

COMPANY RESULTS

China Merchants Bank (3968 HK)

1H23: Reduced Provisions Cushion NIM Pressure And Weakening Fee Income

CMB's 1H23 earnings came in above our expectations, underpinned by lower provisions. Net interest income recorded a margin growth of 1.2% yoy as larger loan scale offset the NIM compression impact. Non-interest income remains a key drag on operating income due to the sluggish performance in wealth management income. Asset quality remains largely stable with the property risk exposure reaching its peak. Maintain BUY on CMB with a lower target price of HK\$50.00.

1H23 RESULTS

Year to 31 Dec (Rmbm)	1H23	1H22	yoy %	2Q23	yoy%	qoq%
Interest earning asset	9,932,882	8,897,584	11.6			
Total loan	6,355,429	5,931,807	7.1			
Total deposit	8,030,232	7,037,185	14.1			
Net interest income	108,996	107,692	1.2	53,587	0.7	-3.3
Net interest margin	2.23%	2.44%	-21bp	2.16%	-21bp	-13bp
Fee income	47,091	53,405	-11.8	22,012	-10.9	-12.2
Operating income	178,465	179,077	-0.3	87,840	0.9	-3.1
Operating expenses	56,372	53,976	4.4	29,049	4.2	6.3
PPOP	120,537	123,645	-2.5	58,028	-0.5	-7.2
Provision	31,059	41,477	-25.1	-14,788	-25.9	-9.9
Net profit	75,752	69,420	9.1	36,913	9.6	-5.0
BVPS (Rmb)	39.09	35.51	10.1			

Source: China Merchants Bank, UOB Kay Hian

RESULTS

- **Beat estimates.** China Merchants Bank's (CMB) 1H23 earnings came in with a 9.1% yoy growth to Rmb75,752m, representing 50.8%/50.6% of our/consensus 2023 estimates, slightly above expectations. The lower credit impairment losses on non-loan assets buffered the adverse impacts of net interest margin (NIM) compression and weakening fee growth, resulting in high single-digit earnings growth in 1H23.
- **Operating income was flattish in 1H23**, thanks to its better performance in 2Q23 (+0.9 yoy vs 1Q23: -1.7% yoy) as the decline of fee and commission income narrowed to -10.9% yoy in 2Q23 (vs 1Q23: -12.6% yoy). Net interest income was up 1.2% yoy in 1H23 as the positive volume growth outweighed the negative impact from the pricing factor.
- **Assets and deposits grew faster than loans in 1H23.** CMB's total assets expanded by 10.4% yoy to Rmb10.74t, while loans achieved a 7.1% yoy growth to Rmb6.36t. Among that, retail loans increased by 7.7% yoy to Rmb3.27t, due to the boost of consumer loans and micro-finance loans. Meanwhile, corporate loans grew at a faster pace of 12.0% yoy due to the bank's continuously increased support to key areas of the real economy. On the liability side, deposits jumped 14.1% yoy to Rmb8.03t and the time deposit ratio advanced by 2.57ppt to 43.51%, mainly attributed to: a) less liquidity and investing activities by corporate, and b) savings demand of residents remaining rigid.

KEY FINANCIALS

Year to 31 Dec (Rmbm)	2021	2022	2023F	2024F	2025F
Net interest income	203,919	218,235	218,591	243,699	282,006
Non-interest income	123,458	123,980	128,551	142,885	155,220
Net profit (rep./act.)	116,309	132,775	144,889	166,629	192,936
Net profit (adj.)	116,309	132,775	144,889	166,629	192,936
EPS (Fen)	461.2	526.5	574.5	660.7	765.0
PE (x)	6.2	5.4	5.0	4.3	3.7
P/B (x)	0.8	0.8	0.7	0.6	0.6
Dividend yield (%)	5.3	6.1	6.6	7.6	8.8
Net int margin (%)	2.5	2.4	2.2	2.2	2.3
Cost/income (%)	35.7	35.7	34.8	34.8	34.7
Loan loss cover (%)	483.9	450.8	448.1	442.7	442.6
Consensus net profit	-	-	149,185	167,521	187,142
UOBKH/Consensus (x)	-	-	0.97	0.99	1.03

Source: China Merchants Bank Co., Ltd., Bloomberg, UOB Kay Hian

BUY

(Maintained)

Share Price	HK\$31.05
Target Price	HK\$50.00
Upside	+61.0%
(Previous TP)	HK\$53.50

BANK DESCRIPTION

China Merchants Bank is a leading bank in China. It provides comprehensive commercial banking services covering retail, corporate and treasury banking.

