



# Sector Report

China Banks  
Sector View: Neutral

## Key data

Average 12E PER (x)	4.9
Average 12E PBV (x)	0.9
Average 12E Dividend Yield (%)	6.0
Sector 3 months avg vol (HK\$mn)	4,241

Source: Company & Bloomberg

## Operating income composition in 1H12 (%)

Net interest income	79.5
Non-interest income	20.5

Source: CBRC

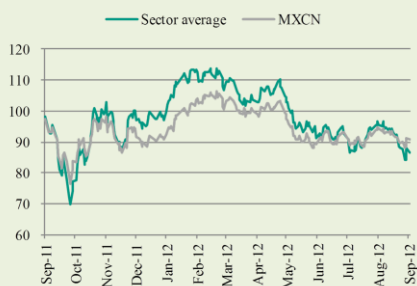
## Share performance (%)

	Absolute	Relative*
1-mth	(9.3)	(5.8)
3-mth	(6.5)	(6.3)
6-mth	(20.9)	(10.1)

\*Relative to MSCI China

Source: Bloomberg

## 1 year price performance



Source: Bloomberg

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## Treasure hunt for outperformer

**With margin squeeze serve with interest rate liberalization and potential hammered by asset quality, we hold cautious view to China Bank sector outlook. Despite continue depression in share price under macro headwinds, we think bearish market view has largely factored into near worst scenario. We expect better risk management banks to outperform among the sector.**

**Outlook remains cautious.** Interest rate liberalization has been re-accelerated since Jul12 by expanding interest rate range for competition. We expect 2-3 interest rate cut to come in 2H12 and 1Q13 with RRR cuts. All these set to reduce profitability of the sector. Considered re-pricing effect, our base case assumes banks NIM to hit hardest in 2013E by 14-27bps, although no loan and deposit pricing worsening seen so far.

**Outperformer during NIM squeeze.** Our interest rate sensitivity showed bigger banks are least impacted on rate cuts. Given narrowing margin, emergency exit of banks will be IEAs growth and balance sheet management for better yield. We believe banks with lower LDR and higher excess reserve are better prepared to grow while balance sheet mix with higher time deposits is more defensive on NIM cut.

**Risk differentiation.** Banks will continue focus SMEs and MSEs growth for better yield. Being positive on asset quality is not realistic, while we do not see high chance of NPLs spike as contagion from coastal area and spread widely among sectors are unlikely. Banks with better risk management will surprise on the upside when worsening accelerates.

**Investment theme.** Under macro uncertainty, we are neutral to the sector as most negative stories are known. We prefer big over small banks for defensive, amongst CCB has most prudence outlook, while ABC despite high NPLs, shall see rooms to continue improve. MSB is the most convincing among smaller banks on its proactive risk management in 1H12. On the downside we expect BoCom has higher geographical risk, and CNCB shall see higher than peers credit cost onward.

**Risk factors:** Prolonged slowdown of China economy, interest rate liberalization and steep increase of credit cost.

## Sector Valuation Summary

Companies	Ticker	Price (HK\$)	12E PER	12E PBV	12E Div yield
CCB	939 HK	5.00	5.4	1.1	6.4
ABC	1288 HK	2.79	5.1	1.0	6.0
MSB	1988 HK	6.00	4.0	0.9	6.4
ICBC	1398 HK	4.22	5.4	1.1	5.4
BOC	3988 HK	2.84	4.9	0.8	6.4
BoCom	3328 HK	5.11	4.8	0.9	6.5
CMB	3968 HK	12.50	5.3	1.1	4.6
CNCB	998 HK	3.58	3.9	0.7	6.3

Source: Company, Bloomberg, ABCI Securities estimates



農銀國際

ABC INTERNATIONAL

ABCI SECURITIES COMPANY LIMITED

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## Challenging operating environment

Looking back in the past decade, China banks had been enjoyed a favorable operating environment under government's banking reform, with four steps from capital injection, non-performing loan (NPL) disposals, foreign strategic partner introduction and finally public listing. Central government intervened to clean up banks' balance sheet, and protecting banks' net interest margin (NIM) by regulating interest rates. Furthermore, being the back bone of the economy, China banks able translated the fast economic growth into their balance sheet growth over the period with 20% CAGR over 2004-11E.

However outlook has been changed since 2008 with increasing uncertainties in global economy such as tighter international regulations requirements, sovereign crisis in Europe and weak US economy impacting China's export, together with the progress of interest rate liberalization and ongoing tightening measures not limited in banking sector. This led to an underperformance of Chinese banks' share price since 2008.

Currently with the modification of China's economic direction from supporting growth to stable economy, banks role has been eventually changed with higher sense of social duty. We believe China regulators will gradually put up higher regulatory requirements and to sacrifice banks' profit for economy growth. All these will as a result hit on banks in the form of narrowing NIM, higher provisions and capital requirements. We are of the view that the overall banking environment is challenging, hence we cautious to the sector with neutral outlook while we expect share price will continue underperform in medium term.

## NIM squeeze is the fact

### Interest rate liberalization is accelerating

Interest rate liberalization on commercial banks was revisited in Oct 2004, when the People Bank of China (PBOC) removed the ceiling on lending rates while kept the floor limit at 10% below benchmark rate. On deposit rates, the rate floor was scraped while rate ceiling remained. This allowed banks to adjust their loan pricing according to loan risk, on the other hand allowing banks to capture cheaper deposits. Later in Aug 2006 and Oct 2008, PBOC further allowed banks to adopt maximum discount on mortgage to 15% and 30% respectively.

### *Exhibit 1: Interest rate liberalization development*

Time	Liberalization measures
Jun-96	Inter-bank lending rate liberalization
Jun-97	Inter-bank repo rate liberalization
1998	Discount rate pricing mechanism reform Auction issue of policy financial bonds
1999	Allow banks to charge 30% premium on SMEs loans Allow banks to charge 30% premium on medium sized firms loans Allow banks to negotiate on long term insurance deposits over Rmb30mn
Sep-00	Forex lending rate liberalization Allow banks to negotiate deposit rates on forex deposits larger than USD3mn
Jul-03	Interest rate liberalization on GBP, SFr, and CAD
Nov-03	Set ceiling rate on petty deposit in USD, JPY, HKD and EUR
Oct-04	Cancel lending rate ceiling and deposit rate floor
Sep-05	Allow banks to decide bank deposit rate except demand and time deposits
Aug-06	Adopt maximum 15% discount on mortgage
Oct-08	Adopt maximum 30% discount on mortgage
Jul-12	Reduce lending rate floor to 20% below benchmark rate Increase deposit rate ceiling to 10% above benchmark rate

Source: PBOC, ABCI Securities estimates



In Jul 2012 during the benchmark rate cut, PBOC at the same time increase the deposit rate ceiling from 1x to 1.1x while lowered the lending rate floor from 0.9x to 0.8x of benchmark rate. We regard this as a signal that PBOC is further accelerating the progress of interest rate liberalization. However, we believe the actual impact from this latest change is very limited to individual banks.

On deposit side, we noticed that banks generally offered 1.1x of benchmark rate subsequent to the effective date of new measure, Although we noted that some larger banks were offering slightly lower rate at 1.08-1.09x, given better bargaining power with extensive deposit franchises and market shares. On lending side we expect impact to be even smaller in short run given loan re-pricing are generally later than deposits, and according to our observation, most banks are not willing to reduce their lending rate for profitability, we believe banks will continue to focus their new loan growth to higher yield sectors such as Small and Medium enterprises (SMEs) and Small and Micro enterprises (MSEs), which offering 20-40% above benchmark rates, to compensate the negative effect in interest rate down cycle.

This has been confirmed in the latest round of 1H12 interim results, which various banks' management ascertained that this is of business decision, which loans and deposits have been remained orderly so far in Jul and Aug, we believe individual banks' SMEs and MSEs portfolio could even see loan pricing improvement.

In all, we believe the liberalization of interest rate in China to take longer time, while would steady depress banks' margin in coming years, triggering by price competition, however in long run a free market should gradually build up market discipline and improve the stability of banking system, banks end up could better demonstrate their unique competitive advantage and differentiate themselves from other market participants.

**Exhibit 2: Rate cut table (8 Jun & 5 Jul 2012)**

	8 Jun reduction		5 Jul reduction		
	Before (%)	After (%)	bps	After (%)	bps
<b>Deposits</b>					
<b>Saving deposits</b>	0.50	0.40	(10)	0.35	(5)
<b>Fixed deposits</b>					
3M	3.10	2.85	(25)	2.60	(25)
6M	3.30	3.05	(25)	2.80	(25)
1Y	3.50	3.25	(25)	3.00	(25)
2Y	4.40	4.10	(30)	3.75	(35)
3Y	5.00	4.65	(35)	4.25	(40)
5Y	5.50	5.10	(40)	4.75	(35)
<b>Loan</b>					
6M	6.10	5.85	(25)	5.60	(25)
1Y	6.56	6.31	(25)	6.00	(31)
1-3Y	6.65	6.40	(25)	6.15	(25)
3-5Y	6.90	6.65	(25)	6.40	(25)
>5Y	7.05	6.80	(25)	6.55	(25)
<b>Personal mortgage</b>					
<5Y	4.45	4.20	(25)	4.00	(20)
>5Y	4.90	4.70	(20)	4.50	(20)

Source: PBOC, ABCI Securities estimates

**Interest rate down cycle begun**

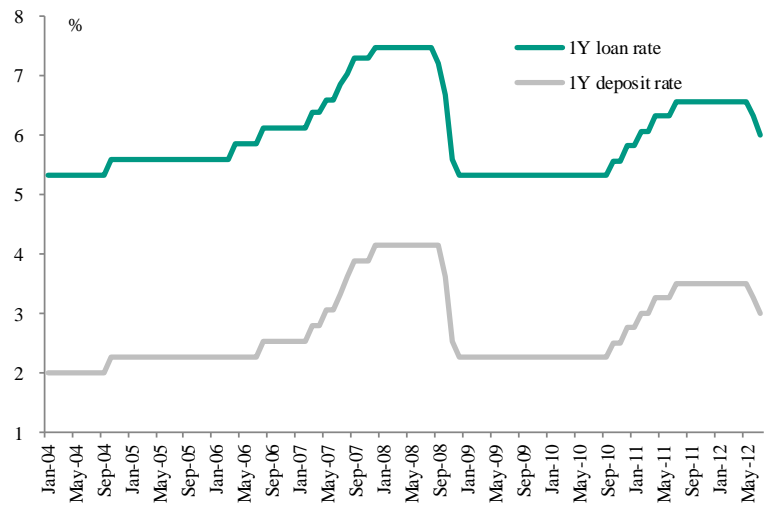
PBOC has recently kicked off the interest rate reduction cycle by two cuts of loan and deposit rates and three times of reduction of Required Reserve Ratio (RRR). PBOC applied a 25bps reduction on both one year loan and deposits on 8 Jun and another asymmetric reduction with 31bps on one year loan rate while 25bps on one year deposit rate. This asymmetric reduction hinting



PBOC's dedication to support China's economy growth at the expenses of banks, which could as a result, narrows banks' NIM in coming quarters.

Considered the previous rate cut cycle back in Sep 2008, PBOC reduced loan rates by 5 times aggregated 216bps (1Y loan rate) while deposit rates by four times totaled 189bps (1Y deposit rate). We expect there will be 2-3 times more reductions under current cycle, likely to happen over 2H12 and 1Q13, total another 60-90bps in an asymmetric manner, unless stabilize and rebound of major economic data such as GDP, PMI and FAI can be seen.

Exhibit 3: China 1 year loan and deposit rates

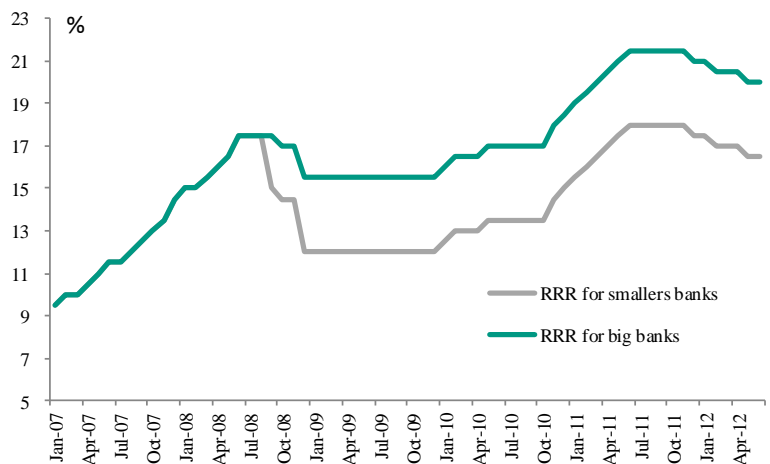


Source: PBOC, ABCI Securities estimates

**Increase expectation on RRR cut**

Together with interest rate cut, PBOC normally adjust simultaneously the RRR, in order to provide sufficient liquidity fuelling up loan growth capacity under decreasing loan rates. In fact PBOC has started to reduce RRR in 4Q11, with 50bps cut each in Nov 2011, Feb and May 2012, resulting RRR for big banks at 20% while medium and small banks at 16.5%.

Exhibit 4: China RRR trend



Source: PBOC, ABCI Securities estimates

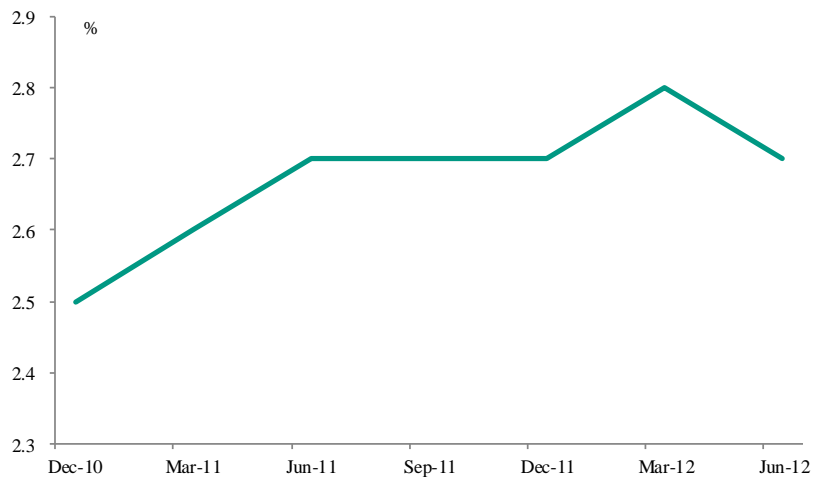


As we can see PBOC has increased the frequency of anti-repo activities since Jun 2012, mainly with short durations of 7 days anti-repo. Market generally perceived these actions as signals to upcoming RRR cuts, under the assumption that such anti-repo were intended to test market reaction towards more liquidity, when PBOC stop such activities, liquidity will need to be substituted by bank loans to the market to sustain stability. We concur with this view and expect there will be 2-3 times RRR cut in 2H12 and 1Q13 with 50-100bps each, which will reduce big banks RRR by 200-300bps to 17-18% level. Theoretically, this would release Rmb1.8-2.7tn liquidity in the banking system.

### NIM set to soften until 2H13

Banks NIM experienced a decent expansion from mid-2009, when PBOC raise benchmark rates to curb inflation, while 2011 margin was further boosted under tight money market and banks' strategic focus on SME lending which offering 20-40bps over benchmark rate. Recent system bank NIM peaked at 2.8% in 1Q12, while slightly reduced to 2.7% in 2Q12.

#### Exhibit 5: China banking system NIM ratio



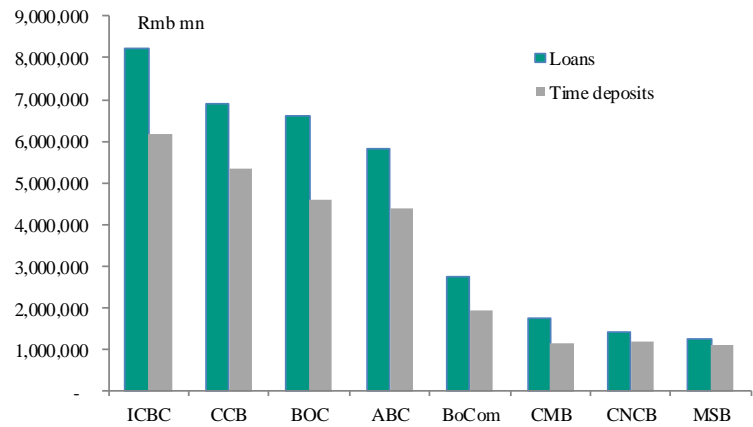
Source: CBRC, ABCI Securities estimates

We believe under interest rate down cycle, especially together with asymmetric interest rate reduction cycle, bank's NIM will be weakened given higher loan balance than time deposits, total time deposits balance for bigger banks are generally ranged 70-80% of loan portfolio, while smaller banks have larger range of 66-88% with Minsheng Bank (MSB, 1988 HK) ranked highest. Theoretically, banks with higher time deposits as percentage to loan would mean lesser NIM impact under rate cuts as reduction in interest income should in a higher portion offset by reduction in interest expenses from deposits, as we believe deposit mix is unlikely to see radical migration between demand and time deposits.

On the other hand, re-pricing of deposits in China mainly within three months while 40-50% of loans shall be re-priced over three months to one year, hence, NIM in 3Q12 shall see a stable trend as in 1H12, while we believe the real impact from rate cut should be reflected more explicitly from 4Q12 onwards, in the other words actual impact of overall NIM in 2012 would be manageable. Under our assumption if there were 2-3 more rate cuts to happen in 2H12 and 1Q13, narrowing NIM trend shall continue until 2-3Q13, before it could be stabilized.



Exhibit 6: H-share banks loans & time deposits (30 Jun 2012)

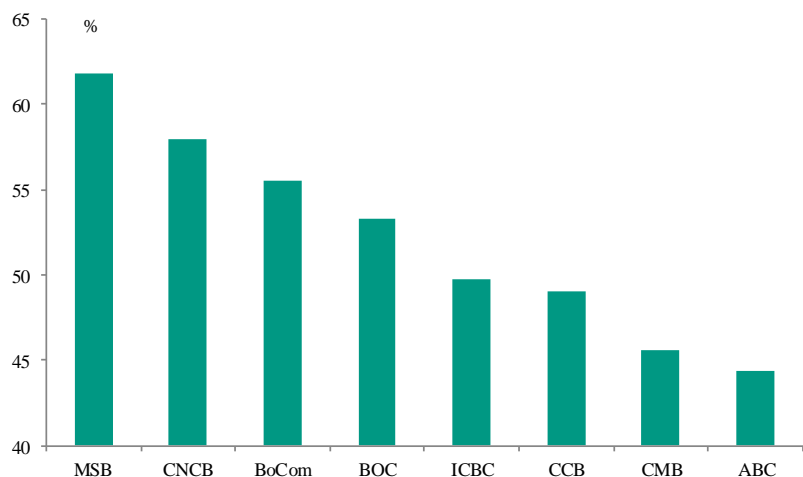


Source: Companies, ABCI Securities estimates

**Higher time deposit mix better protect NIM**

H-shares banks have quite a balanced deposit mix, which saving and time deposits almost equally split, we do not expect this mix to change radically. Time deposits to total deposits under our 2012E forecast ranged 40-60% with Agricultural Bank of China (ABC, 1288 HK) the lowest at 40% and MSB at 60%. This means although high demand deposits position normally implies lower funding cost, which is the fact that ABC current has the lowest deposit cost among the universe. Under a rate cut cycle, banks with higher portion in time deposits should protect themselves from NIM squeeze, through benefiting from a reduction of funding cost, given that saving deposit is less likely moving together with benchmark rates cut.

Exhibit 7: H-share banks time deposits to total deposits 2012E



Source: Companies, ABCI Securities estimates

Interestingly if we looked into 1H12 deposits growth of individual banks, we could see that despite H-share banks deposit growth momentum remained stable, with 7.5-11.2% HoH growth, new deposits were mainly driven by time deposits in 1H12, which raised the proportion of time deposits by 1-3ppt. We believe this could be explained by two reasons, first depositors want to lock up higher interest rate before further rate cut happens, and second banks



turn more aggressive to absorb deposits given higher interbank liabilities cost in 1H12, which was the major reasons drove NIM depressions in 1H12.

**Exhibit 8: H-share banks deposit growth (1H12)**

(%)	ICBC	CCB	BOC	ABC	BoCom	CMB	CNCB	MSB
1H12 HoH	7.5	9.5	7.5	10.2	9.4	10.6	11.2	10.1
1Q12 QoQ	2.9	6.2	7.9	5.4	4.0	1.8	3.8	2.8
2Q12 QoQ	4.5	3.1	-0.4	4.5	5.2	8.7	7.2	7.1

Source: Companies, ABCI Securities estimates

**Exhibit 9: H-share banks deposit mix (30 Jun 2012)**

(%)	ICBC	CCB	BOC	ABC	BoComm	CMB	CNCB	MSB
Corporate saving deposits	29.1	32.9	25.4	25.1	33.1	32.4	37.2	32.5
Retail saving deposits	20.2	18.2	16.4	28.3	12.5	21.1	4.7	5.2
<b>Total saving deposits</b>	<b>49.3</b>	<b>51.2</b>	<b>41.8</b>	<b>53.4</b>	<b>45.6</b>	<b>53.5</b>	<b>41.9</b>	<b>37.7</b>
Corporate time deposits	19.2	20.9	24.1	11.6	34.7	30.9	45.5	48.5
Retail time deposits	27.6	27.9	24.5	29.8	19.6	15.6	12.6	13.3
<b>Total time deposits</b>	<b>46.9</b>	<b>48.8</b>	<b>48.6</b>	<b>41.4</b>	<b>54.4</b>	<b>46.5</b>	<b>58.1</b>	<b>61.9</b>
Other deposits	3.8	-	9.5	5.1	-	-	-	0.4
<b>Total deposits</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>

Source: Companies, ABCI Securities estimates

**How bad can we go?**

We have factored into potential impact of interest rate liberalization into our models. Under our base case, we assume there will be 2-3 more rate cuts towards 1Q13, with 20-30bps each, we expect impact from these rate cuts including the two times happened in Jun and Jul 2012 should be reflected from 4Q12 till 3Q13, at the same time we do not expect radical change of loans and deposits pricing from what we can see so far in Jul and Aug 2012. As a result, we forecast to see 2012E NIM of H-share banks to reduce by 7-12bps, follow by 14-27bps in 2013E and stabilized with 2-11bps reduction in 2014E.

