

# China Brokerage Sector

## Structural changes occurring; valuation attractive to play beta

We've seen gradual structural changes to China brokers revenue mix in FY20, where IB and AM, two business lines we believe brokers' long-term competitiveness thrives from, achieved faster growth, thanks to progress in capital market reforms and transformation of WM and AM. After two years of profitability improvement, China brokers still trades at 2-year low. We see limited downside here and brokers are good proxy to capture potential market sentiment recovery as long as liquidity is not getting too tight. **We maintain OUTPERFORM rating on the sector and our top picks CITICS (6030 HK) and CICC (3908 HK).**

■ **FY20 results recap: Fee growth outpacing capital-based income; leaders gaining shares.** Our covered brokers reported 32% YoY aggregate op. revenue growth, where fee incomes (brokerage+IB+AM) saw higher growth (+47% YoY) and % in total op. rev. picked up 5ppt YoY to 50%. We see this change stemming from 1) accelerated WM transformation and growing asset allocation demand to stocks, 2) implementation of registration-based IPO system that boosted equity financing demands; and 3) mutual fund issuance boom that spurred fund mgmt. AUM. Besides, market consolidation trend was clear across business lines. We see emerging equity financing demand after rapid leverage-up, e.g. CSC, while CITICS already announced plan.

■ **1H21E outlook: Fees and NII to grow on low base; prop-trading a key swing factor.** 2021 YTD market activity remained robust despite volatility in stock market. We expect leaders to continue share gain in brokerage and AM amid ongoing institutionalization, while IB will exhibit divergence as recent tightening IPO rules may slow some brokers' income; the implementation of registration-based IPO system to the whole market is not likely in near term. Brokers with strong overseas IB franchise tend to perform better in 1H21E, in our view. NII is also likely to YoY increase on higher avg. balance. Regarding prop-trading, those gained from stock market rally last year, are faced with potential lower investment yield in FY21E.

■ **Current valuation attractive to welcome sentiment recovery. Maintain OUTPERFORM.** Despite consecutive ROE recovery since 2018, China brokers are still trading undemandingly at 0.7x forward P/B, or at three-year average minus 1SD. The sector is also lagging behind other China H-share financials, down 2% on avg. YTD, vs. China banks +14%/China insurers +2%. We think current market activity is still healthy and any recovery of sentiment could potentially boost brokers' share price performance. **Top picks are CICC (3908 HK) and CITICS (6030 HK). Key risks: 1) tighter-than-expected liquidity; 2) slower-than-expected capital market reforms; 3) stock market plummet.**

### Valuation Table

Name	Ticker	Price (HK\$)	TP (HK\$)	Rating	P/B (x) FY21E	P/E (x) FY21E	Yield FY21E	ROE FY21E
CICC	3908 HK	19.08	23.00	BUY	1.04	10.0	1.1%	10.9%
CITICS	6030 HK	19.04	22.40	BUY	1.05	11.8	3.4%	9.2%
CSC	6066 HK	9.80	13.70	BUY	0.85	6.8	4.3%	13.2%
HTSC	6886 HK	11.30	15.80	BUY	0.62	7.2	4.2%	8.8%
HTS	6837 HK	6.87	8.80	BUY	0.46	6.3	4.8%	7.5%
GFS	1776 HK	11.62	13.10	HOLD	0.70	7.2	4.9%	10.1%
CGS	6881 HK	4.70	5.50	HOLD	0.46	5.7	5.3%	8.3%
<b>Average</b>					<b>0.74</b>	<b>7.85</b>	<b>4.0%</b>	<b>9.7%</b>

Source: Bloomberg, CMBIS estimates

**OUTPERFORM**  
(Maintain)

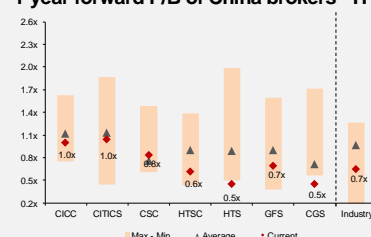
### China Brokerage Sector

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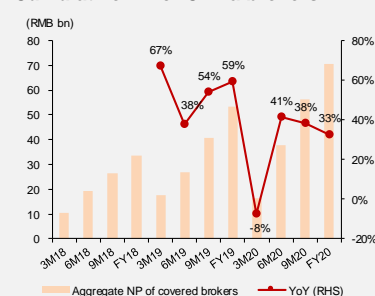
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### 1-year forward P/B of China brokers - H



Source: Bloomberg, CMBIS estimates

### Cumulative NP of China brokers



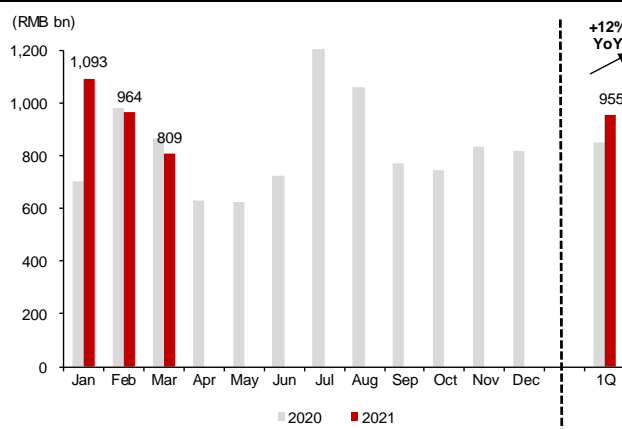
Source: Company data, CMBIS

### Related Reports

1. "3Q20 results wrap: growth on robust fee incomes" – 2 Nov 2020
2. "Optimism & reform suggest more earnings upsides" – 9 Jul 2020
3. "Reform acceleration could drive further divergence" – 12 May 2020
4. "Resilient Mar set for better-than-expected 1Q20E results" – 14 Apr 2020
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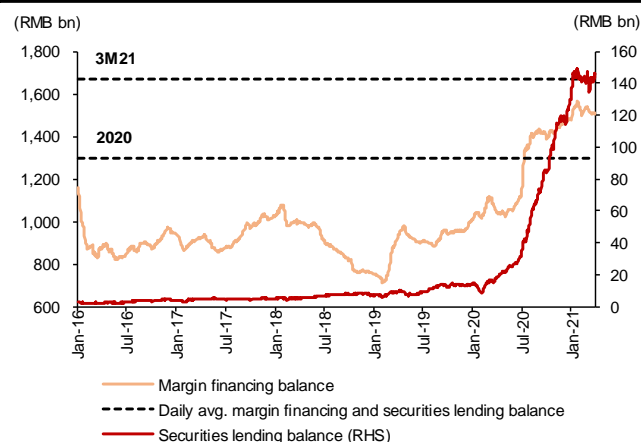
## FY21 YTD market indicators in charts

**Figure 1: A-share ADT softened in Feb-Mar 2021 after a surge in Jan; 1Q21 ADT +12% YoY**



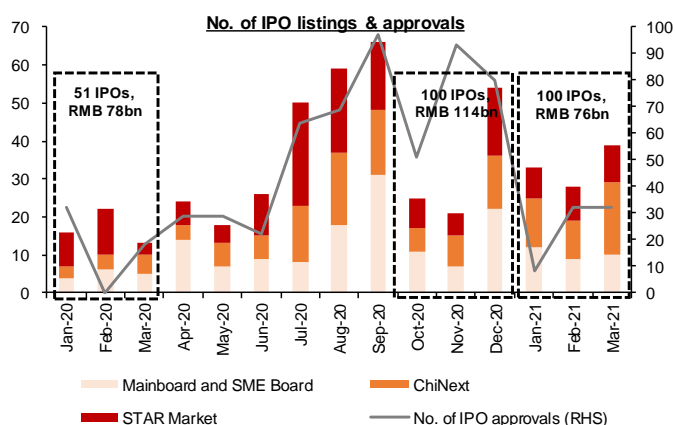
Source: Wind, CMBIS  
Note: data as of 31 Mar, 2021.

