



August 30, 2016
Equity Focus
Rating: BUY
TP: HK\$ 4.56

H-Share price (HK\$) 3.11
Est. share price return 46.62%
Est. div. yield 6.66%
Est. total return 53.28%

Previous Rating & TP BUY; HK\$ 4.56
Previous Report Date April 21, 2016

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Key Data

52Wk H/L(HK\$)	3.35/2.50
Issued shares (mn)	324,794
H-Shares (mn)	30,739
A-Shares (mn)	294,055
Market cap	
H-shares (HK\$ mn)	95,598
A-Shares (HK\$ mn)	1,086,091
3-mth avg daily turnover (HK\$ mn)	315.57
Major shareholder(s) (%):	
Huijin	40.03

Source(s): Company, Bloomberg, ABCI Securities

1H16 revenue breakdown (%)

Corporate banking	49.6
Retail banking	38.2
Treasury operations	7.8
Others	4.4

Source(s): Company, ABCI Securities

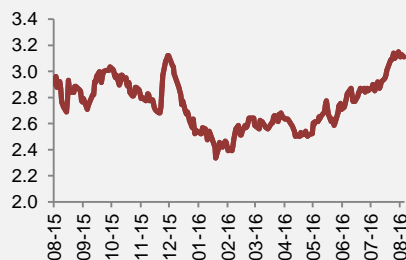
Share performance (%)

	Absolute	Relative*
1-mth	9.1	4.7
3-mth	17.2	6.9
6-mth	30.1	8.9

*Relative to HSI

Source(s): Bloomberg, ABCI Securities

1-Year stock performance (HK\$)



Source(s): Bloomberg

ABC (1288 HK)

Improving business mix with robust risk and capital buffer; reiterate **BUY**

- ABC reported a flat earnings growth in 1H16. Nonetheless, business mix improved with higher contribution from non-interest income and retail loans
- Loan re-pricing is coming to an end. With the follow-on impact of VAT, NIM will be mildly pressured in 2H16
- NPL ratio was under control with increasing NPL handling. ABC's robust risk buffer means additional provision pressure is unlikely in coming quarters
- Clear business direction and solid capital position will sustain dividend payout. Reiterate **BUY**

Improving revenue mix despite a flat earnings growth. ABC's 1H16 net profit attributable to equity holders (net profit) was RMB 105,148mn, up 0.8% YoY, representing 58.14% of our full-year forecast. Slow growth persisted in 1H16 due to NIM squeeze. With NII declining by 9.36% YoY and net fee income increasing by 7.27% YoY, ratio of net fee income-to-operating income gradually increased by 2.23ppt to 19.47%. Agency commission was the key fee driver in 1H16, up 26.8% YoY, contributing to 37.6% to gross fee income. Noticeable growth was seen in e-banking service fee income, which rose by 22.9% YoY in 1H16.

Mild NIM pressure in 2H16 . NIM narrowed by 47bps YoY to 2.31% as a result of loan re-pricing from previous rate cuts and VAT reform. Although average loan yield reduced by 125bps Yoy in 1H16, management said average loan yield in 2Q16 was stable QoQ. This signaled loan re-pricing resulted from previous rate cuts is approaching an end. With the VAT reform effective in 1H16, the Group's NIM will continue to be impacted. Hence, we expect NIM to be mildly pressured in 2H16.

Optimizing business mix. ABC focused on optimizing its business mix in 1H16. Aside from an improved revenue mix, significant changes in loan mix were observed. Most of the new loans in 1H16 came from the retail segment - retail loans grew 11.7% HoH while corporate loans only edged up by 2.19% HoH. On the corporate side, new loans in higher-risk sectors, such as manufacturing and wholesale & retail, saw negative growth of 1.37% and 8.3%; in contrast, lower-risk sectors such as the utilities and transportation enjoyed a decent growth. For retail loans, the relatively low-risk mortgage loans was the key driver (HoH: +16.14%) in 1H16. Overall, the shift in loan mix reflected the Group's prudent risk attitude.

