

China Citic Bank

Bloomberg: 998 HK Equity | 601998 CH Equity | Reuters: 0998.HK | 601998.SS

Refer to important disclosures at the end of this report

DBS Group Research . Equity

14 Jun 2023

H: BUY

Last Traded Price (H) (14 Jun 2023):HK\$4.08(HSI : 19,521)
Price Target 12-mth (H):HK\$5.00 (22.5% upside) (Prev HK\$4.50)

A: HOLD

Last Traded Price (A) (14 Jun 2023):RMB6.14(CSI300 Index : 3,865)
Price Target 12-mth (A):RMB6.80 (10.7% upside) (Prev RMB5.90)

Analyst

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What's New

- Expect further NPL drop in FY23F with early retreat from risky areas and more resilient risk control
- Its risk reporting is largely in line with peers, but the asset quality improvement overlooked by the market
- Expect c.8% earnings CAGR for FY22-25F on steady loan demand and lower credit costs
- Reiterate BUY on a higher HK\$ 5 TP with attractive valuation of 0.3x FY23F P/B and 10.5% dividend yield

Asset quality improvement overlooked by the market

Investment Thesis

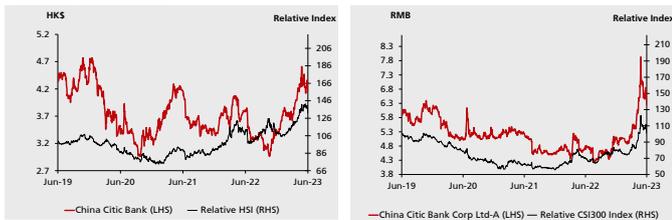
Historical NPL been largely cleaned up. CITIC Bank took efforts to improve its asset quality in the past few years. Compared with peers, it has retreated its exposure to risky sectors such as China property sector earlier. After years of efforts, we see structural improvement in its asset quality, including more prudent risk reporting, lower exposure to risky sectors and better risk management models, etc. We expect the trend of improving asset quality to carry on ahead.

Expect c.8% earnings CAGR in FY22-25F, vs consensus of c.9% after reflecting the impact from the latest interest rate cut. Our earnings assumption is mainly driven by 1) less downward pressure on NIM ahead vs the drop in 1Q23, with CITIC Bank's ongoing effort to manage its balance sheet structure and funding costs and repricing pressure lower than peers; 2) steady growth in corporate loan demand and gradual recovery in its retail loan balance; 3) steady fee income growth; and 4) lower NPL ratio and credit costs to further support its earnings growth.

Improving asset quality is a major re-rating catalyst. CITIC Bank's NPL ratio as of the end of 1Q23 dropped by 14bps y-o-y to 1.21%, despite the challenging environment – the strongest improvement among peers. New NPL formation ratio dropped from 1.74% in FY21 to 1.55% in FY22. We have a positive outlook on its asset quality on the back of the bank's resilient risk management and China's economic recovery.

Reiterate BUY with TP lifted to HK\$5. Our earnings assumptions were revised down by 4/2% for FY23/24F respectively to reflect the latest interest rate cut. Our valuation is based on the DDM model, assuming 15.8% cost of equity, 7% ROE (prev. 6%), and 3% terminal growth to reflect its improving returns and growth trend for the longer term following its strong 1Q23 results. Our TP implies 0.4x FY23F P/B, in line with its five-year average. Its H-share dividend yield is currently at c.10%, the highest vs peers.

Price Relative



Forecasts and Valuation (H Shares)

FY Dec (RMB m)	2022A	2023F	2024F	2025F
Pre-prov. Profit	144,271	142,345	156,450	172,931
Pre-prov. Profit Gth (%)	1	(1)	10	11
Pretax Profit	73,416	75,806	84,095	92,317
Net Profit	57,315	59,337	66,348	73,304
EPS (RMB)	1.17	1.21	1.36	1.50
EPS (HK\$)	1.35	1.40	1.56	1.73
EPS Gth (%)	9	4	12	10
PE (x)	3.0	2.9	2.6	2.4
DPS (HK\$)	0.38	0.39	0.43	0.48
Div Yield (%)	9.3	9.6	10.7	11.7
BV Per Share (HK\$)	15.69	15.71	16.83	18.08
P/Book Value (x)	0.3	0.3	0.2	0.2
ROAE (%)	11.7	12.1	12.9	13.0
ROAE (ex-exceptional) (%)	10.9	10.8	11.6	11.8
ROA (%)	0.69	0.67	0.70	0.72
Earnings Rev (%)		(4)	(1)	(2)
Consensus EPS (RMB)		1.31	1.42	1.56
Other Broker Recs:		B:15	S:0	H:5

