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S&P Global
China Ratings

Credit Rating Report

Postal Savings Bank of China Co., Ltd.

Issuer Credit Rating*: AAA$_{spc}$; Outlook: Stable

January 3, 2020

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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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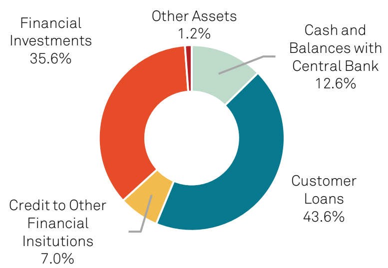
Tear Sheet

Company Name	Rating Type	Current Rating	Rating Date	Outlook/Credit Watch
Postal Savings Bank of China Co., Ltd.	Issuer Credit Rating	AAA$_{spc}$	January 3, 2020	Stable

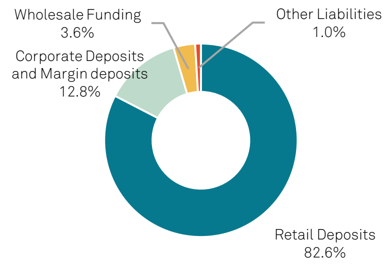
Industry Classification: Commercial Bank

Company Overview: Postal Savings Bank of China Co., Ltd. ("PSBC") is one of the six state-owned mega banks in China. It is a leading retail bank in China and has a very important role in providing banking access to rural and remote areas in China by using China's postal network. As of the end of June 2019, it reported a total asset of 10.07 trillion RMB, ranking the fifth among China's commercial banks.

Asset Breakdown as of the End of 2018



Liability Breakdown as of the End of 2018



Economy and Industry Trends: In our view, China's GDP growth rate may further slow down in 2020 as the government pays more attention to the quality of the economic development, rather than the growth rate of GDP. Should the GDP growth drop become too drastic, we believe that China still has policy space to maintain economic and financial stability. In our view, financial stability is a priority for the government, and this means avoiding blow-out stimulus. We believe that the overall credit profile of the commercial banks in China will remain stable, while their asset quality could still feel downward pressure as the economic growth slows down. In our opinion, small and medium-sized banks may continue to face high funding cost and challenges in liquidity management in 2020. Many of these small banks may also face legacy bad debt problems thanks to under-provisioning in previous years. Meanwhile, state-owned mega banks are expected to maintain stable operations and resilient profitability. Therefore, we believe that the credit profiles of the commercial banks are likely to show greater differentiation in the foreseeable future. We believe that the government is aware of the risks faced by regional banks and measures are taken to stabilize their operations.

Credit Highlights: As one of the six state-owned mega banks of China, PSBC is a leading retail bank in China. It is China's fifth largest bank in terms of both assets and deposits, and the fourth largest in terms of retail deposits. It has a unique "proprietary branches + agency outlets" arrangement with China Post Group, and it covers 99% of counties in China. The bank's asset quality metrics are better than its mega bank peers and the industry average. It has a very solid and sticky funding structure dominated by retail deposits. Thanks to its strong deposit franchise and low loan-to-deposit ratio, it has a liquidity profile significantly better than the industry average. PSBC is indirectly owned by the central government through its parent China Post Group, which is 100% owned by Ministry of Finance of China. We view PSBC as critical to China's financial and social stability and the possibility of it getting central government support in time of stress is extremely high.

Key Metrics of PSBC

	2015	2016	2017	2018	2019.06
Total assets (bil)	7,296.36	8,265.62	9,012.55	9,516.21	10,067.18
Customer deposits (bil)	6,305.01	7,286.31	8,062.66	8,627.44	9,101.19
Net income (bil)	34.86	39.78	47.71	52.38	37.42
Reported regulatory capital adequacy ratio (%)	10.46	11.13	12.51	13.76	12.98
Return on equity (%)	15.20	12.88	12.26	11.56	N.A.
Non-performing loans ratio (%)	0.80	0.87	0.75	0.86	0.82
Reserve coverage ratio (%)	298.15	271.69	324.77	346.80	396.11
Customer deposits/total liabilities (%)	89.74	92.01	93.96	95.43	95.07

Source: PSBC, collected and adjusted by S&P Global (China) Ratings.

Rating Snapshot

Anchor	bbb+
— Business Position	+2
— Capital and Earnings	0
— Risk Position	+1
— Funding and Liquidity	+2
Stand-alone Credit Profile	**aa$_{spc}$**
Government Support	+2
Issuer Credit Rating	**AAA$_{spc}$**
Outlook	**Stable**

Business Position: PSBC is China's fifth largest bank by assets, and the fourth largest by retail deposits. It has the most extensive retail deposit-taking network in China's rural areas, covering 99% of the counties in China.

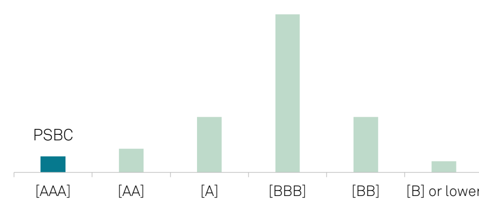
Capital and Earnings: In our view, PSBC has adequate capitalization and healthy profitability. Its recent listing on A-share market can further enhance its capitalization. However, the fast growth of its loan book will continue to be capital-intensive. We expect its capital position to be in line with the industry average.

Risk Position: PSBC's asset quality metrics are better than the industry average and its mega bank peers. Although its loan book is vulnerable to credit risk of small and micro enterprises, we expect it to maintain its good asset quality in the next 24 months.

Funding and Liquidity: Thanks to its extensive network for retail deposit taking, PSBC has a very solid and sticky retail deposit base, and its use of wholesale funding is very limited. Therefore, its funding and liquidity profile is much better than the industry average.

External Support: We believe that PSBC is extremely likely to receive support from central government in time of need, considering its status as a state-owned mega bank, its strong retail franchise, and its important role in providing banking access to rural and remote areas in China.

PSBC's Relative Issuer Credit Rating Position Among Financial Institutions In China



Note: this chart serves as a hypothetical example of S&P Global (China) Ratings' rating distribution of financial institutions. Rating below AAA$_{spc}$ can be adjusted by "+" and "-".

Peer Group Comparison

(The peer group is the six state-owned mega banks in China, including PSBC, ICBC, CCB, ABC, BOC and BoCom.)

(2016-2018 three-year average)	PSBC	Max	Min	Average	Asset-weighted average	Median
Total assets (bil)	**8,931.46**	25,974.62	8,931.46	17,784.34	20,180.45	20,352.75
Customer deposits (bil)	**7,992.14**	19,599.06	5,355.76	13,209.78	15,007.81	15,009.97
Net income (bil)	**46.62**	288.43	46.62	171.70	203.20	190.22
Reported regulatory capital adequacy ratio (%)	**12.47**	15.88	12.47	14.33	14.61	14.30
Return on average equity (%)	**12.23**	14.40	11.03	12.96	13.34	13.05
Non-performing loans ratio (%)	**0.83**	1.93	0.83	1.46	1.53	1.50
Reserve coverage ratio (%)	**314.42**	314.42	155.51	197.56	186.82	172.22
Customer deposits/total liabilities (%)	**93.80**	93.80	64.27	79.96	80.31	81.19

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
Postal Savings Bank of China Co., Ltd.	Issuer Credit Rating	AAA_{spc}	January 3, 2020	Stable

Stand-alone Credit Profile	aa_{spc}
Anchor	bbb+
Business Position	+2
Capital & Earnings	0
Risk Position	+1
Funding & Liquidity	+2
Holistic Adjustment	0

+

External Support	+2
Government Support	+2

Issuer Credit Rating
AAA_{spc} / Stable

Credit Highlights

Strengths	Weaknesses
— Taking advantage of China's postal network, PSBC is a leading retail deposit taker in China and thus enjoys a retail deposit-dominated funding structure significantly more stable than the industry average.	— PSBC started its loan lending business only a decade ago and its lending business franchise is smaller than other mega banks.
— Its asset quality metrics is better than its mega bank peers and the industry average.	— Its operational cost is higher than the industry average because it maintains an extensive network in rural and remote areas.
— It has critical importance to the central government, and it is extremely likely to receive government support in time of stress.	

