

Banking

Last Close	Target Price	Upside
RMB11.71	RMB11.80	+0.8%

16 March 2018

Ping An Bank (000001 CH)

FY17 in line; asset quality and funding challenges persist

- ⊕ **We resume coverage on Ping An Bank (PAB) with a Neutral rating and a TP of RMB11.80.** We believe the improving retail banking franchise bodes well for PAB's long-term profitability. However, we see limited upside from PAB's current valuation given the funding cost and asset quality challenges. PAB's FY17 net profit was in line with Wind consensus, with lower credit cost partly offsetting the NIM contraction. NPL formation rate improved, but remained at the high end among banks we cover.
- ⊕ **Asset quality improved but pressure persists:** PAB's NPL ratio declined by 5bps QoQ to 1.70% at end-2017, thanks to the aggressive write-off. NPL formation rate declined slightly HoH in 2H17 to 2.46% under our estimation, but remained among the highest of banks we cover. Provision coverage ratio declined 1ppt QoQ to 151% at end-2017 and loan loss reserve was at 2.57% of total loans, down 9bps QoQ. NPLs was equivalent to 70% of >90-day overdue loans. With the less prudent NPL classification and high NPL formation rate, we believe provision pressure remains.
- ⊕ **Lackluster NIM outlook:** PAB reported NIM of 2.37% in 2017, compared with 2.41% in 9M17. The NIM further contracted in 4Q17 due to higher interbank funding cost and lower loan yield with lower risk appetite, in our view. Given its weaker deposit franchise and continuous loan structure adjustment, we believe PAB's NIM will remain under pressure amid tight liquidity.
- ⊕ **Building up retail banking franchise:** Retail banking made up 44% of total revenue in 2017, up from 31% in 2016. Credit card loans increased by 68% YoY in 2017, and total retail loans/deposits accounted for 50%/47% of total loans/deposits at end-2017. Leveraging on Ping An Group's franchise, we expect PAB's retail franchise to improve further and support its profitability in the long term.
- ⊕ **Valuation and risks:** Our TP of RMB11.80 is the average of our 3-stage DDM model and Gordon Growth fair P/B model, based on profit growth of 11%/7%/3% in stage 1/2/3 (terminal), dividend payout of 10%, sustainable ROE of 11.5%, and COE of 10.0%. Our TP-implied 2018E P/B is 0.90x. Key risks: Upside: better-than-expected NIM and NPL. Downside: stricter-than-expected regulations on WMPs.

Stock Rating

NEUTRAL

1-year stock performance



Source: Bloomberg

Stock data

52w high (RMB)	15.24
52w low (RMB)	8.54
Market cap (RMB m)	201,066
Avg daily vol (m)	116
YTD change (%)	-12
200d MA (RMB)	11.69

Source: Bloomberg

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Financial highlights

Y/E 31 Dec	2016	2017	2018E	2019E	2020E
Revenue (RMB m)	107,715	105,786	115,525	125,636	133,658
YoY growth (%)	12.0	-1.8	9.2	8.8	6.4
Net profit (RMB m)	22,599	23,189	25,095	27,880	31,199
EPS (RMB)	1.32	1.30	1.41	1.57	1.77
YoY growth (%)	-13.9	-1.3	8.5	11.5	12.3
P/E (x)	8.9	9.0	8.3	7.4	6.6
BVPS (RMB)	10.61	11.77	13.05	14.52	16.13
P/B (x)	1.10	0.99	0.90	0.81	0.73
Dividend yield (%)	1.3	1.2	1.2	1.4	1.6

Source: Company data, BOCOM Int'l estimates

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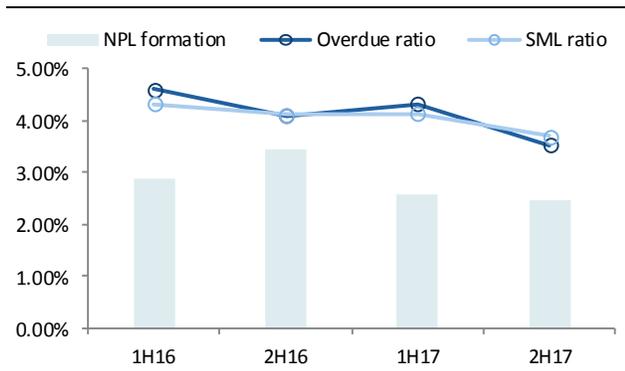
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Asset Quality Pressure Persists

PAB's NPL ratio was down 4bps YoY and 5 bps QoQ in 4Q17, which may be driven by its aggressive write-offs, in our view. NPL write-offs and transfers amounted to RMB37bn in 2017, up 6% YoY, equivalent to around 144% of NPLs at end-2016. Overdue loan balance declined 13% HoH in 2H17 and special-mention loan balance also declined by 5% HoH in 2H17, indicating improving asset quality.

