

CSC Financial Co., Ltd (6066 HK)

Leader of the pack

- A leading integrated investment bank in China with above-peer ROAE
- Investment banking business was ranked 1st in China in terms of lead underwritten amount in 2016.
- Top distributor of mutual funds in China as of June 2016, demonstrating strong sales capabilities for financial products
- Initiate **BUY** with TP of HK\$7.66 on above-peer ROAE and undemanding valuation

China's leading integrated investment bank with superior ROAE. CSC Financial Co., Ltd (CSC) is a leading integrated investment bank in China. Its average return on equity (ROAE) was ranked 1st among the top 20 brokers in China for 4 consecutive years in 2012-2015 and 1H16, demonstrating its strong value creation capability.

Remarkable performance in investment banking. In 2016, the Company was ranked 1st in terms of lead underwritten amount (equity and debt). Its revenue contribution from investment banking in 1H16 (23.4%) was the highest among its H-listed peers. It is well positioned to benefit from the uptrend of direct financing in China.

Strong sales capability for financial products. The Company was ranked 1st in the no. of mutual funds distributed as of June 2016 and 4th in net income from sales of financial products in 2015.

Fast-growing investment management business. Its AUM increased from RMB 148bn in 2013 to RMB 737bn as of June 2016, ranking 3rd in the industry. In addition, its active management products accounted for 22.5% of AUM in June 2016 vs. 16.9% at end-2013.

Initiate BUY with TP of HK\$7.66. The counter is currently trading at 1.05x 2017E adjusted P/B (excluding RMB5 bn of perpetual bonds), which we believe is undemanding. Our TP is calculated based on 1.2x 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 of ROE after listing.

Results and Valuation

FY ended Dec 31	2014A	2015A	2016E	2017E	2018E
Revenue (RMB mn)	11,452	24,513	15,472	17,534	19,985
Chg (% YoY)	56.4	114.0	(36.9)	13.3	14.0
Profit attributable to ordinary shareholders (RMB mn)	3,407	8,345	4,562	5,446	6,385
Chg (% YoY)	90.7	144.9	(45.3)	19.4	17.3
Underlying EPS (RMB)	0.56	1.37	0.64	0.75	0.88
Chg (% YoY)	NA	144.6	(53.6)	18.2	17.3
BVPS (RMB)*	2.73	4.12	5.01	5.65	6.38
Chg (% YoY)	NA	50.6	21.8	12.7	12.9
PE (x)	10.6	4.3	9.3	7.9	6.7
P/B (x)*	2.2	1.4	1.2	1.0	0.9
ROE (%)*	22.9	40.0	14.9	14.2	14.7
ROA (%)	3.6	5.4	2.5	2.8	3.1
DPS(RMB)	0.03	-	0.13	0.15	0.18
Dividend Yield (%)	0.5	-	2.2	2.5	3.0

Source(s): Bloomberg, ABCI Securities estimates

*Equity attributable to ordinary shareholders is used in the calculation

Company Report Initiation

Jan 25, 2017

Rating: **BUY**

TP: **HK\$ 7.66**

Analyst : **Steve Chow**
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 stevechow@abci.com.hk

Share price (HK\$)	6.60
Est. share price return	16.1%
Est. dividend yield	2.6%
Est. total return	18.7%
Previous Rating & TP	NA
Previous Report Date	NA

Source(s): Bloomberg, ABCI Securities

Key Data

52Wk H/L(HK\$)	6.85/6.60
Issued shares (mn)	7,265
Issued H shares (mn)	1,261
H-share market cap (HK\$ mn)	8,411
Avg daily turnover (HK\$ mn) since listing	17.9
Major shareholder(s)	
BSCOMC	37.46%
Huijin	33.29%
Citic Sec	5.95%

Source(s): Company, ABCI Securities

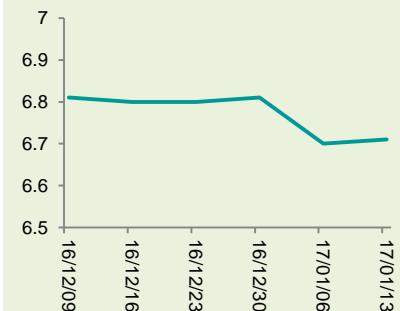
Share Performance

	Absolute	Relative*
1-mth	(1.9%)	3.8%
3-mth	NA	(0.8%)
6-mth	NA	5.5%

*Relative to HSI

Source(s): Bloomberg, ABCI Securities

Share performance(HK\$)



Source(s): Bloomberg, ABCI Securities



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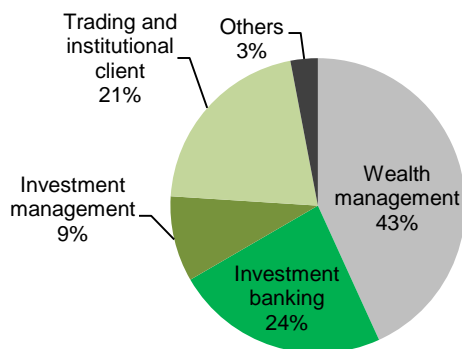
A leading integrated investment bank with superior profitability

CSC Financial Co., Ltd (CSC) is a leading investment bank in China providing a wide range of services such as brokerage and wealth management, investment banking, investment management, and investment & trading.

In 1H16, wealth management accounted for 43% of revenue, followed by investment banking (24%), trading & institutional client business (21%), investment management (9%), and others (3%).

Its major shareholders include BSCOMC (37.46%), Central Huijin (33.29%), and Citic Securities (5.95%).

Exhibit 1: Revenue mix (1H16)



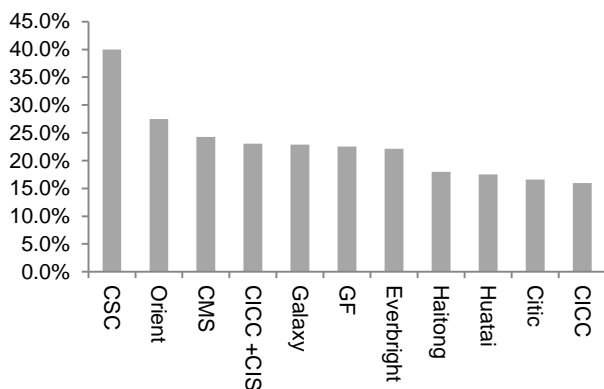
Source(s): Company, ABCI Securities

Above-peer returns show superior value creation capability

The Company achieved the highest ROAE among the top 20 brokers in China for 4 consecutive years in 2012-15. In 1H16, its ROAE was 21.1%, significantly higher than the 7%-11% range among major peers. This demonstrates the Company's efficient use of capitals to create values for shareholders.

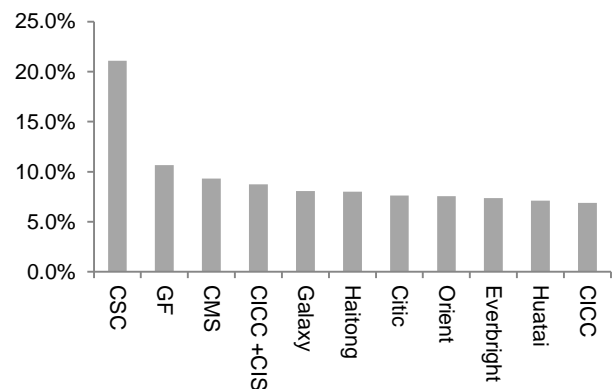
In addition, its ROAA was also the highest among major peers in 2015 and 1H16.

