

China Construction Bank (601939 CH)

Quality growth despite some margin pressure

On 28 Aug, CCB reported 1H19 net profit of RMB 154.2bn, up 4.9% YoY and accounting for 57.0%/58.4% of CMBIS/consensus full-year estimates. 1H19 PPOp had a decent growth of 6.7% YoY. Net interest income rose moderately by 4.6% YoY as margin narrowed, yet non-interest income (incl. fees, trading gains, and investment return) picked up 12.8% YoY. Thanks to slower expansion in opex and impairment charges, bottom-line earnings grew faster at 5.5% YoY in 2Q19 (vs 4.2% YoY in 1Q19). 1H19 annualized ROE declined 1ppt YoY to 15.9%, still the highest of the Big-4 banks. **We initiate coverage on CCB A-share with BUY rating.**

- Results positive: 1) 1H19 net fee income was up 11.1% YoY**, driven by bank card, wealth management, and electronic banking services. As a result, CCB's non-interest income as of total revenue increased 1.5ppt YoY to 27.2%; **2) Asset quality continued to improve**, as NPL ratio fell 3bp QoQ to 1.43% and provision coverage climbed 3.8ppt to 218%. However, we note that overdue loans rebounded 18.2% HoH, and we would seek for management's explanation during results briefing. **3) Credit growth was prudent.** The Bank maintained a stable growth in mortgage (+5.3% HoH) while reduced personal consumption loan (-17.1% HoH). Lending to utility and construction segments, and discounted bills accounted for near 50% of new corporate loans. **4) Capital position remained strongest in the sector**, as CET 1/total CAR only slid 13bp/8bp QoQ to 13.7%/17.1% due to appropriation of cash dividend in 2Q19.
- Results negative: 1) 2Q19 NIM contracted 4bp QoQ to 2.25%**, as liability cost went up faster than asset yield. Given higher proportion of deposit funding, CCB may not benefit as much as most joint-stock peers during monetary loosening, but we believe the weaker margin trend was within expectation. **2) Proportion of demand deposit fell 0.5% HoH to 53.1%**, leading to rising deposit cost thereby smaller net interest spread. **3) Asset growth slowed to 0.8% in 2Q19 from 4.2% in 1Q19**, as interbank assets pulled back 17% QoQ.
- Initiate CCB-A with BUY rating and RMB 8.8 TP.** We expect a positive share price reaction to 1H19 results. CCB-A currently trades at 0.83x FY19E P/B, in line with its past 5-year mean. Our TP of RMB 8.8 is based on GGM-derived target P/B of 1.05x and FY19E BPS of RMB 8.3.

Earnings Summary

(YE 31 Dec)	FY17A	FY18A	FY19E	FY20E	FY21E
Operating income (RMB mn)	594,031	633,772	680,537	724,856	771,203
Net profit (RMB mn)	242,264	254,655	270,345	289,440	311,389
EPS (RMB)	0.96	1.00	1.07	1.14	1.23
EPS CHG (%)	4.7	3.9	6.3	7.2	7.7
P/E (x)	7.2	6.9	6.5	6.1	5.6
P/B (x)	1.02	0.92	0.83	0.76	0.69
Dividend yield (%)	4.2	4.4	4.7	5.0	5.4
ROE (%)	14.8	13.9	13.4	13.1	12.8
NPL ratio (%)	1.49	1.46	1.49	1.53	1.51
Provision coverage (%)	171	208	232	251	275

Source: Company data, CMBIS estimates

BUY (Initiation)

Target Price	RMB 8.80
Up/Downside	+26.6%
Current Price	RMB 6.95

China Banking Sector

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Stock Data

Mkt Cap (RMB mn)	1,339,944
Avg 3 mths t/o (RMB mn)	564.90
52w High/Low (RMB)	7.85/6.19
Total Issued Shares (mn)	9,594 (A)
	240,417 (H)

