

Agricultural Bank of China (1288 HK)

Strong 1H17 results with notable improvement in fundamentals; maintain BUY

- ABC's 1H17 net profit grew 3.35% YoY, faster than the 1.86% YoY increase in 2016. NII rose 6.22% YoY despite hiccups in a few fee income sources
- NIM has been on the rise since 4Q16 and will turn more positive in 2H17, supported by decisive balance sheet management and improving spread outlook
- ABC's asset quality will continue to improve with NPL ratio retreating to a level similar to that of its big bank peers
- The counter is currently trading at 0.77x17E P/B. Reiterate **BUY** on improving earnings momentum and robust risk buffer

Earnings capacity is resuming. Agricultural Bank of China (ABC)'s 1H17 net profit was reported at RMB 108,670mn, up 3.35% YoY, equivalent to 56.6% of our full-year forecast. Such earnings growth was higher than that in 2016 when net profit was up 1.86% YoY. Operating income grew 6.41% YoY in 1H17, of which NII rose 6.22% YoY. NIM has been on the rise from 2.19% in 4Q16 to 2.25% in 2Q17 - we expect decent loan growth (1H17: +7.27% HoH) and decisive balance sheet management will lead to a better NIM in 2H17. Meanwhile, net fee income was down 16.91% YoY – more specifically, agency commissions fell 27.8% YoY under a tighter regulatory environment; in contrast, bank card fees grew steadily by 10.9% YoY in 1H17. Monetization of ABC's online banking platform continues, with E-banking fee income surging by 22.7% YoY in 1H17.

NIM to turn more positive in 2H17. NIM pressure has been easing in 1H17. ABC's NIM narrowed by only 7bps YoY in 1H17 (2016: -41bps YoY) to 2.24%; on a quarterly basis, NIM was up by 2bps in 1Q17 and 4bps in 2Q17. In line with the improvement in the system average loan yield in 1H17, decline in the Bank's average loan yield narrowed by 31bps YoY (2016: -114bps YoY). Hence, loan-deposit spread contracted only by 14bps YoY in 1H17 (2016: -80bps YoY) to 287bps. In addition, the Bank's interbank asset-liability spread widened from 55bps in 2016 to 68bps in 1H17. Balance sheet mix was optimized further in 1H17 with reduced exposure in interbank market and increased asset allocation to investments.

Dedication to asset quality management. ABC's dedication to asset quality management has been evident. As of June 2017, ABC's NPL ratio was 2.19%, down 18bps HoH. Meanwhile, special mention loan ratio fell 29bps HoH in 1H17 to 3.62% and overdue loan ratio was down 20bps HoH to 2.6% in June 2017. We believe, with the increasing use of securitization tools, the establishment of the asset management company, and consistent cautious attitude in risk management, ABC's NPL ratio is retreating to a level similar to that of its big bank peers. Also notable are the provisioning ratio and provision coverage ratio reported at 3.99% and 181.8%. The Bank's risk buffer remained the strongest among the big banks – a major attribute that renders it one of our recommended picks.

Results and Valuation

FY ended Dec 31	2015A	2016A	2017E	2018E	2019E
Revenue (RMB mn)	540,862	510,128	564,905	606,713	657,298
Chg (% YoY)	3.2	(5.7)	10.7	7.4	8.3
Net profit (RMB mn)*	175,982	179,341	187,557	195,496	213,030
Chg (% YoY)	(0.6)	1.9	4.6	4.2	9.0
EPS (RMB)	0.55	0.55	0.58	0.60	0.66
Chg (% YoY)	1.2	0.1	4.6	4.2	9.0
BVPS (RMB)	3.48	3.81	4.21	4.63	5.10
Chg (% YoY)	14.1	9.6	10.6	10.0	10.0
P/E (x)	5.90	5.90	5.64	5.41	4.97
P/B (x)	0.94	0.85	0.77	0.70	0.64
ROAE (%)	16.12	14.55	13.89	13.19	13.10
ROAA (%)	1.07	0.98	0.93	0.88	0.87
DPS (RMB)	0.17	0.17	0.18	0.18	0.19
Yield (%)	5.12	5.22	5.45	5.68	5.97

