

JPM-pp1

Asia Pacific Equity Research

30 March 2015

# China Galaxy Securities Co - H (6881 HK)

Neutral

Price: HK\$8.58

27 Mar 2015

Price Target: HK\$10.75

PT End Date: 31 Dec 2015

## Key takeaways from analyst briefing

Galaxy Securities reported FY14 net profit of RMB3.8 bn, up 77% YoY (Table 1). As Galaxy Securities had pre-announced the key financial data on 6 February 2015 ([link](#) to our comment), we believe the market will focus on details from the analyst briefing on March 30th. Galaxy Securities continues to maintain its advantage in brokerage and margin financing business. Its net commission rate dropped to 6.6.bps in 2014 and 6.3 bps in 1Q15, but still 6% higher than the industry average as of 1Q15.

Details from analyst briefing:

### Management presentation:

- Galaxy has 5.93 mn customers, the largest in the market
- Galaxy had 317,000 new customers in 2014, accounting for 6.81% market share in new account opening
- Galaxy opened 7 branch offices and 96 securities branches in 2014
- Galaxy's trading turnover of stocks and funds amounted to RMB7.71 trn with a market share of 5.08%, ranking #3 in the industry
- Galaxy's margin financing transactions volume was RMB2.09 trn in 2014, accounting for 6.29% market share, ranking #2 in the industry. It had 227,700 credit accounts at end 2014
- Galaxy expects fast growth in equity-based pledge business in 2015
- Galaxy's HK subsidiary had RMB265 mn revenue in 2014, up by 26% YoY

## Q&A

### 1. Commission

- Galaxy's brokerage commission rate (net) was 6.6 bps in 2014, and 6.3 bps in 1Q15
- The commission decreased in 1H14, but was stable in 2H14
- In 1Q15, industry commission rate dropped by 6-8%. Galaxy's commission is 6% higher than industry average
- Galaxy's commission rates (net) for new clients is ~6bps in 2015, while industry average is 2-4 bps
- Galaxy will not enter into pricing war, and will focus more on the wealth management side of the business
- Galaxy expects commission rates to further diverge in the future: higher commission rates for high-end clients, and lower commission rates for low-end clients

### 2. A share IPO and leverage

- Galaxy's A-share listing currently ranks #203 in the queue on the CSRC website. A-share IPO is in the process of CSRC reviewing. No specific timeline can be disclosed
- Leverage was 3.5x at end 2014. Mgmt expect leverage will be slightly lowered after A-share IPO. If the IPO issued by June 2016, mgmt estimates leverage to be 3-3.5x
- Need debt financing to support margin financing business development
- Galaxy expects leverage to be 3.5-5x in the mid term

### 3. Account Management (账户管理)

- Account Management is broader than wealth management on behalf of customers (代客理财). The latter is not allowed until the

## revision of the Securities Law

- The Regulation on Account Management was passed faster than Galaxy expected. Galaxy was one of the promoters of this regulation, and is prepared in this area

- Galaxy believes this regulation will facilitate brokers to transform from commission-based business only to wealth management business

### 4. New branch opening

- Galaxy expects 20+ (no more than 30) new securities branches to be opened in 2015

### 5. Funding cost

- Margin financing rate was narrowed by 25 bps after interest rate cuts

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			
<b>P&amp;L item</b>								
<b>Revenue</b>	8,403	12,970	54%	12,935	0%	4,796	8,174	70%
Total commission and fees income	5,039	7,135	42%	7,416	-4%	2,454	4,681	91%
Total interest income	2,666	4,182	57%	4,191	0%	1,696	2,486	47%
Net investment gain	697	1,653	137%	1,327	25%	646	1,006	56%
Other income	23	47	105%	25	87%	10	37	277%
<b>Total revenue and other income</b>	8,426	13,017	54%	12,960	0%	4,806	8,211	71%
<b>Total expenses</b>	(5,533)	(8,014)	45%	(8,771)	-9%	(3,037)	(4,977)	64%
<b>Profit before tax</b>	2,893	5,003	73%	4,189	19%	1,770	3,233	83%
Income Tax	(738)	(1,213)	64%	(1,069)	13%	(417)	(796)	91%
<b>Tax rates</b>	26%	24%	-5%	26%	-5%	24%	25%	4%
Net profits	2,155	3,790	76%	3,121	21%	1,353	2,438	80%
Minority interest	(20)	(20)	0%	(20)	0%	(6)	(14)	129%
<b>Attributable profits</b>	2,135	3,771	77%	3,101	22%	1,347	2,424	80%
<b>Key balance sheet items</b>								
Client deposits and clearing funds	33,827	74,367	120%	52,165	43%	39,567	74,367	88%
Loan to margin clients	18,393	61,443	234%	55,178	11%	22,557	61,443	172%
<b>Total assets</b>	<b>78,284</b>	<b>180,026</b>	130%	<b>135,648</b>	33%	<b>90,328</b>	<b>180,026</b>	99%
<b>Total liabilities</b>	<b>52,863</b>	<b>141,715</b>	168%	<b>107,694</b>	32%	<b>63,735</b>	<b>141,691</b>	122%
<b>Equity attributable to shareholders</b>	<b>25,175</b>	<b>29,024</b>	15%	<b>27,707</b>	5%	<b>26,295</b>	<b>29,024</b>	10%
<b>Key Ratios</b>								
ROAA	3.00%	2.92%	-8 bps	2.90%	-2 bp	3.19%	3.59%	39 bps
ROAE	10.02%	13.91%	389 bps	11.73%	-219 bp	10.47%	17.53%	706 bps
Avg assets/ avg equity (x)	3.35 x	4.77 x		4.05 x		3.28 x	4.89 x	1.61 x
Avg assets (excl. client\$)/avg equity	1.68 x	2.77 x		2.42 x		1.85 x	2.83 x	0.98 x

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

## Investment Thesis

Galaxy is the largest brokerage firm in China with a strong client and branch network. Its focus on the brokerage business distinguishes it from other HK-listed China brokers, as Galaxy has a simpler balance sheet with lower exposure to proprietary trading and exotic investment products. In addition, we believe its solid capital position, strong network and client base will enable it to achieve faster growth in new business, such as margin financing and securities lending.

## Valuation

Our Dec-15 price target of HK\$10.75 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 22.5% 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) profits contribution from subsidiaries is higher than expected; d) relaxation on capital rule easing pressure on capital.
- Downside risks include: a) commission rates could fall faster than we expect; b) average daily turnover of A-share market could be lower than expected; c) Galaxy may suffer loss on its proprietary trading book amid high interest rate volatility; d) Galaxy may suffer credit loss on its new business, such as repo lending and margin financing; e) Galaxy may list on the A-share market in 2015, and this could dilute 2015 and 2016 ROE by 310bps and 440bps respectively, according to our analysis.

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Date	Rating	Share Price (HK\$)	Price Target (HK\$)
25-Jun-13	OW	4.91	5.70
22-Jan-14	OW	5.92	7.10
15-Jan-15	N	10.00	10.75

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