

## China Merchants Bank (3968 HK / 600036 CH)

### Sustainable profitability in hard times

- Strength in retail segment and strategic focus on extensive wealth management pose well for recovery
- Interest rate down cycle and deposit competition would extend NIM pressure
- Robust risk buffer limits provision size and helps sustain profitability
- Maintain **BUY** on sector-leading profitability. Slash H/A-shr TPs to HK\$ 66.54/RMB 54.07, implying 1.56x/1.46x FY23E P/B

**Core retail competitive edge.** In view of China's slowing macro recovery, the interest rate down cycle, and crisis in the property sector, drastic improvement in sector fundamentals is unlikely in 2H22 in our view. CMB's sector leading profitability, however, would be supported by strategic focus on extensive wealth management. In 1H22, CMB's retail customers AUM grew 8.91% HoH despite the sluggish macro outlook; together with the bank's substantial revenue contribution from non-interest income at 39.86% in 1H22, we believe it will benefit from the wealth management market once macro growth resumes. CMB's 1H22 topline and net profit grew YoY by 6.59% and 13.52%. Supported by its long-established strength in retail segment, we project NII and net fee income to grow at 10.3% and 8.6% CAGRs over FY21A-24E. With our FY22E/23E net profit forecasts lowered by 2.48%/0.36%, topline and net profit would expand at 9.9% and 12.2% CAGRs over FY21A-24E in our base case scenario, and ROAE would be 16.26%-16.49% over FY22E-24E.

**NIM pressure to persist.** Although CMB's 1H22 NIM was down only by 5bps YoY to 2.44%, 2Q22 NIM dropped 14bps QoQ to 2.37%. As predicted in our previous report dated Mar 21 2022, rate cut cycle and policy priority to support the real economy have squeezed the bank's average loan yield by -13bps QoQ in 2Q22; meanwhile, keen competition raised CMB's average deposit cost by 6bps QoQ in 2Q22. Since the possibility of further rate cuts still exist in coming quarters, the sector's NIM would not be stabilized before end-23E. As such, we adjust CMB's FY22E/23E NIM down by 4bps/3bps; we expect its FY22E NIM to narrow by 9bps YoY, to be followed by further contraction of 4bps-7bps YoY each in FY23E-24E.

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#### Results and Valuation

FY ended Dec 31	2020A	2021A	2022E	2023E	2024E
Revenue (RMB mn)	287,398	327,377	358,235	395,457	434,693
Chg (% YoY)	7.2	13.9	9.4	10.4	9.9
Net profit* (RMB mn)	97,342	119,922	131,536	148,234	169,254
Chg (% YoY)	4.8	23.2	9.7	12.7	14.2
EPS (RMB)	3.79	4.61	5.07	5.73	6.57
Chg (% YoY)	4.7	21.6	10.0	13.1	14.5
BVPS (RMB)	25.36	29.01	32.80	37.01	41.84
Chg (% YoY)	10.8	14.4	13.1	12.9	13.1
P/E (x) – H-shr	9.21	7.57	6.88	6.09	5.32
P/B (x) – H-shr	1.38	1.20	1.06	0.94	0.83
P/E (x) – A-shr	8.87	7.29	6.63	5.86	5.12
P/B (x) – A-shr	1.33	1.16	1.03	0.91	0.80
ROAA (%)	1.23	1.36	1.35	1.36	1.39
ROAE (%)	15.73	16.96	16.26	16.27	16.49
DPS(RMB)	1.253	1.522	1.674	1.892	2.167
Yield (%) H-shr	3.59	4.36	4.79	5.42	6.21
Yield (%) A-shr	3.73	4.53	4.98	5.63	6.45

Note: HKD/CNY=1.15

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

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

## Company Report

Rating (H): BUY

Rating (A): BUY

TP (H): HK\$ 66.54

TP (A): RMB 54.07

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Price (H/A shr)	HK\$ 40.15/ RMB 38.56
Est. s price return (H/A shr)	65.73%/60.83%
Est. dividend yield (H/A shr)	5.42%/5.63%
Est. total return (H/A shr)	71.15%/ 66.46%
Last Rating & TP (H/A shr)	BUY, HK\$75.2/ BUY, RMB66.0
Previous Report Date	Mar 21, 2022

