

Bank of Communications (3328 HK)

Asset quality pressure looms with rising NPL formation

BoCom reported 9M19 net profit of RMB 60.1bn, up 5.0% YoY and accounting for 78%/80% of CMBIS/consensus full-year estimates. In 3Q19, revenue growth moderated to 3.5% YoY from 12.2% YoY in 1H19, as growth in net interest income (+5.1% YoY) and investment gain (-14.4% YoY) slowed down, despite stronger net fee income (+11.0% YoY). Opex was down 4.4% YoY on good cost control. However, the bank boosted provision charge by 14.7% YoY, given rising NPL formation. As such, 3Q19 bottom-line earnings remained largely stable at 5.2% YoY. 9M19 annualized ROE slid 0.2ppt YoY to 12.2%.

- **Results positives:** 1) **NIM held up stable QoQ at 1.56%**, as falling loan yield due to LPR reform was offset by better control in funding cost. Management sees margin pressure in coming quarters, but expects to keep NIM steady in 4Q19. 2) **Net fee income growth accelerated** to 11.0% YoY in 3Q19 on stronger wealth management-related fees, whose contribution to fee income should be roughly the same next year based on guidance. 3) **Operating efficiency improved**, as 3Q19 CIR dropped 3.1ppts YoY to 37.6%. 4) **Capital adequacy was strengthened**. CET1/tier-1/total CAR edged up by 21bps/86bps/103bps to 11.07%/12.72%/14.87% in 3Q19. Management expect further capital replenishment through perpetual bond and tier-2 capital bond, given current favorable regulation stance on banks' debt capital raising.
- **Results negatives:** 1) **Deposit balance declined 1.4% QoQ**, pushing up LDR by 2.5ppts to 86.1%. BoCom boosted interbank liabilities by 3.8% QoQ, to take advantage of the low-interest environment. 2) **Loan growth was subdued at 1.5% QoQ**, mainly due to contraction in credit card loans, as the Bank proactively slowed down card issuance and tightened borrowing standards. 3) **Faster NPL formation**. NPL ratio stayed flat at 1.47%, but NPL formation rebounded 29bps QoQ to 1.08% in 3Q19.
- **Maintain HOLD and raise TP to HK\$ 6.2**. BoCom-H currently trades at 0.52x FY19E P/B, slightly below its past 5-year mean of 0.54x. We kept our earnings forecast unchanged, and rolled forward the valuation basis to FY20. Our new HK\$ 6.2 TP is derived from 0.55x target P/B and FY20E BVPS of RMB 10.1.

Earnings Summary

(YE 31 Dec)	FY17A	FY18A	FY19E	FY20E	FY21E
Operating income (RMB mn)	183,800	205,932	214,763	229,469	245,157
Net profit (RMB mn)	70,223	73,630	77,360	81,389	86,146
EPS (RMB)	0.91	0.96	1.01	1.06	1.13
EPS CHG (%)	1.8	5.2	5.4	5.4	6.0
P/E (x)	5.3	5.0	4.8	4.5	4.3
P/B (x)	0.58	0.56	0.52	0.48	0.44
Dividend yield (%)	6.0	6.2	6.5	6.9	7.3
ROE (%)	11.4	11.4	11.3	11.0	10.8
NPL ratio (%)	1.50	1.49	1.52	1.55	1.58
Provision coverage (%)	155	173	178	181	183

Source: Company data, CMBIS estimates

HOLD (Maintain)

Target Price	HK\$ 6.20
(Previous TP)	HK\$ 5.90)
Up/Downside	+15.9%
Current Price	HK\$ 5.35

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Stock Data

Mkt Cap (HK\$ mn)	435,750
Avg 3 mths t/o (HK\$ mn)	109
52w High/Low (HK\$)	7.06/4.98
Total Issued Shares (mn)	35,012 (H)
	39,251 (A)