STOCK DATA

GICS sector	Financials
Bloomberg ticker:	3968 HK
Shares issued (m):	4,590.9
Market cap (HK\$m):	841,655.0
Market cap (US\$m):	107,311.5
3-mth avg daily t'over (US\$m):	86.9

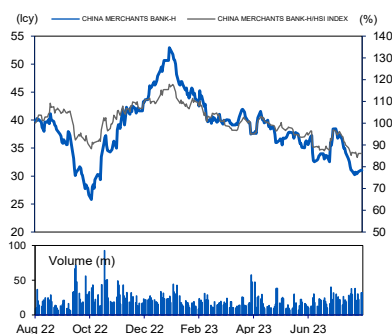
Price Performance (%)

52-week high/low	HK\$52.95/HK\$25.80			
1mth	3mth	6mth	1yr	YTD
(5.9)	(28.6)	41.3	(19.8)	(13.7)

Major Shareholders

China Merchants Group	13.0
COSCO	6.2
FY23 NAV/Share (Rmb)	42.35
FY23 CAR Tier-1 (%)	16.50

PRICE CHART



Source: Bloomberg

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- Volatile capital market continues to weigh on wealth management fee income.** The wealth management and asset management fee income in 1H23 slipped 8.5% yoy to Rmb25.85b, mainly due to the risk-averse stance of customers and the public fund fee reductions as required by regulators. Nonetheless, the balance of asset under management (AUM) for retail customers increased by 5.9% hoh to Rmb12.84t and 76.48% are made up of non-deposits. We expect the bank's non-interest income will return to growth trajectory eventually, considering its extensive retail customer base and growing AUM.
- Asset quality improved.** CMB's non-performing loan (NPL) ratio was 0.95%, 1bp lower than 2022. The provision coverage ratio declined by 3.16ppt hoh to 447.63%, maintaining at higher level than its peers. Additionally, the leading indicators such as special mention loan ratio, migration rate of normal loans and formation ratio of NPL also showed improvements, falling by 0.19ppt/0.89ppt/0.11ppt hoh to 1.02%/0.64%/1.04%.

STOCK IMPACT

- NIM outlook remains challenging.** The bank's NIM in 1H23 compressed 21bp yoy to 2.16%, and the NIM in 2Q23 declined by a larger extent of 13bp qoq to 2.16% (vs 1Q23: -12bp qoq). The NIM dilution is mainly due to: a) the downturn of market interest rate and insufficient effective credit demand, particularly for higher-yield loans such as credit card loan and mortgage loan, which eventually led to the decline of asset yield, b) increase in time deposit ratio, and c) a hike of demand deposit cost as the wealth management products (WMP) temporarily return to balance sheet in the form of demand deposits. Management alluded that the NIM movement in 2H23 is likely to remain under pressure due to the recent two LPR cuts and potential adjustments to the existing mortgage rate. However, management also mentioned that the potential deposit rate cut via disciplined mechanism and less loans repriced in 2H23 may alleviate the downward pressure on NIM.
- Loans disbursement in 2H23.** In term of retail loans, the bank will continue to promote the growth of micro-finance loans, consumer loans and credit-card loans, while maintaining the scale of residential mortgage loans in a relatively steady manner. Meanwhile, in terms of corporate loans, the bank will focus on key policy-driven sectors such as green finance, sci-tech finance, inclusive finance and industrial finance. Overall, management reiterated that the bank will promote steady loan growth and increase retail loans allocation, while reinforcing the loan risk pricing management to build a more sustainable loan portfolio.
- Property risk exposure peaked.** CMB's total real estate exposure in 1H23 reduced by 5.88% hoh to Rmb436.08b and the loans balance to developers also tumbled by 0.57% to Rmb315.011b, accounting for 5.6% of total loan (vs 6.2% in 2022). Despite the NPL of real estate loans rising 1.46ppt hoh to 5.45% in 1H23, management mentioned that the new NPL formation of real estate loans had peaked in 2022 and NPL ratio is expected to meet its turning point this year.