Rating Outlook

The stable outlook reflects our expectation that PSBC's business operations and financial strength will remain stable over the next two years or beyond. We also anticipate that its critical importance to the central government will remain stable.

Downside Scenario: We may consider lowering the ICR if we believe that the bank's importance to the central government declines, which is highly unlikely in our view. We may also consider lowering the SACP if the bank fails to effectively manage the credit risk of its lending business, resulting in significant deterioration of asset quality metrics, or if its capital adequacy ratios can no longer meet minimum regulatory requirements and there is no plausible plan for immediate and effective remediation.

Upside Scenario: We may consider raising its SACP if its capital adequacy ratios rise significantly above industry average and its management is committed to maintaining its capitalization high on a sustainable basis.

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 Trends

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.

In our view, China's GDP growth rate may further slow down in 2020 as the government pays more attention to the quality of the economic development, rather than the growth rate of GDP. Nevertheless, should the GDP growth drop become too drastic, we believe that China still has policy space to maintain economic and financial stability. In our view, financial stability is a priority, and this means avoiding blow-out stimulus.

We believe that the overall macro economy of China will remain stable in 2020 despite the slowing down of GDP growth, and therefore, the general credit profile of China's commercial banking industry would also remain largely unchanged.

We expect asset quality deterioration to remain a challenge for commercial banks over the next two years as the economic restructuring continues. We expect private sector defaults to remain elevated in 2020; while banks still need more time to clean up their legacy bad debt problems accumulated from previous years.

Due to increasing challenges in asset quality control, we believe that the credit quality of commercial banks is likely to show greater differentiation in the foreseeable future. State-owned mega banks have demonstrated great resilience in both business operations and financial performance. In contrast, some smaller banks, especially those with very aggressive risk appetite in previous years, may face liquidity difficulties and capital base erosion over the next two years. We believe that the government is aware of the risks faced by these banks and measures are taken to stabilize their operations and prevent any systemic level instability.

Stand-alone Credit Profile

PSBC is China's fifth largest commercial bank by assets, and the fourth largest by retail deposits.

It has the most extensive retail deposit-taking network in rural and remote areas, covering 99% of the counties in China.

PSBC is one of the six state-owned mega banks in China. It is a leading retail bank in China and has a very important role in providing banking access to rural and remote areas in China by leveraging its extensive network. As of the end of June 2019, it reported a total asset of 10.07 trillion RMB, ranking the fifth among China's commercial banks.

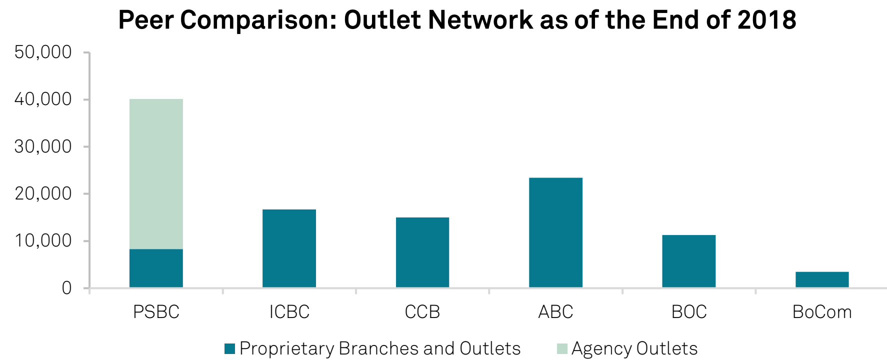
PSBC is indirectly owned by the central government of China through its parent group, China Post Group, which owned 69% of the bank as of the end of June 2019. China Post Group is 100% owned by the Ministry of Finance.

Business Position

We apply two-notch upward adjustment for its business position to reflect its large asset size and very strong franchise in retail banking.

Because of the unique network arrangement of "proprietary branches + agency outlets", PSBC has one of the most extensive deposit taking networks, covering 99% of counties in China. As of the end of June 2019, PSBC had 7,945 proprietary branches and outlets and 31,735 agency outlets. Agency outlets are postal offices operated by China Post Group, which provide retail deposit-taking and other basic banking services on behalf of PSBC.

Chart 1



Note: We consider the other five state-owned mega banks as the peers of PSBC, including Industrial and Commercial Bank of China Limited ("ICBC"), China Construction Bank Corporation ("CCB"), Agricultural Bank of China Limited ("ABC"), Bank of China Limited ("BOC"), and Bank of Communications Co., Ltd. ("BoCom"),

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

Thanks to its unique network, PSBC has a very strong franchise in the retail deposit business with a retail customer base of about 600 million people, representing roughly 40% of China's total population. The bank provides retail banking services in rural and remote areas where banking competition is much weaker than in urban areas. As of the end of June 2019, it had a retail deposit of about 8 trillion RMB, making it the fourth largest retail deposit taker in China, only after ABC, ICBC and CCB. Above 60% of its operating income comes from its retail banking business.

Table 1

PSBC -- Market Share

(%)	2015	2016	2017	2018	2019.06
Total assets /total assets of China's commercial banking industry	4.68	4.55	4.58	4.53	4.33
Gross customer loans/total loans of China's commercial banking industry	3.25	3.47	3.71	3.87	3.81
Customer deposits/total deposits of China's commercial banking industry	4.51	4.68	4.76	4.73	4.72
Retail deposits/total domestic retail deposits of China's commercial banking industry	9.76	10.24	10.52	10.31	9.99

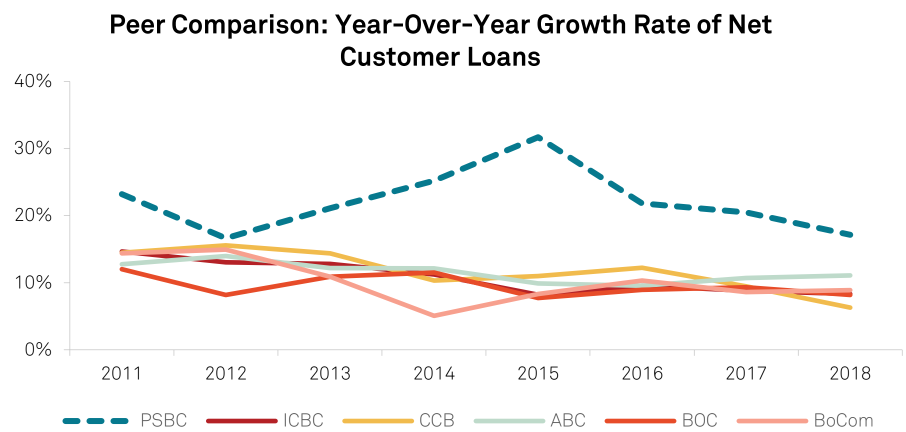
Sources: PSBC, industry data released by CBIRC and PBOC, collected and adjusted by S&P Global (China) Ratings.

Despite the urbanization progress in China and intensifying competition among banks, we expect PSBC to sustain its retail banking competitiveness in the foreseeable future. In our opinion, retail customers in rural areas still prefer conducting their banking activities with a bank with physical presence in their local communities. In addition, PSBC has been investing heavily in financial technology, particularly mobile finance technology, to meet their customers' need to access banking services through mobile phones.

Compared with its very large retail deposit business, PSBC has a relatively small lending business. As of the end of June 2019, the bank had a net loan book of 4.55 trillion RMB and a loan-to-deposit ratio of 52%, significantly lower than the average of 77% for the other five mega banks. PSBC only started its lending business in 2008 so this business is still in its early stage. It has just recently started a pilot program of auxiliary microfinance at agency outlets.