Source(s): Bloomberg, ABCI Securities estimates

* Refers to net profit attributable to ordinary shareholders

Company Report

Sep 1, 2017

Rating: BUY

TP:HK\$4.80

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Share price (HK\$)	3.68
Est. share price return	30.43%
Est. dividend yield	5.45%
Est. total return	35.88%
Previous Rating & TP	BUY;HK\$4.80
Previous Report Date	Aug 2, 2017

Source(s): Bloomberg, ABCI Securities

Key Data

52Wk H/L(HK\$)	3.80/3.10
Issued shares (mn)	324,794
H-share(mn)	30,739
A-shares (mn)	294,055
Market cap (HK\$ mn)	1,427,997.6
H-share(mn)	113,118.9
A-shares (mn)	1,314,878.7
3-mth avg daily turnover(HK\$ mn)	499.65
Major shareholder(s) (%):	
Huijin	40.03

Source(s): Company, ABCI Securities

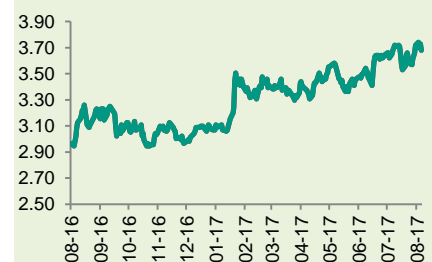
Share Performance (%)

	Absolute	Relative*
1-mth	-	(1.54)
3-mth	3.87	(3.73)
6-mth	10.05	(6.64)

*Relative to HSI

Source(s): Bloomberg, ABCI Securities

1-Year share performance(HK\$)



Source(s): Bloomberg, ABCI Securities



Capital position supported by organic growth. Supported by organic growth, ABC's CT1 increased by 20bps HoH to 10.58% and CAR was up by 12bps HoH to 13.16% in June 2017. We believe capital pressure will not be significant in the near future. According to the Bank, tier-2 instruments totaling RMB 80bn would be issued over 2017-18. So far, no concrete equity issuance plan has been disclosed.

Improving earnings momentum with a strong risk buffer; reiterate BUY. The counter is currently trading at 0.77x17E P/B. We believe ABC's earning momentum will further improve in 2H17 on better NIM and fee income growth. Risk buffer would stay strong with a stabilizing provision expenses supportive to a sustainable earnings growth. Reiterate **BUY**.

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

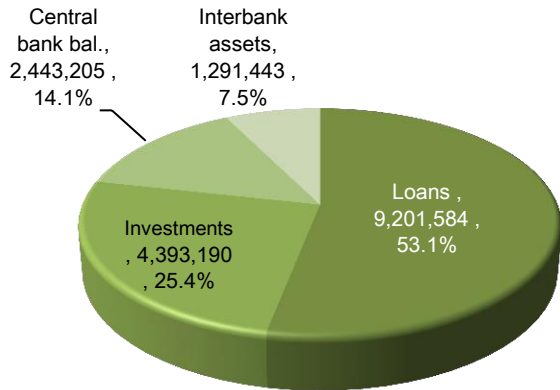
Exhibit 1: ABC 1H17 results summary

(RMB mn)	1H16	1H17	YoY (%)
Income statement			
Net interest income	198,957	211,323	6.22
Net fee income	51,108	42,465	(16.91)
Operating income	262,504	279,319	6.41
Operating expenses	(94,309)	(101,414)	7.53
Impairment	(36,735)	(44,697)	21.67
Profit before tax	131,457	133,210	1.33
Net profits attributable to shareholders of the Company	105,148	108,670	3.35
EPS (Rmb)	0.32	0.33	3.13
Balance sheet			
	2016	1H17	HoH (%)
Total assets	19,570,061	20,573,586	5.13
Total loans (net)	9,319,364	9,996,639	7.27
Total deposits	15,038,001	16,104,949	7.10
Shareholders' equity	1,318,193	1,355,200	2.81
BVPS (Rmb)	3.81	3.93	3.15
Key indicators (%)			
	1H16	1H17	YoY (ppt)
NIM	2.31	2.24	(0.07)
Net fee to topline revenue	19.47	15.20	(4.27)
CIR	30.03	28.31	(1.72)
ROAA	1.15	1.08	(0.07)
ROAE	17.63	16.47	(1.16)
Key indicators (ppt)			
	2016	1H17	HoH (ppt)
Core T1 CAR	10.38	10.58	0.20
Total CAR	13.04	13.16	0.12
NPL ratio	2.37	2.19	(0.18)
Provisioning ratio	4.12	3.99	(0.13)
Provision coverage ratio	173.40	181.80	8.40