Source: Bloomberg

Shareholding Structure

MoF	23.88%
HSBC	18.70%
NCSSF	4.93%

Source: Company data

Share Performance

	Absolute	Relative
1-mth	5.5%	3.4%
3-mth	-7.7%	-1.8%
6-mth	-18.5%	-9.3%

Source: Bloomberg

12-mth Price Performance



Source: Bloomberg

Auditor: PwC

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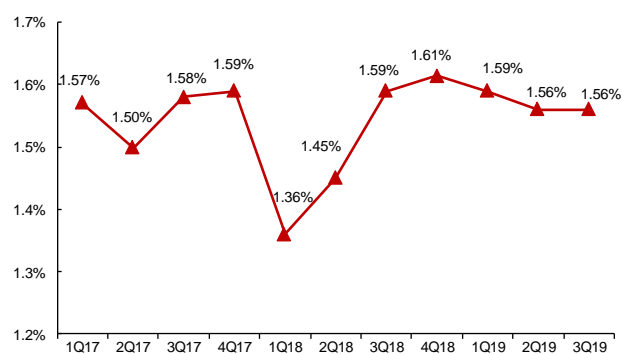
Figure 1: 3Q19 results summary

(RMB mn)						
P&L	9M18	9M19	YoY	3Q18	3Q19	YoY
Net interest income	95,175	106,327	11.7%	34,517	36,265	5.1%
Net fee and commission income	31,393	34,458	9.8%	10,211	11,336	11.0%
Operating income	152,893	166,795	9.1%	54,723	56,651	3.5%
Operating expense	(56,438)	(61,209)	8.5%	(22,264)	(21,282)	-4.4%
PPoP	96,455	105,586	9.5%	32,459	35,369	9.0%
Impairment losses	(30,095)	(36,951)	22.8%	(13,429)	(15,401)	14.7%
Pre-tax profit	66,360	68,635	3.4%	19,030	19,968	4.9%
Income tax	(8,854)	(8,260)	-6.7%	(2,378)	(2,449)	3.0%
Net profit	57,304	60,147	5.0%	16,533	17,398	5.2%

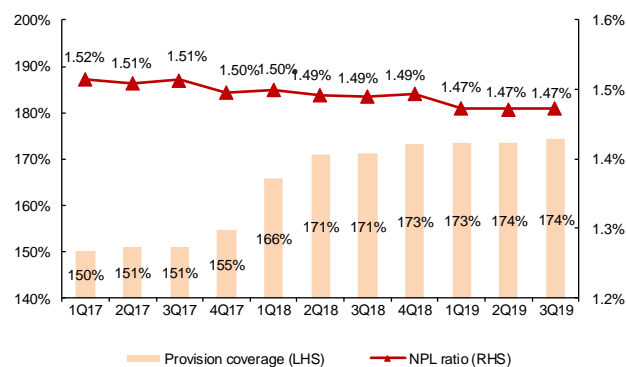
B/S	3Q18	3Q19	YoY	2Q19	3Q19	QoQ
Gross loans	4,852,048	5,206,687	7.3%	5,130,612	5,206,687	1.5%
Customers' deposits	5,705,985	6,048,860	6.0%	6,135,448	6,048,860	-1.4%
Total assets	9,391,537	9,932,879	5.8%	9,886,608	9,932,879	0.5%
NPLs	72,280	76,692	6.1%	75,508	76,692	1.6%

Key ratios	9M18	9M19	YoY	2Q19	3Q19	QoQ
NIM	1.47%	1.57%	10bp	1.56%	1.56%	0bp
ROE	12.4%	12.2%	-0.2ppt	13.2%	10.4%	-2.7ppt
NPL ratio	1.49%	1.47%	-2bp	1.47%	1.47%	0bp
Provision coverage	171.1%	174.2%	3.1ppt	173.5%	174.2%	0.7ppt
LDR	85.0%	86.1%	1.0ppt	83.6%	86.1%	2.5ppt
CET-1 CAR	10.9%	11.1%	20bp	10.9%	11.1%	21bp

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

Financial Summary

Income Statement

YE Dec 31 (RMB mn)	FY17A	FY18A	FY19E	FY20E	FY21E
Interest income	314,200	348,864	387,088	416,656	448,555
Interest expenses	(189,327)	(217,956)	(237,790)	(255,887)	(275,494)
Net interest income	124,873	130,908	149,299	160,769	173,060
Net fee income	40,551	41,237	42,976	45,124	47,381
Others	18,376	33,787	22,489	23,576	24,716
Operating income	183,800	205,932	214,763	229,469	245,157
Operating expenses	(69,258)	(75,898)	(83,366)	(90,623)	(98,523)
PPoP	114,542	130,034	131,397	138,846	146,635
Provision	(31,469)	(43,514)	(40,549)	(43,321)	(45,590)
Operating profit	83,073	86,520	90,849	95,525	101,044
Non-operating income	192	(453)	(453)	(453)	(453)
Pre-tax profit	83,265	86,067	90,396	95,072	100,591
Income tax expenses	(12,574)	(11,902)	(12,501)	(13,147)	(13,911)
Minority interests	(468)	(535)	(535)	(535)	(535)
Net profit	70,223	73,630	77,360	81,389	86,146