As the youngest mega bank in China with a large retail deposit base and a relatively small loan book, PSBC enjoys lending business growth faster than its peers. We expect it to continue to raise its loan-to-deposit ratio and grow its loan book at a fast pace.

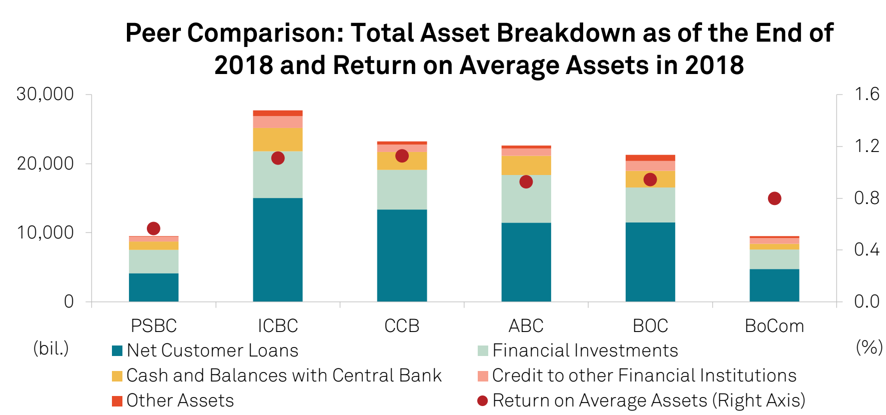
Chart 2



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

The lending business of PSBC focuses on very large enterprises, small enterprises and retail clients. As of the end of June 2019, about 54% of its loan is retail loan, and 13% is micro-financing loans. The bank's large enterprise clients are typically very large SOEs controlled by the central government and leading players in important sectors.

Chart 3



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

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

Because the bank has a relatively low loan-to-deposit ratio, it has a large investment portfolio. As of the end of June 2019, its financial investment portfolio accounted for

37% of its total assets. In addition, its ample funding source makes it one of the largest and most active players in China's interbank market for interbank lending and borrowing.

The bank's main business is traditional deposit taking and lending, and its operating income is dominated by interest income. In 2018, its net fees and commissions income only accounted for 5.5% of its operating income, lower than the average of 17% for the other five mega banks. We don't necessarily view the lack of non-interest income as credit negative as its strong franchise in traditional commercial banking can sustain a stable income flow in the foreseeable future.

Table 2

PSBC -- Business Position

	2015	2016	2017	2018	2019.06
Total assets (bil)	7,296.36	8,265.62	9,012.55	9,516.21	10,067.18
Year-over-year growth of total assets (%)	15.85	13.28	9.04	5.58	N.A.
Gross customer loans (bil)	2,471.85	3,010.65	3,630.14	4,276.87	4,701.67
Year-over-year growth of gross customer loans (%)	31.78	21.80	20.58	17.82	N.A.
Customer deposits (bil)	6,305.01	7,286.31	8,062.66	8,627.44	9,101.19
Year-over-year growth of customer deposits (%)	8.65	15.56	10.65	7.00	N.A.
Operating income (bil)	189.71	188.81	224.57	261.00	141.61
Year-over-year growth of operating income (%)	9.42	-0.47	18.94	16.22	N.A.
Net income (bil)	34.86	39.78	47.71	52.38	37.42
Year-over-year growth of net income (%)	7.03	14.11	19.94	9.80	N.A.
Net fees and commissions income/operating income	4.57	6.09	5.67	5.53	6.60

Sources: PSBC, collected and adjusted by S&P Global (China) Ratings.

Table 3

Peer Comparison -- Business Position

(2016-2018 three-year avg.)	PSBC	Peer Group				
		Max	Min	Average	Asset-weighted average	Median
Total assets (bil)	**8,931.46**	25,974.62	8,931.46	17,784.34	20,180.45	20,352.75
Year-over-year growth of total assets (%)	**9.30**	10.15	7.65	8.64	8.35	8.29
Gross customer loans (bil)	**3,639.22**	14,249.72	3,639.22	9,485.06	10,944.74	10,845.02
Year-over-year growth of customer loans (%)	**20.06**	20.06	8.96	11.21	10.32	9.48
Customer deposits (bil)	**7,992.14**	19,599.06	5,355.76	13,209.78	15,007.81	15,009.97
Year-over-year growth of customer deposits (%)	**11.07**	11.07	7.83	9.07	8.86	8.84
Operating income (bil)	**224.79**	725.39	200.60	469.48	540.78	518.78
Year-over-year growth of operating income (%)	**11.56**	11.56	2.07	4.56	3.89	3.42
Net income (bil)	**46.62**	288.43	46.62	171.70	203.20	190.22
Year-over-year growth of net income (%)	**14.62**	14.62	2.37	5.11	4.11	3.65
Net fees and commissions income/operating income	**5.76**	19.82	5.76	16.20	17.16	18.53

Note: We have chosen the other five state-owned mega banks in China, including ICBC, CCB, ABC, BOC and BoCom, as the peers of PSBC, 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 PSBC, ICBC, CCB, ABC, BOC and BoCom are 8.37%, 24.34%, 20.71%, 19.75%, 18.39% and 8.43% respectively.

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

Capital and Earnings

In our opinion, PSBC's capitalization is consistent with the industry average. Its reported regulatory capital adequacy ratio was 12.98% as of the end of June 2019, comfortably above the minimum regulatory requirement of 10.5%. Its reported regulatory capital ratios are the lowest among the six mega banks, but we believe this difference is partly attributable to different regulatory capital calculation methods. PSBC uses standard approach for risk-weighted asset calculation while the other five mega banks use their own internal models to decide on the risk weights. This difference renders capital adequacy ratios less comparable among the mega banks.

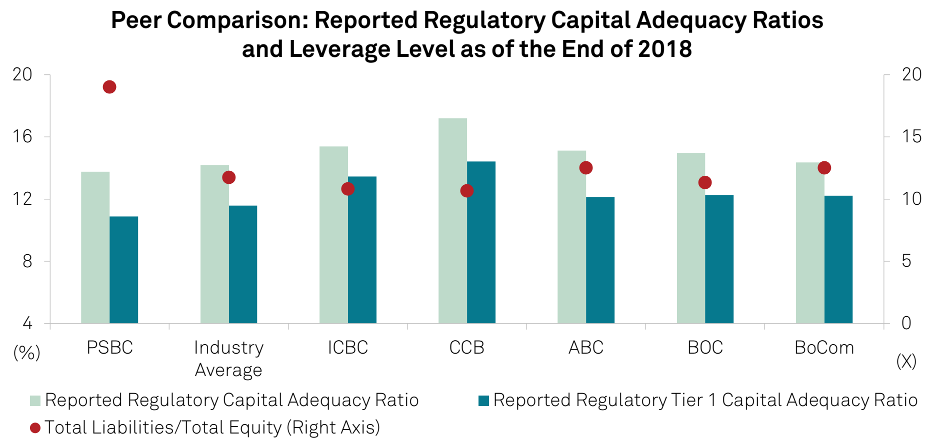
In our view, PSBC has adequate capitalization and healthy profitability.

Its recent listing on A-share market can further enhance its capital base.

Meanwhile, the fast growth of its loan book will continue to be capital-intensive.

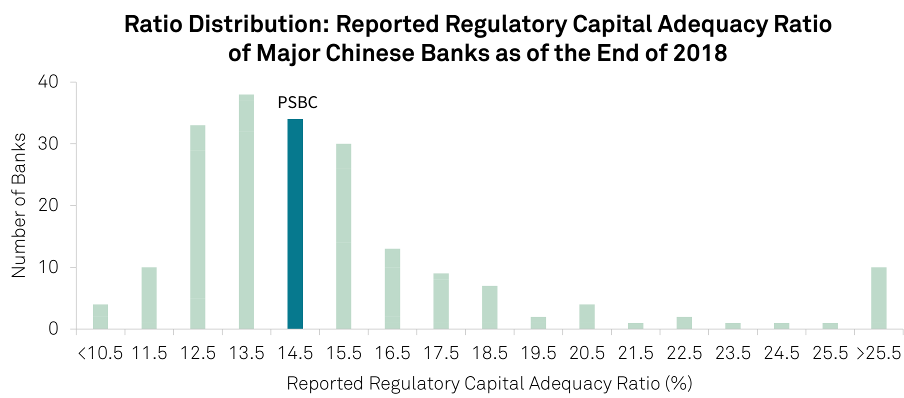
Its capital position is expected to be in line with the industry average. There is no notching adjustment for capital and earnings.

