



# China Securities & Brokerage Sector

## A mixed bag

- In our view, short-term industry outlook is mixed amid ongoing friction between US and China on trade and other issues would impact ADT and MFSL balance. The negative impacts, however, will be partially buffered by supportive policies on IPO
- We believe the current sector valuation is undemanding after recent share price corrections
- Within the sector, we prefer **CSC (6066 HK)** and **GF (1776 HK)** given their higher ROAE than peers over the past few years.

**Weak business environment.** 1H18 A-share ADT was ~RMB 440bn, flat YoY but dropped by 8% lowers HoH. Margin financing and securities lending (MFSL) balance has dropped from ~RMB 1.02trn at end-2017 to ~RMB 0.92trn at end-June 2018. In addition, A-share stock index tumbled in 1H18, with the CSI 300 Index losing ~15% in 1H18 versus a 22% gain in 2017. In our view, such weak business environment should impact brokers' earnings prospects in the near term.

**Investment banking is less impacted.** On a positive note, direct financing accounted for 14% of aggregate financing in the economy in 5M18, up from 7% in 2017, indicating a gradual recovery in recent months. Overall, the government's supportive initiatives on new -economy IPOs and China Deposit Receipt (CDR) would widen deal sources of investment banking business.

**Structural uptrend of direct financing.** Despite the short-term hiccups, we continue to believe that investment banking business would benefit from a long-term structural uptrend, given the government's commitment to deleverage the economy through direct financing in the capital markets with the issuance of corporate bonds and equity securities. Overall, direct financing only accounted for 14% of the aggregate financing in the economy in 5M18 versus 50% in US (2015), implying ample headroom for growth.

**Undemanding valuation.** The sector is currently valued at 0.7x forward FY19 P/B. In our view, current sector valuation is factoring the weak business environment in 1H18 and cautious business outlooks.

**Switch to CSC (6066 HK) and GF (1776 HK).** We hold a neutral stance on the sector as the sluggish business environment might hinder shareholders' return, mitigated by undemanding valuation. We recommend current holders of brokerage stocks to switch to CSC and GF as they achieved above-average ROAE throughout the market cycle.

### Valuation and recommendation

Company	Ticker	Rating	TP	FY18E P/E(x)	FY19E P/E (x)	FY18E P/B (x)	FY19E P/B (x)
CSC	6066 HK	BUY	7.6	8.8	7.5	0.7	0.7
GF	1776 HK	BUY	14.9	9.8	9.1	0.8	0.7
CMS	6099 HK	HOLD	9.9	13.3	12.9	0.8	0.8
DFZQ	3958 HK	HOLD	5.7	19.4	14.7	0.6	0.6

Source(s): Bloomberg, ABCI Securities estimates

## Sector Report

# NEUTRAL

## July 6, 2018

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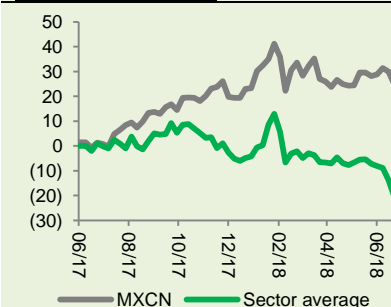
### Sector Performance (%)

	Absolute	Relative*
1-mth	-15.0	-8.5
3-mth	-16.4	-11.1
6-mth	-20.5	-15.8

\*Relative to HSI

Source(s): Bloomberg, ABCI Securities

### Sector performance

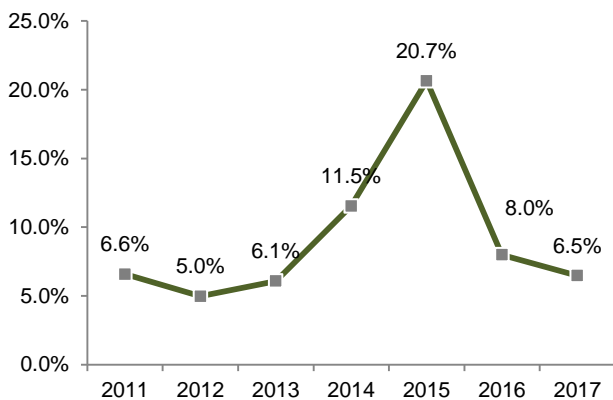


Source(s): Bloomberg, ABCI Securities

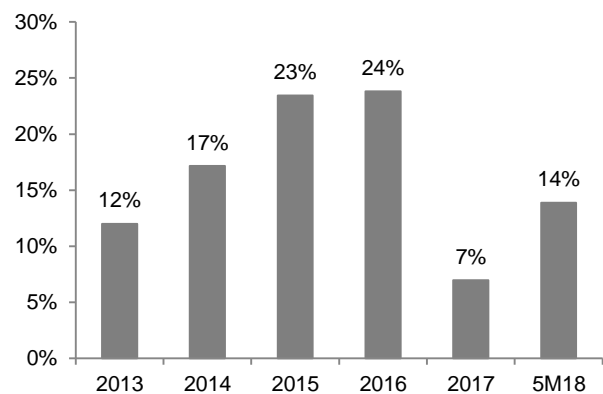
**Structural uptrend of direct financing.** Under the current 13<sup>th</sup> FYP (2016-20), the government will increase the contribution of direct financing in the economy and deleverage through the development of a diverse, multi-layered capital market with GEM, NEEQ, and regional stock market. It also aims to promote product innovations such as high-yield bonds, hybrid financing, and more. In our view, such developments will be supportive to the investment banking business.

**Industry outlook.** Overall, we expect A-share ADT to stay flat in 2018 before resuming a 5% YoY growth in 2019E. We also expect the MFSL balance to drop by 10% YoY in 2018E before resuming a 10% YoY growth in 2019E.

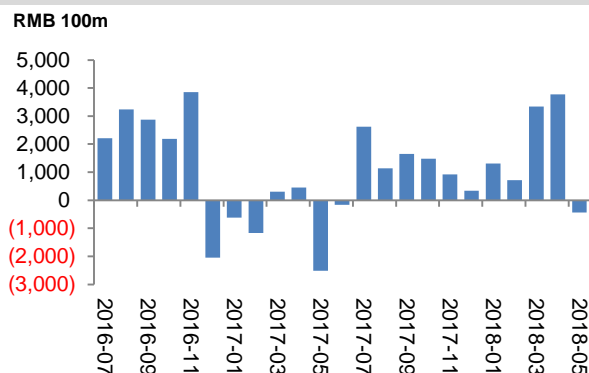
**Risk factors:** 1) Market risk of financial assets; (2) Credit risk associated with bond investments and lending business; (3) Volatility in market turnover; (4) Penalties on misconduct or staff malpractice in securities firms; (5) Regulatory changes in direct financing; (6) Spill-over impact from deleveraging in the financial sector; (6) Intensifying competition after the relaxation of foreign ownership in the industry; (7) Intensifying competition between banks and securities companies in direct financing business.

