

Bank of Communications (3328.HK)

Profit growth was lower than expectation slightly



Phillip Securities (Hong Kong) Ltd

Bloomberg | Reuters | POEMS

Phillip Securities Research

3328.HK | 3328.HK | 3328.HK

Industry: Financial

2014-4-24

Intermediate business incomes increased largely in 2013

Rating: Accumulate, CP: HK\$4.88, TP: HK\$6.10

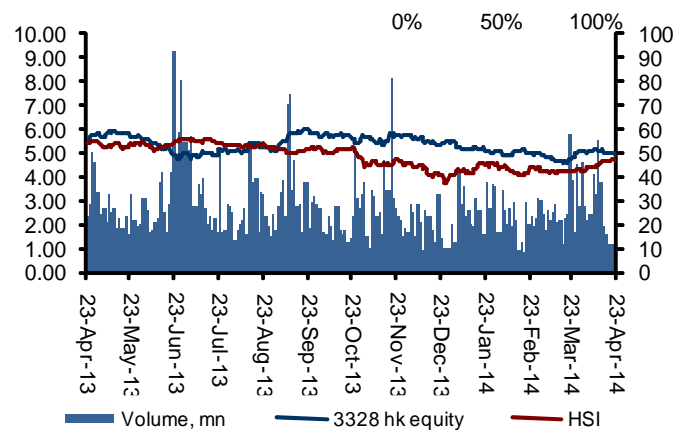
Company Introduction

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

- According to BoCom's 2013 Annual Results, by the end of 2013, the Group's net profits reached to RMB62.295 billion, up 6.7% y-y approximately, around 2.9% lower than our previous expectation, equivalent to the EPS of RMB0.84, down 5.13% 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 incomes. The growth rates decreased from 16% in 2012 and 9% in 2013. Additionally, due to the obvious growth of the NPLs, the Group's impairment losses rose sharply from 16% in 2012 to 27% in 2013. However, BoCom's intermediate business incomes increased strongly by 24% y-y to RMB26 billion during the period;
- The assets of BoCom continued to increase stably, and the Group's total assets raised 13% to RMB5.96 trillion compared with the end of 2012, equivalent to the BVPS of RMB5.65, up 10.4%;
- BoCom's corporate banking business developed stably. Based on the "BoCom strategy", the bank focused on the reform of business unit, and moves wealth management, trustee, private banking businesses to quasi-business units in future. By the end of 2013, BoCom's investment banking business increased strongly with the amount of RMB7.7 billion, up 26.2% y-y. The Group also acted as lead underwriter with the underwriting amount of RMB310.4 billion, up 98% y-y. Additionally, the volume of international settlement increased by 21% y-y to USD556.868 billion, and assets under custody reached RMB2.81 trillion, up 87% compared with the end of 2012;

Rating	1.00	Buy
- Previous Rating	2.00	Accumulate
Target Price (HKD)	6.10	
- Previous Target Price (HKD)	6.13	
Closing Price (HKD)	4.88	
Expected Capital Gains (%)	25.0%	
Expected Dividend Yield (%)	6.6%	
Expected Total Return (%)	31.6%	
Raw Beta (Past 2yrs weekly data)	N/A	
Market Cap. (HKD bn)	352,826	
Enterprise Value (HKD mn)	N/A	
52 w week range (HKD)	4.53 - 6.29	
Closing Price in 52 w week range		



Key Financial Summary

FYE	12/12	12/13	12/14F	12/15F
Operating Profit (RMB mn)	75,212	79,867	85,346	91,607
Net Profit, adj. (RMB mn)	58,373	62,295	66,448	71,120
EPS, adj. (RMB)	0.88	0.84	0.89	0.96
P/E (X)	4.4	4.7	4.4	4.1
BVPS (RMB)	5.12	5.65	6.21	6.84
P/B (X)	0.8	0.7	0.6	0.6
DPS (RMB)	0.24	0.26	0.27	0.29
Div. Yield	6.1%	6.6%	6.8%	7.3%

Source: Bloomberg, PSR est.

