

Company Report

China Merchants Securities (HK) Co., Ltd.
Hong Kong Equity Research

BOCOM (3328 HK)

Undergoing transformation for better outlook; RMB60bn preference shares to further strengthen capital base

■ FY14 NPAT reported at RMB65.9bn, up 5.7% YoY, 0.5%/2.0% ahead of our and consensus forecasts. We project FY15/16E NPAT to slow to 0.2%/4.1% YoY given headwinds from interest rate liberalization and worsening asset quality.

■ Improving mix in total loans/deposits despite a decrease in outstanding balance in 4Q compare to 3Q, paving the way for improvement in profitability in the future.

■ Asset quality remained under great pressure with very small chance for a reverse in asset quality any time soon.

FY14 earnings slightly ahead of our/consensus estimate

Despite moderating growth in net interest incomes – due to larger margin contraction of 16bps YoY to 2.36% in FY14 – and fee incomes, FY14 NPAT came in at RMB65.9bn, up 5.7% YoY and beating our and consensus forecasts by 0.5% and 2.0%. In spite of slowing earnings growth, narrowing margin, decreasing deposits and lingering asset quality pressure, we see ongoing transformation for the Bank in business structure for a better outlook in the future.

Positives: (1) CAR improved further on the adoption of advanced internal ratings-based approach with core T1 CAR/T1 CAR/total CAR at 11.30%/11.30%/14.04% in 4Q; (2) WMP business grew fast with NPAT contribution of RMB3.5bn, up 23% YoY, in FY14; (3) payout ratio stayed at 30.3% in FY14, largely unchanged from that in previous year while most peers lowered the ratio slightly in FY14.

Negatives: (1) NIM contracted 17bps QoQ to 2.25% in 4Q due to falling asset yield and rising funding cost; (2) total deposits decreased 3.1% YoY vs +9.1% for the sector as it reduced the proportion of more costly corporate deposits & time deposits; (3) asset quality pressure increased with rising NPLs/SMLs/overdue loans whereas dropping coverage ratio (-22.41% QoQ to 178.88%) due to enhanced NPL write-off.

Catalysts & valuation

Further progress in mixed-ownership reform, mixed business operation, smaller-than-expected NIM compression and improving profitability could trigger a re-rating for the stock. Trading at 0.76x FY15E P/B and 5.88x FY15E P/E, we think its valuation is undemanding at the current level compared to its historical average of 1.18x PB. Reiterate BUY.

Financials

RMB mn	FY12	FY13	FY14E	FY15E	FY16E
Revenue	148,184	165,028	181,480	187,993	201,288
Growth (%)	16.0%	11.4%	10.0%	3.6%	7.1%
Net profit	58,369	62,295	65,543	65,643	68,307
Growth (%)	15.0%	6.7%	5.2%	0.2%	4.1%
EPS (RMB)	0.86	0.84	0.88	0.88	0.92
DPS (RMB)	0.24	0.26	0.26	0.27	0.28
P/E (x)	6.06	6.20	5.89	5.88	5.65
P/B (x)	1.02	0.92	0.83	0.76	0.69
ROE (%)	17.9%	15.6%	14.8%	13.5%	12.8%

Note: Closing price as of 26 Mar 2015

Sources: Bloomberg, Company data, CMS (HK) research

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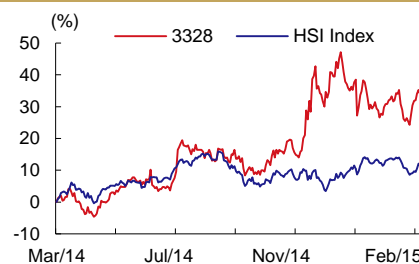
WHAT'S NEW

N.A.

