Completed 31 Oct 2016 09:10 PM HKT
Disseminated 01 Nov 2016 12:01 AM HKT
Asia Pacific Equity Research
01 November 2016

J.P.Morgan

Initiation
Overweight
1658.HK, 1658 HK
Price: HK$4.20
Price Target: HK$5.30

Postal Savings Bank of China

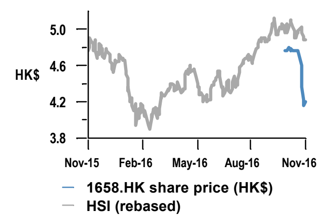
Banking begins with the balance sheet, Initiate with Overweight

We initiate coverage with an OW rating and Dec-17 PT of $5.30: The shares have underperformed the Big 4 peers by c.8% since listing, and the premium over H-share national banks has narrowed from 25% to 14%. In our view, PSBC deserves a premium to peers due to: a) its better risk profile as corporate credits are c.18% of IEA vs peers at c.34%, b) stronger profit growth with 2016E-18E CAGR at 15% vs peers of 6% on average, c) its stronger focus on retail banking.

- **Differentiated balance sheet and customer mix**: 1) Lower risk profile, as corporate loans account for only c.40% of the loan book (51% incl. bills). PSBC avoided the 2009 credit growth cycle due to its relatively short corporate lending history (pilot program in 2009, expanded in 2011); 2) relatively low loan/deposit ratio (40% at 1Q16) and high exposure to treasury and low-risk quasi-government bonds; 3) special focus on retail, which contributed a respective 49%, 85% and 46% to 2015 loans, deposits and pretax profits; and 4) largest retail client base and deposit franchise.
- **Investment positives:** 1) Comparatively fewer credit risks due to lower exposure to corporate loans, particularly high-risk sectors (manufacturing, mining and wholesale & retail); 2) largest retail client base and branch network, with the highest retail business contribution to loans, deposits and profits among peers; 3) liquid balance sheet, with LDR at 40%; 4) leader in SME financing, resulting in higher lending yield; 5) leveraging strategic investors Alibaba and Tencent for e-banking development; and 6) potential ROA expansion on improving operating efficiency, rising LDR and higher fee income contribution (i.e., credit cards in underpenetrated regions in China).
- **Investment risks:** 1) Relatively rapid recent loan growth raises concerns about rising credit risks; 2) risk associated with non-standardized assets on investment book could be under-recognized; 3) higher implicit deposit costs through agency-fee structure with China Postal Group; 4) industry risks associated with slow macro growth, asset quality deterioration and shadow banking; and 5) risk to profit growth due to regulatory intervention on fees and interest rate cuts.
- **Valuation parameters:** Our profit growth estimates of 7%/20%/18% for 2016/17/18E compare with 0%/2%/5% for the Big 4 peers on average, due to NIM stabilization, rising fee contributions, improving operating efficiency and stable asset quality. Our DDM valuation model yields a Dec-17 PT of HK$5.30, implying 2016E P/B of 1.1x and P/E of 9.4x, a c.5% premium to ICBC and CCB, and a c.20% premium to national banks we cover, on a P/B basis.

China
Banks & Financial Services
Katherine Lei AC
(852) 2800-8552
katherine.lei@jpmorgan.com
Bloomberg JPMA LEI <GO>
Anurag Rajat, CFA
(852) 2800-8511
anurag.rajat@jpmorgan.com
Stephen Tsui, CFA
(852) 2800-8592
stephen.tsui@jpmorgan.com
George Cai
(852) 2800-8557
george.cai@jpmorgan.com
J.P. Morgan Securities (Asia Pacific) Limited

Price Performance



	YTD	1m	3m	12m
Abs	-11.8%	-11.9%	-11.8%	-11.8%
Rel	-19.3%	-10.3%	-16.6%	-14.3%

Postal Savings Bank of China (Reuters: 1658.HK, Bloomberg: 1658 HK)

Rmb in mn, year-end Dec	FY14A	FY15A	FY16E	FY17E	FY18E
Operating Profit (Rmb mn)	59,749	67,023	60,835	78,805	96,804
Net Profit (Rmb mn)	32,567	34,859	37,423	44,876	53,107
Cash EPS (Rmb)	0.69	0.61	0.50	0.55	0.66
Adj. EPS (Rmb)	0.69	0.61	0.50	0.55	0.66
DPS (Rmb)	0.00	0.00	0.10	0.11	0.13
EPS growth (%)	5.0%	(12.0%)	(17.8%)	10.7%	18.3%
ROE	19.8%	15.2%	12.1%	12.2%	13.0%
P/E (x)	5.3	6.0	7.3	6.6	5.6
BVPS (Rmb)	3.30	3.94	4.33	4.79	5.33
P/BV (x)	1.1	0.9	0.8	0.8	0.7
Dividend Yield	0.0%	0.0%	2.7%	3.0%	3.6%

Source: Company data, Bloomberg, J.P. Morgan estimates.

Company Data	
52-week Range (HK$)	4.85-4.11
Market Cap (Rmb mn)	297,492
Market Cap ($ mn)	43,885
Shares O/S (mn)	81,031
Fiscal Year End	Dec
Price (HK$)	4.20
Date Of Price	31 Oct 16
3M - Avg daily val (HK$ mn)	-
3M - Avg daily val ($ mn)	-
3M - Avg daily vol (mn)	-
HSI	2,2954.81
Exchange Rate	7.75
Price Target (HK$)	5.30
Price Target End Date	31-Dec-17

See page 84 for analyst certification and important disclosures, including non-US analyst disclosures.

Table of contents

Katherine Lei
(852) 2800-8552
katherine.lei@jpmorgan.com

Key catalyst for the stock price:	Upside risks to our view:	Downside risks to our view:
• Comparatively fewer credit risks • Largest retail client base and branch network • Liquid balance sheet • Potential ROA expansion	• Higher-than-expected loan and fee growth • Better-than-expected improvement in cost efficiency • Better-than-expected macro growth in China	• Risks on NSA could be under-recognized • Lower-than-expected fee growth • Risks to profit gr due to regulatory intervention • Industry risks associated with macro growth and asset quality deterioration

Key financial metrics (RMB mn)	FY15A	FY16E	FY17E	FY18E
NII (LC)	179,259	168,813	192,184	216,164
Total revenue (LC)	190,633	187,726	215,560	245,751
Revenue growth (%)	9.6%	-1.5%	14.8%	14.0%
Costs (LC)	(123,610)	(126,891)	(136,755)	(148,947)
PPOP (LC)	67,023	60,835	78,805	96,804
LLP (LC)	(25,635)	(16,401)	(25,521)	(33,746)
Net income (LC)	34,859	37,423	44,876	53,107
NIMs (%)	2.8%	2.4%	2.4%	2.4%
Non-II/Revenue (%)	6.0%	10.1%	10.8%	12.0%
CIR (%)	64.8%	67.6%	63.4%	60.6%
Costs/Assets (%)	1.8%	1.6%	1.6%	1.6%
PPOP/Assets (%)	1.0%	0.8%	0.9%	1.0%
LLP/Loans (%)	1.1%	0.5%	0.7%	0.8%
ROA (%)	0.5%	0.5%	0.5%	0.6%
ROE (%)	15.2%	12.1%	12.2%	13.0%
Tier 1 capital (%)	8.5%	9.5%	9.1%	8.8%
NPL ratio (%)	0.8%	0.8%	0.9%	0.9%
NPL coverage (%)	298.2%	268.0%	256.0%	265.0%
Key model assumptions	**FY15A**	**FY16E**	**FY17E**	**FY18E**
NIM	2.78%	2.35%	2.39%	2.41%
Loan growth	31.7%	15.3%	17.9%	19.8%
NPL ratio	0.8%	0.8%	0.9%	0.9%

Source: Company and J.P. Morgan estimates.

Sensitivity analysis	PPOP		EPS	
Sensitivity to	FY16E	FY17E	FY16E	FY17E
10bps increase in NIM	11.8%	10.2%	16.2%	15.1%
5 % change in asset growth	4.7%	4.7%	4.7%	4.7%
5 % increase in non-interest income	0.9%	1.2%	*1.3%*	*1.8%*
10 % increase in credit cost	*NA*	*NA*	-6.0%	-5.8%

Source: J.P. Morgan estimates.

Valuation and price target basis

Our PT (Dec-17, DDM-derived) of HK$5.3 implies a forward P/BV of 1.1x and P/E of 9.4x (FY16E).

Cost of equity assumptions	
Risk-free rate	3.50%
Equity premium	8.0%
Beta	1.15
Cost of capital	12.70%
Long-term growth	5.00%
Fair terminal book P/BV	0.93
Valuation date	30-Oct-16
Terminal date	31-Dec-18
PV of terminal value	3.83
PV of dividends	0.23
Current fair value (Rmb)	4.06
Dec-17 price target (Rmb)	**4.70**
Dec-17 price target (HKD)	**5.30**

Source: Bloomberg, Company and J.P. Morgan estimates.

JPMe vs. consensus, change in estimates

EPS	FY16E	FY17E
JPMe old	n.a.	n.a.
JPMe new	0.50	0.55
% chg	n.a.	n.a.
Consensus	0.46	0.48

Source: Bloomberg, J.P. Morgan estimates.

	Ticker	Mkt Cap US$m	Price LC	P/E 2016E	P/E 2017E	P/B 2016E	P/B 2017E	ROE 2016E	ROE 2017E	Div Yld 2016E	Div Yld 2017E
PSBC	1658 HK	43,884	4.2	7.3 x	6.6 x	0.85 x	0.77 x	12.1%	12.2%	2.7%	3.0%
ICBC	1398 HK	228,637	4.67	5.3 x	5.2 x	0.76 x	0.69 x	15.3%	14.0%	5.7%	5.8%
CCB	939 HK	183,538	5.68	5.4 x	5.3 x	0.78 x	0.71 x	15.2%	14.1%	5.6%	5.7%
ABC	1288 HK	150,175	3.27	5.1 x	5.0 x	0.69 x	0.63 x	14.3%	13.2%	5.9%	6.0%
BOC	3988 HK	143,032	3.48	5.2 x	5.1 x	0.63 x	0.58 x	12.6%	11.8%	5.8%	5.9%
BoCom	3328 HK	59,256	5.91	5.7 x	5.5 x	0.68 x	0.62 x	12.4%	11.7%	5.3%	5.5%
CMB	3968 HK	65,606	18.92	6.8 x	6.3 x	1.03 x	0.92 x	16.0%	15.6%	4.4%	4.8%
Minsheng	1988 HK	48,060	8.85	5.9 x	5.7 x	0.84 x	0.75 x	15.0%	13.9%	3.3%	3.5%
Citic	998 HK	40,137	5.01	5.1 x	4.9 x	0.61 x	0.56 x	12.6%	12.0%	4.9%	4.9%

Source: J.P. Morgan estimates, Bloomberg. Price as of Oct 31, 2016.

Katherine Lei
(852) 2800-8552
katherine.lei@jpmorgan.com

Investment Summary

Postal Savings Bank of China Co., Ltd. (PSBC) is the largest retail bank in China in terms of number of retail clients and contribution from retail business (deposits and loans). PSBC is different from other China banks mainly in these areas:

- **Expanded client network by leveraging postal offices:** PSBC is 83.1%-owned by China Postal Group (as of 31 March 2016) and is able to leverage the postal outlets of Postal Group for its deposit-taking business. In return, PSBC pays an agency fee based on the daily average balance of deposits gathered by agency outlets. As such, PSBC has the largest deposits network in China, with 40,057 outlets as of 31 March 2016 (79% are agency outlets owned by China Postal Group) and 505mn retail customers, and the retail business contributed 46% of profits in 2015 (vs the industry average of 30%).
- **Low loan-to-deposit ratio (LDR):** PSBC was established in 2007, mainly with deposit-taking and retail lending business. PSBC started corporate lending in 2009 in a pilot program that was expanded to select self-owned outlets in 2011. As PSBC is late to the lending business, its LDR was only 39.6% at end-1Q16 vs the Big 4 bank average of 72.1%.

We believe there is better earnings visibility at PSBC than at peers, as asset quality concerns are lower due to limited corporate exposure and a focus on retail lending. In addition, we see potential for ROA expansion, as there is room for NIM expansion on higher LDR, optimizing cost-management efficiency and improving the contribution from fee income. We expect PSBC to have profit growth of 7.4%, 19.9% and 18.3% in 2016, 2017 and 2018, respectively, significantly higher than the Big 4 bank averages of 0.5%, 1.8% and 4.5%, respectively, over the same period. We estimate PSBC's sustainable ROE could be 12.2%, implying a Dec-17 target price of HK$5.30.

The key drag on China banks' valuation is concern on asset quality, mainly on corporate credit. Despite banks' reported NPL ratio of ~1.67%, market prices are implying ~7% (excluding Postal). As corporate credit only accounts for 18% of Postal Bank's total interest earning assets (~34% of peers on average), we believe the underlying asset quality for Postal Bank is better than for other listed China banks. Thus, we believe Postal Bank should trade at a premium to listed China banks.

Postal Bank's share price has corrected 11.8% since its listing on Sep 27, 2016, 9.8%pt and 7.6%pt underperformance of the HSCEI and big four SOE banks respectively. Postal Bank's valuation implies 0.85x 2016E P/B, a 14% premium to national banks (SOE banks + joint-stock banks) and 10% to the average of ICBC and CCB. Given the attractive risk and reward, we initiate coverage of Postal Bank with an OW rating and a Dec-17 price target of HKD5.30, implying 2016E P/B of 1.09x and P/E of 9.4x.

Katherine Lei
(852) 2800-8552
katherine.lei@jpmorgan.com

Table 1: China bank H-share valuation table (as of 31 October 2016)

Name	Mkt cap (US$ M)	Price (LC)	P/E 2015	P/E 2016E	P/E 2017E	P/B 2015	P/B 2016E	P/B 2017E	ROE 2015	ROE 2016E	ROE 2017E	Dividend yield 2015	Dividend yield 2016E	Dividend yield 2017E
Chinese banks – H-shares														
PSBC	43,884	4.2	6.0 x	7.3 x	6.6 x	0.93 x	0.85 x	0.77 x	15.2%	12.1%	12.2%	0.0%	2.7%	3.0%
ICBC	228,631	4.67	5.2 x	5.3 x	5.2 x	0.85 x	0.76 x	0.69 x	17.3%	15.3%	14.0%	5.7%	5.7%	5.8%
China Construction Bank	183,538	5.68	5.4 x	5.4 x	5.3 x	0.86 x	0.78 x	0.71 x	17.1%	15.2%	14.1%	5.5%	5.6%	5.7%
ABC	150,171	3.27	5.1 x	5.1 x	5.0 x	0.77 x	0.69 x	0.63 x	16.1%	14.3%	13.2%	5.8%	5.9%	6.0%
Bank of China	143,028	3.48	5.2 x	5.2 x	5.1 x	0.69 x	0.63 x	0.58 x	14.0%	12.6%	11.8%	5.8%	5.8%	5.9%
Big SOE bank average			**5.4 x**	**5.7 x**	**5.4 x**	**0.82 x**	**0.74 x**	**0.68 x**	**15.9%**	**13.9%**	**13.1%**	**4.6%**	**5.1%**	**5.3%**
Bank of Communications	59,255	5.91	5.8 x	5.7 x	5.5 x	0.74 x	0.68 x	0.62 x	13.4%	12.4%	11.7%	5.2%	5.3%	5.5%
China Merchants Bank	65,604	18.92	7.2 x	6.8 x	6.3 x	1.15 x	1.03 x	0.92 x	17.1%	16.0%	15.6%	4.2%	4.4%	4.8%
China Minsheng Banking Corp	48,058	8.85	6.1 x	5.9 x	5.7 x	0.94 x	0.84 x	0.75 x	17.1%	15.0%	13.9%	4.0%	3.3%	3.5%
China CITIC Bank	40,136	5.01	5.0 x	5.1 x	4.9 x	0.67 x	0.61 x	0.56 x	14.3%	12.6%	12.0%	4.8%	4.9%	4.9%
China Everbright Bank*	25,532	3.54	4.8 x	5.0 x	4.9 x	0.68 x	0.64 x	0.59 x	15.4%	13.3%	12.6%	6.0%	5.9%	6.1%
National bank average			**5.8 x**	**5.7 x**	**5.4 x**	**0.84 x**	**0.76 x**	**0.69 x**	**15.5%**	**13.9%**	**13.2%**	**4.9%**	**4.8%**	**5.0%**
Chinese banks – H-share avg.			**5.6 x**	**5.7 x**	**5.4 x**	**0.83 x**	**0.75 x**	**0.68 x**	**15.7%**	**13.9%**	**13.1%**	**4.7%**	**5.0%**	**5.1%**

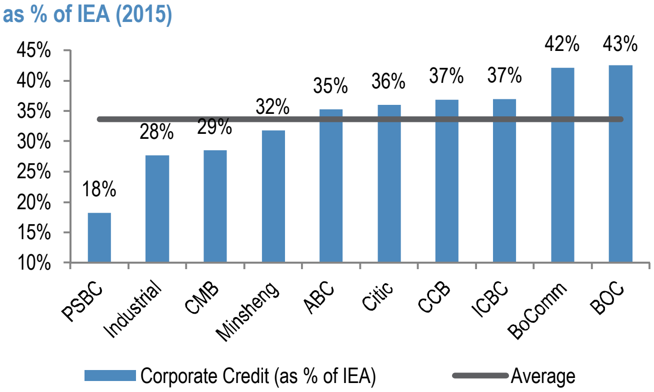
Source: J.P. Morgan estimates, Bloomberg. * China Everbright Bank estimates based on consensus.

Table 2: NPL ratio implied by current trading levels (as of 31 October 2016)

	ICBC	ABC	BOC	CCB	BoCom	Citic	CMB	Minsheng	CRCB	Huishang	Industrial
2016E-2018E ROE	15%	14%	13%	15%	12%	13%	16%	15%	15%	15%	17%
NPL ratio, 2017E	1.6%	2.3%	2.0%	1.8%	1.6%	1.5%	2.2%	1.9%	1.2%	1.2%	2.1%
What's implied in the price?											
FY16E P/B, today	0.76	0.69	0.63	0.78	0.68	0.61	1.03	0.84	0.72	0.78	0.88
Cost of equity	12.50%	12.50%	12.50%	12.50%	12.50%	12.50%	12.50%	12.50%	12.50%	12.50%	12.50%
Long-term growth	5%	5%	5%	5%	5%	5%	5%	5%	5%	5%	5%
Implied sustainable ROE	10.7%	10.2%	9.7%	10.8%	10.1%	9.6%	12.7%	11.3%	10.4%	10.8%	11.6%
Implied NPL ratio	6.6%	8.1%	7.6%	6.9%	4.4%	4.9%	7.4%	6.5%	9.2%	7.3%	9.2%

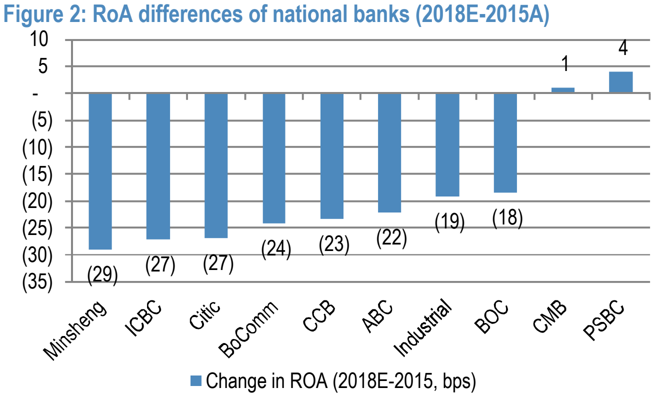
Source: Bloomberg, J.P. Morgan estimates

Figure 1: Corporate credit (corporate loans + bills + corporate bonds) as % of IEA (2015)



Source: Company data

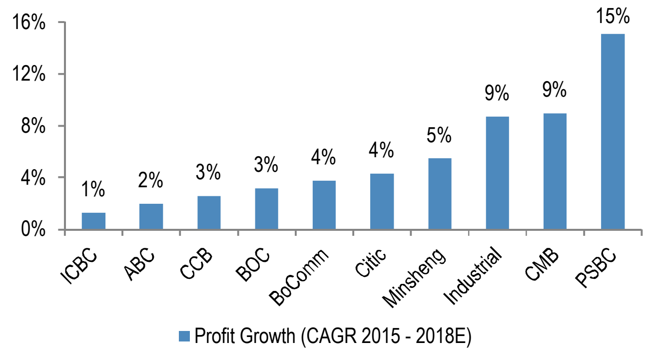
Figure 2: RoA differences of national banks (2018E-2015A)



Source: Company data, J.P. Morgan estimates

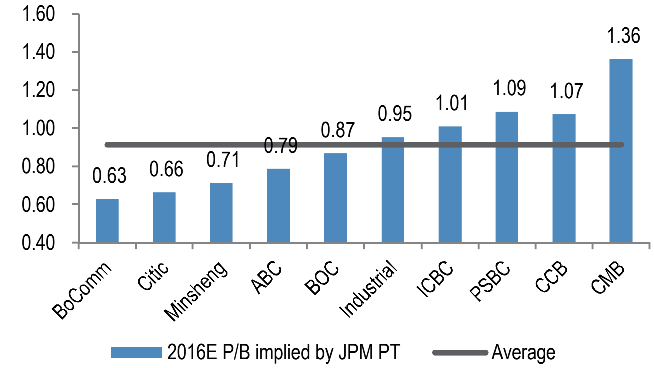
Katherine Lei
(852) 2800-8552
katherine.lei@jpmorgan.com

Figure 3: Profit growth of China banks (2015-2018E)



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

Figure 4: 2016E P/B implied by J.P. Morgan PTs for China banks



Source: J.P. Morgan estimates

Company overview

General information

- **Market positioning:** PSBC ranked #5 in assets and deposits and #7 in loans as of the end of 2015. As of end-1Q16, it ranked #1 in both number of retail outlets (including 31,756 agency outlets) and number of customers.
- **Balance sheet mix:** Deposits accounted for 90% of total liabilities at end-2015. Loans and investment assets account for 33% and 41% of total assets, respectively.
- **Revenue mix:** Retail business contributed to 67% of the revenue mix in 2015. And 94% of revenue is from net interest income.

Table 3: PSBC – Overview of key operating data, industry ranking and market share

		2013	2014	2015	1Q16
Assets	Rmb bn	5,574	6,298	7,296	7,708
	Ranking	6	5	5	5
	Market share	N/A	4.7%	4.7%	4.8%
Deposits	Rmb bn	5,206	5,803	6,305	6,732
	Ranking	5	5	5	5
	Market share	5.8%	5.6%	5.6%	5.9%
Loans	Rmb bn	1,493	1,876	2,472	2,666
	Ranking	10	9	7	7
	Market share	2.5%	2.8%	3.2%	3.5%
Number of retail customers	Number	N/A	N/A	N/A	505
	Ranking	N/A	N/A	N/A	1
Outlets	Number	39,707	39,962	40,055	40,057
	Ranking	N/A	N/A	N/A	1

Source: Company data, CEIC, J.P. Morgan estimates. For the ranking of number of retail customers and outlets, we compare PSBC's 1Q16 numbers to FY15 numbers at our coverage banks. For retail deposits, we compare to our coverage banks. Market share based on commercial banks

Katherine Lei
(852) 2800-8552
katherine.lei@jpmorgan.com

Table 4: PSBC – Asset and liability mix

	2013	2014	2015	2016E	2017E	2018E
Asset mix						
Cash & Central						
Bank assets	22%	22%	16%	16%	16%	16%
Interbank	27%	22%	9%	9%	9%	7%
Investments	23%	25%	41%	40%	38%	37%
Loans	26%	29%	33%	34%	36%	39%
Others	1%	2%	1%	1%	1%	1%
Total assets	**100%**	**100%**	**100%**	**100%**	**100%**	**100%**
Liability mix						
Interbank	2%	3%	8%	9%	10%	10%
Deposit	96%	95%	90%	89%	88%	88%
Others	2%	2%	2%	2%	2%	2%
Total liabilities	100%	100%	100%	100%	100%	100%

Source: Company data, J.P. Morgan estimates

Table 5: PSBC – Revenue by segment

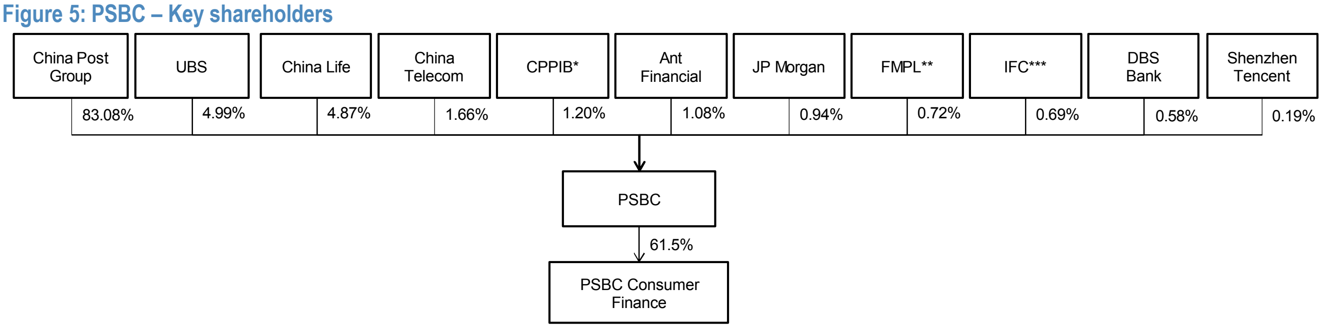
	2013	2014	2015	1Q16
Revenues (Rmb in millions)				
Personal Banking	103,742	115,235	128,204	33,982
Corporate Banking	28,182	31,508	33,648	8,983
Treasury	13,032	26,779	28,341	4,468
Others	278	353	440	81
Total	**145,234**	**173,875**	**190,633**	**47,514**
Revenue mix				
Personal Banking	71%	66%	67%	72%
Corporate Banking	19%	18%	18%	19%
Treasury	9%	15%	15%	9%
Others	0%	0%	0%	0%
Total	**100%**	**100%**	**100%**	**100%**

Source: Company data, J.P. Morgan estimates

Ownership and subsidiaries

As of 31 March 2016, China Postal Group owned 83.1% of PSBC. Ten strategic shareholders invested in PSBC in 2015. New shares issued to shareholders implied 1.0x 2015 book.

Figure 5: PSBC – Key shareholders



Source: Company data. * CPPIB = Canada Pension Plan Investment Board. ** FMPL = Fullerton Management Pte Ltd. *** IFC = International Finance Corporation.

Katherine Lei
(852) 2800-8552
katherine.lei@jpmorgan.com

Investment positives

Lower asset quality concerns lead to better earnings visibility

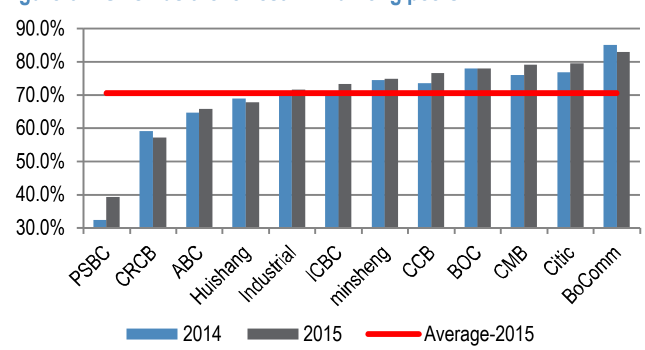
- **Relatively short lending history, not part of 2009 lending spree:** PSBC's predecessor, Postal Savings Bank of China, was established in 2007 and started experimenting with retail credit businesses, including micro loans and credit card loans, in 2007. PSBC started its corporate lending business in 2009, but this was limited to a pilot scheme. Tier 1 branches were not authorized to conduct corporate lending business until 2012. PSBC was not a key participant in the lending spree of 2009, when loan growth recorded 32% in China.

- **Focus on retail business leads to lower asset quality risks:** Forty-nine percent of PSBC's loan book is from retail business, the highest among peers. Retail loans carry lower credit risks because: (1) household leverage was 40% of GDP at end-2015 vs corporate loans at 109%; (2) industrial enterprises' earnings growth was -3% in 2015, but disposable income per capita growth in China was 9%, and the CAGR was 11% over 2011-2015; and as such (3) the NPL ratio for corporate loans was 2.39% at end-2015, while retail loans' NPL ratio was only 1.01% for banks under our coverage.

- **Shying away from high-risk sectors:** Table 19 shows the NPL ratios at major China banks for the Manufacturing, Mining and Wholesale & Retail sectors were 4.2%, 2.1% and 6.7%, respectively, at end-2015, significantly higher than the overall NPL ratio of 1.67% at commercial banks. PSBC's cumulative exposure to these sectors was 10%, the lowest among peers (peer average 23%).

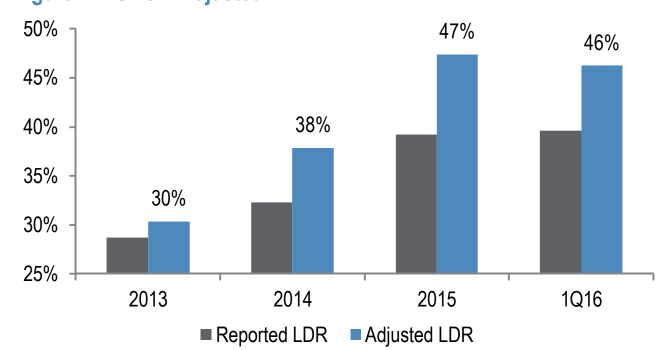
- **More stringent NPL recognition:** NPLs are equivalent to 118% of loans overdue more than 90 days; this indicates that all loans overdue more than 90 days are being recognized as NPLs. This is more stringent than at some peers and in line with Big 4 SOE bank practice.

Figure 6: PSBC has the lowest LDR among peers



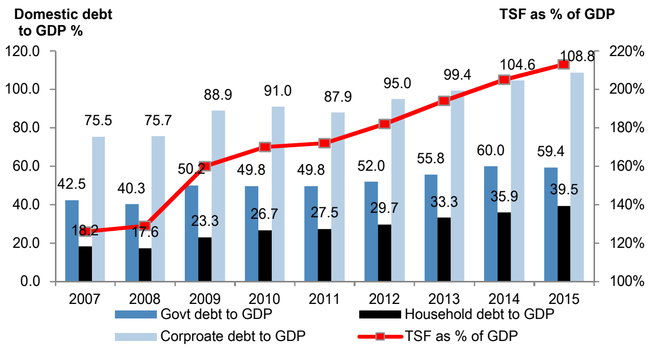
Source: Company data

Figure 7: PSBC – Adjusted LDR



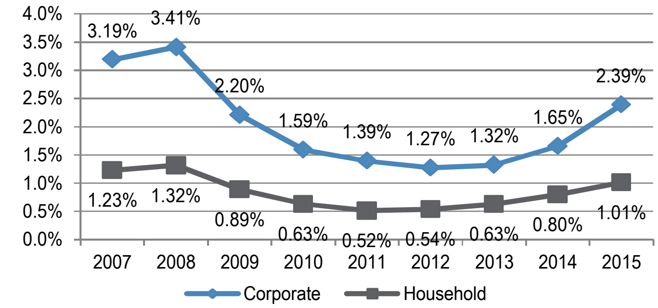
Source: Company data, J.P. Morgan estimates. Note: We add back asset management plans and trust investment plans to loan book to calculate adjusted LDR.

Figure 8: China's system leverage continues to edge up, especially for corporate debt



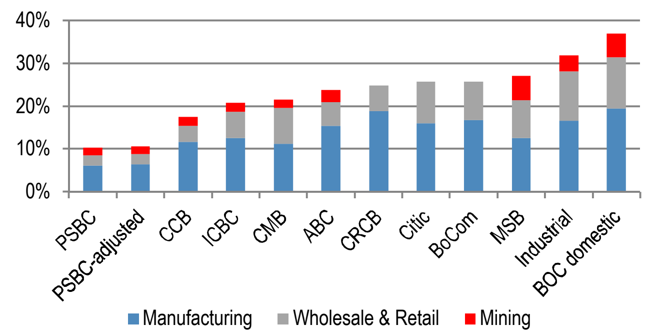
Source: BIS, CEIC, J.P. Morgan Economics team

Figure 9: NPL ratio of national banks under J.P. Morgan coverage – Corporate vs consumer



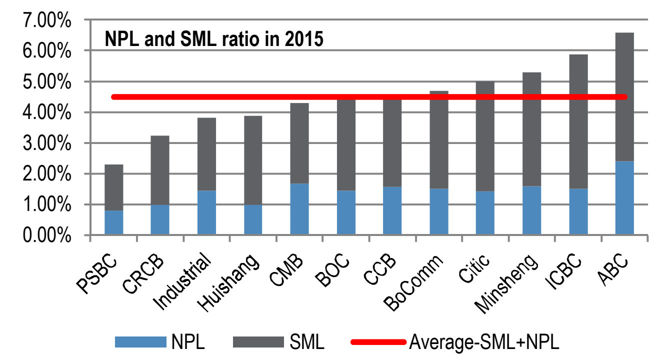
Source: Company data. Note: Based on J.P. Morgan coverage banks, excluding BoCom, CRCB and Huishang.

Figure 10: Manufacturing, Wholesale & Retail and Mining loans as a % of total loans (as of 2015)



Source: Company data. Note: For Citic, BoCom and CRCB, we include only Manufacturing and Wholesale & Retail loans. For PSBC-adjusted, we add back the portion of trust investment plans and asset management plans that invested in the aforementioned sectors.

Figure 11: NPL + SML ratio by bank – PSBC is the lowest among peers and the only bank showing a yoy decline

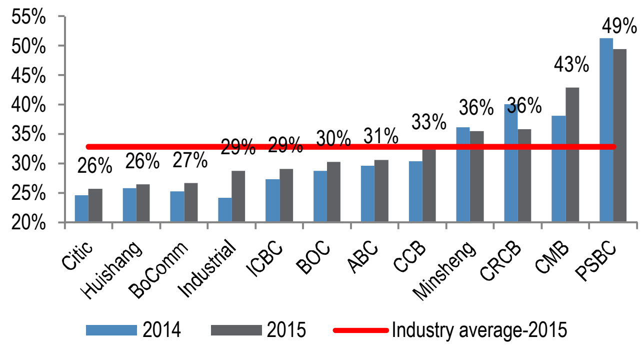


Source: Company data

Largest deposit network with strong retail focus

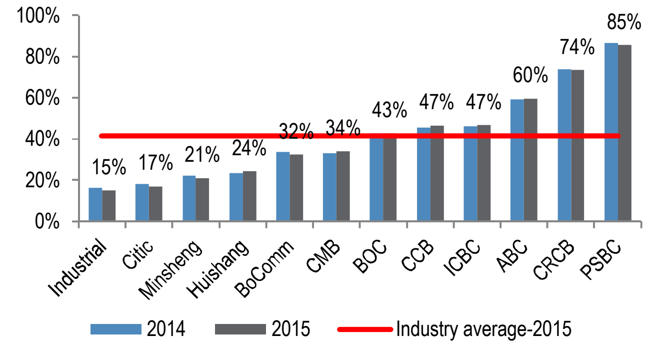
- **PSBC has the largest distribution network in China**, with 40,057 branch outlets. Of these, 8,301 are directly operated by PSBC and 31,756 are agency outlets operated by parent China Postal Group. Agency outlets perform only deposit-taking business for PSBC; they do not participate in lending business. The contribution of fee income from agency outlets to PSBC is immaterial.
- **Largest client base:** PSBC has 505mn retail customers in China, about 37% of the population and the highest among banks (Figure 15).
- **Highest retail contribution to financials:** Retail business contributed 49% of loans and 85% of deposits at end-2015, the highest among peers (Figures 12 and 13). Retail business contributed to 46.0% of pretax profits in 2015, second only to CMB at 46.3%, and significantly above the Big 4 average of 34% (Figure 14).

Figure 12: Retail loans as % of total loans: PSBC ranked at the top among peers



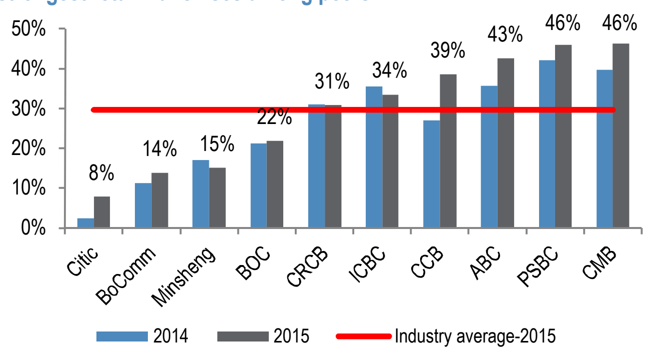
Source: CEIC

Figure 13: Retail deposits represented 85% of total deposits for PSBC



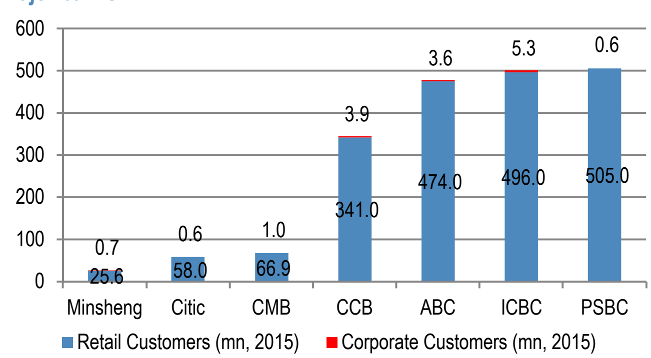
Source: Company data

Figure 14: Retail contribution to PBT: CMB and PSBC have the strongest retail franchises among peers



Source: Company data

Figure 15: PSBC has the largest amount of retail customers among major banks



Source: Company data. For PSBC, data are as of March 2016.

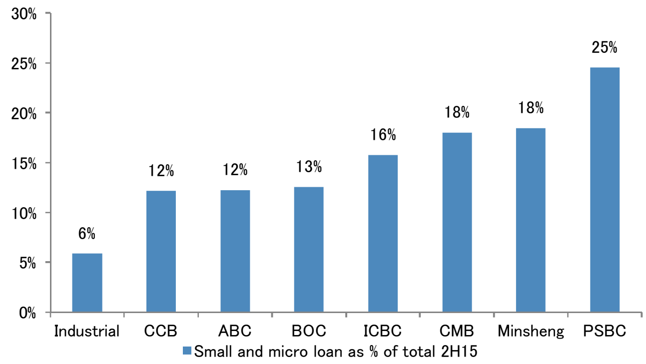
Higher exposure to SMEs leads to resilient lending yield

Only outlets directly owned by PSBC can conduct lending business, and 6,563 outlets out of the total 8,301 are engaged in SME lending. Total SME loans accounted for 25% of PSBC's loan book at end 2015, the highest among national banks we cover (Figure 16).

- **MSE business support lending yields:** Micro-small enterprise loans are priced at 45% above the one-year lending rate, and banks with more exposure to MSE loans usually have higher lending yields. As such, PSBC's lending rates are higher than peers'.
- **Asset quality is less prime, but hidden risk is lower:** The NPL ratio of MSE loans is 2.84% on a blended basis, including the NPL ratio of corporate loans to small enterprises of 4.17%, retail small business loans of 1.68% and micro consumer loans of 3.83%. These are significantly higher than the overall NPL ratio of 0.81% at end-1Q16. However, the lag time with which the risk of MSE borrowers will be reflected is lower than for big corporates, such as zombie companies. Therefore, the underlying credit risks not being reflected on PSBC's book could be lower than at peers, with higher potential exposure to big corporates and zombie companies.

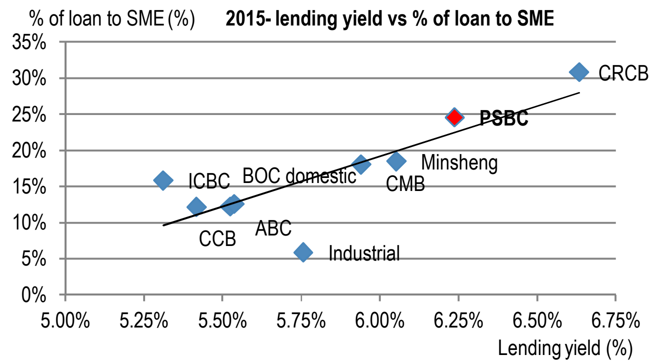
Katherine Lei
(852) 2800-8552
katherine.lei@jpmorgan.com

Figure 16: Loans to small and micro enterprises as a % of total loans for major China banks as of 2015



Source: Company data

Figure 17: PSBC's and CRCB's lending yields and % of loans to SMEs in 2015 were ahead of peers'



Source: Company data

Table 6: Lending rates of PSBC's MSE business

	2013	2014	2015	1Q16
Weighted-average contractual rate of MSE loans				
Loans to small enterprises	7.58%	7.63%	6.80%	6.53%
Personal business loans	8.05%	8.11%	7.33%	6.58%
Micro loans—consumer	13.22%	12.43%	11.07%	10.62%
Overall MSE loans	**9.20%**	**8.99%**	**8.03%**	**7.49%**
PSBC overall lending yield	7.14%	6.97%	6.24%	5.18%
MSE loans vs overall lending yield	*29%*	*29%*	*29%*	*45%*
1yr benchmark lending rate	6.00%	5.97%	4.95%	4.35%
MSE loan yield vs 1yr benchmark lending rate	*53%*	*51%*	*62%*	*72%*

Source: Company data, J.P. Morgan estimates, CEIC

Developments in e-banking by leveraging Ant Finance and Tencent

PSBC has been investing in its IT system to expand its e-banking platform.

