

China

February 20, 2024 - 4:03 PM

Neutral (no change)

Highlighted Companies

Bank of China

ADD, TP HK\$3.60, HK\$3.03 close

We like Bank of China's (BOC) exposure to higher-for-longer US rates via its HK subsidiary. We also like its inexpensive P/BV valuation and its high FY24F dividend yield of 9.2%.

China Construction Bank

ADD, TP HK\$5.70, HK\$4.73 close

We see CCB's FY24F P/E of 3.0x and FY24F P/BV of 0.32x, the lowest among the big-four China banks, coupled with its FY24F dividend yield of 10%, the highest among the big-four banks, as attractive.

China Merchants Bank

ADD, TP HK\$40.40, HK\$30.05 close

China Merchants Bank (CMB) is a sector preferred pick. We believe its better than-peers FY22 ROE and net profit growth should be sustainable through to FY25F, driven by its robust retail banking operations.

Summary Valuation Metrics

	Dec-23F	Dec-24F	Dec-25F
P/E (x)			
Bank of China	3.75	3.62	3.45
China Construction Bank	3.35	3.25	3.08
China Merchants Bank	4.92	4.57	4.05
P/BV (x)			
Bank of China	0.37	0.34	0.32
China Construction Bank	0.37	0.34	0.32
China Merchants Bank	0.76	0.68	0.61
Dividend Yield			
Bank of China	8.51%	8.81%	9.26%
China Construction Bank	9.10%	9.38%	9.89%
China Merchants Bank	6.71%	7.22%	8.15%

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Banks

Squeezing a highly profitable segment

- A 25bp cut to China's 5-year LPR sees the net interest margins of mortgages, one of the most profitable loan segments of banks, continue to be squeezed.
- Nevertheless, we still think China mortgage margins remain higher than most other regions globally and also higher than average margins on all loans.
- We see the LPR cut impact on banks' EPS as very manageable. We maintain our view of bank profitability buffers only eroding back to 2020-21 levels.

Squeezing one of China banks' most profitable segments

- The 25bp cut of China's 5-year loan prime rate (LPR) to 3.95% by the People's Bank of China today (20 Feb) was greater than Bloomberg consensus expectations (of a 10bp cut) and was the largest cut to the 5-year LPR since the introduction of the LPR system in 2019. Banks typically price mortgages based on the 5-year LPR rate. Assuming an unchanged basis point spread relative to the LPR, we think mortgage rates for primary mortgages could fall to 3.59% in Mar 2024F. For outstanding mortgage loans, while they do depend on individual mortgage contracts, we estimate at least half the outstanding mortgages will only enjoy the benefit of the 25bp 5-year LPR cuts on 1 Jan 2025.
- We had previously estimated that mortgage ROEs of the large China banks were in excess of 50% in [China banks in 2020](#), dated 9 Jan 2018. Even with the sizable cuts in mortgage rates of over 170bp since 2018 (Fig 1), we still think that mortgage margins in mainland China remain higher than most other regions in the world and are also higher than the average margins of China banks' lending portfolio.
- We continue to believe that the already record-low banking NIM will continue to trend down in both FY24F and FY25F. The pace of the fall of banking NIM over the 1Q22 – 3Q23 has been relatively rapid, and should such a pace continue, banking sector NIM could fall to 1.16% in FY25F (Fig 4), in our view.

Net profit impact of the 5-year LPR cut is very manageable

- We expect the further release of both provisioning and non-performing-loan (NPL) recognition buffers to help offset the adverse impact on net interest margins, with the consequent impact being a negligible impact on banking EPS in both FY24F and FY25F. We still expect bank profitability buffers, which had been built up since 2016, to only erode back to 2020-21's levels (see [How much are buffers worth](#), dated 25 Oct 2022 and [Significant buffers to absorb LPR cuts](#), dated 15 Aug 2023).
- If these profitability buffers were not used to offset the impact of the LPR cut, we estimate the 25bp cut in 5-year LPR would lower FY24F net profits by 1.7% on average, on an annualised basis, with CCB the most adversely impacted at a -2.5% impact (Fig 6). We expect an average 3.1bp annualised adverse impact to FY24F NIM for the banks under our coverage.
- We still maintain our view of a mid-single-digit mortgage growth for the China banks in FY24F, rising to mid-high-single-digit mortgage growth in FY25F.

