

Agricultural Bank of China (1288 HK)

Improving business mix with stable asset quality outlook; maintain BUY

- ABC's 2016 net profit slightly exceeds consensus; revenue mix continues to improve with robust net fee income growth
- Balance sheet mix improved and loan yield rose in 2H16. We expect NIM pressure to reduce in 2017
- Proactive NPL handling and increased business mix from retail banking contributed to better-than-expected asset quality. We expect provision scale to remain stable given the Bank's high provisioning ratio
- The counter is currently trading at 0.74x 17E P/B. Reiterate **BUY** on ABC's strong risk buffer and solid business strategy aligning with China's macro policies

2016 net profit is above consensus. Agricultural Bank of China (ABC)'s 2016 net profit was reported at RMB 183,941mn, up 1.9% YoY, in line with our forecasts while beating Bloomberg consensus by 3.75%. Operating income fell 5.68% YoY; NII dropped 8.72% YoY; net fee income increased by 10.16% YoY. Hence, contribution from net fee income to operating income went up by 2.57ppt YoY to 17.83%. Extending the momentum from 1H16, agency fee income continued to be the key fee driver in 2H16, and full-year agency fee grew 37.5% YoY. Expansion of ABC's online banking platform also yield positive results with E-banking fee income rising by 11.5% YoY in 2016.

Reducing NIM pressure in 2017. Due to previous interest rate cuts and carry-over impact from VAT reform, NIM narrowed by 41bps YoY to 2.25% in 2016. The Chinese banks will continue to experience NIM pressure in 1H17 although we expect the margin to stabilize in 2H17. Average loan yield fell 114bps YoY in 2016, indicating better loan pricing in 2H16 (1H16 average loan yield fell 125bps YoY). On an annual basis, both the loans-deposit spread and interbank asset-liability spread narrowed by 80bps YoY to 291bps and 55bps in 2016. ABC further optimized its balance sheet mix by reducing exposure in the more volatile interbank market and increasing its asset allocation to higher-yield investments.

Improving business mix and lower risk exposure. Leveraging on ABC's competitive strength in retail banking, contribution of operating income by the retail segment gradually increased from 36.4% in 2015 to 38.1% in 2016; contribution from the corporate banking segment reduced from 50.9% in 2015 to 47.4% in 2016. The majority of 2016 new loans were retail loans, which were up 22.37% YoY, while corporate loans rose slightly by 3.21% YoY. Loan mix in higher-risk sectors, such as manufacturing and wholesale & retail, reduced by 3.1ppt and 2.7ppt to 20.9% and 7.8%; lower-risk sectors, including the finance sector, record a decent loan growth. For retail loans, the relatively low-risk mortgage loan was the key driver (+32.85% YoY) in 2016, accounting for 76.5% of total retail loans. In particular, NPL ratio of mortgage loan stayed low at 0.43% as of Dec 2016.

Results and Valuation

FY ended Dec 31	2014A	2015A	2016A	2017E	2018E
Revenue (RMB mn)	524,126	540,862	510,128	610,252	648,001
Chg (% YoY)	11.9	9.6	(5.7)	19.6	6.2
Net profit (RMB mn)*	179,461	178,182	179,341	183,200	190,272
Chg (% YoY)	7.9	(0.7)	0.7	2.2	3.8
EPS (RMB)	0.55	0.55	0.55	0.56	0.59
Chg (% YoY)	7.4	-	-	1.8	5.4
BVPS (RMB)	3.05	3.48	3.81	4.28	4.70
Chg (% YoY)	17.5	14.1	9.5	12.3	9.8
P/E (x)	5.79	5.79	5.79	5.69	5.40
P/B (x)	1.04	0.92	0.84	0.74	0.68
ROAE (%)	19.57	16.79	15.14	13.38	12.67
ROAA (%)	1.18	1.07	0.99	0.90	0.84
DPS (RMB)	0.18	0.17	0.17	0.18	0.19
Yield (%)	5.71	5.24	5.34	5.63	5.84

Source(s): Bloomberg, ABCI Securities estimates

* Refers to net profit attributable to ordinary shareholders

Company Report

Mar 30, 2017

Rating: BUY

TP:HK\$4.56

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Share price (HK\$)	3.60
Est. share price return	26.67%
Est. dividend yield	5.63%
Est. total return	32.30%
Previous Rating & TP	BUY;HK\$4.56
Previous Report Date	Oct 24,2016

