China Bohai Bank Co., Ltd. (9668 HK)
Outperform on fast growth

- China Bohai Bank (BHB) is the youngest joint-stock bank (JSB) in China; its relatively low market share implies enormous growth potential
- Impressive earnings growth was seen in 1H20
- Robust balance sheet growth and structure optimization would counter against interest rate down cycle and provide NIM upside
- Large provision will limit earnings growth despite benign asset quality outlook
- Initiate with **BUY**; TP at HK$ 5.69 implies 18.79% upside

Company Report
Initiation
Rating: BUY
TP: HK$ 5.69

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Impressive 1H20 earnings growth. BHB, the youngest JSB in China with a relatively low market share among JSBs in China, has enormous growth potential. In 1H20, net profit grew 2.52% YoY in 1H20 - the only JSB in the A/H markets recording a positive growth. In our view, its substantial yet sustainable balance sheet growth will support its earnings. We estimate total assets and total liabilities would expand at 18.7% and 19.0% CAGRs over 2019-22E; as a result, net profit would grow at 11.0% CAGR over the same period.

Improving business mix diversifies risk. Corporate banking has been the core business driver of BHB, but it has sought to balance its business mix in recent years to diversify risk. Contribution from retail segment in operating income rose from 8.1% in 2017 to 24.4% in 1H20. While BHB's outlets are mostly in northern and northeastern China; its dedication to developing e-channels would expand its geographical reach nationwide.

NIM upside on robust balance sheet growth. Robust balance sheet growth and structure optimization could help counter against impacts of the interest rate down cycle. We forecast BHB's NIM to expand by 5bps-27bps YoY each in 2020E-22E to 2.58% by 2022E; NII would grow at 26.3% CAGR over 2019-22E. ROAA and ROAE would be in the range of 0.64%-0.71% and 9.1%-9.52% in 2020E-22E.

Resilient asset quality outlook. We expect NPL to inch up by 6bp-7bps YoY each in 2020E-22E to reach 1.97% by end-2022E; provisioning ratio and provision coverage ratio would be 3.7% and 187.82% by end-2022E. Large provisions would limit earnings growth.

Initiate with BUY. Our Gordon Growth Model derives a TP at HK$ 5.69, implying 21E P/B and P/E at 1.04x and 8.83x. BHB deserves a valuation premium over other listed JSBs given its enormous growth potential and positive earnings outlook. We initiate the counter with **BUY**; nonetheless investors should be aware of its low ADT and possible capital needs resulting from rapid growth.

Results and Valuation

FY ended Dec 31	2018A	2019A	2020E	2021E	2022E
Revenue (RMB mn)	23,210	28,378	35,896	42,574	49,860
Chg (%,YoY)	(8.1)	22.3	26.5	18.6	17.1
Net profit* (RMB mn)	7,080	8,193	8,830	9,891	11,201
Chg (%,YoY)	4.8	15.7	7.8	12.0	13.2
EPS (RMB)	0.49	0.57	0.56	0.57	0.65
Chg (%,YoY)	0.0	16.3	(1.8)	1.9	13.2
BVPS (RMB)	3.87	4.34	4.79	5.45	6.19
Chg (%,YoY)	15.3	12.2	10.4	13.8	13.5
P/E (x)	8.65	7.44	7.57	7.43	6.56
P/B (x)	1.10	0.98	0.89	0.78	0.68
ROAE (%)	13.59	13.71	9.52	9.10	9.27
ROAA (%)	0.70	0.76	0.71	0.67	0.64
DPS(RMB)	0.14	0.15	0.13	0.14	0.16
Yield (%)	3.36	3.47	3.01	3.37	3.81

Note: Company; HKD/CNY=1.13
*Net profit =Net profit attributable to shareholders of the Company
Source(s): Bloomberg, ABCI Securities estimates

Price	HK$ 4.79
Est. sh price return	18.79%
Est. dividend yield	3.37%
Est. total return	22.16%
Last Rating &TP	na
Previous Report Date	na

Source(s): Bloomberg, ABCI Securities estimates

Key Data

52Wk H/L (HK$)	4.85/4.45
Total issued shares (mn)	17,762.0
H shr (mn)	6,200.6
Domestic shr (mn)	11,561.4
Market cap (HK$ mn)	85,257.7
H shr (mn)	29,762.7
Domestic shr (mn)	55,495.0
Avg daily turnover since IPO (HK$ mn)	33.73

Major shareholder(s) (%):

TEDA Investment	20.34
Standard Chartered Bank	16.26

Source(s): Company, Bloomberg, ABCI Securities

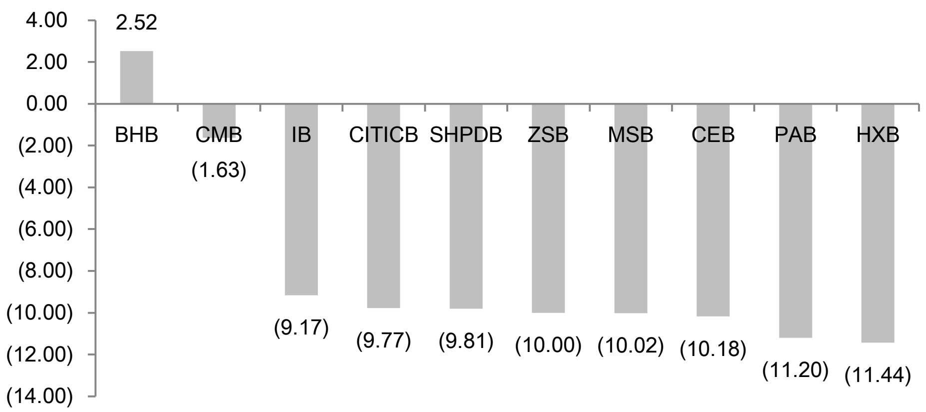
Earnings sustained by balance sheet growth

A snapshot of the China Bohai Bank (BHB)

Established in 2005, BHB is the youngest nationwide joint-stock commercial bank (JSB) in China. The Bank positions itself to be a modern wealth and treasury manager offering the best customer experience. Since establishment, BHB is dedicated to extending its domestic and international footprint through extensive network and FinTech. Its net profit grew by 15.7% YoY in 2019. As of Dec 31, 2019, total assets rose by 30.5% from Jan 1, 2017.

