Banks - China

Asia II Financials meeting takeaways – Week 1&2: another challenging year

Industry Overview

22 January 2024

Equity
China
Banks-Multinational

Meeting takeaways from management for Week 1&2

A/H share banks outperformed major indices YTD despite another challenging year. We hosted 7 banks for calls in the past 2 weeks. See summary below and details inside.

BoComm: new corporate loan amount in Jan-2024 decreased slightly YoY, but overall loan growth is expected to be stable in coming months. BoComm aims flattish or low single digit revenue/profit growth in 2024. Developer NPL ratio rose in 2H23, though the NPL formation should be smaller in 2024. The New Capital Rule is expected to boost its capital ratio by ~1ppt. They expect stable dividend payout.

PSBC targets ~RMB900bn new loans in 2024, similar to 2023. Mortgage back-book repricing will have high-single digit bp drag on its NIM in 2024. Bancassurance fee accounted for ~20% of fee income and PSBC will try to grow volume to offset the fee rate cut impact. It will try to maintain its net interest income and non-interest income at a level similar to 2023. The New Capital Rule's impact is largely neutral.

CMB: NIM will see similar pressure in 2024 as in 2023, due to mortgage repricing and likely more LPR cuts. 1Q24 new loan size should be lower than that of 1Q23, due mainly to weaker demand and regulatory guidance. Fee income growth will be negatively impacted by bancassurance fee cut and mutual fund custodian/management fee cuts introduced in 2023. Asset quality is expected to remain stable. Bottom line growth should be relatively strong among peers thanks to its strong balance sheet.

CQRB tries to maintain a high-single digit loan growth in FY24. Its overall LGFV risk is controllable as its counterparties are either large LGFVs or those in cities/rich counties. The negotiation of LGFV loan swap is project by project, and some LGFVs with relatively good credit are taking the new loan interest rate of 5-6%, which is better than expected. Net profit growth is likely to maintain at a high-single digit level in FY23.

BONJ: FY23 revenue growth and net profit growth are both expected to be higher than that of 9M23. BONJ targets a positive revenue growth for 2024 and hopes the new management could help it catch up with peers on earnings growth. BONJ achieved ~RMB160bn/17% YoY loan growth in FY23, and the FY24 new loan size will be similar to FY23. Non-interest income growth remains under pressure mainly due to fee income.

BOSZ: NIM is expected to continue to decline in 2024 but likely at a milder pace. FY24's loan growth will be largely similar to FY23's. The FY23 earnings growth might slightly slow down from 9M23 level as the bank usually takes some provisions and recognizes some cost in 4Q. For FY24, BOSZ targets to grow its profit not slower than FY23 level.

BOCHK: BOCHK saw much higher credit cost/provision for mainland CRE in 4Q vs. 3Q level (37bp/HK$1.6bn). HK CRE exposure is stable as most of clients are large blue-chip companies with lower leverage ratio. BOCHK expects 2024 NIM to moderately decrease from FY23 level. It targets a higher-than-market loan growth in 2024. Fee income decline will continue to narrow in FY23. BOCHK targets to achieve annual DPS growth.

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CRE: Commercial Real Estate

LPR: Loan Prime Rate

LGFV: Local Government Financing Vehicle

NIM: Net Interest Margin

NPL: Non-performing Loan

More Acronyms at the end of the report

Exhibit 1: 2024 Asia II China Strategy & financials meeting schedule

We will be hosting around 40 calls during January and February 2024

Date	Sector	Company/Topic	10-11am	11-12am	12-2pm	2-3pm	3-4pm	4-5pm	6:30pm
Jan 24th, Wed	Fintech	QFIN (QFIN US/3660 HK) update call with CFO	Zoom1						
Jan 24th, Wed	Group meeting/SG	China Equity Strategy and Financials 2024 YAH & marketing feedback			Register1				Register2
Jan 25th, Thurs	Financial Holding	Mega (2886 TT)				Dial in1			
Jan 25th, Thurs	Bank	Changshu Rural Commercial Bank (601128 CH)						Dial in 2	
Jan 25th, Thurs	Insurance Expert	2024 Jumpstart sales channel check						Dial in 3	
Jan 26th, Fri	Bank	China Construction Bank (939 HK)	Zoom2						
Jan 26th, Fri	Group lunch	China Econ, Strategy, Commodity, Property Lunch			Register3				
Jan 26th, Fri	Bank	Bank of China (3988 HK)				Dial in 4			
Jan 29th, Mon	Bank	China Citic Bank (998 HK)						Dial in5	
Jan 31st, Wed	Bank	Shanghai Pudong Development Bank (600000 CH)	Dial in6						
Jan 31st, Wed	Bank	China Industrial Bank (601166 CH)					Dial in7		
Jan 31st, Wed	Bank	China Everbright Bank (6818 HK)						Dial in8	
Feb 1st, Thurs	Bank	Ping An Bank (000001 CH)	Dial in9						
Feb 1st, Thurs	Bank	Minsheng Bank (1988 HK)						Dial in10	
Feb 2nd, Fri	Bank	Agriculture Bank of China (1288 HK)	Dial in11						
Feb 2nd, Fri	Bank	Industrial & Commercial Bank of China (1398 HK)				Dial in12			
Feb 23rd, Fri	Bank	Hang Seng Bank FY23 post result call with CFO (11 HK)	Register4						
Feb 23rd, Fri	Group lunch	HSBC post result lunch with CFO (5 HK)			Register5				

