result in further pressure on lending spreads.

Earnings due to lower loan loss provisions

Although we have yet to see a resumption of meaningful loan growth, profitability will continue to improve due to lower loan loss provisions, and we project that earnings will increase an average of 28% in 2000. Loss provisions are expected to decline by almost one-half as new NPL accretion has slowed significantly. According to HKMA statistics, the industry-wide NPL ratio declined from a peak of 7.22% in September 1999 to 6.00% at the end of September 2000. Meanwhile, classified loans, which also encompasses NPLs, declined from a peak of 8.99% of total loans to the current level of 7.72%. We expect banks in our coverage universe to report an average NPL ratio of 3.69%, 117 basis points lower than that reported a year earlier at the end of 1999.

Looking beyond provisions, core earnings are expected to decline 4% in 2000. Looking ahead, banks will find it difficult to improve on this result in 2001 if loan growth continues to be weak. Compounding the matter will be pressure on margins and higher spending on technology. To offset the slower lending operations, banks are diversifying into non-interest income, particularly personal wealth management products– large banks are expected to perform better in this area than the small banks, which have limited customer access and products.

Loan growth to remain weak

Hong Kong loans increased at an annual rate of more than20% per annum in the eight years prior the Asia Financial Crisis, but then collapsed in 1998 and 1999, contracting by 5.2% and 7.4% respectively. 2000 represented more of the same, as banks continued to struggle to lend money– loans outstanding increased modestly by only 2.8% in the first 11 months of 2000 and remained at approximately HK$2 trillion. Banks are currently very liquid, as the industry loan to deposit ratio has declined significantly over the last two years, from 112% at the end of 1998, to 89% at the end of 1999 to the current level of 73%, and they are eager to lend.

Figure 7: Loan Growth

	1995A	1996A	1997A	1998A	1999A	2000E	2001E	2002E
Hang Seng Bank	30.7%	7.8%	25.5%	-2.0%	-0.2%	10.9%	7.6%	7.0%
Bank of East Asia	22.4%	24.0%	30.4%	0.0%	0.5%	5.0%	7.7%	7.9%
Dao Heng Bank	19.4%	28.7%	11.5%	-0.4%	2.4%	1.7%	5.6%	5.9%
	24.2%	20.2%	22.5%	-0.8%	0.9%	5.9%	7.0%	6.9%
Mid Cap Banks								
Dah Sing Bank	21.0%	26.2%	19.2%	-9.6%	10.3%	5.9%	7.8%	8.0%
Wing Lung Bank	19.5%	23.7%	21.4%	5.9%	-8.4%	2.0%	2.2%	2.3%
Wing Hang Bank	21.1%	32.3%	32.8%	-3.1%	1.3%	1.9%	4.0%	4.7%
	20.5%	27.4%	24.5%	-2.3%	1.1%	3.3%	4.6%	5.0%
Industry	11.6%	16.4%	22.2%	-5.2%	-7.4%	3.2%	4.7%	4.8%

Source: Lehman Brothers

The key driver to loan growth in the past was property related lending, which accounted for 68% of loan growth in the 90's. However, this is no longer the case as this source of credit extension has dried up. Property prices remain weak, resulting in smaller average mortgage sizes, the number of property transactions continues to decline as a result of the sharp decline in speculative demand and the lack of investment opportunities have resulted in increased loan prepayments. Away from property-related lending, the prospects for corporate lending will continue to be concentrated among the larger foreign banks. Consequently, we project that industry loan growth will reach 3.2% in 2000 and then continue to be weak at 4.7% in 2001 and 4.8% in 2002.

Mortgage competition

The current mortgage war has raged on for over two years now and sub-Prime mortgages now appear to be a permanent fixture on Hong Kong's landscape. Banks are now quoting mortgage rates are low as Prime less 2.25% over the lock-in period of the first two to three years. At this rate, banks are still making a spread of over 125 basis points over incremental cost s of funds. Therefore, the question remains, how much lower are banks willing to go?

Without a strong pick-up in loan growth, which we are not expecting, we expect mortgage rates will go even lower. By our calculations, at the prevailing mortgage rates of Prime less 225 basis points, banks are generating an ROE of 25% on the minimum capital requirement, based on a 6%- incremental cost of funds and a overhead cost of 50 basis points. Nevertheless, despite all the hype around lower mortgage rates, total mortgages outstanding have remained flat over the last 18 months and re-financing activity is up significantly. This means that banks are simply replacing old mortgages with new ones, but at significantly lower yields, which obviously will have a negative impact on profitability.

Banks have been competing so fiercely for mortgages because they were reluctant to lend to the corporate sector, which was the source of the majority of problem loans, and healthy corporates were unwilling to borrow—and this is not expected to change until at least the middle of 2001. Therefore, without an increase in corporate lending as other outlet to channel excess liquidity, banks are likely to continue competing for mortgages.

Surprisingly, HSBC has been quite quiet since its results announcement, at which time management sent a warning to other banks that it would no longer tolerate further shrinkage of its market share in the lucrative mortgage lending market. Over the last 24 months, HSBC's market share in mortgage lending has declined from 40% in mid-1998 to 34% at the end of June 2000. Excluding Hang Seng Bank, which maintained its market share of 16% over this period, Hongkong Bank has seen its market share eroded from 24% to 19%. Hongkong Bank has been losing market share to an aggressive Bank of China Group as well as the smaller local banks. However, HSBC has the ability to price smaller banks out of the market, if it so chooses, as it has a significantly lower cost funding base.

Opportunities in China are still far away for Hong Kong Banks

With limited lending opportunities in Hong Kong, most domestic banks are considering the mainland as a source of loan growth. However, significant obstacles must be overcome before benefits can accrue. Also, most local Hong Kong bank are still wary of this market since it was the source of most of their asset quality problems during the crisis.

China's banking sector is over-crowded, but still needs significant development. There are currently three policy banks (Agricultural Development Bank of China, China Development Bank and Export and Import bank of China which mainly carry out policy-lending function), four state-owned commercial banks (Agricultural Bank of China, Bank of China, China Construction Bank and Industrial and Commercial Bank of China), ten joint stock commercial banks (ownership distributed among State and other investors), 90 city commercial banks, 836 urban credit co-operatives, 41,755 rural credit co-operatives and 177 foreign financial institutions operating in China. The big four state-owned commercial banks account for almost 70% of the aggregate assets of the whole sector in 1999 while foreign financial institutions add up to about 2%.

The China market offers potentially enormous opportunities for both domestic and foreign financial institutions. However opportunities for foreign operators remain limited due to strict regulations. The three most prominent features of the Chinese banking system are 1) the extensive branch networks of the four state banks (over 144,000 branches nationwide), 2) the centrally regulated interest rates on both deposits and loans and 3) the high level of savings. An important feature is the regulated interest rates, which allowed banks to maintain positive lending spreads, which certainly was not the case in other countries, whereby funding costs to exceeded lending rates at the peak of the crisis.

Foreign banks only play a small role in China's banking system. Among the 177 foreign financial institutions in China, less than 30 have received licenses to conduct local currency business in Shanghai area (including Jiangsu and Zhejiang) and Shenzhen area(including Guangdong, Guangxi and Hunan).

Foreign banks are not allowed to source deposits and must fund lending operations through loans from domestic banks. Looking ahead, the government has promised to "fully" open the local currency market within five years of WTO accession. Foreign banks will be allowed to conduct RMB lending to Chinese corporate clients two years after WTO and to Chinese individuals three years later. However, it has been pointed out such full access may still come together with burdensome restrictions, such as branch by branch capital adequacy requirements that will limit the economics for foreign banks.

Of the local listed banks, only Bank of East Asia and HSBC have licenses to conduct Rmb- business. However, these operations are still insignificant, accounting for less than 2% at the former.

Development of Non-interest Income

The lack of loan growth may actually be a blessing in disguise, forcing banks to focus energy on developing non-interest income. In the past, bank earnings were driven by strong asset growth and there was no need to develop other sources of revenue- – non-interest income only accounted for 22% of total income in 1999, well below the 40% exhibited by other developed countries.

However, the operating environment has changed and banks must find other sources of income. To offset the prospect of poor loan growth and possibly narrower margins, banks are concentrating on developing non-interest income, particularly personal wealth management services and we believe that there is tremendous growth potential in this area. In Hong Kong, personal investment usually takes the form of deposits, direct holdings in the equity markets and physical properties. However, given the current sluggishness in both the equity and property markets, investors are actively looking for alternative higher yielding investments such as unit trusts and mutual funds. In addition, as Hong Kong's population ages and becomes more educated, the demand for less risky wealth management products, such as insurance will increase. Under this scenario, we believe large banks are well positioned to capitalize on this growth opportunity because they have strong relationships with their customers, have an extensive distribution network and a wide range of products that can be cross-sold.

Pressure on Net Interest Margins

Bank profitability, as measured by net interest margins, is likely to have come under pressure in the second half of 2000 and remain under pressure for the first half of 2001 as the mortgage war takes it toll. We expect NIMs to decline an average of one basis points in the second half of 2000 and then remain at such levels in the first half of 2001.

We have identified the following as being key drivers to bank NIMs:

1) Direction of interest rates: The direction of interest rates alone do not have a significant impact on NIMs. However, the knock-on effect of loan growth allows banks to leverage up their balance sheets and re-deploy funds into higher yielding

assets. Unfortunately, we are not expecting any meaningful loan growth any time soon.

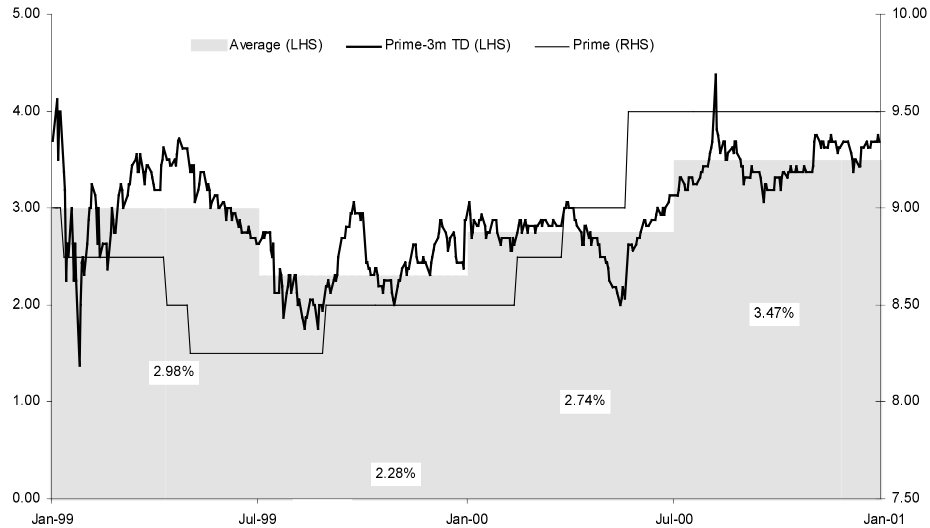
2) Prime-HIBOR Spread and funding costs: The spread between Prime and three-month time deposit rates increased significantly in 2000 and ended the year at 369 basis points, which is near its two-year peak. This widening spread was brought about by significantly lower funding costs. Current three-month deposit rates are being quoted at the same level as savings deposit rates, generating a deposit spread of 140 basis points, and are not likely to decline further.

3) Deposit Rate Deregulation: On July 2, 2001, interest rates on savings and checking accounts are scheduled to be deregulated and banks will be free to offer any rate and compete for these deposits. We do not believe that interest rates offered on savings deposits, which are typically small, are the key determinant to where consumers place deposits. Convenience, bundling of other products and, brand name are more important. Pricing power on these small deposits lies with the banks, and without strong loan demand and excess liquidity in the system, there is no need to compete for deposits. As a result, interest rate deregulation could actually be an opportunity for larger banks that command a large market share of savings and checking accounts.

4) Deposit Insurance: The Hong Kong Monetary Authority (HKMA) is considering introducing a deposit insurance that would protect deposits of up to HK$100,000 at a cost of approximately 10 basis points per year. Deposit insurance will lower the perceived risk for smaller banks and could ultimately result in lower funding costs for smaller banks. This is to the detriment of the larger banks, which currently exhibit lower risk profiles. A mandatory deposit insurance scheme effectively means that depositors at large banks are likely to be subsidizing premiums for smaller banks' depositors who are taking higher risks in return for higher interest rates. Such a scheme will also allow smaller banks to gain market share by aggressively raising their rates, which in turn may encourage the banks to take more risk on the asset side of the balance sheet.

5) Lack of lending opportunities: Due to the lack of lending opportunities, banks do not need any more deposits and are offering rates to reflect this desire. Nevertheless, deposits continue to grow at a faster rate than loans. Thus, banks are simply taking in deposits and placing them in the interbank and generating a spread of only 100-150 basis points, which is lower than the average yield on loan assets.

Figure 8: Interest Rate



Source: Lehman Brothers

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HSBC (HK$116.00) 3-MARKET PERFORM

We are maintaining our 3-Market Perform rating and share price target of HK$105. Excluding goodwill and other non-productive capital, return on tangible book value will peak this year at 24.5% and then drop off over the next two years to 23.4% and 2.6% respectively. All three major markets are now experiencing difficulties. Asia earnings are slowing due to lack of loan growth and margin compression. This is particularly evident in Hong Kong where the group continues to lose market share to both Hang Seng Bank and Bank of China. Meanwhile, European operations are experiencing margin compression (particularly from the liability side of the balance sheet) and US operations are expected to report higher and more normalized loan loss provisions.

HSBC has recently announced that it will not proceed with its planned acquisition of Bangkok Metropolitan Bank (BMB) because it could not agree terms with the Thai authorities. Although not officially stated, previous news articles revealed that the two parties could not agree to terms regarding tax liabilities under a loss sharing agreement for bad loans. BMB had Bt100 billion in NPLs at the end of September, equivalent to 80-90% of its loan portfolio. HSBC had been in negotiations with the Thai government since it signed an agreement in principle in May 2000 to acquire a 75%-stake in 177-branch BMB for US$940 million (Bt36.3 billion).

This transaction is only the latest in a number of high profile deals that HSBC has abandoned. In September 1999, HSBC abandoned its bid for Seoul Bank in Korea and at the end of 2000, HSBC withdrew from the bidding for Banespa in Brazil. In each case, we believe that HSBC formulated strict return requirements, and the prevailing prices would not allow HSBC to meet these strict guidelines.

Despite what management is saying we believe that deposit rate deregulation will be beneficial

HSBC continues to say that deposit rate deregulation will hurt margins and plans to offer tiered deposit pricing upon deposit rate deregulation, paying lower rates on smaller accounts and relatively higher rates on accounts with "deeper" relationships. In addition, most banks in Hong Kong are likely to charge fees for bank services such as ATM usage, minimum balance and check writing, among other services.

However, we do not agree with this argument and do not think that interest rate deregulation will have a significant impact on market share. The likely scenario is that interest rates increase, but only marginally. Small banks are currently paying 6% on three-month deposits and are unlikely to pay higher rates on deposits with shorter maturity. Therefore, in a worst case scenario, small banks will offer 6% and large banks will have to offer 5% to maintain market share. Large banks, such as HSBC and Hang Seng Bank offer convenience that small banks can only dream of. Also, with the lack of loan growth, banks are not likely to bid aggressively for deposits. Thus, we believe that HSBC "has to" come out and say that deposit rate deregulation will lead to a rise in the cost of funds so that it can introduce service fees that would otherwise be condemned by the Consumer Council.

HSBC

Share Price:	116.00	Index:	15,235
52 Week Price Range:	117.50 - 82.75	Current Yield:	0.00
Reuters Code:	0005.HK		
Bloomberg Code:	0005.HK		

INCOME STATEMENT	1999A	2000E	2001E	2002E
(US$m)				
Interest income	29,204	31,225	33,421	35,505
Interest expense	-17,214	-17,809	-19,461	-20,773
Net interest income	11,990	11,990	13,960	14,732
Ave. interest earnings assets	*419,231*	*431,573*	*459,626*	*489,501*
NIM (%)	286.00%	286.00%	3.04%	3.01%
Non-interest income	9,012	9,012	9,012	9,012
Total operating income	21,002	21,002	22,972	23,744
Non-interest expenses	-11,313	-11,313	-12,836	-13,207
Pre provision profit	9,689	9,689	10,136	10,538
Loan loss provisions	-2,244	-2,244	-2,244	-2,244
Non-operating income	609	609	609	609
Pre tax profit	8,054	8,054	8,501	8,903
Tax	1,263	1,263	3,147	3,370
Net profit	6,183	6,183	7,575	8,177

PER SHARE DATA	1999A	2000E	2001E	2002E
(US$m)				
Earnings per share	0.65	0.65	0.86	0.92
Dividends per share	0.34	0.34	0.42	0.46
Effective payout ratio (%)	*46%*	*46%*	*51%*	*52%*
Book value per share	3.18	3.18	4.64	5.07
Adjusted book value per share	3.18	3.23	3.67	4.13

VALUATION	1999A	2000E	2001E	2002E
(X)				
Price to book value (%)	3.6	4.7	3.2	2.9
Price to adjusted book value (%)	4.4	4.6	4.1	3.6
Price to earnings (X)	21.8	22.8	17.3	16.1

PROFITABILITY RATIOS	1999A	2000E	2001E	2002E
(%)				
Net interest margin	286.00%	286.00%	3.04%	3.01%
Yield on interest earning assets	6.97%	7.24%	7.27%	7.25%
Cost on interest bearing liabilities	-3.78%	-3.83%	-3.94%	-3.96%
Net interest spread	3.19%	3.40%	3.33%	3.30%
Non-int. income (% Op income)	42.9%	42.9%	39.2%	38.0%
Cost to income	53.9%	53.9%	55.9%	55.6%
Overhead ratio	#DIV/0!	#DIV/0!	2.36%	2.37%
Cost coverage	79.7%	79.7%	70.2%	68.2%
ROA	1.09%	1.09%	1.25%	1.27%
ROE	16.5%	16.5%	17.7%	17.5%

DUPONT ANALYSIS	1999A	2000E	2001E	2002E
Lending operations				
Net interest margin	286.00%	286.00%	3.04%	3.01%
Interest earnings assets/assets	0.7%	0.7%	73.7%	73.7%
NIM contribution to ROA	2.11%	2.11%	2.24%	2.22%
Non-interest operations				
Non-interest income/assets	1.58%	1.58%	1.44%	1.36%
Overhead ratio	1.99%	1.99%	2.06%	1.99%
Non-int. contribution to ROA	-0.40%	-0.40%	-0.61%	-0.63%
Asset quality analysis				
Provision/loans	0.86%	0.82%	0.82%	0.72%
Loans/assets	46.0%	48.1%	43.9%	46.6%
ROA effect from asset quality	0.39%	0.39%	0.36%	0.34%
Core ROA	2.10%	2.10%	1.98%	1.92%
Non-core contribution to ROA	0.1%	0.1%	0.1%	0.1%
Pre-tax ROA	1.42%	1.42%	1.36%	1.34%
Tax rate	15.8%	15.8%	28.3%	28.3%
After tax ROA	1.19%	1.19%	0.98%	0.96%
Balance sheet leverage (x)	13.8x	13.8x	18.1x	18.2x
ROE	16.5%	16.5%	17.7%	17.5%

BALANCE SHEET	1999A	2000E	2001E	2002E
(US$m)				
Gross loans	261,587	273,929	273,628	309,867
Specific loan loss reserves	*-6,472*	*-5,728*	*-5,427*	*-5,667*
General loan loss reserves	*-1,548*	*-1,627*	*-1,627*	*-1,845*
Net loans	253,567	266,574	266,574	302,355
Other earning assets	222,181	224,082	256,754	254,989
Other assets	93,391	78,484	100,651	107,193
Total Assets	569,139	569,139	623,978	664,537
Deposits	359,972	359,972	418,706	441,735
Other paying liabilities	95,398	104,848	75,317	83,412
Other liabilities	76,704	67,414	83,421	88,672
Total Liabilities	532,075	532,234	577,444	613,820
Minorities & other	3,655	3,496	3,760	4,001
Shareholders' funds	33,409	33,409	42,774	46,716

GEOGRAPHIC BREAKDOWN	1999A	2000E	2001E	2002E
Pre-tax profit (US$m)				
Europe	3,322	3,770	4,354	4,497
Hong Kong	3,054	3,733	3,906	4,130
Other Asian Countries	329	1,289	1,244	1,403
North America	959	732	1,156	1,395
Latin America	318	393	444	490
Total pre-tax profit	7,982	9,917	11,104	11,913

GEOGRAPHIC BREAKDOWN	1999A	2000E	2001E	2002E
Pre-tax profit (% of total)				
Europe	42%	38%	39%	38%
Hong Kong	38%	38%	35%	35%
Other Asian Countries	4%	13%	11%	12%
North America	12%	7%	10%	12%
Latin America	4%	4%	4%	4%
Total pre-tax profit	100%	100%	100%	100%

BALANCE SHEET RATIOS	1999A	2000E	2001E	2002E
(%)				
Loan-to-deposit	70.4%	70.4%	67.8%	68.4%
Loan-to-deposit (incl. CDs)	0.0%	0.0%	0.0%	0.0%
Equity to assets	5.9%	5.9%	6.9%	7.0%
Tier 1 Capital	9.7%	8.5%	8.8%	9.6%
General reserves (% loans)	-0.59%	-0.59%	-0.59%	-0.60%
Specific reserves (% loans)	-2.47%	-2.09%	-1.98%	-1.83%
Total loan provisions	-3.07%	-2.69%	-2.58%	-2.42%

ASSET QUALITY	1999A	2000E	2001E	2002E
Nonperforming loans	10,372	9,350	8,250	7,838
NPL ratio	4.0%	3.4%	3.0%	2.5%
Total provisions/NPLs	77.3%	78.7%	85.5%	95.9%

GROWTH RATES	1999A	2000E	2001E	2002E
(%)				
Income statement				
Net interest income	3.8%	0.0%	16.4%	5.5%
Non-interest income	3.1%	0.0%	0.0%	0.0%
Total operating income	3.5%	0.0%	9.4%	3.4%
Operating expenses	0.7%	0.0%	13.5%	2.9%
Pre-provision earnings	7.0%	0.0%	4.6%	4.0%
Loan loss provisions	-21.7%	0.0%	0.0%	0.0%
Net profit	43.2%	0.0%	22.5%	7.9%
Balance sheet				
Loan growth	8.1%	4.7%	-0.1%	13.2%
Interest earning assets	17.8%	2.9%	6.5%	6.5%
Asset growth	0.0%	0.0%	0.0%	0.0%
Deposit growth	0.0%	0.0%	0.0%	0.0%
Shareholders funds	21.9%	0.0%	28.0%	9.2%
Geogrphic				
Europe	15.2%	13.5%	15.5%	3.3%
Hong Kong	25.8%	22.2%	4.6%	5.7%
Other Asian Countries	743.6%	291.9%	-3.5%	12.8%
North America	-2.8%	-23.7%	58.0%	20.6%
Latin America	35.9%	23.5%	13.1%	10.2%
Total pre-tax profit	**21.5%**	**24.2%**	**12.0%**	**7.3%**

HANG SENG BANK (HK$106.00) 3-MARKET PERFORM

Following a strong 40% share price rise over the last six months, outperforming the Hang Seng Index by almost 50%, we have downgraded our rating on the shares of Hang Seng Bank to 3-Market Perform from 2-Outperform and maintaining our share price target of HK$105.

Expect both top line growth and bottom line growth through improving efficiency and lower provisions

Loan growth is expected to remain strong in the second half of 2000, but will be off the 6.9% pace that was set in the first half of the year. We estimate another 4.2% growth in the second half of the year for a full year figure of 11.4%, the strongest in the sector. Management indicated that loan growth was strong across all sectors. Loan growth could have been even stronger, but management revealed that it had sold some of its PCCW credit in the secondary market to reduce its telecom exposure. This move is not significant given the thin spreads on this loan. Also, the main attraction of this loan was the fees, which are already booked.

Pressure on margins, but volume continues to grow

The NIM is expect to contract in the second half of 2000 from 2.80% to 2.75%. Margin contraction from the mortgage war has been more severe than originally expected. However, the main reason for the margin contraction was the fact that deposits continue to grow, but the bank does not have enough loan demand to absorb the excess liquidity and is placing the extra funds in the interbank market, generating a spread of only 100-150 basis points. HSB's three-month time deposit rates are currently only 4.8%, which is 110 basis points below the current three-month interbank rate of 5.9%. Although margins are narrower, the bank is still generating incremental profit.

Room for cost-to-income ratio to decline further

This bank is among the most efficient in the world and it did not achieve this status by underpaying its staff. Relative to its peers, Hang Seng Bank spends the most on a per staff and a per branch basis. However, Hang Seng Bank is significantly more productive on both a per staff and a per branch basis. The key is information technology and automation.

Development of non-interest income

Going forward, a key area of concentration for management is expansion of the revenue base, particularly the development of wealth management related fee and commission income. Specific focus is being placed on insurance, stock brokerage and unit trust sales – penetration rates of these products are 15%, 15% and 5% respectively, which means there is significant room for growth. Hang Seng Bank will be able to leverage off its strong brand name and relatively wider product range as well as its relationship with HSBC to increase the cross selling ratio to four products per customer within 18-24 months, from the current 2.7x.

Superior capital management and high dividend yield

Finally, the maintenance of a dividend payout policy of 70-80%, resulting in dividend yield of 4-5%, means that management is returning capital to shareholders, rather than sitting on it waiting for an acquisition. Hang Seng Bank has enough capital to fund organic growth and potential acquisitions, and even if it did not, we believe that this bank would be able to easily tap to market.

Hang Seng Bank

Share Price:	106.00	Index:	15,235
52 Week Price Range:	106.00 - 65.25	Current Yield:	4.1%
Reuters Code:	0011.HK		
Bloomberg Code:	0011.HK		

INCOME STATEMENT	1998A	1999A	2000E	2001E	2002E
(HK$m)					
Interest income	32,280	28,072	30,732	31,863	31,863
Interest expense	-20,925	-16,405	-18,727	-18,755	-19,309
Net interest income	11,355	11,667	12,005	13,107	14,073
Ave. interest earnings assets	*383,926*	*406,113*	*431,432*	*467,904*	*503,712*
NIM (%)	2.96%	2.87%	2.78%	2.80%	2.79%
Non-interest income	3,142	3,141	3,831	4,468	4,986
Total operating income	14,497	14,808	15,836	17,575	19,059
Non-interest expenses	-3,865	-3,743	-3,810	-4,040	-4,238
Pre provision profit	10,632	11,065	12,027	13,536	14,821
Loan loss provisions	-2,476	-1,419	-176	-209	-191
Non-operating income	-180	138	351	61	67
Pre tax profit	7,976	9,784	12,202	13,387	14,698
Tax	-1,188	-1,477	-1,824	-2,008	-2,205
Net profit	6,788	8,307	10,378	11,379	12,493

PER SHARE DATA	1998A	1999A	2000E	2001E	2002E
(HK$)					
Earnings per share	3.55	4.35	5.43	5.95	6.53
Dividends per share	3.42	8.20	4.30	4.77	5.23
Effective payout ratio (%)	*96%*	*189%*	*79%*	*80%*	*80%*
Book value per share	23.79	20.70	22.27	23.91	25.70
Adjusted book value per share	21.31	16.40	17.75	19.17	20.72

VALUATION	1998A	1999A	2000E	2001E	2002E
(X)					
Price to book value (x)	2.8	4.3	4.8	4.4	4.1
Price to adjusted book value (x)	3.2	5.4	6.0	5.5	5.1
Price to earnings (X)	18.3	20.4	19.5	17.8	16.2

PROFITABILITY RATIOS	1998A	1999A	2000E	2001E	2002E
(%)					
Net interest margin	2.96%	2.87%	2.78%	2.80%	2.79%
Yield on interest earning assets	8.41%	6.91%	7.12%	6.81%	6.63%
Cost on interest bearing liabilities	5.89%	4.34%	4.90%	4.53%	4.34%
Net interest spread	2.52%	2.57%	2.22%	2.28%	2.29%
Non-int. income (% Op income)	21.7%	21.2%	24.2%	25.4%	26.2%
Cost to income	26.7%	25.3%	24.1%	23.0%	22.2%
Overhead ratio	0.82%	0.77%	0.89%	0.95%	0.99%
Cost coverage	81.3%	83.9%	100.6%	110.6%	117.7%
ROA	1.66%	1.92%	2.20%	2.25%	2.30%
ROE	14.4%	18.5%	25.6%	25.8%	26.4%

DUPONT ANALYSIS	1998A	1999A	2000E	2001E	2002E
Lending operations					
Net interest margin	2.96%	2.87%	2.78%	2.80%	2.79%
Interest earnings assets/assets	94.0%	93.7%	91.6%	92.4%	92.8%
NIM contribution to ROA	2.78%	2.69%	2.55%	2.59%	2.59%
Non-interest operations					
Non-interest income/assets	0.77%	0.72%	0.81%	0.88%	0.92%
Overhead ratio	0.95%	0.86%	0.81%	0.80%	0.78%
Non-int. contribution to ROA	-0.18%	-0.14%	0.00%	0.08%	0.14%
Asset quality analysis					
Provision/loans	-1.21%	-0.70%	-0.08%	-0.09%	-0.08%
Loans/assets	50.1%	46.6%	45.6%	46.0%	46.0%
ROA effect from asset quality	-0.61%	-0.33%	-0.04%	-0.04%	-0.04%
Core ROA	2.00%	2.23%	2.52%	2.63%	2.69%
Non-core contribution to ROA	-0.05%	0.03%	0.07%	0.01%	0.01%
Pre-tax ROA	1.95%	2.26%	2.59%	2.64%	2.71%
Tax rate	14.9%	15.1%	14.9%	15.0%	15.0%
After tax ROA	1.66%	1.92%	2.20%	2.25%	2.30%
Balance sheet leverage (x)	8.7x	9.6x	11.6x	11.5x	11.5x
ROE	14.4%	18.5%	25.6%	25.8%	26.4%

BALANCE SHEET	1998A	1999A	2000E	2001E	2002E
(HK$m)					
Gross loans	202,605	202,244	224,292	241,366	258,179
Specific loan loss reserves	*-3,087*	*-3,522*	*-3,802*	*-3,848*	*-3,887*
General loan loss reserves	*-1,449*	*-1,441*	*-1,518*	*-1,633*	*-1,747*
Net loans	201,156	200,803	222,774	239,732	256,432
Other earning assets	176,303	197,042	225,714	244,786	263,431
Other assets	42,839	44,225	39,579	40,475	41,526
Total Assets	420,298	442,070	488,067	524,993	561,389
Deposits	341,573	364,038	407,186	438,182	462,518
Other paying liabilities	19,512	18,562	19,776	16,791	28,123
Other liabilities	13,708	19,896	18,521	24,304	21,607
Total Liabilities	374,793	402,496	445,483	479,278	512,248
Minorities & other	0	0	0	0	0
Shareholders' funds	45,505	39,574	42,584	45,716	49,141

LOAN BOOK	1998A	1999A	2000E	2001E	2002E
(HK$m)					
Property development	39,535	39,739	47,954	51,867	54,492
Non-bank financials	3,507	4,055	4,178	4,178	4,178
Commercial and industrial	7,417	6,394	6,284	6,538	6,603
Hire purchase	8,558	8,411	9,331	10,985	12,932
Other commercial	17,684	17,443	19,478	21,270	23,227
Trade finance	10,512	8,787	9,794	10,798	11,905
Loans for use outside HK	4,250	3,276	3,226	3,226	3,226
HOS & PSPS loans	31,229	31,936	37,466	41,306	45,540
Residential mortgages	71,864	73,854	77,143	81,048	85,151
Credit cards	3,616	3,835	4,127	4,294	4,467
Individuals	4,433	4,514	5,312	5,856	6,457
Total loans	202,605	202,244	224,292	241,366	258,179

LOAN BOOK BREAKDOWN	1998A	1999A	2000E	2001E	2002E
(%)					
Property development	20%	20%	21%	21%	21%
Non-bank financials	2%	2%	2%	2%	2%
Commercial and industrial	4%	3%	3%	3%	3%
Hire purchase	4%	4%	4%	5%	5%
Other commercial	9%	9%	9%	9%	9%
Trade finance	5%	4%	4%	4%	5%
Loans for use outside HK	2%	2%	1%	1%	1%
HOS & PSPS loans	15%	16%	17%	17%	18%
Residential mortgages	35%	37%	34%	34%	33%
Credit cards	2%	2%	2%	2%	2%
Individuals	2%	2%	2%	2%	3%
Total loans	100%	100%	100%	100%	100%

BALANCE SHEET RATIOS	1998A	1999A	2000E	2001E	2002E
(%)					
Loan-to-deposit	59.3%	55.6%	55.1%	55.1%	55.8%
Loan-to-deposit (incl. CDs)	57.5%	53.8%	52.6%	52.8%	53.6%
Equity to assets	10.8%	9.0%	8.7%	8.7%	8.8%
Tier 1 Capital	17.5%	13.3%	13.0%	13.3%	13.9%
Total Capital adequacy	21.3%	17.3%	16.7%	16.7%	16.8%
General reserves (% loans)	-0.72%	-0.71%	-0.68%	-0.68%	-0.68%
Specific reserves (% loans)	-1.52%	-1.74%	-1.69%	-1.59%	-1.51%
Total loan provisions	-2.24%	-2.45%	-2.37%	-2.27%	-2.18%

ASSET QUALITY	1998A	1999A	2000E	2001E	2002E
Nonperforming loans	8,023	8,658	6,559	5,410	4,422
NPL ratio	4.0%	4.3%	2.9%	2.2%	1.7%
Total provisions/NPLs	56.5%	57.3%	81.1%	101.3%	127.4%

GROWTH RATES	1998A	1999A	2000E	2001E	2002E
(%)					
Income statement					
Net interest income	1.8%	2.7%	2.9%	9.2%	7.4%
Non-interest income	-6.1%	0.0%	22.0%	16.6%	11.6%
Total operating income	0.0%	2.1%	6.9%	11.0%	8.4%
Operating expenses	3.6%	-3.2%	1.8%	6.0%	4.9%
Pre-provision earnings	-8.8%	4.1%	8.7%	12.5%	9.5%
Loan loss provisions	289.9%	-42.7%	-87.6%	19.1%	-8.8%
Net profit	-27.5%	22.4%	24.9%	9.6%	9.8%
Balance sheet					
Loan growth	-2.0%	-0.2%	10.9%	7.6%	7.0%
Interest earning assets	-4.1%	5.4%	12.7%	8.0%	7.3%
Asset growth	6.0%	5.2%	10.4%	7.6%	6.9%
Deposit growth	5.7%	6.6%	11.9%	7.6%	5.6%
Shareholders funds	-8.6%	-13.0%	7.6%	7.4%	7.5%

BANK OF EAST ASIA (HK$20.95) 2-BUY

We are maintaining our 2–Buy rating on the shares of Bank of East Asia. This bank has been a laggard for most of the year, declining 6.3% in 2000, but is finally catching up, increasing 17% over the last six months. Its shares continue to be cheap relative to Dai Heng Bank, its nearest competitor. BEA trades at both a P/E and P/BV discount, yet will generate a similar ROE and higher earnings growth. BEA has historically commanded a significant premium because of its high exposure to China, which was viewed as an extremely lucrative market. However, higher expected return has also been accompanied by higher risk, in the form of deteriorating asset quality. As a result, we do not believe that BEA will be able to return to pre-crisis levels of valuation and that its higher risk profile has resulted in a lower valuation relative to its peers.

Expect stronger loan growth.

Management expects single digit loan growth in the second half of 2000, with key growth areas being loan syndications and China-related lending. We are projecting 4% loan growth in the second half of the year. Also, management had budgeted for 8-10% loan growth in 2001. Again, the key areas are going to be China-related lending, loan syndications and to a lesser extent mortgages. Rmb-denominated lending has more than tripled over the year, from Rmb900 million at the end of 1999 to Rmb3 billion. Looking ahead, Rmb-denominated lending is expected to account for one-quarter of loan growth in 2001, or Rmb1.8-2.2 billion (based on management's forecast of 8-10% loan growth). Meanwhile, management is budgeting for a 3.5% increase in mortgage lending, (which accounts for 40% of the loan book).

Margins are expected to be maintained

BEA reported a NIM of 2.6% in 1H00 and we expect a similar level for the second half of 2000 and for 2001. Lower yields on mortgages (blended yield on the mortgage book is now Prime less 1.5%) have been offset by higher yields on Rmb-denominated loans, generating a spread of 2.5-3%. With regards to deposit rate deregulation, management's view is similar to ours – that initially rates will increase, but once rationality sets in, due to excess liquidity and lack of loan demand, deposit rates will likely decline.

FPB Acquisition allows for further China expansion.

The biggest reason behind this acquisition was to increase its asset size to over US$20 bullion, which will allow BEA to open more branches in China. In addition, management indicated that this transaction will increase the bank's catchment area because BEA focuses on the middle to upper market, while FPB focuses on the lower to middle market. In addition, management indicated that it envisions that 35-40% costs savings can be extracted over the next two years. We calculate that management only has to extract 25% costs savings for this transaction to be earnings accretive. Savings will accrue from merging back office operations and IT. FPB's operating efficiency is below average, with a cost-to-income ratio of 50%. Also, BEA has an extensive branch network of 108, which will undoubtedly overlap with FPB's 23 branches.

Bank of East Asia

Share Price:	20.95	Index:	15,235
52 Week Price Range:	21.35-13.60	Current Yield:	3.3%
Reuters Code:	0023.HK		
Bloomberg Code:	0023.HK		

INCOME STATEMENT	1998A	1999A	2000E	2001E	2002E
(HK$m)					
Interest income	11,338	9,879	10,564	10,068	10,759
Interest expense	-8,011	-6,375	-6,890	-6,349	-6,900
Net interest income	3,327	3,505	3,674	3,719	3,860
Ave. interest earnings assets	*127,948*	*132,927*	*140,527*	*141,371*	*146,222*
NIM (%)	2.60%	2.64%	2.61%	2.63%	2.64%
Non-interest income	1,018	992	1,144	1,249	1,411
Total operating income	4,345	4,496	4,819	4,968	5,271
Non-interest expenses	-1,700	-1,803	-2,099	-2,170	-2,333
Pre provision profit	2,645	2,694	2,720	2,798	2,937
Loan loss provisions	-1,506	-2,215	-333	-195	-187
Non-operating income	-114	2	-55	0	0
Pre tax profit	1,025	481	2,332	2,603	2,751
Tax	-133	-126	-349	-430	-454
Net profit	820	1,488	1,982	2,174	2,297

PER SHARE DATA	1998A	1999A	2000E	2001E	2002E
(HK$)					
Earnings per share	0.59	1.08	1.43	1.57	1.66
Dividends per share	0.32	0.53	0.70	0.75	0.83
Effective payout ratio (%)	*53%*	*50%*	*49%*	*48%*	*50%*
Book value per share	10.21	10.87	11.72	12.54	13.37
Adjusted book value per share	9.21	9.86	10.72	11.54	12.37

VALUATION	1998A	1999A	2000E	2001E	2002E
(X)					
Price to book value (x)	1.3	2.0	1.8	1.7	1.6
Price to adjusted book value (x)	1.4	2.2	2.0	1.8	1.7
Price to earnings (X)	21.6	20.1	14.6	13.3	12.6

PROFITABILITY RATIOS	1998A	1999A	2000E	2001E	2002E
(%)					
Net interest margin	2.60%	2.64%	2.61%	2.63%	2.64%
Yield on interest earning assets	9.17%	7.84%	8.00%	7.42%	7.17%
Cost on interest bearing liabilities	6.86%	5.31%	5.51%	4.98%	5.09%
Net interest spread	2.30%	2.53%	2.49%	2.44%	2.08%
Non-int. income (% Op income)	23.4%	22.1%	23.8%	25.1%	26.8%
Cost to income	39.1%	40.1%	43.6%	43.7%	44.3%
Overhead ratio	0.71%	0.80%	0.77%	0.88%	0.96%
Cost coverage	59.9%	55.0%	54.5%	57.6%	60.5%
ROA	0.60%	1.08%	1.36%	1.47%	1.45%
ROE	5.9%	10.2%	12.6%	12.9%	12.7%

DUPONT ANALYSIS	1998A	1999A	2000E	2001E	2002E
Lending operations					
Net interest margin	2.60%	2.64%	2.61%	2.63%	2.64%
Interest earnings assets/assets	94.3%	96.5%	96.5%	95.6%	92.1%
NIM contribution to ROA	2.45%	2.54%	2.52%	2.51%	2.43%
Non-interest operations					
Non-interest income/assets	0.75%	0.72%	0.79%	0.84%	0.89%
Overhead ratio	1.25%	1.31%	1.44%	1.47%	1.47%
Non-int. contribution to ROA	-0.50%	-0.59%	-0.66%	-0.62%	-0.58%
Asset quality analysis					
Provision/loans	-1.78%	-2.63%	-0.39%	-0.22%	-0.20%
Loans/assets	62.5%	61.1%	58.3%	59.6%	59.8%
ROA effect from asset quality	-1.11%	-1.61%	-0.23%	-0.13%	-0.12%
Core ROA	0.84%	0.35%	1.64%	1.76%	1.73%
Non-core contribution to ROA	-0.08%	0.00%	-0.04%	0.00%	0.00%
Pre-tax ROA	0.76%	0.35%	1.60%	1.76%	1.73%
Tax rate	13.0%	26.1%	15.0%	16.5%	16.5%
After tax ROA	0.66%	0.26%	1.36%	1.47%	1.45%
Balance sheet leverage (x)	9.8x	9.4x	9.3x	8.8x	8.8x
ROE	6.5%	2.4%	12.6%	12.9%	12.7%

BALANCE SHEET	1998A	1999A	2000E	2001E	2002E
(HK$m)					
Gross loans	83,643	84,074	84,884	91,397	98,615
Specific loan loss reserves	*-744*	*-2,399*	*-1,851*	*-1,902*	*-1,984*
General loan loss reserves	*-897*	*-1,200*	*-1,231*	*-1,325*	*-1,430*
Net loans	82,746	82,874	83,653	90,072	97,185
Other earning assets	46,876	56,555	55,035	54,634	52,246
Other assets	6,106	5,912	7,328	8,265	16,112
Total Assets	135,728	145,341	146,016	152,971	165,542
Deposits	100,889	112,259	108,332	114,118	120,391
Other paying liabilities	16,402	13,001	16,408	16,072	20,756
Other liabilities	4,317	5,050	5,063	5,430	5,897
Total Liabilities	121,608	130,310	129,804	135,621	147,044
Minorities & other	0	0	0	0	0
Shareholders' funds	14,120	15,031	16,212	17,350	18,498

LOAN BOOK	1998A	1999A	2000E	2001E	2002E
(HK$m)					
Property development	11,552	12,158	13,606	14,294	15,018
Non-bank financials	2,125	2,844	2,692	2,692	2,692
Commercial and industrial	4,133	3,644	3,797	3,835	3,873
Hire purchase	935	878	1,266	1,490	1,754
Other commercial	3,960	3,906	791	831	873
Trade finance	3,882	2,487	2,222	2,450	2,701
Loans for use outside HK	17,594	18,059	18,971	21,923	25,335
HOS & PSPS loans	2,738	2,492	2,887	3,182	3,509
Residential mortgages	34,216	34,946	35,439	37,233	39,118
Credit cards	760	821	948	967	987
Individuals	1,748	1,837	2,267	2,499	2,756
Total loans	83,643	84,074	84,884	91,397	98,615

LOAN BOOK BREAKDOWN	1998A	1999A	2000E	2001E	2002E
(%)					
Property development	14%	14%	16%	16%	15%
Non-bank financials	3%	3%	3%	3%	3%
Commercial and industrial	5%	4%	4%	4%	4%
Hire purchase	1%	1%	1%	2%	2%
Other commercial	5%	5%	1%	1%	1%
Trade finance	5%	3%	3%	3%	3%
Loans for use outside HK	21%	21%	22%	24%	26%
HOS & PSPS loans	3%	3%	3%	3%	4%
Residential mortgages	41%	42%	42%	41%	40%
Credit cards	1%	1%	1%	1%	1%
Individuals	2%	2%	3%	3%	3%
Total loans	100%	100%	100%	100%	100%

BALANCE SHEET RATIOS	1998A	1999A	2000E	2001E	2002E
(%)					
Loan-to-deposit	82.9%	74.9%	78.4%	80.1%	81.9%
Loan-to-deposit (incl. CDs)	75.2%	69.7%	71.9%	73.8%	75.8%
Equity to assets	10.4%	10.3%	11.1%	11.3%	11.2%
Tier 1 Capital	15.1%	16.4%	15.9%	15.9%	15.6%
Total Capital adequacy	16.7%	18.1%	17.4%	17.2%	16.9%
General reserves (% loans)	-1.07%	-1.43%	-1.45%	-1.45%	-1.45%
Specific reserves (% loans)	-0.89%	-2.85%	-2.18%	-2.08%	-2.01%
Total loan provisions	-1.96%	-4.28%	-3.63%	-3.53%	-3.46%

ASSET QUALITY	1998A	1999A	2000E	2001E	2002E
Nonperforming loans	3,473	6,701	5,772	5,671	5,589
NPL ratio	4.2%	8.0%	6.8%	6.2%	5.7%
Total provisions/NPLs	47.3%	53.7%	53.4%	56.9%	61.1%

GROWTH RATES	1998A	1999A	2000E	2001E	2002E
(%)					
Income statement					
Net interest income	25.2%	5.3%	4.8%	1.2%	3.8%
Non-interest income	-12.6%	-2.6%	15.4%	9.2%	12.9%
Total operating income	13.6%	3.5%	7.2%	3.1%	6.1%
Operating expenses	1.4%	6.1%	16.4%	3.4%	7.5%
Pre-provision earnings	15.4%	1.8%	1.0%	2.9%	5.0%
Loan loss provisions	415.4%	47.1%	-84.9%	-41.5%	-4.3%
Net profit	-44.9%	81.6%	33.2%	9.7%	5.7%
Balance sheet					
Loan growth	0.0%	0.5%	1.0%	7.7%	7.9%
Interest earning assets	5.0%	7.7%	-0.5%	4.4%	3.3%
Asset growth	1.6%	7.1%	0.5%	4.8%	8.2%
Deposit growth	6.6%	11.3%	-3.5%	5.3%	5.5%
Shareholders funds	6.4%	6.4%	7.9%	7.0%	6.6%

DAO HENG BANKING GROUP (HK$45.00) 3-MARKET PERFORM

We are maintaining our 3-Market Perform rating on the shares of Dao Heng Banking Group as we believe that further multiple expansion beyond 2-1/2 x book value will be difficult to achieve given its ROE of only 15-16%. Meanwhile, it is trading at a significant premium to Bank of East Asia, which will exhibit a similar level of ROE and stronger earnings growth.

Weak loan growth

Similar to the rest of the industry, we do not expect DHB to achieve meaningful loan growth in the next 12-18 months. We are projecting loan growth of only 4.8% in FY2001 and 5.1% in FY2002. Meanwhile, management appears to be more optimistic, budgeting for double-digit loan growth. The key areas are expected to be consumer loans and credit card loans, which only account for a combined 10% of the loan book. However, these two areas are the highest yielding assets on the loan book and growth in these areas will help to maintain the net interest margin at 2.6%. Meanwhile, mortgages, the largest component of the loan book at 48%, is only expected to remain at approximately HK$32 billion. DHB is at the forefront of the mortgage war, offering rates as low as Prime less 2.25% plus HK$5,000 in legal fees. We estimate that the mortgage book has already re-priced to Prime less 1.5% and will fully re-price to Prime less 2% by the second half of 2001.

Over the last three years, corporate loans have declined by 40% and now account for 42%, compared to 64% at the end of 1997. The decline is likely to come to an end and we are projecting 3% growth in commercial loans as the company is now focusing on small and medium sized enterprises (SMEs). We estimate that the bank currently has approximately 20,000 SMEs. The typical loan to these borrowers is approximately HK$1 million at a rate of Prime plus 1-2%, which will help stabilize the net interest margin.

Asset quality is no longer a problem and lower loan loss provisions are expected to be the main driver to earnings growth in FY2001. NPLs have already declined by HK$100 million to HK$1.6 billion and the NPL ratio has declined 20 basis points to 3.9% and further improvement is expected. We project loan loss provisions to decline approximately HK$150 million in FY2001 to HK$216 million and then remain at that level thereafter.

We are still waiting for better capital management initiatives to lower the CAR and improve ROE. Management itself has indicated that their optimal CAR is 13-15%, which is well below the current level of 22%. We calculate that the company could return half of its capital, between HK$6-7 billion, or HK$9-10 per share to achieve its optimal CAR of 13-15%. Such a move would almost double ROE. Thus, unless something is done, over capitalization will continue to be a drag on profitability. Management is clearly aware that this is a key concern for investors and we await any new with regards to this concern.

Dao Heng Banking Group

Share Price:	45.00	Index:	15,235
52 Week Price Range:	45.00 - 28.45	Current Yield:	2.7%
Reuters Code:	0223.HK		
Bloomberg Code:	0223.HK		

INCOME STATEMENT	1998A	1999A	2000E	2001E	2002E
(HK$m)					
Interest income	9,951	8,551	8,640	9,600	9,791
Interest expense	-7,360	-5,970	-5,600	-6,309	-6,375
Net interest income	2,591	2,580	3,040	3,291	3,416
Ave. interest earnings assets	*113,629*	*110,743*	*116,487*	*126,986*	*132,990*
NIM (%)	2.28%	2.33%	2.61%	2.59%	2.57%
Non-interest income	885	953	890	999	1,248
Total operating income	3,476	3,534	3,931	4,289	4,664
Non-interest expenses	-1,481	-1,465	-1,571	-1,696	-1,792
Pre provision profit	1,994	2,069	2,359	2,593	2,872
Loan loss provisions	-535	-857	-366	-217	-183
Non-operating income	6	183	-2	25	27
Pre tax profit	1,466	1,395	1,991	2,401	2,716
Tax	-192	-209	-268	-396	-448
Net profit	1,276	1,203	1,730	2,003	2,265

PER SHARE DATA	1998A	1999A	2000E	2001E	2002E
(HK$)					
Earnings per share	1.83	1.74	2.49	2.89	3.26
Dividends per share	0.90	0.90	1.20	1.09	1.23
Effective payout ratio (%)	*49%*	*52%*	*48%*	*38%*	*38%*
Book value per share	15.88	16.82	18.07	20.16	22.20
Adjusted book value per share	14.98	15.90	17.15	19.24	21.29

VALUATION	1998A	1999A	2000E	2001E	2002E
(X)					
Price to book value (x)	0.7	2.1	2.5	2.2	2.0
Price to adjusted book value (x)	0.7	2.2	2.6	2.3	2.1
Price to earnings (X)	6.0	23.6	18.1	15.6	13.8

PROFITABILITY RATIOS	1998A	1999A	2000E	2001E	2002E
(%)					
Net interest margin	2.28%	2.33%	2.61%	2.59%	2.57%
Yield on interest earning assets	8.79%	7.68%	7.37%	7.56%	7.36%
Cost on interest bearing liabilities	7.08%	5.72%	4.97%	5.28%	5.08%
Net interest spread	1.71%	1.96%	2.40%	2.28%	2.29%
Non-int. income (% Op income)	25.5%	27.0%	22.6%	23.3%	26.8%
Cost to income	42.6%	41.5%	40.0%	39.5%	38.4%
Overhead ratio	0.78%	0.86%	0.76%	0.79%	0.94%
Cost coverage	59.7%	65.1%	56.7%	58.9%	69.6%
ROA	1.04%	0.96%	1.27%	1.39%	1.49%
ROE	11.8%	10.6%	14.2%	15.0%	15.3%

DUPONT ANALYSIS	1998A	1999A	2000E	2001E	2002E
Lending operations					
Net interest margin	2.28%	2.33%	2.61%	2.59%	2.57%
Interest earnings assets/assets	92.8%	88.0%	85.4%	88.2%	87.4%
NIM contribution to ROA	2.12%	2.05%	2.23%	2.28%	2.25%
Non-interest operations					
Non-interest income/assets	0.72%	0.76%	0.65%	0.69%	0.82%
Overhead ratio	1.21%	1.16%	1.15%	1.18%	1.18%
Non-int. contribution to ROA	-0.49%	-0.41%	-0.50%	-0.48%	-0.36%
Asset quality analysis					
Provision/loans	-0.81%	-1.30%	-0.55%	-0.32%	-0.25%
Loans/assets	53.6%	52.2%	49.0%	47.4%	47.3%
ROA effect from asset quality	-0.44%	-0.68%	-0.27%	-0.15%	-0.12%
Core ROA	1.19%	0.96%	1.46%	1.65%	1.77%
Non-core contribution to ROA	0.01%	0.15%	0.00%	0.02%	0.02%
Pre-tax ROA	1.20%	1.11%	1.46%	1.67%	1.79%
Tax rate	13.1%	15.0%	13.4%	16.5%	16.5%
After tax ROA	1.04%	0.94%	1.26%	1.39%	1.49%
Balance sheet leverage (x)	11.3x	11.0x	11.2x	10.8x	10.3x
ROE	11.7%	10.4%	14.1%	15.0%	15.4%

BALANCE SHEET	1998A	1999A	2000E	2001E	2002E
(HK$m)					
Gross loans	65,872	66,423	66,877	70,116	74,069
Specific loan loss reserves	*-258*	*-665*	*-719*	*-419*	*-318*
General loan loss reserves	*-875*	*-816*	*-821*	*-861*	*-909*
Net loans	64,996	65,606	66,056	69,256	73,160
Other earning assets	45,649	48,587	59,983	59,383	62,731
Other assets	11,956	17,683	15,947	19,130	20,948
Total Assets	122,601	131,876	141,986	147,768	156,839
Deposits	85,454	93,071	105,000	101,386	107,102
Other paying liabilities	18,474	11,386	7,692	18,108	18,519
Other liabilities	7,578	15,762	16,752	14,286	15,812
Total Liabilities	111,507	120,219	129,444	133,779	141,432
Minorities & other	0	0	0	0	0
Shareholders' funds	11,094	11,657	12,543	13,989	15,406

LOAN BOOK	1998A	1999A	2000E	2001E	2002E
(HK$m)					
Property development	10,991	8,633	7,393	7,393	7,393
Non-bank financials	1,059	472	493	493	518
Commercial and industrial	5,424	4,491	3,953	3,973	4,012
Hire purchase	6,687	6,114	5,647	6,020	6,449
Other commercial	3,470	2,671	2,587	2,718	2,856
Trade finance	6,772	5,557	5,477	5,751	6,340
Loans for use outside HK	3,104	2,875	2,807	3,093	3,242
HOS & PSPS loans	2,050	2,307	4,496	5,193	5,726
Residential mortgages	19,957	27,450	27,248	28,208	29,636
Credit cards	3,246	3,145	3,646	3,906	4,184
Individuals	3,110	2,707	3,129	3,368	3,713
Total loans	65,872	66,423	66,877	70,116	74,069

LOAN BOOK BREAKDOWN	1998A	1999A	2000E	2001E	2002E
(%)					
Property development	17%	13%	11%	11%	10%
Non-bank financials	2%	1%	1%	1%	1%
Commercial and industrial	8%	7%	6%	6%	5%
Hire purchase	10%	9%	8%	9%	9%
Other commercial	5%	4%	4%	4%	4%
Trade finance	10%	8%	8%	8%	9%
Loans for use outside HK	5%	4%	4%	4%	4%
HOS & PSPS loans	3%	3%	7%	7%	8%
Residential mortgages	30%	41%	41%	40%	40%
Credit cards	5%	5%	5%	6%	6%
Individuals	5%	4%	5%	5%	5%
Total loans	100%	100%	100%	100%	100%

BALANCE SHEET RATIOS	1998A	1999A	2000E	2001E	2002E
(%)					
Loan-to-deposit	77.1%	71.4%	63.7%	69.2%	69.2%
Loan-to-deposit (incl. CDs)	70.7%	66.1%	59.5%	64.4%	64.6%
Equity to assets	9.0%	8.8%	8.8%	9.5%	9.8%
Tier 1 Capital	18.4%	19.0%	21.0%	21.9%	22.6%
Total Capital adequacy	21.5%	22.1%	22.1%	23.3%	23.9%
General reserves (% loans)	-1.33%	-1.23%	-1.23%	-1.23%	-1.23%
Specific reserves (% loans)	-0.39%	-1.00%	-1.08%	-0.60%	-0.43%
Total loan provisions	-1.72%	-2.23%	-2.30%	-1.82%	-1.66%

ASSET QUALITY	1998A	1999A	2000E	2001E	2002E
Nonperforming loans	831	2,694	2,612	1,918	1,582
NPL ratio	1.3%	4.1%	3.9%	2.7%	2.1%
Total provisions/NPLs	136.3%	55.0%	58.9%	66.7%	77.6%

GROWTH RATES	1998A	1999A	2000E	2001E	2002E
(%)					
Income statement					
Net interest income	-11.1%	-0.4%	17.8%	8.2%	3.8%
Non-interest income	5.6%	7.7%	-6.6%	12.2%	25.0%
Total operating income	-7.3%	1.7%	11.2%	9.1%	8.7%
Operating expenses	6.0%	-1.1%	7.3%	7.9%	5.6%
Pre-provision earnings	-15.2%	3.7%	14.0%	9.9%	10.7%
Loan loss provisions	58.1%	60.2%	-57.3%	-40.7%	-15.4%
Net profit	-39.8%	-5.7%	43.8%	15.7%	13.1%
Balance sheet					
Loan growth	0.7%	0.8%	0.7%	4.8%	5.6%
Interest earning assets	-2.7%	3.1%	10.3%	2.1%	5.6%
Asset growth	-2.3%	7.6%	7.7%	4.1%	6.1%
Deposit growth	-6.4%	8.9%	12.8%	-3.4%	5.6%
Shareholders funds	4.7%	5.1%	7.6%	11.5%	10.1%

DAH SING FINANCIAL (HK$45.00) 3-MARKET PERFORM

The shares of Dah Sing Financial have been the strongest performer among Hong Kong banks over the last month, rising over 30%. The key driver is the prospect of lower interest rates, which will have the greatest impact on this bank given the huge 34% fixed rate lending component of its loan book. As interest rates decline, funding costs also decline. However, the yield on its fixed rate loans does not change and profitability improves on this component of the loan book.

DSF has been able to deliver on its promise of loan growth.

Since the middle of the year, the loan book has increased by approximately 7% (compared to 0.3% in the first half of the year) or HK$1.9 billion. The key areas have been consumer loans, particularly re-entry into the mortgage war and high yielding personal and credit card loans. Consequently, we are increasing our loan growth forecast from 5% to 8%, equivalent to approximately an additional HK$700 million.

We view this loan growth as extremely positive and its ability to achieve loan growth mitigates one of our main concerns since the interim results. In the first half of the year, DSF decided to exit the mortgage war and reduced its mortgage book by 7%. We did not like this move because today's mortgage borrower is tomorrow's buyer of insurance, unit trusts and stock brokerage services. Thus, we welcome the bank's re-entry into the mortgage business. Since the interim results, the mortgage book has already increased by 12% (or 5% YTD). The current mortgage price being offered is Prime less 2.25%, which is still generating a spread of approximately 1%.

Another concern that has been mitigated is the bank's ability to both expand the loan book and maintain its net interest margin. Our understanding is that the bank has been able to maintain the NIM at 3.7%, the same level as that reported in the first half of the year (45bp expansion in the first half of the year). At that time, we were afraid that the bank was sacrificing loan growth to maintain NIM. However, it appears that the bank has been able to achieve both loan growth and maintain the NIM at its industry-leading NIM.

The bank has been able to offset low mortgage pricing by focusing other loan growth in higher yielding personal and credit card loans. These two areas comprise 10% and 7% respectively of its loan book, well above industry average. A key source of loans has been the Internet, which has been generating 15% of unsecured personal loans.

Meanwhile, despite the lack of success of any business model anywhere in the world, DSF is still going ahead with its plan to set up another brand. It is no longer going to be a stand-alone Internet bank, but rather a multi-channel bank that will compete head-to-head with DSF's existing operations. DSF has already invested HK$29 million and this operation is expected to ready in the first quarter of 2001. DSF plans to use the extra bank license from the Wing On Bank acquisition in 1993 to set up this new bank.

Dah Sing Financial

Share Price:	45.00	Index:	15,235
52 Week Price Range:	45.00 - 22.10	Current Yield:	2.9%

Reuters Code:	0440.HK
Bloomberg Code:	0440.HK

INCOME STATEMENT	1998A	1999A	2000E	2001E	2002E
(HK$m)					
Interest income	3,649	3,489	3,697	3,768	3,909
Interest expense	-2,687	-2,165	-2,187	-2,154	-2,190
Net interest income	962	1,324	1,511	1,614	1,719
Ave. interest earnings assets	*36,705*	*39,293*	*40,296*	*43,469*	*46,765*
NIM (%)	2.62%	3.37%	3.75%	3.71%	3.68%
Non-interest income	468	521	485	555	623
Total operating income	1,429	1,846	1,996	2,169	2,342
Non-interest expenses	-740	-744	-778	-841	-929
Pre provision profit	690	1,102	1,218	1,328	1,414
Loan loss provisions	-255	-407	-293	-211	-211
Non-operating income	-116	-35	9	10	11
Pre tax profit	318	661	933	1,127	1,213
Tax	-50	-65	-144	-175	-192
Net profit	252	587	775	936	1,004

PER SHARE DATA	1998A	1999A	2000E	2001E	2002E
(HK$)					
Earnings per share	1.04	2.40	3.15	3.81	4.08
Dividends per share	0.60	0.82	1.31	1.64	1.80
Effective payout ratio (%)	*58%*	*34%*	*41%*	*43%*	*44%*
Book value per share	15.17	16.75	18.60	20.86	23.32
Adjusted book value per share	13.74	15.34	17.12	19.30	21.69

VALUATION	1998A	1999A	2000E	2001E	2002E
(X)					
Price to book value (%)	1.3	1.9	2.4	2.2	1.9
Price to adjusted book value (%)	1.4	2.0	2.6	2.3	2.1
Price to earnings (X)	10.5	12.0	14.3	11.8	11.0

PROFITABILITY RATIOS	1998A	1999A	2000E	2001E	2002E
(%)					
Net interest margin	2.62%	3.37%	3.75%	3.71%	3.68%
Yield on interest earning assets	9.94%	8.88%	9.18%	8.67%	8.36%
Cost on interest bearing liabilities	7.76%	5.95%	5.69%	5.37%	5.15%
Net interest spread	2.18%	2.93%	3.49%	3.29%	3.21%
Non-int. income (% Op income)	32.7%	28.3%	24.3%	25.6%	26.6%
Cost to income	51.7%	40.3%	39.0%	38.8%	39.6%
Overhead ratio	1.27%	1.33%	1.20%	1.28%	1.33%
Cost coverage	63.2%	70.1%	62.4%	66.0%	67.1%
ROA	0.61%	1.34%	1.65%	1.85%	1.86%
ROE	6.4%	15.1%	17.9%	19.3%	18.4%

DUPONT ANALYSIS	1998A	1999A	2000E	2001E	2002E
Lending operations					
Net interest margin	2.62%	3.37%	3.75%	3.71%	3.68%
Interest earnings assets/assets	89.0%	90.0%	85.6%	85.8%	86.4%
NIM contribution to ROA	2.33%	3.03%	3.21%	3.19%	3.18%
Non-interest operations					
Non-interest income/assets	1.13%	1.19%	1.03%	1.10%	1.15%
Overhead ratio	1.79%	1.70%	1.65%	1.66%	1.72%
Non-int. contribution to ROA	-0.66%	-0.51%	-0.62%	-0.56%	-0.56%
Asset quality analysis					
Provision/loans	-0.95%	-1.54%	-1.06%	-0.70%	-0.65%
Loans/assets	65.2%	60.4%	58.8%	59.1%	59.7%
ROA effect from asset quality	-0.62%	-0.93%	-0.62%	-0.42%	-0.39%
Core ROA	1.05%	1.59%	1.96%	2.21%	2.22%
Non-core contribution to ROA	-0.28%	-0.08%	0.02%	0.02%	0.02%
Pre-tax ROA	0.77%	1.51%	1.98%	2.23%	2.24%
Tax rate	15.8%	9.9%	15.4%	15.5%	15.8%
After tax ROA	0.65%	1.36%	1.68%	1.88%	1.89%
Balance sheet leverage (x)	10.4x	11.3x	10.9x	10.4x	9.9x
ROE	6.8%	15.4%	18.2%	19.6%	18.8%

BALANCE SHEET	1998A	1999A	2000E	2001E	2002E
(HK$m)					
Gross loans	24,710	27,245	28,851	31,089	33,590
Specific loan loss reserves	*-135*	*-236*	*-386*	*-576*	*-765*
General loan loss reserves	*-220*	*-248*	*-263*	*-283*	*-306*
Net loans	24,490	26,997	28,589	30,807	33,284
Other earning assets	10,557	10,951	12,992	13,891	14,840
Other assets	4,978	6,446	7,398	7,538	7,757
Total Assets	40,025	44,394	48,979	52,236	55,881
Deposits	28,855	32,607	34,077	36,051	38,215
Other paying liabilities	5,631	5,323	4,806	5,152	5,599
Other liabilities	1,859	2,365	5,521	5,904	6,332
Total Liabilities	36,345	40,295	44,404	47,107	50,145
Minorities & other	0	0	0	0	0
Shareholders' funds	3,680	4,099	4,575	5,129	5,736

LOAN BOOK	1998A	1999A	2000E	2001E	2002E
(HK$m)					
Property development	2,672	2,609	2,386	2,507	2,634
Non-bank financials	130	179	175	175	175
Commercial and industrial	2,310	2,999	3,306	3,339	3,373
Hire purchase	4,766	4,541	4,821	5,165	5,533
Other commercial	468	560	634	666	699
Trade finance	2,155	2,168	2,306	2,543	2,803
Loans for use outside HK	455	544	586	586	586
HOS & PSPS loans	2,181	1,902	1,747	1,926	2,123
Residential mortgages	6,545	7,613	7,731	8,122	8,533
Credit cards	1,385	1,759	2,098	2,358	2,649
Individuals	1,643	2,373	3,060	3,703	4,481
Total loans	24,710	27,245	28,851	31,089	33,590

LOAN BOOK BREAKDOWN	1998A	1999A	2000E	2001E	2002E
(%)					
Property development	11%	10%	8%	8%	8%
Non-bank financials	1%	1%	1%	1%	1%
Commercial and industrial	9%	11%	11%	11%	10%
Hire purchase	19%	17%	17%	17%	16%
Other commercial	2%	2%	2%	2%	2%
Trade finance	9%	8%	8%	8%	8%
Loans for use outside HK	2%	2%	2%	2%	2%
HOS & PSPS loans	9%	7%	6%	6%	6%
Residential mortgages	26%	28%	27%	26%	25%
Credit cards	6%	6%	7%	8%	8%
Individuals	7%	9%	11%	12%	13%
Total loans	100%	100%	100%	100%	100%

BALANCE SHEET RATIOS	1998A	1999A	2000E	2001E	2002E
(%)					
Loan-to-deposit	85.6%	83.6%	84.7%	86.2%	87.9%
Loan-to-deposit (incl. CDs)	72.9%	73.5%	73.0%	74.9%	77.0%
Equity to assets	9.2%	9.2%	9.3%	9.8%	10.3%
Tier 1 Capital	12.6%	12.7%	12.1%	12.8%	13.4%
Total Capital adequacy	14.0%	13.9%	12.9%	13.4%	13.9%
General reserves (% loans)	-0.89%	-0.91%	-0.91%	-0.91%	-0.91%
Specific reserves (% loans)	-0.55%	-0.87%	-1.34%	-1.85%	-2.28%
Total loan provisions	-1.44%	-1.78%	-2.25%	-2.76%	-3.19%

ASSET QUALITY	1998A	1999A	2000E	2001E	2002E
Nonperforming loans	568	935	799	659	544
NPL ratio	2.3%	3.4%	2.8%	2.1%	1.6%
Total provisions/NPLs	62.6%	51.8%	81.2%	130.4%	196.7%

GROWTH RATES	1998A	1999A	2000E	2001E	2002E
(%)					
Income statement					
Net interest income	-16.1%	37.7%	14.1%	6.8%	6.5%
Non-interest income	24.6%	11.5%	-7.0%	14.5%	12.2%
Total operating income	-6.1%	29.1%	8.1%	8.7%	8.0%
Operating expenses	5.9%	0.6%	4.6%	8.1%	10.4%
Pre-provision earnings	-30.9%	59.8%	10.5%	9.1%	6.4%
Loan loss provisions	281.9%	59.3%	-27.8%	-28.1%	0.2%
Net profit	-62.0%	132.7%	32.1%	20.8%	7.2%
Balance sheet					
Loan growth	-9.6%	10.3%	5.9%	7.8%	8.0%
Interest earning assets	-13.6%	8.3%	9.5%	7.5%	7.7%
Asset growth	-4.7%	10.9%	10.3%	6.6%	7.0%
Deposit growth	1.6%	13.0%	4.5%	5.8%	6.0%
Shareholders funds	-7.2%	11.4%	11.6%	12.1%	11.8%

WING LUNG BANK (HK$31.80) 3-MARKET PERFORM

The shares of Wing Lung Bank were among the worst performing banks in Hong Kong, increasing only 0.3% on the year. However a return to the old economy in the second half of the year helped boost its share price performance to 23%. Despite this strong share price performance in the second half of the year, this stock trades at a steep discount to its peers, yet delivers only a slightly lower ROE. We believe that the discount stems from the company's ultra-conservative management style, which does not appear to be proactive enough to enable it to survive over the longer run.

