

China Merchants Bank

3968 HK

Target (HKD): 20.00 → 21.00

Upside: 13.5%

18 Mar price (HKD): 18.50

- 1 Buy (unchanged)
- 2 Outperform
- 3 Hold
- 4 Underperform
- 5 Sell

Preparing for a rainy day

Leon Qi, CFA

(852) 2532 4381

leon.qi@hk.daiwacm.com

Steve Xu

(852) 2532 4383

steve.xu@hk.daiwacm.com

- PPOP growth still solid; spike in provision charges leads to lower YoY bottom-line growth
- Separate listing of credit-card or wealth management units could be new stock catalysts
- Reiterating Buy (1) with higher TP of HKD21

What's new

China Merchants Bank (CMB) reported a 2014 net profit of CNY55.9bn, up 8.1% YoY and in line with preliminary results. As expected by Daiwa, CMB made a large provision in 4Q14, which led to a QoQ decline in its net profit. Also, CMB's 34% YoY PPOP growth should still be one of the highest among China banks in our coverage.

What's the impact

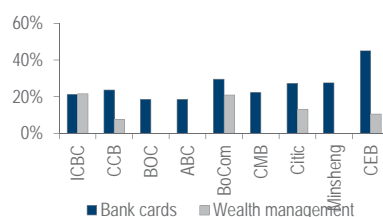
Provision charges. Despite the fact that China banks tend to book large provisions in 4Q, CMB's provision charge rose by 71% QoQ or 371% YoY in 4Q14, resulting in a 3-times-higher amount of provisions in 2014 vs. 2013. Despite that, the provision coverage ratio declined by 33bps YoY and edged up by only 5bps QoQ, suggesting an aggressive NPL write-off in 4Q14, casting a shadow over its better-than-sector 1bp QoQ NPL ratio increase. We understand that most of the

incremental NPLs came from trade finance and micro loans.

Separate-listing of business units.

The CBRC said recently that it encourages banks to set up separate entities for credit card and wealth management units. In case banks list such units, we believe CMB will be a big beneficiary given its relatively high exposure to the credit card and wealth management business.

Contribution of bank cards fee and wealth management to fee income (9M14)



Source: Companies, Daiwa

Note: data of wealth management fee income are not available for BOC, ABC, CMB and Minsheng.

Non-standard debt investments saw moderate growth of 8% QoQ in 4Q14, underpinning a full-year rise of 104% in 2014.

Net-interest margin was down 30bps YoY to 2.52% due to lower yields from the interbank market in 2014 than yields from the interbank market in the 2013, and rising funding costs throughout 9M14. However, 4Q14 NIM saw a 21bp QoQ rebound, on our estimates, due to an easing of deposit competition.

Fee income continued to show strong momentum, with 53% YoY growth in 2014, and accounted for 27% of CMB's operating income for 2014 vs. 22% for 2013.

What we recommend

We reaffirm our Buy (1) call on CMB. We also like BOC (3988 HK,

HKD4.42, Buy [1]) and CEB (6818 HK, HKD4.29, Outperform [2]). Our Gordon Growth Model implies a 2015E PBR of 1.4x, or a fundamental fair value of HKD24.1. Factoring in a 5% corporate exposure haircut (HKD3.10/share), we reach our new 12-month target price of HKD21 (formerly 6-month TP of HKD20), implying a 1.2x 2015E PBR. The main risk to our call is the rising asset quality issue on its micro loans.

How we differ

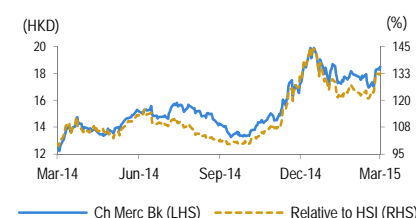
Unlike the market, we are not overly concerned about credit risks for CMB's non-standard investments.

