

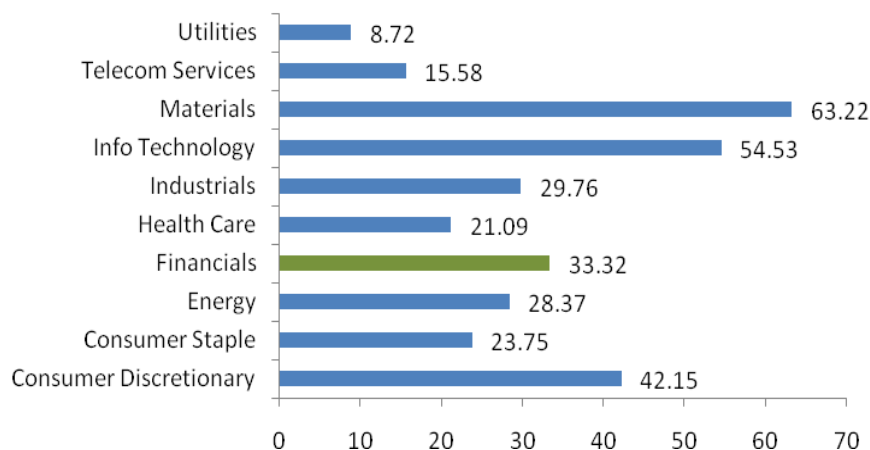


Industry Analysis - Banks

Introduction

Global financial markets achieved above average returns during the year 2009, in part due to the worldwide recovery of equity and bond markets. All sectors recovered, but none more than ones most severely injured during the systemic financial crisis of 2008. Because of the regional differences in recoveries and the risk profile of financial institutions, a brief review of these major financial institutions was warranted. This paper is intended to unveil simple characteristics within the global financial industry.

Chart 1: Global Sector 1 year Performance



Because banks make up the breadth and depth of the global financial industry, one question we asked is “How healthy are these institutions?” Importantly we were concerned about the major differences among regions and - prospects for continued appreciation in equity values. The countries evaluated in this analysis include China, Hong Kong, UK, Canada and Australia.

Analysis

We assessed 33 independent banks in the aforementioned markets: thirteen in China, seven in Hong Kong, four in UK, nine in Canada, and five in Australia. Their market values range from \$851M to \$261B¹. These cover the most influential banks in the regions.

We evaluated profitability statistics including return on equity (ROE), return on assets (ROA), and net interest margin (NIM). After this, we evaluated risk. Risk statistics including Capital Adequacy Ratio (CAR), Loan to Deposit Ratio (LDR), Loan Loss Coverage (LLC), Nonperforming Loan to Total Loan (NPL/TL), and Cash to Total Asset (Cash/TA) were analyzed to understand banks’ exposures to

¹ These and all statistics are as of 12/09.





“unfortunate” loans and to better simulate their insulation from loan losses. Also important, debt to capital ratios were assessed to understand and assess leverage.

Table 1: Summary of Statistics

	NIM	Oper. ROE	ROE	ROA	LT D/TC	CAR	LDR	LLC	NPL/TL	Cash/TA
China	3.52	19.74	18.94	1.10	10.68	12.91	69.41	21.58	1.72	14.27
Hong Kong	1.99	5.19	11.03	0.85	18.98	14.07	66.39	1.15	3.48	3.47
UK	2.06	11.81	10.81	0.40	21.85	12.95	111.18	5.44	3.00	2.69
Canada	2.18	14.34	13.86	0.71	8.72	13.87	77.82	11.24	1.40	1.75
Australia	2.04	9.91	9.75	0.51	55.34	11.47	123.74	26.43	0.90	1.48

Table 1 above represents the summary statistics for the sample. Most obvious differences among the sample include Operating ROE (ranging from 9.9% to 19.7%), ROE (ranging from 9.7% to 18.9%), LDR (ranging from 66.3% to 1.1), and LLC (ranging from 1.1 to 26.4).

Findings

Profitability: Chinese and Canadian banks appear more robust with lower leverage, relatively high NIM, ROE, and expected profits.

Currently, China banks have the highest profitability ratios, with average operating ROE of 19.7%, ROE of 18.9%, and ROA of 1.1%. Canada ranks second, with average operating ROE of 14.3%, ROE of 13.8%, and ROA of 0.7%. Comparatively, UK and Australia have lower ratios, with 11.8% and 9.9% for operating ROE, 10.8% and 9.7% for ROE, and 0.4% and 0.51% for ROA, respectively.

As for China, for the Q309, China’s major banks posted strong profit growth as new lending surged: Industrial and Commercial Bank of China (ICBC) - world’s largest bank by market value - China Construction Bank (CCB), and Bank of China (BOC) all posted over 19% increases in net income. Since lending is still the major source of banks’ revenues, Chinese banks high profitability can be explained by a high net interest margin (NIM), which measures the difference between the interest income generated by banks and interest paid out (see Table 1).

