

China Galaxy Securities (6881 HK)

3Q19 earnings held up by prop trading and brokerage

CGS reported 9M19 net profit of RMB 3.9bn, up 107% YoY, accounting for 84%/86% of CMBIS/consensus FY19 estimates. 3Q19 operating revenue increased 12% QoQ, mainly on decent prop-trading gains and resilient brokerage commission income. Improved operating efficiency and lower provision also helped bottom-line to grow 19% QoQ to RMB 1.3bn. 3Q19 annualized ROE rebounded 1.2ppt QoQ to 7.4%. The results was not bad, but we see limited upside potential ahead given 1) already big re-rating YTD and 2) CGS's lacking structural growth potential. Maintain HOLD.

■ **Results positives:** 1) **Brokerage income was quite resilient**, as A-share ADT contracted 23% QoQ to RMB 454bn in 3Q19, while CGS's brokerage commission declined only 11% QoQ. This may be attributable to the activeness of retail investors which it has large exposure to. 2) **Prop-trading gains delivered strong performance** (+80% QoQ), with investment yield jumping to 4.7%, up 2.1ppt QoQ, likely due to better return from bond investment (ChinaBond Aggregate Index +1.4% QoQ in 3Q19 vs. CSI 300 Index -0.3% QoQ). 3) **Impairment losses decreased** 76% QoQ/79% YoY, as SPL-related risks mitigated amid a stabilizing market condition.

■ **Results negatives:** 1) **Investment banking continued to be the biggest weakness**, as fee income was down 3% QoQ despite the STAR Market launch boom. IPO financing amount surged 129% QoQ in 3Q19 and STAR Market IPOs accounted for 60% of it, yet CGS had no sponsored company listed on the new board. Recently, SSE has sped up the registration process of STAR Market IPOs, and estimated ~100 listings by the end of 2019 (currently 35 listed). As CGS has only one sponsored applicant on STAR Market, we expect its investment banking fee to remain subdued in 4Q19. 2) **Asset management fee was flat QoQ/ down 15% YoY**, showing continuing pressure from new asset management rules. 3) **Net interest income probably dipped slightly QoQ** after excluding the reclassification of bond interests, as margin financing (+1% QoQ) expanded slower than market (+4% QoQ), indicating possible share loss.

■ **Maintain HOLD.** CGS currently trades at 0.54x FY19E P/B, 7% below its historical average minus 1SD (0.58x). The valuation is low but we believe this could be justified by its weaker structural growth potential. The stock has gained 21% YTD, outpacing sector's average of 2% and HSI Index's 4%. Its higher correlation with stock market ADT rebound should be largely priced in. Maintain HOLD on CGS with TP at HK\$ 4.5.

Earnings Summary

(YE 31 Dec)	FY17A	FY18A	FY19E	FY20E	FY21E
Adj. op. revenue (RMB mn)	11,304	9,239	12,298	13,257	14,805
Net profit (RMB mn)	3,981	2,887	4,606	4,998	5,704
EPS (RMB)	0.39	0.28	0.45	0.49	0.56
EPS CHG (%)	(27)	(28)	60	9	14
P/E (x)	9.5	13.1	8.2	7.6	6.6
P/B (x)	0.59	0.57	0.54	0.51	0.49
Yield (%)	3.2	2.4	3.6	4.0	4.5
ROAE (%)	6.5	4.4	6.8	6.9	7.5
Financial leverage (x)	3.0	3.0	3.3	3.4	3.4

Source: Company data, CMBIS estimates

HOLD (Maintain)

Target Price	HK\$4.50
(Previous TP)	HK\$4.50)
Up/Downside	+7.9%
Current Price	HK\$4.17

China Brokerage Sector

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Stock Data

Mkt Cap (HK\$ mn)	92,823
Avg 3 mths t/o (HK\$ mn)	78.11
52w High/Low (HK\$)	6.06/3.37
Total Issued Shares (mn)	3,691 (H)
	6,446 (A)