**Exhibit 1: Sector ROAE trend**


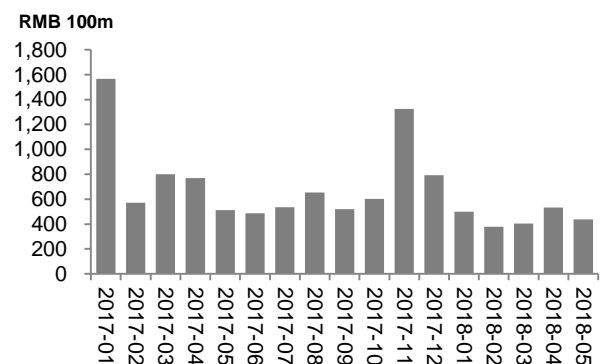
Source(s): SAC, ABCI Securities

**Exhibit 2: Direct financing as a percentage of aggregate financing**


Source(s): PBOC, ABCI Securities

**Exhibit 3: Net financing of corporate bonds**


Source(s): PBOC, ABCI Securities

**Exhibit 4: Equity financing on the stock market by non-financial enterprises**


Source(s): PBOC, ABCI Securities



**Exhibit 5: Sector valuation**

Ticker	Name	Share price (local)	12/18 PER (x)	12/18 P/B (x)	12/19 PER (x)	12/19 P/B (x)
<b>HK-listed China securities companies</b>						
6837 HK Equity	HAITONG SECURI-H	7.39	7.8	0.6	6.8	0.5
6030 HK Equity	CITIC SEC-H	14.96	12.0	1.0	10.4	0.9
2611 HK Equity	GUOTAI JUNAN S-H	15.78	11.4	1.0	10.4	0.9
6886 HK Equity	HUATAI SECURIT-H	11.74	8.9	0.7	7.8	0.7
1776 HK Equity	GF SECURITIES-H	10.86	9.8	0.8	9.1	0.7
6881 HK Equity	CGS-H	3.91	7.6	0.7	7.5	0.7
6099 HK Equity	CHINA MERCHANTS-H	10.14	13.3	0.8	12.9	0.8
6178 HK Equity	EVERBRIGHT SEC-H	9.00	10.4	0.7	9.5	0.6
3958 HK Equity	DFZQ-H	5.85	19.4	0.6	14.7	0.6
3908 HK Equity	CHINA INTERNAT-H	12.74	12.5	1.1	10.3	1.0
6066 HK Equity	CSC FINANCIAL-H	5.25	7.2	0.7	6.3	0.7
<b>Average</b>			<b>10.9</b>	<b>0.8</b>	<b>9.6</b>	<b>0.7</b>

Pricing at Jul 5, 2018

Source(s): Bloomberg, ABCI Securities



## CSC Financial Co., Ltd (6066 HK)

### Rise in direct financing

- 1Q18 revenue growth by 5.5% but net profit to ordinary shareholders fell 1.6%
- Recent completion of A-share issues could remove future dividend risk
- We believe the company is well positioned for a long-term structural uptrend of rise in direct financing in China
- Undemanding valuation; maintain **BUY** with TP of HK\$7.6

**Recent business update.** In 1Q18, the Group grew 5.5% revenue on improving bond market. Having said that, net profit to ordinary shareholders still fell 1.6% on higher operating cost related to business development.

**Completion of A-share issues removes dividend overhang.** The Group has recently completed its A share IPO offering of 400mn new shares at RMB5.42. This price is equivalent to 1.01x end-2017 adjusted P/B (excl. RMB 5bn perpetual bond in the calculation). In our view, this could remove the dividend overhang. To recap, the company omitted dividend in 2017 due to regulatory requirement related to its A-share listing.

**Investment banking remains resilient.** According to Wind, bonds underwritten by CSC increased significantly by ~68% YoY in 1H18, ranking second among all brokers. In our view, the strong growth was partly attributable to the low base in 1H17. According to PBOC, net financing of corporate bonds in China was RMB 871bn in 5M18 against negative RMB 354bn in 5M17.

**Investment banking exposure to benefit from rise in direct financing.** In 2017, investment banking business accounted for 23% of total revenue and 36% of PBT. In our view, CSC possesses a scarcity value for investors looking for Chinese financial plays with investment banking exposure amid the structural uptrend in direct financing.

**Undemanding valuation.** The counter is currently trading at 0.7x 2019E adjusted P/B (excl. RMB 5bn of perpetual bonds), which is undemanding in our view. Our latest TP is HK\$ 7.6 based on 1.0x 2019E adjusted P/B.

#### Results and Valuation

FY ended Dec 31	2016A	2017A	2018E	2019E
Revenue (RMB mn)	17,585	16,421	16,482	17,369
Chg (% YoY)	(28.3)	(6.6)	0.4	5.4
Profit attributable to ordinary shareholders (RMB mn)	4,965	3,722	3,815	4,431
Chg (% YoY)	(40.5)	(25.0)	2.5	16.1
Underlying EPS (RMB)	0.69	0.51	0.50	0.58
Chg (% YoY)	(49.5)	(25.8)	(2.9)	16.1
BVPS (RMB)*	5.03	5.35	5.85	6.36
Chg (% YoY)	22.1	6.4	9.4	8.6
P/E (x)	6.3	8.5	8.8	7.5
P/B (x)*	0.9	0.8	0.7	0.7
ROAE (%)*	18.1	9.9	9.1	9.5
ROAA (%)	2.7	1.9	1.9	2.1
DPS(RMB)	0.18	-	0.07	0.09
Dividend Yield (%)	3.8	-	1.6	1.8

\*Equity attributable to ordinary shareholders is used in the calculation

Source(s): Bloomberg, ABCI Securities estimates

Rating: **BUY**  
TP: HK\$ 7.6

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Share price (HK\$)	5.25
Est. share price return	44.8%
Est. dividend yield	1.6%
Est. total return	46.4%
Previous Rating & TP	BUY/HK\$8.8
Previous Report Date	Mar 1

Source(s): Bloomberg, ABCI Securities

#### Key Data

52Wk H/L(HK\$)	5.4/7.5
Issued shares (mn)	7,646
Issued H shares (mn)	1,261
H-share market cap (HK\$ mn)	6,847
Avg daily turnover (HK\$ mn)	1.6
Major shareholder(s)	
BSCOMC	35.1%
Huijin	31.2%
Citic Sec	5.6%

Source(s): Bloomberg, company, ABCI Securities

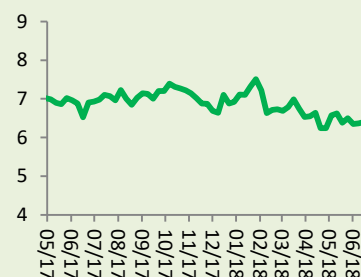
#### Share Performance (%)

	Absolute	Relative*
1-mth	-17.2	-9.3
3-mth	-17.3	-11.7
6-mth	-20.4	-15.4

\*Relative to HSI

Source(s): Bloomberg, ABCI Securities

#### Share performance(HK\$)



Source(s): Bloomberg, ABCI Securities



## Financial forecast

We expect revenue to stay flat in 2018E, in which lower securities brokerage revenue is offset by higher investment banking revenue. For 2019E, we expect revenue to grow by 5% YoY thanks to recovering brokerage revenue.

