20 09 2017

Corporate Research

China Banks

Key Data	
Avg.17E P/E (x)	5.0
Avg.17E P/B (x)	0.74
Avg.17E Dividend Yield (%)	4.5

Source: Bloomberg

Share Price Performance (%)	
1-mth	-9.6
3-mth	-3.6
6-mth	-9.3

Source: Bloomberg

Stock information	
Stock code:	3618 HK
12-mth price target:	HK$4.60
Upside:	-9.0%

Source: CEBI

Marco Yau
Senior Analyst
marco.yau@cebi.com.hk
(852) 2916-9631

Lackluster interim

Downgrade due to credit and margin concern

Chongqing Rural Commercial Bank ("CRCB" 3618 HK) reported a disappointing interim. Although the bank managed to deliver inline profit growth, overdue ratio almost doubled and NPL ratio increased. CRCB also suffered a drastic QoQ NIM decline while large banks showed margin rebound. It seems to us that the asset problem in China is rotating from Eastern to Central/Western areas and CRCB is gradually losing its edge on margin under the deleveraging pressure. We lift the valuation discount in model and arrive at new TP of HK$4.60. Downgrade to Hold.

Sharp margin decline: CRCB delivered 10% YoY profit growth in 1H17, vs the 5% average of others under our coverage. But the bank's net interest income came 7% below our forecast as it faced 14bps QoQ NIM decline in 2Q, because of cheaper corporate loan pricing and increased reliance on expensive NCD. NIM was 2.59% in 1H17, 49bps above Big4, but much lower than the 73bps gap in 2015. That implies CRCB may be gradually losing its edge. ROE was 17.0%, vs 15.3-17.5% of Big4.

Asset quality concern: The bank is known for its low NPL ratio and comfortable coverage. But asset quality deteriorated fast in the first half. Overdue ratio jumped 1.4ppt to 2.90%, special mention ratio rose 8bps to 2.78%. NPL also added 1bp QoQ to 0.97%. Though the figures still look reasonable comparing with peers (Big4's overdue/SM/NPL ratio: 2.07/3.28/1.66%), it is weird as the industry actually showed an overall improvement. It may suggest a geographical rotation of asset problem.

Earnings dilution: CRCB announced share issuance plan in August to issue 7.5% additional shares to some existing domestic shareholders. Subscription price (Rmb5.75) is around 35% above the current stock price. And the bank's CET1 ratio will add 13bps to 9.79% according to our calculation. The bank is preparing for its A-share listing to issue another 14.6% additional shares too. The issuance will unavoidably lead to shareholders' interest dilution.

Downgrade to Hold: The investment story of CRCB was based on its higher margin but decent credit quality lending business, together with a faster growth in fee. But its interim results leads to concern over both credit and margin outlook. Its fee income also fell 2% in 1H17 vs around 40% growth over the past two years, suggesting the bank may have lost its driver in fee business under deleveraging. We raise the near-term valuation discount from 10% to 20% due to the tick up of asset risk and so the target price is cut to HK$4.60. Rating is down from Buy to Hold.

Lackluster interim

Disappointing interim

The investment story of CRCB was based on its higher margin but decent credit quality lending business, together with a faster growth in fee. But its disappointing interim results make us cautious about the story and raise our concern over its asset quality and margin outlook. Its fee income also fell 2% in 1H17 vs around 40% growth over the past two years, suggesting the bank may have lost its driver in fee business under deleveraging. We lift the valuation discount in model and arrive at new TP of HK$4.60. The stock is downgraded to Hold.

Sharp margin decline

14bps NIM decline in 2Q17, while large banks showed margin pick up

CRCB delivered an inline YoY profit growth of 10% in 1H17, vs the 5% average of others under our coverage. But the bank's net interest income came 7% below our forecast as it suffered from 14bps QoQ NIM decline in 2Q, because of cheaper corporate loan pricing and increased reliance on expensive certificate of deposit (CD).