**Exhibit 10: H-share banks NIM trend**

(%)	ICBC	CCB	BOC	ABC	BoCom	CMB	CNCB	MSB
2011	2.61	2.70	2.12	2.85	2.56	3.06	3.00	3.14
2012E	2.53	2.61	2.03	2.75	2.47	3.00	2.88	3.06
2013E	2.34	2.43	1.89	2.57	2.25	2.75	2.62	2.91
2014E	2.28	2.41	1.81	2.47	2.17	2.71	2.51	2.85
<b>YoY change (bps)</b>								
2012E	(8)	(9)	(9)	(10)	(8)	(7)	(12)	(8)
2013E	(19)	(18)	(14)	(18)	(22)	(25)	(27)	(15)
2014E	(6)	(2)	(8)	(10)	(9)	(3)	(11)	(6)

Source: Companies, ABCI Securities estimates

**Interest rate sensitivity**

According to our sensitivity analysis, we believe China Construction Bank (CCB, 939 HK) and Industrial and Commercial Bank of China (ICBC, 1398 HK) would be least sensitive to asymmetric rate cut given their well-diversified business model, followed by ABC and MSB. On other hand China Citic Bank (CNCB 998 HK) and BoCom would be most sensitivity.

Separated from our base case, in order to demonstrate a better picture of interest rate reduction cycle, we did an interest rate sensitivity scenario study on our 2012E forecast. In this case study, we simulate the situation of an asymmetric interest rate cut of 30bps reduction in all loans duration and 25bps reduction in all deposit duration except saving rate, under the assumption that demand deposit is normally move in a minimal way compare to the degree of rate cut. Below table showed that such asymmetric rate cut would reduce NIM by 1-10bps and EPS by 1.3-6.4%,.





**Exhibit 11: H-share banks interest rate sensitivity (2012E)**

	ICBC	CCB	BOC	ABC	BoCom	CMB	CNCB	MSB
<b>Base case</b>								
NIM (%)	2.53	2.61	2.03	2.75	2.47	3.00	2.88	3.06
EPS (Rmb)	0.65	0.77	0.48	0.46	0.88	1.96	0.77	1.26
<b>30bps cut on loan and 25bps cut on deposits</b>								
NIM (%)	2.52	2.59	1.99	2.74	2.39	2.92	2.78	3.02
EPS (Rmb)	0.64	0.76	0.46	0.45	0.83	1.90	0.72	1.23
<b>Change</b>								
NIM (bps)	(1)	(2)	(4)	(1)	(8)	(8)	(10)	(4)
EPS (%)	(1.5)	(1.3)	(4.2)	(2.1)	(5.7)	(3.0)	(6.4)	(2.4)

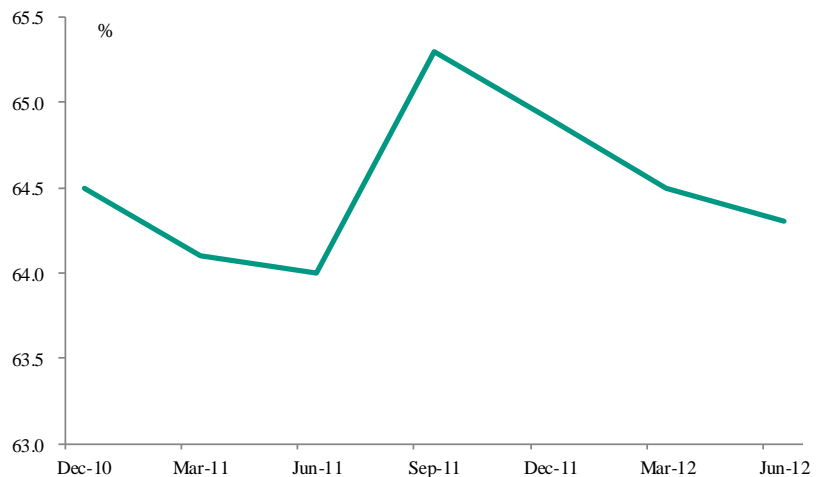
Source: Companies, ABCI Securities estimates

At a glance, we believe the two major factors affecting this result, which are the time deposits to total deposits and the percentage of loan to interest earning assets. ICBC, CCB and ABC have lower loan to interest earning assets below 52% while MSB also outperform for both a low loan to interest earning assets ratio and the highest time deposit mix over 60%.

**Balance sheet management key to excel**

In order to overcome the impact in profitability from NIM squeeze, banks will need to modify their balance sheet, this could mainly be achieved by two ways; 1) growing of interest earning assets (IEAs), 2) twist their balance sheet mix such as focus in higher yield assets and duration mix. In order to grow balance sheet size, banks will need to comply with the 75% loan to deposit ratio (LDR) requirement set by CBRC and to maintain sufficient required reserve. Hence banks with lower LDR and higher excess reserves allow themselves to grow without overly expose themselves to deposit competitions.

**Exhibit 12: China banking system LDR ratio**



Source: CBRC, ABCI Securities estimates

Despite system LDR was well below 65% level, we noticed that among H-share banks, bigger banks such as CCB, ICBC, and ABC possessed lower LDR compare to peers ranged 57-69% by end 1H12. On the other hand H-share banks have an average excess reserve of 1.87% as of end 2011, of which CCB, and Bank of China (BOC, 3988 HK) ranked highest with over 3% excess reserve. Under the assumption of RRR cut over coming quarters, more excess reserve is going to release, which would encourage bank to faster their loan growth in order to compensate weaker margin.



Exhibit 13: H-share banks excess reserve and LDR

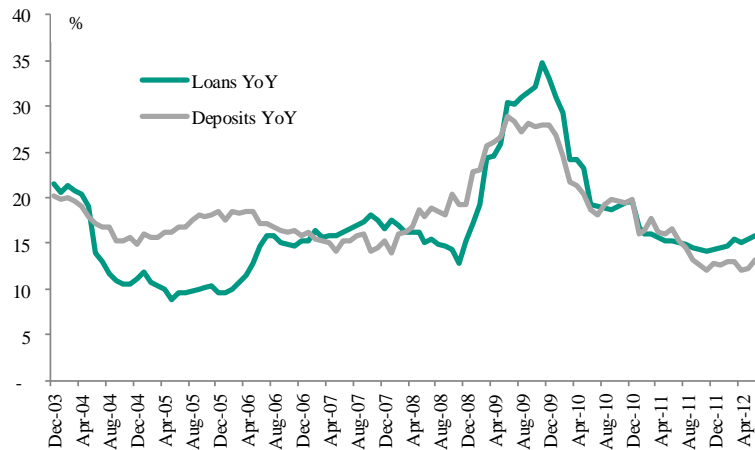
Stock name	Ticker	2011			1H12 LDR (%)
		Total reserve ratio (%)	RRR (%)	Excess reserve ratio (%)	
CCB	939 HK	23.1	20	3.10	65.1
BOC	3988 HK	24.0	20	4.02	68.6
ICBC	1398 HK	22.0	20	1.96	63.5
BOCOMM	3328 HK	22.0	20	1.95	71.9
ABC	1288 HK	21.9	20	1.93	57.3
CMB	3968 HK	17.9	18	(0.14)	72.6
MSB	1988 HK	19.9	18	1.89	72.9
CNCB	998 HK	18.2	18	0.22	73.0

Source: Companies, ABCI Securities estimates

Considered recent pick up trend both in loans and deposits growth with slightly faster system loan growth than deposits growth, we could reasonably expect a steady uptrend on system LDR in coming quarters, we forecast system LDR to remain at 60-65% level over 2012-13E. We assume system loan growth to stay at 12-15% each year in 2012-14E and system deposits growth to maintain at 13-16% over the same period.

Having said that, under current economic uncertainties, we noticed that banks have selectively loan strategy to SMEs in specific sector, such as advanced manufacturing, modern services and strategic emerging sector, this is mainly a balance between increasing asset quality concern and higher yield of 20-40% above benchmark lending rate on SMEs. We anticipate banks will continue modify their asset, shifting to high yield assets in order to compensate the NIM cut under the rate reduction cycle.

Exhibit 14: China banking system loans vs deposits growth



Source: Winds, PBOC, ABCI Securities estimates

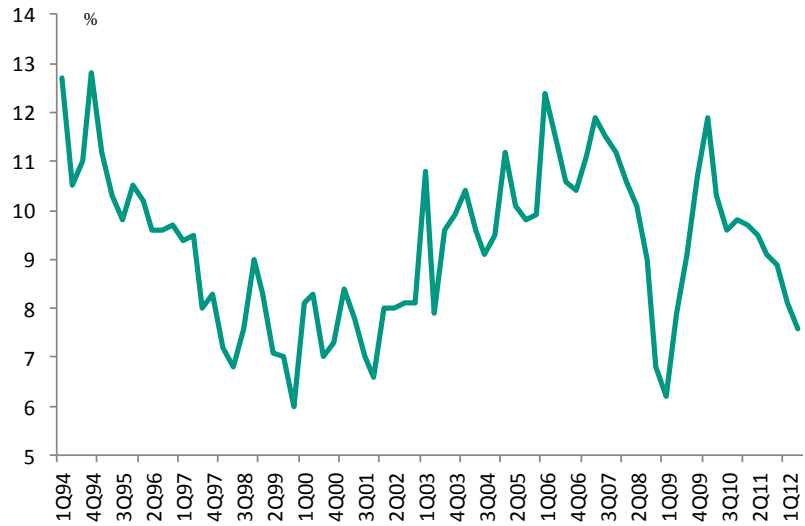


### Differentiation with risk

#### Stable China economy is the hope

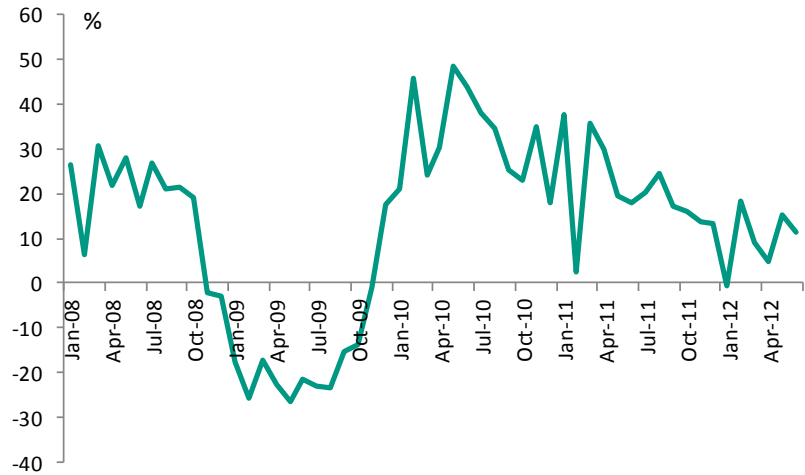
China GDP has been slowing down since 2010, dropped below China government's targeted 8% GDP growth in 2Q12 at 7.6%. This raises concern over sustainability of China economy, which as a result putting market focus on the potential assets quality concerns to Chinese banks. In fact if we looked back to the previous economic cycle including Asian financial crisis in 1997 and European sovereign crisis in 2008, we would notice that 6% level were previous lowest growth rate of China GDP, and we are approaching to that point, we shall expect China economy to rebound at that point if history repeated. We think it is critical for the market to lift concern on Chinese banks' asset quality, with a stabilized and rebound of China economy as turning point.

**Exhibit 15: China GDP Y-Y growth**



Source: Winds, ABCI Securities estimates

**Exhibit 16: China Export YoY growth**

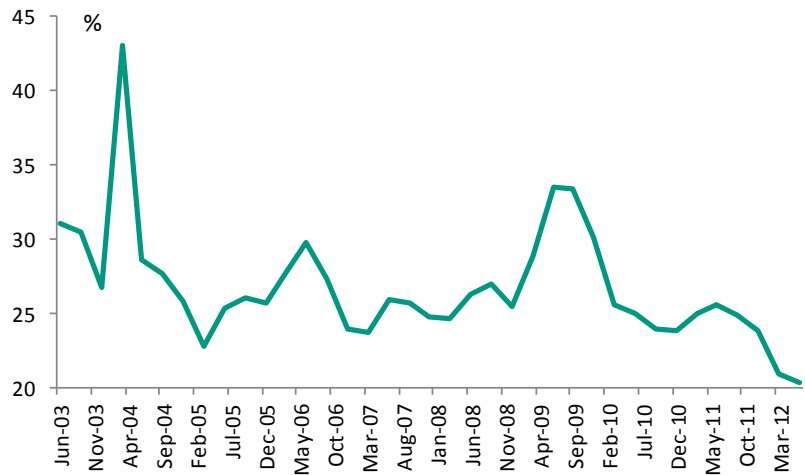


Source: Winds, ABCI Securities estimates



However, major recent macro data are not supporting this “soon to bottom out” story, other than GDP YoY growth fell below 8%, China export growth was trending down from previous peak of 50% YoY in mid-2010 to high single digit, while China fixed assets investment (FAI) consistently create historical low since mid-2003. All these contributed to an undesired outlook adverse economy stability in coming quarters, as a result we believe Chinese banking stocks shall continue to underperform the market in near term.

Exhibit 17: China FAI YoY growth



Source: Winds, ABCI Securities estimates

Nevertheless, under slowing GDP trend, we noticed that recent growth momentum in China is actually contributed by Western and Northern regions in China. The highest growth provinces including Xinjiang, Guizhou, Qinghai, Shaanxi, Yunnan and Chongqing were all belonged to the Western region, while Beijing, Inner Mongolia and Tianjin are located in the Northern China. H-shares banks generally hold 10-15% business mix from the Western region and 15-25% from Northern China, while on the other hand 20-30% business mix from the coastal area and central China. This business mix should point to a neutral impact to banks given coastal area economy are deteriorating could offset by faster western and northern growth.

Exhibit 18: China GDP 2Q12 Y-Y by provinces



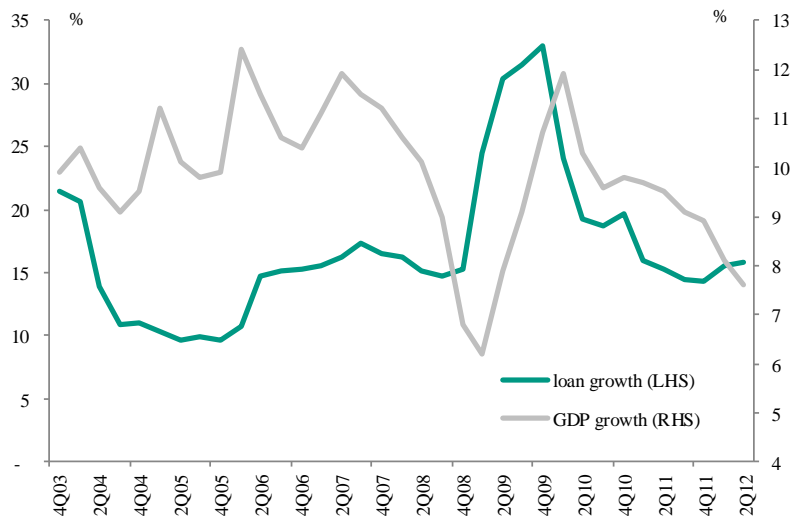
Source: Winds, ABCI Securities estimates



**Loan growth momentum is needed to support economy**

Banking sector being back bone of economy, bank loans have been rapidly used to support China economic growth through fine tuning monetary policies. With reference to the previous cycle in 2008, benchmark rate and RRR cut have been a regular tools used by China government during hard time, China GDP growth decelerated since 3Q07 and dropped below 8% level when it came into 4Q08, in addition to rate cuts, PBOC at that time introduced smaller banks RRR, which was lower than big banks RRR in order to allow smaller banks to increase liquidity for growing their balance sheet and support the economy. Effective result was demonstrated when system loan growth rose over 30% YoY near end 2009, followed by economic growth momentum resumed and peak at 12% YoY in 2Q10.

**Exhibit 19: China system loan vs GDP growth**



Source: Winds, ABCI Securities estimates

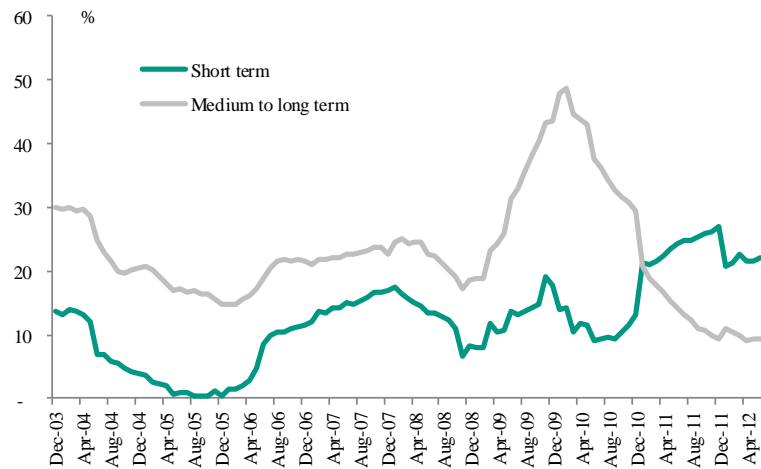
We believe the current economic cycle is similar to what we experienced in 2008, with the kicked off of interest rate and RRR reduction cycle, if few more rate cuts and RRR cuts were happened soon as we expected, we could reasonably expect loan growth power to fuel up in the next few quarters. Having said that banks will still focus their loan growth in SMEs and micro business lending for better yield with cautious, in order to offset NIM depression while remain healthy assets quality, anyhow we expect the rebound of loan growth rate will not as steep as early 2009.

**Duration mix is switching**

If we observed the recent loan growth trend, although YoY loan growth were well maintained at 14-15% level, reliance on short term loan became obvious since end 2010, as of Jun 2012, which short term loan contributed over 60% of new loan growth. We believe this is reflecting banks' strategic focus in SMEs and MSEs loan, which mainly short term in nature. With the open up of new financing channels, large corporates are now having more alternatives to raise fund through equity or bond issuance, SMEs and micro business became the major loan growth driver in the banking system. However, momentum of longer term loan growth is also important, being the indicator on banks and corporates towards longer term economic confidence, we expect medium and long term loan growth rate to pick up on the back of recent policy support in infrastructure sectors, which are typically longer term loans.



Exhibit 20: China system loan growth by maturity



Source: Winds, CBRC, ABCI Securities estimates

Exhibit 21: H-share banks loan growth (1H12)

(%)	ICBC	CCB	BOC	ABC	BoCom	CMB	CNCB	MSB
1H12 HoH	8.1	8.7	6.5	8.0	9.5	8.7	7.0	7.9
1Q12 QoQ	4.7	5.1	3.9	4.6	5.6	3.8	2.9	3.3
2Q12 QoQ	3.3	3.4	2.5	3.2	3.7	4.7	4.0	4.4

Source: Companies, ABCI Securities estimates

**H-share banks 1H12 loan growth outlook**

Looking at H-share banks' 1H12 results, we would see an average of 8% loan growth HoH, which pretty in line with system loan growth close to 9%. It is notably that new loan growth in 1H12 was mainly driven by manufacturing and retail & wholesale sectors of corporate loans and personal mortgage, contributed to an average of 47% of new loan growth. Considered the loan growth momentum in 1H12 and slowing down of macro economy, we forecast H-share banks' loan growth to maintain at an average of 14% each year over 2012-14E.