Source(s): Bloomberg, ABCI Securities

Key Data

52Wk H/L(HK\$)	3.74/2.66
Issued shares (mn)	324,794
H-share(mn)	30,739
A-shares (mn)	294,055
Market cap (HK\$ mn)	1,201,403
H-share(mn)	110,660
A-shares (mn)	1,090,743
3-mth avg daily turnover(HK\$ mn)	487.50
Major shareholder(s) (%):	
Huijin	40.03

Source(s): Company, ABCI Securities

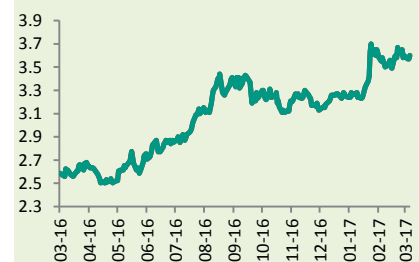
Share Performance (%)

	Absolute	Relative*
1-mth	1.41	(0.53)
3-mth	14.29	2.10
6-mth	5.57	2.23

*Relative to HSI

Source(s): Bloomberg, ABCI Securities

1-Year share performance(HK\$)



Source(s): Bloomberg, ABCI Securities



A mildly positive asset quality outlook. ABC reported a better-than-expected NPL ratio at 2.37%, down 2bps YoY, thanks to the bank's increased effort in NPL handling. Special mention loan ratio further lowered by 29bps HoH in 2H16 to 3.88% and overdue loan ratio fell 30bps YoY to 2.8% in Dec 2016. Going forward, with the increasing use of securitization tools and the establishment of the asset management company, we believe the overall NPL ratio would remain manageable. ABC has the strongest risk buffer among the big banks (2016 provisioning ratio: 4.53%), hence sharp rises in loan provisions are unlikely in coming quarters.

Sustainable dividend payout on solid capital position. In 2016, organic growth supported CT1 to increase by 14bps YoY to 10.38% while CAR was sustained at 13.04%. We believe there will be no significant capital pressure in the near future. The Bank will strengthen its CAR mainly by issuing tier-2 instruments totaling RMB 80bn over 2017-18. So far, the Bank does not have any concrete equity issuance plan. In 2016, dividend payout increased by 58bps YoY to 30.91%. With the Bank's solid capital position, we expect its payout policy to remain stable.

Clear business direction and strong risk buffer; reiterate BUY. The counter is currently trading at 0.74x 17E P/B. We are impressed by ABC's clear business strategy supporting China's macro policies and its strong risk buffer. Reiterate **BUY**. We will revise our forecasts to take into account of the changes in business mix.

Risk factors: 1) Increasing competition from non-bank financial institutions under financial reform; 2) Sharp asset quality deterioration and weak loan demand; 3) New regulations affecting banks' operation and profitability.

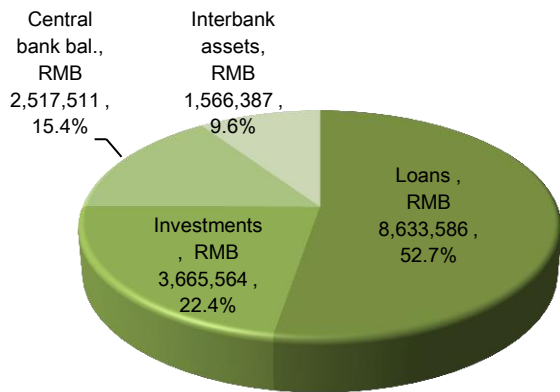
Exhibit 1: ABC's 2016 actual results vs. ABCI estimates

(Rmb mn)	2016A	2016E	AvE (%)
Net interest income	398,104	459,230	(13.31)
Net fee income	90,935	86,953	4.58
Operating income	510,128	570,926	(10.65)
Operating expenses	(178,021)	(220,779)	(19.37)
Pre-provision operating profit	313,070	329,532	(5.00)
Loan impairments	(86,446)	(94,332)	(8.36)
Profit before tax	226,624	235,200	(3.65)
Tax expenses	(42,564)	(54,096)	(21.32)
Net profit	183,941	180,864	1.70
Less: Preference share dividend	(4,600)	(4,600)	0.00
Net profit attributable to ordinary shareholders	179,341	176,264	1.75
Key indicators (%)			
Net interest margin	2.25	2.48	(0.23)
Net interest spread	2.10	2.27	(0.17)
Cost to income ratio	34.59	38.67	(4.08)
Return on average assets	0.99	0.96	0.03
Return on average equity	15.14	14.20	0.94
Dividend payout	30.91	31.00	(0.09)
CT1 CAR	10.38	10.92	(0.54)
Total CAR	13.04	14.07	(1.03)
NPL ratio	2.37	2.60	(0.23)
Provision to total loans	4.53	4.50	0.03
Provision coverage	173.40	173.08	0.32

