SECTOR RESEARCH | China

Kim Eng

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China Banks

OVERWEIGHT (Unchanged)

Bank visits: Full recovery ahead

- Based on our discussions with H-share banks, they should not incur any systematic risks from recent stock market turmoil.
- Banks should be immune from full deposit rate deregulation.
- Expecting stable to slight decline in credit costs in 2016 given stable new NPL formation. Keep O/W. BUY CCB & CQRB.

Analysts

Steven ST Chan
(852) 2268 0645
stevenchan@kimeng.com.hk

Ning Ma
(852) 2268 0672
ningma@kimeng.com.hk

What's New

No systematic risks from recent stock market turmoil. Our strategist recently downgraded China banks to Neutral (*13 Jul: Bull market in a half-suspended exchange*) on concerns over the increasing leveraging of financial sector. However, based on our discussions with H-share banks, they have no direct margin financing to individuals and have limited working capital loans to brokerages. Some of the wealth-management products (WMPs) issued by H-share banks during 4Q14-1Q15 may have minor investments in the senior tranche of "umbrella trusts" (one funding source of margin financing). However, according to media reports, the MOF conducted a stress test on this investment and the potential loss would be <5% even if the SSE Composite Index drops to 2,000. In the case of default on shares pledged for loans (accounting for <5% of banks' total loans), banks will negotiate with the borrowers to add property collateral to extend the loans, or in the worst case, dispose of the shares to repay the loans.

Stable to slight fall in credit costs in 2016. Most H-share banks expect the gross new NPL formation rate to stabilize in 2015. This is mainly due to the gradual reduction in risky loans (steel trading, coal mining and over-capacity industries). Banks also turned cautious on lending to small-to-micro enterprises in 2015. With excess loan-loss provisions, most banks expect their credit costs to stabilize or slightly decline in 2016.

Full recovery in EPS growth in 2016. We forecast EPS growth of 8-22% for the H-share banks in 2016. Gradual economic recovery should sustain healthy loan growth in 2016. Also, the exploration of new fee income opportunities (e.g. electronic banking, e-commerce & community banking in county areas) should help boost the growth in net fees. Banks should see minimal NIM pressure on full deregulations & stable to slight decline in credit costs in 2016.

What's Our View

Maintain OVERWEIGHT. We moderately revise our earnings forecasts and TP for H-share banks based on lower loan growth and credit costs, and higher net fees projections. We upgrade CMB to HOLD and HUSB to BUY. Top Picks are CCB and CQRB.

Changes in ratings & target prices

	Rating		Target price (HKD)		
	Old	New	Old	New	Change
ABC	BUY	BUY	5.10	4.70	-7.8%
BOC	HOLD	HOLD	5.60	4.80	-14.3%
BOCOM	HOLD	HOLD	7.50	7.10	-5.3%
BOCQ	BUY	BUY	9.10	8.85	-2.8%
CCB	BUY	BUY	9.35	7.80	-16.5%
CMB	SELL	HOLD	21.15	20.10	-5.0%
CMSB	SELL	SELL	9.80	8.05	-17.9%
CNCB	HOLD	HOLD	6.85	6.00	-12.4%
CQRB	BUY	BUY	8.30	8.40	1.2%
HUSB	HOLD	BUY	3.96	4.40	11.1%
ICBC	HOLD	HOLD	6.60	6.10	-7.6%

Changes in EPS forecasts

	2015F EPS			2016F EPS		
(CNY)	Old	New	Chg	Old	New	Chg
ABC	0.58	0.57	-1.3%	0.65	0.63	-3.4%
BOC	0.59	0.59	-0.2%	0.66	0.65	-1.8%
BOCOM	0.78	0.83	7.0%	0.86	0.90	4.1%
BOCQ	1.18	1.05	-10.7%	1.41	1.21	-14.3%
CCB	0.96	0.97	1.7%	1.10	1.08	-2.1%
CMB	2.52	2.52	0.3%	3.17	3.03	-4.4%
CMSB	1.16	1.12	-3.9%	1.35	1.32	-2.9%
CNCB	0.85	0.89	3.8%	1.04	1.04	-0.3%
CQRB	0.89	0.91	2.4%	1.08	1.11	2.9%
HUSB	0.56	0.57	1.8%	0.68	0.70	2.8%
ICBC	0.77	0.78	0.7%	0.86	0.85	-1.1%

Financial summary of China banks (share prices as of 22 Jul 2015)

Bank	BB		SP	TP	Upside	Net profit (CNYm)			PER (x)			P/BV (x)			ROE (%)			Yield (%)		
	code	Rating	(HKD)	(HKD)	(%)	2014	2015F	2016F	2014	2015F	2016F	2014	2015F	2016F	2014	2015F	2016F	2014	2015F	2016F
ABC	1288 HK	BUY	3.64	4.70	29.1	179,461	185,608	205,342	5.2	5.2	4.9	1.0	0.9	0.8	19.6	17.6	17.3	6.3	6.3	6.8
BOC	3988 HK	HOLD	4.44	4.80	8.1	169,595	168,927	186,341	6.0	6.2	5.8	1.0	0.9	0.8	17.0	15.0	14.9	5.4	5.2	5.6
BOCOM	3328 HK	HOLD	7.15	7.10	(0.7)	65,850	61,660	66,524	6.4	7.0	6.7	0.9	0.9	0.8	14.8	12.5	12.4	4.8	4.3	4.5
BOCQ	1963 HK	BUY	7.19	8.85	23.1	2,827	3,135	4,251	5.5	5.5	5.0	1.0	0.9	0.8	19.2	16.0	17.2	4.8	3.8	5.0
CCB	939 HK	BUY	6.50	7.80	20.0	227,830	243,204	269,934	5.7	5.4	5.0	1.0	1.0	0.9	19.7	18.4	18.0	5.8	6.1	6.5
CMB	3968 HK	HOLD	21.00	20.10	(4.3)	55,919	63,900	77,823	7.5	6.8	5.8	1.3	1.2	1.1	19.3	18.8	19.8	4.0	4.4	5.2
CMSB	1988 HK	SELL	8.99	8.05	(10.5)	44,546	42,555	50,023	5.5	6.5	5.7	1.0	0.9	0.8	20.3	15.6	15.3	2.6	2.2	2.5
CNCB	998 HK	HOLD	5.81	6.00	3.3	40,692	43,704	51,193	5.3	5.3	4.7	0.8	0.8	0.7	16.8	15.6	16.0	0.0	5.6	6.4
CQRB	3618 HK	BUY	6.01	8.40	39.7	6,793	8,493	10,353	6.5	5.3	4.5	1.1	1.0	0.9	17.5	19.1	20.2	4.2	5.1	6.1
HUSB	3698 HK	BUY	3.69	4.40	19.2	5,673	6,339	7,702	5.7	5.2	4.4	0.9	0.8	0.8	16.7	16.4	17.7	5.4	5.9	7.0
ICBC	1398 HK	HOLD	5.57	6.10	9.5	275,811	274,362	300,225	5.7	5.8	5.5	1.1	1.0	0.9	19.9	17.3	16.9	5.8	5.7	6.0

Source: Bloomberg, company data, Maybank Kim Eng

SEE PAGE 29 FOR IMPORTANT DISCLOSURES AND ANALYST CERTIFICATIONS

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Investment summary

Based on our discussions with the H-share banks, management has little concerns over credit risks from the recent stock market rout. We believe their earnings should see a full recovery in 2016 given limited NIM pressure, strong net fees growth and a stable to slight decline in credit costs.

Key takeaways from our company visits are summarized as follows:

- Banks have limited exposures to brokerages and share-pledged loans, and no margin financing for retail customers. Some banks may have small indirect investments in "umbrella trusts" but the potential loss should be very limited (<5% of the investment) even if the stock market collapses.
- Loan growth rate in 2015 will be similar to that of 2014. This is mainly due to the cautious attitude of banks towards risky loans and small-to-micro-enterprises. Should there be an economic recovery, most banks believe they can request a higher loan quota from the PBOC.
- The removal of the 75% LDR cap should help lower sector funding costs.
- Full deregulation of deposit rates should have a limited impact on NIM.
- Large banks see room to revive their net fees growth while small banks should sustain robust net fees growth in 2015.
- No banks sold "umbrella trust funds" to customers in 2Q15. Banks have limited exposures to brokers and no margin financing for customers.
- Most banks expect the new NPL formation rate to stabilize in 2015, and credit costs to stabilize or decline slightly in 2016.
- Banks are likely to swap their LGFV loans for local government bonds (though it is not a must) and this should not undermine their earnings as interest income from local government bonds is tax free and these assets have a lower risk-weight of 20-25% (100% for LGFV loans).
- No equity capital replenishment is planned in 2H15, and dividend payout in 2015 should be similar to the level in 2014.

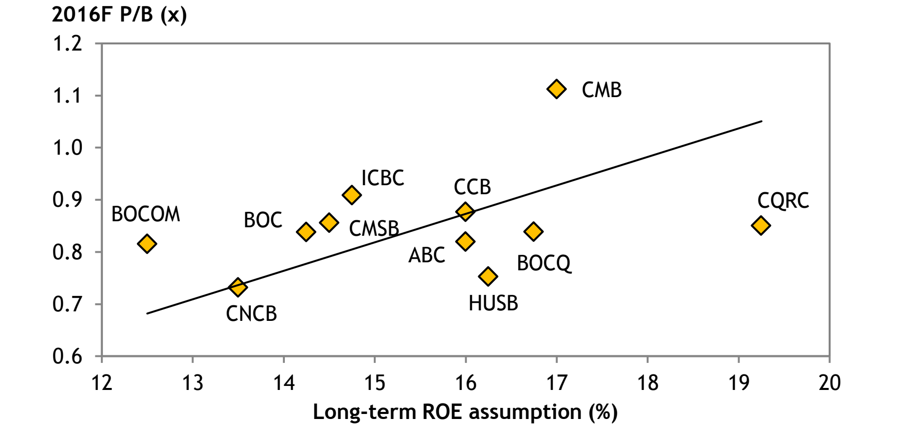
Based on lower loan growth and credit cost, and higher net fees projections, we revise our earnings forecasts and TP for H-share banks. Overall, we expect the EPS growth of H-share banks to rebound by 8-22% YoY in 2016. Key earnings drivers include healthy loan growth, strong net fees growth, tight cost control and stable to slight-decline in credit costs.

We reiterate our **OVERWEIGHT** rating on China banks. This is mainly due to: (i) potential earnings upgrades from the market in 2H15; (ii) mild NIM pressure under full interest rate deregulation; (iii) solid net fees growth given China banks are exploring new business opportunities (e.g. electronic banking, e-commerce, community banking in county areas); and (iv) potential peak-out in gross new NPL formation in 2015. We also upgrade CMB from SELL to HOLD and HUSB from HOLD to BUY.

CCB and CQRB remain our Top Picks. We expect CCB will benefit from minimal NIM pressure in 2015-16 (given tight control on funding costs and an upward revival in new mortgage rates), gradual recovery in net fees (mainly driven by electronic banking, bank cards, and wealth management businesses). Management also expects that credit costs will normalize at 70-80bps in the coming years, lower than 0.93% in 4Q14. Our TP for CCB is HKD7.80, equivalent to a 2016F P/BV of 1.05x.

CQRB remains our top pick among small banks as it will sustain strong loan and net fees growth, minimal NIM pressure (as it has a strong demand deposit base from the county areas) and lower than peers credit costs. Our TP for CQRB is HKD8.40, equivalent to a 2016F P/BV of 1.2x.

Figure 1: Comparison of P/BV vs long-term ROE assumption of H-share banks



Source: Bloomberg, Maybank Kim Eng

Figure 2: Key financial data of H-share banks

	ABC	BOC	BOCOM	BOCQ	CCB	CMB	CMSB	CNCB	CQRB	HUSB	ICBC
Pre-provisional profit (CNYm)											
2014	300,228	278,540	105,276	4,678	360,752	104,954	80,925	78,043	11,396	8,532	416,184
2015E	328,195	294,404	114,530	5,632	407,035	130,711	88,456	88,353	14,019	9,923	446,948
2016E	358,062	321,650	129,866	6,964	449,713	151,785	100,656	97,939	16,479	11,714	486,871
YoY % change											
2014	*12.4*	*18.4*	*7.1*	*30.2*	*11.7*	*33.6*	*15.4*	*21.2*	*25.1*	*25.7*	*11.1*
2015E	*9.3*	*5.7*	*8.8*	*20.4*	*12.8*	*24.5*	*9.3*	*13.2*	*23.0*	*16.3*	*7.4*
2016E	*9.1*	*9.3*	*13.4*	*23.7*	*10.5*	*16.1*	*13.8*	*10.8*	*17.5*	*18.1*	*8.9*
Net profit (CNYm)											
2014	179,461	169,595	65,850	2,827	227,830	55,919	44,546	40,692	6,793	5,673	275,811
2015E	185,608	168,927	61,660	3,135	243,204	63,900	42,555	43,704	8,493	6,339	274,362
2016E	205,342	186,341	66,524	4,251	269,934	77,823	50,023	51,193	10,353	7,702	300,225
YoY % change											
2014	*7.9*	*8.1*	*5.7*	*21.4*	*6.1*	*8.1*	*5.4*	*3.9*	*13.4*	*15.2*	*5.0*
2015E	*3.4*	*(0.4)*	*(6.4)*	*10.9*	*6.7*	*14.3*	*(4.5)*	*7.4*	*25.0*	*11.7*	*(0.5)*
2016E	*10.6*	*10.3*	*7.9*	*35.6*	*11.0*	*21.8*	*17.5*	*17.1*	*21.9*	*21.5*	*9.4*
EPS (CNY)											
2014	0.55	0.59	0.89	1.05	0.91	2.22	1.31	0.87	0.73	0.51	0.78
2015E	0.57	0.59	0.83	1.05	0.97	2.52	1.12	0.89	0.91	0.57	0.78
2016E	0.75	0.65	0.90	1.21	1.08	3.03	1.32	1.04	1.11	0.70	0.85
YoY % change											
2014	*7.9*	*4.6*	*5.7*	*21.4*	*6.1*	*(3.6)*	*5.4*	*3.9*	*13.5*	*(11.0)*	*4.4*
2015E	*3.4*	*(0.4)*	*(6.4)*	*0.8*	*6.7*	*13.8*	*(14.5)*	*2.0*	*25.1*	*11.7*	*(0.5)*
2016E	*30.7*	*10.3*	*7.9*	*14.8*	*11.0*	*20.2*	*17.5*	*17.1*	*21.9*	*21.5*	*9.4*
DPS (CNY)											
2014	0.18	0.19	0.27	0.27	0.30	0.67	0.18	0.00	0.20	0.16	0.26
2015E	0.19	0.19	0.25	0.22	0.32	0.75	0.16	0.27	0.25	0.18	0.26
2016E	0.21	0.21	0.27	0.30	0.36	0.92	0.19	0.31	0.31	0.22	0.28
YoY % change											
2014	*2.8*	*(3.1)*	*3.8*	*21.4*	*0.3*	*8.1*	*85.0*	*(100.0)*	*5.3*	*1.9*	*(1.6)*
2015E	*3.6*	*(0.5)*	*(7.7)*	*(18.0)*	*6.6*	*12.3*	*(14.2)*	*na*	*25.1*	*11.8*	*(0.5)*
2016E	*10.6*	*10.3*	*7.9*	*35.6*	*11.0*	*21.8*	*17.5*	*17.1*	*21.9*	*21.5*	*9.4*
Loan growth (%)											
2014	12.1	11.5	5.1	17.6	10.3	14.4	15.1	12.7	18.0	12.3	11.1
2015E	12.4	10.5	10.5	19.6	10.4	12.4	13.0	12.3	18.9	14.4	10.3
2016E	10.8	10.6	10.2	16.2	10.4	12.5	12.3	12.2	13.7	12.2	10.2
Net interest margin (%)											
2014	2.92	2.25	2.36	2.81	2.80	2.52	2.59	2.40	3.37	2.74	2.66
2015E	2.81	2.16	2.20	2.59	2.68	2.83	2.35	2.32	3.26	2.64	2.53
2016E	2.76	2.15	2.16	2.62	2.64	2.74	2.34	2.29	3.26	2.63	2.47
Cost-income ratio (%)											
2014	42.3	36.7	40.2	37.5	35.2	36.8	40.1	37.5	42.4	33.1	34.4
2015E	41.7	36.6	39.1	35.8	33.9	34.4	40.7	36.9	40.1	32.9	33.7
2016E	41.2	35.7	37.6	33.8	32.9	33.5	40.2	37.0	38.8	32.4	33.2
Credit cost (%)											
2014	0.85	0.58	0.61	0.74	0.66	1.33	1.18	1.07	0.82	0.47	0.54
2015E	0.92	0.61	0.97	1.09	0.82	1.75	1.42	1.10	0.81	0.65	0.71
2016E	0.88	0.60	0.99	0.81	0.81	1.66	1.37	0.97	0.70	0.59	0.70
Core teir-1 CAR (%)											
2014	9.1	10.6	11.3	9.6	12.1	10.4	8.6	8.9	10.1	11.5	11.9
2015E	9.7	10.9	11.2	11.7	12.3	10.8	9.2	9.2	9.6	10.6	12.0
2016E	10.2	11.3	11.3	11.5	12.5	10.9	9.3	9.3	9.7	10.8	12.1

