

# CHINESE BANKS INCREASING DIVIDENDS

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A number of commentators have suggested that Chinese banks are a source of large risk as a result of the country's [shadow banking system](#) and fears about a potential rise in [non-performing loans](#), given the substantial credit expansion over recent years. Although we agree that emerging market banks should be considered riskier than U.S. banks, we do not think all the risk is to the downside. **Increase in Net Profits** Many of the largest Chinese banks recently released their year-end earnings reports for 2012. What might be surprising to some is that the reports came out better than many analysts had expected. Below we examine the top three Chinese bank constituents (by weight as of 03/31/2013) in the [WisdomTree Emerging Markets Equity Income Index](#). All three banks reported an increase in net profits of more than 10% compared to the previous year.<sup>1</sup>

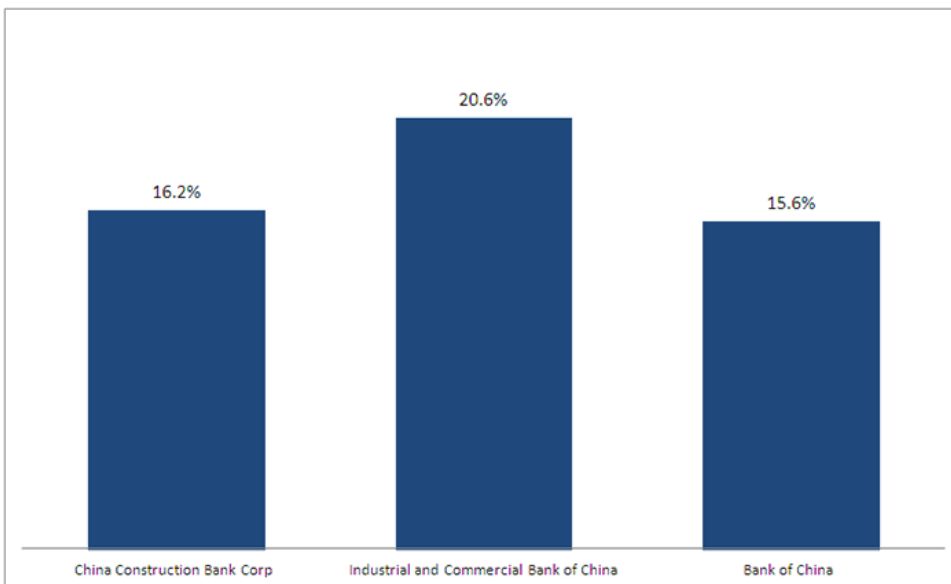
- **China Construction Bank** – net profit was \$30.62 billion, up 14.26% over 2011.
- **Industrial and Commercial Bank of China** – net profit of \$37.80 billion, representing an increase of 14.5% over the previous year.
- **Bank of China** – achieved an after-tax profit of \$22.09 billion for the year, a year-over-year increase of 11.51%.

We also looked at the [return on equity](#)<sup>2</sup>, a common profitability ratio, of the above mentioned Chinese banks. Their return on equity was higher than that of some developed-world banks. To provide context to these ROE numbers, we compare them against the largest market cap banks in the developed world. The below return-on-equity numbers are for the most recent annual calendar year-end.

- **China**
  - o China Construction Bank – 22.04%
  - o Industrial and Commercial Bank of China – 22.92%
  - o Bank of China – 18.01%
- **Developed World**
  - o HSBC Holdings – 8.19%
  - o Wells Fargo – 13.16%
  - o J.P. Morgan Chase – 10.72%

**Increases in Declared Dividends** All three of the Chinese banks mentioned above have also announced an increase in their annual [dividends](#). In the chart below we look at the percentage increase of the announced dividend per share compared to the most recently paid dividend per share, both reported in U.S. dollars.

Chinese Banks' Dividend Increases



Source: Bloomberg (03/31/2013)

- **China Construction Bank** – the 16.2% dividend increase will increase its cash dividend stream by over \$1.4 billion.
- **Industrial and Commercial Bank of China** – the 20.6% dividend increase will add over \$570 million to its current dividend payments.
- **Bank of**

**China** – declared a 15.6% dividend increase of over \$319 million. **Increase in Equity Returns** The increased dividends and profitability have contributed to generating positive stock price performance since these companies were added to the WisdomTree Emerging Markets Equity Income Index. • Industrial and Commercial Bank of China and China Construction Bank were new additions to the Index on June 18, 2012, at which point they received a collective weight of 9.57%. Bank of China was already a member of the Index before the rebalance. • All three banks together made up 11.32% of the Index at the annual rebalance, and each has since posted positive equity returns of at least 20%. Returns below are from 06/18/12 through 03/31/13. • **China Construction Bank** – 20.00% • **Industrial and**

**Commercial Bank of China** – 22.45% • **Bank of China** – 25.36% • **WisdomTree Emerging Markets Equity Income Index** – 11.88% • **MSCI Emerging Markets Index** – 13.24% **Conclusion** We have been very pleased thus far with the Chinese banks' contribution to the performance of the WisdomTree Emerging Markets Equity Income Index. The fundamental screening process for the Index identified attractively priced securities based on their dividend yields at the annual screening date and weighted them in the Index based on their [trailing 12-month cash dividends](#), measured in U.S. dollars. Since being added to the Index, these companies have grown both their profits and their dividends, and their share prices have reacted positively as a result. **Data source Bloomberg unless otherwise noted.** For current holdings in the WisdomTree Emerging Markets Equity Index, [click here](#). <sup>1</sup>Profitability numbers are from 12/31/2011 to 12/31/2012; source: Bloomberg. <sup>2</sup>Source: Bloomberg, as of 12/31/12.

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## DEFINITIONS

**Shadow banking system** : A collection of non-bank financial intermediaries that provide services similar to traditional commercial banks.

**Non-performing loan** : A loan that is in default or close to being in default. Many loans become non-performing after being in default for 90 days, but this can depend on the contract terms.

**Net profit** : A measure of profitability after accounting for all costs.

**WisdomTree Emerging Markets Equity Income Index** : A subset of the WisdomTree Emerging Markets Dividend Index measuring the performance of the higher-yielding stocks as measured by trailing 12-month dividend yields, weighted by cash dividends.

**Return on Equity (ROE)** : Measures a corporation's profitability by revealing how much profit a company generates with the money shareholders have invested.

**Dividend** : A portion of corporate profits paid out to shareholders.

**MSCI Emerging Markets Index** : a broad market cap-weighted Index showing performance of equities across 23 emerging market countries defined as "emerging markets" by MSCI.

**Trailing 12-month cash dividends** : Firm's cash dividends paid over the prior 12-month period.