

Analyst: Paul Sham

CHINA MERCHANTS BANK CO. LTD. (招商銀行)

| | | | |
|-----------------|--|--------------------|-------------------|
| Sector | : Banking | Chairman | : Mr. Li Jianhong |
| HKSE Code | : 03968 | | |
| Market Price | : HK\$18.72 (20/03/2015) | Head of the Bank & | : Mr. Tian Huiyu |
| Shares Issued | : 4,591m (H share) | Executive Director | |
| Mkt. Cap. | : HK\$63,815m (H share) | | |
| 52 weeks Hi/ Lo | : HK\$19.96 / HK\$12.14 | | |
| HSI / HSCEI | : 24,375.24 / 12,156.40 (20/03/2015) | | |
| 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 | 112,000 | +13.2% | |
| • Non-interest income | 54,035 | +59.9% | |
| • Total operating income | 166,035 | +25.1% | |
| • Operating expenses | (61,081) | +12.8% | |
| • Operating profit before impairment losses | 104,954 | +33.6% | |
| • Impairment losses | (31,681) | +210.1% | |
| • Profit before taxation and non-core items | 73,273 | +7.2% | |
| • Non-core items | 158 | +79.5% | |
| • Profit before taxation | 73,431 | +7.3% | |
| • Taxation | (17,382) | +4.2% | |
| • Attributable profit to shareholders | 55,911 | +8.1% | |
| • Total DPS (RMB) | 0.62 | +0.0% | |
| • Basic EPS (RMB) | 2.22 | -3.5% | |
| Selected Balance Sheet Items | 31/12/2014 | Vs 31/12/2013 | Vs 30/06/2014 |
| • Total loans | 2,513,919 | +14.4% | +3.8% |
| • Total deposits | 3,304,438 | +19.1% | -3.4% |
| • Total assets | 4,731,829 | +17.8% | -6.0% |
| Selected Ratios | FY2014 | FY2013 | 1H2014 |
| • Net interest margin | 2.52% | 2.82% | 2.57% |
| • Cost-income ratio | 36.8% | 40.8% | 33.0% |
| • Return on average assets | 1.28% | 1.39% | 1.35% |
| • Return on average equity | 19.3% | 22.2% | 22.1% |
| • Dividend payout ratio | 27.9% | 27.0% | NA |
| | 31/12/2014 | 31/12/2013 | 30/6/2014 |
| • NPL ratio | 1.11% | 0.83% | 0.98% |
| • NPL Coverage ratio | 233.4% | 266.0% | 251.3% |
| • Loan-deposit ratio | 76.1% | 79.2% | 70.8% |
| • Common equity tier 1 CAR | 10.4% | 9.3% | 9.5% |
| • Tier 1 CAR | 10.4% | 9.3% | 9.5% |
| • Total CAR | 12.4% | 11.1% | 11.5% |

- **Strong core profits overshadowed by weakened asset quality** China Merchants Bank (CMB) reported 2014 full-year net profit of RMB55,911m, up 8.1% y-o-y, in-line with the pre-announced results. Driven by strong fee momentum (+53% y-o-y), operating profit before impairment losses rose a strong 33.6% y-o-y, likely one of the best among China banks. Nevertheless, the bottom line was dragged by a sharp rise in impairment charges. CMB maintained the FY14 cash dividend at RMB0.62 per share (unchanged y-o-y), representing a payout ratio of 27.9%, versus 27.0% in FY13.

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- **Net interest income** grew by 13.2% y-o-y to RMB112,000m, thanks to the 26.6% y-o-y increase in the average balances of interest-earning assets. With the negative impact from the rising costs of deposits from customers and inter-bank borrowing, CMB's NIM narrowed by 30bps y-o-y to 2.52% which dragged the overall net interest income. Total loans increased by 14.4% y-o-y, slower than deposit growth of 19.1%. Its loan-to-deposit ratio was accordingly lowered to 76.1% at end-2014, from 79.2% a year earlier.
- **Non-interest income** surged 59.9% y-o-y to RMB54,035m, thanks to the superior 53% y-o-y growth on its net fee income, in particular settlement and clearing fees (+49.3%), bank card fees (+54.8%) and custody and trustee fees (+81.3%). On the other hand, other non-interest income almost doubled y-o-y as a result of the substantial increase in bills spread income and net income from foreign exchange trading.
- **Operating expenses** recorded an increase of 12.8% y-o-y to RMB61,081m. CMB delivered good staff cost control, which only grew 8.1% y-o-y due to increased headcounts. Given a faster increase in net operating income against a relatively slower rise in expenses, cost-to-income ratio improved to 36.8% from 40.8% a year earlier.
- **5.0% contribution from WLB** Profits attributable to WLB was HK\$3,169m, up 22.0% y-o-y. Its net interest margin expanded 14bps y-o-y to 1.72%. Asset quality remained benign, with the NPL ratio standing firm at 0.07% at-end 2014. Capital position improved slightly, with CET1 ratio and Total CAR rising 0.8ppts and 1.2ppts to 10.8% and 16.0% respectively during 2014.
- **Asset quality** is a big negative in the results as impaired ratio deteriorated to 1.11% from 0.83% during FY14, with the amount of NPLs increasing 52.3% to RMB27.9bn at the end of last year. Coverage ratio also worsened to 233.4% from 266.0% during the year.
- **Capital position** CMB was the one of the first domestic banks to implement the advanced approach for capital measurement. Under the advanced approach, CMB's core tier 1, tier 1 and CAR ratios improved to 10.44%, 10.44% and 12.38% respectively at end-2014, up from 9.27%, 9.27% and 11.14% respectively at end-2013.

