

10 May 2018

Financial Services | Banks

Banks

Overweight (Maintained)

Position For High-Yields

We maintain an **OVERWEIGHT** on the sector, with **ABC** and **BOC** as **Top Picks**. The national team's shareholding reduction in 1Q18, together with the recent US-China trade dispute, appears to weigh on investors' sentiment for H-share China banks. Yet, the key re-rating catalysts – NIM expansion and asset quality recovery - have remained intact, in our view. We envision a rising capital inflow into the sector happening in the upcoming dividend payout season. As such, we suggest accumulate quality banks ahead of their ex-dividend date.

Near-term overhang from China Securities Finance Corporation's (CSFC) shareholding cut. According to financial reports of China banks' 1Q18, CSFC cut stakes in most banks (Figure 1) which, together with the trade dispute between the US and China, has led to a cautious market sentiment lately.

A decent yield is likely to spur capital inflow. The nine banks under our coverage provide on average a FY18F dividend yield of 4.9%, with Bank of China (BOC) and Bank of Communications (BoCom) being at the highest levels with 5.5% and 5.6% respectively. These yields are notably above the yields on a 1-year AAA corporate bond or those of wealth management products (WMP). Therefore, we anticipate a pick-up in fund flows into the sector in May/June, to benefit from banks' cash dividends. Trading at 0.8x FY18F P/BV, the H-share China banks look attractive against the major global peers on an ROE-adjusted basis. The current 13% valuation discount to its A-share counterparts also make the sector a favourable target for southbound capital. In addition, we expect yields on WMPs to gradually taper off after the break of implicit guarantee and maturity mismatch, as required by the new asset management rules. This would lower the risk-free rate which in turn is a positive for the valuation of banks.

Limited impact from the relaxation in deposit rate cap. Our recent channel check (done a month after the authorities loosened deposit pricing) suggests that the banks have not raised their regular deposit rates so far. We believe this is due to depositors' insensitivity to rate change, while most yield-chasing clients have already parked their capital in WMPs or money market funds. Meanwhile, banks have raised interest on certificates of deposit (CDs). For example, the 1-year CDs are now priced at 1.45x (from 1.40x previously) benchmark for big banks. However, we see limited impact on banks' funding cost, as CDs only amount up to less than 5% of the total deposits for most banks. That said, we cannot rule out further deposit rate hikes. Our sensitivity test indicates that any additional 10% lift in banks' time deposit rates would result in 3.3bps NIM contraction and 1.7% earnings decline in FY18F. Yet, this could be well absorbed by a rising loan pricing, given the strong credit demand.

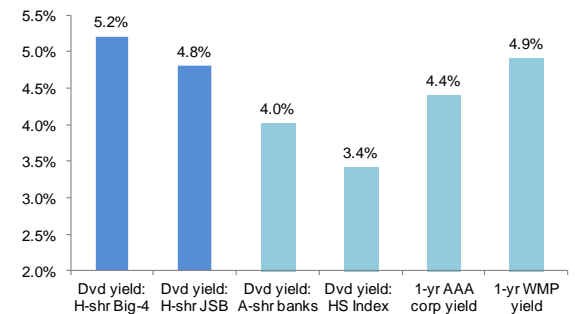
Further policy easing, to support credit growth. The on-going tightening in off-balance sheet financing would continue to subdue M2 as well as deposits growth. However, the banks have to use on-balance sheet loan quotas to fund any existing off-balance credit demand. Therefore, we believe the People's Bank of China (PBoC) may cut the reserve requirement ratio (RRR) by another 50-100bps this year, so as to support banks' credit expansion. This would lower financing cost for the real economy and reduce the risk of potential NPL rebound.

Remain OVERWEIGHT and recommend investors to add positions on large-cap banks with higher dividend yields and undemanding valuations, as we head into the payout season. Top Picks are the Agricultural Bank of China (ABC) and BOC.

Stocks Covered: 9
Ratings (Buy/Neutral/Sell): 6 / 3 / 0
Last 12m Earnings Revision Trend: Positive

Top Picks **Target Price**
Agricultural Bank of China (1288 HK) – BUY HKD5.80
Bank of China (3988 HK) – BUY HKD5.90

The Big-4 banks offer average dividend yield of 5.2%



Source: Bloomberg, Wind, RHB

China banks' ex-dividend and dividend payment date

Company	Ex-dividend date	Dividend payment date
ICBC	5 Jul 2018	6 Aug 2018
CCB	9 Jul 2018	6 Aug 2018
ABC	17 May 2018	14 Jun 2018
BOC	5 Jul 2018	8 Aug 2018
BoCom	25 Jun 2018	20 Jul 2018
CMB	19 Jul 2018	26 Aug 2018
CITIC	29 May 2018	23 Jul 2018
MSB	19 Jun 2018	27 Jul 2018
CEB	2 Jul 2018	27 Aug 2018