Chart 4



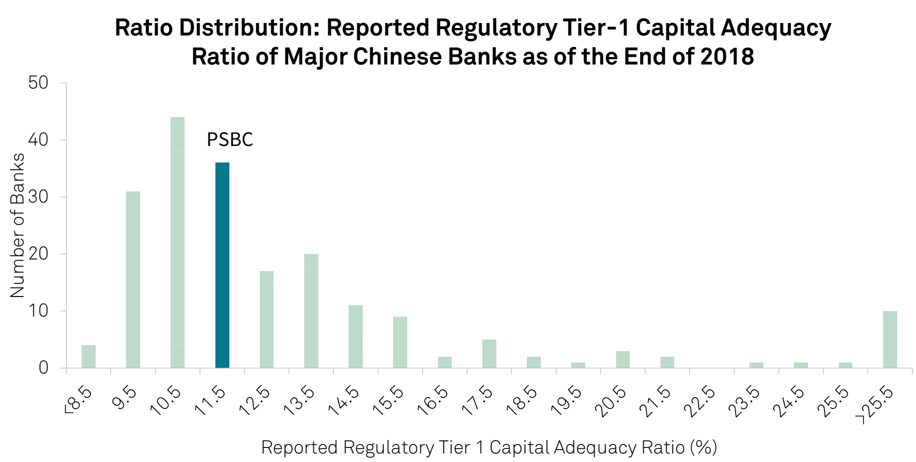
Sources: CBIRC, public data of peer banks, collected and adjusted by S&P Global (China) Ratings.

Chart 5



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

Chart 6



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

PSBC'S recent listing on A-share market improves its access to capital market for equity financing. The bank was listed in Hong Kong stock market (the H-share market) in 2016 and it was also listed in the A-share market in December 2019.

PSBC plans to maintain its capital adequacy level at least one percentage point higher than the minimum regulatory requirements in the 2019 to 2021 planning period. In our view, this capitalization target is easily achievable through retained earnings. Nevertheless, the capital consumption of PSBC is expected to be intensive as it expands its loan book and reduces investment with lower risk weights. But we expect it to maintain adequate capitalization given its good asset quality, listing on A+H stock market and plan to issue tier-1 perpetual bonds in 2020.

Table 4

PSBC -- Capital Adequacy Forecast by S&P Global (China) Ratings

	2017A	2018A	2019E	2020E
Total risk-weighted assets (bil)	4,440.50	4,316.22	4,871.32	5,426.30
- Credit risk (bil)	4,116.14	3,974.79	4,455.74	4,901.32
- Market risk (bil)	65.82	50.92	51.11	55.03
- Operational risk (bil)	258.54	290.51	364.46	469.95
Total capital (bil)	555.45	593.73	677.81	748.09
Tier 1 capital (bil)	429.56	469.61	547.19	598.64
Total capital adequacy ratio forecast (%)	12.51	13.76	13.9	13.8
Tier 1 capital adequacy ratio forecast (%)	9.67	10.88	11.2	11.0

Note:

As of the end of June 2019, the outstanding off-balance sheet wealth management products (WMPs) accounted for 17% of its gross total loans, and the dominating part of the underlying assets in these WMPSs are standard bonds and only a small portion is fixed income investment in non-standardized products. We don't expect these outstanding WMPs to have any significant impact on the bank's overall capitalization.

S & P Global (China) Ratings' base case assumptions include: 1. total assets grow at a rate of 7.5% between 2018 and 2020; 2. by the end of 2020, NPL ratio is about 1% and reserve coverage ratio is about 350%; 3.NIM will be at the level of 2.5% ; 4. cost-to-income ratio remains about 55%; 5. return on average asset stays between to 0.6 to 0.7%, and return on average equity stays above 12%; 6. annual dividend payout ratio stays between 25%-30%. Meanwhile, we have not considered any hybrid bond issuance or equity capital injection in our forecast. If we include issuance of tier 1 perpetual bond (maximum 80 billion RMB) in 2020 into our forecast, total capital adequacy ratio is expected to be in the range of 14% to 15% as of the end of 2020.

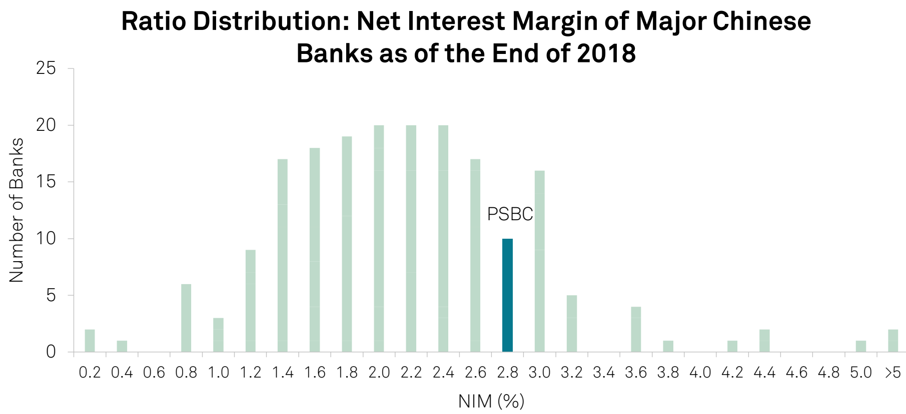
Note: A-actual; E-expected.

Source: 2017 and 2018 data are regulatory filing of PSBC, collected and adjusted by S&P Global (China) Ratings.

Thanks to its low-cost sticky retail deposit funding base, the Net Interest Margin ("NIM") of PSBC is above the industry average. In 2018, it had a NIM of 2.67%, 0.49 percentage point higher than the industry average and 0.60 percentage point higher than the average for the other five mega banks.

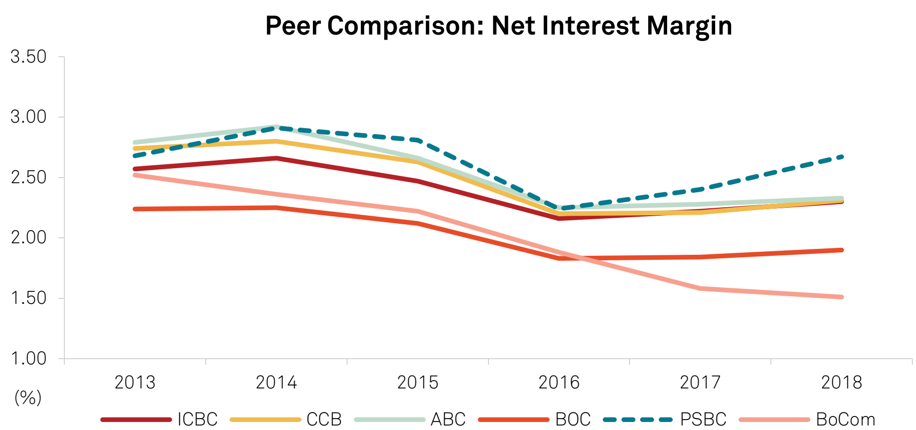
In our view, NIM of PSBC is more resilient against downward pressure compared with its peers. Within its interest-generating assets, its loan book has the highest interest rate. The bank has strong potential in expanding its loan book as its loan-to-deposit ratio was only 52% as of the end of June 2019.

Chart 7



Sources: Wind, collected and adjusted by S&P Global (China) Ratings.

