

China Merchants Bank (3968 HK / 600036 CH)

Risk buffer to sustain profitability

- CMB's 2019 net profit and NIM are largely in line with our forecast
- We adjust our model based on the narrowing spread resulted from COVID-19
- Strong risk buffer shields the bank from substantial increase in provision for potential asset quality deterioration
- Maintain **BUY** with revised H/A shr TP at HK\$ 41.80/RMB 43.49, representing 1.40x/1.60x 20E P/B

2019 net profit in line with our expectation. CMB's 2019 net profit was reported at RMB 92,867mn, up 15.28% YoY, largely in line with our forecast. As expected, NIM was reported at 2.59%, indicating 4Q19 NIM was at 2.41%, or down 14bps QoQ. Declined NIM in 4Q19 was mainly due to the proactive adjustment of balance sheet components. CMB expects impact from LPR to be reflected in the coming year, but it can be managed through 1) adjusting loan duration; 2) risk-based pricing; 3) the use of interest rate derivatives for hedging purpose.

Mild earnings adjustment on narrowing spread. We believe the outbreak of COVID-19 would accelerate the narrowing of loan-deposit spread as regulators urge banks to increase credit support and reduce financing cost for MSEs and private enterprises. We adjust CMB's NIM model based on the assumption that loan-deposit spread would narrow by 2bps / 12 bps YoY in 2020E/21E. We forecast NIM to narrow by 9bps/4bps in 2020E/21E to 2.45% by 2021E. This would translate into a NII CAGR of 9.4% and a net profit CAGR of 11.4% over 2019-21E.

Strong risk buffer to sustain profitability. Aside from the 20bps YoY reduction in NPL ratio to 1.16% by end-Dec 2019, CMB's provisioning ratio and provision coverage ratio stayed high at 4.97% and 426.78%, at leading position among peers. CMB's strength in risk buffer has always been conducive to its high profitability. We factor in a 7bps YoY increase in NPL ratio each in 2020E and 2021E (end-2021E NPL ratio: 1.3%). Taking into account of the mild asset quality deterioration resulted from the epidemic and decelerating economic growth in China. Specifically, NPL ratio from retail banking segment would experience temporary hiccups in 1Q20. Meanwhile, CMB's solid risk buffer would protect the bank against the substantial increase in provision expenses in 2020E-21E.

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Results and Valuation

FY ended Dec 31	2017A	2018A	2019A	2020E	2021E
Revenue (RMB mn)	220,039	247,135	268,065	296,460	320,680
Chg (% YoY)	4.8	12.3	8.5	10.6	8.2
Net profit* (RMB mn)	70,150	80,560	92,867	102,941	115,224
Chg (% YoY)	13.0	14.8	15.3	10.8	11.9
EPS (RMB)	2.78	3.13	3.62	4.08	4.57
Chg (% YoY)	13.00	12.53	15.65	12.76	11.93
BVPS (RMB)	19.04	20.07	22.89	27.26	30.64
Chg (% YoY)	19.35	5.41	14.05	19.09	12.41
P/E (x) – H-shr	10.46	9.29	8.04	7.13	6.37
P/B (x) – H-shr	1.53	1.45	1.27	1.07	0.95
P/E (x) – A-shr	10.84	9.64	8.33	7.39	6.60
P/B (x) – A-shr	1.58	1.50	1.32	1.11	0.98
ROAE (%)	15.90	15.79	16.13	15.85	15.78
ROAA (%)	1.15	1.24	1.31	1.32	1.35
DPS (RMB)	0.84	0.94	1.20	1.41	1.57
Yield (%) H-shr	2.89	3.23	4.13	4.86	5.41
Yield (%) A-shr	2.79	3.12	3.98	4.69	5.22

Note: Company; HKD/CNY=1.0898

*Net profit = Net profit attributable to shareholders of the Company

Source(s): Bloomberg, ABCI Securities estimates

Company Report

Rating (H): BUY

Rating (A): BUY

TP (H): HK\$ 41.80

TP (A): RMB 43.49

Analyst: Johannes Au

Tel: (852) 2147 8802

johannesau@abci.com.hk

Price (H/A shr)	HK\$ 31.70/ RMB 30.16
Est. s price return (H/A shr)	31.9%/44.2%
Est. dividend yield (H/A shr)	4.86%/4.69%
Est. total return (H/A shr)	36.76%/48.89%
Last Rating & TP (H/A shr)	BUY, HK\$46.6/ BUY, RMB46.05
Previous Report Date	12 Mar, 2020

