

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\$6.71 (11/04/2008) | | |
| Shares Issued | : 224,689.1m (H shares) | | |
| Mkt. Cap. | : HK\$1,507,663.9m (H shares) | | |
| 52 weeks Hi/ Lo | : HK\$8.97 / HK\$4.36 | | |
| HSI / HSCEI | : 24,667.79 / 13,357.12 (11/04/2008) | | |
| Main Business | : Banking and related financial services | | |

SUMMARY OF THE FINAL RESULTS FOR THE YEAR ENDED 31ST DECEMBER 2007
Final Results Highlights

| | RMB million | Vs FY2006 (%) | Vs 30/06/2007 (%) |
|---|----------------|----------------|-------------------|
| • Net interest income | 192,775 | +37.3% | |
| • Non-interest income | 27,942 | +148.9% | |
| • Total operating income | 220,717 | +45.6% | |
| • Operating expenses | (92,327) | +38.5% | |
| • Operating profit before impairment losses | 128,390 | +51.2% | |
| • Impairment losses on loans and advances | (20,106) | +5.8% | |
| • Impairment losses on investment and others | (7,489) | +3,351% | |
| • Profit before taxation | 100,816 | +53.4% | |
| • Taxation | (31,674) | +63.3% | |
| • Attributable profit to equity holders | 69,053 | +49.1% | |
| • Total loans | 3,272,157 | +13.9% | +3.4% |
| • Total deposits | 5,349,600 | +13.1% | +5.8% |
| • Total assets | 6,598,177 | +21.1% | +7.9% |
| • Basic EPS (RMB) | 0.30 | +42.9% | |
| • Final DPS (RMB) | 0.065 | -29.3% | |
| Selected Ratios | FY2007 | FY2006 | 1H2007 |
| • Net interest margin | 3.18% | 2.79% | 3.11% |
| • Cost-income ratio | 41.8% | 44.0% | 37.4% |
| • Return on average assets | 1.15% | 0.92% | 1.18% |
| • Return on average equity | 19.5% | 15.0% | 20.9% |
| • NPL ratio | 2.60% | 3.29% | 2.95% |
| • NPL coverage ratio | 104.4% | 82.2% | 90.7% |
| • Loan-deposit ratio | 61.2% | 60.8% | 62.6% |
| • Capital adequacy ratio | 12.6% | 12.1% | 11.3% |

- **FY2007 results in line with market expectations** CCB reported net profit of RMB69,053m for FY07, up 49.1% from FY06's RMB46,322m, in line with market consensus of RMB68,924m. The strong profit growth came in despite a few one-off charges including early retirement benefits of RMB8,998m and impairment losses over its subprime exposure amounting to RMB4,602. Excluding such charges, the pre-tax profit of CCB would have grown 74.1% y-o-y instead of the reported 53.4% growth.
- **Sharp increase of NIM in FY07** CCB's net interest income rose by 37.3% y-o-y, while its net-interest margin (NIM) rose by 39bps y-o-y and 7bps h-o-h to 3.18%. The NIM benefited from the interest rate hikes by the PBOC in FY07, as well as a lower proportion of discounted bills (which fell to 3.14% of total loans for FY07, from 5.55% for FY06).

