

Analyst: Paul Sham
CHINA MERCHANTS BANK CO. LTD. (招商銀行)

Sector	: Banking	Chairman	: Mr. Qin Xiao
HKSE Code	: 03968	CEO & Head of Bank	: Dr. Ma Weihua
Market Price	: HK\$20.75 (15/04/2010)		
Shares Issued	: 3,910.4m (H share)		
Mkt. Cap.	: HK\$81,140.8m (H share)		
52 weeks Hi/ Lo	: HK\$22.00 / HK\$9.57		
HSI / HSCEI	: 22,156.85 / 12,813.88 (15/04/2010)		
Main Business	: Banking and related financial services		

SUMMARY OF THE FINAL RESULTS FOR THE YEAR ENDED 31ST DECEMBER 2009
Final Results Highlights

	RMB million	Vs FY2008 (%)	Vs 30/06/2009 (%)
• Net interest income	40,364	-13.9%	
• Non-interest income	11,129	+28.6%	
• Total operating income	51,493	-7.3%	
• Operating expenses	(26,207)	+10.9%	
• Operating profit before impairment losses	25,286	-20.7%	
• Impairment losses on loans and advances	(3,073)	-17.0%	
• Profit before taxation	22,384	-16.3%	
• Taxation	(4,149)	-28.6%	
• Attributable profit to equity holders	18,235	-13.5%	
• Total loans	1,185,822	+35.6%	+59.7%
• Total deposits	1,612,608	+28.8%	+54.1%
• Total assets	2,067,941	+31.6%	+48.2%
• Basic EPS (RMB)	0.95	-13.6%	
• Final DPS (RMB)	0.21	-47.5%	
• Total DPS (RMB)	0.21	-47.5%	
Selected Ratios	FY2009	FY2008	1H2009
• Net interest margin	2.23%	3.42%	2.24%
• Cost-income ratio	50.9%	42.4%	47.9%
• Return on average assets	1.00%	1.46%	0.93%
• Return on average equity	21.2%	28.6%	20.2%
• NPL ratio	0.82%	1.11%	0.90%
• NPL coverage ratio	246.7%	223.3%	241.4%
• Loan-deposit ratio	73.5%	69.8%	71.7%
• Capital adequacy ratio	10.5%	11.3%	10.6%

- **FY09 results exceeded market expectations** China Merchants Bank (CMB) reported a net profit of RMB18,235m, down 13.5% y-o-y, slightly ahead of market expectations of RMB17,756m. CMB was so far the only listed H-share bank that reported a decline in net profit as lower than expected credit costs failed to offset higher operating costs and significant interest-income decline on net interest margin (NIM) squeeze. CMB's dividend payout ratio fell from 36.4% in FY08 to 22.1% in FY09 in order to preserve its capital for meeting the CAR requirement.
- **Interest income dragged by narrowed NIM** Net interest income was RMB40,364m, a decrease of 13.9% from the previous year, due to the drop in average yield of total interest-earning assets amid the loose monetary policy. NIM dropped from 3.42% in FY08 to 2.23% because of interest rate cuts since late FY08 and CMB's larger holdings in low-yielding discount bills in FY09. Nevertheless, CMB's 4Q09 NIM reached 2.29% compared with just 2.01% in 2Q09, showing its NIM bottomed out during FY09.