Exhibit 22: H-share banks new loan growth by sector (1H12)

HoH (%)	ICBC	CCB	BOC	ABC	BoComm	CMB	CNCB	MSB
Manufacturing	12.7	9.0	6.3	8.2	7.5	13.1	7.7	9.0
Transportation	3.3	8.5	9.0	5.5	4.0	2.0	6.2	1.9
Utility	(1.8)	3.8	(10.9)	6.8	(0.9)	7.6	(12.3)	(6.5)
Retail & wholesales	12.1	7.0	10.5	9.3	25.9	12.1	9.1	24.8
Property development	(2.5)	3.5	6.5	(6.1)	6.2	(6.0)	11.0	13.6
Construction	18.4	12.7	7.1	13.5	18.2	24.4	7.2	21.7
Mining	20.0	12.1	12.1	19.0	29.3	46.9	na	27.4
Other corporates	7.7	7.0	21.0	22.2	8.3	6.6	(1.3)	(2.3)
<b>Total corporates</b>	<b>6.3</b>	<b>7.3</b>	<b>5.5</b>	<b>7.9</b>	<b>9.4</b>	<b>9.9</b>	<b>4.4</b>	<b>8.9</b>
Mortgage	2.1	6.9	6.0	6.7	4.1	2.4	0.9	(7.6)
Credit card	na	25.6	25.3	24.8	24.4	15.5	29.6	30.0
Other personal	7.0	9.1	17.9	7.7	(0.5)	12.3	23.8	7.5
<b>Total personal</b>	<b>4.1</b>	<b>8.4</b>	<b>9.4</b>	<b>8.3</b>	<b>5.9</b>	<b>7.1</b>	<b>9.3</b>	<b>6.4</b>
Discounted bills and other	38.3	25.0	na	na	52.9	5.7	55.4	na
<b>Total loans</b>	<b>8.2</b>	<b>8.7</b>	<b>6.5</b>	<b>8.0</b>	<b>9.5</b>	<b>8.7</b>	<b>7.1</b>	<b>8.1</b>

Source: Companies, ABCI Securities estimates



Exhibit 23: H-share banks loan mix (30 Jun 2012)

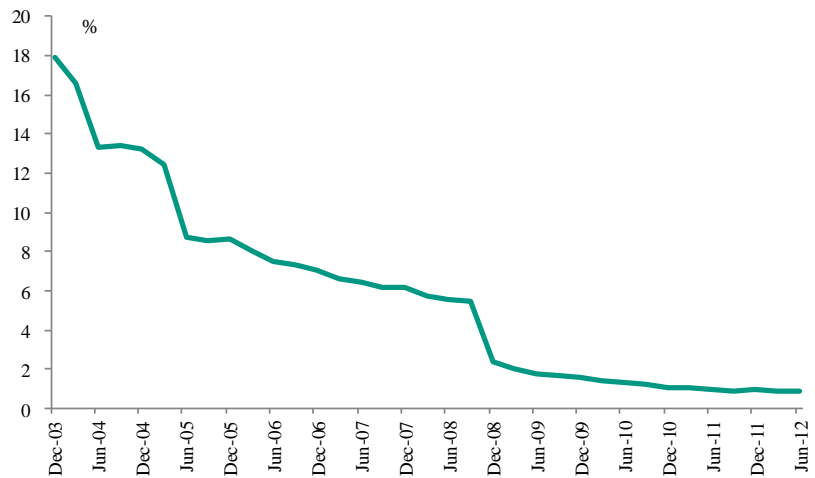
(%)	ICBC	CCB	BOC	ABC	BoComm	CMB	CNCB	MSB
Manufacturing	15.0	16.7	21.7	21.9	19.6	19.5	21.2	15.6
Transportation	12.9	11.4	10.0	8.0	12.2	8.1	8.7	4.9
Utility	12.7	11.7	10.1	11.1	10.3	6.0	8.6	4.5
Retail & wholesales	11.8	9.9	15.4	12.4	13.0	10.6	16.2	9.1
Property development	5.9	6.2	7.9	7.8	6.0	5.9	8.8	11.3
Construction	1.6	3.0	1.7	3.2	3.4	3.1	4.1	2.9
Mining	2.6	2.6	4.7	3.0	2.4	3.0	-	6.3
Other corporates	3.4	5.3	2.4	7.0	11.1	4.9	8.4	15.6
<b>Total corporates</b>	<b>65.8</b>	<b>66.8</b>	<b>73.8</b>	<b>74.5</b>	<b>78.0</b>	<b>61.2</b>	<b>75.9</b>	<b>70.3</b>
Mortgage	14.3	19.9	19.0	15.6	11.6	18.6	11.8	5.9
Credit card	-	1.7	1.8	2.1	3.3	4.7	2.7	3.8
Other personal	10.4	4.1	5.4	7.8	4.3	11.0	4.6	20.0
<b>Total personal</b>	<b>24.6</b>	<b>25.8</b>	<b>26.2</b>	<b>25.5</b>	<b>19.2</b>	<b>34.3</b>	<b>19.1</b>	<b>29.7</b>
Discounted bills and other	9.6	7.4	-	-	2.7	4.5	5.0	-
<b>Total loans</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>

Source: Companies, ABCI Securities estimates

### Rising NPL is confirmed

As part of the banking system reform, central government has helped banks to clear off their problem assets back in late 1990s and early 2000s by set up four assets management companies to acquire problem loan portfolios. NPL ratio in China was gradually improving over the past decade, from as high as 18% in 2003, down to below 1% in 1Q12, it is impressive that the downtrend was continued over 2008 financial crisis. Besides the figure, we believe banks' awareness in risk management has been improved at the same time.

Exhibit 24: China banking system NPL ratio



Source: CBRC, ABCI Securities estimates

If we looked at the latest statistics by China Banking Regulatory Commission (CBRC), we would see that although system NPL ratio in 2Q12 remained flat as 1Q12, NPL balance has been increased from Rmb438.2bn to Rmb456.4bn, which means 4% QoQ, or 6.3% higher than Dec 2011. Reference back to end 2011 statistic, high NPL were mainly attributed to agricultural, manufacturing, retail & wholesale, personal car loan and credit card advances sectors.

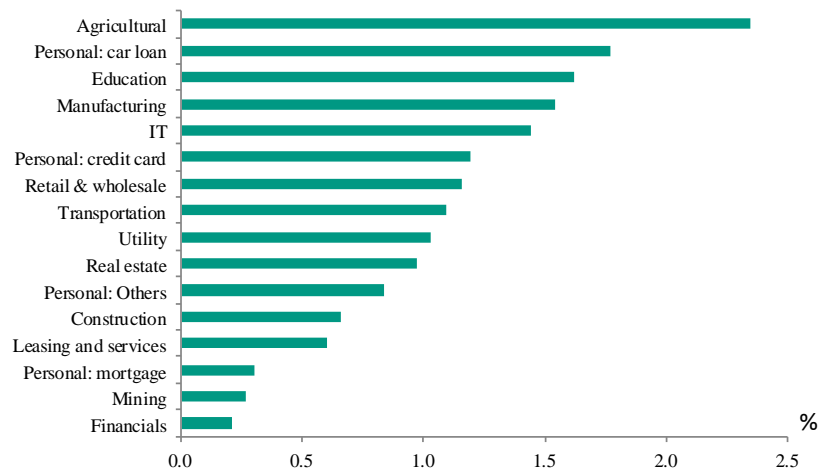


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**Exhibit 25: NPL ratio by sector (2011)**



Source: Winds, ABCI Securities estimates

**NPL growth attributed to specific area**

H-share banks' NPL allocation in 1H12 was similar to the system by end 2011, NPLs were mainly focused in manufacturing and retail & wholesale sector, of which aggregated to an average of 45% of overall NPLs of H-share banks. Corporate new NPLs were mainly driven by these sectors and construction loans, while personal NPLs were mainly driven by credit card loans.

**Exhibit 26: H-share banks NPL mix (30 Jun 2012)**

(%)	ICBC	CCB	BOC	ABC	BoCom	CMB	CNCB	MSB
Manufacturing	31.0	40.0	34.0	34.0	na	31.1	33.3	na
Transportation	13.1	6.4	19.8	8.1	na	5.2	10.9	na
Utility	6.3	5.9	8.2	13.5	na	3.6	2.5	na
Retail & wholesales	16.1	19.2	16.5	14.5	na	18.3	26.4	na
Property development	6.7	7.8	1.9	6.1	na	7.8	7.4	na
Construction	1.8	2.9	0.4	1.3	na	1.6	1.7	na
Mining	0.7	0.6	0.3	0.5	na	na	-	na
Other corporates	3.4	6.3	0.3	8.0	na	7.2	6.1	na
<b>Total corporates</b>	<b>79.0</b>	<b>89.0</b>	<b>81.4</b>	<b>86.1</b>	<b>na</b>	<b>74.7</b>	<b>88.3</b>	<b>na</b>
Mortgage	na	na	6.6	4.3	na	na	2.1	na
Credit card	na	na	3.2	1.5	na	na	7.1	na
Other personal	na	8.1	5.5	7.9	na	na	2.6	na
<b>Total personal</b>	<b>17.6</b>	<b>8.1</b>	<b>15.2</b>	<b>13.7</b>	<b>na</b>	<b>25.3</b>	<b>11.7</b>	<b>na</b>
Discounted bills and other	3.4	2.9	3.4	0.3	na	na	-	na
<b>Total loans</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>na</b>	<b>100.0</b>	<b>100.0</b>	<b>na</b>

Source: Companies, ABCI Securities estimates

Other than sector mix, geographic mix would be another interesting angle, most of the new NPLs were arise from coastal area with particular concentration in Wenzhou, Zhejiang province. Wenzhou has long been the key focus of asset quality concern, recent news reported that the NPL ratio of Wenzhou has been surged to 3% level in Jul 2012, this is more than a double from Dec 2011, recurring news were reported with negative tone that chain effect from non-FI lending institutions could ultimately hammer on the whole banking system.

Oppositely, bank managements delivered consensus view during their 1H12 result briefings that Wenzhou and Zhejiang although were the main area contributed to new NPLs, they do not expect sharp deterioration over 2H12 in these area, minority banks even expect assets quality in these areas has been bottomed. Most banks explained that 1H12 new NPLs were not much





related to worsening of economic conditions, instead it was as a consequence of banks' tighter risk measurement towards economic uncertainties.

**Exhibit 27: H-share banks NPL HoH growth (1H12)**

(%)	ICBC	CCB	BOC	ABC	BoComm	CMB	CNCB	MSB
Manufacturing	(0.6)	10.1	(1.4)	7.3	na	14.7	36.5	na
Transportation	(19.2)	(35.8)	(1.2)	(8.9)	na	(46.7)	(6.7)	na
Utility	(24.1)	(17.5)	(28.9)	(14.7)	na	6.3	(66.8)	na
Retail & wholesales	34.6	32.8	35.8	4.0	na	5.9	43.9	na
Property development	5.5	(31.5)	(35.5)	(16.9)	na	(6.3)	(22.3)	na
Construction	25.4	7.4	(14.2)	(23.6)	na	17.9	22.3	na
Mining	(3.8)	(34.9)	(10.0)	(29.0)	na	na	na	na
Other corporates	(5.0)	(17.8)	4.7	(17.4)	na	(4.4)	(30.7)	na
<b>Total corporates</b>	<b>(0.8)</b>	<b>(1.6)</b>	<b>(1.0)</b>	<b>(4.2)</b>	<b>na</b>	<b>0.1</b>	<b>8.2</b>	<b>na</b>
Mortgage	na	na	4.6	(9.6)	na	na	6.5	na
Credit card	na	na	36.2	46.2	na	na	28.0	na
Other personal	na	10.8	2.0	5.9	na	na	39.9	na
<b>Total personal</b>	<b>23.7</b>	<b>10.8</b>	<b>8.9</b>	<b>3.3</b>	<b>na</b>	<b>40.7</b>	<b>25.8</b>	<b>na</b>
Discounted bills and other	2.8	(1.9)	1.7	(7.2)	na	na	na	na
<b>Total loans</b>	<b>2.9</b>	<b>(0.7)</b>	<b>0.5</b>	<b>(3.3)</b>	<b>na</b>	<b>8.0</b>	<b>10.0</b>	<b>na</b>

Source: Companies, ABCI Securities estimates

We are of the view that current deterioration of assets quality is mainly focused in specific area rather than a nationwide spreading, given robust economic growth still noted in western and northern China. We anticipate contagion of NPLs from coastal to western and northern China is unlikely. Yet we agree that further reduction of NPL from current level is not realistic, while on the other hand we do not expect a rocket surge of NPL in coming quarters.

**Exhibit 28: H-share banks NPLs (30 Jun 2012) and forecast**

(Rmb mn)	ICBC	CCB	BOC	ABC	BoComm	CMB	CNCB	MSB
Normal	8,100,251	6,793,871	6,498,112	5,687,558	2,711,401	1,756,110	1,515,253	1,278,952
Special mention	248,661	197,055	191,990	308,038	71,646	17,890	10,706	15,329
Substandard	25,895	34,506	26,209	29,832	10,326	4,234	4,774	5,274
Doubtful	39,725	26,531	24,997	45,072	8,120	2,366	3,622	2,206
Loss	9,505	9,380	12,356	9,604	4,427	3,303	997	1,496
<b>Total</b>	<b>8,424,037</b>	<b>7,061,343</b>	<b>6,753,664</b>	<b>6,080,104</b>	<b>2,805,920</b>	<b>1,783,903</b>	<b>1,535,352</b>	<b>1,303,257</b>
<b>Total NPLs</b>	<b>75,125</b>	<b>70,417</b>	<b>63,562</b>	<b>84,508</b>	<b>22,873</b>	<b>9,903</b>	<b>9,393</b>	<b>8,976</b>
NPL%	0.89	1.00	0.94	1.39	0.82	0.56	0.61	0.69
Loan loss provision coverage (%)	281.4	262.4	232.6	296.3	273.5	404.0	273.2	352.4
Loan provision as % to total loans	2.51	2.62	2.19	4.12	2.23	2.24	1.67	2.43
<b>Mix (%)</b>								
Normal	96.2	96.2	96.2	93.5	96.6	98.4	98.7	98.1
Special mention	3.0	2.8	2.8	5.1	2.6	1.0	0.7	1.2
Substandard	0.3	0.5	0.4	0.5	0.4	0.2	0.3	0.4
Doubtful	0.5	0.4	0.4	0.7	0.3	0.1	0.2	0.2
Loss	0.1	0.1	0.2	0.2	0.2	0.2	0.1	0.1
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
<b>NPL% forecast</b>								
2011	0.94	1.09	1.00	1.55	0.86	0.56	0.60	0.63
2012E	1.10	1.24	1.43	2.00	0.97	0.83	0.82	0.95
2013E	1.30	1.37	1.63	2.50	1.13	1.06	1.03	1.20
2014E	1.40	1.49	1.81	2.80	1.20	1.25	1.23	1.35
<b>YoY changes (bps)</b>								
2012E	16	15	43	45	11	27	22	32
2013E	20	13	20	50	16	23	21	25
2014E	10	12	18	30	7	19	20	15

Source: Companies, ABCI Securities estimates



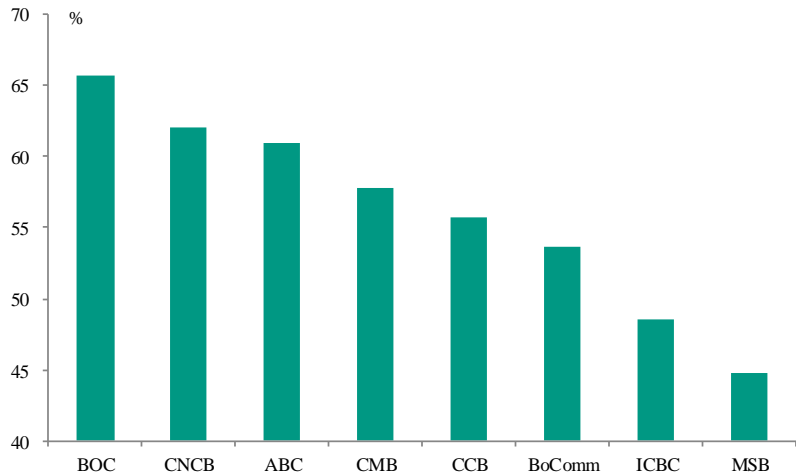
**Risk management makes a difference**

Moreover, instead of overly pessimistic on the upcoming assets quality deterioration, we choose to treasure banks with better risk management sense, which we think would contribute as an outperform trigger if things really turn bad as market wish. We firmly believe that high NPLs and provisions are not the only factor, as that could hint to a conservative management looking from the other side. CCB has long developed its prudence growth strategy, with second highest NPL ratio after ABC, we assure that this is mainly because of tighter classification and provisioning policy. Among smaller banks, we are most impressed by MSB’s risk management dedication 1H12, although the bank showed higher than peers NPL growth and credit cost in 1H12, we are convinced that this is a strategic move to plan ahead as management well understand the importance of risk management especially for a bank focuses in SMEs and MSEs business.

**1H12 asset quality still resilient**

Despite we do not see sharp increase trend of NPLs and credit cost from H-share banks’ 1H12 results, we still conservatively taken into account an assets quality deteriorating scenario, with most new NPLs should continue contribute by manufacturing and retail & wholesale sector, while property related loan trigger another concern under continue tightening measures. We regard these industries as high risk exposure including personal mortgage loan as property related, H-share banks generally have a range of 40-66% in these sectors. Particularly BOC has the highest exposure at 66% while MSB has smaller exposure to these sectors with around 45%.

**Exhibit 29: H-share banks – exposure in high risk industry**



Source: Companies, ABCI Securities estimates

We expect the most rapid growth under this NPL cycle in these sectors to happen in 2013E while start to stabilize in 2014E. However, we anticipate the actual impact to banks would be manageable, given the fact that banks has started to prepare for this hammer and shall make sufficient provision for this risk in advance. NPL ratio shall rise in the coming quarters in a manageable manner which we forecast H-share banks to grow by 11-45bps in 2012E and 16-50bps in 2013E, later to stabilize at 7-30bps in 2014E.

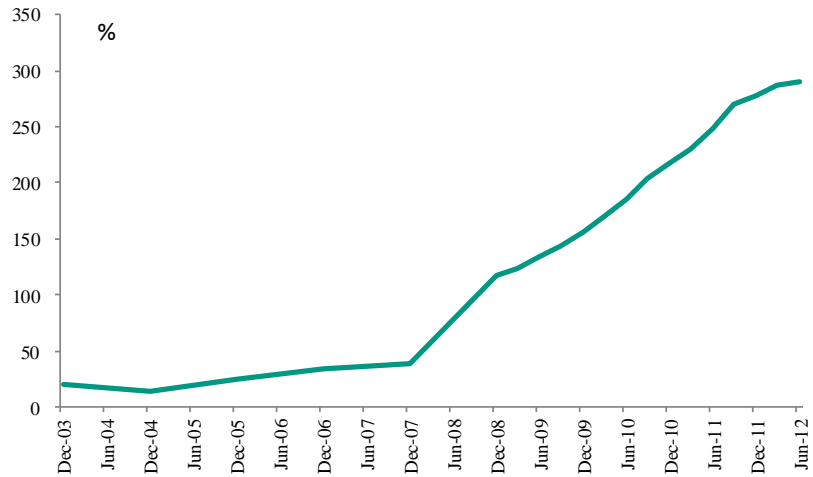
**High level provision coverage**

Although NPLs put concerns on banks’ credit cost, we are of the view that Chinese banks are well prepared on this credit cost cycle as early as in 2007, when we saw the China system provision coverage ratio was started to



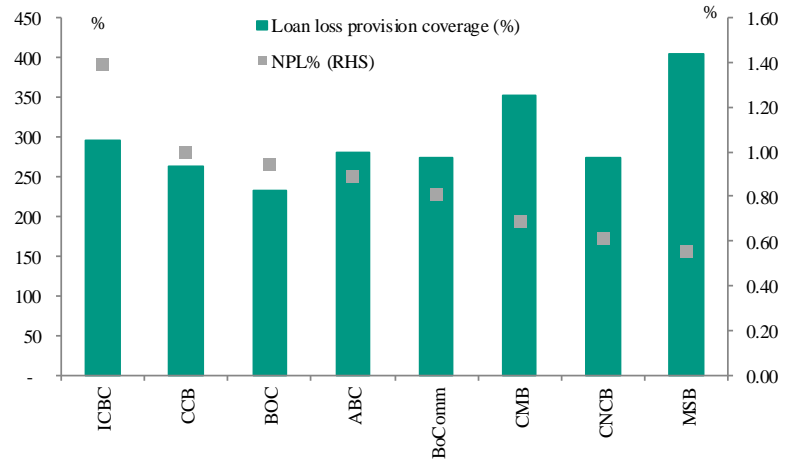
improve from only 39% by end 2007 to over 290% in 2Q12. Looking into banks' 1H12 results, it is notably that all of the listed banks have maintained their loan loss provision coverage at higher than 230%, China Merchants Bank (CMB, 3968 HK) and MSB even reached 400% and 350% respectively. NPLs of these banks well maintained at low level with only ABC higher than 1%. This is mainly due to historical high agricultural NPLs by ABC.

Exhibit 30: China banking system provision coverage ratio



Source: Winds, CBRC, ABCI Securities estimates

Exhibit 31: H-share banks LLR coverage and NPL%



Source: Companies, ABCI Securities estimates

## Unfavorable policy with low visibility

At the same time we considered policy risk to the banking sector is high, as most policies under the main theme of interest rate liberalization are negative to banks' margin in short term, while visibility of China policy is fairly low. Although we believe the whole liberalization reform takes time, policies combined as negative jaws on China banks' share price in near term. Below are some of the major policies in talk, which could affect the banking industry as a whole.

### Basel III implementation

The implementation of Basel III standard is in fact the most concrete policy in talk, CBRC published the preliminary version of commercial bank capital management methodology on 8 Jun 2012, which will start to implement from 2013, with the transition period through 2018. The mentioned methodology was basically in line with Basel III, with 11.5% total CAR for systematic important banks while 10.5% total CAR for smaller banks. Although this level of requirement is the same as current required capital level, where most H-share banks appeared well above, calculation will be tighter on risk weighted haircut rate, basically focused on small business and retail loans, we believe this will drag down total CAR of H-share banks by 50-150bps, yet with 6 years of transitional period, we do not see immediate needs on capital raising activities. This has been taken into account not only the minimum requirement of CAR and capital conservative buffer, but also the new concept of countercyclical buffer at the range of 0-2.5% and additional fully loss absorbing capital as introduced by Basel committee.