Source(s): Company, ABCI Securities

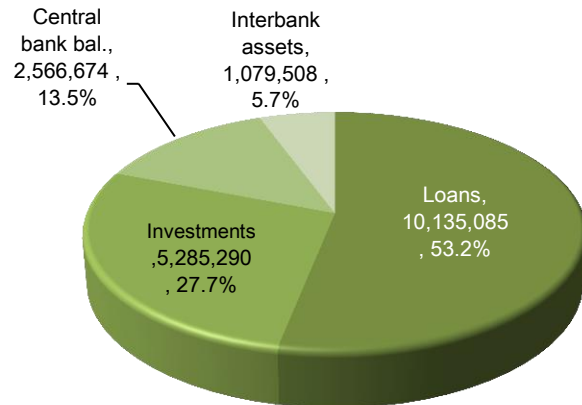


Exhibit 2: ABC's AIEA mix (1H16)



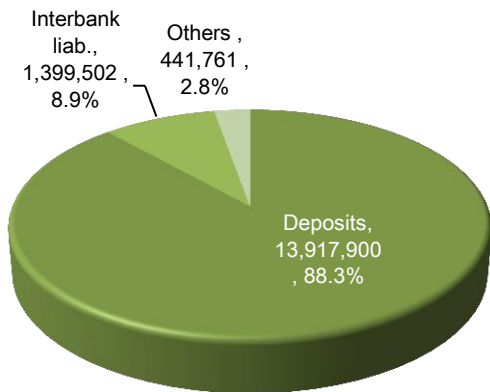
Source(s): Company, ABCI Securities

Exhibit 3: ABC's AIEA mix (1H17)



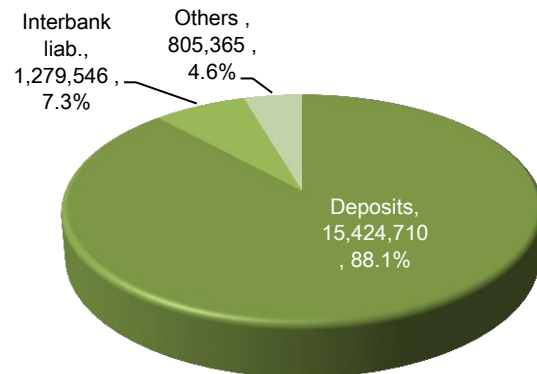
Source(s): Company, ABCI Securities

Exhibit 4: ABC's AIBL mix (1H16)



Source(s): Company, ABCI Securities

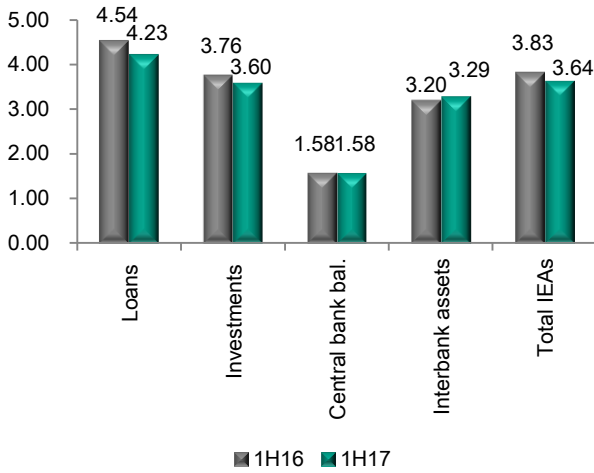
Exhibit 5: ABC's AIBL mix (1H17)



Source(s): Company, ABCI Securities

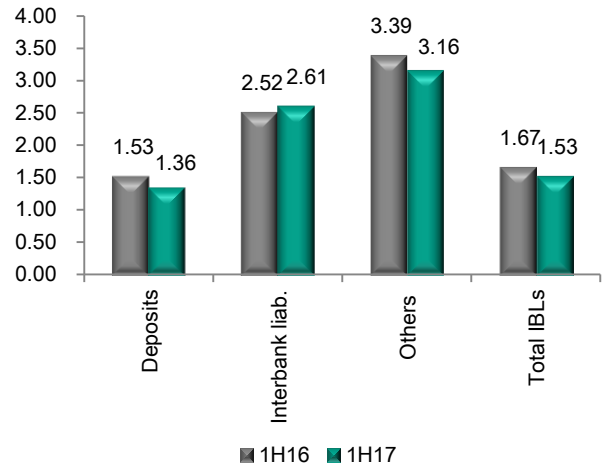


Exhibit 6: ABC's asset yield (%)