Chart 8

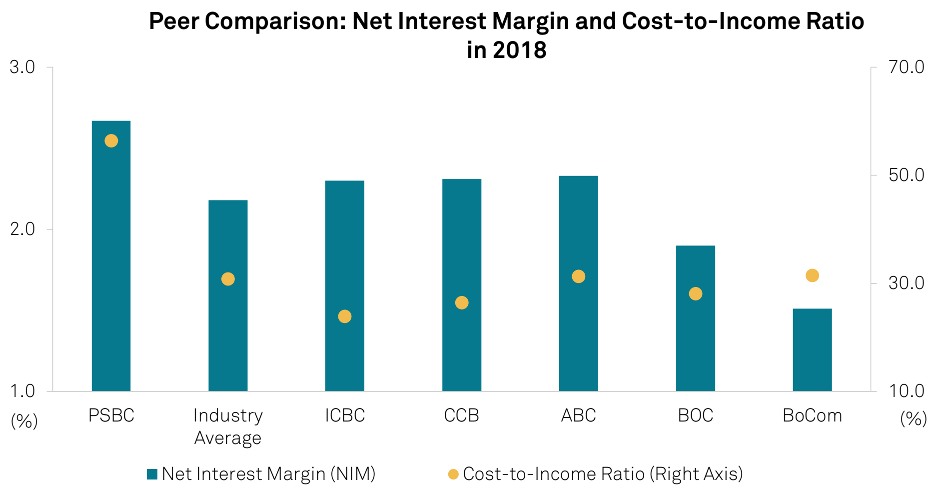


Sources: Wind, collected and adjusted by S&P Global (China) Ratings.

In our opinion, owing to its sound asset quality, the bank's credit cost is manageable. 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. As its loan loss reserve can comfortably cover its NPLs and SMLs, we don't expect any drastic increase of provisioning in the next 24 months.

PSBC's operational cost is higher than its peers because it needs to maintain an extensive network in rural and remote areas. Although the low-cost sticky retail deposit base help it to have a healthy NIM, it is expensive to access that client base in terms of operations. This cost is mainly reflected in the agency fee it pays to China Post Group for the agency outlets' efforts of deposit collection on its behalf. Typically, this agency fee accounts for about half of its total operating expenses. This unique cost leads to a high cost-to-income ratio which was 56% in 2018, higher than the industry average of 31% and the average of 28% for the other five mega banks.

Chart 9



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

Because of high agency fee expense in its cost structure, PSBC has a low return on assets ratio compared with its peers. In 2018, its return on assets was 0.57%, lower than the industry average of 0.90% and the average of 0.98% for the other five mega banks.

In our view, the bank's overall profitability is healthy and contributes significantly to the sustainability of its capitalization. In 2018, the bank's return on equity was 12.31%, similar to the industry average and its peers. Because of its good asset quality, we view its earning quality as solid.

Table 5

PSBC -- Capital and Earnings

	2015	2016	2017	2018	2019.06
Reported regulatory tier 1 capital adequacy ratio (%)	8.53	8.63	9.67	10.88	10.26
Reported regulatory capital adequacy ratio (%)	10.46	11.13	12.51	13.76	12.98
Reported net interest margin (%)	2.78	2.24	2.40	2.67	N.A.
Net interest margin adjusted by S&P Global (China) Ratings (%)	2.67	2.05	2.21	2.56	N.A.
Cost-to-income ratio (%)	60.81	66.47	61.57	56.41	51.08
Return on average assets (%)	0.51	0.51	0.55	0.57	N.A.
Return on average equity (%)	15.20	12.88	12.26	11.56	N.A.
Reported return on assets (%)	0.51	0.51	0.55	0.57	N.A.
Reported return on equity (%)	15.20	13.44	13.07	12.31	N.A.

Note 1: Return on average assets =net income/ [(total assets at the beginning of the year +total assets at the end of the year)/2]

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

Note 3: Net Interest Margin 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]

Source: PSBC, collected and adjusted by S&P Global (China) Ratings.

Table 6

Peer Comparison -- Capital and Earnings

(2016-2018 three-year avg.)	PSBC	Peer Group				
		Max	Min	Average	Asset-weighted average	Median
Reported Tier 1 capital adequacy ratio (%)	**9.73**	13.76	9.73	12.10	12.45	12.13
Reported regulatory capital adequacy ratio (%)	**12.47**	15.88	12.47	14.33	14.61	14.30
Net Interest Margin adjusted by S&P Global (China) Ratings (%)	**2.27**	2.27	1.59	2.04	2.07	2.16
Provisioning/pre-provisioning operating profits	**36.67**	36.67	25.35	30.01	29.15	29.10
Cost-to-income ratio (%)	**61.48**	61.48	24.76	33.91	30.71	29.44
Return on average assets (%)	**0.54**	1.15	0.54	0.94	1.00	0.97
Return on average equity (%)	**12.23**	14.40	11.03	12.96	13.34	13.05

Note 1: the peer group includes the six state-owned mega banks.

Note 2: Provisioning/pre-provisioning operating profits= Asset impairment loss / (Net profit on continuing operations before non-recurring, impairment and tax expense)

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

Note 4: Return on average equity =net income/ [(total equity at the beginning of the year +total equity at the end of the year)/2]

Note 5: 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]

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

Risk Position

PSBC has maintained sound asset quality in recent years as indicated by its good asset quality metrics. As of the end of June 2019, its combined non-performing loans ("NPLs") plus special mention loans ("SMLs") ratio was 1.49% of its total loans, significantly lower than the industry average of 4.75% and the average of 4.04% for the other five mega banks. Thanks to its good asset quality, its net write-off ratio in 2018 was only 0.18%, much lower than the average of 1% for the other five mega banks.

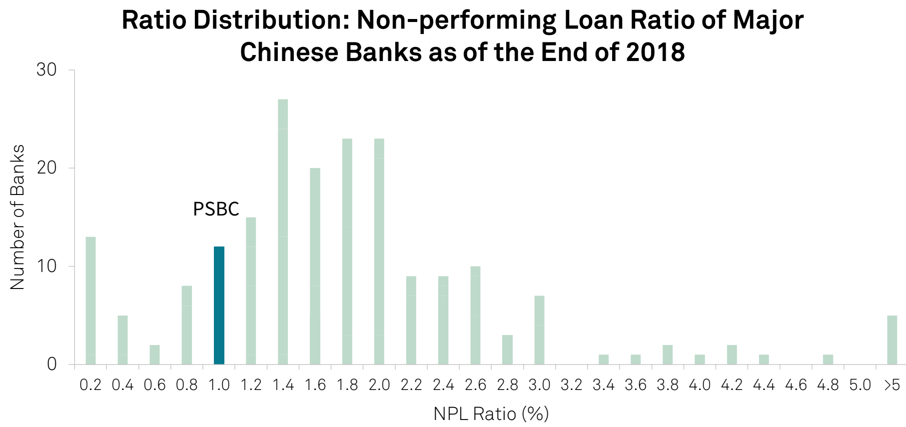
Although the bank may increase its credit exposure to small and micro enterprises which can be vulnerable to economic slowdown, we expect its asset quality to remain good in the next 24 months. As of the end of June 2019, the small and micro enterprise loan portfolio accounted for 13.65% of its total loan book, which face a higher credit risk. But we don't expect this portfolio to become a dominant part of its loan book in the next 2 years. One important reason for its good asset quality metrics is its large lending exposure to retail customers (particularly mortgage customers) and very strong SOEs.

PSBC's asset quality metrics are better than the industry average and its mega bank peers.

Its loan book is exposed to credit risk of small and micro enterprises, but we expect it to maintain good asset quality metrics in the next 24 months.

