

# China Everbright Bank - A (601818 CH)

## Cloud Payment – A booster for digital transformation

**SUMMARY.** We attended CEB's reverse road show in Shanghai, with recent operating results, wealth management business, and technology development strategy as main themes. Cloud Payment, the Bank's key digitalization initiative, offers a great boost to client base growth and potential earnings, in our view.

- The largest open-ended payment platform in China.** Retail business and technology utilization are crucial for CEB's strategic goal of "building a first-class wealth management bank". Cloud Payment (云缴费) is one of the Bank's initiatives to carry out inclusive finance and explore the utilization of financial technology. The number of user and transaction amount saw an explosive growth in the past years, reaching 253mn and RMB 206bn, respectively, in 2018, making it the largest open-ended payment platform in China.
- Contribution to fee/deposit/customer base.** Cloud Payment's major contribution to CEB are threefold: 1) Fee income, including agency and platform access fee, was RMB 160mn (up 159% YoY) in 2018 and expected to reach RMB 300mn in 2019; 2) Deposit inflow from payment receiving institutions, as they have to set up account in CEB for settlement and clearing purpose; 3) Collection of massive user data and conversion of users into customers of the Bank.
- Other questions/concerns from investors.** 1) CEB's wealth management business transformation is ahead of peers, in terms of product design and brand building. It targets to be the first JSB to get approval for operation of WM subsidiary; 2) Credit card business remains a strategic focus, but growth will moderate due to proactive risk control, e.g. restricting the usage of credit card overdraft and adjusting client mix; 3) Despite stricter NPL recognition and faster disposal in 2018, management was cautious on 2019 outlook. Classifying >60-day overdue loans to NPLs may result in some asset quality pressure; 4) NIM trend should be largely stable in 2019. Asset yields may further decline, and deposit cost hike will be eased by scrutiny on irregular deposit absorption; 5) Management was confident that the RMB 30bn CB issued in 2017 would be converted to equity in foreseeable future.
- Initiate CEB-A with BUY rating and RMB 4.50 TP.** CEB-A trades at 0.65x FY19E P/B, 11% below historical mean of 0.73x and 14% below A-share banks' average of 0.76x. Our TP of RMB 4.50 is based on GGM-derived target P/B of 0.75x and 2019E BPS of RMB 5.98.

### Earnings Summary

(YE 31 Dec)	FY17A	FY18A	FY19E	FY20E	FY21E
Operating income (RMB mn)	92,018	110,386	130,978	141,752	152,688
Net profit (RMB mn)	31,545	33,659	36,014	38,847	42,299
EPS (RMB)	0.61	0.61	0.66	0.71	0.78
EPS CHG (%)	(3.2)	1.1	7.3	8.2	9.2
P/E (x)	6.4	6.3	5.9	5.4	5.0
P/B (x)	0.71	0.71	0.65	0.59	0.54
Dividend yield (%)	4.7	4.2	4.5	4.8	5.2
ROE (%)	12.3	11.6	11.5	11.4	11.3
NPL (%)	1.59	1.59	1.62	1.69	1.75
Provision coverage (%)	158	176	203	229	248

Source: Company data, CMBIS estimates

**BUY (Initiation)**

Target Price **RMB 4.50**

Up/Downside **+16.3%**  
Current Price **RMB 3.87**

### China Banking Sector

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### Stock Data

Mkt Cap (RMB mn)	193,463
Avg 3 mths t/o (RMB mn)	558.04
52w High/Low (RMB)	4.62/ 3.44
Total Issued Shares (mn)	<b>39,811 (A)</b> 12,679 (H)