Source: Bloomberg

Shareholding Structure

Central Huijin	57.31%
CSFC	0.88%

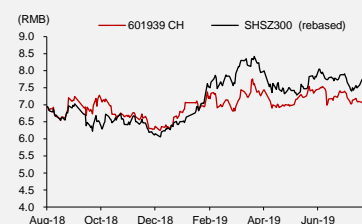
Source: Company data

Share Performance

	Absolute	Relative
1-mth	-5.6%	-4.5%
3-mth	-0.6%	-5.3%
6-mth	-4.1%	-7.6%

Source: Bloomberg

12-mth Price Performance



Source: Bloomberg

Auditor: PwC

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Figure 1: 1H19 results summary

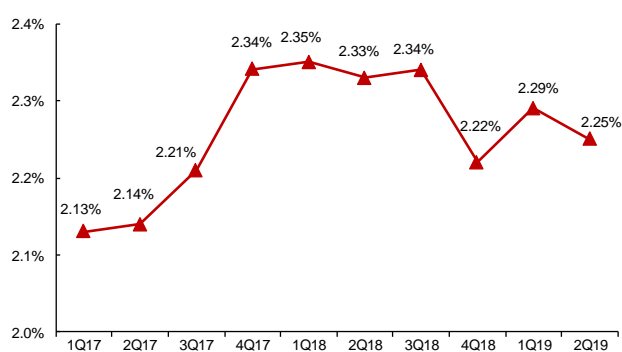
(RMB mn)						
P&L	1H18	1H19	YoY	2Q18	2Q19	YoY
Net interest income	239,486	250,436	4.6%	119,746	125,361	4.7%
Net fee and commission income	69,004	76,695	11.1%	31,073	33,666	8.3%
Operating income	322,422	343,974	6.7%	157,504	165,149	4.9%
Operating expense	(74,060)	(78,284)	5.7%	(37,827)	(38,892)	2.8%
PPoP	248,362	265,690	7.0%	119,677	126,257	5.5%
Impairment losses	(67,029)	(74,638)	11.4%	(28,789)	(31,043)	7.8%
Pre-tax profit	181,333	191,052	5.4%	90,888	95,214	4.8%
Income tax	(33,955)	(35,472)	4.5%	(17,538)	(17,556)	0.1%
Net profit	147,027	154,190	4.9%	73,212	77,274	5.5%

B/S	4Q18	2Q19	HoH	1Q19	2Q19	QoQ
Gross loans	13,783,053	14,539,839	5.5%	14,227,115	14,539,839	2.2%
Customers' deposits	17,108,678	18,214,072	6.5%	18,053,818	18,214,072	0.9%
Total assets	23,222,693	24,383,151	5.0%	24,190,914	24,383,151	0.8%
NPLs	200,881	208,069	3.6%	207,463	208,069	0.3%

Key ratios	1H18	1H19	YoY	1Q19	2Q19	QoQ
NIM	2.34%	2.27%	-7bp	2.29%	2.25%	-4bp
ROE	17.0%	15.9%	-1.0ppt	15.9%	15.7%	-0.2ppt
NPL ratio	1.48%	1.43%	-4bp	1.46%	1.43%	-2bp
Provision coverage	193.2%	218.0%	24.9ppt	214.2%	218.0%	3.8ppt
LDR	79.3%	79.8%	0.5ppt	78.8%	79.8%	1.0ppt
CET-1 CAR	13.1%	13.7%	62bp	13.8%	13.7%	-13bp

