

China Merchants Bank (CMB, 3968 HK)

Optimizing business mix and FinTech to propel growth

- CMB's edge in retail banking has helped expand loan-deposit spread. Continuous optimization in business mix would improve NIM going forward
- Risk buffer was way above system average. We expect a stable NPL handling scale, which points to a mild increase in NPL ratio over 2019E-20E
- The Group is committed to FinTech investment; we believe additional value would be unleashed upon monetization of its technology platform
- The counter is currently trading at 1.27x 19E P/B. Reiterate **BUY** on sustainable high profitability and strong risk buffer

Optimization of business mix. Thanks to CMB's strength in retail business, retail loan mix increased from 53.36% in 2017 to 54.43% in 2018 while retail loan grew 12.66% YoY. To align with the government's direction, the proportion of micro finance in retail loans rose from 12.04% in 2017 to 17.03% in 2018. We expect CMB to further optimize its business mix, which in turn would widen both loan-deposit spread and NIM. We forecast NIM to expand by 4bps and 7bps YoY in 2019E and 2020E (2020E NIM: 2.68%). CMB's NIM expanded by 14bps YoY to 2.57% in 2018, which implied a better NIM in 4Q18 than the 1Q-3Q (9M18 NIM: 2.54%). Higher NIM in 2018 was driven by a widened loan-deposit spread (+ 14bps YoY to 368bps in 2018) and a reversal of interbank asset-liability spread from -3bps in 2017 to 24bps in 2018.

Sector-leading risk buffer amid uncertainty. CMB has been building up its risk buffer over the past quarters – provisioning ratio and provision coverage surged 66bps and 96.07ppt YoY to 4.88% and 358.18% as of Dec 2018, way above system average. Meanwhile, NPL ratio dropped by 25bps YoY to 1.36% through increased handling efforts, much lower than the system average at 1.83%. Given CMB's outstanding asset quality position, NPL handling scale is unlikely to increase further (total handling size in 2018: RMB 39.06bn). We estimate NPL ratio to inch up to 1.6% by end-2020E, with provisioning ratio and provision coverage lowered to 4.7% and 293.75% by end-2020E.

Long-term vision in FinTech. Total investment in technology amounted to RMB 6.5bn in 2018, equivalent to 2.78% of the bank's topline revenue (Fintech investment is equivalent to 1% of topline revenue in 2017). Management targets to increase the investment scale in technology to more than 3.5% of topline revenue in 2019. We believe when the FinTech platform start to monetize, additional corporate value will be unleashed. To be conservative, our base case assumption does not include potential financial impact from the FinTech platform. (Continue next page)

Results and Valuation

FY ended Dec 31	2016A	2017A	2018E	2019E	2020E
Revenue (RMB mn)	209,949	220,039	247,135	281,230	309,504
Chg (% YoY)	3.8	4.8	12.3	13.8	10.1
Net profit (RMB mn)	62,081	70,150	80,560	93,044	105,308
Chg (% YoY)	7.6	13.0	14.8	15.5	13.2
EPS (RMB)	2.46	2.78	3.13	3.69	4.18
Chg (% YoY)	7.6	13.0	12.5	17.9	13.2
BVPS (RMB)	15.95	19.04	20.07	24.20	26.84
Chg (% YoY)	11.5	19.4	5.4	20.6	10.9
P/E (x)	12.46	11.02	9.80	8.31	7.34
P/B (x)	1.92	1.61	1.53	1.27	1.14
ROAE (%)	16.27	16.54	16.57	16.16	16.36
ROAA (%)	1.09	1.15	1.24	1.32	1.39
DPS(RMB)	0.74	0.84	0.94	1.21	1.36
Yield (%)	2.41	2.74	3.07	3.94	4.43

Net profit = Net profits attributable to shareholders of the Company; HKD/CNY=1.1693

Source(s): Bloomberg, ABCI Securities estimates

Company Report

Mar 26, 2019

Rating: BUY

TP:HK\$ 41.50

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Share price (HK\$)	35.85
Est. share price return	15.76%
Est. dividend yield	3.94%
Est. total return	19.70%
Previous Rating & TP	BUY;HK\$41.5
Previous Report Date	Sep 20,2018

Source(s): Bloomberg, ABCI Securities

Key Data

52Wk H/L(HK\$)	38.9/26.4
Issued shares (mn)	25,219.8
H-share(mn)	4,590.9
A-shares (mn)	20,628.9
Market cap (HK\$ mn)	916,526
H-share(mn)	164,584
A-shares (mn)	751,942
3-mth avg daily turnover(HK\$ mn)	738.38
Major shareholder(s) (%):	
China Merchants Group	13.04
China Ocean Shipping	6.24

Source(s): Company, ABCI Securities

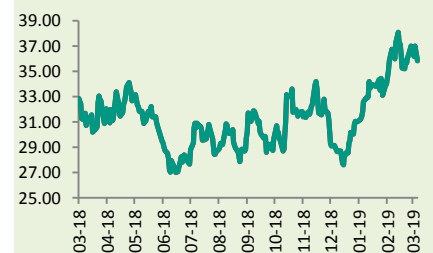
Share Performance (%)

	Absolute	Relative*
1-mth	0.00	1.03
3-mth	22.98	10.60
6-mth	15.46	11.31

*Relative to HSI

Source(s): Bloomberg, ABCI Securities

1-Year share performance(HK\$)



Source(s): Bloomberg, ABCI Securities



Maintain BUY on stellar profitability. The counter is currently trading at 1.27x 19E P/B, the sector's high-end range. Our GGM TP implies a target P/B of 1.49x. We reiterate **BUY** on its sustainably high profitability, above-peer ROAE (2018: 16.57%) and decent risk buffer.