Exhibit 2: ROAE (2015)



Source(s): Companies, ABCI Securities

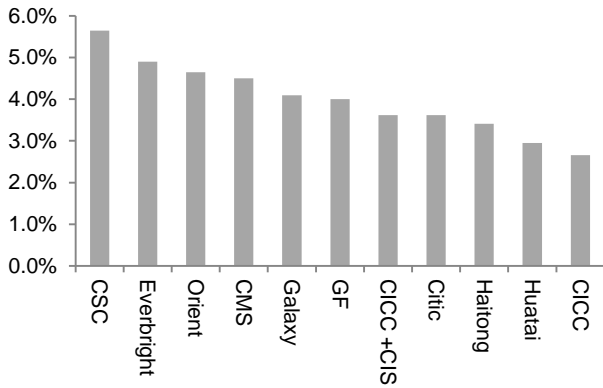
Exhibit 3: ROAE (1H16)



Source(s): Companies, ABCI Securities

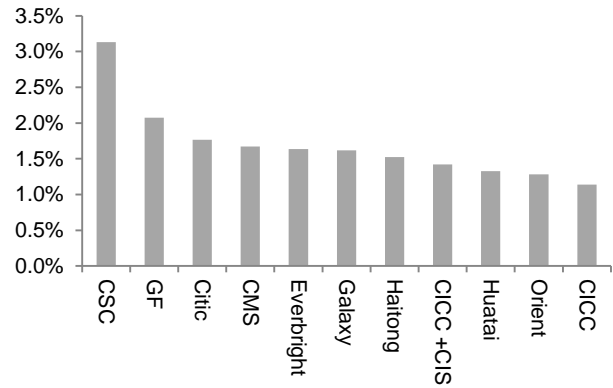


Exhibit 4: ROAA (2015)



Source(s): Companies, ABCI Securities

Exhibit 5: ROAA (1H16)



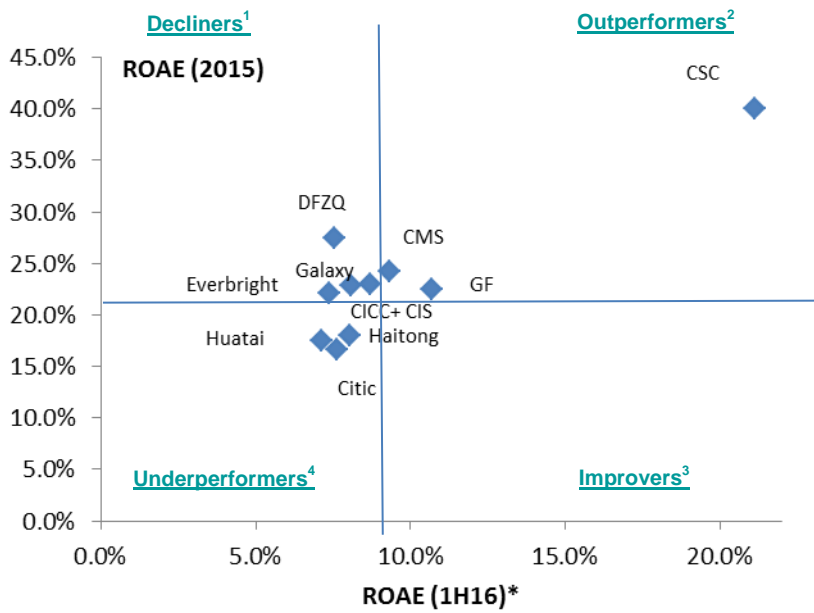
Source(s): Companies, ABCI Securities

To assess the performance of brokers throughout a market cycle, we compare the ROAEs of major brokers in 2015 and 1H16 and conclude that the Company has demonstrated solid execution capability by consistently achieving above-peer ROAEs in 2015 and 1H16.

On the other hand, Everbright (6178 HK), Galaxy (6881 HK), and DFZQ (3958 HK) had high ROAEs in 2015 but performance failed to sustain during the market correction in 1H16. In addition, Huatai (6886 HK), Haitong (6837 HK), Citic Sec (6030 HK) are underperformers with below-peer ROAEs in 2015 and 1H16.



Exhibit 6: ROAE comparison



*Annualized

According to SAC, sector ROAE of PRC brokers were 20.6% and 8.6% in 2015 and 1H16, respectively.

¹Decliners: Those with above-average ROAE in 2015 and below-average ROAE in 1H16

²Outperformers: Those with above-average ROAE in both 2015 and 1H16

³Improver: Those with below-average ROAE in 2015 and above-average ROAE in 1H16

⁴Underperformers: Those with below-average ROAE in both 2015 and 1H16

Source(s): Companies, SAC, ABCI Securities



Investment banking business signifies strength

The Company has a top-ranked and balanced investment banking business, which enables it to benefit from the upsurge in capital market fundraising activities amid the government's plan to boost direct financing in the economy.

Equity underwriting: the Company was ranked 1st and 3rd in terms of aggregate number and amount of A-share IPOs between 2013 and 1H16. In addition, it was ranked 1st in the number of follow-on offering underwriting for A-shares in 2015.

Bond underwriting: In 2013-1H16, it was ranked 2nd in both aggregate underwriting number and amount of domestic debt. In 2015, it was ranked 2nd in terms of aggregate underwriting number and amount of domestic debt. In particular, it was ranked 1st in corporate bond underwriting amount in 2015, surpassing the sum of underwriting amount by competitors ranked 2nd and 3rd.

Financial advisory: the Company was ranked 3rd by domestic M&A transaction value in 2013-1H16, and 3rd by domestic M&A transaction value in 2015.

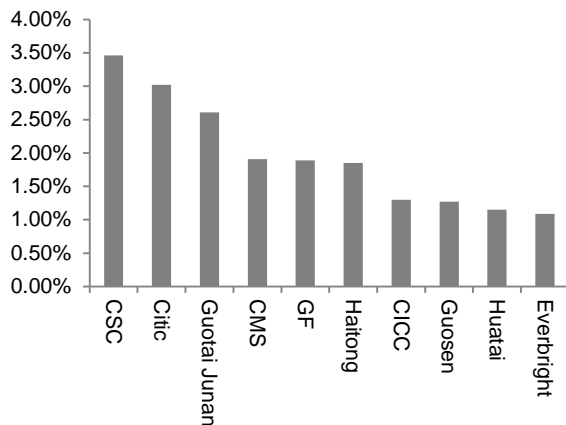
Upcoming deal pipeline: Up till end-June 2016, it had 48 IPOs, 29 follow-on offerings, and 18 M&A projects in the pipeline, ranking 3rd, 1st, and 2nd in the industry, respectively.

Equity underwriting		Bond underwriting		Financial advisory	
Item	Rank	Item	Rank	Item	Rank
A-share IPO underwriting amount (2013-1H16)	3	Domestic debt underwriting amount (2013-1H16)	2	Domestic M&A values (2013 to 1H16)	3
A-share IPO underwriting number (2013-1H16)	1	Domestic debt underwriting number (2013-1H16)	2	Domestic M&A values (2015)	3
Follow-on offerings underwriting number (2015)	1	Domestic debt underwriting number and amount (2015)	2		
		Corporate bond underwriting amount, surpassing the sum of the underwriting amount by the No. 2 and No.3 players (2015)	1		

In 2016, it was ranked 1st in terms of lead underwritten amount with about a 3.5% market share.



Exhibit 8: Underwriting market share (2016)



Source(s): Wind, ABCI Securities

In 1H16, investment banking accounted for 23.4% of total revenue, the highest among listed peers. Hence, we believe the Company is well positioned to ride on the uptrend in China’s capital market.

Unique expertise and leading advantages

The Company possesses unique expertise and leading advantages in various sectors such as high-end manufacturing, TMT, and banking via completing various landmark transactions.

- For the high-end manufacturing sector, the Company completed two right issues with an aggregate amount of RMB 2.6bn for China Spacesat, a leader in the small commercial satellite manufacturing and application industry, in 2007 and 2013. In addition, it completed a RMB 46bn private placement for BOE Technology Group in 2014, the largest A-share follow-on offering at the time.
- For the TMT sector, the Company completed a RMB 4.2bn A-share IPO for China Film in 2016, which was the largest IPO in the PRC media industry. In addition, it was the sole financial advisor in the RMB116.7bn transaction where China Mobile injected its telecommunication tower assets into China Tower Corporation in 2015.
- For the banking sector, as of end-June 2016, the Company sponsored 6 out of the 18 completed or post-hearing and pending A share IPOs of PRC city commercial banks and rural commercial banks, ranking 1st in the industry.

In addition, the Company has a leading position in large- and mega-sized bond offerings. It participated in the underwriting of large corporate bond offerings (>RMB 5bn) by PetroChina, Shanghai Shimao Jianshe, and Beijing Urban Construction Investment Development. Since 2015, it has acted as the lead underwriter in 11 of the 27 bond offerings, each with an offering size of over RMB 10bn, ranking 2nd in the industry.



農銀國際

ABC INTERNATIONAL

ABCI SECURITIES COMPANY LIMITED

Superior innovation capability

CSC Financial Co., Ltd.
China Securities & Brokerage
Jan 25, 2017

The Company has completed various projects which were the first of their kinds in various industries.