Source(s): Bloomberg, ABCI Securities estimates

Key Data

52Wk H/L (HK\$) (H shr)	42.72/29.80
52Wk H/L (RMB) (A shr)	40.16/27.71
Total issued shares (mn)	25,219.8
Issued H shr (mn)	4,590.9
Issued A shr (mn)	20,628.9
Market cap (HK\$ mn)	82,354.5
H-shr market cap (HK\$ mn)	145,531.6
A-shr market cap (HK\$ mn)	678,016.9
3-mth avg daily turnover (HK\$ mn) (H shr)	670.74
3-mth avg daily turnover (RMB mn) (A shr)	2,292.40
Major shareholder(s) (%):	
China Merchants Group	13.04
China Ocean Shipping	6.24

Source(s): Bloomberg, ABCI Securities

Surprise increase in dividend payout; maintain BUY. CMB has increased its dividend payout ratio from 30% in previous years to 33% for 2019. The counter for H/A shr is currently trading at 1.07x/1.11 20E P/B. Our GGM-based H/A shr TP implies 1.40x/1.60x 20E P/B. We reiterate **BUY** on CMB's sustainably high profitability, above-peer ROAE (2019: 16.13%), and robust risk buffers.

Risk Factors: 1) Radical change in business environment induced by heavy-handed supervision and policies; 2) Increasing competition from non-bank financial institutions; 3) Sharp deterioration in asset quality in specific regions; 4) Sharp decline in loan demand; 5) Policy risk in new and fast-growing businesses; 6) Prolonged COVID-19 epidemic.

Exhibit 1: CMB's 2019 actual results vs. ABCI estimates

(RMB mn)	2019E	2019A	AvE (%)
Net interest income	178,296	173,090	(2.92)
Net fee and commission	71,235	71,493	0.36
Operating income	272,235	268,065	(1.53)
Operating expenses	(91,176)	(91,497)	0.35
Impairment losses	(61,132)	(61,159)	0.04
Profit before tax	121,563	117,132	(3.65)
Income tax expenses	(29,175)	(23,709)	(18.74)
Net profit	92,090	92,867	0.84
Key indicators (%)			AvE (ppt)
Net interest margin	2.59	2.59	(0.00)
Net interest spread	2.44	2.48	0.04
Cost to income ratio	33.49	34.13	0.64
Return on average assets	1.31	1.31	0.00
Return on average equity	16.05	16.13	0.08
Dividend payout	30.00	32.59	2.59
CT1 CAR	11.84	11.95	0.11
Total CAR	14.65	15.54	0.89
NPL ratio	1.40	1.16	(0.24)
Provision to total loans	5.00	4.97	(0.03)
Provision coverage	357.14	426.78	69.64

Source(s): Company, ABCI Securities estimates

Exhibit 2: Changes of 2020E and 2021E forecasts

(RMB mn)	2020E (old)	2020E (new)	change (%)	(RMB mn)	2021E (old)	2021E (new)	change (%)
Net interest income	194,759	192,404	(1.21)	Net interest income	211,313	207,126	(1.98)
Net fee and commission	76,679	77,052	0.49	Net fee and commission	82,580	82,769	0.23
Operating income	296,412	296,460	0.02	Operating income	321,364	320,680	(0.21)
Operating expenses	(101,185)	(100,827)	(0.35)	Operating expenses	(110,922)	(110,288)	(0.57)
Impairment losses	(63,073)	(61,582)	(2.36)	Impairment losses	(61,890)	(60,681)	(1.95)
Profit before tax	134,150	136,291	1.60	Profit before tax	150,948	152,578	1.08
Income tax expenses	(32,196)	(32,710)	1.60	Income tax expenses	(36,227)	(36,619)	1.08
Net profit attributable to equity holders	101,611	102,941	1.31	Net profit attributable to equity holders	114,326	115,224	0.79
Key indicators (%)			change (ppt)	Key indicators (%)			change (ppt)
Net interest margin	2.63	2.50	(0.13)	Net interest margin	2.69	2.45	(0.24)
Net interest spread	2.48	2.30	(0.18)	Net interest spread	2.53	2.23	(0.30)
CIR	34.14	34.01	(0.13)	CIR	34.52	34.39	(0.13)
ROAA	1.35	1.32	(0.03)	ROAA	1.41	1.35	(0.06)
ROAE	15.77	15.85	0.08	ROAE	15.82	15.78	(0.04)
Dividend payout	30.00	33.00	3.00	Dividend payout	30.00	33.00	3.00
CT1 CAR	12.11	11.61	(0.50)	CT1 CAR	12.60	11.79	(0.81)
Total CAR	14.78	14.30	(0.48)	Total CAR	15.17	14.39	(0.78)
NPL ratio	1.46	1.23	(0.23)	NPL ratio	1.50	1.30	(0.20)
Provision to total loans	5.11	5.05	(0.06)	Provision to total loans	5.16	5.11	(0.05)
Provision coverage ratio	350.00	410.57	60.57	Provision coverage ratio	344.00	393.08	49.08

