



October 25, 2016

Sector Rating:  
**OVERWEIGHT**

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**Key Data**

Avg.16E P/E (x)	11.8
Avg.16E P/B (x)	1.1
Avg.16E Dividend Yield (%)	2.6

Source(s): ABCI Securities estimates

**Sector performance (%)**

	Absolute	Relative*
1-mth	0.38	1.34
3-mth	2.38	(4.12)
6-mth	(4.41)	(14.15)

\* Relative to Hang Seng Index  
Source(s): Bloomberg, ABCI Securities

## China Securities & Brokerage sector Investment banking is the sweet spot

- Investment banking business will be the industry's bright spot in the next 2-3 years; under the 13<sup>th</sup> FYP, the government is committed to boosting direct financing in capital markets.
- The market size of debt financing is 3-4 times larger than that of equity financing. As a result, brokers with a strong market position in bond underwriting should benefit the most from rising direct financing in our view
- We recommend **BUY** for GF (1776 HK). In our sector universe, GF's ROEs were above peers in 2015 and 1H16, demonstrating consistent execution capability in both ups and downs

**Investment banking – the industry's bright spot.** Investment banking business will be the industry's bright spot in the next 2-3 years. Revenue from investment banking among major brokers still achieved a 50% growth in 1H16, as compared to the 61%, 50%, and 43% declines in brokerage, trading, and total revenue. We expect investment banking to outperform other business segments over the next few years.

**The rise of direct financing.** We believe investment banking business are riding on a long-term structural uptrend, given the government's commitment to deleverage the economy through boosting direct financing in the capital markets via issuance of corporate bonds and equity securities. Direct financing accounted for 24% of the aggregate financing in the economy in 1H16, up from 17% in 2014, and we expect the trend to continue in the near term.

**Direct financing to help deleverage the economy.** Financial leverages of large SOEs and industrial enterprises have been increasing in recent years. Liabilities-assets ratio of SOEs increased to 68% at end-June 2016 from 66% at end-2014 while that of the industrial enterprises above the designated size rose to 57% from 56%. In addition, the lack of medium-to long-term funding sources to finance asset growth has become one of the bottlenecks of economic growth.

**The 13<sup>th</sup> five-year plan (FYP).** Under the current 13<sup>th</sup> FYP (2016-20), the government will increase the contribution of direct financing in the economy and deleverage through the development of a diverse, multi-layered capital market with GEM, NEEQ, regional stock market, etc. It also aims to promote product innovations such as high-yield bonds, hybrid financing and more. In our view, the plan will be supportive to the investment banking business.

**Favor GF (1776 HK) for consistent performance.** To assess the performance of brokers throughout a market cycle, we compare the ROEs of major brokers in 2015 and 1H16 and conclude that : 1) GF(1776 HK) and China Securities have demonstrated solid execution capability by consistently achieving above-peer ROEs in 2015 and 1H16; 2) Everbright (6178 HK), Galaxy (6881 HK), and DFZQ (3958 HK) had high ROEs in 2015 but performance failed to sustain during the market correction in 1H16; 3) Huatai (6886 HK), Haitong (6837 HK, CITIC (6030 HK), and CICC (3908 HK) are underperformers with below-peer ROEs in 2015 and 1H16. In particular, CICC had the lowest ROEs among peers in 2015 and 1H16, indicating erosion of competitive edge in our view.

**Valuation and recommendation summary**

Company	Ticker	Rating	TP (HK\$)	Upside (%)	FY16F P/E(x)	FY17F P/E(x)	FY16F P/B (x)	FY17F P/B (x)	FY16F Yield (%)	FY17F Yield (%)
GF	1776 HK	BUY	19.5	12.3	12.9	11.0	1.4	1.3	2.3	2.7
DFZQ	3958 HK	HOLD	8.3	4.5	14.8	12.8	1.0	1.0	2.0	2.3
CICC	3908 HK	HOLD	11.4	(2.2)	21.6	18.2	1.3	1.2	0.0	0.0
Guolian	1456 HK	HOLD	4.4	4.0	9.5	8.0	0.9	0.8	3.2	3.8

Source(s): ABCI Securities estimates



### **Direct financing is 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 fell to 59% in 1H16 from 61% in 2014. In particular, undiscounted bank bills fell RMB 1.3tn in 1H16 after declining RMB 1.1tn in 2015 and RMB 0.1tn in 2014. We believe the undiscounted bank bill market has been partially eroded by the increasing issuance of short-term corporate bonds. Companies with good credit ratings are able to issue corporate bonds at a lower interest cost or with a longer maturity.

Direct financing (including net corporate bond financing and domestic equity financing from non-financial institutions) accounted for 24% of aggregate financing in the economy in 1H16, up from 17% in 2014.

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

### **Bonds matter more than equity**

In direct financing, debt financing historically accounted for 70-80% of the total amount while equity financing only took up a minor proportion. As a result, brokers with a strong market position in bond underwriting should benefit the most from the increase in direct financing.

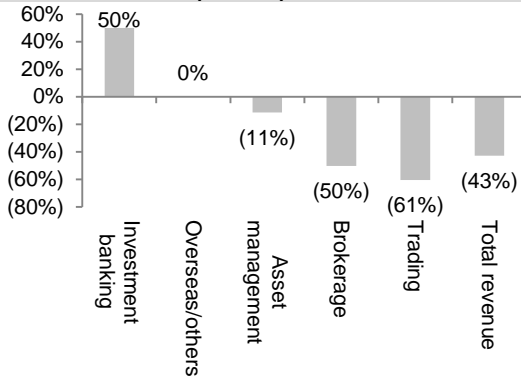
Net financing of corporate bonds increased from RMB 1.3trn in 1H14 to RMB 1.7tr in 1H16, indicating a healthy market in general. Debt financing accounted for 18% of total aggregate financing in 1H16, up from 12% in 1H14. The easing of regulations on corporate bond issuance by CSRC in 2015 (e.g. companies 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.

### **Share placement matters more than IPO**

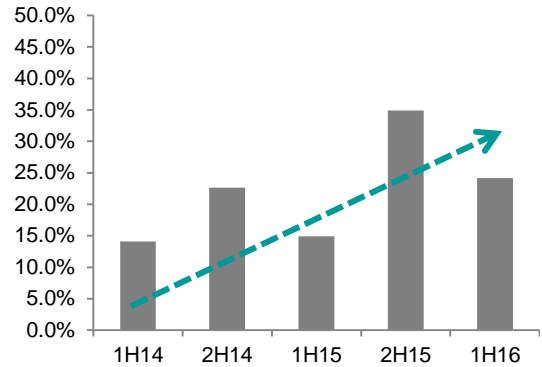
Overall, fundraising activities in the A-share market have been rising in recent years. According to PBOC, equity financing by non-financial enterprises in the stock market rose 53% YoY to RMB 0.6tn in 1H16. Equity financing accounted for 6.1% of total aggregate financing in 1H16, up from 1.8% in 1H14.

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 in the market and its impact on the brokerage industry since IPO market usually draws the most spotlight.

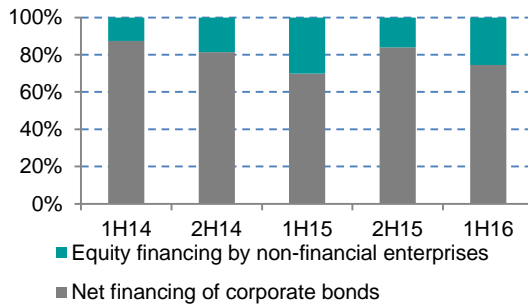
**Risk factors:** (1) Market risk of financial assets; (2) Credit risk associated with bond investments and lending business; (3) Volatility in market turnover; (4) Penalties on misconduct or staff malpractice in securities firms; (5) Regulatory changes in direct financing.

