

Bank of Communications (3328 HK / 601328 CH)

Topline growth takes time to recover

- NIM pressure to gradually reduce on better loan demand and pricing
- Takes time for net fee income to turn around
- Despite manageable asset quality, the bank needs to enhance risk buffers
- Low valuation renders the counter a bargain **BUY**. Our GGM-based H/A-shr TPs imply 0.48x/0.58x target 23E P/B

Lessening NIM pressure in coming quarters. Based on our estimates, banks' NIM will continue to trend down sector-wide over 2023 but NIM pressure should lessen after 1Q23. NIM in 1Q23 was 1.33%, down by 23bps YoY. Since a significant proportion of retail loans re-pricing have already taken place and with better corporate loans demand in 1Q23, we expect new loan pricing to improve starting from 2Q23. According to PBOC's 1Q23 loan allocation report, YoY growth in corporate loans was 14.3% YoY as of Mar 2023, 70bps higher than that in Dec 2022; medium-to-long-term loans grew 17.4% YoY as of Mar 2023, 2.9ppt higher than Dec 2022. Faster loan growth signaled the revival of loan demand, along with better macro growth momentum in 1Q23. In addition, with disciplined deposit costs and solid balance sheet growth, we project the Bank of Communications (BoCom)'s NIM to narrow 6bps-7bps each in FY24E-25E, after the 16bps YoY decline in FY23E to 1.32%. Consequently, we project FY22-25E NII CAGR to be 4.5%.

Net fee growth momentum still weak. Nevertheless, 1Q23 net fee income came in weaker than expected, down 7.7% YoY. Aside from a high base effect in 1Q22, a weak capital market and reduction in fee rates also contributed to the decline. We project the YoY negative growth in net fee income to reduce for the rest of FY23; the recovering macro outlook and rising consumptions would help support that. On an annual basis, however, we still expect BoCom's net fee income to shrink 4.0% and 1.0% YoY in FY23E and FY24E before a turnaround in FY25E. Our base case suggests topline to grow at 4.7% CAGR over FY22-25E.

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Results and Valuation

FY ended Dec 31	2021A	2022A	2023E	2024E	2025E
Revenue (RMB mn)	269,748	273,528	281,193	296,768	313,631
Chg (% YoY)	9.3	1.4	2.8	5.5	5.7
Net profit* (RMB mn)	87,581	92,149	94,103	103,722	115,718
Chg (% YoY)	11.9	5.2	2.1	10.2	11.6
EPS (RMB)	1.10	1.14	1.17	1.30	1.46
Chg (% YoY)	10.9	3.3	2.3	11.1	12.5
BVPS (RMB)	10.64	11.43	11.99	12.62	13.32
Chg (% YoY)	7.7	7.4	5.0	5.2	5.5
P/E (x) – H-shr	4.14	4.01	3.91	3.52	3.13
P/B (x) – H-shr	0.43	0.40	0.38	0.36	0.34
P/E (x) – A-shr	5.05	4.89	4.78	4.30	3.82
P/B (x) – A-shr	0.52	0.49	0.46	0.44	0.42
ROAA (%)	0.80	0.75	0.76	0.76	0.77
ROAE (%)	10.76	10.33	10.01	10.03	10.67
DPS(RMB)	0.354	0.373	0.373	0.415	0.466
Yield (%) H-shr	7.75	8.17	8.17	9.08	10.21
Yield (%) A-shr	6.36	6.70	6.70	7.45	8.37

Note: HKD/CNY=1.13

*Net profit =Net profit attributable to equity holders of the Company

Source(s): Company, Bloomberg, ABCI Securities estimates

Company Report

May 4, 2023

Rating (H): BUY
Rating (A): BUY
TP (H): HK\$ 6.54
TP (A): RMB 6.95

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Price (H/A shr)	HK\$ 5.16/ RMB 5.57
Est. s price return (H/A shr)	26.74%/ 24.78%
Est. dividend yield (H/A shr)	8.17%/6.70%
Est. total return (H/A shr)	34.91%/ 31.48%
Last Rating & TP (H/A shr)	BUY, HK\$6.69/ BUY, RMB6.66
Previous Report Date	11 May, 2022

