

JPM-pp1

Asia Pacific Equity Research

27 March 2015

# Industrial and Commercial Bank of China - H (1398 HK)

Overweight

Price: HK\$5.57

26 Mar 2015

Price Target: HK\$6.80

PT End Date: 31 Dec 2015

## FY14 results - stable growth amid challenging environment

ICBC reported FY14 net profits of Rmb275.8bn, up 5% yoy, largely in line with our estimate. We believe this is a solid set of numbers. Key positives are: improving sequential trend in NIM, relatively stable asset quality, ample balance sheet liquidity and strong capital position. The key downside was the cutting of the dividend payout ratio to 33% from 35% last year, and FY14 dividend per share was down 2% yoy. However, following the dividend cut by ABC and BOC, ICBC's move is within expectations.

- **NIM improved 3bps qoq in 4Q14:** This is better than the industry trend of up 2bps qoq. We note that the loan-deposits spread improved 2bps hoh in 2H14 and the interbank asset yield went up 26bps, while interbank liabilities funding cost was flat hoh.
- **Relatively stable asset quality:** The NPL ratio went up 7bps qoq, to 1.13%, better than the industry trend of 9bps qoq and peers (ABC +25bps qoq). ICBC's NPL coverage was ~207% at end-2014 (-10ppt qoq). ICBC's overdue loans and special-mentioned loans went up 18% and 28% hoh, respectively, in line with industry data. The key sectors that saw asset quality deterioration were Manufacturing (NPL ratio 2.33%), Wholesale & Retail (NPL ratio 4.61%) and personal business loans (NPL ratio 5.33%). Management acknowledged that credit risks are spreading from micro-small enterprises to medium and big enterprises. It also mentioned that it has introduced measures to control credit risks: (1) reduced LGFV loans by one-third in the past three years, NPL ratio went down to 0.07%; (2) Monitor loans in overcapacity sector, NPL ratio was 2.05%; (3) re-examine half of the loan book to ensure risk is exposed early; (4) implement a stringent accountability system. Net NPL went up Rmb30.8bn in 2014, including gross formation of close to Rmb140bn, NPL transfer/disposed of Rmb25.8bn, cash collection (recovery) of Rmb40.7bn and write-offs of Rmb38.2bn.
- **Strong capital position:** ICBC's core tier 1 ratio went up 13bps, to 11.92%, due mainly to the conversion of CB of Rmb7.7bn in 4Q14. The tier 1 ratio was 12.19% at end-2014, up 39bps qoq, due mainly to CB conversions and preference shares issuances of Rmb34bn. We expect the core tier 1 ratio to improve 8bps due to the CB conversion in 1Q15 and the tier 1 ratio to improve 36bps due to the preference shares issuance in 2015.
- **Balance sheet liquidity:** The calculated loan-deposits ratio was 70.9% at end-2014, and if according to the new rule by CBRC, LDR was 68.4% at end-2014, significantly below the 75% ceiling.
- **Net profits growth:** Management commented that it is hard to assess if 2015 net profits will be up, flat or down, mainly due to uncertainties in the macro environment, regulations and further actions on interest rate liberalization, etc.
- **Dividend payout ratio:** This was cut to 33% in 2014 from 35% in 2013. DPS was cut 2% yoy, to Rmb0.2554 from Rmb0.2617, due partly to a decline in the payout ratio and an increase in share numbers of 0.6% due to the CB conversion. However, this should be within market expectations. The question remains how much DPS will decline in 2015 due to further dividend payout ratio cuts.

