

China Merchants Bank (3968.HK)

The asset quality continued to go down

HONG KONG | BANKING | COMPANY REPORT

16 March 2016

Summary

- Based on the 3Q2015 earnings result reported by China Merchants Bank (CMB / Group), CMB's profit growth slowed down. As of Sep 2015, net profit attributable to shareholders increased by 5.9% to RMB48.50 billion, equivalent to the EPS of RMB1.92;
- The asset size of CMB maintained the stable growth. As of 3Q2015, the total assets of the Group greatly grew by 10.37% from 2014 to RMB5.22 trillion. During the period, shareholders' net assets reached RMB348.962 billion, equivalent to the BVPS of RMB13.84, representing a 10.99% increase from 2014;
- The asset quality of the bank continued to go down. As of Sep 2015, NPL ratio of the Group jumped by 0.49ppts from 2014 to 1.6%, which was higher than our previous expectation. However, NPL allowance coverage ratio dropped by 37.95ppts to 195.47%;
- The capital adequacy ratio of CMB has been persistently lower than its peers, which means it still faces relatively higher fund-raising pressure. As of Sep, the core Tier 1 capital adequacy ratio and capital adequacy ratio of CMB rose by 0.45ppts and 0.40ppts from 2014 to 10.05% and 12.14% respectively. We expect that CMB will have higher funding needs in future;
- Overall speaking, CMB's profit growth slowed down, its asset quality and capital adequacy will continue to be the major operating risks in future. However, recently the regulators announced several good news, e.g. the expansion of ABS business, and we believe it has the positive impact on the bank's performance in future. Considering the low level of the price and valuation, we give the target price to HKD22.00. It is higher than the latest closing price by 38% and equivalent to a prospective 2016 P/E of 7.8x and P/B of 1.2x. We maintain a "BUY" rating. (Closing price as at 14 Mar 2016)

Buy (Maintain)

CMP: HK\$ 15.96
(Closing price as at 14 Mar 2016)
TARGET: HK\$ 22.00 (+38%)

COMPANY DATA

O/S SHARES (MN) :	4,591
MARKET CAP (HK\$ MN) :	73,271
52 - WK HI/LO (HK\$) :	26.85/ 12.72

SHARE HOLDING PATTERN, %

HKSCC Nominees Ltd	18.00
China Merchants Steam Navigation Company	12.54
Anbang Property & Casualty Insurance	10.72

PRICE PERFORMANCE, %

	1MTH	3MTH	1YR
CMB	24.30	-9.06	-12.60
HSI	11.55	-25.57	-14.22

KEY FINANCIALS

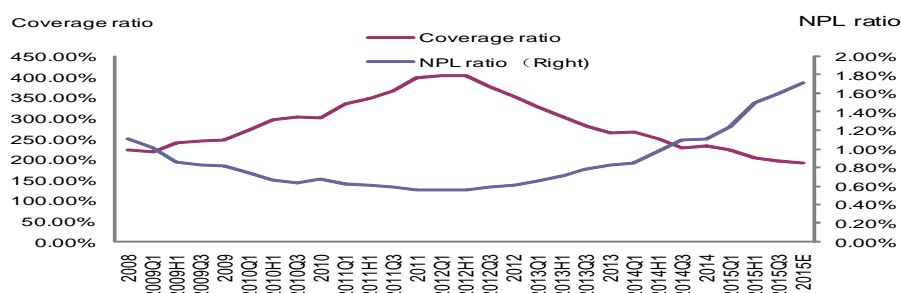
Key Financial Summary	12/13	12/14	12/15F	12/16F
FYE				
Operating Profit (RMB mn)	68,337	73,273	76,807	77,906
Net Profit, adj. (RMB mn)	51,743	55,911	58,603	59,588
EPS, adj. (RMB)	2.30	2.22	2.32	2.32
P/E (X)	5.8	6.0	5.7	5.8
BVPS (RMB)	10.53	12.47	14.21	15.78
P/B (X)	1.3	1.1	0.9	0.8
DPS (RMB)	0.62	0.67	0.70	0.70
Div. Yield	4.64%	4.98%	5.22%	5.22%

Source: Bloomberg, PSR est.

*All multiples & yields based on current market price

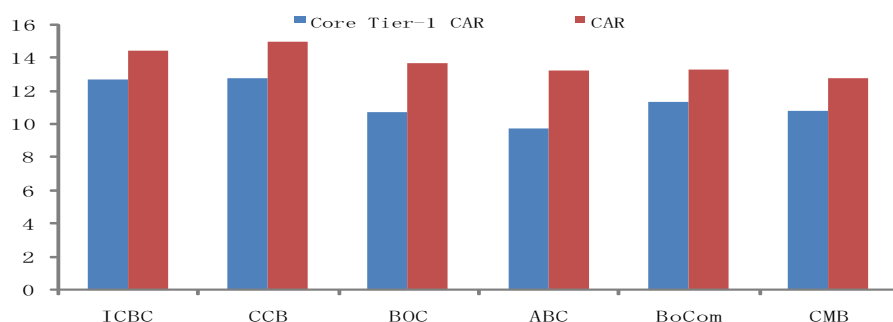
Source: Company reports, Phillip Securities Est.