Source(s): Bloomberg, ABCI Securities estimates

#### Key Data

52Wk H/L (HK\$) (H shr)	70.80/39.35
52Wk H/L (RMB) (A shr)	56.23/32.95
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)	979,817.3
H-shr market cap (HK\$ mn)	184,324.7
A-shr market cap (HK\$ mn)	795,492.6
3-mth avg daily turnover (HK\$ mn) (H shr)	866.76
3-mth avg daily turnover (RMB mn) (A shr)	2,556.60

#### Major shareholder(s) (%):

China Merchants Group	13.04
China Ocean Shipping	6.24

Source(s): Bloomberg, ABCI Securities

**High risk buffer to sustain profitability.** We believe CMB's profitability would continue to be shielded by its sector-leading risk buffers. As of June 2022, CMB's provisioning ratio and provision coverage ratio were 4.32% and 454.06%. High risk buffer will limit the size of provision expenses and support earnings growth. Assuming provisioning ratio and provision coverage ratio to stand at 4.12% and 392.38% by FY24E, we project a provision expenses CAGR of -2.5% over FY21A-24E. Although CMB's NPL ratio rose only 4bps HoH to 0.95% as of June 2022, NPL ratio of the property development sector has doubled HoH to 2.82%. We believe asset quality risk from property sector will increase in coming quarters, and banks will need to deploy NPL handling measures, meaning asset quality outlook will be compromised in the near term.

**Maintain BUY on leading profitability.** By factored in slower macro recovery than our previous forecasts, we lower sustainable ROAE and raise risk assumptions in our GGM model. Also, we roll over TP calculation based on FY23E BVPS. Consequently, CMB's H/A-share TPs were slashed 11.5%/18.1% to HK\$ 66.54/RMB 54.07, which imply 1.56x/1.46x FY23E P/B. Trading valuations of the H/A-shr counters are normalizing at 0.94x/0.91x FY23E P/B. Reiterate **BUY** on CMB's sector-leading profitability.

**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 of COVID-19.

**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	231,092	226,209	(2.11)	Net interest income	252,197	250,910	(0.51)
Net fee and commission	105,781	100,114	(5.36)	Net fee and commission	118,474	109,124	(7.89)
Operating income	368,784	358,235	(2.86)	Operating income	405,774	395,457	(2.54)
Operating expenses	(134,411)	(132,073)	(1.74)	Operating expenses	(153,228)	(147,922)	(3.46)
Impairment losses	(69,530)	(64,092)	(7.82)	Impairment losses	(71,456)	(64,670)	(9.50)
Profit before tax	164,843	165,697	0.52	Profit before tax	181,090	186,710	3.10
Income tax expenses	(33,976)	(33,139)	(2.46)	Income tax expenses	(37,477)	(37,342)	(0.36)
Net profit attributable to equity holders	134,883	131,536	(2.48)	Net profit attributable to equity holders	148,776	148,234	(0.36)
<b>Key indicators (%)</b>			<b>change (ppt)</b>	<b>Key indicators (%)</b>			<b>change (ppt)</b>
Net interest margin	2.43	2.39	(0.04)	Net interest margin	2.38	2.35	(0.03)
Net interest spread	2.23	2.21	(0.02)	Net interest spread	2.16	2.14	(0.02)
CIR	36.45	36.87	0.42	CIR	37.76	37.41	(0.35)
ROAA	1.39	1.35	(0.04)	ROAA	1.39	1.36	(0.03)
ROAE	15.66	15.31	(0.35)	ROAE	15.53	15.52	(0.01)
Dividend payout	33.00	33.00	-	Dividend payout	33.00	33.00	-
CT1 CAR	12.90	12.53	(0.37)	CT1 CAR	13.16	12.62	(0.54)
Total CAR	16.90	16.42	(0.48)	Total CAR	16.94	16.20	(0.74)
NPL ratio	0.93	0.98	0.05	NPL ratio	0.96	1.02	0.06
Provision to total loans	4.40	4.30	(0.10)	Provision to total loans	4.45	4.22	(0.23)
Provision coverage ratio	473.12	438.78	(34.34)	Provision coverage ratio	463.54	413.73	(49.81)

Source(s): Company, ABCI Securities estimates

**Exhibit 2: Changes in GGM assumptions**

	H-shr		A-shr		Rationale
	Old	new	old	new	
TP (HKD/RMB)	75.20	66.54	66.00	54.07	
Sustainable ROE (%)	15.44	15.29	15.44	15.29	Factor in larger macro uncertainties
COE (%)	12.17	13.10	11.90	13.37	Reduced risk free rate and higher risk premium
L-T growth (%)	8.50	9.20	8.50	9.20	Drive by extensive wealth management
Target 23E P/B (x)	1.77	1.56	1.78	1.46	

