

Bank of Communications (3328.HK)

Lower-than-expected profit growth and the asset quality deteriorated

continually



Phillip Securities (Hong Kong) Ltd

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3328.HK | 3328.HK | 3328.HK

Industry: Financial

2013-11-04

Lower-than-expected profit growth in 3Q2013

Rating: Accumulate, CP: HK\$5.69, TP:HK\$6.13

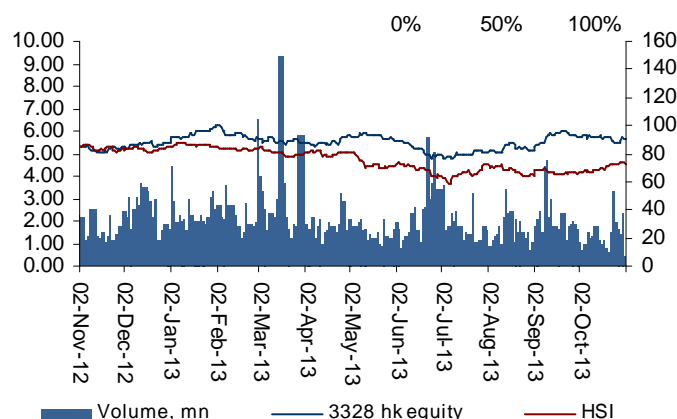
Company Introduction

Bank of Communications (BoCom or the Group) was founded in 1908, which was the one of Big-4 in early stage of domestic banking sector. BoCom was restructured in 1986 and operated in April 1987. It was the first state-owned commercial bank in China and today it is the one of top five largest state-owned banks located in Shanghai. BoCom was listed in H and A Shares in Jun 2005 and May 2007 respectively.

Summary

- Recently BoCom announced its 3Q2013 results, by the end of Sep 2013, the Group's net profits reached to RMB48.706 billion, up 9.43% y-y, 4.2% lower than our previous expectation, equivalent to the EPS of RMB0.66, down 5.71% y-y, mainly because of the dilution due to the increase of total capital. The profits were lower than the expectation due to the decrease of interest and intermediate business incomes. The growth rates decreased by 1.75ppts and 1.3ppts to 9.58% and 25.46% compared with 1H;
- The assets of BoCom continued to increase stably, and the Group's total assets raised 9.38% to RMB5.77 trillion compared with the end of 2012, equivalent to the BVPS of RMB5.5, up 7.42%;
- According to the operating performance, BoCom's corporate banking business developed continually. Based on the "BoCom strategy", the bank focused on Industry Chain Finance. By the end of Sep, BoCom built over 14,000 industry chain networks with over 80,000 enterprises on the chains. The Group's investment banking business increased strongly with the amount of RMB6 billion, up 40.5% y-y. Additionally, the Group's volume of international settlement increased by 20.8% y-y to USD417.719 billion, and assets under custody reached RMB2.61 trillion, up 74% compared with the end of 2012;
- Meanwhile, BoCom expanded the transformation of new businesses actively with the strong growth of the internet and mobile banking businesses. It is the first to introduce the 2nd generation mobile banking with "cloud + terminal" technology providing smart functions and supporting secure random money transfer and contactless IC card recharge. By the end of Sep, customer number of mobile banking increased by 52.57%, and transaction volume and number increased by 90.48% and 270.94% y-y to RMB0.69 trillion and 41.85 million respectively;

Rating	2.00	Accumulate
- Previous Rating	2.00	Accumulate
Target Price (HKD)	6.13	
- Previous Target Price (HKD)	6.13	
Closing Price (HKD)	5.69	
Expected Capital Gains (%)	7.7%	
Expected Dividend Yield (%)	4.8%	
Expected Total Return (%)	12.6%	
Raw Beta (Past 2yrs weekly data)	N/A	
Market Cap. (HKD bn)	408,913	
Enterprise Value (HKD mn)	N/A	
52 week range (HKD)	4.71 - 6.7	
Closing Price in 52 week range		



Key Financial Summary

FYE	12/12	12/13F	12/14F	12/15F
Operating Profit (RMB mn)	75,212	83,020	89,829	96,956
Net Profit, adj. (RMB mn)	58,373	64,121	69,353	74,969
EPS, adj. (RMB)	0.88	0.86	0.93	1.01
P/E (X)	5.1	5.2	4.8	4.4
BVPS (RMB)	5.12	5.78	6.57	7.42
P/B (X)	0.9	0.8	0.7	0.6
DPS (RMB)	0.24	0.22	0.23	0.25
Div. Yield	5.4%	4.8%	5.2%	5.6%

Source: Bloomberg, PSR est.