**Exhibit 1: Segmental revenue growth of major brokers\* in 1H16 (YoY %.)**


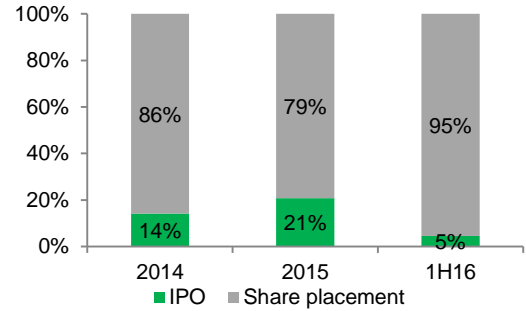
\* Aggregate of CMS, DFZQ, CITIC, Galaxy, GF, Haitong, Huatai, and China Securities  
 Source(s): Companies, ABCI Securities

**Exhibit 2: Direct financing as a percentage of aggregate financing**


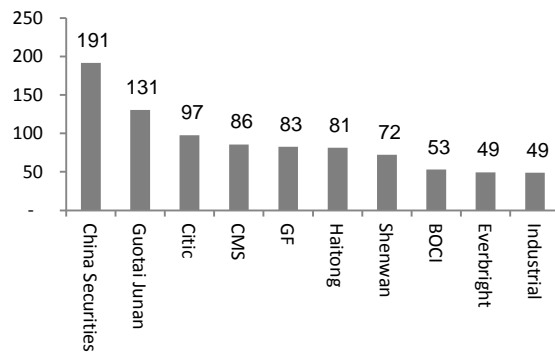
Source(s): PBOC

**Exhibit 3: Direct finance – equity vs. bonds**


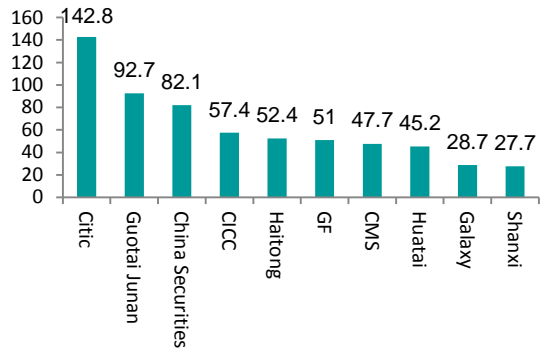
Source(s): PBOC

**Exhibit 4: Equity finance – IPO vs. share placement**


Source(s): WIND

**Exhibit 5: Bond underwriting amount in 2015 (RMB bn)**


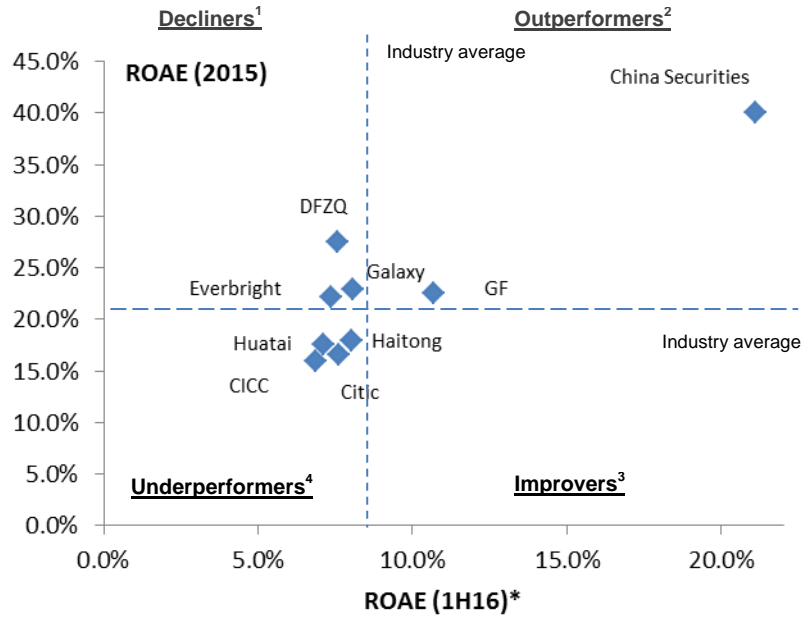
Source(s): SAC

**Exhibit 6: Equity underwritten amount in 2015 (RMB bn)**


Source(s): SAC



Exhibit 7: ROAE comparison



\*Annualized

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

<sup>1</sup>Decliners: Those with above-average ROE in 2015 and below-average ROE in 1H16

<sup>2</sup>Outperformers: Those with above-average ROE in both 2015 and 1H16

<sup>3</sup>Improver: Those with below-average ROE in 2015 and above-average ROE in 1H16

<sup>4</sup>Underperformers: Those with below-average ROE in both 2015 and 1H16

Source(s): Companies, SAC, ABCI Securities



October 25, 2016  
Company Report  
Rating: BUY  
TP: HK\$ 19.5

Share price (HK\$)	17.36
Est. share price return	12.3%
Est. dividend yield	2.3%
Est. total return	14.6%

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**Key Data**

52Wk H/L(HK\$)	20.3/13.4
Issued shares (mn)	7,621
- H shares (mn)	1,702
- A shares (mn)	5,919
H-share market cap (HK\$ mn)	28,418
3-mth avg daily turnover (HK\$ mn)	70
Major shareholder(s) (%):	
Jilin Aodong Pharmaceutical	16.7%
Liaoning Cheng Da	16.4%
Zhongshan Public Utilities	10.2%

Source(s): Company, Bloomberg, ABCI Securities

**1H16 Revenue Breakdown (%)**

Wealth management	45
Trading	22
Investment management	20
Investment banking	10
Others	3

Source(s): Company, Bloomberg, ABCI Securities

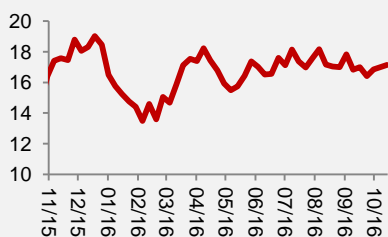
**Share performance (%)**

	Absolute	Relative*
1-mth	(8.5)	1.8
3-mth	(4.8)	13.7
6-mth	7.5	13.4

\*Relative to HSI

Source(s): Bloomberg, ABCI Securities

**1-Year stock performance (HK\$)**



Source(s): Bloomberg, ABCI Securities

**GF Securities (1776 HK)**  
**Premium justified on high ROE;**  
**recommend BUY**

- 1H16 net profit fell 52% YoY to RMB 4.0bn, largely in line with the industry trend. Decline in 9M16 net profit narrowed to 41%, however
- Well-positioned to ride on the structural uptrend in asset management industry
- Robust growth in investment banking driven by SME focus
- Watch out for potential impact from recent CSRC's downgrade
- Valuation premium justified. Recommend **BUY**

**1H16 and 9M16 highlights.** In 1H16, revenue and net profit dropped 43% and 52% to RMB 13.7bn and RMB 4.0bn. Operating margin fell from 46.5% in 1H15 to 37.4% in 1H16 while net margin declined from 35.0% to 29.5% over the same period. ROE was 5.1% vs.16.2% a year ago. For 9M16, decline in revenue and net profit narrowed to 42% and 41%

**Superior ROE compared to peers.** In 1H16, its ROE of 5.1% was higher than the sector average of ~4%. We attribute it to its strong execution and efficient management.

**Asset management as the bright spot.** Revenue contribution from asset management business increased from 11% in 1H15 to 20% in 1H16, higher than the 10% average for its major peers. Its total AUM and collective schemes (CAM) AUM were ranked 4<sup>th</sup> and 1<sup>st</sup> in the industry. In our view, GF is well positioned to ride on the uptrend in China's asset management industry.

**Strengthened position in investment banking.** Investment banking is another bright spot with a 74% revenue growth in 1H16, driven by the general industry uptrend as well as GF's focus on SME investment banking despite its low contribution (10% of total revenue).

**Potential impact from CSRC's downgrade.** GF, together with most H-listed brokers, have recently been downgraded from their "AA" rating by CSRC. In our view, a lower regulatory rating could adversely affect business development, funding channels, financing cost, and capital requirement.

**Premium justified on strong fundamentals.** The counter is currently trading at 1.3x forward 2017E P/B, higher than the average level of 1.1x. In our view, this reflects its strong business fundamentals as well as superior ROE. We set our TP at HK\$19.5, equivalent to 1.5x 2017E P/B. Recommend **BUY**.

**Risk factor:** (1) Regulatory changes in asset management; (2) Credit risk associated with bond investments; (3) Volatility in market turnover.

**Results and Valuation**

FY ended Dec 31	2014A	2015A	2016E	2017E	2018E
Revenue (RMB mn)	16,163	42,733	28,765	32,541	36,773
Chg (% YoY)	73.2	164.4	(32.7)	13.1	13.0
Net profit (RMB mn)	5,023	13,201	8,618	10,140	11,979
Chg (% YoY)	78.5	162.8	(34.7)	17.7	18.1
Underlying EPS (RMB)	0.9	1.9	1.1	1.3	1.6
Chg (% YoY)	NA	117.6	(38.9)	17.7	18.1
BVPS (RMB)	6.7	10.2	10.2	11.1	12.2
Chg (% YoY)	NA	52.0	0.0	9.2	9.9
Underlying PE (x)	17.2	7.9	12.9	11.0	9.3
P/B (x)	2.2	1.4	1.4	1.3	1.2
ROE (%)	25.4	22.5	11.1	12.5	13.5
ROA (%)	2.8	4.0	2.2	2.8	3.1
DPS(HK\$)	0.2	0.9	0.4	0.5	0.6
Yield (%)	1.4	5.5	2.3	2.7	3.2



### 1H16 performance by business segment

**Investment banking.** Driven by upsurge of fundraising in China's capital market, investment banking revenue increased by 74% to RMB 1.4bn in 1H16, accounting for 10% of total revenue.

In 1H16, its equity lead underwriting amount was RMB 31.8bn (1H15: RMB 10.6bn), ranking 6<sup>th</sup> in the industry. It was the lead underwriter for 7 IPOs and was ranked 1<sup>st</sup> in the industry in terms of the number of underwriting projects. In addition, its bond lead underwritten increased from RMB 15.4bn in 1H15 to RMB 75.4bn in 1H16.