Source: Bloomberg

### Shareholding Structure

China Everbright Group	25.4%
Central Huijin	19.5%
Overseas Chinese Town	8.0%

Source: HKEx

### Share Performance

	Absolute	Relative
1-mth	-4.2%	1.5%
3-mth	-7.3%	-7.4%
6-mth	2.1%	-11.6%

Source: Bloomberg

### 12-mth Price Performance



Source: Bloomberg

**Auditor: Ernst & Young**

## Overview of Cloud Payment

### Largest open-ended payment platform in China

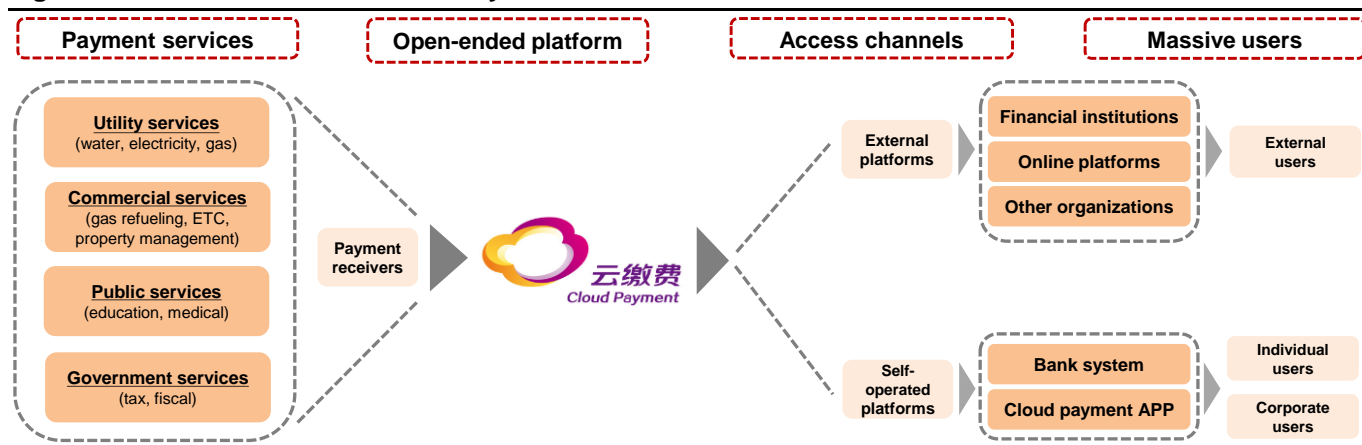
Set up in 2008, Cloud Payment is one of CEB's initiatives to carry out inclusive finance and explore the utilization of financial technology. Based on the payment needs in people's daily life, with an open-ended platform as core fundamental, Cloud Payment offers standardized and integrated full-process payment services. It connects to various service providers and gives access to individual users within CEB and through external platforms.

From 2015 to 2018, both number of user and annual transaction value saw an explosive growth, reaching 253mn and RMB 206bn, respectively, in 2018, making Cloud Payment the largest open-ended payment platform in China. As of May 2019, the system supported over 5500 payment items and covered more than 300 cities nationwide.

### Multifaceted business contribution

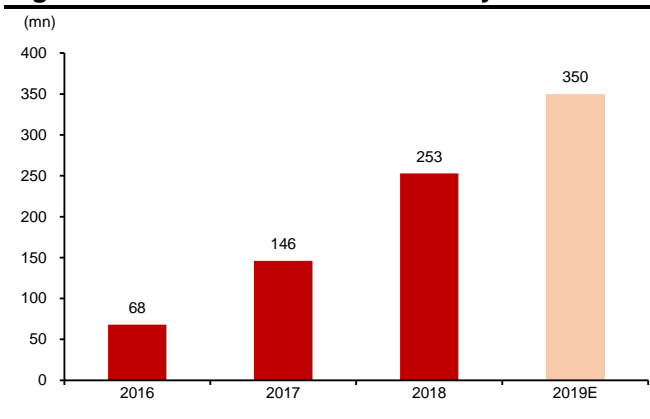
Cloud Payment's major contribution to CEB are threefold: 1) Fee income, including agency and platform access fee, was RMB 160mn (up 159% YoY) in 2018 and expected to reach RMB 300mn in 2019; 2) Deposit inflow from payment receiving institutions, as they have to set up account in CEB for settlement and clearing purpose; 3) Collection of massive user data and conversion of users into bank customers.

