

Agriculture Bank of China (1288.HK)

Profit Growth Slowed Down and the Valuation Becomes Attractive

9 October 2015

HONG KONG | BANKING | COMPANY NOTE

Summary

- Based on the 2015H1 earnings result reported by Agriculture Bank of China (ABC or the Group), ABC maintained a decrease trend of profit growth. As of June 2015, net profit attributable to shareholders increased slightly by 0.27% to RMB104.325 billion;
- The asset size of ABC maintained its high growth trend. As of 2015H1, total assets of the Group grew 9.30% from 2014 to RMB517.46 trillion. During the period, shareholders' net assets reached RMB1.12 trillion, equivalent to the BVPS of RMB3.20;
- The asset quality of the bank remains our major concern. As of June 2015, NPL ratio of the Group jumped by 0.29ppts from 2014 to 1.83%. However, NPL allowance coverage ratio dropped by 47.53ppts to 238.99%;
- The capital adequacy ratio (CAR) of ABC has delivered stable growth, as of June, the core Tier-1 CAR and CAR rose by 0.21ppts and 0.56ppts from 2014 to 9.30% and 10.02% respectively;
- Overall, ABC's profit growth slowed down, and its asset quality will continue to go down as well. We expect it will last in the next few years. However, considering the large operating network and the valuation of the share price becomes attractive after the sharp decrease recently, we believe now it is a good time to buy, increase our target price to HK\$4.00. It is higher than the latest closing price by 29% and equivalent to a prospective 2016 P/E of 5.7x and P/B of 0.9x respectively. We upgrade to a "BUY" rating. (Closing price as at Morning, 7 Oct 2015)

Profit Growth Went Down with Continuous Deterioration in Asset Quality

As of June 2015, net profit attributable to shareholders increased slightly by 0.27% to RMB104.325 billion. Regarding its operating income, ABC's net interest income grew only by 4.8% yoy to RMB219.493 billion while net fee and commission income decreased slightly by 0.43% yoy to RMB47.643 billion. ABC's intermediate business is weaker than other state-owned banks. However, its net gains on investment securities increased significantly by 31 times to RMB800 million benefited from the bull market in 1H, but we expect such incomes would go down obviously in 2H.

On the other hand, looking into the assets, C The asset size of ABC maintained its high growth trend. As of 2015H1, total assets of the Group grew 9.30% from 2014 to RMB517.46 trillion. During the period, shareholders' net assets reached RMB1.12 trillion, equivalent to the BVPS of RMB3.20.

The loan quality of the bank continued to go down, in line with our expectation. As of June 2015, NPL ratio of the Group jumped by 0.29ppts from 2014 to 1.83%. However, NPL allowance coverage ratio dropped by 47.53ppts to 238.99%. We expect that both NPL volume and ratio of CMB will continue to rise in the upcoming years. The NPL ratio might be over 2% this year, representing the poorer asset quality.

Buy (Upgrade)

CMP: HK\$ 3.09
(Closing price as at Morning, 7 Oct 2015)

TARGET: HK\$ 4.00 (+29%)

COMPANY DATA

O/S SHARES (MN) :	30,739
MARKET CAP (HK\$ MN) :	94,983
52 - WK HI/LO (HK\$) :	4.55/ 2.87

SHARE HOLDING PATTERN, %

MOF	42.23
Huijin	40.03
Citigroup Inc.	0.64

PRICE PERFORMANCE, %

	1MTH	3MTH	1YR
ABC	5.82	-19.95	-11.46
HSI	5.91	-12.54	-5.33

KEY FINANCIALS

Key Financial Summary

FYE	12/13	12/14	12/15F	12/16F
Operating Profit (RMB mn)	214,174	232,257	234,843	240,152
Net Profit, adj. (RMB mn)	166,315	179,461	181,529	185,771
EPS, adj. (RMB)	0.51	0.55	0.56	0.57
P/E (X)	4.9	4.6	4.5	4.4
BVPS (RMB)	2.60	3.05	3.39	3.82
P/B (X)	1.0	0.8	0.7	0.7
DPS (RMB)	0.18	0.18	0.20	0.20
Div. Yield	7.0%	7.2%	7.7%	7.9%

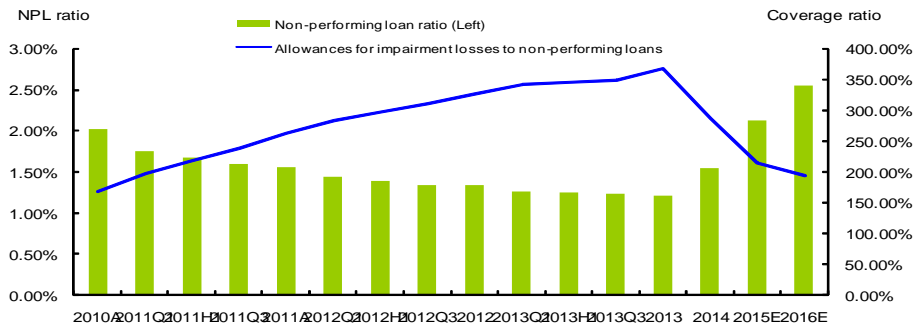
Source: Bloomberg, PSR est.

