

FIG
Banks
Equity – China

Buy

Target price	HKD5.80		
Share price	HKD4.72		
Upside/ Downside (%)	23		
Performance	1M	3M	12M
Absolute (%)	-2	-1	42
Relative ^A (%)	0	-7	18
Index ^A	HSCEI		
RIC	3618.HK		
Bloomberg	3618.HK		
Market cap (USDbn)	6		
Market cap (HKDbn)	44		
Free float (%)	27		

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Chongqing Rural CB (3618 HK)

Buy: Solid top-line growth and asset quality

- **Strong top-line growth from net interest margin improvement (+8bp q-o-q in 4Q) and fee income (+57% y-o-y in FY14) drove pre-provision profit up by 25% y-o-y**
- **Asset quality trend is solid. Dual decline in NPL ratio and NPL balance with healthy early-warning indicators. The 31bp rise in credit costs was due to conservative provisioning**
- **We establish a Buy rating on CQRCB with a fair value TP of HKD5.80**

FY14 profit was RMB6.8bn, up 14% y-o-y. This is 1% ahead of our estimates and 2% ahead of consensus estimates. 4Q14 profit rose by 17% y-o-y.

What we liked: (i) Margin improved by 8bp q-o-q to 3.40% in 4Q14. In 2H14, loan and investment yield improved by 8bp and 16bp h-o-h, respectively, partly offset by a 10bp rise in deposit funding cost. (ii) Strong fee growth momentum at 116% y-o-y in 4Q14. FY14 fee income grew by 57% y-o-y, led by consultancy fees (+115% y-o-y), bank card fees (+64%) and settlement clearing fees (+24%). Non-interest income contribution to revenue rose to 7.3% in 2014 from 3.7% in 2013. (iii) NPL balance and ratio both fell by 1% and 2bp q-o-q in 4Q14. Full-year NPL ratio was down 2bp, outperforming other listed peers. Early indicators show moderate asset quality pressure ahead: loans that are overdue less than 90 days fell 37% h-o-h in 2H14 or +9% y-o-y; special mention loans up-3% h-o-h in 2H14 or +9% y-o-y. (iv) Cost to-income ratio fell 2ppt y-o-y to 42%.

What we disliked: (i) Capital consumption was 173bp of Tier-1 capital in FY14, with the Tier 1 ratio at end-FY14 of 10.12%. Risk-weighted asset growth was 35%, with the fast growth partly a result of a more stringent classification in non-standard credit investments. (ii) Credit cost rose by 31bp y-o-y to 82bp for FY14, the highest level since the listing of the bank in 2010. Note however the loan loss reserve ratio rose 12bp y-o-y to 3.58%, and the provisioning coverage ratio also rose 29ppt y-o-y to 460%, suggesting a more conservative provisioning approach.

Other points of interest: (i) Non-standard credit investments exposure fell to 13% of assets in 2H14 from 17% in 1H14 (and 20% in 2013). (ii) Loan to deposit ratio was flat y-o-y at 59% in 2014. (iii) Dividend payout ratio was lowered by 2.3ppt to 27.2%.

We establish a Buy rating on CQRCB (vs OW(V) under our previous rating system). See pg. 2 for valuation and risks. We like CQRCB on its better asset quality and growth momentum than peers.

