



Nov 14, 2014
Company Report
Rating: BUY
TP: HK\$ 7.80

Share price (HK\$)	7.24
Est. share price return	7.7%
Est. dividend yield	2.0%
Est. total return	9.7%

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Key Data

52Wk H/L(HK\$)	7.37/4.22
Issued shares (mn)	7,537.3
Market cap (HK\$ mn)	54,570
3-mth avg daily turnover (HK\$ mn)	121.1
Major shareholder(s) (%): Huijin	69.23

Source(s): Company, Bloomberg, ABCI Securities

1H14 Revenue breakdown (%)

Securities brokerage	62
Proprietary trading	14
Investment banking	10
Futures brokerage	6
Asset management	2
Overseas	2
Private equity	1
Others	3

Source(s): Company, ABCI Securities

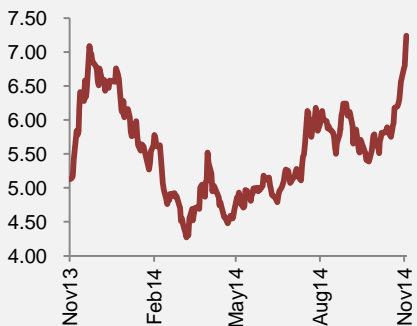
Share performance (%)

	Absolute	Relative*
1-mth	31.40	26.08
3-mth	20.67	25.36
6-mth	48.06	40.11

*Relative to HSI

Source(s): Bloomberg, ABCI Securities

1-Year stock performance (HK\$)



Source(s): Bloomberg, ABCI Securities

China Galaxy Securities (6881 HK) Riding on the A-share tide

- A-share market turnover exceeded RMB 500bn for the first time since Nov 2010 to reach RMB 575bn on Nov 11, 2014 - a record high in history
- Average daily turnover of A-share market rebounded to RMB 291bn in 3Q14. 10M2014 ADT was RMB 232bn (vs 10M2013: RMB 198bn). The launch of SH-HK stock connect is expected to boost turnover in the A-share market.
- In our view, SH-HK stock connect is unlikely to drive up brokerage fee income substantially with the limited quota, however, it would fuel market sentiment and enhance investors' confidence, benefiting multiple business lines such as investment banking and margin financing
- Maintain BUY with revised TP of HK\$ 7.80, reflecting 1.5x 2015E P/B

Strong market volume with 10M14 ADT increasing by 17% YoY. SHCOMP index rose 15% in 3Q14 amid improving liquidity and optimistic market sentiment in anticipation of the official launch of the SH-HK stock connect. ADT rebounded to RMB 291bn in 3Q14, compared with RMB 155bn and RMB 209bn in 2Q14 and 1Q14. 10M14 ADT was RMB 232bn (vs. 10M13: RMB 198 bn). Turnover of the A-share market exceeded RMB 500bn for the first time since Nov 2010 to reach RMB 575bn on Nov 11, 2014 - a record high in history, according to the Wind data. The launch of SH-HK stock connect is expected to offer some support to A-share market. We believe CGS would be one of the key beneficiaries given its stable market share, high exposure in brokerage business (accounted 69% of the Group's revenue in 1H14), and its strong client base.

Margin financing and securities lending balance continue to expand. The scale of margin financing and securities lending (MFSL) business has grown rapidly since its inception and has helped stabilize brokerage commission rates and increases brokerage trading volume. Balance of MFSL in China surged from RMB 38bn in 2011 to RMB 406bn in 1H14. By end-Oct 2014, the balance of MFSL reached RMB 702bn, rising by 72.3% since end-June 2014 and reflecting the continuity of momentum. As at Oct 31 2014, market share of CGS's MFSL business was ranked 5th in China to reach 5.5%, expanding by 0.08ppt and 0.27ppt from end-Sep and end-Jun this year. Given the buoyant A-share market, we expect the margin finance balance to maintain its growth and boost the Group's interest income.