**Wealth management.** Wealth management revenue dropped by 55% YoY to RMB 6.1bn amid lower turnover and weak market sentiment. Still, brokerage remained as the largest contributor, accounting for 45% of total revenue in 1H16.

Its stock and fund turnover dropped 58% to RMB 6.0tr in 1H16, ranking 5<sup>th</sup> in the industry with a market share of ~4.6%.

Margin finance and securities lending balance was RMB 48.2bn in end-June 2016, 28% lower than that at end-2015. Market share was 5.6%, ranking 5<sup>th</sup> in the industry.

**Trading and institutional client services.** Segment revenue fell 50% to RMB 3bn in 1H16 on a less-than-sanguine investment environment. Overall, it reported a small investment loss of RMB 84m from equity trading, cushioned by the RMB 2.5bn investment gains from fixed income.

**Investment management.** Segment revenue increased by 2% to RMB 2.8bn in 1H16 and accounted for 20% of total revenue. Overall, total AUM under GF Asset Management was RMB 679bn in June 2016 vs. RMB 346bn in June 2015, ranking 4<sup>th</sup> in the industry. In addition, AUM of collective schemes was ranked 1<sup>st</sup> and the active management size was ranked 2<sup>nd</sup>.

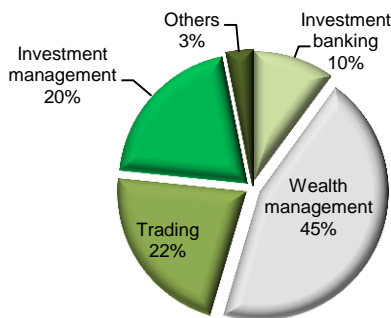


Exhibit 1: 1H16 highlight

	1H15	1H16	YoY	Comment
Fee and commission income	10,603	6,531	(38%)	
Interest income	6,565	3,946	(40%)	
Investment income	6,676	3,358	(50%)	
Other income	149	-181	(221%)	
<b>Total revenue and other income</b>	<b>23,993</b>	<b>13,654</b>	<b>(43%)</b>	
Total expenses	12,827	8,551	(33%)	
<b>Operating Profits</b>	<b>11,166</b>	<b>5,103</b>	<b>(54%)</b>	
Share of profit of associates	173	202	17%	
Profit before tax	11,339	5,305	(53%)	
Tax	2,701	1,102	(59%)	
Profit after tax	8,638	4,203	(51%)	
Minority interests	232	172	(26%)	
<b>Net Profits</b>	<b>8,406</b>	<b>4,030</b>	<b>(52%)</b>	
<b>Revenue by segment</b>				
Investment banking	787	1,365	74%	Increased capital market fundraising
Wealth management	13,560	6,086	(55%)	Falling market turnover
Trading	6,002	3,009	(50%)	Lower investment return
Investment management	2,705	2,761	2%	
Others	939	432	(54%)	
<b>Total revenue and other income</b>	<b>23,993</b>	<b>13,654</b>	<b>74%</b>	
<b>Ratios</b>				
Operating margin	46.5%	37.4%		
Net margin	35.0%	29.5%		
ROAE	16.2%	5.1%		

Source(s): Company, ABCI Securities

Exhibit 1: 1H16 sales breakdown



Source(s): Company, ABCI Securities

Exhibit 2: CSRC rating among major brokers

Company	2015 rating	2016 rating
DFZQ (3958 HK)	AA	AA
CICC (3908 HK)	AA	A
Galaxy (6881 HK)	AA	A
Guolian (1456 HK)	A	A
CITIC (6030 HK)	AA	BBB
GF (1776 HK)	AA	BBB
Haitong (6837 HK)	AA	BBB
Huatai (6886 HK)	AA	BBB

Source(s): CSRC, ABCI Securities





## Financial Summary

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

FY Ended Dec 31 (RMB mn)	2014A	2015A	2016E	2017E	2018E
Fee and commission income	8,217	20,046	13,981	16,257	18,989
Interest income	4,325	12,336	8,784	9,784	10,784
Investment income	3,605	10,396	6,000	6,500	7,000
<b>Total revenue</b>	<b>16,147</b>	<b>42,779</b>	<b>28,765</b>	<b>32,541</b>	<b>36,773</b>
Other income	17	(46)	0	0	0
<b>Total revenue and other income</b>	<b>16,163</b>	<b>42,733</b>	<b>28,765</b>	<b>32,541</b>	<b>36,773</b>
<b>Total expenses</b>	<b>9,852</b>	<b>25,217</b>	<b>17,933</b>	<b>19,805</b>	<b>21,738</b>
<b>Operating Profits</b>	<b>6,312</b>	<b>17,516</b>	<b>10,832</b>	<b>12,736</b>	<b>15,035</b>
Share of profit of investments in associates	337	290	406	487	584
<b>Profit before tax</b>	<b>6,649</b>	<b>17,806</b>	<b>11,238</b>	<b>13,223</b>	<b>15,620</b>
Tax	1,503	4,193	2,360	2,777	3,280
<b>Profit after tax</b>	<b>2,137</b>	<b>13,613</b>	<b>8,878</b>	<b>10,446</b>	<b>12,339</b>
Minority interests	123	411	260	305	361
<b>Profits attributable to shareholders</b>	<b>2,014</b>	<b>13,201</b>	<b>8,618</b>	<b>10,140</b>	<b>11,979</b>
<b>Growth</b>					
Total revenue and other income (%)	73.2	164.4	(32.7)	13.1	13.0
Total expenses	57.7	156.0	(28.9)	10.4	9.8
Operating Profits (%)	104.6	177.5	(38.2)	17.6	18.1
Net profit (%)	78.5	162.8	(34.7)	17.7	18.1
<b>Operating performance</b>					
Operating margin (%)	39.0	41.0	37.7	39.1	40.9
Net margin (%)	12.5	30.9	30.0	31.2	32.6
ROAE (%)	25.4	22.5	11.1	12.5	13.5
ROAA (%)	2.8	4.0	2.2	2.8	3.1

Source(s): Company, ABCI Securities estimates





Consolidated balance sheet (2014A-2018E)

As of Dec 31 (RMB mn)	2014A	2015A	2016E	2017E	2018E
Property and equipment	1,642	1,923	2,019	2,120	2,226
Other intangible assets	155	216	227	238	250
Investment in associates and JV	1,584	3,348	3,515	3,691	3,875
AFS	2,110	17,850	16,065	16,868	17,712
Financial assets held under resale agreements	432	1,835	1,468	1,542	1,619
Other non-current assets	516	1,070	1,223	1,284	1,348
<b>Total non-current assets</b>	<b>6,438</b>	<b>26,241</b>	<b>24,516</b>	<b>25,742</b>	<b>27,029</b>
Cash & equivalents	70,229	111,528	83,924	91,124	99,657
Clearing settlement funds	22,625	31,222	21,855	22,948	24,096
AFS	32,300	78,733	70,859	74,402	78,122
Financial assets at FVTPL	26,937	83,912	79,717	83,702	87,888
Derivatives	91	271	284	298	313
Other current assets	1,419	264	216	227	239
Other receivables and prepayments	3,563	6,046	4,267	4,480	4,704
Advances to customers	64,696	68,970	55,176	57,935	60,831
Financial assets held under resale agreements	11,801	11,911	12,506	13,131	13,788
<b>Total current assets</b>	<b>233,661</b>	<b>392,855</b>	<b>328,804</b>	<b>348,249</b>	<b>369,638</b>
<b>Total assets</b>	<b>240,099</b>	<b>419,096</b>	<b>353,321</b>	<b>373,991</b>	<b>396,667</b>
Accounts payable	71,466	118,487	100,714	105,750	111,037
Loans and debt	31,946	31,266	28,927	29,980	31,085
Other current liabilities	62,118	113,505	97,831	102,722	107,858
<b>Total current liabilities</b>	<b>165,530</b>	<b>263,258</b>	<b>227,472</b>	<b>238,452</b>	<b>249,981</b>
Financial assets sold under repurchase agreements	4,050	-	-	-	-
Loans and bonds payables	29,031	75,739	45,443	47,716	50,101
Other non-current liabilities	112	278	292	307	322
<b>Total non-current liabilities</b>	<b>33,192</b>	<b>76,017</b>	<b>45,736</b>	<b>48,023</b>	<b>50,424</b>
<b>Total liabilities</b>	<b>198,722</b>	<b>339,275</b>	<b>273,207</b>	<b>286,474</b>	<b>300,404</b>
<b>Net current assets</b>	<b>68,132</b>	<b>129,597</b>	<b>101,332</b>	<b>109,797</b>	<b>119,657</b>
Equity attributable to owners of the parent	39,611	77,519	77,552	84,650	93,035
Minority interest	1,767	2,302	2,561	2,867	3,227
<b>Total equity</b>	<b>41,377</b>	<b>79,821</b>	<b>80,113</b>	<b>87,517</b>	<b>96,263</b>

