

# Agricultural Bank of China (ABC, 1288 HK)

## Numerous bright spots with strong fundamentals; maintain BUY

- Solid profit growth momentum, supported by both interest and non-interest income sources
- Expanding spreads and robust balance sheet growth with optimizing mix indicate a better NIM outlook
- NPL ratio normalized to the system average level. Sustainability of strong risk buffer is impressive
- The counter is currently trading at 0.79x 18E P/B with a 5.22% 18E dividend yield. ABC remains to be our stop pick in the sector

**Solid topline revenue growth.** 2017 net profit was reported at RMB 192,962mn, up 4.9% YoY, in line with both consensus and our forecasts. NIM expanded by 3bps YoY to 2.28%, translating into an 11% YoY growth in NII. Robust balance sheet growth was evident, with total assets up 7.6% YoY and loan growing by 10.3% YoY. Partially offset by a 19.8% YoY lowered in net fee income under a tightened regulatory environment, topline revenue rose 6.4% YoY in 2017. Settlement & clearing fees and agency commissions suffered the most, down 33.5% and 42.2% YoY. Positive developments in online banking platform - e-banking service fees surged 46.1% YoY while bank card fees increased 12.9% YoY.

**A more positive NIM outlook.** Leveraging on its strength in county area banking, ABC continued to enjoy a relatively low deposit cost (down 13bps YoY to 1.34%). Both interbank asset-liability spread and loan-deposit spread improved mildly in 2017 by 11bps YoY to 0.66% and 1bps YoY to 2.92%, supporting the 3bps YoY expansion in NIM despite the 12bps YoY reduction in average loan yield. With ABC's ongoing optimization of balance sheet mix that lowers exposure in the interbank market, we are convinced that its NIM outlook would improve further in coming years. To be conservative, however, our base case scenario still assumes some slight NIM pressure for 2018E.

**Actively managing asset quality.** Thanks to the Bank's dedication to asset quality management, NPL ratio retreated by 56bps YoY to 1.81% in 2017, comparable to the system average level. Special-mention loan ratio and overdue loan ratio dropped 61bps to 3.27% and 70bps to 2.1% - a result of increased effort in NPL handling (2016-17: ~RMB 300bn) and fine-tuning of loan portfolio that increased exposure in low-risk segments. Manufacturing accounted for 12.6% of total corporate loans in 2016 to 11.6% in 2017; wholesale & retail sector took up fell from 3.3% of total corporate loans in 2017 compared to 4.2% in 2016. Loan mix in the relatively low-risk residential mortgage rose from 23.9% in 2016 to 29.2% in 2017. Moreover, risk buffer remained sound - provisioning ratio and provision coverage ratio were 3.77% and 208.37% as of Dec 2017. We believe this cautious attitude will serve the Bank well in the long run.

### Results and Valuation

FY ended Dec 31	2015A	2016A	2017A	2018E	2019E
Revenue (RMB mn)	540,862	510,128	542,898	594,721	651,254
Chg (% YoY)	3.2	(5.7)	6.4	9.5	9.5
Net profit (RMB mn)*	180,582	183,941	192,962	206,191	228,530
Chg (% YoY)	0.6	1.9	4.9	6.9	10.8
EPS (RMB)	0.55	0.55	0.58	0.61	0.68
Chg (% YoY)	0.2	0.1	5.0	5.5	11.1
BVPS (RMB)	3.48	3.81	4.15	4.60	5.08
Chg (% YoY)	13.0	9.6	8.9	10.8	10.5
P/E (x)	6.61	6.60	6.28	5.96	5.36
P/B (x)	1.05	0.96	0.88	0.79	0.72
ROAE (%)	16.12	14.55	14.57	13.57	13.69
ROAA (%)	1.07	0.98	0.95	0.90	0.91
DPS(RMB)	0.17	0.17	0.18	0.19	0.20
Yield (%)	4.58	4.66	4.89	5.22	5.60

Source(s): Bloomberg, ABCI Securities estimates

\* Refers to net profit attributable to equity shareholders

## Company Report

Mar 27, 2018

Rating: BUY

TP:HK\$ 6.38

Analyst : Johannes Au

Tel: (852) 2147 8802

johannesau@abci.com.hk

Share price (HK\$)	4.52
Est. share price return	41.15%
Est. dividend yield	5.22%
Est. total return	46.37%
Previous Rating & TP	BUY;HK\$6.38
Previous Report Date	Feb 26,2018

