

China Merchants Bank (3968.HK)

Better-than-expected profit growth with the deterioration of asset quality

Bloomberg | Reuters | POEMS
3968.HK | 3968.HK | 3968.HK
Industry: Financial

Phillip Securities Research Pte Ltd

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Strong profit growth in 3Q2012 and larger capital pressure in future

Rating: Accumulative | CP: HK\$16.44 | TP: HK\$18.28

Company Introduction

Established in 1987 in Shenzhen, China Merchants Bank ("CMB") is China's first joint-stock commercial bank, which became listed in A+H Shares in 2002 and 2006 respectively. The Bank was short listed as a World-Class Chinese Brand and ranked No. 1 in the list of the world's top 50 banks with the largest market value by the British Financial Times. It was also listed No.60 among the world's Top 1,000 Banks by The Banker.

Summary


According to CMB's 3Q2012 result, its accumulate net profits reached RMB34.790 billion, a significant increase by 22.55% y-y, and 49% q-q respectively, translating to an EPS of RMB1.98, higher than our expectation.

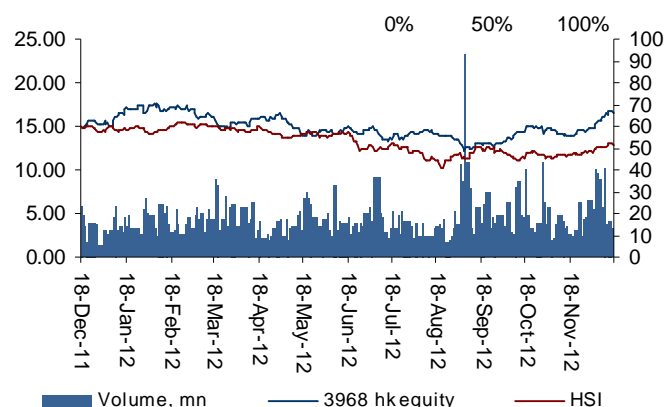
The Group's total assets increased sharply by 12.51% to RMB3.14 trillion compared to the end of 2011, equivalent to BVPS of RMB8.85, 15.69% higher than that of 2011.

We note there was the deterioration of CMB's asset quality with the increase of both amount and ratio of NPLs. As at the end of 3Q2012, the Group's NPL ratio increased by 0.03 percentage points to 0.59% compared with the end of 2011, and the converge ratio dropped 22.76 percentage points to 377.37%.

We concern about CMB's financing plan. Currently, CMB had announced the delay of financing plan, and showed large capital pressure under the low CAR. By the end of Sep, the Core CAR and CAR of CMB recorded 8.47% and 11.56%, increasing by 0.25 and 0.03 percentage points respectively, which are at the bottom of the industry.

Considering the better-than-expected profit growth, we slightly increase 12-m TP of CMB to HK\$18.28, 11.18% higher than the latest closing price, equivalent to P/E6.9x and P/B1.4x in 2013 respectively, and we recommend Accumulate rating.

Rating	2.00	Accumulate
- Previous Rating	1.00	Buy
Target Price (HKD)	18.28	
- Previous Target Price (HKD)	17.90	
Closing Price (HKD)	16.44	
Expected Capital Gains (%)	11.2%	
Expected Dividend Yield (%)	3.7%	
Expected Total Return (%)	14.9%	
Raw Beta (Past 2yrs weekly data)	N/A	
Market Cap. (HKD bn)	321,302	
Enterprise Value (HKD mn)	N/A	
52 w week range (HKD)	12.02 - 18.3	
Closing Price in 52 w week range		



Key Financial Summary

FYE	12/11	12/12F	12/13F	12/14F
Operating Profit (RMB mn)	47,059	56,231	60,192	64,644
Net Profit, adj. (RMB mn)	36,127	42,768	45,857	49,252
EPS, adj. (RMB)	1.67	1.98	2.13	2.28
P/E (X)	7.9	6.7	6.2	5.8
BVPS (RMB)	7.65	9.26	10.51	11.78
P/B (X)	1.7	1.4	1.3	1.1
DPS (RMB)	0.42	0.50	0.53	0.57
Div. Yield	3.18%	3.75%	4.02%	4.32%

Source: Bloomberg, PSR est.

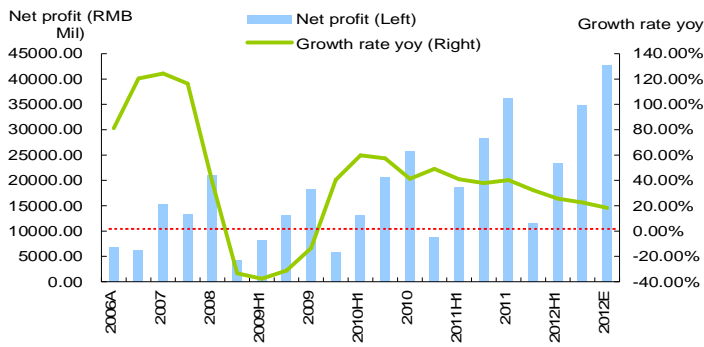
*All multiples & yields based on current market price