Replay	China Pacific Insurance Group (2601 HK)	Takeaway	CPIC: Dividend, growth and assumption changes
Replay	CITIC Securities (6030 HK)	Takeaway	CITICS & Huatai: Mutual funds, IPO, prop trading
Replay	China Merchant Bank (3968 HK)	Takeaway	CMB: Top line remain challenged in 2024
Replay	Huatai Securities (6886 HK)	Replay	Bank of Suzhou (002966 CH)
Replay	Zhong An Online P&C (6060 HK)	Replay	BOC Hong Kong (2388 HK)
Replay	Expert call on muni bond issuance & LGFV risks	Takeaway	LGFV: increased market confidence, but challenges remain
Replay	PICC Group/PICC P&C (1339 HK/2328 HK)	Takeaway	PICC Property & Casualty: CoR, dividend, and investment
Replay	Chongqing Rural Commercial Bank (3618 HK)	Replay	Expert call on China e-payment industry development
Replay	Bank of Nanjing (601009 CH)	Replay	Expert call on evolving FinTech credit industry landscape
Replay	New China Life (1336 HK)	Replay	China Life (2628 HK)
Replay	Bank of Communication (3328 HK)	Replay	Postal Savings Bank of China (1658 HK)

Source: BofA Global Research

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Company meeting takeaways

Bank of Communications (BoComm, 3328 HK)

Loan growth: new corporate loan amount in Jan-2024 decreased slightly from Jan-2023 level, as 1) regulators guided a smooth growth, 2) loan demand decreased a little bit in Jan partly due to late Spring Festival. Overall, BoComm expects a stable loan growth in coming months. **Inclusive SME loans** rose ~30% YoY to ~RMB600bn by end-2023, and the growth is likely to continue outpacing the overall loan growth.

Revenue and profit growth: BoComm targets flattish (low-single-digit) revenue/profit growth in 2024. It will try to keep NPL coverage ratio stable or improving a bit, but unlikely to lower NPL coverage ratio to boost profit.

Loan allocation: BoComm targets to grant 40% of new loans to retail side in 2024, which would help support its NIM. Sector focus of corporate lending would be similar to that of last year, focusing on manufacturing, rental housing, utilities, wholesale & retail, software and IT. Retail loans witnessed some improvements as 1) personal mortgage loan issuance improved, together with less early repayment. BoComm expects mortgage loan growth to improve in 2024 from 2023 level; 2) unsecured consumer loans increased ~50% YoY to ~RMB100bn by end-2023; 3) credit card loans: both interest-bearing balance and the asset quality are improving, NPL ratio is a little above 2%.

NIM is weighed by mortgage back-book repricing, LPR cuts and deposit maturity lengthening. NIM decline in 1Q24 will probably be higher than 4Q23, but hopefully be milder in the following 3 quarters. BoComm will try to grow more retail loans, increase demand deposit mix and control high-cost deposits (compress 3-5yr certificate of deposits, and stop renewing agreement deposits when they mature).

Asset quality: Developer loans: BoComm's developer loan NPL ratio rose from 2.8% by 2H22 to 3.4% by 1H23. The NPL ratio further increased in 2H23 due to risk exposure and tightened NPL recognition standards post the implementation of the new risk classification rules, but was still lower than other big 5 bank peers'. It expects developer loan risk to continue to expose in 2024, but probably be less than 2023's. **LGFV loan** asset quality is stable without systemic risk. The LGFV debt de-risking will focus on debt that matures in recent 2 years (via rolling over loans and cutting loan interest rates etc.). The interest rates of newly issued loans will be set at levels that are not loss-making. **Consumer lending** NPL ratio was at ~1.1% with some credit risk, but the overall asset quality is good. **Credit card** NPL ratio was ~2.2% and was decreasing.

Capital: BoComm's internal analysis estimates that the **New Capital Rule** will have 1ppt positive impact on its capital ratio, which will be reflected in its 2024 annual report. After being included into G-SIB, BoComm needs to issue **TLAC** (Total Loss Absorbing Capacity) bonds to meet first-stage requirement in 2026, and second-stage requirement in 2029. Its **CET1 ratio** was 9.98% by 3Q23 and may see some pressure to support growth in the long run. It's hard to raise capital externally given the very low P/B. BoComm is in talks with the MOF (Ministry of Finance) and major shareholders to discuss ways to raise capital. **Dividend payout**: the bank doesn't see any signals to change dividend policy. Dividend payout ratio will be stable at around 30%.

Postal Savings Bank of China (PSBC, 1658 HK)

Loan growth: PSBC granted ~RMB900bn new loans in 2023, a record high. In 2024, PSBC targets a similar amount of new loans thus the loan growth rate might be lower due to a higher base. PSBC grew its mortgage loans by RMB80bn in 2023, higher than peers' level but smaller than its previous years' level. It targets to grant more mortgage loans in 2024 or at least to grant similar amount of new mortgage loans as in 2023, but so far it hasn't seen any strong demand recovery. **Loan allocation** pace will be based on regulatory guidance. It will allocate around 40% of loan quota in 1Q of 2024.

NIM faces continued pressure in 2024, weighed by LPR cuts last year and mortgage back-book repricing, of which, mortgage back-book repricing will drag NIM by high-single-digit bp in 2024. Meanwhile, the multiple rounds of deposit pricing cuts help. Retail deposit rate was lowered by ~10bp in 2023, which helped stabilize NIM. PSBC will try to maintain its NIM at a relatively high level and to control the NIM to decline less compared with peers.

Deposit agency fee: the deposit agency fee adjustment in Nov 2022 has helped PSBC lower its composite deposit agency fee rate by 3bp to 1.24% and saved the bank ~RMB1bn deposit agency fee by end-2023. The average net interest spread of the big four banks is expected to fall below 1.64% in FY23 and will trigger the renegotiation of deposit agency fee rate again. PSBC has started to prepare for the renegotiation and will make a timely update to investors if any.