Source(s): Bloomberg, ABCI Securities estimates

Key Data

52Wk H/L (HK\$) (H shr)	5.54/3.83
52Wk H/L (RMB) (A shr)	5.63/4.44
Total issued shares (mn)	74,262.8
Issued H shr (mn)	35,011.9
Issued A shr (mn)	39,250.9
Market cap (HK\$ mn)	427,710.5
H-shr market cap (HK\$ mn)	180,661.4
A-shr market cap (HK\$ mn)	247,049.1
3-mth avg daily turnover (HK\$ mn) (H shr)	69.2
3-mth avg daily turnover (RMB mn) (A shr)	159.17

Major shareholder(s) (%):

HSBC	19.03
MoF	23.88

Source(s): Bloomberg, ABCI Securities



Need to strengthen risk buffers. BoCom has the lowest risk buffers among the big banks; as of Mar 2023, its provisioning ratio and provision coverage ratio were 2.46% and 183.25%; NPL ratio was 1.34% as of Mar 2023. Despite the mild asset quality risk from the real estate sector, we expect BoCom's NPL ratio to remain manageable in the range of 1.32%-1.37% over FY23E-25E. In our view, BoCom would need to raise its risk buffer further to reduce earnings volatility. Assuming a provision expense CAGR of -1.6% for FY22-25E, the bank's provisioning ratio would increase by 3bps-5bps YoY each in FY23E-25E to 2.55% by end-FY25E. We estimate provision coverage ratio would stay in the range of 186.13%-188.64% in FY23E-25E.

Maintain BUY on low valuation. We lower FY23E/24E net profit forecasts by 3.64% and 2.94% mainly on lower net fee income. Based on our base case forecasts, net profit would expand at 7.9% CAGR in FY22-25E. Factoring in a lower sustainable ROAE and long-term growth and a higher COE, our GGM-derived H/A TPs changed by -2.2%/4.4% to HK\$ 6.54/ RMB 6.95, implying 0.48x/0.58x FY23E target P/B. Despite BoCom's weaker fundamentals compared to other big banks, its valuation renders it a bargain **BUY**.

Risk Factors: 1) Persisting NIM pressure and possible further LPR cut; 2) Asset quality risk from the real estate sector; 3) Net fee income decline continuously. 4) Earnings growth to slowdown in 2Q-4Q23.

Exhibit 1: Major changes in forecasts

(RMB mn)	2023E (old)	2023E (new)	change (%)	(RMB mn)	2024E (old)	2024E (new)	change (%)
Net interest income	170,674	174,759	2.39	Net interest income	179,422	184,454	2.80
Net fee and commission	52,949	42,853	(19.07)	Net fee and commission	56,655	42,425	(25.12)
Operating income	295,178	281,193	(4.74)	Operating income	313,310	296,768	(5.28)
Operating expenses	(125,806)	(119,220)	(5.24)	Operating expenses	(134,510)	(125,181)	(6.94)
Impairment losses	(64,519)	(61,475)	(4.72)	Impairment losses	(64,214)	(60,822)	(5.28)
Profit before tax	104,853	100,498	(4.15)	Profit before tax	114,587	100,765	(12.06)
Net profit attributable to equity holders	97,660	94,103	(3.64)	Net profit attributable to equity holders	106,859	103,722	(2.94)
Key indicators (%)			change (ppt)	Key indicators (%)			change (ppt)
Net interest margin	1.46	1.32	(0.14)	Net interest margin	1.42	1.25	(0.17)
CIR	30.62	30.40	(0.22)	Cost to income ratio	30.93	30.18	(0.75)
ROAA	0.82	0.76	(0.06)	ROAA	0.83	0.76	(0.07)
ROAE	10.73	10.01	(0.72)	ROAE	11.18	10.03	(1.15)
Dividend payout	32.00	32.00	-	Dividend payout	32.00	32.00	-
CT1 CAR	11.06	10.07	(0.99)	CT1 CAR	10.94	9.83	(1.11)
Total CAR	16.00	15.01	(0.99)	Total CAR	15.96	14.79	(1.17)
NPL ratio	1.55	1.32	(0.23)	NPL ratio	1.59	1.35	(0.24)
Provision to total loans	2.53	2.49	(0.04)	Provision to total loans	2.57	2.52	(0.05)
Provision coverage ratio	163.23	188.64	25.41	Provision coverage	161.64	186.67	25.03