**Exhibit 32: Expected Basel III timeline (effective from 1Jan of each year)**

(%)	2013	2014	2015	2016	2017	2018	2019
Min. common equity capital ratio	3.5	4.0	4.5	4.5	4.5	4.5	4.5
Min. T1 capital	4.5	5.5	6.0	6.0	6.0	6.0	6.0
Min. total CAR	8.0	8.0	8.0	8.0	8.0	8.0	8.0
Capital conservative buffer	-	-	-	0.625	1.25	1.875	2.5
Total min. common equity capital ratio	3.5	4.0	4.5	5.125	5.75	6.375	7.0
Total min. T1 capital ratio	4.5	5.5	6.0	6.625	7.25	7.875	8.5
Total CAR min. requirement	8.0	8.0	8.0	8.625	9.25	9.875	10.5

Source: Basel committee, ABCI Securities estimates

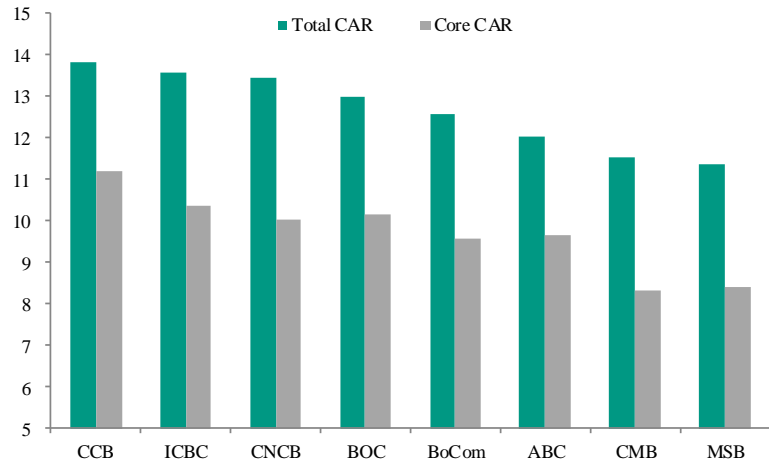
Besides, after the observation period from 2011 to 2012, Basel committee will introduce another two new measures by Jan 2015, which are the liquidity coverage ratio (LCR) and net stable funding ratio (NSFR), with minimum standard will be adopted by Jan 2018. These two ratios were aimed to maintain individual bank's liquidity position at a prudence level towards any sudden hit on bank's balance sheet.

If we observe the latest 1H12 result of H-shares banks, we believe most banks have already position themselves at a sufficient level, to fulfill the Basel III requirements. Especially after the latest private equity issuance of Bank of Communications (BoCom, 3328 HK) approved in Aug. Banks have above 8% core CAR and 11.5% of total CAR, allowing them to take a discount factor of 50-150bps reduction under new calculation methodology in Basel III. Among all the banks, CMB and MSB has the lowest CAR position, which marginally fulfills the new requirement, of which CMB has a delayed right issue plan pending regulatory approval to execute. For MSB, CSRC has approved its Rmb20bn A-share convertible bond issuance in Jul 2012, we believe this would raise core CAR by 1.2% . After these, we do not expect another round of equity raising activity by H-share banks in coming



years.

**Exhibit 33: H-share banks CAR & Core CAR ratio (30 Jun 2012)**



Source: Companies, ABCI Securities estimates

#### **Establish deposit insurance system**

Being part of the 12<sup>th</sup> 5-year plan, deposit insurance system is one of the mechanisms mentioned to improve banking system stability. Under this system, banks will need to pay insurance premium to insurers according to different class of deposits, while insurers would provide financial support or directly settle deposits liabilities for banks if banks were facing liquidity problem and go bankrupt.

This system although aim to protect central government from settling the bills for banks in case problem arise, on banks however it may levy extra premium expenditure to banks. Still at preliminary stage, actual impact on banks' profitability would still be a question.

#### **Launch of prime rate system**

According to some Chinese presses, China regulators are now at research phase to launch a prime rate system. The difference between the current benchmark rate system and the prime rate system primarily is who determining interest rate. Under current benchmark system, rates are set by regulator while under prime system; rates will be defined by major banks. Banks would then have larger degree of freedom to compete with each other.

In the other words, this is another milestone of interest rate liberalization for free pricing competition, yet we believe any establishment of such prime rate system is not going to be sharp cut off; a dual system parallel run may exist at the beginning. Repeatedly saying, we believe interest rate liberalization would hurt banks' margin in short term, while in long run a free market would better help banks to identify their own strength and differentiate themselves with peers.

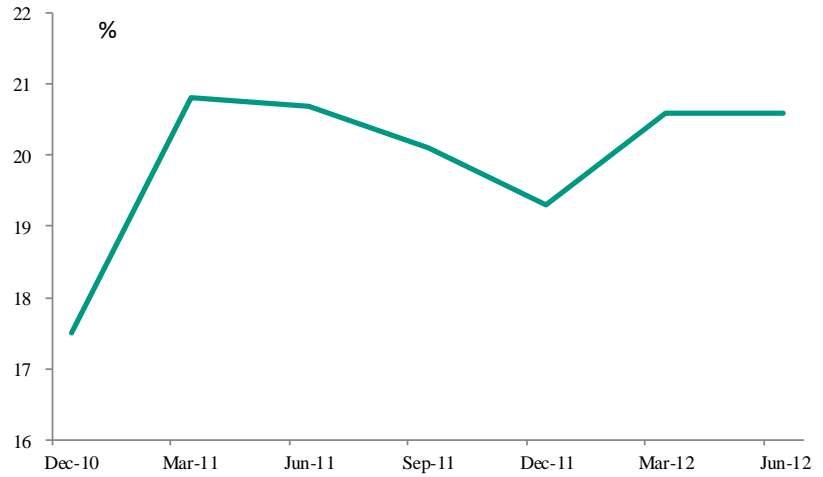
#### **Bank fee tightening measures**

Besides the interest rate liberalization hammering banks' NIM, there were news flows about the potential tightening of banks' fee income by CBRC. This could include regulating of fee income types and fee rates, in fact CBRC has already put up guidance to prohibit banks from using fees as a distortion tools to charge more on riskier loans, i.e. charging riskier customer at lower interest rate package with other fee items such as insurance and



administrative charges.

**Exhibit 34: China banking system non-fee income to topline revenue**



Source: Winds, CBRC, ABCI Securities estimates

Although currently fee income aggregated around 20% of bank's top line revenue, we believe it would become one of the most important growth drivers to sustain profitability under interest rate liberalization. However given low visibility on upcoming measures, we do not have sufficient information to factor in the expected impact and timeline on this issue.



## Fundamental and forecasts

### Revenue

#### Net interest income

Under interest rate liberalization and recent rate cuts, we forecast to see another 2-3 benchmark rate cuts in China in 2H12 and 1Q13, total 60-90bps reduction. Together with the possibility of 2-3 cuts in RRR, which aggregate to 200-300bps. In the declining interest rate cycle, we expect H-share banks' NIM to reduce by average of 7-20 bps each in 2012-14E, which in return increase net interest income by 9-13% CARG over 2012-14E.

**Exhibit 35: H-share banks NIM and NII forecast**

(%)	ICBC	CCB	BOC	ABC	BoCom	CMB	CNCB	MSB
<b><u>NIM</u></b>								
2011	2.61	2.70	2.12	2.85	2.56	3.06	3.00	3.14
2012E	2.53	2.61	2.03	2.75	2.47	3.00	2.88	3.06
2013E	2.34	2.43	1.89	2.57	2.25	2.75	2.62	2.91
2014E	2.28	2.41	1.81	2.47	2.17	2.71	2.51	2.85
<b>Change (bps)</b>								
2012E	(8)	(9)	(9)	(10)	(8)	(7)	(12)	(8)
2013E	(19)	(18)	(14)	(18)	(22)	(25)	(27)	(15)
2014E	(6)	(2)	(8)	(10)	(9)	(3)	(11)	(6)
<b><u>Net interest income</u></b>								
<b><u>(Rmb mn)</u></b>								
2011	362,764	304,275	228,064	307,199	102,601	76,307	65,106	64,821
2012E	406,279	344,439	249,360	351,167	118,192	85,109	76,389	72,639
2013E	429,841	367,224	263,915	381,025	129,586	90,931	83,357	78,535
2014E	474,985	408,788	283,223	413,468	147,056	102,743	94,740	84,383
<b>Change (%)</b>								
2012E	12	13	9	14	15	12	17	12
2013E	6	7	6	9	10	7	9	8
2014E	11	11	7	9	13	13	14	7

Source: Companies, ABCI Securities estimates

Considered the latest announced 1H12 results, NIM generally stay firm in 1H12 as 2H11, although some banks show declining 1H12 NIM. We would expect NIM decline become more obvious from 2H12 as we expect the previous rate cuts shall fully reflect from 3Q12 onwards due to the delayed re-pricing effect, as a result 2H12 shall reduce by 1-26bps, pointing to overall 2012E NIM to drop by 9-12bps. However change of net interest income (NII) will be a mix view given individual banks' assets growth and mix.

#### Fee income

Although fee income currently contributed to around 20% of bank's topline revenue, we believe its importance would gradually increase both by organic growth with new fee income channels and slower NII under weakening NIM, which will reduce NII's importance in topline income. We believe bank management would put more focus to develop alternative income source to sustain their profitability under the landscape of declining NIM outlook. As a result our forecast show H-share banks' fee income to increase by 20-30% CAGR over 2012-14E, and increase the mix to topline revenue to 19-28% by 2014E.



**Exhibit 36: H-share banks fee income forecast**

(Rmb mn)	ICBC	CCB	BOC	ABC	BoCom	CMB	CNCB	MSB
<b>Net fee income</b>								
2011	101,550	86,994	64,662	68,750	19,549	15,628	8,837	15,101
2012E	126,333	107,192	76,857	91,651	24,658	20,073	10,958	20,826
2013E	153,805	129,331	92,987	119,176	30,079	24,591	13,348	27,468
2014E	181,270	154,944	110,716	148,213	35,641	29,302	15,944	34,376
<b>Change (%)</b>								
2012E	23	23	19	33	26	28	24	38
2013E	21	21	21	30	22	23	22	32
2014E	17	20	19	24	18	19	19	25
<b>Net fee to topline (%)</b>								
2011	21.6	21.8	19.7	18.1	15.3	16.2	11.5	18.4
2012E	23.4	23.3	20.8	20.4	16.5	18.0	12.0	21.6
2013E	26.0	25.6	22.9	23.4	18.0	20.1	13.2	25.1
2014E	27.3	27.0	24.6	25.9	18.7	20.9	13.8	28.0

Source: Companies, ABCI Securities estimates

**Exhibit 37: H-share fee income mix (1H12)**

(%)	ICBC	CCB	BOC	ABC	BoCom	CMB	CNCB	MSB
Bank card fees	17.9	18.1	18.4	17.4	29.2	25.2	27.9	21.2
Remittance and settlement fees	23.4	12.2	19.4	24.7	8.1	10.5	24.9	15.8
Agency services fees	1.5	14.4	18.6	24.2	6.1	19.0	8.0	9.5
Credit commitment and loan comm	2.5	2.9	16.9	3.0	14.5	11.4	4.5	12.8
Trust services fees	4.8	9.0	2.9	1.8	13.0	22.4	8.8	29.1
Financial advisory	25.4	20.7	5.8	22.1	27.4	-	25.9	10.2
Others	24.5	22.6	18.0	6.9	1.7	11.6	0.1	1.4
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Source: Companies, ABCI Securities estimates

## Expenses

### Operating expenses

Operating expenses are relatively stable in the financial statements, with the growth of bank's expense mainly on branch expansion and inflation of organic expenses. We forecast operating expenses to growth by 13-20% CAGR in 2012-14E.

**Exhibit 38: H-share banks operating expenses forecasts**

(Rmb mn)	ICBC	CCB	BOC	ABC	BoCom	CMB	CNCB	MSB
<b>Operating expenses</b>								
2011	169,613	144,537	140,815	157,330	49,865	41,194	28,381	36,645
2012E	197,333	169,718	164,630	189,476	60,131	47,149	34,388	42,169
2013E	222,947	197,132	190,709	225,761	71,106	53,396	41,208	47,940
2014E	246,594	227,276	217,706	265,632	82,802	60,558	48,890	54,030
<b>Change (%)</b>								
2012E	16	17	17	20	21	14	21	15
2013E	13	16	16	19	18	13	20	14
2014E	11	15	14	18	16	13	19	13

Source: Companies, ABCI Securities estimates

### Asset impairment

Under our assumption of asset deterioration, we would expect loan impairment to increase accordingly, in order to sustain loan loss coverage at desire level. After the relatively slow credit cost in 1H12, we conservatively expect banks to speed up provisions from 2H12. This is pointing to an average 23% YoY increase of credit cost in 2012E, followed by 21% in 2013E and 11% in 2014E. We assume banks to gradually build up their provision to total loans by 10-25bps each year in 2012-14E.





**Exhibit 39: H-share banks credit cost forecasts**

(%)	ICBC	CCB	BOC	ABC	BoCom	CMB	CNCB	MSB
<b>Impairment provision</b>								
2011	31,121	35,783	19,355	64,225	12,479	8,350	7,207	8,376
2012E	43,920	43,197	24,437	66,485	18,965	9,179	8,302	9,641
2013E	53,717	42,780	29,934	70,871	22,240	11,080	12,895	11,674
2014E	68,173	52,438	27,468	62,981	25,088	12,727	14,532	13,288
<b>Change (%)</b>								
2012E	41	21	26	4	52	10	15	15
2013E	22	(1)	22	7	17	21	55	21
2014E	27	23	(8)	(11)	13	15	13	14
<b>Provision to loans</b>								
2012E	2.7	2.8	2.3	4.6	2.4	2.4	1.8	2.5
2013E	2.9	2.9	2.4	4.9	2.6	2.6	2.1	2.8
2014E	3.1	3.0	2.5	5.0	2.8	2.8	2.3	3.1

Source: Companies, ABCI Securities estimates

As mentioned in earlier chapter, this would be mainly caused by specific sector including manufacturing and wholesale & retail in coastal area, yet we also taken into account the chain effect from these sectors to others. However under our base case assumption, we believe contagion effect geographically will be manageable, with new NPLs mainly stay in Yangtze River Delta (YRD) area.

**Exhibit 40: H-share credit quality HoH (1H12)**

(%)	ICBC	CCB	ABC	BOC	BoCom	MSB	CMB	CNCB
NPL	2.9	(0.7)	(3.3)	0.5	(8.5)	19.1	8.0	10.0
Special mention loans	7.3	12.9	(2.1)	(0.3)	23.1	15.0	5.5	(27.3)
Overdue loans	7.0	33.5	15.7	17.4	10.1	63.2	15.5	53.0

Source: Companies, ABCI Securities estimates

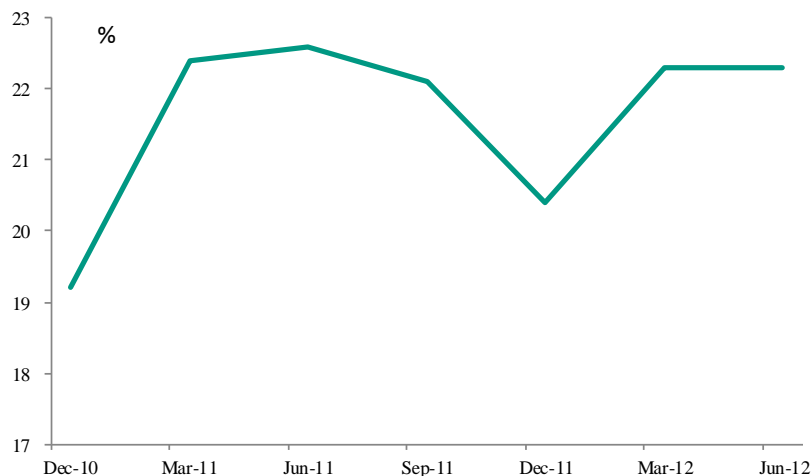
We noticed other than NPL ratio and balance, there are side concerns on special mention loan and overdue loan on individual banks, which could be signals point to future NPLs. Review H-shares banks 1H12 results, three banks CCB, ABC and BoCom saw HoH reduction of NPLs. ABC demonstrates a most decent outlook, which we would explained by a historical high NPL given its late listing than peers. CCB's overdue loan according to management was distorted as half of the overdue were in relation to previous NPLs, while half of the remaining has already been repaid in Jul and Aug. Under current economic landscape, we believe larger banks are more defensive than smaller banks given a well-diversified business mix.

**Profitability**

China banking sector is one of the most profitable countries in the world, with over 20% ROE, compare to other Asian countries such as Taiwan, Korea and Singapore with mid-teens ROE and high single digits in matured economies like US, Europe and Japan. However under ongoing interest rate liberalization and slowing economy, we anticipate the profitability of H-share banks to steady reduce, which under our assumption, should approaching to an average 18.5% by 2014E. This is as a result of 8-15% net profit CAGR over 2012-14E under our forecast model. Nevertheless, we believe bank with quality could excel despite tough operating environment, below table showing that CCB, ABC, CMB and MSB shall be able to maintain over 20% ROE by 2014E, with MSB the highest at 21%.



**Exhibit 41: China banking system ROE**



Source: Winds, CBRC, ABCI Securities estimates

Among these four banks, we like CCB most for its long developed prudence growth strategy, with tighter than peers provisioning policy. ABC demonstrated continue asset quality improvement in 1H12 results, although the bank has historically higher NPLs, we believe there are still rooms for the bank to improve. Meanwhile we are impressed by MSB's proactive effort in 1H12 to prepare for the worst, increasing focus in risk management shall differentiate the bank from peers. Lastly, despite CMB also could achieve above 20% ROE by 2014E, we hesitate on this name for the delayed equity fund raising pending approval, which shall continue to shadow CMB's share price on potential dilution.

**Exhibit 42: H-share banks ROE trend**

(Rmb mn)	ICBC	CCB	BOC	ABC	BoCom	CMB	CNCB	MSB
<b>Net profit</b>								
2011	208,265	169,258	124,182	121,927	50,735	36,129	30,819	27,920
2012E	225,498	192,861	133,660	148,350	54,709	42,394	35,880	33,738
2013E	237,848	201,499	140,194	163,287	57,420	44,788	34,877	37,764
2014E	264,292	229,542	154,727	186,774	64,788	51,460	38,906	41,998
<b>Change (%)</b>								
2012E	8	14	8	22	8	17	16	21
2013E	5	4	5	10	5	6	(3)	12
2014E	11	14	10	14	13	15	12	11
<b>ROAE (%)</b>								
2012E	21.8	22.1	17.4	21.1	18.8	23.1	18.7	23.7
2013E	19.9	20.1	16.3	20.1	17.4	20.4	15.5	22.3
2014E	19.3	20.1	16.1	20.0	17.5	20.0	15.0	21.0

Source: Companies, ABCI Securities estimates



## Valuation

We use traditional Gordon Growth Model (GGM) to value banks (i.e. (ROE-g)/COE-g), with our cost of equity (COE) assumption derived from capital asset pricing model (CAPM) (i.e. risk free rate + beta\*risk premium). Our COE assumption included 3.3% risk free rate (10Y China government bond yield) and 11.8% China country risk premium together with individual bank's beta. We calculation sustainable ROE with simple average of individual bank's historical ROE, which covered the past economy cycle. We assumed long term growth at 6%, 2ppt below current 8% target GDP growth in China. This indicates an average target mid-13E P/B multiple of 1.18x. Our target prices are calculated based on the target P/B and mid-13E book value of individual bank.

### Exhibit 43: H-share banks target price summary

Ticker	Rating	Sh. price (Rmb)	TP (Rmb)	Upside (%)	Target PB (x)	ROE (%)	COE (%)	LT growth (%)	
CCB	939 HK	Buy	5.00	6.30	26.0	1.57	20.4	15.2	6.0
ABC	1288 HK	Buy	2.79	3.45	23.7	1.38	19.6	15.9	6.0
MSB	1988 HK	Buy	6.00	7.66	27.7	1.21	18.6	16.5	6.0
ICBC	1398 HK	Hold	4.22	4.44	5.2	1.30	17.7	15.0	6.0
BOC	3988 HK	Hold	2.84	2.94	3.5	0.95	14.8	15.3	6.0
BoCom	3328 HK	Hold	5.11	5.13	0.4	0.96	15.5	15.9	6.0
CMB	3968 HK	Hold	12.50	13.47	7.8	1.32	20.1	16.7	6.0
CNCB	998 HK	Hold	3.58	3.61	0.8	0.75	15.2	18.2	6.0
<b>Average</b>					<b>11.9</b>	<b>1.18</b>			

Source: Bloomberg, ABCI Securities estimates(price as of 11 Sep 2012)

H-Share banks currently are trading at an average of 1.0x 2012E PB, implying -1.5-2 s.d. below mean, as low as 2008 crisis. We noted that the Chinese banking sector has been underperformed the market since 2008 for margin squeeze under interest rate liberalization and massive asset quality deterioration under slowing down of economy.

We agree the increasingly challenging sector outlook of Chinese banking sector for 2H12 & 2013, yet we think it is unfair to penalize higher quality banks which have made effort to prepare themselves to the challenges over these years. Consider that most headwinds such as interest rate liberalization, NIM squeeze, credit quality concern are well expected by the market, with 4.5-6.5% dividend yield and trough valuation, we have a Neutral outlook on China banking sector, and selectively like high quality banks for defensive to risk.