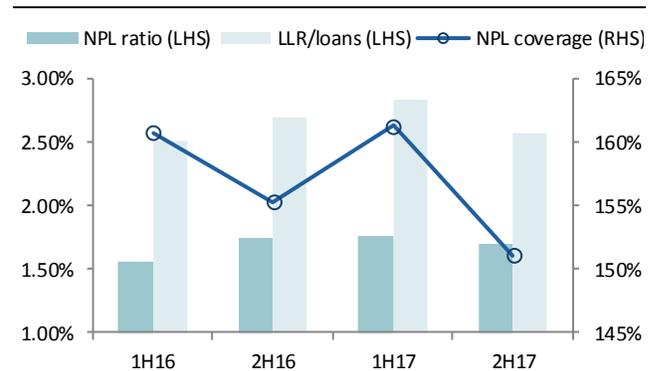
However, PAB's NPL formation rate remained at 2.46% in 2H17 under our estimation, among the highest of banks we cover. We believe PAB still has to maintain relatively high write-offs for stable NPL ratios. Given the 151% NPL coverage ratio, close to the regulatory requirement of 150%, we believe the provision pressure remains high.

Figure 1: NPL formation rate, overdue ratio and SML ratio declined in 2H17



Source: Company data, BOCOM Int'l estimates

Figure 2: Provision pressure intact



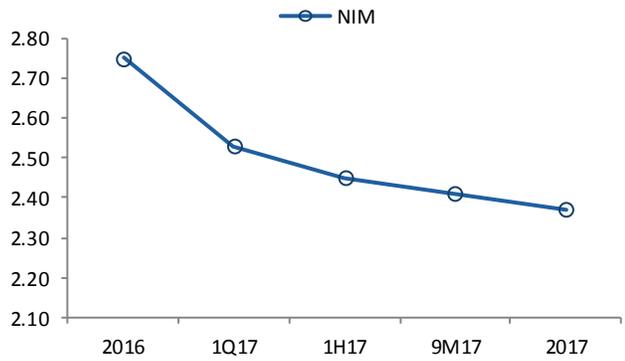
Source: Company data, BOCOM Int'l estimates

NIM Contracted due to High Interbank Funding Cost

PAB's interbank liability made up around 30% of total liabilities (including NCD and borrowing from PBOC) at end-2017, up from 26% at end-2016. The surge in interbank market rates resulted in higher interbank funding cost and pressured PAB's NIM. PAB's deposits only increased by 4% YoY, compared with loan growth of 15% YoY in 2017. Also, given the asset quality deterioration pressure, PAB turned more cautious on risky loans in our view, and some new loan pricing is lower than that in the past few years. Although PAB increased its high-yield retail loans, the overall loan yield declined in 2H17, by our estimates.

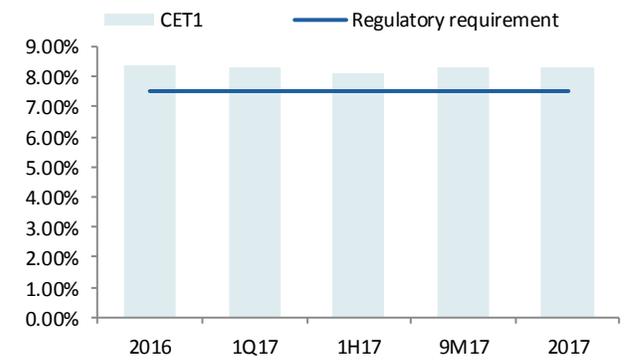
We expect PAB's NIM to remain under pressure in the near term given the high interbank market rates, risk appetite adjustments and relatively weak deposit franchise.

