

China Merchants Bank (3968.HK)

Stable profit growth and pay attention to the future development



Phillip Securities (Hong Kong) Ltd

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Stable profit growth in 1Q2013 with large capital pressure

Rating: Buy, CP: HK\$16.70, TP: HK\$21.36

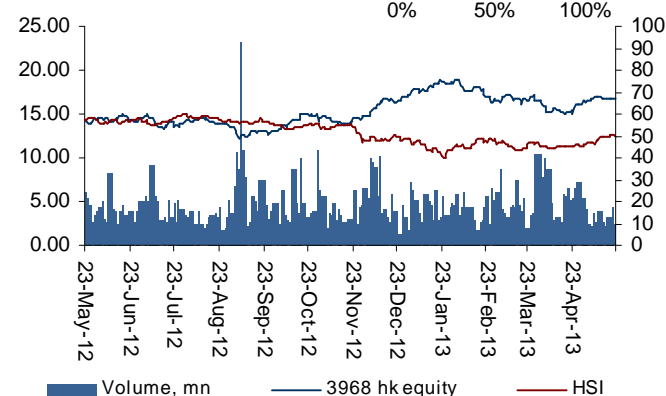
Company Introduction

Established in 1987 in Shenzhen, China Merchants Bank ("CMB") is China's first joint-stock commercial bank, which were listed in A+H Shares in 2002 and 2006 respectively. It's the first time CMB listed in Fortune500 in 2012, and ranked No. 498 in the list. CMB was also listed No.56 among the world's Top 1,000 Banks by The Banker.

Summary

- According to CMB's 1Q2013 result, it maintained stable profit growth that accumulate net profits achieved to RMB13.021 billion, increased by 11.84% y-y, equivalent to EPS of RMB1.60 with the growth rate of 11.11%, slightly lower than our expectation;
- After the strong growth as high as 22% in 2012, the asset growth of CMB starts to slow down in 2013. As at the end of March, the Group's total assets increased only by 3.09% to RMB3.51 trillion compared with the end of 2012, with net assets of RMB214.397 billion, equivalent to the BVPS of RMB9.94, 7% higher than that of 2012;
- We pay attention to the changes of the quality of loans, and it showed that there was the deterioration of CMB's asset quality with the consistent increase of both amount and ratio of NPLs since 3Q2012. As at the end of 1Q2013, the Group's NPL ratio increased by 0.05 ppts to 0.66% compared with the end of 2012, with the amount of RMB13.050 billion, increased by RMB1.356 billion. Meanwhile the converge ratio dropped 23.71 ppts to 328.08%;
- We also concern about CMB's financing plan. CMB has large capital pressure with the lower CAR compared with the peers. By the end of 1Q, based on new calculation method, the Tier 1 Ratio and CAR of CMB recorded to 8.6% and 11.41%, increased by 0.65 ppts and the same respectively, on the bottom of the industry;
- Additionally, CMB announced that the former president and CEO of the bank, Mr Ma Weihua would retire due to the age problem. Mr Ma gained the high reputation in the industry and served as the president of the bank for 14 years. Under his leadership, CMB developed retail businesses actively and expand E-bank business, which led CMB to become one of the largest retail banks in China from a small local bank. Therefore it will remain huge pressure to his successor, and the market is also wondering if CMB can maintain its competitive advantages continually in future.

Rating	1.00	Buy
- Previous Rating	2.00	Accumulate
Target Price (HKD)	21.36	
- Previous Target Price (HKD)	18.28	
Closing Price (HKD)	16.70	
Expected Capital Gains (%)	27.9%	
Expected Dividend Yield (%)	4.8%	
Expected Total Return (%)	32.7%	
Raw Beta (Past 2yrs weekly data)	N/A	
Market Cap. (HKD bn)	378,151	
Enterprise Value (HKD mn)	N/A	
52 week range (HKD)	12.02 - 19.02	
Closing Price in 52 week range		



Key Financial Summary

FYE	12/11	12/12	12/13F	12/14F
Operating Profit (RMB mn)	47,059	59,500	67,167	74,428
Net Profit, adj. (RMB mn)	36,129	45,273	51,166	56,545
EPS, adj. (RMB)	1.67	2.10	2.37	2.62
P/E (X)	7.9	6.3	5.6	5.0
BVPS (RMB)	7.65	9.29	11.30	12.59
P/B (X)	1.7	1.4	1.2	1.0
DPS (RMB)	0.42	0.63	0.71	0.79
Div. Yield	3.18%	4.77%	5.39%	5.96%

Source: Bloomberg, PSR est.