Retain sector Neutral rating; top picks are BOC, CCB, CMB & CITIC

- We value the China banks using a stress-test-adjusted GGM. Upside/downside risks: an improving/worsening Chinese economy, and better/worse NIM trends.

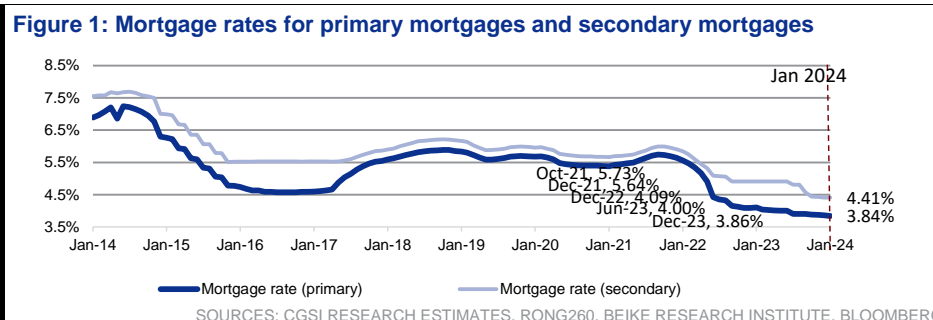


Figure 2: China banks valuation table (H-share and A-share banks)

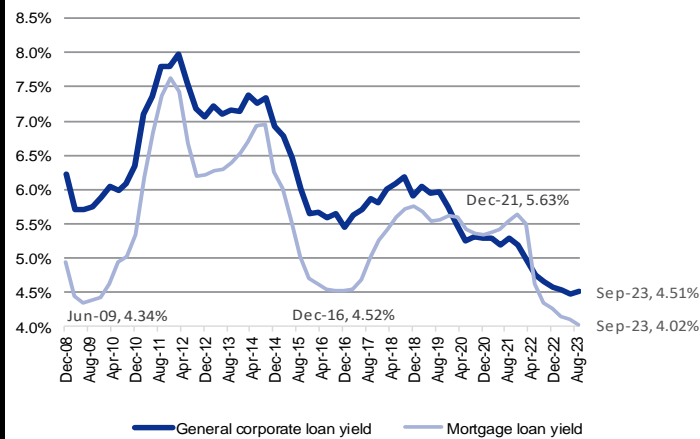
Company	Ticker	Rating	Mkt cap (US\$ bn)	Price (Lcy)	Target price (Lcy)	Upside/ Downside	P/BV (x)		P/E (x)		P/POP (x)		Dividend yield		ROE(%)		
							FY23F	FY24F	FY23F	FY24F	FY23F	FY24F	FY23F	FY24F	FY23F	FY24F	
ICBC	1398 HK	Add	224.0	3.92	3.90	-1%	0.38	0.36	3.7	3.6	2.2	2.1	8.5	8.7	10.8	10.3	
CCB	0939 HK	Add	151.5	4.73	5.70	21%	0.37	0.35	3.4	3.3	2.1	2.0	9.0	9.3	11.5	10.9	
BOC	3988 HK	Add	150.1	3.03	3.60	19%	0.37	0.35	3.8	3.7	2.1	2.1	8.4	8.7	10.2	9.8	
ABC	1288 HK	Add	175.4	3.16	2.90	-8%	0.43	0.40	4.2	4.0	2.3	2.3	7.7	8.0	10.7	10.3	
BOCOM	3328 HK	Add	53.6	4.89	4.90	0%	0.37	0.35	3.9	3.8	2.1	2.1	8.4	8.6	9.8	9.5	
CMB	3968 HK	Add	96.2	30.05	40.40	34%	0.76	0.69	5.0	4.6	3.3	3.3	6.6	7.1	16.2	15.6	
CITIC	0998 HK	Add	32.3	4.07	5.30	30%	0.31	0.29	3.0	2.7	1.3	1.3	9.5	10.4	10.9	11.1	
MSB	1988 HK	Reduce	21.5	2.68	2.30	-14%	0.21	0.20	3.4	3.1	1.3	1.3	9.0	9.6	6.3	6.5	
CQRCB	3618 HK	Hold	6.1	3.12	2.50	-20%	0.29	0.27	3.0	2.8	1.7	1.7	10.0	11.0	9.5	10.0	
H-share weighted average								0.42	0.39	3.9	3.7	2.2	2.2	8.3	8.6	11.2	10.8
ICBC - A	601398 CH	Reduce	224.0	5.27	3.80	-28%	0.55	0.52	5.3	5.2	3.1	3.1	5.9	6.0	10.8	10.3	
CCB - A	601939 CH	Hold	151.5	7.04	5.60	-20%	0.60	0.55	5.4	5.3	3.3	3.2	5.6	5.8	11.5	10.9	
BOC - A	601988 CH	Hold	150.1	4.51	3.70	-18%	0.60	0.56	6.1	5.9	3.4	3.3	5.3	5.4	10.2	9.8	
ABC - A	601288 CH	Reduce	175.4	4.08	2.90	-29%	0.60	0.55	5.8	5.6	3.2	3.2	5.6	5.7	10.7	10.3	
BOCOM - A	601328 CH	Reduce	53.6	6.25	4.90	-22%	0.51	0.48	5.4	5.2	2.9	2.9	6.1	6.3	9.8	9.5	
CMB - A	600036 CH	Add	96.2	31.62	37.90	20%	0.86	0.78	5.6	5.2	3.7	3.8	5.9	6.3	16.2	15.6	
CITIC - A	601998 CH	Add	32.3	6.30	6.00	-5%	0.52	0.48	4.9	4.5	2.2	2.1	5.7	6.3	10.9	11.1	
MSB - A	600016 CH	Reduce	21.5	4.01	2.40	-40%	0.33	0.32	5.4	5.0	2.1	2.1	5.6	6.0	6.3	6.5	
PAB - A	000001 CH	Add	25.5	9.81	13.10	34%	0.47	0.42	4.1	3.7	1.6	1.6	3.2	3.5	12.1	12.1	
CQRCB - A	601077 CH	Reduce	6.1	4.38	3.00	-32%	0.43	0.40	4.6	4.2	2.6	2.6	6.7	7.3	9.5	10.0	
A-share weighted average								0.61	0.56	5.5	5.2	3.2	3.1	5.6	5.8	11.6	11.2
Combined sector weighted average								0.52	0.48	4.7	4.5	2.7	2.7	6.9	7.2	11.4	11.0

