



May 8, 2014
Company Report
Rating: BUY
TP: HK\$ 3.14

H-Share price (HK\$) 2.69
Est. share price return 16.73%
Est. FY14E dividend yield 4.37%
Est. total return 21.10%

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Key Data

52Wk H/L(HK\$)	2.98/2.68
Issued shares (mn)	
H-Shares (mn)	3,024
Domestic (mn)	7,972
Market cap	
H-Shares (HK\$ mn)	8,133
Domestic (HK\$ mn)	21,445
3-mth avg daily turnover (HK\$ mn)	33.66
Pre-IPO major shareholder(s) (%):	
Harbin Economic Development and Investment Company	29.48

Source(s): Company, Bloomberg, ABCI Securities

FY13 Revenue breakdown (%)

Corporate banking	34.0
Retail banking	28.5
Treasury	36.0
Others	1.5

Source(s): Company, ABCI Securities

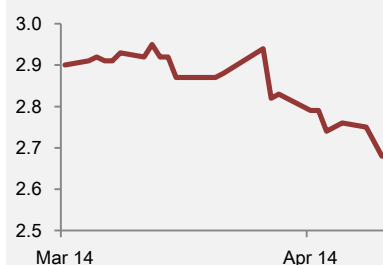
Share performance (%)

	Absolute	Relative*
1-mth	(7.9)	(5.2)
3-mth	na	na
6-mth	na	na

Relative to HSI

Source(s): Bloomberg, ABCI Securities

1 Year stock performance (HK\$)



Harbin Bank Co., Ltd. (6138 HK)

The Big Microlender in China

Harbin Bank (HRB) differentiates itself from other city commercial banks by its (1) extensive branch network covering 14 provinces and municipalities in China; (2) early entry in rural finance; (3) overseas exposure in Russia. In addition, we are impressed by its focus on the niche market of microcredit business that allows HRB to excel. With its enormous domestic and overseas potential, we believe the Group should be traded at a premium to its H-Share peers. We initiate coverage on HRB with a BUY rating. Our TP of HK\$ 3.14 implies a 16.73% upside and represents a target P/B of 0.93x.

Extensive branch network covering 14 provinces and municipalities as major competitive edge. Unlike other city commercial banks, HRB has an extensive branch network covering 14 provinces and municipalities in China. This represents a major advantage over its peers as approval for city commercial banks to establish branches outside their home regions are hard to obtain at present. Thanks to its extensive distribution in urban and rural HLJ, HRB's market share in the region is increasing.

Microcredit business as focus. HRB identified microcredit as its major business focus early in 2001 to avoid competition from big players. As of 2013, microcredit accounted for 69.1% of its total loan and grew at 30.7% CAGR over 2010-13 and contributed to 67.9% of net interest income in 2013. The lending premium of 20%-40% to the benchmark rates offers strong support to the Group's NIM. The Group's asset quality is also better than market perception while its low LDR allows the Group to grow in the future.

Exposure in Russia represents huge potential. Neighboring Russia, HRB is the first northeastern bank in China to start the CNY-RUB forex business. Having linked up with 105 Russian banks, HRB is now one of the 4 largest market makers of RUB in China. Despite revenue contribution from Russia-related business is estimated to be limited at present, we believe it could become HRB's core revenue contributor upon expansion.

Initiate with BUY rating. We believe HRB deserves to a higher valuation than its H-share peers based on the Group's extensive franchise network covering 14 provinces and municipalities in China and its exposure in Russia. Current valuations of H-share district banks also demonstrate investors' preference for larger banks with more extensive networks. We initiate coverage on HRB with a BUY recommendation at a TP of HK\$3.14, implying a 16.73% upside and a target valuation of 0.93x 14E P/B.

Risk factors: 1) Asset quality deterioration HLJ; 2) Pricing competition from big banks entering the local regions; 3) Failure to optimize business mix and raise LDR; 4) Cross-region business development risk.

Financial summary

FY ended Dec 31	2012A	2013A	2014E	2015E	2016E
Revenue (RMB mn)	7,711	8,544	11,301	13,838	16,604
Chg (%.yoy)	42.4	10.8	32.3	22.5	20.0
Net profit (RMB mn)	2,864	3,350	4,137	5,065	5,954
Chg (%.yoy)	54.5	17.0	23.5	22.4	17.5
EPS (RMB)	0.37	0.42	0.40	0.46	0.54
Chg (%.yoy)	8.8	14.6	(5.3)	14.8	17.5
BVPS (RMB)	2.24	2.42	2.68	3.13	3.66
Chg (%.yoy)	20.2	7.9	11.0	16.8	16.7
P/E (x)	5.82	5.08	5.36	4.67	3.97
P/B (x)	0.96	0.89	0.80	0.69	0.59
ROAA (%)	1.19	1.12	1.17	1.20	1.22
ROAE (%)	20.35	18.36	16.74	15.84	15.95
DPS(RMB)	0.02	0.04	0.09	0.12	0.14
Yield (%)	1.03	1.77	4.37	5.35	6.29

Source(s): Prospectus, ABCI Securities estimates



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Executive summary

Diversified franchises crucial to success

Harbin Bank (HRB, The Group), established in 1997, has dedicated to be the market leader in microcredit business. In terms of total assets and net profit, HRB has been the largest player with approximately 11% of market share in the Heilongjiang (HLJ) province. HRB has an outlet base with 301 branches, the highest among the currently listed city commercial banks. These branches spread over 14 provinces and municipalities. The Group achieved the fastest growth among peers in total assets, total loans and net profit over 2010-2013 while its market share increased in HLJ at the same time. In our opinion, HRB's diversified and strategic branch network differentiates itself from other city commercial banks.

Decent growth in local market

HRB's increasing market share in the local market demonstrates its ability to compete with larger peers, although we also believe the big banks have not expanded aggressively in HLJ yet. HLJ's nominal GDP grew at 13.3% CAGR in 2008-12, slightly lower than the national rate at 13.4% CAGR. Meanwhile, HLJ is one of the two provinces with a higher GDP target for 2014 than in 2013, signaling the government's positive outlook on the region's development. As a market leader in domestic market, HRB would be the major beneficiary of the regional growth. As of Sep 2013, HLJ contributed 52% (Dec 2013: 50.9%) of total loans and 61.8% of deposits of HRB, and accounted for 67.9% of the Group's net interest income in 2013.

Early exposure in rural business

Unlike other city commercial banks with businesses focusing on urban areas, HRB has been developing its rural business since 2005. Rural loans usually entails higher interest rates at more than 40% premium to the benchmark rate on high demand and credit loan nature. As of 2013, HRB extended its rural business to 14 provinces and municipalities under its coverage and rural loans accounted for 8.9% of total loans in 2013. Despite the lending premium, we are convinced that the Group has adopted a prudent approach by selecting sizable and quality rural customers.

Existing branches in non-home regions is a major advantage

According to our channel checks, it is extremely difficult for city commercial banks to establish branches outside home regions due to difficulties in obtaining regulators' approval. Nevertheless, banks with existing branches in non-home regions are allowed to open new sub-branches without encountering the same obstacle. For HRB, revenue contribution from non- HLJ regions have increased rapidly from 14.4% in 2010 to 35.9% in 2013. HRB's rapid expansion shows the usual difficulties such as the lack of government support and local expertise when operating in non-home regions present no major barriers for the Group.

Microcredit business as focus

With a forward-looking mentality, HRB has set the niche market of microcredit business as its key focus since 2001, while other listed peers, including BoCQ, CQRB, MSB and HB, only entered the segment during 2007-10. Microcredit business accounted for 69.1% of HRB's total loans in 2013. The business has 4 major components, including (1) corporate loans to small enterprises, (2) loans to small enterprises owners, (3) loans to farmers, and (4) personal consumption loans. Revenue from microcredit business, a key growth driver of HRB, expanded by 25.2% yoy in 2013, of which approximately 40% of the



segment total came from non-home regions.

Despite the fact that HRB set its lending premium at 20%-40% to the benchmark rates, the Group's asset quality in its microcredit segment is healthier than expected. NPL ratios in microcredit, small business loans and personal loans were 1.14%, 1.69% and 0.44%, respectively, in Sep 2013, much lower than the CBRC's tolerance level at 3%. This allows HRB to achieve a high asset yield while maintaining a low NPL ratio. HRB's low LDR would also support the Group's future growth.

Exposure in Russia represents huge opportunities

With HLJ adjoining to Russia and HRB's ambition to go international, the Group has targeted Russia as its primary overseas market and linked up with 105 Russian banks to co-operate with leading microcredit international players in recent years. Trade volume between Russia and China is expected to reach US\$ 200bn by 2020E, expanding at 14.9% CAGR over 2015E-20E. In view of the huge opportunity, HRB was the first city commercial bank in northeastern China to start forex operation in CNY-RUB, and has become one of the four largest market makers. While we estimate revenue contribution from Russian financial services is not significant at present, we believe the business would become one of the key earnings drivers of HRB in the next decade.

Major forecasts and assumptions

To improve HRB's overall performance, we expect management to fine-tune its balance sheet mix by reducing its reliance on interbank exposure and raising LDR to its long-term target at 60%. We forecast HRB's NIM to drop by 7bps in 2014E after a yoy reduction of 45bps in 2013; NIM would stabilize to 2.5% - 2.6% over 2014E-16E to support a 21.2% net interest income CAGR in 2013-16E, assuming loans and deposits would grow at 18.1% and 17.0% CAGRs over 2013-16E.

Fee income would grow by 40%-45% each in 2014E-16E, accounting for 21.35% of operating income by 2016E. Combined with a 20%-28% operating expenses growth, we forecast HRB's net profit to increase at 21.1% CAGR in 2013-16E, while ROE would maintain at 15.84% -16.74% over 2014E-16E.

Initiate with BUY rating

Applying the Gordon Growth Model (GGM), we initiate coverage on HRB with a BUY rating. Our TP of HK\$3.14 represents a valuation 0.93x 14E P/B with an upside of 16.73% from current price. We believe HRB deserves to trade at a premium to its closest H-share peers Huishang Bank (3698 HK, BUY, HB) for the Group's extensive franchise network covering 14 provinces and municipalities in China and its exposure in Russia. Current valuations of listed H-share district banks show investors' preference in larger banks with extensive networks.

Diversified franchises as key to success

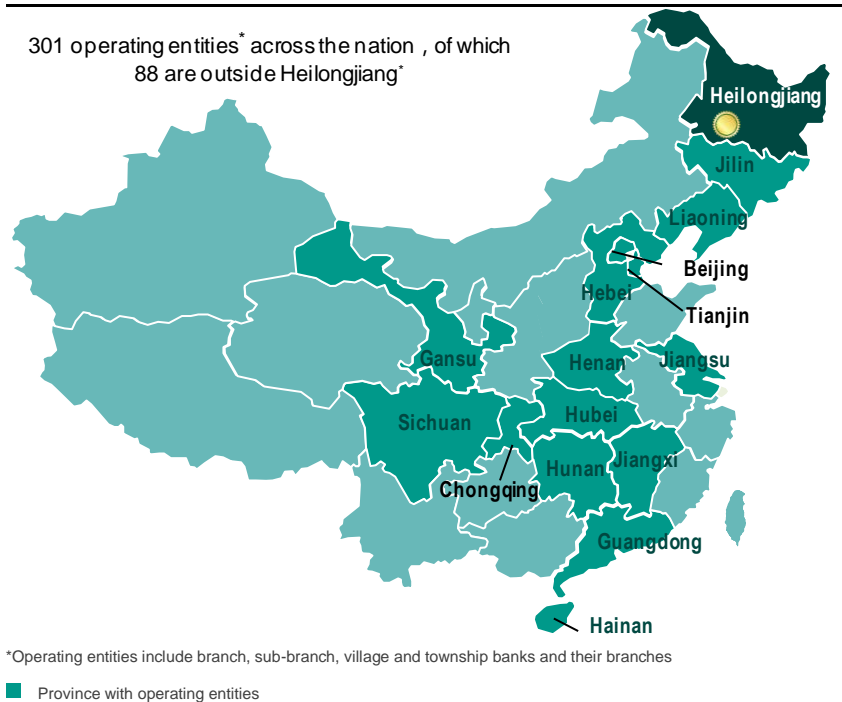
HRB– An overview

Harbin Bank (HRB), established in 1997, identified microcredit as its primary business early on. Being one of the 6 city commercial banks in the Heilongjiang (HLJ) province, HRB owns the largest market share of 11.49% in 2012 by total assets, while the remaining banks have a joint market share of 8.64%.

Early on, HRB began to develop its branch network outside its core region. As of 2013, HRB owned 301 outlets, of which 213 are located in the HLJ province while 138 are based in the Harbin city. As of June 2013, HRB ranked first in deposits and net profit in the Harbin city and second in total assets and net profit in the HLJ province among banks in the region.

HRB has 5 branches and 47 sub-branches locating in economically affluent cities including Tianjin, Dalian, Shenyang, Chongqing and Chengdu. HRB's outlet network covers 14 provinces and municipalities in China, extending from the northern HLJ to southern Hainan and western Sichuan.

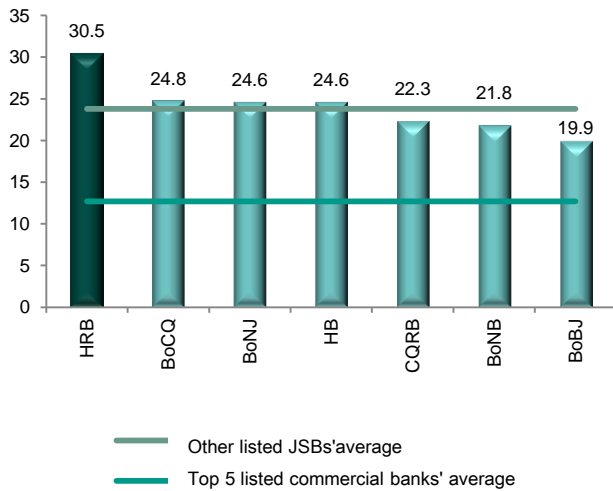
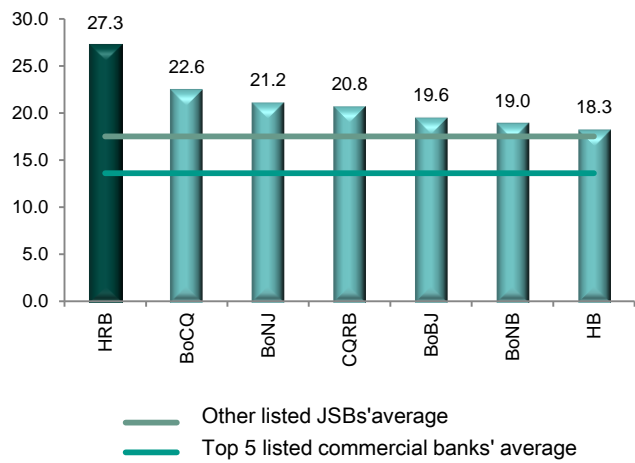
Exhibit 1: HRB's branch network



Source(s): Prospectus, ABCI Securities

Superb growth among peers

In 2010-Sep 2013, HRB had the highest CAGRs in total assets, total loans and net profit among other listed city commercial banks, outperforming by 4.7 - 9.6 ppt. Despite its total deposits CAGR ranked fifth among peers, HRB's deposits growth was still on par with the third fastest-growing player and surpassed other JSBs and the "big five" banks during the same period.

Exhibit 2: CAGR of total assets in 2010-Sep13 (%)

Exhibit 3: CAGR of total loans in 2010-Sep13 (%)


Source(s): Prospectus, company reports, ABCI Securities

(*) PingAn Bank, Industrial Bank, MSB, CEB, Huaxia Bank, CMB, SPDB, CITICB

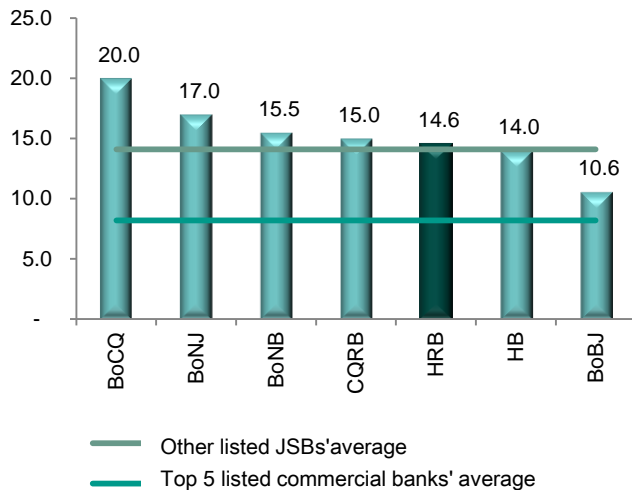
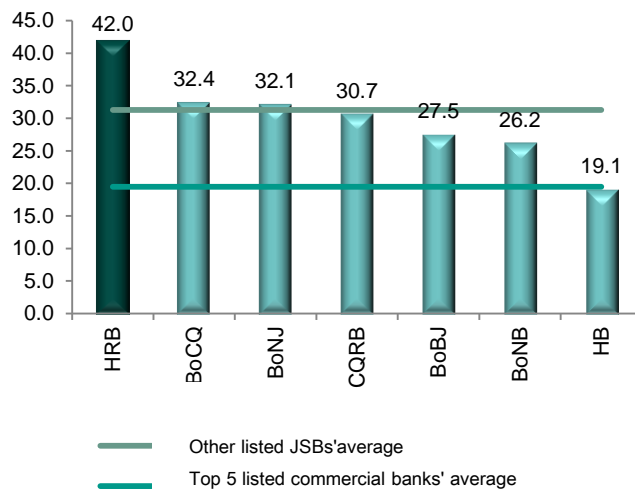
(**) ABC, ICBC, CCB, BOC, BoCom

Source(s): Prospectus, company reports, ABCI Securities

(*) PingAn Bank, Industrial Bank, MSB, CEB, Huaxia Bank, CMB, SPDB, CITICB

(**) ABC, ICBC, CCB, BOC, BoCom

While city commercial banks are still in their fast-growth phases, HRB's impressive growth has been mainly driven by its diversified outlet franchises. The Group has covered not only the rural and urban regions in the HLJ province, but also 13 other provinces and municipalities across China. Also, we believe its geographic proximity to and strong co-operative network in Russia would support its future growth. We expect HRB's total assets and net profit to grow at 17.3% and 21.1% CAGRs in 2013-16E.