Source: Company data, Maybank Kim Eng

Limited stock market exposure and FX risks

None of the H-share banks have direct or indirect margin financing (i.e. through brokers) to individuals. They have checked the usage of consumer finance, unsecured personal loans and working capital corporate loans carefully to avoid these loans from flowing into the stock market. They also request for property collateral for SME loans and micro-finance.

H-share banks also have limited exposure to share-pledged loans (<5% of total loans). In the case of default in these loans, banks will ask for property collateral to extend these loans. In the worst case, banks still have the right to dispose of the shares to repay the loans.

Most banks did not sell third-party “umbrella trust funds” to customers. BOCOM, CCB and CMB have sold some WMPs and asset-management plans with investment in the senior tranche of “umbrella trust funds” during 4Q14-1Q15. However, they stopped selling these products in 2Q15. They have not suffered from any defaults in this investment up until now. All the H-share banks have already checked the funding sources and usage of entrusted loans in the past. Besides, banks should bear no credit risk from any potential defaults of the entrusted loans as they are only acting as agents between the lenders and borrowers.

Potential depreciation of RMB vs USD should not result in massive credit risks to the H-share banks’ FX loans. These loans are mostly short-term guaranteed trade finance and property-collateralized working capital loans with corresponding foreign currency revenue sources for loan repayment. The H-share banks also hedged most of their own open positions in FX assets/liabilities.

Q1. What are the exposures to margin financing, umbrella trust and entrusted loans? What will be the impact of RMB depreciation?

In light of the stock market rally during Jan-May 2015, margin financing in China surged from CNY1.0t in Dec 2014 to CNY2.1t in May 2015 (CNY1.4t in mid-Jul 2015). With the recent consolidation in the A-shares, the market has concerns over China banks’ credit risks. However, China banks are not allowed to provide direct margin financing to individuals or funding to brokers for margin financing purposes. Some banks may provide a limited amount of working capital loans to large brokers. Hence, they should not suffer from potential default in margin financing or potential closure of small brokerages.

Meanwhile, some banks have ensured borrowings from consumer finance and supply-chain finance will flow directly to the merchants. For unsecured personal loans (used for home decoration), most banks indicate that they will check the receipts of building materials and labour payroll to avoid money flowing into the stock market. Moreover, for working capital loans to SMEs and micro-enterprises, banks will request for property collateral and the loans are granted based on an LTV of <60%.

Finally, the H-share banks have limited exposure to share-pledged loans (<5% of total loans). In the case of default in these loans, the banks will negotiate with the borrowers to add property collateral to extend the loans. In the worst case, banks still have the right to dispose of the shares to repay the loans. The H-share banks did not see any default in these loans during the recent consolidation in the A-share market.

Figure 3: Impact of margin financing, umbrella trust, entrusted loans and depreciation of RMB

	Margin financing	Umbrella trust	Entrusted loans	Depreciation of RMB
ABC	Limited exposures to brokers; No margin financing to individuals	Not selling any third-party umbrella trust funds	Limited exposures to entrusted loans; Always checking the funding source & usage of entrusted loans	Limited exposures to FX loans & bonds. Borrowers should have FX revenue to repay the FX loans.
BOC	No margin financing to individuals and direct lending to brokers. May consider lending to China Securities Finance Corporation	Not selling any third-party umbrella trust funds	Limited exposures and BOC should bear no credit risk on these loans	Most FX open positions have been hedged. Customers borrowing FX loans should have FX revenue sources to repay the loans
BOCOM	Limited exposures to brokers; No margin financing to individuals	Some of the wealth management products sold in 4Q14-1Q15 had invested in umbrella trust. Not selling these products now.	Limited exposures to entrusted loans. Always checking the funding source & usage of entrusted loans	Always checking whether customers will have FX revenue source to match borrowing; BOCOM has hedged most of the FX risk
BOCQ	No margin financing to individuals & no exposures to brokers or China Securities Finance Corporation	Not selling any third-party umbrella trust funds	Limited exposures to entrusted loans and actively checking the usage of loans	Depreciation of RMB may revive China exports and help the export-oriented manufacturers in Chongqing
CCB	No margin financing to individuals. Only provides working capital loans to limited number of brokers and credit facilities to China Securities Finance Corporation	CCB's subsidiary asset management company has stopped issuing umbrella trust funds. CCB did not sell third-party umbrella trust funds.	Entrusted loans are mainly pension-fund related housing loans	Overseas assets accounted for 5% of total assets. FX open positions are mostly hedged. Borrowers of FX loans should have FX revenue source to repay the loans
CMB	Limited exposures to brokers. No margin financing to individuals	Sold some third-party umbrella trust funds in 4Q14-1Q15. Have not sold any more in recent weeks.	Entrusted loans of ~CNY30b and always checking the funding source & usage of entrusted loans	CMB hedged most of the FX risks and borrowers of FX loans should have FX revenue sources to repay the loans
CMSB	No margin financing to individuals but has some lending to brokers. Will support China Securities Finance Corporation	Not selling any third-party umbrella trust funds	Limited exposures to entrusted loans and always checking the funding source & usage of entrusted loans	Limited exposures to FX loans & bonds.
CNCB	No margin financing to individuals & no exposures to brokers or China Securities Finance Corporation	Not selling any third-party umbrella trust funds	Limited exposures to entrusted loans	CNCB hedged most of the FX risks and borrowers of FX loans should have FX revenue sources to repay the loans
CQRB	No margin financing to individuals & no exposures to brokers or China Securities Finance Corporation	Not selling any third-party umbrella trust funds	Limited exposures to entrusted loans and mainly acting as agency bank of guarantee companies	Depreciation of RMB may revive China exports and help the export-oriented manufacturers in Chongqing
HUSB	No margin financing to individuals & no exposures to brokers or China Securities Finance Corporation	Not selling any third-party umbrella trust funds	Limited exposures to entrusted loans and always checking the funding source & usage of entrusted loans	Limited exposures to FX loans & bonds. Depreciation may benefit exporters but may hurt importers.
ICBC	No margin financing to individuals. Small amount of working capital loans to major brokers and may consider financing China Securities Finance Corporation	Not selling any third-party umbrella trust funds	Entrusted loans are mainly pension-fund related housing loans	ICBC has hedged most of its FX risk. Most of the FX loans are made to mainland companies expanding overseas and they should have corresponding FX revenue to repay the loans.

Source: Company data, Maybank Kim Eng

On the other hand, most H-share banks have not sold third-party "umbrella trust funds" to customers (the funds are issued by asset management companies and used as deposits for margin financing to invest in the A-share market). Both CCB and CMB may have sold some asset-management plans with small investment in the senior tranche of umbrella trust funds during 4Q14-1Q15 (<10% of the investment portfolio) but they stopped selling these products in 2Q15. Meanwhile, some WMPs issued by BOCOM in 1Q15 may have investment in the senior tranche of umbrella trust funds. Again, they stopped selling these in 2Q15. None of these banks have suffered from default in repayment from these funds in recent months.

According to media reports, the WMPs issued by other state-owned banks and joint-stock banks may also have mild investment in "umbrella trust funds" during 4Q14-1Q15. The media reported that the MOF has conducted a stress test on this investment and the potential loss would be <5% even if the SSE Composite Index drops to 2,000 (>3,900 at present). Hence, the sharp fall in the SSE Composite Index should have a limited impact on bank earnings.

Finally, the CBRC drafted new rules for the entrusted loans business of banks in early 2015. Under the new rules, China banks have to check the funding sources and the usage of entrusted loans carefully. Entrusted loans with funding sources from bank borrowing and funds raised from investors will be forbidden. Entrusted loans used to invest in properties and the stock market will not be permitted either. Indeed, all H-share banks indicated it had already been their practice to check the funding sources and the usage of entrusted loans carefully. Besides, they have limited exposure to entrusted loans (mainly for quality customers). Even if there is a default in these loans, banks should not suffer from any credit risk as they are acting only as agents between the lenders and borrowers.

Concerning the potential depreciation of RMB against USD (given potential USD interest rate hikes in 2H15), most H-share banks do not expect the PBOC will allow for a sharp depreciation under the current managed float exchange rate regime. Besides, most banks have limited exposure to FX loans and bonds. Overseas lending accounted for 3-22% of H-share banks' total loans in Dec 2014. Most of these loans are related to trade finance and mainland companies' overseas expansion. The H-share banks have hedged most of their open positions in foreign currency assets/liabilities.

The H-share banks do not see potential credit risks on these loans. This is because: (i) most of these loans are short-term trade finance with corresponding foreign currency revenue; (ii) banks will ask for counter-guarantee from the parent of the borrowers if it is related to overseas expansion or acquisition; (iii) they will take collateral in China and overseas for medium-term FX working capital loans; and (iv) they will request borrowers to hedge the currency risks if there are no corresponding foreign currency revenue sources to repay the loans.

Recuperating economy & cautious loan growth

Most H-share banks expect growth in real GDP and M2 will be close to 7% and 12%, respectively in 2015. They also expect a slight revival in the domestic economy and hence M2 growth in 2H15. Most banks expect further RRR cuts of 50-100bps and an interest rate cut of 25bps.

Most banks expect that sector loan growth will be CNY10-11t in 2015. With the exception of BOCQ and CQRB, loan growth of H-share banks in 2015 will be similar to that in 2014 (i.e.10-13%). But the loan growth target of both BOCQ and CQRB is higher at 15-18% in 2015. Most banks believe that the loan quota only reflects PBOC guidance. For example, they can request loan growth higher than the loan quota if there is strong loan demand and they have solid liquidity and capital positions.

Banks continue to move away from lending to risky sectors. They also have become more selective in lending to small-to-micro enterprises. Key loan growth drivers are mortgages, consumer finance, credit card advances, infrastructure loans, manufacturing loans of government-supporting industries, and lending to counter-cyclical sectors.

The H-share banks expect that the removal of the 75% LDR cap should help moderate the competition for deposits from small city and rural commercial banks. This could help lower average banking sector funding costs.

Based on company guidance, we lower our loan growth forecast of most banks, except for BOC, BOCQ, CQRB and HUSB.

Q2. What is the expected growth of real GDP and M2 in China in 2015? And what will be the trend of RRR and interest rates in 2H15?

Most H-share banks expect the Chinese government to maintain a real GDP growth of 7% in 2015 (+7.0% YoY in 1H15). With a potential revival in economic growth, most banks expect M2 growth to accelerate towards 12% by the end of Dec 2015 (average M2 growth of 13% YoY in 2014 and 11.3% during 1H15).

Some banks believe that the decline in foreign reserves (USD3.69t in Jun 2015 vs. USD3.84t in Dec 2014) was related to the increase in overseas direct investment of mainland companies (USD56b during 1H15; +29.2% YoY) instead of massive capital outflows. They expect increased government spending through additional infrastructure projects (including the “One belt one road” project), a relaxed monetary policy, and a gradual recovery in the global economy to help revive China’s economy in 2H15 vs. 1H15.

Figure 4: Outlook for economy, money supply, interest rates and RRR

	2015 Real GDP growth	2015 M2 growth	2H15 Trend of RRR	2H15 Trend of interest rate
ABC	~7%	11-12%	Cut 50-100bps	Cut 25bps
BOC	~7%	~12%	Cut 50-100bps	Slight downtrend
BOCOM	~7%	≤ 12%	Cut 50-100bps	Cut 25-50bps
BOCQ	6.5-7%	~12%	Cut 50bps	Cut 25bps
CCB	~7%	~12%	Cut 50-100bps	Slight downtrend
CMB	~7%	≤ 12%	Cut 50-100bps	Cut 25-50bps
CMSB	7-7.5%	~12%	Cut 50-100bps	Slight downtrend
CNCB	~7%	~12%	Cut 50-100bps	Stable
CQRB	~7%	11-12%	Cut 50bps	Cut 25bps
HUSB	~7%	~12-13%	Cut 50bps	Stable
ICBC	~7%	~12%	Cut 100bps	Stable

Source: Company data, Maybank Kim Eng

Still, most banks expect further cuts in RRR of 50-100bps in 2H15. With the exception of CMB, CMSB, BOCQ, CQRB and HUSB, the H-share banks did not benefit from the selective cut in RRR in Apr 2014 and Jun 2015 (for banks with strong exposures to micro-finance and agriculture-related loans). The recent trough RRR for large banks was 15.5% during 2008-09 (vs. 18.5% in Jun 2015). As such, most banks see room for further RRR cuts in 2H15.