Conservative management in an ever-changing environment

WLB is the most conservative bank in our coverage universe, and with the significant changes that are occurring in the sector, namely increased usage of the Internet as a delivery channel and the deregulation of deposit rates, competition is likely to intensify. Small banks without a concise strategy will find it more difficult to compete against their larger counterparts, which have more resources to invest in technology and have a broader range of products to offer. Smaller banks must find niche strategies if they are to survive in today's environment, which is extremely beneficial to larger banks.

Low NPL figures, but deficient loan loss reserves:

Conservative management has however, led to among the best asset quality in the sector. The NPL ratio is expected to decline to 3.7% and with a general loan loss reserve equivalent to 1.6% of total loans, total reserve coverage of NPLs is expected to exceed 90% by year end-2000.

Our main concern about this bank is its lack of a strategy to develop non-interest income, particularly wealth management related fees and commissions. Non-interest income only accounts for 22% of total income, among the lowest in the sector. We estimate that fee income, which accounts for 45% of non-interest income, will continue to be slow since this bank generates most of its fee income from loan origination.

However, this bank has among the best operating efficiency. Increased usage of automation has allowed this bank to achieve a cost-to-income ratio of 27%, second best in the sector behind only Hang Seng's 25%. Productivity has increased significantly over the last five years. WLB has only expanded its branch network modestly since 1994, increasing from 31 to the current 35. However, total assets have almost doubled, from HK$32.7 billion to HK$59.7 billion.

Wing Lung Bank's loan book increased by only 1.2% at the interim and we are only expecting another 1% in the second half of the year. The slow loan growth has resulted in a decline in the loan-to-deposit ratio to 57%, down slightly from 60% at the end of 1999. Overall, net interest income increased by 6% year on year and 2% half on half. Meanwhile, due to the significant liquidity in the system, low cost of funds will continue to offset lower lending yields, particularly on mortgages.

Wing Lung Bank

Share Price:	31.80	Index:	15,235
52 Week Price Range:	31.80 - 22.15	Current Yield:	5.4%

INCOME STATEMENT	1998A	1999A	2000E	2001E	2002E
(HK$m)					
Interest income	4,330	3,965	3,979	3,719	3,816
Interest expense	-3,180	-2,629	-2,572	-2,251	-2,288
Net interest income	1,150	1,336	1,408	1,468	1,528
Ave. interest earnings assets	*49,668*	*56,090*	*56,953*	*58,145*	*59,815*
NIM (%)	2.32%	2.38%	2.47%	2.53%	2.56%
Non-interest income	404	377	393	421	469
Total operating income	1,554	1,713	1,801	1,889	1,997
Non-interest expenses	-475	-466	-495	-553	-596
Pre provision profit	1,079	1,247	1,307	1,337	1,401
Loan loss provisions	-357	-258	-118	-102	-84
Non-operating income	-2	-50	-2	0	0
Pre tax profit	719	938	1,187	1,235	1,316
Tax	-119	-165	-196	-204	-217
Net profit	600	855	991	1,031	1,099

PER SHARE DATA	1998A	1999A	2000E	2001E	2002E
(HK$)					
Earnings per share	2.58	3.68	4.27	4.44	4.73
Dividends per share	1.02	1.33	1.71	1.78	1.89
Effective payout ratio (%)	*39%*	*36%*	*40%*	*40%*	*40%*
Book value per share	26.25	26.33	27.95	30.62	33.46
Adjusted book value per share	18.65	20.97	23.52	26.19	29.03

VALUATION	1998A	1999A	2000E	2001E	2002E
(X)					
Price to book value (%)	1.0	0.8	1.1	1.0	1.0
Price to adjusted book value (%)	1.4	1.0	1.4	1.2	1.1
Price to earnings (X)	10.4	6.6	7.5	7.2	6.7

PROFITABILITY RATIOS	1998A	1999A	2000E	2001E	2002E
(%)					
Net interest margin	2.32%	2.38%	2.47%	2.53%	2.56%
Yield on interest earning assets	8.72%	7.07%	6.99%	6.40%	6.38%
Cost on interest bearing liabilities	7.26%	5.46%	5.15%	4.47%	4.50%
Net interest spread	1.45%	1.61%	1.84%	1.92%	1.88%
Non-int. income (% Op income)	26.0%	22.0%	21.8%	22.3%	23.5%
Cost to income	30.6%	27.2%	27.5%	29.2%	29.9%
Overhead ratio	0.81%	0.67%	0.69%	0.72%	0.78%
Cost coverage	85.1%	80.9%	79.6%	76.2%	78.6%
ROA	1.17%	1.49%	1.68%	1.71%	1.78%
ROE	10.0%	14.2%	15.4%	15.0%	14.7%

DUPONT ANALYSIS	1998A	1999A	2000E	2001E	2002E
Lending operations					
Net interest margin	2.32%	2.38%	2.47%	2.53%	2.56%
Interest earnings assets/assets	96.7%	98.0%	96.4%	96.6%	97.1%
NIM contribution to ROA	2.24%	2.33%	2.38%	2.44%	2.48%
Non-interest operations					
Non-interest income/assets	0.79%	0.66%	0.67%	0.70%	0.76%
Overhead ratio	0.92%	0.81%	0.84%	0.92%	0.97%
Non-int. contribution to ROA	-0.14%	-0.16%	-0.17%	-0.22%	-0.21%
Asset quality analysis					
Provision/loans	-1.23%	-0.88%	-0.43%	-0.36%	-0.29%
Loans/assets	56.5%	51.1%	46.9%	46.9%	46.9%
ROA effect from asset quality	-0.70%	-0.45%	-0.20%	-0.17%	-0.14%
Core ROA	1.40%	1.73%	2.01%	2.05%	2.14%
Non-core contribution to ROA	0.00%	-0.09%	0.00%	0.00%	0.00%
Pre-tax ROA	1.40%	1.64%	2.01%	2.05%	2.14%
Tax rate	-16.6%	-17.6%	-16.5%	-16.5%	-16.5%
After tax ROA	1.63%	1.93%	2.34%	2.39%	2.49%
Balance sheet leverage (x)	8.6x	9.5x	9.2x	8.8x	8.2x
ROE	14.0%	18.4%	21.5%	21.0%	20.5%

Reuters Code:	0096.HK
Bloomberg Code:	0096.HK

BALANCE SHEET	1998A	1999A	2000E	2001E	2002E
(HK$m)					
Gross loans	29,908	27,382	27,940	28,552	29,220
Specific loan loss reserves	*-293*	*-525*	*-493*	*-585*	*-659*
General loan loss reserves	*-431*	*-439*	*-447*	*-457*	*-468*
Net loans	29,476	26,943	27,493	28,095	28,752
Other earning assets	20,263	28,658	28,064	29,165	30,334
Other assets	3,563	4,135	3,852	3,708	2,789
Total Assets	53,302	59,736	59,408	60,967	61,875
Deposits	41,960	45,480	47,282	48,058	48,900
Other paying liabilities	3,393	3,973	2,606	2,701	2,022
Other liabilities	1,854	4,168	3,030	3,099	3,184
Total Liabilities	47,207	53,621	52,917	53,858	54,106
Minorities & other	0	0	0	0	0
Shareholders' funds	6,095	6,115	6,491	7,109	7,769

LOAN BOOK	1998A	1999A	2000E	2001E	2002E
(HK$m)					
Property development	6,523	5,996	5,841	5,841	5,841
Non-bank financials	396	497	484	484	484
Commercial and industrial	2,004	1,783	1,683	1,575	1,474
Hire purchase	873	1,214	1,683	1,803	1,931
Other commercial	4,043	2,948	3,518	3,518	3,518
Trade finance	711	664	619	650	683
Loans for use outside HK	1,642	957	781	781	781
HOS & PSPS loans	3,987	3,790	3,755	3,755	3,755
Residential mortgages	8,949	8,713	8,716	9,157	9,621
Credit cards	210	279	327	399	483
Individuals	569	540	534	589	649
Total loans	29,908	27,382	27,940	28,552	29,220

LOAN BOOK BREAKDOWN	1998A	1999A	2000E	2001E	2002E
(%)					
Property development	22%	22%	21%	20%	20%
Non-bank financials	1%	2%	2%	2%	2%
Commercial and industrial	7%	7%	6%	6%	5%
Hire purchase	3%	4%	6%	6%	7%
Other commercial	14%	11%	13%	12%	12%
Trade finance	2%	2%	2%	2%	2%
Loans for use outside HK	5%	3%	3%	3%	3%
HOS & PSPS loans	13%	14%	13%	13%	13%
Residential mortgages	30%	32%	31%	32%	33%
Credit cards	1%	1%	1%	1%	2%
Individuals	2%	2%	2%	2%	2%
Total loans	100%	100%	100%	100%	100%

BALANCE SHEET RATIOS	1998A	1999A	2000E	2001E	2002E
(%)					
Loan-to-deposit	71.3%	60.2%	59.1%	59.4%	59.8%
Loan-to-deposit (incl. CDs)	67.3%	57.1%	56.5%	56.9%	57.6%
Equity to assets	11.4%	10.2%	10.9%	11.7%	12.6%
Tier 1 Capital	12.2%	14.7%	16.1%	17.6%	19.5%
Total Capital adequacy	17.6%	21.0%	20.2%	21.7%	23.7%
General reserves (% loans)	-1.44%	-1.60%	-1.60%	-1.60%	-1.60%
Specific reserves (% loans)	-0.98%	-1.92%	-1.76%	-2.05%	-2.25%
Total loan provisions	-2.42%	-3.52%	-3.36%	-3.65%	-3.85%

ASSET QUALITY	1998A	1999A	2000E	2001E	2002E
Nonperforming loans	756	1,303	1,023	812	645
NPL ratio	2.5%	4.8%	3.7%	2.8%	2.2%
Total provisions/NPLs	95.8%	74.0%	91.9%	128.3%	174.5%

GROWTH RATES	1998A	1999A	2000E	2001E	2002E
(%)					
Income statement					
Net interest income	-2.1%	16.2%	5.4%	4.3%	4.1%
Non-interest income	-7.2%	-6.7%	4.3%	7.0%	11.3%
Total operating income	-3.5%	10.2%	5.1%	4.9%	5.7%
Operating expenses	2.1%	-1.8%	6.1%	11.7%	7.9%
Pre-provision earnings	-8.0%	15.6%	4.8%	2.3%	4.8%
Loan loss provisions	533.4%	-27.7%	-54.2%	-13.6%	-17.5%
Net profit	-36.1%	42.5%	15.8%	4.1%	6.6%
Balance sheet					
Loan growth	5.9%	-8.4%	2.0%	2.2%	2.3%
Interest earning assets	3.4%	11.7%	-0.1%	3.1%	3.2%
Asset growth	7.9%	12.1%	-0.5%	2.6%	1.5%
Deposit growth	6.7%	8.4%	4.0%	1.6%	1.8%
Shareholders funds	6.0%	0.3%	6.2%	9.5%	9.3%

WING HANG BANK (HK$29.80) 2-BUY

We are maintaining our 2-Buy rating on the shares of Wing Hang Bank. These shares increased 6% in 2000, outperforming the Hang Seng Index by 17%. However the stock performance was significantly better in the second half the year, increasing by 45% and outperforming the Hang Seng Index by 52%. Despite this impressive performance, the shares are still trading at a discount to Dah Sing Financial, Wing Hang's closest comparable.

We expect strong earnings growth on the back of lower loans loss provisions as the NPL ratio is expected to decline slightly to 4.1% by the end of 2000, from 4.4% at the interim. Consequently, we expect the bank to take another HK$140 million in loan loss provisions in 2H00 for a fully year figure of HK$320 million, down 27% from the year before. Meanwhile, core, pre-provision earnings are expected to increase by 4-5% in 2000 and 2001 on the back of both loan growth and a better net interest margin.

Loan growth will continue to be slow this year, but is expected to pick up in 2001. Similar to the first half of the year, management is expecting loan growth of approximately 2% in the second half of 2000. The key focus areas are personal lending and credit cards, which account for only 7% of the loan book, but are the highest yielding, generating an average yield of over 20% per annum. Elsewhere, management expects to be able to maintain its mortgage book, which accounts for one-third of its loan book. However, mortgage re-pricing, with new rates between Prime less 2% to 2.25%, is bringing the yield on the mortgage book down by an average of approximately six basis points per month. Currently, the average yield on mortgages is Prime less 40 basis points and the entire mortgage portfolio is expected to re-price by the middle of 2002.

Over the longer run, management is considering the mainland as the bank wants to increase its China exposure and is applying for a Renminbi-license for its branch in Shenzhen. China lending currently accounts for 2% of its loan book or HK$600 million. The bank is required to have HK$1.2 billion (US$150 million) in loan assets before it can apply for a Rmb-license. Management feels that it will be able to achieve this threshold by the middle of 2001. China loans, primarily mortgages, generate a yield of approximately 9%, well above that generated in Hong Kong.

Internet strategy could pay off over the longer term. In addition to the traditional services offered on the Internet, WHB is focusing its Internet strategy on stock brokerage through 50%-owned eZ Finance. This subsidiary will provide a full range of electronic stock-trading services, both on the Internet and mobile phone, including order execution, clearing and settlement and likely share finance arrangements to class "C" brokerages. 25 brokerages have already signed up and the target is for 70-80. Clients of the brokerages will likely open accounts with WHB for easier fund transfer transactions. We believe that this is a good customer acquisition and business generation strategy.

Wing Hang Bank

Share Price:	29.80	Index:	15,235
52 Week Price Range:	29.80 - 15 15.25	Current Yield:	3.7%

Reuters Code:	0302.HK		
Bloomberg Code:	0302.HK		

INCOME STATEMENT	1998A	1999A	2000E	2001E	2002E
(HK$m)					
Interest income	4,365	3,834	4,053	3,671	3,715
Interest expense	-3,073	-2,390	-2,452	-2,053	-2,051
Net interest income	1,292	1,444	1,602	1,618	1,664
Ave. interest earnings assets	*43,646*	*48,239*	*50,360*	*50,709*	*52,211*
NIM (%)	2.96%	2.99%	3.18%	3.19%	3.19%
Non-interest income	352	338	355	404	428
Total operating income	1,644	1,782	1,956	2,022	2,092
Non-interest expenses	-525	-517	-607	-646	-702
Pre provision profit	1,119	1,265	1,349	1,376	1,389
Loan loss provisions	-512	-439	-313	-214	-186
Non-operating income	-24	-5	0	0	0
Pre tax profit	583	821	1,037	1,162	1,203
Tax	-78	-119	-169	-191	-199
Net profit	503	683	868	971	1,005

PER SHARE DATA	1998A	1999A	2000E	2001E	2002E
(HK$)					
Earnings per share	1.71	2.32	2.95	3.30	3.42
Dividends per share	0.62	0.85	1.10	1.22	1.27
Effective payout ratio (%)	*36%*	*37%*	*37%*	*37%*	*37%*
Book value per share	15.05	16.55	18.00	20.92	24.00
Adjusted book value per share	13.96	15.46	16.85	19.72	22.74

VALUATION	1998A	1999A	2000E	2001E	2002E
(X)					
Price to book value (%)	1.0	1.6	1.7	1.4	1.2
Price to adjusted book value (%)	1.1	1.7	1.8	1.5	1.3
Price to earnings (X)	8.9	11.1	10.1	9.0	8.7

PROFITABILITY RATIOS	1998A	1999A	2000E	2001E	2002E
(%)					
Net interest margin	2.96%	2.99%	3.18%	3.19%	3.19%
Yield on interest earning assets	9.40%	8.00%	8.05%	7.24%	7.11%
Cost on interest bearing liabilities	7.27%	5.50%	5.48%	4.59%	4.54%
Net interest spread	2.13%	2.50%	2.57%	2.65%	2.57%
Non-int. income (% Op income)	21.4%	19.0%	18.1%	20.0%	20.4%
Cost to income	31.9%	29.0%	31.0%	31.9%	33.6%
Overhead ratio	0.81%	0.70%	0.70%	0.80%	0.82%
Cost coverage	67.1%	65.3%	58.4%	62.5%	60.9%
ROA	1.05%	1.39%	1.69%	1.90%	1.91%
ROE	11.7%	14.7%	16.9%	17.1%	15.3%

DUPONT ANALYSIS	1998A	1999A	2000E	2001E	2002E
Lending operations					
Net interest margin	2.96%	2.99%	3.18%	3.19%	3.19%
Interest earnings assets/assets	91.4%	98.2%	98.3%	99.1%	99.3%
NIM contribution to ROA	2.70%	2.94%	3.13%	3.16%	3.17%
Non-interest operations					
Non-interest income/assets	0.74%	0.69%	0.69%	0.79%	0.81%
Overhead ratio	1.10%	1.05%	1.19%	1.26%	1.34%
Non-int. contribution to ROA	-0.36%	-0.36%	-0.49%	-0.47%	-0.52%
Asset quality analysis					
Provision/loans	-1.57%	-1.36%	-0.95%	-0.64%	-0.53%
Loans/assets	68.2%	65.6%	64.0%	65.6%	66.7%
ROA effect from asset quality	-1.07%	-0.89%	-0.61%	-0.42%	-0.35%
Core ROA	1.27%	1.68%	2.02%	2.27%	2.29%
Non-core contribution to ROA	-0.05%	-0.01%	0.00%	0.00%	0.00%
Pre-tax ROA	1.22%	1.67%	2.02%	2.27%	2.29%
Tax rate	13.4%	14.5%	16.3%	16.5%	16.5%
After tax ROA	1.06%	1.43%	1.69%	1.90%	1.91%
Balance sheet leverage (x)	11.1x	10.6x	10.0x	9.0x	8.0x
ROE	11.7%	15.1%	16.9%	17.1%	15.3%

BALANCE SHEET	1998A	1999A	2000E	2001E	2002E
(HK$m)					
Gross loans	31,903	32,331	32,936	34,253	35,858
Specific loan loss reserves	*-310*	*-359*	*-806*	*-1,007*	*-1,177*
General loan loss reserves	*-327*	*-334*	*-338*	*-351*	*-368*
Net loans	31,575	31,998	32,598	33,902	35,490
Other earning assets	15,507	17,052	17,294	17,300	17,394
Other assets	1,362	1,391	874	749	660
Total Assets	48,445	50,441	50,766	51,950	53,544
Deposits	38,481	41,774	42,400	43,668	45,302
Other paying liabilities	3,980	2,870	2,234	1,246	259
Other liabilities	1,559	931	842	887	926
Total Liabilities	44,020	45,576	45,476	45,801	46,487
Minorities & other	0	0	0	0	0
Shareholders' funds	4,425	4,865	5,290	6,149	7,056

LOAN BOOK	1998A	1999A	2000E	2001E	2002E
(HK$m)					
Property development	6,000	5,788	5,640	5,362	5,097
Non-bank financials	832	1,127	1,277	1,355	1,437
Commercial and industrial	2,957	2,396	2,166	2,080	1,998
Hire purchase	762	1,104	1,376	1,474	1,579
Other commercial	2,186	2,342	2,380	2,380	2,380
Trade finance	2,011	1,679	1,699	1,699	1,785
Loans for use outside HK	3,166	3,177	2,920	3,219	3,549
HOS & PSPS loans	668	727	746	823	907
Residential mortgages	9,955	10,616	11,222	11,790	12,387
Credit cards	312	307	385	393	401
Individuals	1,977	2,032	2,173	2,630	3,182
Total loans	31,903	32,331	32,936	34,253	35,858

LOAN BOOK BREAKDOWN	1998A	1999A	2000E	2001E	2002E
(%)					
Property development	19%	18%	17%	16%	14%
Non-bank financials	3%	3%	4%	4%	4%
Commercial and industrial	9%	7%	7%	6%	6%
Hire purchase	2%	3%	4%	4%	4%
Other commercial	7%	7%	7%	7%	7%
Trade finance	6%	5%	5%	5%	5%
Loans for use outside HK	10%	10%	9%	9%	10%
HOS & PSPS loans	2%	2%	2%	2%	3%
Residential mortgages	31%	33%	34%	34%	35%
Credit cards	1%	1%	1%	1%	1%
Individuals	6%	6%	7%	8%	9%
Total loans	100%	100%	100%	100%	100%

BALANCE SHEET RATIOS	1998A	1999A	2000E	2001E	2002E
(%)					
Loan-to-deposit	82.9%	77.4%	77.7%	78.4%	79.2%
Loan-to-deposit (incl. CDs)	77.5%	73.1%	73.9%	74.7%	75.5%
Equity to assets	9.1%	9.6%	10.4%	11.8%	13.2%
Tier 1 Capital	13.0%	14.1%	15.5%	17.6%	19.5%
Total Capital adequacy	14.8%	16.0%	16.6%	18.7%	20.6%
General reserves (% loans)	-1.03%	-1.03%	-1.03%	-1.03%	-1.03%
Specific reserves (% loans)	-0.97%	-1.11%	-2.45%	-2.94%	-3.28%
Total loan provisions	-2.00%	-2.14%	-3.47%	-3.97%	-4.31%

ASSET QUALITY	1998A	1999A	2000E	2001E	2002E
Nonperforming loans	1,396	1,508	1,308	1,105	941
NPL ratio	4.4%	4.7%	4.0%	3.2%	2.6%
Total provisions/NPLs	45.7%	46.0%	87.5%	123.0%	164.2%

GROWTH RATES	1998A	1999A	2000E	2001E	2002E
(%)					
Income statement					
Net interest income	-4.3%	11.8%	10.9%	1.0%	2.8%
Non-interest income	-12.2%	-4.0%	5.0%	13.7%	6.0%
Total operating income	-6.1%	8.4%	9.8%	3.3%	3.5%
Operating expenses	1.0%	-1.4%	17.4%	6.4%	8.7%
Pre-provision earnings	-10.3%	13.0%	6.7%	2.0%	1.0%
Loan loss provisions	206.3%	-14.3%	-28.7%	-31.5%	-13.0%
Net profit	-42.3%	35.7%	27.1%	11.9%	3.5%
Balance sheet					
Loan growth	-3.1%	1.3%	1.9%	4.0%	4.7%
Interest earning assets	6.0%	4.2%	1.7%	2.6%	3.3%
Asset growth	2.2%	4.1%	0.6%	2.3%	3.1%
Deposit growth	6.3%	8.6%	1.5%	3.0%	3.7%
Shareholders funds	7.8%	9.9%	8.7%	16.2%	14.7%

SINGAPOREAN BANKS

Summary

We were Underweight or Neutral on the Singaporean bank sector from May to December, but now see some positive movements under way. Additionally, our fears of a "double dip" recession in the more distressed Asian markets have us seeking shelter in Singapore's relatively well-capitalized and high quality banks. Accordingly, we rate the sector as an OVERWEIGHT, with the following rationale.

Key Investment Factors

- ROEs Must Clear the Hurdle: Investor patience with the Singaporean banks is waning. While core ROE has improved from an average 4.2% in 1998 to 10.1% in 1999 and an estimated 12.2% for 2000, this level still badly lags that posted by banks in other non-distressed markets, such as Hong Kong. Capital is too high at every bank in the country, and loan growth generally too low. With little potential for ROE-accretive acquisitions in the region, banks must return capital to shareholders, and the sooner the better.

- Loan Growth Lags GDP, but is Improving: Over the past year, Singapore's GDP has grown at blistering rates sometimes approaching double digits—but loan growth has remained flat as a pancake despite the best efforts of bankers and a stellar performance by the consumer lending segment. Although still slack, lending has begun to pick up overall, with year-on-year growth now estimated at 4.1% and recent monthly figures showing strength. Given Singaporean banks' extremely underleveraged balance sheets and poor ROEs, low growth has justifiably kept a lid on share price appreciation.

- We note that growth in the key consumer lending sector has been strong all year and continues to advance, rising at double-digit rates in the most recent monthly reports. Consumer income is rising swiftly, which will help maintain this aggressive growth. Banks such as UOB, OUB, and DBS with substantial consumer exposure will benefit from this trend.

- Favorable Interest Rate Policy: A U.S. interest rate loosening will benefit Asia's large interest sensitive bank stocks. We see this as a positive only for Singapore within SE Asia, as other countries have margin structures which are still driven strictly by internal liquidity and excess NPLs.

- Strong Balance Sheets: Singapore's banks are by and large well-positioned with regard to asset quality and balance sheet strength. The overstuffed capital bases which hinder ROE offer a large (and, we believe, unnecessary) cushion against losses. Furthermore, all banks are well-reserved against residual NPLs, and have curbed their non-Singaporean lending, from whence most NPLs came.

- Restructuring Potential: We expect that capital management and rationalization, long a bugaboo of these banks, will finally be addressed in 1Q01. In particular, OCBC and OUB have substantial non-core assets which are undervalued and produce minimal return. Sales of these assets (already mandated by the MAS) will produce gains and higher income as funds are redirected into higher-yielding assets or returned to shareholders.

- Fee Income Generation: Given the high levels of capital held at the banks, in part driven by the MAS' over-conservative 12% CAR requirement, pure deposit-taking and lending—at least in Singapore—will not be enough to generate acceptable ROE for the bank sector. The winners will be those banks which are able to use this core business as a base upon which to build fee-generating businesses such as asset management and insurance. An early leader in this field is UOB, which leads Singapore in assets under management and already generates close to 8% of non-interest income from fund management fees.

- Consolidation: While we no longer predict that Singapore will have only two domestic banks any time in the near future, domestic consolidation continues to make compelling economic sense in this compact and mature market. The most sensible potential transaction remains an OCBC-OUB tie-up of some sort. While OCBC is still the most likely acquiror, investors have grown somewhat impatient with the slow rate of change at OCBC, and this could lead to a credible bid for the bank by OUB, possibly with a foreign partner. Keppel and UOB would also make a complementary pair; however, KTLB's AIB and Keppel Corp. ownership stakes will give management ample ability to resist being acquired.

Investment Opinion

Specific Recommendations in the Sector

We continue to be less positive on prospects for the larger banks given their recent underperformance in generating loan growth. In line with our regional view on the importance of the emerging consumer lending sector, we favor banks such as UOB with demonstrated ability to garner assets and fees in this area of the business. Additionally, we believe that restructuring and potential consolidation will produce benefits for OUB, OCBC, and UOB. Brief comments:

- UOB (Top Pick): The key drivers of our view on UOB continue to be superior in growth and higher ROE, both currently and prospectively. At 13% for the most recent period, UOB's core ROE is still materially outpacing that of its domestic competitors. The bank reported customer loan growth of 6.7% year on year for the first half (5.0% half on half), well above the industry average. Not only is UOB taking share from its domestic competitors (mainly DBS and OCBC), the bank is squarely positioned in the highest-margin business segments: SMEs and consumer lending. Finally, UOB's leadership in asset management will help cement its client relationships and increase cross-sell potential, further improving earnings. 1-Strong Buy.

- OUB: OUB has been executing well, but remains primarily a takeover and restructuring play due to its fundamentally weaker franchise. We believe that an in-market acquisitor could pay a substantial premium for OUB while still maintaining earnings accretion due to the large potential for cost savings. In addition, rationalization of the OUB/OUE stake-holdings would boost earnings and special gains while potentially reducing shares outstanding. 2-Buy.

- Keppel TatLee: KTLB is clearly a value play, currently selling below book value despite its faster-than-average growth. However, the bank is limited in its ability to grow in Singapore and Malaysia, and so will be hard pressed to increase its leverage without share buy-backs. The government's controlling stake in KTLB (through Keppel Corp. and Temasek) means that shareholders are unlikely to be able to realize value through a merger, despite the attractive nature of the bank's franchise. 2-Buy.

- DBS: While DBS has been a share loser in recent periods, and has squandered shareholder funds in an ill-fated (to-date) regional diversification, the bank remains the largest consumer lender in Singapore, and is well positioned to benefit from the effects of higher spending and borrowing. Additionally, as the largest mortgage lender, DBS should be lifted by an apparent end to the mortgage price war. 2-Buy.

- OCBC: OCBC has been beset by troubles in its core Singaporean lending business, as the bank has lost share due to a weak product line-up and shaky IT. Instead, management has poured its efforts into establishing two new standalone Internet banks (one in partnership with ANZ). We believe that this strategy is fundamentally flawed and will increase minimum capital needs without generating positive returns.

While OCBC does have upside potential due to its sub-optimal capital structure and large holdings of non-core assets, we believe that the assessment of these assets and the anticipated gains (already included in capital in our models at appraised value) is already in OCBC's valuation. 3-Market Perform.

Sector Discussion

Excess Capital Continues to be a Drag on Shareholder Returns

Banks in Singapore continued to pile up capital last year, with equity to assets at year-end standing at an average of 13.5%, up from 12.4% in 1998. BIS capital adequacy ratios reached 20.3% on average, contributing to an average core return on equity for the sector of only 11.85%.

With MAS promoting the consolidation theme throughout the year, managements have been fortifying their positions by retaining capital far beyond what is necessary for foreseeable operating needs, either in hopes of building a war chest to make acquisitions or as a defensive measure to make a takeover of their institution prohibitively expensive. Now that central banking authorities have backed away from the forced consolidation theme, we expect the capital trend to run the other way, as managements realize that the only certain route to oblivion and inviability going forward will be a single-digit core ROE in a peak year.

Acquisitions Have Yet to Add Value

As Singaporean banks have attempted to deploy excess capital in other markets, we have seen a wave of foreign acquisitions: Kwong On (DBS), Thai Danu (DBS), Radanasin (UOB), Westmont (UOB), and BPI (DBS), as well as abortive Keppel TatLee acquisitions of stakes in Siam City Bank and Equitable PCI Bank. What we have yet to see are significant returns from these outlays, with DBS in particular being an egregious offender. Management teams who wish to avoid forced consolidation may instead be tempted to grow by acquisition in order to gain scale at the expense of returns, a very real risk for investors.

Asset Quality Has Bottomed Out

FY1999 was the last year of extraordinary provisions for banks in Singapore, with average provisions falling by 33% for the full year. At this stage, only DBS and OUB are under-reserved by our (conservative) methodology, with the other banks comfortably above our threshold for full coverage of portfolio losses. We expect that DBS' sale of Thai Danu loans after the end of 1H00 and OUB's steady progress in reducing NPLs will bring them up above 100% of our desired level by year-end.

NPLs have peaked at below 10% of loans, ending 1H00 at 8.9% of total loans. We project a fairly rapid drop-off to 8.0% in FY2000 and 6.3% in FY2001, with interim charge-offs falling to an equilibrium level of 0.5% per annum.

Internet Increases Risk of the Status Quo

As one of the most highly "wired" countries in the world, Singapore is on the leading edge of the Internet's impact on traditional businesses. While Singaporean bank managements in general appreciate the magnitude of the change that is upon them, many are choosing to address this change through proprietary portal strategies and through the liability-led customer acquisition drives that have failed in other markets. We believe that the way forward lies with the type of asset-focused customer strategy typified by KTLB.

While rising FY2000 earnings at the Singaporean banks are basically assured by falling loan loss provisions and very strong fee income gains, we expect loan growth to be a differentiating factor between winners and losers in FY2001 and beyond. With a surfeit of capital at every institution, and consolidation seemingly stalled for the time being, the five remaining banks are dependent upon stronger asset growth in order to leverage their balance sheets and post respectable ROEs.

With the Singaporean economy running essentially flat-out but loan growth expected to end the year up a meager 3.4%, Singapore has experienced one of the longest instances of GDP/loan growth de-linking we can recall. However, there are several bright spots in the overall gloom: Consumer lending has been increasingly strong, with YTD growth (through November) of 13.7%. Mortgage lending has improved, mitigating the effects of rate competition, with banks as a class have been taking mortgage and other consumer business away from the remaining non-bank finance companies.

Loans to manufacturing companies continue to fall. With substantial excess capacity and utilization still well below its pre-crisis level, manufacturing loan demand is only strong in the working capital segment, and not for plant and equipment financing.

Figure 9: Bank Loans By Category

	Total Loans	Agri/ Mining	Mfg.	Bldg/ Construct.	Resid. Mortgage	Commerce	Transpt, Stg. & Telco	Financial	Consumer	Other
Nov-00	152,722.10	186.60	11,479.90	25,232.90	38,219.80	19,463.80	3,655.60	20,785.60	24,555.40	9,142.50
% of Total	100.0%	0.1%	7.5%	16.5%	25.0%	12.7%	2.4%	13.6%	16.1%	6.0%
Oct-00	152,112.70	173.90	11,238.90	25,004.60	37,821.40	19,478.70	3,701.30	20,991.20	24,358.00	9,344.70
% of Total	100.0%	0.1%	7.4%	16.4%	24.9%	12.8%	2.4%	13.8%	16.0%	6.1%
Sep-00	150,757.90	172.00	11,751.40	24,938.30	37,506.80	18,855.00	3,848.70	20,964.90	23,806.10	8,914.70
% of Total	100.0%	0.1%	7.8%	16.5%	24.9%	12.5%	2.6%	13.9%	15.8%	5.9%
Aug-00	151,280.70	156.20	12,014.90	24,888.70	37,394.30	18,806.90	3,960.30	21,146.30	23,609.00	9,304.10
% of Total	100.0%	0.1%	7.9%	16.5%	24.7%	12.4%	2.6%	14.0%	15.6%	6.2%
Jul-00	150,653.80	164.50	11,476.60	24,387.60	37,161.10	19,169.40	3,923.30	21,387.30	23,438.90	9,545.00
% of Total	100.0%	0.1%	7.6%	16.2%	24.7%	12.7%	2.6%	14.2%	15.6%	6.3%
Jun-00	150,249.60	191.20	12,260.10	23,552.60	36,908.80	19,086.30	3,881.70	22,233.40	22,855.40	9,280.00
% of Total	100.0%	0.1%	8.2%	15.7%	24.6%	12.7%	2.6%	14.8%	15.2%	6.2%
Dec-99	147,185.50	191.40	11,574.70	23,444.00	35,154.10	19,949.30	3,743.30	21,062.80	21,594.20	10,471.70
% of Total	100.0%	0.1%	7.9%	15.9%	23.9%	13.6%	2.5%	14.3%	14.7%	7.1%
Dec-98	151,640.90	223.60	12,249.20	25,580.00	31,788.50	21,549.10	4,459.70	22,724.10	21,766.10	11,300.60
% of Total	100.0%	0.1%	8.1%	16.9%	21.0%	14.2%	2.9%	15.0%	14.4%	7.5%
Dec-97	143,243.80	187.60	12,472.00	26,234.80	22,934.80	26,349.50	3,575.70	20,997.40	22,775.40	7,716.50
% of Total	100.0%	0.1%	8.7%	18.3%	16.0%	18.4%	2.5%	14.7%	15.9%	5.4%

Source: Monetary Authority of Singapore

Figure 10: Bank Loans By Category—YTD % Change

	Total Loans	Agri/ Mining	Mfg.	Bldg/ Construct.	Resid. Mortgage	Commerce	Transpt, Stg. & Telco	Financial	Consumer	Other
2000 YTD	3.8%	-2.5%	-0.8%	7.6%	8.7%	-2.4%	-2.3%	-1.3%	13.7%	-12.7%
1999	-2.9%	-14.4%	-5.5%	-8.4%	10.6%	-7.4%	-16.1%	-7.3%	-0.8%	-7.3%
1998	5.9%	19.2%	-1.8%	-2.5%	38.6%	-18.2%	24.7%	8.2%	-4.4%	46.4%
1997	12.8%	41.3%	1.8%	22.6%	12.4%	10.1%	36.5%	8.0%	12.4%	17.8%

Source: Monetary Authority of Singapore

Figure 11: Actual and Projected Loan Growth (YoY Basis)

	Total Loan Growth (HoH)				Total Loan Growth (YoY)					
	1999A		2000							
	1H	2H	1HA	2HE	1997A YE	1998A YE	1999A YE	2000E YE	2001E YE	2002E YE
DBS	13.5%	-3.0%	-2.2%	-1.8%	18.7%	37.9%	10.1%	-4.0%	3.4%	4.0%
OCBC	-9.0%	6.0%	-1.0%	1.5%	11.4%	0.2%	-3.5%	0.5%	3.1%	5.3%
OUB	2.0%	-15.3%	18.7%	2.1%	16.0%	11.5%	-13.6%	21.2%	5.1%	5.8%
UOB	-5.0%	13.2%	4.1%	4.7%	16.1%	1.8%	7.6%	9.0%	10.7%	6.7%
KTLB	-2.1%	8.1%	7.3%	3.9%	26.7%	84.2%	5.8%	11.5%	9.9%	5.5%
Average	**-0.1%**	**1.8%**	**5.4%**	**2.1%**	**17.8%**	**27.1%**	**1.3%**	**7.7%**	**6.5%**	**5.4%**

Source: Company reports; Lehman Brothers

Asset Management Adds a New Dimension

New data from the MAS and other sources have shown that the Singaporean unit trust market—a key factor in expanding bank asset management operations—is continuing to expand, rising by 4% quarter on quarter in 3Q00 despite losses from a slumping stock market. The overall Singaporean unit trust market has grown at a CAGR of 39% since 1997, albeit from a low base, and now totals S$8.9 billion. For several structural reasons, we expect this inflow of money to continue, with growth moderating only slightly to a CAGR of 31% over the 2001-2005 period. First among these is the beneficial effect of the mandatory CPF scheme, which by itself will directly account for a substantial amount of the growth.

The CPF also has the effect of raising investors' comfort level with unit trusts in general, which may induce them to invest outside the CPF. With a relatively high concentration of affluent investors, Singapore has ample capacity to further increase its consumption of asset management products.

On the institutional side, Singapore's government has made a concerted effort to attract international money management firms, with a fairly impressive amount of early success. While banks such as OUB and DBS have substantial institutional management arms, it bears keeping in mind that this sector is considerably less profitable than the high-margin unit trust business, where sales charges of 4% are still common, although fierce competition means that their day is swiftly fading.

Singapore's banks are well positioned in both the retail and institutional asset management markets, with some important distinctions within the sector. UOB and OUB lead in total assets under management, both narrowly ahead of DBS, but with very different profiles. UOB is a retail powerhouse, offering some 26 different funds through its powerful consumer banking franchise, OUB has concentrated heavily on the institutional side of the market. While DBS runs a close third in total AUM, the bank contracts partners such as Frank Russell to manage many of the portfolios, giving up a share of revenues.

Figure 12: Singaporean Bank Assets Under Management

S$, MM	Total AUM	Retail	Institutional
UOB	4,000	1,600	2,400
OUB	3,800	200	3,600
DBS	3,700	900	2,800
OCBC	3,000	900	2,100
KTLB	1,000	150	850

Source: Company reports; Lehman Brothers

Asset management revenues account for a material and rising percentage of Singapore bank non-interest income, with aggregate revenue increasing at a 200%+ annual rate over the past six quarters. Currently, we estimate that UOB and OUB derive the greatest percentage of their NII from asset management—a factor we feel is frequently overlooked when valuing these franchises as the entire business is off-balance-sheet and poor disclosure hampers an accurate evaluation of revenues.

Figure 13: Singaporean Bank Asset Management Revenues

S$, MM FY2001E	Asset Mgmt Income	Total Non-Int Income	AMI as % of NII
DBS	51	919	5.49%
OCBC	44	697	6.24%
OUB	41	460	8.91%
UOB	64	804	7.96%
KTLB	12	179	6.52%

Source: Company reports; Lehman Brothers

The Mortgage War Spreads to Singapore

All five banks cut their mortgage rates substantially in the fourth quarter, led by OUB and UOB. Although cutting rates in the absence of incremental loan growth is unequivocally a negative-sum game, it does not seem out of the realm of possibility that banks may be able to stimulate some additional borrowing, particularly given the US rate cuts.

Any of the banks that can effectively use lower rates to increase share and balances will benefit from the interest rate war; we expect DBS to be the biggest loser due to its dominant current market share and Keppel TatLee and OUB to continue as relative outperformers in mortgage lending.

Figure 14: Mortgage Lending Rates By Bank

Bank		Mortgage Rate in Year: 1	2	3	4	5	6+
DBS		**2.75%**	**3.90%**	5.00%	5.00%	5.00%	5.75%
OCBC	(1)	**2.98%**	**4.27%**	5.50%	5.50%	5.50%	5.50%
	(2)	**3.28%**	**5.22%**	**5.25%**	**5.25%**	**5.25%**	6.00%
OUB		**3.00%**	**4.25%**	5.00%	5.00%	5.00%	5.50%
UOB		**3.00%**	**4.25%**	5.00%	5.00%	5.00%	5.50%
KTLB		**3.00%**	**4.00%**	4.75%	4.75%	4.75%	5.75%
StanChart		3.25%	4.50%	4.75%	4.75%	4.75%	5.00%
ABN AMRO		3.25%	4.00%	4.75%	4.75%	4.75%	4.75%
HSBC		**2.95%**	**4.25%**	5.00%	5.00%	5.00%	5.00%

Bold = fixed rate.

Source: Company reports; Dollardex.com

Given the surplus capital and general liquidity of the sector, we believe that rates could fall considerably further without removing the profitability of mortgages. In our analysis, we assume that banks fund additional mortgages by either borrowing in the interbank market or by removing their own invested funds from interbank borrowers.

Using the statutory 12% risk-based capital requirement and 50% residential mortgage weighting, we have included a 6% capital charge in our base break-even analysis, which assumes a generous 15% cost of capital. We have also included 25 basis point charges for servicing and bad debt costs.

The resulting funding cost of 3.57% for mortgages is above some banks' first and second year teaser rates, but is well below the average yield of 4.91% on mortgages assuming that they maintain a seven-year average life. This indicates that banks could drop rates by an additional 130+ basis points over the course of the loan without losing money.

Even assuming that refinancings occasioned by the low rate environment reduce the average life to five years (an extreme case given that almost all of these mortgages carry prepayment penalties), the average yield would drop to only 4.64%, leaving 107 basis points between funding cost and asset yield.

However, with all of the banks severely overcapitalized, it is far from clear that they should (or will) be pricing in the full cost of capital, as it is not a near-term constraint. Using only the marginal cost of mortgage funding, without charging for capital, yields an average mortgage funding cost of only 2.81%, below even the lowest teaser rates.

Non-Core Asset Divestments Will Yield Better Banks

After years of hopeful waiting, investors will finally be able to hold "pure play" Singaporean banks in the near future, without being forced to subsidize property or holding company investments. The MAS announced new regulations during the second half which will limit its supervised banks' ability to hold non-financial assets and businesses within their corporate structures. The measures are intended to limit the banking system's exposure to losses at unrelated companies and enhance transparency, both of which aims we loudly applaud. Effects will be most significantly felt at OCBC, which holds the greatest proportion of unrelated businesses. We see this move as a positive for the sector and particularly for OCBC.

- Regulatory Effects: Over the next three years (although we expect effectively full compliance by year-end 2001), Singaporean banks must segregate financial and non-financial assets into different holding companies, and divest the non-financial assets either through direct sales or via spin-offs to shareholders. The regulations do contemplate banks keeping certain non-financial businesses which have "clear synergies" with the banks' core businesses. We believe that this will include most Internet and e-commerce ventures; however, it appears to exclude most investment real estate.

- No Keiretsu Structures: Cross-shareholdings between the financial and non-financial arms of the current banking groups will be prohibited. In addition, managements (including a majority of each Board of Directors) must be separate and independent. Non-financial companies will not be permitted to use the banks' logos, or even to share names (viz. DBS Land) which may imply connections with the banking groups.

- Possible Tax Benefits: In order to minimize any tax effects from the sale of these businesses, the government has agreed to an unspecified set of one-time rules for these transactions which we believe will shelter most gains on sale.

OCBC: OCBC has the largest proportion of non-financial assets, including stakes in Fraser & Neave Ltd. (12.5%), Robinson and Company (21.1%), and the Straits Trading Company (16.1%). In addition, the bank holds large amounts of investment real estate, with property revaluation accounting for over S$3.1 billion of the bank's capital. As these assets have had little synergy with the bank, we are pleased to see them go so that capital can be rationalized.

DBS: DBS has already divested many of its non-core assets, including property and most of its stake in DBS Land. The company reports that the MAS directive will affect listed investments (including stakes in NatSteel, Intraco and CWT Distribution) with market value of S$170 million and unlisted investments with NAV of S$65 million at last reporting period.

UOB: UOB will have to divest its holdings in United Overseas Land (44.9%) and Haw Par Corp. (43.4%). The bank reports that no investment property will need to be sold.

OUB: OUB will need to sell or distribute its holdings in hospitality firms Overseas Union Enterprise (49.4%) and Hotel Negara Ltd. (53.4%). The bank reports that no investment property will need to be sold.

Keppel TatLee: After the divestiture of KTLB's 49% stake in TLB Land during FY1999, the company has no non-core assets which will need to be sold under the new regulations.

DBS BANK (S$19.80) 2-BUY

Investment Summary

As the largest consumer and corporate bank in Singapore, and one of the largest asset managers, DBS will be a major beneficiary of a rebound in the sector. Down over 28% in 2000, DBS has been punished by investors (and by us) for poor regional diversification and shrinking loan share, even as the bank has failed to generate appropriate ROEs. However, we believe that several factors now stand in favor of DBS, and accordingly lifted our rating to 2-Buy from 3-Market Perform in late December, with a new price target of S$22.75.

Having reached the end of its recovery from the Asian Crisis, DBS needs to generate growth in its home market and returns from its expensive regional strategy in order to be able to post returns. While Thai Danu should be a drag on earnings no longer, the bank has yet to make any significant contribution. Ditto for DBS' investments in Hong Kong, the Philippines and Indonesia.

Key Points

- Interest Rate Cuts Will Benefit Growth and Margins: DBS has exposure to what are now reasonably clean franchises in Singapore, Hong Kong, Thailand, and the Philippines—all of which have been suffering from compressed margins. We expect lower rates to spur growth in outstandings and margins.

- "Thailand Discount" Lessens: DBS has additional upside due to the removal of DTDB as a major drag on consolidated margins. We expect that lower foregone interest income alone at DTDB will add 3–5 basis points of net interest margin to the group by the end of FY2001.

- Retail Share Still Strong: DBS remains the largest consumer lender in Singapore, although its proportional exposure lags behind that of UOB and Keppel TatLee. However, the bank is well positioned to benefit from the effects of higher spending and borrowing, Additionally, as the largest mortgage lender, DBS should be lifted by an apparent end to the mortgage price war.

- Asset Management Adds Return: DBS has added S$1 billion this year in retail AUM through its Horizon and Eight unit trust products; there appears to be substantial headroom to increase this figure. A recent conversation with management revealed that DBS currently has over 3,000 retail customers with current account balances in excess of S$1 million—prime candidates for conversion into mutual fund customers.

This conversion will move balances from low margin spread-based balance sheet accounts which require capital backing to off-balance-sheet, fee-based relationships which produce higher income without capital requirements, boosting profits and ROE.

- Management is Unmatched: We believe that DBS management is perhaps the most impressive among those of the regional banks. As investors seek shelter from a potential economic downturn elsewhere in Asia, we believe that they will continue to attach a premium to DBS due to its management strength, transparency, and disclosure.

- Still an Expensive Franchise: While we believe that DBS will be able to reap rewards by using its premier market position and regional scope, we believe that the bank's premium to the rest of the sector is unwarranted given its sub-par ROEs. We believe that investors should be focused around the value names in the sector during early 2001.

Strategy: Acquisitions are Planned; Investors are Skeptical

Size Matters

The centerpiece of the DBS strategy continues to be adding scale. This includes not only bulking up the balance sheet and capital account to facilitate eventual moves into North Asia, but gaining a diversity of business streams from more developed markets in order to smooth earnings. Once this is accomplished, management feels that the bank will be able to expand its presence in more severely distressed markets without a negative reaction from investors, as emerging risks will then represent a much smaller portion of the overall institution.

Developed Market Acquisition Focus

In order to gain size and stable earnings, DBS is focusing on Hong Kong and Australia. The Hong Kong market is considered particularly attractive by management due to the perception that customers are underserved in key segments including unit trusts. Any Hong Kong acquisition would be merged into Kwong On Bank (which is gradually being re-branded with the DBS name), and would not keep a separate listing.

Developing Markets No Longer A Priority

While DBS has made small-scale moves, such as boosting its stake in DBS Bank Indonesia (the former TatLee Buana joint venture bank), management indicated that further expansion in Indonesia and Thailand is not a priority—at least in part due to the expectation that investors would react negatively to any additional capital commitments in these countries.

BPI Stake Slow To Add Value

We remain negative on DBS' S$1.2 billion investment in Bank of the Philippine Islands, although we do think that BPI is the best franchise in the country. DBS has invested S$1.2 billion in a ~20% stake—far above the current market price. In return, DBS gains access to the bank's distribution channels, primarily for bancassurance and unit trusts.

DBS plans to link its ATMs in Singapore, Hong Kong, and potentially Thailand with BPI's network within a year. Among other things, this will enable Filipino overseas workers to remit money ATM to ATM, without necessarily having to maintain multiple accounts. While this is an innovative entry in a historically lucrative market segment, it is difficult to see initiatives of this type ever producing a market return on the aggregate DBS investment.

Loan Growth and Margins: A Game of Inches

DBS was not able to capitalize on its market power to boost the loan book during the first half of 2000, with total customer loans down 3.5% in the half versus our projection of 1.5% growth. With no top line growth, margins continued to be constrained, rising to 2.21% from 2.16% in 2H99, but below the 2.23% recorded in 1H99.

Management can rightly point to increasing margins as evidence of execution in its core business; however, we note that much of the increased margin by our calculations comes from lower foregone interest income on NPLs as problem assets decline. While this is of course commendable, it is less positive than an operating margin expansion. In any case, DBS promises to continue expanding margins by exiting unprofitable business areas and applying a strict 15% ROE hurdle for lending. As for the recent mortgage war outbreak, CFO Jackson Tai says that management is "repulsed by price competition."

Asset Quality is No Longer a Driver

Asset quality improved during the half as expected. DBS has now completely escaped the legacy of the Asian crisis, and is fully provided against loan losses post the Thai Danu NPL sale transaction. NPLs dropped from an estimated 9.8% of total loans to 9.4% of total loans during the period, slightly above our projection of 9.1%. Reserves cover 49% of NPLs; DBS reports that collateral covers 55% of gross NPLs.

Thai Danu NPL Sale: Subsequent to the close of the half, DBS' Thai unit Thai Danu Bank sold Bt30.6 billion face value (S$1.3 billion) in NPLs to a consortium led by Lehman Brothers and National Finance and Securities PCL for Bt8.4 billion (S$356 million), a haircut of approximately 73%. We estimate that this transaction has caused total consolidated NPLs at DBS to fall by 23% (to 7.2% of total loans), and that the loan loss reserve is now fully adequate.

We believe that the difference between book and sale value at TDB, approximately S$1 billion, was absorbed by reserves both at the TDB and DBS level, resulting in no consolidated P&L impact. We have assumed, based on John Olds' statement that the majority of the TDB loans sold were "toxic," that all Bt30.6 billion in NPL reduction came from TDB's well-stocked Loss loan category.

DBS Bank

Share Price:	19.80	Index:	1,926.83
52 Week Price Range:	25.80 - 16.50	Current Yield:	0.9%
Reuters Code:	DBSMe.SI		
Bloomberg Code:	DBS SP		

INCOME STATEMENT	1998A	1999A	2000E	2001E	2002E
(S$m)					
Interest income	n.a	n.a	n.a	n.a	n.a
Interest expense	n.a	n.a	n.a	n.a	n.a
Net interest income	1,430	2,035	2,166	2,365	2,541
Ave. int. earnings assets	*68,233*	*86,446*	*97,558*	*102,440*	*106,577*
NIM (%)	2.10%	2.35%	2.22%	2.31%	2.38%
Non-interest income	481	957	852	971	1,080
Total operating income	1,911	2,992	3,018	3,335	3,620
Non-interest expenses	-754	-1,065	-1,240	-1,255	-1,274
Pre provision profit	1,157	1,927	1,779	2,081	2,347
Loan loss provisions	-996	-1,063	-114	-45	-45
Non-operating income	-5	143	67	0	0
Pre tax profit	155	1,007	1,727	2,036	2,302
Tax	-72	-345	-389	-529	-598
Net profit	223	1,072	1,367	1,519	1,693
Core earnings	225	977	1,314	1,519	1,693

PER SHARE DATA (S$)	1998A	1999A	2000E	2001E	2002E
EPS	0.24	0.91	1.16	1.29	1.44
DPS	0.15	0.17	0.27	0.45	0.50
Effective payout ratio (%)	*55%*	*19%*	*23%*	*35%*	*35%*
BVPS	10.98	10.42	10.70	11.54	12.47
ABVPS	9.84	9.23	9.51	10.35	11.29

VALUATION	1998A	1999A	2000E	2001E	2002E
Price to book value (x)	1.4	1.9	1.9	1.7	1.6
Price to adjusted book value (x)	1.5	2.2	2.1	1.9	1.8
Price to earnings (X)	62.1	22.2	17.1	15.4	13.8

PROFITABILITY RATIOS	1998A	1999A	2000E	2001E	2002E
(%)					
Net interest margin	2.10%	2.35%	2.22%	2.31%	2.38%
Yield on interest earning assets	n.a	n.a	n.a	n.a	n.a
Cost on interest bearing liabilities	n.a	n.a	n.a	n.a	n.a
Net interest spread	n.a	n.a	n.a	n.a	n.a
Non-int. income (% Op income)	25.2%	32.0%	28.2%	29.1%	29.8%
Cost to income	39.6%	34.0%	40.2%	37.6%	35.2%
Overhead ratio	1.11%	1.23%	1.27%	1.22%	1.19%
Cost coverage	63.8%	89.9%	68.7%	77.4%	84.8%
ROA	0.27%	1.04%	1.25%	1.32%	1.38%
ROE	2.7%	10.7%	12.4%	13.0%	13.3%

OROA ANALYSIS	1998A	1999A	2000E	2001E	2002E
Net interest margin	2.10%	2.35%	2.22%	2.31%	2.38%
Non-interest inc./gross inc.	24.98%	35.10%	29.70%	29.10%	29.82%
Efficiency ratio	39.58%	33.96%	40.23%	37.62%	35.18%
Provision/assets	1.01%	1.00%	0.10%	0.04%	0.04%
Operating return on assets	0.68%	1.40%	1.79%	1.99%	2.17%
Equity/assets	10.29%	11.52%	11.26%	11.45%	11.67%
Operating return on equity	6.62%	12.12%	15.85%	17.41%	18.57%

BALANCE SHEET	1998A	1999A	2000E	2001E	2002E
(S$m)					
Gross loans	76,741	84,439	81,070	83,770	87,137
Loan loss reserves	*2,265*	*4,069*	*3,639*	*3,274*	*2,892*
Net loans	73,609	79,463	76,575	79,628	83,359
Total earning assets	78,188	94,704	100,412	104,467	108,687
Other assets	20,788	11,761	11,451	14,209	17,216
Total Assets	98,975	106,465	111,863	118,676	125,903
Deposits	86,477	89,759	90,645	94,109	97,432
Customer deposits	-	82,268	81,606	84,797	87,791
Other deposits	-	7,491	9,039	9,312	9,640
Other paying liabilities	2,715	2,818	2,846	2,954	3,059
Other liabilities	655	3,012	7,166	9,418	12,118
Total Liabilities	89,846	95,589	100,657	106,482	112,608
Equity with revaluation	10,188	12,270	12,600	13,588	14,689
Adjusted equity	9,129	10,876	11,206	12,194	13,295

BALANCE SHEET RATIOS	1998A	1999A	2000E	2001E	2002E
(%)					
Loan-to-deposit	87.7%	93.1%	88.5%	88.1%	88.5%
Equity to assets	10.3%	11.5%	11.3%	11.4%	11.7%
Tier 1 Capital	-	-	-	-	-
Total Capital adequacy	-	-	-	-	-
Total loan provisions	2.99%	4.87%	4.54%	3.95%	3.35%

ASSET QUALITY	1998A	1999A	2000E	2001E	2002E
Nonperforming assets	7,086	8,149	5,605	4,660	3,410
Special mention	-	-	-	-	-
Substandard	-	4,952	4,696	3,826	2,694
Doubtful	-	621	539	520	460
Loss	-	2,576	371	314	256
ORE	-	-	-	-	-
NPAs/total loans	9.3%	9.8%	7.0%	5.6%	4.0%
Reserve coverage of NPAs	32.0%	49.9%	64.9%	70.3%	84.8%
Required reserves	n.a	4,640	2,334	2,130	1,862
Actual reserves	n.a	4,069	3,639	3,274	2,892
Shortfall (surplus)	n.a	571	(1,305)	(1,143)	(1,029)
Actual to required reserves	n.a	88%	156%	154%	155%
Shortfall to capital	n.a	5%	-10%	-8%	-7%

GROWTH RATES	1998A	1999A	2000E	2001E	2002E
(%)					
Income statement					
Net interest income	42.7%	42.3%	6.5%	9.2%	7.4%
Non-interest income	-6.7%	131.1%	-16.8%	6.1%	11.2%
Total operating income	26.0%	64.5%	-1.7%	8.2%	8.5%
Non-interest expenses	53.1%	41.1%	16.4%	1.2%	1.5%
Pre-provision earnings	13.0%	79.8%	-11.0%	13.0%	12.8%
Loan loss provisions	101.1%	6.7%	-89.2%	-60.6%	0.0%
Core earnings	-47.4%	333.8%	34.4%	15.6%	11.4%
Net profit	-49.0%	381.2%	27.5%	11.2%	11.4%
Balance sheet					
Loan growth	37.9%	10.1%	-4.0%	3.4%	4.0%
Interest earning assets	34.2%	21.1%	6.0%	4.0%	4.0%
Asset growth	51.9%	7.6%	5.1%	6.1%	6.1%
Deposit growth	60.0%	3.8%	1.0%	3.8%	3.5%
Shareholders funds	21.8%	20.4%	2.7%	7.8%	8.1%

OVERSEA-CHINESE BANKING CORP. (S$13.00) 3-MARKET PERFORM

Investment Summary

OCBC, once our favorite Singaporean bank, has fallen on hard times of late due mainly to poor execution in its home market and a confused strategy which relies heavily on technology investments. The bank is still operating in a challenging environment, and will likely continue lag its regional and Singaporean peers in performance. However, as OCBC is the Singaporean bank most dependent on pure interest spread (as opposed to fee income) for its profits, a rise in growth or margins on the bank of the Fed's easing trend will be a most welcome boost.

While other recent developments, including the appointment of a well-regarded new CFO from National Australia Bank and the upcoming release of the bank's capital restructuring plan, appear positive, we still rate OCBC only as a 3-Market Perform pending concrete execution.

Key Points

- Loan Share Continues to Slide: Customer loan growth has been negative at OCBC over the prior period as the bank has lost share in a marginally-expanding market. Management hopes to end the year with a flat loan book, which would imply 2-3% customer loan growth in 2H00 in the SGD book, with the non-SGD book (some 25% of the portfolio) still declining. Both commercial and housing loans have begun to recover for the bank, although most other sectors are still stagnant or worse.

- Asset Quality Weakened, But is Back on Track: NPLs, which had begun to rise again in 1H00, are once again dropping, with the peak having occurred in March. These NPLs, unlike the regional portfolio which caused the initial 1998-99 rise, are mainly Singaporean and Malaysian. Management commented that the Malaysian NPL book had become unexpectedly difficult to cure; we may see this impact other Singaporean banks with significant Malaysia operations such as UOB and OUB.

NPLs had risen from 9.2% at year-end 1999 to 9.7% at 1H00; we now forecast that they will fall to 9.0% at year-end 2000—a gross amount of approximately S$4.3 billion. OCBC's current reserves of S$2.46 billion are more than adequate to cover known and potential losses in the portfolio. In fact, we calculate a reserve surplus in excess of S$500 million, which will allow for potential write-backs in coming years.

- Restructuring Plans Will Drive Returns: OCBC's plan for divesting its non-core assets, along with its matching capital rationalization plans, will set the tone for investor perceptions of the bank over the next few years. We expect to see a comprehensive plan by the year-end earnings announcement in late 1Q01, and will be looking for substantial return of capital to shareholders.

Strategy: How Best To Use Excess Capital?

OCBC is Acquisition-minded

The bank has recently reaffirmed its desire to use its substantial excess capital position, along with prospective gains from the sale of real estate and other non-core assets, to make acquisitions. We see this as a bad plan for shareholders, and would much prefer a significant return of capital, which we calculate could total over S$5 billion.

With the exception of an in-market merger (most likely to be OUB), we are likely to be extremely negative on any announced transaction, with the following rationale:

- Price: The banks at which OCBC has been reportedly looking, including Dao Heng and IBA (OCBC was also reportedly a suitor of FPB Bank Holdings before its sale to Bank of East Asia), are either already fully priced or would likely be so after adding acquisition premium. Any deals done at these prices will be dilutive to OCBC's already poor returns.

- Synergy: The synergy between OCBC and a small or medium-sized Hong Kong bank would be minimal, as the positioning, clientele, and products offered are fairly different and will remain so for structural reasons. Cost saves given the widely separated markets will be limited, and therefore the market premium which would be necessary to pry one of the Hong Kong banks away from its controlling shareholders is not warranted. Ditto for Taiwan, the Philippines, Thailand and the other acquisition markets *du jour*.

The only market where potential synergies exist is Malaysia, where OCBC already has a substantial presence. However, OCBCM is virtually at its limit for branch expansion, and OCBC will not be permitted to buy a local Malaysian bank before 2003 at the earliest.

- Management: OCBC has failed to execute its own operating plan in Singapore. The bank has been consistently losing market share, its e-banking strategy can be charitably described as confusedly optimistic (and the bank's internal IT is reportedly chaotic), and management's dilatory attitude towards returning capital to its owners is baffling. We find it hard to see any benefit which would accrue to an acquired institution from OCBC's management supervision.

Investors would seem to be better off using returned capital to assemble their own portfolios of non-Singaporean banks, rather than paying OCBC to do it for them at a premium.

Will the Tables be Turned?

Given that OCBC's strategy appears to be adrift, and the poor performance of its shares, it may well be time for shareholders to explore selling the bank to someone who would be able to extract more value from its operations. Is Singapore's first hostile bank tender on the horizon?

Lending Strategy

Mortgage War: Management confirmed that, as in Hong Kong, the mortgage war is depressing spreads without spurring the overall market. OCBC sees no incremental growth in mortgage loans, but continues to be very competitive in this area of the consumer market, albeit at a high cost.

New Products: OCBC introduced other new consumer lending products this fall, including auto loans and unsecured personal credit. It is a measure of how slow the bank has been to exploit this critical sector that neither product has previously been available from the bank. Management reports that auto finance take-up has been disappointing; despite low rates it may be that the bank's decision not to tie up with dealership partners has cost it business.

The unsecured credit product has just been introduced, so no performance data are yet available. The bank has launched the loans with a promotional rate of 6.5% through June 2001, after which the rate will be 14.8%. This compares quite favorably with existing rates at other banks, currently 11–16%.

Internet Banking Standalone Plans are Questionable

OCBC has instituted two standalone net-bank ventures one with 50% partner ANZ, and the wholly-owned finatiQ, which operates through the group's Bank of Singapore (BOS) subsidiary.

While OCBC management makes a good case for the differing strategies of OCBC/ANZ and finatiQ, we feel that both pure net banks fail to exploit the group's existing brand, branch networks and customer data. In our opinion, OCBC will be hard pressed to establish two regional net-bank brands and operations simultaneously.

The joint venture e-bank will focus on affluent Asian consumers, but will be launched outside OCBC/ANZ's home markets of Singapore, Australia and New Zealand, although it will be accessible to consumers in all countries. While management is not yet willing to disclose the bank's target launch markets, the Boom.com tie-up and OCBC's historic strength in China would indicate a Hong Kong/China focus, while previous conversations with management have illustrated their belief that Korea and India will also be major e-banking markets.