Upbeat growth in investment banking activities. Since China restarted its A-share IPO market in 1Q14, a total of 81 companies have executed their IPOs by end-Sep. Total new equity funds raised in 9M14 (including IPO, placement and rights issues) was RMB 528bn, up 78.4% YoY. Due to the lower bond yield, the amount of bonds underwritten by the Group soared 119.3% YoY to RMB 59.0bn in 10M14. According to Wind, CGS was ranked 8th by bonds underwriting amount and 12th by equity underwriting amount among brokers in 9M14. We expect fee income from investment banking to rebound sharply in FY14 and the momentum to extend into 2015. (Continue to next page)

Financial Summary

FY ended Dec 31	2012A	2013A	2014E	2015E	2016E
Revenue (RMB mn)	5,962	8,426	10,588	12,339	13,754
Chg (% YoY)	(7.3)	41.3	25.7	16.5	11.5
Net profit (RMB mn)	1,420	2,135	2,869	3,463	3,874
Chg (% YoY)	(10.0)	50.4	34.4	20.7	11.9
EPS (RMB)	0.24	0.31	0.38	0.46	0.51
Chg (% YoY)	(10.0)	30.0	23.7	20.7	11.9
BVPS (RMB)	2.90	3.34	3.68	4.09	4.42
Chg (% YoY)	8.9	15.0	10.3	10.9	8.2
P/E (x)	24.2	18.6	15.0	12.5	11.1
P/B (x)	2.0	1.7	1.6	1.4	1.3
ROAE (%)	8.5	9.9	10.7	11.7	12.0
ROAA (%)	2.3	3.0	3.0	2.9	2.9
DPS(RMB)	-	0.06	0.11	0.14	0.18
Yield (%)	-	1.1	2.0	2.4	3.1

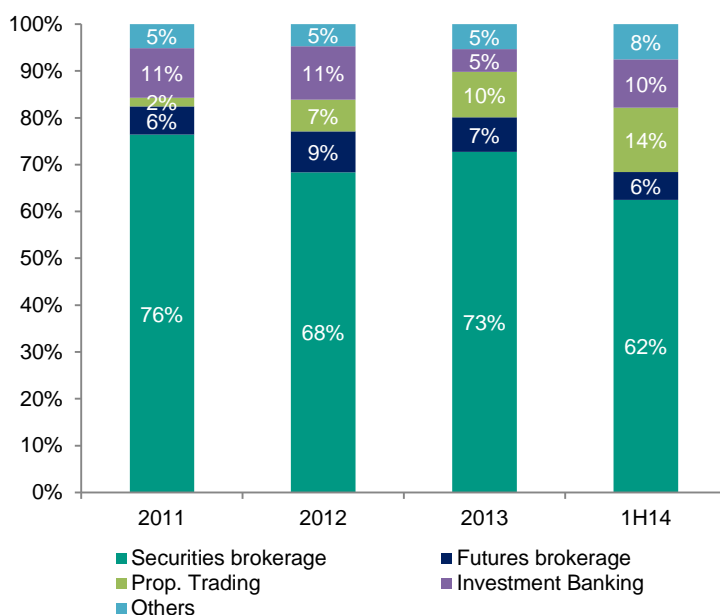
Source(s): Company, ABCI Securities estimates

Potential relaxation of China's capital rules. According to the China Securities Journal, the CSRC plans to relax rules on net capital ratios; specifically, the regulatory requirement for net capital-to-net assets ratio, net capital-to-liabilities ratio, and net assets-to-liabilities ratio will be lowered to 20%, 4% and 10% from the current 40%, 8% and 20%, respectively. We estimate that a 20% cut in net capital-to-net assets ratio requirement will free up ~RMB 5bn in capital for CGS, which would offer support to the capital-based intermediary businesses. CGS's net capital-to-net assets ratio was 82% in 2013, higher than CSRC's required standard of 40%. A strong capital position enables CGS to develop its MFSL business. The increasing contribution from MFSL business would reduce CGS's reliance on tradition brokerage business and help develop a more balanced revenue mix.