Exhibit 4: Total deposits CAGR in 2010-Sep13 (%)

Exhibit 5: Net profit CAGR in 2010-Sep13 (%)


Source(s): Prospectus, company reports, ABCI Securities

(*) PingAn Bank, Industrial Bank, MSB, CEB, Huaxia Bank, CMB, SPDB, CITICB

(**) ABC, ICBC, CCB, BOC, BoCom

Source(s): Prospectus, company reports, ABCI Securities

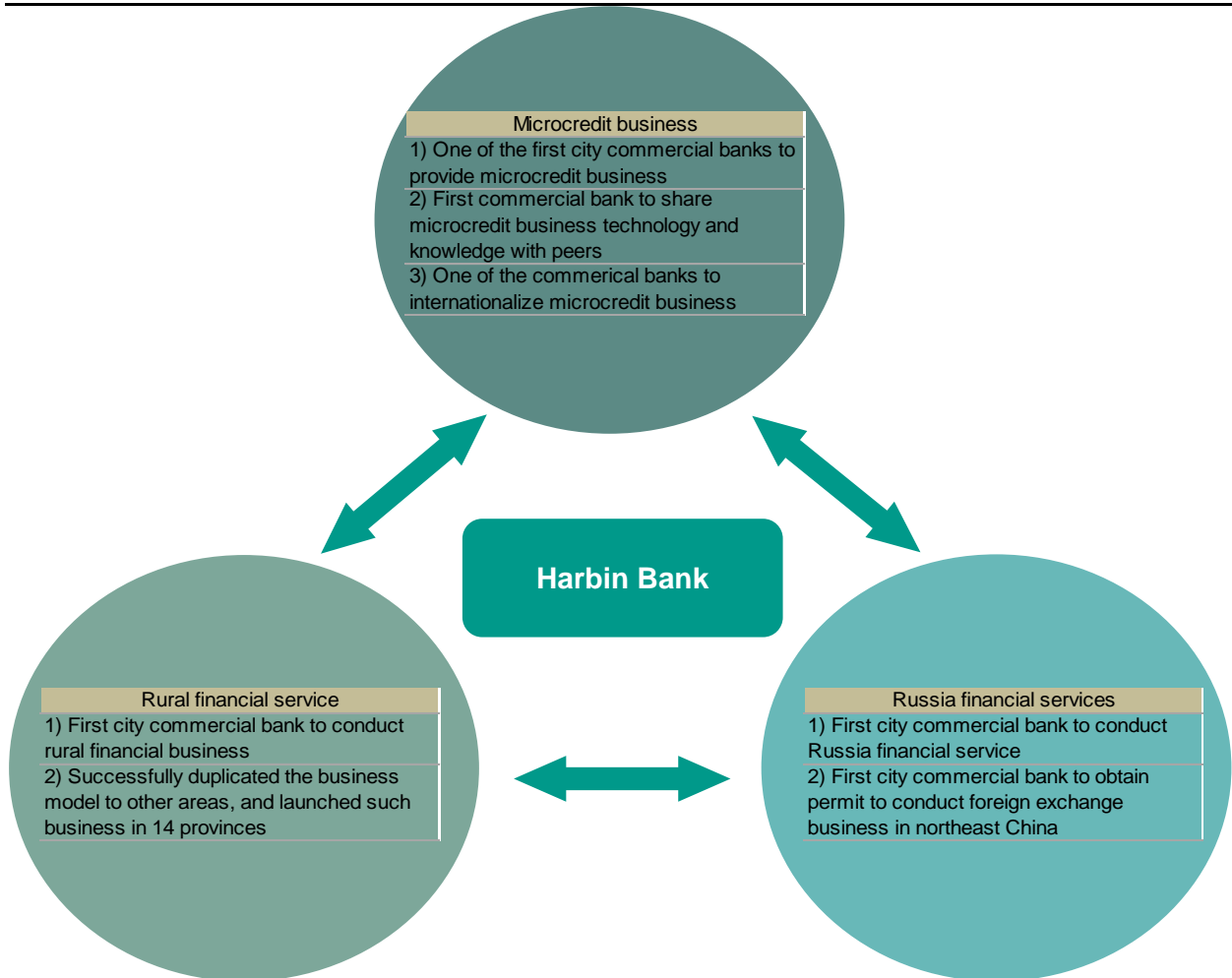
(*) PingAn Bank, Industrial Bank, MSB, CEB, Huaxia Bank, CMB, SPDB, CITICB

(**) ABC, ICBC, CCB, BOC, BoCom

Three core businesses

HRB's core businesses include (1) microcredit business, (2) rural finance services and (3) Russia finance services. The Group has proven to be the market leader in these segments. HRB was the first city commercial bank to enter these businesses and was also the first to share microcredit knowledge with peers, as well as extending its rural business to 14 provinces and municipalities in China. Moreover, it was the first city commercial bank in northeast China to obtain the forex operation right in CNY-RUB.

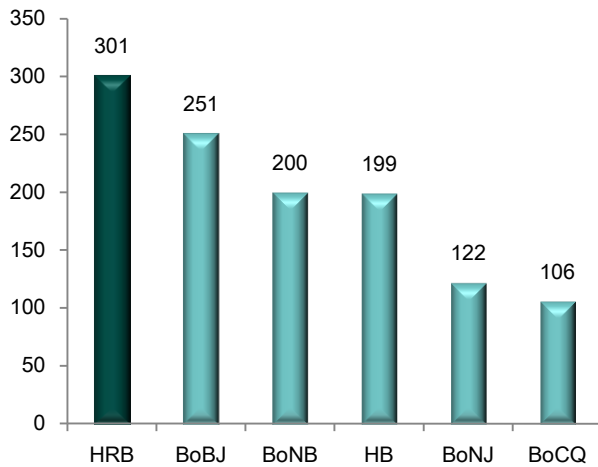
Exhibit 6: HRB's core businesses



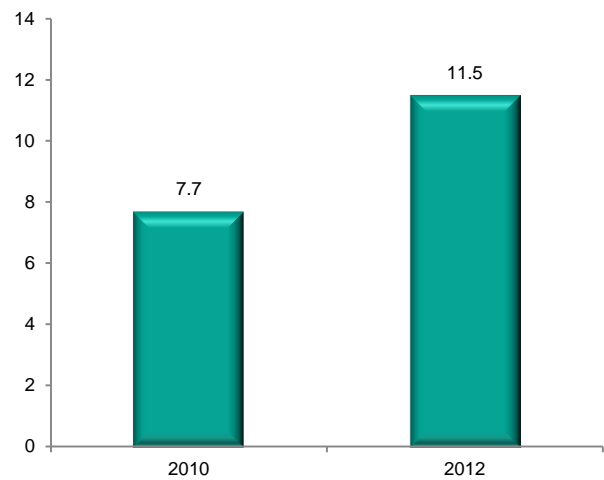
Source(s): ABCI Securities

Competitiveness based on diversified network

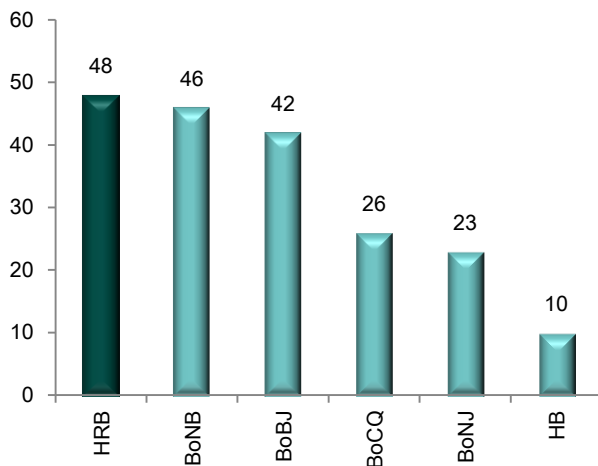
We believe HRB's strategic branch network covering 14 provinces and municipalities in China, together with its geographic advantage that enables it to conduct cross-border business with Russia, have contributed to the Group's success. HRB has the highest number of branches compared to peers, which in turn allows it to expand its share in domestic market (in terms of total asset) from 7.7% in 2010 to 11.5% in 2012, HRB also had the highest non-domestic loans-to-total loans ratio among peers at 48%, exceeding two other H-share city commercial banks, Bank of Chongqing (BoCQ, 26%) and Huishang Bank (HB, 10%).

Exhibit 7: Branch network comparison among city commercial banks as of 2013 (no. of branches)


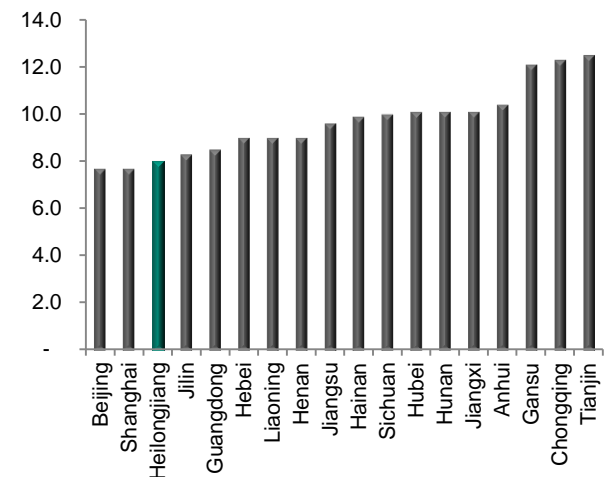
Source(s): Prospectus, company reports and websites, ABCI Securities

Exhibit 8: HRB's total assets market share in HLJ (%)


Source(s): Prospectus, ABCI Securities

Exhibit 9: Proportion of loans outside home regions in among city commercial banks as of Sep 2013 (%)


Source(s): Prospectus, company reports, ABCI Securities

Exhibit 10: 2013 GDP growth in various provinces in China (yoy %)


Source(s): people.com.cn, ABCI Securities

Decent growth supported by local economy

The increasing domestic market share demonstrates HRB's success in home region, although we believe it is partly enabled by the fact that big banks and JSBs have not initiated any aggressive plans to expand in the HLJ province yet. Early on, HRB began to expand beyond its home region to capture business opportunities.

HLJ province's GDP growth was decent at 10% in 2012, slightly lower than the national average of 11%. Nominal GDP CAGR of HLJ and China were at similar levels of 13.3% and 13.4% over 2008-12. Still, HLJ's GDP growth in 2012 was comparable with the 10% in Bohai Rim (BR) at 10%, and was higher than the 7% in the Pearl River Delta (PRD) region. HLJ province's loans and deposits grew at 21.6% and 16.1% CAGRs over 2008-12. We forecast the HLJ's GDP growth to sustain and HRB would experience faster loans and deposits growth in coming years.



According to the Chinese media (people.com.cn), upon completion of the National People's Congress at the provincial level, GDP growth target was set at 8.5% yoy for 2014E, 50bps higher than that in 2013 (2013E GDP growth: 8% yoy). HLJ is one of the two provinces whose 2014E target is higher than 2013 (the other province is Hainan, whose 2014E growth target is 10%). Most provinces are expected to achieve lower GDP growth in 2014 than in 2013, while 7 provinces are expected to attain the same GDP growth as last year.

Exhibit 11: 2014 GDP growth targets of Chinese provinces

	2013E (%)	2014 target (%)	Changes (%)
Beijing	7.7	7.50	-0.2
Tianjin	12.5	11.00	-1.5
Hebei	9.0	8.00	-1.0
Shanxi	9.0	9.00	0.0
Inner Mongolia	9.0	9.00	0.0
Liaoning	9.0	9.00	0.0
Jilin	8.3	8.00	-0.3
Heilongjiang	8.0	8.50	0.5
Shanghai	7.7	7.50	-0.2
Jiangsu	9.6	9.00	-0.6
Zhejiang	8.2	8.00	-0.2
Anhui	10.4	9.50	-0.9
Fujian	11.0	10.50	-0.5
Jiangxi	10.1	10.00	-0.1
Shandong	9.6	9.00	-0.6
Henan	9.0	9.00	0.0
Hubei	10.1	10.00	-0.1
Hunan	10.1	10.00	-0.1
Guangdong	8.5	8.50	0.0
Guangxi	10.3	10.00	-0.3
Hainan	9.9	10.00	0.1
Chongqing	12.3	11.00	-1.3
Sichuan	10.0	9.00	-1.0
Guizhou	12.5	12.50	0.0
Yunnan	12.1	11.00	-1.1
Tibet	12.5	12.00	-0.5
Shaanxi	11.1	11.00	-0.1
Gansu	12.1	11.00	-1.1
Qinghai	10.8	10.50	-0.3
Ningxia	10.0	10.00	0.0
Xinjiang	11.1	11.00	-0.1

Source(s): people.com.cn, ABCI Securities

Rural exposure enables better yield

The Chinese government has been pushing forward the Sannong policy over the past years, with Document No.1 being panned out during 2004-08. The document has its primary objective to increase banks' support in rural economies. As the agricultural segment is one of the major economic drivers in HLJ, HRB entered the segment of rural finance early in 2005 when other city commercial banks were concentrating almost exclusively in the urban area of their home regions.

One could broadly divide rural finance into three categories: (1) planting and husbandry loans, which are direct funding to agricultural production; (2) machinery loans granted for the purchase of agricultural equipment and tools; (3) liquidity loans intended to maintain cash flow flexibility for farmers and cover their necessary cash flows during credit period.

As of 2013, HRB has successfully extended its rural business into all provinces under coverage with additional business outlets and a dedicated team of over 400 rural experts. Growing at 12.1% CAGR over 2010-12, rural loans accounted for 8.9% of HRB's total loans as of 2013, and we expect the ratio to remain at 9%-15% over 2014E-16E. According to HRB's management, the Group has been cautiously selecting rural customers due to the credit loan



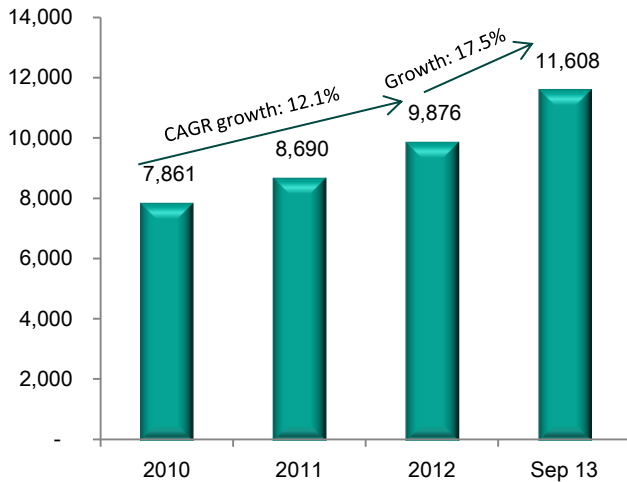
nature. The Group would grant loans only to sizeable farms and agricultural groups.