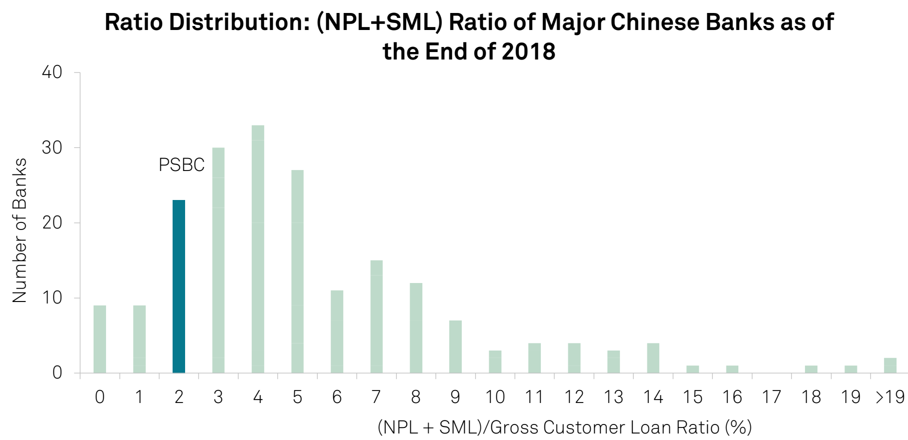
Therefore, there is one notch uplift adjustment for risk position.

Chart 10



Source: S&P Global Market Intelligence Database, collected and adjusted by S&P Global (China) Ratings.

Chart 11



Source: S&P Global Market Intelligence Database, collected and adjusted by S&P Global (China) Ratings.

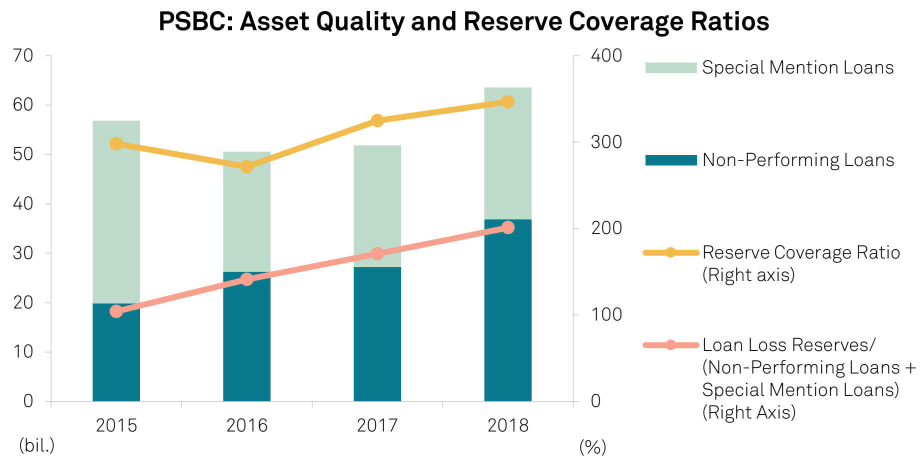
We believe that the bank takes a disciplined approach in its loan credit risk classification. As of the end of June 2019, all its loans overdue over 90 days were classified as NPLs, the ratio of NPLs to loans overdue over 90 days was 124%, and the ratio of SMLs to its loans overdue less than 90 days was 213%.

In our view, the bank's exposure to latent credit risk is limited and manageable in its loan book. As of the end of June 2019, 0.01% of its loans was restructured loan and 0.12% of its loans were extended loans.

The bank has a limited exposure to local government financing vehicles ("LGFVs"). As of the end of June 2019, about 3% of its loan book was lent to LGFVs, and there were no bad debts in its LGFV loan portfolio.

The bank's credit exposure to the real estate industry has generally good asset quality. As of the end of June 2019, the bank's mortgage lending portfolio accounted for 33% of its loan book, with an NPL ratio of 0.36%; its loans to the real estate industry only accounted for 1.4% of its total loans, with an NPL ratio of 0.02%.

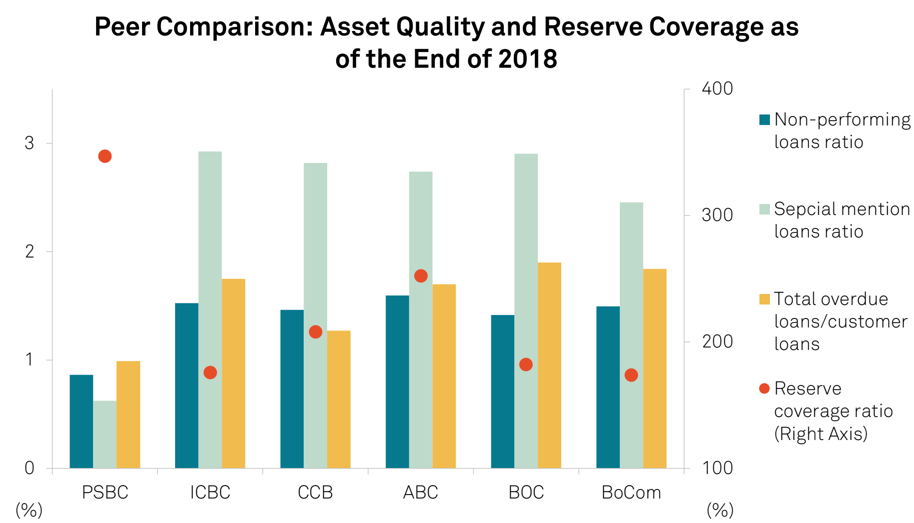
Chart 12



Source: PSBC, collected and adjusted by S&P Global (China) Ratings.

In our view, thanks to strong asset quality metrics and prudent provisioning policies, its reserve coverage of bad debts is better than its peers. We believe that PSBC has sufficient reserve coverage for both NPLs and SMLs. As of the end of June 2019, its loan loss reserves were 396% of its non-performing loan, and 218% of its combined NPLs and SMLs.

Chart 13



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

We believe that the credit risk of PSBC's large investment portfolio is manageable. As of the end of June 2019, about 88% of its investment portfolio is credit exposure to governments and financial institutions. In addition, about 84% of its investment portfolio is bonds and the bank's credit exposure to shadow banking is limited.

Table 7

PSBC -- Risk Position

	2015	2016	2017	2018	2019.06
Non-performing loan ratio (%)	0.80	0.87	0.75	0.86	0.82
(Non- performing loans + special mention loans)/gross customer loans (%)	2.30	1.68	1.43	1.49	1.49
Loan loss reserves/gross customer loans (%)	2.40	2.37	2.44	2.99	3.23
Reserve coverage ratio (%)	298.15	271.69	324.77	346.80	396.11
Loan loss reserves/ (non-performing loans + special mention loans) (%)	104.20	141.33	170.78	201.08	217.98
Net write-offs/average gross customer loans (%)	0.32	0.28	0.12	0.18	N.A.

Source: PSBC, collected and adjusted by S&P Global (China) Ratings.

Table 8

Peer Comparison -- Risk Position

(2016-2018 three-year avg.)	PSBC	Peer Group				
		Max	Min	Average	Asset-weighted average	Median
Non-performing loan ratio (%)	**0.83**	1.93	0.83	1.46	1.53	1.50
(Non- performing loans + special mention loans)/gross customer loans (%)	**1.53**	5.35	1.53	4.19	4.53	4.38
Loan loss reserves/gross customer loans (%)	**2.60**	3.97	2.40	2.74	2.78	2.51
Reserve coverage ratio (%)	**314.42**	314.42	155.51	197.56	186.82	172.22
Loan loss reserves/ (non-performing loans + special mention loans) (%)	**171.06**	171.06	46.70	77.89	68.44	58.53
Net write-offs/average gross customer loans (%)	**0.19**	1.02	0.19	0.65	0.70	0.67

Note1: the peer group includes the six state-owned mega banks.

