

China Merchants Securities Company Ltd - H

Higher margin, higher quality. Initiate coverage at OW

Initiation
Overweight



6099.HK, 6099 HK

Price: HK\$12.26

Price Target: HK\$15.50

We initiate coverage of China Merchant Securities (CMS) with an OW rating and a Dec-17 PT of HK\$15.5. We believe the business strategy of prioritizing profit margins over volume growth and noted emphasis on risk management will position it for superior growth and stronger/more stable margin vs peers.

- **Emphasis on margins:** CMS is differentiated from peers by focusing more on higher margin segments such as institutional customers, where it ranks first for trading volume with mutual funds and prime brokerage services with PE funds in China, and HNWI individuals via its Zhiyuan WM plans for equity brokerage, SME/NEEQ/ABS for equity/debt underwriting, and collective asset management schemes on AM businesses. CMS thus is able to enjoy superior commission rates on average and deliver the highest ROA among H-share listed brokers.
- **Stronger risk management:** CMS is one of the few brokers to maintain an AA regulatory rating in 2016, while other leading H-share listed peers were downgraded. The regulatory rating is beneficial to earnings, as it helps limit contributions to investors' protection funds and benefit funding costs. It also supports higher capital efficiency and facilitates new business development that is crucial for institutional businesses.
- **Investment risks:** 1) Risks related to contributions to the government stabilization fund (the CSFC) and ban on hedging; 2) tighter regulatory supervision on the rapidly emerging domestic asset management businesses; 3) long-term pressure on brokerage commission rates due to the development of online/mobile industry platforms and fragmented market conditions, combined with uncertainties from potential deregulation of brokerage fee structure.
- **Valuation:** We expect CMS to deliver superior ROA through the cycle on the back of its more stable commission rates, focuses on higher margin segments, and better capital efficiency. Based on our DDM model, our Dec-17 PT of HK\$15.5 implies 1.5x and 1.4x FY16/17E P/B and 15x and 11x FY16/17E P/E.

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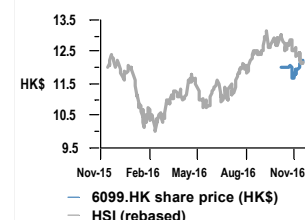
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Price Performance



	YTD	1m	3m	12m
Abs	2.2%	2.0%	2.2%	2.2%
Rel	0.5%	6.1%	5.0%	1.0%

China Merchants Securities Company Ltd - H (Reuters: 6099.HK, Bloomberg: 6099 HK)

	FY14A	FY15A	FY16E	FY17E	FY18E
Operating Profit (Rmb mn)	4,633	13,083	6,710	9,523	11,811
Net Profit (Rmb mn)	3,851	10,909	5,889	8,197	10,089
EPS (Rmb)	0.72	1.88	0.93	1.21	1.49
DPS (Rmb)	0.15	0.77	0.22	0.30	0.37
EPS Growth	50.9%	160.0%	(50.2%)	29.1%	23.1%
ROE	11.2%	24.3%	10.6%	12.5%	13.9%
P/E	15.0	5.8	11.6	9.0	7.3
BVPS (Rmb)	7.15	8.32	9.23	10.13	11.25
P/BV	1.5	1.3	1.2	1.1	1.0
Div. Yield	1.4%	7.1%	2.0%	2.8%	3.4%

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

Company Data

52-week Range (HK\$)	12.30-11.58
Market Cap (Rmb mn)	73,586
Market Cap (\$ mn)	10,728
Shares O/S (mn)	6,789
Fiscal Year End	Dec
Price (HK\$)	12.26
Date Of Price	16 Nov 16
3M - Avg daily val (HK\$ mn)	-
3M - Avg daily val (\$ mn)	-
3M - Avg daily vol (mn)	-
HSI	22,324
Exchange Rate	7.76
Price Target End Date	31-Dec-17

See page 77 for analyst certification and important disclosures, including non-US analyst disclosures.

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Key catalysts for the stock price:	Upside risks to our view:	Downside risks to our view:
<ul style="list-style-type: none"> Improving A-share market sentiment and trading volumes Capital market reform Improving M&A opportunities in China that could boost CMS's financial consultancy fees 	<ul style="list-style-type: none"> Higher-than-expected brokerage commission Higher-than-expected income from new business Improving ADT 	<ul style="list-style-type: none"> Higher-than-expected investment risks on prop book; New entrants, particularly internet banking/brokerage providers, banks and subsidiaries of global players, may take market share from CMS and further drive down commission rates

Key financial metrics (RMB mn)	FY15A	FY16E	FY17E	FY18E
Brokerage commissions (LC)	14,506	6,365	6,416	6,282
Brokerage commission growth (%)	192.7%	-56.1%	0.8%	-2.1%
Underwriting commissions (LC)	2,423	2,888	4,398	5,927
Net investment gain/loss (LC)	5,681	707	3,108	3,946
Total interest income (LC)	9,906	6,947	6,679	7,384
Total Revenue (LC)	34,989	19,713	24,491	28,871
Revenue growth (%)	154.5%	-43.8%	24.3%	17.9%
Brokerage & commission expenses (LC)	(2,869)	(1,544)	(1,771)	(2,002)
Total Operating expenses (LC)	(21,906)	(13,003)	(14,968)	(17,060)
PPP (LC)	13,083	6,710	9,523	11,811
PPP margin (%)	37.4%	34.0%	38.9%	40.9%
Net income (LC)	10909	5889	8197	10089
Brokerage Commission / avg assets (%)	6.0%	2.3%	2.3%	2.1%
DPS (LC)	0.77	0.22	0.30	0.37
ROA (%)	4.5%	2.1%	3.0%	3.3%
ROE (%)	24.3%	10.6%	12.5%	13.9%
Avg assets/ avg equity (x)	5.4x	5.0x	4.2x	4.2x
Payout ratio (%)	40.9%	23.2%	25.0%	25.0%
Key model assumptions	FY15A	FY16E	FY17E	FY18E
Asset growth	50.8%	-9.1%	9.3%	8.0%
Avg assets/ avg equity (x)	5.4x	5.0x	4.2x	4.2x
ADT (RMB bn)	1,048	576	645	710

Source: Company and J.P. Morgan estimates.

Sensitivity analysis	Total revenue		EPS	
	FY16E	FY17E	FY16E	FY17E
Sensitivity to				
If equity brokerage commission up by 1bps	6.1%	5.5%	14.3%	11.5%
If equity brokerage turnover up by 10%	3.2%	2.6%	7.6%	5.5%
If debt underwriting volume up by 10%	0.0%	0.0%	0.0%	0.0%

Source: J.P. Morgan estimates.

Table 1: Comparative metrics

14-Nov-16	BBG code	Price (LC)	Rating	Dec 17		P/E (x)		P/BV (x)		Dividend yield		ROE		ROA	
				PT (LC)		16E	17E	16E	17E	16E	17E	16E	17E	16E	17E
CMS - H	6099 HK	12.26	OW	15.50		11.6	9.0	1.2	1.1	2.8	3.4	10.6	12.5	2.1	3.0
Galaxy - H	6881 HK	7.70	OW	9.50		12.4	10.1	1.1	1.0	2.6	3.1	9.0	10.3	1.9	2.4
Haitong - H	6837 HK	14.24	N	13.00		16.8	14.2	1.2	1.1	1.8	2.1	8.0	8.9	1.5	1.7
CITIC - H	6030 HK	17.66	N	19.50		16.8	14.6	1.3	1.2	1.8	2.1	7.9	8.6	2.0	2.4
Huatai - H	6886 HK	16.86	OW	22.00		15.8	12.8	1.2	1.2	1.7	2.0	8.1	9.4	1.5	1.8
Average						14.7	12.1	1.2	1.1	2.1	2.6	8.7	9.9	1.8	2.3

Source: Bloomberg, JPM estimates

Valuation and price target basis

Our H-Share PT of HK\$15.5 (Dec-17, DDM-derived) implies a forward P/BV of 1.4x and P/E of 11x (FY17E).

Valuation assumptions

Risk-free rate	3.50%
Equity premium	8.00%
Beta*	1.25
Cost of capital*	13.50%
Long-term growth	6.00%
Fair terminal P/BV multiple*	1.29
Valuation date	16-Nov-16
Terminal date	31-Dec-18
Book value (RMB)*	11.06
Dividend (RMB)*	0.77
Dec-17 price target (HKD)	15.50

Source: Bloomberg, Company and J.P. Morgan estimates.

JPM vs. consensus, change in estimates

EPS	FY16E	FY17E
JPM old		
JPM new	0.93	1.20
% chg		
Consensus	1.06	1.32

Source: Bloomberg, J.P. Morgan estimates.

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Investment Summary

CMS is one of the top-ten full-platform brokers in China, with a leading market position in the institutional business, ranking number one in both trading volume among mutual funds, and in prime brokerage for PE funds in China. CMS has also been focusing on more profitable segments such as high net worth individuals (HNW) and collective asset management among brokerage and wealth management businesses; all these should lead to more stable commission rates compared to peers. Meanwhile, its prudent risk management makes it one of the few H-share listed brokers with an AA rating, which could allow it to enjoy better capital efficiency and thus superior ROA through the cycle.

Recent developments

Enlarged capital position post H-share listing

CMS issued 980mn new shares (including over-allotment) for its H-share listing in early October at HK\$12 per share with total new capital of Rmb9.9bn, which will be deployed to expand its brokerage/WM, institutional, overseas and asset management businesses. We expect the new capital will allow CMS more flexibility to develop capital intensive businesses such as margin finance, prime brokerage and asset management under the new capital rules effective since October.

Improving earnings momentum in 3Q16

Preliminary 3Q16 earnings at CMS came in at Rmb1.74bn, up 41% QoQ and 14% YoY; there was sequential improvement in fee/commission, interest income and investment gains, with effective cost control compared to 2Q16. We expect YoY earnings growth momentum to pick up in the coming quarters.

Company overview

China Merchants Securities (CMS) was established in 1991 as the securities department of China Merchants Bank and was renamed China Merchants Securities in 1993. It became a full platform securities firm with international exposure through a series of M&A between 1996 and 2006, including acquiring the brokerage business assets of Beijing Securities and CMSHK, etc.

When facing a fragmented market with fierce competition and limited differentiation among players, CMS positioned itself as one of the top-ten full platform players, but with specific attention to servicing its institutional clients and high-net-worth clients, as well as focusing on risk management and compliance.

Market position

CMS is one of the top-ten full-platform players in the PRC securities industry. Below is its market positioning according to WIND data:

- Brokerage business: No. 8 in terms of stock and fund trading volume in 2015 and 1H16
- Margin financing: No. 7 in terms of outstanding balance of margin financing at end-2015 and end-1H16
- Underwriting business: No. 5/12 in terms of equity underwriting and No.3 in terms of debt underwriting among brokers in 2015 and 1H16

CMS is particularly focusing on business with higher margin and growth potential:

- Institutional brokerage business:
 - No. 1 in terms of trading volume of mutual funds using trading seats and private equity funds under custody
 - No 1 in PE fund custodian as at 2015 and 1H16
- Underwriting business:
 - Number 1 in ABS underwriting, higher than its overall debt underwriting of ranking of number 3 as at 2015
 - Number 4 in underwriting in SME boards, higher ranking than its overall equities underwriting of number 5 in 2015

Table 2: Revenue breakdown compared with H-share peers as of FY15

Revenue breakdown in 2015	CMS	Huatai	Citic S	Haitong	Galaxy	GF	CICC
Brokerage and wealth management	70%	72%	37%	53%	78%	55%	28%
Investment banking	8%	5%	6%	4%	2%	5%	25%
Asset management	4%	6%	11%	7%	2%	14%	29%
Investment and trading	16%	11%	40%	20%	14%	22%	17%
Overseas & others	2%	5%	6%	16%	3%	4%	2%

Source: Company data (Note: For CICC, we group equity sales and trading business as brokerage, and FICC as Investment and trading).

Table 3: Revenue breakdown compared with H-share peers as of 1H16

Revenue breakdown in 1H16	CMS	Huatai	Citic S	Haitong	Galaxy	GF	CICC
Brokerage and wealth management	73%	69%	31%	44%	72%	44%	29%
Investment banking	13%	9%	12%	5%	6%	10%	23%
Asset management	5%	12%	15%	3%	4%	21%	16%
Investment and trading	6%	7%	28%	20%	13%	22%	29%
Overseas & others	3%	2%	14%	27%	5%	3%	3%

Source: Company data (Note: For CICC, we group equity sales and trading business as brokerage, and FICC as Investment and trading).

Table 4: CMS's market positions

Top 10 securities firms* (by 2015 revenue)	Balance of margin financing							
	Stock and fund brokerage		and securities lent		Equities underwriting		Debt underwriting	
	Ranking	Market share	Ranking	Market share	Ranking	Market share	Ranking	Market share
Citic Securities	7	4.24%	5	5.61%	1	9.93%	1	11.51%
Guosen	9	3.89%	9	3.91%	7	3.91%	10	2.68%
Guangfa	3	4.78%	3	5.70%	3	5.41%	6	3.98%
Haitong	6	4.99%	8	5.17%	9	3.52%	5	4.07%
Galaxy	2	5.09%	2	5.89%	26	1.08%	8	3.54%
Shenwan Hongyuan	5	4.69%	1	5.95%	17	1.84%	13	1.88%
CMS	8	4.11%	7	5.35%	5	5.00%	3	7.36%
Huatai	1	8.37%	4	5.63%	6	4.25%	14	1.88%
Guotai Junan	4	4.72%	6	5.55%	2	7.72%	4	6.96%
Everbright Securities	11	2.70%	10	3.30%	20	1.52%	11	2.63%

Source: WIND. * Ranking based on 2015 consolidated PRC GAAP revenue. Stock and fund brokerage trading volume based on companies' consolidated data.

Note: There could be discrepancy between company data and WIND data due to different criteria in calculation.

Table 5: Overview of CMS's key operating data, industry ranking and market share

		2013	2014	2015	1H16
Trading volume of stocks and funds	Rmb bn	4,130.7	6,614.7	22,049.8	4,979.1
	Ranking	5	7	8	8
	Market share*	4.34%	4.25%	4.11%	3.82%
Average securities brokerage commission rate		8.1bps	7.5bps	6.6bps	5.7bps
Balance of margin financing and securities lent	Rmb bn	19.8	57.9	62.9	45.8
	Ranking	6	6	7	7
	Market share*	5.64%	5.70%	5.35%	5.36%
Amount of equity securities underwritten	Rmb bn	5.60	19.20	47.80	16.10
	Ranking	10	9	5	12
	Market share*	3.24%	3.05%	5.00%	3.10%
Average commission rate for equity underwriting		2.07%	3.24%	1.62%	1.05%
Amount of debt securities underwritten	Rmb bn	28.2	59.0	225.8	157.9
	Ranking	10	8	3	3
	Market share*	2.78%	3.68%	7.36%	7.22%
Average commission rate for debt underwriting		0.31%	0.60%	0.53%	0.42%
AUM of securities-firm asset management business	Rmb bn	68.9	177.8	414.8	517.5
	Ranking*	9	8	10	9
	Market share*	1.33%	2.23%	3.49%	3.50%
Trading seats leasing income (From mutual funds)	Rmb mn	235.8	287.0	668.1	N/A
	Ranking	5	3	2	N/A
	Market share	4.60%	4.89%	5.31%	N/A
Stock trading volume of mutual funds using trading seats	Rmb bn	263.4	324.9	798.1	226.4
	Ranking	5	3	1	N/A
	Market share	4.58%	4.88%	5.38%	4.90%

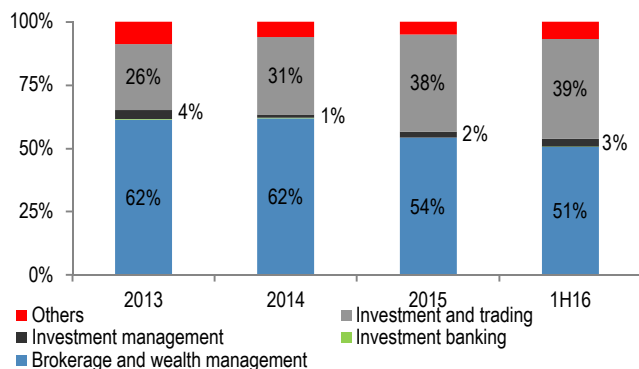
Source: Company data, Securities Association of China, * From WIND (Note: For market share of trading volume of stocks and funds, margin financing and securities lent, equity/debt underwritten and AUM of securities-firm AM business, we used WIND data which could be different from company data due to difference in classifications).