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- **Solid loan growth** CCB reported total loan growth of 13.9% y-o-y. Total deposit grew 13.1% y-o-y, in line with the loan growth. Loan mix improved as retail loans increased 23.7% y-o-y, while discounted bills declined 35.5% y-o-y. As a result, retail loans accounted for 22.1% of total loans at end-2007 (vs. 20.4% at end-2006), and discounted bills accounted for 3.1% of total loans (vs. 5.5% at end-2006), illustrating that CCB was migrating its loan mix towards higher yield loans during FY07.
- **Non-interest income dragged by FX losses** Non-interest income jumped 148.9% y-o-y to RMB27,942m, slightly dragged by the foreign exchange loss of RMB7,820 as a result of RMB appreciation. Thanks to the buoyant stock market in 2007, agency fees for securities soared by RMB12,170m to RMB16,439m (+285% y-o-y). Bank card fees also rose to RMB5,254m (+40.0% y-o-y). As a result of stronger growth in net fee income, non-interest income accounted for 12.7% (2006: 7.4%) of total operating income in FY07.
- **Jump in operating expenses due to one-off** Operating expenses for CCB rose RMB25,665m or 38.5% y-o-y to RMB92,327m, mainly due to higher salary expenses (+55% y-o-y), of which RMB8,998m or 35.1% of the increment, was the cost arising from early retirement benefits. However, stronger operating income growth during the year translated to a lower cost-to-income ratio of 41.8% in FY07 from 44.0% in FY06.
- **Detailed disclosure about FX investment including sub-prime** Total impairment losses increased by RMB8,381m, mainly because of an increase in provisions for investments of RMB7,075m. Of the losses, RMB4,602 was related to US subprime mortgages. There is new disclosure of Alt-A bond exposure of US\$643m on top of the US\$1,000m sub-prime related exposure. CCB had been more aggressive in providing for potential loss – 63% on sub-prime and 20% on Alt-A, which lowered exposure to US\$370m and US\$515m, respectively, representing 0.61% and 0.86% of the shareholders' equity at end-2007.
- **Improving loan quality** NPL amount was down 9.8% y-o-y to RMB85,170m whilst NPL ratio was also down 69bps y-o-y to 2.60%. In addition, loan loss coverage ratio was increased from 82.2% in FY06 to 104.4% in FY07, illustrating the bank's improving loan quality.
- **Solid profitability and healthy financial position** CCB's profitability was solid, with ROA and ROE of 1.15% and 19.5% respectively for FY07 (FY06: 0.92% and 15.0%). Meanwhile, the bank's CAR stood at 12.6% as of 31/12/2007.

Outlook & Prospects

- **Best asset quality and profitability among the big players** CCB had the best asset quality among the big listed PRC banks (CCB, ICBC and BOC) in FY07 as its NPL ratio dropped to 2.60%, from 3.29% in FY06. Its net interest margin (3.18%) and ROE (19.5%) were also the highest compared with ICBC (2.80% and 16.2%) and BOC (2.76% and 14.0%), confirming that CCB remains the best PRC large bank in terms of asset quality and profitability.
- **Higher income momentum supported by organic growth** Relative to other large PRC banks, CCB's income performance was strong. Operating income grew 45.6%, compared to 41.0% growth for ICBC and 23.1% growth for BOC. This was helped by strong growth in both interest income (+37.3% for both CCB and ICBC, 25.8% for BOC) and non-interest income growth (+149% for CCB, +74.4% for ICBC and +11% for BOC). We believe the higher income momentum would help CCB continue to lead the way in the top line growth.



- **Brilliant personal banking performance** CCB has a strong branch network, with number of branches just behind Agricultural Bank of China (unlisted) and ICBC, giving the bank a competitive edge over most of its rivals in expanding its retail-banking business, especially wealth management and credit cards. The 145.4% y-o-y pre-tax profit growth in personal banking proved CCB has been successful in developing its retail banking business in 2007.
- **Reducing exposure to property lending but still the highest among peers** CCB reduced its exposure to in loans to developer from 10.5% of total loans in 2006 to 9.7% in 2007. However, its exposure is still the highest among the H-share banks (average of 7%). As such, CCB should be more vulnerable than other mainland banks in case of a marked property market downturn.
- **Premium valuations on strong fundamentals** The attractiveness of CCB is premised on the bank's robust top line growth, leading profitability & asset quality and strong contribution from retail banking. Nevertheless, despite its valuations of 22.4x FY2007 P/E and 3.72x FY2007 P/B, are slightly cheaper than those of ICBC, CCB is not very 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 31/12/2007 | 1.47% | 1.24% | 2.60% |
| As of 30/06/2007 | 1.61% | 1.07% | 2.95% |
| As of 31/12/2006 | 1.45% | 1.25% | 3.29% |

