

Credit Rating Report

Luzhou Bank Co., Ltd.

Issuer Credit Rating*: BBB; Outlook: Stable

July 30, 2019

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* This rating is an Issuer Credit Rating (ICR). An ICR reflects our view of the senior unsecured credit rating of an issuer and is not specific to an individual issuance that it may issue.

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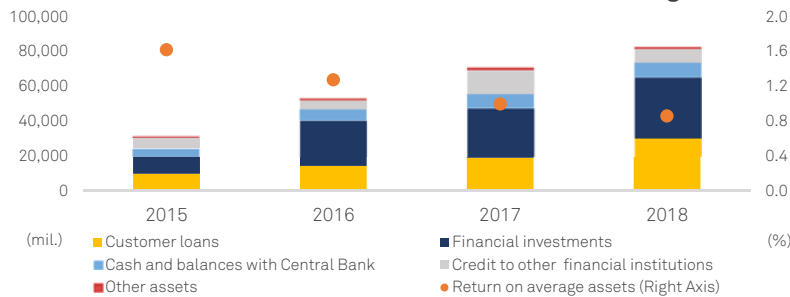
This document is prepared in both English and Chinese. The English translation is for reference only, and the Chinese version will prevail in the event of any inconsistency between the English version and the Chinese version.

Tear Sheet

Company Name	Rating Type	Current Rating	Rating Date	Outlook/Credit Watch
Luzhou Bank Co., Ltd.	Issuer Credit Rating	BBB	July 30, 2019	Stable

Industry Classification: Commercial Bank

Company Overview: Luzhou Bank Co., Ltd. ("Luzhou Bank") is a city commercial bank headquartered in Luzhou City of Sichuan Province. Founded in 1997, the bank is listed on Stock Exchange of Hong Kong (HKEx) starting from December 2018. As of the end of 2018, the bank reported total assets of RMB 82.5 billion, total customer loans of RMB 31.3 billion, and total customer deposits of RMB 52.4 billion. In 2018, it generated net income of RMB 660 million and achieved a return on average equity of 14.3%.

Luzhou Bank: Total Assets And Return on Average Assets

Economy and Industry Trends: China's monetary policy in 2019 is more accommodative than 2018. We expect that GDP growth for the full-year of 2019 can meet the target range of 6% - 6.5%, and the domestic macroeconomic situation in 2019 will not change significantly from that in 2018. We believe that the overall credit condition of the commercial banks in China will remain stable, while their asset quality could still feel downward pressure due to higher refinancing risk faced by their corporate clients. We view that the takeover of Baoshang Bank by the government would eventually turn out to be positive for the mid-to-long term stability of small and medium-sized banks by pushing for better corporate governance and reducing moral hazard in the banking industry. After the Baoshang Bank takeover, a few small and medium-sized financial institutions have faced increasing funding pressures. We believe that the credit profiles of commercial banks are likely to show greater differentiation in the future. We also believe that, small and median-sized banks, as a group, will generally maintain adequate liquidity, as the People's Bank of China ("PBOC") and the China Banking and Insurance Regulatory Commission ("CBIRC") have taken effective measures to control contagion risk after the Baoshang Bank takeover.

Credit Highlights: Luzhou Bank has a leading market position in Luzhou and has enjoyed rapid growth over the past few years. As a small city bank, its deposit market share was only about 0.03% in China and its business has high geographical concentration. Its operations are nimble and efficient. Its management and governance have further improved after listing on HKEx. The bank's asset quality metrics have been better than the industry average, while there is still uncertainty in its future asset quality performance because its loan book has grown very fast and is largely unseasoned. We view that it has a stable deposit base in Luzhou, with adequate liquidity. The bank is a state-controlled bank committed to funding local small and medium-sized entities ("SMEs"), and its operations have received support from different levels of governments.

Key Metrics of Luzhou Bank

	2015	2016	2017	2018
Total assets (bil)	31.8	53.3	70.9	82.5
Customer deposits (bil)	20.4	31.0	42.1	52.4
Net income (bil)	0.45	0.54	0.62	0.66
Regulatory total capital adequacy ratio (%)	18.58	13.62	13.69	13.29
Return on average equity (%)	19.68	14.87	14.83	14.25
Non-performing loan ratio (%)	0.30	0.53	0.99	0.80
Reserve coverage ratio (%)	920.6	486.6	294.5	319.4
Customer deposits/total liabilities (%)	71.57	62.95	63.33	68.76

Note: Data in this table has been adjusted by S&P Global (China) Ratings.

Rating Snapshot

Anchor	bbb+
— Business Position	-2
— Capital and Earnings	0
— Risk Position	0
— Funding and Liquidity	0
Stand-alone Credit Profile	bbb-
Government Support	+1
Issuer Credit Rating	BBB
Outlook	Stable

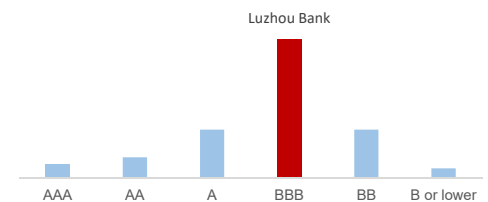
Business Position: Luzhou Bank enjoys a leading market position in Luzhou and has been growing rapidly. However, its operations are small with a deposit market share of only 0.03% in China. It has high geographic concentration.

Capital and Earnings: Fast growth has led to quick consumption of its capital. We anticipate that it will continue to meet regulatory capital requirements. Thanks to high net interest margin (NIM) and sound asset quality, its profitability is above industry average.

Risk Position: Luzhou Bank has adequate risk management capabilities, and its asset quality metrics are better than the industry average. However, due to its fast growth, its loan book is largely unseasoned and there is uncertainty concerning its asset quality performance through the credit cycle.

Funding and Liquidity: The funding structure of Luzhou Bank is aligned with industry average. It has a solid and sticky deposit base. Owing to the fast growth of customer deposits, its reliance on wholesale funding has declined.

External Support: We believe that Luzhou Bank is likely to receive varying degrees of support from different levels of government in time of stress, considering its state-controlled status, leading market position in Luzhou, and the important role it plays in meeting financial needs of local SMEs.

Luzhou Bank's Relative Issuer Credit Rating Position among Chinese Financial Institutions

Note: this chart serves as a hypothetical example of S&P Global (China) Ratings' ratings distribution of financial institutions. Rating below AAA could be adjusted by "+" and "-".

Peer Group Comparison

(The peer group includes Luzhou Bank, Leshan Bank, Great Wall West China Bank, Mianyang Bank and Zigong Bank, all of which are city banks based in Sichuan Province)

(2016-2018 three-year average)	Luzhou Bank	Max	Min	Average	Asset-weighted average	Median
Total assets (bil)	68.9	106.6	68.9	86.0	89.2	77.4
Customer deposits (bil)	41.8	64.4	40.4	48.1	49.4	45.6
Net income (bil)	0.61	0.61	0.44	0.56	0.56	0.59
Regulatory total capital adequacy ratio (%)	13.53	13.97	12.05	12.95	13.01	12.97
Return on average equity (%)	14.65	14.65	8.24	10.89	10.50	9.82
Non-performing loan ratio (%)	0.77	2.71	0.77	1.71	1.83	1.57
Reserve coverage ratio (%)	366.8	366.8	177.6	249.5	244.4	245.3
Customer deposits/total liabilities (%)	65.0	65.7	48.7	60.7	60.1	62.8

Note: Data in this table has been adjusted by S&P Global (China) Ratings.