Source(s): Company, ABCI Securities estimates



October 25, 2016  
Company Report  
Rating: HOLD  
TP: HK\$ 4.4

Share price (HK\$)	4.20
Est. share price return	4.0%
Est. dividend yield	3.2%
Est. total return	7.2%

Analyst : Steve Chow  
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**Key Data**

52Wk H/L(HK\$)	5.6/3.1
Issued shares (mn)	1,902
H shares (mn)	443
Unlisted shares (mn)	1,460
H-share market cap (HK\$ mn)	1,832
3-mth avg daily turnover (HK\$ mn)	6
Major shareholder(s) (%):	
Guolian Group	72.35

Source(s): Company, Bloomberg, ABCI Securities

**1H16 Sales breakdown (%)**

Brokerage	46.5
Investment banking	19.9
Credit	19.9
Trading	6.4
Investment Management	4.4
Others	2.9

Source(s): Company, ABCI Securities

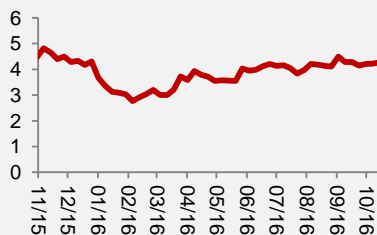
**Share performance (%)**

	Absolute	Relative*
1-mth	7.8	4.2
3-mth	4.5	10.9
6-mth	19.3	19.4

\*Relative to HSI

Source(s): Bloomberg, ABCI Securities

**1-Year stock performance (HK\$)**



Source(s): Bloomberg, ABCI Securities

## Guolian Securities (1456 HK)

### Not immune to industry downturn

- 1H16 profit dropped by 49% YoY to RMB 575mn on the back 34% revenue decline, largely in line with the industry trend.
- Brokerage and credit businesses, which jointly accounted for two-thirds of total revenue, were the main drags although some of the impacts were mitigated by gains in the investment banking segment
- Potentially less competition from major H-listed brokers after recent CSRC's rating downgrade of peers
- Valuation discount to listed national brokers to persist. Recommend **HOLD**

**1H16 highlights.** Revenue and net profit dropped 47% and 65% to RMB 1.2bn and RMB 334mn given the high base in 1H15 and industry slowdown. The declining performance was largely in line with the industry trend. Operating margin dropped from 57.2% in 1H15 to 36.8% in 1H16 while net margin fell from 43.6% to 28.6% over the same period. ROE was 4.5% vs. 21.3% a year ago

**Brokerage and credit businesses were the main drags.** In 1H16, brokerage and credit businesses accounted for 67% of total revenue. In our view, its dependence on the two businesses affected its overall performance in 1H16 given the weakened market turnover in recent months.

**Investment banking- the bright spot.** Investment banking revenue increased by 28% to RMB 232mn. Despite its small size, the Group has been able to ride on the recent tailwind in capital market. In 1H16, net financing of corporate bonds and stock market equity financing by non-financial enterprises in China increased by 83% and 53% YoY in 1H16.

**Maintain an "A" rating amid a slew of downgrades by CSRC** Most H-listed brokers have recently been downgraded and lost their "AA" ratings from CSRC. Guolian maintains its "A" rating. In our view, a lower regulatory rating could negatively affect business development, funding channel and cost, and capital requirement. In our view, competition from these large players could be lessened in the near term.

**HOLD with TP of HK\$ 4.4.** We expect net profit to drop by 51% to RMB 727mn in 2016E before restoring a 19% and 21% growth in 2017E and 2018E. The counter has been trading at a discount to major listed national broker due to its smaller size as a regional broker, and we expect the valuation gap to persist. We set our TP to HK\$4.4, equivalent to 0.85x 2017E P/B.

**Risk factor: (1)** Market risk of financial assets; **(2)** Credit risk inherent to bond investments and lending business; **(3)** Market turnover volatility; **(4)** Low share turnover

**Results and Valuation**

FY ended Dec 31	2014A	2015A	2016E	2017E	2018E
Revenue (RMB mn)	2,132	3,833	2,219	2,419	2,768
Chg (% YoY)	NA	79.8	(42.1)	9.0	14.4
Net profit (RMB mn)	715	1,471	727	867	1,048
Chg (% YoY)	NA	105.8	(50.6)	19.3	20.8
Underlying EPS (RMB)	0.48	0.88	0.38	0.46	0.55
Chg (% YoY)	NA	83.3	(56.6)	19.3	20.8
BVPS (RMB)	2.7	4.1	4.1	4.4	4.8
Chg (% YoY)	NA	49.4	0.1	7.8	8.8
Underlying PE (x)	7.6	4.1	9.5	8.0	6.6
P/B (x)	1.3	0.8	0.9	0.8	0.8
ROE (%)	35.0	24.9	9.4	10.8	12.0
ROA (%)	7.0	5.7	2.5	3.1	3.6
DPS(HK\$)	0.1	0.5	0.1	0.2	0.2
Yield (%)	2.0	11.3	3.2	3.9	4.7

Source(s): Company, ABCI Securities estimates



## 1H16 performance by business segment

**Brokerage and credit.** Brokerage and credit revenues dropped 54% and 20% to RMB 543mn and RMB 233mn on lower turnover and weakened market sentiment compared to last year. Overall, brokerage and credit businesses remained the largest contributors, jointly accounting for 67% of total revenue in 1H16.

Its stock and fund turnover was RMB 932bn in 1H16 and was ranked 38<sup>th</sup> in the industry. As at June 2016, the Company had 59 securities branches.

Margin finance and securities lending balance was RMB 4.2bn in June 2016, down 47.8% YoY.

**Investment banking** Investment banking revenue increased by 28% to RMB 232mn and accounted for 20% of total revenue in 1H16. Overall, the Group has been able to ride on the upturn in China's capital market despite its small size.

In 1H16, it completed 2 follow-on financing projects with an aggregate underwriting amount of RMB 489mn. Currently, it has 3 IPO projects and 4 follow-on financing projects under regulatory review. For debt financing, it completed 15 bonds lead-underwriting projects in 1H16 with an aggregate underwriting amount of RMB 15.2bn.

**Asset management.** Segmental revenue fell 37% to RMB 51mn in 1H16 on less favorable investment environment compared to 2015. Overall, total AUM increased by 6.6% to RMB 22.5mn in June 2016. Nonetheless, contribution of the business was still low at ~ 4% of total revenue.

**Proprietary trading.** Segmental revenue fell 83% to RMB 75mn in 1H 16 on less favorable investment environments. As a result, the segment only accounted for 6% of total revenue in 1H16, compared to 20% in 2015.

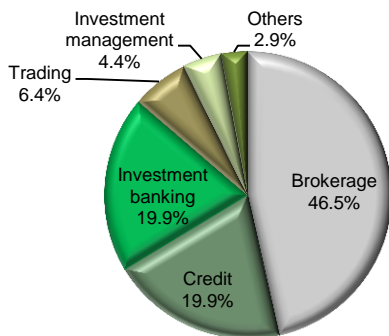


**Exhibit 1: 1H16 results highlights**

	1H15	1H16	YoY	Comment
Fee and commission income	1,225	654	-47%	Dragged by brokerage and credit businesses
Interest income	443	410	-8%	
Investment income	523	101	-81%	Unfavorable market environment
Other income	2	4	100%	
<b>Total revenue and other income</b>	<b>2,193</b>	<b>1,168</b>	<b>-47%</b>	
Total expenses	938	738	-21%	
<b>Operating Profits</b>	<b>1,255</b>	<b>430</b>	<b>-66%</b>	
Share of profit of associates	28	16	-44%	
Other gains	0	23	NA	
Profit before tax	1,283	469	-63%	
Tax	317	120	-62%	
Minority interests	9	14	54%	
<b>Net Profits</b>	<b>957</b>	<b>334</b>	<b>-65%</b>	
Revenue by segment				
Brokerage	1,185	543	-54%	
Credit	292	233	-20%	
Investment banking	182	232	28%	
Trading	440	75	-83%	
Investment management	81	51	-37%	
Others	13	34	162%	
	2,193	1,168	-47%	
Ratios				
Operating margin	57.2%	36.8%		
Net margin	43.6%	28.6%		
ROAE	21.3%	4.5%		

Source(s): Company, ABCI Securities

**Exhibit 2: 1H16 sales breakdown**



Source(s): Company, ABCI Securities

**Exhibit 3: CSRC rating among major brokers**

Company	2015 rating	2016 rating
Orient (3958 HK)	AA	AA
CICC (3908 HK)	AA	A
Galaxy (6881 HK)	AA	A
<b>Guolian (1456 HK)</b>	<b>A</b>	<b>A</b>
CITIC (6030 HK)	AA	BBB
GF (1776 HK)	AA	BBB
Haitong (6837 HK)	AA	BBB
Huatai (6886 HK)	AA	BBB

