

Company Report

Agricultural Bank of China (1288 HK)

Maintain NEUTRAL on loan quality pressure

- Steady 1H20 performance expected for ABC
- Pressure on loan quality persists across the sector
- Maintain NEUTRAL; TP revised down to HKD3.1

Steady 1H20 performance expected for ABC

In 1Q20, total amount of NPL increased ~5.1% qoq. Aggregate NPL ratio and provision coverage of impaired loans virtually unchanged at 1Q20 vs. end-2019 (Figure 1). NPL ratio of county area loan stood at 1.50% at end-1Q20, vs. 1.58% at end-2019 (Figure 2). Overall loan quality of ABC remained stable in 1Q20. In our view, LPR cuts might weigh on ABC's NIM in 2Q20, but its loan quality is expected to be stable in 2Q20 given: 1) credit spread of industrial bond declined in May-June, which could suggest alleviated pressure from enterprise credit risk for major banks in 2Q20. In the past, credit spread of industrial bond showed some positive correlation with large state-owned banks' (except for PSBC) average NPL formation ratio (Figure 5); 2) Mfg sector is a significant source of NPL for ABC (Figure 9). Cumulative growth of industrial enterprises' revenue (88% is from mfg sector as of 2019) continuously rebounded in March-June, which could suggest alleviated pressure from mfg sector on major banks' loan quality in 2Q20. In the past, industrial enterprises' revenue/profit growth showed some negative correlation with NPL formation ratio of major banks (Figure 6).

Pressure on loan quality persists across the sector

The CBIRC recently indicated asset quality pressure might linger on across the sector, which is similar to our view, as: 1) The risks of NPLs not yet fully exposed due to the time lag between the economic downturn and the financial statements; 2) The flexible loan repayment policy temporarily granted to SMEs affected by COVID-19 totalled at ~RMB1.8tr, or ~1.1% of total existing RMB loans. But this may not fundamentally reduce the operation risks of those SMEs. The CBIRC sees relatively high default risks for these loans in foreseeable future; 3) Inclusive SME loans totalled at ~RMB13tr in 1H20 (~28% yoy), or ~8% of total existing RMB loans. We think the fast increase in inclusive SME loans may bring additional risks for banks.

Maintain NEUTRAL; TP cut to HKD3.1

ABC is trading at ~0.47x 2020E P/B. Valuation undemanding. Assuming ~31% dividend payout ratio, ABC's dividend yield is ~12% below the record high in 2016, and its spread over 10Y government bond yield is ~20% below the record high in 2016 (Figure 10-13). We revised down ABC's 20/21E EPS by 1%/3%. Maintain NEUTRAL on the loan quality pressure across the sector. Cut TP by 16% to HKD3.1, equivalent to ~0.51x 20E P/B (vs. 0.61x 20E P/B previously), representing a ~28% discount to its avg. P/B multiple for the last 5 years. Key catalysts: NIM expansion, upward asset quality trend. Key downside risks: NIM pressure, downward asset quality trend, decreased dividend.

Financials

Year ended 31 Dec (RMB mn)	2018	2019	2020E	2021E	2022E
Operating income	602,557	629,350	672,490	724,297	778,261
Ord. shareholders' net profit	198,183	207,498	214,491	225,241	240,386
EPS (RMB)	0.6	0.6	0.6	0.6	0.7
BVPS (RMB)	4.54	5.00	5.43	5.89	6.38
P/E (x)	4.3	4.3	4.2	4.0	3.7
P/B (x)	0.56	0.51	0.47	0.43	0.40
ROE (%)	13.5	12.4	11.8	11.4	11.2
Dividend yield	6.8	7.1	7.4	7.8	8.3

Sources: Company data, CMS (HK) estimates; Note: price as of July 23, 2020

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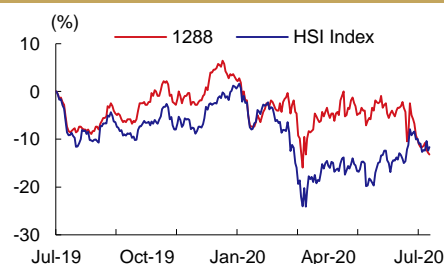
WHAT'S NEW

