

# CSC Financial Co., Ltd (6066 HK)

## Superior ROAE in FY16

- Net income attributable to ordinary shareholders for FY16 was 9% higher of our expectation on strong investment banking business
- Superior ROAE of 18.1% in 2016 versus the industry average of 8%. We expect the trend to continue in 2017-18
- Maintain **BUY** with TP of HK\$8.40 on above-peer ROAE

**2016 results highlight.** In 2016, net income attributable to ordinary shareholders dropped 41% to RMB 4.9bn, 9% higher than expectation. This is attributable to better-than-expected revenue of the investment banking business. On the other hand, revenue and other income dropped 28% YoY to RMB 17.6bn given its high base in 2015.

**Superior ROAE versus peers.** In 2016, the Company's ROAE was 18.1%, significantly higher than the industry average at 8%. The Group's ROAE was also higher than peers in the more bullish environment in 2015. For 2017E-18E, we expect its ROAE to normalize to the 13-15% range but the figure should still be significantly higher than peers' high-single-digit level.

**Leading position in investment banking.** In 2016, investment banking revenue and other income rose 38% YoY to RMB 4.7bn and accounted for 26.6% of the Group's total. It was ranked 2<sup>nd</sup> in equity underwritten amount and 1<sup>st</sup> in bond underwritten amount. We continue to believe the Company is well positioned to ride on the government's plan to boost direct financing.

**Maintain BUY with TP of HK\$8.40.** We maintain **BUY** on CSC given its higher ROAE than peers as well as its leading position in investment banking. The counter is currently trading at 1.18x 2017E adjusted P/B (excluding RMB5 bn of perpetual bonds). Our new TP is based on 1.35x 2017E adjusted P/B.

**Risk factors:** 1) Further decline in brokerage commission rates; 2) Sharp decline in A-share market turnover; 3) Sharp decline in capital market fundraising; 4) Penalties related to violation of regulatory requirements; 5) Decline in ROAE after listing.

### Results and Valuation

FY ended Dec 31	2014A	2015A	2016A	2017E	2018E
Revenue (RMB mn)	11,452	24,513	17,585	18,280	20,926
Chg (% YoY)	56.4	114.0	(28.3)	4.0	14.5
Profit attributable to ordinary shareholders (RMB mn)	3,407	8,345	4,965	5,172	6,222
Chg (% YoY)	90.7	144.9	(40.5)	4.2	20.3
Underlying EPS (RMB)	0.56	1.37	0.69	0.71	0.86
Chg (% YoY)	NA	144.6	(49.5)	3.2	20.3
BVPS (RMB)*	2.73	4.12	5.03	5.57	6.25
Chg (% YoY)	NA	50.6	22.1	10.8	12.2
PE (x)	11.2	4.6	9.1	8.8	7.3
P/B (x)*	2.3	1.5	1.2	1.1	1.0
ROAE (%)*	22.9	40.0	18.1	13.5	14.5
ROAA (%)	3.6	5.4	2.7	2.8	3.1
DPS (RMB)	0.03	-	0.18	0.18	0.21
Dividend Yield (%)	0.5	-	2.9	2.8	3.4

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

Source(s): Bloomberg, ABCI Securities estimates

## Company Report

Mar 22, 2017  
 Rating: **BUY**  
 TP: **HK\$ 8.40**

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Share price (HK\$)	7.38
Est. share price return	13.8%
Est. dividend yield	2.7%
Est. total return	16.5%
Previous Rating & TP	BUY/HK\$7.66
Previous Report Date	Jan 25

Source(s): Bloomberg, ABCI Securities

### Key Data

52Wk H/L (HK\$)	7.60/6.51
Issued shares (mn)	7,265
Issued H shares (mn)	1,261
H-share market cap (HK\$ mn)	9,457
Avg daily turnover (HK\$ mn)	11.4
Major shareholder(s)	
BSCOMC	37.46%
Huijin	33.29%
Citic Sec	5.95%

Source(s): Company, ABCI Securities

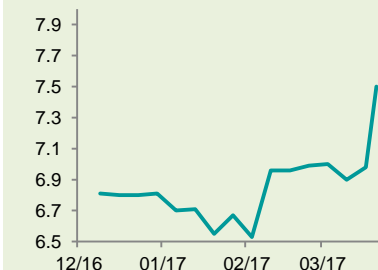
### Share Performance (%)