*All multiples & yields based on current market price

Valuation Method

PB, DDM

Research Analyst

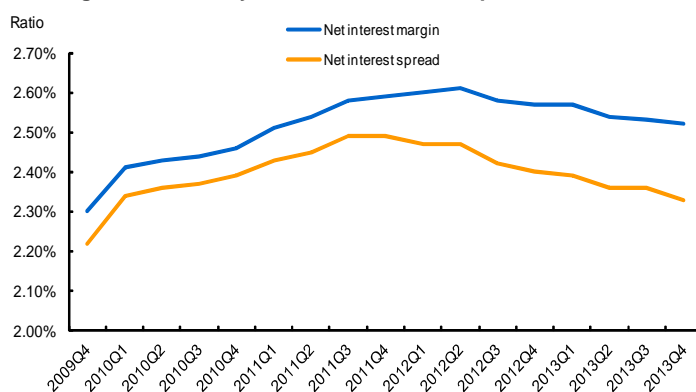
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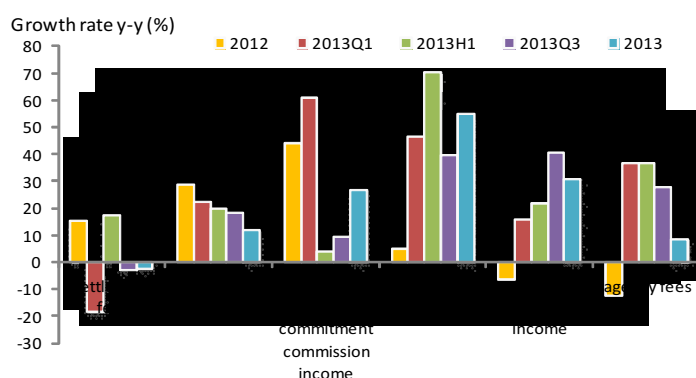
- Meanwhile, BoCom continued to expand the transformation of new businesses actively with the strong growth of the internet and mobile banking businesses. It was the first to introduce the 2nd generation mobile banking with “cloud + terminal” technology providing smart functions and supporting secure random money transfer and contactless IC card recharge. By the end of 2013, customer number of mobile banking increased by 81.46%, and transaction volume and number increased by 61.62% and 232% y-y to RMB0.88 trillion and 62.76 million respectively;
- In 2013, the CAR of BoCom declined continually, representing the increase of capital pressure, the Core Tier-1 ratio and CAR dropped 0.11ppts and 0.16ppts to 9.76% and 12.08% respectively. According to the management’s feedback in the result conference, the bank will try to issue the subordinated notes firstly, and the issuance of the preferred stock would be delayed if the subordinated notes can meet the capital demand. However, we believe BoCom will still face quite larger capital pressures, and therefore it must issue the preferred stock in future;
- On the other hand, BoCom’s asset quality went down. In recent years, BoCom focused on expanding the loans to SMMEs, and the portion of the loans to total loans increased by 0.83ppts to 42.61% in 2013 from 41.78% in 2012, with the amount of RMB1.25 trillion, up 12.15%. However, the bad debts in excess capacity industries and SMMEs increased consistently under the downturn of the macroeconomic environment, especially in Zhejiang and Jiangshu Provinces, which caused the Group’s asset quality to deteriorate continually, the NPL ratio increased from 0.92% in 2012 to 1.05% in 2013, with the sharp growth of doubtful and loss loans. The coverage ratio cut from 250.68% to 213.65%, down 37.02ppts. 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 the short term;
- In all, the businesses of BoCom recorded the stable growth, but the profit growth continued to go down, we expect its net profit growth would maintain around 6-7% in 2014. However, BoCom’s dividend payout ratio still stays at the high level as 30%, based on 3-stage DDM, we maintain the Group’s 12-m target price to HK\$6.10 approximately, around 25% higher than the current price, equivalent to 5.5xP/E and 0.8xP/B in 2014E respectively, and upgrade to Buy rating.

Figure 1. Quarterly NIM and net interest spread of BoCom



Source: PSR, Company report

Figure 2. Structure of net fee and commission income of BoCom



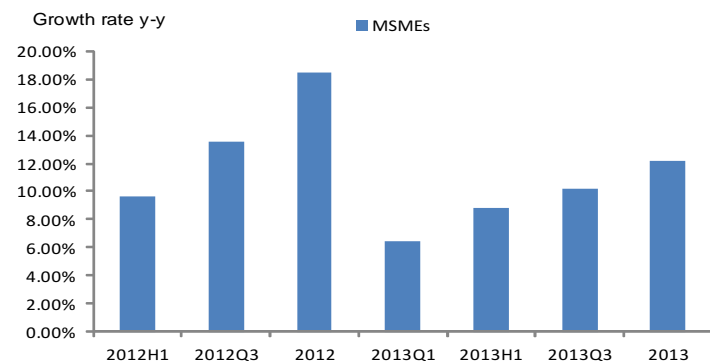
Source: PSR, Company report

Table 1. Estimated value (EV) and real value (RV) of BoCom’s operating performance