**Figure 2: Margin financing and securities lending stabilized at post-2015 high in 3M21**



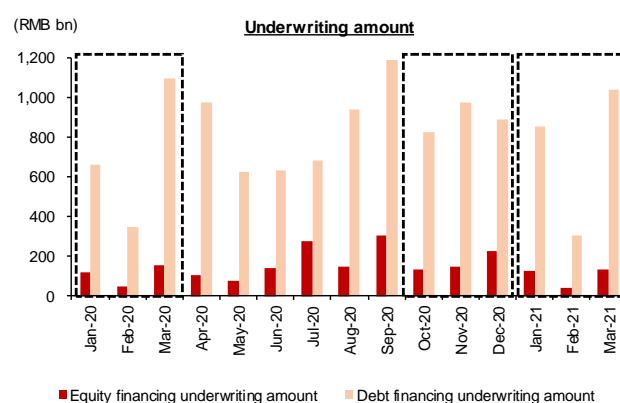
Source: Wind, CMBIS  
Note: data as of 31 Mar, 2021.

**Figure 3: 1Q21 IPO issuance pace remained stable QoQ while approval pace slowed down**



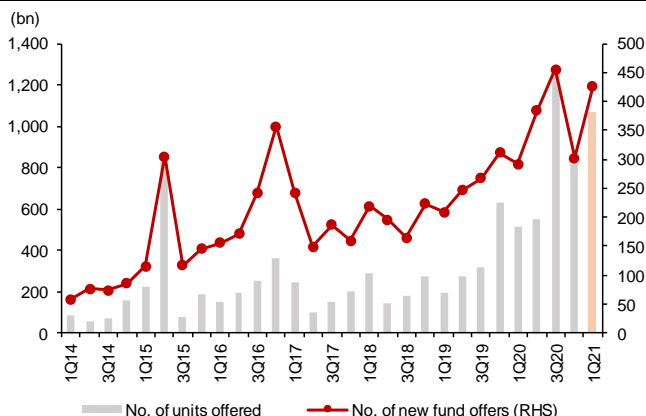
Source: Wind, CMBIS  
Note: data as of 31 Mar, 2021.

**Figure 4: 1Q21 Equity and debt underwriting amount was flat YoY but decreased QoQ**



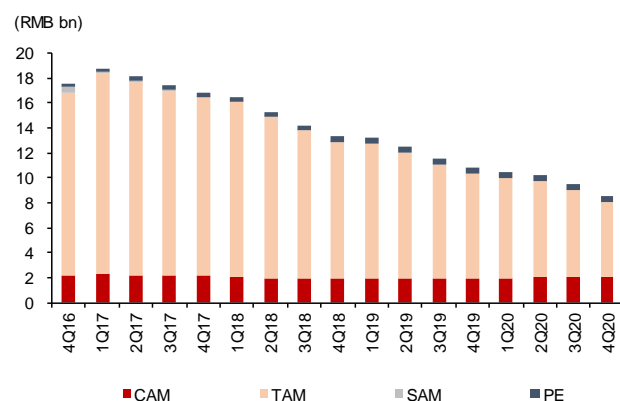
Source: Wind, CMBIS  
Note: data as of 31 Mar, 2021.

**Figure 5: Domestic mutual fund product issuance boom continued in 1Q21**



Source: Wind, CMBIS  
Note: data as of 31 Mar, 2021.

**Figure 6: AUM of brokers' AM continuously contracted while CAM began to stabilize since 2Q20**



Source: Wind, CMBIS

**Figure 7: China brokers' FY20 results comparison**

FY20	CITICS 6030 HK	HTS 6837 HK	HTSC 6886 HK	GFS 1776 HK	CSC 6066 HK	CGS 6881 HK	CICC 3908 HK
<b>(RMB mn)</b>							
<b>I/S</b>							
Brokerage commission	11,252	5,208	6,460	6,571	4,836	6,921	4,610
Investment banking fees	6,882	4,939	3,644	649	5,857	950	5,956
Asset mgmt. fees*	8,006	3,372	3,155	6,598	1,292	592	3,059
Net interest income^	2,587	4,891	2,605	4,254	1,331	4,178	(1,069)
Prop-trading gains	17,907	11,077	10,160	6,808	8,673	4,828	13,159
Other income and gains	1,456	2,997	4,161	2,489	117	146	(2,091)
<b>Adj. op. revenue</b>	<b>48,089</b>	<b>32,483</b>	<b>30,185</b>	<b>27,369</b>	<b>22,106</b>	<b>17,615</b>	<b>23,624</b>
Adj. op. expenses	(20,543)	(12,129)	(15,375)	(12,914)	(8,584)	(7,962)	(13,939)
<b>PPoP</b>	<b>27,546</b>	<b>20,354</b>	<b>14,810</b>	<b>14,455</b>	<b>13,522</b>	<b>9,652</b>	<b>9,685</b>
Provision	(7,076)	(4,597)	(1,306)	(856)	(1,396)	(496)	(973)
<b>Net profit</b>	<b>14,902</b>	<b>10,875</b>	<b>10,822</b>	<b>10,038</b>	<b>9,509</b>	<b>7,244</b>	<b>7,207</b>
<b>B/S</b>							
Margin accounts	116,741	73,068	102,574	86,153	46,515	82,018	33,885
Reverse repos	39,227	57,965	19,536	16,794	16,117	31,863	18,431
Financial investment	486,017	253,507	339,053	200,012	186,753	184,435	284,818
Borrowings and bonds	181,712	153,448	129,072	98,162	67,735	81,255	214,111
<b>Key ratios</b>							
ROE	8.7%	7.8%	8.6%	10.6%	15.3%	9.5%	12.6%
ROA	1.6%	1.6%	1.7%	2.4%	2.9%	1.9%	1.7%
Financial leverage	4.7x	3.8x	4.5x	3.6x	4.4x	4.3x	6.3x
Investment yield	4.3%	4.6%	3.6%	5.3%	6.4%	4.4%	5.9%
Cost-to-income ratio	42%	37%	50%	47%	38%	44%	59%
<b>YoY growth</b>							
<b>I/S</b>							
Brokerage commission	52%	46%	57%	57%	70%	52%	55%
Investment banking fees	54%	43%	87%	-55%	59%	98%	40%
Asset mgmt. fees*	40%	41%	7%	69%	21%	-7%	32%
Net interest income^	27%	18%	23%	34%	-15%	20%	-2%
Prop-trading gains	13%	-3%	11%	2%	97%	-1%	89%
Other income and gains	-24%	2%	18%	130%	37%	-45%	-2913%
<b>Adj. operating revenue</b>	<b>28%</b>	<b>16%</b>	<b>27%</b>	<b>34%</b>	<b>62%</b>	<b>23%</b>	<b>53%</b>
Adj. operating expenses	15%	8%	33%	36%	31%	12%	39%
PPoP	41%	22%	20%	32%	91%	33%	77%
Provision	173%	62%	82%	26%	-2449%	21%	510%
<b>Net profit</b>	<b>22%</b>	<b>14%</b>	<b>20%</b>	<b>33%</b>	<b>73%</b>	<b>39%</b>	<b>70%</b>
<b>B/S</b>							
Margin accounts	65%	38%	49%	57%	67%	40%	46%
Reverse repos	-33%	1%	6%	-19%	-24%	5%	29%
Financial investment	23%	2%	19%	3%	47%	52%	44%
Repos, borrowings and bonds	19%	0%	25%	15%	44%	50%	43%
<b>Key ratios</b>							
ROE	0.9ppt	0.0ppt	0.6ppt	2.0ppt	4.7ppt	1.9ppt	3.1ppt
ROA	-0.1ppt	0.1ppt	-0.2ppt	0.4ppt	0.6ppt	0.1ppt	0.3ppt
Financial leverage	0.5x	-0.5x	0.6x	0.2x	0.6x	1.0x	0.2x
Investment yield	-0.5ppt	-0.7ppt	-1.1ppt	-0.1ppt	1.1ppt	-1.3ppt	1.3ppt
Cost-to-income ratio	-5ppt	-3ppt	3ppt	1ppt	-9ppt	-4ppt	-6ppt

Source: Company data, CMBIS

\*: Includes AM fees, fund mgmt. fees and other fee income for CICC.