- Innovation by internal efforts: PSBC developed and obtained patents for its cloud data systems in 2012. It also developed and registered copyrights for various software, including its retail customer marketing system, corporate customer marketing system, Mobile Business Development System, Outlet Centralization System, etc.
- Leveraging rural e-commerce, such as leveraging the client networks of New Rural Social Endowment Insurance (NSEI) and New Rural Cooperative Medical Services (NCMS) schemes.
- Collaborating with strategic shareholders Ant Finance and Tencent.

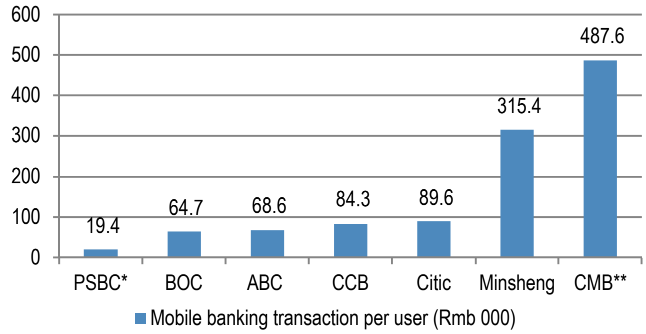
Despite its fast development in e-banking in recent years, PSBC's e-banking business trails the early movers by a wide margin. For example:

- PSBC's average mobile transaction per user is Rmb19,400, lower than the Rmb72,500 average for BOC, CCB and ABC (ICBC does not have relevant disclosures, Figure 18).
- We see an even bigger gap in average online transactions per customer (Figure 82). We believe this is partly because PSBC is relatively weak in corporate banking business, which may be primarily transacted through online banking.

We believe the rising penetration of smartphones in China will increase rural population usage of mobile banking services.

Katherine Lei
(852) 2800-8552
katherine.lei@jpmorgan.com

Figure 18: Mobile transactions per user, 2015



Source: Company data. * Only personal banking for PSBC. We calculate PSBC numbers based on annualized 1Q16 data. ** CMB based on active users.

Table 7: PSBC – Internet banking data

	1Q16	2013-1Q16 CAGR
No. of registered customers (mn)		
Mobile banking	106.6	65%
Online banking – Personal	135.3	31%
Electronic banking	158.4	32%
Telephone banking	107.0	17%
Transactions amount (Rmb bn)		**2013-2015 CAGR**
Mobile banking	517.0	343%
Online banking – Personal	485.0	26%
No. of Wechat followers (mn)	2.37	351% *
No. of customers of Wechat banking services (mn)	1.47	N/A
% of transactions through electronic banking channel	73.8%	N/A

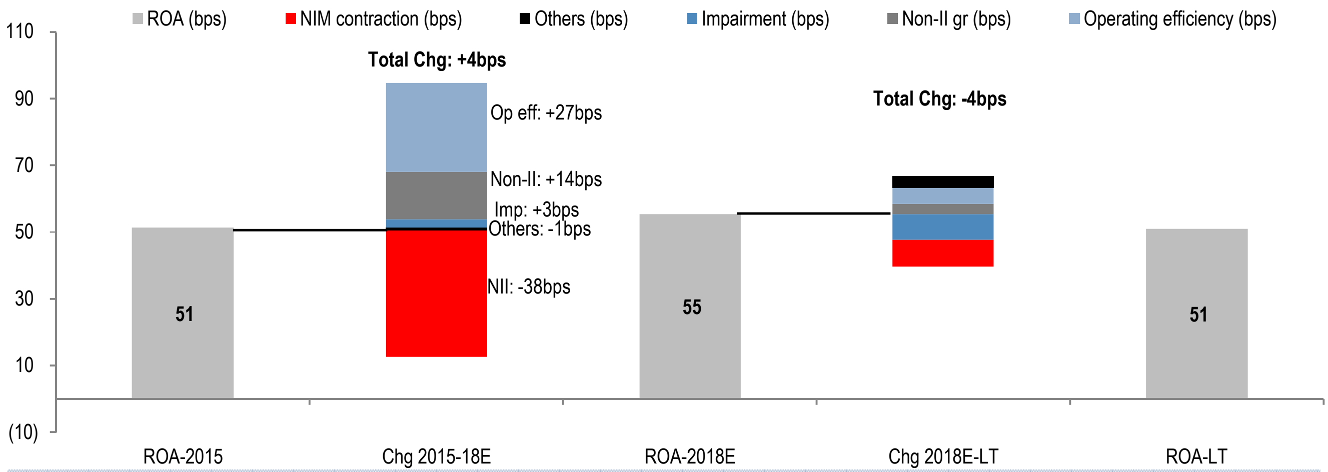
Source: Company data, J.P. Morgan. Note: Electronic banking entails both online banking and online-to-offline transactions, like ATMs. * CAGR for 2013-1Q16.

ROA expansion on optimizing costs and fee growth

- LDR expansion may drive NIM expansion in 2017 and 2018.
- Non-interest income contributed only 6% of total income in 2015, the lowest among peers (average 25% for national banks and 24% for Big 4 SOEs). We see upside on fee growth, mainly from credit card fees, payment services and wealth management business, on the back of rising disposable income in China and improvement in business “know how” by leveraging strategic shareholders, in particular, Ant Finance, Tencent, UBS, J.P. Morgan and DBS.
- Improving operating efficiency: Adjusting out agency fees, which are part of funding costs, PSBC’s cost-income ratio was ~50.8% in 2015, significantly higher than the Big 4 SOE bank average of 36.8%. We believe PSBC may be able to narrow the gap with peers by: (1) optimizing its IT infrastructure, such as centralizing back-office work; (2) developing mobile/Internet banking to reduce operating costs for the retail and SME businesses; and (3) growing its corporate banking business to optimize operating efficiency.

Katherine Lei
(852) 2800-8552
katherine.lei@jpmorgan.com

Figure 19: PSBC – Long-term ROA



	ROA-2015	ROA-2018E	ROA-LT
ROA:	**0.51%**	**0.55%**	**0.51%**
Leverage:	30x	23x	24x
ROE:	**15.2%**	**13.0%**	**12.2%**

Source: J.P. Morgan estimates

Table 8: Branch distribution network vs distribution of credit cards issued in China: PSBC has a higher presence in areas with low credit card penetration

	Branch network distribution in China (% of total)						Distribution of credit cards issued in China
	ICBC	CCB	BOC	ABC	PSBC-self owned	PSBC-agency	
Northeastern China	11.2%	10.4%	9.9%	8.7%	10.8%	11.3%	6.0%
Central China	27.0%	21.6%	24.2%	0.0%	27.6%	26.8%	9.1%
Pearl River Delta	7.8%	12.5%	12.8%	25.5%	9.5%	7.4%	10.7%
Western China	28.5%	23.0%	20.4%	15.6%	26.2%	29.1%	12.7%
Bohai Rim	13.5%	16.8%	16.3%	17.3%	14.3%	13.3%	19.7%
Yangtze River Delta	11.9%	15.5%	16.4%	32.9%	11.6%	12.0%	41.6%

Source: Company data, Unionpay Data Service. Note: Distribution of credit card issued as reported by Unionpay Data Service.

Table 9: Operating efficiency of Big 4 banks has improved significantly since listing

		Cost/assets		CIR		PBT/branch (Rmb M)		PBT/staff (Rmb 000)	
	Year of IPO	Year of IPO	2015	Year of IPO	2015	Year of IPO	2015	Year of IPO	2015
PSBC	2016*	1.64%	1.82%	67.6%	64.8%	N/A	5.0	N/A	257.7
ICBC	2006	1.11%	1.03%	42.6%	33.0%	4.2	20.8	205.1	778.9
CCB	2005	1.27%	1.11%	45.1%	33.2%	4.8	20.0	220.7	808.5
BOC	2006	1.37%	1.16%	46.3%	39.1%	6.0	19.9	292.0	746.6
ABC	2010	1.33%	1.34%	43.8%	41.8%	5.1	9.8	271.6	458.9
Big 4 average		1.27%	1.16%	44.5%	36.8%	5.1	17.6	247.4	698.2

Source: Company data. Note: (1) We use number of staff as of 1Q16 to calculate PBT/staff for PSBC in 2015. (2) For PSBC, we take out agency cost in operating expense in the calculation of cost/assets and cost/income. (3) For PSBC, we include self-owned branches only in the above calculations. (4) * For 2016, we use JPM estimates for PSBC

Katherine Lei
(852) 2800-8552
katherine.lei@jpmorgan.com

Investment negatives

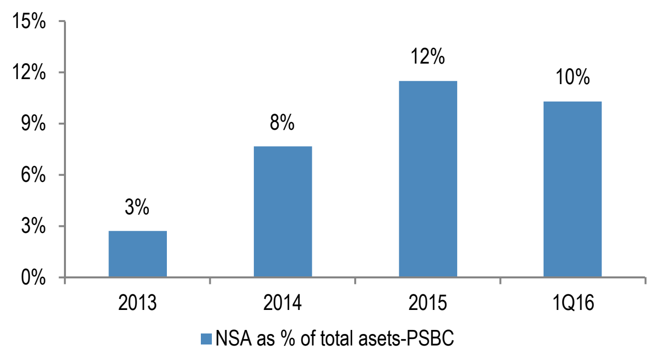
Relatively high non-standardized investments on balance sheet

One market concern about China banks is investments into non-standardized assets (NSAs), which could be de facto loans structured into SPVs. NSAs include asset management plans, trust beneficial funds and WMPs issued by other banks. PSBC's investments into non-standardized assets reached Rmb795bn at end-1Q16, ~10% of total assets. The percentage of NSAs in total assets was 12% at end-2015 vs the peer average of 12%, but significantly higher than the Big 4 bank average of 1%.

However, some areas of comfort here, in our view:

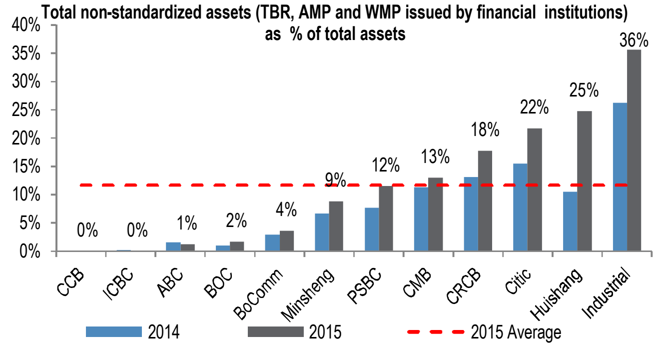
- 56% of NSAs are trust beneficiary rights (TBR) and asset management plans (AMP).
- 73% of TBR and AMP are issued by financial institutions.
- 50.7% of the products are guaranteed by financial institutions, 45% are backed by NCDs and 1% backed by banks' deposits certificates. As such, net risk exposure is low.

Figure 20: PSBC – NSAs as % of total assets declined from 12% in FY15 to 10% in 1Q16



Source: Company data

Figure 21: PSBC – Exposure to NSAs is higher than for Big 4 banks



Source: Company data, J.P. Morgan. Note: This includes investments in both investment book and as reverse repos in interbank book.

Table 10: PSBC – Breakdown of investments in trust investment plans and asset management plans by security type

Rmb in millions	Trust investment plans	AMPs	Total	% of total
Pledged by certificates of deposit	4,898	199	5,097	1.1%
Guaranteed by or credit of financial institutions	27,486	198,742	226,228	50.7%
Guaranteed by corporates	249	13,840	14,089	3.2%
Backed by negotiated certificates-of-deposit assets	131,230	69,493	200,723	45.0%
Total	**163,863**	**282,274**	**446,137**	**100.0%**

Source: Company data

Implicit funding costs high due to agency fee arrangement

PSBC has to pay agency fees to China Postal Group. The fee rate was 1.42-1.44% of deposits in 2013-2015 (Table11). Although this is booked under opex, we see it as part of funding costs. On an adjusted basis, PBSC's funding cost was 2.81% in 2015, higher than the Big 4 average of 1.96%, and adjusted NIM was 1.93%, lower than the Big 4 average of 2.47% in 2015.

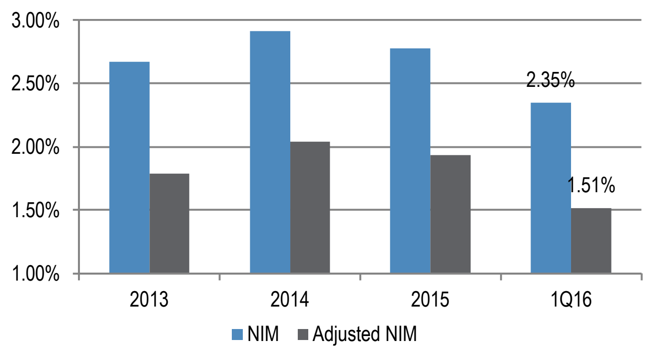
Katherine Lei
(852) 2800-8552
katherine.lei@jpmorgan.com

Table 11: Calculation of deposit agency fee paid to China Postal Group

	2013*			2014			2015			1Q16		
Rmb in billions	Daily avg. balance	Scaled fee rate	Deposit agency fee	Daily avg. balance	Scaled fee rate	Deposit agency fee	Daily avg. balance	Scaled fee rate	Deposit agency fee	Daily avg. balance	Scaled fee rate	Deposit agency fee
Demand	1,142	2.20%	25.1	1,237	2.30%	28.46	1,305	2.30%	30.01	1,436	2.30%	8.26
Demand or time	19	1.48%	0.3	17	1.50%	0.25	14	1.50%	0.21	14	1.50%	0.05
Call deposits	14	1.58%	0.2	13	1.70%	0.21	13	1.70%	0.21	20	1.70%	0.08
3-month time deposit	108	1.25%	1.3	121	1.25%	1.51	128	1.25%	1.60	131	1.25%	0.41
Half-year time deposit	125	1.18%	1.5	144	1.15%	1.65	153	1.15%	1.75	145	1.15%	0.42
1-year time deposit	1,419	1.12%	15.9	1,571	1.08%	16.96	1,769	1.08%	19.10	1,898	1.08%	5.11
2-year time deposit	128	0.70%	0.9	150	0.50%	0.75	177	0.50%	0.88	174	0.50%	0.22
3-year time deposit	188	0.45%	0.8	220	0.30%	0.66	231	0.30%	0.69	239	0.30%	0.18
5-year deposit	46	0.35%	0.2	51	0.20%	0.10	50	0.20%	0.10	48	0.20%	0.02
Daily aggregate catch (including cash in transit)	12	-1.50%	(0.2)	13	-1.50%	-0.20	11	-1.50%	-0.17	16	-1.50%	-0.06
Total	3,189	1.44%	46.1	3,522	1.43%	50.37	3,838	1.42%	54.40	4,105	1.43%	14.67

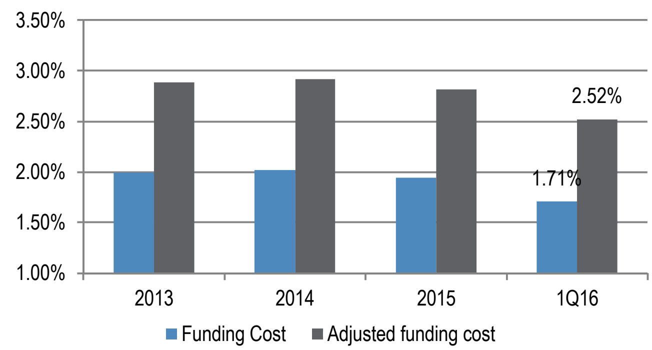
Source: Company data, J.P. Morgan estimates. Note: For 2013 data, we take the average of the daily average balances of 1H13 and 2H13 given in company data to come up with the daily average balance for FY13. Scaled fee rates were revised in 2H13; we take the average of the rates before and after adjustment. The total daily average balance does not include the daily aggregate cash (including cash in transit).

Figure 22: PSBC – NIM is significantly lower than reported figures if agency costs are included as part of interest expense



Source: Company data, J.P. Morgan estimates

Figure 23: PSBC – Funding cost is higher if agency costs are included as part of interest expense



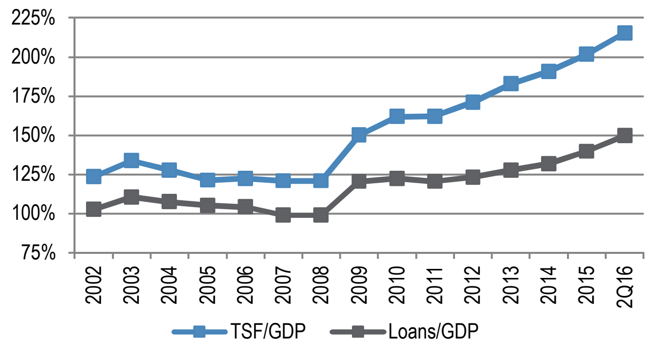
Source: Company data, J.P. Morgan estimates

Contagious risks on asset quality and shadow banking

- **Corporate leverage a key vulnerability:** Corporate leverage (109% of GDP) is a key driver of overall leverage in China, but as economic growth slows along with corporate profit growth, asset quality pressures have come to the fore. NPLs have risen from 1% in 2013 to 1.75%, and are 3.5% adjusted for NPLs written-off/disposed by banks. We expect asset quality pressures to continue.
- **Households vulnerable to spillover impact:** While over-leveraged corporates are the focus of asset quality, even households with relatively lower leverage (40% of GDP) could see spillover effects. As corporates default, there could be direct income effects on the household sector, as well as wealth effects through bond defaults on WMPs or stock market corrections.
- **Shadow banking risks:** Stock of non-bank TSF went up a by CAGR of 21% over 2011-2015. Banks may see contagion risks if there are defaults in shadow banking assets.

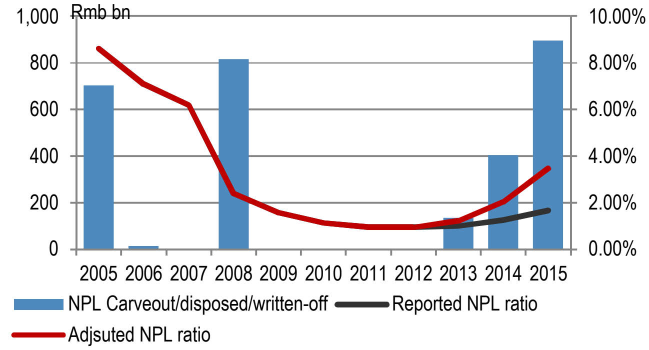
Katherine Lei
(852) 2800-8552
katherine.lei@jpmorgan.com

Figure 24: TSF/GDP and loan/GDP



Source: CEIC, WIND

Figure 25: NPL ratio up to 1.75%, and 3.5% adjusted for write-offs/disposals



Source: CEIC, J.P. Morgan estimates

P&L risks: Earnings could be lower than expected

Chinese regulators have continued to ask banks to "sacrifice" revenue (NIM and fees) in order to lower overall financing costs for the economy. Indeed, national service by banks has weighed on profitability, as PPoP growth slowed from 29% at end-2011 to 10% as of 2015. This is due mainly to NIM contraction after six interest rate cuts since November 2014 and intervention in banks' fee business. There are risks of further rate cuts and depression on fee income if macro growth remains weak.

Financial estimates

Table 12: PSBC – Key financials and estimates

					YoY growth			
Rmb in millions	**2015**	**2016E**	**2017E**	**2018E**	**2015**	**2016E**	**2017E**	**2018E**
Balance sheet								
Loans	2,471,853	2,842,631	3,354,305	4,025,165	32%	15%	18%	20%
Deposits	6,305,014	6,998,566	7,698,422	8,468,264	9%	11%	10%	10%
Total assets	7,296,364	8,203,668	9,131,204	10,072,101	16%	12%	11%	10%
Income statement								
NII	179,259	168,813	192,184	216,164	7%	-6%	14%	12%
Non-NII	11,374	18,913	23,376	29,587	88%	66%	24%	27%
Opex	(123,610)	(126,891)	(136,755)	(148,947)	8%	3%	8%	9%
PPoP	67,023	60,835	78,805	96,804	12%	-9%	30%	23%
Impairment	(25,635)	(16,401)	(25,521)	(33,746)	26%	-36%	56%	32%
Net profits	34,859	37,423	44,876	53,107	7%	7%	20%	18%
Key ratios								
Loan-deposits ratio	39.2%	40.6%	43.6%	47.5%	6.9 ppt	1.4 ppt	3.0 ppt	4.0 ppt
NPL ratio	0.80%	0.80%	0.85%	0.89%	16 bps	-01 bps	05 bps	04 bps
NPL coverage	298%	268%	256%	265%	-65.9 ppt	-30.2 ppt	-12.0 ppt	9.0 ppt
NIM	2.78%	2.35%	2.39%	2.41%	-14 bps	-43 bps	04 bps	03 bps
Credit cost	1.07%	0.50%	0.73%	0.83%	00 bps	-56 bps	22 bps	11 bps
ROAA	0.51%	0.48%	0.52%	0.55%	-04 bps	-03 bps	03 bps	04 bps
ROAE	15.2%	12.1%	12.2%	13.0%	-4.6 ppt	-3.2 ppt	0.1 ppt	0.8 ppt

Source: Company data, J.P. Morgan estimates

Valuation

Dividend-derived valuation

Our preferred and primary valuation method is a dividend-derived valuation approach. In this method, we consider both the company's short-term growth potential and its long-term sustainable ROE. We derive a Dec-17 price target of HKD5.30, translating into 1.09x FY16E book value and 9.4x of earnings.

Table 13: PSBC – Dividend-derived valuation

	Postal Bank
Cost of capital	12.70%
Normalized ROE	12.2%
Fair value (HKD)	5.30
Implied P/B, 2016E	1.09 x
Implied P/B, 2017E	0.98 x
Implied P/E, 2016E	9.40 x
Implied P/E, 2017E	8.49 x

Source: Company data, J.P. Morgan estimates

COE assumptions

In our model, we assume the following:

- Cost of capital of 12.70%. To derive this, we use a risk-free rate of 3.5% and an equity premium of 8.0%, both in line with our China banks coverage. We use a beta of 1.15, in line with our practice for our large banks coverage.
- Long-term growth rate of 5.0%, in line with our SOE banks coverage.
- Terminal date of valuation of Dec-18.

Sustainable ROE assumptions

Our valuation range is derived by assuming different long-term ROE estimates. We estimate that average ROE for 2016E-2018E will be 12.4% (Table 15), lower than ROE of 15.2% in 2015. The ROE compression is driven mainly by an enlarged capital base and NIM compression due to six interest rate cuts from 4Q14 to 4Q15. In order to derive a range of sustainable ROE, we consider factors such as NIM compression and a deterioration in the credit environment, though these could be offset by company-specific elements, such as improving fee income and cost management. We estimate that sustainable ROE for PSBC could be 12.2%.

ROE assumption 1: Net interest margin estimates

- We estimate that PSBC's NIM will be compressed by a significant 43bps YoY in 2016 when it prices in the interest rate cut and prices down non-lending asset yields. However, NIM should somewhat recover to 2.41% in 2018E due mainly to a rising LDR from 39% at end-2015 to 48% at end-2018. Note lending yield was 6.24% in 2015, higher than the overall asset yield of 4.66% for PSBC. Other factors leading to an NIM recovery in 2017 and 2018 include the impacts of rate cuts on time deposits to fade in when those deposits are re-priced. In the long term, PSBC's NIM could vary, depending on if it continues to leverage up its LDR, funding costs management, money market rates, etc.
- We assume that sustainable NIM will contract 5bps from average 2016-2018E levels, or 8bps from 2018E levels, to 2.33% in the long run. Here, we assume a decline in the monetary market environment, rising funding costs and flat LDR.

Katherine Lei
(852) 2800-8552
katherine.lei@jpmorgan.com

ROE assumption 2: Asset impairment costs

- Provision charges: We estimate that average credit costs in 2016E-2018E will be 69bps and that the impairment charge on average assets is 29bps due to PSBC's low LDR (44% on average). Following the industry trend, we expect credit costs to go up due to a macro growth slowdown in China.
- We expect that PSBC has lower credit costs than peers because: (1) it did not have a lending license until 2007; (2) it rolled out full-scale corporate lending only in 2011; (3) retail loans account for 49% of total loans (vs industry 33%), and the retail loans' NPL ratio is generally 44bps lower than for corporate loans, based on industry experience (Figure 29); (4) on its investment book, NSAs of 840bn accounted for 12% of total assets as of 2015. Among the NSAs, 27% are TBRs (Rmb228bn) and 34% are AMPs (Rmb285bn), and 50.7% of TBRs and AMPs are guaranteed by financial institutions, 45% are backed by NCDs and 1% are backed by banks' deposits certificates; and (5) investments issued by government and quasi-government account for 16% of PSBC's assets, higher than the peer average of 10%.
- We assume that normalized impairment charges/average assets will go up to 40bps (vs 29bps in 2016E-2018E), driven mainly by higher credit costs (~90bps) on loans and rising impairment charges on non-lending assets. Although we assume credit costs will go up, the magnitude is lower than for peers.

ROE assumption 3: Cost management

- Potential improvement in cost management: Based on the cost-income ratio (adjusted for agency fees) of 49% in 2106E-18E, we believe PSBC could further improve cost management by improving IT infrastructure, leveraging electronic banking channels and increasing exposure to the corporate segment. Thus, we expect normalized CIR in the range of 43%, significantly above the Big 4 average of 36.8% in 2015.
- We assume that the adjusted cost-income ratio is ~43%, referencing to ABC's average CIR of 43% during the period its financial data were available (2007-2015; adjusted out 2008, as CIR was distorted due to bad debt carve-outs and restructuring).

ROE assumption 4: Rising non-interest income contribution

- Potential improvement in non-interest income contribution: We expect non-interest income to contribute 11% of total revenues in 2016E-18E. However, PSBC could grow its fee business (especially credit cards, WMP) by leveraging its strategic investors (Tencent and Ant Finance) and branch network, as well as by exploring new opportunities in the corporate segment. As such, we expect a sustainable contribution from non-interest income to revenues of 13.5%.
- The non-interest income contribution is significantly lower than the Big 4 peers' 24% in 2015 and five-year average of 23.7%.

Table 14: Normalized ROE

	Postal Bank
NIM (on avg. IEA)	2.33%
Avg. IEA/avg. assets	92.9%
Margin (on avg. assets)	2.17%
Non-IR/revenues	13.5%
Revenue/avg. assets	2.51%
Cost/income	59.9%
Operating ROA	1.00%
Provision charge/assets	-0.40%
Pretax ROAA	0.60%
Effective tax rate	15.8%
Minority/assets	0.00%
RoAA	**0.51%**
Asset/equity	23.9x
Normalized ROE	**12.2%**

Source: J.P. Morgan estimates

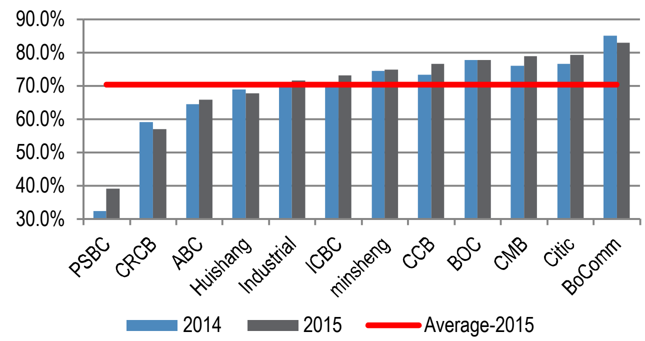
The table below presents a DuPont analysis of ROA/ROE assumptions compared to PSBC's profitability over the past two years and expected profitability until 2018E.

Table 15: PSBC: DuPont analysis

	2014	2015	2016E	2017E	2018E	Average (2016E-18E)
NIM (as % of avg. IEA)	2.92%	2.78%	2.35%	2.39%	2.41%	2.38%
Earnings assets/assets	97.0%	95.0%	92.6%	92.9%	93.3%	92.9%
Margins (as % of avg. assets)	2.83%	2.64%	2.18%	2.22%	2.25%	2.22%
Non-int revenue/revenue	3.5%	6.0%	10.1%	10.8%	12.0%	11.0%
Non-int revenue/avg. assets	0.1%	0.2%	0.2%	0.3%	0.3%	0.3%
Revenue/assets	2.9%	2.8%	2.4%	2.5%	2.6%	2.5%
Cost/income	65.6%	64.8%	68%	63%	61%	63.9%
Cost/assets	1.9%	1.8%	1.6%	1.6%	1.6%	1.6%
Pre-provision ROA	1.0%	1.0%	0.8%	0.9%	1.0%	0.9%
LLP/loans	1.06%	1.07%	0.50%	0.73%	0.83%	0.69%
Loan/assets	29.1%	33.1%	33.9%	35.9%	39.0%	36.3%
Pretax ROA	0.7%	0.6%	0.6%	0.6%	0.7%	0.6%
Tax rate	17.2%	15.8%	15.8%	15.8%	15.8%	15.8%
ROA	**0.55%**	**0.51%**	**0.48%**	**0.52%**	**0.55%**	**0.52%**
RoRWA	1.62%	1.30%	1.09%	1.12%	1.15%	1.12%
Avg. assets/equity	36.1x	29.7x	25.0x	23.5x	23.4x	23.9x
ROE	**19.8%**	**15.2%**	**12.1%**	**12.2%**	**13.0%**	**12.4%**

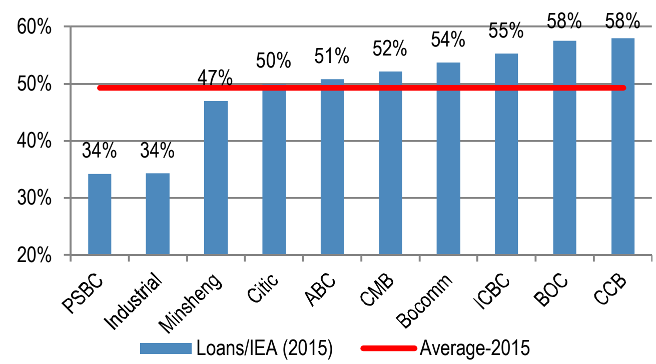
Source: J.P. Morgan estimates

Figure 26: PSBC has the lowest LDR among peers, with room for improvement



Source: Company data

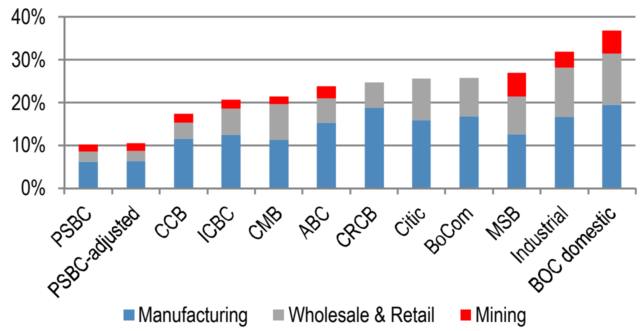
Figure 27: Loans/IEA (2015) – there is room for improvement



Source: Company data

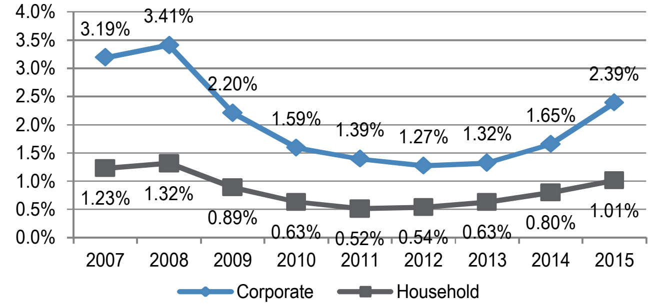
Katherine Lei
(852) 2800-8552
katherine.lei@jpmorgan.com

Figure 28: Problematic loans (Manufacturing, W&R, Mining) as % of total loans is lowest, better asset quality



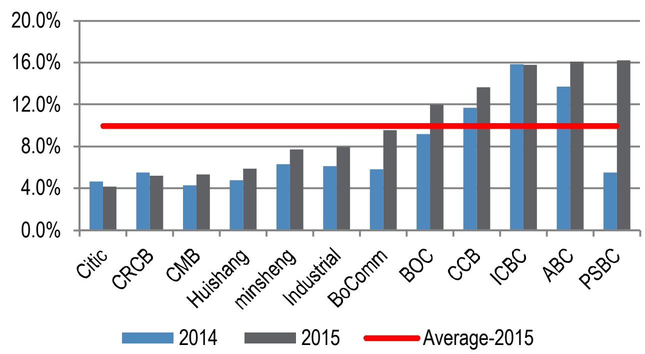
Source: Company data. Note: For Citic, BoCom and CRCB, we include only Manufacturing and Wholesale & Retail loans. For PSBC-adjusted, we add back the portion of trust investment plans and asset management plans that invested in the aforementioned sectors.

Figure 29: NPL ratio of national banks under J.P. Morgan coverage – Corporate vs consumer



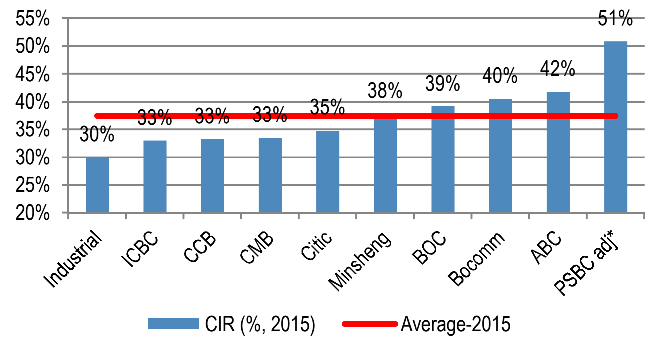
Source: Company data. Note: Based on J.P. Morgan coverage banks, excluding BoCom, CRCB and Huishang.

Figure 30: Investment in government/quasi-government bonds as % of total assets – PSBC ranked at the top among peers



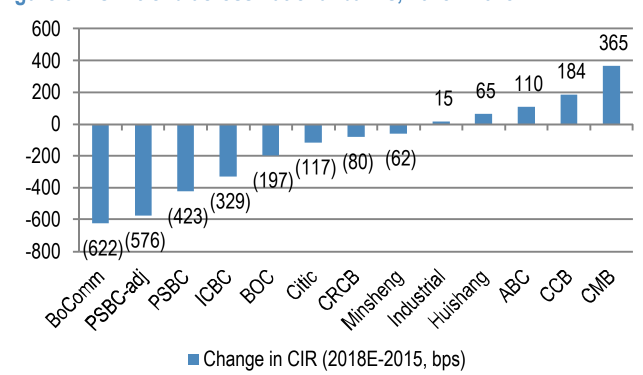
Source: Company data

Figure 31: 2015 CIR highest among peers



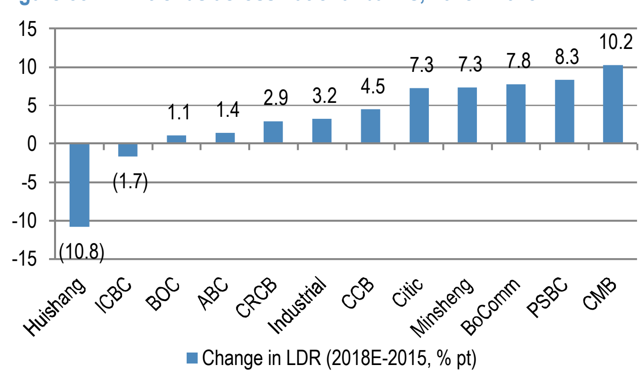
Source: Company data. * PSBC CIR adjusted to reclassify agency costs as funding cost.

Figure 32: CIR trend across national banks, 2018E-2015A



Source: Company data, J.P. Morgan estimates. * PSBC CIR adjusted to reclassify agency costs as funding cost.

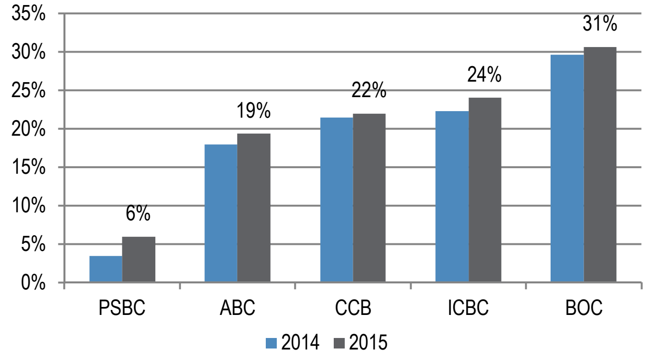
Figure 33: LDR trends across national banks, 2018E-2015A



Source: Company data, J.P. Morgan estimates

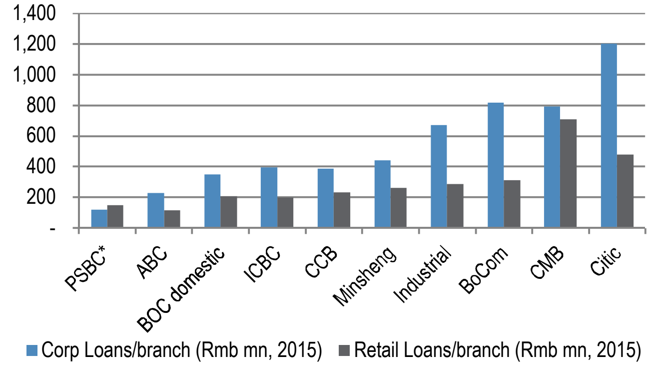
Katherine Lei
(852) 2800-8552
katherine.lei@jpmorgan.com

Figure 34: Non-interest revenues as % of total revenues – PSBC vs Big 4 banks



Source: Company data, J.P. Morgan estimates

Figure 35: Corporate and retail loans per branch, 2015



Source: Company data. * PSBC based on self-owned branches only.

Katherine Lei
(852) 2800-8552
katherine.lei@jpmorgan.com

Peer comparison

China banks are trading at 0.75x 2016E book and Big 4 SOE banks at 0.72x. However, we should take into consideration the following when comparing PSBC with peers:

- **The market has discounted a 10.7% sustainable ROE for China banks:** Consensus ROE for national China banks (SOE and joint-stock banks) listed in H-shares is ~13% for 2016E-2018E, but current trading levels imply an ROE of 10.7%. For Big 4 SOE banks, consensus ROE is 13.3% for 2016E-18E, but the current trading level is implying 10.4%.
- **The market has priced in an NPL ratio of 7.1%:** Concerns about ROE compression for China banks are driven mainly by asset quality deterioration. We estimate that the market has priced in an NPL ratio of 7.1% vs the average of 1.67% reported by banks in 1Q16 and the average of 2.0% at end-2018E.
- **PSBC has more resilient asset quality and higher visibility into ROE than peers:** Due to its limited exposure to corporate lending (such as zombie companies) and higher % of government or quasi-government investments, PSBC has lower underlying NPLs than peers. In addition, PSBC's ROE is likely to expand due to improving CIR and fee income contribution.
- Our price target imply a 2016E P/B of 0.93x for the Big 4 SOE banks on average and 1.09x for Postal Bank.

Table 16: China bank H-share valuation table (as of 31 October 2016)

	Mkt cap	Price	P/E			P/B			ROE			Dividend yield		
Name	(US$ M)	(LC)	2015	2016E	2017E	2015	2016E	2017E	2015	2016E	2017E	2015	2016E	2017E
Chinese banks – H-shares														
PSBC	43,884	4.2	6.0 x	7.3 x	6.6 x	0.93 x	0.85 x	0.77 x	15.2%	12.1%	12.2%	0.0%	2.7%	3.0%
ICBC	228,631	4.67	5.2 x	5.3 x	5.2 x	0.85 x	0.76 x	0.69 x	17.3%	15.3%	14.0%	5.7%	5.7%	5.8%
China Construction Bank	183,538	5.68	5.4 x	5.4 x	5.3 x	0.86 x	0.78 x	0.71 x	17.1%	15.2%	14.1%	5.5%	5.6%	5.7%
ABC	150,171	3.27	5.1 x	5.1 x	5.0 x	0.77 x	0.69 x	0.63 x	16.1%	14.3%	13.2%	5.8%	5.9%	6.0%
Bank of China	143,028	3.48	5.2 x	5.2 x	5.1 x	0.69 x	0.63 x	0.58 x	14.0%	12.6%	11.8%	5.8%	5.8%	5.9%
Big SOE bank average			**5.4 x**	**5.7 x**	**5.4 x**	**0.82 x**	**0.74 x**	**0.68 x**	**15.9%**	**13.9%**	**13.1%**	**4.6%**	**5.1%**	**5.3%**
Bank of Communications	59,255	5.91	5.8 x	5.7 x	5.5 x	0.74 x	0.68 x	0.62 x	13.4%	12.4%	11.7%	5.2%	5.3%	5.5%
China Merchants Bank	65,604	18.92	7.2 x	6.8 x	6.3 x	1.15 x	1.03 x	0.92 x	17.1%	16.0%	15.6%	4.2%	4.4%	4.8%
China Minsheng Banking Corp	48,058	8.85	6.1 x	5.9 x	5.7 x	0.94 x	0.84 x	0.75 x	17.1%	15.0%	13.9%	4.0%	3.3%	3.5%
China CITIC Bank	40,136	5.01	5.0 x	5.1 x	4.9 x	0.67 x	0.61 x	0.56 x	14.3%	12.6%	12.0%	4.8%	4.9%	4.9%
China Everbright Bank*	25,532	3.54	4.8 x	5.0 x	4.9 x	0.68 x	0.64 x	0.59 x	15.4%	13.3%	12.6%	6.0%	5.9%	6.1%
National bank average			**5.8 x**	**5.7 x**	**5.4 x**	**0.84 x**	**0.76 x**	**0.69 x**	**15.5%**	**13.9%**	**13.2%**	**4.9%**	**4.8%**	**5.0%**
Chinese banks – H-share avg.			**5.6 x**	**5.7 x**	**5.4 x**	**0.83 x**	**0.75 x**	**0.68 x**	**15.7%**	**13.9%**	**13.1%**	**4.7%**	**5.0%**	**5.1%**

Source: J.P. Morgan estimates, Bloomberg. * China Everbright Bank estimates based on consensus.