Meanwhile, inflation in China remained low at 1.4% in Jun 2015. As a result, the real interest rate has stayed high at 3.7% (based on the 1Y benchmark lending rate). Most banks expect slight cuts in interest rates of 25bps in 2H15 in order to reduce the interest burden of SMEs and micro-enterprises, and to revive the growth in fixed asset investment (+11.4% YoY during 1H14), industrial production (+6.3% YoY during 1H15), and foreign direct investment (+10.5% YoY during 5M15).

Q3. What will be the loan growth target in 2015? Will the loan quota restrict loan growth in 2015?

The sector RMB loan growth remained solid at CNY6.6t in 1H15. As such, most banks expect sector loan growth to reach CNY10-11t in 2015 (or +12.2-13.4% YoY; RMB loan growth was CNY9.8t in 2014). Still, the H-share banks remained cautious in new lending during 1H15. Most banks indicate that they have gradually moved away from lending to small-to-micro enterprises to avoid deterioration in asset quality. Meanwhile, loan demand from their target corporate customers (i.e. mid-to-large size enterprises) remained weak due to the slow recovery in the domestic economy.

Figure 5: Loan growth targets & loan quotas

	2014 YoY growth	1Q15 YTD growth	1Q15 YoY growth	2015 target	View on loan quota	2015F Sector loan growth
ABC	12.1%	4.9%	12.5%	~12%	There could be a chance to increase loan quota but ABC will remain cautious in lending	~CNY10-11t
BOC	11.5%	3.8%	7.9%	10-11% (11% for domestic RMB & <11% for FX & overseas operations	Banks may ask for higher loan quota if they prove to the PBOC that there is demand and they have good liquidity & capital positions	>CNY11t
BOCOM	5.1%	4.7%	8.5%	~10%	Banks may ask for higher loan quota if they prove to the PBOC that there is demand and they have good liquidity & capital positions	~CNY10-11t
BOCQ	17.6%	4.5%	na	15-18%	PBOC is unlikely to increase loan quota to avoid excess liquidity flowing into risky industries	CNY11t
CCB	10.3%	3.6%	10.0%	>10%	There could be chance to increase loan quota. However, banks will remain very selective on customer	~CNY11t
CMB	14.4%	4.3%	11.6%	11-12%	Even if there is a change in loan quota, CMB will turn more cautious towards lending to SMEs & micro-enterprises	~CNY10-11t
CMSB	15.1%	4.1%	15.4%	~12-13%	Banks may ask for higher loan quota if they prove to the PBOC that there is demand and they have good liquidity & capital positions	~CNY10-11t
CNCB	12.7%	2.6%	9.8%	11-12%	Even if loan quota is increased, CNCB is subject to a heavy deposit constraint	~CNY10-11t
CQRB	18.0%	4.9%	18.1%	~18%	CQRB will remain cautious in its lending business whether there is an increase in loan quota	~CNY10-11t
HUSB	12.3%	na	na	>12%	No more loan quota from the PBOC but HUSB will remain cautious in lending	~CNY11t
ICBC	11.1%	2.7%	9.1%	~10%	Loan quota unlikely to increase as economy should pick up in 2H15. ICBC should remain cautious in lending.	~CNY10-11t

Source: Company data, Maybank Kim Eng

With the exception of BOCQ and CQRB, the H-share banks expect loan growth of 10-13% YoY in 2015. This is similar to their loan growth in 2014 (though the absolute loan growth amount in 2015 will be higher than that in 2014). Meanwhile, as the economic growth of Chongqing is much higher than national GDP (real GDP growth of Chongqing was 10.7% YoY in 1Q15), both BOCQ and CQRB expect loan growth of 15-18% during 2015, notwithstanding their asset quality was better than the other H-share banks in 1Q15.

Following the removal of the 75% loan-to-deposit ratio (LDR) cap, most banks believe that the PBOC will regard the loan quota as guidance (rather than a cap) to their loan growth. Instead, the PBOC will closely review the liquidity and capital positions of banks to monitor their loan growth. Hence, banks may request loan growth higher than the loan quota if there is overwhelming loan demand from government supporting industries and they have solid liquidity and capital positions.

Overall, based on company guidance, we lower our loan growth forecasts of most H-share banks (with the exception of BOC, BOCQ, CQRB and HUSB). However, if loan demand from medium-to-large sized enterprises picks up due to an economic recovery, we see a chance for H-share banks to lift loan growth (given their strong liquidity and capital positions).

Figure 6: Change in loan growth forecasts of H-share banks

	Loan growth forecasts (previous)			Loan growth forecasts (new)			Change in forecasts (rounded)		
	2015E	2016E	2017E	2015E	2016E	2017E	2015E	2016E	2017E
ABC	13.49%	10.74%	10.01%	12.36%	10.77%	10.05%	-1ppts	0ppts	0ppts
BOC	10.53%	10.64%	10.78%	10.53%	10.64%	10.78%	0ppts	0ppts	0ppts
BOCOM	12.93%	9.36%	8.86%	10.47%	10.24%	9.99%	-2ppts	1ppts	1ppts
BOCQ	19.63%	16.22%	15.17%	19.63%	16.22%	15.17%	0ppts	0ppts	0ppts
CCB	12.45%	11.26%	10.51%	10.38%	10.44%	10.49%	-2ppts	-1ppts	0ppts
CMB	16.54%	13.42%	12.62%	12.36%	12.46%	12.56%	-4ppts	-1ppts	0ppts
CMSB	15.92%	12.12%	11.01%	12.99%	12.26%	12.03%	-3ppts	0ppts	1ppts
CNCB	15.37%	12.41%	12.10%	12.30%	12.16%	11.94%	-3ppts	0ppts	0ppts
CQRB	18.94%	13.73%	12.39%	18.94%	13.73%	12.39%	0ppts	0ppts	0ppts
HUSB	14.44%	12.18%	12.25%	14.44%	12.18%	12.25%	0ppts	0ppts	0ppts
ICBC	12.73%	10.97%	10.74%	10.26%	10.19%	10.18%	-2ppts	-1ppts	-1ppts

Source: Company data, Maybank Kim Eng

Q4. What will be the key loan growth drivers in 2015?

Most banks indicate that they continue to trim lending to risky sectors such as over-capacity industries (e.g. steel, aluminum, and building materials), as well as steel trading and coal mining. In view of the deterioration in asset quality, most banks have turned more cautious in lending to small to micro enterprises.

Key loan growth drivers by sector include residential mortgages, credit card advances, consumer finance, and infrastructure. In terms of manufacturing loans, growth is mainly seen in new industries supported by the government, and industries with high value-added products. Additionally, banks are keen to lend to counter-cyclical industries, such as healthcare and education. However, BOC indicates that demand for offshore lending has weakened, partly due to slower growth in trade finance. The growth in offshore RMB loans has also moderated because the discount in the offshore RMB lending rate against the onshore lending rate has significantly narrowed after consecutive rate cuts.

Figure 7: Key loan growth drivers in 2015

	Key loan growth drivers
ABC	Manufacturing, wholesale & retail trade, infrastructure loans
BOC	Mortgages, new emerging industries, real estate and manufacturing loans
BOCOM	Credit card advances, utilities, manufacturing loans to high value added industries, and new industries and mortgages
BOCQ	Medical, education, modern agriculture & other new emerging industries
CCB	Residential mortgages, infrastructure lending, consumer finance
CMB	Residential mortgages, consumer finance & credit card advances, discounted bills
CMSB	Continued shift from micro-finance to SME loans
CNCB	Credit card advances, consumer finance, real estate & LGFV loans
CQRB	Residential mortgages, new emerging industries (computers), manufacturing, wholesale & retail trade
HUSB	Infrastructure lending, industries related to urbanization, consumer finance, mortgages
ICBC	Mortgages, consumer finance, overseas lending, counter-cyclical industries, and small-to-micro enterprises

Source: Company data, Maybank Kim Eng

Q5. What is the impact of new LDR rules and the removal of the LDR cap?

Effective from 1 Jan 2015, the PBOC announced a further relaxation in the rules on calculating the loan-to-deposit ratio (LDR) of China banks by including their deposits from non-bank financial institutions (e.g. brokers and asset management companies). However, banks indicate that the CBRC still adopts the old rules to calculate LDR (i.e. only negotiated deposits are included as deposits). Hence, the PBOC's new LDR rules should have no impact on their loan and deposit growth strategies.

Figure 8: Loan-to-deposit ratio and the impact of removal of the LDR cap

	LDR (Dec 2013)	LDR (Sep 2014)	LDR (Dec 2014)	LDR (Mar 2015)	Impact of LDR cap removal
ABC	61.2	63.3	64.6	64.2	Limited impact to ABC. Small banks may be less aggressive in competing for deposits.
BOC#	72.2	71.7	70-72%	70-72%	Small banks may be less aggressive in competing for deposits. This may lower sector funding cost.
BOCOM	73.4	73.9	74.5	73.2	BOCOM may seek for faster loan growth. There is no need to compete aggressively for deposits.
BOCQ	60.8	na	64.2	63.3	Limited impact as PBOC will still control loan growth of banks through liquidity and capital management
CCB	70.3	72.0	64.5	64.5	Small banks may be less aggressive in competing for deposits. This may lower sector funding cost.
CMB	73.8	71.1	62.4	66.9	Limited impact as banks are still subject to liquidity & capital management.
CMSB	73.3	73.0	60.4	64.3	Small banks may be less aggressive in competing for deposits. This may lower sector funding cost.
CNCB	73.2	73.9	73.1	72.4	CNCB may seek for faster loan growth. There is no need to compete aggressively for deposits.
CQRB	59.0	57.5	42.0	42.0	Small banks may be less aggressive in competing for deposits. This may lower sector funding cost.
HUSB	71.6	na	68.2	<68%	Slight pressure on NIM, but small banks should be less aggressive in competing for deposits.
ICBC	67.9	68.1	69.5	69.9	Limited impact to ICBC though small banks may be less aggressive in competing for deposits.

Source: Company data, Maybank Kim Eng #Domestic RMB

Meanwhile, most banks agree that the removal of the 75% LDR cap should prompt small city and rural commercial banks to become less aggressive in competing for deposits. This may help lower the average sector funding cost. Banks with relatively higher RMB LDR such as BOCOM and CNCB may seek faster loan growth in the medium term (after the recovery of domestic economy). Some banks also indicate that they may shift their emphasis from asset management (adjusting loan growth based on deposit balance) to liability management (adjusting deposit growth based on loan balance).

Limited NIM pressure & solid net fees growth; stable-to-improving cost-income ratio

Most H-share banks expect minimal NIM pressure in 2Q15 vs. 1Q15 given the symmetric interest rate cuts in 1H15. They expect their NIM to narrow by 8-16bps in 2015, and are seeking ways to minimize NIM pressures. These include a reduction in expensive structured & negotiated deposits, and the shift towards high-yield and fixed-rate loans. The H-share banks only raised their time deposit rate at <1.3x of the benchmark rate despite the PBOC lifting the cap to 1.5x the benchmark rate. Hence, most banks believe that full deregulation of deposit rates should have limited impact on their NIM.

Due to the rallying stock market, consecutive interest rate cuts, and the recovery in retail sales, H-share banks benefited from solid growth in bank cards, wealth and asset management, and custodian businesses. As such, large H-share banks expect mild improvement in their net fees growth, while other H-share banks should maintain robust net fees growth in 2015.

Based on company guidance, we have fine-tuned our NIM forecasts for some H-share banks. Meanwhile, we raise our net fees growth forecast for BOCOM, BOCQ, CMSB, CQRB and HUSB.

With tight control on staff costs and administrative & marketing expenses and the promotion of electronic banking, most H-share banks are confident they can maintain a stable-to-slight improvement in their cost-income ratio in 2015. HUSB may go for a slight rise in cost-income ratio in order to explore new business opportunities in county areas of Anhui province.

Q6. What is the guidance of NIM for 2Q15 and 2015?

Most banks indicate that they have limited NIM pressure in 2Q15 vs. 1Q15. This was partly due to the symmetric interest rate cuts of the PBOC during 1H15. Besides, the rate cut impact has not been fully reflected given that residential mortgages are re-priced on 1 Jan and some corporate loans are not re-priced immediately after each rate cut. This has helped offset the negative impact of migration towards time deposits (in particular for deposits with maturity of >1Y).

Figure 9: NIM outlook and the impact of full interest rate deregulation

	2014	4Q14	1Q15	2Q15E	2015E NIM outlook	Current quotation of time deposit rate	Impact of full interest rate deregulation	Ways to minimize NIM pressure
ABC	2.92%	2.97%	2.89%	~2.8%	2.8%-2.85%	Time deposit rate is 1.1-1.2x of the benchmark rate	Limited impact on time deposit rate	Reduce structured & negotiated deposits; Increase in loan duration and high-yield loans
BOC	2.25%	2.21%	2.22%	>2.15%	~2.1%-2.15%	Time deposit rate is 1.3x of the benchmark rate	Slight negative impact on NIM	Will shift towards liability management to reduce average funding cost and may raise the LDR
BOCOM	2.36%	2.22%	2.29%	<2.29%	~2.2%	Time deposit rate is 1.1-1.3x of the benchmark rate	Some slight pressure on NIM in the medium term	Increase low cost deposits through promotion of clearing & settlement business; Increase loan pricing of some SME loans & micro-finance
BOCQ	2.81%	na	2.51%	~2.51%	~2.6%	Time deposit rate of <2Y is 1.05-1.1x of the benchmark rate	Some slight pressure on NIM in 3 years' time	Tight control in time deposit rate and strong price bargaining power on lending to micro-enterprises
CCB	2.80%	2.77%	2.72%	~2.65%	~2.7%	3-6M time deposit rate is <1.2x of the benchmark rate	No further impact on time deposit rate	Slight increase in mortgage rate; reduced exposures to expensive negotiated deposits
CMB	na	2.72%	2.90%	2.8%-2.85%	>2.8%	Time deposit rate is 1.2-1.3x of the benchmark rate	Limited impact on time deposit rate & NIM	Reduce low-yield interbank assets; Expanding fixed rate corporate loans
CMSB	2.59%	2.52%	2.37%	≤2.37%	~2.37%	Time deposit rate is 1.22x of the benchmark rate on average	Slight negative impact on NIM	Establish community banking unit to absorb more demand deposits. Price bargaining power of micro-finance remains strong
CNCB	2.40%	2.50%	2.32%	2.35%-2.4%	~2.3%	Time deposit rate is 1.25x of the benchmark rate	Limited impact on time deposit rate & NIM	Shift towards consumer finance; Increase loan pricing of some corporate loans
CQRB	3.37%	3.37%	3.28%	~3.28%	3.2%-3.3%	3-6M time deposit rate is <1.3x of the benchmark rate	Limited impact on time deposit rate	Replacing negotiated deposits with CDs and lower the ceiling of medium-to-long-term deposits
HUSB	2.74%	na	na	na	~2.7%	Time deposit rate is <1.3x of the benchmark rate	Slight negative impact on NIM	Actively reduce the funding cost through increase in demand deposits. Increase the share of fixed rate loans
ICBC	2.66%	2.76%	2.60%	2.5%-2.6%	~2.5%	<1Y time deposit rate is 1.125-1.15x of the benchmark rate	No further impact on time deposit rate	Shift towards high-yield loans and better price bargaining power with small-to-micro-enterprises

Source: Company data, Maybank Kim Eng

On the other hand, the PBOC has raised the cap of RMB deposit rates to 1.5x of the benchmark rate in the rate cut of 11 May 2015. Still, the banks maintained their short-term time deposit rate (maturity of <1Y) at 1.1x-1.3x of the benchmark rate. They also lowered the medium-to-long-term time deposit rate (maturity of >1Y) to <1.2x of the benchmark rate. Most banks did not provide any premium for their demand deposit rate. Despite a possible full deregulation of deposit rates in the next round of rate cut, most banks believe any change would have limited impact on their deposit rate premium and hence, their NIM.

