

China Merchants Bank (3968 HK)

Clear differentiation with strength in retail banking

- CMB's 2017 earnings are broadly in line with consensus and our forecasts. Core competitive edge in retail banking has supported NIM and net fee income growth
- Impressive capital position strengthened through organic growth; no further capital pressure in near term
- The proposed setup of AM subsidiary would further enhance CMB's risk management in WMPs and NPL handling capacity
- The counter is currently trading at 1.28x 18E P/B. Reiterate **BUY** on sustainable growth and robust risk buffer

Strength in retail segment supported earnings growth. China Merchants Bank (CMB) reported its 2017 net profits at RMB 70,150mn, YoY increased by 13.0%, in line with both consensus and our forecast. NII rose 7.6% YoY while NIM narrowed by 7bps YoY to 2.43%. Thanks to the Bank's competitive edge in retail banking, deposit cost stayed at 1.27%. Net fee income grew 5.2% YoY despite tightened regulation in wealth management business. Going forward, the Group would accelerate its development in fintech, to cope with an industry-wide structural change in business model.

Organic growth bolstered capital position. We are impressed by CMB's ability to fuel up CT1 through organic growth. CT1 rose 52bps YoY to 12.06%. Upon the completion of preference share issuance in 2017, CAR was elevated by 2.15ppt YoY to 15.48%. CMB's capital position is well above regulatory requirements. Therefore, capital pressure should be minimal in the near term.

Proposed setup of asset management subsidiary. The Bank proposed to establish a wholly-owned assets management (AM) subsidiary with a registered capital of RMB 5bn, with a primary intention to operate its AM business more independently as well as standardizing its products. In our view, this would help enhance CMB's ability to manage both risk and asset quality. As of Dec 2017, the Bank's NPL ratio was marked at 1.61%, down 26bps YoY; outstanding provision ratio and provision coverage ratio were 4.22% and 262.11%.

Maintain BUY on solid fundamentals. The counter is trading at 1.28x 18E P/B. Reiterate **BUY**. With one of the highest valuations in the China banks sector, CMB may not have the greatest upside potential among peers. Yet, the Bank remains to be one of our favorite picks based on its sustainable growth and sturdy risk buffer.

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.

Results and Valuation

FY ended Dec 31	2015A	2016A	2017A	2018E	2019E
Revenue (RMB mn)	202,166	209,949	220,039	243,881	268,611
Chg (% YoY)	21.5	3.8	4.8	10.8	10.1
Net profit (RMB mn)	57,696	62,081	70,150	80,975	92,763
Chg (% YoY)	3.2	7.6	13.0	15.4	14.6
EPS (RMB)	2.29	2.46	2.78	3.17	3.59
Chg (% YoY)	3.19	7.60	12.94	14.02	13.12
BVPS (RMB)	14.31	15.95	17.69	20.47	23.24
Chg (% YoY)	14.76	11.51	10.88	15.71	13.53
P/E (x)	11.42	10.61	9.40	8.24	7.29
P/B (x)	1.83	1.64	1.48	1.28	1.12
ROAE (%)	17.09	16.27	16.54	16.67	16.83
ROAA (%)	1.13	1.09	1.15	1.20	1.26
DPS(RMB)	0.69	0.74	0.84	0.96	1.10
Yield (%)	2.64	2.83	3.21	3.69	4.22

Source(s): Bloomberg, ABCI Securities estimates

Company Report

Mar 26, 2018

Rating: BUY

TP:HK\$ 43.50

Analyst : Johannes Au

Tel: (852) 2147 8802

johannesau@abci.com.hk

Share price (HK\$)	32.40
Est. share price return	34.26%
Est. dividend yield	3.69%
Est. total return	37.95%
Previous Rating & TP	BUY;HK\$43.5
Previous Report Date	Feb 26,2018

Source(s): Bloomberg, ABCI Securities

Key Data

52Wk H/L(HK\$)	39.50/19.66
Issued shares (mn)	25,212
H-share(mn)	4,591
A-shares (mn)	20,621
Market cap (HK\$ mn)	925,511
H-share(mn)	148,745
A-shares (mn)	776,766
3-mth avg daily turnover(HK\$ mn)	897.05
Major shareholder(s) (%):	
China Merchants Group	13.04
Anbang	10.72

Source(s): Company, ABCI Securities

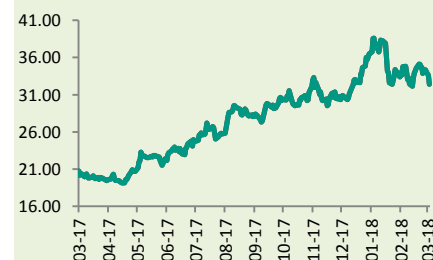
Share Performance (%)

	Absolute	Relative*
1-mth	(6.76)	(3.82)
3-mth	4.85	2.32
6-mth	15.71	4.99

*Relative to HSI

Source(s): Bloomberg, ABCI Securities

1-Year share performance(HK\$)



