

China Brokerage Sector

COVID-19 disruption unlikely to derail industry upswing

China brokers Jan 2019 net profit increased YoY and 2MTD market data showed encouraging recovery from the COVID-19 hit, alleviating a major short-term threat over brokers' profitability and stock performance. Going forward, we expect easier monetary policy and ramp-up of capital market reforms following the epidemic period to keep the industry upswing on track. **Maintain OUTPERFORM on sector with CITICS and CICC as top picks.**

- **1M20 major brokers' net profit increased 23% YoY/dropped 49% MoM**, due to sequential market correction in Jan and better market activity (see details in Fig.8). **We saw market condition improved further since Feb**, with even stronger ADT (+18% MoM), rising margin balance (~RMB 1.03tn) and indices regaining lost ground. The market seems to recover from the COVID-19 outbreak better and quicker than expected, betting on more countercyclical policies.
- **COVID-19: limited direct impact and alleviated indirect impact as market confidence returned.** 1) Brokers would be indirectly but most materially impacted by fear-triggered market plunge on COVID-19 as 10% decline of CSI 300 Index may reduce their revenue by 11% on average, based on our estimates; but this risk is easing. 2) Stabilizing market, together with regulators' supporting measures, will help mitigate pressure on SPL/debt invt. impairment due to borrowers' issuers' deteriorating cash flows. 3) Brokerage saw limited direct impact as over 95% of the transactions could be done online according to CSRC. 4) Investment banking is the key business line exposed to direct pressure, where on-site works are delayed due to travel restrictions. But we estimate the financial impact to be mild as 10% decrease in equity financing amount will reduce brokers' revenue by less than 1% (Fig.3). Lessons during SARS also show that the IPO pace would be ramped up after the epidemic period (Fig. 7).
- **Two factors to back sector upswing: 1) Easier monetary policy**, as the PBoC already lowered OMO rates by 10bps and suggested possible MLF rate/LPR cut in coming week. Ample liquidity and lower funding cost will favor stock market and brokers' earnings. 2) **Implementation of capital market reforms**, which is still on track in our view, and could bring in incremental businesses in 2H20E.
- **Short-term volatility may be inevitable; suggest to add leaders when there is a correction.** The sector touches historical low again (0.72x 1yr fwd P/B), while leaders trade modestly above their historical avg. minus 1SD. undemanding to accumulate. We **maintain CITICS (6030 HK) and CICC (3908 HK) as top picks** for their strong franchises in investment banking and institutionalization to capture reform-related opportunities. **Key risks:** 1) prolonged COVID-19 spread that hits China's economy harder; and 2) slower-than-expected implementation of reforms.

Valuation Table

| Name | Ticker | Price (HK\$) | TP (HK\$) | Rating | P/B (x) FY20E | P/E (x) FY20E | Yield FY20E | ROE FY20E |
|----------------|---------|--------------|-----------|--------|---------------|---------------|-------------|-------------|
| CITICS | 6030 HK | 16.96 | 18.70 | BUY | 1.05 | 13.0 | 3.1% | 8.3% |
| CICC | 3908 HK | 14.76 | 17.20 | BUY | 1.13 | 12.6 | 1.2% | 9.3% |
| HTSC | 6886 HK | 13.46 | 14.90 | BUY | 0.87 | 12.3 | 3.2% | 7.2% |
| CSC | 6066 HK | 6.72 | 7.20 | BUY | 0.84 | 9.3 | 3.2% | 9.4% |
| HTS | 6837 HK | 9.03 | 10.40 | BUY | 0.62 | 9.1 | 3.3% | 7.0% |
| GFS | 1776 HK | 9.48 | 9.80 | HOLD | 0.64 | 8.4 | 3.6% | 7.8% |
| CGS | 6881 HK | 4.51 | 4.50 | HOLD | 0.51 | 7.6 | 3.9% | 6.9% |
| Average | | | | | 0.81 | 10.3 | 3.1% | 8.0% |

Source: Bloomberg, CMBIS estimates

OUTPERFORM
(Maintain)