In terms of key assumptions, we expect the Group's ADT to stay flat in 2018 before resuming a 5% YoY growth in 2019E, in line with our industry assumptions. We also expect the Group's MFSL balance to drop by 10% YoY in 2018E before resuming a 10% YoY growth in 2019E, in line with our industry assumptions. For its investment banking business, we expect the volume of bonds underwritten to grow by 50% YoY in 2018E due to rising momentum in bond market as well as the low base in 2017. For 2019E, we expect growth in bonds underwritten to normalize to 10% YoY.

As a result, we expect net profit to ordinary shareholders to rise by 3% and 16% in 2018 and 2019, which translates into ROAE of 9.1% and 9.5% in the respective periods.

## Valuation

The counter is currently trading at 0.7x 2019E adjusted P/B (excl. RMB 5bn of perpetual bonds), which is undemanding in our view. We value the counter at HK\$7.6 based on 1.0x 2019E adjusted P/B.

**Risk factors:** 1) Decline in brokerage commission rates; 2) Decline in A-share market turnover; 3) Decline in capital market fundraising; 4) Penalties related to violation of regulatory requirements; 5) Low daily turnover.



**Consolidated income statement (2016A-2019E)**

<b>FY Ended Dec 31 (RMB mn)</b>	<b>2016A</b>	<b>2017A</b>	<b>2018E</b>	<b>2019E</b>
Fee and commission income	10,584	8,781	9,104	9,487
Interest income	4,441	5,257	4,795	5,160
Investment income	2,412	2,414	2,584	2,721
<b>Total revenue</b>	<b>17,437</b>	<b>16,452</b>	<b>16,482</b>	<b>17,369</b>
Other income	148	-31	0	0
<b>Total revenue and other income</b>	<b>17,585</b>	<b>16,421</b>	<b>16,482</b>	<b>17,369</b>
<b>Total expenses</b>	<b>10,524</b>	<b>11,072</b>	<b>11,021</b>	<b>11,089</b>
<b>Operating Profits</b>	<b>7,061</b>	<b>5,349</b>	<b>5,461</b>	<b>6,280</b>
Share of profit of investments in associates	-3	6	7	9
Profit before tax	<b>7,057</b>	<b>5,355</b>	<b>5,469</b>	<b>6,288</b>
Tax	1,744	1,294	1,312	1,509
<b>Profit after tax</b>	<b>5,313</b>	<b>4,062</b>	<b>4,156</b>	<b>4,779</b>
Minority interests	54	46	47	54
Profits attributable to perpetual bondholders	294	294	294	294
<b>Profits attributable to ordinary shareholders</b>	<b>4,965</b>	<b>3,722</b>	<b>3,815</b>	<b>4,431</b>
<b>Growth</b>				
Total revenue and other income (%)	(28.3)	(6.6)	0.4	5.4
Total expenses	(19.4)	5.2	(0.5)	0.6
Operating Profits (%)	(38.4)	-24.2	2.1	15.0
Profits attributable to ordinary shareholders (%)	(40.5)	-25.0	2.5	16.1
<b>Operating performance</b>				
Operating margin (%)	40.2	32.6	33.1	36.2
Net margin (%)	28.5	22.6	23.1	25.5
ROAE (%)*	18.1	9.9	9.1	9.5
ROAA (%)	2.7	1.9	1.9	2.1

\*Net profit attributable to ordinary shareholders/Average equity attributable to ordinary shareholders

Source(s): Company, ABCI Securities estimates

Note: Individual items may not sum to total due to rounding difference



Consolidated balance sheet (2016A-2019E)

As of Dec 31 (RMB mn)	2016A	2017A	2018E	2019E
Property and equipment	579	565	593	623
Goodwill	144	170	178	187
Other intangible assets	278	574	602	632
Investment in associates and JV	172	206	217	227
AFS	6,112	5,327	5,593	5,872
Financial assets held under resale agreements	625	5,109	5,365	5,633
Other non-current assets	4,464	3,229	3,390	3,560
<b>Total non-current assets</b>	<b>12,374</b>	<b>15,179</b>	<b>15,938</b>	<b>16,735</b>
Cash & equivalents	17,526	11,228	11,195	14,264
Clearing settlement funds	55,083	39,741	37,754	35,866
AFS	28,483	34,255	35,968	37,766
Financial assets at FVTPL	325	307	322	339
Derivatives	49	120	126	133
Other current assets	1,785	2,559	2,687	2,821
Account receivables	378	1,370	1,438	1,510
Other receivables and prepayments	27,605	32,347	33,964	35,662
Advances to customers	31,007	47,821	43,039	47,343
Financial assets held under resale agreements	7,080	20,956	22,003	23,104
<b>Total current assets</b>	<b>169,320</b>	<b>190,704</b>	<b>188,498</b>	<b>198,808</b>
<b>Total assets</b>	<b>181,694</b>	<b>205,882</b>	<b>204,435</b>	<b>215,542</b>
Accounts payable	56,736	41,417	43,487	45,662
Borrowings	1,782	2,051	2,153	2,261
Placements from banks and other financial institutions	9,360	14,000	9,800	9,800
Other current liabilities	58,334	80,466	77,579	81,458
<b>Total current liabilities</b>	<b>126,212</b>	<b>137,933</b>	<b>133,019</b>	<b>139,180</b>
Loans and bonds payables	13,653	23,873	21,485	22,560
Other non-current liabilities	567	79	82	85
<b>Total non-current liabilities</b>	<b>14,220</b>	<b>23,951</b>	<b>21,567</b>	<b>22,645</b>
<b>Total liabilities</b>	<b>140,432</b>	<b>161,884</b>	<b>154,587</b>	<b>161,825</b>
<b>Net current assets</b>	<b>43,108</b>	<b>52,771</b>	<b>55,478</b>	<b>59,627</b>
<b>Equity attributable to ordinary shareholders</b>	<b>36,063</b>	<b>38,754</b>	<b>44,737</b>	<b>48,596</b>
Other equity instruments (perpetual subordinated bonds)	5,000	5,000	5,000	5,000
Non-controlling interests	200	245	112	121
<b>Total equity</b>	<b>41,263</b>	<b>43,999</b>	<b>49,849</b>	<b>53,717</b>

Source(s): Company, ABCI Securities estimates

Note: Individual items may not sum to total due to rounding difference



## GF Securities (1776 HK) Undemanding valuation

- 1Q18 revenue and net profit dropped by 21.3% and 27.8% YoY
- Unfavorable A-share market performance likely hit GF's investment gains in 2018
- GF has been delivering above-average ROAE in 2016-17 and we expect the trend to continue
- Undemanding valuation after recent share price correction

**Recent business update.** 1Q18 revenue and net profit (excl. extraordinary items) dropped 21.3% and 27.8% to RMB 3.9bn and RMB 1.5bn amid decline in investment banking revenue and investment gains. Results are largely in line with the softening industry momentum observed in recent months.