Source(s): Company, ABCI Securities estimates

## Financial statements

### CMB (3968HK/600036CH) Consolidated income statement

FY Ended Dec 31 (RMB mn)	2020A	2021A	2022E	2023E	2024E
Net interest income	185,031	203,919	226,209	250,910	273,892
Non-interest income	102,367	123,458	132,026	144,546	160,801
Of which: Fees and commissions	79,486	94,447	100,114	109,124	121,128
<b>Operating income</b>	<b>287,398</b>	<b>327,377</b>	<b>358,235</b>	<b>395,457</b>	<b>434,693</b>
Operating expenses	(102,814)	(116,879)	(132,073)	(147,922)	(164,193)
<b>Pre-provision operating profit</b>	<b>184,584</b>	<b>210,498</b>	<b>226,162</b>	<b>247,535</b>	<b>270,500</b>
Impairment losses on loans	(65,025)	(66,355)	(64,092)	(64,670)	(61,526)
<b>Operating profit</b>	<b>119,559</b>	<b>144,143</b>	<b>162,070</b>	<b>182,865</b>	<b>208,974</b>
Non-operating income	2,881	4,030	3,627	3,845	4,152
<b>Profit before tax</b>	<b>122,440</b>	<b>148,173</b>	<b>165,697</b>	<b>186,710</b>	<b>213,126</b>
Tax	(24,481)	(27,339)	(33,139)	(37,342)	(42,625)
Minority interests	(617)	(912)	(1,021)	(1,134)	(1,247)
<b>Net profit attributable to equity holders</b>	<b>97,342</b>	<b>119,922</b>	<b>131,536</b>	<b>148,234</b>	<b>169,254</b>
Preference share dividend	(1,651)	(3,613)	(3,613)	(3,613)	(3,613)
<b>Net profit attributable to ordinary shareholders</b>	<b>95,691</b>	<b>116,309</b>	<b>127,923</b>	<b>144,621</b>	<b>165,641</b>
<b>Growth (%)</b>					
Net interest income	6.9	10.2	10.9	10.9	9.2
Of which: Fees and commissions	11.2	18.8	6.0	9.0	11.0
<b>Operating income</b>	<b>7.2</b>	<b>13.9</b>	<b>9.4</b>	<b>10.4</b>	<b>9.9</b>
Operating expenses	12.4	13.7	13.0	12.0	11.0
<b>Pre-provision operating profit</b>	<b>4.5</b>	<b>14.0</b>	<b>7.4</b>	<b>9.5</b>	<b>9.3</b>
Impairment losses on loans	6.3	2.0	(3.4)	0.9	(4.9)
<b>Operating profit</b>	<b>3.6</b>	<b>20.6</b>	<b>12.4</b>	<b>12.8</b>	<b>14.3</b>
Non-operating income	67.2	39.9	(10.0)	6.0	8.0
<b>Profit before tax</b>	<b>4.5</b>	<b>21.0</b>	<b>11.8</b>	<b>12.7</b>	<b>14.1</b>
Tax	3.3	11.7	21.2	12.7	14.1
Minority interests	11.0	47.8	12.0	11.0	10.0
<b>Net profit attributable to equity holders</b>	<b>4.8</b>	<b>23.2</b>	<b>9.7</b>	<b>12.7</b>	<b>14.2</b>
Preference share dividend	(1.1)	118.8	0.0	0.0	0.0
<b>Net profit attributable to ordinary shareholders</b>	<b>4.9</b>	<b>21.5</b>	<b>10.0</b>	<b>13.1</b>	<b>14.5</b>
<b>Per share (RMB)</b>					
EPS	3.79	4.61	5.07	5.73	6.57
BVPS	25.36	29.01	32.80	37.01	41.84
DPS	1.253	1.522	1.674	1.892	2.167
<b>Key ratio (%)</b>					
Net interest margin	2.49	2.48	2.39	2.35	2.28
Net interest spread	2.40	2.39	2.21	2.14	2.07
Cost to income ratio	35.77	35.70	36.87	37.41	37.77
Return on average assets	1.23	1.36	1.35	1.36	1.39
Return on average equity	15.73	16.96	16.26	16.27	16.49
Effective tax rate	19.99	18.45	20.00	20.00	20.00
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