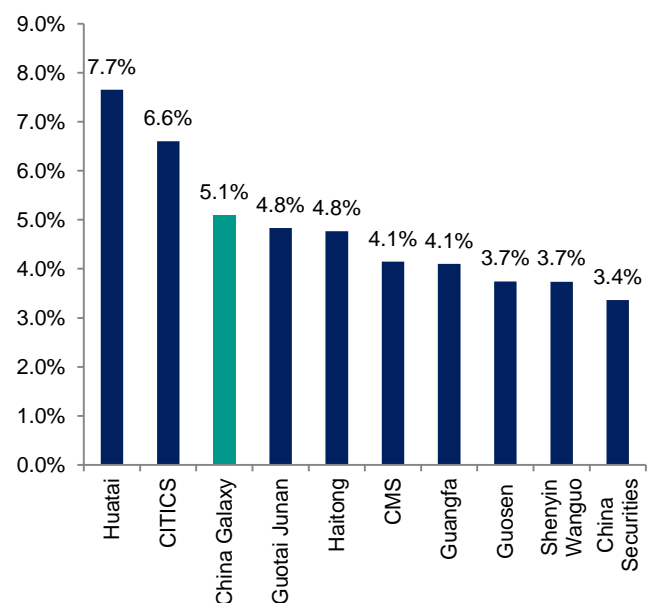
Higher leverage to enhance ROE. China's securities industry is currently operating at a relatively low leverage (i.e. total asset/total equity). According to the Securities Association of China, the industry leverage in 2013 was 2.8x compared to 9.8x among China's insurers and 14.9x among China's banks. Besides, CGS's leverage ratio is low compared to its peers. Under the new capital rules, if the net assets-to-liabilities ratio is lowered to 10%, the maximum leverage would be increased from 6x to 11x. We expect the industry leverage would rise upon the progressive regulatory relaxation, raising the industry's ROE in the long run.

Maintain BUY with revised TP of HK\$ 7.80. We have raised our 2014-16E earnings by 7-14% on increasing trading volume in A-share market and reviving sentiment, since CGS has the largest market share in brokerage income in 2013. Also, robust momentum in MFSL business is likely to persist. CGS's FY13 ROAE at 10% was the highest among peers (CITICS: 6.0%, HTS: 6.7%, CCS: 6.3%), yet the counter is trading at a discount to peers. CGS, a key beneficiary of A-share market revival, is our top pick for the sector. We revise up our Gordon Growth Model-derived TP by 21.9% to HK\$7.8, which implies 1.5x 2015E P/B.

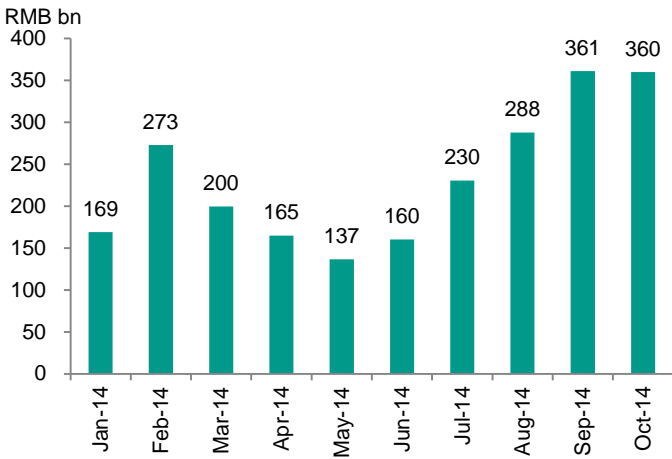
Risk factors: 1) Further decline in commission rates; 2) Higher-than-expected proprietary trading loss; 3) Decline in market share of brokerage business.

