

March 30, 2015

China Cinda Asset Management

Improving ROE with more rational restructured NPL business, but some new concerns in leasing business

Industry View

Attractive

Stock Rating

Overweight

Cinda reported 2014 net income of RMB11.9bn, up 32% YoY, 2% higher than Bloomberg cons., but 4% below our est. We saw more rational growth in restructured NPLs, but with new concerns in leasing business. Investment gains beat our est., offset by higher than expected financing cost & provision.

Positives: 1) ROE recovery to 14.9% in 2H14 from 13.3% in 1H14 with stable leverage. The improvement is partly aided by the deployment of Rmb24bn cash into income generating assets. **2) More prudent strategy on restructuring distressed assets to maintain profitability and contain credit risks.** In 2H14, the growth of restructuring distressed assets slowed down significantly, to merely 3% HoH from 61% in 1H14. The average yield was steady at 12.2% in 2H14. While NPL balance and NPL ratio still posted dual increases by 16% and 0.1ppt in 2H14, the pace of growth was notably slower than 74% in 1H14 with likely lower past due loans. As a result, credit cost of restructuring distressed assets declined to 90bps in 2H14, down 170bps HoH. **3) Faster asset turnover on traditional distressed assets.** In 2H14, Cinda accelerated the pace of acquisition and disposal of the business to RMB24bn and RMB4bn, respectively. While the disposal return almost halved to 48% in 2H14 from 87% in 1H14, the internal rate of return remained stable at around 19%, thanks to quick asset turnover. **4) Rising return on financial investments.** By end of 2014, financial investments accounted for 17% of total assets. In 2H14, return from financial assets was raised to 11.7% (from 6.5% in 1H14), likely aided by mark to market gains on trading financial assets benefiting bond and equity market rally. **5) Cinda raised dividend payout ratio to 30%,** implying a current dividend yield of approximately 3.3%.

Negatives: 1) Some concerning signs in Cinda's leasing business. We noted continued elevated growth in leasing receivables in a slowing economy. Leasing receivables increased 65% yoy and 28% hoh in 2H14 despite slowing down from 95% yoy and 29% hoh growth in 1H14. Impaired loans for Cinda's leasing business nearly tripled in 2H14 with impaired loan ratio increase to 2.1% by the end of 2H14 from 0.9% at the end of 1H14. **2) Higher than expected provision cost on loans to customers (leasing) and AFS financial assets.** As a result of the deterioration of credit quality in Cinda's leasing business, its related provision increased 2.5X hoh. In addition, despite buoyant equity market performance in 2H14, Cinda still made RMB886m provision on AFS financial assets, increasing 41% HoH, which was likely due to rapid growth in such assets (AFS ex. DES assets increased 86% hoh to

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China Cinda Asset Management (1359.HK, 1359 HK)

China Financials / China

Stock Rating

Industry View

Shr price, close (Mar 27, 2015)

52-Week Range

Sh out, dil, curr (mn)

Mkt cap, curr (mn)

EV, curr (mn)

Avg daily trading value (mn)

Overweight

Attractive

HK\$3.69

HK\$4.54-3.31

35,459

Rmb104,881

Rmb173,604

HK\$216

Fiscal Year Ending	12/13	12/14e	12/15e	12/16e
ModelWare EPS (Rmb)	0.28	0.35	0.44	0.51
Prior ModelWare EPS (Rmb)	-	-	-	-
Consensus EPS (Rmb)\$	0.24	0.34	0.42	0.50
Revenue, net (Rmb mn)	-	-	-	-
EBITDA (Rmb mn)	16,051	22,872	27,610	32,325
ModelWare net inc (Rmb mn)	9,028	12,417	15,449	18,178
P/E	13.7	8.6	6.8	5.8
P/BV	1.8	1.2	1.0	0.9
RNOA (%)	12.3	11.6	12.4	12.1
ROE (%)	16.5	16.3	17.2	17.6
EV/EBITDA	12.6	8.0	7.2	6.7
Div yld (%)	0.0	0.0	0.0	0.0
FCF yld ratio (%)	-	-	-	-
Leverage (EOP) (%)	18.5	17.3	17.6	17.7