### Exhibit 44: H-share banks valuation summary

Ticker	Mkt cap (HK\$mn)	Sh. price (Rmb)	12E PE	13E PE	12E PB	13E PB	12E ROE	12E Div Yield	
CCB	939 HK	1,248,346	5.00	5.4	5.1	1.1	1.0	22.1	6.5
ABC	1288 HK	974,640	2.79	5.1	4.7	1.0	0.9	21.1	6.0
MSB	1988 HK	193,339	6.00	4.0	3.5	0.9	0.7	23.7	6.4
ICBC	1398 HK	1,583,942	4.22	5.4	5.2	1.1	1.0	21.8	5.4
BOC	3988 HK	888,348	2.84	4.9	4.7	0.8	0.7	17.4	6.3
BoCom	3328 HK	384,024	5.11	4.8	4.6	0.9	0.8	18.8	6.3
CMB	3968 HK	267,677	12.50	5.4	5.0	1.1	0.9	23.1	4.7
CNCB	998 HK	202,044	3.58	3.9	4.0	0.7	0.6	18.7	6.4
<b>Average</b>				<b>4.9</b>	<b>4.6</b>	<b>0.9</b>	<b>0.8</b>	<b>20.8</b>	<b>6.0</b>

Source: Bloomberg, ABCI Securities estimates(price as of 11 Sep 2012)



農銀國際

ABC INTERNATIONAL

ABCI SECURITIES COMPANY LIMITED

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Our investment theme would generally prefer larger banks over smaller banks, for their defensive business model. Among big banks we prefer CCB for its consistent prudence growing model and ABC as we view the other way on its high NPLs, given late start of risk management, we see easier room to improve than peers despite worsening system credit quality. Among smaller banks, we favor MSB as we believe it's management are most proactive towards risk differentiation, given market generally expect this name to underperform for its MSEs business focus edge, think the other way round, this set to surprise the market on the upside if MSB able to deliver consistent better than expected asset quality in coming quarters.



# Company Report

**CCB (939 HK) - Buy**  
Diversified Bank Sector  
Initiation

## Key data

Share price (HK\$)	5.00
Target price (HK\$)	6.30
Upside potential (%)	26.0
52Wk H/L(HK\$)	6.62/4.41
Issued shares (mn)	
- A shares	9,594
- H-shares	240,417
Market cap	
- A share (Rmb mn)	37,799
- H-share (HK\$mn)	1,202,087
30-day avg vol (HK\$mn)	1,354
Major shareholder (%)	
Huijin	57.03

Source: Company & Bloomberg

## Operating income mix (1H12) (%)

Corporate banking	46.9
Personal banking	28.0
Treasury	21.3
Others	3.8

Source: Company

## Share performance (%)

	Absolute	Relative*
1-mth	(4.9)	(3.4)
3-mth	(4.5)	(9.1)
6-mth	(19.4)	(14.1)

\*Relative to Hang Seng Index

Source: Bloomberg

## 1 year price performance



Source: Bloomberg

## Analyst

Report Date: 12 September 2012

Johannes Au

Tel: (852) 2147 8802

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## Fort of prudence

**We initiate coverage on CCB with Buy rating, our target price of HK\$6.3 implying 26% upside. Despite low funding cost edge from CCB's mega franchises, we are impressed by the bank's long developed prudence growth strategy, contributed to proactive higher than peers provision and NPLs, which we believe could differentiate the bank during hard time.**

**Prudent growth strategy.** We appreciate CCB's prudence growth strategy under current market circumstances. The bank has gradually reduced their corporate property loans exposures from 12.8% in 2007 to 9.2% in 1H12. Meanwhile we noted that CCB has long been adopted a conservative provision policy, with 14bps higher NPL and 12bps higher provision to total loans than peer average. This would better protect CCB under an asset quality worsening cycle.

**Low LDR high SRR set to grow.** Given CCB's low LDR and high surplus reserves, we believe the bank would be major beneficiary under rate cut cycle by faster IEAs growth to offset NIM impact with lesser exposure to deposit competition than peers. CCB's mega deposit franchise and high demand deposit mix at 51.2% result a historically low end funding cost compare to peers.

**Record high 2Q12.** We are impressed by the bank's record high quarterly net profit at Rmb54.8bn with NIM further expanded to 2.77% on better bond yield and loan re-pricing. This is an extraordinary achievement through balance sheet management when many peers hit hard on NIM by higher interbank liabilities cost in 1H12.

**Valuation.** With consistent prudence strategy, we expect CCB's EPS to grow by 10.7% CAGR through 2012-14E for a balanced growth in topline and lower than peers credit cost, trading at 1.11x 12E P/B, implying 26% upside to our target price of HK\$6.3, **we initiate CCB with a Buy rating.**

**Risk factors:** Prolonged slow economy in China, interest rate liberalization, sharp deterioration of asset quality and faster than expected operating cost growth.

## Results and valuation

(FY ended Dec 31)	FY10A	FY11A	FY12E	FY13E	FY14E
<b>Operating income (Rmb mn)</b>	325,780	399,403	459,917	505,491	573,372
YoY Chg (%)	21.0	22.6	15.2	9.9	13.4
<b>Net profit (Rmb mn)</b>	134,844	169,258	192,861	201,499	229,542
YoY Chg (%)	26.3	25.5	13.9	4.5	13.9
<b>EPS (Rmb)</b>	0.54	0.68	0.77	0.81	0.92
<b>BVPS (Rmb)</b>	2.79	3.24	3.75	4.27	4.87
<b>PE (x)</b>	--	6.1	5.4	5.1	4.5
<b>PB (x)</b>	--	1.29	1.11	0.98	0.86
<b>ROAE (%)</b>	21.5	22.4	22.1	20.1	20.1

Source: Company, ABCI Securities estimates



**Income statement forecast**

(Rmb mn)	2010A	2011A	2012E	2013E	2014E
Net interest income	251,500	304,572	344,439	367,224	408,788
Non-interest income	74,280	94,831	115,479	138,268	164,583
Of which: fees and commissions	66,132	86,994	107,192	129,331	154,944
<b>Operating income</b>	<b>325,780</b>	<b>399,403</b>	<b>459,917</b>	<b>505,491</b>	<b>573,372</b>
Operating expenses	(119,394)	(142,437)	(167,492)	(194,773)	(224,774)
Amortization	(1,972)	(2,100)	(2,226)	(2,360)	(2,501)
<b>Pre-prov. operating profits</b>	<b>204,414</b>	<b>254,866</b>	<b>290,199</b>	<b>308,359</b>	<b>346,096</b>
Impairment losses	(29,292)	(35,783)	(39,518)	(46,459)	(47,775)
Operating profit	175,122	219,083	250,681	261,900	298,321
Non-operating income	34	24	25	26	28
<b>Profit before tax</b>	<b>175,156</b>	<b>219,107</b>	<b>250,706</b>	<b>261,927</b>	<b>298,349</b>
Tax	(40,125)	(49,668)	(57,662)	(60,243)	(68,620)
Minority interests	(187)	(181)	(183)	(185)	(186)
<b>Net profit</b>	<b>134,844</b>	<b>169,258</b>	<b>192,861</b>	<b>201,499</b>	<b>229,542</b>
<b>Growth (%)</b>					
Net interest income	19	21	13	7	11
Non-interest income	29	28	22	20	19
Of which: fees and commissions	38	32	23	21	20
<b>Operating income</b>	<b>21</b>	<b>23</b>	<b>15</b>	<b>10</b>	<b>13</b>
Operating expenses	16	19	18	16	15
Amortization	5	6	6	6	6
<b>Pre-prov. operating profits</b>	<b>25</b>	<b>25</b>	<b>14</b>	<b>6</b>	<b>12</b>
Impairment losses	15	22	10	18	3
Operating profit	26	25	14	4	14
Non-operating income	100	(29)	5	5	5
<b>Profit before tax</b>	<b>26</b>	<b>25</b>	<b>14</b>	<b>4</b>	<b>14</b>
Tax	26	24	16	4	14
Minority interests	134	(3)	1	1	1
<b>Net profit</b>	<b>26</b>	<b>26</b>	<b>14</b>	<b>4</b>	<b>14</b>
<b>Per share data (Rmb)</b>					
EPS	0.54	0.68	0.77	0.81	0.92
BVPS	2.79	3.24	3.75	4.27	4.87
DPS	0.21	0.24	0.27	0.28	0.32
<b>Key ratio (%)</b>					
Net interest margin	2.49	2.70	2.61	2.43	2.41
Net interest spread	2.40	2.57	2.49	2.32	2.29
Cost to income ratio	37.3	36.2	36.9	39.0	39.6
Return on average assets	1.32	1.47	1.45	1.33	1.34
Return on average equity	21.5	22.4	22.1	20.1	20.1
Effective tax rate	22.9	22.7	23.0	23.0	23.0
Dividend payout	39.3	34.9	35.0	35.0	35.0

Source: Company, ABCI Securities estimates

**CCB – PB band chart**



Source: Winds, ABCI Securities estimates



**Balance sheet forecast**

(Rmb mn)	2010A	2011A	2012E	2013E	2014E
Cash & cash equivalent	2,029,104	2,579,854	3,085,776	3,530,189	3,997,652
Dues from banks	142,280	385,792	731,610	914,513	1,097,416
Investment securities	2,887,653	2,718,654	2,981,308	3,266,393	3,471,027
Net loans and advances	5,526,026	6,325,194	7,155,301	8,049,047	9,045,854
<b>Total interest earning assets</b>	<b>10,585,063</b>	<b>12,009,494</b>	<b>13,953,995</b>	<b>15,760,142</b>	<b>17,611,949</b>
Property and equipment	83,434	94,222	105,529	116,082	125,368
Other non-interest earning assets	141,820	178,118	211,601	247,805	283,680
<b>Total assets</b>	<b>10,810,317</b>	<b>12,281,834</b>	<b>14,271,124</b>	<b>16,124,029</b>	<b>18,020,997</b>
Customer deposits	9,075,369	9,987,450	11,537,981	13,002,142	14,406,089
Due to banks	749,809	1,044,954	1,306,193	1,567,431	1,818,220
Subordinated debt	79,901	119,861	143,833	165,408	181,949
<b>Total interest bearing liabilities</b>	<b>9,923,415</b>	<b>11,211,177</b>	<b>13,061,647</b>	<b>14,823,349</b>	<b>16,510,532</b>
Current taxes liabilities	34,241	47,189	52,852	59,194	65,113
Deferred tax liabilities	243	358	501	677	880
Other liabilities	151,513	206,449	212,957	165,380	218,393
<b>Total liabilities</b>	<b>10,109,412</b>	<b>11,465,173</b>	<b>13,327,957</b>	<b>15,048,599</b>	<b>16,794,919</b>
Share capital	250,011	250,011	250,011	250,011	250,011
Reserves	446,781	561,130	686,809	818,118	967,673
Minorities	4,113	5,520	6,348	7,300	8,395
<b>Shareholder's equity</b>	<b>700,905</b>	<b>816,661</b>	<b>943,168</b>	<b>1,075,429</b>	<b>1,226,079</b>
<b>Growth (%)</b>					
Cash & cash equivalent	(1)	27	20	14	13
Dues from banks	15	171	90	25	20
Investment securities	13	(6)	10	10	6
Net loans and advances	18	14	13	12	12
Total interest earning assets	12	13	16	13	12
<b>Total assets</b>	<b>12</b>	<b>14</b>	<b>16</b>	<b>13</b>	<b>12</b>
Customer deposits	13	10	16	13	11
Due to other banks & FIs	(8)	39	25	20	16
Subordinated term debt	0	50	20	15	10
Total interest bearing liabilities.	11	13	17	13	11
<b>Total liabilities</b>	<b>12</b>	<b>13</b>	<b>16</b>	<b>13</b>	<b>12</b>
<b>Shareholder's equity</b>	<b>25</b>	<b>17</b>	<b>15</b>	<b>14</b>	<b>14</b>
<b>Key ratio (%)</b>					
Loan to deposits	62.5	65.0	63.8	63.8	64.7
Core CAR	10.4	11.0	10.8	10.8	10.9
Total CAR	12.7	13.7	13.5	13.4	13.5
NPL ratio	1.14	1.09	1.24	1.37	1.49
NPL growth	(10.3)	9.6	28.4	25.2	22.1
Net bad debt charge ratio	0.5	0.5	0.5	0.6	0.5
Provision to total loans	2.5	2.6	2.8	2.9	3.0
Provision coverage	221.1	241.4	222.3	211.0	201.1

Source: Company, ABCI Securities estimates





# Company Report

## ABC (1288 HK) - Buy

Diversified Bank Sector  
Initiation

### Key data

Share price (HK\$)	2.79
Target price (HK\$)	3.45
Upside potential (%)	23.7
52Wk H/L(HK\$)	3.98/2.26
Issued shares (mn)	
- A share	294,054
- H-share	30,739
Market cap	
- A share (Rmb mn)	726,316
- H-share (HK\$m)	85,761
30-day avg vol (HK\$m)	312
Major shareholder (%)	
Huijin	40.13

Source: Company & Bloomberg

### Operating income mix (1H12) (%)

Corporate banking	56.3
Personal banking	36.1
Treasury	7.0
Others	0.6

Source: Company

### Share performance (%)

	Absolute	Relative*
1-mth	(11.3)	(9.9)
3-mth	(3.8)	(8.4)
6-mth	(24.2)	(19.2)

\*Relative to Hang Seng Index

Source: Bloomberg

### 1 year price performance



Source: Bloomberg

### Analyst

Report Date: 12 September 2012

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## Running elephant

We believe ABC will continue act as the fastest growth big banks in China in 2012-14E. The highest NIM among big five banks was driven by lower than peers funding cost given low agricultural deposit cost with higher demand deposit mix. Although ABC has higher than peer NPLs, we expect continue risk enhancement should offset assets deterioration. Initiate with Buy with 24% upside.

**Market leader in county area.** ABC has built up its county leader position with approximately 30% business mix, which county area accounted for 50% of China's GDP and 70% of total population. ABC would be the major beneficiary on government's Sannong policy given its extensive county outlets and market share. This fuel up ABC with highest growth rate among big five Chinese banks, we forecast to see 15.3% EPS CAGR over 2012-14E.

**Unbreakable cost leadership.** County advantage combined with one of the highest demand deposit mixes of 53.4% in 1H12 allowed ABC to achieve substantially lower than peers deposit cost. Resulting ABC the highest NIM of 2.85% in 1H12 among big five peers. Besides we are surprised by the stable deposit base of ABC, with its average deposit balance accounted for 94% of total deposits compare to peers average around 80%.

**Peers high NPLs are manageable.** We believe the worse than peers asset quality was partly due to late listing of ABC, which result a late start to build up its risk management. Yet we saw room improve, which we believe the continue dedication on risk management could partly offset the impact from asset deterioration under slowing economy. This has been reflected in its 1H12 result with 16 bps HoH reduction of NPLs to 1.39%.

**Valuation.** ABC is currently trading at 1x 2012E P/B, or -1.5 s.d. below historical mean, approaching to its previous valuation trough in Sep 2011. Our Gordon Growth Valuation suggest target price of HK\$3.45, implying 24% upside from here. **Initiate ABC with Buy rating.**

**Risk factors:** Prolonged slow economy in China, interest rate liberalization, sharp deterioration of asset quality, increase in deposit costs and slower county economic growth.

### Results and valuation

(FY ended Dec 31)	FY10A	FY11A	FY12E	FY13E	FY14E
Operating income (Rmb mn)	292,253	379,756	448,665	508,740	571,227
YoY Chg (%)	30.7	29.9	18.1	13.4	12.3
Net profit (Rmb mn)	94,873	121,927	148,350	163,287	186,774
YoY Chg (%)	46.0	28.5	21.7	10.1	14.4
EPS (Rmb)	0.36	0.38	0.46	0.50	0.58
BVPS (Rmb)	1.67	2.00	2.32	2.68	3.08
PE (x)	--	6.1	5.1	4.7	4.0
PB (x)	--	1.16	1.00	0.87	0.75
ROAE (%)	21.4	20.5	21.1	20.1	20.0

Source: Company, ABCI Securities estimates





**Income statement forecast**

(Rmb mn)	2010A	2011A	2012E	2013E	2014E
Net interest income	242,152	307,199	351,167	381,025	413,468
Non-interest income	50,101	72,557	97,498	127,715	157,759
Of which: fees and commissions	46,128	68,750	91,651	119,176	148,213
<b>Operating income</b>	<b>292,253</b>	<b>379,756</b>	<b>448,665</b>	<b>508,740</b>	<b>571,227</b>
Operating expenses	(116,811)	(144,200)	(174,377)	(208,699)	(246,522)
Amortization	(11,296)	(13,130)	(15,100)	(17,062)	(19,110)
<b>Pre-prov. operating profits</b>	<b>164,146</b>	<b>222,426</b>	<b>259,189</b>	<b>282,978</b>	<b>305,595</b>
Impairment loans losses	(43,412)	(64,225)	(66,485)	(70,871)	(62,981)
Operating profit	120,734	158,201	192,703	212,107	242,614
<b>Profit before tax</b>	<b>120,734</b>	<b>158,201</b>	<b>192,703</b>	<b>212,107</b>	<b>242,614</b>
Tax	(25,827)	(36,245)	(44,322)	(48,785)	(55,801)
Minority interests	(34)	(29)	(32)	(35)	(39)
<b>Net profit</b>	<b>94,873</b>	<b>121,927</b>	<b>148,350</b>	<b>163,287</b>	<b>186,774</b>
<b>Growth (%)</b>					
Net interest income	33.3	26.9	14.3	8.5	8.5
Non-interest income	19.3	44.8	34.4	31.0	23.5
Of which: fees and commissions	29.4	49.0	33.3	30.0	24.4
<b>Operating income</b>	<b>30.7</b>	<b>29.9</b>	<b>18.1</b>	<b>13.4</b>	<b>12.3</b>
Operating expenses	18.2	23.4	20.9	19.7	18.1
Amortization	4.8	16.2	15.0	13.0	12.0
<b>Pre-prov. operating profits</b>	<b>43.9</b>	<b>35.5</b>	<b>16.5</b>	<b>9.2</b>	<b>8.0</b>
Impairment loans losses	8.1	47.9	3.5	6.6	(11.1)
Operating profit	63.3	31.0	21.8	10.1	14.4
<b>Profit before tax</b>	<b>63.3</b>	<b>31.0</b>	<b>21.8</b>	<b>10.1</b>	<b>14.4</b>
Tax	189.3	40.3	22.3	10.1	14.4
Minority interests	240.0	(14.7)	10.0	10.0	10.0
<b>Net profit</b>	<b>46.0</b>	<b>28.5</b>	<b>21.7</b>	<b>10.1</b>	<b>14.4</b>
<b>Per share data (Rmb)</b>					
EPS	0.36	0.38	0.46	0.50	0.58
BVPS	1.67	2.00	2.32	2.68	3.08
DPS	0.15	0.13	0.14	0.15	0.17
<b>Key ratio (%)</b>					
Net interest margin	2.57	2.85	2.75	2.57	2.47
Net interest spread	2.50	2.73	2.49	2.36	2.28
Cost to income ratio	40.0	38.0	38.9	41.0	43.2
Return on average assets	0.99	1.11	1.16	1.10	1.09
Return on average equity	21.4	20.5	21.1	20.1	20.0
Effective tax rate	21.4	22.9	23.0	23.0	23.0
Dividend payout	52.3	35.0	30.0	30.0	30.0

Source: Company, ABCI Securities estimates

**ABC – PB band chart**



Source: Winds, ABCI Securities estimates



*Balance sheet forecast*

(Rmb mn)	2010A	2011A	2012E	2013E	2014E
Cash & cash equivalent	2,082,332	2,487,082	2,815,903	3,195,284	3,635,872
Dues from banks	698,599	873,997	1,640,554	2,269,426	2,930,155
Investment securities	2,527,431	2,628,052	2,847,787	3,082,728	3,334,735
Net loans and advances	4,789,008	5,398,863	6,168,109	7,037,368	8,042,302
<b>Total interest earning assets</b>	<b>10,097,370</b>	<b>11,387,994</b>	<b>13,472,354</b>	<b>15,584,806</b>	<b>17,943,065</b>
Property and equipment	121,391	131,815	143,678	155,173	166,035
Other non-interest earning assets	118,645	157,768	193,848	233,760	277,231
<b>Total assets</b>	<b>10,337,406</b>	<b>11,677,577</b>	<b>13,809,880</b>	<b>15,973,739</b>	<b>18,386,330</b>
Customer deposits	8,887,905	9,622,026	11,127,753	12,923,048	14,978,390
Due to banks	582,982	724,286	1,158,858	1,448,572	1,738,286
Subordinated debt	62,344	119,390	137,299	157,893	181,577
<b>Total interest bearing liabilities.</b>	<b>9,533,231</b>	<b>10,465,702</b>	<b>12,423,909</b>	<b>14,529,513</b>	<b>16,898,254</b>
Current taxes	16,413	37,868	49,228	62,520	78,150
Deferred tax liabilities	82	27	31	36	41
Other liabilities	245,444	524,192	582,114	511,801	408,282
<b>Total liabilities</b>	<b>9,795,170</b>	<b>11,027,789</b>	<b>13,055,283</b>	<b>15,103,869</b>	<b>17,384,726</b>
Share capital	324,794	324,794	324,794	324,794	324,794
Reserves	217,277	324,807	429,598	544,851	676,568
Minorities	165	187	206	224	242
<b>Shareholder's equity</b>	<b>542,236</b>	<b>649,788</b>	<b>754,597</b>	<b>869,869</b>	<b>1,001,604</b>
<b>Growth (%)</b>					
Cash & cash equivalent	37	19	13	13	14
Dues from banks	31	25	88	38	29
Investment securities	(3)	4	8	8	8
Net loans and advances	19	13	14	14	14
Total interest earning assets	16	13	18	16	15
<b>Total assets</b>	<b>16</b>	<b>13</b>	<b>18</b>	<b>16</b>	<b>15</b>
Customer deposits	19	8	16	16	16
Due to banks	(3)	24	60	25	20
Subordinated debt	13	92	15	15	15
Total interest bearing liabilities.	17	10	19	17	16
<b>Total liabilities</b>	<b>15</b>	<b>13</b>	<b>18</b>	<b>16</b>	<b>15</b>
<b>Shareholder's equity</b>	<b>58</b>	<b>20</b>	<b>16</b>	<b>15</b>	<b>15</b>
<b>Key ratio (%)</b>					
Loan to deposits	55.8	58.5	58.1	57.3	56.5
Core CAR	9.8	9.5	9.0	9.0	9.2
Total CAR	11.6	11.9	11.3	11.1	11.3
NPL ratio	2.0	1.6	2.0	2.5	2.8
NPL growth	(16.5)	(13.0)	34.1	29.4	24.7
Net bad debt charge ratio	1.0	1.2	1.1	1.0	0.8
Provision to total loans	3.4	4.1	4.6	4.9	5.0
Provision coverage	168.1	263.1	251.0	239.3	224.0

Source: Company, ABCI Securities estimates



# Company Report

## MINSHENG BANK (1988 HK) - Buy

Diversified Bank Sector  
Initiation

### Key data

Share price (HK\$)	6.00
Target price (HK\$)	7.66
Upside potential (%)	27.7
52Wk H/L(HK\$)	8.23/4.24
Issued shares (mn)	
- A share	22,588
- H-share	5,778
Market cap	
- A share (Rmb mn)	129,653
- H-share (HK\$m)	34,668
30-day avg vol (HK\$m)	232
Major shareholder (%)	
New Hope Group	8.38

Source: Company & Bloomberg

### Operating income mix (1H12) (%)

Corporate banking	44.3
Retail banking	26.5
Treasury	27.3
Others	1.9

Source: Company

### Share performance (%)

	Absolute	Relative*
1-mth	(17.5)	(16.2)
3-mth	(18.8)	(22.7)
6-mth	(18.6)	(13.3)

\*Relative to Hang Seng Index

Source: Bloomberg

### 1 year price performance



Source: Bloomberg

### Analyst

Report Date: 12 September 2012

Johannes Au

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Email: johannesau@abci.com.hk

### Differentiation with risk

**Although small business focus of MSB raise market concern on potential assets quality downside, we appreciate MSB's forward looking risk enhancement in 1H12 to prepare for the challenging outlook. Besides fast growth potential driven by SMEs and MSEs, 2H12 investment theme would be on risk management quality. With 15% net profit CAGR, we initiate a Buy with 28% upside.**

**SMEs and micro business focus.** MSB is a relatively small H-share bank with business strength in small and medium enterprises (SMEs) and micro and small business (MSEs). In view of ongoing development of China financial system, we believe larger corporate will gradually open up with more financial channels, while smaller enterprises would be the major growth focus of commercial banks. Consequently MSB could ride on the momentum given its established client base and expertise with small enterprises.