Strong buffer reduces provision pressure. NPL ratio inched up by 1bp to 2.4% HoH in 1H16 as ABC increased its scale of NPL handling. Meanwhile, special mention loan ratio fell slightly by 3bps HoH to 4.17% by June 2016. In 2H16, we believe ABC will further increase its effort in NPL handling, which in turn may result in a mild increase in NPL ratio. Nevertheless, with a provisioning ratio high at 4.26% and provisioning coverage ratio at 177.72%, ABC's robust risk buffer would help defend its earnings as additional provision pressure is unlikely in coming quarters.

Results and Valuation

FY ended Dec 31	2014A	2015A	2016E	2017E	2018E
Revenue (RMB mn)	524,126	540,862	570,926	610,252	648,001
Chg (% YoY)	12.5	3.2	5.6	6.9	6.2
Net profit (RMB mn)	179,461	180,582	180,864	187,800	194,872
Chg (% YoY)	7.9	0.6	0.2	3.8	3.8
EPS (RMB)	0.55	0.56	0.56	0.58	0.60
Chg (% YoY)	7.9	0.6	0.2	3.8	3.8
BVPS (RMB)	3.05	3.48	3.85	4.23	4.62
Chg (% YoY)	17.5	14.1	10.5	9.9	9.3
P/E (x)	4.69	4.66	4.65	4.48	4.32
P/B (x)	0.85	0.74	0.67	0.61	0.56
ROAE (%)	19.15	16.12	14.20	13.38	12.67
ROAA (%)	1.18	1.07	0.96	0.90	0.84
DPS(RMB)	0.18	0.17	0.17	0.18	0.19
Yield (%)	7.02	6.44	6.66	6.92	7.18

Source(s): Bloomberg, ABCI Securities estimates



Promising dividend payout on solid capital position. As of June 2016, ABC's CT1 and CAR were 10.06% and 12.81%, from which we do not see any significant capital pressure in the near future. ABC's capital position would be sustained by organic growth and continuous expansion of low capital base business lines. Without any concrete equity issuance plan, the Group would strengthen its CAR by issuing RMB 80bn of tier-2 instrument in coming years. We believe dividend payout would be stable in 2016-17.

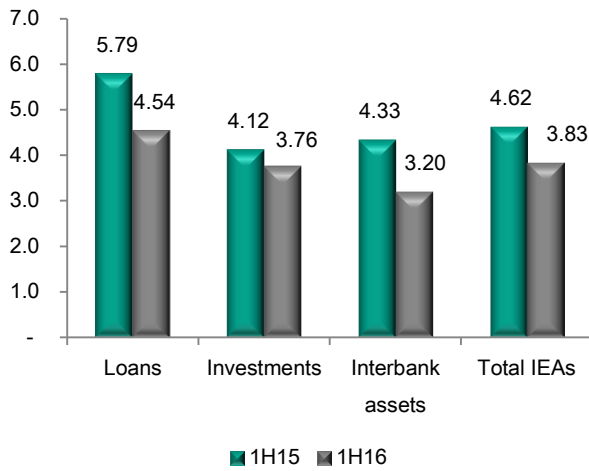
Clear business direction; reiterate BUY. The counter is currently trading at an undemanding valuation of 0.67x 16E P/B. We are impressed by ABC's clear business strategy that leverages on its Sannong competitive edge and the continuous expansion of its online business platform. Reiterate **BUY**.

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

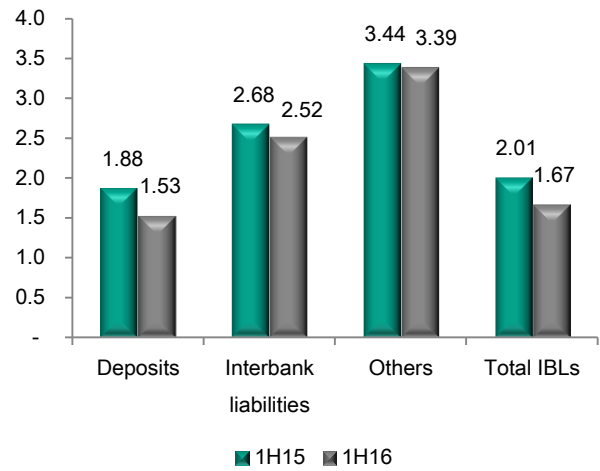
Exhibit 1: 1H16 results key indicators summary