Unless otherwise noted, all metrics are based on Morgan Stanley ModelWare framework

\$ = Consensus data is provided by Thomson Reuters Estimates

e = Morgan Stanley Research estimates

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Rmb44.2bn). **3) Average funding cost continued to rise to 5.4% in 2H14,** up 0.8ppt YoY and 0.4ppt HoH, due to the replacement of low-cost government funding by commercial bank loans and financial bonds. Moreover, despite moderating interbank yield, Cinda's bank borrowing cost remained elevated at 6% in 2H14, vs. 5.9% in 1H14.

While we believe Cinda's ROE improvement could support the stock, given its low valuation at 1.0x 2015E P/B, we will be looking for more guidance on the firm's strategy on traditional NPL disposal, leasing business strategy, and funding cost outlook from the firm's analyst briefing, which will be key for the stock's medium-term performance, in our view.

Key financial trends

Exhibit 1: Annual results comparison: net income increased by 32% YoY, 4% lower than our estimate on faster than expected growth of provision and operating expenses

Year end 31 Dec. (Rmb mn)	2013	2014	YoY	MS estimate	Actual vs estimate
P&L					
Investment income	22,545	34,131	51%	32,707	4%
Distressed assets	19,757	26,679	35%	27,279	-2%
Other financial assets	2,788	7,452	167%	5,428	37%
Interest income	5,059	8,811	74%	8,203	7%
Interest expense	-7,804	-15,961	105%	-15,575	2%
Net fee income	2,333	2,782	19%	2,804	-1%
Other income and other net gains or losses	2,195	2,057	-6%	2,295	-10%
Total income	24,329	31,819	31%	30,434	5%
Total operating expenses	-8,035	-9,911	23%	-9,200	8%
PPOP	16,293	21,908	34%	21,235	3%
Provision	-6,153	-5,438	-12%	-5,060	7%
Operating profit	10,140	16,470	62%	16,174	2%
Other profit	1,632	-163	-110%	671	-124%
Profit Before Tax	11,773	16,307	39%	16,845	-3%
NPAT	9,028	11,896	32%	12,417	-4%
B&S					
Total Assets	383,785	544,427	42%	532,788	2%
Distressed assets	156,637	245,975	57%	258,800	-5%
Other financial assets	74,505	95,075	28%	88,125	8%
Loans to customers	49,578	82,015	65%	79,802	3%
Interest bearing liabilities	229,633	339,447	48%	353,183	-4%
Shareholders' equity	75,998	93,368	23%	89,688	4%
Selected Ratios					
Total asset / equity	5.0	5.8	0.8	5.9	-0.1
ROAE	13.8%	14.0%	0.2	15.0%	-0.9
ROAA	2.8%	2.6%	-0.3	2.7%	-0.1
Cost to income ratio	-33%	-31%	1.9	-30%	-0.9

Source: Company data, Morgan Stanley Research

Exhibit 2: Semiannual result comparison: net profit growth at 25% HoH and 33% YoY