Table 1: Summary of 2014 results

Rmb in millions	FY13	FY14	YoY	FY14E	A vs. E	1H14	2H14	HoH
Nil	443,335	493,522	11%	491,833	0%	237,607	255,915	8%
Non-Interest Income	135,566	141,336	4%	141,828	0%	79,246	62,090	-22%
Fees	122,326	132,497	8%	131,810	1%	73,228	59,269	-19%
Non-fee	13,240	8,839	-33%	10,018	-12%	6,018	2,821	-53%
Total Income	578,901	634,858	10%	633,661	0%	316,853	318,005	0%
Operating expenses	(204,140)	(218,674)	7%	(216,635)	1%	(99,612)	(119,062)	20%
Staff costs	(103,455)	(112,022)	8%	(108,794)	3%	(49,452)	(62,570)	27%
Other operating expenses	(100,685)	(106,652)	6%	(107,840)	-1%	(50,160)	(56,492)	13%
PPOP	374,761	416,184	11%	417,027	0%	217,241	198,943	-8%
LLP	(38,098)	(56,267)	48%	(53,360)	5%	(23,988)	(32,279)	35%
Pre-Tax	338,537	361,612	7%	365,019	-1%	194,090	167,522	-14%
Income Tax	(75,572)	(85,326)	13%	(85,964)	-1%	(45,709)	(39,617)	-13%
Attributable Income	262,649	275,811	5%	278,494	-1%	148,100	127,711	-14%
Gross Loans	9,922,374	11,026,331	11%	11,125,190	-1%	10,646,115	11,026,331	4%
Deposits	14,620,825	15,556,601	6%	15,885,615	-2%	15,728,332	15,556,601	-1%
Equity	1,274,134	1,530,859	20%	1,485,251	3%	1,354,857	1,530,859	13%
Total Assets	18,917,752	20,609,953	9%	20,861,080	-1%	20,303,677	20,609,953	2%
<b>Key Ratios</b>								
NIM	2.57%	2.66%	8 bps	2.60%	6 bps	2.62%	2.70%	7 bps

Cost income ratio	35.3%	34.4%	-82 bps	34.2%	26 bps	31.4%	37.4%	600 bps
ROE	21.9%	19.7%	-223 bps	20.2%	-52 bps	22.5%	17.7%	-483 bps
ROA	1.44%	1.40%	-5 bps	1.40%	0 bps	1.5%	1.2%	-26 bps
NPL Ratio	0.94%	1.13%	18 bps	1.14%	-1 bps	0.99%	1.13%	14 bps
NPL Coverage ratio	257%	207%	-50 pt	213%	-6 pt	238%	207%	-31 pt
Loan loss reserve	2.43%	2.34%	-9 bps	2.43%	-9 bps	2.36%	2.34%	-3 bps
LDR	67.9%	70.9%	301 bps	70.0%	85 bps	67.7%	70.9%	319 bps
Credit costs	0.41%	0.54%	13 bps	0.51%	3 bps	0.47%	0.60%	13 bps
Core capital ratio	10.57%	11.92%	134 bps	11.72%	20 bps	11.36%	11.92%	56 bps
Tier 1 Ratio	10.57%	12.19%	162 bps	11.99%	20 bps	11.36%	12.19%	83 bps
Total CAR	13.12%	14.53%	140 bps	14.16%	36 bps	13.67%	14.53%	86 bps
Dividend payout ratio	35%	33%	-2 pt	35.00%	-2 pt			

Source: Company reports, J.P. Morgan estimates.

Table 2: Summary of 4Q14 financials

Rmb in millions	4Q13	1Q14	2Q14	3Q14	4Q14	QoQ	YoY
<b>Key P&amp;L Items</b>							
NII	115,699	115,825	121,782	125,327	130,588	4%	13%
Non-Interest Income	30,728	41,038	38,208	27,361	34,729	27%	13%
Fees	26,823	37,682	35,546	27,657	31,612	14%	18%
Others	3,905	3,356	2,662	(296)	3,117	-1153%	-20%
Total Income	146,427	156,863	159,990	152,688	165,317	8%	13%
Operating expenses	(63,412)	(47,928)	(51,684)	(50,766)	(68,296)	35%	8%
PPOP	83,015	108,935	108,306	101,922	97,021	-5%	17%
LLP	(9,834)	(13,672)	(10,316)	(8,238)	(24,041)	192%	144%
Pre-Tax	73,888	95,657	98,433	94,141	73,381	-22%	-1%
Income Tax	(16,694)	(22,196)	(23,513)	(21,667)	(17,950)	-17%	8%
Attributable Income	57,116	73,302	74,798	72,364	55,347	-24%	-3%
<b>Key Balance Sheet Items</b>							
Gross Loans	9,922,374	10,372,180	10,646,115	10,853,652	11,026,331	2%	11%
Including NPL amount	93,689	100,550	105,741	115,471	124,497	8%	33%
Total deposits	14,620,825	15,160,980	15,728,332	15,339,964	15,556,601	1%	6%
Total assets	18,917,752	19,734,683	20,303,677	20,150,956	20,609,953	2%	9%
Equity	1,274,134	1,358,485	1,354,857	1,427,581	1,530,859	7%	20%
<b>Key Ratios</b>							
NIM	2.59%	2.60%	2.64%	2.68%	2.71%	3bp	12bp
Cost income ratio	43.3%	30.6%	32.3%	33.2%	41.3%	806bp	-199bp
ROE	18.2%	22.3%	22.1%	20.8%	15.1%	-566bp	-309bp
ROA	1.21%	1.52%	1.49%	1.43%	1.09%	-34bp	-13bp
NPL Ratio	0.94%	0.97%	0.99%	1.06%	1.13%	7bp	18bp
NPL Coverage ratio	257.2%	245.4%	238.0%	216.6%	206.9%	-10 pt	-50 pt
Loan loss reserve	2.43%	2.38%	2.36%	2.30%	2.34%	3bp	-9bp
Credit cost	0.40%	0.54%	0.39%	0.31%	0.88%	57bp	48bp
LDR	67.9%	68.4%	67.7%	70.8%	70.9%	12bp	301bp
Core capital ratio	10.57%	10.88%	11.36%	11.79%	11.92%	13bp	134bp
Tier 1 Ratio	10.57%	10.88%	11.36%	11.80%	12.19%	39bp	162bp
Total CAR	13.12%	13.22%	13.67%	14.20%	14.53%	33bp	140bp

