

China Banking Sector

Assessing 2019-nCoV's impact

China banks' negative share price reaction due to concerns on nCoV appears overdone. We believe 2020E earnings downside is manageable at 4.8% max. Continued pro-growth policies and banks' solid provision buffer will likely mitigate the actual impact. The sector's defensive nature and near-trough valuation offer attractive risk-reward, in our view.

- **Slower lending pace in 1Q20 but full-year outlook remains intact.** Reduced economic activities during nCoV's outbreak will contain the demand of operation and consumption related loans by corporates and individuals. Assuming the epidemic is under control in Mar/Apr, we expect lending pace to accelerate in subsequent months driven by countercyclical measures, hence little impact to our full-year loan growth estimate (9.0% YoY for banks under coverage).
- **A drag on fee income growth.** Fee income from credit card, trade, and capital market related businesses might see slower growth in 1Q20. Those mostly generated through online channels, such as payment and wealth management fees, should see limited impact.
- **Potential hit to asset quality.** We believe a temporary rebound in overdue loans is unavoidable in 1Q20, mainly from corporates in wholesale & retail, transportation, and hotel & catering sectors (15.0% of total loans by 1H19). In particular, MSEs (5.1% of total loans by 1H19) in these industries are more vulnerable, as they are likely to suffer from cash flow problem on delayed operation and banks' falling risk appetite. However, to what extent overdue loans will transfer to NPLs largely depends on the effect of authorities' policy support.
- **Liquidity loosening may add NIM pressure.** CBIRC has called for greater credit support for borrowers affected by the epidemic, including loan extension/rollover and moderate cut in lending rate, etc. Meanwhile, PBoC conducted net liquidity injection of RMB 550bn in the past two days and cut reverse repo rate by 10bp on 3 Feb, suggesting increased likelihood of MLF and LPR rate cut ahead.
- **Overall earnings impact capped at 4.8%.** We attempt to quantify nCoV's possible impact to banks' 2020E earnings from four aspects: 1) 1.0ppt slowdown in loan growth, 2) 1.0ppt weakening in fee income growth, 3) 5bp increase in credit cost on rising defaults, and 4) 10bp decline in loan yield on regulators' window guidance, accompanied with interbank rate drop by the same magnitude. Based on our analysis, above four cases will trim the sector's 2020E net profit by 0.6%/0.4%/2.6%/1.2%, respectively. That said, actual impact would be smaller, as banks will likely use excess provision to cushion earnings volatility. We maintain our FY20E net profit growth forecast of 6.5% YoY for the sector.
- **Valuation looks attractive.** After 8.7%/9.2% YTD slump (vs 7.6%/5.4% for CSI300/HSI), A/H-share China banks trade at 0.74x/0.60x FY20E P/B, close to 1SD below historical mean. We believe recent market correction has created bottom-fishing opportunities. **Top picks are PAB (000001 CH), CEB (6818 HK), and CCB (939 HK).**

OUTPERFORM
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China Banking Sector

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Historical P/B of H-share China banks



Source: Bloomberg, CMBIS

Valuation discount to historical mean

H-share	Price chg YTD	P/B (x)	Diff vs 5Y mean
ICBC	-11.8%	0.62	-11.6%
CCB	-9.7%	0.60	-13.0%
ABC	-12.0%	0.50	-19.3%
BOC	-8.1%	0.45	-21.0%
BoCom	-9.4%	0.45	-16.4%
CMB	-4.6%	1.33	17.7%
CITICB	-11.6%	0.38	-23.7%
MSB	-7.6%	0.44	-15.2%
CEB	-11.0%	0.44	-18.3%
PSBC	-6.4%	0.71	-6.3%
Average	-9.2%	0.60	-12.7%