BHB published its 1H20 financial results not long after its IPO in Hong Kong on July 16, 2020. Despite the impacts of COVID-19 and decelerating economic growth in China, net profit went up by 2.52% YoY, rendering it as the only listed JSB in A/H markets recording a positive earnings growth in 1H20. We believe the impressive result was attributable to the robust balance sheet growth marked by 13.49%/14.1% HoH increases in total assets/total liabilities in 1H20.

Exhibit 1: 1H20 net profit YoY of listed JSBs in A/H markets



Source(s): Companies, ABCI Securities

Improving outlet efficiency and strengthening e-channels

Geographically, BHB's business franchises are mainly located in northern and northeastern China, which accounted for 45.3% of its total number of outlets. The remaining outlets were located in eastern China (25.3%), central and southern China (23.3%), and western China (6.1%) as of Dec 31, 2019.

To enhance efficiency of its outlet network, BHB has further trimmed down the number from 245 in 2019 to 240 by end-June 2020. The Bank has been widening its customer reach through expanding its electronic channels in recent years. Specifically, online banking customers increased from 2.08mn in 2017 to 2.61mn in 2019; mobile banking customers grew from 1.73mn in 2017 to 2.3mn in 2019.

Exhibit 2: Number of outlets by geographic area

	2017	2018	2019
Northern and Northeastern	117	115	111
Eastern	64	59	62
Central and Southern	60	57	57
Western	18	18	15
Total	**259**	**249**	**245**

Source(s): Company, ABCI Securities

Competition landscape

There were 12 nationwide JSBs in China, which jointly accounted for 18.1% and 18.2% of total assets and total liabilities of various types of banking financial institutions in China as of July 2020, according to the CBIRC statistics. Compared to the large commercial banks, which accounted for 39.4% and 39.5% market share in total assets and total liabilities by end-July 2020, JSBs have more flexibility in adapting to changes in operating environment and customer needs. Given its short operating history, BHB has the second lowest market share among the 12 JSBs in terms of total assets, total deposits, total loans, and total net profit in 2019.

Exhibit 3: JSB market share (%, 2019)

	Total assets	Total deposits	Total loans	Shareholders' equity	Net profit
CMB	13.9	15.7	14.9	14.5	21.0
IB	13.4	12.2	11.5	12.9	15.0
SHPDB	13.2	11.8	13.2	13.1	13.3
CITICB	12.7	13.1	13.3	12.5	11.0
MSB	12.5	11.7	11.6	12.4	12.3
CEB	8.9	9.7	9.0	9.0	8.4
PAB	7.4	7.9	7.7	7.3	6.3
HXB	5.7	5.4	6.2	6.3	5.0
GFB	4.9	5.1	5.2	4.9	2.8
ZSB	3.4	3.7	3.4	3.0	2.9
BHB	2.1	2.1	2.4	1.9	1.8
HFB	1.9	1.8	1.5	2.0	0.1
Total	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**

Source(s): Companies, ABCI Securities

A diversified ownership structure

Unlike other nationwide JSBs, BHB has a mixed shareholder structure which comprises foreign, state-owned, and domestic shareholders. As of June 30, 2020, major shareholders of the Bank included TEDA Holding (20.34%), Standard Chartered Bank (SCB, 16.26%), China Shipping Investment (11.12%), SDIC (9.49%), China Baowu Steel Group (9.49%), Oceanwide Industry (7.72%), Tianjin Shanghui Investment (6.51%). Stated-owned stake amounted to 50.44% (Teda, China Shipping, SDIC, and China Baowu Steel Group), while SCB is the only foreign shareholder of the Bank.

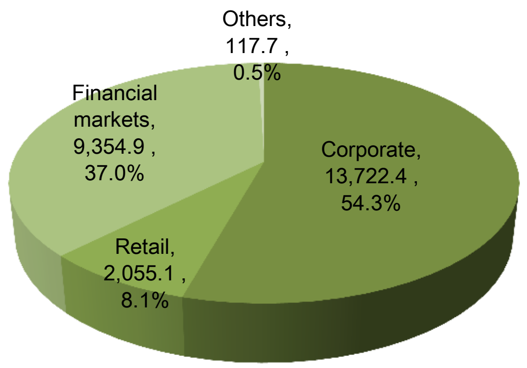
To internationalize, we expect BHB to increase its cooperation and synergy with SCB in global business. Aiming to develop a cross-border financial services ecosystem, BHB would further develop its Hong Kong branch as the hub of its international business; meanwhile, its branches in the Shanghai Free Trade Zone would become its frontier outlets for international business.

Well-balanced business mix to diversify risk

Similar to most commercial banks in China, BHB has relied heavily on the corporate banking segment as a core business driver in the past; in 2017, the segment took up 54.3% of total operating income. Contribution form the corporate banking, however, gradually fell to 45.0% of total operating income in 1H20. In contrast, retail banking segment caught up to account for 24.4% of total operating income in 1H20, as compared to 8.1% in 2017.