Source: Bloomberg, RHB

Company Name	Rating	Price	Target	% Upside (Downside)	P/E (x) Dec-18F	P/B (x) Dec-18F	Yield (%) Dec-18F
Agricultural Bank of China	BUY	HKD4.37	HKD5.80	32.7	5.7	0.7	5.3
Bank of China	BUY	HKD4.16	HKD5.90	41.8	5.6	0.6	5.5
China CITIC Bank	BUY	HKD5.70	HKD6.50	14.0	5.2	0.6	5.3
China Construction Bank	BUY	HKD8.09	HKD10.30	27.3	6.5	0.9	4.8
China Merchants Bank	BUY	HKD33.8	HKD37.50	10.9	8.8	1.4	3.5
ICBC	BUY	HKD6.77	HKD8.50	25.6	6.6	0.9	4.7
Bank of Communications	NEUTRAL	HKD6.28	HKD6.30	0.3	5.3	0.6	5.6
China Everbright Bank	NEUTRAL	HKD3.92	HKD4.00	2.0	5.2	0.6	4.9
China Minsheng Banking Corp	NEUTRAL	HKD7.40	HKD7.90	6.8	4.7	0.6	3.6

Source: Company data, RHB.

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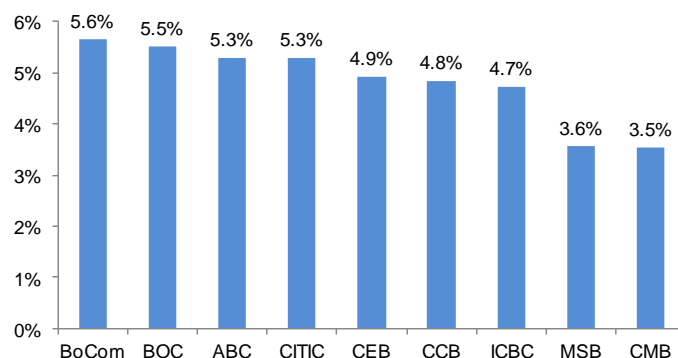
10 May 2018

Figure 1: CSFC cut stakes in major listed banks in 1Q18

	1Q17	2Q17	3Q17	4Q17	1Q18	QoQ
ICBC	1.30%	1.32%	1.22%	1.12%	0.66%	-0.45%
CCB	1.03%	1.05%	1.07%	1.07%	0.83%	-0.23%
ABC	1.83%	1.83%	1.80%	1.83%	0.32%	-1.50%
BOC	2.54%	2.55%	2.59%	2.74%	2.77%	0.03%
BoCom	2.33%	2.45%	2.61%	3.24%	3.27%	0.03%
CMB	3.34%	3.50%	3.26%	3.41%	3.28%	-0.13%
CITIC	1.84%	1.92%	1.86%	2.11%	2.06%	-0.05%
MSB	4.57%	4.99%	4.99%	4.75%	4.90%	0.15%
CEB	2.48%	2.63%	2.50%	3.20%	3.77%	0.56%
Big-4	1.68%	1.69%	1.67%	1.69%	1.15%	-0.54%
Others	2.91%	3.10%	3.04%	3.34%	3.46%	0.11%

