

China Galaxy Securities (6881.HK)

Obvious advantages of brokerage business with strong profit growth

Rating:

Buy

HONG KONG | FINANCIAL | COMPANY RESULTS

- According to 1H2014 results of China Galaxy Securities (hereinafter referred to as CGS or the Group), the Group's performance met our expectation. As at the end of June, commission and fee income increased by 6.28% y-y to RMB2.454 billion. Meanwhile, interest income and investment gains also increased largely during the same period. Total revenue grew 25.55% y-y to RMB4.796 billion;
- According to the businesses, brokerage business is still one of key competitive advantages of CGS. Securities brokerage net revenue ranked No.1 from 2008 to 2013. By the end of 1H2014, incomes of securities brokerage business reached to RMB3.073 billion, up 13.44% y-y. However, the growth of the commission fee continued to go down due to the fiercer competition, and we believe the market share of CGS will go down in future. On the other hand, due to the improvement of the market, margin financing and securities lending increased significantly in 2014, and CGS recorded RMB21.271 billion in such business during the period, up 81.3% y-y strongly. We believe its growth would increase over 100% in 2014;
- CGS also made great efforts to expand asset management business except traditionally brokerage business in 2014. Incomes of investment banking business grew obviously due to the re-opening of IPOs in A Shares. By the end of 1H2014, incomes of CGS's investment banking business amounted to RMB506 million, up 161.73% y-y largely. Asset management business and overseas business maintained strong growth, increased significantly by 22.39% and 78.57% y-y to RMB84 million and 100 million respectively. The performance of the Group's investment banking business is in line with our expectation;
- CGS's assets maintained stable growth. As at the end of 1H2014, total assets achieved to RMB90.328 billion, up 15.39% compared with the end of 2013. Net assets increased by 4.44% to RMB26.294 billion. Meanwhile, current liabilities increased by 20.6% to RMB63.735 billion, which caused the gearing ratio to increase by 4.51ppts to 43.74%;
- The market environment in 2014 will be better than that of 2013, and CGS will maintain the competitive advantages in its brokerage business, and other businesses such as investment banking will also increase strongly, therefore we expect its profit growth would maintain at the stable level in future, and increase the profit estimation in the next two years. We are confident of the Group's performance in future and increase its 12-m target price to HK\$7.2.

How we view this

CGS's performance increased stably, and the operating performance is better than expected. Although the income growth of traditional brokerage business slows down, it will improve after new businesses such as Shanghai-Hong Kong Stock Connect are implemented in future, and the activity of trading will increase obviously, we believe the Group's commission incomes will increase strongly, and considering the strong growth of businesses such as investment banking and wealth management, therefore profits will continue to increase largely.

We estimate CGS's net profit would increase by 20% y-y approximately in average in the next two years.

Maintian at Buy

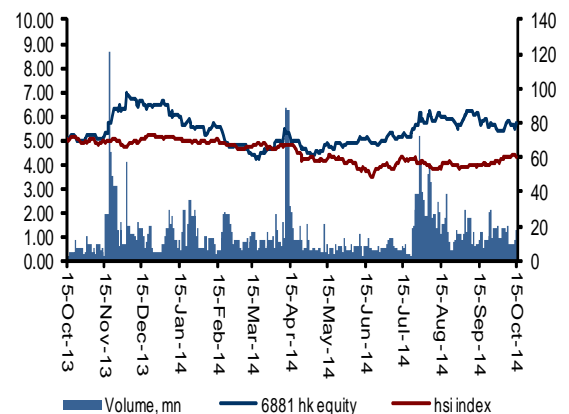
Target Price (HKD)	7.20
Forecast Dividend (HKD)	0.13
Closing Price (HKD)	5.69
Potential Upside	28.5%

Company Description

China Galaxy Securities (CGS) was established in Beijing in 2007 with a registered capital of RMB6 billion. The main promoter of the Company was Galaxy Financial Holdings and held 99.89% of shares, and the remaining four promoters held approximately 0.11% of the shares. Huijin is the company's actual controller. By the end of 1H2014, the company had 6,868 staffs, and ranked No.1 in brokerage business.