Source(s): Bloomberg, ABCI Securities



Exhibit 1: CMB's 2017 actual results vs. ABCI estimates

(Rmb mn)	2017A	2017E	AvE (%)
Net interest income	144,852	141,586	2.31
Net fee and commission	64,018	64,344	(0.51)
Operating income	220,039	221,868	(0.82)
Operating expenses	(70,431)	(69,680)	1.08
Impairment losses	(59,926)	(63,374)	(5.44)
Profit before tax	90,680	89,215	1.64
Income tax expenses	(20,042)	(18,735)	6.98
Net profit	70,150	70,136	0.02
Key indicators (%)			AvE (ppt)
Net interest margin	2.43	2.39	0.04
Net interest spread	2.29	2.27	0.02
Cost to income ratio	30.21	31.41	(1.20)
Return on average assets	1.15	1.13	0.02
Return on average equity	16.54	16.36	0.18
Dividend payout	30.22	30.00	0.22
CT1 CAR	12.06	11.73	0.33
Total CAR	15.48	13.74	1.74
NPL ratio	1.61	1.61	-
Provision to total loans	4.22	3.85	0.37
Provision coverage	262.11	239.13	22.98

Source(s): Company, ABCI Securities estimates



Consolidated income statement (2015A-2019E)

FY Ended Dec 31 (RMB mn)	2015A	2016A	2017A	2018E	2019E
Net interest income	137,586	134,595	144,852	158,445	176,755
Non-interest income	64,580	75,354	75,187	85,436	91,856
Of which: Fees and commissions	53,009	60,865	64,018	67,586	71,328
Operating income	202,166	209,949	220,039	243,881	268,611
Operating expenses	(67,957)	(65,148)	(70,431)	(74,440)	(79,350)
Pre-provision operating profit	134,209	144,801	149,608	169,441	189,261
Impairment losses on loans	(59,266)	(66,159)	(59,926)	(66,938)	(71,876)
Operating profit	74,943	78,642	89,682	102,503	117,386
Non-operating income	136	321	998	498	612
Profit before tax	75,079	78,963	90,680	103,000	117,998
Tax	(17,061)	(16,583)	(20,042)	(21,630)	(24,780)
Minority interests	(322)	(299)	(488)	(395)	(455)
Net profit attributable to equity holders	57,696	62,081	70,150	80,975	92,763
Preference share dividend	0	0	0	(1,499)	(1,499)
Net profit attributable to ordinary shareholders	57,696	62,081	70,150	79,476	91,265
Growth (%)					
Net interest income	17.4	(2.2)	7.6	9.4	11.6
Of which: Fees and commissions	34.2	14.8	5.2	5.6	5.5
Operating income	21.5	3.8	4.8	10.8	10.1
Operating expenses	10.7	(4.1)	8.1	5.7	6.6
Pre-provision operating profit	27.9	7.9	3.3	13.3	11.7
Impairment losses on loans	87.1	11.6	(9.4)	11.7	7.4
Operating profit	2.3	4.9	14.0	14.3	14.5
Non-operating income	(13.9)	136.0	210.9	(50.1)	23.0
Profit before tax	2.2	5.2	14.8	13.6	14.6
Tax	(1.8)	(2.8)	20.9	7.9	14.6
Minority interests	133.3	(7.1)	63.2	(19.0)	15.0
Net profit attributable to equity holders	3.2	7.6	13.0	15.4	14.6
Preference share dividend	na	na	na	na	14.6
Net profit attributable to ordinary shareholders	3.2	7.6	13.0	13.3	14.6
Per share (RMB)					
EPS	2.29	2.46	2.78	3.17	3.59
BVPS	14.31	15.95	17.69	20.47	23.24
DPS	0.69	0.74	0.84	0.96	1.10
Key ratio (%)					
Net interest margin	2.77	2.50	2.43	2.43	2.48
Net interest spread	2.61	2.37	2.29	2.36	2.44
Cost to income ratio	33.61	31.03	30.21	30.52	29.54
Return on average assets	1.13	1.09	1.15	1.20	1.26
Return on average equity	17.09	16.27	16.54	16.67	16.83
Effective tax rate	22.72	21.00	22.10	21.00	21.00
Dividend payout	30.16	30.06	30.22	30.00	30.00

Source(s): Company, ABCI Securities estimates



Consolidated balance sheet (2015A-2019E)