Balance Sheet (RMB Million)	2013E	2013A	RV / EV
Loans and advances to customers	3,167,591	3,193,063	0.80%
Total Assets	5,850,619	5,960,937	1.89%
Deposits from customers	4,119,895	4,157,833	0.92%
Total Liabilities	5,419,340	5,539,453	2.22%
Shareholders’ equity	429,333	419,561	-2.28%
Minority interest	1,946	1,923	-1.17%
Total shareholders’ equity	431,279	421,484	-2.27%
Total shareholders’ equity and liabilities	5,850,619	5,960,937	1.89%
BVPS (RMB)	5.78	5.65	-2.28%
Income Statement (RMB Million)	2013E	2013A	
Net interest income	129,746	130,658	0.70%
Net fee and commission income	25,253	25,968	2.83%
Operating income	164,231	165,028	0.49%
Operating profit before impairment losses	101,918	98,277	-3.57%
Impairment losses	(18,898)	(18,410)	-2.58%
Profit before tax	83,035	79,909	-3.76%
Net profit for the period	64,286	62,461	-2.84%
Minority interest	165	166	0.73%
Net profit attributable to equity holders of the Bank	64,121	62,295	-2.85%
EPS (RMB)	0.86	0.84	-2.84%
Financial ratio	2013E	2013A	RV-EV (ppts)
Net interest spread	2.34%	2.33%	(0.01)
Net interest margin	2.50%	2.52%	0.02
Loan to deposit ratio	72.89%	79.17%	6.29
Cost-to-income ratio	28.31%	29.68%	1.37
Return on average assets	1.15%	1.11%	(0.04)
Return on average equity	15.85%	15.58%	(0.27)
Non-performing loan ratio	1.05%	1.05%	(0.00)
Provision coverage of impaired loans	218.39%	213.65%	(4.73)
Allowances for impairment losses to total loans	2.30%	2.24%	(0.06)

Source: PSR, Company report

Figure 3. Growth of MSMEs of BoCom



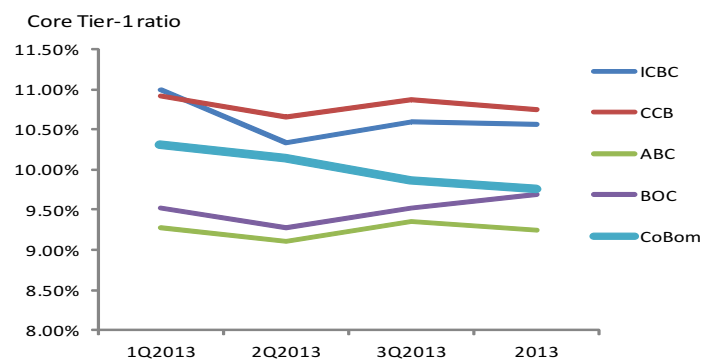
Source: PSR, Company report

Table 2. The structure of BoCom's loans in 2013

Proportion of industry (%)	2012A	2013A	Changes (ppt)
Mining	2.44	2.82	0.38
Manufacturing	19.82	19.31	-0.51
Electricity, gas and water production and supply	4.49	4.07	-0.42
Construction	3.16	3.25	0.09
Transportation, storage and postal service	12.34	11.84	-0.50
IT services and telecommunications	0.34	0.32	-0.02
Wholesale and retail	13.22	11.99	-1.23
Accommodation and catering	0.79	0.82	0.03
Financial institutions	0.80	1.00	0.20
Real estate	6.10	6.16	0.06
Services	6.25	6.33	0.08
Water conservancy, environment and other public services	4.66	4.00	-0.66
Education	1.28	1.51	0.23
Others	1.69	1.73	0.04
Discounted bills	2.20	1.85	-0.35
Total corporate loans	79.59	77.00	-2.59
Mortgage loans	12.16	14.03	1.87
Credit card advances	4.04	5.02	0.98
Medium-term and long-term working capital loans	1.87	1.79	-0.08
Short-term working capital loans	1.07	0.75	-0.32
Car loans	0.12	0.06	-0.06
Others	1.15	1.35	0.20
Total personal loans	20.41	23.00	2.59
Total loans	100.00	100.00	