Fee income: net fee income is expected to achieve double-digit growth in 2023 if excluding the one-off factor of the transformation to net asset value (NAV) wealth management products in the prior year. However, it faces some pressure in 2024. Bancassurance fee contributed to ~20% of its fee income previously. The bancassurance fee cut is expected to negatively impact its fee income but also opens the doors for PSBC to cooperate with some large insurers. On the other hand, PSBC also tries to develop other businesses (credit card, custody, trading, supply-chain financing etc.) to offset the impact of bancassurance fee cut. For now, PSBC is not sure if they can use volume growth to make up for the bancassurance fee cut as it takes time to observe the trend. Mutual fund sales fee mix is very small in its total fee income.

Revenue/net profit face many challenges in 2024 and highly depend on economic growth. PSBC will try to maintain its net interest income and non-interest income at a level similar to 2023, but the outcome is uncertain. There is room for the bank to optimize asset structure. PSBC will try to control its funding costs as well as maintain a good asset quality to reduce credit cost. PSBC will be prudent on provision taking.

New capital rule's impact is expected to be largely neutral. On one hand, the new rules benefit banks with more mortgage/retail exposure. As PSBC's retail/mortgage loan mixes are high at 50%/30% respectively, it could enjoy some capital savings. On the other hand, PSBC's interbank & investment mix is high (~40% of total assets), which will consume more capital under the new rules. The bank will try to optimize its total asset structure and improve its risk adjusted return on capital. It will stick to its retail banking position and serve more SMEs.

China Merchants Bank (CMB, 3968 HK)

NIM pressure in 2024 is expected to be no less than that in 2023, when new corporate loan yield declined by 35bp YoY, new mortgage loan yield down by 55bp, SME loan yield down by 60bp, and consumption loan yield dropped even more, due to a lack of quality assets, mortgage loan repricing and lower LPR.
Deposit cost increased on continued lengthening of maturity, and the trend will continue until the capital market improves.

Loan growth: 2024 loan growth is expected to be slower than in 2023 due to weak demand. In 2023, loan growth was mainly coming from corporate, SMEs and consumer loans (excluding credit card loans), while mortgage loans missed target. Corporate loan growth was satisfactory, driven by infrastructure, manufacturing, and wholesale & retail sectors, which accounted for 70% of the new corporate loans. Net mortgage loan issuance was negative in each month during 9M23 and turned positive in Oct, Nov, and Dec, but the demand is weak in Jan YTD, and homebuyers' expectation on the real estate market remains low. CMB used to issue RMB150bn mortgage loans p.a. in prior years, but the golden days are over. CMB targets higher mortgage issuance in 2024 vs. actual issuance in 2023. Early mortgage repayment peaked in Mar-23 at RMB32mn, but remained at evaluated levels, and the trend is expected to continue in 2024.

Fee income will see a big negative impact in 2024 from the fee cuts introduced by regulators in 2023: 1) bancassurance commission fee cut in late 3Q23 - commission rate drops more than 50% and it is impossible to offset the decline from volume growth; 2) fund management and custodian fee cuts in 2Q23 also have negative impact on CMB in 2024. But the fee decline in 2024 was driven by regulatory factors, while CMB's core competitiveness remains strong among peers. CMB is expected to have a much better fee income performance in 2025.

Asset quality: CMB is confident it can maintain good asset quality in 2024. NPL formation is expected to come from the developer loans and credit card loans. CMB has reduced its developer loan size and exposed related risk as early as possible, thus it doesn't expect a sharp increase in developer loan NPLs. Compared with its overall Loan Reserve Ratio (LRR) of >4%, its developer loans' LRR is >13%, which helps to protect its bottom line.

Credit cost will depend on asset quality, although CMB doesn't expect a big change YoY. Provision on non-loan assets saw writeback in 2023 because: 1) non-loan business scale decreased, and 2) quality of some non-loan assets improved or was better than expected. CMB expects the writeback to re-occur in 2024.

LGFV: the recent policy measures had minimum impact on CMB, as it traditionally has a very small LGFV exposure at RMB245bn(-RMB18.4bn YoY), among which LGFV loan exposure is RMB135.2bn, with NPL ratio at 0.14% (the same as in 2022).

Wealth Management (WM): Mutual fund AUM growth was weak but still made positive contribution to its incremental AUM. CMB's WMP AUM balance grew fast in 2023, vs. negative growth in the sector, which means CMB's market share is growing, together with a better structure and quality.

Long-term ROE: top line growth to remain lackluster in 2024, but bottom line growth should be relatively strong among peers. It has a higher proportion of the non-interest income (25% by 3Q23), low NPL ratio (0.96%), high provision coverage (446%) and high loan reserve ratio (4.27%). It can deliver stronger returns to shareholders with strong internal capital-generation capability compared with its peers.

Chongqing Rural Commercial Bank (CQRB, 3618 HK)

NIM: CQRB still sees NIM pressure in 2024, as 1) LPR cut will continue to weigh on loan yield while the benefits of deposit pricing cut will take more time to gradually show up; 2) competition intensified especially on corporate loans, the bank sees reduced bargaining power to large corporate clients on intensified competition and its corporate loan yield is declining. Its NIM still stays above the industry average level, partly helped by its stable and relatively high retail loan yield. In 2024, it will try to provide comprehensive financing service to enhance the stickiness of its corporate borrowers, increase retail loan mix and strengthen the deposit management to lower the funding cost.

Loan growth: FY23 loan growth should be largely in line with 9M23. For FY24, it will try to maintain a high-single digit loan growth and grant most of the new loans in 1H24 following traditional practice of the early issuance, the early payback. It has sufficient corporate loan pipeline for FY24 jump-start sales, which is RMB20bn higher than that of the year-ago period. Retail loan demand didn't fully recover in 2023, but the bank will strengthen the effort in 2024, focusing on consumption loans, online lending, and SME loans to improve its retail loan mix.