	Absolute	Relative*
1-mth	7.0	4.5
3-mth	9.9	12.6
6-mth	NA	NA

\*Relative to HSI

Source(s): Bloomberg, ABCI Securities

### Share performance (HK\$)



Source(s): Bloomberg, ABCI Securities



Exhibit 1: 2016 results highlight

RMB mn	2015	2016	YoY	Comment
Fee and commission income	14,901	10,584	-29%	
Interest income	5,573	4,441	-20%	
Investment income	3,980	2,412	-39%	
Other income	59	148	151%	
<b>Total revenue and other income</b>	<b>24,513</b>	<b>17,585</b>	<b>-28%</b>	High base in 2015
Total expenses	13,051	10,524	-19%	Cost control
<b>Operating Profits</b>	<b>11,462</b>	<b>7,061</b>	<b>-38%</b>	
Share of profit of associates	0	-3	NA	
Profit before tax	11,462	7,057	-38%	
Tax	2,810	1,744	-38%	
<b>Net profit of the group</b>	<b>8,652</b>	<b>5,313</b>	<b>-39%</b>	
Attribute to:				
Minority interests	13	54	315%	
Other equity instrument	294	294		Paid to perpetual sub-bonds holders
<b>Ordinary shareholder</b>	<b>8,345</b>	<b>4,965</b>	<b>-41%</b>	
<b>Revenue mix</b>				
Wealth management	13,786	7,234	-48%	Falling ADT
Investment banking	3,398	4,682	38%	Strong investment banking business
Investment management	1,400	1,565	12%	
Trading and institutional client	5,444	3,575	-34%	
Others	485	529	9%	
	<b>24,512</b>	<b>17,585</b>	<b>-28%</b>	
<b>% of total revenue</b>				
Wealth management	56%	41%		
Investment banking	14%	27%		
Investment management	6%	9%		
Trading and institutional client	22%	20%		
Others	2%	3%		
<b>Ratios</b>				
Operating margin	46.8%	40.2%		
Net margin	34.0%	28.2%		
ROAE*	40.0%	18.1%		Superior ROE versus peers

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

Source(s): Company, ABCI Securities



## Risk factors

**PRC securities markets are highly dependent on the economic and market conditions in China.** Brokerage industry in the PRC and the Company's business are directly affected by the inherent risks associated with the securities markets such as market volatility, overall investment sentiments, the supply of liquidity and perceived credit worthiness of the securities industry in the marketplace. Unfavorable economic conditions and government policies may result in declines in trading turnover as well as financial and investment activities, which could adversely affect the commission and fee income from the Company's securities brokerage business; underwriting commission and sponsors fees from its investment banking business may also be negatively impacted. Any prolonged downturn could also increase the risk of defaults in the margin loans that the Company provides to clients.

**Decrease in market turnover and intensified competition in brokerage commission rate may have significant adverse impacts on brokerage revenue.** Fee and commission income from brokerage services was RMB4.73bn, down 55.7% YoY in 2016, contributing to 27% of total revenue. The Company generates a significant portion of revenue from securities brokerage business. Increasing competition in China's securities industry and the growing popularity of online trading systems may reduce brokerage commission further, lowering profitability of the brokerage business.

**Volatility in the A-share market may cause investment losses in the proprietary trading business.** Available-for-sales financial assets increased to RMB 28.5bn at end-2016, up 79% YoY, representing 16% of the Company's total assets. The Company trades primarily equity and fixed-income securities on its own account. Equity and fixed-income securities are subject to market volatility, and performance of the Company's securities trading activities is generally correlated with that of the PRC securities market.

**Credit risks in credit transaction business.** The Company's credit exposure mainly originates from its MFSL, securities-backed lending and securities repurchase businesses. Pre-provision margin accounts were RMB31.1bn at end-2016. In 2016, impaired loss of margin account was RMB87mn. Any material non-payment or non-performance by a client or counterparty could adversely affect the Company's financial position, results of operations, and cash flows.

**Interest rate risk.** The Company's interest rate risk mainly originates from its interest rate sensitive financial instrument whose fair values are subject to adverse movements in market interest rates.

**Risks related to extensive regulatory requirements in China.** The Company is subject to extensive regulatory requirements in China. These regulations often serve to limit activities by imposing capital requirements, regulating products/services offered, restricting the type of securities eligible for investment and setting limits on the number and location of branches. The Company could be subject to administrative penalties from the CSRC should violations occur and results of operation, financial condition and prospects could be materially and adversely affected.

**Comprehensive net profit attributable to ordinary shareholders were less than reported net profit attributable to shareholders 2016.** CSC recorded decline of fair value of financial assets which were capitalized in balance sheet but not in income statement. The comprehensive net profit attributable to ordinary shareholders was RMB 4.6bn in 2016, or 7.8% lower than reported net profit attributable to ordinary shareholders.