Rating Summary

Company Name	Rating Type	Current Rating	Rating Date	Outlook/CreditWatch
Luzhou Bank Co., Ltd.	Issuer Credit Rating	BBB	July 30, 2019	Stable

Stand-alone Credit Profile	bbb-	+	External Support	+1	Issuer Credit Rating
Anchor	bbb+		Government Support	+1	BBB / Stable
Business Position	-2				
Capital & Earnings	0				
Risk Position	0				
Funding & Liquidity	0				
Holistic Adjustment	0				

Credit Highlights

Strengths	Weaknesses
— Leading market position in Luzhou;	— Small size and high geographic concentration; and
— Solid deposit base and fast growth in retail deposit; and	— Rapid growth resulting in unseasoned loan book, leading to uncertainty in future asset quality.
— Asset quality and profitability better than industry average.	

Rating Outlook

The stable outlook reflects our expectation that Luzhou Bank's business operations and financial strength will remain stable over the next two years or beyond. We also anticipate that its importance to the government will remain stable, and that the support policies of the government and the central bank toward small and medium-sized banks will remain largely unchanged.

Downside Scenario: We may consider lowering the rating if we believe that the bank's importance to the government declines because the government significantly reduces its ownership. We may also consider lowering the rating if the bank fails to effectively manage its business in areas outside Luzhou, resulting in asset quality lower than industry average, or if its capital base is eroded by bad loans and its capital adequacy ratios can no longer meet regulatory requirements, and there is no reasonable plan for immediate and effective remediation, or if its inter-bank funding significantly increases and its reliance on which becomes higher than industry average.

Upside Scenario: We may consider raising the rating if the bank substantially grows its business and reduces geographic concentration, or if it is able to maintain above-average asset quality through credit cycle, or if its capital adequacy ratios rise above industry average and remain high on a sustainable basis, or if its inter-bank funding decreases significantly and the reliance on which becomes lower than industry average.

Related Methodologies, Models & Research

Methodology Applied:

- [S&P Global \(China\) Ratings Financial Institutions Methodology](#).

Related Research & Commentary:

- [S&P Global \(China\) Ratings General Considerations on Rating Modifiers and Relative Ranking](#).

Model Applied: None.

Anchor

Macro-Economic and Industry Trend

In our view, China is expected to achieve its GDP growth target range of 6%-6.5% in 2019. Should the economic slowdown intensify and GDP growth drop to below 6% for 2019, we expect that further stimulation policies are likely to be used. Since 2018, deleveraging has somewhat paused, but not yet reversed. We generally expect a monetary easing in 2019, but only a moderate and careful one. Inter-bank liquidity is expected to be better than 2018. We believe local government infrastructure investments may be among the first to benefit from this round of easing, but effective borrowing rates for the real economy may remain relatively high given lending caution around the credit risk in the real economy.

We anticipate the economic growth of Sichuan Province and Luzhou City will remain stable. Sichuan is a large province in terms of resources, population and economy. In recent years, it has above-average GDP growth compared with other provinces in China. In 2018, the province achieved a GDP of RMB 4.1 trillion, ranking sixth in China and first in West China, with a GDP growth rate of 8.0%. Luzhou is located in Southeast part of the province, bordering Chongqing Municipality and Guizhou Province. In 2018, Luzhou achieved a GDP of RMB 169.5 billion, ranking sixth in the province, with a GDP growth rate of 7.6%.

We believe that the overall macro economy of China will remain stable in 2019, and therefore, the general credit profile of China's commercial banking industry would also remain largely unchanged. We expect that city banks will continue to enjoy the highest growth, followed by state-owned mega banks and rural banks, while joint-stock banks are expected to experience growth pace below the industry average.

We anticipate that asset quality deterioration remains a challenge for commercial banks over the next two years, mainly due to the following reasons: private sector defaults remain high; the growth of property development lending has slowed down and some developers may experience liquidity difficulties; consumer loans are experiencing higher overdue rates; and the credit risk exposure to small and micro businesses is increasing.

Due to increasing challenges in asset quality control, we may see more credit differentiation among banks. State-owned mega banks have demonstrated great resilience in both business operations and financial performance through the credit cycle. In contrast, a few smaller banks, especially those with very aggressive risk appetite, may face capital base erosion over the next two years.

After the takeover of Baoshang Bank in May 2019, some small and medium-sized financial institutions experienced funding challenges. The central bank and CBIRC have taken effective measures to mitigate market-wide risk and small and medium-sized banks, as a group, have generally maintained adequate liquidity profiles. But we expect larger differentiation of borrowing cost in the inter-bank market among small and medium-sized banks.

We believe that the central bank will continue to provide liquidity support to small and medium-sized banks, because these banks play important roles in serving small, medium and micro-sized enterprises and developing inclusive finance in China.

Considering the economic risk and industry risk faced by China's commercial banking industry, we typically apply an anchor of "bbb+" to commercial banks in China.

We believe that the government's takeover of Baoshang Bank could be positive to general credit stability of the small and medium-sized banks in the mid-to-long term. We believe that this incident serves as a market education opportunity and may help improve corporate governance of small and medium-sized banks and reduce moral hazard of the banking industry.

Stand-alone Credit Profile

Luzhou Bank, originally known as Luzhou City Cooperative Bank, was set up in 1997. It is one of the first batch of city commercial banks set up in Sichuan Province. It has been listed on Stock Exchange of Hong Kong (HKEx) since December 2018.

Luzhou Bank is the only city bank headquartered in Luzhou. As of the end of 2018, the bank had 841 employees, 26 sub-branches in Luzhou and one branch in Chengdu, the capital city of the province. It had total assets of RMB 82.5 billion, customer deposits of RMB 52.4 billion, and customer loans of RMB 31.3 billion as of the end of 2018. It reported net income of RMB 660 million and a return on average equity of 14.3% in 2018.

Luzhou Bank is a state-controlled bank jointly founded by local government, corporations and individuals. As of the end of 2018, the government and state-owned enterprises ("SOEs") altogether held about 45.44% of Luzhou Bank's total equity.

Business Position

Luzhou Bank is a small-sized city bank based in Luzhou of Sichuan Province. As of the end of 2018, the bank recorded total assets of RMB 82.5 billion, representing about 0.04% market share among commercial banks in China. We view the geographic concentration of the bank as high, which may make its business less stable than its larger competitors. However, the bank has grown rapidly over the past few years, with a pace faster than the industry average. It has doubled its market share in the past three years. We expect that it can gain more market share going forward.

Table 1

Luzhou Bank -- Market Share				
(%)	2015	2016	2017	2018
Total assets /total assets of China's commercial banking industry	0.02	0.03	0.04	0.04
Customer loans/total loans of China's commercial banking industry	0.01	0.02	0.02	0.03
Customer deposits/total deposits of China's commercial banking industry	0.01	0.02	0.02	0.03
Customer loans/total loans in Sichuan	0.26	0.34	0.40	0.58
Customer deposits/total deposits in Sichuan	0.34	0.47	0.59	0.69
Customer loans/total loans in Luzhou	9.13	11.34	12.41	16.73
Customer deposits/total deposits in Luzhou	11.11	14.21	17.00	19.74

Sources: Luzhou Bank's annual reports and provided data, data released by CBIRC, statistics released by Sichuan provincial government and Luzhou municipal government, adjusted by S&P Global (China) Ratings.

Luzhou Bank enjoys leading market share in Luzhou and has grown very fast.

The bank is small and has high geographic concentration. Its customer deposits market share is 0.03% in China.

As a city bank with a nimble and lean management framework, the bank has good operating efficiency, and its corporate governance has further improved after listing on HKEx.