As of Dec 31 (RMB mn)	2015A	2016A	2017A	2018E	2019E
Cash & equivalent	664,130	703,523	702,646	752,699	779,598
Interbank assets	529,617	478,950	407,178	431,699	417,618
Investment securities	1,438,017	1,459,610	1,602,351	1,578,568	1,625,925
Net loans and advances	2,739,444	3,151,649	3,414,612	4,066,859	4,593,862
Total interest earning assets	5,371,208	5,793,732	6,126,787	6,829,825	7,417,003
Property and equipment	33,543	45,558	51,424	60,774	71,106
Other non-interest earning assets	70,227	103,021	119,427	146,119	178,312
Total assets	5,474,978	5,942,311	6,297,638	7,036,719	7,666,422
Customer deposits	3,571,698	3,802,049	4,064,345	4,403,454	4,768,842
Interbank liabilities	1,138,584	1,297,533	1,126,690	1,656,690	1,838,926
Subordinated debt	251,507	275,082	296,477	320,856	346,524
Total interest bearing liabilities	4,989,591	5,409,392	5,487,512	6,426,528	7,005,739
Current taxes	12,820	19,523	26,701	22,561	23,914
Deferred tax liabilities	867	897	1,070	897	897
Other liabilities	109,942	109,137	298,963	69,493	48,772
Total liabilities	5,113,220	5,538,949	5,814,246	6,519,478	7,079,322
Share capital	25,220	25,220	25,220	25,220	25,220
Reserves	335,586	377,130	454,990	491,008	560,868
Minorities	952	1,012	3,182	1,012	1,012
Shareholder's equity	361,758	403,362	483,392	517,240	587,100
Growth (%)					
Cash & equivalent	(8.5)	5.9	(0.1)	3.5	3.6
Interbank assets	12.9	(9.6)	(15.0)	(4.5)	(3.3)
Investment securities	44.3	1.5	9.8	3.0	3.0
Net loans and advances	11.9	15.0	8.3	13.6	13.0
Total interest earning assets	15.8	7.9	5.7	8.5	8.6
Total assets	15.7	8.5	6.0	8.8	8.9
Customer deposits	7.4	6.4	6.9	8.1	8.3
Due to other banks & FIs	29.5	14.0	7.8	12.0	11.0
Subordinated debt	196.4	9.4	1.4	8.0	8.0
Total interest bearing liabilities	15.7	8.4	1.4	9.1	9.0
Total liabilities	15.8	8.3	5.0	8.4	8.6
Shareholder's equity	14.8	11.5	19.8	13.4	13.5
Key ratio (%)					
Loan to deposit	66.38	73.28	73.79	83.53	86.89
CT1 CAR	10.83	11.54	12.06	12.05	12.37
Total CAR	12.57	13.33	15.48	14.03	14.32
NPL ratio	1.68	1.87	1.61	1.65	1.69
Provision to total loans	3.00	3.37	4.22	3.90	3.95
Provision coverage ratio	178.95	180.02	262.11	236.36	233.73

Source(s): Company, ABCI Securities estimates



Disclosures

Analyst Certification

I, Johannes Au, being the person primarily responsible for the content of this research report, in whole or in part, hereby certify that all of the views expressed in this report accurately reflect my personal view about the subject company or companies and its or their securities. I also certify that no part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or views expressed in this report. I and/or my associates have no financial interests in relation to the listed company (ies) covered in this report, and I and/or my associates do not serve as officer(s) of the listed company (ies) covered in this report.

Disclosures of Interests

ABCI Securities Company Limited and/or its affiliates may pursue financial interests to the companies mentioned in the report.

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.

Disclaimers

This report is for our clients only and is for distribution only under such circumstances as may be permitted by applicable law. It has no regard to the specific investment objectives, financial situation or particular needs of any specific recipient. It is published solely for informational purposes and is not to be construed as a solicitation or an offer to buy or sell any securities or related financial instruments. No representation or warranty, either expresses or implied, is provided in relation to the accuracy, completeness or reliability of the information contained herein. This report should not be regarded by recipients as a substitute for the exercise of their own judgment. Any opinions expressed in this report are subject to change without notice and may differ or be contrary to opinions expressed by other business areas as a result of using different assumptions and criteria. The analysis contained herein is based on numerous assumptions. Different assumptions could result in materially different results. The analyst(s) responsible for the preparation of this report may interact with trading desk personnel, sales personnel and other constituencies for the purpose of gathering, synthesizing and interpreting market information. ABCI Securities Company Limited is under no obligation to update or keep current the information contained herein. ABCI Securities Company Limited relies on information barriers to control the flow of information contained in one or more areas within ABCI Securities Company Limited, into other areas, units, groups or affiliates of ABCI Securities Company Limited. The compensation of the analyst who prepared this report is determined exclusively by research management and senior management (not including investment banking). Analyst compensation is not based on investment banking revenues, however, compensation may relate to the revenues of ABCI Securities Company Limited as a whole, of which investment banking, sales and trading are a part. The securities described herein may not be eligible for sale in all jurisdictions or to certain categories of investors. The price and value of the investments referred to in this research and the income from them may fluctuate. Past performance is not necessarily indicative of future results. Foreign currency rates of exchange may adversely affect the value, price or income of any security or related instrument mentioned in this report. For investment advice, trade execution or other enquiries, clients should contact their local sales representative. Neither ABCI Securities Company Limited nor any of its affiliates, directors, employees or agents accepts any liability for any loss or damage arising out of the use of all or any part of this report. Additional information will be made available upon request.

Copyright 2018 ABCI Securities Company Limited

No part of this material may be (i) copied, photocopied or duplicated in any form by any means or (ii) redistributed without the prior written consent of ABCI Securities Company Limited.

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

Tel: (852) 2868 2183