

Analyst: Paul Sham

AGRICULTURAL BANK OF CHINA LIMITED (中國農業銀行)

Sector	: Banking	Chairman	: Mr. Liu Shiyu
HKSE Code	: 01288		
Market Price	: HK\$3.76 (25/03/2015)	Vice Chairman &	: Mr. Zhang Yun
Shares Issued	: 115,579m (H shares)	Head of the Bank	
Mkt. Cap.	: HK\$101,746m (H shares)		
52 weeks Hi/ Lo	: HK\$4.10 / HK\$3.18		
HSI / HSCEI	: 24,528.23 / 11,968.91 (25/03/2015)		
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	429,891	+14.3%	
• Non-interest income	94,235	+5.2%	
• Total operating income	524,126	+12.5%	
• Operating expenses	(223,898)	+12.7%	
• Operating profit before impairment losses	300,228	+12.4%	
• Impairment losses	(67,971)	+28.3%	
• Profit before taxation	232,257	+8.4%	
• Taxation	(52,747)	+10.0%	
• Attributable profit to shareholders	179,461	+7.9%	
• Total DPS (RMB)	0.1820	+2.8%	
• Basic EPS (RMB)	0.5500	+7.8%	
Selected Balance Sheet Items	31/12/2014	Vs 31/12/2013	Vs 30/06/2014
• Total loans	8,098,067	+12.1%	+3.3%
• Total deposits	12,533,397	+6.1%	-2.2%
• Total assets	15,974,152	+9.7%	-0.2%
Selected Ratios	FY2014	FY2013	1H2014
• Net interest margin	2.92%	2.79%	2.93%
• Cost-income ratio	42.7%	42.6%	38.6%
• Return on average assets	1.18%	1.20%	1.36%
• Return on average equity	19.6%	20.9%	23.0%
• Dividend payout ratio	33.1%	34.7%	NA
	31/12/2014	31/12/2013	30/6/2014
• NPL ratio	1.54%	1.22%	1.24%
• NPL Coverage ratio	286.5%	367.0%	346.4%
• Loan-deposit ratio	64.6%	61.2%	61.2%
• Common equity tier 1 CAR	9.09%	9.25%	8.7%
• Tier 1 CAR	9.46%	9.25%	8.7%
• Total CAR	12.82%	11.86%	11.9%

- **Weak earnings with asset quality pressure** Agricultural Bank of China (ABC) reported 2014 full-year net profit of RMB179,461m, up 7.9% y-o-y, below market estimate of RMB182,840m. ABC is the first large China bank to report 2014 results and the numbers are weak. ABC showed a fast increase in NPL ratio and a weak fee momentum. Its 4Q profit also posted an unexpected y-o-y decline as net fee income fell and bad-loan provisions swelled. The 4Q net income of RMB27bn, down 4% y-o-y, trailed the analysts' estimates average of RMBRMB31.8bn. ABC declared a dividend of Rmb0.182 for 2014 (up 2.8% y-o-y), implying a small cut in dividend payout ratio to 33% from 35% in 2013.

This report has been prepared solely for information purposes and we, East Asia Securities Company Limited are not soliciting any action based upon it. Neither this document nor its contents shall be construed as an offer, invitation, advertisement, inducement or representation of any kind or form whatsoever. This document is based upon information, which we consider reliable, but accuracy and completeness are not guaranteed. Opinions expressed herein are subject to change without notice. At the time of preparing this report, we have no position in securities of the company or companies mentioned herein, while other Bank of East Asia Group companies may from time to time have interests in securities of the company or companies mentioned herein.