*All multiples & yields based on current market price

Valuation Method

PB, DDM

Research Analyst

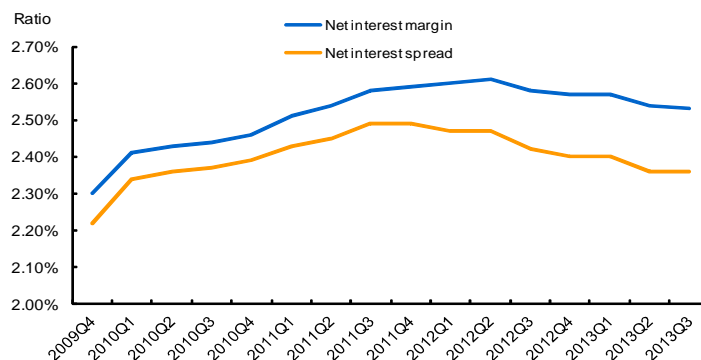
Xingyu Chen

chenxingyu@phillip.com.cn

+86 21 5169 9400 - 105

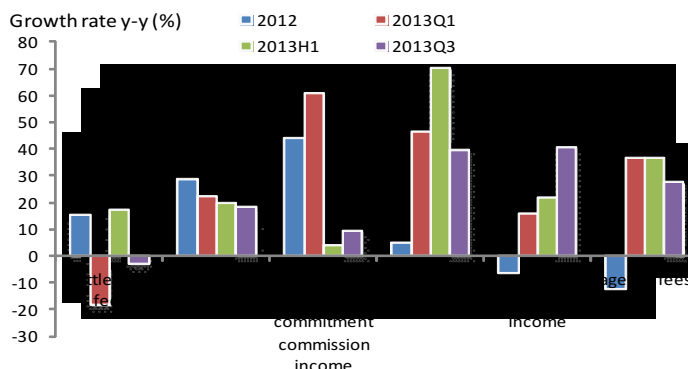
- As at the end of 1H2013, total assets of overseas offices increased by 20.62% to RMB404.663 billion, the proportion of such assets to total assets increased from 7.67% in 2012 to 8.54%, and net profit recorded to RMB1.958 billion with the year-on-year growth rate of 30.10%, the portion increased from 4.84% in 1H2012 to 5.62%. Meanwhile, under the development of the process of RMB internalization, cross-border RMB settlement expanded strongly, and the volume by domestic and overseas branches amounted to RMB354.632 billion, up 77.47% y-y. Additionally, the operating performance of subsidiaries gained the great record, net profit increased significantly by 138.59% y-y to RMB1.014 billion. The trust scale of BoCom International Trust achieved to RMB221.6 billion, up 42% compared with the end of 2012;
- In 3Q2013, the CAR of BoCom declined continually, representing the increase of capital pressure, the Core Tier-1 ratio and CAR dropped 0.27ppts and 0.44ppts to 9.87% and 12.24% respectively. According to the management's feedback in the result conference, the bank will face the capital pressure under the large growth of businesses, with the large decrease of the capital, but BoCom will not to announce new financing plans in the near future, and will focus on the business transformation and control the large capital-consumption projects;
- On the other hand, we always concern about the asset quality. In recent years, BoCom focuses on expanding the loans to SMEs, and the portion of the loans to total loans increased by 0.97ppts to 42.75% in 3Q2013 from 2012, with the amount of RMB1.23 trillion, up 10.15%. The management stated that the bad debts in excess capacity industries and SMEs increased consistently, especially in Zhejiang and Jiangsu Provinces, which caused the Group's asset quality to deteriorate continually, the NPL ratio increased from 0.92% in 2012 to 1.01% in 3Q2013, with the sharp growth of doubtful and loss loans. The coverage ratio went down from 250.68% to 217.49%, down 33.19ppts. We believe BoCom will still face the risk of deterioration of asset quality in future, the amount and ratio of NPLs will continue to increase but would still be under the control in general;
- In all, the businesses of BoCom recorded the stable growth, but the profit growth will continue to go down. Based on 3-stage DDM, we maintain the Group's 12-m target price to HK\$6.13, around 7.7% higher than the current price, equivalent to 5.2xP/E and 0.7xP/B in 2014 respectively, and recommend Accumulate rating.