Company update and TP cut

NEUTRAL

Previous	NEUTRAL
Price	HKD2.83
12-month Target Price (Potential up/downside)	HKD3.1 (+10%)
Previous	HKD3.7

Price Performance



Source: Bigdata

%	1m	6m	12m
1288 HK	(4.0)	(7.3)	(6.1)
HSI	1.4	(9.5)	(11.3)

Sector: Bank

Hang Seng Index (July 23, 2020)	25,263
HSCEI (July 23, 2020)	10,325

Key Data

52-week range (HKD)	2.69-3.5
Market cap (HKD mn)	990,452
Avg. daily volume (mn)	115.76

Shareholding Structure

Central Huijin Investment Co., Ltd.	40.03%
Ministry of Finance of PRC	35.29%
HKSCC Nominees Limited	8.73%
National Council for Social Security Fund	6.72%
Free float	9.23%
No. of shares outstanding (mn)	349,983

Sources: Bloomberg, Bigdata, Company data

Related Research

1. ABC (1288 HK) - Downgrade to "NEUTRAL" on sector headwinds (December 17, 2019)

Focus charts

Figure 1: ABC – 1Q20 key result review

(RMB million)	1Q20	2019	1Q19	1Q20/2019 (qoq)
Profitability (%)				
PPOP growth yoy	7.81	11.14	11.20	n.a.
Return on average total assets (annualized)	1.01	0.90	1.07	n.a.
Return on weighted average equity for ord. shareholders (annualized)	14.25	12.43	14.96	n.a.
Net interest margin	n.a.	2.17	n.a.	n.a.
Ratio of net fee and commission income to operating income	16.66	11.16	16.83	n.a.
Asset quality (%)				
Aggregate NPL ratio	1.40	1.40	1.53	n.a.
Corporate loan NPL ratio	n.a.	2.10	n.a.	n.a.
Personal loan NPL ratio	n.a.	0.59	n.a.	n.a.
Allowance to NPL ratio	289.91	288.75	263.93	n.a.
Allowance to total loans ratio	4.06	4.06	4.04	n.a.
Operating performance (in RMB mn)				
Net interest income	129,659	126,398	119,113	8.9% (yoy)
Net fee and commission income	31,149	17,069	29,218	6.6% (yoy)
Total loans and advances to customers	14,138,099	13,360,188	12,664,116	5.8%
Corporate loans	7,721,472	7,095,770	6,985,759	8.8%
Personal loans	5,602,451	5,392,473	4,913,316	3.9%
Due to customers	19,539,807	18,542,861	18,447,181	5.4%
Time deposits	7,751,458	7,022,112	6,894,825	10.4%
Demand deposits	10,694,788	10,561,852	10,453,997	1.3%
Loan-to-deposit ratio (%)	72.4	72.1	68.7	n.a.
Investments assets	7,556,865	7,422,930	6,998,722	1.8%

Sources: Company data, CMS (HK)

Figure 2: ABC's businesses in county and urban areas – scales and growths

	2015	2016	2017	2018	2019	1Q20
County area business:						
Growth of loans and advances to customers (yoy)	7.9%	11.1%	12.3%	12.3%	13.7%	6.9% (qoq)
Growth of deposits (yoy)	9.2%	10.7%	7.7%	6.7%	7.9%	6.8% (qoq)
Non-performing loan ratio (%)	3.02	3.00	2.17	2.08	1.58	1.50
Urban area business:						
Growth of loans and advances to customers (yoy)	11.1%	8.1%	9.3%	10.9%	11.0%	5.3%(qoq)
Growth of deposits (yoy)	7.2%	11.4%	7.7%	7.4%	6.2%	4.3%(qoq)
Non-performing loan ratio (%)	2.09	2.07	1.63	1.35	1.31	1.33
Total:						
County area loans and advances/ total loans and advances (%)	32.1	32.7	33.3	33.5	34.1	34.4
Growth of total loans and advances (yoy)	10.0%	9.1%	10.3%	11.4%	11.9%	5.8%(qoq)
Growth of total deposits (yoy)	8.0%	11.1%	7.7%	7.1%	6.9%	5.4%(qoq)
Non-performing loan ratio (%)	2.39	2.37	1.81	1.59	1.40	1.40
Allowance to non-performing loans (%)	189.4	173.4	208.4	252.2	288.8	289.9