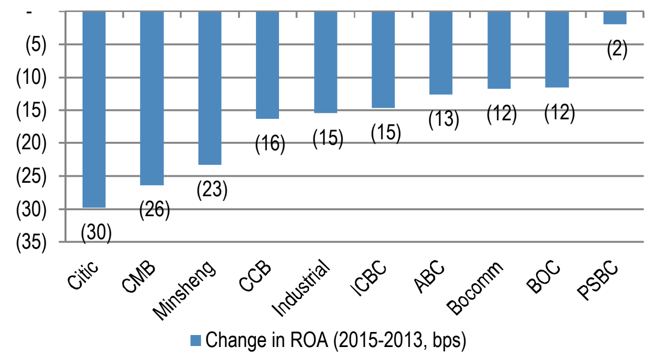
Table 17: NPL ratio implied by current trading levels (as of 31 October 2016)

	ICBC	ABC	BOC	CCB	BoCom	Citic	CMB	Minsheng	CRCB	Huishang	Industrial
2016E-2018E ROE	15%	14%	13%	15%	12%	13%	16%	15%	15%	15%	17%
NPL ratio, 2017E	1.6%	2.3%	2.0%	1.8%	1.6%	1.5%	2.2%	1.9%	1.2%	1.2%	2.1%
What's implied in the price?											
FY16E P/B, today	0.76	0.69	0.63	0.78	0.68	0.61	1.03	0.84	0.72	0.78	0.88
Cost of equity	12.50%	12.50%	12.50%	12.50%	12.50%	12.50%	12.50%	12.50%	12.50%	12.50%	12.50%
Long-term growth	5%	5%	5%	5%	5%	5%	5%	5%	5%	5%	5%
Implied sustainable ROE	10.7%	10.2%	9.7%	10.8%	10.1%	9.6%	12.7%	11.3%	10.4%	10.8%	11.6%
Implied NPL ratio	6.6%	8.1%	7.6%	6.9%	4.4%	4.9%	7.4%	6.5%	9.2%	7.3%	9.2%

Source: Bloomberg, J.P. Morgan estimates

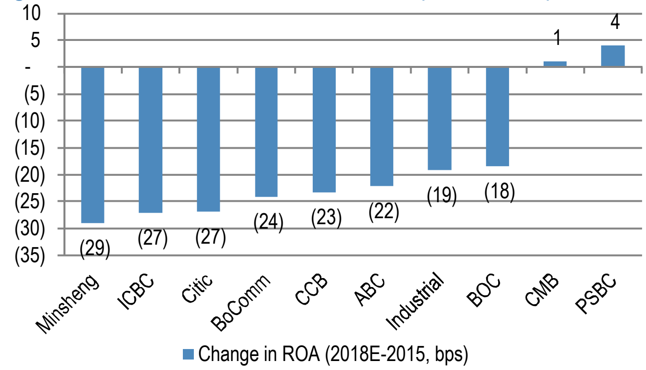
Katherine Lei
(852) 2800-8552
katherine.lei@jpmorgan.com

Figure 36: RoA contraction across national banks, 2013-15



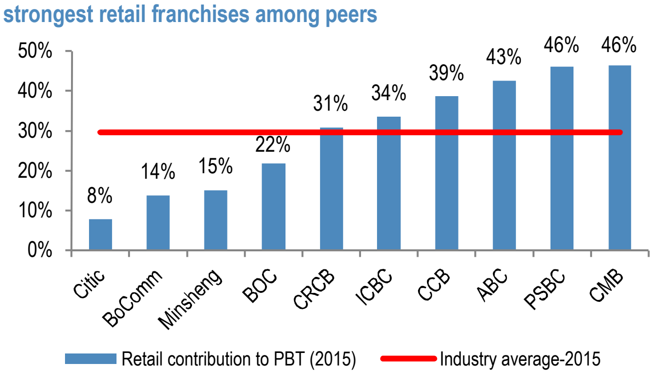
Source: Company data

Figure 37: RoA differences of national banks (2018E-2015A)



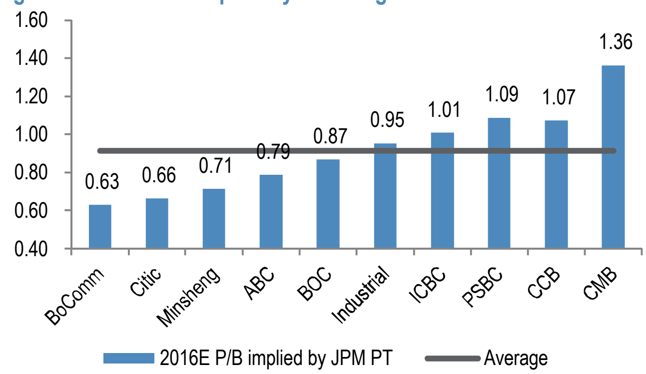
Source: Company data, J.P. Morgan estimates

Figure 38: Retail contribution to PBT– CMB and PSBC have the strongest retail franchises among peers



Source: Company data

Figure 39: 2016E P/B implied by J.P. Morgan PTs for China banks



Source: J.P. Morgan estimates

Katherine Lei
(852) 2800-8552
katherine.lei@jpmorgan.com

Investment Positives

Lower asset quality concerns than for peers lead to better earnings visibility

Lower credit risks on loan book

PSBC's NPL and SML ratios were 0.80% and 1.50% at end-2015, respectively, both the lowest among national banks we cover (Figure 41). The same holds for its overdue loans, as total overdue ratios and overdue more than 90 days were 0.99% and 0.68%, respectively, both the lowest among national peers. The better asset quality is due to the following reasons:

- **Relatively short lending history, not part of 2009 lending spree:** PSBC's predecessor, Postal Savings Bank of China, was established in 2007 and started experimenting with retail credit businesses, including micro loans and credit card loans, in 2007. PSBC started its corporate lending business in 2009, but this was limited to a pilot scheme. Tier 1 branches were not authorized to conduct corporate lending business until 2012. PSBC was not a key participant in the lending spree of 2009, when loan growth recorded 32% in China.

- **Focus on retail business leads to lower asset quality risks:** Forty-nine percent of PSBC's loan book is from retail business, the highest among peers. Retail loans carry lower credit risks because: (1) household leverage was 40% of GDP at end-2015 vs corporate loans at 109%; (2) industrial enterprises' earnings growth was -3% in 2015, but disposable income per capita growth in China was 9%, and the CAGR was 11% over 2011-2015; and as such (3) the NPL ratio for corporate loans was 2.39% at end-2015, while retail loans' NPL ratio was only 1.01% for banks under our coverage.

- **Shying away from high-risk sectors:** Table 20 shows that the NPL ratios at major China banks for the Manufacturing, Mining and Wholesale & Retail sectors were 4.2%, 2.1% and 6.7%, respectively, at end-2015, significantly higher than the overall NPL ratio of 1.69% at commercial banks. PSBC's cumulative exposure to these sectors was 10%, the lowest among peers (peer average 23%).

- **More stringent NPL recognition:** NPLs are equivalent to 118% of loans overdue more than 90 days; this indicates that all loans overdue more than 90 days are being recognized as NPLs. This is more stringent than at some peers and in line with Big 4 SOE bank practices (Figure 43).

- **Agency outlets are not allowed to extend loans:** PSBC leverages client data collected through agency outlets, but only directly owned outlets can engage in lending business. PSBC checks multiple sources and documents in order to ensure data accuracy before making loan approval decisions. For detailed procedure, please see Appendix II on credit risk management.

Table 18: Milestones of PSBC's lending business

Year	Major events
2007	- Established Postal Savings Bank of China Limited **- Launched micro loan business and entered retail credit business** - Launched first lending product
2008	- Issued first credit card; launched personal business loan and personal consumer loan businesses
2009	**- Launched corporate proprietary loans, and corporate loans to small enterprise businesses** - Pilot program in corporate lending - Cumulative micro loans extended exceeded Rmb100bn - Rmb10bn capital injection by China Post Group
2010	- Launched online banking services for retail customers - Started cash management services for corporate customers - Rmb11bn capital injection by China Post Group
2012	- Converted into joint stock limited liability company, Postal Savings Bank of China Co., Ltd. **- Expand pilot program in corporate lending to Tier 1 branches** - Launched cross-border Renminbi settlement business - Started mobile banking services
2013	- Aggregate corporate lending to small enterprise exceeded Rmb100bn (~6.7% of loan book and 1.8% of total assets at end-2013)

Source: Company data

Table 19: Loan mix and NPL ratio by segment for major China banks

	Loan mix			NPL ratio			
	2013	2014	2015	2013	2014	2015	YoY
Manufacturing	17%	15%	14%	2.23%	2.92%	4.22%	130 bps
Wholesale and retail	8%	7%	7%	2.69%	4.41%	6.70%	228 bps
Mining*	3%	3%	3%	0.16%	0.78%	2.14%	136 bps
Others	33%	34%	33%	0.60%	0.52%	0.73%	21 bps
Total corporate loans	**62%**	**60%**	**56%**	**1.30%**	**1.63%**	**2.35%**	**72 bps**
Total consumer loans	**30%**	**31%**	**33%**	**0.65%**	**0.81%**	**1.02%**	**22 bps**
Others	8%	9%	11%	0.17%	0.31%	0.31%	00 bps
Total loan	**100%**	**100%**	**100%**	**1.02%**	**1.26%**	**1.69%**	**44 bps**

Source: Company reports, JP Morgan estimates (Note: The balance includes ABC, BOC, CCB, ICBC, CMB, Minsheng, Citic, CRCB, PSBC, * Mining not reported by Citic and CRCB)

Table 20: PSBC – Loan mix and NPL ratio

	Loan mix				NPL ratio			
	2013	2014	2015	1Q16	2013	2014	2015	1Q16
Corporate	**47%**	**43%**	**40%**	**39%**	**0.12%**	**0.39%**	**0.73%**	**0.80%**
Manufacturing	7%	6%	6%	6%	0.40%	1.15%	2.16%	2.30%
Production of electric and heating power, gas & water	7%	6%	5%	5%	0.00%	0.02%	0.02%	0.04%
Wholesale & Retail	3%	3%	2%	2%	0.72%	2.61%	4.25%	5.03%
Mining	2%	1%	2%	1%	0.00%	0.16%	0.26%	0.25%
Real estate	1%	1%	2%	2%	0.07%	0.05%	0.02%	0.04%
Construction	1%	1%	2%	2%	0.07%	0.34%	0.80%	0.89%
Other corporate	27%	24%	21%	20%	0.03%	0.00%	0.10%	0.18%
Discount bills	**3%**	**6%**	**11%**	**13%**	**0.01%**	**0.00%**	**0.00%**	**0.00%**
Retail	**49%**	**51%**	**49%**	**49%**	**0.92%**	**0.92%**	**1.04%**	**1.02%**
Mortgages	20%	21%	23%	24%	0.09%	0.14%	0.22%	0.23%
Personal business loans	16%	15%	12%	11%	0.35%	0.69%	1.50%	1.68%
Others	13%	15%	14%	13%				
Total	**100%**	**100%**	**100%**	**100%**	**0.51%**	**0.64%**	**0.80%**	**0.81%**

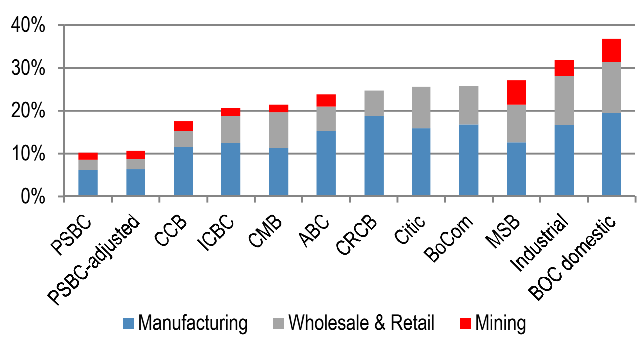
Source: Company data, J.P. Morgan.

Table 21: PSBC – Breakdown of investments in trust investment plans and asset management plans by industry, as of 1Q16

Rmb in millions	Trust investment plans	AMPs	Total	% of total
Public facilities management	22,251	36,887	59,138	13%
Real estate and construction	6,024	15,447	21,471	5%
Manufacturing	3,318	1550	4,868	1%
Production and supply of electricity, gas, water	1,234	14,505	15,739	4%
Financial services	127,942	196,693	324,635	73%
Mining	597	3,233	3,830	1%
Leasing and commercial services	2,062	11293	13,355	3%
Hotels, catering, culture	435	2666	3,101	1%
Total	**163,863**	**282,274**	**446,137**	**100%**

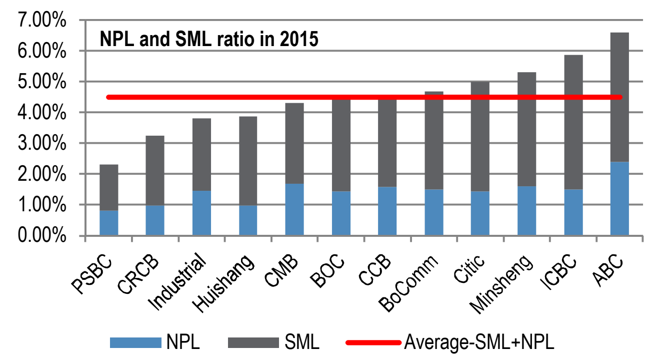
Source: Company data

Figure 40: Manufacturing, Wholesale & Retail and Mining loans as a % of total loans (as of 2015)



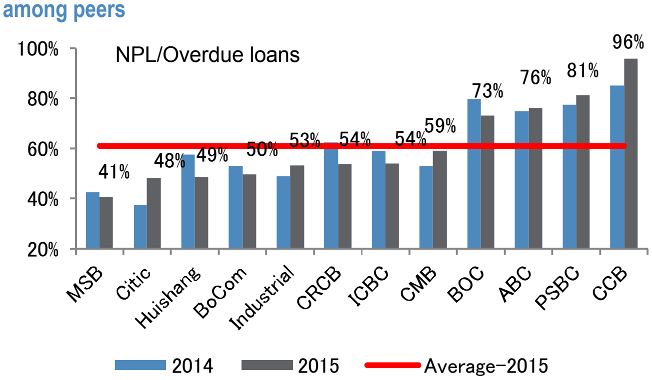
Source: Company data. Note: For Citic, BoCom and CRCB, we include only Manufacturing and Wholesale & Retail loans. For PSBC-adjusted, we add back the portion of trust investment plans and asset management plans that invested in the aforementioned sectors.

Figure 41: NPL + SML ratio by bank – PSBC is the lowest among peers and the only bank showing a yoy decline



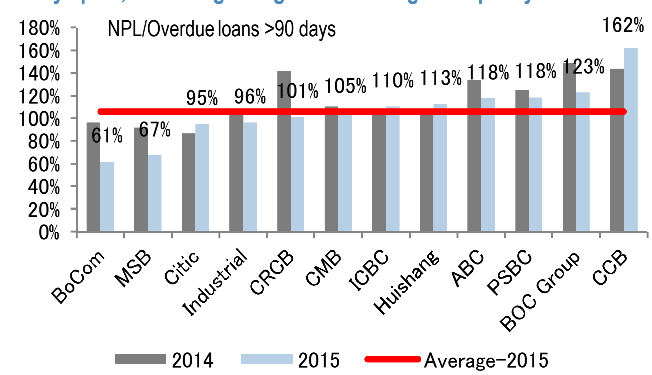
Source: Company data

Figure 42: CCB and PSBC have the highest NPL/overdue loans among peers



Source: Company data

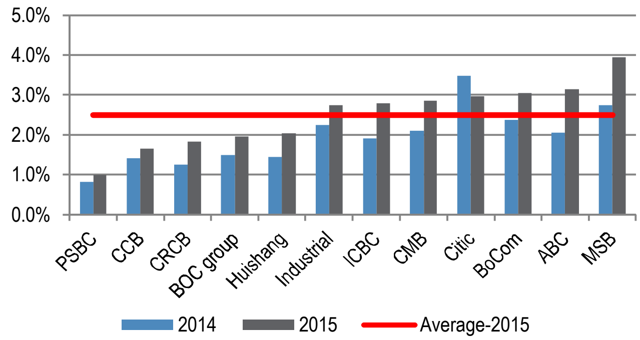
Figure 43: Big banks have recognized more NPLs than loans overdue 90 days plus, indicating stringent NPL recognition policy



Source: Company data

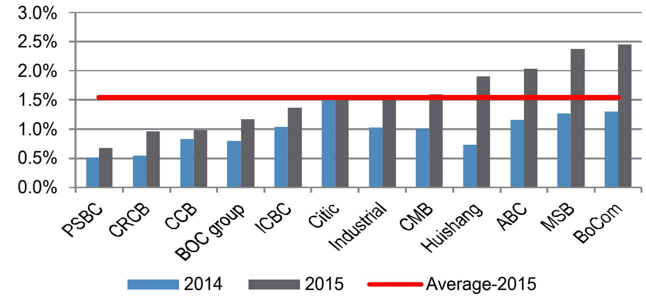
Katherine Lei
(852) 2800-8552
katherine.lei@jpmorgan.com

Figure 44: PSBC has the lowest overdue loan ratio among peers



Source: Company data

Figure 45: PSBC has the lowest overdue loan ratio (>90 days) among peers



Source: Company data

Table 22: Loans to LGFV and overcapacity sectors – PSBC and Big 4 banks

	LGFV loans			Loan to overcapacity sectors			Loans to LGFV + overcapacity sectors as % of total loans		
Rmb in billions	2014	2015	1Q16	2014	2015	1Q16	2014	2015	1Q16
PSBC	95	101	106	40.7	67.3	67.5	7.23%	6.79%	6.51%
ABC	334	NA	NA	NA	NA	NA	4.12%	N/A	N/A
BOC	350	310	NA	164.2	163.4	NA	6.06%	5.18%	N/A
CCB	346	292	NA	133.8	130.3	NA	5.06%	4.03%	N/A
ICBC	464	NA	NA	NA	NA	NA	4.20%	N/A	N/A
Big 4 average							**4.86%**	**4.60%**	**N/A**

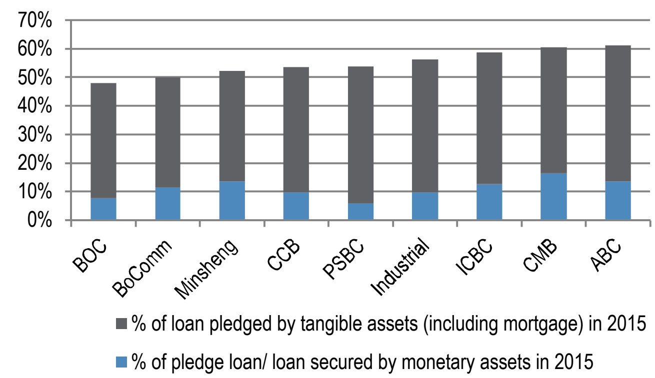
Source: Company data

Table 23: PSBC – Loans by collateral

Type of collateral	2013	2014	2015	1Q16
Loans secured by mortgages	49%	50%	48%	47%
Unsecured loans	29%	28%	27%	26%
Discounted bills	3%	6%	11%	13%
Guaranteed loans	11%	10%	9%	8%
Loans secured by pledges	8%	6%	6%	6%
Total	100%	100%	100%	100%

Source: Company data

Figure 46: Loan pledged by monetary assets and tangible assets as a % of total loans for national bank, as of 2015



Source: Company data. Note: We use loan secured by monetary assets if pledged loan is not given.

Low credit risks on overall balance sheet

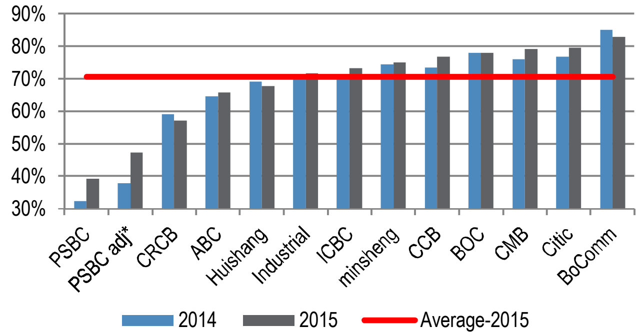
In addition to better asset quality in its loan book, PSBC enjoys lower overall balance sheet risk than peers.

- **Low LDR ratio, even if we count non-standardized investment assets on the balance sheet:** PSBC's loan-deposits ratio was 39.6% at end-1Q16, the lowest among peers. Even if we add the NSAs on-balance-sheet back to loan book, the adjusted LDR ratio is 46%, still the lowest among national banks we cover. This indicates that balance sheet risk is lower than peers'.

Katherine Lei
(852) 2800-8552
katherine.lei@jpmorgan.com

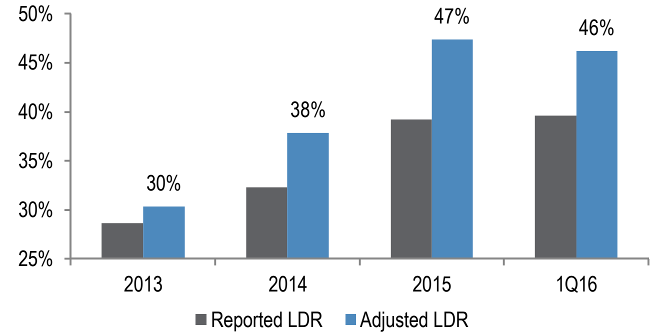
- **Low risk in non-lending book:** Government or quasi-government (i.e., policy banks and PBOC) issued securities accounted for 16.2% of total assets at end-2015, the highest among banks we cover (Figure 50). This is another reason for the low balance sheet risk.
- **Low risk-taking on balance sheet:** Risk-weighted assets as a % of total assets was 42% at end-1Q16, the lowest among banks we cover (Figure 49).

Figure 47: PSBC has the lowest LDR among peers



Source: Company data. Note: We add back asset management plans and trust investment plans to loan book to calculate adjusted LDR.

Figure 48: PSBC – Adjusted LDR



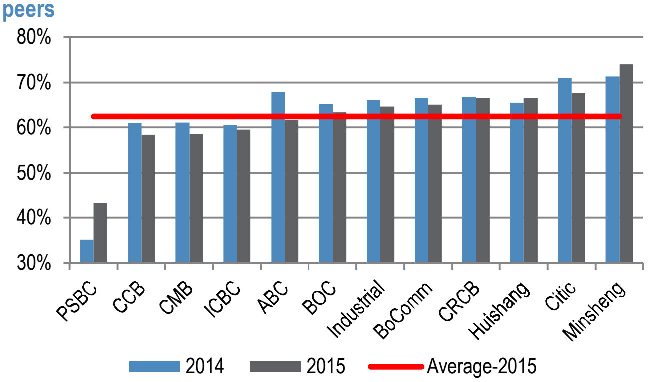
Source: Company data, J.P. Morgan estimates. Note: We add back asset management plans and trust investment plans to loan book to calculate adjusted LDR.

Table 24: PSBC – Breakdown of investment book by issuer

	2013	2014	2015	1Q16
Gov't & quasi-government	28%	22%	13%	14%
Financial institutions	68%	74%	84%	82%
Corporates	4%	5%	2%	2%
Others (AMP, CDs)	0%	0%	1%	2%
Total investments	**100%**	**100%**	**100%**	**100%**

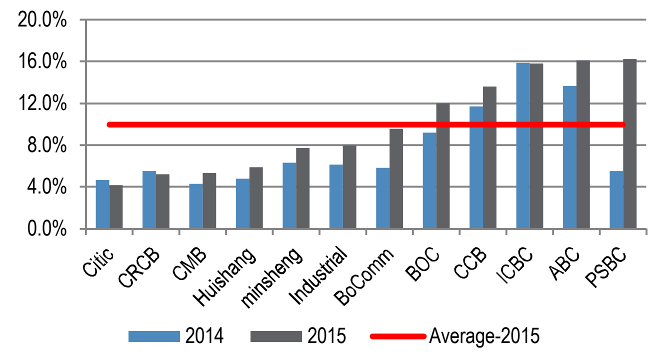
Source: Company data, J.P. Morgan

Figure 49: PSBC – RWA as a % of total assets is the lowest among peers



Source: Company data

Figure 50: Investment in government/quasi-government bonds as a % of total assets – PSBC ranked at the top among peers



Source: Company data

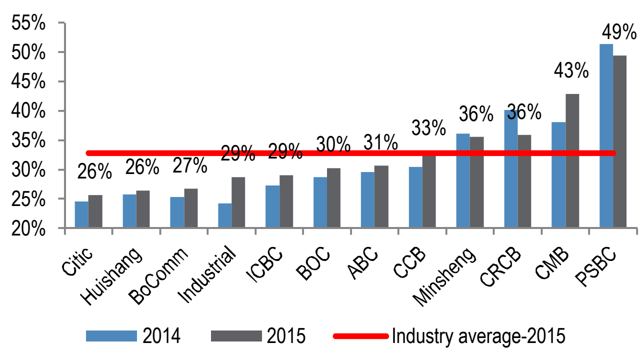
Katherine Lei
(852) 2800-8552
katherine.lei@jpmorgan.com

Largest client base with special focus on retail business

Focus on retail banking in China

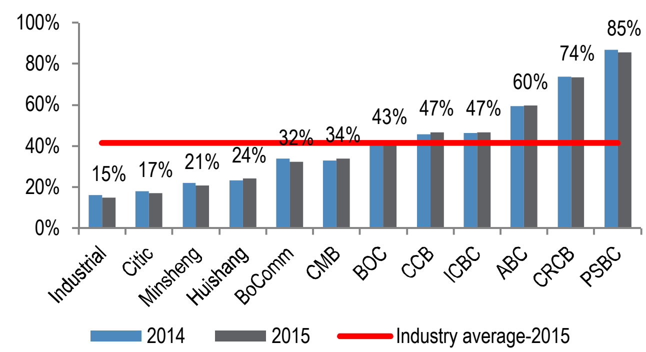
- **Largest client base:** PSBC has 505mn retail customers in China, about 37% of the population and the highest among banks (Figure 54).
- **Highest retail contribution to financials:** Retail business contributed 49% of loans and 85% of deposits at end-2015, the highest among peers (Figures 51-52). Retail business contributed to 46.0% of pretax profits in 2015, second only to CMB at 46.3% and significantly above the Big 4 average of 34% (Figure 53).
- **Leveraging retail strength to grow its loan book:** Growth in retail loans (excluding personal business and micro loans) increased at a CAGR of 45% over 2013-2015, the highest among peers and significantly above the peer average of 19% (Figure 55).
- **Joint venture with DBS to explore opportunities in consumer financing:** PSBC cooperated with Singapore bank DBS in 2015 to form a consumer financing company in which PSBC held a 61.5% of stake as of 31 March 2016. The subsidiary is still in the initial development stage, with a loan book of Rmb482mn and 12,821 customers, but demonstrates PSBC's focus on retail business and ability to cooperate with its strategic shareholder on business development.
- **Leveraging the experience of strategic shareholders:** UBS, J.P. Morgan and DBS are PSBC's strategic investors. There could be exchanges in experience in terms of credit card business and, potentially, wealth management business.

Figure 51: Retail loans as % of total loans – PSBC ranks at the top among peers



Source: Company data

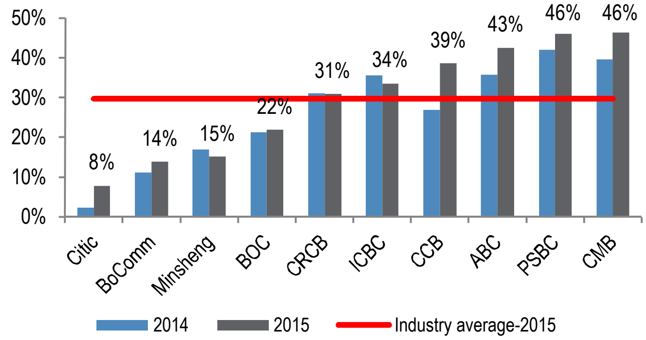
Figure 52: Retail deposits represented 85% of total deposits for PSBC



Source: Company data

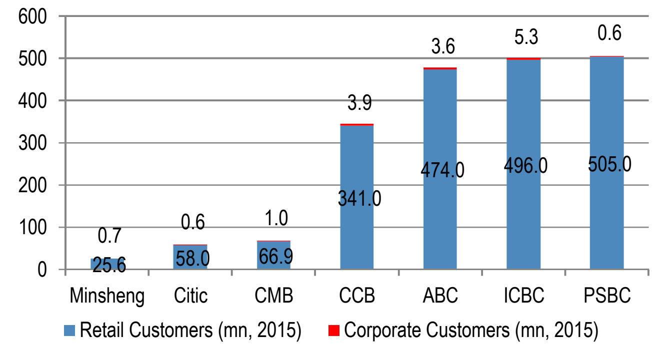
Katherine Lei
(852) 2800-8552
katherine.lei@jpmorgan.com

Figure 53: Retail contribution to PBT– CMB and PSBC have the strongest retail franchises among peers



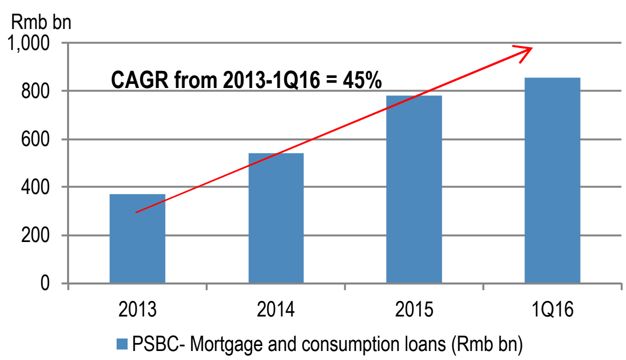
Source: Company data

Figure 54: PSBC has the largest amount of retail customers among major banks



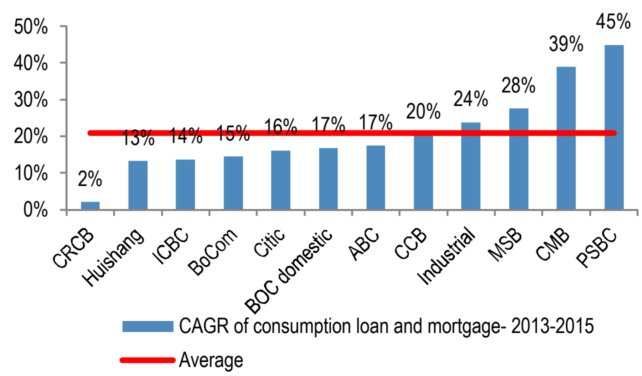
Source: Company data. For PSBC, data are as of March 2016.

Figure 55: PSBC's mortgage and consumption loans grew at a 45% CAGR over 2013-1Q16



Source: Company data

Figure 56: Mortgage and consumption loans 2013-2015 CAGR by bank



Source: Company data

Table 25: PSBC's potential collaborations with strategic shareholders on retail business

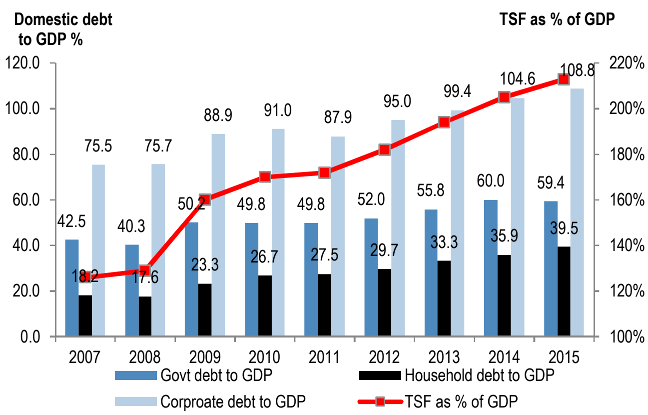
	Comments
Joint venture with DBS to explore opportunities in consumer financing	- PSBC collaborated with DBS in 2015 to form a consumer financing company; PSBC held a 61.5% stake as of 1Q16 - Still in initial stages of development, with loan book of Rmb482mn and 12,821 customers - Shows focus on retail business and ability to cooperate with strategic shareholders
Leverage experience of DBS/UBS on credit cards/WM	– PSBC could leverage the experience of DBS, J.P. Morgan and UBS in developing credit card and wealth management businesses
Collaboration with Ant Finance/Tencent	- PSBC has already pushed out new online lending products by leveraging Alipay and Alibaba's Tmall platform - PSBC is also developing scenario-based finance products, such as collaborating with Ant Financial and Tmall to conduct an "instant auto loan" business by connecting PSBC's business system with e-commerce platforms; this allows users to apply for loans on such online platforms directly - PSBC established its "Weibank" service to provide banking services on Internet social platforms, including WeChat (1.47mn customers registered for its WeChat banking platform)

Source: Company data, J.P. Morgan

Growth of retail business is key driver of banking profits

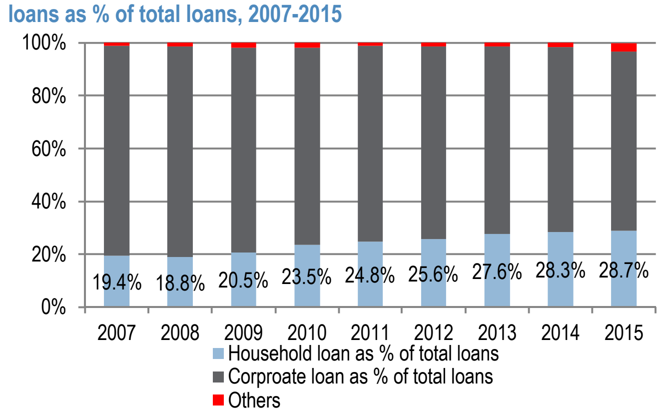
- **Low household leverage propels growth:** China's household leverage was 40% of GDP at end-2015, significantly lower than international peers' (Figure 57). Household loans account for only 29% of total loans in China, lower than for regional peers (Figure 58). This indicates that there is room for China's households to leverage up and suggests a revenue opportunity for banks.
- **China's retail banking is under-penetrated:** China's credit cards per capita is 0.32 and household loans per capita is US$3,000, both significantly lower than the international averages, as shown in Figures 63 and 64. We see potential for growth in both areas.
- **Household loans entail lower credit risks** for the following reasons: (1) household leverage was 40% of GDP at end-2015 vs corporate loans at 109%; (2) industrial enterprises' earnings growth was -3% in 2015, but disposable income per capita growth in China was 9%, and the CAGR was 11% over 2011-2015; and as such (3) the NPL ratio for corporate loans was 2.39% at end-2015, while retail loans' NPL ratio was only 1.01% for banks under our coverage.

Figure 57: China's system leverage continues to edge up, especially for corporate debt



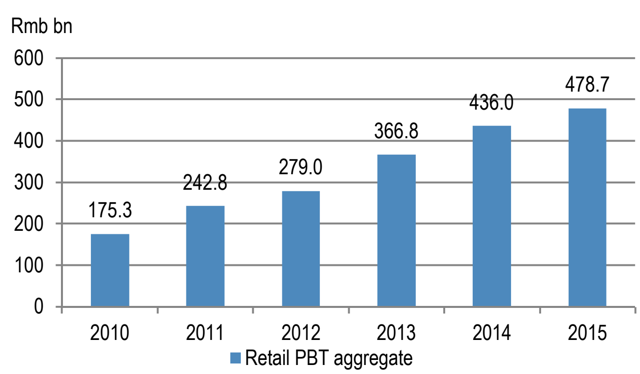
Source: BIS, CEIC, J.P. Morgan Economics team

Figure 58: China's retail loans as % of total loans, and corporate loans as % of total loans, 2007-2015



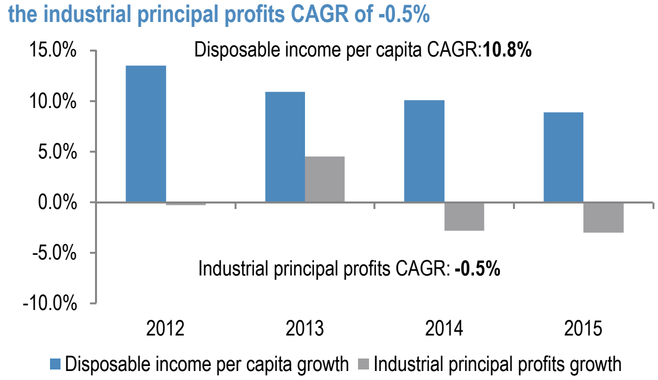
Source: CEIC

Figure 59: Retail income grew at a 22% CAGR for national banks over 2010-15



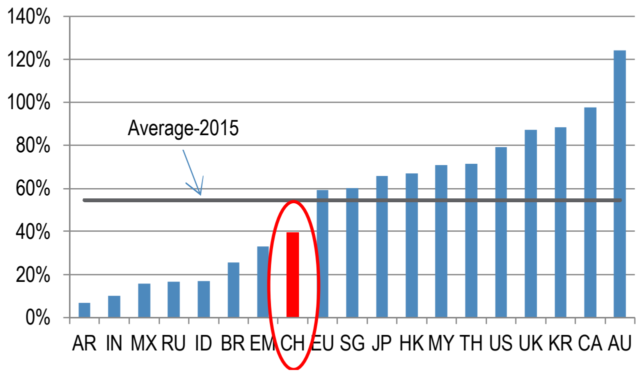
Source: Company data. Note: The retail PBT aggregate includes ABC, BOC, CCB, ICBC, BoCom, Citic, CMB and Minsheng.

Figure 60: Disposable income grew at an 11% CAGR (2011-2015) vs the industrial principal profits CAGR of -0.5%



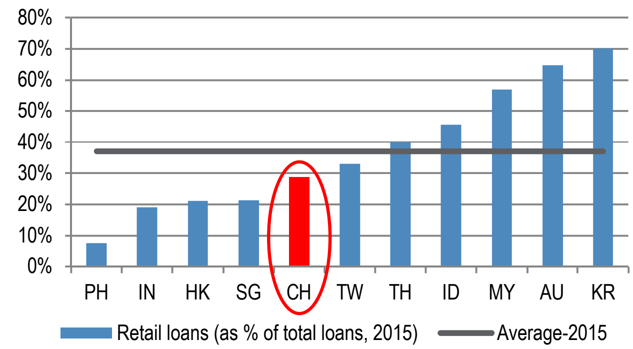
Source: CEIC

Figure 61: Retail leverage in China is relatively low (household debt/GDP as of 2015)



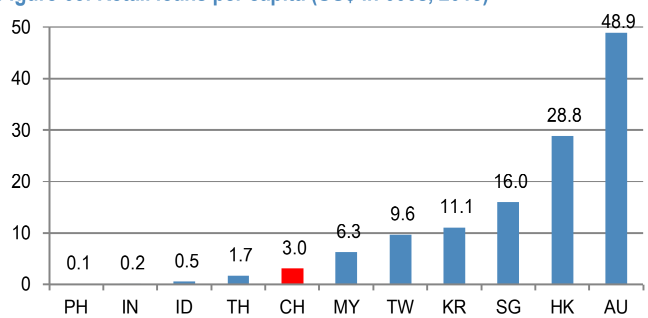
Source: BIS

Figure 62: Retail loans (as % of total loans, 2015)



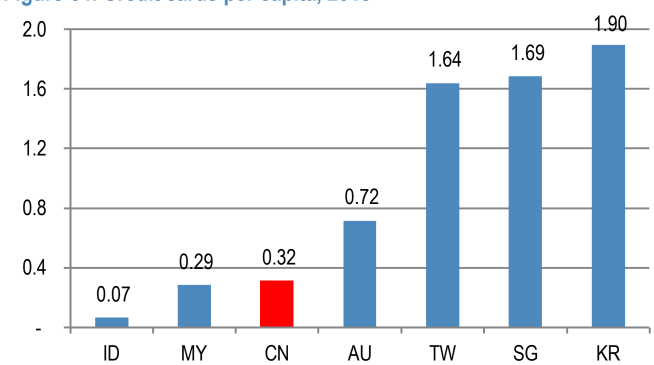
Source: CEIC

Figure 63: Retail loans per capita (US$ in 000s, 2015)



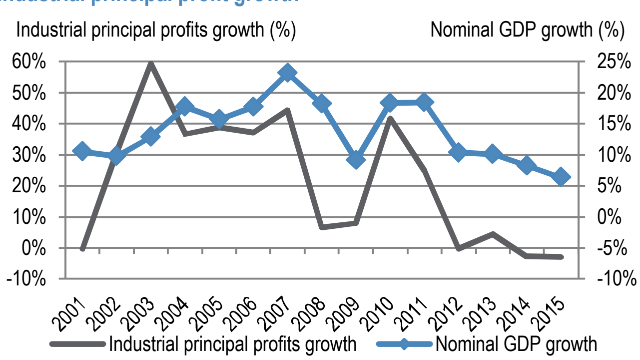
Source: CEIC, Bloomberg

Figure 64: Credit cards per capita, 2015



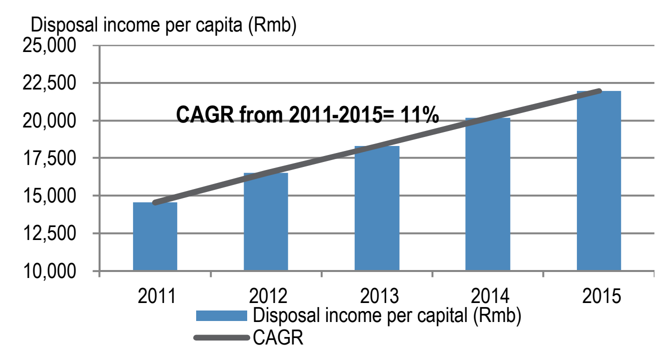
Source: CEIC. Note: For CN and KR, number of cards issued; for AU, number of accounts; for TW and MY, cards in circulation; for SG, number of main + supplementary cards.

