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IPO Analysis: Agricultural Bank of China (1288)

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Agricultural Bank of China (ABC) was the third biggest commercial bank in China in terms of assets at end 2009. It has an extensive network with 23,624 outlets in China as at end 2009. ABC sought a listing on both the H and A share markets. The H-share offer is priced at HK\$2.88-3.48/share to raise gross proceeds of HK\$73-88B, while the A-share offer is priced at RMB2.52-2.68/share to raise gross proceeds of RMB56-60B.

IPO highlights

Offer price per H share	HK\$2.88 - 3.48
H shares to be offered	25,412M
Shares O/S after IPO	317,647M
Proceeds to be raised from H shares	HK\$73.2-88.4B
Market capitalization	HK\$914.8-1,105.4B
Prospective 2010 P/E	9.7-11.7x
Sponsors and bookrunners	CICC, Goldman Sachs, Morgan Stanley, Deutsche Bank, JP Morgan, Macquarie, ABC International
Application lists close (H share)	12:00 noon, 6 July 2010
Listing date (H share)	16 July 2010

Valuation and recommendation

Based on the H-share offer price range, and assuming that the A share is priced at the mid-point, ABC would be valued at a prospective 2010 P/B of **1.5-1.7x**. Valuation on a P/B basis is at some discount to peers. As a reference, BOC (3988) is currently trading at 1.9x 2010 P/B, CCB (939) at 1.9x P/B and ICBC (1398) at 2.2x. On a P/E basis, ABC is valued at prospective 2010 P/E of **9.7-11.7x**, based on its earnings forecast of not less than RMB82.91B for 2010, up 27.6% YOY. For 1Q10, ABC reported net profit of RMB25.0B, up 38.5% YOY, and accounting for 30% of the full-year forecast. The 2010 forecast appears to be highly achievable.

In terms of asset quality, non-performing loan (NPL) ratio was 2.91% as at end 2009, down from 4.32% a year earlier.

Asset quality is the worst among all China banks listed in Hong Kong. This explains its P/B discount to its peers. Overall, however, valuation is not demanding, and ABC should be able to further improve its asset quality in the future. Quam initiates **ACCUMULATE and HIGH RISK** ratings on ABC. Investors can Subscribe for a controlled amount of the share. However, smart investors might do equally well, if not even better, to invest at spot the China banks currently listed, in particular those with higher asset quality. **Major risks** of ABC, like other China banks, are deterioration in asset quality and dampening of loan growth.

1Q results in line with sector

In 2009, ABC reported a net profit of RMB65B, up 26.3% YOY. Despite suppression in net interest margin (NIM) to 2.28% from 3.13% a year earlier, results were bolstered by a 49.8% YOY growth in net fee income to RMB35.6B and positive trading and fair value gains of RMB6.4B (from RMB9.8B loss a year earlier). Gross total loans at year end was RMB4,138B, up 33.5% YOY, largely in line with the sector. Despite the strong loan growth, loan-to-deposit ratio was still at a low level of 55.2%.

Compared with other listed banks, ABC has a stronger focus on the country areas. In 2009, ABC earned 38.2% of its total income and 28.3% of its profit before tax from the country areas. Despite stronger growth potential, country area business had poorer asset quality with NPL at 3.69% at end 2009, compared with 2.91% of group total.

For 1Q10, ABC reported net profit of RMB25.0B, up 38.5% YOY, and accounting for 30% of the full-year forecast. That was driven by a recovery in net interest income by 29.2% YOY to RMB53.5B. Performance was in line with other China banks, which achieved 1Q net profit growth of 30-40%.

2009 performance breakdown by country and urban areas

RMB M	Country	Urban	Total
Net interest income	70,453	111,186	181,639
Net fee income	13,693	21,947	35,640
Other net income	1,215	5,143	6,358
Total operating income	85,361	138,276	223,637
Operating expenses	(46,892)	(62,675)	(109,567)
Provisions for impairment loss	(17,524)	(22,618)	(40,142)
Profit before tax	20,945	52,983	73,928

Source: Company

Income statement

RMB M	2009	2008	2007
Interest income	296,147	321,855	250,035
Interest expense	(114,508)	(121,852)	(85,852)
Net interest income	181,639	200,003	164,183
Net fee income	35,640	23,798	22,995
Trading & fair value gains	6,358	(9,785)	(3,727)
Operating income	223,637	214,016	183,451
Operating expenses	(109,567)	(110,175)	(74,620)
Provisions for impairment losses	(40,142)	(51,478)	(30,574)
Share of associate	0	(14)	0
Profit before tax	73,928	52,349	78,257
Income tax	(8,926)	(896)	(34,470)
Net profit	65,002	51,453	43,787
ROE	19.0%	17.7%	N.A.
Cost-to-income ratio	43.4%	45.3%	34.6%
Net interest margin (NIM)	2.28%	3.13%	2.94%
Core capital adequacy ratio	7.7%	8.0%	N.A.
Capital adequacy ratio	10.1%	9.4%	N.A.
Non-performing loan (NPL) ratio	2.9%	4.3%	23.6%
Allowance to NPL	105.4%	63.5%	93.4%