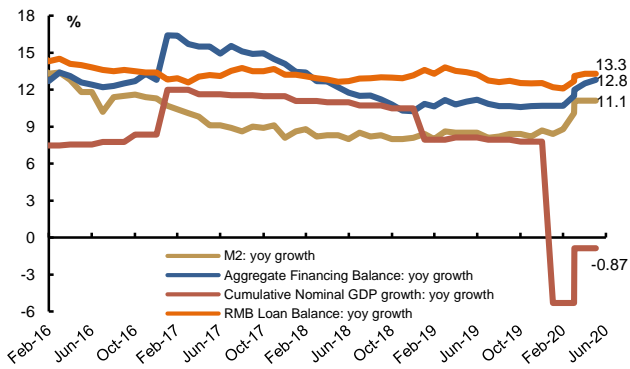
Sources: Company data, CMS (HK)

Figure 3: ABC key forecast revision

(RMB mn)	New		Old		Change	
	2020E	2021E	2020E	2021E	2020E New/Old	2021E New/Old
Net profit for ordinary equity holders of the parent company	214,491	225,241	217,092	232,310	-1%	-3%
Net interest income	522,710	562,674	528,904	567,380	-1%	-1%
Net interest margin (%)	2.05	2.03	2.11	2.12	-6 bps	-9 bps

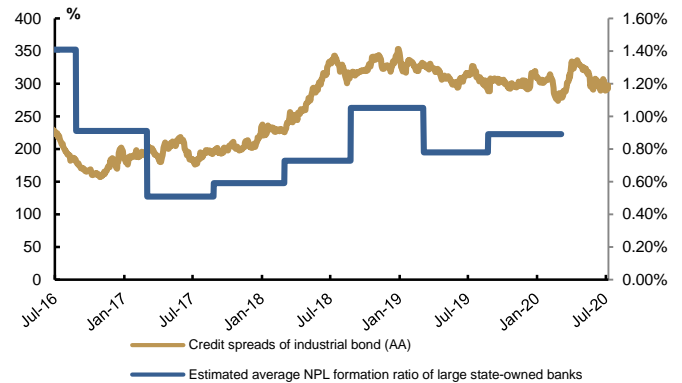
Sources: Company data, CMS (HK) estimates

Figure 4: Growth rates of M2, Aggregate Financing, RMB Loan, and Nominal GDP



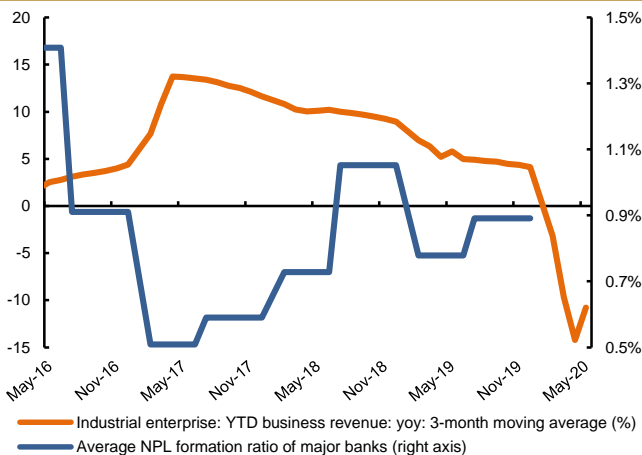
Sources: Wind, CMS (HK)

