

# China Galaxy Securities (6881 HK)

## Fee incomes weaker than expected in 4Q19

CGS reported FY19 net profit of RMB 5.2bn, up 81% YoY, in-line with preliminary results. FY19 operating revenue increased 55% YoY to RMB 14.3bn, supported by strong brokerage rebound and prop-trading gains as A-share market significantly recovered, while other fee incomes remained weak. The Company is at disadvantage amid the sped-up capital market reform due to its relatively weak competitiveness in investment banking business and the recent risk-off sentiment may not favor its franchise in brokerage. Maintain HOLD.

- **Results positives: 1) Prop-trading gains +25% QoQ in 4Q19**, maintaining resilient and decent yields throughout the year (5.7% in FY19 vs. 2.6% in FY18). **2) Net interest income +4% QoQ in 4Q19**, attributable to 9% QoQ growth in margin financing balance, with mild increase in debt (+4% QoQ) and declining finance cost trend.
- **Results negatives: 1) Brokerage commission unexpectedly weak (-17% QoQ)**, a much steeper decline than domestic turnover of -8% QoQ, which may indicate pressure from both market share and commission rate in 2H19. **2) Investment banking fee weakness continued (-47% QoQ)**, as equity financing underwriting amount was nil in 4Q19, according to Wind. CGS recorded no IPO underwriting in 3M20, though its three STAR Market IPO in pipeline may lift investment banking fees in coming quarters. **3) Asset management fee -11% QoQ**, showing consistent AUM contraction (-17% YoY/-11% HoH) and limited improvement in fee rates. **4) Impairment losses surged QoQ in 4Q19 though was flat YoY in FY19**. Credit risk was mainly observed from reverse repos (on B/S SPLs) and debt investments in 2H19.
- **Maintain HOLD**. CGS currently trades at 0.45x 1-year forward P/B, close to historical trough of 0.41x. Except for weakness in investment banking, with high exposure to brokerage commission (32% in FY19 revenue), the softening A-share ADT (from >RMB 1tn in late Feb to ~RMB 0.7tn last week) amid heightened market volatility may dampen the Company's profitability more than other brokers we cover. We maintain earnings forecast unchanged, and maintain HOLD rating with TP at HK\$ 4.20.

### Earnings Summary

(YE 31 Dec)	FY18A	FY19A	FY20E	FY21E	FY22E
Adj. op. revenue (RMB mn)	9,239	14,320	14,869	16,540	17,980
Net profit (RMB mn)	2,887	5,228	5,563	6,198	6,780
EPS (RMB)	0.28	0.52	0.55	0.61	0.67
EPS CHG (%)	(28)	81	6	11	9
Consensus EPS (RMB)	N/A	N/A	0.51	0.53	N/A
P/E (x)	11.7	6.5	6.1	5.4	5.0
P/B (x)	0.51	0.48	0.45	0.42	0.40
Yield (%)	2.7	4.8	4.9	5.5	6.0
ROE (%)	4.4	7.6	7.6	8.0	8.3
Adj. financial leverage (x)	3.0	3.5	3.6	3.6	3.8

Source: Company data, Bloomberg, CMBIS estimates

### HOLD (Maintain)

Target Price	HK\$ 4.20
(Previous TP	HK\$ 4.20)
Up/Downside	+13.2%
Current Price	HK\$ 3.71

### China Brokerage Sector

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### Stock Data

Mkt Cap (HK\$ mn)	82,103
Avg 3 mths t/o (HK\$ mn)	90.36
52w High/Low (HK\$)	5.69/3.36
Total Issued Shares (mn)	<b>3,691 (H)</b>
	6,446 (A)

Source: Wind

### Shareholding Structure

China Galaxy Financial Holdings Limited	51.16%
BlackRock, Inc.	2.30%
Wenze Int'l Investment Ltd.	2.17%

Source: Company data

### Share Performance

	Absolute	Relative
1-mth	-13.7%	-4.0%
3-mth	-16.4%	0.4%
6-mth	-10.4%	-1.0%

Source: Wind

### 12-mth Price Performance



Source: Wind

### Auditor: Ernst & Young

### Related Reports

1. "On an upward policy trajectory" – 19 Mar 2020
2. "COVID-19 unlikely to derail industry upswing" – 12 Feb 2020
3. "Policy implementation to light up the road ahead" – 18 Dec 2019
4. "3Q19 earnings held up by prop trading and brokerage" - 29 Oct 2019
5. "Higher earnings visibility given favorable policy environment" – 6 Sep 2019