Source of all data on this page: Company, DBS Bank (Hong Kong) Limited ("DBS HK"), Thomson Reuters

Key Risks

China economic recovery not as strong as expected; asset quality deterioration; fee income growth lower than expected

At A Glance

Issued Capital - H shares (m shs)	14,882
- Non H shrs (m shs)	34,053
H shs as a % of Total	30
Total Mkt Cap (HK\$m/US\$m)	289,207 / 36,919
Major Shareholders (%)	
CITIC Corporation Limited	84.9
China National Tobacco Corp	6.3
Major H Shareholders (As % of H shares)	
CITIC Corporation Limited	20.6
Summit Idea Ltd.	15.4
H Shares-Free Float (%)	64.0
3m Avg. Daily Val. (US\$m)	19.2
GICS Industry: Financials / Banks	

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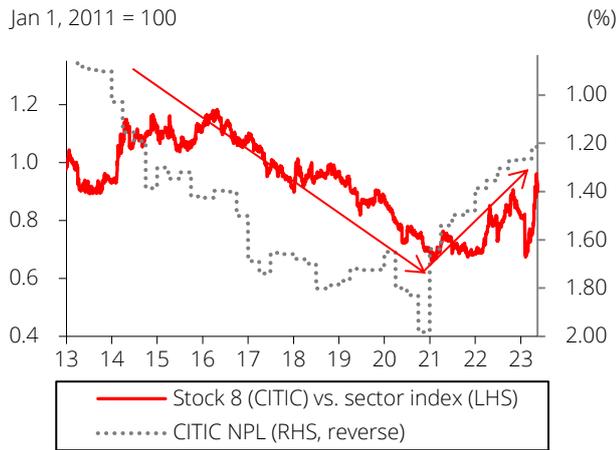
WHAT'S NEW

Asset quality improvement as key share price driver

A turnaround story in asset quality to drive re-rating.

CITIC Bank's share price performance had underperformed its peers in 2017-2021 with a deteriorating trend in asset quality. Asset quality has been improving since 2021 after change of senior management and the bank made an effort on NPL disposals, driving re-rating of the stock when its valuation was at a discount to peers.

Fig 1: CITIC Bank H-share performance relative to peers vs NPL ratio



Source: Bloomberg Finance L.P., DBS HK

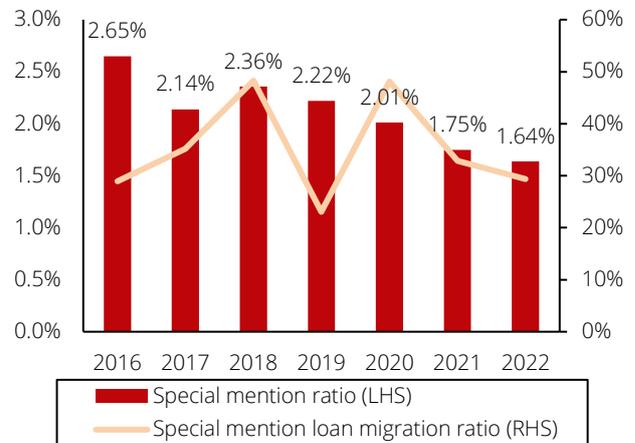
Now that the NPL risks has been largely digested, looking ahead, we expect asset quality improvement trend to carry on and continue to be a positive share price driver. Our key arguments are as follows:

1) Risk reporting largely in line with peers

Looking into the details of CITIC Banks' risk profile, we conclude that its risk reporting can be considered to be prudent and largely in line with peers. Its better-than-peers improvement in asset quality is not due to a more relaxed reporting standard for NPLs. Its NPL/>90 days overdue ratio has gradually improved from below 1 in 2016/17 to >1.3 since 2019.

In addition to NPL ratio, CITIC Bank's special mention loan ratio has also been falling in the last 5 years. The migration ratio from special mention loan to NPL dropped from c.48% in FY20 to c.29% in FY22 and is largely in line with its joint-stock bank peers. The falling trend in special mention loan and migration ratios have paved the way for a further fall in the NPL ratio.