Company Data

Market Cap. (HKD mn)	42,887
Enterprise Value (HKD mn)	N/A
52 week range (HKD)	4.22 - 7.12
Closing Price in 52 week range	



Major Shareholders

1.Huijin	69.23%
2.Galaxy Financial Holdings	69.23%
3.National Council for social Security Fund	1.14%

Valuation Method

P/E, P/B, DDM

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Investment Action

We believe the market environment in 2014 will be better, and CGS's incomes will increase obviously, and the profit growth will maintain at the stable level in future. Therefore we are confident of the Group's performance in future and increase its profit estimation in the next two years, and increase its 12-m target price to HK\$7.2, 26.5% higher than the latest closing price, equivalent to 12.8xP/E and 1.4xP/B in 2015 respectively, the valuation is attractive, and recommend Buy rating.

Key Financial Summary

FYE	12/13	12/14F	12/15F	12/16F
Total revenue	8,426	10,251	12,271	14,528
Net Profit, adj. (RMB mn)	2,135	2,889	3,357	3,807
EPS, adj. (RMB)	0.31	0.38	0.45	0.51
P/E (X)	14.6	11.7	10.1	8.9
BVPS (RMB)	3.34	3.67	4.03	4.45
P/B (X)	1.3	1.2	1.1	1.0
DPS (RMB)	0.06	0.09	0.10	0.12
Div. Yield	1.4%	1.9%	2.3%	2.8%

Source: Bloomberg, PSR est.

RMB mil	2013H1	2014H1	Growth rate	Note
Commission and fee income	2,309	2,454	6.3%	Brokerage incomes decreased
Interest income	1,124	1,696	50.9%	Strong growth of financing margin
Net investment gains	387	646	66.9%	Large increase of investment incomes
Total revenue	3,828	4,806	25.5%	
Total expenses	(2,498)	(3,036)	21.5%	Sharp growth of interest expenses and staff costs
Profit before income tax	1,330	1,770	33.1%	
Income tax	(352)	(417)	18.5%	
Profit for the year	978	1,353	38.3%	
Minority interest	10	6	-40.0%	
Net profit	968	1,347	39.2%	

Source: PSR, Company report

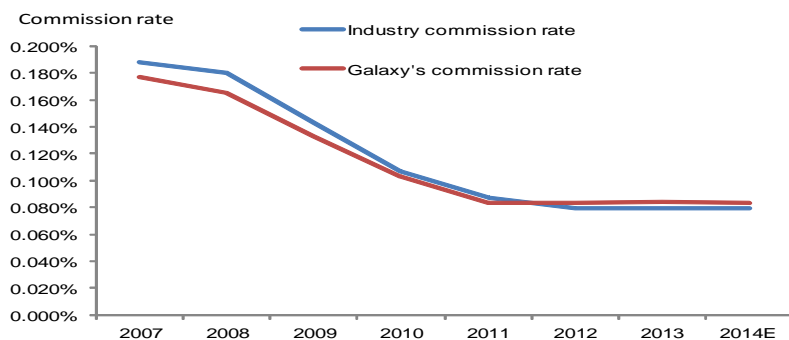
Obvious advantages of the brokerage business

CGS is one of the largest brokers in China, and its securities brokerage net revenue ranked No.1 in recent years. CGS has the widest networks in the industry. By the end of 2013, the incomes of brokerage business amounted to RMB3.9 billion, with the market share of 5.14%. As at the end of June 2014, the Group has completed the establishment of 7 branch offices and 64 securities branches, and there were another 36 branches that were in the process of establishment.

During the period, CGS insisted on combining online and offline services, organizing and conducting new marketing services for clients through online channels such as payment by third parties and marketing through Baidu Search. The Group received the letter of approval from CSRC, and became the first batch of securities traders with qualification for doing internet securities business on a pilot basis in the industry. Meanwhile, the Group also increased the supplies of financing products. By the end of 1H2014, the sales of financial products amounted to RMB6.348 billion, up 68.7% y-y.

Due to obvious advantages of brokerage business, the proportion of incomes of such businesses was around 80% in recent years, much higher than the peers. However, the growth of the commission fee continued to go down due to the fiercer competition. By the end of June, incomes of securities brokerage business reached to RMB3.073 billion, up 13.44% y-y, around 64% of total revenue, mainly caused by the low level of commission rate, and we expect the proportion will go down continually in future.

