



## China Bank Sector – Neutral Diversified Banks Industry

### Key Data

|                                  |       |
|----------------------------------|-------|
| Average PER (x)                  | 5.6   |
| Average PBV (x)                  | 1.1   |
| Average Dividend Yield (%)       | 5.3   |
| Sector 3 months avg vol (HK\$mn) | 4,421 |

Source: Company, Bloomberg, ABCI Securities

### Operating income composition in 1H12 (%)

|                     |      |
|---------------------|------|
| Net interest income | 79.5 |
| Non-interest income | 20.5 |

Source: CBRC

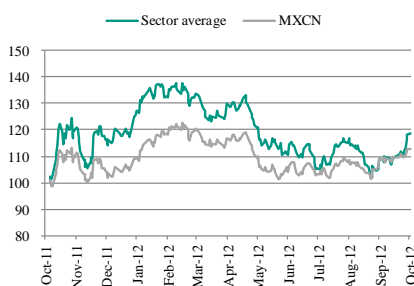
### Share performance (%)

|       | Absolute | Relative* |
|-------|----------|-----------|
| 1-mth | 10.2     | 6.2       |
| 3-mth | 11.9     | 3.4       |
| 6-mth | (7.0)    | (4.7)     |

Source: Bloomberg

\*Relative to MSCI China

### 1 year price performance



Source: Bloomberg

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### Big banks defensive for diversification

Moody's recent report expected NIM reduction solely from interest rate deregulations at 4-6bps in 2012 and 10-13bps in 2013. Our base case has also taken into account current rate cut cycle, which points to 7-12bps and 15-27bps over same period. We prefer big banks as better diversification protect from NIM squeeze, with our top picks CCB and ABC. The sector is trading at 1.5s.d. below mean.

**Moody's sees challenges in banking sector.** Moody's estimated that Chinese banks' NIM to reduce by 4-6bps and 10-13bps in 2012 and 2013 solely for interest rate deregulations without factor into impact from previous rate cut. Estimation scope covered 13 listed banks, and this would translate into Rmb28.5bn and Rmb79.6bn net profit evaporation in 2012 and 2013 respectively, which equivalent to 3% and 8% of 2011 banking system net profits. Besides, it expects NIM depression would encourage banks to extend loans in high yield SMEs, which could ultimately results assets quality issues.

**Concur with our view.** We do not see significant new angle from Moody's latest report, while it concurred with our view that banks will focus their loan growth in higher margin segments to overcome NIM squeeze. However we are of the view that asset quality concerns are still geographic and industry specific, while SME loans are easier to manage in terms of risk exposure given smaller size and shorter duration. We expect big banks to be more protective from NIM squeeze given their well-developed brand name and diversified business mix.

**Big banks are more defensive.** Under our base case forecast, factored into both impact from deregulation and rate cut cycle, we expect H-share banks' NIM to reduce by 7-12bps and 15-27bps in 2012 and 2013 respectively. Big banks shall see relatively fewer narrowing by 5-6bps in 2013. The sector is currently trading at an average of 1.5s.d. below mean. We believe big banks are more defensive, with CCB and ABC are our top picks.

**Risk factors.** Prolonged slowdown of China economy, interest rate liberalization and sharp deterioration of asset quality. Upcoming 3Q12 results in late Oct will reflect the consequence of rate cut in Jun and Jul 2012.

### Sector Valuation Summary

| Companies | Ticker  | Rating | Price (HK\$) | Target (HK\$) | Upside (%) | 12E PER | 12E PBV | 12E Yield |
|-----------|---------|--------|--------------|---------------|------------|---------|---------|-----------|
| CCB       | 939 HK  | Buy    | 5.78         | 6.30          | 9.0        | 6.3     | 1.3     | 5.6       |
| ABC       | 1288 HK | Buy    | 3.24         | 3.45          | 6.5        | 5.9     | 1.2     | 5.2       |
| MSB       | 1988 HK | Buy    | 6.90         | 7.66          | 11.0       | 4.6     | 1.0     | 5.6       |
| ICBC      | 1398 HK | Hold   | 4.97         | 4.44          | (10.7)     | 6.4     | 1.3     | 4.6       |
| BOC       | 3988 HK | Hold   | 3.08         | 2.94          | (4.5)      | 5.3     | 0.9     | 5.8       |
| BoCom     | 3328 HK | Hold   | 5.75         | 5.13          | (10.8)     | 5.4     | 1.0     | 5.6       |
| CMB       | 3968 HK | Hold   | 14.42        | 13.47         | (6.6)      | 6.1     | 1.3     | 4.1       |
| CNCB      | 998 HK  | Hold   | 4.14         | 3.61          | (12.8)     | 4.5     | 0.8     | 5.5       |

Source: Company, Bloomberg, ABCI Securities estimates

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### Definition of equity rating

| Rating | Definition   |
|--------|--|
| Buy    | Stock return $\geq$ Market return rate                         |
| Hold   | Market return $- 6\% \leq$ Stock return $<$ Market return rate |
| Sell   | Stock return $<$ Market return $- 6\%$                         |

Stock return is defined as the expected % change of share price plus gross dividend yield over the next 12 months

Market return: 5-year average market return rate 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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