BUY

Previous	BUY
Price	HKD6.44
12-month Target Price (Potential upside)	HKD7.19 (+11.6%)
Previous	HKD7.19

Price Performance



Source: Bigdata

%	1m	6m	12m
3328 HK	(1.2)	13.7	41.8
HSI	(1.0)	3.2	12.9

Bank

Hang Seng Index	24497
HSCEI	11917

Key Data

52-week range (HKD)	4.75-7.36
Market cap (USD bn)	68.9
Avg. daily volume (mn)	32.63
BVPS (RMB)	6.86

Shareholdings Structure

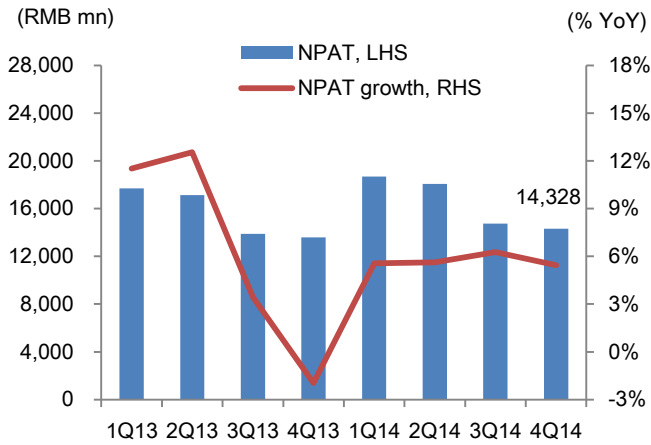
Ministry of Finance of PRC	26.53%
HKSCC Nominees Limited	20.09%
HSBC	18.70%
No. of shares outstanding	74.3bn
Free float	22.5%

Related Research

- BOCOM (3328 HK) - Continue to benefit from pilot reforms: maintain BUY (BUY) 2015/03/17
- BOCOM (3328 HK) - 3Q14 results in line; early signs of improving profitability (BUY) 2014/10/30
- BOCOM (3328 HK) - Further stock purchase by management strengthens confidence in its future profitability; Reiterate BUY (BUY) 2014/09/15

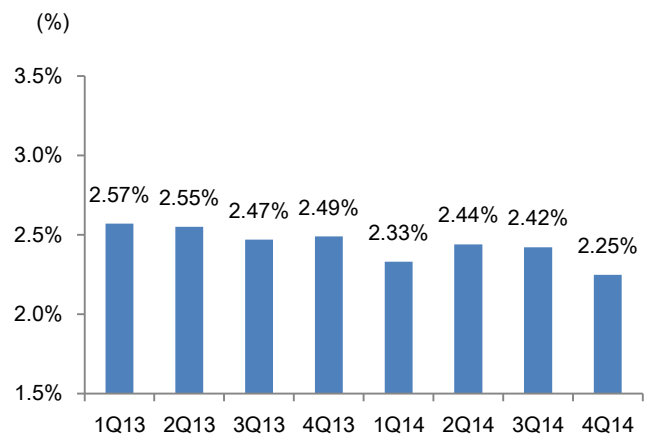
Focus charts

Figure 1: Quarterly NPAT & YoY growth



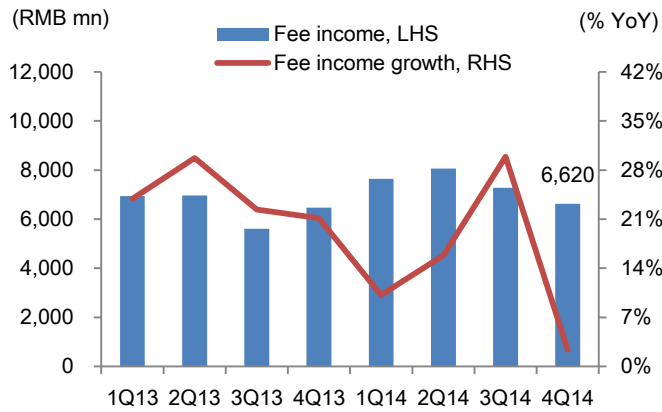
Sources: Company data, CMS (HK) research.

