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**Asia Pacific
Financial services**

**UWT Asian Banks
vs Asian Markets**

Overweight

Indonesia
Thailand
Malaysia
Philippines
Singapore
Korea

Underweight

China
Hong Kong
India
Australia
Japan
Taiwan

STAN - OPF
HSBC - UPF

Convergence

China's bank valuations were high post listing, but have de-rated for years. This is despite their relatively good financial statements, including ROE and ROA. We are beginning to believe that the state bank valuations in India may be the comparable model. They are both operating in high growth economies with similar ROEs, but China is 50% more expensive on market capitalisation to assets. Also, we note that in terms of market capitalisation to GDP, China is nearly double the level vs India's banks. They are converging in PB, maybe market capitalisation is next?

Market value to GDP

- Before China banks had H share listings, they had A share listings
- Their combined market value/GDP averaged 0.8% for the years 2000-1H05
- Immediately after H share listing this rose to 24%; and since came down to 15%
- This is interesting, as the pre H share listing valuations are similar to India banks
- India's banks are valued at 8% to GDP which may be telling us something on China

Convergence of PB

- India's PSU banks have ROEs not too different than China's banks at nearly 20%
- Yet India's PSU banks, trade at low valuations, at 0.8x PB and 5.0x PE
- The numbers for China's banks are identical, on 0.9x PB and 5.0x PE
- Over five years, CCB and SBI have been converging on price/book
- Risk remains on convergence to other metrics, as well

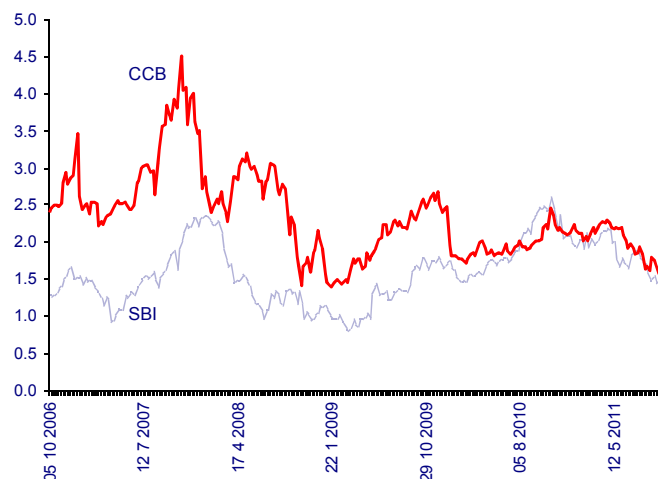
ROE and LLP volatility

- India's PSU banks averaged 15.9% ROE for years with 2.5% standard deviation
- Credit costs for India's PSU banks averaged 1.4% with 0.5% standard deviation
- The critical question here is if it is possible for China's banks to see these trends
- Indeed we have just raised our LLP estimates from 60bps to 80bps; more to come?
- At 120bps LLP/loans China's banks ROEs fall to 14.8% from 18.8% - not impossible

Dividends

- For India's state banks dividend payout averaged 21% for the past 15 years
- Our new China bank estimates now have payout falling a lot, to 24% by 12CL
- This is a meaningful decline in of itself from 31% 11CL, and is far lower than past
- This is also likely a driver of China bank values as they move to India PSU payout

CCB and SBI price to book ratio



Source: CLSA Asia-Pacific Markets, Datastream

Convergence

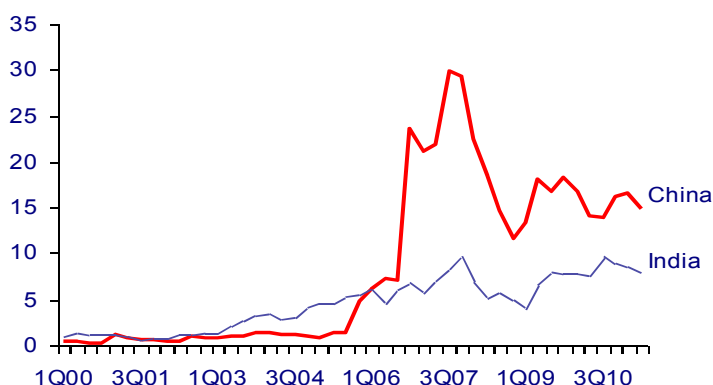
Maybe the high valuations of the China banks was just a short lived anomaly post their H-share listing. Their valuations and performance are certainly at odds with stated financials. There are many similarities to India's PSU banks, which can give us insights on to possible future valuations and stock price drivers.