- **IPO:** First A-share IPO in China's film and television entertainment in 2009; first IPO in China's landscaping and gardening sector in 2009; first IPO for China's railway safety equipment integrated solution provider in 2015.
- **M&A advisory:** First financial holding enterprise's restructuring and listing in the A-share market; first significant asset restructuring in 2015 with financing from preferred share issuance in the A-share market; first project approved through the fast track after the bifurcated review system was adopted in 2015; first transaction in which an A-share listed company acquired and privatized a NASDAQ listed US-incorporate company.
- **Others:** First securitization project with trust beneficiary right as underlying assets in 2014; first corporate bond offered by a guarantee company in China in 2015; first domestic renewable corporate bond for a SOE in the real estate industry in 2016; first green panda corporate bond in China in 2016.

Solid client base with strong loyalty

Up till end-June 2016, the Company had serviced 155 A-share listed companies, accounting for ~5.4% of total no. of A-share companies, ranked 2nd in the industry. In addition, it had provided listing service for 301 companies in NEEQ up to end-June 2016, ranking first among comparable H-listed brokers.

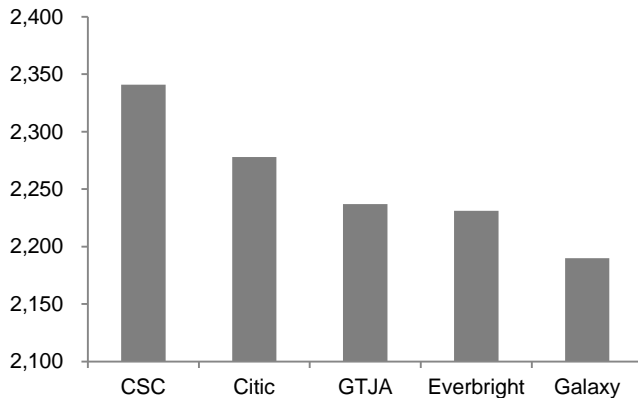
In addition, 91.5% of its IPO clients have continued using the Company's capital market services after the listing, demonstrating a high retention rate.

Wealth management with strong sales capability

High sales capability for financial products.

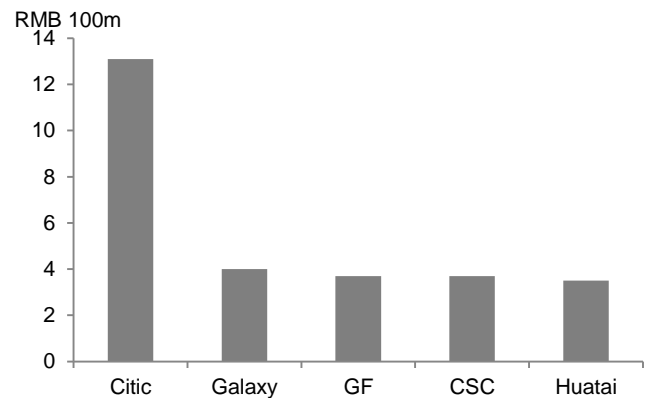
As of June 2016, the Company was ranked 1st by the number of mutual funds distributed. In addition, it was ranked 4th in terms of net income attributed to the agency sales of financial products in 2015.

Exhibit 9: No. of mutual funds distributed (as of June 2016)



Source(s): Companies, Wind

Exhibit 10: Net income from sales of financial products (2015)



Source(s): Companies, Wind

Rapid growth in mid-to-high-end client

As of June 2016, it had 5.3mn of wealth management customers, of which the no. of mid-to-high-end clients (with account balance equivalent to or above RMB 0.5mn but less than RMB 5mn) increased from 73,100 as of Dec 31, 2013 to 175,700 as of Dec 31, 2015, representing a 2-year CAGR of 55.0%.

In addition, it also had about 9,000 institutional clients and over 13,400 corporate clients in China, including large corporates in various key industries such as finance, TMT, properties, high-end manufacturing, healthcare, energy, etc.

Strategically located branch network with O2O integration

As of June 2016, it had 225 securities branches, of which 55.6% were located in the affluent regions including Beijing, Shanghai, Guangdong, Jiangsu, Shandong, Zhejiang, and Fujian. In addition, it had 36 branches in Beijing, ranking 1st among peers.

In terms of internet finance, the Company has developed internet platforms in PC, web, app, and WeChat to broaden its client reach. In 1H16, the Company acquired 552K of new customers via internet channels, which accounted for about 98% of total new customers.

In 1H16, its stock and fund turnover market share was 3.0% while the average commission rate was 4.9bps.

Exhibit 11: Branch network (June 2016)



Source(s): Company



Influential research and comprehensive institutional client services

Influential research team

The Company has a highly influential research team with 106 members as of June 30, 2016, covering 26 industries and 2,073 A-share listed companies, accounting for 72.2% of all A-share listed companies.

In the “13th New Fortune Best Analyst” competition in 2015 held by New Fortune magazine, it was ranked 8th in the category of “Best Domestic Research Team” and top 10 in 8 research categories. In addition, from 2012-15, it was ranked 1st in telecommunication research and was among the top 2 in the real estate research for 4 consecutive years.

Strong trading and product design capabilities

We view the Company’s strong trading and product design capabilities as its core competitive edge in institutional client services.

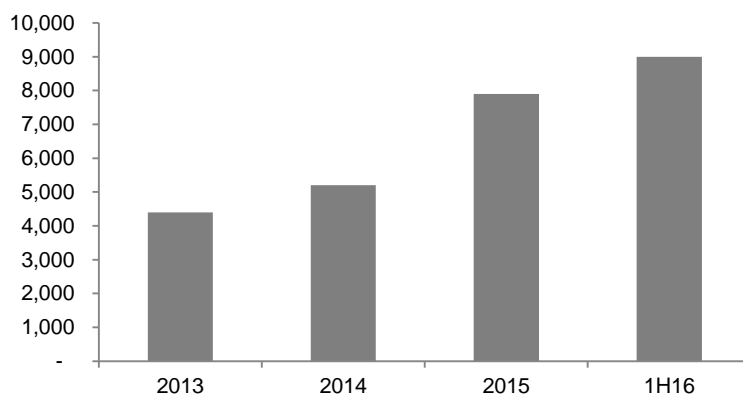
With a deep understanding of FICC market and strong trading capabilities, the Company had 65.4% of its investment assets allocated to debt investment as of end-2015 – the highest among comparable H-listed peers. In addition, it generated a net investment return of 10% over trading assets in 2015, ranking 3rd among comparable H-listed peers.

In addition, it has a leading position in asset securitization products, ranking 3rd in terms of total offering size (RMB 74bn) in 2015. In addition, it had a 29% market share in non-performing loan securitization business in 7M16, ranking 2nd in the industry. In Sep 2016, it became the first broker to issue a credit risk mitigation warrant, or CRMW.

In 2015, it launched a new hybrid investment business named “Fixed Income plus Commodity”. By June 2016, the size ballooned to RMB 6bn.

In the derivative business, it maintains a leading position in trading volume of treasury futures. It was awarded the “Outstanding Treasury Futures Trading Team” by the China Financial Futures Exchange for 2 consecutive years in 2014 and 2015.

Exhibit 12: The number of institutional clients

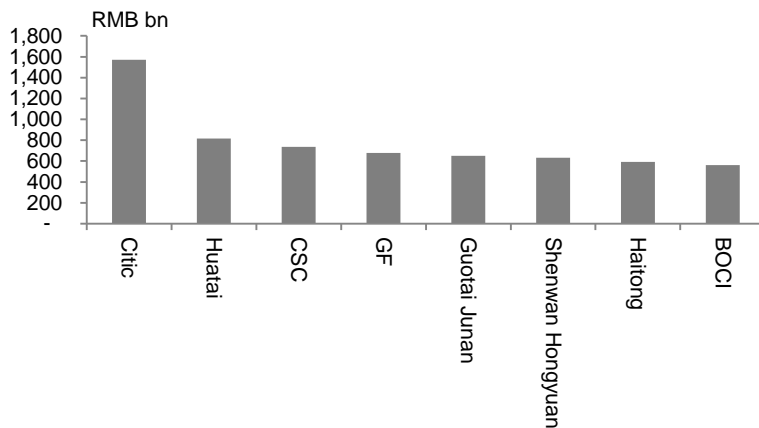


Source(s): Company

Fast-growing investment management business

In the investment management business, its AUM increased from RMB 148bn in 2013 to RMB 737bn in June 2016. Its AUM at end-June 2016 was ranked 3rd in the industry. In addition, portfolio management for its AUM is transforming from passive to active — active management products accounted for 22.5% of AUM in June 2016 vs. 16.9% at end-2013.