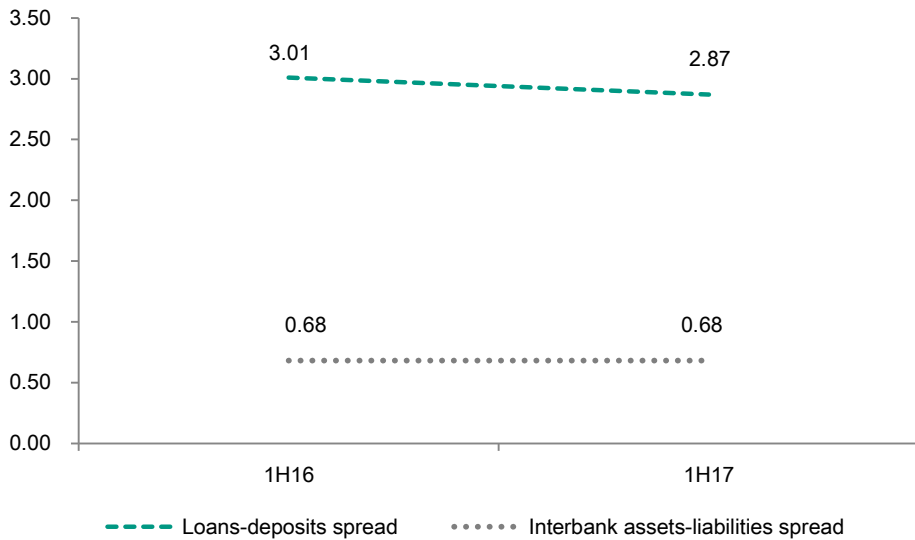
Source(s): Company, ABCI Securities

Exhibit 7: ABC's funding cost (%)



Source(s): Company, ABCI Securities

Exhibit 8: ABC's spread analysis (ppt)



Source(s): Company, ABCI Securities



Consolidated income statement (2015A-2019E)

FY Ended Dec 31 (RMB mn)	2015A	2016A	2017E	2018E	2019E
Net interest income	436,140	398,104	440,762	472,117	513,465
Non-interest income	104,722	112,024	124,143	134,595	143,832
Of which: Fees and commissions	82,549	90,935	99,347	107,038	114,292
Operating income	540,862	510,128	564,905	606,713	657,298
Operating expenses	(206,200)	(178,021)	(195,050)	(212,487)	(230,697)
Amortization	(19,633)	(19,037)	(20,560)	(22,205)	(23,981)
Pre-provision operating profit	315,029	313,070	349,295	372,021	402,619
Impairment loans losses	(84,172)	(86,446)	(105,870)	(118,499)	(126,843)
Profit before tax	230,857	226,624	243,425	253,521	275,776
Tax	(50,083)	(42,564)	(51,119)	(53,239)	(57,913)
Minority interests	(192)	(119)	(149)	(186)	(232)
Net profit attributable to equity holders	180,582	183,941	192,157	200,096	217,630
Preference share dividend	4,600	4,600	4,600	4,600	4,600
Net profit attributable to ordinary shareholders	175,982	179,341	187,557	195,496	213,030
Growth (%)					
Net interest income	1.5	(8.7)	10.7	7.1	8.8
Non-interest income	11.1	7.0	10.8	8.4	6.9
Of which: Fees and commissions	3.0	10.2	9.3	7.7	6.8
Operating income	3.2	(5.7)	10.7	7.4	8.3
Operating expenses	0.8	(13.7)	9.6	8.9	8.6
Amortization	1.6	(3.0)	8.0	8.0	8.0
Pre-provision operating profit	4.9	(0.6)	11.6	6.5	8.2
Impairment loans losses	23.8	2.7	22.5	11.9	7.0
Profit before tax	(0.6)	(1.8)	7.4	4.1	8.8
Tax	(5.1)	(15.0)	20.1	4.1	8.8
Minority interests	291.8	(38.0)	25.0	25.0	25.0
Net profit attributable to equity holders	0.6	1.9	4.5	4.1	8.8
Preference share dividend	91.7	0.0	0.0	0.0	0.0
Net profit attributable to ordinary shareholders	(0.6)	1.9	4.6	4.2	9.0
Per share (RMB)					
EPS	0.55	0.55	0.58	0.60	0.66
BVPS	3.48	3.81	4.21	4.63	5.10
DPS	0.17	0.17	0.18	0.18	0.19
Key ratio (%)					
Net interest margin	2.66	2.25	2.19	2.15	2.12
Net interest spread	2.49	2.11	2.01	2.02	2.02
Cost to income ratio	38.12	34.90	34.53	35.02	35.10
Return on average assets	1.07	0.98	0.93	0.88	0.87
Return on average equity	16.12	14.55	13.89	13.19	13.10
Effective tax rate	21.69	18.78	21.00	21.00	21.00
Dividend payout	30.23	31.00	30.00	30.00	29.00