Risk factors: 1) Increasing competition from non-bank financial institutions amid financial reform; 2) Sharp asset quality deterioration and weak loan demand; 3) New regulations affecting banks' operation and profitability; 4) Failure to monetize investment in technology platform.

Exhibit 1: CMB's 2018 actual results vs. ABCI estimates

(Rmb mn)	2018A	2018E	AvE (%)
Net interest income	160,384	158,425	1.24
Net fee and commission	66,480	74,271	(10.49)
Operating income	247,135	253,358	(2.46)
Operating expenses	(81,110)	(80,029)	1.35
Impairment losses	(60,837)	(66,832)	(8.97)
Profit before tax	106,497	107,645	(1.07)
Income tax expenses	(25,678)	(25,835)	(0.61)
Net profit	80,560	81,200	(0.79)
Key indicators (%)			AvE (ppt)
Net interest margin	2.57	2.54	0.03
Net interest spread	2.44	2.38	0.06
Cost to income ratio	31.04	31.59	(0.55)
Return on average assets	1.24	1.24	-
Return on average equity	16.57	15.90	0.67
Dividend payout	30.03	31.00	(0.97)
CT1 CAR	11.78	11.49	0.29
Total CAR	15.68	14.40	1.28
NPL ratio	1.36	1.45	(0.09)
Provision to total loans	4.88	4.60	0.28
Provision coverage	358.18	317.24	40.94

Source(s): Company, ABCI Securities estimates



Consolidated income statement (2016A-2020E)

FY Ended Dec 31 (RMB mn)	2016A	2017A	2018A	2019E	2020E
Net interest income	134,595	144,852	160,384	174,914	191,621
Non-interest income	75,354	75,187	86,751	106,315	117,883
Of which: Fees and commissions	60,865	64,018	66,480	84,619	95,103
Operating income	209,949	220,039	247,135	281,230	309,504
Operating expenses	(65,148)	(70,431)	(81,110)	(86,918)	(94,503)
Pre-provision operating profit	144,801	149,608	166,025	194,312	215,001
Impairment losses on loans	(66,159)	(59,926)	(60,837)	(72,202)	(76,701)
Operating profit	78,642	89,682	105,188	122,110	138,300
Non-operating income	321	998	1,309	1,320	1,518
Profit before tax	78,963	90,680	106,497	123,429	139,818
Tax	(16,583)	(20,042)	(25,678)	(29,623)	(33,556)
Minority interests	(299)	(488)	(259)	(763)	(953)
Net profit attributable to equity holders	62,081	70,150	80,560	93,044	105,308
Preference share dividend	0	0	1,651	1,611	1,611
Net profit attributable to ordinary shareholders	62,081	70,150	78,909	91,432	103,697
Growth (%)					
Net interest income	(2.2)	7.6	10.7	9.1	9.6
Of which: Fees and commissions	14.8	5.2	3.8	27.3	12.4
Operating income	3.8	4.8	12.3	13.8	10.1
Operating expenses	(4.1)	8.1	15.2	7.2	8.7
Pre-provision operating profit	7.9	3.3	11.0	17.0	10.6
Impairment losses on loans	11.6	(9.4)	1.5	18.7	6.2
Operating profit	4.9	14.0	17.3	16.1	13.3
Non-operating income	136.0	210.9	31.2	0.8	15.0
Profit before tax	5.2	14.8	17.4	15.9	13.3
Tax	(2.8)	20.9	28.1	15.4	13.3
Minority interests	(7.1)	63.2	(46.9)	194.4	25.0
Net profit attributable to equity holders	7.6	13.0	14.8	15.5	13.2
Preference share dividend	na	na	na	(2.4)	0.0
Net profit attributable to ordinary shareholders	7.6	13.0	12.5	15.9	13.4
Per share (RMB)					
EPS	2.46	2.78	3.13	3.69	4.18
BVPS	15.95	19.04	20.07	24.20	26.84
DPS	0.74	0.84	0.94	1.21	1.36
Key ratio (%)					
Net interest margin*	2.50	2.43	2.57	2.61	2.68
Net interest spread	2.37	2.29	2.44	2.48	2.57
Cost to income ratio	31.03	30.21	31.04	30.91	30.53
Return on average assets	1.09	1.15	1.24	1.32	1.39
Return on average equity	16.27	16.54	16.57	16.16	16.36
Effective tax rate	21.00	22.10	24.11	24.00	24.00
Dividend payout	30.06	30.20	30.03	31.00	31.00

