

Bank of China (3988 HK)

Outstanding margin and asset quality trend

On 30 Aug, BOC reported 1H19 net profit of RMB 114bn, up 4.5% YoY and accounting for 60.4%/62.9% of CMBIS/consensus full-year estimates. 1H19 PPOp had a decent growth of 8.1% YoY, driven by strong trading/investment gains and better cost efficiency, despite a softer net interest income growth. In 2Q19, the Bank set aside less provisions, offsetting a YoY surge in tax expenses. Therefore, bottom-line earnings growth accelerated to 5.0% YoY in 2Q19 (vs 4.0% YoY in 1Q19).

■ **Results positive:** 1) **2Q19 NIM edged up 2bp QoQ to 1.84%**, vs a downward margin trend for other large banks. This was attributed to optimized asset mix and strict control in liability cost, according to management's explanation during results briefing; 2) **Demand deposit rose 7.2% HoH**, faster than total deposit growth of 5.5% HoH. In particular, retail demand deposits expanded 11.5% HoH. The proportion of total demand deposit climbed 0.8ppt HoH to 49.5%; 3) **Asset quality improved notably**, as NPL slid 2bp QoQ to 1.40%, lowest among the Big-5 banks. Both special mention and overdue loans saw double-decline in 2Q19. NPL recognition was more stringent, as NPLs covered 135.9% of >90-day overdue loans and 98.5% of total overdue loans (vs 123.5% and 75.9% in 4Q18); 4) **CAR was supported by multi-channel capital replenishment**. BOC issued RMB 40bn perpetual bonds and RMB 73b preference share in 1H19, boosting total CAR by 36bp HoH to 15.3%.

■ **Results negative:** 1) **Provision coverage dropped 7.1ppt to 177.5%**, lower than Big-5 average of 208%, indicating less buffer to hold up earnings should topline growth weakens. 2) **Net fee income growth slowed to 3.6% YoY in 2Q19**, dragged by falling fees on credit commitment and foreign exchange businesses. 3) **1H19 annualized ROE declined 0.7ppt to 14.6%**, as net profit growth remained subdued at 4.5% YoY.

■ **Maintain BUY and lower TP to HK\$4.3.** BOC currently trades at 0.48x FY19E P/B, 17% below its past 5-year mean of 0.58x. We trim our TP to HK\$4.3 from HK\$5.2, given a lower sustainable ROE forecast of 11.0%, higher COE assumption of 14.5%, and adjusted HK\$/RMB exchange rate of 0.897.

Earnings Summary

(YE 31 Dec)	FY17A	FY18A	FY19E	FY20E	FY21E
Operating income (RMB mn)	461,154	486,798	536,026	572,547	615,568
Net profit (RMB mn)	172,407	180,086	189,224	200,490	214,094
EPS (RMB)	0.56	0.59	0.62	0.66	0.70
EPS CHG (%)	4.9	4.6	5.3	6.2	7.0
P/E (x)	4.8	4.6	4.3	4.1	3.8
P/B (x)	0.57	0.52	0.48	0.44	0.41
Dividend yield (%)	6.6	6.9	7.2	7.6	8.1
ROE (%)	12.2	11.9	11.5	11.3	11.1
NPL ratio (%)	1.45	1.42	1.43	1.45	1.46
Provision coverage (%)	159	182	192	201	212

Source: Company data, CMBIS estimates

BUY (Maintain)

Target Price	HK\$ 4.30
(Previous TP)	HK\$ 5.20)
Up/Downside	+43.8%
Current Price	HK\$ 2.99

China Banking Sector

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Stock Data

Mkt Cap (HK\$ mn)	1,066,138
Avg 3 mths t/o (HK\$ mn)	779.01
52w High/Low (HK\$)	3.84/2.91
Total Issued Shares (mn)	83,622 (H)
	210,766 (A)

Source: Bloomberg

Shareholding Structure

Huijin	64.63%
CSFC	2.92%

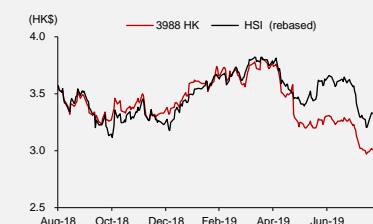
Source: Company data

Share Performance

	Absolute	Relative
1-mth	-8.1%	0.5%
3-mth	-7.8%	-2.3%
6-mth	-19.1%	-9.9%

Source: Bloomberg

12-mth Price Performance



Source: Bloomberg

Auditor: Ernst & Young

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Figure 1: 1H19 results summary