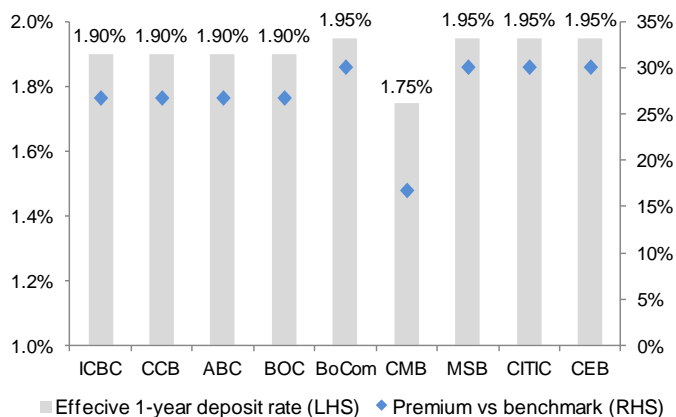
Source: Company data, RHB

Figure 2: China banks' FY18F dividend yields



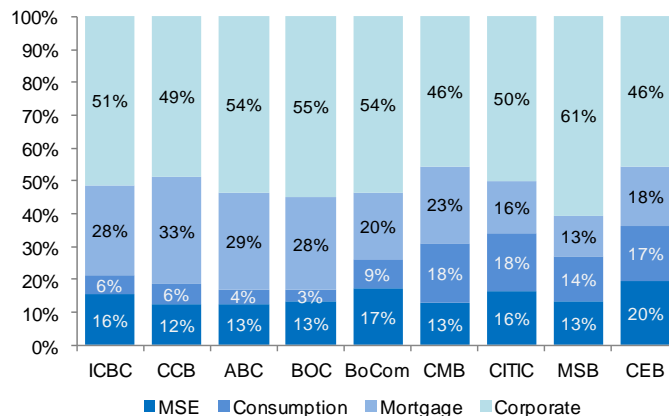
Source: Bloomberg, RHB

Figure 3: Effective 1-year deposit rates in tier-1 cities



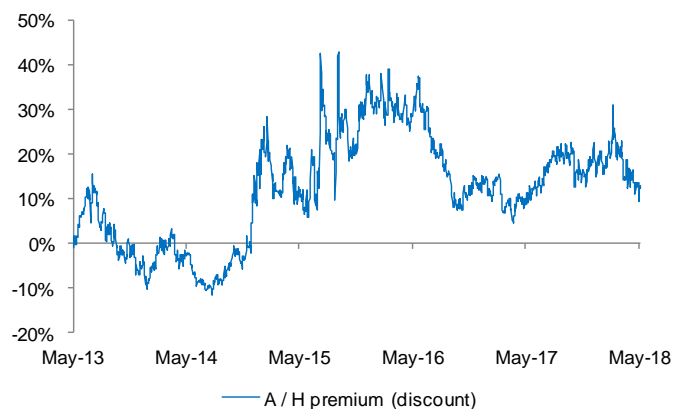
Note: Deposit rate is the average of Beijing, Shanghai, Guangzhou, and Shenzhen.
Source: Rong360, RHB

Figure 4: Loan breakdown by type of borrower as of 2017



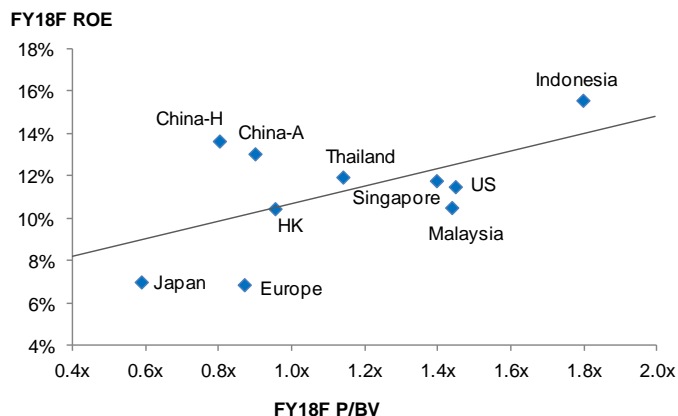
Source: Company data, RHB

Figure 5: H-share banks trade at a 13% discount to A-share



Source: Bloomberg, RHB

Figure 6: China banks' ROE-P/BV matrix vs global peers



Source: Bloomberg, RHB

10 May 2018

Impact From Relaxation In Deposit Rate Cap

The regulatory authority has reportedly lifted the cap on banks' deposit pricing on 12 Apr. However, the official time deposit rates advertised on banks' websites have remained unchanged. The effective rates for 1-year time deposit still stand at 1.2x and 1.3x benchmark for state-owned banks and joint-stock banks, respectively.

Our recent channel check (around a month after the regulatory move) also suggest that banks did not raise their deposit rates after the relaxation in pricing. We believe this is primarily due to depositors' relatively low sensitivity to rate change, while most yield-chasing clients have already parked their capital into WMPs or money market funds.

Meanwhile, most banks have raised interest for CDs, a fixed-term product issued to retail clients with minimum deposit amounts of CNY200-300k. For example, 1-year CDs are now priced at 1.45x (from previously 1.4x) benchmark for big banks.

However, we see limited impact to banks' overall funding cost at the moment, as CDs only amount to less than 5% of total deposits for most banks. That said, we cannot rule out potential rate hikes for regular time deposits. Assuming banks lift time deposit rates by an additional 10% of the benchmark, it would result in 3.3bps NIM contraction and 1.7% earnings decline in FY18, based on our estimates.