Figure 3: NIM further contracted in 4Q17 due to higher interbank funding cost



Source: Company data, BOCOM Int'l estimates

Figure 4: Limited capitalization buffer



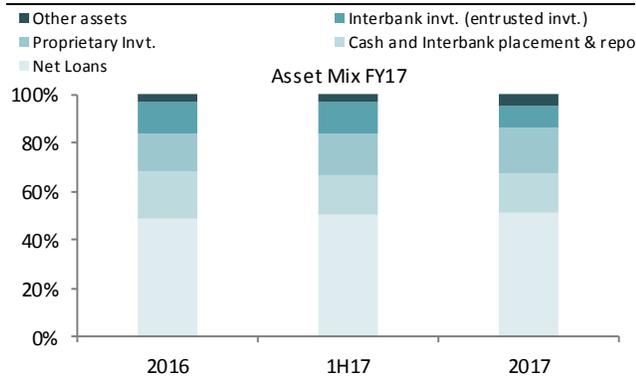
Source: Company data, BOCOM Int'l estimates

Limited Capital Buffer

PAB's CET1 declined 4bps QoQ and 8bps YoY to 8.28% at end-2017, slightly higher than regulatory requirement of 7.5%. We expect higher capitalization pressure in 2018 for PAB, considering the higher risk weighting for interbank investment and credit shift from off-balance-sheet to balance-sheet assets. PAB announced its plan to issue RMB26bn convertible bonds (CB) in mid-2017. However, it may take some time to transfer the CB into core capital after the issuance, in our view.

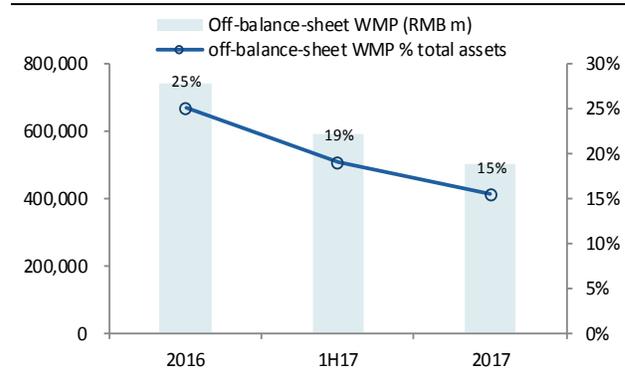
PAB adjusted its exposure to interbank investments and off-balance-sheet WMP in 2H17. Interbank investments balance declined 26% HoH and off-balance-sheet WMP balance was down 15% HoH in 2H17.

Figure 5: Interbank investments at 9% of total assets at end-2017, down from 13% at end-1H17



Source: Company data, BOCOM Int'l

Figure 6: Off-balance-sheet WMPs at 15% of total assets, down from 19% at end-1H17



Source: Company data, BOCOM Int'l

Building up Retail Franchise

The operating profit and revenue of PAB’s retail banks accounted for 67% and 44% of total, respectively, in 2017. The proportion of retail loans and deposits also increased in 2017. In general, retail loan pricing is higher than corporate loans and the credit cost is less affected by economic cycles in China. We believe better retail banking franchise may help PAB to improve its asset quality and NIM in the long term.

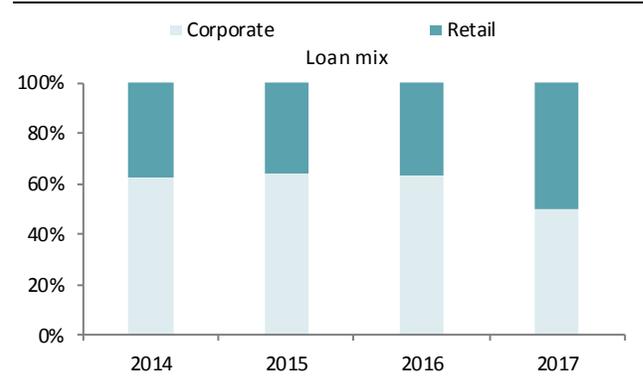
The retail franchise may also support the bank’s fee income growth. PAB’s fee income increased by 10% YoY in 2017 despite the declines in WMPs and consulting fees, as its bank card fees increased by 49% YoY.

