

JPM-pp1

Asia Pacific Equity Research

24 March 2015

CITIC Securities Co Ltd - H (6030 HK)

Neutral

Price: HK\$27.70

23 Mar 2015

Price Target: HK\$32.00

PT End Date: 31 Dec 2015

2014 results review and key takeaways from analyst briefing

Citic Securities reported FY14 net profit of Rmb11.3bn, up 116% YoY (Table 1). As Citic Securities had pre-announced the key financial data on 30 January 2015 ([link](#) to our comment), we believe the market will focus on details from the analysts' briefing today. On a company level, Citic Securities continues to lead the league table on brokerage, underwriting and asset management business. However, our key takeaways from the analysts' briefing is that the industry might see some major challenges: a) increasing competition as banks might obtain the license to participate in equity underwriting within two years; b) commission rate in 2014 continued to trend down by 13% yoy to 6.91bps; c) there is a implicit cap on leverage level (asset/equity) of 5x under the current liquidity regulation in China. We are positive on brokers in the long term based on the expansion of capital markets in China. Nevertheless, this long-term positive story might seem less compelling due to rising competition and the implicit cap on leverage level.

Details from analysts briefing:

Management presentation:

- If excluding CLSA and China AMC, Citic Securities' revenue went up 60% yoy, and net profit rose 123% yoy in 2014. Cost income ratio decreased from 44.5% in 2013 to 37.9% in 2014.
- Industry brokerage commission fee dropped 13% to 6.91bps in 2014. Citic Securities' commission rate dropped 13-15% as well
- Citic Securities has 6.46% market share in the brokerage business
- Asset management: Citic Securities' (not including China AMC) AUM is Rmb755 bn, of which ~Rmb600 bn is from bank-broker cooperation (low commission); ~RMB160bn is actively managed AUM
- ABS issuance size is 300bn for the industry
- Citic Securities believes margin financing will be driven by institutional investors, rather than retail as in the past

Q&A

1. Leverage

- Citic Securities considers its current leverage of 3.7x prudent and within control
- After Citic Securities' planned Rmb25-30 bn refinancing, its leverage will drop to ~3.0x
- Citic Securities also announced Rmb80 bn bond issuance plan
- Future constraint on leverage may be liquidity. Liquidity metrics need to be 120%+ if leverage is above 5x
- There is some difference in liquidity calculation vs international standard, i.e., even margin loans maturing in 3 months do not count as near-term cash flow

2. International business

- International business accounts for 20% revenue, 4-5% in profit in 2014
- CLSA contributed 2/3 international business revenue, 1/3 international business profit.
- Benefits from CLSA consolidation: IB business integration, QFII clients, cooperation in connect program, reduction in costs in some overseas business

3. Revision on Securities Law

- Under the "new normal" economy, it is important to develop the capital market
- The revised regulation needs to include more than just regular equity products
- Potential areas for development include: bond market, SME pre-listing board (新三板), OTC, participation from social funds, SOE reform, REITs
- Citic Securities believes brokers industry growth could be faster than banking industry growth in China

4. Margin financing business

- Competition different from brokerage business
- Key is if the broker can obtain the funding, and if the funding is cheap enough
- Citic Securities plans to enhance its ability in offering sophisticated services
- Citic Securities' margin financing market share in the future hard to predict

5. Broker license and competition from non-brokers

- Banks are already underwriting debt

- Citic Securities expects banks will get the equity underwriting license within 2 years
- Citic Securities is talking to regulators to issue license to brokers to do some banking business, such as settlements
- Banks may see interest rate de-regulation, and may see compression on NIM, so drive them to do more other financial services;
- Internet business: Citic Securities plans to offer tailor-made products that internet finance cannot imply replicate on a mass-scale