Figure 5: Credit spreads of industrial bond, and NPL formation ratio of large state-owned banks



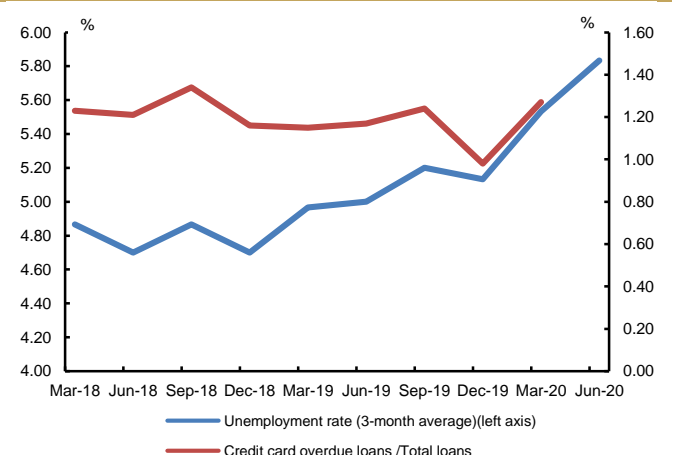
Sources: Wind, CMS (HK)

Figure 6: Revenue growth of industrial enterprises and NPL formation ratio of major banks



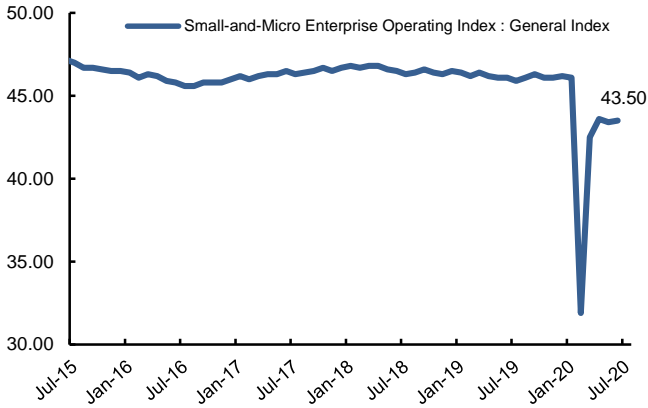
Sources: Wind, CMS (HK)

Figure 7: Unemployment rate and credit card loan quality



Sources: Wind, CMS (HK)

Figure 8: Small-and-Micro Enterprise Operating Index



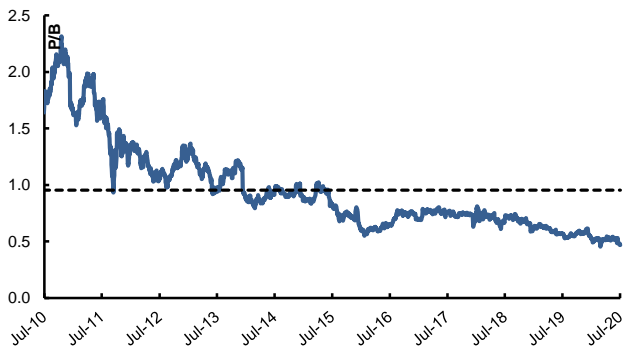
Sources: Wind, CMS (HK)

Figure 9: ABC's distribution of loans and NPLs (2019)

	Sector loans /total loans	Sector NPLs /total NPLs
Transportation, storage and postal services	12.32%	6.75%
Manufacturing	9.00%	32.30%
Real estate	5.20%	5.40%
Wholesale & retail	2.30%	16.30%
Mining	1.50%	2.50%
Leasing & commercial services	7.79%	8.09%
Other corporate	15.09%	8.06%
Personal	40.50%	16.90%
Including:		
Mortgage	31.20%	6.60%
Consumer	1.30%	0.90%
Credit card	3.60%	4.00%
Others	2.00%	2.30%
Rural households	2.40%	3.10%