Exhibit 12: HRB's loans to farmers as of Sep 2013

No. of rural customers	237,000
Loans to farmer	RMB 11,608.2mn (28.4% of total loans)
Average loan size to farmer	RMB 48,980
NPL ratio	3.84%

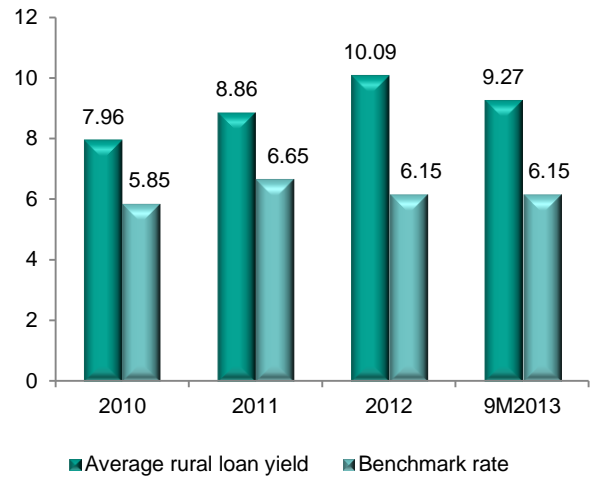
Source(s): Prospectus, ABCI Securities

Exhibit 13: HRB's rural loans balance (RMB mn)



Source(s): Prospectus, ABCI Securities

Exhibit 14: HRB's rural loans yield (%)



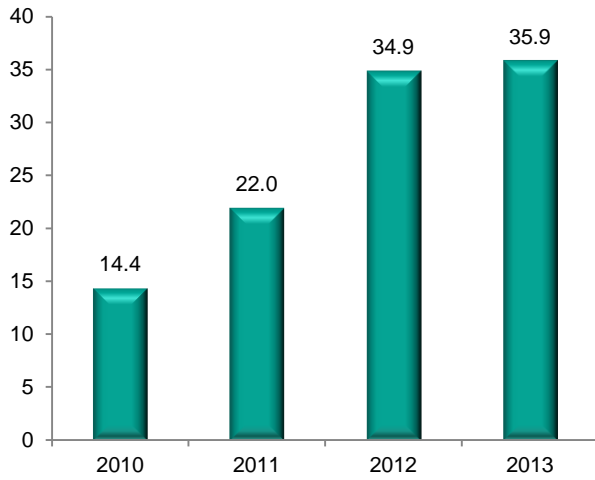
Source(s): Prospectus, ABCI Securities estimates
*2010 to 2012 being ABCI Securities estimates

Since credit loans normally entail higher yields, the business segment is supportive to HRB's overall NIM. HRB's rural loans yields were estimated at 7.96% -10.09% in 2010-12; the figure was reported at 9.27% in 9M13, representing a premium of more than 40% to the benchmark rate. Given the huge demand in rural area, we forecast the lending premium should continue to persist at high levels in the next three years.

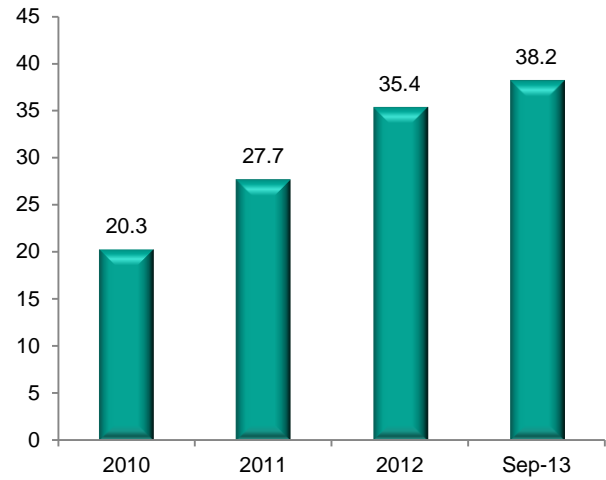
Definitive advantage outside home region

Regulatory approval is required for city commercial banks to expand beyond their home regions. According to our channel checks with city commercial banks, it has become extremely difficult for city commercial banks to obtain approval to set up branches in non-home regions. However, banks with existing branches outside their home provinces are allowed to set up their sub-branch without encountering the same approval barrier. HRB has set its footprints over 14 provinces and municipalities in China and this becomes an important competitive edge for HRB over its peers. HRB, with its branch network covering 14 provinces and municipalities, has the ability to expand its operational network like a national bank.

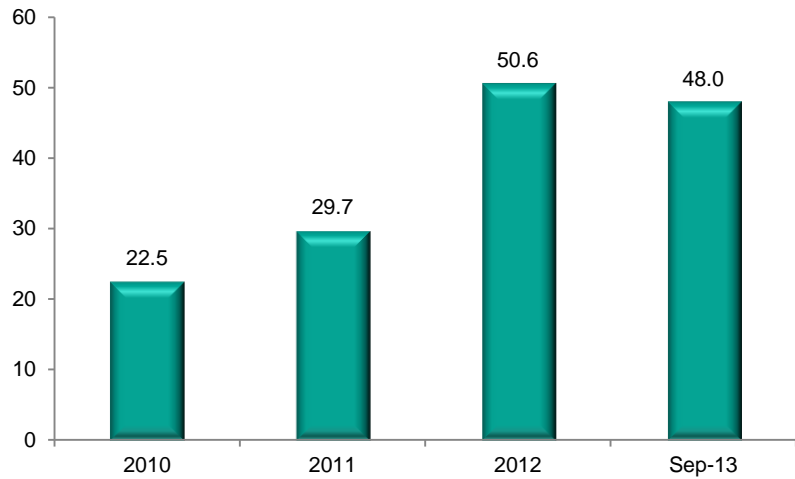
Revenue contribution outside HLJ increased rapidly from 14.4% in 2010 to 35.9% in 2013. Loans and deposits mixes in non-home regions increased significantly from 22.5% and 20.3% in 2010 to 48% (Dec 2013: 49.1%) and 38.2% as of Sep 2013.

Exhibit 15: HRB's non-home region revenue mix (%)


Source(s): Prospectus, ABCI Securities

Exhibit 16: HRB's non-home region deposits mix (%)


Source(s): Prospectus, ABCI Securities

Exhibit 17: HRB's non-home region loan mix (%)


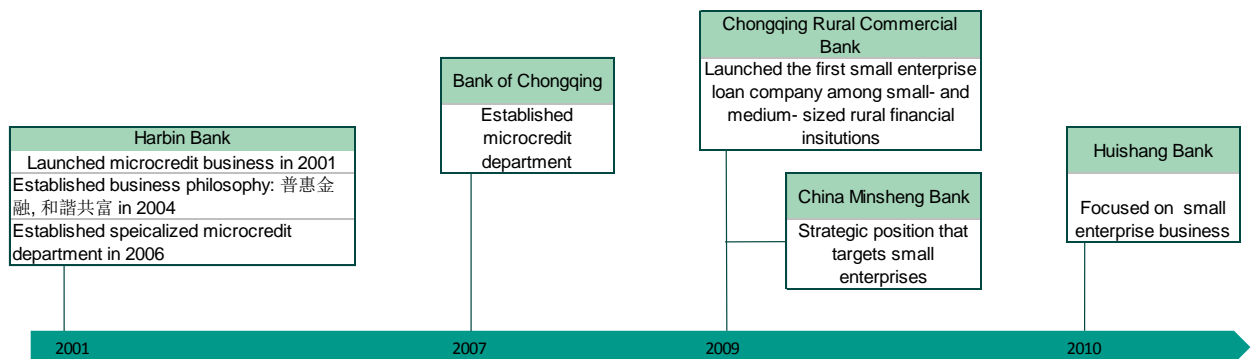
Source(s): Prospectus, ABCI Securities

We believe the diversified and strategic location of HRB's outlets have differentiated the Group from other city commercial banks. In our opinion, HRB, unlike any other city commercial banks, has a business diversification similar to that of a national bank.

Early entry in the microcredit segment

We believe a clear business focus and a well-defined competitive advantage have always been crucial to the survival of any business enterprises. HRB has focused its resources to develop the microcredit business back in 2001 and was the first city commercial bank in China to enter the segment. Other listed peers, such as Bank of Chongqing (BoCQ), Chongqing Rural Commercial Bank (CQRB), Minsheng Bank (MSB), and Huishang Bank (HB) only started to focus on this segment in 2007-2010. Later in 2004, HRB completed its preliminary stage in the business and established its microcredit department in 2006.

Exhibit 18: Roadmap of development in microcredit business

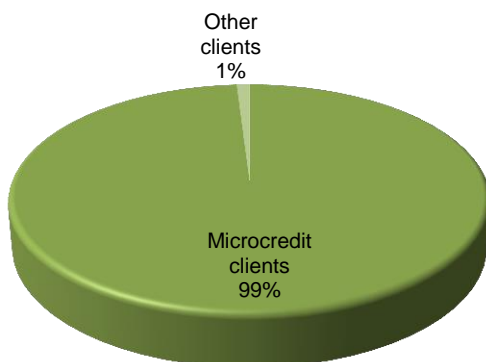


Source(s): Company reports and websites, ABCI Securities

Components of microcredit business

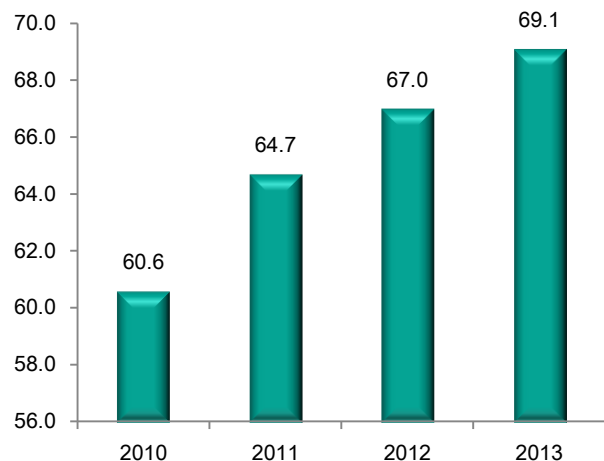
HRB has its clear objective to become a microcredit bank. As of 2013, 99% of its loan customers were related to its microcredit business. Total loans balance from microcredit was 69.1% of total loans in 2013, compared to 60.6% in 2010.

Exhibit 19: HRB's client mix (2013)



Source(s): Prospectus, ABCI Securities

Exhibit 20: Percentage of microcredit to total loans (%)



Source(s): Prospectus, ABCI Securities

As shown in Exhibit 21, microcredit is a combination of small enterprises loans from corporate banking and other components in retail banking. HRB has around 480,000 microcredit customers, while the average loan size of these 4 loan categories ranging between RMB 49,000 and RMB 7.03mn. In terms of asset quality in Sep 2013, only the NPLs of small enterprise owner loans (1%) and loans to farmers (3.84%) were above the Group's overall NPL level of 0.86%. The remaining 84% of microcredit loans as of Sep 2013 carried an NPL ratio of 1% or below.

Exhibit 21: Overview of HRB's microcredit business

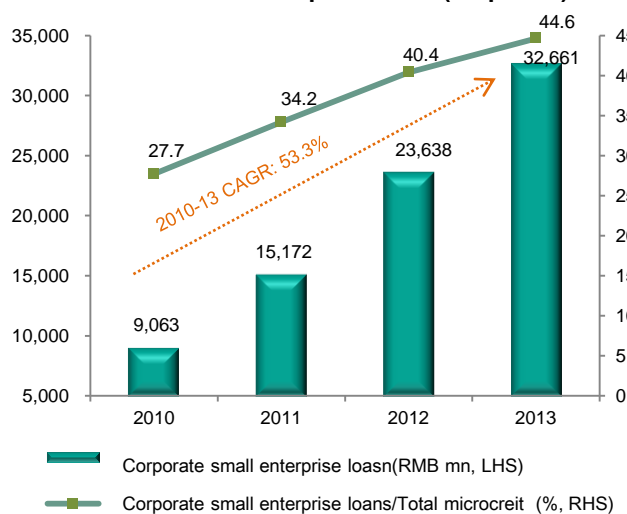
As of Sep 30, 2013	Number of clients	Average loan amount (RMB)	NPL ratio (%)	% of microcredit loans
Corporate loans to small enterprise	More than 4,500	~7.035 mn	0.44	43.6
Loans to small enterprise owners	~28,000	~534 k	1.00	20.6
Loans to farmers	~237,000	~49 k	3.84	16.0
Personal consumption loan	~214,000	~67 k	0.67	19.7

Source(s): Prospectus, ABCI Securities

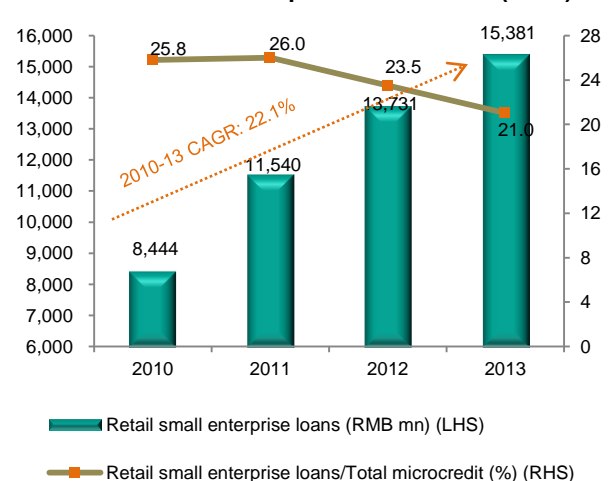
High NPL in loans to farmers in 2013 was mainly caused by floods in HLJ in the summer that affected the overall harvest in the region. We consider hostile weather conditions to be an ordinary business risk associated with agricultural loans, which is well compensated by the better loan yields and collaterals.

Key driver of future loan growth

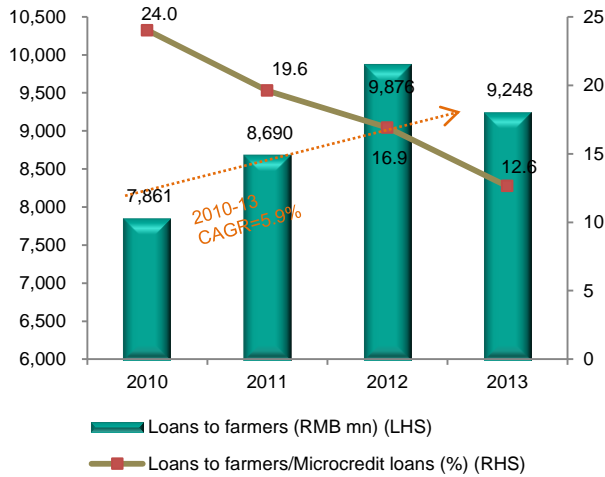
Among microcredit business, corporate small enterprise loans grew the fastest at 53.3% CAGR over 2010-13, compared to 22.1% in retail small enterprise loans, 29.2% in personal consumption loans, and 5.9% in loans to farmers. As the average size of corporate small enterprise loans was much larger, its overall balance accounted for 44.6% of total microcredit loans in 2013, while retail small enterprise, personal consumption and farmer loans accounted for 21.0%, 21.7% and 12.6% of total, respectively, as of Dec 2013.

Exhibit 22: HRB's small enterprise loans (corporate)


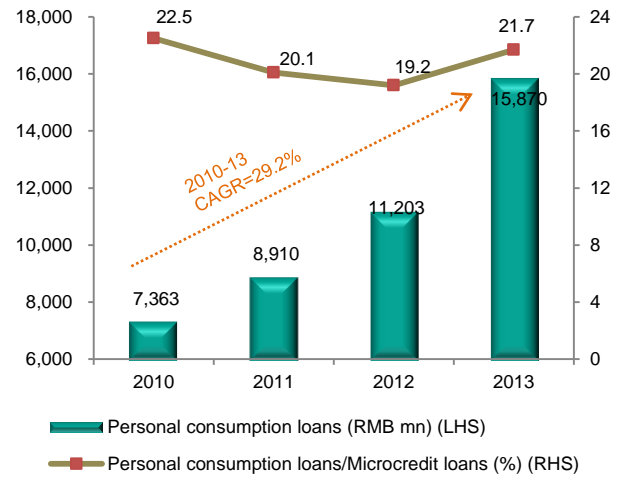
Source(s): Prospectus, ABCI Securities

Exhibit 23: HRB's small enterprise owner loans (retail)


Source(s): Prospectus, ABCI Securities

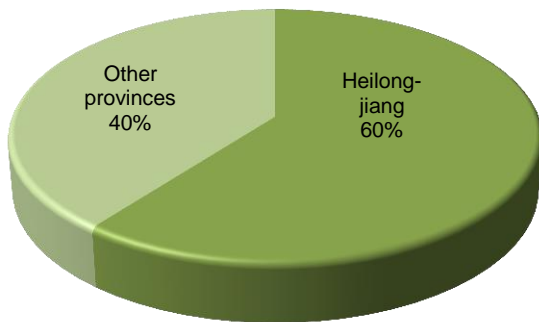
Exhibit 24: HRB's loans to farmers


Source(s): Prospectus, ABCI Securities

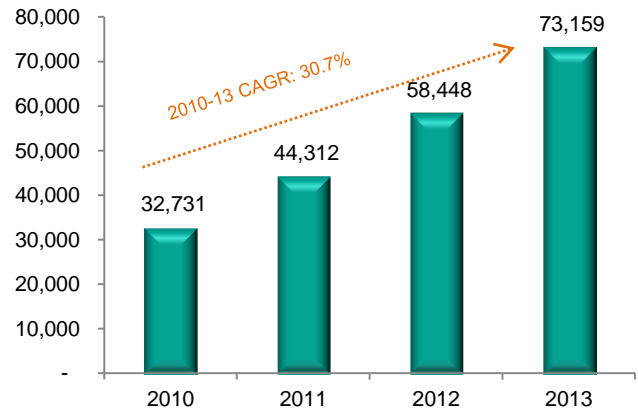
Exhibit 25: HRB's personal consumption loans


Source(s): Prospectus, ABCI Securities

Geographically, 60.5% of these microcredit loans were attributed to HLJ, while the rest were aggregated from the remaining provinces with HRB's franchises. Microcredit loans balance grew at 30.7% CAGR over 2010-13, reaching RMB 73.2bn in Dec 2013, or represented 69.1% of total loans. We forecast microcredit will continue to be the major driver of HRB's loans, which should lead to a growth of 16.2% to 19.9% yoy annually in 2014E-16E.