Figure 65: Nominal GDP growth has a positive relationship with industrial principal profit growth



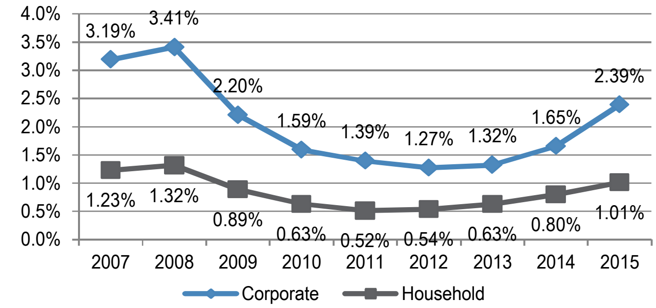
Source: CEIC

Figure 66: Disposal income per capita grew 9% yoy in 2015



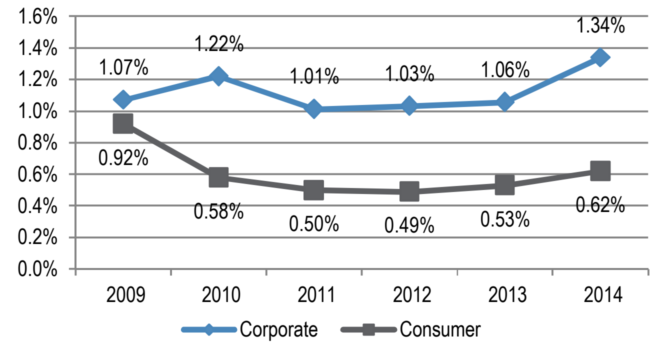
Source: CEIC

Figure 67: NPL ratio of national banks under J.P. Morgan coverage – Corporate vs consumer



Source: Company data. Note: Based on J.P. Morgan coverage banks, excluding BoCom, CRCB and Huishang.

Figure 68: System NPL ratio – Corporate vs consumer



Source: CBRC, CEIC. Note: Corporate NPL ratio is estimated from the sector breakdown.

Solid distribution network and balance sheet liquidity

Largest distribution network

By leveraging the agency outlets of China Postal Group, PSBC has the largest distribution network in China, as of 31 March 2016.

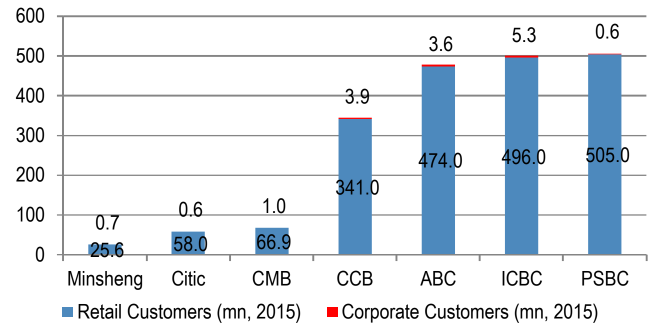
- **PSBC has the largest distribution network in China**, with 40,057 branch outlets. Among these, 8,301 are directly operated by PSBC and 31,756 are agency outlets operated by parent China Postal Group (Figure 70).
- **Low level of competition in county areas:** 71.2% of PSBC's branch outlets were in county areas, covering 98.9% of county areas in China. ABC, an SOE bank with significant exposure in county areas, has only 23,670 outlets (as of end-2015).
- **Balanced geographic exposure:** 33.3% of the outlets are located in China's economically developed areas (Yangtze River Delta, Pearl River Delta and Bohai Rim), 28.5% in Western China, 27% in Central China and 11.2% in Northern China.

Table 26: Branch outlets by geography, as of FY15

	PSBC	ICBC	CCB	BOC	ABC
Head Office	-	30	3		8
Yangtze River Delta	4,760	2,637	2,453	3,614	3,122
Bohai Rim	5,416	2,855	2,426	1,901	3,386
Pearl River Delta	3,144	2,133	1,904	2,804	2,594
Central China	10,810	3,676	3,607		5,255
Northeastern China	4,497	1,765	1,475	953	2,269
Western China	11,428	3,906	3,049	1,717	7,036
Total domestic	40,055	17,002	14,917	10,989	23,670
% of total					
Head Office	0%	0%	0%	0%	0%
Yangtze River Delta	12%	16%	16%	33%	13%
Bohai Rim	14%	17%	16%	17%	14%
Pearl River Delta	8%	13%	13%	26%	11%
Central China	27%	22%	24%		22%
Northeastern China	11%	10%	10%	9%	10%
Western China	29%	23%	20%	16%	30%
Total domestic	100%	100%	100%	100%	100%

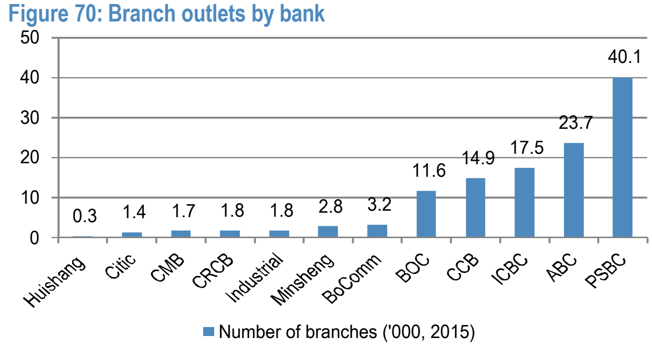
Source: Company data.
Note: The categorization of BOC is different from others. We group outlets in Eastern China under Yangtze River Delta, outlets in Northern China under Bohai Rim, outlets in Central and Southern China under Pearl River Delta and Central China.

Figure 69: Retail and corporate customers of China banks



Source: Company data. Note: PSBC as of 1Q16.

Figure 70: Branch outlets by bank

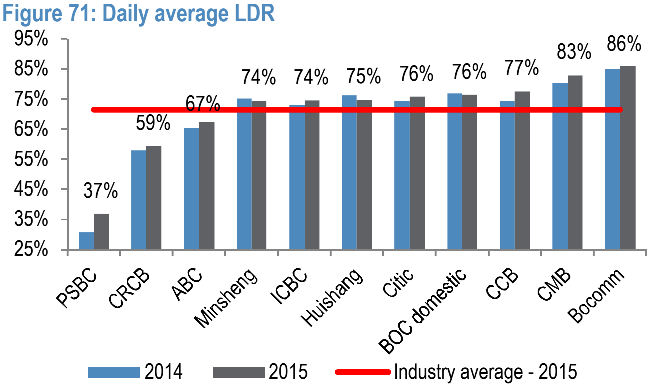


Source: Company data. Note: PSBC include agency outlets.

Stable funding sources

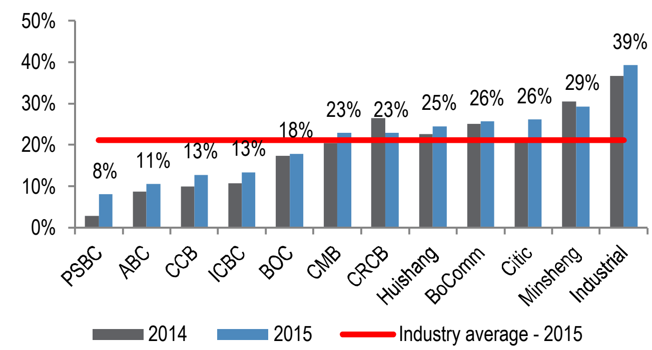
- **Stable source of funding:** Ninety-seven percent of PSBC's daily interest-bearing liabilities (IBLs) were customer deposits in 2015, significantly higher than peers' 76%. Only 9% of IBLs are interbank funds.
- **Low LDR indicates room for improvement:** On a daily average basis, the loan-deposits ratio (LDR) was only 37% in 2015, significantly lower than the industry average of 71% and the Big 4 average of 74%.
- **Ability to lock in relatively high-yield investments with long-term stable funding:** In an environment of declining asset yields, PSBC is able to invest in long-duration investments with stable returns.

Figure 71: Daily average LDR



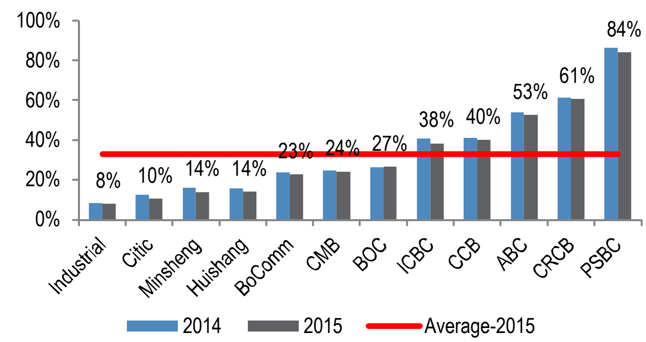
Source: Company data

Figure 72: Interbank funding as % of total funding (daily average)



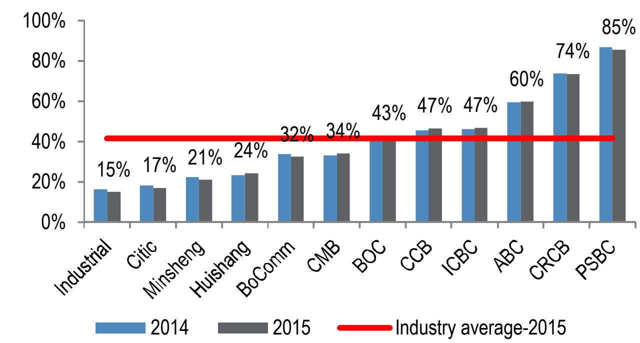
Source: Company data. Note: Interbank liabilities as % of total IBL.

Figure 73: Daily average retail deposits as % of average IBL



Source: Company data.

Figure 74: Retail deposits as % of total deposits



Source: Company data.

Leader in SME financing – positioned for growth in low-yield environment

Only outlets directly owned by PSBC can conduct lending business. And 6,563 outlets out of the total 8,301 are engaged in SME lending. Total SME loans accounted for 25% of PSBC's loan book at the end of 2015, the highest among national banks we cover (Figure 75).

High exposure to SME leads to the highest lending yield among peers

As at end 1Q16, SME loans included the following (Table 27):

- Loans to small enterprises of Rmb159.6bn in its corporate loan book, accounting for~6.0% of loans. The lending yield was about 6.53% in 1Q16, ~50% above the one-year benchmark lending rate (4.35%);
- Personal business loans of Rmb303.5bn in its retail book, accounting for 11.4% of total loans. The lending yield of the personal business loan was 6.58% in 1Q16, 51% above the one-year lending rate (4.35%);
- Micro loans of Rmb138.9bn in its retail book, accounting for 5.20% of total loans. The lending yield micro loan was 10.62% in 1Q16, ~144% above the one-year lending rate (4.35%).

Banks charge a higher premium on SME loans. This explains why PSB's lending yield is the highest among peers (Figures 77-78).

Table 27: PSBC's SME loans – balance and NPL ratio

	Loan balance				NPL ratio			
	2013 Rmb mn	2014 Rmb mn	2015 Rmb mn	1Q16 Rmb mn	2013 %	2014 %	2015 %	1Q16 %
Loan to small enterprise	134,908	149,044	166,131	159,607	0.51%	1.57%	3.40%	4.17%
Personal business loans	237,486	286,971	304,930	303,460	0.35%	0.69%	1.50%	1.68%
Micro loans-consumer	123,719	134,477	136,207	138,876	4.36%	4.33%	4.22%	3.83%
Total SME loans	496,113	570,492	607,268	601,943	1.39%	1.77%	2.63%	2.84%
As % of total loans	33%	30%	25%	23%				
Total loan	1,492,605	1,875,748	2,471,853	2,665,754	0.51%	0.64%	0.80%	0.81%

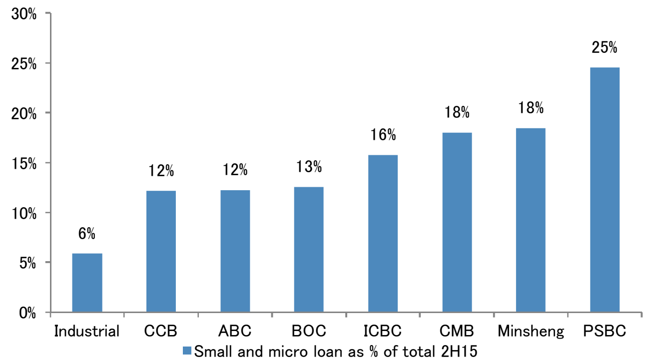
Source: Company data

Table 28: Lending rates of PSBC's SME business

	2013	2014	2015	1Q16
Weighted average contractual rate of MSE loans				
Loan to small enterprise	7.58%	7.63%	6.80%	6.53%
personal business loan	8.05%	8.11%	7.33%	6.58%
micro loan-consumer	13.22%	12.43%	11.07%	10.62%
Overall MSE loans	**9.20%**	**8.99%**	**8.03%**	**7.49%**
PSBC overall lending yield	7.14%	6.97%	6.24%	5.18%
MSE loans vs overall lending yield	*29%*	*29%*	*29%*	*45%*
1-year benchmark lending rate	6.00%	5.97%	4.95%	4.35%
MSE loan yield vs 1yr benchmark lending rate	*53%*	*51%*	*62%*	*72%*

Source: Company data, J.P. Morgan calculations, CEIC

Figure 75: Loans to small and micro enterprises as a percentage of total loans for major China banks as of 2015



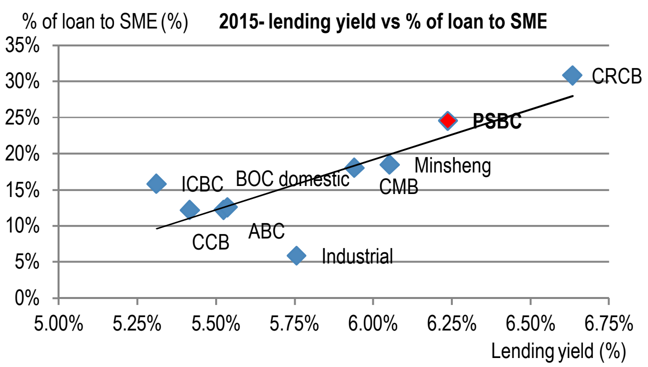
Source: Company data

Figure 76: PSBC – Higher risk-adjusted returns of MSE loans over the years

	2013	2014	2015	1Q16
MSE loans				
Yield	9.20%	8.99%	8.03%	7.49%
NPL ratio	1.39%	1.77%	2.63%	2.84%
Risk adjusted return	**7.81%**	**7.22%**	**5.40%**	**4.65%**
Overall loans				
Yield	7.14%	6.97%	6.24%	5.18%
NPL ratio	0.51%	0.64%	0.80%	0.81%
Risk adjusted return	**6.63%**	**6.33%**	**5.44%**	**4.37%**

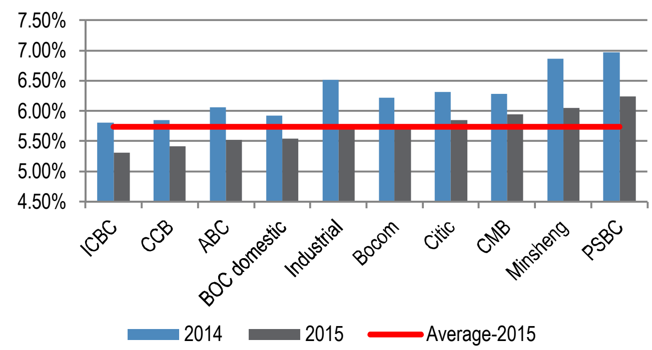
Source: Company data

Figure 77: PSBC's and CRCB's lending yield and percentage of loans to SMEs in 2015 are ahead of peers



Source: Company data

Figure 78: Lending yield of major China banks



Source: Company data

Leveraging the experience of international peers

- Cooperating with GIZ (Deutsche Gesellschaft für Internationale Zusammenarbeit) to develop micro loan products: GIZ is a company representing the German government to execute technical assistance projects in developing countries in "Micro Loans and Retail Banking Business Project". PSBC's cooperation with GIZ on micro loans won GIZ's "the crowning achievement award for international cooperation project".
- Learning from Bank Rakyat Indonesia (BRI): on credit staff selection, training, risk management and customer retention, etc. BRI went public in Indonesia in 2003; it has a special focus on SME lending, which accounted for 53% of its loan book as of 1Q16.

Leverage on e-banking platform

PSBC launched the Mobile Business Development platform in 2015. It also leverages big data systems to enhance its credit risk management. For details, please refer to the section on the next page.

Katherine Lei
(852) 2800-8552
katherine.lei@jpmorgan.com

Table 29: Examples of PSBC's efforts to leverage e-banking platform and experience of international peers

Learning from international peers

- **Cooperate with GIZ** (Deutsche Gesellschaft für Internationale Zusammenarbeit), a company representing the German government to execute technical assistance projects in developing countries, **on "Micro Loans and Retail Banking Business Project"** to develop micro-loan products. The project won GIZ's "the crowning achievement award for international cooperation project".
- **Learning from Bank Rakyat Indonesia (BRI)**: on credit staff selection, training, risk management and customer retention, etc. BRI went public in Indonesia in 2003, it has a special focus on SME lending, which accounted for 53% of its loan book as of 1Q16.

Developing e-banking platform

- **Launched the Mobile Business Development platform** in 2015. And it also leverages big data systems to enhance its credit risk management.
- **Expanding the e-banking platform,** which includes (1) developing and obtaining patents for its cloud data systems in 2012, (2) developing and registering copyrights for various software, including its retail customer marketing system, corporate customer marketing system, Mobile Business Development System, and Outlet Centralization System

Source: Company data

e-Banking opportunity – synergy with Alibaba and Tencent

PSBC has been investing in its IT system to expand its e-banking platform. For example, PSBC developed and obtained patents for its cloud data systems in 2012. It also developed and registered copyright for various software, including its retail customer marketing system, corporate customer marketing system, Mobile Business Development System, and Outlet Centralization System. Achievement and recognition includes:

- Its mobile banking transaction reached Rmb517bn in 1Q16, and a CAGR of 343% from 2013-2015;
- Number of Wechat followers reached 2.37mn (0.5% of its total customers), representing a CAGR of 351% from 2013-1Q16.
- PSBC received multiple awards in e-banking from 2013-2015 (Table 31).
- PSBC has been able to push out new online lending products by leveraging Alipay and Alibaba's Tmall platform. And PSBC has 1.47mn customers registered on its WeChat banking services platform.

For details, please refer to Table 30.

Table 30: PSBC-Internet banking data

	2013	2014	2015	1Q16	CAGR-2013-1Q16
Number of registered customers (mn)					
Mobile banking	34.5	N/A	N/A	106.6	65%
Online banking- Personal	73.7	N/A	N/A	135.3	31%
Electronic banking	85.2	N/A	N/A	158.4	32%
Telephone banking	74.5	N/A	N/A	107.0	17%
Transactions amount (Rmb bn)					**CAGR-2013-2015**
Mobile banking	69.6	N/A	1,366.1	517.0	343%
Online banking- Personal	1,114.6	N/A	1,780.4	485.0	26%
No of Wechat followers (mn)	0.08	N/A	N/A	2.37	351%*
Number of customers of Wechat banking services (mn)	N/A	N/A	N/A	1.47	N/A
% of transactions through electronic banking channel	50.0%	N/A	N/A	73.8%	N/A

Source: Company data, J.P. Morgan. (Note: Electronic banking entails both online banking and online-to-offline transactions, like ATM. *CAGR from 2013-1Q16)

Katherine Lei
(852) 2800-8552
katherine.lei@jpmorgan.com

Table 31: PSBC has received awards from numerous institutions for its internet banking since 2013

Year	Award
2013	2013 Best mobile banking in China
2013	2013 Best Online Banking Security Award
2014	Best Electronic Banking User Experience Award
2014	Electronic Banking Top Security Award
2015	"2015 China's Internet Financial Development Innovation Award"
2015	2015 Best WeChat Platform in Financial Industry
2015	2015 Best Mobile Banking Security Award in China
2015	2015 Best Online Banking User Experience Award in China

Source: Company data

Internet finance + rural e-commerce

- PSBC provides collection and payment agency services for the New Rural Social Endowment Insurance (NSEI) and the New Rural Cooperative Medical Services (NCMS) schemes. Therefore PSBC has access to customers in rural areas. Customers in County Areas business contributed 69.5% and 70.1% of its total retail deposits, and retail customer population as of 1Q16 respectively
- However a significant proportion of clients in county/rural areas access financial services through agency outlets operated by China Postal Group. This means the chances of expanding lending and fee business to these clients are limited. On the other hand, opening a directly operated branch outlet in county areas is not cost efficient.
- One way to leverage its vast client resources in economically less developed areas is to leverage internet or mobile banking; this offers high operating leverage as the marginal cost after the initial investment is low.

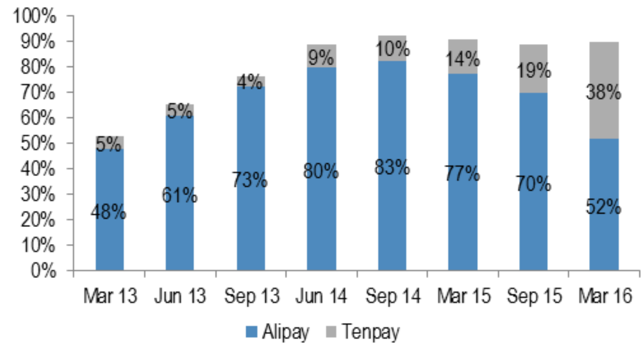
Synergy with strategic investors Ant Finance and Tencent

Ant Finance and Tencent are strategic investors of PSBC. They each held 1.08% and 0.19% of PSBC as at the end of 1Q16. The aggregate market share of Tenpay and Alipay, online payment subsidiaries of Tencent and Ant Finance, have more than 90% of market share in third-party mobile payment in China (Figure 79).

There could be synergies for PSBC and these two fintech companies, in our view. Examples are as follow:

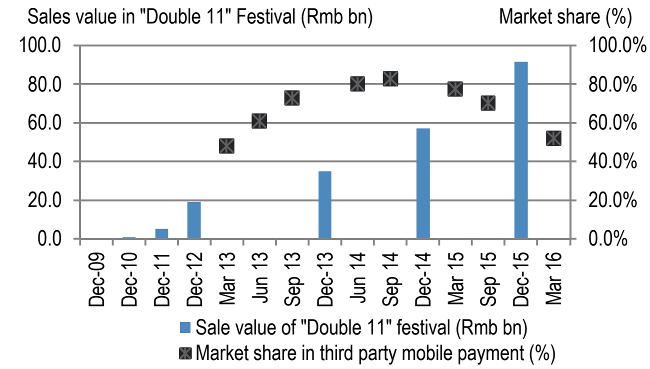
- ***Ant Finance & Alibaba's Tmall***: PSBC actively develops scenario-based internet finance products, such as cooperating with Ant Financial and Alibaba's Tmall to conduct the business of instant auto loans. This connects PSBC's business system with external e-commerce platforms, which enables consumers to apply for loans on such an online platform directly when purchasing cars on e-commerce platforms. PSCB's credit system is able to receive and handle the online loan applications passed from e-commerce platforms, review and approve loan applications, and extend loans.
- ***Tencent (Wechat)***: PSBC established a "Weibank" service system by providing banking services on internet social platforms including WeChat, EasyChat and Weibo since 2013. PSCB is the first commercial bank to provide financial services on both EasyChat and Weibo platforms. Customers can sign up their WeChat banking services to use basic debit card and credit card services, as well as other services such as fee payment. The number of Wechat followers increased from 80,000 in 2013 to 2.37mn at the end of 1Q16; of these 1.47mn signed up for PSBC's WeChat banking services.

Figure 79: Market share of Tenpay & Alipay in third-party mobile payment



Source: WIND

Figure 80: Market share of Alipay in third-party mobile payment vs sales value of "Double 11" Festival



Source: WIND

Table 32: Internet finance products offered by PSBC

Name of product	Date of launch	Details
車秒貸	Jun-16	To connect PSBC's business system with external platforms enables clients to apply for loans on such online platforms directly when purchasing cars on e-commerce platforms. PSBC's personal credit system is able to receive and handle the online loan applications passed from e-commerce platforms, review and approve loan applications and extend loans
E convenient loan	2014	An internet-based product to enable PSBC to carry out online applications, drawdowns and repayments
Express loan	N/A	Product offered to small and micro business owners who run a stable business with high-quality guarantees. This product aims to improve the customer experience by shortening the processing time
PSBC e-loan	N/A	Online loan brand under which PSBC provides products for small enterprises customers, operatos of small-scale supermarkets, etc.
Convenient Merchant loan	N/A	Loans offered to operators of small-scale supermarkets
Mobile Business Development System	2015	To enable client managers to use a secured mobile network terminal for paperless operations such as pre-loan due diligence and post-loan management.
PSBC Student Loan	N/A	Online loan products offered to students
PSBC Wage-earners loan	N/A	Online loan products offered to salaried workers
PSBC Prime Loan	N/A	Online loan products offered to high-quality customers

Source: Company data

Set to close gap with peers

Despite its fast development of e-banking in recent years, PSBC's e-banking business trails the early-movers by a wide margin (Table 33). For example,

- Average mobile transaction per user of PSBC is Rmb19,400, lower than the average of BOC, CCB and ABC of Rmb72,500 (ICBC does not have relevant disclosures);
- In the average online transaction per customer, we see an even bigger gap (Figure 82); we believe this is partly because PSBC is relatively weak in corporate banking business, which may primarily transact through online banking.

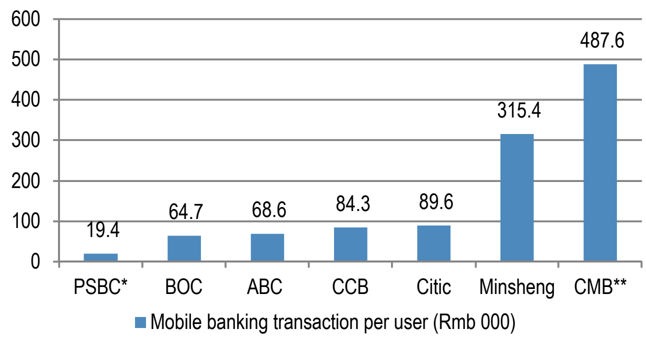
Due to the rising penetration of smartphones in China, we believe it will increase the rural population usage of mobile banking services.

Table 33: PSBC's e banking business is lagging behind peers in terms of transaction volume

	Number of customers (mn)								Transaction amount (Rmb tn)							
	Mobile banking				Online banking				Mobile banking				Online banking			
	2013	2014	2015	1Q16	2013	2014	2015	1Q16	2013	2014	2015	1Q16	2013	2014	2015	1Q16
PSBC *	34.5	N/A	N/A	106.6	73.7	N/A	N/A	135.3	0.07	N/A	1.37	0.52	1.1	N/A	1.8	0.5
ICBC	N/A	N/A	N/A	N/A	~100	180.0	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
CCB	117	146.8	182.8	N/A	152.8	182.0	212.8	N/A	3.67	7.38	15.42	N/A	136.8	168.4	222.6	N/A
ABC	83.0	111.0	140.0	N/A	113.4	138.2	153.8	N/A	1.55	5.49	9.60	N/A	170.2	175.0	184.5	N/A
BOC	52.1	64.6	80.0	N/A	103.3	115.1	125.3	N/A	0.37	2.05	5.18	N/A	106.6	131.9	149.1	N/A
BoCom	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	0.88	1.13	4.06	N/A	N/A	N/A	N/A	N/A
Citic	3.4	6.5	12.7	N/A	10.5	N/A	N/A	N/A	0.02	0.12	1.14	N/A	33.6	N/A	N/A	N/A
CMB **	5.6	11.8	18.9	N/A	16.1	19.2	21.8	N/A	1.14	3.56	9.20	N/A	53.8	74.5	114.0	N/A
Minsheng	5.5	13.0	19.0	N/A	7.8	12.1	N/A	N/A	1.13	3.22	6.00	N/A	28.9	54.4	N/A	N/A
Huishang	0.1	0.3	0.7	N/A	1.1	1.3	1.7	N/A	0.00	0.00	0.04	N/A	1.9	2.2	1.6	N/A
CRCB	1.3	2.2	3.8	N/A	N/A	N/A	N/A	N/A	0.42	0.74	0.88	N/A	0.5	1.0	1.4	N/A
Industrial	2.7	5.3	N/A	N/A	6.9	8.3	N/A	N/A	0.28	0.75	N/A	N/A	39.2	56.9	N/A	N/A
Average	30.5	40.2	57.2	N/A	54.0	82.0	103.1	N/A	0.86	2.44	5.29	N/A	57.3	83.1	96.4	N/A

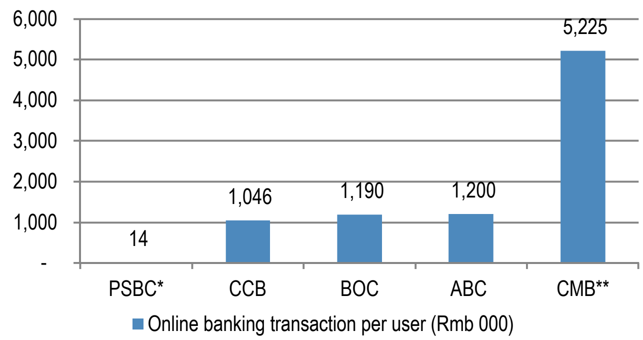
Source: Company data. Note: *We only included retail customer data for online banking for Citic and PSBC. ** for CMB, the data is based on active users only. ***For Minsheng, the data for online banking in 2015 only entails retail customer data.)

Figure 81: Mobile transactions per user (2015)



Source: Company data. Note: * Only personal banking for PSBC. We calculated PSBC numbers based on annualized 1Q16 data; ** CMB based on active users.

Figure 82: Online transactions per user (2015)



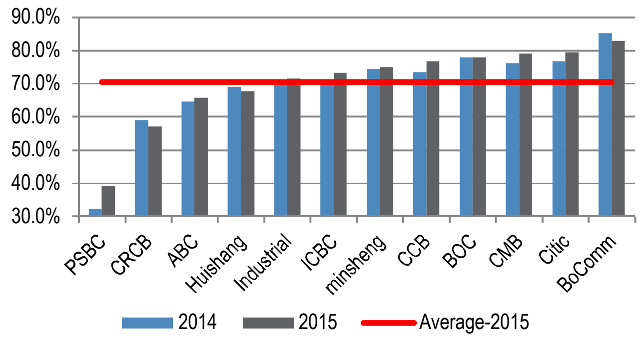
Source: Company data. Note: * Only personal online banking for PSBC; ** CMB based on active users.

ROA expansion: improving revenue & operating leverage

Growth in net interest income through leveraging up its balance sheets

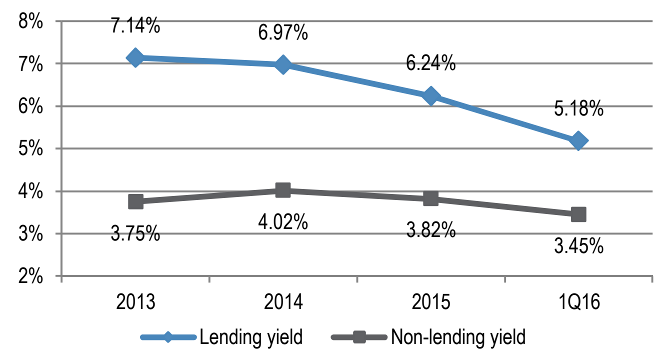
- PSBC's LDR is 39%, the lowest among banks we cover. We believe there is room for PSBC to increase its LDR.
- Lending yield of PSBC was 5.2% in 1Q16, 173bp higher than non-lending yield. Thus, improving LDR will improve its NIM in 2017 and 2018, we estimate.
- We expect PSBC's net interest income (adjusted for agency fee from OPEX to funding costs) to grow by 17% and 14% in 2017 and 2018, respectively, faster than the Big 4 banks' average of 7.5% and 10.5%.

Figure 83: PSBC has the lowest LDR among peers



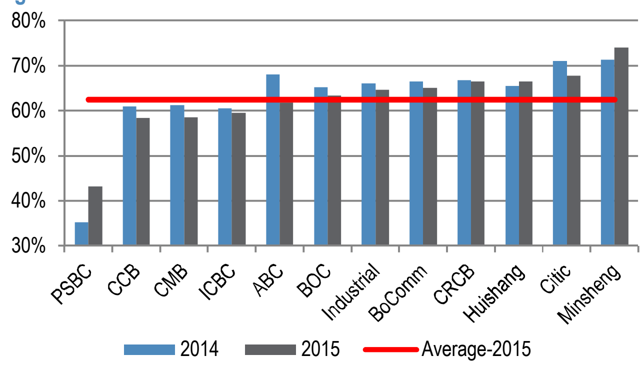
Source: CEIC

Figure 84: Lending yield vs non-lending yield (2013-1Q16, PSB)



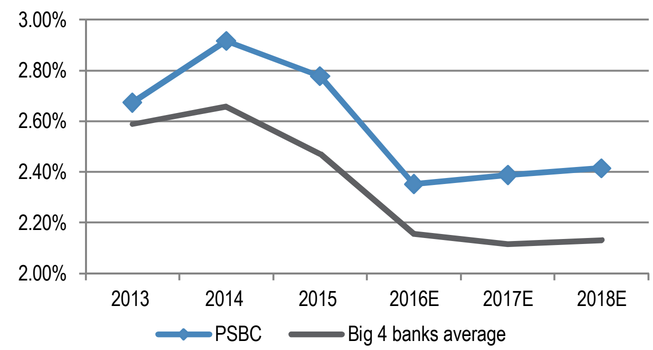
Source: Company data

Figure 85: RWA/assets



Source: Company data.

Figure 86: NIM in 2013-2018E (PSBC vs average of Big 4 banks)



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

Fee income – low hanging fruits

Fee income as a percentage of revenue and as a percentage of assets for PSBC is significantly lower than peers'. This is partly because PSB only accounts for fee business conducted in its self-owned branches. We see potential improvement in fee income due to the following:

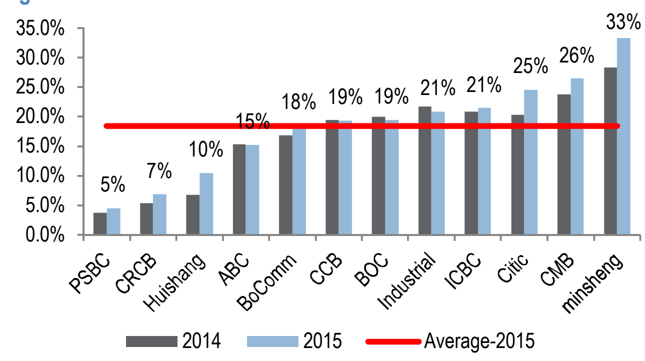
- Leveraging its shareholders, Tencent and Ant Finance: these two companies (through subsidiaries) account for 90% of third-party online payment market share in China. We believe there could be cross-selling opportunities for PSBC to advertise its products on WeChat or Alipay platforms;
- Credit card business: in terms of credit cards issued and credit cards per retail clients, PSBC trails peers (Figure 89-90). PSBC issued 9.6mn credit cards, while the Big 4 average was 75.3mn, and credit card per retail client was 0.02, Big 4 average (ex-BOC) is 0.19. We believe this is partly due to PSBC being a latecomer, and only its directly-owned outlets can conduct credit card business. By increasing its know-how from its other strategic shareholders, such as UBS, J.P. Morgan, and DBS, we believe PSBC could improve its credit card business.
- Serving underpenetrated clients: According to China Unionpay Data Service, 41.6% and 19.7% of credit cards were issued in Eastern China (i.e., Yangtze River Delta) and North China (i.e., Bohai Rim), respectively (Figure 93). It is fair to say that penetration is relatively high and competition among banks in those

Katherine Lei
(852) 2800-8552
katherine.lei@jpmorgan.com

areas is fierce. However, PSBC has a relatively higher presence in Central and Western China, where competition is mainly from local banks, rather than national banks (JSBs and 5 SOE banks); as such, growth prospects are better than for peers.

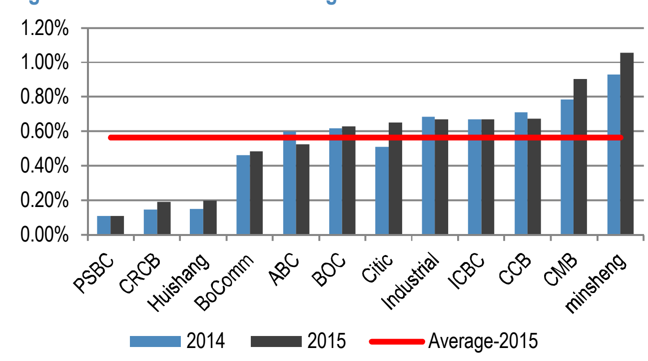
- WMP business: PSBC's WMP outstanding as a percentage of assets was 6% in 2015, the lowest among banks with relevant disclosure. But its CAGR over 2013-2015 was 88%, the fastest among peers. We see potential upside here due to rising disposable income in China and due to depositors, even those in tier 3-4 cities and County areas, becoming more financially savvy.

Figure 87: Fee income as % of total revenue



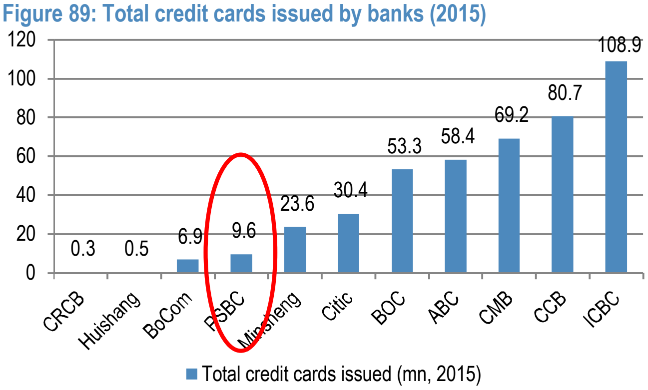
Source: Company data

Figure 88: Fee income as % average assets



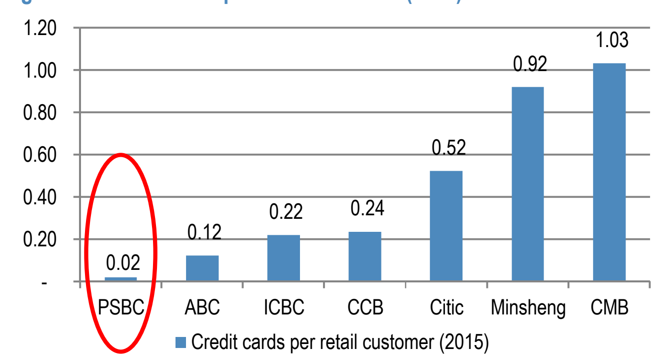
Source: Company data

Figure 89: Total credit cards issued by banks (2015)



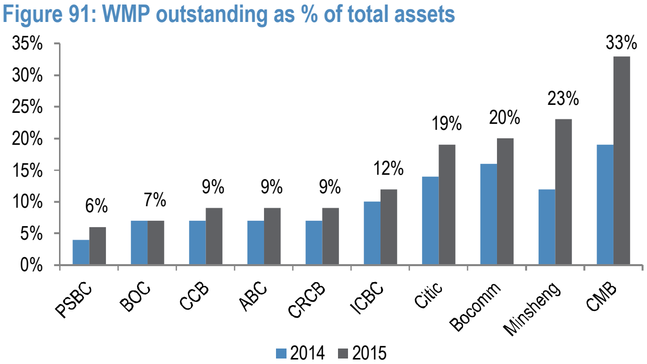
Source: Company data.

Figure 90: Credit cards per retail customer (2015)



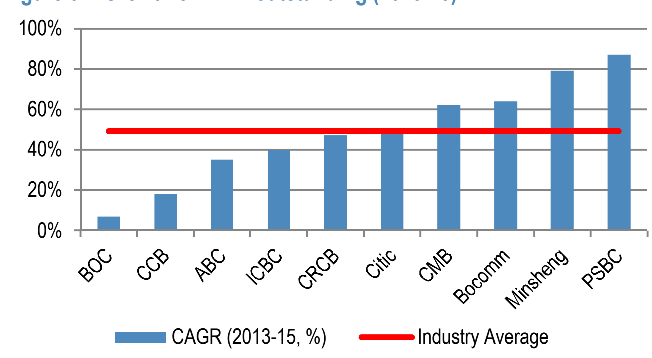
Source: Company data.

Figure 91: WMP outstanding as % of total assets



Source: Company data

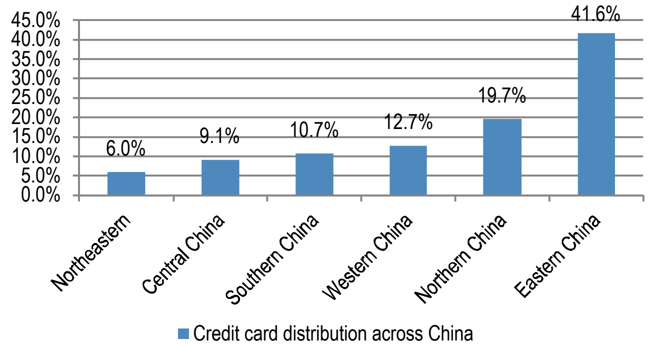
Figure 92: Growth of WMP outstanding (2013-15)



Source: Company data

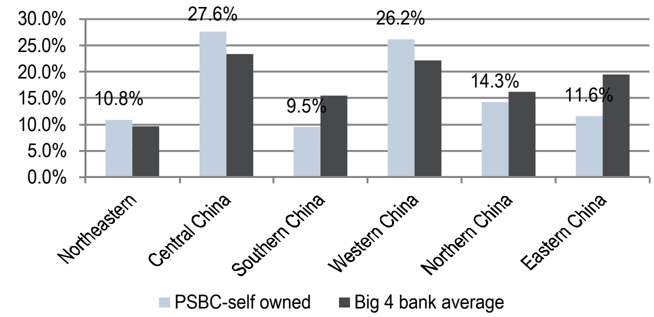
Katherine Lei
(852) 2800-8552
katherine.lei@jpmorgan.com

Figure 93: Credit card distribution across China



Source: China Unionpay data service

Figure 94: Regional branches % total branches (PSBC self-owned vs Big 4 bank average)



Source: Company reports. Regions adjusted from the bank-disclosed ones: Yangtze River Delta to Eastern China, Bohai Rim to North China, Pearl River Delta to South China.