OCBC management see the OCBC/ANZ net-bank as offering a wider range of banking services than will finatiQ, with all products originated through the bank itself or its partners. The new venture will also offer shopping, entertainment, and travel lifestyle services—the model for these would seem to be UK net-bank Egg. In contrast, finatiQ will remain primarily an aggregator of other financial institutions' products, with a more independent and non-traditional customer base.

Until now, finatiQ has focused its marketing in Singapore; this will have to change if the effort is to have a reasonable chance of profitability. We believe that finatiQ is looking to expand in many of the same markets as will its younger sibling, so that direct competition is a virtual certainty. We agree with OCBC that the Internet space is large enough for many players; however, the group appears to be slighting the needs of its core banking business in favor of a diffuse program of investments, partnerships, and new ventures.

We continue to feel that pure net-banks will find it hard going when competing against integrated institutions which offer customers Internet, phone, branch, and ATM channels. If we're wrong, then why isn't OCBC moving its entire consumer business into the Web channel, as OUB has considered? Either this is too much ado about nothing, or it's not enough.

Oversea-Chinese Banking Corp.

Share Price:	13.00	Index:	1,926.83
52 Week Price Range:	15.20 - 9.30	Current Yield:	1.9%
Reuters Code:	OCBC.SI		
Bloomberg Code:	OCBC SP		

INCOME STATEMENT	1998A	1999A	2000E	2001E	2002E
(S$m)					
Interest income	n.a	n.a	n.a	n.a	n.a
Interest expense	n.a	n.a	n.a	n.a	n.a
Net interest income	1,415	1,291	1,260	1,312	1,384
Ave. int. earnings assets	*52,183*	*51,087*	*52,063*	*54,337*	*56,400*
NIM (%)	2.71%	2.53%	2.42%	2.42%	2.45%
Non-interest income	373	607	686	720	753
Total operating income	1,788	1,897	1,946	2,033	2,136
Non-interest expenses	-485	-528	-595	-615	-635
Pre provision profit	1,303	1,369	1,350	1,418	1,501
Loan loss provisions	-938	-516	-64	-20	-20
Non-operating income	181	48	2	0	0
Pre tax profit	546	898	1,288	1,398	1,481
Tax	-117	-206	-345	-377	-400
Net profit	425	690	936	1,013	1,073
Core earnings	283	652	934	1,013	1,073

PER SHARE DATA (S$)	1998A	1999A	2000E	2001E	2002E
EPS	0.35	0.54	0.73	0.79	0.83
DPS	0.12	0.25	0.28	0.30	0.31
Effective payout ratio (%)	*34%*	*46%*	*39%*	*38%*	*37%*
BVPS	7.51	8.17	8.63	9.12	9.64
ABVPS	5.51	5.74	6.26	6.75	7.28

VALUATION	1998A	1999A	2000E	2001E	2002E
Price to book value (x)	1.5	1.2	1.5	1.4	1.3
Price to adjusted book value (x)	2.0	1.8	2.1	1.9	1.8
Price to earnings (X)	32.1	18.8	17.9	16.5	15.6

PROFITABILITY RATIOS	1998A	1999A	2000E	2001E	2002E
(%)					
Net interest margin	2.71%	2.53%	2.42%	2.42%	2.45%
Yield on interest earning assets	n.a	n.a	n.a	n.a	n.a
Cost on interest bearing liabilities	n.a	n.a	n.a	n.a	n.a
Net interest spread	n.a	n.a	n.a	n.a	n.a
Non-int. income (% Op income)	20.9%	32.0%	35.2%	35.4%	35.2%
Cost to income	24.6%	27.2%	30.6%	30.2%	29.7%
Overhead ratio	0.93%	1.03%	1.14%	1.13%	1.13%
Cost coverage	76.9%	114.9%	115.2%	117.2%	118.5%
ROA	0.75%	1.25%	1.67%	1.71%	1.71%
ROE	6.5%	9.3%	12.1%	12.1%	11.9%

OROA ANALYSIS	1998A	1999A	2000E	2001E	2002E
Net interest margin	2.71%	2.53%	2.42%	2.42%	2.45%
Non-interest inc./gross inc.	28.12%	33.52%	35.31%	35.44%	35.24%
Efficiency ratio	24.61%	27.20%	30.56%	30.24%	29.73%
Provision/assets	1.68%	0.95%	0.11%	0.03%	0.03%
Operating return on assets	1.16%	1.82%	2.49%	2.58%	2.63%
Equity/assets	16.41%	19.32%	19.30%	19.23%	19.17%
Operating return on equity	7.08%	9.40%	12.88%	13.40%	13.73%

BALANCE SHEET	1998A	1999A	2000E	2001E	2002E
(S$m)					
Gross loans	49,341	47,589	47,813	49,318	51,935
Loan loss reserves	*2,265*	*2,466*	*2,356*	*2,136*	*1,904*
Net loans	46,697	44,765	45,101	46,815	49,644
Total earning assets	53,334	50,599	53,528	55,146	57,655
Other assets	2,403	3,691	3,913	5,793	6,995
Total Assets	55,737	54,290	57,440	60,939	64,650
Deposits	46,917	43,330	46,315	49,200	51,549
Customer deposits	36,993	36,762	39,564	42,280	44,420
Other deposits	9,439	6,567	6,750	6,920	7,129
Other paying liabilities	(46,917)	1,539	(46,315)	(49,200)	(51,549)
Other liabilities	49,031	2,045	49,397	52,263	55,301
Total Liabilities	49,031	46,914	49,397	52,263	55,301
Equity with revaluation	9,146	10,490	11,086	11,718	12,392
Adjusted equity	6,706	7,376	8,043	8,675	9,349

BALANCE SHEET RATIOS	1998A	1999A	2000E	2001E	2002E
(%)					
Loan-to-deposit	104.4%	109.0%	102.5%	99.5%	100.0%
Equity to assets	16.4%	19.3%	19.3%	19.2%	19.2%
Tier 1 Capital	-	-	-	-	-
Total Capital adequacy	-	-	-	-	-
Total loan provisions	4.63%	5.22%	4.97%	4.36%	3.69%

ASSET QUALITY	1998A	1999A	2000E	2001E	2002E
Nonperforming assets	4,059	4,335	3,846	3,427	3,049
Special mention	-	-	-	-	-
Substandard	-	2,876	2,580	2,245	1,942
Doubtful	-	1,260	1,211	1,151	1,079
Loss	-	199	55	31	27
ORE	-	-	-	-	-
NPAs/total loans	8.3%	9.2%	9.1%	7.9%	6.8%
Reserve coverage of NPAs	55.8%	56.9%	54.8%	55.0%	54.4%
Required reserves	n.a	1,837	1,616	1,515	1,444
Actual reserves	2,265	2,466	2,356	2,136	1,904
Shortfall (surplus)	n.a	(629)	(740)	(621)	(459)
Actual to required reserves	n.a	134%	146%	141%	132%
Shortfall to capital	n.a	-6%	-7%	-5%	-4%

GROWTH RATES	1998A	1999A	2000E	2001E	2002E
(%)					
Income statement					
Net interest income	16.4%	-8.8%	-2.4%	4.2%	5.4%
Non-interest income	-15.5%	17.5%	5.7%	4.7%	4.5%
Total operating income	5.3%	-1.4%	0.3%	4.4%	5.1%
Non-interest expenses	-0.3%	9.0%	12.7%	3.3%	3.3%
Pre-provision earnings	7.2%	-4.8%	-4.3%	4.8%	5.9%
Loan loss provisions	64.8%	-45.0%	-87.6%	-68.8%	0.0%
Core earnings	-46.9%	130.0%	43.4%	8.4%	6.0%
Net profit	-26.8%	62.1%	35.7%	8.2%	6.0%
Balance sheet					
Loan growth	0.2%	-3.5%	0.5%	3.1%	5.3%
Interest earning assets	4.5%	-5.1%	5.8%	3.0%	4.5%
Asset growth	-3.1%	-2.6%	5.8%	6.1%	6.1%
Deposit growth	-2.9%	-7.6%	6.9%	6.2%	4.8%
Shareholders funds	3.5%	14.7%	5.7%	5.7%	5.7%

OVERSEAS UNION BANK (S$8.00) 2-BUY

Investment Summary

While OUB remains a fundamentally weaker franchise than our favored banks in Singapore, management has managed to drum up sector-beating loan growth while maintaining credit quality. Additionally, we believe that OUB is the best way for investors to gain from restructuring of the bank sector, as OUB's structure is particularly susceptible to a positive transaction. Finally, OUB's price has a floor due to its status as a takeover target. We believe that an in-market acquiror could pay a substantial premium while still completing an earnings-accretive transaction.

Due to these factors, we rate OUB as a 2-Buy, and our favorite in the sector after UOB.

Key Points

- Loan Growth: OUB showed total loan growth of 18.7% half-over-half in 1H00, although loans were still essentially flat from a year ago. However, the key statistic of customer loans rose 5.2% year-on-year, well above the industry average. OUB is taking share particularly in the prime sectors of housing loans (+51% year on year) and consumer lending (+18% year on year). With all of the Singaporean banks underleveraged, we expect that the ability to book high margin assets will prove to be the differentiating factor in profitability going forward.

- Rates and Margins: Net interest margin increased by 17 basis points to 2.45% in the half, and is 32 basis points over the mark recorded in the comparable period of 1999. NIM expanded on a large increase in yield on earning assets of 16 b.p. during the year, against an increase of only 4 b.p. in the bank's cost of interest-bearing liabilities. NIM is also expanding faster than interest spread, as loan growth has made the mix of assets more favorable.

- Divestiture of Associated Companies: In our last conversation with CEO Peter Seah, he presented a compelling rationale for attributing value to the bank's pending disposal of unrelated investments. OUB's investments in listed associates alone are on the books at S$586 million, and we believe that they could be worth up to S$1 billion if properly disposed of. These assets currently produce little return for the bank, particularly when the cost of capital is factored in.

If this value can be unlocked (even if it is only invested in securities or interbank placements), OUB stands to realize not only a windfall gain on any market value increase, but a continuing source of incremental earnings. Note, however, that any sale revenue realized in excess of the current book value would increase OUB's already excessive capital, potentially further stifling the group's ROE (note that we already calculate our ROEs for all banks including revaluations where discernable so as to account for the true economic return on capital).

We note with interest, however, that primary associate Overseas Union Enterprises (OUE, S$4.66, Not Rated), 44.62%-owned by OUB, in turn holds a 9.37% stake in OUB. This stake is worth some S$665 million at current prices, 81% of OUE's trading market value of S$822 million. Given OUE's numerous stakes in properties and hotels, it seems likely that the company would be worth significantly more if divorced from the bank group completely.

In order to accomplish this, OUB could conceivably sell its OUE shares back to the company in return for OUE's stake in OUB, thus at once raising the value of its investment, freeing up funds for investment at higher rates, and buying back shares to increase leverage and ROE. We consider this a very positive potential development.

- Malaysia: OUB has long had a presence in Malaysia, through wholly-owned subsidiary OUB (Malaysia) Berhad ("OUBM"). However, the bank has heretofore conducted an exclusively commercial and wholesale business. OUBM now plans to expand its franchise into the consumer market, and towards that end has embarked on a rebranding campaign for its branch network. In addition, the merger of OUB Finance (Malaysia) Bhd into the bank at year-end 1998 has allowed OUBM to obtain approval to relocate some of its branches to more desirable areas, which should pay off in expanded business by FY2001. With Malaysian loan growth outpacing Singapore's, this could be an excellent way for OUB to deploy funds freed up by asset divestiture.

- Acquisitions: President Seah indicated that OUB will not be making any richly-priced foreign acquisitions in order to sop up excess capital, but will focus on Internet banking to penetrate other Asian markets. Naturally, he did not rule out making regional acquisitions at reasonable prices, but was fairly dismissive of the acquisitions made by Singaporean banks so far. That's our view as well, so we felt warm and validated.

- Internet Banking: It had been a source of consternation to us that OUB, which we viewed as the only bank to appreciate early the magnitude of change the Internet is bringing to financial services, had been moving quickly in what we believe to be the wrong direction, via a standalone JV with European e-bank first-e. However, given first-e's troubles in its own market, the JV is on what we suspect is permanent hold.

We wondered why OUB had elected to create a new subsidiary to engage in these operations, given management's view that they are integral to the future of banking in Asia, rather than choosing to re-make the existing bank with a robust Internet channel (OUB already has the most effective net presence among the Singaporean banks). Mr. Seah explained that he felt OUB was not capable of implementing the radical changes needed to grasp the Internet as quickly as a smaller, more nimble bank. We are optimistic that this will prove not to be the case.

Overseas Union Bank

Share Price:	8.00	Index:	1,926.83	Reuters Code:	OUB.SI
52 Week Price Range:	10.10 - 5.65	Current Yield:	1.5%	Bloomberg Code:	OUB SP

INCOME STATEMENT	1998A	1999A	2000E	2001E	2002E
(S$m)					
Interest income	n.a	n.a	n.a	n.a	n.a
Interest expense	n.a	n.a	n.a	n.a	n.a
Net interest income	843	851	1,043	1,154	1,253
Ave. int. earnings assets	*38,601*	*38,960*	*41,045*	*46,150*	*48,964*
NIM (%)	2.18%	2.19%	2.54%	2.50%	2.56%
Non-interest income	254	403	452	484	611
Total operating income	1,098	1,255	1,495	1,638	1,864
Non-interest expenses	-387	-478	-466	-502	-521
Pre provision profit	711	776	1,029	1,135	1,343
Loan loss provisions	-474	-211	-107	-100	-80
Non-operating income	2	0	1	0	0
Pre tax profit	239	565	923	1,035	1,263
Tax	-58	-130	-235	-280	-341
Net profit	180	409	657	711	867
Core earnings	179	409	657	711	867

PER SHARE DATA (S$)	1998A	1999A	2000E	2001E	2002E
EPS	0.22	0.41	0.66	0.72	0.87
DPS	0.12	0.12	0.26	0.29	0.31
Effective payout ratio (%)	*54%*	*30%*	*40%*	*40%*	*35%*
BVPS	5.50	5.47	5.95	6.38	6.95
ABVPS	5.03	4.76	5.24	5.67	6.24

VALUATION	1998A	1999A	2000E	2001E	2002E
Price to book value (x)	1.3	1.4	1.3	1.3	1.2
Price to adjusted book value (x)	1.4	1.6	1.5	1.4	1.3
Price to earnings (X)	32.6	18.2	12.1	11.2	9.2

PROFITABILITY RATIOS	1998A	1999A	2000E	2001E	2002E
(%)					
Net interest margin	2.18%	2.19%	2.54%	2.50%	2.56%
Yield on interest earning assets	n.a	n.a	n.a	n.a	n.a
Cost on interest bearing liabilities	n.a	n.a	n.a	n.a	n.a
Net interest spread	n.a	n.a	n.a	n.a	n.a
Non-int. income (% Op income)	23.2%	32.2%	30.2%	29.6%	32.8%
Cost to income	35.1%	38.1%	31.2%	30.7%	27.9%
Overhead ratio	1.00%	1.23%	1.14%	1.09%	1.06%
Cost coverage	65.8%	84.3%	96.9%	96.4%	117.3%
ROA	0.44%	0.99%	1.51%	1.44%	1.66%
ROE	4.4%	9.3%	13.2%	13.1%	14.7%

OROA ANALYSIS	1998A	1999A	2000E	2001E	2002E
Net interest margin	2.18%	2.19%	2.54%	2.50%	2.56%
Non-interest inc./gross inc.	23.34%	32.15%	30.28%	29.55%	32.78%
Efficiency ratio	35.14%	38.12%	31.18%	30.66%	27.94%
Provision/assets	1.10%	0.54%	0.22%	0.20%	0.15%
Operating return on assets	0.75%	1.46%	2.28%	2.26%	2.59%
Equity/assets	10.38%	13.77%	12.37%	12.51%	12.84%
Operating return on equity	7.24%	10.58%	18.46%	18.09%	20.21%

BALANCE SHEET	1998A	1999A	2000E	2001E	2002E
(S$m)					
Gross loans	37,097	32,047	38,855	40,856	43,210
Loan loss reserves	*1,205*	*1,332*	*1,179*	*1,079*	*949*
Net loans	35,891	30,715	37,676	39,777	42,261
Total earning assets	40,673	37,247	44,843	47,458	50,470
Other assets	2,596	2,125	2,900	3,192	3,265
Total Assets	43,269	39,372	47,743	50,650	53,735
Deposits	37,608	32,876	40,491	43,639	45,180
Customer deposits	-	24,564	28,719	31,512	32,624
Other deposits	-	8,312	11,772	12,128	12,556
Other paying liabilities	335	293	269	290	301
Other liabilities	1,214	1,482	1,774	1,086	2,056
Total Liabilities	39,157	34,651	42,534	45,016	47,537
Equity with revaluation	4,492	5,421	5,908	6,335	6,898
Adjusted equity	4,112	4,721	5,208	5,635	6,198

BALANCE SHEET RATIOS	1998A	1999A	2000E	2001E	2002E
(%)					
Loan-to-deposit	98.6%	97.5%	96.0%	93.6%	95.6%
Equity to assets	10.4%	13.8%	12.4%	12.5%	12.8%
Tier 1 Capital	-	-	-	-	-
Total Capital adequacy	-	-	-	-	-
Total loan provisions	3.25%	4.16%	3.03%	2.64%	2.20%

ASSET QUALITY	1998A	1999A	2000E	2001E	2002E
Nonperforming assets	2,888	2,991	2,581	2,096	1,590
Special mention	-	-	-	-	-
Substandard	-	2,182	1,905	1,434	941
Doubtful	-	266	214	211	209
Loss	-	543	462	450	441
ORE	-	-	-	-	-
NPAs/total loans	7.8%	9.3%	6.9%	5.9%	5.0%
Reserve coverage of NPAs	41.7%	44.5%	44.0%	44.7%	43.5%
Required reserves	n.a	1,403	1,313	1,230	1,149
Actual reserves	n.a	1,332	1,179	1,079	949
Shortfall (surplus)	n.a	71	134	151	201
Actual to required reserves	n.a	95%	90%	88%	83%
Shortfall to capital	n.a	1%	2%	2%	3%

GROWTH RATES	1998A	1999A	2000E	2001E	2002E
(%)					
Income statement					
Net interest income	4.2%	0.9%	22.5%	10.6%	8.6%
Non-interest income	3.6%	57.1%	12.3%	6.8%	26.3%
Total operating income	4.1%	14.1%	19.2%	9.5%	13.8%
Non-interest expenses	2.1%	23.7%	-2.5%	7.7%	3.7%
Pre-provision earnings	5.2%	8.8%	32.6%	10.3%	18.3%
Loan loss provisions	49.7%	-55.5%	-49.4%	-6.5%	-20.0%
Core earnings	-29.8%	129.0%	60.5%	8.2%	22.0%
Net profit	-29.3%	126.8%	60.7%	8.1%	22.0%
Balance sheet					
Loan growth	11.5%	-13.6%	21.2%	5.1%	5.8%
Interest earning assets	11.3%	-8.4%	20.4%	5.8%	6.3%
Asset growth	11.3%	-9.0%	21.3%	6.1%	6.1%
Deposit growth	12.0%	-12.6%	23.2%	7.8%	3.5%
Shareholders funds	1.6%	20.7%	9.0%	7.2%	8.9%

UNITED OVERSEAS BANK (S$13.20) 1-STRONG BUY

Investment Summary

UOB continues as our top pick in the sector, with the most optimal risk/reward tradeoff and the strongest core returns, highest capital and best asset quality. The bank is tightly focused on generating ROE through its off-balance-sheet and fee-generating business lines, such as asset management. The bank is gaining share in both asset and liability products versus its domestic competitors. We maintain our 1-Strong Buy rating and recommended list status on UOB.

Key Points

- High Value Added: UOB has been forced to climb up the value chain away from dependence on the pure deposit-taking and lending business by virtue of its high capital levels, which make earning an acceptable ROE on the "plain vanilla" business lines in a low-growth environment virtually impossible. The bank has diversified into asset management and securities trading, and focuses its lending on the high margin consumer and SME segments. This has made UOB the institution in Singapore with the least reliance on traditional interest rate spreads to generate profits. All that remains to drive ROE above 20% is either additional balance sheet leverage or return of capital.

- Loan Growth: UOB's loan growth continues to surprise in a stagnant overall market—the bank reported customer loan growth of 6.7% year on year for the first half (5.0% half on half), well above the industry average. Management predicts that loan growth will improve to the "low double digits" by year-end. Lending will come from UOB's red-hot consumer book, where auto finance is the latest product to catch fire, and from its network of SME customers in both Singapore and Malaysia.

- Rates and Margins: UOB's net interest margin (NIM) expanded by 5 basis points to 2.51% in the first half, in line with our expectations. While the cost of interest-bearing liabilities has increased with added leverage, forcing interest spread down from 2.35% in 2H99 to an estimated 1.76% in 1H00, the more-favorable asset mix engendered by loan growth has increased NIM.

Per management, margins in Singapore remained stable, with the growth coming primarily from UOB Malaysia. We anticipate that further margin expansion at the consolidated level will go hand in hand with asset growth, lifting NIM by 4 basis points in 2H00 and by 11 basis points in FY2001.

- Asset Quality: UOB's non-performing loans declined modestly during the period, from S$2.99 billion to S$2.94 billion. NPLs now total 6.5% of loans, down from 6.9% in 2H99. This is the strongest asset quality in the sector, and has been achieved in spite of UOB's consolidation of Thai and Philippine subsidiaries during FY1999, as well as the company's sizable Malaysian exposure.

- Reserves: We are quite comfortable saying that UOB is fully provided against loan losses. At year end 2000, we estimate under our very conservative methodology that the bank had excess reserves of S$368 million, or 4% of gross equity. Management has stated its belief that a substantial portion of the bank's current reserve will be written-back and taken into income over the next two years.

- Strategic Goals: UOB Deputy Chairman Wee Ee Cheong recently reiterated management's oft-expressed desire for a Hong Kong acquisition, adding that the bank also sees opportunities in Taiwan and California. Hong Kong and Taiwan are seen as staging points for the bank's eventual move into mainland China, while a west coast US acquisition makes little apparent sense. On the asset management front, UOB plans to announce a mainland joint venture with an "established European name" in the near future.

- Solid Malaysian Franchise: UOB also has significant exposure to the attractive Malaysian market, with local assets of over RM10 billion in its UOB (Malaysia) banking arm. UOBM has its own extensive (26 offices) branch network, which it uses primarily to originate asset products.

Acquisition Strategy

UOB continues to focus on greater China, including Hong Kong, Taiwan, and the Mainland, as markets in which the bank would like to increase its presence.

By the end of the decade, UOB plans to generate 50% of its profits outside of Singapore, up from 17% currently. Non-interest income will also represent a rising percentage of revenues, and is projected to equal net interest income by 2010, up from 1H00's 38%/62% split. We note that UOB is already the institution with the least reliance on traditional interest rate spreads to generate profits.

Hong Kong: In Hong Kong the bank lost I n the bidding for FPB Bank. UOB is exploring the possibility of purchasing another small Hong Kong bank, in order to fill out its branch network, which currently numbers four offices.

It is worth noting that UOB already has a multi-branch license in Hong Kong, and so does not need to buy a bank in order to open as many additional branches as it would like. Rather, management is seeking to minimize expansion costs by leveraging an existing customer base. However, the desirability of the multi-branch license for other non-Hong Kong banks may mean that UOB is either priced out of the market or has to pay an inflated price. Clearly we would prefer the latter.

In contrast to DBS, which wants a substantial Hong Kong franchise in order to smooth out earnings, UOB is looking for a more bare-bones operation which would service its core SME and trade customers and provide a platform for a consumer finance business.

China: The real attraction in Hong Kong will be China access, where UOB has already been quite successful. The bank recently tied up with Allianz in a mainland joint venture to sell investment products. Together, the partners intend to set up a domestic asset management company with a local partner. In addition, UOB plans to add to its existing four mainland offices (Beijing, Shanghai, Guangzhou and Xiamen) as permitted.

Taiwan: UOB is also keen to acquire a bank in Taiwan; with the recent liberalization of foreign ownership, this should be possible. However, UOB insists on majority control (and would generally prefer 100% ownership) and promises to pay only a modest premium, which could make consummating a deal difficult.

Malaysia: UOB has reached its maximum allowable footprint in Malaysia—26 branches, and by all accounts UOBM should post excellent results and growth for the year. Management would consider an acquisition in Malaysia under ideal circumstances, but predicts that Malaysia will not open to foreign takeovers even in 2002, which makes such a potential transaction a far-off possibility.

Indonesia: UOB has renamed its former joint venture with Bank Bali (UOB Bank Bali) UOB Indonesia, and now holds 80% to IBRA's 20% of the profitable (albeit tiny) subsidiary. The UOBI does a mainly trade-related business, with approximately 50% of its book in foreign currency terms. Interestingly, UOBI has foregone the typical concentration of branches in the Jakarta metro area for a spread of eight branches (soon to be ten) with only two in the capital area.

United Overseas Bank

Share Price:	13.20	Index:	1,926.83
52 Week Price Range:	15.30 - 9.50	Current Yield:	3.0%
Reuters Code:	UOB.SI		
Bloomberg Code:	UOB SP		

INCOME STATEMENT	1998A	1999A	2000E	2001E	2002E
(S$m)					
Interest income	n.a	n.a	n.a	n.a	n.a
Interest expense	n.a	n.a	n.a	n.a	n.a
Net interest income	1,201	1,133	1,305	1,614	1,808
Ave. int. earnings assets	*42,050*	*45,915*	*53,274*	*61,340*	*66,922*
NIM (%)	2.86%	2.47%	2.45%	2.63%	2.70%
Non-interest income	530	708	800	861	902
Total operating income	1,731	1,840	2,104	2,475	2,710
Non-interest expenses	-567	-581	-701	-755	-794
Pre provision profit	1,164	1,260	1,403	1,720	1,915
Loan loss provisions	-654	-253	-118	-100	-50
Non-operating income	0	20	0	0	0
Pre tax profit	511	1,026	1,286	1,620	1,865
Tax	-137	-251	-344	-437	-504
Net profit	368	760	942	1,183	1,362
Core earnings	368	745	942	1,183	1,362

PER SHARE DATA (S$)	1998A	1999A	2000E	2001E	2002E
EPS	0.37	0.72	0.89	1.12	1.29
DPS	0.18	0.40	0.31	0.45	0.45
Effective payout ratio (%)	*49%*	*55%*	*35%*	*40%*	*35%*
BVPS	6.83	7.39	8.05	8.72	9.57
ABVPS	5.59	5.88	6.54	7.22	8.06

VALUATION	1998A	1999A	2000E	2001E	2002E
Price to book value (x)	1.6	1.4	1.6	1.5	1.4
Price to adjusted book value (x)	1.9	1.8	2.0	1.8	1.6
Price to earnings (X)	28.7	14.5	14.8	11.7	10.2

PROFITABILITY RATIOS	1998A	1999A	2000E	2001E	2002E
(%)					
Net interest margin	2.86%	2.47%	2.45%	2.63%	2.70%
Yield on interest earning assets	n.a	n.a	n.a	n.a	n.a
Cost on interest bearing liabilities	n.a	n.a	n.a	n.a	n.a
Net interest spread	n.a	n.a	n.a	n.a	n.a
Non-int. income (% Op income)	30.6%	38.4%	38.0%	34.8%	33.3%
Cost to income	32.7%	31.2%	33.3%	30.5%	29.3%
Overhead ratio	1.35%	1.26%	1.32%	1.23%	1.19%
Cost coverage	93.5%	121.9%	114.1%	114.1%	113.5%
ROA	0.74%	1.50%	1.70%	1.86%	1.96%
ROE	6.8%	12.9%	14.4%	16.3%	16.9%

OROA ANALYSIS	1998A	1999A	2000E	2001E	2002E
Net interest margin	2.86%	2.47%	2.45%	2.63%	2.70%
Non-interest inc./gross inc.	30.61%	39.11%	38.00%	34.80%	33.29%
Efficiency ratio	32.73%	31.21%	33.32%	30.50%	29.32%
Provision/assets	1.30%	0.50%	0.20%	0.15%	0.07%
Operating return on assets	1.47%	2.29%	2.44%	2.65%	2.79%
Equity/assets	13.45%	15.31%	14.07%	13.70%	14.02%
Operating return on equity	10.96%	14.94%	17.34%	19.38%	19.92%

BALANCE SHEET	1998A	1999A	2000E	2001E	2002E
(S$m)					
Gross loans	40,818	43,912	47,866	53,004	56,531
Loan loss reserves	*1,429*	*1,933*	*1,949*	*1,792*	*1,566*
Net loans	39,122	41,691	45,603	50,864	54,605
Total earning assets	43,340	48,489	58,059	64,621	69,223
Other assets	7,129	2,300	2,157	2,401	2,571
Total Assets	50,469	50,789	60,215	67,021	71,795
Deposits	42,598	47,180	50,715	53,323	55,205
Customer deposits	-	40,728	38,933	41,304	42,762
Other deposits	-	6,452	11,782	12,019	12,443
Other paying liabilities	(42,598)	(47,180)	(50,715)	(53,323)	(55,205)
Other liabilities	44,911	44,598	53,333	59,429	63,317
Total Liabilities	44,911	44,598	53,333	59,429	63,317
Equity with revaluation	6,789	7,778	8,470	9,180	10,065
Adjusted equity	5,559	6,191	6,883	7,593	8,478

BALANCE SHEET RATIOS	1998A	1999A	2000E	2001E	2002E
(%)					
Loan-to-deposit	95.2%	92.5%	93.8%	98.7%	101.7%
Equity to assets	13.5%	15.3%	14.1%	13.7%	14.0%
Tier 1 Capital	-	-	-	-	-
Total Capital adequacy	-	-	-	-	-
Total loan provisions	3.52%	4.43%	4.10%	3.40%	2.79%

ASSET QUALITY	1998A	1999A	2000E	2001E	2002E
Nonperforming assets	2,191	2,993	2,701	2,438	1,911
Special mention	-	-	-	-	-
Substandard	-	1,947	1,830	1,725	1,408
Doubtful	-	245	216	189	163
Loss	-	801	655	523	339
ORE	-	-	-	-	-
NPAs/total loans	5.4%	6.9%	5.7%	4.6%	3.4%
Reserve coverage of NPAs	65.2%	64.6%	72.2%	73.5%	82.0%
Required reserves	n.a.	1,722	1,581	1,469	1,248
Actual reserves	n.a.	1,933	1,949	1,792	1,566
Shortfall (surplus)	n.a.	(211)	(368)	(324)	(318)
Actual to required reserves	n.a.	112%	123%	122%	125%
Shortfall to capital	n.a.	-3%	-4%	-4%	-3%

GROWTH RATES	1998A	1999A	2000E	2001E	2002E
(%)					
Income statement					
Net interest income	8.4%	-5.7%	15.2%	23.7%	12.0%
Non-interest income	-4.1%	37.3%	9.9%	7.7%	4.7%
Total operating income	4.2%	7.5%	13.1%	17.6%	9.5%
Non-interest expenses	-4.9%	2.5%	20.8%	7.6%	5.3%
Pre-provision earnings	9.4%	9.9%	9.7%	22.6%	11.4%
Loan loss provisions	95.0%	-61.2%	-53.5%	-15.1%	-50.0%
Core earnings	-26.7%	102.6%	26.4%	25.6%	15.1%
Net profit	-26.7%	106.7%	23.9%	25.6%	15.1%
Balance sheet					
Loan growth	1.8%	7.6%	9.0%	10.7%	6.7%
Interest earning assets	6.3%	11.9%	19.7%	11.3%	7.1%
Asset growth	2.2%	0.6%	18.6%	11.3%	7.1%
Deposit growth	2.4%	10.8%	7.5%	5.1%	3.5%
Shareholders funds	3.5%	14.6%	8.9%	8.4%	9.6%

KEPPEL TATLEE BANK (S$2.20) 2-BUY

Investment Summary

Keppel TatLee Bank (KTLB) has begun to show the results of its capital management re-think, although a lack of near-term catalysts has led us to prefer UOB and OUB at the present time. The bank has reconstituted its subsidiaries under a holding company, which will permit lower consolidated capital levels as only the lead bank will be required to meet the MAS' stiff standards. In addition, the new structure will facilitate overseas acquisitions and the addition of strategic partners in each of the group's businesses. However, capital management is still lacking, and as ROE suffers investors have continued to avoid the stock.

KTLB is a compelling value play at this point, trading at only 1.17x adjusted book and 11.1x estimated FY2000 earnings. We rate the shares a 2-Buy.

Key Points

- New Structure: KTLB and its subsidiaries are now grouped under a financial services holding company called Keppel Capital Holdings (KCH). The reorganization was carried out by exchanging KTLB shares for KCH shares in a ratio of five KCH shares for every four KTLB shares.

KTLB subsidiaries which were transferred to KCH include Keppel TatLee Finance (KTF), Keppel Securities, Keppel Insurance, Keppel Bullion and Futures, Keppel Investment Management and Indonesian subsidiary Bank Keppel TatLee Buana.

In a related move, 71%-owned finance company affiliate KTF underwent its own capital restructuring, and returned S$177 million to shareholders via a share reorganization. We see this move as a prelude to similar changes at the bank, about which we are very positive due to the beneficial impact they will have on ROE.

- Rates and Margins: While Keppel's middling disclosure makes comparisons difficult, we believe that the bank's margins contracted slightly in the half, from 2.31% in 2H99 to 2.28% in 1H00, primarily due to a rise in the cost of interest-bearing liabilities. This would be only slightly below our estimate level of 2.34%. Management has expressed its view that overall group margins are not shrinking; we await additional information with which to refine our calculations.

- Strong Loan Growth: Keppel TatLee continues to post loan growth, which is well above that of the sector. While total sector loans have increased by only 2.1% YTD, KTLB has managed to expand its loan book by 7.3% in the half and by 16.0% from 1H99, a comparatively blistering pace. This compares extremely favorably with last week's disappointing DBS Bank report of –3.5% loan growth in the first half.

Loan originations were particularly strong in the mortgage and consumer sectors, with balances up 46% and 31%, respectively, on a year-on-year basis. In mortgages alone, Keppel has put on close to S$1 billion in assets since 1H99, through a combination of new originations (~60%) and refinancing or line increases (~40%). The bank has been able to take share through a combination of speed, effective use of phone, branch, and Internet channels, and aggressive pricing.

- Internet Lending Adds Value Now: The bank's e-lending strategy continues to pay current dividends. We believe that Keppel's asset-led Internet push is the most sensible way to approach on-line banking, as it plays to the needs of KTLB's time-pressured and tech-savvy clientele. Keppel remains the only bank in Singapore to offer not only online applications for loans, but instantaneous on-line approval and commitment.

The bank's Prestige Credit overdraft product, the first such loan system to be placed on the bank's web site, attracted over 10,000 approved customers in its first six months, doubling KTLB's balances and market share in this product while halving marketing expense per closed loan. End-to-end Internet originations now account for 50% of all Prestige Credit accounts open. Per management, 90% of these customers are new to the bank, and their observed credit quality is actually better than that of customers processed through the branch network.

New consumer e-lending products on tap include the long-awaited e-mortgage, which will feature on-line application and "27 minute" on-line approval, eMargin financing for share purchases, and on-line approval for Keppel's newly-launched credit cards. On the B2B front, Keppel will improve its existing suite of SME and corporate services by inaugurating Internet factoring and on-line corporate treasury management services, which draw heavily on AIB's experience in the area.

- Asset Quality and Reserves: Keppel's asset quality continues to improve, with NPLs falling from 17.6% of total loans in 1H99 and 13.0% at year-end to 11.9% currently. While this is still a high level of classified assets, Keppel is now more than fully reserved by our methodology for all existing and potential loan losses. Provisions fell 63% year on year (and 18% half on half), to S$25 million, with roughly half of this amount going towards write-downs on non-loan assets. Given the high level of reserve coverage and declining NPLs, management has indicated that we should now expect essentially nominal provisions over the next 18 months.

- Income and Expenses: Fee income remains strong, albeit on a year-on-year basis (up 11%) rather than on a half-on-half basis (down 18%). The half-on-half decline is largely a result of lower securities trading commissions during the period, as the Singaporean market comes down from the giddy volume of the last half of 1999. Expenses rose sharply across the board, continuing the trend we first saw in the DBS results. However, year-on-year and half-on-half increases of 17% and 5%, respectively, are well off the 30% pace set by the industry leader.

We anticipate further gains in core fee income as KTLB continues to flesh out its product line, with contributions coming from credit cards, bancassurance, and treasury products.

Keppel Tatlee Bank

Share Price:	2.20	Index:	1,926.83	Reuters Code:	KPBK.SI
52 Week Price Range:	3.09 - 2.11	Current Yield:	3.7%	Bloomberg Code:	KEPC SP

INCOME STATEMENT	1998A	1999A	2000E	2001E	2002E
(S$m)					
Interest income	n.a	n.a	n.a	n.a	n.a
Interest expense	n.a	n.a	n.a	n.a	n.a
Net interest income	263	464	520	587	654
Ave. int. earnings assets	*15,020*	*20,049*	*22,732*	*24,958*	*27,097*
NIM (%)	1.75%	2.32%	2.29%	2.35%	2.41%
Non-interest income	89	154	179	199	217
Total operating income	352	619	699	786	872
Non-interest expenses	-163	-209	-239	-231	-235
Pre provision profit	189	410	460	555	637
Loan loss provisions	-105	-96	-50	-50	-50
Non-operating income	377	28	0	0	0
Pre tax profit	84	342	411	505	587
Tax	-21	-69	-113	-139	-159
Net profit	430	260	282	347	406
Core earnings	53	237	282	347	406

PER SHARE DATA (S$)	1998A	1999A	2000E	2001E	2002E
EPS	0.40	0.24	0.21	0.25	0.30
DPS	0.02	0.08	0.14	0.11	0.10
Effective payout ratio (%)	*6%*	*34%*	*67%*	*44%*	*35%*
BVPS	2.09	2.21	1.95	2.09	2.28
ABVPS	2.09	2.21	1.95	2.09	2.28

VALUATION	1998A	1999A	2000E	2001E	2002E
Price to book value (x)	1.4	1.5	1.1	1.1	1.0
Price to adjusted book value (x)	1.4	1.5	1.1	1.1	1.0
Price to earnings (X)	7.3	14.3	10.7	8.7	7.4

PROFITABILITY RATIOS	1998A	1999A	2000E	2001E	2002E
(%)					
Net interest margin	1.75%	2.32%	2.29%	2.35%	2.41%
Yield on interest earning assets	n.a	n.a	n.a	n.a	n.a
Cost on interest bearing liabilities	n.a	n.a	n.a	n.a	n.a
Net interest spread	n.a	n.a	n.a	n.a	n.a
Non-int. income (% Op income)	25.2%	25.0%	25.6%	25.3%	24.9%
Cost to income	46.2%	32.2%	34.2%	29.4%	26.9%
Overhead ratio	1.08%	1.04%	1.05%	0.93%	0.87%
Cost coverage	54.6%	74.0%	75.0%	86.2%	92.6%
ROA	2.63%	1.17%	1.12%	1.25%	1.35%
ROE	23.9%	11.1%	11.1%	12.5%	13.5%

OROA ANALYSIS	1998A	1999A	2000E	2001E	2002E
Net interest margin	1.75%	2.32%	2.29%	2.35%	2.41%
Non-interest inc./gross inc.	25.25%	28.27%	25.62%	25.33%	24.92%
Efficiency ratio	46.22%	32.24%	34.17%	29.40%	26.91%
Provision/assets	0.52%	0.40%	0.19%	0.17%	0.16%
Operating return on assets	0.74%	1.79%	1.84%	2.05%	2.19%
Equity/assets	11.29%	10.01%	10.18%	9.83%	10.12%
Operating return on equity	6.52%	17.88%	18.04%	20.89%	21.65%

BALANCE SHEET	1998A	1999A	2000E	2001E	2002E
(S$m)					
Gross loans	12,811	13,555	15,117	16,620	17,527
Loan loss reserves	*1,309*	*1,155*	*1,146*	*1,116*	*1,080*
Net loans	11,502	12,400	13,971	15,504	16,447
Total earning assets	18,287	21,811	23,652	26,263	27,930
Other assets	1,809	2,423	2,673	2,968	3,081
Total Assets	20,096	24,234	26,325	29,231	31,011
Deposits	15,892	19,071	20,784	22,074	22,853
Customer deposits	12,089	12,928	14,343	15,439	15,984
Other deposits	3,802	6,142	6,441	6,635	6,870
Other paying liabilities	885	954	1,039	1,104	1,143
Other liabilities	1,051	1,785	1,823	3,180	3,878
Total Liabilities	17,827	21,809	23,645	26,358	27,874
Equity with revaluation	2,268	2,425	2,680	2,873	3,137
Adjusted equity	2,268	2,425	2,680	2,873	3,137

BALANCE SHEET RATIOS	1998A	1999A	2000E	2001E	2002E
(%)					
Loan-to-deposit	80.6%	71.1%	72.7%	75.3%	76.7%
Equity to assets	11.3%	10.0%	10.2%	9.8%	10.1%
Tier 1 Capital	-	-	-	-	-
Total Capital adequacy	18.5%	18.8%	17.4%	16.9%	-
Total loan provisions	10.22%	8.52%	7.58%	6.71%	6.16%

ASSET QUALITY	1998A	1999A	2000E	2001E	2002E
Nonperforming assets	2,213	1,767	1,695	1,597	1,080
Special mention	-	-	-	-	-
Substandard	-	1,030	991	952	427
Doubtful	-	408	397	377	369
Loss	-	329	307	269	284
ORE	-	-	-	-	-
NPAs/total loans	17.3%	13.1%	10.9%	9.0%	7.7%
Reserve coverage of NPAs	59.2%	65.0%	69.4%	74.9%	80.3%
Required reserves	n.a.	857	838	798	719
Actual reserves	n.a.	1,155	1,146	1,116	1,080
Shortfall (surplus)	n.a.	(298)	(308)	(318)	(362)
Actual to required reserves	n.a.	135%	137%	140%	150%
Shortfall to capital	n.a.	-12%	-12%	-11%	-12%

GROWTH RATES	1998A	1999A	2000E	2001E	2002E
(%)					
Income statement					
Net interest income	12.6%	76.5%	12.0%	12.9%	11.4%
Non-interest income	-7.9%	105.9%	-2.0%	11.2%	9.0%
Total operating income	6.6%	83.9%	8.1%	12.5%	10.8%
Non-interest expenses	46.4%	28.3%	14.5%	-3.2%	1.4%
Pre-provision earnings	-13.5%	131.6%	5.0%	20.6%	14.7%
Loan loss provisions	-14.5%	-8.4%	-48.5%	0.6%	0.0%
Core earnings	-27.7%	347.1%	19.1%	23.1%	17.0%
Net profit	486.7%	-39.6%	8.6%	23.1%	17.0%
Balance sheet					
Loan growth	84.2%	5.8%	11.5%	9.9%	5.5%
Interest earning assets	55.6%	19.3%	8.4%	11.0%	6.3%
Asset growth	60.1%	20.6%	8.6%	11.0%	6.1%
Deposit growth	51.0%	20.0%	9.0%	6.2%	3.5%
Shareholders funds	69.9%	6.9%	10.5%	7.2%	9.2%

SOUTH KOREAN BANKS

South Korean banks share prices underwent a roller-coaster ride in 2000, as the twin threats of default among the investment trust companies and Hyundai hounded the sector. However, the strong banks were clearly distinguished from the weak banks by the market and our two top picks, H&CB and Kookmin Bank, outperformed the market by 39% and 35% respectively. We continue to recommend these two banks as our top investments in the sector. The key drivers of the sector's price performance in 2001 we expect to be the successful and timely implementation of the second round of financial restructuring, and a resilient consumer segment to support loan growth. Increased pace of mergers among the strong banks we expect also to be a catalyst to drive share prices higher. We reiterated our OVERWEIGHT stance on the Korean banking sector.

Implementation of Round 2 restructuring

Since receiving a US$58 billion bailout package from the IMF at the end of 1997, South Korea has gone through one major round of financial restructuring. During this first round of restructuring, 11 banks were closed, nationalized or merged. In addition, 477 other financial institutions were also forced to close their operations. Having gone through the painful first round of restructuring, the government embarked on the second round of restructuring. The primary objectives in this second phase are to clean up substantially the bad assets on the banks' balance sheets, boost the capital bases of the weak banks via an injection of public funds and the formation of financial holding companies. In order to fund the second round of restructuring, the Ministry of Finance and Economy (MOFE) had to go cap in hand to the National Assembly to request an additional KRW40 trillion.

After weeks of bickering, debate and delay, the National Assembly finally approved the MOFE's request on December 2, 2000. The government has injected a first tranche of KRW4.13 trillion into six distressed financial institutions at the end of December 2000, while more funds will be disbursed in 1H01 depending on the progress of rehabilitation efforts at the financial institutions. An additional KRW10 trillion is expected to be raised from the recovery of previously injected public funds.

The six weak banks (Hanvit, Seoul, Peace, Kwangju, Cheju and Kyongnam) will receive a combined KRW7.1 trillion in the two tranches. The funds will be in the form of KDIC-issued bonds in exchange for new shares. Given that the losses at some of these banks are so huge that existing capital will be completely wiped out and these banks will be 100% nationalized following the government recapitalization. The government stipulated that these six banks would have to recognize their losses and write-down their existing capital before the government injected fresh funds, which they did at the end of December 2000. Additionally, the banks would have to sign an MOU which clearly lays out productivity and profitability goals. Should a bank fail to attain the specified results, the government would force it to freeze all employee wages and immediately implement additional self-rescue plans.

More stringent monitoring

Given that MOFE has already spent KRW110 trillion of taxpayers' money in the first round of restructuring, the National Assembly has demanded that the usage of the additional KRW40 trillion be conducted in a transparent and fair manner. The key points are that the funds would be injected in tranches, which allows closer monitoring of progress of rehabilitation as well as the requirement that MOFE has to make quarterly reports to the National Assembly.

Figure 15: Allocation and Management of Public Funds

	First round of restructuring	Second round of restructuring
Role of KDIC	Conducts independent due diligence of financial institutions	Provision of FSS due diligence results to KDIC in advance to strengthen evaluation and supervisory functions of KDIC policy committee
Type of injection	Lump-sum	Tranches
Monitoring and accountability of financial institutions that receive public funds	Difficult to hold the financial institutions responsible for failing to meet MOU targets	• Ceilings on total public fund injections stipulated in MOU • Standardization and public announcements of MOU • Inclusion of salary freezes and punishment clauses against financial institutions that fail to adhere to MOU
Recovery system	No system in effect to evaluate proper recovery of public funds	• Evaluation Subcommittee established to oversee recovery of public funds • Prompt liquidation procedures devised and implemented
Management system	• Principles guiding public fund injections not clarified by law • Public Funds Committee possessed limited power to manage public funds	• Principles guiding public fund injections clarified by law • Management Committee for Public Funds legally empowered to manage public funds
Report to National Assembly	If necessary	Quarterly

Source: Financial Supervisory Service.

Putting the weak banks together

The government has been trying to kick-start consolidation in the banking sector by placing four weak banks (Hanvit, Peace, Kwangju and Kyongnam) under a state-run financial holding company structure, scheduled to be launched in 1Q01. We would highlight, however, that such a structure does not reduce the number of banks as the four banks are still allowed to operate as separate entities. The government is also attempting to sell off Seoul Bank in 1H01 for foreign investors, failing which it would also be placed under the holding company. The holding company structure was promulgated as a compromise with the labor unions, which strongly voiced their opposition to an outright merger, as it would mean massive layoffs. Nevertheless, it is a meaningful step forward for the government as it will eventually be able to restructure the business operations of the banks under the holding company.

The placement of the weak banks under the holding company structure is also positive news for the good banks because the government will not force them to take over the weaker banks. Indeed, the authorities stated that the good banks are welcome to join in the state-run holding company if they want to. We believe the market should increasingly be confident that the government will not force a good bank/bad bank merger. This is especially so in the case of Kookmin and H&CB as they are widely held by foreign investors as well as having strategic foreign partners (Goldman Sachs with a 11% stake in Kookmin and ING Bank with a 10% in H&CB).

Mergers...slowly but surely

Amid the second round of financial reform, we also expect mergers among the good banks. In the case of Hana and Koram, the possibility of a merger was muted at the beginning of the year, but nothing has happened in part due to disagreements between the shareholders. Amongst the strong retail banks, Kookmin and H&CB have already announced that they have signed a memorandum of understanding to merge.

Share price targets raised for H&CB and Kookmin

A merger between Kookmin and H&CB makes a lot of sense as their business lines are complementary. Kookmin runs a lucrative credit card subsidiary and has established a strong niche in SME lending, while H&CB is the market-leader in mortgages and personal loans. The merger would thus create a retail banking powerhouse. Additionally, the merged entity would the largest bank in South Korea with total assets of US$125 billion, almost twice the size of the next largest bank. In a regional context, the merged institution would be the second largest bank in Asia ex-Japan, after HSBC.

Figure 16: Key pro forma data*

(KRWbn)	Kookmin	H&CB	Mergerd entity
Loans	48,556	41,977	90,533
Assets	93,563	64,380	45.0
Deposits	69,281	52,565	46.2
Capital	4,158	2,484	50.1
Branches	587	550	46.5
NPL%	7.8	6.8	57.0

**Data as of Sept 30, 2000 and assuming pooling-of-interest*

Source: Bank data.

While the labor unions will attempt to delay any proposed bank mergers by threatening to strike, the government has also stated that it will remain on the reform path and not allow the unions to derail the much-needed restructuring in the sector. Additionally, the recent strikes at Kookmin Bank and H&CB failed to gather support from other bank unions, underscoring our view that the necessary reforms are increasingly being accepted by the employees. We believe that the government/management will eventually be able to work out a mutually agreeable pact with the unions.

With the merger announcement, we believe the H&CB and Kookmin valuations will expand. In the case of H&CB, it has traded as high as 1.6x PBR in the past 52 weeks. Given that the investment environment is increasingly brighter, we expect the stock to trade at 1.6x 2001 book value, which raises our share price target to KRW42,000 (from KRW36,000). Similarly, we believe Kookmin deserves to trade at 1.6x PBR, which pushes up our new share price target to KRW22,000 (from KRW18,000).

Declining trend in bad debt expected to reverse

As part of its restructuring plan in the corporate sector, all banks were required to produce a list of non-viable companies in early November 2000. After going through 287 companies, the banks announced that 29 of these companies are non-viable and should undergo court receivership or be liquidated. As a result of these findings, the amount of substandard and below loans (bad loans) has increased in 4Q00. Until then, the bad loan amount and ratio have been consistently declining throughout this year. With the announcement of the 29 companies, and coupled with a marked slowdown in the economy forecast for 1Q01, we expect the bad debt ratio in Korea to rise to 13% by end-00 and 15% in 1H01, before retreating slightly in 2H01.

Figure 17: Substandard and below loans, and provisions

	Total loans (KRWbn)	<Substandard loans (KRWbn)	<Substandard/ total loans (%)	Accum prov (KRWbn)	Accum prov/ <substandard (%)
1Q00	339.3	47.4	14.0	21.3	44.9
2Q00	348.1	43.3	12.4	19.6	45.3
3Q00	359.9	39.4	10.9	18.2	46.2

Source: Financial Supervisory Service.

Figure 18: Comparison of substandard and below loans (9M00)

	Total loans (KRWbn)	<Substandard loans (KRWbn)	<Substandard/ total loans (%)	Accum prov (KRWbn)	Accum prov/ <substandard (%)
Hana	31,148	2,009	6.5	872	43.4
Hanvit	54,193	8,595	15.9	3,863	45.0
H&CB	45,793	3,099	6.8	1,431	46.2
Kookmin	53,260	4,132	7.8	2,071	50.1
Koram	17,436	1,850	10.6	861	46.5
Shinhan	32,148	1,549	4.8	884	57.0

Source: Bank data.

Role of KAMCO

Since the crisis started three years ago, the banks have been reducing their bad loans by selling them to the Korea Asset Management Company (KAMCO), the state-run agency authorized to purchase and dispose non-performing assets from financial institutions. As of end-November, KAMCO had purchased a total of KRW82.9 trillion (face value) of NPLs at KRW33.7 trillion. Much of the NPL sales this year were from the investment trust companies (ITC) which were big holders of Daewoo debt.

Unlike countries like Taiwan and the Philippines in which state-run asset management companies have yet to be established, KAMCO has played a crucial role in helping the banks monetize their non-performing assets. In turn, KAMCO attempts to collect on these loans, hold public auctions or issue ABS to dispose of these NPLs. To date, the agency has been able to dispose of KRW41.8 trillion of NPLs. The ability of KAMCO to continue to purchase more NPLs from the banks will be crucial for the fundamental turnaround of the more distressed banks.

Growth opportunities in retail lending

Coming from the brink of a total collapse of the banking sector during the Asian financial crisis, many of the private sector banks have successfully restructured their balance sheets and operations. Consequently, they are on track to record a significant rebound in earnings growth and expanding ROEs in both 2000 and 2001, largely on the back of strong retail demand for (i) mortgages, (ii) credit cards and (iii) personal loans. Our economists project private consumption in Korea to grow 3.3% in 1H01 and accelerate to 6.5% in 2H01. Coming off a high base in 2000, we expect overall loan growth in the sector to be a relatively healthy 16% and 14% in 2001 and 2002 respectively.

The private sector banks are much better positioned to benefit from the growth opportunities in the retail segment. H&CB, for example, has 50% of its loan books in mortgage lending, while 31% goes to other personal loans. Such exposure has enabled the bank to register overall loan growth of over 35% in the first nine months of 2000, and which we believe will continue to help support a healthy 19% growth in 2001. H&CB's merger partner, Kookmin is strong in credit cards as well as lending to the SME market. As such, the merger of these two private sector banks will create a retail banking powerhouse.

Top picks

We continue to adopt an Overweight stance in Korea, based on our belief that reforms will accelerate in 1H01 and that strong domestic consumption will fuel loan growth. Additionally, valuations for the banks are not demanding, trading at less than 1.3x PBR for most banks. For specific investment opportunities in the sector for 2001, we would strongly recommend the retail banks H&CB and Kookmin Bank. These two banks are our top picks in the sector. They will directly benefit from (i) strong private consumption growth, especially in 2H01, due to their strengths in retail lending, (ii) relatively lower loan exposure to *chaebol*, and (iii) strong foreign strategic investors. The eventual merger between these two banks will also greatly strengthen their leadership position in the Korean banking sector.

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HANA BANK (KRW6,840) 2-BUY

Investment Case

Niche in serving the high net worth individual

Hana Bank has built its banking business by focusing on high net worth individuals (defined as individuals with more than KRW100 million on deposit), and has succeeded in becoming the fourth largest bank by won deposits in Korea. Some 63% of this deposit base is from about 36,000 high net worth individuals.

Moving into retail banking and SME lending

On the asset side of its balance sheet, Hana's loan portfolio is still largely exposed to large corporates, largely due to its legacy as a corporate lender. This market segment presently accounts for 50% of its total loan books. We would highlight, however, that its corporate loan exposure was higher than 60% in 1998. The reduction is in line with management's strategy of expanding more aggressively into retail lending by leveraging off its strength in attracting retail deposits. From its traditional niche of high net worth individuals, Hana is moving into the middle and mass market segments. Key product lines that management has been concentrating on are credit cards, mortgage and personal finance lending. This strategy has been successful as evidenced by the contribution of retail lending to total loans increasing from 13% in 1998 to 20% as of September 2000.

Another area of focus is lending to the small and medium size enterprises (SMEs). However, the bank is facing very stiff competition from Kookmin Bank and Shinhan Bank as these banks have done very well in building this part of their business. Consequently, the share of SME lending as a percentage of total loans has increased by a much lesser magnitude, from 27% in 1998 to 29% in September 2000.

Merger talks with Koram Bank stalled

Hana forged a strategic alliance with Koram in June 2000, whereby the two banks will join together in information technology and Internet banking. Such an alliance was aimed at lowering required investments by jointly developing IT systems, which both banks will use in their branches and ATMs. Even prior to this alliance, both banks had been rumored to be in merger talks, and this alliance was seen as a prelude to a full merger.

However, after months of talks, the two banks failed to come to a firm agreement to merge. Subsequently, Hana management stated that the two banks have abandoned merger negotiations, largely due to disagreements among the shareholders, on January 1, 2001. Management also added that it is open to any other merger proposals, although there are none at present.

Valuation

We view Hana as fundamentally a sound bank with good asset quality. However, it lags the other strong retail banks in terms of strategy and profitability. We continue to rate the bank as a 2-Buy due to its cheap valuation of 0.6x PBR.

Hana

Share Price (KRW):	6,840	Index:	558.02
52 Week Price Range (KRW):	11,800 - 4,320	Current Yield:	
Reuters Code:	0736.KS		
Bloomberg Code:	0736 KS		

INCOME STATEMENT	1999A	2000E	2001E	2002E
(KRWm)				
Interest income	2,842,229	3,015,589	3,476,019	3,896,636
Interest expense	-2,316,637	-2,365,658	-2,677,878	-3,013,258
Net interest income	525,592	649,931	798,141	883,378
Ave. int. earnings assets	*33,894,653*	*37,520,185*	*43,909,668*	*49,243,236*
NIM (%)	1.55%	1.73%	1.82%	1.79%
Non-interest income	832,156	535,048	579,442	637,406
Total operating income	1,357,748	1,184,979	1,377,583	1,520,784
Non-interest expenses	-677,816	-614,495	-685,813	-756,212
Pre provision profit	679,932	570,484	691,770	764,572
Loan loss provisions	-488,529	-457,172	-237,855	-171,152
Non-operating income	56,104	0	0	0
Pre tax profit	191,403	113,312	453,915	593,420
Tax	-67,911	-28,328	-113,479	-148,355
Net profit	136,511	49,874	299,072	399,947

PER SHARE DATA (KRW)	1999A	2000E	2001E	2002E
EPS	1,355	413	2,405	3,216
DPS	400	80	361	482
Effective payout ratio (%)	*30%*	*19%*	*15%*	*15%*
BVPS	11,615	11,618	13,662	16,396
ABVPS	11,783	11,184	13,329	16,196

VALUATION	1999A	2000E	2001E	2002E
Price to book value (x)	0.6	0.6	0.5	0.4
Price to adjusted book value (x)	0.6	0.6	0.5	0.4
Price to earnings (X)	5.0	16.6	2.8	2.1

PROFITABILITY RATIOS	1999A	2000E	2001E	2002E
(%)				
Net interest margin	1.55%	1.73%	1.82%	1.79%
Yield on interest earning assets	8.89%	8.16%	8.04%	8.03%
Cost on interest bearing liabilities	7.15%	6.50%	6.45%	6.45%
Net interest spread	1.74%	1.66%	1.59%	1.58%
Non-int. income (% Op income)	61.3%	45.2%	42.1%	41.9%
Cost to income	49.9%	51.9%	49.8%	49.7%
Overhead ratio	1.84%	1.52%	1.46%	1.44%
Cost coverage	122.8%	87.1%	84.5%	84.3%
ROA	0.37%	0.13%	0.67%	0.80%
ROE	7.8%	2.8%	15.6%	18.1%

DUPONT ANALYSIS	1999A	2000E	2001E	2002E
Lending operations				
Net interest margin	1.55%	1.73%	1.82%	1.79%
Interest earnings assets/assets	92.09%	92.60%	93.26%	93.60%
NIM contribution to ROA	1.43%	1.60%	1.70%	1.68%
Non-interest operations				
Non-interest income/assets	2.26%	1.32%	1.23%	1.21%
Overhead ratio	1.84%	1.52%	1.46%	1.44%
Non-int. contribution to ROA	0.42%	-0.20%	-0.23%	-0.23%
Asset quality analysis				
Provision/loans	-2.64%	-2.19%	-0.95%	-0.60%
Loans/assets	50.27%	51.57%	53.15%	54.03%
ROA effect from asset quality	-1.33%	-1.13%	-0.51%	-0.33%
Core ROA	0.52%	0.28%	0.96%	1.13%
Non-core contibution to ROA	0.15%	0.00%	0.00%	0.00%
Pre-tax ROA	0.67%	0.28%	0.96%	1.13%
Tax rate	34.17%	30.80%	30.80%	30.80%
After tax ROA	0.37%	0.13%	0.67%	0.80%
Balance sheet leverage (x)	20.9	22.9	24.6	23.8
ROE	7.8%	2.9%	16.5%	19.0%

BALANCE SHEET	1999A	2000E	2001E	2002E
(KRWm)				
Gross loans	19,439,761	24,337,042	27,880,737	31,223,211
Specific loan loss reserves	*0*	*0*	*0*	*0*
Loan loss reserves	*-938,092*	*-1,049,293*	*-1,119,352*	*-1,132,776*
Net loans	18,501,669	23,287,749	26,761,385	30,090,435
Other earning assets	15,392,984	17,857,969	19,912,233	21,722,418
Other assets	2,912,237	3,080,377	3,264,199	3,465,216
Total Assets	36,806,890	44,226,095	49,937,817	55,278,069
Deposits	26,620,895	29,282,985	32,796,943	36,732,576
Other paying liabilities	7,354,280	9,534,631	11,434,383	12,454,517
Other liabilities	1,073,429	1,122,304	1,165,887	1,210,200
Total Liabilities	35,048,604	39,939,919	45,397,213	50,397,293
Minorities & other	0	0	0	0
Shareholders' funds	1,758,286	1,786,176	2,040,604	2,380,776

LOAN BOOK	1999A	2000E	2001E	2002E
(KRWbn)				
Large corporates	12,184	13,876	14,570	15,152
SMEs	6,125	7,890	9,153	10,709
Households	3,300	5,442	6,802	8,162
Total loans	21,609	27,208	30,524	34,023

LOAN BOOK BREAKDOWN	1999A	2000E	2001E	2002E
(%)				
Large corporates	56%	51%	48%	45%
SMEs	28%	29%	30%	31%
Households	15%	20%	22%	24%
Total loans	100%	100%	100%	100%

BALANCE SHEET RATIOS	1999A	2000E	2001E	2002E
(%)				
Loan-to-deposit	69.5%	79.5%	81.6%	81.9%
Loan-to-deposit (incl. CDs)	0.0%	0.0%	0.0%	0.0%
Equity to assets	4.8%	4.0%	4.1%	4.3%
Tier 1 Capital	9.1%	*7.3%*	*7.5%*	*7.8%*
Total Capital adequacy	12.3%	10.0%	10.5%	11.2%
General reserves (% loans)	-4.83%	-4.31%	-4.01%	-3.63%
Specific reserves (% loans)	0.00%	0.00%	0.00%	0.00%
Total loan provisions	-4.83%	-4.31%	-4.01%	-3.63%

ASSET QUALITY	1999A	2000E	2001E	2002E
Nonperforming loans	1,281,375	1,729,856	1,677,961	1,577,283
NPL ratio	6.6%	7.1%	6.0%	5.1%
Total provisions/NPLs	71.0%	59.0%	65.0%	70.0%

GROWTH RATES	1999A	2000E	2001E	2002E
(%)				
Income statement				
Net interest income		23.7%	22.8%	10.7%
Non-interest income		-35.7%	8.3%	10.0%
Total operating income		-12.7%	16.3%	10.4%
Operating expenses		-9.3%	11.6%	10.3%
Pre-provision earnings		-16.1%	21.3%	10.5%
Loan loss provisions		-6.4%	-48.0%	-28.0%
Net profit		-63.5%	499.7%	33.7%
Balance sheet				
Loan growth		25.2%	14.6%	12.0%
Interest earning assets		21.1%	13.3%	10.8%
Asset growth		20.2%	12.9%	10.7%
Deposit growth		10.0%	12.0%	12.0%
Shareholders funds		1.6%	14.2%	16.7%

H&CB (KRW29,900) 1-STRONG BUY

Investment Case

Best regarded and professionally run bank

H&CB became the first Korean bank, and only the third Asian bank to list its American Depository Receipts (ADRs) on the NYSE. The listing of H&CB's ADRs is an indication of the bank's strong fundamentals, prudent management and superior financial reporting and transparency. Additionally, the listing serves to expand further its investor base. In a market where investors have been perennially frustrated by lack of disclosure and transparency, the bank has done very well to be able to distinguish itself in these aspects. Management has also emphasized releasing information to all investors at once and shied away from making any pre-earnings releases or statements. All this reflects the professionalism of the bank.

Merger with Kookmin would create retail banking powerhouse

The bank announced in the last week of December that it had signed a Memorandum of Understanding with Kookmin Bank to merge before the end of 1H01. Both banks are currently in the process of conducting due diligence and the stock exchange ratio is scheduled to be announced at the end of January. It is also worth highlighting that one big concern was that the labor unions would cause the merger to collapse. However, as witnessed in the strike that the unions held at both banks in the last week of December 2000, the staff failed to gather sufficient support from the other unions at other banks and eventually returned to work on the last day of the year. This underscores our view that the necessary reforms are increasingly being accepted by the employees.

A merger between Kookmin and H&CB makes a lot of sense as their business lines are complementary. Kookmin runs a lucrative credit card subsidiary and has established a strong niche in SME lending, while H&CB is the market-leader in mortgages and personal loans. The merger would thus create a retail banking powerhouse. Additionally, the merged entity would the largest bank in South Korea with total assets of US$125 billion, almost twice the size of the next largest bank. In a regional context, the merged institution would be the second largest bank in Asia ex-Japan, after HSBC.

Good asset quality

Being a retail bank and having prudent management, H&CB has one of the lowest NPLs in the country at 6.8% as of September 2000. Its NPL coverage ratio of 46% is in line with the sector, and management is focused on improving this ratio to 60% - 65% in 2001. The fact that the bank has traditionally lent to the consumer segment and has much less exposure to the *chaebol* is the key reason we believe the bank would be able to contain its NPLs to less than 6.5% this year.

Valuation

The stock was the best performing Korean bank stock in 2000, out-performing the broader market by 39% in 2000. With ROEs expected to reach 28% this year, and still trading at an undemanding 1.1x PBR, we continue to rate H&CB as one of our top picks in the sector.