Exhibit 26: Microcredit geographical mix in 2013 (%)


Source(s): Prospectus, ABCI Securities

Exhibit 27: Microcredit loans balance (RMB mn)


Source(s): Prospectus, ABCI Securities

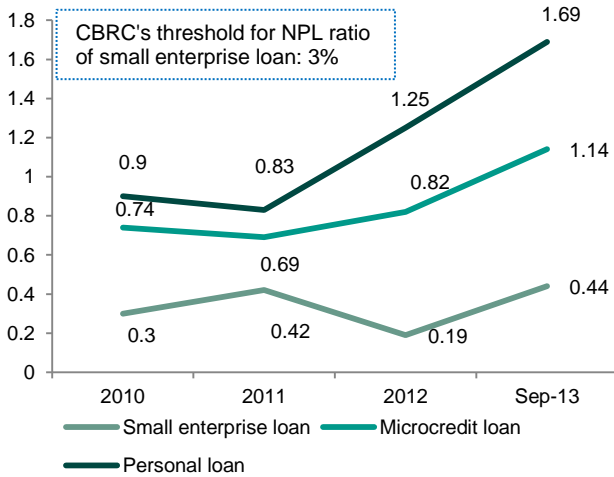
Asset quality is better than perceived

More often than not, small customers are perceived to have a higher default risk. HRB's NPL ratios in microcredit, small business loans and personal loans were 1.14%, 1.69% and 0.44%, respectively, in 2012, much lower than the tolerance level of 3% on MSE loans set by CBRC. HRB's healthy asset quality proved the soundness of its proprietary microcredit system and database, which has been widely used in HRB outlets as well as by its peer banks.

High yield to compensate for risk

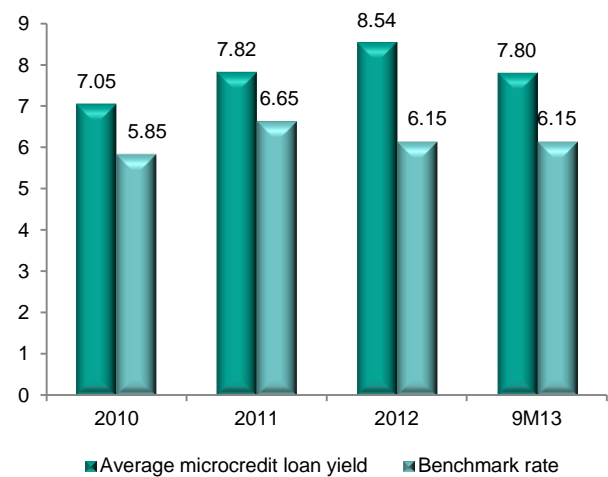
HRB's microcredit yield was at 20%-40% premium to the benchmark rates over 2010-12. For 9M13, loan rate premium dropped to 26.8%, which was low for SME and MSE loans in our view. We believe there is still plenty of room for HRB to increase its microcredit loans yield going forward, which would in turn support the Group's NIM.

Exhibit 28: HRB's microcredit NPL ratio (%)



Source(s): Prospectus, ABCI Securities

Exhibit 29: HRB's microcredit yield (%)

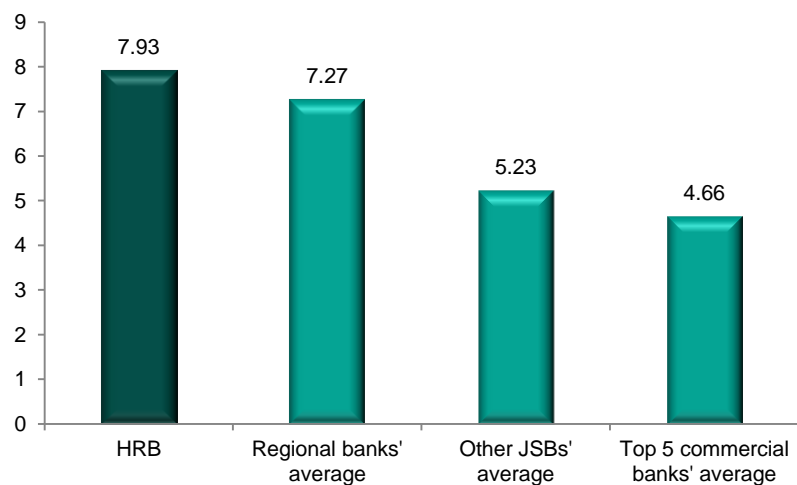


Source(s): Prospectus, PBOC, ABCI Securities

Leading loan yield

With its microcredit business, HRB's overall loan yield was 7.93% in 2012, 66bps higher than the regional banks' average, or 270bps and 327bps higher than the average of JSBs and big banks. We believe the microcredit business is relatively immune to competition from big banks and JSBs as the loan sizes involved in microcredit are too small to attract interests from these larger players, who are usually reluctant to allocate additional administrative cost and resources to a business with a limited segmental revenue compared to other segments.

Exhibit 30: Total loans yield comparison among banks in 2012 (%)

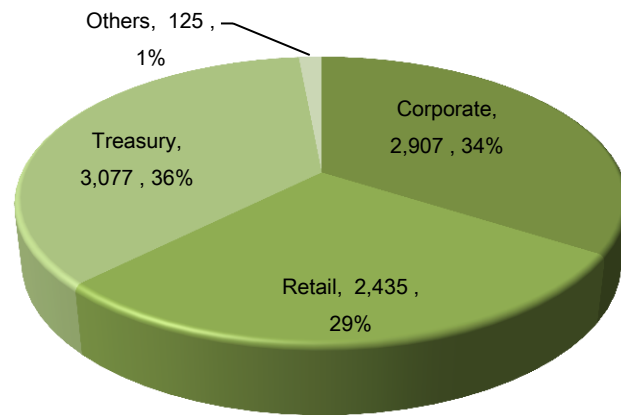


Source(s): Prospectus, company reports, CBRC, ABCI Securities

Balanced business mix

Thanks to HRB's dedication to microcredit business, the Group, unlike most city commercial banks that rely heavily on contribution from corporate banking, has a relatively balanced business mix. Corporate banking and retail banking accounted for 34% and 29% of operating income in 2013, given that loans to small enterprises and farmers were classified as retail loans and accounted for 38.0% and 22% of total retail loans. Meanwhile, treasury business took up the remaining 36% of operating income, although we believe it is mainly a liquidity tool rather than a core business focus of HRB.

Exhibit 31: HRB's revenue mix in 2013 (RMB mn)

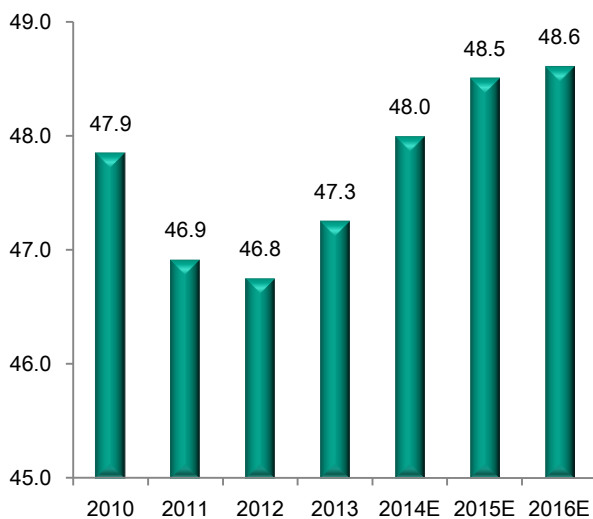


Source(s): Prospectus, ABCI Securities

Sufficient capacity to future growth

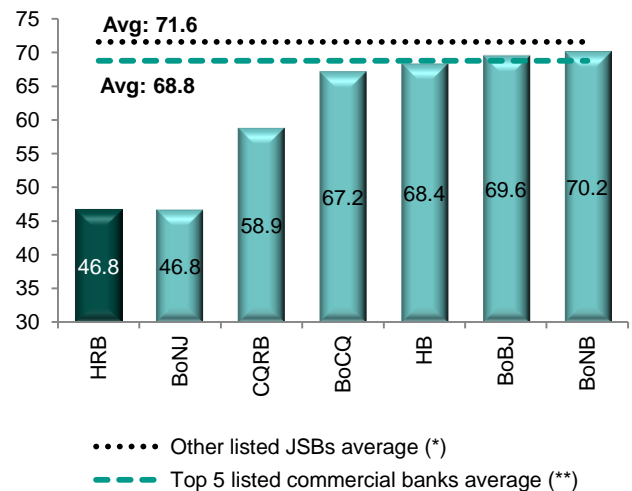
HRB achieved the lowest LDR among listed peers in 2012 at 46.8%, compared to the big five banks' average of 68.8% and other JSBs' average of 71.6%. LDR has been an important indicator of a bank's loan growth potential and the need to participate in deposits fight in the future.

Exhibit 32: HRB's historical and projected LDR (%)



Source(s): Prospectus, ABCI Securities estimates

Exhibit 33: LDR comparison among banks in 2012 (%)



Source(s): Prospectus, company reports, ABCI Securities
 (*) PingAn Bank, Industrial Bank, MSB, CEB, Huaxia Bank, CMB, SPDB, CITICB
 (**) ABC, ICBC, CCB, BOC, BoCom



With deposits growing faster than loans, HRB's LDR was reported at 46.8% in 2012. However, it surged to 54.94% in Sep 2013 due to a flat deposits growth in 9M13. The LDR of HRB has fallen back to 47.3% by Dec 2013 with deposits growth picked up in 4Q13. Deposit growth in 2013 was 20.1% yoy. This level of LDR, in our opinion, provides a sufficient support to future growth without exceeding the 75% LDR cap set by CBRC. Hence, we believe HRB is unlikely to participate aggressively in deposits fight in coming years.

In our base case scenario, we forecast HRB's loans and deposits to grow by 16.2%-19.9% and 16%-18% each year over 2014E-16E, which should lead to a gradual rise of HRB's LDR to 48.6% by 2016E. Together with a sustainable loan yield supported by microcredit business, the NIM impact from interest rate liberalization should be manageable. In a longer term, we expect HRB will increase its LDR to 60% - an optimal point between loan growth and deposits cost.

Ambition in international business

Development between China and Russia

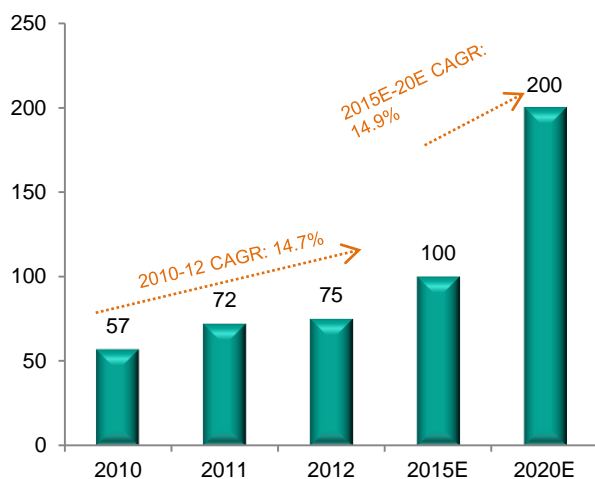
The Sino-Russian relationship could be divided into three phases. The first phase refers to 1992-93 when cross-border trade increased significantly to US\$ 7.7bn in 1993. The surge in trade transaction between the two countries was triggered by the high demand of goods exported to Russia after disintegration of the USSR as production in the country's stated-owned enterprises diminished.

During the second phase in 1994-96, total transaction amount dropped to US\$ 5.08bn after Russia had changed its attitude to encourage export and to pressure import by raising import duty to slash trading margin of products from China. Export from Russia therefore increased during 1995-96. Trading volume further reduced to US\$ 6.12bn in 1997 and US\$ 5.48bn in 1998.

The third phase refers to the period from 1999 to present. Trading momentum resumed in 1999 after Russia and China signed a trade agreement in 2000 in relation to the cross-border trade in 2001-05. The two governments signed another cooperation treaty in July 2001, boosting total trade to US\$ 8bn in 2000, exceeding the previous peak in 1993. Transaction rose further to reach US\$ 10.6bn in 2001.

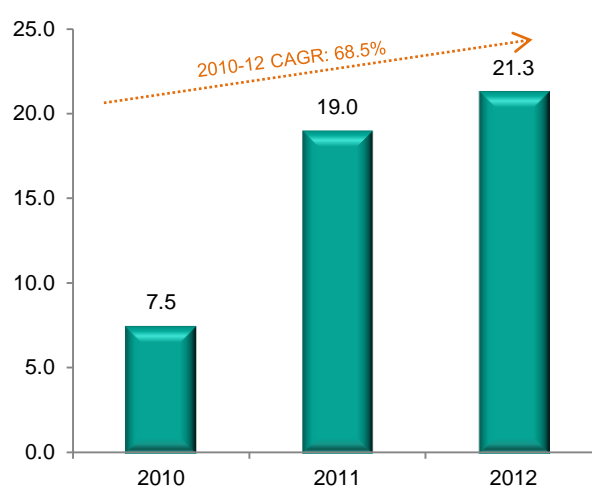
Cross-border trade between China and Russia mainly involve commodity products. Russia's exports include machinery, minerals, timber, steel, fertilizer, chemical products, marine products, non-ferrous metals, and pulp, which altogether accounted for over 90% of total trading volume in past years. In return, China's exports include machinery, leather products, footwear, textiles, knitted garments, chemical products, meat, toys and sports equipment, fur, fruits, vegetables, dried fruit products, food, ceramics, and mineral fuels, which added up to ~ 80% of total trade in past years.

Exhibit 34: China-Russia trading volume (US\$ bn)



Source(s): Prospectus, ABCI Securities

Exhibit 35: HLJ-Russia trading volume (US\$ bn)



Source(s): Prospectus, ABCI Securities

Cross-border trade between the two countries has accelerated rapidly in recent years, and we expect the momentum to continue in the future. Total trading volume grew at 14.7% CAGR over 2010-12 to reach US\$ 75bn. Among which, about 28.4% of these cross-border transactions (US\$ 21.3bn) were done through HLJ in 2012, as compared to only 13.2% in 2010.



According to the joint declaration by China and Russia in 2013, trading volume is targeted to reach US\$ 100bn by 2015E and US\$ 200bn by 2020E, representing a 14.9% CAGR over 2015E-20E. As we believe HLJ would be one of the major regions in China to benefit from the prospering cross-border trade given its geographical proximity to Russia, HRB, as a leading financial player in the province, should benefit from the fastened trade ties as well.

Russia as springboard for internationalization

Being one of the earliest Chinese banks to establish cross-border business with Russia, HRB has targeted Russia as its first market for international business and become a pilot bank in various banking businesses with Russia. As a participant of the Financial Cooperation Sub-committee of the Regular Sino-Russian Premier-level Meeting Committee, HRB was the first city commercial bank to announce direct exchange rate of CNY-RUB and start its CNY-RUB market-making business in 2010. Based on data up to Sep 2013, HRB accounted for the largest cash operation scale among the Chinese banks and was one of the 4 largest CNY-RUB market makers. In addition, HRB was the first to extend RMB-denominated loans to Russia.

Without any offshore outlet, HRB has established an agency relationship with 105 Russian banks in all major Russian cities instead. Nevertheless, we believe HRB is likely to establish offshore branches in Russia to enhance their brand reputation although such move will be subjected to regulatory approval.

HRB's Russia-related business covers settlement, financing, liquidation, exchange, capital transaction and agency services. We estimate contribution from Russia-related business was mainly reflected in the fee income. Although such contribution is accounting for low single-digit percentage of its top-line revenue at present, we forecast this segment to grow rapidly in coming years at 50% CAGR or higher in 2013-16E. We believe HRB will develop its Russian banking business in both the interbank and cross-border financing markets.

We believe more business opportunities will arise from online transactions with Russia. In fact, HLJ is the only province allowed to operate online settlement business with Russia, pointing to the possibility that Harbin may become the largest CNY-RUB settlement center in China. We believe this business opportunity is exclusive to HRB given its geographic location and well-established connection, experience and expertise in the business.

