

**Analyst: Paul Sham**
**CHINA CONSTRUCTION BANK CORPORATION (中國建設銀行)**

Sector	: Banking	Chairman	: Mr. Guo Shuqing
HKSE Code	: 0939	Vice Chairman & President	: Mr. Zhang Jianguo
Market Price	: HK\$6.19 (25/08/2008)		
Shares Issued	: 224,689.1m (H shares)		
Mkt. Cap.	: HK\$1,390,825.5m (H shares)		
52 weeks Hi/ Lo	: HK\$8.97/ HK\$4.88		
HSI / HSCEI	: 20,392.06 / 10,916.50 (25/08/2008)		
Main Business	: Banking and related financial services		

**SUMMARY OF THE INTERIM RESULTS FOR THE SIX MONTHS ENDED 30<sup>TH</sup> JUNE 2008**
**Interim Results Highlights**

	RMB million	Vs 1H2007 (%)	Vs 31/12/2007 (%)
• Net interest income	111,080	+24.5%	
• Non-interest income	24,656	+133.5%	
• Total operating income	135,736	+36.0%	
• Operating expenses	(46,193)	+23.9%	
• Operating profit before impairment losses	89,543	+43.3%	
• Impairment losses on loans and advances	(11,458)	-1.6%	
• Profit before taxation	75,655	+49.7%	
• Taxation	(16,963)	+4.2%	
• <b>Attributable profit to equity holders</b>	<b>58,667</b>	<b>+71.4%</b>	
• Total loans	3,537,537	+11.8%	+8.1%
• Total deposits	5,793,029	+14.5%	+8.5%
• Total assets	7,057,706	+15.4%	+7.0%
• Basic EPS (RMB)	0.25	+66.7%	
• Interim DPS (RMB)	0.000	-100.0%	
<b>Selected Ratios</b>	<b>1H2008</b>	<b>1H2007</b>	<b>FY2007</b>
• Net interest margin	3.29%	3.11%	3.18%
• Cost-income ratio	34.0%	37.4%	41.8%
• Return on average assets	1.72%	1.18%	1.15%
• Return on average equity	26.4%	19.80%	19.5%
• NPL ratio	2.21%	2.95%	2.60%
• NPL coverage ratio	117.2%	90.70%	104.4%
• Loan-deposit ratio	61.1%	62.6%	61.2%
• Capital adequacy ratio	12.1%	11.34%	12.6%

- **On-track 1H08 results** China Construction Bank (CCB)'s 1H08 net profit grew by 71.4% y-o-y to RMB58,667 million. The positive surprise was the much stronger trading / FX gains that offset the weaker-than-expected fee income. Similar to its peers that have already reported the interim result, margin expansion, stable loan growth, benign credit cost, reduction in cost-income ratio and lower effective tax rate were CCB's key earning drivers.
- **NIM expansion lagged peers** Net interest income was up 24.5% y-o-y. Net interest margin was 3.29% during 1H08, 11bps higher than that of 3.18% in FY07. However, NIM widened 18bps y-o-y only, which is much slower than other H-share banks' 36bps -70bps. Loan yields improved by 99bps y-o-y, the slowest among peers while deposit cost increased 47bps h-o-h, the highest among these peers.