Property: Chongqing's housing price is relatively low compared to other big cities thus the housing price isn't expected to further drop much in the future. CQRB's developer loan mix was <1% and the risk is controllable. **Mortgage early repayment** has peaked in 1H23 and stabilized at an elevated level. The mortgage loan book was mainly from the primary housing and currently the housing sales remain lackluster.

LGFV: Chongqing is one of the 12 "high-risk" areas to resolve LGFV risks with the support by the government. CQRB's overall LGFV risk is low and controllable because its counterparties are either large LGFVs or those in cities/rich counties. The negotiation of LGFV loan swap is project by project, some LGFVs with relatively good credit are taking the new loan interest rate of 5-6%, which is better than expected. CQRB expects the debt swap to be largely completed by 1H24.

Fee income growth was weighed by WM business and is expected to maintain negative growth for the full-year 2023. CQRB's bancassurance fee achieved double-digit growth but as the base is small, the impact from recent bancassurance fee cut is limited. CQRB will further develop its advantages to offer more diversified products to drive the growth of its fee income in 2024.

Asset quality: CQRB's NPL ratio dropped by 2bp YTD to 1.22% in 9M23 and is likely to continue the trend. NPL formation mainly came from consumption loans and SME loans. Mortgage loan NPL ratio saw some uptick to 1.04% by Sep-23 but declined in 2H23 vs. 1H23. CQRB NPL coverage will be relatively stable at around 300%+ level.

Net profit growth is likely to maintain at a high-single digit level in FY23, similar to 9M23. For FY24, as revenue growth remains under pressure, the bank keeps the earnings growth target similar to FY23.

Capital replenishment: CQRB issued RMB4bn capital bond in FY23 on a rolling budgeting basis. For the core capital, it will focus on internal capital generation.

The resignation of deputy president Dong Lu is a normal management reshuffle; she will then work for Chongqing Three Gorges Bank.

Bank of Nanjing (BONJ, 601009 CH)

Revenue and net profit growth: BONJ's FY23 revenue growth and net profit growth are both expected to be higher than that of 9M23. BONJ targets a positive revenue growth for 2024 and hopes its new Chairman of the Board's strategy could help the bank to gradually catch up with its peers on earnings growth.

NIM: BONJ still sees NIM pressure in 2024 but the room for a further decline is limited. **On asset side,** loan yield is likely to be relatively stable, given: 1) BONJ is adjusting the strategy to issue loans dynamically based on the real demand situation rather than on geographic location; 2) the retail loan yield remains solid as traditional consumption loans (low yield, high quality) only account for a small portion of its retail loan book, and most of its retail loans are coming from the long tail customers via its BON BNPP Consumer Finance Company and online lending, which saw loan yield at >10%. **On liability side**, BONJ targets to lower its funding cost by a few bp in 2024. It will 1) follow large banks/joint-stock banks to cut deposit rate, and 2) adjust the deposit structure and slow down the deposit growth. In 2023, as its collateral deposits and guaranteed deposit fund were reduced by the new regulation rule on bills, it had to use retail deposits to cover the decline in corporate deposits. Thus, its funding cost rose significantly.

Loan growth: BONJ issued RMB160bn new loans in FY23 and achieved ~17% YoY loan growth. In 2024, the new loan amount will be similar to 2023's. Thus, the loan growth rate is likely to slow down slightly. Geographically, BONJ's loan issuance focuses on Jiangsu, Zhejiang, Shanghai, and Beijing. **For corporate loans**, advanced manufacturing, green financing, and semiconductor will be the key sectors. BONJ will cap its LGFV-related loan mix (mainly in leasing and commercial services sector) in the future, due mainly to the likely slowdown in such area. **Retail loan** growth is mainly driven by consumption loans amid lackluster housing market. Its Consumer Finance Company enables BONJ to expand its business nationwide and currently they have branches in Guangzhou, Shenzhen, Chengdu and Hefei. BONJ targets to grant more retail loans, higher than 2023 level (26%-27% of total new loan) in 2024 and the new retail loan target amount is >RMB40bn.

LGFV debt risk: Jiangsu is not one of the 12 high-risk areas and its LGFV loans' pricing diverged among cities. Some cities saw LGFV pricing already below LPR thus are not expected to see further pricing decline. North regions in Jiangsu province saw higher LGFV loan yield, but currently there is no clear guidance on reducing the loan pricing. BONJ is communicating with regulators closely on any potential debt risk resolution.

Asset quality: BONJ's property sector risk is small and controllable. Its property loan concentration ratio is low with ~RMB40bn developer loans and ~RMB70bn mortgage loans. Developer loans' NPL ratio was around 1%, as of 1H23, due mainly to one project from Evergrande and the bank has written it off already. For retail loans, the asset quality is largely depending on macro economy and currently BONJ hasn't observed any deterioration. Credit card witnessed some uptick in NPL ratio, but this is mainly due to the lower balance of the credit card loans.

Non-interest income mix of BONJ is relatively high among peers at ~44%, as of 9M23, and most of them are from investment business. In 2023, benefited from bull bond market, its bond investment income grew very fast, while such growth is likely to return to normal level in 2024. Bancassurance fee cut has very limited impact on BONJ as it has very small mix in such business. Its bond underwriting business was negatively impacted by the fee cut guided by the regulator, but the room of further decline is limited in 2024. WM fee suffered in 4Q22 on market fluctuation and is still at recovering stage. The bank hopes its WM business to return to a stable growth in 2024. BONJ didn't perform well in sales of private/public fund products due to weak capital market in 2023 and it is hard to forecast for 2024. **Overall**, in 2024, BONJ's non-interest income growth remains under pressure mainly in fee income, but the fee income may not decline as much as in 2023.

