

# Chong Hing Bank (1111 HK)

Share Price: HKD29.90

MCap (USD): 1.7B

Hong Kong

Target Price: HKD18.31 (-39%)

ADTV (USD): 2M

Banks

**SELL**

(Unchanged)

## Back to fundamentals: SELL

- After completion of the partial takeover, we expect share price of CHB will return to its weak fundamental value.
- Yue Xiu has no immediate plan to revive CHB's ROE. Also, CHB's low CET1 CAR restrains asset injections from parent.
- Maintain SELL. Slashed TP to HKD18.31 (-39%).

### What's New

**Potential selling pressure.** The results of the partial offer made by Yue Xiu Enterprises to Chong Hing Bank (CHB) will be announced on 5 Feb 2014. Completion of the deal will be before 14 Feb 2014. Besides, if all shareholders of CHB accept the partial offer, Liu Chong Hing Investment (LCHI) will hold 12.55% stake in CHB (54.6m shares). To maintain the public float of CHB, we believe LCHI will announce the distribution of its CHB shares as bonus dividends to its shareholders. Share price of CHB will return to its weak fundamental value after completion of the deal. We thus expect selling pressure of CHB shares after the deal.

**No immediate plan to revive ROE.** We expect CHB's fundamentals will remain weak as: (i) its NIM will remain lower than peers at 1.17% in 2014F given its high share of time deposits (62% of total deposits in Jun 2013); (ii) its heavy reliance on securities brokerage business (45.9% of total fees in 1H13); and (iii) poor track record of cost control (cost-income ratio was 51.7% in 1H13).

**Capital constraint restricts asset injections from parent.** Yue Xiu Group has securities brokerage, futures, asset management, leasing and small loan finance businesses in China. CHB's CET1 CAR was low at 10.8% in Jun 2013. We see it difficult for Yue Xiu Group to inject its China assets into CHB without a massive rights issue.

### What's Our View

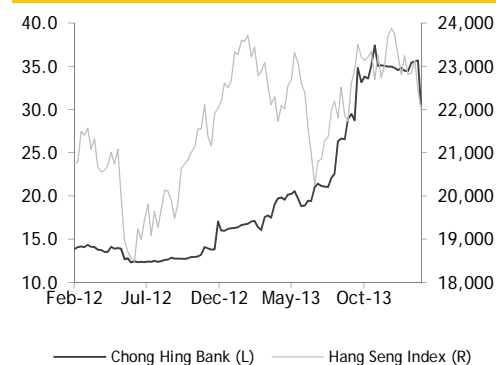
**Reiterate SELL.** Based on the long-term ROE assumption of 7% in our Gordon Growth Model. We cut our TP from HKD35.87 to HKD18.31 to reflect the fundamental value of CHB. This is equivalent to a Dec 2014 P/B of 1x.

FYE Dec (HKD m)	FY12A	FY13A	FY14E	FY15E	FY16E
Operating income	1,323	1,357	1,433	1,531	1,642
Pre-provision profit	534	599	597	654	721
Core net profit	543	490	494	545	594
Core EPS (HKD)	1.2	1.1	1.1	1.3	1.4
Core EPS growth (%)	(3.1)	(9.8)	0.8	10.3	9.0
Net DPS (HKD)	0.5	0.5	0.5	0.5	0.5
Core P/E (x)	24.5	27.2	27.0	24.5	22.4
P/BV (x)	1.8	1.7	1.7	1.6	1.5
Net dividend yield (%)	1.5	1.5	1.5	1.6	1.6
Book value (HKD)	16.95	17.63	18.31	19.06	19.93
ROAE (%)	7.6	6.5	6.3	6.7	7.0
ROAA (%)	0.7	0.6	0.6	0.6	0.6

### Key Data

52w high/low (HKD)	37.40/15.58
Free float (%)	19.1
Issued shares (m)	435
Market capitalization	HKD13.3B
Major shareholders:	
-Liu Chong Hing Investment Ltd.	50%
-China State-Owned Assets Supervision & J	20%
-Mitsubishi UFJ Financial Group, Inc.	10%

### Share Price Performance



	1 Mth	3 Mth	12 Mth
Absolute(%)	(11.0)	(12.6)	82.7
Relative to country (%)	(7.9)	(7.7)	96.6

### Maybank vs Market

	Positive	Neutral	Negative
Market Recs	1	0	1
	Maybank Consensus		% +/-
Target Price (HKD)	18.31	30.48	(39.9)
2014 PATMI(HKDm)	494	494	0.0
2015 PATMI(HKDm)	545	545	0.0

Source: FactSet; Maybank

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## Valuation and recommendation

After completion of the partial takeover from Yue Xiu Enterprises, we expect CHB's share price to return to its fundamental value. We therefore estimate the post-takeover fair value of CHB by using of our Gordon Growth Model (GGM).