Source(s): Company, ABCI Securities estimates

**Exhibit 3: Changes of GGM assumptions**

	H-shr		A-shr		Reason
	old	new	old	new	
TP (HKD/RMB)	46.60	41.80	46.05	43.49	Higher equity risk; forecasts roll over to mid-2021 BVPS
Sustainable ROE (%)	16.12	16.13	16.12	16.13	Sustain on CMB's solid risk buffers against asset quality deterioration
COE (%)	14.22	14.75	13.80	14.20	
Target 20E P/B (x)	1.51	1.40	1.70	1.60	
Rfr (%)	3.30	2.65	3.30	2.65	Reference to China 10Y government bond
Beta	1.30	1.10	1.25	1.05	Reference to Bloomberg data
ERP (%)	8.40	11.00	8.40	11.00	Factored in higher equity risk as a result of changes in macro environment
LT gr (%)	10.50	10.36	10.50	10.36	

Source(s): Company, ABCI Securities estimates

Financial statements

CMB (3968HK/600036CH) Consolidated income statement (2017A-2021E)

FY Ended Dec 31 (RMB mn)	2017A	2018A	2019A	2020E	2021E
Net interest income	144,852	160,384	173,090	192,404	207,126
Non-interest income	75,187	86,751	94,975	104,056	113,554
Of which: Fees and commissions	64,018	66,480	71,493	77,052	82,769
Operating income	220,039	247,135	268,065	296,460	320,680
Operating expenses	(70,431)	(81,110)	(91,497)	(100,827)	(110,288)
Pre-provision operating profit	149,608	166,025	176,568	195,633	210,392
Impairment losses on loans	(59,926)	(60,837)	(61,159)	(61,582)	(60,681)
Operating profit	89,682	105,188	115,409	134,051	149,711
Non-operating income	998	1,309	1,723	2,240	2,867
Profit before tax	90,680	106,497	117,132	136,291	152,578
Tax	(20,042)	(25,678)	(23,709)	(32,710)	(36,619)
Minority interests	(488)	(259)	(556)	(639)	(735)
Net profit attributable to equity holders	70,150	80,560	92,867	102,941	115,224
Preference share dividend	0	1,650	1,670	1,670	1,670
Net profit attributable to ordinary shareholders	70,150	78,910	91,197	101,272	113,554
Growth (%)					
Net interest income	7.6	10.7	7.9	11.2	7.7
Of which: Fees and commissions	5.2	3.8	7.5	7.8	7.4
Operating income	4.8	12.3	8.5	10.6	8.2
Operating expenses	8.1	15.2	12.8	10.2	9.4
Pre-provision operating profit	3.3	11.0	6.4	10.8	7.5
Impairment losses on loans	(9.4)	1.5	0.5	0.7	(1.5)
Operating profit	14.0	17.3	9.7	16.2	11.7
Non-operating income	210.9	31.2	31.6	30.0	28.0
Profit before tax	14.8	17.4	10.0	16.4	12.0
Tax	20.9	28.1	(7.7)	38.0	12.0
Minority interests	63.2	(46.9)	114.7	15.0	15.0
Net profit attributable to equity holders	13.0	14.8	15.3	10.8	11.9
Preference share dividend	na	na	1.2	0.0	0.0
Net profit attributable to ordinary shareholders	13.0	12.5	15.6	11.0	12.1
Per share (RMB)					
EPS	2.78	3.13	3.62	4.08	4.57
BVPS	19.04	20.07	22.89	27.26	30.64
DPS	0.84	0.94	1.20	1.41	1.57
Key ratio (%)					
Net interest margin	2.43	2.57	2.59	2.50	2.45
Net interest spread	2.29	2.49	2.48	2.30	2.23
Cost to income ratio	32.01	32.82	34.13	34.01	34.39
ROAA	1.15	1.24	1.31	1.32	1.35
ROAE	15.90	15.79	16.13	15.85	15.78
Effective tax rate	22.10	24.11	24.00	24.00	24.00
Dividend payout	30.20	30.04	33.19	33.00	33.00

Notes: Individual items may not sum to total due to rounding difference

Key ratios may not match with financial reports due to adjustment for comparison consistency among individual equities