Bank of Suzhou (BOSZ, 002966 CH)

NIM is expected to continue to decline in 2024 but the decline will be less than that in 2023. Loan yield will continue to be weighed by LPR cut in 2024, while the benefit from deposit cut will not be enough to offset the negative impact on loan yield side.

Loan growth: 4Q23 loan growth will be slightly slower than 9M23 level as the bank was preparing for the jump-start sales in 1Q24. FY24's loan growth will be largely in line with that of FY23, and the loan granting pace will also be similar to FY23. **Mortgage loan** balance is relatively small and achieved positive growth in FY23, BOSZ expects to maintain such trend in FY24, but the overall housing demand is lackluster.

Loan allocation: BOSZ aims to grow more retail loans, but the demand remains weak. Corporate loan will still be a growth driver in FY24, focusing on manufacturing sector. Within corporate loans, real economy and private corporations account for 50% and government/SOE-related loans account for the rest.

Loan pricing: BOSZ witnessed around 30-40bp loan yield decline among most types of loans in 2023, and corporate loan pricing even declined more. The bank expects the loan yield decline to gradually stabilize in 2024.

Fee income: Bancassurance commission fee cut (around 40-50% cut) has a large impact on the banking industry, especially in 2024. BOSZ will try to increase the sales volume of insurance products as well as other products to mitigate the negative impact, but it is not likely to offset the gap.

Asset quality: property related loans and SME loans may continue to expose the risks, but the overall risk is under control. BOSZ's developer loans' balance is small at around RMB14bn and its asset quality is controllable. Currently there are only two property projects categorized as NPLs and BOSZ has taken the full provision on them. Other projects are under normal operation. BOSZ's LGFV exposure is around RMB12bn, and Jiangsu province is not among the high-risk areas.

Net profit growth: as the bank usually takes some provisions and recognizes some cost in 4Q, the FY23 earnings growth might slightly slow down from 9M23 level. For FY24, BOSZ targets to grow its profit not slower than FY23 level.

Capital replenishment: BOSZ's CB conversion will depend on the market situation. The bank may plan to issue perpetual bond and tier-2 bond to meet the capital requirements.

BOC Hong Kong (BOCHK, 2388 HK)

Asset quality: BOCHK saw much higher credit cost/provision in 4Q vs. 3Q level (37bp/HK$1.6bn). BOCHK increased provision coverage to 50% for substandard loans, and further increased the provision coverage to 60-70% or even higher for doubtful, and to 90%+ for loss category. As of 1H, BOCHK's CRE exposure was around HK$93bn and ~80% exposure was to SOEs and ~20% to POEs. It has downgraded most of mainland POE customers' exposure to NPLs and increased provisions accordingly. Most of such loans are syndicated loans without collaterals thus need higher provisions. For the remaining POE developers, they are market leaders without negative news and their 2024 outlook is expected to be quite stable. For 2024, if the market situation stabilizes from 2023 level, the 2024 pressure will be released. BOCHK reviewed its developer customer one by one and expects the loss ratio of those downgraded customers to be much higher than other NPLs, thus, the 6-12M time to build up provision is for other types of NPLs but it only takes a short-time for the bank to take provision for developer customers. BOCHK only downgraded a few developers but as those developers' mix to total CRE exposure is not low, the impact is indeed big. For example, it downgraded one customer to SML in 2Q23, which increased its SML ratio from 0.8% to 3.2%.

HK CRE exposure situation is stable as most of its exposure is on large blue-chip companies with lower leverage ratio, good liquidity and much easier NPL disposal. BOCHK downgraded one medium-sized HK property investment customer. This is a single case and is not related to any systematic risk in HK CRE. Excluding this customer, total NPL ratio would be only 0.12%, as of Dec-2023. The situation is also likely to be better with the expected market rate cut. For mortgage side, BOCHK has no concern about asset quality.

NIM was below the market expectation in 3Q due mainly to the short-term liquidity needs coming from their clients, which also dragged down its NIM in 4Q with higher AIEA, but NII will increase in 4Q on higher HIBOR. BOCHK expects 2024 NIM to moderately decrease from 2023 full-year level. It will try to maintain a faster-than-market loan growth, optimize deposit structure (increase CASA ratio), and extend the duration of bond investment to lock the long-term return.

Loan growth: 4Q loan balance looks stable vs. 3Q. BOCHK targets a higher-than-market loan growth in 2024. Loans used in HK saw decent growth in 9M while loan demand in mainland China decreased. BOCHK also aims a faster loan and deposit growth in Southeast Asia and such loan mix is likely to increase to 5% in the future.

Fee income fell 7% YoY in 9M23 due to investment-related business, 4Q situation hadn't changed much. For the full-year 2023, the fee income decline will continue to narrow, but the magnitude missed their expectations at the beginning of the year. BOCHK made a lot of efforts to try to strength its wealth management capability and it has seen the progress in the cross-border business.

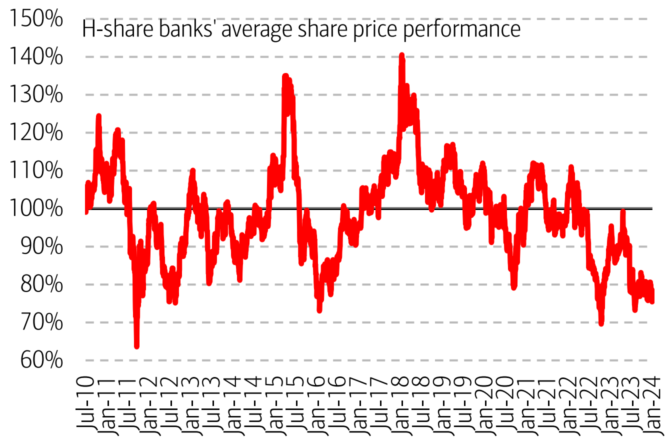
Cost-income ratio (CIR): 2024 cost growth will be stable, and it will focus on CIR in 2024. Its CIR is expected to return to the pre-COVID level.