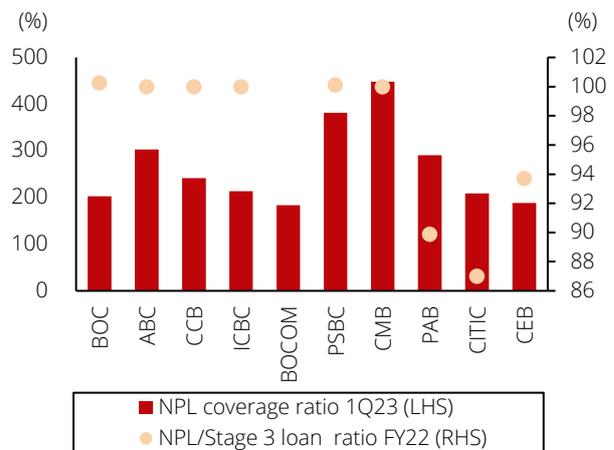
Fig 2: CITIC Bank special mention loan and migration ratios



Source: Company, DBS HK

CITIC Banks' NPL over Stage 3 loan ratio was 87% in FY22, indicating that it has covered 87% of Stage 3 loans, which are loans already impaired. The ratio was at the lower end of our covered joint stock banks, still largely in line. Its NPL coverage ratio was 208.9% in 1Q23, also in line with peers.

Fig 3: CITIC Bank special mention loan and migration ratio



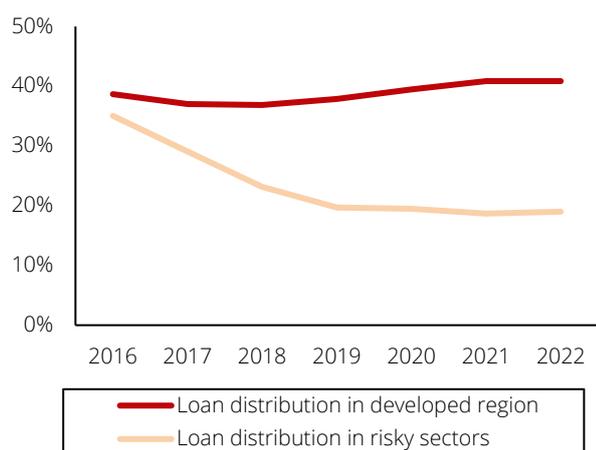
Source: Company, DBS HK

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2) Structural change in its loan book and risk models

CITIC Bank has taken heed from the high credit risks in earlier years. It has now adjusted its risk model and approval benchmarks. We see a structural improvement in its loan book. Loans in developed regions to total loans increased from c.37% in FY18 to c.41% in FY22. Loan exposure to risky industries dropped from c.35% in FY16 to c.19% in FY22. The exposure to the property sector has dropped from c.10% in FY16 to c.5.4% in FY22. Corporate customers' quality is also higher. Currently, more than 60% of its corporate customers have an internal A rating. The strategic change in its risk control helps with the long-term healthy growth of its loan book.

Fig 4: CITIC Bank's improving loan book structure



Source: Company, DBS HK

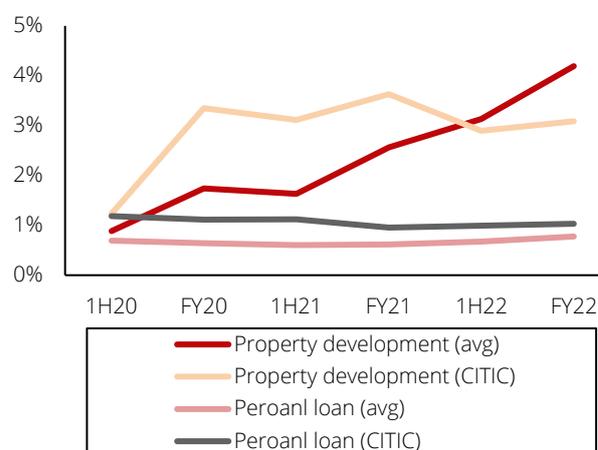
Developed regions: Yangtze River Delta and Pearl River Delta

Risky sectors: Manufacturing, wholesale and retail, property, construction

3) Trending better than peers in areas of concern

The property sector remains the key sector of concern for China banks in FY23 and we also expect to see continuous pressure on retail loans in 1H23 as the residential balance sheet may need more time to recover. Compared with peers, we believe CITIC Bank has better asset quality trends in these two areas of concern in FY23F.