As for Canada, six major Canadian banks reported Q409 earnings: Bank of Montreal (BMO), Toronto-Dominion Bank (TD), Canadian Imperial Bank of Commerce (CIBC), National Bank of Canada, Royal Bank of Canada (RBC) and Scotia bank. All the banks met or exceeded average analysts’ estimates, with only exception of the National Bank of Canada.

Risks: China and Canada banks balance sheet risks appear low.

Although the capital adequacy ratio (CAR) for all banks in this survey exceeds the Basel II minimum requirement of 8%, China, Hong Kong, and Canada appear more conservative. These have loan-to-deposit ratios of around 70%, compared with Australia and UK whose ratios exceed 100%. Without more thoroughly analyzing the composition of the balance sheet, we project a level of risk inherent in ratios that exceed 80%, especially if asset quality turns down. Loan loss coverage - a way to assess





loan protection – is mixed among these institutions: China and Australia have relatively high ratios (21.5 and 26.4, respectively) compared to Hong Kong (1.2) and Canada (1.4). Moreover, China, Canada, and Australia have lower non performing loan ratios - or loans in arrears for 90 or more days - than UK and Hong Kong. In addition, China has significantly stronger cash position than other countries.

Although Chinese banks appear to have lower balance sheet risks, they may have off-balance sheet concerns:

- Interest rates: China's central bank cut its one-year lending rate by more than 1% during the financial crisis, which reduced banks' NIMs. With interest rates likely on hold until Q210, and regulators pushing for a slowdown in lending, the profit outlook for Chinese banks may be diminished.
- Credit: In Q309 households received 62% of all new loans, up from 14% share in H109. This surge in mortgages may be troubling. The last time households received more than 50% of total loans was at the height of the property bubble in 2007. However, Chinese banks are now more diversified among business and households lending.

Risk: Australian banks may benefit from future inflation.

Australia banks have high long-term debt to total capital, with an average ratio of 55.3%, compared with 10.6% in China, and 8.7% in Canada. However, since Australia just raised its main interest rate for the second month in a row, the exposure to the long term debt may not be as onerous as it appears today.





Champion's Allocations

Based on the analyses above, Champion's funds will:

Overweight Canada (financials):

- Good earnings due to investment banking & trading activities;
- Tight capital requirements;
- Stringent government restrictions and limited subprime exposure, due to the prudent and disciplined risk management practices.

Overweight China (financials):

- Highest profitability expectation;
- Lowest risk statistics.

Lessen current over-allocation to Australia:

- Lower profitability expectations;
- Highest LDR and weakest cash position.