Source: Company reports.

## Investment Thesis

- Fortress balance sheet with abundant liquidity (LDR 67.9% at end 2013) and strong capital position (tier 1 10.6% at end-2013).
- Less downside to NIM than peers due to funding advantage (funding cost 2.05% vs. sector 2.39% in 2013).
- ROE expanded 6% over 2007-2013. We believe its more protected NIM, balanced risk profile and cost efficiency (due to slow branch expansion) will support a stable ROE, while peers will see ROE compression.
- Interbank liabilities accounted for only 9% of total IBL in 2013, one of the lowest among peers.

## Valuation

- Our Dec-15 price target of HK\$6.80 is based on DDM, using a cost of equity of 13.7%, normalized ROE of 13.6% and a terminal date of 31 December 2016.

## Risks to Rating and Price Target

- Key risks to our PT include: lower-than-expected fee growth; deterioration in pricing power, which could lead to NIM erosion; and a sharp rise in non-performing loans, which could push up credit costs.

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18-Dec-06	N	4.15	4.40
07-Jan-07	N	4.78	5.10
02-Apr-07	N	4.40	5.00
04-Apr-07	N	4.31	4.90
16-Jul-07	OW	4.78	5.80
23-Aug-07	OW	4.90	5.90
25-Oct-07	OW	7.03	8.80
15-Jan-08	OW	5.24	8.20
26-Feb-08	OW	5.23	7.20
06-Jul-08	OW	5.11	7.00
21-Aug-08	OW	5.23	7.10
28-Sep-08	OW	4.74	6.60
26-Oct-08	OW	2.80	6.20
07-Jan-09	N	3.96	5.90
04-Mar-09	OW	3.03	5.70
26-Mar-09	OW	4.11	6.10
28-Jun-09	OW	5.45	7.30
20-Aug-09	OW	5.27	7.40
30-Oct-09	OW	6.08	7.30
30-Nov-09	OW	6.55	8.08
10-Mar-10	OW	5.91	7.80
26-Mar-10	OW	5.70	7.40
09-Aug-10	OW	5.98	7.30
27-Aug-10	OW	5.58	7.20
11-Nov-10	OW	6.63	8.50
27-Nov-10	OW	6.03	8.20
31-Mar-11	OW	6.30	8.60
10-Nov-11	OW	4.74	8.70
12-Jan-12	OW	5.03	8.80
30-Mar-12	OW	4.93	8.60
31-Jul-12	OW	4.45	5.80
07-Nov-12	OW	5.21	6.25
20-Feb-13	OW	5.71	6.85
28-Apr-13	OW	5.42	6.85
31-Oct-13	OW	5.47	7.10
09-Feb-14	OW	4.70	6.80
10-Apr-14	OW	4.93	6.30
26-Jun-14	OW	4.81	6.20
17-Oct-14	OW	4.92	6.40
03-Mar-15	OW	5.58	6.80

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