II. Comparison of China Construction Bank's loan book: 31/12/2007 vs 31/12/2006

| Loans-by industry | 31 st Dec, 2007 | Up/(down) | 31 st Dec, 2006 |
|-------------------------------|----------------------------|-----------|----------------------------|
| | RMB million | | RMB million |
| Manufacturing | 592,502 | +16.1% | 510,427 |
| Other corporate loans | 1,752,255 | +13.2% | 1,547,534 |
| Personal mortgage loans | 527,888 | +23.3% | 428,039 |
| Other personal loans | 195,917 | +24.8% | 157,046 |
| Discounted bills | 102,826 | -35.5% | 159,368 |
| Loans for overseas operations | 100,769 | +41.5% | 71,195 |
| | <u>3,272,157</u> | +13.9% | <u>2,873,609</u> |

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

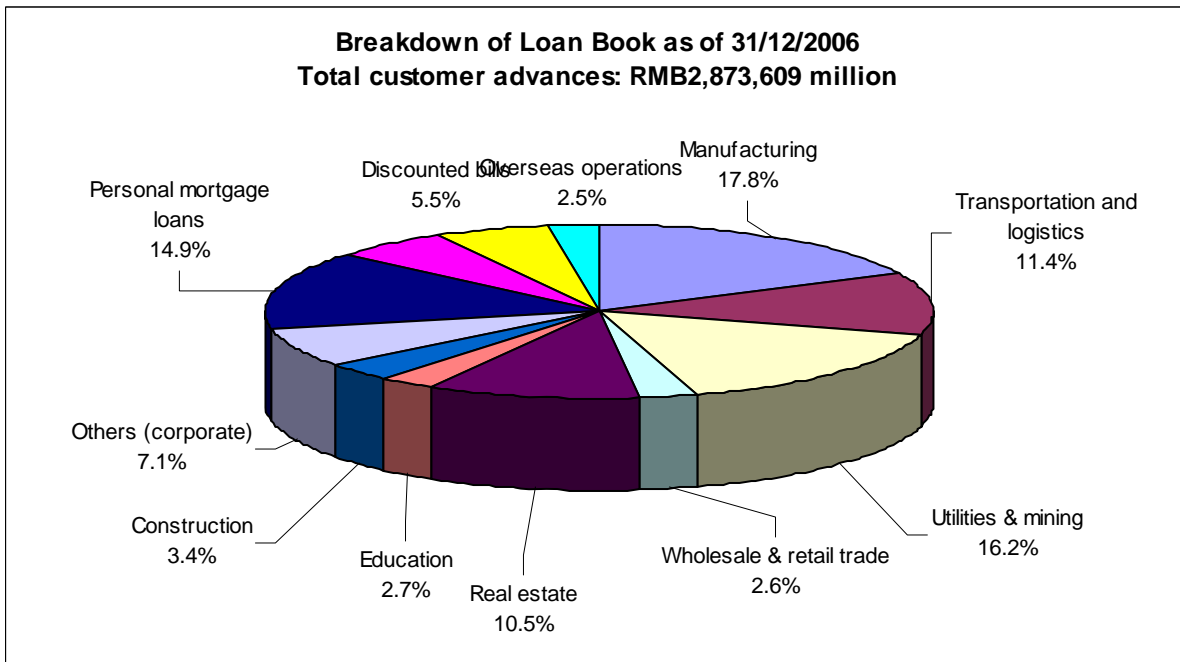
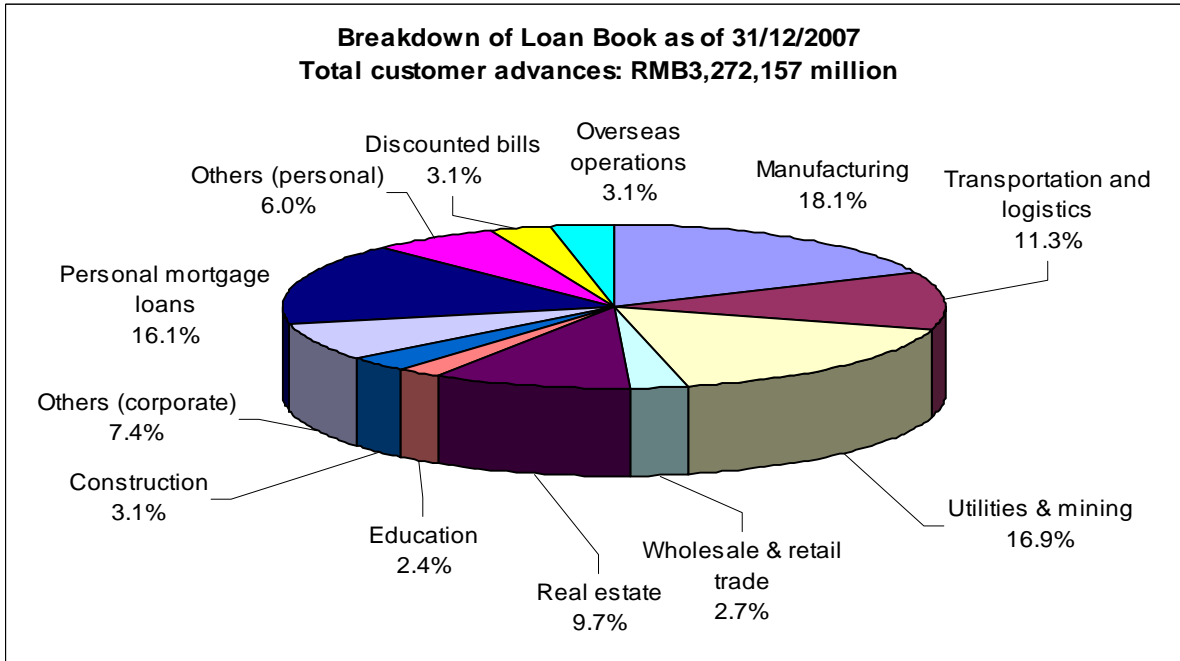
| Loans-by industry | 31 st Dec, 2007 | Up/(down) | 30 th Jun, 2007 |
|-------------------------------|----------------------------|-----------|----------------------------|
| | RMB million | | RMB million |
| Manufacturing | 592,502 | +4.9% | 564,902 |
| Other corporate loans | 1,752,255 | +3.7% | 1,689,181 |
| Personal mortgage loans | 527,888 | +11.4% | 474,037 |
| Other personal loans | 195,917 | -5.1% | 206,534 |
| Discounted bills | 102,826 | -29.3% | 145,403 |
| Loans for overseas operations | 100,769 | +17.8% | 85,510 |
| | <u>3,272,157</u> | +3.4% | <u>3,165,567</u> |

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

| Pre-tax profit by businesses (RMB million) | | | | Breakdown | |
|---|----------------|---------------|-----------|----------------|----------------|
| | FY2007 | FY2006 | y-o-y (%) | FY2007 | FY2006 |
| Corporate banking | 61,391 | 36,642 | +67.5% | 60.9% | 55.8% |
| Personal banking | 26,146 | 10,655 | +145.4% | 25.9% | 16.2% |
| Treasury operations | 13,347 | 18,348 | -27.3% | 13.2% | 27.9% |
| Others | (68) | 72 | -194.4% | (0.1%) | 0.1% |
| Total pre-tax profit | <u>100,816</u> | <u>65,717</u> | +53.4% | <u>100.00%</u> | <u>100.00%</u> |



Breakdown of loan book of China Construction Bank





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