

Bank of Communications (601328 CH)

Earnings laggard on asset quality deterioration

BoCom's net profit declined 30.6%/14.6% YoY in 2Q/1H20, despite a solid revenue growth of 6.6%/5.2% YoY. Notable earnings contraction was mainly due to mounting provisions (+99.2% YoY in 2Q20) against deteriorating asset quality. The Bank is following policy guidance to pile up risk reserves, and conceded total RMB14bn profit to the real economy during anti-COVID-19 campaign in 1H20. Although NPL formation may ease in 2H20, credit cost is likely to stay elevated given lower-than-peers provision coverage, further weighing on earnings growth.

■ **Results positives: 1) Loan/deposit growth was healthy at 2.9%/3.1% in 2Q/1H20.** Majority of new loans went to corporate side (+9.9%) in 1H20, but management said retail loan extension started to accelerate in 2Q20 and should account for more than 40% of full-year loan growth. **3) Non-interest income was up 8.8% YoY,** driven by management service fees and investment gains. **3) Wealth management business capacity enhanced,** with retail AUM +8.2% HoH, no. of OTO fortune customers +8.5% HoH, and private banking clients +13.3% HoH.

■ **Results negatives: 1) NIM narrowed 3bp QoQ/5bp YoY to 1.52%/1.53% in 2Q/1H20.** Due to LPR cuts, asset yields shrank faster than liability cost in 1H20. In particular, loan yield dropped 17bp HoH, but deposit cost only slid 1bp HoH. Management expected further margin pressure in 2H20, but will try to stabilize NIM by replacing higher-cost structured deposits/MLF with cheaper interbank funding. **2) Asset quality worsened.** NPL ratio edged up 9bp QoQ to 1.68%, and provision coverage declined 5.5ppt QoQ to 148.7%. This was partly due to more prudent NPL recognition, as SML ratio retreated 38bp HoH. The good news is that credit card NPLs peaked out in Jun and will likely recovered to pre-pandemic level in 3Q20. Loans under deferred repayment scheme amounted to RMB176bn, 3.1% of total loans as of 2Q20. **3) 2Q20 cost-income ratio rose 0.4ppt YoY to 36.2%,** higher than large bank peers. **4) Capital position weakened,** as CET1 ratio dropped 20bp QoQ to 10.63% on sluggish earnings and cash dividend payout.

■ **Maintain HOLD and trim TP to RMB5.40.** We cut our FY20/21E earnings estimates by 14-16%, to factor in lower NIM/fee income and higher credit cost assumptions. Our revised RMB5.40 TP is based on 0.55x (from 0.62x) target P/B and FY20E BVPS of RMB9.9.

Earnings Summary

(YE 31 Dec)	FY18A	FY19A	FY20E	FY21E	FY22E
Operating income (RMB mn)	205,932	221,040	232,151	246,783	266,428
Net profit (RMB mn)	73,630	77,281	66,286	70,233	76,342
EPS (RMB)	0.96	1.00	0.86	0.91	0.99
EPS CHG (%)	5.2	5.1	(14.7)	6.2	9.0
Consensus EPS (RMB)	NA	NA	1.01	1.05	1.11
P/E (x)	5.0	4.7	5.6	5.2	4.8
P/B (x)	0.55	0.51	0.48	0.45	0.42
Dividend yield (%)	6.3	6.6	5.6	5.9	6.5
ROE (%)	11.4	11.2	8.9	8.9	9.1
NPL ratio (%)	1.49	1.47	1.74	1.75	1.71
Provision coverage (%)	173	172	153	160	169

Source: Company data, Bloomberg, CMBIS estimates

HOLD (Maintain)

Target Price	RMB 5.40
(Previous TP)	RMB 6.10)
Up/Downside	+13.2%
Current Price	RMB 4.77

China Banking Sector

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Stock Data

Mkt Cap (RMB mn)	316,867
Avg 3 mths t/o (RMB mn)	670
52w High/Low (RMB)	5.78/4.73
Total Issued Shares (mn)	39,251 (A) 35,012 (H)

Source: Bloomberg

Shareholding Structure

MoF	23.88%
HSBC	18.70%
NCSSF	6.07%

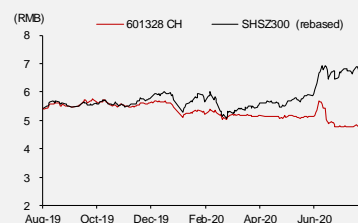
Source: Company data

Share Performance

	Absolute	Relative
1-mth	0.2%	-5.5%
3-mth	-7.6%	-26.4%
6-mth	-8.3%	-25.4%
12-mth	-12.3%	-31.2%