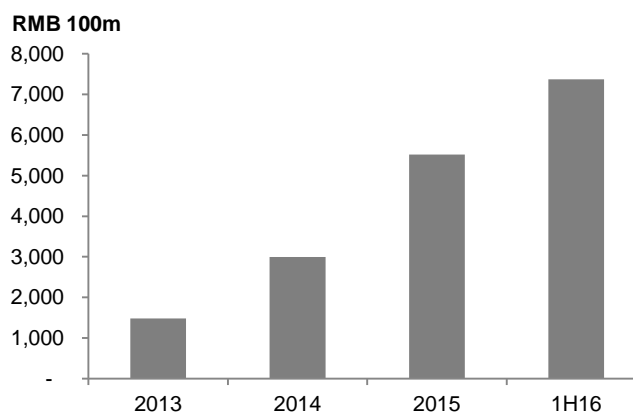
Exhibit 13: AUM among securities firms (June 2016)



Source(s): AMAC

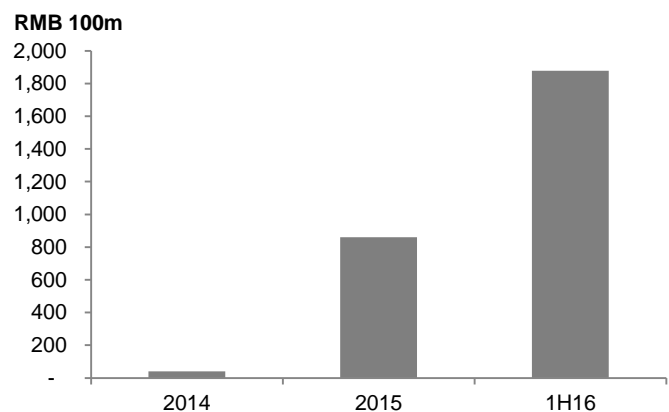
In addition, its fund management subsidiary, China Securities Funds, increased its AUM from RMB 4bn in 2014 to RMB 86.1bn in 2015, representing a growth rate of 20.5 times. As of June 30, 2016, the AUM of fund management business reached RMB 187.8bn.

Exhibit 14: AUM of asset management business



Source(s): Company

Exhibit 15: AUM of fund management business



Source(s): Company

For its private equity business, the Company, via its subsidiary China Securities Capital, managed 9 funds with an AUM of RMB 3.97bn at June 2016. As of June 30, 2016, it completed over 50 investment projects, including 4 mainboard listings and 14 NEEQ quotations. Average investment yield of the 4 projects was 346% when exited.

CSRC's AA rating as recognition of solid corporate governance

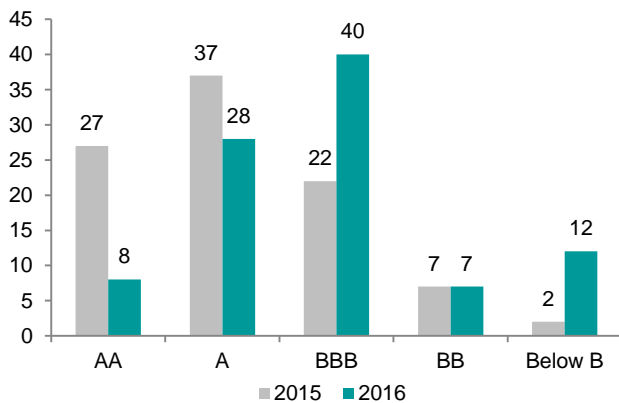
The Company is 1 of the 3 PRC securities companies with an "AA" rating, the highest rating CSRC has issued to PRC brokers, for 7 consecutive years.

CSRC conducts an annual review on the securities industry based on various criteria such as regulatory compliance, information disclosures and financial resources before assigning ratings to individual brokers.

In its latest rating review in July 2016, various major brokers including Citic Sec (6030 HK), Galaxy Sec (6881 HK), GF Sec (1776 HK), Haitong Sec (6837 HK), Huatai Sec (6886 HK) have lost their "AA" ratings due to regulatory issues. The Company, however, has been able to retain its "AA" rating for the 7th consecutive year since 2010.

Overall, the no. of brokers with an "AA" rating dropped to 8 from 27, and the no. of brokers with an "A" rating fell from 37 to 28. The no. of "BBB" brokers increased from 22 to 40 as a result of the downgrade.

Exhibit 16: CSRC's rating distribution (by no. of brokers)



Source(s): CSRC, ABCI Securities

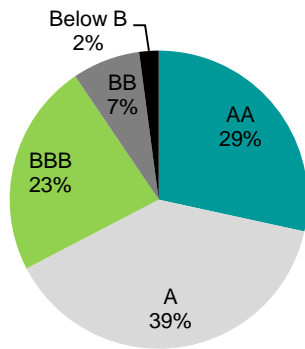
Exhibit 17: CSRC's rating of major brokers

	2015 rating	2016 rating
CSC	AA	AA
Everbright	A	AA
DFZQ	AA	AA
CMS	AA	AA
Galaxy	AA	A
GF	AA	BBB
Haitong	AA	BBB
Huatai	AA	BBB
CITIC	AA	BBB

Source(s): CSRC, ABCI Securities

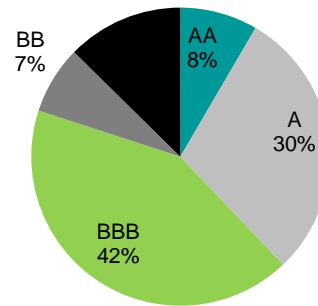


Exhibit 18: CSRC's rating distribution (2015)



Source(s): CSRC, ABCI Securities

Exhibit 19: CSRC's rating distribution (2016)



Source(s): CSRC, ABCI Securities

We believe its AA rating is recognition of CSC's stringent corporate governance standard. Also, CSRC's high rating may bring numerous benefits.

Business development – In our view, a higher CSRC rating may facilitate regulatory approval process for business development such as branch expansion and fundraising. In addition, we believe large financial institutions, including insurance companies, would select and allocate businesses among counterparties based on CSRC's rating.

Securities Investors Protection Fund (SIPF) – Lower contribution to SIPF (0.75% revenue contribution for "AA" brokers vs. 1.5% for "BBB" brokers)

Funding channel and cost – More funding channels and lower funding cost for brokers with a higher rating in general.

Capital requirement — General lower capital requirement for brokers with a higher rating.

As many PRC brokers have been downgraded in the latest review, we believe the Company would enjoy a relative advantage in the aforementioned aspects in the short term.

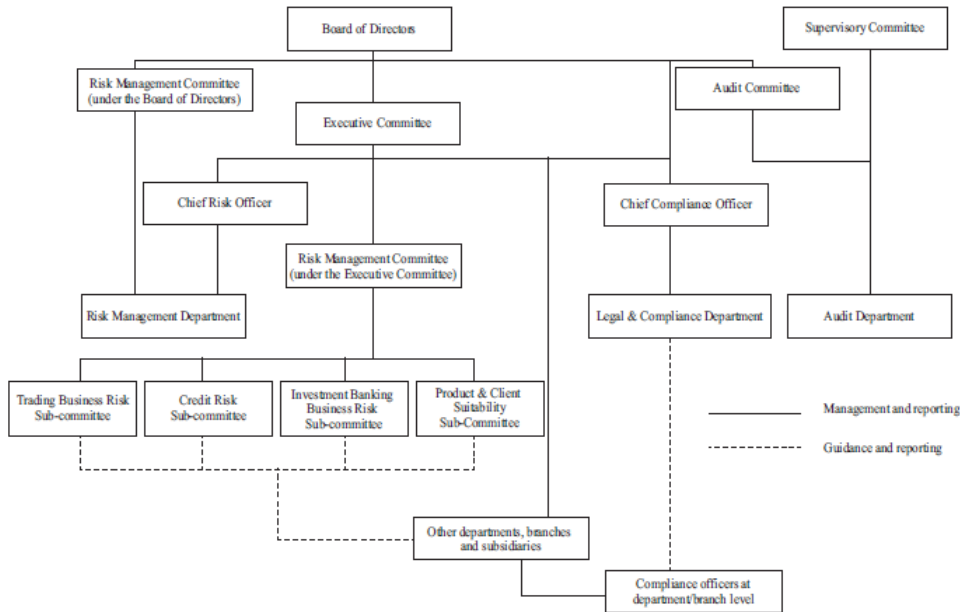


Prudent risk management and internal control

CSC's strength in risk management is reflected by its "AA" rating from CSRC. Over the years, the Company has established an effective risk management and internal control to monitor, evaluate, and manage various risks in businesses.