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- **Healthy loan growth** Loans expanded moderately by 8.1% h-o-h. Corporate loans reached RMB2,522,705 million, an increase of 7.59% h-o-h and accounted for 71.3% of total loans. Personal loans increased by 6.74% h-o-h, accounting for 21.8% of total loans. Besides, CCB increased its discounted bill holdings at a faster rate of 14.0% h-o-h in light of growing yield on discounted bills. Overseas Loan also grew rapidly at 24.0% h-o-h.
- **Strong fee income growth** Fee income grew 57.7% y-o-y (but only +12.2% h-o-h amid the weak stock market in 1H08) attributable to good results from consultancy and trust & fiduciary activities that showed strong growth of 161% h-o-h and 114% h-o-h, respectively. Moreover, FX-related business turned from a net loss of RMB3,568m in 1H07 to a net gain of RMB759m in 1H08, attributable to the unwinding of FX swaps. Coupled with strong net trading gains, non-interest income jumped 133.5% y-o-y in 1H08 to RMB24,656m, representing 18.2% of total operating income (1H07: 10.6%).
- **Continuing improvement in operating efficiency** Operating costs increased 23.9% y-o-y, driven by an 18.9% increase in staff costs on higher salaries, a 36.2% surge in business tax & surcharges as well as a 33.6% rise in other G&A expenses. Nevertheless, a stronger 36.0% growth in total operating income helped reduce the bank's cost-to-income ratio to 34.0% from 37.4% a year earlier.
- **"Double-decline" in NPLs** Amount of NPLs fell by 8.3% h-o-h while the impaired loan ratio also improved to 2.21% as of 30 June 2008 from 2.95% at 2007 year end. The ratio of allowances to non-performing loans was 117%, up 12.82 percentage points over the end of 2007. The higher-than-expected impairment charges of RMB11,458m was mainly due to the RMB3,486m charges (30% of credit cost) against the Sichuan earthquake.
- **Freddie & Fannie, Alt-A and US subprime exposure** CCB only has minimal Freddie and Fannie, with RMB22,279m nominal value of Freddie and Fannie bonds that are AAA credit ratings, representing 0.3% of total assets. CCB also disclosed that the carrying amount of its Alt-A bonds was RMB2,449m, accounting for 0.03% of total assets. Besides, it held about RMB6.6bn nominal value of US subprime mortgage debts with cumulative RMB4.7bn MTM loss being made (71% cumulative provisioning). The remaining carrying amount for the subprime-related debt is only RMB1.9bn or 1% of 2008 pre-tax profit.
- **Strong profitability and healthy financial position** CCB's profitability enhanced notably, with ROA and ROE up to 1.72% and 26.4% respectively for 1H08 from 1.18% and 19.8% for 1H07. Meanwhile, the bank's CAR stood at 12.1% as of 30/06/2008.

### **Outlook & Prospects**

- **Best asset quality and profitability among the big players** CCB has the best asset quality among the big listed PRC banks (CCB, ICBC and BOC) in 2008 as its NPL ratio dropped to 2.21%. Its net interest margin (3.29%) and ROE (26.4%) were also the highest compared with ICBC (3.01% and 22.8%) and BOC (expecting <3.0% and <20%), showing that CCB remains the best PRC large bank in terms of asset quality and profitability.
- **Concerns over a slowdown in profit growth** Despite CCB enjoyed one of the highest NIM among major China banks in 1H08, its NIM improved by only 18bp y-o-y in 1H08, lower than 36-70bp at peers. Moreover, its non-interest income also showed a slower 12.2% h-o-h growth momentum due to the weakened stock markets. During the analyst briefing session, Management predicated that the high growth momentum of CCB might not be sustainable in the coming years, further supporting our belief that the robust growth seen in the past years might have already reached the peak of the cycle.



- **BoA stake sale** Bank of America (BoA) has exercised part of its call option to purchase 6 billion H-listed CCB shares from Huijin at a price of approximately HK\$2.42 per share. This represents 2.5% of total CCB shares on issue and brings BoA current stake up to 10.75%. These shares will be locked-up until August 2011. The market has speculated that the timing of this move is based around BoA's desire to boost its capital base. Fears that BoA would exercise considerably more of the call option, and divest a large part of its existing stake have been an overhang on CCB's stock price.
- **Premium valuations on strong fundamentals** CCB remains one of our top picks of the Chinese banks. Its market leading margin and continuing operational improvements should enable CCB to outperform its peers in medium term. Nevertheless, its valuations of 12.1x FY08 PE and 2.06x FY08 PB, are not particularly cheap in a regional context. As such, we recommend investors to "Accumulate" the counter on weakness.

