

China Banking Sector

Earnings negative mostly priced in, turning point looms

The overhang risk on China banks' earnings has largely materialized after CBIRC reported 9.4% YoY decline in the sector's 1H20 net profit. We expect earnings growth to bottom out in 2Q20, on the back of stabilizing NIM and easing credit cost.

- **CBIRC reported 9.4% YoY net profit decline in 1H20** for China banks, implying a sharp contraction of 24% YoY in 2Q20, vs 5% YoY growth in 1Q20. We see earnings drag mainly from counter-cyclical provisions. Topline growth should remain solid, as evidenced by moderate NIM shrink (-1bp QoQ), healthy asset expansion (+10.8% YoY), and lower cost-income ratio (-0.6ppt YoY). Meanwhile, lower fee rate as part of the profit concession measures and possible bond trading loss from yield hike might result in softer non-interest income. We believe China banks also intended for kitchen-sinking amid COVID-19 shock and disappointing results for major US and European banks.
- **Better-than-expected asset quality despite prudent provision.** During the mid-year work conference, CBIRC urged banks to plan ahead for asset quality deterioration, with stricter NPL recognition and more proactive impairment charge. In 2Q20, sector's NPL ratio rose 3bp to 1.94%, but SML ratio retreated notably by 21bp to 2.75%, suggesting underlying asset quality stays benign. In particular, joint-stock banks and city commercial banks saw -1bp and -15bp QoQ decline in NPL ratio. Most banks joined our corporate day in mid-Jul anticipated that retail NPL formation will peak in 2Q20, and corporate side should face more pressure onwards.
- **Earnings growth is poised to rebound from 2Q20 trough.** Given the lackluster bottomline growth revealed by CBIRC, we believe investors will focus more on China banks' PPOP, NIM, and asset quality indicators in the upcoming 2Q20 results. Looking into 2H20, we expect relatively stable NIM trend on normalizing monetary policy and sequential decline in credit cost due to strengthened provision buffer. As illustrated in Figure 6, banks' profit growth is highly correlated with GDP growth. Therefore, earnings should return to expansion along with economic recovery in coming quarters.
- **Retail banks on favorable spot.** We continue to prefer retail-focused banks, including PAB, PSBC, and CEB, given faster asset quality recovery thus more resilient earnings.

Valuation Table

Name	Ticker	Price (Local ccy)	TP (Local ccy)	Rating	P/B (x) FY20E	P/E (x) FY20E	Yield FY20E	ROE FY20E
ICBC	1398 HK	4.65	7.30	BUY	0.55	4.6	6.6%	12.5%
CCB	939 HK	5.80	8.70	BUY	0.57	4.7	6.5%	12.6%
ABC	1288 HK	2.74	4.70	BUY	0.45	4.0	7.8%	11.9%
BOC	3988 HK	2.60	4.60	BUY	0.38	3.6	8.5%	11.0%
PSBC	1658 HK	4.30	6.30	BUY	0.62	5.1	6.1%	12.7%
CITICB	998 HK	3.42	5.60	BUY	0.31	3.0	8.7%	11.0%
CEB	6818 HK	2.97	4.90	BUY	0.41	3.6	8.7%	11.8%
BoCom	3328 HK	4.27	5.70	HOLD	0.38	3.6	8.5%	10.9%
MSB	1988 HK	4.92	6.30	HOLD	0.39	3.4	8.8%	11.9%
PAB	000001 CH	14.13	19.80	BUY	0.91	8.8	1.7%	10.8%

Source: Bloomberg, CMBIS estimates

OUTPERFORM
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China Banking Sector

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Historical P/B of H-share China banks



Source: Bloomberg, CMBIS

Historical P/B of A-share China banks



Source: Bloomberg, CMBIS

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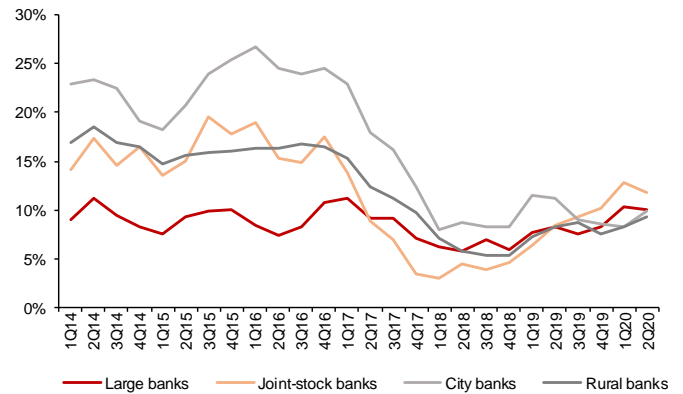
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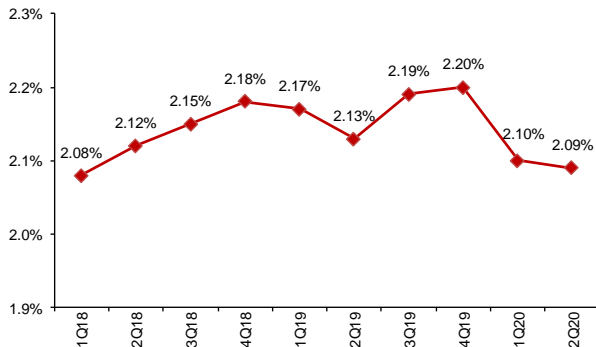
Figure 1: Earnings growth for different types of banks

