

FIG
Diversified Financial Services
 Equity – China

Galaxy Securities (6881 HK)

Buy

Target price (HKD)	13.60
Share price (HKD)	8.58
Upside/Downside (%)	58.5

Performance	1M	3M	12M
Absolute (%)	-7.6	-6.5	85.9
Relative ^A (%)	-5.6	-9.8	53.0

Index^A Hang Seng Index

RIC 6881.HK
 Bloomberg 6881 HK

Market cap (USDm) 8,291
 Market cap (HKDm) 64,670

Free float (%) 22

Buy: FY14 result shows prominent proxy value

- ▶ **Profit grew 77% in 2014. Stockbrokerage fee contributed 43% of total revenue – higher than its H-share listed peers**
- ▶ **We believe buoyant turnover is well-supported; concerns about competition, opening and regulations are overblown**
- ▶ **We establish a Buy rating with HKD13.6 fair value TP (from HKD13.8)**

Best turnover proxy. Galaxy reported net profit up 77% y-o-y to RMB3.8bn in 2014, with a sector-leading ROE of 14%; 43% of its gross revenue is derived from the brokerage fee, above the 25-41% of the three other H-share listed China brokers. Looking forward, we expect brokerage to remain its key focus under the “one core, two wings” strategy and this, in our view, makes Galaxy the best proxy to China’s active stock market. YTD, the A-share market stock average daily turnover (ADT) has exceeded RMB700bn, or over 130% above the 2014 level (of RMB304bn), supporting our view that the buoyant market turnover is well supported by China’s monetary easing and capital market reforms. We forecast Galaxy to maintain a sector-leading ROE in 2015e, even after taking into account its coming H-share placement.

Concerns are overblown. We note Galaxy’s share price has dropped YTD alongside its peers, probably reflecting some exaggerated concerns:

- ▶ **Regulatory changes:** The margin financing cooling measures announced by the regulator in January 2015 seems to have created lingering concern about unfavourable policy changes. Nevertheless, we believe the policy initiatives are intended to preserve a healthy long-term industry development; looking forward, with the prospective Securities Law revision in 2H15, more supportive measures might be unveiled.
- ▶ **Price war:** We estimate the industry’s brokerage commission rate has declined to 7bp (in a net basis) in 2014. Whilst we see further downside, especially with potential brokerage account liberalization in China, the pace of decline should be moderate (for details, see our thematic report on *China Brokers: Expanding the horizon*, on 16 January 2015).
- ▶ **Industry opening:** Some worry banks might be a potential threat after industry opening. We nevertheless believe the potential risks are contained, particularly under the “risk segregation” basis (for details, please read our note on *China brokers: Banks are coming but we don’t see risks materializing*, published on 9 March 2015).

We establish a Buy rating on Galaxy. We have not revised our forecast. Our fair value TP of HKD13.6 (from HKD13.8) is derived from a three-stage residual income valuation approach which implies a 2.5x 2015e PB. Key downside risks include unfavourable M&A, unexpected changes to the market and industry conditions and slower-than-expected leveraging process.

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Galaxy: Comparison of 2H14/FY14 results (RMBm unless otherwise specified)

	2H13	1H14	2H14	yoy	hoh	FY13	FY14	yoy
Income statement								
Fee and commission income	2,731	2,454	4,681	71%	91%	5,039	7,135	42%
Interest income	1,542	1,696	2,486	61%	47%	2,666	4,182	57%
Investment income	310	646	1,006	224%	56%	697	1,653	137%
Other income	15	10	37	148%	277%	23	47	105%
Total revenues and other income	4,598	4,806	8,211	79%	71%	8,426	13,017	54%
Finance costs	(396)	(460)	(917)	132%	99%	(685)	(1,377)	101%
Staff cost	(1,390)	(1,540)	(2,651)	91%	72%	(2,490)	(4,191)	68%
Impairment expenses	(70)	(19)	(22)	-69%	18%	(192)	(41)	-79%
Other expenses	(1,179)	(1,018)	(1,386)	18%	36%	(2,166)	(2,404)	11%
Total operating expenses	(3,035)	(3,037)	(4,976)	64%	64%	(5,533)	(8,013)	45%
Profit before tax	1,563	1,770	3,233	107%	83%	2,893	5,003	73%
Income tax	(386)	(417)	(796)	106%	91%	(738)	(1,213)	64%
Minority interests	(9)	(6)	(14)	44%	129%	(20)	(20)	0%
Net profit to shareholders	1,168	1,347	2,424	108%	80%	2,135	3,771	77%
Balance sheet								
Available for sale investments	9,790	9,994	11,584	18%	16%	9,790	11,584	18%
Financial assets held for trading	5,970	5,148	7,322	23%	42%	5,970	7,322	23%
Financing assets	19,585	23,212	61,846	216%	166%	19,585	61,846	216%
Bank balance and cash	3,340	5,016	7,654	129%	53%	3,340	7,654	129%
Brokerage client deposits	29,744	34,232	44,158	48%	29%	29,744	44,158	48%
Others	9,856	12,725	47,463	382%	273%	9,856	47,463	382%
Total assets	78,284	90,328	180,026	130%	99%	78,284	180,026	130%
Accounts payable	36,451	43,059	78,408	115%	82%	36,451	78,408	115%
Total liabilities	52,863	63,735	150,690	185%	136%	52,863	150,690	185%
Total shareholders' equity	25,175	26,294	29,024	15%	10%	25,175	29,024	15%
Key drivers and ratios								
Stock ADT (RMBbn)	206	183	418	103%	129%	197	304	54%
SHCOMP (closing balance)	2,116	2,048	3,235	53%	58%	2,116	3,235	53%
Cost to income	64.5%	62.8%	60.3%	NA	NA	63.4%	61.2%	NA
ROA (annualized)	2.9%	3.2%	3.6%	NA	NA	3.0%	2.9%	NA
ROE (annualized)	9.3%	10.5%	17.5%	NA	NA	10.0%	13.9%	NA
Adjusted leverage	1.7	1.8	3.5	NA	NA	1.7	3.5	NA