**Figure 1: CGS's 4Q19 results summary**

(RMB mn)											vs. CMBIS est.
I/S	1Q19	2Q19	3Q19	4Q19	QoQ	4Q18	YoY	FY18	FY19	YoY	
Net fee and commissions	1,429	1,631	1,471	1,242	-16%	1,026	21%	4,805	5,773	20%	-4%
Brokerage	1,145	1,296	1,150	960	-17%	730	31%	3,464	4,551	31%	-5%
Investment banking	103	152	147	78	-47%	112	-31%	531	480	-10%	-3%
Asset Management	163	163	163	145	-11%	174	-17%	747	634	-15%	-2%
Net interest income	742	888	912	950	4%	807	18%	3,445	3,492	1%	0%
Prop trading gains	1,430	686	1,236	1,545	25%	1,056	46%	946	4,897	418%	10%
<b>Adj. op. revenue</b>	<b>3,602</b>	<b>3,247</b>	<b>3,649</b>	<b>3,823</b>	<b>5%</b>	<b>2,916</b>	<b>31%</b>	<b>9,239</b>	<b>14,320</b>	<b>55%</b>	<b>2%</b>
Adj. op. expenses	(1,654)	(1,765)	(1,904)	(1,756)	-8%	(1,551)	13%	(5,149)	(7,079)	37%	-1%
<b>PPoP</b>	<b>1,948</b>	<b>1,482</b>	<b>1,744</b>	<b>2,067</b>	<b>18%</b>	<b>1,365</b>	<b>51%</b>	<b>4,090</b>	<b>7,241</b>	<b>77%</b>	<b>5%</b>
Provision	54	(87)	(21)	(356)	1599%	(92)	288%	(408)	(410)	1%	467%
<b>Pre-tax profit</b>	<b>2,001</b>	<b>1,395</b>	<b>1,723</b>	<b>1,711</b>	<b>-1%</b>	<b>1,273</b>	<b>34%</b>	<b>3,682</b>	<b>6,830</b>	<b>85%</b>	<b>0%</b>
Income tax expense	(459)	(332)	(449)	(340)	-24%	(245)	39%	(750)	(1,580)	111%	3%
<b>Net profit</b>	<b>1,533</b>	<b>1,062</b>	<b>1,265</b>	<b>1,368</b>	<b>8%</b>	<b>1,018</b>	<b>34%</b>	<b>2,887</b>	<b>5,228</b>	<b>81%</b>	<b>0%</b>
<b>B/S</b>	<b>1Q19</b>	<b>2Q19</b>	<b>3Q19</b>	<b>4Q19</b>	<b>QoQ</b>	<b>4Q18</b>	<b>YoY</b>	<b>FY18</b>	<b>FY19</b>	<b>YTD</b>	
Margin accounts	51,060	53,148	53,806	58,721	9%	47,376	24%	44,632	51,060	14%	
Financial investment	108,275	104,005	108,061	121,437	12%	84,011	45%	92,477	108,275	17%	
Reverse repos	38,982	33,140	34,816	30,438	-13%	42,400	-28%	39,967	38,982	-2%	
Customer deposits	83,594	82,959	79,496	80,509	1%	59,302	36%	56,695	83,594	47%	
Total shareholder's equity	67,966	68,137	69,494	70,896	2%	65,517	8%	65,982	67,966	3%	
<b>Ratios</b>	<b>1Q19</b>	<b>2Q19</b>	<b>3Q19</b>	<b>4Q19</b>	<b>QoQ</b>	<b>4Q18</b>	<b>YoY</b>	<b>FY18</b>	<b>FY19</b>	<b>YoY</b>	
ROE	9.2%	6.2%	7.4%	7.8%	0.4ppt	6.2%	1.6ppt	4.4%	7.6%	3.2ppt	
ROA	2.2%	1.4%	1.6%	1.8%	0.1ppt	1.6%	0.2ppt	1.1%	1.8%	0.7ppt	
Leverage	3.3x	3.6x	3.3x	3.5x	0.2x	3.0x	0.5x	3.0x	3.5x	0.5x	
Investment yield	5.7%	2.6%	4.7%	5.4%	0.7ppt	4.8%	0.6ppt	2.6%	5.7%	3.1ppt	
Cost-to-income ratio	45%	53%	51%	45%	-6ppt	52%	-7ppt	55%	49%	-6ppt	