Source: Company

1Q10 results

RMB M	1Q10	1Q09
Interest income	81,220	69,804
Interest expense	(27,672)	(28,369)
Net interest income	53,548	41,435
Net fee income	10,857	9,040
Trading & fair value gains	1,930	1,610
Operating income	66,335	52,085
Operating expenses	(26,047)	(20,715)

Provisions for impairment losses	(8,500)	(7,077)
Profit before tax	31,788	24,293
Income tax	(6,809)	(6,259)
Net profit	24,979	18,034

Source: Company

Poor, but improving asset quality

Asset quality is a concern for ABC. NPL ratio was 2.91% as at end 2009, down from 4.32% a year earlier. NPL coverage is insufficient. Despite improvement, asset quality is still currently the worst among all China banks listed in Hong Kong. This explains its P/B discount to its peers. Indeed, ABC had disposed of RMB760B of NPLs and impaired assets in 2008 to prepare for the listing. This helped explain its decline in NPL ratio from 23.6% at end 2007 to 4.3% at end 2008.

Loan quality analysis

RMB M	Dec 09	Dec 08	Dec 07
5-tier loan classification			
Normal	3,693,136	2,568,164	2,386,505
Special mention	324,810	397,928	268,816
Substandard	52,575	87,104	51,341
Doubtful	62,895	43,968	217,721
Loss	4,771	2,995	549,791
Total loans & advances	4,138,187	3,100,159	3,474,174
NPL	120,241	134,067	818,853
NPL Ratio %	2.91%	4.32%	23.57%
Impairment loss allowance	126,692	85,175	764,982
NPL Coverage %	105.37%	63.53%	93.42%
Allowance movement			
At period beginning	85,175	764,982	
Charge for the period	44,289	39,858	
Unwinding of discount	(1,724)	(2,060)	
Recoveries	26	22	
Write-offs	(1,070)	(29)	
Disposal of NPLs	0	(717,531)	
Other movements	(4)	(67)	

At period end	126,692	85,175
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Source: Company

Loan analysis

Gross total loans at 2009 year end was RMB4,138B, up 33.5% YOY, largely in line with the sector. Personal loans accounted for 19.1% of total. Exposure to loans to property developers, accounting for 10.5% of loan book, was relatively high. This could be a concern should China's property prices suffer substantial correction.

Breakdown of loans

RMB M	Dec 09	Dec 08
Corporate loans	3,348,731	2,635,654
Manufacturing	954,760	821,258
Transportation	314,872	203,809
Wholesale & retail	263,963	203,576
Property development	434,926	342,237
Others	1,380,210	1,064,774
Personal loans	789,456	464,505
Mortgage loans	497,950	319,505
Credit card receivables	14,118	7,901
Others	277,388	137,099
Gross total loans	4,138,187	3,100,159
Impairment loss allowance	(40,142)	(51,478)
Net total loans	4,098,045	3,048,681
Property development loans % of total	10.5%	11.0%
Mortgage % of total	12.0%	10.3%
Personal loans % of total	19.1%	15.0%

Source: Company

Use of proceeds

Proceeds raised will be used solely to strengthen the bank's capital base to support its future development. ABC intends to adopt a dividend payout ratio of 35-50% in 2010-2012.

Notes on Ratings:

- Accumulate: The share is undervalued and investors may accumulate on weakness to secure more unrealized value. However, if investors already own excessive holdings of this stock, then they might have to reduce their holdings. Despite having the same rating of “accumulate”, some stocks might have higher unrealized value than others.
- Hold: The share is priced close to its value. If investors own excessive holdings of this stock, then they might have to reduce their holdings. Despite having the same rating of “hold”, some stocks might have higher unrealized value than others.
- Reduce: The share is not attractively priced and investors should reduce their exposures
- Low risk: Earnings predictability is high. Investors may own relatively high exposures of the share.
- Medium risk: There is a certain degree of earnings predictability. Investors may own controlled exposures of the share. However, if investors own excessive holdings of this stock, then they might have to reduce their holdings.
- High risk: Earnings predictability is low. Exposure should be strictly controlled. If investors own excessive holdings of this stock, then they should reduce their holdings.

Disclosure: Raymond Siu (AMW596), the author of this document declares that as of the date of the publication of this report, he does not hold an interest in HK stock 1288.