

China Merchants Bank (3968 HK / 600036 CH)

Fundamental outlook remains challenging

- NIM continues to narrow in coming quarters though gradual easing can be expected from 2Q23
- 4Q22 net fee income growth to remain sluggish; expect better momentum in FY23
- Expect mild increment in NPL ratio driven mainly by property-related sectors
- Maintain **BUY** on sector-leading fundamentals. Our GGM-based H/A-shr TPs imply 1.34x/1.27x FY23E P/Bs

Further NIM squeeze in coming quarters. Downside pressure on NIM will be inevitable in coming quarters as a result of loan re-pricing from previous interest rate cuts. Specifically, a sharper NIM drop will take place 1Q23 since a larger proportion of loans will be re-priced at year-start. NIM pressure would ease from 2Q23 onwards, however. In our NIM model, we project CMB's NIM to narrow by 5bps-6bps each in FY22E-24E, and NII would expand at 8.5% CAGR over FY21-24E. Aside from balance sheet growth, CMB would defend NIM through managing balance sheet components, which includes increasing allocation to higher-yield assets, reducing interbank exposure, and controlling deposit cost. Our base case projects CMB's total assets and liabilities to grow at 8.7% and 8.5% CAGRs over FY21-24E, while gross loans and customer deposits would grow at 8.8% and 12.2% CAGRs over FY21-24E.

Better net fee momentum in 2023. Shadowed by a slew of factors such as slow economic growth, volatile capital market, low retail investment, sluggish spending sentiment, and COVID-19 lockdowns in various areas, net fee growth among the Chinese banks was weak in 9M22. Assuming more supportive measures will take place in 4Q22 and 1Q23 after the 20th Party Congress, macro outlook should gradually improve in FY23 and drive recovery in net fee income growth. We project CMB's net fee income to increase at 4.3% CAGR over FY21-24E to account for over 25% of topline revenue over the period.

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Results and Valuation

FY ended Dec 31	2020A	2021A	2022E	2023E	2024E
Revenue (RMB mn)	287,398	327,377	352,942	380,987	410,821
Chg (% YoY)	7.2	13.9	7.8	7.9	7.8
Net profit* (RMB mn)	97,342	119,922	133,900	149,108	163,893
Chg (% YoY)	4.8	23.2	11.7	11.4	9.9
EPS (RMB)	3.79	4.61	5.17	5.77	6.36
Chg (% YoY)	4.7	21.6	12.1	11.7	10.2
BVPS (RMB)	25.36	29.01	32.76	36.87	41.38
Chg (% YoY)	10.8	14.4	12.9	12.6	12.2
P/E (x) – H-shr	7.03	5.78	5.16	4.62	4.19
P/B (x) – H-shr	1.05	0.92	0.81	0.72	0.64
P/E (x) – A-shr	7.50	6.16	5.50	4.93	4.47
P/B (x) – A-shr	1.12	0.98	0.87	0.77	0.69
ROAA (%)	1.23	1.36	1.39	1.43	1.44
ROAE (%)	15.73	16.96	16.56	16.39	16.06
DPS(RMB)	1.253	1.522	1.705	1.904	2.097
Yield (%) H-shr	4.70	5.71	6.40	7.15	7.87
Yield (%) A-shr	4.41	5.36	6.00	6.70	7.38

Note: HKD/CNY=1.07

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

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

Company Report

Nov 3, 2022

Rating (H): BUY

Rating (A): BUY

TP (H): HK\$ 53.05

TP (A): RMB 46.73

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Price (H/A shr)	HK\$ 28.50/ RMB 28.42
Est. s price return (H/A shr)	86.14%/64.43%
Est. dividend yield (H/A shr)	7.15%/6.70%
Est. total return (H/A shr)	93.29%/71.13%
Last Rating & TP (H/A shr)	BUY, HK\$66.54/ BUY, RMB54.07
Previous Report Date	Aug 23, 2022