Figure 2: Quarterly NIM trend



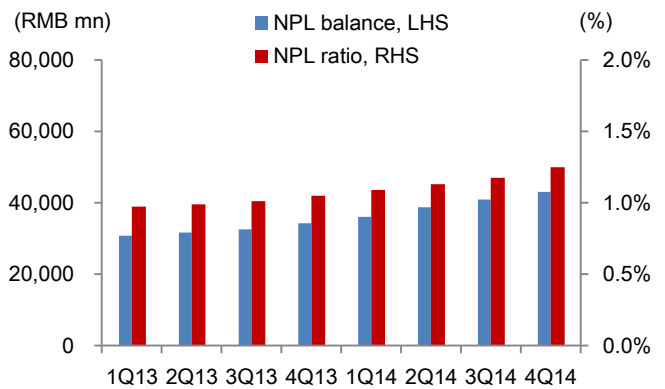
Sources: Company data, CMS (HK) research.

Figure 3: Fee income & YoY growth



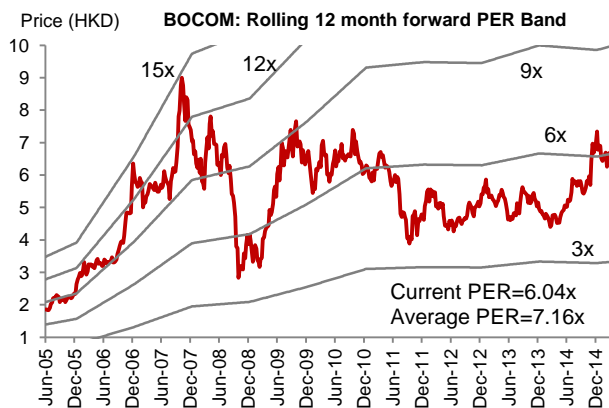
Sources: Company data, CMS (HK) research.

Figure 4: NPL balance & ratio



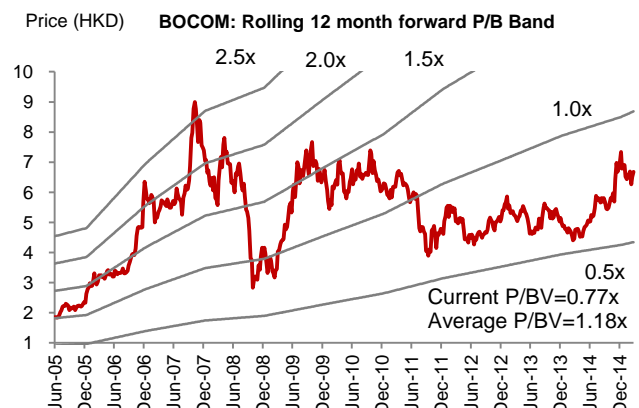
Sources: Company data, CMS (HK) research.

Figure 5: P/E Band



Note: Closing price as of 20 Mar 2015.
Sources: Bloomberg, Company data, CMS (HK) research.

Figure 6: P/B Band



Note: Closing price as of 20 Mar 2015.
Sources: Bloomberg, Company data, CMS (HK) research.

Proposal of RMB60bn domestic & offshore preference shares to strengthen capital base

Non-core T1 CAR/total CAR is estimated to be lifted by about 1.4%

BOCOM announced to issue no more than RMB45bn A-share preference shares and RMB15bn H-share preference shares via private placement to replenish its non-core tier-1 capital to further strengthen its capital base. Core tier-1 CAR, non-core tier-1 CAR and total CAR stood at 11.30%, 11.30% and 14.04% by end FY14. We expect the issuance of RMB60bn preference shares should boost non-core T1 CAR/total CAR by about 1.4%.

The proposal has been approved by the Board as of 26 March 2015 and subject to the approval from CBRC and CSRC. We expect the Bank to complete the issuance of A-share and H-share preference shares in full amount before the end of FY15E. We see no imminent need for the Bank to raise capital from equity market on top of the proposed preference share issuance plan.