Market value to GDP

Banks were not always as important to GDP in China as they are today. Before the H-share listings, their value to GDP was for many years about 1% compared with now at 15%. There are similarities here with India banks, where market value for more than 10 years averaged just over 4% and indeed figures were 1% from 2000-2002. The euphoria of the H-share listings has waned and/or they are now moving to where they should have been in the first place, like India's banks. The implications are for further downside.

Figure 1

China vs India – Market capitalisation to GDP (%)



Source: CLSA Asia-Pacific Markets, Datastream

Convergence of PB

On the cover chart we show how CCB and SBI are converging in terms of PB. This is also the case on PE, where both are at 5x on 12CL. Where China's state banks report aggregate 19% ROEs, this is similar to India's state banks on 17% ROE. When we look at market capitalisation to assets for these banks, there remains a significant variance. China's banks are on 7% with India's PSU banks on 5%. Downside risks remain significant for China banks.

Figure 2

Market capitalisation to assets for lowest five countries in Asia (%)

China	Taiwan	Korea	India-PSU	Japan
7.2	6.6	5.5	5.1	2.0

Source: CLSA Asia-Pacific Markets

ROE and LLP volatility

There has been some volatility in India's PSU banks' ROE and LLP/loans over the past 15 years and the critical question is if this can occur at China's banks. We believe this is not simply a case of crash or not crash, but rather like India, a matter of degrees. For India's PSU banks, ROE varying from 12-20% over the years and LLP/loans varying from 1.0-2.0% has been enough to keep valuations low. This is possible at China's banks and does not require

banks to report losses or to be recapitalised from those losses. We show this below, where we simply take our existing 11CL estimates and show the impact to profit and ROE for 100bps, 120bps and 140bps LLP/loans for 12CL estimates. Note that our base case is 80bps LLP/loans for 12CL. We see here that ROE can decline to 14.6% from 18.8% in 11CL for 120bps LLP/loans and profit growth can go from 18% in 11CL to -9%. These numbers are not at all devastating to capital, but they would very much gel with what we have seen in terms of ROE and LLP volatility for India PSU banks. And these banks appear to be converging on PB and PE metrics, at least.

Figure 3

India PSU banks – ROE and LLP/loans (%)

	95A	96A	97A	98A	99A	00A	01A	02A	03A	04A	05A	06A	07A	08A	09A	10A	11A	Avg	Standev
ROE	13.4	16.5	17.2	19.2	11.8	14.7	11.8	16.6	19.9	20.8	16.2	14.8	14.3	14.7	17.0	16.4	15.9	15.9	2.5
LLP/loans	1.5	2.0	1.3	0.9	1.1	1.3	1.5	1.8	1.9	2.5	2.1	1.5	1.1	0.8	0.8	0.6	1.0	1.4	0.5

Source: CLSA Asia-Pacific Markets

Figure 4

Sensitivity to higher LLP/loans on 12CL – China banks

China banks aggregated (Rmbm)	11CL	12CL (80bps)	12CL (100bps)	12CL (120bps)	12CL (140bps)
Operating income	1,165,517	1,271,049	1,271,049	1,271,049	1,271,049
Total prov'n expenses	-265,628	-292,072	-373,413	-448,096	-522,778
Net operating income	899,888	978,977	897,636	822,954	748,271
Non-recurring income	4,004	4,571	4,571	4,571	4,571
Profit before taxation	903,892	983,548	902,208	827,525	752,842
Tax	-205,171	-223,081	-204,621	-187,683	-170,745
Profit after tax before minorities	698,721	760,468	697,587	639,842	582,098
Minority interests	-7,974	-9,419	-9,419	-9,419	-9,419
Net profit	690,747	751,049	688,168	630,423	572,679
ROE	18.8	17.4	15.9	14.6	13.3
Profit growth	18	9	0	-9	-17

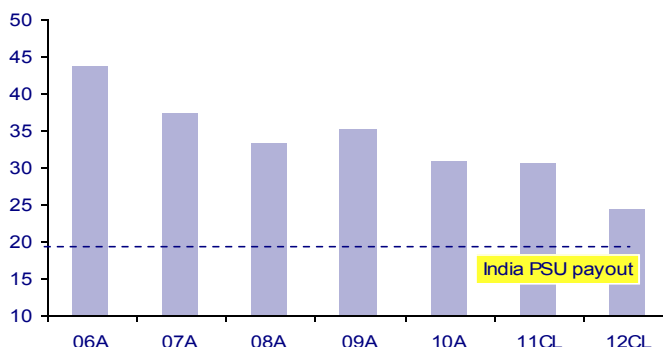
Source: CLSA Asia-Pacific Markets, Co reports

Dividends

As we further consider drivers of low value bank stocks like China and India PSU banks, we come to dividends. Here payout has averaged 19% for some time for India's PSU banks. What is interesting here is the sharp decline in China's payout ratio over the years, from 44% at its peak to 31% last year. Our new forecast for next year is -21% in the payout ratio (to 24%), the single largest annual decline we have seen for the China banks.