Pay-out ratio: BOCHK targets to achieve DPS growth annually. It redeemed AT1 in 2023, which could save HKD1.4bn interest payment.

Share price performance and valuation

The H-share banks as a whole fell by 5.6% YTD, outperforming the MSCI China Index by 3.4ppt, HSI Index by 4.6ppt, and H-FIN Index by 1.9ppt. H-share banks' share prices are close to the low end of their long-term trading range, with valuation at 0.34x P/B, 2.0x P/PPOP and 3.3x P/E. We believe that the bank sector at these levels offers good downside protection in a challenging equity market.

Exhibit 2: H-share banks' weighted average stock price performance
H-share banks' average share price at the low end of their LT average level



Source: Bloomberg, *Performance is not adjusted for dividends

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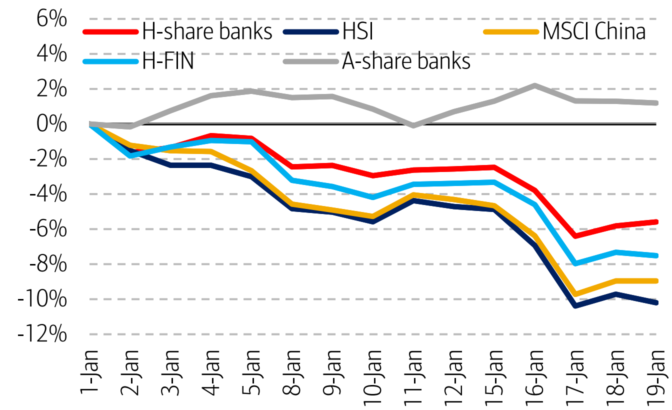
Exhibit 3: H-share bank and market performance YTD
Both A and H share banks outperformed major indices YTD



Source: Bloomberg, *Performance is not adjusted for dividends

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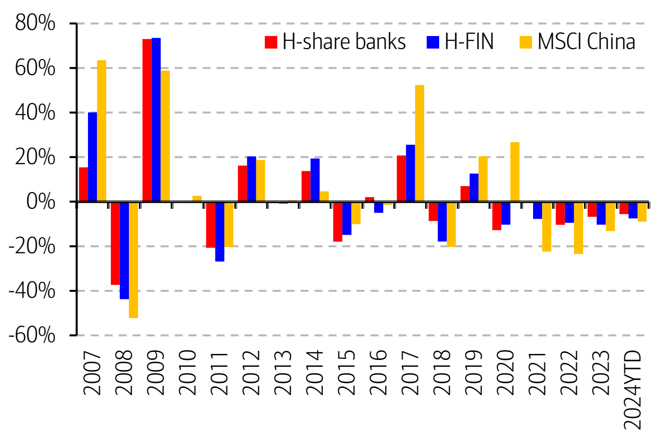
Over the past 16 years, the H-share banks tended to be defensive and have lower beta than non-bank financials and the broader China markets. They underperformed non-bank financials and the MSCI China index in the bull markets (eg 2007, 2012, 2017, 2019, 2020), but outperformed in the down or flattish markets (eg 2008, 2014, 2016, 2018, 2021, 2022, 2023, 2024YTD).

Exhibit 4: H-share banks' relative performance vs markets
H-share banks outperformed MSCI China and H-FIN index YTD



Source: Bloomberg, *Performance is not adjusted for dividends

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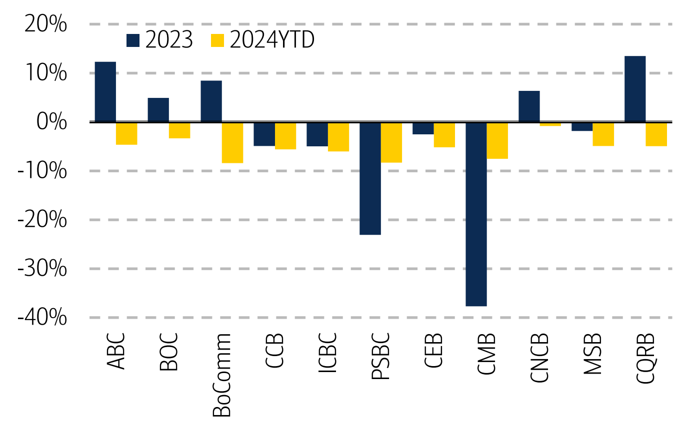
Exhibit 5: Individual banks' H-share performance in 2023/24YTD
CNCB was the best performer YTD, BoComm, PSBC and CMB lagged



Source: Bloomberg *Performance is not adjusted for dividends

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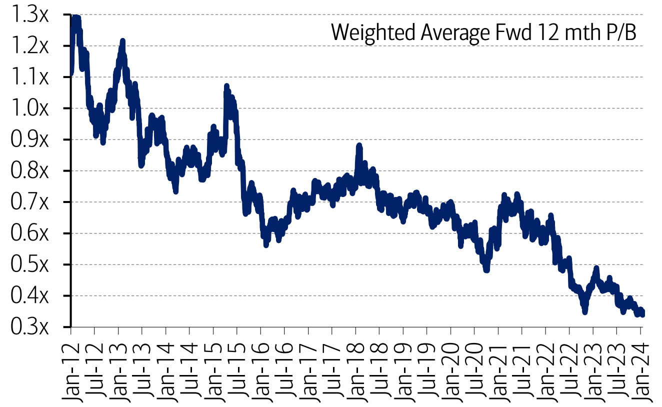
The valuation of the H-share bank sector suffered long-term de-rating. It reached a new low of 0.35x 12-month forward P/B, 3.1x P/E and 1.8x P/PPOP in October 2022. The valuation recovered post reopening but declined again since February 2023. P/B reached a record low of 0.34x in December 2023, while P/E and P/PPOP are at historical low levels. We see sufficient room for multiple expansion, especially if macro economy stabilizes in the coming quarters.