*All multiples & yields based on current market price

Valuation Method

DDM

Research Analyst

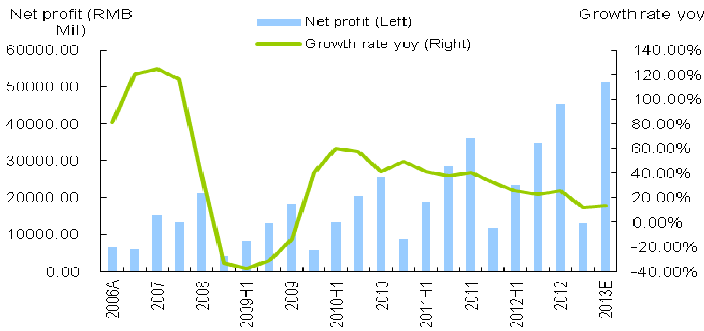
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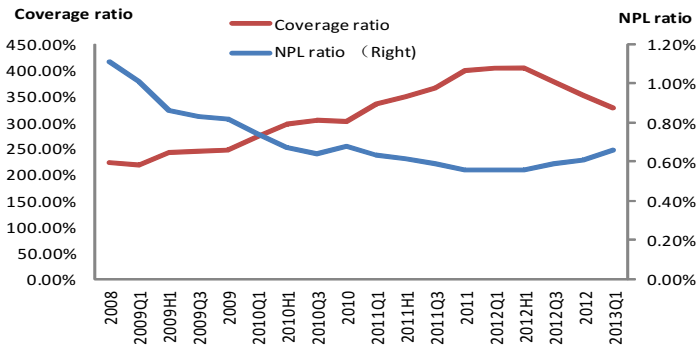
- In all, the profit performance of CMB maintains stable, and we should concern about its asset quality and business development in future. However, we still hold confidence in CMB's competitive business model and brand influence, based on 3-stage DDM, we increase 12-m TP of CMB to HK\$21.36, 27.91% higher than the latest closing price, equivalent to 10.3xP/E and P/B2.2x in 2014 respectively, and we upgrade Buy rating