Business mix

CMS is a full-service investment bank with the brokerage business as the key source of revenue. Its key lines of business are as follows:

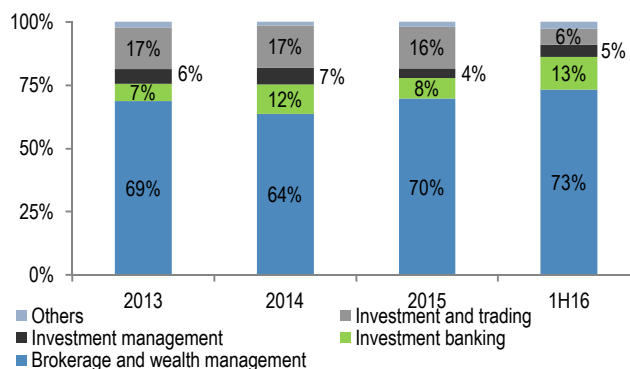
- **Brokerage and WMP:** CMS is the eighth-largest brokerage provider in the PRC and brokerage contributed 70/73% of revenues in 2015/1H16, respectively; this includes brokerage (mainly equity securities and futures), institutional sales and research, and margin financing and securities lending, as well as wealth management fees (from the sale of financial products from other FIs).
- **Investment banking (IB):** This includes equity and debt underwriting, as well as financial advisory. IB contributed 8/13% of revenues in 2015/1H16, respectively, of which 85% are from the underwriting businesses.
- **Investment and trading:** This contributed 16/6% of revenues in 2015/1H16, respectively.
- **Asset management:** CMS's asset management businesses comprised 4%/5% of revenues in 2015/1H16, respectively; it provides asset management primarily through collective investment plans and targeted investment plans.

Figure 1: CMS Asset mix by business lines (2013-1H16)



Source: Company data.

Figure 2: CMS's revenue mix – Brokerage is the key segment

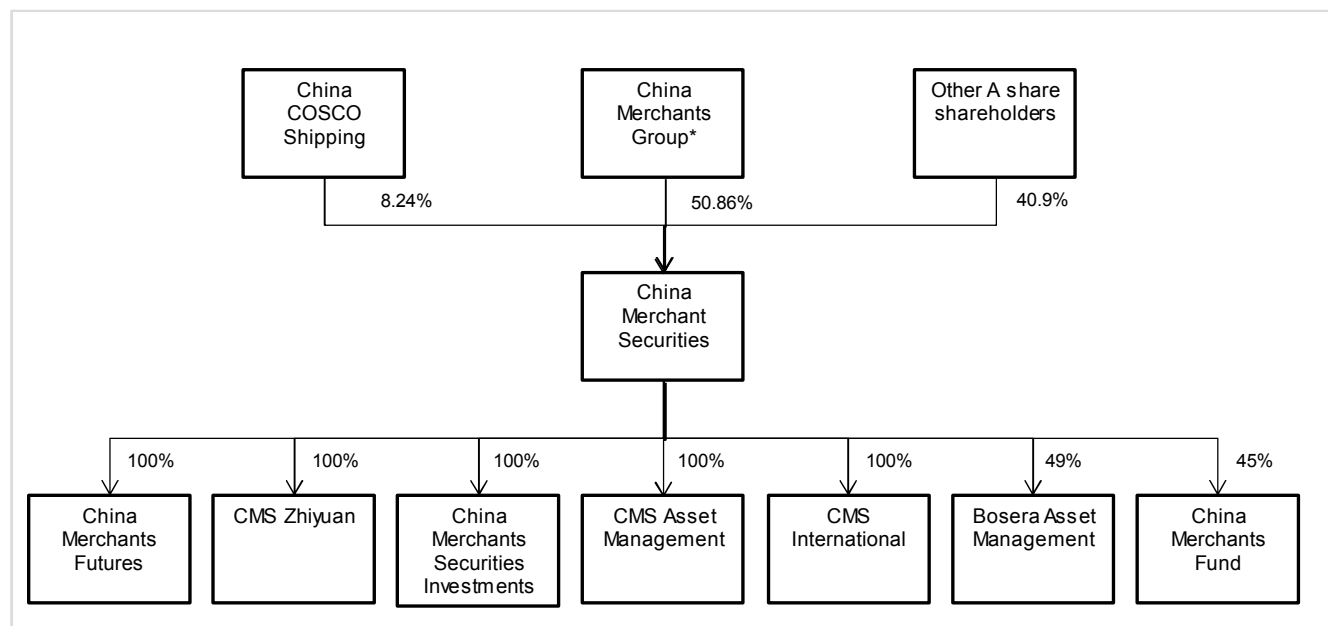


Source: Company data.

Ownership and subsidiaries

China Merchants Group is the controlling shareholder of CMS with a 50.86% stake (prior to H-share global offering) through three of its wholly-owned subsidiaries: China Merchants Finance Investment Holdings, Shenzhen Jisheng Investment Development Co., and China Merchants Steam Navigation Co.

Table 6: CMS's corporate structure (latest disclosed-before H-share global offering)



Source: Company data (Note: China Merchants Group holds CMS through three of its wholly owned subsidiaries- of which China Merchants Finance Investment Holdings holds 24.71% of CMS, Shenzhen Jisheng Investment Development Co., Ltd holds 23.09% of CMS, and China Merchants Steam Navigation Co., Ltd holds 3.05%, respectively).

Investment Positives: Strong focus on margin while keeping risks abated

CMS is a top-ten broker with full-service platform but focus on high margin/more profitable businesses.

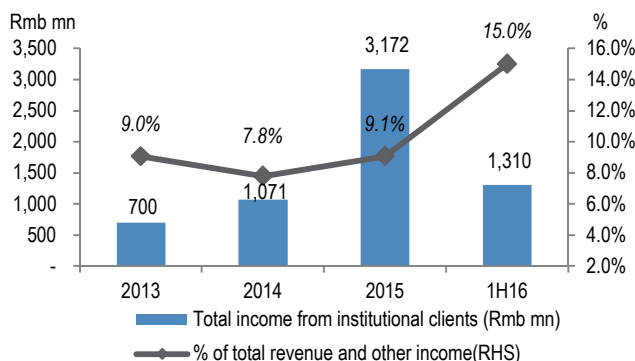
- **Institutional business:** CMS is positioned ahead of peers at gaining market share in institutional businesses, ranking first/second in terms of market share and fees from trading seats to mutual funds. It has been enjoying decent growth at its prime brokerage businesses, with aggregate financial assets under fund custody amounting to Rmb449.3bn from 3,959 funds (market share of 29.3%) and aggregate financial assets using outsourcing services amounting to Rmb396.1bn. Growing revenue from this part of the business, which is recurring along with AUM and more stable due to higher client adherence, should help to enhance earnings stability.
- **High-net-worth clients:** CMS has also been putting efforts into high-net-worth clients via its Zhiyuan Wealth Management plan, where the commission rates are more than double its average brokerage commission rates; related fee and commission income accounted for 16% of total revenue in 1H16, nearly double from the level in FY14.
- **Underwriting:** Investment banking is one key way for CMS to develop institutional business; CMS has been enhancing its market position with strength in niche segments such as SME (ranked 4th), NEEQ (7th) among equity underwriting and ABS (1st), non-financial enterprises (2nd) among debt underwriting that are able to generate higher underwriting fees than the main board.
- **Asset management:** CMS is ranked ninth in terms of AUM of total asset management plans but ranked fifth in particular for collective asset management schemes, which are more retail-oriented with much higher fee charges.

As a result, CMS's gross commission rate of 6.6bps in 2015 was the second-highest among HK listed peers. Its net commissions in 1H16 were 4.4bps, contracted 19% from 2015; the decline is smaller than the industry average of 20% from 5.0bps in 2015 to 4.0bps in 1H16, on our estimates. We believe this is the key reason behind its highest ROA, both in 2015 and avg from 2013-15, in addition to its effective cost control.

Risk management: CMS is one of the few brokers to maintain an AA regulatory rating in 2016 (its H-share listed peers were all downgraded) and nine consecutive years of AA rating demonstrates its strong risk management capability. Prudent risk management could also be demonstrated by its capital-based intermediary businesses; collateral-to-loan ratios at margin financing and stock pledge repurchases have been consistently above 250%, more than adequate against market volatility, we believe, while CMS still set aside provisions equivalent to 0.28% of outstanding balance.

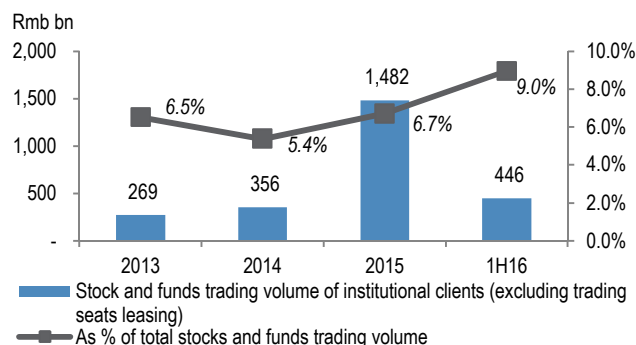
A higher regulatory rating would offer CMS greater competitive advantages including: 1) lower contribution (as a percentage of operating income) to investors' protection funds and lower funding costs in the capital markets (including interbank and bond issuance); 2) higher capital efficiency on the back of lower risk charges with regard to net capital/risk capital reserve ratios compared to A-/BBB-rated peers by 33-50% under the old capital rules and 13-22% under the new capital rules that come into effect this October; and 3) facilitation of new business development/innovation, which is critical to its institutional businesses.

Figure 3: Revenue contribution from institutional clients



Source: Company data.

Figure 4: Stock and funds trading volume of institutional clients (excluding trading seats leasing)



Source: Company data. Institutions in trading seats leasing include mutual funds and insurance companies.

Table 7: CMS ranked #1 in trading volume of mutual funds using trading seats (2015)

Rank	Broker	Stock trading volume (Rmb mn)	Market share
1	CMS	798,125	5.4%
2	Citic S	786,407	5.3%
3	Haitong	722,642	4.9%
4	Shenwan Hongyuan	702,463	4.7%
5	Guosen	692,515	4.7%
6	China galaxy	683,623	4.6%
7	Guotai Junan	682,735	4.6%
8	Essence	664,699	4.5%
9	China Securities	652,716	4.4%
10	GF Securities	648,290	4.4%
	Market total	14,829,724	100.0%

Source: Wind. (Note: There could be a discrepancy between company data and WIND data in this set of data due to different criteria in calculation)

Table 8: CMS ranked #2 in trading commission income from leasing trading seats to mutual funds (2015)

Rank	Broker	Commission income (Rmb mn)	Market share
1	Citic Securities	668	5.3%
2	CMS	668	5.3%
3	Haitong	607	4.8%
4	Guosen Securities	586	4.6%
5	Essence Securities	582	4.6%
6	China Galaxy	561	4.5%
7	Guotai Junan	561	4.5%
8	GF Securities	559	4.4%
9	Shenwan Hongyuan	550	4.4%
10	China Securities	536	4.3%
	Market total	12,593	100.0%

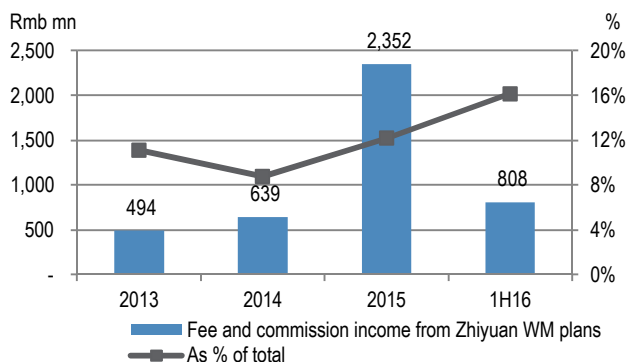
Source: Wind. (Note: There could be a discrepancy between company data and WIND data in this set of data due to different criteria in calculation).

Table 9: CMS – Market share and ranking of securities trading business for institutional clients

Securities Trading		2013	2014	2015	CAGR-2013-2015	1H15	1H16	YoY
Trading seats leasing income	Rmb mn	298	359	855	69.4%	440	265	-39.8%
	Ranking	N/A	5	5			N/A	
	Market share	N/A	5.0%	5.1%			N/A	
Trading seats leasing income (From mutual funds)	Rmb mn	236	287	668	68.3%	N/A	N/A	N/A
	Ranking	5	3	2			N/A	
	Market share	4.6%	4.9%	5.3%			N/A	
Stocks and funds trading volume of institutional clients (excl. trading seats leasing)	Rmb bn	269	356	1,482	134.7%	701	446	-36.4%
	Ranking	N/A	N/A	N/A			N/A	
	Market share	N/A	N/A	N/A			N/A	
Stock trading volume of mutual funds using trading seats	Rmb bn	263	325	798	74.1%	359	226	-36.9%
	Ranking	5	3	1			N/A	
	Market share	4.6%	4.9%	5.4%		4.7%	4.9%	0.2ppts
No of registered PE funds under custody	No. of funds	N/A	N/A	2,370	N/A	N/A	N/A	N/A
	Ranking	N/A	N/A	1				
	Market share	N/A	N/A	29.1%			29.3%	

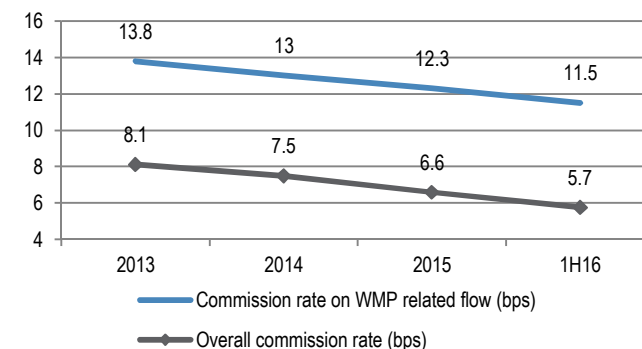
Source: Company data, Securities Association of China, WIND (Note: For ranking and market share, we used WIND and SAC data which could be different from company data due to differences in classifications)

Figure 5: CMS – Fee and commission income from Zhiyuan Wealth Management plans as % of total



Source: Company data.

Figure 6: CMS – Average brokerage commission rate for “Zhiyuan Wealth Management Plans” are significantly higher than overall average brokerage commission rate



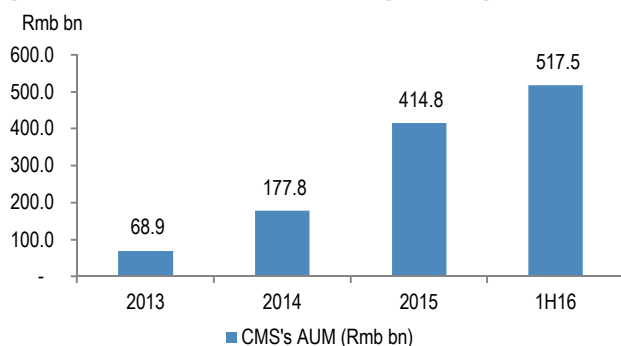
Source: Company data.

