

# Chinese Banks

## Trip Takeaways: Navigating Through Challenges and Complexity

- **Management quality matters** – We traveled through Beijing, Hefei, Hangzhou and Shanghai last week meeting banks and various contacts. Fundamentals are challenging as NPL pressure remains and internet MMFs are pressuring deposits and WMPs. The sector is trading at the lower end of the range (currently on 0.8x FY14E P/B); upcoming results in late March and the payment of annual dividends in May/June will likely be positive events. Given the increasingly complex environment, we believe management quality will matter and CMB therefore remains our sector favorite. Other sector preferences: ABC and CCB.
- **NPL pressures remain** – SME asset quality has been deteriorating for the past 18-24 months but it seems that the bottom has yet to be reached. In Zhejiang province, the SME heartland, local regulators see risks in special mention loans (migration into NPL status) and corporate guarantors that have been funded by banks to repay NPLs. The latter has been used by banks to delay the reporting of NPLs. Medium sized companies have fared the worst and many banks have cut-back or exited this segment. Micro enterprises have been relatively resilient due to the small loan sizes (easier to repay) and the lack of access to credit in the past (ie. less leveraged).
- **Loans going to larger companies, difficult to raise loan pricing** – Despite strong system loan growth YTD (Rmb1.3trn new lending in Jan), we felt that SMEs and companies on the ground continue to find it difficult to borrow from banks. We believe that banks have been de-risking their lending by shifting towards larger and higher quality companies. Raising loan pricing in this segment is difficult given the competition. Even though higher loan pricing is available in the SME space, we believe banks are still shying away from this segment due to the risks.
- **WMPs impacted by internet MMFs, but their returns should decline** – High returns by internet money market funds such as Alibaba's Yu E Bao (6.147% latest 7-day ann. return) have impacted bank WMPs' growth and margins. Bank WMP margins have declined 20-30bps as banks lift WMP returns to compete with MMFs. What is unusual this year is that returns on WMPs have risen after CNY despite easing of market liquidity. Negotiated deposit rates have also eased post CNY (currently 5%-plus vs a peak of over 9% in Dec) and so internet MMF returns should decline further as c80% of MMF assets are invested in negotiated deposits.
- **Micro + mass retail strategy becoming mainstream** – A common strategy we see among joint stock and city commercial banks is to target micro enterprises and mass market retail to defend against rate liberalization and deposit disintermediation. Micro is seen as a source of high yield loans and low cost settlement deposits; mass retail is viewed as a new customer base, less WMP disintermediation. Many medium/smaller sized banks plan to expand smaller-sized/community branches. Whether this strategy works depends on execution; risk is that the younger generation is migrating to the internet, away from branches.

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Figure 1. Chinese Banks – Valuation Comps