Year end 31 Dec. (Rmb mn)	2H13	1H14	2H14	HoH	YoY
P&L					
Investment income	11,991	14,468	19,663	36%	64%
Distressed assets	10,379	12,024	14,655	22%	41%
Receivables	5,900	7,577	10,537	39%	79%
Fair value	2,650	2,302	1,775	-23%	-33%
DES distressed asset	1,829	2,145	2,343	9%	28%
Other financial assets	1,612	2,444	5,007	105%	211%
Interest income	3,125	3,807	5,004	31%	60%
Leasing income	1,979	2,719	3,472	28%	75%
Interest expense	(4,649)	(6,817)	(9,144)	34%	97%
Net fee income	1,310	1,298	1,484	14%	13%
Other income	1,123	1,133	923	-19%	-18%
Total income	12,901	13,889	17,930	29%	39%
Total operating expenses	(4,593)	(3,950)	(5,961)	51%	30%
PPOP	8,308	9,939	11,969	20%	44%
Provision	(2,677)	(2,686)	(2,752)	2%	3%
Operating profit	5,631	7,253	9,217	27%	64%
Profit Before Tax	6,635	7,266	9,041	24%	36%
Effective Tax	(1,551)	(1,906)	(2,258)	18%	46%
Minorities	(122)	(64)	(183)	186%	50%
NPAT	4,963	5,296	6,600	25%	33%
B&S					
Total Assets	383,785	482,156	544,427	13%	42%
Distressed assets	156,637	221,915	245,975	11%	57%
Other financial assets	74,505	75,836	95,075	25%	28%
Loans to customers	49,578	63,841	82,015	28%	65%
Interest bearing liabilities	229,633	316,357	339,447	7%	48%
Shareholders' equity	75,998	83,808	93,368	11%	23%
Selected Ratios					
Total asset / equity	5.0	5.8	5.8	0.1	0.8
ROAE	15.0%	13.3%	14.9%	1.6	-0.1
ROAA	3.0%	2.4%	2.6%	0.1	-0.4

Source: Company data, Morgan Stanley Research

Exhibit 3: Balance sheet analysis: restructuring distressed asset growth slowed down notably to 3% HoH, while traditional distressed asset balance expanded by 89% due to faster NPL acquisitions from Chinese banks; loan and advances to customers also moved up moderately by 28% HoH

	2H13	1H14	2H14	HoH	YoY
Distressed assets	156,637	221,915	245,975	11%	57%
Receivables	97,971	157,740	162,109	3%	65%
Fair value	16,392	22,423	42,302	89%	158%
DES assets (AFS)	42,275	41,752	41,564	0%	-2%
Financial investments	74,505	75,836	95,075	25%	28%
Loan and advances to customers	49,578	63,841	82,015	28%	65%
Cash and bank balances	57,059	66,998	43,891	-34%	-23%
Others	46,006	53,566	77,471	45%	68%
Total assets	383,785	482,156	544,427	13%	42%
As % total assets					
Distressed assets	41%	46%	45%	(0.8)	4.4
Receivables	26%	33%	30%	(2.9)	4.2
Fair value	4%	5%	8%	3.1	3.5
DES assets (AFS)	11%	9%	8%	(1.0)	(3.4)
Financial investments	19%	16%	17%	1.7	(1.9)
Loan and advances to customers	13%	13%	15%	1.8	2.1
Cash and bank balances	15%	14%	8%	(5.8)	(6.8)
Others	12%	11%	14%	3.1	2.2

Source: Company data, Morgan Stanley Research

Exhibit 4: Distressed asset analysis: DES assets - stable growth of revenue as lower disposal return in 2H14 compensated by faster disposals; Receivables - stable yield with slowing asset quality deterioration; Fair value - faster asset turnover, weaker than expected revenue due to lower disposal return

	2H13	1H14	2H14	HoH	YoY
DES Assets					
Revenue	1,829	2,145	2,343	9%	28%
Asset	42,275	41,752	41,564	0%	-2%
Dividend yield	3.9%	0.4%	1.7%	1.3	(2.2)
Disposal return	52%	164%	85%	(79.1)	32.8
% disposed (annualized)	9%	6%	11%	5.2	2.6
Restructured distressed assets					
Revenue	5,900	7,577	10,537	39%	79%
Asset	97,971	157,740	162,109	3%	65%
Yield	13.0%	11.5%	12.8%	1.3	(0.3)
Credit cost (bps)	162	264	89	-66%	-45%
Impairment ratio	1.0%	1.1%	1.2%	0.1	0.2
Coverage ratio	291%	266%	266%	0.0	(25.1)
Traditional distressed assets					
Revenue	2,650	2,302	1,775	-23%	-33%
Asset	16,392	22,423	42,302	89%	158%
Acquisition	10,166	7,186	24,325	239%	139%
Disposal	2,034	1,833	4,302	135%	112%
Return on disposal	161%	89%	48%	(41.2)	(113.1)