H&CB

Share Price (KRW):	29,900	Index:	558.02
52 Week Price Range (KRW):	34,239 - 11,822	Current Yield:	5.02%
Reuters Code:	2746.KS		
Bloomberg Code:	2746 KS		

INCOME STATEMENT	1999A	2000E	2001E	2002E
(KRWm)				
Interest income	4,265,327	4,609,909	5,812,733	6,743,022
Interest expense	-3,029,834	-3,177,298	-4,072,814	-4,751,655
Net interest income	1,235,493	1,432,610	1,739,919	1,991,367
Ave. int. earnings assets	*43,789,315*	*51,989,433*	*66,631,601*	*78,034,843*
NIM (%)	2.82%	2.76%	2.61%	2.55%
Non-interest income	1,273,894	1,079,138	1,274,498	1,429,668
Total operating income	2,509,387	2,511,748	3,014,417	3,421,035
Non-interest expenses	-1,395,631	-1,285,282	-1,453,196	-1,685,743
Pre provision profit	1,113,756	1,226,466	1,561,221	1,735,292
Loan loss provisions	-393,269	-404,135	-353,376	-326,181
Non-operating income	-79,303	27,900	0	0
Pre tax profit	720,487	822,331	1,207,845	1,409,112
Tax	-219,114	-261,871	-372,016	-434,006
Net profit	451,795	586,431	825,015	962,625

PER SHARE DATA (KRW)	1999A	2000E	2001E	2002E
EPS	4,862	5,502	7,565	8,826
DPS	150	1,500	1,500	1,500
Effective payout ratio (%)	*3%*	*27%*	*20%*	*17%*
BVPS	18,587	20,759	26,824	34,150
ABVPS	16,417	20,425	27,549	36,534

VALUATION	1999A	2000E	2001E	2002E
Price to book value (x)	1.6	1.4	1.1	0.9
Price to adjusted book value (x)	1.8	1.5	1.1	0.8
Price to earnings (X)	6.1	5.4	4.0	3.4

PROFITABILITY RATIOS	1999A	2000E	2001E	2002E
(%)				
Net interest margin	2.82%	2.76%	2.61%	2.55%
Yield on interest earning assets	8.89%	9.01%	8.84%	8.75%
Cost on interest bearing liabilities	6.35%	6.38%	6.39%	6.40%
Net interest spread	2.54%	2.63%	2.45%	2.35%
Non-int. income (% Op income)	50.8%	43.0%	42.3%	41.8%
Cost to income	55.6%	51.2%	48.2%	49.3%
Overhead ratio	2.87%	2.25%	2.02%	2.01%
Cost coverage	91.3%	84.0%	87.7%	84.8%
ROA	0.93%	1.03%	1.15%	1.15%
ROE	21.0%	24.8%	28.4%	26.5%

DUPONT ANALYSIS	1999A	2000E	2001E	2002E
Lending operations				
Net interest margin	2.82%	2.76%	2.61%	2.55%
Interest earnings assets/assets	89.97%	91.14%	92.50%	93.10%
NIM contribution to ROA	2.54%	2.51%	2.42%	2.38%
Non-interest operations				
Non-interest income/assets	2.62%	1.89%	1.77%	1.71%
Overhead ratio	2.87%	2.25%	2.02%	2.01%
Non-int. contribution to ROA	-0.25%	-0.36%	-0.25%	-0.31%
Asset quality analysis				
Provision/loans	-1.26%	-1.09%	-0.75%	-0.60%
Loans/assets	64.22%	64.93%	65.31%	65.13%
ROA effect from asset quality	-0.81%	-0.71%	-0.49%	-0.39%
Core ROA	1.48%	1.44%	1.68%	1.68%
Non-core contibution to ROA	-0.16%	0.05%	0.00%	0.00%
Pre-tax ROA	1.32%	1.49%	1.68%	1.68%
Tax rate	34.17%	30.80%	30.80%	30.80%
After tax ROA	0.93%	1.03%	1.15%	1.15%
Balance sheet leverage (x)	22.6	24.1	24.8	23.1
ROE	21.0%	24.8%	28.4%	26.5%

BALANCE SHEET	1999A	2000E	2001E	2002E
(KRWm)				
Gross loans	32,997,275	44,838,264	53,525,923	60,382,296
Specific loan loss reserves	*0*	*0*	*0*	*0*
Loan loss reserves	*-1,740,094*	*-2,019,890*	*-2,259,437*	*-2,468,298*
Net loans	31,257,181	42,818,375	51,266,486	57,913,997
Other earning assets	12,532,134	17,371,177	21,807,165	25,082,038
Other assets	4,884,301	5,218,298	5,583,355	5,982,461
Total Assets	48,673,616	65,407,849	78,657,006	88,978,497
Deposits	34,357,895	48,101,053	60,126,316	67,341,474
Other paying liabilities	7,550,310	9,606,276	9,642,592	11,393,638
Other liabilities	4,611,696	5,125,567	5,651,724	6,207,981
Total Liabilities	41,908,205	57,707,329	69,768,909	78,735,112
Minorities & other	0	0	0	0
Shareholders' funds	2,153,715	2,574,953	3,236,373	4,035,403

LOAN BOOK	1999A	2000E	2001E	2002E
(KRWbn)				
Corporate	39,739	47,954	51,867	54,492
Personal	4,055	4,178	4,178	4,178
Mortgage	6,394	6,284	6,538	6,603
Foreign currency loans	8,411	9,331	10,985	12,932
Total loans	58,599	67,747	73,567	78,206

LOAN BOOK BREAKDOWN	1999A	2000E	2001E	2002E
(%)				
Corporate	68%	71%	71%	70%
Personal	7%	6%	6%	5%
Mortgage	11%	9%	9%	8%
Foreign currency loans	14%	14%	15%	17%
Total loans	100%	100%	100%	100%

BALANCE SHEET RATIOS	1999A	2000E	2001E	2002E
(%)				
Loan-to-deposit	91.0%	89.0%	85.3%	86.0%
Loan-to-deposit (incl. CDs)	0.0%	0.0%	0.0%	0.0%
Equity to assets	4.4%	3.9%	4.1%	4.5%
Tier 1 Capital	9.0%	8.0%	7.8%	8.0%
Total Capital adequacy	10.5%	9.3%	9.0%	9.2%
General reserves (% loans)	-5.27%	-4.50%	-4.22%	-4.09%
Specific reserves (% loans)	0.00%	0.00%	0.00%	0.00%
Total loan provisions	-5.27%	-4.50%	-4.22%	-4.09%

ASSET QUALITY	1999A	2000E	2001E	2002E
Nonperforming loans	2,674,500	3,108,483	3,414,848	3,519,583
NPL ratio	8.8%	6.9%	6.4%	5.8%
Total provisions/NPLs	63.6%	63.7%	65.0%	69.0%

GROWTH RATES	1999A	2000E	2001E	2002E
(%)				
Income statement				
Net interest income		16.0%	21.5%	14.5%
Non-interest income		-15.3%	18.1%	12.2%
Total operating income		0.1%	20.0%	13.5%
Operating expenses		-7.9%	13.1%	16.0%
Pre-provision earnings		10.1%	27.3%	11.1%
Loan loss provisions		2.8%	-12.6%	-7.7%
Net profit		29.8%	40.7%	16.7%
Balance sheet				
Loan growth		35.9%	19.4%	12.8%
Interest earning assets		36.6%	21.1%	13.4%
Asset growth		34.4%	20.3%	13.1%
Deposit growth		40.0%	25.0%	12.0%
Shareholders funds		19.6%	25.7%	24.7%

KOOKMIN BANK (KRW17,800) 1-STRONG BUY

Investment Case

SME and household loans to drive loan growth

Kookmin has a very strong retail banking franchise, perhaps second only to H&CB. The bank has 34% of its loan book exposed to the household sector (mortgage and personal loans), which has helped to boost overall loan growth. As of September 30, 2000 mortgage loans grew 41% year on year while personal loans grew 35% year on year. We expect these two segments to remain key drivers of loan growth, albeit decelerating to more sustainable growth rates of 23% and 16% respectively in 2001. The bank also specializes in serving the SMEs, especially companies engaged in technology-related manufacturing. We forecast, however, that loan growth to SMEs will decelerate to 14% next year, after increasing 26% this year. Overall, we expect loan growth to reach 14% in 2001.

Strong credit card franchise

The bank holds a 74.3% stake in publicly listed Kookmin Credit Card, which is the third largest card issuer with 7.2 million cards-in-force and a 18.2% market share. Although competition in the credit card sector is heating up, we note that the government is playing an active role in encouraging credit card usage. Measures introduced by the government includes: (i) up to KRW3 million of credit card spending may be tax-deductible for individuals; (ii) credit card receipts double as state-sponsored lottery tickets and (iii) corporate travel and entertainment expenses charged to credit cards are tax-deductible.

Merger with H&CB would create retail banking powerhouse

The bank announced in the last week of December that it had signed a Memorandum of Understanding with H&CB to merge before the end of 1H01. While there were initial fears that such a plan would be thwarted by the banks' labor unions, the strikes failed to gather wide support and did not affect either banks' operations. A merger between Kookmin and H&CB makes sense as their business lines are complementary. Kookmin runs a lucrative credit card subsidiary and has established a strong niche in SME lending, while H&CB is the market-leader in mortgage and personal loans. The merger would thus create a retail-banking powerhouse. Additionally, the merged entity would the largest bank in South Korea with total assets of US$125 billion, almost twice the size of the next largest bank. In a regional context, the merged institution would be the second largest bank in Asia ex-Japan, after HSBC.

Valuation

Coming from two years of losses brought about by the crisis, Kookmin is expected to rebound strongly to achieve ROEs of 18% and 24% in 2000 and 2001 respectively. Earnings should be buoyed by lower loan loss provisions and its SME and retail focus on lending. Notwithstanding its good earnings prospects, the stock is trading at very attractive valuations of 1.3x PBR and only 5.7x 2001 earnings. Kookmin is one of our two top picks in the sector.

Kookmin

Share Price (KRW):	17,800	Index:	558.02
52 Week Price Range (KRW):	21,200 - 8,600	Current Yield:	5.27%
Reuters Code:	2313.KS		
Bloomberg Code:	2313 KS		

INCOME STATEMENT (KRWm)	1999A	2000E	2001E	2002E
Interest income	6,853,045	6,367,745	7,351,879	7,946,620
Interest expense	-5,028,924	-4,312,286	-5,025,315	-5,504,805
Net interest income	1,824,121	2,055,459	2,326,564	2,441,815
Ave. int. earnings assets	*65,626,411*	*74,999,869*	*88,765,297*	*98,228,672*
NIM (%)	2.78%	2.74%	2.62%	2.49%
Non-interest income	2,885,974	2,588,918	2,678,307	2,821,834
Total operating income	4,710,095	4,644,377	5,004,871	5,263,649
Non-interest expenses	-3,131,029	-2,904,807	-3,102,948	-3,354,196
Pre provision profit	1,579,066	1,739,570	1,901,922	1,909,452
Loan loss provisions	-1,387,190	-828,038	-524,843	-289,075
Non-operating income	-87,564	0	0	0
Pre tax profit	104,312	911,532	1,377,080	1,620,377
Tax	-121,483	-268,902	-413,124	-486,113
Net profit	-29,806	621,071	935,970	1,102,872

PER SHARE DATA (KRW)	1999A	2000E	2001E	2002E
EPS	-109	2,073	3,124	3,681
DPS	50	622	937	1,104
Effective payout ratio (%)	*-46%*	*30%*	*30%*	*30%*
BVPS	10,950	11,501	13,688	16,265
ABVPS	9,175	9,762	12,049	14,775

VALUATION	1999A	2000E	2001E	2002E
Price to book value (x)	1.6	1.5	1.3	1.1
Price to adjusted book value (x)	1.9	1.8	1.5	1.2
Price to earnings (X)	-163.1	8.6	5.7	4.8

PROFITABILITY RATIOS (%)	1999A	2000E	2001E	2002E
Net interest margin	2.78%	2.74%	2.62%	2.49%
Yield on interest earning assets	8.53%	8.49%	8.29%	8.09%
Cost on interest bearing liabilities	5.75%	5.77%	5.70%	5.67%
Net interest spread	2.78%	2.72%	2.59%	2.42%
Non-int. income (% Op income)	61.3%	55.7%	53.5%	53.6%
Cost to income	66.5%	62.5%	62.0%	63.7%
Overhead ratio	4.29%	3.52%	3.20%	3.14%
Cost coverage	92.2%	89.1%	86.3%	84.1%
ROA	-0.04%	0.75%	0.97%	1.03%
ROE	-0.9%	17.4%	23.5%	23.5%

DUPONT ANALYSIS	1999A	2000E	2001E	2002E
Lending operations				
Net interest margin	2.78%	2.74%	2.62%	2.49%
Interest earnings assets/assets	89.95%	90.82%	91.65%	91.92%
NIM contribution to ROA	2.50%	2.49%	2.40%	2.28%
Non-interest operations				
Non-interest income/assets	3.96%	3.14%	2.77%	2.64%
Overhead ratio	4.29%	3.52%	3.20%	3.14%
Non-int. contribution to ROA	-0.34%	-0.38%	-0.44%	-0.50%
Asset quality analysis				
Provision/loans	-3.74%	-1.98%	-1.05%	-0.51%
Loans/assets	50.78%	50.76%	51.63%	53.08%
ROA effect from asset quality	-1.90%	-1.00%	-0.54%	-0.27%
Core ROA	0.26%	1.10%	1.42%	1.52%
Non-core contibution to ROA	-0.12%	0.00%	0.00%	0.00%
Pre-tax ROA	0.14%	1.10%	1.42%	1.52%
Tax rate	29.50%	30.00%	30.00%	30.00%
After tax ROA	-0.04%	0.75%	0.97%	1.03%
Balance sheet leverage (x)	20.9	23.1	24.3	22.8
ROE	-0.9%	17.4%	23.5%	23.5%

BALANCE SHEET (KRWm)	1999A	2000E	2001E	2002E
Gross loans	39,565,557	49,778,864	56,388,778	63,443,443
Specific loan loss reserves	*0*	*0*	*0*	*0*
Loan loss reserves	*-2,515,838*	*-2,995,600*	*-3,171,735*	*-3,217,254*
Net loans	37,049,719	46,783,264	53,217,043	60,226,189
Other earning assets	28,576,692	37,590,063	39,940,224	43,073,888
Other assets	7,335,764	7,820,335	8,349,354	8,927,068
Total Assets	72,962,175	92,193,662	101,506,621	112,227,145
Deposits	44,537,854	57,899,210	66,005,100	74,585,763
Other paying liabilities	20,955,180	26,187,751	26,268,955	27,164,240
Other liabilities	3,998,573	4,470,883	4,941,570	5,414,136
Total Liabilities	69,491,607	88,557,845	97,215,624	107,164,139
Minorities & other	0	0	0	0
Shareholders' funds	3,488,063	3,653,312	4,308,491	5,080,502

LOAN BOOK (KRWbn)	1999A	2000E	2001E	2002E
SMEs	15,455	19,498	22,812	26,006
Large corporates	6,818	8,295	8,544	8,800
Mortgage	5,188	6,992	8,600	10,578
Personal	6,915	9,756	11,317	13,128
Others	628	136	137	138
Total loans	35,004	44,676	51,410	58,650

LOAN BOOK BREAKDOWN (%)	1999A	2000E	2001E	2002E
SMEs	44%	44%	44%	44%
Large corporates	19%	19%	17%	15%
Mortgage	15%	16%	17%	18%
Personal	20%	22%	22%	22%
Others	2%	0%	0%	0%
Total loans	100%	100%	100%	100%

BALANCE SHEET RATIOS (%)	1999A	2000E	2001E	2002E
Loan-to-deposit	83.2%	80.8%	80.6%	80.7%
Loan-to-deposit (incl. CDs)	0.0%	0.0%	0.0%	0.0%
Equity to assets	4.8%	4.0%	4.2%	4.5%
Tier 1 Capital	7.0%	6.0%	6.2%	6.4%
Total Capital adequacy	11.4%	9.4%	9.4%	9.4%
General reserves (% loans)	-6.36%	-6.02%	-5.62%	-5.07%
Specific reserves (% loans)	0.00%	0.00%	0.00%	0.00%
Total loan provisions	-6.36%	-6.02%	-5.62%	-5.07%

ASSET QUALITY	1999A	2000E	2001E	2002E
Nonperforming loans	5,110,680	5,224,135	5,230,604	4,871,124
NPL ratio	11.2%	9.1%	8.1%	6.7%
Total provisions/NPLs	46.3%	54.5%	57.8%	63.0%

GROWTH RATES (%)	1999A	2000E	2001E	2002E
Income statement				
Net interest income		12.7%	13.2%	5.0%
Non-interest income		-10.3%	3.5%	5.4%
Total operating income		-1.4%	7.8%	5.2%
Operating expenses		-7.2%	6.8%	8.1%
Pre-provision earnings		10.2%	9.3%	0.4%
Loan loss provisions		-40.3%	-36.6%	-44.9%
Net profit		-2183.7%	50.7%	17.8%
Balance sheet				
Loan growth		25.8%	13.3%	12.5%
Interest earning assets		28.2%	10.3%	10.6%
Asset growth		26.4%	10.1%	10.6%
Deposit growth		30.0%	14.0%	13.0%
Shareholders funds		4.7%	17.9%	17.9%

KORAM BANK (KRW5,930) 2-BUY

Investment Case

BoA relationship has benefited the bank

KorAm Bank was founded in 1983 as a joint venture between Bank of America (BoA) and a group of Korean companies, including Samsung and Daewoo. Largely due to the presence of the US bank, KorAm's management has been able to operate independently from the government and did not engage in government-directed lending. Rather, it was able to make independent credit decisions by adopting BoA's credit procedures and systems. Having been invested in the bank for close to two decades and partly due to its own merger in the U.S., BoA has indicated its interest to eventually sell-off its present 10.1% stake.

Entry of another foreign strategic investor – the Carlyle led consortium

The potential exit of BoA from KorAm should not be a concern that the bank would lose its independent banking practices. This is because another US consortium consisting of the Carlyle Group and J.P. Morgan Corsair has successfully purchased KorAm's global depository receipts (GDRs) in November 2000. The consortium paid KRW444.7 billion for the newly issued GDRs at KRW6,800 per share, and thereby became the bank's single largest shareholder with a 40.1% stake. The other large shareholders in the bank include BoA (10.1%), Samsung (10.1%) and KDB (7.7%).

Huge provisions to be taken in 2000

With the entry of the US consortium, management will adopt J.P. Morgan's advanced financial technology. More importantly, KorAm will fully provide for all of its loans classified as substandard and below, which at September 2000 amounted to KRW1.85 trillion. Given that the bank has existing loan loss reserves of KRW850 billion, it will set aside loan loss provisions of approximately KRW1.0 trillion in 2000. With such a huge one-time provision, management estimates that the bank will register a net loss of KRW460 billion in 2000, which will result in its BIS capital adequacy ratio declining from 11.5% to 8.5%. On the other hand, such aggressive provisioning would establish KorAm as the bank with the highest NPL cover of 100%.

Merger talks with Hana collapsed

The entry of the Carlyle-consortium, however, has stalled the merger negotiations with Hana Bank. While KorAm has expressed the merits of such a merger, the US investor has balked in giving its approval, presumably because it would prefer to concentrate on improving the operations of KorAm first. We understand also that there have been disagreements over the stock exchange ratio that would be used to effect any potential merger.

Valuation

Although KorAm will report a large loss in 2000, the bank will start 2001 with a much cleaner balance sheet. Provisions will be substantially lower this year and we forecast the bank to be able to achieve ROEs of 20% this year. Despite its strong profitability, the bank is trading at only 1.0x PBR and 4.7x PER. We have upgraded the stock from 3-Market perform to 2-Buy.

KorAm

Share Price (KRW):	5,930	Index:	558.02
52 Week Price Range (KRW):	11,300 - 4,335	Current Yield:	0.00%
Reuters Code:	1683.KS		
Bloomberg Code:	1683 KS		

INCOME STATEMENT	1999A	2000E	2001E	2002E
(KRWm)				
Interest income	1,873,245	2,148,479	2,399,040	2,675,658
Interest expense	-1,471,692	-1,673,006	-1,902,138	-2,088,450
Net interest income	401,553	475,473	496,902	587,207
Ave. int. earnings assets	*20,536,845*	*22,060,850*	*25,328,665*	*28,702,814*
NIM (%)	1.96%	2.16%	1.96%	2.05%
Non-interest income	764,296	534,557	590,184	647,675
Total operating income	1,165,849	1,010,030	1,087,085	1,234,882
Non-interest expenses	-873,295	-783,213	-843,446	-867,714
Pre provision profit	292,554	226,817	243,639	367,168
Loan loss provisions	-387,228	-996,384	-91,593	-77,383
Non-operating income	165,295	0	0	0
Pre tax profit	192,531	-635,466	299,557	414,411
Tax	-20,285	195,724	-92,264	-127,639
Net profit	169,646	-442,343	204,693	284,172

PER SHARE DATA (KRW)	1999A	2000E	2001E	2002E
EPS	1,761	-4,074	1,255	1,743
DPS	0	0	0	0
Effective payout ratio (%)	*0%*	*0%*	*0%*	*0%*
BVPS	7,566	5,739	6,995	8,737
ABVPS	5,060	5,739	6,995	8,737

VALUATION	1999A	2000E	2001E	2002E
Price to book value (x)	0.8	1.0	0.8	0.7
Price to adjusted book value (x)	1.2	1.0	0.8	0.7
Price to earnings (X)	3.4	-1.5	4.7	3.4

PROFITABILITY RATIOS	1999A	2000E	2001E	2002E
(%)				
Net interest margin	1.96%	2.16%	1.96%	2.05%
Yield on interest earning assets	8.89%	10.03%	9.83%	9.66%
Cost on interest bearing liabilities	6.35%	7.61%	7.56%	7.38%
Net interest spread	2.54%	2.42%	2.28%	2.28%
Non-int. income (% Op income)	65.6%	52.9%	54.3%	52.4%
Cost to income	74.9%	77.5%	77.6%	70.3%
Overhead ratio	3.79%	3.18%	3.01%	2.74%
Cost coverage	87.5%	68.3%	70.0%	74.6%
ROA	0.74%	-1.80%	0.73%	0.90%
ROE	17.0%	-45.7%	19.7%	22.2%

DUPONT ANALYSIS	1999A	2000E	2001E	2002E
Lending operations				
Net interest margin	1.96%	2.16%	1.96%	2.05%
Interest earnings assets/assets	89.18%	89.56%	90.24%	90.76%
NIM contribution to ROA	1.74%	1.93%	1.77%	1.86%
Non-interest operations				
Non-interest income/assets	3.32%	2.17%	2.10%	2.05%
Overhead ratio	3.79%	3.18%	3.01%	2.74%
Non-int. contribution to ROA	-0.47%	-1.01%	-0.90%	-0.70%
Asset quality analysis				
Provision/loans	-3.20%	-7.86%	-0.64%	-0.47%
Loans/assets	52.53%	51.50%	51.27%	52.50%
ROA effect from asset quality	-1.68%	-4.05%	-0.33%	-0.24%
Core ROA	-0.41%	-3.12%	0.54%	0.92%
Non-core contibution to ROA	0.72%	0.00%	0.00%	0.00%
Pre-tax ROA	0.31%	-3.12%	0.54%	0.92%
Tax rate	30.80%	30.80%	30.80%	30.80%
After tax ROA	0.74%	-1.80%	0.73%	0.90%
Balance sheet leverage (x)	23.0	25.5	27.0	24.7
ROE	17.0%	-45.7%	19.7%	22.2%

BALANCE SHEET	1999A	2000E	2001E	2002E
(KRWm)				
Gross loans	12,898,626	15,109,527	17,267,802	19,367,743
Specific loan loss reserves	*0*	*0*	*0*	*0*
Loan loss reserves	*-801,260*	*-1,837,904*	*-1,757,534*	*-1,671,553*
Net loans	12,097,366	13,271,623	15,510,268	17,696,191
Other earning assets	8,439,479	10,313,232	11,562,207	12,636,963
Other assets	2,490,490	2,650,551	2,825,890	3,017,998
Total Assets	23,027,335	26,235,406	29,898,365	33,351,151
Deposits	14,684,445	16,887,112	19,251,307	21,542,213
Other paying liabilities	5,765,948	6,653,515	7,562,030	8,245,295
Other liabilities	1,577,884	1,758,875	1,944,430	2,138,874
Total Liabilities	22,028,277	25,299,502	28,757,768	31,926,382
Minorities & other	0	0	0	0
Shareholders' funds	999,058	935,903	1,140,597	1,424,769

LOAN BOOK	1999A	2000E	2001E	2002E
(KRWbn)				
Large corporates	7,084	7,067	7,915	8,707
SMEs	5,925	6,678	7,747	9,141
Households	2,769	3,569	4,461	5,309
Others	322	353	364	364
Total loans	16,100	17,668	20,487	23,521

LOAN BOOK BREAKDOWN	1999A	2000E	2001E	2002E
(%)				
Large corporates	44%	40%	39%	37%
SMEs	37%	38%	38%	39%
Households	17%	20%	22%	23%
Others	2%	2%	2%	2%
Total loans	100%	100%	100%	100%

BALANCE SHEET RATIOS	1999A	2000E	2001E	2002E
(%)				
Loan-to-deposit	82.4%	78.6%	80.6%	82.1%
Loan-to-deposit (incl. CDs)	0.0%	0.0%	0.0%	0.0%
Equity to assets	4.3%	3.6%	3.8%	4.3%
Tier 1 Capital	8.9%	4.3%	4.3%	4.3%
Total Capital adequacy	12.1%	8.5%	8.6%	8.6%
General reserves (% loans)	-6.21%	-12.16%	-10.18%	-8.63%
Specific reserves (% loans)	0.00%	0.00%	0.00%	0.00%
Total loan provisions	-6.21%	-12.16%	-10.18%	-8.63%

ASSET QUALITY	1999A	2000E	2001E	2002E
Nonperforming loans	2,123,000	1,910,700	1,719,630	1,633,649
NPL ratio	13.7%	12.7%	10.0%	8.5%
Total provisions/NPLs	36.0%	100.0%	100.0%	100.0%

GROWTH RATES	1999A	2000E	2001E	2002E
(%)				
Income statement				
Net interest income		18.4%	4.5%	18.2%
Non-interest income		-30.1%	10.4%	9.7%
Total operating income		-13.4%	7.6%	13.6%
Operating expenses		-10.3%	7.7%	2.9%
Pre-provision earnings		-22.5%	7.4%	50.7%
Loan loss provisions		157.3%	-90.8%	-15.5%
Net profit		-360.7%	146.3%	38.8%
Balance sheet				
Loan growth		17.1%	14.3%	12.2%
Interest earning assets		19.1%	13.4%	11.0%
Asset growth		13.9%	14.0%	11.5%
Deposit growth		15.0%	14.0%	11.9%
Shareholders funds		-6.3%	21.9%	24.9%

SHINHAN BANK (KRW11,650) 1-STRONG BUY

Investment Case

Pursuing financial holding company structure

In an environment where even the strong banks are seeking to merge with each other, Shinhan Bank has decided to stay independent and instead focus on re-organizing itself into a financial holding company. Following the passage of the Financial Holding Company Act in October, Shinhan is aiming to be the first Korean bank to adopt a holding company structure. Most major banks in Hong Kong and Singapore have already formed such holding companies and Korean banks are now following suit. The key advantages of forming a holding company are (i) consolidating new, non-interest revenues and (ii) more efficient capital adequacy management as non-bank assets are not considered in computing BIS ratios.

Under the holding company, Shinhan envisages five key subsidiaries: (i) commercial bank; (ii) life insurance; (iii) brokerage; (iv) asset management and (v) financial portal.

The commercial bank would be the key subsidiary, accounting for more than 90% of the holding company's assets. However, management is aiming to attract foreign partners to help shape the other subsidiaries to be leaders in their respective market segments. Management also expects such a structure to boost overall revenues via cross-selling, whereby the bank branches would serve as distribution channels. Management is aiming to finalize its holding company structure and seek approval from the authorities by March 2001.

Aiming to place Cheju Bank under its holding company

Following initial press reports, Shinhan management has publicly stated that it is agreeable to acquiring Cheju Bank, a small provincial bank that has requested capital infusion from the government. The provincial bank's total assets account for less than 3% of Shinhan's. Shinhan officials emphasized, however, that the bank would only consider placing Cheju under its holding company structure after the smaller bank had been recapitalized by the government and operations have normalized. Shinhan's holding company is expected to be established in March 2001 at the earliest. In the meantime, the bank has signed a management advisory agreement with the Cheju, in which Shinhan management would help the weaker bank with reconstruction.

Valuation

Notwithstanding its good share price performance in 2000, where it outperformed the KOSPI by 35%, Shinhan is still trading at only 1.0x PBR. The bank has the best asset quality in the sector, with NPLs at 4.8% and an NPL coverage ratio of 57%. Coupled with its sound capital adequacy ratio of 13%, we believe Shinhan is an attractive bank investment.

Shinhan

Share Price (KRW):	11,650		Index:	558.02
52 Week Price Range (KRW):	15,300 - 6,400		Current Yield:	5.09%

Reuters Code:	1558.KS
Bloomberg Code:	1558 KS

INCOME STATEMENT	1999A	2000E	2001E	2002E
(KRWm)				
Interest income	3,283,348	3,949,208	4,522,212	5,010,255
Interest expense	-2,544,164	-2,993,949	-3,481,262	-3,885,452
Net interest income	739,184	955,259	1,040,949	1,124,803
Ave. int. earnings assets	*39,322,022*	*43,114,769*	*49,932,255*	*55,985,860*
NIM (%)	1.88%	2.22%	2.08%	2.01%
Non-interest income	1,031,770	960,301	1,056,315	1,153,791
Total operating income	1,770,954	1,915,559	2,097,264	2,278,593
Non-interest expenses	-875,329	-929,531	-1,022,415	-1,115,540
Pre provision profit	895,625	986,028	1,074,849	1,163,054
Loan loss provisions	-734,225	-419,245	-385,537	-321,922
Non-operating income	0	0	0	0
Pre tax profit	161,400	566,784	689,312	841,132
Tax	-57,360	-187,039	-212,308	-259,069
Net profit	111,002	387,705	485,945	591,978

PER SHARE DATA (KRW)	1999A	2000E	2001E	2002E
EPS	451	1,577	1,976	2,407
DPS	400	473	593	722
Effective payout ratio (%)	*89%*	*30%*	*30%*	*30%*
BVPS	10,413	11,517	12,900	14,585
ABVPS	8,973	10,188	12,519	13,722

VALUATION	1999A	2000E	2001E	2002E
Price to book value (x)	1.1	1.0	0.9	0.8
Price to adjusted book value (x)	1.3	1.1	0.9	0.8
Price to earnings (X)	25.8	7.4	5.9	4.8

PROFITABILITY RATIOS	1999A	2000E	2001E	2002E
(%)				
Net interest margin	1.88%	2.22%	2.08%	2.01%
Yield on interest earning assets	8.78%	9.24%	9.13%	9.02%
Cost on interest bearing liabilities	6.60%	7.17%	7.21%	7.20%
Net interest spread	2.19%	2.06%	1.92%	1.82%
Non-int. income (% Op income)	58.3%	50.1%	50.4%	50.6%
Cost to income	49.4%	48.5%	48.7%	49.0%
Overhead ratio	2.05%	2.00%	1.91%	1.86%
Cost coverage	117.9%	103.3%	103.3%	103.4%
ROA	0.26%	0.83%	0.91%	0.99%
ROE	3.9%	13.0%	14.7%	16.1%

DUPONT ANALYSIS	1999A	2000E	2001E	2002E
Lending operations				
Net interest margin	1.88%	2.22%	2.08%	2.01%
Interest earnings assets/assets	92.23%	92.65%	93.21%	93.52%
NIM contribution to ROA	1.73%	2.05%	1.94%	1.88%
Non-interest operations				
Non-interest income/assets	2.42%	2.06%	1.97%	1.93%
Overhead ratio	2.05%	2.00%	1.91%	1.86%
Non-int. contribution to ROA	0.37%	0.07%	0.06%	0.06%
Asset quality analysis				
Provision/loans	-4.45%	-2.29%	-1.79%	-1.30%
Loans/assets	38.66%	39.26%	40.26%	41.22%
ROA effect from asset quality	-1.72%	-0.90%	-0.72%	-0.54%
Core ROA	0.38%	1.22%	1.29%	1.40%
Non-core contibution to ROA	0.00%	0.00%	0.00%	0.00%
Pre-tax ROA	0.38%	1.22%	1.29%	1.40%
Tax rate	33.00%	30.80%	30.80%	30.80%
After tax ROA	0.26%	0.83%	0.91%	0.99%
Balance sheet leverage (x)	14.9	15.6	16.3	16.3
ROE	3.9%	13.0%	14.7%	16.1%

BALANCE SHEET	1999A	2000E	2001E	2002E
(KRWm)				
Gross loans	17,759,484	21,308,683	24,457,283	27,711,119
Specific loan loss reserves	*0*	*0*	*0*	*0*
Loan loss reserves	*-1,278,514*	*-1,251,603*	*-1,379,549*	*-1,433,159*
Net loans	16,480,970	20,057,079	23,077,733	26,277,960
Other earning assets	22,841,052	26,850,437	29,879,261	32,736,767
Other assets	3,313,530	3,523,910	3,754,831	4,008,320
Total Assets	42,635,552	50,431,426	56,711,825	63,023,047
Deposits	22,918,401	28,877,185	33,208,763	37,857,990
Other paying liabilities	15,144,881	16,516,429	17,927,838	18,970,141
Other liabilities	1,718,508	1,912,657	2,109,907	2,315,215
Total Liabilities	39,781,790	47,306,271	53,246,508	59,143,346
Minorities & other	0	0	0	0
Shareholders' funds	2,853,762	3,125,155	3,465,317	3,879,701

LOAN BOOK	1999A	2000E	2001E	2002E
(KRWbn)				
Large corporates	5,069	5,346	5,667	5,979
SMEs	13,592	15,831	17,890	19,857
Households	5,829	8,525	10,230	12,173
Total loans	24,490	29,703	33,786	38,009

LOAN BOOK BREAKDOWN	1999A	2000E	2001E	2002E
(%)				
Large corporates	21%	18%	17%	16%
SMEs	56%	53%	53%	52%
Households	24%	29%	30%	32%
Total loans	100%	100%	100%	100%

BALANCE SHEET RATIOS	1999A	2000E	2001E	2002E
(%)				
Loan-to-deposit	71.9%	69.5%	69.5%	69.4%
Loan-to-deposit (incl. CDs)	0.0%	0.0%	0.0%	0.0%
Equity to assets	6.7%	6.2%	6.1%	6.2%
Tier 1 Capital	10.4%	8.5%	8.4%	8.5%
Total Capital adequacy	13.9%	11.8%	11.6%	11.7%
General reserves (% loans)	-7.20%	-5.87%	-5.64%	-5.17%
Specific reserves (% loans)	0.00%	0.00%	0.00%	0.00%
Total loan provisions	-7.20%	-5.87%	-5.64%	-5.17%

ASSET QUALITY	1999A	2000E	2001E	2002E
Nonperforming loans	1,965,700	1,812,508	1,717,269	1,578,307
NPL ratio	7.6%	6.2%	5.1%	4.2%
Total provisions/NPLs	60.4%	64.0%	75.0%	85.0%

GROWTH RATES	1999A	2000E	2001E	2002E
(%)				
Income statement				
Net interest income		29.2%	9.0%	8.1%
Non-interest income		-6.9%	10.0%	9.2%
Total operating income		8.2%	9.5%	8.6%
Operating expenses		6.2%	10.0%	9.1%
Pre-provision earnings		10.1%	9.0%	8.2%
Loan loss provisions		-42.9%	-8.0%	-16.5%
Net profit		249.3%	25.3%	21.8%
Balance sheet				
Loan growth		20.0%	14.8%	13.3%
Interest earning assets		18.6%	12.8%	11.2%
Asset growth		18.3%	12.5%	11.1%
Deposit growth		26.0%	15.0%	14.0%
Shareholders funds		9.5%	10.9%	12.0%

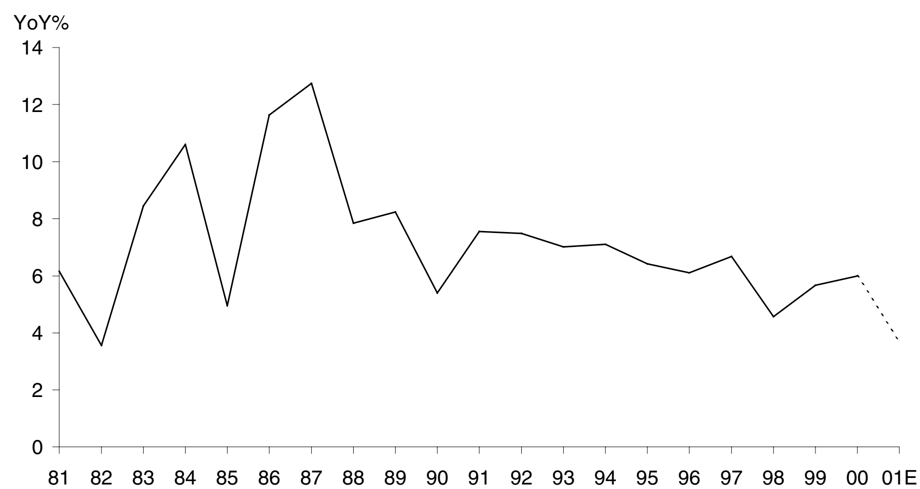
TAIWANESE BANKS

The Taiwanese banking sector is facing a crucial stage in its development. While it escaped relatively unscathed from the 1997 Asian financial crisis, asset quality is now at its lowest level ever. Lack of transparency and less stringent classifications have led to nagging suspicions that the worst is yet to come. Coupled with our pessimistic view on the macro outlook for the island, we believe the banks will be facing a very challenging 2001. The sector also remains very fragmented, with the less efficient state-banks still accounting for about 75% of total banking assets. Until we witness the authorities aggressively tackling the NPL issue and consolidation is accelerated, we remain Underweight the sector.

Bleak macro outlook

The macro-economic outlook for Taiwan has been deteriorating since we downgraded the sector to Underweight in September 2000. The latest economic data show that growth in industrial production more than halved in October to 7.2% year on year, from 16.6% in the prior month. Likewise, export growth declined to 10.3% in November, from 19.4% in October. One of our biggest concerns with the Taiwan economy stems from the impending slowdown expected in the electronics industry. Growth in the export of electronic products was 32% in November, compared to 47% in the first ten months, while exports of telecommunication products grew only 11%, compared to 32% in the comparable periods. Against such an economic backdrop, our economists have further revised down their 2001 GDP forecast from 4.3% to 3.7%, which would be the island's lowest economic growth rate since 1982.

Figure 19: Yearly GDP Growth



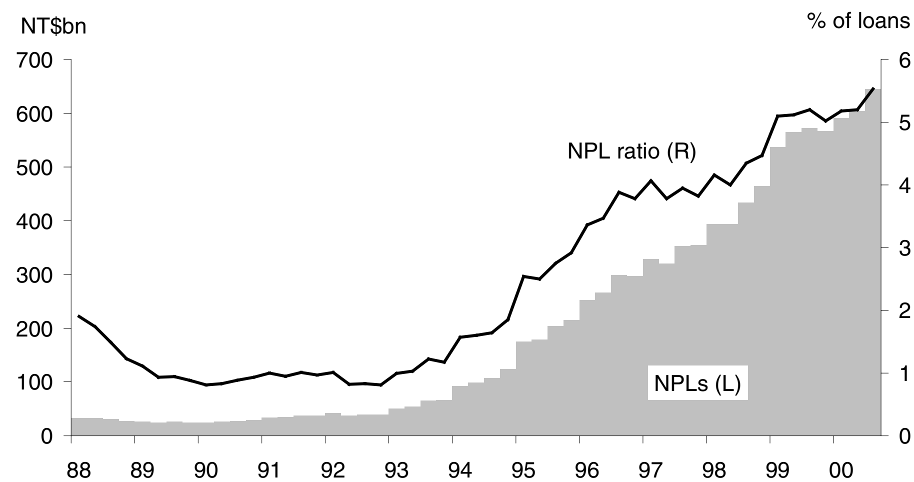
Source: Lehman Brothers

Asset quality is key concern

With a much more challenging economic outlook ahead, we believe that Taiwanese banks are headed for a sharp cyclical slowdown in 2001. Of greatest concern is the quality of the banks' loan books. The non-performing loan classifications in Taiwan are less stringent than regional and international standards. For example, missed payments on installment loans are classified non-performing only after six months, rather than three months.

We are also particularly worried about cases where the government essentially forced the banks to restructure the loan, but yet the banks were not allowed to classify these accounts as NPLs even though interest and principal would not be paid in the next six to 12 months. Given such instances, it is perhaps little wonder that the market has remained sceptical over the true asset quality in the banking sector. Consequently, even though the officially released NPL ratio for the sector is 5.5%, we believe that the figure is closer to 10%. The government recent conceded that under a broader definition, NPLs in the sector stand at 8.4%. In any case, we believe that NPLs in the system will continue to trend up, and we expect NPLs to reach 12% in 2001.

Figure 20: Quarterly NPL



Source: Lehman Brothers

Still in denial

The government has been very slow in introducing other policies to address the rising NPL issue. Indeed, it appears to still be in the denial phase and MoF officials have insisted that bad loans are not a problem in Taiwan. Consequently, the authorities have been dragging their feet in the setting up of a state run resolution trust corporation (RTC), and instead have been trying to attract foreign investment banks to set up privately run asset management corporations (AMC).

The Bank Association of the Republic of China has announced that it is aiming to raise NT$15 billion in its first stage of fund raising, which involves largely domestic banks. To date, 33 domestic banks have agreed to join the AMC. Officials stated that the association would also seek to raise an additional NT$10 billion in the second stage by tapping foreign funds.

While the AMC concept appears to make sense, the key question is who is going to shoulder the shortfall between the face value and the market value of these NPLs. To the extent that state-owned or controlled banks account for about 75% of banking assets, and that these banks have much greater NPLs than the private-sector banks, the government has to realize that it would have foot the bill. We believe that until the government takes concrete steps to curb and reduce NPLs in the sector, the situation will only worsen, especially given our pessimistic outlook for the overall economy.

One way that the authorities did try to curb the rise in NPLs is to encourage the banks to accelerate bad loan write-offs by providing tax incentives. From January 1, 2001, the banks' 2% business tax rate has been totally eliminated. The business tax rate for the banks was first cut to 2% from 5% on July 1, 1999. The banks will be required to use the tax savings to write off their bad loans. Such measures will help to cushion the impact of bad loan write-offs on the banks' bottom lines.

Weak loan demand

Unlike South Korea where retail banks stand to benefit from strong demand for mortgage and personal loans, loan demand in Taiwan has been weak across most segments. As of October 2000, consumer loan growth was barely 5%. This dragged overall loan growth down as they account for almost 40% of total loans. While loans to the manufacturing sector still increased 12.8% in the same period, we believe that corporate demand for credit will inevitably weaken given our more cautious view on the electronic sector. Credit cards is the only segment in which we see continued strong demand. As of September 2000, credit card receivables in the sector grew by a robust 33%. The impact on overall growth, however, was negligible given that credit cards receivables account for only 1.7% of total credit. Over the next twelve months, we forecast overall loan growth of only 5.0%, a deceleration from an estimated 6.5% growth in 2000, before picking up to 6.8% in 2002

Too fragmented

There are 52 domestic banks (including five medium business banks) and 41 foreign banks in Taiwan. The largest bank in Taiwan (Bank of Taiwan) accounts for only 11% of total deposits in the sector, with the top five banks accounting for 39%. With the sector becoming increasingly competitive, we believe that bank consolidation in Taiwan is inevitable. Although the authorities have been discussing sector consolidation since 1998, there have not been any notable mergers.

Indeed, the government publicized at the end of 1999 that three state-owned banks (Bank of Taiwan, Land Bank of Taiwan and Central Trust of China) would be merged, only to announce 12 months later that the plan had been suspended. The slow pace of mergers can be attributed to three factors: (i) layoffs which usually accompany mergers are socially unacceptable, especially among state-owned/controlled banks; (ii) the private banks are generally still profitable, which reduces the urgency to merge and (iii) MoF's inability to introduce merger incentives quickly. The authorities only managed to finally offer tax incentives to merging banks in November 2000.

Recommended exposure

Given the poor operating outlook for the sector and our view that NPLs will continue to rise significantly, we continue to recommend investors Underweight Taiwanese banks. The only bank that we would recommend for exposure to the sector is Chinatrust. This bank has superior asset quality, a well-diversified loan portfolio between the corporate and retail segments and a lucrative credit card operation.

CHINATRUST (NT$23.00) 1-STRONG BUY

Investment Case

Dynamic and resilient private sector bank

Against an increasingly challenging operating environment, we believe Chinatrust will be one of the better performers given its competent management team, sound asset quality and diversified loan portfolio. While many of the private sector banks have largely focused on consumer lending, Chinatrust has a more balanced loan portfolio, with 58% of its loans to the corporate sector. Among its retail banking activities, its focus on home equity loans and credit card receivables has enabled the bank to register above-average growth. In the first nine months of 2000, the bank's total loan portfolio grew 12.6% year to date and 20% year on year, which is ahead of the sector average loan growth of 7% year on year. This implies that Chinatrust continues to grab market share mainly from the state-owned banks.

Number one credit card issuer

Chinatrust was one of the first banks to issue credit cards back in 1974 and has since managed to expand this business substantially. The bank is currently the largest credit issuer on the island, with 17% market share. In addition to its ordinary credit cards, it also has a tie-up with department store Takashimaya. From 2.4 millions cards-in-force at the end of September, we expect the bank to expand its portfolio to three million cards by the end of 2001 and contribute 29% to the bank's pre-tax profits.

Looking to set up AMC

The government has stated that it would like to see the private banks and foreign banks play an active role in setting up asset management companies (AMC). While Chinatrust has no problem managing its own NPL portfolio, the bank is studying the feasibility of setting up an AMC to manage some of the rising NPLs in the system. We believe that with a more challenging macro environment over the next 12 months, NPLs in the sector (especially among the state banks) will be rising.

Room for issuance of subordinated debt

The bank issued non-convertible preferred shares in the domestic market in the third quarter, raising NT$2.5 billion. This helped to boost its CAR from 9.5% to 11%. The preferred shares carry a dividend rate of 6.12% with a six-year tenure. Management has emphasized that it would only seek to raise debt-like instruments in the current environment instead of a dilutive rights issue. Indeed, with the recent approval by the MoF for banks to issue subordinated-debt, which would quality as Tier 2 capital, we believe Chinatrust management will be keen to tap this window as the need arises.

Valuation

While its share price has performed, outperformed the sector by a mere 7% in 2000, Chinatrust enjoyed a strong rally in the past month, outstripping the Taiwan Weighted Index by 22%. Given that the bank is expected to achieve 15% ROE in 2001, the highest in the sector, we believe that its current valuation of 1.5x PBR is undemanding. The stock is our recommended exposure to an otherwise Underweight sector.

Chinatrust

Share Price (NT$):	23	Index:	5136.13
52 Week Price Range (NT$):	35.3 - 15.2	Current Yield:	0.00%
Reuters Code:	2815.TW		
Bloomberg Code:	2815 TT		

INCOME STATEMENT	1998A	1999A	2000E	2001E	2002E
(NT$m)					
Interest income	42,020	43,870	49,413	56,272	63,949
Interest expense	-29,862	-27,837	-30,898	-35,248	-40,507
Net interest income	12,158	16,033	18,514	21,024	23,442
Ave. int. earnings assets	*534,290*	*571,950*	*640,891*	*742,376*	*851,516*
NIM (%)	2.32%	2.88%	2.89%	2.83%	2.75%
Non-interest income	7,713	8,985	10,476	11,817	13,511
Total operating income	19,871	25,018	28,990	32,841	36,953
Non-interest expenses	-9,521	-10,902	-13,812	-15,648	-17,948
Pre provision profit	10,350	14,116	15,178	17,193	19,005
Loan loss provisions	-5,036	-8,358	-5,332	-5,300	-4,735
Non-operating income	342	369	388	407	428
Pre tax profit	5,314	5,758	9,846	11,893	14,270
Tax	-1,505	-1,266	-2,047	-2,460	-2,940
Net profit	4,151	4,861	8,187	9,840	11,758

PER SHARE DATA (NT$)	1998A	1999A	2000E	2001E	2002E
EPS	1.05	1.23	2.06	2.46	2.94
DPS	0.00	0.00	0.00	0.00	0.00
Effective payout ratio (%)	*0%*	*0%*	*0%*	*0%*	*0%*
BVPS	12.15	13.29	15.37	17.86	20.84
ABVPS	12.15	12.78	15.37	17.86	20.84

VALUATION	1998A	1999A	2000E	2001E	2002E
Price to book value (x)	1.9	1.7	1.5	1.3	1.1
Price to adjusted book value (x)	1.9	1.8	1.5	1.3	1.1
Price to earnings (X)	21.8	18.7	11.2	9.4	7.8

PROFITABILITY RATIOS	1998A	1999A	2000E	2001E	2002E
(%)					
Net interest margin	2.32%	2.88%	2.89%	2.83%	2.75%
Yield on interest earning assets	8.03%	7.88%	7.71%	7.58%	7.51%
Cost on interest bearing liabilities	5.78%	5.07%	5.10%	5.09%	5.08%
Net interest spread	2.25%	2.82%	2.61%	2.49%	2.43%
Non-int. income (% Op income)	38.8%	35.9%	36.1%	36.0%	36.6%
Cost to income	47.9%	43.6%	47.6%	47.6%	48.6%
Overhead ratio	1.69%	1.80%	2.05%	2.01%	2.02%
Cost coverage	81.0%	82.4%	75.8%	75.5%	75.3%
ROA	0.74%	0.80%	1.21%	1.27%	1.32%
ROE	10.5%	10.4%	14.5%	15.0%	15.4%

DUPONT ANALYSIS	1998A	1999A	2000E	2001E	2002E
Lending operations					
Net interest margin	2.32%	2.88%	2.89%	2.83%	2.75%
Interest earnings assets/assets	94.92%	94.59%	94.95%	95.56%	95.81%
NIM contribution to ROA	2.21%	2.73%	2.74%	2.71%	2.64%
Non-interest operations					
Non-interest income/assets	1.37%	1.49%	1.55%	1.52%	1.52%
Overhead ratio	1.69%	1.80%	2.05%	2.01%	2.02%
Non-int. contribution to ROA	-0.32%	-0.32%	-0.49%	-0.49%	-0.50%
Asset quality analysis					
Provision/loans	-1.29%	-1.90%	-1.06%	-0.91%	-0.71%
Loans/assets	69.11%	72.63%	74.32%	75.05%	75.51%
ROA effect from asset quality	-0.89%	-1.38%	-0.79%	-0.68%	-0.53%
Core ROA	0.99%	1.03%	1.46%	1.53%	1.61%
Non-core contibution to ROA	0.06%	0.06%	0.06%	0.05%	0.05%
Pre-tax ROA	1.05%	1.09%	1.52%	1.58%	1.65%
Tax rate	26.61%	20.67%	20.00%	20.00%	20.00%
After tax ROA	0.77%	0.86%	1.21%	1.27%	1.32%
Balance sheet leverage (x)	13.7	12.1	11.9	11.9	11.6
ROE	10.5%	10.4%	14.5%	15.0%	15.4%

BALANCE SHEET	1998A	1999A	2000E	2001E	2002E
(NT$m)					
Gross loans	419,364	470,494	545,122	636,504	726,076
Specific loan loss reserves	*0*	*0*	*0*	*0*	*0*
Loan loss reserves	*-5,575*	*-5,995*	*-6,302*	*-9,318*	*-11,084*
Net loans	413,789	464,499	538,819	627,186	714,992
Other earning assets	136,671	128,940	149,523	169,223	191,631
Other assets	30,401	34,970	33,221	35,716	38,679
Total Assets	580,862	628,409	721,564	832,125	945,302
Deposits	412,641	461,204	521,161	614,970	707,215
Other paying liabilities	114,935	110,255	119,076	129,792	142,772
Other liabilities	5,450	4,524	20,715	16,910	13,104
Total Liabilities	533,026	575,984	660,951	761,672	863,091
Minorities & other	0	0	0	0	0
Shareholders' funds	47,835	52,425	60,612	70,453	82,211

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

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

BALANCE SHEET RATIOS	1998A	1999A	2000E	2001E	2002E
(%)					
Loan-to-deposit	100.3%	100.7%	103.4%	102.0%	101.1%
Loan-to-deposit (incl. CDs)	0.0%	0.0%	0.0%	0.0%	0.0%
Equity to assets	8.2%	8.3%	8.4%	8.5%	8.7%
Tier 1 Capital	9.2%	9.2%	9.2%	9.2%	9.4%
Total Capital adequacy	9.2%	9.2%	9.2%	9.2%	9.4%
General reserves (% loans)	-1.33%	-1.27%	-1.16%	-1.46%	-1.53%
Specific reserves (% loans)	0.00%	0.00%	0.00%	0.00%	0.00%
Total loan provisions	-1.33%	-1.27%	-1.16%	-1.46%	-1.53%

ASSET QUALITY	1998A	1999A	2000E	2001E	2002E
Nonperforming loans	6,210	9,136	11,419	14,845	16,330
NPL ratio	1.7%	1.9%	2.1%	2.3%	2.2%
Total provisions/NPLs	89.8%	65.6%	55.2%	62.8%	67.9%

GROWTH RATES	1998A	1999A	2000E	2001E	2002E
(%)					
Income statement					
Net interest income		31.9%	15.5%	13.6%	11.5%
Non-interest income		16.5%	16.6%	12.8%	14.3%
Total operating income		25.9%	15.9%	13.3%	12.5%
Operating expenses		14.5%	26.7%	13.3%	14.7%
Pre-provision earnings		36.4%	7.5%	13.3%	10.5%
Loan loss provisions		66.0%	-36.2%	-0.6%	-10.7%
Net profit		17.1%	68.4%	20.2%	19.5%
Balance sheet					
Loan growth		12.3%	16.0%	16.4%	14.0%
Interest earning assets		7.8%	15.9%	16.0%	13.9%
Asset growth		8.2%	14.8%	15.3%	13.6%
Deposit growth		11.8%	13.0%	18.0%	15.0%
Shareholders funds		9.6%	15.6%	16.2%	16.7%

BANK SINOPAC (NT$16.10) 2-BUY

Investment Case

Niche in mortgage lending and other personal finance

Bank SinoPac is one of the 16 "new" banks granted a banking license in 1992. While SinoPac is considerably smaller, in terms of asset base, than the government-linked banks, it is a professionally run bank with a strong niche in mortgage financing. In the corporate banking segment, SinoPac has concentrated on serving the electronic/ technology manufacturers.

SinoPac's traditional niche is in serving the consumer, especially the homebuyer. Management concedes that demand for primary mortgage loans has been weak. However, the bank managed to boost its secondary mortgage business through attractive financing schemes. Additionally, the bank is also offering a personal revolving credit facility backed by a mortgage. The amount of revolving credit is limited to the principal repayment from the original mortgage loan. This ensures that the revolving credit is secured by collateral.

Excellent asset quality

Largely due to its exposure to the lower-credit risk mortgage segment, SinoPac boasts of having the best asset quality in the sector. Its NPL portfolio is (on a three-month past due basis) barely 1.0%. Such a low NPL ratio is indeed remarkable especially given that the official NPL ratio for the sector is 5.5%. More importantly, the bank's NPL coverage ratio is also the highest in the sector, at approximately 90%. Management emphasized that it would continue to improve its overall asset quality with aggressive write-offs and maintaining its current rate of provisioning. Prior to the crisis, the bank has managed to provide more than 100% of its NPLs every year.

An attractive merger and acquisition target

With high asset quality, a strong niche in consumer lending and attractive valuations, it is not surprising that SinoPac has become a prime merger and acquisition candidate. Especially with the MoF permitting domestic banks to be fully owned by foreign banks, the market has been rife with speculation that the bank is being sought after by both foreign and domestic banks. At the end of December 2000, Taiwan's leading investment bank, China Development Industrial Bank (CDIB) conceded that it is in the preliminary stages of merger talks with SinoPac. The latter bank's management, however, has stressed that nothing firm has been discussed and it is too early to say if the two banks will merge.

Valuation

In terms of shareholder make-up, SinoPac is one of the most widely held Taiwanese bank stocks with qualified foreign institutional investors holding more than 35% of the stock, a testimony to the bank's fundamentals. Indeed, the stock outperformed the broader market by 30% in 2000 and 22% in the past month. The stock is currently trading at a undemanding 1.2x PBR. However, its profitability lags Chinatrust and we continue to rate it a notch lower at 2-Buy.

Bank SinoPac

Share Price (NT$):	16.1	Index:	5136.13
52 Week Price Range (NT$):	24.6 - 11.2	Current Yield:	0.00%

Reuters Code:	2839.TW
Bloomberg Code:	2839 TT

INCOME STATEMENT	1998A	1999A	2000E	2001E	2002E
(NT$m)					
Interest income	12,603	12,613	14,236	16,361	18,763
Interest expense	-9,721	-9,146	-10,052	-11,522	-13,664
Net interest income	2,882	3,468	4,184	4,839	5,098
Ave. int. earnings assets	*172,625*	*187,186*	*209,354*	*244,200*	*280,457*
NIM (%)	1.70%	1.90%	2.00%	1.98%	1.82%
Non-interest income	1,465	2,418	3,058	3,446	3,817
Total operating income	4,347	5,886	7,241	8,285	8,915
Non-interest expenses	-2,761	-3,122	-3,509	-3,874	-4,464
Pre provision profit	1,586	2,764	3,732	4,410	4,451
Loan loss provisions	-288	-744	-608	-784	-502
Non-operating income	12	0	-170	-240	60
Pre tax profit	1,299	2,020	3,124	3,627	3,949
Tax	-305	-230	-399	-457	-541
Net profit	1,005	1,791	2,556	2,930	3,468

PER SHARE DATA (NT$)	1998A	1999A	2000E	2001E	2002E
EPS	0.58	1.03	1.47	1.68	1.99
DPS	0.00	0.34	0.00	0.00	0.00
Effective payout ratio (%)	*0%*	*33%*	*0%*	*0%*	*0%*
BVPS	11.20	11.93	13.40	15.08	17.07
ABVPS	11.20	11.50	13.31	14.86	16.90

VALUATION	1998A	1999A	2000E	2001E	2002E
Price to book value (x)	1.4	1.3	1.2	1.1	0.9
Price to adjusted book value (x)	1.4	1.4	1.2	1.1	1.0
Price to earnings (X)	27.9	15.7	11.0	9.6	8.1

PROFITABILITY RATIOS	1998A	1999A	2000E	2001E	2002E
(%)					
Net interest margin	1.70%	1.90%	2.00%	1.98%	1.82%
Yield on interest earning assets	7.45%	6.92%	6.80%	6.70%	6.69%
Cost on interest bearing liabilities	6.17%	5.38%	5.39%	5.38%	5.40%
Net interest spread	1.28%	1.53%	1.41%	1.32%	1.29%
Non-int. income (% Op income)	33.7%	41.1%	42.2%	41.6%	42.8%
Cost to income	63.5%	53.0%	48.5%	46.8%	50.1%
Overhead ratio	1.52%	1.58%	1.58%	1.50%	1.50%
Cost coverage	53.1%	77.5%	87.1%	88.9%	85.5%
ROA	0.55%	0.90%	1.15%	1.13%	1.16%
ROE	5.9%	9.3%	11.6%	11.8%	12.4%

DUPONT ANALYSIS	1998A	1999A	2000E	2001E	2002E
Lending operations					
Net interest margin	1.70%	1.90%	2.00%	1.98%	1.82%
Interest earnings assets/assets	95.02%	94.60%	94.28%	94.27%	94.16%
NIM contribution to ROA	1.62%	1.80%	1.88%	1.87%	1.71%
Non-interest operations					
Non-interest income/assets	0.81%	1.22%	1.38%	1.33%	1.28%
Overhead ratio	1.52%	1.58%	1.58%	1.50%	1.50%
Non-int. contribution to ROA	-0.71%	-0.36%	-0.20%	-0.17%	-0.22%
Asset quality analysis					
Provision/loans	-0.25%	-0.58%	-0.41%	-0.45%	-0.25%
Loans/assets	64.05%	64.28%	66.16%	66.61%	66.84%
ROA effect from asset quality	-0.16%	-0.38%	-0.27%	-0.30%	-0.17%
Core ROA	0.75%	1.07%	1.41%	1.40%	1.33%
Non-core contibution to ROA	0.00%	0.00%	-0.08%	-0.09%	0.02%
Pre-tax ROA	0.75%	1.07%	1.33%	1.31%	1.35%
Tax rate	23.29%	11.37%	13.50%	13.50%	13.50%
After tax ROA	0.57%	0.95%	1.15%	1.13%	1.16%
Balance sheet leverage (x)	10.3	9.8	10.1	10.4	10.6
ROE	5.9%	9.3%	11.6%	11.8%	12.4%

BALANCE SHEET	1998A	1999A	2000E	2001E	2002E
(NT$m)					
Gross loans	120,859	135,971	160,513	187,827	213,989
Specific loan loss reserves	*0*	*0*	*0*	*0*	*0*
Loan loss reserves	*-1,248*	*-1,195*	*-1,478*	*-1,756*	*-1,868*
Net loans	119,611	134,776	159,035	186,071	212,121
Other earning assets	62,652	57,333	67,564	75,728	86,993
Other assets	9,341	12,021	13,396	16,300	18,503
Total Assets	191,603	204,129	239,996	278,100	317,618
Deposits	160,701	164,109	187,084	217,017	260,421
Other paying liabilities	4,564	10,534	11,272	12,963	15,685
Other liabilities	6,860	8,684	18,282	21,833	11,757
Total Liabilities	172,125	183,327	216,638	251,813	287,862
Minorities & other	0	0	0	0	0
Shareholders' funds	19,479	20,802	23,358	26,287	29,755

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

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

BALANCE SHEET RATIOS	1998A	1999A	2000E	2001E	2002E
(%)					
Loan-to-deposit	74.4%	82.1%	85.0%	85.7%	81.5%
Loan-to-deposit (incl. CDs)	0.0%	0.0%	0.0%	0.0%	0.0%
Equity to assets	10.2%	10.2%	9.7%	9.5%	9.4%
Tier 1 Capital	15.5%	15.3%	14.6%	14.0%	13.9%
Total Capital adequacy	15.5%	15.3%	14.6%	14.0%	13.9%
General reserves (% loans)	-1.03%	-0.88%	-0.92%	-0.93%	-0.87%
Specific reserves (% loans)	0.00%	0.00%	0.00%	0.00%	0.00%
Total loan provisions	-1.03%	-0.88%	-0.92%	-0.93%	-0.87%

ASSET QUALITY	1998A	1999A	2000E	2001E	2002E
Nonperforming loans	1,041	1,627	1,806	2,167	2,276
NPL ratio	0.9%	1.2%	1.1%	1.2%	1.1%
Total provisions/NPLs	120.0%	73.5%	81.8%	81.0%	82.1%

GROWTH RATES	1998A	1999A	2000E	2001E	2002E
(%)					
Income statement					
Net interest income		20.3%	20.6%	15.7%	5.4%
Non-interest income		65.0%	26.4%	12.7%	10.8%
Total operating income		35.4%	23.0%	14.4%	7.6%
Operating expenses		13.1%	12.4%	10.4%	15.2%
Pre-provision earnings		74.3%	35.0%	18.2%	0.9%
Loan loss provisions		158.7%	-18.3%	29.0%	-35.9%
Net profit		78.1%	42.7%	14.6%	18.4%
Balance sheet					
Loan growth		12.7%	18.0%	17.0%	14.0%
Interest earning assets		5.3%	18.0%	15.6%	14.2%
Asset growth		6.5%	17.6%	15.9%	14.2%
Deposit growth		2.1%	14.0%	16.0%	20.0%
Shareholders funds		6.8%	12.3%	12.5%	13.2%

TAISHIN INTERNATIONAL BANK (NT$16.40) 3-MARKET PERFORM

Investment Case

A top tier credit card issuer

Taishin International Bank is one of the 16 private banks and was granted its banking license in 1992. While the bank has an almost equal split between its corporate and consumer banking loan books, it is best known as a major credit card issuer. With over one million cards in force, Taishin is the second largest domestic issuer in Taiwan.

The bank was the first among the 16 new private banks to issue credit cards. In 1998, it adopted a no annual fee policy in order to boost its card in force. Consequently, Taishin currently has 1.18 million cards issued, with the VISA credit card accounting for almost 80% of its card portfolio. Taishin has a 7% market share and ranks as the second largest domestic issuer (third largest if we include Citibank). Management stated that with its credit card business contributing about 25% of the bank's pretax profit, it would continue to focus on the growth in this segment. Through its tie-up with Shin Kong Matsukoshi, one of the leading department store chains in Taipei, management is confident that it can increase its card base to at least 2.1 million by the end of 2001, from the present 1.7 million cards.

Asset quality in line with other private sector banks

Taishin registered NPLs of 2.4% as of November 2000 is in line with those of other private banks in Taiwan. If we include the NPLs of state-owned banks, the sector NPLs were 5.5%. If we were to add the bank's Other Real Estate Owned (OREO), its total non-performing assets (NPA) ratio is slightly higher at 2.8%. Again, this ratio is very much in line with that of the private bank sector. Its OREO is low given its propensity to sell the backing collateral as soon as possible. Similar to other banks, Taishin has also been rather aggressive in writing off its bad debts. Coupled with the provisions that it has set aside, the bank currently has an NPL coverage ratio of 42%. While this ratio is comparable to that of the sector, we expect the bank to continue setting aside large provisions in order to improve its NPL coverage ratio to 57% this year.

Exposure to the construction sector is a concern

While management has done well to contain its NPLs, we would highlight that its exposure to the construction sector at 13% is higher than the sector average, which is only 4.1%. Management has conceded that its exposure to this segment is a concern, given how weak the construction industry has been, and thus it is looking to reduce its exposure to less than 10%.

Valuation

While Taishin is a fundamentally sound bank, we are worried about its exposure to the construction sector. As such, even though its valuation of 1.1x PBR is not demanding we would rate the stock as a market performer. For exposure to the small private sector banks, we recommend investors focus on SinoPac instead.