**Consolidated income statement (2014A-2018E)**

<b>FY Ended Dec 31 (RMB mn)</b>	<b>2014A</b>	<b>2015A</b>	<b>2016A</b>	<b>2017E</b>	<b>2018E</b>
Fee and commission income	6,541	14,901	10,584	10,548	12,659
Interest income	2,930	5,573	4,441	5,183	5,618
Investment income	1,903	3,980	2,412	2,400	2,500
<b>Total revenue</b>	<b>11,374</b>	<b>24,454</b>	<b>17,437</b>	<b>18,130</b>	<b>20,776</b>
Other income	78	59	148	150	150
<b>Total revenue and other income</b>	<b>11,452</b>	<b>24,513</b>	<b>17,585</b>	<b>18,280</b>	<b>20,926</b>
<b>Total expenses</b>	<b>6,908</b>	<b>13,051</b>	<b>10,524</b>	<b>10,914</b>	<b>12,144</b>
<b>Operating Profits</b>	<b>4,544</b>	<b>11,462</b>	<b>7,061</b>	<b>7,367</b>	<b>8,783</b>
Share of profit of investments in associates	0	0	-3	-4	-5
Profit before tax	4,544	11,462	7,057	7,363	8,778
Tax	1,145	2,810	1,744	1,841	2,194
<b>Profit after tax</b>	<b>3,398</b>	<b>8,652</b>	<b>5,313</b>	<b>5,522</b>	<b>6,583</b>
Minority interests	-9	13	54	56	67
Profits attributable to perpetual bondholders	0	294	294	294	294
<b>Profits attributable to ordinary shareholders</b>	<b>3,407</b>	<b>8,345</b>	<b>4,965</b>	<b>5,172</b>	<b>6,222</b>
<b>Growth</b>					
Total revenue and other income (%)	56.4	114.0	(28.3)	4.0	14.5
Total expenses	40.9	88.9	(19.4)	3.7	11.3
Operating Profits (%)	87.7	152.3	(38.4)	4.3	19.2
Profits attributable to ordinary shareholders (%)	90.7	144.9	(40.5)	4.2	20.3
<b>Operating performance</b>					
Operating margin (%)	39.7	46.8	40.2	40.3	42.0
Net margin (%)	25.0	34.1	28.5	28.5	29.9
ROAE (%)*	22.9	40.0	18.1	13.5	14.5
ROAA (%)	3.6	5.0	2.7	2.8	3.1

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

Source(s): Company, ABCI Securities estimates



Consolidated balance sheet (2014A-2018E)

As of Dec 31 (RMB mn)	2014A	2015A	2016A	2017E	2018E
Property and equipment	486	580	579	608	639
Goodwill	100	122	144	152	159
Other intangible assets	-	374	278	291	306
Investment in associates and JV	20	50	172	181	190
AFS	835	1,457	6,112	6,418	6,738
Financial assets held under resale agreements	-	-	625	657	690
Other non-current assets	1,914	3,055	4,464	4,687	4,921
<b>Total non-current assets</b>	<b>3,356</b>	<b>5,638</b>	<b>12,374</b>	<b>12,993</b>	<b>13,643</b>
Cash & equivalents	11,448	16,154	17,526	15,874	17,476
Clearing settlement funds	42,762	70,664	55,083	57,837	60,729
AFS	11,453	15,891	28,483	29,907	31,402
Financial assets at FVTPL	526	1,504	325	341	359
Derivatives	151	142	49	51	54
Other current assets	1,028	1,715	1,785	1,874	1,968
Account receivables	164	153	378	397	417
Other receivables and prepayments	18,318	28,500	27,605	28,985	30,434
Advances to customers	31,941	35,931	31,007	37,208	40,929
Financial assets held under resale agreements	2,260	6,896	7,080	7,434	7,805
<b>Total current assets</b>	<b>120,051</b>	<b>177,551</b>	<b>169,320</b>	<b>179,909</b>	<b>191,573</b>
<b>Total assets</b>	<b>123,406</b>	<b>183,188</b>	<b>181,694</b>	<b>192,902</b>	<b>205,216</b>
Accounts payable	43,487	72,045	56,736	59,573	62,551
Borrowings	500	1,123	1,782	1,871	1,964
Placements from banks and other financial institutions	3,584	2,284	9,360	9,828	10,319
Other current liabilities	49,850	60,447	58,334	61,251	64,313
<b>Total current liabilities</b>	<b>97,421</b>	<b>135,899</b>	<b>126,212</b>	<b>132,522</b>	<b>139,148</b>
Loans and bonds payables	7,989	15,072	13,653	14,336	15,052
Other non-current liabilities	1,269	2,034	567	595	624
<b>Total non-current liabilities</b>	<b>9,257</b>	<b>17,107</b>	<b>14,220</b>	<b>14,931</b>	<b>15,677</b>
<b>Total liabilities</b>	<b>106,678</b>	<b>153,005</b>	<b>140,432</b>	<b>147,453</b>	<b>154,825</b>
<b>Net current assets</b>	<b>22,630</b>	<b>41,652</b>	<b>43,108</b>	<b>47,387</b>	<b>52,425</b>
<b>Equity attributable to ordinary shareholders</b>	<b>16,669</b>	<b>25,106</b>	<b>36,063</b>	<b>40,348</b>	<b>45,278</b>
Other equity instruments (perpetual subordinated bonds)	-	5,000	5,000	5,000	5,000
Non-controlling interests	59	77	200	101	113
<b>Total equity</b>	<b>16,728</b>	<b>30,183</b>	<b>41,263</b>	<b>45,449</b>	<b>50,391</b>

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

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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