

JPM-pp1

Asia Pacific Equity Research

29 March 2015

China Construction Bank - H (939 HK)

Overweight

Price: HK\$6.31

27 Mar 2015

Price Target: HK\$7.60

PT End Date: 31 Dec 2015

FY14 results - in line with expectation

CCB reported FY14 net profits of RMB227.8bn, up 6% YoY, inline with our estimate. This is a balanced set of results and largely inline with industry trend. On a sequential basis, we noted NIM contraction of 3bps qoq and NPL ratio went up by 7bps qoq, but this is within expectation. CCB's capital ratio remains the highest among big banks, with core tier 1 ratio of 12.12%, up 47bps qoq. The key downside will be deposits contraction of 1% qoq in 4Q14 and cut of dividend payout ratio to 33% from 35%, but this is within expectation following similar move by ABC, BOC and ICBC. And CCB's DPS, after cutting dividend payout ratio, was flat YoY; this is better than ICBC and BOC.

What we like about the results:

- **Strong capital position:** There is no difference between core tier 1 and tier 1 ratios, they were 12.12% at end 2014. CCB's core tier 1 ratio was the highest among banks we cover. We expect tier 1 ratio to be strengthened by 78bps, all else equal, as CCB plans to issue preference shares of RMB80bn.
- **Asset quality deterioration slower than peers:** CCB's NPL ratio went up by 7bps qoq, slower than industry trend of 9bps qoq, the sequential asset quality deterioration trend was the same as ICBC and better than ABC and BOC. And its overdue loans went up by 10.6% HoH, ABC (+35% HoH) and ICBC (+18% HoH), similar to BOC (+10.5% HoH). Special-mention loans went up by 28% HoH, same as industry trend. On provision, CCB stepped up provision level, so annualized credit costs on loans went up to 93bps in 4Q14, higher than 55bps in the first nine months of 2014. In addition, CCB has made RMB2.6bn of provision charges in 2014 for potential impairment on non-loan assets, including off-balance sheet exposures; we believe this is a prudent move amid regulatory tightening on shadow banking and worsening macro environment.

What we don't like about the results:

- **NIM contracted by 3bps qoq:** This is weaker than industry trend (+2bps qoq) and big 4 peers (ABC +10bps qoq, ICBC +3bps qoq and BOC -2bps qoq). We believe this could have been contributed by rising deposits costs faster than peers. For example, we noted that other big 3 banks priced their 1-year term deposits at ~1.1x base rate, but CCB priced at 1.16x base rate. On semi-annual basis, NIM was flat, as rising loan yield (+4bps hoh) was offset by increasing deposits funding costs (+4bps hoh).
- **Fee income only went up by 4% YoY, slowest since IPO:** We believe this is mainly due to NDRC's inspection on fee income charged to SMEs. So we expect growth rate to resume in 2015 due to low base effect in 2014 and impact of the inspection should be taken up in 2014. In addition, on a quarterly basis, we noted that fee income went up 5% qoq in 4Q14.

Table 1: Summary of 2014 results

RMB mn	FY13 Actual	FY14 Actual	YoY	Actual vs JPM		1H14	2H14	HoH
				FY14 JPM Est.	est			
Nil	389,544	437,398	12%	438,343	0%	211,292	226,106	7%
Non-Interest Income	121,596	119,342	-2%	117,424	2%	65,435	53,907	-18%
Fees	104,283	108,517	4%	109,277	-1%	60,180	48,337	-20%
Non-fee	17,313	10,825	-37%	8,147	33%	5,255	5,570	6%
Total Income	511,140	556,740	9%	555,767	0%	276,727	280,013	1%
Operating expenses	(188,185)	(195,988)	4%	(190,697)	3%	(84,139)	(111,849)	33%
Staff costs	(86,830)	(91,563)	5%	(89,601)	2%	(38,957)	(52,606)	35%
Other operating expenses	(101,355)	(104,425)	3%	(101,096)	3%	(45,182)	(59,243)	31%
PPOP	322,955	360,752	12%	365,070	-1%	192,588	168,164	-13%
LLP	(42,666)	(59,264)	39%	(64,410)	-8%	(21,286)	(37,978)	78%
Other Provisions	(543)	(2,647)	387%	(3,336)	-21%	(1,836)	(811)	-56%
Pre-Tax	279,806	299,086	7%	297,374	1%	169,516	129,570	-24%
Income Tax	(64,684)	(70,839)	10%	(67,314)	5%	(38,546)	(32,293)	-16%
Attributable Income	214,657	227,830	6%	229,452	-1%	130,662	97,168	-26%
Gross Loans	8,590,057	9,474,523	10%	9,742,037	-3%	9,190,601	9,474,523	3%
Deposits	12,223,037	12,898,675	6%	13,216,095	-2%	12,956,956	12,898,675	0%
Equity	1,065,951	1,242,179	17%	1,236,233	0%	1,137,914	1,242,179	9%
Total Assets	15,363,210	16,744,130	9%	16,893,536	-1%	16,399,790	16,744,130	2%
Key Ratios								
NIM	2.74%	2.80%	6 bps	2.81%	-1 bps	2.80%	2.80%	0 bps
Cost income ratio	36.8%	35.2%	-161 bps	34.3%	89 bps	30.4%	39.9%	954 bps