Corporate lending yield fell significantly

Interest expense on debt increased due to issuance of CD

Fig. 1 Annualized yield of CRCB's lending and funding portfolio

Interest income	1H16	1H17
Loans and advances to customers		
Corporate loans	5.48%	4.91%
Discounted bills	3.13%	3.49%
Personal loans	5.79%	5.89%
Overseas		
Total	5.52%	5.17%
Deposits with central banks	1.56%	1.57%
Interbank	4.24%	3.88%
Investment securities	5.03%	4.86%
Total	4.71%	4.47%
Interest expense		
Deposits from customers		
Corporate		
Demand	0.63%	0.69%
Time	2.61%	2.38%
Total	1.03%	1.01%
Personal		
Demand	0.30%	0.30%
Time	2.50%	2.25%
Total	1.88%	1.72%
Others		
Total	1.65%	1.54%
Interbank	3.40%	3.35%
Debt and other liabilities	3.63%	3.75%
Total	2.01%	2.05%

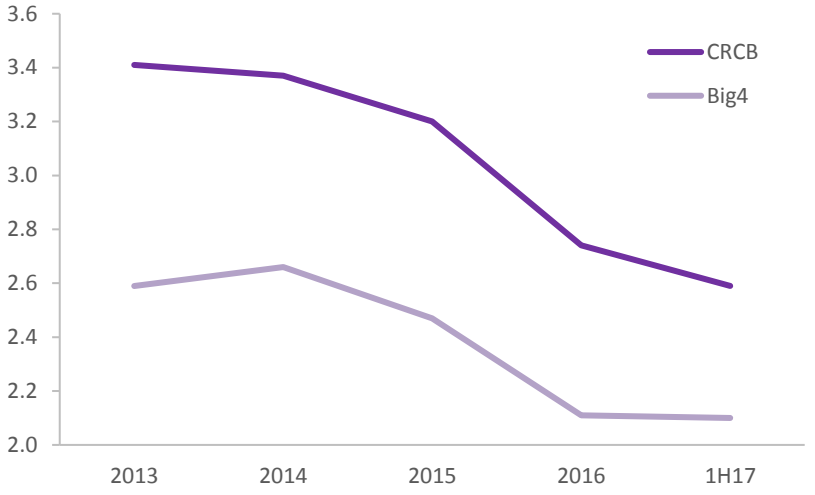
Source: Company, CEBI

NIM -14bps in 2Q17

Most of the large banks reported NIM expansion in 2Q17, BOC and ICBC even added 8bps QoQ. But CRCB's NIM came down to 2.59% in 1H17. Though it is still 49bps above the average of Big4, it's much lower than the 73bps gap in 2015. That implies CRCB may be gradually losing its edge on margin. ROE was 17.0%, vs 15.3-17.5% of Big4.

Gradually losing its edge on margin

Fig 2: NIM trend (%)