Fig 5: CITIC Bank and industry NPL trends in property and retail



Source: Companies, DBS HK

In the property sector, CITIC Bank's NPL ratio hit a peak earlier than the industry and it retreated earlier from the sector. The ratio dropped y-o-y in FY22 while the average NPL ratio in property sector of major China banks under our coverage was still on an upward trend. We expect CITIC Bank's NPL ratio in property sector to be on a downward trend with lower new NPL formation in 1H23, while the NPL ratio of some of its peers may peak in 2Q23.

In the retail sector (mainly credit card loans and mortgage), CITIC Bank's NPL ratio was slightly higher than the industry average, but the rate of increase in its NPL ratio was lower than the industry average in the challenging year in FY22 (e.g. CITIC's NPL was up by 8bps y-o-y while industry average was up by 16bps).

The 1-90-day delinquency ratio of underlying assets of CITIC Bank's MBS product in May 2023 was in the range of 0.13%-0.68%, averaging 0.43%. This latest leading indicator for mortgage asset quality was largely stable for CITIC Bank and we don't expect a material deterioration in its mortgage NPL ratio in 2Q23.

On the credit card side, the policy that allowed delayed repayment of principal and interest came to an end in Mar 2023, which may lead to downgrading of some credit card loans in 2Q23.

Meanwhile, CITIC Bank is making more effort on disposal of credit card NPLs in 2Q23. Overall, we expect a small increase in NPL ratio on the credit card side in 2Q23.

Earnings upside from improving asset quality

Based on the above analysis, we expect CITIC Bank's NPL ratio to continue on an improving trend in FY23/24F as a result of structural changes. Its NPL ratio dropped by 14bps y-o-y to 1.21%

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in 1Q23. We expect asset quality in FY23/24 to be slightly better than 1Q23 as the economy recovers in China and the bank's continuous efforts to improve its risk management. We believe consensus forecast and current market valuation has not yet fully priced in these positives.

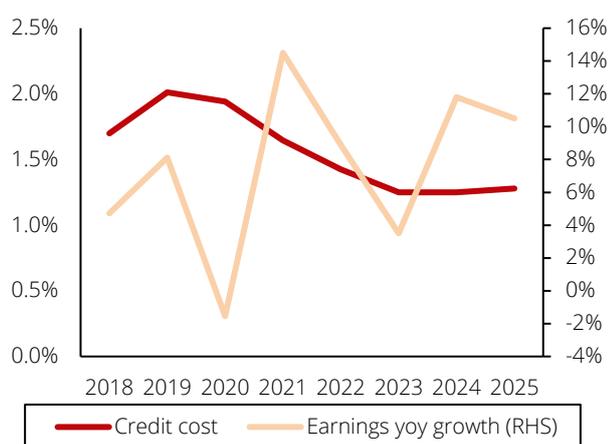
Fig 6: We are more positive on CITIC bank's asset quality than consensus

NPL ratio (%)	FY22	1Q23	FY23F	FY24F	FY25F
DBS forecast	1.27	1.21	1.20	1.18	1.19
Consensus	1.27	1.21	1.27	1.29	1.31

Source: Visible Alpha, DBS HK

CITIC Bank's credit cost peaked in 2019 at 2% and has been dropping thereafter to reach 1.42% in FY22. Its earnings CAGR improved from 3.9% in 2016-19 to 7.1% in 2019-22 accordingly. Looking ahead, we expect a further drop in credit cost in FY23-25F to 1.25-1.3% vs FY22. We expect earnings CAGR for FY22-25F to further improve to 7.9% on significantly lower credit costs than in previous years, though there were challenges from NIM side.