Source(s): Company, ABCI Securities estimates

Exhibit 2: Changes in GGM assumptions

	H-shr		A-shr		
	old	new	old	new	Reason
TP (HKD/RMB)	6.69	6.54	6.66	6.95	
Sustainable ROE (%)	10.01	9.56	10.01	9.56	Factor in lower ROAE
COE (%)	13.59	14.44	12.60	12.87	Adjust beta and risk premium with reference to Bloomberg
LT gr (%)	6.20	5.00	6.20	5.00	Adjust on lower earnings growth
Target 23E P/B (x)	0.49	0.48	0.56	0.58	

Source(s): Company, ABCI Securities estimates



Financial statements

Consolidated income statement

FY Ended Dec 31 (RMB mn)	2021A	2022A	2023E	2024E	2025E
Net interest income	161,693	169,937	174,759	184,454	193,992
Non-interest income	108,055	103,591	106,435	112,314	119,639
Of which: Fees and commissions	47,573	44,639	42,853	42,425	42,849
Operating income	269,748	273,528	281,193	296,768	313,631
Operating expenses	(107,098)	(113,005)	(119,220)	(125,181)	(130,814)
Pre-provision operating profit	162,650	160,523	161,973	171,586	182,817
Impairment losses on loans	(68,691)	(62,308)	(61,475)	(60,822)	(59,314)
Profit before tax	93,959	98,215	100,498	110,765	123,503
Tax	(5,020)	(6,185)	(6,532)	(7,200)	(7,966)
Minorities interests	(1,358)	119	137	157	181
Net profit attributable to equity holders	87,581	92,149	94,103	103,722	115,718
Dividend to other capital instrument holders	(5,613)	(7,483)	(7,483)	(7,483)	(7,483)
Net profit attributable to ordinary shareholders	81,968	84,666	86,620	96,239	108,235
Growth (%)					
Net interest income	5.5	5.1	2.8	5.5	5.2
Non-interest income	15.7	(4.1)	2.7	5.5	6.5
Of which: Fees and commissions	5.5	(6.2)	(4.0)	(1.0)	1.0
Operating income	9.3	1.4	2.8	5.5	5.7
Operating expenses	9.6	5.5	5.5	5.0	4.5
Pre-provision operating profit	9.2	(1.3)	0.9	5.9	6.5
Impairment losses on loans	9.8	(9.3)	(1.3)	(1.1)	(2.5)
Profit before tax	8.7	4.5	2.3	10.2	11.5
Tax	(26.8)	23.2	5.6	10.2	10.6
Minorities & other dilutions	4.8	(108.8)	15.0	15.0	15.0
Net profit attributable to equity holders	11.9	5.2	2.1	10.2	11.6
Dividend to other capital instrument holders	27.7	33.3	0.0	0.0	0.0
Net profit attributable to ordinary shareholders	10.9	3.3	2.3	11.1	12.5
Per share (RMB)					
EPS	1.10	1.14	1.17	1.30	1.46
BVPS	10.64	11.43	11.99	12.62	13.32
DPS	0.354	0.373	0.373	0.415	0.466
Key ratio (%)					
Net interest margin	1.56	1.48	1.32	1.25	1.19
Cost to income ratio	27.67	28.14	30.40	30.18	29.71
Return on average assets	0.80	0.75	0.76	0.76	0.77
Return on average equity	10.76	10.33	10.01	10.03	10.67
Effective tax rate	5.34	6.30	6.50	6.50	6.45
Dividend payout	32.07	32.72	32.00	32.00	32.00

Note: Individual items may not sum to total due to rounding difference

Key ratios and figures may not match with financial reports due to adjustment and reclassification for comparison consistency among individual equities