Figure 1. Quarterly NIM and net interest spread of BoCom



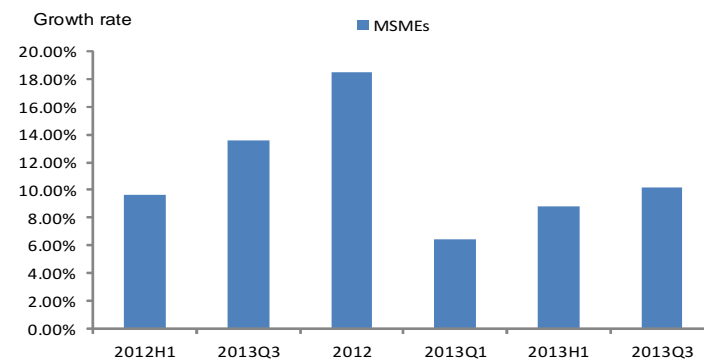
Source: PSR, Company report

Figure 2. Net fee and commission income of BoCom



Source: PSR, Company report

Figure 3. Growth of MSMEs of BoCom



Source: PSR, Company report

Table 1. The structure of BoCom's loans in 3Q2013

Proportion of industry (%)	2012A	2013Q3	Changes (ppt)
Mining	2.44	2.75	0.31
Manufacturing	19.82	19.66	-0.16
Electricity, gas and water production and supply	4.49	4.10	-0.39
Construction	3.16	3.31	0.15
Transportation, storage and postal service	12.34	11.99	-0.35
IT services and telecommunications	0.34	0.31	-0.03
Wholesale and retail	13.22	12.32	-0.90
Accommodation and catering	0.79	0.83	0.04
Financial institutions	0.80	0.97	0.17
Real estate	6.10	6.18	0.08
Services	6.25	6.28	0.03
Water conservancy, environment and other public services	4.66	4.34	-0.32
Education	1.28	1.43	0.15
Others	1.69	1.81	0.12
Discounted bills	2.20	1.89	-0.31
Total corporate loans	79.59	78.07	-1.52
Mortgage loans	12.16	13.49	1.33
Credit card advances	4.04	4.42	0.38
Medium-term and long-term working capital loans	1.87	1.79	-0.08
Short-term working capital loans	1.07	0.81	-0.26
Car loans	0.12	0.07	-0.05
Others	1.15	1.35	0.20
Total personal loans	20.41	21.93	1.52
Gross loans	100.00	100.00	

Source: PSR, Company report

Table 2. The breakdown of BoCom's five loan categories (stipulated by the Chinese banking regulatory authorities) in 3Q2013

Loan quality analysis (RMB Million)	2012A	2013Q3	Growth rate y-y	Portion	Portion
Normal	2,851,980	3,124,154	9.54%	96.77%	97.09%
Special Mention	68,324	61,066	-10.62%	2.32%	1.90%
Substandard	13,269	13,365	0.72%	0.45%	0.42%
Doubtful	9,793	13,573	38.60%	0.33%	0.42%
Loss	3,933	5,609	42.61%	0.13%	0.17%
Total non-performing loans	26,995	32,547	20.57%	0.92%	1.01%
Total loans and advances to customers	2,947,299	3,217,767	9.18%	100.00%	100.00%
Asset quality ratios			Changes (ppt)		
Non-performing loan ratio	0.92%	1.01%	0.10		
Allowances for impairment losses to non	250.68%	217.49%	-33.19		