Outlook & Prospects

- **Asset quality pressure eased in 4Q14** Although CMB showed a worsened asset quality trend in 2014, with NPL ratio +28bps and coverage ratio -33bps y-o-y, we see CMB's asset quality to stabilize in 4Q14. CMB's NPL ratio rose only 1bps q-o-q in 4Q14, following a 12bps spike in 3Q14. In addition, its loan loss coverage rebounded by 5.4ppt q-o-q in 4Q14. Meanwhile, Management added that they conducted stress test for CMB, assuming 6.5% real GDP growth, 12% M2 and 1.5% CPI. Under such scenario, CMB's NPL ratio should still be under 3%, which could relieve some concern over CMB's deteriorating asset quality.
- **Brokerage license further boost fee income** CSRC is studying the possibility of granting securities brokerage licenses to banks, according to a CSRC spokesman, albeit there's no timeline yet. As China's stock market is dominated by retail investors, the potential regulation will likely benefit CMB more than bigger peers. Currently CMB's retail banking business contributes 40% of its pre-tax profit vs. peers' average of 24%. If CMB successfully gets brokerage license, it is expected to see further improvement on CMB's fee income.
- **Potential spin-offs** CBRC said recently that it encourages banks to set up separate entities for credit card and wealth management units. CMB's president and chief executive Tian Huiyu also revealed that CMB was interested in potential business spin-offs, a day after China Everbright Bank said it was considering such reforms. In case banks list such units, we believe CMB will be a major beneficiary given its relatively high exposure to the credit card and wealth management businesses.
- **Valuation** CMB's earnings momentum remained strong in 2014, especially its non-interest income. CMB also achieved better net profits growth (8% y-o-y) than other joint-stocks bank peers that pre-announced FY14 earnings (CITIC's 4% and Minsheng's 5%), reflecting CMB's better fundamentals among medium-sized banks. Nevertheless, trading at 1.05x FY15E P/B, valuation of CMB is at premium over bigger banks like CCB's 0.93x and ICBC's 0.97x. On the other hand, from yield-seeking investors' point of view, CMB's 4.5% is less appealing compared with bigger banks' >6%. As such, we continue to prefer bigger peers like ICBC and CCB with better risk-adjusted return.

Recommendation: *Prefer ICBC and CCB*


Appendix I
I. Comparison of China Merchants Bank's loan book: 31/12/2014 vs 31/12/2013

| Loans-by industry | 31st Dec, 2014 | Up/(down) | 31st Dec, 2013 |
|--|----------------------------------|------------------|----------------------------------|
| | RMB million | | RMB million |
| Corporate loans | | | |
| <i>Manufacturing</i> | 342,005 | -8.4% | 373,458 |
| <i>Wholesale and retail</i> | 259,298 | +0.4% | 258,251 |
| <i>Real estate</i> | 143,952 | +46.3% | 98,367 |
| <i>Transportation and logistics</i> | 140,548 | +16.5% | 120,598 |
| <i>Power generation & supplies</i> | 98,514 | +69.8% | 58,028 |
| <i>Construction</i> | 98,350 | +10.1% | 89,314 |
| <i>Mining</i> | 61,179 | -4.7% | 64,199 |
| <i>Other corporate loans</i> | 164,808 | +22.4% | 134,696 |
| Personal loans | 956,700 | +21.3% | 788,439 |
| Discounted bills | 75,007 | +5.6% | 71,035 |
| Loans outside China | 173,558 | +23.3% | 140,709 |
| | <u>2,513,919</u> | <u>+14.4%</u> | <u>2,197,094</u> |