Key Ratio

YE Dec 31 (RMB mn)	FY17A	FY18A	FY19E	FY20E	FY21E
Op. income mix					
Net interest income	68%	64%	70%	70%	71%
Net fee income	22%	20%	20%	20%	19%
Others	10%	16%	10%	10%	10%
Total	100%	100%	100%	100%	100%
Growth, YoY					
Net interest income	-7.4%	4.8%	14.0%	7.7%	7.6%
Net fee income	10.2%	1.7%	4.2%	5.0%	5.0%
Operating income	-0.6%	12.0%	4.3%	6.8%	6.8%
PPoP	-1.4%	13.5%	1.0%	5.7%	5.6%
Net profit	4.5%	4.9%	5.1%	5.2%	5.8%
Gross loans	11.6%	6.0%	8.5%	8.0%	8.0%
Customer deposits	17.3%	4.5%	7.0%	7.0%	7.0%
Efficiency					
Cost-to-income ratio	36.3%	35.6%	37.5%	38.1%	38.8%

Balance Sheet

YE Dec 31 (RMB mn)	FY17A	FY18A	FY19E	FY20E	FY21E
Due from central banks	921,948	825,506	872,487	933,561	998,910
Interbank assets	782,468	848,067	775,225	808,004	842,422
Investments	2,528,276	2,821,909	3,104,100	3,337,742	3,589,342
Gross loans	4,579,256	4,854,228	5,266,837	5,688,184	6,143,239
Less: provision	106,001	125,540	142,240	159,768	177,515
Other assets	332,307	307,001	394,003	408,179	428,193
Total assets	9,038,254	9,531,171	10,270,412	11,015,902	11,824,591
Due to central banks	532,867	520,138	572,152	629,367	692,304
Interbank liabilities	1,723,807	2,008,908	2,154,199	2,297,210	2,453,698
Customer deposits	5,545,366	5,793,324	6,198,857	6,632,777	7,097,071
Debt securities issued	287,662	317,688	354,625	403,258	461,618
Other liabilities	272,281	185,805	192,505	199,539	206,926
Total liabilities	8,361,983	8,825,863	9,472,338	10,162,152	10,911,616
Shareholders' equity	671,143	698,405	791,171	846,847	906,071
Incl. Perpetual bonds	-	-	40,000	40,000	40,000
Incl. Preferred stocks	59,876	59,876	59,876	59,876	59,876
Minority interest	5,128	6,903	6,903	6,903	6,903
Total equity	676,271	705,308	798,074	853,750	912,974

Asset quality					
NPL ratio	1.50%	1.49%	1.52%	1.55%	1.58%
Provision coverage	155%	173%	178%	181%	183%
Provision/ total loans	2.31%	2.59%	2.70%	2.81%	2.89%
Credit costs	0.69%	0.90%	0.78%	0.77%	0.75%
Capital adequacy					
CET-1 CAR	10.8%	11.2%	11.3%	11.4%	11.5%
Tier-1 CAR	11.9%	12.2%	13.0%	12.9%	12.9%
Total CAR	14.0%	14.4%	15.0%	14.8%	14.7%
Profitability					
NIM	1.51%	1.51%	1.54%	1.54%	1.54%
ROE	11.4%	11.4%	11.3%	11.0%	10.8%
ROA	0.77%	0.76%	0.76%	0.74%	0.73%
RoRWA	1.25%	0.00%	0.00%	0.00%	0.00%
Per share					
EPS (RMB)	0.91	0.96	1.01	1.06	1.13
DPS (RMB)	0.29	0.30	0.31	0.33	0.35
BVPS (RMB)	8.23	8.60	9.31	10.06	10.86

Source: Company data, CMBIS estimates

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