Source: PSR, Company report

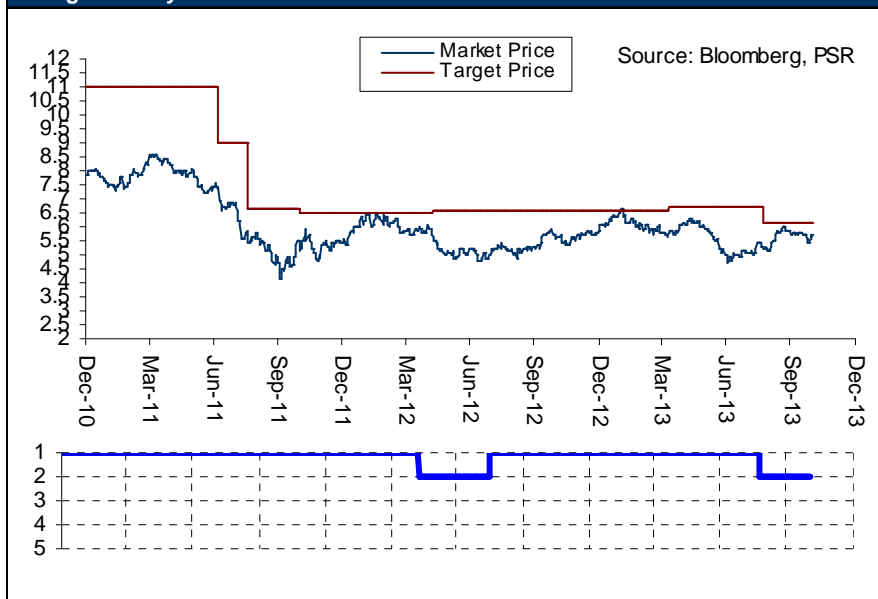
Financial Status

FYE	FY11	FY12	FY13F	FY14F	FY15F
Valuation Ratios					
P/E (X)	5.5	5.1	5.2	4.8	4.4
P/B (X)	1.0	0.9	0.8	0.7	0.6
Dividend Payout ratio	13.31%	30.53%	25.00%	25.00%	25.00%
Dividend Yield	2.44%	5.37%	4.83%	5.22%	5.64%
Per share data (RMB)					
EPS, reported	0.82	0.88	0.86	0.93	1.01
EPS, adj.	0.82	0.88	0.86	0.93	1.01
DPS	0.11	0.24	0.22	0.23	0.25
BVPS	4.39	5.12	5.78	6.57	7.42
Growth					
Net interest income	20.7%	17.1%	8.0%	5.9%	4.9%
Net fee and commission income(exp.)	35.0%	6.8%	20.9%	25.2%	28.2%
Operating income	22.0%	16.0%	10.8%	10.0%	10.1%
Net Income, adj.	29.9%	15.1%	9.8%	8.2%	8.1%
Key Ratios					
Net interest spread	2.49%	2.43%	2.34%	2.36%	2.34%
Net interest margin	2.59%	2.59%	2.50%	2.47%	2.40%
Loan to deposit ratio	71.94%	73.23%	72.89%	72.54%	72.89%
Cost-to-income ratio	30.19%	29.85%	28.31%	27.31%	26.28%
Return on average assets	1.19%	1.18%	1.15%	1.12%	1.09%
Return on average equity	20.52%	17.91%	15.85%	15.12%	14.43%
Non-performing loan ratio	0.86%	0.92%	1.05%	1.12%	1.21%
Provision coverage of impaired loans	256.37%	250.68%	218.39%	213.50%	198.97%
Allowances for impairment losses to total loans	2.20%	2.30%	2.30%	2.40%	2.40%
Core capital adequacy ratio	9.27%	11.24%	10.65%	10.85%	10.70%
Capital adequacy ratio	12.44%	14.07%	13.15%	13.45%	13.20%
Income Statement (RMB mn)					
Net interest income	102,601	120,126	129,746	137,394	144,143
Net fee and commission income	19,549	20,882	25,253	31,610	40,530
Other incomes	5,645	7,176	9,231	11,570	14,146
Operating income	127,795	148,184	164,231	180,573	198,819
Operating expenses	(49,372)	(57,805)	(61,273)	(65,562)	(70,152)
Insurance business expense	(491)	(630)	(1,040)	(1,559)	(2,183)
Operating profit before impairment losses	77,932	89,749	101,918	113,452	126,484
Impairment losses	(12,479)	(14,537)	(18,898)	(23,623)	(29,528)
Operating profit	65,453	75,212	83,020	89,829	96,956
Shares of P/L of Jonit controlled Entities	(2)	4	15	20	25
Profit before tax	65,451	75,216	83,035	89,849	96,981
Income tax	(14,634)	(16,740)	(18,749)	(20,249)	(21,666)
Effective income tax rate	22.36%	22.26%	22.58%	22.54%	22.34%
Net profit for the period	50,817	58,476	64,286	69,600	75,315
Minority interest	82	103	165	247	346
Net profit attributable to equity holders of the period	50,735	58,373	64,121	69,353	74,969
Dividend	6,751	17,823	16,030	17,338	18,742
Balance Sheet (RMB mn)					
Cash and balances with banks and other financial institutions	443,240	520,963	541,802	574,310	631,741
Balances with central bank	736,999	816,846	857,688	917,726	991,145
Financial assets held for trading	48,422	52,161	56,334	60,841	65,099
Loans and advances to customers	2,505,385	2,879,628	3,167,591	3,500,188	3,885,208
Investments	757,109	833,618	1,017,014	1,220,417	1,403,479
Fixed assets	37,017	45,536	49,179	51,638	54,220
Deferred tax assets	7,926	12,501	14,126	16,104	18,036
Other assets	75,079	112,126	146,885	190,951	229,141
Total Assets	4,611,177	5,273,379	5,850,619	6,532,173	7,278,069
Deposits and placements from banks and other financial institutions	854,499	942,989	1,027,858	1,134,755	1,270,926
Deposits from customers	3,283,232	3,728,412	4,119,895	4,573,084	5,053,258
Financial liabilities at fair value through profit or loss	18,921	23,060	35,743	55,402	78,116
Other liabilities	95,666	110,769	123,840	154,800	184,212
Current taxes	4,247	7,125	8,550	10,260	12,312
Deferred tax liabilities	21	5	10	14	19
Subordinated notes issued	81,803	79,572	103,444	113,788	125,167
Total Liabilities	4,338,389	4,891,932	5,419,340	6,042,102	6,724,009
Share capital	61,886	74,263	74,263	74,263	74,263
Reserves	209,916	305,655	355,070	413,560	477,041
Shareholders' equity	271,802	379,918	429,333	487,823	551,304
Minority interest	986	1,529	1,946	2,249	2,756
Total shareholders' equity	272,788	381,447	431,279	490,072	554,060
Total shareholders' equity and liabilities	4,611,177	5,273,379	5,850,619	6,532,173	7,278,069