ROE	21.4%	19.7%	-165 bps	19.9%	-20 bps	23.7%	16.3%	-738 bps
ROA	1.46%	1.42%	-5 bps	1.42%	0 bps	1.65%	1.17%	-47 bps
NPL Ratio	0.99%	1.19%	20 bps	1.21%	-2 bps	1.04%	1.19%	15 bps
NPL Coverage ratio	268%	222%	-46 pt	230%	-8 pt	249%	222%	-27 pt
Loan loss reserve	2.66%	2.66%	-1 bps	2.78%	-13 bps	2.59%	2.66%	7 bps
LDR	70.3%	73.5%	318 bps	73.7%	-26 bps	70.9%	73.5%	252 bps
Credit costs	0.53%	0.66%	13 bps	0.70%	-5 bps	0.48%	0.81%	34 bps
Core capital ratio	10.75%	12.12%	137 bps	11.45%	67 bps	11.21%	12.12%	91 bps
Tier 1 Ratio	10.75%	12.12%	137 bps	11.45%	67 bps	11.21%	12.12%	91 bps
Total CAR	13.34%	14.87%	153 bps	14.13%	73 bps	13.89%	14.87%	98 bps
Dividend payout ratio	35%	33%	-2 pt	35%	-2 pt			

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

Table 2: Summary of 4Q14 financials

<i>RMB mn</i>	4Q13	1Q14	2Q14	3Q14	4Q14	QoQ	YoY
Key P&L Items							
NII	103,034	103,207	108,085	111,945	114,161	2%	11%
Non-Interest Income	29,225	44,729	20,706	26,743	27,164	2%	-7%
Fees	24,195	32,121	28,059	23,621	24,716	5%	2%
Non-fees	5,030	12,608	(7,353)	3,122	2,448	-22%	-51%
Total Income	132,259	147,936	128,791	138,688	141,325	2%	7%
Operating expenses	(63,511)	(50,634)	(33,505)	(46,698)	(65,151)	40%	3%
PPOP	68,748	97,302	95,286	91,990	76,174	-17%	11%
LLP	(17,313)	(10,690)	(10,596)	(16,060)	(21,918)	36%	27%
Pre-Tax	51,207	85,767	83,749	75,717	53,853	-29%	5%
Income Tax	(12,952)	(19,845)	(18,701)	(16,002)	(16,291)	2%	26%
Attributable Income	38,175	65,780	64,882	59,636	37,532	-37%	-2%
Key Balance Sheet Items							
Gross Loans	8,590,057	8,921,128	9,190,601	9,349,489	9,474,523	1%	10%
Including NPL amount	85,264	90,808	95,668	105,320	113,171	7%	33%
Total deposits	12,223,037	12,858,602	12,956,956	12,982,406	12,898,675	-1%	6%
Total assets	15,363,210	16,141,448	16,399,790	16,735,863	16,744,130	0%	9%
Equity	1,065,951	1,139,141	1,137,914	1,197,823	1,242,179	4%	17%
Key Ratios							
NIM	2.82%	2.81%	2.78%	2.81%	2.78%	-3bp	-4bp
Cost income ratio	48.0%	34.2%	26.0%	33.7%	46.1%	1243bp	-192bp
ROE	14.5%	23.9%	22.8%	20.4%	12.3%	-812bp	-219bp
ROA	1.01%	1.67%	1.60%	1.44%	0.90%	-54bp	-11bp
NPL Ratio	0.99%	1.02%	1.04%	1.13%	1.19%	7bp	20bp
NPL Coverage ratio	268.2%	260.2%	248.9%	234.5%	222.3%	-12 pt	-46 pt
Loan loss reserve	2.66%	2.65%	2.59%	2.64%	2.66%	1bp	-1bp
Credit cost	0.82%	0.49%	0.47%	0.69%	0.93%	24bp	12bp
LDR	70.3%	69.4%	70.9%	72.0%	73.5%	144bp	318bp
Core capital ratio	10.75%	11.11%	11.21%	11.65%	12.12%	47bp	137bp
Tier 1 Ratio	10.75%	11.11%	11.21%	11.65%	12.12%	47bp	137bp
Total CAR	13.34%	13.50%	13.89%	14.53%	14.87%	34bp	153bp