Appendix: Banks' data²

Name	NIM	Oper. ROE	ROE	ROA	3 Yr ROE	5 Yr ROE	3 Y ROA	5 Y ROA	LT D/TC	CAR	LDR	LLC	NPL/TL	Cash/TA
China	3.52	19.74	18.94	1.10	18.20	16.88	0.93	0.74	10.68	12.91	69.41	21.58	1.72	14.27
IND & COMM BK OF CHINA - A	3.42	19.22	19.43	1.20	16.43		0.97	0.84	2.98	13.06	55.59	14.98	2.89	17.35
CHINA CONSTRUCTION BANK -A	3.88	20.83	20.88	1.31	18.09	19.88	1.13	1.16	10.42	12.16	59.01	24.38	2.38	16.51
BANK OF CHINA LTD-A	3.12	14.35	14.55	0.99	14.20	13.19	0.95	0.79	8.29	13.43	62.16	22.25	2.73	17.88
BANK OF COMMUNICATIONS-A	3.20	20.11	20.10	1.18	17.47	14.13	1.01	0.78	21.93	13.47	71.21	24.46		13.50
CHINA MERCHANTS BANK -A	3.78	29.17	28.58	1.46	23.36	20.39	1.21	0.96	14.46	11.34	69.81	52.06	1.12	13.47
CHINA CITIC BANK -A	4.23	14.77	14.86	1.21	14.43		0.93		6.10	14.32	70.30	25.26	2.12	17.42
INDUSTRIAL BANK CO LTD -A	3.34		25.90	1.22					17.63	11.24	78.96	18.16	0.83	12.52
SHANGHAI PUDONG DEVEL BANK-A	3.41		35.77	1.13	24.34	21.11	0.78	0.66	6.00	9.06	73.64	24.45	1.21	12.42
CHINA MINSHENG BANKING-A	3.66		15.15	0.80	18.34	18.49	0.72	0.64	16.47	9.22	83.78	8.17		17.53
BANK OF BEIJING CO LTD -A	3.41		17.92	1.40	20.16		1.11		13.89	16.42	61.13	22.14	1.55	11.82
SHENZHEN DEVELOPMENT BANK-A	3.66		4.18	0.15	18.76	13.99	0.54	0.39	7.46	8.58	78.96		0.68	8.38
HUAXIA BANK CO LTD-A	2.95		15.17	0.46	15.11	13.85	0.41	0.40	10.29	11.40	73.69	4.03	1.82	17.28
BANK OF NANJING CO LTD -A	3.72		13.71	1.72	17.78		1.40		2.88	24.12	64.05	18.63	1.64	9.43
Hong Kong	1.99	5.19	11.03	0.85	16.81	16.83	1.29	1.30	18.98	14.07	66.39	1.15	3.48	3.47
HSBC HOLDINGS PLC	2.21	7.40							24.64	11.40	85.78		3.48	2.31
HANG SENG BANK LTD	2.30								12.10	12.50	55.32	46.64		0.80
BOC HONG KONG HOLDINGS LTD	2.10								12.42	16.17	58.32	(60.55)		6.14
BANK OF EAST ASIA	1.87								15.55	13.80	70.34	2.68		4.57
WING HANG BANK LIMITED	1.89		11.03	0.85	16.81	16.83	1.29	1.30	24.12	15.40	68.90	7.12		2.29
DAH SING BANKING GROUP LTD	2.19	2.97							32.62	13.60	70.10	9.34		2.17
CHONG HING BANK LTD	1.37								11.43	15.64	55.97	1.69		5.98
UK	2.06	11.81	10.81	0.40	17.14	18.22	0.67	0.77	21.85	12.95	111.18	5.44	3.00	2.69
HSBC HOLDINGS PLC	2.21	7.40	5.17	0.23	12.36	14.03	0.69	0.86	24.64	11.40	85.78		3.48	2.31
LLOYDS BANKING GROUP PLC	2.16	7.66	7.61	0.21	20.70	21.74	0.67	0.75	20.36	11.20	144.09	2.55	3.47	1.37
BARCLAYS PLC	1.23	15.19	14.63	0.27	19.90	20.12	0.38	0.45	13.87	13.60	139.59	3.72	3.35	1.54
STANDARD CHARTERED PLC	2.63	16.99	15.85	0.89	15.59	17.00	0.93	1.01	28.54	15.60	75.27	10.05	1.71	5.55
Canada	2.18	14.34	13.86	0.71	15.54	16.82	0.78	0.84	8.72	13.87	77.82	11.24	1.40	1.75
ROYAL BANK OF CANADA	2.26	15.12	12.04	0.53	18.18	19.22	0.72	0.76	6.37	14.20	71.34	3.74	1.92	1.28
TORONTO-DOMINION BANK	2.54	11.50	9.07	0.53	14.58	17.09	0.76	0.83	15.05	14.90	65.34	4.14	0.90	0.43
BANK OF NOVA SCOTIA	1.91	16.82	16.87	0.67	19.05	20.03	0.78	0.89	7.76	12.90	76.81	4.55	1.46	0.68
BANK OF MONTREAL	1.76	10.10	9.87	0.41	12.36	14.94	0.50	0.64	6.42	14.87	68.64	2.73	2.03	2.56
CAN IMPERIAL BK OF COMMERCE	1.88	9.05	9.07	0.29	6.50	9.06	0.21	0.29	9.06	16.10	75.82	2.97	2.26	0.54
NATIONAL BANK OF CANADA	1.77	15.72	15.71	0.61	14.78	16.96	0.56	0.65	5.66	14.30	70.88	11.05	0.76	0.22
CANADIAN WESTERN BANK		13.21	13.22	0.87	15.50	14.88	1.01	1.03	22.57	15.40	96.82	11.93	1.48	0.26
HOME CAPITAL GROUP INC	3.17	27.82	27.84	2.02	28.03	29.49	1.98	2.00	-	14.20	88.81	56.44	0.93	9.54
LAURENTIAN BANK OF CANADA	2.15	9.78	11.01	0.48	10.89	9.71	0.48	0.42	5.64	8.00	85.88	3.61	0.87	0.28
Australia	2.04	9.91	9.75	0.51	14.74	15.86	0.74	0.82	55.34	11.47	123.74	26.43	0.90	1.48
COMMONWEALTH BANK OF AUSTR/	2.08	16.49	16.71	0.85	18.67	18.24	1.00	1.03	61.35	10.42	130.93	8.31	0.83	0.62
WESTPAC BANKING CORP	2.58	12.11	13.21	0.67	19.73	20.42	0.88	0.95	71.55	10.80	142.00	4.60	0.81	0.68
NATIONAL AUSTRALIA BANK LTD	2.16	7.60	8.40	0.39	14.72	15.94	0.66	0.76	38.39	11.48	110.60	4.16	1.56	3.95
AUST AND NZ BANKING GROUP	2.42	10.43	10.19	0.61	14.94	16.54	0.84	0.95	50.19	13.70	121.48			0.65
BENDIGO AND ADELAIDE BANK	1.47	3.62	2.42	0.15	8.43	10.92	0.49	0.60	76.28	10.91	120.23	(7.37)		1.94
BANK OF QUEENSLAND LTD	1.57	9.19	7.55	0.40	11.93	13.11	0.56	0.60	34.28	11.50	117.21	122.43	0.41	1.04

² Data source: Bloomberg. There is some missing data for banks in Hong Kong.