Taishin

Share Price (NT$):	16.4	Index:	5136.13
52 Week Price Range (NT$):	24.1 - 12.0	Current Yield:	0.00%
Reuters Code:	2844.TW		
Bloomberg Code:	2844 TT		

INCOME STATEMENT	1998A	1999A	2000E	2001E	2002E
(NT$m)					
Interest income	17,724	19,327	20,914	23,612	25,965
Interest expense	-11,799	-11,075	-11,834	-13,871	-15,979
Net interest income	5,925	8,253	9,081	9,741	9,986
Ave. int. earnings assets	*201,374*	*227,622*	*243,472*	*271,712*	*304,399*
NIM (%)	2.98%	3.68%	3.73%	3.58%	3.28%
Non-interest income	1,027	1,646	2,033	2,428	2,847
Total operating income	6,952	9,899	11,114	12,168	12,833
Non-interest expenses	-4,375	-4,904	-5,422	-6,002	-6,753
Pre provision profit	2,577	4,995	5,692	6,166	6,081
Loan loss provisions	-905	-2,820	-2,450	-2,596	-2,165
Non-operating income	138	78	0	0	0
Pre tax profit	1,673	2,175	3,242	3,570	3,916
Tax	-326	-436	-616	-678	-744
Net profit	1,485	1,816	2,626	2,892	3,172

PER SHARE DATA (NT$)	1998A	1999A	2000E	2001E	2002E
EPS	0.95	1.05	1.46	1.61	1.81
DPS	0.00	0.00	0.00	0.00	0.00
Effective payout ratio (%)	*0%*	*0%*	*0%*	*0%*	*0%*
BVPS	11.33	13.19	14.74	16.46	18.34
ABVPS	11.33	12.24	14.74	16.46	18.34

VALUATION	1998A	1999A	2000E	2001E	2002E
Price to book value (x)	1.4	1.2	1.1	1.0	0.9
Price to adjusted book value (x)	1.4	1.3	1.1	1.0	0.9
Price to earnings (X)	17.3	15.7	11.3	10.2	9.1

PROFITABILITY RATIOS	1998A	1999A	2000E	2001E	2002E
(%)					
Net interest margin	2.98%	3.68%	3.73%	3.58%	3.28%
Yield on interest earning assets	8.91%	8.62%	8.59%	8.69%	8.53%
Cost on interest bearing liabilities	6.06%	5.08%	5.14%	5.33%	5.39%
Net interest spread	2.85%	3.54%	3.45%	3.36%	3.14%
Non-int. income (% Op income)	14.8%	16.6%	18.3%	19.9%	22.2%
Cost to income	62.9%	49.5%	48.8%	49.3%	52.6%
Overhead ratio	2.08%	2.06%	2.13%	2.11%	2.12%
Cost coverage	23.5%	33.6%	37.5%	40.4%	42.2%
ROA	0.71%	0.76%	1.03%	1.02%	0.99%
ROE	9.7%	9.1%	11.2%	11.0%	10.8%

DUPONT ANALYSIS	1998A	1999A	2000E	2001E	2002E
Lending operations					
Net interest margin	2.98%	3.68%	3.73%	3.58%	3.28%
Interest earnings assets/assets	95.61%	95.46%	95.55%	95.64%	95.35%
NIM contribution to ROA	2.85%	3.52%	3.56%	3.43%	3.13%
Non-interest operations					
Non-interest income/assets	0.49%	0.69%	0.80%	0.85%	0.89%
Overhead ratio	2.08%	2.06%	2.13%	2.11%	2.12%
Non-int. contribution to ROA	-1.59%	-1.37%	-1.33%	-1.26%	-1.22%
Asset quality analysis					
Provision/loans	-0.60%	-1.59%	-1.26%	-1.22%	-0.91%
Loans/assets	72.00%	74.27%	76.08%	75.19%	74.30%
ROA effect from asset quality	-0.43%	-1.18%	-0.96%	-0.91%	-0.68%
Core ROA	0.83%	0.97%	1.27%	1.26%	1.23%
Non-core contibution to ROA	0.02%	0.03%	0.00%	0.00%	0.00%
Pre-tax ROA	0.85%	1.00%	1.27%	1.26%	1.23%
Tax rate	17.98%	19.37%	19.00%	19.00%	19.00%
After tax ROA	0.70%	0.81%	1.03%	1.02%	0.99%
Balance sheet leverage (x)	13.7	11.9	10.8	10.8	10.9
ROE	9.6%	9.6%	11.2%	11.0%	10.8%

BALANCE SHEET	1998A	1999A	2000E	2001E	2002E
(NT$m)					
Gross loans	171,580	186,197	205,834	226,751	254,315
Specific loan loss reserves	*0*	*0*	*0*	*0*	*0*
Loan loss reserves	*-1,658*	*-1,928*	*-2,402*	*-2,975*	*-3,686*
Net loans	169,922	184,268	203,432	223,775	250,628
Other earning assets	55,344	45,710	53,534	62,682	71,711
Other assets	10,255	11,409	11,269	13,479	16,199
Total Assets	235,521	241,388	268,235	299,937	338,538
Deposits	197,167	197,315	219,019	251,872	284,616
Other paying liabilities	20,095	21,265	22,859	26,745	29,687
Other liabilities	560	585	1,508	(6,422)	(6,678)
Total Liabilities	217,821	219,165	243,386	272,196	307,626
Minorities & other	0	0	0	0	0
Shareholders' funds	17,700	22,223	24,849	27,741	30,913

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

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

BALANCE SHEET RATIOS	1998A	1999A	2000E	2001E	2002E
(%)					
Loan-to-deposit	86.2%	93.4%	92.9%	88.8%	88.1%
Loan-to-deposit (incl. CDs)	0.0%	0.0%	0.0%	0.0%	0.0%
Equity to assets	7.5%	9.2%	9.3%	9.2%	9.1%
Tier 1 Capital	8.6%	9.2%	9.3%	9.4%	9.5%
Total Capital adequacy	0.0%	9.2%	9.3%	9.4%	9.5%
General reserves (% loans)	-0.97%	-1.04%	-1.17%	-1.31%	-1.45%
Specific reserves (% loans)	0.00%	0.00%	0.00%	0.00%	0.00%
Total loan provisions	-0.97%	-1.04%	-1.17%	-1.31%	-1.45%

ASSET QUALITY	1998A	1999A	2000E	2001E	2002E
Nonperforming loans	3,325	4,596	5,056	5,814	6,396
NPL ratio	1.9%	2.5%	2.5%	2.6%	2.5%
Total provisions/NPLs	49.8%	49.9%	42.0%	47.5%	51.2%

GROWTH RATES	1998A	1999A	2000E	2001E	2002E
(%)					
Income statement					
Net interest income		39.3%	10.0%	7.3%	2.5%
Non-interest income		60.3%	23.5%	19.4%	17.3%
Total operating income		42.4%	12.3%	9.5%	5.5%
Operating expenses		12.1%	10.6%	10.7%	12.5%
Pre-provision earnings		93.8%	14.0%	8.3%	-1.4%
Loan loss provisions		211.7%	-13.1%	5.9%	-16.6%
Net profit		22.3%	44.6%	10.1%	9.7%
Balance sheet					
Loan growth		8.4%	10.4%	10.0%	12.0%
Interest earning assets		2.2%	11.8%	11.6%	12.6%
Asset growth		2.5%	11.1%	11.8%	12.9%
Deposit growth		0.1%	11.0%	15.0%	13.0%
Shareholders funds		25.6%	11.8%	11.6%	11.4%

UNITED WORLD CHINESE COMMERCIAL BANK (NT$25.40) 4-MARKET UNDERPERFORM

Investment Case

Access to low cost deposits due to its status as the largest stock-clearing bank

UWCCB is the second largest private sector bank in Taiwan. Over the years, it has managed to establish a niche as the largest clearing bank for Taiwan's stock market. This gives the bank access to the deposits of the retail investor, which are very active in trading on the local market. Given that these deposits are liquid and easily transferable between accounts, they usually remain in UWCCB as virtually zero cost funds. This enables the bank to have lower average cost of funds compared to its peers.

In order to facilitate fund transfer for its clients who tend to do so using the PC, the bank tied-up with local ISP is.net to provide exclusive telecommunication lines to customers. Known as Virtual Private Dial-up Network (VPDN), this Intranet system allows its clients to perform fund transfers at home or at the office.

Weak asset quality

UWCCB has the highest NPLs among the banks under our coverage at 2.7% and NPL coverage of 40%. We would caution that such a ratio fails to include its exposure to the distressed Ever Fortune group. If we do so, NPLs would rise by 1.8 percentage points to 4.5%. This Ever Fortune issue highlights one of the key concerns that investors have over the banking sector. This conglomerate had to request a restructuring of its loan in September 2000, for which UWCCB is the lead creditor. However, despite having to lower the loan rate by 125bps and postponing principal repayments for two years, the MoF has allowed the banks to not classify the exposure as non-performing. We are also concerned about UWCCB's loan exposure to the real estate and construction sector, which stands at 25% of total loans as of September 2000.

Merger with state-controlled banks not positive

Following the passage of the merger bill in November 2000, the market started speculating that UWCCB might be merged with state-controlled Chiao Tung Bank and International Commercial Bank of China. While such a merger is positive for the sector as we have long argued that it is too fragmented, it would not be positive for UWCCB as all three banks are largely focused on corporate lending, and as such their business lines are less complementary. Additionally, being merged with a state-controlled bank would also be viewed negatively by the market, especially as layoffs are socially sensitive.

Valuation

Having rallied 20% in the past three months, the stock is currently trading at 1.3x PBR. Given that its expected ROE for this year is relatively low at 11%, the bank is consequently trading at a higher PER multiple. In fact at 11.5x prospective earnings, UWCCB is the most expensive stock in our universe. We have rated the stock a 4-Market Underperform.

UWCCB

Share Price (NT$):	25.4	Index:	5136.13
52 Week Price Range (NT$):	39.7 - 17.9	Current Yield:	2.16%

Reuters Code:	2826.TW
Bloomberg Code:	2826 TT

INCOME STATEMENT	1998A	1999A	2000E	2001E	2002E
(NT$m)					
Interest income	36,175	35,850	40,391	45,794	53,767
Interest expense	-23,893	-22,078	-25,092	-29,693	-35,816
Net interest income	12,282	13,773	15,299	16,101	17,952
Ave. int. earnings assets	*492,932*	*554,044*	*619,491*	*687,596*	*754,101*
NIM (%)	2.56%	2.55%	2.47%	2.34%	2.38%
Non-interest income	3,078	3,375	3,800	4,288	4,781
Total operating income	15,360	17,148	19,099	20,389	22,733
Non-interest expenses	-7,107	-7,255	-7,518	-7,963	-8,651
Pre provision profit	8,253	9,892	11,581	12,426	14,081
Loan loss provisions	-1,054	-2,320	-2,666	-3,506	-2,381
Non-operating income	48	35	0	0	0
Pre tax profit	7,199	7,573	8,915	8,920	11,701
Tax	-1,208	-1,235	-1,426	-1,427	-1,872
Net profit	6,040	6,373	7,488	7,493	9,828

PER SHARE DATA (NT$)	1998A	1999A	2000E	2001E	2002E
EPS	1.78	1.87	2.20	2.20	2.89
DPS	0.00	0.95	0.55	0.55	0.72
Effective payout ratio (%)	*0%*	*51%*	*25%*	*25%*	*25%*
BVPS	17.06	17.82	19.47	21.12	23.28
ABVPS	17.06	16.68	19.47	21.12	23.28

VALUATION	1998A	1999A	2000E	2001E	2002E
Price to book value (x)	1.5	1.4	1.3	1.2	1.1
Price to adjusted book value (x)	1.5	1.5	1.3	1.2	1.1
Price to earnings (X)	14.3	13.6	11.6	11.5	8.8

PROFITABILITY RATIOS	1998A	1999A	2000E	2001E	2002E
(%)					
Net interest margin	2.56%	2.55%	2.47%	2.34%	2.38%
Yield on interest earning assets	7.55%	6.63%	6.52%	6.66%	7.13%
Cost on interest bearing liabilities	5.02%	4.19%	4.25%	4.54%	5.01%
Net interest spread	2.52%	2.44%	2.27%	2.12%	2.12%
Non-int. income (% Op income)	20.0%	19.7%	19.9%	21.0%	21.0%
Cost to income	46.3%	42.3%	39.4%	39.1%	38.1%
Overhead ratio	1.36%	1.23%	1.15%	1.10%	1.09%
Cost coverage	43.3%	46.5%	50.5%	53.9%	55.3%
ROA	1.15%	1.08%	1.14%	1.03%	1.24%
ROE	13.1%	10.7%	11.8%	10.8%	13.0%

DUPONT ANALYSIS	1998A	1999A	2000E	2001E	2002E
Lending operations					
Net interest margin	2.56%	2.55%	2.47%	2.34%	2.38%
Interest earnings assets/assets	94.23%	94.25%	94.46%	94.82%	95.10%
NIM contribution to ROA	2.41%	2.40%	2.33%	2.22%	2.26%
Non-interest operations					
Non-interest income/assets	0.59%	0.57%	0.58%	0.59%	0.60%
Overhead ratio	1.36%	1.23%	1.15%	1.10%	1.09%
Non-int. contribution to ROA	-0.77%	-0.66%	-0.57%	-0.51%	-0.49%
Asset quality analysis					
Provision/loans	-0.33%	-0.65%	-0.68%	-0.81%	-0.51%
Loans/assets	61.67%	60.61%	60.04%	59.70%	59.23%
ROA effect from asset quality	-0.20%	-0.39%	-0.41%	-0.48%	-0.30%
Core ROA	1.44%	1.35%	1.36%	1.23%	1.48%
Non-core contibution to ROA	0.01%	0.01%	0.00%	0.00%	0.00%
Pre-tax ROA	1.45%	1.35%	1.36%	1.23%	1.48%
Tax rate	16.67%	16.23%	16.00%	16.00%	16.00%
After tax ROA	1.21%	1.13%	1.14%	1.03%	1.24%
Balance sheet leverage (x)	11.4	9.9	10.3	10.5	10.5
ROE	13.7%	11.2%	11.8%	10.8%	13.0%

BALANCE SHEET	1998A	1999A	2000E	2001E	2002E
(NT$m)					
Gross loans	342,817	376,896	419,050	457,542	494,726
Specific loan loss reserves	*0*	*0*	*0*	*0*	*0*
Loan loss reserves	*-3,456*	*-3,658*	*-4,756*	*-5,961*	*-7,019*
Net loans	339,360	373,238	414,294	451,580	487,707
Other earning assets	184,815	210,676	240,774	268,545	300,370
Other assets	31,930	35,706	36,927	38,204	39,538
Total Assets	556,105	619,620	691,995	758,329	827,615
Deposits	421,646	494,490	553,829	609,212	657,948
Other paying liabilities	75,335	63,079	69,387	75,632	86,976
Other liabilities	1,224	1,369	2,482	1,568	3,401
Total Liabilities	498,205	558,938	625,697	686,411	748,325
Minorities & other	0	0	0	0	0
Shareholders' funds	57,900	60,682	66,298	71,918	79,289

LOAN BOOK	1998A	1999A	2000E	2001E	2002E
(NT$m)					
Manufacturing	23,997	30,152	33,524	37,212	41,677
Construction	6,856	7,538	8,381	9,051	9,866
Trading	17,141	15,076	16,762	17,935	19,370
Real estate	54,851	75,379	96,381	113,730	133,064
Commerce	17,141	22,614	23,467	24,405	25,382
Individuals	198,834	203,524	209,525	216,230	229,203
Gov't institutions	3,428	3,769	1,676	1,844	2,065
Others	20,569	18,845	29,333	33,734	38,794
Total loans	342,817	376,896	419,050	454,141	499,421

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

BALANCE SHEET RATIOS	1998A	1999A	2000E	2001E	2002E
(%)					
Loan-to-deposit	80.5%	75.5%	74.8%	74.1%	74.1%
Loan-to-deposit (incl. CDs)	0.0%	0.0%	0.0%	0.0%	0.0%
Equity to assets	10.4%	9.8%	9.6%	9.5%	9.6%
Tier 1 Capital	13.2%	13.2%	13.0%	12.9%	13.2%
Total Capital adequacy	13.2%	13.2%	13.0%	12.9%	13.2%
General reserves (% loans)	-1.01%	-0.97%	-1.13%	-1.30%	-1.42%
Specific reserves (% loans)	0.00%	0.00%	0.00%	0.00%	0.00%
Total loan provisions	-1.01%	-0.97%	-1.13%	-1.30%	-1.42%

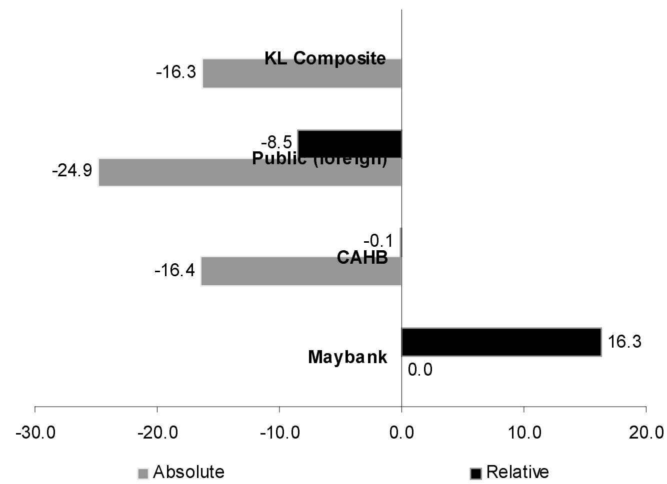
ASSET QUALITY	1998A	1999A	2000E	2001E	2002E
Nonperforming loans	8,944	10,459	11,505	13,231	14,554
NPL ratio	2.6%	2.8%	2.7%	2.9%	2.9%
Total provisions/NPLs	38.6%	35.0%	41.3%	45.1%	48.2%

GROWTH RATES	1998A	1999A	2000E	2001E	2002E
(%)					
Income statement					
Net interest income		12.1%	11.1%	5.2%	11.5%
Non-interest income		9.6%	12.6%	12.8%	11.5%
Total operating income		11.6%	11.4%	6.8%	11.5%
Operating expenses		2.1%	3.6%	5.9%	8.6%
Pre-provision earnings		19.9%	17.1%	7.3%	13.3%
Loan loss provisions		120.0%	15.0%	31.5%	-32.1%
Net profit		5.5%	17.5%	0.1%	31.2%
Balance sheet					
Loan growth		10.0%	11.0%	9.0%	8.0%
Interest earning assets		11.4%	12.3%	10.0%	9.5%
Asset growth		11.4%	11.7%	9.6%	9.1%
Deposit growth		17.3%	12.0%	10.0%	8.0%
Shareholders funds		4.8%	9.3%	8.5%	10.2%

MALAYSIAN BANKS

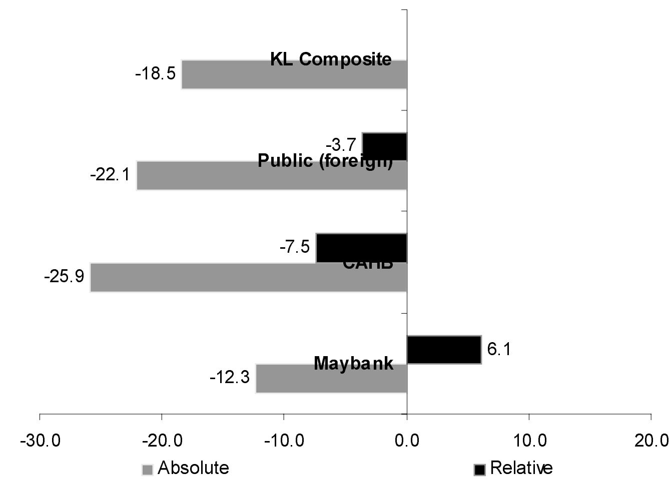
We are maintaining our Underweight position in Malaysian banks and expect that the share price performance of these banks will continue to drift sideways as a result of continual "merger pains". In 2000, the shares of Public Bank and Commerce Asset were down on the year, 25% and 16% respectively. Meanwhile, the shares of Maybank, were flat on the year. Although Maybank has been having problems with the acquisition of Phileo Allied, the small size of this target will not have any meaningful impact on the acquisitor. The next phase of the merger process will require integrating back offices and information technology platforms as well as streamlining branch networks and consolidating staff numbers. The whole process will still require significant management time and effort, and we believe the core banking operations will suffer, which will be reflected in share price performances.

Figure 21: 12-Month Price Performance



Source: Lehman Brothers

Figure 22: 6-Month Price Performance



Source: Lehman Brothers

Six down, three in the process and one starting from scratch

Of the ten proposed mergers, six were completed on time, three are in the final stages and one is starting over again. The following banks have completed theist merger processes: Bumiputra-Commerce, RHB Bank, Hong Leong Bank, Multi-Purpose bank, Southern Bank and EON Bank. Meanwhile the following are still in the process of completing there mergers (largely paper work): Maybank has been given until January 29 to finalize its acquisition of PhileoAllied, Public Bank has revised its agreement with Hock Hua Bank and is in the process of completing this transaction, while Perwira Affin Bank is also in the final stages of its acquisition of BSN Merchant Bankers. The only transaction that could not be completed was the one between AMMB and Utama Bank Group, which has now been cancelled. Consequently, AMMB is now seeking to acquire MBf Finance from Danmodal and the Utama Group is pursuing a merger with EON Bank.

In all, 94% of total bank assets of the domestic banking sector have been rationalized and consolidated. The government is forcing its 21 banks, 25 finance companies and 12 merchant banks to merge into ten anchor institutions.

Despite the "lack of pain" that Malaysia's banking system has had to endure relative to its regional counterparts, it is undertaking ambitious banking sector reforms and consolidation. Industry consolidation was on the agenda long before the crisis, however with little results — five mergers in the last 15 years. While we view consolidation as a positive, policy driven consolidation runs the risk of moral hazard.

Thus, because market-driven consolidation was not occurring fast enough, 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.

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 recently indicated that it will allow voluntary separation schemes. In addition, revenue enhancement and organizational synergy will also be limited given the current weak demand for credit. However, over the longer term, banks will benefit from natural attrition of staff and the return to meaningful loan growth.

Now that the mergers are largely complete, the next hurdle is the RM2 billion capital minimum requirement 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 may be a lot of capital raising efforts in the market this year.

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. We project that the cost to income ratio at the three banks that we cover will increase an average of 6.3 percentage points to an average of 40%. Thus, cost savings from the mergers are not likely to accrue for at least two to three years.

NPLs on the rise

Gross NPLs (on a three-month basis) in Malaysia increased by 1.6% to approximately RM50.7 billion at the end of October. This was the second straight month that NPLs increased, which is of concern, but not distressful because the overall NPL ratio in the country is still low. The NPL ratio for Malaysia is 11.3% at the end of October, which is a significant improvement from the 15.3% at the start of the year.

Resumption of loan growth, driven by consumer finance

Loan growth appears to be recovering, following two years of contraction. In 1998 and 1999, loans contracted by 2% and 5% respectively, loans have increased by 4.1% in the first 11 months of 2000. Although this is good 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 16% since the beginning of 2000 to account for 55% 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% throughout the year, up from 76% at the end of 1998 and 85% at the end of 1999. Manufacturing loans, which account for 15% of total loans, increased by only 4% during the year, which is surprising given the high capacity utilization ratio of 85% throughout the year – this is the level at which corporates are likely to consider investing in machinery and equipment.

Looking ahead, we expect loan growth to continue to be weak and banks to struggle to achieve loan growth of 5-8%. However, the 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.

Interest rate outlook

The direction of interest rates in the U.S. will have little impact on local rates due primarily to the capital controls that were put in place in 1998. U.S. interest rates increased by 100 basis points in 2000, but the base lending rate (BLR) declined by 30 basis points over this period. BLR, is effectively set by the central bank by way of the intervention rate and statutory reserve requirements.

Malaysia has coped with a dysfunctional interest rate environment all year, whereby 3-month deposit rates (approximately 3.45% at the end of 2000) were 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 those 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 are projecting inflation to remain benign at 2.8% 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.

MALAYAN BANK (RM13.80) 2-BUY

Lowering rating to 2-Buy

We are lowering our rating on the shares of Maybank to 2-Buy, which would be our only exposure in the sector. Maybank is the only bank in Malaysia not to record a share price decline in 2000 – it did not report a gain either as its share price ended the year at the same level as it started the year. However, on a relative basis, Maybank outperformed the KL Composite by 16%.

Although Maybank's merger plans are proceeding, we expect it, along with all the other banks, to experience integration problems. Integration, consolidation of branch networks and staff retrenchments are all key components of any successful merger. However, we believe that all three will involve significant expenses in terms of technology spending as well as staff severance packages. Thus, for any exposure to Malaysia, we would recommend Maybank.

The integration process will require additional expenditure on technology as well as staff retrenchment expenses. Consequently, the cost-to-income ratio is expected to increase to 34% in 2001, from 32% in 2000.

Bigger is better – size has its advantages. Size is one of Maybank's competitive advantages, and the recent mergers have not changed this as it will control a market share of close to 25% on all metrics, assets, loans and deposits, all of which are almost twice that of its nearest competitor. The competitive advantage is garnered through its extensive branch network of 421 branches combined with its relationship with the government, which together, has resulted in a core of cheap deposits.

Earnings growth to come from lower loan loss provisions

Strong earnings growth will be attributed to lower loan loss provisions as core operations are expected to remain weak. After reporting loan growth of 5% in 2000, we project Maybank will improve on this and report loan growth of 8% in each of the following two years. However, this figure is dragged down by contraction in the region. Loans for use in Malaysia are expected to increase by almost 10% in 2001 and 2002, following 7.5% growth in 2000. The key driver to loan growth will be mortgages.

Superior asset quality and conservative loan loss reserve policy.

Maybank's lending policies have been prudent, resulting in the second best asset quality in the sector, behind only Public Bank. NPLs on a three-month basis were only 9.7% at the end of September 2000, well below the industry figure of 11.3%. Meanwhile, these NPLs are well provided for. The general loan loss reserve is equivalent to 3.6% of total loan and the reserve coverage of NPLs is close to 90%, both of which are better than even Public Bank.

Malayan Bank Berhad

Share Price:	13.80	Index:	664
52 Week Price Range:	13.50-17.80	Current Yield:	0.9%

Reuters Code:	vMBM.MK
Bloomberg Code:	MAY.MK

INCOME STATEMENT	1998A	1999A	2000A	2001E	2002E
(HK$m)					
Interest income	11,755	9,609	7,566	7,850	8,128
Interest expense	-7,715	-6,148	-3,769	-3,908	-3,966
Net interest income	4,040	3,460	3,797	3,941	4,162
Ave. interest earnings assets	*109,425*	*117,040*	*126,991*	*135,052*	*145,808*
NIM (%)	4.08%	3.23%	2.99%	2.92%	2.85%
Non-interest income	973	1,152	1,265	1,087	1,125
Total operating income	5,013	4,612	5,062	5,029	5,287
Non-interest expenses	-1,627	-1,437	-1,594	-1,729	-1,770
Pre provision profit	3,386	3,175	3,468	3,300	3,517
Loan loss provisions	-2,909	-2,274	-1,520	-896	-821
Non-operating income	76	110	190	199	209
Pre tax profit	553	1,011	2,137	2,604	2,905
Tax	-442	-59	-764	-781	-872
After tax profit	111	952	1,374	1,822	2,034
Minority interest	18	18	-14	1	1
Net profit	130	970	1,360	1,824	2,035

PER SHARE DATA	1998A	1999A	2000A	2001E	2002E
(HK$)					
Earnings per share	0.06	0.42	0.58	0.78	0.87
Dividends per share	0.05	0.09	0.13	0.14	0.22
Effective payout ratio (%)	0.95	0.20	0.22	0.19	0.25
Book value per share	3.68	3.99	4.44	5.21	5.94
Adjusted book value per share	3.68	3.59	4.44	5.21	5.94

VALUATION	1998A	1999A	2000A	2001E	2002E
(X)					
Price to book value (x)	1.1	2.9	3.0	2.6	2.3
Price to adjusted book value (x)	1.1	3.2	3.0	2.6	2.3
Price to earnings (X)	73.7	26.9	23.2	17.7	15.8

PROFITABILITY RATIOS	1998A	1999A	2000A	2001E	2002E
(%)					
Net interest margin	4.08%	3.23%	2.99%	2.92%	2.85%
Yield on interest earning assets	10.7%	8.2%	6.0%	5.8%	5.6%
Cost on interest bearing liabilities	8.3%	6.3%	3.7%	3.6%	3.4%
Net interest spread	2.46%	1.89%	2.30%	2.19%	2.20%
Non-int. income (% Op income)	19.4%	25.0%	25.0%	21.6%	21.3%
Cost to income	32.45%	31.17%	31.49%	34.38%	33.48%
Overhead ratio	1.49%	1.23%	1.26%	1.28%	1.21%
Cost coverage	60%	80%	79%	63%	64%
ROA	0.12%	0.84%	1.10%	1.40%	1.44%
ROE	1.5%	11.0%	13.7%	16.3%	15.6%

DUPONT ANALYSIS	1998A	1999A	2000A	2001E	2002E
Lending operations					
Net interest margin	4.08%	3.23%	2.99%	2.92%	2.85%
Interest earnings assets/assets	97%	101%	103%	104%	103%
NIM contribution to ROA	3.97%	3.26%	3.08%	3.02%	2.95%
Non-interest operations					
Non-interest income/assets	0.87%	0.99%	1.03%	0.83%	0.80%
Overhead ratio	1.45%	1.24%	1.29%	1.32%	1.26%
Non-int. contribution to ROA	-0.58%	-0.25%	-0.27%	-0.49%	-0.46%
Asset quality analysis					
Provision/loans	-3.47%	-2.72%	-1.74%	-0.95%	-0.80%
Loans/assets	74.49%	72.06%	71.10%	72.31%	72.40%
ROA effect from asset quality	-2.59%	-1.96%	-1.23%	-0.69%	-0.58%
Core ROA	0.80%	1.05%	1.58%	1.84%	1.91%
Non-core contribution to ROA	0.1%	0.1%	0.1%	0.2%	0.1%
Pre-tax ROA	0.49%	1.16%	1.72%	2.00%	2.06%
Tax rate	79.9%	5.8%	35.7%	30.0%	30.0%
After tax ROA	0.1%	0.8%	1.1%	1.4%	1.4%
Balance sheet leverage (x)	13.2	13.2	12.4	11.7	10.8
ROE	1.5%	11.0%	13.7%	16.3%	15.6%

BALANCE SHEET	1998A	1999A	2000A	2001E	2002E
(HK$m)					
Gross loans	83,786	83,585	87,586	94,339	102,090
Specific loan loss reserves	*-2,740*	*-3,593*	*-4,106*	*-4,480*	*-4,773*
General loan loss reserves	*-2,671*	*-2,728*	*-3,170*	*-3,414*	*-3,694*
Net loans	81,115	80,857	84,416	90,925	98,395
Other earning assets	16,348	19,985	19,069	20,643	22,524
Other assets	17,051	16,637	22,187	23,898	25,861
Total Assets	114,514	117,479	125,673	135,466	146,780
Deposits	70,025	77,551	84,899	89,625	95,059
Other paying liabilities	32,406	26,999	26,197	29,126	32,928
Other liabilities	3,676	3,711	4,205	4,536	4,914
Total Liabilities	106,107	108,261	115,301	123,287	132,901
Minorities & other	0	0	0	0	0
Shareholders' funds	8,408	9,217	10,372	12,179	13,879

LOAN BOOK	1998A	1999A	2000A	2001E	2002E
(RMm)					
Manufacturing	10,233	10,082	11,170	12,330	13,610
Construction & real estate	11,687	12,990	11,726	11,726	11,726
Purchase of landed property	9,666	11,806	14,169	17,223	20,934
Fin. insur. & bus. service	7,235	10,512	10,688	11,122	11,573
Other Commercial	9,360	10,039	10,493	11,003	11,542
Purchase of securities	9,781	7,075	6,922	7,203	7,495
Purchase of transp. vehicles	4,782	5,281	5,854	6,462	7,133
Consumption credit	2,293	2,266	2,743	3,209	3,754
Others	2,966	2,082	2,848	2,964	3,084
Total domestic loans	63,742	66,912	71,962	78,716	86,466
Loans outside Malaysia	20,043	16,673	15,624	15,624	15,624
Total loans	83,786	83,585	87,586	94,339	102,090

LOAN BOOK BREAKDOWN	1998A	1999A	2000A	2001E	2002E
(%)					
Manufacturing	12%	12%	13%	13%	13%
Construction & real estate	14%	16%	13%	12%	11%
Purchase of landed property	12%	14%	16%	18%	21%
Fin. insur. & bus. service	9%	13%	12%	12%	11%
Other Commercial	11%	12%	12%	12%	11%
Purchase of securities	12%	8%	8%	8%	7%
Purchase of transp. vehicles	6%	6%	7%	7%	7%
Consumption credit	3%	3%	3%	3%	4%
Others	4%	2%	3%	3%	3%
Total domestic loans	76%	80%	82%	83%	85%
Loans outside Malaysia	24%	20%	18%	17%	15%
Total loans	100%	100%	100%	100%	100%

BALANCE SHEET RATIOS	1998A	1999A	2000A	2001E	2002E
(%)					
Loan-to-deposit	119.7%	107.8%	103.2%	105.3%	107.4%
Equity to assets	7.3%	7.8%	8.3%	9.0%	9.5%
Tier 1 Capital	11.2%	10.2%	11.0%	11.3%	11.8%
Total Capital adequacy	14.5%	14.8%	15.2%	14.9%	15.4%
General reserves (% loans)	-3.2%	-3.3%	-3.6%	-3.6%	-3.6%
Specific reserves (% loans)	-3.27%	-4.30%	-4.69%	-4.75%	-4.68%
Total loan provisions	-6.46%	-7.56%	-8.31%	-8.37%	-8.29%

ASSET QUALITY	1998A	1999A	2000A	2001E	2002E
Nonperforming loans	7,024	8,885	8,628	8,664	8,817
NPL ratio	8.4%	10.6%	9.9%	9.2%	8.6%
Total provisions/NPLs	77.0%	71.1%	84.3%	91.1%	96.0%

GROWTH RATES	1998A	1999A	2000A	2001E	2002E
(%)					
Income statement					
Net interest income	24.6%	-14.3%	9.7%	3.8%	5.6%
Non-interest income	-3.1%	18.4%	9.8%	-14.0%	3.4%
Total operating income	18.0%	-8.0%	9.7%	-0.7%	5.1%
Operating expenses	114.8%	-11.6%	10.9%	8.5%	2.4%
Pre-provision earnings	-16.7%	-6.3%	9.2%	-4.8%	6.6%
Loan loss provisions	337.9%	-21.8%	-33.1%	-41.1%	-8.3%
Net profit	-95.7%	755.0%	44.3%	32.6%	11.6%
Balance sheet					
Loan growth	22.9%	-0.2%	4.8%	7.7%	8.2%
Interest earning assets	13.1%	3.4%	3.0%	7.8%	8.4%
Asset growth	3.7%	2.6%	7.0%	7.8%	8.4%
Deposit growth	7.6%	10.7%	9.5%	5.6%	6.1%
Shareholders funds	-2.0%	9.6%	12.5%	17.4%	14.0%

COMMERCE ASSET HOLDING BERHAD (RM7.85) 3-MARKET PERFORM

We are maintaining our 3-Market Perform rating on the shares of Commerce Asset Holdings. These shares declined by 16% in 2000, which was in line with the performance of the KL Composite. However, in the second half of the year when merger problems became more apparent, the shares declined by 26%, underperforming the KL Composite by almost 8%. We believe further integration problems will continue to suppress sentiment towards 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 the 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.

Similar to the other banks, integration pains will result in additional expenses, resulting in a cost-to-income ratio of 48% in 2000, up from 35% in 1999. Management has indicated that the voluntary separation scheme to shed some 20% of staff will commence in June 2001, reducing 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. Our earnings model incorporates 10% loan growth in 2000 then increasing to 11% in each of the following two years – this may be aggressive, now that the merger is not going through as smoothly as first envisioned. The longer the merger process takes, the more management time and effort will be diverted from core lending operations.

Commerce Asset Holding Berhad

Share Price:	7.85	Index:	664
52 Week Price Range:	13.10-7.35	Current Yield:	0.01
Reuters Code:	:OMM.MK		
Bloomberg Code:	CAHB.MK		

INCOME STATEMENT	1998A	1999A	2000E	2001E	2002E
(HK$m)					
Interest income	2,247	2,181	4,181	4,367	4,737
Interest expense	-1,525	-1,378	-2,370	-2,503	-2,635
Net interest income	722	803	1,812	1,864	2,102
Ave. interest earnings assets	*20,025*	*36,627*	*56,116*	*60,889*	*67,654*
NIM (%)	3.23%	1.97%	3.23%	3.06%	3.11%
Non-interest income	254	518	861	1,156	1,969
Total operating income	975	1,321	2,672	3,020	4,071
Non-interest expenses	-422	-456	-1,293	-1,418	-1,498
Pre provision profit	553	865	1,380	1,602	2,573
Loan loss provisions	-438	-423	-478	-483	-387
Non-operating income	-9	12	5	7	8
Pre tax profit	106	454	907	1,126	2,194
Tax	-54	-10	-245	-338	-675
After tax profit	52	444	662	788	1,519
Minority interest	31	-49	-36	-46	-56
Net profit	84	394	626	742	1,462

PER SHARE DATA	1998A	1999A	2000E	2001E	2002E
(HK$)					
Earnings per share	0.10	0.43	0.53	0.63	1.25
Dividends per share	0.05	0.06	0.05	0.13	0.26
Effective payout ratio (%)	0.48	0.14	0.10	0.21	0.21
Book value per share	4.13	4.05	4.62	5.66	7.70
Adjusted book value per share	4.13	1.82	3.12	4.91	7.45

VALUATION	1998A	1999A	2000E	2001E	2002E
(X)					
Price to book value (x)	0.7	0.7	1.8	1.4	1.0
Price to adjusted book value (x)	0.7	1.6	2.6	1.6	1.1
Price to earnings (X)	28.1	6.8	15.3	12.4	6.3

PROFITABILITY RATIOS	1998A	1999A	2000E	2001E	2002E
(%)					
Net interest margin	3.23%	1.97%	3.23%	3.06%	3.11%
Yield on interest earning assets	11.2%	6.0%	7.5%	7.2%	7.0%
Cost on interest bearing liabilities	8.2%	3.8%	4.3%	4.2%	4.1%
Net interest spread	3.03%	2.11%	3.19%	2.95%	2.93%
Non-int. income (% Op income)	26.0%	39.2%	32.2%	38.3%	48.4%
Cost to income	43.30%	34.53%	48.37%	46.96%	36.80%
Overhead ratio	2.11%	1.25%	2.30%	2.33%	2.21%
Cost coverage	60%	114%	67%	82%	131%
ROA	0.35%	0.88%	0.91%	1.00%	1.77%
ROE	2.6%	9.9%	12.2%	12.3%	18.7%

DUPONT ANALYSIS	1998A	1999A	2000E	2001E	2002E
Lending operations					
Net interest margin	3.23%	1.97%	3.23%	3.06%	3.11%
Interest earnings assets/assets	83%	97%	97%	96%	96%
NIM contribution to ROA	2.68%	1.91%	3.13%	2.95%	3.00%
Non-interest operations					
Non-interest income/assets	1.05%	1.15%	1.25%	1.55%	2.38%
Overhead ratio	1.75%	1.01%	1.88%	1.91%	1.81%
Non-int. contribution to ROA	-0.70%	0.14%	-0.63%	-0.35%	0.57%
Asset quality analysis					
Provision/loans	-2.78%	-1.23%	-1.26%	-1.15%	-0.83%
Loans/assets	65.39%	76.45%	55.02%	56.47%	56.65%
ROA effect from asset quality	-1.82%	-0.94%	-0.69%	-0.65%	-0.47%
Core ROA	0.17%	1.11%	1.81%	1.95%	3.10%
Non-core contribution to ROA	0.1%	-0.1%	0.0%	-0.1%	-0.1%
Pre-tax ROA	0.44%	1.03%	1.76%	1.90%	3.04%
Tax rate	50.9%	2.2%	27.0%	30.0%	30.8%
After tax ROA	0.3%	0.9%	0.9%	1.0%	1.8%
Balance sheet leverage (x)	7.6	11.3	13.4	12.4	10.6
ROE	2.6%	9.9%	12.2%	12.3%	18.7%

BALANCE SHEET	1998A	1999A	2000E	2001E	2002E
(HK$m)					
Gross loans	15,758	34,410	37,897	42,032	46,782
Specific loan loss reserves	*-245*	*-1,012*	*-843*	*-1,165*	*-1,284*
General loan loss reserves	*-290*	*-602*	*-654*	*-725*	*-807*
Net loans	15,468	33,808	37,243	41,307	45,975
Other earning assets	7,967	31,658	30,374	33,458	37,252
Other assets	982	2,568	3,277	3,544	3,852
Total Assets	24,417	68,035	70,894	78,308	87,079
Deposits	13,249	43,865	47,704	52,909	58,889
Other paying liabilities	6,865	15,973	14,517	15,155	15,171
Other liabilities	1,080	3,501	3,262	3,608	3,997
Total Liabilities	21,194	63,339	65,483	71,673	78,058
Minorities & other	0	0	0	0	0
Shareholders' funds	3,223	4,695	5,411	6,636	9,021

LOAN BOOK	1998A	1999A	2000E	2001E	2002E
(RMm)					
Manufacturing	3,714	6,351	7,092	7,829	8,641
Construction & real estate	3,706	6,037	7,246	7,998	8,828
Purchase of landed property	2,426	8,039	8,292	10,079	12,251
Fin. insur. & bus. service	1,648	1,532	2,319	2,413	2,511
Other Commercial	3,288	7,308	7,810	8,209	8,633
Purchase of securities	1,441	2,014	2,050	2,133	2,220
Purchase of transp. vehicles	15	1,281	1,316	1,453	1,603
Consumption credit	228	1,657	1,843	2,156	2,523
Others	436	1,864	2,517	2,619	2,725
Total domestic loans	15,758	34,410	37,897	42,032	46,782
Loans outside Malaysia	0	0	0	0	0
Total loans	15,758	34,410	37,897	42,032	46,782

LOAN BOOK BREAKDOWN	1998A	1999A	2000E	2001E	2002E
(%)					
Manufacturing	24%	18%	19%	19%	18%
Construction & real estate	24%	18%	19%	19%	19%
Purchase of landed property	15%	23%	22%	24%	26%
Fin. insur. & bus. service	10%	4%	6%	6%	5%
Other Commercial	21%	21%	21%	20%	18%
Purchase of securities	9%	6%	5%	5%	5%
Purchase of transp. vehicles	0%	4%	3%	3%	3%
Consumption credit	1%	5%	5%	5%	5%
Others	3%	5%	7%	6%	6%
Total domestic loans	100%	100%	100%	100%	100%
Loans outside Malaysia	0%	0%	0%	0%	0%
Total loans	100%	100%	100%	100%	100%

BALANCE SHEET RATIOS	1998A	1999A	2000E	2001E	2002E
(%)					
Loan-to-deposit	118.9%	78.4%	79.4%	79.4%	79.4%
Equity to assets	13.2%	6.9%	7.6%	8.5%	10.4%
Tier 1 Capital	10.7%	13.8%	12.1%	13.4%	16.2%
Total Capital adequacy	14.2%	15.4%	13.5%	14.9%	18.0%
General reserves (% loans)	-1.8%	-1.7%	-1.7%	-1.7%	-1.7%
Specific reserves (% loans)	-1.55%	-2.94%	-2.22%	-2.77%	-2.75%
Total loan provisions	-3.39%	-4.69%	-3.95%	-4.50%	-4.47%

ASSET QUALITY	1998A	1999A	2000E	2001E	2002E
Nonperforming loans	1,677	5,194	4,668	3,811	3,052
NPL ratio	10.6%	15.1%	12.3%	9.1%	6.5%
Total provisions/NPLs	31.9%	31.1%	32.1%	49.6%	68.5%

GROWTH RATES	1998A	1999A	2000E	2001E	2002E
(%)					
Income statement					
Net interest income	25.7%	11.3%	125.5%	2.9%	12.8%
Non-interest income	-21.1%	103.9%	66.3%	34.4%	70.2%
Total operating income	8.9%	35.4%	102.3%	13.0%	34.8%
Operating expenses	107.9%	8.0%	183.4%	9.7%	5.6%
Pre-provision earnings	42.0%	56.4%	59.5%	16.1%	60.6%
Loan loss provisions	103.7%	-3.3%	12.9%	1.1%	-19.8%
Net profit	-45.1%	752.3%	49.3%	19.0%	92.7%
Balance sheet					
Loan growth	5.4%	118.4%	10.1%	10.9%	11.3%
Interest earning assets	8.7%	178.5%	3.3%	10.6%	11.3%
Asset growth	2.7%	178.6%	4.2%	10.5%	11.2%
Deposit growth	-0.5%	231.1%	8.8%	10.9%	11.3%
Shareholders funds	2.0%	45.7%	15.2%	22.6%	35.9%

PUBLIC BANK HOLDING BERHAD (RM3.08) 2-BUY

We are maintaining our 2-Buy rating on the shares of Public Bank and believe that its share price will recover following a terrible 2000, in which its share price declined by 25% and 22% on an 12-month and six-month basis, underperforming the index by 9% and 4% respectively. Public Bank has among the easiest mergers and should be able to concentrate on core lending operations ahead of other banks.

Public Bank has been able to take market share, increasing is loan book by almost 10% in 2000, versus market growth of only 4%. Key areas were mortgages, for which Public controls an 8% market share and accounts for over 20% of its loan book. Despite the strong top line growth, bottom line growth will be constrained by a higher tax charge in 2000 onwards.

Public Bank has the strongest balance sheet in the sector. Public has a tier 1 ratio of 18%, which is easily enough to carry out its merger as well as fund organic growth. 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% gets penalized. Public Bank has to put a portion of its deposit base into the interbank market and generate a negative spread. Thus we expect Public Bank it increase its loan-to-deposit ratio to 80% by 2001 and 83% by 2002.

Public Bank also has the best asset quality in the sector with a NPL ratio projected at 8.3% at the end of 2000. 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.

Coming out of the crisis, better capital management is needed. 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 is significantly below average at only 14%.

Public Bank Berhad

Share Price:	3.08	Index:	664.00	Reuters Code:	PYBM.MK
52 Week Price Range:	5.70-2.76	Current Yield:	0.02	Bloomberg Code:	PBKF.MK

INCOME STATEMENT	1998A	1999A	2000E	2001E	2002E
(HK$m)					
Interest income	4,363	3,142	2,849	2,852	3,069
Interest expense	-2,895	-1,662	-1,191	-1,194	-1,242
Net interest income	1,468	1,480	1,658	1,658	1,827
Ave. interest earnings assets	*40,302*	*43,020*	*43,268*	*46,640*	*52,284*
NIM (%)	3.64%	3.44%	3.83%	3.55%	3.49%
Non-interest income	394	434	525	649	716
Total operating income	1,862	1,914	2,183	2,307	2,543
Non-interest expenses	-794	-695	-832	-877	-921
Pre provision profit	1,068	1,219	1,351	1,429	1,622
Loan loss provisions	-887	-413	-249	-194	-182
Non-operating income	18	32	54	62	74
Pre tax profit	199	838	1,156	1,297	1,514
Tax	-112	-51	-374	-389	-454
After tax profit	87	787	782	908	1,060
Minority interest	-36	-171	-198	-255	-310
Net profit	51	616	584	653	750

PER SHARE DATA	1998A	1999A	2000E	2001E	2002E
(HK$)					
Earnings per share	0.05	0.26	0.25	0.28	0.32
Dividends per share	0.02	0.00	0.05	0.05	0.06
Effective payout ratio (%)	0.44	0.00	0.19	0.18	0.18
Book value per share	1.40	1.62	1.86	2.09	2.35
Adjusted book value per share	1.40	1.39	1.72	2.09	2.35

VALUATION	1998A	1999A	2000E	2001E	2002E
(X)					
Price to book value (x)	1.4	0.0	1.6	1.5	1.3
Price to adjusted book value (x)	1.4	0.0	1.7	1.5	1.3
Price to earnings (X)	44.3	0.0	12.0	11.2	9.7

PROFITABILITY RATIOS	1998A	1999A	2000E	2001E	2002E
(%)					
Net interest margin	3.64%	3.44%	3.83%	3.55%	3.49%
Yield on interest earning assets	10.8%	7.3%	6.5%	6.1%	5.9%
Cost on interest bearing liabilities	8.1%	4.6%	3.2%	2.9%	2.8%
Net interest spread	2.74%	2.75%	3.30%	3.22%	3.12%
Non-int. income (% Op income)	21.2%	22.7%	24.1%	28.1%	28.2%
Cost to income	42.64%	36.31%	38.10%	38.03%	36.23%
Overhead ratio	1.97%	1.62%	1.90%	1.88%	1.76%
Cost coverage	50%	62%	63%	74%	78%
ROA	0.12%	1.43%	1.35%	1.38%	1.41%
ROE	1.7%	17.3%	14.0%	13.9%	14.2%

DUPONT ANALYSIS	1998A	1999A	2000E	2001E	2002E
Lending operations					
Net interest margin	3.64%	3.44%	3.83%	3.55%	3.49%
Interest earnings assets/assets	96%	100%	100%	98%	98%
NIM contribution to ROA	3.50%	3.43%	3.82%	3.50%	3.43%
Non-interest operations					
Non-interest income/assets	0.94%	1.01%	1.21%	1.37%	1.35%
Overhead ratio	1.89%	1.61%	1.92%	1.85%	1.73%
Non-int. contribution to ROA	-0.95%	-0.60%	-0.71%	-0.48%	-0.39%
Asset quality analysis					
Provision/loans	-3.98%	-1.78%	-0.98%	-0.68%	-0.57%
Loans/assets	53.17%	53.76%	58.53%	59.86%	59.91%
ROA effect from asset quality	-2.12%	-0.96%	-0.57%	-0.41%	-0.34%
Core ROA	0.43%	1.87%	2.54%	2.61%	2.70%
Non-core contribution to ROA	0.0%	-0.3%	-0.3%	-0.4%	-0.4%
Pre-tax ROA	0.47%	1.54%	2.21%	2.20%	2.26%
Tax rate	56.2%	6.1%	32.3%	30.0%	30.0%
After tax ROA	0.1%	1.4%	1.3%	1.4%	1.4%
Balance sheet leverage (x)	13.7	12.1	10.4	10.1	10.1
ROE	1.7%	17.3%	14.0%	13.9%	14.2%

BALANCE SHEET	1998A	1999A	2000E	2001E	2002E
(HK$m)					
Gross loans	22,287	23,208	25,377	28,384	31,888
Specific loan loss reserves	*-800*	*-770*	*-783*	*-778*	*-788*
General loan loss reserves	*-431*	*-436*	*-486*	*-544*	*-611*
Net loans	21,856	22,772	24,891	27,840	31,277
Other earning assets	19,334	19,830	18,712	20,929	23,513
Other assets	762	726	1,185	1,421	1,623
Total Assets	41,952	43,328	44,788	50,191	56,412
Deposits	32,500	33,044	32,618	35,349	38,436
Other paying liabilities	4,015	5,349	6,504	8,509	10,883
Other liabilities	2,206	1,092	1,259	1,389	1,534
Total Liabilities	38,721	39,485	40,381	45,247	50,853
Minorities & other	0	0	0	0	0
Shareholders' funds	3,231	3,843	4,407	4,944	5,559

LOAN BOOK	1998A	1999A	2000E	2001E	2002E
(RMm)					
Manufacturing	1,529	1,661	1,709	1,886	2,082
Construction & real estate	3,066	2,628	2,785	2,785	2,785
Purchase of landed property	4,674	5,553	7,298	8,870	10,782
Fin. insur. & bus. service	1,725	1,751	1,469	1,529	1,591
Other Commercial	3,786	3,833	4,063	4,244	4,435
Purchase of securities	1,171	749	690	719	748
Purchase of transp. vehicles	4,622	4,344	4,353	4,805	5,304
Consumption credit	1,935	2,019	2,367	2,769	3,240
Others	612	948	1,224	1,274	1,325
Total domestic loans	22,287	23,208	25,377	28,384	31,888
Loans outside Malaysia	0	0	0	0	0
Total loans	22,287	23,208	25,377	28,384	31,888

LOAN BOOK BREAKDOWN	1998A	1999A	2000E	2001E	2002E
(%)					
Manufacturing	7%	7%	7%	7%	7%
Construction & real estate	14%	11%	11%	10%	9%
Purchase of landed property	21%	24%	29%	31%	34%
Fin. insur. & bus. service	8%	8%	6%	5%	5%
Other Commercial	17%	17%	16%	15%	14%
Purchase of securities	5%	3%	3%	3%	2%
Purchase of transp. vehicles	21%	19%	17%	17%	17%
Consumption credit	9%	9%	9%	10%	10%
Others	3%	4%	5%	4%	4%
Total domestic loans	100%	100%	100%	100%	100%
Loans outside Malaysia	0%	0%	0%	0%	0%
Total loans	100%	100%	100%	100%	100%

BALANCE SHEET RATIOS	1998A	1999A	2000E	2001E	2002E
(%)					
Loan-to-deposit	68.6%	70.2%	77.8%	80.3%	83.0%
Equity to assets	7.7%	8.9%	9.8%	9.8%	9.9%
Tier 1 Capital	16.2%	19.8%	18.6%	18.9%	19.1%
Total Capital adequacy	17.9%	21.9%	24.4%	24.7%	25.0%
General reserves (% loans)	-1.9%	-1.9%	-1.9%	-1.9%	-1.9%
Specific reserves (% loans)	-3.59%	-3.32%	-3.09%	-2.74%	-2.47%
Total loan provisions	-5.52%	-5.20%	-5.00%	-4.66%	-4.39%

ASSET QUALITY	1998A	1999A	2000E	2001E	2002E
Nonperforming loans	2,642	2,360	2,114	1,625	1,325
NPL ratio	11.9%	10.2%	8.3%	5.7%	4.2%
Total provisions/NPLs	46.6%	51.1%	60.0%	81.3%	105.6%

GROWTH RATES	1998A	1999A	2000E	2001E	2002E
(%)					
Income statement					
Net interest income	-4.8%	0.8%	12.0%	0.0%	10.2%
Non-interest income	-13.3%	10.1%	20.9%	23.5%	10.4%
Total operating income	-6.8%	2.8%	14.0%	5.7%	10.3%
Operating expenses	91.1%	-12.5%	19.7%	5.5%	5.0%
Pre-provision earnings	20.0%	14.1%	10.8%	5.8%	13.5%
Loan loss provisions	74.9%	-53.4%	-39.7%	-22.2%	-6.1%
Net profit	-81.4%	804.6%	-0.6%	16.1%	16.7%
Balance sheet					
Loan growth	-1.3%	4.1%	9.3%	11.9%	12.3%
Interest earning assets	6.8%	3.4%	2.4%	11.9%	12.3%
Asset growth	0.2%	3.3%	3.4%	12.1%	12.4%
Deposit growth	1.0%	1.7%	-1.3%	8.4%	8.7%
Shareholders funds	12.4%	18.9%	14.7%	12.2%	12.5%

THAI BANKS

We continue to be aggressively UNDERWEIGHT the Thai banking sector, due primarily to poor fundamentals. While asset quality has improved during the year, balance sheet strength in general has deteriorated, as capital used to write down assets has not been replenished due to fleeing investors and widespread insolvency.

Our rationale against investment in Thai banks rests on the following key points:

- Losses are Not Yet Covered and Possibly Unknown: Known loan losses, even using banks' internal classifications, have yet to be provided for, resulting in substantial reserve underfunding. In addition, we believe that there are still unrecorded—and perhaps substantial—losses in the loan and securities portfolios.

- Pervasive Insolvency: Primarily due to reserve deficiencies, every bank in our Thai universe save for Krung Thai (post its extraordinary government bail-out) is insolvent, with capital shortfalls ranging from Bt10.0 billion at IFCT (1.02x capital) to Bt143 billion at Bangkok Bank (5.40x capital). These banks will all be forced back to market for capital at least once over the next 18-24 months.

- Insufficient Management Depth: Managements have shown little ability (and much resistance) to deal with the fundamental changes in their business, somewhat understandable given the severity of their asset quality problems. Nevertheless, the system is in need of experienced international banking managers.

- Growing Competition From Foreign Banks: Given the arrival of foreign banks on the scene (UOB/Radanasin, DBS/Thai Danu, Standard Chartered/Nakornthon, ABN/Bank of Asia), domestic Thai banks can not afford to remain an isolated pocket of inefficiency. The aforementioned foreigners all have deep pools of experienced lenders, marketers, and workout staff, and have the ability to spread technology and branding costs over much larger bases. In addition, they have access to capital and low-cost foreign currency funding which the domestic banks lack.

- Low Loan Demand: Loan growth continues to be negative, even with excess liquidity and low interest rates. Slowing growth in most of Thailand's major export markets will not help matters, and China's pending WTO accession will substantially increase competition in many of Thailand's main industries, further limiting growth potential.

- Weak Supervision and Accounting Standards: The BOT has repeatedly rejiggered standards to meet the banks' reported numbers rather than forcefully imposing them.

Investment Opinion

Specific Recommendations in the Sector

We do not believe that the government will allow any of the prestigious large banks (BBL, TFB, and SCB) to go under, whatever the cost, and in recognition of this we assign their local shares our highest rating within the sector (3-Market Perform), as we do shares of the quasi-governmental IFCT. Brief comments:

- SCB (Top Pick): In the best financial shape of the commercial banks, SCB also trades at a more reasonable 1.2x adjusted book (pre-reserve adjustments). Where the two classes of shares trade near parity, we would avoid the common in favor of the preferred shares, which are convertible 1-for-1 into common but which offer interim downside protection, especially in the likely event of additional capital-raising.

- BBL: The weakest of the large banks, we expect BBL to attempt to raise capital again soon. While additional capital, if obtainable, will improve the bank's balance sheet, it will also likely reduce or eliminate the foreign share premium, now at over 40%. Because of these near term downside catalysts, we rate the foreign shares only 4-Market Underperform, with the local maintained at 3-Market Perform.

- TFB: Healthier than BBL, but at a high valuation price—over 3.3x adjusted book value with no earnings in sight.

- Avoid financially weak and marginal banks like Krung Thai, Thai Military, and Bank of Ayudhya.

Government Aid is Necessary

State Assistance Moves Closer to Reality

The situation in Thailand cries out for immediate and meaningful government intervention, as the public sector would appear to be the only entity capable and *willing* to inject the necessary capital (we estimate total capital needs at Bt950 billion, or US$24.4 billion) into the banks, particularly those with weak franchises. While the recent Krung Thai bail-out is a good first step, Thailand must remediate the industry's problems on a systemic basis.

- Realization and Disclosure of Losses. It's been years since most of these borrowers stopped paying their loans, bonds, and so on. Yet we still don't know with any certainty what the real cost of this was. It's time to go through these portfolios, classify loans and other assets according to international standards, write off accrued accounts that will never be paid and worthless equity swaps, and total up the check.

- Removal of NPLs. Sheehan's Iron Law of Bank Management states that once bad assets pass 10%, management must spend at least 90% of its time dealing with restructuring, credit workout, litigation and associated capital-raisings. With Thailand not expected to reach this level for at least 36 months, this means that bankers will not have substantial time (or capital) to devote to rationalizing their core operations, refocusing their product lines around high-margin consumer finance, and improving customer service for approximately the same amount of time. Such a delay will be fatal to the industry. To have any chance of redemption, the banks must have their NPLs removed.

- Consolidation and Closings. There are too many institutions in Thailand given the poor loan growth and profitability. In addition, with foreign competition having established substantial beachheads in the market, there is little reason to assume that Thailand needs to generate all of its financial growth through domestic banks. We believe that the country could profitably support six to eight commercial banks given current economic conditions, rather than 14.

- Staff Reductions and Branch Closings. In line with bank closings, redundant and overlapping branches should be closed. In addition, existing branches should be relocated to better reflect changing residential and working patterns. To their credit, many banks are making these changes, at least on a small scale, opening smaller "kiosk" branches, and even placing branches on the platforms of the Bangkok Sky Train.

- Best Practice Accounting and Supervision. Thailand's accounting and bank regulation are both suspect. Thailand should harmonize its GAAP with international standards and enforce disclosure appropriately. Likewise, the Bank of Thailand needs to adopt a credible regime of supervision, examination, and enforcement. Regulatory forbearance is no substitute for capital adequacy.

- Management Changes. In order to address serious current problems and upgrade the system for the future, Thailand needs to be importing talent aggressively from other industries and countries. There is not enough expertise within the system currently to overcome its problems and compete with foreign banks for domestic business.

Bank of Thailand Supervision

The Balancing Act Continues: Liquidity Prevents Systemic Failure

NPLs and negative capital are not the proximate causes of bank failure, although they are usually at the root of the problem. The real culprit is liquidity, and on this score the Bank of Thailand (BOT) and banks have acted brilliantly to maintain public confidence in the banking system. Despite the persistent level of technical insolvency in the Thai banking sector, the resultant high level of liquidity is preventing a string of bank failures. The BOT is well aware of this phenomenon and has not moved to close many of its large banks.

Instead, the BOT permits banks to survive provided they maintain a minimum CAR of 8.5% (Tier 1 capital of 4.25%) under its very loose interpretation, as well as the minimum step-up loan loss provision requirement.

Sham Restructurings and Phantom Equity

The BOT also continues to accept what we feel are questionable standards and disclosure around restructured loans and the nature of assets contained in a loan portfolio. A case in point: while all banks have claimed that they are not taking, or only taking, minimal haircuts in restructuring loans (leaving aside the material adverse NPV impact of lowering rates and extending maturities), delving into some typical restructuring methodologies reveals alarming and deceptive practices.

If a Bt100 billion loan is restructured, and the originating bank concludes that the maximum loan amount which could be serviced by the borrower, even at a reduced rate and on an extended repayment schedule, is Bt50 billion, the bank will commonly perform what officials have termed a "debt-for-equity swap" on the remaining portion of the loan. Rather than writing off the Bt50 billion which would appear uncorrectable, the bank will instead "swap" this amount of debt for an equity stake in the company. So far, we have no objections. Even though the stock should be worthless at the time of the swap (as the company has theoretically been loaded down with the maximum amount of debt it can conceivably service), it does in fairness represent a call option on the recovery of the firm, and is certainly better than nothing.

However, whereas in most countries this (usually unlisted and unmarketable) equity would be valued at zero until sold, and the Bt50 billion loan amount forgiven charged-off against reserves, in Thailand it is perfectly acceptable to the BOT to record the equity as Bt50 billion worth of loans – simply because it was exchanged for Bt50 billion of loans. Furthermore, this portion of the loan portfolio, although it is theoretically without current value, has no traded price or liquidity, and pays no dividend, is considered *performing*.

In this way, a Bt100 billion doubtful loan with 50% loss can be transformed into Bt100 billion in performing loans without changing the actual loss the bank will incur.

This structure is reminiscent of some of the more exotic derivatives strategies used by the Japanese banks to hide or postpone losses in the 80s and early 90s. We all remember how that ended.

Asset Quality

NPLs Continue to be a Problem

Asset quality remains extraordinarily poor, with average non-performing assets (criticized loans, other real estate, and excess accrued interest receivables) stubbornly high at 33.9% of loans, down from 45.4% at year-end 1998 and 43.6% at year-end 1999, despite the contention by the BOT that NPLs are rapidly coming off the books. Recently, several large banks have reported that NPLs are once again increasing.

Figure 23: Asset Quality

	Gross NPLs (THB, Mil)							NPLs (% of Loan Book)						
	1997A	1998A	1999A	3Q00A	2000E	2001E	2002E	1997A	1998A	1999A	3Q00A	2000E	2001E	2002E
Bangkok Bank	180,572	460,000	475,873	219,708	207,731	170,772	144,278	16.8%	48.3%	51.4%	29.4%	27.7%	21.9%	17.5%
Bank of Ayudhya	55,344	137,700	117,468	91,484	84,498	65,762	54,490	13.6%	37.6%	32.5%	27.8%	25.5%	19.0%	14.8%
IFCT	NA	46,365	46,884	35,980	34,485	29,105	22,521	NA	35.2%	34.5%	24.7%	24.4%	19.8%	14.4%
Krung Thai Bank	95,550	475,848	420,769	132,101	128,293	114,293	102,061	13.9%	49.7%	45.0%	30.5%	29.8%	27.1%	24.7%
Siam Commercial Bank	66,403	179,609	175,949	162,190	153,655	125,765	105,758	11.7%	33.0%	35.6%	33.4%	31.8%	24.8%	19.8%
Thai Farmers Bank	105,379	348,237	219,544	179,770	173,393	141,672	116,104	17.3%	57.2%	41.4%	35.2%	34.1%	28.5%	23.7%
Thai Military Bank	60,000	110,252	137,800	108,091	102,980	85,614	72,100	19.8%	38.0%	48.8%	40.5%	37.8%	26.9%	19.3%
Average								***15.5%***	***42.7%***	***41.3%***	***31.6%***	***30.1%***	***24.0%***	***19.2%***

	NPAs (Gross NPLs + ORE + Excess AIR), THB, Mil)							NPAs (% of Loan Book+ORE)						
	1997A	1998A	1999A	3Q00A	2000E	2001E	2002E	1997A	1998A	1999A	3Q00A	2000E	2001E	2002E
Bangkok Bank	186,172	466,703	486,093	234,950	223,278	187,600	162,494	17.2%	48.7%	51.9%	30.8%	29.2%	23.5%	19.3%
Bank of Ayudhya	57,922	150,173	128,111	103,345	95,508	73,979	61,184	14.2%	40.9%	34.7%	30.4%	27.9%	20.8%	16.3%
IFCT	2,805	51,615	53,966	42,448	40,892	35,621	28,054	NA	39.1%	39.1%	28.7%	28.4%	23.7%	17.7%
Krung Thai Bank	104,859	510,949	457,644	149,133	148,266	134,872	123,286	15.2%	53.1%	48.6%	33.4%	33.3%	30.9%	28.7%
Siam Commercial Bank	71,889	192,482	185,152	172,106	163,789	136,821	117,819	12.6%	35.1%	36.8%	34.7%	33.2%	26.4%	21.6%
Thai Farmers Bank	107,037	355,082	227,374	194,033	188,012	153,580	125,803	17.5%	58.2%	42.2%	36.9%	35.9%	30.2%	25.1%
Thai Military Bank	65,718	129,014	148,443	114,798	106,816	88,739	74,645	21.4%	43.2%	51.8%	42.3%	38.7%	27.6%	19.9%
Average								***16.4%***	***45.4%***	***43.6%***	***33.9%***	***32.4%***	***26.2%***	***21.2%***

Source: Lehman Brothers

As described above, we believe that many loan restructurings are not bona-fide workouts, but are primarily cosmetic in nature, and designed to reduce provisioning needs by removing loans from the non-performing roster. Our judgement is confirmed in that 6-10% of all restructured loans have already returned to NPL status, which implies that the estimates by bank management teams of at most a 15% NPL reversion over the remaining life of the restructured loans are optimistically low.