Table 10: Rising market share in investment banking business for CMS

		2013	2014	2015
Equity underwriting volume	Rmb bn	8.7	15.7	47.5
	Ranking	10	9	5
	Market share	3.2%	3.0%	5.0%
Bond underwriting volume	Rmb bn	31.5	73.5	265.7
	Ranking	10	8	3
	Market share	2.8%	3.7%	7.4%
ABS underwriting volume	Rmb bn	N/A	22.4	82.4
	Ranking	NA	4	1
	Market share	N/A	7.4%	14.5%
SME Board Underwriting volume	Rmb bn	N/A	2.6	1.1
	Ranking	NA	2	4
	Market share	N/A	13.3%	6.1%

Source: WIND, company data (Note: There could be discrepancy between company data and WIND data due to different criteria in calculation).

Figure 7: AUM of CMS's investment management segment



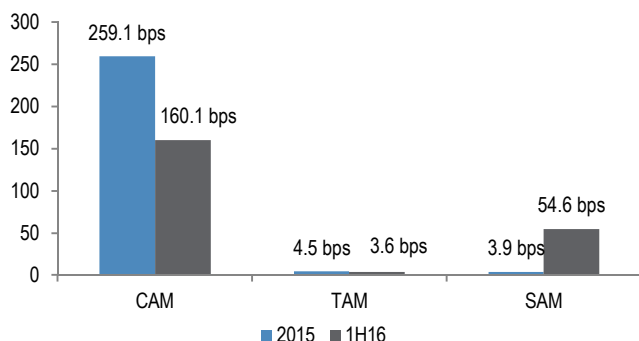
Source: Company data.

Table 11: Collective asset management ranking by brokers as of Aug. 2016

Rank	Broker	AUM (Rmb bn)	Market share
1	Guangfa	291.8	1.9%
2	Huatai	101.0	0.7%
3	Citic securities	95.1	0.6%
4	Guotai Junan	86.7	0.6%
5	CMS	56.4	0.4%
6	Qilu	54.7	0.4%
7	Haitong	50.1	0.3%
8	Everbright	43.0	0.3%
9	Huarong	42.6	0.3%
10	Caitong securities	42.3	0.3%
	Total	863.7	5.7%

Source: Wind.

Figure 8: CAM schemes have much higher fee charges



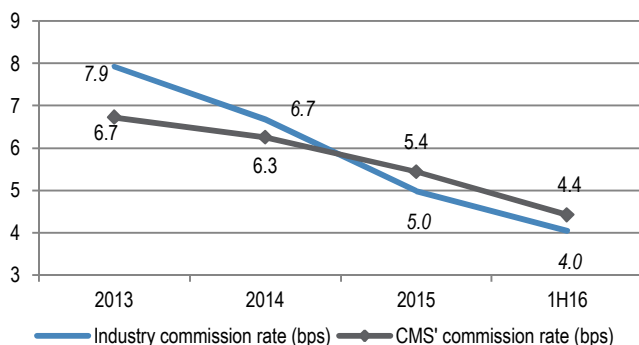
Source: Company data. (Note: fee rate of AMP= management fee/ average balance of AMP).

Table 12: Ranking of mutual funds as of 1H16

Rank	Funds	AUM (Rmb bn)
1	Tianhong Asset Management	850.5
2	China Asset Management	515.7
3	ICBC Credit Suisse	482.4
4	Efund Management	405.7
5	China Southern Asset Management	342.7
6	Harvest Fund	313.3
7	China Universal	286.2
8	Bosera Fund	249.8
9	CCB Principal Asset Management	245.4
10	BOC Investment Management	244.5
11	China Merchant Fund	240.9

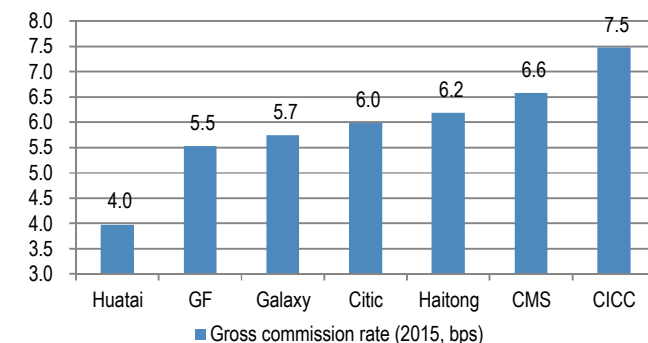
Source: Asset Management Association of China.

Figure 9: Net commission rate for CMS vs. Industry (bps)



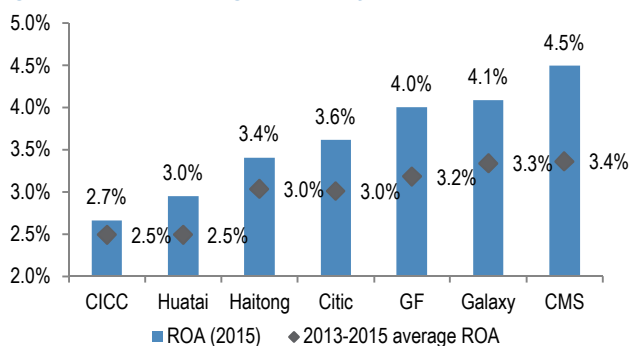
Source: Company data, CEIC.

Figure 10: 2015 gross commission rate: CMS vs. H-share brokers



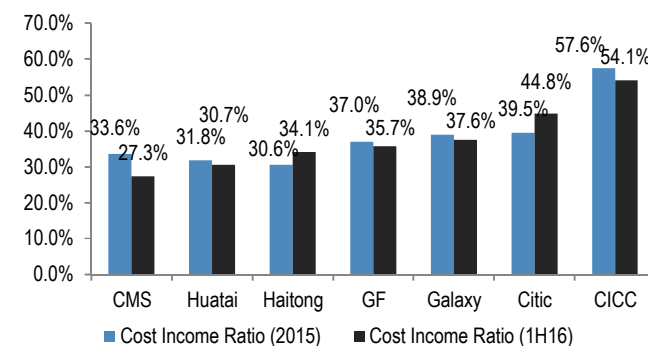
Source: Company data. J.P. Morgan

Figure 11: ROA (excluding client money)



Source: Company data.

Figure 12: Cost Income Ratio



Source: Company data. (Note: we excluded interest expense and commission expense in our calculations).

Table 13: Regulatory ratings of top Chinese brokers (2010-16)

Name	2010	2011	2012	2013	2014	2015	2016	Downgraded in 2016?
Guotai Junan	AA	AA	AA	AA	AA	AA	AA	N
Citic Securities	AA	AA	AA	AA	AA	AA	BBB	Y
Galaxy	AA	AA	AA	AA	AA	AA	A	Y
Huatai	AA	AA	AA	AA	AA	AA	BBB	Y
Guangfa	A	AA	AA	AA	AA	AA	BBB	Y
Guosen	AA	AA	AA	AA	AA	AA	BBB	Y
Haitong	AA	AA	AA	A	AA	AA	BBB	Y
CMS	AA	AA	AA	AA	AA	AA	AA	N
China Securities	AA	AA	AA	AA	AA	AA	AA	N
Founder Securities	A	A	A	AA	A	A	C	Y

Source: CSRC, Wind

Table 14: Adjustment factor for the calculation of Risk Capital Reserve based on regulatory rating of brokers

Regulatory ratings	Old capital rules	New capital rules
"Type A" for 3 consecutive years (AAA, AA, A)	0.2x	0.7x
Type A (AAA, AA, A)	0.3x	0.8x
Type B (BBB, BB, B)	0.4x	0.9x
Type C (CCC, CC, C)	1x	1x
Type D	2x	2x

Source: CSRC

Investment Negatives

Market volatility-induced intervention to constrain trading flexibility

CMS contributed Rmb9.3bn to China Securities Finance Corporation Limited under the market stabilization measures in July and September 2015 and has committed to not reducing the A-share proprietary trading positions below the balance as of July 3, 2015 as long as SHCOMP is below 4,500, a commitment that constrains its flexibility on trading should the market experience material corrections. Although the A-share market performance has been much more stable in recent months, there are always risks that brokers will be included in market stabilization measures amid meaningful market turmoil.

Table 15: Equities investment as a percentage of book

1H16 (Rmb m)	Citic	Haitong	Galaxy	Huatai	CMS
Equity investments					
--AFS	24,829	11,482	6,488	23,658	3,340
--through P&L	7,467	13,086	716	4,329	0
--held for trading	47,790	0	1,919	0	7,620
- Investment in CSFC	21,100	19,457	10,500	14,440	9,300
Equity investment as % of assets*	18%	8%	8%	11%	8%
Equity investment as % of equity *	74%	42%	36%	54%	42%

Source: Company data, J.P. M estimates (Note*: we have included investment in CSFC as part of equity investment in the calculation)

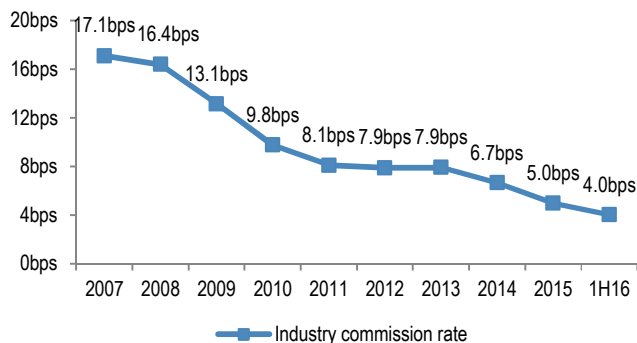
Tighter supervision on asset management businesses

China Securities Regulatory Commission is more closely supervising asset management businesses as a result of its fast growth in recent years; under the new capital rules that are coming into effect in October, risk weights on AUM for targeted asset management schemes, which accounted for nearly 90% of total AUM at CMS, have increased to 35bps compared to 20bps before and would be even higher (63bps) if the underlying investments are non-standardized assets. CMS also invests its own capital into collective asset management schemes in order to attract customers; capital contribution was Rmb617m as of 1H16, among which Rmb218m is in the subordinated tranche for credit enhancements should investment returns of senior tranches fall below the anticipated yields. Along with the growing AUM, invested capital could also increase and is subject to market/credit risks as well.

Long-term pressure on brokerage commission rates

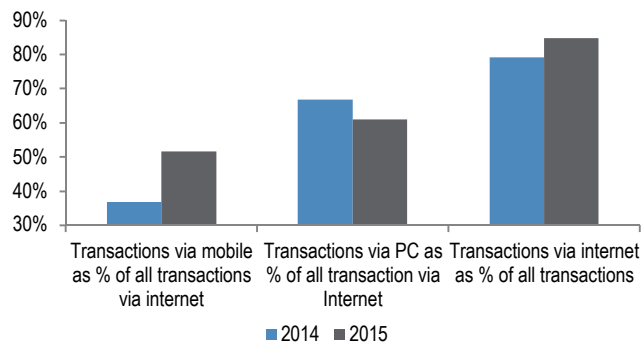
Fierce competition in retail brokerage triggered industrywide commission rate compression in recent years. We think the downward trend is likely to persist in the foreseeable future since the deregulation to allow individual investors to open up to 20 brokerage accounts offers investors greater bargaining power over brokers (but the revision of account opening regulations in Oct 16 could alleviate such pressure to some extent, in our view) and continued development of online and mobile platforms should allow brokers to lower operating costs, thus leaving more room for brokers to lower commission rates. Moreover, the fragmented industry landscape is a result of structural issues that are unlikely to change in the foreseeable future, while the reported drafting of Measures on Brokerage Securities Business might lead to deregulation of the brokerage fee structure, which could result in additional uncertainty, although the impact is subject to final details.

Figure 13: Industry commission rate declined from 18.8 bps in 2007 to 4.0 bps in 1H16



Source: WIND.

Figure 14: Brokerage transactions via internet represented 85% of all transactions in 2015, rising from 79% in 2014



Source: WIND, Company data.

Financial Estimates

We estimate net profits to grow 39% and 23% in FY17 and FY18, respectively, after a 46% decline in FY16, mainly driven by:

- Gradual improvement in turnover in the A share markets
- Continued growth in the M&A, equity/debt underwriting, and asset management businesses
- Return-to-normal of operating performance at investment & trading and investment management after the market disruptions in 2H15 and 1Q16

Table 16: Key P&L items and estimates

(In Rmb mn)	2013	2014	2015	2016E	2017E	2018E
Revenue	7,702	13,713	34,905	19,621	24,380	28,738
Total commission & fees income	4,447	7,290	19,317	11,967	14,594	17,408
Total interest income	1,985	3,885	9,906	6,947	6,679	7,384
Net investment gain	1,270	2,538	5,681	707	3,108	3,946
Operating expense	(5,359)	(9,133)	(21,906)	(13,003)	(14,968)	(17,060)
Profit before tax	2,650	4,972	13,634	7,371	10,250	12,611
Attributable profits	2,232	3,851	10,909	5,889	8,197	10,089
Growth YoY						
Revenue		78%	155%	-44%	24%	18%
Total commission & fees income		64%	165%	-38%	22%	19%
Total interest income		96%	155%	-30%	-4%	11%
Net investment gain		100%	124%	-88%	340%	27%
Operating expense		70%	140%	-41%	15%	14%
Profit before tax		88%	174%	-46%	39%	23%
Attributable profits		73%	183%	-46%	39%	23%

Source: Company data, JPM estimates (Note: Please refer to the Disclaimer (pages 2 & 3) for disclosures on estimates, forecasts and projections)

Valuation Considerations

We believe the most appropriate valuation metric by which to compare CMS to peer companies is the Gordon Growth Model (GGM). We assume CMS's long-term leverage will normalize at 5.6x, and we derive a Dec-17 PT of HK\$15.5 based on our DDM model. The PT implies 1.5x and 1.4x P/BV for FY16E and FY17E, respectively and equates to a P/E of 15x and 11x, based on our FY16E and FY17E estimates, respectively. CITIC, Haitong, Galaxy, GF and Huatai Securities are the most relevant peer references for CMS, in our view.

Valuation approaches for securities businesses

Given that Chinese securities companies' earnings and stock market performance are highly volatile, we do not think P/E is the most appropriate method to value securities companies. Because the capital base in China is still one of the most important regulatory factors for business expansion, we derive our PT by using the GGM with a fair P/BV multiple, cross-referencing it with the implied P/E multiple.

*Fair value = PV of three years of expected dividends + terminal value, where terminal value is calculated as fair book multiple * terminal book value (adjusted, if necessary) and fair P/B = (sustainable ROE - LT growth) / (cost of equity - LT growth).*

Sustainable ROE

Cost of equity ("k")

We use CAPM to derive cost of equity. Our cost of equity for CMS is 13.5%, similar to that for other Chinese brokers in our coverage.

- **Risk-free rate:** Under normal circumstances, the long-term bond yield is often a proxy for risk-free rates and a proxy for a country's long-term growth prospects. We apply a 3.5% risk-free rate for China.
- **Market risk premium:** We apply an 8% market premium for China.
- **Beta:** We apply beta of 1.25.

Long-term growth

We assign a 6% growth rate. We expect GDP growth to be 6.7% in 2016 and to continue to slow. In our view, our long-term growth rate assumption reasonably reflects the GDP growth prospects in the medium and long term.