Figure 1: Business model of Cloud Payment



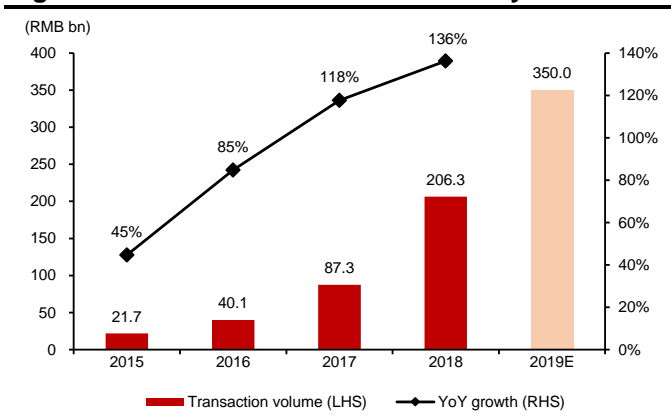
Source: Company data, CMBIS

Figure 2: Number of user of Cloud Payment



Source: Company data, CMBIS

Figure 3: Transaction value of Cloud Payment



Source: Company data, CMBIS

## Key points of concern from investors

### Wealth management business

CEB started to implement the strategy of “building a first-class wealth management bank” in 2018. Wealth management is also one of the six E-SBU (Ecosphere Strategic Business Unit) of China Everbright Group. It is difficult for JSBs to beat large SOE banks in product scale, therefore they tend to stay on the forefront of product innovation. In early-2018, CEB launched its net-value product series “Sunshine” (七彩阳光净值型产品), which complies with PBoC’s new asset management rule. CEB was one of the first two JSBs to receive CBIRC’s approval on establishing wealth management subsidiary, and the Bank targets to be the first JSB to get regulatory permission on business operation.

### Credit card business

Credit card business has been CEB’s strategic focus and contributed to over 30% of the Bank’s revenue in the past years. After rapid expansion in 2016-2018, credit card business will moderate and maintain a steady growth pace. Looking forward, the Bank will carry out following measures: 1) restricting the purpose of credit card overdraft to consumption instead of cash loans; 2) adjusting client mix to 80s and 90s and improving product design correspondingly; 3) strengthening cooperation with technology companies, such as Xiaomi and JD finance.

### Asset quality outlook

Although CEB had proactively improved recognition and disposal of NPLs in 2018, management remained cautious on asset quality outlook in 2019. They see new NPLs mainly from overcapacity corporate sectors, such as manufacturing and wholesale & retail, which together contributed to 27% of total corporate loans, but 57% of corporate NPLs. Classifying above 60-day overdue loans to NPLs may add some pressure. That said, management was confident to keep overall asset quality risk under control.

### NIM outlook

NIM trend is likely to remain largely stable on quarterly basis in 2019. Asset yields may further decline, but would be mitigated by optimized loan mix, i.e. higher proportion of retail loans. On the flip side, there is limited downside in funding cost, but deposit cost will be controlled with regulatory scrutiny on issuance of structured deposit and certificate of deposit.

### Convertible bond

CB is favored by capital market and encouraged by CSRC. It is also cost efficient for banks, as average coupon rate was only 0.5% for CEB’s RMB 30bn CB issued in 2017. Management was confident that the CB would convert to equity, as stellar financial performance would gradually boost the Bank’s valuation. Management also mentioned to improve market recognition through more frequent investor communications.

## Valuation

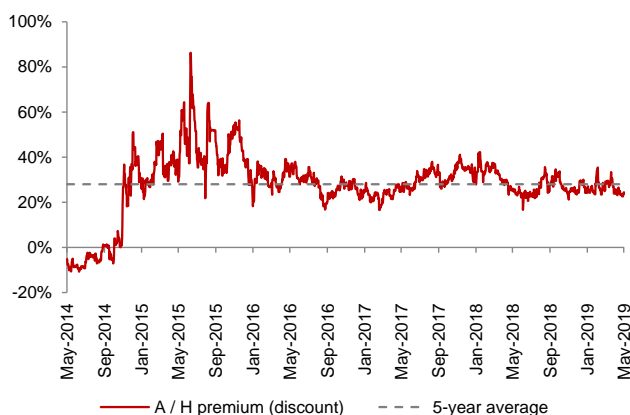
We use Gordon Growth Model to derive the TP for CEB-A. Our key assumptions include: 1) Market risk premium of 9.4%; 2) Risk free rate of 3.0%, 3) Sustainable ROE of 11.2%; 4) Long-term growth rate of 3.0%. Our TP of RMB 4.50 is based on a target P/B of 0.75x and 2019E BVPS of RMB 5.98.