Source(s): Bloomberg, ABCI Securities

### Key Data

52Wk H/L(HK\$)	5.02/3.40
Issued shares (mn)	324,794
H-share(mn)	30,739
A-shares (mn)	294,055
Market cap (HK\$ mn)	1,551,513
H-share(mn)	139,247
A-shares (mn)	1,412,266
3-mth avg daily turnover(HK\$ mn)	1,199.86
Major shareholder(s) (%):	
Huijin	40.03

Source(s): Company, ABCI Securities

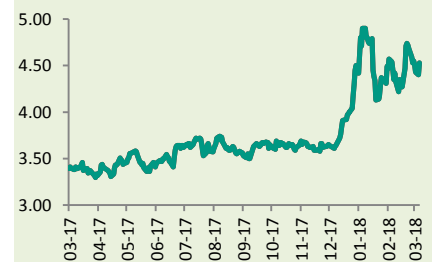
### Share Performance (%)

	Absolute	Relative*
1-mth	(0.88)	0.66
3-mth	25.48	20.62
6-mth	28.69	14.99

\*Relative to HSI

Source(s): Bloomberg, ABCI Securities

### 1-Year share performance(HK\$)



Source(s): Bloomberg, ABCI Securities



**A stronger capital position with organic growth.** Extending the momentum from 1H17, CT1 increased by another 5bps HoH in 2H17 to 10.63% with organic growth; CAR was up 58bps HoH to 13.74% in 2H17, supported mainly by the planned issuance of tier-2 instruments. ABC's capital position will be further enhanced upon the completion of the proposed A-share placement announced in Mar 2018. We expect capital pressure to be minimal in the medium term and a stable payout ratio would be sustained. To note, we have not factored in the effect of placement in our latest valuation due to the unconfirmed completion schedule.

**Improved fundamentals with numerous bright spots; reiterate BUY.** The counter is currently trading at 0.79x 18E P/B with a 5.22% 18E dividend yield. The Bank's fundamentals show a multitude of encouraging signals: improving earnings momentum driven by NIM and fee income growth; normalizing asset quality with strong risk buffer; optimizing balance sheet mix; and a healthy capital position. Moreover, ABC would be the key beneficiary of the government's policies to support inclusive finance and Sannong development. The counter remains to be our top pick in the sector.

**Risk factors:** 1) Increasing competition from non-bank financial institutions amid financial reform; 2) Sharp asset quality deterioration and weak loan demand; 3) New regulations affecting banks' operation and profitability; 4) Potential dilution effect from the proposed A-share placement.

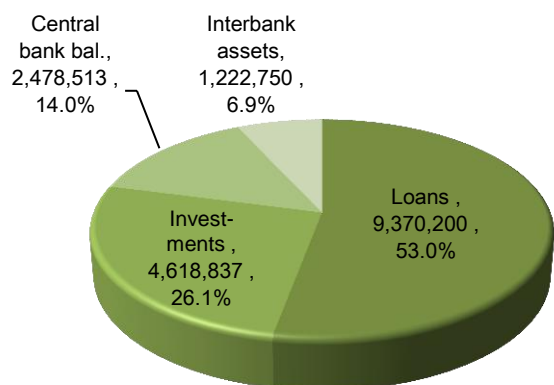
**Exhibit 1: ABC's 2017 actual results vs. ABCI estimates**

(Rmb mn)	2017A	2017E	AvE (%)
Net interest income	441,930	440,623	0.30
Net fee and commission	72,903	82,468	(11.60)
Operating income	542,898	545,328	(0.45)
Operating expenses	(205,268)	(217,282)	(5.53)
Impairment losses	(98,166)	(84,189)	16.60
Profit before tax	239,478	243,857	(1.80)
Income tax expenses	(46,345)	(51,210)	(9.50)
Net profit	192,962	192,498	0.24
<b>Key indicators (%)</b>			<b>AvE (ppt)</b>
Net interest margin	2.28	2.21	0.07
Net interest spread	2.15	2.04	0.11
Cost to income ratio	32.96	36.07	(3.11)
Return on average assets	0.95	0.93	0.02
Return on average equity	14.57	13.91	0.66
Dividend payout	30.74	30.00	0.74
CT1 CAR	10.63	10.66	(0.03)
Total CAR	13.74	13.26	0.48
NPL ratio	1.81	1.80	0.01
Provision to total loans	3.77	3.95	(0.18)
Provision coverage	208.37	219.44	(11.07)