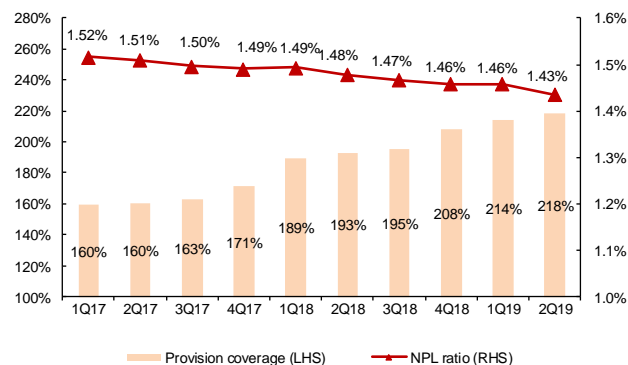
Source: Company data, CMBIS

Figure 2: Quarterly NIM of CCB



Source: Company data, CMBIS

Figure 3: NPL ratio and provision coverage of CCB



Source: Company data, CMBIS

Valuation

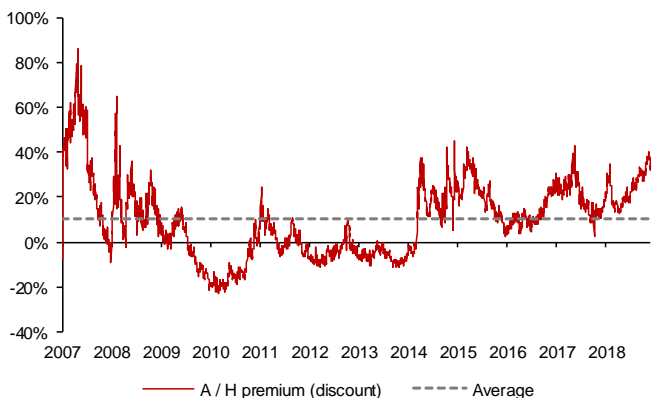
We use Gordon Growth Model to derive the TP for CCB-A. Our key assumptions include: 1) Cost of equity of 12.5%, 2) Sustainable ROE of 13.0%; 3) Long-term growth rate of 3.0%. Our TP of RMB 8.8 is based on a target P/B of 1.05 x and FY19E BVPS of RMB 8.3.

Figure 4: Peers valuation for A-share China banks

Company	Ticker	Mkt. Cap (US\$ mn)	Avg 3M (US\$ mn)	Price (RMB)	P/B (x)		P/E (x)		Dvd yield (%)		ROE (%)	
					FY19E	FY20E	FY19E	FY20E	FY19E	FY20E	FY19E	FY20E
Nationwide SOE & joint-stock banks												
ICBC	601398 CH	257.3	123.7	5.40	0.77	0.71	6.2	5.9	4.9	5.1	12.9	12.4
ABC	601288 CH	163.2	109.3	3.40	0.67	0.62	5.6	5.3	5.4	5.7	12.4	12.0
BOC	601988 CH	135.7	43.5	3.54	0.64	0.59	5.7	5.4	5.4	5.6	11.4	11.0
BoCom	601328 CH	52.5	56.3	5.44	0.57	0.53	5.4	5.1	5.7	5.9	11.0	10.6
CMB	600036 CH	120.0	216.0	34.50	1.50	1.33	9.7	8.6	3.1	3.5	16.3	16.3
CITIC	601998 CH	34.1	15.3	5.57	0.62	0.57	5.9	5.6	4.4	4.6	10.6	10.4
MSB	600016 CH	34.2	50.5	5.83	0.57	0.52	4.9	4.7	5.2	5.6	12.0	11.6
CEB	601818 CH	25.7	37.8	3.69	0.61	0.57	5.5	5.1	4.9	5.2	11.3	11.3
PAB	000001 CH	34.2	172.7	14.27	0.99	0.89	8.9	7.9	1.1	1.3	11.6	11.8
SPDB	600000 CH	46.4	52.2	11.32	0.67	0.60	5.6	5.3	3.3	3.4	12.4	12.0
IND	601166 CH	50.4	172.8	17.37	0.73	0.65	5.6	5.1	4.3	4.8	13.6	13.4
HXB	600015 CH	15.7	14.2	7.29	0.52	0.46	5.3	4.9	3.0	3.3	10.0	9.3
Average					0.75	0.68	6.2	5.8	4.2	4.5	12.2	11.9
Regional city & rural commercial banks												
Bank of Beijing	601169 CH	15.5	30.8	5.26	0.59	0.54	5.3	4.8	5.1	5.8	11.2	11.2
Bank of Shanghai	601229 CH	17.8	32.8	8.96	0.80	0.72	6.4	5.2	4.6	5.3	12.4	12.8
Bank of Nanjing	601009 CH	9.3	46.9	7.83	0.85	0.74	5.3	4.6	5.1	5.9	16.0	16.1
Bank of Ningbo	002142 CH	17.6	56.5	22.65	1.54	1.32	9.0	7.7	2.1	2.5	17.1	17.6
Bank of Jiangsu	600919 CH	10.8	20.5	6.71	0.65	0.59	5.4	4.8	5.1	4.9	15.0	15.1
Bank of Guiyang	601997 CH	3.7	14.2	8.30	0.75	0.65	3.9	3.5	3.4	3.9	17.6	16.5
Bank of Hangzhou	600926 CH	5.8	16.1	8.05	0.79	0.71	7.0	5.9	3.6	4.2	10.9	11.4
Bank of Chengdu	601838 CH	4.1	15.2	8.22	0.84	0.73	5.4	4.5	5.0	5.8	16.5	17.1
JYRCB	002807 CH	1.3	3.9	4.41	0.83	0.77	10.0	9.2	2.2	2.3	7.9	8.0
WXRCB	600908 CH	1.4	4.2	5.24	0.85	0.78	8.0	7.2	2.5	2.7	11.2	11.4
CSRCB	601128 CH	2.9	18.3	7.68	1.25	1.11	10.5	8.9	2.9	3.4	13.1	13.5
WJRCB	603323 CH	1.3	9.0	5.13	0.77	0.72	8.9	8.2	2.9	3.3	8.9	8.9
ZJGRCB	002839 CH	1.4	8.6	5.40	0.95	0.88	10.6	9.3	-	-	9.3	-
Average					0.88	0.79	7.4	6.4	3.7	4.2	12.9	13.3