Figure 7: Retail deposits made up 47% of total at end-2017



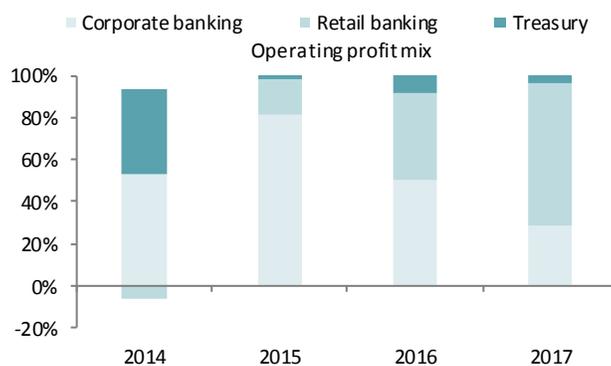
Source: Company data, BOCOM Int'l

Figure 8: Retail loans grew fast in 2017



Source: Company data, BOCOM Int'l

Figure 9: Retail banking became the largest profit driver in 2017



Source: Company data, BOCOM Int'l

Figure 10: PAB's FY17 results at-a-glance

FYE 31 December	4Q16	1Q17	2Q17	3Q17	4Q17	4Q17 QoQ (%/bps/ppt)	4Q17 YoY (%/bps/ppt)	FY16	FY17	FY17 YoY (%/bps/ppt)
Profit & loss (RMB m)										
Net interest income	21,848	18,869	18,492	18,121	18,527	2.2	-15.2	76,411	74,009	-3.1
Non-interest income	3,899	8,843	7,869	7,639	7,426	-2.8	90.5	31,304	31,777	1.5
Total operating income	25,747	27,712	26,361	25,760	25,953	0.7	0.8	107,715	105,786	-1.8
Operating expense	5,610	7,050	6,839	8,124	10,625	30.8	89.4	31,418	32,638	3.9
PPOP	20,137	20,662	19,522	17,636	15,328	-13.1	-23.9	76,297	73,148	-4.1
Impairment loss	14,903	12,434	11,282	9,104	10,105	11.0	-32.2	46,518	42,925	-7.7
Operating profit	5,234	8,228	8,240	8,532	5,223	-38.8	-0.2	29,779	30,223	1.5
Goodwill impairment	-	-	-	-	-	-	-	-	-	-
Associate profit / loss	-	-	-	-	-	-	-	-	-	-
Other non-operating items	141	2	(38)	(25)	(5)	-80.0	-103.5	156	(66)	
Pre-tax profit	5,375	8,230	8,202	8,507	5,218	-38.7	-2.9	29,935	30,157	0.7
Income tax	1,495	2,016	1,862	1,908	1,182	-38.1	-20.9	7,336	6,968	-5.0
Minority interest	-	-	-	-	-	-	-	-	-	-
Net profit att. to ord. s/h	3,880	6,214	6,340	6,599	4,036	-38.8	4.0	22,599	23,189	2.6
EPS (RMB)	0.45	0.72	0.74	0.77	0.47	-38.8	4.0	1.32	1.30	-1.3
DPS (RMB)	-	-	-	-	-	-	-	0.16	0.14	-13.9
Payout ratio (%)	-	-	-	-	-	-	-	12	10	
Balance sheet (RMB m)										
Loans, gross	1,475,801	1,548,162	1,594,281	1,646,824	1,704,230	3.5	15	1,475,801	1,704,230	15.5
Assets HFT/FV	57,179	44,044	49,083	41,327	39,575	-4.2	-30.8	57,179	39,575	-30.8
Investments AFS/HTM/ Receivables	796,267	866,309	872,424	839,720	855,137	1.8	7.4	796,267	855,137	7.4
Total assets	2,953,434	3,006,195	3,092,142	3,137,481	3,248,474	3.5	10.0	2,953,434	3,248,474	10.0
Deposits, non-bank	1,921,835	1,912,082	1,912,333	1,911,741	2,000,420	4.6	4.1	1,921,835	2,000,420	4.1
Shareholders' equity	202,171	207,739	211,454	218,111	222,054	1.8	9.8	202,171	222,054	9.8
Capital (%)										
CET1	8.36	8.28	8.13	8.32	8.28	-4bps	-8bps	8.36	8.28	-836bps
Tier-1 CAR	9.34	9.23	9.05	9.23	9.18	-5bps	-17bps	9.34	9.18	-17bps
Total CAR	10.65	11.48	11.23	11.28	9.60	-168bps	-105bps	11.53	11.20	-33bps
Asset quality (%)										
NPLs (RMB m)	25,702	26,927	28,037	28,796	28,997	0.7	12.8	25,702	28,997	12.8
NPL ratio	1.74	1.74	1.76	1.75	1.70	-5bps	-4bps	1.74	1.70	-4bps
Loan loss reserve / NPL	155.4	163	161	152	151	-1.0ppt	-4.3ppt	155.4	151.1	-4.3ppt
Loan loss reserve / gross loans	2.71	2.84	2.84	2.66	2.57	-9bps	-14bps	2.71	2.57	-14bps
Impairment / gross loans (ann'd)	4.04	3.21	2.83	2.21	2.37	16bps	-167bps	3.15	2.52	-63bps
Others (%)										
LDR	76.8	81.0	83.4	86.1	85.2	-0.9ppt	8.4ppt	76.8	85.2	8.4ppt
NIM (ann'd)	3.13	2.61	2.50	2.41	2.42	1bps	-71bps	2.88	2.49	-40bps
Non-interest / total income	15.1	31.9	29.9	29.7	28.6	-1.0ppt	13.5ppt	29.1	30.0	1.0ppt
Cost / income	21.8	25.4	25.9	31.5	40.9	9.4ppt	19.2ppt	29.2	30.9	1.7ppt
ROAE (ann'd)	7.8	12.1	12.1	12.3	7.3	-5.0ppt	-0.4ppt	13.1	11.6	-1.5ppt
ROAA (ann'd)	0.54	0.83	0.83	0.85	0.51	-34bps	-3bps	0.83	0.75	-8bps