**Unfavorable A-share market impacts investment gains.** In 2017, net investment gain, driven by favorable A-share market performance (CSI 300: +22% YoY), increased by 34% to RMB 8.7bn, accounting for 30% of revenue. Market sentiment has reversed in recent months, however, with CSI 300 Index losing c. 15% in 1H18. This would impact GF's financial performance in the near term, in our view.

**Mixed industry outlook in the near term.** In our view, near-term outlook is mixed given the US-China trade war concern, which could impact ADT and MFSL balance. 1H18 A-share ADT was ~RMB 440bn, largely flat YoY but 8% lower when compared with 2H17. MFSL balance fell from ~RMB 1.02trn at end-2017 to ~RMB 0.92trn at end-June 2018. On a positive note, direct financing accounted for 14% of aggregate financing in the economy in 5M18, up from 7% in 2017, indicating gradual recovery in investment banking business.

**Above-peer ROAE.** On a positive note, the Group has delivered above-peer ROAE in recent years. The figure was 10.3% and 10.5% in 2016 and 2017, outperforming most H-listed peers.

**Undemanding valuation.** The counter is currently trading at c. 0.7x 2019E P/B versus historical average of 1.2x, which is undemanding in our view. Our latest TP is HK\$ 14.9 based on 1.0x 2019E P/B.

### Results and Valuation

FY ended Dec 31	2016A	2017A	2018E	2019E
Revenue (RMB mn)	27,488	28,614	24,586	25,896
Chg (% YoY)	(35.7)	4.1	(14.1)	5.3
Net profit (RMB mn)	8,030	8,596	7,052	7,555
Chg (% YoY)	(39.2)	7.0	(18.0)	7.1
EPS (RMB)	1.05	1.13	0.93	0.99
Chg (% YoY)	(43.0)	7.0	(18.0)	7.1
BVPS (RMB)	10.3	11.1	11.7	12.4
Chg (% YoY)	1.3	8.1	5.4	5.5
P/E (x)	8.6	8.0	9.8	9.1
P/B (x)	0.9	0.8	0.8	0.7
ROAE (%)	10.3	10.5	8.1	8.2
ROAA (%)	2.1	2.4	1.9	2.0
DPS(HK\$)	0.42	0.48	0.39	0.42
Yield (%)	3.7	4.2	3.4	3.7

Source(s): Bloomberg, ABCI Securities estimates

Rating: BUY  
TP: HK\$ 14.9

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Share price (HK\$)	10.88
Est. share price return	36.9%
Est. dividend yield	3.4%
Est. total return	40.3%
Previous Rating & TP	BUY/HK\$18.4
Previous Report Date	Dec 6

Source(s): Bloomberg, ABCI Securities

### Key Data

52Wk H/L(HK\$)	18.2/10.9
Issued shares (mn)	7,621
Issued H shares (mn)	1,702
H-share market cap (HK\$ mn)	2,484
Avg daily turnover (HK\$ mn)	10.0
Major shareholder(s)	
Jilin Aodong Pharmaceutical	16.7%
Liaoning Cheng Da Co	16.4%
Zhongshan Public Utilities	10.2%

Source(s): Bloomberg, company, ABCI Securities

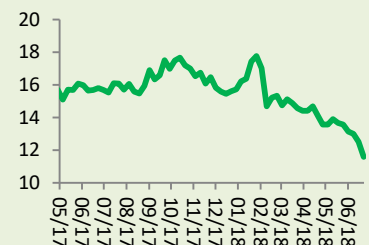
### Share Performance (%)

	Absolute	Relative*
1-mth	-16.0	-8.1
3-mth	-22.2	-16.7
6-mth	-27.4	-22.4

\*Relative to HSI

Source(s): Bloomberg, ABCI Securities

### Share performance(HK\$)



Source(s): Bloomberg, ABCI Securities





## Financial forecast

We expect revenue to drop by 14% YoY in 2018 due to lower securities brokerage revenue and investment gains. In 2019, we expect revenue to grow by 5% to reflect gradual improvement in operating environment.

In terms of key assumptions, we expect the Group's ADT to stay flat in 2018 before resuming a 5% YoY growth in 2019E, in line with our industry assumptions. We also expect the Group's MFSL balance to drop by 10% YoY in 2018E before resuming a 10% YoY growth in 2019E, in line with our industry assumptions. For its asset management business, after a 27% YoY drop in AUM in 2017, we expect operating environment to stabilize in 2018 with AUM remaining largely unchanged. For 2019E, we expect AUM to resume a modest growth of 5% YoY.

As a result, we expect net profit to drop by 18% YoY in 2018 before resuming a 7% growth YoY in 2019. This translates into 2018E/19E ROAE of 8.1%/8.2%.

## Valuation

The counter is currently trading at c. 0.7x 2019E P/B versus historical average of 1.2x, which is undemanding in our view. We roll over to 2019E and value the counter at HK\$ 14.9 based on 1.0x 2019E P/B. Maintain **BUY**.

**Risk factors:** 1) Decline in brokerage commission rates; 2) Decline in A-share market turnover; 3) Decline in capital market fundraising; 4) Penalties related to violation of regulatory requirements; 5) Low daily turnover.