- **Net interest income** increased 14.3% y-o-y to RMB429,891m, primarily due to the 9.2% y-o-y increase in the average balance of its interest-earning assets. Its NIM expanded by 13bps y-o-y to 2.92% as ABC increased investment on debt securities. Since ABC's deposit grew at a slower pace of 6.1% in 2014, the loan-to-deposit ratio (LDR) of ABC rose by 3.4ppts to 64.6%, but was still the lowest LDR among HK-listed PRC banks.
- **Non-interest income** rose a mere 5.2% y-o-y to RMB94,235m, dragged by 3.7% y-o-y decline in net fee income. Consultancy and advisory fees dropped notably by 32.6% y-o-y due to a decline in income from financial advisory and other investment banking businesses. Despite the weak net fee income, the strong performance of ABC Life as well as higher net gains on foreign exchange helped lift the overall non-interest income.
- **Operating costs** rose 12.7% y-o-y to RMB223,898m during 2014. Staff expense, the key cost contributor, increased by 6.4% y-o-y. The overall operating cost was lifted by a substantial increase in provision for the off-balance sheet guarantees and commitments, which jumped almost 10 folds to RMB8,087m. Since the costs grew at a similar pace as the operating income (+12.5%), the cost-to-income ratio maintained at 42.7% in FY14, vs 42.6% a year ago.
- **Impairment charges** increased by 28.3% y-o-y in 2014. Similar to the industry's worsening trend, ABC's NPL ratio deteriorated to 1.54% from 1.22% a year earlier. Despite its coverage ratio weakened notably from 367% to 287% during FY14, the lowest since 1Q12, ABC still has the best reserve coverage among big four banks.
- **Capital position** ABC's CET1 CAR dropped slightly to 9.09% at end-2014, from 9.25% a year ago. Thanks to the issuance of the first tranche of preference shares (RMB40bn, counted as additional tier 1 capital) in November 2014, ABC's tier 1 and total CAR was boosted to 9.46% and 12.82% respectively at end-2014, from 9.25% and 11.86% a year ago. In addition, ABC completed the issuance of the second tranche of preference shares, also RMB40bn, in March 2015.
- **County Area Banking Business** During FY14, County Area Banking contributed RMB76,820m pre-tax profit in 2014 (-0.55% y-o-y), accounting for 33% of ABC's total (vs FY13's 36%). The lower % contribution suggests Urban Area banking outperformed County Area banking during 2014.

Outlook & Prospects

- **Capital remained a concern** Aided by preferred shares issuance, ABC's tier 1 ratio improved notably to 9.46% at end-2014. With another RMB40bn issued in 1Q15, we think ABC's Tier 1 will continue to improve. Nevertheless, ABC's CET1 ratio is still a concern as the ratio of 9.09% was still marginally lower than CBRC's requirement as systematically-important banks like ABC in China are required to have CET1 ratio of 9.5% by ends of 2018. In addition, Management said the cut in dividend payout ratio in FY14 was caused by a slowdown in the organic generation of capital, reinforcing the belief that the CET1 ratio is still inadequate at the moment.
- **Asset quality is under pressure** ABC's NPLs rose 20.8% q-o-q and 42% y-o-y with the NPL ratio rising 25bps q-o-q / 32bps y-o-y to 1.54%. Management commented that retail & wholesale and manufacturers were the main source of new NPLs (sector NPL ratio 5.93% and 3.69% respectively by 2014), citing NPL formation may stabilise at 2015 year-end or 1H16.
- **Competitive advantage from County Area Banking faded away** County Area Banking used to be ABC's competitive advantage due to its lower LDR as well as lower funding costs in the county area. ABC was thought to be less impacted by interest rate liberalisation as a large portion of its depositors comes from county area, which is less sensitive to the change of deposit rate. Nevertheless, ABC failed to deliver a strong expansion in FY14 and even recorded declining profit from county areas, suggesting that ABC's competitive advantage on County Area Banking over other bigger peers is fading away.
- **Undemanding valuation but prefer ICBC and CCB** The growth potential in county banking used to be ABC's growth driver but the effect is now fading. On valuation front, ABC is currently traded at 0.88x FY14E P/B, representing only a little discount to CCB's 0.92x and ICBC's 0.95x. As such, we prefer other large cap banks like CCB and ICBC over ABC, as they offer better fundamentals, and hence lower downside risk.

Recommendation: Prefer CCB and ICBC



I. Impairment allowances, overdue and rescheduled advances of Agricultural Bank of China

As % of total customer advances	Individual allowance	Collective allowance	NPLs
As of 31/12/2014	0.90%	3.52%	1.54%
As of 30/6/2014	0.67%	3.64%	1.24%
As of 31/12/2013	0.69%	3.77%	1.22%