Particularly worrisome is the distribution of nonperforming assets among the classification categories. Fully 61.2% of all impaired assets are in the "Loss" category, which implies that there will be virtually no return from these loans. When combined with the "Doubtful" category, the most seriously categorized loans account for almost 67% of all nonperforming assets.

Figure 24: NPLs

	BBL %	BAY %	IFCT %	KTB %	SCB %	TFB %	TMB %
Total Impaired Assets							
Special Mention	10.3%	7.9%	11.6%	11.7%	17.7%	4.6%	20.9%
Substandard	4.6%	14.9%	1.6%	12.3%	15.3%	8.3%	13.5%
Doubtful	7.5%	4.3%	10.5%	4.3%	8.3%	7.6%	10.3%
Loss	71.1%	61.5%	61.0%	60.2%	52.9%	72.1%	49.4%
ORE	6.5%	10.3%	5.6%	9.4%	5.8%	7.4%	3.5%
Excess Accrued Interest	0.0%	1.2%	9.6%	2.0%	0.0%	0.0%	2.3%

Source: Banks and Lehman Brothers

Collateral Clouds the Issue

Collateral values are basically meaningless if banks have neither the intention nor the ability to foreclose on their problem assets. However, since the BOT requires provisions on a net-of-collateral basis and **not** based on a borrower's willingness and ability to repay, we are forced to investigate collateral values. Despite the brouhaha surrounding the passage of improved bankruptcy laws in Thailand, Thai foreclosure laws have been left largely intact. Although this has meant that bankers are unable to foreclose on much of the collateral securing their NPLs, it has in some ways been a perverse blessing, as the lack of ability to seize and sell impaired collateral has kept the market from clearing at what we suspect would be a level significantly below that now assumed by banks for purposes of reserve adequacy calculations. Our reserve calculations (see below) are made gross of collateral, in line with international standards.

Reserve Adequacy

Thai bank reserves are not adequate to meet the actual losses contained within their loan portfolios. On average, we find that the banks have reserved against only 26% of their losses as currently identified by the banks' classifications themselves. This despite aggregate provisions of Bt645 billion in our covered universe since 1Q97. At the end of 3Q00, the aggregate reserve shortfall at our covered institutions was Bt552 billion, *even after* the Krung Thai recapitalization, which reduced NPLs by Bt537 billion.

Figure 25: Actual versus required reserves

	BBL	BAY	IFCT	KTB	SCB	TFB	TMB	Average
3Q00 (actual)								
Actual/Required Reserves	9%	12%	35%	50%	23%	34%	17%	26%
Reserve Shortfall/Capital	640%	445%	202%	78%	157%	406%	424%	336%
4Q00 (est.)								
Actual/Required Reserves	9%	15%	37%	53%	26%	37%	21%	28%
Reserve Shortfall/Capital	656%	468%	198%	73%	138%	414%	470%	346%

Source: Banks and Lehman Brothers

Reserve Adequacy Calculation Methodology

We divide the Thai Banks' loan portfolios into the international standard categories of Pass (performing), Special Mention, Substandard, Doubtful, and Loss, with Loss comprising both the BOT's Doubtful of Loss classification and loans classified as Uncollectable. Note that this analysis accepts each bank's internal classification of their own loans, which we believe to be more lenient than the standards applied outside of Thailand.

We then apply reserve weightings as follows to determine the appropriate minimum level of required reserves: 1% on Pass; 5% on Special Mention; 20% on Substandard; 50% on Doubtful; and 100% on Loss loans. In addition, where not included in banks' internal classifications, we classify all excess (above 1.25%) accrued interest receivables and Other Real Estate (ORE, or foreclosed property) as Substandard. All assets are classified on a gross of collateral basis.

This is quite a bit more stringent than the BOT methodology, which is one of the most lenient in the world, but directly in line with the standards applied by the BIS and major regulators in the US and UK.

Figure 26: Required reserve calculations

Bangkok Bank

at 3Q00 THB Mil.	Gross Amount	Reserve Percentage	Required Reserve
Loan Portfolio:			
Pass	529,158	1%	5,292
Special Mention	24,244	5%	1,212
Substandard	10,797	20%	2,159
Doubtful	17,565	50%	8,783
Loss	167,101	100%	167,101
ORE	15,242	20%	3,048
Excess AIR	-	20%	-
Total	764,109		187,596
Actual Reserves			17,733
Surplus (Shortfall)			**(169,863)**

Bank of Ayudhya

at 3Q00 THB Mil.	Gross Amount	Reserve Percentage	Required Reserve
Loan Portfolio:			
Pass	242,720	1%	2,427
Special Mention	8,152	5%	408
Substandard	15,402	20%	3,080
Doubtful	4,422	50%	2,211
Loss	63,507	100%	63,507
ORE	10,620	20%	2,124
Excess AIR	1,241	20%	248
Total	346,066		74,006
Actual Reserves			8,872
Surplus (Shortfall)			**(65,134)**

IFCT

at 3Q00 THB Mil.	Gross Amount	Reserve Percentage	Required Reserve
Loan Portfolio:			
Pass	115,616	1%	1,156
Special Mention	4,913	5%	246
Substandard	678	20%	136
Doubtful	4,476	50%	2,238
Loss	25,913	100%	25,913
ORE	2,398	20%	480
Excess AIR	4,070	20%	814
Total	158,064		30,982
Actual Reserves			10,472
Surplus (Shortfall)			**(20,510)**

Krung Thai Bank

at 3Q00 THB Mil.	Gross Amount	Reserve Percentage	Required Reserve
Loan Portfolio:			
Pass	309,173	1%	3,092
Special Mention	17,475	5%	874
Substandard	18,355	20%	3,671
Doubtful	6,482	50%	3,241
Loss	89,789	100%	89,789
ORE	13,985	20%	2,797
Excess AIR	3,047	20%	609
Total	458,306		104,073
Actual Reserves			51,702
Surplus (Shortfall)			**(52,371)**

Siam Commercial Bank

at 3Q00 THB Mil.	Gross Amount	Reserve Percentage	Required Reserve
Loan Portfolio:			
Pass	326,695	1%	3,267
Special Mention	30,468	5%	1,523
Substandard	26,373	20%	5,275
Doubtful	14,234	50%	7,117
Loss	91,115	100%	91,115
ORE	9,916	20%	1,983
Excess AIR	-	20%	-
Total	498,802		110,280
Actual Reserves			24,951
Surplus (Shortfall)			**(85,329)**

Thai Farmers Bank

at 3Q00 THB Mil.	Gross Amount	Reserve Percentage	Required Reserve
Loan Portfolio:			
Pass	335,768	1%	3,358
Special Mention	8,938	5%	447
Substandard	16,103	20%	3,221
Doubtful	14,834	50%	7,417
Loss	139,895	100%	139,895
ORE	14,263	20%	2,853
Excess AIR	-	20%	-
Total	529,800		157,190
Actual Reserves			53,952
Surplus (Shortfall)			**(103,238)**

Thai Military Bank

at 3Q00 THB Mil.	Gross Amount	Reserve Percentage	Required Reserve
Loan Portfolio:			
Pass	165,027	1%	1,650
Special Mention	23,954	5%	1,198
Substandard	15,519	20%	3,104
Doubtful	11,876	50%	5,938
Loss	56,742	100%	56,742
ORE	4,038	20%	808
Excess AIR	2,669	20%	534
Total	279,825		69,974
Actual Reserves			11,648
Surplus (Shortfall)			**(58,326)**

Source: Lehman Brothers Estimates

Capital

Short Supply and High Demand for Equity

All of our covered institutions—save for the essentially nationalized KTB—are insolvent by a wide margin when international standards of loan loss provisioning are taken into account. The Thai banks will continue to require large amounts of additional capital over the next two years in order to cover losses which, by and large, truly occurred years ago. It is not clear why investors have been willing to support these banks over the past three rounds of "final" recapitalization, but we are certainly suggesting that investors take a wait and see attitude when evaluating the Thai banks as a viable investment alternative.

We expect to see attempted share offerings from Bangkok Bank and Bank of Ayudhya early in the first half, with additional capital required at the other banks (with the possible exception of SCB and IFCT) during 2H2001. Given the current attitude of investors, its is difficult to assume that all banks would be able to access the required funding, and we foresee several failures among these attempted capital-raisings.

Upper Tier 2 Capital Looks Attractive to Banks and Investors

The Bank of Thailand has broadened its definition of bank capital to allow financial institutions to count additional classes of debt securities as capital, subject to certain restrictions. This move is in line with international standards, and should not in itself be considered a deviation from prudent supervision.

The new securities, which fall into a capital category known as *upper Tier 2*, are similar to existing subordinated debt issues (mainly counted as lower Tier 2 capital), but allow banks to defer paying interest under certain circumstances. Deferred interest is capitalized and must be paid, unlike the dividends on non-cumulative preferred stock, which counts as Tier 1 capital. Although these securities are bonds, the distressed nature of the Thai banks, along with the anticipated conversion features, make them trade more like equity instruments.

While upper Tier 2 will be ruinously expensive, and will hurt long-term earnings potential at the banks, we believe that the need for capital is so great that banks will be forced to accept what would in normal markets be considered unfavorable terms in order to continue operating. We believe that the major banks (BBL, SCB, TFB, and IFCT) will securely perform on these subordinated debt obligations, giving investors the potential for a very attractive return on UT2 securities—possibly combined with various forms of equity upside potential.

Earnings

Continued Losses in 2000 and 2001

Earnings continue to be poor, with our covered universe showing a collective loss in every period since 4Q97, and aggregate losses during this period of Bt577 billion. NPLs remain the problem, with foregone interest income on non-current loans and provisions against principal losses accounting for the vast majority of the difference between the Thai banks' theoretical earning power based on loan and deposit spreads versus the dismal actual performance.

Figure 27: Net Interest Margins

	1Q97	2Q97	3Q97	4Q97	1Q98	2Q98	3Q98	4Q98	1Q99	2Q99	3Q99	4Q99	1Q00	2Q00	3Q00	4Q00	1Q01	2Q01	3Q01	4Q01
Bangkok Bank	3.87%	3.91%	3.84%	3.54%	2.55%	0.75%	-0.59%	0.00%	-0.18%	0.37%	1.02%	1.47%	2.02%	2.30%	1.97%	2.09%	2.11%	2.11%	2.16%	2.20%
Bank of Ayudhya	3.15%	3.37%	3.86%	3.75%	1.53%	1.18%	0.49%	0.83%	0.69%	0.50%	0.61%	1.05%	1.80%	1.57%	1.27%	1.74%	1.66%	1.72%	1.76%	1.68%
IFCT	3.25%	3.05%	1.71%	3.92%	1.55%	1.31%	-0.09%	-0.56%	-1.36%	-1.21%	-1.11%	-1.19%	-0.96%	-1.20%	-1.26%	-0.58%	-0.62%	-0.49%	-0.45%	0.02%
Krung Thai Bank	3.65%	4.33%	4.21%	3.44%	3.07%	2.13%	1.05%	0.38%	0.20%	0.45%	0.57%	1.18%	1.25%	1.21%	1.34%	1.38%	1.38%	1.34%	1.30%	1.20%
Siam Commercial Bank	4.01%	4.23%	4.48%	4.45%	2.82%	3.73%	0.44%	-0.46%	1.00%	1.25%	1.69%	1.97%	2.22%	2.47%	2.35%	2.61%	2.70%	2.78%	2.83%	2.79%
Thai Farmers Bank	4.35%	4.18%	4.31%	3.64%	3.10%	2.27%	0.79%	0.91%	1.21%	0.87%	1.34%	1.95%	2.13%	2.00%	2.17%	2.19%	2.27%	2.35%	2.43%	2.47%
Thai Military Bank	3.00%	3.38%	2.92%	1.33%	1.43%	1.19%	0.28%	0.27%	0.00%	2.30%	0.79%	0.51%	0.39%	0.62%	0.82%	1.00%	1.10%	1.20%	1.30%	1.50%
Average	3.61%	3.78%	3.62%	3.44%	2.29%	1.79%	0.34%	0.19%	0.22%	0.65%	0.70%	0.99%	1.26%	1.28%	1.24%	1.49%	1.51%	1.57%	1.62%	1.69%

Source: Banks and Lehman Brothers

While we do expect continued heavy provisioning burdens, we anticipate that the pace of reported losses will slacken as banks meet and pass the BOT's loan loss reserve guidelines for year-end 2000. Due to the overwhelming size of reserve underfunding compared with earnings, however, we will not be focusing overmuch on the reported bottom line numbers.

Figure 28: Loan Loss Provisions

THB Mil.	1997	1998	1999	2000	2001	2002	2Q00A	3Q00A	4Q00E
Bangkok Bank	28,368	47,992	68,210	38,498	28,000	20,000	4,028	3,924	5,000
Bank of Ayudhya	7,085	4,606	17,713	10,270	7,000	4,000	6,173	(845)	2,000
IFCT	3,477	3,141	6,046	682	2,000	1,200	182	1	500
Krung Thai Bank	18,973	64,989	84,384	27,787	8,000	4,000	739	15,048	2,000
Siam Commercial Bank	11,597	12,611	43,285	8,109	7,000	7,000	2,490	1,606	2,000
Thai Farmers Bank	16,810	44,076	42,009	2,735	10,000	6,000	(595)	1,137	2,500
Thai Military Bank	3,505	9,864	9,110	25,718	10,000	7,000	20,720	48	2,650

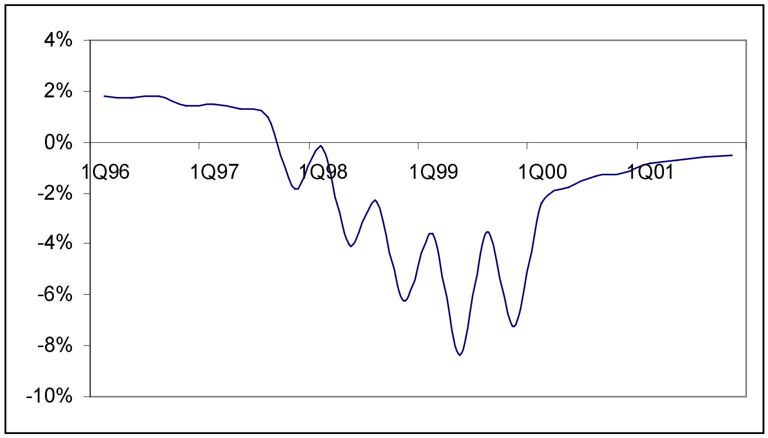
Source: Banks and Lehman Brothers

Figure 29: Overhead and efficiency ratios

	Overhead Ratio							Efficiency Ratio						
	1997A	1998A	1999A	3Q00A	2000E	2001E	2002E	1997A	1998A	1999A	3Q00A	2000E	2001E	2002E
Bangkok Bank	2.16%	2.44%	1.91%	2.13%	1.93%	1.99%	1.98%	40.3%	105.2%	72.9%	51.3%	56.2%	65.6%	61.4%
Bank of Ayudhya	2.41%	2.27%	2.44%	2.07%	2.30%	2.10%	2.14%	50.3%	186.1%	181.1%	129.0%	117.5%	101.9%	112.5%
IFCT	0.91%	0.37%	0.33%	0.42%	0.39%	0.43%	0.49%	27.9%	-74.8%	-43.8%	-56.1%	-699.0%	68.0%	34.5%
Krung Thai Bank	2.07%	2.11%	2.17%	2.10%	1.93%	2.12%	2.18%	42.9%	82.1%	153.0%	134.9%	104.7%	113.8%	114.1%
Siam Commercial Bank	2.83%	2.78%	2.52%	2.48%	2.52%	2.45%	2.35%	47.1%	168.8%	67.4%	62.2%	57.1%	54.8%	52.8%
Thai Farmers Bank	2.52%	2.60%	2.46%	2.97%	2.86%	2.73%	2.71%	47.9%	89.4%	127.5%	87.5%	86.1%	81.6%	79.5%
Thai Military Bank	2.04%	1.93%	1.95%	1.81%	1.62%	0.88%	0.44%	55.0%	173.7%	160.2%	154.0%	107.9%	44.2%	20.4%
Average	2.13%	2.07%	1.97%	2.00%	1.93%	1.81%	1.76%	44.47%	104.36%	102.63%	80.40%	-24.23%	75.73%	67.88%

Source: Banks and Lehman Brothers

Figure 30: Core return on average assets



Source: Lehman Brothers Estimates

Poor Downsizing Efforts

Thailand is seriously lagging behind its Asian counterparts in bank restructuring, particularly in organizational downsizing. In Thailand, it is considered poor business practice to lay employees off. Reducing the heavy overhead burden, in our opinion, is one of the many areas the sector critically needs to address, as it would enable the banks to free up some costs to take the necessary provisioning. While banks are downsizing somewhat, it is coming at a very high cost with their early retirement schemes, which are prohibitive to a quick recovery. Krung Thai Bank reportedly looked into massive downsizing but found that it came under the State-Owned Enterprise Labor Law which prevents such a move. Further inhibiting recovery is the lack of in-market consolidation or the elimination of over-capacity in the market. This was a key ingredient to the U.S. bank recovery that we find would be very useful in expediting recovery in Thailand.

Competition

Market Share

The Thai banking market remains highly concentrated, with the top four banks collectively controlling 65% of assets and deposits. This percentage has increased in recent years due mainly to the growing balance sheet of Krung Thai, which has absorbed assets of Bangkok Bank of Commerce and First Bangkok City Bank during this time, offsetting a steady decline in Bangkok Bank's share of the market, which has fallen from 24.51% in 1997 to 21.88% currently – a decline in share of over 10%. Other large share losers include Thai Military (-10.3%) and Bank of Ayudhya (-8.9%). Share winners, aside from KTB (29.8%), have been Bank Thai (216.0%), Radanasin (26.8%), Bank of Asia (3.27%), and Siam Commercial (1.3%).

Figure 31: Comparative market share

THB Mil. at 9/30/00	Assets	Total Loans	Deposits	Market Share Assets	Loans	Deposits
Bangkok Bank	1,216,368	746,395	1,007,385	21.88%	16.96%	21.95%
Krung Thai Bank	993,266	432,817	845,923	17.86%	9.84%	18.43%
Thai Farmers Bank	763,119	510,944	637,909	13.72%	11.61%	13.90%
Siam Commercial Bank	703,151	485,749	585,163	12.65%	11.04%	12.75%
Bank of Ayudhya	434,983	328,852	362,449	7.82%	7.47%	7.90%
Thai Military Bank	337,108	267,110	265,060	6.06%	6.07%	5.78%
Siam City Bank	252,814	226,617	208,674	4.55%	5.15%	4.55%
Bank Thai	237,156	231,022	171,646	4.27%	5.25%	3.74%
IFCT	175,443	145,705	160,928	3.16%	3.31%	3.51%
Bangkok Metropolitan Bank	155,919	175,478	158,166	2.80%	3.99%	3.45%
Bank of Asia	158,127	131,369	134,271	2.84%	2.99%	2.93%
DBS Thai Danu Bank	93,986	65,123	70,107	1.69%	1.48%	1.53%
Standard Chartered Nakornthon Bank	77,762	57,658	56,661	1.40%	1.31%	1.23%
UOB Radanasin	62,358	6,405	45,326	1.12%	0.15%	0.99%
Total	5,661,561	3,811,245	4,709,670	101.82%	86.63%	102.62%

Source: SET; Lehman Brothers' estimates

Branch Networks

Most banks' branches are heavily concentrated in the Metro Bangkok area and Central Thailand, with an average of 57% of the top four institutions' offices so located, and the remainder spread across the country, with an emphasis on the North and Northeast regions. Bangkok in particular is over-banked, with inefficient branches located too close to each other. Six banks have over 100 branches in Bangkok alone, with Thai Farmers operating the most at 158. By comparison, Citibank operates only 109 branches in New York City. The experience of Radanasin and Thai Danu seems to indicate that fewer branches are needed to provide adequate coverage of the city.

Figure 32: Comparative branch networks

	Bangkok Branches	Total Branches
Krung Thai Bank	150	643
Thai Farmers Bank	158	533
Bangkok Bank	128	526
Siam Commercial Bank	148	496
Bank of Ayudhya	134	418
Thai Military Bank	111	361
Siam City Bank	64	211
Bangkok Metropolitan Bank	65	177
Bank of Asia	64	121
Bank Thai	45	116
DBS Thai Danu Bank	43	95
UOB Radanasin Bank	31	68
Standard Chartered Nakornthon Bank	38	67

Source: Banks and Lehman Brothers

Branch and Staff Productivity

As you would expect from our ranking of the quality of their respective franchises, BBL, SCB, and TFB finish in the top tier when looking at per-branch and per-employee measures of productivity (as does IFCT with a surprisingly strong performance, even given its lack of deposit-taking operations and distinctly different clientele), while TMB and BAY lag.

Figure 33: Branch and staff productivity

	BBL	BAY	IFCT	KTB	SCB	TFB	TMB	Average
Branches	526	418	27	643	496	533	361	429
Staff	20,434	9,988	952	18,392	10,469	13,338	7561	11,591
Assets/Branch	2,246.6	1,068.3	6,367.2	1,547.2	1,395.3	1,375.5	928.0	2,132.6
Deposits/Branch	1,827.9	864.1	5,665.9	1,247.4	1,146.2	1,141.8	719.8	1,801.9
Assets/Staff	57.8	44.7	180.6	54.1	66.1	55.0	44.3	71.8
Deposits/Staff	47.1	36.2	160.7	43.6	54.3	45.6	34.4	60.3

Source: Banks and Lehman Brothers

Valuation

Book Value and Adjusted Book Value

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

Property Revaluation

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.

- Inferior Protection Against Losses. In the case of revaluation increment on bank property, such as branches and offices, actually used within the business, as opposed to that held for investment, the gain can not be realized without selling the property. However, this action is inconsistent with the valuation of the entity as an ongoing business, as the property is necessary to the conduct of business. Therefore, this capital is available only under a liquidation scenario. We bear in mind that scenarios under which banks are required to liquidate assets and capital in order to pay out liabilities are closely correlated with scenarios under which the value and ready liquidity of real estate can be expected to fall, due to general economic depression, panic selling, and unavailability of credit to finance the purchase of property. Therefore, real estate revaluation is available to serve as capital only so long as it is not needed, and so is less valuable than other forms of capital.

- Subjective Timing. Real estate is generally written-up at a time (and using a method) of management's choosing, and is rarely, if ever, written down. In addition, management frequently has wide discretion to select appraisers, and can "cherry-pick" appreciated properties from a portfolio that may have an aggregate loss.

- Included in Enterprise Value. The value contributed to the bank by its property is already subsumed within our estimate of the value of the bank's branch network, customer relationships and deposit franchise. This estimate of continuing enterprise value is the key factor that typically produces a "multiple effect" on bank valuations, causing them to trade at above book value. In this case, it would be double-counting that value to include property revaluation in our overall assessment of value.

- Cross-Market Comparisons. Many jurisdictions, including the U.S. and Singapore, do not permit the use of property revaluation on the balance sheet, while others including Hong Kong, Indonesia and the Philippines do. Therefore, for purposes of comparability, we always include revaluation in our estimates and calculations of book value, grossing up reported book with revaluation if not reported as such within a particular jurisdiction, and we always subtract revaluation from our calculation of adjusted book value.

Loan Loss Reserves

Secondly, we have deducted loan loss reserve underfunding from adjusted book value to arrive at fully adjusted book value, which is negative for all of our covered Thai banks. This allows us to compare institutions within the market and across markets based on their underlying economics, and not on the timing of provisions or loss recognition, which is highly variable at management's discretion. As fully adjusted book 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 throughout this report.

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 begun to compare 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 20.4% standing out as rich compared with less-distressed markets. This despite an average price decline of over 60% in Thai bank share prices last year.

Figure 34: Book value adjustments

Bangkok Bank

	THB Mil.	% of Capital	Per Share	Price to:
Stated Book Value	26,535	100%	18.09	2.10
Less: Property Revaluation	(10,524)	-40%	(7.18)	
Adjusted Book Value	16,010	60%	10.92	3.48
Less: Reserve Shortfall	(169,863)	-640%	(115.83)	
Fully Adjusted Book Value	(153,853)	-580%	(104.91)	(0.36)

Bank of Ayudhya

	THB Mil.		Per Share	Price to:
Stated Book Value	14,581	100%	7.88	0.67
Less: Property Revaluation	(1,239)	-8%	(0.67)	
Adjusted Book Value	13,343	92%	7.21	0.73
Less: Reserve Shortfall	(64,886)	-445%	(35.07)	
Fully Adjusted Book Value	(51,543)	-353%	(27.86)	(0.19)

IFCT

	THB Mil.		Per Share	Price to:
Stated Book Value	9,746	100%	8.39	0.68
Less: Property Revaluation	(698)	-7%	(0.60)	
Adjusted Book Value	9,048	93%	7.79	0.73
Less: Reserve Shortfall	(19,696)	-202%	(16.96)	
Fully Adjusted Book Value	(10,648)	-109%	(9.17)	(0.62)

Krung Thai Bank

	THB Mil.		Per Share	Price to:
Stated Book Value	66,332	100%	3.02	3.81
Less: Property Revaluation	(4,030)	-6%	(0.18)	
Adjusted Book Value	62,302	94%	2.83	4.06
Less: Reserve Shortfall	(51,761)	-78%	(2.35)	
Fully Adjusted Book Value	10,540	16%	0.48	23.99

Siam Commercial Bank

	THB Mil.		Per Share	Price to:
Stated Book Value	54,322	100%	17.35	1.09
Less: Property Revaluation	(3,467)	-6%	(1.11)	
Adjusted Book Value	50,855	94%	16.25	1.17
Less: Reserve Shortfall	(85,329)	-157%	(27.26)	
Fully Adjusted Book Value	(34,473)	-63%	(11.01)	(1.73)

Thai Farmers Bank

	THB Mil.		Per Share	Price to:
Stated Book Value	25,429	100%	8.77	2.48
Less: Property Revaluation	(6,660)	-26%	(2.30)	
Adjusted Book Value	18,770	74%	6.47	3.36
Less: Reserve Shortfall	(103,238)	-406%	(35.60)	
Fully Adjusted Book Value	(84,468)	-332%	(29.13)	(0.75)

Thai Military Bank

	THB Mil.		Per Share	Price to:
Stated Book Value	13,641	100%	3.41	1.70
Less: Property Revaluation	(994)	-7%	(0.25)	
Adjusted Book Value	12,647	93%	3.16	1.84
Less: Reserve Shortfall	(57,792)	-424%	(14.44)	
Fully Adjusted Book Value	(45,144)	-331%	(11.28)	(0.51)

Source: Lehman Brothers' estimates

Figure 35: Deposit premium valuations calculations

at 9/30/00 THB (Mil.)	Share Price 12/7/00	Market Cap.	Adjusted Equity	Mkt. Cap. Less Adj. Equity	Total Deposits	Deposit Premium
Bangkok Bank	38.00	55,727	(153,853)	209,580	1,007,385	20.80%
Bank of Ayudhya	5.30	9,807	(51,792)	61,598	362,449	16.99%
IFCT	5.70	6,621	(11,462)	18,083	160,928	11.24%
Krung Thai Bank	11.50	252,828	9,931	242,897	845,923	28.71%
Siam Commercial Bank	19.00	59,479	(34,473)	93,952	585,163	16.06%
Thai Farmers Bank	21.75	63,073	(84,468)	147,541	637,909	23.13%
Thai Military Bank	5.80	23,217	(45,678)	68,895	265,060	25.99%
Average		**67,250**				**20.42%**

Source: Lehman Brothers

Figure 36: Valuation summary

	For. Shr. Rating	Market Price 12/7/00	Market Price 52-Week High	Market Price 52-Week Low	Mkt. Cap. (THB, Mil.)	Price-to-Earnings Ratio 1996A	1997A	1998A	1999A	2000E	2001E	2002E	1999 Div. Yield	Price to BV (%)	Price to ABV (%)
Bangkok Bank	4	38.00			55,727	11.97	29.81	NM	NM	NM	NM	NM	0.0%	210%	348%
Bank of Ayudhya	4	5.30			9,807	5.44	4.97	NM	NM	NM	NM	NM	0.0%	67%	73%
IFCT	3	5.70			6,621	12.79	2.19	NM	NM	NM	NM	19.02	0.0%	68%	73%
Krung Thai Bank	4	11.50			252,828	7.11	70.40	NM	NM	3.30	NM	NM	0.0%	381%	406%
Siam Commercial Bank	3	19.00			59,476	7.40	6.56	NM	NM	20.37	17.05	8.23	0.0%	109%	117%
Thai Farmers Bank	3	21.75			63,073	10.79	87.51	NM	NM	31.16	24.83	NM	0.0%	248%	336%
Thai Military Bank	4	5.80			23,217	10.34	7.26	NM	NM	NM	NM	128.08	0.0%	170%	184%
Average					67,250	9.41	29.81	NM	NM	18.28	20.94	51.78	0.0%	179%	220%

Source: Lehman Brothers

BANGKOK BANK (BT38.00) 4-UNDERPERFORM (F)

Investment Summary

Bangkok Bank (BBL) is Thailand's largest publicly-owned commercial bank, and has historically been perceived as the country's leading financial institution. For this reason, we find it unlikely that the bank will be allowed to fail, particularly as it has been able to make full provisions under the BOT standards for year-end 2001. However, the bank is weaker than many of its large competitors, and unattractive from a valuation standpoint, even though it may be permitted to operate indefinitely from an insolvent position.

We rate the foreign shares as 4-Market Underperform and the local shares as 3- Market Perform.

Key Points

- Beware False Profits: BBL trumpeted its return to reported earnings in the second and third quarters after eight straight quarters of losses—but these earnings are not real. Underprovisioning and securities gains have permitted the bank to record bottom line profits, but on an operating basis the bank remains unprofitable. BBL will not be able to restore its capital base or make appropriate provisions through earnings in the foreseeable future.

- It's the Bad Assets: For all the attempts to spin the results, restructure loans at off-market rates, and present an improving picture, Bangkok Bank remains at 28% net NPLs/Loans, more than three years into the crisis. Staggering provisions of Bt178 billion made during this period are almost completely gone, with current reserves totaling less than Bt18 billion.

- Reserves are Inadequate: By our model, BBL requires additional loan loss provisions of Bt170 billion—equivalent to all the bank's remaining capital 6.4x over. Current reserves cover only 9% of our required amount.

- BBL is Counting on 85% Recovery: For the bank to be solvent at its disclosed level of NPLs (which we consider to be low), it will need to achieve 85% recovery on all NPLs—an unprecedented level. Our model estimates a 22% NPV recovery, while the recent Thai Danu sale of an NPL portfolio at 27% of face value would seem to confirm that real recoveries will be much lower than the level required to preserve capital at BBL.

- Capital is Badly Needed: BBL is insolvent by a substantial margin, and urgently needs a capital infusion to make provisions and keep operating. While management has been window-dressing the results in order to facilitate another round of equity issuance, investors have thus far evinced no interest. We believe that any offering would have to be done at a punitive discount—another reason to avoid the shares, particularly the overvalued foreign shares.

- Only a Political Solution Will Save the Bank: We continue to believe that the Thai banks require immediate and meaningful government intervention, as the public sector appears to be the only entity capable of injecting the necessary capital into the banks, particularly those with weak franchises. If BBL gets a Krung Thai-like solution, it may yet preserve its market position. However, while we believe that the government will save the bank, it's a stretch to assume that it will bail out existing investors as well.

Bangkok Bank

Share Price:	38.00	Index:	278.75
52 Week Price Range:	112.00 - 28.00	Current Yield:	0.0%

Reuters Code:	BBL.BK
Bloomberg Code:	BBL TB

INCOME STATEMENT	1998A	1999A	2000E	2001E	2002E
(THBm)					
Interest income	n.a	65,621	68,116	*73,272*	*79,348*
Interest expense	n.a	*57,772*	44,707	48,245	51,295
Net interest income	8,847	7,849	23,409	25,028	28,053
Ave. int. earnings assets	*1,250,834*	*1,183,699*	*1,117,947*	*1,167,374*	*1,218,707*
NIM (%)	0.71%	0.66%	2.09%	2.14%	2.30%
Non-interest income	19,344	11,865	11,899	10,386	11,223
Total operating income	28,192	19,714	35,308	35,414	39,276
Non-interest expenses	-30,472	-22,585	-21,613	-23,249	-24,109
Pre provision profit	-2,280	-2,871	13,695	12,165	15,167
Loan loss provisions	-47,992	-68,210	-38,498	-28,000	-20,000
Non-operating income	783	11,253	3,309	0	0
Pre tax profit	-49,489	-59,828	-21,640	-15,835	-4,833
Tax	0	0	0	0	0
Net profit	-49,489	-59,829	-21,785	-15,835	-4,833
Core earnings	-50,272	-71,082	-25,094	-15,835	-4,833

PER SHARE DATA (THB)	1998A	1999A	2000E	2001E	2002E
EPS	(37.64)	(40.80)	(14.86)	(10.80)	(3.30)
DPS	0.00	0.00	0.00	0.00	0.00
Effective payout ratio (%)	*0%*	*0%*	*0%*	*0%*	*0%*
BVPS	76.95	30.87	17.10	6.30	3.01
ABVPS	69.43	23.62	9.95	(0.75)	(3.94)

VALUATION	1998A	1999A	2000E	2001E	2002E
Price to book value (x)	0.9	3.1	2.2	6.0	12.6
Price to adjusted book value (x)	1.0	4.0	3.8	-50.9	-9.6
Price to earnings (X)	-1.8	-2.3	-2.6	-3.5	-11.5

PROFITABILITY RATIOS	1998A	1999A	2000E	2001E	2002E
(%)					
Net interest margin	0.71%	0.66%	2.09%	2.14%	2.30%
Yield on interest earning assets	n.a	6.02%	5.94%	6.17%	6.35%
Cost on interest bearing liabilities	n.a	5.20%	3.82%	3.96%	4.05%
Net interest spread	n.a	0.83%	2.12%	2.20%	2.30%
Non-int. income (% Op income)	68.6%	60.2%	33.7%	29.3%	28.6%
Cost to income	105.2%	72.9%	56.2%	65.6%	61.4%
Overhead ratio	2.44%	1.91%	1.93%	1.99%	1.98%
Cost coverage	63.5%	52.5%	55.1%	44.7%	46.5%
ROA	-3.70%	-4.89%	-1.80%	-1.25%	-0.37%
ROE	-53.6%	-95.0%	-88.5%	-234.6%	NM

OROA ANALYSIS	1998A	1999A	2000E	2001E	2002E
Net interest margin	0.71%	0.66%	2.09%	2.14%	2.30%
Non-interest inc./gross inc.	69.47%	74.65%	39.15%	29.33%	28.57%
Efficiency ratio	105.2%	72.9%	56.2%	65.6%	61.4%
Provision/assets	3.79%	5.77%	3.12%	2.15%	1.51%
Operating return on assets	-3.91%	-5.06%	-1.61%	-1.11%	-0.26%
Equity/assets	7.99%	3.83%	2.03%	0.71%	0.33%
Operating return on equity	-48.9%	-132.2%	-79.2%	-156.2%	-79.0%

BALANCE SHEET	1998A	1999A	2000E	2001E	2002E
(THBm)					
Gross loans	959,494	928,378	*751,627*	*782,144*	*826,057*
Loan loss reserves	*102,077*	*170,417*	*15,879*	*25,399*	*32,152*
Net loans	850,468	*756,072*	734,248	*755,184*	*792,256*
Total earning assets	1,277,819	1,089,579	1,146,314	1,188,434	1,248,979
Other assets	-10,870	92,106	89,111	112,430	78,098
Total Assets	1,266,949	1,181,685	1,235,425	1,300,864	1,327,077
Deposits	969,780	961,459	1,017,459	1,058,772	1,101,763
Other paying liabilities	165,819	150,063	152,619	158,816	165,264
Other liabilities	40,059	35,527	50,754	84,372	65,835
Total Liabilities	1,175,658	1,147,049	1,220,832	1,301,960	1,332,862
Equity with revaluation	101,168	45,273	25,081	9,246	4,412
Adjusted equity	91,292	34,637	14,593	(1,096)	(5,785)

BALANCE SHEET RATIOS	1998A	1999A	2000E	2001E	2002E
(%)					
Loan-to-deposit	98.2%	96.4%	*73.7%*	*73.7%*	*74.8%*
Equity to assets	8.0%	3.8%	2.0%	0.7%	0.3%
Tier 1 Capital	-	-	-	-	-
Total Capital adequacy	-	-	-	-	-
Total loan provisions	10.72%	18.39%	2.12%	3.25%	3.90%

ASSET QUALITY	1998A	1999A	2000E	2001E	2002E
Nonperforming assets	466,703	486,093	223,278	187,600	162,494
Special mention	53,422	26,316	23,032	18,760	15,280
Substandard	40,468	16,171	8,098	2,562	811
Doubtful	161,343	27,121	14,930	*7,794*	4,068
Loss	236,870	406,264	161,671	141,656	124,119
ORE	6,703	10,220	15,547	16,829	18,216
NPAs/total loans	49.0%	52.5%	29.8%	24.0%	19.7%
Reserve coverage of NPAs	21.9%	35.1%	7.1%	13.5%	19.8%
Required reserves	332,981	428,900	177,346	153,117	133,897
Actual reserves	102,077	170,417	15,879	25,399	32,152
Shortfall (surplus)	230,903	258,483	161,467	127,718	101,745
Actual to required reserves	31%	40%	9%	17%	24%
Shortfall to capital	228%	571%	644%	1381%	2306%

GROWTH RATES	1998A	1999A	2000E	2001E	2002E
(%)					
Income statement					
Net interest income	-80.5%	-11.3%	198.2%	6.9%	12.1%
Non-interest income	23.8%	14.9%	-34.8%	-31.0%	8.1%
Total operating income	-53.0%	6.9%	24.2%	-7.9%	10.9%
Non-interest expenses	22.7%	-25.9%	-4.3%	7.6%	3.7%
Pre-provision earnings	-104.1%	-659.6%	101.1%	-27.8%	24.7%
Loan loss provisions	69.2%	42.1%	-43.6%	-27.3%	-28.6%
Core earnings	-865.7%	41.4%	-64.7%	-36.9%	-69.5%
Net profit	-1326.9%	20.9%	-63.6%	-27.3%	-69.5%
Balance sheet					
Loan growth	-11.3%	-2.7%	-19.0%	4.1%	5.6%
Interest earning assets	4.4%	-14.7%	5.2%	3.7%	5.1%
Asset growth	-10.1%	-6.7%	4.5%	5.3%	2.0%
Deposit growth	2.5%	-0.9%	5.8%	4.1%	4.1%
Shareholders funds	-2.1%	-55.2%	-44.6%	-63.1%	-52.3%

BANK OF AYUDHYA (BT5.40) 4-UNDERPERFORM (F)

Investment Summary

Bank of Ayudhya (BAY) reported a profit of Bt387 million for 3Q00, its first after eleven consecutive quarterly losses. However, the bank was unprofitable on an operating basis, and the profit was caused by negative provisioning. As BAY's reserve remains severely underfunded, we do not agree that the writeback was warranted or prudent, and by our measures the bank continues to be significantly insolvent.

We believe that BAY will not survive as an independent entity without material government aid. The bank now appears fair game for one of the smaller foreign-owned banks like Bank of Asia or Radanasin, but is still overpriced given its weak franchise and distressed balance sheet.

Key Points

- Margins Falling: Net interest margin is now only 1.27%, down 53 basis points from 1Q00. NIM compression has come primarily on a precipitous fall in earning asset yield, which shed 37 b.p. in 3Q alone. BAY appears to have reached a floor in terms of funding costs, with cost of funds lagging benchmark rates on the downside.

- Asset Quality: The bank has written off Bt30–40 billion in bad loans since 1Q, although NPLs remain high at 31% of loans. What is disturbing is that the severity of NPLs began to creep up again in the third quarter, with Substandard, Doubtful, and Loss loans increasing while loans in the least-severe Special Mention category decreased.

- Provisions and Reserves: BAY wrote-back Bt845 million in provisions in the quarter, which leaves us scratching our heads. By our calculation, BAY needs reserves of Bt73.8 billion and has existing reserves of only Bt8.9 billion (down from Bt32.4 billion at 1Q due to the depleting effects of NPL write-offs), leaving a shortfall of Bt64.9 billion, or 4.5x capital. Negative provisioning under these circumstances is negligent.

- Capital Raising: Bank of Ayudhya officials have received shareholder approval to raise additional capital, a necessity given the bank's thin equity base of 3.2% of equity and under-reserved position. Given an issue of the maximum number of new shares (3.7 billion), plus conversion of all 1.7 billion approved warrants into shares at the current market price, BAY would raise only Bt30 billion–a substantial sum, but one not sufficient to provisioning needs of Bt65 billion.

- Valuation: While BAY is trading at 80% of stated book value, its adjusted book value is strongly negative given the low level of reserves. With the bank expected to continue to lose money throughout FY2001 and FY2002, we find the stock unattractive, and maintain our 4-Market Underperform rating and Bt5 price target.

Bank of Ayudhya

Share Price:	5.40	Index:	278.75
52 Week Price Range:	16.50 - 5.00	Current Yield:	0.0%
Reuters Code:	BAY.BK		
Bloomberg Code:	BAY TB		

INCOME STATEMENT	1998A	1999A	2000E	2001E	2002E
(THBm)					
Interest income	n.a	26,934	23,267	25,155	27,950
Interest expense	n.a	23,747	16,805	18,009	21,164
Net interest income	4,616	3,187	6,462	7,146	6,786
Ave. int. earnings assets	*448,067*	*435,518*	*408,123*	*419,494*	*440,865*
NIM (%)	1.03%	0.73%	1.58%	1.70%	1.54%
Non-interest income	4,226	2,266	1,495	1,480	1,597
Total operating income	8,841	5,453	7,957	8,626	8,383
Non-interest expenses	-10,149	-10,616	-9,367	-8,793	-9,431
Pre provision profit	-1,308	-5,163	-1,411	-167	-1,048
Loan loss provisions	-4,606	-17,713	-10,270	-7,000	-4,000
Non-operating income	-3,389	410	18	0	0
Pre tax profit	-9,302	-22,466	-11,662	-7,167	-5,048
Tax	-272	-27	87	717	505
Net profit	-9,575	-21,973	-10,996	-6,451	-4,543
Core earnings	-6,086	-22,384	-11,014	-6,451	-4,543

PER SHARE DATA (THB)	1998A	1999A	2000E	2001E	2002E
EPS	(18.60)	(11.88)	(5.94)	(3.49)	(2.46)
DPS	0.00	0.00	0.00	0.00	0.00
Effective payout ratio (%)	*0%*	*0%*	*0%*	*0%*	*0%*
BVPS	52.19	12.39	6.89	3.40	0.94
ABVPS	49.71	11.72	6.22	2.73	0.28

VALUATION	1998A	1999A	2000E	2001E	2002E
Price to book value (x)	0.2	1.3	0.8	1.6	5.7
Price to adjusted book value (x)	0.2	1.4	0.9	2.0	19.6
Price to earnings (X)	-0.6	-1.3	-0.9	-1.5	-2.2

PROFITABILITY RATIOS	1998A	1999A	2000E	2001E	2002E
(%)					
Net interest margin	1.03%	0.73%	1.58%	1.70%	1.54%
Yield on interest earning assets	n.a	6.61%	5.69%	5.85%	6.19%
Cost on interest bearing liabilities	n.a	5.71%	4.07%	4.15%	4.64%
Net interest spread	n.a	0.91%	1.62%	1.70%	1.54%
Non-int. income (% Op income)	47.8%	41.6%	18.8%	17.2%	19.0%
Cost to income	186.1%	181.1%	117.5%	101.9%	112.5%
Overhead ratio	2.27%	2.44%	2.30%	2.10%	2.14%
Cost coverage	41.6%	21.3%	16.0%	16.8%	16.9%
ROA	-1.96%	-4.72%	-2.48%	-1.43%	-0.96%
ROE	-37.9%	-93.0%	-66.3%	-77.9%	-163.3%

OROA ANALYSIS	1998A	1999A	2000E	2001E	2002E
Net interest margin	1.03%	0.73%	1.58%	1.70%	1.54%
Non-interest inc./gross inc.	15.35%	45.65%	18.98%	17.15%	19.05%
Efficiency ratio	186.1%	181.1%	117.5%	101.9%	112.5%
Provision/assets	0.95%	3.97%	2.33%	1.51%	0.82%
Operating return on assets	-2.00%	-5.06%	-2.67%	-1.55%	-1.06%
Equity/assets	5.56%	5.13%	2.89%	1.36%	0.36%
Operating return on equity	-36.0%	-98.5%	-92.4%	-114.2%	-294.9%

BALANCE SHEET	1998A	1999A	2000E	2001E	2002E
(THBm)					
Gross loans	382,079	368,750	336,797	350,823	370,878
Loan loss reserves	*15,531*	*30,078*	*10,863*	*17,840*	*21,826*
Net loans	350,716	331,262	320,867	329,072	346,374
Total earning assets	463,864	407,172	409,074	429,914	451,816
Other assets	19,734	39,360	31,346	32,943	34,622
Total Assets	483,598	446,532	440,420	462,858	486,438
Deposits	403,896	361,178	364,262	382,819	402,322
Other paying liabilities	40,390	55,056	48,581	51,056	53,657
Other liabilities	13,718	8,616	16,073	23,929	29,949
Total Liabilities	458,004	424,850	428,916	457,804	485,928
Equity with revaluation	26,875	22,929	12,742	6,292	1,749
Adjusted equity	25,594	21,682	11,504	5,053	510

BALANCE SHEET RATIOS	1998A	1999A	2000E	2001E	2002E
(%)					
Loan-to-deposit	90.7%	100.0%	91.1%	90.6%	91.5%
Equity to assets	5.6%	5.1%	2.9%	1.4%	0.4%
Tier 1 Capital	-	-	-	-	-
Total Capital adequacy	-	-	-	-	-
Total loan provisions	4.24%	8.32%	3.27%	5.14%	5.93%

ASSET QUALITY	1998A	1999A	2000E	2001E	2002E
Nonperforming assets	138,920	135,275	94,588	73,979	61,184
Special mention	-	8,136	7,744	6,308	5,138
Substandard	-	14,776	11,552	3,655	1,156
Doubtful	-	8,153	3,759	1,962	1,024
Loss	-	96,460	61,443	53,837	47,172
ORE	1,220	7,750	10,089	8,218	6,693
NPAs/total loans	37.9%	34.7%	28.5%	21.3%	16.6%
Reserve coverage of NPAs	11.2%	24.0%	11.5%	24.1%	35.7%
Required reserves	n.a	106,237	68,493	58,676	51,309
Actual reserves	n.a	30,078	10,863	17,840	21,826
Shortfall (surplus)	n.a	76,158	57,630	40,836	29,484
Actual to required reserves	n.a	28%	16%	30%	43%
Shortfall to capital	n.a	332%	452%	649%	1686%

GROWTH RATES	1998A	1999A	2000E	2001E	2002E
(%)					
Income statement					
Net interest income	-68.9%	-30.9%	102.7%	10.6%	-5.0%
Non-interest income	-82.9%	219.9%	-43.5%	-2.2%	7.9%
Total operating income	-72.4%	7.5%	36.0%	8.2%	-2.8%
Non-interest expenses	2.2%	4.6%	-11.8%	-6.1%	7.3%
Pre-provision earnings	-147.9%	1.2%	-70.7%	-88.0%	525.7%
Loan loss provisions	-35.0%	284.6%	-42.0%	-31.8%	-42.9%
Core earnings	-410.2%	267.8%	-50.8%	-41.4%	-29.6%
Net profit	-588.0%	129.5%	-50.0%	-41.3%	-29.6%
Balance sheet					
Loan growth	-9.9%	-1.3%	-8.2%	4.6%	6.1%
Interest earning assets	7.3%	-12.2%	0.5%	5.1%	5.1%
Asset growth	-2.1%	-7.7%	-1.4%	5.1%	5.1%
Deposit growth	3.8%	-10.6%	0.9%	5.1%	5.1%
Shareholders funds	2.5%	-14.7%	-44.4%	-50.6%	-72.2%

INDUSTRIAL FINANCE CORP. OF THAILAND (BT5.70) 3-MARKET PERFORM (F)

Investment Summary

Set up by a special act of Parliament, Industrial Finance Corporation of Thailand (IFCT) is Thailand's only development bank. Its main objectives are to assist in the establishment and modernization of private industrial enterprises.

IFCT reported its earnings for 3Q00, showing a recorded loss of Bt498.6 million, or Bt0.43 per share, in line with our estimates. While this compares favorably with 3Q99's loss of Bt1.3 billion (Bt1.14/share), the quarter's loss outpaced that of 1Q and 2Q combined, even though IFCT made negligible provisions for bad debts in the period. These results show an institution still in deep structural trouble on an operating basis.

While the bank, like all of the Thai banks in our universe (ex-Krung Thai), is insolvent if appropriate reserves for loan losses are applied, having made 100% of the BOT-mandated loan loss provision and with an implicit government guarantee, IFCT does not appear to be in any near-term difficulty as regards liquidity.

Key Points

- Rates and Margins: IFCT continues to have a negative net interest margin. While the bank's cost of funds has steadily fallen, earning asset yields have failed to make up the slack. A good portion of the negative NII is due to foregone interest income on IFCT's substantial NPL portfolio. However, even if we assume a foregone interest margin of 6% on all classified assets, foregone interest income of Bt466 million would not suffice to restore NII to positive territory. We suspect that two additional factors—loan restructurings and depressed yield on impaired securities—are combining with foregone interest to render the bank unprofitable:

- Asset Quality: IFCT continues to be plagued by NPLs, which now account for 26.3% of total loans. While this has declined from the 2Q99 peak of 42.1%, it remains a serious concern. Existing reserves are inadequate to support identified NPLs, totaling only 35% of our required reserve of Bt30 billion. The shortfall is equivalent to 2.0x IFCT's remaining capital base, leaving the bank insolvent.

In addition to these impaired assets, IFCT continues to have an excessive and unsupportable amount of accrued interest receivable (AIR), more than three years into the crisis. AIR of Bt5.9 billion exceeds 4% of total loans, which is well above even the year-end 1997 level. The poor quality of this asset should be reflected, in our opinion, by reversing AIR through NII. In the meantime, it is perfectly reasonable to consider all IFCT's AIR as at least a substandard asset, which would require an additional Bt1.2 billion in provisions.

While this paints a bleak picture, IFCT is generally well-positioned relative to its commercial bank peers in its collateral coverage of loans, as management has been more conservative in assessing appraised values, as well as in their maximum loan commitments to appraised values. IFCT will typically haircut collateral value by 40%-50% of appraised value, lending only 70%-80% of the adjusted value. In addition, the bank has historically been a cash-flow based lender versus mainly collateral-based lending by the commercial banks. With borrowers' assets difficult to repossess in Thailand, this has made a large difference in write-offs to date.

Symbiotic Relationship With the Government

IFCT, under the Industrial Finance Corporation Act of 1959, is entitled to certain benefits as a specialized financial institution, as follows:

- Implied Government Guaranty: IFCT does not accept deposits and primarily funds itself though debentures and long-term bonds. While certain obligations are guaranteed by the Ministry of Finance (MOF), the overall government ownership position of IFCT implies a government guarantee even for external borrowings that are not explicitly backed, thus producing a lower cost of funds.

- Concessional Lending: IFCT is a direct beneficiary of the government's channeling of concessional loans to specialized finance institutions that will alleviate the liquidity problems of the industrial and SME sectors. Borrowing rates from the government are, of course, below market. IFCT historically has been a recipient of concessional loans from foreign development banks, as well, including the World Bank, Asian Development Bank, the Export-Import Bank of Japan, and various European development banks. In the past year, IFCT has received Bt3.5 billion from the Overseas Economic Cooperation Fund of Japan, US$25 million from the Netherlands Development Co. and US$45 million from Kreditanstalt, a German development bank.

- Special Tax Exemption: IFCT is not subject to corporate income tax and is exempt from paying business taxes and stamp duty. This factor alone enables stronger earnings and ROEs compared to the commercial banks.

IFCT

Share Price:	5.70	Index:	278.75
52 Week Price Range:	20.50 - 5.40	Current Yield:	0.0%
Reuters Code:	IFCT.BK		
Bloomberg Code:	IFCT TB		

INCOME STATEMENT	1998A	1999A	2000E	2001E	2002E
(THBm)					
Interest income	n.a	9,525	8,844	9,303	10,201
Interest expense	n.a	11,614	10,469	9,941	9,493
Net interest income	1,107	-2,089	-1,625	-639	708
Ave. int. earnings assets	*177,446*	*168,155*	*162,295*	*166,917*	*171,235*
NIM (%)	0.62%	-1.24%	-1.00%	-0.38%	0.41%
Non-interest income	-554	1,520	1,692	1,698	1,717
Total operating income	553	-569	67	1,059	2,425
Non-interest expenses	-665	-556	-626	-720	-837
Pre provision profit	-112	-1,125	-559	339	1,588
Loan loss provisions	-3,141	-6,046	-682	-2,000	-1,200
Non-operating income	-1,442	-700	-156	0	0
Pre tax profit	-4,695	-7,871	-1,398	-1,661	388
Tax	0	0	0	0	0
Net profit	-4,695	-7,908	-1,418	-1,698	348
Core earnings	-3,253	-7,208	-1,261	-1,698	348

PER SHARE DATA (THB)	1998A	1999A	2000E	2001E	2002E
EPS	(8.62)	(6.81)	(1.22)	(1.46)	0.30
DPS	0.00	0.00	0.00	0.00	0.00
Effective payout ratio (%)	*0%*	*0%*	*0%*	*0%*	*0%*
BVPS	18.94	10.73	7.90	6.44	6.74
ABVPS	17.82	10.11	7.31	5.87	6.19

VALUATION	1998A	1999A	2000E	2001E	2002E
Price to book value (x)	0.8	1.7	0.7	0.9	0.8
Price to adjusted book value (x)	0.8	1.8	0.8	1.0	0.9
Price to earnings (X)	-1.7	-2.7	-4.7	-3.9	19.0

PROFITABILITY RATIOS	1998A	1999A	2000E	2001E	2002E
(%)					
Net interest margin	0.62%	-1.24%	-1.00%	-0.38%	0.41%
Yield on interest earning assets	n.a	5.96%	5.37%	5.50%	5.88%
Cost on interest bearing liabilities	n.a	7.43%	6.59%	6.10%	5.69%
Net interest spread	n.a	-1.47%	-1.22%	-0.60%	0.19%
Non-int. income (% Op income)	-100.2%	-266.8%	2532.8%	160.3%	70.8%
Cost to income	-74.8%	-43.8%	-699.0%	68.0%	34.5%
Overhead ratio	0.37%	0.33%	0.39%	0.43%	0.49%
Cost coverage	-83.3%	273.5%	270.2%	235.7%	205.2%
ROA	-2.40%	-4.43%	-0.81%	-0.93%	0.18%
ROE	-37.9%	-73.7%	-14.0%	-22.2%	5.0%

OROA ANALYSIS	1998A	1999A	2000E	2001E	2002E
Net interest margin	0.62%	-1.24%	-1.00%	-0.38%	0.41%
Non-interest inc./gross inc.	224.57%	-64.57%	-1713.89%	160.31%	70.80%
Efficiency ratio	-74.8%	-43.8%	-699.0%	68.0%	34.5%
Provision/assets	1.70%	3.52%	0.38%	1.08%	0.62%
Operating return on assets	-2.57%	-4.60%	-0.82%	-0.87%	0.31%
Equity/assets	5.58%	7.25%	5.13%	4.02%	4.05%
Operating return on equity	-46.1%	-63.5%	-16.0%	-21.7%	7.6%

BALANCE SHEET	1998A	1999A	2000E	2001E	2002E
(THBm)					
Gross loans	138,170	142,566	147,068	152,362	160,880
Loan loss reserves	*4,714*	*10,252*	*10,796*	*12,057*	*12,474*
Net loans	127,005	125,721	130,616	135,011	143,418
Total earning assets	176,559	159,751	164,838	168,997	173,473
Other assets	8,457	12,163	13,953	16,945	19,908
Total Assets	185,016	171,914	178,791	185,943	193,380
Deposits	170,766	152,978	155,273	159,155	163,134
Other paying liabilities	3,663	3,281	3,641	3,732	3,825
Other liabilities	881	3,907	11,388	16,238	19,229
Total Liabilities	175,310	160,166	170,302	179,125	186,188
Equity with revaluation	10,318	12,468	9,180	7,482	7,830
Adjusted equity	9,706	11,748	8,489	6,818	7,192

BALANCE SHEET RATIOS	1998A	1999A	2000E	2001E	2002E
(%)					
Loan-to-deposit	77.1%	88.9%	91.1%	92.4%	95.6%
Equity to assets	5.6%	7.3%	5.1%	4.0%	4.0%
Tier 1 Capital	-	-	-	-	-
Total Capital adequacy	-	-	-	-	-
Total loan provisions	3.58%	7.54%	7.63%	8.20%	8.00%

ASSET QUALITY	1998A	1999A	2000E	2001E	2002E
Nonperforming assets	46,811	49,072	37,003	32,165	25,014
Special mention	-	5,843	4,667	3,802	3,096
Substandard	-	646	644	525	427
Doubtful	-	6,118	4,297	3,650	2,849
Loss	-	34,277	24,876	21,129	16,148
ORE	446	2,188	2,518	3,061	2,493
NPAs/total loans	35.5%	36.1%	26.2%	21.9%	16.0%
Reserve coverage of NPAs	10.1%	20.9%	29.2%	37.5%	49.9%
Required reserves	n.a	39,152	29,017	25,093	19,695
Actual reserves	n.a	10,252	10,796	12,057	12,474
Shortfall (surplus)	n.a	28,900	18,221	13,036	7,222
Actual to required reserves	n.a	26%	37%	48%	63%
Shortfall to capital	n.a	232%	198%	174%	92%

GROWTH RATES	1998A	1999A	2000E	2001E	2002E
(%)					
Income statement					
Net interest income	-78.6%	-288.7%	-22.2%	-60.7%	-210.9%
Non-interest income	-1049.9%	-141.1%	87.3%	10.6%	1.1%
Total operating income	-116.5%	42.9%	-92.9%	-1281.9%	129.0%
Non-interest expenses	-55.7%	-16.4%	12.7%	15.0%	16.2%
Pre-provision earnings	-140.0%	17.5%	-60.8%	-147.3%	368.7%
Loan loss provisions	-9.6%	92.5%	-88.7%	193.1%	-40.0%
Core earnings	-232.2%	121.6%	-82.5%	34.6%	-120.5%
Net profit	-354.6%	68.5%	-82.1%	19.8%	-120.5%
Balance sheet					
Loan growth	-15.2%	3.2%	4.0%	4.0%	6.0%
Interest earning assets	-1.0%	-9.5%	3.2%	2.5%	2.6%
Asset growth	-10.6%	-7.1%	4.0%	4.0%	4.0%
Deposit growth	-8.6%	-10.4%	1.5%	2.5%	2.5%
Shareholders funds	-34.2%	20.8%	-26.4%	-18.5%	4.7%

KRUNG THAI BANK (BT11.75) 4-MARKET UNDERPERFORM (F)

Investment Summary

At long last, the government has completed the bail-out of Krung Thai, the country's most troubled bank. The FIDF purchased Bt537 billion in troubled loans from Krung Thai, in return for interest-bearing government bonds. The bank was then able to write-back Bt108 billion in reserves held against the NPLs, which was used to repurchase the government's preferred shares in the bank. We consider the Bt108 billion write-back an extraordinary gain, which explains the discrepancy between core and net earnings for FY2000.

The government also received warrants to purchase 10.8 billion preferred shares at par; we continue to look at Krung Thai on a fully-diluted basis assuming eventual conversion of these shares.

Post asset transfer, Krung Thai is now solvent—the only Thai bank which can make such a claim under our methodology. Reserve underfunding of Bt51.8 billion is only 78% of capital, leaving the bank with positive equity even after making allowances for impaired assets. However, the residual institution will still have difficulty returning to normal operation, with its franchise seriously eroded.

Key Points

- Asset Quality Still Poor: Krung Thai's NPLs fell from Bt658 billion in 1Q00 to Bt132 billion at 3Q00, with net non-performing assets dropping from Bt432 billion to Bt94 billion over the same period. Although this is an excellent result (albeit one produced solely by government intervention and not by business improvement), NPLs to assets are still high at 13.3%, leaving KTB a lot of work to do.

In addition, we note with approval that accrued interest receivables fell to 1.95% of loans from 4.38%. Although the amount is still out of line, it reverses an adverse trend dating back to 1Q96.

- AMC: KTB's bad assets—substantially all loans delinquent for at least one year—were purchased by the Financial Institutions Development Fund, which has set up Sukhumvit AMC, an Asset Management Company to manage these bad assets. The bad assets include former loans of First Bangkok City Bank, which was forcibly merged into KTB in 1998. Krung Thai has no ownership of or continuing responsibility for the assets in the AMC.

- NPL Transfer Funding: Sukhumvit is primarily funded by loans from Krung Thai, which are fully guaranteed by the government. The notes given to KTB pay interest equivalent to the average savings rate paid on the banks deposits, plus the FIDF bank tax charges on income. In essence, KTB is making a zero-margin five-year loan to the FIDF of Bt313 billion, or 32% of the bank's assets.

- Reserve Adequacy: Current reserves of Bt52 billion are still inadequate, with our estimate of required reserves now standing at Bt103 billion, implying a shortfall of Bt52 billion, or 0.78x remaining book capital. The government purchase plan lowered NPLs, but also depleted reserves, leaving post-recap coverage at 50% of required reserves with NPL coverage of 35%.

- Ownership: Krung Thai remains overwhelmingly controlled by the government. Among the FIDF, Ministry of Finance, and various other state entities, collective KTB ownership is currently (i.e., not including warrant conversion) over 92%, which will limit trading float and index inclusion. Foreign ownership is less than 4%.

- M&A Potential: As KTB is now solvent, it could make an attractive strategic partner for a foreign bank looking to enter the market; however, we doubt a near-term deal for a variety of reasons: First, the bank has poor management even by the standards of the sector, so that any partner would presumably insist on management control.

Second, the sheer size of the bank—~$22.5 billion in assets—would require a substantial commitment of risk assets to Thailand. Only a few global banks could possibly do such a deal, and most either have existing Thai operations or have passed on the opportunity to acquire same. Finally, the Thai government's track record in selling banks is mixed at best, and we doubt that they would be willing to place a realistic value on the government's stake in the bank.

In-market consolidation could make sense as a way for KTB to improve its float and acquire a better management team, IT platform and brand name, but government opposition to cost saves and consolidation of operations could easily nix this option. We see it more likely that the government will use Krung Thai as a vehicle to absorb other failed banks under government supervision, such as Bank Thai.