Source(s): CSRC, ABCI Securities



## Financial Summary

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

FY Ended Dec 31 (RMB mn)	2014A	2015A	2016E	2017E	2018E
Fee and commission income	1,080	2,236	1,187	1,337	1,486
Interest income	375	925	733	733	833
Investment income	666	666	300	350	450
<b>Total revenue</b>	<b>2,121</b>	<b>3,826</b>	<b>2,219</b>	<b>2,419</b>	<b>2,768</b>
Other income	11	7	0	0	0
<b>Total revenue and other income</b>	<b>2,132</b>	<b>3,833</b>	<b>2,219</b>	<b>2,419</b>	<b>2,768</b>
<b>Total expenses</b>	<b>1,185</b>	<b>1,991</b>	<b>1,319</b>	<b>1,345</b>	<b>1,470</b>
<b>Operating Profits</b>	<b>947</b>	<b>1,842</b>	<b>901</b>	<b>1,074</b>	<b>1,298</b>
Share of profit of investments in associates	16	30	36	43	51
<b>Profit before tax</b>	<b>963</b>	<b>1,871</b>	<b>936</b>	<b>1,117</b>	<b>1,349</b>
Tax	233	492	197	235	283
<b>Profit after tax</b>	<b>2,137</b>	<b>1,379</b>	<b>740</b>	<b>883</b>	<b>1,066</b>
Minority interests	15	27	13	15	18
<b>Profits attributable to shareholders</b>	<b>2,121</b>	<b>1,353</b>	<b>727</b>	<b>867</b>	<b>1,048</b>
<b>Growth</b>					
Total revenue and other income (%)	NA	79.8	(42.1)	9.0	14.4
Total expenses	NA	68.1	(33.8)	2.0	9.3
Operating Profits (%)	NA	94.5	(51.1)	19.3	20.8
Net profit (%)	NA	105.8	(50.6)	19.3	20.8
<b>Operating performance</b>					
Operating margin (%)	44.4	48.1	40.6	44.4	46.9
Net margin (%)	25.0	35.3	32.8	35.9	37.8
ROAE (%)	35.0	24.9	9.4	10.8	12.0
ROAA (%)	7.0	5.0	2.5	3.1	3.6

Source(s): Company, ABCI Securities estimates



Consolidated balance sheet (2014A-2018E)

As of Dec 31 (RMB mn)	2014A	2015A	2016E	2017E	2018E
Property and equipment	105	104	109	114	120
Other intangible assets	24	19	20	21	22
Investment in associates and JV	195	204	214	224	236
AFS	80	753	791	830	872
Financial assets held under resale agreements	88	128	135	141	148
Other non-current assets	34	29	30	31	33
<b>Total non-current assets</b>	<b>526</b>	<b>1,236</b>	<b>1,297</b>	<b>1,362</b>	<b>1,430</b>
Cash & equivalents	950	3,961	3,561	3,772	4,092
Clearing settlement funds	2,776	4,360	2,180	2,289	2,403
AFS	809	819	656	688	723
Financial assets at FVTPL	4,280	2,594	2,853	2,996	3,146
Other current assets	5,719	10,333	10,333	10,850	11,392
Other receivables and prepayments	3,738	6,085	4,260	4,473	4,696
Advances to customers	190	239	251	264	277
Financial assets held under resale agreements	1,461	1,546	1,624	1,705	1,790
<b>Total current assets</b>	<b>19,923</b>	<b>29,937</b>	<b>25,717</b>	<b>27,036</b>	<b>28,520</b>
<b>Total assets</b>	<b>20,449</b>	<b>31,173</b>	<b>27,014</b>	<b>28,398</b>	<b>29,950</b>
Accounts payable	7,769	13,557	11,524	12,100	12,705
Loans and debt	850	3,850	1,925	1,925	1,925
Other current liabilities	5,216	3,907	3,683	3,868	4,061
<b>Total current liabilities</b>	<b>13,835</b>	<b>21,315</b>	<b>17,132</b>	<b>17,893</b>	<b>18,691</b>
Loans and bonds payables	2,150	1,800	1,800	1,800	1,800
Other non-current liabilities	115	30	32	33	35
<b>Total non-current liabilities</b>	<b>2,265</b>	<b>1,830</b>	<b>1,832</b>	<b>1,833</b>	<b>1,835</b>
<b>Total liabilities</b>	<b>16,100</b>	<b>23,145</b>	<b>18,964</b>	<b>19,726</b>	<b>20,526</b>
<b>Net current assets</b>	<b>6,088</b>	<b>8,623</b>	<b>8,585</b>	<b>9,144</b>	<b>9,829</b>
Equity attributable to owners of the parent	4,082	7,735	7,744	8,351	9,085
Minority interest	267	294	306	321	339
<b>Total equity</b>	<b>4,349</b>	<b>8,029</b>	<b>8,050</b>	<b>8,673</b>	<b>9,424</b>

Source(s): Company, ABCI Securities estimates



October 25, 2016  
Company Report  
Rating: HOLD  
TP: HK\$ 8.30

Share price (HK\$)	7.96
Est. share price return	4.5%
Est. dividend yield	2.0%
Est. total return	6.5%

Analyst : Steve Chow  
Tel: (852) 2147 8809  
Email: stevechow@abci.com.hk

**Key Data**

52Wk H/L(HK\$)	8.6/8.1
Issued shares (mn)	6,216
- H shares (mn)	1,028
- A shares (mn)	5,188
H-share market cap (HK\$ mn)	8,397
Avg daily turnover (HK\$ mn)*	32
Major shareholder(s) (%):	
Shenergy Group	24.74%
Shanghai Haiyan	4.61%
Wenhui Xinmin United Press	3.97%

Source(s): Company, Bloomberg, ABCI Securities

\*Since listing on Jul 8, 2016

**1H16 Revenue breakdown (%)**

Brokerage	50
Others	16
Investment banking	14
Investment management	12
Trading	8

Source(s): Company, ABCI Securities

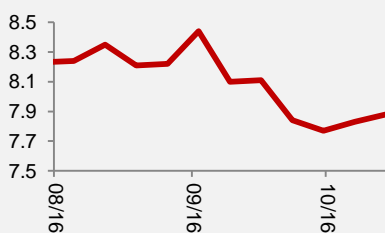
**Share performance (%)**

	Absolute	Relative*
1-mth	(1.0)	3.8
3-mth	NA	NA
6-mth	NA	NA

\*Relative to HSI

Source(s): Bloomberg, ABCI Securities

**Stock performance (HK\$)**



Source(s): Bloomberg, ABCI Securities

**DFZQ (3958 HK)**

**A high-beta play**

- 1H16 profit dropped by 78% YoY to RMB 1.3bn on steep decline in proprietary trading
- Heavy exposure to trading income makes it a high-beta play although asset allocation to high-grade bonds has helped mitigate overall risk
- May benefit from CSRC's downgrade of various H-listed brokers
- Limited re-rating potential in the near term due to high-beta nature. Recommend **HOLD**

**1H16 highlights.** Revenue and net profit dropped by 57% and 78% to RMB 5.8bn and RMB 1.3bn. Due to significant drop in revenue from proprietary trading, the Group suffered from a steeper decline in earnings than peers. Operating margin dropped from 56.5% in 1H15 to 24.8% in 1H16 while net margin fell from 44.0% to 22.3% over the same period. ROE was 3.5% vs. 13.2% a year ago

**High beta driven by proprietary trading.** Proprietary trading revenue dropped 93% to RMB 484mn in 1H16 due to unfavorable investment environment. As a result, revenue from proprietary trading only accounted for 8% of total revenue, vs. 53% in 1H15. Overall, its high dependence on trading income has led to more volatile earnings than peers. To mitigate market risk, the Group has allocated ~76% of the trading assets to bonds. Most of these bonds (98%) achieved an external rating of "AA" or higher.

**Expanding into gold trading.** DFZQ is actively developing its gold trading business and has obtained the international membership to conduct gold proprietary trading and agency business on the international board.

**May benefit from rating downgrade of H-listed peers.** Maintaining its "AA" rating, it may benefit from CSRC's recent rating downgrade of H-listed brokers including CITICS (6030 HK), Galaxy (6881 HK), GF (1776 HK), Haitong (6837 HK), Huatai (6886 HK), and CICC (3908 HK). We believe a lower regulatory rating could lead to higher headwinds in business development, funding channel and cost, as well as capital requirement.

**Limited re-rating potential in the near term.** The counter is currently trading at 1.1x forward P/B, in line with the sector average. We believe re-rating potential is limited in the near term due to its high exposure in proprietary trading. We set our TP to HK\$ 8.30, equivalent to 1.05x 2017E P/B. Recommend **HOLD**.

**Risk factor:** (1) Market risk of financial assets; (2) Credit risk inherent to bond investments and lending business; (3) Volatility in market turnover; (4) BVPS drops in 2016.