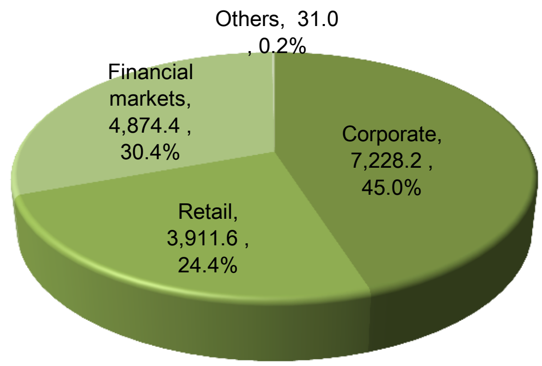
The change in business mix was driven by the development of FinTech that creates an ecosystem in three major sectors: travel and tourism, real estate and lifestyle, and modern logistics. BHB's strategic change has resulted in a more balanced business mix, allowing the Bank to diversify operating risk and adapt more flexibly to changes in the macro environment or a specific business line.

Exhibit 4: BHB's operating income mix (RMB mn, 2017)



Source(s): Company, ABCI Securities

Exhibit 5: BHB's operating income mix (RMB mn, 1H20)



Source(s): Company, ABCI Securities

In BHB's loan portfolio, medium to large enterprises was the largest component accounting for 72.1% of total corporate loans as of Dec 31, 2019, compared to 67.9% in 2017. Following the new policy goals of increasing support to MSEs and the real economy, the proportion of corporate loans made to the smaller enterprises will increase. We believe investment in FinTech would help the Bank increase access to MSEs; moreover, the growing proportion of higher-yield MSE loans may help alleviate NIM pressure.

By sector, lease & business services, real estate from corporate segment, residential mortgage, and personal consumption loans from retail segment were the major loan components contributing to 19.2%, 14.9%, 17.6%, and 13.0% of total loans as of June 2020. Decent growth was seen in personal consumption loans, whose contributions rose from 1.9% of total loans in 2017 to 13.0% in June 2020. In contrast, the proportions of loans allocated in residential mortgage, manufacturing sector, and environmental sector have all declined since 2017.

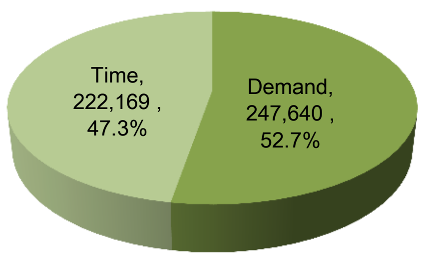
Retail business boosted by FinTech

As of Dec 31, 2019, BHB had ~4.46mn retail banking customers, (2017: 3.72mn). BHB has identified two major groups of retail customers: (1) the "pressurized generation" with strong demand for financial products and services; (2) the "grey-haired group" needing wealth management services for their accumulated wealth. With the aid of rapid usage in FinTech, BHB's retail loan portfolio showed significant changes. The proportion of personal loans in total loans increased steadily from 25.6% in 2017 to 32.5% in June 2020. Growth in personal consumption loan was the most apparent, contributing to 7.4% of total personal loans in 2017 vs. 39.9% in June 2020. BHB can capture the opportunities engendered by the rising internet consumer finance industry. Meanwhile, exponential growth in retail deposits at 63.5% HoH was recorded in 1H20. We forecast retail deposits would drive BHB's deposit balance to grow at 21.6% CAGR in 2019-22E.

Competition induces deposit migration

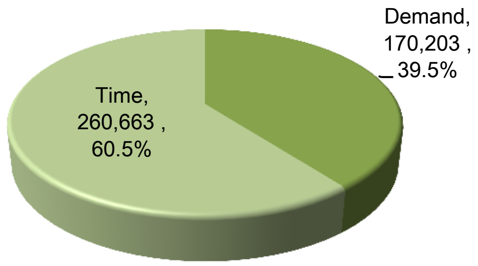
Driven by intensifying deposit competition among commercial banks, we believe deposit migration has started since 2018. BHB's time deposits in total corporate deposits increased from 47.3% in 2017 to 60.5% in June 2020. Similarly, time deposits were the major component in BHB's retail deposits that accounted for 71.1% of total retail deposits in June-20 (2017: 54.5%).

Exhibit 6: BHB's corporate deposit mix (RMBmn, 2017)



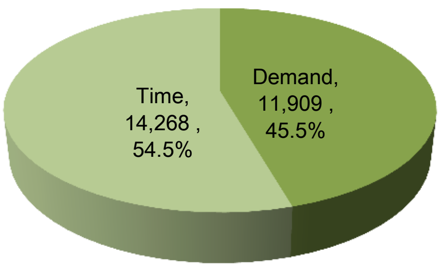
Source(s): Company, ABCI Securities

Exhibit 7: BHB's corporate deposit mix (RMBmn, June 2020)



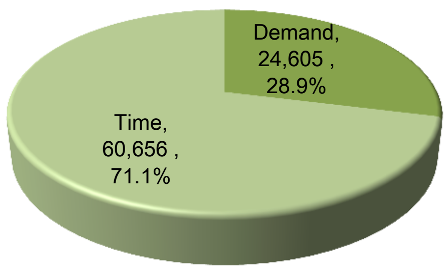
Source(s): Company, ABCI Securities

Exhibit 8: BHB's retail deposit mix (RMBmn, 2017)



Source(s): Company, ABCI Securities

Exhibit 9: BHB's retail deposit mix (RMBmn, June 2020)



Source(s): Company, ABCI Securities

Continuous increase in the proportion of time deposits elevated BHB's average deposit cost from 2.66% in June 2019 to 2.71% in June 2020 despite the downtrend in market interest rate. Riding on BHB's rapid deposit growth, we project the bank's average deposit cost would also increase from 2.72% in 2020E to 2.85% by 2022E.