Figure1. Profit growth of CMB



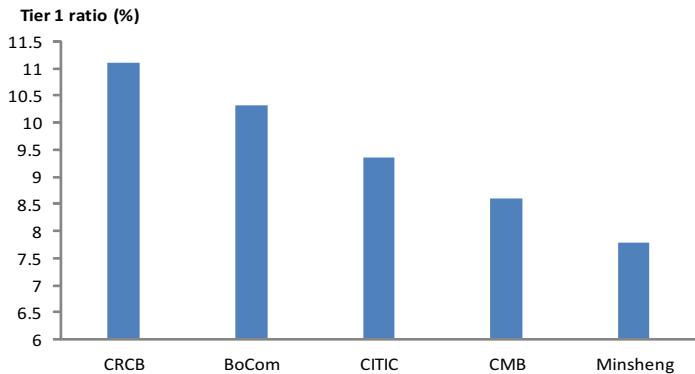
Source: PSR, Company report

Figure2. NPL and coverage ratios of CMB



Source: PSR, Company report

Figure 3. Tier1 Ratio of domestic joint-venture commercial banks listed in HK



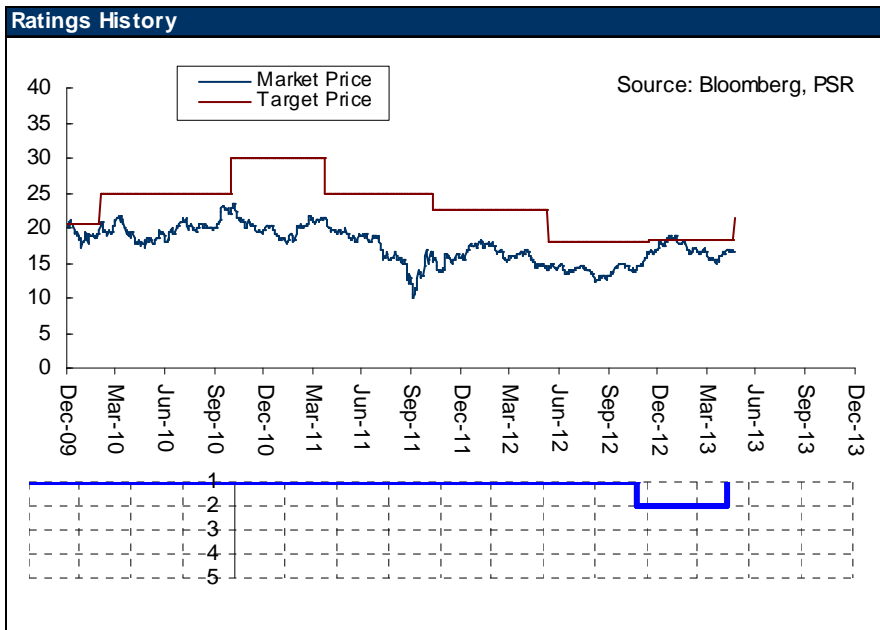
Source: PSR, Company report

Financial Status

FYE	FY10	FY11	FY12	FY13F	FY14F
Valuation Ratios					
P/E (X)	10.7	7.9	6.3	5.6	5.0
P/B (X)	2.1	1.7	1.4	1.2	1.0
Dividend Payout ratio	23.50%	25.08%	30.02%	30.00%	30.00%
Dividend Yield	2.13%	3.18%	4.77%	5.39%	5.96%
Per share data (RMB)					
EPS, reported	1.23	1.67	2.10	2.37	2.62
EPS, adj.	1.23	1.67	2.10	2.37	2.62
DPS	0.28	0.42	0.63	0.71	0.79
BVPS	6.21	7.65	9.29	11.30	12.59
Growth					
Net interest income	41.4%	33.7%	15.8%	10.6%	10.4%
Net fee and commission income(exp.)	41.7%	37.9%	26.3%	29.6%	24.2%
Operating profit	49.1%	41.4%	26.4%	12.9%	10.8%
Net Income, adj.	41.3%	40.2%	25.3%	13.0%	10.5%
Key Ratios					
Net interest spread	2.56%	2.94%	2.87%	2.74%	2.77%
Net interest margin	2.65%	3.06%	3.05%	2.93%	3.02%
Loan to deposit	73.91%	72.27%	73.58%	72.29%	70.38%
Cost to income ratio	39.69%	36.00%	35.84%	35.00%	36.00%
ROAA	1.15%	1.39%	1.46%	1.39%	1.34%
ROAE	22.73%	24.17%	24.77%	23.02%	21.92%
NPL ratio	0.68%	0.56%	0.61%	0.72%	0.81%
Coverage ratio	302.41%	400.13%	351.79%	355.31%	362.41%
Core CAR	8.04%	8.22%	8.49%	8.70%	9.27%
CAR	11.47%	11.53%	12.14%	11.75%	12.10%
Income Statement (RMB mn)					
Net interest income	57,076	76,307	88,374	97,744	107,910
Net fee and commission income	11,330	15,628	19,739	25,589	31,794
Operating income	71,692	96,603	113,754	129,559	146,864
Operating expenses	(32,634)	(40,889)	(48,350)	(55,603)	(64,499)
Operating profit before impairment losses	38,780	55,409	65,083	73,588	81,940
Impairment losses	(5,501)	(8,350)	(5,583)	(6,420)	(7,512)
Operating profit	33,279	47,059	59,500	67,167	74,428
Profit before tax	33,343	47,122	59,564	67,315	74,633
Income tax	(7,574)	(10,995)	(14,287)	(16,144)	(18,082)
Effective income tax rate	22.72%	23.33%	23.99%	23.98%	24.23%
Profit before tax	25,769	36,127	45,277	51,171	56,551
Minority interest	0	(2)	4	5	6
Net profit attributable to equity holders of the B	25,769	36,129	45,273	51,166	56,545
Declared and paid Dividends	6,056	9,062	13,593	15,350	16,964
Balance Sheet (RMB mn)					
Cash and balances w ith banks and other financial inst	28,961	63,046	280,870	252,783	262,894
Balances w ith central bank	294,955	408,304	471,415	560,984	633,912
Placements w ith banks and other financial institutions	58,917	131,381	103,420	108,591	112,935
