

Industry Report

China Merchants Securities (HK) Co., Ltd.
Hong Kong Equity Research

China's banking sector

Banking sector updates and outlook

- Bank loans may speed up partly on downside rate expectations
- NIM and loan quality a short-to-medium term concern
- Maintain NEUTRAL, Top Pick ABC (1288 HK)

Bank loans may speed up in 1Q19

We expect higher-than-expected loan growth in January and 1Q19, given: 1) Against the background of interest rate downside expectations, banks may choose to grant loans upfront to increase near-term profitability; 2) The executive meeting of the State Council reiterated that commercial banks whose capital is replenished already should increase their lending support for private, small and micro enterprises. On the other hand, the State Council also stated to support capital replenishment through multiple channels for banks (e.g. to improve the efficiency of approval of perpetual bonds). Banks will be able to grant more loans with enhanced capital adequacy in longer term.

NIM and loan quality a short-to-medium term concern

Despite loans may speed up, NIM and loan quality are under pressure for banks in the short-to-medium term. First, the bill financing interest rate out of the weighted average lending rate already showed signs of decline. This decline may conduce to the decline of general loan interest rate and personal residential mortgage rate and consequently the decline of the weighted average lending rate. Second, the growth rate of revenue from principal business of industrial enterprises (which has a strong negative correlation with the trends of non-performing loan formation ratio of banks) continues decreasing as shown by recent data. This trend demonstrates that banks' asset quality is still under pressure in the short-to-medium term.

Sector recommendation

China's banking sector is currently trading at ~0.58x 2019E P/B ratio, not demanding. Maintain "NEUTRAL" rating for the sector given the concerns on NIM and loan quality. Top pick is ABC (1288 HK, BUY) on its low funding costs, relatively low NPL formation ratios in recent periods, and its relatively high allowance to NPL ratio. The PBOC and CBIRC issued the "Guiding Opinions on Financial Services Supporting Rural Revitalization". It stated that monetary policy support will be increased to assist rural revitalization, requiring ABC to actively implement internet financial services and to improve the coverage and credit penetration of rural financial services, which is in-line with ABC's strategy in county business. TP for ABC is HK\$4.5, or 0.77x 19E P/B, or 6.4x 19E P/E. Key catalyst: better-than-expected asset quality; Key downside risks: a macroeconomic downturn and worse-than-expected asset quality.

Financials

Company	Ticker	Rating	Current Price (HKD)	Target Price (HKD)	Upside (%)	P/E (x)		P/B (x)		Dividend yield (%)		ROE (%)	
						FY18E	FY19E	FY18E	FY19E	FY18E	FY19E	FY18E	FY19E
ABC	1288 HK	BUY	3.66	4.5	23%	5.4	5.2	0.68	0.63	4.9	5.1	13.7	12.6
BOCOM	3328 HK	NEUTRAL	6.50	6.8	5%	6.0	6.0	0.67	0.62	4.5	4.5	11.4	10.9
CCB	0939 HK	NR	6.94	n.a.	n.a.	5.8	5.4	0.79	0.72	5.2	5.5	14.1	13.8
BOC	3988 HK	NR	3.59	n.a.	n.a.	5.2	4.9	0.60	0.55	6.0	6.4	11.9	11.6
PSBC	1658HK	NR	4.58	n.a.	n.a.	5.9	5.3	0.74	0.67	3.7	4.2	12.9	13.1
CITIC	0998 HK	NR	4.98	n.a.	n.a.	4.8	4.6	0.53	0.48	6.2	6.5	11.2	11.0
CEB	6818 HK	NR	3.70	n.a.	n.a.	5.2	4.9	0.57	0.52	5.7	5.9	11.2	11.0

Price as of Feb 12, 2019; *CCB, BOC, PSBC, CITIC and CEB data based on Bloomberg consensus;

Sources: Bloomberg, CMS (HK) estimates

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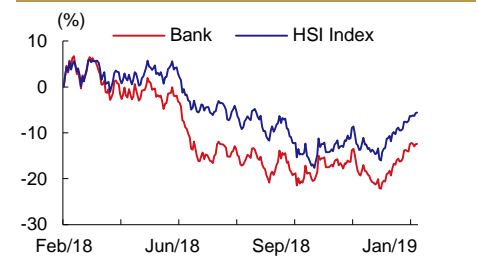
WHAT'S NEW