Figure 5

China banks' dividend payout ratios (%)



Source: CLSA Asia-Pacific Markets, Co reports

Figure 6

India PSU Banks – Dividend payout ratio

(%)	95A	96A	97A	98A	99A	00A	01A	02A	03A	04A	05A	06A	07A	08A	09A	10A	11A	12CL	13CL
India - PSU	13	19	21	21	23	32	28	21	21	19	22	21	22	20	18	18	18	19	19

Source: CLSA Asia-Pacific Markets, Co reports

Figure 7

Asian bank valuations

	Mktcap/ asset(%)	P/E(x)			P/B (x)			Div yields (%)			ROAE (%)			ROAA (%)			EPS growth (%)			CAR (%)		
		10A	11CL	12CL	10A	11CL	12CL	10A	11CL	12CL	10A	11CL	12CL	10A	11CL	12CL	10A	11CL	12CL	10A	11CL	12CL
Bank of China	6.1	5.0	4.7	4.4	0.86	0.76	0.68	7.1	7.4	6.7	18.0	17.1	16.2	1.09	1.05	0.98	29	5	6	12.6	12.5	12.2
CCB	8.1	7.1	6.0	5.6	1.42	1.23	1.07	5.2	5.8	5.3	21.5	21.9	20.3	1.32	1.42	1.33	24	17	7	12.7	12.1	12.1
BoCom	5.6	5.3	5.2	4.7	0.93	0.84	0.73	5.8	6.1	3.2	20.2	17.8	16.7	1.08	1.04	1.00	30	3	11	12.4	12.8	12.4
ICBC	8.5	6.8	6.1	5.6	1.39	1.22	1.05	5.4	5.7	5.3	22.1	21.3	20.1	1.31	1.29	1.23	28	10	9	12.3	12.5	12.3
ABC	6.6	6.4	5.7	5.0	1.28	1.12	0.96	7.3	6.2	5.0	21.4	21.0	20.6	0.99	1.10	1.08	32	14	13	11.6	12.2	12.6
CMB	8.3	7.3	6.4	7.2	1.49	1.26	1.10	3.0	3.1	2.8	23.4	21.4	17.7	1.19	1.20	1.11	33	14	(12)	11.5	11.9	13.7
China Citic Bank	7.3	4.8	4.5	4.7	0.86	0.76	0.67	0.0	5.1	4.3	19.3	17.7	15.2	1.12	1.12	1.03	50	7	(3)	11.3	13.2	13.2
China	7.2	6.1	5.5	5.3	1.18	1.03	0.89	4.8	5.6	4.7	20.9	19.7	18.1	1.15	1.17	1.11	32	10	4	12.0	12.5	12.6
SBI	5.9	10.4	7.7	6.0	1.33	1.16	0.99	1.7	2.0	2.3	12.8	16.2	17.9	0.69	0.82	0.92	(9)	36	29	12.3	12.2	12.4
Bank of Baroda	6.7	6.9	6.3	5.2	1.38	1.18	1.00	2.2	2.7	3.4	23.5	20.1	20.8	1.33	1.16	1.16	29	8	22	14.5	13.6	13.2
Oriental Bank	4.6	5.3	5.2	4.5	0.77	0.69	0.62	3.6	4.1	4.8	15.6	13.9	14.4	1.01	0.94	0.94	23	0	15	14.2	13.3	12.7
HDFC Bank	30.5	26.6	20.6	16.3	4.12	3.57	3.06	0.7	1.0	1.2	16.7	18.6	20.3	1.57	1.64	1.67	31	30	26	16.2	14.8	13.6
ICICI Bank	20.1	18.4	14.6	11.8	1.72	1.60	1.47	1.7	2.1	2.4	9.6	11.3	12.9	1.34	1.48	1.56	24	26	24	19.5	18.6	18.0
Corp Bank	3.6	4.2	3.8	3.3	0.84	0.72	0.62	4.7	5.3	6.0	21.9	20.3	20.1	1.11	0.99	0.97	16	12	14	14.1	12.4	12.3
HDFC	58.2	26.8	23.0	19.7	5.46	4.89	3.90	1.4	1.4	1.7	21.7	22.4	22.5	2.76	2.72	2.84	22	16	17	14.4	14.7	16.5
Canara Bank	4.8	4.5	4.6	4.0	0.94	0.81	0.69	2.6	3.1	3.7	23.2	18.8	18.6	1.34	1.12	1.10	28	(2)	15	15.4	14.9	15.3