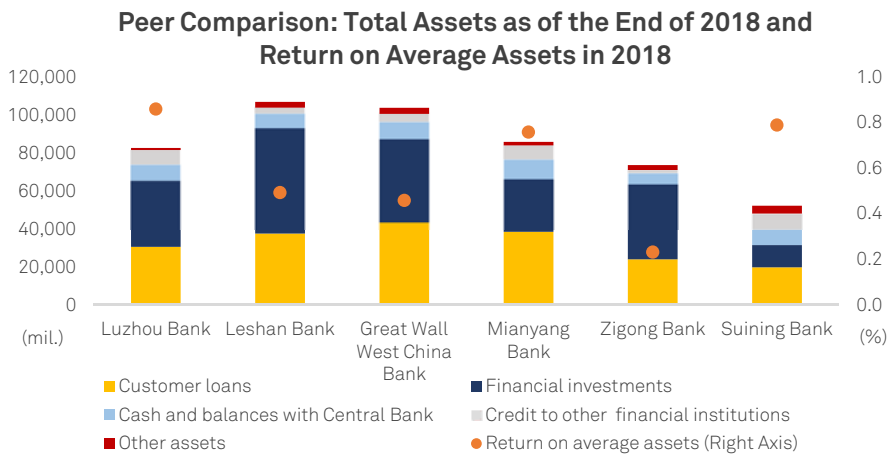
We apply two-notch downward adjustment for its business position to reflect its small size.

Luzhou Bank's deposit business enjoys a strong franchise in Luzhou and has grown rapidly in recent years, which has laid a solid foundation for its lending business growth. Between 2016 and 2018, customer deposits have seen a cumulative annual growth rate (CAGR) of 30%, among which, retail deposits have enjoyed a CAGR of 52%. In 2015, the bank launched mid-to-long term retail deposit products, which have been designed to meet market needs and proved to be very competitive in the local market. We believe that the bank's retail deposits have the potential to grow further owing to its coverage expansion in rural areas and branch setup outside Luzhou. As the only city bank headquartered in Luzhou, the bank has established long-term and deep relationship with local enterprises and public institutions, which constitute a sticky and solid corporate deposit base.

Luzhou Bank's loan business mainly targets SMEs and small business owners, which constitute a profitable client base. As of the end of 2018, the bank's total customer loans amounted to RMB 31.3 billion, among which 52% were lent to SMEs, 21% to micro enterprises, and 9% to small business owners. Its loan book has experienced a CAGR of 47% between 2016 and 2018. To better support small businesses, the bank set up a micro loan center in 2018.

We believe that the bank's expansion into new areas beyond Luzhou may reduce its geographic concentration and bring new development opportunities. In 2017, it established a branch in Chengdu, which is its first branch outside its headquarters city. It plans to set up another branch in Meishan, another city in Sichuan Province, in the second half of 2019. We anticipate that the bank will establish more branches within Sichuan Province and develop better geographic diversification in the future.

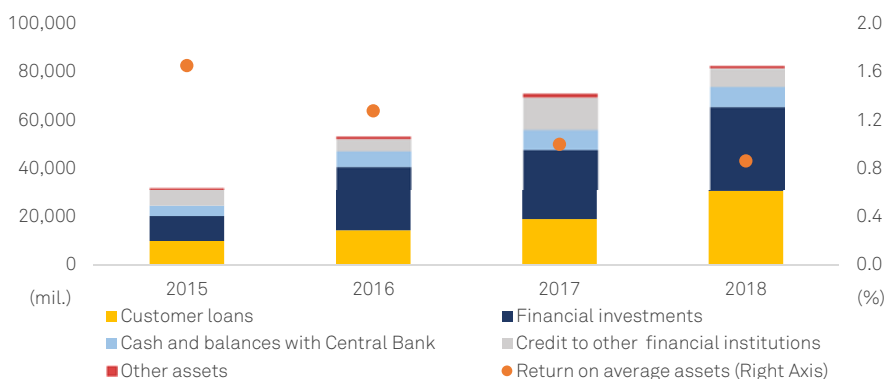
Chart 1



Sources: public data of peer banks, adjusted by S&P Global (China) Ratings.

Chart 2

Luzhou Bank: Total Assets and Return on Average Assets



Sources: Luzhou Bank annual reports and provided data, adjusted by S&P Global (China) Ratings.

We believe that the bank has lean decision-making mechanisms, efficient management and operations, and clear business strategies. Following its listing on the HKEx in December 2018, the bank continues to improve its corporate governance and operational transparency.

Table 2

Luzhou Bank -- Business Position

	2015	2016	2017	2018
Total assets (bil)	31.76	53.28	70.88	82.55
Year-over-year growth of total assets (%)	39	68	33	16
Customer loans (bil)	9.98	14.53	19.40	31.28
Year-over-year growth of customer loans (%)	31	46	33	61
Customer deposits (bil)	20.38	31.02	42.15	52.39
Year-over-year growth of customer deposits (%)	41	52	36	24
Operating income (bil)	0.94	1.31	1.68	1.93
Year-over-year growth of operating income (%)	37	39	29	15
Net income (bil)	0.45	0.54	0.62	0.66
Year-over-year growth of net income (%)	32	20	14	6

Sources: Luzhou Bank's annual reports and provided data, adjusted by S&P Global (China) Ratings.

Table 3

(2016-2018 three-year avg.)	Luzhou Bank	Peer Group				
		Max	Min	Average	Asset-weighted average	Median
Total assets (bil)	68.90	1,06.58	68.90	85.99	89.20	77.39
Year-over-year growth of total assets (%)	39.08	39.08	8.51	20.71	19.16	18.00
Customer loans (bil)	21.74	42.55	19.81	29.61	30.96	31.13
Year-over-year growth of customer loans (%)	46.79	46.79	15.67	26.15	24.44	21.74
Customer deposits (bil)	41.85	64.43	40.36	48.06	49.36	45.58
Year-over-year growth of customer deposits (%)	37.45	37.45	8.56	18.68	17.44	14.75
Operating income (bil)	1.64	2.53	1.39	1.84	1.91	1.64
Year-over-year growth of operating income (%)	27.47	27.47	-1.74	10.50	8.95	7.47
Net income (bil)	0.61	0.61	0.44	0.56	0.56	0.59
Year-over-year growth of net income (%)	13.56	13.56	-14.44	2.37	2.29	8.99

Note: In the peer comparison table in this report, we have chosen four city banks based in Sichuan Province, including Leshan Bank, Great Wall West China Bank, Mianyang Bank and Zigong Bank as the peers of Luzhou Bank, for peer comparison tables. The weights for the asset-weighted average calculation are the three-year average of total assets of these banks from 2016 to 2018. Therefore, the weights of Luzhou Bank, Leshan Bank, Great Wall West China Bank, Mianyang Bank and Zigong Bank are 16.03%, 24.79%, 24.55%, 18.00% and 16.63% respectively.

Sources: public data of peer banks, adjusted by S&P Global (China) Ratings.

Capital and Earnings

The bank's overall capital adequacy position is consistent with the industry average. Luzhou Bank's rapid growth has led to fast consumption of capital. It has relied on capital injection and hybrid bond issuance to replenish its capital base. In addition, its listing on the stock market has provided an additional channel to raise capital. In 2018, the bank raised new capital of RMB 1.5 billion from its listing on HKEx. Its capital increased to RMB 7.9 billion at the end of 2018 from RMB 3.5 billion at the end of 2015. Due to rapid growth, its regulatory capital adequacy ratio has declined marginally to 13.3% at the end of 2018 from 13.7% at the end of 2017.