Improving revenue quality of financial market business

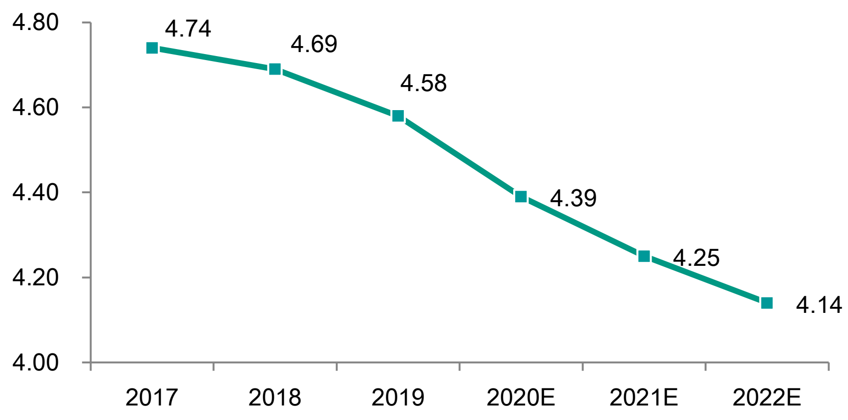
Financial market business mainly consists of interbank market transactions, investment management, wealth management, and bill discounting and rediscounting. Operating income contribution from this segment has been stable in recent years, ranging from 33%-36.5% in 2017-June 2020. Revenue quality of the segment has been improving, as shown by the reduced asset allocation size in related balances.

BHB's exposure in interbank market reduced from a net borrower position of RMB 170,736mn in 2017 to RMB 84,644mn; meanwhile, net financial investment balance fell from RMB 412,649mn in 2017 to RMB 329,822mn by June 2020.

Reasonable investment risk

Debt securities aggregated to 55.9% of BHB's total financial investment balance as of Dec 2019. The risk exposure of these investments are relatively low, given the PRC government and policy banks were counterparties for 94.4% of the amount. SPV investments added up to 43.4% of BHB's investment portfolio as of Dec 2019, among which 47.3% were trust plans (TPs) and 33.2% were asset management plans (AMPs).

Exhibit 10: BHB's average investment yield (%)



Source(s): Company, ABCI Securities estimates

The Bank assessed these SPV investments regularly for potential impairments. By sector, as of Dec 2019, 44.3% of BHB's TPs and SMPs were related to the real estate sector, followed by 21.2% and 20.4% in finance and lease & business services sectors. As of Dec 31, 2019, 6.9%, 33.8% and 13.1% of BHB's TPs and AMPs were secured by pledge, collateral, and guarantee.

We analyze the risk level of its investment portfolio according to the risk-and-return principle that assumes a higher risk is compensated by a higher yield, and vice versa. BHB has scaled down the size of financial investment over 2017-19 to reduce risk; hence, average investment yield fell from 4.74% in 2017 to 4.58% in 2019 and 4.35% in 1H20.

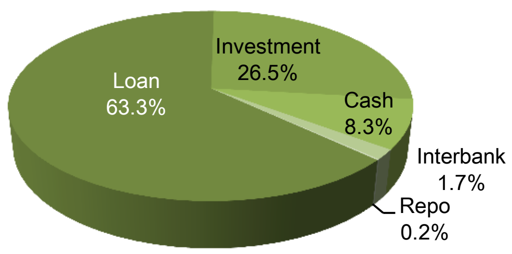
We forecast the Bank's investment balance to grow slightly slower than total assets at 15.3% CAGR over 2019-22E. As a result of the shrunken risk appetite and the falling asset yield under the rate cut cycle, we expect BHB's average investment yield to drop by 11bps-19bps YoY each in 2020E-22E to arrive at 4.14% by 2022E.

Profitability supported by robust balance sheet growth

BHB's earning capacity would be further enhanced through its robust balance sheet growth and structure optimization. In our base-case scenario, we project BHB's total assets and total liabilities to grow at 18.7% and 19.0% CAGRs over 2019-22E.

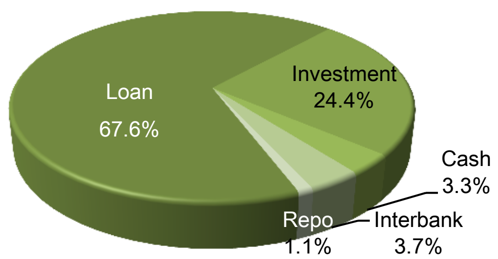
On the asset front, we project a gross loans CAGR of 21.8% over 2019-22E. The proportion of loans in interest-earning assets (IEAs) would gradually increase from 63.3% in 2019 to 67.6% in 2022E, while the proportion of investment and cash in IEAs would fall from 26.5% and 8.3% in 2019 to 24.4% and 3.3% in 2022E. The mix of interbank assets balance is expected to rebound from 1.7% in 2019 to 3.7% in 2022E.