Fig 7: Credit cost and earnings growth

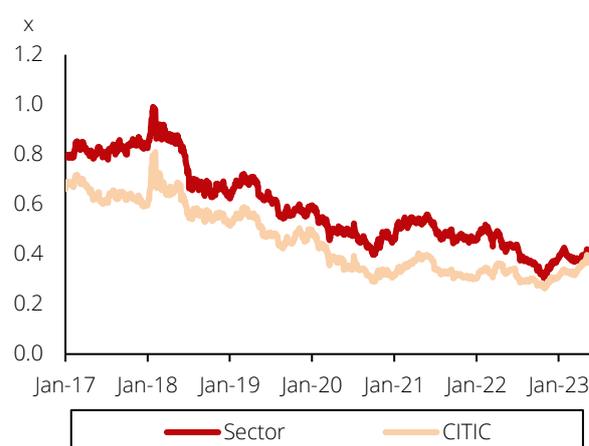


Source: Company, DBS HK

How much upside in valuation?

With market having concerns on its asset quality and growth, CITIC Bank (H-share) has long been trading at a discount to peers. The stock is now trading at c.0.27x FY23 P/B and offers 10.5% FY23F dividend yield. Even after its share price outperformance YTD, it is still trading at a discount to peers of 0.41x FY23F P/B. Meanwhile, its ROE of 13.9% and earnings growth of 10.3% y-o-y in 1Q23 were both at the higher end of its peers. In our view, CITIC Bank's valuation is underpriced by the market.

Fig 8: Sector average vs CITIC Bank (H) 1yr forward P/B



Source: Bloomberg Finance L.P., DBS HK

Our TP of HK\$5 implies c.0.39x FY23x P/B, on par with its peers average. We expect the trading gap with peers to gradually narrow as it delivers improving earnings. Still, the target multiple we have assigned to CITIC Bank is lower than its peers. In terms of internal control, risk management and capital adequacy ratio, CITIC Bank still ranks at the lower end among peers and there is room for further improvement. The A-H spread now is at 80% or more, or significantly higher than the 5-yr average of c.56%. We see its H-share as a better buy than the A-share.

Completion of rights issue as a near-term catalyst

CITIC Bank has a relatively low CET-1 ratio compared to peers at 8.8% as of the end of 1Q23 and is just above the regulatory requirement of 8% as a D-SIB. As of the end of FY22, its CET-1 ratio was 0.56ppts lower than the peer average. Market has been concerned about its capital ratio especially in FY22 especially with the weak China property sector and mortgage suspension triggering a systematic risk.

In Apr 2022, CITIC Bank announced a rights issue for its A/H shares to raise no more than Rmb 40bn. Existing shareholders will be offered no more than 3 new shares for every 10 existing shares. The pricing and timeline of the right issue is not yet known. The right issue has not yet been completed and the market expects it to be completed soon with the new management team recently coming on board.

We expect the completion of right issue as a near-term catalyst for CITIC Bank's share price. Although there will be some share dilution and short-term volatilities, we expect the market should have already largely digested the negative impacts given the share price had dropped by c.14% in 2022 after the rights issue announcement. We think the final completion of the deal will remove these uncertainties. And the bank's loan balance and

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earnings growth is likely to be higher supported by the capital raised. Similar right issue case on A-share show that share price reacts positively in the medium term after the deal completion, despite of the share dilution, if the bank could properly use the capital for growth purposes.

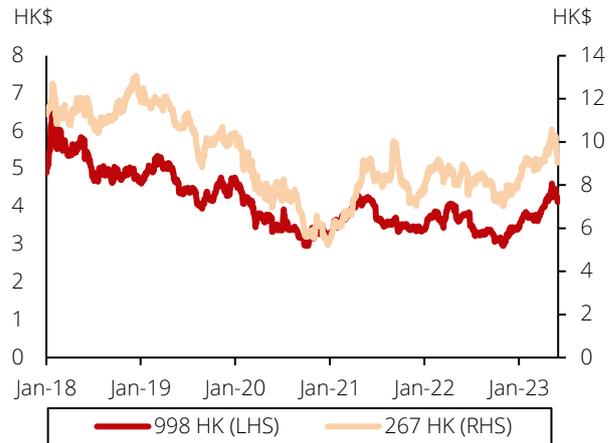
We believe in CITIC Bank's case, the capital could be well used to support growth and generate higher returns in the medium term. The completion of the deal is expected to improve the CET-1 ratio by 0.63ppt. We expect the concerns on its tight capital position to ease after the deal completion. Also, as an SOE, we expect it to also continue to benefit from the SOE revaluation theme.