	Large	Joint-stock	City	Rural	Total
1Q19	4.6%	11.2%	8.8%	0.3%	9.5%
1H19	5.3%	10.5%	3.6%	7.7%	9.8%
9M19	5.6%	11.2%	-0.6%	4.9%	9.2%
FY19	5.2%	9.1%	2.0%	9.2%	8.9%
1Q20	4.7%	9.4%	-1.2%	1.9%	5.0%
1H20	-12.0%	-8.5%	-2.1%	-11.4%	-9.4%

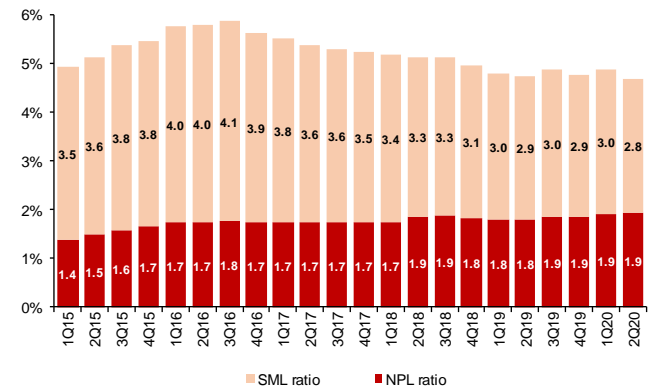
Source: CBIRC, CMBIS

Figure 2: Asset growth remained stable in 2Q20

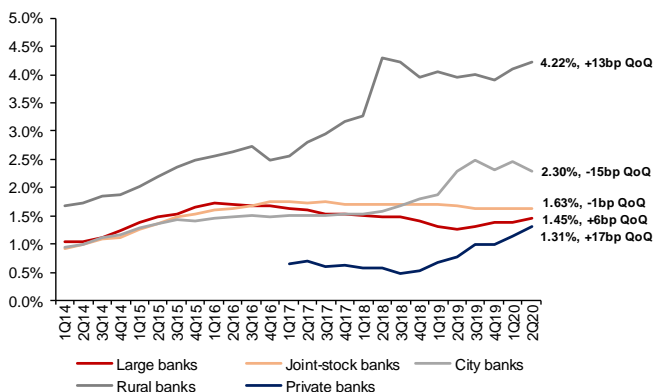
Source: CBIRC, CMBIS

Figure 3: Sector NIM only narrowed 1bp in 2Q20, vs 10bp contraction in 1Q20

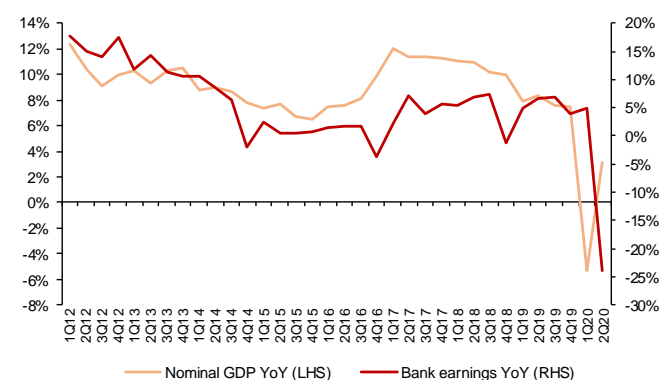
Source: CBIRC, CMBIS

Figure 4: NPL ratio rose 3bp QoQ to 1.94%, but SML ratio dropped 21bp QoQ to 2.75%

Source: CBIRC, CMBIS

Figure 5: NPL ratio for different types of banks

Source: CBIRC, CMBIS

Figure 6: Banks' earnings growth vs GDP growth

Source: Wind, Company data, CMBIS

Note: Bank earnings is aggregate data for banks under our coverage, and 2Q20 earnings growth is CBIRC's reported data.