Exhibit 6: H-share banks' forward P/B valuation since 2012
P/B rebounded in Jan-2023 but declined to 0.34x by now



Source: Bloomberg

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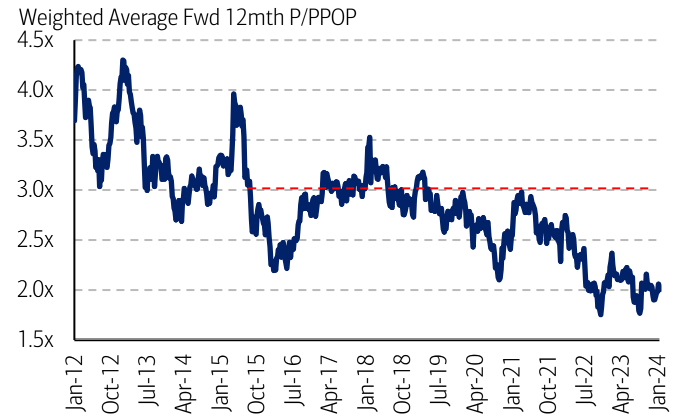
Exhibit 7: H-share banks' forward P/PPOP valuation since 2012
P/PPOP of the sector is at 2.0x currently



Source: Bloomberg

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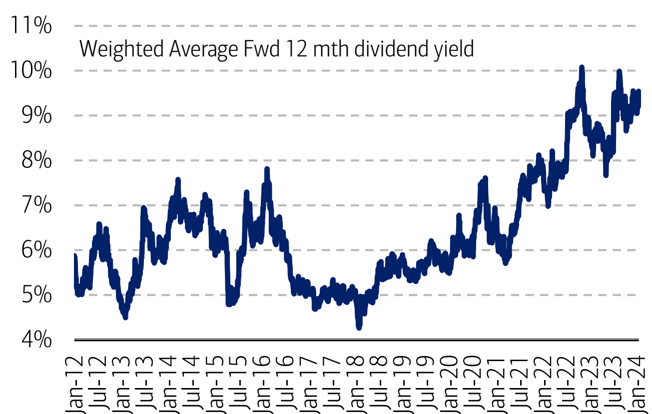
Gross dividend yield of the banks reached 7.8% in Feb-2016, dropped to 4.3% in Jan-2018, rebounded to a new high of 10.1% in Oct-2022, and is at 9.5% currently.

The H-share banks continue to be underweighted by global investors, although the underweighting was reduced significantly during 2H16-3Q18. The underweighting remained largely stable during 2018 to 1H22, but widened again in the past 12-18 months, due partly to property market turmoil, LGFV debt risks, and geopolitical tensions. As of November 2023, the underweight position on H-share banks was close to the lowest level since 2018.

Exhibit 8: H-share banks' average dividend yield
Dividend yield is 9.5%, a historical high level



Source: Bloomberg

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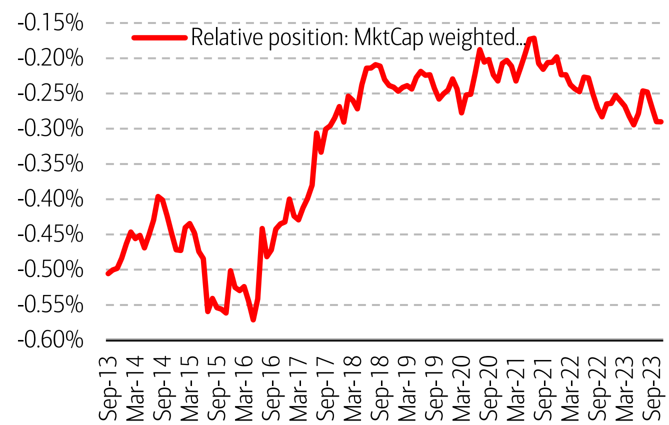
Exhibit 9: H-share banks' relative position to the benchmark
Banks' underweighting was largely stable since 2018



Source: BofA Global Asia Pac Quant Strategy, MSCI, FTSE, Factset, 13F Filings, Benchmark indices, Country Stock Exchanges