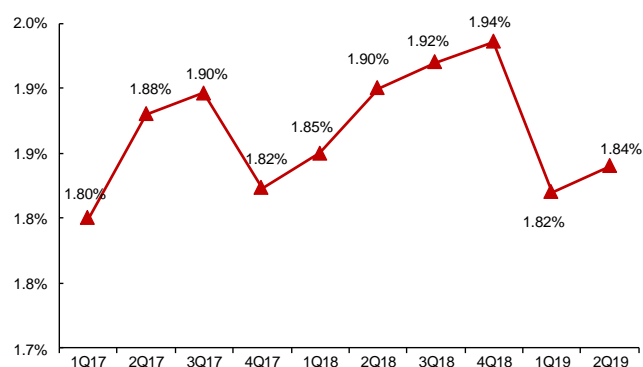
(RMB mn)						
P&L	1H18	1H19	YoY	2Q18	2Q19	YoY
Net interest income	172,451	181,684	5.4%	88,577	92,303	4.2%
Net fee and commission income	48,188	50,564	4.9%	22,406	23,209	3.6%
Operating income	243,518	263,312	8.1%	117,432	122,306	4.2%
Operating expense	(74,168)	(77,754)	4.8%	(30,771)	(30,096)	-2.2%
PPoP	169,350	185,558	9.6%	86,661	92,210	6.4%
Impairment losses	(28,270)	(33,670)	19.1%	(12,775)	(6,335)	-50.4%
Pre-tax profit	141,080	151,888	7.7%	73,886	85,875	16.2%
Income tax	(26,386)	(31,116)	17.9%	(10,886)	(19,553)	79.6%
Net profit	109,088	114,048	4.5%	60,087	63,083	5.0%

B/S	4Q18	2Q19	HoH	1Q19	2Q19	QoQ
Gross loans	11,819,272	12,569,734	6.3%	12,260,376	12,569,734	2.5%
Customers' deposits	14,595,788	15,392,934	5.5%	15,207,131	15,392,934	1.2%
Total assets	21,267,275	22,266,024	4.7%	21,616,555	22,266,024	3.0%
NPLs	166,941	175,899	5.4%	173,083	175,899	1.6%

Key ratios	1H18	1H19	YoY	1Q19	2Q19	QoQ
NIM	1.88%	1.83%	-5bp	1.82%	1.84%	2bp
ROE	15.5%	14.8%	-0.7ppt	13.2%	16.1%	2.8ppt
NPL ratio	1.43%	1.40%	-3bp	1.42%	1.40%	-2bp
Provision coverage	163.9%	177.5%	13.6ppt	184.6%	177.5%	-7.1ppt
LDR	81.3%	81.7%	0.3ppt	80.6%	81.7%	1.0ppt
CET-1 CAR	11.0%	11.2%	22bp	11.4%	11.2%	-17bp

