

BoCom (3328.HK)

Operating performance met expectation

CHINA | BANKING | COMPANY REPORT

4 November 2015

Summary

- According to the 3Q2015 results released by Bank of Communication ("BoCom" or the "Group" in the following text) last Friday, as at the end of Sep 2015, the Group's net profit attributable to shareholders approximately amounted to RMB52.040 billion, up 1.01% yoy, in line with our previous expectation, equivalent to the EPS of RMB0.70. However, the growth rate of net profit is far slower than 3Q2014, which is mainly due to the significant increase of the Group's impairment of asset, increased by 19.4% yoy to RMB19.704 billion. On the other hand, BoCom's income from intermediate business still kept stable growth, and the net administration fee and commission incomes in the period under review increased approximately by 19.3% yoy to RMB27.428 billion;
- The asset quality of BoCom appeared to become worse in 3Q2015 continually. As at the end of Sep 2015, BoCom's NPL ratio climbed up from 1.25% in end of 2014 to 1.42%, with doubtful loan and loss loan particularly surged. The provision coverage ratio dropped from 178.88% in end of 2014, to 165.33%, down 13.55ppts. We believe the asset quality of BoCom will keep deteriorating, while the amount and ratio of NPLs will keep growing, and the NPL ratio would go up to 1.50% in 2015, the trend meets our expectation;
- The level of capital adequacy ratio of BoCom maintained stable, although it was still lower than the end of 2014, it increased compared with that of 2Q. As at the end of Sep 2015, the core tier-one CAR and CAR dropped 0.33 ppts and 0.74 ppts respectively compared to end of 2014, reaching 10.97% and 13.30%;
- In all, BoCom has steady development on its business, with profit growth slowing down, met our expectation. Considering the development of the market environment in 4Q, we expect its net profit growth in 2015 would be around 1%. In addition, BoCom's dividend payout ratio still stays at the level of 30%, based on 3-stage dividend discount model, to reflect the upcoming market risk, and we maintain the Group's 12-month target price to HK\$7.00, which is around 24% higher than the latest closing price, equivalent to 6.3xEPS and 0.8xBVPS in 2016E respectively. The valuation is still attractive, and we maintain "Buy" rating. (Closing price as at 2 Nov 2015)

Profit growth will slow down in 2015

As at the end of 3Q2015, the Group's net profit attributable to shareholders approximately amounted to RMB52.040 billion, up 1.01% yoy, in line with our previous expectation, equivalent to the EPS of RMB0.70. However, the growth rate of net profit is far slower than 3Q2014, which is mainly due to the significant increase of the Group's impairment of asset, increased by 19.4% yoy to RMB19.704 billion.

On the other hand, BoCom's income from intermediate business still kept stable growth and the net administration fee and commission incomes in the period under review increased approximately by 19.3% yoy to RMB27.428 billion. Among these, incomes from investment banking business and management fees and commission surged 26.97% and 47.28% respectively, reaching RMB5.847 billion and RMB7.526 billion respectively. Income from bank card fees also recorded an increase of 5.12% yoy to RMB8.321 billion.

Although the market has undergone severe volatility since mid-June 2015, we expect the market situation would be better in 4Q2015, Therefore, BoCom's income from interest margin and intermediate business would keep stable growth throughout the whole year. However, the increase of operating expenses, in particular the surge of impairment of asset, caused a consistent decline in the Group's net profit growth rate, which kept at around 1%, approximately amounted to RMB67 billion.

Buy (Maintain)

CMP: HK\$ 5.65

(Closing price as at 2 Nov 2015)

TARGET: HK\$ 7.00 (+24%)

COMPANY DATA

O/S SHARES (MN) :	35,012
MARKET CAP (HK\$ MN) :	197,817
52 - WK HI/LO (HK\$) :	8.61/ 5.17

SHARE HOLDING PATTERN, %

MOF:	26.53
HKSCC Nominees	20.12
HSBC	18.70

PRICE PERFORMANCE, %

	1MTH	3MTH	1YR
BoCom	3.29	-16.91	-2.75
HSI	4.02	-8.36	-6.78

KEY FINANCIALS

Key Financial Summary

FYE	12/13	12/14	12/15F	12/16F
Operating Profit (RMB mn)	79,867	84,837	85,812	86,689
Net Profit, adj. (RMB mn)	62,295	65,850	66,537	67,050
EPS, adj. (RMB)	0.84	0.89	0.90	0.90
PE (X)	5.5	5.2	5.2	5.1
BVPS (RMB)	5.65	6.34	6.89	7.43
PB (X)	0.8	0.7	0.7	0.6
DPS (RMB)	0.26	0.27	0.27	0.27
Div. Yield	6.7%	6.2%	5.8%	5.9%

Source: Bloomberg, PSR est.