Figure 7: China banks' official time deposit rates remained unchanged after the relaxation in deposit rate cap

Company	Effective time deposit rates on banks' website (%)					Floating ratio vs benchmark rate (x)				
	3M	6M	1Y	2Y	3Y	3M	6M	1Y	2Y	3Y
Benchmark rate	1.10	1.30	1.50	2.10	2.75					
ICBC	1.35	1.55	1.75	2.25	2.75	1.23	1.19	1.17	1.07	1.00
CCB	1.35	1.55	1.75	2.25	2.75	1.23	1.19	1.17	1.07	1.00
ABC	1.35	1.55	1.75	2.25	2.75	1.23	1.19	1.17	1.07	1.00
BOC	1.35	1.55	1.75	2.25	2.75	1.23	1.19	1.17	1.07	1.00
BoCom	1.35	1.55	1.75	2.25	2.75	1.23	1.19	1.17	1.07	1.00
SOE banks average	1.35	1.55	1.75	2.25	2.75	1.23	1.19	1.17	1.07	1.00
CMB	1.35	1.55	1.75	2.25	2.75	1.23	1.19	1.17	1.07	1.00
CNCB	1.40	1.65	1.95	2.35	2.80	1.27	1.27	1.30	1.14	1.09
MSB	1.40	1.65	1.95	2.35	2.80	1.27	1.27	1.30	1.12	1.02
CEB	1.40	1.65	1.95	2.41	2.75	1.27	1.27	1.30	1.15	1.00
Joint-stock banks average	1.39	1.63	1.90	2.34	2.77	1.26	1.25	1.27	1.12	1.03

Source: Company data, RHB

Figure 8: Impact on NIM and profitability from a 10% hike in time deposit rates

Company	Time deposits (CNYbn)	As % of interest bearing liabilities	Change in average deposit cost (bp)	Impact to FY18 forecast		
				NIM (bp)	Net profit	ROE (ppt)
ICBC	9,048	39.9%	7.2	-3.7	-1.79%	-0.35
CCB	7,391	38.0%	6.3	-3.3	-1.63%	-0.33
ABC	6,246	33.2%	6.2	-3.3	-1.73%	-0.34
BOC	6,274	37.7%	6.0	-2.9	-1.69%	-0.28
BoCom	2,429	31.0%	7.0	-2.7	-1.60%	-0.27
CMB	1,510	27.2%	5.2	-2.3	-0.97%	-0.23
CITIC	1,521	30.9%	6.0	-2.4	-1.78%	-0.30
MSB	1,577	30.3%	8.1	-2.8	-1.71%	-0.18
CEB	1,262	35.8%	7.5	-2.8	-1.84%	-0.28
Total / average	37,259	33.8%	6.8	-3.3	-1.67%	-0.31

Source: Company data, RHB

10 May 2018

Figure 9: Valuation comparison for banks under our coverage

Company	Ticker	Rating	Mkt cap (USDbn)	3M ADT (USDm)	Price (HKD)	P/E		P/BV		Dividend yield		ROE	
						2018E	2019E	2018E	2019E	2018E	2019E	2018E	2019E
ICBC	1398 HK	BUY	327.9	248.0	6.8	6.6	6.0	0.86	0.79	4.7%	5.1%	13.9%	13.8%
CCB	939 HK	BUY	259.2	397.2	8.1	6.5	5.9	0.87	0.79	4.8%	5.4%	14.2%	14.0%
ABC	1288 HK	BUY	196.9	109.5	4.4	5.7	5.1	0.76	0.66	5.3%	6.0%	13.8%	13.3%
BOC	3988 HK	BUY	172.6	202.2	4.2	5.6	5.1	0.64	0.59	5.5%	6.1%	12.2%	12.2%
CMB	3968 HK	BUY	116.0	94.0	33.8	8.8	7.5	1.35	1.21	3.5%	4.0%	16.7%	17.1%
CITIC	998 HK	BUY	46.2	48.3	5.7	5.2	4.8	0.55	0.53	5.3%	6.5%	11.5%	11.5%
BoCom	3328 HK	NEUTRAL	66.1	27.8	6.3	5.3	4.9	0.57	0.53	5.6%	5.7%	11.3%	11.2%
MSB	1988 HK	NEUTRAL	43.3	37.4	7.4	4.7	4.8	0.54	0.56	3.6%	3.3%	13.0%	12.3%
CEB	6818 HK	NEUTRAL	31.8	7.4	3.9	5.2	4.9	0.56	0.52	4.9%	6.4%	11.3%	11.2%
Average						6.3	5.7	0.82	0.74	4.9%	5.4%	13.4%	13.3%

Note: Prices are as at 9 May 2018

Source: Bloomberg, RHB

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Neutral: Share price may fall within the range of +/- 10% over the next 12 months

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