Figure 7: Details of BOCOM's domestic and offshore preference shares issuance plans

	Domestic	Offshore
Number of shares	No more than 450mn	No more than 150mn
Issue price	At par with nominal value of RMB100 per share	At par with nominal value of RMB100 per share
Issuance method	Non-public placement	Non-public placement
Target investors	A-share investors, no more than 200 investors in total	H-share investors, no more than 200 investors in total
Lock-up period	No	No
Dividend yield rate	Floating, consisting of benchmark interest rate and fixed premium rate	Floating, consisting of benchmark interest rate and fixed premium rate
Payment of dividend	Cash; non-compulsory	Cash; non-compulsory
Frequency of dividend payment	Annually	Annually
Dividend accumulation	Nil	Nil
Voting right	Nil	Nil

Sources: Company data, CMS (HK) research.

Figure 8: Annual CAR requirement

Type of Bank	Item	As of 31 December					
		2013	2014	2015	2016	2017	2018
Systematically Important Bank	Core Tier 1 capital adequacy ratio	6.50%	6.90%	7.30%	7.70%	8.10%	8.50%
	Tier 1 capital adequacy ratio	7.50%	7.90%	8.30%	8.70%	9.10%	9.50%
	Capital adequacy ratio	9.50%	9.90%	10.30%	10.70%	11.10%	11.50%
Other Banks	Core Tier 1 capital adequacy ratio	5.50%	5.90%	6.30%	6.70%	7.10%	7.50%
	Tier 1 capital adequacy ratio	6.50%	6.90%	7.30%	7.70%	8.10%	8.50%
	Capital adequacy ratio	8.50%	8.90%	9.30%	9.70%	10.10%	10.50%

Sources: CBRC and CMS (HK) research.

Figure 9: 2014 results table

P&L (RMB mn)	4Q13	3Q14	4Q14	4Q14 q-q	4Q14 y-y	2H13	2H14	2H14 h-h	2H14 y-y	2013	2014	2014 y-y
Interest Income	68,511	73,437	71,660	-2.4%	4.6%	134,203	145,097	1.2%	8.1%	259,292	288,509	11.3%
Interest Expense	(35,488)	(38,268)	(39,264)	2.6%	10.6%	(68,553)	(77,532)	1.7%	13.1%	(128,634)	(153,733)	19.5%
Net Interest Income (NII)	33,023	35,169	32,396	-7.9%	-1.9%	65,650	67,565	0.5%	2.9%	130,658	134,776	3.2%
Non-Interest Income	7,476	9,697	10,456	7.8%	39.9%	14,442	20,153	-14.6%	39.5%	34,370	43,760	27.3%
Dealing gain/loss - trading	(660)	1,036	1,800	73.7%	na	(895)	2,836	-16.8%	na	(734)	6,246	na
Dealing gain/loss - investment securities	58	25	42	68.0%	-27.6%	62	67	-48.5%	8.1%	159	197	23.9%
Net fee and commission income	6,467	7,283	6,620	-9.1%	2.4%	12,073	13,903	-11.5%	15.2%	25,968	29,604	14.0%
Others	1,611	1,353	1,994	47.4%	23.8%	3,202	3,347	-23.3%	4.5%	8,977	7,713	-14.1%
Operating Income	40,499	44,866	42,852	-4.5%	5.8%	80,092	87,718	-3.4%	9.5%	165,028	178,536	8.2%
Operating Expenses	(18,098)	(18,741)	(21,000)	12.1%	16.0%	(35,336)	(39,741)	18.6%	12.5%	(66,751)	(73,260)	9.8%
Pre-provision Profits	22,401	26,125	21,852	-16.4%	-2.5%	44,756	47,977	-16.3%	7.2%	98,277	105,276	7.1%
Provisions	(5,066)	(6,341)	(3,939)	-37.9%	-22.2%	(9,941)	(10,280)	1.2%	3.4%	(18,410)	(20,439)	11.0%
Associated Companies	31	36	(1)	na	na	34	35	-36.4%	2.9%	42	90	114.3%
Pre-tax Profits	17,366	19,820	17,912	-9.6%	3.1%	34,849	37,732	-20.1%	8.3%	79,909	84,927	6.3%
Taxes	(3,745)	(5,021)	(3,571)	-28.9%	-4.6%	(7,306)	(8,592)	-16.6%	17.6%	(17,448)	(18,892)	8.3%
Net Profit	13,621	14,799	14,341	-3.1%	5.3%	27,543	29,140	-21.0%	5.8%	62,461	66,035	5.7%
Minority interest	32	50	13	-74.0%	-59.4%	75	63	-48.4%	-16.0%	166	185	11.4%
PROFITS attributable to shareholders	13,589	14,749	14,328	-2.9%	5.4%	27,468	29,077	-20.9%	5.9%	62,295	65,850	5.7%