Source(s): Company, ABCI Securities estimates

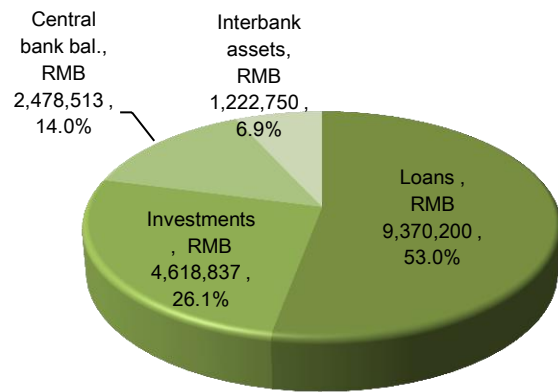


Exhibit 2: ABC's AIEA mix (2015)



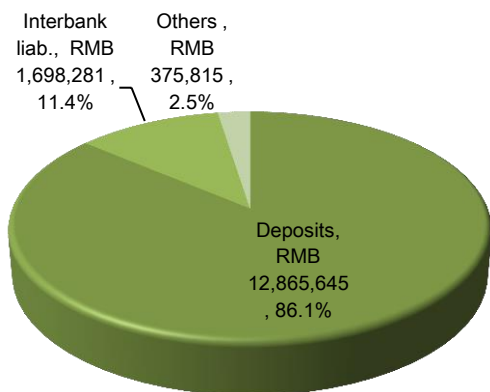
Source(s): Company, ABCI Securities

Exhibit 3: ABC's AIEA mix (2016)



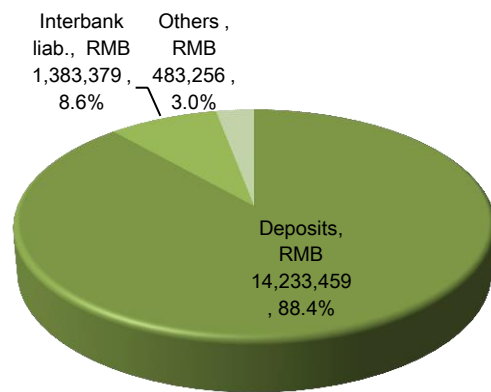
Source(s): Company, ABCI Securities

Exhibit 4: ABC's AIBL mix (2015)



Source(s): Company, ABCI Securities

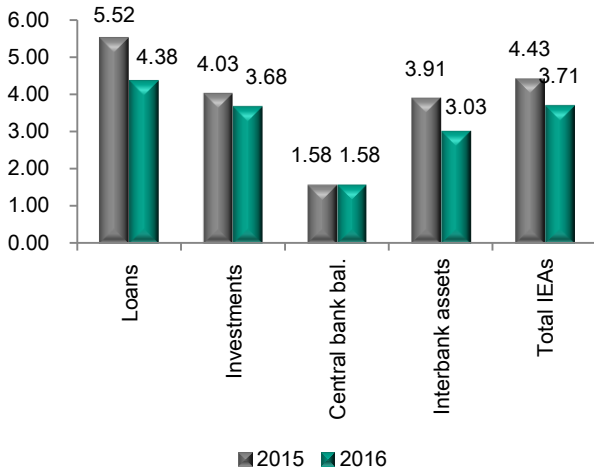
Exhibit 5: ABC's AIBL mix (2016)