**CMB (3968HK/600036CH)**  
**Consolidated balance sheet**

As of Dec 31 (RMB mn)	2020A	2021A	2022E	2023E	2024E
Cash & central bank balance	538,446	567,208	600,841	633,545	664,798
Due from FIs	616,516	799,372	485,858	519,219	551,708
Investment securities	2,108,828	2,193,392	2,763,674	3,233,498	3,750,858
Net loans and advances	4,804,361	5,335,391	5,986,496	6,608,261	7,234,775
<b>Total interest earning assets</b>	<b>8,068,151</b>	<b>8,895,363</b>	<b>9,836,869</b>	<b>10,994,523</b>	<b>12,202,140</b>
Property and equipment	71,093	81,787	106,323	132,904	162,143
Other non-interest earning assets	222,204	271,871	329,226	396,353	474,320
<b>Total assets</b>	<b>8,361,448</b>	<b>9,249,021</b>	<b>10,272,418</b>	<b>11,523,780</b>	<b>12,838,603</b>
Customer deposits	5,664,135	6,385,154	7,611,719	8,894,586	10,163,290
Financial liabilities	110,412	91,043	95,595	100,375	100,375
Due to central bank and FIs	1,198,541	1,083,655	909,545	793,488	709,417
Subordinated debt	346,141	446,645	321,584	289,426	260,483
<b>Total interest bearing liabilities</b>	<b>7,319,229</b>	<b>8,006,497</b>	<b>8,938,444</b>	<b>10,077,875</b>	<b>11,233,565</b>
Current taxes	18,648	22,491	26,314	29,998	33,598
Deferred tax liabilities	1,073	1,353	1,624	1,916	2,222
Other liabilities	292,144	352,999	343,863	344,301	376,316
<b>Total liabilities</b>	<b>7,631,094</b>	<b>8,383,340</b>	<b>9,310,245</b>	<b>10,454,090</b>	<b>11,645,702</b>
Share capital	25,220	25,220	25,220	25,220	25,220
Other equity instruments	84,054	127,043	127,043	127,043	127,043
Reserves	614,476	706,482	801,934	908,254	1,030,089
Minorities	6,604	6,936	7,976	9,173	10,549
<b>Shareholder's equity</b>	<b>730,354</b>	<b>865,681</b>	<b>962,173</b>	<b>1,069,690</b>	<b>1,192,901</b>
<b>Growth (%)</b>					
Cash & central bank balance	(16.1)	5.3	5.9	5.4	4.9
Due from FIs	51.1	29.7	(39.2)	6.9	6.3
Investment securities	15.3	4.0	26.0	17.0	16.0
Net loans and advances	12.3	11.1	12.2	10.4	9.5
<b>Total interest earning assets</b>	<b>12.7</b>	<b>10.3</b>	<b>10.6</b>	<b>11.8</b>	<b>11.0</b>
Property and equipment	4.0	15.0	30.0	25.0	22.0
Other non-interest earning assets	15.1	22.4	21.1	20.4	19.7
<b>Total assets</b>	<b>12.7</b>	<b>10.6</b>	<b>11.1</b>	<b>12.2</b>	<b>11.4</b>
Customer deposits	16.2	12.7	19.2	16.9	14.3
Financial liabilities	65.7	(17.5)	5.0	5.0	0.0
Due to central bank and FIs	5.3	(9.6)	(16.1)	(12.8)	(10.6)
Subordinated debt	(40.1)	29.0	(28.0)	(10.0)	(10.0)
<b>Total interest bearing liabilities</b>	<b>9.9</b>	<b>9.4</b>	<b>11.6</b>	<b>12.7</b>	<b>11.5</b>
Current taxes	(2.2)	20.6	17.0	14.0	12.0
Deferred tax liabilities	12.2	26.1	20.0	18.0	16.0
Other liabilities	141.5	20.8	(2.6)	0.1	9.3
<b>Total liabilities</b>	<b>12.2</b>	<b>9.9</b>	<b>11.1</b>	<b>12.3</b>	<b>11.4</b>
Share capital	0.0	0.0	0.0	0.0	0.0
Other equity instruments	146.7	51.1	0.0	0.0	0.0
Reserves	11.3	15.0	13.5	13.3	13.4
Minorities	3.1	5.0	15.0	15.0	15.0
<b>Shareholder's equity</b>	<b>18.2</b>	<b>18.5</b>	<b>11.1</b>	<b>11.2</b>	<b>11.5</b>
<b>Key ratio (%)</b>					
CT1 CAR	12.29	12.66	12.53	12.62	12.83
Total CAR	16.54	17.48	16.42	16.20	16.13
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

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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