Strategic cooperation with international players

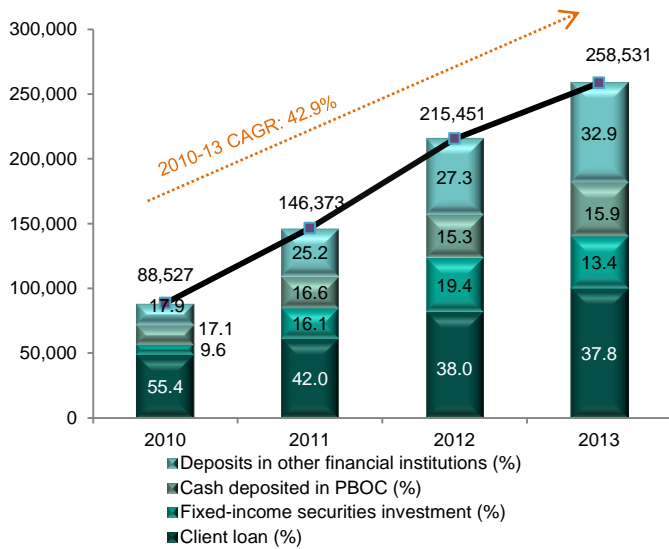
In order to enhance its microcredit technology and international reputation, HRB has commenced business dialogue with some advanced international microfinance players, including PlaNet Finance in France, ACCION International in the U.S., Grameen Bank in Bangladesh, and ICICI Bank in India. Meanwhile, the Group agreements have also established more concrete strategic co-operation agreements with International Finance Corporation (IFC) and United National Development Programme (UNDP).

Forecasts and Assumptions

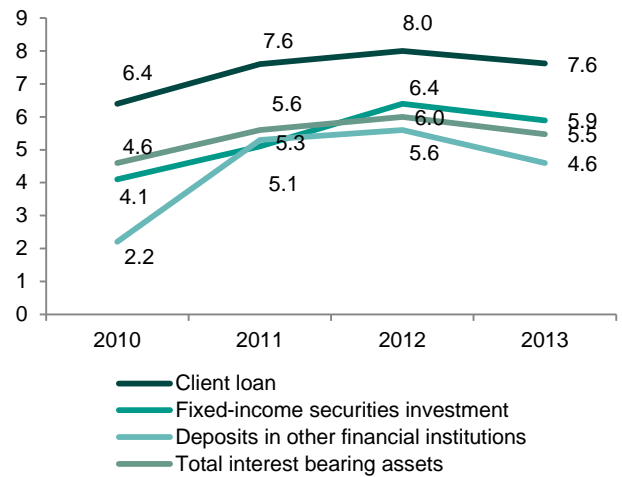
Balance sheet analysis

With a relatively low LDR, loans only accounted for 38.7% of HRB's total average interest-earning assets (AIEA) in 2013, while the Group has a comparatively high exposure in interbank assets at 29.8%. Fueled by capital injection in previous years, total AIEA grew significantly by 56% CAGR in 2010-12, and further expanded by 20% yoy in 2013. We project HRB's AIEA to increase by 16%-35% annually throughout 2014E-16E.

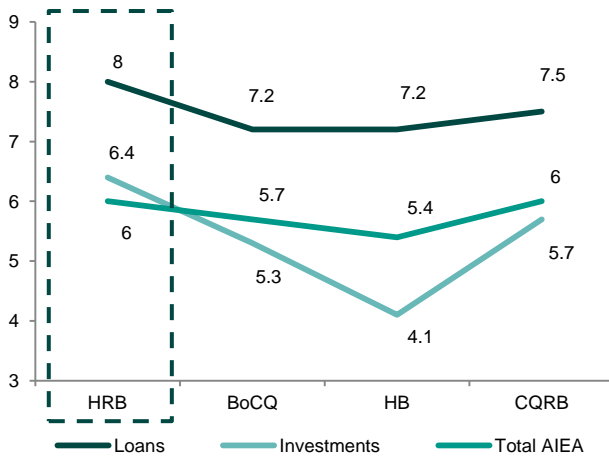
As we believe HRB's management would fine-tune its balance sheet mix for better return and less reliance on interbank funding, the proportion of interbank assets should gradually fall to 25.4%, substituted by increasing proportions of investment and cash that reach 27.4% and 13.5% by 2016E. Contribution from loans should remain stable at 34%-36% over 2014E-16E.

Exhibit 36: HRB's AIEA (RMB mn, %)


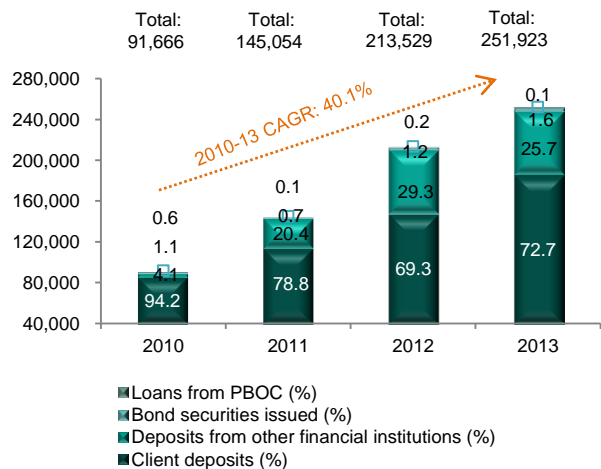
Source(s): Prospectus, ABCI Securities

Exhibit 37: HRB's AIEA yield (%)


Source(s): Prospectus, ABCI Securities

Exhibit 38: AIEA yield comparison (2012, %)


Source(s): Prospectus, company reports, ABCI Securities

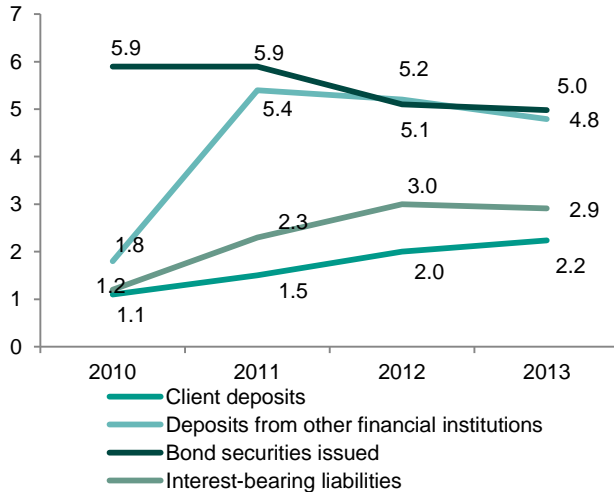
Exhibit 39: HRB's AIBL (RMB mn, %)


Source(s): Prospectus, ABCI Securities

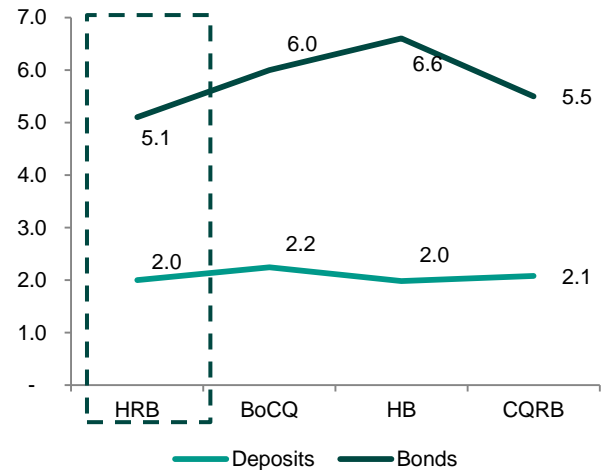
In terms of asset yield, HRB's loan yield has stayed at high levels of 6.4% - 8% since 2010, thanks to the high yield from microcredit and rural credit loans. Investment yield improved significantly from 4.1% in 2010 to 5.9% in 2013. In 2012, HRB achieved better yields in loans, investment, and overall AIEA compared to H-share peers including BoCQ, HB and CQRB. Taken into account of a lower loan yield in 2013 due to the two rate cuts in 2012, HRB's AIEA yield in 2013 was 5.5%, and would stabilize at 5.29% to 5.34% over 2014E-16E. We believe our loan rate assumption is conservative enough to reflect any potential impacts from interest rate liberalization, which include a 5bps-32bps reduction in average loan yield in 2014E-16E annually after a 40bps declined in 2013.

On the liability side, HRB's funding, like other city commercial banks, has relied heavily on customer deposits, which accounted for 72.7% of total AIBL as of 2013. Interbank liabilities was the second funding source, accounting for 25.7% of total average interest-bearing liabilities (AIBL). In fact, HRB has increased the use of interbank funding in recent years, which reduced the AIBL mix in deposits from 94.2% in 2010 to the current level.

To better control funding cost, we believe management would continue to strengthen the Group's deposits franchise and avoid over-exposure in interbank liability, whose liquidity concern has been clouding the sector since mid-2013. Deposits would continue to account for the majority of AIBL at 73.8%-75.1% in 2014E-16E, interbank exposure would come down to 21.6% by 2016E. As debt only contributed to 1.2% of AIBL in 2013, we expect HRB to utilize this alternative funding source in coming years by increasing its mix to 3%-4%.

Exhibit 40: HRB's AIBL yield (%)


Source(s): Prospectus, ABCI Securities

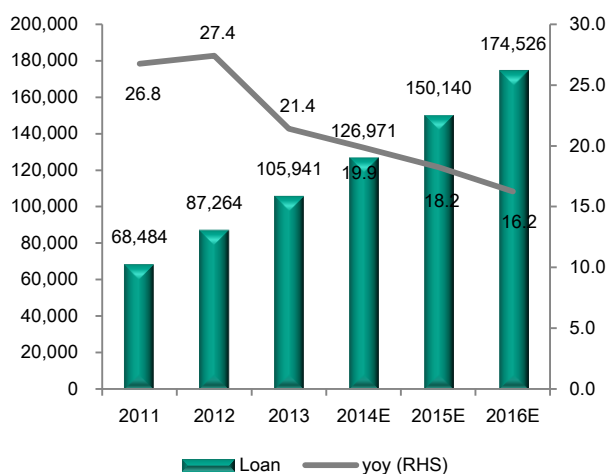
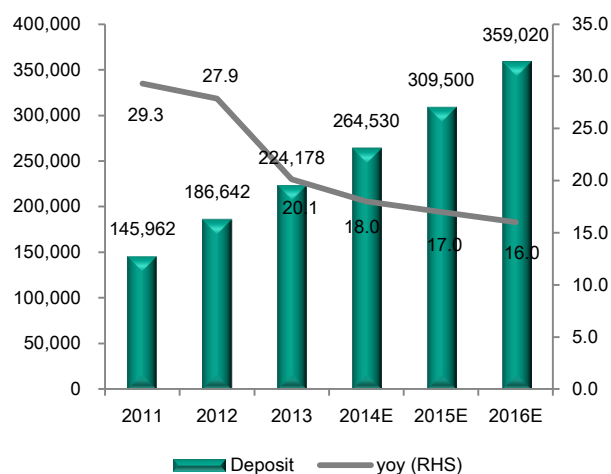
Exhibit 41: AIBL yield comparison among commercial banks (2012) (%)


Source(s): Prospectus, company reports, ABCI Securities

In our base case scenario, we forecast deposits cost to grow by 5bps-11bps annually in 2014E-16E and reach 2.5% by 2016E, taking into account of the progressive development in interest rate liberalization and HRB's low LDR. Yield of interbank liabilities, the most expensive funding channel, would stay at 4.7%-4.8% over 2014E-16E. Combined with the improving balance mix, overall AIBL cost reduced by 8bps in 2013, and we expect it to maintain at 2.94%-3.06% in 2014E-16E.

We have factored into a 16.2%-19.9% yoy loan growth and 16.0%-18.0% yoy deposits growth in 2014E-16E, which should steadily increase HRB's LDR from 46.8% in 2012 to 48.6% in 2016E with a longer-term optimal business mix target of 60%. We believe HRB would keep its loan growth focus on

microcredit, with the primary aim to increase the number of loan customers through absorbing new clients and cross-selling from its deposits customers.

Exhibit 42: HRB's total loans (RMB mn, yoy%)

Exhibit 43: HRB's total deposits (RMB mn, yoy%)


Source(s): Prospectus, ABCI Securities estimates

Source(s): Prospectus, ABCI Securities estimates

Exhibit 44: HRB's NIM model 2013-14E

RMB mn	Growth (%)	Balance	2013			Growth (%)	Balance	2014E		
			Average balance	Yield (%)	Interest inc/exp			Average balance	Yield (%)	Interest inc/exp
Corporate loans	24.3	63,538			22.0	77,517				
Retail loans	16.3	40,499			16.0	46,978				
Discounted bills	41.5	1,905			30.0	2,476				
Total loans	21.4	105,941	99,991	7.62	7,621	126,971	116,456	7.30	8,501	
Fin. investment	58.2	68,524			30.0	89,081				
Held for trading	(8.6)	7,202			15.0	8,282				
Investment	48.0	75,725	40,289	5.89	2,373	97,363	86,544	5.80	5,020	
Cash	(0.6)	51,552	41,263	1.46	602	57,738	54,645	1.45	792	
Deposits with FIs	18.5	84,982	76,989	4.60	3,545	100,279	92,630	4.55	4,215	
Total IEAs	21.5	318,201	258,531	5.47	14,142	382,351	350,276	5.29	18,528	
Other assets	(36.4)	6,401			20.0	7,681				
Provision	23.4	(2,426)			25.6	(3,047)				
Total assets	19.3	322,175			20.1	386,984				
Cus. deposits	20.1	224,178	185,802	2.24	4,161	18.0	264,530	244,354	2.35	5,742
Deposits with FIs	17.6	70,489	62,621	4.77	2,989	12.0	78,948	74,719	4.70	3,512
Bonds	0.0	3,500	3,500	4.98	174	150.0	8,750	6,125	4.80	294
Total ILBs	19.2	298,167	251,923	2.91	7,324	18.1	352,228	325,198	2.94	9,548
Other liabilities	33.4	4,081			28.8	5,256				
Total liabilities	19.4	302,248			18.3	357,485				
NIS				2.56					2.35	
NIM				2.64					2.56	

Source(s): ABCI Securities estimates

HRB's NIM dropped by 7bps in 2013 to 2.64%, mainly due to the re-pricing impact from the two rate cuts in mid-2012. Going forward, we think the abilities to grow loans and sustain loan yield would be more crucial to success than the capability to capture deposits. This is especially applicable to banks with a low LDR such as the city commercial banks. We estimate HRB's NIM to stabilize at 2.52%-2.56% over 2014E-16E, which would translate into a net interest income CAGR of 21.1% in 2013-16E.



Exhibit 45: HRB's NIM model 2015E-16E

RMB mn	Growth (%)	2015E				2016E				
		Balance	Average balance	Yield (%)	Interest inc/exp	Balance	Average balance	Yield (%)	Interest inc/exp	
Corporate loans	20.0	93,020				109,764				
Retail loans	15.0	54,025				61,048				
Discounted bills	25.0	3,095				3,714				
Total loans	18.2	150,140	138,555	7.25	10,045	16.2	174,526	162,333	7.20	11,688
Fin. investment	25.0	111,351				133,621				
Held for trading	10.0	9,110				10,021				
Investment	23.7	120,461	108,912	5.75	6,262	19.2	143,642	132,051	5.70	7,527
Cash	8.0	62,357	60,048	1.50	901	8.0	67,346	64,852	1.50	973
Deposits with FIs	16.0	116,323	108,301	4.50	4,874	10.0	127,956	122,140	4.50	5,496
Total IEAs	17.5	449,282	415,816	5.31	22,082	14.3	513,470	481,376	5.34	25,684
Other assets	20.0	9,217				11,061				
Provision	23.2	(3,753)				(4,450)				
Total assets	17.5	454,746				14.4	520,080			
Cus. deposits	17.0	309,500	287,015	2.45	7,032	16.0	359,020	334,260	2.50	8,357
Deposits with FIs	10.0	86,843	82,895	4.70	3,896	10.0	95,527	91,185	4.80	4,377
Bonds	100.0	17,500	13,125	4.75	623	-	17,500	17,500	4.70	823
Total ILBs	17.5	413,843	383,036	3.02	11,551	14.1	472,047	442,945	3.06	13,556
Other liabilities	22.6	6,447				7,836				
Total liabilities	17.6	420,290				14.2	479,883			
NIS					2.29					2.28
NIM					2.53					2.52

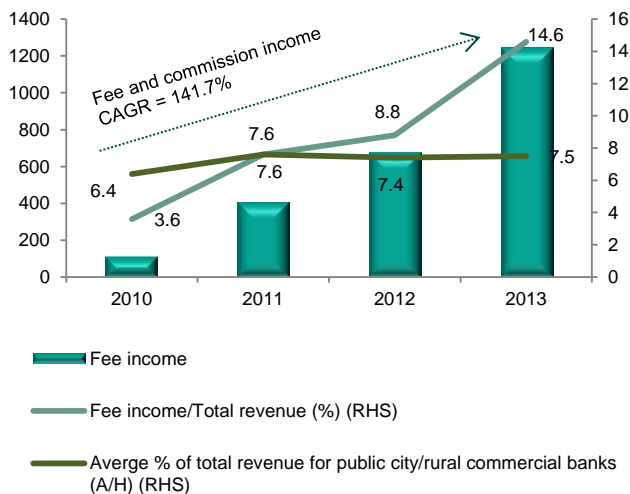
Source(s): ABCI Securities estimates

Profitability

Meanwhile, fee contribution from Russia-related business and the proactive expansion of wealth management products (WMPs) in recent years drove HRB's fee income to grow at 141.7% CAGR in 2010-12; percentage of fee income to total income reached 14.6% in 2013, compared to 3.6% in 2010. The proportion is high compared to other city commercial banks, whose fee income usually account for a low single-digit percentage of top-line revenue.