^: Refers to net interest loss for CICC.

**Figure 8: China brokers' 4Q20 results comparison**

4Q20	CITICS 6030 HK	HTS 6837 HK	HTSC 6886 HK	GFS 1776 HK	CSC 6066 HK	CGS 6881 HK	CICC 3908 HK
<b>(RMB mn)</b>							
<b>I/S</b>							
Brokerage commission	2,717	1,386	1,612	1,557	1,306	1,305	1,154
Investment banking fees	2,389	1,069	898	55	1,911	305	2,586
Asset mgmt. fees	2,612	986	504	1,893	436	149	1,165
Net interest income	755	1,348	801	1,201	260	1,028	(275)
Prop-trading gains	2,030	3,073	2,036	533	2,588	936	3,424
Other income and gains	(13)	371	876	951	(85)	354	(1,428)
<b>Adj. op. revenue</b>	<b>10,491</b>	<b>8,233</b>	<b>6,728</b>	<b>6,191</b>	<b>6,416</b>	<b>4,076</b>	<b>6,626</b>
Adj. op. expenses	(5,312)	(3,594)	(4,494)	(3,347)	(2,689)	(1,765)	(3,480)
<b>PPoP</b>	<b>5,179</b>	<b>4,640</b>	<b>2,233</b>	<b>2,844</b>	<b>3,727</b>	<b>2,311</b>	<b>3,145</b>
Provision	(1,689)	(1,127)	(163)	(328)	(1,161)	(364)	(799)
<b>Net profit</b>	<b>2,242</b>	<b>2,398</b>	<b>1,984</b>	<b>1,898</b>	<b>2,018</b>	<b>1,593</b>	<b>1,277</b>
<b>B/S</b>							
Margin accounts	116,741	73,068	102,574	86,153	46,515	82,018	33,885
Reverse repos	39,227	57,965	19,536	16,794	16,117	31,863	18,431
Financial investment	486,017	253,507	339,053	200,012	186,753	184,435	284,818
Borrowings and bonds	181,712	153,448	129,072	98,162	67,735	81,255	214,111
<b>Key ratios</b>							
ROE	5.0%	6.2%	6.2%	7.8%	12.5%	8.2%	13.1%
ROA	0.9%	1.3%	1.1%	1.7%	2.2%	1.5%	1.7%
Financial leverage	4.7x	3.8x	4.5x	3.6x	4.4x	4.3x	6.3x
Investment yield	1.6%	4.7%	2.4%	1.1%	5.7%	2.1%	4.7%
Cost-to-income ratio	50%	43%	66%	53%	41%	42%	52%
<b>QoQ growth</b>							
<b>I/S</b>							
Brokerage commission	-23%	-13%	-22%	-28%	-15%	-49%	-21%
Investment banking fees	5%	-51%	-39%	-68%	-3%	-18%	89%
Asset mgmt. fees*	24%	32%	-47%	2%	69%	12%	77%
Net interest income^	-26%	1%	3%	-4%	-37%	-15%	-7%
Prop-trading gains	-50%	42%	-25%	-59%	58%	-3%	-19%
Other income and gains	-103%	-7%	-23%	308%	-176%	769%	-271%
<b>Adj. operating revenue</b>	<b>-22%</b>	<b>-5%</b>	<b>-20%</b>	<b>-13%</b>	<b>8%</b>	<b>-19%</b>	<b>5%</b>
Adj. operating expenses	1%	-2%	4%	-11%	20%	-25%	-12%
PPoP	-37%	-7%	-45%	-16%	0%	-14%	34%
Provision	-45%	101%	-83%	96%	4372%	400%	12125%
<b>Net profit</b>	<b>-40%</b>	<b>-20%</b>	<b>-18%</b>	<b>-21%</b>	<b>-31%</b>	<b>-24%</b>	<b>16%</b>
<b>B/S</b>							
Margin accounts	12%	4%	3%	9%	4%	-5%	10%
Reverse repos	-11%	-6%	21%	9%	-1%	20%	-8%
Financial investment	-6%	-7%	-3%	7%	5%	7%	11%
Repos, borrowings and bonds	3%	-11%	-1%	6%	3%	1%	1%
<b>Key ratios</b>							
ROE	-3.4ppt	-2.2ppt	-1.5ppt	-2.2ppt	-6.8ppt	-3.2ppt	-0.7ppt
ROA	-0.6ppt	-0.4ppt	-0.4ppt	-0.5ppt	-1.3ppt	-0.6ppt	0.1ppt
Financial leverage	-0.1x	-0.2x	0.0x	0.1x	-0.2x	-0.1x	-1.1x
Investment yield	-1.6ppt	1.5ppt	-1.1ppt	-1.6ppt	1.8ppt	-0.3ppt	-1.5ppt
Cost-to-income ratio	11ppt	1ppt	15ppt	1ppt	4ppt	-3ppt	-10ppt

Source: Company data, CMBIS

\*: Includes AM fees, fund mgmt. fees and other fee income for CICC.

^: Refers to net interest loss for CICC.

## FY20 results wrap and 1H21E outlook

### Brokerage: undergoing institutionalization and WM transformation

#### Review: (+) CSC, CICC, HTSC, CITICS; (-) GFS, CGS

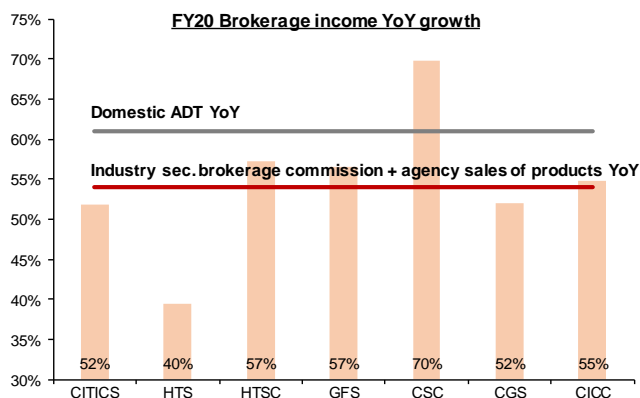
Our covered brokers posted a 55% YoY aggregate brokerage income (incl. brokerage commission, income from agency sales of financial products and future brokerage income) growth in FY20, in-line with 54% YoY growth of industry brokerage commission & agency sales income. The stellar growth was primarily propelled by 61% YoY growth in domestic stock market ADT in FY20.

But unlike in 1H19, when small- to mid-sized brokers took the lead in commission as ADT growth was mainly powered by retail participation, in FY20, many leading large brokers regained market share in brokerage, due to 1) increasing institutionalization of A-share market, and 2) better wealth management transformation that helped attract and retained customers. This was especially true for CICC, which has strong franchise in serving institutional clients while also made promising progress in its WM transformation by leveraging retail client sources from CICC WM (prev. CIS). In contrast, CGS, which used to be a leading player in brokerage, lagged behind industry growth in FY20, suggesting slower progress in adapting to these two industry trends.