Exhibit 11: BHB's IEA mix (2019)



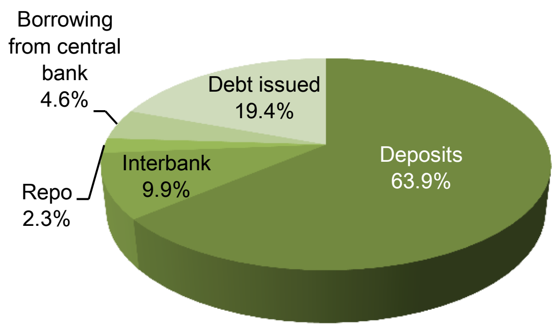
Note:
Loans – gross loans and advances to customers
Investment – gross financial investments
Interbank – deposits and placements with FIs
Source(s):Company, ABCI Securities

Exhibit 12: BHB's IEA mix (2022E)



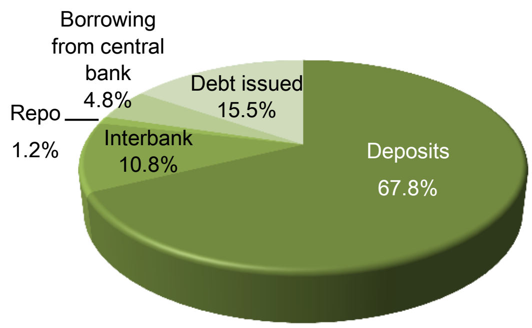
Note:
Loans – gross loans and advances to customers
Investment – gross financial investments
Interbank – deposits and placements with FIs
Source(s):Company, ABCI Securities estimates

Exhibit 13: BHB's IBL mix (2019)



Note: Interbank – deposits and placements from FIs
Source(s):Company, ABCI Securities

Exhibit 14: BHB's IBL mix (2022E)



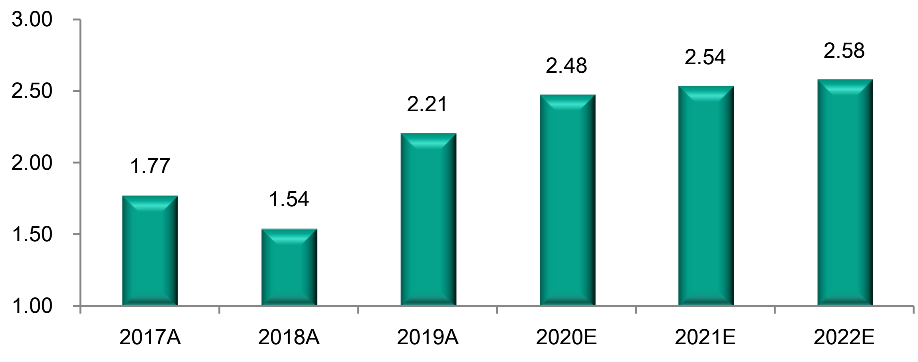
Note: Interbank – deposits and placements from FIs
Source(s):Company, ABCI Securities estimates

BHB's loan-deposit ratio (LDR) would remain at 108.98%-109.75%, based on our assumption that deposits would grow at a CAGR of 21.6% in 2020E-22E. Meanwhile, BHB's use of issued debts would increase at 10.6% CAGR over 2020E-22E, and maintaining its interbank net borrower position at RMB 115,858mn by 2022E. We expect the proportion of interest-bearing liability (IBL) in deposits would inch up from 63.9% in 2019 to 67.8% in 2022E while the amount of issued debts would lower from 19.4% in 2019 to 15.5% in 2022E.

Potential growth driven NIM expansion

BHB's NIM rebounded by 35bps YoY in 1H20 to 2.41%, mainly supported by its 19bps YoY increase in average loan yield to 5.88% and robust balance sheet growth, in our view. Assuming a mild enhancement in asset yield through structure optimization and substantial balance sheet growth, we project NIM to expand mildly by 5bps-27bps YoY each in 2020E-22E, reaching 2.58% by 2022E. NII would grow at 26.3% CAGR over 2019A-22E.

Exhibit 15: BHB's NIM (%)



Source(s): Company, ABCI Securities estimates

In our NIM model, better asset yield would be mostly driven by a higher average loan yield that increases by 12bps-23bps YoY each in 2020E-22E. Deposit migration induced by competition would raise deposit cost by 5bps-7bps YoY each for the same period, and loan-deposit spread would therefore expand by 5bps-18bps YoY annually. Investment yield would fall by 11bps-19bps YoY each in 2020E-22E. Our base case scenario assumes that interbank asset-liability spread to narrow by 104bps YoY in 2020E before turning stable in 2021E-22E.

Net fee income to see mild rebound

Due to increased regulatory control in wealth management products (WMPs), BHB's net fee income fell 26.8% and 33.5% YoY in 2018 and 2019, with the sharpest reduction seen in consulting, custodian, and agency services fees. Net fee income further declined by 40% YoY 1H20. However, we believe a mild rebound would ensue in 2021E when economic activities recover, with bank card and settlement & clearing fee expanding at 7.5% CAGR in 2020E-22E. Topline revenue would grow at 20.7% CAGR in 2019A-22E.

Defensive profitability outlook

Although we expect BHB's topline growth to stay strong, profitability would be rather stable on large provisions. In our base case scenario, we project operating expense and provisions to grow at CAGRs of 8.7% and 36.8% over 2019A-22E. Large provision would drag ROAA by 2bps-5bps each in 2020E-22E to reach 0.64% by 2022E. ROAE would sustain at 9.1%-9.52% over the same period.