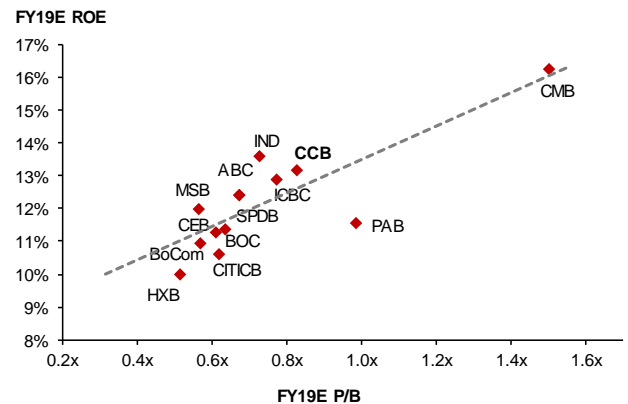
Source: Bloomberg, CMBIS

Figure 5: CCB's A/H valuation premium (discount)



Source: Bloomberg, CMBIS

Figure 6: P/B vs ROE for A-share China banks



Source: Bloomberg, CMBIS

Financial Summary

Income Statement

YE Dec 31 (RMB mn)	FY17A	FY18A	FY19E	FY20E	FY21E
Interest income	750,154	811,026	878,878	944,691	1,015,181
Interest expenses	(297,698)	(324,748)	(349,390)	(377,862)	(409,331)
Net interest income	452,456	486,278	529,487	566,829	605,850
Net fee income	117,798	123,035	129,187	135,646	142,428
Others	23,777	24,459	21,862	22,381	22,925
Operating income	594,031	633,772	680,537	724,856	771,203
Operating expenses	(167,043)	(174,764)	(186,068)	(197,185)	(208,839)
PPoP	426,988	459,008	494,468	527,671	562,363
Provision	(127,362)	(150,988)	(167,534)	(177,717)	(185,949)
Operating profit	299,626	308,020	326,935	349,954	376,414
Non-operating income	161	140	140	140	140
Pre-tax profit	299,787	308,160	327,075	350,094	376,554
Income tax expenses	(56,172)	(52,534)	(55,759)	(59,683)	(64,194)
Minority interests	(1,351)	(971)	(971)	(971)	(971)
Net profit	242,264	254,655	270,345	289,440	311,389