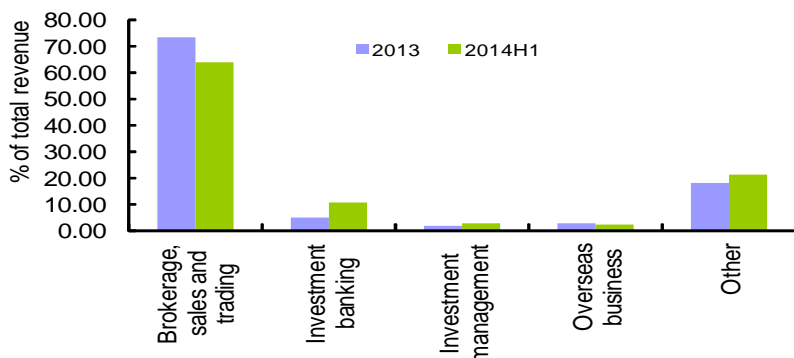
Figure 1 Galaxy's commission rate



Source: WIND, the company's report, Phillip Securities

CGS also made great efforts to expand asset management business except traditionally brokerage business in 2014. Incomes of investment banking business grew obviously due to the re-opening of IPOs in A Shares. By the end of 1H2014, incomes of CGS's investment banking business amounted to RMB506 million, up 161.73% y-y largely. Asset management business and overseas business maintained strong growth, increased significantly by 22.39% and 78.57% y-y to RMB84 million and 100 million respectively. The performance of the Group's investment banking business is in line with our expectation.

Figure 2 Proportion of businesses of CGS



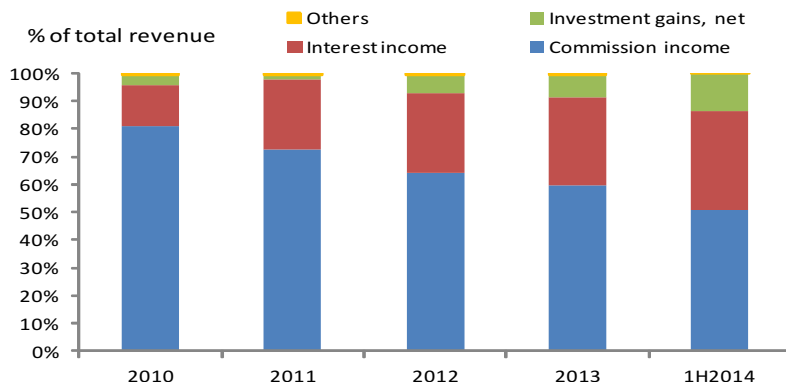
Source: the Company's report, Phillip Securities

Strong growth of new businesses

Due to the improvement of the market, margin financing and securities lending also increased significantly in 2014, and as at the end of June, CGS recorded RMB21.271 billion in such business, up 81.3% y-y strongly. We believe its growth would increase over 100% in 2014;

According to the type of business, interest income increased largely due to the strong growth of margin financing, the proportion grew from 14.7% in 2010 to 31.6% in 2013. As at the end of June, the proportion of interest income to total revenue increased to 35.3%. We believe it will continue to go up in future.

Figure 3 Portion of interest and commission incomes of CGS



Source: the Company's report, Phillip Securities

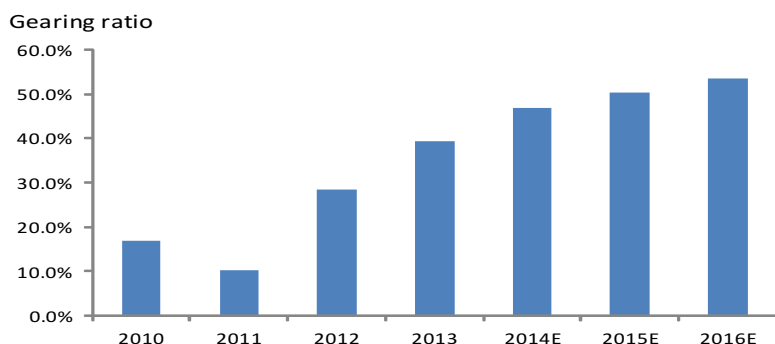
Stable growth of asset scale

Due to the demand of the business development in recent years, CGS's capital pressure increased. Considering the increased demand of the capital, The Group was listed in H Shares in 2013, raising proceeds together with interest income amounting to HK\$8.148 billion, equivalent to RMB6.498 billion.