**Results and Valuation**

FY ended Dec 31	2014A	2015A	2016E	2017E	2018E
Revenue (RMB mn)	7,888	20,459	11,794	13,367	15,068
Chg (% YoY)	72.0	159.4	(42.4)	13.3	12.7
Net profit (RMB mn)	2,342	7,325	2,822	3,249	3,863
Chg (% YoY)	132.5	212.7	(61.5)	15.2	18.9
Underlying EPS (RMB)	0.50	1.11	0.45	0.52	0.62
Chg (% YoY)	NA	122.0	(59.1)	15.2	18.9
BVPS (RMB)	4.3	6.6	6.4	6.8	7.2
Chg (% YoY)	NA	54.4	(3.4)	5.7	6.4
Underlying PE (x)	13.6	6.1	14.8	12.8	10.8
P/B (x)	1.9	1.0	1.0	1.0	0.9
ROE (%)	13.8	27.5	7.6	7.9	8.9
ROA (%)	2.8	4.6	1.4	1.6	1.8
DPS(HK\$)	0.22	0.53	0.16	0.18	0.22
Yield (%)	2.2	6.6	2.0	2.3	2.8

Source(s): Company, ABCI Securities estimates





### 1H16 performance by business segment

**Proprietary trading.** Segment revenue fell 93% to RMB 484mn in 1H16 on less favorable investment compared with 1H15. Proprietary trading asset balance remained largely stable at RMB 49.3bn in June 2016 vs. RMB 50.3bn at end-2015.

In terms of asset allocation, bonds accounted for 76% of total trading assets, followed by stocks and funds (18%) and others (6%). In addition, about 98% of bonds had a crediting rating of “AA” or higher. It remained to be the top 5 market makers among all securities companies in the interbank bond market. Overall, trading assets accounted for 26% of total assets and 150% of total equity in June 2016.

It is also expanding into gold trading after getting an international membership to trade on the international board.

**Investment banking.** Investment banking revenue increased by 35% to RMB 801mn in 1H16, largely in line with the increase in fundraising activities during the period. Overall, investment banking accounted for 14% of total revenue in 1H16.

In 1H16, it completed 10 equity deals, including 4 IPOs, 2 private placements, and 2 financial advisory projects. Its equity lead underwriting amount increased from RMB 4.7bn in 1H15 to RMB 6.0bn in 1H16 while its bond lead underwriting amount increased from RMB 18bn in 1H15 to RMB 40bn in 1H16.

**Brokerage.** Brokerage revenue dropped 29% RMB 2.9bn amid lower turnover and weak market sentiment compared with last year. Overall, brokerage remained the largest contributor, accounting for 50% of total revenue in 1H16.

Its stock and fund turnover was RMB1.7trn in 1H16 with a 1.28% market share.

Securities financing balance was RMB 38.8bn in June 2016, 2.3% higher than that in end-2015. Margin finance and securities lending balance dropped from RMB 13.6bn at end-2015 to RMB 9.3bn in June 2016. Collateralized stock repurchase and repurchase agreement balance increased from RMB 24.1bn at end-2015 to RMB 28.9bn in June 2016.

**Investment management.** Segment revenue fell 38% to RMB 677mn in 1H16 and accounted for 12% of total revenue. Overall, total AUM of Orient Securities Asset Management was RMB 124bn in June 2016, up 14.1% compared with end-2015. In terms of product mix, targeted asset management schemes (TAM) accounted for 53.1% of total AUM, followed by mutual funds (20.1%), collective asset management schemes (CAM) (17.5%), and specialized asset management schemes (SAM) (9.3%).

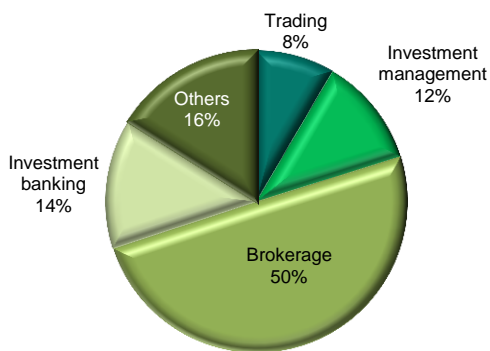


**Exhibit 1: 1H16 results highlight**

	1H15	1H16	YoY	Comment
Fee and commission income	3,692	2,270	(39%)	
Interest income	1,986	2,203	11%	
Investment income	7,557	1,002	(87%)	Less favorable market environment
Other income	114	275	142%	
<b>Total revenue and other income</b>	<b>13,349</b>	<b>5,749</b>	<b>(57%)</b>	
Total expenses	5,810	4,322	(26%)	Cost control
<b>Operating Profits</b>	<b>7,539</b>	<b>1,428</b>	<b>(81%)</b>	
Share of profit of associates	161	133	(18%)	
Profit before tax	7,700	1,560	(80%)	
Tax	1,768	204	(88%)	
Profit after tax	5,932	1,356	(77%)	
Minority interests	55	73	33%	
<b>Net Profits</b>	<b>5,878</b>	<b>1,283</b>	<b>(78%)</b>	
<b>Revenue by segment</b>				
Trading	7,084	484	(93%)	Unfavorable investment return
Investment management	1,090	677	(38%)	
Brokerage	4,055	2,863	(29%)	Falling market turnover
Investment banking	593	801	35%	
Others	527	925	76%	
<b>Total revenue and other income</b>	<b>13,349</b>	<b>5,749</b>	<b>(57%)</b>	
<b>Ratios</b>				
Operating margin	56.5%	24.8%		
Net margin	44.0%	22.3%		
ROAE	22.3%	3.7%		

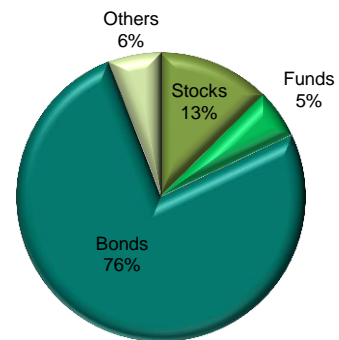
Source(s): Company, ABCI Securities

**Exhibit 3: 1H16 sales breakdown**



Source(s): Company, ABCI Securities

**Exhibit 4: Asset allocation of trading assets (June 2016)**



Source(s): Company, ABCI Securities



## Financial Summary

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

FY Ended Dec 31 (RMB mn)	2014A	2015A	2016E	2017E	2018E
Fee and commission income	2,460	6,621	5,187	5,660	6,461
Interest income	1,446	4,290	4,400	5,000	5,600
Investment income	3,906	9,342	2,000	2,500	2,800
<b>Total revenue</b>	<b>7,812</b>	<b>20,253</b>	<b>11,587</b>	<b>13,160</b>	<b>14,861</b>
Other income	76	207	207	207	207
<b>Total revenue and other income</b>	<b>7,888</b>	<b>20,459</b>	<b>11,794</b>	<b>13,367</b>	<b>15,068</b>
<b>Total expenses</b>	<b>5,090</b>	<b>11,397</b>	<b>8,722</b>	<b>9,855</b>	<b>10,900</b>
<b>Operating Profits</b>	<b>2,798</b>	<b>9,062</b>	<b>3,072</b>	<b>3,512</b>	<b>4,168</b>
Share of profit of investments in associates	136	436	524	628	754
<b>Profit before tax</b>	<b>2,934</b>	<b>9,499</b>	<b>3,595</b>	<b>4,140</b>	<b>4,922</b>
Tax	575	2,125	755	869	1,034
<b>Profit after tax</b>	<b>2,137</b>	<b>7,374</b>	<b>2,840</b>	<b>3,271</b>	<b>3,888</b>
Minority interests	17	49	19	21	25
<b>Profits attributable to shareholders</b>	<b>2,120</b>	<b>7,325</b>	<b>2,822</b>	<b>3,249</b>	<b>3,863</b>
<b>Growth</b>					
Total revenue and other income (%)	72.0	159.4	(42.4)	13.3	12.7
Total expenses	42.3	123.9	(23.5)	13.0	10.6
Operating Profits (%)	176.9	223.9	(66.1)	14.3	18.7
Net profit (%)	132.5	212.7	(61.5)	15.2	18.9
<b>Operating performance</b>					
Operating margin (%)	35.5	44.3	26.0	26.3	27.7
Net margin (%)	27.1	36.2	24.4	24.7	26.0
ROAE (%)	13.8	27.5	7.6	7.9	8.9
ROAA (%)	2.8	4.6	1.4	1.6	1.8

Source(s): Company, ABCI Securities estimates



Consolidated balance sheet (2014A-2018E)