Luzhou Bank's assets have grown rapidly, leading to fast consumption of its capital.

Shareholders have frequently injected new capital.

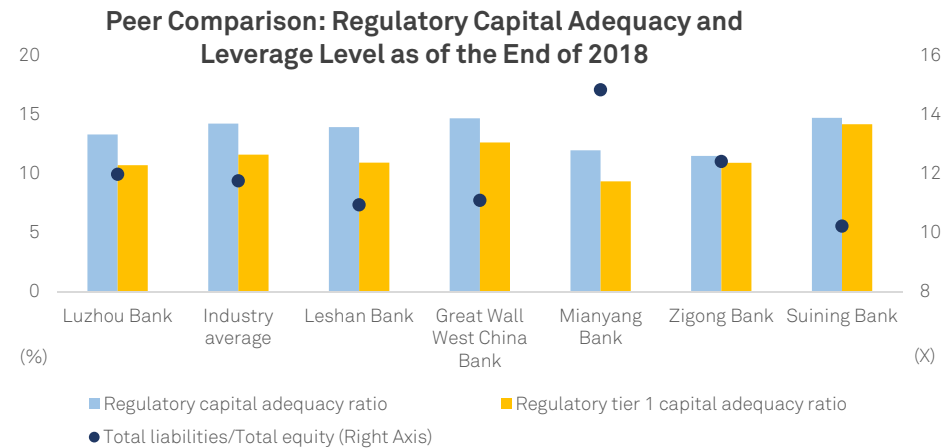
Its NIM and overall profitability are above the industry average.

Fast credit asset growth has restricted its ability of building up capital through retained earnings.

Its capital position is in line with the industry average.

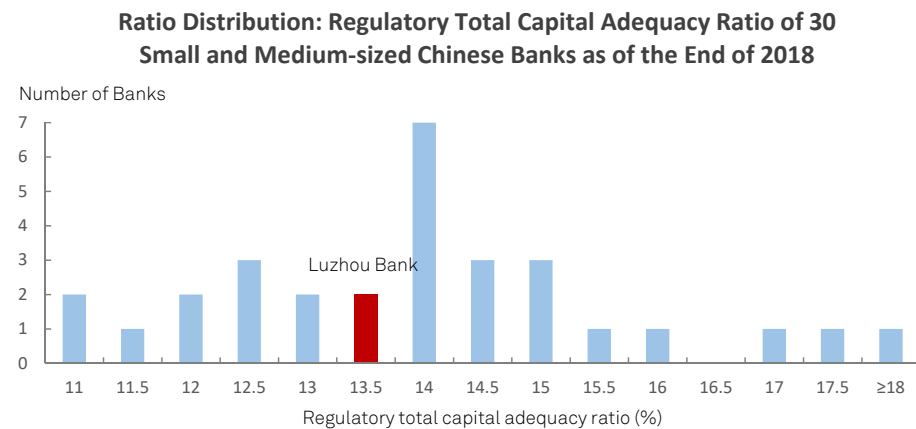
There is no notching adjustment for capital and earnings.

Chart 3



Sources: Data published by CBIRC, public data of peer banks, adjusted by S&P Global (China) Ratings.

Chart 4

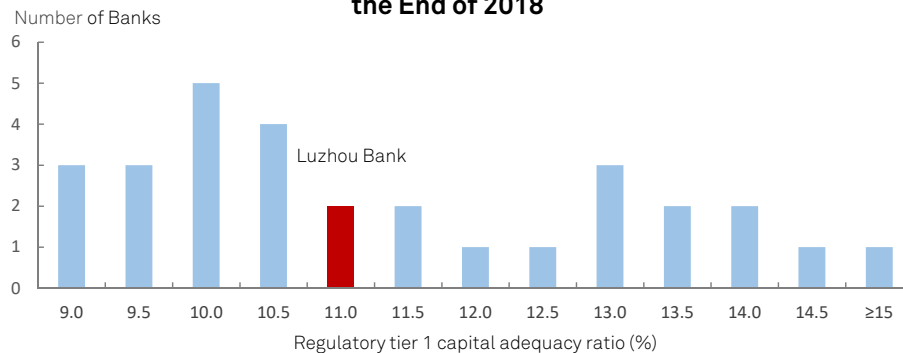


Note: the 30 small and medium-sized banks have a total asset range from RMB 50 billion to RMB 170 billion, and they are Fujian Haixia Bank, Tianjin Binhai Rural Commercial Bank, Zhejiang Mintai Commercial Bank, Bank of Inner Mongolia, Bank of Liuzhou, Bank of Weifang, Bank of Qinghai, Bank of Chengde, Leshan City Commercial Bank, Jiangsu Jianguo Rural Commercial Bank, Qishang Bank, Bank of Shaoxing, Jiangsu Zhangjiagang Rural Commercial Bank, Lai Shang Bank, Bank of Shangrao, Jiangsu Kunshan Rural Commercial Bank, Yantai Bank, Foshan Rural Commercial Bank, Changchun Rural Commercial Bank, Linshang Bank, Ningbo Commerce Bank, Bank of Jinhua, Bank of Huludao, Jiangsu Haian Rural Commercial Bank, Bank of Jining, Bank of Jiaxing, Zhejiang Yiwu Rural Commercial Bank, Zhuhai Rural Commercial Bank, Bank of Taian and Jiangmen Rural Commercial Bank.

Sources: S&P Global Market Intelligence SNL Database, adjusted by S&P Global (China) Ratings.

Chart 5

Ratio Distribution: Regulatory Tier 1 Capital Adequacy Ratio of 30 Small and Medium-sized Chinese Banks as of the End of 2018



Sources: S&P Global Market Intelligence SNL Database, adjusted by S&P Global (China) Ratings.

We believe that the bank has sound asset liability management and will maintain its capital adequacy level above minimum regulatory requirements. It plans to issue tier 2 capital instruments later 2019 and may raise more equity in the future. We believe that, when necessary, the bank also has the option of slowing down its growth to maintain sufficient regulatory capital.

Table 4

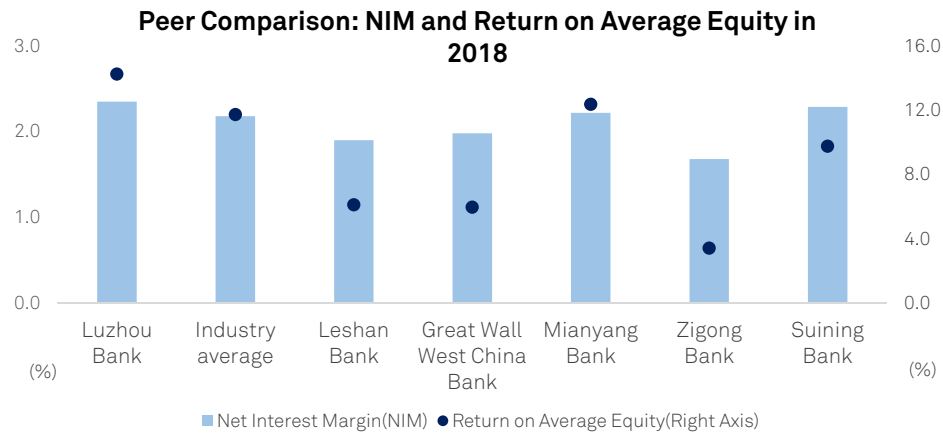
Luzhou Bank -- Capital Adequacy Forecast by S&P Global (China) Ratings				
	2017A	2018A	2019E	2020E
Total risk-weighted assets (bil)	40.96	59.56	75.53	83.45
- Credit risk (bil)	38.00	53.89	68.98	75.88
- Market risk (bil)	0.49	2.58	2.84	3.12
- Operational risk (bil)	2.47	3.09	3.71	4.45
Total capital (bil)	5.95	7.82	8.88	9.71
Tier 1 capital (bil)	4.59	6.27	7.09	7.64
Tier 1 capital adequacy ratio forecast (%)			9.4	9.2
Total capital adequacy ratio forecast (%)			11.8	11.6

Our base case assumptions include: 1. total assets grow at a CAGR of 13% between 2018 and 2020; 2. by the end of 2020, NPL ratio is about 1% and reserve coverage over NPL is about 300%; 3. NIM stays above 2.5%; 4. cost-to-income ratio remains above 30%; 5. return on average asset is about 1%, and return on average equity stays above 13.5%. In addition, we have not considered any hybrid bond issuance or capital injection in our forecast of capital growth. If we include issuance of tier 2 capital instrument in the second half of 2019 into our forecast, we expect total capital adequacy ratio to be around 14% as of the end of 2020.