*All multiples & yields based on current market price

Source: Company reports, Phillip Securities Est.

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It is worth to note that, as our previous estimation, with respect to the continued growth of NPL, we expect BoCom's impairment provision would still significantly increase if the Group's profit growth rate still maintain at a low level. Therefore, there is the risk for the Group's profit growth rate changing from positive to negative in 2015Q4 or the next year.

The growth of BoCom's commission fees by the end of 3Q2015

RMB Million	2015Q3	2014Q3	growth rate y-y
			2015Q3
Settlement fees	2,254	2,453	-8.11%
Bank card fees	8,321	7,916	5.12%
Guarantee and commitment commission income	2,607	3,182	-18.07%
Management income	7,526	5,110	47.28%
Investment banking income	5,847	4,605	26.97%
agency fees	2,763	1,412	95.68%
Others	585	719	-18.64%

Source: Company, Phillip Securities (HK) Research

Asset quality keeps deteriorating

The asset of BoCom keeps stable growth. The Group's total asset recorded as at end of Sep 2015 increased nearly 14.97% compared to end of 2014, to RMB7.21 trillion; while net asset growth reached around 10.76%, to RMB519.011 billion, representing BVPS amounted to RMB6.79.

The asset quality of BoCom appeared to become worse in 3Q2015 continually. As at the end of Sep 2015, the Group's NPL ratio climbed up from 1.25% in end of 2014 to 1.42%, with doubtful loan and loss loan particularly surged. The provision coverage ratio dropped from 178.88% in end of 2014, to 165.33%, down 13.55ppts. We believe the asset quality of BoCom will keep deteriorating, while the amount and ratio of NPLs will keep growing, and the NPL ratio would go up to 1.50% in 2015, there is higher risk for BoCom to face the deterioration of asset quality in the future.

We believe the ratio and amount of NPLs of BoCom would keep growing in the near future, and the NPL ratio would go up to 1.47% in 2015, such trend meets our expectation.

The breakdown of BoCom's five loan categories (stipulated by the Chinese banking regulatory authorities) in 3Q2015

Loan quality analysis (RMB Million)	2014A	2015Q3	Growth rate	Portion (2014)	Portion (2015Q3)
Normal	3,296,815	3,558,283	7.93%	96.07%	95.47%
Special Mention	91,903	115,972	26.19%	2.68%	3.11%
Substandard	16,103	18,758	16.49%	0.47%	0.50%
Doubtful	18,680	23,421	25.38%	0.54%	0.63%
Loss	8,234	10,696	29.90%	0.24%	0.29%
Total non-performing loans	43,017	52,875	22.92%	1.25%	1.42%
Total loans and advances to customers	3,431,735	3,727,130	8.61%	100.00%	100.00%
Asset quality ratios			Changes (ppt)		
Non-performing loan ratio	1.25%	1.42%	0.17		
Allowances for impairment losses to non-performing loans	178.88%	165.33%	-13.55		

Source: Company, Phillip Securities (HK) Research

Risk

Lower-than-expected growth rate of income;

Worse-than-expected asset quality due to consistent growth of the amount of NPLs;

Increase in capital pressure continually;

Large short-term decline in stock price due to market volatility.