**Shifting to prudence strategy.** We are impressed by MSB's prudence strategy by shifting business growth to western and northern China while scale down growth in coastal area in 1H12. Further the bank introduced new risk measurement including enhancing credit plan, tighter rating system, and consolidating monitoring, which as a result increased MSB's NPL ratio by 6bps in 1H12, while reduced credit cost by 38% in 2Q12 QoQ.

**Policy uncertainty.** Although MSB has excellent ROE track record above 20%, we saw potential downside risk if there were new policy limiting SME loan pricing and fee charges, however we believe huge volume potential from the small and micro business segment should help to offset any impact. Under our assumptions, we expect MSB's competitive edge to maintain the bank's ROE above 20% over 2014E.

**Risk management drives differentiation.** We believe risk management will be the key to differentiate Chinese banks through 2H12 to 2013. The proactive move by MSB demonstrated its management's forward looking ability. Forecast 15% net profit CARG over 2012-14E, **we initiate the stock with Buy rating with 28% upside.**

**Risk factors:** Prolonged slow economy in China, interest rate liberalization, sharp deterioration of asset quality and competition from larger banks in SMEs segment.

### Results and valuation

(FY ended Dec 31)	FY10A	FY11A	FY12E	FY13E	FY14E
Operating income (Rmb mn)	54,667	82,196	96,373	109,481	122,765
YoY Chg (%)	30.0	50.4	17.2	13.6	12.1
Net profit (Rmb mn)	17,581	27,920	33,738	37,764	41,998
YoY Chg (%)	45.2	58.8	20.8	11.9	11.2
EPS (Rmb)	0.78	1.05	1.26	1.41	1.57
BVPS (Rmb)	3.90	4.85	5.81	6.89	8.08
PE (x)	--	4.8	4.0	3.5	3.2
PB (x)	--	1.03	0.86	0.73	0.62
ROAE (%)	18.3	23.9	23.7	22.3	21.0

Source: Company, ABCI Securities estimates



**農銀國際**

ABC INTERNATIONAL

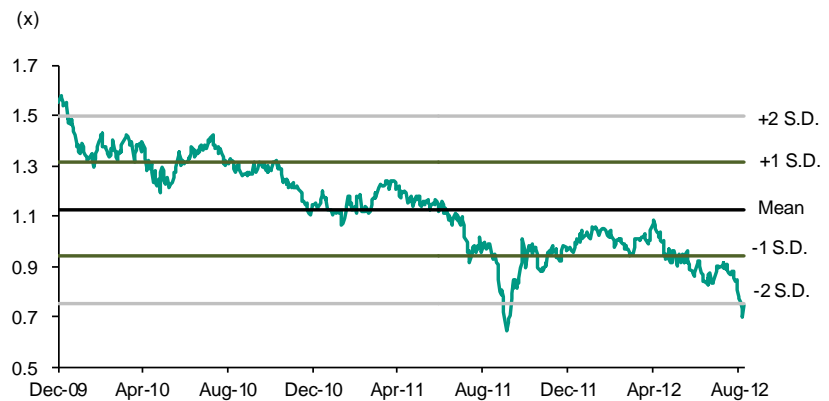
ABCI SECURITIES COMPANY LIMITED

**Income statement forecast**

(Rmb mn)	2010A	2011A	2012E	2013E	2014E
Net interest income	45,873	64,821	72,639	78,535	84,383
Non-interest income	8,794	17,375	23,734	30,945	38,382
Of which: fees and commissions	8,289	15,101	20,826	27,468	34,376
<b>Operating income</b>	<b>54,667</b>	<b>82,196</b>	<b>96,373</b>	<b>109,481</b>	<b>122,765</b>
Operating expenses	(25,146)	(35,352)	(40,682)	(46,260)	(52,149)
Amortization	(1,041)	(1,293)	(1,487)	(1,680)	(1,882)
<b>Pre-prov. operating profits</b>	<b>28,480</b>	<b>45,551</b>	<b>54,204</b>	<b>61,541</b>	<b>68,734</b>
Impairment loans losses	(5,504)	(8,376)	(9,641)	(11,674)	(13,288)
Operating profit	22,976	37,175	44,563	49,866	55,447
<b>Profit before tax</b>	<b>22,976</b>	<b>37,175</b>	<b>44,563</b>	<b>49,866</b>	<b>55,447</b>
Tax	(5,288)	(8,732)	(10,249)	(11,469)	(12,753)
Minority interests	(107)	(523)	(575)	(633)	(696)
<b>Net profit</b>	<b>17,581</b>	<b>27,920</b>	<b>33,738</b>	<b>37,764</b>	<b>41,998</b>
<b>Growth (%)</b>					
Net interest income	42	41	12	8	7
Non-interest income	(10)	98	37	30	24
Of which: fees and commissions	78	82	38	32	25
<b>Operating income</b>	<b>30</b>	<b>50</b>	<b>17</b>	<b>14</b>	<b>12</b>
Operating expenses	24	41	15	14	13
Amortization	44	24	15	13	12
<b>Pre-prov. operating profits</b>	<b>36</b>	<b>60</b>	<b>19</b>	<b>14</b>	<b>12</b>
Impairment loans losses	4	52	15	21	14
Operating profit	47	62	20	12	11
<b>Profit before tax</b>	<b>47</b>	<b>62</b>	<b>20</b>	<b>12</b>	<b>11</b>
Tax	49	65	17	12	11
Minority interests	2,575	389	10	10	10
<b>Net profit</b>	<b>45</b>	<b>59</b>	<b>21</b>	<b>12</b>	<b>11</b>
<b>Per share data (Rmb)</b>					
EPS	0.78	1.05	1.26	1.41	1.57
BVPS	3.90	4.85	5.81	6.89	8.08
DPS	0.10	0.30	0.32	0.35	0.39
<b>Key ratio (%)</b>					
Net interest margin	2.94	3.14	3.06	2.91	2.85
Net interest spread	2.82	2.96	2.81	2.70	2.70
Cost to income ratio	46.0	43.0	42.2	42.3	42.5
Return on average assets	1.08	1.38	1.39	1.36	1.35
Return on average equity	18.3	23.9	23.7	22.3	21.0
Effective tax rate	23.0	23.5	23.0	23.0	23.0
Dividend payout	15.2	28.7	25.0	25.0	25.0

Source: Company, ABCI Securities estimates

**MSB – PB band chart**



Source: Bloomberg, ABCI Securities estimates



**Balance sheet forecast**

(Rmb mn)	2010A	2011A	2012E	2013E	2014E
Cash & cash equivalent	266,835	332,805	370,421	416,993	466,861
Dues from banks	274,847	411,103	610,097	687,636	773,399
Investment securities	180,943	211,485	201,143	208,083	219,264
Net loans and advances	1,037,723	1,178,285	1,325,114	1,491,038	1,670,410
<b>Total interest earning assets</b>	<b>1,760,348</b>	<b>2,133,678</b>	<b>2,506,774</b>	<b>2,803,751</b>	<b>3,129,934</b>
Property and equipment	8,809	9,971	10,968	11,955	12,912
Other non-interest earning assets	54,580	85,415	102,847	121,709	140,497
<b>Total assets</b>	<b>1,823,737</b>	<b>2,229,064</b>	<b>2,620,589</b>	<b>2,937,415</b>	<b>3,283,343</b>
Customer deposits	1,417,877	1,644,738	1,875,528	2,120,872	2,373,990
Due to banks	226,482	320,326	384,391	453,582	521,619
Subordinated debt	21,048	31,030	36,615	42,108	47,582
<b>Total interest bearing liabilities</b>	<b>1,665,407</b>	<b>1,996,094</b>	<b>2,296,535</b>	<b>2,616,561</b>	<b>2,943,191</b>
Current taxes	4,940	5,770	6,636	7,631	8,775
Other liabilities	48,133	93,090	157,179	123,835	109,677
<b>Total liabilities</b>	<b>1,718,480</b>	<b>2,094,954</b>	<b>2,460,350</b>	<b>2,748,027</b>	<b>3,061,644</b>
Share capital	26,715	26,715	26,715	26,715	26,715
Reserves	77,393	102,882	128,560	157,261	189,141
Minorities	1,149	4,513	4,964	5,411	5,844
<b>Shareholder's equity</b>	<b>105,257</b>	<b>134,110</b>	<b>160,240</b>	<b>189,388</b>	<b>221,700</b>
<b>Growth (%)</b>					
Cash & cash equivalent	302	25	11	13	12
Dues from banks	(7)	50	48	13	12
Investment securities	16	17	(5)	3	5
Net loans and advances	20	14	12	13	12
Total interest earning assets	27	21	17	12	12
<b>Total assets</b>	<b>28</b>	<b>22</b>	<b>18</b>	<b>12</b>	<b>12</b>
Customer deposits	26	16	14	13	12
Due to other banks & FIs	36	41	20	18	15
Subordinated term debt and others	(10)	47	18	15	13
Total interest bearing liabilities	26	20	15	14	12
<b>Total liabilities</b>	<b>28</b>	<b>22</b>	<b>17</b>	<b>12</b>	<b>11</b>
<b>Shareholder's equity</b>	<b>18</b>	<b>27</b>	<b>19</b>	<b>18</b>	<b>17</b>
<b>Key ratio (%)</b>					
Loan to deposits					
Core CAR	74.6	73.3	72.5	72.3	72.6
Total CAR	8.1	7.9	7.7	8.1	8.6
NPL ratio	10.4	10.9	11.1	11.3	11.9
NPL growth	0.69	0.63	0.95	1.20	1.35
Net bad debt charge ratio	(0.8)	2.7	80.3	69.3	42.3
Provision to total loans	0.5	0.7	0.7	0.8	0.8
Provision coverage	1.9	2.2	2.5	2.8	3.1

Source: Company, ABCI Securities estimates



# Company Report

## ICBC (1398 HK) - Hold

Diversified Bank Sector  
Initiation

### Key data

Share price (HK\$)	4.22
Target price (HK\$)	4.44
Upside potential (%)	5.2
52Wk H/L(HK\$)	5.72/3.46
Issued shares (mn)	
- A share	262,527
- H-share	86,794
Market cap	
- A share (Rmb mn)	994,978
- H-share (HK\$m)	366,270
30-day avg vol (HK\$m)	1,168
Major shareholder (%)	
Huijin	35.4

Source: Company & Bloomberg

### Operating income mix (1H12) (%)

Corporate banking	57.7
Personal banking	25.8
Treasury	17.2
Others	(0.7)

Source: Company

### Share performance (%)

	Absolute	Relative*
1-mth	(5.5)	(4.1)
3-mth	0.0	(4.8)
6-mth	(19.8)	(14.5)

\*Relative to Hang Seng Index

Source: Bloomberg

### 1 year price performance



Source: Bloomberg

### Analyst

Report Date: 12 September 2012

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## Set to global diversification

**Being market leader in the Chinese bank universe, ICBC possesses a prudence and selective growth strategy resulting best asset quality among big banks. Meanwhile, aggressive global expansion set to diversify domestic outlook uncertainties. However we expect potential major shareholder divestment could further depress share price. At trough valuation of 1.1x 12E PB, we initiate with Hold.**

**Firm market leader position.** ICBC has long been the market leader in the Chinese bank universe in terms of size and business franchises. Extensive network combined with over 50% demand deposits mix allow ICBC to take advantage of low end funding cost. We believe its low end LDR ratio of 63.1% will contribute as a differentiating factor in medium term under interest rate liberalization.

**Prudence growth strategy.** We notice ICBC has adopted a selective and prudence growth model over time, historical slower than system loan growth indicated the bank did not expand loan growth at the expense of asset quality, reflected by only 0.89% in 1H12, lowest among big five, while two other worrying area special mentioned loans and overdue loans were mildly grew each by 7% in 1H12, lowest amount H-share banks.

**Aggressive global presence.** ICBC has been one of the most aggressive Chinese banks to expand its overseas footprints in past years. Major overseas operating regions included Malaysia, Thailand, Middle East, UK, Europe, Russia, Canada and Africa. Despite overseas business currently only accounted for 3% of the group's revenue, diversified platform should help to reduce challenge under domestic deteriorating landscape.

**Divestment by strategic holder.** Although we like prudence player, potential divestment by Social Security Fund (SSF) shadow this name. Total stake hold by SSF reduced from 22.88% upon listing to 12.99%, latest divestment included four times in 2011 and two times in 2012. Trading at trough valuation of -2 s.d. below historical mean. **We initiate the stock with Hold rating.**

**Risk factors:** Prolonged slow economy in China, interest rate liberalization, sharp deterioration of asset quality and overseas business risk.

### Results and valuation

(FY ended Dec 31)	FY10A	FY11A	FY12E	FY13E	FY14E
Operating income (Rmb mn)	380,748	470,601	539,444	591,019	664,103
YoY Chg (%)	23.1	23.6	14.6	9.6	12.4
Net profit (Rmb mn)	165,156	208,265	225,498	237,848	264,292
YoY Chg (%)	28.4	26.1	8.3	5.5	11.1
EPS (Rmb)	0.49	0.60	0.65	0.68	0.76
BVPS (Rmb)	2.35	2.74	3.19	3.66	4.19
PE (x)	--	5.9	5.4	5.2	4.6
PB (x)	--	1.28	1.10	0.96	0.84
ROAE (%)	22.1	23.4	21.8	19.9	19.3

Source: Company, ABCI Securities estimates

### Income statement forecast

(Rmb mn)	2010A	2011A	2012E	2013E	2014E
Net interest income	303,749	362,764	406,279	429,841	474,985
Non-interest income	76,999	107,837	133,165	161,178	189,118
Of which: Fees and commissions	72,840	101,550	126,333	153,805	181,270
<b>Operating income</b>	<b>380,748</b>	<b>470,601</b>	<b>539,444</b>	<b>591,019</b>	<b>664,103</b>
Operating expenses	(127,322)	(156,160)	(182,846)	(207,477)	(230,211)
Amortization	(12,158)	(13,453)	(14,486)	(15,471)	(16,383)
<b>Pre-prov. operating profits</b>	<b>241,268</b>	<b>300,988</b>	<b>342,111</b>	<b>368,072</b>	<b>417,509</b>
Impairment loans losses	(27,988)	(31,121)	(43,920)	(53,717)	(68,173)
Operating profit	213,280	269,867	298,191	314,355	349,337
Non-operating income	2,146	2,444	2,737	3,066	3,372
<b>Profit before tax</b>	<b>215,426</b>	<b>272,311</b>	<b>300,928</b>	<b>317,421</b>	<b>352,709</b>
Tax	(49,401)	(63,866)	(75,232)	(79,355)	(88,177)
Minority interests	(869)	(180)	(198)	(218)	(240)
<b>Net profit</b>	<b>165,156</b>	<b>208,265</b>	<b>225,498</b>	<b>237,848</b>	<b>264,292</b>
<b>Growth (%)</b>					
Net interest income	24	19	12	6	11
Non-interest income	21	40	23	21	17
Of which: Fees and commissions	32	39	24	22	18
<b>Operating income</b>	<b>23</b>	<b>24</b>	<b>15</b>	<b>10</b>	<b>12</b>
Operating expenses	16	23	17	13	11
Amortization	11	11	8	7	6
<b>Pre-prov. operating profits</b>	<b>28</b>	<b>25</b>	<b>14</b>	<b>8</b>	<b>13</b>
Impairment loans losses	20	11	41	22	27
Operating profit	29	27	10	5	11
Non-operating income	8	14	12	12	10
<b>Profit before tax</b>	<b>29</b>	<b>26</b>	<b>11</b>	<b>5</b>	<b>11</b>
Tax	30	29	18	5	11
Minority interests	16	(79)	10	10	10
<b>Net profit</b>	<b>28</b>	<b>26</b>	<b>8</b>	<b>5</b>	<b>11</b>
<b>Per share data</b>					
EPS	0.49	0.60	0.65	0.68	0.76
BVPS	2.35	2.74	3.19	3.66	4.19
DPS	0.18	0.20	0.19	0.20	0.23
<b>Key ratio (%)</b>					
Net interest margin	2.44	2.61	2.53	2.34	2.28
Net interest spread	2.35	2.49	2.38	2.21	2.15
Cost to income ratio	33.4	33.2	33.9	35.1	34.7
Return on average assets	1.31	1.44	1.35	1.25	1.23
Return on average equity	22.1	23.4	21.8	19.9	19.3
Effective tax rate	22.9	23.5	25.0	25.0	25.0
Dividend payout	38.9	34.0	30.0	30.0	30.0

Source: Company, ABCI Securities estimates

### ICBC – PB band chart



Source: Winds, ABCI Securities estimates





**Balance sheet forecast**

(Rmb mn)	2010A	2011A	2012E	2013E	2014E
Cash & cash equivalent	2,282,999	2,762,156	2,997,066	3,278,925	3,615,834
Dues from banks	511,087	810,287	1,635,236	2,326,624	3,134,193
Investment securities	3,732,268	3,919,727	4,176,876	4,443,444	4,717,911
Net loans and advances	6,623,372	7,594,019	8,610,812	9,671,186	10,861,777
<b>Total interest earning assets</b>	<b>13,149,726</b>	<b>15,086,189</b>	<b>17,419,990</b>	<b>19,720,179</b>	<b>22,329,715</b>
Property and equipment	103,412	119,028	130,931	141,405	152,718
Other non-interest earning assets	205,484	271,651	292,725	315,452	339,962
<b>Total assets</b>	<b>13,458,622</b>	<b>15,476,868</b>	<b>17,843,646</b>	<b>20,177,036</b>	<b>22,822,395</b>
Customer deposits	11,145,557	12,261,219	13,977,724	15,878,525	17,955,997
Due to banks	1,048,002	1,341,290	1,676,613	2,095,766	2,514,919
Subordinated debt	102,264	204,161	244,993	269,493	296,442
<b>Total interest bearing liabilities.</b>	<b>12,305,137</b>	<b>13,848,096</b>	<b>15,949,041</b>	<b>18,303,437</b>	<b>20,838,942</b>
Current taxes	33,759	51,535	64,419	77,303	92,763
Deferred tax liabilities	318	103	118	136	157
Other liabilities	297,751	619,311	715,508	516,562	427,778
<b>Total liabilities</b>	<b>12,636,965</b>	<b>14,519,045</b>	<b>16,729,087</b>	<b>18,897,437</b>	<b>21,359,640</b>
Share capital	349,019	349,084	349,084	349,084	349,084
Reserves	471,411	607,658	764,340	929,323	1,112,420
Minorities	1,227	1,081	1,135	1,192	1,251
<b>Shareholder's equity</b>	<b>821,657</b>	<b>957,823</b>	<b>1,114,559</b>	<b>1,279,599</b>	<b>1,462,756</b>
<b>Growth (%)</b>					
Cash & cash equivalent	35	21	9	9	10
Dues from banks	(21)	59	102	42	35
Investment securities	4	5	7	6	6
Net loans and advances	19	15	13	12	12
Total interest earning assets	14	15	15	13	13
<b>Total assets</b>	<b>14</b>	<b>15</b>	<b>15</b>	<b>13</b>	<b>13</b>
Customer deposits	14	10	14	14	13
Due to banks	5	28	25	25	20
Subordinated debt	36	100	20	10	10
Total interest bearing liabilities.	13	13	15	15	14
<b>Total liabilities</b>	<b>14</b>	<b>15</b>	<b>15</b>	<b>13</b>	<b>13</b>
<b>Shareholder's equity</b>	<b>21</b>	<b>17</b>	<b>16</b>	<b>15</b>	<b>14</b>
<b>Key ratio (%)</b>					
Loan to deposits	60.9	63.5	63.3	62.7	62.4
Core CAR	10.0	10.1	10.2	10.3	10.4
Total CAR	12.3	13.2	13.4	13.3	13.3
NPL ratio	1.08	0.94	1.10	1.30	1.40
NPL growth	(17.2)	(0.3)	36.2	33.6	23.6
Net bad debt charge ratio	0.4	0.4	0.5	0.6	0.6
Provision to total loans	2.5	2.5	2.7	2.9	3.1
Provision coverage	228.2	266.9	235.7	213.6	211.7

Source: Company, ABCI Securities estimates





# Company Report

## BANK OF CHINA (3988 HK) - Hold

Diversified Bank Sector  
Initiation

### Key data

Share price (HK\$)	2.84
Target price (HK\$)	2.94
Upside potential (%)	3.5
52Wk H/L(HK\$)	3.45/2.20
Issued shares (mn)	
- A share	195,525
- H-share	83,622
Market cap	
- A share (Rmb mn)	531,828
- H-share (HK\$mnn)	237,487
30-day avg vol (HK\$mnn)	726
Major shareholder (%)	
Huijin	67.55

Source: Company & Bloomberg

### Operating income mix (1H12) (%)

Corporate banking	54.8
Personal banking	30.0
Treasury	9.6
Others	5.6

Source: Company

### Share performance (%)

	Absolute	Relative*
1-mth	(5.0)	(3.5)
3-mth	1.4	(3.5)
6-mth	(13.4)	(7.7)

\*Relative to Hang Seng Index

Source: Bloomberg

### 1 year price performance



Source: Bloomberg

### Analyst

Report Date: 12 September 2012

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## Two extreme in the universe

**BOC has the biggest offshore contribution through BOCHK, which currently accounted for 20% of profit, and aim at 30% mix driven by offshore RMB business growth. Meanwhile BOC is the least profitable bank in terms of ROE in the universe with lowest loan and deposit growth in 1H12. Net net, with high single digit net profit CAGR over 2012-14E, we initiate the stock with Hold.**

**Growing overseas exposures.** BOC has one of the best offshore platforms among H-share banks, with BOCHK contributed to 20% of profit. Looking at the decent 1H12 result, we believe BOCHK would continue to be the bright spot towards 2H12 with better RMB business outlook. While management has cleared direction to focus BOC's offshore business growth to a mix of 30%, which could help to defend the bank from onshore deteriorating business environment.