As of Dec 31 (RMB mn)	2014A	2015A	2016E	2017E	2018E
Property and equipment	1,537	1,719	1,804	1,895	1,989
Goodwill	32	32	32	32	32
Other intangible assets	86	97	101	106	112
Investment in associates and JV	1,004	1,909	2,004	2,104	2,209
AFS	2,893	11,369	11,938	12,535	13,161
Financial assets held under resale agreements	5,482	10,210	10,720	11,256	11,819
Deposits with exchanges and a non-bank financial institution	-	-	-	-	-
Other non-current assets	1,321	612	642	674	708
<b>Total non-current assets</b>	<b>12,354</b>	<b>25,946</b>	<b>27,242</b>	<b>28,602</b>	<b>30,031</b>
Cash & equivalents	23,803	55,344	54,836	57,010	59,612
Clearing settlement funds	5,649	8,825	7,060	7,413	7,784
AFS	37,540	48,507	53,358	56,026	58,827
Financial assets at FVTPL	7,274	31,871	22,310	23,425	24,596
Financial assets held for trading	0	0	0	0	0
Derivatives	57	77	81	85	89
Other current assets	757	1,060	848	890	935
Other receivables and prepayments	2,113	5,737	4,338	4,555	4,783
Advances to customers	9,946	14,241	11,393	11,962	12,561
Financial assets held under resale agreements	8,037	16,289	19,546	20,524	21,550
<b>Total current assets</b>	<b>95,175</b>	<b>181,951</b>	<b>173,770</b>	<b>181,891</b>	<b>190,737</b>
<b>Total assets</b>	<b>107,529</b>	<b>207,897</b>	<b>201,012</b>	<b>210,493</b>	<b>220,768</b>
Accounts payable	21,783	43,193	34,554	36,282	38,096
Loans and debt	6,985	15,365	22,217	22,472	22,740
Financial liabilities at FV through P/L	878	3,147	3,305	3,470	3,643
Financing instrument payables	6,780	8,396	8,816	9,257	9,719
Other current liabilities	38,840	42,662	44,795	47,035	49,386
<b>Total current liabilities</b>	<b>75,266</b>	<b>112,763</b>	<b>113,687</b>	<b>118,515</b>	<b>123,585</b>
Financial assets sold under repurchase agreements	94	11,215	5,608	5,888	6,182
Loans and bonds payables	363	385	405	425	446
Financing instrument payables	501	977	1,025	1,077	1,131
Other non-current liabilities	12,680	47,181	40,104	42,109	44,215
<b>Total non-current liabilities</b>	<b>13,637</b>	<b>59,758</b>	<b>47,142</b>	<b>49,499</b>	<b>51,974</b>
<b>Total liabilities</b>	<b>88,904</b>	<b>172,521</b>	<b>160,828</b>	<b>168,014</b>	<b>175,559</b>
<b>Net current assets</b>	<b>19,908</b>	<b>69,188</b>	<b>60,083</b>	<b>63,376</b>	<b>67,152</b>
Equity attributable to owners of the parent	18,353	34,958	39,747	42,022	44,726
Minority interest	272	418	436	458	483
<b>Total equity</b>	<b>18,625</b>	<b>35,376</b>	<b>40,183</b>	<b>42,479</b>	<b>45,209</b>

Source(s): Company, ABCI Securities estimates



October 25, 2016  
Company Report  
Rating: HOLD  
TP: HK\$ 11.40

Share price (HK\$)	11.70
Est. share price return	(2.2%)
Est. dividend yield	0.0%
Est. total return	(2.2%)

Analyst : Steve Chow  
Tel: (852) 2147 8809  
Email: stevechow@abci.com.hk

**Key Data**

52Wk H/L(HK\$)	13.6/9.5
Issued shares (mn)	2,307
H-shares (mn)	1,520
Unlisted shares (mn)	787
H-share market cap (HK\$ mn)	17,330
3-mth avg daily turnover (HK\$ mn)	18
Major shareholder(s) (%):	
Huijin	28.45%
GIC	11.84%
TPG	7.45%
KKR	7.23%

Source(s): Company, Bloomberg, ABCI Securities

**1H16 Sales breakdown (%)**

Equity	28.9
Investment banking	22.7
FICC	18.5
Wealth Management	16.2
Investment Management	10.3
Others	3.4

Source(s): Company, ABCI Securities

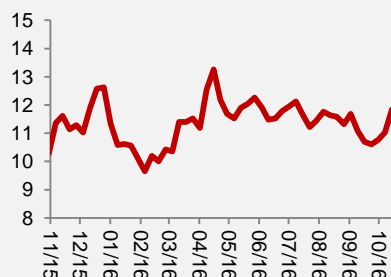
**Share performance (%)**

	Absolute	Relative*
1-mth	1.6	4.7
3-mth	(5.3)	11.3
6-mth	17.2	19.9

\*Relative to HSI

Source(s): Bloomberg, ABCI Securities

**1-Year stock performance (HK\$)**



Source(s): Bloomberg, ABCI Securities

**CICC (3908 HK)**

**Intensified competition in investment banking**

- 1H16 profit dropped by 49% YoY to RMB 575mn because of the 34% decline in revenue
- Revenue from investment banking fell 27% on intensified competition despite positive outlook of the specific segment
- Watch out for potential impact from the CSRC's downgrade from "AA" to "A"
- **HOLD** with TP of HK\$ 11.40 based on 1.2x 2017E P/B

**1H16 highlights.** The Group posted a 49% net profit decline to RMB 575mn in 1H16 because of the high base in 1H15 and industry slowdown. Revenue and other income fell 34% to RMB 3.2bn, dragged by 32% and 54% declines in fee and commission income and investment income. Net margin dropped to 17.8% from 23.3% in 1H15 while ROE declined to 3.5% from 13.2% during the same period.

**Intensified competition in investment banking.** In 1H16, investment banking revenue, which accounted for 23% of total revenue, dropped 27% to RMB 730mn. This is inconsistent with the upsurge of activities in China's capital market (e.g. net financing of corporate bonds and stock market equity financing by non-financial enterprises increased by 83% and 53% YoY in 1H16). In our view, the decline in performance implies its market share in the IPO market may have fallen amid intensified competition. On a positive note, its lead underwriting amount for A-share follow-on offerings increased by 196% in 1H16, partially offsetting its lackluster performance in the IPO market.

**Non-investment-banking business: low base ahead. Revenue of non-investment-banking business, including equity, FICC (fixed income instruments, currencies, and commodities), wealth management, and investment management, which collectively accounted for 77% of total revenue, declined by 36% YoY to RMB 2.5bn mainly due to general slowdown in secondary market turnover and falling investment return. On a brighter note, low base in 2H15 would favor YoY comparison for 2H16.**

**Potential impact from CSRC's downgrade.** CSRC has recently downgraded H-listed brokers, including CITIC (6030 HK), Galaxy (6881 HK), GF (1776 HK), Haitong (6837 HK), Huatai (6886 HK), and CICC (3908 HK) from "AA" to lower levels. In our view, a lower regulatory rating could adversely affect business development, funding channels, financing cost, and capital requirement. Nonetheless, the downgrade was one-notch ("AA" to "A") for CICC; as compared to the two-notch demotion ("AA" to "BBB") for some of its abovementioned peers.

**HOLD with TP of HK\$ 11.40.** We expect net profit to drop by 45% to RMB 1.1bn in 2016 before restoring a 19% and 20% growth in 2017E and 2018E. We set our TP to HK\$ 11.40, equivalent to 1.2x 2017E P/B.

**Risk factor:** (1) Market risk of financial assets; (2) Credit risk inherent to bond investments and lending business; (3) Market turnover volatility.

**Results and Valuation**

FY ended Dec 31	2014A	2015A	2016E	2017E	2018E
Revenue (RMB mn)	6,156	9,507	6,438	7,478	8,670
Chg (% YoY)	51.4	54.4	(32.3)	16.2	15.9
Net profit (RMB mn)	1,119	1,953	1,081	1,282	1,536
Chg (% YoY)	201.5	74.6	(44.6)	18.6	19.8
Underlying EPS (RMB)	0.7	1.1	0.5	0.6	0.7
Chg (% YoY)	NA	67.2	(58.1)	18.6	19.8
BVPS (RMB)	4.8	7.1	7.6	8.2	8.8
Chg (% YoY)	NA	48.7	6.6	7.3	8.2
Underlying P/E (x)	15.1	9.0	21.6	18.2	15.2
P/B (x)	2.1	1.1	1.3	1.2	1.1
ROE (%)	15.1	16.0	6.4	7.1	7.8
ROA (%)	2.6	2.7	1.2	1.3	1.5
DPS(HK\$)	0	0	0	0	0
Yield (%)	na	na	na	na	na

Source(s): Company, ABCI Securities estimates



## 1H16 performance by business segment

**Investment banking.** Investment banking revenue dropped 27% to RMB 730mn in 1H16, which was inconsistent with the structural uptrend in China's capital market where net financing of corporate bonds and stock market equity financing by non-financial enterprises increased by 83% and 53% YoY for the period. In our view, this reflected the Company's declining market share amid intensified competition.

For CICC, its overseas IPO underwriting amount dropped significantly to US\$ 956mn in 1H16 from US\$ 4.1bn in 1H15. The Company completed only 1 IPO each in Hong Kong and Singapore and none in the A-share market during the period. Having said that, the Company still completed 11 A-share equity follow-on offerings as lead underwriters in 1H16, with an aggregate offering size of RMB17.3bn, up 196% YoY.