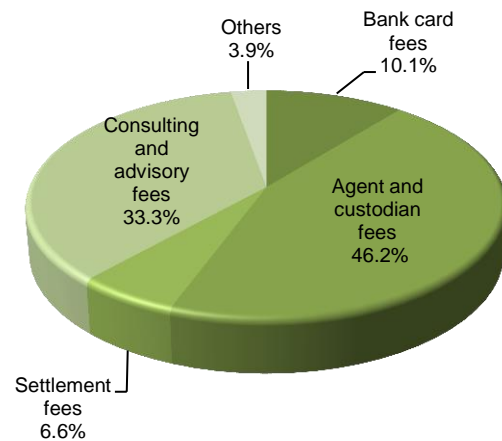
In 2013, agency and custodian fee and consulting & advisory fee were the major fee sources, accounting for 46.2% and 33.3% of total fee income, while traditional bank card fee and settlement fee (the main area of Russia-related business) took up 10.1% and 6.6% of total.

Exhibit 46: Fee income to total revenue (%)



Source(s): Prospectus, ABCI Securities

Exhibit 47: HRB's fee income mix in 2013 (%)



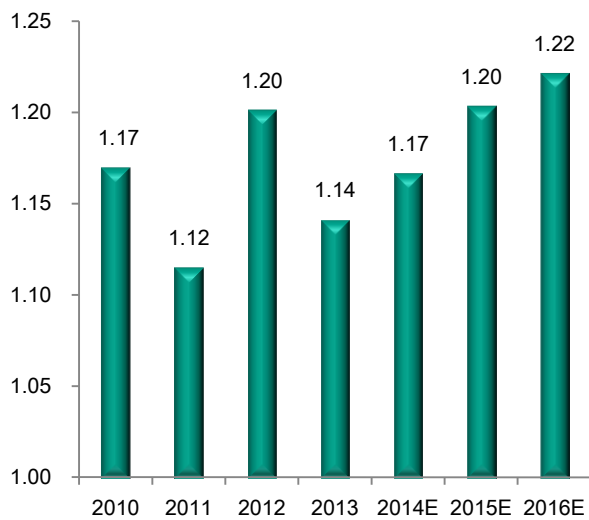
Source(s): Prospectus, ABCI Securities



We factor in an annual growth of 40%-45% yoy in HRB's net fee income for 2014E-16E, assuming rapid growth in Russia-related business (forex and trade settlement) and WMPs. Combined with net interest income, we expect HRB's top-line revenue to grow at 24.8% CAGR in 2013-16E, with percentage of fee income to operating income rising to 21.35% by 2016E.

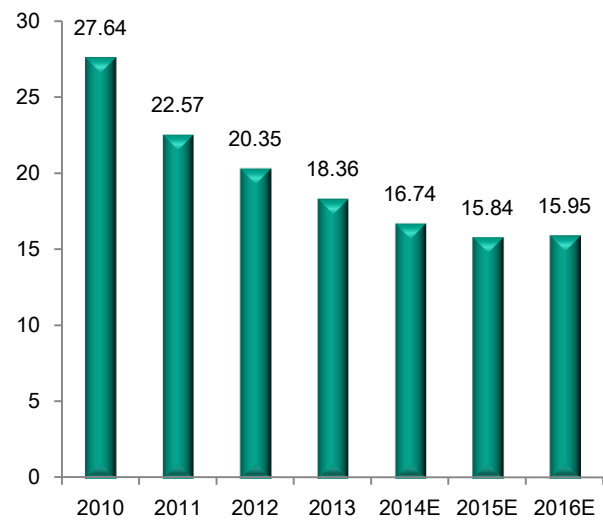
Combined with a 20%-28% yoy growth in operating expenses annually in 2014E-16E, HRB's cost-to-income ratio (CIR) would remain at low levels of 40.67%-43.26% over 2014E-16E. HRB's ROAE has been declining since 2011 despite its net profit grew by 52.8% CAGR over 2010-12, partly due to the series of capital injections that took place in past years. In our base case scenario, we project HRB's net profit to grow at 21.1% CAGR over 2013-16E; ROAE would be 15.84%-16.74% in 2014E-16E, while ROAA would improve to 1.22% by 2016E.

Exhibit 48: HRB's ROAA (%)



Source(s): Prospectus, ABCI Securities estimates

Exhibit 49: HRB's ROAE (%)



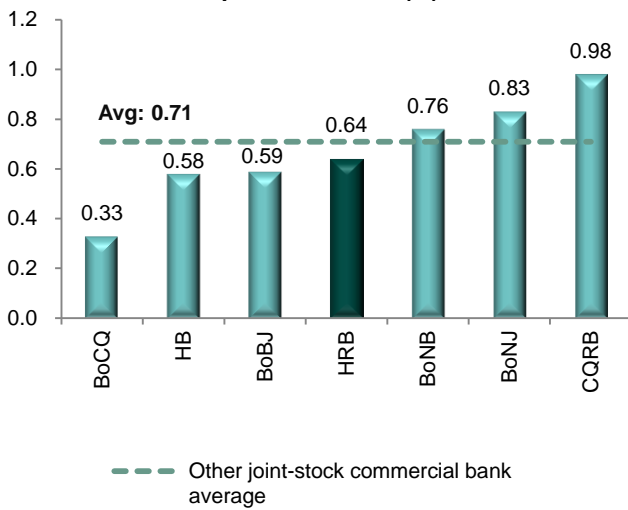
Source(s): Prospectus, ABCI Securities estimates

Asset quality

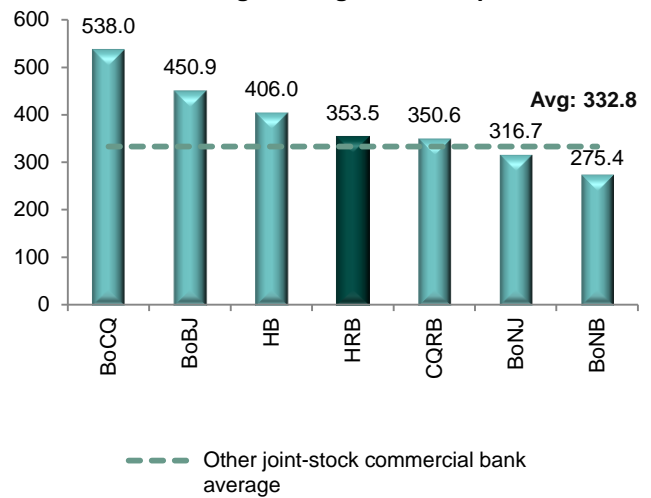
Although HRB's microcredit business is presumably risky, NPL of HRB was low, thanks to the closely monitored risk system and domestic expertise. In 2012, HRB's NPL ratio and provision coverage ranked 4th after its peers BoCQ, HB, and Bank of Beijing (BoBJ), and were better than JSBs' average at 0.64% and 353.5%.

As of Sep 2013, overall NPL ratio has increased to 0.86% and flat at 0.85% by Dec 2013. This was mainly caused by the risen NPL ratio in loans to farmers at 3.84%, which in turn was driven by the harvest loss resulted from natural disasters in the HLJ province. We regard natural disaster to be a normal business risk considering the loan nature. Moreover, the risk is well compensated by the better loan yield. Overall, the Group's NPL ratio was lower than the provincial one reported at 1.54%. We are also glad to see that HRB is able to maintain a low NPL in non-home regions.

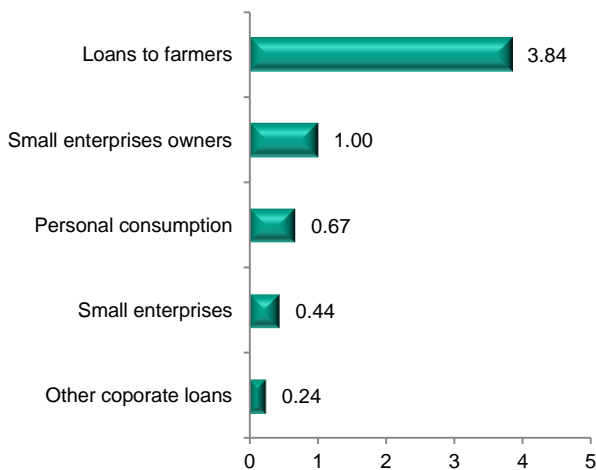
In line with loan distribution, corporate NPLs were mainly from wholesale & services sector and the manufacturing sector, which represented 59.8% and 33% of total NPL as of Sep 2013. Still, NPL by sector were 0.57% and 0.52%, lower than the Group level. Therefore, we do not consider the asset quality of HRB's corporate loans as a major concern. Furthermore, overdue loans as of Sep 2013 amounted to RMB 1.3bn, or 1.2% of total loans, of which loans overdue for over 90 days aggregated to 0.8% of total loans, as reflected by the NPL ratio of 0.86% at the Group level.

Exhibit 50: NPL comparison in 2012 (%)


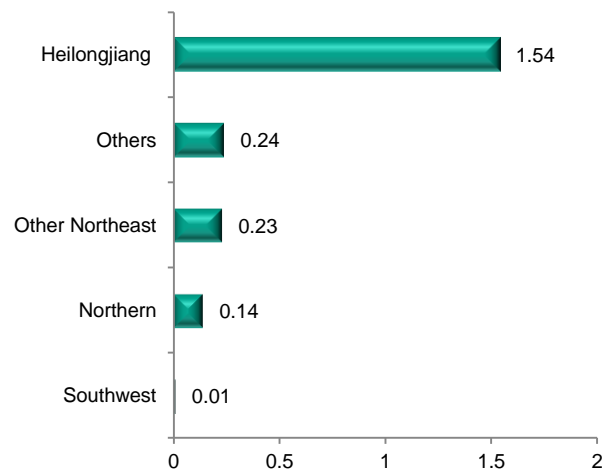
Source(s): Prospectus, company reports, ABCI Securities

Exhibit 51: Provisioning coverage ratio comparison in 2012


Source(s): Prospectus, company reports, ABCI Securities

Exhibit 52: NPL ratio by business line in Sep 2013 (%)


Source(s): Prospectus, ABCI Securities

Exhibit 53: NPL ratio by geographical in Sep 2013 (%)


Source(s): Prospectus, ABCI Securities

Under our base case assumptions, we forecast HRB's NPL ratio to be 0.9% by Dec 2014E, and gradually rise to 1% by end-2016E. In order to fulfill the regulatory requirement of attaining a provisioning ratio of 2.5% by 2016, we factor in a 5-11bps increment in provisioning ratio annually in 2014E-16E. This would allow HRB to maintain a buffer at 2.55% by 2016E. HRB would be able to maintain a provisioning coverage ratio at above 250% over 2013E-16E.

Capital adequacy ratio

According to the new capital rule benchmarking with Basel III, commercial banks are required to fulfill their core tier one (CT1) CAR, core CAR and total CAR of 7.5%, 8.5% and 10.5%, respectively, by end of 2018. This also includes the base CT1 CAR, core CAR, and total CARs of 5%, 6% and 8%, respectively, plus a capital conservation buffer of 2.5%.

Based on the calculation under the new capital rule, HRB's CT1 CAR and total CAR were 11.67% and 12.55% in 2013, meaning that both have fulfilled the regulatory requirement. Hence, we do not expect the Group to incur any major

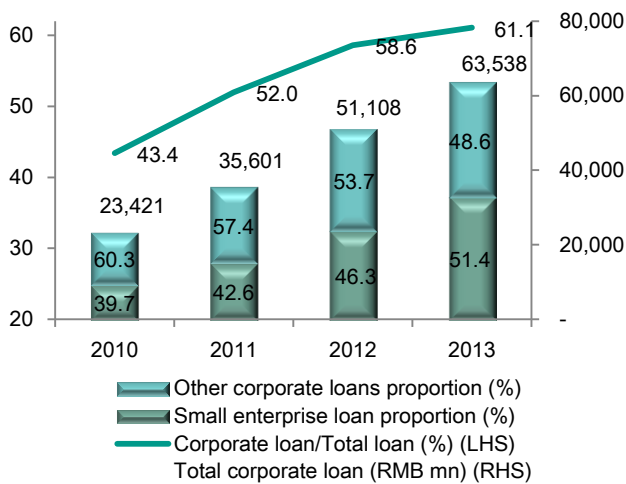
funding need in the future and forecast CT1 CAR and total CAR to sustain at 11.87% and 13.61% by end-2016E.

Segmental analysis

Corporate banking

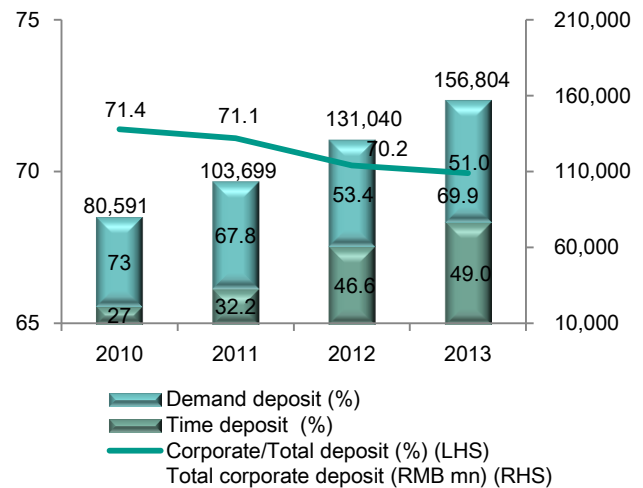
As of 2013, HRB's corporate banking had over 57,000 customers, with most of them from the northeastern region. The combined number of customers in Tianjin, Chengdu, and Chongqing grew at a CAGR of 39.7% over 2010-12 to exceed 7,000. We believe microcredit loans of RMB 32.7bn were classified into the corporate banking portfolio in Dec 2013. Corporate loans grew at 39.5% CAGR in 2010-13, and accounted for 61.1% of total loans booked in Dec 2013. Corporate deposits grew at 24.8% CAGR over 2010-13, accounting for 69.9% of total deposits in Dec 2013. Among which, 49.0% of its corporate deposits were time deposits.

Exhibit 54: HRB's corporate loans



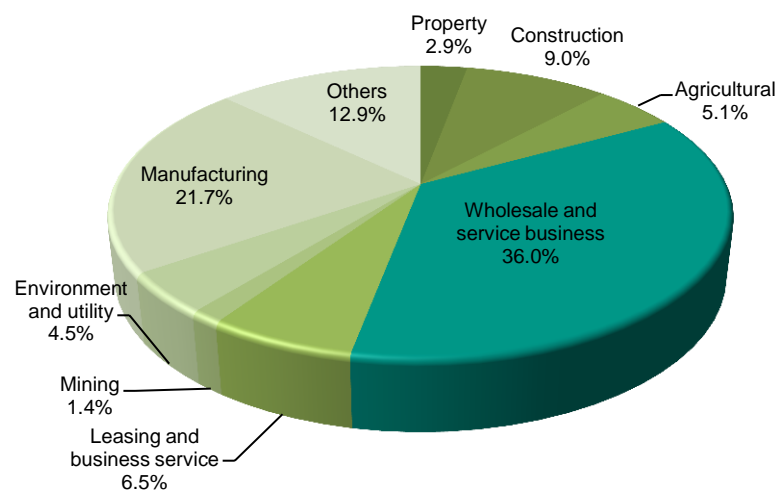
Source(s): Prospectus, ABCI Securities

Exhibit 55: HRB's corporate deposits



Source(s): Prospectus, ABCI Securities

Exhibit 56: HRB's corporate loans by segment (Sep 2013)

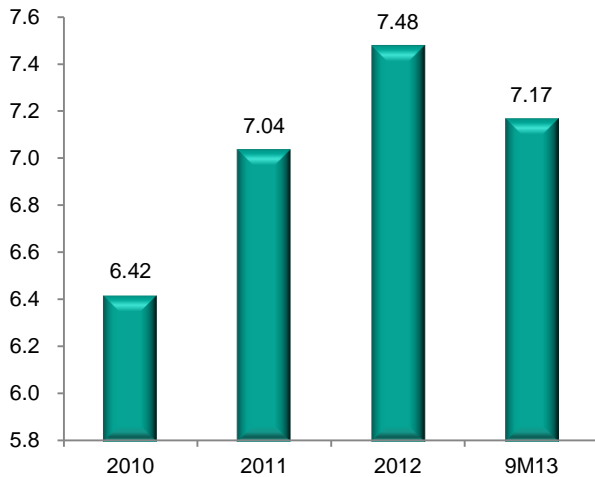


Source(s): Prospectus, ABCI Securities

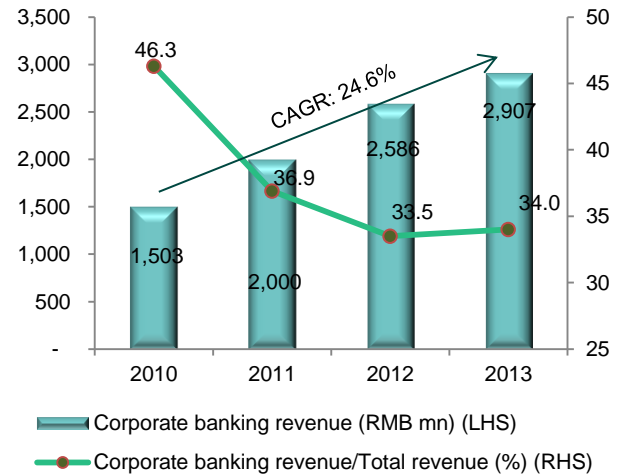
In the loan portfolio, wholesale & service sector and the manufacturing sector accounted for 36% and 21.7% of total corporate loans, while construction and real estate loans aggregated to 9% and 2.9% of total. HRB's exposure to local government financing vehicle (LGFV) was RMB 5.5bn, or 2.1% and 5.3% of total assets and total loans balance, which were low compared to other city commercial banks. HRB's LGFV primarily consists of loans to LGFV in HLJ. Exposure in loans/bonds investments, investment in fund trust plans and directional asset management plans were RMB 2bn, RMB 1.4bn and RMB 2.1bn respectively.