Valuation Method

DDM

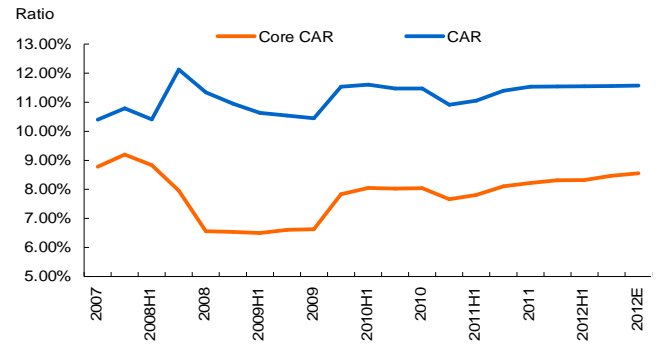
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Fig.1. Profit growth of CMB



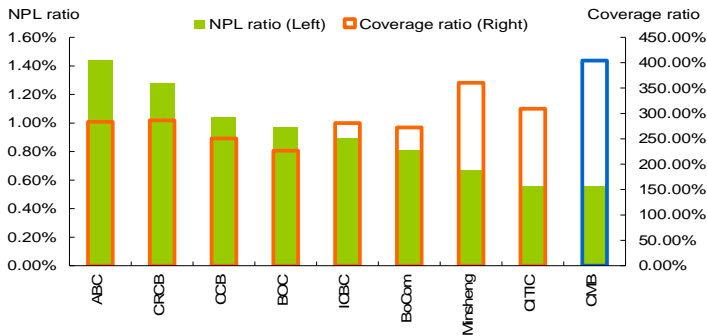
Source: PSR, Company report

Fig. 3. CAR and Core CAR of CMB



Source: PSR, Company report

Fig 2. NPL and coverage ratios of domestic banks in 3Q2012



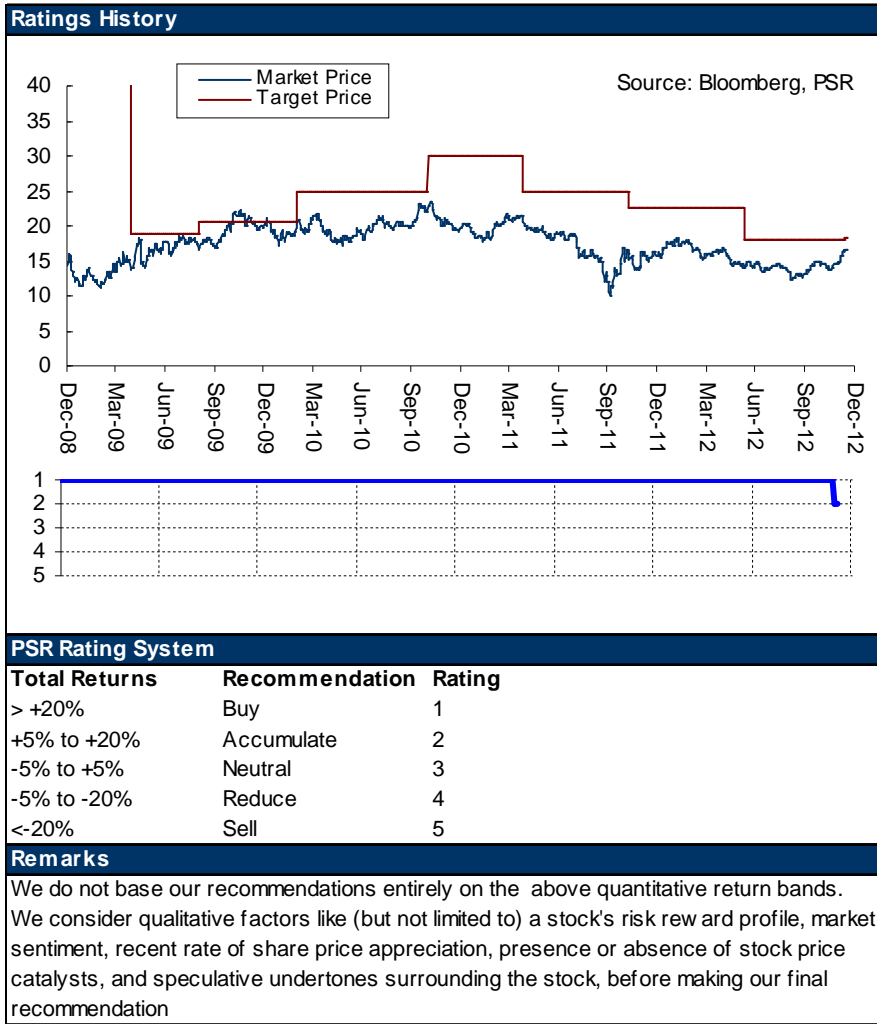
Source: PSR, Company report

Financial Status

FYE	FY10	FY11	FY12F	FY13F	FY14F
Valuation Ratios					
P/E (X)	10.7	7.9	6.7	6.2	5.8
P/B (X)	2.1	1.7	1.4	1.3	1.1
Dividend Payout ratio	23.50%	25.08%	25.00%	25.00%	25.00%
Dividend Yield	2.12%	3.18%	3.75%	4.02%	4.32%
Per share data (RMB)					
EPS, reported	1.23	1.67	1.98	2.13	2.28
EPS, adj.	1.23	1.67	1.98	2.13	2.28
DPS	0.28	0.42	0.50	0.53	0.57
BV/PS	6.21	7.65	9.26	10.51	11.78
Growth					
Net interest income	41.4%	33.7%	14.1%	9.9%	11.5%
Net fee and commission income(exp.)	41.7%	37.9%	24.6%	29.6%	24.1%
Operating profit	49.1%	41.4%	19.5%	7.0%	7.4%
Net Income, adj.	41.3%	40.2%	18.4%	7.2%	7.4%
Key Ratios					
Net interest spread	2.56%	2.94%	2.85%	2.94%	2.97%
Net interest margin	2.65%	3.06%	2.97%	3.03%	3.08%
Loan to deposit	73.91%	72.27%	74.31%	73.64%	74.18%
Cost to income ratio	39.69%	36.00%	34.10%	35.00%	36.00%
ROAA	1.15%	1.39%	1.42%	1.33%	1.26%
ROAE	22.73%	24.17%	23.44%	21.49%	20.47%
NPL ratio	0.68%	0.56%	0.61%	0.69%	0.75%
Coverage ratio	302.41%	400.13%	362.50%	373.38%	392.04%
Core CAR	8.04%	8.22%	8.55%	9.12%	9.67%
CAR	11.47%	11.53%	11.57%	12.15%	12.45%
Income Statement (RMB mn)					
Net interest income	57,076	76,307	87,075	95,738	106,729
Net fee and commission income	11,330	15,628	19,470	25,227	31,306
Operating income	71,692	96,603	112,305	127,589	145,653
Operating expenses	(32,634)	(40,889)	(49,476)	(59,371)	(71,245)
Operating profit before impairment losses	38,780	55,409	62,494	67,832	73,965
Impairment losses	(5,501)	(8,350)	(6,263)	(7,640)	(9,321)
Operating profit	33,279	47,059	56,231	60,192	64,644
Profit before tax	33,343	47,122	56,511	60,563	65,134
Income tax	(7,574)	(10,995)	(13,744)	(14,706)	(15,882)
Effective income tax rate	22.72%	23.33%	24.32%	24.28%	24.38%