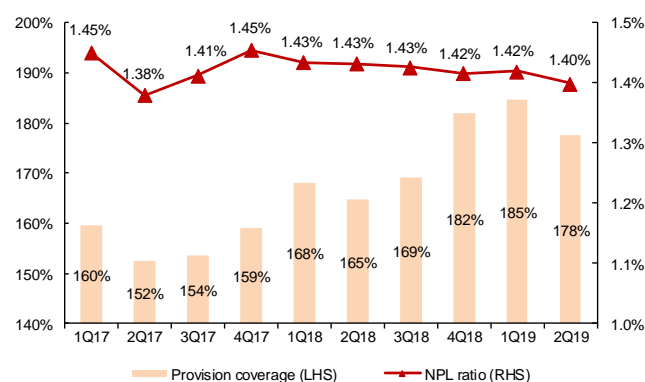
Source: Company data, CMBIS

Figure 2: Quarterly NIM of BOC



Source: Company data, CMBIS

Figure 3: NPL ratio and provision coverage of BOC



Source: Company data, CMBIS

Financial Summary

Income Statement

YE Dec 31 (RMB mn)	FY17A	FY18A	FY19E	FY20E	FY21E
Interest income	622,616	687,900	771,650	825,658	886,572
Interest expenses	(284,227)	(328,194)	(361,907)	(386,848)	(412,703)
Net interest income	338,389	359,706	409,743	438,810	473,870
Net fee income	88,691	87,208	91,568	96,147	100,954
Others	34,074	39,884	34,715	37,590	40,744
Operating income	461,154	486,798	536,026	572,547	615,568
Operating expenses	(151,252)	(159,971)	(175,802)	(188,880)	(203,671)
PPoP	309,902	326,827	360,224	383,667	411,896
Provision	(88,161)	(99,294)	(120,312)	(128,691)	(138,901)
Operating profit	221,741	227,533	239,912	254,976	272,995
Non-operating income	1,162	2,110	2,110	2,110	2,110
Pre-tax profit	222,903	229,643	242,022	257,086	275,105
Income tax expenses	(37,917)	(37,208)	(39,214)	(41,655)	(44,574)
Minority interests	(12,579)	(12,349)	(13,584)	(14,942)	(16,437)
Net profit	172,407	180,086	189,224	200,490	214,094

Key Ratio

YE Dec 31 (RMB mn)	FY17A	FY18A	FY19E	FY20E	FY21E
Op. income mix					
Net interest income	73%	74%	76%	77%	77%
Net fee income	19%	18%	17%	17%	16%
Others	7%	8%	6%	7%	7%
Total	100%	100%	100%	100%	100%
Growth, YoY					
Net interest income	10.6%	6.3%	13.9%	7.1%	8.0%
Net fee income	0.0%	-1.7%	5.0%	5.0%	5.0%
Operating income	-1.6%	5.6%	10.1%	6.8%	7.5%
PPoP	-0.2%	5.5%	10.2%	6.5%	7.4%
Net profit	4.8%	4.5%	5.1%	6.0%	6.8%
Gross loans	9.3%	8.5%	8.0%	8.0%	8.0%
Customer deposits	5.3%	9.9%	8.0%	8.0%	8.0%
Efficiency					
Cost-to-income ratio	31.8%	31.9%	31.6%	31.8%	31.9%

Balance Sheet

YE Dec 31 (RMB mn)	FY17A	FY18A	FY19E	FY20E	FY21E
Due from central banks	2,227,614	2,331,053	2,516,098	2,717,385	2,934,776
Interbank assets	1,060,456	1,405,534	1,291,040	1,342,562	1,396,661
Investments	4,554,722	5,054,551	5,545,985	5,886,894	6,248,911
Gross loans	10,896,558	11,819,272	12,764,814	13,785,999	14,888,879
Less: provision	252,254	303,781	351,900	402,566	460,110
Other assets	980,328	960,646	1,136,614	1,244,413	1,323,034
Total assets	19,467,424	21,267,275	22,902,651	24,574,688	26,332,151
Due to central banks	1,035,797	907,521	907,521	907,521	907,521
Interbank liabilities	2,313,240	2,781,557	3,011,946	3,173,482	3,345,614
Customer deposits	13,280,464	14,595,788	15,763,451	17,024,527	18,386,489
Debt securities issued	488,702	631,854	651,854	671,854	691,854
Other liabilities	772,542	625,158	667,424	713,128	762,549
Total liabilities	17,890,745	19,541,878	21,002,196	22,490,512	24,094,027
Shareholders' equity	1,496,016	1,612,980	1,788,037	1,971,760	2,125,707
Incl. Perpetual bonds	-	-	40,000	80,000	80,000
Incl. Preferred stocks	99,714	99,714	99,714	99,714	99,714
Minority interest	80,663	112,417	112,417	112,417	112,417
Total equity	1,576,679	1,725,397	1,900,454	2,084,177	2,238,124

Asset quality					
NPL ratio	1.45%	1.42%	1.43%	1.45%	1.46%
Provision coverage	159%	182%	192%	201%	212%
Provision/ total loans	2.31%	2.58%	2.76%	2.92%	3.09%
Credit costs	0.81%	0.95%	0.94%	0.93%	0.93%
Capital adequacy					
CET-1 CAR	11.2%	11.4%	12.4%	12.5%	12.6%
Tier-1 CAR	12.0%	12.3%	13.1%	13.2%	13.3%
Total CAR	14.2%	15.0%	16.2%	16.2%	16.2%
Profitability					
NIM	1.84%	1.90%	1.90%	1.90%	1.91%
ROE	12.2%	11.9%	11.5%	11.3%	11.1%
ROA	0.88%	0.85%	0.83%	0.82%	0.81%
RoRWA	1.41%	1.39%	1.37%	1.35%	1.35%
Per share					
EPS (RMB)	0.56	0.59	0.62	0.66	0.70
DPS (RMB)	0.18	0.18	0.19	0.20	0.22
BVPS (RMB)	4.74	5.14	5.60	6.09	6.61

Source: Company data, CMBIS estimates

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