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H-share valuation comp

Exhibit 10: HK/China banks valuation comp

Bank sector valuation is attractive, with high dividend yield

	BofA Ticker	Rating	Price (HKD)	Mkt cap (USD mn)	P/E 2023E	P/E 2024E	P/B 2023E	P/B 2024E	P/PPOP 2023E	P/PPOP 2024E	Div Yield 2023E	Div Yield 2024E	ROE 2023E	ROE 2024E	ROA 2023E	ROA 2024E
China Banks (H share)																
ABC	ACGBF	BUY	2.87	174,634	3.7x	3.7x	0.39x	0.36x	2.1x	2.1x	8.7%	8.6%	10.8%	10.0%	0.7%	0.6%
BOC	BACHF	BUY	2.88	147,137	3.6x	3.6x	0.35x	0.33x	2.0x	1.9x	8.8%	8.8%	10.1%	9.5%	0.7%	0.6%
CCB	CICHF	BUY	4.39	143,586	3.2x	3.2x	0.34x	0.32x	1.9x	1.9x	9.6%	9.6%	11.3%	10.4%	0.9%	0.8%
ICBC	IDCBF	BUY	3.59	223,158	3.4x	3.4x	0.35x	0.33x	2.1x	2.1x	9.2%	9.2%	10.6%	9.9%	0.8%	0.7%
BoComm	BKFCF	BUY	4.46	51,456	3.6x	3.5x	0.34x	0.32x	1.9x	1.9x	9.2%	9.2%	9.8%	9.2%	0.6%	0.6%
PSBC	PSBKF	NEUTRAL	3.42	57,202	3.7x	3.9x	0.40x	0.37x	2.6x	2.6x	8.5%	8.4%	11.0%	9.9%	0.5%	0.5%
CEB	CEBCF	UNDERPERFORM	2.20	22,924	2.8x	2.9x	0.28x	0.26x	1.1x	1.2x	9.5%	9.6%	9.7%	9.1%	0.6%	0.6%
CMB	CIHHF	BUY	25.15	100,039	4.2x	4.0x	0.64x	0.57x	2.8x	2.7x	7.9%	8.3%	16.1%	15.1%	1.3%	1.3%
CNCB	CHBJF	BUY	3.65	33,533	2.7x	2.5x	0.28x	0.26x	1.2x	1.2x	10.6%	11.1%	10.8%	10.5%	0.7%	0.7%
MSB	CGMBF	UNDERPERFORM	2.52	21,270	3.1x	3.0x	0.19x	0.18x	1.2x	1.2x	9.6%	10.0%	6.3%	6.2%	0.4%	0.4%
CQRB	COGQF	BUY	2.88	6,078	2.8x	2.8x	0.26x	0.24x	1.6x	1.6x	10.7%	10.9%	9.5%	9.0%	0.8%	0.7%
Sector average				**981,017**	**3.5x**	**3.5x**	**0.38x**	**0.35x**	**2.1x**	**2.0x**	**9.0%**	**9.1%**	**11.1%**	**10.4%**	**0.8%**	**0.7%**
HK Banks																
BEA	BKEAF	UNDERPERFORM	8.92	3,021	5.7x	5.9x	0.24x	0.24x	2.2x	2.4x	9.6%	10.3%	4.3%	4.1%	0.5%	0.5%
BOCHK	BNKHF	BUY	18.56	25,089	6.0x	5.8x	0.62x	0.59x	4.3x	4.3x	9.0%	9.5%	10.5%	10.4%	0.9%	0.8%
HSB	HSNGF	NEUTRAL	82.50	20,166	7.7x	8.3x	0.98x	0.94x	5.8x	6.5x	7.4%	8.0%	13.3%	11.6%	1.1%	1.0%
Sector average				**48,276**	**6.7x**	**6.8x**	**0.75x**	**0.71x**	**4.8x**	**5.1x**	**8.3%**	**8.9%**	**11.3%**	**10.5%**	**0.9%**	**0.9%**
HSBC	XHSBF	BUY	58.65	143,656	5.8x	5.5x	0.83x	0.84x	4.2x	3.9x	8.0%	10.9%	14.2%	14.9%	1.2%	1.1%
StanChart	XCHBF	NEUTRAL	56.85	19,371	7.7x	4.9x	0.45x	0.40x	3.2x	2.8x	3.5%	4.2%	6.0%	8.7%	0.3%	0.5%
Sector average				**163,027**	**6.0x**	**5.4x**	**0.79x**	**0.78x**	**4.1x**	**3.8x**	**7.5%**	**10.1%**	**13.2%**	**14.1%**	**1.1%**	**1.0%**

Source: BofA Global Research estimates, Bloomberg

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Acronym

ABC: Agricultural Bank of China
BOC: Bank of China
BoComm: Bank of Communications
CCB: China Construction Bank
ICBC: Industrial and Commercial Bank of China
PSBC: Postal Savings Bank of China
CEB: China Everbright Bank
CMB: China Merchants Bank
CNCB: China CITIC Bank
MSB: China Minsheng Bank
CIB: China Industrial Bank
SPDB: Shanghai Pudong Development Bank
PAB: Ping An Bank
BOCD: Bank of Chengdu
BOHZ: Bank of Hangzhou
BOJS: Bank of Jiangsu
BONB: Bank of Ningbo
CQRB: Chongqing Rural Commercial Bank
BEA: Bank of East Asia
BOCHK: Bank of China (Hong Kong) Limited
HSB: Hang Seng Bank
StanChart: Standard Chartered

ASEAN: The Association of Southeast Asian Nations
AT1: Additional Tier 1
CAR: Capital Adequacy Ratio
CASA: Current Account Savings Account
CET1: Core Equity Tier 1
CIR: Cost-to-Income Ratio
GBA: Greater Bay Area
HKMA: Hong Kong Monetary Authority
FVTOCI: Fair Value Through Other Comprehensive Income
FVTPL: Fair Value Through P&L
LGFV: Local Government Financing Vehicle
LPR: Loan Prime Rate
LTV: Loan to Value
MOF: Ministry of Finance
MTM: Mark to Market
NAV: Net Asset Value
NII: Net Interest Income
NIM: Net Interest Margin
NPL: Non-performing Loan
PBOC: People's Bank of China
PPOP: Pre-provision Profit
ROE: Return on Equity
RWA: Risk Weighted Asset
SME: Small-and-Medium sized Enterprise
SML: Special Mention Loan
SOE: State-owned Enterprise
TLAC: Total Loss Absorption Capacity
TSF: Total Social Financing
WMP: Wealth Management Product
YRD: Yangtze River Delta

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Neutral	≥ 0%	≤ 30%
Underperform	N/A	≥ 20%

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