Table 34: Branch distribution by geography as of FY15

	PSBC-self owned	PSBC-agency	ICBC	CCB	BOC	ABC
Head Office	-	-	30	3		8
Yangtze River Delta	962	3,798	2,637	2,453	3,614	3,122
Bohai Rim	1,189	4,227	2,855	2,426	1,901	3,386
Pearl River Delta	788	2,356	2,133	1,904	2,804	2,594
Central China	2,293	8,517	3,676	3,607		5,255
Northeastern China	900	3,597	1,765	1,475	953	2,269
Western China	2,174	9,254	3,906	3,049	1,717	7,036
Total-Domestic	8,306	31,749	17,002	14,917	10,989	23,670
% of total						
Head Office	0%	0%	0%	0%	0%	0%
Yangtze River Delta	12%	12%	16%	16%	33%	13%
Bohai Rim	14%	13%	17%	16%	17%	14%
Pearl River Delta	9%	7%	13%	13%	26%	11%
Central China	28%	27%	22%	24%		22%
Northeastern China	11%	11%	10%	10%	9%	10%
Western China	26%	29%	23%	20%	16%	30%
Total-Domestic	100%	100%	100%	100%	100%	100%

Source: Company reports. Note: The categorization of BOC is different from others. We grouped outlets in Eastern China under Yangtze River Delta, outlets in Northern China under Bohai Rim, outlets in Central and Southern China under Pearl River Delta and Central China.

Improving operating leverage

- Adjusting for agency fees, which are part of funding costs, the cost-income ratio (CIR) of PSBC was ~50.8% in 2015, significantly higher than the Big 4 SOE banks' average of 36.8%.
- Note that SOE banks reduced their CIR significantly after their restructuring (Table 35), and we believe PSBC can also optimize its CIR;
- This can be done through: a) optimizing its IT infrastructure, such as centralization of back-office work; b) developing mobile/internet banking to reduce operating costs for the retail business and SME business; and c) growth of its corporate banking business, which will optimize operating efficiency.

Katherine Lei
(852) 2800-8552
katherine.lei@jpmorgan.com

Table 35: Operating efficiency of Big 4 banks has improved significantly since listing

		Cost/assets		CIR		PBT/branch (Rmb M)		PBT/staff (Rmb 000)	
	Year of IPO	Year of IPO	2015	Year of IPO	2015	Year of IPO	2015	Year of IPO	2015
PSBC	2016*	1.64%	1.82%	67.6%	64.8%	N/A	5.0	N/A	257.7
ICBC	2006	1.11%	1.03%	42.6%	33.0%	4.2	20.8	205.1	778.9
CCB	2005	1.27%	1.11%	45.1%	33.2%	4.8	20.0	220.7	808.5
BOC	2006	1.37%	1.16%	46.3%	39.1%	6.0	19.9	292.0	746.6
ABC	2010	1.33%	1.34%	43.8%	41.8%	5.1	9.8	271.6	458.9
Big 4 average		1.27%	1.16%	44.5%	36.8%	5.1	17.6	247.4	698.2

Source: Company data. Note: (1) We use number of staff as of 1Q16 to calculate PBT/staff for PSBC in 2015. (2) For PSBC, we take out agency cost in operating expense in the calculation of cost/assets and cost/income. (3) For PSBC, we include self-owned branches only in the above calculations. (4) * For 2016, we use JPM estimates for PSBC

Table 36: Revenue mix and profitability of Big 4 banks have improved since listing

		Fee/revenue		Revenue/assets		Revenue/branch		PBT/branch		ROA		RoRWA	
	Year of IPO	Year of IPO %	2015 %	Year of IPO %	2015 %	Year of IPO Rmb mn	2015 Rmb mn	Year of IPO Rmb mn	2015 Rmb mn	Year of IPO Rmb mn	2015 Rmb mn	Year of IPO Rmb mn	2015 Rmb mn
PSBC	2016*	6.5%	4.5%	2.4%	2.8%	N/A	16.4	N/A	5.0	0.48%	0.51%	1.09%	1.30%
ICBC	2006	9.0%	21.4%	2.6%	3.1%	10.7	38.2	4.2	20.8	0.71%	1.29%	1.42%	2.16%
CCB	2005	6.6%	19.4%	2.8%	3.3%	11.1	39.3	4.8	20.0	1.03%	1.30%	1.84%	2.18%
BOC	2006	13.6%	19.5%	2.9%	3.0%	13.2	40.7	6.0	19.9	0.85%	1.07%	1.30%	1.66%
ABC	2010	15.8%	15.3%	3.0%	3.2%	12.4	22.9	5.1	9.8	0.99%	1.07%	1.94%	1.65%
Big 4 average		11.2%	18.9%	2.8%	3.2%	11.9	35.3	5.1	17.6	0.89%	1.18%	1.63%	1.91%

Source: Company data, J.P. Morgan estimates (Note: (1) We have included self-owned branches in our calculations only; (2) For PSBC, we included agency cost in net interest income in the calculation of fee/revenue, revenue/assets and revenue/branch). (3) * For 2016, we use JPM estimates for PSBC

Katherine Lei
(852) 2800-8552
katherine.lei@jpmorgan.com

Investment Negatives

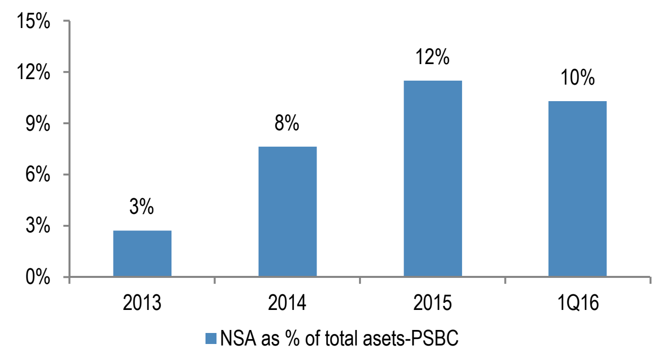
Risk of investment book (i.e. NSA)

One concern the market has had about China banks is investment in non-standardized assets (NSAs), which could be de-facto loans structured into SPVs. NSAs include asset management plans, trust beneficial funds, and WMP issued by other banks.

PSBC's investments in non-standardized assets were Rmb795bn at end 1Q16, ~10% of total assets. NSA was 12% of total assets at the end of 2015, compared to the peer average of 12%, but significantly higher than the Big 4 banks' average of 1%.

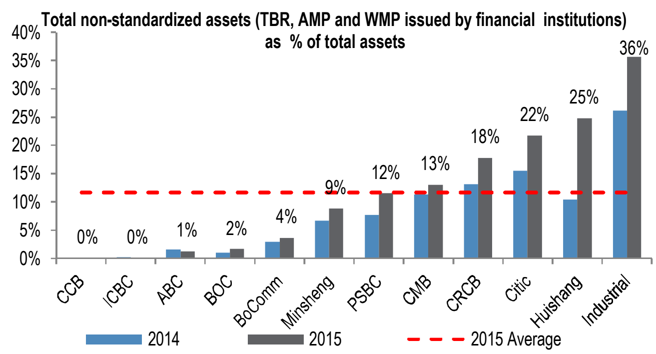
- ***Regulatory risks:*** NSAs are part of shadow banking. Regulators, including CIRC, CBRC and CSRC, have issued regulations or consultation papers to tighten up such products; please refer to Table 40 for details.
- ***Credit risks:*** While such regulations are positive in the long run to reduce financial risks in the system, there could be negative impacts on system liquidity in the near term, leading to rising default risks of the products.

Figure 95: Non-standardized assets as % of total assets for PSBC declined from 12% in FY15 to 10% in 1Q16



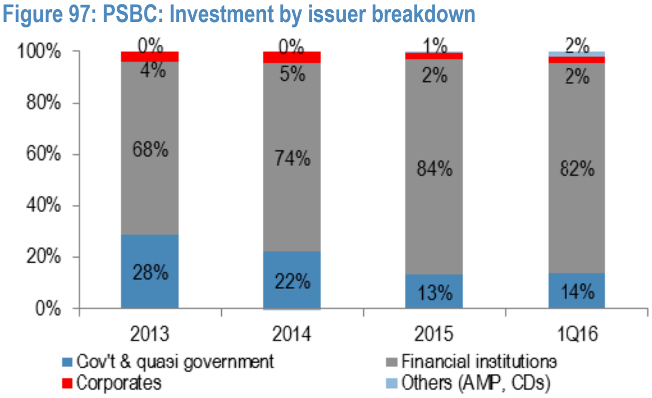
Source: Company data

Figure 96: PSBC's exposure to non-standardized assets is higher than that of the Big 4 banks



Source: Company data, J.P. Morgan. Note: This includes investments in both investment book and as reverse repos in interbank book.

Figure 97: PSBC: Investment by issuer breakdown



Source: Company data

Table 37: PSBC: Breakdown of assets

Mix	2013	2014	2015	1Q16
Cash & central bank assets	22%	22%	16%	17%
Interbank	27%	22%	9%	10%
Investments	23%	25%	41%	38%
Loans	26%	29%	33%	34%
Others	1%	2%	1%	1%
Total Assets	**100%**	**100%**	**100%**	**100%**

Source: Company data

Katherine Lei
(852) 2800-8552
katherine.lei@jpmorgan.com

Table 38: Underlying assets of non-standardized assets in PSBC book

Type of NSA	Details
Asset management plans	Asset management plans issued by securities firms and their subsidiaries, fund management companies and their subsidiaries, and insurance asset management companies
Trust investment plans	The beneficiary rights of a trust plan which is initiated, established and managed by a trust company. Please refer to Table 39 for the underlying industry.
Bank WMP	WMP issued by other commercial banks. These banks invest the proceeds in financial assets including money market instruments, government bonds, corporate bonds with "AA-" or above credit ratings, bank deposits.

Source: Company data

Table 39: Breakdown of non-standardized assets of PSBC

Rmb mn	2013	2014	2015	1Q16	QoQ
Commercial bank WMP	64,225	162,150	326,581	349,209	7%
Asset management plans	79,486	223,781	285,426	282,274	-1%
Trust investment plans	7,987	96,597	228,317	163,863	-28%
Total non standardized investments (NSA)	***151,698***	***482,528***	***840,324***	***795,346***	***-5%***
Securities investment funds	-	-	246,103	157,356	-36%
Total interbank investments	***151,698***	***482,528***	***1,086,427***	***952,702***	***-12%***

Source: Company data (Note: Securities Investment Funds include Money market funds, which invest in low risk assets such as cash, bank deposits, bank deposits, bond repurchases, PBOC bills, negotiable certificates of deposit, bonds, debt financing instruments issued by non-financial institutions and asset-backed securities")

Table 40: Recent regulatory measures since 2Q16

Regulator	Target	Date	Details
CBRC	Tightening on Trust beneficiary rights	Apr-16	According to local news (Sina, Caixin), the CBRC issued new rules (Document 82) on Apr 28, 2016 to require commercial banks to account for the transfer of credit assets beneficial rights, such as trust beneficial rights (TBR), properly. The new rules include (1) require seller banks to make provision on credit assets sold through TBR; (2) require banks to register all transactions involving TBR with regulators (3) tighten requirement on qualification of buyers; and (4) disallow selling banks to offer "re-purchase agreements" to buy back the credit assets.
CSRC	AMP issued by AMC and its subsidiaries	May-16	According to local news (Securities Times and Sina),CSRC circulated a consultation paper to asset management companies, targeting to introduce capital and leverage requirements on the AMPs issued by subsidiaries of asset management companies
CIRC	AMP issued by insurers	Jun-16	According to local news (Securities Times and Sina), CIRC has issued guidelines on insurance companies' issued AMPs, primarily targeting the ones acting as investments channels (SPVs) for bank
CSRC	Capital requirement of brokers	Jun-16	CSRC on 17 June finalized the new version of "Measures for the Risk Control Indexes of Securities Companies", which will come into effective in October, by highlighting the four key capital measures with regard to risks, capital, and liquidity. The key changes include new definition/calculation of net capital and risk capital reserves and introduction of capital leverage ratios
CSRC	Underwriting of bonds and IPO, share placement	Jul-16	'- According to Caixin, CSRC requires brokers to strengthen internal management and improve in due diligence, underwriting process for company bond sales. Also, brokers need to fulfill their responsibilities as trustee of bonds and supervise the use of proceeds from bond sales - According to Sina, CSRC requires brokers to improve their IPO standards. Brokers are required to do better due diligence on prospective clients when arranging IPO deals, bond issues and secondary share sales. -According to Caixin, CSRC advises that proceeds raised through additional share sale in private placement by listed companies can't be used for non-capital expenditures. Controlling shareholder or major holder with >5% stake should buy share of listed companies in private placement directly as single purchaser, rather than accumulating shares through asset management plans or with a third party.
CBRC	WMP business of banks	Jul-16	Local media (Caixin, 21st Century) have reported that the China Banking Regulatory Commission (CBRC) is going to circulate a consultation paper (The paper) on tightening banks' wealth management products (WMP) business. Key measures include banning of multi-tranches WMPs, reducing participation of small banks, potential limitation on investment into equities and non-standardized credit assets and risk reserves by banks on WMPs.

Source: Sina, Caixin, CBRC, CSRC, Bloomberg

Katherine Lei
(852) 2800-8552
katherine.lei@jpmorgan.com

Some comforts on credit risks

For AMPs and Trust plans on balance sheet, PSBC gave

- Only 2% of the investments in AMPs and TPs are invested into the high-risk sectors, such as manufacturing and Mining;
- Note 73% of the products are into financial services sector;
- 50.7% of the products are guaranteed by financial institutions, 45% are backed by NCDs and 1% is backed by banks' deposits certificates. As a result, net risk exposure is low.

Table 41: PSBC- Breakdown of investments in trust investment plans and asset management plans by industry as of 1Q16

Industry	Trust investment plans Rmb mn	Asset management plans Rmb mn	Total Rmb mn	% of total %
Public facilities management	22,251	36,887	59,138	13%
Real estate and construction	6,024	15,447	21,471	5%
Manufacturing	3,318	1550	4,868	1%
Production and supply of electricity, gas, water	1,234	14,505	15,739	4%
Financial services	127,942	196,693	324,635	73%
Mining	597	3,233	3,830	1%
Leasing and commercial services	2,062	11293	13,355	3%
Hotels, catering, culture	435	2666	3,101	1%
Total	**163,863**	**282,274**	**446,137**	**100%**

Source: Company data

Table 42: PSBC – Breakdown of investments in trust investment plans and asset management plans by security types as of 1Q16

in Rmb mn	Trust investment plans	Asset management plans	Total	% of total
Pledged by certificates of deposit	4,898	199	5,097	1.1%
Guaranteed by or credit of financial institutions	27,486	198,742	226,228	50.7%
Guaranteed by corporates	249	13,840	14,089	3.2%
Backed by negotiated certificates-of-deposit assets	131,230	69,493	200,723	45.0%
Total	**163,863**	**282,274**	**446,137**	**100.0%**

Source: Company data

Rising credit risks due to relatively fast loan growth

We estimate that Postal Bank's loans will increase at a CAGR of 17.6% over 2015-2018E, faster than the Big 4 SOE banks' 10.2% or H-share national banks' 12.1%. Relatively fast loan growth at a time when the banking industry has yet to see inflection on asset quality leads to concerns about the credit risks of the loan book in the medium to long term.

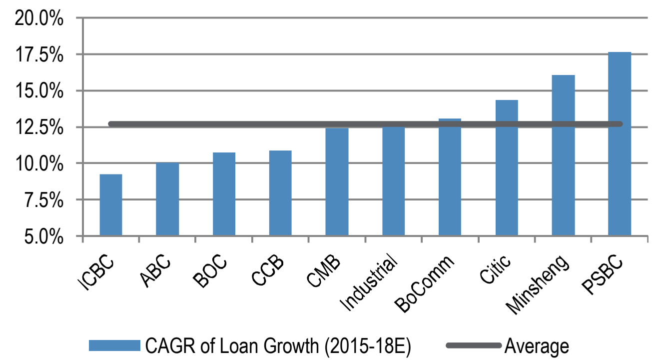
However, we believe additional risks may not be as high as thought, due mainly to the following reasons:

- **Learn from peers' mistakes:** China banks grew their loan book by an average of 33.7% in 2009 when the Rmb4tn stimulus package was rolled out. A significant portion of loans was extended to local-government financing platforms (LGFVs) and over-capacity industries, leading to asset quality concerns. We do not expect another big round of monetary easing from this point onward. Further, concerns about LGFVs, over-capacity sectors and zombie companies are brought to banks' attention, so PSBC could avoid certain industries or companies for risk management purposes.

Katherine Lei
(852) 2800-8552
katherine.lei@jpmorgan.com

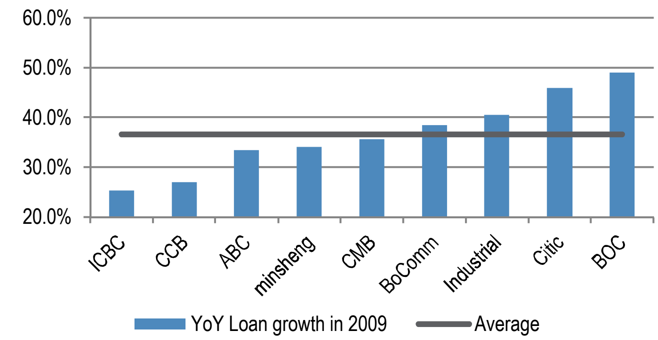
- **PSBC's gross loan growth rate is average compared to peers:** Taking ICBC as an example: The average duration of the loan book is 2.56, with 38% of loans maturing within one year. ICBC's loan book was Rmb12tn at end-2015; this means that Rmb4.6tn of loans will mature in 2016 with a loan growth rate of 10%, implying gross loans to be lent out in 2016 will be Rmb5.9tn, ~49% of loans at end-2015. Following the same logic, we calculate that the Big 4's average gross loan rate is 50%, JSBs 79% and PSBC 58%, in the middle of the range. In absolute terms, the gross loans to be lent out by PSBC are only Rmb1.4tn in 2016, significantly less than Rmb5.0tn on average for the Big 4 SOE banks. As such, we believe the additional credit risks to PSBC due to faster loan growth are not significantly higher than peers'.

Figure 98: Loan growth of China banks – CAGR 2015-2018E



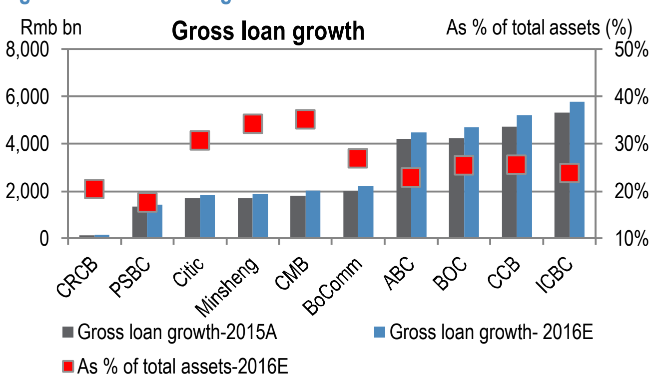
Source: Company data, J.P. Morgan.

Figure 99: Loan growth of China banks in 2009



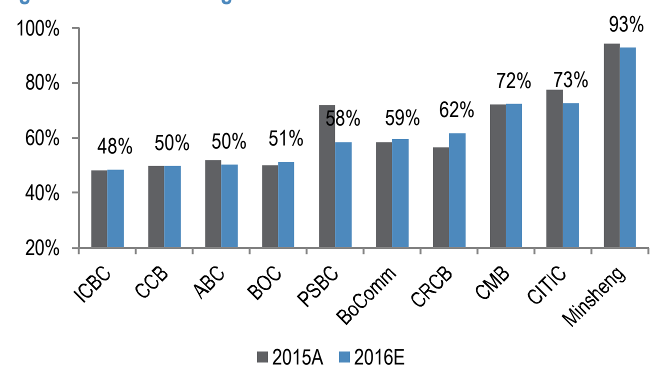
Source: Company data.

Figure 100: Gross loan growth in Rmb and as % of total assets



Source: Company reports, J.P. Morgan. Note: Gross loan growth= loan growth of gross loans + turnover of existing loans (gross loans * % of loans maturing in one year).

Figure 101: Gross loan growth ratio



Source: Company reports, J.P. Morgan. Note: loan growth ratio= Gross loan growth/gross loan.

Katherine Lei
(852) 2800-8552
katherine.lei@jpmorgan.com

High implicit funding costs through agency-fee structure

Of the 40,057 total outlets at end 1Q16, only 8,301 are directly managed by PSBC, and the rest are agency outlets managed by China Postal Group.

- Deposits taking: PSBC has to pay agency fees to China Postal Group for its deposit-taking services. This leads to higher funding costs than thought.
- Fee business: no actual impact because for fee business conducted in agency outlet, PSBC will initially book the related income as "gross fee income", but then reimburse China Postal Group and book it as "fee expenses". Therefore the direct contributing of agency outlets to net fee income is nil.
- Agency outlets are not allowed to conduct credit card business (except for credit card repayment), corporate deposits business or credit and treasury businesses.

Table 43: Scope of fee business conducted by agency outlets

Services offered by agency outlets	Notes
Deposits taking	
Taking of Rmb and FX personal deposits	PSBC pays deposit agency fee to China Post Group based on the personal deposits PSBC take through agency outlets. Please see Table 45 for detailed calculations of deposit agency fee
Fee business	
Domestic and international remittance Bank card (debit card) Credit card repayment Electronic banking business (including self-service banking business and SMS business) Collection and payment agency business Issuance and settlement of government bonds as an agent Provision of personal deposit record services Bancassurance Agency sale of funds, personal WM, asset management scheme and other financial products Provision of third-party escrow services Other business entrusted by PSBC	PSBC follows the principle of "fee payable to the entity providing the service" to recognize fee revenue. For fee business offered by agency outlets, PSBC will book gross fee and commission revenue and pay fee and commission expenses for commission-based businesses conducted by agency outlets.
Services not offered by agency outlets	
Credit and treasury businesses Corporate deposit business Other business not entrusted by PSBC	Agency outlets shall not conduct credit and treasury businesses as well as corporate deposits business

Source: Company data

Table 44: PSBC – Number of outlets

	2013	2014	2015	1Q16
Directly-operated outlets	8,108	8,257	8,306	8,301
Agency outlets	31,599	31,705	31,749	31,756
Total	39,707	39,962	40,055	40,057

Source: Company data

Katherine Lei
(852) 2800-8552
katherine.lei@jpmorgan.com

De facto funding costs on deposits higher than thought

- Agency outlets will perform deposits taking services for PSBC. In return, PSBC will pay agency fees to China Postal Group. The agency fee is calculated based on scaled fee rates multiplied by the daily average balance of deposits gathered by the agency outlets. The agency fee is reported as part of OPEX by PSBC.
- The scale fee rates differ by duration of deposits, for example, demand deposits of 2.3% and one-year deposits of 1.08%. For details, please refer to Table 45.
- If we include the agency fee as part of deposits costs, PSBC's deposits cost would be 2.83% in 2015, significantly higher than the Big 4 peers' 1.88%. As a result, PSBC's NIM would be 1.93% in 2015 instead of the reported 2.78% (Figure 102); this would be significantly below the Big 4 average of 2.47%.
- The scale fee rate is referenced to the 10-year average deposit rate of the Big 4 SOE banks. And the process of changing the scale fee rate is complex, as indicated in Table 47.
- This type of arrangement and funding structure is unfavorable in an interest rate cut cycle. The agency fee rate is inelastic and does not go down with market rates despite PBOC cutting the deposit benchmark rate.

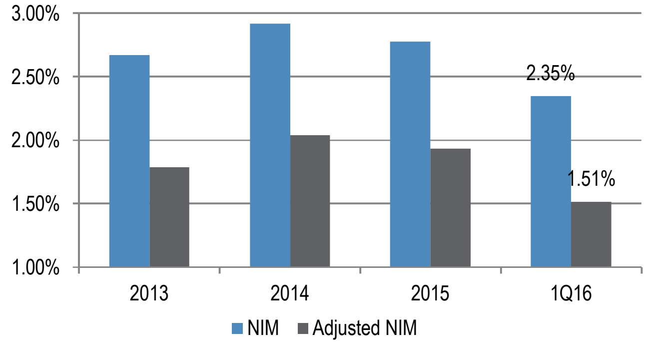
Table 45: Calculation of deposit agency fee paid to China Postal Group

	2013*			2014			2015			1Q16		
(In Rmb bn except for the percentages)	Daily avg. balance	Scaled fee rate	Deposit agency fee	Daily avg. balance	Scaled fee rate	Deposit agency fee	Daily avg. balance	Scaled fee rate	Deposit agency fee	Daily avg. balance	Scaled fee rate	Deposit agency fee
Demand	1,142	2.20%	25.1	1,237	2.30%	28.46	1,305	2.30%	30.01	1,436	2.30%	8.26
Demand or time	19	1.48%	0.3	17	1.50%	0.25	14	1.50%	0.21	14	1.50%	0.05
Call deposits	14	1.58%	0.2	13	1.70%	0.21	13	1.70%	0.21	20	1.70%	0.08
3-month time deposit	108	1.25%	1.3	121	1.25%	1.51	128	1.25%	1.60	131	1.25%	0.41
Half-year time deposit	125	1.18%	1.5	144	1.15%	1.65	153	1.15%	1.75	145	1.15%	0.42
1-year time deposit	1,419	1.12%	15.9	1,571	1.08%	16.96	1,769	1.08%	19.10	1,898	1.08%	5.11
2-year time deposit	128	0.70%	0.9	150	0.50%	0.75	177	0.50%	0.88	174	0.50%	0.22
3-year time deposit	188	0.45%	0.8	220	0.30%	0.66	231	0.30%	0.69	239	0.30%	0.18
5-year deposit	46	0.35%	0.2	51	0.20%	0.10	50	0.20%	0.10	48	0.20%	0.02
Daily aggregate catch (including cash in transit)	12	-1.50%	(0.2)	13	-1.50%	-0.20	11	-1.50%	-0.17	16	-1.50%	-0.06
Total	**3,189**	**1.44%**	**46.1**	**3,522**	**1.43%**	**50.37**	**3,838**	**1.42%**	**54.40**	**4,105**	**1.43%**	**14.67**

Source: Company data, J.P. Morgan estimates (Note: For 2013 data, we took the average of daily average balance of 1H13 and 2H13 given in company data to come up with the daily average balance for FY13. For scaled fee rate, it was revised in 2H13, we took the average of the rates before and after adjustment). (Note 2: The total daily average balance does not include the daily aggregate cash (including cash in transit)

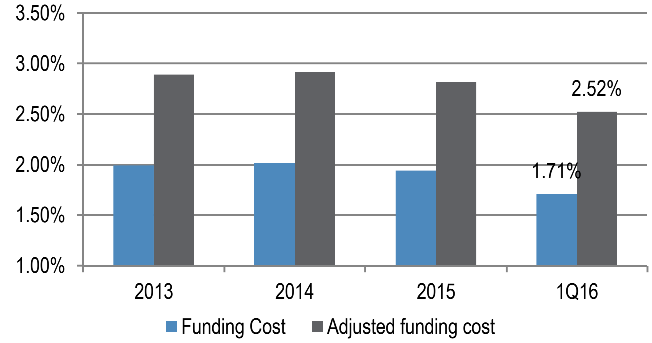
Katherine Lei
(852) 2800-8552
katherine.lei@jpmorgan.com

Figure 102: NIM of PSBC would be significantly lower than reported figures if we included agency costs as a part of interest expenses



Source: Company data, J.P. Morgan estimates

Figure 103: Funding costs would be higher if we included agency costs as a part of interest expenses



Source: Company data, J.P. Morgan estimates

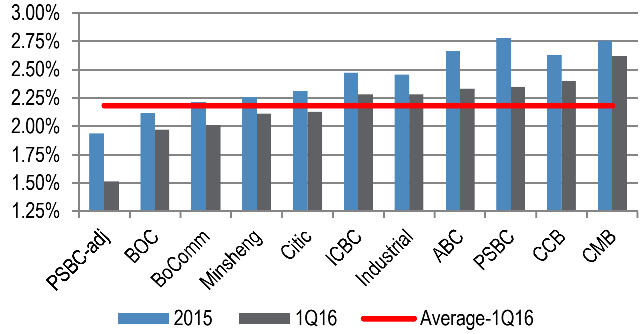
Table 46: Breakdown of personal deposits from agency outlets and directly operated outlets

Rmb mn unless otherwise stated	2013	2014	2015	1Q16
Deposit from agency outlets	3,305,910	3,677,186	3,945,546	4,279,472
Deposits from self-owned outlets	1,231,639	1,355,135	1,441,084	1,538,019
Total retail deposits	**4,537,549**	**5,032,321**	**5,386,630**	**5,817,491**
As % of period end balance				
Deposit from agency outlets	72.9%	73.1%	73.2%	73.6%
Deposits from self-owned outlets	27.1%	26.9%	26.8%	26.4%
As % of daily average balance				
Deposit from agency outlets	71.5%	72.4%	73.2%	72.2%
Deposits from self-owned outlets	28.5%	27.6%	26.8%	27.8%

Source: Company data

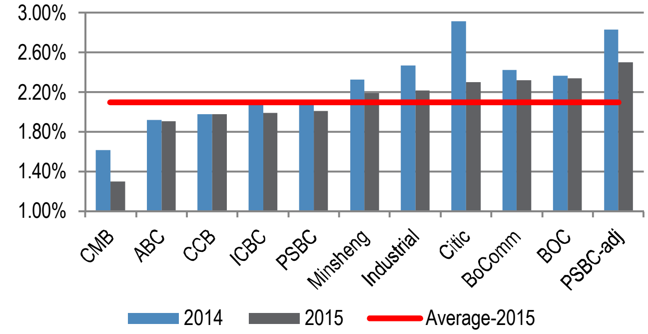
Katherine Lei
(852) 2800-8552
katherine.lei@jpmorgan.com

Figure 104: NIM of PSBC would be the lowest among national banks in 1Q16 if we included agency costs in interest expense



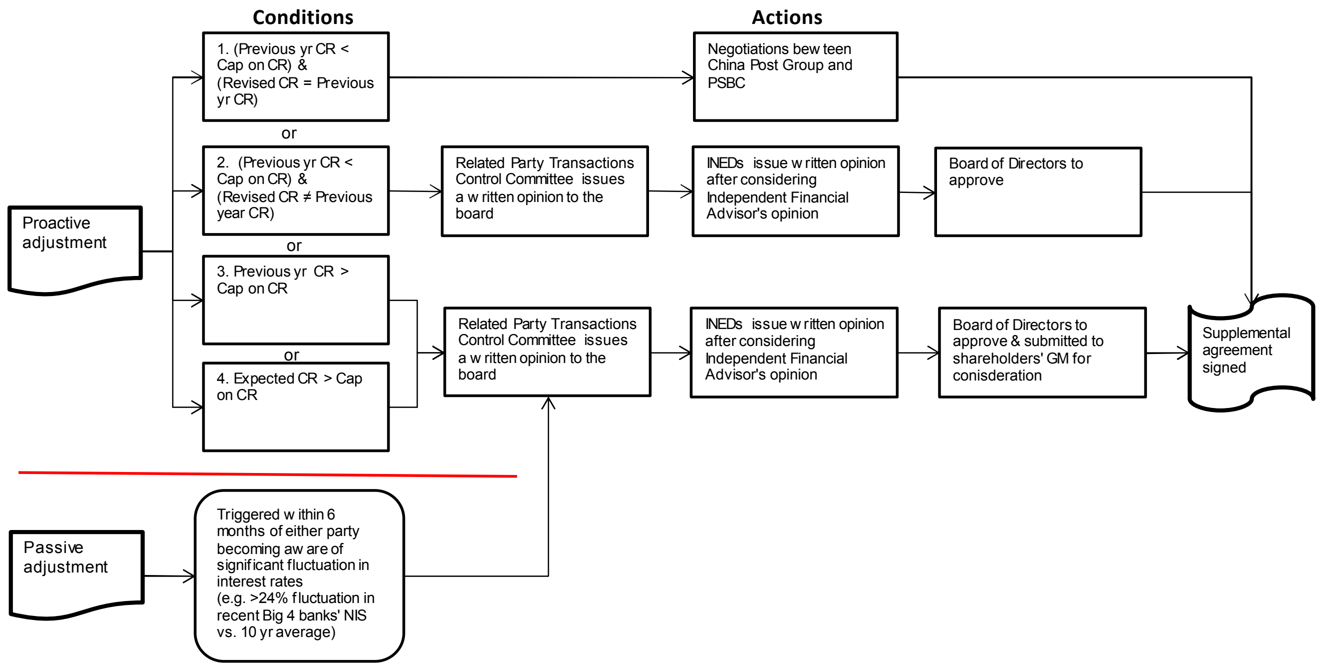
Source: Company data, J.P. Morgan estimates

Figure 105: Deposit costs of PSBC would be the highest among national banks in 2015 if we included agency costs in interest expenses



Source: Company data, J.P. Morgan estimates

Table 47: Adjustment mechanism of deposit agency cost



Source: Company data. Note: CR- Composite rate, INED- Independent Non-executive Directors

Table 48: How the triggering threshold works under the passive adjustment mechanism for deposit agency cost

Bank		NIM/ threshold
NIS of Big 4 banks in the past 10 years (2006-2015)		
ABC *		2.65%
BOC		2.15%
CCB		2.64%
ICBC		2.45%
Big 4 average NIS from 2006-2015	a	**2.47%**
Initial triggering threshold	b	24%
Lower band of triggering threshold	c=a*(1-b)	1.88%
Upper band of triggering threshold	d=a*(1+b)	3.06%
NIS of Big 4 banks in 2016E (J.P. Morgan estimates)		2.12%

Source: Company data, J.P. Morgan estimates, company data (Note: For: ABC, we used the average from 2007-2015 as NIS in 2006 is not available).

Difficult to improve operating leverage of agency outlets

- Fee business conducted in agency outlets is not contributing to the P&L of PSBC;
- It is difficult to revise the agency fee rates despite declining money market rates and deposits costs in the industry, leading to resilient de-facto funding costs for PSBC. So the actual interest spread (yield minus actual funding costs) of PSBC declined faster than peers;
- Staff members in agency outlets are not on PSBC's payroll, so it will be difficult for PSBC to conduct cross-selling or reward top performers.

Operations and governance

We note a series of operating risk incidents from 2008 to 2015. In addition, we believe the operational risk of agency outlets is higher than that of directly-owned outlets, as PSBC has lower control of the staff and implementation of risk management procedures, in our view.

Katherine Lei
(852) 2800-8552
katherine.lei@jpmorgan.com

Table 49: Special incidents of PSBC from 2013 to 1Q16

Date	Incident	Details
Oct-08- Feb-15	Loan Fraud Incident	Yang Bing, former president of PSBC's Yiling sub-branch located in Yichang, Hubei Province, was suspected of committing the crime of the illegal extension of loans with identity fraud, worth ~Rmb130mn. As of the Latest Practicable Date, Yang Bing had been arrested.
Jan-11 – Jan 13	Loan Fraud Incident	Kong Ming, the former credit staff of PSBC's Yangquan branch located in Shanxi Province, was suspected of committing the crime of the illegal extension of loans for extending micro loans to borrowers whose identities were stolen with an aggregate amount of Rmb13mn. On October 3, 2015, the High People's Court of Shanxi Province had made a final judgment on this case.
Dec-10 – Dec -14	Chen Shuguo Incident	Chen Shuguo, the chief officer of Shiliting Post Office of Shahe Post Bureau located in Xingtai City, Hebei Province, defrauded and embezzled customer funds for gambling activities by entering into agreements with customers using illegally engraved stamps during his term of office from December 2010 to December 2014, according to company data. The amount involved in the case was Rmb124mn. The case was filed with competent court on February 15, 2015. As of the Latest Practicable Date, Chen Shuguo had been arrested.
Apr-11	Bu Congfang, Li Guixiang and Zhang Jiaxia Incident	On April 29, 2011, Bu Congfang, Li Guixiang and Zhang Jiaxia, the former cashiers of PSBC's Zhangqiu sub-branch of Shandong branch, deposited customers' cash, which should have been deposited into other banks' corporate accounts or vaults with security companies, into another bank under the name of irrelevant third parties to assist the employees of the receiving bank to achieve the target amount of deposits. The amount involved in this case was Rmb94.24mn. PSBC stated in company data that there are no financial losses caused by this case because all the involved cash was returned to PSBC. This case was filed with competent court on August 23, 2012. The People's Court of Zhangqiu City rendered a judgment on the case on January 10, 2014.
Dec -15	Tao Liming Incident	On December 2, 2015, the Intermediate People's Court of Hebi City in Henan Province rendered its first instance judgment against Tao Liming, PSBC's former president, for accepting bribes and embezzling public funds. Tao Liming was sentenced to life imprisonment and deprival of political rights for life. Tao Liming has appealed against the judgment of the first instance. The findings in the first instance proceedings include that Tao Liming took advantage of his position during his term of office from April 2002 to May 2012, providing benefits for others with respect to bank book printing business, personnel arrangement and loan extension, and illegally accepted bribes. From 2000 to 2004, Tao Liming, in conspiracy with others, issued certificated treasury bonds in excess of regulatory quota and invested the funds raised from the over-issued certificated treasury bonds for their own benefits. Tao Liming died in June 2016, when the competent people's court did not render its second-instance judgment on the case.

Source: Company data

Industry risk: asset quality & shadow banking

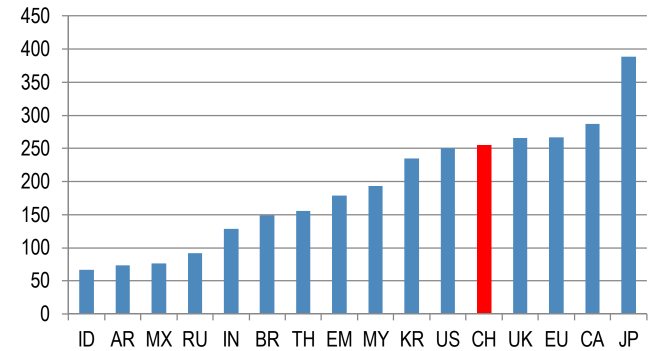
Asset quality concerns

Leverage in China stands out from that of international peers with the highest leverage among EM countries (Figure 106). China saw a sharp rise of leverage in China from 150% of TSF/GDP in 2009 to 215% in 2Q16.

- **Corporate leverage a key vulnerability:** Corporate leverage (109% of GDP) is a key driver of overall leveraging in China, but as economic growth slows down along with corporate profit growth asset quality pressures have come to the fore. NPLs have risen from 1% in 2013 to 1.75%, and adjusting for NPLs written-off/disposed by banks, the NPL ratio is at 3.5%. We estimate that NPLs in China would rise to 7% (Figures 109-110, Table 50), and expect asset quality pressures to continue.
- **Household vulnerable to spillover impact:** While over-levered corporates are the focus of asset quality, even households with relatively low leverage (40% of GDP) could see spillover effects. As corporates default, there could be direct income effect on the household sector as well as wealth effect through bond defaults impact on WMPs or stock markets correction.

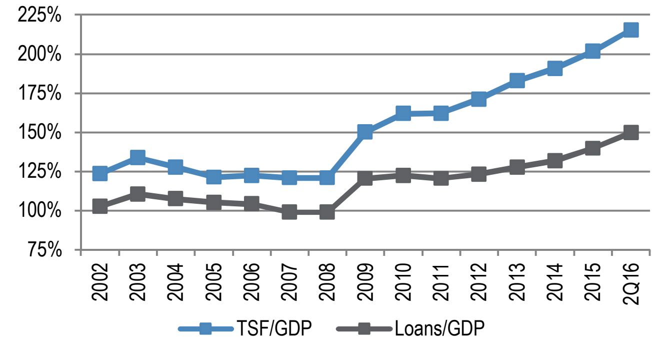
Katherine Lei
(852) 2800-8552
katherine.lei@jpmorgan.com

Figure 106: China's leverage highest among EM – Non-financial credit/GDP (2015)



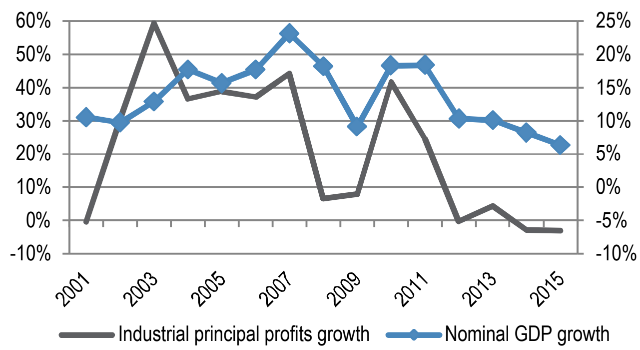
Source: BIS.

Figure 107: Rising leverage in China



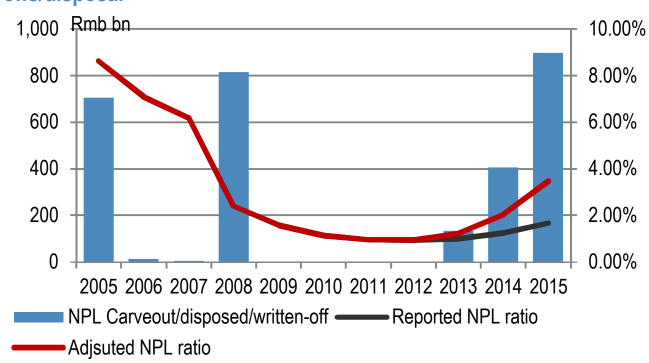
Source: CEIC.