Source(s): Bloomberg, ABCI Securities estimates

Key Data

52Wk H/L (HK\$) (H shr)	70.80/25.40
52Wk H/L (RMB) (A shr)	54.49/26.30
Total issued shares (mn)	25,219.8
Issued H shr (mn)	4,590.9
Issued A shr (mn)	20,628.9
Market cap (HK\$ mn)	758,153.2
H-shr market cap (HK\$ mn)	130,840.7
A-shr market cap (HK\$ mn)	627,312.5
3-mth avg daily turnover (HK\$ mn) (H shr)	707.09
3-mth avg daily turnover (RMB mn) (A shr)	2,324.48

Major shareholder(s) (%):

China Merchants Group	13.04
China Ocean Shipping	6.24

Source(s): Bloomberg, ABCI Securities

Maintaining asset quality as key mission. Despite overall asset quality stay benign in 3Q22 (Sep 2022 NPL ratio: 0.95%), we are not ruling out chances of a minor uptick in NPL ratio in coming quarters. Our base case projects CMB's NPL ratio to rise by 3bps-7bps each year in FY22E-24E and reach 1.05% by end-FY24E, which is still much lower than the sector's average at 1.67% as of Jun 2022. We believe new NPLs from property-related sectors to increase at a declining scale. In our opinion, sustaining benign asset quality would be key missions of banks in coming quarters. Meanwhile CMB sustained its sector-leading risk buffers, with provisioning ratio and provision coverage ratio at 4.34% and 455.67% as of Sep 2022. We forecast the two respective ratios to reduce mildly to 4.12% and 392.38% by end-FY24E.

Maintain BUY on leading fundamentals. The sector's fundamental outlook will remain challenging in coming quarters. CMB, with its business edge in retail segment and wealth management, in addition to sector-leading profitability and risk buffers, is one of our preferred names in the sector. We expect its net profit to expand at 11.0% CAGR in FY21-24E. Factoring in a slower macro recovery than previously expected, we lower our sustainable ROAE, raise the COE, and adjust the exchange rate assumptions in our GGM model. As such, CMB's H/A-share TPs are down by 20.3%/13.6% to HK\$ 53.05/RMB 46.73, which imply 1.34x/1.27x FY23E P/Bs. Reiterate **BUY**.

Risk Factors: 1) Radical change in business environment induced by heavy-handed supervision and policies; 2) Increasing competition from non-bank financial institutions; 3) Sharp deterioration in asset quality in specific region or sector; 4) Unfavorable interest rate environment; 5) Prolonged economic impact from COVID-19; 6) Rising NPL ratio and declining NIM in FY22E-24E; 7) Downward revision of equity valuation.

Exhibit 1: Changes in 2022E and 2023E forecasts

(RMB mn)	2022E (old)	2022E (new)	change (%)	(RMB mn)	2023E (old)	2023E (new)	change (%)
Net interest income	226,209	225,058	(0.51)	Net interest income	250,910	243,459	(2.97)
Net fee and commission	100,114	95,391	(4.72)	Net fee and commission	109,124	100,161	(8.21)
Operating income	358,235	352,942	(1.48)	Operating income	395,457	380,987	(3.66)
Operating expenses	(132,073)	(130,904)	(0.89)	Operating expenses	(147,922)	(143,995)	(2.65)
Impairment losses	(64,092)	(64,439)	0.54	Impairment losses	(64,670)	(60,702)	(6.14)
Profit before tax	165,697	160,621	(3.06)	Profit before tax	186,710	178,859	(4.20)
Income tax expenses	(33,139)	(25,699)	(22.45)	Income tax expenses	(37,342)	(28,617)	(23.37)
Net profit attributable to equity holders	131,536	133,900	1.80	Net profit attributable to equity holders	148,234	149,108	0.59
Key indicators (%)			change (ppt)	Key indicators (%)			change (ppt)
Net interest margin	2.39	2.42	0.03	Net interest margin	2.35	2.35	-
Net interest spread	2.21	2.22	0.01	Net interest spread	2.14	2.12	(0.02)
CIR	36.87	37.09	0.22	CIR	37.41	37.80	0.39
ROAA	1.35	1.39	0.04	ROAA	1.36	1.43	0.07
ROAE	15.31	16.56	1.25	ROAE	15.52	16.39	0.87
Dividend payout	33.00	33.00	-	Dividend payout	33.00	33.00	-
CT1 CAR	12.53	12.98	0.45	CT1 CAR	12.62	13.26	0.64
Total CAR	16.42	17.02	0.60	Total CAR	16.20	17.05	0.85
NPL ratio	0.98	0.98	-	NPL ratio	1.02	1.02	-
Provision to total loans	4.30	4.30	-	Provision to total loans	4.22	4.22	-
Provision coverage ratio	438.78	438.78	-	Provision coverage ratio	413.73	413.73	-