**Consolidated income statement (2016A-2019E)**

<b>FY Ended Dec 31 (RMB mn)</b>	<b>2016A</b>	<b>2017A</b>	<b>2018E</b>	<b>2019E</b>
Fee and commission income	13,391	11,565	9,370	9,493
Interest income	7,831	8,018	7,316	7,703
Investment income	6,511	8,734	7,900	8,700
<b>Total revenue</b>	<b>27,732</b>	<b>28,316</b>	<b>24,586</b>	<b>25,896</b>
Other income	-244	298	0	0
<b>Total revenue and other income</b>	<b>27,488</b>	<b>28,614</b>	<b>24,586</b>	<b>25,896</b>
<b>Total expenses</b>	<b>17,185</b>	<b>17,431</b>	<b>15,603</b>	<b>16,286</b>
<b>Operating Profits</b>	<b>10,303</b>	<b>11,183</b>	<b>8,983</b>	<b>9,609</b>
Share of profit of investments in associates	403	461	507	558
<b>Profit before tax</b>	<b>10,705</b>	<b>11,644</b>	<b>9,490</b>	<b>10,167</b>
Tax	2,296	2,561	2,040	2,186
<b>Profit after tax</b>	<b>8,409</b>	<b>9,083</b>	<b>7,450</b>	<b>7,981</b>
Minority interests	379	488	398	426
<b>Profits attributable to shareholders</b>	<b>8,030</b>	<b>8,595</b>	<b>7,052</b>	<b>7,555</b>
<b>Growth</b>				
Total revenue and other income (%)	(35.7)	4.1	(14.1)	5.3
Total expenses	(31.8)	1.4	(10.5)	4.4
Operating Profits (%)	(41.2)	8.5	(19.7)	7.0
Net profit (%)	(39.2)	7.0	(18.0)	7.1
<b>Operating performance</b>				
Operating margin (%)	37.5	39.1	36.5	37.1
Net margin (%)	29.0	30.4	28.7	29.2
ROAE (%)	10.3	10.5	8.1	8.2
ROAA (%)	2.1	2.4	1.9	2.0

Source(s): Company, ABCI Securities estimates

Note: Individual items may not sum to total due to rounding difference



Consolidated balance sheet (2016A-2019E)

As of Dec 31 (RMB mn)	2016A	2017A	2018E	2019E
Fixed asset	2,093	2,449	2,571	2,700
Other intangible assets	260	287	301	316
Investment in associates and JV	3,771	4,376	4,595	4,825
AFS	19,676	18,139	19,046	19,998
Financial assets held under resale agreements	3,879	8,846	9,288	9,753
Financial assets at fair value through profit and loss	-	1,280	1,280	1,280
Other non-current assets	4,184	3,702	3,887	4,081
<b>Total non-current assets</b>	<b>33,864</b>	<b>39,079</b>	<b>40,969</b>	<b>42,953</b>
Cash & equivalents	85,431	61,447	68,788	68,359
Clearing settlement funds	21,743	17,653	18,536	19,462
AFS	72,405	74,455	78,178	82,087
Financial assets at FVTPL	61,732	61,919	65,015	68,266
Derivatives	693	5,451	5,723	6,009
Other current assets	87	192	201	211
Other receivables and prepayments	7,580	10,493	11,017	11,568
Advances to customers	58,186	61,396	55,256	60,782
Financial assets held under resale agreements	18,082	24,821	26,062	27,365
<b>Total current assets</b>	<b>325,937</b>	<b>317,826</b>	<b>328,776</b>	<b>344,110</b>
<b>Total assets</b>	<b>359,801</b>	<b>356,905</b>	<b>369,745</b>	<b>387,063</b>
Accounts payable	85,727	65,080	68,334	71,751
Loans and debt	47,121	48,677	49,127	49,758
Other current liabilities	83,726	85,106	89,362	93,830
<b>Total current liabilities</b>	<b>216,573</b>	<b>198,863</b>	<b>206,823</b>	<b>215,338</b>
Financial assets and other liabilities	901	3,401	-	-
Loans and bonds payables	60,843	65,926	69,223	72,684
Deferred tax liabilities	131	88	93	97
<b>Total non-current liabilities</b>	<b>61,875</b>	<b>69,416</b>	<b>69,315</b>	<b>72,781</b>
<b>Total liabilities</b>	<b>278,448</b>	<b>268,279</b>	<b>276,138</b>	<b>288,119</b>
<b>Net current assets</b>	<b>109,365</b>	<b>118,963</b>	<b>121,954</b>	<b>128,772</b>
Equity attributable to shareholders	78,530	84,854	89,438	94,349
Minority interest	2,823	3,771	4,169	4,595
<b>Total equity</b>	<b>81,353</b>	<b>88,626</b>	<b>93,607</b>	<b>98,944</b>

Source(s): Company, ABCI Securities estimates

Note: Individual items may not sum to total due to rounding difference



## China Merchants Securities (6099 HK) Lack of positive catalyst

- 1Q18 revenue and net profit dropped 7.2% and 20.9% YoY amid lower investment banking revenues and trading income
- High exposure to brokerage business will not bode well amid softening ADT in recent months.
- Lack of positive catalyst in the near term

**Recent business update.** In 1Q18, revenue and net profit (excl. extraordinary items) dropped 7.2% and 20.9% YoY to RMB2.6bn and RMB1.1bn amid lower investment banking revenues and revaluation losses. Annualized ROAE for 1Q18 was 5.5% vs. 8.3% in 2017.

**Exposure to brokerage business.** In 2017, brokerage segment revenue accounted for 64% of total revenue, the second highest (after Galaxy) among major HK-listed brokers. The Group is highly reliant on secondary trading commission as a revenue source. In 1H18, A-share ADT was about RMB 440bn, largely flat YoY but 8% lower HoH. Margin financing and securities lending (MFSL) balance in the industry dropped from ~RMB 1.02trn at end-2017 to ~RMB 0.92trn at end-June 2018. We believe soft ADT and MFSL balance will not bode well for the company.

**Investment banking – a mixed picture.** According to Wind data, CMS's equity underwritten was down ~30% YoY in 1H18 mainly due to shrunken volume of secondary placement underwriting. On a positive note, bond underwriting grew 22%. In 2017, investment banking business was the secondary largest revenue contributor accounting for 13% of total revenue.

**Lack of positive catalyst.** After recent share price corrections, the counter is currently trading at 0.8x 2019E adjusted P/B\*, which is undemanding in our view. Expecting a soft ADT outlook in the near term, we see limited positive catalyst given the company's high reliance on brokerage business. Our latest TP is HK\$ 9.9 based on 0.8x 2019E adjusted P/B. Maintain **HOLD**.