Balance Sheet (RMB mn)	4Q13	3Q14	4Q14	4Q14 q-q	4Q14 y-y	2H13	2H14	2H14 h-h	2H14 y-y	2013	2014	2014 y-y
Total Assets	5,960,937	6,212,718	6,268,299	0.9%	5.2%	5,960,937	6,268,299	-0.2%	5.2%	5,960,937	6,268,299	5.2%
Gross Loans	3,266,368	3,479,148	3,431,735	-1.4%	5.1%	3,266,368	3,431,735	-0.1%	5.1%	3,266,368	3,431,735	5.1%
Non-performing loans	34,310	40,872	43,017	5.2%	25.4%	34,310	43,017	11.0%	25.4%	34,310	43,017	25.4%
Loan loss reserves	73,305	82,271	76,948	-6.5%	5.0%	73,305	76,948	-2.7%	5.0%	73,305	76,948	5.0%
Total deposits	4,157,833	4,116,546	4,029,668	-2.1%	-3.1%	4,157,833	4,029,668	-7.9%	-3.1%	4,157,833	4,029,668	-3.1%
Shareholder's Funds	419,561	455,800	471,055	3.3%	12.3%	419,561	471,055	6.9%	12.3%	419,561	471,055	12.3%
Per share data (RMB)												
Issued shares (mn)	74,263	74,263	74,263	0.0%	0.0%	74,263	74,263	0.0%	0.0%	74,263	74,263	0.0%
BVPS	5.65	6.14	6.34	3.3%	12.3%	5.65	6.34	6.9%	12.3%	5.65	6.34	12.3%
EPS	0.18	0.19	0.20	5.3%	11.1%	0.37	0.39	-22.0%	5.4%	0.84	0.89	6.0%
DPS	0.26	0.00	0.27	na	3.8%	0.26	0.27	na	3.8%	0.26	0.27	3.8%
PPOP	0.30	0.35	0.29	-16.4%	-2.5%	0.60	0.65	-16.3%	7.2%	1.32	1.42	7.1%

Ratios (%)	4Q13	3Q14	4Q14	4Q14 q-q	4Q14 y-y	2H13	2H14	2H14 h-h	2H14 y-y	2013	2014	2014 y-y
1. CIR	44.69%	41.77%	49.01%	7.23pp	4.32pp	44.12%	45.31%	8.40pp	8.40pp	40.45%	41.03%	0.59pp
2. Effective tax rate	21.57%	25.33%	19.94%	-5.40pp	-1.63pp	20.96%	22.77%	0.95pp	0.95pp	21.83%	22.24%	0.41pp
3. ROA	0.93%	0.95%	0.92%	-0.03pp	-0.01pp	0.94%	0.93%	-0.28pp	-0.28pp	1.11%	1.08%	-0.03pp
4. ROE	13.13%	13.16%	12.37%	-0.80pp	-0.76pp	13.47%	12.76%	-4.34pp	-4.34pp	15.58%	14.79%	-0.80pp
5. Customer LDR	78.56%	84.52%	85.16%	0.65pp	6.60pp	78.56%	85.16%	6.69pp	6.69pp	78.56%	85.16%	6.60pp
6. NPL ratio	1.05%	1.17%	1.25%	8bps	20bps	1.05%	1.25%	12bps	20bps	1.05%	1.25%	20bps
7. Provision coverage of impaired loan	213.65%	201.29%	178.88%	-22.41pp	-34.77pp	213.65%	178.88%	-25.28pp	-25.28pp	213.65%	178.88%	-34.77pp
8. Loan-loss provision ratio	2.24%	2.36%	2.24%	-12bps	0bps	2.24%	2.24%	-6bps	0bps	2.24%	2.24%	0bps
9. NIM	2.49%	2.42%	2.25%	-17bps	-24bps	2.48%	2.33%	-6bps	-15bps	2.52%	2.36%	-16bps
10. Credit cost	0.63%	0.73%	0.46%	-28bps	-17bps	0.61%	0.60%	1bps	-1bps	0.59%	0.61%	2bps
11. Non-interest income as % total income	18.46%	21.61%	24.40%	2.79pp	5.94pp	18.03%	22.97%	-3.02pp	-3.02pp	20.83%	24.51%	3.68pp
12. Fee income as % total income	15.97%	16.23%	15.45%	-0.78pp	-0.52pp	15.07%	15.85%	-1.44pp	-1.44pp	15.74%	16.58%	0.85pp
13. Core Tier 1 CAR	9.76%	11.10%	11.30%	0.20pp	1.54pp	9.76%	11.30%	0.60pp	0.60pp	9.76%	11.30%	1.54pp
14. Tier 1 CAR	9.76%	11.10%	11.30%	0.20pp	1.54pp	9.76%	11.30%	0.60pp	0.60pp	9.76%	11.30%	1.54pp
15. CAR	12.08%	13.80%	14.04%	0.24pp	1.96pp	12.08%	14.04%	1.29pp	1.29pp	12.08%	14.04%	1.96pp