Sources: A-actual; E-expected, and the 2017 and 2018 data are regulatory filing of Luzhou Bank, adjusted by S&P Global (China) Ratings.

We anticipate that the NIM of Luzhou Bank will stay healthy, likely above 2.5% over the next two years. Due to increasing interest costs, its NIM dropped to 2.4% in 2018 from 2.8% in 2016. We expect marginal improvement of NIM in 2019.

Chart 6



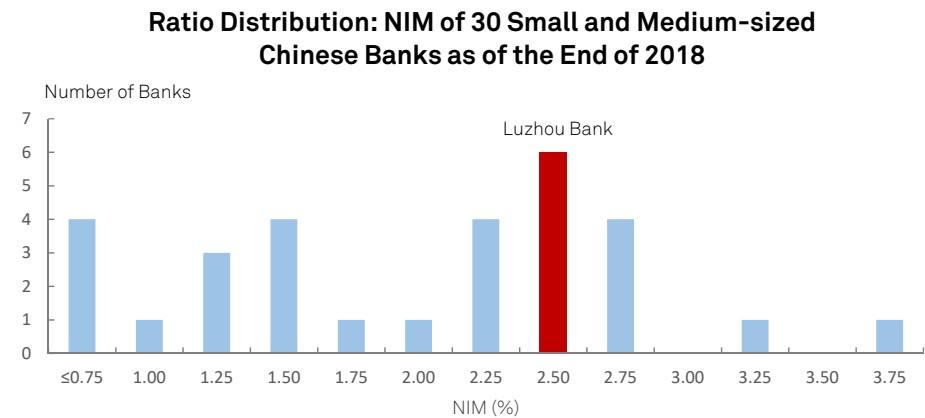
Note: Net Interest Margin (NIM) adjusted by S&P Global (China) Ratings = adjusted interest income/ [(interest-bearing assets at the beginning of the year+interest-bearing assets at the end of the year)/2]

Sources: Data published by CBIRC, public data of peer banks, adjusted by S&P Global (China) Ratings.

Owing to its sound asset quality, the bank’s credit cost is lower than the industry average. Its credit cost has increased in recent years as it stepped up its provisioning efforts. Its provisioning as a percentage of pre-provisioning operating profit increased to over 30% in 2018 from 18% in 2016.

The bank’s overall profitability is above the industry average and we anticipate stable profitability performance in 2019. In 2018, the bank reported return on average asset of 0.9%. Meanwhile, we believe that fast asset growth has restricted its ability of building up capitals through retained earnings.

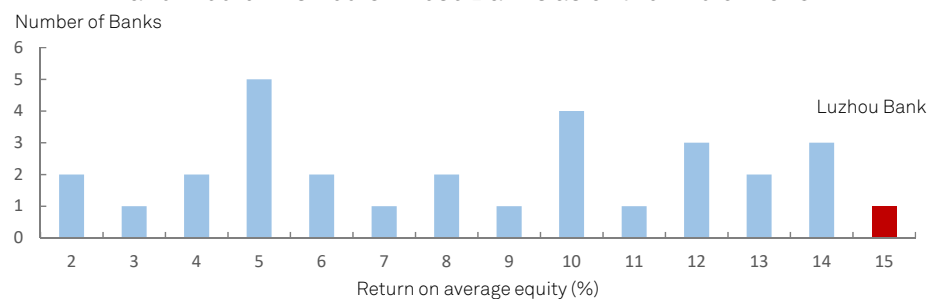
Chart 7



Sources: S&P Global Market Intelligence SNL Database, adjusted by S&P Global (China) Ratings.

Chart 8

Ratio Distribution: Return on Average Equity of 30 Small and Medium-sized Chinese Banks as of the End of 2018



Sources: S&P Global Market Intelligence SNL Database, adjusted by S&P Global (China) Ratings.

Table 5

Luzhou Bank -- Capital and Earnings

	2015	2016	2017	2018
Tier 1 capital adequacy ratio (%)	17.53	12.68	10.40	10.69
Total capital adequacy ratio (%)	18.58	13.62	13.69	13.29
Net interest margin* (%)	3.76	3.24	2.65	2.53
Net interest margin adjusted by S&P Global (China) Ratings (%)	3.30	2.78	2.59	2.35
Cost-to-income ratio (%)	24.27	31.46	31.89	34.54
Return on average assets (%)	1.65	1.27	1.00	0.86
Return on average equity (%)	19.68	14.87	14.83	14.25
Return on average common equity* (%)	19.68	14.87	14.83	14.66

Note 1: NIM adjusted by S&P Global (China) Ratings = adjusted interest income/ [(interest-bearing assets at the beginning of the year+interest-bearing assets at the end of the year)/2]

Note 2: Return on average assets =net income/ [(total assets at the beginning of the year +total assets at the end of the year)/2]

Note 3: Return on average equity net income/ [(total equity at the beginning of the year +total equity at the end of the year)/2]

Note *: Ratios from Luzhou Bank 2018 annual report.

Sources: Luzhou Bank annual reports and provided data, adjusted by S&P Global (China) Ratings.

Table 6

Peer Comparison -- Capital and Earnings

(2016-2018 three-year avg.)	Luzhou Bank	Peer Group				
		Max	Min	Average	Asset-weighted average	Median
Tier 1 capital adequacy ratio (%)	11.25	11.46	10.30	10.92	10.86	10.92
Total capital adequacy ratio (%)	13.53	13.97	12.05	12.95	13.01	12.97

Net interest margin adjusted by S&P Global (China) Ratings (%)	2.57	2.57	1.89	2.21	2.19	2.23
Cost-to-income ratio (%)	32.63	37.96	29.60	33.46	33.57	32.63
Return on average assets (%)	1.04	1.04	0.56	0.75	0.72	0.72
Return on average equity (%)	14.65	14.65	8.24	10.89	10.50	9.82

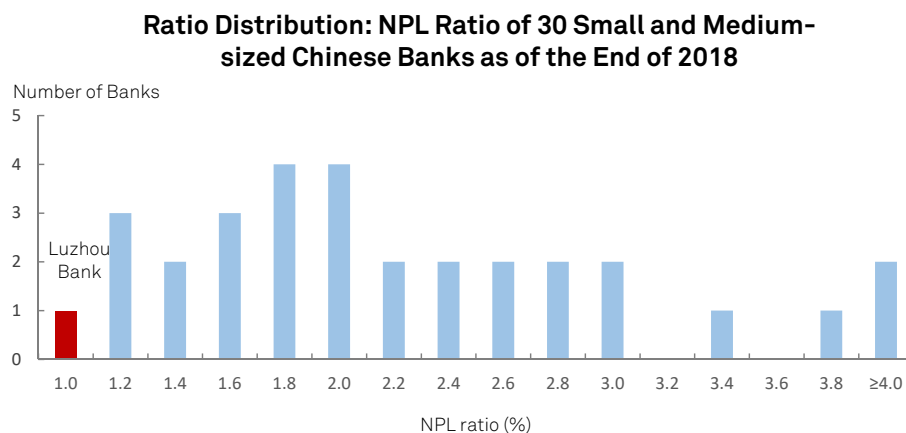
Sources: public data of peer banks, adjusted by S&P Global (China) Ratings.