### Results and Valuation

FY ended Dec 31	2016A	2017A	2018E	2019E
Revenue (RMB mn)	18,552	19,259	18,489	18,808
Chg (% YoY)	(47.0)	3.8	(4.0)	1.7
Net profit to ordinary shareholders (RMB mn)	5,404	5,194	4,242	4,371
Chg (% YoY)	(50.5)	(3.9)	(18.3)	3.0
EPS (RMB)	0.9	0.8	0.6	0.7
Chg (% YoY)	-51.6	-14.3	-18.8	3.0
BVPS (RMB)*	8.9	9.6	10.0	10.4
Chg (% YoY)	7.3	7.4	4.0	3.9
PE (x)	9.3	10.8	13.3	12.9
PB (x)*	0.9	0.9	0.8	0.8
ROAE (%)*	10.5	8.4	6.5	6.4
ROAA (%)	2.0	2.0	1.5	1.4
DPS(HK\$)	0.2	0.4	0.3	0.3
Yield (%)	2.2	4.0	3.0	3.0

Source(s): Bloomberg, ABCI Securities estimates

\*Equity attributable to ordinary shareholders is used in the calculation

Rating: **HOLD**  
TP: **HK\$ 9.9**

Analyst : **Steve Chow**

Tel: **(852) 2147 8809**

[stevechow@abci.com.hk](mailto:stevechow@abci.com.hk)

Share price (HK\$)	10.14
Est. share price return	-2.4%
Est. dividend yield	3.0%
Est. total return	0.6%
Previous Rating & TP	HOLD/HK\$13.2
Previous Report Date	Dec 6, 2017

Source(s): Bloomberg, ABCI Securities

### Key Data

52Wk H/L(HK\$)	9.9/14.0
Issued shares (mn)	6,699
Issued H shares (mn)	980
H-share market cap (HK\$ mn)	9,820
Avg daily turnover (HK\$ mn)	2.3
Major shareholder(s)	
China Merchant Finance	20.9%
Shenzhen Jiheng	19.6%

Source(s): Bloomberg, company, ABCI Securities

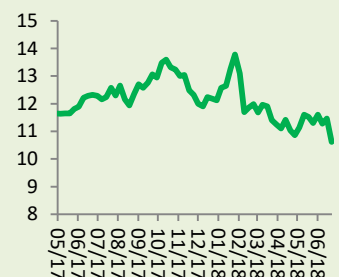
### Share Performance (%)

	Absolute	Relative*
1-mth	-9.4	-1.5
3-mth	-9.4	-3.8
6-mth	-16.2	-11.2

\*Relative to HSI

Source(s): Bloomberg, ABCI Securities

### Share performance(HK\$)



Source(s): Bloomberg, ABCI Securities



## Financial forecast

We expect 2018E revenue to drop by 4% mainly on lower securities brokerage income. For 2019E, we expect revenue to grow by 2% to reflect a gradually improving operating environment.

In terms of key assumptions, we expect the Group's ADT to stay flat in 2018 before resuming a 5% YoY growth in 2019E, in line with our industry assumptions. We also expect the Group's MFSL balance to drop by 10% YoY in 2018E before resuming a 10% YoY growth in 2019E, in line with our industry assumptions. For its asset management business, we expect AUM to remain largely stable in 2018 and grow by 5% YoY for 2019E.

As a result, we expect net profit to drop by 18% in 2018 before climbing 3% in 2019E, which translates into an ROAE of 6.5% and 6.4% respectively.

## Valuation

The counter is currently trading at 0.8x 2019E adjusted P/B, which is undemanding in our view. With the soft ADT outlook in the near term, we see limited positive catalyst in the near term given the Group's high reliance on brokerage business. We roll over our valuation to 2019E and our revised TP of HK\$ 9.9 is based on 0.8x2019E adjusted P/B.

**Risk factors:** 1) Decline in brokerage commission rates; 2) Decline in A-share market turnover; 3) Decline in capital market fundraising; 4) Penalties related to violation of regulatory requirements; 5) Low daily turnover



**Consolidated income statement (2016A-2019E)**

<b>FY Ended Dec 31 (RMB mn)</b>	<b>2016A</b>	<b>2017A</b>	<b>2018E</b>	<b>2019E</b>
Fee and commission income	10,303	9,750	8,928	9,038
Interest income	6,470	6,718	6,428	6,501
Investment income	1,395	2,877	2,733	2,870
<b>Total revenue</b>	<b>18,168</b>	<b>19,346</b>	<b>18,089</b>	<b>18,408</b>
Other income	384	-87	400	400
<b>Total revenue and other income</b>	<b>18,552</b>	<b>19,259</b>	<b>18,489</b>	<b>18,808</b>
<b>Total expenses</b>	<b>12,728</b>	<b>12,998</b>	<b>13,017</b>	<b>13,266</b>
<b>Operating Profits</b>	<b>5,824</b>	<b>6,261</b>	<b>5,472</b>	<b>5,543</b>
Share of profit of investments in associates	629	846	930	1,023
<b>Profit before tax</b>	<b>6,453</b>	<b>7,107</b>	<b>6,402</b>	<b>6,566</b>
Tax	1,036	1,302	1,345	1,379
<b>Profit after tax</b>	<b>5,417</b>	<b>5,805</b>	<b>5,058</b>	<b>5,187</b>
Minority interests	14	19	13	14
Profits attributable to perpetual bondholders	0	592	802	802
<b>Profits attributable to ordinary shareholders</b>	<b>5,404</b>	<b>5,194</b>	<b>4,242</b>	<b>4,371</b>
<b>Growth</b>				
Total revenue and other income (%)	(47.0)	3.8	(4.0)	1.7
Total expenses	(41.9)	2.1	0.1	1.9
Operating Profits (%)	(55.5)	7.5	(12.6)	1.3
Net profit (%)	(50.5)	(3.9)	(18.3)	3.0
<b>Operating performance</b>				
Operating margin (%)	31.4	32.5	29.6	29.5
Net margin (%)	29.7	26.8	23.5	23.7
ROAE (%)*	10.5	8.4	6.5	6.4
ROAA (%)	2.0	2.0	1.5	1.4

Source(s): Company, ABCI Securities estimates

\*Net profit attributable to ordinary shareholders/Average equity attributable to ordinary shareholders

Note: Individual items may not sum to total due to rounding difference



Consolidated balance sheet (2016A-2019E)