Note2: Net write-offs=write-offs – recoveries

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

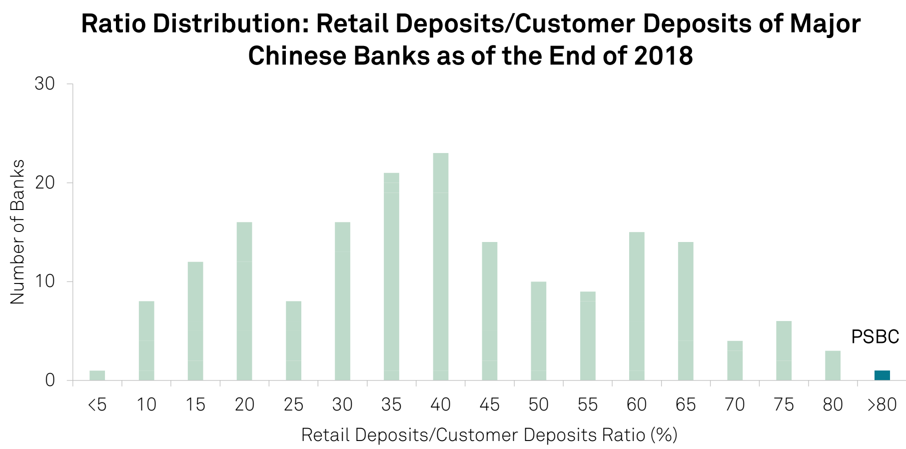
Funding and Liquidity

PSBC has a very solid and sticky retail deposit base in China, and its funding structure is dominated by retail deposits. Its funding and liquidity profiles are significantly better than the industry average.

Therefore, there is two-notch uplift for funding and liquidity.

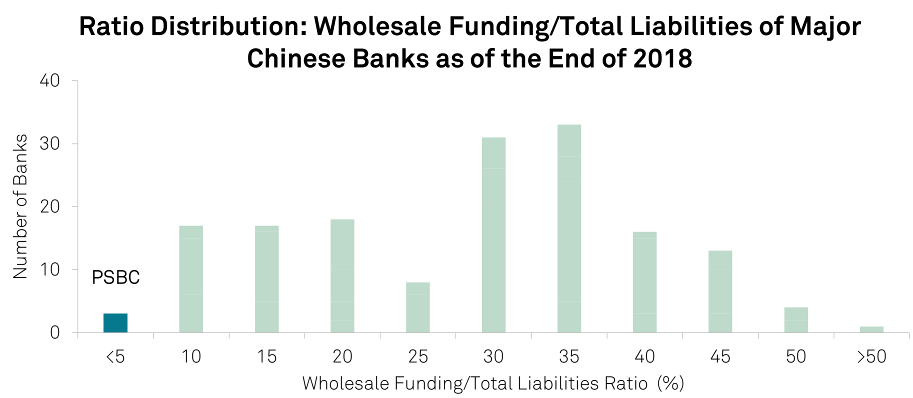
In our opinion, PSBC has a very stable funding structure thanks to its large sticky retail deposit base, and the stability of its funding structure is significantly better than the industry average. Retail deposits are its dominant funding source. As of the end of June 2019, 95% of its liabilities were customer deposits, and 87% of its deposits were retail deposits. Its use of wholesale funding was less than 4% of its total liabilities, significantly than its peers and the industry average.

Chart 14



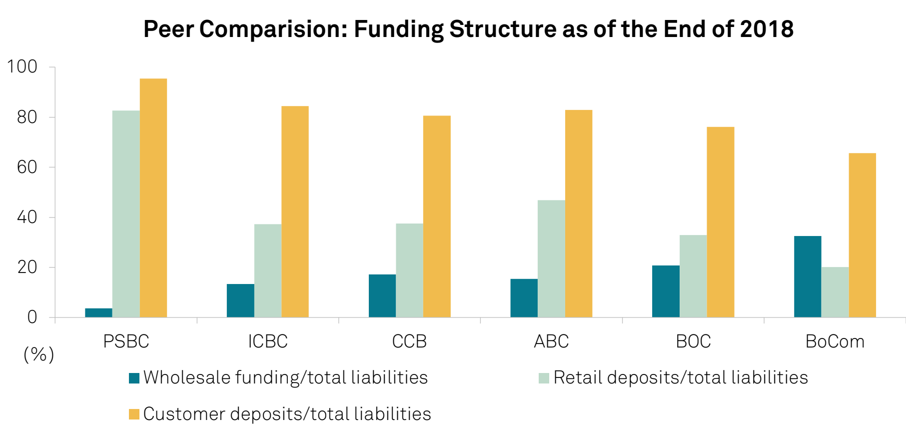
Source: S&P Global Market Intelligence Database, collected and adjusted by S&P Global (China) Ratings.

Chart 15



Source: S&P Global Market Intelligence Database, collected and adjusted by S&P Global (China) Ratings.

Chart 16



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

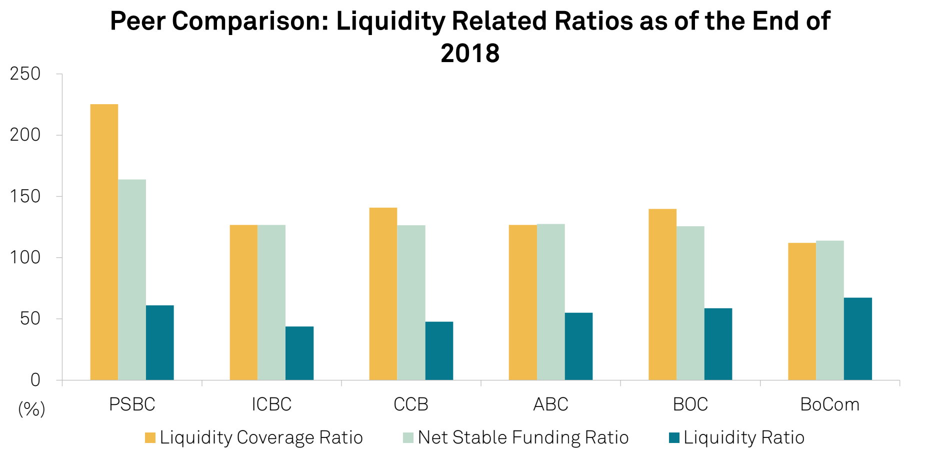
Because of its low loan-to-deposit ratio and large bond investment portfolio, the bank's overall asset structure has a better liquidity profile compared with the industry

PSBC is assigned an SACP of aa_{spc}, five notches higher than its anchor of bbb+. Its SACP reflects its very strong business franchise as a leading retail bank in China, good asset quality, and very strong funding and liquidity profile.

average. As of the end of June 2019, 45% of its assets are loan portfolio, and 28% are invested into government bonds and policy bank bonds which has generally good liquidity.

PSBC has the best liquidity metrics among its peers. As of the end of June 2019, the bank's liquidity coverage ratio was 196%, significantly higher than the average of 132% for the other five mega banks.

Chart 17



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

Table 9

PSBC – Funding and Liquidity

	2015	2016	2017	2018	2019.06
Customer loans/customer deposits (%)	39.20	41.32	45.02	49.57	51.66
Customer deposits/total liabilities (%)	89.74	92.01	93.96	95.43	95.07
Wholesale funding /total liabilities (%)	8.34	6.20	4.13	3.62	3.97
Retail deposits/customer deposits (%)	85.43	85.23	85.10	86.56	87.02
Liquidity coverage ratio (%)	122.47	128.19	145.79	225.20	195.76
Net stable funding ratio (%)	-	-	-	163.91	158.20

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

Source: PSBC, collected and adjusted by S&P Global (China) Ratings.

Table 10

Peer Comparison -- Funding and Liquidity

(2016-2018 three-year avg.)	PSBC	Peer Group				
		Max	Min	Average	Asset-weighted average	Median
Customer loans/customer deposits (%)	**45.31**	84.46	45.31	71.07	72.53	75.66
Customer deposits/total liabilities (%)	**93.80**	93.80	64.27	79.96	80.31	81.19
Wholesale funding /total liabilities (%)	**4.65**	33.22	4.65	17.34	16.84	16.00
Retail deposits/customer deposits (%)	**85.63**	85.63	31.05	51.21	49.33	45.10
Liquidity coverage ratio (%)	**166.39**	166.39	111.36	131.87	130.31	128.44

Note: the peer group includes the six state-owned mega banks.