CGS's assets maintained stable growth. As at the end of 1H2014, total assets achieved to RMB90.328 billion, up 15.39% compared with the end of 2013. Net assets increased by 4.44% to RMB26.294 billion. Meanwhile, current liabilities increased by 20.6% to RMB63.735 billion, which caused the gearing ratio to increase by 4.51ppts to 43.74%.

We expect the Group's gearing ratio will increase continually in future.

Figure 4 The gearing ratio of CGS



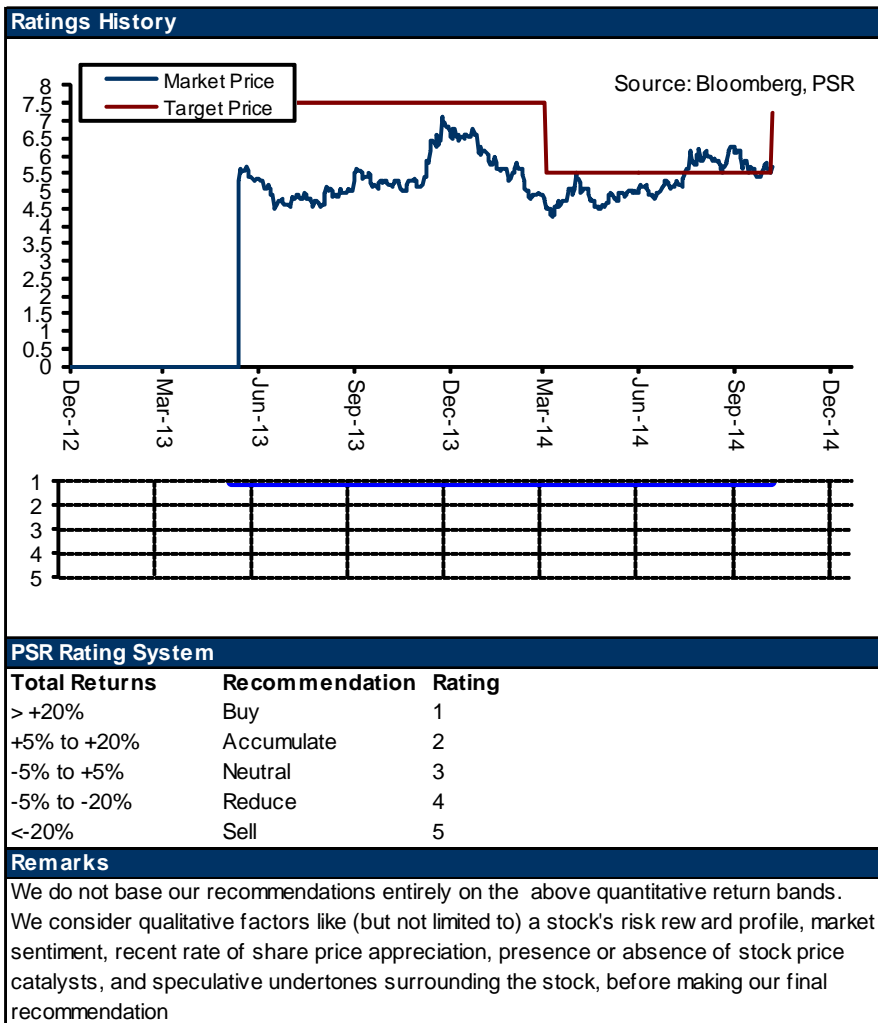
Source: the Company's report, Phillip Securities

Risks

- Decrease of fee and commission income;
- Investment gains dropped significantly;
- Share price declined sharply affected by the market environment.