Source(s): Company, ABCI Securities estimates

Exhibit 2: Changes in GGM assumptions

	H-shr		A-shr		Rationale
	Old	new	old	new	
TP (HKD/RMB)	66.54	53.05	54.07	46.73	
Sustainable ROE (%)	15.29	15.19	15.29	15.19	Adjusted on weaker topline outlook
COE (%)	13.10	13.58	13.37	13.87	Factored in higher macro uncertainties
L-T growth (%)	9.20	8.90	9.20	8.90	Expect fundamental outlook to remain challenging
Target 23E P/B (x)	1.56	1.34	1.46	1.27	

Source(s): Company, ABCI Securities estimates



Financial statements

Consolidated income statement

FY Ended Dec 31 (RMB mn)	2020A	2021A	2022E	2023E	2024E
Net interest income	185,031	203,919	225,058	243,459	260,304
Non-interest income	102,367	123,458	127,884	137,527	150,517
Of which: Fees and commissions	79,486	94,447	95,391	100,161	107,172
Operating income	287,398	327,377	352,942	380,987	410,821
Operating expenses	(102,814)	(116,879)	(130,904)	(143,995)	(156,954)
Pre-provision operating profit	184,584	210,498	222,037	236,992	253,867
Impairment losses on loans	(65,025)	(66,355)	(64,439)	(60,702)	(59,712)
Operating profit	119,559	144,143	157,598	176,290	194,155
Non-operating income	2,881	4,030	3,023	2,569	2,441
Profit before tax	122,440	148,173	160,621	178,859	196,596
Tax	(24,481)	(27,339)	(25,699)	(28,617)	(31,455)
Minority interests	(617)	(912)	(1,021)	(1,134)	(1,247)
Net profit attributable to equity holders	97,342	119,922	133,900	149,108	163,893
Preference share dividend	(1,651)	(3,613)	(3,613)	(3,613)	(3,613)
Net profit attributable to ordinary shareholders	95,691	116,309	130,287	145,495	160,280
Growth (%)					
Net interest income	6.9	10.2	10.4	8.2	6.9
Of which: Fees and commissions	11.2	18.8	1.0	5.0	7.0
Operating income	7.2	13.9	7.8	7.9	7.8
Operating expenses	12.4	13.7	12.0	10.0	9.0
Pre-provision operating profit	4.5	14.0	5.5	6.7	7.1
Impairment losses on loans	6.3	2.0	(2.9)	(5.8)	(1.6)
Operating profit	3.6	20.6	9.3	11.9	10.1
Non-operating income	67.2	39.9	(25.0)	(15.0)	(5.0)
Profit before tax	4.5	21.0	8.4	11.4	9.9
Tax	3.3	11.7	(6.0)	11.4	9.9
Minority interests	11.0	47.8	12.0	11.0	10.0
Net profit attributable to equity holders	4.8	23.2	11.7	11.4	9.9
Preference share dividend	(1.1)	118.8	0.0	0.0	0.0
Net profit attributable to ordinary shareholders	4.9	21.5	12.0	11.7	10.2
Per share (RMB)					
EPS	3.79	4.61	5.17	5.77	6.36
BVPS	25.36	29.01	32.76	36.87	41.38
DPS	1.253	1.522	1.705	1.904	2.097
Key ratio (%)					
Net interest margin	2.49	2.48	2.42	2.35	2.31
Net interest spread	2.40	2.39	2.22	2.12	2.03
Cost to income ratio	35.77	35.70	37.09	37.80	38.21
Return on average assets	1.23	1.36	1.39	1.43	1.44
Return on average equity	15.73	16.96	16.56	16.39	16.06
Effective tax rate	19.99	18.45	16.00	16.00	16.00
Dividend payout	33.02	33.00	33.00	33.00	33.00