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- **Loan portfolio expanded 35.6% y-o-y** Helped by strong growth in residential mortgage loans business (+72.6% y-o-y), retail loans grew by 64.2% y-o-y to RMB381,877m, accounting for 32.2% of its total loans and advances (FY08: 26.6%). Corporate loans grew at a slower pace of 28.5% y-o-y to RMB701,396m, which accounted for 59.2% of total loan portfolio. As its loans and advances outpaced the growth of deposit, CMB's loan-to-deposit ratio was lifted to 73.5% as of 31/12/2009 from 69.8% a year earlier.
- **Slower fee income growth** Non-interest income was up 28.6% to RMB11,129m due to higher net gains of its financial assets designated at fair value and available-for-sale assets, totalling RMB3,132m (versus RMB917m gains in FY08). The performance of net fee income was disappointing at 3.2% y-o-y, mainly dragged down by the lukewarm growth in Bank card fees (+4.3%) and settlement and clearance fees (-2.8%), the two primary fee income contributors. Agency service fees registered the strongest growth among various fee income segment, up 52.2% y-o-y due to the increase of income from fund agency services, insurance and debt underwriting business.
- **Lower cost efficiency** The 10.9% increase in expenses were attributable to the increases in staff cost (+13.6% y-o-y) as the bank recruited additional headcounts along with business expansion. Rental expenses and general administrative expense rose 31.9% and 9.8% respectively, primarily due to opening of new branches and offices. Cost-to-income ratio accordingly rose to 50.9% from 42.4% a year earlier.
- **Turnaround in Wing Lung Bank** Wing Lung Bank (WLB) reported a net profit of HK\$884m (versus HK\$816 losses in FY08), equivalent to roughly 4.3% of CMB's total net profit for 2009. Overall loan quality remained sound despite a rise in NPL ratio to 0.80% (FY08: 0.47%). Loans portfolio expanded by 21.6% y-o-y for 2009 to HK\$52,868m while new deposit grew by 10.9% y-o-y. CMB also disclosed WLB had made full provisions of HK\$213 million for the Lehman Brothers Minibonds scheme.
- **Impairment losses on loans fell 17.0% y-o-y** CMB's NPL balance was flat y-o-y at RMB9,732m. The NPL ratio declined to 0.82% at end-2009 from 1.11% a year earlier. Coverage ratio saw a slight 23.4 percentage point increase to 246.7%, which was much higher than the regulatory guideline of 150%. The much higher provision coverage ratio would help CMB decrease its credit cost in the coming years.
- **CAR stood firm above 10%** As at 31 December 2009, the total CAR and core CAR of CMB were 10.45% and 6.63% respectively (FY08: 11.34% and 6.56%). The decline in total CAR was attributable to the rapid growth in businesses which brought about a faster increase in risk-weighted assets than capital increase.

Outlook & Prospects

- **CAR boosted by rights issue** With the RMB27.1bn rights issued, capital concern should no longer be an issue for CMB. CMB guided that 1Q10 CAR was 11.4% (post A share rights issue). With the H-share issuance completed in early April, CMB's CAR would be lifted to above 12%. CMB also suggested that it would not need to raise capital for three years after the recent right issues.
- **Recovery continued in 1Q10** CMB pre-announced its 1Q10 results, with its attributable profit increasing 40% y-o-y to RMB5,900m, possibly due to the better-than-expected NIM recovery. It also announced that the NPL ratio declined from 0.82% as of end-2009 to 0.74% as of end-1Q10.
- **Disclosures on government loans** Management stated that government financing vehicles (GFVs) exposure was around 6% of total outstanding loans in 2009, which looked to be lower than peers (15%-18%) and included segments such as transportation, infrastructure, state asset management agency, etc. Management further stated that more than 75% of these loans are granted to relatively affluent Eastern and Southern China, and that the NPL ratio for GFV loans stood at 0.07% in FY09.
- **Rich valuations not justified** Trading at 2.92x FY10E P/B and 15.4x FY10E P/E, valuations of CMB are the highest among the H-share banks. We believe CMB's premium valuations over peers like BoCom are not justified as both banks are having similar ROE in 2009 (CMB: 21.2%; BoCom: 20.1%). BoCom is currently trading at 2.09x FY10E PB and 11.1x FY10E PE. As such, we prefer BoCom to CMB in the China banking sector.

