

Guolian Securities (1456 HK)

Fairly priced

- 2016 profit dropped 59% YoY to RMB 610mn due to a 39% decline in revenue. The profit decline was more severe than the 50% profit drop averaged among the industry players
- Brokerage and credit businesses, which jointly accounted for 62% of total revenue, were the main drags.
- After a correction in 2016, we believe business outlook will turn more stable in 2017
- Valuation discount to listed national brokers will persist. Maintain **HOLD**

2016 results highlight. In 2016, net income attributable to shareholders dropped 59% to RMB 610m amid the high base in 2015 and slowdown in A-share market in 2016. Overall, the profit decline of 59% was deeper than the 50% drop among the industry players. Revenue and other income fell 39% YoY to RMB 2.3bn, largely in line with the industry trend. ROE for 2016 was 8.0%, similar to the industry average.

Brokerage, credit, and trading were the main drags. In 2016, revenue from brokerage and credit businesses, which jointly accounted for 62% of total revenue, dropped 46% YoY. In addition, trading revenue, which accounted for 6% of total revenue in 2016, also tumbled 72% amid less favorable market condition compared with that in 2015.

A steady 2017. After the correction in 2016, we expect outlook for the brokerage industry to slowly improve in 2017 amid the stabilizing A-share ADT in recent months. We expect net profit to grow by 9% and 10% in 2017E and 2018E. We predict its ROAE will slightly improve to 8.5%-8.8% in 2017-18 from 8.0% in 2016.

Maintain HOLD with TP of HK\$4.50. The counter has been trading at a discount to major listed national brokers due to its smaller size as a regional player, and we expect the valuation gap to persist. In addition, recent listing of various national brokers, such as Everbright Securities (6178 HK), China Merchant Securities (6099 HK), and CSC (6066 HK), have opened up more choices for investors. We maintain our **HOLD** recommendation with a new TP to HK\$ 4.50, equivalent to 0.95x 2017E P/B. With single digit ROAE, current valuation is fairly priced by the market, in our view.

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) Very low daily stock turnover value.

Results and Valuation

FY ended Dec 31	2014A	2015A	2016A	2017E	2018E
Revenue (RMB mn)	2,132	3,833	2,336	2,378	2,535
Chg (% YoY)	NA	79.8	(39.1)	1.8	6.6
Profit attributable to shareholders	715	1,471	610	664	733
Chg (% YoY)	NA	105.8	(58.6)	9.0	10.3
Underlying EPS (RMB)	0.48	0.88	0.32	0.35	0.39
Chg (% YoY)	NA	83.3	(63.6)	9.0	10.3
BVPS (RMB)	2.7	4.6	4.0	4.2	4.5
Chg (% YoY)	NA	70.5	(14.2)	6.1	6.4
PE (x)	7.9	4.3	11.9	10.9	9.9
P/B (x)	1.4	0.8	1.0	0.9	0.8
ROAE (%)	35.0	24.9	8.0	8.5	8.8
ROAA (%)	7.0	5.7	2.2	2.7	2.9
DPS(HK\$)	0.08	0.45	0.16	0.12	0.13
Dividend Yield (%)	1.8	10.5	3.7	2.8	3.0

Source(s): Bloomberg, ABCI Securities estimates

Company Report

Apr 7, 2017
 Rating: **HOLD**
 TP: **HK\$ 4.50**

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Share price (HK\$)	4.29
Est. share price return	5.7%
Est. dividend yield	2.8%
Est. total return	8.5%
Previous Rating & TP	HOLD/ HK\$4.37
Previous Report Date	Sep 1, 2016

Source(s): Bloomberg, ABCI Securities

Key Data

52Wk H/L(HK\$)	4.76/3.72
Issued shares (mn)	1,902
Issued H shares (mn)	443
H-share market cap (HK\$ mn)	1,900
Avg daily turnover (HK\$ mn)	0.03
Major shareholder(s)	
Guolian Group	72.35%

Source(s): Company, ABCI Securities

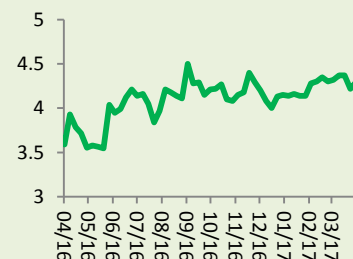
Share Performance (%)

	Absolute	Relative*
1-mth	-1.2	-3.3
3-mth	3.4	7.4
6-mth	1.9	1.4

*Relative to HSI

Source(s): Bloomberg, ABCI Securities

Share performance(HK\$)