#### Outlook: Leaders' share gains likely to continue

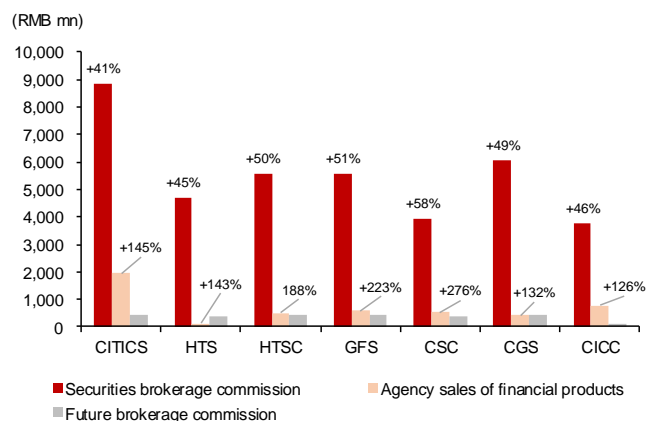
1Q21 marked another active quarter in A-share market, where ADT grew 12% YoY, and mutual fund issuance hit 2nd quarterly high in the history. Therefore, we still expect large brokers to continue their share gain in brokerage income, through stronger franchise in institutionalization, diversified service and product offerings, more user-friendly mobile or online platform, etc.

**Figure 9: Covered brokers posted an overall 55% YoY growth of brokerage income**



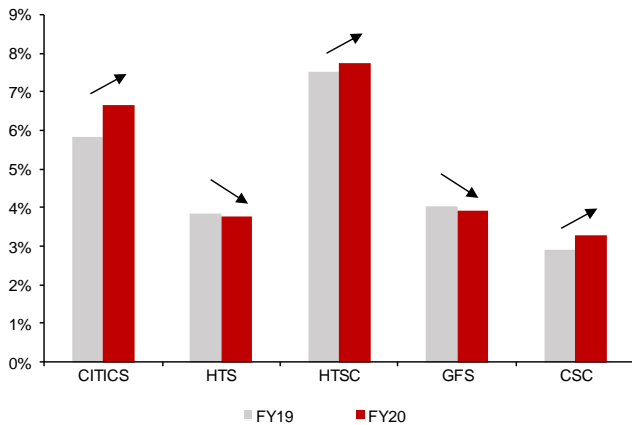
Source: Company data, CMBIS

**Figure 10: Brokerage income mix of covered brokers; income from agency sales surged**



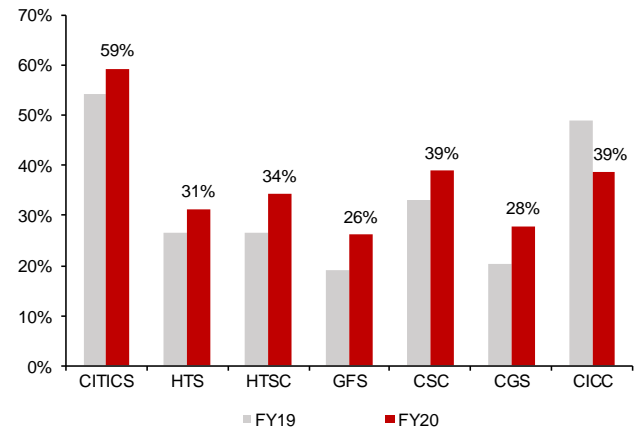
Source: Company data, CMBIS

**Figure 11: Many large brokers regained market share in brokerage in FY20**



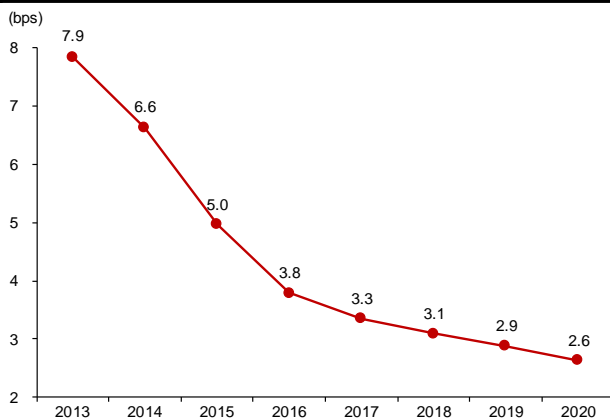
Source: Company data, CMBIS estimates  
Note: data of CGS and CICC is not available.

**Figure 12: % of institutional clients' brokerage deposits in total significantly increased in FY20**



Source: Company data, CMBIS

**Figure 13: Industry brokerage commission rate continued to slide in FY20**



Source: Company data, CMBIS estimates

## Investment banking: reforms enhanced leadership

### Review: (+) CITICS, CSC, CICC, HTS; (-) GFS

Covered brokers' investment banking income jumped 46% YoY in FY20, as the implementation of registration-based IPO system in ChiNext and STAR Market accelerated IPO issuance pace therefore boosted IPO underwriting amount by 86% YoY. Follow-on offering and debt underwriting amount also saw 30%+ YoY growth.

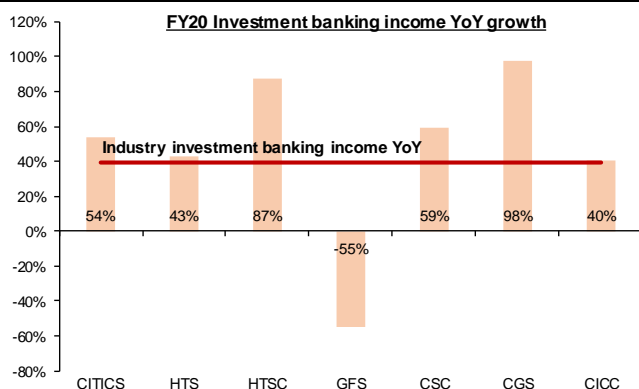
HTS performed surprisingly well in domestic IB (income +119% YoY) thanks to its sponsorship in several STAR Market mega deals, while CSC, CICC and CITICS maintained their leadership in IB under favorable policy environment. HTSC and CGS recorded significantly higher YoY growth mainly due to low base in FY19.

## Outlook: tightening rules may slow domestic IB income in 1-2Qs, while robust overseas fund raising activity may help compensate that

As the mainland regulators are tightening scrutiny over IPOs, both the issuance and approval pace of IPO slowed down QoQ in 1Q21E with over 80 companies withdrew their IPO applications. We think CSRC's aim is to ensure the quality of listing candidates and protect retail investors rather than hindering the capital market reforms, though this will temporarily slow brokers' IB income growth in one to two quarters and post downside risks to our industry underwriting assumption in FY21E.

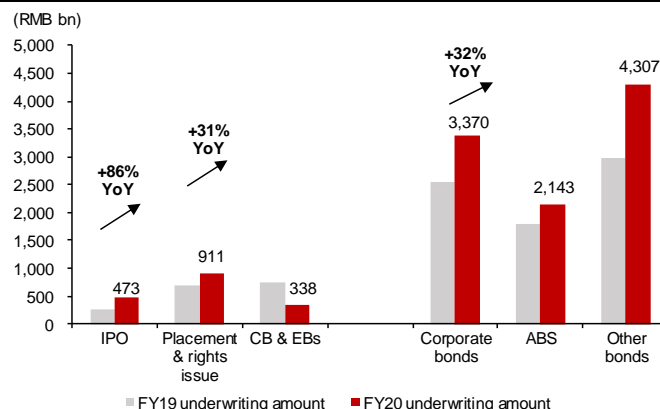
Given this situation, we believe IB leaders, which hold more large and high quality candidates as well as better risk management capability, will continue their outperformance in underwriting. Currently, CITICS was ranked 1st by no. of IPO sponsorship while CICC topped by underwriting amount of sponsored IPOs in both STAR Market and ChiNext. We think CITICS, HTSC and HTS are likely to post better YoY domestic IB growth in 1H21E. Besides, as overseas equity financing market recovered greatly from low base in 1Q20, we expect overseas underwriting will have positive contribution to brokers with strong overseas IB franchise, e.g. CICC, HTS and CITICS.