Source: PSR

Source: Company, PSR

Ratings History



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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Contact Information (Regional Member Companies)

SINGAPORE

Phillip Securities Pte Ltd
Raffles City Tower
250, North Bridge Road #06-00
Singapore 179101
Tel : (65) 6533 6001
Fax : (65) 6535 6631
Website: www.poems.com.sg

HONG KONG

Phillip Securities (HK) Ltd
Exchange Participant of the Stock Exchange of Hong Kong
11/F United Centre 95 Queensway
Hong Kong
Tel (852) 22776600
Fax (852) 28685307
Websites: www.phillip.com.hk

INDONESIA

PT Phillip Securities Indonesia
ANZ Tower Level 23B,
Jl Jend Sudirman Kav 33A
Jakarta 10220 – Indonesia
Tel (62-21) 57900800
Fax (62-21) 57900809
Website: www.phillip.co.id

THAILAND

Phillip Securities (Thailand) Public Co. Ltd
15th Floor, Vorawat Building,
849 Silom Road, Silom, Bangrak,
Bangkok 10500 Thailand
Tel (66-2) 6351700 / 22680999
Fax (66-2) 22680921
Website www.phillip.co.th

UNITED KINGDOM

King & Shaxson Capital Limited
6th Floor, Candlewick House,
120 Cannon Street,
London, EC4N 6AS
Tel (44-20) 7426 5950
Fax (44-20) 7626 1757
Website: www.kingandshaxson.com

AUSTRALIA

PhillipCapital Australia
Level 12, 15 William Street,
Melbourne, Victoria 3000, Australia
Tel (613) 96188238
Fax (613) 92002272
Website: www.phillipcapital.com.au

MALAYSIA

Phillip Capital Management Sdn Bhd
B-3-6 Block B Level 3 Megan Avenue II,
No. 12, Jalan Yap Kwan Seng, 50450
Kuala Lumpur
Tel (603) 21628841
Fax (603) 21665099
Website: www.poems.com.my

JAPAN

PhillipCapital Japan K.K.
Nagata-cho Bldg.,
8F, 2-4-3 Nagata-cho,
Chiyoda-ku, Tokyo 100-0014
Tel (81-3) 35953631
Fax (81-3) 35953630
Website: www.phillip.co.jp

CHINA

Phillip Financial Advisory (Shanghai) Co. Ltd
No 436 Hengfeng Road,
Greentech Unit 604,
Postal code 200070
Tel (86-21) 51699400
Fax (86-21) 63532643
Website: www.phillip.com.cn

FRANCE

King & Shaxson Capital Limited
3rd Floor, 35 Rue de la Bienfaisance 75008
Paris France
Tel (33-1) 45633100
Fax (33-1) 45636017
Website: www.kingandshaxson.com

UNITED STATES

Phillip Futures Inc
141 W Jackson Blvd Ste 3050
The Chicago Board of Trade Building
Chicago, IL 60604 USA
Tel +1.312.356.9000
Fax +1.312.356.9005