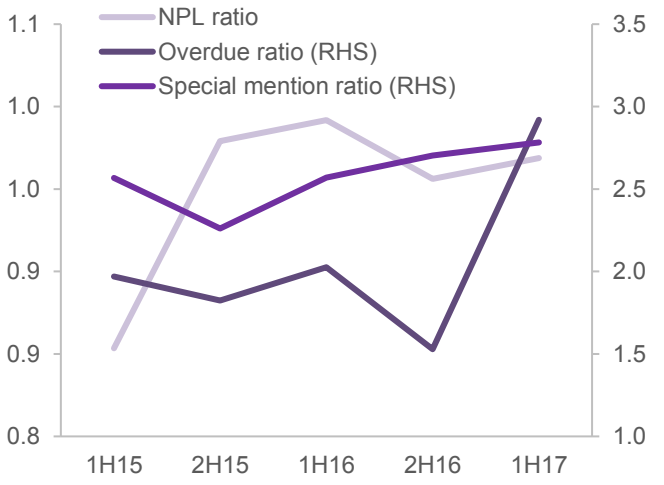
Source: Company, CEBI

Asset quality concern

Surge in overdue

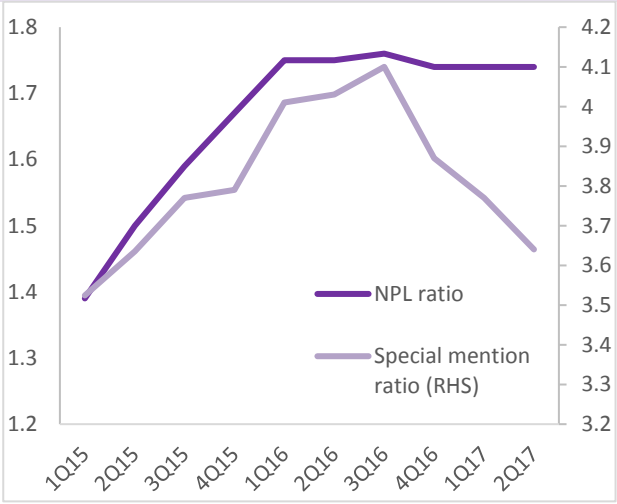
The bank is known for its low NPL ratio and comfortable coverage. But asset quality deteriorated fast in the first half. Overdue ratio jumped 1.4ppt to 2.90%, special mention ratio rose 8bps to 2.78%. NPL also added 1bp QoQ to 0.97%. The deterioration showed an opposite trend compared with large banks and industry overall figures.

Fig 3: CRCB's asset quality (%)



Source: Company, CEBI

Fig 4: Industry asset quality (%)



Source: CBRC, CEBI

Maybe a geographical rotation of asset problem

Though the figures still look reasonable comparing with peers (Big4's overdue/SM/NPL ratio: 2.07/3.28/1.66%), it is weird as the industry actually showed an overall improvement. It may suggest a geographical rotation of asset problem. If the conspiracy theory is true, asset risk may still tick up.

Earnings dilution

Share issuance plan

CRCB announced share issuance plan in August to issue 7.5% additional shares to some existing domestic shareholders. Subscription price (Rmb5.75) is around 35% above the current stock price. And the bank's CET1 ratio will add 13bps to 9.79% according to our calculation. But the issuance will unavoidably lead to shareholders' interest dilution.

Fig. 5 Capital adequacy ratio

(%)	1H17 Actual	After issuance (Pro-forma)
CET1	9.66	9.79
T1	9.68	9.80
Total	12.41	12.53

Source: Company, CEBI

Also preparing for A-share listing

Besides, the bank is also preparing for its A-share offering to issue another 14.6% additional shares. Interest will be further diluted after the A-share listing.

Prefer large banks to avoid negative surprise

Downgrade to Hold

When large banks are showing signs of recovery, we can't see the point staying with smaller lenders with similar valuation, but are still in asset quality problem and may even give further negative surprise. We raise the near-term valuation discount from 10% to 20% due to the tick up of asset risk and so the target price is cut to HK$4.60. Rating is down from Buy to Hold.