Figure 108: Nominal GDP growth and Industrial profit growth have slowed



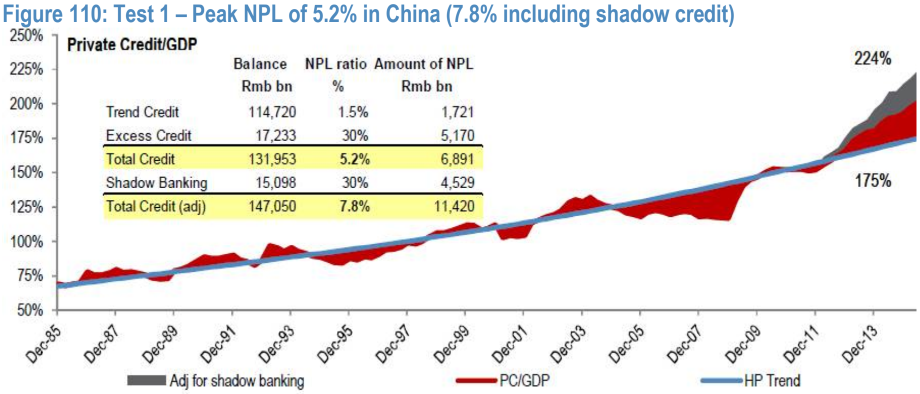
Source: CEIC.

Figure 109: NPL ratio up to 1.75%, and 3.5% adjusted for write-offs/disposal



Source: CEIC, J.P. Morgan estimates.

Figure 110: Test 1 – Peak NPL of 5.2% in China (7.8% including shadow credit)



Source: BIS, World Bank, Wind, J.P. Morgan.

Table 50: Test 2 – Adding NPL of interbank assets and shadow banking assets, NPL could go to ~7.4% on a static basis

Rmb bn		Potential NPL		
	Balances	Ratio	Amount	Notes on NPL assumptions
Bank loans	99,346	5.97%	5,934	Assume 25% NPL ratio for over-capacity sectors and normalized NPL for other loans
Potential credit assets in interbank	20,400	3.0%	609	Mostly discounted bills repo on banks book, assume NPL ratio is half of normal bank loans
High-risk shadow banking assets	18,450	20.0%	3,690	NPL ratio for major commercial banks in early 2000s. There is overlap in the high-risk assets above, so we take 50% of the high-risk assets in table above for NPL calculation.
Total	**138,196**	**7.4%**	**10,233**	
Reported asset quality at end 2015		**NPL**		
	Balances	**Ratio**	**Amount**	
Bank loans	99,346	1.67%	1,659	NPL ratio for commercial banks is 1.67% in 4Q15
Potential credit assets in interbank	20,400	0%	-	
High-risk shadow banking assets	18,450	0%	-	This represents 50% of the sum of single-funded trust, targeted AMPs and WMP

Source: J.P. Morgan estimates, PBOC; Note: Based on system data on bank loans and NPL data of commercial banks in China.

Shadow-banking risks

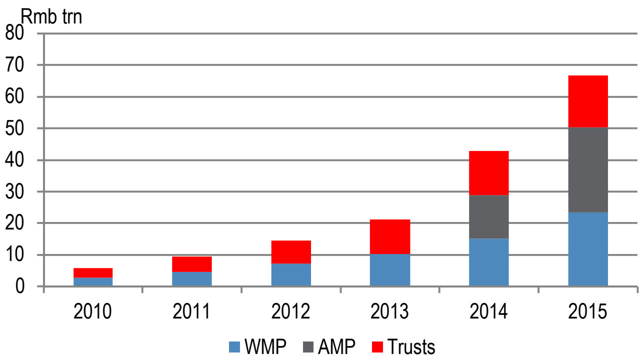
- **Shadow banking has grown at a 63% CAGR since 2010, supported by implicit guarantee:** Search for higher returns has led to a surge in shadow-banking products, from Rmb5.8tn in 2010 to Rmb67tn in 2015. There may be some overlap amongst various products, and the actual amount may be somewhat lower, but the overall scale is still large. The demand for WMPs was further boosted by implicit guarantee by banks, which meant higher returns for Chinese investors without any extra risk.

- **Banks holding shadow-banking products puts balance sheets at risk:** Banks have also increased their holdings of shadow-banking products in part due to the search for higher yields. Indeed, WMPs accounted for 16% of total assets for China banks, and non-standardized assets (NSAs) accounted for 12% as of 2015. We estimate that corporate bond defaults could rise to 1-6% (in an extreme case they could go as high as 13%, please see Figure 114), which would directly impact banks' investment/interbank books. Furthermore, defaults would also hit the off-balance sheet WMPs that banks have sponsored.

- **But implicit guarantee & bailout costs are a bigger concern:** However, the bigger concern is the implicit guarantee by banks to bonds underwritten by them. For example, if we consider the case of a 5% default (Table 51), the direct default loss to banks would be a manageable ~6% of 2016E earnings, but the bailout costs would be almost five times larger (~29% of 2016E earnings). Even though implicit guarantees are not reflected in the financials of banks, they are a drag on bank valuations. Breaking implicit guarantee by allowing corporate bond defaults is essential for efficient risk pricing and re-rating of banks.

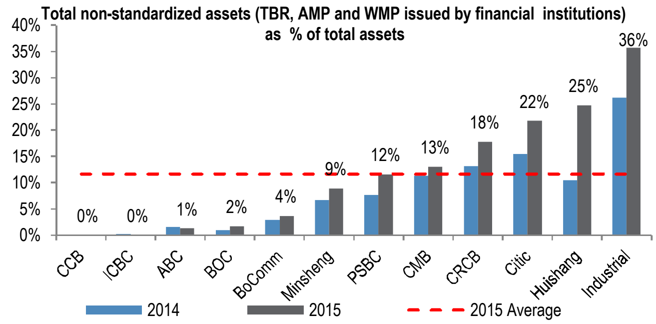
Katherine Lei
(852) 2800-8552
katherine.lei@jpmorgan.com

Figure 111: Shadow banking (Trust+WMP+AMP) grew at 65% CAGR



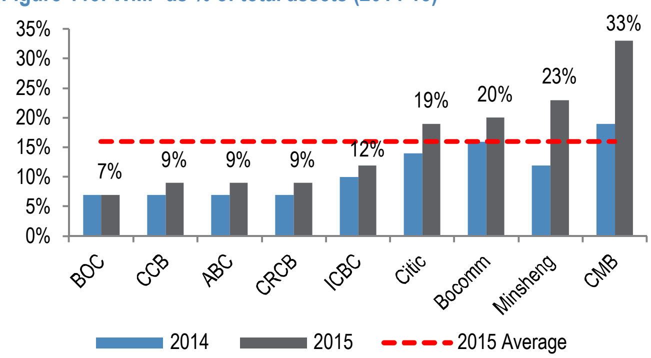
Source: CEIC, Wind, J.P. Morgan. Note: There may be overlap amongst the three categories

Figure 112: Non-standardized assets (interbank + investment book) as % of total assets in 2014-15



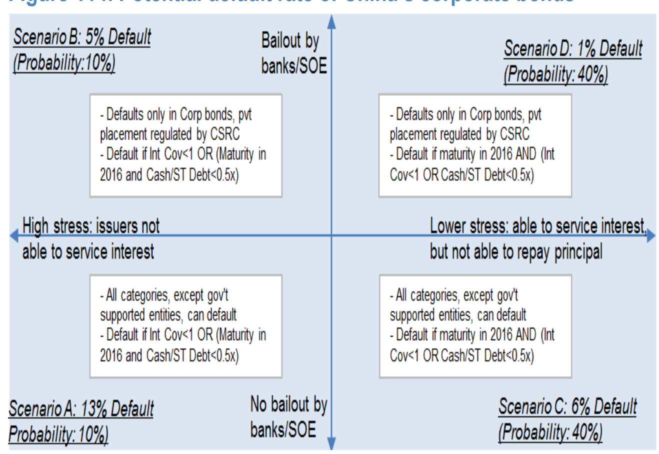
Source: Company data, J.P. Morgan. Note: This includes investments in both investment book and as reverse repos in interbank book.

Figure 113: WMP as % of total assets (2014-15)



Source: Company data, J.P. Morgan.

Figure 114: Potential default rate of China's corporate bonds



Source: J.P. Morgan estimates. Based on corporate bond issuers' financial data.

Table 51: Potential bailout costs plus default losses as a % of banks' 2016E earnings

Potential default ratios	13% (A)	6% (C)	5% (B)			1% (D)		
Banks to bail out?	No	No	Yes			Yes		
Costs/loss as % of 2016E earnings	Default loss	Default loss	Default loss	Bail out cost	Sub-total	Default loss	Bail out cost	Sub-total
ABC	-15%	-7%	-6%	-29%	-35%	-1%	-13%	-15%
BOC	-15%	-7%	-6%	-30%	-35%	-1%	-14%	-15%
CCB	-12%	-5%	-4%	-24%	-28%	-1%	-11%	-12%
ICBC	-13%	-6%	-5%	-24%	-29%	-1%	-11%	-12%
BoComm	-16%	-7%	-6%	-31%	-37%	-1%	-14%	-16%
Citic	-18%	-8%	-7%	-37%	-43%	-1%	-17%	-18%
CMB	-11%	-5%	-4%	-28%	-32%	-1%	-13%	-14%
Minsheng	-7%	-3%	-3%	-29%	-32%	-1%	-13%	-14%
Huishang	-9%	-4%	-3%	-30%	-34%	-1%	-14%	-15%
CRCB	-46%	-21%	-18%	-30%	-48%	-4%	-14%	-18%
Average-National banks (SOEs + JSBs)	**-13%**	**-6%**	**-5%**	**-29%**	**-34%**	**-1%**	**-13%**	**-14%**
Average-All banks under our coverage	**-16%**	**-7%**	**-6%**	**-29%**	**-35%**	**-1%**	**-14%**	**-15%**

Source: J.P. Morgan estimates.

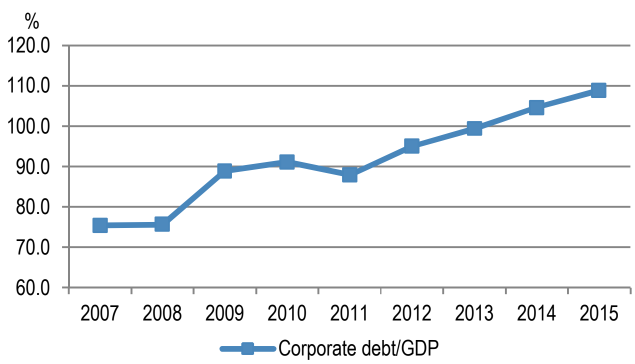
Katherine Lei
(852) 2800-8552
katherine.lei@jpmorgan.com

Execution risk on reform, failure of which may lead to stagnation of growth

Long-term rerating of banks and sustained growth is contingent on progress of reform to deal with high leverage and overcapacity.

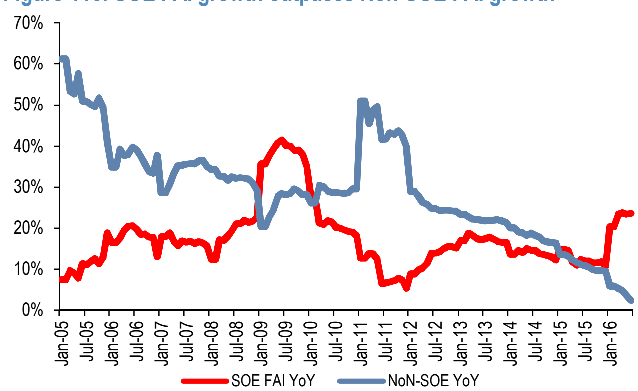
- **Some signs of progress in reforms:** There are some encouraging signs of progress in reforms as shown by faster growth of tertiary industry as compared to secondary industry, resulting in share of tertiary industry in GDP to increase from 45% in 2Q16 to 51% in 2012, while share of secondary industry has fallen from 45% to 40%. This is also reflected in relatively slower electricity consumption growth of heavy industry over the past 1.5 years.
- **But, challenges remain:** Despite the initial signs of progress in reforms, challenges remain including: a) corporate leverage continues to increase (up from 105% of GDP in 2014 to 109% in 2015); b) inefficient allocation of capital persists as shown by SOE FAI growth outpacing private FAI growth (24% vs 2%); c) rising steel production and new housing starts for real estate construction (Figure 118) could be negative for de-stocking, cutting over-capacity and shutting down zombie companies.

Figure 115: Corporate leverage continues to rise



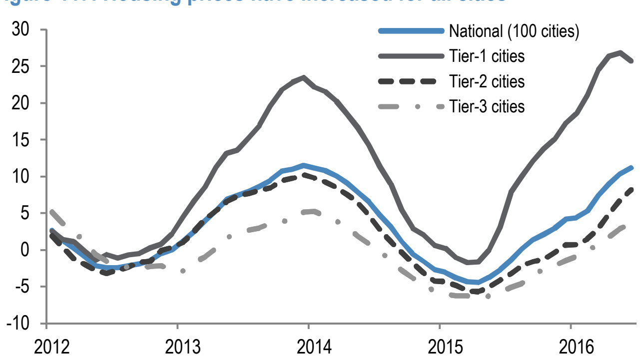
Source: J.P. Morgan Economics team, CEIC.

Figure 116: SOE FAI growth outpaces Non-SOE FAI growth



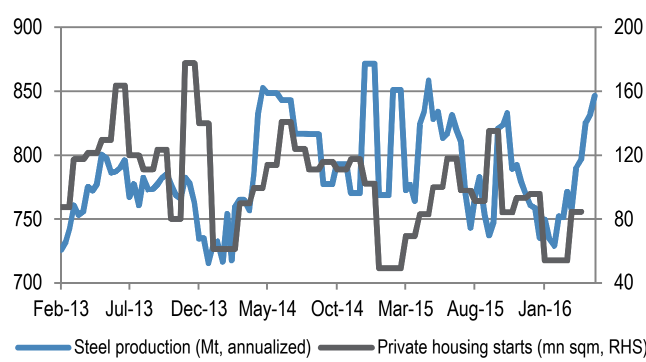
Source: CEIC.

Figure 117: Housing prices have increased for all cities



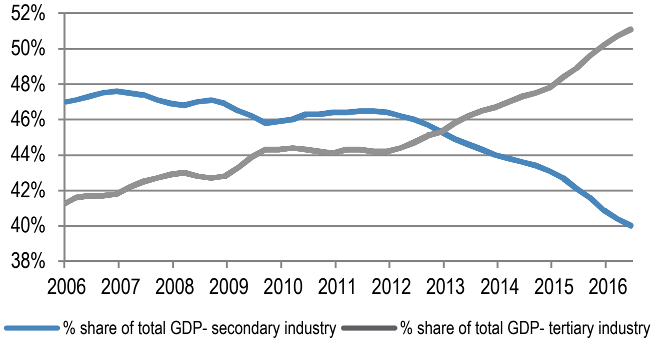
Source: Wind.

Figure 118: China steel production vs new housing starts – challenge for destocking



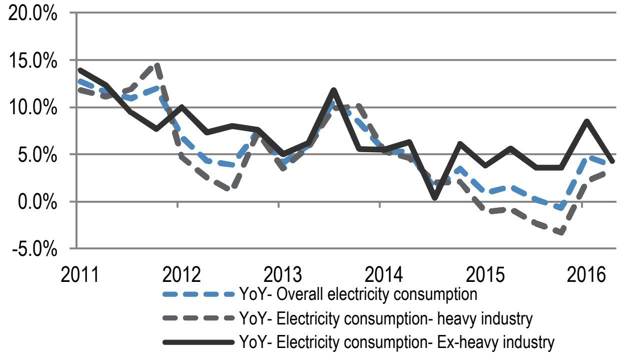
Source: CISA, WSD, CEIC.

Figure 119: GDP contribution from tertiary industries rising



Source: CEIC.

Figure 120: Electricity consumption of light industries faster than heavy industries



Source: CEIC.

P&L risks: Regulatory intervention on fee business and rate cut

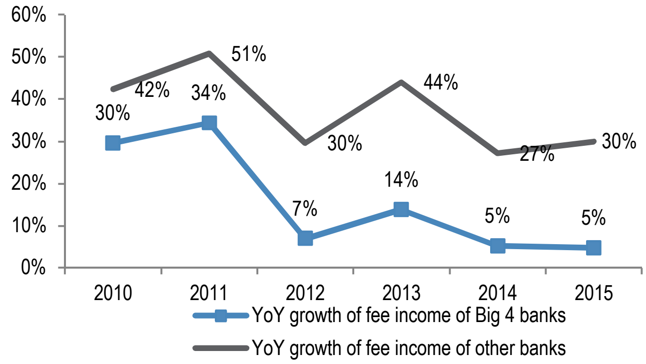
Chinese regulators have continued to ask banks to "sacrifice" revenue (NIM and fees) in order to lower overall financing costs for the economy. Indeed, "national service" by banks has weighed on profitability as PPoP growth has slowed from 29% at end-2011 to 10% as of 2015.

Regulatory headwinds to fee growth

Fee income growth at national banks slowed from 31% in 2013 to 18% in 2015, driven by regulatory changes, such as:

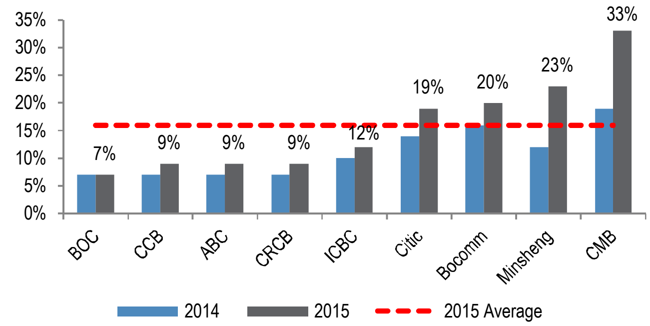
- **Tightening of WMP regulations:** Regulators have been focusing on WMP regulations to reduce contagion risks and improve transparency, but that comes at the cost of banks' earnings. CBRC is expected to further tighten regulations on banks' WMP business, based on local media reports (*Caixin*) on July 27. Please see Table 53 for a summary of the announcement. Among other things, banks would be required to create risk reserves (~50% of fees on non-NAV products & 10% of fees on NAV products), which would lower banks' fee income and drag down 2017E earnings by ~6% on average.
- **Lowering credit card fees:** In Mar-16, NDRC and PBOC cut card processing fees from 0.9% to no more than 0.35% for debit cards and 0.45% on credit cards. While the cut did not change anything for the consumers, it would support the businesses at the expense of bank profitability.
- **Intervention in SME and settlement fees:** Regulators have pushed the banks to lower remittance and online fees as well to support economic activity using measure like: a) CBRC guidance to lower/waive various fees for SME (Nov-11); b) CBRC guidelines to waive advisory fees, consultancy fees, and other fees for SMEs (2014); c) Big 5 banks announced the waiver of settlement fees for all remittance through mobile banking & below Rmb5,000 through online banking.

Figure 121: Declining fee income growth



Source: Company data.

Figure 122: WMP as % of total assets of major banks



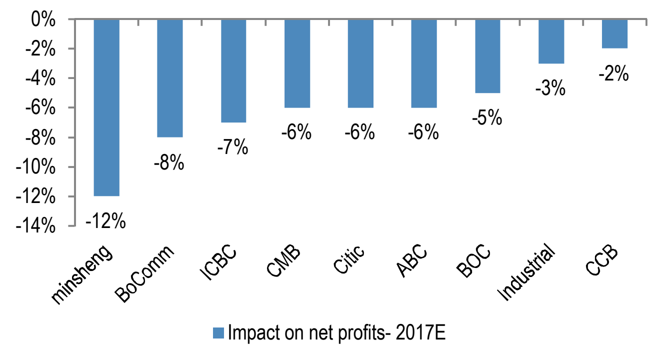
Source: Company data

Table 52: NAV product as % of WMP for major banks

Bank	NAV product as % of total WMP
ABC	Less than 10%
BOC	Less than 50%
CCB	10%
ICBC	22%
BoComm	5%
Citic	N/A
CMB	53%
Minsheng	N/A
Industrial	10%

Source: Company data (Note: CMB disclosed NAV product as % of WMP in their annual report. For Citic and Industrial, the numbers are not disclosed)

Figure 123: Impact on 2017E earnings under the new rules on WMP



Source: J.P. Morgan estimates

Table 53: Summary of WMP regulations announced on July 27, 2016

WMP regulatory changes announced
Limit small banks' scope on WMP business – banks with less than three years of track record in WMP business or net capital < Rmb5bn can only conduct "basic WMP business"
Ban WMPs with different tranches
Limit leverage of WMPs to 140% asset to NAV
Limit underlying investment of WMPs – Banks' WMP not allowed to invest into credit assets or WMPs issued by issuing banks, bad-debt ABS issued by banks
Only high-net worth clients to invest into equity investments
Banks have to create risk reserve on WMPs equivalent to 50% of fees from non-NAV products and 10% of fees for NAV products; capped at 1% of WMP outstanding

Source: Caixin, 21st Century.

Table 54: Regulatory intervention on SME and settlement fees

Regulatory Measures
In August 2015, the Big 5 banks announced the waiver of settlement fees for remittance through mobile banking. Settlement fees for remittance through online banking amounting to Rmb5,000 or less were also waived.
In 2014, a number of banks announced the waiver of SME advisory fees, consultancy fees and other types of fees after CBRC issued guidance encouraging banks to lower SMEs' financing costs.
CBRC issued guidance in Nov-11 requiring banks to support SMEs by increasing lending to SMEs and lowering/waiving different types of fees.

Source: PBOC, News Sources, J.P. Morgan.

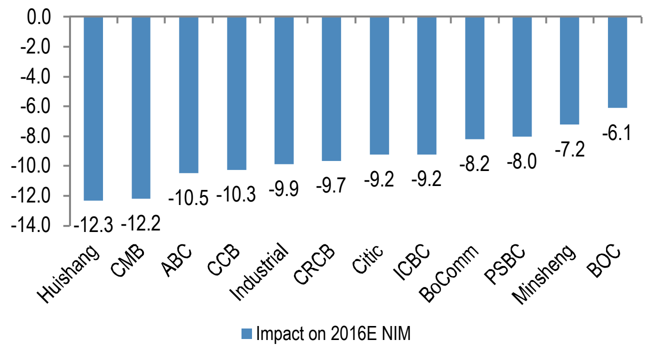
Katherine Lei
(852) 2800-8552
katherine.lei@jpmorgan.com

NIM pressures from potential rate cuts

China banks are already facing NIM pressure, as the average margin dropped 14bp y/y in 2015 as PBOC cut rates 165bp since 2014. The policy support is partly the reason we saw growth recover in 2Q16 to 7.1% q/q saar, from 6.2% in 1Q16. While we expect fiscal policy to do the heavy lifting for now, if economic growth falters in the future, we may see policy makers reach for monetary levers. Indeed, our economists already expect one 25bp rate cut (although it is a close call) in 4Q16 amidst slowing growth.

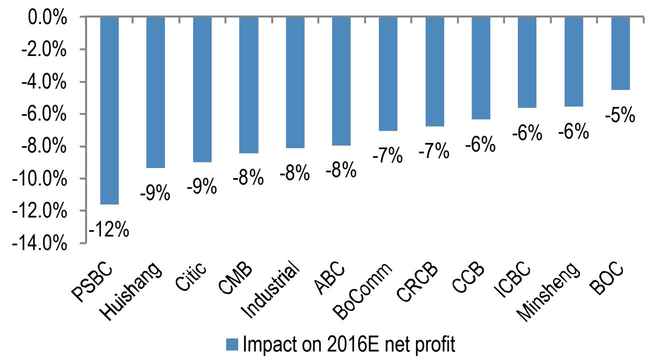
Overall, we estimate that a 25bp rate cut will push down 2016E NIMs by 9bp on average, and net profit by 8%. The impact on PSBC's profits would be more pronounced (-12%) due to the sticky nature of agency fees, which are generally renegotiated annually through a lengthy process. As a result, agency rates would not adjust down for some time while lending rates and overall money market rates fall putting pressure on margins.

Figure 124: Impact of 25bp rate cut on NIM



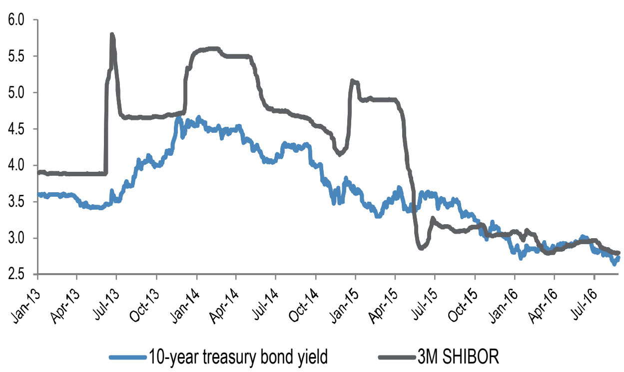
Source: Company data, J.P. Morgan estimates.

Figure 125: Impact of 25bp rate cut on 2016E net profit



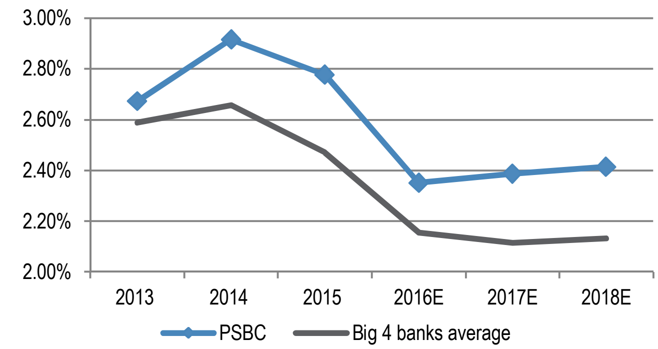
Source: Company data, J.P. Morgan estimates.

Figure 126: 10Y treasury yield and interbank yields



Source: CEIC, Wind.

Figure 127: NIM under pressure from rate cuts



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

Katherine Lei
(852) 2800-8552
katherine.lei@jpmorgan.com

Financial Analysis

We forecast PSBC's net profit to grow by 7%, 20%, and 18% in 2016, 2017, and 2018, respectively, based on our view of:

- Strong revenue growth driven by loan growth, margin expansion and robust fee income growth.
- Defensive asset quality characteristics relative to peers.
- Cost-efficiency improvement driven by expansion into the corporate segment, leveraging e-channels for retail business and increase in share of self-owned branch deposits.

Please see Table 55 and 56 for key forecast assumptions and DuPont breakdown.

Table 55: Key growth forecasts of PSBC

Year-end Dec	2014	2015	2016E	2017E	2018E
Loans	25%	32%	15%	18%	20%
Deposits	11%	9%	11%	10%	10%
Assets	13%	16%	12%	11%	10%
Equity	33%	44%	30%	11%	11%
RWA	22%	42%	18%	16%	15%
Net interest income	21%	7%	-6%	14%	12%
Non-interest income	-3%	88%	66%	24%	27%
of which: fee income	9%	34%	40%	34%	34%
Revenue	20%	10%	-2%	15%	14%
Costs	12%	8%	3%	8%	9%
Pre-provisional profits	37%	12%	-9%	30%	23%
Loan loss provision	122%	29%	-42%	68%	37%
Pre-tax income	12%	5%	7%	20%	18%
Attributable income	10%	7%	7%	20%	18%

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

Table 56: DuPont analysis of PSBC

Year-end Dec	2013	2014	2015	2016E	2017E	2018E
NIM (as % of avg IEA)	2.67%	2.92%	2.78%	2.35%	2.39%	2.41%
Earnings assets/Assets	93.3%	97.0%	95.0%	92.6%	92.9%	93.3%
Margins (as % of avg assets)	2.49%	2.83%	2.64%	2.18%	2.22%	2.25%
Non-int rev/Revenue	4.3%	3.5%	6.0%	10.1%	10.8%	12.0%
Non-int rev/Avg assets	0.1%	0.1%	0.2%	0.2%	0.3%	0.3%
Rev/Assets	2.6%	2.9%	2.8%	2.4%	2.5%	2.6%
Cost/Income	69.9%	65.6%	64.8%	68%	63%	61%
Cost/Assets	1.8%	1.9%	1.8%	1.6%	1.6%	1.6%
Pre-provision ROA	0.8%	1.0%	1.0%	0.8%	0.9%	1.0%
LLP/Loans	0.54%	1.06%	1.07%	0.50%	0.73%	0.83%
Loan/Assets	26.2%	29.1%	33.1%	33.9%	35.9%	39.0%
Pre-Tax ROA	0.6%	0.7%	0.6%	0.6%	0.6%	0.7%
Tax rate	15.5%	17.2%	15.8%	15.8%	15.8%	15.8%
ROA	0.57%	0.55%	0.51%	0.48%	0.52%	0.55%
RoRWA	1.63%	1.62%	1.30%	1.09%	1.12%	1.15%
Avg. Assets/Equity	39.5x	36.1x	29.7x	25.0x	23.5x	23.4x
ROE	21.0%	19.8%	15.2%	12.1%	12.2%	13.0%

Source: Company data, J.P. Morgan estimates. Note: * We include business taxes and surcharges in costs.

Katherine Lei
(852) 2800-8552
katherine.lei@jpmorgan.com

Balance sheet analysis

Assets

We forecast healthy asset growth of 12%, 11%, and 10% in 2016-18, faster than at the Big 4 SOE banks. We expect a shift in asset mix away from investment towards loans as the share of investments in assets drops from 41% of total assets in 2015 to 37% in 2018E.

- **Strong loan growth (~18% CAGR 2016E-18E):** We forecast robust loan growth of 15%/18%/20% in 2016-18, faster than peers (12% average growth at national banks) mainly driven by: a) continued focus on retail loans; and b) taking advantage of corporate loans opportunities by leveraging past experience. Indeed, due to strong loan growth, we expect the LDR for PSBC to increase from 39% in 2015 to 48% by 2018, but still significantly below the 75% average LDR of the Big 4 SOE banks in 2018E.
- **Investment growth to slowdown:** Investment book grew 89% y/y in 2015 as PSBC opportunistically took advantage of higher-yielding non-standardized assets (NSA), as NSAs rose from 8% of total assets in 2014 to 15% in 2015. However, NSAs come with additional regulatory and credit risks, and combined with falling money market yields tend to constrain investment growth. As a result, we expect 9%, 8%, and 6% growth in investment book in 2016-18E.

Table 57: PSBC – Asset growth

	2013	2014	2015	2016E	2017E	2018E
Asset balance (Rmb bn)						
Cash and Central bank assets	1,226	1,390	1,131	1,310	1,431	1,575
Interbank	1,525	1,401	673	754	807	734
Investment	1,277	1,580	2,987	3,255	3,500	3,710
Loan	1,463	1,832	2,413	2,782	3,281	3,930
Others	83	95	92	102	112	123
Total assets	**5,574**	**6,298**	**7,296**	**8,204**	**9,131**	**10,072**
Growth rate						
Cash and Central bank assets		13%	-19%	16%	9%	10%
Interbank		-8%	-52%	12%	7%	-9%
Investment		24%	89%	9%	8%	6%
Loan		25%	32%	15%	18%	20%
Others		15%	-3%	10%	10%	10%
Total assets		**13%**	**16%**	**12%**	**11%**	**10%**

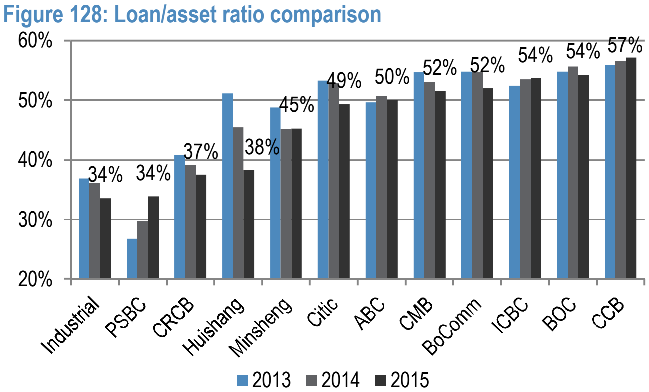
Source: J.P. Morgan estimates, Company data.

Table 58: PSBC – Asset composition

Asset Composition	2013	2014	2015	2016E	2017E	2018E
Cash & central bank assets	22%	22%	16%	16%	16%	16%
Interbank	27%	22%	9%	9%	9%	7%
Investments	23%	25%	41%	40%	38%	37%
Loans	26%	29%	33%	34%	36%	39%
Others	1%	2%	1%	1%	1%	1%
Total Assets	100%	100%	100%	100%	100%	100%

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

Figure 128: Loan/asset ratio comparison



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

Loan breakdown

Figure 129: Loan composition comparison as of 2015

Loan mix	PSBC	ABC	BOC domestic	ICBC	CCB	BoCom	Citic	CMB	Minsheng	CRCB	Huishang
Corporate	**40%**	**60%**	**56%**	**58%**	**55%**	**70%**	**64%**	**48%**	**61%**	**62%**	**65%**
Manufacturing	6%	15%	19%	13%	12%	17%	16%	11%	13%	19%	15%
Production of Electric and heating power, gas & water	5%	7%	7%	7%	6%	4%	2%	4%	1%	4%	11%
Wholesale & Retail	2%	6%	12%	6%	4%	9%	10%	8%	9%	6%	21%
Mining	2%	3%	6%		2%			2%	6%		
Real estate	2%	6%	6%	4%	4%	6%	9%	6%	12%	7%	6%
Construction	2%	2%	2%	2%	2%	3%	4%	3%	3%	3%	5%
Other Corporate	21%	22%	4%	27%	25%	32%	24%	13%	17%	24%	6%
Discount Bills	**11%**	**4%**	**10%**	**4%**	**4%**	**3%**	**3%**	**3%**	**4%**	**3%**	**9%**
Retail	**49%**	**31%**	**33%**	**29%**	**33%**	**27%**	**26%**	**43%**	**36%**	**36%**	**26%**
Mortgages	23%	22%	25%	21%	26%	16%	10%	17%	6%	16%	18%
Personal business loans	12%	3%						11%	18%	13%	4%
Others	14%	6%	9%	8%	7%	10%	15%	15%	11%	7%	4%
Overseas	**0%**	**5%**	**0%**	**9%**	**8%**		**6%**	**6%**	**0%**	**0%**	**0%**
Total	**100%**	**100%**	**100%**	**100%**	**100%**	**100%**	**100%**	**100%**	**100%**	**100%**	**100%**

Source: Company data.

Table 59: PSBC – loan mix

Loan mix	2013	2014	2015	1Q16	1Q16-adj *
Corporate	**47%**	**43%**	**40%**	**39%**	**47%**
Manufacturing	7%	6%	6%	6%	5%
Production of Electric and heating power, gas & water	7%	6%	5%	5%	5%
Wholesale & Retail	3%	3%	2%	2%	2%
Mining	2%	1%	2%	1%	1%
Real estate	1%	1%	2%	2%	2%
Construction	1%	1%	2%	2%	1%
Other Corporate	27%	24%	21%	20%	30%
Discount Bills	**3%**	**6%**	**11%**	**13%**	**11%**
Retail	**49%**	**51%**	**49%**	**49%**	**42%**
Mortgages	20%	21%	23%	24%	21%
Personal business loans	16%	15%	12%	11%	10%
Others	13%	15%	14%	13%	11%
Total	**100%**	**100%**	**100%**	**100%**	**100%**

Source: Company data. Note: * adjusted for non-standardized assets.

Liabilities

We forecast liabilities growth of 12%/11%/10% in 2016-18, with a recovery in deposit growth in 2016, while interbank growth slows.

- **Stable deposit growth:** Deposits grew 9% y/y in 2015, but we expect faster deposit growth in line with a pick-up M2 growth. As such, we forecast stable deposit growth of 11%/10%/10% y/y in 2016/17/18.
- **Interbank funding growth to slowdown:** In 2015, interbank funding jumped 219% y/y due to: a) slower deposit growth, down from 11% y/y in 2014 to 9% in 2015; and b) opportunistic shift driven by falling interbank rates in 2015. As deposit growth recovers, we expect interbank funding growth to slow down to 20%, 25% and 12% y/y during 2016-18.

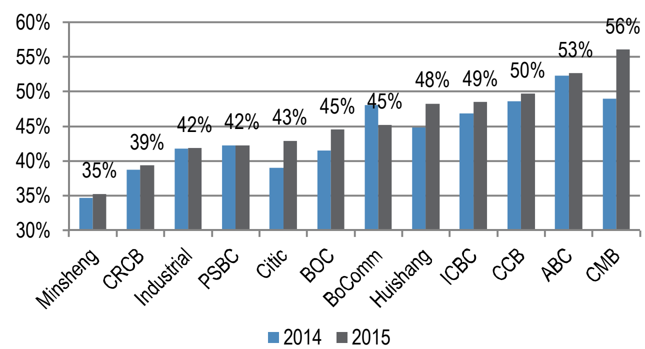
Katherine Lei
(852) 2800-8552
katherine.lei@jpmorgan.com

Table 60: PSBC – Liabilities breakdown and growth rates

	2013	2014	2015	2016E	2017E	2018E
Liability Balances (Rmb bn)						
Interbank	113	175	557	668	836	936
Deposits	5,206	5,803	6,305	6,999	7,698	8,468
Others	114	133	163	186	209	236
Total liabilities	**5,433**	**6,110**	**7,026**	**7,853**	**8,743**	**9,640**
Growth rate						
Interbank		55%	219%	20%	25%	12%
Deposits		11%	9%	11%	10%	10%
Others		16%	23%	14%	12%	13%
Total liabilities		**12%**	**15%**	**12%**	**11%**	**10%**

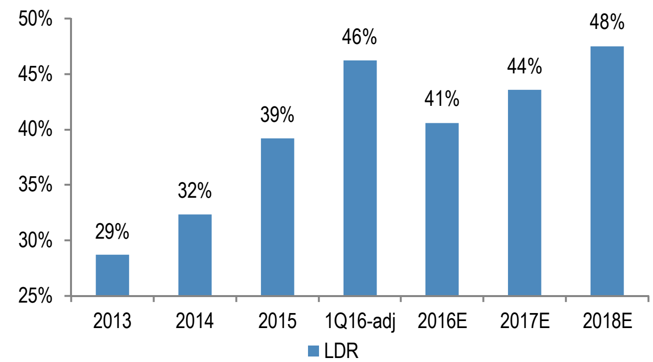
Source: J.P. Morgan estimates, Company data.

Figure 130: Deposit mix comparison – demand deposit (as % of total deposits)



Source: Company data.

Table 61: PSBC – LDR trend



Source: J.P. Morgan estimates, Company data. Note: 1Q16 LDR is adjusted by adding NSA to loan book.

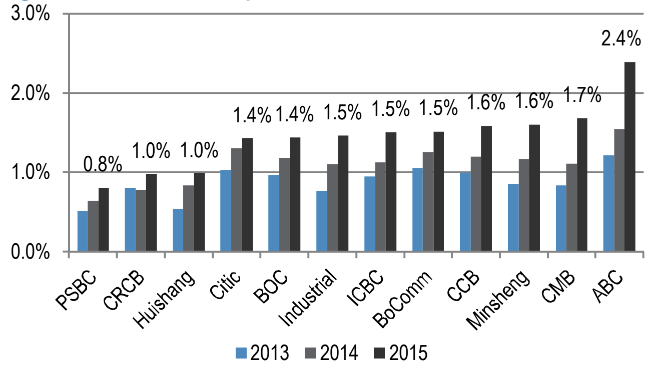
Asset quality

PSBC's NPL and SML ratios were 0.80% and 1.50%, respectively, in 2015, the lowest among the national banks we cover. PSBC's better asset quality is due to a) its relatively short lending history, and not being exposed to the 2009 lending spree; b) focus on retail business; c) low exposure to high-risk sectors; d) more stringent NPL recognition. As a result, we expect the following trends for asset quality:

- **Asset quality to deteriorate, but better than peers:** Asset quality at PSBC will deteriorate in line with industry trend, in our view. Indeed, we expect the NPL ratio to rise from 0.80% in 2015, to 0.89% in 2018. That said, asset quality at PSBC should remain better than peers' (2% average NPL ratio for national banks in 2018E). For more details on asset quality trends at PSBC, please refer to page 24.
- **Healthy NPL coverage & credit costs in 2017E-18E:** In 2016/17, we expect PSBC to draw down NPL coverage (from 298% in 2015 to 256% in 2017E) to support earnings growth, but coverage would remain relatively healthy (265% in 2018E). As a result, credit costs in 2017E-18E would be driven by NPL pressures, and we forecast credit costs of 73bps/83bps in 2017/18, lower than the national banks' average (142bps/146bps).

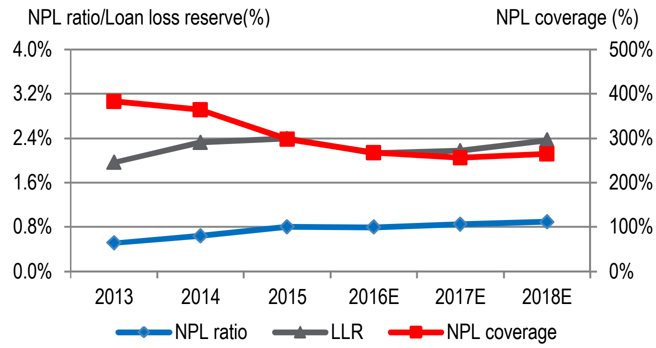
Katherine Lei
(852) 2800-8552
katherine.lei@jpmorgan.com

Figure 131: NPL ratio comparison



Source: Company data.