Synergies with CITIC Group to unlock more value

In Mar 2022, CITIC Financial Holdings was established. CITIC Bank has some synergies with entities under the same parent company CITIC Group (267 HK). For example, the Financial Holdings company, Bank and Brokers under CITIC brand share their resource channels and wealth management capabilities to provide better wealth management services to clients.

As an important part of the Group, we see that CITIC Bank's share price will have an increasing correlation with CITIC Group. The share price correlation between the two entities in recent 5 years reached 0.9. On one hand, we expect the Group's resources to further strengthen CITIC Bank's NPL disposal and wealth management capabilities. On the other hand, the Group's share performance is likely to be positively impacted by an improving CITIC Bank as well.

Fig 9: CITIC Bank vs CITIC Group share price performance



Source: Bloomberg Finance L.P., DBS HK

Company Background

Founded in 1987, CITIC Bank (CITIC) was the earliest commercial bank established during China's reform. The bank simultaneously listed its A and H-shares in April 2007 and acquired CITIC International Financial Holdings Corporation Limited (CIFH) in 2009. By the end of 2022, CITIC had total assets worth more than Rmb8.5tn.

Historical PE and PB band

Forward PE band (x)



PB band (x)



Source: Thomson Reuters, DBS HK

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Key Assumptions

FY Dec	2021A	2022A	2023F	2024F	2025F
NIM (%)	2.05	1.97	1.83	1.83	1.84
Loan growth (%)	9	6	8	9	8
Fee growth (%)	24	3	3	11	9
Cost-to-income (%)	30.4	31.7	32.9	31.8	30.6
Credit cost (%)	1.65	1.42	1.25	1.25	1.28
Customer Deposits Growth (%)	5	8	9	8	8
Yld. On Earnings Assets (%)	4.23	4.08	3.94	3.90	3.93
Avg Cost Of Funds (%)	2.25	2.19	2.17	2.12	2.14

Source: Company, DBS HK

Income Statement (RMB m)

FY Dec	2021A	2022A	2023F	2024F	2025F
Net Interest Income	147,896	150,647	148,030	158,526	172,036
Non-Interest Income	56,658	60,462	64,236	70,961	77,194
Operating Income	204,554	211,109	212,267	229,487	249,229
Operating Expenses	(62,224)	(66,838)	(69,922)	(73,038)	(76,298)
Pre-provision Profit	142,330	144,271	142,345	156,450	172,931
Provisions	(77,048)	(71,404)	(67,141)	(73,038)	(81,349)
Associates	212	623	643	713	783
Exceptionals	0	0	0	0	0
Pre-tax Profit	65,517	73,416	75,806	84,095	92,317
Taxation	(9,140)	(10,466)	(10,807)	(11,988)	(13,161)
Minority Interests	(736)	(847)	(875)	(970)	(1,065)
Preference Dividend	(3,010)	(4,788)	(4,788)	(4,788)	(4,788)
Net Profit	52,631	57,315	59,337	66,348	73,304
Net Profit bef Except	52,631	57,315	59,337	66,348	73,304

Growth (%)

Net Interest Income Gth	(1.74)	1.86	(1.74)	7.09	8.52
Net Profit Gth	14.49	8.90	3.53	11.82	10.48

Margins, Costs & Efficiency (%)

Spread	1.97	1.90	1.77	1.78	1.78
Net Interest Margin	2.04	1.96	1.82	1.82	1.83
Cost-to-Income Ratio	30.4	31.7	32.9	31.8	30.6

Business Mix (%)

Net Int. Inc / Opg Inc.	72.3	71.4	69.7	69.1	69.0
Non-Int. Inc / Opg inc.	27.7	28.6	30.3	30.9	31.0
Fee Inc / Opg Income	17.5	17.6	17.9	18.4	18.5
Oth Non-Int Inc/Opg Inc	10.2	11.1	12.3	12.5	12.5

Profitability (%)

ROAE Pre Ex.	10.8	10.9	10.8	11.6	11.8
ROAE	10.7	11.7	12.1	12.9	13.0
ROA Pre Ex.	0.7	0.8	0.7	0.8	0.8
ROA	0.7	0.7	0.7	0.7	0.7

Source: Company, DBS HK

Quarterly Income Statement (RMB m)