Risk Position

We believe Luzhou Bank has set up an effective risk management framework in line with its business profile. After its listing on the HKEx in 2018, its risk governance and integrated risk management capability have experienced noticeable improvement.

Luzhou Bank has maintained sound asset quality in recent years. As of the end of 2018, the bank's non-performing loan ratio was 0.8%, significantly lower than the industry average of 1.8%; and its special mention loan ratio was 1.7%, also lower than the industry average of 3.1%.

Chart 9



Sources: S&P Global Market Intelligence SNL Database, adjusted by S&P Global (China) Ratings.

We believe that the rapid growth of its loan book in recent years may put pressure on credit risk control in the future. Its loan book has seen a CAGR of 47% from 2016 to 2018. We believe that this largely unseasoned loan book may experience credit risk challenges in the next three to five years due to credit cycle.

Luzhou Bank's capability to manage credit risk outside Luzhou is still untested because it just set up its first branch outside the city in 2017. The operations of its Chengdu Branch may create new exposure to operational risk and credit risk but may also help diversify its portfolio and reduce its geographical concentration.

In addition to its loan book, Luzhou Bank also has an investment portfolio with a risk profile similar to its customer loans, which accounts for about 25% of its total assets. Due to the similarity between this investment portfolio and its loan book, the bank has been managing this portfolio in the same way as it manages its loan book. So far, the asset quality of this investment portfolio remains good, consistent with its loan book credit quality.

Luzhou Bank's asset quality metrics are better than the industry average.

Its loan book is largely unseasoned due to its rapid growth.

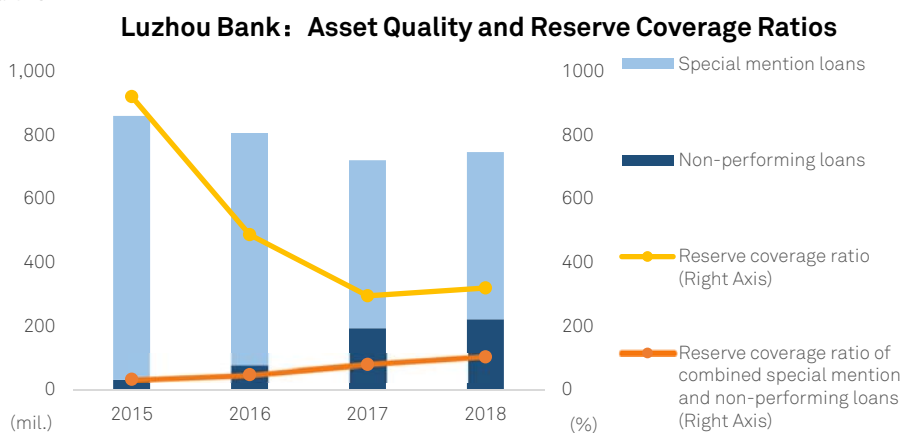
The bank is faced with downward pressure for maintaining asset quality.

Luzhou Bank's risk management is in line with the industry average and there is no notching adjustment for risk position.

Luzhou Bank has a relatively large exposure to property developers. Loans and investment related to property development account for about 19% of its total assets. We anticipate that the local real estate market will remain relatively stable and the bank’s credit risk exposure to the property sector will remain manageable. However, like the other small and medium-sized Chinese banks, it faces the tail risk of sharp price drop in local real estate market.

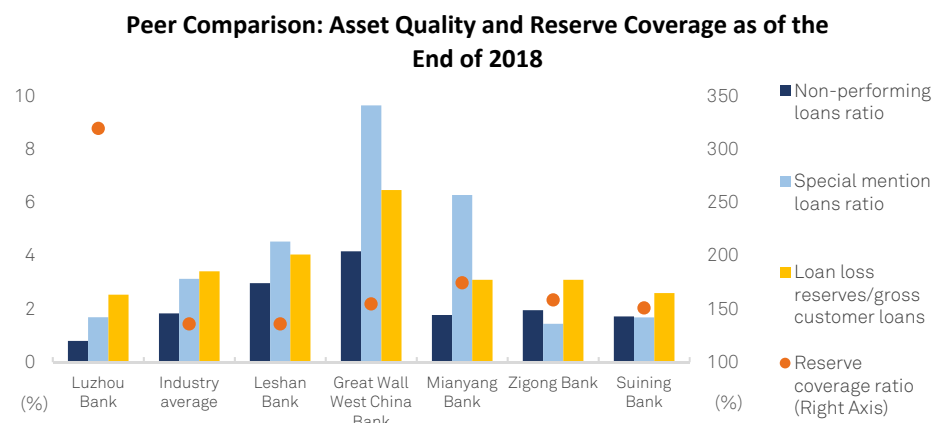
We believe Luzhou Bank has sufficient provision coverage for both non-performing loans and special mention loans. As of the end of 2018, its loan loss reserves were 319% of its non-performing loan, 102% of its combined non-performing and special mention loans, and 2.5% of its total loans. We anticipate that the reserve coverage for bad loans will remain around 300% in 2019, but the reserve coverage for special mention loans may decrease in the future.

Chart 10



Sources: Luzhou Bank annual reports and provided data, adjusted by S&P Global (China) Ratings.

Chart 11



Sources: Data published by CBIRC, public data of peer banks, adjusted by S&P Global (China) Ratings.

We expect the size of bad debt write-off will remain low over the next two years. Given the good asset quality and effective bad debt collection efforts, Luzhou Bank has maintained a very low write-off level. The average net write-off/average customer loan ratio was 0.07% from 2016 to 2018.

Table 7

Luzhou Bank -- Risk Position				
	2015	2016	2017	2018
Non-performing loan ratio (%)	0.30	0.53	0.99	0.80
(Non-performing loans + special mention loans)/customer loans (%)	8.62	5.53	3.71	2.48
Loan loss reserves/customer loans (%)	2.75	2.58	2.93	2.54
Reserve coverage ratio (%)	920.6	486.6	294.5	319.4
Loan loss reserves/ (non-performing loans + special mention loans) (%)	31.92	46.71	78.76	102.49
Net write-offs/average customer loans (%)	-0.02	0.05	0.12	0.04

Sources: Luzhou Bank annual reports and provided data, adjusted by S&P Global (China) Ratings.