Source: Company data, BOCOM Int'l

Financial Statements

Balance sheet (RMB m)					
As of 31 Dec	2016	2017	2018E	2019E	2020E
Cash & equivalent	4,495	4,226	4,477	4,760	5,059
Interbank assets	579,971	537,143	625,492	664,898	706,787
Inv. HFT & FV	65,909	55,655	58,966	62,681	66,630
Inv. AFS & HTM	796,267	855,137	890,167	901,188	957,963
Gross loans	1,475,801	1,704,230	1,878,061	2,038,636	2,212,939
Loan loss reserve	-39,932	-43,810	-45,989	-58,611	-61,784
Other assets	70,923	135,893	148,726	162,841	178,369
Total assets	2,953,434	3,248,474	3,559,901	3,776,393	4,065,963
Interest-earning	2,852,039	3,096,510	3,393,721	3,604,722	3,877,689
RWA	2,033,715	2,226,112	2,439,527	2,587,884	2,786,320
Customer deposits	1,921,835	2,000,420	2,119,445	2,252,970	2,394,907
Interbank liabilities	483,015	595,939	723,449	733,739	801,797
Debt securities	263,464	342,492	376,741	414,415	455,857
Other liabilities	82,949	87,569	96,326	105,958	116,554
Total liabilities	2,751,263	3,026,420	3,315,962	3,507,082	3,769,115
Interest-bearing	2,668,314	2,938,851	3,219,636	3,401,124	3,652,561
Minority interests	0	0	0	0	0
Equity	202,171	222,054	243,940	269,311	296,848
Total equity excl. pref. shares	182,218	202,101	223,987	249,358	276,895
BVPS (RMB)	10.61	11.77	13.05	14.52	16.13
Shares: Period end (m)	17,170	17,170	17,170	17,170	17,170

Income statement (RMB m)					
Y/E 31 Dec	2016	2017	2018E	2019E	2020E
Net interest income	76,411	74,009	80,377	86,214	92,347
Non-interest income	31,304	31,777	35,148	39,422	41,311
Operating income	107,715	105,786	115,525	125,636	133,658
Operating expense	-31,418	-32,638	-35,716	-38,919	-41,627
PPOP	76,297	73,148	79,810	86,717	92,031
Loan loss provision	-45,435	-40,803	-45,674	-48,959	-49,956
Other provisions	-1,083	-2,122	-1,500	-1,500	-1,500
Operating profit	29,779	30,223	32,636	36,258	40,575
Non-operating items	156	-66	0	0	0
Pre-tax profit	29,935	30,157	32,636	36,258	40,575
Tax	-7,336	-6,968	-7,541	-8,378	-9,375
Minorities	0	0	0	0	0
Net profit	22,599	23,189	25,095	27,880	31,199
Ordinary shares dividends	2,713	2,335	2,509	2,788	3,120
Preference shares dividends	0	874	874	874	874
EPS (RMB)	1.32	1.30	1.41	1.57	1.77
Effective tax rate (%)	25	23	23	23	23
DPS (RMB)	0.16	0.14	0.15	0.16	0.18
Dividend payout (%)	12	10	10	10	10