Table 1: Summary of 2014 results

In Rmb mm unless otherwise stated	2013 Actual	2014 Actual	YoY	Actual vs JPM		1H14	2H14	HoH
				2014 JPM Est.	est			
P&L item								
Revenue	20,048	36,971	84%	35,013	6%	13,995	22,975	64%
Total commission and fees income	10,699	18,915	77%	20,637	-8%	6,805	12,110	78%
Total interest income	4,090	7,851	92%	8,729	-10%	3,227	4,624	43%
Net investment gain	5,259	10,204	94%	5,646	81%	3,964	6,241	57%
Other income	231	2,555	1008%	2,566	0%	2,335	220	-91%
Total revenue and other income	20,279	39,525	95%	37,578	5%	16,330	23,195	42%
Total expenses	(13,644)	(24,733)	81%	(26,002)	-5%	(10,531)	(14,201)	35%
Profit before tax	6,846	15,422	125%	14,077	10%	5,824	9,598	65%
Income Tax	(1,538)	(3,560)	131%	(3,324)	7%	(1,490)	(2,070)	39%
Net profits	5,308	11,861	123%	10,752	10%	4,334	7,528	74%
Minority interest	(64)	(524)	718%	(605)	-13%	(258)	(266)	3%
Attributable profits	5,244	11,337	116%	10,147	12%	4,076	7,262	78%
Key balance sheet items								
Client deposits and clearing funds	40,125	96,841	141%	63,152	53%	49,814	96,841	94%
Loan to margin clients	34,302	74,135	116%	91,553	-19%	38,734	74,135	91%
Total assets	271,354	479,626	77%	374,029	28%	339,744	479,626	41%
Total liabilities	181,952	378,495	108%	276,323	37%	248,305	378,495	52%
Equity attributable to shareholders	87,688	99,099	13%	95,992	3%	89,731	99,099	10%
Key Ratios								
ROAA	2.4%	3.0%	63 bps	3.14%	13 bp	2.67%	3.54%	88 bps
ROAE	6.0%	12.1%	612 bps	11.05%	-109 bp	9.19%	15.38%	619 bps
Avg assets/ avg equity (x)	252.6%	402.1%		3.51 x		3.44 x	4.34 x	
Avg assets (excl. client\$)/avg equity	210.1%	328.7%		2.95 x		2.94 x	3.56 x	

Source: J.P. Morgan estimates, Company data.

Investment Thesis

1. CITIC Securities is the largest securities firm in China in terms of asset size at end 2013. It provides full full-platform services, including brokerage, investment banking, assets management, etc.
2. CITIC Securities ranked number 1 in terms equity turnover in the Brokerage business. It ranks number 1 in both equity underwriting and debts underwriting among brokers in terms of underwriting volume in 2013.
3. CITIC Securities' brokerage business market share is the largest in Hong Kong compared to other Chinese brokers, mainly due to its acquisition of regional brokers, CLSA, which becomes a wholly-owned subsidiary of Citic S in 2013.
4. However, CITIC Securities sees constraint on capital ratio as its net capital to net assets was 49% at end 2013, close to warning level of 48%. This becomes a key constraint for Citic Securities to expand its flow base business.
5. Investment assets contributed to 39% of CITIC Securities' total assets, highest among peers at end 2013. Investment income accounted for 26% of CITIC Securities, highest among peers. Thus, CITIC Securities is subject to higher investment risk than peers.

Valuation

Our Dec-15 price target of HK\$32.0 is based on DDM valuation. Key assumptions include: risk-free rate of 4.5%, equity premium of 8%, cost of capital of 14.9%, long term growth of 7%, long term ROE of 31.1% and terminal date of valuation of Dec-16.

Risks to Rating and Price Target

Upside risks include: a) faster than expected fee-base business, such as advisory and underwriting; b) improving ADT and commission rates for the industry; c) contribution from subsidiaries, such as CLSA and China AMC, higher than expected; d) relaxation on capital rule easing pressure on capitals.

Downside risks include: a) faster-than-expected capital consumption lead to rising capital replenishment need; b) loss on investment; c) unable to exit on principal investments due to sluggish capital markets; d) deteriorating trend on A shares.

Banks & Financial Services

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Date	Rating	Share Price (HK\$)	Price Target (HK\$)
31-May-12	N	15.70	16.00
30-Aug-12	N	13.24	14.00
12-Aug-14	N	19.50	21.00
15-Jan-15	N	29.30	32.00

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