The following chart illustrates its five-level risk management system.

Exhibit 20: Risk management system



Source(s): The Company

It complies with all of CSRC's capital adequacy and risk control index requirements, as listed in the table below.

Exhibit 21: Net capital and key regulatory risk control index

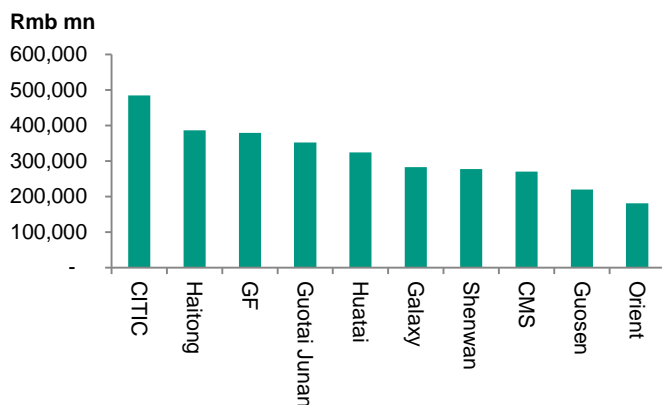
	As of Dec31			As of June 30	Warning level	Minimum/Maximum level
	2013	2014	2015	2016		
Net capital (RMB bn)	9.3	15.0	24.5	28.1	N/A	N/A
Net capital/total risk capital reserves (%)	475.7%	468.8%	585.2%	593.3%	>120%	>100%
Net capital/net assets (%)	72.5%	91.9%	83.0%	88.4%	48%	>40%
Net capital/total liabilities (%)	26.9%	25.9%	36.2%	44.9%	9.6%	>8.0%
Net assets/total liabilities (%)	37.0%	28.1%	43.6%	50.7%	24.0%	>20.0%
Value of equity securities and derivatives held/net capital (%)	30.8%	58.2%	49.4%	59.2%	80.0%	<100.0%
Value of fixed-income securities held/net capital (%)	214.5%	126.9%	97.9%	99.6%	400.0%	<500.0%

Source(s): The Company, ABCI Securities

Industry overview

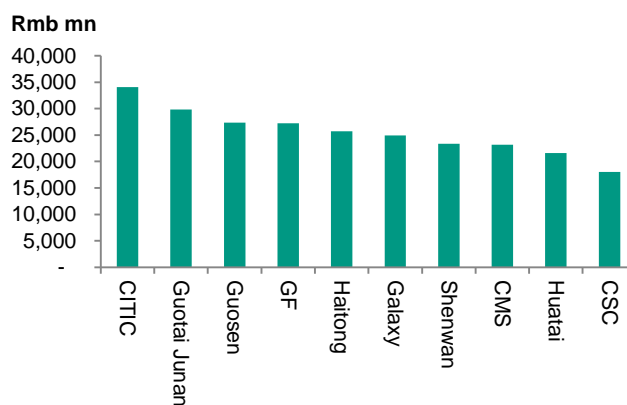
According to SAC, there were 125 brokers in China at end-2015. The following charts compare the top 10 securities companies in terms of total asset, revenue, net profit, and net capital.

Exhibit 22: Total asset of PRC securities companies (2015)



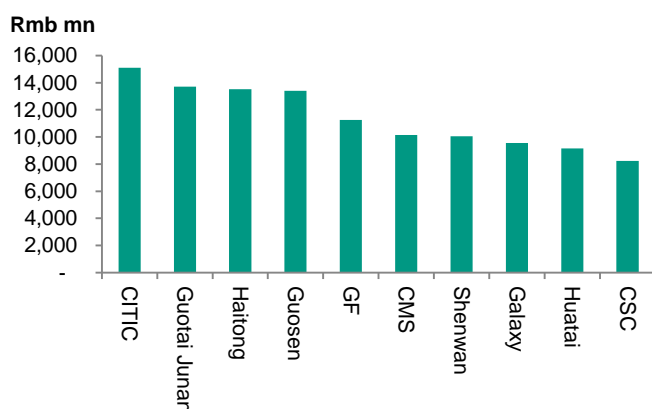
Source(s): SAC, ABCI Securities

Exhibit 23: Revenue of PRC securities companies (2015)



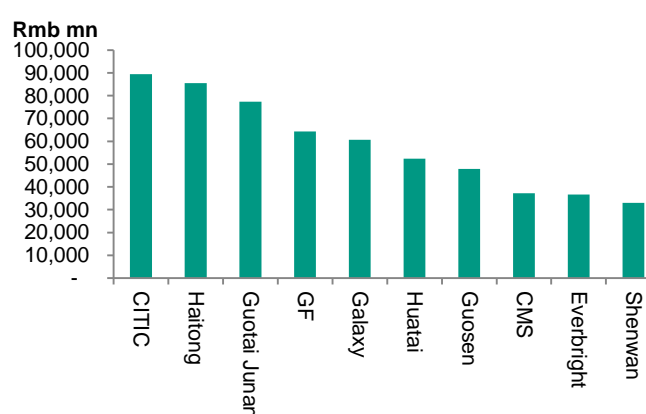
Source(s): SAC, ABCI Securities

Exhibit 24: Net profit of PRC securities companies (2015)



Source(s): SAC, ABCI Securities

Exhibit 25: Net capital of PRC securities companies (2015)



Source(s): SAC, ABCI Securities

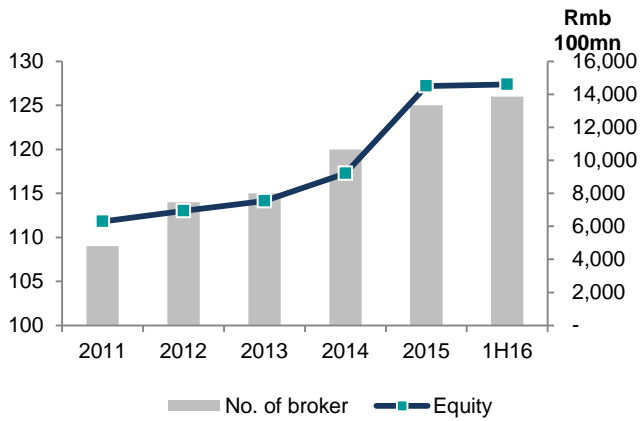
Size and profitability are rising

Overall, the number of brokers has been steadily increasing from 109 in 2011 to 126 in 1H16; the industry's total net assets rose from RMB 0.63tr to RMB 1.46tr over the same period, indicating a healthy industry growth.

Industry revenue increased from RMB 0.14tr in 2011 to RMB 0.57tr in 2015 before normalizing to RMB 0.16tr in 1H16. In addition, the industry's net margin rose from 29% in 2011 to 40% in 1H16, indicating an improving profitability as a whole.

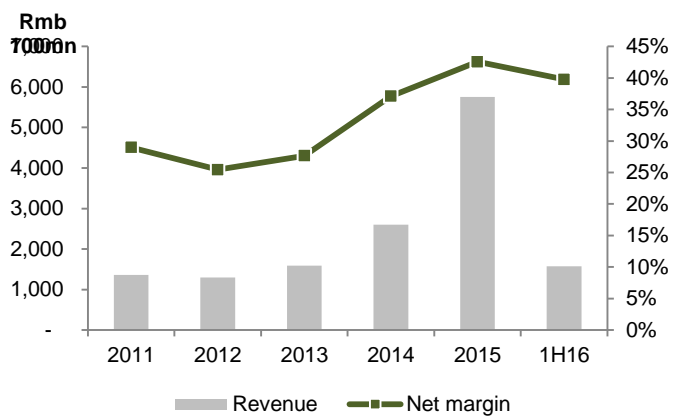


Exhibit 26: No. of brokers (LHS) and net assets (RHS)



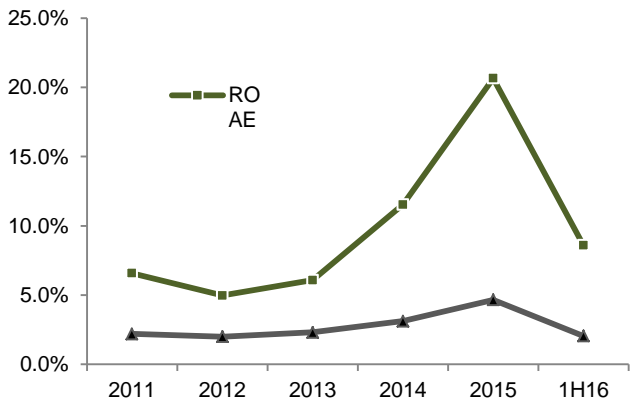
Source(s): SAC, ABCI Securities

Exhibit 27: Revenue (LHS) and margin (RHS)



Source(s): SAC, ABCI Securities

Exhibit 28: ROAE and ROAA improved in 2011-2015 before normalizing in 1H16



Source(s): SAC, ABCI Securities

* Annualized for 1H16

Investment banking business – the rise of direct financing

In our view, the investment banking segment is set to benefit from the government's commitment to deleverage the economy through direct financing in the capital markets.