Valuation scenarios

Sensitivity to long-term ROA and financial leverage

In our sensitivity analysis, we make assumptions on both return of average assets (ROAA) and leverage level (average assets/average equity). Based on the GGM we described above, we derive a Dec-17 PT of HK\$15.5. Detailed assumptions in our estimates are as follows:

- Long-term ROAA of 2.8%, the same as average ROAA estimate from 2016-2018.
- Long-term leverage of 5.6x. Leverage ratio was to 5.6x in 1H16. We expect average leverage of CMS in 2016-2018e amounted to ~4.4x. We assume leverage to eventually come back to the 1H16 level of 5.6x.

Table 17: PT-implied valuation multiples (CMS-H)

Valuation method	Multiple
2016E P/E	15x
2017E P/E	11x
2016E P/B	1.5x
2017E P/B	1.4x

Source: J.P. Morgan estimates

During the market turmoil in June and July 2015, brokers were asked to contribute 15% of their net capital to the CSFC funding pool to buy stocks to support the stock market. Furthermore, brokers are not allowed to short futures to hedge their risk on the long position, which could have increased their investment risk. This limited brokers' ability to leverage up their book through investment and market-making activities. This is particularly unfavourable to CMS, which is strong in investment activities and adopts market-neutral strategies.

Core peer valuation comparison – H-share brokers

Peer comparison – Business

We believe CMS's closest peers are CITIC, Haitong, Galaxy, Huatai and GFS. CICC has a different model as it focuses on IB business rather than a full platform broker as the ones mentioned above. These are brokers listed in Hong Kong. Comparing the companies, we note the following:

- CMS has the highest ROA among peers, both in 2015 and the three-years average (2013-2015). ROA compression in 1H16 was highest among peers for CMS, partly due to fluctuations in investment income. We believe in the long run, the ban on hedging will be lifted and CMS, which adopts a market-neutral strategy on investment, would see investment income normalize.
- CMS's institutional brokerage business is the strongest among peers; as such, its commission rate is higher than peers and more resilient amid the retail price war.
- We believe the company's strong institutional business should allow it to trade at a premium to peers. Citic, which is a full platform broker with particular strength in institutional business, trades at a premium to peers. Average premium in the past three years was 17.9%. The premium contracted since August 2015 to 1.1% of late, due to company-specific regulatory issues.

Table 18: ROA decomposition of Galaxy, Haitong, CITIC, HTSC and GF and CMS

DuPont analysis (2015)	Galaxy	CITIC	Haitong	HTSC	GF	CMS
Gross fee income / avg. assets	7.19%	6.25%	4.70%	5.57%	6.1%	7.96%
Interest income / avg. assets	4.88%	2.85%	3.94%	3.28%	3.7%	4.08%
Investment gain / avg. assets	1.85%	3.56%	2.38%	1.86%	3.2%	2.34%
Cost / avg. assets	-8.58%	-7.99%	-7.46%	-7.06%	-7.7%	-9.03%
Operating ROAA	5.34%	4.67%	3.56%	3.66%	5.3%	5.36%
ROAA	4.09%	3.61%	3.41%	2.95%	4.0%	4.50%
ROAA (excl. client assets)	6.76%	4.63%	4.36%	4.13%	5.6%	6.47%
ROAE	22.89%	16.62%	17.99%	17.52%	22.5%	24.27%
Avg. assets/ avg. equity (x)	5.6x	4.6x	5.3x	5.9x	5.6 x	5.4x
Avg. assets (excl. client\$)/avg. equity	3.4x	3.6x	4.1x	4.2x	4.02 x	3.8x

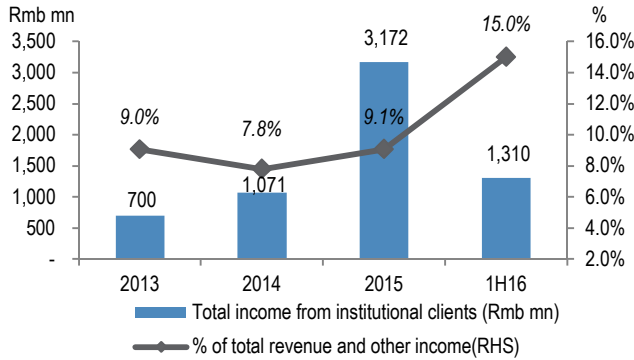
Source: Company data.

Table 19: Institutional securities trading business in terms of revenue, broker ranking and market share

Securities Trading		2013	2014	2015	CAGR-2013-2015	1H15	1H16	YoY
Trading seats leasing income	Rmb mn	298	359	855	69.4%	440	265	-39.8%
	Ranking	N/A	5	5			N/A	
	Market share	N/A	5.0%	5.1%			N/A	
Trading seats leasing income (From mutual funds)	Rmb mn	236	287	668	68.3%	N/A	N/A	N/A
	Ranking	5	3	2			N/A	
	Market share	4.6%	4.9%	5.3%			N/A	
Stocks and funds trading volume of institutional clients (excl. trading seats leasing)	Rmb bn	269	356	1,482	134.7%	701	446	-36.4%
	Ranking	N/A	N/A	N/A			N/A	
	Market share	N/A	N/A	N/A			N/A	
Stock trading volume of mutual funds using trading seats	Rmb bn	263	325	798	74.1%	359	226	-36.9%
	Ranking	5	3	1			N/A	
	Market share	4.6%	4.9%	5.4%		4.7%	4.9%	0.2ppts

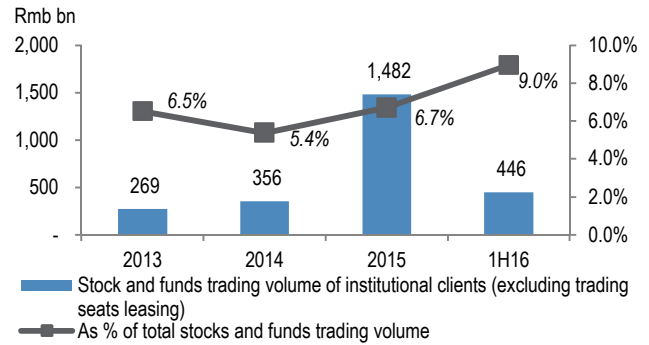
Source: Company data, Securities Association of China, WIND (Note: For ranking and market share, we used WIND data which could be different from company data due to difference in classifications).

Figure 15: Revenue contribution from institutional clients



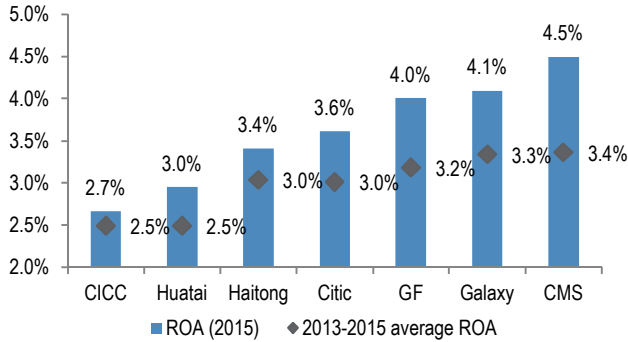
Source: Company data.

Figure 16: Stock and funds trading volume of institutional clients (excluding trading seats leasing)



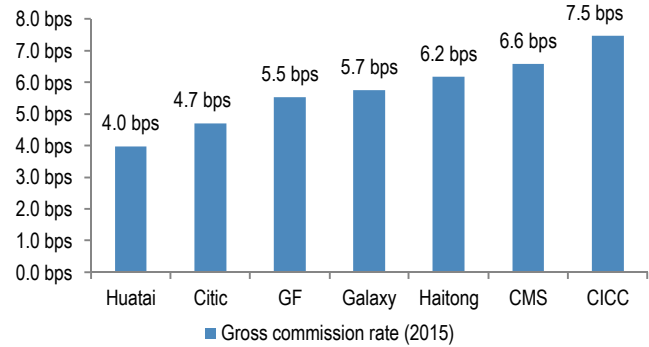
Source: Company data. Institutions in trading seats leasing include mutual funds and insurance companies.

Figure 17: ROA of H-share brokers



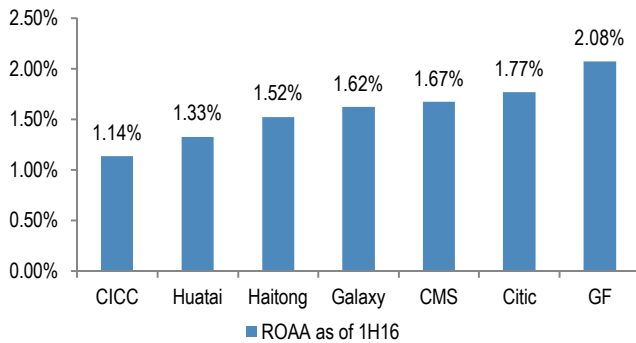
Source: Company data.

Figure 18: Gross commission rate of H-Share brokers



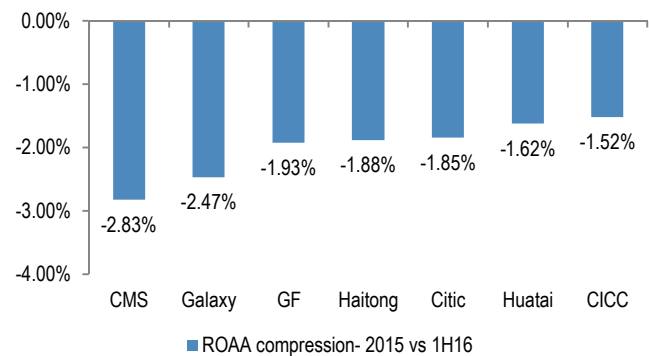
Source: Company data.

Figure 19: ROAA in 1H16 (annualized)



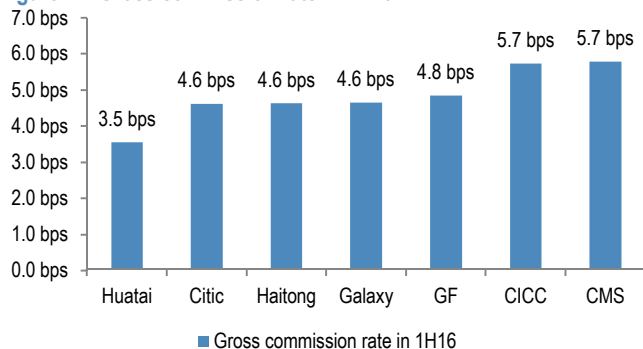
Source: Company data

Figure 20: ROAA compression in 1H16 vs 2015



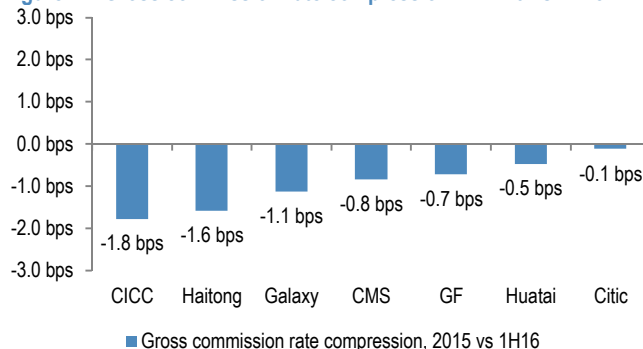
Source: Company data.

Figure 21: Gross commission rate in 1H16



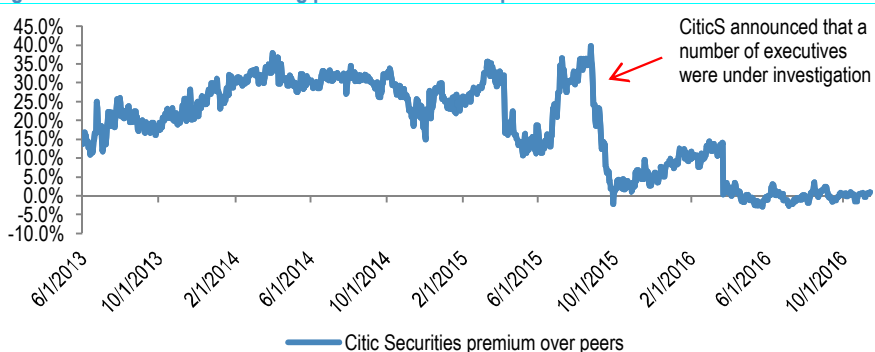
Source: Company data, J.P. Morgan

Figure 22: Gross commission rate compression in 1H16 vs FY15



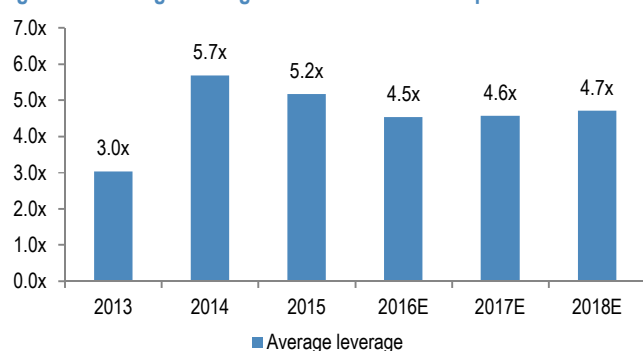
Source: Company data, J.P. Morgan

Figure 23: Citic Securities trading premium relative to peers



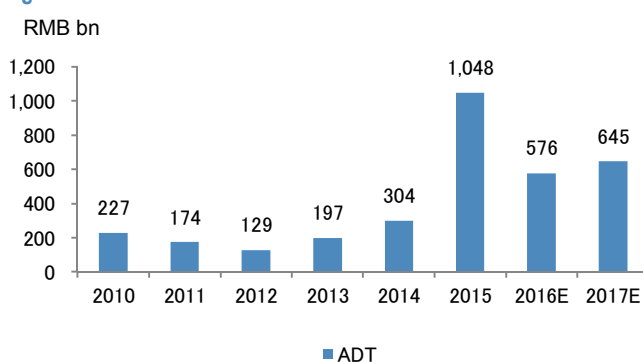
Source: Bloomberg.

Figure 24: Average leverage ratio of H-share listed peers



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

Figure 25: A-share ADT



Source: WIND, J.P. Morgan estimates.

Table 20: Citic Securities has been de-rated due to company-specific regulatory issues

Date	Incidence
15-Aug	According to Xinhua, seven executives at Citic Securities, including President Cheng Boming, were under investigation for alleged offences including "insider trading". The executives were requested by the public security authority to assist in the investigation.
30-Aug	Citic Securities announced that a number of executives were requested by regulatory authority to assist in the investigation on certain issues and the investigation is currently underway.
15-Sep	Citic Securities announced that Mr Cheng Boming, the former President, and Yu Xinli, the person-in-charge of the Operation Management Department under the Brokerage Development and Management Committee, and Wang Jinling of the Information and Technology Centre, were being investigated pursuant to the law by the public security authority for insider dealing and leaking inside information.
20-Oct	Citic Securities announced that Mr Wang Dongming, chairman of the Board, will perform the duties of the person-in-charge of the accounting affairs of the Company, and be additionally responsible for the accounting work, on behalf and during the absence of Mr Ge Xiaobo, who is assisting with investigations and therefore unable to perform his duties normally
15-Nov	Haitong and Citic Securities received an investigation notice from CSRC for suspected branch of relevant provisions of PRC Securities Law in relation to the failure of entering into business contract with customer in accordance with relevant rules for margin financing and securities lending business.

Source: Company data, HKEX announcements.