Sources: Company data, CMS (HK) research.

Financial Summary

Statement of financial position

RMB mn	FY12	FY13	FY14E	FY15E	FY16E
Cash and balance with central banks	816,846	896,556	986,212	1,084,833	1,193,316
Due from banks and other financial institutions	520,963	566,429	600,415	630,435	655,653
Customer Loans and Advances	2,879,628	3,193,063	3,470,573	3,748,763	4,039,419
Investments	833,618	1,011,594	1,160,644	1,312,626	1,467,235
Fixed assets	45,536	57,179	62,897	69,187	76,105
Deferred tax assets	12,501	17,224	18,946	20,841	22,925
Interest in associate	302	344	361	379	398
Other assets	163,985	218,548	304,261	359,726	391,441
Total assets	5,273,379	5,960,937	6,604,309	7,226,790	7,846,493
Due to other banks and financial institutions	942,989	1,126,563	1,351,876	1,595,213	1,850,447
Customer Deposits	3,728,412	4,157,833	4,400,921	4,671,549	4,930,386
Current tax	7,125	6,107	6,412	6,733	7,070
Debt securities issued	70,000	82,238	122,238	122,238	122,238
Certificates of deposit issued	9,572	24,619	104,619	156,929	204,007
Other liabilities	133,834	142,093	153,496	164,610	175,609
Total liabilities	4,891,932	5,539,453	6,139,562	6,717,272	7,289,757
Share Capital	74,263	74,263	74,263	74,263	74,263
Reserves	305,655	345,298	390,484	435,255	482,473
Shareholder's funds	379,918	419,561	464,747	509,518	556,736
Minority interests	1,529	1,923	2,058	2,202	2,353
Total equity	381,447	421,484	466,805	511,720	559,089

Growth rate (% YoY)

	FY12	FY13	FY14E	FY15E	FY16E
Net interest income	17.1%	8.8%	6.6%	-0.8%	3.9%
Non-interest income	11.4%	22.5%	22.8%	18.1%	15.8%
Operating income	16.0%	11.4%	10.0%	3.6%	7.1%
Operating expense	17.2%	14.2%	10.1%	6.5%	10.5%
PPOP	15.2%	9.5%	9.9%	1.6%	4.6%
Provisions	16.5%	26.6%	25.9%	6.9%	6.5%
Pre-tax profit	14.9%	6.2%	6.1%	0.2%	4.1%
After-tax profit	15.1%	6.8%	5.2%	0.2%	4.1%
NP to Parents	15.0%	6.7%	5.2%	0.2%	4.1%
Gross loans	15.1%	10.8%	8.8%	8.2%	8.1%
Total assets	14.4%	13.0%	10.8%	9.4%	8.6%
RWA	16.0%	31.8%	-2.7%	12.9%	13.6%
Customer deposits	13.6%	11.5%	5.8%	6.1%	5.5%
Total liabilities	12.8%	13.2%	10.8%	9.4%	8.5%

Note: Closing price as of 26 Mar 2015.