Note1: Individual items may not sum to total due to rounding difference

Note 2: Key ratios may not match with financial reports due to adjustment for comparison consistency among individual equities

* Forecast calculation based on IFRS9 (excluding interest income from FVTPL financial assets)

Source(s): Company, ABCI Securities estimates



Consolidated balance sheet (2016A-2020E)

As of Dec 31 (RMB mn)	2016A	2017A	2018A	2019E	2020E
Cash & equivalent	703,523	702,646	600,180	588,342	548,098
Interbank assets	478,950	407,178	512,797	620,303	687,668
Investment securities	1,459,610	1,597,272	1,705,619	1,244,275	1,219,389
Net loans and advances	3,151,649	3,414,612	3,749,949	4,407,965	4,952,908
Total interest earning assets	5,793,732	6,121,708	6,568,545	6,860,885	7,408,064
Property and equipment	45,558	51,424	58,267	63,930	70,323
Other non-interest earning assets	103,021	124,506	118,917	378,687	394,566
Total assets	5,942,311	6,297,638	6,745,729	7,303,502	7,872,954
Customer deposits	3,802,049	4,064,345	4,427,566	4,952,488	5,411,168
Interbank liabilities	1,297,533	1,252,310	1,158,231	1,046,931	994,585
Subordinated debt	275,082	296,477	424,926	463,245	579,057
Total interest bearing liabilities	5,409,392	5,661,608	6,010,723	6,531,306	7,063,747
Current taxes	19,523	26,701	20,411	32,602	36,514
Deferred tax liabilities	897	1,070	1,211	1,070	1,070
Other liabilities	109,137	124,867	169,779	124,069	89,838
Total liabilities	5,538,949	5,814,246	6,202,124	6,689,048	7,191,169
Share capital	25,220	59,285	59,285	59,285	59,285
Reserves	377,130	420,925	480,833	550,961	617,660
Minorities	1,012	3,182	3,487	4,208	4,839
Shareholder's equity	403,362	483,392	543,605	614,455	681,784
Growth (%)					
Cash & equivalent	5.9	(0.1)	(14.6)	(2.0)	(6.8)
Interbank assets	(9.6)	(15.0)	25.9	21.0	10.9
Investment securities	1.5	9.4	6.8	(27.0)	(2.0)
Net loans and advances	15.0	8.3	9.8	17.5	12.4
Total interest earning assets	7.9	5.7	7.3	4.5	8.0
Property and equipment	35.8	12.9	13.3	9.7	10.0
Other non-interest earning assets	46.7	20.9	(4.5)	218.4	4.2
Total assets	8.5	6.0	7.1	8.3	7.8
Customer deposits	6.6	8.3	8.9	11.9	9.8
Due to other banks & FIs	9.4	7.8	(7.5)	(9.6)	25.0
Subordinated debt	8.4	4.7	43.3	9.0	8.2
Total interest bearing liabilities	8.4	4.7	6.2	8.7	8.2
Current taxes	52.3	36.8	(23.6)	59.7	12.0
Deferred tax liabilities	3.5	19.3	13.2	(11.6)	0.0
Other liabilities	(0.7)	14.4	36.0	(26.9)	(27.6)
Total liabilities	8.3	5.0	6.7	7.9	7.5
Share capital	0.0	135.1	0.0	0.0	0.0
Reserves	12.4	11.6	14.2	14.6	12.1
Minorities	6.3	214.4	9.6	20.7	15.0
Shareholder's equity	11.5	19.8	12.5	13.0	11.0
Key ratio (%)					
CT1 CAR	11.54	12.06	11.78	11.97	12.20
Total CAR	13.33	15.48	15.68	14.82	14.99
NPL ratio	1.87	1.61	1.36	1.52	1.60
Provision to total loans	3.37	4.22	4.88	4.65	4.70
Provision coverage ratio	180.02	262.11	358.18	305.92	293.75

Note1: Individual items may not sum to total due to rounding difference

Note2: Key ratios may not match with financial reports due to adjustment for comparison consistency among individual equities

Source(s): Company, ABCI Securities estimates

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Rating	Definition
Buy	Stock return rate \geq Market return rate (10%)
Hold	- Market return rate (-10%) \leq Stock return rate < Market return rate (+10%)
Sell	Stock return < - Market return (-10%)

Notes: Stock return rate: expected percentage change of share price plus gross dividend yield over the next 12 months
Market return rate: average market return rate since 2005 (HSI total return index 2005-17 CAGR at 10%)

Time horizon of share price target: 12-month

Stock rating, however, may vary from the stated framework due to factors including but not limited to: corporate governance, market capitalization, historical price volatility relative to corresponding benchmark index, average daily turnover of the stock relative to market capitalization of the stock, competitive advantages in corresponding industry, etc.

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