FYE	FY12	FY13	FY14F	FY15F	FY16F
Valuation Ratios					
P/E (X)	19.0	14.6	11.7	10.1	8.9
P/B (X)	1.5	1.3	1.2	1.1	1.0
Dividend Payout ratio	0.00%	20.16%	22.63%	23.37%	24.73%
Dividend Yield	0.0%	1.4%	1.9%	2.3%	2.8%
Per share data (RMB)					
EPS, reported	0.24	0.31	0.38	0.45	0.51
EPS, adj.	0.24	0.31	0.38	0.45	0.51
DPS	0.00	0.06	0.09	0.10	0.12
BVPS	2.91	3.34	3.67	4.03	4.45
Growth					
Total revenue	-7.3%	41.3%	21.7%	19.7%	18.4%
Profit before income tax	-16.6%	53.4%	34.8%	16.1%	13.2%
Profit for the year	-9.6%	50.4%	34.8%	16.5%	13.3%
Net Income, adj.	-10.0%	50.4%	35.3%	16.2%	13.4%
Key Ratios					
Operating margin	31.64%	34.33%	38.05%	36.90%	35.29%
Net margin	23.97%	25.41%	28.26%	27.43%	26.28%
D/E Ratio	28.48%	39.23%	46.75%	50.33%	53.39%
ROAA	2.30%	2.99%	3.21%	3.06%	3.02%
ROAE	8.49%	10.02%	10.94%	11.58%	11.91%
Current ratio (x)	1.3	1.4	1.4	1.3	1.3
Adjusted current ratio (x)	3.2	2.4	2.1	1.9	1.8
Income Statement (RMB mn)					
Revenue	5,924	8,403	10,224	12,238	14,489
Other income and gains	38	23	28	33	40
Total revenue	5,962	8,426	10,251	12,271	14,528
Total expenses	(4,075)	(5,533)	(6,351)	(7,743)	(9,401)
Profit before income tax	1,886	2,893	3,900	4,528	5,127
Income tax	(454)	(738)	(996)	(1,146)	(1,295)
Income tax rate	24.06%	25.51%	25.54%	25.30%	25.25%
Profit for the year	1,433	2,155	2,904	3,382	3,832
Minority interest	13	20	15	25	25
Net profit	1,420	2,135	2,889	3,357	3,807
Dividend	0	467	654	785	941
Balance sheet (RMB Million)					
Advances to customers	5,439	18,392	29,427	37,078	45,977
Available-for-sale financial asset:	5,908	9,295	10,039	10,741	11,493
Financial assets held under resale	810	1,284	770	963	1,252
Financial assets held for trading	4,622	5,027	4,273	4,401	4,621
Financial assets designated as at	831	943	1,650	1,980	2,218
Deposits with exchanges and a r	2,614	2,841	4,119	4,737	5,353
Clearing settlement funds	4,541	4,374	6,124	7,655	9,568
Bank balances	36,607	33,084	41,355	45,491	49,130
Total current assets	62,277	76,495	99,807	115,575	132,773
Property, plant and equipment	516	394	374	401	429
Goodwill	223	223	223	223	223
Other intangible assets	363	349	359	377	396
Available-for-sale financial asset:	743	495	470	484	513
Deferred tax assets	174	308	200	210	231
Total non-current assets	2,019	1,789	1,899	2,018	2,117
Total assets	64,296	78,284	101,706	117,594	134,890
Due to banks and a non-bank fina	319	593	1,957	2,544	3,333
Accounts payable to brokerage c	39,746	36,451	49,209	55,606	61,723
Accrued staff costs	1,105	1,288	1,610	1,932	2,241
Financial assets sold under repur	5,183	8,898	13,792	18,619	24,019
Total current liabilities	46,737	52,863	73,751	86,802	100,784
Share capital	6,000	7,537	7,537	7,537	7,537
Reserves	6,268	11,542	12,783	14,032	15,682
Retained profits	5,162	6,095	7,314	8,777	10,357
Equity attributable to owners	17,430	25,175	27,634	30,346	33,575
Minority interest	129	247	320	445	530
Total equity	17,559	25,422	27,954	30,791	34,105
Total liabilities and equity	64,296	78,284	101,706	117,594	134,890

Source: PSR



PHILLIP RESEARCH STOCK SELECTION SYSTEMS

Total Return	Recommendation	Rating	Remarks
>+20%	Buy	1	>20% upside from the current price
+5% to +20%	Accumulate	2	+5% to +20% upside from the current price
-5% to +5%	Neutral	3	Trade within \pm 5% from the current price
-5% to -20%	Reduce	4	-5% to -20% downside from the current price
<-20%	Sell	5	>20% downside from the current price

We do not base our recommendations entirely on the above quantitative return bands. We consider qualitative factors like (but not limited to) a stock's risk reward profile, market sentiment, recent rate of share price appreciation, presence or absence of stock price catalysts, and speculative undertones surrounding the stock, before making our final recommendation

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