SOURCES: CGSI RESEARCH, COMPANY REPORTS, BLOOMBERG

ICBC: INDUSTRIAL AND COMMERCIAL BANK OF CHINA; CCB: CHINA CONSTRUCTION BANK; BOC: BANK OF CHINA; ABC: AGRICULTURAL BANK OF CHINA; BOCOM: BANK OF COMMUNICATIONS; CMB: CHINA MERCHANTS BANK; CITIC: CHINA CITIC BANK; MSB: CHINA MINSHENG BANK; CQRCB: CHONGQING RURAL COMMERCIAL BANK

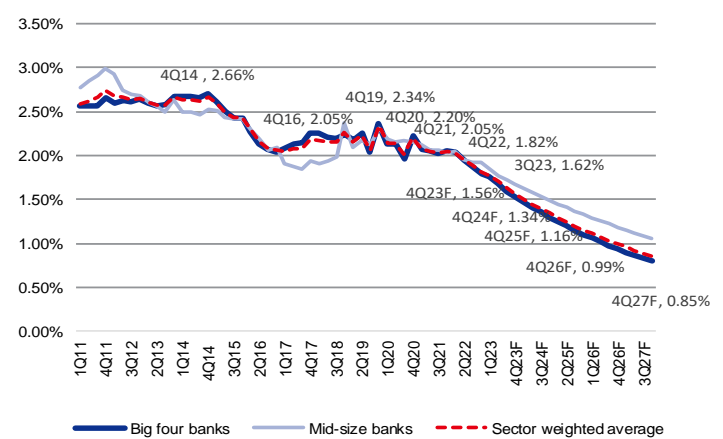
DATA AS OF 19 FEB 2024

Figure 3: Loan yields in China for mortgages and general corporate loans



SOURCES: CGSI RESEARCH, PEOPLE'S BANK OF CHINA (PBOC)

Figure 4: What if the average qoq fall in banking NIM over 1Q22 - 3Q23 continues at the same rate over 4Q23F - 4Q26F?



