

18 November 2014

# Huishang Bank (3698.HK)

## Stable profit growth with the easing of capital pressure

HONG KONG | FINANCIAL | COMPANY RESULTS

Rating:

**Buy**

Upgraded to Buy

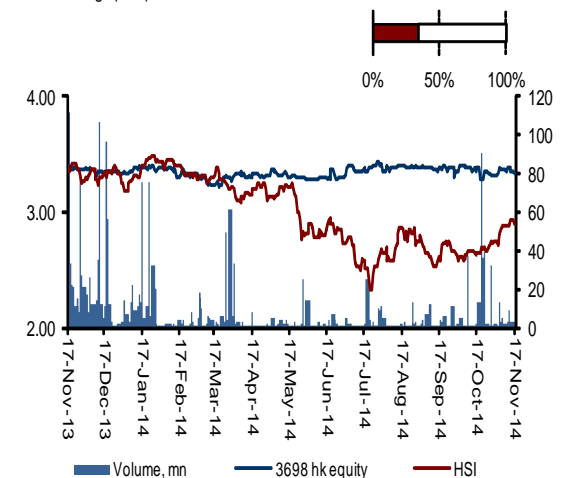
Target Price (HKD)	4.10
Forecast Dividend (HKD)	0.24
Closing Price (HKD)	3.34
Potential Upside	28.7%

### Company Description

Huishang Bank (HSB) was established in 2005 through a merger of all the city commercial banks and urban credit cooperatives in Anhui Province, and according to the asset scale, now it is the largest city commercial bank in Central China. As at the end of 2012, HSB ranked No. 4 in China by total loans and total deposits. It was also No. 7 city commercial bank in China according to total assets. On 13th Nov 2013, HSB was listed in H Shares, and became the second domestic city commercial bank listed in Hong Kong.

### Company Data

Raw Beta (Past 2yrs weekly data)	N/A
Market Cap. (HKD bn)	36,906.40
Enterprise Value (HKD mn)	N/A
52 week range (HKD)	3.18 - 3.64



### Major Shareholders

1.HKSCC Nominees	28.57%
2.Anhui Guoyuan Holding	7.19%
3.Anhui Energy Group	6.94%

### Valuation Method

P/E, P/B, DDM

### Analyst

Xingyu Chen  
[chenxingyu@phillip.com.cn](mailto:chenxingyu@phillip.com.cn)  
+86 21 51699400-105

- In recent years, HSB's profit growth rate is higher than the industry average. From 2009 to 2013, its operating income increased at a CAGR of 21.99% from RMB4.594 billion to RMB10.173 billion. As at the end of 1H2014, HSB's net profit was RMB2.839 billion, up 15.78% y-y, and we estimate HSB's net profit growth rate will go up slightly in 2014 with the amount of RMB5.771 billion, up 17.15% y-y, equivalent to the EPS of RMB0.52, which would be lower than RMB0.58 in 2013 due to the dilution of the increased capital after the IPO in 2013;
- By the end of 1H2014, HSB's net fee and commission incomes increased strongly by 59.73% y-y to RMB468 million, comparing with HRB's 62.37%, BOCQ's 24.00% and CRCB's 31.29%. The main reason of the strong growth was the sharp increase of custodian and bank card fees;
- HSB's assets increased strongly, as at the end of 1H2014, total assets increased by 15.93% to RMB442.966 billion compared with the end of 2013, and net assets grew 5.21% to RMB33.274 billion, with the BVPS of RMB3.01;
- One of the main reasons of large increase of assets is the significant growth of "Financial assets held under resale agreements" and "Investment securities classified as loans and receivables", which increased by 57.31% and 2160.08% to RMB57.848 billion and RMB16.363 billion respectively;
- In 1H2014, HSB's net loans increased by 8.33% to RMB207.222 billion compared with the end of 2013 while the deposits increased by 12.35%. The loan-to-deposit ratio dropped due to the larger growth of deposits, which decreased from 71.65% in 2013 to 69.10%;
- HSB owns quite good ability of risk control, and both ratio and the amount of the NPLs are much lower than the peers, but started to go up. As at the end of 1H2014, the Group's NPL ratios increased from 0.54% in 2013 to 0.67%, and the ratios of allowance for impairment losses to NPLs dropped from 396.67% to 323.30%;
- By the end of 1H2014, according to the new method, HSB's CAR and Core Tier-1 CAR were 14.68% and 12.43%, still maintained at the high level although they decreased slightly, and we believe the ratios will go down this year;
- According to 3-stage DDM and P/B method, we estimate the 12-m target price of HSB would be HK\$4.10, around 22.8% higher than the latest closing price, equivalent to 5.8xP/E and 0.9xP/B in 2015 respectively, the valuation is attractive and we upgraded it to Buy rating.