Krung Thai Bank

Share Price:	11.75	Index:	278.75	Reuters Code:	KTB.BK
52 Week Price Range:	21.50 - 10.00	Current Yield:	0.0%	Bloomberg Code:	KTB TB

INCOME STATEMENT	1998A	1999A	2000E	2001E	2002E
(THBm)					
Interest income	n.a	48,510	41,056	43,062	46,288
Interest expense	n.a	42,484	29,084	31,153	34,192
Net interest income	12,723	6,026	11,972	11,909	12,097
Ave. int. earnings assets	*779,143*	*883,233*	*927,727*	*913,748*	*895,609*
NIM (%)	1.63%	0.68%	1.29%	1.30%	1.35%
Non-interest income	9,284	6,483	5,089	5,147	5,154
Total operating income	22,007	12,509	17,061	17,056	17,251
Non-interest expenses	-16,447	-19,145	-17,864	-19,366	-19,545
Pre provision profit	5,561	-6,636	-803	-2,310	-2,294
Loan loss provisions	-64,989	-84,384	-27,787	-8,000	-4,000
Non-operating income	-1,971	0	108,000	0	0
Pre tax profit	-61,399	-91,019	-28,590	-10,310	-6,294
Tax	-185	-2	-2,852	0	0
Net profit	-61,585	-91,022	76,558	-10,310	-6,294
Core earnings	-59,608	-91,022	-31,442	-10,310	-6,294

PER SHARE DATA (THB)	1998A	1999A	2000E	2001E	2002E
EPS	(16.91)	(4.14)	3.48	(0.47)	(0.29)
DPS	0.00	0.00	0.00	0.00	0.00
Effective payout ratio (%)	*0%*	*0%*	*0%*	*0%*	*0%*
BVPS	22.92	4.65	2.91	2.44	2.16
ABVPS	21.77	4.46	2.73	2.26	1.97

VALUATION	1998A	1999A	2000E	2001E	2002E
Price to book value (x)	0.9	3.3	4.0	4.8	5.5
Price to adjusted book value (x)	0.9	3.4	4.3	5.2	6.0
Price to earnings (X)	-1.2	-3.7	3.4	-25.1	-41.0

PROFITABILITY RATIOS	1998A	1999A	2000E	2001E	2002E
(%)					
Net interest margin	1.63%	0.68%	1.29%	1.30%	1.35%
Yield on interest earning assets	n.a	5.20%	4.45%	4.76%	5.22%
Cost on interest bearing liabilities	n.a	4.86%	3.21%	3.34%	3.55%
Net interest spread	n.a	0.35%	1.24%	1.42%	1.67%
Non-int. income (% Op income)	42.2%	51.8%	29.8%	30.2%	29.9%
Cost to income	82.1%	153.0%	104.7%	113.5%	113.3%
Overhead ratio	2.11%	2.17%	1.93%	2.12%	2.18%
Cost coverage	56.5%	33.9%	28.5%	26.6%	26.4%
ROA	-6.63%	-8.84%	7.76%	-1.04%	-0.62%
ROE	-101.9%	-102.7%	96.9%	-18.8%	-13.5%

OROA ANALYSIS	1998A	1999A	2000E	2001E	2002E
Net interest margin	1.63%	0.68%	1.29%	1.30%	1.35%
Non-interest inc./gross inc.	36.50%	51.83%	29.83%	30.18%	29.88%
Efficiency ratio	82.1%	153.0%	104.7%	113.5%	113.3%
Provision/assets	6.10%	8.48%	2.84%	0.80%	0.39%
Operating return on assets	-5.64%	-9.23%	-2.93%	-1.05%	-0.65%
Equity/assets	7.84%	10.27%	6.54%	5.38%	4.65%
Operating return on equity	-72.0%	-89.9%	-44.7%	-19.6%	-13.9%

BALANCE SHEET	1998A	1999A	2000E	2001E	2002E
(THBm)					
Gross loans	1,000,155	976,592	441,850	433,079	424,482
Loan loss reserves	*141,960*	*226,121*	*53,163*	*59,037*	*60,953*
Net loans	815,481	708,921	377,489	363,067	352,772
Total earning assets	833,921	932,546	922,908	904,588	886,631
Other assets	231,481	62,274	55,460	93,494	131,563
Total Assets	1,065,402	994,819	978,367	998,082	1,018,194
Deposits	803,716	802,102	854,382	880,303	907,011
Other paying liabilities	72,985	72,839	51,932	53,507	55,131
Other liabilities	109,405	21,875	12,085	14,612	12,687
Total Liabilities	986,106	896,815	918,398	948,423	974,829
Equity with revaluation	83,477	102,185	63,999	53,689	47,396
Adjusted equity	79,296	98,004	59,969	49,659	43,365

BALANCE SHEET RATIOS	1998A	1999A	2000E	2001E	2002E
(%)					
Loan-to-deposit	119.1%	116.6%	50.4%	47.9%	45.6%
Equity to assets	7.8%	10.3%	6.5%	5.4%	4.7%
Tier 1 Capital	-	-	-	-	-
Total Capital adequacy	-	-	-	-	-
Total loan provisions	14.83%	24.18%	12.34%	13.99%	14.73%

ASSET QUALITY	1998A	1999A	2000E	2001E	2002E
Nonperforming assets	480,202	665,435	142,453	129,173	117,700
Special mention	-	19,578	17,300	16,619	15,964
Substandard	-	29,745	18,171	17,455	16,768
Doubtful	-	10,390	6,287	5,566	4,928
Loss	-	598,710	86,534	74,652	64,402
ORE	4,354	7,013	14,159	14,881	15,639
NPAs/total loans	50.2%	45.7%	33.1%	30.6%	28.4%
Reserve coverage of NPAs	29.6%	52.9%	37.3%	45.7%	51.8%
Required reserves	n.a	615,417	100,144	87,922	77,370
Actual reserves	n.a	226,121	53,163	59,037	60,953
Shortfall (surplus)	n.a	389,297	46,981	28,885	16,417
Actual to required reserves	n.a	37%	53%	67%	79%
Shortfall to capital	n.a	381%	73%	54%	35%

GROWTH RATES (%)	1998A	1999A	2000E	2001E	2002E
Income statement					
Net interest income	-54.7%	-100.0%	98.7%	-0.5%	1.6%
Non-interest income	28.3%	-11.3%	-21.5%	1.1%	0.1%
Total operating income	-40.7%	-37.6%	36.4%	0.0%	1.1%
Non-interest expenses	13.5%	16.4%	-6.7%	8.4%	0.9%
Pre-provision earnings	-81.4%	-284.9%	-87.9%	187.6%	-0.7%
Loan loss provisions	242.5%	29.8%	-67.1%	-71.2%	-50.0%
Core earnings	-28341.4%	52.7%	-65.5%	-67.2%	-39.0%
Net profit	-29278.1%	47.8%	-184.1%	-113.5%	-39.0%
Balance sheet					
Loan growth	39.2%	-2.3%	-53.9%	-2.0%	-2.0%
Interest earning assets	15.1%	-100.0%	-1.0%	-2.0%	-2.0%
Asset growth	34.7%	-100.0%	-1.7%	2.0%	2.0%
Deposit growth	38.6%	-100.0%	6.5%	3.0%	3.0%
Shareholders funds	82.4%	-100.0%	-37.4%	-16.1%	-11.7%

SIAM COMMERCIAL BANK (BT20.50) 3-MARKET PERFORM (F)

Investment Summary

Siam Commercial Bank has continued to show marginal profits, with 3Q00 results representing an annualized ROAA of 0.43% and an ROAE of 6.06%, remarkable only in the severely depressed Thai market. While the earnings result was anemic, we continue to feel that SCB is the healthiest of the major Thai banks, with a relatively reasonable valuation to boot.

Investors have been justifiably sceptical about the stock due to fears that SCB is more aggressive than the other banks in valuing collateral against its loans; however, we stress that our book adjustment and reserve adequacy calculations do not take into account collateral values, and yet have still shown SCB to be healthier than its top-tier peers in previous quarters—we must await the detailed earnings release to see if this continues to be so.

Key Points

- Margins: SCB's margins are among the best in the sector, although they contracted in the last quarter, with net interest margin falling by 15 basis points to 2.26%. However, the bank showed a continued reduction in accrued interest receivable, which depressed interest income, as management elected to reverse excess AIR through the interest income accounts rather than write it off against reserves.

- Book Capital is Adequate: Having completed its last public offering and recapitalization in mid-1999, SCB has sufficient capital at 7.6% of assets for operations, which it has bolstered with small profits in each of the last five quarters. SCB is under no immediate pressure to make additional provisions, as it meets the BOT standard, and should be able to manage the timing of further capital raisings accordingly.

- Reserves: The bank continues to be under-reserved and insolvent. We estimate that SCB requires additional reserves at 3Q00 of Bt85.3 billion, or 1.6x capital.

- Preferred Dividend: The SCB preferred shares pay a dividend of 5.25% on the original issue price of Bt26.00; however, this dividend is only payable if SCB is a) profitable during the period; and b) does not have accumulated losses. The dividend is non-cumulative, so that the dividend for any period in which these conditions are not met is permanently lost. This dividend is payable through May of 2009, at which point the dividend becomes equivalent to the yield on regular common shares. SCB must pay preferred dividends in full before it can pay anything to common shareholders.

Siam Commercial Bank

Share Price:	20.50	Index:	278.75
52 Week Price Range:	54.00 - 14.75	Current Yield:	0.0%
Reuters Code:	SCB.BK		
Bloomberg Code:	SCB TB		

INCOME STATEMENT	1998A	1999A	2000E	2001E	2002E
(THBm)					
Interest income	n.a	40,892	37,046	40,655	44,554
Interest expense	n.a	31,104	21,693	21,933	24,358
Net interest income	10,783	9,788	15,353	18,721	20,196
Ave. int. earnings assets	*622,703*	*645,805*	*633,982*	*657,536*	*691,035*
NIM (%)	1.73%	1.52%	2.42%	2.85%	2.92%
Non-interest income	10,844	7,209	10,835	11,003	11,526
Total operating income	21,628	16,996	26,188	29,724	31,722
Non-interest expenses	-17,312	-16,247	-15,885	-15,953	-16,120
Pre provision profit	4,316	749	10,303	13,772	15,602
Loan loss provisions	-12,611	-43,285	-8,109	-7,000	-7,000
Non-operating income	-11,373	7,125	1,655	0	0
Pre tax profit	-19,668	-35,411	3,850	6,772	8,602
Tax	-247	-74	-80	-20	-26
Net profit	-19,559	-35,550	3,681	6,599	8,364
Core earnings	-8,043	-42,690	2,060	6,599	8,364

PER SHARE DATA (THB)	1998A	1999A	2000E	2001E	2002E
EPS	(33.22)	(11.39)	1.18	2.11	2.67
DPS	0.00	0.00	0.00	0.00	0.00
Effective payout ratio (%)	*0%*	*0%*	*0%*	*0%*	*0%*
BVPS	64.66	17.21	17.64	19.75	22.42
ABVPS	58.62	16.09	16.53	18.66	21.34

VALUATION	1998A	1999A	2000E	2001E	2002E
Price to book value (x)	0.3	2.7	1.2	1.0	0.9
Price to adjusted book value (x)	0.3	2.9	1.2	1.1	1.0
Price to earnings (X)	-0.6	-4.1	17.4	9.7	7.7

PROFITABILITY RATIOS	1998A	1999A	2000E	2001E	2002E
(%)					
Net interest margin	1.73%	1.52%	2.42%	2.85%	2.92%
Yield on interest earning assets	n.a	6.52%	5.78%	6.03%	6.29%
Cost on interest bearing liabilities	n.a	5.04%	3.43%	3.38%	3.75%
Net interest spread	n.a	1.49%	2.35%	2.65%	2.54%
Non-int. income (% Op income)	50.1%	42.4%	41.4%	37.0%	36.3%
Cost to income	168.8%	67.4%	57.1%	53.7%	50.8%
Overhead ratio	2.78%	2.52%	2.51%	2.43%	2.33%
Cost coverage	62.6%	44.4%	68.2%	69.0%	71.5%
ROA	-2.75%	-5.09%	0.53%	0.93%	1.17%
ROE	-53.9%	-83.9%	7.2%	12.0%	13.4%

OROA ANALYSIS	1998A	1999A	2000E	2001E	2002E
Net interest margin	1.73%	1.52%	2.42%	2.85%	2.92%
Non-interest inc./gross inc.	-5.15%	59.42%	44.86%	37.02%	36.33%
Efficiency ratio	168.8%	67.4%	57.1%	53.7%	50.8%
Provision/assets	1.79%	6.25%	1.15%	0.98%	0.97%
Operating return on assets	-2.92%	-5.04%	0.74%	1.11%	1.29%
Equity/assets	5.39%	7.76%	7.83%	8.69%	9.69%
Operating return on equity	-54.1%	-64.9%	9.4%	12.8%	13.3%

BALANCE SHEET	1998A	1999A	2000E	2001E	2002E
(THBm)					
Gross loans	559,690	498,005	486,945	511,753	537,824
Loan loss reserves	*31,423*	*23,325*	*26,347*	*30,854*	*35,234*
Net loans	512,846	470,794	456,973	477,089	498,586
Total earning assets	664,850	626,760	641,203	673,869	708,200
Other assets	41,138	65,290	64,408	37,403	15,962
Total Assets	705,988	692,051	705,612	711,272	724,162
Deposits	591,150	568,522	591,015	624,197	636,775
Other paying liabilities	41,380	48,967	42,276	24,968	12,736
Other liabilities	38,940	24,350	20,560	3,707	7,847
Total Liabilities	671,471	641,838	653,851	652,872	657,357
Equity with revaluation	38,069	53,711	55,217	61,816	70,179
Adjusted equity	34,517	50,212	51,760	58,400	66,805

BALANCE SHEET RATIOS	1998A	1999A	2000E	2001E	2002E
(%)					
Loan-to-deposit	92.1%	86.9%	81.8%	81.4%	83.8%
Equity to assets	5.4%	7.8%	7.8%	8.7%	9.7%
Tier 1 Capital	-	-	-	-	-
Total Capital adequacy	-	-	-	-	-
Total loan provisions	5.77%	4.72%	5.45%	6.07%	6.60%

ASSET QUALITY	1998A	1999A	2000E	2001E	2002E
Nonperforming assets	183,864	185,152	163,789	136,821	117,819
Special mention	-	18,196	30,849	32,421	34,072
Substandard	-	31,720	25,714	23,237	20,999
Doubtful	-	23,926	12,811	8,405	5,515
Loss	-	102,107	84,281	61,702	45,172
ORE	4,256	9,203	10,134	11,056	12,062
NPAs/total loans	33.8%	37.5%	33.9%	26.9%	22.1%
Reserve coverage of NPAs	17.1%	12.6%	16.1%	22.6%	29.9%
Required reserves	n.a	126,385	102,732	78,244	60,565
Actual reserves	n.a	23,325	26,347	30,854	35,234
Shortfall (surplus)	n.a	103,060	76,385	47,390	25,331
Actual to required reserves	n.a	18%	26%	39%	58%
Shortfall to capital	n.a	192%	138%	77%	36%

GROWTH RATES (%)	1998A	1999A	2000E	2001E	2002E
Income statement					
Net interest income	-55.4%	-9.2%	56.9%	21.9%	7.9%
Non-interest income	-106.9%	-2812.2%	-12.9%	-11.9%	4.8%
Total operating income	-67.8%	135.2%	15.4%	6.8%	6.7%
Non-interest expenses	15.6%	-6.1%	-2.2%	0.4%	1.0%
Pre-provision earnings	-141.9%	-211.6%	51.9%	15.2%	13.3%
Loan loss provisions	8.7%	243.2%	-81.3%	-13.7%	0.0%
Core earnings	-351.8%	430.8%	-104.8%	220.3%	26.7%
Net profit	-712.3%	81.8%	-110.4%	79.3%	26.7%
Balance sheet					
Loan growth	-4.2%	-9.2%	-2.2%	5.1%	5.1%
Interest earning assets	14.5%	-5.7%	2.3%	5.1%	5.1%
Asset growth	-1.6%	-2.0%	2.0%	0.8%	1.8%
Deposit growth	5.8%	-3.8%	4.0%	5.6%	2.0%
Shareholders funds	-8.7%	41.1%	2.8%	12.0%	13.5%

THAI FARMERS BANK (BT23.50) 3-MARKET PERFORM (F)

Investment Summary

TFB has fallen back into the negative profit zone as of 3Q00, having seemingly run out of the smoke and mirrors accounting sleight-of-hand which boosted earnings into putatively profitable territory in 1Q and 2Q.

TFB remains underprovisioned by Bt103 billion on a consolidated basis, equivalent to 406% of remaining capital, leaving the bank insolvent even as capital continues to dwindle. Total and Tier 1 CARs under the Thai methodology now total 11.73% and 7.07%, off 46bp and 30bp respectively despite declining risk-weighted assets.

We believe that TFB is under pressure to report a turnaround in order to clear the decks for an equity offering, which will be necessary within the next 12 months. Even at current depressed valuations, we believe that TFB is poor value, although we believe that the bank will survive.

Key Points

- Rates and Margins: Net interest margin improved to 2.17% in the quarter, slightly above the 2.13% earned in 1Q00 but well below our 2.44% forecast. The cost of interest-bearing liabilities continued to fall, dropping by 9 basis points, to 3.70%, while yield on earning assets (primarily loans) ticked up by 3 basis points to 5.77%. Weak net interest income remains depressed by NPLs and low-rate restructured loans.

- Provisions: TFB has made no loan loss provisions thus far in FY2000. As TFB's gross consolidated reserves total only 34% of what we would consider an adequate level, this is far from defensible. We believe that TFB should have taken a Bt2.5 billion charge for provisions in each quarter of the year, which would have allowed the bank to reach 50% of our required reserve level by 4Q01—a minimal standard.

- Asset Quality: Criticized loans fell to Bt 180 billion from Bt190 billion, leaving the ratio of non-performing assets (NPAs) to total loans at 39.3%—flat from 2Q00. Loan loss reserves fell by some Bt20 billion, indicating that real asset quality is still deteriorating.

- Capital Position and Fund Raising: Thai Farmers completed several capital raising transactions during 1999, and in consequence has been able to maintain a respectable capital level for longer than some of its peers. However, even the cosmetic profit just reported did not keep capital from falling to Bt25 billion from Bt32 billion in the previous quarter. At approximately 3.3% capital/assets, TFB's capital level is still high enough to sustain additional losses without requiring near-term replenishment, but low enough that the bank will need to add equity by next year in order to continue writing-off bad loans.

Thai Farmers Bank

Share Price:	23.50	Index:	278.75
52 Week Price Range:	65.50 - 20.00	Current Yield:	0.0%
Reuters Code:	TFB.BK		
Bloomberg Code:	TFB TB		

INCOME STATEMENT (THBm)	1998A	1999A	2000E	2001E	2002E
Interest income	77,602	45,536	40,928	43,464	46,118
Interest expense	64,768	35,902	26,071	26,549	28,279
Net interest income	12,834	9,634	14,856	16,916	17,839
Ave. int. earnings assets	*697,193*	*698,173*	*700,628*	*710,462*	*720,506*
NIM (%)	1.84%	1.38%	2.12%	2.38%	2.48%
Non-interest income	9,579	6,531	7,273	6,827	6,727
Total operating income	22,413	16,165	22,130	23,743	24,567
Non-interest expenses	-18,153	-17,186	-20,025	-19,384	-19,530
Pre provision profit	4,260	-1,020	2,105	4,358	5,037
Loan loss provisions	-44,076	-42,009	-2,735	-10,000	-6,000
Non-operating income	-2,117	-1,462	340	0	0
Pre tax profit	-41,934	-45,720	505	-5,642	-963
Tax	1,763	-2,625	-420	282	48
Net profit	-40,121	-47,019	806	-5,474	-934
Core earnings	-38,093	-45,403	1,410	-5,474	-934

PER SHARE DATA (THB)	1998A	1999A	2000E	2001E	2002E
EPS	(34.12)	(16.21)	0.28	(1.89)	(0.32)
DPS	0.00	0.00	0.00	0.00	0.00
Effective payout ratio (%)	*0%*	*0%*	*0%*	*0%*	*0%*
BVPS	44.58	10.91	8.07	6.18	5.86
ABVPS	41.24	9.57	5.78	3.91	3.60

VALUATION	1998A	1999A	2000E	2001E	2002E
Price to book value (x)	0.9	5.8	2.9	3.8	4.0
Price to adjusted book value (x)	0.9	6.6	4.1	6.0	6.5
Price to earnings (X)	-1.1	-3.9	84.6	-12.4	-73.0

PROFITABILITY RATIOS (%)	1998A	1999A	2000E	2001E	2002E
Net interest margin	1.84%	1.38%	2.12%	2.38%	2.48%
Yield on interest earning assets	11.08%	6.54%	5.80%	6.07%	6.36%
Cost on interest bearing liabilities	9.44%	5.23%	3.63%	3.53%	3.59%
Net interest spread	1.64%	1.31%	2.17%	2.54%	2.76%
Non-int. income (% Op income)	42.7%	40.4%	32.9%	28.8%	27.4%
Cost to income	89.4%	127.5%	86.1%	81.6%	79.5%
Overhead ratio	2.60%	2.46%	2.86%	2.73%	2.71%
Cost coverage	52.8%	38.0%	36.3%	35.2%	34.4%
ROA	-5.17%	-6.31%	0.11%	-0.71%	-0.12%
ROE	-79.2%	-123.3%	3.6%	-39.0%	-8.6%

OROA ANALYSIS	1998A	1999A	2000E	2001E	2002E
Net interest margin	1.84%	1.38%	2.12%	2.38%	2.48%
Non-interest inc./gross inc.	36.77%	28.50%	36.14%	28.76%	27.38%
Efficiency ratio	89.4%	127.5%	86.1%	81.6%	79.5%
Provision/assets	5.82%	5.73%	0.36%	1.28%	0.75%
Operating return on assets	-5.52%	-6.26%	0.11%	-0.66%	-0.05%
Equity/assets	6.93%	4.32%	3.05%	2.29%	2.13%
Operating return on equity	-79.7%	-145.1%	3.5%	-29.0%	-2.5%

BALANCE SHEET (THBm)	1998A	1999A	2000E	2001E	2002E
Gross loans	621,740	536,260	513,576	500,194	494,081
Loan loss reserves	*78,138*	*50,343*	*55,816*	*63,307*	*66,841*
Net loans	530,790	480,507	453,305	432,943	423,748
Total earning assets	700,331	696,015	705,241	715,682	725,329
Other assets	56,508	37,107	61,693	66,707	72,825
Total Assets	756,839	733,121	766,934	782,388	798,154
Deposits	628,090	608,554	644,288	674,440	706,004
Other paying liabilities	58,234	77,823	73,659	77,106	80,715
Other liabilities	22,020	18,995	32,231	19,514	997
Total Liabilities	708,344	705,372	750,178	771,061	787,715
Equity with revaluation	52,417	31,645	23,405	17,931	16,997
Adjusted equity	48,495	27,750	16,757	11,328	10,439

BALANCE SHEET RATIOS (%)	1998A	1999A	2000E	2001E	2002E
Loan-to-deposit	96.9%	87.2%	79.0%	73.6%	69.5%
Equity to assets	6.9%	4.3%	3.1%	2.3%	2.1%
Tier 1 Capital	-	-	-	-	-
Total Capital adequacy	-	-	-	-	-
Total loan provisions	12.83%	9.48%	10.96%	12.76%	13.62%

ASSET QUALITY	1998A	1999A	2000E	2001E	2002E
Nonperforming assets	349,881	227,374	188,012	153,580	125,803
Special mention	16,700	9,178	8,491	6,916	5,633
Substandard	33,321	23,264	14,815	9,936	6,664
Doubtful	93,153	21,096	14,388	11,966	9,952
Loss	205,064	166,007	135,699	112,854	93,856
ORE	1,644	7,830	14,620	11,908	9,699
NPAs/total loans	57.5%	42.8%	36.9%	30.9%	25.6%
Reserve coverage of NPAs	22.3%	22.1%	29.7%	41.2%	53.1%
Required reserves	262,203	186,399	152,606	127,137	106,166
Actual reserves	78,138	50,343	55,816	63,307	66,841
Shortfall (surplus)	184,065	136,056	96,790	63,830	39,324
Actual to required reserves	30%	27%	37%	50%	63%
Shortfall to capital	351%	430%	414%	356%	231%

GROWTH RATES (%)	1998A	1999A	2000E	2001E	2002E
Income statement					
Net interest income	-53.9%	-24.9%	54.2%	13.9%	5.5%
Non-interest income	16.0%	-48.5%	118.9%	-18.8%	-1.5%
Total operating income	-40.7%	-33.6%	72.7%	2.1%	3.5%
Non-interest expenses	10.7%	-5.3%	16.5%	-3.2%	0.7%
Pre-provision earnings	-88.0%	-273.2%	-187.3%	34.5%	15.6%
Loan loss provisions	162.2%	-4.7%	-93.5%	265.6%	-40.0%
Core earnings	-1294.4%	19.2%	-103.1%	-488.3%	-82.9%
Net profit	-5110.2%	17.2%	-101.7%	-779.3%	-82.9%
Balance sheet					
Loan growth	-0.1%	-12.8%	-4.1%	-2.5%	-1.1%
Interest earning assets	0.9%	-0.6%	1.3%	1.5%	1.3%
Asset growth	-4.8%	-3.1%	4.6%	2.0%	2.0%
Deposit growth	6.7%	-3.1%	5.9%	4.7%	4.7%
Shareholders funds	-7.7%	-39.6%	-26.0%	-23.4%	-5.2%

THAI MILITARY BANK (BT5.70) 4-UNDERPERFORM (F)

Investment Summary

TMB has not reported a profit since 3Q97, and we expect continued losses through year-end 2001. Even after the painful and punitive share offering TMB undertook during 2Q00, which raised almost Bt30 billion, the bank remains insolvent by a multiple of its capital and is unprofitable on an operating basis.

The bank's survival is now in jeopardy, with prospects for another offering to boost capital dim. Management has indicated their willingness to sell up to 100% of the bank to a domestic or foreign bidder (presumably having discussed this with the Bank of Thailand), but the under-funded loan loss reserve makes TMB an expensive franchise even as its stock price approaches zero.

Key Points

- Capital Raising: At the end of 1Q00, TMB had minimal capital of Bt6 billion, or 1.8% of assets. During 2Q00, TMB raised an additional Bt30 billion in capital by issuing 996 million common and two billion Class B convertible preferred shares, resulting in 3Q00 equity of Bt13.6 billion–a barely-adequate 4.0% of assets. The bank will require additional capital within the next 18-24 months; it is certainly difficult to imagine investors sinking additional funds into this franchise.

- Asset Quality: Asset quality remains poor, with non-performing assets still totaling 42.0% of total loans. TMB's reserve is underfunded by Bt58 billion, or 4.2x remaining capital. Criticized assets have declined only marginally since the extraordinary write-off of the second quarter, and we would not be surprised to see them begin to creep up again.

- Potential Merger: The possibility of a merger with finance and securities company National Finance PCL has been raised by NFS' subscription to the TMB share offering through its Ekachart Finance subsidiary. An acquisition of TMB by National Finance would give the latter control of a full banking license for the first time, long a corporate goal. NFS had its application to upgrade Ekachart from a finance company license to a restricted bank license pending before the BOT for some time before the TMB recap, and it could be that the central bank forced NFS to prop up TMB as the price of access to a bank franchise.

Thai Military Bank

Share Price:	5.70	Index:	278.75
52 Week Price Range:	16.39 - 5.20	Current Yield:	0.0%
Reuters Code:	TMB.BK		
Bloomberg Code:	TMB TB		

INCOME STATEMENT (THBm)	1998A	1999A	2000E	2001E	2002E
Interest income	n.a	19,239	15,263	17,419	18,807
Interest expense	n.a	17,313	13,032	13,074	13,464
Net interest income	2,972	1,925	2,231	4,345	5,343
Ave. int. earnings assets	*358,783*	*339,635*	*323,828*	*340,331*	*356,258*
NIM (%)	0.83%	0.57%	0.69%	1.28%	1.50%
Non-interest income	3,002	2,206	2,967	2,560	2,712
Total operating income	5,974	4,131	5,197	6,904	8,055
Non-interest expenses	-6,941	-6,617	-5,254	-3,174	-1,842
Pre provision profit	-967	-2,487	-57	3,730	6,213
Loan loss provisions	-9,864	-9,110	-25,718	-10,000	-7,000
Non-operating income	-1,977	0	-327	0	0
Pre tax profit	-12,808	-11,597	-26,102	-6,270	-787
Tax	-34	-27	-24	-14	-8
Net profit	-12,842	-11,624	-26,126	-6,283	-795
Core earnings	-10,859	-11,624	-25,799	-6,283	-795

PER SHARE DATA (THB)	1998A	1999A	2000E	2001E	2002E
EPS	(12.65)	(11.45)	(6.53)	(1.57)	(0.20)
DPS	0.00	0.00	0.00	0.00	0.00
Effective payout ratio (%)	*0%*	*0%*	*0%*	*0%*	*0%*
BVPS	15.09	8.73	2.84	1.27	1.07
ABVPS	14.06	7.73	2.59	1.02	0.82

VALUATION	1998A	1999A	2000E	2001E	2002E
Price to book value (x)	0.6	1.7	2.0	4.5	5.3
Price to adjusted book value (x)	0.6	2.0	2.2	5.6	6.9
Price to earnings (X)	-0.7	-1.3	-0.9	-3.6	-28.7

PROFITABILITY RATIOS (%)	1998A	1999A	2000E	2001E	2002E
Net interest margin	0.83%	0.57%	0.69%	1.28%	1.50%
Yield on interest earning assets	n.a	6.11%	4.59%	5.00%	5.16%
Cost on interest bearing liabilities	n.a	5.43%	4.09%	3.90%	3.82%
Net interest spread	n.a	0.67%	0.50%	1.10%	1.34%
Non-int. income (% Op income)	50.3%	53.4%	57.1%	37.1%	33.7%
Cost to income	173.7%	160.2%	107.9%	46.0%	22.9%
Overhead ratio	1.93%	1.95%	1.62%	0.93%	0.52%
Cost coverage	43.3%	33.3%	56.5%	80.6%	147.2%
ROA	-3.46%	-3.37%	-7.70%	-1.78%	-0.21%
ROE	-97.1%	-105.1%	-287.0%	-87.0%	-21.6%

OROA ANALYSIS	1998A	1999A	2000E	2001E	2002E
Net interest margin	0.83%	0.57%	0.69%	1.28%	1.50%
Non-interest inc./gross inc.	25.65%	53.39%	54.20%	37.07%	33.67%
Efficiency ratio	173.7%	160.2%	107.9%	46.0%	22.9%
Provision/assets	2.78%	2.72%	7.48%	2.77%	1.84%
Operating return on assets	-3.60%	-3.45%	-7.60%	-1.67%	-0.10%
Equity/assets	4.32%	2.64%	3.30%	1.40%	1.13%
Operating return on equity	-83.4%	-130.5%	-230.0%	-119.0%	-8.8%

BALANCE SHEET (THBm)	1998A	1999A	2000E	2001E	2002E
Gross loans	303,725	292,210	272,452	283,515	295,027
Loan loss reserves	*17,816*	*21,261*	*13,957*	*22,561*	*28,107*
Net loans	272,320	261,081	258,495	260,954	266,919
Total earning assets	364,165	315,106	332,549	348,113	364,404
Other assets	-9,800	19,897	11,301	13,255	15,374
Total Assets	354,364	335,002	343,850	361,368	379,778
Deposits	293,772	259,843	268,373	282,045	296,414
Other paying liabilities	44,066	58,825	50,492	53,064	55,768
Other liabilities	2,251	8,488	14,622	22,178	24,311
Total Liabilities	340,089	327,156	333,487	357,288	376,493
Equity with revaluation	15,314	8,859	11,357	5,074	4,279
Adjusted equity	14,276	7,846	10,363	4,080	3,285

BALANCE SHEET RATIOS (%	1998A	1999A	2000E	2001E	2002E
Loan-to-deposit	98.8%	108.7%	101.5%	100.5%	99.5%
Equity to assets	4.3%	2.6%	3.3%	1.4%	1.1%
Tier 1 Capital	-	-	-	-	-
Total Capital adequacy	-	-	-	-	-
Total loan provisions	6.14%	7.53%	5.12%	7.96%	9.53%

ASSET QUALITY	1998A	1999A	2000E	2001E	2002E
Nonperforming assets	119,052	142,104	106,816	88,739	74,645
Special mention	-	26,500	21,558	14,144	9,280
Substandard	-	14,600	14,743	12,008	9,781
Doubtful	-	11,800	11,639	10,735	9,902
Loss	-	84,900	55,040	48,727	43,137
ORE	8,800	4,304	3,836	3,125	2,545
NPAs/total loans	41.0%	50.3%	39.2%	31.3%	25.3%
Reserve coverage of NPAs	15.0%	15.0%	13.1%	25.4%	37.7%
Required reserves	n.a	97,450	67,348	59,807	53,247
Actual reserves	n.a	21,261	13,957	22,561	28,107
Shortfall (surplus)	n.a	76,189	53,390	37,246	25,139
Actual to required reserves	n.a	22%	21%	38%	53%
Shortfall to capital	n.a	860%	470%	734%	587%

GROWTH RATES (%)	1998A	1999A	2000E	2001E	2002E
Income statement					
Net interest income	-67.0%	-35.2%	15.9%	94.8%	23.0%
Non-interest income	-67.3%	115.1%	19.7%	-3.0%	6.0%
Total operating income	-67.1%	3.3%	17.9%	41.8%	16.7%
Non-interest expenses	3.8%	-4.7%	-20.6%	-39.6%	-42.0%
Pre-provision earnings	-153.9%	-15.5%	-84.6%	-1072.2%	66.6%
Loan loss provisions	181.4%	-7.6%	182.3%	-61.1%	-30.0%
Core earnings	-669.2%	7.0%	122.0%	-75.6%	-87.4%
Net profit	-1038.6%	-9.5%	124.8%	-75.9%	-87.4%
Balance sheet					
Loan growth	-4.3%	-2.7%	-3.5%	4.1%	4.1%
Interest earning assets	3.0%	-13.5%	5.5%	4.7%	4.7%
Asset growth	-8.8%	-5.5%	2.6%	5.1%	5.1%
Deposit growth	14.1%	-11.5%	3.3%	5.1%	5.1%
Shareholders funds	-31.1%	-42.2%	28.2%	-55.3%	-15.7%

INDONESIAN BANKS

It has been another punishing year for Indonesian bank stocks, with the average of our coverage universe down over 45% even in rupiah terms, despite the 18% gain posted by Bank Central Asia (BCA) post its June listing. While we remain UNDERWEIGHT the sector, significant progress in certain areas bears notice.

At the end of 1999, the weightiest arguments against investment in Indonesian banks were institution-specific: virtually all banks were massively insolvent and losing money on an operating basis due to negative net interest income. Asset quality was extremely poor, with the worst banks having NPLs exceeding a staggering 90% of total loans. Serious questions abounded about the government's ability to recapitalize banks, remove impaired assets and force consolidation.

Against long odds, these caveats have been largely eliminated for the moment, with NPAs to Assets at banks in our coverage universe now totaling 11.7%, versus the Thai commercial bank average of 23.4%. The major public Indonesian banks (BCA, Lippo, Panin) are at least healthy enough to be able to make strides in restructuring their operations—closing underperforming branches, improving information technology, and repositioning what was largely a process culture as a customer-focused sales effort.

Key Investment Factors

Under-levered Balance Sheets. Commercial bank assets in Indonesia are currently up to 80% government recap bonds, which produce little spread and are not easily saleable at par. The ability of banks to improve their spreads depends on their ability to find creditworthy borrowers and make high-margin loans.

Negative Loan Growth. After the rapid credit expansion during the early 1990s (24.3% per year between 1992 and 1996), loan growth in Indonesia has turned strongly negative since the crisis. A return to corporate loan growth will depend on how quickly corporate debt restructuring takes place. Meanwhile, most banks are focusing on lending to small businesses and consumers, similar to the strategy of good Korean banks.

Consumer Lending is Key. There are tremendous opportunities for banks to lend to the retail customer in Indonesia. Until now, the retail customer has been viewed merely as a source of deposits to fund the ambitions of the banks' owners. Now, however, the retail lending market appears quite attractive, as it should offer the banks loan diversification with relatively low risk. However, with virtually all banks having identified this as their target market, there exists substantial risk of uneconomic pricing and/or poor credit decisions.

Foreign Competition is Rising. Foreign banks are in Indonesia to stay. While most banks were just gaining a foothold when the crisis hit, and many almost completely curtailed their lending activities, they have nevertheless gained substantial deposit market share even while paying sharply lower rates. As these banks have long serviced

Indonesia's wealthy from offshore and have a substantial advantage in providing foreign currency loans to Indonesia's remaining prosperous corporations, foreign banks will soon be in a position to compete for most large corporate credit relationships. We expect that the next step for these banks will be to acquire domestic institutions in order to gain the required scale to tap the consumer market.

Inexperienced Credit Officers. Bank credit officers mostly lack the expertise required to evaluate the credit-worthiness of borrowers. Many were reared in the pre-reform environment, where credit analysis was a minor issue in extending a loan. As elsewhere in Asia, the main criteria for lending were the availability of collateral, primarily land, and the borrower's connection with bank ownership. This, when coupled with the desperation of banks to put on profitable loan assets, leaves Indonesia vulnerable to another asset quality crisis.

Poor Supervision. The central bank has a poor record of supervision, and its credibility is meager—Bank Indonesia's Governor is under indictment and has spent a good portion of the second half under police confinement. A majority of the other board members have resigned due to their unhappiness with the slow pace of reforms. Meanwhile, BI's accounting remains impenetrable, although it seems undisputed that the institution is insolvent by several billion dollars.

Investment Opinion

Specific Recommendations in the Sector

Due to the low volume of trading in Indonesia, we formally cover only the three most significant publicly-traded institutions: BCA, Lippo Bank, and Bank Pan-Indonesia (Panin). Note that while other banks such as Danamon, Bali, and BNI remain theoretically listed, the government owns in excess of 99% of the shares in each, and trading is virtually non-existent.

Our key area of focus for investment remains the consumer market, which has historically been ignored by domestic banks, and which is less subject to macroeconomic trends if properly managed. We also see exciting opportunities in domestic M&A, with the overcapitalized good banks able to solidify their positions by consolidating the remaining 70-odd small Category "A" banks and weak Category "B" banks.

- Bank Central Asia (BCA)—Our Top Pick: We continue to believe that BCA is clearly the premier institution in a troubled market, with substantial remaining upside. After IBRA's restructuring and financial assistance, BCA has a pristine balance sheet, solid capital base, and leading position in the lucrative consumer market. At 0.8x book value (1.4x adjusted book value) and 4.7x FY2000 EPS estimates, BCA is also among the cheapest stocks in the sector. The bank is our only 1-Strong Buy in Indonesia, and we recommend that investors limit any Indonesian exposure to BCA.

- Lippo Bank: Lippo is a medium-sized but dynamic player with a strong brand name, well-positioned branch network and retail customer base, and savvy marketing ability.

While capital is still relatively thin, and the bank maintains a higher-than-prudent amount of impaired assets on its books, we believe that Lippo will continue to outperform its peers in 2001, and so rate the bank a 2-Buy.

- Panin Bank: Panin was the only significant bank in Indonesia to be rated a Category A bank under the bank recapitalization program implemented by IBRA, a recognition of the bank's relative financial strength and historic conservativism. However, Panin remains beset by asset quality difficulties and we have reservations about the bank's strategic direction, as typified by the bank's decision to re-orient efforts towards the consumer banking market. Additionally, Panin's recent special dividend of Rp40 per share appears imprudent to us. While Panin's valuation is particularly attractive on a price-to-book basis, we nonetheless find the market and management risk permits us to rate the shares only as 3-Market Perform.

The Economics of Slow Growth

Deteriorating Economy Limits Corporate Banking Upside

While we have pointed to some positive signs, the once-promising sectoral macro environment has deteriorated seriously, and still argues against significant foreign investment in the banking sector. IBRA's program has been slowed by political infighting and by the replacement of two Chairmen (and many other executives) during the year. The Bank Bali scandal and indictment of Bank Indonesia's Governor (who remains in office as of publication date) have cast a pall over market confidence in government institutions, and approval for the Wahid administration has fallen both internally and externally.

These factors have contributed to slowing GDP growth, even as Indonesia was one of the only Asian countries to benefit from higher oil prices. With banks underlevered and government bond spreads relatively low, the bank sector will need substantial growth in order to generate loan originations and convert now-strengthened balance sheets into robust income statements.

The China Syndrome

A factor of unknown but potentially significant magnitude will be China's pending WTO accession. Should China gain full WTO privileges, its low-wage manufacturing will encroach on much of Indonesia's industrial and export base. Given the lure of China's large domestic market and its government's investment-friendly policies, we expect that Indonesia will lose investment to its larger neighbor.

Consolidation Is Underway

Indonesia had the most unwieldy banking system in Asia, with 239 banks in operation prior to the crisis. The large number of banks in Indonesia put competitive pressure on managers to make riskier loans. In a sense, the counterparts of banks in Indonesia were the finance companies in Thailand, most of which had to be closed by the Thai government in 1997. The sector has been rationalized somewhat, down to 164 banks, but is still vastly overpopulated.

Figure 37: Indonesian Financial Institutions: *End 1996 Versus Today*

End 1996	Actions Taken	Current Status
Seven State Banks	Merger of four State Banks into Bank Mandiri	Four State Banks
164 Private Banks	72 banks closed 13 banks taken over (BTO) Nine banks recapitalized	72 "A" surviving banks 20* banks in the rehabilitation process
41 Joint Venture/Foreign Banks	Three banks closed, three banks opened as a result of Foreign investment	41 Joint Venture/Foreign Banks
27 Regional Gov't Banks	No action to date	27 Regional Gov't Banks
239 Total Banks		**164 Total Banks**

Two banks have both BTO and Recapitalized Bank status.

Source: Lehman Brothers

As is evident from Figure 38, a good portion of the consolidation was involuntary. Of the top twenty banks in the country on the eve of the crisis, eight have been closed or forcibly merged into other institutions, including five of the top ten.

Figure 38: Top 20 Banks: Year End 1997

Top 20 Banks: Year End 1997

Bank Central Asia (BCA)	Taken Over
Bank Negara Indonesia (BNI)	Recapitalized
Bank Dagang Negara (BDN)	Merged (Mandiri)
Bank Rakyat Indonesia (BRI)	Recapitalized
Bank Bumi Daya	Merged (Mandiri)
Bank Ekspor Impor Indonesia (Bank Exim)	Merged (Mandiri)
Bank Danamon	Recapitalized
Bank Internasional Indonesia (BII)	Recapitalized
Bank Pembangunan Indonesia (BAPINDO)	Merged (Mandiri)
Bank Tabungan Negara (BTN)	Merged (BNI)
Bank Umum	Closed
Bank Lippo	Recapitalized
Bank Bali	Recapitalized
Bank Niaga	Recapitalized
Bank Harapan Sentosa	Closed
Bank Duta	**Remained Solvent**
Panin Bank	**Remained Solvent**
Bank Universal	Recapitalized
Bank Indonesia Raya (Bank Bira)	Closed

Source: Lehman Brothers

Indonesia's banking system is now dominated by a few large banks, with four of the top five completely (99%+) government owned, and the fifth (BCA) majority controlled by IBRA. Post-IBRA recaps, the rural and regional government banks have become increasingly irrelevant, and will probably either consolidate or disappear. Likewise, the overwhelming majority of private banks do not have the scale to thrive under Indonesia's new supervisory regime, and will be at increasing disadvantage when competing against large national banks. We expect this to lead to a consolidation which will eliminate most if not all of the smaller institutions.

With government entities making no secret of their desire for fewer, larger banks, we expect to see minimum capital requirements rise sharply in the next few years, similar to the path taken by the Philippines. This, along with an initially low loan growth environment, will provoke more strategic mergers, with the market eventually making room for 10-15 large banks and a like number of niche players.

Flight to Quality Continues to Favor Scale

We expect that the remaining large banks will continue to increase their collective share of the market as consolidation further reduces the ranks of Indonesian banks. Any further volatility or uncertainty will benefit those institutions seen as dominant and stable. In addition, the 'A' banks, formerly the most prudent and safe organizations, are now significantly more distressed than are the huge banks that failed, as their balance sheets have not been swept clean by IBRA and they are capital constrained.

Figure 39: Comparative market share

	Total Assets	Total Loans	Total Equity
Mandiri	232,816	42,300	5,439
BNI	114,285	31,088	7,185
BCA	96,855	5,893	6,027
Danamon	60,542	5,685	3,044
BRI	54,036	26,620	(5,790)
BII	35,270	17,128	1,836
Lippo	21,827	4,272	2,397
BTN	20,520	7,140	(3,069)
Niaga	17,560	5,728	822
Panin	15,148	4,406	2,886
Bali (Recap Pro-forma)	11,193	1,211	545
Bali	5,652	1,384	(4,527)
NISP	4,748	2,587	348

Source: Banks

Bank Supervision

Indonesia has introduced a number of reforms to strengthen the banking system, although confidence in bank supervisory agencies has if anything slipped this year due to ongoing turmoil at the central bank. Bank Indonesia is now the primary government body overseeing the banking system. Prior to this, the banking system was also supervised by the Ministry of Finance. These reforms include the following:

- All directors and commissioners of a bank must pass a "fit and proper test" performed by Bank Indonesia prior to being appointed. Directors are not permitted to become directors of or hold executive positions in other companies or banks while they serve as directors of commercial banks.

- Banks are required to maintain a minimum capital adequacy ratio of 4% of risk weighted assets, to be increased to 8% by the end of 2001. Total capital includes both Tier 1 and Tier 2 capital. BI's uses the BIS methodology to calculate risk-based capital ratios.

- Banks cannot extend credit of more than 30% of capital to non-affiliates, 10% to affiliates and 10% to state-owned enterprises. Affiliates are borrowers connected with the bank through share ownership or directors.

- A minimum of 80% of foreign exchange loans must be made to export-oriented companies.

- The maximum net open foreign exchange position allowed is 20% of capital.

- Banks are required to maintain a loan to deposit ratio of less than 110%.

- Foreign investors are now allowed to own up to 99% of the shares of an Indonesian bank.

- Banks are required to classify the assets in their portfolio in one of five categories and required to maintain minimum loan loss provisions.

Indonesia's Recapitalization Process

Classifying the Banks by Capital

To begin the process of bank restructuring, the government decided in June 1998 to have international auditors determine the solvency of Indonesia's banks based on international banking standards. Upon completion of this solvency test, Indonesia's private banks were placed in three different categories based on their capital adequacy ratios, as detailed below:

- Category A Banks. With CARs above 4%, these banks were considered sufficiently capitalized so as not to require additional funds from the government. They can continue operations without government interference. Into this category fell 73 banks.

- Category B Banks. These banks, with CARs between negative 25% and positive 4%, were eligible for recapitalization, provided that they met certain criteria.

- Category C Banks. Banks with CARs of less than negative 25% were given 30 days to meet the capital requirements to become Category B (subject to the same criteria for recapitalization) or face closure.

Recapitalization Eligibility

The recapitalization program for private sector banks was carried out only on selected banks. This selection process consisted of first classifying the banks into A, B, and C categories and then conducting further appraisal on the Category B Banks. Eligible banks had to establish their viability by submitting a rehabilitation plan and subjecting management and owners to a "fit and proper test" by IBRA and BI and settling all intra-group loans exceeding the legal lending limit. Based on the results of this appraisal, bank selection was carried out as follows:

- Category B Banks that passed the further appraisals and whose controlling shareholders were willing to contribute a minimum of 20% of the total recapitalization cost as of December 31, 1998 were entered in the private sector bank restructuring and recapitalization program.

- Category B Banks that passed the further appraisal but whose shareholders were unwilling or unable to participate in the recapitalization were taken over by the government (banks taken over or BTO).

- Category B Banks that failed to pass the appraisal had their operations frozen (BBKU), except for banks with more than 80,000 depositors (BCA and Bank Danamon), which were considered too big to fail and taken over by the government. Subsequently, Bank Niaga and Bank Bali, both initially Category B, were taken over and recapitalized when their controlling shareholders failed to participate in the recapitalization process.

Recap Mechanism

In undertaking a recapitalization, the government entered into an Investment Agreement with the bank and its controlling shareholders. The principal provisions of this agreement were as follows:

- The controlling shareholders pledged their willingness to participate in the recapitalization, with a minimum investment of 20% of the recapitalization needs as of December 31, 1998.

- The government agreed to fund the remaining recapitalization needs as calculated by an independent public accountant, in cooperation with the bank's shareholders. Recapitalization funds would be injected primarily in the form of government bonds (*see below*).

- The bank would transfer all Category 5 (Loss) loans to IBRA, with the exception of loans with principal balances of less than Rp5 billion.

- The bank would repay liquidity assistance and correct any legal lending limit violations within one year.

- The bank agreed to comply with financial and operational targets set out in the business plan, and to submit periodic progress reports.

- IBRA agreed not to participate in the day-to-day management of the bank.

IBRA recapitalized seven private sector banks through the issuance of government bonds and become a shareholder in these banks. Public participation in the recapitalization of these banks has exceeded the minimum 20% requirement, reducing the government's ownership so that it has an average of 63% ownership, versus the 80% originally forecast.

Figure 40: Category B Banks Recapitalized

Bank	Recap Cost (Rp Bil.)	Gov't Injection (Rp Bil.)	Ownership
Bank Internasional Indonesia	11,114	6,628	60%
Lippo Bank	8,737	4,787	55%
Bank Universal	5,063	4,098	81%
Bank Prima Express	584	531	91%
Bank Bukopin	476	370	78%
Bank Arta Media	165	130	79%
Bank Patriot	62	51	83%
Total	**26,201**	**16,595**	**63%**

Source: IBRA

All State Banks Recapitalized

The state-owned banks were deemed so important to national development that they were recapitalized regardless of their capital ratios. The government plans to complete the recapitalization of BNI, BRI, and BTN and allow them to continue operating as separate entities. The remaining four banks (Bank Bumi Daya, Bank Dagang Negara, Bank Exim and Bapindo) were merged to form Bank Mandiri.

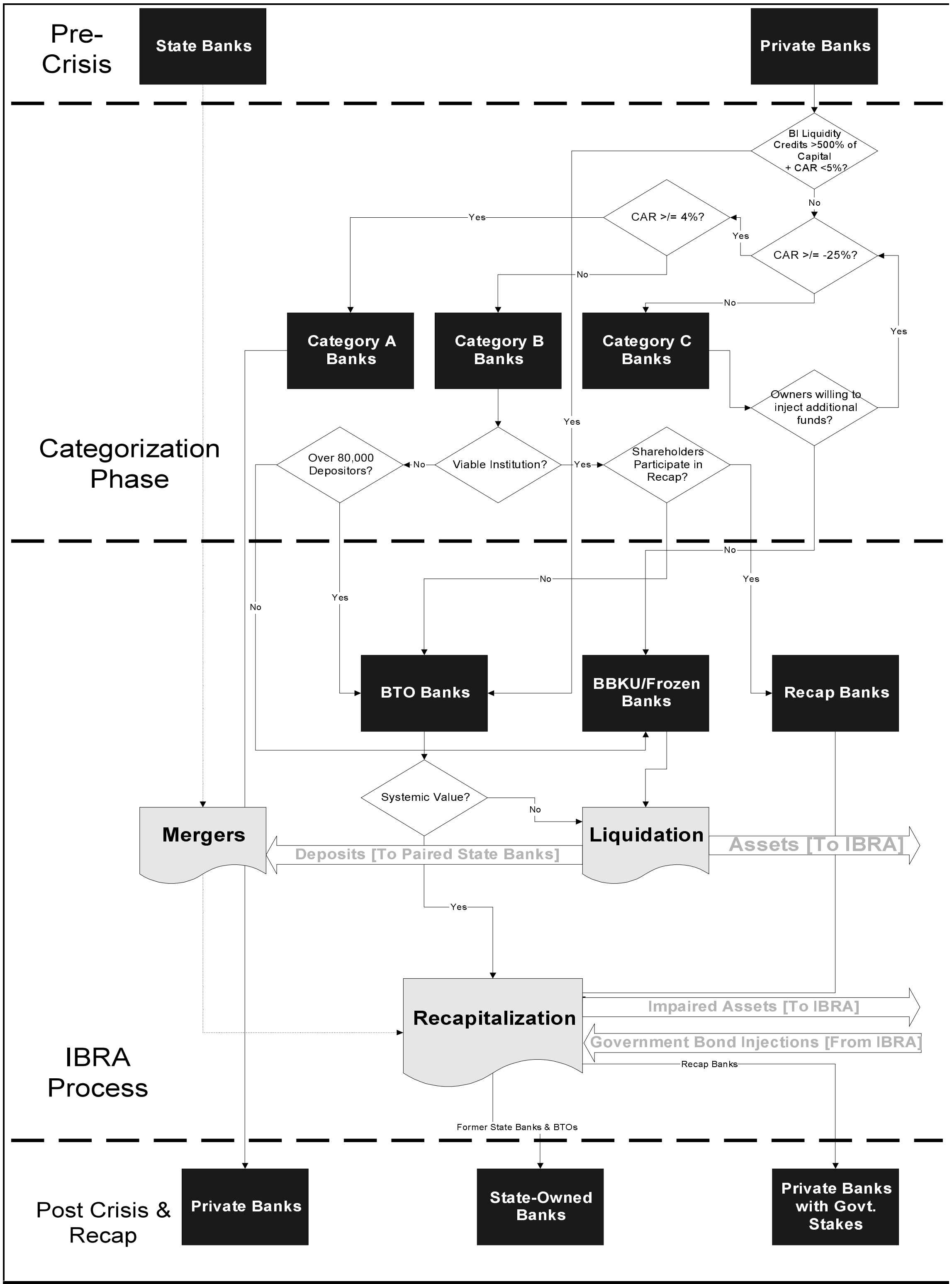
Liquidated and Merged Banks

To date, 48 banks have had their operations frozen. This group includes 10 whose operations were frozen in April 1998 and 38 banks whose commercial activities were frozen in March 1999. Additionally 13 banks have been taken over by IBRA; of these 61 banks only BCA, Danamon, Niaga and Bali survive.

Bank Tiara Asia, Bank PDFCI, Bank Duta, Bank Nusa Nasional, Bank Pos, Bank Jaya, Bank Tamara, Bank Rama, and Bank Risjad Salim International were merged into Bank Danamon in mid-2000. All other banks underwent the following wind-down process:

- Payment of Bank Liabilities. In accordance with the government's guarantee program, IBRA will pay all the eligible liabilities of the taken over and frozen banks.
- Transfer of Bank Assets. All the assets of banks whose operations have been frozen were transferred to IBRA.
- Management of Bank Assets. IBRA continues to service performing loans and restructure NPLs.
- Shareholder Settlements. If there were any violations of banking regulations by a bank's controlling shareholders, IBRA seeks to recover the liabilities from the former controlling shareholders.
- Liquidation. Any restructured or performing assets are sold or transferred to one of the IBRA portfolio entities for later packaging and auction, branches are closed, and operations cease.

Figure 41: Recapitalization process



Source: IBRA and Lehman Brothers

Indonesia by the Numbers

Although so much of the country's banking sector is not public, the tremendous effect that these companies exert on the industry as a whole, as well as the likelihood of additional IPOs and secondary government sales over the next year, make it desirable to present comparisons not only between the listed banks, but among the primary government banks as well. Note that all figures are as of 3Q00, with the following caveat: Bank Bali was recapitalized after September 30; where possible we have presented both 3Q00 actuals and our estimate of a recapitalized pro-forma highlighted as such.

Asset Quality

Figure 42: Loan Classification Criteria and Provisioning Requirements

	Current	Special Mention	Substandard	Doubtful	Loss
Business Prospects					
Growth Potential of Industry	Good	Limited	No growth	Decline	Discontinue
Sensitivity to Economy	Unaffected	Slightly	Affected	Affected	In decline
Competition	Limited	Some	Much	Intense	
Management	Very good	Good	Fair	Inexperienced	Very weak
Affiliated Companies	Supportive	Stable	Negative	Negative	Damaging
Employees	No strikes	No strikes	Unrest	Unrest	Strikes
Financial Conditions					
Earnings	High	Stable	Low	Negative	Big loss
Debt/Equity Ratio	Low	Good	Quite high	High	Very high
Liquidity	Strong	Good	Lacking	Low	None
Cash Flow Analysis	Can repay	Likely to repay	Pays interest	Unable	Operating loss
Forex/Interest Sensitivity	Low	Some	Affected	Greatly affected	Threatened
New Loans Used to			Offset problems	Pay principal	Cover losses
Repayment Ability					
Arrears	No arrears	Up to 90 days	90-180 days	181 to 270 days	Over 270 days
Relationship to Bank	Good	Good	Compromised	Weak	
Documentation/Collateral	Complete	Complete, breaches	Incomplete, breaches	Many breaches	None
Provisioning Requirements					
Up to May 2000	0.625%	2.5%	7.5%	50%	100%
From June 2001	1.000%	5.0%	15.0%	50%	100%

Source: Bank Indonesia

Figure 43: Comparative asset quality

9/30/2000, IDR 000s	Mandiri	BNI	BCA	Danamon	BRI	BII	Lippo	BTN	Niaga	Panin	Bali	NISP
Total Loans	42,300,143	31,087,750	5,892,521	5,685,129	26,620,312	17,127,955	4,271,714	7,140,249	5,727,782	4,405,896	1,383,731	2,586,520
Asset Classifications:												
Pass (Loans Only)	12,737,779	4,696,270	5,515,657	3,438,607	20,146,978	11,690,692	1,097,794	5,766,379	1,161,711	2,235,663	417,630	2,402,114
Special Mention	4,734,890	11,952,802	49,150	795,996	2,354,811	1,296,101	1,228,227	634,442	1,194,951	290,634	76,356	31,434
Substandard	12,603,908	6,792,111	199,584	463,952	3,066,003	1,084,004	596,303	203,941	2,116,688	555,802	384,281	22,866
Doubtful	2,080,922	4,882,810	102,246	252,766	349,974	786,119	332,522	61,136	503,030	368,092	482,584	53,235
Loss	10,142,644	2,763,757	25,884	733,808	702,546	2,271,039	1,016,868	474,351	751,402	955,705	22,880	76,871
Total Criticized Assets (NPAs)	29,562,364	26,391,480	376,864	2,246,522	6,473,334	5,437,263	3,173,920	1,373,870	4,566,071	2,170,233	966,101	184,406
NPAs / Total Loans	69.89%	84.89%	6.40%	39.52%	24.32%	31.74%	74.30%	19.24%	79.72%	49.26%	69.82%	7.13%
NPAs / Total Assets	12.70%	23.09%	0.39%	3.71%	11.98%	15.42%	14.54%	6.70%	26.00%	14.33%	17.09%	3.88%
Required Reserves	14,068,009	7,208,187	174,538	1,027,167	1,809,944	3,062,611	1,374,779	635,093	1,497,619	1,287,800	349,022	133,655
Actual Reserves	22,977,952	7,461,396	261,976	1,016,115	3,878,520	2,264,189	1,124,421	313,551	1,548,136	604,547	300,670	100,947
Shortfall	(8,909,943)	(253,209)	(87,438)	11,052	(2,068,576)	798,422	250,358	321,542	(50,517)	683,253	48,352	32,708
Actual / Required Reserves	163.33%	103.51%	150.10%	98.92%	214.29%	73.93%	81.79%	49.37%	103.37%	46.94%	86.15%	75.53%
Shortfall / Capital	-163.83%	-3.52%	-1.45%	0.36%	35.73%	43.48%	10.44%	-10.48%	-6.15%	23.67%	-1.07%	9.41%
Reserve Coverage of NPAs	77.73%	28.27%	69.51%	45.23%	59.92%	41.64%	35.43%	22.82%	33.91%	27.86%	31.12%	54.74%
Weighted Classified Asset Ratio	32.96%	23.04%	2.03%	17.46%	6.04%	17.20%	31.93%	8.09%	25.94%	28.72%	24.92%	4.24%

Source: Banks and Lehman Brothers

Figure 44: Capital

9/30/2000, IDR 000s	Book Capital	% of Assets	CAR
BNI	7,184,682	6.29%	13.07%
BCA	6,026,906	6.22%	45.90%
Mandiri	5,438,634	2.34%	25.84%
Danamon	3,043,991	5.03%	41.27%
Panin	2,886,384	19.05%	54.36%
Lippo	2,396,969	10.98%	19.66%
BII	1,836,409	5.21%	6.75%
Niaga	821,617	4.68%	17.98%
Bali (Recap Pro-forma)	545,000	4.87%	25.77%
NISP	347,628	7.32%	10.90%
BTN	(3,068,789)	-14.96%	-87.83%
Bali	(4,527,166)	-80.10%	-49.58%
BRI	(5,789,654)	-10.71%	-25.60%

Source: Banks and Lehman Brothers

Figure 45: Valuation

		Share Price	Equity		Deposit Premium		Price/Book		Price/Earnings		
	12/22/00	Market Cap	Book	Adjusted	Book	Adjusted	Book	Adjusted	1999	2000	2001
BNI	95.00	19,113,150	7,184,682	NA	26.41%	NA	2.66	NA	NM	NM	10.67
BCA	1,650.00	4,857,577	6,026,906	3,475,040	-1.33%	1.58%	0.81	1.40	7.57	4.70	3.48
Danamon	65.00	31,894,990	3,043,991	NA	144.85%	NA	10.48	NA	NM	81.66	36.54
Panin	180.00	1,072,000	2,646,624	1,926,828	-25.79%	-14.00%	0.41	0.56	30.33	22.33	8.05
Lippo	50.00	1,957,866	2,396,969	977,465	-2.36%	5.28%	0.82	2.00	NM	11.72	10.16
BII	40.00	3,711,739	1,836,409	(451,772)	6.67%	14.81%	2.02	NM	NM	11.70	7.72
Niaga	60.00	4,694,764	821,617	NA	39.30%	NA	5.71	NA	NM	NM	23.90
Bali (Recap Pro-forma)	75.00	5,376,047	545,000	496,648	95.49%	96.44%	9.86	10.82	NM	NM	85.81

Source: Banks and Lehman Brothers

BANK CENTRAL ASIA (BCA) (IDR1,625) 1-STRONG BUY

Investment Summary

BCA's strong financial condition makes it the country's premier bank, and gives it a significant advantage over all of its domestic competitors, as it is the only major Indonesian bank to be completely free from asset quality and capital-raising issues. BCA is also well positioned to benefit from the burgeoning consumer lending market due to its existing relationships with eight million consumers, leading branch and ATM networks, and status as Indonesia's *de facto* national payments system.

We believe strongly that the potential return of BCA outweighs the very real risks of investing in Indonesia, thus our 1-Strong Buy rating price target of IDR1,950.

Key Points

- Pristine Balance Sheet: BCA has had the vast majority of its NPLs stripped away by the Indonesian government, leaving the bank with the cleanest asset book in our Asian universe. The bank will be able to fund capital needs internally for the foreseeable future, so that the likelihood of dilutive issuances in the short term is small.

- Cheap Valuation: Although BCA is one of the only bank stocks to post gains in 2000, the shares remain inexpensive, at less than 80% of book value and 1.3x adjusted book. On an earnings basis, BCA trades at 4.8x our estimate of FY2000 earnings—among the lowest valuations in the sector.

- Loan Growth is Steady But Unspectacular: Total loans grew by 11% in the quarter, for a year-on-year change of 54%, albeit off a very low base. The loan-to-deposit ratio is now 7%, up from 5% at 1Q00. Management claims to be on course to reach its target of IDR7.7 trillion of loans on balance sheet by year-end, which would put the bank well ahead of our forecast of IDR7 trillion. However, BCA will continue to be underlevered for the foreseeable future.

- Capital Management: BCA remains well capitalized, with an estimated CAR of 41%, despite the additional risk-weighted assets put on by loan purchases. With no M&A on the horizon, management is now considering share buybacks or dividends beginning in FY2002. Any dividend would require special dispensation from capital market regulators, as Indonesian companies are generally not permitted to pay dividends until they clear any accumulated deficit. While BCA could easily reorganize the capital structure so as to eliminate this deficit, under current tax laws the bank would lose its ability to use accumulated tax loss carry-forwards.

- Profitability: BCA earned an ROAA of 1.40% in 3Q00—a solid result—for a total YTD ROAA of 0.88%. The bank's ROAE for the quarter was 43.1%; we expect a full year ROAE of 33.73%.

- Rates & Margins: Net interest margin in the most recent quarter was robust at 2.92%, well above the 1Q level of 2.01% as deposit book management has allowed management to lag rising interest rates on the funding side. The bank's cost of funds has been comparatively stable at 9.43% in 3Q00 versus actual 2Q00 COF of 9.13%, even as the reference SBI rate has risen from 11.1% to 13.3%. This has been due to a planned roll-off of expensive time deposits (the bank's interest spread on these deposits is generally less than 50 basis points), which has been effected by lowering rates so as to make BCA's CDs unattractive to price-sensitive consumers.

Time deposit balances currently stand at around IDR28.5 trillion, down from IDR42 trillion at year-end 1999, and management projects a further reduction to IDR25 billion over the next few months. To further trim unprofitable balances, BCA has raised the minimum initial deposit on its popular Tahapan account ten-fold, to IDR500,000, although it has not changed the requirements for existing customers. Even so, BCA reports that the bank is still adding 100,000 Tahapan accounts each month.

- Branch Network: BCA has no plans to expand its current branch network of 795 branches, and in truth a smaller footprint of approximately 600 branches is probably more sustainable in the long run. However, the bank does intend to keep expanding its ATM network, with plans to add 200 machines a year to the existing base of 1770. BCA will open up this proprietary network to selected small banks (with which it does not directly compete) such as NISP in return for transaction fees.

- Acquisition Strategy: The bank is not actively searching for major acquisitions at this time, although management seems willing to consider purchasing small merchant banking operations to fill out its loan and bond syndication capacity.

BCA

Share Price:	1,625	Index:	409.83
52 Week Price Range:	1,765 - 1,400	Current Yield:	0.0%

INCOME STATEMENT	1998A	1999A	2000E	2001E	2002E
(IDRb)					
Interest income	15,933	13,933	10,460	10,750	11,127
Interest expense	31,023	18,311	8,846	8,734	8,525
Net interest income	-15,090	-4,379	1,614	2,016	2,602
Ave. int. earnings assets	*48,054*	*65,760*	*87,535*	*93,833*	*101,336*
NIM (%)	-31.40%	-6.66%	1.84%	2.15%	2.57%
Non-interest income	-3,480	6,237	1,134	1,432	1,517
Total operating income	-18,570	1,858	2,748	3,448	4,119
Non-interest expenses	-1,104	-1,242	-1,476	-1,698	-1,928
Pre provision profit	-19,675	616	1,271	1,751	2,191
Loan loss provisions	-9,980	-382	-50	-200	-300
Non-operating income	0	0	0	0	0
Pre tax profit	-29,655	234	1,221	1,551	1,891
Tax	0	407	-188	-155	-284
Net profit	-29,655	641	1,033	1,396	1,607
Core earnings	-29,655	641	1,033	1,396	1,607

PER SHARE DATA (IDR)	1998A	1999A	2000E	2001E	2002E
EPS	(10,076.40)	217.90	351.08	474.24	546.06
DPS	0.00	0.00	0.00	0.00	0.00
Effective payout ratio (%)	*0%*	*0%*	*0%*	*0%*	*0%*
BVPS	(9,096.02)	1,740.07	2,109.58	2,583.82	3,129.88
ABVPS	(9,096.02)	823.84	1,257.74	1,821.56	2,560.35

VALUATION	1998A	1999A	2000E	2001E	2002E
Price to book value (x)	NM	NM	0.8	0.6	0.5
Price to adjusted book value (x)	NM	NM	1.3	0.9	0.6
Price to earnings (X)	NM	NM	4.6	3.4	3.0

PROFITABILITY RATIOS	1998A	1999A	2000E	2001E	2002E
(%)					
Net interest margin	-31.40%	-6.66%	1.84%	2.15%	2.57%
Yield on interest earning assets	33.47%	16.60%	11.47%	11.14%	10.48%
Cost on interest bearing liabilities	34.00%	20.37%	9.66%	9.40%	8.19%
Net interest spread	-0.53%	-3.77%	1.81%	1.74%	2.29%
Non-int. income (% Op income)	18.7%	335.6%	41.3%	41.5%	36.8%
Cost to income	-5.9%	66.8%	53.7%	49.2%	46.8%
Overhead ratio	2.30%	1.89%	1.69%	1.81%	1.90%
Cost coverage	-315.1%	502.2%	76.8%	84.4%	78.7%
ROA	-49.59%	0.79%	1.06%	1.38%	1.48%
ROE	239.4%	-5.3%	33.7%	30.8%	24.9%

OROA ANALYSIS	1998A	1999A	2000E	2001E	2002E
Net interest margin	-31.40%	-6.66%	1.84%	2.15%	2.57%
Non-interest inc./gross inc.	18.74%	335.62%	41.27%	41.54%	36.84%
Efficiency ratio	-5.95%	66.83%	53.73%	49.23%	46.81%
Provision/assets	14.97%	0.40%	0.05%	0.19%	0.26%
Operating return on assets	-55.91%	0.54%	1.40%	1.67%	1.90%
Equity/assets	-40.15%	5.31%	6.34%	7.33%	8.08%
Operating return on equity	139.27%	10.19%	22.11%	22.81%	23.51%

Reuters Code:	BBCA.JK
Bloomberg Code:	BBCA IJ

BALANCE SHEET	1998A	1999A	2000E	2001E	2002E
(IDRb)					
Gross loans	58,167	4,142	7,053	10,526	14,737
Loan loss reserves	*10,158*	*320*	*295*	*404*	*631*
Net loans	39,798	3,781	6,696	10,039	13,989
Total earning assets	47,605	83,915	91,155	96,511	106,162
Other assets	19,077	12,535	6,790	7,189	7,907
Total Assets	66,682	96,450	97,945	103,699	114,069
Deposits	57,604	86,803	88,055	89,365	100,089
Other paying liabilities	33,649	3,080	3,522	3,575	4,004
Other liabilities	2,199	4,142	2,666	5,399	2,442
Total Liabilities	93,452	94,026	94,243	98,338	106,534
Equity with revaluation	(26,770)	5,121	6,208	7,604	9,211
Adjusted equity	(26,770)	2,425	3,702	5,361	7,535

BALANCE SHEET RATIOS	1998A	1999A	2000E	2001E	2002E
(%)					
Loan-to-deposit	86.7%	4.7%	7.9%	11.7%	14.6%
Equity to assets	-40.1%	5.3%	6.3%	7.3%	8.1%
Tier 1 Capital	-	-	-	-	-
Total Capital adequacy	-	-	-	-	-
Total loan provisions	20.33%	7.79%	4.21%	3.87%	4.31%

ASSET QUALITY	1998A	1999A	2000E	2001E	2002E
Nonperforming assets	52,737	948	384	401	627
Special mention	-	-	50	52	84
Substandard	-	-	202	210	339
Doubtful	-	-	103	107	143
Loss	-	-	26	27	36
ORE	4,058	49	3	5	25
NPAs/total loans	105.6%	23.1%	6.2%	5.8%	4.3%
Reserve coverage of NPAs	19.3%	33.7%	67.7%	66.2%	100.6%
Required reserves	n.a	n.a	188	228	326
Actual reserves	n.a	n.a	295	404	631
Shortfall (surplus)	n.a	n.a	(107)	(176)	(305)
Actual to required reserves	n.a	n.a	157%	177%	193%
Shortfall to capital	n.a	n.a	-2%	-2%	-3%

GROWTH RATES	1998A	1999A	2000E	2001E	2002E
(%)					
Income statement					
Net interest income	-1996.2%	-71.0%	-136.9%	24.9%	29.0%
Non-interest income	-633.9%	-279.2%	-81.8%	26.3%	5.9%
Total operating income	-1382.8%	-110.0%	47.9%	25.5%	19.4%
Non-interest expenses	27.4%	12.5%	18.9%	15.0%	13.6%
Pre-provision earnings	-3486.3%	-103.1%	106.3%	37.7%	25.1%
Loan loss provisions	2708.4%	-96.2%	-86.9%	300.0%	50.0%
Core earnings	-19652.4%	-102.2%	61.1%	35.1%	15.1%
Net profit	-19652.4%	-102.2%	61.1%	35.1%	15.1%
Balance sheet					
Loan growth	25.1%	-91.8%	70.4%	49.4%	40.0%
Interest earning assets	-1.9%	76.3%	8.6%	5.9%	10.0%
Asset growth	26.0%	44.6%	1.5%	5.9%	10.0%
Deposit growth	31.0%	50.7%	1.4%	1.5%	12.0%
Shareholders funds	-1444.8%	-119.1%	21.2%	22.5%	21.1%

LIPPO BANK (IDR50.00) 2-BUY

Investment Summary

Lippo is a medium-sized but dynamic player with a strong brand name, well-positioned branch network and retail customer base, and savvy marketing ability. The bank has largely completed its recapitalization and is operating under private management, with the support of an experienced foreign management team. With much of Indonesia's banking sector tied up in the form of monolithic state banks (BNI, Mandiri, BRI) or unrecapitalized zombie banks under IBRA conservatorship (Bank Bali, Niaga), Lippo has a free hand to take share of the plum consumer and SME markets.