Exhibit 1. Yearly and quarterly financial comparisons

P&L summary (RMBm)	2013	2014	2014 y-o-y	2014a vs y% HSBC est.	1Q14	2Q14	3Q14	4Q14	4Q14 q-o-q %	4Q14 y-o-y %
Net interest income	15,703	18,349	17	1	4,258	4,593	4,688	4,810	3	17
Net fees & commissions	680	1,070	57	15	156	242	288	384	33	116
Other non-interest income	-77	384	-598	54	69	164	33	118	254	-397
Operating income	16,306	19,802	21	2	4,482	4,998	5,009	5,312	6	25
Operating expense	-7,208	-8,401	17	0	-1,790	-1,998	-2,137	-2,475	16	15
PPOP	9,098	11,402	25	4	2,692	3,000	2,872	2,837	-1	35
Impairment on loans	-973	-1,841	89	-6	-265	-655	-509	-412	-19	46
Impairment on other assets	-208	-451	117	209	0	1	0	-452	4,515,200	117
Profit before tax	7,917	9,110	15	2	2,427	2,346	2,363	1,974	-16	23
Taxation	-1,902	-2,297	21	7	-583	-588	-600	-526	-12	48
Attributable profit	5,991	6,828	14	1	1,834	1,757	1,783	1,454	-18	17
Balance sheet items (RMBbn)										
Total assets	502	619	23		550	594	609	619	2	23
Customer loans	205	242	18		215	227	233	242	4	18
Customer deposits	348	410	18		384	395	406	410	1	18
Total equity	36	41	14		38	38	40	41	4	14
Ratios (%)										
Net interest margin	3.41	3.37	-0.04		3.39	3.37	3.32	3.40	0.08	-0.04
Loans / Deposits ratio	59	59	0		56	57	58	59	2	0
Cost / income ratio	44	42	-2		40	40	43	47	4	-4
NPL ratio	0.80	0.78	-0.02		0.69	0.85	0.81	0.78	-0.04	-0.02
Coverage ratio	431	460	29		500	419	442	460	17	29
Credit costs	0.51	0.82	0.31		0.50	1.19	0.89	0.69	-0.19	0.13
Loan loss reserve	3.46	3.58	0.12		3.45	3.56	3.60	3.58	-0.02	0.12
Core Tier-1 ratio	11.85	10.12	-1.73		10.96	9.80	9.87	10.12	0.25	-1.73
Tier-1 ratio	11.85	10.12	-1.73		10.96	9.80	9.87	10.12	0.25	-1.73
CAR	13.64	12.45	-1.19		12.60	12.68	12.69	12.45	-0.24	-1.19
ROAE	17.6	17.6	0.0		19.7	18.4	18.3	14.3	-4.0	0.4
ROAA	1.28	1.22	-0.06		1.39	1.23	1.19	0.95	-0.24	-0.05
Effective Tax	24.02	25.21	1.19		24.03	25.07	25.38	26.64	1.26	4.47
EPS (Rmb)	0.64	0.73	0.09		0.20	0.19	0.19	0.15	-0.04	0.02

Source: Company data, HSBC

Valuation and risks: We use a discounted Gordon Growth model to value CQRCB. We first derive a target PB multiple of 1.34x, assuming COE = 13.0%, g = 5%, and a sustainable ROE proxied by the average of FY15-17e ROE of 15.7%. We apply this target PB multiple to FY15e book value per share of RMB5.00 and then also apply a combined valuation discount of 30% to reflect CQRCB's positioning with respect to the upcoming challenges facing the sector. We thus arrive at our target price of HKD5.80.

Under our new ratings system, we establish a Buy rating on CQRCB (vs OW(V) before).

There are no changes to our FY15-17 earnings estimates or our target price.

Key downside risks: worse-than-expected asset quality due to a slowdown in growth in Chongqing's economy.

Financials & valuation:

Chongqing Rural Commercial Bank

Buy

H-share: 3618 HK	Buy			HKD5.80
Year to	12/2014a	12/2015e	12/2016e	12/2017e
P&L summary				
Net Interest Income	18,349	19,336	20,678	23,606
Non-interest Income	1,454	1,380	1,617	1,899
Net fees/commission	1,070	1,117	1,341	1,609
Trading profits	384	263	276	289
Other	0	0	0	0
Total Operating income	19,802	20,716	22,294	25,505
Operating expense	-8,401	-8,944	-9,626	-11,012
Staff costs	-4,918	-5,428	-5,841	-6,682
Other oper expenses	-3,483	-3,517	-3,785	-4,330
PPOP	11,402	11,771	12,668	14,493
Provisions	-2,297	-2,325	-2,776	-3,333
Bad debt	-1,841	-2,166	-2,605	-3,160
Other	-456	-158	-172	-173
Other non-op profit(loss)	5	0	0	0
HSBC PBT	9,110	9,447	9,892	11,160
Exceptionals	0	0	0	0
Profit-before tax	9,110	9,447	9,892	11,160
Taxation	-2,297	-2,269	-2,376	-2,681
PAT	6,813	7,178	7,516	8,479
Minorities+pref dividend	15	-24	-24	-24
Attributable profit	6,828	7,154	7,492	8,455
HSBC attributable profit	6,828	7,154	7,492	8,455
B/S summary				
Total assets	618,889	706,813	827,387	971,668
Customer loans (net)	233,520	271,279	315,409	366,219
Debt assets	134,726	144,299	158,659	237,256
Other assets	250,643	291,236	353,319	368,193
Total Liabilities	576,041	659,783	774,974	913,010
Customer deposits	409,720	466,094	536,008	616,410
Debt securities issued	5,000	7,300	7,300	7,300
Other liabilities	161,321	186,388	231,666	289,300
Total capital	42,848	47,123	52,505	58,751
Ordinary equity	41,426	46,486	51,867	58,113
Minorities+other capital	1,422	638	638	638
IEA (avg)	545,020	637,297	742,939	863,613
IBL (avg)	501,040	579,759	668,068	768,279
Capital adequacy (%)				
RWA (RMBm)	413,387	501,368	595,170	708,673
Core tier 1	10.1	9.3	8.7	8.2
Total tier 1	10.1	9.3	8.7	8.2
Total Capital	12.3	11.6	10.9	10.1
Per share data (RMBm)				
EPS	0.73	0.77	0.81	0.91
HSBC EPS (fully diluted)	0.73	0.77	0.81	0.91
DPS	0.20	0.23	0.24	0.27
NAV (incl intangibles)	4.45	5.00	5.58	6.25
NAV (tangible)	4.45	5.00	5.58	6.25
ROA analysis (%)				
Net interest income	3.3	3.0	2.7	2.6
Total interest income	5.8	5.6	5.4	5.3
Total interest expense	-2.6	-2.6	-2.7	-2.7
Net fees & commission	0.2	0.2	0.2	0.2
Other income	0.1	0.0	0.0	0.0
Operating income	3.5	3.2	2.9	2.8
Operating expenses	-1.5	-1.4	-1.3	-1.2
Staff costs	-0.9	-0.8	-0.8	-0.7
Other oper exp	-0.6	-0.5	-0.5	-0.5
PPOP	2.0	1.8	1.7	1.6
Provisions	-0.4	-0.4	-0.4	-0.4
Non-op items	0.0	0.0	0.0	0.0
PBT	1.6	1.4	1.3	1.2
Taxation	-0.4	-0.3	-0.3	-0.3
PAT	1.2	1.1	1.0	0.9