### How we view this

In all, HSB's performance maintained stable, especially for the strong growth of intermediate business incomes. The risks are under control although the asset quality trends to deteriorate in future.

### Investment Action

Under the current lower valuation of the bank, we estimate the 12-m target price of HSB would be HK\$4.10, around 22.8% higher than the latest closing price, equivalent to 5.8xP/E and 0.9xP/B in 2015 respectively, and the valuation is attractive.

**Key Financial Summary**

FYE	12/13	12/14F	12/15F	12/16F
Operating Profit (RMB mn)	6,351	7,476	7,910	8,266
Net Profit, adj. (RMB mn)	4,926	5,771	6,127	6,419
EPS, adj. (RMB)	0.58	0.52	0.55	0.58
P/E (X)	4.6	5.1	4.8	4.5
BVPS (RMB)	2.86	3.15	3.65	4.07
P/B (X)	0.9	0.8	0.7	0.6
DPS (RMB)	0.16	0.18	0.19	0.20
Div. Yield	5.9%	6.9%	7.3%	7.7%

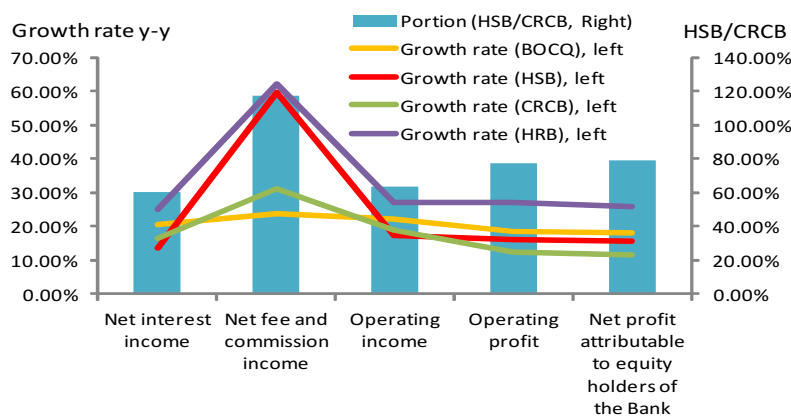
Source: Bloomberg, PSR est.

\*All multiples & yields based on current market price

RMB Million	2013H1	2014H1	Growth rate y-y	Note
Net interest income	4,724	5,361	13.48%	Stable growth of interest income
Net fee and commission income	293	468	59.73%	Large increase of custodian and bank card fee
<b>Operating income</b>	<b>5,118</b>	<b>6,000</b>	<b>17.23%</b>	
Operating expenses	(1,511)	(1,834)	21.38%	
Operating profit before impairment losses	3,607	4,166	15.50%	Strong growth of NPLs
Impairment losses	(424)	(474)	11.79%	
<b>Profit before tax</b>	<b>3,207</b>	<b>3,731</b>	<b>16.34%</b>	
Income tax	(754)	(890)	18.04%	
Profit for the year	2,452	2,840	15.82%	
<b>Net profit</b>	<b>2,452</b>	<b>2,839</b>	<b>15.78%</b>	