Source: Company data, BOCOM Int'l estimates

Growth drivers (%)					
Y/E 31 Dec	2016	2017	2018E	2019E	2020E
Deposit growth	10.8	4.1	6.0	6.3	6.3
Loan growth	21.4	15.5	10.2	8.6	8.6
Interest-earning asset growth	16.6	8.6	9.6	6.2	7.6
Net interest margin	2.88	2.49	2.48	2.46	2.47
Net interest income growth	11.6	-3.1	8.6	7.3	7.1
Fee income growth	15.7	10.1	10.0	10.0	5.0
Non-interest income growth	13.0	1.5	10.6	12.2	4.8
Non-interest income/Income	29.1	30.0	30.4	31.4	30.9
Operating income growth	12.0	-1.8	9.2	8.8	6.4
Cost-to-income ratio	26.0	29.9	29.9	30.0	30.1
Opex (core) growth	-7.1	13.0	9.3	8.9	6.9
PPOP growth	28.5	-4.1	9.1	8.7	6.1
LLP/Avg. gross loans	3.38	2.57	2.55	2.50	2.35
Operating profit growth	3.1	1.5	8.0	11.1	11.9
Net profit growth	3.4	2.6	8.2	11.1	11.9
EPS growth	-13.9	-1.3	8.5	11.5	12.3
DPS growth	-55.2	-13.9	7.5	11.1	11.9

Financial ratios					
Y/E 31 Dec	2016	2017	2018E	2019E	2020E
Capital, asset quality & liquidity (%)					
Core Tier 1 CAR	8.4	8.3	8.4	8.8	9.0
Tier 1 CAR	9.3	9.2	9.2	9.5	9.8
Total CAR	11.5	11.2	11.0	11.3	11.4
RWA growth	22.4	9.5	9.6	6.1	7.7
RoRWA	1.11	1.04	1.03	1.08	1.12
NPL ratio	1.74	1.70	1.61	1.91	1.57
Loan loss reserve/NPL	155.4	151.1	151.9	150.3	178.0
Loan loss reserve/Gross loans	2.7	2.6	2.4	2.9	2.8
Loan-deposit ratio	76.8	85.2	88.6	90.5	92.4
Deposits/Total assets	65.1	61.6	59.5	59.7	58.9
Interbank liabilities/Total assets	16.4	18.3	20.3	19.4	19.7
Debt securities/Total assets	8.9	10.5	10.6	11.0	11.2
Common equity/Total assets	6.8	6.8	6.9	7.1	7.3

Business segments					
% of operating profit	2016	2017	2018E	2019E	2020E
Corporate banking	50	28	NA	NA	NA
Retail banking	41	67	NA	NA	NA
Treasury	8	4	NA	NA	NA

16 March 2018

Ping An Bank (000001 CH)



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Rating System

Analyst Stock Ratings:

Buy: The stock's total return is expected to **exceed** that of the corresponding industry over the next 12 months.

Neutral: The stock's total return is expected to be **in line with** that of the corresponding industry over the next 12 months.

Sell: The stock's total return is expected to be **below** that of the corresponding industry over the next 12 months.

Not-Rated: The analyst **does not have conviction** regarding the outlook of the stock's total return relative to that of the corresponding industry over the next 12 months.

Analyst Industry Views:

Outperform: The analyst expects the industry coverage universe to be **attractive** relative to the relevant broad market benchmark over the next 12 months.

Market perform: The analyst expects the industry coverage universe to be **in line with** the relevant broad market benchmark over the next 12 months.

Underperform: The analyst expects the industry coverage universe to be **unattractive** relative to the relevant broad market benchmark over the next 12 months.

Broad market benchmark for Hong Kong is **the Hang Seng Composite Index**, for China A-shares is the **MSCI China A Index**, for US-listed Chinese companies is **S&P US Listed China 50 (USD) Index**.

16 March 2018

Ping An Bank (000001 CH)



Analyst certification

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