Source(s): Company, ABCI Securities estimates

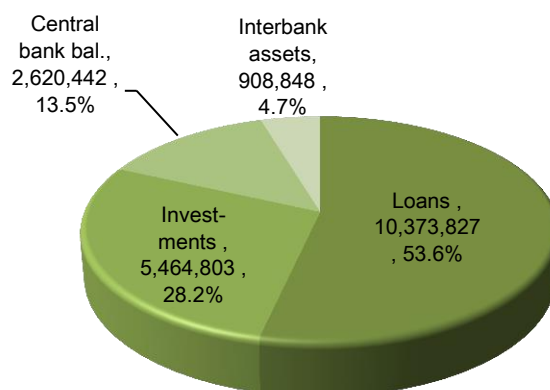


Exhibit 2: ABC's AIEA mix (2016)



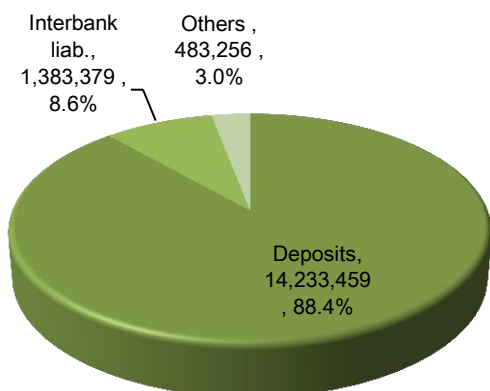
Source(s): Company, ABCI Securities

Exhibit 3: ABC's AIEA mix (2017)



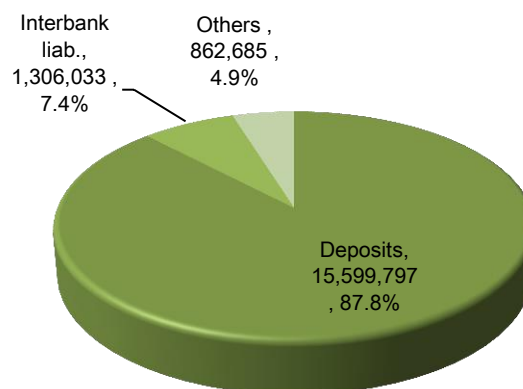
Source(s): Company, ABCI Securities

Exhibit 4: ABC's AIBL mix (2016)



Source(s): Company, ABCI Securities

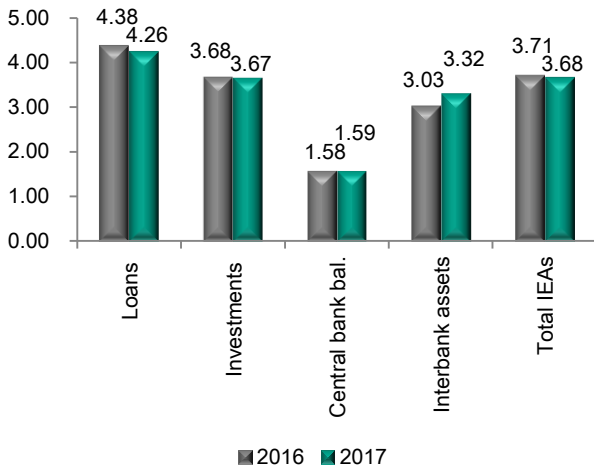
Exhibit 5: ABC's AIBL mix (2017)



Source(s): Company, ABCI Securities

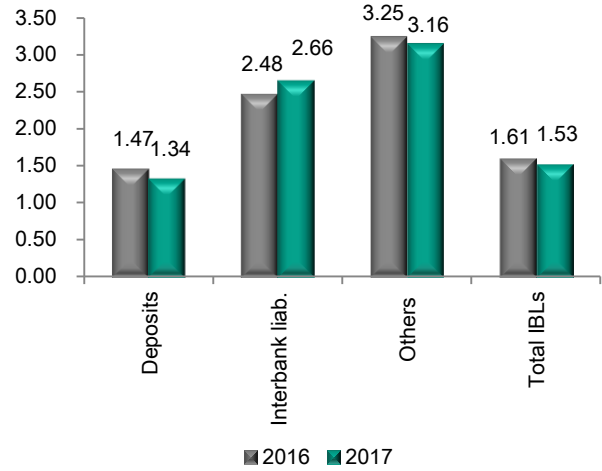


Exhibit 6: ABC's asset yield (%)