China Brokerage Sector

Karen Sui

(852) 3761 8775

suixiaomeng@cmbi.com.hk

1yr forward P/B of China brokers - H



Source: Bloomberg, CMBIS estimates

Sector vs. HSI Index since 2019

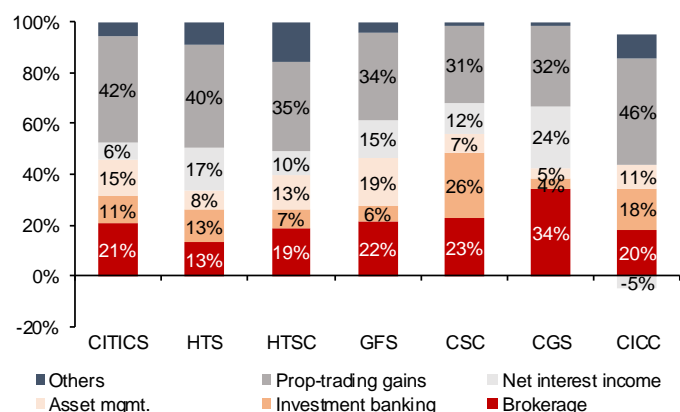


Source: Bloomberg, CMBIS

Related Reports

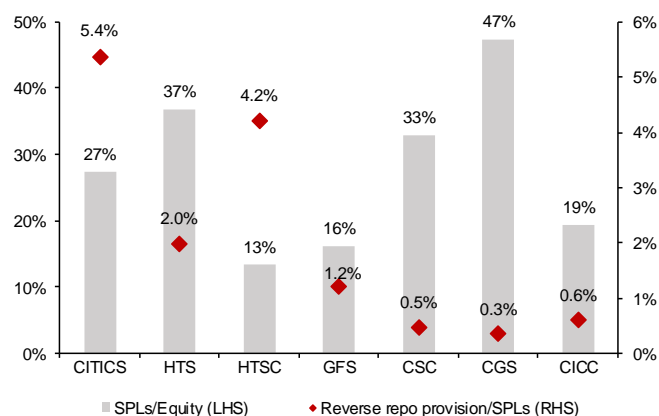
1. "Policy implementation to light up the road ahead" – 18 Dec 2019
2. "Higher earnings visibility given favorable policy environment" – 6 Sep 2019
3. "Valuation close to trough - attractive risk/reward" – 19 Jun 2019

Figure 1: Covered brokers' revenue mix in 9M19; prop-trading gains as the largest revenue contributor (~37% on average)



Source: Company data, CMBIS

Figure 2: SPL exposure and provision for SPLs of covered brokers in 1H19; CITICS and HTSC with more sufficient buffer



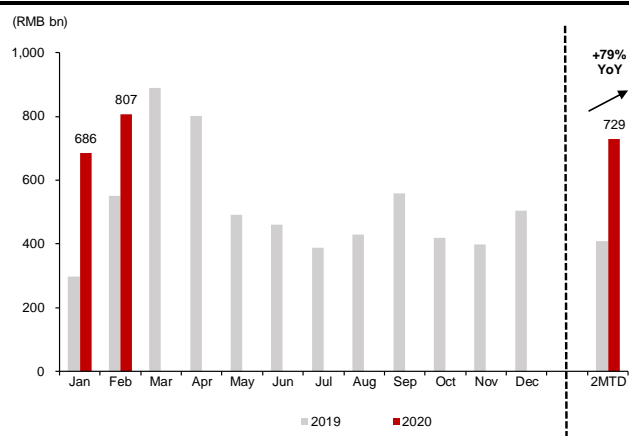
Source: Company data, CMBIS

Figure 3: Covered brokers' FY20E revenue sensitivity; CGS is most sensitive to domestic ADT changes while CSC and CICC are more sensitive to investment banking volume changes

| | Domestic stock and fund ADT +/-10% | Equity financing underwriting amount +/-10% | Investment yield +/-1.0ppt |
|--------|---------------------------------------|--|-------------------------------|
| CITICS | 1.1% | 0.4% | 10.1% |
| HTSC | 1.8% | 0.2% | 11.2% |
| HTS | 1.2% | 0.1% | 10.0% |
| GFS | 2.0% | 0.4% | 9.9% |
| CSC | 1.8% | 0.7% | 9.9% |
| CGS | 3.5% | 0.1% | 8.2% |
| CICC | 1.4% | 0.6% | 12.0% |