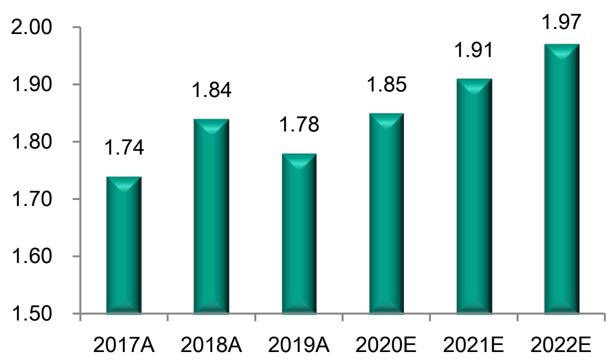
Asset quality remains resilient

BHB developed a risk management concept of "comprehensive, proactive, and agile", and built a modern banking risk management system featuring "consolidation, independence verticality, balance, and integration". In addition, given its relatively short operating history, we are of the view that the Bank is relatively unburdened by legacy issues compared to peers.

Prudent risk attitude; benign asset quality

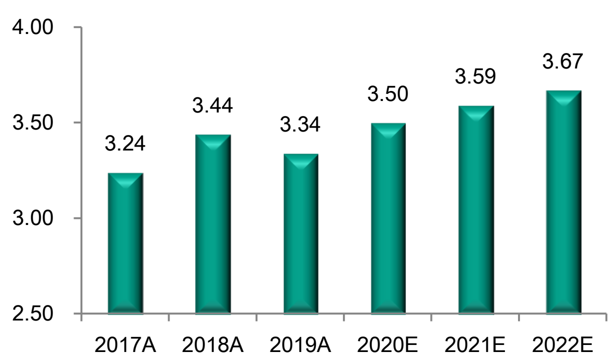
Thanks to restrained risk appetite and prudent compliance practices, NPL ratio has been manageable over the past years. Despite a mild increase in 2018 to 1.84% from 1.74% in 2017, the ratio once again fell to 1.78% by end-2019 and stayed flat at 1.78% by June 2020 amid the economic slowdown. By sector, manufacturing and wholesale & retail sectors contributed the most to BHB's NPL. NPL ratios of the two sectors were 9.11% and 4.45% as of June 2020, jointly accounting for 56.8% of total NPLs. In fact, the Bank still outperformed in this regard compared to the sector average at 1.94% as of June 2020, according to the CBIRC statistics.

Exhibit 16: BHB's NPL ratio (%)



Source(s): Company, ABCI Securities estimates

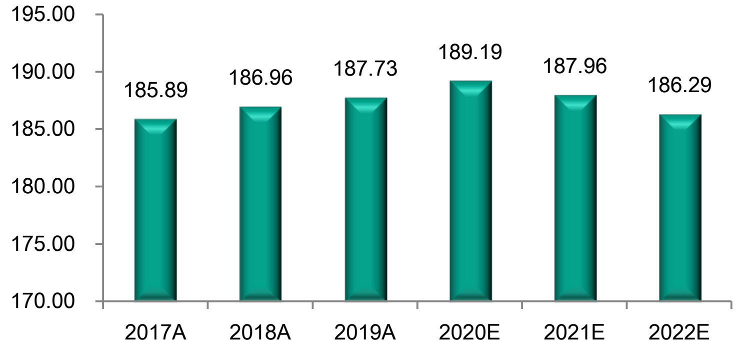
Exhibit 17: BHB's provisioning ratio (%)



Source(s): Company, ABCI Securities estimates

With the moderating growth in China and potential deterioration in asset quality resulted from the COVID-19 pandemic, we project NPL ratio would increase by 6bps-7bps YoY each in 2020E-22E to reach 1.97% by end-22E. Nonetheless, BHB would strengthen its risk buffer through large provision expenses, which we expect to grow at 36.8% CAGR in 2019-22E; as a result, provisioning ratio and provision coverage ratio would reach 3.67% and 186.29% by 2022E.

Exhibit 18: BHB's provisioning coverage ratio (%)



Source(s): Company, ABCI Securities estimates

Valuation

Initiate with BUY; TP at HK$ 5.69

Based on the Gordon Growth Model (GGM), a widely adopted valuation method for banks, we derive BHB's target price (TP) at HK$ 5.69. Initiate with **BUY**. Our TP implies 1.04x 2021E P/B, or 8.83x 2021E P/E, justified by enormous potential in balance sheet growth and better-than-peer earnings outlook. Nonetheless, we remain cautious on the counter's low ADT and the rising capital needs on balance sheet growth.

Based on our estimates, net profit would grow at 11.0% CAGR over 2019A-22E. NII would increase at 26.3% CAGR over the same period, while net fee income would rebound in 2021E and increase at 7.5% CAGR in 2020E-22E. ROAA and ROAE would be in the ranges of 0.64%-0.71% and 9.1%-9.52% for 2020E-22E.

Gordon growth model assumptions

Our base case calculation assumes:

1. A sustainable ROAE of 8.7% (assume 3% below simple average of BHB's historical ROAE and our ROAE forecasts);
2. A cost of equity (COE) of 8.9%;
3. A risk-free rate 3.16% (10-year Chinese government bond);
4. An equity beta of 0.82 (simple average of H-share JSBs);
5. An equity risk premium of 7.0% (assuming lower risk than listed JSB peers on fast growth);
6. A long-term growth of 6.5% (assuming higher growth than that of China's nominal GDP).