Source: PSR, Company report

Figure 4. Core Tier-1 Ratio of the Big-5 (New method)



Source: PSR, Company report

Table 3. The breakdown of BoCom's five loan categories (stipulated by the Chinese banking regulatory authorities) in 2013

Loan quality analysis (RMB Million)	2012A	2013A	Growth rate y-y	Portion	Portion
Normal	2,851,980	3,173,011	11.26%	96.77%	97.14%
Special Mention	68,324	59,047	-13.58%	2.32%	1.81%
Substandard	13,269	13,778	3.84%	0.45%	0.42%
Doubtful	9,793	13,586	38.73%	0.33%	0.42%
Loss	3,933	6,946	76.61%	0.13%	0.21%
Total non-performing loans	26,995	34,310	27.10%	0.92%	1.05%
Total loans and advances to customers	2,947,299	3,266,368	10.83%	100.00%	100.00%
Asset quality ratios			Changes (ppt)		
Non-performing loan ratio	0.92%	1.05%	0.13		
Allowances for impairment losses to non-performing loans	250.68%	213.65%	-37.03		

Source: PSR, Company report

Table 4. 3-stage DDM of BoCom

High growth period	2014-2018
Growth rate	20%
Stable growth period	2019-2028
Growth rate	10%
Perpetuity growth period	2028 thereafter
Growth rate	5%
ROE	15.5%
Dividend payout ratio	30%
Cost of equity	15.00%
PV of the dividends for 2014 to 2028 (RMB)	4.02
PV of the terminal value of 2028 (RMB)	2.17
Total PV (RMB)	6.18
Estimated value after conversion (HK\$)	7.68
Target Price (HK\$)	6.14
2014 P/E (X)	5.5
2014 P/B (X)	0.8