A-share: n.a.	n.a.			RMB n.a.
Year to	12/2014a	12/2015e	12/2016e	12/2017e
Growth (y-o-y %)				
Net interest income	16.8	5.4	6.9	14.2
Non-interest income	137.3	(5.1)	17.1	17.4
Operating expense	16.6	6.5	7.6	14.4
PPOP	25.2	3.2	7.6	14.4
Provisions	94.5	1.2	19.4	20.0
PBT	15.1	3.7	4.7	12.8
PAT	14.3	4.7	4.7	12.9
Net Loans	17.8	16.2	16.3	16.1
Total Assets	23.2	14.2	17.1	17.4
RWA	35.0	21.3	18.7	19.1
Customer deposits	17.8	13.8	15.0	15.0
Ratios (%)				
NIM	3.37	3.03	2.78	2.73
Gross yield	6.00	5.71	5.61	5.53
Cost of funds	2.86	2.95	3.15	3.15
Spread	3.14	2.77	2.47	2.39
NPL/gross loans	0.78	1.07	1.22	1.37
Credit cost	0.82	0.83	0.86	0.89
LLR	3.58	3.67	3.72	3.77
Coverage	459.8	343.0	304.9	275.2
NPL/RWA	0.5	0.6	0.7	0.7
Provision/RWA	5.1	4.7	4.8	4.8
Net write-off/RWA	-1.1	-1.5	-1.6	-1.8
NPL/NTA	4.6	6.5	7.7	9.0
Net loans/assets	37.7	38.4	38.1	37.7
RWA/assets	66.8	70.9	71.9	72.9
Loans/deposits	59.1	60.4	61.1	61.7
Avg IEA/avg assets	97.2	96.1	96.9	96.0
Avg IBL/avg liab	96.2	93.8	93.1	91.0
Cost/income	42.4	43.2	43.2	43.2
Non-int inc/total inc	7.3	6.7	7.3	7.4
ROAA (incl goodwill)	1.22	1.10	0.98	0.94
ROAE (incl goodwill)	17.6	16.3	15.3	15.4
Return on avg tier 1	18.8	17.2	16.0	16.2
Leverage (x)	14.1	14.7	15.4	16.2
Valuation data				
PE (diluted EPS)	5.2	4.9	4.7	4.2
P/PPOP	3.1	3.0	2.8	2.4
P/BVPS	0.8	0.8	0.7	0.6
P/NTA	0.8	0.8	0.7	0.6
Dividend yield (%)	5.3	6.0	6.3	7.1
P/Deposit	0.1	0.1	0.1	0.1
P/Asset	0.1	0.0	0.0	0.0

Price Relative Chart



Source: Bloomberg, HSBC estimates

Note: Price as at close of 27-Mar-15

Disclosure appendix

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Rating distribution for long-term investment opportunities

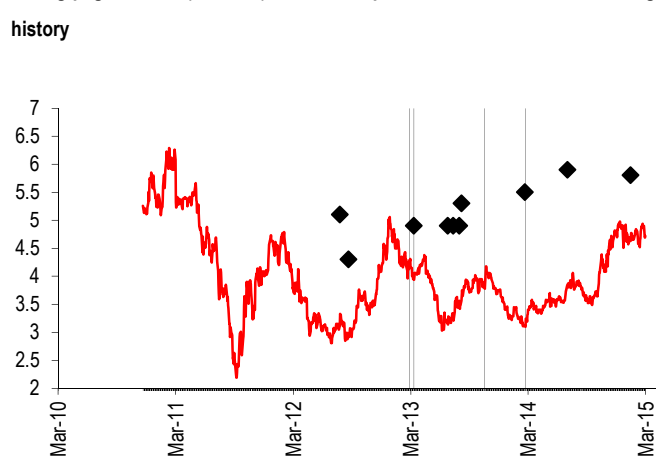
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Share price and rating changes for long-term investment opportunities

Chongqing Rural Co (3618.HK) Share Price performance HKD Vs HSBC rating history



Source: HSBC

Recommendation & price target history

From	To	Date
Overweight (V)	Neutral (V)	24 March 2013
Neutral (V)	Overweight (V)	07 April 2013
Overweight (V)	Overweight	13 November 2013
Overweight	Overweight (V)	19 March 2014
Target Price	Value	Date
Price 1	5.10	20 August 2012
Price 2	4.30	16 September 2012
Price 3	4.90	07 April 2013
Price 4	4.90	22 July 2013
Price 5	4.90	08 August 2013
Price 6	4.90	27 August 2013
Price 7	5.30	03 September 2013
Price 8	5.50	19 March 2014
Price 9	5.90	29 July 2014
Price 10	5.80	10 February 2015

Source: HSBC

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