Sector valuation summary – H shr (Data as of Sep 11, 2020)

Company	Ticker	Rating	Price (HK$)	TP (HK$)	Upside (%)	FY20E P/B(x)	FY21E P/B (x)	FY20E P/E (x)	FY21E P/E (x)	FY20E Yield(%)	FY21E Yield(%)
ICBC	1398 HK	BUY	4.30	7.19	67.21	0.50	0.46	4.20	4.04	7.37	7.66
CCB	939 HK	BUY	5.39	8.94	65.86	0.52	0.48	4.29	4.13	7.09	7.37
CMB	3968 HK	BUY	37.85	41.80	10.44	1.23	1.09	8.21	7.33	4.22	4.70
MSB	1988 HK	BUY	4.60	7.00	52.17	0.36	0.34	3.18	3.03	9.85	10.32
CITICB	998 HK	BUY	3.18	5.56	74.84	0.29	0.26	2.70	2.47	9.51	10.34
CEB	6818 HK	BUY	2.70	3.92	45.19	0.37	0.34	3.34	3.10	10.49	11.18
BHB	9668 HK	BUY	4.79	5.69	18.79	0.89	0.78	7.57	7.43	3.01	3.37

*CNY/HKD =1.13 throughout this report, unless otherwise stated
Note: No revision of forecasts and TPs since the last report published on May 12, 2020
Source(s): Bloomberg, ABCI Securities estimates

Sector valuation summary – A shr (Data as of Sep 11, 2020)

Company	Ticker	Rating	Price (RMB)	TP (RMB)	Upside (%)	FY20E P/B(x)	FY21E P/B (x)	FY20E P/E (x)	FY21E P/E (x)	FY20E Yield(%)	FY21E Yield(%)
ICBC	601398CH	BUY	4.93	7.46	51.32	0.65	0.60	5.43	5.23	5.69	5.91
CCB	601939CH	BUY	6.15	9.21	49.76	0.67	0.62	5.54	5.32	5.50	5.71
CMB	600036CH	BUY	37.24	43.49	16.78	1.37	1.22	9.12	8.15	3.79	4.23
MSB	600016CH	BUY	5.46	6.99	28.02	0.49	0.45	4.26	4.06	7.34	7.69
CITICB	601998CH	BUY	5.10	5.97	17.06	0.52	0.48	4.89	4.48	5.25	5.71
CEB	601818CH	HOLD	3.72	3.70	(0.54)	0.57	0.52	5.20	4.83	6.74	7.18

Note: No revision of forecasts and TPs since the last report published on May 12, 2020
Source(s): Bloomberg, ABCI Securities estimates

Risk factors

Concentration risk

As of Jun, 2020, BHB's corporate loans formed 63.4% of total gross loans. By sector, the lease and business services, real estate, and manufacturing aggregated to 19.17%, 14.91% and 8.73% of total corporate loans on Jun 30, 2020; in particular, NPL ratio of the manufacturing sector was reported at 9.11%. Geographically, 46.12% of BHB's total loans were from northern and northeastern China as of Jun 30, 2020.

Asset quality risk

BHB's NPL ratio increased from 1.74% in 2017 to 1.84% in 2018, mainly due to the weakened repayment ability of individual clients affected by the slowing economy in China. As of Jun 30, 2020, BHB's provisioning ratio and provision coverage ratio were marked at 3.35% and 187.98%, reflecting a sufficient risk buffer against the rising asset quality risk. Nevertheless, the Bank's financial position could still be adversely affected if asset quality in the China deteriorates sharply.

Risk related to COVID-19

Since early 2020, the PRC Government has introduced a wide range of fiscal and monetary easing initiatives to alleviate the impacts of the COVID-19 pandemic. Specifically, banks and financial institutions are encouraged to increase credit support to affected enterprises and individuals. On Feb 15, 2020, CBIRC announced that it may raise regulatory tolerance of banks' NPL to businesses facing liquidity difficulties. In response, BHB launched various supportive measures for qualified entities, which include offering loans at reduced interest rates, waiving fees, and expediting credit approval procedures. Unpredictable development of COVID-19 could still materially affect BHB's customers, business operations, financial condition, and results of operations.

Risk related to major shareholder

According to media reports, Oceanwide Industry, which holds 7.72% stake in BHB, is facing downgrade by credit rating company and a potential debt instrument restructure with its investors. Liquidity risk faced by Oceanwide Industry could lead to forced disposal of its stake in BHB in the future.

Policy risk

We remain cautious on China's policy risk with repeated emphasis on policy direction in risk management, prevention against financial systematic risk, and support for MSEs. These policies may affect operation and competition in the banking industry. Also, JSBs in China are expected to take up a degree of social responsibility to support economic activities amid the COVID-19 pandemic, which could adversely affect BHB's ordinary operation results.

Financial statements

Consolidated income statement (2017A-2022E)