Source(s): Company, ABCI Securities estimates



CMB (3968HK/600036CH)
Consolidated balance sheet (2017A-2021E)

As of Dec 31 (RMB mn)	2017A	2018A	2019A	2020E	2021E
Cash & equivalent	702,646	600,180	678,103	737,127	789,634
Interbank assets	407,178	512,797	416,394	411,647	408,112
Investment securities	1,597,272	1,705,619	1,828,656	1,938,375	2,054,678
Net loans and advances	3,414,612	3,741,139	4,267,751	4,800,727	5,362,162
Total interest earning assets	6,121,708	6,559,735	7,190,904	7,887,876	8,614,586
Property and equipment	51,424	58,267	68,333	79,266	91,156
Other non-interest earning assets	124,506	127,727	158,003	183,576	213,335
Total assets	6,297,638	6,745,729	7,417,240	8,150,718	8,919,077
Customer deposits	4,064,345	4,400,674	4,858,801	5,368,302	5,910,283
Interbank liabilities	1,252,310	1,150,156	1,138,714	1,115,940	1,082,462
Subordinated debt	296,477	424,926	578,191	722,739	903,423
Total interest bearing liabilities	5,661,608	6,056,470	6,642,340	7,266,951	7,950,141
Current taxes	26,701	20,411	19,069	17,925	17,029
Deferred tax liabilities	1,070	1,211	956	1,061	1,061
Other liabilities	124,867	124,032	137,168	169,918	169,553
Total liabilities	5,814,246	6,202,124	6,799,533	7,455,856	8,137,783
Share capital	59,285	59,285	59,285	59,285	59,285
Reserves	420,925	480,833	552,016	628,211	713,536
Minorities	3,182	3,487	6,406	7,367	8,472
Shareholder's equity	483,392	543,605	617,707	694,863	781,293
Growth (%)					
Cash & equivalent	(0.1)	(14.6)	13.0	8.7	7.1
Interbank assets	(15.0)	25.9	(18.8)	(1.1)	(0.9)
Investment securities	9.4	6.8	7.2	6.0	6.0
Net loans and advances	8.3	9.6	14.1	12.5	11.7
Total interest earning assets	5.7	7.2	9.6	9.7	9.2
Property and equipment	12.9	13.3	17.3	16.0	15.0
Other non-interest earning assets	20.9	2.6	23.7	16.2	16.2
Total assets	6.0	7.1	10.0	9.9	9.4
Customer deposits	1.5	5.9	5.8	6.3	6.0
Due to other banks & FIs	7.8	43.3	36.1	25.0	25.0
Subordinated debt	4.7	7.0	9.7	9.4	9.4
Total interest bearing liabilities	4.7	7.0	9.7	9.4	9.4
Current taxes	36.8	(23.6)	(6.6)	(6.0)	(5.0)
Deferred tax liabilities	19.3	13.2	(21.1)	11.0	0.0
Other liabilities	14.4	(0.7)	10.6	23.9	(0.2)
Total liabilities	5.0	6.7	9.6	9.7	9.1
Share capital	135.1	0.0	0.0	0.0	0.0
Reserves	11.6	14.2	14.8	13.8	13.6
Minorities	214.4	9.6	83.7	15.0	15.0
Shareholder's equity	19.8	12.5	13.6	12.5	12.4
Key ratio (%)					
CT1 CAR	12.06	11.78	11.95	11.61	11.79
Total CAR	15.48	15.68	15.54	14.30	14.39
NPL ratio	1.61	1.36	1.16	1.23	1.30
Provision to total loans	4.22	4.88	4.97	5.05	5.11
Provision coverage ratio	262.11	358.18	426.78	410.57	393.08

Notes: Individual items may not sum to total due to rounding difference

Key ratios may not match with financial reports due to adjustment for comparison consistency among individual equities

Source(s): Company, ABCI Securities estimates

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Rating	Definition
Buy	Stock return \geq Market return rate (10%)
Hold	- Market return (-10%) \leq Stock return $<$ Market return rate (10%)
Sell	Stock return $<$ - Market return (-10%)

Notes: Stock return rate: expected percentage change of share price plus gross dividend yield over the next 12 months

Market return rate: average market return rate since 2008 (HSI total return index 2008-19 CAGR at 10%)

Time horizon of share price target: 12-month

Stock rating, however, may vary from the stated framework due to factors including but not limited to: corporate governance, market capitalization, historical price volatility relative to corresponding benchmark index, average daily turnover of the stock relative to market capitalization of the stock, competitive advantages in corresponding industry, etc.

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

Tel: (852) 2868 2183