Exhibit 1: CGS's revenue mix


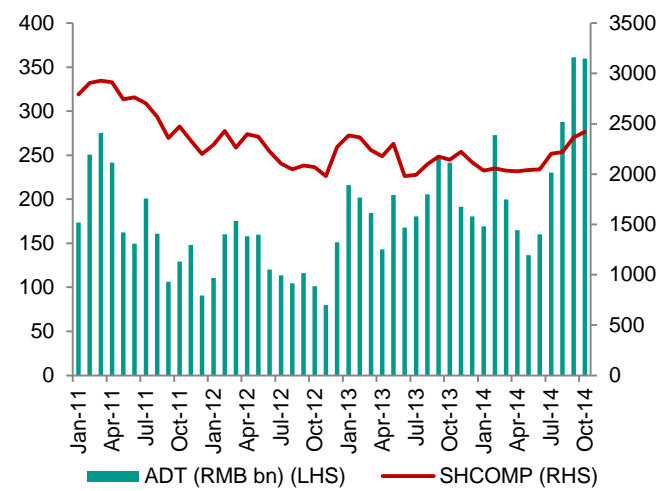
Note: Others include asset management, PE investment and overseas business
 Source(s): WIND, ABCI Securities

Exhibit 2: Market share by trading volume (stocks + funds) in 9M14


Source(s): Company, ABCI Securities

Exhibit 3: Monthly ADT of A-share market


Source(s): WIND, ABCI Securities

Exhibit 4: ADT rebounded sharply in the 3Q14


Source(s): WIND, ABCI Securities

Exhibit 5: Total equity underwriting amount among brokers in 9M14

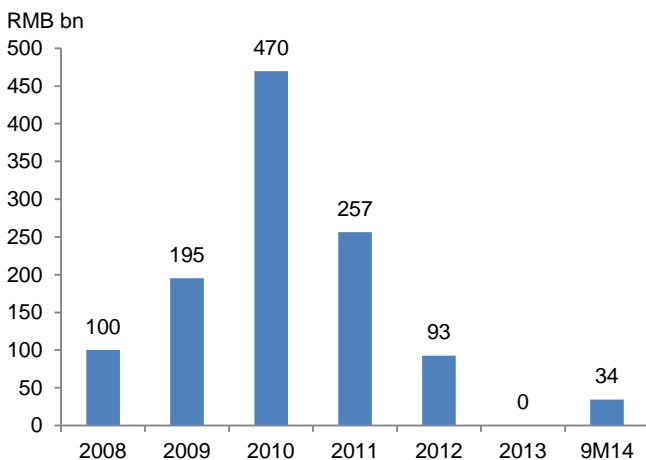
Ranking	Brokers	Total underwriting amount (RMB bn)	Market share (%)
1	China Securities	35	9.2
2	HTS	27	7.1
3	CITICS	24	6.4
4	Guotai Junan	24	6.4
5	Guosen	21	5.4
6	Southwest	20	5.3
7	GF securities	20	5.2
8	Huatai	17	4.4
9	Changjiang	13	3.4
10	Essence	12	3.2
11	Soochow	11	3.0
12	China Galaxy	11	2.9

Source(s): WIND, ABCI Securities

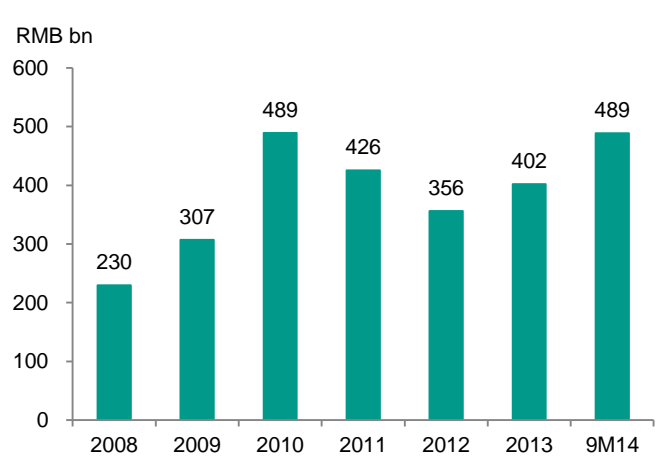
Exhibit 6: Total bond underwriting amount among brokers in 9M14

Ranking	Brokers	Total underwriting amount (RMB bn)	Market share (%)
1	CITICS	241	15.8
2	CDB	122	8.0
3	CICC	96	6.3
4	China Securities	89	5.8
5	Guotai Junan	83	5.4
6	GF securities	62	4.1
7	Guosen	56	3.7
8	China Galaxy	52	3.4
9	CMS	50	3.3
10	Haitong	49	3.2