The need for deleveraging

Financial leverages of large SOEs and industrial enterprises have been rising in recent years. Increasingly, the lack of medium-to-long-term funding sources to finance asset growth has become one of the bottlenecks of economic growth.

In our view, these trends have prompted the government to develop direct financing via issuance of corporate bonds and equity securities to expand funding sources while deleveraging the economy,

Direct financing are taking shares away from bank loans

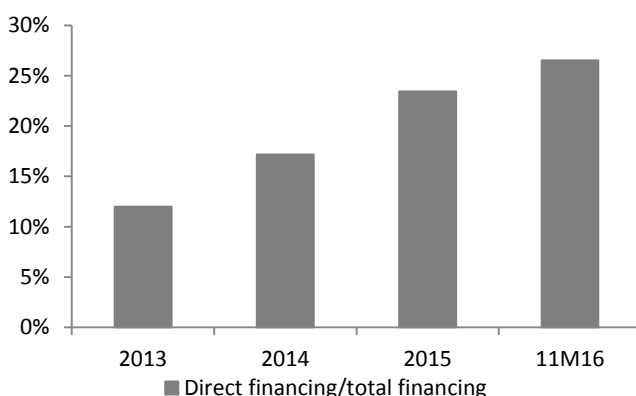
Traditionally, bank loans and undiscounted bank bills have played an important role in financing the economy. However, their joint proportion in the economy's aggregate financing reduced to 55% in 11M16 from 61% in 2014.

In particular, undiscounted bank bills reduced by RMB 2.1trn in 11M16 after declining by RMB 1.1trn in 2015 and RMB 0.1tr in 2014. We believe the undiscounted bank bill market has been partially eroded by the increasing issuance of short-term corporate bonds, as companies with good credit ratings are able to issue corporate bonds with a lower interest cost or a longer maturity.

On the other hand, direct financing (including net corporate bond financing and domestic equity financing from non-financial institutions) accounted for 27% of aggregate financing in the economy in 11M16, up from 17% in 2014.

Looking forward, we believe direct financing will continue to take away market share from the banks in the economy's aggregate financing. This should bode well for equity and bond underwriting business.

Exhibit 29: Direct financing as a percentage of aggregate financing in the economy

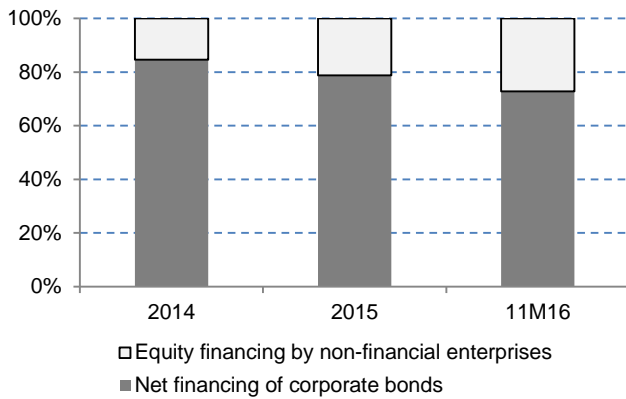


Source(s): PBOC, ABCI Securities



Within direct financing, debt financing historically accounted for 70-80% of the total amount while equity financing only contributed to a minor proportion. As a result, brokers with a strong market position in bond underwriting should benefit the most from this structural uptrend, in our view.

Exhibit 30: Direct financing – bonds vs. equity



Source(s): PBOC, ABCI Securities

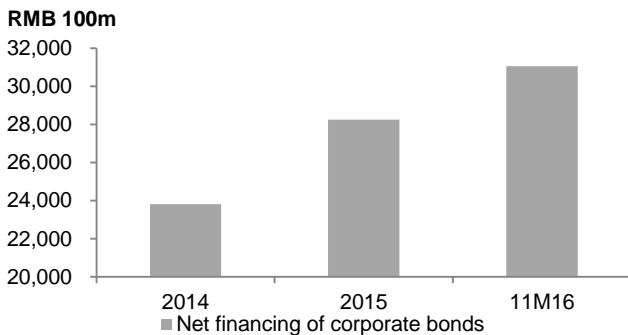
Debt financing

For debt financing, net financing of corporate bonds increased from RMB 2.4tr in 2014 to RMB 3.1trn in 11M16, indicating a healthy market in general. Debt financing accounted for 19% of total aggregate financing in 11M16, up from 15% in 2014.

In particular, easing of regulations on corporate bond issuance by CSRC in 2015 (e.g. companies are required to register instead of obtaining approval and authorization from CSRC to issue bonds; unlisted companies are eligible to issue corporate bonds) have stimulated market development in recent quarters.

On the other hand, the rise in bond issuance has been reinforced by increasing demand from investors pursuing for better yields. E.g., banks are increasing bond investment and reducing loans in their fund uses. According to PBOC, total investments in bond portfolio and shares accounted for 28% of total fund uses at end-June 2016, up from 25% at end-Dec 2015. In 1H16, total investments in bond portfolio and shares increased by 25%, while total domestic loans to households and non-households only expanded by 10.9% and 6.1%.

Exhibit 31: Net financing of corporate bonds in China



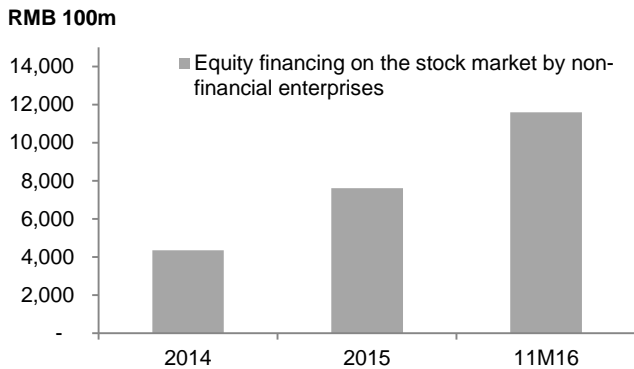
Source(s): PBOC, ABCI Securities



Equity financing

Overall, fundraising activities in the A-share market have been rising in recent years. The momentum has remained intact in recent months. According to PBOC, equity financing by non-financial enterprises in the stock market rose to RMB 1.2trn in 11M16 from RMB0.4trn in 2014. Equity financing accounted for 7% of total aggregate financing in 11M16, up from 3% in 2014.

Exhibit 32: Equity financing in the stock market by non-financial enterprises

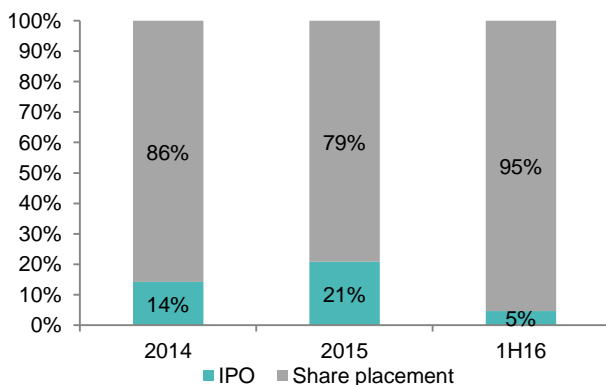


Source(s): PBOC, ABCI Securities

In equity financing, IPO's contribution to total equity financing has been much lower than that of share placement in the secondary market. In 1H16, about 95% of equity financing was conducted via share placement in the secondary market while IPO only accounted for 5%.

In our view, investors might have underestimated the significance of share placement activities and its impact on the brokerage industry since most of the focus has been on the IPO market.