Source: Bloomberg, CMBIS

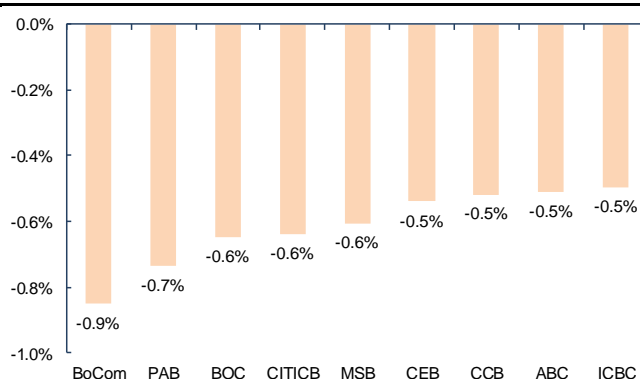
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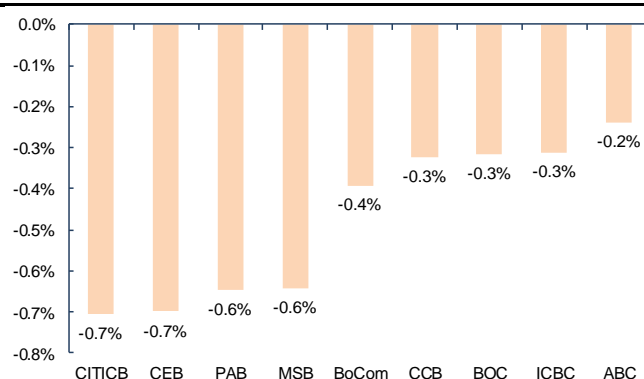
Figure 1: FY20E earnings sensitivity to potential impacts from nCoV outbreak

	Loan growth -1ppt	Fee growth -1ppt	Credit cost +5bp	Loan/interbank rate -10bp	Total
ICBC	-0.5%	-0.3%	-2.3%	-1.6%	-4.7%
CCB	-0.5%	-0.3%	-2.5%	-1.4%	-4.7%
ABC	-0.5%	-0.2%	-2.5%	-1.5%	-4.8%
BOC	-0.6%	-0.3%	-3.1%	-1.6%	-5.7%
BoCom	-0.9%	-0.4%	-2.9%	-1.0%	-5.1%
CITICB	-0.6%	-0.7%	-3.3%	-1.0%	-5.6%
MSB	-0.6%	-0.6%	-2.6%	-0.2%	-4.0%
CEB	-0.5%	-0.7%	-2.8%	-1.0%	-5.0%
PAB	-0.7%	-0.6%	-2.6%	-1.2%	-5.2%
Average	-0.6%	-0.4%	-2.6%	-1.2%	-4.8%