*All multiples & yields based on current market price

Source: Company reports, Phillip Securities Est.

Research Analyst
Xingyu CHEN
(+ 86 21 51699400-105)
chenxingyu@phillip.com.cn

NPL and coverage ratios of ABC



Source: Company, Phillip Securities (HK) Research

Risk

- Surge in NPL volume, worse than expected deterioration in asset quality;
- Slower than expected growth in Interest and non-interest income;
- Sharp share price correction amid volatile market in the short run.

FINANCIALS

FYE	FY12	FY13	FY14	FY15F	FY16F
Valuation Ratios					
P/E (X)	5.7	4.9	4.6	4.5	4.4
P/B (X)	1.1	1.0	0.8	0.7	0.7
Dividend Payout ratio	35.03%	34.57%	32.94%	35.00%	35.00%
Dividend Yield	6.2%	7.0%	7.2%	7.7%	7.9%
Per share data (RMB)					
EPS, reported	0.45	0.51	0.55	0.56	0.57
EPS, adj.	0.45	0.51	0.55	0.56	0.57
DPS	0.16	0.18	0.18	0.20	0.20
BV/PS	2.31	2.60	3.05	3.39	3.82
Growth					
Net interest income	11.3%	10.0%	14.3%	4.2%	3.6%
Net fee and commission income(exp.)	8.9%	11.1%	-3.7%	-5.4%	0.4%
Operating profit	18.8%	14.0%	8.4%	1.1%	2.3%
Net Income, adj.	19.0%	14.6%	7.9%	1.2%	2.3%
Key Ratios					
Net interest margin	2.84%	2.79%	2.93%	2.74%	2.68%
Cost to income ratio	36.56%	36.30%	34.56%	34.37%	33.97%
ROAA	1.16%	1.20%	1.18%	1.07%	0.98%
ROAE	20.74%	20.88%	19.57%	17.02%	15.85%
NPL ratio	1.33%	1.22%	1.54%	2.13%	2.54%
Allowances for impairment losses to total loans and advances to customers	4.35%	4.46%	4.42%	4.57%	4.94%
Coverage ratio	326.14%	367.04%	286.53%	214.41%	194.13%
Core CAR	9.67%	9.25%	9.09%	9.54%	9.87%
CAR	12.61%	11.86%	12.82%	13.12%	13.45%
Income Statement (RMB mn)					
	FY12	FY13	FY14	FY15F	FY16F
Interest income	566,063	613,384	699,289	755,232	808,098
Interest expense	(224,184)	(237,182)	(269,398)	(307,114)	(343,967)
Net interest income	341,879	376,202	429,891	448,118	464,131
Net fee and commission income	74,844	83,171	80,123	75,832	76,163
Other income	8,241	6,398	14,112	12,878	13,592
Operating income	424,964	465,771	524,126	536,828	553,886
Operating expenses	(182,802)	(198,607)	(223,898)	(230,615)	(235,227)
Operating profit before impairment losses	242,162	267,164	300,228	306,213	318,659
Impairment losses	(54,235)	(52,990)	(67,971)	(71,370)	(78,507)
Operating profit	187,927	214,174	232,257	234,843	240,152
Shares of P/L of Jonit controlled Entities	0	0	0	0	0
Profit before tax	187,927	214,174	232,257	234,843	240,152
Income tax	(42,796)	(47,963)	(52,747)	(53,274)	(54,340)
Effective income tax rate	22.77%	22.39%	22.71%	22.69%	22.63%
Profit for the period	145,131	166,211	179,510	181,569	185,812
Minority interest	37	(104)	49	40	41
Net profit attributable to equity holders of the Bank	145,094	166,315	179,461	181,529	185,771
Declared and paid Dividends	50,830	57,489	59,113	63,535	65,020
Balance Sheet (RMB mn)					
	FY12	FY13	FY14	FY15F	FY16F
Deposits with banks and other financial institutions	228,262	397,678	572,805	859,208	1,031,049
Placements with banks and other financial institutions	165,021	308,655	407,062	305,297	311,402
Cash and balances with central banks	2,542,086	2,603,802	2,743,065	2,935,080	3,023,132
Financial assets held under resale agreements	898,726	737,052	509,418	738,656	886,387
Loans and advances to customers	6,153,411	6,902,522	7,739,996	8,675,703	9,517,437
Investments	2,672,893	2,897,216	3,160,970	3,669,865	4,201,971
Other assets	122,767	139,989	165,203	239,544	323,385
Total Assets	13,244,342	14,542,917	15,953,964	18,028,261	19,972,007
Deposits from banks and other financial Institutions	784,352	729,354	831,141	1,645,659	2,119,609
Borrowings from central bank	66	104	80,121	3,100	5,000
Placements from banks and other financial institutions	149,721	174,363	224,923	303,646	394,740
Due to customers	10,862,935	11,811,411	12,533,397	13,690,733	14,890,774
Financial liabilities designated as fair value through profit or loss	155,071	285,454	347,282	277,826	286,160
Financial assets sold under repurchase agreements	7,631	26,787	131,021	78,613	62,890
Debt securities issued	192,639	266,261	325,167	390,200	468,240
Other liabilities	495,629	709,277	815,720	773,334	807,608
Total Liabilities	12,492,988	13,717,565	14,941,533	16,945,296	18,748,886
Share capital	324,794	324,794	324,794	324,794	324,794
Capital reserve	98,773	98,773	98,773	98,773	98,773
Other reserve	117,760	176,059	237,566	282,536	343,152
Retained profits	208,488	243,482	329,989	395,987	475,184
Shareholders' equity	749,815	843,108	1,031,066	1,102,090	1,241,903
Minority interest	1,539	1,429	1,553	1,876	2,218
Total shareholders' equity	751,354	844,537	1,032,619	1,103,965	1,244,121
Total shareholders' equity and liabilities	13,244,342	14,562,102	15,974,152	18,049,261	19,993,007