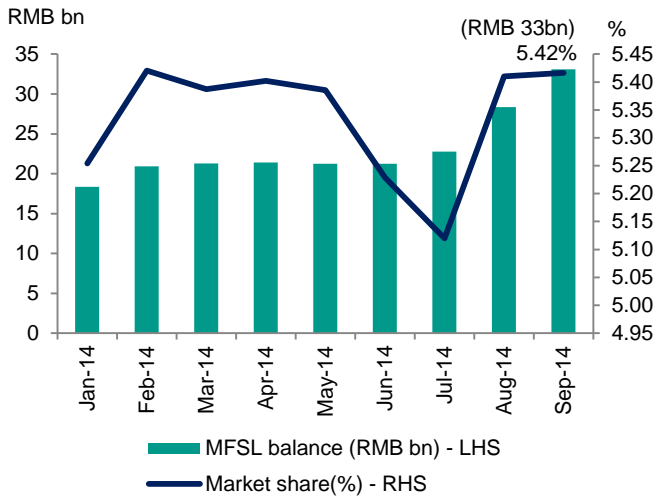
Source(s): WIND, ABCI Securities

Exhibit 7: Fund raised through IPO in the A-share market


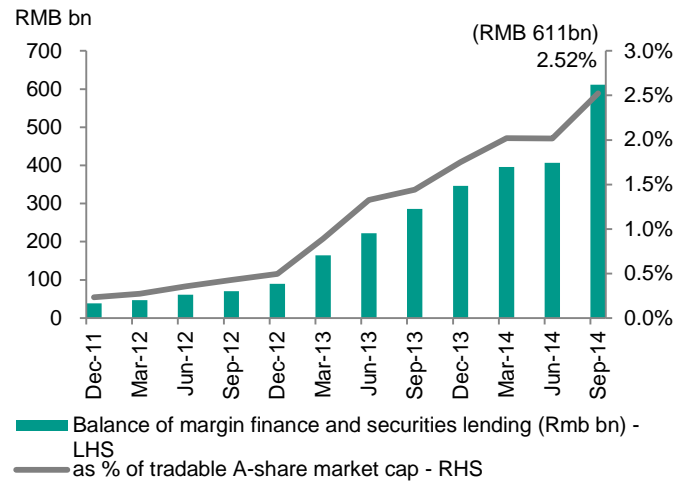
Source(s): WIND, ABCI Securities

Exhibit 8: Fund raised through secondary offerings in the A-share market


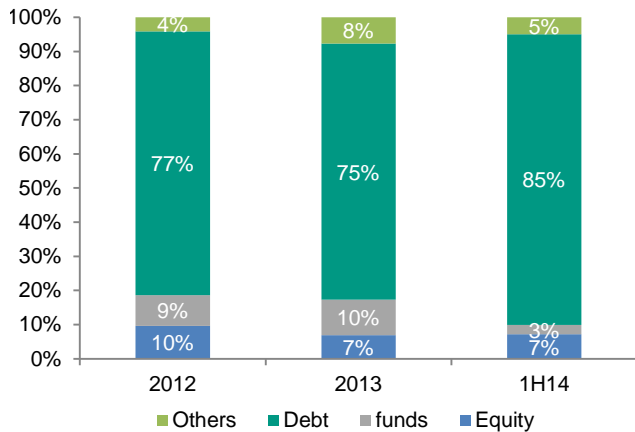
Source(s): WIND, ABCI Securities

Exhibit 9: CGS's MFSL balance


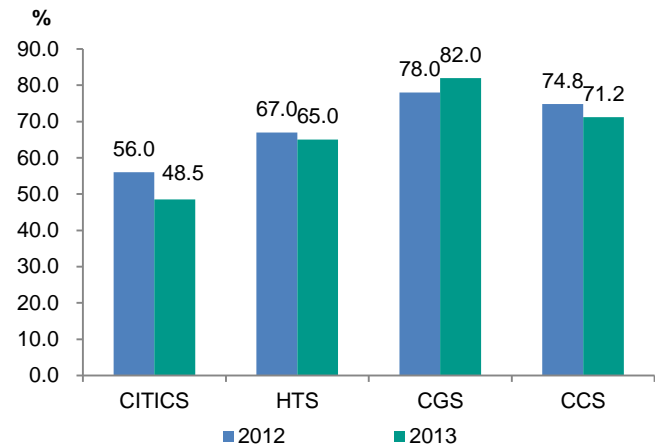
Source(s): WIND, ABCI Securities

Exhibit 10: Balance of MFSL in China