Figure 132: PSBC – NPL ratio, LLR, NPL coverage



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

Table 62: NPL, special mention and overdue loan ratios

	NPL ratio			Special mention loan ratio			Overdue loan ratio		
	2013	2014	2015	2013	2014	2015	2013	2014	2015
PSBC	**0.51%**	**0.64%**	**0.80%**	**3.47%**	**2.25%**	**1.50%**	**0.60%**	**0.82%**	**0.99%**
ABC	1.22%	1.54%	2.39%	3.82%	3.84%	4.20%	1.39%	2.06%	3.14%
BOC domestic	1.16%	1.47%	1.77%	2.95%	2.86%	3.02%	1.16%	1.48%	1.96%
ICBC	0.94%	1.13%	1.50%	1.98%	2.90%	4.36%	1.35%	1.91%	2.79%
CCB	0.99%	1.19%	1.58%	2.38%	2.97%	2.89%	1.01%	1.41%	1.65%
BoComm	1.05%	1.25%	1.51%	1.81%	2.68%	3.17%	1.41%	2.37%	3.04%
Citic	1.03%	1.30%	1.43%	1.19%	3.12%	3.57%	1.83%	3.47%	2.96%
CMB	0.83%	1.11%	1.68%	1.12%	1.86%	2.61%	1.50%	2.10%	2.85%
Minsheng	0.85%	1.17%	1.60%	1.29%	1.98%	3.69%	1.74%	2.74%	3.94%
CRCB	0.80%	0.78%	0.98%	2.56%	2.35%	2.26%	1.23%	1.25%	1.82%
Huishang	0.54%	0.83%	0.99%	1.91%	2.07%	2.89%	0.77%	1.45%	2.03%
Industrial	0.76%	1.10%	1.46%	0.64%	1.82%	2.35%	1.06%	2.25%	2.74%

Source: Company data.

Figure 133: NPL trend by loan segment

NPL ratio by loan segment	2013	2014	2015
Corporate	**0.12%**	**0.39%**	**0.73%**
Manufacturing	0.40%	1.15%	2.16%
Production of Electric and heating power, gas & water	0.00%	0.02%	0.02%
Wholesale & Retail	0.72%	2.61%	4.25%
Mining	0.00%	0.16%	0.26%
Real estate	0.07%	0.05%	0.02%
Construction	0.07%	0.34%	0.80%
Discount Bills	**0.01%**	**0.00%**	**0.00%**
Retail	**0.92%**	**0.92%**	**1.04%**
Mortgages	0.09%	0.14%	0.22%
Personal business loans	0.35%	0.69%	1.50%
Total	**0.51%**	**0.64%**	**0.80%**

Source: Company data.

Figure 134: PSBC – NPL ratio by geography

NPL ratio by geography	2013	2014	2015
Head office	0.05%	0.13%	0.21%
Central China	0.72%	0.60%	0.72%
Western China	0.53%	0.60%	1.06%
Yangtze River Delta	0.55%	0.67%	0.68%
Bohai Rim	0.73%	0.55%	0.68%
Pearl River Delta	0.51%	0.50%	0.71%
North-eastern China	1.66%	2.08%	1.96%
Total	**0.51%**	**0.64%**	**0.80%**

Source: Company data.

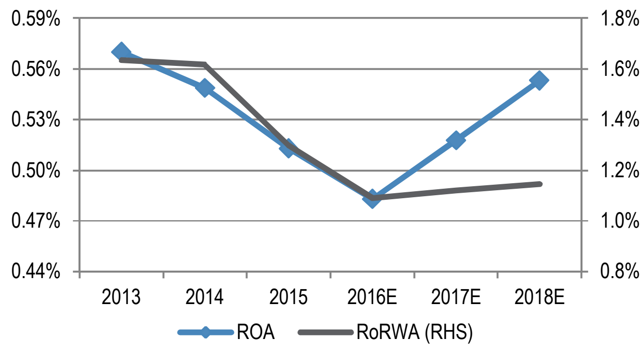
Katherine Lei
(852) 2800-8552
katherine.lei@jpmorgan.com

Profitability analysis

We expect ROA to be under pressure in 2016 (down to 0.48%, from 0.51% in 2015) largely due to margin pressure. That said, we forecast ROA to recover in 2017-18 driven by recovery in NII growth, stable asset quality, and improving cost efficiency. We forecast ROE of 12.1%, 12.2%, and 13.0% in 2016, 2017, and 2018, respectively.

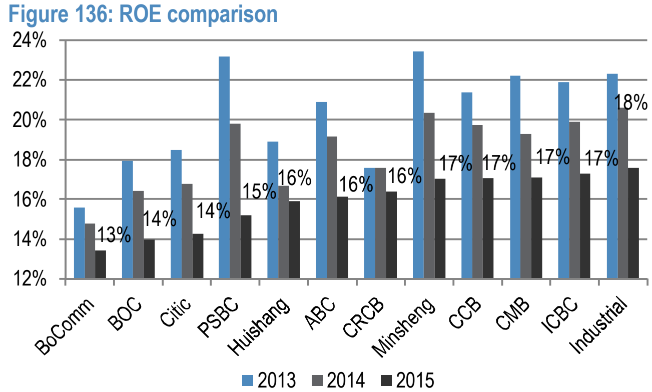
ROA, RoRWA, and ROE

Figure 135: PSBC – ROA and RORWA trend



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

Figure 136: ROE comparison



Source: Company data.

Net interest income

- **6% NII drop in 2016E driven by NIM pressure:** We forecast NII to drop 6% y/y in 2016 largely driven by margin pressures (-43bps y/y). We expect asset yields to bottom out in 1H16 as the impact of rate cuts gets priced into lending yields and money market rates fall over the last year.
- **NII growth to recover in 2017E-18E:** Beyond 2016, we expect NII growth to pick up to 14%/12% in 2017/18 along with NIM expansion from 2.35% in 2016E to 2.39% and 2.41% in 2017E-18E, driven by:

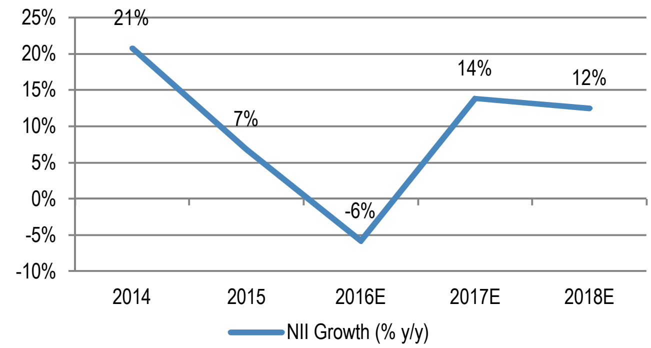
  a) **Rising LDR to support NIM:** As loan growth outpaces deposit growth (19% vs 10% 2017E-18E average), we expect LDR to rise to ~48% in 2018. PSBC's lending yield was ~173bp higher than the non-lending yield in 1Q16 and rising LDR would support NIM in the future.

  b) **Lower deposit costs, partly offset by investment yields:** Due to the high proportion of time deposits at PSBC, we expect deposits to price in the rate cuts with a lag relative to loans. Lower deposit costs (1.48% 2017E-18E average vs 1.93% in 2015) would partly be offset by falling investment yields (down 10bp/11bp in 2017E/18E) as maturing NSAs would be replaced with lower-yielding assets.

  c) **Supportive volume growth:** We expect NII to get an additional boost from volume growth with loans growing at 18%/20% and IEA growing at 12%/10% in 2017E/18E, compared to 11%/10% IBL growth.

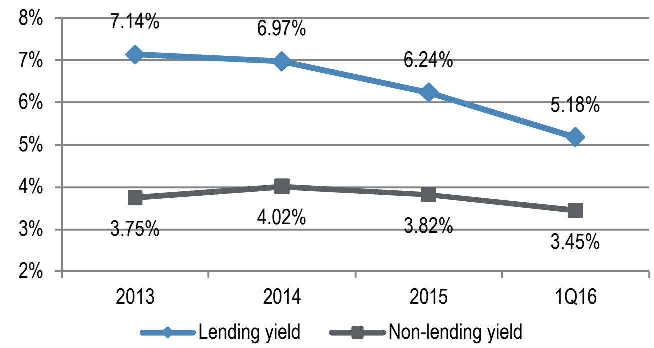
Katherine Lei
(852) 2800-8552
katherine.lei@jpmorgan.com

Figure 137: NII growth trend



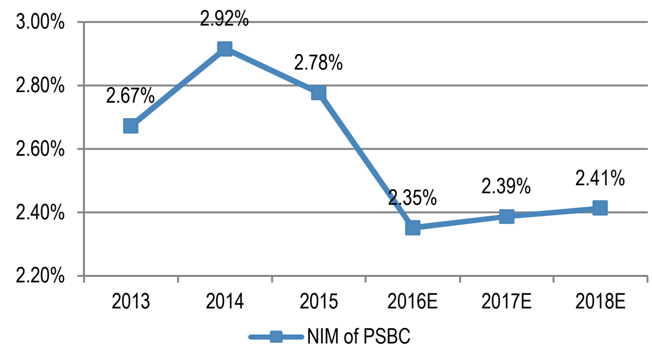
Source: CEIC

Figure 138: Lending yield vs non-lending yield



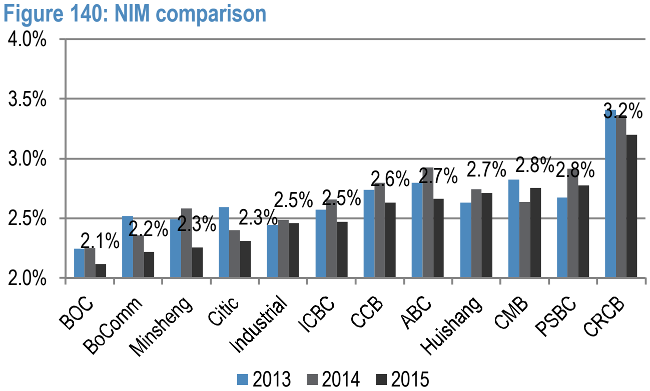
Source: Company data

Figure 139: PSBC – NIM trend



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

Figure 140: NIM comparison



Source: Company data.

Table 63: PSBC – NIM breakdown

NIM Breakdown	2013	2014	2015	2016E	2017E	2018E
Gross loans	7.14%	6.97%	6.24%	4.80%	4.93%	5.02%
Investments	3.94%	4.44%	4.55%	3.87%	3.76%	3.65%
Central bank	1.98%	1.92%	1.87%	1.87%	1.87%	1.87%
Other interbank	4.98%	5.49%	4.87%	3.87%	3.87%	3.87%
Average IEA Yield	**4.66%**	**4.90%**	**4.66%**	**3.87%**	**3.89%**	**3.93%**
Deposits	1.97%	2.01%	1.93%	1.48%	1.47%	1.50%
Interbank	3.79%	2.72%	2.23%	2.38%	2.38%	2.38%
Debt and Securities	NA	NA	4.50%	4.50%	4.50%	4.50%
Average Funding Costs	**2.00%**	**2.02%**	**1.94%**	**1.54%**	**1.54%**	**1.56%**
NIM	**2.67%**	**2.92%**	**2.78%**	**2.35%**	**2.39%**	**2.41%**

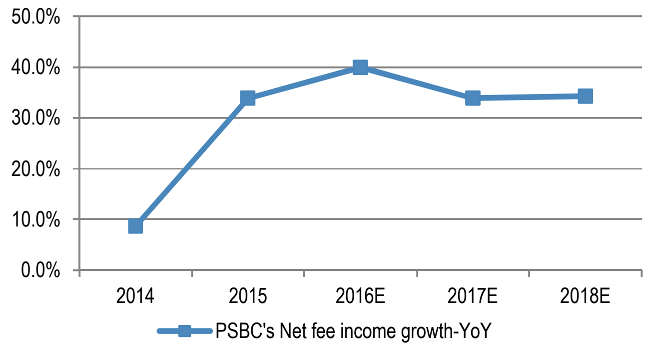
Source: Company data, J.P. Morgan estimates.

Katherine Lei
(852) 2800-8552
katherine.lei@jpmorgan.com

Fee income

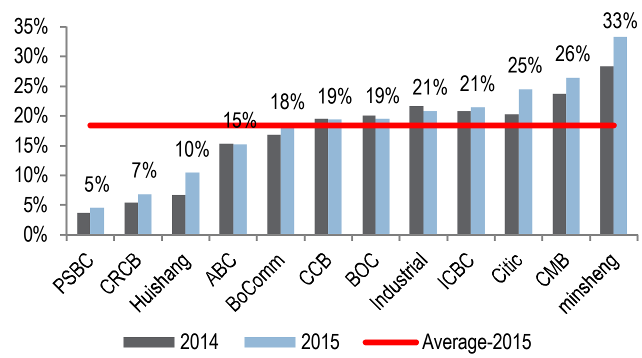
We forecast strong fee income growth of 40%, 34%, and 34% in 2016E-18E, as PSBC takes advantage of expanding business scope including credit card business, WMP & agency business. As such, we expect contribution of fee income to revenue to increase from 5% in 2015 to 9% in 2018. For more details on drivers of fee income growth please refer to page 41 of investment positives.

Figure 141: PSBC – Net fee income growth



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

Figure 142: Fee income contribution to revenue



Source: Company data.

Operating expense & efficiency

We forecast operating expense growth of 3%, 8%, and 9% in 2016E-18E for PSBC, slower than revenue growth, resulting in cost efficiency improvement. Key trends on costs and efficiency are:

- **Improving cost efficiency:** CIR for PSBC is expected to trend down from 65% in 2015 to 61% in 2018E. Agency cost accounts for ~44% of operating expense, and adjusted for agency costs, CIR was 51% in 2015 and we expect it to fall to 45% in 2018E. We expect cost efficiency to be driven by:

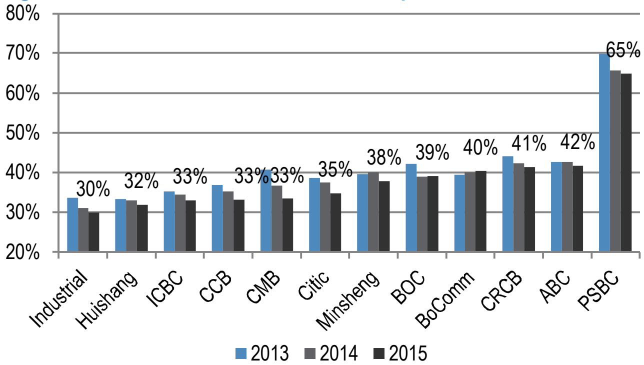
  a) Past experience in efficiency improvement: Past experience suggests that banks significantly improved efficiency after listing. Indeed, the SOE banks had 45% average CIR when they listed vs 37% in 2015, and we expect PSBC to follow similar trend (please see Table 35 for details).

  b) Efficiency boost from e-channel, corporate business growth: CIR is usually higher for retail banks, but PSBC has the potential to leverage online/mobile channels to boost efficiency. Furthermore, we expect that PSBC would continue to develop its corporate business which would further boost efficiency.

- **Modest agency fee growth:** Agency fees for deposit taking accounted for 44% of total operating expense in 2015, growing at 8% y/y. We forecast agency fee growth of 7%/9%/10% in 2016E-18E, slower than deposit growth. This is driven by a) falling deposit share of agency balance (down from 63% of total deposits in 2015 to 61% in 2018E); b) steady composite rate of ~1.4%.

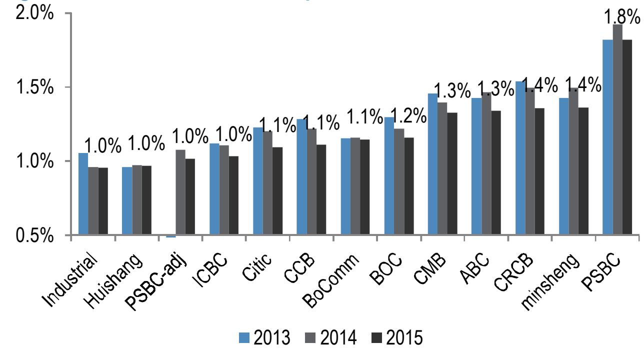
Katherine Lei
(852) 2800-8552
katherine.lei@jpmorgan.com

Figure 143: PSBC – Cost/income ratio comparison



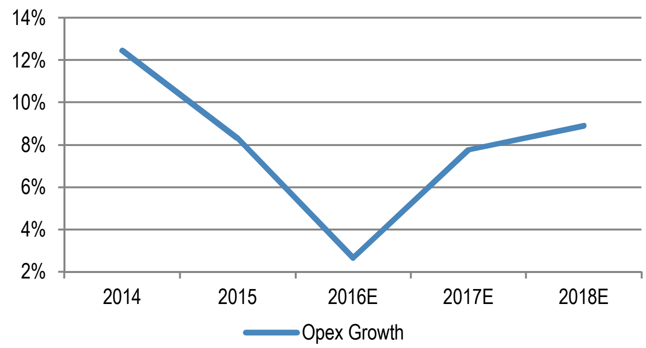
Source: Company data.

Figure 144: Cost/asset ratio comparison



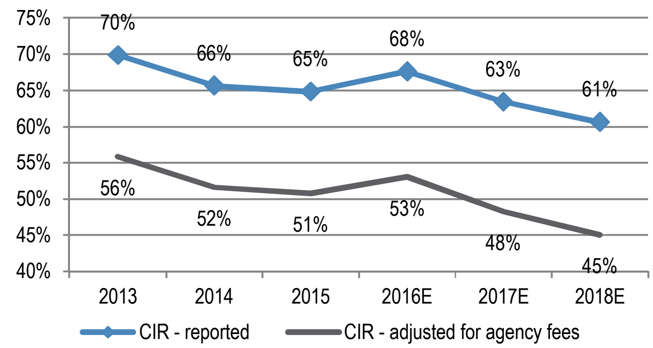
Source: Company data.

Figure 145: Cost growth trend



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

Figure 146: Cost income ratio – Reported vs adjusted for agency fees



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

1Q16 review

PSBC reported 1Q16 net profit of Rmb12.5bn, up 11% y/y, largely driven by Rmb2.2bn write-back on non-loan provisions even as PPOP declined 13% y/y due to flat revenues and 9% y/y increase in costs. Key highlights of 1Q16:

- **Flat revenues as NII & NIM under pressure:** Revenues were flat y/y as NII dropped 7% y/y driven by a 57bp y/y drop in NIM, due to PBOC rate cuts. Pressure on NII was offset by 137% y/y growth in non-interest income and 36% y/y growth in fee income.
- **CIR rose 535bp:** Costs grew 9% y/y in 1Q16 and along with flat revenues pushed up CIR by 535bp y/y, to 65.5%. Cost growth was driven by 22% y/y growth in G&A expenses and 10% y/y growth in agency deposit fee even as staff cost growth was much more muted at 2% y/y.
- **Stable asset quality:** Asset quality showed signs of stabilizing in 1Q16, with NPL ratio of 0.81% in 1Q16 vs 0.80% in 4Q15. Despite the stable NPL ratio, NPL coverage dropped 11%pts q/q, to 287%, still significantly above the average of the Big 4 banks at 156%.

Katherine Lei
(852) 2800-8552
katherine.lei@jpmorgan.com

Table 64: PSBC – 1Q16 income statement summary

Rmb mn	1Q15	1Q16	y/y
NII	44,972	41,700	-7%
Non-Interest Income	2,458	5,814	137%
Fees	2,184	2,963	36%
Non-Fee	274	2,851	941%
Total income	47,430	47,514	0%
Operating expenses	-28,510	-31,103	9%
PPOP	18,920	16,411	-13%
LLP	-4,473	-4,302	-4%
Other Provisions	-333	2,174	n.m.
Pre-Tax Income	14,114	14,283	1%
Income Tax	-2,858	-1,796	-37%
Attributable income	11,256	12,492	11%
Key ratios			
NIM	2.92%	2.35%	-57 bps
CIR	60.1%	65.5%	535 bps
ROA	0.71%	0.67%	-4 bps
Return on net assets	23.63%	18.44%	-519 bps

Source: Company data, J.P. Morgan.

Table 65: PSBC – 1Q16 balance sheet summary

Rmb mn	4Q15	1Q16	q/q
Gross Loans	2,471,853	2,665,754	7.8%
NPLs	19,875	21,500	8.2%
Assets	7,296,364	7,707,634	5.6%
Deposits	6,305,014	6,732,381	6.8%
Equity	270,448	273,426	1.1%
Key ratios			
NPL ratio	0.80%	0.81%	1 bps
NPL coverage	298%	287%	-11%
LDR	39%	40%	39 bps
Tier1 Ratio	8.53%	8.35%	-18 bps
CAR	10.46%	10.26%	-20 bps

Source: Company data.

1H16/2Q16 highlights

Asset quality seems to be at an inflection point and NIM is showing early signs of stabilizing for PSBC in 1H16. Some key trends for 1H16 are as follows:

- **NII fell 7% y/y driven by VAT regime and margins:** Net interest income fell 7% y/y in 1H16, to Rmb81.6bn, (and -4.3% q/q in 2Q16) due to a) New VAT regime which requires VAT payables to be deducted from NII; b) continued pressures on margins due to PBOC rate cuts and higher deposit costs.
- **Early signs of NIM stabilization:** Even though NIM fell 44bp h/h, we note that NIM compression trend appears to be stabilizing. Based on our estimates, NIM fell 10bp q/q in 2Q16, compared to larger drop in 1Q16 (2.35% in 1Q16 vs 2.74% in 2H15). This supports our view that NIM would bottom out in 2H16.
- **Asset quality at inflection point:** NPL ratio improved 3bp q/q and 2bp h/h, to 0.78%, driven by focus on risk management, loan collection and NPL disposal. PSBC's higher exposure to retail and SME loans make NPLs reflect asset quality more timely than other banks which have larger corporate/SOE exposures.

Katherine Lei
(852) 2800-8552
katherine.lei@jpmorgan.com

- **Asset growth slowed in 2Q16, in line with expectations:** PSBC's assets grew 9.3% h/h in 1H16, to Rmb7.97tn, but we also note that asset growth slowed in 2Q16 to 3.5% q/q vs 5.6% in 1Q16, in line with expectations.

Table 66: PSBC – 1H16/2Q16 highlights

	2H15	1H16	h/h	1Q16	2Q16	q/q
NIM	2.74%	2.30%	-44 bps	2.35%	2.25%	-10 bps
NPL ratio	0.80%	0.78%	-2 bps	0.81%	0.78%	-3 bps
NII (Rmb bn)	91.6	81.6	-11%	41.7	39.9	-4.3%
Assets (Rmb bn)	7,296	7,975	9.3%	7,708	7,975	3.5%

Source: Company data, J.P. Morgan calculations

Katherine Lei
(852) 2800-8552
katherine.lei@jpmorgan.com

Investment Thesis, Valuation and Risks

Postal Savings Bank of China *(Overweight; Price Target: HK$5.30)*

Investment Thesis

We initiate coverage with an Overweight rating and a Dec-17 price target of HK$5.30. The shares have underperformed their Big 4 peers by c.7% since listing, and the premium over H-share national banks has narrowed from 25% to 13%. In our view, PSBC deserves a premium to peers due to: a) its better risk profile as corporate credits are c.18% of IEA vs peers at c.34%, b) stronger profit growth with 2016E-2018 CAGR at 15% vs peers of 6% on average; and c) its stronger focus on retail banking.

Valuation

Our Dec-17 price target of HK$5.30 is based on DDM using a cost of equity of 12.7%, normalized ROE of 12.2% and terminal date of 31 December 2018.

Risks to Rating and Price Target

- Relatively rapid recent loan growth raises concerns about rising credit risks
- Risk associated with non-standardized assets on investment book could be under-recognized
- Higher implicit deposit costs through agency-fee structure with China Postal Group
- Industry risks associated with slow macro growth, asset quality deterioration and shadow banking
- Risk to profit growth due to regulatory intervention on fees and interest rate cuts

Katherine Lei
(852) 2800-8552
katherine.lei@jpmorgan.com

Appendix I: History of Postal Savings Bank of China

Table 67: History and major events of PSBC

Year	Major events
2007	- Postal Savings Bank of China Limited was established
	- Launched micro loan business and entering retail credit business
2008	-Issued first credit card; launched personal business loan and personal consumer loan businesses
2009	- Launched corporate proprietary loan, and corporate loans to small enterprises businesses
	- Cumulative micro loans extended exceeded Rmb100bn
	- Rmb10bn capital injection by China Post Group
2010	- Launched online banking services for retail customers
	- Started cash management services for corporate customers
	- Rmb11bn capital injection by China Post Group
2012	- Converted into joint stock limited liability company, Postal Savings Bank of China Co., Ltd.
	- Tier 1 branches authorized to engage in corporate credit business
	- Launched cross-border Renminbi settlement business
	- Started mobile banking services
2013	- Balance of corporate loans to small enterprise exceeded Rmb100bn
2014	- Rmb2bn capital injection by China Post Group
	- Number of electronic banking customers exceeded 100mn
	- Balance of personal deposits exceeded Rmb5tn
	- Became the 5th largest PRC commercial banks, assets reached Rmb6,298bn
2015	- Rmb10bn capital injection by China Post Group
	- Introduced 10 strategic investors, who invested Rmb45.14bn
	- Established PSBC Consumer Finance subsidiary in Nov-15
	- Issued Rmb25bn of Tier-2 capital bonds in Sep-15

Source: Company data

Katherine Lei
(852) 2800-8552
katherine.lei@jpmorgan.com

Appendix II: Risk Management & Credit Recognition

Credit approval process

To manage credit risk, PSBC follows stringent measures for the approval of loans including information collection, pre-loan processing by client managers, pre-loan due diligence, appraisal of collateral, and credit review by the authorization officers/credit review committee. Details of the credit risk approval process for corporate loans, personal loans and micro loans are shown in Tables 68-69.

Table 68: PSBC- Pre-loan approval process for corporate loans

Corporate loans	Corporate loans to small enterprises
- Client managers conduct pre-loan investigations (collecting information, reviewing loan materials, assigning customer credit ratings, calculating risk limits, and preparing credit investigation reports) and on-site inspections - PSBC uses 18 grade credit ratings using 25 customer rating models -Collateral appraisal conducted by internal or third-party appraisers prior to approving secured loans -Upon receipt of due-diligence report and borrower's supporting material, application submitted to credit management department -Corporate loan applications reviewed primarily at head office or branches (depending on authorization limits) - Corporate loan approval is carried out by credit approval committees and qualified, authorized credit approval officers at HO/branches. - Lastly, approved loans are sent for final approval by head of originating branch or deputy head in-charge of credit management.	-Small enterprises finance department responsible for managing loans to small enterprises and personal business loans - Client managers conduct pre-loan investigations upon receipt of application and supporting documents, including collecting customer information, reviewing application material, assigning credit ratings, calculating credit limits, preparing credit investigations report, onsite inspection -PSBC uses a separate credit rating system for small enterprises (7 categories: AAA-C). PSBC doesn't accept loan applications from applicants with ratings below BBB. - Appraisal of collateral and guarantee is done by internal/third party, followed by final confirmation by internal personnel - Credit review and approval for small enterprise conducted mainly at Tier-1 and Tier-2 branches within authorization limits. After review and receipt of due diligence report, business manager review loan before submitting to credit management department. Focus primarily on financial information, operating conditions, and generally requires collateral/pledge -Approval of loans to small enterprises by single approval office or panel of two approval officers or credit review committee and subject to final approval by authorized final approval (usually head of originating branch)

Source: Company data

Table 69: PSBC- Pre-loan approval process for personal loans, consumer loans, micro loans

Personal Loans	Consumer loans	Micro Loans
-Client managers conduct due diligence using both on-site (primarily for business loans) and off-site investigations (primarily for consumer loans) and issue investigation report. - PSBC considers basic information, credit history, income, intended use of proceeds, source/methods/ability of repayment. PSBC also uses personal credit scoring system - Personal loan applications are reviewed and approved primarily at our tier 1 and tier 2 branches within their authorization limits. Upon receipt of due diligence report, the business manager at originating branch/sub-branch review application and submit to credit management department. - Applications are approved by approval officers (single, panel of two or credit review committee) at the same level or submitted to supervising branch if above authorization limit.	- Consumer Credit Department responsible for centralized management of our consumer loans - Client managers meet applicants for consumer loans face-to-face to prevent fraud - Pre-loan investigations conducted on-site (for self employed) and off-site(for salaried borrowers) for consumer loans - Consumer loans reviewed and approved at Tier 1 and 2 branches	- Sannong Finance Department carries out centralized management of micro loans - PSBC has adopted risk adjusted pricing policy for micro loans - Pre-loan investigations for micro loans conducted by client managers. Investigators are required to visit the residence and business premises of the borrower, collect basic information about borrower and borrower's business application. - Focus on borrower's repayment ability and also seek to obtain credit enhancements to mitigate risks. - Use credit scorecards to evaluate the credit profile of applicants of micro loans. - Authority to review and approve applications is centralized at our Tier-1 and Tier-2 branches. - Applications approved by single/two approval officers or credit review committee.

Katherine Lei
(852) 2800-8552
katherine.lei@jpmorgan.com

Corporate loans	Corporate loans to small enterprises
- Client managers conduct pre-loan investigations (collecting information, reviewing loan materials, assigning customer credit ratings, calculating risk limits, and preparing credit investigation reports) and on-site inspections - PSBC uses 18 grade credit ratings using 25 customer rating models -Collateral appraisal conducted by internal or third-party appraisers prior to approving secured loans -Upon receipt of due-diligence report and borrower's supporting material, application submitted to credit management department -Corporate loan applications reviewed primarily at head office or branches (depending on authorization limits) - Corporate loan approval is carried out by credit approval committees and qualified, authorized credit approval officers at HO/branches. - Lastly, approved loans are sent for final approval by head of originating branch or deputy head in-charge of credit management.	-Small enterprises finance department responsible for managing loans to small enterprises and personal business loans - Client managers conduct pre-loan investigations upon receipt of application and supporting documents. Including collecting customer information, reviewing application material, assigning credit ratings, calculating credit limits, preparing credit investigations report, onsite inspection -Separate credit rating system for small enterprises (7 categories: AAA-C). Don't accept loan applications below BBB. -Appraisal of collateral and guarantee by internal/third party, followed by final confirmation by internal personnel - Credit review and approval for small enterprise mainly at T1 and T2 branches within authorization limits. After review and receipt of due diligence report, business manager review loan before submitting to credit management department. Focus primarily on financial information, operating conditions, and generally requires collateral/pledge -Approval of loans to small enterprises by single approval office or panel of two approval officers or credit review committee and subject to final approval by authorized final approval (usually head of originating branch)

Source: Company data

Table 70: PSBC: Collateral appraisal

Type of Collateral	Maximum LTV
Mortgages	
Buildings	70%
Land use right	70%
Vehicles	60%
Pledge	
Certificate of time deposits	90%-100%
Bank notes	90%-100%
Receivables	70%

Source: Company data

Post-loan management

Post-loan management responsibility is generally shared by client managers, credit management department and risk management department. Details of post-loan management for various types of loans are shown in Tables 71-72.

Table 71: PSBC: Post-loan management of corporate loans

Corporate loans	Corporate loans to small enterprises
- Post-loan management responsibility is shared by business departments, credit management department and risk management department - Post-loan management includes cash account monitoring, on-site inspections, routine tracking, supervision of collateral/guarantor, etc. - Risk alert systems has been setup at branches and sub-branches to identify and mitigate risks by monitoring various information (accounts, financial condition, suppliers, customers, industry trends, national macro trends)	- Post-loan management is based on customer risk and outstanding amount - Inspections include initial inspection, routine inspection, and special inspections - Originating branches required to conduct inspections into source of repayment and submit monthly inspection reports as well as hold regular meetings for post-loan management - PSBC maintains list of key borrowers of NPL from small enterprises and requires originating branches to develop plans to reduce exposures to high risk small enterprise customers

Source: Company data

Table 72: PSBC: Post-loan management of personal loans, consumer loans, micro loans

Personal loans	Consumer loans	Micro loans
- Personal loan department of originating branch is responsible for post-loan management, carried out by client managers. - Monitor risk exposure through routine post-loan inspections, account monitoring and online monitoring - Established mechanism to reduce exposure to high-risk personal loans	- Post loan management handled by client managers and post-loan management specialists through regular/ad hoc inspections	- Post loan management is carried out by client managers and post-loan management specialists. - Post loan management includes initial/regular/adhoc inspections. - Also, monitors associated industry risks and market risks at head office, branches and sub-branches - To handle overdue loans, PSBC sends automatic text messages and make phone calls when loans are due. Adopts various measures to recover NPL, including immediate repayment, loan restructuring, disposal of collateral, and disposal of assets

Source: Company data

NPL recognition

PSBC uses a five-category loan classification system, in accordance with CBRC guidelines. In general, loan classification depends on various criteria including type of borrower, type of collateral and overdue period. The key criteria for corporate loans to small enterprises, micro and other personal loans are shown in Tables 73-75.

Table 73: PSBC: Corporate loans to small enterprises

		Overdue by					
Type of collateral	Current	1-30 days	31-90 days	91-180 days	181-360 days	361-720 days	No less than 721 days
Loans secured by mortgages	Normal	Special mention	Special mention	Substandard	Doubtful	Doubtful	Loss
Loans secured by pledges	Normal	Special mention	Special mention	Substandard	Doubtful	Doubtful	Loss
Guaranteed loans	Normal	Special mention	Substandard	Doubtful	Doubtful	Loss	Loss
Unsecured loans	Normal	Special mention	Substandard	Doubtful	Doubtful	Loss	Loss

Source: Company data.

Table 74: PSBC: micro loans

		Overdue by					
Type of collateral	Current	1-10 days	11-30 days	31-90 days	91-180 days	181-360days	No less than 361 days
Loans secured by mortgages	Normal	Special mention	Special mention	Special mention	Substandard	Doubtful	Loss
Loans secured by pledges	Normal	Special mention	Special mention	Special mention	Substandard	Doubtful	Loss
Guaranteed loans	Normal	Special mention	Substandard	Doubtful	Doubtful	Loss	Loss
Unsecured loans	Normal	Special mention	Substandard	Doubtful	Doubtful	Loss	Loss

Source: Company data.

Katherine Lei
(852) 2800-8552
katherine.lei@jpmorgan.com

Table 75: PSBC: Personal loans other than micro loans

		Overdue by				
Type of collateral	**Current**	**1-30 days**	**31-90 days**	**91-180 days**	**181-360 days**	**No less than 361 days**
Loans secured by mortgages	Normal	Special mention	Special mention	Substandard	Doubtful	Loss
Loans secured by pledges	Normal	Special mention	Special mention	Substandard	Doubtful	Loss
Guaranteed loans	Normal	Special mention	Substandard	Doubtful	Loss	Loss
Unsecured loans	Normal	Special mention	Substandard	Doubtful	Loss	Loss

Source: Company data.

Appendix III: Biographies of Senior Management

Table 76: Biographies of senior management of PSBC

Name	Age	Position	Date of joining	Responsibilities	Bio
Li Guohua	56	Chairman, Non-executive Director	Mar-07	Responsible for presiding over the Board, and Chairman of the Strategic Planning Committee	Mr. Li has more than 30 years of experience in Posts & Telecommunications, including: Deputy Chief of Jiangxi Posts & Telecommunications Administration Bureau from Dec-96 to Dec-98; Deputy Chief and then Chief at Jiangxi Post Bureau from Dec-98 to Jul-05; Deputy Post Master General of the State Post Bureau from Jul-05 to Nov-06; Deputy President of China Post Group Nov-06 to Sep-11, and has been the President of China Post Group since Sep-11.
Lyu Jiajin	48	Executive Director, President	Mar-07	Responsible for daily operations & management of the company, and is in charge of Risk Management, Human Resources and General Office Departments. Mr. Lyu is also Chairman of Social Responsibility Committee, and member of various committees including, Strategic Planning, Risk Management, Nomination & Remuneration Committees	Mr. Lyu joined PSBC as Executive Director in Mar-07, and was appointed the President in Dec-12. He has more than 20 years experience in savings and remittance, including: Deputy Chief at Henan Post Bureau from Mar-01 to Feb-04; Deputy Chief of Liaoning Post Bureau from Feb-04 to Jul-05; and Deputy Director General at Postal Savings & Remittance Bureau of State Post Bureau from Jul-05 to Mar-07. Mr. Lyu has also been the Deputy President of China Post Group since May-16. He is also the Deputy Chairman of Standing Council of China Banking Association.
Zhang Xuewen	54	Executive Director, Vice President	Dec-12	Heads the Corporate Banking, Strategic Customers, Investment Banking, Financial Management, and Security departments. Also member of various committees including Strategic Planning, Related Party Transactions Control, and Nomination & Remuneration Committees.	Mr. Zhang has been ED and VP of PSBC since Dec-12, and prior to that has 17 years of experience at MOF including Deputy Director and Director of grain division of Economic Development Department of MOF from Jun-00 to Jul-04; Deputy Director General of Economic Development Department of MOF from Jul-04 to Dec-12. Mr. Zhang currently also serves as Deputy Chairman of Rural Social Insurance Commission of China Social Insurance Association, and Deputy Chairman of Banking Accounting Society of China
Yao Hong	50	Executive Director, Vice President	Mar-07	Responsible for Personal Banking department, Credit Card Center, International Business department, & Asset Liability department. Also, member of Strategic Planning Committee, Related Party Transactions Committee, and Social Responsibility Committee.	Ms. Yao joined PSBC as VP in Mar-07, and was appointed ED in May-16. She has more than 25 years of experience in postal savings and remittance including: Deputy Director of Saving Business Division under Postal Savings & Remittance Bureau of Ministry of Posts & Telecommunications from Aug-87 to Feb-98, the Director of savings business division and Associate Director General of Postal Savings & Remittance Bureau of State Post Bureau from Feb-98 to Mar-07. She also currently serves as Director of China Post Life Insurance Company since Aug-09, Director of China UnionPay Co. since Mar-14.
Qu Jiawen	53	Vice President	Dec-07	Responsible for Electronic Banking, Accounting & Operations, Audit Office, Information Technology, Software Research & Development Center, Data Center, Hefei Base Management Center, and Construction departments.	Mr. Qu was appointed VP in Dec-12 and prior to that was President of PSBC's Heilongjiang branch from Dec-07 to Apr-13. He has more than 25 years of experience in engineering, and technology within Posts and Telecommunication industry including Deputy Director & Director of engineering construction division, Director of network planning and cooperation division, Director of science & technology division, Associate Chief and Deputy Chief of Heilongjiang Post Bureau from Jan-99 to Feb-07, Deputy General Manager of Heilongjiang Post Company from Feb-07 to Dec-07. Currently, Mr. Qu is also Deputy Chairman of Internet Society of China and Executive Council member of Payment & Clearing Association of China
Xu Xueming	49	Vice President, Secretary to the Board	Nov-07	Heads the Office of the Board of Directors, Financial Markets, Asset Management, Custodian Business, Legal & Compliance, and Strategic Development departments.	Mr. Xu was appointed VP and Secretary of the Board in Dec-12, and prior to that was President of the Beijing branch from Nov-07 to Apr-13. Mr. Xu has more than 25 years of experience in savings & remittance function of Postal department, including Chief of Beijing Western Post Bureau from Jul-04 to May-06; Deputy Chief of Beijing Postal Administration Bureau from May-06 to Feb-07; and Deputy General Manager of Beijing Post Company from Feb-07 to Nov-07. Mr. Xu is also a Director of China Post Securities Company Ltd. since Dec-14.
Shao Zhibao	54	Vice President	Sep-07	Responsible for Sannong Finance, Consumer Credit, Small Enterprise Finance, Asset Resolution, and Procurement departments.	Mr. Shao was appointed PSBC's VP in Dec-12, and served as the President of the Guangdong branch from Sep-07 to Apr-13. He has more than 25 years of experience including, Associate GM and Deputy GM of Guangdong Southern Communication Group from Sep-97 to Jan-99; Chief of Guangdong Post Bureau from Jan-99 to Feb-07; Deputy GM of Guangdong Post Company from Feb-07 to Sep-07.