	ABC	CCB	BoCom	CMB	CITICB	CEB	ZSB	BCQ	BQD	HRB	BJZ
YoY (%)											
NII	(9.36)	(6.07)	(4.10)	1.39	7.42	1.62	31.40	15.10	25.45	21.60	65.95
Net fee income	7.27	5.57	8.14	22.87	21.83	2.51	123.24	23.89	20.46	33.53	219.87
Operating income	(5.00)	(0.72)	2.01	8.63	12.04	3.28	51.56	14.69	23.82	24.40	67.76
Operating expenses	(7.82)	(9.51)	(4.98)	(0.27)	(0.50)	(1.89)	43.45	(11.18)	27.17	3.44	7.72
Impairment losses	(6.58)	13.00	29.27	23.99	43.10	18.71	75.29	98.57	58.58	123.44	(3.72)
Profit before tax	(2.39)	0.40	0.43	4.87	3.85	1.03	41.69	10.08	16.09	13.60	164.97
Net profit	0.80	1.15	0.90	6.84	4.49	1.22	42.37	10.45	17.49	15.04	164.51
EPS	0.00	0.00	0.00	6.87	0.00	(5.71)	0.00	(4.41)	(13.89)	15.79	100.00
HoH%											
Total assets	5.00	7.69	11.19	1.14	9.46	18.85	14.54	7.35	10.59	7.44	16.81
Loans	5.75	6.13	7.07	7.16	8.72	12.65	18.88	14.28	11.46	29.62	11.87
Deposits	7.29	7.37	5.57	3.39	8.56	9.20	24.91	12.25	9.52	7.78	17.03
Total equity	4.57	4.24	3.30	4.81	3.84	2.62	27.13	5.68	2.78	3.48	22.57
BVPS	4.02	2.77	3.43	4.82	3.85	2.98	2.63	5.68	1.69	(7.64)	22.57
Major financial indicators (%)											
NIM (annualized)	2.31	2.32	1.97	2.58	2.05	1.88	2.10	2.47	2.36	2.68	3.78
Net fee income to operating income	19.47	22.72	21.96	40.49	27.17	29.52	25.07	19.41	15.95	18.41	5.39
CIR	30.03	22.24	25.61	23.34	24.86	27.49	25.29	19.03	28.43	24.85	14.37
ROAA (annualized)	1.15	1.41	1.00	1.28	0.89	0.95	0.86	1.23	1.28	1.16	1.94
ROAE (annualized)	17.63	17.80	14.08	19.07	14.66	14.55	16.88	18.64	14.98	14.36	28.03
CT1	10.06	13.06	10.92	10.44	8.89	8.54	10.16	10.31	11.25	10.34	9.12
CAR	12.81	15.09	13.18	12.46	11.26	10.87	11.72	12.33	13.49	13.26	10.75
NPL ratio	2.40	1.63	1.54	1.83	1.40	1.50	1.33	0.96	1.26	1.54	1.10
Provisioning ratio	4.26	2.48	2.32	3.45	2.20	2.25	3.06	2.65	2.71	2.46	4.20
Provision coverage ratio	177.72	151.63	150.45	189.11	156.99	150.25	229.27	274.97	216.05	159.73	382.66
Changes (ppt)											
NIM (YoY)	(0.47)	(0.35)	(0.30)	(0.18)	(0.27)	(0.39)	(0.35)	(0.11)	0.02	-	0.62
Net fee income to operating income (YoY)	2.23	1.35	1.25	4.25	2.18	(0.22)	11.50	1.44	(0.44)	1.26	2.56
CIR (YoY)	0.46	(0.99)	(0.26)	(1.01)	(1.19)	0.80	0.67	(4.81)	3.29	(3.33)	(6.09)
ROAA (YoY)	(0.10)	(0.10)	(0.12)	(0.05)	(0.17)	(0.18)	-	(0.10)	(0.04)	0.09	0.92
ROAE (YoY)	(2.33)	(2.38)	(1.47)	(1.33)	(2.13)	(2.75)	(0.25)	(3.76)	(4.64)	0.36	10.26
CT1 (HoH)	(0.18)	(0.07)	(0.22)	0.51	(0.23)	0.04	0.81	(0.18)	(1.23)	(0.80)	0.16
CAR (HoH)	(0.59)	(0.30)	(0.31)	0.55	(0.61)	0.03	0.68	0.70	(1.55)	1.62	0.25
NPL ratio (HoH)	0.01	0.05	0.03	0.15	(0.03)	(0.11)	0.10	(0.01)	0.07	0.14	0.07
Provisioning ratio (HoH)	(0.27)	0.09	(0.03)	0.45	(0.19)	(0.27)	0.11	0.28	(0.10)	0.03	0.38
Provision coverage ratio (HoH)	(11.71)	0.64	(5.12)	10.16	(10.82)	(6.14)	(11.56)	30.99	(20.08)	(14.10)	13.53