Table 8

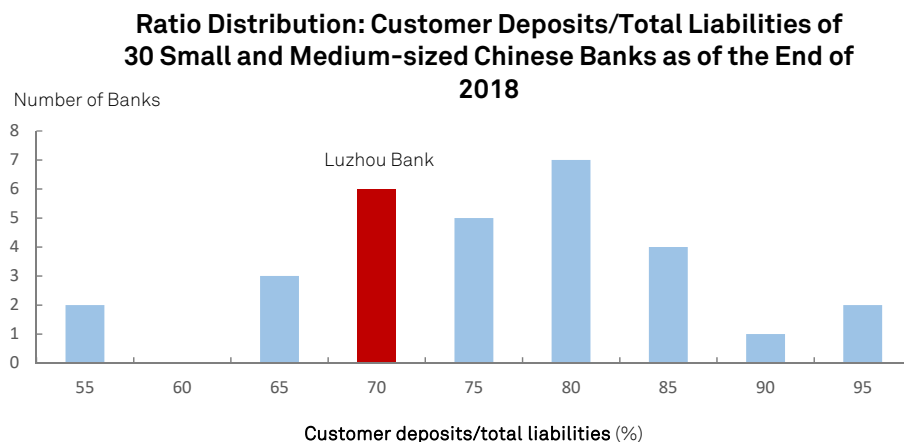
Peer Comparison -- Risk Position						
(2016-2018 three-year avg.)	Luzhou Bank	Peer Group				
		Max	Min	Average	Asset-weighted average	Median
Non-performing loan ratio (%)	0.77	2.71	0.77	1.71	1.83	1.57
(Non-performing loans + special mention loans)/customer loans (%)	3.91	10.97	3.10	7.10	7.48	7.29
Loan loss reserves/customer loans (%)	2.68	6.11	2.68	3.76	3.97	3.14
Reserve coverage ratio (%)	366.8	366.8	177.6	249.5	244.4	245.3
Loan loss reserves/ (non-performing loans + special mention loans) (%)	75.99	104.01	28.28	64.55	62.81	57.98
Net write-offs/average customer loans (%)	0.07	0.63	-0.04	0.22	0.27	0.11

Sources: public data of peer banks, adjusted by S&P Global (China) Ratings.

Funding and Liquidity

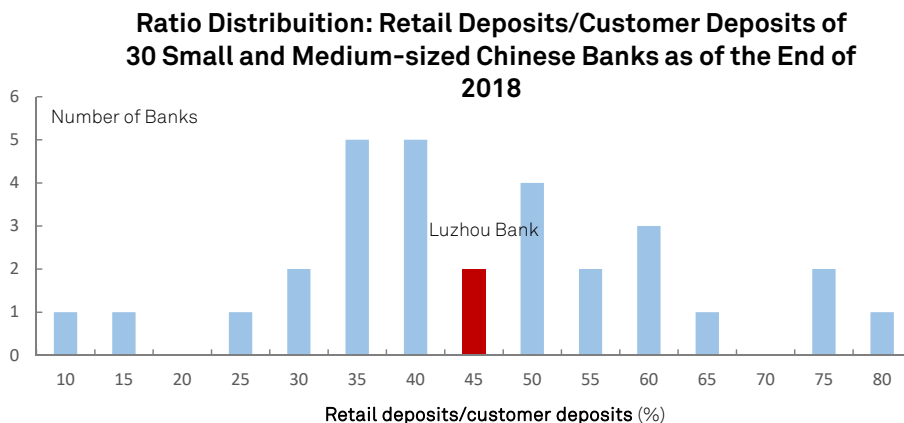
Luzhou Bank's major funding source is customer deposits, and its overall funding structure is in line with the industry average. As of the end of 2018, 69% of its liabilities were customer deposits, and 42% of its deposits were retail deposits. It has a solid and expanding retail deposit base thanks to its highly popular retail deposit products. Owing to its deep relationship with local corporate clients, it also has a sticky corporate deposit base.

Chart 12



Sources: S&P Global Market Intelligence SNL Database, adjusted by S&P Global (China) Ratings.

Chart 13



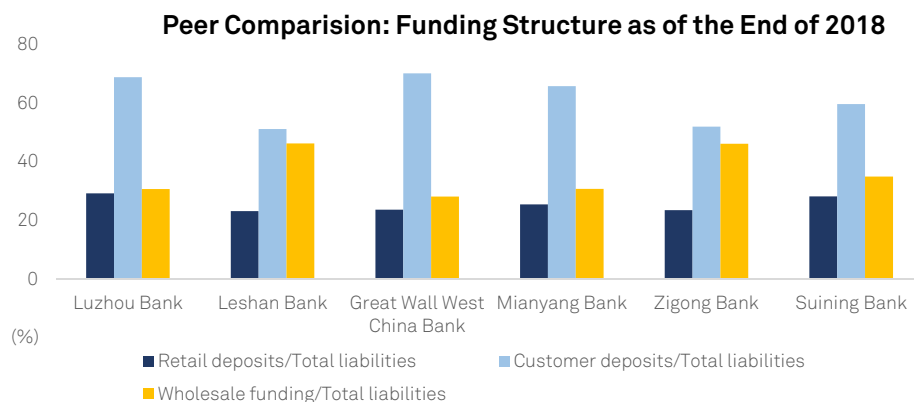
Sources: S & P Global Market Intelligence SNL Database, adjusted by S&P Global (China) Ratings.

Luzhou Bank has benefited from its expanding deposit base, and is now less reliant on wholesale funding, which is positive for its funding stability. During its rapid expansion in 2016 and 2017, over 35% of the bank's funding was wholesale funding, which was above the industry average. As of the end of 2018, this ratio dropped to 31%, which is approaching the industry average.

Luzhou Bank has solid and sticky deposit base in Luzhou, and its funding and liquidity level is consistent with the industry average.

There is no notching adjustment for funding and liquidity.

Chart 14



Sources: public data of peer banks, adjusted by S&P Global (China) Ratings.

Table 9

Luzhou Bank – Funding and Liquidity				
	2015	2016	2017	2018
Customer loans/customer deposits (%)	48.95	46.86	46.03	59.71
Customer deposits/total liabilities (%)	71.57	62.95	63.33	68.76
Wholesale funding /total liabilities (%)	26.35	35.60	35.21	30.64
Retail deposits/customer deposits (%)	20.61	31.13	38.04	42.43

Note: wholesale funding=borrowing from central government + borrowing and deposits from other financial institutions+ financial assets sold for repurchase + transactional monetary liabilities + bonds payable

Sources: Luzhou Bank annual reports and provided data, adjusted by S&P Global (China) Ratings.

We believe that Luzhou Bank has prudent liquidity risk management and has maintained adequate liquidity. According to the *Liquidity Risk Management Rules of Commercial Banks* issued by CBIRC in May 2018, commercial banks with an asset size less than RMB 200 billion are required to meet minimum regulatory requirements for high-quality liquidity asset adequacy ratio, liquidity ratio and liquidity matching ratio on a continuous basis. As of the end of 2018, the bank's high-quality liquidity asset adequacy ratio was 103%, liquidity ratio 73%, and liquidity matching ratio 125%, all in line with regulatory requirements.

Table 10

(2016-2018 three-year avg.)	Luzhou Bank	Peer Group				
		Max	Min	Average	Asset-weighted average	Median
Customer loans/customer deposits (%)	50.87	68.07	50.23	60.57	61.76	65.88
Customer deposits/total liabilities (%)	65.01	65.73	48.72	60.70	60.12	62.77
Wholesale funding /total liabilities (%)	33.82	48.48	32.43	37.04	37.59	34.39
Retail deposits/customer deposits (%)	37.20	38.96	28.70	34.96	34.79	36.22

Sources: public data of peer banks, adjusted by S&P Global (China) Ratings.

Luzhou Bank is small, and its geographic concentration is significantly higher than larger competitors.

We believe that Luzhou Bank is efficient in its operations and management, and its current asset quality is better than the industry average.

Due to rapid growth in recent years, its loan book remains largely unseasoned and there is uncertainty regarding its future asset quality performance.

Luzhou Bank is assigned an SACP of bbb-, two notches lower than its anchor of bbb+.