Source: Bloomberg

Shareholding Structure

China Galaxy Financial Holdings Limited	51.16%
BlackRock, Inc.	2.30%
Wenze International Investment Limited	2.17%

Source: Company data

Share Performance

	Absolute	Relative
1-mth	-0.5%	-3.1%
3-mth	-5.5%	0.6%
6-mth	-21.4%	-12.7%

Source: Bloomberg

12-mth Price Performance



Source: Bloomberg

Auditor: Ernst & Young

Related Reports

1. "Higher earnings visibility given favorable policy environment" – 6 Sep 2019
2. "Valuation close to trough - attractive risk/reward" – 19 Jun 2019

Figure 1: CGS's 3Q19 results summary

(RMB mn)

I/S	4Q18	1Q19	2Q19	3Q19	QoQ	3Q18	YoY	9M18	9M19	YoY
Net fee and commission income	1,026	1,429	1,631	1,471	-10%	1,037	42%	3,779	4,531	20%
Brokerage	730	1,145	1,296	1,150	-11%	761	51%	2,733	3,591	31%
Investment banking	112	103	152	147	-3%	85	73%	418	402	-4%
Asset Management	174	163	163	163	0%	190	-14%	572	489	-15%
Net interest income*	807	742	888	912	3%	883	3%	2,637	2,542	-4%
Prop trading gains*	1,056	1,430	686	1,236	80%	118	946%	(111)	3,352	N/A
Adj. op. revenue	2,916	3,602	3,247	3,649	12%	2,008	82%	6,323	10,498	66%
Adj. op. expenses	(1,551)	(1,654)	(1,765)	(1,904)	8%	(1,216)	57%	(3,598)	(5,323)	48%
PPoP	1,365	1,948	1,482	1,744	18%	791	120%	2,725	5,174	90%
Provision	(92)	54	(87)	(21)	-76%	(102)	-79%	(317)	(55)	-83%
Pre-tax profit	1,273	2,001	1,395	1,723	24%	689	150%	2,409	5,120	113%
Income tax expense	(245)	(459)	(332)	(449)	35%	(120)	274%	(505)	(1,240)	145%
Net profit	1,018	1,533	1,062	1,265	19%	559	126%	1,869	3,860	107%
B/S	4Q18	1Q19	2Q19	3Q19	QoQ	3Q18	YoY	FY18	3Q19	YTD
Margin accounts	44,632	51,060	53,148	53,806	1%	47,376	14%	44,632	53,806	21%
Financial investment	92,477	108,275	104,005	108,061	4%	84,011	29%	92,477	108,061	17%
Reverse repos	39,967	38,982	33,140	34,816	5%	42,400	-18%	39,967	34,816	-13%
Customer brokerage deposits	56,695	83,594	82,959	79,496	-4%	59,302	34%	56,695	79,496	40%
Total shareholder's equity	65,982	67,966	68,137	69,494	2%	65,517	6%	65,982	69,494	5%
Ratios	4Q18	1Q19	2Q19	3Q19	QoQ	3Q18	YoY	9M18	9M19	YoY
ROAE	6.2%	9.2%	6.2%	7.4%	1.2ppt	3.4%	4.0ppt	3.8%	7.8%	4.0ppt
ROAA	1.6%	2.2%	1.4%	1.6%	0.3ppt	0.9%	0.7ppt	1.0%	2.0%	1.0ppt
Leverage	3.0x	3.3x	3.6x	3.3x	-0.3x	3.1x	0.2x	3.1x	3.3x	0.2x
Investment yield	4.8%	5.7%	2.6%	4.7%	2.1ppt	0.6%	4.1ppt	-0.2%	4.5%	4.7ppt
Cost-to-income ratio	52%	45%	53%	51%	-2ppt	59%	-8ppt	56%	50%	-6ppt

Source: Company data, CMBIS

*: Adjusted for reclassification of interest income from other debt investments.