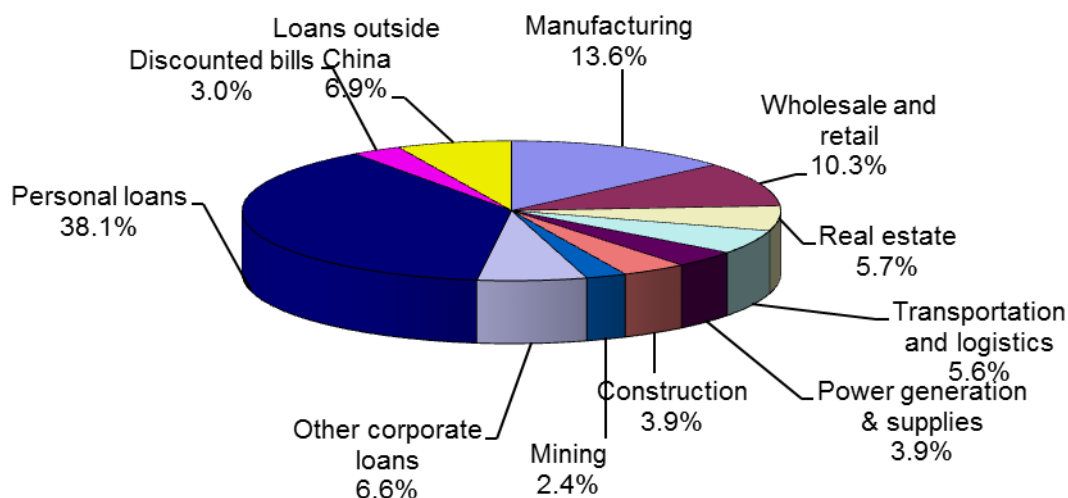
II. China Merchants Bank's pre-tax profit breakdown by businesses

| Pre-tax profit by businesses | Breakdown | | | | |
|-------------------------------------|------------------|---------------|------------------|----------------|----------------|
| (RMB million) | FY2014 | FY2013 | y-o-y (%) | FY2014 | FY2013 |
| Corporate banking | 30,798 | 40,807 | -24.5% | 41.9% | 59.6% |
| Retail banking | 29,105 | 23,495 | +23.9% | 39.6% | 34.3% |
| Treasury operations | 16,199 | 9,114 | +77.7% | 22.1% | 13.3% |
| Others | (2,671) | (4,991) | -46.5% | (3.6%) | (7.3%) |
| Total pre-tax profit | <u>73,431</u> | <u>68,425</u> | <u>+7.3%</u> | <u>100.00%</u> | <u>100.00%</u> |

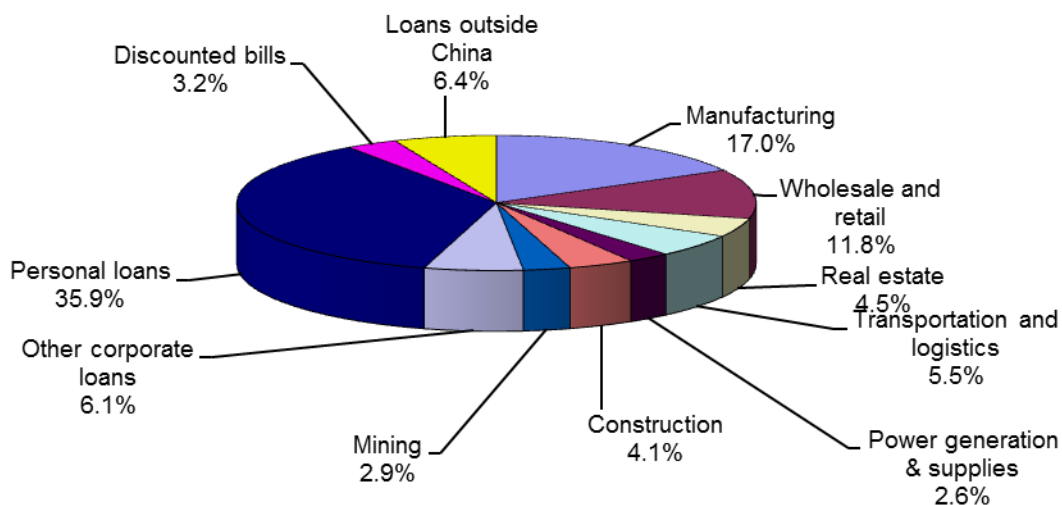


III. Breakdown of loan book of China Merchants Bank

Breakdown of Loan Book as of 31/12/2014
Total customer advances: RMB2,513,919 million



Breakdown of Loan Book as of 31/12/2013
Total customer advances: RMB2,197,094 million



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