**Figure 14: Overall investment banking income of covered brokers increased 46% YoY**



Source: Company data, CMBIS

**Figure 15: Capital market reforms boosted both equity and debt underwriting amount in FY20**



Source: Wind, CMBIS

**Figure 16: Market share ranking by domestic equity underwriting amount in FY20**

FY20		Equity underwriting amount		IPO underwriting amount	
Rank (#)	Company	Market share	Amount YoY change	Market share	Amount YoY change
1	CITICS	19.1%	11%	9.5%	0%
2	CSC	13.0%	75%	17.8%	411%
3	HTSC	8.4%	-10%	5.1%	258%
4	CICC	8.0%	-38%	10.6%	-17%
6	HTS	5.4%	90%	12.9%	1647%
9	CGS	2.5%	216%	1.5%	1224%
43	GFS	0.3%	-84%	0.9%	-51%
Top 5		56%	4%	56%	72%

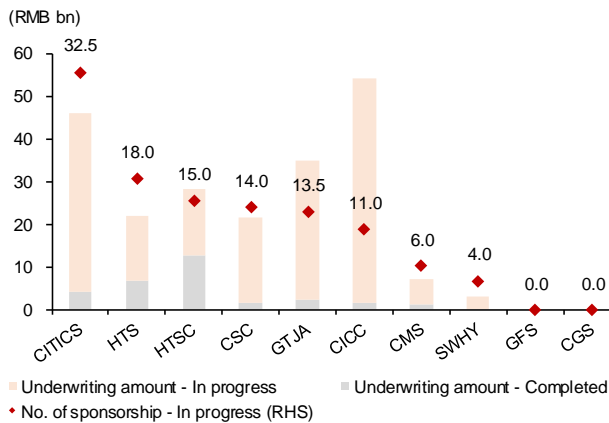
Source: Wind, CMBIS

**Figure 17: Market share ranking by domestic debt underwriting amount in FY20**

FY20		Debt underwriting amount		Corp. bond underwriting amount	
Rank (#)	Company	Market share	Amount YoY change	Market share	Amount YoY change
1	CITICS	12.6%	37%	8.2%	37%
2	CSC	11.0%	31%	11.9%	19%
4	CICC	6.8%	31%	4.3%	35%
5	HTSC	5.4%	80%	3.4%	85%
6	HTS	4.8%	23%	4.4%	40%
20	CGS	1.2%	97%	0.7%	25%
22	GFS	1.1%	-45%	0.5%	-54%
Top 5		42%	31%	35%	28%

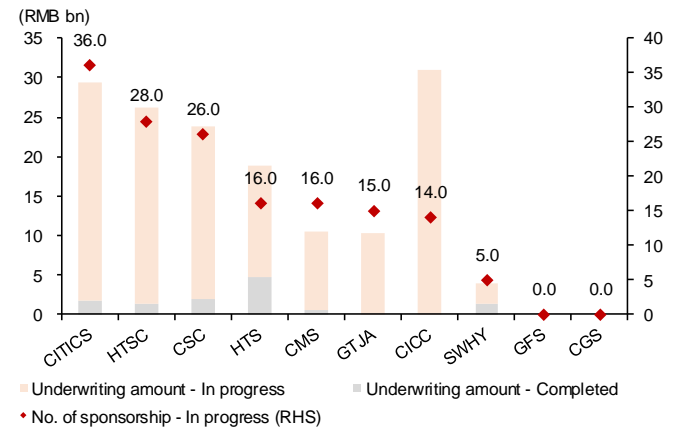
Source: Wind, CMBIS



**Figure 18: Major large brokers' STAR Market IPO pipeline in 2021**

Source: Company data, CMBIS

Note: data as of 30 Mar, 2021; 0.5 sponsorship refers to joint-sponsorship by two brokers.

**Figure 19: Major large brokers' ChiNext IPO pipeline in 2021**

Source: Wind, CMBIS

Note: data as of 30 Mar, 2021.

## Asset management: Mutual fund boom made the difference

### Review: (+) CITICS, GFS, HTS, CICC; (-) CGS

Asset management income of our covered brokers advanced 38% YoY, of which 28% YoY growth was fueled by fund management fees amid mutual fund issuance boom in FY20. Therefore, brokers with strong fund subsidiaries, e.g. GFS (holding GF Fund), CITICS (holding China AMC) and HTS (holding HFT Fund), reported higher AM income growth, than those holding fund companies as associates or JVs.

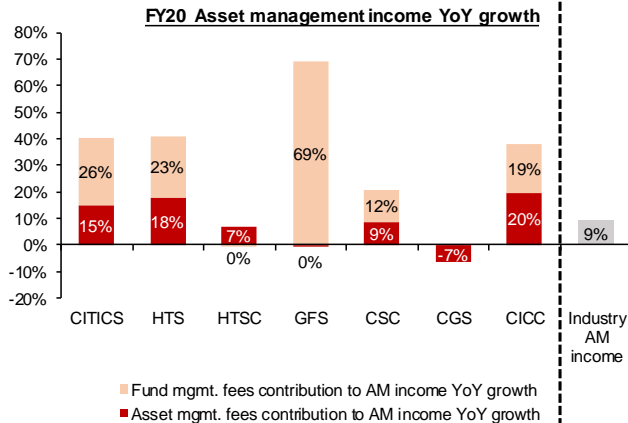
On asset management side, covered brokers reported 10% YoY income growth, in-line with industry income growth of 9%, as AUM was still negatively affected by regulations. All covered brokers grew their actively managed AUM and improved its % in total AUM greatly during FY20 (Fig. 21). Among them, CITICS, HTS and CICC showed better growth on stronger active management capabilities.

### Outlook: AM AUM to stabilize; fund sub. likely again acts as major growth driver

Industry wise AUM of collective asset management (mostly actively managed) has stabilized since 2Q20 although AUM of target asset management (mostly "channel business") will continue to decrease. As brokers have been improving their AUM mix for several years, we believe the AUM contraction will be milder in FY21E and have less negative impact on brokers' asset management fee income. Meanwhile, as the market saw another mutual fund issuance surge in 1Q21E, and due to lower base in 1H20, we believe brokers with fund subsidiaries will continue to see higher AM income than other peers.

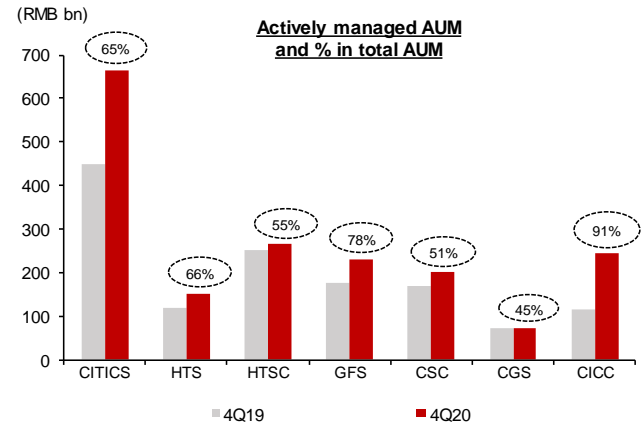


**Figure 20: Covered brokers reported an overall 38% YoY growth in AM income, incl. 28% from fund mgmt.**



Source: Company data, CMBIS

**Figure 21: Brokers continued to enhance active mgmt. capability**



Source: AMAC, CMBIS

Note: measured by monthly avg. balance.