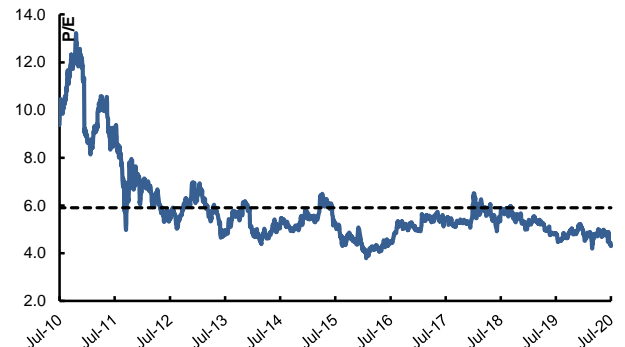
Sources: Wind, CMS (HK)

Figure 10: P/B of ABC



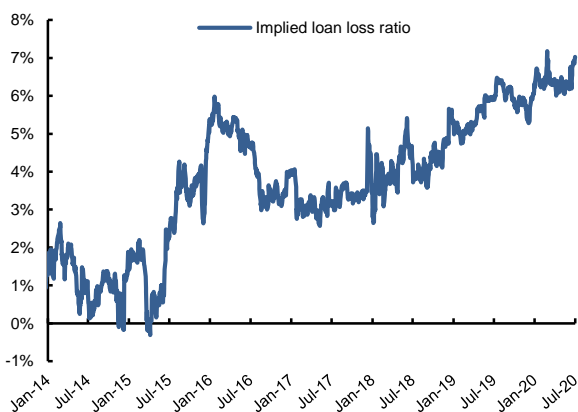
Sources: Company data, CMS (HK) estimates

Figure 11: P/E of ABC



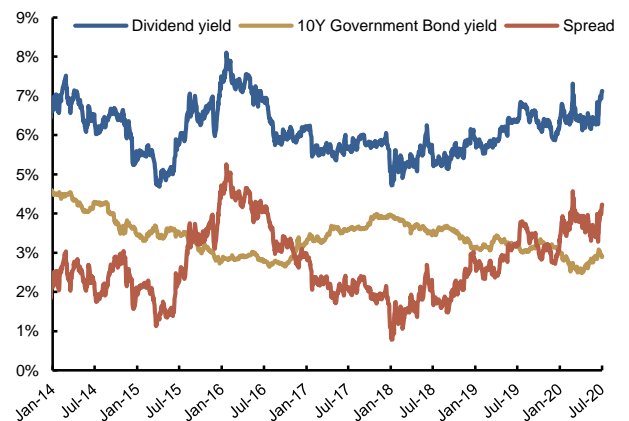
Sources: Company data, CMS (HK) estimates

