



August 23, 2016  
 Equity Focus  
 Rating: Not rated

H-Share price (HK\$) 3.86

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**Key Data**

52Wk H/L(HK\$)	4.00/3.65
Issued shares (mn)	17,959.7
H-Shares (mn)	3,795.0
Unlisted shares (mn)	14,164.7
Market cap	
H-shares (HK\$ mn)	14,648
Unlisted shares (HK\$ mn)	54,676
3-mth avg daily turnover (HK\$ mn)	2.30
Major shareholder(s) (%):	
Zhejiang Provincial Fin. Hldg	14.79
Traveller Automobile Group	7.50
Hengdian Group Hldg	6.92

Source(s): Company, Bloomberg, ABCI Securities

**1H16 Operating income breakdown (%)**

Corporate banking	48.82
Retail banking	8.36
Treasury	42.71
Others	0.11

Source(s): Company, ABCI Securities

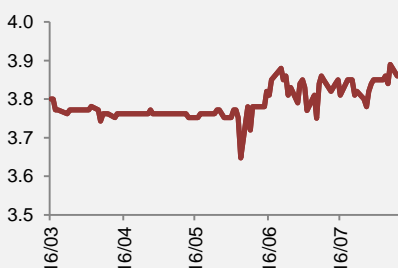
**Share performance (%)**

	Absolute	Relative*
1-mth	0.3	(4.2)
3-mth	2.6	(11.5)
6-mth	na	na

\*Relative to HSI

Source(s): Bloomberg, ABCI Securities

**1-Year stock performance (HK\$)**



Source(s): Bloomberg

**China Zheshang Bank (2016 HK)**  
 Superb earnings growth under the FACO strategy

- ZSB reported an outstanding net profit growth of 42.37% YoY in 1H16; NII and net fee income rose by 31.4% and 123.24% YoY
- NII was defended by robust balance sheet growth while wealth management fee income should continue to drive fee income growth
- Full-asset class operation (FACO) business model shows ZSB's ability to cope with challenges through flexible balance sheet management
- With strong risk buffers and stabilizing asset quality, provision expenses would reduce in 2H16
- The counter is currently trading at 0.92x June-16 P/B

**Outstanding growth exceeding peers.** ZSB's 1H16 net profit was RMB 4,735mn, up 42.37% YoY, the second highest growth among peers who had reported 1H16 results on or before Aug 23. NIM narrowed 35bps YoY to 2.1% in 1H16 whereas loans grew by 18.88% HoH, hence NII grew by 31.4% YoY. Meanwhile, net fee income surged by 123.24% YoY, supported by a 548% YoY jump in wealth management business fee income that accounted for 68.56% of gross fee income. We believe wealth management fee income will continue be the core driver of fee income. Overall, contribution of non-interest income to topline revenue climbed 11.5ppt YoY to 25.07% in 1H16.

**FACO business model drives success.** ZSB's FACO strategy has been effective in offsetting NIM pressure under the interest rate cut cycle. Asset allocation to loan and investment gradually increased from 32.49% and 33.69% in Dec 2015 to 33.69% and 52.58% in June 2016; the proportion of interbank assets reduced from 7.42% in Dec 2015 to 3.89% in June 2016. On the liability side, funding from the lower-cost customer deposit increased 5.08ppt HoH to 57.63% by June 2016 while interbank funding lowered by 6.2ppt HoH to 29.92%.

**Asset quality stayed benign.** NPL ratio HoH increased by 11bps to 1.33%, much lower than the system average of 1.75% as of June 2016. ZSB maintained a strong risk buffer by further raising its provisioning ratio by 1bps HoH to 3.06%. Provision coverage ratio remained high at 229.27% as of June 2016. Thanks to a prudent risk attitude, overdue loan ratio reduced by 17bps HoH to 1.66% by June 2016. Nonetheless, we believe the stabilizing asset quality would reduce provision expenses in 2H16.

**Valuation.** The counter is currently trading at 0.92x June-16 P/B.

**Risk factors:** 1) Asset quality deterioration in eastern China; 2) Surge in treasury asset price volatility; 3) Failure to optimize balance sheet mix amid rapid changes in the industry environment; 4) Low average daily turnover of shares.

**Results and Valuation**

FY ended Dec 31	2012A	2013A	2014A	2015A
Revenue (RMB mn)	10,466	13,496	17,397	25,130
Chg (% YoY)	na	28.9	28.9	44.5
Net profit (RMB mn)	4,026	4,901	5,096	7,051
Chg (% YoY)	na	21.8	3.9	38.4
EPS (RMB)	0.40	0.45	0.44	0.54
Chg (% YoY)	na	12.5	(2.2)	22.7
BVPS (RMB)	2.27	2.42	2.88	3.42
Chg (% YoY)	na	6.5	19.2	18.8
P/E (x)	8.04	7.15	7.31	5.96
P/B (x)	1.42	1.33	1.12	0.94
ROAE (%)	18.55	19.40	16.72	17.03
ROAA (%)	1.16	1.11	0.88	0.83
DPS(RMB)	0.20	0.00	0.00	0.13
Yield (%)	6.22	-	-	4.04