FINANCIALS

FYE	FY12	FY13	FY14	FY15F	FY16F
Valuation Ratios					
P/E (X)	5.2	5.5	5.2	5.2	5.1
P/B (X)	0.9	0.8	0.7	0.7	0.6
Dividend Payout ratio	30.53%	30.99%	30.45%	30.00%	30.00%
Dividend Yield	5.19%	6.66%	6.21%	5.82%	5.86%
Per share data (RMB)					
EPS, reported	0.88	0.84	0.89	0.90	0.90
EPS, adj.	0.88	0.84	0.89	0.90	0.90
DPS	0.24	0.26	0.27	0.27	0.27
BVPS	5.12	5.65	6.34	6.89	7.43
Growth					
Net interest income	17.1%	8.8%	3.2%	4.3%	4.6%
Net fee and commission income(exp.)	6.8%	24.4%	14.0%	12.3%	9.8%
Operating income	16.0%	11.4%	8.2%	4.8%	6.2%
Net Income, adj.	15.1%	6.7%	5.7%	1.0%	0.8%
Key Ratios					
Net interest spread	2.43%	2.33%	2.17%	2.09%	2.15%
Net interest margin	2.59%	2.52%	2.36%	2.28%	2.34%
Loan to deposit ratio	73.23%	79.17%	79.25%	77.02%	76.30%
Cost-to-income ratio	29.85%	29.68%	30.52%	29.56%	29.15%
Return on average assets	1.18%	1.11%	1.08%	0.98%	0.86%
Return on average equity	17.91%	15.58%	14.79%	13.34%	12.26%
Non-performing loan ratio	0.92%	1.05%	1.25%	1.48%	1.73%
Provision coverage of impaired loans	250.68%	213.65%	178.88%	162.06%	138.39%
Allowances for impairment losses to total loans	2.30%	2.24%	2.34%	2.40%	2.40%
Core capital adequacy ratio	11.24%	9.76%	11.30%	11.31%	11.32%
Capital adequacy ratio	14.07%	12.08%	14.04%	13.98%	14.10%
Income Statement (RMB mn)					
	FY12	FY13	FY14	FY15F	FY16F
Net interest income	120,126	130,658	134,776	140,521	146,994
Net fee and commission income	20,882	25,968	29,604	33,256	36,509
Other incomes	7,176	8,402	14,156	13,307	15,092
Operating income	148,184	165,028	178,536	187,084	198,594
Operating expenses	(57,805)	(65,578)	(70,732)	(72,147)	(75,754)
Insurance business expense	(630)	(1,173)	(2,528)	(4,803)	(6,965)
Operating profit before impairment losses	89,749	98,277	105,276	110,134	115,876
Impairment losses	(14,537)	(18,410)	(20,439)	(24,322)	(29,187)
Operating profit	75,212	79,867	84,837	85,812	86,689
Shares of P/L of Jonit controlled Entities	4	42	90	65	135
Profit before tax	75,216	79,909	84,927	85,877	86,824
Income tax	(16,740)	(17,448)	(18,892)	(19,081)	(19,463)
Effective income tax rate	22.26%	21.83%	22.24%	22.22%	22.42%
Net profit for the period	58,476	62,461	66,035	66,796	67,361
Minority interest	103	166	185	259	311
Net profit attributable to equity holders of the Bank	58,373	62,295	65,850	66,537	67,050
Dividend	17,823	19,308	20,051	19,961	20,115
Balance Sheet (RMB mn)					
	FY12	FY13	FY14	FY15F	FY16F
Cash and balances with banks and other financial institutions	520,963	566,429	525,033	787,550	984,437
Balances with central bank	816,846	896,556	938,055	844,250	911,789
Financial assets held for trading	52,161	73,310	135,634	203,451	252,279
Loans and advances to customers	2,879,628	3,193,063	3,354,787	3,656,718	4,058,957
Investments	833,618	1,011,594	1,057,174	1,480,044	1,642,848
Fixed assets	45,536	57,179	69,767	87,209	101,162
Deferred tax assets	12,501	17,224	16,077	18,489	22,186
Other assets	112,126	145,582	171,772	231,892	252,762
Total Assets	5,273,379	5,960,937	6,268,299	7,309,601	8,226,422
Deposits and placements from banks and other financial institutions	942,989	1,126,563	1,408,275	1,718,096	1,960,347
Deposits from customers	3,728,412	4,157,833	4,029,668	4,513,228	5,054,816
Financial liabilities at fair value through profit or loss	23,060	28,640	38,580	106,095	122,009
Other liabilities	110,769	113,435	142,139	198,995	238,794
Current taxes	7,125	6,107	7,852	11,385	13,662
Deferred tax liabilities	5	18	32	130	150
Subordinated notes issued	79,572	106,857	168,148	231,708	266,464
Total Liabilities	4,891,932	5,539,453	5,794,694	6,779,637	7,656,242
Share capital	74,263	74,263	74,263	74,263	74,263
Reserves	305,655	345,298	396,792	452,561	492,485
Shareholders' equity	379,918	419,561	471,055	526,824	566,748
Minority interest	1,529	1,923	2,550	3,141	3,432
Total shareholders' equity	381,447	421,484	473,605	529,964	570,180
Total shareholders' equity and liabilities	5,273,379	5,960,937	6,268,299	7,309,601	8,226,422

Source: PSR

 Source: Company, Phillip Securities (HK) Research Estimates
 (Financial figures as at 2 November 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

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