23-Feb-2014	ABC	ICBC	CCB	BoC	CMB	BoCom	CNCB	MSB	CRCB	HSB	Average
Stock code	1288.CN	1398.CN	0939.CN	3988.CN	3968.CN	3328.CN	0998.CN	1988.CN	3618.CN	3698.CN	
Market cap (US\$ bn)	140.30	212.05	171.18	117.07	45.92	48.26	25.64	28.97	3.99	5.04	
Recommendation	1	1	1	1	1	2	2	3	1	3	
Price (HK\$)	3.35	4.68	5.31	3.25	14.12	5.04	4.25	7.92	3.33	3.54	
Target (HK\$)	4.20	6.60	7.80	4.20	19.00	5.60	3.90	7.00	5.00	3.30	
Expected Return	25%	41%	47%	29%	35%	11%	-8%	-12%	50%	-7%	
<b>EPS (Rmb)</b>											
12	0.45	0.67	0.77	0.50	2.10	0.88	0.66	1.34	0.58	0.53	
13F	0.51	0.71	0.83	0.53	2.14	0.82	0.70	1.43	0.67	0.56	
14F	0.55	0.76	0.92	0.56	2.24	0.86	0.75	1.57	0.74	0.52	
<b>EPS (Rmb) growth (%)</b>											
12	19.0	14.5	14.1	12.2	25.3	7.9	(6.7)	28.6	26.2	23.3	15.0
13F	13.6	5.5	7.9	6.9	1.9	(7.3)	4.8	6.1	16.6	7.3	6.7
14F	8.1	7.1	9.7	4.9	4.6	5.4	7.7	10.3	10.0	(8.5)	7.3
<b>EPS (HK\$)</b>											
12	0.57	0.86	0.99	0.64	2.68	1.13	0.85	1.72	0.74	0.67	0.95
13F	0.65	0.90	1.06	0.68	2.73	1.05	0.89	1.82	0.86	0.72	1.01
14F	0.70	0.97	1.17	0.72	2.86	1.10	0.96	2.01	0.94	0.66	1.08
<b>EPS (HK\$) growth (%)</b>											
12	22.1	17.5	17.2	15.2	28.6	10.7	(4.2)	32.0	29.6	26.6	18.1
13F	13.6	5.5	7.9	6.9	1.9	(7.3)	4.8	6.1	16.6	7.3	6.7
14F	8.1	7.1	9.7	4.9	4.6	5.4	7.7	10.3	10.0	(8.5)	7.3
<b>PER (x)</b>											
12	5.9	5.5	5.4	5.1	5.3	4.5	5.0	4.6	4.5	5.3	5.3
13F	5.2	5.2	5.0	4.8	5.2	4.8	4.8	4.4	3.9	4.9	5.0
14F	4.8	4.8	4.5	4.5	4.9	4.6	4.4	3.9	3.5	5.4	4.7
<b>Price/PPOP (x)</b>											
12	3.5	3.8	3.6	3.4	3.7	2.9	2.8	2.9	3.2	3.7	3.5
13F	3.2	3.5	3.3	3.0	3.3	2.9	2.6	2.7	2.7	3.3	3.2
14F	3.0	3.2	3.0	2.8	3.1	2.7	2.4	2.4	2.4	3.6	3.0
<b>BVPS (HK\$)</b>											
12	2.95	4.10	4.81	3.77	11.85	6.53	5.28	7.34	4.38	3.20	4.75
13F	3.40	4.71	5.53	4.23	13.59	7.26	5.97	8.97	5.05	3.78	5.44
14F	3.87	5.38	6.33	4.71	15.71	8.04	6.70	10.61	5.76	4.32	6.20
<b>Price/Book (x)</b>											
12	1.1	1.1	1.1	0.9	1.2	0.8	0.8	1.1	0.8	1.1	1.1
13F	1.0	1.0	1.0	0.8	1.0	0.7	0.7	0.9	0.7	0.9	0.9
14F	0.9	0.9	0.8	0.7	0.9	0.6	0.6	0.7	0.6	0.8	0.8
<b>DPS (HK\$)</b>											
12	0.20	0.31	0.34	0.22	0.80	0.08	0.19	0.19	0.22	0.13	0.29
13F	0.23	0.32	0.37	0.24	0.73	0.31	0.22	0.36	0.27	0.12	0.32
14F	0.25	0.34	0.41	0.25	0.86	0.33	0.24	0.40	0.29	0.13	0.35
<b>Dividend yield (%)</b>											
12	6.0	6.5	6.4	6.9	5.7	1.6	4.5	2.4	6.5	3.6	5.9
13F	6.8	6.9	7.0	7.3	5.2	6.2	5.2	4.6	8.0	3.3	6.7
14F	7.3	7.4	7.7	7.7	6.1	6.6	5.6	5.1	8.8	3.7	7.2