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

Issuer Credit Rating

External Support

In our opinion, as one of the six state-owned mega banks in China, PSBC has critical importance to the central government for financial stability and social stability in China.

We believe that PSBC has a unique role in providing basic financial services to rural and remote areas of China and it is very important for the central government's goal of achieving financial inclusiveness. It has about 600 million people as its retail clients, representing 40% of the total population in China, and its services cover 99% of China's counties.

In our view, the central government's indirect ownership of PSBC through China Post Group is long-term and strategic. China Post Group held 69% of the bank's equity as of the end of June 2019. Although China Post Group's ownership dropped mildly after its A-share market listing in December 2019, we expect the group to maintain its controlling shareholder status. China Post Group is 100% owned by the Ministry of Finance of China. It is entrusted by the central government to provide universal postal services in China. As of the end of 2018, the bank accounted for 97% of the total assets of the group, and its net income accounted for 117% of the net income of the group in 2018. If PSBC gets into stress, we expect extraordinary supports to directly come from the central government instead of the parent group because the bank is critically important to the government.

Overall, we believe that PSBC has extremely high likelihood of receiving extraordinary government support due to its very large size and important social function. Therefore, we assign an ICR of AAA_{spc} to PSBC, representing two-notch uplift from its SACP of aa_{spc}.

We believe that as one of the six state-owned mega banks in China, PSBC has critical importance to the central government for financial and social stability in China.

The extremely high likelihood of government support results in two-notch uplift from its SACP of aa_{spc} and therefore we assign an ICR of AAA_{spc} to PSBC.

Appendix 1: Key Financial Data

PSBC -- Key Financial Data

	2015	2016	2017	2018	2019.06
Business Position					
Total assets (bil)	7,296.36	8,265.62	9,012.55	9,516.21	10,067.18
Gross customer loans (bil)	2,471.85	3,010.65	3,630.14	4,276.87	4,701.67
Customer deposits (bil)	6,305.01	7,286.31	8,062.66	8,627.44	9,101.19
Total equity (bil)	270.83	346.89	431.36	475.31	494.06
Operating income (bil)	189.71	188.81	224.57	261.00	141.61
Net income (bil)	34.86	39.78	47.71	52.38	37.42
Total assets / total assets of China's commercial banking industry (%)	4.68	4.55	4.58	4.53	4.33
Customer loans/total loans of China's commercial banking industry (%)	3.25	3.47	3.71	3.87	3.81
Customer deposits/total deposits of China's commercial banking industry (%)	4.51	4.68	4.76	4.73	4.72
Capital and Earnings					
Reported regulatory capital adequacy ratio (%)	10.46	11.13	12.51	13.76	12.98
Reported regulatory tier 1 capital adequacy ratio (%)	8.53	8.63	9.67	10.88	10.26
Reported net interest margin (%)	2.78	2.24	2.40	2.67	N.A.
Net interest margin adjusted by S&P Global (China) Ratings (%)	2.67	2.05	2.21	2.56	N.A.
Cost-to-income ratio (%)	60.81	66.47	61.57	56.41	51.08
Reported return on assets (%)	0.51	0.51	0.55	0.57	N.A.
Reported return on equity (%)	15.20	13.44	13.07	12.31	N.A.
Risk Position					
Non-performing loan ratio (%)	0.80	0.87	0.75	0.86	0.82
(Non-performing loans + special mention loans)/gross customer loans (%)	2.30	1.68	1.43	1.49	1.49
Loan loss reserve/gross customer loans (%)	2.40	2.37	2.44	2.99	3.23
Reserve coverage ratio (%)	298.15	271.69	324.77	346.80	396.11
Loan loss reserve/ (non-performing loans + special mention loans) (%)	104.20	141.33	170.78	201.08	217.98
Net write-offs/average gross customer loans (%)	0.32	0.28	0.12	0.18	N.A.
Funding and Liquidity					
Retail deposits/customer deposits (%)	85.43	85.23	85.10	86.56	87.02
Customer deposits/total liabilities (%)	89.74	92.01	93.96	95.43	95.07
Wholesale funding /total liabilities (%)	8.34	6.20	4.13	3.62	3.97
Customer loans/customer deposits (%)	39.20	41.32	45.02	49.57	51.66

Note1: In our view, PSBC has clear business model and sound financial management. Its annual financial reports have been audited by PricewaterhouseCoopers. Therefore, we haven't conducted any material adjustments to its financial data.

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

Source: PSBC, collected and adjusted by S&P Global (China) Ratings.

Appendix 2: Peer Comparison Data

Peer Comparison Data

(2016-2018 three-year avg.)	PSBC	Peer Group				
		Max	Min	Average	Asset-weighted average	Median
Business Position						
Total assets (bil)	**8,931.46**	25,974.62	8,931.46	17,784.34	20,180.45	20,352.75
Gross customer loans (bil)	**3,639.22**	14,249.72	3,639.22	9,485.06	10,944.74	10,845.02
Customer deposits (bil)	**7,992.14**	19,599.06	5,355.76	13,209.78	15,007.81	15,009.97
Total equity (bil)	**417.85**	2,155.70	417.85	1,351.48	1,572.62	1,535.82
Operating income (bil)	**224.79**	725.39	200.60	469.48	540.78	518.78
Net income (bil)	**46.62**	288.43	46.62	171.70	203.20	190.22
Capital and Earnings						
Reported regulatory capital adequacy ratio (%)	**12.47**	15.88	12.47	14.33	14.61	14.30
Reported regulatory tier 1 capital adequacy ratio (%)	**9.73**	13.76	9.73	12.10	12.45	12.13
Net interest margin adjusted by S&P Global (China) Ratings (%)	**2.27**	2.27	1.59	2.04	2.07	2.16
Cost-to-income ratio (%)	**61.48**	61.48	24.76	33.91	30.71	29.44
Provisioning/pre-provisioning operating profits (%)	**36.67**	36.67	25.35	30.01	29.15	29.10
Return on average assets (%)	**0.54**	1.15	0.54	0.94	1.00	0.97
Return on average equity (%)	**12.23**	14.40	11.03	12.96	13.34	13.05
Risk Position						
Non-performing loan ratio (%)	**0.83**	1.93	0.83	1.46	1.53	1.50
(Non-performing loans + special mention loans)/gross customer loans (%)	**1.53**	5.35	1.53	4.19	4.53	4.38
Loan loss reserves/gross customer loans (%)	**2.60**	3.97	2.40	2.74	2.78	2.51
Reserve coverage ratio (%)	**314.42**	314.42	155.51	197.56	186.82	172.22
Loan loss reserve/ (non-performing loans + special mention loans) (%)	**171.06**	171.06	46.70	77.89	68.44	58.53
Net write-offs/average gross customer loans (%)	**0.19**	1.02	0.19	0.65	0.70	0.67
Funding and Liquidity						
Customer loans/customer deposits (%)	**45.31**	84.46	45.31	71.07	72.53	75.66
Customer deposits/total liabilities (%)	**93.80**	93.80	64.27	79.96	80.31	81.19
Wholesale funding/total liabilities (%)	**4.65**	33.22	4.65	17.34	16.84	16.00
Retail deposits/customer deposits (%)	**85.63**	85.63	31.05	51.21	49.33	45.10

Note 1: In this report, we have chosen the other five state-owned mega banks, including ICBC, CCB, ABC, BOC and BoCom as the peers of PSBC for peer comparison purpose. The weights for the asset-weighted average calculation are the three-year average of total assets of these six banks from 2016 to 2018. Therefore, the weights of PSBC, ICBC, CCB, ABC, BOC and BoCom are 8.37%, 24.34%, 20.71%, 19.75%, 18.39% and 8.43% respectively.

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

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

Note 4: Return on average equity =net income/ [(total equity at the beginning of the year +total equity at the end of the year)/2]

Note 5: Net write-offs=write-offs – recoveries

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