The H-share banks indicate that they will find ways to minimize the pressure. For example, they will reduce their reliance on expensive structured and negotiated deposits. These deposits may be replaced by certificates of deposit (CDs). Some banks such as CMSB and CQRB have established community banking units to absorb demand deposits in small county areas. HUSB has increased the proportion of fixed rate new loans to reduce the shock of a lending rate cut. Other banks have also shifted towards higher-yield consumer finance, credit card advances, and quality SME loans & micro-finance.

Based on company guidance, we revise slightly downward our NIM forecast of ABC, BOC and CMSB. Both ABC and CMSB are suffering from increasing migration towards time deposits, while BOC sees increasing NIM pressure on its domestic foreign currency and overseas businesses. On the contrary, we slightly raise our NIM forecast of BOCOM and CNCB. BOCOM is benefitting from efforts to lower its average funding costs, while CNCB has increased the pricing of some of its corporate loans.

Figure 10: Change in NIM forecasts of H-share banks

	NIM forecasts (previous)			NIM forecasts (new)			Change in forecasts (rounded)		
	2015E	2016E	2017E	2015E	2016E	2017E	2015E	2016E	2017E
ABC	2.84%	2.79%	2.75%	2.81%	2.76%	2.73%	-2bps	-2bps	-2bps
BOC	2.19%	2.19%	2.19%	2.16%	2.15%	2.16%	-3bps	-4bps	-4bps
BOCOM	2.17%	2.08%	2.06%	2.20%	2.16%	2.13%	3bps	8bps	7bps
BOCQ	2.59%	2.63%	2.60%	2.59%	2.62%	2.60%	-1bps	-1bps	0bps
CCB	2.67%	2.63%	2.60%	2.68%	2.64%	2.62%	0bps	1bps	2bps
CMB	2.83%	2.72%	2.67%	2.83%	2.74%	2.71%	0bps	2bps	4bps
CMSB	2.39%	2.38%	2.36%	2.35%	2.34%	2.32%	-4bps	-4bps	-4bps
CNCB	2.28%	2.25%	2.22%	2.32%	2.29%	2.27%	4bps	4bps	5bps
CQRB	3.26%	3.27%	3.26%	3.26%	3.26%	3.26%	0bps	-1bps	0bps
HUSB	2.63%	2.63%	2.62%	2.64%	2.63%	2.62%	0bps	0bps	0bps
ICBC	2.54%	2.49%	2.46%	2.53%	2.47%	2.44%	-1bps	-2bps	-2bps

Source: Company data, Maybank Kim Eng

Overall, with the exception of BOCQ and CMSB, we expect the NIM of H-share banks to narrow by 8-16bps in 2015 vs. 2014. We forecast the NIM of BOCQ and CMSB will shed 22bps and 24bps in 2015, respectively. Both banks have suffered from increased migration towards time deposits.

Q7. What will be the outlook for net fees growth in 2015?

Large banks suffered from a significant slowdown in net fees growth in 2014. This was due to the regulators' review of fee charges of banks in Aug 2014. As such, some fee charges of SMEs & micro-enterprises, as well as bank cards should be reduced or exempted. We believe the residual effect of the adjustment in fee charges should remain intact in 1H15.

Figure 11: Outlook on net fees growth and key growth drivers

	2013 YoY growth	2014 YoY growth	1Q15 YoY growth	2015 fee growth outlook	Key growth drivers	View on universal banking
ABC	11.1%	-3.7%	0.3%	Single digit growth	Investment banking, credit card & wealth management	No imminent plan
BOC	17.4%	11.1%	-15.9%	Return to positive growth	Bank card, agency, and clearing & settlement fees	Banks are not allowed to run brokerage business through their branch network. They still have to wait for change in banking law
BOCOM	24.4%	14.0%	29.3%	Could be ~20%	Bank cards, asset and wealth management & trust	May seek for special approvals to run brokerage business through branch network
BOCQ	75.1%	41.0%	169.2%	>50%	Credit card, wealth management, leasing, consumer finance & trust	May diversify into securities brokerage business
CCB	11.5%	4.1%	5.6%	High single digit growth	Electronic banking, bank card, distribution of unit trusts, bancassurance, wealth management	May seek for special approval to establish brokerage business
CMB	47.8%	53.2%	49.2%	>30%	Custodian, bancassurance, distribution of wealth management products & unit trusts	May seek for special approval to establish brokerage business
CMSB	46.0%	27.7%	38.0%	≥30%	Credit card, bond underwriting, wealth management & trust	No imminent plan
CNCB	50.0%	50.6%	32.7%	>30%	Bond underwriting, bank card, custodian & wealth management	No imminent plan
CQRB	56.0%	57.4%	100.8%	>57%	Bank card, electronic banking, wealth management & custodian	If allowed, CQRB may diversify into asset management business & custodian for mutual funds
HUSB	36.3%	58.7%	na	Could be >50%	Bank cards, wealth management, distribution of unit trust, investment banking	No imminent plan
ICBC	15.3%	8.3%	-1.3%	May revive in 2H15	Distribution of unit trusts & wealth management products, private banking, bank cards	May seek for special approval to establish brokerage business

Source: Company data, Maybank Kim Eng

However, due to the rallying stock market and consecutive interest rate cuts, most H-share banks saw robust growth in wealth management, custodian, and asset management (mainly related to the distribution of unit trusts) businesses in 1H15. The gradual recovery in retail sales (+10.4% YoY during 1H15) also prompted solid growth in bank card fees. Large banks continued to diversify into electronic banking and bancassurance businesses. However, BOC reported a sharp decline in net fees of 15.9% YoY in 1Q15. This was partly due to a decline in international trade-related fees, international clearing & settlement fees and FOREX income. Still, BOC expects its net fees growth to return to positive territory in 2H15. Other large H-share banks also expect a slight improvement in their net fees growth for 2015.

Other H-share banks did not suffer as much from the adjustment in fee charges as large banks. With a low base for comparison, they expect their net fees should maintain solid growth of greater than 20% in 2015. This should improve their net fees contribution in the coming years. Based on company guidance, we revise upward our net fees growth forecast of BOCOM and CMSB to about 20-30% YoY for 2015. We also raise our net fees growth forecast of BOCQ, CQRB and HUSB to greater than 50% for 2015 given that they are still in the initial stage of diversifying into credit card, wealth management, and custodian businesses.

Figure 12: Change in net fees growth forecasts for H-share banks

	Net fees growth forecasts (previous)			Net fees growth forecasts (new)			Change in forecasts		
	2015E	2016E	2017E	2015E	2016E	2017E	2015E	2016E	2017E
ABC	8.7%	9.5%	9.8%	8.7%	9.5%	9.8%	0ppts	0ppts	0ppts
BOC	5.5%	9.2%	9.4%	5.5%	9.2%	9.4%	0ppts	0ppts	0ppts
BOCOM	13.5%	13.6%	13.2%	18.1%	17.1%	16.0%	5ppts	3ppts	3ppts
BOCQ	30.3%	24.5%	20.7%	50.8%	31.4%	29.1%	21ppts	7ppts	8ppts
CCB	9.7%	9.9%	10.3%	9.7%	9.9%	10.3%	0ppts	0ppts	0ppts
CMB	35.9%	28.0%	23.0%	35.9%	28.0%	23.0%	0ppts	0ppts	0ppts
CMSB	22.3%	20.2%	18.3%	29.2%	24.7%	20.4%	7ppts	5ppts	2ppts
CNCB	34.8%	29.6%	24.0%	34.8%	29.6%	24.0%	0ppts	0ppts	0ppts
CQRB	26.2%	22.7%	21.3%	51.2%	35.9%	27.6%	25ppts	13ppts	6ppts
HUSB	35.3%	31.0%	24.5%	52.6%	36.9%	31.4%	17ppts	6ppts	7ppts
ICBC	9.4%	10.2%	10.2%	9.4%	10.2%	10.2%	0ppts	0ppts	0ppts

Source: Company data, Maybank Kim Eng

Meanwhile, according to media reports, CSRC has approved the acquisition of a 33.3% stake Hua Ying Securities for CNY266m by BOCOM International, a Hong Kong-based subsidiary of BOCOM. Some H-share banks have indicated they also are interested in diversifying into the securities brokerage business. However, the current China banking laws do not allow universal banking model. Hence, diversification into securities brokerage will need special approval from the regulators. In the case of BOCOM, the potential investment in Hua Ying Securities does not imply that it may run the securities brokerage business through its branch network. Hence, earnings contribution from this investment may not be significant.

Q8. What will be the outlook for cost-income ratio?

The H-share banks expect their operating efficiencies to remain stable or improve slightly in 2015. This will be done through tight control on staff costs, administrative & marketing expenses, minimal expansion of branch outlets and the promotion of electronic banking to customers.

Among the H-share banks, only HUSB plans to increase its cost-income ratio slightly in the coming years. Management intends to increase its foothold in the county areas of Anhui province. This is because the geographical coverage of banking services in these areas remains low. Most of the rural commercial banks in Anhui province are still small with provisions of limited banking services. This should provide huge business opportunities for HUSB (e.g. deposit taking, bank card and wealth management business).

Figure 13: Outlook for cost-income ratio of H-share banks

	2014	1Q15	2015F	Cost-income ratio outlook for 2015
ABC	42.3%	35.8%	41.7%	Stable outlook for 2015
BOC	36.7%	37.5%	36.6%	Stable outlook for 2015
BOCOM	40.2%	36.0%	39.1%	Stable outlook for 2015
BOCQ	37.5%	27.9%	35.8%	Room to reduce by ~1ppt
CCB	35.2%	28.2%	33.9%	Stable-to-slight downtrend
CMB	36.8%	30.2%	34.4%	Slight downtrend
CMSB	40.1%	32.8%	40.7%	Stable outlook for 2015
CNCB	37.5%	35.9%	36.9%	Stable-to-slight downtrend
CQRB	42.4%	38.3%	40.1%	Slight downtrend
HUSB	33.1%	na	32.9%	May increase slightly to expand into rural areas
ICBC	34.4%	29.5%	33.7%	Stable outlook for 2015

Source: Company data, Maybank Kim Eng

Asset quality – towards stable-to-better outlook

Most H-share banks expect a continued rise in total NPLs (and possibly NPL ratio) in 2Q15 and 2015. However, as they have gradually reduced their exposures to the risky sectors (steel trading, coal mining and overcapacity industries), they expect the gross new NPL formation rate should stabilize or peak out in 2015.

However, some H-share banks still need to increase their provision-to-loan ratio gradually to the regulatory minimum of 2.5%. As such, most banks expect their credit costs to increase slightly in 2015 vs 2014. With potential stabilization in gross new NPL formation rate, most banks expect their credit costs to stabilize or fall slightly in 2016. Based on company guidance, we lower our credit cost forecasts for most banks.

Most banks indicated they will negotiate with local governments on a debt-to-bond swap agreement. They believe this will not affect their earnings significantly as the income from local government bonds is tax free and these bonds have lower risk weight than LGFV loans (20-25% vs 100%). Hence, the risk-weighted return of local government bonds should be higher than LGFV loans (14% vs 4.5%)

Most banks indicated they have gradually reduced the reverse repo transactions that are collateralized by shadow bank assets. Some banks may still invest in asset management plans. Still, they will strike a balance between the yield and additional impairment & capital charges of these assets.

Q9. What is the outlook for NPLs in 2015?

China banks recorded a continued rise in the NPL ratio from 1.25% in Dec 2014 to 1.39% in Mar 2015. With the exception of ABC, all the H-share banks reported an NPL ratio lower than the sector average in 1Q15 (ABC's NPL ratio was 1.65% in Mar 2015). Meanwhile, based on our estimation, five H-share banks saw a decline in gross new NPL formation rate in 1Q15 vs 4Q14 (including ABC, BOCOM, CMSB, CNCB and CQRB).

Figure 14: Outlook for NPLs of H-share banks

	NPL ratio (%)			New NPL formation rate (%)					New NPL formation sectors	NPL outlook in 2015
	Dec-14	Mar-15	Dec-15F	2Q14	3Q14	4Q14	1Q15	2014		
ABC	1.54	1.65	1.70	0.80	0.69	1.64	0.88	0.89	Manufacturing, wholesale & retail trade loans, coal mining	New NPL formation should stabilize in 2015
BOC	1.18	1.33	1.42	0.69	0.67	0.82	1.09	0.67	Manufacturing & wholesale & retail trade lending for SMEs	New NPL formation will stabilize in early 2016
BOCOM	1.25	1.30	1.52	0.57	0.67	1.35	0.59	0.78	Manufacturing, credit card advances, wholesale & retail trade loans	New NPL formation gradually stabilizing
BOCQ*	0.69	0.86	0.95	na	na	na	1.03	0.60	Steel manufacturing, coal mining and luxury catering industry	New NPL formation to peak in 3Q15 and NPL ratio will be <1%
CCB	1.19	1.30	1.46	0.54	0.71	0.96	1.11	0.66	Manufacturing, wholesale & retail trade, coal mining	New NPL formation gradually stabilizing
CMB	1.11	1.24	1.38	0.44	0.82	1.11	1.53	1.07	Steel trading, coal mining, non-ferrous metal manufacturing, shipping and micro-enterprise loans	New NPL formation may still be on a slight uptrend
CMSB	1.17	1.22	1.30	1.48	1.11	1.24	1.12	1.57	Manufacturing & wholesale & retail trade lending for SMEs	New NPL formation may stabilize in 2H15
CNCB	1.30	1.35	1.62	0.89	1.00	1.15	0.71	0.99	Manufacturing, wholesale & retail trade	New NPL formation gradually stabilizing & NPL ratio <1.35%
CQRB	0.95	0.74	0.86	0.88	0.34	1.12	0.23	0.57	SME manufacturers and luxury catering industry	New NPL formation should peak in 2015 and NPL ratio will be <1%
HUSB	0.83	na	0.97	na	na	na	na	0.51	Manufacturing and retail trade	New NPL formation should stabilize and keep NPL ratio at <1% in 2015
ICBC	1.13	1.29	1.45	0.40	0.73	0.94	1.64	0.67	Manufacturing loans and wholesale & retail trade lending	New NPL formation will peak in early 2016 & target NPL ratio of <1.45% for 2015

Source: Company data, Maybank Kim Eng

All H-share banks expect their total NPLs and NPL ratio to continue to rise for the rest of 2015. However, most of them expect that the gross NPL formation rate will peak in 2H15 or remain rather stable in 2015. BOCQ, CQRB and HUSB are confident that their NPL ratio will remain lower than peers (and may have a chance to remain <1%) in 2015.