Key Ratio

YE Dec 31 (RMB mn)	FY17A	FY18A	FY19E	FY20E	FY21E
Op. income mix					
Net interest income	76%	77%	78%	78%	79%
Net fee income	20%	19%	19%	19%	18%
Others	4%	4%	3%	3%	3%
Total	100%	100%	100%	100%	100%
Growth, YoY					
Net interest income	8.3%	7.5%	8.9%	7.1%	6.9%
Net fee income	-0.6%	4.4%	5.0%	5.0%	5.0%
Operating income	6.1%	6.7%	7.4%	6.5%	6.4%
PPoP	10.0%	7.5%	7.7%	6.7%	6.6%
Net profit	4.7%	5.1%	6.2%	7.1%	7.6%
Gross loans	9.8%	6.8%	8.0%	8.0%	8.0%
Customer deposits	6.2%	4.6%	7.0%	7.0%	7.0%

Efficiency

Cost-to-income ratio	27.1%	26.6%	26.4%	26.2%	26.1%
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Balance Sheet

YE Dec 31 (RMB mn)	FY17A	FY18A	FY19E	FY20E	FY21E
Due from central banks	2,914,380	2,567,648	2,742,905	2,931,681	3,133,673
Interbank assets	708,598	1,038,521	1,080,355	1,124,280	1,170,402
Investments	5,181,648	5,714,909	6,114,953	6,532,514	6,978,831
Gross loans	12,903,441	13,783,053	14,885,697	16,076,553	17,362,677
Less: provision	328,968	417,623	515,097	617,272	721,770
Other assets	745,284	536,185	696,413	849,932	1,027,150
Total assets	22,124,383	23,222,693	25,005,225	26,897,688	28,950,964
Due to central banks	547,287	554,392	609,831	670,814	737,896
Interbank liabilities	2,116,279	2,250,045	2,435,326	2,648,449	2,895,453
Customer deposits	16,363,754	17,108,678	18,306,285	19,587,725	20,958,866
Debt securities issued	275,160	404,202	442,475	492,129	549,231
Other liabilities	1,026,076	913,782	989,593	1,072,237	1,162,348
Total liabilities	20,328,556	21,231,099	22,783,509	24,471,355	26,303,794
Shareholders' equity	1,779,760	1,976,463	2,206,585	2,411,202	2,632,039
Incl. Perpetual bonds	-	-	40,000	40,000	40,000
Incl. Preferred stocks	79,636	79,636	79,636	79,636	79,636
Minority interest	16,067	15,131	15,131	15,131	15,131
Total equity	1,795,827	1,991,594	2,221,716	2,426,333	2,647,170

Asset quality

NPL ratio	1.49%	1.46%	1.49%	1.53%	1.51%
Provision coverage	171%	208%	232%	251%	275%
Provision/ total loans	2.55%	3.03%	3.46%	3.84%	4.16%
Credit costs	1.00%	1.07%	1.11%	1.09%	1.06%

Capital adequacy

CET-1 CAR	13.1%	13.8%	14.3%	14.6%	14.9%
Tier-1 CAR	13.7%	14.4%	14.9%	15.1%	15.3%
Total CAR	15.5%	17.2%	16.6%	16.7%	16.9%

Profitability

NIM	2.21%	2.31%	2.28%	2.27%	2.26%
ROE	14.8%	13.9%	13.4%	13.1%	12.8%
ROA	1.12%	1.11%	1.11%	1.10%	1.10%
RoRWA	1.94%	1.89%	1.89%	1.89%	1.89%

Per share

EPS (RMB)	0.96	1.00	1.07	1.14	1.23
DPS (RMB)	0.29	0.31	0.32	0.35	0.37
BVPS (RMB)	6.80	7.59	8.35	9.17	10.05

Source: Company data, CMBIS estimates

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