Source(s): Company, ABCI Securities

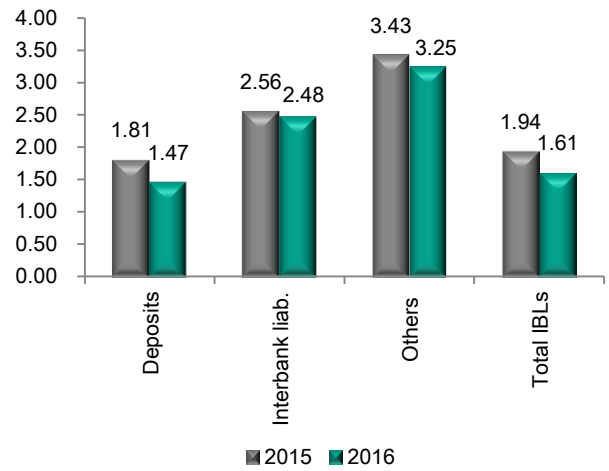


Exhibit 6: ABC's asset yield (%)



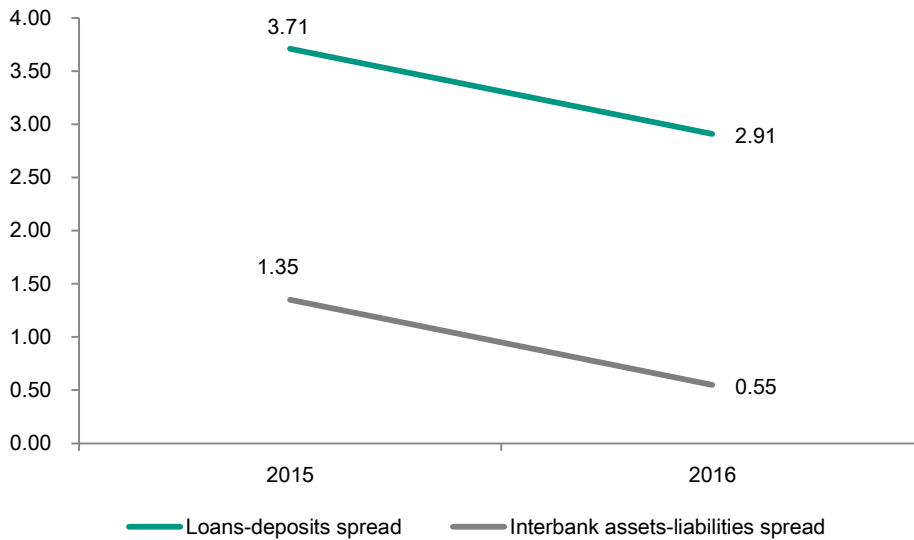
Source(s): Company, ABCI Securities

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 (2014A-2018E)

FY Ended Dec 31 (RMB mn)	2014A	2015A	2016A	2017E	2018E
Net interest income	429,891	436,140	398,104	491,016	521,327
Non-interest income	94,235	104,722	112,024	119,236	126,674
Of which: Fees and commissions	80,123	82,549	90,935	91,352	95,289
Operating income	524,126	540,862	510,128	610,252	648,001
Operating expenses	(204,570)	(206,200)	(178,021)	(236,409)	(252,091)
Amortization	(19,328)	(19,633)	(19,037)	(21,645)	(22,511)
Pre-provision operating profit	300,228	315,029	313,070	352,197	373,398
Impairment loans losses	(67,971)	(84,172)	(86,446)	(107,912)	(119,831)
Profit before tax	232,257	230,857	226,624	244,286	253,567
Tax	(52,747)	(50,083)	(42,564)	(56,186)	(58,320)
Minority interests	(49)	(192)	(119)	(300)	(375)
Net profit	179,461	180,582	183,941	187,800	194,872
Less: preference share dividend	0	(2,400)	(4,600)	(4,600)	(4,600)
Net profit attributable to ordinary shareholders	179,461	178,182	179,341	183,200	190,272
Growth (%)					
Net interest income	11.3	10.0	(8.7)	23.3	6.2
Non-interest income	14.5	7.8	7.0	6.4	6.2
Of which: Fees and commissions	8.9	11.1	10.2	0.5	4.3
Operating income	11.9	9.6	(5.7)	19.6	6.2
Operating expenses	16.0	8.3	(13.7)	32.8	6.6
Amortization	18.0	12.7	(3.0)	13.7	4.0
Pre-provision operating profit	8.9	10.3	(0.6)	12.5	6.0
Impairment loans losses	(15.6)	(2.3)	2.7	24.8	11.0
Profit before tax	18.8	14.0	(1.8)	7.8	3.8
Tax	18.1	12.1	(15.0)	32.0	3.8
Minority interests	27.6	(381.1)	(38.0)	152.1	25.0
Net profit	19.0	14.6	1.9	2.1	3.8
Net profit attributable to ordinary shareholders	7.9	(0.7)	0.7	2.2	3.9
Per share (RMB)					
EPS	0.55	0.55	0.55	0.56	0.59
BVPS	3.05	3.48	3.81	4.28	4.70
DPS	0.18	0.17	0.17	0.18	0.19
Key ratio (%)					
Net interest margin	2.92	2.66	2.25	2.39	2.28
Net interest spread	2.76	2.49	2.10	2.16	2.08
Cost to income ratio	39.03	38.12	34.59	38.74	38.90
Return on average assets	1.18	1.07	0.99	0.90	0.84
Return on average equity	19.15	16.12	15.14	13.38	12.67
Effective tax rate	22.71	21.69	18.78	23.00	23.00
Dividend payout	32.94	30.00	30.91	31.00	31.00