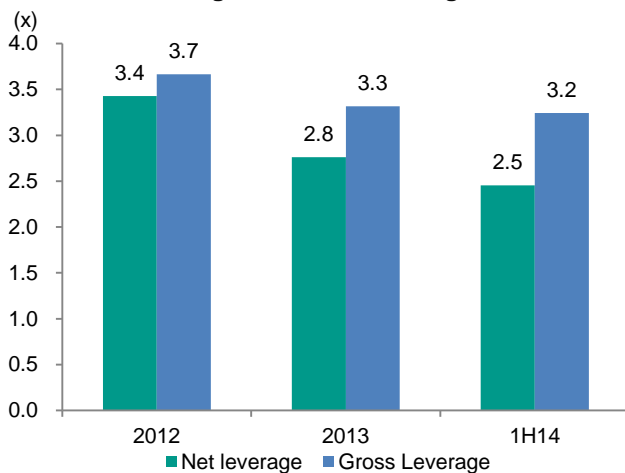
Source(s): WIND, ABCI Securities

Exhibit 11: CGS's investment assets mix by securities category


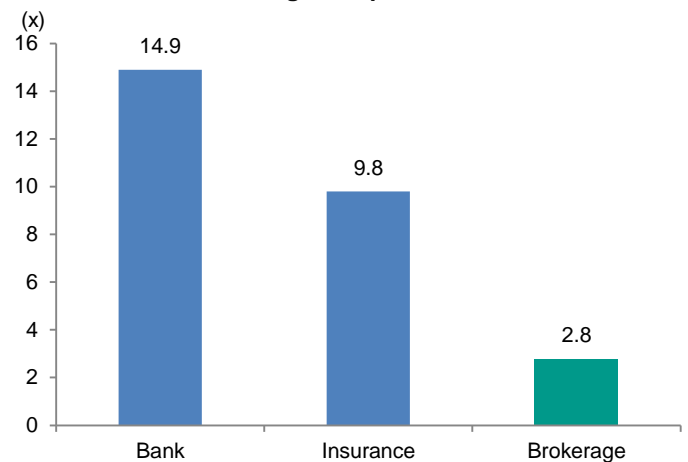
Source(s): Company, ABCI Securities

Exhibit 12: Net capital/net assets ratio for HK-listed China brokers


Source(s): Company, ABCI Securities

Exhibit 13: CGS's gross and net leverage ratios


Source(s): Company, ABCI Securities

Exhibit 14: Gross leverage comparison


Source(s): CBRC, CIRC, SAC, ABCI Securities



Consolidated income statement (2012A-2016E)