FY Ended Dec 31 (RMB mn)	2017A	2018A	2019A	2020E	2021E	2022E
Net interest income	17,020	15,228	22,910	32,326	39,026	46,166
Net fee and commission	8,686	6,357	4,226	2,514	2,640	2,904
Other operating income	(456)	1,625	1,242	1,056	908	790
Operating income	25,250	23,210	28,378	35,896	42,574	49,860
Operating expenses	(9,071)	(8,676)	(8,857)	(9,654)	(10,523)	(11,365)
Impairment losses	(7,755)	(6,508)	(9,567)	(15,205)	(19,687)	(24,494)
Profit before tax	8,425	8,027	9,902	11,038	12,364	14,001
Income tax expenses	(1,672)	(947)	(1,709)	(2,208)	(2,473)	(2,800)
Net profit attributable to shareholders	6,754	7,080	8,193	8,830	9,891	11,201
Growth (%)						
Net interest income	na	(10.5)	50.5	41.1	20.7	18.3
Net fee and commission	na	(26.8)	(33.5)	(40.5)	5.0	10.0
Other operating income	na	(456.1)	(23.6)	(15.0)	(14.0)	(13.0)
Operating income	na	(8.1)	22.3	26.5	18.6	17.1
Operating expenses	na	(4.4)	2.1	9.0	9.0	8.0
Impairment losses	na	(16.1)	47.0	58.9	29.5	24.4
Profit before tax	na	(4.7)	23.3	11.5	12.0	13.2
Income tax expenses	na	(43.3)	80.4	29.2	12.0	13.2
Net profit attributable to shareholders	na	4.8	15.7	7.8	12.0	13.2
Per share (RMB)						
EPS	0.49	0.49	0.57	0.56	0.57	0.65
BVPS	3.35	3.87	4.34	4.79	5.45	6.19
DPS	0.00	0.14	0.15	0.13	0.14	0.16
Key ratio (%)						
Net interest margin	1.77	1.54	2.21	2.48	2.54	2.58
Net interest spread	1.60	1.46	2.03	2.02	2.14	2.22
Net fee to operating income	34.40	27.39	14.89	7.00	6.20	5.82
Cost to income ratio	34.22	35.40	29.50	26.89	24.72	22.79
ROAA	0.73	0.70	0.76	0.71	0.67	0.64
ROAE	15.12	13.59	13.71	9.52	9.10	9.27
Effective tax rate	19.8	11.8	17.3	20.0	20.0	20.0
Dividend payout	1.0	29.11	25.98	25.00	25.00	25.00

Notes: Individual items may not sum to total due to rounding difference and may not equal to financial statements due to reclassification
Source(s): Company, ABCI Securities estimates

Consolidated balance sheet (2017A-2022E)

As of Dec 31 (RMB mn)	2017A	2018A	2019A	2020E	2021E	2022E
Cash and bank	105,000	123,250	93,014	79,062	69,574	62,617
Repo	0	10,571	1,850	11,009	15,413	20,036
Deposit with FIs	8,723	25,923	14,052	37,939	51,218	65,559
Placement with FIs	10,168	2,059	4,411	3,970	3,692	3,507
Net loans	449,814	546,004	687,279	861,189	1,037,608	1,232,034
Investment securities	412,649	309,420	300,307	351,359	404,063	460,632
Total IEA	986,353	1,017,227	1,100,912	1,344,528	1,581,567	1,844,386
Other assets	16,214	17,225	16,018	18,901	22,114	25,652
Total assets	1,002,567	1,034,451	1,116,930	1,363,429	1,603,681	1,870,038
Customer deposits	582,103	606,701	647,765	816,183	987,582	1,165,347
Deposit with FIs	151,789	69,588	78,547	100,541	122,660	147,192
Debt issued	138,415	218,679	196,604	216,264	233,565	266,265
Repo	2,214	22,364	23,069	21,916	20,820	19,779
Borrowing from central bank	24,000	28,596	46,906	58,632	70,358	83,023
Placement from FIs	37,837	19,535	21,500	26,875	32,250	37,733
Total IBL	936,359	965,463	1,014,391	1,240,411	1,467,235	1,719,337
Other liabilities	17,743	13,129	19,901	20,070	22,014	23,477
Total liabilities	954,102	978,592	1,034,291	1,260,481	1,489,249	1,742,814
Total equity	48,465	55,859	82,639	102,947	114,432	127,224
Growth (%)						
Cash and bank	na	17.4	(24.5)	(15.0)	(12.0)	(10.0)
Repo	na	na	(82.5)	495.0	40.0	30.0
Deposit with FIs	na	197.2	(45.8)	170.0	35.0	28.0
Placement with FIs	na	na	114.2	(10.0)	(7.0)	(5.0)
Net loans	na	21.4	25.9	25.3	20.5	18.7
Investment securities	na	(25.0)	(2.9)	17.0	15.0	14.0
Total IEA	na	3.1	8.2	22.1	17.6	16.6
Other assets	na	6.2	(7.0)	18.0	17.0	16.0
Total assets	na	3.2	8.0	22.1	17.6	16.6
Customer deposits	na	4.2	6.8	26.0	21.0	18.0
Deposit with FIs	na	(54.2)	12.9	28.0	22.0	20.0
Debt issued	na	na	na	na	8.0	14.0
Repo	na	910.2	3.2	(5.0)	(5.0)	(5.0)
Borrowing from central bank	na	na	na	25.0	20.0	18.0
Placement from FIs	na	na	10.1	na	na	na
Total IBL	na	3.1	5.1	22.3	18.3	17.2
Other liabilities	na	(26.0)	51.6	0.9	9.7	6.6
Total liabilities	na	2.6	5.7	21.9	18.1	17.0
Total equity	na	15.3	47.9	24.6	11.2	11.2
Key ratio (%)						
CT1 CAR	8.12	8.61	8.06	9.40	8.90	8.53
Total CAR	11.43	11.77	13.07	12.73	11.88	11.22
NPL ratio	1.74	1.84	1.78	1.85	1.91	1.97
Provision to total loans	3.24	3.44	3.34	3.50	3.59	3.67
Provision coverage	185.9	186.96	187.73	189.19	187.96	186.29

Notes: Individual items may not sum to total due to rounding difference and may not equal to financial statements due to reclassification
Source(s): Company, ABCI Securities estimates

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Definition of equity rating

Rating	Definition
Buy	Stock return rate≥ Market return rate (10%)
Hold	- Market return rate (-10%) ≤ Stock return rate < Market return rate (+10%)
Sell	Stock return < - Market return (-10%)

Notes: Stock return rate: expected percentage change of share price plus gross dividend yield over the next 12 months
Market return rate: average market return rate since 2008 (HSI total return index 2008-19 CAGR at 10%)

Time horizon of share price target: 12-month

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

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