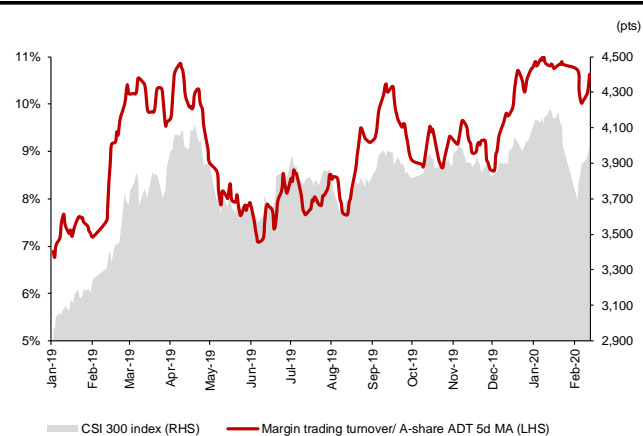
Source: CMBIS estimates

Figure 4: 2020YTD A-share ADT remained strong

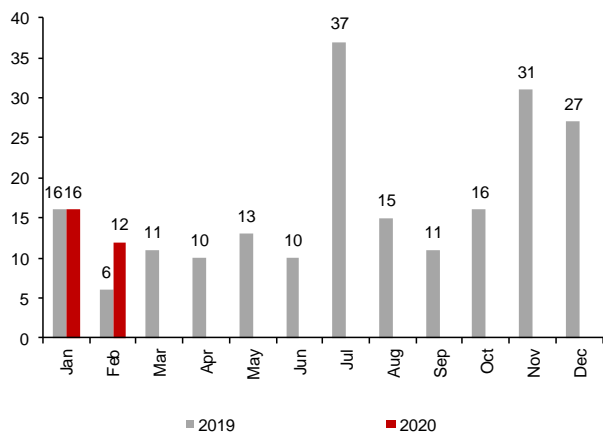


Source: Wind, CMBIS

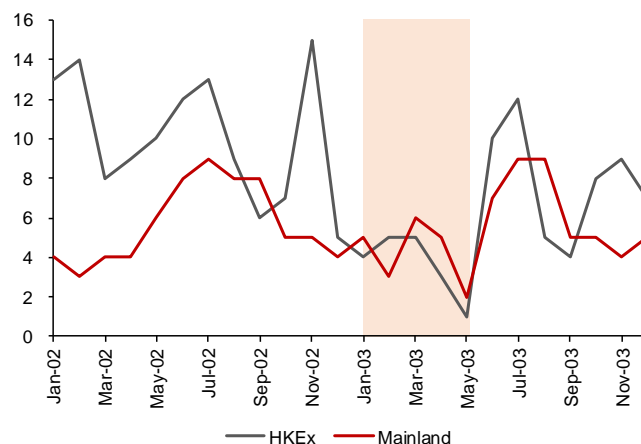
Figure 5: Margin trading turnover climbed back, suggesting improving risk appetite



Source: Wind, CMBIS

Figure 6: Issuing pace of IPOs was largely normal during 2MTD; ~60 IPOs are approved but not yet listed


Source: Wind, CMBIS

Figure 7: No. of IPOs in Mainland China and HK dropped during SARS peak period but soon rebounded


Source: Wind, CMBIS

Figure 8: Jan 2020 major H-share China brokers' financial data (parent company level)

| Company | Ticker | Revenue (RMB mn) | | | Net profit (RMB mn) | | |
|--------------|---------|------------------|-------------|-----------|---------------------|-------------|------------|
| | | Jan-20 | MoM | YoY | Jan-20 | MoM | YoY |
| CITICS | 6030 HK | 2,015 | -51% | -9% | 885 | -41% | 17% |
| GTJA | 2611 HK | 985 | -72% | -27% | 352 | -68% | -21% |
| HTS | 6837 HK | 1,448 | -42% | 41% | 681 | -36% | 57% |
| HTSC | 6886 HK | 1,132 | -62% | 3% | 441 | -67% | 4% |
| GFS | 1776 HK | 1,323 | -37% | 17% | 611 | -40% | 23% |
| CMS | 6099 HK | 1,216 | -43% | 11% | 577 | -53% | 29% |
| SWHY | 6806 HK | 783 | -64% | -13% | 331 | -54% | -10% |
| CSC | 6066 HK | 1,321 | -31% | 66% | 590 | -40% | 183% |
| CGS | 6881 HK | 1,012 | -39% | 6% | 430 | -30% | 9% |
| Total | | 11,236 | -51% | 6% | 4,898 | -49% | 23% |

Source: Company data, CMBIS; Revenue and net profit are the sum of parent company and reported subsidiaries, excluding dividends from subsidiaries.