As of Dec 31 (RMB mn)	2016A	2017A	2018E	2019E
Property and equipment	1,779	1,832	1,924	2,020
Goodwill	10	10	10	11
Other intangible assets	23	22	23	24
Investment in associates and JV	5,289	7,490	7,864	8,257
AFS	8,809	7,793	8,183	8,592
Financial assets held under resale agreements	6,462	8,802	9,242	9,704
Other non-current assets	1,403	1,101	1,156	1,214
<b>Total non-current assets</b>	<b>23,776</b>	<b>27,049</b>	<b>28,401</b>	<b>29,821</b>
Cash & equivalents	61,272	52,657	62,767	61,782
Clearing settlement funds	19,044	14,011	14,711	15,447
AFS	15,913	25,482	26,756	28,094
Financial assets at FVTPL	48,245	73,070	76,724	80,560
Derivatives	1,110	1,022	1,073	1,126
Other current assets	540	1,225	1,286	1,350
Account receivables	6,827	4,082	4,286	4,500
Other receivables and prepayments	491	514	540	567
Advances to customers	53,352	59,235	53,312	58,643
Financial assets held under resale agreements	12,491	27,298	28,663	30,096
<b>Total current assets</b>	<b>219,283</b>	<b>258,595</b>	<b>270,117</b>	<b>282,165</b>
<b>Total assets</b>	<b>243,059</b>	<b>285,643</b>	<b>298,518</b>	<b>311,986</b>
Accounts payable	67,582	51,095	53,650	56,333
Loans and debt	31,902	75,006	78,756	82,694
Other current liabilities	37,182	50,265	52,778	55,417
<b>Total current liabilities</b>	<b>136,665</b>	<b>176,366</b>	<b>185,184</b>	<b>194,444</b>
Loans and bonds payables	45,465	28,795	30,235	31,747
Other non-current liabilities	1,013	1,149	1,206	1,266
<b>Total non-current liabilities</b>	<b>46,478</b>	<b>29,944</b>	<b>31,441</b>	<b>33,013</b>
<b>Total liabilities</b>	<b>183,143</b>	<b>206,310</b>	<b>216,625</b>	<b>227,456</b>
<b>Net current assets</b>	<b>82,618</b>	<b>82,229</b>	<b>84,932</b>	<b>87,721</b>
Equity attributable to ordinary shareholders	59,826	64,230	66,776	69,398
Equity attributable to perpetual bond holders	-	15,000	15,000	15,000
Minority interest	89	104	117	131
<b>Total equity</b>	<b>59,915</b>	<b>79,334</b>	<b>81,893</b>	<b>84,529</b>

Source(s): Company, ABCI Securities estimates

Note: Individual items may not sum to total due to rounding difference



## DFZQ (3958 HK)

### Volatile earnings trend to persist

- 1Q18 net profit dropped by 43% YoY on lower trading income
- Reliance on trading income leads to high earnings volatility; expect sluggish near-term earnings outlook due to sluggish A-share performance
- Current low valuation reflects investors' concern on company's reliance on trading income and volatile earnings trend

**Recent business update.** In 1Q18, revenue and net profit (excl. extraordinary items) dropped by 8.7% and 43% YoY to RMB 1.9bn and RMB366mn. Significant profit decline is largely due to lower gains arising from sizable investment portfolio. ROAE for 1Q18 was 3.3% (annualized) vs. 7.6% in 2017.

**Sluggish A-share market performance taking its toll.** In 2017, net investment gain, driven by favorable A-share performance (CSI 300: +22% YoY), increased by 140% to RMB 6.7bn, accounting for 40% of revenue - the highest among major H-listed brokers. Market sentiment, however, has reversed in recent months, with CSI 300 Index losing c. 15% in 1H18. We believe this would impact the Group's financial performance in 2018.

**High earnings volatility.** High reliance on trading income has led to volatile earnings in the past. For example, the Group's net profits dropped by 68% in 2016 but increased by 54% in 2017. Sluggish A-share performance is set to hurt the company's profitability significantly in 2018.

**Lack of positive catalyst.** After recent share price corrections, the counter is currently trading at 0.6x 2019E P/B. Based on the softening A-share market and the Group's high earnings sensitivity to A-share market performance, we recommend **HOLD** with a revised TP at HK\$ 5.7 based on 0.6x 2019E P/B.

#### Results and Valuation

FY ended Dec 31	2016A	2017A	2018E	2019E
Revenue (RMB mn)	12,242	16,679	13,043	14,426
Chg (% YoY)	(40.2)	36.2	(21.8)	10.6
Net profit (RMB mn)	2,314	3,554	1,758	2,313
Chg (% YoY)	(68.4)	53.6	(50.5)	31.5
EPS (RMB)	0.41	0.57	0.25	0.33
Chg (% YoY)	(71.9)	39.0	(55.9)	31.5
BVPS (RMB)	6.6	7.6	7.7	8.0
Chg (% YoY)	(0.6)	15.1	2.2	2.8
P/E (x)	11.9	8.6	19.4	14.7
P/B (x)	0.7	0.6	0.6	0.6
ROAE (%)	6.1	7.6	3.3	4.2
ROAA (%)	1.1	1.6	0.7	0.9
DPS(HK\$)	0.18	0.24	0.11	0.14
Yield (%)	3.0	4.0	1.8	2.3

Source(s): Bloomberg, ABCI Securities estimates

Rating: **HOLD**  
TP: **HK\$ 5.7**

Analyst : **Steve Chow**  
Tel: (852) 2147 8809  
stevechow@abci.com.hk

Share price (HK\$)	5.85
Est. share price return	-2.6%
Est. dividend yield	1.8%
Est. total return	-0.6%
Previous Rating & TP	HOLD/HK\$8.3
Previous Report Date	Dec 6

Source(s): Bloomberg, ABCI Securities

#### Key Data

52Wk H/L(HK\$)	5.8/9.2
Issued shares (mn)	6,994
Issued H shares (mn)	1,027
H-share market cap (HK\$ mn)	6,183
Avg daily turnover (HK\$ mn)	2.0
Major shareholder(s)	
Shenergy	25.3%

Source(s): Bloomberg, company, ABCI Securities

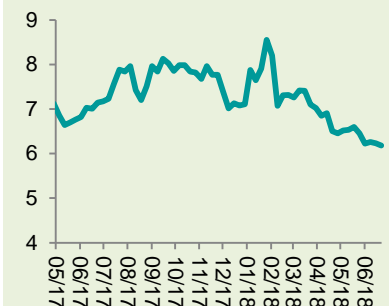
#### Share Performance (%)

	Absolute	Relative*
1-mth	(11.0)	(3.1)
3-mth	(18.1)	(12.6)
6-mth	(18.9)	(13.9)

\*Relative to HSI

Source(s): Bloomberg, ABCI Securities

#### Share performance(HK\$)



Source(s): Bloomberg, ABCI Securities





## Financial forecasts

We overall expect revenue to drop by 22% in 2018, mainly due to lower trading income. For 2019E, we expect revenue to grow by 11% to reflect an improved operating environment.

In terms of key assumptions, we expect the Group's ADT to stay flat in 2018 before resuming a 5% YoY growth in 2019E, in line with our industry assumptions. We also expect the Group's MFSL balance to drop by 10% YoY in 2018E before resuming a 10% YoY growth in 2019E, in line with our industry assumptions. We expect its trading income to drop by 55% YoY in 2018, which implies an investment return of 2.4% vs. 6.1% in 2017. In 2019E, we expect a 25% growth in trading income which implies a 2.9% investment return, similar to 2016 level.

As a result, we expect net profit to drop by 51% YoY in 2018E before resuming a 32% YoY growth in 2019. This translates into ROAE of 3.3%/4.2% for 2018E/19E.