Figure 7: China banks' 2Q20 results calendar

Company	Ticker	Tentative reporting date
CITICB	998 HK / 601998 CH	26-Aug-2020
PAB	000001 CH	27-Aug-2020
ICBC	1398 HK / 601398 CH	28-Aug-2020
BOC	3988 HK / 601988 CH	28-Aug-2020
BoCom	3328 HK / 601328 CH	28-Aug-2020
CMB	3968 HK / 600036 CH	28-Aug-2020
MSB	1988 HK / 600016 CH	28-Aug-2020
CEB	6818 HK / 601818 CH	28-Aug-2020
CCB	939 HK / 601939 CH	30-Aug-2020
ABC	1288 HK / 601288 CH	30-Aug-2020
PSBC	1658 HK / 601658 CH	30-Aug-2020

Source: Bloomberg, SSE, CMBIS

Figure 8: Valuation summary

Company	Ticker	Mkt cap (bn)	Last Price	TP	Rating	P/B (x)		P/E (x)		Yield		ROE	
		(Local ccy)	(Local ccy)	(Local ccy)		2020E	2021E	2020E	2021E	2020E	2021E	2020E	2021E
H-share													
ICBC	1398 HK	1,902	4.65	7.30	BUY	0.55	0.50	4.6	4.3	6.6%	7.0%	12.5%	12.1%
CCB	939 HK	1,461	5.80	8.70	BUY	0.57	0.52	4.7	4.4	6.5%	6.9%	12.6%	12.3%
ABC	1288 HK	1,235	2.74	4.70	BUY	0.45	0.42	4.0	3.7	7.8%	8.2%	11.9%	11.6%
BOC	3988 HK	1,005	2.60	4.60	BUY	0.38	0.35	3.6	3.5	8.5%	9.0%	11.0%	10.7%
PSBC	1658 HK	434	4.30	6.30	BUY	0.62	0.56	5.1	4.5	6.1%	7.0%	12.7%	13.2%
CITICB	998 HK	248	3.42	5.60	BUY	0.31	0.29	3.0	2.7	8.7%	9.6%	11.0%	11.2%
CEB	6818 HK	209	2.97	4.90	BUY	0.41	0.37	3.6	3.3	8.7%	9.5%	11.8%	11.9%
BoCom	3328 HK	358	4.27	5.70	HOLD	0.38	0.35	3.6	3.5	8.5%	9.0%	10.9%	10.6%
MSB	1988 HK	262	4.92	6.30	HOLD	0.39	0.36	3.4	3.2	8.8%	9.4%	11.9%	11.7%
CMB	3968 HK	1,043	38.90	-	NR	1.34	1.19	8.8	7.9	3.7%	4.2%	16.0%	16.2%
Average						0.60	0.55	4.8	4.5	6.9%	7.3%	12.6%	12.4%
A-share													
ICBC	601398 CH	1,704	4.98	7.60	BUY	0.66	0.60	5.5	5.2	5.5%	5.9%	12.5%	12.1%
CCB	601939 CH	1,309	6.20	9.10	BUY	0.68	0.62	5.6	5.3	5.4%	5.8%	12.6%	12.3%
ABC	601288 CH	1,107	3.23	5.20	BUY	0.59	0.55	5.2	4.9	5.9%	6.2%	11.9%	11.6%
BOC	601988 CH	901	3.35	5.00	BUY	0.55	0.51	5.2	5.0	5.9%	6.3%	11.0%	10.7%
PSBC	601658 CH	389	4.65	6.90	BUY	0.74	0.67	6.1	5.4	5.1%	5.8%	12.7%	13.2%
CITICB	601998 CH	223	5.20	7.30	BUY	0.53	0.49	5.0	4.5	5.1%	5.7%	11.0%	11.2%
CEB	601818 CH	187	3.85	5.50	BUY	0.59	0.54	5.2	4.7	6.0%	6.6%	11.8%	11.9%
PAB	000001 CH	274	14.13	19.80	BUY	0.91	0.82	8.8	7.7	1.7%	2.0%	10.8%	11.2%
BoCom	601328 CH	321	4.77	6.10	HOLD	0.47	0.44	4.5	4.3	6.9%	7.2%	10.9%	10.6%
MSB	600016 CH	235	5.58	7.00	HOLD	0.50	0.46	4.4	4.1	7.0%	7.4%	11.9%	11.7%
CMB	600036 CH	934	37.54	-	NR	1.45	1.28	9.4	8.3	3.5%	3.9%	16.2%	16.5%
Average						0.73	0.67	6.0	5.5	5.3%	5.7%	12.5%	12.3%

Source: Bloomberg, CMBIS estimates. Note: Bloomberg consensus for CMB.

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