



Aug 19, 2014
Company Report
Rating: BUY
TP: HK\$ 6.40

Share price (HK\$)	5.88
Est. share price return	8.8%
Est. dividend yield	2.6%
Est. total return	11.4%

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Key Data

52Wk H/L(HK\$)	7.12/4.22
Issued shares (mn)	7,537.3
Market cap (HK\$ mn)	44,319
3-mth avg daily turnover (HK\$ mn)	91.48
Major shareholder(s) (%): Huijin	69.23

Source(s): Company, Bloomberg, ABCI Securities

1H14 Revenue breakdown (%)

Securities brokerage	64
Proprietary trading	14
Investment banking	11
Futures brokerage	6
Asset management	2
Overseas	2
Private equity	1

Source(s): Company, ABCI Securities

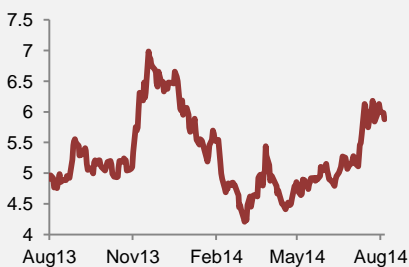
Share performance (%)

	Absolute	Relative*
1-mth	14.0	6.4
3-mth	20.1	9.2
6-mth	9.5	-1.5

*Relative to HSI

Source(s): Bloomberg, ABCI Securities

1-Year stock performance (HK\$)



Source(s): Bloomberg, ABCI Securities

China Galaxy Securities (6881 HK)
Solid 1H14 results: stellar growth in IB business

- 1H14 net profit rose 39.2% YoY to RMB1,347mn; revenue grew 25.5% YoY to RMB 4,806mn.
- Net brokerage commission and fee income declined 10.8% YoY to RMB 1,768mn.
- Margin business continued its growth momentum; interest income from these businesses soared 118.6% YoY, representing 19% of the Group's total revenue in 1H14.
- Investment banking business rebounded sharply with the segment's net income soaring by 162.2% YoY to RMB 526mn.
- Two key strengths remain intact: 1) Proxy for trading activity in the A-share market; 2) Sound capital position
- Reiterate BUY with TP of HK\$ 6.40 to imply 1.4x 2014E P/B

1H14 net profit rose 39.2% YoY to RMB 1,347mn. CGS's 1H14 revenue grew 25.5% YoY to RMB 4,806mn; net profit increased 39.2% YoY to RMB 1,347mn on strong growth in investment banking business. As domestic securities trading market remained weak in 1H14, net brokerage commission and fee income declined 10.8% YoY to RMB 1,768mn. Net investment banking income surged 162.2% YoY to RMB 526mn, while net interest income rose 47.9% YoY to RMB 1,236mn. Net investment gains climbed 66.9% YoY to RMB 646mn. Weighted average return on equity rose to 10.4% (vs. 9.9% in FY13).

Net brokerage commission and fee income declined. A-share market remained weak in 1H14 with turnover of the stock market amounting to RMB 21.55tn only, representing a slight increase of 2.43% YoY. Net brokerage commission and fee income declined 10.8% YoY to RMB 1,768mn.

Increasing revenue contribution from margin financing business. Margin business extended its growth momentum with the balance of margin financing and securities lending (MFSL) surging by 81.3% YoY to RMB 21.27bn as at June 30, 2014, representing a market share of 5.23%. As such, interest income from these businesses jumped 118.6% YoY to RMB 91.7mn, representing 19% of the Group's total revenue in 1H14 and driving up CGS's net interest income by 47.9% YoY.

Upbeat growth in investment banking business. Given the resumption of A-share IPO market and the recovery of bond market, investment banking business rebounded sharply with the segment's net income leaping 162.2% YoY to RMB 526mn and gross revenue accounting for ~11% of total revenue. The amount of equity securities underwritten increased by 223.3% to RMB 9.3bn while the amount of bonds underwritten surged 59.9% YoY to RMB 37.5bn.

Operating expense is in-line with expectation. Operating expense was up 21.6% YoY to RMB 3,036.9mn, driven by increased staff cost (+40.0% YoY) and interest expense (+59.3% YoY) resulted from business expansion and revenue growth. Cost-income ratio declined 2.5ppt from 2013 to 63.2% in 1H14. (Continue next page)

Financial Summary

FY ended Dec 31	2012A	2013A	2014E	2015E	2016E
Revenue (RMB mn)	5,962	8,426	10,240	11,618	13,007
Chg (% YoY)	(7.3)	41.3	21.5	13.5	11.9
Net profit (RMB mn)	1,420	2,135	2,681	3,032	3,406
Chg (% YoY)	(10.0)	50.4	25.6	13.1	12.4
EPS (RMB)	0.24	0.31	0.36	0.40	0.45
Chg (% YoY)	(10.0)	30.0	15.7	13.1	12.4
BVPS (RMB)	2.90	3.34	3.65	3.99	4.28
Chg (% YoY)	8.9	15.0	9.2	9.4	7.2
P/E (x)	20.1	15.4	13.3	11.8	10.5
P/B (x)	1.6	1.4	1.3	1.2	1.1
ROAE (%)	8.5	9.9	10.1	10.4	10.8
ROAA (%)	2.3	3.0	3.2	3.2	3.2
DPS(RMB)	-	0.12	0.12	0.14	0.16
Yield (%)	0.0	2.6	2.6	3.0	3.4

Source(s): Company, ABCI Securities estimates



Two key strengths remain intact. 1) Proxy for trading activity in the A-share market: Trading volume was strong in the A-share market, with average daily turnover (ADT) in Aug reaching RMB 290bn (vs. RMB 203bn YTD). We expect ADT would improve in 2H14 compared to 1H14 due to ample liquidity. As a result, we believe CGS's brokerage income would increase given its largest market share in brokerage income (2013: 5.14%) and strong client base; **2) Sound capital position:** Net capital/net asset ratio was 82% in 2013, higher than CSRC's required standard of 40%. A strong capital position enables CGS to further develop its capital-based intermediary businesses such as margin financing and securities lending. The increasing contribution from MFSL business would reduce CGS's reliance on tradition brokerage business to develop a more well-balanced revenue mix.