Peer trading range – H-share brokers

We note the following about H-share broker performance:

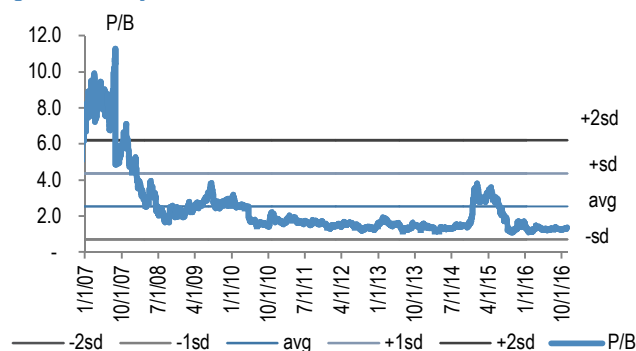
- H-share brokers trade at 1.2x 2016E P/B and 1.2x 2017E P/B as of 16 Nov 16.

However, the H-share listing histories of China brokers are relatively short, with CITIC-H listed in Oct-11, Haitong-H in Apr-12, Galaxy in May-13, GF on 9-Apr-15 and Huatai in May-15. Therefore, we also look at their A-share trading histories for full-cycle performance.

- CITIC traded at a historical low of ~1.4x one-year-forward P/BV. At the 2007 peak, it traded at 11.3x.
- Haitong traded at 1.6x one-year-forward P/BV. At the 2007 peak, its valuation reached 6.5x.

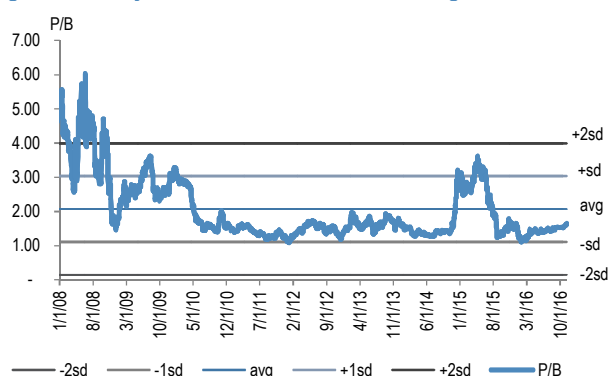
ADT YTD in 2016 is Rmb521bn, much higher than Rmb190bn in 2007.

Figure 26: One-year-forward P/BV band of CITIC-A since 2007



Source: Bloomberg.

Figure 27: One-year-forward P/BV band of Haitong-A since 2008



Source: Bloomberg.

Other peer valuation comparisons – A-share brokers and brokers in other regions

Peer trading range – A-share brokers

- A-share brokers trade at 2.4x 2016E P/B and 2.3x 2017E P/B, as of Nov 16, 2016
- For China brokers dual-listed in Hong Kong and Shanghai, A-shares trade at a ~26% premium.

Table 21: H-share brokers' trading comps (as of Nov 16, 2016)

	BBG code	Price (LC)	Rating	Dec-17 PT (LC)	% to PT	Mkt cap (US\$ B)	P/E (x)		P/BV (x)		Dividend yield		ROE	
							FY16E	FY17E	FY16E	FY17E	FY16E	FY17E	FY16E	FY17E
Huatai - H	6886 HK	16.86	OW	22.00	30%	20	15.8	12.8	1.2	1.2	1.7%	2.0%	8.1%	9.4%
Galaxy - H	6881 HK	7.70	OW	9.50	23%	9	12.4	10.1	1.1	1.0	2.6%	2.5%	9.0%	10.3%
CMS - H	6099 HK	12.26	OW	15.50	26%	18	11.6	9.0	1.2	1.1	2.0%	2.8%	10.6%	12.5%
Haitong - H	6837 HK	14.24	N	13.00	-9%	26	16.7	14.2	1.2	1.1	1.8%	1.7%	8.0%	8.9%
CITIC - H	6030 HK	17.66	N	19.50	10%	30	16.8	14.6	1.3	1.2	1.8%	1.6%	7.9%	8.6%
GF-H	1776 HK	17.86	NC	NA	NA	20	14.2	11.9	1.5	1.4	2.3%	2.7%	10.6%	12.2%
CICC - H	3908 HK	11.30	NC	NA	NA	3	14.9	13.0	1.3	1.2	0.3%	0.4%	8.6%	9.4%
Average							14.6	12.2	1.2	1.2	1.8%	2.0%	9.0%	10.2%

Source: Bloomberg, J.P. Morgan estimates. Note: Galaxy, Haitong, CITIC Securities, Huatai and CMS are using J.P. Morgan estimated data; GF and CICC are using Bloomberg consensus

Table 22: Valuation premium for dual-listed brokers (as of Nov 16, 2016)

Brokers	H share ticker	A share ticker	H share price (HKD)	A share price (CNY)	Premium (A/H)
CITIC Securities	6030 HK	600030 CH	17.66	17.46	12%
Haitong Securities	6837 HK	600837 CH	14.24	16.95	34%
Guangfa Securities	1776 HK	000776 CH	17.86	19.16	21%
Huatai Securities	6886 HK	601688 CH	16.86	20.98	40%
China Merchant Securities	6099 HK	600999 CH	12.26	19.2	77%
Average					36.9%

Source: Bloomberg, J.P. Morgan estimates.

Table 23: Direct peer valuation comparison (as of Nov 16, 2016)

Name	Ticker	Mkt Cap US\$m	Price LC	P/E		P/B		ROE		ROA		Div Yld	
				2016E	2017E	2016E	2017E	2016E	2017E	2016E	2017E	2016E	2017E
Huatai - H	6886 HK	20,357	16.86	15.8x	12.8x	1.2x	1.2x	8.1%	9.4%	1.5%	1.8%	1.7%	2.0%
Haitong - H	6837 HK	26,220	14.24	16.7x	14.2x	1.2x	1.1x	8.0%	8.9%	1.5%	1.7%	1.8%	1.7%
CITIC - H	6030 HK	30,186	17.66	16.8x	14.6x	1.3x	1.2x	7.9%	8.6%	2.0%	2.4%	1.8%	1.6%
Galaxy - H	6881 HK	9,468	7.70	12.4x	10.1x	1.1x	1.0x	9.0%	10.3%	1.9%	2.4%	2.6%	2.5%
CMS - H	6099 HK	17,529	12.26	11.6x	9.0x	1.2x	1.1x	10.6%	12.5%	2.1%	3.0%	2.0%	2.8%
CICC - H	3908 HK	3,360	11.30	14.9x	13.0x	1.3x	1.2x	8.6%	9.4%	1.4%	1.6%	0.3%	0.4%
GF-H	1776 HK	20,423	17.86	14.2x	11.9x	1.5x	1.4x	10.6%	12.2%	2.1%	2.5%	2.3%	2.7%
H share brokers				14.6x	12.2x	1.2x	1.2x	9.0%	10.2%	1.8%	2.2%	1.8%	2.0%
Citic	600030 CH	30,186	17.46	18.8x	16.3x	1.4x	1.2x	7.9%	8.6%	2.0%	2.4%	1.6%	1.9%
Haitong	600837 CH	26,220	16.95	22.5x	19.1x	1.6x	1.3x	8.0%	8.9%	1.5%	1.7%	1.4%	1.6%
Shenwan Hongyuan	000166 CH	20,169	6.91	18.5x	15.6x	2.2x	2.3x	15.4%	16.5%	n/a	n/a	n/a	n/a
Guosen	002736 CH	21,575	18.08	18.9x	16.6x	2.9x	2.7x	16.0%	16.5%	3.3%	3.2%	1.1%	1.1%
Guangfa	000776 CH	20,423	19.16	17.2x	13.8x	1.8x	1.7x	11.0%	13.3%	2.2%	3.1%	1.7%	2.0%
Merchants	600999 CH	17,529	19.2	20.5x	15.9x	2.1x	1.9x	10.6%	12.5%	1.5%	1.8%	1.1%	1.6%
Huatai	601688 CH	20,357	20.98	22.2x	18.0x	1.7x	1.6x	8.1%	9.4%	1.5%	1.8%	1.2%	1.5%
Orient	600958 CH	13,754	16.76	35.1x	29.1x	2.9x	2.8x	6.6%	10.1%	1.1%	1.5%	1.7%	2.6%
Founder	601901 CH	10,602	8.85	27.2x	21.6x	2.1x	2.0x	8.8%	9.3%	n/a	n/a	n/a	n/a
Everbright	601788 CH	11,211	17.79	19.4x	16.8x	1.6x	1.5x	7.9%	8.8%	1.8%	2.0%	1.3%	1.0%
Industrial	601377 CH	8,547	8.77	23.5x	17.9x	2.0x	1.9x	9.6%	11.3%	n/a	n/a	1.0%	1.5%
Western	002673 CH	10,517	25.85	59.0x	46.6x	4.8x	4.9x	10.5%	12.3%	n/a	n/a	n/a	n/a
Changjiang	000783 CH	10,123	12.58	28.5x	22.7x	2.8x	2.4x	11.0%	11.8%	3.4%	4.2%	1.2%	1.4%
Dongxing	601198 CH	9,745	24.28	46.9x	33.4x	3.4x	3.2x	7.8%	9.3%	n/a	n/a	n/a	n/a
Southwest	600369 CH	6,400	7.79	25.7x	20.9x	2.2x	2.1x	8.8%	10.0%	2.2%	2.5%	1.0%	1.3%
Guoyuan	000728 CH	6,991	24.46	33.5x	25.5x	2.3x	2.2x	7.5%	9.1%	1.7%	2.4%	1.7%	3.1%
Dongwu	601555 CH	6,645	15.22	30.4x	23.4x	2.3x	2.2x	8.1%	9.9%	n/a	n/a	0.9%	1.3%
Sinolink	600109 CH	6,439	14.63	28.1x	22.6x	2.5x	2.4x	9.1%	10.3%	2.7%	3.0%	0.7%	0.9%
Shanxi	002500 CH	6,097	14.81	52.5x	40.7x	2.5x	2.4x	5.4%	7.2%	n/a	n/a	n/a	n/a
Pacific	601099 CH	5,694	5.74	85.7x	42.8x	3.6x	3.7x	7.6%	9.4%	n/a	n/a	n/a	n/a
Northeast	000686 CH	4,837	14.2	19.3x	10.4x	2.5x	2.6x	11.5%	14.0%	n/a	n/a	n/a	n/a
Guohai	000750 CH	4,871	7.94	29.6x	25.6x	2.4x	2.2x	10.4%	11.2%	n/a	n/a	n/a	n/a
A share brokers				31.0x	23.4x	2.4x	2.3x	9.4%	10.9%	2.1%	2.5%	1.2%	1.6%

Source: Bloomberg, J.P. Morgan estimates. Note: Galaxy, Haitong, Citic Securities, Huatai and CMS are using J.P. Morgan estimates. Other peers are using Bloomberg consensus estimates.

Table 24: Indirect peer valuation comparison (as of Nov 16, 2016)

Name	Ticker	Mkt Cap US\$m	Price LC	P/E		P/B		ROE		ROA		Div Yld	
				2016E	2017E	2016E	2017E	2016E	2017E	2016E	2017E	2016E	2017E
Yuanta FHC	2885 TT	4,334	11.5	10.4x	9.8x	0.7x	0.7x	6.7%	6.8%	0.7%	0.7%	4.0%	4.3%
Samsung	016360 KS	2,281	35000	12.6x	11.0x	0.7x	0.7x	5.7%	6.4%	0.6%	0.6%	2.5%	2.8%
Daewoo	006800 KS	2,189	7860	13.7x	11.6x	0.6x	0.6x	4.4%	5.0%	0.5%	0.6%	3.2%	3.7%
Daiwa	8601 JT	10,796	675.5	9.9x	12.0x	0.9x	0.9x	9.1%	7.8%	0.5%	0.4%	4.1%	3.2%
Nomura	8604 JT	20,845	596.9	12.4x	12.8x	0.8x	0.8x	6.6%	6.3%	0.5%	0.6%	2.6%	2.5%
Asia Large Cap Regional Brokers				11.8x	11.4x	0.7x	0.7x	6.5%	6.5%	0.6%	0.6%	3.3%	3.3%
Goldman Sachs	GS US	88,163	211.19	13.5x	12.1x	1.2x	1.1x	8.6%	9.3%	0.8%	0.8%	1.2%	1.3%
Morgan Stanley	MS US	74,913	40	14.6x	12.9x	1.1x	1.0x	7.2%	7.8%	0.6%	0.7%	1.7%	2.2%
US Institutional Brokers				14.1x	12.5x	1.1x	1.0x	7.9%	8.6%	0.7%	0.8%	1.5%	1.8%
E-Trade	ETFC US	9,189	33.56	18.5x	18.9x	1.5x	1.4x	8.6%	7.4%	1.1%	0.9%	0.0%	0.0%
Ameritrade	AMTD US	19,917	37.84	24.3x	23.1x	4.0x	3.6x	16.7%	16.3%	3.2%	3.3%	1.8%	2.0%
Scwab	SCHW US	49,315	37.2	28.9x	24.4x	3.3x	2.9x	13.1%	13.8%	1.0%	1.2%	0.7%	0.9%
US E-Brokers				23.9x	22.1x	2.9x	2.6x	12.8%	12.5%	1.8%	1.8%	0.8%	1.0%
Piper Jaffray	PJC US	996	65.85	14.3x	12.5x	1.1x	1.1x	7.1%	7.4%	2.5%	2.4%	n/a	n/a
Stifel Financial	SF US	3,206	48.39	18.8x	16.5x	1.3x	1.4x	8.0%	8.9%	1.0%	1.3%	0.0%	0.0%
Raymond James	RJF US	10,187	71.9	20.2x	16.8x	2.1x	1.9x	10.7%	11.7%	1.8%	2.1%	1.1%	1.2%
Cowen	COWN US	333	3.1	-77.5x	8.2x	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
FBR & Co	FBRC US	83	12.05	-1.2x	301.3x	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
US Regional Brokers				-5.1x	71.0x	1.5x	1.5x	8.6%	9.3%	1.8%	1.9%	0.6%	0.6%

Source: Bloomberg.

Investment Positives

Leading broker in institutional business

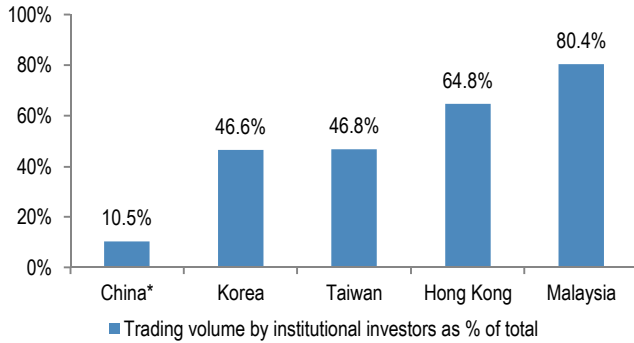
The development of institutional business in China

According to China's Securities Association, there are 126 brokers as of 1H16 in China. Competition is intense. With the increasing penetration of low-cost online or mobile trading platforms, brokerage commission fees have declined to 4.0 bps on average in 1H16 in China. But commission rates offered to institutional clients remain relatively resilient as institutional clients require more value-added services. For example, for CMS, the commission rate for mutual fund clients is 5bps to 10bps, vs ~5.7bps for overall commission in 1H16.