**RMB internationalization theme.** Given BOCHK's strategic position as CNH clearing bank, and the well-established business mix in export related sectors, we believe BOC would be the major beneficiary under RMB internationalization theme. However, we have concerns on ongoing export trend given weak US and Europe economy, and the sustainability of monopoly clearing position towards free market.

**Relatively low growth and profitability.** We think BOC has relatively low operating efficiency compare to peers, reflected by its lowest profitability of NIM at 2.1% and ROE below 20% in 1H12. On the other hand slower than peers' growth both in loans and deposits at 6.5% and 7.5% when peers average at 1H12 were 8.1% and 9.5% respectively. We are not convinced by BOC's domestic growth outlook.

**Overseas growth offset China concern.** Given the fact that China banking environment is deteriorating under policy headwinds and deteriorating asset quality, switching focus to improving profitability market such as Hong Kong should help to offset China concerns. However lower profitability track record explains its discounted valuation, we expect 7.6% net profit CAGR for BOC over 2012-14E, **initiate the stock with a Hold rating.**

**Risk factors:** Prolonged slow economy in China, interest rate liberalization, sharp deterioration of asset quality and slower than expected RMB internationalization.

### Results and valuation

(FY ended Dec 31)	FY10A	FY11A	FY12E	FY13E	FY14E
Operating income (Rmb mn)	276,518	328,298	369,597	406,080	449,596
YoY Chg (%)	18.9	18.7	12.6	9.9	10.7
Net profit (Rmb mn)	104,418	124,182	133,660	140,194	154,727
YoY Chg (%)	29.2	18.9	7.6	4.9	10.4
EPS (Rmb)	0.37	0.44	0.48	0.50	0.55
BVPS (Rmb)	2.31	2.59	2.92	3.26	3.63
PE (x)	--	5.4	4.9	4.7	4.3
PB (x)	--	0.91	0.81	0.73	0.65
ROAE (%)	18.0	18.2	17.4	16.3	16.1

Source: Company, ABCI Securities estimates



**Income statement forecast**

(Rmb mn)	2010A	2011A	2012E	2013E	2014E
Net interest income	193,962	228,064	249,360	263,915	283,223
Non-interest income	82,556	100,234	120,238	142,165	166,373
Of which: fees and commissions	54,483	64,662	76,857	92,987	110,716
<b>Operating income</b>	<b>276,518</b>	<b>328,298</b>	<b>369,597</b>	<b>406,080</b>	<b>449,596</b>
Operating expenses	(122,409)	(140,815)	(164,630)	(190,709)	(217,706)
Amortization	(10,319)	(12,257)	(14,708)	(17,356)	(20,480)
<b>Pre-prov. operating profits</b>	<b>154,109</b>	<b>187,483</b>	<b>204,967</b>	<b>215,372</b>	<b>231,890</b>
Impairment losses on loans	(12,993)	(19,355)	(24,437)	(29,934)	(27,468)
Operating profit	141,116	168,128	180,530	185,438	204,422
Non-operating income	1,029	516	567	624	686
<b>Profit before tax</b>	<b>142,145</b>	<b>168,644</b>	<b>181,098</b>	<b>186,062</b>	<b>205,109</b>
Tax	(32,454)	(38,325)	(40,810)	(38,709)	(42,651)
Minority interest	(5,273)	(6,137)	(6,628)	(7,158)	(7,731)
<b>Net profit</b>	<b>104,418</b>	<b>124,182</b>	<b>133,660</b>	<b>140,194</b>	<b>154,727</b>
<b>Growth (%)</b>					
Net interest income	22	18	9	6	7
Non-interest income	12	21	20	18	17
Of which: fees and commissions	18	19	19	21	19
<b>Operating income</b>	<b>19</b>	<b>19</b>	<b>13</b>	<b>10</b>	<b>11</b>
Operating expenses	14	15	17	16	14
Amortization	19	19	20	18	18
<b>Pre-prov. operating profits</b>	<b>23</b>	<b>22</b>	<b>9</b>	<b>5</b>	<b>8</b>
Impairment losses on loans	(13)	49	26	22	(8)
Operating profit	28	19	7	3	10
Non-operating income	25	(50)	10	10	10
<b>Profit before tax</b>	<b>28</b>	<b>19</b>	<b>7</b>	<b>3</b>	<b>10</b>
Tax	26	18	6	(5)	10
Minority interest	16	16	8	8	8
<b>Net profit</b>	<b>29</b>	<b>19</b>	<b>8</b>	<b>5</b>	<b>10</b>
<b>Per share data</b>					
EPS	0.37	0.44	0.48	0.50	0.55
BVPS	2.31	2.59	2.92	3.26	3.63
DPS	0.15	0.15	0.15	0.16	0.18
<b>Key ratio (%)</b>					
Net interest margin	2.07	2.12	2.03	1.89	1.81
Net interest spread	1.98	2.01	1.91	1.78	1.69
Cost to income ratio	44.3	42.9	44.5	47.0	48.4
Return on average assets	1.09	1.11	1.06	0.98	0.97
Return on average equity	18.0	18.2	17.4	16.3	16.1
Effective tax rate	22.8	22.7	22.5	20.8	20.8
Dividend payout	39.0	34.8	32.0	32.0	32.0

Source: Company, ABCI Securities estimates

**BOC – PB band chart**



Source: Winds, ABCI Securities estimates



*Balance sheet forecast*

(Rmb mn)	2010A	2011A	2012E	2013E	2014E
Cash & equivalent	636,126	590,964	795,580	875,493	954,487
Dues from banks	1,787,638	2,538,017	3,124,606	3,812,096	4,572,413
Investment securities	2,055,324	2,000,759	2,208,377	2,430,634	2,645,489
Net loans and advances	5,537,765	6,203,138	6,818,523	7,467,808	8,175,961
<b>Total interest earning assets</b>	<b>10,016,853</b>	<b>11,332,878</b>	<b>12,947,085</b>	<b>14,586,031</b>	<b>16,348,349</b>
Property and equipment	137,407	152,850	160,493	163,702	166,976
Derivative assets	39,974	42,757	43,612	44,484	45,374
Other non-interest earning assets	265,631	301,581	316,660	332,493	349,118
<b>Total assets</b>	<b>10,459,865</b>	<b>11,830,066</b>	<b>13,467,850</b>	<b>15,126,711</b>	<b>16,909,817</b>
Customer deposits	7,733,537	8,817,961	10,054,175	11,399,565	12,831,290
Due to banks	1,580,030	1,718,237	1,890,061	2,060,166	2,245,581
Subordinated debt	151,386	196,626	220,221	242,243	266,468
<b>Total interest bearing liabilities.</b>	<b>9,464,953</b>	<b>10,732,824</b>	<b>12,164,457</b>	<b>13,701,974</b>	<b>15,343,339</b>
Trading liabilities	35,711	35,473	36,182	36,906	37,644
Current taxes	22,775	29,353	32,288	35,517	39,069
Deferred tax liabilities	3,919	4,486	4,710	4,946	5,193
Other liabilities	256,357	272,036	382,725	403,862	435,190
<b>Total liabilities</b>	<b>9,783,715</b>	<b>11,074,172</b>	<b>12,620,363</b>	<b>14,183,205</b>	<b>15,860,435</b>
Share capital	279,147	279,147	279,147	279,147	279,147
Reserves	365,018	444,015	534,953	630,304	735,500
Minority interest	31,985	32,732	33,387	34,054	34,735
<b>Shareholders' equity</b>	<b>676,150</b>	<b>755,894</b>	<b>847,487</b>	<b>943,505</b>	<b>1,049,383</b>
<b>Growth (%)</b>					
Cash & equivalent	46	(7)	35	10	9
Dues from banks	34	42	23	22	20
Investment securities	13	(3)	10	10	9
Net loans and advances	15	12	10	10	9
Total interest earning assets	19	13	14	13	12
<b>Total assets</b>	<b>20</b>	<b>13</b>	<b>14</b>	<b>12</b>	<b>12</b>
Customer deposits	17	14	14	13	13
Due to banks	37	9	10	9	9
Subordinated debt	33	30	12	10	10
Total interest bearing liabilities.	20	13	13	13	12
<b>Total liabilities</b>	<b>19</b>	<b>13</b>	<b>14</b>	<b>12</b>	<b>12</b>
<b>Shareholders' equity</b>	<b>24</b>	<b>12</b>	<b>12</b>	<b>11</b>	<b>11</b>
<b>Key ratio (%)</b>					
Loan to deposits	73.2	71.9	69.4	67.1	65.3
Core CAR	10.6	10.5	9.6	9.1	8.5
Total CAR	12.6	13.0	11.8	11.0	10.2
NPL ratio	1.10	1.00	1.43	1.63	1.81
NPL growth	(3.5)	1.3	57.3	25.4	21.9
Net bad debt charge ratio	0.2	0.3	0.4	0.4	0.3
Provision to total loans	2.2	2.2	2.3	2.4	2.5
Provision coverage	196.7	220.7	159.9	147.2	135.0

Source: Company, ABCI Securities estimates



# Company Report

## BANKCOMM (3328 HK) - Hold

Diversified Bank Sector  
Initiation

### Key data

Share price (HK\$)	5.11
Target price (HK\$)	5.13
Upside potential (%)	0.4
52Wk H/L(HK\$)	6.55/4.15
Issued shares (mn)	
- A share	39,250
- H-share	35,012
Market cap	
- A share (Rmb mn)	167,601
- H-share (HK\$m)	178,911
30-day avg vol (HK\$m)	126
Major shareholder (%)	
MOF	26.52

Source: Company & Bloomberg

### Net interest income mix (1H12) (%)

Corporate banking	64.5
Retail banking	20.4
Treasury	14.8
Others	0.3

Source: Company

### Share performance (%)

	Absolute	Relative*
1-mth	(4.0)	(2.5)
3-mth	2.6	(2.3)
6-mth	(17.5)	(12.0)

\*Relative to Hang Seng Index

Source: Bloomberg

### 1 year price performance



Source: Bloomberg

### Analyst

Report Date: 12 September 2012

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## Undesired geographic risk

**BoCom among big five banks has more flexible loan pricing power, which we perceive from a lower portion of stated-loans compare to other big banks. However it is notably its NIM suffered from relative high deposit cost and higher mix of interbank liabilities with increasing yield. Without radical change mix expectation and unwanted geographic mix in Eastern China, we recommend a Hold.**

**Best loan pricing ability.** BoCom historically has the best loan pricing among big banks and comparable to smaller players, we perceive this from a more flexible loan pricing given lower stated-loans proportion than other big five banks. Although this is supposed to be a bright spot of BoCom, the bank's deposit cost was at pretty high level as well, dragged down its 1H12 NIM to 2.61%, second least among H-share banks

**Large interbank liabilities.** Considered the spike up of interbank liabilities yield in 1H12, BoCom's undesired high 25% mix of interbank funding in interest bearing liabilities hitting on the bank's NIM. Given we assume similar interbank liquidity atmosphere in 2H12, and we do not expect a substantial change of BoCom's funding mix, this push back on the bank's profitability shall remain in coming quarters.

**Unwanted geographic focus.** Even though overall asset quality of BoCom were well maintained at healthy level, while the double reductions in 1H12 both on NPL ratio and NPL balance appeared encouraging. In view that current asset quality concern were mainly attributed to coastal area, we conservatively hold back on BoCom's high Eastern China loan mix close to 50 %, as we believe BoCom could hit hardest if YRD and PRD economy turn negative.

**Valuation.** Taken into account the riskier geographic mix, we assumption 14% CAGR topline revenue growth over 2012-14E, which netting by 26% CAGR in credit cost growth over same period, resulting 8% net profit growth CAGR. We believe BoCom's share price will underperform despite trading at only 0.85x 12E P/B. **We initiate the stock with Hold.**

**Risk factors:** Prolonged slow economy in China, interest rate liberalization, sharp deterioration of asset quality and large exposure in interbank liabilities.

### Results and valuation

(FY ended Dec 31)	FY10A	FY11A	FY12E	FY13E	FY14E
Operating income (Rmb mn)	104,743	127,795	149,346	167,078	191,074
YoY Chg (%)	28.4	22.0	16.9	11.9	14.4
Net profit (Rmb mn)	39,042	50,735	54,709	57,420	64,788
YoY Chg (%)	29.6	29.9	7.8	5.0	12.8
EPS (Rmb)	0.74	0.86	0.88	0.93	1.05
BVPS (Rmb)	3.96	4.39	5.01	5.65	6.33
PE (x)	--	5.0	4.8	4.6	4.1
PB (x)	--	0.97	0.85	0.75	0.67
ROAE (%)	20.2	20.5	18.8	17.4	17.5

Source: Company, ABCI Securities estimates



**Income statement forecast**

(Rmb mn)	2010A	2011A	2012E	2013E	2014E
Net interest income	84,995	102,601	118,192	129,586	147,056
Non-interest income	19,748	25,194	31,154	37,492	44,018
Of which: fees and commissions	14,479	19,549	24,658	30,079	35,641
<b>Operating income</b>	<b>104,743</b>	<b>127,795</b>	<b>149,346</b>	<b>167,078</b>	<b>191,074</b>
Operating expenses	(42,543)	(49,865)	(60,131)	(71,106)	(82,802)
Pre-prov. operating profits	62,200	77,930	89,215	95,971	108,272
Impairment losses on loans	(12,246)	(12,479)	(18,965)	(22,240)	(25,088)
Operating profit	49,954	65,451	70,250	73,732	83,184
<b>Profit before tax</b>	<b>49,954</b>	<b>65,451</b>	<b>70,250</b>	<b>73,732</b>	<b>83,184</b>
Tax	(10,782)	(14,634)	(15,455)	(16,221)	(18,300)
Minorities interests	(130)	(82)	(86)	(90)	(95)
<b>Net profit</b>	<b>39,042</b>	<b>50,735</b>	<b>54,709</b>	<b>57,420</b>	<b>64,788</b>
<b>Growth (%)</b>					
Net interest income	27	21	15	10	13
Non-interest income	32	28	24	20	17
Of which: fees and commissions	27	35	26	22	18
<b>Operating income</b>	<b>28</b>	<b>22</b>	<b>17</b>	<b>12</b>	<b>14</b>
Operating expenses	33	17	21	18	16
<b>Pre-prov. operating profits</b>	<b>26</b>	<b>25</b>	<b>14</b>	<b>8</b>	<b>13</b>
Impairment losses on loans	9	2	52	17	13
Operating profit	30	31	7	5	13
<b>Profit before tax</b>	<b>30</b>	<b>31</b>	<b>7</b>	<b>5</b>	<b>13</b>
Tax	34	36	6	5	13
Minorities interests	(4)	(37)	5	5	5
<b>Net profit</b>	<b>30</b>	<b>30</b>	<b>8</b>	<b>5</b>	<b>13</b>
<b>Per share data</b>					
EPS	0.74	0.86	0.88	0.93	1.05
BVPS	3.96	4.39	5.01	5.65	6.33
DPS	0.22	0.21	0.27	0.30	0.37
<b>Key ratio (%)</b>					
Net interest margin	2.42	2.56	2.47	2.25	2.17
Net interest spread	2.35	2.46	2.40	2.17	2.07
Cost to income ratio	40.6	39.0	40.3	42.6	43.3
Return on average assets	1.08	1.19	1.08	0.96	0.92
Return on average equity	20.2	20.5	18.8	17.4	17.5
Effective tax rate	21.6	22.4	22.0	22.0	22.0
Dividend payout	31.7	25.5	30.0	32.0	35.0

Source: Company, ABCI Securities estimates

**BoCom – PB band chart**



Source: Winds, ABCI Securities estimates



**Balance sheet forecast**

(Rmb mn)	2010A	2011A	2012E	2013E	2014E
Cash & equivalent	586,554	736,999	833,696	951,717	1,087,849
Dues from banks	262,976	443,240	696,301	972,733	1,248,046
Investment securities	814,551	805,531	860,222	942,170	1,028,966
Net loans and advances	2,190,490	2,505,385	2,986,155	3,512,755	4,060,117
<b>Total interest earning assets</b>	<b>3,854,571</b>	<b>4,491,155</b>	<b>5,376,374</b>	<b>6,379,374</b>	<b>7,424,979</b>
Property and equipment	33,911	37,017	38,868	40,811	42,852
Other non-interest earning assets	63,111	83,005	75,101	67,967	61,528
<b>Total assets</b>	<b>3,951,593</b>	<b>4,611,177</b>	<b>5,490,343</b>	<b>6,488,153</b>	<b>7,529,359</b>
Customer deposits	2,867,847	3,283,232	3,869,296	4,551,753	5,302,189
Due to banks	717,032	854,499	1,110,849	1,388,561	1,638,502
Subordinated debt	52,000	81,803	80,985	81,795	82,613
<b>Total interest bearing liabilities</b>	<b>3,636,879</b>	<b>4,219,534</b>	<b>5,061,129</b>	<b>6,022,109</b>	<b>7,023,304</b>
Trading liabilities	14,379	18,921	20,813	22,894	25,184
Current taxes	4,615	4,247	4,672	5,139	5,653
Deferred tax liabilities	66	21	22	23	24
Other liabilities	71,997	95,666	92,354	87,296	82,176
<b>Total liabilities</b>	<b>3,727,936</b>	<b>4,338,389</b>	<b>5,178,990</b>	<b>6,137,462</b>	<b>7,136,341</b>
Share capital	56,260	61,886	61,886	61,886	61,886
Capital surplus	166,513	209,916	248,382	287,612	329,819
Minorities	884	986	1,085	1,193	1,312
<b>Shareholder's equity</b>	<b>223,657</b>	<b>272,788</b>	<b>311,352</b>	<b>350,691</b>	<b>393,018</b>
<b>Growth (%)</b>					
Cash & equivalent	35	26	13	14	14
Dues from banks	18	69	57	40	28
Investment securities	5	(1)	7	10	9
Net loans and advances	22	14	19	18	16
Total interest earning assets	19	17	20	19	16
<b>Total assets</b>	<b>19</b>	<b>17</b>	<b>19</b>	<b>18</b>	<b>16</b>
Customer deposits	21	14	18	18	16
Due to banks	10	19	30	25	18
Subordinated debt	(2)	57	(1)	1	1
Total interest bearing liabilities	18	16	20	19	17
<b>Total liabilities</b>	<b>19</b>	<b>16</b>	<b>19</b>	<b>19</b>	<b>16</b>
<b>Shareholder's equity</b>	<b>36</b>	<b>22</b>	<b>14</b>	<b>13</b>	<b>12</b>
<b>Key ratio (%)</b>					
Loan to deposits	78.0	78.0	79.1	79.2	78.8
Core CAR	9.6	9.3	10.0	9.3	8.7
Total CAR	12.4	12.4	13.1	12.0	11.2
NPL ratio	1.12	0.86	0.97	1.13	1.20
NPL growth	(0.1)	(12.0)	35.5	36.5	23.6
Net bad debt charge ratio	0.6	0.5	0.7	0.7	0.6
Provision to total loans	2.1	2.2	2.4	2.6	2.8
Provision coverage	185.8	256.4	246.5	230.5	232.7

Source: Company, ABCI Securities estimates





# Company Report

## CM BANK (3968 HK) - Hold

Diversified Bank Sector  
Initiation

### Key data

Share price (HK\$)	12.50
Target price (HK\$)	13.47
Upside potential (%)	7.8
52Wk H/L(HK\$)	18.6/9.9
Issued shares (mn)	
- A share	17,666
- H-share	3,910
Market cap	
- A share (Rmb mn)	178,781
- H-share (HK\$m)	48,881
30-day avg vol (HK\$m)	246
Major shareholder (%)	
China Merchants Group	18.01

Source: Company & Bloomberg

### Operating income mix (1H12) (%)

Wholesale banking	61.0
Retail banking	39.0

Source: Company

### Share performance (%)

	Absolute	Relative*
1-mth	(13.6)	(12.2)
3-mth	(12.5)	(16.7)
6-mth	(24.7)	(19.7)

\*Relative to Hang Seng Index

Source: Bloomberg

### 1 year price performance



Source: Bloomberg

### Analyst

Report Date: 12 September 2012

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### A dilemma pick

**We initiate a Hold on CMB with target price of HK\$13.47 with 8% upside, on the back of 12.5% net profit CAGR over 2012-14E. Despite we still treasure CMB's retail business edge, which could surprise the market by fee income growth, we hold back for its high business exposures in risky sectors and regions, together with the shadow from delayed right issue. Stock initiated with Hold.**

**Shifting asset mix.** Although CMB recorded solid business outlook in 1H12, it's NIM dropped by 20bps QoQ, which mainly due to the re-allocation of its assets mix with high portion in interbank assets. Cash and interbank assets contribution to IEAs has been increased from 24.7% in 2011 to 31.6% by Jun 2012. We believe this is temporary as CMB will shift lower yield interbank assets into investments and loans by year end. This point to our forecast 3% 2012E NIM, given 3.11% reported for 1H12, follow by another 25bps down in 2013E, resulting 12.5% net profit CAGR in 2012-14E.