Source: Company data, Morgan Stanley Research

Exhibit 5: Yield Analysis: declining yield of traditional distressed assets due to fast asset turnover, increasing financial investment yield benefiting from mark to market gains from a buoyant equity and bond market in 2H14, stable leasing business yield, average funding cost still inched up in 2H14 despite falling interbank rates

Yield analysis	2H13	1H14	2H14	HoH	YoY
Distressed assets					
Receivables	13.0%	11.5%	12.8%	1.3	(0.3)
Fair value	42.8%	23.7%	11.0%	(12.8)	(31.8)
DES assets (AFS)	8.5%	10.2%	11.3%	1.0	2.7
Financial investments	5.4%	6.5%	11.7%	5.2	6.3
Loan and advances to customers	9.6%	9.6%	9.5%	(0.1)	(0.1)
Average funding cost	4.6%	5.0%	5.4%	0.5	0.8

Source: Company data, Morgan Stanley Research

Exhibit 6: Asset quality of distressed assets at receivables and loans to customers: impaired ratio increased to 1.5% largely due to faster credit quality worsening of loans to customers (leasing)

Year end 31 Dec. (Rmb mn)	2H13	1H14	2H14	HoH	YoY
Impaired credit assets	1,537	2,350	3,767	60%	145%
Impaired ratio	1.0%	1.0%	1.5%	0.5	0.5
Coverage ratio	253%	250%	190%	-60.1	-63.1
Allowance to credit assets	2.6%	2.6%	2.9%	0.3	0.3

Source: Company data, Morgan Stanley Research

Exhibit 7: Credit assets distribution (including restructuring distressed assets and loans to customers)

Distribution by Industry	2H13	1H14	2H14	YoY	HoH
Real estate	75,621	118,676	127,230	113%	7%
Manufacturing	16,671	24,492	31,042	90%	27%
Water, environment and public utilities management	12,465	14,051	12,836	34%	-9%
Leasing and commercial services	12,017	12,624	10,922	63%	-13%
Construction	6,417	10,076	10,227	99%	1%
Transportation, logistics and postal services	5,710	10,696	10,129	99%	-5%
Mining	5,420	7,662	9,973	105%	30%
Others	16,169	27,987	37,122	137%	33%
Sum	150,491	226,265	249,479	101%	10%

Source: Company data, Morgan Stanley Research

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(as of February 28, 2015)

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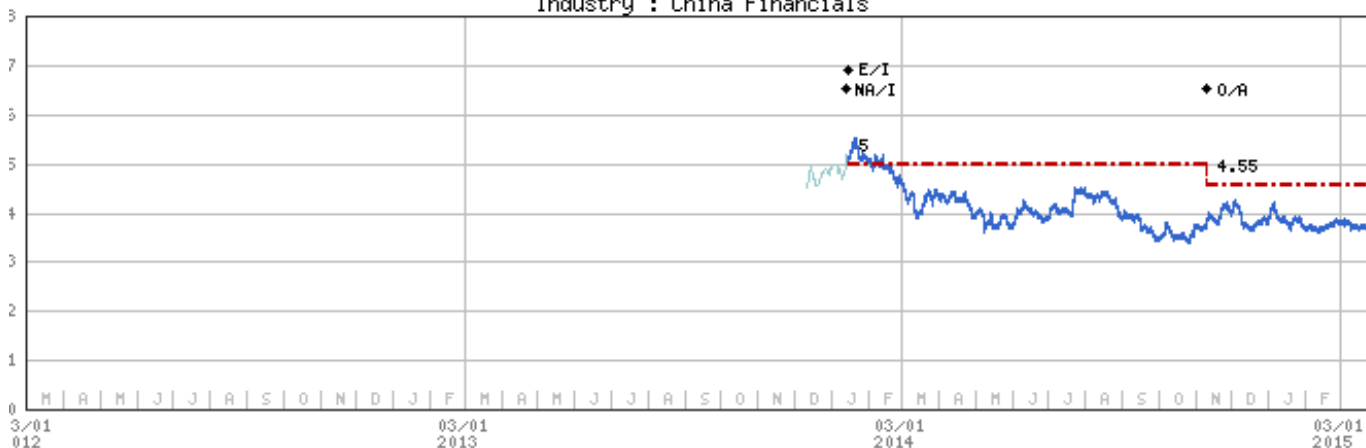
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China Cinda Asset Management (1359.HK) - As of 3/29/15 in HKD
Industry : China Financials