**Figure 22: Covered brokers' holding in fund mgmt. companies and their FY20 financial performance**

Broker	CITICS 6030 HK	HTS 6837 HK		HTSC 6886 HK		GFS 1776 HK		CSC 6066 HK	CICC 3908 HK
Fund mgmt. sub./asso./JV	China AMC	HFT Fund	Fullgoal	China Southern Fund	Huatai- Pine Bridge	GF Fund	Efund	China Fund	CICC Fund
Brokers' shareholding	62%	51%	28%	41%	49%	55%	23%	55%	100%
FY20 financial data									
YE mutual fund AUM (RMB bn)	657	125	588	808	162	763	1,225	27	55
YoY change	22%	12%	179%	30%	51%	52%	68%	55%	98%
Revenue (RMB mn)	5,539	1,326	5,317	5,630	1,124	6,251	9,253	300	N/A
YoY change	39%	63%	86%	45%	49%	89%	49%	26%	N/A
Net profit (RMB mn)	1,598	378	1,652	1,484	272	1,824	2,750	48	-43
YoY change	33%	70%	109%	65%	44%	54%	59%	-9%	N/A*

Source: Company data, CMBIS

\*: CICC Fund recorded net loss of RMB 28.7mn in FY19.

Note: fund mgmt. names in red refers to those are subsidiaries of brokers.

## Prop trading: Stock market rally increased gains

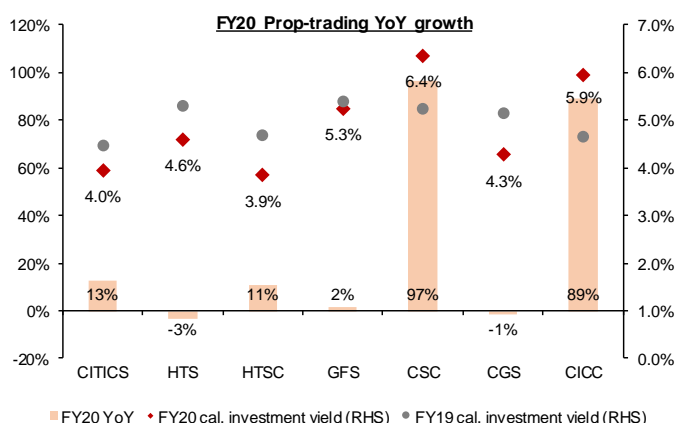
### Review: (+) CSC, CICC; (-) HTS, GFS, CGS

After a surged growth in FY19, the prop-trading gains of covered brokers varied in volatile FY20. CSC and CICC posted ~100% YoY growth with improved investment yield (+ >1ppt YoY), while others reported relatively stable YoY growth and lower investment yield. We think the divergence was likely due to different stock allocations, and partly due to FV gains from sponsorship investment into STAR Market IPOs. Except for GFS, all other brokers increased their financial assets, especially position in equities, which for some brokers, like CITICS, was mainly for hedging demands for customer-driven derivatives.

### Outlook: Stock market volatility may weigh on YoY trend

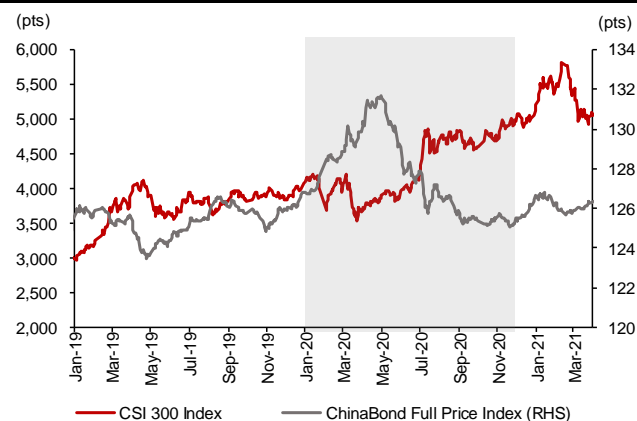
Domestic stock market went on another rollercoaster ride in 1Q21E, which posed pressure on brokers' prop-trading this year, especially those gained high on stock market rally in FY20. We expect brokers with higher exposure to fixed income and stronger capabilities in derivative business to deliver more stable prop-trading performance in FY21E, e.g. CIITCS and CICC.

**Figure 23: Covered brokers reported 22% YoY growth of aggregate prop-trading gains in FY20**



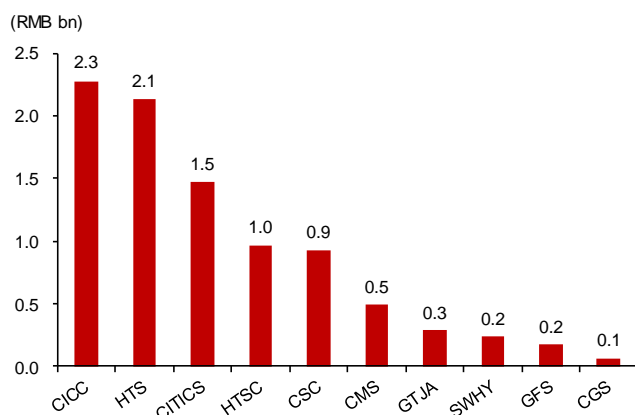
Source: Company data, CMBIS

**Figure 24: China's stock market significantly outperformed bond market esp. in 2H20**



Source: Wind, CMBIS

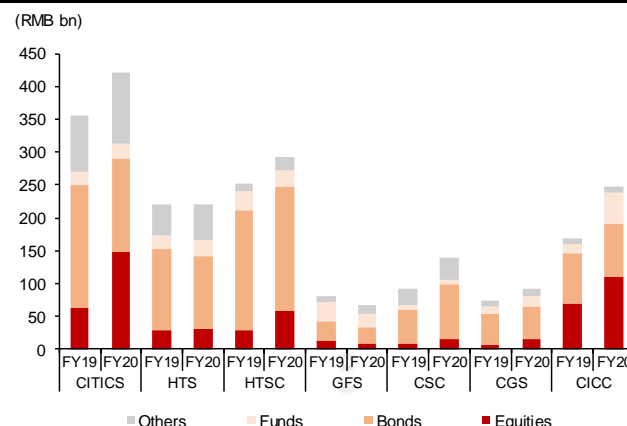
**Figure 25: STAR Board sponsors' investment FV gains in FY20; CICC and HTS**



Source: Wind, CMBIS estimates

Note: brokers usually apply discount on FV gains from sponsors' mandatory investment in STAR Board IPOs in financial reports due to long lock-up period (24 months).

**Figure 26: Trading financial assets breakdown of covered brokers; equities position increased**



Source: Company data, CMBIS

## Margin & SPLs: spread expansion + margin boom; credit loss not a big concern

### Review: (+) CITICS, HTSC, GFS; (-) CSC, CICC

The aggregate NII of covered brokers recorded 22% YoY growth, mainly due to 1) strong margin financing and securities lending demand (covered brokers margin acct. balance +52% YoY on average), 2) lower financing costs thanks to easing monetary policy, though this was partly offset by reduced SPL balance and increased debt balance.

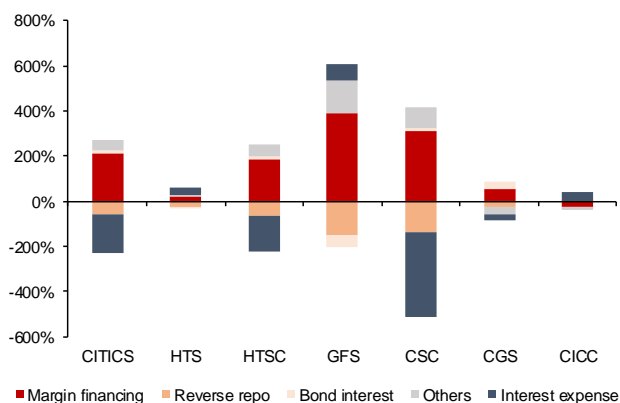
Specifically, we saw soaring growth of brokers' securities lending business as refinancing ("转融通") securities lending and strategic investment in STAR Board IPOs have greatly increased shares available for lending in A-share market. Brokers achieved high growth by leveraging their solid institutional client base or edges in digitalization (e.g. HTSC's open-ended platform Securities Lending Path ("融券通")). As daily securities lending turnover now only accounts for less than 1% in A-share ADT, we think this business has plenty potential for growth and increasing contribution to brokers' NII.