Forecast revisions (%)

Year to 31 Dec	15E	16E	17E
PPOP change	3.5	0.2	n.a.
Net profit change	(4.4)	(2.4)	n.a.
Core EPS (FD) change	(4.4)	(2.4)	n.a.

Source: Daiwa forecasts

Share price performance



12-month range	12.22-19.90
Market cap (USDbn)	60.10
3m avg daily turnover (USDm)	61.45
Shares outstanding (m)	25,220
Major shareholder	China Merchants Group (17.9%)

Financial summary (CNY)

Year to 31 Dec	15E	16E	17E
Total operating income (m)	188,045	203,475	214,479
Pre-provision operating profit(m)	119,068	127,781	131,710
Net profit (m)	61,861	67,832	69,414
Core EPS (fully-diluted)	2.453	2.690	2.752
EPS change (%)	10.6	9.7	2.3
Daiwa vs Cons. EPS (%)	(3.0)	(3.9)	(1.7)
PER (x)	6.1	5.5	5.4
Dividend yield (%)	5.0	5.5	5.6
DPS	0.741	0.813	0.832
PBR (x)	1.1	0.9	0.8
ROE (%)	18.4	17.8	16.2

Source: FactSet, Daiwa forecasts

■ CMB: P&L summary

(CNY m)	2014	2013	% YoY	2H14	1H14	2H13	% HoH	% YoY	4Q14	3Q14	4Q13	% QoQ	% YoY
Net interest income	112,000	98,913	13.2	58,142	53,858	51,472	8.0	13.0	29,733	28,409	26,341	4.7	12.9
Non-interest income	54,035	33,786	59.9	23,639	30,396	17,208	(22.2)	37.4	11,152	12,487	8,827	(10.7)	26.3
of which: fees	44,696	29,184	53.2	20,994	23,702	15,020	(11.4)	39.8	10,450	10,544	7,478	(0.9)	39.7
Operating income	166,035	132,699	25.1	81,781	84,254	68,680	(2.9)	19.1	40,885	40,896	35,168	(0.0)	16.3
Operating expenses	(61,081)	(54,144)	12.8	(33,319)	(27,762)	(29,906)	20.0	11.4	(18,171)	(15,148)	4,193	20.0	(533.4)
Pre-provisioning profits	104,954	78,555	33.6	48,462	56,492	38,774	(14.2)	25.0	22,714	25,748	39,361	(11.8)	(42.3)
Impairment losses	(31,681)	(10,218)	210.1	(15,361)	(16,320)	(5,259)	(5.9)	192.1	(9,683)	(5,678)	(2,056)	70.5	371.0
Operating profit	73,273	68,337	7.2	33,101	40,172	33,515	(17.6)	(1.2)	13,031	20,070	37,305	(35.1)	(65.1)
Other income	158	88	79.5	65	93	62	(30.1)	4.8	28	37	(236)	(24.3)	(111.9)
Profit before tax	73,431	68,425	7.3	33,166	40,265	33,577	(17.6)	(1.2)	13,059	20,107	37,069	(35.1)	(64.8)
Tax & others	(17,520)	(16,682)	5.0	(7,714)	(9,806)	(8,105)	(21.3)	(4.8)	(2,952)	(4,762)	(3,766)	(38.0)	(21.6)
Net profit	55,911	51,743	8.1	25,452	30,459	25,472	(16.4)	(0.1)	10,107	15,345	33,303	(34.1)	(69.7)

Source: Company, Daiwa

■ CMB: key balance-sheet items

(CNY m)	2014	3Q14	2Q14	1Q14	2013	% QoQ	% HoH	% YoY
Gross loans	2,513,919	2,445,504	2,422,092	2,349,185	2,197,094	3%	4%	14%
Deposits	3,304,438	3,265,520	3,420,748	3,057,360	2,775,276	1%	-3%	19%
NPL balance	27,917	26,923	23,697	19,870	18,332	4%	18%	52%
Special mention loans	46,634	n/a	30,071	n/a	24,603	n/a	55%	90%
Overdue loans	52,704	n/a	45,050	n/a	32,995	n/a	17%	60%