Unlike previous years, steel trading loans were no longer a major source of new NPLs in 1H15 as most banks have aggressively exited from this lending. Manufacturing loans (related to overcapacity industries and mainly for SMEs and micro-enterprises) and wholesale & retail trade loans (partly related to retailers selling luxury goods) remained the key sources of new NPLs in 1H15. ABC, BOCQ and CCB also saw an increase in coal mining loans in 1H15 though they have limited exposures to these loans. To avoid further deterioration in asset quality, banks continued to reduce their exposures to overcapacity industries. Besides, they became more cautious in lending to small-to-micro-enterprises.

Most H-share banks maintained tight control on the growth of real estate loans and lending to local government financing vehicles (LGFV) in 1H15. Still, asset quality of these loans (especially for LGFV loans) remained benign. This was due to: (i) H-share banks have focused on lending to large property developers in first and second tier cities; (ii) the LGFV loans have high cash collateral coverage ratio (>95% of these loans have 100% cash collateral coverage).

Q10. What are exposures of banks to risky sectors?

Following years of massive write-offs and active reduction in loans outstanding, the balance of steel trading loans of all H-share banks has dropped to <CNY50b in 1Q15 (or <1.2% of total loans). As a result, there was limited new NPL formation in these loans during 1H15. Meanwhile, some banks such as BOCQ, CCB and CNCB have relatively higher exposures to coal mining loans (2-5% of total loans) in 1Q15. Hence, they saw some increase in new NPL formation for these loans during 1H15. These banks will gradually move away from these loans in the near term.

Figure 15: Exposures to risky sectors

	Real estate loans	Steel trading loans	Coal mining loans	LGFV loans
ABC	CNY300b (focus on developers with projects in tier-1 & tier-2 cities and with good cash flow positions	<CNY50b	NA	CNY300b with NPL ratio of 0.3%
BOC	CNY372b, with NPL ratio of 0.43%	<CNY30b with NPL ratio of >5%	NA	CNY342b with NPL ratio of 0.1%
BOCOM	CNY210b with NPL ratio of 0.17% (focus on 1st-2nd tier cities)	CNY4b with NPL ratio of 30%	CNY98b with NPL ratio of 0.85%	CNY200b with close to 0% NPL ratio and most of the loans will be swapped into bonds.
BOCQ	6% of total loans (prudent selection in borrowers)	<1% of total loans	4-5% of total loans	CNY10b with 0% NPL. Most loans will be swapped into bonds.
CCB	Target loan growth of CNY30b in 2015. NPL ratio is lower than overall NPL ratio of CCB	CNY20b with limited new NPLs	Outstanding balance of CNY200b with NPL ratio of >3% in 2Q15	CNY300b with limited NPL ratio. May not need to swap the loans into bonds as most bonds are offered to the public.
CMB	~5% of total loans. Focuses on large developers in tier-1 cities	CNY20-30b (still cleaning up the portfolio)	NA	4% of total loans with 0% NPL ratio
CMSB	CNY110b with NPL ratio of 0.24%	CNY10b with NPL ratio of >10% but with limited new NPL formation	NA	CNY160b with 0% NPL ratio. Most of them are likely to be swapped into bonds
CNCB	<10% of total loans	CNY24b with NPL ratio of 15%	CNY60.6b with NPL ratio of 2.1%	CNY164b with 0% NPL ratio
CQRB	5-6% of total loans with limited NPLs	No exposures	Very limited exposures	CNY24b with 0% NPL. Need to negotiate with Chongqing government on bond swap.
HUSB	8-10% of total loans with limited NPLs	<CNY0.2b (gradually clearing these loans)	Not much exposures	<12% of total loans (on a gradual downtrend) & no NPLs. May not need to swap into bonds
ICBC	~CNY50b and have low NPL ratio of 0.81%	CNY34.3b with NPL ratio of 15.2%. Limited new NPL formation	NA	CNY440b with NPL ratio of 0.07%. May need to swap most of the matured loans with bonds

Source: Company data, Maybank Kim Eng

As encouraged by the regulators, the H-share banks remained very selective in real estate loans despite that the NPL ratio of these loans was lower than the banks' overall NPL ratio. The H-share banks focused on lending to the projects of leading property developers in tier-1 and tier-2 cities. With the recent relaxation in property measures (removal of property purchase restrictions and reduction in down-payment requirement for first-home mortgages in some cities), most banks believe that asset quality of these loans should remain sound in 2015.

Most H-share banks have gradually reduced their exposure to LGFV loans. Still, these loans have the best asset quality with an NPL ratio of close to 0% for most banks. This was mainly due to the high cash collateral coverage ratio of these loans. According to the Document 43 issued by the State Council, local governments may negotiate with banks and replace some of these loans with local government bonds. Although the H-share banks may refuse to replace their LGFV loans with local government bonds (due to a reduction in asset yield of ~250bps), they are willing to negotiate with local governments on a debt-to-bond swap agreement.

Most H-share banks believe that they will swap their LGFV loans into local government bonds. Still, this is unlikely to undermine their earnings as: (i) interest income from local government bonds is exempt from corporate tax; (ii) banks may request for more fiscal deposits (mainly demand deposits) from the local governments; (iii) local governments may refer quality project financing to banks; and (iv) the risk-weight will be reduced from 100% to 20-25% under the debt-to-bond swaps. Hence, the risk-weighted return of local government bonds should be higher than that of LGFV loans (14% vs 4.5%).

Q11. What is the outlook for credit costs?

Despite the continued rise in total NPLs, most H-share banks expect their credit cost in 2Q15 will be similar to the level in 1Q15. This was mainly due to: (i) the stabilization in gross new NPL formation rate; (ii) continued write-offs and disposal of some NPLs should result in a write-back in loan impairment allowances (150% provision coverage of NPLs); and (iii) excess loan loss provisions to weather further weakening in asset quality.

Figure 16: Outlook for credit costs

	Credit costs				
	3Q14	4Q14	1Q15	2014	Credit costs outlook in 2015
ABC	0.81	1.09	0.97	0.85	Credit cost in 2015 will be slightly higher than 2014; may stay at the level of 1Q15
BOC	0.54	0.37	0.64	0.58	Likely to stay at ~0.6%
BOCOM	0.73	0.46	0.62	0.61	Credit cost in 2015 may be similar to that in 2014
BOCQ*	na	na	1.31	0.74	Should be the level in 1Q15
CCB	0.69	0.93	0.80	0.66	Likely to normalize at around 70-80bps
CMB	0.93	1.49	1.98	1.33	Credit cost in 2015 will be higher than 2014 but it will be <2%
CMSB	1.38	1.52	1.38	1.18	May be higher than the level in 2014
CNCB	1.11	0.98	1.12	1.07	Credit cost in 2015 will be slightly higher than 2014
CQRB	0.89	0.77	0.68	0.82	Could be similar to the level of 1Q15
HUSB	na	na	na	0.47	Credit costs in 2015 may be slightly higher than 2014
ICBC	0.31	0.88	0.74	0.54	Credit cost in 2015 will be slightly higher than 2014

Source: Company data, Maybank Kim Eng

Looking ahead, most H-share banks expect their credit costs in 2015 could be similar or slightly higher than the level in 2014. This was partly due to some banks (including BOCOM, BOCQ, CMSB, CNCB and HUSB) needing to increase their provision-to-loan ratio to the regulatory minimum of 2.5%.

Still, with the expectation of stabilization in gross new NPL formation in 2015, most H-share banks believe their credit costs will likely to stabilize or even fall slightly in 2016.

Based on the company guidance and our downward revision in loan growth forecasts for some banks (which should lower the amount of collective loan impairment allowances), we lower our credit costs forecasts for most H-share banks. We raise our credit cost forecasts for BOCQ slightly as management intends to increase the provision-to-loan ratio more aggressively in 2015 (2.37% in Mar 2015 vs 2.19% in Dec 2014).

Figure 17: Change in credit cost forecasts for H-share banks

	Credit cost forecasts (previous)			Credit cost forecasts (new)			Change in forecasts		
	2015E	2016E	2017E	2015E	2016E	2017E	2015E	2016E	2017E
ABC	0.96%	0.87%	0.80%	0.92%	0.88%	0.81%	-3bps	1bps	1bps
BOC	0.67%	0.61%	0.56%	0.61%	0.60%	0.57%	-5bps	-2bps	0bps
BOCOM	1.05%	0.97%	0.90%	0.97%	0.99%	0.92%	-8bps	2bps	2bps
BOCQ	0.80%	0.71%	0.64%	1.09%	0.81%	0.71%	29bps	9bps	7bps
CCB	0.90%	0.82%	0.75%	0.82%	0.81%	0.76%	-8bps	-1bps	1bps
CMB	1.82%	1.63%	1.51%	1.75%	1.66%	1.56%	-6bps	3bps	5bps
CMSB	1.45%	1.34%	1.32%	1.42%	1.37%	1.36%	-3bps	3bps	4bps
CNCB	1.14%	0.95%	0.90%	1.10%	0.97%	0.92%	-4bps	2bps	2bps
CQRB	0.81%	0.70%	0.64%	0.81%	0.70%	0.64%	0bps	0bps	0bps
HUSB	0.65%	0.59%	0.57%	0.65%	0.59%	0.57%	0bps	0bps	0bps
ICBC	0.75%	0.69%	0.66%	0.71%	0.70%	0.67%	-3bps	0bps	1bps

Source: Company data, Maybank Kim Eng

Q12. What will be the exposures to shadow bank assets?

The banking regulators launched new regulations on "Lending and placement to banks and financial institutions (including reverse repo agreements)" (Document no. 127 & 140) in May 2014. The new rules will mainly include: (i) for reverse repo or repo agreements, the borrowers will not be allowed to transfer the assets pledged to the borrowings to the lenders; (ii) total amount of borrowings from banks and non-bank financial institutions (including repo agreements) should not be more than one-third of the total liabilities of the borrowers; (iii) banks have to make adequate risk-weight (100% for shadow bank assets) and provisions for their exposures to shadow bank assets (1% on new balances after May 2014).

Large H-share banks had limited exposures to shadow bank assets in previous years and they have no intention to increase their holdings in these assets. Other H-share banks indicate that they have aggressively reduced the reverse repo transactions which are collateralized by shadow bank assets. Some indicate they will continue to invest in asset management plans issued by asset management companies. Part of the investment portfolio of these plans could be related shadow bank assets. Still, these banks will strike a balance between higher asset yield and additional impairment & capital charges in holding these assets.

Figure 18: Trend of shadow bank assets in 2015

	Trend of shadow bank assets in 2015
ABC	Limited exposures in shadow bank assets
BOC	Gradually reduced those reverse REPO which are collateralized by shadow bank assets & direct investment in shadow bank assets
BOCOM	Gradually reduced those reverse REPO which are collateralized by shadow bank assets
BOCQ	Amount of shadow bank assets may remain stable given low LDR
CCB	Limited exposures in shadow bank assets for CCB and CCB Life
CMB	Gradually reduced those reverse REPO which are collateralized by shadow bank assets
CMSB	Gradually reduced those reverse REPO which are collateralized by shadow bank assets
CNCB	May have no intention to reduce reverse repo as it needs to match the maturity of its interbank borrowings
CQRB	Gradually reduced those reverse REPO which are collateralized by shadow bank assets
HUSB	Gradually reduced those reverse REPO which are collateralized by shadow bank assets
ICBC	Limited exposures with some investment in the asset management plans of brokers & asset management companies

Source: Company data, Maybank Kim Eng

No imminent core capital replenishment plan

Most small-to-medium sized H-share banks replenished their equity capital in 1H15. We estimate that this will enhance their CET1 CAR by 0.19-2.5ppts. No other banks have equity capital replenishment in 2H15. Meanwhile, most large-to-medium sized H-share banks will complete the issue of preference shares in 2015. We estimate this will enhance their tier-1 CAR by 0.5-1.4ppts. Most banks indicate they have no imminent plan of mixed ownership reform except for the consideration of employee stock ownership scheme.

Large H-share banks have lowered their dividend payout ratio from 35% in 2013 to 32-33% in 2014. We believe this is to pave way for the payment of preference share dividends in 2015. All H-share banks expect to maintain a stable dividend payout policy (30-35% for most banks) for 2015. CMSB will maintain a lower dividend payout ratio than peers at ~15-20% for 2015.

Q13. Are there any imminent capital replenishment plans? Any plan for mixed ownership reform?

The minimum CET1 CAR, tier-1 CAR and total CAR requirement for small China banks should be 7.5%, 8.5% and 10.5% respectively by end-Dec 2018. For domestic systemically important banks (BOCOM, CCB and CMB), the minimum CET1 CAR, tier-1 CAR and total CAR requirement should be 8.5%, 9.5% and 11.5% by end-Dec 2018. For ABC, BOC and ICBC, which are classified as global systemically important banks, a 1.5ppt additional countercyclical buffer will be required. Hence, their minimum CET1 CAR requirement should be 10% by end-Dec 2018.