Figure 9: Jan 2020 market data recap

| Item | Amount | MoM change | YoY change |
|---|--------|------------|------------|
| Trading data (RMB bn, except for trading days) | | | |
| A-share ADT | 692 | 35% | 132% |
| A-share trading days | 16 | -27% | -27% |
| Northbound net inflows | 38 | -47% | -37% |
| Margin financing & securities lending (month-end) | 1,037 | 2% | 42% |
| Index performance (month-end) | | | |
| CSI 300 Index | 4,004 | -2% | 25% |
| ChiNext Index | 1,928 | 7% | 57% |
| ChinaBond Aggregate Return Index | 127.5 | 0.6% | 1.3% |
| Underwriting amount (RMB bn) | | | |
| Equity financing | 132 | -36% | 9% |
| Incl. IPO | 42 | -18% | 228% |
| Incl. Placement & rights issue | 42 | -61% | -59% |
| Debt financing | 640 | -16% | 27% |
| Incl. Enterprise bonds | 21 | -61% | -36% |
| Incl. Corporate bonds | 200 | -25% | 28% |
| Incl. ABS | 109 | -57% | 6% |

Source: Wind, CMBIS

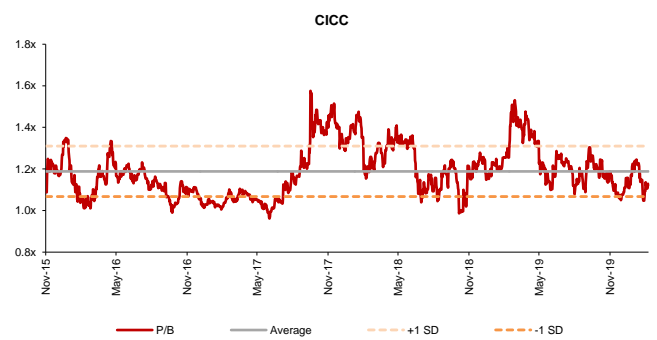
Valuation of H-share China brokers

Figure 10: CITICS's 1yr forward P/B



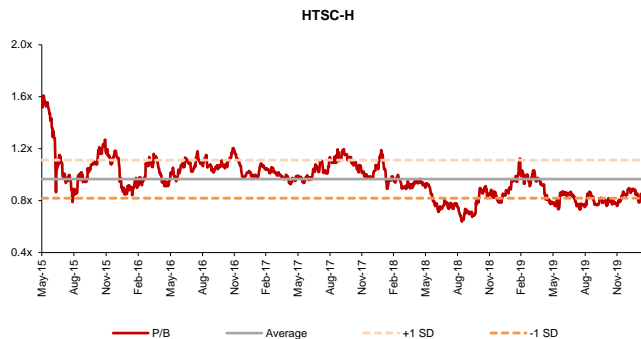
Source: Bloomberg, CMBIS estimates

Figure 11: CICC's 1yr forward P/B



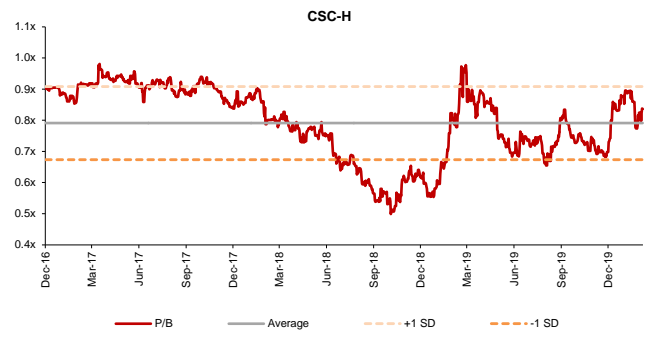
Source: Bloomberg, CMBIS estimates

Figure 12: HTSC's 1yr forward P/B



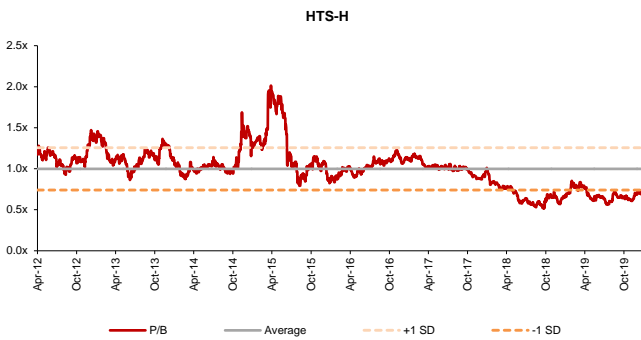
Source: Bloomberg, CMBIS estimates

Figure 13: CSC's 1yr forward P/B



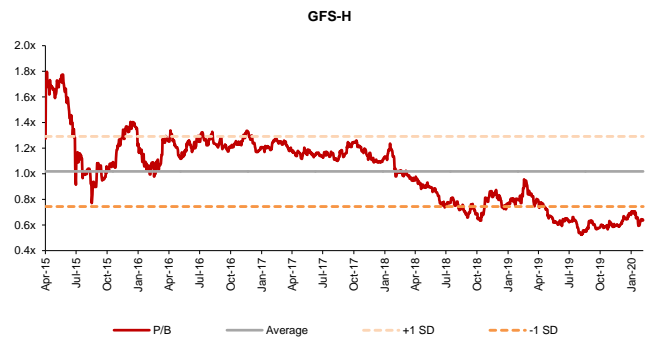
Source: Bloomberg, CMBIS estimates

Figure 14: HTS's 1yr forward P/B



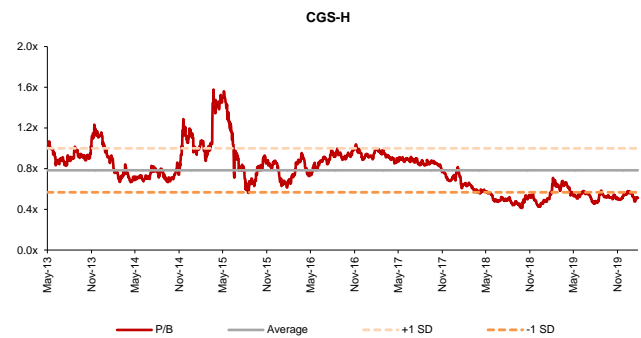
Source: Bloomberg, CMBIS estimates