Figure 12: Implied loan loss ratio of ABC



Sources: Company data, CMS (HK) estimates

Figure 13: Dividend yield of ABC



Sources: Company data, CMS (HK) estimates

Valuation comparison

Company	Ticker	Rating	Price Local ccy	TP (HKD)	Mkt Cap (USD mn)	P/E		P/B		ROE (%)		Dividend Yield (%)	
						2020E	2021E	2020E	2021E	2020E	2021E	2020E	2021E
HK Listed Peers													
Industrial and Commercial Bank of China	1398 HK	NEUTRAL	4.74	5.30	246,697	4.8	4.6	0.56	0.52	12.2	11.8	6.3	6.6
Agricultural Bank of China	1288 HK	NEUTRAL	2.83	3.10	160,268	4.2	4.0	0.47	0.43	11.8	11.4	7.4	7.8
Postal Savings Bank of China	1658 HK	NEUTRAL	4.40	5.00	56,408	5.4	4.8	0.64	0.58	12.3	12.7	5.8	6.6
Bank of Communications *	3328 HK	Restricted	4.36	Restricted	46,929	3.8	3.7	0.39	0.36	10.4	10.0	8.0	8.4
China Construction Bank *	939 HK	NR	5.96	n.a.	193,443	5.0	4.7	0.59	0.54	12.2	11.8	6.2	6.5
Bank of China *	3988 HK	NR	2.70	n.a.	131,740	3.9	3.8	0.40	0.37	10.3	9.9	8.0	8.2
China CITIC Bank *	998 HK	NR	3.46	n.a.	32,168	3.2	3.0	0.31	0.29	10.4	10.2	8.1	8.4
China Minsheng Bank *	1988 HK	NR	4.93	n.a.	33,696	3.6	3.4	0.39	0.36	11.2	10.8	7.9	8.4
China Everbright Bank *	6818 HK	NR	2.96	n.a.	26,895	3.8	3.5	0.40	0.37	11.3	11.5	8.0	8.7
Arithmetic Average						4.2	3.9	0.46	0.43	11.4	11.1	7.3	7.7
Weighted Average						4.5	4.2	0.51	0.47	11.7	11.3	6.9	7.3
China A-share Listed Peers *													
Industrial and Commercial Bank of China	601398 CH	NR	5.03	n.a.	246,697	5.7	5.4	0.67	0.61	11.9	11.6	5.3	5.6
Agricultural Bank of China	601288 CH	NR	3.27	n.a.	160,268	5.3	5.1	0.60	0.56	11.5	11.1	5.7	6.0
Bank of Communications	601328 CH	NR	4.86	n.a.	46,929	4.7	4.5	0.48	0.45	10.3	9.9	6.6	6.8
Postal Savings Bank of China	601658 CH	NR	4.71	n.a.	56,408	6.2	5.5	0.75	0.68	12.2	12.6	5.1	5.6
China Construction Bank	601939 CH	NR	6.27	n.a.	193,443	5.8	5.5	0.68	0.62	12.2	11.7	5.3	5.6
Bank of China	601988 CH	NR	3.41	n.a.	131,740	5.4	5.2	0.56	0.52	10.4	10.0	5.7	5.9
China CITIC Bank	601998 CH	NR	5.25	n.a.	32,168	5.3	4.9	0.53	0.49	10.3	10.1	4.8	5.0
China Minsheng Bank	600016 CH	NR	5.61	n.a.	33,696	4.5	4.2	0.49	0.45	11.1	10.7	6.3	6.6
Industrial Bank	601166 CH	NR	15.99	n.a.	47,426	4.8	4.4	0.62	0.56	12.9	12.7	5.0	5.4
China Everbright Bank	601818 CH	NR	3.88	n.a.	26,895	5.2	4.7	0.59	0.54	11.0	11.1	5.7	6.2
Shanghai Pudong Development Bank	600000 CH	NR	10.84	n.a.	45,427	5.4	5.1	0.59	0.54	11.3	10.9	4.8	4.9
Ping An Bank	000001 CH	NR	14.01	n.a.	38,817	8.7	7.6	0.91	0.82	10.5	10.9	1.6	1.9
Huaxia Bank	600015 CH	NR	6.46	n.a.	14,192	4.5	4.3	0.43	0.39	9.9	9.5	3.9	4.1
Bank of Beijing	601169 CH	NR	4.88	n.a.	14,731	4.6	4.3	0.50	0.45	10.5	10.2	6.6	6.7
Bank of Shanghai	601229 CH	NR	8.32	n.a.	16,876	5.5	5.0	0.68	0.62	12.4	12.2	5.0	5.3
Bank of Ningbo	002142 CH	NR	31.69	n.a.	27,183	11.5	9.7	1.79	1.56	15.7	16.3	1.8	2.1
Arithmetic Average						5.8	5.3	0.68	0.62	11.5	11.3	5.0	5.2
Weighted Average						5.7	5.4	0.66	0.60	11.6	11.3	5.2	5.5
Global Peers *													
HSBC	HSBA LN	NR	367.10	n.a.	95,399	16.5	10.0	0.55	0.54	2.8	4.8	2.7	7.6
Standard Chartered	STAN LN	NR	436.30	n.a.	17,571	18.5	9.7	0.40	0.39	1.3	4.0	2.2	4.3
Barclays	BARC LN	NR	116.46	n.a.	25,775	25.9	8.9	0.37	0.36	2.0	3.9	1.5	3.9
Hang Seng Bank	11 HK	NR	127.10	n.a.	31,349	12.3	12.0	1.38	1.33	11.8	11.7	5.5	5.8
Bank of East Asia	23 HK	NR	17.96	n.a.	6,754	14.4	12.6	0.50	0.49	3.7	3.7	3.4	3.9
BOC Hong Kong	2388 HK	NR	22.35	n.a.	30,485	8.3	8.0	0.80	0.75	10.0	9.9	6.3	6.5
Bank of America	BAC US	NR	24.54	n.a.	212,899	16.1	11.4	0.87	0.82	5.3	7.2	3.0	3.1
J.P. Morgan Chase & Co.	JPM US	NR	98.98	n.a.	301,594	17.3	11.2	1.26	1.20	7.3	11.0	3.7	3.7
Wells Fargo	WFC US	NR	26.35	n.a.	108,551	153.2	12.3	0.68	0.65	0.6	4.9	4.9	2.9
Deutsche Bank	DBK GR	NR	8.52	n.a.	19,869	n.a.	30.2	0.32	0.32	(2.4)	0.7	0.0	0.3
BNP Paribas	BNP FP	NR	37.57	n.a.	54,536	10.3	8.4	0.46	0.45	4.2	4.6	5.5	5.9
Average						29.3	12.3	0.69	0.66	4.2	6.1	3.5	4.4