Sector updates and outlook

NEUTRAL

Previous	NEUTRAL
HSI	28171
HSCEI	11045

Sector Performance

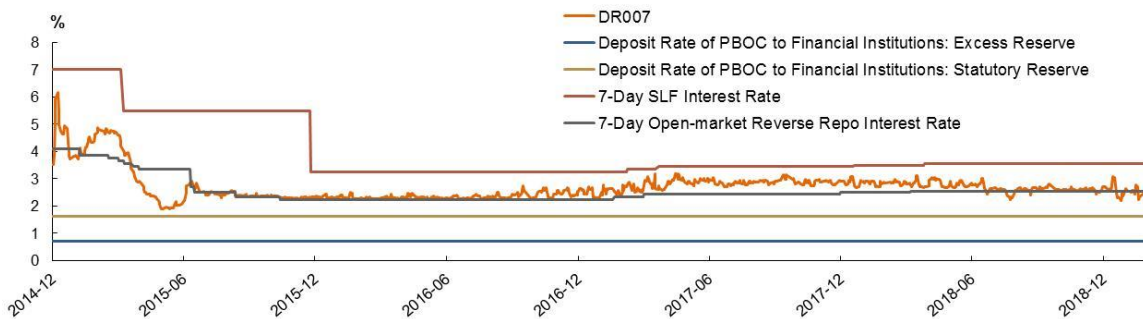


Source: Bloomberg

%	1m	6m	12m
Absolute return	7.0	1.0	(11.7)
Relative return	1.5	1.8	(7.1)

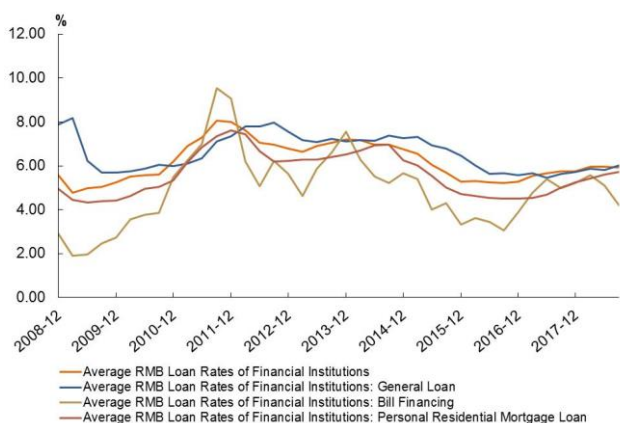
Focus Charts

Figure 1: Interest rate corridor



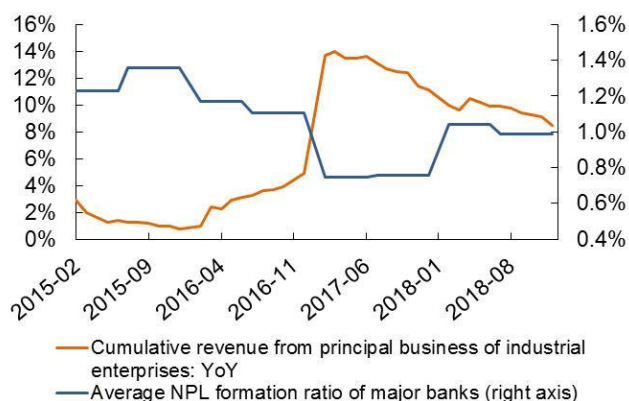
Sources: Wind, CMS (HK)

Figure 2: Weighted average lending rates



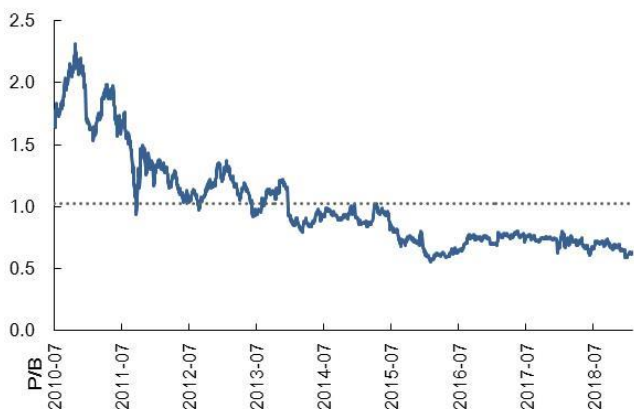
Sources: Wind, CMS (HK)