Corporate loans yield has been stable over time, improving from 6.42% in 2010 to 7.48% in 2012, and fell only slightly to 7.17% in 3Q13 despite the two rate cuts in 2012. On the back of huge microcredit loans demand and the upside potential of the relevant yields, we expect HRB's corporate loans yield to remain stable and believe that downside from the current level is limited.

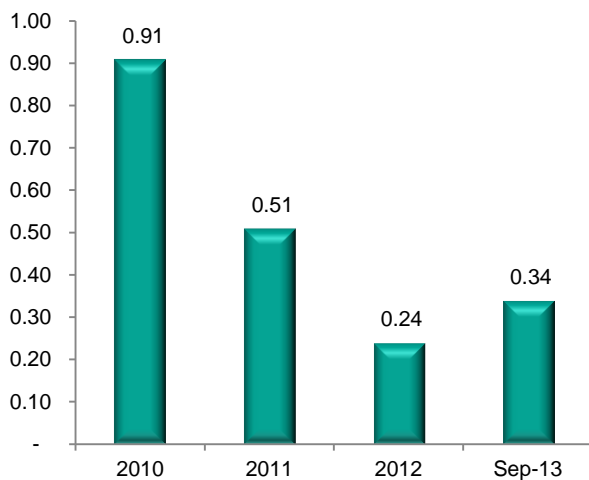
With corporate banking revenue increasing at 24.6% CAGR over 2010-13, we forecast the growth to maintain at 20%-25% annually in 2013E-16E, contributing to 35%-40% of top-line revenue.

Exhibit 57: HRB's corporate loans yield


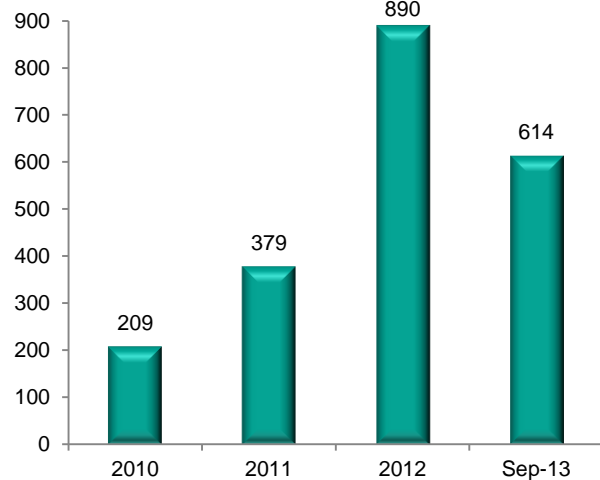
Source(s): Prospectus, ABCI Securities

Exhibit 58: HRB's revenue from corporate bank


Source(s): Prospectus, ABCI Securities

Exhibit 59: HRB's corporate banking NPL (%)


Source(s): Prospectus, ABCI Securities

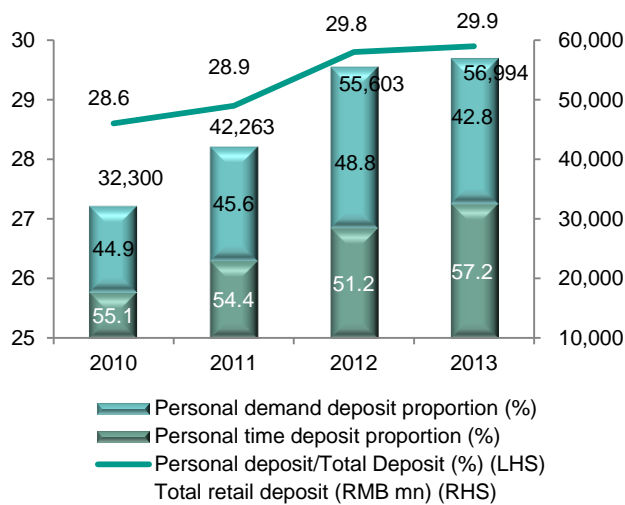
Exhibit 60: HRB's corporate banking provision coverage (%)


Source(s): Prospectus, ABCI Securities

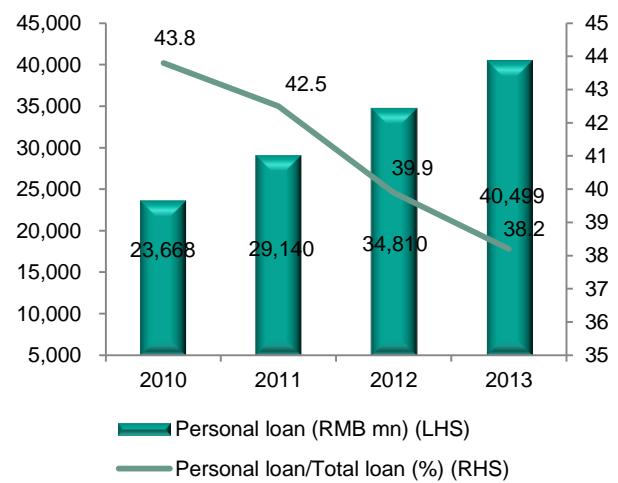
Asset quality in corporate banking was outstanding with an NPL ratio as low as 0.24% in 2012 and 0.34% by Sep 2013. Provision coverage ratio was high at 614% in Sep 2013, which should provide the Group sufficient buffer for its corporate banking operation.

Retail banking

HRB had over 5.59mn retail customers as of Sep 2013, including small enterprises, individual industrial and commercial customers, farmers, civil servants, and social security customers. Of which, 480,000 maintained a loan balance with the Group. Specifically, the number of small enterprises, farmers, and personal loans customers were 28,000, 237,000, and 214,000, respectively. We regard this loans-to-deposits customer ratio to be low. We believe if the Group is able to cross-sell its credit services to its retail deposits customers, the potential for loan growth would be enormous.

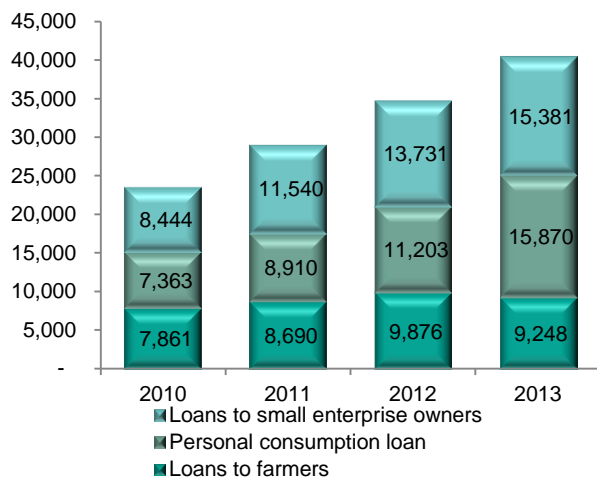
Exhibit 61: HRB's retail deposits mix


Source(s): Prospectus, ABCI Securities

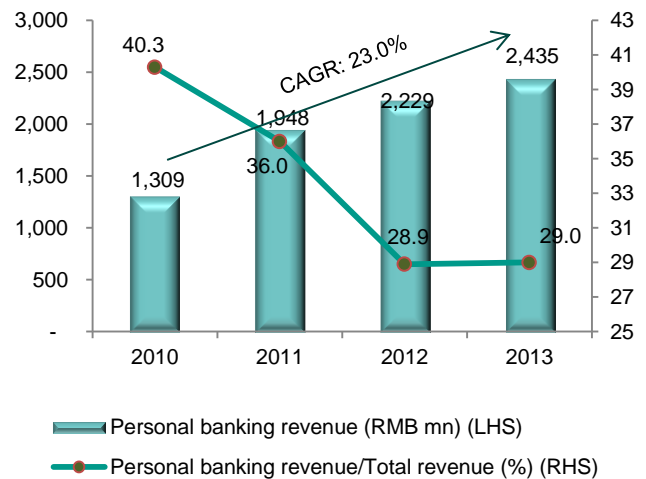
Exhibit 62: HRB's retail loans mix


Source(s): Prospectus, ABCI Securities

Retail loans and deposits grew at 19.6% and 20.8% CAGRs over 2010-13 to reach RMB 40.5bn and RMB 57bn by Dec 2013, accounting for 38.2% and 29.9% of total loans and deposits. As of Dec 2013, small enterprise loans, loans to farmers, and personal consumption were 38.0%, 22.8%, and 39.2% of total retail loans, respectively.

Exhibit 63: HRB's retail loans by product


Source(s): Prospectus, ABCI Securities

Exhibit 64: HRB's revenue form retail segment


Source(s): Prospectus, ABCI Securities

HRB's retail banking revenue grew at 23.0% CAGR in 2010-13. The segment had a high LDR at 71.7% in Sep 2013 and loan yield dropped on the two rate cuts in 2012. Yet, we believe the downside was fully reflected in 2013, and HRB's retail revenue should rebound in 2014E.

Treasury business

HRB's treasury segment covers interbank market, financial asset investments, bond underwriting, derivatives and bills businesses. We believe the segment mainly serves as a liquidity tool for the Group instead of an earning driver. Treasury revenue grew rapidly at 101.3% CAGR over 2010-13 mainly due to its low base.

Exhibit 65: HRB's revenue from treasury segment

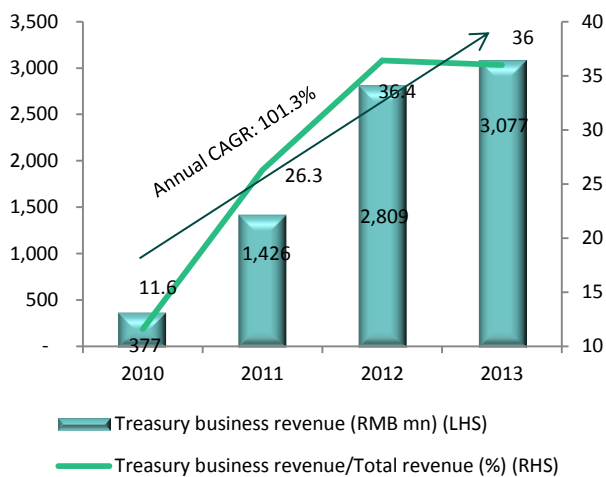
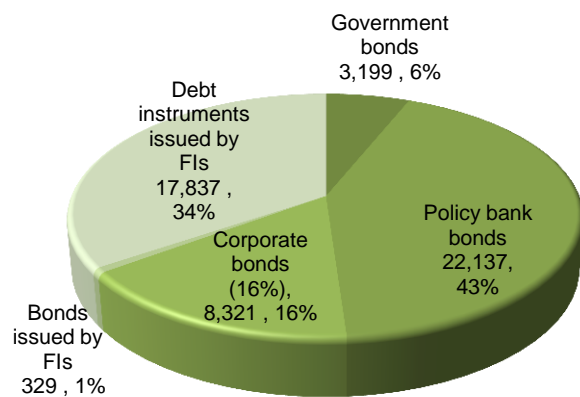


Exhibit 66: HRB investment portfolio as of Sep 2013 (RMB mn)



Source(s): Prospectus, ABCI Securities

Source(s): Prospectus, ABCI Securities

The Group's investment portfolio is relatively conservative. As of Sep 2013, 43% of the portfolio was policy bank bonds, followed by 35% in FIs debt instruments, 6% in government bond, and 16% in corporate bonds. HRB held investment in receivables, in which the total exposure to capital trust schemes, specific client asset management plans, and wealth management products was RMB 17,837mn, or 34.4% of total HRB's investment portfolio as of Sep 2013.

In order to diversify the business mix, HRB increased its risk exposure in the fast-growing wealth management product business. Total balances from principal guaranteed and non-principal guaranteed products were RMB 1,238mn and RMB 28,939mn, equivalent to 0.47% and 11.06% of its total assets. Underlying assets of these products are mainly interbank bonds in China and capital trust schemes. As 95.9% of these products are non-principal guaranteed, relative risk to HRB will be minimal even if the underlying assets default.

Valuation

Initiate with BUY rating

Based on the Gordon Growth Model (GGM), a widely adopted valuation method for banks, we set our target 14E P/B at 0.93x, taken into account of the Group's district bank background and its relatively small operational scale compared to the national banks. We initiate coverage on HRB with a BUY rating and a 14E target price of HK\$ 3.14, which implies a 16.73% upside. We believe this could be justified by HRB's sustainable NIM, robust fee growth and better-than-peer asset quality. Major risks fall on the Group's ability to raise its LDR and sustain its loan pricing.

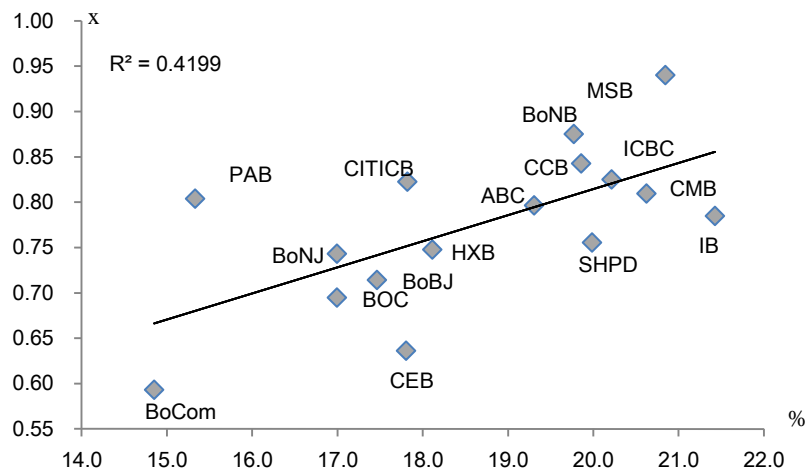
Gordon growth model assumptions

Our base case calculation has factored in a sustainable ROE of 15.7% (simple average of HRB's historical and our ROE forecasts minus 1 ppt) and a cost of equity (COE) of 16.4% based on a risk-free rate 4.4% (10-year China government bond), an equity beta of 1.2, an equity risk premium of 10% (same for our Chinese bank universe) and a long-term growth of 6% (with reference to China's GDP growth).

Deserve a higher valuation than existing peers

We believe HRB should trade slightly higher than Huishang Bank (3698 HK, BUY, HB), given HRB's extensive franchise network in 14 Chinese provinces and municipalities, a unique geographic location beneficial to its Russia-related business, and a similar total asset size.

Exhibit 67: A-share banks' FY14E ROE vs P/B

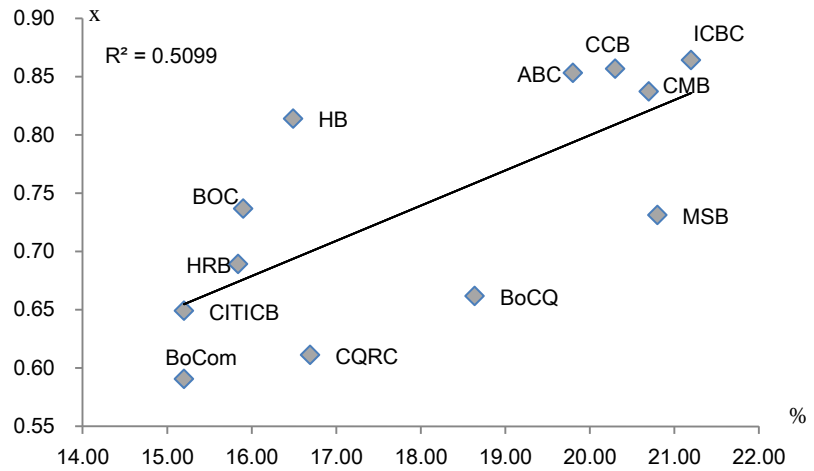


Source(s): Bloomberg, ABCI Securities estimates

HB is currently trading at 0.82x 14E P/B (above regression line), and has been an outperformer in the China banks sector since its IPO in 4Q13. Its peers, BoCQ and CQRB, are trading below the regression line at 0.67x and 0.6x 14E P/B. In our opinion, the current valuations reveal that H-share investors prefer district banks of larger scale with more extensive branch networks.