Source: Company data, CEIC

Valuation and risks

We continue to use a three-stage residual income valuation approach to value Galaxy. Our key assumptions include a 13.5% medium-term growth rate and a 14% COE, both of which are unchanged. Our target price is adjusted to HKD13.6 (from HKD13.8) to reflect HSBC FX team's latest FX forecast of 1.23 (RMB:HKD). Our TP represents the current value and implies a 2015e PB of 2.5x. Note we haven't revised our forecasts, which haven't taken into the consideration of the coming H-share placement.

Key downside risks include: 1) **unfavourable M&A moves**. Galaxy has stated its intention to act as an industry consolidator. However, the targets, pricing and timing remain unclear; 2) **change in market conditions**. Brokerage is a volatile industry and Galaxy derives a large percentage of its revenue from brokerage fee. This makes it particular sensitive to changes in market turnover and commission rates in China; 3) **growth in financing business**. The speed of leverage expansion to support financing business growth could be faster or slower than we have expected, and could affect Galaxy positively or negatively.

Disclosure appendix

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From 23rd March 2015 HSBC has assigned ratings on the following basis:

The target price is based on the analyst's assessment of the stock's actual current value, although we expect it to take six to 12 months for the market price to reflect this. When the target price is more than 20% above the current share price, the stock will be classified as a Buy; when it is between 5% and 20% above the current share price, the stock may be classified as a Buy or a Hold; when it is between 5% below and 5% above the current share price, the stock will be classified as a Hold; when it is between 5% and 20% below the current share price, the stock may be classified as a Hold or a Reduce; and when it is more than 20% below the current share price, the stock will be classified as a Reduce.

Our ratings are re-calibrated against these bands at the time of any 'material change' (initiation or resumption of coverage, change in target price or estimates).

Upside/Downside is the percentage difference between the target price and the share price.

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For each stock we set a required rate of return calculated from the cost of equity for that stock's domestic or, as appropriate, regional market established by our strategy team. The target price for a stock represented the value the analyst expected the stock to reach over our performance horizon. The performance horizon was 12 months. For a stock to be classified as Overweight, the potential return, which equals the percentage difference between the current share price and the target price, including the forecast dividend yield when indicated, had to exceed the required return by at least 5 percentage points over the succeeding 12 months (or 10 percentage points for a stock classified as Volatile*). For a stock to be classified as Underweight, the stock was expected to underperform its required return by at least 5 percentage points over the succeeding 12 months (or 10 percentage points for a stock classified as Volatile*). Stocks between these bands were classified as Neutral.

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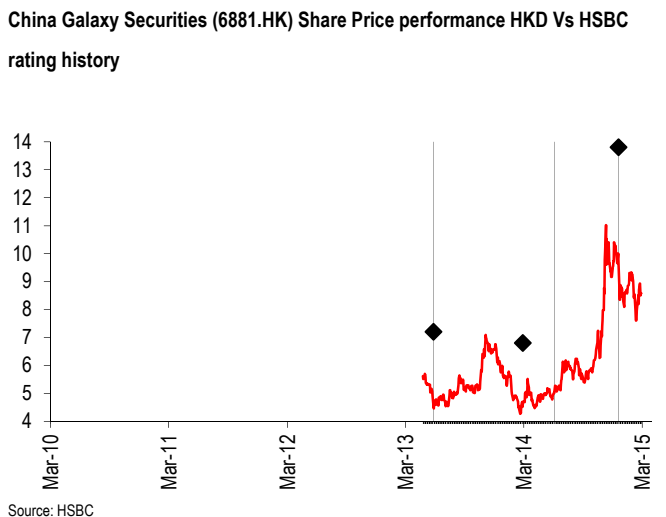
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As of 30 March 2015, the distribution of all ratings published is as follows:

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Share price and rating changes for long-term investment opportunities



Recommendation & price target history		
From	To	Date
N/A	Overweight (V)	24 June 2013
Overweight (V)	Overweight	02 July 2014
Overweight	Overweight (V)	16 January 2015
Target Price	Value	Date
Price 1	7.20	24 June 2013
Price 2	6.80	27 March 2014
Price 3	13.80	16 January 2015

Source: HSBC

HSBC & Analyst disclosures

Disclosure checklist

Company	Ticker	Recent price	Price Date	Disclosure
CHINA GALAXY SECURITIES	6881.HK	8.58	27-Mar-2015	1, 4, 5, 6, 11

Source: HSBC

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