**Equity.** In 1H16, equity revenue dropped 37% to RMB 931mn, dragged by overall decrease in market turnover and falling investment returns. Its net average brokerage commission rate at 5.7bps was above the industry average, indicating its superior market position. In addition, the Group maintained a leading position in QFII/RQFII market, accounting for 42.2% of the QFII/RQFII market by the number of consumer. The number of QFII/RQFII customers increased by 9 to 186 in 1H16.

**FICC.** In 1H16, the segment's revenue declined by 40% YoY to RMB 595mn due to the volatile market conditions. E.g., the outbreak of credit defaults in Apr 2016 resulted in substantial redemption of bond funds and selling pressure, which in turn drove up yield and credit spread.

**Wealth management.** The segment's revenue fell to RMB 523mn in 1H16, representing a 42% YoY drop due to declines in market turnover and commission rate. Overall, the Group had 28K customers as at June 2016 and asset per account was RMB15mn.

**Asset management.** The segment's revenue fell by 26% YoY to RMB 333mn in 1H16 on less favorable investment environment compared with 1H15. Overall, total AUM reached RMB 130mn in June 2016, compared with RMB 107mn at end-2015. The Company had 235 investment products, most of which were under active management.

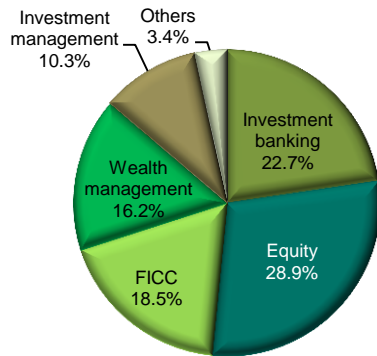


**Exhibit 1: CICC's 1H16 results highlights**

	1H15	1H16	YoY	Comments
Fee and commission income	3,119	2,107	-32%	
Interest income	419	455	9%	
Investment income	1,314	606	-54%	Less favorable market environment
Other income	29	52	77%	
<b>Total revenue and other income</b>	<b>4,881</b>	<b>3,221</b>	<b>-34%</b>	
Total expenses	3,405	2,507	-26%	Cost control
<b>Operating Profits</b>	<b>1,476</b>	<b>714</b>	<b>-52%</b>	
Share of profit of associates	36	26	-29%	
Profit before tax	1,513	739	-51%	
Tax	376	165	-56%	
Profit after tax	1,136	575	-49%	
Minority interests	0	0	N/A	
<b>Net Profits</b>	<b>1,136</b>	<b>575</b>	<b>-49%</b>	
Revenue by segment				
Investment banking	998	730	-27%	Intensified competition
Equity	1,485	931	-37%	Falling market turnover
FICC	995	595	-40%	Outbreak of credit defaults in Apr 2016
Wealth management	900	523	-42%	Falling market turnover
Investment management	449	333	-26%	
Others	54	109	101%	
Total revenue	<b>4,881</b>	<b>3,221</b>	<b>-34%</b>	
Ratios				
Operating margin	30.2%	22.2%		
Net margin	23.3%	17.8%		
ROAE	13.2%	3.5%		

Source(s): Company, ABCI Securities

**Exhibit 2: 1H16 sales breakdown**



Source(s): Company, ABCI Securities

**Exhibit 3 CSRC rating among major H-share brokers**

Company	2015 rating	2016 rating
Orient (3958 HK)	AA	AA
<b>CICC (3908 HK)</b>	<b>AA</b>	<b>A</b>
Galaxy (6881 HK)	AA	A
Guolian (1456 HK)	A	A
CITIC (6030 HK)	AA	BBB
GF (1776 HK)	AA	BBB
Haitong (6837 HK)	AA	BBB
Huatai (6886 HK)	AA	BBB

Source(s): CSRC, ABCI Securities





## Financial Summary

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

FY Ended Dec 31 (RMB mn)	2014A	2015A	2016E	2017E	2018E
Fee and commission income	4,152	6,588	4,093	4,883	5,775
Interest income	450	1,021	1,100	1,250	1,450
Investment income	1,527	1,853	1,200	1,300	1,400
<b>Total revenue</b>	<b>6,128</b>	<b>9,462</b>	<b>6,393</b>	<b>7,433</b>	<b>8,625</b>
Other income	27	45	45	45	45
<b>Total revenue and other income</b>	<b>6,156</b>	<b>9,507</b>	<b>6,438</b>	<b>7,478</b>	<b>8,670</b>
<b>Total expenses</b>	<b>4,717</b>	<b>6,989</b>	<b>5,079</b>	<b>5,864</b>	<b>6,736</b>
<b>Operating Profits</b>	<b>1,438</b>	<b>2,518</b>	<b>1,359</b>	<b>1,614</b>	<b>1,933</b>
Share of profit of investments in associates	68	104	83	95	114
<b>Profit before tax</b>	<b>1,506</b>	<b>2,621</b>	<b>1,442</b>	<b>1,710</b>	<b>2,048</b>
Tax	387	668	360	427	512
<b>Profit after tax</b>	<b>2,137</b>	<b>1,953</b>	<b>1,081</b>	<b>1,282</b>	<b>1,536</b>
Minority interests	0	0	0	0	0
<b>Profits attributable to shareholders</b>	<b>2,137</b>	<b>1,953</b>	<b>1,081</b>	<b>1,282</b>	<b>1,536</b>
<b>Growth</b>					
Total revenue and other income (%)	51.4	54.4	(32.3)	16.2	15.9
Total expenses	30.6	48.2	(27.3)	15.4	14.9
Operating Profits (%)	217.5	75.0	(46.0)	18.8	19.8
Net profit (%)	201.5	74.6	(44.6)	18.6	19.8
<b>Operating performance</b>					
Operating margin (%)	23.4	26.5	21.1	21.6	22.3
Net margin (%)	34.9	20.6	16.9	17.3	17.8
ROAE (%)	15.1	16.0	6.4	7.1	7.8
ROAA (%)	2.6	2.7	1.2	1.3	1.5

Source(s): Company, ABCI Securities estimates



Consolidated balance sheet (2014A-2018E)

As of Dec 31 (RMB mn)	2014A	2015A	2016E	2017E	2018E
Property and equipment	135	166	175	183	193
Other intangible assets	3	1	1	2	2
Investment in associates and JV	565	453	476	499	524
AFS	388	581	610	641	673
Other non-current assets	868	1,258	1,229	1,290	1,355
<b>Total non-current assets</b>	<b>1,959</b>	<b>2,460</b>	<b>2,491</b>	<b>2,615</b>	<b>2,746</b>
Cash & equivalents	3,418	8,434	9,112	9,889	10,894
Clearing settlement funds	11,085	24,301	19,441	20,413	21,433
AFS	46	618	649	681	715
Financial assets at FVTPL	21,654	45,459	50,005	52,505	55,130
Derivatives	732	736	773	811	852
Other current assets	49	95	100	105	110
Other receivables and prepayments	8,678	7,153	5,842	6,134	6,441
Advances to customers	3,458	3,296	2,637	2,769	2,907
Financial assets held under resale agreements	1,622	1,557	1,635	1,717	1,802
<b>Total current assets</b>	<b>50,742</b>	<b>91,649</b>	<b>90,193</b>	<b>95,024</b>	<b>100,285</b>
<b>Total assets</b>	<b>52,701</b>	<b>94,109</b>	<b>92,684</b>	<b>97,639</b>	<b>103,032</b>
Accounts payable	15,054	25,218	20,174	21,183	22,242
Loans and debt	2,430	3,337	3,419	3,505	3,595
Financial liabilities at FV through P/L	7,526	5,584	5,863	6,156	6,464
Other current liabilities	15,377	35,117	36,873	38,716	40,652
<b>Total current liabilities</b>	<b>40,387</b>	<b>69,256</b>	<b>66,329</b>	<b>69,561</b>	<b>72,954</b>
Loans and bonds payables	4,010	6,071	6,375	6,693	7,028
Financing instrument payables	-	1,623	1,704	1,789	1,879
Other non-current liabilities	311	717	752	790	830
<b>Total non-current liabilities</b>	<b>4,321</b>	<b>8,411</b>	<b>8,831</b>	<b>9,273</b>	<b>9,736</b>
<b>Total liabilities</b>	<b>44,708</b>	<b>77,667</b>	<b>75,160</b>	<b>78,833</b>	<b>82,690</b>
<b>Net current assets</b>	<b>10,355</b>	<b>22,393</b>	<b>23,864</b>	<b>25,463</b>	<b>27,332</b>
Equity attributable to owners of the parent	7,992	16,442	17,523	18,806	20,341
Minority interest	-	-	-	-	-
<b>Total equity</b>	<b>7,992</b>	<b>16,442</b>	<b>17,523</b>	<b>18,806</b>	<b>20,341</b>

Source(s): Company, ABCI Securities estimates

## Disclosures

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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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