Source: PSR

Source: Company, Phillip Securities (HK) Research Estimates

(Financial figures as at morning 7 October 2015)

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

GENERAL DISCLAIMER

This publication is prepared by Phillip Securities (Hong Kong) Ltd ("Phillip Securities"). By receiving or reading this publication, you agree to be bound by the terms and limitations set out below.

This publication shall not be reproduced in whole or in part, distributed or published by you for any purpose. Phillip Securities shall not be liable for any direct or consequential loss arising from any use of material contained in this publication.

The information contained in this publication has been obtained from public sources which Phillip Securities has no reason to believe are unreliable and any analysis, forecasts, projections, expectations and opinions (collectively the "Research") contained in this publication are based on such information and are expressions of belief only. Phillip Securities has not verified this information and no representation or warranty, express or implied, is made that such information or Research is accurate, complete or verified or should be relied upon as such. Any such information or Research contained in this publication is subject to change, and Phillip Securities shall not have any responsibility to maintain the information or Research made available or to supply any corrections, updates or releases in connection therewith. In no event will Phillip Securities be liable for any special, indirect, incidental or consequential damages which may be incurred from the use of the information or Research made available, even if it has been advised of the possibility of such damages.

Any opinions, forecasts, assumptions, estimates, valuations and prices contained in this material are as of the date indicated and are subject to change at any time without prior notice.

This material is intended for general circulation only and does not take into account the specific investment objectives, financial situation or particular needs of any particular person. The products mentioned in this material may not be suitable for all investors and a person receiving or reading this material should seek advice from a financial adviser regarding the suitability of such products, taking into account the specific investment objectives, financial situation or particular needs of that person, before making a commitment to invest in any of such products.

This publication should not be relied upon as authoritative without further being subject to the recipient's own independent verification and exercise of judgment. The fact that this publication has been made available constitutes neither a recommendation to enter into a particular transaction nor a representation that any product described in this material is suitable or appropriate for the recipient. Recipients should be aware that many of the products which may be described in this publication involve significant risks and may not be suitable for all investors, and that any decision to enter into transactions involving such products should not be made unless all such risks are understood and an independent determination has been made that such transactions would be appropriate. Any discussion of the risks contained herein with respect to any product should not be considered to be a disclosure of all risks or a complete discussion of such risks.

Nothing in this report shall be construed to be an offer or solicitation for the purchase or sale of a security. Any decision to purchase securities mentioned in this research should take into account existing public information, including any registered prospectus in respect of such security.

Disclosure of Interest

Analyst Disclosure: Neither the analyst(s) preparing this report nor his associate has any financial interest in or serves as an officer of the listed corporation covered in this report.

Firm's Disclosure: Phillip Securities does not have any investment banking relationship with the listed corporation covered in this report nor any financial interest of 1% or more of the market capitalization in the listed corporation. In addition, no executive staff of Phillip Securities serves as an officer of the listed corporation.

Availability

The information, tools and material presented herein are not directed, intended for distribution to or use by, any person or entity in any jurisdiction or country where such distribution, publication, availability or use would be contrary to the applicable law or regulation or which would subject Phillip Securities to any registration or licensing or other requirement, or penalty for contravention of such requirements within such jurisdiction.

Information contained herein is based on sources that Phillip Securities (Hong Kong) Limited ("PSHK") believed to be accurate. PSHK does not bear responsibility for any loss occasioned by reliance placed upon the contents hereof. PSHK (or its affiliates or employees) may have positions in relevant investment products. For details of different product's risks, please visit the Risk Disclosures Statement on <http://www.phillip.com.hk>.

© 2015 Phillip Securities (Hong Kong) Limited

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