Source: Bloomberg

12-mth Price Performance



Source: Bloomberg

Auditor: PwC

Related Reports

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Figure 1: 2Q20 results summary

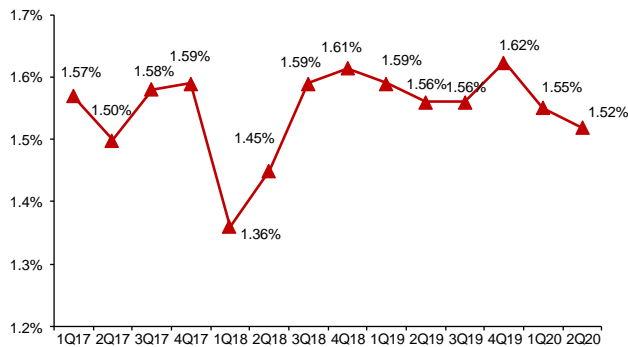
(RMB mn)							
P&L	2Q19	3Q19	4Q19	1Q20	2Q20	QoQ	YoY
Net interest income	35,205	36,265	37,756	36,736	37,113	1.0%	5.4%
Non-interest income	19,446	20,386	16,489	20,850	21,153	1.5%	8.8%
Operating income	54,651	56,651	54,245	57,586	58,266	1.2%	6.6%
Operating expense	(19,611)	(21,282)	(19,459)	(21,371)	(21,116)	-1.2%	7.7%
PPoP	35,040	35,369	34,786	36,215	37,150	2.6%	6.0%
Impairment losses	(10,845)	(15,401)	(15,273)	(11,892)	(21,600)	81.6%	99.2%
Pre-tax profit	24,195	19,968	19,513	24,323	15,550	-36.1%	-35.7%
Income tax	(2,636)	(2,449)	(1,878)	(2,804)	(157)	-94.4%	-94.0%
Net profit	21,678	17,398	17,134	21,451	15,054	-29.8%	-30.6%

B/S	2Q19	3Q19	4Q19	1Q20	2Q20	QoQ	YoY
Gross loans	5,130,612	5,206,687	5,304,275	5,568,059	5,729,513	2.9%	11.7%
Total deposits	6,135,448	6,048,860	6,072,908	6,366,064	6,560,867	3.1%	6.9%
Total assets	9,886,608	9,932,879	9,905,600	10,454,383	10,669,932	2.1%	7.9%
NPLs	75,508	76,692	78,043	88,455	96,292	8.9%	27.5%

Key ratio	2Q19	3Q19	4Q19	1Q20	2Q20	QoQ	YoY
NIM	1.56%	1.56%	1.62%	1.55%	1.52%	-3bp	-4bp
ROE	13.2%	10.4%	10.0%	12.2%	8.5%	-3.7ppt	-4.7ppt
NPL ratio	1.47%	1.47%	1.47%	1.59%	1.68%	9bp	21bp
Provision coverage	173.5%	174.2%	171.8%	154.2%	148.7%	-5.5ppt	-24.8ppt
LDR	83.6%	86.1%	87.3%	87.5%	87.3%	-0.1ppt	3.7ppt
CET-1 CAR	10.9%	11.1%	11.2%	10.8%	10.6%	-20bp	-23bp

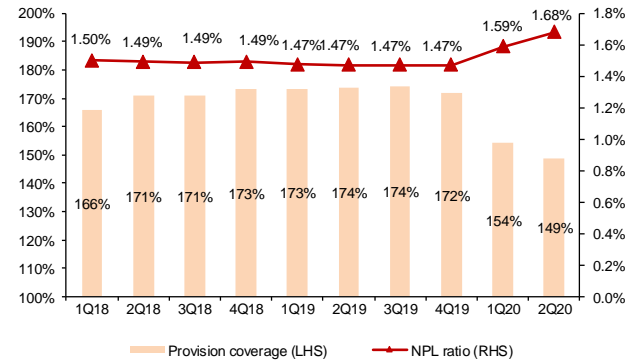
Source: Company data, CMBIS

Figure 2: Quarterly NIM of BoCom



Source: Company data, CMBIS

Figure 3: NPL ratio and provision coverage of BoCom



Source: Company data, CMBIS

Figure 4: Adjustments of earnings forecasts

	NIM			Fee income growth			Credit cost			Net profit (RMB mn)		
	Old	New	Change	Old	New	Change	Old	New	Change	Old	New	Change
FY20E	1.53%	1.50%	-3bp	7.0%	4.0%	-3ppt	1.02%	1.20%	+18bp	78,726	66,286	-15.8%
FY21E	1.50%	1.48%	-2bp	7.0%	5.0%	-2ppt	1.00%	1.15%	+15bp	81,555	70,233	-13.9%