Institutional investors only account for 10.5% of China's total equity shares trading flow in 2015, significantly below regional peers, such as Korea of 46.6% and 46.8% in Taiwan (see chart below). We see the following catalysts which may increase institutional flow going forward:

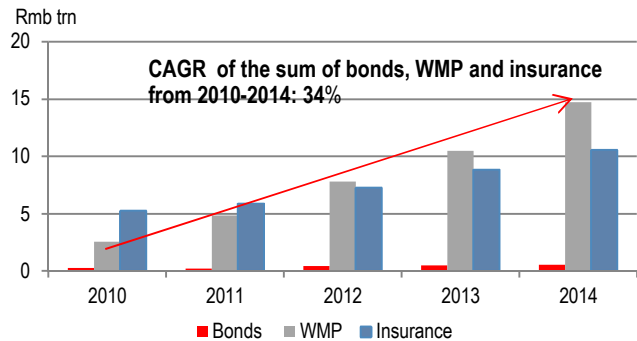
- ***Rising financial assets coupled with a volatile equities market positive for development of institutional business:*** Total household financial assets in China increased from Rmb49trn in 2010 to 103trn in 2014, at a CAGR of 34%, according to WIND. We estimate that in 2015 financial assets rose to 118trn. Equities investments only account 4.5% of financial assets at end 2014. We believe that with the stock market volatility in 2015 and beginning 2016, some investors may consider increasing asset allocation to funds or insurance products; as such, growth of institutional investors will speed up, in our view.
- ***Rising opportunities for overseas institutional clients:*** We note a series of policy actions aiming to open up China's capital markets to foreign institutional investors. This includes the expansion of QFII quota, SH-HK Connect, SZ-HK Connect and the opening up of bond/interbank market to qualified foreign investors. The immediate impact for local brokers is limited, but eventually this will be positive to research or other advisory business from local brokers.
- ***Clarification on pension fund investment into equities market:*** In August 2015, the State Council announced that the upper limit of equities investment for pension funds (which account for 90% of social insurance fund) is 30%. Previously, the pension fund investment was limited to low-yielding treasury notes and bank deposits. Total assets of social insurance funds in China are ~Rmb3.5trn, with investible assets of ~Rmb2trn at the end of 2014 according to the Ministry of Human Resources and Social Security; this implies equities investment could reach Rmb600bn.
- ***Tightening regulation on shadow banking assets may lead to rising asset allocation into equities:*** The tightening on WMP and Asset Management Plans are aimed at reducing channel business and increase NAV products which have better liquidity. This may lead to asset allocation into equities, bonds and money market products. In addition, such tightening may reduce non-standardized assets in the mix, eventually lowering yield and even break up "implicit guarantee" of some products, thus likely leading to a rising allocation to equities.

Figure 28: Trading flow of % of institutional clients (China, vs the HK, TW, Malaysia and Korea)



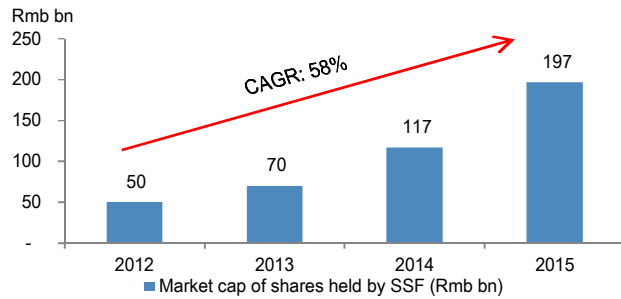
Source: WIND. Note: * For China, the data represents split of trading volume in Shanghai Stock Exchange. For MY & KR, average of buy/sell share; Institutional is ex-retail/individual.

Figure 29: Total household financial assets and CAGR growth line



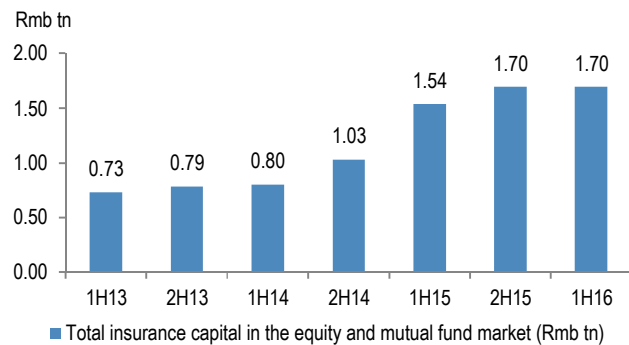
Source: WIND. (Note: Total household financial assets represent sum of bonds, WMP and insurance)

Figure 30: Market capitalization of equities held by National Social Security Fund has been increasing



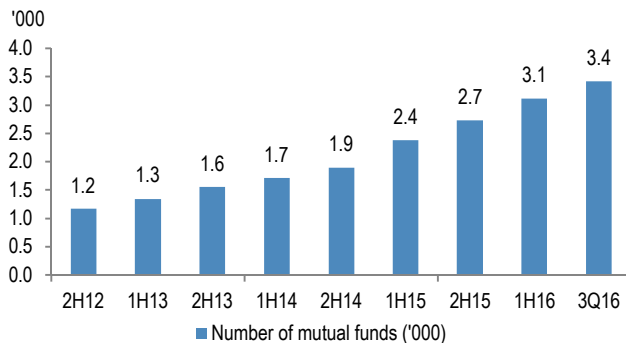
Source: WIND.

Figure 31: Total insurance assets into the equity and mutual fund markets



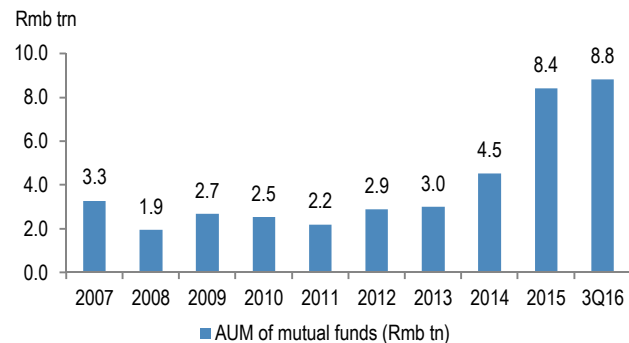
Source: WIND. The data is calculated by multiplying Insurance fund balance (保险资金运用余额) by Equity and fund investment percentage of insurance fund balance.

Figure 32: Number of mutual funds



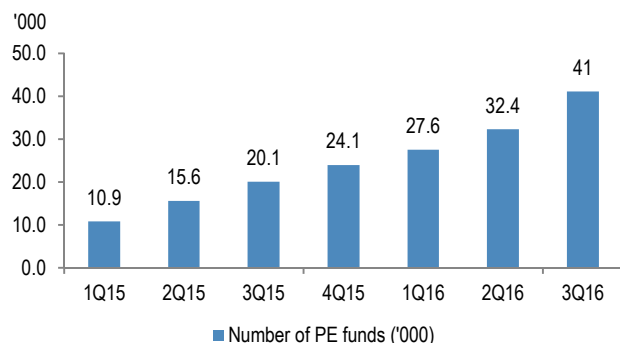
Source: WIND.

Figure 33: AUM of mutual funds



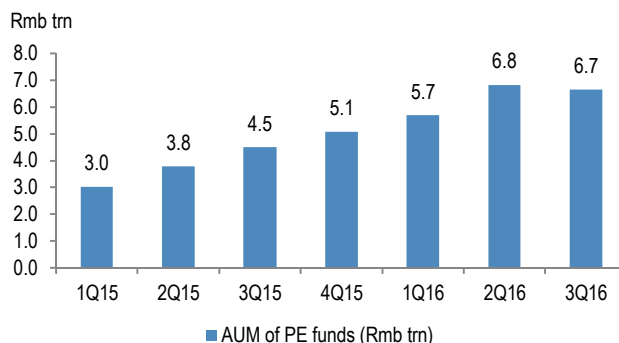
Source: WIND.

Figure 34: Number of PE funds



Source: WIND.

Figure 35: AUM of PE funds



Source: WIND.

Table 25: Table of action by regulators which could raise institutional trade flows

Actions	Date	Eligible investors	Details
Expansion of QFII	Since July 2013	Qualified institutional investors including asset management companies, insurance companies, securities firms, commercial banks, and others such as pension funds, charity foundations, endowment funds, sovereign wealth funds.	In July 2013, CSRC raised total QFII quota to US\$150bn from US\$80bn; In Feb 2016, in place of the need to obtain SAFE approval of each investment quota, a QFII can make a filing with SAFE for a "base investment quota" of up to a maximum amount, to be set within a range of US\$20 million to US\$5 billion (increased from the previous upper limit of US\$1 billion) under the new rules.
Shanghai-HK Connect	Announced on Apr 10, 2014; Launched on Nov 17, 2014	SFC requires Mainland investors participating in the Southbound Trading Link to be limited: 1) institutional investors; 2) individual investors with an aggregate balance of not less than RMB500,000 in their securities and cash accounts.	CSRC and SFC jointly announced the establishment of Shanghai-HK Stock Connect, which is a pilot program for mutual stock market access between Mainland China and HK investors. Quota as follows: Northbound: RMB13bn daily quota; Southbound: RMB10.5bn daily quota. CSRC and SFC subsequently announced in Aug 16 that there is no aggregate quota after Aug 16, 2016.
Opening of interbank bond market to foreign institutions	Announced and effective on Jul 14, 2015	Foreign central banks, international financial institutions and sovereign wealth funds.	Foreign institutions can access the onshore interbank market, after registering with the central bank. They are allowed to trade bonds, repos, IRS, and other permitted products.
Clarification on Social Insurance Fund for equity investment	Announced on Aug 17, 2015	Institutional investors authorized by the State Council will manage the pension fund.	The pension fund (~90% of total social insurance fund pool) investment guideline, which was announced on Aug 17, 2015, allows the country's pension fund (which was limited to low-yielding treasury notes and bank deposits) to invest in stocks and equities market with maximum 30% of total net assets. Total investible pension fund nationwide was ~Rmb 2trn (by end of 2014, according to the Ministry of Human Resources and Social Security), which leads to theoretically equity investment amount of Rmb 600bn at max, according to the calculation of local news (China Daily).
Shenzhen-HK Connect	Announced in Aug 2016	Northbound: At the initial stage, investors eligible to trade shares that are listed on the ChiNext Board of SZSE will be limited to institutional professional investors as defined in the relevant Hong Kong rules and regulations. Subject to the resolution of related regulatory issues, other investors may subsequently be allowed to trade such shares. Southbound: 1) institutional investors; 2) individual investors who hold an aggregate balance of not less than RMB 500,000 in their securities and cash accounts.	State Council announced approval of Shenzhen-HK Stock Connect in Aug 2016, which is a pilot program for mutual stock market access between Mainland China (Shenzhen market) and HK investors. Quota: Northbound: daily quota of RMB13.0bn; Southbound: daily quota of RMB10.5bn. No aggregate quota under SZ-HK Stock Connect.

Source: CSRC, SFC, HKEX, PBOC, State Council.

CMS's position ahead of peers

CMS is positioned ahead of peers in terms of gaining market share in institutional business (see table below). This is positive as commission rates of trading flows from mutual funds is about 5-10bps, according to CMS, total blended commission rates was only 5.7bps in 1H16. Thus, institutional business is a higher-margin business. With the rising market share in institutional business, contribution to revenue also went up to 15% in 1H16 from 9% in 2013 (see chart below).

Table 26: CMS – Income from institutional clients

		2013	2014	2015	CAGR- 2013-2015	1H15	1H16	YoY
Income from institutional clients	Rmb mn	700	1,071	3,172	112.8%	1,477	1,310	-11.3%
Securities Trading								
Trading seats leasing income	Rmb mn	298	359	855	69.4%	440	265	-39.8%
Trading seats leasing income (From mutual funds)	Rmb mn	236	287	668	68.3%	N/A	N/A	N/A
Stocks and funds trading volume of institutional clients (excl. trading seats leasing)	Rmb bn	269	356	1,482	134.7%	701	446	-36.4%
Stock trading volume of mutual funds using trading seats	Rmb mn	263	325	798	74.1%	359	226	-36.9%
Investment advisory								
Income from investment advisory business	Rmb bn	25	47	54	46.9%	19.1	40	108.4%
Capital-based Intermediary Businesses:								
Number of institutional clients with margin accounts	No.	151	244	476	77.5%	NA	635	NA
Balance of margin loans and securities lent to institutional clients	Rmb mn	1,535	4,760	4,971	80.0%	NA	3,103	NA
Fund custody and outsourcing								
Income from fund custody and outsourcing	Rmb mn	1	16	247	1397.9%	81.7	164	100.6%
No of funds under custody	No.	23	469	2,760	995.4%	NA	3,959	NA
AUM of funds under custody (Rmb bn)	Rmb bn	3	55	333	889.2%	NA	449	NA
No of funds under outsourcing	No.	8	390	2,474	1658.6%	NA	3,631	NA
AUM of funds under outsourcing (Rmb bn)	Rmb bn	1	38	292	1399.0%	NA	396	NA

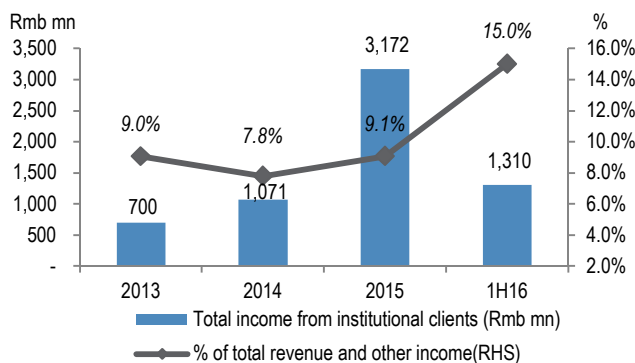
Source: Company data, Securities Association of China, WIND (Note: For ranking and market share, we used WIND data which could be different from company data due to difference in classifications).

Table 27: CMS – Market share and ranking of securities trading business for institutional clients

		2013	2014	2015	CAGR- 2013-2015	1H15	1H16	YoY
Securities Trading								
Trading seats leasing income	Rmb mn	298	359	855	69.4%	440	265	-39.8%
	Ranking	N/A	5	5			N/A	
	Market share	N/A	5.0%	5.1%			N/A	
Trading seats leasing income (From mutual funds)	Rmb mn	236	287	668	68.3%	N/A	N/A	N/A
	Ranking	5	3	2			N/A	
	Market share	4.6%	4.9%	5.3%			N/A	
Stocks and funds trading volume of institutional clients (excl. trading seats leasing)	Rmb bn	269	356	1,482	134.7%	701	446	-36.4%
	Ranking	N/A	N/A	N/A			N/A	
	Market share	N/A	N/A	N/A			N/A	
Stock trading volume of mutual funds using trading seats	Rmb bn	263	325	798	74.1%	359	226	-36.9%
	Ranking	5	3	1			N/A	
	Market share	4.6%	4.9%	5.4%		4.7%	4.9%	0.2ppts
No of registered PE funds under custody	No. of funds	N/A	N/A	2,370	N/A	N/A	N/A	N/A
	Ranking	N/A	N/A	1				
	Market share	N/A	N/A	29.1%			29.3%	

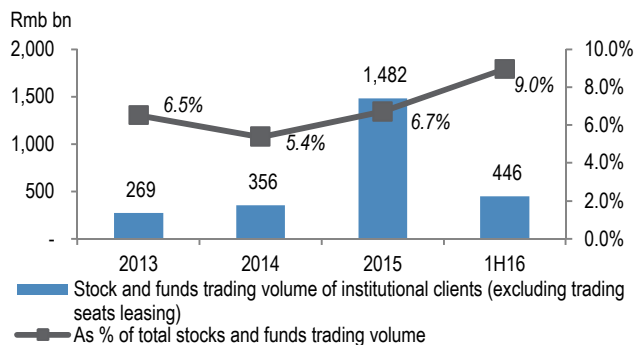
Source: Company data, Securities Association of China, WIND (Note: For ranking and market share, we used WIND data which could be different from company data due to difference in classifications).

Figure 36: Revenue contribution from institutional clients



Source: Company data.

Figure 37: Stock and funds trading volume of institutional clients (excluding trading seats leasing)



Source: Company data. Institutions in trading seats leasing include mutual funds and insurance companies.