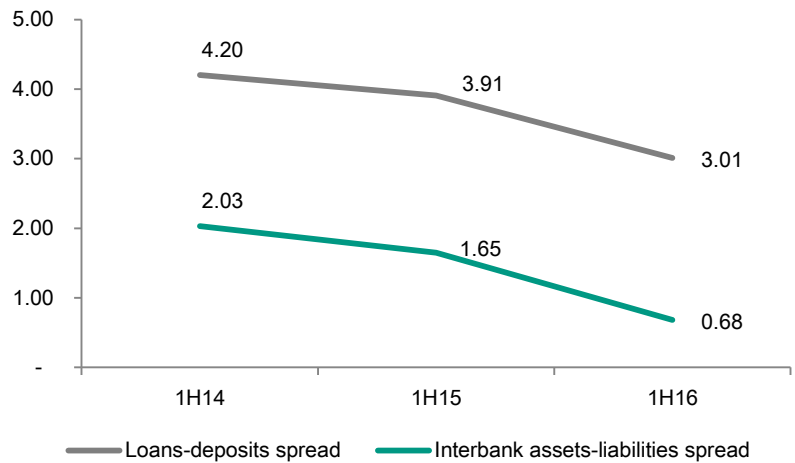
Source(s): Company reports, ABCI Securities

Exhibit 2: ABC's asset yields (%)


Source(s): Company, ABCI Securities

Exhibit 3: ABC's liability costs (%)


Source(s): Company, ABCI Securities

Exhibit 4: Spread analysis (%)


Source(s): Company, ABCI Securities

Exhibit 5: ABC forward P/B band chart (%)


Source(s): Bloomberg, ABCI Securities estimates



Consolidated income statement (2014A-2018E)

FY Ended Dec 31 (RMB mn)	2014A	2015A	2016E	2017E	2018E
Net interest income	429,891	436,140	459,230	491,016	521,327
Non-interest income	94,235	104,722	111,695	119,236	126,674
Of which: Fees and commissions	80,123	82,549	86,953	91,352	95,289
Oper. income (Top line)	524,126	540,862	570,926	610,252	648,001
Operating expenses	(204,570)	(206,200)	(220,779)	(236,409)	(252,091)
Amortization	(19,328)	(19,633)	(20,615)	(21,645)	(22,511)
PPOP	300,228	315,029	329,532	352,197	373,398
Impairment loans losses	(67,971)	(84,172)	(94,332)	(107,912)	(119,831)
Profit before tax	232,257	230,857	235,200	244,286	253,567
Tax	(52,747)	(50,083)	(54,096)	(56,186)	(58,320)
Minority interests	(49)	(192)	(240)	(300)	(375)
Net profit	179,461	180,582	180,864	187,800	194,872
Less: preference share dividend	-	(2,400)	(4,600)	(4,600)	(4,600)
Net profit attributable to ordinary shareholders	179,461	178,182	176,264	183,200	190,272
Growth (%)					
Net interest income	14.3	1.5	5.3	6.9	6.2
Non-interest income	5.2	11.1	6.7	6.8	6.2
Of which: Fees and commissions	(3.7)	3.0	5.3	5.1	4.3
Oper. income (Top line)	12.5	3.2	5.6	6.9	6.2
Operating expenses	12.9	0.8	7.1	7.1	6.6
Amortization	10.7	1.6	5.0	5.0	4.0
PPOP	12.4	4.9	4.6	6.9	6.0
Impairment loans losses	28.3	23.8	12.1	14.4	11.0
Profit before tax	8.4	(0.6)	1.9	3.9	3.8
Tax	10.0	(5.1)	8.0	3.9	3.8
Minority interests	(147.1)	291.8	25.0	25.0	25.0
Net profit	7.9	0.6	0.2	3.8	3.8
Per share (RMB)					
EPS	0.55	0.56	0.56	0.58	0.60
BVPS	3.05	3.48	3.85	4.23	4.62
DPS	0.18	0.17	0.17	0.18	0.19
Key ratio (%)					
Net interest margin	2.92	2.66	2.48	2.39	2.28
Net interest spread	2.76	2.49	2.27	2.16	2.08
Cost to income ratio	39.03	38.12	38.67	38.74	38.90
Return on average assets	1.18	1.07	0.96	0.90	0.84
Return on average equity	19.15	16.12	14.20	13.38	12.67
Effective tax rate	22.71	21.69	23.00	23.00	23.00
Dividend payout	32.94	30.00	31.00	31.00	31.00