Exhibit 33: Equity financing – IPO vs. share placement



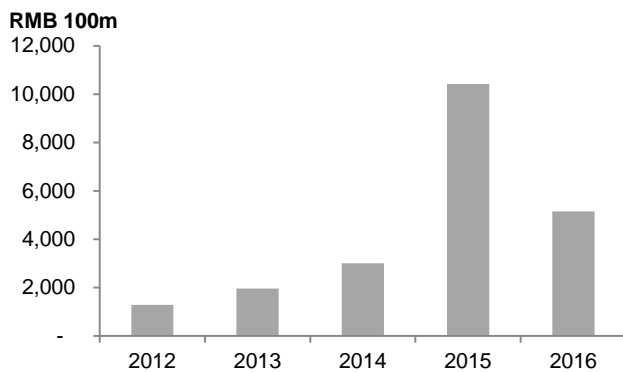
Source(s): Wind, ABCI Securities

Trading volume in the A-share market are bottoming out

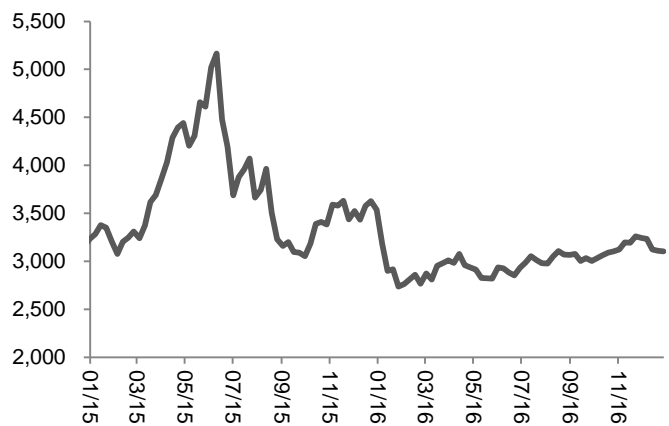
The average daily turnover (ADT) in Shenzhen and Shanghai Stock Exchange has been trending up in recent years. In particular, ADT increased significantly in 2015, driven by improving liquidity and optimistic market sentiment spurred by the Shanghai-Hong Kong stock connect program and China's monetary easing since 2Q15.

Overall, ADT grew at a CAGR of 101% during 2012-15 to RMB 10.5trn. After a bullish year in 2015, ADT normalized to RMB 515bn in 2016. However, sequential improvement has been observed in recent months.

ADT in 2016 was ~51% lower than that in 1H15 but was 71% higher than that in 2014, indicating an ongoing market development despite the high base in 2015. For 2017 and beyond, we expect a healthy market sentiment to continue on stabilizing economic outlook and recovering investor confidence.

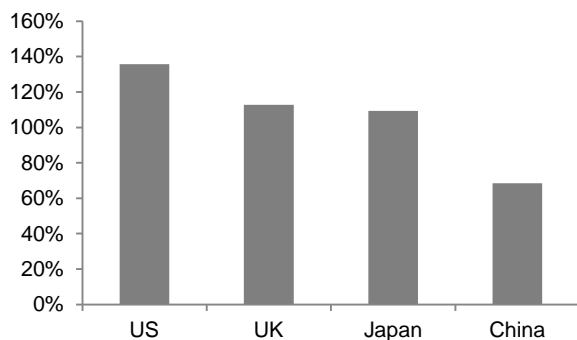
Exhibit 34: A-share ADT


Source(s): Wind, ABCI Securities

Exhibit 35: SHCOMP index


Source(s): Bloomberg, ABCI Securities

Structurally, the stock market cap in China accounted for 69% of nominal GDP in 2015, significantly lower than the 109% in Japan, 113% in the U.K., and 136% in the U.S., indicating much room for development in the equity market. Various measures such as widening channels for overseas investors to participate in the domestic stock market, further expansion of the HK-China stock connect program, and a wider range of products and services would help facilitate growth in China's equity market

Exhibit 36: Stock market cap/GDP (2015)


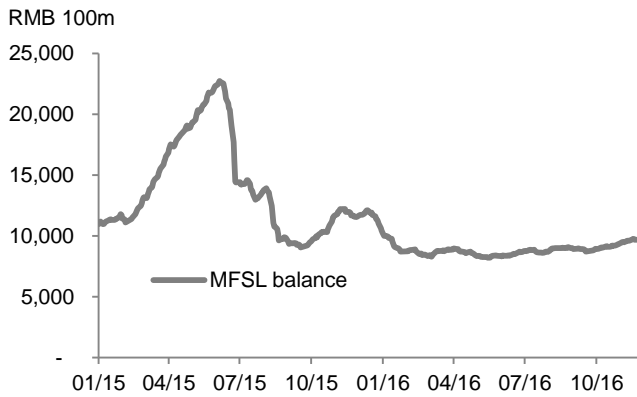
Source(s): Bloomberg, ABCI Securities



Margin financing and securities lending (MFSL)

MFSL business has grown rapidly in recent years since CSRC's approval in Mar 2010. Balance of MFSL in China surged from RMB 90bn in 2012 to about RMB 900bn in recent months

Exhibit 37: MFSL balance in China



Source(s): Wind, ABCI Securities



Future strategies

Looking forward, the Company aims to become a large best-in-class, full-service investment bank with equal emphasis on capital-light and capital-intensive businesses. It would strengthen synergies among business lines and optimize the market incentive mechanism.

It will enhance its capabilities for serving clients, supporting real economy, and improving the efficiency of wealth generation and management through the following strategies.

- Solidify its leading position of investment banking business and maintain its status as the top choice for clients
- Strengthen its extensive sales channel and build an industry-leading wealth management platform
- Enhance its FICC product advantages and build a preferred prime brokerage service platform
- Optimize the multi-layered investment management platform to become an industry-leading financial product provider
- Build a leading full-spectrum investment research team
- Enhance its overseas businesses to develop a full-service international investment bank
- Reinforce its IT infrastructure to provide technological foundation for businesses
- Optimize risk management system
- Strengthen employee career development to attract and cultivate top talents



Valuation

Hong Kong-listed PRC securities companies are currently trading at an average of 1.1x 2017E P/B and 11.1x 2017E P/E; A-share peers are trading at an average of 1.8x 2017E P/B and 17.6x 2017E P/E. The higher valuation in the A-share market may reflect differences in investor structure between the A-share and H-share markets, with the former being dominated by retail investors and the latter by institutional investors.

Exhibit 38: Peer comparison table

Ticker	Name	Share price (local)	12/16 PER (x)	12/16 P/B (x)	12/17 PER (x)	12/17 P/B (x)
HK-listed China securities companies						
Nationwide securities companies						
6837 HK Equity	HAITONG SECURI-H	13.90	15.6	1.3	12.6	1.2
6030 HK Equity	CITIC SEC-H	15.82	15.3	1.2	12.2	1.1
6886 HK Equity	HUATAI SECURIT-H	14.90	14.2	1.1	11.1	1.0
1776 HK Equity	GF SECURITIES-H	16.80	13.9	1.4	11.6	1.3
6881 HK Equity	CGS-H	7.26	12.8	1.0	10.9	1.0
6099 HK Equity	CHINA MERCHANT-H	12.02	12.0	1.2	10.0	1.1
6178 HK Equity	EVERBRIGHT SEC-H	12.60	13.7	1.1	11.5	1.0
3958 HK Equity	DFZQ-H	7.57	15.1	1.0	12.4	0.9
3908 HK Equity	CHINA INTERNAT-H	10.88	14.6	1.3	13.4	1.2
6066 HK Equity	CSC FINANCIAL-H	6.60	9.3	1.2	7.9	1.0
Regional securities companies						
1375 HK Equity	CC SECURITIES-H	4.05	13.1	1.3	11.9	1.3
1456 HK Equity	GUOLIAN SECURI-H	4.16	9.7	0.9	8.0	0.8
1476 HK Equity	HENGTOU SECURI-H	3.54				
Average			13.2	1.2	11.1	1.1
Nationwide			14.1	1.2	11.7	1.1
Regional			11.4	1.1	10.0	1.0
China-listed China securities companies						
600030 CH Equity	CITIC SECURITI-A	16.38	17.1	1.4	13.7	1.3
601211 CH Equity	GUOTAI JUNAN S-A	19.03	13.0	1.5	11.1	1.4
002736 CH Equity	GUOSEN SECURIT-A	14.83	15.6	2.5	13.4	2.3
600837 CH Equity	HAITONG SECURI-A	16.28	21.3	1.7	16.3	1.6
600999 CH Equity	CHINA MERCHANT-A	16.69	16.7	1.8	13.5	1.7
600958 CH Equity	ORIENT SECURIT-A	15.17	33.9	2.6	27.1	
601688 CH Equity	HUATAI SECURIT-A	18.36	19.3	1.6	15.6	1.5
000776 CH Equity	GF SECURITIES-A	17.23	15.9	1.7	13.5	1.5
601901 CH Equity	FOUNDER SECURI-A	7.73	20.6	1.8		
601788 CH Equity	EVERBRIG SEC -A	15.96	19.1	1.5	16.1	1.4
002673 CH Equity	WESTERN SECUR+A	18.57	41.0	3.9	32.4	3.5
601377 CH Equity	INDUSTRIAL-A	7.76	19.6	1.8	15.1	1.6
000783 CH Equity	CHANGJIANG SEC-A	9.92	22.2	2.0	17.8	1.9
601198 CH Equity	DONGXING SECUR-A	19.07	39.3	2.6	26.7	2.5
600109 CH Equity	SINOLINK SECUR-A	13.28	28.8	2.3	22.8	2.1
000728 CH Equity	GUOYUAN SECURI-A	18.52	26.0	1.8	19.3	1.7
002500 CH Equity	SHANXI SECURIT-A	10.93	44.6	1.9		
601099 CH Equity	PACIFIC SECURI-A	5.03	54.1	3.4	30.5	
000686 CH Equity	NORTHEAST SECU-A	12.04	18.2	2.3	9.1	2.2
Average			23.3	1.9	17.6	1.8