Due to slow recovery in NIM, continued high cost-income ratio and limited write-back in loan-loss provisions, we forecast net profit of CHB will grow at a CAGR of 0.1% during 2012-15. We expect its ROE will remain low at 6.3-6.7% during 2013-15.

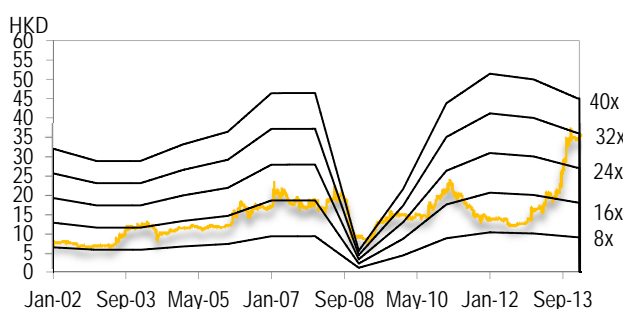
We applied a long-term ROE assumption of 7% for CHB in our GGM. This is slightly higher than its historic average ROE of 6.3% during 2002-12. We derive a fair price of HKD18.31, which is based on the fundamentals of This is equivalent to a fair Dec 2014 P/B of 1x and is also slightly above its historic average P/B of 0.97x during 2002-12. We therefore cut our TP from HKD35.87 to HKD18.31 to reflect the fundamental value of CHB after completion of the partial takeover. We maintain our **SELL** rating on CHB. Key upside risks to our rating include significant revenue synergies between CHB and Yue Xiu Enterprises, and asset injections to CHB by Yue Xiu Group.

Figure 1: CHB - Gordon Growth Model

		5.00%	6.00%	7.00%	8.00%	9.00%
Implied ROE						
Long-term dividend payout ratio (k)	40.0%					
Cost of Equity (CoE= Rf + Rm * B)	7.0%					
Long term sustainable growth (g)	4.2%					
Discount rate (CoE - g)	2.8%					
Target P/B (x): (ROE * k) / (CoE - g)		0.71	0.86	1.00	1.14	1.29
Dec14F BVPS	18.31					
Target price based on 1x Dec14F P/B		13.08	15.70	18.31	20.93	23.54