FY Ended Dec 31 (RMB mn)	2012A	2013A	2014E	2015E	2016E
Fee and commission income	3,831	5,039	5,489	5,730	6,331
Interest income	1,699	2,666	4,173	5,532	6,178
Investment income	395	697	901	1,049	1,215
Other income	38	23	25	27	30
Revenue	5,962	8,426	10,588	12,339	13,754
Operating costs	(3,827)	(5,334)	(6,500)	(7,443)	(8,294)
Operating EBITDA	2,135	3,092	4,088	4,895	5,460
Depreciation	(248)	(199)	(209)	(219)	(230)
Operating EBIT	1,886	2,893	3,879	4,676	5,229
Associates & JCEs	0	(0)	(0)	0	0
Profit before tax	1,886	2,893	3,878	4,676	5,229
Tax	(454)	(738)	(989)	(1,193)	(1,334)
Profit after tax	1,433	2,155	2,889	3,483	3,895
Minority interests	(13)	(20)	(20)	(20)	(21)
Net profits	1,420	2,135	2,869	3,463	3,874
Growth (%)					
Revenue	(7.3)	41.3	25.7	16.5	11.5
Operating EBITDA	(15.2)	44.9	32.2	19.8	11.5
Operating EBIT	(16.6)	53.4	34.1	20.6	11.8
Net profit	(10.0)	50.4	34.4	20.7	11.9
Operating performance (%)					
Operating EBITDA margin	35.8	36.7	38.6	39.7	39.7
Operating EBIT margin	31.6	34.3	36.6	37.9	38.0
Net margin	23.8	25.3	27.1	28.1	28.2
Effective tax rate	24.1	25.5	25.5	25.5	25.5
Dividend payout	-	20.2	30.0	30.0	35.0
ROAE	8.5	9.9	10.7	11.7	12.0
ROAA	2.3	3.0	3.0	2.9	2.9
Segmental revenue (RMB mn)					
Securities brokerages	4,081	6,174	7,145	8,291	9,116
Futures brokerage	521	623	773	991	1,275
Proprietary trading	401	824	1,069	1,230	1,365
Investment bank	685	411	1,088	1,243	1,363
Asset management	45	137	171	188	207
Private equity investment	25	10	27	32	35
Overseas	33	203	248	287	310
Other income	169	46	66	78	145

Source(s): Company, ABCI Securities estimates



Consolidated balance sheet (2012A-2016E)

FY Ended Dec 31 (RMB mn)	2012A	2013A	2014E	2015E	2016E
Fixed assets	516	394	409	426	434
Goodwill	223	223	223	223	223
Other intangible assets	363	349	367	378	389
Investment securities	743	495	520	546	573
Other non-current assets	174	328	266	217	178
Total non-current assets	2,019	1,789	1,786	1,790	1,797
Cash & equivalents	36,607	33,084	40,362	45,206	48,822
Advances to customers	5,439	18,393	39,462	47,354	52,089
Trading securities	4,622	5,027	5,297	5,600	5,920
Investment securities	6,739	10,238	12,090	14,336	16,234
Other current assets	8,870	9,754	11,935	12,991	14,080
Total current assets	62,277	76,495	109,146	125,487	137,145
Total assets	64,296	78,284	110,932	127,277	138,942
Accounts payable	39,746	36,451	38,274	41,336	44,643
Other liabilities	6,991	16,411	44,621	54,843	60,659
Total liabilities	46,737	52,863	82,894	96,179	105,301
Equity attributable to owners of the Company	17,430	25,175	27,760	30,790	33,308
Minority interest	129	247	278	308	333
Total equity	17,559	25,421	28,038	31,098	33,641
Growth (%)					
Advances to customers	113.4	238.2	114.5	20.0	10.0
Investment securities	949.9	51.9	18.1	18.6	13.2
Total assets	8.6	21.8	41.7	14.7	9.2
Accounts payables	(3.6)	(8.3)	5.0	8.0	8.0
Total liabilities	8.5	13.1	56.8	16.0	9.5
Total equity	8.9	44.8	10.3	10.9	8.2

Source(s): Company, ABCI Securities estimates



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Definition of equity rating

Rating	Definition
Buy	Stock return \geq Market return rate
Hold	Market return - 6% \leq Stock return < Market return rate
Sell	Stock return < Market return - 6%

Stock return is defined as the expected % change of share price plus gross dividend yield over the next 12 months

Market return: 5-year average market return rate from 2009-2013

Time horizon of share price target: 12-month

Definition of share price risk

Rating	Definition
Very high	$2.6 \leq$ 180 day volatility/180 day benchmark index volatility
High	$1.5 \leq$ 180 day volatility/180 day benchmark index volatility < 2.6
Medium	$1.0 \leq$ 180 day volatility/180 day benchmark index volatility < 1.5
Low	180 day volatility/180 day benchmark index volatility < 1.0

We measure share price risk by its volatility relative to volatility of benchmark index. Benchmark index: Hang Seng Index.

Volatility is calculated from the standard deviation of day to day logarithmic historic price change. The 180-day price volatility equals the annualized standard deviation of the relative price change for the 180 most recent trading days closing price.

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