Source(s): Company, ABCI Securities estimates



Consolidated balance sheet (2014A-2018E)

As of Dec 31 (RMB mn)	2014A	2015A	2016A	2017E	2018E
Cash & cash equivalent	2,743,065	2,587,057	2,811,653	2,764,860	2,891,441
Due from banks & non-bank FI	1,489,285	1,673,984	1,526,665	2,163,561	2,436,078
Investment securities	3,575,630	4,512,047	5,333,535	6,403,357	7,480,990
Net loans and advances	7,739,996	8,506,675	9,139,364	10,107,523	10,965,136
Total interest earning assets	15,547,976	17,279,763	18,811,217	21,439,300	23,773,645
Property and equipment	154,950	156,178	158,669	162,488	165,737
Other non-interest earn assets	271,226	355,452	600,175	481,042	555,941
Total assets	15,974,152	17,791,393	19,570,061	22,082,830	24,495,323
Customer deposits	12,533,597	13,538,360	15,038,001	15,809,834	16,926,586
Due to other banks & FIs	1,136,185	1,598,259	1,749,117	2,437,345	2,924,814
Subordinated term debt	325,167	382,742	388,215	523,897	602,482
Total interest bearing liabilities	13,994,949	15,519,361	17,175,333	18,771,076	20,453,882
Current taxes	41,338	38,097	16,356	32,596	30,640
Deferred tax liabilities	43	111	58	173	217
Other liabilities	905,203	1,021,939	1,056,723	1,806,740	2,400,767
Total liabilities	14,941,533	16,579,508	18,248,470	20,610,586	22,885,506
Share capital	364,738	404,693	404,693	404,693	404,693
Reserves	666,328	805,398	913,500	1,065,178	1,202,396
Minorities	1,553	1,794	3,398	2,373	2,728
Shareholder's equity	1,032,619	1,211,885	1,321,591	1,472,244	1,609,817
Growth (%)					
Cash & cash equivalent	5.1	(0.4)	8.7	(1.7)	4.6
Dues from banks & non-bank FI	48.8	11.0	(8.8)	41.7	12.6
Investment securities	8.5	12.5	18.2	20.1	16.8
Net loans and advances	13.7	12.2	7.4	10.6	8.5
Total interest earning assets	13.3	9.6	8.9	14.0	10.9
Total assets	13.4	9.9	10.0	12.8	10.9
Customer deposits	12.9	8.7	11.1	5.1	7.1
Due to other banks & FIs	29.0	(3.2)	9.4	39.3	20.0
Subordinated term debt	61.4	38.2	1.4	35.0	15.0
Total interest bearing liabilities	14.6	8.3	10.7	9.3	9.0
Total liabilities	13.3	9.8	10.1	12.9	11.0
Shareholder's equity	15.4	12.4	9.1	11.4	9.3
Key ratio (%)					
CT1 CAR	9.09	10.24	10.38	10.98	10.83
Total CAR	12.82	13.40	13.04	14.15	13.97
NPL ratio	1.53	2.39	2.37	2.80	2.90
NPL growth	42.82	71.50	8.44	16.94	12.51
Provision to total loans	4.50	4.40	4.53	4.62	4.75
Provision coverage	288.48	189.43	173.40	165.00	163.79

Source(s): Company, ABCI Securities estimates

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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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