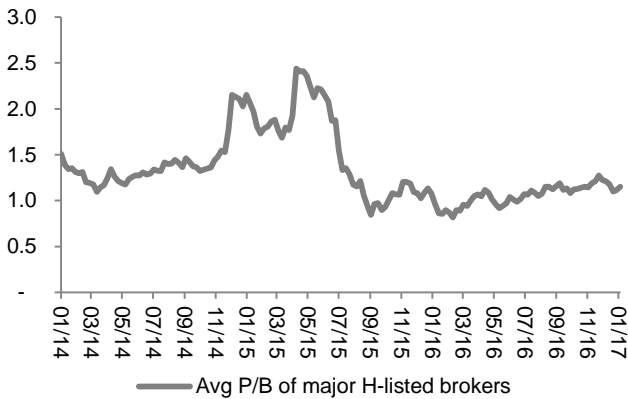
Source(s): Bloomberg, ABCI Securities

Closing price: 24 Jan, 2017



Overall, sector valuation has been volatile given the cyclical nature of the industry. E.g., major H-listed brokers generally traded at above 2x P/B in 1H15 and fell below 1.0x P/B in 2H15 during market corrections. In our view, sector valuation is undemanding at present and could potentially experience a re-rating in the future if market sentiment improves.

Exhibit 39: Historical valuation



Source(s): Bloomberg, ABCI Securities

*Average of Haitong, Citic, Galaxy

Net profit trend in 2016E-18E. After an exceptional year in 2015, we expect net profit to normalize to RMB 4.6bn in 2016, implying a YoY drop of 45%.

For 2017E-18E, we expect net profit to grow 19% and 17% YoY to RMB 5.5bn and RMB 6.4bn. Overall, we believe the Company would benefit from its leading position, capturing opportunities arising from China’s capital market reform.

Key concerns remain on further decline in brokerage commission rates, severe downturn in A-share market turnover, and slowdown in China’s economic growth.

Initiate BUY with TP of HK\$7.66. The counter is currently trading at 1.05x 2017E adjusted P/B (excluding RMB5bn perpetual bonds), which is undemanding in our view. Our TP is based on 1.2x 2017E adjusted P/B.

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. 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 brokerage business.

Volatility in the A-share market may cause investment losses in the proprietary trading business. 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. 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 consequently.

Comprehensive net profit attributable to ordinary shareholders were less than reported net profit attributable to shareholders in 1H16. CSC recorded decline of fair value of financial assets which were capitalized in balance sheet but not in income statement.



Financial summary

Consolidated income statement (2014A-2018E)

FY Ended Dec 31 (RMB mn)	2014A	2015A	2016E	2017E	2018E
Fee and commission income	6,541	14,901	9,129	10,506	12,275
Interest income	2,930	5,573	4,743	5,428	6,110
Investment income	1,903	3,980	1,500	1,500	1,500
Total revenue	11,374	24,454	15,372	17,434	19,885
Other income	78	59	100	100	100
Total revenue and other income	11,452	24,513	15,472	17,534	19,985
Total expenses	6,908	13,051	8,952	9,834	11,030
Operating Profits	4,544	11,462	6,520	7,700	8,955
Share of profit of investments in associates	0	0	0	0	0
Profit before tax	4,544	11,462	6,520	7,700	8,955
Tax	1,145	2,810	1,630	1,925	2,239
Profit after tax	3,398	8,652	4,890	5,775	6,716
Minority interests	-9	13	7	9	10
Profits attributable to perpetual bondholders	0	294	321	321	321
Profits attributable to ordinary shareholders	3,407	8,345	4,562	5,446	6,385
Growth					
Total revenue and other income (%)	56.4	114.0	(36.9)	13.3	14.0
Total expenses	40.9	88.9	(31.4)	9.8	12.2
Operating Profits (%)	87.7	152.3	(43.1)	18.1	16.3
Profits attributable to ordinary shareholders (%)	90.7	144.9	(45.3)	19.4	17.3
Operating performance					
Operating margin (%)	39.7	46.8	42.1	43.9	44.8
Net margin (%)	25.0	34.1	29.7	31.2	32.1
ROAE (%)*	22.9	40.0	14.9	14.2	14.7
ROAA (%)	3.6	5.0	2.5	2.8	3.1

Source(s): Company, ABCI Securities estimates

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



Consolidated balance sheet (2014A-2018E)

As of Dec 31 (RMB mn)	2014A	2015A	2016E	2017E	2018E
Property and equipment	486	580	609	639	671
Goodwill	100	122	128	134	141
Other intangible assets	-	374	393	413	433
Investment in associates and JV	20	50	53	55	58
AFS	835	1,457	1,530	1,607	1,687
Financial assets held under resale agreements	-	-	-	-	-
Other non-current assets	1,914	3,055	3,208	3,368	3,536
Total non-current assets	3,356	5,638	5,920	6,216	6,527
Cash & equivalents	11,448	16,154	22,220	22,198	21,465
Clearing settlement funds	42,762	70,664	63,597	66,777	70,116
AFS	11,453	15,891	25,425	26,696	28,031
Financial assets at FVTPL	526	1,504	1,579	1,658	1,741
Derivatives	151	142	149	157	164
Other current assets	1,028	1,715	1,801	1,891	1,985
Account receivables	164	153	161	169	177
Other receivables and prepayments	18,318	28,500	31,349	32,917	34,563
Advances to customers	31,941	35,931	26,948	32,338	38,806
Financial assets held under resale agreements	2,260	6,896	7,241	7,603	7,983
Total current assets	120,051	177,551	180,471	192,405	205,033
Total assets	123,406	183,188	186,391	198,620	211,559
Accounts payable	43,487	72,045	64,841	68,083	71,487
Borrowings	500	1,123	1,179	1,238	1,300
Placements from banks and other financial institutions	3,584	2,284	2,398	2,518	2,644
Other current liabilities	49,850	60,447	62,188	65,298	68,563
Total current liabilities	97,421	135,899	130,606	137,137	143,993
Loans and bonds payables	7,989	15,072	13,565	14,243	14,955
Other non-current liabilities	1,269	2,034	1,146	1,203	1,263
Total non-current liabilities	9,257	17,107	14,711	15,447	16,219
Total liabilities	106,678	153,005	145,317	152,583	160,212
Net current assets	22,630	41,652	49,865	55,268	61,039
Equity attributable to ordinary shareholders	16,669	25,106	35,984	40,935	46,231
Other equity instruments (perpetual subordinated bonds)	-	5,000	5,000	5,000	5,000
Non-controlling interests	59	77	90	102	116
Total equity	16,728	30,183	41,074	46,037	51,347

Source(s): Company, ABCI Securities estimates

Disclosures

Analyst Certification

I, Steve Chow, 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 have no financial interests in relation to the listed company (ies) covered in this report, and I and/or my associates do not serve as officer(s) of the listed company (ies) covered in this report.

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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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