EARNINGS REVISION/RISK

- Trim 2023 earnings forecast by 3%** after factoring in lower NIM assumptions and weaker fee income growth.

VALUATION/RECOMMENDATION

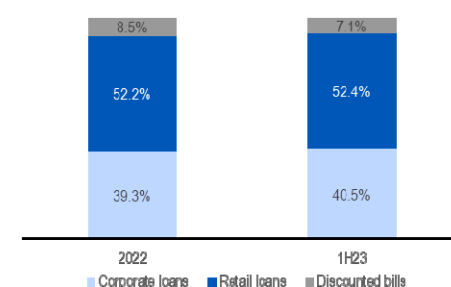
- Maintain BUY with a lower target price of HK\$50.00,** to reflect earning adjustments. Our target price is pegged to 1.21x 2023F P/B on par with historical mean.
- Despite the intense pressure on NIM and weak macro environment, CMB still managed to maintain its ROE above 17%, better than our conservative assumptions of 16.8%. Additionally, the bank has progressively built its CET 1 ratio to 13.09%, the second highest among its SOE and joint-stock peers, providing more scope for balance sheet expansion while maintaining current dividend payout ratio. As such, the current P/B valuation of CMB is at -1.8SD below historical mean which we deem to be very appealing given its outstanding ROE and solid capital buffer.

KEY FINANCIAL INDICATORS (1H23)

Financial Ratios (%)	1H23	yoy ppt chg
NIM	2.23	-21bp
NPL Ratio	0.95	0.00
Provision Coverage	447.63	-6.43
Credit Cost Ratio	0.88	0.09
Formation ratio of new NPL	1.04	-0.09
ROE (Annualized)	17.55	-0.52
Cost-Income Ratio	29.07	1.31
CAR	17.09	0.29
Tier-1 CAR	14.99	0.53
CET1 CAR	13.09	0.77

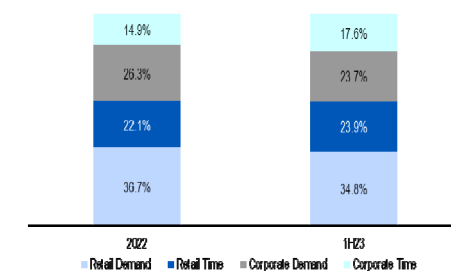
Source: CMB, UOB Kay Hian

LOAN MIX



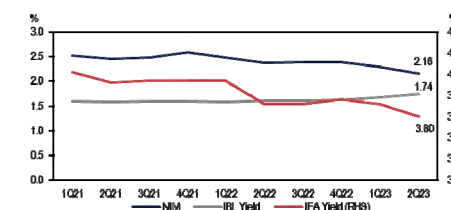
Source: CMB, UOB Kay Hian

DEPOSIT MIX



Source: CMB, UOB Kay Hian

NIM TREND



Source: CMB, UOB Kay Hian

PROFIT & LOSS

Year to 31 Dec (Rmbm)	2022	2023F	2024F	2025F
Interest income	353,380	384,631	431,200	485,988
Interest expense	(135,145)	(166,040)	(187,501)	(203,983)
Net interest income	218,235	218,591	243,699	282,006
Fees & commissions	94,275	93,221	104,753	114,042
Other income	29,705	35,330	38,132	41,178
Non-interest income	123,980	128,551	142,885	155,220
Income from islamic banking	0	0	0	0
Total income	342,215	347,143	386,584	437,226
Staff costs	(70,657)	(69,429)	(77,317)	(87,445)
Other operating expense	(51,404)	(51,377)	(57,214)	(64,272)
Pre-provision profit	220,154	226,337	252,053	285,508
Loan loss provision	(56,751)	(54,067)	(54,330)	(56,920)
Other provisions	(815)	(776)	(780)	(817)
Associated companies	2,525	2,778	3,055	3,361
Pre-tax profit	165,113	174,271	199,998	231,131
Tax	(25,819)	(27,012)	(31,000)	(35,825)
Minorities	(6,519)	(2,370)	(2,370)	(2,370)
Net profit	132,775	144,889	166,629	192,936
Net profit (adj.)	132,775	144,889	166,629	192,936