Figure 3: Revenue from principal business of industrial enterprises growth and NPL formation ratio



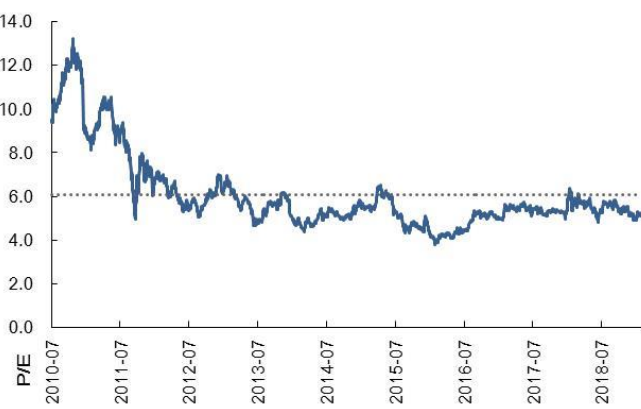
Sources: Wind, Company data, CMS (HK)

Figure 4: P/B valuation of ABC (1288 HK)



Sources: Bloomberg, Company data, CMS (HK) estimates

Figure 5: P/E valuation of ABC (1288 HK)



Sources: Bloomberg, Company data, CMS (HK) estimates

Figure 6: Average costs of interest-bearing liabilities

	1H16	2016	1H17	2017	1H18
ABC	1.67%	1.61%	1.53%	1.53%	1.57%
CCB	1.65%	1.61%	1.55%	1.56%	1.61%
BOC	1.73%	1.69%	1.65%	1.69%	1.83%
CITIC	2.20%	2.12%	2.32%	2.33%	2.47%
BOCOM	2.22%	2.17%	2.34%	2.39%	2.65%
CEB	2.34%	2.33%	2.60%	2.68%	2.84%

Sources: Company data, CMS (HK)

Figure 7: NPL formation ratios

	2015	2016	2017	1H18	3Q18
CCB	0.96%	0.46%	0.45%	0.40%	0.54%
ABC	1.66%	1.17%	0.61%	0.61%	0.68%
BOC	0.91%	0.76%	0.85%	0.96%	0.85%
CEB	1.14%	0.68%	0.57%	0.72%	0.90%
BOCOM	0.84%	0.74%	0.60%	1.49%	1.38%
CITIC	1.63%	1.87%	1.47%	2.47%	2.00%

Sources: Wind, Company data, CMS (HK)