Source: Company data

Katherine Lei
(852) 2800-8552
katherine.lei@jpmorgan.com

Appendix IV: Favourable Policy on Rural Development

Table 77: Government policies to support Central and Western regions, Sannong and MSE sector

Sector	Year	Details
Central and Western region		
	2013	CBRC issued special policy measures to support Western Region development by requiring banks to improve the rural financial services in remote and poverty-stricken areas in Western region.
	2016	According to Sina, the government will revise the "Notice of General Administration of Customs for Implementing the Catalogue of Priority Industries for Foreign Investment in the Central-Western Region" (中西部地区外商投资优势产业目录), in order to attract more foreign capital into the Central and Western region. In particular, market access for foreign companies will be relaxed; approval process for foreign capital entry will be simplified.
	2016	The State Council published the Certain Opinions on Deepening the Development of New Urbanization (關於深入推進新型城鎮化建設的若干意見) issued by the State Council, directing greater support to counties and major towns with significant development potential and strong population-carrying capacity in Central and Western China.
	2016	In the 13th five-year plan, the government stated that it will expand market access for foreign companies in various industries to invest in china's Northeast, Central and Western regions. The government also aims at synchronizing the pace of development of the more developed eastern coastal region with that of the central and western region in order to stimulate the construction and economic activities of urban and rural areas in the central and western regions.
Urbanization		
	2014	According to the "National New-type Urbanization Plan" (国家新型城镇化规划), the government aims to lift the urbanization rate to 60% by 2020, while residents with city "hukou" should account for about 45% of the population. The government also aims to optimize city layouts by enhancing the leading role of major cities, increasing the number of small and medium-sized cities and improving the service functions of small towns.
	2014	The State Council released a circular on the household registration – "hukou"- system, which states that the government aims to remove limits in townships and small cities, relax restrictions in medium-sized cities, and set qualifications for big cities. It plans to help about 100mn people settle in towns and cities by 2020, as the dual household registration system is phased out. Authorities will set no limits for those who want to settle in small cities and towns. Medium-sized cities with a population of 1-3mn will have a low threshold, while megacities with more than 5mn residents will try to strictly control the influx of new citizens.
Small and micro enterprises		
	2013	In March 2013, the CBRC issued the Notice on Deepening Small and Micro Enterprises Banking Services (關於深化小微企業金融服務的意見), clarifying favorable policies and measures to financial institutions in respect of information sharing, credit enhancement and fiscal and tax supports for their financial service to small and micro enterprises, in order to encourage commercial banks to improve their service quality and expand financial product offerings, financing channels and network coverage for small and micro enterprises.
	2013	The Guiding Opinion of the General Office of State Council on Financial Support for Adjustment, Transformation and Upgrading of Economic Structure (國務院辦公廳關於金融支持經濟結構調整和轉型升級的指導意見) issued by the Office of the State Council on July 1, 2013, the Implementation Opinion of the General Office of State Council on Financial Support for the Development of Small and Micro Enterprises (國務院辦公廳關於金融支持小微企業發展的實施意見) issued by the Office of the State Council on August 8, 2013, and the Opinions of CBRC on Deepening the Financial Services for Small and Micro Enterprises (中國銀監會關於深化小微企業金融服務的意見) issued by the CBRC on March 21, 2013, provides that banking financial institutions shall adhere to the commercial sustainability principle and give priority in providing financial support to those small and micro enterprises whose businesses are in line with the national industrial and environmental policies, can create more job opportunities and have the intention and capability to repay the loan. Banking financial institutions shall positively adjust the credit structure subject to commercial sustainability and effective risk control.
	2013	In August 2013, the General Office of the State Council issued the Implementation Opinions on Financial Support to Developing Small and Micro Enterprises (關於金融支持 小微企業發展的實施意見) and the CBRC issued the Guiding Opinions on Further Enhancing Small and Micro Enterprises Banking Services (關於進一步做好小微企業金融 服務工作的指導意見), providing policy support to service innovations, credit enhancement and information services as well as direct financing channels, as well as financial and tax support to small and micro enterprises. This reinforced the requirements that (i) the growth rate of loans extended by each banking institution to small and micro enterprises be no lower than their respective average growth rate of loans, and (ii) the incremental loans of each banking institution to small and micro enterprises be no less than those of the previous year.
	2014	In July 2014, the CBRC issued the Notice on the Improvement and Innovation of Loan Services for Small and Micro Enterprises to Improve the Quality of Small and Micro Enterprises Banking Services (關於完善和創新小微企業貸款服務提高小微企業金融服務水平的通知), which encourages banking institutions to set reasonable loan maturities to support the working capital needs of small and micro enterprises, to expand and refine working capital loan product offerings to small and micro enterprises, and to actively explore innovative models to provide working capital loans to small and micro enterprises.
	2016	In January 2016, the State Council issued the Issuance of Plan for Promoting Inclusive Finance (2016 to 2020) (關於印發推進普惠金融發展規劃(2016-2020 年)), encouraging large banks to accelerate the establishment of specialized institutions for small and micro enterprises.
Sannong sector		
	2012	On September 17, 2012, the CBRC issued the Circular on the Publication of Measures for the Management of Rural Loans (中國銀監會

	關於印發農戶貸款管理辦法的通 知), which requires improvement in the level of services provided by banking financial institutions to support the rural community, regulation on the rural loan business activities, enhancement of risk management and control over rural loans and promotion of stable and healthy development in rural loans.
2014	In June 2014, the PBOC lowered the Renminbi statutory deposit reserve ratio by 0.5 percentage points for commercial banks which satisfied the prudent operational requirements for granting loans to small and micro enterprises and borrowers in the agricultural industry or rural areas or to farmers. In February 2015, the PBOC further lowered the Renminbi statutory deposit reserve ratio by 0.5 percentage points for commercial banks that satisfy conditions mentioned above.
2015	CBRC urged banks to channel more financial support to rural areas to help modernize the agriculture sectors. In particular - Chinese commercial banks should increase the number of loans and financial bonds they give to rural regions, - Agricultural infrastructure, including water conservation projects and road construction, in under developed areas will be prioritized - Postal Savings Bank of China should expand its petty loan business,
2015	CBRC issued the Notice on Further Improving Rural Financial Services in 2015 (hereinafter referred to as "the Notice"), requiring banking institutions to further deepen the institutional reform and continuously enhance rural financial services, so as to vigorously support agricultural modernization. The Notice points out that banking institutions should taken on more social responsibilities on supporting agriculture, proactively adapt to the actual situations of rural areas, characteristics of agricultural production and farmers' demands, continue to deepen rural financial reform and innovation, improve the pro-agricultural financial system and the capacity, and allocate more financial resources to agriculture, farmers, and rural areas.
2015	CBRC urged banks to channel more financial support to rural areas to help modernize the agriculture sectors. In particular - Chinese commercial banks should increase the number of loans and financial bonds they give to rural regions, - Agricultural infrastructure, including water conservation projects and road construction, in under developed areas will be prioritized - Postal Savings Bank of China should expand its petty loan business,
2016	The CBRC issued the Notice on Strengthening Rural Financial Service in 2016 (hereinafter referred to as the "Notice"), which requires that the banking institutions should follow the spirit of the Central Poverty Alleviation and Development Work Conference and Central Rural Work Conference, and continuously strengthen rural financial service and rigorously promote agricultural modernization. In particular: (1) To deepen the reform in agro-related financial department in rural commercial banks (2) rural credit cooperatives should better play the role of major driving force in providing services for rural households (3) banks should encourage the transformation of agricultural development model and promote the integrated development of industries in rural areas
2016	The Plan for Promoting the Development of Financial Institution (2016-2020) issued by the State Council outlined the policies and supporting measures in regards to the agricultural sector. In particular: - To promote the development of vulnerable areas and groups including micro and small enterprises, agriculture, rural areas and farmers. - Encourage financial institutions to improve services for small and micro enterprises, rural areas and farmers and urban residents. - Expanding financing channels for micro credit companies and pawnshops - Support agricultural enterprises to seek funding from capital market - Use differentiated required reserve ratio and other monetary policy tools to strengthen support for agricultural and SME re-lending and re-discount. - To incentivize FIs to strengthen support for MSE and Sannong. - to make affordable, easy and secured financial service available to farmers, small and micro enterprises and low income urban population

Source: State Council, CBRC, Sina

Katherine Lei
(852) 2800-8552
katherine.lei@jpmorgan.com

Appendix V: Comparison of Key Metrics with Peers

Table 78: Comparison with peers

as of 2015	ABC	BOC	CCB	ICBC	Big 4 Average	BoComm	Citic	CMB	Minsheng	Industrial	CRCB	Huishang	Peer Average	PSBC
Growth Rates														
Loans	10.0%	7.7%	10.7%	8.2%	**9.2%**	8.5%	15.6%	12.3%	13.0%	11.7%	10.9%	11.0%	**10.9%**	31.8%
Deposits	8.0%	7.8%	6.0%	4.7%	**6.6%**	11.3%	11.7%	8.1%	12.3%	9.5%	14.8%	13.0%	**9.7%**	8.7%
Assets	11.4%	10.3%	9.6%	7.8%	**9.7%**	14.2%	23.8%	15.7%	12.6%	20.3%	15.8%	31.8%	**15.7%**	15.8%
Equity	17.4%	14.4%	15.5%	14.3%	**15.4%**	10.4%	22.4%	14.8%	25.4%	21.6%	12.9%	13.2%	**16.6%**	44.0%
RWA	1.2%	7.2%	5.1%	5.9%	**4.9%**	11.7%	17.9%	10.9%	16.9%	17.7%	15.2%	33.8%	**13.1%**	42.4%
Revenue	3.2%	3.9%	5.4%	5.3%	**4.4%**	7.9%	16.6%	21.5%	13.9%	23.6%	10.5%	33.2%	**13.2%**	9.6%
Costs	0.9%	4.3%	-0.6%	1.0%	**1.4%**	8.7%	8.1%	10.8%	7.6%	19.3%	8.0%	28.9%	**8.8%**	8.3%
Attributable income	0.6%	0.7%	0.1%	0.5%	**0.5%**	1.0%	1.1%	3.2%	3.5%	6.5%	5.8%	8.6%	**2.9%**	7.0%
EPS	0.6%	-4.0%	0.1%	-0.8%	**-1.0%**	1.0%	1.1%	3.2%	2.3%	6.5%	5.8%	8.6%	**2.2%**	
DPS	-8.4%	-7.9%	-9.0%	-8.7%	**-8.5%**	0.0%	n.a.	3.0%	27.0%	7.0%	0.0%	0.0%	**0.3%**	
Balance Sheet Gearing														
Loan/Deposit	65.8%	77.9%	76.7%	73.3%	**73.4%**	83.0%	79.5%	79.1%	75.0%	71.6%	57.1%	67.8%	**73.3%**	39.2%
Investment/Assets	25.4%	21.4%	23.3%	22.6%	**23.1%**	23.7%	33.0%	26.1%	20.2%	49.0%	29.8%	36.2%	**28.2%**	40.9%
Loan/Assets	50.1%	54.3%	57.1%	53.7%	**53.8%**	52.0%	49.4%	51.6%	45.3%	33.6%	37.5%	38.3%	**47.5%**	33.9%
Deposit/Liability	81.7%	75.9%	80.9%	79.8%	**79.5%**	67.8%	66.3%	69.9%	64.9%	49.9%	70.3%	60.5%	**69.8%**	89.7%
Interbank Liability/Liability	10.2%	17.0%	12.3%	12.8%	**13.0%**	24.8%	25.5%	22.3%	28.8%	38.5%	22.5%	24.0%	**21.7%**	7.9%
Asset Quality/Capital														
Loan loss reserve/loans	4.5%	2.2%	2.4%	2.4%	**2.9%**	2.3%	2.4%	3.0%	2.5%	3.1%	4.1%	2.3%	**2.8%**	2.4%
NPLs/loans	2.4%	1.4%	1.6%	1.5%	**1.7%**	1.5%	1.4%	1.7%	1.6%	1.5%	1.0%	1.0%	**1.5%**	0.8%
Loan loss reserves/NPLs	189%	153%	151%	156%	**163%**	156%	168%	179%	154%	210%	420%	229%	**197%**	298%
Growth in NPL	70%	30%	47%	44%	**48%**	31%	27%	70%	55%	48%	39%	31%	**45%**	66%
Tier 1 ratio	11.0%	12.1%	13.3%	13.5%	**12.5%**	11.5%	9.2%	10.8%	9.2%	9.2%	9.9%	9.8%	**10.8%**	8.5%
Total CAR	13.4%	14.1%	15.4%	15.2%	**14.5%**	13.5%	11.9%	12.6%	11.5%	11.2%	12.1%	13.2%	**13.1%**	10.5%
Du Pont Highlights														
NIM (as % of avg. IEA)	2.7%	2.1%	2.6%	2.5%	**2.5%**	2.2%	2.3%	2.8%	2.3%	2.5%	3.2%	2.7%	**2.5%**	2.8%
Non-int rev/Revenue	19.4%	30.7%	22.0%	24.1%	**24.0%**	24.1%	28.2%	32.4%	38.7%	22.4%	7.9%	12.6%	**23.8%**	6.0%
Cost/Income*	41.8%	39.1%	33.2%	33.0%	**36.8%**	40.5%	34.8%	33.5%	37.8%	30.0%	41.5%	32.0%	**36.1%**	64.8%
Cost/Assets*	1.3%	1.2%	1.1%	1.0%	**1.2%**	1.1%	1.1%	1.3%	1.4%	1.0%	1.4%	1.0%	**1.2%**	1.8%
Pre-provision ROA	1.9%	1.8%	2.2%	2.1%	**2.0%**	1.7%	2.1%	2.6%	2.2%	2.2%	1.9%	2.1%	**2.1%**	1.0%
LLP/Loans	1.0%	0.6%	0.9%	0.7%	**0.8%**	0.8%	1.5%	2.2%	1.7%	2.2%	1.2%	1.2%	**1.3%**	1.1%
Loan/Assets	50.1%	54.3%	57.1%	53.7%	**53.8%**	52.0%	49.4%	51.6%	45.3%	33.6%	37.5%	38.3%	**47.5%**	33.9%
ROA	1.1%	1.1%	1.3%	1.3%	**1.2%**	1.0%	0.9%	1.1%	1.1%	1.0%	1.1%	1.1%	**1.1%**	0.5%
RoRWA	1.7%	1.7%	2.2%	2.2%	**1.9%**	1.5%	1.3%	1.9%	1.5%	1.6%	1.6%	1.7%	**1.7%**	1.3%
Equity/Assets	6.8%	7.8%	7.8%	7.7%	**7.5%**	7.3%	6.2%	6.6%	6.7%	5.9%	6.5%	6.5%	**6.9%**	3.7%
ROE	16.1%	14.0%	17.1%	17.3%	**16.1%**	13.4%	14.3%	17.1%	17.0%	17.6%	16.4%	15.9%	**16.0%**	15.2%

Source: Company data, J.P. Morgan. .Note: We include business taxes and surcharges in costs

Katherine Lei
(852) 2800-8552
katherine.lei@jpmorgan.com

Postal Savings Bank of China: Summary of Financials

Income Statement					
Rmb in millions, year end Dec	FY14	FY15	FY16E	FY17E	FY18E
NIM (as % of avg. assets)	2.9%	2.7%	2.2%	2.2%	2.3%
Earning assets/assets	97.0%	95.0%	92.6%	92.9%	93.3%
Margins (as % of Avg. Assets)	2.8%	2.5%	2.0%	2.1%	2.1%
Net Interest Income	167,816	179,259	168,813	192,184	216,164
Total Non-Interest Income	6,059	11,374	18,913	23,376	29,587
Fee Income	6,479	8,672	12,136	16,243	21,815
Dealing Income	(1,197)	1,221	5,000	5,000	5,000
Total operating revenues	173,875	190,633	187,726	215,560	245,751
Operating costs	(114,126)	(123,610)	(126,891)	(136,755)	(148,947)
Pre-Prov. Profits	59,749	67,023	60,835	78,805	96,804
Provisions	(20,412)	(25,635)	(16,401)	(25,521)	(33,746)
Other Inc	0	0	0	0	0
Other Exp.	-	-	-	-	-
Exceptionals	-	-	-	-	-
Associate	-	-	-	-	-
Pre-tax	39,337	41,388	44,434	53,284	63,058
Tax	(6,770)	(6,531)	(7,012)	(8,408)	(9,950)
Minorities	0	2	0	0	0
Attributable Income	32,567	34,859	37,423	44,876	53,107

Per Share Data CNY	FY14	FY15	FY16E	FY17E	FY18E
EPS	0.69	0.61	0.50	0.55	0.66
DPS	0.00	0.00	0.10	0.11	0.13
Payout	0.0%	0.0%	20.0%	20.0%	20.0%
Book value	3.30	3.94	4.33	4.79	5.33
Fully Diluted Shares	47,137	57,318	74,817	81,031	81,031
PPOP per share	1.27	1.17	0.81	0.97	1.19

Key Balance sheet Rmb in millions	FY14	FY15	FY16E	FY17E	FY18E
Net Loans	1,832,067	2,412,595	2,781,897	3,281,248	3,929,924
LLR	(43,681)	(59,258)	(60,734)	(73,057)	(95,241)
Gross Loans	1,875,748	2,471,853	2,842,631	3,354,305	4,025,165
NPLs	11,997	19,875	22,662	28,538	35,940
Investments	1,580,222	2,986,667	3,255,467	3,499,627	3,709,605
Other earning assets	58,452	55,835	61,419	67,560	74,316
Avg. IEA	5,755,501	6,454,488	7,178,841	8,051,009	8,954,910
Goodwill	-	-	-	-	-
Assets	6,298,325	7,296,364	8,203,668	9,131,204	10,072,101
Deposits	5,802,946	6,305,014	6,998,566	7,698,422	8,468,264
Long-term borrowing	0	24,973	24,973	24,973	24,973
Interbank borrowing	174,801	557,027	668,432	835,541	935,805
Avg. IBL	5,648,562	6,434,450	7,294,666	8,131,662	9,000,198
Avg. Assets	5,936,388	6,797,345	7,750,016	8,667,436	9,601,652
Common Equity	187,909	270,448	350,568	387,959	432,091
RWA	2,214,818	3,153,015	3,709,166	4,311,162	4,956,834
Avg. RWA	2,015,493	2,683,917	3,431,091	4,010,164	4,633,998

Growth Rates	FY14	FY15	FY16E	FY17E	FY18E
Loans	25.7%	31.8%	15.0%	18.0%	20.0%
Deposits	11.5%	8.7%	11.0%	10.0%	10.0%
Assets	13.0%	15.8%	12.4%	11.3%	10.3%
Equity	33.2%	43.9%	29.6%	10.7%	11.4%
RWA	22.0%	42.4%	17.6%	16.2%	15.0%
Net Interest Income	20.8%	6.8%	(5.8%)	13.8%	12.5%
Non-Interest Income	(3.2%)	87.7%	66.3%	23.6%	26.6%
of which Fee Grth	8.6%	33.8%	39.9%	33.8%	34.3%
Revenues	19.7%	9.6%	(1.5%)	14.8%	14.0%
Costs	12.5%	8.3%	2.7%	7.8%	8.9%
Pre-Provision Profits	36.5%	12.2%	(9.2%)	29.5%	22.8%
Loan Loss Provisions	122.2%	29.4%	(42.2%)	68.1%	36.5%
Pre-Tax	12.1%	5.2%	7.4%	19.9%	18.3%
Attributable Income	9.8%	7.0%	7.4%	19.9%	18.3%
EPS	5.0%	(12.0%)	(17.8%)	10.7%	18.3%
DPS	-	-	-	10.7%	18.3%

Balance Sheet Gearing	FY14	FY15	FY16E	FY17E	FY18E
Loan/deposit	31.6%	38.3%	39.7%	42.6%	46.4%
Investment/assets	24.1%	33.6%	40.3%	39.0%	37.5%
Loan/Assets	28.4%	32.0%	34.3%	35.7%	38.4%
Customer deposits/liab.	95.0%	89.7%	89.1%	88.1%	87.8%
LT debt/liabilities	0.0%	0.2%	0.3%	0.3%	0.3%

Asset Quality/Capital	FY14	FY15	FY16E	FY17E	FY18E
Loan loss reserves/loans	(2.3%)	(2.4%)	(2.1%)	(2.2%)	(2.4%)
NPLs/loans	0.6%	0.7%	0.8%	0.8%	0.9%
Loan loss reserves/NPLs	371.4%	323.0%	282.1%	261.3%	261.0%
Core Tier 1 Ratio	-	-	-	-	-
Tier 1 Ratio	8.4%	8.5%	9.5%	9.1%	8.8%
Total CAR	9.6%	10.5%	11.2%	10.5%	10.0%

Du-Pont Analysis	FY14	FY15	FY16E	FY17E	FY18E
NIM (as % of avg. assets)	2.9%	2.7%	2.2%	2.2%	2.3%
Earning assets/assets	97.0%	95.0%	92.6%	92.9%	93.3%
Margins (as % of Avg. Assets)	2.8%	2.5%	2.0%	2.1%	2.1%
Non-Int. Rev./ Revenues	3.5%	6.0%	10.1%	10.8%	12.0%
Non IR/Avg. Assets	0.1%	0.2%	0.2%	0.3%	0.3%
Revenue/Assets	2.9%	2.8%	2.4%	2.5%	2.6%
Cost/Income	65.6%	64.8%	67.6%	63.4%	60.6%
Cost/Assets	1.9%	1.8%	1.6%	1.6%	1.6%
Pre-Provision ROA	1.0%	1.0%	0.8%	0.9%	1.0%
LLP/Loans	(1.1%)	(1.1%)	(0.5%)	(0.7%)	(0.8%)
Loan/Assets	28.4%	32.0%	34.3%	35.7%	38.4%
Other Prov, Income/ Assets	0.0%	0.0%	0.0%	0.0%	0.0%
Operating ROA	0.7%	0.6%	0.6%	0.6%	0.7%
Pre-Tax ROA	0.7%	0.6%	0.6%	0.6%	0.7%
Tax rate	17.2%	15.8%	15.8%	15.8%	15.8%
Minorities & Outside Distbn.	0.0%	0.0%	0.0%	0.0%	0.0%
ROA	0.5%	0.5%	0.5%	0.5%	0.6%
RORWA	1.6%	1.3%	1.1%	1.1%	1.1%
Equity/Assets	2.8%	3.4%	4.0%	4.3%	4.3%
ROE	19.8%	15.2%	12.1%	12.2%	13.0%

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

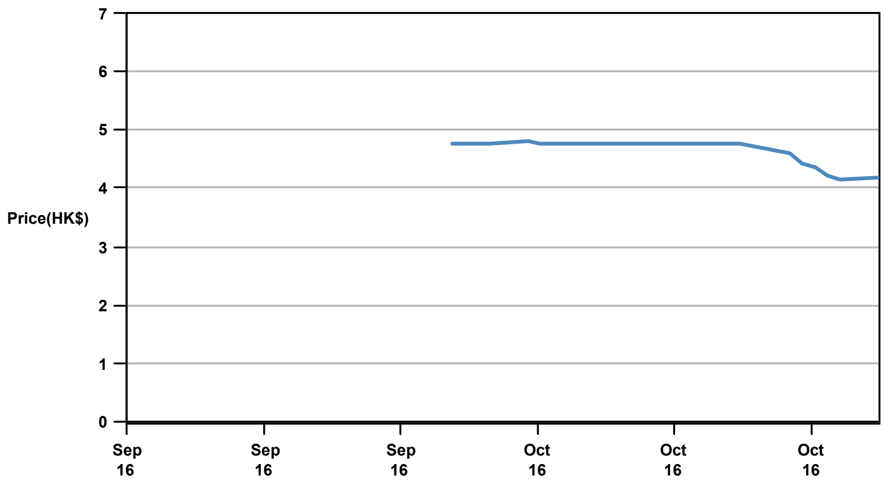
Analyst Certification: The research analyst(s) denoted by an "AC" on the cover of this report certifies (or, where multiple research analysts are primarily responsible for this report, the research analyst denoted by an "AC" on the cover or within the document individually certifies, with respect to each security or issuer that the research analyst covers in this research) that: (1) all of the views expressed in this report accurately reflect his or her personal views about any and all of the subject securities or issuers; and (2) no part of any of the research analyst's compensation was, is, or will be directly or indirectly related to the specific recommendations or views expressed by the research analyst(s) in this report. For all Korea-based research analysts listed on the front cover, they also certify, as per KOFIA requirements, that their analysis was made in good faith and that the views reflect their own opinion, without undue influence or intervention.

Important Disclosures

- **Lead or Co-manager:** J.P. Morgan acted as lead or co-manager in a public offering of equity and/or debt securities for Postal Savings Bank of China within the past 12 months.
- **Beneficial Ownership (1% or more):** J.P. Morgan beneficially owns 1% or more of a class of common equity securities of Postal Savings Bank of China.
- **Client:** J.P. Morgan currently has, or had within the past 12 months, the following entity(ies) as clients: Postal Savings Bank of China.
- **Client/Investment Banking:** J.P. Morgan currently has, or had within the past 12 months, the following entity(ies) as investment banking clients: Postal Savings Bank of China.
- **Client/Non-Investment Banking, Securities-Related:** J.P. Morgan currently has, or had within the past 12 months, the following entity(ies) as clients, and the services provided were non-investment-banking, securities-related: Postal Savings Bank of China.
- **Investment Banking (past 12 months):** J.P. Morgan received in the past 12 months compensation for investment banking services from Postal Savings Bank of China.
- **Investment Banking (next 3 months):** J.P. Morgan expects to receive, or intends to seek, compensation for investment banking services in the next three months from Postal Savings Bank of China.
- **Non-Investment Banking Compensation:** J.P. Morgan has received compensation in the past 12 months for products or services other than investment banking from Postal Savings Bank of China.
- **Other Significant Financial Interests:** J.P. Morgan owns a position of 1 million USD or more in the debt securities of Postal Savings Bank of China.

Company-Specific Disclosures: Important disclosures, including price charts and credit opinion history tables, are available for compendium reports and all J.P. Morgan–covered companies by visiting https://jpmm.com/research/disclosures, calling 1-800-477-0406, or e-mailing research.disclosure.inquiries@jpmorgan.com with your request. J.P. Morgan's Strategy, Technical, and Quantitative Research teams may screen companies not covered by J.P. Morgan. For important disclosures for these companies, please call 1-800-477-0406 or e-mail research.disclosure.inquiries@jpmorgan.com.

Postal Savings Bank of China (1658.HK, 1658 HK) Price Chart



Source: Bloomberg and J.P. Morgan; price data adjusted for stock splits and dividends.

The chart(s) show J.P. Morgan's continuing coverage of the stocks; the current analysts may or may not have covered it over the entire period.
J.P. Morgan ratings or designations: OW = Overweight, N= Neutral, UW = Underweight, NR = Not Rated

Explanation of Equity Research Ratings, Designations and Analyst(s) Coverage Universe:
J.P. Morgan uses the following rating system: Overweight [Over the next six to twelve months, we expect this stock will outperform the average total return of the stocks in the analyst's (or the analyst's team's) coverage universe.] Neutral [Over the next six to twelve months, we expect this stock will perform in line with the average total return of the stocks in the analyst's (or the analyst's team's) coverage universe.] Underweight [Over the next six to twelve months, we expect this stock will underperform the average total return of the stocks in the analyst's (or the analyst's team's) coverage universe.] Not Rated (NR): J.P. Morgan has removed the rating and, if applicable, the price target, for this stock because of either a lack of a sufficient fundamental basis or for legal, regulatory or policy reasons. The previous rating and, if applicable, the price target, no longer should be relied upon. An NR designation is not a recommendation or a rating. In our Asia (ex-Australia) and U.K. small- and mid-cap equity research, each stock's expected total return is compared to the expected total return of a benchmark country market index, not to those analysts' coverage universe. If it does not appear in the Important Disclosures section of this report, the certifying analyst's coverage universe can be found on J.P. Morgan's research website, www.jpmorganmarkets.com.

Coverage Universe: Lei, Katherine: Agricultural Bank of China - A (601288.SS), Agricultural Bank of China - H (1288.HK), Bank of China - A (601988.SS), Bank of China - H (3988.HK), Bank of Communications - A (601328.SS), Bank of Communications - H (3328.HK), CITIC Securities - A (600030.SS), CITIC Securities - H (6030.HK), China Cinda Asset Management Co Ltd (1359.HK), China Citic Bank - A (601998.SS), China Citic Bank - H (0998.HK), China Construction Bank - A (601939.SS), China Construction Bank - H (0939.HK), China Merchants Bank - A (600036.SS), China Merchants Bank - H (3968.HK), China Minsheng Banking - A (600016.SS), China Minsheng Banking - H (1988.HK), Chongqing Rural Commercial Bank (3618.HK), HSBC Holdings plc (0005.HK), Huatai Securities - A (601688.SS), Huatai Securities - H (6886.HK), Huishang Bank (3698.HK), Industrial Bank - A (601166.SS), Industrial and Commercial Bank of China - A (601398.SS), Industrial and Commercial Bank of China - H (1398.HK), Noah Holdings Ltd (NOAH), Standard Chartered Plc (HK) (2888.HK)

J.P. Morgan Equity Research Ratings Distribution, as of October 03, 2016

	Overweight (buy)	Neutral (hold)	Underweight (sell)
J.P. Morgan Global Equity Research Coverage	42%	46%	12%
IB clients*	51%	48%	34%
JPMS Equity Research Coverage	42%	50%	8%
IB clients*	68%	61%	43%

*Percentage of investment banking clients in each rating category.
For purposes only of FINRA/NYSE ratings distribution rules, our Overweight rating falls into a buy rating category; our Neutral rating falls into a hold rating category; and our Underweight rating falls into a sell rating category. Please note that stocks with an NR designation are not included in the table above.

Equity Valuation and Risks: For valuation methodology and risks associated with covered companies or price targets for covered companies, please see the most recent company-specific research report at http://www.jpmorganmarkets.com, contact the primary analyst or your J.P. Morgan representative, or email research.disclosure.inquiries@jpmorgan.com.

Equity Analysts' Compensation: The equity research analysts responsible for the preparation of this report receive compensation based upon various factors, including the quality and accuracy of research, client feedback, competitive factors, and overall firm revenues.

Registration of non-US Analysts: Unless otherwise noted, the non-US analysts listed on the front of this report are employees of non-US affiliates of JPMS, are not registered/qualified as research analysts under NASD/NYSE rules, may not be associated persons of JPMS, and may not be subject to FINRA Rule 2711 and NYSE Rule 472 restrictions on communications with covered companies, public appearances, and trading securities held by a research analyst account.

Other Disclosures

J.P. Morgan ("JPM") is the global brand name for J.P. Morgan Securities LLC ("JPMS") and its affiliates worldwide. J.P. Morgan Cazenove is a marketing name for the U.K. investment banking businesses and EMEA cash equities and equity research businesses of JPMorgan Chase & Co. and its subsidiaries.

All research reports made available to clients are simultaneously available on our client website, J.P. Morgan Markets. Not all research content is redistributed, e-mailed or made available to third-party aggregators. For all research reports available on a particular stock, please contact your sales representative.

Options related research: If the information contained herein regards options related research, such information is available only to persons who have received the proper option risk disclosure documents. For a copy of the Option Clearing Corporation's Characteristics and Risks of Standardized Options, please contact your J.P. Morgan Representative or visit the OCC's website at http://www.optionsclearing.com/publications/risks/riskstoc.pdf

Legal Entities Disclosures
U.S.: JPMS is a member of NYSE, FINRA, SIPC and the NFA. JPMorgan Chase Bank, N.A. is a member of FDIC. **U.K**.: JPMorgan Chase N.A., London Branch, is authorised by the Prudential Regulation Authority and is subject to regulation by the Financial Conduct Authority and to limited regulation by the Prudential Regulation Authority. Details about the extent of our regulation by the Prudential Regulation Authority are available from J.P. Morgan on request. J.P. Morgan Securities plc (JPMS plc) is a member of the London Stock Exchange and is authorised by the Prudential Regulation Authority and regulated by the Financial Conduct Authority and the Prudential Regulation Authority. Registered in England & Wales No. 2711006. Registered Office 25 Bank Street, London, E14 5JP. **South Africa**: J.P. Morgan Equities South Africa Proprietary Limited is a member of the Johannesburg Securities Exchange and is regulated by the Financial Services Board. **Hong Kong**: J.P. Morgan Securities (Asia Pacific) Limited (CE number AAJ321) is regulated by the Hong Kong Monetary Authority and the Securities and Futures Commission in Hong Kong and/or J.P. Morgan Broking (Hong Kong) Limited (CE number AAB027) is regulated by the Securities and Futures Commission in Hong Kong. **Korea**: This material is issued and distributed in Korea by or through J.P. Morgan Securities (Far East) Limited, Seoul Branch, which is a member of the Korea Exchange(KRX) and is regulated by the Financial Services Commission (FSC) and the Financial Supervisory Service (FSS). **Australia**: J.P. Morgan Australia Limited (JPMAL) (ABN 52 002 888 011/AFS Licence No: 238188) is regulated by ASIC and J.P. Morgan Securities Australia Limited (JPMSAL) (ABN 61 003 245 234/AFS Licence No: 238066) is regulated by ASIC and is a Market, Clearing and Settlement Participant of ASX Limited and CHI-X. **Taiwan**: J.P.Morgan Securities (Taiwan) Limited is a participant of the Taiwan Stock Exchange (company-type) and regulated by the Taiwan Securities and Futures Bureau. **India:** J.P. Morgan India Private Limited (Corporate Identity Number - U67120MH1992FTC068724), having its registered office at J.P. Morgan Tower, Off. C.S.T. Road, Kalina, Santacruz - East, Mumbai – 400098, is registered with Securities and Exchange Board of India (SEBI) as a 'Research Analyst' having registration number INH000001873. J.P. Morgan India Private Limited is also registered with SEBI as a member of the National Stock Exchange of India Limited (SEBI Registration Number - INB 230675231/INF 230675231/INE 230675231) and Bombay Stock Exchange Limited (SEBI Registration Number - INB 010675237/INF 010675237). Telephone: 91-22-6157 3000, Facsimile: 91-22-6157 3990 and Website: www.jpmipl.com. For non local research reports, this material is not distributed in India by J.P. Morgan India Private Limited. **Thailand**: This material is issued and distributed in Thailand by JPMorgan Securities (Thailand) Ltd., which is a member of the Stock Exchange of Thailand and is regulated by the Ministry of Finance and the Securities and Exchange Commission and its registered address is 3rd Floor, 20 North Sathorn Road, Silom, Bangrak, Bangkok 10500. **Indonesia**: PT J.P. Morgan Securities Indonesia is a member of the Indonesia Stock Exchange and is regulated by the OJK a.k.a. BAPEPAM LK. **Philippines**: J.P. Morgan Securities Philippines Inc. is a Trading Participant of the Philippine Stock Exchange and a member of the Securities Clearing Corporation of the Philippines and the Securities Investor Protection Fund. It is regulated by the Securities and Exchange Commission. **Brazil**: Banco J.P. Morgan S.A. is regulated by the Comissao de Valores Mobiliarios (CVM) and by the Central Bank of Brazil. **Mexico**: J.P. Morgan Casa de Bolsa, S.A. de C.V., J.P. Morgan Grupo Financiero is a member of the Mexican Stock Exchange and authorized to act as a broker dealer by the National Banking and Securities Exchange Commission. **Singapore:** This material is issued and distributed in Singapore by or through J.P. Morgan Securities Singapore Private Limited (JPMSS) [MCI (P) 193/03/2016 and Co. Reg. No.: 199405335R], which is a member of the Singapore Exchange Securities Trading Limited and/or JPMorgan Chase Bank, N.A., Singapore branch (JPMCB Singapore) [MCI (P) 089/09/2016], both of which are regulated by the Monetary Authority of Singapore. This material is issued and distributed in Singapore only to accredited investors, expert investors and institutional investors, as defined in Section 4A of the Securities and Futures Act, Cap. 289 (SFA). This material is not intended to be issued or distributed to any retail investors or any other investors that do not fall into the classes of "accredited investors," "expert investors" or "institutional investors," as defined under Section 4A of the SFA. Recipients of this document are to contact JPMSS or JPMCB Singapore in respect of any matters arising from, or in connection with, the document. **Japan**: JPMorgan Securities Japan Co., Ltd. and JPMorgan Chase Bank, N.A., Tokyo Branch are regulated by the Financial Services Agency in Japan. **Malaysia**: This material is issued and distributed in Malaysia by JPMorgan Securities (Malaysia) Sdn Bhd (18146-X) which is a Participating Organization of Bursa Malaysia Berhad and a holder of Capital Markets Services License issued by the Securities Commission in Malaysia. **Pakistan**: J. P. Morgan Pakistan Broking (Pvt.) Ltd is a member of the Karachi Stock Exchange and regulated by the Securities and Exchange Commission of Pakistan. **Saudi Arabia**: J.P. Morgan Saudi Arabia Ltd. is authorized by the Capital Market Authority of the Kingdom of Saudi Arabia (CMA) to carry out dealing as an agent, arranging, advising and custody, with respect to securities business under licence number 35-07079 and its registered address is at 8th Floor, Al-Faisaliyah Tower, King Fahad Road, P.O. Box 51907, Riyadh 11553, Kingdom of Saudi Arabia. **Dubai**: JPMorgan Chase Bank, N.A., Dubai Branch is regulated by

the Dubai Financial Services Authority (DFSA) and its registered address is Dubai International Financial Centre - Building 3, Level 7, PO Box 506551, Dubai, UAE.

Country and Region Specific Disclosures

U.K. and European Economic Area (EEA): Unless specified to the contrary, issued and approved for distribution in the U.K. and the EEA by JPMS plc. Investment research issued by JPMS plc has been prepared in accordance with JPMS plc's policies for managing conflicts of interest arising as a result of publication and distribution of investment research. Many European regulators require a firm to establish, implement and maintain such a policy. Further information about J.P. Morgan's conflict of interest policy and a description of the effective internal organisations and administrative arrangements set up for the prevention and avoidance of conflicts of interest is set out at the following link https://www.jpmorgan.com/jpmpdf/1320678075935.pdf. This report has been issued in the U.K. only to persons of a kind described in Article 19 (5), 38, 47 and 49 of the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005 (all such persons being referred to as "relevant persons"). This document must not be acted on or relied on by persons who are not relevant persons. Any investment or investment activity to which this document relates is only available to relevant persons and will be engaged in only with relevant persons. In other EEA countries, the report has been issued to persons regarded as professional investors (or equivalent) in their home jurisdiction. **Australia:** This material is issued and distributed by JPMSAL in Australia to "wholesale clients" only. This material does not take into account the specific investment objectives, financial situation or particular needs of the recipient. The recipient of this material must not distribute it to any third party or outside Australia without the prior written consent of JPMSAL. For the purposes of this paragraph the term "wholesale client" has the meaning given in section 761G of the Corporations Act 2001. **Germany:** This material is distributed in Germany by J.P. Morgan Securities plc, Frankfurt Branch and J.P.Morgan Chase Bank, N.A., Frankfurt Branch which are regulated by the Bundesanstalt für Finanzdienstleistungsaufsicht. **Hong Kong:** The 1% ownership disclosure as of the previous month end satisfies the requirements under Paragraph 16.5(a) of the Hong Kong Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission. (For research published within the first ten days of the month, the disclosure may be based on the month end data from two months prior.) J.P. Morgan Broking (Hong Kong) Limited is the liquidity provider/market maker for derivative warrants, callable bull bear contracts and stock options listed on the Stock Exchange of Hong Kong Limited. An updated list can be found on HKEx website: http://www.hkex.com.hk. **Japan:** There is a risk that a loss may occur due to a change in the price of the shares in the case of share trading, and that a loss may occur due to the exchange rate in the case of foreign share trading. In the case of share trading, JPMorgan Securities Japan Co., Ltd., will be receiving a brokerage fee and consumption tax (shouhizei) calculated by multiplying the executed price by the commission rate which was individually agreed between JPMorgan Securities Japan Co., Ltd., and the customer in advance. Financial Instruments Firms: JPMorgan Securities Japan Co., Ltd., Kanto Local Finance Bureau (kinsho) No. 82 Participating Association / Japan Securities Dealers Association, The Financial Futures Association of Japan, Type II Financial Instruments Firms Association and Japan Investment Advisers Association. **Korea:** This report may have been edited or contributed to from time to time by affiliates of J.P. Morgan Securities (Far East) Limited, Seoul Branch. **Singapore:** As at the date of this report, JPMSS is a designated market maker for certain structured warrants listed on the Singapore Exchange where the underlying securities may be the securities discussed in this report. Arising from its role as designated market maker for such structured warrants, JPMSS may conduct hedging activities in respect of such underlying securities and hold or have an interest in such underlying securities as a result. The updated list of structured warrants for which JPMSS acts as designated market maker may be found on the website of the Singapore Exchange Limited: http://www.sgx.com.sg. In addition, JPMSS and/or its affiliates may also have an interest or holding in any of the securities discussed in this report – please see the Important Disclosures section above. For securities where the holding is 1% or greater, the holding may be found in the Important Disclosures section above. For all other securities mentioned in this report, JPMSS and/or its affiliates may have a holding of less than 1% in such securities and may trade them in ways different from those discussed in this report. Employees of JPMSS and/or its affiliates not involved in the preparation of this report may have investments in the securities (or derivatives of such securities) mentioned in this report and may trade them in ways different from those discussed in this report. **Taiwan**: This material is issued and distributed in Taiwan by J.P. Morgan Securities (Taiwan) Limited. **India:** For private circulation only, not for sale. **Pakistan:** For private circulation only, not for sale. **New Zealand:** This material is issued and distributed by JPMSAL in New Zealand only to persons whose principal business is the investment of money or who, in the course of and for the purposes of their business, habitually invest money. JPMSAL does not issue or distribute this material to members of "the public" as determined in accordance with section 3 of the Securities Act 1978. The recipient of this material must not distribute it to any third party or outside New Zealand without the prior written consent of JPMSAL. **Canada:** The information contained herein is not, and under no circumstances is to be construed as, a prospectus, an advertisement, a public offering, an offer to sell securities described herein, or solicitation of an offer to buy securities described herein, in Canada or any province or territory thereof. Any offer or sale of the securities described herein in Canada will be made only under an exemption from the requirements to file a prospectus with the relevant Canadian securities regulators and only by a dealer properly registered under applicable securities laws or, alternatively, pursuant to an exemption from the dealer registration requirement in the relevant province or territory of Canada in which such offer or sale is made. The information contained herein is under no circumstances to be construed as investment advice in any province or territory of Canada and is not tailored to the needs of the recipient. To the extent that the information contained herein references securities of an issuer incorporated, formed or created under the laws of Canada or a province or territory of Canada, any trades in such securities must be conducted through a dealer registered in Canada. No securities commission or similar regulatory authority in Canada has reviewed or in any way passed judgment upon these materials, the information contained herein or the merits of the securities described herein, and any representation to the contrary is an offence. **Dubai:** This report has been issued to persons regarded as professional clients as defined under the DFSA rules. **Brazil**: Ombudsman J.P. Morgan: 0800-7700847 / ouvidoria.jp.morgan@jpmorgan.com.

General: Additional information is available upon request. Information has been obtained from sources believed to be reliable but JPMorgan Chase & Co. or its affiliates and/or subsidiaries (collectively J.P. Morgan) do not warrant its completeness or accuracy except with respect to any disclosures relative to JPMS and/or its affiliates and the analyst's involvement with the issuer that is the subject of the research. All pricing is indicative as of the close of market for the securities discussed, unless otherwise stated. Opinions and estimates constitute our judgment as of the date of this material and are subject to change without notice. Past performance is not indicative of future results. This material is not intended as an offer or solicitation for the purchase or sale of any financial instrument. The opinions and recommendations herein do not take into account individual client circumstances, objectives, or needs and are not intended as recommendations of particular securities, financial instruments or strategies to particular clients. The recipient of this report must make its own independent decisions regarding any securities or financial instruments mentioned herein. JPMS distributes in the U.S. research published by non-U.S. affiliates and accepts responsibility for its contents. Periodic updates may be provided on companies/industries based on company specific developments or announcements, market conditions or any other publicly available information. Clients should contact analysts and execute transactions through a J.P. Morgan subsidiary or affiliate in their home jurisdiction unless governing law permits otherwise.

"Other Disclosures" last revised October 8, 2016.