II. Comparison of Agricultural Bank of China's loan book: 31/12/2014 vs 31/12/2013

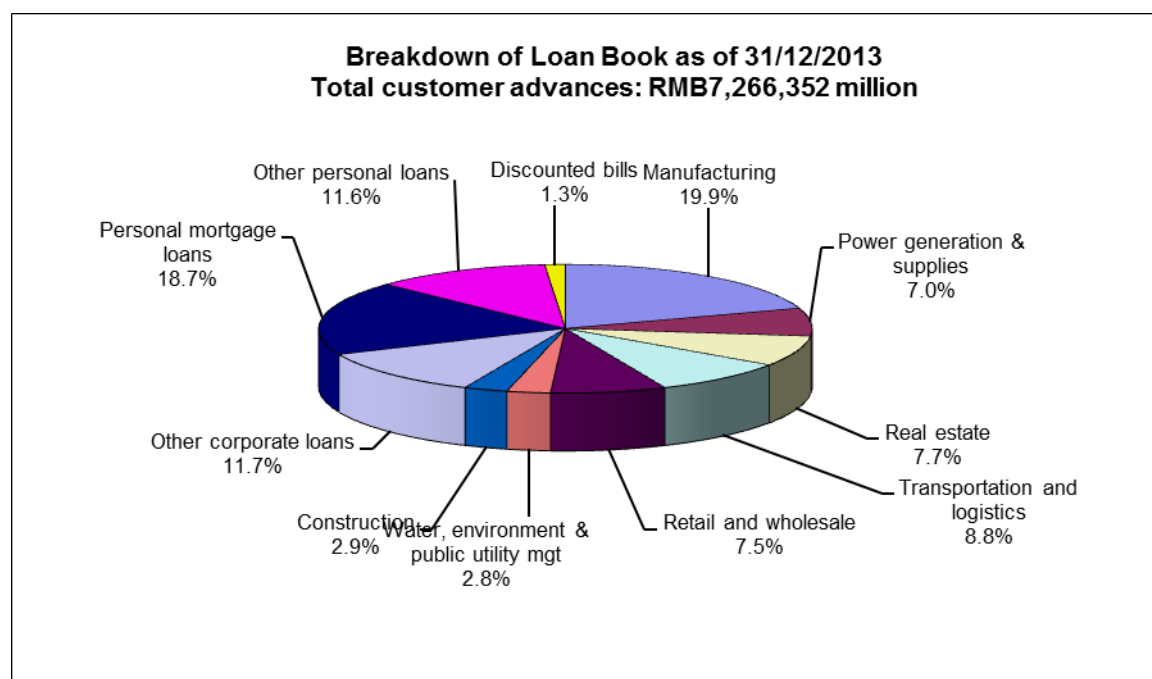
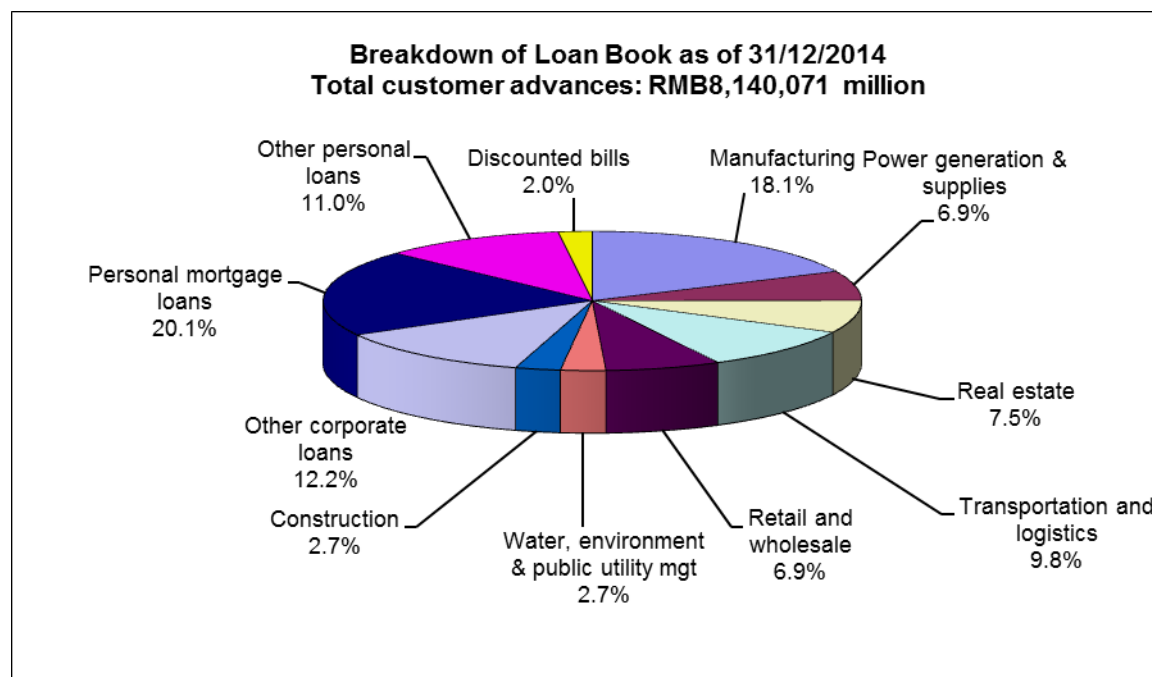
Loans-by industry	31 st Dec, 2014 RMB million	Up/(down)	31 st Dec, 2013 RMB million
Corporate loans			
<i>Manufacturing</i>	1,391,090	+1.3%	1,373,317
<i>Power generation & supplies</i>	528,725	+8.8%	485,990
<i>Real estate</i>	581,072	+9.4%	531,271
<i>Transportation and logistics</i>	756,578	+23.8%	611,311
<i>Retail and wholesale</i>	530,896	+1.7%	522,078
<i>Water, environment & public utility mgt</i>	207,977	+6.1%	196,043
<i>Construction</i>	207,823	+5.4%	197,242
<i>Other corporate loans</i>	943,249	+16.2%	811,605
Personal mortgage loans	1,550,673	+20.0%	1,292,007
Other personal loans	845,966	+5.6%	801,298
Discounted bills	157,349	+69.5%	92,823
Loans for overseas operations	396,669	+28.1%	309,728
	8,098,067	+12.1%	7,224,713