Source(s): Bloomberg, ABCI Securities



**Exhibit 1: ZSB's interim results summary (RMB mn)**

Income statement	1H15	1H16	YoY (%)
Net interest income	9,104	11,962	31.40
Net fee and commission income	1,436	3,207	123.24
Operating income	10,534	15,964	51.56
Operating expenses	(3,199)	(4,589)	43.45
Impairment losses	(2,926)	(5,129)	75.29
Profit before tax	4,408	6,246	41.69
Net profit	3,326	4,735	42.37
EPS (RMB/share)	0.29	0.29	0.00

Key ratio (annualized, %)			
NIM	2.45	2.10	(0.35)
Net fee to operating income	13.57	25.07	11.50
CIR	24.62	25.29	0.67
ROAA	0.86	0.86	0.00
ROAE	17.13	16.88	(0.25)

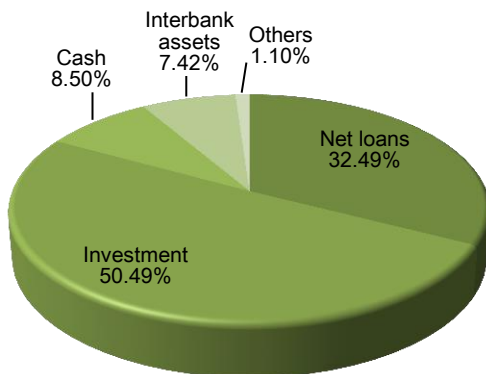
Balance sheet	Dec-15	Jun-16	HoH (%)
Total assets	1,031,650	1,181,634	14.54
Loans	345,423	410,622	18.88
Deposits	516,026	644,545	24.91
Total equity	49,657	63,127	27.13
BVPS (RMB/share)	3.42	3.51	2.63

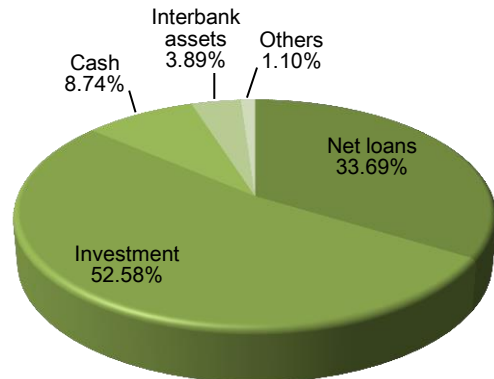
Key ratio (%)			
CT1 CAR	9.35	10.16	0.81
Total CAR	11.04	11.72	0.68
NPL ratio	1.23	1.33	0.10
Provisioning ratio	2.95	3.06	0.11
Provision coverage ratio	240.83	229.27	(11.56)

Source(s): Company, ABCI Securities

**Exhibit 1: ZSB's assets mix (Dec 2015)**



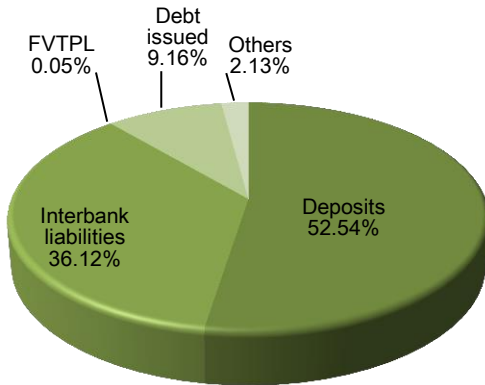
**Exhibit 2: ZSB's assets mix (Jun 2016)**