Peers comparison

Company	Ticker	Rating	Price	TP (HK\$)	Mkt Cap	P/E		P/B		ROE (%)		Dividend Yield (%)	
						Local ccy	(USD m)	2018E	2019E	2018E	2019E	2018E	2019E
HK Listed Peers													
Agricultural Bank of China	1288 HK	BUY	3.66	4.5	189,615	5.4	5.2	0.68	0.63	13.7	12.6	4.9	5.1
Bank of Communications	3328 HK	NEUTRAL	6.50	6.8	64,682	6.0	6.0	0.67	0.62	11.4	10.9	4.5	4.5
China Construction Bank *	939 HK	NR	6.94	n.a.	222,570	5.8	5.4	0.79	0.72	14.1	13.8	5.2	5.5
Bank of China *	3988 HK	NR	3.59	n.a.	152,726	5.2	4.9	0.60	0.55	11.9	11.6	6.0	6.4
Postal Savings Bank of China *	1658 HK	NR	4.58	n.a.	47,285	5.9	5.3	0.74	0.67	12.9	13.1	3.7	4.2
China CITIC Bank *	998 HK	NR	4.98	n.a.	38,041	4.8	4.6	0.53	0.48	11.2	11.0	6.2	6.5
China Minsheng Bank *	1988 HK	NR	5.80	n.a.	37,239	4.1	4.1	0.52	0.46	13.0	12.2	3.4	3.5
China Everbright Bank *	6818 HK	NR	3.70	n.a.	29,715	5.2	4.9	0.57	0.52	11.2	11.0	5.7	5.9
Average						5.3	5.0	0.64	0.58	12.4	12.0	4.9	5.2
China A-share Listed Peers *													
Agricultural Bank of China	601288 CH	NR	3.72	n.a.	189,617	6.20	5.85	0.81	0.74	13.63	13.01	4.84	5.19
Bank of Communications	601328 CH	NR	6.16	n.a.	64,683	6.35	5.99	0.69	0.64	10.95	10.81	4.81	5.10
China Construction Bank	601939 CH	NR	7.05	n.a.	222,572	6.85	6.36	0.93	0.84	14.05	13.71	4.44	4.75
Bank of China	601988 CH	NR	3.68	n.a.	152,727	6.12	5.78	0.71	0.65	11.88	11.68	5.11	5.38
China CITIC Bank	601998 CH	NR	5.69	n.a.	38,041	6.32	5.94	0.70	0.64	11.27	11.11	4.53	4.85
China Minsheng Bank	600016 CH	NR	5.94	n.a.	37,239	4.84	4.76	0.62	0.55	13.02	12.27	3.13	3.30
Industrial Bank	601166 CH	NR	16.33	n.a.	50,070	5.63	5.25	0.76	0.68	14.00	13.41	4.19	4.49
China Everbright Bank	601818 CH	NR	4.04	n.a.	29,716	6.47	6.05	0.72	0.67	11.15	11.04	4.60	4.70
Shanghai Pudong Development Bank	600000 CH	NR	10.72	n.a.	46,441	5.79	5.55	0.70	0.63	12.52	11.68	2.25	2.41
Ping An Bank	000001 CH	NR	11.19	n.a.	28,358	7.92	7.14	0.86	0.77	10.93	11.00	1.38	1.52
Huaxia Bank	600015 CH	NR	7.68	n.a.	17,442	4.99	4.84	0.59	0.52	11.77	11.07	3.29	3.41
Bank of Beijing	601169 CH	NR	5.98	n.a.	18,661	6.26	5.86	0.72	0.65	11.34	11.21	4.21	4.55
Bank of Shanghai	601229 CH	NR	11.55	n.a.	18,629	7.00	6.04	0.87	0.77	13.78	14.47	3.55	4.16
Average						6.2	5.8	0.75	0.67	12.3	12.0	3.9	4.1
Global Peers *													
HSBC	HSBA LN	NR	650.50	n.a.	168,727	11.11	11.02	1.02	1.00	8.63	8.93	6.12	6.13
Standard Chartered	STAN LN	NR	627.30	n.a.	26,908	11.29	10.28	0.59	0.57	4.96	5.27	2.51	3.52
Barclays	BARC LN	NR	156.84	n.a.	34,723	7.52	7.02	0.51	0.49	5.36	7.28	4.12	5.07
Bank of America	BAC US	NR	28.41	n.a.	274,704	11.17	9.83	1.15	1.05	10.49	11.22	1.90	2.41
J.P. Morgan Chase & Co.	JPM US	NR	100.88	n.a.	335,467	10.95	10.21	1.43	1.36	13.49	13.62	2.70	3.35
Wells Fargo	WFC US	NR	47.65	n.a.	218,299	11.00	9.61	1.27	1.21	11.52	12.67	3.45	3.82
Deutsche Bank	DBK GR	NR	7.31	n.a.	17,448	24.79	12.09	0.25	0.25	0.44	1.74	1.58	2.83
BNP Paribas	BNP FP	NR	40.51	n.a.	57,419	6.73	6.96	0.55	0.53	7.77	7.54	7.28	7.37
Average						11.8	9.6	0.85	0.81	7.8	8.5	3.7	4.3

Sources: Company data, Bloomberg, CMS (HK) estimates; Price as of Feb 12, 2019; * Forecast based on Bloomberg consensus

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Industry Rating	Definition
OVERWEIGHT	Expect sector to outperform the market over the next 12 months
NEUTRAL	Expect sector to perform in-line with the market over the next 12 months
UNDERWEIGHT	Expect sector to underperform the market over the next 12 months

Company Rating	Definition
BUY	Expect stock to generate 10%+ return over the next 12 months
NEUTRAL	Expect stock to generate +10% to -10% over the next 12 months
SELL	Expect stock to generate loss of 10%+ over the next 12 months

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