Note1: Individual items may not sum to total due to rounding difference

Note2: 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)	2020A	2021A	2022E	2023E	2024E
Cash & central bank balance	538,446	567,208	610,854	646,115	677,459
Due from FIs	616,516	799,372	450,878	393,738	345,694
Investment securities	2,108,828	2,193,392	2,632,070	3,026,881	3,420,375
Net loans and advances	4,804,361	5,335,391	5,860,698	6,389,919	6,898,874
Total interest earning assets	8,068,151	8,895,363	9,554,501	10,456,653	11,342,403
Property and equipment	71,093	81,787	102,234	124,725	149,670
Other non-interest earning assets	222,204	271,871	311,288	353,451	401,484
Total assets	8,361,448	9,249,021	9,968,023	10,934,829	11,893,558
Customer deposits	5,664,135	6,385,154	7,264,210	8,132,778	9,019,674
Financial liabilities	110,412	91,043	95,595	100,375	100,375
Due to central bank and FIs	1,198,541	1,083,655	901,396	814,136	739,346
Subordinated debt	346,141	446,645	236,722	201,214	181,092
Total interest bearing liabilities	7,319,229	8,006,497	8,497,923	9,248,503	10,040,487
Current taxes	18,648	22,491	26,989	32,117	37,898
Deferred tax liabilities	1,073	1,353	1,691	2,030	2,415
Other liabilities	292,144	352,999	486,210	591,413	636,166
Total liabilities	7,631,094	8,383,340	9,012,813	9,874,062	10,716,967
Share capital	25,220	25,220	25,220	25,220	25,220
Other equity instruments	84,054	127,043	120,446	120,446	120,446
Reserves	614,476	706,482	800,874	904,697	1,018,440
Minorities	6,604	6,936	8,670	10,404	12,485
Shareholder's equity	730,354	865,681	955,210	1,060,767	1,176,591
Growth (%)					
Cash & central bank balance	(16.1)	5.3	7.7	5.8	4.9
Due from FIs	51.1	29.7	(43.6)	(12.7)	(12.2)
Investment securities	15.3	4.0	20.0	15.0	13.0
Net loans and advances	12.3	11.1	9.8	9.0	8.0
Total interest earning assets	12.7	10.3	7.4	9.4	8.5
Property and equipment	4.0	15.0	25.0	22.0	20.0
Other non-interest earning assets	15.1	22.4	14.5	13.5	13.6
Total assets	12.7	10.6	7.8	9.7	8.8
Customer deposits	16.2	12.7	13.8	12.0	10.9
Financial liabilities	65.7	(17.5)	5.0	5.0	0.0
Due to central bank and FIs	5.3	(9.6)	(16.8)	(9.7)	(9.2)
Subordinated debt	(40.1)	29.0	(47.0)	(15.0)	(10.0)
Total interest bearing liabilities	9.9	9.4	6.1	8.8	8.6
Current taxes	(2.2)	20.6	20.0	19.0	18.0
Deferred tax liabilities	12.2	26.1	25.0	20.0	19.0
Other liabilities	141.5	20.8	37.7	21.6	7.6
Total liabilities	12.2	9.9	7.5	9.6	8.5
Share capital	0.0	0.0	0.0	0.0	0.0
Other equity instruments	146.7	51.1	(5.2)	0.0	0.0
Reserves	11.3	15.0	13.4	13.0	12.6
Minorities	3.1	5.0	25.0	20.0	20.0
Shareholder's equity	18.2	18.5	10.3	11.1	10.9
Key ratio (%)					
CT1 CAR	12.29	12.66	12.98	13.26	13.67
Total CAR	16.54	17.48	17.02	17.05	17.22
NPL ratio	1.07	0.91	0.98	1.02	1.05
Provision to total loans	4.67	4.42	4.30	4.22	4.12
Provision coverage ratio	437.68	483.87	438.78	413.73	392.38

Note1: Individual items may not sum to total due to rounding difference

Note2: 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 -10%)
Hold	- Market return rate (\sim -10%) \leq Stock return rate < Market return rate (\sim +10%)
Sell	Stock return < - Market return (\sim -10%)

Notes: Stock return rate: expected percentage change of share price plus gross dividend yield over the next 12 months
Market return rate: average market return rate since 2009 (For reference: HSI total return index 2009-21 averaged at 9.2%)

Time horizon of share price target: 12-month

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