**Higher asset quality risk.** We consider manufacturing, retail & wholesale, and property related loans are the major risk sectors under asset quality concern, CMB has relatively high exposure in these sectors of 58%. Meanwhile, coastal focus business mix raise another concern as we assume coastal area would be the disaster region of new NPLs. Hence we hold conservative view on CMB despite its high quality retail business could surprise the market on fee income growth.

**Low end CAR position.** CMB has the lowest capital position among H-share banks, with core CAR of 8.32% and total CAR of 11.55% as of Jun 2012, implying bigger need to improve capital position. We expect the delayed Rmb35bn right issue plan to happen any time subject to approval, which will shadow CMB's share price.

**Valuation.** CMB currently trading at 1.11x 12E PB, approaching to -1.5s.d. below historical mean, our target price HK\$13.47 implies 8% upside. Although we still treasure CMB's retail edge for better fee income growth outlook, we hold back on the uncertain timing of equity raising. **We initiate coverage with Hold.**

**Risk factors:** Prolonged slow economy in China, interest rate liberalization, sharp deterioration of asset quality and rising competition in non-interest income businesses.

### Results and valuation

(FY ended Dec 31)	FY10A	FY11A	FY12E	FY13E	FY14E
Operating income (Rmb mn)	71,692	96,603	111,313	122,564	140,030
YoY Chg (%)	38.3	34.7	15.2	10.1	14.3
Net profit (Rmb mn)	25,769	36,129	42,394	44,788	51,460
YoY Chg (%)	41.3	40.2	17.3	5.6	14.9
EPS (Rmb)	1.27	1.67	1.96	2.08	2.38
BVPS (Rmb)	6.21	7.65	9.39	10.99	12.88
PE (x)	--	6.2	5.3	5.0	4.4
PB (x)	--	1.36	1.11	0.95	0.81
ROAE (%)	22.7	24.2	23.1	20.4	20.0

Source: Company, ABCI Securities estimates



**Income statement forecast**

(Rmb mn)	2010A	2011A	2012E	2013E	2014E
Net interest income	57,076	76,307	85,109	90,931	102,743
Non-interest income	14,616	20,296	26,204	31,633	37,287
Of which: fees and commissions	11,330	15,628	20,073	24,591	29,302
<b>Operating income</b>	<b>71,692</b>	<b>96,603</b>	<b>111,313</b>	<b>122,564</b>	<b>140,030</b>
Operating expenses	(32,912)	(41,194)	(47,149)	(53,396)	(60,558)
<b>Pre-prov. operating profits</b>	<b>38,780</b>	<b>55,409</b>	<b>64,164</b>	<b>69,168</b>	<b>79,472</b>
Impairment losses	(5,501)	(8,350)	(9,179)	(11,080)	(12,727)
Operating profit	33,279	47,059	54,985	58,088	66,745
Non-operating income	64	63	69	76	84
<b>Profit before tax</b>	<b>33,343</b>	<b>47,122</b>	<b>55,054</b>	<b>58,164</b>	<b>66,829</b>
Tax	(7,574)	(10,995)	(12,662)	(13,378)	(15,371)
Minority interests	0	2	2	2	2
<b>Net profit</b>	<b>25,769</b>	<b>36,129</b>	<b>42,394</b>	<b>44,788</b>	<b>51,460</b>
<b>Growth (%)</b>					
Net interest income	41	34	12	7	13
Of which: fees and commissions	42	38	28	23	19
<b>Operating income</b>	<b>38</b>	<b>35</b>	<b>15</b>	<b>10</b>	<b>14</b>
Operating expenses	24	25	14	13	13
<b>Pre-prov. operating profits</b>	<b>53</b>	<b>43</b>	<b>16</b>	<b>8</b>	<b>15</b>
Impairment losses on loans	85	52	10	21	15
Operating profit	49	41	17	6	15
Non-operating income	(7)	(2)	10	10	10
<b>Profit before tax</b>	<b>49</b>	<b>41</b>	<b>17</b>	<b>6</b>	<b>15</b>
Tax	83	45	15	6	15
Minority interests	na	na	0	0	0
<b>Net profit</b>	<b>41</b>	<b>40</b>	<b>17</b>	<b>6</b>	<b>15</b>
<b>Per share data</b>					
EPS	1.27	1.67	1.96	2.08	2.38
BVPS	6.21	7.65	9.39	10.99	12.88
DPS	0.29	0.42	0.49	0.52	0.60
<b>Key ratio (%)</b>					
Net interest margin	2.65	3.06	3.00	2.75	2.71
Net interest spread	2.56	2.94	3.03	2.79	2.72
Cost to income ratio	45.9	42.6	42.4	43.6	43.2
Return on average assets	1.15	1.39	1.35	1.21	1.24
Return on average equity	22.7	24.2	23.1	20.4	20.0
Effective tax rate	22.7	23.3	23.0	23.0	23.0
Dividend payout	24.3	25.1	25.0	25.0	25.0

Source: Company, ABCI Securities estimates

**CMB – PB band chart**



Source: Winds, ABCI Securities estimates





**Balance sheet forecast**

<b>(Rmb mn)</b>	<b>2010A</b>	<b>2011A</b>	<b>2012E</b>	<b>2013E</b>	<b>2014E</b>
Cash & cash equivalent	323,916	471,350	662,518	686,633	737,799
Dues from banks	235,464	205,356	402,603	500,720	586,964
Investment securities	394,176	459,061	540,285	607,218	674,392
Net loans and advances	1,402,160	1,604,371	1,826,013	2,060,465	2,317,136
<b>Total interest earning assets</b>	<b>2,355,716</b>	<b>2,740,138</b>	<b>3,431,419</b>	<b>3,855,036</b>	<b>4,316,291</b>
Property and equipment	18,397	19,210	19,786	20,380	20,991
Other non-interest earning assets	28,394	35,623	42,574	50,087	57,600
<b>Total assets</b>	<b>2,402,507</b>	<b>2,794,971</b>	<b>3,493,779</b>	<b>3,925,503</b>	<b>4,394,881</b>
Customer deposits	1,902,231	2,235,040	2,588,369	2,953,894	3,361,224
Due to banks	282,023	315,247	535,920	562,716	590,852
Subordinated debt	31,232	31,187	68,611	68,611	68,611
<b>Total interest bearing liabilities</b>	<b>2,218,660</b>	<b>2,587,667</b>	<b>3,206,524</b>	<b>3,602,934</b>	<b>4,042,827</b>
Current taxes	4,972	7,112	8,179	9,406	10,816
Deferred tax liabilities	924	864	864	864	864
Other liabilities	43,945	34,318	75,607	75,239	62,351
<b>Total liabilities</b>	<b>2,268,501</b>	<b>2,629,961</b>	<b>3,291,175</b>	<b>3,688,442</b>	<b>4,116,859</b>
Share capital	21,577	21,577	21,577	21,577	21,577
Reserves	112,429	143,420	181,015	215,471	256,433
Minorities	0	13	13	13	13
<b>Shareholder's equity</b>	<b>134,006</b>	<b>165,010</b>	<b>202,605</b>	<b>237,061</b>	<b>278,023</b>
<b>Growth (%)</b>					
Cash & cash equivalent	22	46	41	4	7
Dues from banks	6	(13)	96	24	17
Investment securities	5	16	18	12	11
Net loans and advances	21	14	14	13	12
Total interest earning assets	16	16	25	12	12
<b>Total assets</b>	<b>16</b>	<b>16</b>	<b>25</b>	<b>12</b>	<b>12</b>
Customer deposits	18	17	16	14	14
Due to banks	6	12	70	5	5
Subordinated debt	(0)	(0)	120	0	0
Total interest bearing liabilities.	16	17	24	12	12
<b>Total liabilities</b>	<b>15</b>	<b>16</b>	<b>25</b>	<b>12</b>	<b>12</b>
<b>Shareholder's equity</b>	<b>44</b>	<b>23</b>	<b>23</b>	<b>17</b>	<b>17</b>
<b>Key ratio (%)</b>					
Loan to deposits	75.3	73.4	72.3	71.6	70.9
Core CAR	8.0	8.2	9.0	9.1	9.4
Total CAR	11.5	11.5	12.6	12.3	12.2
NPL ratio	0.7	0.6	0.8	1.1	1.3
NPL growth	(0.5)	(5.3)	69.6	44.5	33.0
Net bad debt charge ratio	0.4	0.5	0.5	0.6	0.6
Provision to total loans	2.0	2.2	2.4	2.6	2.8
Provision coverage	302.4	400.1	288.6	244.7	223.2

Source: Company, ABCI Securities estimates



# Company Report

## CITIC BANK (998 HK) - Hold

Diversified Bank Sector  
Initiation

### Key data

Share price (HK\$)	3.58
Target price (HK\$)	3.61
Upside potential (%)	0.8
52Wk H/L(HK\$)	5.15/2.93
Issued shares (mn)	
- A share	31,905
- H-share	14,882
Market cap	
- A share (Rmb mn)	121,558
- H-share (HK\$m)	53,278
30-day avg vol (HK\$m)	117
Major shareholder (%)	
CITIC Group	61.85

Source: Company & Bloomberg

### Operating income mix (1H12) (%)

Corporate banking	76.2
Personal banking	15.2
Treasury	8.6

Source: Company

### Share performance (%)

	Absolute	Relative*
1-mth	(10.9)	(9.5)
3-mth	(5.8)	(10.3)
6-mth	(28.3)	(23.6)

\*Relative to Hang Seng Index

Source: Bloomberg

### 1 year price performance



Source: Bloomberg

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### Low credit cost visibility

**With relatively weak retail franchise, we expect CNCB's funding cost to pick up under high 70% LDR, which shall point to larger than peers NIM squeeze. Meanwhile, we query on sustainability of CNCB's low credit cost, as we believe this is not realistic under current sluggish economy. With low visibility of future credit cost, we initiate coverage on CNCB with Hold.**

**Slow retail business growth.** Over the past years, we saw slow progress for CNCB to develop its retail banking segment, as of 1H12 retail businesses only accounted for 10% of top line revenue or 5% of profit before tax. Without diversified branch network, we do not forecast CNCB can outpace peers to grow its retail business in medium term.

**Possible surge on funding cost.** At 70% LDR as of 1H12, absorbing deposit would be a challenge given weak franchise network to fuel the bank's upcoming growth. This set to a higher funding cost outlook to CNCB both on higher deposit cost and shift of liability mix into higher yield interbank funding. Looking into 2Q12, this has been started to reflect with 40bps NIM reduction QoQ, we expect CNCB to hit hardest on NIM among H-share bank with 11-27bps each year in 2012-14E.

**Unconvinced low credit cost.** Further to low end NPL ratio of 0.6% by CNCB, the bank has lowest impairment to total loans at 1.67% compare to sector average of 2.5%. Besides according to the latest result, we noted that CNCB's 2Q12 credit cost recorded sharp reduction, when both NPL ratio and NPL balance increased. Despite management expect stable asset quality in coming quarter, we think this is too good to be true under current slowing macro landscape.

**Valuation.** We expect CNCB's net profit to grow by 8% CAGR over 2012-14E, factored into 30bps increase of provision to total loans, under our assumption of accelerating worsen of credit quality in 2013E. Trading at 2.s.d below historical mean, we have low visibility on the bank's future credit cost trend, we think current share price are fairly reflect CNCB's value, **initiate with a Hold.**

**Risk factors:** Prolonged slow economy in China, interest rate liberalization, sharp deterioration of asset quality and slow progress to develop its retail business.

### Results and valuation

(FY ended Dec 31)	FY10A	FY11A	FY12E	FY13E	FY14E
Operating income (Rmb mn)	56,356	77,092	91,114	101,158	115,906
YoY Chg (%)	37.5	36.8	18.2	11.0	14.6
Net profit (Rmb mn)	21,509	30,819	35,880	34,877	38,906
YoY Chg (%)	50.2	43.3	16.4	-2.8	11.6
EPS (Rmb)	0.55	0.72	0.77	0.75	0.83
BVPS (Rmb)	3.08	3.73	4.46	5.15	5.93
PE (x)	--	4.1	3.9	4.0	3.6
PB (x)	--	0.80	0.67	0.58	0.50
ROAE (%)	19.3	20.9	18.7	15.5	15.0

Source: Company, ABCI Securities estimate



**Income statement forecast**

(Rmb mn)	2010A	2011A	2012E	2013E	2014E
Net interest income	48,135	65,106	76,389	83,357	94,740
Non-interest income	8,221	11,986	14,725	17,802	21,166
Of which: fees and commissions	5,696	8,837	10,958	13,348	15,944
<b>Operating income</b>	<b>56,356</b>	<b>77,092</b>	<b>91,114</b>	<b>101,158</b>	<b>115,906</b>
Operating expenses	(22,284)	(27,956)	(33,878)	(40,596)	(48,168)
Amortization	(354)	(425)	(510)	(612)	(722)
<b>Pre-prov. operating profits</b>	<b>33,718</b>	<b>48,711</b>	<b>56,726</b>	<b>59,950</b>	<b>67,016</b>
Impairment losses on loans	(5,249)	(7,207)	(8,302)	(12,895)	(14,532)
Operating profit	28,469	41,504	48,423	47,055	52,485
Non-operating income	226	86	99	114	131
<b>Profit before tax</b>	<b>28,695</b>	<b>41,590</b>	<b>48,522</b>	<b>47,168</b>	<b>52,615</b>
Tax	(6,916)	(10,746)	(12,616)	(12,264)	(13,680)
Minorities interests	270	25	26	28	29
<b>Net profit</b>	<b>21,509</b>	<b>30,819</b>	<b>35,880</b>	<b>34,877</b>	<b>38,906</b>
<b>Growth (%)</b>					
Net interest income	34	35	17	9	14
Non-interest income	64	46	23	21	19
Of which: fees and commissions	35	55	24	22	19
<b>Operating income</b>	<b>38</b>	<b>37</b>	<b>18</b>	<b>11</b>	<b>15</b>
Operating expenses	19	25	21	20	19
Amortization	(12)	20	20	20	18
<b>Pre-prov. operating profits</b>	<b>54</b>	<b>44</b>	<b>16</b>	<b>6</b>	<b>12</b>
Impairment losses on loans	100	37	15	55	13
Operating profit	48	46	17	(3)	12
Non-operating income	606	(62)	15	15	15
<b>Profit before tax</b>	<b>49</b>	<b>45</b>	<b>17</b>	<b>(3)</b>	<b>12</b>
Tax	47	55	17	(3)	12
Minorities interests	13	(91)	5	5	5
<b>Net profit</b>	<b>50</b>	<b>43</b>	<b>16</b>	<b>(3)</b>	<b>12</b>
<b>Per share data</b>					
EPS	0.55	0.72	0.77	0.75	0.83
BVPS	3.08	3.73	4.46	5.15	5.93
DPS	0.07	0.14	0.19	0.19	0.21
<b>Key ratio (%)</b>					
Net interest margin	2.63	3.00	2.88	2.62	2.51
Net interest spread	2.54	2.85	2.71	2.43	2.25
Cost to income ratio	40.2	36.8	37.7	40.7	42.2
Return on average assets	1.12	1.27	1.21	1.02	1.00
Return on average equity	19.3	20.9	18.7	15.5	15.0
Effective tax rate	24.1	25.8	26.0	26.0	26.0
Dividend payout	12.0	22.0	25.0	25.0	25.0

Source: Company, ABCI Securities estimates

**CNCB – PB band chart**



Source: Winds, ABCI Securities estimates



**Balance sheet forecast**

(Rmb mn)	2010A	2011A	2012E	2013E	2014E
Cash & cash equivalent	256,323	366,391	408,881	452,942	497,300
Dues from banks	278,220	699,750	733,531	815,213	893,309
Investment securities	269,005	251,176	353,029	435,016	523,991
Net loans and advances	1,246,026	1,410,779	1,643,877	1,896,193	2,188,367
<b>Total interest earning assets</b>	<b>2,049,574</b>	<b>2,728,096</b>	<b>3,139,318</b>	<b>3,599,364</b>	<b>4,102,968</b>
Property and equipment	10,222	10,388	10,907	11,453	12,025
Trading assets	4,478	4,683	4,917	5,163	5,421
Other non-interest earning assets	17,040	22,714	20,443	18,532	16,806
<b>Total assets</b>	<b>2,081,314</b>	<b>2,765,881</b>	<b>3,175,585</b>	<b>3,634,512</b>	<b>4,137,221</b>
Customer deposits	1,730,816	1,968,051	2,336,804	2,734,443	3,148,806
Due to banks	153,116	550,028	533,527	560,204	588,214
Subordinated debt	34,915	33,730	59,028	64,930	70,125
<b>Total interest bearing liabilities</b>	<b>1,918,847</b>	<b>2,551,809</b>	<b>2,929,358</b>	<b>3,359,577</b>	<b>3,807,144</b>
Trading liabilities	14,855	3,764	4,329	4,978	5,725
Current taxes	2,598	4,015	5,019	6,123	7,347
Other liabilities	20,476	27,512	23,924	18,060	34,771
<b>Total liabilities</b>	<b>1,956,776</b>	<b>2,587,100</b>	<b>2,962,629</b>	<b>3,388,737</b>	<b>3,854,987</b>
Share capital	39,033	46,787	46,787	46,787	46,787
Reserve	81,142	127,709	161,670	194,263	230,722
Minorities	4,363	4,285	4,499	4,724	4,724
<b>Shareholder's equity</b>	<b>124,538</b>	<b>178,781</b>	<b>212,956</b>	<b>245,774</b>	<b>282,234</b>
<b>Growth (%)</b>					
Cash & equivalent	(9)	43	12	11	10
Dues from banks	34	152	5	11	10
Investment securities	30	(7)	41	23	20
Net loans and advances	19	13	17	15	15
Total interest earning assets	17	33	15	15	14
<b>Total assets</b>	<b>17</b>	<b>33</b>	<b>15</b>	<b>14</b>	<b>14</b>
Customer deposits	29	14	19	17	15
Due to other banks & FIs	(46)	259	(3)	5	5
Subordinated term debt	90	(3)	75	10	8
Total interest bearing liabilities.	17	33	15	15	13
<b>Total liabilities</b>	<b>17</b>	<b>32</b>	<b>15</b>	<b>14</b>	<b>14</b>
<b>Shareholder's equity</b>	<b>16</b>	<b>44</b>	<b>19</b>	<b>15</b>	<b>15</b>
<b>Key ratio (%)</b>					
Loan to deposits	73.0	72.9	71.6	70.8	71.1
Core CAR	8.5	9.9	9.7	9.3	9.0
Total CAR	11.3	12.3	11.7	11.0	10.5
NPL ratio	0.67	0.60	0.82	1.03	1.23
NPL growth	(16.0)	0.1	61.3	45.4	37.8
Net bad debt charge ratio	0.4	0.4	0.4	0.6	0.6
Provision to total loans	1.4	1.6	1.8	2.1	2.3
Provision coverage	213.5	272.3	212.5	198.1	186.7

Source: Company, ABCI Securities estimates



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## 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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