Source(s): Company, ABCI Securities estimates



Consolidated balance sheet (2014A-2018E)

As of Dec 31 (RMB mn)	2014A	2015A	2016E	2017E	2018E
Cash & cash equivalent	2,743,065	2,587,057	2,663,848	2,764,860	2,891,441
Dues from banks & non-bank FI	1,489,285	1,673,984	1,906,987	2,163,561	2,436,078
Investment securities	3,575,630	4,512,047	5,415,435	6,403,357	7,480,990
Net loans and advances	7,739,996	8,506,675	9,320,267	10,107,523	10,965,136
Total IEA	15,547,976	17,279,763	19,306,537	21,439,300	23,773,645
Property and equipment	154,950	156,178	159,302	162,488	165,737
Other non-int. earn assets	271,226	355,452	414,310	481,042	555,941
Total assets	15,974,152	17,791,393	19,880,149	22,082,830	24,495,323
Customer deposits	12,533,597	13,538,360	14,677,451	15,809,834	16,926,586
Due to other banks & FIs	1,136,185	1,598,259	1,997,824	2,437,345	2,924,814
Subordinated term debt	325,167	382,742	451,636	523,897	602,482
Total IBL	13,994,949	15,519,361	17,126,910	18,771,076	20,453,882
Current taxes	41,338	38,097	35,049	32,596	30,640
Deferred tax liabilities	43	111	139	173	217
Other liabilities	905,203	1,021,939	1,378,433	1,806,740	2,400,767
Total liabilities	14,941,533	16,579,508	18,540,531	20,610,586	22,885,506
Ordinary share capital	364,738	404,693	404,693	404,693	404,693
Preference share capital	39,994	79,899	79,899	79,899	79,899
Reserves	626,334	725,499	852,962	985,279	1,122,497
Minorities	1,553	1,794	2,063	2,373	2,728
Shareholder's equity	1,032,619	1,211,885	1,339,617	1,472,244	1,609,817
Growth (%)					
Cash & cash equivalent	5.3	(5.7)	3.0	3.8	4.6
Dues from banks & non-bank FI	3.2	12.4	13.9	13.5	12.6
Investment securities	11.0	26.2	20.0	18.2	16.8
Net loans and advances	12.1	9.9	9.6	8.4	8.5
Total IEA	9.7	11.1	11.7	11.0	10.9
Total assets	9.7	11.4	11.7	11.1	10.9
Customer deposits	6.1	8.0	8.4	7.7	7.1
Due to other banks & FIs	25.7	40.7	25.0	22.0	20.0
Subordinated term debt	22.1	17.7	18.0	16.0	15.0
Total IBL	7.8	10.9	10.4	9.6	9.0
Total liabilities	8.9	11.0	11.8	11.2	11.0
Shareholder's equity	22.3	17.4	10.5	9.9	9.3
Key ratio (%)					
Loan to deposits	64.03	65.04	65.60	66.01	66.86
CT1 CAR	9.09	10.24	10.92	10.98	10.83
Total CAR	12.82	13.40	14.07	14.15	13.97
NPL ratio	1.53	2.39	2.60	2.80	2.90
NPL growth	42.82	71.50	19.20	16.94	12.51
Net bad debt charge ratio	0.85	0.96	0.98	1.04	1.06
Provision to total loans	4.50	4.40	4.50	4.62	4.75
Provision coverage	288.48	189.43	173.08	165.00	163.79

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

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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