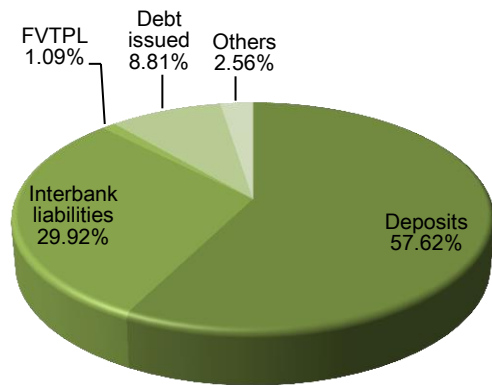
Source(s): Company, ABCI Securities

Source(s): Company, ABCI Securities

**Exhibit 4: ZSB's liabilities mix (Dec 2015)**



**Exhibit 5: ZSB's liabilities mix (Jun 2016)**



Source(s): Company, ABCI Securities

Source(s): Company, ABCI Securities



**Consolidated income statement (2012A-2015A)**

<b>FY Ended Dec 31 (RMB mn)</b>	<b>2012A</b>	<b>2013A</b>	<b>2014A</b>	<b>2015A</b>
<b>Net interest income</b>	<b>9,492</b>	<b>11,115</b>	<b>14,535</b>	<b>20,585</b>
Net fee and commission	878	2,319	2,621	4,101
Other operating income	97	61	240	444
<b>Operating income</b>	<b>10,466</b>	<b>13,496</b>	<b>17,397</b>	<b>25,130</b>
Operating expenses	(4,045)	(5,271)	(6,028)	(8,257)
Impairment losses	(1,063)	(1,703)	(4,576)	(7,493)
<b>Profit before tax</b>	<b>5,359</b>	<b>6,522</b>	<b>6,792</b>	<b>9,380</b>
Income tax expenses	(1,333)	(1,620)	(1,697)	(2,329)
<b>Net profit</b>	<b>4,026</b>	<b>4,902</b>	<b>5,096</b>	<b>7,051</b>
<b>Growth (%)</b>				
<b>Net interest income</b>	<b>na</b>	<b>17.1</b>	<b>30.8</b>	<b>41.6</b>
Net fee and commission	na	164.5	13.0	56.4
Other operating income	na	(37.1)	293.4	40.0
<b>Operating income</b>	<b>na</b>	<b>28.9</b>	<b>28.9</b>	<b>44.5</b>
Operating expenses	na	30.3	14.4	37.0
Impairment losses	na	60.2	168.7	63.7
<b>Profit before tax</b>	<b>na</b>	<b>21.7</b>	<b>4.1</b>	<b>38.1</b>
Income tax expenses	na	21.5	4.8	37.2
<b>Net profit</b>	<b>na</b>	<b>21.8</b>	<b>3.9</b>	<b>38.4</b>
<b>Per share</b>				
EPS	0.40	0.45	0.44	0.54
BVPS	2.27	2.42	2.88	3.42
DPS	0.20	0.00	0.00	0.13
<b>Key ratio (%)</b>				
Net interest margin	2.91	2.63	2.62	2.31
Net interest spread	2.68	2.41	2.38	2.12
Cost to income ratio	31.01	32.08	28.32	27.66
Return on average assets	1.16	1.11	0.88	0.83
Return on average equity	18.55	19.40	16.72	17.03
Effective tax rate	24.9	24.84	24.99	25.00

Source(s): Company, ABCI Securities



Consolidated balance sheet (2012A-2015A)

As of Dec 31 (RMB mn)	2012A	2013A	2014A	2015A
Cash and bank	61,018	64,356	75,427	87,650
Due from bank and FIs	117,726	158,521	93,686	76,607
Net loans	178,740	212,571	252,312	335,229
Investment securities	31,810	46,748	240,657	520,848
<b>Total IEA</b>	<b>389,295</b>	<b>482,196</b>	<b>662,083</b>	<b>1,020,334</b>
Other assets	4,544	5,921	7,874	11,316
<b>Total assets</b>	<b>393,839</b>	<b>488,117</b>	<b>669,957</b>	<b>1,031,650</b>
Customer deposits	266,888	319,795	363,280	516,026
Due to bank and FIs	91,744	127,342	214,998	354,657
Debt securities issued	4,450	5,950	47,898	89,936
<b>Total IBL</b>	<b>363,082</b>	<b>453,087</b>	<b>626,176</b>	<b>960,619</b>
Other liabilities	8,048	7,221	10,631	21,374
<b>Total liabilities</b>	<b>371,130</b>	<b>460,308</b>	<b>636,807</b>	<b>981,993</b>
<b>Total equity</b>	<b>22,709</b>	<b>27,808</b>	<b>33,150</b>	<b>49,657</b>
<b>Growth (%)</b>				
Cash and bank	na	5.5	17.2	16.2
Due from bank and FIs	na	34.7	(40.9)	(18.2)
Net loans	na	18.9	18.7	32.9
Investment securities	na	47.0	414.8	116.4
<b>Total IEA</b>	<b>na</b>	<b>23.9</b>	<b>37.3</b>	<b>54.1</b>
<b>Total assets</b>	<b>na</b>	<b>23.9</b>	<b>37.3</b>	<b>54.0</b>
Customer deposits	na	19.8	13.6	42.0
Due to bank and FIs	na	38.8	68.8	65.0
Subordinated debt	na	na	705.0	87.8
<b>Total IBL</b>	<b>na</b>	<b>24.8</b>	<b>38.2</b>	<b>53.4</b>
<b>Total liabilities</b>	<b>na</b>	<b>24.0</b>	<b>38.3</b>	<b>54.2</b>
<b>Total equity</b>	<b>na</b>	<b>22.5</b>	<b>19.2</b>	<b>49.8</b>
<b>Key ratio (%)</b>				
Loan to deposits	68.14	67.77	68.63	66.48
CT1 CAR	na	9.17	8.62	9.35
Total CAR	na	11.53	10.60	11.04
NPL ratio	0.46	0.64	0.88	1.23
Provision to total loans	1.96	2.10	2.59	2.95
Provision coverage	421.9	329.28	292.96	240.83

Source(s): Company, ABCI Securities



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### 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.

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