

Analyst: Paul Sham

BANK OF COMMUNICATIONS CO., LTD. (交通銀行)

Sector	: Banking	Chairman & Head of Bank	: Mr. Niu Ximing
HKSE Code	: 03328	Vice Chairman	: Mr. Peng Chun
Market Price	: HK\$6.65 (31/03/2015)		
Shares Issued	: 35,012m (H share)		
Mkt. Cap.	: HK\$2m (H share)		
52 weeks Hi/ Lo	: HK\$7.36 / HK\$4.75		
HIS / HSCEI	: 24,900.89 / 12,346.09 (31/03/2015)		
Main Business	: Banking and related financial services		

SUMMARY OF THE FINAL RESULTS FOR THE YEAR ENDED 31ST DECEMBER 2014

Final Results Highlights

Profit & Loss Accounts	RMB million	Vs FY2013 (%)	
• Net interest income	134,776	+3.2%	
• Non-interest income	41,232	+24.2%	
• Total operating income	176,008	+7.4%	
• Operating expenses	(70,732)	+7.9%	
• Operating profit before impairment losses	105,276	+7.1%	
• Impairment losses	(20,439)	+11.0%	
• Profit before taxation and non-core items	84,837	+6.2%	
• Non-core items	90	+114.3%	
• Profit before taxation	84,927	+6.3%	
• Taxation	(18,892)	+8.3%	
• Attributable profit to shareholders	65,850	+5.7%	
• Total DPS (RMB)	0.27	+3.8%	
• Basic EPS (RMB)	0.89	+6.0%	

Selected Balance Sheet Items	31/12/2014	Vs 31/12/2013	Vs 30/06/2014
• Total loans	3,431,735	+5.1%	-0.1%
• Total deposits	4,029,668	-3.1%	-7.9%
• Total assets	6,268,299	+5.2%	-0.2%

Selected Ratios	FY2014	FY2013	1H2014
• Net interest margin	2.36%	2.52%	2.39%
• Cost-income ratio	40.2%	40.0%	35.4%
• Return on average assets	1.08%	1.11%	1.21%
• Return on average equity	14.8%	15.6%	17.1%
• Dividend payout ratio	30.3%	31.0%	NA

	31/12/2014	31/12/2013	30/6/2014
• NPL ratio	1.25%	1.05%	1.13%
• NPL Coverage ratio	178.9%	213.7%	204.2%
• Loan-deposit ratio	85.2%	78.6%	78.5%
• Common equity tier 1 CAR	11.3%	9.8%	10.7%
• Tier 1 CAR	11.3%	9.8%	10.7%
• Total CAR	14.0%	12.1%	12.8%

- **Weak fundamentals as expected** Bank of Communications ("BoCom") reported full-year net profit of RMB65,850m, up 5.7% y-o-y, in-line with market estimates of RMB64,237m. BoCom is so far the only China bank reporting sub-15% ROE and y-o-y decline in deposit in 2014, suggesting that

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fundamentals of BoCom continued to be the weakest within the sector. The only noticeable positive is that BoCom lifted CET1 CAR to a comfortable level at 11.3%, thanks to the shrinking risk-weighted assets (-2.6% y-o-y). BoCom declared a final cash dividend of RMB0.27 per share (+3.8% y-o-y), making the FY14 dividend payout ratio to 30.3%, down from 31.0% in FY13.