Source(s): Bloomberg, ABCI Securities



Exhibit 1: 2016 results highlight

	2015	2016	YoY	Comment
Fee and commission income	2,236	1,317	-41%	Dragged by brokerage and credit
Interest income	925	768	-17%	
Investment income	666	241	-64%	Unfavorable market environment
Other income	7	10	53%	
Total revenue and other income	3,833	2,336	-39%	
Total expenses	1,991	1,563	-22%	
Operating Profits	1,842	773	-58%	
Share of profit of associates	30	28	-7%	
Other gains	119	59	-50%	
Profit before tax	1,990	860	-57%	
Tax	492	216	-56%	
Minority interests	27	34	25%	
Net profit	1,471	610	-59%	
Revenue by segment				
Brokerage	2,138	1,009	-53%	
Credit	534	433	-19%	
Investment banking	404	535	32%	
Trading	517	147	-72%	
Investment management	167	143	-14%	
Others	73	69	-5%	
	3,833	2,336	-39%	
% of total revenue				
Brokerage	56%	43%		
Credit	14%	19%		
Investment banking	11%	23%		
Trading	13%	6%		
Investment management	4%	6%		
Others	2%	3%		
Ratios				
Operating margin	48.1%	33.1%		
Net margin	38.4%	26.1%		
ROAE	24.9%	8.0%		

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. Revenue and other income from brokerage and credit businesses dropped by 53% and 19% to RMB1.0b and RMB433mn respectively in 2016. 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 and financial assets at fair value collectively amounted to RMB 4.4bn at end-2016, representing 18% 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 RMB4.4bn at end-2016. 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. The Company 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 shareholders was RMB 594mn in 2016, or 2.5% lower than reported net profit attributable to shareholders.



Consolidated income statement (2014A-2018E)

FY Ended Dec 31 (RMB mn)	2014A	2015A	2016A	2017E	2018E
Fee and commission income	1,080	2,236	1,317	1,337	1,394
Interest income	375	925	768	741	841
Investment income	666	666	241	300	300
Total revenue	2,121	3,826	2,325	2,378	2,535
Other income	11	7	10	0	0
Total revenue and other income	2,132	3,833	2,336	2,378	2,535
Total expenses	1,185	1,991	1,563	1,555	1,631
Operating Profits	947	1,842	773	823	904
Share of profit of investments in associates	16	30	28	33	40
Profit before tax	963	1,871	801	856	944
Tax	233	492	216	180	198
Profit after tax	2,137	1,379	584	676	746
Minority interests	15	27	34	12	13
Profits attributable to shareholders	2,121	1,353	551	664	733
Growth					
Total revenue and other income (%)	NA	79.8	(39.1)	1.8	6.6
Total expenses	NA	68.1	(21.5)	(0.5)	4.9
Operating Profits (%)	NA	94.5	(58.0)	6.4	9.9
Profits attributable to shareholders (%)	NA	105.8	(58.6)	9.0	10.3
Operating performance					
Operating margin (%)	44.4	48.1	33.1	34.6	35.7
Net margin (%)	25.0	35.3	23.7	27.9	28.9
ROAE (%)	35.0	24.9	8.0	8.5	8.8
ROAA (%)	7.0	5.0	2.2	2.7	2.9

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	105	104	106	111	116
Other intangible assets	24	19	28	29	31
Investment in associates and JV	195	204	219	230	242
AFS	80	753	887	932	978
Financial assets held under resale agreements	88	128	80	84	88
Other non-current assets	34	29	29	30	32
Total non-current assets	526	1,236	1,349	1,416	1,487
Cash & equivalents	950	3,961	2,465	2,506	2,574
Clearing settlement funds	2,776	4,360	3,296	3,461	3,634
AFS	809	819	777	816	857
Financial assets at FVTPL	4,280	2,594	2,732	2,869	3,012
Other current assets	5,719	10,333	6,774	7,113	7,468
Other receivables and prepayments	3,738	6,085	4,353	4,571	4,799
Advances to customers	190	239	265	278	292
Financial assets held under resale agreements	1,461	1,546	1,981	2,080	2,184
Total current assets	19,923	29,937	22,643	23,693	24,820
Total assets	20,449	31,173	23,992	25,110	26,307
Accounts payable	7,769	13,557	9,626	10,107	10,613
Loans and debt	850	3,850	1,800	1,800	1,800
Other current liabilities	5,216	3,907	3,171	3,330	3,496
Total current liabilities	13,835	21,315	14,597	15,237	15,909
Loans and bonds payables	2,150	1,800	1,500	1,500	1,500
Other non-current liabilities	115	30	-	-	-
Total non-current liabilities	2,265	1,830	1,500	1,500	1,500
Total liabilities	16,100	23,145	16,097	16,737	17,409
Net current assets	6,088	8,623	8,046	8,456	8,911
Equity attributable to shareholders	4,082	7,735	7,569	8,034	8,547
Minority interest	267	294	327	339	351
Total equity	4,349	8,029	7,896	8,373	8,899

Source(s): Company, ABCI Securities estimates

Disclosures

Analyst Certification

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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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