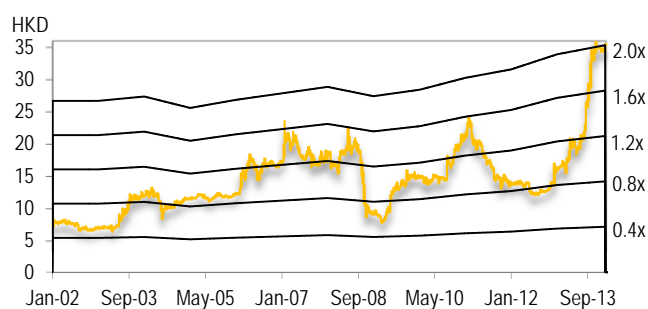
Source: Company data, Maybank Kim Eng

Figure 2: CHB – trading P/E bands



Source: Company data, Maybank Kim Eng

Figure 3: CHB – trading P/B bands



Source: Company data, Maybank Kim Eng

FYE 31 Dec (HKD m)	FY12A	FY13A	FY14E	FY15E	FY16E
<b>Key Metrics</b>					
Core P/E (x)	24.5	27.2	27.0	24.5	22.4
Core FD P/E (x)	na	na	na	na	na
P/BV (x)	1.8	1.7	1.7	1.6	1.5
P/NTA (x)	na	na	na	na	na
Net dividend yield (%)	1.5	1.5	1.5	1.6	1.6
<b>Income Statement</b>					
Interest income	1,564	1,671	1,848	2,039	2,192
Interest expense	(727)	(741)	(867)	(987)	(1,060)
<b>Net interest income</b>	<b>837</b>	<b>930</b>	<b>981</b>	<b>1,052</b>	<b>1,132</b>
Net insurance income	0	0	0	0	0
Net fees and commission	189	206	227	249	274
Other income	297	221	225	230	236
<b>Total non-interest income</b>	<b>486</b>	<b>427</b>	<b>452</b>	<b>479</b>	<b>510</b>
<b>Operating income</b>	<b>1,323</b>	<b>1,357</b>	<b>1,433</b>	<b>1,531</b>	<b>1,642</b>
Staff costs	(454)	(477)	(501)	(526)	(552)
Other operating expenses	(334)	(281)	(334)	(351)	(369)
<b>Operating expenses</b>	<b>(789)</b>	<b>(758)</b>	<b>(835)</b>	<b>(877)</b>	<b>(921)</b>
<b>Pre-provision profit</b>	<b>534</b>	<b>599</b>	<b>597</b>	<b>654</b>	<b>721</b>
Loan impairment allowances	65	(37)	(32)	(30)	(40)
Other allowances	0	0	0	0	0
Associates & JV income	36	17	19	21	23
<b>Pretax profit</b>	<b>646</b>	<b>583</b>	<b>588</b>	<b>648</b>	<b>707</b>
Income tax	(103)	(93)	(94)	(103)	(113)
Minorities	0	0	0	0	0
Discontinued operations	0	0	0	0	0
<b>Reported net profit</b>	<b>543</b>	<b>490</b>	<b>494</b>	<b>545</b>	<b>594</b>
<b>Core net profit</b>	<b>543</b>	<b>490</b>	<b>494</b>	<b>545</b>	<b>594</b>
<b>Balance Sheet</b>					
Cash & deposits with banks	22,121	23,147	24,022	25,216	26,486
Dealing securities	1,401	1,401	1,401	1,401	1,401
Investment securities	13,822	11,716	10,563	9,315	9,302
Loans & advances	42,111	46,563	51,474	56,555	60,664
Central bank deposits	0	0	0	0	0
Investment in associates/JVs	183	183	183	183	183
Insurance assets	0	0	0	0	0
Fixed assets	1,066	855	898	943	990
Intangible assets	0	0	0	0	0
Other assets	51	51	51	51	51
<b>Total assets</b>	<b>80,755</b>	<b>83,917</b>	<b>88,591</b>	<b>93,664</b>	<b>99,078</b>
Deposits from customers	67,509	70,477	74,848	79,496	84,441
Deposits from banks & FIs	2,277	2,277	2,277	2,277	2,277
Subordinated debt	0	0	0	0	0
Other borrowings	0	0	0	0	0
Insurance liabilities	0	0	0	0	0
Other liabilities	3,595	3,494	3,502	3,599	3,692
<b>Total liabilities</b>	<b>73,381</b>	<b>76,249</b>	<b>80,627</b>	<b>85,372</b>	<b>90,410</b>
Share capital	218	218	218	218	218
Reserves	7,157	7,451	7,747	8,074	8,450
Shareholders' funds	7,374	7,668	7,965	8,292	8,668
Preference shares	0	0	0	0	0
Minority interest	0	0	0	0	0
<b>Total equity</b>	<b>7,374</b>	<b>7,668</b>	<b>7,965</b>	<b>8,292</b>	<b>8,668</b>
<b>Total liabilities &amp; equity</b>	<b>80,755</b>	<b>83,917</b>	<b>88,591</b>	<b>93,664</b>	<b>99,078</b>

FYE 31 Dec (HKD m)	FY12A	FY13A	FY14E	FY15E	FY16E
<b>Key Ratios</b>					
<b>Growth (%)</b>					
Net interest income	2.6	11.1	5.5	7.2	7.6
Non-interest income	(2.7)	(12.1)	5.8	6.1	6.4
Operating expenses	1.9	(3.9)	10.2	5.0	5.0
Pre-provision profit	(1.3)	12.1	(0.2)	9.5	10.2
Core net profit	(3.1)	(9.8)	0.8	10.3	9.0
Gross loans	(5.2)	11.1	11.0	10.3	(7.7)
Customer deposits	4.2	4.4	6.2	6.2	6.2
Total assets	4.3	3.9	5.6	5.7	5.8
<b>Profitability (%)</b>					
Non-int. income/Total income	36.7	31.5	31.5	31.3	31.1
Average lending yields	2.06	2.12	2.20	2.27	2.30
Average cost of funds	1.00	0.98	1.10	1.18	1.20
Net interest margin	1.10	1.18	1.17	1.17	1.19
Cost/income	59.6	55.9	58.3	57.3	56.1
<b>Liquidity (%)</b>					
Loans/customer deposits	57.8	61.5	64.3	66.8	58.0
<b>Asset quality (%)</b>					
Net NPL	na	na	na	na	na
Gross NPL	0.1	0.1	0.1	0.1	0.1
(SP+GP)/average gross loans	(0.2)	0.1	0.1	0.1	0.1
Loan loss coverage	801.9	895.5	820.5	757.2	713.9
<b>Capital adequacy (%)</b>					
CET1	10.6	10.7	10.5	10.2	10.1
Core capital	10.6	10.7	10.5	10.2	10.1
Risk-weighted capital	15.3	15.4	15.0	14.6	14.3
<b>Returns (%)</b>					
ROAE	7.6	6.5	6.3	6.7	7.0
ROAA	0.7	0.6	0.6	0.6	0.6
Shareholders equity/assets	9.1	9.1	9.0	8.9	8.7

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