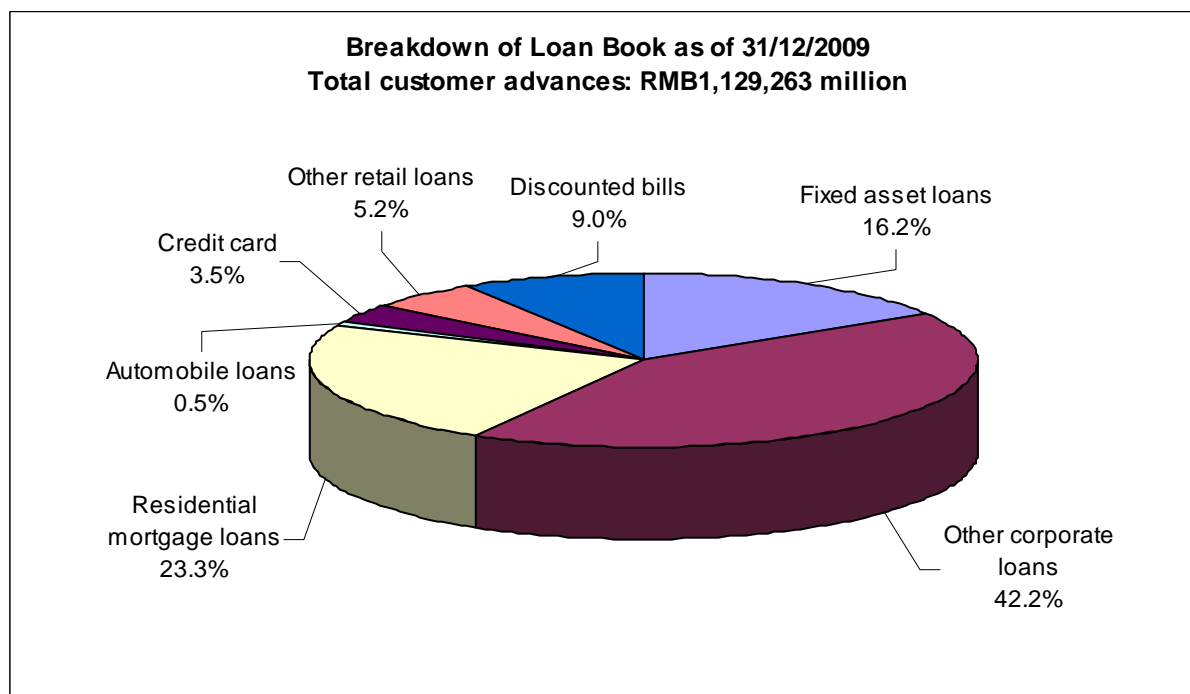
Recommendation: Prefer BoCom (03328.HK)

I. Comparison of China Merchants Bank's loan book: 31/12/2009 vs 31/12/2008

Loans-by industry	31 st Dec, 2009	Up/(down)	31st Dec, 2008
	RMB million		RMB million
Fixed asset loans	182,437	+61.7%	112,827
Other corporate loans	476,738	+17.5%	405,613
Residential mortgage loans	263,592	+77.6%	148,452
Automobile loans	5,514	+149.3%	2,212
Credit card	39,942	+26.4%	31,604
Other retail loans	59,284	+59.9%	37,074
Discounted bills	101,756	+6.3%	95,766
	<u>1,129,263</u>	<u>+35.5%</u>	<u>833,548</u>

II. China Merchants Bank's pre-tax profit breakdown by businesses

Pre-tax profit by businesses (RMB million)				Breakdown	
	FY2009	FY2008	y-o-y (%)	FY2009	FY2008
Corporate banking	12,708	15,333	-17.1%	57.5%	57.3%
Retail banking	2,196	4,253	-48.4%	9.9%	15.9%
Treasury operations	7,007	7,583	-7.6%	31.7%	28.3%
Others	201	(410)	-149.0%	0.9%	(1.5%)
Total pre-tax profit	<u>22,112</u>	<u>26,759</u>	<u>-17.4%</u>	<u>100.00%</u>	<u>100.00%</u>

III. Breakdown of loan book of China Merchants Bank




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