NPL and coverage ratios of CMB



Source: Company, Phillip Securities (HK) Research

CARs of large-sized commercial banks



Source: Company, Phillip Securities (HK) Research

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

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

Balance Sheet (RMB Million)	2012A	2013A	2014A	2015E	2016E
Cash and balances with banks and other financial institutions	280,870	38,850	55,986	78,380	105,814
Balances with central bank	471,415	517,239	654,785	661,333	694,399
Placements with banks and other financial institutions	103,420	148,047	124,085	105,472	110,746
Loans and advances to customers	1,863,325	2,148,330	2,448,754	2,693,629	2,989,929
Investments	642,513	1,101,706	1,366,441	1,844,168	2,160,865
Other assets	8,722	9,604	14,091	17,614	21,137
Total Assets	3,408,099	4,016,399	4,731,829	5,495,825	6,206,940
Deposits from banks and other financial institutions	258,692	514,182	697,448	927,606	1,096,430
Placements from banks and other financial institutions	109,815	125,132	94,603	95,549	109,881
Deposits from customers	2,532,444	2,775,276	3,304,438	3,585,315	3,872,140
Other liabilities	26,471	38,028	39,678	92,847	106,773
Total Liabilities	3,207,698	3,750,443	4,416,769	5,136,469	5,800,922
Shareholder's equity	200,328	265,465	314,404	358,294	404,752
Minority interest	73	491	656	1,062	1,266
Total shareholders' equity	200,401	265,956	315,060	359,356	406,018
Total shareholders' equity and liabilities	3,408,099	4,016,399	4,731,829	5,495,825	6,206,940
Income Statement (RMB Million)	2012A	2013A	2014A	2015E	2016E
Net interest income	88,374	98,913	112,000	126,537	137,982
Net fee and commission income	19,739	29,184	44,696	65,286	92,092
Operating income	113,754	133,030	166,367	203,196	242,586
Operating expenses	(48,350)	(54,144)	(61,081)	(69,022)	(75,924)
Operating profit before impairment losses	65,083	78,555	104,954	133,832	166,296
Impairment losses	(5,583)	(10,218)	(31,681)	(57,026)	(88,390)
Operating profit	59,500	68,337	73,273	76,807	77,906
Profit before tax	59,564	68,425	73,431	77,009	78,208
Income tax	(14,287)	(16,683)	(17,382)	(18,251)	(18,434)
Effective income tax rate	23.99%	24.38%	23.67%	23.70%	23.57%
Profit before tax	45,277	51,742	56,049	58,758	59,774
Minority interest	4	(1)	138	155	186
Net profit attributable to equity holders of the Bank	45,273	51,743	55,911	58,603	59,588
Declared and paid Dividends	13,593	15,636	16,773	17,581	17,877
Items per share	2012A	2013A	2014A	2015E	2016E
Basic EPS(RMB)	2.10	2.30	2.22	2.32	2.32
Book value per share(RMB)	9.28	10.53	12.47	14.21	15.78
Dividend per Share(RMB)	0.63	0.62	0.67	0.70	0.70
Financial ratio	2012A	2013A	2014A	2015E	2016E
P/E(x)	6.4	5.8	6.0	5.7	5.8
P/B(x)	1.4	1.3	1.1	0.9	0.8
Dividend payout ratio	30.03%	30.22%	30.00%	30.00%	30.00%
Dividend Yield	4.72%	4.64%	4.98%	5.22%	5.22%
Net interest spread	2.87%	2.65%	2.45%	2.72%	2.93%
Net interest margin	3.03%	2.82%	2.64%	2.83%	3.14%
Loan to deposit	73.58%	77.41%	74.11%	75.13%	77.22%
Cost to income ratio	35.84%	34.23%	30.42%	21.28%	28.10%
ROAA	1.46%	1.39%	1.28%	1.15%	1.02%
ROAE	24.78%	22.22%	19.25%	17.38%	15.57%
NPL ratio	0.61%	0.83%	1.11%	1.72%	2.05%
Coverage ratio	351.79%	266.00%	233.42%	191.40%	176.09%
Core CAR	8.34%	9.27%	9.60%	9.98%	10.10%
CAR	11.41%	11.14%	11.74%	11.83%	12.16%

Source: Company, Phillip Securities (HK) Research Estimates
(Financial figures as at 14 March 2016)

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)

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