- **Net interest income** grew very slowly at 3.2% to RMB134,776m during 2014, dragged by the disappointment in net interest margin. BoCom's NIM narrowed notably by 16bps y-o-y to 2.36% under the impact of interest rate liberalization. Its 5.1% y-o-y expansion in loan book was also weaker than the double-digit growth of listed peers. Meanwhile, deposit fell by 3.1% y-o-y, the first time since its listing, pushing up its loan-to-deposit ratio to 85.2% at end-2014, from 78.6% a year ago. .
- **Non-interest income** grew by 24.0% y-o-y to RMB41,232m. BoCom's net fee income growth was one of the few positives in FY14 results, which rose by 14.0% y-o-y, supported by bank card fees (+16.9% y-o-y), management service fees (+24.7%) and agency services fees (+14.4%). Apart from a healthy growth in net fees, other non-interest income surged 60.9% y-o-y in 2014 mainly driven by mark-to-market gain in bond investment and forex dealing profit.
- **Operating expenses** increased by 7.9% y-o-y in FY14, slightly faster than total revenue growth of 7.4%. As such, the bank's cost-income ratio edged higher to 40.2% in FY14 from 40.0% a year earlier. As usual, BoCom did not provide detailed breakdown for its expenses.
- **Asset quality** BoCom's asset quality trend was in-line with peers. Its NPL balance grew by 25% y-o-y while NPL ratio came up to 1.25% at end-2014, from 1.05% a year earlier. Total overdue loans, the indicator of future NPL formation, jumped 40% y-o-y. Similar to other H-share peers, BoCom's NPL coverage ratio dropped notably from 213.7% at end-2013 to 178.9% at end-2014, and was the lowest within the sector.
- **Capital positions** BoCom's capital position used to be the weakest in the sector. Thanks to the 2.6% y-o-y contraction in risk weighted assets, BoCom's capital position improved notably in FY14. Its CET1 CAR and total CAR were strengthened to comfortable levels of 11.3% and 14.0% respectively at end-2014, which were at the high end among peers.

Outlook & Prospects

- **Mix-ownership reform plan could be a long-term catalyst** BoCom revealed in July 2014 that it was studying plans to deepen its mixed-ownership structure, a move that might introduce more private and foreign investment into the state-controlled bank. Market speculates that the government is committed to economic reforms and China is willing to open up the banking sector to allow market forces to play a bigger role. Management provided very scarce details in the SOE reform in the results briefing but the mix-ownership reform plan will remain a positive catalyst in the medium term for BoCom.
- **High LDR likely drags earnings** While most of its peers saw mild NIM expansion in FY14, BoCom's NIM shrank by 16bps y-o-y, indicating that the bank might be under higher pressure than peers amid interest rate deregulation. Its overly-stretched LDR of 85.2% makes BoCom difficult to reverse the worsening NIM trend as BoCom will have to either raise the deposit rate to attract deposit or slow the loan underwriting under the constrain of LDR. Both actions will have negative impacts on BoCom's earnings in 2015.
- **Sufficient capital level at current stage** BoCom plans to issue up to RMB15bn preference shares offshore and RMB45bn onshore, which will boost up its tier 1 CAR. Meanwhile, BoCom's CET1 stood at a comfortable level of 11.3% at-end 2014, which is close to the sector leader CCB's 12.1% and ICBC's 11.9%. Therefore, we believe BoCom should have no urge to raise capital in the near term.
- **Valuation** BoCom was the best performing large cap bank shares in 2014, due to its cheap valuation and the promising "mixed ownership reform". Considering its stretched LDR, slow asset growth and relatively low ROE, BoCom was the weakest player among peers. However, BoCom's shares are currently trading at 0.76x FY15E P/B, which is the lowest among H-share banks, and should have factored in the aforesaid weaknesses. As such, we consider valuation of BoCom is fair and recommend a "hold" rating on the counter.

Recommendation: *Hold*


I. Comparison of Bank of Communications' loan book: 31/12/2014 vs 31/12/2013

Loans-by sectors	31st Dec, 2014	Up/(down)	31st Dec, 2013
	RMB million		RMB million
Corporate loans			
<i>Manufacturing</i>	624,673	-0.9%	630,355
<i>Transportation</i>	388,980	+0.6%	386,822
<i>Wholesale and retail</i>	333,003	-15.0%	391,772
<i>Public services</i>	138,903	+6.2%	130,777
<i>Real estate</i>	207,566	+3.1%	201,300
<i>Electricity, Gas and water supply</i>	132,234	-0.5%	132,942
<i>Services</i>	233,905	+13.0%	206,910
<i>Other corporate loans</i>	429,566	+14.9%	373,737
Personal mortgage loans	529,871	+15.6%	458,356
Other personal loans	338,486	+15.5%	292,954
Discounted bills	74,548	+23.3%	60,443
	<u>3,431,735</u>	<u>+5.1%</u>	<u>3,266,368</u>