**Recommendation: *Accumulate on weakness***

**I. Impairment allowances, overdue and rescheduled advances of China Construction Bank**

As % of total customer advances	Individual allowance	Collective allowance	NPLs
As of 30/06/2008	1.21%	1.38%	2.21%
As of 31/12/2007	1.47%	1.24%	2.60%
As of 30/06/2007	1.61%	1.07%	2.95%

**II. Comparison of China Construction Bank's loan book: 30/06/2008 vs 31/12/2007**

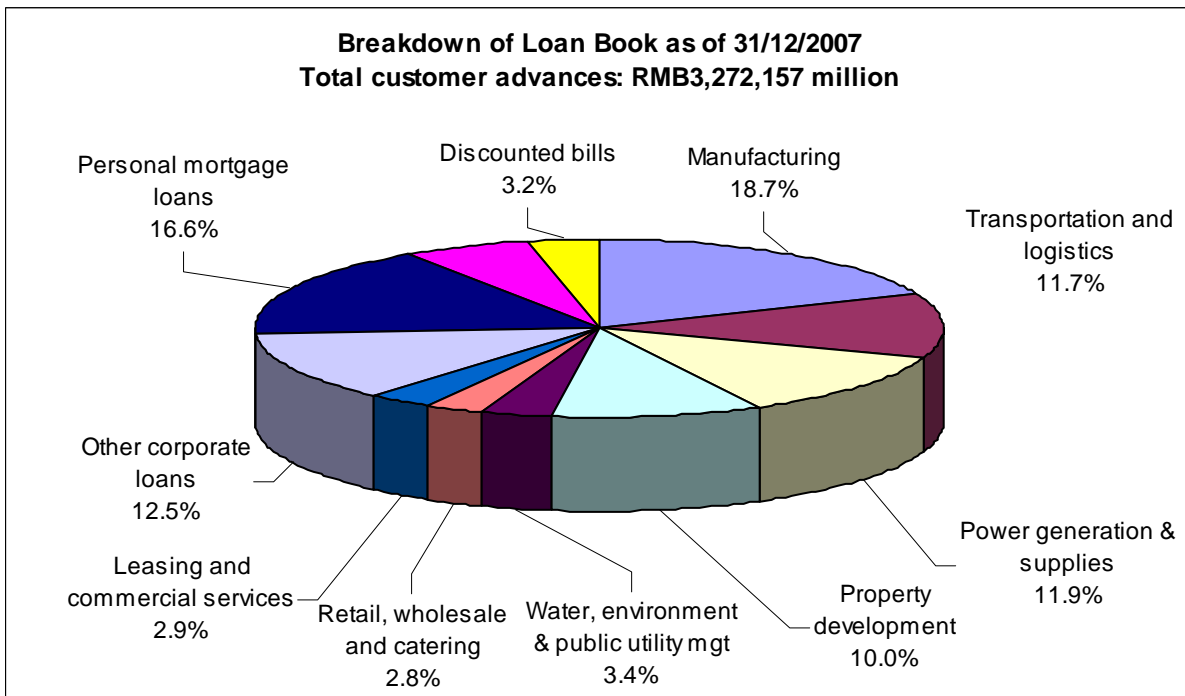
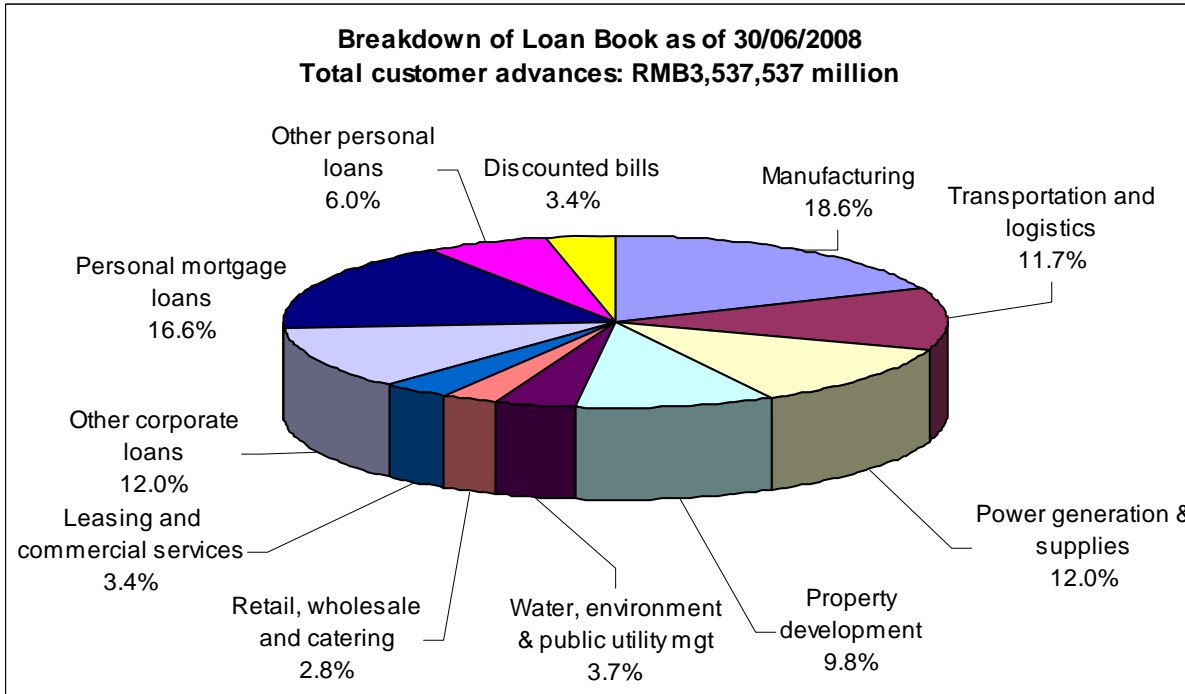
Loans-by industry	30 <sup>th</sup> Jun, 2008	Up/(down)	31 <sup>st</sup> Dec, 2007
	RMB million		RMB million
Corporate loans			
<i>Manufacturing</i>	634,805	+7.1%	592,502
<i>Transportation and logistics</i>	399,572	+7.8%	370,732
<i>Power generation &amp; supplies</i>	408,726	+8.3%	377,285
<i>Property development</i>	333,177	+4.8%	317,780
<i>Water, environment &amp; public utility mgt</i>	125,993	+18.1%	106,693
<i>Retail, wholesale and catering</i>	96,244	+7.8%	89,289
<i>Leasing and commercial services</i>	114,665	+23.3%	92,968
<i>Other corporate loans</i>	409,523	+3.0%	397,508
Personal mortgage loans	567,303	+7.5%	527,888
Other personal loans	205,310	+4.8%	195,917
Discounted bills	117,225	+14.0%	102,826
Loans for overseas operations	124,994	+24.0%	100,769
	<u>3,537,537</u>	+8.1%	<u>3,272,157</u>

**III. China Construction Bank's pre-tax profit breakdown by businesses**

Pre-tax profit by businesses (RMB million)				Breakdown	
	1H2008	1H2007	y-o-y (%)	1H2008	1H2007
Corporate banking	40,116	27,984	+43.4%	53.0%	55.4%
Personal banking	11,651	12,698	-8.2%	15.4%	25.1%
Treasury operations	22,533	10,167	+121.6%	29.8%	20.1%
Others	1,355	(307)	-541.4%	1.8%	(0.6%)
Total pre-tax profit	<u>75,655</u>	<u>50,542</u>	+49.7%	<u>100.00%</u>	<u>100.00%</u>



**Breakdown of loan book of China Construction Bank**





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