Although we expect Lippo to outperform the local market, we continue to maintain our underweight position on the Indonesian bank sector, as well as our global underweight in financial institutions. At the current time, we would recommend that investors seeking Indonesian exposure confine their positions to BCA. However, any broad recovery in the Indonesian political and macroeconomic environment will be positive for Lippo Bank due to its greater leverage. We rate the shares of Lippo as 2-Buy, with a twelve-month price target of Rp85.

Key Points

- Management: The bank is currently managed under a three-year contract with ING Bank, under which ING has provided Lippo's President and CEO, Ian Clyne, and a team of twelve executives who act as advisors to the Board. Each Board member has an ING team advisor assigned directly to him, and is directly responsible for an operating area or business line. ING performed a thorough financial and business audit of the bank in mid-1999, and has since undertaken to remedy deficiencies in the strategy and operations of the institution.

While ING has disclaimed any intention of taking an equity stake in the bank, and is being compensated on a fee plus performance bonus basis, we would be not at all surprised to see a strategic stake or outright acquisition of Lippo by ING in the future.

- Customer Base: Lippo, although small compared to the pre-crisis state banks and BCA, has an enviable franchise base among both consumers and corporates. Like most other private conglomerate banks, Lippo Bank formerly had an extensive lending relationship with its group affiliates, such as Lippo Land. However, the bulk of these loans were repaid as a condition of the approval of the bank's recapitalization plan by the government. In addition, Lippo has attracted consumers by a combination of savvy marketing and comparatively nimble execution.

- Funding Book: Lippo has been aggressive in seeking savings and demand deposits while rolling off marginally-profitable time deposits—we believe this to be a shrewd strategy overlooked by most of the local banks either because of poor liquidity or poor asset/liability management. While BCA is pursuing a similar strategy, Lippo's differs in that it has introduced a fee-free savings account with a minimum deposit of only Rp10,000, against BCA's new minimum of Rp500,000.

Although the account has tiered interest rates and frequently pays depositors very low rates, customers are so fed up with spiraling bank charges that Lippo has picked up 200 thousand accounts in just over a month, while maintaining a spread averaging 4%. Management believes that savings deposits can be sustainably grown at 4–7% per year over the next few years.

- Lending: Lippo's SME business is generating approximately Rp50 billion per month in new originations, mainly in the retail, tobacco, and pharmaceuticals industries—not enough to lever the organization from its 23% loan-to-deposit ratio but a fairly good start.

Consumer lending, given Lippo's brand image, customer base, and excellent marketing ability, is a natural extension, and the bank has been working to broaden its product line with innovative structures. Mortgages, still a fairly new product for banks, offer tiered interest rates based on loan-to-value, exactly the type of explicit credit-risk pricing that Asia has been conspicuously lacking. Additionally, Lippo is willing to extend residential mortgages of up to 20 years, a longer term than any other bank now offers.

- Credit and Debit Cards: Lippo was marginally active in credit cards pre-crisis, although it wound up with Rp24 billion in write-offs. The bank is now placing new emphasis on this area, having just hired away Citibank's Indonesian card manager.

In the interim, the real action is in debit cards, where Lippo has scaled up to over 1 million Visa debit cards through the Electron program. The attraction of this product from a customer's perspective is that the Electron card is signature-based rather than PIN-based, and so is easier for merchants to implement and more comfortable for consumers to carry and use. As over 500,000 of the debit cards represent new customers, it is evident that Lippo's product differentiation in this area is paying dividends.

- Asset Quality: Lippo's asset quality remains poor even post IBRA cleansing; however, we consider the bank effectively fully provisioned against losses from these legacy bad assets, with our theoretical required reserve 88% met by Lippo's actual reserves and the difference amounting to only 7% of book equity.

- Capital: Lippo currently has a high CAR of 19.65%, primarily due to the large amount (Rp6 trillion, or 28% of assets) of zero-weighted government bonds on the books. However, we estimate that the bank could add an additional Rp7 trillion in fully-weighted loans while maintaining a CAR of 12%+, well within the realm of safety. For this reason, we do not believe that Lippo will have to come to market for equity in the next 12 months, although abundance of caution or an acquisition opportunity could bring an offering if the market is favorable.

- Ownership: Lippo's major shareholders include IBRA, which owns 59% of the company, and Lippo E-Net (the former Lippo Life Insurance), which remains controlled by the Riady family and owns 7.2% of the bank. Public float is approximately 33%.

Lippo Bank

Share Price:	50.00	Index:	409.83
52 Week Price Range:	250.00 - 45.00	Current Yield:	0.0%
Reuters Code:	LPBN.JK		
Bloomberg Code:	LPBN IJ		

INCOME STATEMENT	1998A	1999A	2000E	2001E	2002E
(IDRb)					
Interest income	3,605	2,481	1,989	2,391	2,812
Interest expense	4,873	3,589	1,398	1,672	1,922
Net interest income	-1,269	-1,108	591	719	890
Ave. int. earnings assets	*10,030*	*12,828*	*16,673*	*18,974*	*24,451*
NIM (%)	-12.65%	-8.64%	3.54%	3.79%	3.64%
Non-interest income	595	196	482	506	538
Total operating income	-674	-913	1,073	1,225	1,427
Non-interest expenses	-879	-801	-824	-936	-1,023
Pre provision profit	-1,553	-1,713	249	289	404
Loan loss provisions	-6,801	-114	-64	-75	-75
Non-operating income	1	0	0	0	0
Pre tax profit	-8,354	-1,827	186	214	329
Tax	651	187	-19	-21	-49
Net profit	-7,702	-1,640	167	193	280
Core earnings	-7,703	-1,640	167	193	280

PER SHARE DATA (IDR)	1998A	1999A	2000E	2001E	2002E
EPS	(1,703.46)	(41.88)	4.27	4.92	7.14
DPS	0.00	0.00	0.00	0.00	0.00
Effective payout ratio (%)	*0%*	*0%*	*0%*	*0%*	*0%*
BVPS	(1,116.44)	59.08	62.71	67.63	74.77
ABVPS	(1,398.77)	13.19	27.45	34.01	43.67

VALUATION	1998A	1999A	2000E	2001E	2002E
Price to book value (x)	-0.4	6.8	0.8	0.7	0.7
Price to adjusted book value (x)	-0.3	30.3	1.8	1.5	1.1
Price to earnings (X)	-0.2	-9.6	11.7	10.2	7.0

PROFITABILITY RATIOS	1998A	1999A	2000E	2001E	2002E
(%)					
Net interest margin	-12.65%	-8.64%	3.54%	3.79%	3.64%
Yield on interest earning assets	40.92%	14.72%	12.05%	11.15%	10.24%
Cost on interest bearing liabilities	25.24%	19.25%	6.99%	7.15%	7.15%
Net interest spread	15.68%	-4.52%	5.06%	4.00%	3.09%
Non-int. income (% Op income)	-88.4%	-21.5%	44.9%	41.3%	37.7%
Cost to income	-130.6%	-87.7%	76.8%	76.4%	71.7%
Overhead ratio	8.77%	6.24%	4.94%	4.94%	4.19%
Cost coverage	67.7%	24.5%	58.5%	54.1%	52.5%
ROA	-54.94%	-8.44%	0.71%	0.77%	0.97%
ROE	289.5%	56.5%	21.0%	16.0%	NM

OROA ANALYSIS	1998A	1999A	2000E	2001E	2002E
Net interest margin	-12.65%	-8.64%	3.54%	3.79%	3.64%
Non-interest inc./gross inc.	-88.36%	-21.47%	44.92%	41.31%	37.67%
Efficiency ratio	-130.6%	-87.7%	76.8%	76.4%	71.7%
Provision/assets	45.10%	0.48%	0.27%	0.28%	0.24%
Operating return on assets	-60.58%	-13.84%	1.22%	1.24%	1.41%
Equity/assets	-33.47%	9.73%	10.58%	9.92%	9.54%
Operating return on equity	181.0%	-142.2%	11.5%	12.5%	14.8%

BALANCE SHEET	1998A	1999A	2000E	2001E	2002E
(IDRb)					
Gross loans	9,490	4,245	4,214	5,478	7,669
Loan loss reserves	*4,930*	*1,068*	*1,111*	*1,158*	*1,195*
Net loans	4,517	3,018	3,103	4,320	6,474
Total earning assets	8,810	16,847	16,499	21,449	27,454
Other assets	6,271	6,932	6,713	5,246	3,244
Total Assets	15,080	23,779	23,212	26,694	30,698
Deposits	18,549	18,066	19,547	22,479	25,851
Other paying liabilities	757	580	444	899	1,034
Other liabilities	2,098	4,617	2,147	1,984	2,104
Total Liabilities	21,405	23,263	22,138	25,363	28,988
Equity with revaluation	(5,048)	2,313	2,456	2,648	2,928
Adjusted equity	(6,325)	517	1,075	1,332	1,710

BALANCE SHEET RATIOS	1998A	1999A	2000E	2001E	2002E
(%)					
Loan-to-deposit	50.9%	22.6%	21.6%	24.4%	29.7%
Equity to assets	-33.5%	9.7%	10.6%	9.9%	9.5%
Tier 1 Capital	-	-	-	-	-
Total Capital adequacy	-	-	-	-	-
Total loan provisions	52.19%	26.14%	26.36%	21.15%	15.58%

ASSET QUALITY	1998A	1999A	2000E	2001E	2002E
Nonperforming assets	n.a.	5,453	2,914	2,331	1,632
Special mention	-	856	870	696	487
Substandard	-	647	590	472	330
Doubtful	-	1,147	834	668	467
Loss	-	99	619	495	347
ORE	2,455	2,704	-	-	-
NPAs/total loans	n.a.	133.5%	69.1%	42.5%	21.3%
Reserve coverage of NPAs	n.a.	19.6%	38.1%	49.7%	73.2%
Required reserves	n.a.	1,400	1,211	990	731
Actual reserves	n.a.	1,068	1,111	1,158	1,195
Shortfall (surplus)	n.a.	332	100	(169)	(464)
Actual to required reserves	n.a.	76%	92%	117%	163%
Shortfall to capital	n.a.	14%	4%	-6%	-16%

GROWTH RATES	1998A	1999A	2000E	2001E	2002E
(%)					
Income statement					
Net interest income	-326.1%	-12.6%	-153.3%	21.7%	23.7%
Non-interest income	259.8%	-67.1%	146.0%	5.0%	6.2%
Total operating income	-192.7%	35.5%	-217.6%	14.2%	16.5%
Non-interest expenses	108.3%	-9.0%	2.9%	13.7%	9.3%
Pre-provision earnings	-610.4%	10.3%	-114.6%	16.0%	39.8%
Loan loss provisions	4970.9%	-98.3%	-44.3%	17.8%	0.0%
Core earnings	-6660.1%	-78.7%	-110.2%	15.3%	45.2%
Net profit	-6621.5%	-78.7%	-110.2%	15.3%	45.2%
Balance sheet					
Loan growth	-9.5%	-56.7%	3.1%	30.0%	40.0%
Interest earning assets	-21.7%	91.2%	-2.1%	30.0%	28.0%
Asset growth	16.4%	57.7%	-2.4%	15.0%	15.0%
Deposit growth	65.6%	-2.6%	8.2%	15.0%	15.0%
Shareholders funds	-603.3%	-145.8%	6.1%	7.8%	10.6%

PANIN BANK (IDR170.00) 3-MARKET PERFORM

Investment Summary

Panin was the only significant bank in Indonesia to be rated a Category A bank under the bank recapitalization program implemented by IBRA, and as such received no government funds. Ironically, while Panin's less-prudent competitors, such as BCA and Lippo, are now relatively healthy due to infusions of recap bonds and the removal of their category five (loss) loans, Panin remains beset by asset quality difficulties. 25% of Panin's total asset base is comprised of various non-performing or criticized assets, versus 15% for Lippo Bank and less than 0.5% for BCA.

In addition, we have doubts about the bank's strategic plan, which calls for turning what was a small corporate lender into a retail bank and dramatically expanding the branch network. Although we agree that the consumer lending space is an attractive one, we note that Panin has no 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.

Nevertheless, given our poor overall view of the sector, and the availability of opportunities in franchises which we would prefer to this one, we rate the shares of Panin as only 3-Market Perform.

Key Points

- Asset Quality: Panin is still in restructuring mode, with the primary method for cleaning up the balance sheet (still 41% NPLs/loans) being write-offs. Most of Panin's NPLs are syndicated loans, so that IBRA and the lead banks are driving the workout process. Management expects a further Rp1.1 trillion in provisions will be needed in FY2001-02 to cover gross NPLs of Rp3.2 trillion. This amount represents 11.8 quarters of net interest income at the 2Q00 level, indicating that provisions will continue to drive Panin's profitability.

- Reserve Adequacy: We consider Panin's reserves inadequate by our methodology, with actual consolidated reserves of Rp858 billion meeting only 49% of our requirement of Rp1.75 billion—a shortfall equivalent to 31% of Panin's total capital. Management's provisioning plan appears to be sufficient to cover this over the next two years, barring further deterioration, but this will be a severe drag on earnings.

- Loan Growth: Management predicts loan growth of Rp500 billion in 2H00 (with growth of Rp3.5 trillion already seen in 1H00) and Rp1 trillion in FY2001, which appears reasonable given that Panin's large competitors are still at earlier stages of their recoveries. Loan growth is projected at a 50/50 mix of consumer and corporate, with state-owned enterprises making up most of the corporate lending. We are, to say the least, not crazy about this SOE strategy, and we question Panin's ability to enter the consumer market and maintain profitability and asset quality.

- ANZ Partnership: 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.

In addition, Panin and ANZ are partners in an Indonesian joint venture bank, PT ANZ Panin Bank, of which ANZ owns 85%. ANZ Panin has a deposit taking and lending operation, and also purchased the credit card operations of the former Bank Papan Sejahtera from IBRA in mid-1998. From a base of 47,000 cards, this operation has now grown to 70,000.

- Capital: Panin has a high CAR of 51% due to its relatively unlevered balance sheet and high book equity of 22% 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. Therefore, our major adjustment to book value is reserve underfunding.

- IT and Technology: Panin has the usual quota of IT improvements either in place or on the way. Mobile banking is now in place, with a 24-hour call center scheduled to go live this month. Internet banking using the ANZ platform is scheduled for a January 2001 launch, not a major factor given the paucity of net users in the country.

- Branch Network: Panin has grown from 100 branches pre-crisis to 110 now, mainly in metro Jakarta and Java. While management has spoken in the past of taking this branch network up to the 200-300 level, this is now being downplayed—a good idea in our opinion. The bank has been steadily adding ATMs, however, going from 62 pre-crisis to 140 currently.

- Valuation: Panin now trades at only 35% of stated book value; however, we feel that this book value is overstated. Subtracting our estimate of reserve underfunding Panin trades at 45% of book value, which still looks to be a bargain level. However, Panin's NPLs are more severe than those of the other extant Indonesian banks, as its Category 5 (Loss) loans have not been removed by IBRA.

Given that the oversight and due diligence on the portfolio has been at a lower level, and that the bank has had no incentive to disclose NPLs (whereas Category B and C banks had incentive to show as many NPLs as possible in order to have them removed and increase their recapitalization funds), we believe that there is still a wide margin for error in reported numbers, and true price-to-book valuations may be considerably higher than even our adjusted numbers.

On an earnings basis, Panin trades at 21.1x our FY2000 estimates, and at 6.9x FY2001 projections. While not in itself high, this level is above the earnings valuation of BCA and presents a less attractive risk-reward tradeoff.

Panin Bank

Share Price:	165.00	Index:	409.83
52 Week Price Range:	750.00 - 160.00	Current Yield:	0.0%
Reuters Code:	PNBN.JK		
Bloomberg Code:	PNBN IJ		

INCOME STATEMENT	1998A	1999A	2000E	2001E	2002E
(IDRb)					
Interest income	2,781	1,652	1,223	1,276	1,405
Interest expense	2,322	1,130	794	836	870
Net interest income	459	522	429	439	535
Ave. int. earnings assets	*8,335*	*9,755*	*11,008*	*12,384*	*13,520*
NIM (%)	5.50%	5.35%	3.90%	3.55%	3.96%
Non-interest income	204	72	215	232	250
Total operating income	663	594	644	671	786
Non-interest expenses	-180	-188	-193	-207	-223
Pre provision profit	483	406	451	464	563
Loan loss provisions	-446	-451	-400	-300	-300
Non-operating income	-31	83	0	0	0
Pre tax profit	8	36	51	164	263
Tax	-2	-2	-3	-16	-26
Net profit	4	35	48	148	237
Core earnings	29	-43	48	148	237

PER SHARE DATA (IDR)	1998A	1999A	2000E	2001E	2002E
EPS	2.55	5.93	8.06	24.65	39.48
DPS	16.87	0.00	0.00	0.00	0.00
Effective payout ratio (%)	*661%*	*0%*	*0%*	*0%*	*0%*
BVPS	847.33	482.45	485.18	509.83	549.31
ABVPS	844.98	325.44	373.95	451.14	549.05

VALUATION	1998A	1999A	2000E	2001E	2002E
Price to book value (x)	0.0	0.0	0.3	0.3	0.3
Price to adjusted book value (x)	0.0	0.0	0.4	0.4	0.3
Price to earnings (X)	0.0	0.0	20.5	6.7	4.2

PROFITABILITY RATIOS	1998A	1999A	2000E	2001E	2002E
(%)					
Net interest margin	5.50%	5.35%	3.90%	3.55%	3.96%
Yield on interest earning assets	29.79%	16.23%	10.33%	9.87%	9.96%
Cost on interest bearing liabilities	26.26%	13.61%	7.88%	7.55%	7.45%
Net interest spread	3.53%	2.62%	2.44%	2.32%	2.51%
Non-int. income (% Op income)	30.8%	12.1%	33.3%	34.5%	31.9%
Cost to income	28.4%	27.8%	30.0%	30.8%	28.3%
Overhead ratio	2.16%	1.93%	1.75%	1.67%	1.65%
Cost coverage	113.4%	38.2%	111.3%	111.9%	112.4%
ROA	0.04%	0.33%	0.40%	1.10%	1.63%
ROE	0.3%	2.1%	2.3%	6.0%	7.9%

OROA ANALYSIS	1998A	1999A	2000E	2001E	2002E
Net interest margin	0.06	5.35%	3.90%	3.55%	3.96%
Non-interest inc./gross inc.	0.28	22.75%	33.34%	34.53%	31.86%
Efficiency ratio	28.4%	27.8%	30.0%	30.8%	28.3%
Provision/assets	0.04	3.98%	3.10%	2.15%	1.99%
Operating return on assets	0.01	1.02%	1.00%	1.60%	2.17%
Equity/assets	0.13	25.35%	22.54%	21.93%	21.87%
Operating return on equity	8.9%	4.0%	4.4%	7.3%	9.9%

BALANCE SHEET	1998A	1999A	2000E	2001E	2002E
(IDRb)					
Gross loans	5,090	4,489	8,161	9,161	10,250
Loan loss reserves	*518*	*848*	*1,057*	*1,311*	*1,560*
Net loans	4,543	3,430	7,104	7,849	8,690
Total earning assets	9,335	10,175	11,841	12,927	14,112
Other assets	1,072	1,160	1,064	1,010	940
Total Assets	10,407	11,335	12,905	13,937	15,052
Deposits	6,347	6,578	7,149	7,864	8,651
Other paying liabilities	2,496	1,722	2,918	3,210	3,028
Other liabilities	209	1,096	596	159	82
Total Liabilities	9,051	9,396	10,663	11,233	11,761
Equity with revaluation	1,360	2,873	2,908	3,056	3,293
Adjusted equity	1,356	1,938	2,241	2,704	3,291

BALANCE SHEET RATIOS	1998A	1999A	2000E	2001E	2002E
(%)					
Loan-to-deposit	79.7%	65.0%	114.1%	116.5%	118.5%
Equity to assets	13.1%	25.3%	22.5%	21.9%	21.9%
Tier 1 Capital	-	-	-	-	-
Total Capital adequacy	-	-	-	-	-
Total loan provisions	10.23%	19.83%	12.95%	14.31%	15.22%

ASSET QUALITY	1998A	1999A	2000E	2001E	2002E
Nonperforming assets	n.a.	3,329	3,137	3,037	2,727
Special mention	-	814	573	545	490
Substandard	-	487	537	510	459
Doubtful	-	515	684	650	585
Loss	-	1,338	1,154	1,097	987
ORE	137	175	189	236	207
NPAs/total loans	n.a.	77.8%	38.4%	33.2%	26.6%
Reserve coverage of NPAs	n.a.	25.5%	33.7%	43.2%	57.2%
Required reserves	n.a	1,782	1,722	1,661	1,514
Actual reserves	n.a	848	1,057	1,311	1,560
Shortfall (surplus)	n.a	933	665	350	(46)
Actual to required reserves	n.a	48%	61%	79%	103%
Shortfall to capital	n.a	32%	23%	11%	-1%

GROWTH RATES	1998A	1999A	2000E	2001E	2002E
(%)					
Income statement					
Net interest income	11.7%	13.7%	-17.8%	2.4%	21.8%
Non-interest income	128.4%	-12.4%	39.6%	8.0%	8.0%
Total operating income	30.1%	6.5%	-4.7%	4.3%	17.1%
Non-interest expenses	36.8%	4.5%	2.5%	7.4%	7.6%
Pre-provision earnings	27.6%	7.3%	-7.5%	3.0%	21.3%
Loan loss provisions	112.9%	1.1%	-11.4%	-25.0%	0.0%
Core earnings	-71.2%	-247.6%	-213.5%	205.8%	60.2%
Net profit	-96.0%	762.8%	36.7%	205.8%	60.2%
Balance sheet					
Loan growth	22.2%	-15.5%	90.8%	12.3%	11.9%
Interest earning assets	27.3%	9.0%	16.4%	9.2%	9.2%
Asset growth	31.9%	8.9%	13.9%	8.0%	8.0%
Deposit growth	52.9%	3.6%	8.7%	10.0%	10.0%
Shareholders funds	31.8%	111.3%	1.2%	5.1%	7.7%

PHILIPPINE BANKS

The catalyst for a strong rally in Philippine bank share prices, and indeed the whole market, can be summarized in one word: IMPEACHED. When charges of graft and corruption against President Estrada surfaced in October 2000, the stock market sank to levels not seen since the 1997 financial crisis. Unfortunately, the on-going impeachment process has seriously damaged both investor and businessmen confidence, which will adversely impact the overall economy in the coming quarters, even if the president is removed from office. Consequently, we do not see loan growth picking up significantly, especially since the NPL cycle is still in the upswing. Investors should remain UNDERWEIGHT the sector.

Huge political overhang

The Philippines continues to be plagued with political uncertainties. The on-going impeachment trial of President Estrada is expected to drag onto 1Q01, even though the Senate has publicly stated that the trial would end before the end of December 2000. The longer the impeachment process drags on, the more the overall economy would suffer since business confidence would be weak. The prevailing view is that President Estrada will eventually be acquitted, which translates to possibly another four years of political and economic uncertainty (his term ends in 2004).

While we believe that the market would react positively if the president were found guilty and removed from office, the economy has already sustained enough damage such that it would take at least another twelve months for recovery take place. As such, work would definitely be cut out for Vice President Gloria Macapagal Arroyo, who would assume the presidency if President Estrada were impeached. As pointed out by our economist, the government (incumbent or new) must urgently address perceptions of a policy vacuum in Philippine politics and strive to rebuild confidence.

Anemic loan growth

Ever since the corruption charges against President Estrada were made in October 2000, the local banks reported that loan demand had weakened. The reasons for the weakness were (i) higher interest rates to curb the sliding peso and (ii) declining business confidence. Most local bankers concur that the political uncertainty will continue to depress economic activity and the banks forecast 2001 GDP to be only 3% to 3.5%, in line with our Lehman economist's forecast of 3.1%, which is a deceleration from this year's expected 4.0% growth.

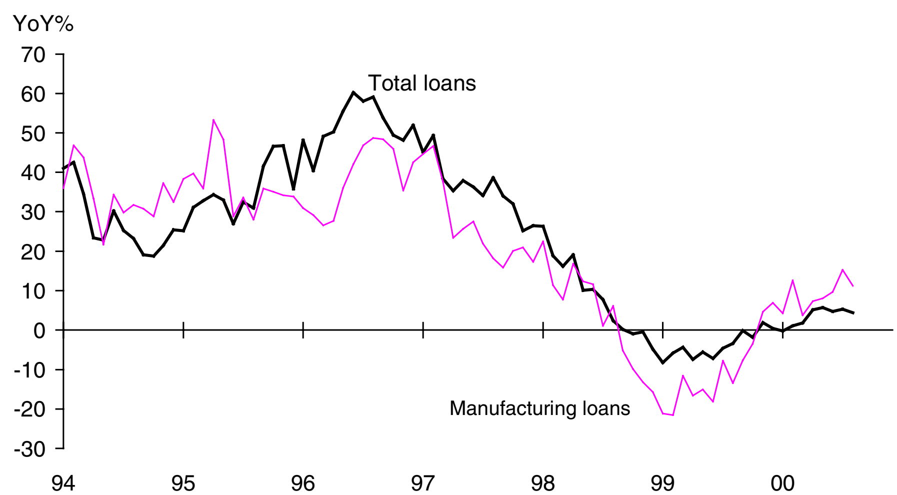
In the first eight months of 2000, overall loan growth in the system has grown 4.4%. However, the operating environment has since deteriorated as the central bank increased interest rates by four percentage points and increased the banks' reserve requirements by 400bps in October 2000. These moves were aimed at curbing the slide in the currency. With higher cost of money, we expect loan growth to weaken in this quarter and in 1Q01.

One of the drivers for the economy and loan growth has been the manufacturing sector, which accounts for almost 30% of total loan demand. Within this sector, electronics-related manufacturing has been especially robust. Indeed, electronics exports have been one of the saving graces for the Philippine economy. Unfortunately, with US demand, the country's largest trading partner, expected to slacken in the coming quarters, electronics exports and thus loans flowing into this segment is also expected to slow.

On mortgage lending, while there is inherent demand for new homes from the middle-income families, no one is willing to buy a home given the political and sporadic social uncertainties. Coupled with a volatile interest rate environment, we do not expect demand for mortgage loans to pick up in the next twelve months.

Against the difficult operating backdrop we expect over the next few months, we believe loan growth will remain in single digits, a view held by most bank management. We forecast loan growth of 3.5% in 2000 and 6% in 2001. The banks are targeting a slightly higher 8% to 9% for 2001.

Figure 46: Loan Growth



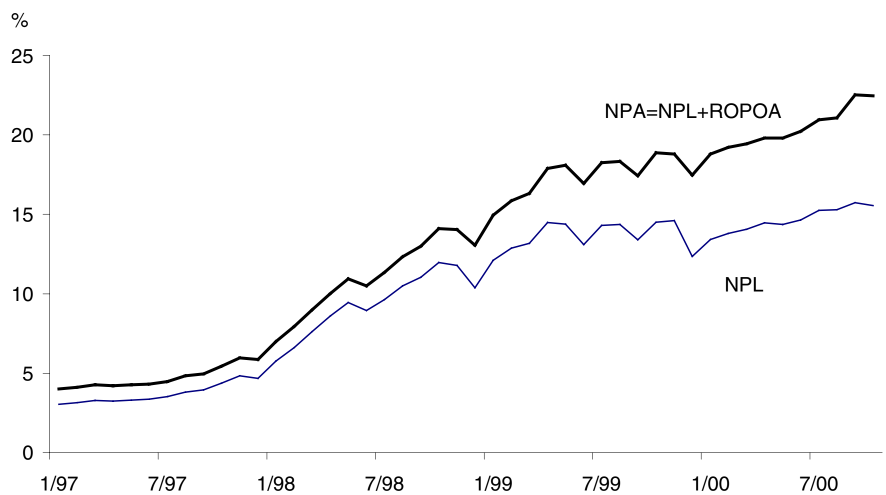
Source: Lehman Brothers

Non-performing assets still rising

Non performing loans in the sector continued their upward trend throughout 3Q00. From 14.6% in June 2000, NPLs account for 15.6% of total loans as of October 2000. We would also highlight that if we include 6.5% of foreclosed loans (termed ROPOA in the Philippines), total NPAs would reach 21.8%. Looking ahead, the downturn in industrial production and business sentiment in 4Q00, coupled with interest rate increases to defend the sliding peso, would translate to further rises in NPLs over the next two quarters at least. We forecast NPLs to reach 16.5% in 2000 and 18% in 2001.

As in Taiwan, there are no government-funded AMCs, which could facilitate the management and monetization of the banks' NPLs and collateral. This is in part due to the banks' continued belief that the collateral, which is largely real estate, will eventually increase in value. While we would concur that property prices do move in cycles, some down-turns can and do last many years. It has been four years since property prices fell in the Philippines and all this time the increasing ROPOAs are weighing down the banks' balance sheets and impeding profitability. The banks should be more pro-active in forming either a consortium to manage the sector's NPLs, or be willing to sell-off these non-performing assets (even at a discount) so that the cash received can be put into some revenue-generating assets.

Figure 47: Non-performing Loans and Assets



Source: Lehman Brothers

Recommended exposure

Given that the NPL cycle has yet to peak, with slow loan growth prospects and high investment risk stemming from the political arena, we maintain our Underweight position in Philippine banks. For any country-dedicated funds, we would focus on banks with superior asset quality and thus would only recommend Bank of the Philippine Islands, its richer valuations notwithstanding. Especially in times of political and economic uncertainty, BPI has always been regarded as a safe haven bank and should benefit from deposit inflows.

BANK OF THE PHILIPPINE ISLANDS (P58.00) 2-BUY

Investment Case

Smooth merger with FEB; full integration expected by 1Q01

Bank of the Philippine Islands (BPI) officially merged with Far East Bank in April 2000 to form the country's second largest bank. Management has been very successful in reducing the combined headcount. Even prior to the official merger in April, the two banks have already reduced the combined headcount by 1,300 and as of end-September 2000, BPI managed to cut a further 2,000-odd personnel. The reduction were achieved via a combination of natural attrition and offering early retirement packages. Management expects total headcount to be further reduced in 1Q01 as all branches are fully rationalized.

FEB adds middle market exposure to loan portfolio

Prior to the merger with FEB, BPI has largely focused on the top corporate sector and the consumer sector. The FEB loan increased the merged bank's exposure to the middle market segment. The bank currently has 42% of its loan book exposed to top corporates, 40% middle market and 18% consumer. In 2001, management aims to increase its market share in top corporates and consumer banking. We forecast overall loan growth to improve from an estimated 3% in 2000 to 6% in 2001.

Beneficiary of political and economic uncertainty

BPI has traditionally been viewed as a bastion of sound banking in the Philippines. This reputation is largely due to its competent and conservative management, which is reflected in its superior asset quality and strong overall balance sheet. The fact that the Ayala family (34% stake) and DBS (21% stake) are major shareholders in BPI further strengthens the perception of it being a safe haven bank. Consequently, the bank has been experiencing inflow of deposits during unstable times, especially with the recent political turmoil created by the impeachment of President Estrada and the implication of some banks by the proceedings.

Sound balance sheet

Management has always paid very close attention to its asset quality by instituting prudent credit policies. While it cannot escape unscathed from the financial crisis, its NPL ratio has always been the lowest in the sector and did not reach double-digit levels during the crisis. Even though the merger with FEB caused the combined NPL portfolio to rise to 12.8% as of September 30, 2000, it is still considerably lower than the sector's NPL ratio of 15.6%. More importantly, BPI has demonstrated its willingness to strengthen its asset quality by setting aside more provisions at the expense of short-term profitability. The bank has an NPL coverage ratio of 50% as of end-3Q00, which it aims to improve to 55%-60% by the end of 2000. This compares with an NPL coverage ratio of 44% for the sector.

Valuation

Although BPI, at 1.7x PBR, is trading at a premium to the other banks in the sector, we believe it is well-justified given its superior balance sheet, well-regarded management team and respected major shareholder groups. This is the only bank in the Philippines that we would recommend to investors.

BPI

Share Price (P):	58	Index:	1475.11
52 Week Price Range (P):	94.4 - 48.0	Current Yield:	0.89%
Reuters Code:	BPI.PS		
Bloomberg Code:	BPI PM		

INCOME STATEMENT	1998A	1999A	2000E	2001E	2002E
(Php m)					
Interest income	41,026	31,572	31,213	33,516	38,071
Interest expense	-22,829	-17,365	-18,145	-20,376	-23,596
Net interest income	18,197	14,207	13,068	13,140	14,474
Ave. int. earnings assets	*323,146*	*323,537*	*338,513*	*366,455*	*406,516*
NIM (%)	5.63%	4.39%	3.86%	3.59%	3.56%
Non-interest income	7,935	7,380	7,067	7,928	9,161
Total operating income	26,133	21,587	20,134	21,067	23,635
Non-interest expenses	-13,012	-13,417	-14,379	-14,552	-15,359
Pre provision profit	13,120	8,170	5,755	6,515	8,276
Loan loss provisions	-4,446	-2,726	-2,009	-2,108	-1,763
Non-operating income	0	0	0	0	0
Pre tax profit	8,674	5,444	3,746	4,407	6,513
Tax	-1,905	-766	-562	-793	-1,303
Net profit	6,770	4,678	3,184	3,614	5,210

PER SHARE DATA (Php)	1998A	1999A	2000E	2001E	2002E
EPS	4.41	3.05	2.08	2.36	3.40
DPS	1.73	1.14	0.52	0.59	0.85
Effective payout ratio (%)	*39%*	*37%*	*25%*	*25%*	*25%*
BVPS	30.53	32.23	33.79	35.56	38.10
ABVPS	30.53	33.80	33.79	35.56	38.10

VALUATION	1998A	1999A	2000E	2001E	2002E
Price to book value (x)	1.9	1.8	1.7	1.6	1.5
Price to adjusted book value (x)	1.9	1.7	1.7	1.6	1.5
Price to earnings (X)	13.1	19.0	27.9	24.6	17.1

PROFITABILITY RATIOS	1998A	1999A	2000E	2001E	2002E
(%)					
Net interest margin	5.63%	4.39%	3.86%	3.59%	3.56%
Yield on interest earning assets	12.70%	9.76%	9.22%	9.15%	9.37%
Cost on interest bearing liabilities	7.80%	5.99%	6.01%	6.25%	6.38%
Net interest spread	4.89%	3.77%	3.21%	2.89%	2.99%
Non-int. income (% Op income)	30.4%	34.2%	35.1%	37.6%	38.8%
Cost to income	49.8%	62.2%	71.4%	69.1%	65.0%
Overhead ratio	3.63%	3.71%	3.79%	3.55%	3.37%
Cost coverage	61.0%	55.0%	49.1%	54.5%	59.6%
ROA	1.89%	1.29%	0.84%	0.88%	1.14%
ROE	15.2%	9.7%	6.3%	6.8%	9.2%

DUPONT ANALYSIS	1998A	1999A	2000E	2001E	2002E
Lending operations					
Net interest margin	5.63%	4.39%	3.86%	3.59%	3.56%
Interest earnings assets/assets	90.18%	89.42%	89.22%	89.30%	89.28%
NIM contribution to ROA	5.08%	3.93%	3.44%	3.20%	3.18%
Non-interest operations					
Non-interest income/assets	2.21%	2.04%	1.86%	1.93%	2.01%
Overhead ratio	3.63%	3.71%	3.79%	3.55%	3.37%
Non-int. contribution to ROA	-1.42%	-1.67%	-1.93%	-1.61%	-1.36%
Asset quality analysis					
Provision/loans	-2.39%	-1.60%	-1.17%	-1.18%	-0.91%
Loans/assets	51.82%	47.21%	45.07%	43.55%	42.41%
ROA effect from asset quality	-1.24%	-0.75%	-0.53%	-0.51%	-0.39%
Core ROA	2.42%	1.50%	0.99%	1.07%	1.43%
Non-core contibution to ROA	0.00%	0.00%	0.00%	0.00%	0.00%
Pre-tax ROA	2.42%	1.50%	0.99%	1.07%	1.43%
Tax rate	21.96%	14.06%	15.00%	18.00%	20.00%
After tax ROA	1.89%	1.29%	0.84%	0.88%	1.14%
Balance sheet leverage (x)	8.1	7.5	7.5	7.7	8.1
ROE	15.2%	9.7%	6.3%	6.8%	9.2%

BALANCE SHEET	1998A	1999A	2000E	2001E	2002E
(Php m)					
Gross loans	181,979	179,574	185,678	197,552	217,290
Specific loan loss reserves	*0*	*0*	*0*	*0*	*0*
Loan loss reserves	*-8,804*	*-11,110*	*-12,159*	*-13,622*	*-14,968*
Net loans	173,175	168,464	173,518	183,929	202,322
Other earning assets	145,610	159,824	175,220	200,242	226,540
Other assets	36,585	39,993	41,834	46,017	51,599
Total Assets	355,369	368,282	390,572	430,188	480,461
Deposits	267,406	271,289	287,567	316,323	370,098
Other paying liabilities	19,069	22,275	22,944	24,779	28,744
Other liabilities	22,054	25,260	28,217	34,530	23,156
Total Liabilities	308,529	318,825	338,727	375,632	421,998
Minorities & other	5	5	5	5	5
Shareholders' funds	46,835	49,451	51,839	54,550	58,458

LOAN BOOK	1998A	1999A	2000E	2001E	2002E
(Php m)					
Agriculture	2,217	2,109	4,085	4,003	3,923
Mining	1,478	316	743	750	758
Manufacturing	29,451	33,953	60,345	67,587	78,400
Utilities	1,478	2,003	2,228	2,340	2,457
Construction	1,900	844	4,271	4,313	4,356
Trading	13,617	15,606	37,321	39,187	41,147
Transport & comm	2,745	3,796	7,056	6,844	6,913
Financial scvs	8,762	7,170	14,854	15,597	16,377
Real estate	14,778	9,701	16,711	16,210	16,372
Com & soc svcs	2,217	3,269	8,913	9,358	9,826
Consumer	26,918	26,678	29,151	32,067	36,876
Total loans	105,560	105,445	185,678	198,255	217,404

LOAN BOOK BREAKDOWN	1998A	1999A	2000E	2001E	2002E
(%)					
Agriculture	2%	2%	2%	2%	2%
Mining	1%	0%	0%	0%	0%
Manufacturing	28%	32%	33%	34%	36%
Utilities	1%	2%	1%	1%	1%
Construction	2%	1%	2%	2%	2%
Trading	13%	15%	20%	20%	19%
Transport & comm	3%	4%	4%	3%	3%
Financial scvs	8%	7%	8%	8%	8%
Real estate	14%	9%	9%	8%	8%
Com & soc svcs	2%	3%	5%	5%	5%
Consumer	26%	25%	16%	16%	17%
Total loans	100%	100%	100%	100%	100%

BALANCE SHEET RATIOS	1998A	1999A	2000E	2001E	2002E
(%)					
Loan-to-deposit	64.8%	62.1%	60.3%	58.1%	54.7%
Loan-to-deposit (incl. CDs)	0.0%	0.0%	0.0%	0.0%	0.0%
Equity to assets	13.2%	13.4%	13.3%	12.7%	12.2%
Tier 1 Capital	22.8%	18.9%	18.1%	17.9%	17.5%
Total Capital adequacy	22.8%	18.9%	18.1%	17.9%	17.5%
General reserves (% loans)	-4.84%	-6.19%	-6.55%	-6.90%	-6.89%
Specific reserves (% loans)	0.00%	0.00%	0.00%	0.00%	0.00%
Total loan provisions	-4.84%	-6.19%	-6.55%	-6.90%	-6.89%

ASSET QUALITY	1998A	1999A	2000E	2001E	2002E
Nonperforming loans	16,100	19,193	21,496	20,851	17,723
NPL ratio	8.8%	10.7%	11.6%	10.6%	8.2%
Total provisions/NPLs	54.7%	57.9%	56.6%	65.3%	84.5%

GROWTH RATES	1998A	1999A	2000E	2001E	2002E
(%)					
Income statement					
Net interest income		-21.9%	-8.0%	0.6%	10.2%
Non-interest income		-7.0%	-4.3%	12.2%	15.6%
Total operating income		-17.4%	-6.7%	4.6%	12.2%
Operating expenses		3.1%	7.2%	1.2%	5.5%
Pre-provision earnings		-37.7%	-29.6%	13.2%	27.0%
Loan loss provisions		-38.7%	-26.3%	4.9%	-16.4%
Net profit		-30.9%	-31.9%	13.5%	44.2%
Balance sheet					
Loan growth		-2.7%	3.0%	6.0%	10.0%
Interest earning assets		3.6%	6.3%	10.2%	11.6%
Asset growth		3.6%	6.1%	10.1%	11.7%
Deposit growth		1.5%	6.0%	10.0%	17.0%
Shareholders funds		5.6%	4.8%	5.2%	7.2%

METROPOLITAN BANK AND TRUST (P185.00) 3-MARKET PERFORM

Investment Case

Staying the largest bank with multiple acquisitions

In its pursuit to maintain its status as the largest bank in the country, Metrobank stepped up its acquisition spree when BPI announced its merger with FEB. Metrobank successfully acquired two smaller banks (Philippine Banking Corp and Asian Bank) in late 1999. It followed these acquisitions with yet another purchase, the medium-sized Solidbank in April 2000. While these acquisitions enabled the bank to retain its throne as the largest Philippine bank, it had to incur significant merger-related costs. We note also that since Solidbank was acquired under a purchase accounting method, Metrobank incurred P6.5 billion of goodwill. Assuming a 40-year amortization schedule, the bank will be recording a goodwill expense of P163 million each year.

Rapid deterioration in asset quality; NPL coverage is one of the lowest

The acquisition of Solidbank also significantly increased Metrobank's NPLs from 14.5% in June 2000 to 18% in September 2000. Consequently, the bank has to also set aside much higher provisions. In the first nine months, it set aside P1.4 billion of provisions, more than 50% more than the year-ago period. We would highlight, however, that despite higher provisions, Metrobank still has one of the lowest NPL coverage ratios in the sector at 33%. The comparable ratio for the sector is 44%. Management has stated that it aims to set aside an additional P600 million in 4Q00, which we estimate would only improve its NPL ratio marginally to 35%. Once again, Metrobank is still lagging the other banks in strengthening its loan loss reserve position.

Focusing on consumer for growth

Metrobank's niche has traditionally been serving the middle market, especially businesses run by Chinese-Filipinos. The middle market segment accounts for 50% of the bank's loan portfolio. The growth of this market segment is closely linked with the overall economy. With our pessimistic view of the Philippine economy this year, we believe that loan growth demand will be sluggish for Metrobank. Management appears to recognize this as it has stated that it would focus on the consumer sector to drive loan growth in 2001. We believe it will face stiff competition from BPI as this bank is the leading bank for consumer loans. As a result, we suspect that management's loan growth target of 10% this year might be too optimistic. We forecast a slightly lower loan growth of 8%.

Open for foreign strategic partner

Management has stated that it is willing to have foreign banks as strategic shareholders. Thus far, one Asian bank and one European bank have reportedly expressed interest in Metrobank. While the local press reported that majority shareholder George Ty is willing to sell 20% of his 65% effective stake in the bank, we find it unlikely that he is willing to reduce his stake to less than 50%.

Valuation

The stock has slightly under-performed the broader market by 7% in 2000, and is trading at 1.2xPBR. While such valuation is undemanding, we believe the market should continue attach a discount to its valuations given its lower-than-average asset quality.

MBT

Share Price (P):	185	Index:	1475.11
52 Week Price Range (P):	282 - 161	Current Yield:	0.68%
Reuters Code:	MBT.PS		
Bloomberg Code:	MBT PM		

INCOME STATEMENT	1998A	1999A	2000E	2001E	2002E
(Php m)					
Interest income	31,453	25,498	29,242	30,910	34,548
Interest expense	-18,994	-14,983	-18,215	-18,915	-20,994
Net interest income	12,459	10,515	11,027	11,995	13,555
Ave. int. earnings assets	*244,247*	*294,650*	*341,879*	*364,543*	*410,703*
NIM (%)	5.10%	3.57%	3.23%	3.29%	3.30%
Non-interest income	5,460	5,335	6,295	7,302	8,251
Total operating income	17,919	15,850	17,322	19,297	21,806
Non-interest expenses	-8,710	-10,108	-12,340	-14,022	-15,882
Pre provision profit	9,209	5,742	4,981	5,275	5,924
Loan loss provisions	-2,692	-1,802	-1,998	-1,594	-1,297
Non-operating income	0	0	0	0	0
Pre tax profit	6,517	3,940	2,983	3,680	4,626
Tax	-1,686	-658	-656	-810	-1,018
Net profit	4,704	3,126	2,237	2,758	3,483

PER SHARE DATA (Php)	1998A	1999A	2000E	2001E	2002E
EPS	15.84	10.52	7.23	8.44	10.66
DPS	2.38	1.82	1.08	1.27	1.60
Effective payout ratio (%)	*15%*	*17%*	*15%*	*15%*	*15%*
BVPS	144.30	151.55	151.63	150.77	159.83
ABVPS	142.55	149.49	139.91	147.08	156.14

VALUATION	1998A	1999A	2000E	2001E	2002E
Price to book value (x)	1.3	1.2	1.2	1.2	1.2
Price to adjusted book value (x)	1.3	1.2	1.3	1.3	1.2
Price to earnings (X)	11.7	17.6	25.6	21.9	17.4

PROFITABILITY RATIOS	1998A	1999A	2000E	2001E	2002E
(%)					
Net interest margin	5.10%	3.57%	3.23%	3.29%	3.30%
Yield on interest earning assets	12.88%	8.65%	8.55%	8.48%	8.41%
Cost on interest bearing liabilities	8.44%	5.32%	5.35%	5.25%	5.23%
Net interest spread	4.44%	3.34%	3.20%	3.23%	3.18%
Non-int. income (% Op income)	30.5%	33.7%	36.3%	37.8%	37.8%
Cost to income	48.6%	63.8%	71.2%	72.7%	72.8%
Overhead ratio	3.09%	2.91%	3.01%	3.20%	3.23%
Cost coverage	62.7%	52.8%	51.0%	52.1%	52.0%
ROA	1.67%	0.90%	0.55%	0.63%	0.71%
ROE	11.5%	7.1%	4.9%	5.7%	6.9%

DUPONT ANALYSIS	1998A	1999A	2000E	2001E	2002E
Lending operations					
Net interest margin	5.10%	3.57%	3.23%	3.29%	3.30%
Interest earnings assets/assets	86.68%	84.89%	83.37%	83.17%	83.55%
NIM contribution to ROA	4.42%	3.03%	2.69%	2.74%	2.76%
Non-interest operations					
Non-interest income/assets	1.94%	1.54%	1.53%	1.67%	1.68%
Overhead ratio	3.09%	2.91%	3.01%	3.20%	3.23%
Non-int. contribution to ROA	-1.15%	-1.38%	-1.47%	-1.53%	-1.55%
Asset quality analysis					
Provision/loans	-1.66%	-0.99%	-0.96%	-0.71%	-0.53%
Loans/assets	57.44%	52.53%	50.72%	51.02%	49.84%
ROA effect from asset quality	-0.96%	-0.52%	-0.49%	-0.36%	-0.26%
Core ROA	2.31%	1.14%	0.73%	0.84%	0.94%
Non-core contibution to ROA	0.00%	0.00%	0.00%	0.00%	0.00%
Pre-tax ROA	2.31%	1.14%	0.73%	0.84%	0.94%
Tax rate	25.88%	16.71%	22.00%	22.00%	22.00%
After tax ROA	1.67%	0.90%	0.55%	0.63%	0.71%
Balance sheet leverage (x)	8.1	7.9	8.9	9.1	9.7
ROE	13.5%	7.1%	4.9%	5.7%	6.9%

BALANCE SHEET	1998A	1999A	2000E	2001E	2002E
(Php m)					
Gross loans	169,312	214,849	229,181	246,777	272,209
Specific loan loss reserves	*0*	*0*	*0*	*0*	*0*
Loan loss reserves	*5,645*	*13,884*	*14,149*	*14,543*	*14,429*
Net loans	163,666	200,964	215,032	232,234	257,780
Other earning assets	87,147	137,522	130,239	151,580	179,810
Other assets	39,506	65,364	71,059	76,432	85,299
Total Assets	290,319	403,851	416,330	460,247	522,889
Deposits	208,217	305,650	320,933	343,398	398,342
Other paying liabilities	22,888	26,900	27,438	28,809	32,267
Other liabilities	15,284	20,484	15,151	32,774	33,930
Total Liabilities	246,389	353,034	363,521	404,982	464,538
Minorities & other	1,070	5,802	5,892	6,005	6,130
Shareholders' funds	42,860	45,015	46,916	49,260	52,221

LOAN BOOK	1998A	1999A	2000E	2001E	2002E
(Php m)					
Agriculture	5,079	7,520	7,896	7,659	7,965
Mining	1,693	1,074	1,042	1,094	1,105
Manufacturing	46,561	49,415	56,827	64,783	76,444
Utilities	4,233	6,445	6,574	6,772	6,907
Construction	16,931	19,336	19,530	19,725	19,922
Trading	38,942	48,341	56,075	65,608	77,418
Transport & comm	8,466	11,817	11,226	10,777	10,238
Financial scvs	27,090	40,821	40,005	41,205	43,265
Com & soc svcs	20,317	30,079	30,380	30,683	30,990
Total loans	169,312	214,849	229,555	248,306	274,255

LOAN BOOK BREAKDOWN	1998A	1999A	2000E	2001E	2002E
(%)					
Agriculture	3%	4%	3%	3%	3%
Mining	1%	1%	0%	0%	0%
Manufacturing	28%	23%	25%	26%	28%
Utilities	3%	3%	3%	3%	3%
Construction	10%	9%	9%	8%	7%
Trading	23%	23%	24%	26%	28%
Transport & comm	5%	6%	5%	4%	4%
Financial scvs	16%	19%	17%	17%	16%
Com & soc svcs	12%	14%	13%	12%	11%
Total loans	100%	100%	100%	100%	100%

BALANCE SHEET RATIOS	1998A	1999A	2000E	2001E	2002E
(%)					
Loan-to-deposit	78.6%	65.7%	67.0%	67.6%	64.7%
Loan-to-deposit (incl. CDs)	0.0%	0.0%	0.0%	0.0%	0.0%
Equity to assets	14.8%	11.1%	11.3%	10.7%	10.0%
Tier 1 Capital	16.0%	16.5%	13.8%	13.4%	12.9%
Total Capital adequacy	16.5%	17.0%	14.2%	13.8%	13.2%
General reserves (% loans)	3.33%	6.46%	6.17%	5.89%	5.30%
Specific reserves (% loans)	0.00%	0.00%	0.00%	0.00%	0.00%
Total loan provisions	3.33%	6.46%	6.17%	5.89%	5.30%

ASSET QUALITY	1998A	1999A	2000E	2001E	2002E
Nonperforming loans	15,352	30,950	30,022	28,220	25,398
NPL ratio	9.1%	14.4%	13.1%	11.4%	9.3%
Total provisions/NPLs	36.8%	44.9%	47.1%	51.5%	56.8%

GROWTH RATES	1998A	1999A	2000E	2001E	2002E
(%)					
Income statement					
Net interest income		-15.6%	4.9%	8.8%	13.0%
Non-interest income		-2.3%	18.0%	16.0%	13.0%
Total operating income		-11.5%	9.3%	11.4%	13.0%
Operating expenses		16.1%	22.1%	13.6%	13.3%
Pre-provision earnings		-37.7%	-13.2%	5.9%	12.3%
Loan loss provisions		-33.1%	10.9%	-20.2%	-18.6%
Net profit		-33.5%	-28.4%	23.3%	26.3%
Balance sheet					
Loan growth		22.8%	7.0%	8.0%	11.0%
Interest earning assets		37.4%	2.0%	10.8%	13.5%
Asset growth		39.1%	3.1%	10.5%	13.6%
Deposit growth		46.8%	5.0%	7.0%	16.0%
Shareholders funds		5.0%	4.2%	5.0%	6.0%

PHILIPPINE NATIONAL BANK (P38.00) 4-UNDERPERFORM

Investment Case

Continues to be hounded by poor asset quality

It has been more than three years since the financial crisis hit the Philippine banking sector, and PNB is still struggling to get back on its feet. The bank has reported huge losses in 1998 and 1999, and it is still very much in the red as of September 30, 2000. One of the key reasons for its poor performance is that its balance sheet is laden with NPLs and ROPOA (or foreclosed assets). At 38% as of end-3Q00, PNB has the highest NPL ratio in the sector. And if we include its ROPOA portfolio, total non performing assets (NPA) stand at a staggering 49%. Management has been dragging its feet in disposing of its NPAs and a complete review of its existing loan portfolio. Consequently, it has to keep setting aside huge provisions just to be able to maintain its NPL coverage ratio at about 41%.

Capital infusion is useless unless NPAs are cleaned up

Having sustained heavy losses in 1998, PNB had to tap shareholders for fresh capital in order to meet minimum capital adequacy requirements. No minority shareholders were willing to inject new money, while the government (which is the majority shareholder) had a huge fiscal deficit to contend with and as such was in no position to subscribe to the rights issue. Lucio Tan, a prominent Chinese-Filipino businessman, came to the rescue by taking up the unsubscribed shares and the bank managed to raise P9.4 billion. The fresh funds were promptly virtually wiped out as the bank reported another loss of P8.52 billion in 1999 on the back of further provisions. We believe that management has to undergo a thorough review of its assets, be willing to sell-off its NPLs and foreclosed assets, even at a discount. Until that is done, any new capital put into the bank would simply be used up.

Ownership issue is an added overhang

While Lucio Tan, who currently has a 70% stake, has indeed invested a lot of his money into the bank, the market has been very skeptical of his management. It is widely known that Lucio Tan is a close friend of President Estrada, which has led to PNB being labeled a crony bank. Indeed, the process by which he came to control one of the nation's largest bank has been questioned by many industry observers. Additionally, the bank received P25 billion in loans from the BSP and PDIC in October 2000, after the bank reportedly encountered massive withdrawals. This led to accusations that the bank was able to obtain such a huge amount so quickly because of cronyism. Such events underscore our view that PNB not only has to clean up its balance sheet, but also regain investor confidence that its transactions are all above board.

Valuation and recommendation

Given its weak financial position and lingering uncertainties over treatment of minority shareholders, it is perhaps not surprising that the stock has languished in the past 12 months, underperforming the sector by 30%. With no clear indications that management is seriously cleaning up its balance sheet and with ownership issues remaining an overhang, we have downgraded the stock to 4-Market Underperform.

PNB

Share Price (P):	38	Index:	1475.11
52 Week Price Range (P):	114 - 36	Current Yield:	0.00%
Reuters Code:	PNB.PS		
Bloomberg Code:	PNB PM		

INCOME STATEMENT	1998A	1999A	2000E	2001E	2002E
(Php m)					
Interest income	23,287	16,243	15,012	15,084	16,110
Interest expense	-17,988	-12,580	-13,235	-13,208	-14,327
Net interest income	5,299	3,664	1,776	1,877	1,783
Ave. int. earnings assets	*187,181*	*140,578*	*137,459*	*147,351*	*157,578*
NIM (%)	3.12%	2.61%	1.29%	1.27%	1.13%
Non-interest income	4,338	5,967	5,023	5,597	6,359
Total operating income	9,637	9,631	6,799	7,474	8,142
Non-interest expenses	-8,960	-8,050	-7,976	-8,711	-9,572
Pre provision profit	678	1,581	-1,177	-1,237	-1,430
Loan loss provisions	-8,884	-8,516	-1,511	-739	-655
Non-operating income	0	0	0	0	0
Pre tax profit	-8,206	-6,935	-2,688	-1,976	-2,085
Tax	955	-2,939	365	384	443
Net profit	-7,252	-9,874	-2,323	-1,593	-1,642

PER SHARE DATA (Php)	1998A	1999A	2000E	2001E	2002E
EPS	(52.75)	(63.84)	(11.03)	(4.21)	(4.34)
DPS	0.00	0.00	0.00	0.00	0.00
Effective payout ratio (%)	*0%*	*0%*	*0%*	*0%*	*0%*
BVPS	107.77	71.65	59.39	55.18	50.83
ABVPS	107.77	63.92	51.61	47.40	43.06

VALUATION	1998A	1999A	2000E	2001E	2002E
Price to book value (x)	0.4	0.5	0.6	0.7	0.7
Price to adjusted book value (x)	0.4	0.6	0.7	0.8	0.9
Price to earnings (X)	-0.7	-0.6	-3.4	-9.0	-8.7

PROFITABILITY RATIOS	1998A	1999A	2000E	2001E	2002E
(%)					
Net interest margin	3.12%	2.61%	1.29%	1.27%	1.13%
Yield on interest earning assets	12.44%	10.33%	9.46%	8.87%	8.84%
Cost on interest bearing liabilities	9.15%	7.12%	7.34%	6.88%	6.88%
Net interest spread	3.29%	3.21%	2.12%	1.99%	1.95%
Non-int. income (% Op income)	45.0%	62.0%	73.9%	74.9%	78.1%
Cost to income	93.0%	83.6%	117.3%	116.6%	117.6%
Overhead ratio	4.45%	4.00%	3.81%	3.88%	3.98%
Cost coverage	48.4%	74.1%	63.0%	64.2%	66.4%
ROA	-3.23%	-4.51%	-1.11%	-0.71%	-0.68%
ROE	-38.7%	-61.3%	-12.5%	-7.4%	-8.2%

DUPONT ANALYSIS	1998A	1999A	2000E	2001E	2002E
Lending operations					
Net interest margin	3.12%	2.61%	1.29%	1.27%	1.13%
Interest earnings assets/assets	83.35%	69.83%	65.61%	65.68%	65.60%
NIM contribution to ROA	2.60%	1.82%	0.85%	0.84%	0.74%
Non-interest operations					
Non-interest income/assets	1.93%	2.96%	2.40%	2.49%	2.65%
Overhead ratio	4.45%	4.00%	3.81%	3.88%	3.98%
Non-int. contribution to ROA	-2.52%	-1.03%	-1.41%	-1.39%	-1.34%
Asset quality analysis					
Provision/loans	-6.79%	-8.05%	-1.64%	-0.79%	-0.67%
Loans/assets	58.27%	52.55%	44.09%	41.79%	40.60%
ROA effect from asset quality	-3.96%	-4.23%	-0.72%	-0.33%	-0.27%
Core ROA	-3.87%	-3.45%	-1.28%	-0.88%	-0.87%
Non-core contibution to ROA	0.00%	0.00%	0.00%	0.00%	0.00%
Pre-tax ROA	-3.87%	-3.45%	-1.28%	-0.88%	-0.87%
Tax rate	11.63%	-42.37%	31.00%	31.00%	31.00%
After tax ROA	-3.23%	-4.51%	-1.11%	-0.71%	-0.68%
Balance sheet leverage (x)	12.0	13.6	11.3	10.4	12.0
ROE	-38.7%	-61.3%	-12.5%	-7.4%	-8.2%

BALANCE SHEET	1998A	1999A	2000E	2001E	2002E
(Php m)					
Gross loans	127,201	106,380	106,386	107,728	110,739
Specific loan loss reserves	*0*	*0*	*0*	*0*	*0*
Loan loss reserves	*-8,018*	*-14,007*	*-14,013*	*-12,584*	*-10,838*
Net loans	119,183	92,373	92,373	95,144	99,901
Other earning assets	29,850	39,751	50,421	56,764	63,346
Other assets	51,597	69,854	74,218	79,748	85,536
Total Assets	200,630	201,978	217,011	231,656	248,783
Deposits	158,196	164,708	172,943	188,508	203,589
Other paying liabilities	18,227	12,171	10,954	11,501	12,651
Other liabilities	9,392	10,323	10,661	10,786	13,324
Total Liabilities	185,814	187,202	194,558	210,796	229,564
Minorities & other	0	0	0	0	0
Shareholders' funds	14,816	14,776	22,453	20,861	19,219

LOAN BOOK	1998A	1999A	2000E	2001E	2002E
(Php m)					
Agriculture	5,023	3,605	3,677	3,567	3,709
Mining	539	519	519	493	498
Manufacturing	28,358	26,040	25,780	26,811	28,419
Utilities	7,376	8,162	7,917	8,155	8,318
Construction	5,105	3,682	3,719	3,756	3,794
Trading	33,159	30,427	30,731	31,346	32,913
Transport & comm	8,236	7,636	7,483	7,184	6,897
Real estate & financial svcs	34,759	24,321	24,078	23,596	25,484
Total loans	122,555	104,392	103,904	106,908	112,034

LOAN BOOK BREAKDOWN	1998A	1999A	2000E	2001E	2002E
(%)					
Agriculture	4%	3%	4%	3%	3%
Mining	0%	0%	0%	0%	0%
Manufacturing	23%	25%	25%	25%	25%
Utilities	6%	8%	8%	8%	7%
Construction	4%	4%	4%	4%	3%
Trading	27%	29%	30%	29%	29%
Transport & comm	7%	7%	7%	7%	6%
Real estate & financial svcs	28%	23%	23%	22%	23%
Total loans	100%	100%	100%	100%	100%

BALANCE SHEET RATIOS	1998A	1999A	2000E	2001E	2002E
(%)					
Loan-to-deposit	75.3%	56.1%	53.4%	50.5%	49.1%
Loan-to-deposit (incl. CDs)	0.0%	0.0%	0.0%	0.0%	0.0%
Equity to assets	7.4%	7.3%	10.3%	9.0%	7.7%
Tier 1 Capital	5.0%	4.8%	7.9%	7.1%	6.1%
Total Capital adequacy	6.1%	6.0%	9.1%	8.2%	7.2%
General reserves (% loans)	-6.30%	-13.17%	-13.17%	-11.68%	-9.79%
Specific reserves (% loans)	0.00%	0.00%	0.00%	0.00%	0.00%
Total loan provisions	-6.30%	-13.17%	-13.17%	-11.68%	-9.79%

ASSET QUALITY	1998A	1999A	2000E	2001E	2002E
Nonperforming loans	18,100	30,100	36,120	34,314	29,853
NPL ratio	14.2%	28.3%	34.0%	31.9%	27.0%
Total provisions/NPLs	44.3%	46.5%	38.8%	36.7%	36.3%

GROWTH RATES	1998A	1999A	2000E	2001E	2002E
(%)					
Income statement					
Net interest income		-30.9%	-51.5%	5.7%	-5.0%
Non-interest income		37.5%	-15.8%	11.4%	13.6%
Total operating income		-0.1%	-29.4%	9.9%	8.9%
Operating expenses		-10.2%	-0.9%	9.2%	9.9%
Pre-provision earnings		133.3%	-174.5%	5.1%	15.5%
Loan loss provisions		-4.1%	-82.3%	-51.1%	-11.3%
Net profit		36.2%	-76.5%	-31.4%	3.1%
Balance sheet					
Loan growth		-22.5%	0.0%	3.0%	5.0%
Interest earning assets		-7.0%	7.3%	4.9%	5.8%
Asset growth		0.7%	7.4%	6.7%	7.4%
Deposit growth		4.1%	5.0%	9.0%	8.0%
Shareholders funds		-0.3%	52.0%	-7.1%	-7.9%

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FINANCIAL SERVICES

Banks

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Antonio Vitti	415 274-5386
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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); 4 = **Market Underperform** (expected to underperform the market by 5-15 percentage points); 5 = **Sell** (expected to underrperform 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).