Sources: Company data, Bloomberg, CMS (HK) estimates; Price as of July 23, 2020; * forecast based on Bloomberg consensus

Financial Summary

Consolidated Statement of Financial Position

Year ended 31 Dec (RMB mn)	2018	2019	2020E	2021E	2022E
Cash and balances with central banks	2,805,107	2,699,895	2,781,902	2,940,234	3,112,413
Deposits with banks and other financial institutions	109,728	235,742	312,814	263,648	229,768
Placements with and loans to banks and other financial institutions	552,013	523,183	526,822	534,006	528,004
Precious metals	21,268	30,063	30,063	30,063	30,063
Loans and advances to customers	11,461,542	12,819,610	14,513,765	15,986,699	17,582,663
Financial investments	7,293,020	8,156,425	8,830,043	9,539,367	10,315,775
Investments in associates and joint ventures	4,005	6,672	6,672	6,672	6,672
Property and equipment	152,452	152,484	152,484	152,484	152,484
Goodwill	1,381	1,381	1,381	1,381	1,381
Deferred income tax assets	113,293	120,952	120,952	120,952	120,952
Other assets	95,662	131,881	176,915	169,237	154,119
Total assets	22,609,471	24,878,288	27,453,813	29,744,744	32,234,294
Borrowings from central banks	561,195	608,536	608,536	608,536	608,536
Deposits from banks and other financial institutions	1,124,322	1,503,909	1,533,987	1,457,288	1,384,423
Placements from banks and other financial institutions	325,541	325,363	331,870	315,277	299,513
Financial liabilities at fair value through profit or loss	286,303	330,627	357,077	385,643	416,495
Derivative financial liabilities	34,554	29,548	29,548	29,548	29,548
Financial assets sold under repurchase agreements	157,101	53,197	53,197	53,197	53,197
Due to customers	17,346,290	18,542,861	20,667,671	22,759,191	25,023,864
Debt securities issued	780,673	1,108,212	1,222,940	1,324,990	1,435,888
Deferred tax liabilities	139	520	520	520	520
Other liabilities	318,566	415,753	415,753	415,753	415,753
Total liabilities	20,934,684	22,918,526	25,221,099	27,349,943	29,667,737
Ordinary shares	349,983	349,983	349,983	349,983	349,983
Preference shares and AT1	79,899	199,886	319,886	319,886	319,886
Reserves and retained earnings	1,240,412	1,398,486	1,551,156	1,712,924	1,884,205
Shareholders' equity	1,670,294	1,948,355	2,221,025	2,382,793	2,554,074
Non-controlling interests	4,493	11,407	11,689	12,007	12,483
Total equity	1,674,787	1,959,762	2,232,714	2,394,801	2,566,557