Axis Bank	14.0	12.5	10.4	8.7	2.23	1.91	1.64	1.4	1.9	2.3	19.3	19.8	20.3	1.60	1.49	1.45	33	20	20	12.7	11.8	11.2
Punjab National	6.6	6.6	6.1	5.1	1.37	1.17	0.99	2.7	3.5	4.3	22.6	20.7	21.0	1.31	1.18	1.19	13	9	19	12.4	11.8	11.9
Bank of India	4.2	6.7	5.8	4.7	0.99	0.88	0.77	2.2	3.2	4.5	15.8	16.1	17.4	0.80	0.78	0.82	40	17	22	12.2	11.6	11.1
IDFC	29.5	12.5	10.9	9.5	1.63	1.43	1.30	1.7	1.6	1.9	14.7	14.0	14.4	3.05	2.98	2.86	13	15	15	24.5	21.7	19.1
Union Bank of India	4.5	5.7	5.1	4.4	0.95	0.85	0.75	3.5	4.2	5.0	17.9	17.4	17.9	0.96	0.94	0.94	(2)	12	15	13.0	11.3	11.4
Yes bank	11.5	12.4	10.0	8.1	2.40	1.99	1.63	1.1	1.3	1.5	21.1	21.6	22.2	1.53	1.31	1.22	41	23	24	16.5	14.1	12.7
India - PSU	5.1	6.3	5.6	4.7	1.07	0.93	0.81	2.9	3.5	4.3	19.2	17.9	18.5	1.07	0.99	1.01	17	11	19	13.5	12.6	12.5
India - Private	19.0	17.5	13.9	11.2	2.62	2.27	1.95	1.2	1.6	1.9	16.7	17.8	18.9	1.51	1.48	1.48	32	25	24	16.2	14.8	13.9
Hong Kong	11.4	11.4	9.7	9.1	1.63	1.48	1.36	4.7	5.1	5.0	15.1	15.8	15.4	1.19	1.22	1.19	30	18	7	14.9	14.9	14.2
Indonesia	28.8	12.2	11.8	9.9	2.89	2.47	2.07	2.5	2.5	3.1	22.4	22.2	22.3	2.38	2.55	2.64	50	9	20	18.1	17.7	16.6
Korea	5.5	7.4	5.6	7.0	0.82	0.73	0.67	3.3	5.6	3.4	10.4	14.0	9.9	0.71	1.03	0.77	68	37	(21)	14.6	15.1	15.4
Malaysia	15.7	14.0	12.1	10.9	2.16	1.99	1.81	3.5	4.5	5.2	16.6	17.2	17.3	1.29	1.35	1.37	25	16	11	15.0	15.2	15.4
Philippines	13.2	12.6	11.8	10.5	1.49	1.39	1.29	1.5	2.1	2.2	12.1	11.6	12.2	1.15	1.13	1.19	39	6	12	16.6	16.8	15.8
Singapore	9.6	10.8	10.5	9.7	1.26	1.16	1.08	4.3	4.3	4.5	9.9	10.8	10.8	0.97	1.00	1.00	27	3	7	18.6	17.6	18.0
Taiwan	6.6	14.2	10.2	8.3	1.08	1.01	0.94	3.0	3.7	4.7	7.2	9.3	10.9	0.48	0.63	0.71	33	39	24	12.2	11.8	11.5
Thailand	13.7	12.7	9.6	8.7	1.61	1.43	1.29	3.0	4.0	4.9	13.1	15.7	15.6	1.28	1.49	1.49	26	33	11	15.7	15.6	15.7
Asian average	12.6	11.3	9.6	8.7	1.60	1.43	1.28	3.3	4.0	4.1	14.6	15.4	15.1	1.21	1.30	1.29	35	19	9	15.3	15.1	14.9
Japan	2.0	6.4	6.3	5.8	0.55	0.54	0.50	4.7	4.7	4.7	8.8	8.7	8.9	0.30	0.31	0.33	32	1	8	15.6	15.9	16.3
Australia	9.2	12.0	10.3	9.5	1.78	1.69	1.56	6.3	7.1	7.6	14.6	15.9	16.2	0.86	0.96	1.00	41	16	9	11.4	11.6	12.1
HSBC	5.2	10.7	7.5	7.0	0.95	0.85	0.78	4.3	4.9	6.3	9.5	12.0	11.7	0.55	0.73	0.71	119	42	7	15.2	15.2	15.0
Stanchart	8.3	10.8	10.6	9.7	1.19	1.18	1.10	3.3	3.6	4.1	12.9	11.7	12.0	0.89	0.84	0.84	21	1	10	18.4	18.3	18.3

Source: CLSA Asia-Pacific Markets

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