Source: PSR, the Company's report

**Fig 1. Profit growth of HSB, HRB, BOCQ and CRCB in 1H2014**



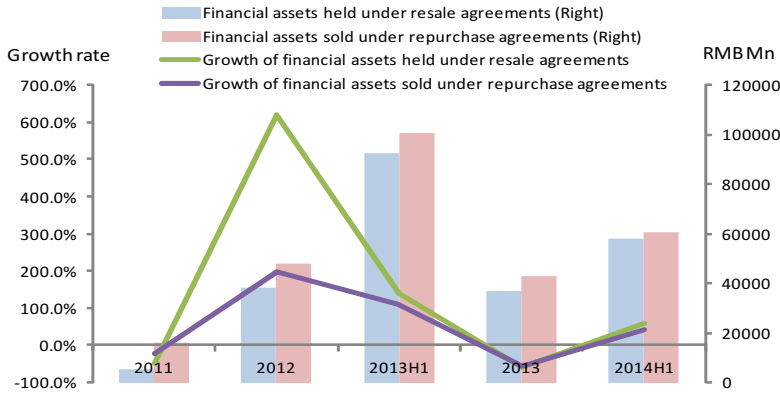
Source: PSR, Companies' reports

**Table 1. Growth of HSB's fee and commission income in 1H2014**

RMB Million	2013H1	2014H1	Preportion (2014H1)	Growth rate y-y
Consultancy and advisory fees	75	86	16.93%	14.67%
Custodian and other fiduciary service fees	55	189	37.20%	243.64%
Bank cards	48	70	13.78%	45.83%
Settlement and clearing fees	41	52	10.24%	26.83%
Guarantee and commitment services	34	23	4.53%	-32.35%
Agency commissions	15	14	2.76%	-6.67%
Others	61	74	14.57%	21.31%
<b>Fee and commission income</b>	<b>329</b>	<b>508</b>	<b>100.00%</b>	<b>54.41%</b>
Total expense	-36	-40		11.11%
<b>Net fee and commission income</b>	<b>293</b>	<b>468</b>		<b>59.73%</b>

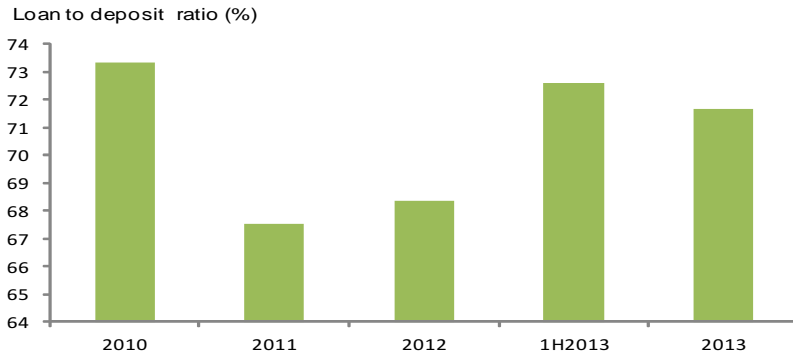
Source: PSR, Company report

**Fig 2. Growth of HSB's financial assets held under resale agreements and financial assets sold under repurchase agreements** Source: PSR, Company report



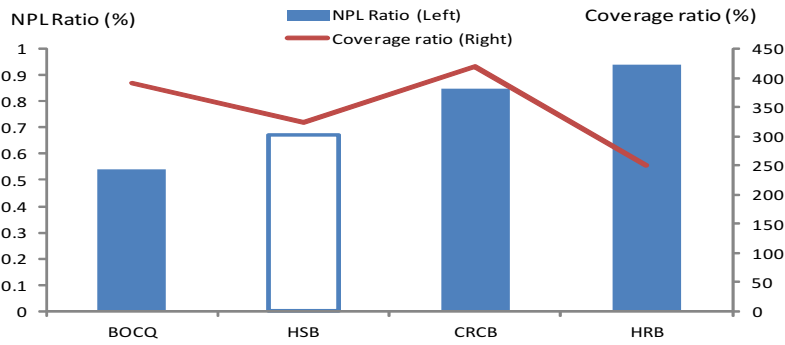
Source: PSR, Company's report

**Fig 3. Loan-to-deposit ratios of HSB**



Source: PSR, Company report

**Fig 4. NPL and coverage ratios of domestic listed city commercial banks in HK in 1H2014**



Source: PSR, Company report

**Fig 5. Change of HSB's NPL ratios**

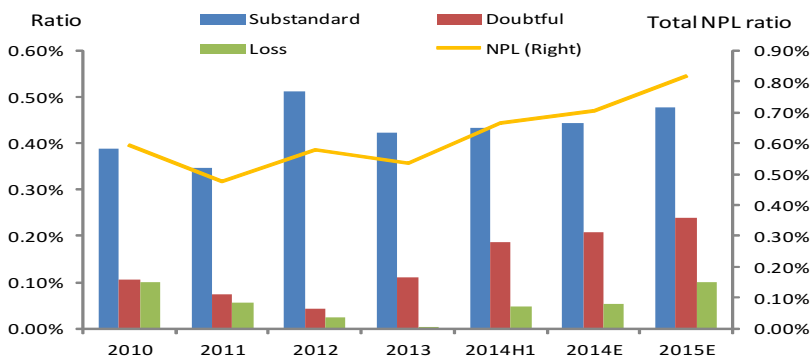
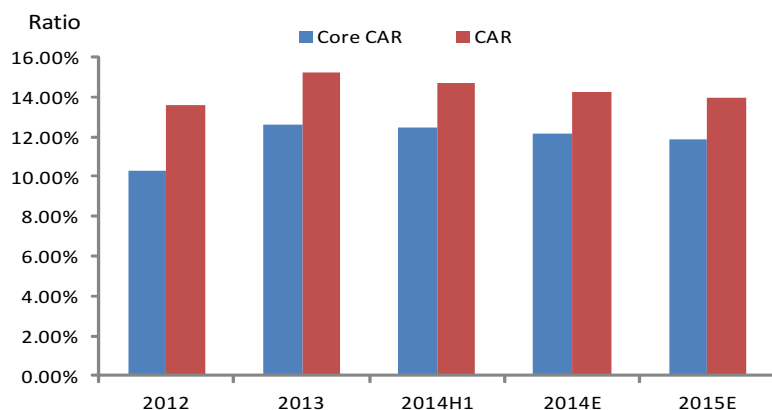