Source: Morgan Stanley Research Date Format : MM/DD/YY Price Target -- No Price Target Assigned (NA)
 Stock Price (Not Covered by Current Analyst) — Stock Price (Covered by Current Analyst) —
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 Stock Ratings: Overweight (O) Equal-weight (E) Underweight (U) Not-Rated (NR) No Rating Available (NA)
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INDUSTRY COVERAGE: China Financials

COMPANY (TICKER)	RATING (AS OF)	PRICE* (03/27/2015)
Xu CFA, Richard		
Agricultural Bank of China Limited (1288.HK)	O (03/20/2013)	HK\$3.76
Agricultural Bank of China Limited (601288.SS)	O (09/05/2014)	Rmb3.64
Bank of China Limited (601988.SS)	O (11/11/2014)	Rmb4.33
Bank of China Limited (3988.HK)	O (11/11/2014)	HK\$4.32
Bank of Chongqing (1963.HK)	E (12/11/2013)	HK\$6.21
Bank of Communications (3328.HK)	U (10/11/2012)	HK\$6.38
Bank of Communications (601328.SS)	U (09/05/2014)	Rmb6.33
China Cinda Asset Management (1359.HK)	O (11/11/2014)	HK\$3.69
China CITIC Bank Corporation Limited (601998.SS)	U (09/05/2014)	Rmb7.29
China CITIC Bank Corporation Limited (0998.HK)	E (10/11/2012)	HK\$5.64
China Construction Bank Corp. (601939.SS)	O (09/05/2014)	Rmb5.99
China Construction Bank Corp. (0939.HK)	O (10/11/2012)	HK\$6.31
China Everbright Bank Co Ltd (6818.HK)	E (01/23/2014)	HK\$4.18
China Everbright Bank Co Ltd (601818.SS)	E (09/05/2014)	Rmb4.64
China Merchants Bank (3968.HK)	O (11/11/2014)	HK\$18.42
China Merchants Bank (600036.SS)	O (11/11/2014)	Rmb15.27
China Minsheng Banking Corp. (1988.HK)	E (01/28/2014)	HK\$9.15
China Minsheng Banking Corp. (600016.SS)	E (09/05/2014)	Rmb9.51
Chongqing Rural Commercial Bank (3618.HK)	O (01/28/2014)	HK\$4.72
CITIC Securities Co. (6030.HK)	U (04/15/2014)	HK\$27.10
CITIC Securities Co. (600030.SS)	U (08/13/2014)	Rmb32.13
Galaxy Securities (6881.HK)	O (02/05/2015)	HK\$8.58
Haitong Securities (600837.SS)	U (08/13/2014)	Rmb22.81
Haitong Securities (6837.HK)	E (12/18/2014)	HK\$17.96
Huishang Bank Corporation Limited (3698.HK)	E (12/17/2013)	HK\$3.43
Industrial and Commercial Bank of China (601398.SS)	O (09/05/2014)	Rmb4.71
Industrial and Commercial Bank of China (1398.HK)	O (08/09/2013)	HK\$5.50
Industrial Bank Co. Ltd. (601166.SS)	O (11/11/2014)	Rmb16.99
Ping An Bank (000001.SZ)	U (03/20/2013)	Rmb15.08
Sun Hung Kai & Co (0086.HK)	++	HK\$6.68

Stock Ratings are subject to change. Please see latest research for each company.

* Historical prices are not split adjusted.