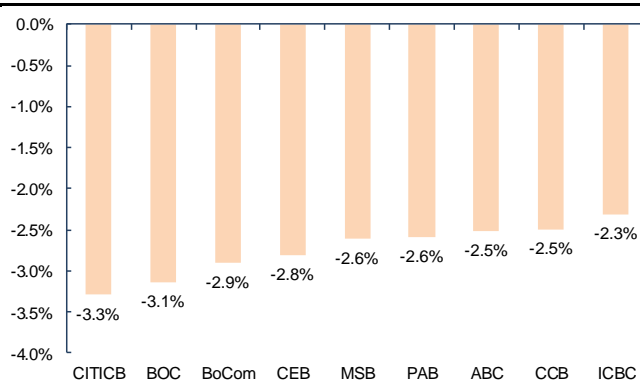
Source: Company data, CMBIS estimates

Figure 2: FY20E net profit impact from 1ppt decline in loan growth

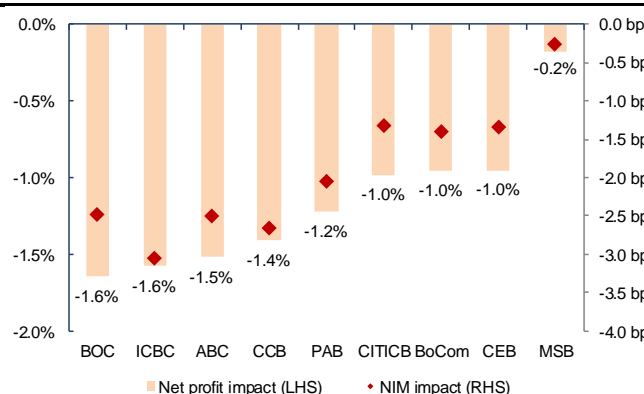
Source: Company data, CMBIS estimates

Figure 3: FY20E net profit impact from 1ppt decline in fee income growth

Source: Company data, CMBIS estimates

Figure 4: FY20E net profit impact from 5bp rise in credit cost

Source: Company data, CMBIS estimates

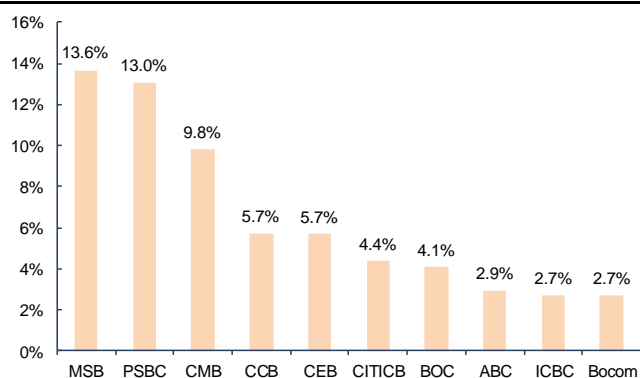
Figure 5: FY20E NIM and net profit impact from 10bp cut in loan and interbank rates

Source: Company data, CMBIS estimates

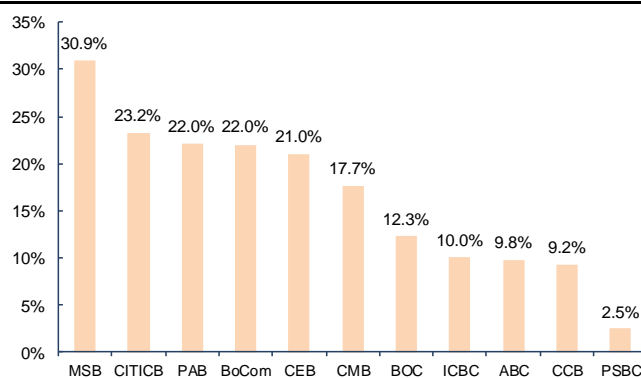
Figure 6: China banks loan breakdown by sector (1H19)

Loan sectors	ICBC	CCB	ABC	BOC	BoCom	PSBC	CMB	CITICB	MSB	CEB	PAB
Corporate loans	62.9%	57.2%	60.6%	62.1%	67.7%	45.8%	48.2%	57.0%	59.4%	57.4%	41.2%
Manufacturing	10.2%	8.8%	10.4%	13.5%	12.0%	5.8%	6.1%	7.3%	8.8%	9.8%	5.2%
Transportation and postal services	13.3%	10.2%	12.2%	9.8%	11.5%	9.7%	7.0%	3.9%	2.0%	3.5%	1.7%
Wholesale and retail	3.7%	3.3%	3.1%	4.3%	4.7%	2.2%	3.9%	4.1%	5.3%	4.4%	5.5%
Electricity, gas and water supply	6.3%	5.8%	6.9%	5.3%	4.0%	4.0%	3.4%	2.0%	1.5%	1.7%	0.8%
Leasing and commercial services	7.6%	7.8%	8.0%	8.7%	-	2.0%	3.4%	7.7%	11.7%	6.3%	4.6%
Real estate	5.7%	4.4%	5.5%	8.0%	4.8%	1.4%	7.9%	7.9%	14.5%	8.1%	9.6%
Public utility	5.5%	3.0%	3.9%	2.5%	5.3%	1.5%	1.2%	6.2%	3.3%	9.3%	-
Construction	1.8%	2.5%	2.2%	2.1%	3.0%	2.1%	2.2%	2.5%	2.8%	3.3%	2.1%
Mining	1.4%	1.7%	1.7%	2.5%	2.3%	1.3%	0.9%	-	3.5%	-	1.6%
Others	7.4%	9.7%	6.9%	5.4%	20.0%	15.8%	12.1%	15.4%	5.9%	10.9%	10.1%
Retail loans	37.1%	42.8%	39.4%	37.9%	32.3%	54.2%	51.8%	43.0%	40.6%	42.6%	58.8%
Mortgage	30.2%	35.2%	30.3%	30.0%	20.9%	33.3%	24.0%	19.1%	11.0%	15.2%	9.0%
Credit card	3.9%	4.7%	3.5%	3.7%	8.9%	2.3%	15.1%	13.0%	13.1%	16.5%	24.5%
Others	3.0%	2.9%	5.6%	4.3%	2.6%	18.6%	12.7%	10.8%	16.4%	10.8%	25.3%

