

Analyst: Kevin Tam

Main Board H-share Listing – Research

招商銀行股份有限公司

China Merchants Bank Co. Ltd. [Stock Code: 3968]
Joint Global Coordinators and Joint Sponsors : CICC & UBS Investment Bank

Joint Bookrunners : CICC, UBS Investment Bank & JP Morgan Chase

Sector : Banks

Business: Commercial banking and related services

Total share offer: 2,420 million H shares (approximately 16.45% of total enlarged share capital) Hong Kong Offer: 110 million H Shares (4.6%) International Offer: 2,090 million H Shares (86.4%) Over-allotment Option: 220 million H Shares (9%)	<u>Business of China Merchants Bank (“CMB”)*</u> China Merchants Bank (CMB), head quartered in Shenzhen, was incorporated in 1987. It became a joint stock limited company in 1994 and completed its domestic IPO on the Shanghai Stock Exchange in April 2002. CMB ranks 6 th among China’s commercial banks and 2 nd among the Other National Commercial Banks in terms of total assets as of 30 th June 2006, according to the PBOC. As of 30 th June 2006, CMB had total assets of some US\$103.1 billion, some US\$66.54 billion in loan and some US\$88 billion in customers’ deposits. CMB operates a retail network of 463 branches and sub-branches, 747 self-service centres, 2,288 ATMs in 39 cities in China’s relatively affluent regions, such as the Yangtze River Delta, the Pearl River Delta and the Bohai Rim. It also operates a branch and a subsidiary in Hong Kong, as well as a representative office in New York.
Offer Price Range: HK\$7.30 – HK\$8.55 per share Market Cap of H shares: HK\$17,666 million to HK\$20,691million Fully diluted FY06E P/E: 19.8X to 23.1X Adjusted NTA per share: HK\$3.26 – HK\$3.44 Staffing: 20,950 (as of 30 th June 2006)	
HK Public Offer period: 8 th to 13 th September 2006 Receiving bank: HSBC Bank of China (Hong Kong) Bank of Communications (HK) Bank of East Asia ICBC (Asia) Standard Chartered Bank (HK)	
H Share registrar: Computershare Hong Kong Investor Services Limited	
Listing date: 22 nd September 2006	

Major Shareholders after Listing (Assuming the over-allotment option is not exercised)

China Merchants Steam Navigation and its two affiliates	17.95%
COSCO	6.57%
China Shipping and its two affiliates	5.49%
China Construction Communications Group (Ltd.) and its five affiliates	3.22%
Other A Shareholders	50.06%
H Shareholders	16.71%
	<u>100.00%</u>

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Use of Proceeds

Net proceeds from the Global Offering are estimated at HK\$16,791 million. (Assuming the over-allotment option is not exercised and an offer price at HK\$7.925 per H-share, being the mid-point of offer price range.) The Bank intends to use the net proceeds to strengthen its capital base to support the ongoing growth of the Bank's business.

Selected Income Statement Data

	<u>Year ended 31st December</u>			<u>Six months ended 30th June</u>	
	2003	2004	2005	2005	2006
	RMB million	RMB million	RMB million	RMB million	RMB million
Net Interest Income	10,119	14,292	16,642	7,901	9,428
Net fee and commission income	559	889	1,567	598	1,124
Other net income	491	495	1,005	404	389
Operating Income	11,169	15,676	19,214	8,903	10,941
Pre-provision operating profit	5,653	8,244	10,099	4,740	6,093
Provision for impairment losses	(2,236)	(3,066)	(3,637)	(1,595)	(1,698)
Profit before tax	3,417	5,178	6,462	3,145	4,395
Net profit	2,211	3,276	3,749	1,929	2,777

❖ According to the prospectus, forecasted net profit for FY06 will be no less than RMB5.5 billion.

Selected Balance Sheet Data

	<u>As at 31st December,</u>			<u>As at 30th June,</u>
	2003	2004	2005	2006
	RMB million	RMB million	RMB million	RMB million
Loans to customers, total	307,480	374,017	472,185	531,577
Total assets	494,017	586,715	734,613	824,316
Deposits from customers	406,886	512,586	634,404	703,602

Selected Financial Ratios

	<u>Year ended 31st December</u>			<u>Six months ended</u>
	2003	2004	2005	30 th June 2006
Profitability				
Return on average assets	0.51%	0.61%	0.57%	0.71%
Return on average equity	12.57%	16.25%	15.64%	18.91%
Net interest margin	2.54%	2.67%	2.69%	2.56%
Cost-to-income ratio	43.62%	41.18%	41.1%	37.91%
Capital adequacy				
Core capital adequacy ratio	6.17%	5.41%	5.57%	6.44%
Capital adequacy ratio	9.49%	9.47%	9.01%	8.36%
Total equity to total assets	3.72%	3.74%	3.54%	3.97%
Asset quality				
Non performing loan ratio	3.15%	2.88%	2.58%	2.3%
NPL loss coverage	88.03%	101.36%	111.04%	123.2%
Allowance to total loans	2.77%	2.92%	2.86%	2.83%

Strengths/Opportunities

- ✓ Because of its relatively low base of comparison and effective management, China Merchants Bank has been experiencing stronger growth than its peers. The Bank's CAGR from FY03-05 in total asset, total loan book, net fee and commission income and pre-tax profit were 22%, 24%, 67% and 37% respectively.
- ✓ In 1H06, CMB's achieved NPL ratio at 2.3%, loan-to-deposit ratio at 75.5%, cost to income ratio at 38%, and ROE at 19%, which were better than its Hong Kong listed peers.
- ✓ As of 30 June 2006, CMB was the number one credit card issuer (24% market share in dual-currency card according to VISA and MasterCard International) with 6.9 million credit cards in issue. During FY03-05, total number of cards in issue and transaction volume of credits achieved CAGR of 194% and 211% respectively. The buyout card business contributed to a high net fee and commission income to total income ratio at 10.3%.
- ✓ CMB is focused in China's affluent regions with higher GDP growth, such as the Yangtze River Delta, the Pearl River Delta and the Bohai Rim. Over 74% of the Bank's operating income is generated from Eastern, Southern and Central China.
- ✓ CMB's revenue structure made it less vulnerable to tightening measures. First of all, CMB has a more diverse revenue source with 10.3% operating revenue from net fee and commission income, which is higher than its Hong Kong listed peers. Secondly, CMB loan mix is less sensitive to austerity measures. For instance, two less policy sensitive sector, transportation and telecommunications sector; and energy and resources sector account for a higher 22.8% and 16% of CMB's corporate loan book respectively.
- ✓ The IPO price range implies a historical P/B at 2.24X - 2.49X, which is roughly in-line with other PRC banks listed in Hong Kong. Nevertheless, given its sustainable ROE at 19% and higher project profit growth, there should be double-digit upside potential in the IPO price range.

Weaknesses/Threats

- × The Bank's capital adequacy ratio is just 8.4% compared with double-digit level of its Hong Kong listed peers. In the event that CMB launches a more aggressive acquisition, there may be pressure to further raise funds and dilute shareholders' interest. The low CAR may also limit the dividend payout capability.
- × Despite CMB's emphasis as a leading retail bank, pre-tax profit contribution from retail banking recorded a slight 0.8% y-o-y decline to RMB631 million for 1H06, attributable to narrowing net interest margin and higher operating cost. There may be some challenges lying ahead for this sector.
- × CMB's NPL ratio for credit cards rose to 1.92% in 1Q06 from 1.71% in FY05. Aggressive expansion in card business may be at the expense of lower credit quality.

Recommendation: Subscribe

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