Financial Summary

Income statement

YE 31 Dec (RMB mn)	FY17A	FY18A	FY19E	FY20E	FY21E
Brokerage commission	4,757	3,464	4,242	4,623	5,211
Investment banking fee	557	531	459	530	623
Asset management fee	700	747	632	616	663
Net interest income	2,986	2,267	1,985	2,267	2,529
Prop-trading gains	2,256	2,123	4,868	5,115	5,702
Others	48	107	111	107	77
Adj. op. revenue	11,304	9,239	12,298	13,257	14,805
Adj. op. expenses	(5,813)	(5,149)	(6,245)	(6,878)	(7,550)
PPoP	5,491	4,090	6,053	6,379	7,254
Provision	(682)	(408)	(150)	(97)	(62)
Pre-tax profit	4,809	3,682	5,903	6,282	7,193
Income tax expense	(790)	(750)	(1,265)	(1,250)	(1,439)
Minority interests	(38)	(45)	(32)	(34)	(50)
Net profit	3,981	2,887	4,606	4,998	5,704

Balance sheet

YE 31 Dec (RMB mn)	FY17A	FY18A	FY19E	FY20E	FY21E
Deposit held on behalf of clients	50,777	42,529	58,010	61,383	68,241
Clearing reserves	12,538	12,687	12,960	15,005	17,060
Margin accounts	60,064	44,632	54,451	59,896	64,688
Reverse repos	38,256	39,967	35,171	37,281	39,518
Financial investments	71,250	92,477	106,348	115,920	124,034
Other assets	21,929	19,072	36,467	34,351	35,295
Total assets	254,815	251,363	303,407	323,835	348,836
Customer brokerage deposits	64,787	56,695	73,673	77,956	85,983
Short-term debts	50,095	39,833	59,602	65,100	70,308
Long-term debts	62,881	79,501	77,911	84,144	90,876
Other liabilities	12,166	8,996	20,896	21,602	22,333
Total liabilities	189,929	185,025	232,083	248,802	269,501
Total shareholders' equity	64,513	65,982	70,168	73,819	78,060
Incl. Perpetual bonds	0	0	0	0	0
Minority interest	373	356	1,156	1,214	1,275

Key Ratios

YE 31 Dec (RMB mn)	FY17A	FY18A	FY19E	FY20E	FY21E
Operating revenue mix					
Brokerage commission	42%	37%	34%	35%	35%
Investment banking fee	5%	6%	4%	4%	4%
Asset management fee	6%	8%	5%	5%	4%
Net interest income	26%	25%	16%	17%	17%
Prop-trading gains	20%	23%	40%	39%	39%
Others	0%	1%	1%	1%	1%
Total	100%	100%	100%	100%	100%
Growth, YoY					
Brokerage commission	-22%	-27%	22%	9%	13%
Investment banking fee	-46%	-5%	-14%	16%	17%
Asset management fee	54%	7%	-15%	-3%	8%
Net interest income	21%	-24%	-12%	14%	12%
Prop-trading gains	-25%	-6%	129%	5%	11%
Adj. op. revenue	-15%	-18%	33%	8%	12%
PPoP	-20%	-26%	48%	5%	14%
Net profit	-23%	-27%	60%	9%	14%
Total assets	4%	-1%	21%	7%	8%
Efficiency					
Cost-to-income ratio	51%	55%	50%	51%	50%
Leverage					
Adj. financial leverage (x)	3.0	3.0	3.3	3.4	3.4
Investment/ equity	110%	140%	152%	157%	159%
Profitability					
ROE	6.5%	4.4%	6.8%	6.9%	7.5%
ROA	1.6%	1.1%	1.7%	1.6%	1.7%
Per share					
EPS (RMB)	0.39	0.28	0.45	0.49	0.56
DPS (RMB)	0.12	0.09	0.14	0.15	0.17
BVPS (RMB)	6.36	6.51	6.92	7.28	7.70

Source: Company data, CMBIS estimates

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