Source: PSR, Company report

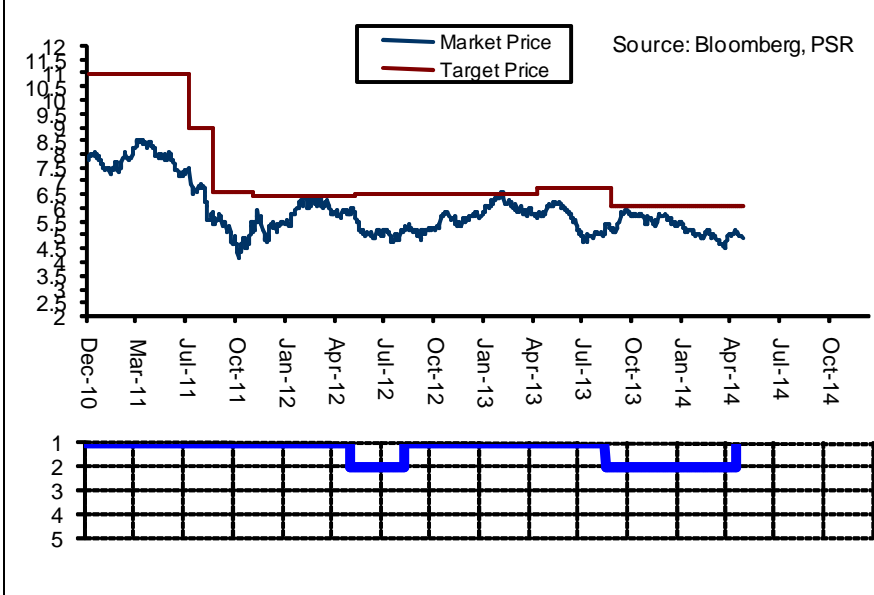
Financial Status

FYE	FY11	FY12	FY13	FY14F	FY15F
Valuation Ratios					
P/E (X)	4.8	4.4	4.7	4.4	4.1
P/B (X)	0.9	0.8	0.7	0.6	0.6
Dividend Payout ratio	13.31%	30.53%	30.99%	30.00%	30.00%
Dividend Yield	2.78%	6.11%	6.62%	6.83%	7.31%
Per share data (RMB)					
EPS, reported	0.82	0.88	0.84	0.89	0.96
EPS, adj.	0.82	0.88	0.84	0.89	0.96
DPS	0.11	0.24	0.26	0.27	0.29
BVPS	4.39	5.12	5.65	6.21	6.84
Growth					
Net interest income	20.7%	17.1%	8.8%	6.0%	4.9%
Net fee and commission income(exp.)	35.0%	6.8%	24.4%	25.1%	28.1%
Operating income	22.0%	16.0%	11.4%	10.4%	10.1%
Net Income, adj.	29.9%	15.1%	6.7%	6.7%	7.0%
Key Ratios					
Net interest spread	2.49%	2.43%	2.33%	2.36%	2.34%
Net interest margin	2.59%	2.59%	2.52%	2.47%	2.40%
Loan to deposit ratio	71.94%	73.23%	79.17%	72.38%	72.04%
Cost-to-income ratio	30.19%	29.85%	29.68%	30.58%	29.81%
Return on average assets	1.19%	1.18%	1.11%	1.05%	1.01%
Return on average equity	20.52%	17.91%	15.58%	15.09%	14.68%
Non-performing loan ratio	0.86%	0.92%	1.05%	1.12%	1.21%
Provision coverage of impaired loans	256.37%	250.68%	213.65%	215.02%	198.58%
Allowances for impairment losses to total loans	2.20%	2.30%	2.24%	2.40%	2.40%
Core capital adequacy ratio	9.27%	11.24%	9.76%	10.15%	10.70%
Capital adequacy ratio	12.44%	14.07%	12.08%	12.45%	12.90%
Income Statement (RMB mn)					
Net interest income	102,601	120,126	130,658	138,457	145,307
Net fee and commission income	19,549	20,882	25,968	32,475	41,602
Other incomes	5,645	7,176	8,402	11,322	13,833
Operating income	127,795	148,184	165,028	182,254	200,742
Operating expenses	(49,372)	(57,805)	(65,578)	(72,136)	(77,907)
Insurance business expense	(491)	(630)	(1,173)	(1,760)	(2,463)
Operating profit before impairment losses	77,932	89,749	98,277	108,359	120,372
Impairment losses	(12,479)	(14,537)	(18,410)	(23,013)	(28,766)
Operating profit	65,453	75,212	79,867	85,346	91,607
Shares of P/L of Jonit controlled Entities	(2)	4	42	20	25
Profit before tax	65,451	75,216	79,909	85,366	91,632
Income tax	(14,634)	(16,740)	(17,448)	(18,669)	(20,163)
Effective income tax rate	22.36%	22.26%	21.83%	21.87%	22.00%
Net profit for the period	50,817	58,476	62,461	66,697	71,469
Minority interest	82	103	166	249	349
Net profit attributable to equity holders of tf	50,735	58,373	62,295	66,448	71,120
Dividend	6,751	17,823	19,308	19,934	21,336
Balance Sheet (RMB mn)					
Cash and balances w ith banks and other financia	443,240	520,963	566,429	600,415	642,444
Balances w ith central bank	736,999	816,846	896,556	950,349	1,016,874
Financial assets held for trading	48,422	52,161	73,310	98,969	113,814
Loans and advances to customers	2,505,385	2,879,628	3,193,063	3,525,142	3,877,656
Investments	757,109	833,618	1,011,594	1,203,797	1,381,959
Fixed assets	37,017	45,536	57,179	69,187	80,326
Deferred tax assets	7,926	12,501	17,224	21,530	26,913
Other assets	75,079	112,126	145,582	189,257	229,000
Total Assets	4,611,177	5,273,379	5,960,937	6,658,644	7,368,984
Deposits and placements from banks and other fir	854,499	942,989	1,126,563	1,261,751	1,375,308
Deposits from customers	3,283,232	3,728,412	4,157,833	4,615,195	5,099,790
Financial liabilities at fair value through profit or lo	18,921	23,060	28,640	35,800	45,466
Other liabilities	95,666	110,769	113,435	141,794	168,735
Current taxes	4,247	7,125	6,107	7,328	8,794
Deferred tax liabilities	21	5	18	24	34
Subordinated notes issued	81,803	79,572	106,857	133,571	160,286
Total Liabilities	4,338,389	4,891,932	5,539,453	6,195,463	6,858,412
Share capital	61,886	74,263	74,263	74,263	74,263
Reserves	209,916	305,655	345,298	386,669	433,583
Shareholders' equity	271,802	379,918	419,561	460,932	507,846
Minority interest	986	1,529	1,923	2,250	2,726
Total shareholders' equity	272,788	381,447	421,484	463,181	510,572
Total shareholders' equity and liabilities	4,611,177	5,273,379	5,960,937	6,658,644	7,368,984

Source: PSR

Note: There is no comparability between Core CAR before 2012 and Core Tier-1 Ratio after 2013 based on different calculation methods.

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

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