Source: Company reports.

Investment Thesis

- Strong balance sheet with stable source of funding - interbank liability only accounted for 7% of IBL in 2013, the lowest in the sector
- Strong capital position (Tier 1 ratio 10.8% at end 2013) and efficient capital allocation (RoRWA at 2.45% vs. sector 2.06% in 2013)
- Stable asset quality (NPL up 1bp YoY vs peers' average of 4bp) as a result of prudent risk management (NPL/overdue loans ratio 98% vs. sector 71% at end-2013).

Valuation

Our Dec-15 price target of HK\$7.6 is DDM-derived, assuming a cost of equity of 13.7%, normalised ROE of 13.1%, and terminal date of 31 December 2016

Risks to Rating and Price Target

Risk to our investment view will be mainly from unexpected changes in regulatory environment, monetary policy, and structural reforms in China. Other risks include: lower-than-expected loan growth; higher-than-expected NIM contraction; and deterioration of asset quality.

Banks & Financial Services

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Date	Rating	Share Price (HK\$)	Price Target (HK\$)
04-Dec-06	OW	4.04	4.80
07-Jan-07	OW	4.89	5.60
16-Apr-07	OW	4.64	6.00
25-Jul-07	OW	5.89	6.80
28-Aug-07	OW	6.15	7.10
28-Oct-07	OW	7.77	10.10
13-Jan-08	OW	6.45	8.90
26-Feb-08	OW	5.51	7.80
14-Apr-08	OW	6.71	8.40
27-Apr-08	OW	6.76	8.80
06-Jul-08	OW	5.92	7.80
24-Aug-08	OW	5.97	8.00
16-Sep-08	N	5.15	8.00
28-Sep-08	N	4.91	7.20
17-Oct-08	OW	3.75	7.10
04-Mar-09	OW	3.96	6.80
30-Mar-09	OW	4.70	6.90
28-Jun-09	OW	6.04	8.20
23-Aug-09	OW	5.99	8.40
03-Nov-09	OW	6.77	8.30
30-Nov-09	OW	6.90	9.19
10-Mar-10	OW	6.20	8.60
29-Mar-10	OW	6.09	8.40
09-Aug-10	OW	6.93	8.20
27-Nov-10	OW	7.05	9.30
23-Mar-11	OW	7.06	9.40
28-Mar-11	OW	7.15	9.20
30-Apr-11	OW	7.34	9.50
12-Jan-12	OW	5.63	10.10
27-Mar-12	OW	5.99	9.90
31-Jul-12	OW	5.07	6.75
07-Nov-12	OW	5.99	7.00
19-Feb-13	OW	6.51	7.70
28-Oct-13	OW	5.77	7.90
09-Feb-14	OW	5.26	7.60
10-Apr-14	OW	5.61	7.00

<http://gps-app.emea.jpmchase.net:6080/server/console/chart/?shareClassId=503876&shareClassServerId=4&chartDesignation=1&actionType=C>

26-Jun-14	OW	5.84	6.80
17-Oct-14	OW	5.51	7.10
03-Mar-15	OW	6.35	7.60

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