Consolidated Cash Flow Statement

Year ended 31 Dec (RMB mn)	2018	2019	2020E	2021E	2022E
Net cash from operating activities	105,927	352,571	400,923	581,944	630,097
Net cash from investing activities	(439,087)	(230,805)	(489,980)	(490,104)	(533,501)
Net cash from financing activities	304,873	351,765	133,239	(6,537)	(3,834)
Net increase in cash and cash equivalents	(28,287)	473,531	44,182	85,302	92,762
Effect of foreign exchange rate changes	5,482	2,609	-	-	-
Cash and cash equivalents at end of year	978,441	1,454,581	1,498,763	1,584,065	1,676,827

Consolidated Statement of Profit or Loss

Year ended 31 Dec (RMB mn)	2018	2019	2020E	2021E	2022E
Interest income	784,724	859,141	909,885	987,252	1,067,980
Interest expense	(306,964)	(372,270)	(387,176)	(424,577)	(462,466)
Net interest income	477,760	486,871	522,710	562,674	605,514
Fee and commission income	91,525	103,011	108,478	118,600	128,692
Fee and commission expense	(13,384)	(16,085)	(16,939)	(18,519)	(20,095)
Net fee and commission	78,141	86,926	91,540	100,081	108,597
Net trading income	16,069	19,067	19,067	19,067	19,067
Net gain on financial instruments designated at FVPL	8,460	5,793	4,644	7,487	6,457
Net gain on investment securities	30	0	10	13	8
Other operating income	22,097	30,693	34,520	34,975	38,618
Operating income	602,557	629,350	672,490	724,297	778,261
Operating expenses	(213,963)	(224,096)	(238,458)	(253,802)	(270,200)
Impairment losses on assets	(136,898)	(138,723)	(157,522)	(177,587)	(196,024)
Operating profit	251,696	266,531	276,511	292,908	312,037
Share of result of associate	(22)	45	7	11	10
Profit before tax	251,674	266,576	276,518	292,919	312,047
Income tax expense	(49,043)	(53,652)	(55,304)	(58,584)	(62,409)
Profit for the period	202,631	212,924	221,214	234,335	249,638
Attributable to:					
Ordinary equity holders of the parent company	198,183	207,498	214,491	225,241	240,386

Financial Ratios

	2018	2019	2020E	2021E	2022E
EPS for ordinary shares (RMB)	0.59	0.59	0.61	0.64	0.69
BVPS for ordinary shares (RMB)	4.54	5.00	5.43	5.89	6.38
Return on average total assets (%)	0.93	0.90	0.85	0.82	0.81
Return on equity for ord. shareholders (%)	13.50	12.43	11.75	11.36	11.19
Net interest spread (%)	2.20	2.03	1.84	1.79	1.74
Net interest margin (%)	2.33	2.17	2.05	2.03	2.01
Non-performing loans ratio (%)	1.59	1.40	1.40	1.50	1.50
Allowance to NPL (%)	252.18	288.75	288.75	288.75	288.75
Allowance to total loans ratio (%)	4.02	4.06	4.04	4.33	4.33
Core tier 1 capital adequacy ratio (%)	11.55	11.24	11.09	11.11	11.11
Capital adequacy ratio (%)	15.12	16.13	16.28	16.15	15.81

Sources: Company data & CMS (HK) estimates

Investment Ratings

Industry Rating	Definition
OVERWEIGHT	Expect sector to outperform the market over the next 12 months
NEUTRAL	Expect sector to perform in-line with the market over the next 12 months
UNDERWEIGHT	Expect sector to underperform the market over the next 12 months

Company Rating	Definition
BUY	Expect stock to generate 10%+ return over the next 12 months
NEUTRAL	Expect stock to generate +10% to -10% over the next 12 months
SELL	Expect stock to generate loss of 10%+ over the next 12 months

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