Covered brokers posted 128% YoY surge of aggregate impairment losses in FY20, mostly charged for SPLs, margin financing and bond investments, which reduced brokers' PPoP by 15%. We do not think this suggests brokers are faced with increasing credit risks, but rather a choice to build up their capital buffer when profitability is good. Covered brokers maintained stable maintenance coverage ratio for margin financing and higher ratio for SPLs, showing enhanced countercyclicality.

### Outlook: YoY balance growth to defend against normalizing monetary policy

Entering into 2021, daily average margin financing and securities lending balance stayed relatively stable at ~RMB 1.7tn, while still grew ~60% YoY. Regarding interest spread, we expect mild contraction in FY21E, as the normalizing monetary policy will lift brokers' financing costs, and intense competition in margin and lending business will pressure yields. That said, we still expect YoY growth of brokers' NII in 1H21E due to low base in 1H20. We also expect lower credit loss for brokers in FY21E given already raised capital buffer.

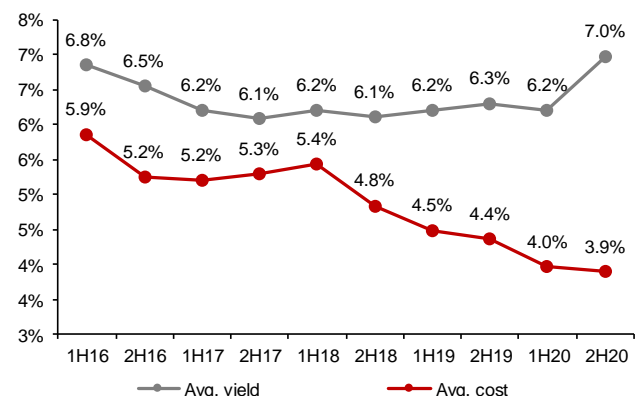
**Figure 27: NII YoY growth of covered brokers by income/expense; margin income the key driver**



Source: Company data, CMBIS

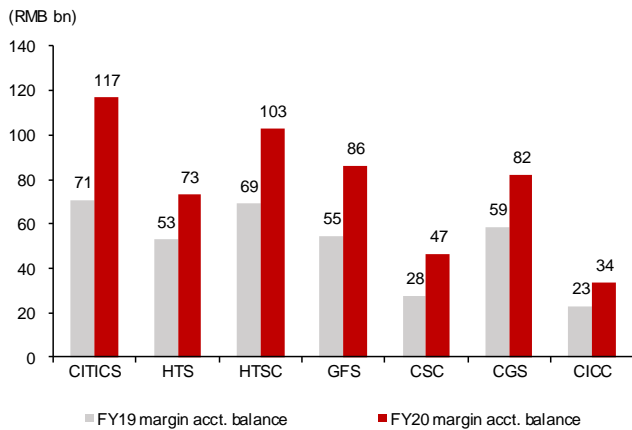
Note: CICC recorded a 2% YoY decrease of net interest loss in FY20.

**Figure 28: Interest spread of covered brokers widened in FY20 thanks to lower cost and higher yield**



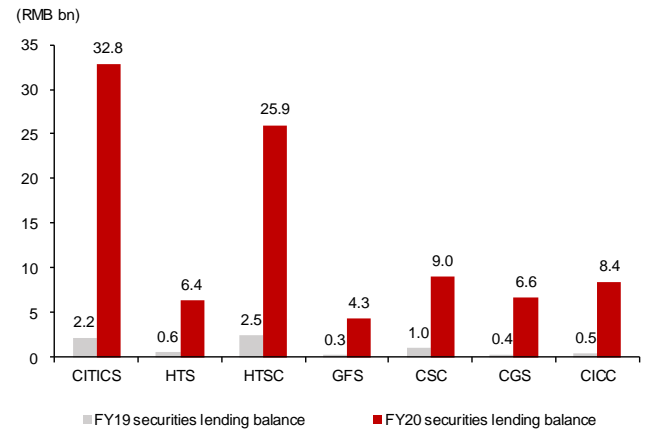
Source: Company data, CMBIS estimates

**Figure 29: Covered brokers' margin acct. increased 52% YoY on average due to strong demand**



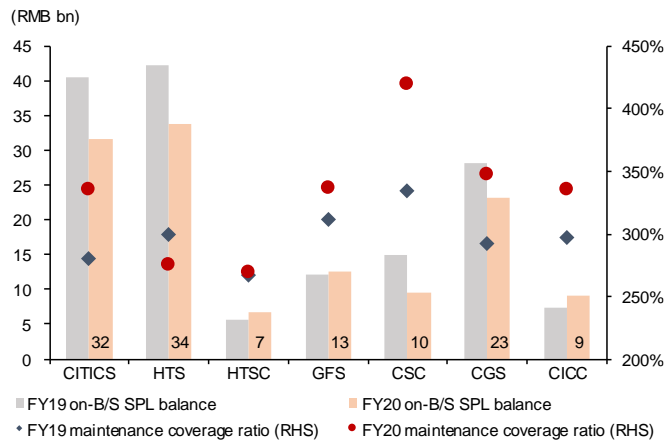
Source: Company data, CMBIS

**Figure 30: Covered brokers' securities lending balance more than decupled YoY in FY20**



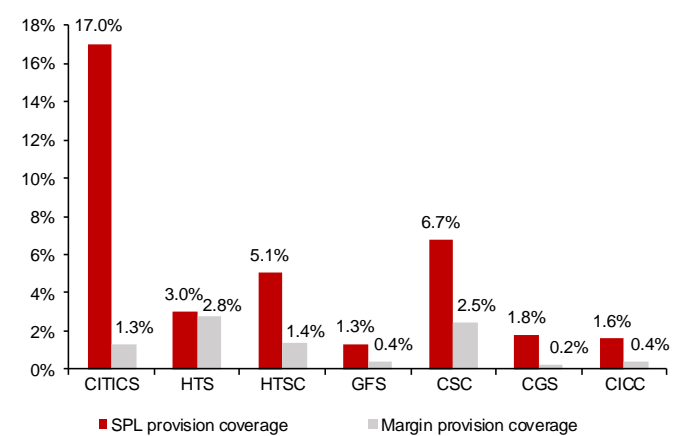
Source: Company data, CMBIS

**Figure 31: Most covered brokers kept reducing SPLs and maintained high coverage ratio**



Source: Company data, CMBIS

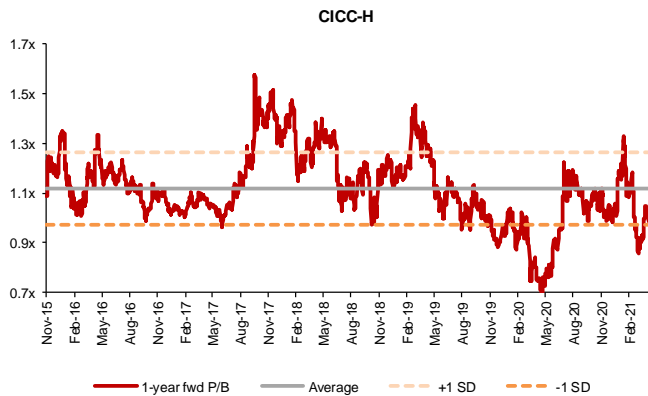
**Figure 32: Brokers greatly increased their buffer over SPLs after heavy impairment charges in FY20**