## Valuation

The counter is currently trading at 0.6x 2019E P/B. In our view, such low valuation reflects investors' concern on the Group's reliance on trading income and volatile earnings trend. Given the sluggish A-share outlook which has already taken toll on the Group's trading income, we see limited positive catalyst in the near term. We value the counter at HK\$ 5.7 based on 0.6x 2019E P/B.

**Risk factors:** 1) Decline in brokerage commission rates; 2) Decline in A-share market turnover; 3) Decline in capital market fundraising; 4) Penalties related to violation of regulatory requirements; 5) Low daily turnover.



**Consolidated income statement (2016A-2019E)**

<b>FY Ended Dec 31 (RMB mn)</b>	<b>2016A</b>	<b>2017A</b>	<b>2018E</b>	<b>2019E</b>
Fee and commission income	4,620	5,378	5,465	6,015
Interest income	4,272	3,931	3,945	4,029
Investment income	2,814	6,739	3,000	3,750
<b>Total revenue</b>	<b>11,705</b>	<b>16,047</b>	<b>12,410</b>	<b>13,794</b>
Other income	537	632	632	632
<b>Total revenue and other income</b>	<b>12,242</b>	<b>16,679</b>	<b>13,043</b>	<b>14,426</b>
<b>Total expenses</b>	<b>9,828</b>	<b>12,768</b>	<b>11,357</b>	<b>12,143</b>
<b>Operating Profits</b>	<b>2,414</b>	<b>3,912</b>	<b>1,685</b>	<b>2,283</b>
Share of profit of investments in associates	399	477	572	686
<b>Profit before tax</b>	<b>2,813</b>	<b>4,389</b>	<b>2,258</b>	<b>2,970</b>
Tax	387	786	474	624
<b>Profit after tax</b>	<b>2,426</b>	<b>3,603</b>	<b>1,783</b>	<b>2,346</b>
Minority interests	113	49	25	33
<b>Profits attributable to shareholders</b>	<b>2,314</b>	<b>3,554</b>	<b>1,758</b>	<b>2,313</b>
<b>Growth</b>				
Total revenue and other income (%)	(40.2)	36.2	(21.8)	10.6
Total expenses	(13.8)	29.9	(11.0)	6.9
Operating Profits (%)	(73.4)	62.1	(56.9)	35.5
Net profit (%)	(68.4)	53.6	(50.5)	31.5
<b>Operating performance</b>				
Operating margin (%)	19.7	23.5	12.9	15.8
Net margin (%)	19.8	22.1	14.2	16.8
ROAE (%)	6.1	7.6	3.3	4.2
ROAA (%)	1.1	1.6	0.7	0.9

Source(s): Company, ABCI Securities estimates

Note: Individual items may not sum to total due to rounding difference



Consolidated balance sheet (2016A-2019E)

As of Dec 31 (RMB mn)	2016A	2017A	2018E	2019E
Property and equipment	1,845	2,034	2,135	2,242
Goodwill	32	32	32	32
Other intangible assets	115	128	134	141
Investment in associates and JV	3,515	4,006	4,206	4,416
AFS	10,713	9,941	10,438	10,960
Financial assets held under resale agreements	15,456	9,933	10,430	10,951
Other non-current assets	613	188	197	207
<b>Total non-current assets</b>	<b>32,288</b>	<b>26,261</b>	<b>27,572</b>	<b>28,949</b>
Cash & equivalents	44,168	42,346	44,199	43,931
Clearing settlement funds	10,505	9,349	9,817	10,308
AFS	66,549	62,294	65,408	68,679
Financial assets at FVTPL	23,329	48,029	50,431	52,952
Derivatives	71	169	177	186
Other current assets	1,100	1,025	1,076	1,130
Other receivables and prepayments	4,648	4,762	5,000	5,250
Advances to customers	10,652	12,940	11,646	12,811
Financial assets held under resale agreements	19,103	24,686	25,920	27,216
<b>Total current assets</b>	<b>180,123</b>	<b>205,599</b>	<b>213,673</b>	<b>222,461</b>
<b>Total assets</b>	<b>212,411</b>	<b>231,860</b>	<b>241,245</b>	<b>251,411</b>
Accounts payable	35,652	28,220	29,630	31,112
Loans and debt	29,602	25,167	25,727	26,315
Financial liabilities at FV through P/L	7,472	6,060	6,363	6,681
Financing instrument payables	4,943	1,811	1,901	1,996
Other current liabilities	46,305	60,409	63,429	66,601
<b>Total current liabilities</b>	<b>123,974</b>	<b>121,666</b>	<b>127,051</b>	<b>132,705</b>
Financial assets sold under repurchase agreements	5,720	2,940	3,087	3,241
Loans and bonds payables	859	-	-	-
Financing instrument payables	358	82	86	90
Other non-current liabilities	40,563	53,670	56,354	59,172
<b>Total non-current liabilities</b>	<b>47,500</b>	<b>56,692</b>	<b>59,527</b>	<b>62,503</b>
<b>Total liabilities</b>	<b>171,474</b>	<b>178,358</b>	<b>186,577</b>	<b>195,208</b>
<b>Net current assets</b>	<b>56,149</b>	<b>83,933</b>	<b>86,623</b>	<b>89,757</b>
Equity attributable to shareholders	40,483	52,986	54,127	55,628
Minority interest	455	516	541	575
<b>Total equity</b>	<b>40,938</b>	<b>53,501</b>	<b>54,668</b>	<b>56,203</b>

Source(s): Company, ABCI Securities estimates

Note: Individual items may not sum to total due to rounding difference



## Disclosures

### Analyst Certification

I, Steve Chow Sau Shing, being the person primarily responsible for the content of this research report, in whole or in part, hereby certify that all of the views expressed in this report accurately reflect my personal view about the subject company or companies and its or their securities. I also certify that no part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or views expressed in this report. I and/or my associates do not serve as officer(s) of the listed company (ies) covered in this report. I and/or my associates have no financial interests (except "Disclosures of Interests" below) in relation to the listed Group (ies) covered in this report.

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### Definition of equity rating

Rating	Definition
Buy	Stock return rate $\geq$ Market return rate (10%)
Hold	- Market return rate (-10%) $\leq$ Stock return rate < Market return rate (+10%)
Sell	Stock return < - Market return (-10%)

Notes: Stock return rate: expected percentage change of share price plus gross dividend yield over the next 12 months  
Market return rate: average market return rate since 2005 (HSI total return index 2005-17 CAGR at 10%)

Time horizon of share price target: 12-month

Stock rating, however, may vary from the stated framework due to factors including but not limited to: corporate governance, market capitalization, historical price volatility relative to corresponding benchmark index, average daily turnover of the stock relative to market capitalization of the stock, competitive advantages in corresponding industry, etc.

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