**Figure 4: Peers valuation for A-share China banks**

Company	Ticker	Mkt. Cap (US\$ mn)	Avg 3M (US\$ mn)	Price (RMB)	P/B (x)		P/E (x)		Dvd yield (%)		ROE (%)	
					FY19E	FY20E	FY19E	FY20E	FY19E	FY20E	FY19E	FY20E
<b>Nationwide SOE &amp; joint-stock banks</b>												
ICBC	601398 CH	281.6	191.3	5.65	0.81	0.74	6.5	6.2	4.7	5.0	13.0	12.5
CCB	601939 CH	198.0	122.8	6.96	0.83	0.76	6.5	6.1	4.7	4.9	13.2	12.8
ABC	601288 CH	183.1	170.2	3.68	0.73	0.67	6.0	5.7	5.1	5.4	12.7	12.3
BOC	601988 CH	151.3	94.9	3.84	0.69	0.64	6.2	5.9	5.0	5.2	11.4	11.0
BoCom	601328 CH	60.9	108.7	5.97	0.62	0.58	5.9	5.6	5.2	5.5	10.9	10.7
CMB	600036 CH	124.4	254.5	34.25	1.50	1.32	9.6	8.5	3.1	3.6	16.4	16.4
CITIC	601998 CH	36.9	46.6	5.80	0.65	0.60	6.2	5.9	4.3	4.6	10.7	10.4
MSB	600016 CH	37.3	110.4	6.13	0.59	0.55	5.1	4.9	4.2	4.4	12.2	11.5
PAB	000001 CH	30.8	195.7	12.40	0.85	0.77	7.9	7.0	1.4	1.6	11.3	11.5
SPDB	600000 CH	47.2	74.8	11.12	0.65	0.59	5.7	5.4	2.8	3.1	12.0	11.4
IND	601166 CH	53.2	255.0	17.68	0.74	0.67	5.6	5.2	4.2	4.5	13.5	13.4
HXB	600015 CH	16.7	51.2	7.50	0.51	0.46	5.2	4.9	3.2	3.7	10.3	9.7
<b>Average</b>					<b>0.76</b>	<b>0.69</b>	<b>6.4</b>	<b>5.9</b>	<b>4.0</b>	<b>4.3</b>	<b>12.3</b>	<b>12.0</b>
<b>Regional city &amp; rural commercial banks</b>												
Bank of Beijing	601169 CH	17.9	52.4	5.85	0.64	0.59	5.8	5.4	4.9	5.2	11.3	11.2
Bank of Shanghai	601229 CH	18.0	56.5	11.38	0.79	0.74	6.7	5.8	3.6	4.2	12.3	12.6
Bank of Nanjing	601009 CH	10.2	91.0	8.30	0.91	0.79	5.9	5.0	4.4	5.3	15.5	15.8
Bank of Ningbo	002142 CH	17.7	60.2	23.45	1.58	1.35	9.3	7.9	2.1	2.5	16.6	17.1
Bank of Jiangsu	600919 CH	12.2	54.0	7.28	0.69	0.63	5.9	5.2	4.1	4.5	12.2	12.3
Bank of Guiyang	601997 CH	4.3	47.2	12.95	0.86	0.74	5.1	4.5	3.2	3.6	17.8	17.0
Bank of Hangzhou	600926 CH	6.1	40.8	8.26	0.81	0.73	7.2	6.1	3.5	4.1	10.9	11.4
Bank of Chengdu	601838 CH	4.5	37.0	8.60	0.94	0.82	5.5	4.6	4.1	4.8	17.6	17.8
JSJYRCB	002807 CH	1.5	18.0	4.70	0.86	0.80	9.7	8.8	2.3	2.6	9.1	9.4
WXRCB	600908 CH	1.6	15.1	5.86	0.96	0.88	9.0	8.1	2.7	3.0	11.3	11.4
JSCSRCB	601128 CH	2.9	48.2	7.37	1.21	1.07	9.9	8.4	3.1	3.7	13.3	13.7
JSWJRCB	603323 CH	1.5	33.9	6.13	0.90	0.85	10.0	9.3	2.1	2.4	9.9	10.4
JSZJGRCB	002839 CH	1.5	36.0	5.74	1.04	0.97	11.4	10.2	2.1	2.3	9.5	9.9
<b>Average</b>					<b>0.94</b>	<b>0.84</b>	<b>7.8</b>	<b>6.9</b>	<b>3.3</b>	<b>3.7</b>	<b>12.9</b>	<b>13.1</b>