Source: Company data, CMBIS

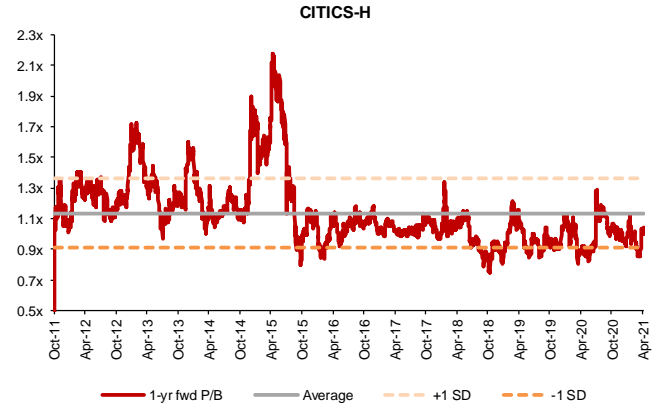
## Valuation of H-share China brokers

Figure 33: CICC's 1-year forward P/B



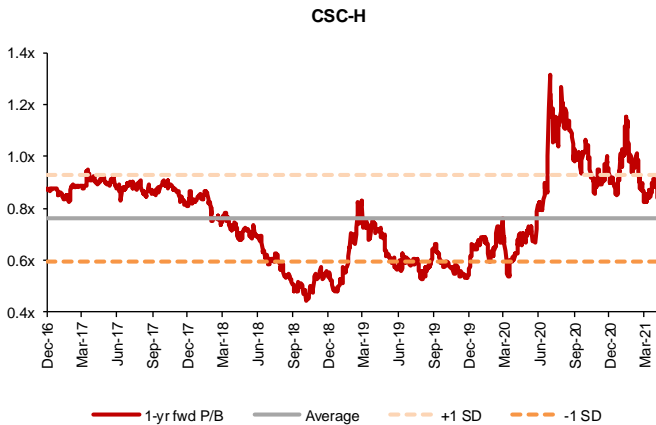
Source: Bloomberg, CMBIS estimates

Figure 34: CITICS's 1-year forward P/B



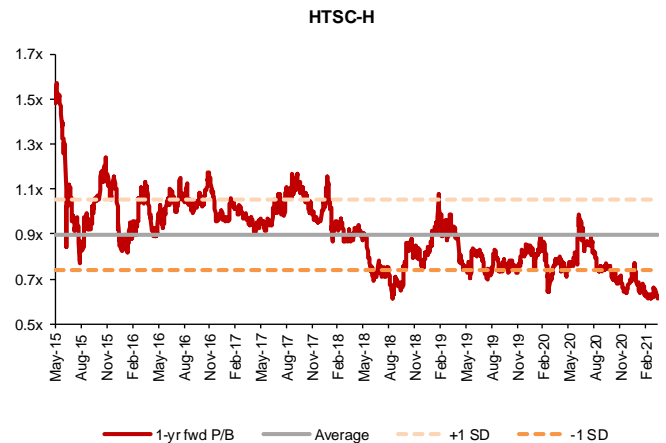
Source: Bloomberg, CMBIS estimates

Figure 35: CSC's 1-year forward P/B



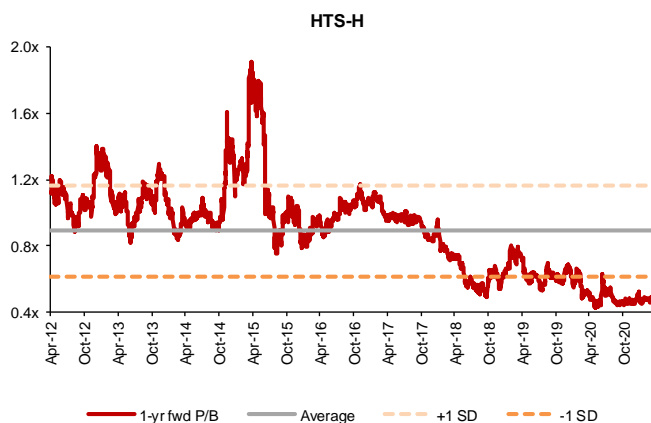
Source: Bloomberg, CMBIS estimates

Figure 36: HTSC's 1-year forward P/B



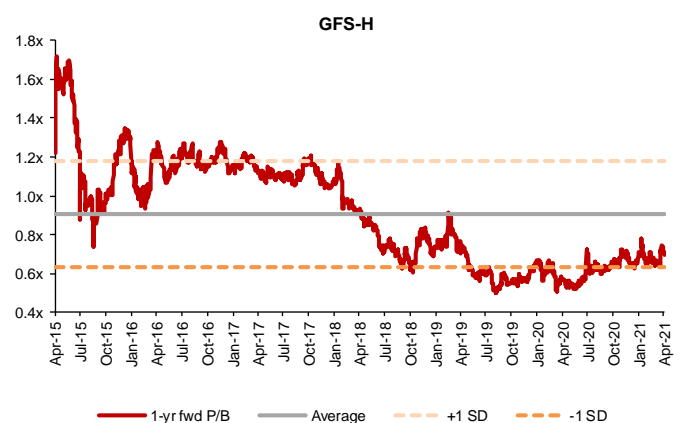
Source: Bloomberg, CMBIS estimates

Figure 37: HTS's 1-year forward P/B

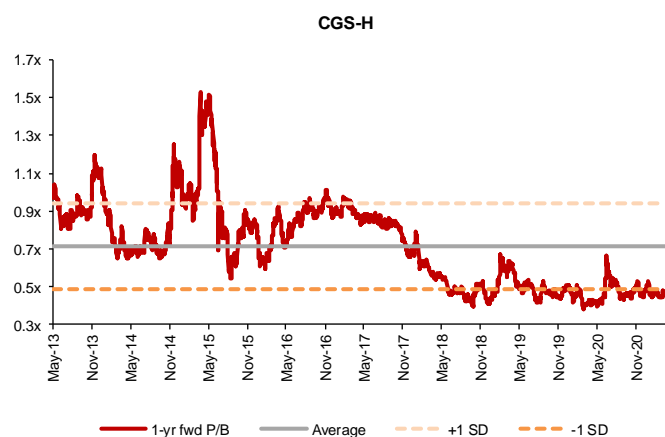


Source: Bloomberg, CMBIS estimates

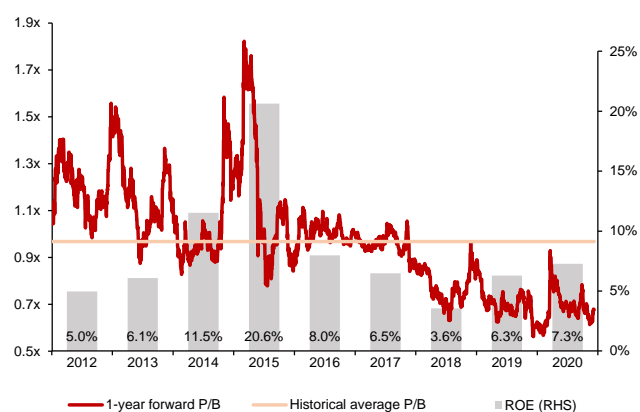
Figure 38: GFS's 1-year forward P/B



Source: Bloomberg, CMBIS estimates

**Figure 39: CGS's 1-year forward P/B**

Source: Bloomberg, CMBIS estimates

**Figure 40: China brokers P/B vs. historical ROE**

Source: SAC, Bloomberg, CMBIS estimates

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