Figure 19: Capital adequacy ratio, capital replenishment plan and mixed ownership reform

	CET1 CAR			Tier-1 CAR				
	Dec-14	Mar-15	2015F	Dec-14	Mar-15	2015F	Capital replenishment plan in 2015	Plans on mixed ownership reform
ABC	9.1	9.4	9.7	9.5	10.1	10.3	May be under pressure to replenish equity capital as its CET1 CAR is lower than peers	No imminent plan
BOC	10.6	10.9	10.9	11.3	11.9	11.8	No more capital replenishment plan in 2H15	May consider employee stock ownership scheme
BOCOM	11.3	11.2	11.2	11.3	11.2	12.5	To complete the issue of preference shares in 2H15	Has a well-diversified ownership
BOCQ*	9.6	9.9	11.7	9.6	9.9	11.7	Equity capital replenishment of HKD6.15b. May consider issuing preference shares in 2016	May consider employee stock ownership scheme
CCB	12.1	12.5	12.1	12.1	12.5	12.9	No capital replenishment plan	No imminent plan
CMB	10.4	10.6	10.8	10.4	10.6	10.8	Equity capital replenishment of CNY6b from employee stock ownership scheme	No imminent plan
CMSB	8.6	8.8	9.2	8.6	8.8	10.1	Converting CNY20b CBs into ordinary shares & addition of CNY8b equity capital from employee stock ownership scheme	No imminent plan
CNCB	8.9	9.0	9.2	8.9	9.0	10.4	Equity capital replenishment of CNY12b. The issue of preference shares of CNY35b	No imminent plan
CQRB	10.1	10.0	9.6	10.1	10.0	9.6	No capital replenishment plan	Has a well-diversified ownership
HUSB	11.5	na	10.6	11.5	na	10.6	No capital replenishment plan	Has a well-diversified ownership
ICBC	11.9	12.2	11.8	11.9	12.2	11.8	Issue of another CNY45b preference shares. No plan for equity capital replenishment	No imminent plan

Source: Company data, Maybank Kim Eng

With steady loan growth, healthy net fees growth, tight cost control and slight rise in credit costs, most H-share banks saw further improvement in their CET1 CAR in 1Q15. Still, the medium-to-small-sized H-share banks have lower CET1 CAR than large banks. As such, some banks (including BOCQ, CMB, CMSB and CNCB) have replenished their equity capital in 1H15. Both BOCQ and CNCB have engaged in private share placements, raising a total of HKD6.15b and CNY12b respectively. We estimate that this should help increase their CET1 CAR by 2.5ppts and 0.37ppt. Both CMB and CMSB have engaged in employee stock ownership scheme, raising total equity of CNY6b and CNY8b. CMSB also had some CNY20b of its convertible bonds being converted into equity capital. We estimate these should raise the CET1 CAR of CMB and CMSB by 0.19ppt and 0.83ppt. None of the other H-share banks have equity capital replenishment in 2H15.

Meanwhile, most large-to-medium sized banks (including ABC, BOC, BOCOM, CCB, CMSB and CNCB) should complete the issue of conditional convertible preference shares in 2015. These will be classified as AT1 capital under the Basel III rules. We estimate that the new AT1 capital will help raise the tier-1 CAR of these banks by 0.5-1.4ppts. Among other H-share banks, BOCQ may consider issuing preference shares in 2016 subject to the approval of regulators.

According to media reports, management of BOCOM has intention to engage in mixed ownership reform. Based on our discussion with the management, the reform does not necessarily imply a substantial change in current shareholding structure as BOCOM already had a well-diversified shareholding structure. Rather, the reform will focus on the implementation of employee stock ownership scheme and the modification of board structure (i.e. separate the board into different committees to handle different issues of BOCOM). Most of the other H-share banks also indicated they have no imminent plan for mixed ownership reform as they have a well-diversified ownership structure. Still, some banks may be interested in implementing employee stock ownership scheme.

Q14. What will be the outlook for dividend policy?

The large H-share banks have reduced the dividend payout ratio slightly from ~35% in 2013 to ~32-33% in 2014. This was partly due to the strengthening of their equity capital positions. However, we believe that they also pave way for the payment of preference share dividends in 2015. We estimate that the preference share dividends will account for about 1.5-3.5% of our net profit forecast for large H-share banks in 2015.

As the CET1 CAR of most H-share banks will remain stable or improve slightly in 2015, all banks expect a stable dividend payout ratio for 2015, similar to the level in 2014. In other words, most H-share banks should be able to maintain a dividend payout ratio of 30-33% in 2015. BOCQ and CMSB will maintain a lower dividend payout ratio of ≥26% and ~15-20% respectively in 2015. CNCB stopped paying dividends for 2014. This is mainly to facilitate the completion of its private share placement (CNY12b) in 1H15. Management indicates it will resume a dividend payout ratio of 25-30% for 2015.

Figure 20: Dividend payout ratio & outlook for dividend policy

	2013 dividend payout	2014 dividend payout	2015 dividend policy outlook
ABC	34.6%	32.9%	Maintain at the level in 2014
BOC	34.9%	32.3%	Stay at the level of 2014
BOCOM	31.0%	30.4%	Maintain at ~30%
BOCQ	26.0%	26.0%	>26%
CCB	34.9%	33.0%	Maintain at the level in 2014
CMB	30.2%	30.2%	~30%
CMSB	17.3%	14.2%	15-20%
CNCB	30.1%	-	May return to 25-30%
CQRB	29.5%	27.4%	~27-30%
HUSB	35.0%	31.0%	Stable dividend policy
ICBC	35.0%	33.0%	Stay at the level of 2014

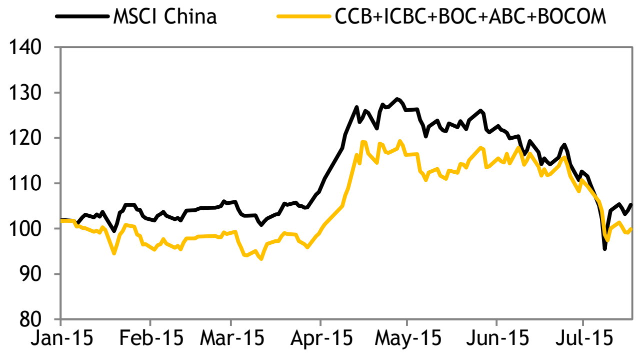
Source: Company data, Maybank Kim Eng

Valuations and recommendations

China banks outperformed the market in recent weeks

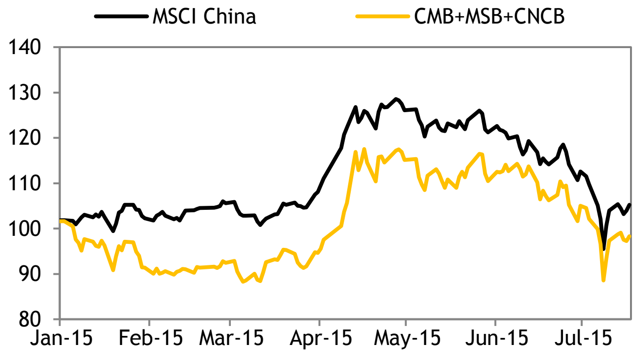
The share prices of H-share banks have largely moved in line with the MSCI China index since the beginning of 2015. Most large H-share banks have performed mostly in line with the market, while small-sized banks have outperformed the market slightly during this period. This could be related to the better-than-expected 1Q15 results by the small-sized H-share banks. Besides, small city and rural commercial banks have benefited from the PBOC's selective RRR cut.

Figure 21: Relative performance of state-owned H-share Banks* against MSCI China index



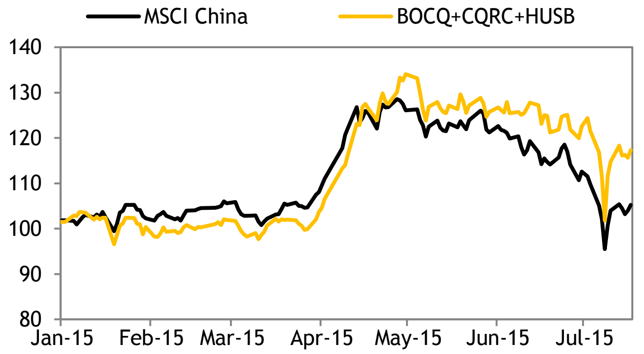
*Source: Bloomberg, Maybank Kim Eng *Simple average of share performance*

Figure 22: Relative performance of middle H-share banks* against MSCI China index



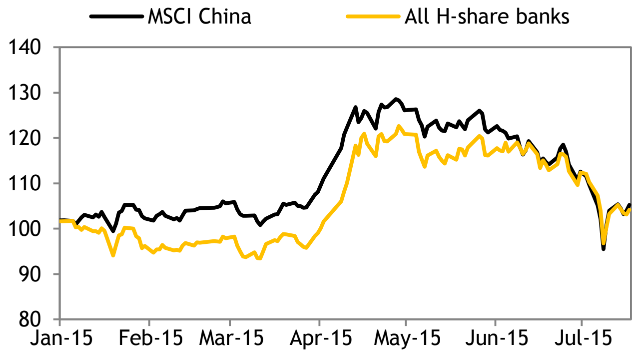
*Source: Bloomberg, Maybank Kim Eng *Simple average of share performance*

Figure 23: Relative performance of small H-share banks* against MSCI China index



*Source: Bloomberg, Maybank Kim Eng *Simple average of share performance*

Figure 24: Relative performance of all H-share banks* against MSCI China index



*Source: Bloomberg, Maybank Kim Eng *Simple average of share performance*

Meanwhile, despite consolidation of the A-share market in recent weeks, the share prices of H-share banks have outperformed the MSCI China index since end-May 2015. The market may have taken the view that recent government measures to stabilize the stock market should put more emphasis on the big-cap blue chips (mainly China banks). Besides, the market also realized that the potential default in margin financing is unlikely to generate systematic credit risks to China banks. As mentioned, most H-share banks have no exposure to margin financing, nor had they sold umbrella trusts during 2Q15. They also had limited working-capital loans extended to mainland brokers.

Consensus forecasts for 2016 remain bearish

Based on our latest company visits, we have changed the following assumptions in our earnings models for H-share banks:

- Lowered our 2015 loan growth forecast for medium- to large-sized banks from 11-17% to 10-13%.
- Raised our 2015 net fees growth forecast for small- to medium-sized banks from 14-35% to ~20-50%.
- Lowered our credit-cost assumptions by 1-8bps for most H-share banks due to a reduction in collective loan impairment allowances.
- Factored in the dilution effect of BOCQ and CMSB's capital replenishment.

With the exception of CCB, we expect limited rise in EPS for large H-share banks for 2015. This is mainly due to slight NIM narrowing, mild rise in credit costs and the dilution effect from payment of preference share dividends. We forecast CCB's 2015 EPS to grow 7% YoY. With the exception of CMSB, we forecast 2015 EPS growth of 1-25% YoY for small- to medium-sized H-share banks. Strong growth in net fees should more than offset the NIM pressure and rise in credit costs. Among them, we expect CQRB to see EPS growth of 25% YoY in 2015 given strong loan and net fees growth, and stable credit costs. Meanwhile, we forecast 14% YoY decline in EPS for CMSB in 2015, mainly due to the dilution effect of its capital replenishment.

As mentioned, most banks believe the full deregulation of deposit rates should have a limited impact on their NIM. This should reduce their NIM pressure in 2016. Besides, most banks expect gross new NPL formation to stabilize in 2015. This should stabilize or trim their credit costs in 2016. As such, we expect a strong rebound in EPS of H-share banks of 8-22% YoY for 2016.

Figure 25: Changes in target prices, earnings & EPS forecasts for H-share banks

	Target price (HKD)			Net profit forecasts (Previous; CNYm)			Net profit forecasts (New; CNYm)			Change in forecasts			EPS (Previous; CNY)			EPS (New; CNY)			Change in forecasts		
	Previous	New	Change	2015F	2016F	2017F	2015F	2016F	2017F	2015F	2016F	2017F	2015F	2016F	2017F	2015F	2016F	2017F	2015F	2016F	2017F
ABC	5.10	4.70	-7.8%	188,094	212,539	235,962	185,608	205,342	227,884	-1.3%	-3.4%	-3.4%	0.58	0.65	0.73	0.57	0.63	0.70	-1.3%	-3.4%	-3.4%
BOC	5.60	4.80	-14.3%	169,301	189,673	212,645	168,927	186,341	207,195	-0.2%	-1.8%	-2.6%	0.59	0.66	0.74	0.59	0.65	0.72	-0.2%	-1.8%	-2.6%
BOCOM	7.50	7.10	-5.3%	57,607	63,906	72,557	61,660	66,524	76,043	7.0%	4.1%	4.8%	0.78	0.86	0.98	0.83	0.90	1.02	7.0%	4.1%	4.8%
BOCQ	9.10	8.85	-2.8%	3,191	3,820	4,377	3,135	4,251	5,026	-1.7%	11.3%	14.8%	1.18	1.41	1.62	1.05	1.21	1.43	-10.7%	-14.3%	-11.6%
CCB	9.35	7.80	-16.5%	239,060	275,730	310,210	243,204	269,934	299,183	1.7%	-2.1%	-3.6%	0.96	1.10	1.24	0.97	1.08	1.20	1.7%	-2.1%	-3.6%
CMB	21.15	20.10	-5.0%	63,717	81,392	97,452	63,900	77,823	91,791	0.3%	-4.4%	-5.8%	2.52	3.17	3.80	2.52	3.03	3.58	0.3%	-4.4%	-5.8%
CMSB	9.80	8.05	-17.9%	41,401	48,176	53,436	42,555	50,023	56,739	2.8%	3.8%	6.2%	1.16	1.35	1.50	1.12	1.32	1.49	-3.9%	-2.9%	-0.7%
CNCB	6.85	6.00	-12.4%	42,087	51,343	60,049	43,704	51,193	59,642	3.8%	-0.3%	-0.7%	0.85	1.04	1.22	0.89	1.04	1.21	3.8%	-0.3%	-0.7%
CQRB	8.30	8.40	1.2%	8,295	10,063	11,528	8,493	10,353	12,136	2.4%	2.9%	5.3%	0.89	1.08	1.24	0.91	1.11	1.31	2.4%	2.9%	5.3%
HUSB	3.96	4.40	11.1%	6,229	7,495	8,663	6,339	7,702	9,017	1.8%	2.8%	4.1%	0.56	0.68	0.78	0.57	0.70	0.82	1.8%	2.8%	4.1%
ICBC	6.60	6.10	-7.6%	272,506	303,577	340,135	274,362	300,225	335,433	0.7%	-1.1%	-1.4%	0.77	0.86	0.96	0.78	0.85	0.95	0.7%	-1.1%	-1.4%

Source: Bloomberg, Maybank Kim Eng

Our 2016F EPS forecasts for most H-share banks are higher than Bloomberg consensus forecasts. We believe the market remains skeptical about the chances of mild NIM pressure and potential stabilization of credit costs of China banks in 2016. We thus see high chance for the Street to revise up 2016F earnings forecasts for H-share banks in the coming months.