Fig. 6 Key financials

Key data	2016	1Q17	2Q17	1H17	2017E
EPS	0.85	0.26	0.23	0.49	0.91
BPS	5.66	5.92	5.97	5.97	6.12
DPS	0.20	NA	NA	0.00	0.20
Dividend payout	23.4%	NA	NA	0.0%	23.0%
Profit growth	10.0%	10.7%	9.3%	10.0%	10.6%
EPS growth	10.0%	10.7%	9.3%	10.0%	6.6%
ROE	16.0%	18.1%	15.7%	17.0%	15.4%
ROA	1.05%	1.21%	1.04%	1.12%	1.06%
Key drivers					
NIM	2.74%	2.66%	2.52%	2.59%	2.55%
Cost-to-income ratio	38.8%	32.0%	32.4%	32.2%	36.2%
LDR (estimated)	58.0%	56.1%	56.8%	56.8%	57.4%
Deposit growth	10.2%	7.4%	2.3%	9.9%	10.4%
Loan growth	11.9%	4.0%	3.6%	7.8%	9.3%
RWA growth	0.0%	3.6%	3.7%	0.0%	0.0%
NII growth	-3.8%	2.4%	7.6%	4.9%	8.3%
Fee growth	41.7%	-7.9%	4.4%	-1.9%	-0.7%
PPOP growth	3.9%	10.3%	12.7%	11.5%	11.4%
Asset quality					
Credit cost	0.83%	0.76%	0.85%	0.80%	0.89%
NPL increase (estimated)	1,567	118	147	560	1,009
NPL increase	243	0.96%	0.97%	264	363
NPL ratio	0.96%	4.06%	4.12%	0.97%	0.99%
Overdue ratio	1.53%	425%	425%	2.92%	3.08%
Special mention ratio	2.70%	0.76%	0.85%	2.78%	2.89%
LLR ratio	4.10%	118	147	4.12%	4.43%
Provision coverage	428.4%	0.96%	0.97%	425.1%	449.2%
Capital					
CAR					
Core tier 1	9.85%	9.92%	9.79%	9.79%	10.43%
Tier 1	9.86%	9.93%	9.80%	9.80%	10.45%
Total	12.70%	12.72%	12.53%	12.53%	13.13%
Asset/equity (x)	14.8	14.6	15.4	15.4	13.7

Source: Company, CEBI

Fig 7: Sector Valuation Summary

	TP	Rating	PE (x)		PB (x)		EPS growth (%)		ROE (%)		Yield (%)	
	(HK$)		2017E	2018E	2017E	2018E	2017E	2018E	2017E	2018E	2017E	2018E
ICBC	5.5	Hold	6.6	6.2	0.89	0.81	1.4	7.1	14.0	13.7	4.6	4.9
CCB	7.6	Buy	6.2	5.8	0.86	0.78	3.5	6.2	14.6	14.1	4.9	5.2
ABC	4.0	Hold	5.5	5.2	0.76	0.69	3.2	6.9	14.3	13.9	5.5	5.9
BOC	4.7	Buy	6.0	5.7	0.73	0.67	8.7	6.6	12.6	12.3	5.2	5.5
Bocom	5.1	Sell	5.7	5.4	0.62	0.57	0.7	4.9	11.3	11.0	5.5	5.7
CMB	26.7	Hold	9.1	8.3	1.40	1.24	10.3	10.1	16.1	15.8	3.3	3.6
CNCB	4.9	Hold	5.4	5.1	0.60	0.55	-0.9	5.2	11.6	11.2	4.8	5.0
Minsheng	7.5	Hold	5.1	4.8	0.67	0.61	2.0	5.7	13.9	13.2	4.3	4.5
CRCB	4.6	Hold	5.0	4.7	0.74	0.64	6.6	6.5	15.4	14.7	4.5	4.9

Source: CEBI

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Buy	**Expected return 10 % over the next twelve month**
Hold	**Expected return between -10% and 10% over the next twelve month**
Sell	**Expected return -10 % over the next twelve month**

Explanation of Stock Ratings: (i) Buy: A return potential of 10% or more relative to overall market within 6 – 12 months; (ii) Neutral: A return potential ranging from -10% to 10% relative to overall market within 6 – 12 months; and (iii) Sell: A negative return of 10% or more relative to overall market within 6 –12 months.

Explanation of Sector Ratings: (i) Overweight: The sector will outperform the overall market by 10% or higher within 6 –12 months; (ii) Neutral: The sector performance will range from -10% to 10% relative to overall market within 6 –12 months; and (iii) Underweight: The sector will underperform the overall market by 10% or lower within 6 – 12 months.(iv) Not Rated: No sector rating is given to the sector.

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