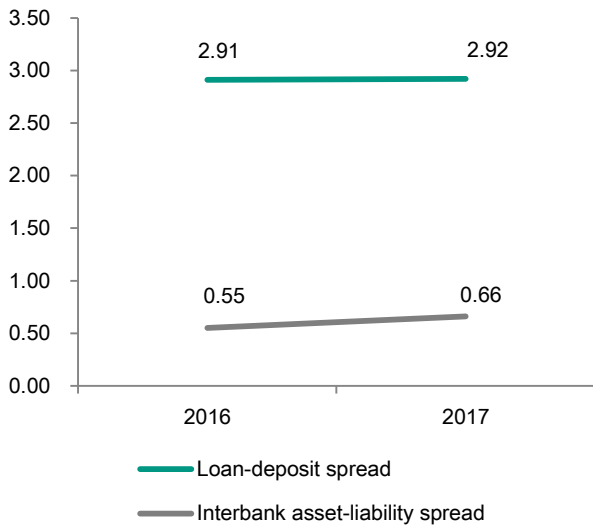
Source(s): Company, ABCI Securities

Exhibit 7: ABC's funding cost (%)



Source(s): Company, ABCI Securities

Exhibit 8: ABC's spread analysis (ppt)



Source(s): Company, ABCI Securities



Consolidated income statement (2015A-2019E)

FY Ended Dec 31 (RMB mn)	2015A	2016A	2017A	2018E	2019E
Net interest income	436,140	398,104	441,930	493,659	551,058
Non-interest income	104,722	112,024	100,968	101,062	100,196
Of which: Fees and commissions	82,549	90,935	72,903	77,600	75,537
<b>Operating income</b>	<b>540,862</b>	<b>510,128</b>	<b>542,898</b>	<b>594,721</b>	<b>651,254</b>
Operating expenses	(206,200)	(178,021)	(186,989)	(215,548)	(234,027)
Amortization	(19,633)	(19,037)	(18,279)	(22,205)	(23,981)
<b>Pre-provision operating profit</b>	<b>315,029</b>	<b>313,070</b>	<b>239,464</b>	<b>356,968</b>	<b>393,245</b>
Impairment loans losses	(84,172)	(86,446)	(98,166)	(95,731)	(103,673)
<b>Profit before tax</b>	<b>230,857</b>	<b>226,624</b>	<b>239,478</b>	<b>261,237</b>	<b>289,572</b>
Tax	(50,083)	(42,564)	(46,345)	(54,860)	(60,810)
Minority interests	(192)	(119)	(171)	(186)	(232)
<b>Net profit attributable to equity holders</b>	<b>180,582</b>	<b>183,941</b>	<b>192,962</b>	<b>206,191</b>	<b>228,530</b>
Preference share dividend	4,600	4,600	4,600	4,600	4,600
<b>Net profit attributable to ordinary shareholders</b>	<b>175,982</b>	<b>179,341</b>	<b>188,362</b>	<b>201,591</b>	<b>223,930</b>
<b>Growth (%)</b>					
Net interest income	1.5	(8.7)	11.0	11.7	11.6
Non-interest income	11.1	7.0	(9.9)	0.1	(0.9)
Of which: Fees and commissions	3.0	10.2	(19.8)	6.4	(2.7)
<b>Operating income</b>	<b>3.2</b>	<b>(5.7)</b>	<b>6.4</b>	<b>9.5</b>	<b>9.5</b>
Operating expenses	0.8	(13.7)	5.0	15.3	8.6
Amortization	1.6	(3.0)	(4.0)	21.5	8.0
<b>Pre-provision operating profit</b>	<b>4.9</b>	<b>(0.6)</b>	<b>(23.5)</b>	<b>49.1</b>	<b>10.2</b>
Impairment loans losses	23.8	2.7	13.6	(2.5)	8.3
<b>Profit before tax</b>	<b>(0.6)</b>	<b>(1.8)</b>	<b>5.7</b>	<b>9.1</b>	<b>10.8</b>
Tax	(5.1)	(15.0)	8.9	18.4	10.8
Minority interests	291.8	(38.0)	43.7	8.7	25.0
<b>Net profit attributable to equity holders</b>	<b>0.6</b>	<b>1.9</b>	<b>4.9</b>	<b>6.9</b>	<b>10.8</b>
Preference share dividend	91.7	0.0	0.0	0.0	0.0
<b>Net profit attributable to ordinary shareholders</b>	<b>(0.6)</b>	<b>1.9</b>	<b>5.0</b>	<b>7.0</b>	<b>11.1</b>
<b>Per share (RMB)</b>					
EPS	0.55	0.55	0.58	0.61	0.68
BVPS	3.48	3.81	4.15	4.60	5.08
DPS	0.17	0.17	0.18	0.19	0.20
<b>Key ratio (%)</b>					
Net interest margin	2.66	2.25	2.28	2.25	2.27
Net interest spread	2.49	2.11	2.15	2.12	2.18
Cost to income ratio	38.12	34.90	32.96	36.24	35.93
Return on average assets	1.07	0.98	0.95	0.90	0.91
Return on average equity	16.12	14.55	14.57	13.57	13.69
Effective tax rate	21.69	18.78	19.35	21.00	21.00
Dividend payout	30.23	31.00	30.74	30.00	29.00