Figure 26: Kim Eng forecasts vs. Bloomberg consensus forecasts of H-share banks

	Kim Eng net profit forecasts (CNYb)		Bloomberg consensus net profit forecasts (CNYb)		Kim Eng EPS forecasts (HKD)		Bloomberg consensus EPS forecasts (HKD)		Bloomberg stock-rating (Number of)			Kim Eng	Target price (HKD)	
	2015F	2016F	2015F	2016F	2015F	2016F	2015F	2016F	BUY	HOLD	SELL	rating	Bloomberg	Kim Eng
ABC	185,608	205,342	184,377	193,170	0.57	0.63	0.57	0.60	22	10	2	BUY	4.87	4.70
BOC	168,927	186,341	174,772	184,381	0.59	0.65	0.60	0.63	26	6	1	HOLD	5.96	4.80
BOCOM	61,660	66,524	65,162	67,329	0.83	0.90	0.88	0.89	13	11	7	HOLD	8.23	7.10
BOCQ	3,135	4,251	3,204	3,597	1.05	1.21	1.14	1.27	6	4	2	BUY	8.47	8.85
CCB	243,204	269,934	234,024	244,983	0.97	1.08	0.93	0.98	28	5	1	BUY	8.89	7.80
CMB	63,900	77,823	61,620	68,778	2.52	3.03	2.43	2.71	20	9	4	HOLD	25.30	20.10
CMSB	42,555	50,023	46,330	49,688	1.12	1.32	1.34	1.43	14	9	8	SELL	11.43	8.05
CNCB	43,704	51,193	42,159	45,799	0.89	1.04	0.88	0.94	13	10	6	HOLD	7.20	6.00
CQRB	8,493	10,353	7,472	8,330	0.91	1.11	0.81	0.90	17	4	4	BUY	7.34	8.40
HUSB	6,339	7,702	6,038	6,509	0.57	0.70	0.54	0.58	5	6	2	BUY	4.51	4.40
ICBC	274,362	300,225	278,930	292,646	0.78	0.85	0.79	0.82	28	5	-	HOLD	7.79	6.10

Source: Bloomberg, Maybank Kim Eng

Maintain OVERWEIGHT

We have adopted the Gordon Growth Model (GGM), which captures a bank's long-term growth potential, to estimate the fair value of the H-share banks. We use the CAPM to estimate the cost of equity of each stock. However, based on Bloomberg estimate, the risk-free rate in China has increased from 1.9% to 2.35% after the recent consolidation of the A-share market and the government measures to stabilize the stock market. The country's risk premium remained rather stable at ~9%.

Based on our revised earnings forecasts (and hence the revised long-term sustainable ROE) for H-share banks and the higher cost of equity, we derived a slightly lower target price for most of the H-share banks under our universe. We also compared the fair value derived from our model with each bank's own historical ROE, PER and P/BV bands (during 2005-14) to check whether the TP is at a reasonable trading range.

Figure 27: Current valuations vs historical valuations of H-share banks

	Share	2005-2014															Projected
	price	PER (x)			P/BV (x)			ROE (%)			2015F			2016F			long-term
	22-Jul-15	Max	Avg	Min	Max	Avg	Min	Max	Avg	Min	PER (x)	P/B (x)	ROE (%)	PER (x)	P/B (x)	ROE (%)	ROE (%)
ABC	3.64	12.3	7.2	4.7	2.4	1.4	0.9	21.4	20.8	20.5	5.2	0.9	17.6	4.9	0.8	17.3	16.0
BOC	4.44	16.6	7.6	3.5	2.0	1.1	0.6	18.2	15.9	14.0	6.2	0.9	15.0	5.8	0.8	14.9	14.3
BOCOM	7.15	31.4	11.5	4.2	4.5	1.8	0.6	20.9	17.9	14.1	7.0	0.9	12.5	6.7	0.8	12.4	12.5
BOCQ	7.19	5.4	4.5	4.0	1.0	0.8	0.7	42.3	24.3	21.4	5.5	0.9	16.0	5.0	0.8	17.2	16.8
CCB	6.50	28.0	11.0	4.5	4.6	2.0	0.9	22.4	20.2	15.0	5.4	1.0	18.4	5.0	0.9	18.0	16.0
CMB	21.00	36.3	12.8	4.2	7.7	2.7	0.9	28.2	23.1	21.2	6.8	1.2	18.8	5.8	1.1	19.8	17.0
CMSB	8.99	11.2	5.8	3.1	1.7	1.1	0.6	25.7	20.2	15.2	6.5	0.9	15.6	5.7	0.8	15.3	14.5
CNCB	5.81	39.4	9.8	3.4	4.5	1.3	0.6	20.9	16.4	12.9	5.3	0.8	15.6	4.7	0.7	16.0	13.5
CQRB	6.01	12.1	6.0	3.7	2.1	1.0	0.6	17.9	18.7	16.9	5.3	1.0	19.1	4.5	0.9	20.2	19.3
HUSB	3.69	5.5	5.0	4.8	1.0	0.9	0.8	44.3	19.6	14.2	5.2	0.8	16.4	4.4	0.8	17.7	16.3
ICBC	5.57	29.6	11.3	4.6	4.4	2.0	0.9	23.4	19.4	16.2	5.8	1.0	17.3	5.5	0.9	16.9	14.8

Source: Bloomberg, company data, Maybank Kim Eng

Among H-share banks, we expect BOC, CCB, CNCB, CQRB and HUSB will have higher long-term ROE than historical trough level. However, most of them are trading at a 2016F P/BV close to their historical trough value.

Meanwhile, even under our conservative assumptions on asset quality, the valuation for all H-share banks (in terms of 2016F PER) remain cheaper than their Asian peers, implying they should be the preferred choice for investors within the region.

Figure 28: ROE and valuation comparison of Asian banks* (based on share price on 22 Jul 2015)

		ROE (%)			P/E (x)			P/B (x)		
Stock code	Name	2014	2015F	2016F	2014	2015F	2016F	2014	2015F	2016F
1288 HK	ABC	19.6	17.6	17.3	5.2	5.2	4.9	1.0	0.9	0.8
3988 HK	BOC	17.0	15.0	14.9	6.0	6.2	5.8	1.0	0.9	0.8
3328 HK	BOCOM	14.8	12.5	12.4	6.4	7.0	6.7	0.9	0.9	0.8
1963 HK	BOCQ	19.2	16.0	17.2	5.5	5.5	5.0	1.0	0.9	0.8
939 HK	CCB	19.7	18.4	18.0	5.7	5.4	5.0	1.0	1.0	0.9
3968 HK	CMB	19.3	18.8	19.8	7.5	6.8	5.8	1.3	1.2	1.1
1988 HK	CMSB	20.3	15.6	15.3	5.5	6.5	5.7	1.0	0.9	0.8
998 HK	CNCB	16.8	15.6	16.0	5.3	5.3	4.7	0.8	0.8	0.7
3618 HK	CQRB	17.5	19.1	20.2	6.5	5.3	4.5	1.1	1.0	0.9
3698 HK	HUSB	16.7	16.4	17.7	5.7	5.2	4.4	0.9	0.8	0.8
1398 HK	ICBC	19.9	17.3	16.9	5.7	5.8	5.5	1.1	1.0	0.9
5 HK	HSBC	7.0	8.1	8.9	13.0	11.1	9.8	0.9	0.9	0.9
2888 HK	SCB	5.4	7.4	8.5	15.5	11.2	9.5	0.8	0.8	0.8
11 HK	HSB	12.3	18.2	12.2	19.6	11.1	15.7	2.1	1.9	1.9
23 HK	BEA	9.6	8.5	8.8	12.1	12.8	11.8	1.1	1.1	1.0
2388 HK	BOCHK	14.6	14.8	15.4	13.8	12.4	11.0	1.9	1.8	1.6
DBS SP	DBS	11.2	11.2	11.4	12.6	12.2	11.0	1.4	1.3	1.2
UOB SP	UOB	12.2	11.4	11.5	12.4	11.5	10.5	1.4	1.3	1.2
OCBC SP	OCBC	14.2	12.2	12.2	10.2	10.9	10.1	1.4	1.3	1.2
2891 TT	CTBC	18.7	13.7	13.1	8.0	11.0	10.4	1.4	1.4	1.3
2886 TT	Mega Financial	12.0	11.6	11.7	10.1	10.7	10.1	1.2	1.2	1.1
2892 TT	First Financial	9.6	9.4	9.7	12.3	11.7	11.0	1.1	1.1	1.0
May MK	Maybank	13.6	12.5	12.6	12.4	12.6	11.9	1.6	1.5	1.4
CIMB MK	CIMB	9.2	9.3	10.8	14.8	12.5	10.4	1.3	1.2	1.1
PBK MK	Public Bank	18.7	16.2	16.1	14.8	15.5	14.3	2.5	2.4	2.2
SCB TB	Siam Commercial	20.1	17.1	16.9	11.6	9.9	8.9	2.2	1.6	1.4
BBL TB	Bangkok Bank	11.7	10.5	10.8	10.2	9.1	8.4	1.1	0.9	0.9
CBA AU	Commonwealth Bank	18.3	18.3	17.8	15.2	15.7	15.2	2.7	2.8	2.6
WBC AU	Westpac Banking	15.9	15.7	15.2	13.2	14.0	13.6	2.1	2.1	2.0
8306 JP	Mitsubishi Financial	7.4	7.9	7.2	10.2	12.0	11.5	0.7	0.9	0.8
8316 JP	Sumitomo Financial	9.2	10.2	8.6	8.3	9.7	9.7	0.7	0.9	0.8
8411 JP	Mizuho Financial	8.6	9.1	7.9	8.5	10.8	10.6	0.7	0.9	0.8
055550 KS	Shinhan Financial	7.1	7.3	7.3	10.6	9.0	8.6	0.7	0.6	0.6
105560 KS	KB Financial	5.3	5.9	5.7	10.0	8.3	8.2	0.5	0.5	0.5
086790 KS	Hana Financial	4.5	5.4	5.4	10.1	7.1	6.9	0.4	0.4	0.4
BBCA IJ	Bank Central Asia	23.3	21.7	20.8	19.6	17.9	15.8	4.2	3.6	3.1
BBRI IJ	Bank Rakyat	27.4	24.0	22.9	11.9	9.8	8.7	2.9	2.2	1.8
BMRI IJ	Bank Mandiri Persero	20.9	19.6	19.2	12.7	10.9	9.6	2.4	2.0	1.7
ICICIBC IN	ICICI	15.2	15.7	17.0	14.9	16.3	14.3	2.2	2.3	2.1
HDFCB IN	HDFC	19.9	20.3	17.6	23.2	26.5	22.0	4.1	4.6	3.9
SBIN IN	State Bank of India	11.0	11.2	11.8	11.7	14.7	12.2	1.2	1.6	1.4

*Source: Bloomberg, company data, Maybank Kim Eng   *Maybank Kim Eng estimates for China and HK banks; Bloomberg consensus estimates for banks in other regions*

We thus maintain **OVERWEIGHT** rating on China banks. This is based on the grounds of: (i) mild NIM pressure under the scenario of full interest rate deregulation; (ii) solid net fees growth given China banks are still at the initial stage of developing intermediary businesses; (iii) stable-to-slight decline in credit costs in 2016; and (iv) strong capital positions implying low chance of equity capital replenishment in 2016.

Key risks to our sector rating include: (i) sharp depreciation in RMB after the USD interest rate hikes which results in massive capital outflow from China; and (ii) collapse of the stock and property market which lead to significant economic downturn in China (and hence slower loan growth and higher credit costs of banks).

CCB and CQRB as top picks

We maintain our BUY rating for CCB as management foresees minimal NIM pressure in 2015 (given tight control on funding cost). Besides, CCB should see gradual revival of its net fees, driven by electronic banking, bank cards and wealth management businesses. Management also expects the normalized credit costs should stay at 70-80bps, lower than 0.93% in 4Q14.

Among small banks, we like CQRB the most. We believe the bank will continue to benefit from strong loan growth, low-cost deposits from the county area and active exploration of new fee income opportunities. Moreover, high provision coverage and low NPL ratio should help sustain a lower-than-peers credit costs for CQRB.

Figure 29: Fair value and recommendation of H-share banks (based on share price on 22 Jul 2015)

		Share	Target		PER				EPS	P/B				Yield	ROE			
	Stock	Price	Price		2014	2015F	2016F	2017F	CAGR (%)	2014	2015F	2016F	2017F	2016F	2014	2015F	2016F	2017F
	Code	(HKD)	(HKD)	Rating	(x)	(x)	(x)	(x)	2014-17F	(x)	(x)	(x)	(x)	(%)	(%)	(%)	(%)	(%)
ABC	1288 HK	3.64	4.70	BUY	5.6	5.2	5.2	4.9	5.0	1.1	1.0	0.9	0.8	6.3	20.9	19.6	17.6	17.3
BOC	3988 HK	4.44	4.80	HOLD	6.3	6.0	6.2	5.8	2.8	1.0	1.0	0.9	0.8	5.2	17.9	17.0	15.0	14.9
BOCOM	3328 HK	7.15	7.10	HOLD	6.8	6.4	7.0	6.7	0.4	1.0	0.9	0.9	0.8	4.2	15.6	14.8	12.5	12.4
BOCQ	1963 HK	7.19	8.85	BUY	6.6	5.5	5.5	5.0	10.0	1.1	1.0	0.9	0.8	3.8	21.4	19.2	16.0	17.2
CCB	939 HK	6.50	7.80	BUY	6.0	5.7	5.4	5.0	6.0	1.2	1.0	1.0	0.9	6.1	21.4	19.7	18.4	18.0
CMB	3968 HK	21.00	20.10	HOLD	7.2	7.5	6.8	5.8	7.6	1.6	1.3	1.2	1.1	4.4	22.2	19.3	18.8	19.8
CMSB	1988 HK	8.99	8.05	SELL	5.7	5.5	6.5	5.7	0.1	1.2	1.0	0.9	0.8	2.2	23.4	20.3	15.6	15.3
CNCB	998 HK	5.81	6.00	HOLD	5.5	5.3	5.3	4.7	5.5	0.9	0.8	0.8	0.7	5.6	18.5	16.8	15.6	16.0
CQRB	3618 HK	6.01	8.40	BUY	7.4	6.5	5.3	4.5	17.9	1.2	1.1	1.0	0.9	5.1	17.6	17.5	19.1	20.2
HUSB	3698 HK	3.69	4.40	BUY	5.1	5.7	5.2	4.4	4.6	1.0	0.9	0.8	0.8	5.9	18.9	16.7	16.4	17.7
ICBC	1398 HK	5.57	6.10	HOLD	5.9	5.7	5.8	5.5	2.4	1.2	1.1	1.0	0.9	5.7	21.9	19.9	17.3	16.9

Source: Bloomberg, Maybank Kim Eng

Upgrade CMB to HOLD & HUSB to BUY

We upgrade CMB from SELL to HOLD as recent consolidation in its share price has already hit our target price. Besides, we believe the bank will continue to benefit from its solid net fees growth (mainly driven by credit cards, bancassurance and wealth management businesses). Recent capital replenishment from employee stock ownership scheme should also make it unnecessary to further replenish equity capital in 2016.

Meanwhile, we raise our EPS forecasts for HUSB by 2.8% and 4.1% for 2016 and 2017 respectively. This was mainly due to company guidance of limited NIM pressure, robust growth in net fees (mainly driven by bank cards, wealth management and investment banking businesses) and solid capital positions. Besides, management intends to extend its branch network to the county areas of Anhui province (which are currently under-covered by rural commercial banks). This should help to absorb low-cost demand deposits and allow it to explore new fee income opportunities in the medium term. We thus upgrade HUSB from HOLD to BUY.