FY Dec	1Q2022	2Q2022	3Q2022	4Q2022	1Q2023
Net Interest Income	36,946	36,902	37,504	39,295	36,626
Non-Interest Income	17,008	17,362	14,470	11,622	14,626
Operating Income	53,954	54,264	51,974	50,917	51,252
Operating Expenses	(13,832)	(13,555)	(15,346)	(24,105)	(14,739)
Pre-Provision Profit	40,122	40,709	36,628	26,812	36,513
Provisions	(19,142)	(23,277)	(19,238)	(9,747)	(14,200)
Associates	147	165	132	179	198
Exceptionals	0	0	0	0	0
Pretax Profit	21,127	17,584	17,521	17,184	22,511
Taxation	(3,589)	(2,187)	(2,724)	(1,966)	(3,066)
Minority Interests	(188)	(23)	(218)	(418)	(301)
Net Profit	17,350	15,374	14,579	10,012	19,144

Growth (%)

Net Interest Income Gth	(1.2)	0.6	2.5	5.6	(0.9)
Net Profit Gth	10.9	14.6	14.6	(7.7)	10.3

Source: Company, DBS HK

Interim Income Statement (RMB m)

FY Dec	2H2020	1H2021	2H2021	1H2022	2H2022
Net Interest Income	85,580	74,082	73,814	73,848	76,799
Non-Interest Income	7,619	31,574	25,084	34,370	26,092
Operating Income	93,199	105,656	98,898	108,218	102,891
Operating Expenses	(30,580)	(25,413)	(36,811)	(27,387)	(39,451)
Pre-Provision Profit	62,619	80,243	62,087	80,831	63,440
Provisions	(35,760)	(45,370)	(31,678)	(42,419)	(28,985)
Associates	(209)	28	184	312	311
Exceptionals	0	0	0	0	0
Pretax Profit	26,615	34,923	30,594	38,711	34,705
Taxation	(3,543)	(5,443)	(3,697)	(5,776)	(4,690)
Minority Interests	(71)	(420)	(316)	(211)	(636)
Net Profit	19,991	29,060	23,571	32,724	24,591

Growth (%)

Net Interest Income Gth	22.1	14.1	(13.7)	(0.3)	4.0
Net Profit Gth	9.6	14.0	17.9	12.6	4.3

Source: Company, DBS HK

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Balance Sheet (RMB m)

FY Dec	2021A	2022A	2023F	2024F	2025F
Cash/Bank Balance	435,383	477,381	447,703	483,519	522,200
Government Securities	0	0	0	0	0
Inter Bank Assets	343,211	310,728	326,264	342,578	376,835
Total Net Loans & Adv.	4,748,076	5,038,967	5,433,058	5,923,331	6,407,110
Investment	1,822,086	1,945,275	2,042,539	2,144,666	2,273,346
Associates	5,753	6,341	6,341	6,341	6,341
Fixed Assets	34,731	34,946	35,162	35,380	35,599
Goodwill	14,396	15,442	15,442	15,442	15,442
Other Assets	639,248	718,463	823,488	884,890	971,504
Total Assets	8,042,884	8,547,543	9,129,997	9,836,147	10,608,377
Customer Deposits	4,789,969	5,157,864	5,596,282	6,043,985	6,527,504
Inter Bank Deposits	1,540,631	1,590,133	1,637,837	1,686,972	1,737,581
Debts/Borrowings	956,992	974,171	1,057,591	1,203,841	1,371,780
Others	112,666	139,545	150,643	165,207	181,203
Minorities	16,323	20,412	21,280	22,243	23,301
Shareholders' Funds	626,303	665,418	666,364	713,898	767,008
Total Liab& S/H's Funds	8,042,884	8,547,543	9,129,997	9,836,147	10,608,377

Source: Company, DBS HK

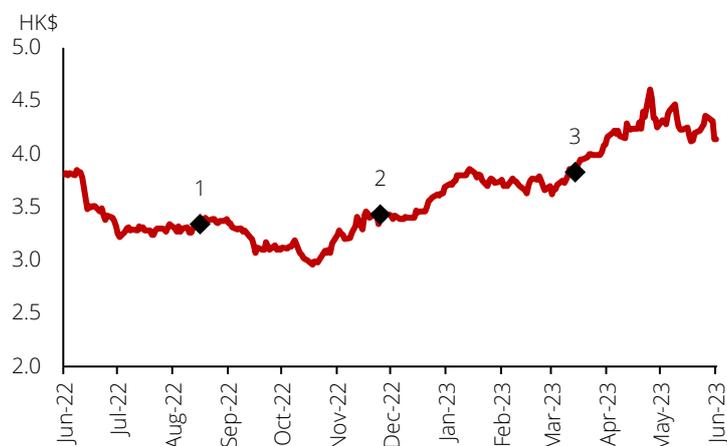
Financial Stability Measures (%)