Source(s): Company, ABCI Securities estimates



Consolidated balance sheet (2015A-2019E)

As of Dec 31 (RMB mn)	2015A	2016A	2017E	2018E	2019E
Cash & equivalent	2,587,057	2,811,653	3,038,588	3,266,325	3,489,254
Interbank assets	1,673,984	1,526,665	1,499,801	1,513,009	1,543,132
Investment securities	4,512,047	5,333,535	6,292,229	7,349,260	8,504,534
Net loans and advances	8,506,675	9,319,364	10,125,173	10,988,132	11,906,871
Total interest earning assets	17,279,763	18,991,217	20,955,792	23,116,727	25,443,792
Property and equipment	156,178	158,669	161,842	165,079	168,381
Other non-interest earning assets	355,452	420,175	489,236	567,767	656,117
Total assets	17,791,393	19,570,061	21,606,871	23,849,572	26,268,290
Customer deposits	13,538,360	15,038,001	16,725,339	18,538,928	20,463,242
Interbank liabilities	1,598,259	1,749,117	1,906,538	2,059,061	2,223,785
Subordinated debt	382,742	388,215	407,626	428,007	449,407
Total interest bearing liabilities	15,519,361	17,175,333	19,039,502	21,025,995	23,136,435
Current taxes	38,097	16,356	15,048	13,994	13,155
Deferred tax liabilities	111	58	73	90	111
Other liabilities	1,021,939	1,056,723	1,099,457	1,219,751	1,377,224
Total liabilities	16,579,508	18,248,470	20,154,080	22,259,831	24,526,924
Share capital	404,693	404,693	404,693	404,693	404,693
Reserves	805,398	913,500	1,044,190	1,180,555	1,331,505
Minorities	1,794	3,398	3,908	4,494	5,168
Shareholder's equity	1,211,885	1,321,591	1,452,791	1,589,742	1,741,365
Growth (%)					
Cash & equivalent	(5.7)	8.7	8.1	7.5	6.8
Interbank assets	12.4	(8.8)	(1.8)	0.9	2.0
Investment securities	26.2	18.2	18.0	16.8	15.7
Net loans and advances	9.9	9.6	8.6	8.5	8.4
Total interest earning assets	11.1	9.9	10.3	10.3	10.1
Total assets	11.4	10.0	10.4	10.4	10.1
Customer deposits	8.0	11.1	11.2	10.8	10.4
Interbank liabilities	40.7	9.4	9.0	8.0	8.0
Subordinated debt	17.7	1.4	5.0	5.0	5.0
Total interest bearing liabilities	10.9	10.7	10.9	10.4	10.0
Total liabilities	11.0	10.1	10.4	10.4	10.2
Shareholder's equity	17.4	8.9	9.9	9.4	9.5
Key ratio (%)					
Loan to deposits	65.04	63.89	62.55	61.35	60.30
CT1 CAR	10.24	10.38	10.69	10.68	10.62
Total CAR	13.40	13.04	13.30	13.30	13.24
NPL ratio	2.39	2.37	2.00	1.95	1.90
NPL growth	71.50	8.44	10.00	10.96	10.69
Net bad debt charge ratio	0.96	0.85	1.02	1.05	1.03
Provision to total loans	4.40	4.50	3.95	3.80	3.70
Provision coverage ratio	189.43	173.40	197.50	194.87	194.74

Source(s): Company, ABCI Securities estimates



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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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