Figure 15: GFS's 1yr forward P/B



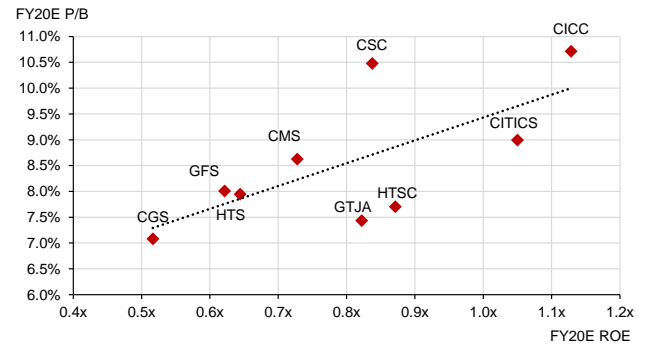
Source: Bloomberg, CMBIS estimates

Figure 16: CGS's 1yr forward P/B



Source: Bloomberg, CMBIS estimates

Figure 17: China H-share brokers' P/B-ROE regression



Source: Bloomberg

Disclosures & Disclaimers

Analyst Certification

The research analyst who is primary responsible for the content of this research report, in whole or in part, certifies that with respect to the securities or issuer that the analyst covered in this report: (1) all of the views expressed accurately reflect his or her personal views about the subject securities or issuer; and (2) no part of his or her compensation was, is, or will be, directly or indirectly, related to the specific views expressed by that analyst in this report.

Besides, the analyst confirms that neither the analyst nor his/her associates (as defined in the code of conduct issued by The Hong Kong Securities and Futures Commission) (1) have dealt in or traded in the stock(s) covered in this research report within 30 calendar days prior to the date of issue of this report; (2) will deal in or trade in the stock(s) covered in this research report 3 business days after the date of issue of this report; (3) serve as an officer of any of the Hong Kong listed companies covered in this report; and (4) have any financial interests in the Hong Kong listed companies covered in this report.

Disclaimer

CMBIS or its affiliate(s) have investment banking relationship with the issuers covered in this report in preceding 12 months.

