Credit Rating Report for China Merchants Bank Co., Ltd.'s 2018-1 Tier-2 Capital Bond

Ratings

Long-term credit rating of the issuer: AAA

Credit rating of the tier-2 capital bond: AAA

Outlook: Stable

Date of Rating

October 15, 2018

Key data:

Item	End of Jun. 2018	End of 2017	End of 2016	End of 2015
Total assets (CNY 100mn)	65373.40	62976.38	59423.11	54749.78
Shareholders' equity (CNY 100mn)	5040.51	4833.92	4033.62	3617.58
NPL ratio (%)	1.43	1.61	1.87	1.68
Provision coverage ratio (%)	316.08	262.11	180.02	178.95
Loan loss provision coverage ratio (%)	4.51	4.22	3.37	3.00
RMB liquidity ratio (%)	43.01	40.68	59.42	65.67
Shareholders' equity/total assets (%)	7.71	7.68	6.79	6.61
Capital adequacy ratio (%)	15.08	15.48	13.33	12.57
Tier-1 capital adequacy ratio (%)	12.51	13.02	11.54	10.83
Core tier-1 capital adequacy ratio (%)	11.61	12.06	11.54	10.83
Item	**Jan-Jun 2018**	**2017**	**2016**	**2015**
Revenue (CNY 100mn)	1261.46	2208.97	2097.20	2014.71
Total profit before provision (CNY 100mn)	903.74	1506.06	1451.22	1343.45
Net profit (CNY 100mn)	448.69	706.38	623.80	580.18
Net interest margin (%)	2.42	2.29	2.37	2.61
Cost/income ratio (%)	26.84	30.23	27.67	27.67
ROA before provision (%)	-	2.46	2.54	2.63
Average rate of return on assets (%)	-	1.15	1.09	1.13
Average rate of return on net assets (%)	-	16.54	16.27	17.09

Source: China Merchants Bank's 2015-2017 annual reports and 1H2018 report, information compiled by Lianhe Ratings.

Note: 1. Capital adequacy ratios are calculated using the advanced measurement techniques outlined in the *Administrative Measures on Capital of Commercial Banks (For Trial Implementation)*; financial data of 2015 and 2016 use period beginning balances in the audit reports for 2016 and 2017, respectively;

2. Average rate of return on net assets refers to the weighted average return on net assets attributable to ordinary shareholders of the parent company;

3. Financial data from January to June 2018 are unaudited.

Analysts

Ge Chengdong, Fu Zhengbing, Liu Yuxin

Tel: 010-85679696
Fax: 010-85679228
Email: lianhe@lhratings.com
Address: 17/F PICC Tower, No. 2 Jianguomenwai Avenue, Chaoyang District, Beijing (100022)
Website: www.lhratings.com

Rationale

In recent years, China Merchants Bank Co., Ltd. ("CMB" or the "Bank") has continued pushing forward with its strategic transformation into a "light-operation bank", and built a "one body with two wings" business structure, with retail finance as its core, supported by its corporate finance and interbank business. CMB has maintained competitive advantages in retail finance such as private banking, wealth management, credit card and consumer credit, serving a broad retail customer base, with retail finance making a growing contribution to its growth. In its corporate finance segment, CMB has been focusing on building its customer base and promoting strategic transformation of its businesses. The Bank has kept improving its transaction banking and investment banking systems, with increased abilities to provide differentiated services. Interbank business has become a new source of earnings growth for CMB. With both its assets and liabilities continuing to grow and the quality of its credit assets improving, the Bank has maintained decent profitability, with sufficient capital and provision. As a listed bank, CMB has set up a sound capital replenishment mechanism and boasts well-functioning financing channels, making it well-positioned to achieve sustainable development. However, CMB also has a large amount of non-standard investment assets such as trust products and asset management plans.

Credit risks and liquidity risks associated with such assets merit attention. The Bank's net interest margin is set to keep narrowing as a result of the replacement of business tax with a value-added tax and rising interest rates in the debt market, which could weigh on its profitability.

China Lianhe Credit Rating Co., Ltd. has affirmed China Merchants Bank Co., Ltd.'s long-term credit rating at "AAA" and the credit rating of its proposed 2018-1 tier-2 capital bond of up to CNY 20 billion at "AAA". The Outlook is Stable. The rating affirmation reflects that the default risk of CMB's latest tier-2 capital bond is extremely low.

Strengths

- As a nationwide joint-stock commercial bank, CMB has a clear strategic positioning and has achieved good results in its business transformation. It is a leading and financially strong player in the industry where it operates, with distinctive business features;
- It has a well-functioning corporate governance mechanism and an improving internal control system;
- The Bank has continually enhanced its comprehensive service capabilities, and has strong innovative capacities and substantial competitive advantages in retail banking;
- Since 2017, it has witnessed a decrease in both non-performing loans and NPL ratios, thanks to adjustments to its credit structure, tightened credit policies in some high-risk regions, strengthened management and control of credit risks, and increased efforts to dispose of non-performing assets, with improved quality of credit assets and sufficient loan loss provision;
- The Bank has a robust income structure, with non-interest income making up a large proportion of its total, and has maintained decent profitability, thanks to fewer impairment losses on assets as its asset quality improves and less provision is made;
- The Bank has sufficient capital. Its issuance of preferred shares both in and outside China in 2017 has helped it improve capital adequacy, optimize capital structure, enhance abilities to achieve sustainable development, ward off risks, and boost overall competitiveness.

Concerns

- Non-performing loans and overdue loans still account for a significant portion of loans it has lent in some areas in western and northeast China and in the manufacturing and mining industries, meaning the Bank remains under pressure to manage credit risks;
- It has a large amount of non-standard investment assets such as trust products and asset management plans. Credit risks and liquidity risks associated with such assets merit attention;
- Its net interest margin will likely keep narrowing due to the adoption of IFRS 9 Financial Instruments and an increase in the overall costs of taking deposits, which could weigh on the bank's profitability;
- Commercial banks will come under pressure in terms of operation as economic growth slows, economic restructuring continues, and financial regulation tightens.