Source: Company data, CMBIS

Figure 7: MSE loan as % of total loans (1H19)

Source: Company data, CMBIS

Figure 8: Interbank as % of total liabilities (3Q19)

Source: Company data, CMBIS

Figure 9: Valuation summary

Company	Ticker	Last Price	TP	Rating	P/B (x)		P/E (x)		Yield		ROE	
		(HK\$)	(HK\$)		2019E	2020E	2019E	2020E	2019E	2020E	2019E	2020E
H-share												
ICBC	1398 HK	5.29	7.50	BUY	0.68	0.62	5.5	5.2	5.6%	5.9%	13.1%	12.6%
CCB	939 HK	6.08	9.10	BUY	0.65	0.60	5.2	4.9	5.9%	6.2%	13.3%	12.8%
ABC	1288 HK	3.02	4.70	BUY	0.55	0.50	4.5	4.3	6.8%	7.2%	12.6%	12.2%
BOC	3988 HK	3.06	4.60	BUY	0.49	0.45	4.5	4.2	7.0%	7.3%	11.5%	11.1%
CITICB	998 HK	4.13	5.90	BUY	0.41	0.38	3.8	3.4	7.1%	7.8%	11.4%	11.5%
CEB	6818 HK	3.22	4.90	BUY	0.48	0.44	4.2	3.8	6.2%	6.9%	12.0%	12.1%
BoCom	3328 HK	5.02	6.20	HOLD	0.48	0.45	4.5	4.2	6.9%	7.3%	11.3%	11.0%
MSB	1988 HK	5.44	6.30	HOLD	0.48	0.44	4.0	3.8	7.5%	8.0%	12.3%	12.0%
PSBC	1658 HK	4.96	-	NR	0.78	0.71	6.5	5.8	4.6%	5.1%	12.4%	12.5%
CMB	3968 HK	38.20	-	NR	1.55	1.38	10.0	8.8	3.0%	3.4%	17.0%	16.6%
Average					0.66	0.60	5.3	4.8	6.1%	6.5%	13.1%	12.7%
A-share												
ICBC	601398 CH	5.50	7.80	BUY	0.79	0.72	6.3	6.0	4.8%	5.1%	13.1%	12.6%
CCB	601939 CH	6.68	9.40	BUY	0.80	0.73	6.3	6.0	4.8%	5.1%	13.3%	12.8%
ABC	601288 CH	3.42	5.10	BUY	0.69	0.63	5.7	5.4	5.4%	5.7%	12.6%	12.2%
BOC	601988 CH	3.50	5.00	BUY	0.63	0.58	5.7	5.4	5.5%	5.8%	11.5%	11.1%
CITICB	601998 CH	5.51	7.30	BUY	0.62	0.56	5.6	5.1	4.8%	5.2%	11.4%	11.5%
CEB	601818 CH	3.80	5.60	BUY	0.63	0.57	5.5	5.0	4.7%	5.2%	12.0%	12.1%
PAB	000001 CH	14.60	21.30	BUY	1.04	0.92	9.8	8.1	1.0%	1.3%	11.7%	12.1%
BoCom	601328 CH	5.20	6.50	HOLD	0.56	0.52	5.2	4.9	6.0%	6.3%	11.3%	11.0%
MSB	600016 CH	5.83	7.00	HOLD	0.57	0.52	4.8	4.5	6.3%	6.7%	12.3%	12.0%
PSBC	601658 CH	5.54	-	NR	0.99	0.90	8.1	7.1	3.7%	4.2%	12.4%	12.5%
CMB	600036 CH	35.35	-	NR	1.64	1.45	10.5	9.2	2.9%	3.3%	17.0%	16.6%
Average					0.81	0.74	6.7	6.1	4.5%	4.9%	13.0%	12.7%

Source: Bloomberg, CMBIS estimates

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