Source: Company data, Citi Research estimates

Figure 2. Chinese Banks – Performance Ratio Comps

23-Feb-2014	ABC	ICBC	CCB	BoC	CMB	BoCom	CNCB	MSB	CRCB	HSB	Average
<b>ROA (stated)</b>											
12	1.16	1.44	1.47	1.14	1.46	1.18	1.08	1.38	1.38	1.48	1.33
13F	1.17	1.36	1.40	1.11	1.30	1.07	1.01	1.23	1.38	1.33	1.26
14F	1.13	1.32	1.36	1.05	1.32	1.00	0.95	1.24	1.31	1.24	1.22
<b>ROE (stated)</b>											
12	20.7	23.0	22.0	18.0	24.8	17.9	17.1	25.7	17.9	22.9	21.3
13F	20.4	20.9	20.6	17.0	20.5	15.2	15.8	22.3	18.8	18.9	19.7
14F	19.3	19.5	19.7	16.0	19.5	14.4	15.1	20.5	18.0	16.3	18.6
<b>Net interest margin</b>											
12	2.77	2.58	2.75	2.15	3.03	2.59	2.65	2.88	3.50	2.96	2.63
13F	2.64	2.45	2.61	2.23	2.77	2.52	2.57	2.54	3.38	2.64	2.52
14F	2.57	2.39	2.53	2.14	2.77	2.38	2.48	2.55	3.28	2.53	2.45
<b>Cost/income</b>											
12	43.0	35.9	37.0	43.7	42.8	39.2	39.0	41.7	44.5	33.9	39.4
13F	43.9	35.8	37.0	43.0	41.9	38.9	39.7	42.9	42.9	31.1	39.5
14F	44.7	36.1	37.3	43.4	41.2	39.7	40.7	43.5	42.6	31.9	39.9
<b>Non-interest inc/total operating income</b>											
12	19.6	21.1	23.6	29.8	22.3	18.6	15.9	24.8	4.1	7.2	22.4
13F	21.9	24.1	24.0	31.2	25.0	19.9	18.3	28.8	4.4	7.1	24.3
14F	22.6	25.2	24.7	32.5	26.2	20.8	18.6	30.7	4.9	6.8	25.2
<b>Loans/deposits</b>											
12	59.2	64.5	66.2	74.8	75.2	79.0	73.7	71.9	58.9	68.4	67.5
13F	59.8	65.9	66.8	75.4	75.7	79.4	71.3	72.3	59.8	70.0	68.2
14F	60.3	67.2	67.2	75.7	76.2	79.5	71.3	72.6	60.5	71.5	68.8
<b>Loan growth</b>											
12	14.1	13.0	15.6	8.2	16.0	15.1	16.0	14.9	20.2	19.2	13.6
13F	13.2	12.5	14.4	12.5	15.7	13.6	14.1	13.7	17.9	17.8	13.4
14F	13.3	12.1	13.3	11.3	14.8	13.0	12.9	13.5	18.5	16.2	12.8
<b>Equity/assets</b>											
12	5.7	6.4	6.8	6.8	5.9	7.2	6.7	5.2	7.4	6.3	6.4
13F	5.8	6.7	6.9	6.8	6.7	7.0	6.5	6.1	7.4	7.6	6.6
14F	5.9	6.9	7.0	6.8	6.8	6.9	6.4	6.4	7.3	7.6	6.7
<b>Tier 1 CAR</b>											
12	9.7	10.6	11.3	10.5	8.5	11.3	9.9	8.1	12.0	10.3	10.4
13F	9.1	10.9	11.0	9.7	9.2	10.2	9.1	7.8	11.3	12.3	10.1
14F	9.3	11.3	11.3	9.9	9.3	10.1	9.0	8.1	10.3	12.4	10.4
<b>Total CAR</b>											
12	12.6	13.7	14.3	12.6	12.1	14.2	13.4	10.8	12.9	13.5	13.3
13F	11.6	13.8	12.9	12.6	12.2	12.6	11.3	9.4	11.8	14.8	12.6
14F	11.6	14.1	13.1	12.6	12.0	12.3	11.0	9.6	10.8	14.8	12.7
<b>Bad Debt Provisions/Average Loans</b>											
12	0.90	0.41	0.57	0.29	0.31	0.53	0.85	0.71	0.32	0.30	0.54
13F	0.75	0.56	0.62	0.49	0.60	0.70	0.95	0.78	0.53	0.45	0.63
14F	0.75	0.61	0.62	0.55	0.65	0.70	0.95	0.79	0.66	0.50	0.65
<b>Impaired loans ratio</b>											
12	1.33	0.85	0.99	0.95	0.61	0.92	0.74	0.76	0.98	0.58	0.96
13F	1.27	0.90	1.06	1.01	0.84	1.08	1.02	0.83	1.05	0.62	1.02
14F	1.43	0.92	1.15	1.06	1.08	1.26	1.12	0.86	1.10	0.70	1.11
<b>Provision coverage</b>											
12	326.4	296.0	271.3	236.3	353.4	250.7	288.2	315.1	350.6	406.1	289.3
13F	348.0	297.0	268.8	252.9	281.9	224.7	218.1	309.2	322.5	374.4	286.8
14F	315.0	309.1	261.6	262.1	236.8	207.5	210.3	316.8	316.3	341.9	280.1

Source: Company data, Citi Research estimates

## Appendix A-1

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