BALANCE SHEET

Year to 31 Dec (Rmbm)	2022	2023F	2024F	2025F
Cash with central bank	605,989	1,007,333	1,102,786	1,104,426
Govt treasury bills & securities	1,555,457	1,711,003	2,053,203	2,258,524
Interbank loans	631,598	690,370	759,407	835,347
Customer loans	5,807,154	6,485,021	7,430,124	8,312,614
Investment securities	1,217,232	1,200,321	1,091,026	1,105,802
Derivative receivables	18,671	18,671	18,671	18,671
Associates & JVs	25,112	25,112	25,112	25,112
Fixed assets (incl. prop.)	117,472	121,766	126,338	131,199
Other assets	160,227	168,113	174,117	180,830
Total assets	10,138,912	11,427,710	12,780,784	13,972,525
Interbank deposits	1,075,369	1,182,906	1,252,453	1,333,594
Customer deposits	7,535,742	8,575,613	9,629,783	10,554,030
Derivative payables	18,636	18,636	18,636	18,636
Debt equivalents	344,267	350,982	357,898	365,021
Other liabilities	331,106	368,856	479,657	529,618
Total liabilities	9,305,120	10,496,993	11,738,427	12,800,900
Shareholders' funds	825,057	921,982	1,033,623	1,162,890
Minority interest - accumulated	8,735	8,735	8,735	8,735
Total equity & liabilities	10,138,912	11,427,710	12,780,784	13,972,525

OPERATING RATIOS

Year to 31 Dec (%)	2022	2023F	2024F	2025F
Capital Adequacy				
Tier-1 CAR	13.7	13.7	13.6	13.8
Total CAR	17.8	17.8	17.6	18.0
Total assets/equity (x)	12.3	12.4	12.4	12.0
Tangible assets/tangible common equity (x)	12.5	12.6	12.5	12.1
Asset Quality				
NPL ratio	1.0	0.9	0.9	0.8
Loan loss coverage	450.8	448.1	442.7	442.6
Loan loss reserve/gross loans	4.3	4.1	3.8	3.6
Increase in NPLs	0.1	0.1	0.1	0.0
Credit cost (bp)	77.7	78.8	70.0	65.0
Liquidity				
Loan/deposit ratio	80.3	78.9	80.2	81.7
Liquid assets/short-term liabilities	32.2	34.7	35.8	35.1
Liquid assets/total assets	27.5	29.8	30.6	30.0

KEY METRICS

Year to 31 Dec (%)	2022	2023F	2024F	2025F
Growth				
Net interest income, yoy chg	7.0	0.2	11.5	15.7
Fees & commissions, yoy chg	(0.2)	(1.1)	12.4	8.9
Pre-provision profit, yoy chg	4.6	2.8	11.4	13.3
Net profit, yoy chg	14.2	9.1	15.0	15.8
Net profit (adj.), yoy chg	14.2	9.1	15.0	15.8
Customer loans, yoy chg	8.8	11.7	14.6	11.9
Customer deposits, yoy chg	18.7	13.8	12.3	9.6
Profitability				
Net interest margin	2.4	2.2	2.2	2.3
Cost/income ratio	35.7	34.8	34.8	34.7
Adjusted ROA	1.4	1.3	1.4	1.5
Reported ROE	17.1	16.6	17.0	17.6
Adjusted ROE	17.1	16.6	17.0	17.6
Valuation				
P/BV (x)	0.8	0.7	0.6	0.6
P/NTA (x)	0.9	0.8	0.7	0.6
Adjusted P/E (x)	5.4	5.0	4.3	3.7
Dividend Yield	6.1	6.6	7.6	8.8
Payout ratio	33.0	33.0	33.0	33.0

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