Source: Company, Daiwa

■ CMB: key ratios

(%)	2014	2013	Chg YoY (pp)	1Q14	2Q14	3Q14	4Q14
NIM	2.52	2.82	(0.30)	2.65	2.49	2.36	2.59
Loan-to-deposit	76.1	79.2	(3.1)	76.8	70.8	74.9	76.1
NPL ratio	1.11	0.83	0.28	0.85	0.98	1.10	1.11
SML ratio	1.86	1.12	0.74	n.a	1.24	n.a	1.86
Overdue loan ratio	2.10	1.50	0.60	n.a	1.86	n.a	2.10
Provision coverage	233	266	(33)	268	251	228	233
Loan-loss reserves	2.59	2.22	0.37	2.27	2.46	2.51	2.59
Credit cost - annualized (bps)	132	49	83	134	146	100	147
Cost-to-income ratio (incl. business tax)	36.8	40.8	(4.0)	33.7	32.3	36.8	44.7
Core tier-1 CAR	10.44	9.27	1.17	9.09	9.47	10.35	10.44
Total CAR	12.38	11.14	1.24	10.90	11.45	12.28	12.38
ROE	19.3	22.2	(2.9)				
Payout ratio	30.2	30.2	-				

Source: Company, Daiwa

Note: Loan-to-deposit ratio, credit cost and ROE are based on Daiwa's estimates; 2014 CAR calculated under advanced approaches

■ CMB: special mention, NPL and overdue loans

(CNY m)	2014	1H14	2013	% HoH	% YoY
Special mention loans	46,634	30,071	24,603	55.1	89.5
Non-performing loans (NPL)	27,917	23,697	18,332	17.8	52.3
Overdue loans					
- less than 3 months	27,480	25,338	17,017	8.5	61.5
- over 3 months but less than 12 months	19,542	13,228	8,689	47.7	124.9
- over 12 months but less than 3 years	4,751	4,902	4,743	(3.1)	0.2
- over 3 years	931	1,582	2,546	(41.2)	(63.4)
Total overdue loans	52,704	45,050	32,995	17.0	59.7
Overdue loans over 3 months	25,224	19,712	15,978	28.0	57.9

Source: Company, Daiwa

Financial summary

■ Key assumptions

Year to 31 Dec	2010	2011	2012	2013	2014	2015E	2016E	2017E
Net interest margin (%)	2.65	3.06	3.03	2.82	2.52	2.45	2.43	2.36
NPL (%)	0.7	0.6	0.6	0.8	1.1	1.6	1.9	2.1
Credit cost (bps)	40.1	54.1	31.5	48.8	132.0	147.6	137.8	133.0
Provision coverage (%)	302	400	352	266	233	206	214	231
Loan loss reserve (%)	2.05	2.24	2.16	2.22	2.59	3.24	4.07	4.81
Loan growth (%)	20.7	14.6	16.0	15.4	14.4	11.0	10.0	9.0
Deposit growth (%)	18.0	17.0	14.1	9.6	19.1	12.0	10.0	9.0
Fee to income ratio (%)	15.9	16.2	17.4	22.0	26.9	28.5	30.3	31.6
Expense to income ratio (%)	45.7	42.5	42.6	40.8	36.8	36.7	37.2	38.6

■ Profit and loss (CNYm)