Source: Company data, CMBIS

## Financial Summary

### Income statement

YE 31 Dec (RMB mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Brokerage commission	3,464	4,551	6,342	7,090	7,712
Investment banking fee	531	480	519	546	568
Asset management fee	747	634	610	627	659
Net interest income	3,445	3,492	3,679	4,037	4,392
Prop-trading gains	946	4,897	3,612	4,164	4,573
Others	107	266	107	77	77
<b>Adj. op. revenue</b>	<b>9,239</b>	<b>14,320</b>	<b>14,869</b>	<b>16,540</b>	<b>17,980</b>
Adj. op. expenses	(5,149)	(7,079)	(7,644)	(8,477)	(9,170)
PPoP	4,090	7,241	7,225	8,063	8,810
Provision	(408)	(410)	(58)	(52)	(47)
Pre-tax profit	3,682	6,830	7,167	8,011	8,764
Income tax expense	(750)	(1,580)	(1,570)	(1,762)	(1,928)
Minority interests	(45)	(22)	(34)	(50)	(55)
<b>Net profit</b>	<b>2,887</b>	<b>5,228</b>	<b>5,563</b>	<b>6,198</b>	<b>6,780</b>

### Balance sheet

YE 31 Dec (RMB mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Deposit held on behalf of clients	42,529	60,282	82,728	91,692	100,929
Clearing reserves	12,687	11,276	20,682	22,923	25,232
Margin accounts	44,632	58,721	64,158	69,933	74,129
Reverse repos	39,967	30,438	37,985	40,264	41,874
Financial investments	92,477	121,437	129,190	139,525	146,501
Other assets	19,072	33,511	31,196	29,586	42,112
<b>Total assets</b>	<b>251,363</b>	<b>315,666</b>	<b>365,939</b>	<b>393,922</b>	<b>430,777</b>
Customer brokerage deposits	56,695	80,509	105,065	115,532	137,263
Short-term debts	39,833	86,468	73,068	78,913	83,329
Long-term debts	79,501	64,023	90,155	96,465	101,289
Other liabilities	8,996	12,744	21,602	22,333	23,174
<b>Total liabilities</b>	<b>185,025</b>	<b>243,744</b>	<b>289,889</b>	<b>313,244</b>	<b>345,054</b>
<b>Total shareholders' equity</b>	<b>65,982</b>	<b>70,896</b>	<b>74,930</b>	<b>79,502</b>	<b>84,511</b>
Incl. Perpetual bonds	0	0	0	0	0
Minority interest	356	1,026	1,121	1,177	1,212

### Key Ratios

YE 31 Dec (RMB mn)	FY18A	FY19A	FY20E	FY21E	FY22E
<b>Operating revenue mix</b>					
Brokerage commission	37%	32%	43%	43%	43%
Investment banking fee	6%	3%	3%	3%	3%
Asset management fee	8%	4%	4%	4%	4%
Net interest income	37%	24%	25%	24%	24%
Prop-trading gains	10%	34%	24%	25%	25%
Others	1%	2%	1%	0%	0%
<b>Total</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>
<b>Growth, YoY</b>					
Brokerage commission	-27%	31%	39%	12%	9%
Investment banking fee	-5%	-10%	8%	5%	4%
Asset management fee	7%	-15%	-4%	3%	5%
Net interest income	15%	1%	5%	10%	9%
Prop-trading gains	-58%	418%	-26%	15%	10%
<b>Adj. op. revenue</b>	<b>-18%</b>	<b>55%</b>	<b>4%</b>	<b>11%</b>	<b>9%</b>
PPoP	-26%	77%	0%	12%	9%
<b>Net profit</b>	<b>-27%</b>	<b>81%</b>	<b>6%</b>	<b>11%</b>	<b>9%</b>
Total assets	-1%	26%	16%	8%	9%
<b>Efficiency</b>					
Cost-to-income ratio	55%	49%	50%	50%	50%
<b>Leverage</b>					
Adj. financial leverage (x)	3.0	3.5	3.6	3.6	3.8
Investment/ equity	140%	171%	172%	175%	173%
<b>Profitability</b>					
ROE	4.4%	7.6%	7.6%	8.0%	8.3%
ROA	1.1%	1.8%	1.6%	1.6%	1.6%
<b>Per share</b>					
EPS (RMB)	0.28	0.52	0.55	0.61	0.67
DPS (RMB)	0.09	0.16	0.16	0.18	0.20
BVPS (RMB)	6.51	6.99	7.39	7.84	8.34

Source: Company data, CMBIS estimates

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