Exhibit 68: H-share banks' FY14E ROE vs P/B



Source(s): Bloomberg, ABCI Securities estimates

Exhibit 69: Valuation comparison table

Name	BBG code	Market cap (US\$m)	Price (Lcy)	P/E		P/B		EPS gr	ROE		Div payout		Div yield
				2014 E	2015 E	2014 E	2015 E		2014 E	2015 E	2014 E	2015 E	
A-share													
ICBC	601398 CH	196,589	3.42	4.18	3.87	0.83	0.73	9.07	20.22	19.06	34.23	34.43	8.19
CCB	601939 CH	169,507	3.94	4.18	3.90	0.84	0.72	9.65	19.86	18.75	32.87	31.95	7.87
ABC	601288 CH	124,975	2.38	4.18	3.88	0.79	0.70	11.76	19.31	18.14	32.28	31.48	7.73
BOC	601988 CH	118,058	2.60	4.21	3.81	0.69	0.62	10.36	16.99	16.30	34.95	34.70	8.31
BoCom	601328 CH	44,846	3.71	4.10	3.92	0.59	0.54	7.62	14.85	14.15	27.43	27.91	6.68
CMB	600036 CH	40,583	9.86	4.09	3.69	0.81	0.70	4.78	20.63	19.99	27.30	26.86	6.67
MSB	600016 CH	33,536	7.70	4.51	4.05	0.94	0.80	14.70	20.85	19.60	17.44	17.87	3.87
CITICB	601998 CH	31,639	4.50	4.93	4.43	0.82	0.72	8.57	17.82	17.25	26.32	26.01	5.33
INDB	601166 CH	29,966	9.81	3.83	3.33	0.78	0.66	18.47	21.43	20.75	19.62	19.27	5.12
SHPD	600000 CH	28,890	9.66	3.93	3.51	0.75	0.64	12.10	19.99	19.75	25.46	25.17	6.47
CEB	601818 CH	18,301	2.43	3.65	3.35	0.64	0.56	0.76	17.81	17.77	24.96	25.76	6.83
PAB	000001 CH	16,562	10.85	5.50	4.69	0.80	0.70	6.02	15.33	15.90	16.38	16.59	2.98
HXB	600015 CH	11,878	8.32	4.06	3.68	0.74	0.64	17.70	18.12	10.47	21.34	21.07	5.25
BOBJ	601169 CH	10,525	7.46	4.48	3.92	0.71	0.62	8.89	17.47	9.34	20.05	22.54	4.48
BONB	002142 CH	4,147	8.97	4.70	4.11	0.87	0.75	13.57	19.77	11.32	21.49	21.28	4.57
BONJ	601009 CH	3,708	7.79	4.46	3.98	0.74	0.64	15.70	17.00	9.93	26.22	26.21	5.88
Average				4.31	3.88	0.77	0.67	10.61	18.59	16.15	25.52	25.57	6.01
H-share													
ICBC*	1398 HK	196,590	4.60	4.38	4.04	0.87	0.85	12.00	21.20	21.10	34.52	35.16	7.88
CCB*	939 HK	169,508	5.27	4.49	4.22	0.86	0.76	10.59	20.30	19.00	35.11	35.00	7.83
ABC*	1288 HK	124,975	3.22	4.60	4.22	0.86	0.77	7.69	19.80	19.30	35.71	34.43	7.76
BOC*	3988 HK	118,059	3.38	4.92	4.51	0.74	0.67	5.77	15.90	15.60	34.55	35.00	7.03
BoCom*	3328 HK	44,847	4.76	4.09	3.77	0.59	0.53	10.71	15.20	14.80	24.73	24.75	6.04
CMB*	3968 HK	40,583	13.46	4.34	3.89	0.83	0.72	13.24	20.70	19.90	29.84	29.96	6.87
MSB*	1988 HK	33,536	7.58	3.61	3.14	0.73	0.62	8.39	20.80	20.10	17.26	17.10	4.78
CITICB*	998 HK	31,639	4.49	4.49	4.08	0.64	0.56	14.29	15.20	14.60	25.00	25.00	5.57
HB*	3698 HK	5,032	3.53	5.33	4.71	0.82	0.70	-8.62	16.49	16.16	24.53	25.00	4.60
CRCB	3618 HK	4,007	3.34	3.77	3.44	0.60	0.54	10.63	16.69	16.32	28.95	28.83	7.67
HRB*	6138 HK	3,816	2.69	5.36	4.67	0.80	0.69	14.78	15.84	15.95	25.00	25.00	4.37
BoCQ*	1963 HK	1,713	4.91	3.89	3.39	0.67	0.56	-9.82	18.64	18.01	24.75	25.00	6.36
Average				4.38	3.95	0.74	0.65	7.47	18.06	17.57	28.33	28.35	6.48

Source(s): Bloomberg, ABCI Securities estimates (*)
Closing price as of 7 May 2014



Risk factors

Concentration risk

HRB's loans were highly concentrated in sectors including wholesale & services (36%), manufacturing (21.7%), construction (9%), rental and commercial services (6.5%) and agriculture, forestry, husbandry and fishery (5.1%). These loans aggregated to 78.3% of total corporate loans as of Sep 2013. In particular, wholesale & services and manufacturing sectors accounted for 59.8% and 33% of total NPL. Geographically, 68.4% of total loans and 75.9% of total deposits were concentrated in northeastern China. This implies HRB could be severely impacted if these sectors or regions experience an economic slowdown or deterioration in asset quality.

Interest rate risk

Both interest rate liberalization and changes in interest rate environment pose risk to the China banks sector. Banks' NIM has been under pressure since the two rate cuts in June and July in 2012, with one-year loan and deposits rate being reduced to 6% and 3%. In addition, on June 8, 2012, PBOC took its first step in interest rate liberalization by raising deposits rate ceiling to 110% and lowering loan rate floor to 70%, which in turn exerted more downward pressure on NIM. According to the Group's prospectus, a 100bps change in interest rate would have induced changes of 7.99% and 1% in net profit and total equity for 9M13.

Exhibit 70: Interest rate sensitivity

RMB mn	2010		2011		2012		9M13	
	Net profit	Equity	Net profit	Equity	Net profit	Equity	Net profit	Equity
+100bps	(153.1)	(47.2)	(108.8)	(101.1)	(80.6)	(153.9)	(188.5)	(181.7)
-100bps	153.1	50.0	108.8	107.2	80.6	162.3	188.5	192.7
%								
+100bps	(12.47)	(0.94)	(5.87)	(0.89)	(2.81)	(0.92)	(7.99)	(0.97)
-100bps	12.47	0.99	5.87	0.94	2.81	0.97	7.99	1.02

Source(s): Prospectus, ABCI Securities

Credit risk

Despite HRB has demonstrated its ability to manage NPL (NPL ratio in 2013: 0.85%) via its self-developed risk system and close client monitoring, we believe NPL may continue to rise as system NPL has been trending up for the past quarters. In particular, loans to farmers could be highly impacted by uncontrollable natural factors. Nonetheless, we believe such risks would be factored in HRB's loan pricing. If economic recovery is milder than expected, China banks' asset quality may deteriorate.

NPL ratio of loans to farmers increased from 1.1% in 2010 to 1.46% in 2011, 2.5% in 2012 and 3.84% in Sep 2013, while coverage ratio of loans to farmers fell from 163% in 2011 to 101% in 2012 and 87.7% in Sep 2013. These trends raise concerns on future increase in provision related the specific type of loan, which may reduce HRB's overall earnings .

Exposure on LGFV via loans & investments

Total exposure in LGFV increased from RMB 3,780.8mn in 2011 to RMB4,412.6mn 2011 and RMB 5,523mn by Sep 13. Although loans to LGFV declined from Dec 11 to Sep 13, exposure to LGFV via bond investments, funds trust plans, and directional asset management plans increased significantly in 2011, 2012 and 9M13. Moreover, loans to LGFV were made primarily to government enterprises in HLJ. Hence, any unfavorable economic developments, changes in government policies, weakening financial condition of local governments, significant slowdown in the property market that may affect the capability of LGFV to repay debt would compromise asset quality,



financial condition or results of operations in HRB.

Liquidity risk

Given its low LDR, HRB is unlikely to increase liquidity aggressively as its loan book expands. Yet with the rapid development in WMPs, mismatch between WMPs tenor and underlying assets could trigger a temporary liquidity strain in HRB, which may force the Group to increase funding in the interbank market. The high interbank rates may squeeze its NIM.

Policy risk

We remain cautious on China's policy risk as we believe financial reform will accelerate under the 12th Five-Year Plan, especially since new rules concerning interbank exposure and WMPs were announced in early 2014. Although we expect to see more policies targeting to control banks' operation and systemic risk will be rolled out, details and timing of these regulations remain uncertain.

Macroeconomic risk

Since a majority portion of HRB's loans, deposits, and income are based in HLJ, a slowdown in regional economy would have major impacts on the Group. Real GDP growth in HLJ trended down from 12.6% in 2010, 12.2% in 2011, 10% in 2012 and 8.4% in 9M13 according to the NBSC. If the economic growth continues to decelerate, HRB's business will be adversely affected.

Exhibit 71: HLJ's economic growth and RMB loan growth (%)

	2010	2011	2012	9M13
Real GDP growth	12.6	12.2	10.0	8.4
Nominal GDP growth	20.6	21.3	8.8	4.3
RMB loan growth	20.7	18.2	15.9	-

Source(s): NBSC, Harbin PBOC, ABCI Securities

Meanwhile, a sharp decline in GDP growth in 2012 and 9M13 may increase credit risk and lower growth in loan and deposits regionally in subsequent years.

International business risk

Russia is the primary market for HRB's international business development. Changes in internal policies, diplomatic relationship, political and economic conditions in Russia could adversely affected HRB's business. Hence, Russia's military intervention in the latest Ukraine crisis could cast additional operation risks to HRB.

As of Sep 2013, total RUB-denominated assets and liabilities were RMB 45.5mn and RMB 4.0mn. Net exposure of RUB-denominated assets amounted to RMB41.5mn. Although the exposure is small on the balance sheet, total onshore and offshore market-making transactions of CNY-RUB via HRB increased from RUB 22.4mn in 2010 to RUB 6.56bn in 2012 and RUB 3.46bn in 9M13, while total RUB cash exchange volume via HRB increased from RUB 130.9mn to RUB 4.17bn in 9M13.



Financial forecasts

Consolidated income statement (2012A-2016E)

FY Ended Dec 31 (RMB mn)	2012A	2013A	2014E	2015E	2016E
Interest income	12,993	14,142	18,528	22,082	25,684
Interest expense	(6,335)	(7,324)	(9,548)	(11,551)	(13,556)
Net interest income	6,658	6,818	8,980	10,531	12,128
Net fee and commission	679	1,247	1,746	2,532	3,544
Other operating income	374	479	575	776	931
Operating income	7,711	8,544	11,301	13,838	16,604
Operating expenses	(3,026)	(3,591)	(4,596)	(5,746)	(7,182)
Impairment losses	(836)	(506)	(1,165)	(1,316)	(1,461)
Investment in associates	9	3	4	4	5
Profit before tax	3,859	4,450	5,543	6,781	7,966
Income tax expenses	(987)	(1,079)	(1,386)	(1,695)	(1,991)
MI	(7)	(21)	(20)	(20)	(20)
Net profit	2,864	3,350	4,137	5,065	5,954
Growth (%)					
Interest income	58.1	8.8	31.0	19.2	16.3
Interest expense	86.4	15.6	30.4	21.0	17.4
Net interest income	38.2	2.4	31.7	17.3	15.2
Net fee and commission	64.8	83.8	40.0	45.0	40.0
Other operating income	103.2	28.0	20.0	35.0	20.0
Operating income	42.4	10.8	32.3	22.5	20.0
Operating expenses	45.3	18.7	28.0	25.0	25.0
Impairment losses	1.5	(39.5)	130.1	13.0	11.0
Investment in associates	na	na	15.0	15.0	15.0
Profit before tax	53.9	15.3	24.6	22.3	17.5
Income tax expenses	51.7	9.3	28.4	22.3	17.5
MI	228.3	187.8	(3.6)	0.0	0.0
Net profit	54.5	17.0	23.5	22.4	17.5
Key ratios (%)					
Net interest margin	3.09	2.64	2.56	2.53	2.52
Net interest spread	3.06	2.56	2.35	2.29	2.28
CIR	39.24	42.03	40.67	41.52	43.26
Net fee to topline	8.80	14.60	15.45	18.29	21.35
Credit cost	1.07	0.52	1.00	0.95	0.90
ROAA	1.19	1.14	1.17	1.20	1.22
ROAE	20.35	18.36	16.74	15.84	15.95
Dividend payout	5.99	9.35	25.00	25.00	25.00
Core CAR	11.94	11.67	12.59	11.96	11.87
Total CAR	12.97	12.55	14.92	13.92	13.61
LDR	46.75	47.26	48.00	48.51	48.61
Provision coverage	352.06	269.44	266.67	263.16	255.00
Provisioning ratio	2.25	2.29	2.40	2.50	2.55
NPL ratio	0.64	0.85	0.90	0.95	1.00
Effective tax rate	25.6	24.2	25.0	25.0	25.0

Source(s): Company, ABCI Securities estimates



Consolidated balance sheet (2012A-2016E)

As of Dec 31 (RMB mn)	2012A	2013A	2014E	2015E	2016E
Cash and bank	51,859	51,552	57,738	62,357	67,346
Due from bank and FIs	71,692	84,982	100,279	116,323	127,956
Total loans	87,264	105,941	126,971	150,140	174,526
- loan provision	(1,966)	(2,426)	(3,047)	(3,753)	(4,450)
Net loans	85,298	103,515	123,924	146,386	170,075
Investment securities	51,180	75,725	97,363	120,461	143,642
- Financial investment	43,301	68,524	89,081	111,351	133,621
- Held for trading	7,879	7,202	8,282	9,110	10,021
Total IEA	260,029	315,774	379,303	445,528	509,019
Other assets	10,061	6,401	7,681	9,217	11,061
Total assets	270,090	322,175	386,984	454,746	520,080
Customer deposits	186,642	224,178	264,530	309,500	359,020
Due to bank and FIs	59,951	70,489	78,948	86,843	95,527
Subordinated debt	3,500	3,500	8,750	17,500	17,500
Total IBL	250,093	298,167	352,228	413,843	472,047
Other liabilities	3,060	4,081	5,256	6,447	7,836
Total liabilities	253,153	302,248	357,485	420,290	479,883
Net assets	16,937	19,927	29,500	34,456	40,197
Share capital	7,560	8,247	10,996	10,996	10,996
Retained earnings	3,179	4,031	7,134	10,933	15,399
Reserves	6,025	7,450	11,078	12,186	13,405
MI	172	200	292	341	398
Total equity	16,937	19,927	29,500	34,456	40,197
Growth (%)					
Cash and bank	67.6	(0.6)	12.0	8.0	8.0
Due from bank and FIs	8.8	18.5	18.0	16.0	10.0
Total loans	27.4	21.4	19.9	18.2	16.2
- loan provision	34.2	23.4	25.6	23.2	18.6
Net loans	27.3	21.4	19.7	18.1	16.2
Investment securities	42.0	48.0	28.6	23.7	19.2
- Financial investment	38.5	58.2	30.0	25.0	20.0
- Held for trading	64.8	(8.6)	15.0	10.0	10.0
Total IEA	30.1	21.4	20.1	17.5	14.3
Other assets	48.6	(36.4)	20.0	20.0	20.0
Total assets	30.7	19.3	20.1	17.5	14.4
Customer deposits	27.9	20.1	18.0	17.0	16.0
Due to bank and FIs	29.8	17.6	12.0	10.0	10.0
Subordinated debt	250.0	0.0	150.0	100.0	0.0
Total IBL	29.5	19.2	18.1	17.5	14.1
Other liabilities	55.3	33.4	28.8	22.6	21.5
Total liabilities	29.7	19.4	18.3	17.6	14.2
Net assets	46.9	17.7	48.0	16.8	16.7
Share capital	22.2	9.1	33.3	0.0	0.0
Retained earnings	95.0	26.8	77.0	53.3	40.8
Reserves	68.9	23.6	48.7	10.0	10.0
MI	19.0	16.0	46.2	16.8	16.7
Total equity	46.9	17.7	48.0	16.8	16.7

Source(s): Company, ABCI Securities estimates



Disclosures

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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 from 2007-2011

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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