Table 28: CMS ranked #1 in trading volume of mutual funds using trading seats (2015)

Rank	Broker	Stock trading volume (Rmb mn)	Market share
1	CMS	798,125	5.4%
2	Citic Securities	786,407	5.3%
3	Haitong	722,642	4.9%
4	Shenwan Hongyuan	702,463	4.7%
5	Guosen	692,515	4.7%
6	China galaxy	683,623	4.6%
7	Guotai Junan	682,735	4.6%
8	Essence	664,699	4.5%
9	China Securities	652,716	4.4%
10	GF Securities	648,290	4.4%
	Market total	14,829,724	100.0%

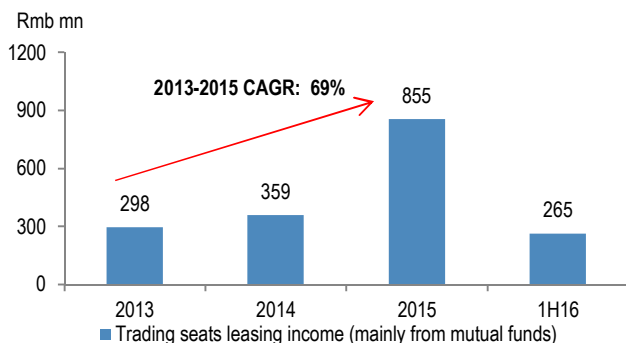
Source: Wind. (Note: There could be a discrepancy between company data and WIND data in this set of data due to different criteria in calculation).

Table 29: CMS ranked #2 in trading commission income from leasing trading seats to mutual funds (2015)

Rank	Broker	Commission income (Rmb mn)	Market share
1	Citic Securities	668	5.3%
2	CMS	668	5.3%
3	Haitong	607	4.8%
4	Guosen Securities	586	4.6%
5	Essence Securities	582	4.6%
6	China Galaxy	561	4.5%
7	Guotai Junan	561	4.5%
8	GF Securities	559	4.4%
9	Shenwan Hongyuan	550	4.4%
10	China Securities	536	4.3%
	Market total	12,593	100.0%

Source: Wind. (Note: There could be a discrepancy between company data and WIND data in this set of data due to different criteria in calculation).

Figure 38: Trading seats leasing income (mainly from mutual funds)



Source: Company data.

Table 30: CMS ranked #1 in PE funds under custody at end 2015

Rank	Broker	Number of PE funds	Market share
1	CMS	2,370	29.1%
2	Guosen Securities	1,890	23.2%
3	Guotai Junan	1,243	15.2%
4	Citic Securities	969	11.9%
5	GF Securities	402	5.0%
6	China Securities	373	4.6%
7	Haitong Securities	259	3.2%
8	Huatai Securities	242	3.0%
9	Industrial Securities	239	2.9%
10	Galaxy Securities	85	1.0%
	Total	8,144	

Source: Wind. (Note: There could be a discrepancy between company data and WIND data in this set of data due to different criteria in calculation).

Table 31: Equity underwriting market share (2015)

Rank	Company	Underwriting volume (Rmb bn)	Market share
1	Citic Securities	94.3	9.9%
2	Guotai Junan	73.3	7.7%
3	Guangfa Securities	51.4	5.4%
4	China Securities	50.1	5.3%
5	CMS	47.5	5.0%
6	Huatai Securities	40.4	4.3%
7	Guosen Securities	37.2	3.9%
8	Southwest Securities	35.6	3.7%
9	Haitong Securities	33.5	3.5%
10	ZhongDe Securities	29.1	3.1%
	Total	949.7	100.0%

Source: Wind. (Note: There could be a discrepancy between company data and WIND data in this set of data due to different criteria in calculation).

Table 32: Bond underwriting market share (2015)

Rank	Company	Underwriting volume (Rmb bn)	Market share
1	Citic Securities	415.6	11.5%
2	China Securities	370.3	10.3%
3	CMS	265.7	7.4%
4	Guotai Junan	251.1	7.0%
5	Haitong	147.0	4.1%
6	Guangfa	143.7	4.0%
7	CICC	137.3	3.8%
8	Galaxy	127.8	3.5%
9	CDB Securities	106.3	2.9%
10	Guosen	96.7	2.7%
	Total	3,610.5	100.0%

Source: Wind. (Note: There could be a discrepancy between company data and WIND data in this set of data due to different criteria in calculation).

Table 33: ABS underwriting market share (2015)

Rank	Company	Underwriting volume (Rmb bn)	Market share
1	CMS	82.4	14.5%
2	Citic Securities	69.5	12.3%
3	CDB Securities	60.3	10.6%
4	Galaxy Securities	49.5	8.7%
5	China Securities	38.9	6.9%
6	Guotai Junan	38.7	6.8%
7	Hengtai Securities	24.6	4.3%
8	Guangfa	22.1	3.9%
9	CICC	19.3	3.4%
10	Orient Securities	14.2	2.5%
	Total	566.8	100.0%

Source: Wind. (Note: There could be a discrepancy between company data and WIND data in this set of data due to different criteria in calculation).

Table 34: M&A transaction value- market share (2015)

Rank	Company	Transaction value (Rmb bn)	Market share
1	Huatai Securities	264.9	12.2%
2	Citic Securities	234.7	10.8%
3	Southwest Securities	153.3	7.0%
4	Guotai Junan	148.8	6.8%
5	Haitong Securities	147.5	6.8%
6	CICC	125.7	5.8%
7	Guangfa Securities	115.7	5.3%
8	Great Wall Securities	91.6	4.2%
9	Morgan Stanley Huaxin	65.9	3.0%
10	China Securities	64.9	3.0%
11	CMS	64.4	2.9%

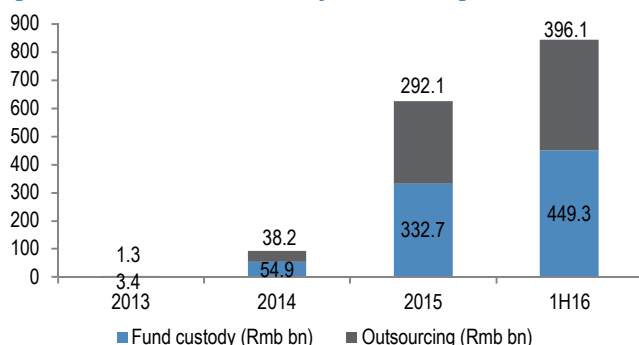
Source: Wind. (Note: There could be a discrepancy between company data and WIND data in this set of data due to different criteria in calculation).

Institutional sales and trading: CMS provides one-stop services including sales and trading, investment research, and prime brokerage to institutional clients such as mutual funds, private investment funds, and insurance companies. As of 1H16, CMS has over 15,000 institutional clients, including 984 private investment funds and 101 mutual funds. Aggregate income from institutional clients reached Rmb3.2bn in 2015, nearly triple from 2014.

Trading seats to mutual funds: CMS makes trading commissions by leasing the trading seats to mutual funds and insurance companies for securities trading on stock exchanges, with commission rates of 5-10bps. Trading volume/commission income by mutual funds clients through CMS trading seats amounted to Rmb798.1bn/ Rmb668m in 2015, ranked first/second in the industry with market share of 5.4%/5.3%.

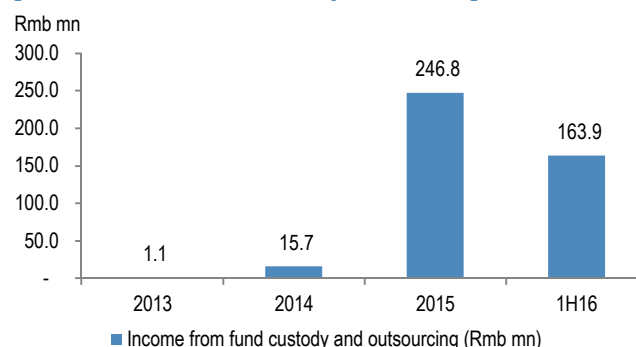
Prime brokerage business: CMS was the first to be qualified as prime broker in the industry in 2013 to offer services including prime brokerage trading system, fund custody and outsourcing, settlement, margin financing and securities lending, as well as integrated issuance solutions. As of 1H16, aggregate financial assets under fund custody by CMS amounted to Rmb449.3bn from 3,959 funds (market share of 29.3%) and aggregate financial assets using outsourcing services amounted to Rmb396.1bn; income from fund custody and outsourcing has grown enormously in recent years and more than doubled YoY in 1H16; growing revenue from this part of the business, which is recurring along with AUM and is more stable due to higher client adherence, would help to enhance earnings stability.

Figure 39: AUM under fund custody & outsourcing



Source: Company data.

Figure 40: Income from fund custody & outsourcing



Source: Company data.

Stringent risk management proven effective

CSRC released 2016 regulatory rating on 95 brokers in July, among which the number of AA-rated brokers (no AAA rated) significantly decreased to 8 from 27 in 2015, including the six H-share listed leading brokers (Citic, Haitong, Huatai and Guangfa were downgraded to BBB, while Galaxy and CICC were downgraded to A). On the other hand, CMS has maintained its AA rating for nine consecutive years, a demonstration of its superior risk management capabilities, we believe.

A higher regulatory rating should offer CMS greater competitive advantages. From the perspective of financial impact, CMS will enjoy lower contribution (as a percentage of operating income) to investors' protection funds and lower funding costs in the capital markets (including interbank and bond issuance). Moreover, CMS should be able to maintain higher capital efficiency on the back of lower risk charges with regards to net capital/risk capital reserve ratios compared to A-/BBB-rated peers by 33-50% under the existing capital rules and 13-22% under the new capital rules that will come into effect this October. Meanwhile, it is difficult to quantify but a higher regulatory rating would likely facilitate CMS on new business development/innovation, which is critical to its institutional businesses.

In addition, prudent risk management is also demonstrated by its capital-based intermediary businesses. For instance, collateral-to-loan ratios at margin financing and stock pledge repurchase have been consistently above 250%, very much sufficient against market volatility, while CMS still sets aside provisions equivalent to 0.28% of the outstanding balance.

Table 35: Regulatory ratings of top Chinese brokers (2010-16)

Name	2010	2011	2012	2013	2014	2015	2016	Downgraded in 2016?
Guotai Junan	AA	AA	AA	AA	AA	AA	AA	N
Citic Securities	AA	AA	AA	AA	AA	AA	BBB	Y
Galaxy	AA	AA	AA	AA	AA	AA	A	Y
Huatai	AA	AA	AA	AA	AA	AA	BBB	Y
Guangfa	A	AA	AA	AA	AA	AA	BBB	Y
Guosen	AA	AA	AA	AA	AA	AA	BBB	Y
Haitong	AA	AA	AA	A	AA	AA	BBB	Y
CMS	AA	AA	AA	AA	AA	AA	AA	N
China Securities	AA	AA	AA	AA	AA	AA	AA	N
Founder Securities	A	A	A	AA	A	A	C	Y

Source: CSRC, Wind.

Table 36: Definition of regulatory ratings per "Regulations of Classification of Securities Companies"

Regulatory rating	Definition
Type A (AAA, AA, A)	Risk management capabilities are the best among peers, and the company is well positioned to manage risks arising from new products or new businesses
Type B (BBB, BB, B)	Risk management capabilities above industry average, and the company is better positioned to control risks amid business growth
Type C (CCC, CC, C)	The company is capable of managing risks intertied from its existing operations
Type D	Risk management capability is substandard and the business risks are beyond the control of the company
Type E	The company facing notable business risks and CSRC are conducting risk management procedures on it

Source: CSRC.

Table 37: Adjustment factor for the calculation of Risk Capital Reserve based on regulatory rating of brokers

Regulatory ratings	Existing capital rules	New capital rules
"Type A" for 3 consecutive years (AAA, AA, A)	0.2x	0.7x
Type A (AAA, AA, A)	0.3x	0.8x
Type B (BBB, BB, B)	0.4x	0.9x
Type C (CCC, CC, C)	1x	1x
Type D	2x	2x

Source: CSRC.

Table 38: Impact on capital ratio after downgrades & new capital regulation

	Existing capital regulation			New capital regulation			Regulatory minimum (no change)
	Before downgrade	After downgrade	Difference	Before downgrade	After downgrade	Difference	
Galaxy	1253%	1253%	N/A	358%	358%	N/A	100%
Citic	663%	332%	-332 ppt	190%	147%	-42 ppt	100%
Haitong	1269%	635%	-635 ppt	363%	282%	-81 ppt	100%
Huatai	881%	440%	-440 ppt	252%	196%	-56 ppt	100%
CMS	728%	728%	00 ppt	208%	208%	00 ppt	100%

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

Table 39: Impact of regulatory rating downgrades on P&L

		Galaxy	Citic	Haitong	Huatai	CMS
Operating income in 2015 (A share data)	a	33,459	56,013	38,086	26,262	25,292
Current regulatory rating		AA	AA	AA	AA	AA
% of operating income to investor protection fund-current	b	-0.50%	-0.50%	-0.50%	-0.50%	-0.50%
Contribution to investor protection fund- current	c=a*b	(167)	(280)	(190)	(131)	(126)
New regulatory rating		A	BBB	BBB	BBB	AA
% of operating income to investor protection fund- pro forma	d	-0.75%	-1.50%	-1.50%	-1.50%	-0.50%
Contribution to investor protection fund- pro forma	e=a*d	(251)	(840)	(571)	(394)	(126)
Impact on P/L	f=e-c	(84)	(560)	(381)	(263)	0
Net income in 2015	g	9,836	19,800	15,839	10,697	10,909
% of impact	h=f*(1-tax rate)/g	-0.6%	-2.1%	-1.8%	-1.8%	0%

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

Table 40: Guidelines on new capital requirements by CSRC

No	Details
	Amendment on the calculation of net capital and risk capital reserves to improve the quality of capital and to better quantify the risks. In particular:
1	<ul style="list-style-type: none"> - Net capital is divided into net core capital and net supplementary capital, - Risk adjustments for financial assets are quantified universally in the calculation of risk capital reserve and are no longer deducted from net capital, which were double-counting. - To quantify the overall risk adjusted capital reserve according to different type of risks, including market risk, credit risk, operational risk.
	The new calculation methodology will allow securities firms to conduct comprehensive risk management more aligned with actual underlying operations; given the material changes in terms of the scope and computation methods, new capital ratios are no longer comparable to historical data.
2	Enhancing the leverage indicators and risk controls: Replacing the two indicators, net capital/total liabilities and net assets/total liabilities with capital leverage ratio, which is defined as core net capital/total assets (on & off balance sheets); securities companies should maintain at a level of not less than 8%.
3	Optimizing liquidity supervision and strengthening asset/liability duration management: Liquidity coverage ratio and net stable funding ratio will become official regulatory requirements from industry self-discipline indicators.
4	Refining risk indicators at individual businesses: Adjusting the risk calculation of equity securities & margin financing businesses and classifying derivatives as principal investment and non-principal investment. There will be six months grace period for securities companies to comply the new rules (by end of Mar 2017) should their fixed income related portfolio exceed regulatory requirements.
5	Specifying countercyclical adjustment mechanism for effective risk controls: CSRC will adjust the calculation of relevant risk indicators according to the industry risk, market condition and type of securities firm on a dynamic basis.
6	Improving overall risk management mechanism: Securities companies are required to improve overall risk management from the perspective of system setup, corporate structure, human resource allocation, IT supports, risk indicators, and responsive mechanism.

Source: CSRC.