Fig 6. HSB's CAR and Core CAR



Source: PSR, Company report

Table 2. 3-stage DDM of HSB

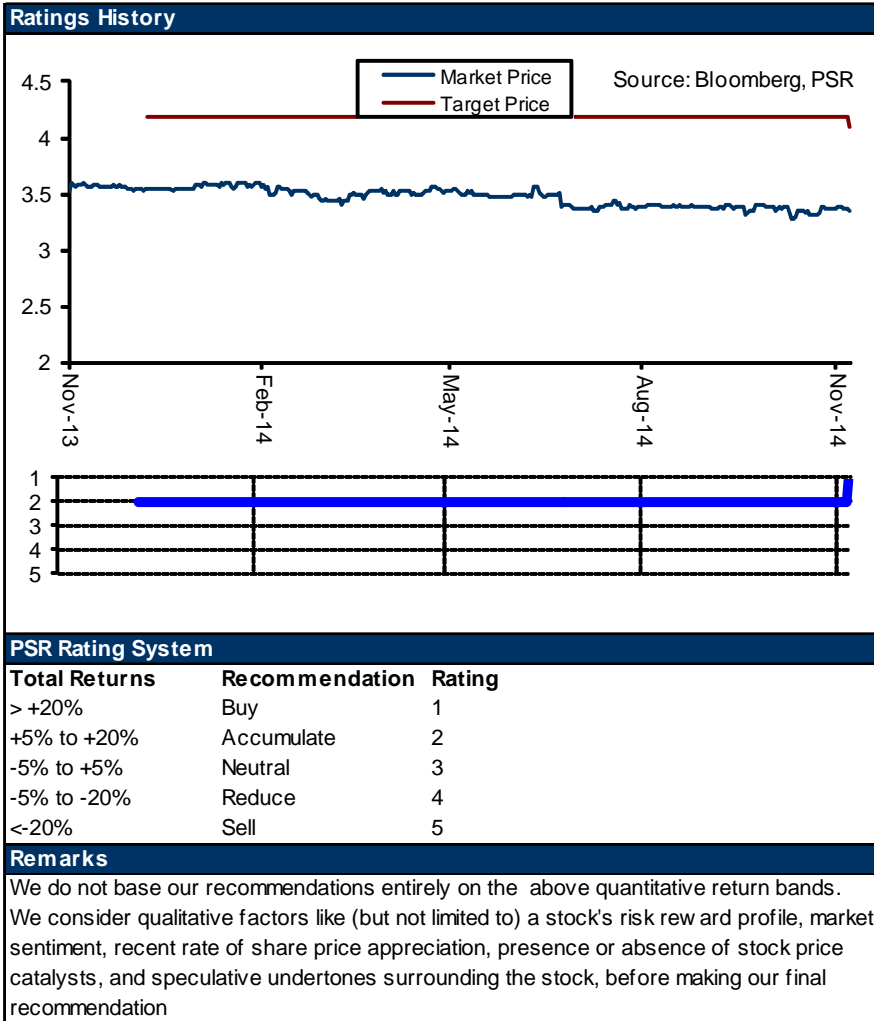
<b>High growth period</b>	<b>2014-2018</b>
Growth rate	20%
<b>Stable growth period</b>	<b>2019-2028</b>
Growth rate	10%
<b>Perpetuity growth period</b>	<b>2028 thereafter</b>
Growth rate	5%
ROE	15.50%
Dividend payout ratio	20.00%
Cost of equity	15.00%
PV of the dividends for 2013 to 2027 (RMB)	2.41
PV of the terminal value of 2027 (RMB)	1.30
Total PV (RMB)	3.71
<b>Estimated value after conversion (HK\$)</b>	<b>4.70</b>
<b>Target Price (HK\$)</b>	<b>4.70</b>
2015 P/E (X)	6.7
2015 P/B (X)	1.0