Loans and advances to customers	1,402,160	1,604,371	1,863,325	2,086,924	2,316,486
Investments	580,700	547,485	642,513	873,175	1,100,201
Fixed assets	15,038	17,500	19,287	19,673	20,656
Intangible assets	2,620	2,605	2,851	2,800	2,856
Deferred tax assets	3,706	4,337	4,987	6,483	8,558
Goodw ill	9,598	9,598	9,598	9,598	9,598
Other assets	5,852	5,888	9,953	12,939	16,303
Total Assets	2,402,507	2,794,971	3,408,219	3,933,950	4,484,398
Deposits from banks and other financial Institutions	203,011	205,699	258,692	266,453	277,111
Placements from banks and other financial institutions	45,573	67,484	109,815	142,760	171,311
Deposits from customers	1,897,178	2,220,060	2,532,444	2,886,986	3,291,164
Financial liabilities at fair value through profit or loss	1,165	4,724	6,854	8,225	9,705
Current taxation	4,972	7,112	6,679	7,948	9,299
Deferred tax liabilities	924	864	827	852	911
Other liabilities	30,356	14,918	26,471	31,765	39,834
Total Liabilities	2,268,501	2,629,961	3,207,712	3,690,000	4,212,428
Share capital	21,577	21,577	21,577	21,577	21,577
Capital reserve	36,197	37,508	37,545	38,780	38,780
Surplus reserve	10,880	14,325	18,618	18,618	18,618
Investment revaluation reserve	(1,311)	157	37	1,425	1,923
Regulatory general reserve	16,812	18,794	39,195	43,075	47,383
Retained profits	49,063	64,446	85,025	106,281	128,919
Shareholder's equity	134,006	164,997	200,434	243,764	271,746
Minority interest	0	13	73	186	224
Total shareholders' equity	134,006	165,010	200,507	243,950	271,970
Total shareholders' equity and liabilities	2,402,507	2,794,971	3,408,219	3,933,950	4,484,398

Source: PSR

Source: Company, PSR



PSR Rating System

Total Returns	Recommendation	Rating
> +20%	Buy	1
+5% to +20%	Accumulate	2
-5% to +5%	Neutral	3
-5% to -20%	Reduce	4
<-20%	Sell	5

Remarks

We do not base our recommendations entirely on the above quantitative return bands. We consider qualitative factors like (but not limited to) a stock's risk reward profile, market sentiment, recent rate of share price appreciation, presence or absence of stock price catalysts, and speculative undertones surrounding the stock, before making our final recommendation

PHILLIP RESEARCH STOCK SELECTION SYSTEMS

Total Return	Recommendation	Rating	Remarks
>+20%	Buy	1	>20% upside from the current price
+5% to +20%	Accumulate	2	+5% to +20% upside from the current price
-5% to +5%	Neutral	3	Trade within \pm 5% from the current price
-5% to -20%	Reduce	4	-5% to -20% downside from the current price
<-20%	Sell	5	>20% downside from the current price

PHILLIP RESEARCH STOCK SELECTION SYSTEMS

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