Year to 31 Dec	2010	2011	2012	2013	2014	2015E	2016E	2017E
Net-interest income	57,076	76,307	88,374	98,913	112,000	124,524	131,486	135,872
Net fees & commission	11,330	15,628	19,739	29,184	44,696	53,635	61,680	67,849
Trading and other income	2,933	4,294	5,227	4,507	9,196	9,728	10,136	10,569
Net insurance income	75	69	93	95	143	157	173	190
Total operating income	71,414	96,298	113,433	132,699	166,035	188,045	203,475	214,479
Personnel expenses	(16,002)	(20,316)	(23,938)	(26,990)	(29,179)	(32,643)	(36,288)	(40,037)
Other expenses	(16,632)	(20,573)	(24,418)	(27,154)	(31,902)	(36,333)	(39,406)	(42,733)
Total expenses	(32,634)	(40,889)	(48,356)	(54,144)	(61,081)	(68,976)	(75,693)	(82,769)
Pre-provision operating profit	38,780	55,409	65,077	78,555	104,954	119,068	127,781	131,710
Total provision	(5,501)	(8,350)	(5,583)	(10,218)	(31,681)	(38,006)	(38,903)	(40,765)
Operating profit after prov.	33,279	47,059	59,494	68,337	73,273	81,062	88,878	90,945
Non-operating income	64	63	64	88	158	168	178	188
Profit before tax	33,343	47,122	59,558	68,425	73,431	81,230	89,056	91,133
Tax	(7,574)	(10,995)	(14,286)	(16,683)	(17,382)	(19,228)	(21,081)	(21,572)
Min. int./pref. div./other items	0	2	(4)	1	(138)	(141)	(144)	(146)
Net profit	25,769	36,129	45,268	51,743	55,911	61,861	67,832	69,414
Adjusted net profit	25,769	36,129	45,268	51,743	55,911	61,861	67,832	69,414
EPS (CNY)	1.231	1.674	2.098	2.301	2.217	2.453	2.690	2.752
EPS (adjusted) (CNY)	1.231	1.674	2.098	2.301	2.217	2.453	2.690	2.752
EPS (adjusted fully-diluted) (CNY)	1.231	1.674	2.098	2.301	2.217	2.453	2.690	2.752
DPS (CNY)	0.290	0.420	0.630	0.620	0.670	0.741	0.813	0.832

■ Change (YoY %)

Year to 31 Dec	2010	2011	2012	2013	2014	2015E	2016E	2017E
Net-interest income	41.4	33.7	15.8	11.9	13.2	11.2	5.6	3.3
Non-interest income	28.8	39.4	25.4	34.8	59.9	17.6	13.3	9.2
Total operating income	38.7	34.8	17.8	17.0	25.1	13.3	8.2	5.4
Total expenses	24.5	25.3	18.3	12.0	12.8	12.9	9.7	9.3
Pre-provision operating profit	53.4	42.9	17.4	20.7	33.6	13.4	7.3	3.1
Total provisions	85.2	51.8	(33.1)	83.0	210.1	20.0	2.4	4.8
Operating profit after provisions	49.1	41.4	26.4	14.9	7.2	10.6	9.6	2.3
Profit before tax	49.0	41.3	26.4	14.9	7.3	10.6	9.6	2.3
Net profit (adjusted)	41.3	40.2	25.3	14.3	8.1	10.6	9.7	2.3
EPS (adjusted, FD)	29.1	36.0	25.3	9.7	(3.7)	10.6	9.7	2.3
Gross loans	20.7	14.6	16.0	15.4	14.4	11.0	10.0	9.0
Deposits	18.0	17.0	14.1	9.6	19.1	12.0	10.0	9.0
Total assets	16.2	16.3	21.9	17.9	17.8	6.6	6.2	6.5
Total liabilities	14.9	15.9	22.0	16.9	17.8	6.1	5.7	6.0
Shareholders' equity	44.4	23.1	21.4	32.5	18.4	13.7	13.2	12.0
Avg interest-earning assets	19.1	15.8	17.3	20.1	26.6	14.4	6.4	6.3
Avg risk-weighted assets	24.5	21.7	18.0	32.1	5.4	17.7	8.3	8.6

Source: FactSet, Daiwa forecasts

Financial summary continued ...