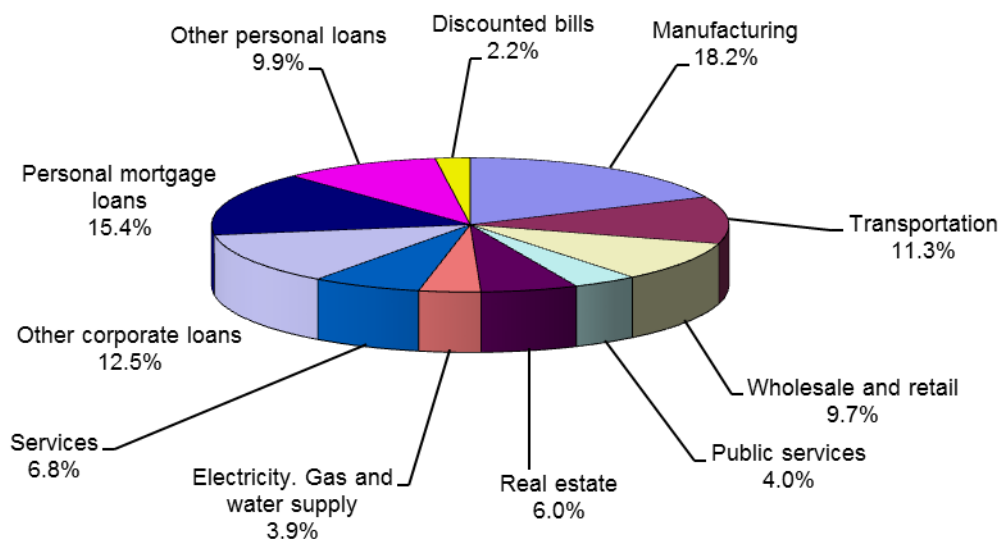
II. Comparison of Bank of Communications' loan book (by geographies): 31/12/2014 vs 31/12/2013

Loans-by geographies	31st Dec, 2014	Up/(down)	31st Dec, 2013
	RMB million		RMB million
Northern China	524,090	+1.2%	517,921
Northeastern China	177,888	+7.1%	166,065
Eastern China	1,465,863	+5.4%	1,390,342
Central and Southern China	638,822	+7.0%	597,291
Western China	348,089	+10.3%	315,507
Overseas	276,983	-0.8%	279,242
	<u>3,431,735</u>	<u>+5.1%</u>	<u>3,266,368</u>

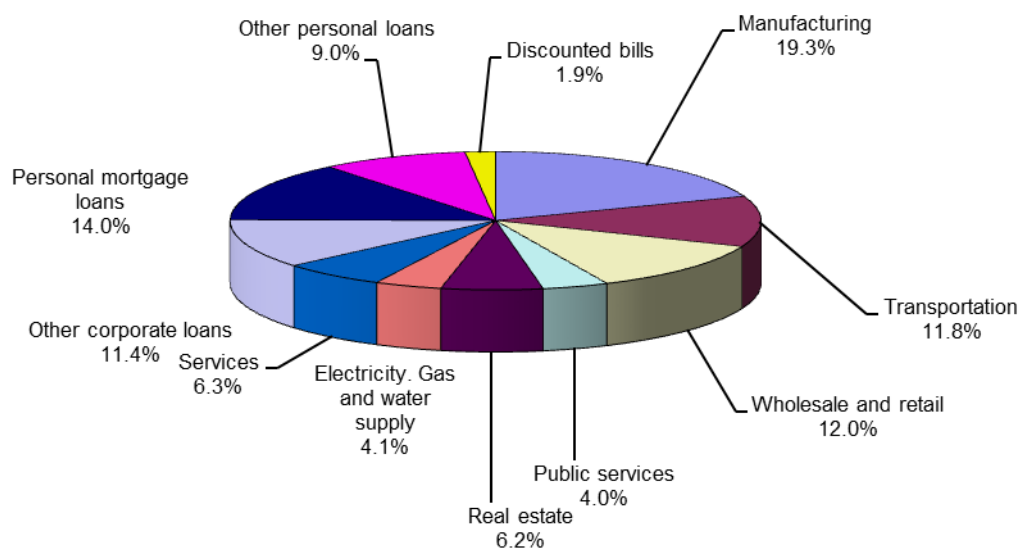


Breakdown of loan book of Bank of Communications by sectors

Breakdown of Loan Book as of 31/12/2014
Total customer advances: RMB3,431,735 million



Breakdown of Loan Book as of 31/12/2013
Total customer advances: RMB3,266,368 million



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