Source: PSR, Company report

For Financial Summary at the end of report

FYE	FY12	FY13	FY14F	FY15F	FY16F
<b>Valuation Ratios</b>					
P/E (X)	5.0	4.6	5.1	4.8	4.5
P/B (X)	1.1	0.9	0.8	0.7	0.6
Dividend Payout ratio	19.14%	27.05%	34.95%	34.90%	34.98%
Dividend Yield	3.82%	5.91%	6.91%	7.33%	7.70%
<b>Per share data (RMB)</b>					
EPS, reported	0.53	0.58	0.52	0.55	0.58
EPS, adj.	0.53	0.58	0.52	0.55	0.58
DPS	0.10	0.16	0.18	0.19	0.20
BVPS	2.51	2.86	3.15	3.65	4.07
<b>Growth</b>					
Net interest income	20.9%	12.1%	11.3%	6.3%	5.5%
Net fee and commission income(exp.)	-4.1%	36.4%	36.6%	30.0%	25.7%
Operating profit	23.5%	12.5%	17.7%	5.8%	4.5%
Net Income, adj.	23.3%	14.4%	17.2%	6.2%	4.8%
<b>Key Ratios</b>					
Net interest spread	2.88%	2.44%	2.35%	2.34%	2.31%
Net interest margin	3.03%	2.63%	2.60%	2.56%	2.50%
Loan to deposit ratio	68.38%	71.65%	71.58%	71.14%	70.26%
Cost-to-income ratio	33.90%	33.29%	28.78%	29.57%	30.29%
Return on average assets	1.48%	1.39%	1.34%	1.17%	1.05%
Return on average equity	22.93%	18.91%	17.36%	16.29%	15.04%
Non-performing loan ratio	0.58%	0.54%	0.71%	0.82%	0.98%
Provision coverage of impaired loans	406.11%	396.67%	350.69%	302.15%	251.52%
Core CAR	10.30%	12.60%	12.19%	11.84%	11.50%
CAR	13.54%	15.19%	14.25%	13.96%	13.57%
Total equity/total assets	6.32%	8.29%	7.27%	7.14%	6.87%
<b>Income Statement (RMB mn)</b>					
Net interest income	8,569	9,603	10,684	11,361	11,984
Net fee and commission income	396	540	737	959	1,205
<b>Operating income</b>	<b>9,235</b>	<b>10,173</b>	<b>11,724</b>	<b>12,698</b>	<b>13,663</b>
Operating expenses	(3,132)	(3,387)	(3,726)	(4,136)	(4,549)
Operating profit before impairment losses	6,103	6,786	7,998	8,562	9,114
Impairment losses	(458)	(435)	(522)	(653)	(848)
<b>Operating profit</b>	<b>5,645</b>	<b>6,351</b>	<b>7,476</b>	<b>7,910</b>	<b>8,266</b>
Investments in associates	35	48	60	70	80
Profit before tax	5,680	6,399	7,536	7,980	8,346
Income tax	(1,374)	(1,473)	(1,768)	(1,856)	(1,930)
Effective income tax rate	24.19%	23.02%	23.45%	23.26%	23.13%
Profit for the year	4,306	4,926	5,769	6,124	6,416
Minority interest	0	0	2	3	3
<b>Net profit attributable to equity holders of the Bank</b>	<b>4,306</b>	<b>4,926</b>	<b>5,771</b>	<b>6,127</b>	<b>6,419</b>
Declared and paid Dividends	824	1,724	2,017	2,138	2,245
<b>Balance Sheet (RMB mn)</b>					
Cash and balances w irh central bank	57,649	76,178	79,987	85,586	95,856
Deposits w ith banks and other financial institutions	3,834	11,000	26,400	33,000	44,550
Financial assets designated at fair value through profit or loss	3,599	1,805	1,823	1,860	1,897
Loans to customers, net	159,941	191,280	218,059	246,407	275,976
Investment securities	53,458	58,461	81,823	97,062	115,546
<b>Total assets</b>	<b>324,224</b>	<b>382,109</b>	<b>479,963</b>	<b>566,024</b>	<b>655,723</b>
Deposits and loans from banks and other financial institutions	6,863	18,970	36,043	52,262	67,941
Deposits from customers	239,543	272,798	312,354	355,146	402,736
<b>Total liabilities</b>	<b>303,743</b>	<b>350,437</b>	<b>445,069</b>	<b>525,588</b>	<b>610,691</b>
Equity attributable to equity holders	20,481	31,625	34,844	40,384	44,977
Total equity and liabilities	324,224	382,109	479,963	566,024	655,723

Source: PSR



**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

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

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**Contact Information (Regional Member Companies)**

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**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](http://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](http://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](http://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](http://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](http://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](http://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](http://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](http://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](http://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](http://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