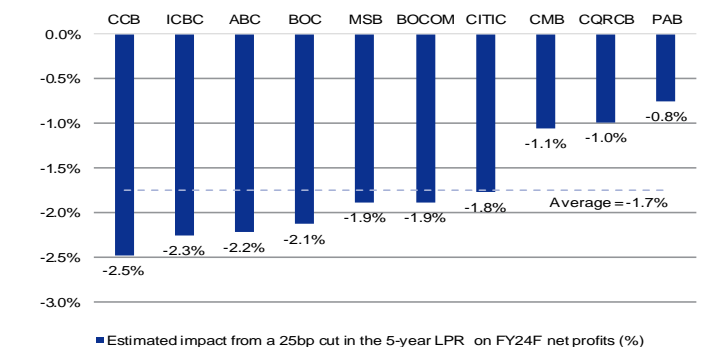
SOURCES: CGSI RESEARCH, COMPANY REPORTS

Figure 5: China banks mortgage mix of loans

(%)	FY14	FY15	FY16	FY17	FY18	FY19	FY20	FY21	FY22	1H23
ICBC	18.8	21.1	24.8	27.7	29.8	30.8	30.8	30.8	27.7	25.2
CCB	24.0	26.7	30.8	33.0	35.1	35.6	34.7	34.0	30.6	27.8
BOC	20.0	22.4	26.4	28.1	29.7	30.6	31.2	30.8	28.1	25.3
ABC	19.1	21.6	26.3	29.2	30.7	31.2	30.7	30.5	27.0	24.4
BOCOM	15.4	16.2	18.8	19.6	20.8	21.4	22.1	22.7	20.7	19.2
CMB	13.1	17.7	22.3	23.4	23.6	24.7	25.3	24.7	23.0	21.7
CITIC	10.6	10.6	15.1	15.8	17.8	19.4	20.5	20.0	18.9	18.3
MSB	3.8	5.6	12.0	12.5	11.0	12.0	13.4	14.7	13.8	12.8
PAB	5.4	3.8	5.8	9.0	9.1	8.6	9.0	9.1	9.1	8.4
CQRCB	19.0	16.4	14.5	14.8	15.8	16.7	18.0	17.3	17.3	14.1
Big four banks	20.5	22.9	27.1	29.5	31.4	32.1	31.9	31.6	28.4	25.7
Mid-size banks	11.1	12.4	16.3	17.3	17.8	18.6	19.4	19.6	18.2	17.2
Sector average	18.3	20.5	24.4	26.4	27.9	28.6	28.7	28.5	25.9	23.6

SOURCE: CGSI RESEARCH, COMPANY REPORTS

Figure 6: Our estimated impact of a 25bp cut in China's 5-year LPR on FY24F net profits for China banks



SOURCES: CGSI RESEARCH ESTIMATES, COMPANY REPORTS

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Score Range:	90 - 100	80 – 89	70 - 79	Below 70	No Survey Result
Description:	Excellent	Very Good	Good	N/A	N/A

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Distribution of stock ratings and investment banking clients for quarter ended on 31 December 2023		
636 companies under coverage for quarter ended on 31 December 2023		
	Rating Distribution (%)	Investment Banking clients (%)
Add	67.5%	1.3%
Hold	22.5%	0.0%
Reduce	10.1%	0.2%

Recommendation Framework

Stock Ratings

Definition:

- Add** The stock's total return is expected to exceed 10% over the next 12 months.
- Hold** The stock's total return is expected to be between 0% and positive 10% over the next 12 months.
- Reduce** The stock's total return is expected to fall below 0% or more over the next 12 months.

The total expected return of a stock is defined as the sum of the: (i) percentage difference between the target price and the current price and (ii) the forward net dividend yields of the stock. Stock price targets have an investment horizon of 12 months.

Sector Ratings

Definition:

- Overweight** An Overweight rating means stocks in the sector have, on a market cap-weighted basis, a positive absolute recommendation.
- Neutral** A Neutral rating means stocks in the sector have, on a market cap-weighted basis, a neutral absolute recommendation.
- Underweight** An Underweight rating means stocks in the sector have, on a market cap-weighted basis, a negative absolute recommendation.

Country Ratings

Definition:

- Overweight** An Overweight rating means investors should be positioned with an above-market weight in this country relative to benchmark.
- Neutral** A Neutral rating means investors should be positioned with a neutral weight in this country relative to benchmark.
- Underweight** An Underweight rating means investors should be positioned with a below-market weight in this country relative to benchmark.