■ Balance sheet (CNYm)

As at 31 Dec	2010	2011	2012	2013	2014	2015E	2016E	2017E
Cash & equivalent	559,380	676,706	962,670	1,029,674	1,195,058	1,280,741	1,321,899	1,399,633
Investment securities	394,176	460,948	520,446	763,401	996,217	965,646	984,959	1,004,658
Net loans and advances	1,402,160	1,604,371	1,863,325	2,148,330	2,448,754	2,700,095	2,944,651	3,184,918
Fixed assets	18,397	19,210	22,030	25,900	29,129	32,042	35,246	38,771
Goodwill	0	0	0	0	0	0	0	0
Other assets	28,394	33,736	39,628	49,390	62,671	67,698	73,213	79,264
Total assets	2,402,507	2,794,971	3,408,099	4,016,695	4,731,829	5,046,222	5,359,969	5,707,244
Customers deposits	1,903,584	2,239,764	2,545,457	2,796,217	3,325,729	3,723,762	4,095,359	4,463,255
Borrowing	283,844	316,716	536,059	825,572	927,486	776,115	642,684	541,146
Debentures	31,232	31,187	64,098	45,027	60,032	69,037	79,392	91,301
Other liabilities	49,841	42,294	62,084	83,627	103,522	119,050	136,908	157,444
Total liabilities	2,268,501	2,629,961	3,207,698	3,750,443	4,416,769	4,687,964	4,954,343	5,253,146
Share capital	21,577	21,577	21,577	25,220	25,220	25,220	25,220	25,220
Reserves & others	112,429	143,420	178,751	240,237	289,184	332,350	379,682	428,119
Shareholders' equity	134,006	164,997	200,328	265,457	314,404	357,570	404,902	453,339
Minority interests	0	13	73	491	656	689	723	759
Total equity & liabilities	2,402,507	2,794,971	3,408,099	4,016,391	4,731,829	5,046,222	5,359,969	5,707,244
Avg interest-earning assets	2,150,615	2,489,714	2,921,423	3,507,220	4,440,702	5,080,851	5,404,935	5,745,581
Avg risk-weighted assets	1,446,883	1,760,884	2,077,755	2,744,991	2,893,732	3,406,833	3,691,024	4,007,229
BVPS (CNY)	6.211	7.647	9.284	10.526	12.466	14.178	16.055	17.975

■ Key ratios (%)

Year to 31 Dec	2010	2011	2012	2013	2014	2015E	2016E	2017E
Loan/deposit	75.2	73.3	74.8	78.6	75.6	74.9	75.0	75.0
Tier-1 CAR	8.0	8.2	8.5	9.3	10.4	11.4	11.8	12.1
Total CAR	11.5	11.5	12.1	11.1	12.4	13.1	13.3	13.5
NPLs/gross loans	0.7	0.6	0.6	0.8	1.1	1.6	1.9	2.1
Total loan-loss prov./NPLs	302.4	400.1	351.8	266.0	202.0	206.3	213.9	231.1
ROAA	1.2	1.4	1.5	1.4	1.3	1.3	1.3	1.3
ROAE	22.7	24.2	24.8	22.2	19.3	18.4	17.8	16.2
Net-interest margin	2.7	3.1	3.0	2.8	2.5	2.5	2.4	2.4
Gross yield	3.9	4.9	5.1	4.9	5.0	4.5	4.4	4.3
Cost of funds	1.4	1.9	2.3	2.3	2.7	2.4	2.3	2.3
Net-interest spread	2.6	2.9	2.9	2.6	2.3	2.2	2.1	2.1
Total cost/total income	45.7	42.5	42.6	40.8	36.8	36.7	37.2	38.6
Effective tax	22.7	23.3	24.0	24.4	23.7	23.7	23.7	23.7
Dividend-payout	23.5	25.1	30.0	26.9	30.2	30.2	30.2	30.2

Source: FactSet, Daiwa forecasts

■ Company profile

Founded in 1987, China Merchants Bank (CMB) is the banking arm of China Merchants Group, one of the leading conglomerates in China. Headquartered in Shenzhen, the bank geographically focuses on wealthy areas in China and has established a good brand-name in retail/credit-card businesses.

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