Profit before tax	25,769	36,127	42,768	45,857	49,252
Minority interest	0	0	0	0	0
Net profit attributable to equity holders of the B	25,769	36,127	42,768	45,857	49,252
Declared and paid Dividends	6,056	9,062	10,692	11,464	12,313
Balance Sheet (RMB mn)					
Cash and balances w ith banks and other financial inst	28,961	63,046	68,090	72,175	75,062
Balances w ith central bank	294,955	408,304	449,134	534,470	614,640
Placements w ith banks and other financial institutions	58,917	131,381	137,950	144,848	150,641
Loans and advances to customers	1,402,160	1,604,371	1,812,939	2,012,363	2,233,722
Investments	580,700	547,941	712,323	854,788	983,006
Fixed assets	15,038	16,242	17,054	17,395	18,265
Intangible assets	2,620	2,605	2,800	2,800	2,856
Deferred tax assets	3,706	4,337	5,855	7,611	10,047
Goodw ill	9,598	9,598	9,598	9,598	9,598
Other assets	5,852	7,146	17,150	22,296	29,430
Total Assets	2,402,507	2,794,971	3,232,894	3,678,343	4,127,269
Deposits from banks and other financial Institutions	203,011	205,699	207,756	213,989	222,548
Placements from banks and other financial institutions	45,573	67,484	104,600	135,980	163,176
Deposits from customers	1,897,178	2,220,060	2,439,846	2,732,627	3,011,355
Financial liabilities at fair value through profit or loss	1,165	4,724	5,669	6,803	8,027
Current taxation	4,972	7,112	8,179	9,733	11,485
Deferred tax liabilities	924	864	873	899	962
Other liabilities	30,356	14,918	37,295	44,754	55,943
Total Liabilities	2,268,501	2,629,961	3,033,027	3,451,456	3,872,975
Share capital	21,577	21,577	21,577	21,577	21,577
Capital reserve	36,197	37,508	37,508	37,508	37,508
Surplus reserve	10,880	14,325	14,325	14,325	14,325
Investment revaluation reserve	(1,311)	157	100	135	182
Regulatory general reserve	16,812	18,794	18,944	21,407	23,762
Retained profits	49,063	64,446	98,216	123,162	149,396
Shareholder's equity	134,006	164,997	199,792	226,801	254,199
Minority interest	0	13	75	86	94
Total shareholders' equity	134,006	165,010	199,867	226,887	254,293
Total shareholders' equity and liabilities	2,402,507	2,794,971	3,232,894	3,678,343	4,127,269

Source: PSR

Source: Company, PSR



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