Research Offices

REGIONAL

Sadiq CURRIMBHOY
Regional Head, Research & Economics
(65) 6231 5836 sadiq@maybank-ke.com.sg

WONG Chew Hann, CA
Regional Head of Institutional Research
(603) 2297 8686 wchewh@maybank-ib.com

ONG Seng Yeow
Regional Head of Retail Research
(65) 6432 1453
ongsengyeow@maybank-ke.com.sg

ECONOMICS

Suhaimi ILIAS
Chief Economist
Singapore | Malaysia
(603) 2297 8682 suhaimi_ilias@maybank-ib.com

Luz LORENZO
Philippines
(63) 2 849 8836
luz_lorenzo@maybank-atrke.com

Tim LEELAHAPHAN
Thailand
(66) 2658 6300 ext 1420
tim.l@maybank-ke.co.th

JUNIMAN
Chief Economist, BII
Indonesia
(62) 21 29228888 ext 29682
Juniman@bankbii.com

STRATEGY

Sadiq CURRIMBHOY
Global Strategist
(65) 6231 5836 sadiq@maybank-ke.com.sg

Willie CHAN
Hong Kong / Regional
(852) 2268 0631 williechan@kimeng.com.hk

MALAYSIA

WONG Chew Hann, CA *Head of Research*
(603) 2297 8686 wchewh@maybank-ib.com
• Strategy

Desmond CH'NG, ACA
(603) 2297 8680
desmond.chng@maybank-ib.com
• Banking & Finance

LIAW Thong Jung
(603) 2297 8688 tjliaw@maybank-ib.com
• Oil & Gas Services- Regional

ONG Chee Ting, CA
(603) 2297 8678 ct.ong@maybank-ib.com
• Plantations - Regional

Mohshin AZIZ
(603) 2297 8692 mohshin.aziz@maybank-ib.com
• Aviation - Regional • Petrochem

YIN Shao Yang, CPA
(603) 2297 8916 samuel.y@maybank-ib.com
• Gaming – Regional • Media

TAN Chi Wei, CFA
(603) 2297 8690 chiwei.t@maybank-ib.com
• Power • Telcos

WONG Wei Sum, CFA
(603) 2297 8679 weisum@maybank-ib.com
• Property

LEE Yen Ling
(603) 2297 8691 lee.yl@maybank-ib.com
• Building Materials • Glove • Ports • Shipping

CHAI Li Shin, CFA
(603) 2297 8684 lishin.c@maybank-ib.com
• Plantation • Construction & Infrastructure

Ivan YAP
(603) 2297 8612 ivan.yap@maybank-ib.com
• Automotive • Semiconductor • Technology

Kevin WONG
(603) 2082 6824 kevin.wong@maybank-ib.com
• REITs • Consumer Discretionary

LIEW Wei Han
(603) 2297 8676 weihan.l@maybank-ib.com
• Consumer Staples

LEE Cheng Hooi *Regional Chartist*
(603) 2297 8694
chenghooi.lee@maybank-ib.com

Tee Sze Chiah *Head of Retail Research*
(603) 2297 6858 szechiah.t@maybank-ib.com

Cheah Chong Ling
(603) 2297 8767 chongling.c@maybank-ib.com

HONG KONG / CHINA

Howard WONG *Head of Research*
(852) 2268 0648
howardwong@kimeng.com.hk
• Oil & Gas - *Regional*

Alexander LATZER
(852) 2268 0647
alexanderlatzer@kimeng.com.hk
• Metals & Mining – *Regional*

Benjamin HO
(852) 2268 0632 benjaminho@kimeng.com.hk
• Consumer & Auto

Jacqueline KO, CFA
(852) 2268 0633 jacquelineko@kimeng.com.hk
• Consumer Staples & Durables

Ka Leong LO, CFA
(852) 2268 0630 kllo@kimeng.com.hk
• Consumer Discretionary & Auto

Mitchell KIM
(852) 2268 0634 mitchellkim@kimeng.com.hk
• Internet & Telcos

Osbert TANG, CFA
(86) 21 5096 8370
osberttang@kimeng.com.hk
• Transport & Industrials

Ricky WK NG, CFA
(852) 2268 0689 rickyng@kimeng.com.hk
• Utilities & Renewable Energy

Steven ST CHAN
(852) 2268 0645 stevenchan@kimeng.com.hk
• Banking & Financials - *Regional*

Warren LAU
(852) 2268 0644
warrenlau@kimeng.com.hk
• Technology – *Regional*

INDIA

Jigar SHAH *Head of Research*
(91) 22 6623 2632 jigar@maybank-ke.co.in
• Oil & Gas • Automobile • Cement

Anubhav GUPTA
(91) 22 6623 2605 anubhav@maybank-ke.co.in
• Metal & Mining • Capital Goods • Property

Vishal MODI
(91) 22 6623 2607 vishal@maybank-ke.co.in
• Banking & Financials

Abhijeet KUNDU
(91) 22 6623 2628 abhijeet@maybank-ke.co.in
• Consumer

Neerav DALAL
(91) 22 6623 2606 neerav@maybank-ke.co.in
• Software Technology • Telcos

SINGAPORE

Gregory YAP
(65) 6231 5848 gyap@maybank-ke.com.sg
• SMID Caps
• Technology & Manufacturing • Telcos

YEAK Chee Keong, CFA
(65) 6231 5842
yeakcheekeong@maybank-ke.com.sg
• Offshore & Marine

Derrick HENG, CFA
(65) 6231 5843 derrickheng@maybank-ke.com.sg
• Transport • Property • REITs (Office)

Joshua TAN
(65) 6231 5850 joshuatan@maybank-ke.com.sg
• REITs (Retail, Industrial)

WEI Bin
(65) 6231 5844 weibin@maybank-ke.com.sg
• Commodity • Logistics • S-chips

John CHEONG
(65) 6231 5845 johncheong@maybank-ke.com.sg
• Small & Mid Caps • Healthcare

TRUONG Thanh Hang
(65) 6231 5847 hang.truong@maybank-ke.com.sg
• Small & Mid Caps

INDONESIA

Isnaputra ISKANDAR *Head of Research*
(62) 21 2557 1129
isnaputra.iskandar@maybank-ke.co.id
• Strategy • Metals & Mining • Cement

Rahmi MARINA
(62) 21 2557 1128
rahmi.marina@maybank-ke.co.id
• Banking & Finance

Aurellia SETIABUDI
(62) 21 2953 0785
aurellia.setiabudi@maybank-ke.co.id
• Property

Pandu ANUGRAH
(62) 21 2557 1137
pandu.anugrah@maybank-ke.co.id
• Infra • Construction • Transport• Telcos

Janni ASMAN
(62) 21 2953 0784
janni.asman@maybank-ke.co.id
• Cigarette • Healthcare • Retail

Adhi TASMIN
(62) 21 2557 1209
adhi.tasmin@maybank-ke.co.id
• Plantations

PHILIPPINES

Luz LORENZO *Head of Research*
(63) 2 849 8836
luz_lorenzo@maybank-atrke.com
• Strategy
• Utilities • Conglomerates • Telcos

Lovell SARREAL
(63) 2 849 8841
lovell_sarreal@maybank-atrke.com
• Consumer • Media • Cement

Rommel RODRIGO
(63) 2 849 8839
rommel_rodrigo@maybank-atrke.com
• Conglomerates • Property • Gaming
• Ports/ Logistics

Katherine TAN
(63) 2 849 8843
kat_tan@maybank-atrke.com
• Banks • Construction

Ramon ADVIENTO
(63) 2 849 8845
ramon_adviento@maybank-atrke.com
• Mining

Michael BENGSON
(63) 2 849 8840
michael_bengson@maybank-atrke.com
• Conglomerates

Jaclyn JIMENEZ
(63) 2 849 8842
jaclyn_jimenez@maybank-atrke.com
• Consumer

Arabelle MAGHIRANG
(63) 2 849 8838
arabelle_maghirang@maybank-atrke.com
• Banks

THAILAND

Maria LAPIZ *Head of Institutional Research*
Dir (66) 2257 0250 | (66) 2658 6300 ext 1399
Maria.L@maybank-ke.co.th
• Consumer • Materials • Ind. Estates

Sittichai DUANGRATTANACHAYA
(66) 2658 6300 ext 1393
Sittichai.D@maybank-ke.co.th
• Services Sector • Transport

Sukit UDOMSIRIKUL *Head of Retail Research*
(66) 2658 6300 ext 5090
Sukit.u@maybank-ke.co.th

Mayuree CHOWVIKRAN
(66) 2658 6300 ext 1440
mayuree.c@maybank-ke.co.th
• Strategy

Padon VANNARAT
(66) 2658 6300 ext 1450
Padon.v@maybank-ke.co.th
• Strategy

Surachai PRAMUALCHAROENKIT
(66) 2658 6300 ext 1470
Surachai.p@maybank-ke.co.th
• Auto • Conmat • Contractor • Steel

Suttatip PEERASUB
(66) 2658 6300 ext 1430
suttatip.p@maybank-ke.co.th
• Media • Commerce

Sutthichai KUMWORACHAI
(66) 2658 6300 ext 1400
sutthichai.k@maybank-ke.co.th
• Energy • Petrochem

Termporn TANTIVIVAT
(66) 2658 6300 ext 1520
termporn.t@maybank-ke.co.th
• Property

Jaroonpan WATTANAWONG
(66) 2658 6300 ext 1404
jaroonpan.w@maybank-ke.co.th
• Transportation • Small cap

VIETNAM

THAI Quang Trung, CFA, Deputy Manager, Institutional Research
(84) 8 44 555 888 x 8180
trung.thai@maybank-kimeng.com.vn
• Real Estate • Construction • Materials

Le Nguyen Nhat Chuyen
(84) 8 44 555 888 x 8082
chuyen.le@maybank-kimeng.com.vn
• Oil & Gas

NGUYEN Thi Ngan Tuyen, *Head of Retail Research*
(84) 8 44 555 888 x 8081
tuyen.nguyen@maybank-kimeng.com.vn
• Food & Beverage • Oil&Gas • Banking

TRINH Thi Ngoc Diep
(84) 4 44 555 888 x 8208
diep.trinh@maybank-kimeng.com.vn
• Technology • Utilities • Construction

PHAM Nhat Bich
(84) 8 44 555 888 x 8083
bich.pham@maybank-kimeng.com.vn
• Consumer • Manufacturing • Fishery

NGUYEN Thi Sony Tra Mi
(84) 8 44 555 888 x 8084
mi.nguyen@maybank-kimeng.com.vn
• Port operation • Pharmaceutical
• Food & Beverage

TRUONG Quang Binh
(84) 4 44 555 888 x 8087
binh.truong@maybank-kimeng.com.vn
• Rubber plantation • Tyres and Tubes • Oil&Gas

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Malaysia

Maybank Investment Bank Berhad
(A Participating Organisation of
Bursa Malaysia Securities Berhad)
33rd Floor, Menara Maybank,
100 Jalan Tun Perak,
50050 Kuala Lumpur
Tel: (603) 2059 1888;
Fax: (603) 2078 4194

Stockbroking Business:
Level 8, Tower C, Dataran Maybank,
No.1, Jalan Maarof
59000 Kuala Lumpur
Tel: (603) 2297 8888
Fax: (603) 2282 5136

Singapore

Maybank Kim Eng Securities Pte Ltd
Maybank Kim Eng Research Pte Ltd
50 North Canal Road
Singapore 059304

Tel: (65) 6336 9090

London

Maybank Kim Eng Securities (London) Ltd
5th Floor, Aldermary House
10-15 Queen Street
London EC4N 1TX, UK

Tel: (44) 20 7332 0221
Fax: (44) 20 7332 0302

New York

Maybank Kim Eng Securities USA Inc
777 Third Avenue, 21st Floor
New York, NY 10017, U.S.A.

Tel: (212) 688 8886
Fax: (212) 688 3500

Hong Kong

Kim Eng Securities (HK) Ltd
Level 30,
Three Pacific Place,
1 Queen's Road East,
Hong Kong

Tel: (852) 2268 0800
Fax: (852) 2877 0104

Indonesia

PT Maybank Kim Eng Securities
Plaza Bapindo
Citibank Tower 17th Floor
Jl Jend. Sudirman Kav. 54-55
Jakarta 12190, Indonesia

Tel: (62) 21 2557 1188
Fax: (62) 21 2557 1189

India

Kim Eng Securities India Pvt Ltd
2nd Floor, The International 16,
Maharishi Karve Road,
Churchgate Station,
Mumbai City - 400 020, India

Tel: (91) 22 6623 2600
Fax: (91) 22 6623 2604

Philippines

Maybank ATR Kim Eng Securities Inc.
17/F, Tower One & Exchange Plaza
Ayala Triangle, Ayala Avenue
Makati City, Philippines 1200

Tel: (63) 2 849 8888
Fax: (63) 2 848 5738

Thailand

Maybank Kim Eng Securities (Thailand) Public Company Limited
999/9 The Offices at Central World,
20th - 21st Floor,
Rama 1 Road Pathumwan,
Bangkok 10330, Thailand

Tel: (66) 2 658 6817 (sales)
Tel: (66) 2 658 6801 (research)

Vietnam

Maybank Kim Eng Securities Limited
4A-15+16 Floor Vincom Center Dong
Khoi, 72 Le Thanh Ton St. District 1
Ho Chi Minh City, Vietnam

Tel : (84) 844 555 888
Fax : (84) 8 38 271 030

Saudi Arabia

In association with
Anfaal Capital
Villa 47, Tujjar Jeddah
Prince Mohammed bin Abdulaziz
Street P.O. Box 126575
Jeddah 21352

Tel: (966) 2 6068686
Fax: (966) 26068787

South Asia Sales Trading

Kevin Foy
Regional Head Sales Trading
kevinfoy@maybank-ke.com.sg
Tel: (65) 6336-5157
US Toll Free: 1-866-406-7447

Malaysia

Rommel Jacob
rommeljacob@maybank-ib.com
Tel: (603) 2717 5152

Indonesia

Harianto Liong
harianto.liong@maybank-ke.co.id
Tel: (62) 21 2557 1177

New York

Andrew Dacey
adacey@maybank-keusa.com
Tel: (212) 688 2956

Vietnam

Tien Nguyen
thuytien.nguyen@maybank-kimeng.com.vn
Tel: (84) 44 555 888 x8079

North Asia Sales Trading

Andrew Lee
andrewlee@kimeng.com.hk
Tel: (852) 2268 0283
US Toll Free: 1 877 837 7635

Thailand

Tanasak Krishnasreni
Tanasak.K@maybank-ke.co.th
Tel: (66)2 658 6820

India

Manish Modi
manish@maybank-ke.co.in
Tel: (91)-22-6623-2601

Philippines

Keith Roy
keith_roy@maybank-atrke.com
Tel: (63) 2 848-5288

www.maybank-ke.com | www.maybank-keresearch.com