Sources: Bloomberg, Company data, CMS (HK) research

Statement of comprehensive income

RMB mn	FY12	FY13	FY14E	FY15E	FY16E
Interest income	240,596	259,292	285,163	280,228	288,622
Interest expense	(120,470)	(128,634)	(145,897)	(142,091)	(145,083)
Net interest income	120,126	130,658	139,266	138,137	143,538
Net fees and commissions	20,882	25,968	30,655	36,139	42,145
Trading related profits	1,598	(575)	895	996	915
Other operating revenue	5,578	8,977	10,664	12,721	14,689
Non-interest income	28,058	34,370	42,214	49,856	57,749
Operating income	148,184	165,028	181,480	187,993	201,288
Operating expense	(58,440)	(66,751)	(73,508)	(78,270)	(86,479)
PPOP	89,744	98,277	107,972	109,723	114,808
Provisions	(14,537)	(18,410)	(23,186)	(24,786)	(26,406)
Pre-tax Profit	75,211	79,909	84,807	84,960	88,424
Taxes	(16,739)	(17,448)	(19,082)	(19,116)	(19,895)
After-tax Profit	58,472	62,461	65,725	65,844	68,528
NCI	(103)	(166)	(183)	(201)	(221)
NP to Parents	58,369	62,295	65,543	65,643	68,307

Ratios

	FY12	FY13	FY14E	FY15E	FY16E
NIM	2.59%	2.52%	2.37%	2.16%	2.07%
Net interest spread	2.38%	2.26%	2.05%	1.74%	1.54%
Asset yield	5.07%	4.85%	4.86%	4.38%	4.15%
Funding cost	2.69%	2.58%	2.81%	2.64%	2.61%
Effective tax rate	22.26%	21.83%	22.50%	22.50%	22.50%
Cost-to-income ratio	39.44%	40.45%	40.50%	41.63%	42.96%
Non-interest income/operating income	18.93%	20.83%	23.26%	26.52%	28.69%
LDR	79.05%	78.56%	80.73%	82.32%	84.29%
NPL ratio	0.92%	1.05%	1.22%	1.35%	1.42%
Coverage ratio	250.68%	213.65%	190.74%	187.52%	196.92%
Allowance/total loans	2.30%	2.24%	2.32%	2.52%	2.80%
Credit cost	0.53%	0.59%	0.68%	0.67%	0.66%
Payout ratio	30.54%	30.99%	30.00%	30.00%	30.00%
ROA	1.18%	1.11%	1.05%	0.95%	0.91%
ROE	17.91%	15.58%	14.82%	13.48%	12.81%
Core tier-1 CAR	n.a.	9.76%	10.98%	10.57%	10.09%
Tier-1 CAR	11.24%	9.76%	10.98%	10.57%	10.09%
Total CAR	14.07%	12.08%	14.46%	13.81%	13.14%

Per share ratios & Valuations

	FY12	FY13	FY14E	FY15E	FY16E
BVPS (RMB)	5.12	5.65	6.26	6.86	7.50
EPS (RMB)	0.86	0.84	0.88	0.88	0.92
DPS (RMB)	0.24	0.26	0.26	0.27	0.28
P/E (x)	6.06	6.20	5.89	5.88	5.65
P/B (x)	1.02	0.92	0.83	0.76	0.69
Dividend yield (%)	4.62	5.00	5.09	5.10	5.31

Investment Ratings

Rating	Definition
BUY	Expected to outperform the market index by >10% over the next 12 months
NEUTRAL	Expected to outperform or underperform the market index by 10% or less over the next 12 months
SELL	Expected to underperform the market index by >10% over the next 12 months

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