Source: CMBIS estimates

Financial Summary

Income Statement

YE 31 Dec (RMB mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Interest income	348,864	367,453	393,838	421,642	454,722
Interest expenses	(217,956)	(223,370)	(242,621)	(260,884)	(279,750)
Net interest income	130,908	144,083	151,217	160,758	174,972
Net fee income	41,237	43,625	45,421	47,692	50,077
Others	33,787	33,332	35,512	38,333	41,379
Operating income	205,932	221,040	232,151	246,783	266,428
Operating expenses	(75,898)	(80,668)	(87,214)	(94,568)	(103,218)
PPoP	130,034	140,372	144,936	152,215	163,210
Provision	(43,514)	(52,224)	(69,211)	(72,030)	(76,124)
Operating profit	86,520	88,148	75,725	80,185	87,087
Non-operating income	(453)	52	52	52	52
Pre-tax profit	86,067	88,200	75,777	80,237	87,139
Income tax expenses	(11,902)	(10,138)	(8,710)	(9,223)	(10,016)
Minority interests	(535)	(781)	(781)	(781)	(781)
Net profit	73,630	77,281	66,286	70,233	76,342

Key Ratio

YE 31 Dec	FY18A	FY19A	FY20E	FY21E	FY22E
Revenue mix					
Net interest income	64%	65%	65%	65%	66%
Net fee income	20%	20%	20%	19%	19%
Others	16%	15%	15%	16%	16%
Total	100%	100%	100%	100%	100%
Growth, YoY					
Net interest income	4.8%	10.1%	5.0%	6.3%	8.8%
Net fee income	1.7%	5.8%	4.1%	5.0%	5.0%
Operating income	12.0%	7.3%	5.0%	6.3%	8.0%
PPoP	13.5%	8.0%	3.3%	5.0%	7.2%
Net profit	4.9%	5.0%	-14.2%	6.0%	8.7%
Gross loans	6.0%	9.3%	8.5%	8.5%	8.5%
Customer deposits	4.5%	4.8%	8.0%	7.5%	7.5%
Efficiency					
Cost-to-income ratio	35.6%	35.3%	36.2%	37.0%	37.4%

Balance Sheet

YE 31 Dec (RMB mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Due from central banks	825,506	745,704	787,682	846,758	910,265
Interbank assets	848,067	648,488	687,397	728,641	772,360
Investments	2,821,909	3,005,843	3,214,819	3,396,207	3,587,904
Gross loans	4,854,228	5,304,275	5,755,138	6,244,325	6,775,093
Less: provision	125,540	134,052	153,568	168,567	182,888
Other assets	307,001	335,342	353,811	342,616	329,112
Total assets	9,531,171	9,905,600	10,645,280	11,389,980	12,191,845
Due to central banks	520,138	462,933	486,080	510,384	535,903
Interbank liabilities	2,008,908	1,940,140	2,081,703	2,209,137	2,345,813
Customer deposits	5,793,324	6,072,908	6,558,741	7,050,646	7,579,445
Debt securities issued	317,688	403,918	444,310	488,741	537,615
Other liabilities	185,805	224,789	233,312	242,262	251,659
Total liabilities	8,825,863	9,104,688	9,804,146	10,501,170	11,250,434
Shareholders' equity	698,405	793,247	833,469	881,145	933,746
Incl. Perpetual bonds	-	39,994	39,994	39,994	39,994
Incl. Preferred stocks	59,876	59,876	59,876	59,876	59,876
Minority interest	6,903	7,665	7,665	7,665	7,665
Total equity	705,308	800,912	841,134	888,810	941,411

Asset quality					
NPL ratio	1.49%	1.47%	1.74%	1.75%	1.71%
Provision coverage	173%	172%	153%	160%	169%
Provision/ total loans	2.59%	2.53%	2.67%	2.80%	2.88%
Credit costs	0.90%	0.97%	1.20%	1.15%	1.12%
Capital adequacy					
CET-1 CAR	11.2%	11.2%	11.6%	11.6%	11.5%
Tier-1 CAR	12.2%	12.8%	13.2%	13.0%	12.9%
Total CAR	14.4%	14.8%	13.4%	13.2%	13.1%
Profitability					
NIM	1.51%	1.58%	1.50%	1.48%	1.50%
ROE	11.4%	11.2%	8.9%	8.9%	9.1%
ROA	0.76%	0.77%	0.62%	0.61%	0.62%
RoRWA	0.00%	0.00%	0.00%	0.00%	0.00%
Per share					
EPS (RMB)	0.96	1.00	0.86	0.91	0.99
DPS (RMB)	0.30	0.32	0.27	0.28	0.31
BVPS (RMB)	8.60	9.34	9.88	10.52	11.23

Source: Company data, CMBIS estimates

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