Source(s): Company, ABCI Securities estimates



Consolidated balance sheet (2015A-2019E)

As of Dec 31 (RMB mn)	2015A	2016A	2017A	2018E	2019E
Cash & equivalent	2,587,057	2,811,653	2,896,619	3,266,325	3,489,254
Interbank assets	1,673,984	1,526,665	1,175,900	1,513,009	1,543,132
Investment securities	4,512,047	5,333,535	6,152,743	7,349,260	8,504,534
Net loans and advances	8,506,675	9,319,364	10,316,311	11,088,181	12,044,090
<b>Total interest earning assets</b>	<b>17,279,763</b>	<b>18,991,217</b>	<b>20,541,573</b>	<b>23,216,775</b>	<b>25,581,011</b>
Property and equipment	156,178	158,669	155,258	165,079	168,381
Other non-interest earning assets	355,452	420,175	356,551	567,767	656,117
<b>Total assets</b>	<b>17,791,393</b>	<b>19,570,061</b>	<b>21,053,382</b>	<b>23,949,621</b>	<b>26,405,509</b>
Customer deposits	13,538,360	15,038,001	16,194,279	18,538,928	20,463,242
Interbank liabilities	1,598,259	1,749,117	1,720,738	2,059,061	2,223,785
Subordinated debt	382,742	388,215	475,017	428,007	449,407
<b>Total interest bearing liabilities</b>	<b>15,519,361</b>	<b>17,175,333</b>	<b>18,390,034</b>	<b>21,025,995</b>	<b>23,136,435</b>
Current taxes	38,097	16,356	32,842	13,994	13,155
Deferred tax liabilities	111	58	87	90	111
Other liabilities	1,021,939	1,056,723	1,201,022	1,315,295	1,502,199
<b>Total liabilities</b>	<b>16,579,508</b>	<b>18,248,470</b>	<b>19,623,985</b>	<b>22,355,374</b>	<b>24,651,899</b>
Share capital	404,693	404,693	404,693	404,693	404,693
Reserves	805,398	913,500	1,021,722	1,185,060	1,343,749
Minorities	1,794	3,398	2,982	4,494	5,168
<b>Shareholder's equity</b>	<b>1,211,885</b>	<b>1,321,591</b>	<b>1,429,397</b>	<b>1,594,247</b>	<b>1,753,610</b>
<b>Growth (%)</b>					
Cash & equivalent	(5.7)	8.7	3.0	12.8	6.8
Interbank assets	12.4	(8.8)	(23.0)	28.7	2.0
Investment securities	26.2	18.2	15.4	19.4	15.7
Net loans and advances	9.9	9.6	8.2	13.0	8.6
<b>Total interest earning assets</b>	<b>11.1</b>	<b>9.9</b>	<b>8.2</b>	<b>13.0</b>	<b>10.2</b>
<b>Total assets</b>	<b>11.4</b>	<b>10.0</b>	<b>7.6</b>	<b>13.8</b>	<b>10.3</b>
Customer deposits	8.0	11.1	7.7	14.5	10.4
Interbank liabilities	40.7	9.4	(1.6)	19.7	8.0
Subordinated debt	17.7	1.4	22.4	(9.9)	5.0
<b>Total interest bearing liabilities</b>	<b>10.9</b>	<b>10.7</b>	<b>7.1</b>	<b>14.3</b>	<b>10.0</b>
<b>Total liabilities</b>	<b>11.0</b>	<b>10.1</b>	<b>7.5</b>	<b>13.9</b>	<b>10.3</b>
<b>Shareholder's equity</b>	<b>17.4</b>	<b>8.9</b>	<b>8.2</b>	<b>11.5</b>	<b>10.0</b>
<b>Key ratio (%)</b>					
CT1 CAR	10.24	10.38	10.63	10.66	10.64
Total CAR	13.40	13.04	13.74	13.28	13.24
NPL ratio	2.39	2.37	1.81	1.70	1.60
Provision to total loans	4.40	4.50	3.77	3.80	3.70
Provision coverage ratio	189.43	173.40	208.37	223.53	231.25