Issuer Credit Rating

External Support

Luzhou Bank is a state-controlled city bank. As of the end of 2018, the bank's largest shareholder is Luzhou Laojiao Group, a state-owned liquor company based in Luzhou, which held about 15% of its total shares; the Luzhou municipal government directly owned about 7% of its shares. The government and local SOEs collectively owned about 45.44% of its shares. The leadership of the bank is appointed by the Luzhou municipal government.

As the only city bank based in Luzhou, Luzhou Bank has received strong support from the municipal government for its business expansion. The Luzhou municipal government has viewed the bank's development as an integral part of the overall financial industry development of Luzhou. To support its rapid expansion, the municipal government and local SOEs have injected substantial amount of capital into the bank in recent years.

Luzhou Bank has a leading market position in Luzhou and plays an important role in the economic development of the city. Its role is particularly significant in meeting the financing needs of local SMEs and small business owners.

We believe that the Sichuan provincial government is committed to maintain regional financial stability. Since 2019, Sichuan provincial government has further enhanced its liquidity risk management of city and rural banks based in the province. We believe that Luzhou Bank may benefit from the liquidity support policy of the provincial government.

Although Luzhou Bank's market share is small in China, we believe that it may still receive some level of support from the central government. We view that the bank is committed to serving local small businesses, which is in line with the central government's positioning for small and medium-sized banks. We anticipate that the central government will maintain its general supportive stance for small and medium-sized banks and the central bank will continue to provide these banks with liquidity support.

Overall, we believe that Luzhou Bank is likely to receive various degrees of support from different levels of government as well as the central bank in time of stress. Therefore, we assign an ICR of BBB to Luzhou Bank, representing one-notch uplift from its SACP of bbb-.

We believe that as a state-controlled city bank, Luzhou Bank has received strong supports from the municipal government.

We believe that Sichuan provincial government is committed to maintaining the stability and health of city and rural banks based in the province.

We expect that the central government will maintain its general policy to support small and medium-sized banks.

We believe government support results in one-notch uplift from its SACP of bbb- and therefore we assign an ICR of BBB to Luzhou Bank.

Appendix 1: Key Financial Data

Luzhou Bank -- Key Financial Data				
	2015	2016	2017	2018
Business Position				
Total assets (bil)	31.76	53.28	70.88	82.55
Customer loans (gross) (bil)	9.98	14.53	19.40	31.28
Customer deposits (bil)	20.38	31.02	42.15	52.39
Total equity (bil)	3.28	4.01	4.34	6.37
Operating income (bil)	0.94	1.31	1.68	1.93
Net income (bil)	0.45	0.54	0.62	0.66
Total assets / total assets of China's commercial banking industry (%)	0.02	0.03	0.04	0.04
Customer loans/total loans of China's commercial banking industry (%)	0.01	0.02	0.02	0.03
Customer deposits/total deposits of China's commercial banking industry (%)	0.01	0.02	0.02	0.03
Capital and Earnings				
Regulatory total capital adequacy ratio (%)	18.58	13.62	13.69	13.29
Regulatory tier 1 capital adequacy ratio (%)	17.53	12.68	10.40	10.69
Net interest margin adjusted by S&P Global (China) Ratings (%)	3.30	2.78	2.59	2.35
Cost-to-income ratio (%)	24.27	31.46	31.89	34.54
Return on average assets (%)	1.65	1.27	1.00	0.86
Return on average equity (%)	19.68	14.87	14.83	14.25
Risk Position				
Non-performing loan ratio (%)	0.30	0.53	0.99	0.80
(Non-performing loans + special mention loans)/customer loans (%)	8.62	5.53	3.71	2.48
Loan loss reserve/customer loans (%)	2.75	2.58	2.93	2.54
Reserve coverage ratio (%)	920.6	486.6	294.5	319.4
Loan loss reserve/ (non-performing loans + special mention loans) (%)	31.92	46.71	78.76	102.49
Net write-offs/average customer loans (%)	-0.02	0.05	0.12	0.04
Funding and Liquidity				
Retail deposits/customer deposits (%)	20.61	31.13	38.04	42.43
Customer deposits/total liabilities (%)	71.57	62.95	63.33	68.76
Wholesale funding /total liabilities (%)	26.35	35.60	35.21	30.64
Customer loans/customer deposits (%)	48.95	46.86	46.03	59.71

Note: In our view, Luzhou Bank has clear business model and sound financial management. Its annual financial reports have been audited by PricewaterhouseCoopers since 2018. Therefore, we haven't conducted any substantial adjustments to its financial data.

Sources: Luzhou Bank annual reports and provided data, adjusted by S&P Global (China) Ratings.

Appendix 2: Peer Comparison Data

(2016-2018 three-year avg.)	Luzhou Bank	Peer Group				
		Max	Min	Average	Asset-weighted average	Median
Business Position						
Total assets (bil)	68.90	106.58	68.90	85.99	89.20	77.39
Customer loans (gross) (bil)	21.74	42.55	19.81	29.61	30.96	31.13
Customer deposits (bil)	41.85	64.43	40.36	48.06	49.36	45.58
Total equity (bil)	4.90	7.85	4.85	6.00	6.26	4.98
Operating income (bil)	1.64	2.53	1.39	1.84	1.91	1.64
Net income (bil)	0.61	0.61	0.44	0.56	0.56	0.59
Capital and Earnings						
Regulatory total capital adequacy ratio (%)	13.53	13.97	12.05	12.95	13.01	12.97
Regulatory tier 1 capital adequacy ratio (%)	11.25	11.46	10.30	10.92	10.86	10.92
Net interest margin adjusted by S&P Global (China) Ratings (%)	2.57	2.57	1.89	2.21	2.19	2.23
Cost-to-income ratio (%)	32.63	37.96	29.60	33.46	33.57	32.63
Return on average assets (%)	1.04	1.04	0.56	0.75	0.72	0.72
Return on average equity (%)	14.65	14.65	8.24	10.89	10.50	9.82
Risk Position						
Non-performing loan ratio (%)	0.77	2.71	0.77	1.71	1.83	1.57
(Non-performing loans + special mention loans)/customer loans (%)	3.91	10.97	3.10	7.10	7.48	7.29
Loan loss reserves/customer loans (%)	2.68	6.11	2.68	3.76	3.97	3.14
Reserve coverage ratio (%)	366.8	366.8	177.6	249.5	244.4	245.3
Loan loss reserve/ (non-performing loans + special mention loans) (%)	75.99	104.01	28.28	64.55	62.81	57.98
Net write-offs/average customer loans (%)	0.07	0.63	-0.04	0.22	0.27	0.11
Funding and Liquidity						
Customer loans/customer deposits (%)	50.87	68.07	50.23	60.57	61.76	65.88
Customer deposits/total liabilities (%)	65.01	65.73	48.72	60.70	60.12	62.77
Wholesale funding/total liabilities (%)	33.82	48.48	32.43	37.04	37.59	34.39
Retail deposits/customer deposits (%)	37.20	38.96	28.70	34.96	34.79	36.22

Note: In this report, we have chosen four city banks based in Sichuan Province, including Leshan Bank, Great Wall West China Bank, Mianyang Bank and Zigong Bank as the peers of Luzhou Bank for peer comparison purpose. The weights for the asset-weighted average calculation are the three-year average of total assets of these banks from 2016 to 2018. Therefore, the weights of Luzhou Bank, Leshan Bank, Great Wall West China Bank, Mianyang Bank and Zigong Bank are 16.03%, 24.79%, 24.55%, 18.00% and 16.63% respectively.

Sources: public data of peer banks, adjusted by S&P Global (China) Ratings.

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