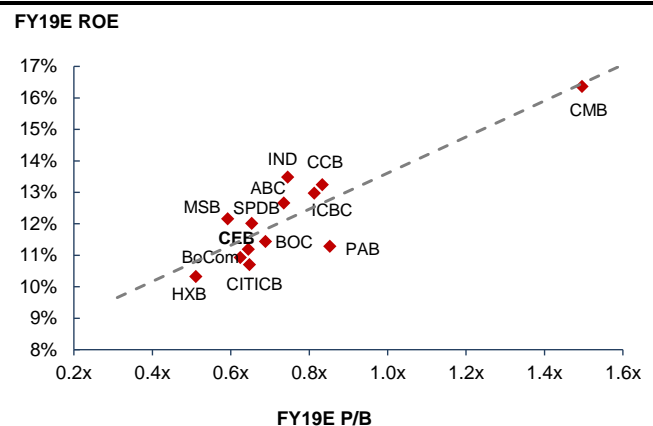
Source: Bloomberg, CMBIS

**Figure 5: CEB's A/H valuation premium (discount)**



Source: Bloomberg, CMBIS

**Figure 6: P/B vs ROE for A-share China banks**



Source: Bloomberg, CMBIS

## Financial Summary

### Income Statement

YE 31 Dec (RMB mn)	FY17A	FY18A	FY19E	FY20E	FY21E
Interest income	160,343	168,567	200,344	216,302	232,292
Interest expenses	(99,393)	(107,524)	(114,157)	(122,821)	(131,636)
Net interest income	60,950	61,043	86,187	93,481	100,656
Net fee income	30,774	36,894	42,428	45,822	49,488
Others	294	12,449	2,362	2,449	2,544
<b>Operating income</b>	<b>92,018</b>	<b>110,386</b>	<b>130,978</b>	<b>141,752</b>	<b>152,688</b>
Operating expenses	(30,802)	(33,706)	(40,631)	(45,208)	(50,217)
<b>PPoP</b>	<b>61,216</b>	<b>76,680</b>	<b>90,346</b>	<b>96,544</b>	<b>102,472</b>
Provision	(20,570)	(35,828)	(46,641)	(49,407)	(51,153)
Operating profit	40,646	40,852	43,705	47,137	51,319
Non-operating income	-	-	-	-	-
Pre-tax profit	40,646	40,852	43,705	47,137	51,319
Income tax expenses	(9,035)	(7,131)	(7,629)	(8,228)	(8,958)
Minority interests	(66)	(62)	(62)	(62)	(62)
<b>Net profit</b>	<b>31,545</b>	<b>33,659</b>	<b>36,014</b>	<b>38,847</b>	<b>42,299</b>