Source(s): Company, ABCI Securities estimates

## Disclosures

### Analyst Certification

I, Johannes Au, being the person primarily responsible for the content of this research report, in whole or in part, hereby certify that all of the views expressed in this report accurately reflect my personal view about the subject company or companies and its or their securities. I also certify that no part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or views expressed in this report. I and/or my associates have no financial interests in relation to the listed company (ies) covered in this report, and I and/or my associates do not serve as officer(s) of the listed company (ies) covered in this report.

### Disclosures of Interests

ABCI Securities Company Limited and/or its affiliates, within the past 12 months, have investment banking relationship with one or more of the companies mentioned in the report.

### Definition of equity rating

Rating	Definition
Buy	Stock return $\geq$ Market return rate
Hold	Market return $- 6\% \leq$ Stock return $<$ Market return rate
Sell	Stock return $<$ Market return $- 6\%$

Stock return is defined as the expected % change of share price plus gross dividend yield over the next 12 months

Market return: 5-year average market return rate

Time horizon of share price target: 12-month

### Definition of share price risk

Rating	Definition
Very high	$2.6 \leq$ 180 day volatility/180 day benchmark index volatility
High	$1.5 \leq$ 180 day volatility/180 day benchmark index volatility $<$ 2.6
Medium	$1.0 \leq$ 180 day volatility/180 day benchmark index volatility $<$ 1.5
Low	180 day volatility/180 day benchmark index volatility $<$ 1.0

We measure share price risk by its volatility relative to volatility of benchmark index. Benchmark index: Hang Seng Index. Volatility is calculated from the standard deviation of day to day logarithmic historic price change. The 180-day price volatility equals the annualized standard deviation of the relative price change for the 180 most recent trading days closing price.

### Disclaimers

This report is for our clients only and is for distribution only under such circumstances as may be permitted by applicable law. It has no regard to the specific investment objectives, financial situation or particular needs of any specific recipient. It is published solely for informational purposes and is not to be construed as a solicitation or an offer to buy or sell any securities or related financial instruments. No representation or warranty, either expresses or implied, is provided in relation to the accuracy, completeness or reliability of the information contained herein. This report should not be regarded by recipients as a substitute for the exercise of their own judgment. Any opinions expressed in this report are subject to change without notice and may differ or be contrary to opinions expressed by other business areas as a result of using different assumptions and criteria. The analysis contained herein is based on numerous assumptions. Different assumptions could result in materially different results. The analyst(s) responsible for the preparation of this report may interact with trading desk personnel, sales personnel and other constituencies for the purpose of gathering, synthesizing and interpreting market information. ABCI Securities Company Limited is under no obligation to update or keep current the information contained herein. ABCI Securities Company Limited relies on information barriers to control the flow of information contained in one or more areas within ABCI Securities Company Limited, into other areas, units, groups or affiliates of ABCI Securities Company Limited. The compensation of the analyst who prepared this report is determined exclusively by research management and senior management (not including investment banking). Analyst compensation is not based on investment banking revenues, however, compensation may relate to the revenues of ABCI Securities Company Limited as a whole, of which investment banking, sales and trading are a part. The securities described herein may not be eligible for sale in all jurisdictions or to certain categories of investors. The price and value of the investments referred to in this research and the income from them may fluctuate. Past performance is not necessarily indicative of future results. Foreign currency rates of exchange may adversely affect the value, price or income of any security or related instrument mentioned in this report. For investment advice, trade execution or other enquiries, clients should contact their local sales representative. Neither ABCI Securities Company Limited nor any of its affiliates, directors, employees or agents accepts any liability for any loss or damage arising out of the use of all or any part of this report. Additional information will be made available upon request.

Copyright 2018 ABCI Securities Company Limited

No part of this material may be (i) copied, photocopied or duplicated in any form by any means or (ii) redistributed without the prior written consent of ABCI Securities Company Limited.

**Office address: ABCI Securities Company Limited, 13/F Fairmont House, 8 Cotton Tree Drive, Central, Hong Kong.**

**Tel: (852) 2868 2183**