CMBIS Ratings

| | |
|------------------|---|
| BUY | : Stock with potential return of over 15% over next 12 months |
| HOLD | : Stock with potential return of +15% to -10% over next 12 months |
| SELL | : Stock with potential loss of over 10% over next 12 months |
| NOT RATED | : Stock is not rated by CMBIS |

| | |
|-----------------------|---|
| OUTPERFORM | : Industry expected to outperform the relevant broad market benchmark over next 12 months |
| MARKET-PERFORM | : Industry expected to perform in-line with the relevant broad market benchmark over next 12 months |
| UNDERPERFORM | : Industry expected to underperform the relevant broad market benchmark over next 12 months |

CMB International Securities Limited

Address: 45/F, Champion Tower, 3 Garden Road, Hong Kong, Tel: (852) 3900 0888 Fax: (852) 3900 0800

CMB International Securities Limited ("CMBIS") is a wholly owned subsidiary of CMB International Capital Corporation Limited (a wholly owned subsidiary of China Merchants Bank)

Important Disclosures

There are risks involved in transacting in any securities. The information contained in this report may not be suitable for the purposes of all investors. CMBIS does not provide individually tailored investment advice. This report has been prepared without regard to the individual investment objectives, financial position or special requirements. Past performance has no indication of future performance, and actual events may differ materially from that which is contained in the report. The value of, and returns from, any investments are uncertain and are not guaranteed and may fluctuate as a result of their dependence on the performance of underlying assets or other variable market factors. CMBIS recommends that investors should independently evaluate particular investments and strategies, and encourages investors to consult with a professional financial advisor in order to make their own investment decisions.

This report or any information contained herein, have been prepared by the CMBIS, solely for the purpose of supplying information to the clients of CMBIS or its affiliate(s) to whom it is distributed. This report is not and should not be construed as an offer or solicitation to buy or sell any security or any interest in securities or enter into any transaction. Neither CMBIS nor any of its affiliates, shareholders, agents, consultants, directors, officers or employees shall be liable for any loss, damage or expense whatsoever, whether direct or consequential, incurred in relying on the information contained in this report. Anyone making use of the information contained in this report does so entirely at their own risk.

The information and contents contained in this report are based on the analyses and interpretations of information believed to be publicly available and reliable. CMBIS has exerted every effort in its capacity to ensure, but not to guarantee, their accuracy, completeness, timeliness or correctness. CMBIS provides the information, advices and forecasts on an "AS IS" basis. The information and contents are subject to change without notice. CMBIS may issue other publications having information and/ or conclusions different from this report. These publications reflect different assumption, point-of-view and analytical methods when compiling. CMBIS may make investment decisions or take proprietary positions that are inconsistent with the recommendations or views in this report.

CMBIS may have a position, make markets or act as principal or engage in transactions in securities of companies referred to in this report for itself and/or on behalf of its clients from time to time. Investors should assume that CMBIS does or seeks to have investment banking or other business relationships with the companies in this report. As a result, recipients should be aware that CMBIS may have a conflict of interest that could affect the objectivity of this report and CMBIS will not assume any responsibility in respect thereof. This report is for the use of intended recipients only and this publication, may not be reproduced, reprinted, sold, redistributed or published in whole or in part for any purpose without prior written consent of CMBIS.

Additional information on recommended securities is available upon request.

For recipients of this document in the United Kingdom

This report has been provided only to persons (I) falling within Article 19(5) of the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005 (as amended from time to time) ("The Order") or (II) are persons falling within Article 49(2) (a) to (d) ("High Net Worth Companies, Unincorporated Associations, etc.") of the Order, and may not be provided to any other person without the prior written consent of CMBIS.

For recipients of this document in the United States

This report is intended for distribution in the United States to "major US institutional investors", as defined in Rule 15a-6 under the US, Securities Exchange Act of 1934, and may not be furnished to any other person in the United States. Each major US institutional investor that receives a copy of this research report by its acceptance hereof represents and agrees that it shall not distribute or provide this research report to any other person.

For recipients of this document in Singapore

This report is distributed in Singapore by CMBI (Singapore) Pte. Limited (CMBISG) (Company Regn. No. 201731928D), an Exempt Financial Adviser as defined in the Financial Advisers Act (Cap. 110) of Singapore and regulated by the Monetary Authority of Singapore. CMBISG may distribute reports produced by its respective foreign entities, affiliates or other foreign research houses pursuant to an arrangement under Regulation 32C of the Financial Advisers Regulations. Where the report is distributed in Singapore to a person who is not an Accredited Investor, Expert Investor or an Institutional Investor, as defined in the Securities and Futures Act (Cap. 289) of Singapore, CMBISG accepts legal responsibility for the contents of the report to such persons only to the extent required by law. Singapore recipients should contact CMBISG at +65 6350 4400 for matters arising from, or in connection with the report.