Reiterate BUY with TP at HK\$ 6.40. CGS's share price has outperformed the HSI for the past 3 months primarily due to the buoyant A-share market and blazing market sentiment. Given the reviving A-share market and turnover, as well as CGS's diversifying revenue mix and solid capital position, we reiterate **BUY** for CGS with the Gordon Growth Model-derived TP of HK\$6.40 that implies 1.4x 2014E 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: 1H14 net profit grew 39.2% YoY

RMB mn	1H13	1H14	YoY(%)
Commission and fee income	2,309	2,454	6%
Interest income	1,124	1,696	51%
Investment income	387	646	67%
Other income	8	10	24%
Total revenue	3,828	4,806	26%
Fee and commission expenses	67	78	17%
Finance cost	289	460	59%
Staff costs	1,101	1,540	40%
Depreciation	121	97	-20%
Impairment losses	122	19	-85%
Other operating expenses	799	844	6%
Total operating expenses	2,498	3,037	22%
Operating profits	1,330	1,769	33%
Share of results of Associates	-	1	-
Share of results of JCEs	-	-	-
Profit before tax	1,330	1,770	33%
Income tax expenses	352	417	19%
Minority interest	10	6	-42%
Net profit	968	1,347	39%

Source(s): Company, 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	5,573	5,689	5,698
Interest income	1,699	2,666	3,733	4,853	6,066
Investment income	395	697	909	1,049	1,213
Other income	38	23	25	27	30
Revenue	5,962	8,426	10,240	11,618	13,007
Operating costs	(3,827)	(5,334)	(6,404)	(7,302)	(8,175)
Operating EBITDA	2,135	3,092	3,836	4,316	4,831
Depreciation	(248)	(199)	(209)	(219)	(230)
Operating EBIT	1,886	2,893	3,627	4,097	4,601
Associates & JCEs	0	(0)	(0)	0	0
Profit before tax	1,886	2,893	3,627	4,097	4,601
Tax	(454)	(738)	(925)	(1,045)	(1,174)
Profit after tax	1,433	2,155	2,701	3,052	3,427
Minority interests	(13)	(20)	(20)	(20)	(21)
Net profits	1,420	2,135	2,681	3,032	3,406
Growth (%)					
Revenue	(7.3)	41.3	21.5	13.5	11.9
Operating EBITDA	(15.2)	44.9	24.0	12.5	11.9
Operating EBIT	(16.6)	53.4	25.4	12.9	12.3
Net profit	(10.0)	50.4	25.6	13.1	12.4
Operating performance (%)					
Operating EBITDA margin	35.8	36.7	37.5	37.1	37.1
Operating EBIT margin	31.6	34.3	35.4	35.3	35.4
Net margin	23.8	25.3	26.2	26.1	26.2
Effective tax rate	24.1	25.5	25.5	25.5	25.5
Dividend payout	-	40.4	35.0	35.0	36.0
ROAE	8.5	9.9	10.1	10.4	10.8
ROAA	2.3	3.0	3.2	3.2	3.2
Segmental revenue (RMB mn)					
Securities brokerages	4,081	6,174	7,268	8,158	8,947
Futures brokerage	521	623	746	956	1,275
Proprietary trading	401	824	1,072	1,230	1,361
Investment bank	685	411	714	773	850
Asset management	45	137	138	149	164
Private equity investment	25	10	27	32	38
Overseas	33	203	225	260	301
Other income	169	46	51	61	131

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	413	422	430
Goodwill	223	223	223	223	223
Other intangible assets	363	349	367	378	389
Investment securities	743	495	569	598	628
Other non-current assets	174	328	266	217	178
Total non-current assets	2,019	1,789	1,839	1,837	1,848
Cash & equivalents	36,607	33,084	34,738	36,475	38,299
Advances to customers	5,439	18,393	24,636	28,708	32,727
Trading securities	4,622	5,027	5,631	6,081	6,568
Investment securities	6,739	10,238	12,191	15,062	18,638
Other current assets	8,870	9,754	10,814	11,562	12,365
Total current assets	62,277	76,495	88,009	97,888	108,596
Total assets	64,296	78,284	89,848	99,726	110,444
Accounts payable	39,746	36,451	38,274	41,336	44,643
Other liabilities	6,991	16,411	23,805	28,018	33,227
Total liabilities	46,737	52,863	62,079	69,354	77,870
Net current assets	15,540	23,632	25,931	28,534	30,726
Equity attributable to owners of the Company	17,430	25,175	27,495	30,071	32,251
Minority interest	129	247	275	301	323
Total equity	17,559	25,421	27,770	30,372	32,574
Growth (%)					
Advances to customers	113.4	238.2	33.9	16.5	14.0
Investment securities	949.9	51.9	19.1	23.6	23.7
Total assets	8.6	21.8	14.8	11.0	10.7
Accounts payables	(3.6)	(8.3)	5.0	8.0	8.0
Total liabilities	8.5	13.1	17.4	11.7	12.3
Total equity	8.9	44.8	9.2	9.4	7.2

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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