Source(s): Company, ABCI Securities estimates



Consolidated balance sheet

As of Dec 31 (RMB mn)	2021A	2022A	2023E	2024E	2025E
Cash & balance with central banks	734,728	806,102	886,712	966,516	1,043,838
Due from FIs	632,708	690,421	752,559	805,238	853,552
Investment securities	3,523,249	3,955,207	4,429,832	4,961,412	5,556,781
Net loans and advances	6,412,201	7,136,677	7,798,956	8,551,724	9,339,460
Total interest earning assets	11,302,886	12,588,407	13,868,059	15,284,890	16,793,631
Property and equipment	171,194	194,169	221,353	250,129	280,144
Other non-interest earning assets	191,677	209,843	235,480	267,059	306,087
Total assets	11,665,757	12,992,419	14,324,892	15,802,078	17,379,862
Customer deposits	7,039,777	7,949,072	8,971,733	10,072,475	11,240,921
Due to FIs	1,947,768	2,034,894	2,136,639	2,264,837	2,400,727
Subordinated debt and others	1,481,667	1,717,980	1,924,138	2,135,793	2,349,372
Total interest bearing liabilities	10,469,212	11,701,946	13,032,509	14,473,104	15,991,021
Current taxes	4,725	3,937	4,252	4,550	4,823
Deferred tax liabilities	1,889	1,786	1,893	2,007	2,147
Other liabilities	212,695	249,010	208,961	199,163	207,362
Total liabilities	10,688,521	11,956,679	13,247,615	14,678,824	16,205,353
Share capital	74,263	74,263	74,263	74,263	74,263
Other capital instruments	174,790	174,790	174,790	174,790	174,790
Reserves	715,594	774,356	816,509	863,072	914,884
Minorities	12,589	12,331	11,714	11,129	10,572
Shareholder's equity	977,236	1,035,740	1,077,276	1,123,253	1,174,509
Growth (%)					
Cash & balance with central banks	(10.1)	9.7	10.0	9.0	8.0
Due from FIs	10.8	9.1	9.0	7.0	6.0
Investment securities	8.8	12.3	12.0	12.0	12.0
Net loans and advances	12.1	11.3	9.3	9.7	9.2
Total interest earning assets	9.2	11.4	10.2	10.2	9.9
Property and equipment	1.0	13.4	14.0	13.0	12.0
Other non-interest earning assets	5.6	9.5	12.2	13.4	14.6
Total assets	9.1	11.4	10.3	10.3	10.0
Customer deposits	6.5	12.9	12.9	12.3	11.6
Due to FIs	9.0	4.5	5.0	6.0	6.0
Subordinated debt and others	13.8	15.9	12.0	11.0	10.0
Total interest bearing liabilities	8.0	11.8	11.4	11.1	10.5
Current taxes	24.8	(16.7)	8.0	7.0	6.0
Deferred tax liabilities	46.9	(5.5)	6.0	6.0	7.0
Other liabilities	82.4	17.1	(16.1)	(4.7)	4.1
Total liabilities	8.9	11.9	10.8	10.8	10.4
Share capital	0.0	0.0	0.0	0.0	0.0
Other capital instruments	31.1	0.0	0.0	0.0	0.0
Reserves	8.6	8.2	5.4	5.7	6.0
Minorities	4.7	(2.0)	(5.0)	(5.0)	(5.0)
Shareholder's equity	11.2	6.0	4.0	4.3	4.6
Key ratio (%)					
CT1 CAR	10.62	10.06	10.07	9.83	9.51
Total CAR	15.45	14.97	15.01	14.79	14.42
NPL ratio	1.48	1.35	1.32	1.35	1.37
Provision to total loans	2.46	2.44	2.49	2.52	2.55
Provision coverage ratio	166.50	180.68	188.64	186.67	186.13

Note: Individual items may not sum to total due to rounding difference

Key ratios and figures may not match with financial reports due to adjustment and reclassification for comparison consistency among individual equities

Source(s): Company, ABCI Securities estimates

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Rating	Definition
Buy	Stock return rate \geq Market return rate ($\sim 9\%$)
Hold	- Market return rate ($\sim 9\%$) \leq Stock return rate $<$ Market return rate ($\sim 9\%$)
Sell	Stock return $<$ - Market return ($\sim 9\%$)

Notes: Stock return rate: expected percentage change of share price plus gross dividend yield over the next 12 months
Market return rate: average market return rate since 2006 (For reference: HSI total return index 2006-22 averaged at 8.4%)

Time horizon of share price target: 12-month

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

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