FY Dec	2021A	2022A	2023F	2024F	2025F
Balance Sheet Structure					
Loan-to-Deposit Ratio	101.7	99.9	99.8	100.9	101.2
Net Loans / Total Assets	59.0	59.0	59.5	60.2	60.4
Investment / Total Assets	22.7	22.8	22.4	21.8	21.4
Cust. Dep./Int. Bear. Liab.	65.9	67.1	67.6	67.8	67.8
Interbank Dep / Int. Bear.	21.8	19.8	19.5	18.9	18.2
Asset Quality					
NPL / Total Gross Loans	1.4	1.3	1.2	1.2	1.2
NPL / Total Assets	0.8	0.8	0.7	0.7	0.7
Loan Loss Reserve Coverage	180.1	174.5	224.3	241.9	256.7
Provision Charge-Off Rate	1.6	1.4	1.2	1.2	1.2
Capital Strength					
Total CAR	13.5	13.1	12.5	12.6	12.5
Tier-1 CAR	8.8	8.7	8.0	8.3	8.4

Source: Company, DBS HK

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H Share - Target Price & Ratings 12-mth History

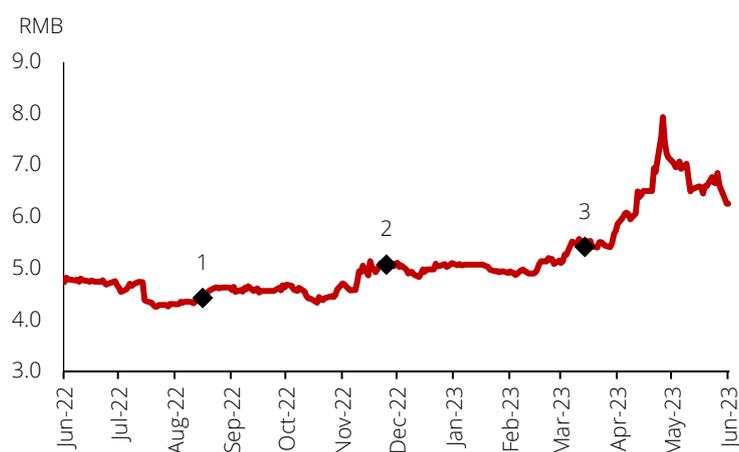


S.No.	Date	Closing Price	Target Price	Rating
1	29-Aug-22	HK\$3.32	HK\$3.60	HOLD
2	8-Dec-22	HK\$3.34	HK\$4.10	BUY
3	27-Mar-23	HK\$3.86	HK\$4.50	BUY

Source: DBS HK

Analyst: Manyi Lu
Ken Shih
Iris GAO

A Share - Target Price & Ratings 12-mth History



S.No.	Date	Closing Price	Target Price	Rating
1	29-Aug-22	RMB4.36	RMB4.40	HOLD
2	8-Dec-22	RMB5.01	RMB5.20	HOLD
3	27-Mar-23	RMB5.57	RMB5.90	HOLD

Source: DBS HK

Analyst: Manyi Lu
Ken Shih
Iris GAO

DBS HK recommendations are based on an Absolute Total Return* Rating system, defined as follows:

STRONG BUY (>20% total return over the next 3 months, with identifiable share price catalysts within this time frame)

BUY (>15% total return over the next 12 months for small caps, >10% for large caps)

HOLD (-10% to +15% total return over the next 12 months for small caps, -10% to +10% for large caps)

FULLY VALUED (negative total return, i.e., > -10% over the next 12 months)

SELL (negative total return of > -20% over the next 3 months, with identifiable share price catalysts within this time frame)

*Share price appreciation + dividends

Completed Date: 14 Jun 2023 17:17:53 (HKT)

Dissemination Date: 14 Jun 2023 17:43:10 (HKT)

Sources for all charts and tables are DBS HK unless otherwise specified.

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