III. Agricultural Bank of China's operating income breakdown by businesses

Operating income by businesses (RMB million)	FY2014	FY2013	y-o-y (%)	Breakdown FY2014	FY2013
Corporate banking	280,701	253,092	+10.9%	53.6%	54.3%
Personal banking	189,876	180,223	+5.4%	36.2%	38.7%
Treasury operations	45,686	27,916	+63.7%	8.7%	6.0%
Others	7,863	4,540	+73.2%	1.5%	1.0%
Total pre-tax profit	524,126	465,771	+12.5%	100.00%	100.00%



Breakdown of loan book of Agricultural Bank of China



Important Disclosure / Analyst Certification / Disclaimer

This document is published by East Asia Securities Company Limited, a wholly-owned subsidiary of The Bank of East Asia, Limited (BEA).

The research analyst primarily responsible for the content of this report, in part or in whole certifies that the views on the companies and their securities mentioned in this report accurately reflect his/her personal views. The analyst also certifies that no part of his/her compensation was, is, or will be, directly, or indirectly, related to specific recommendations or views expressed in this report.

This report has been prepared solely for information purposes and has no intention whatsoever to solicit any action based upon it. Neither this report nor its contents shall be construed as an offer, invitation, advertisement, inducement or representation of any kind or form whatsoever. The information is based upon information, which East Asia Securities Company Limited considers reliable, but accuracy or completeness is not guaranteed. Information and opinions expressed herein reflect a judgment as of the date of this document and are subject to change without notice. Any recommendation contained in this report does not have regard to the specific investment objectives, financial situation and the particular needs of any specific addressee. This report is not to be taken in substitution for the exercise of judgment by respective readers of this report, who should obtain separate legal or financial advice. East Asia Securities Company Limited and / or The BEA Group accepts no liability whatsoever for any direct or consequential loss arising from any use of this report or further communication given in relation to this report.

At time of this report, East Asia Securities Company Limited has no position in securities of the company or companies mentioned herein the report, while BEA along with its affiliates and/or persons associated with any of them may from time to time have interests in the securities mentioned in this report. BEA and its associates, its directors, and/or employees may have positions in, and may effect transactions in securities mentioned herein and may also perform or seek to perform broking, investment banking and other banking services for these companies.

BEA and/or any of its affiliates may beneficially own a total of 1% or more of any class of common equity securities of the subject company or companies mentioned in this report and may, within the past 12 months, have received compensation and/or within the next 3 months seek to obtain compensation for investment banking services from the subject company or companies mentioned in the report.

This document is not directed to, or intended for distribution to or use by, any person or entity who is a citizen or resident of, or located in, any locality, state, country or other jurisdiction, publication, availability or use would be contrary to law and regulation.