### Balance Sheet

YE 31 Dec (RMB mn)	FY17A	FY18A	FY19E	FY20E	FY21E
Due from central banks	348,119	361,854	389,522	421,131	453,905
Interbank assets	285,011	175,463	161,694	167,890	174,396
Investments	1,297,936	1,301,080	1,391,472	1,476,627	1,556,529
<b>Gross loans</b>	<b>2,032,056</b>	<b>2,428,487</b>	<b>2,683,478</b>	<b>2,911,574</b>	<b>3,159,058</b>
Less: provision	51,238	67,209	88,331	112,677	136,732
Other assets	176,359	157,657	212,250	238,348	275,470
<b>Total assets</b>	<b>4,088,243</b>	<b>4,357,332</b>	<b>4,750,084</b>	<b>5,102,893</b>	<b>5,482,625</b>
Due to central banks	232,500	267,193	293,912	308,608	324,038
Interbank liabilities	1,024,283	958,144	1,036,137	1,107,114	1,183,334
<b>Customer deposits</b>	<b>2,272,665</b>	<b>2,571,961</b>	<b>2,777,718</b>	<b>2,999,935</b>	<b>3,239,930</b>
Debt securities issued	150,939	164,844	174,844	184,844	194,844
Other liabilities	102,420	72,717	77,436	82,550	88,092
<b>Total liabilities</b>	<b>3,782,807</b>	<b>4,034,859</b>	<b>4,360,047</b>	<b>4,683,051</b>	<b>5,030,239</b>
<b>Shareholders' equity</b>	<b>304,760</b>	<b>321,488</b>	<b>389,052</b>	<b>418,857</b>	<b>451,402</b>
Incl. Perpetual bonds	-	-	40,000	40,000	40,000
Incl. Preferred stocks	35,108	35,108	35,108	35,108	35,108
Minority interest	676	985	985	985	985
<b>Total equity</b>	<b>305,436</b>	<b>322,473</b>	<b>390,037</b>	<b>419,842</b>	<b>452,387</b>

### Key Ratios

YE 31 Dec (RMB mn)	FY17A	FY18A	FY19E	FY20E	FY21E
<b>Op. income mix</b>					
Net interest income	66%	55%	66%	66%	66%
Net fee income	33%	33%	32%	32%	32%
Others	0%	11%	2%	2%	2%
Total	100%	100%	100%	100%	100%
<b>Growth, YoY</b>					
Net interest income	-6.6%	0.2%	41.2%	8.5%	7.7%
Net fee income	9.5%	19.9%	15.0%	8.0%	8.0%
Operating income	-2.5%	20.0%	18.7%	8.2%	7.7%
PPoP	-4.5%	25.3%	17.8%	6.9%	6.1%
Net profit	4.0%	6.7%	7.0%	7.9%	8.9%
Gross loans	13.2%	19.5%	10.5%	8.5%	8.5%
Customer deposits	7.2%	13.2%	8.0%	8.0%	8.0%
<b>Efficiency</b>					
Cost-to-income ratio	32.4%	29.5%	29.8%	30.6%	31.6%
<b>Asset quality</b>					
NPL ratio	1.59%	1.59%	1.62%	1.69%	1.75%
Provision coverage	158%	176%	203%	229%	248%
Provision/ total loans	2.52%	2.78%	3.29%	3.87%	4.33%
Credit costs	1.03%	1.54%	1.79%	1.73%	1.65%
<b>Capital adequacy</b>					
CET-1 CAR	9.6%	9.1%	10.0%	10.2%	10.4%
Tier-1 CAR	10.6%	10.1%	11.1%	11.2%	11.3%
Total CAR	13.5%	13.0%	12.8%	12.8%	12.8%
<b>Profitability</b>					
NIM	1.52%	1.74%	1.84%	1.85%	1.85%
ROE	12.3%	11.6%	11.5%	11.4%	11.3%
ROA	0.74%	0.76%	0.76%	0.76%	0.77%
RoRWA	1.09%	1.07%	1.10%	1.15%	1.17%
<b>Per share</b>					
EPS (RMB)	0.61	0.61	0.66	0.71	0.78
DPS (RMB)	0.18	0.16	0.17	0.19	0.20
BVPS (RMB)	5.44	5.46	5.98	6.55	7.17

Source: Company data, CMBIS estimates

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