Table 41: Major non-compliance incidences of brokers since 1H15

Date	Incidence
Aug-15	According to Xinhua, seven executives at Citic Securities, including President Cheng Boming, were under investigation for alleged offences including "insider trading".
Sep-15	The CSRC announced punishments for five brokers for illegal operations on 11 September, 2015, including Huatai Securities, Haitong Securities, Guangfa Securities, Founder Securities and Zheshang Futures. The first four brokers were alleged to have failed to ascertain the real identities of clients, and Zheshang Futures was accused of insufficient risk control. The CSRC claimed that these brokers have carried out "illegal trading activities" which it attributed to stock market volatility recently. As such, it will confiscate the illegal profits the brokers earned and impose fines on them. Please refer to our note for details
Nov-15	CSRC announced that 4 securities firm, including Galaxy, China Securities and Shenwan Hongyuan, violated certain regulations to ascertain the real identities of brokerage clients. These brokers were prohibited from opening new brokerage accounts for one month.
Nov-15	Haitong and Citic Securities received an investigation notice from CSRC for suspected breach of relevant provisions of PRC Securities Law in relation to the failure of entering into business contract with customer in accordance with relevant rules for margin financing and securities lending business.

Source: CSRC, Xinhua, Sina.

Table 42: CMS's maximum investment scale in each asset class

Asset Class	Maximum Investment Scale
Equity securities and derivatives ⁽¹⁾	100% of our Net Capital ⁽²⁾
A-share directional investment	50% of our Net Capital as of June 30, 2015
Fixed-income securities	400% of our Net Capital ⁽²⁾

Source: Company data. Note: (1) Inclusive of the contribution to designated accounts at China Securities Finance. (2) Refers to the real-time Net Capital.

Table 43: CMS's risk appetite indicator

Risk appetite indicator	Minimum/Maximum level
VaR of investment portfolio at a one-day 95% confidence interval /net assets	≤ 0.5%
Directional equity trading position/net assets	≤ 15%
Portfolio diversification ⁽¹⁾	≥ 20%
Concentration ratio of directional equity trading portfolio ⁽²⁾	≤ 30%
Duration of fixed-income securities	≤ Five years

Source: Company data. Note: (1) Portfolio diversification = 1 – total portfolio VaR/the aggregate number of VaR of single security. (2) Concentration ratio of directional equity trading portfolio = the aggregate cost of three largest holding equity securities in our long-only trading activities/the maximum investment scale of directional equity trading.

Table 44: CMS's risk tolerance indicator

Risk tolerance indicator	Maximum level
Stop-loss limits of investment portfolio by securities investment department (mainly engages in equity securities and derivatives trading) ⁽¹⁾	N/A
Stop-loss limits of investment portfolio by fixed-income department (mainly engages in fixed-income securities trading)	RMB500.0 million

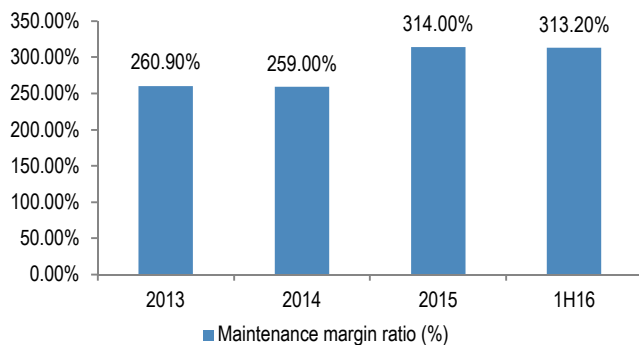
Source: Company data. Note: (1) Not applicable during the period in which CMS undertakes not to reduce our A-share proprietary trading positions below the balance as of July 3, 2015 if the SSE Composite Index is below 4,500 points.

Table 45: CMS maximum collateral conversion rates by type of securities applicable our margin financing and securities lending business

Type of securities	Maximum collateral conversion rate
Treasury bonds	95%
ETFs	90%
Non-ETF listed securities investment funds and non-MOF bonds	80%
SSE 180 Index and SZSE 100 Index constituent stocks	70%
Non-ST stocks (excluding SSE 180 Index and SZSE 100 Index constituent stocks)	65%
ST stocks	0%

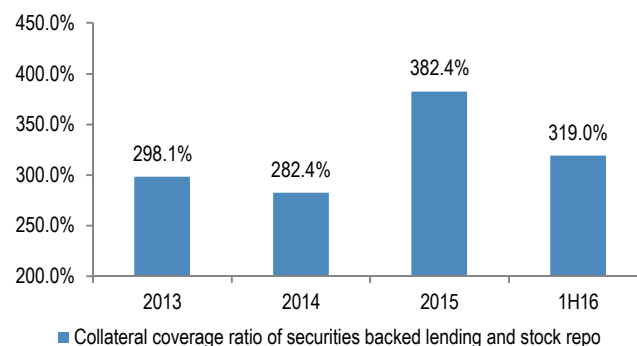
Source: Company data.

Figure 41: Margin financing deposits guarantee rate



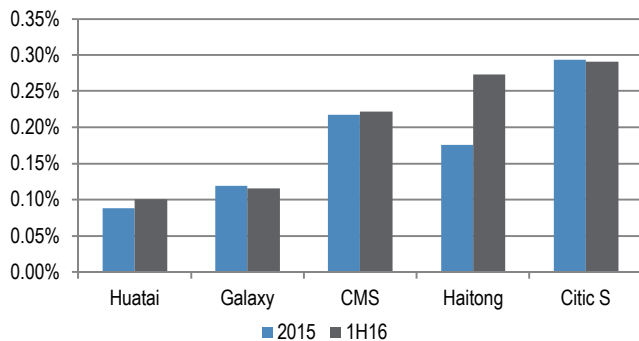
Source: Company data.

Figure 42: Collateral coverage ratio of securities backed lending and stock repo



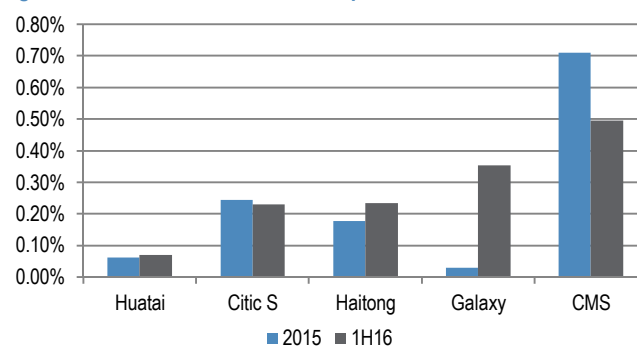
Source: Company data.

Figure 43: Reserve as % of margin loan balance



Source: Company data (Note: provision rate= allowance of impairment loss/ gross margin loan balance).

Figure 44: Reserve as % of reverse repo balance



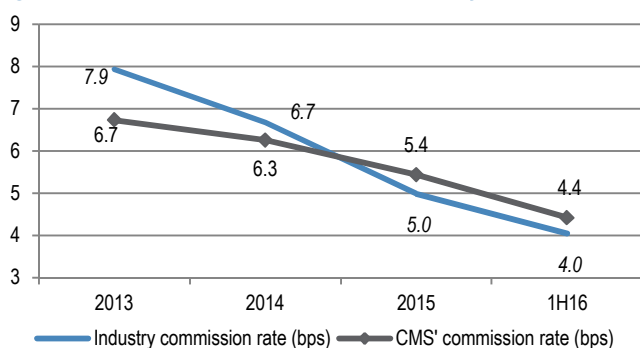
Source: Company data (Note: provision rate= allowance of impairment loss/ gross reverse repo balance).

Stable commission rate due to strategic client selections

CMS' gross commission rate was 6.6bps in 2015, the second highest among HK listed peers (see chart below). Net commission in 1H16 was 4.4bps, which contracted 19% from 2015 but the decline is smaller than the industry average of 20% from 5.0bps in 2015 to 4.0bps in 1H16 (see chart below). We believe the relatively stable commission rate is due to the following:

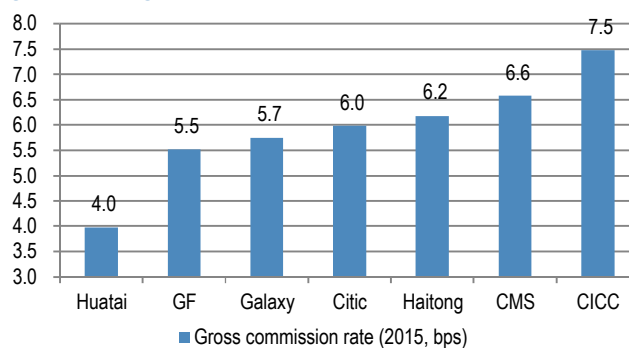
- **Rising market share in institutional business.** For example, commission rate for mutual funds clients is 5-10bps, higher than that of average retail clients;
- **Development of WMP business:** WMP trading turnover account for 14% of total trading turnover in 1H16, up from 9% in 2013, 7% in 2014, and 9% in 2015. Commission rates from WMP trading turnover is 11.5bps in 1H16, significantly higher than 5.7bps of average trading turnover;
- **Margin financing business:** Ranking of margin financing business (in terms of turnover) increased to #7 at end 1H16 from #8 at end 2015. Commission rates from turnover of margin financing clients is 6.0bps in 1H16, also higher than 5.7bps of average trading turnover;

Figure 45: Net commission rate for CMS vs Industry (bps)



Source: Company data, CEIC

Figure 46: 2015 gross commission rate: CMS vs H-share brokers

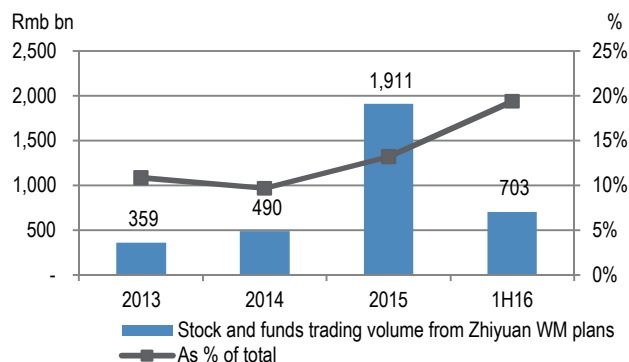


Source: Company data.

Wealth management business

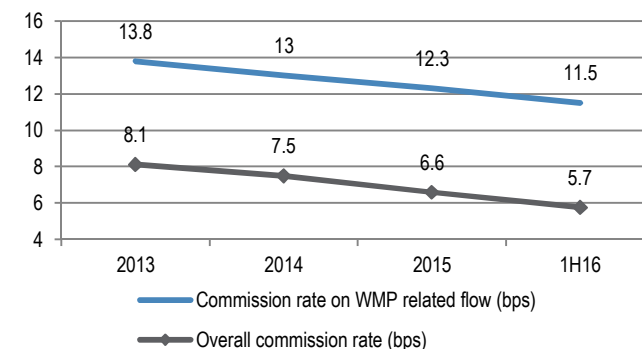
As at end 1H16, CMS has approximately 6.45 million customers. Among that, 0.2% have account balances of more than RMB8mil, 3.0% has AUM of more than 0.5mil. In 2010, it launched the "Zhiyuan Wealth Management Plan" for brokerage customers. There are five different commission rate brackets within the plan. Overall, the average commission rate of 11.5bps in 1H16 only contracted 6.5% from 2015. This is better than overall commission rate, which contracted by ~14% from 2015 to 5.7bps in 1H16.

Figure 47: CMS – Stock and funds from Zhiyuan WMP clients as % of total turnover



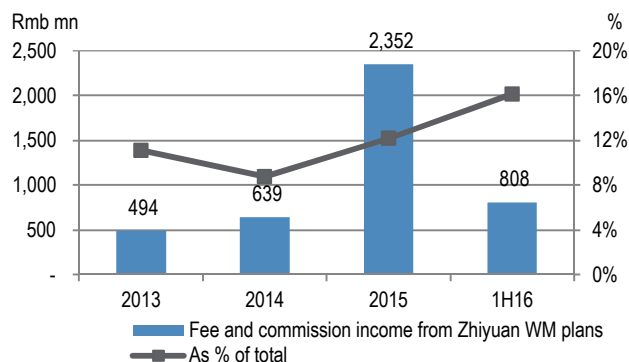
Source: Company data. (Note: trading volume of margin accounts are not included.)

Figure 48: CMS – Average brokerage commission rate for “Zhiyuan Wealth Management Plans” are significantly higher than overall average brokerage commission rate



Source: Company data.

Figure 49: CMS – Fee and commission income from Zhiyuan Wealth Management plans as % of total



Source: Company data.

Table 46: CMS has seen rising income contribution from affluent, high-net-worth clients for brokerage and wealth management segment

Affluent+High-net-worth clients contribution to brokerage & WM	2013	1H16	Change
% of customers	2.7%	3.2%	0.5 %pt
% of customer assets	88.9%	90.2%	1.3 %pt
% of income	37.5%	51.6%	14.1 %pt
% of affluent and high net-worth customers to open margin account	55.7%	91.6%	35.9%pt

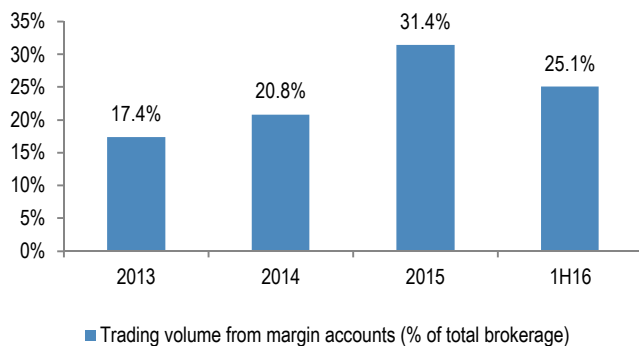
Source: Company data. (Note: Retail customers represent customers with an account balance of less than Rmb 500k; Affluent customers represent customers with an account balance of at least Rmb 500k, but less than Rmb 8mn; High net worth customers represent customers with an account balance of Rmb 8mn or more).

Margin financing business

CMS’ market share on equities trading turnover was only 4.1% in 2015 (3.8% in 2016 YTD), but its market share on margin financing turnover reached 4.8% in 2015 (4.5% 1H16). 91.6% of its WMP clients have opened margin accounts with CMS as of end 1H16. Commission rate on margin accounts is 6.1bps in 1H16 based on our calculations, higher than the overall commission rate of 5.7bps.

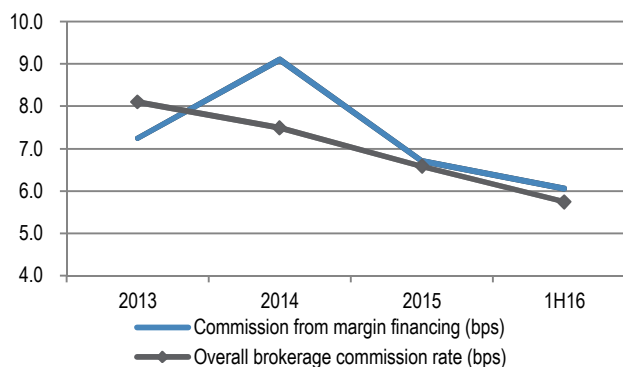
We note that turnover of margin clients normalized to ~25.1% of total turnover in 1H16, vs 31.4% in 2015. As such, the market share on margin accounts related trading turnover declined to 4.5% in 1H16 from 4.8% in 2015. We believe declining turnover ratio of margin accounts amid a volatile market reflects a more prudent attitude of CMS’s financial advisors and their clients.

Figure 50: CMS – Trading flow contribution from margin financing business



Source: Company data. (Note: its calculated by turnover of margin financing/ total brokerage turnover).

Figure 51: CMS – Commission from margin financing vs overall brokerage commission rate



Source: Company data.

Table 47: CMS ranked #7 in margin financing balance (2015)

Rank	Broker	Margin financing balance (Rmb bn)	Market share
1	Shenwan Hongyuan	69.8	5.9%
2	Galaxy	69.1	5.9%
3	Guangfa	66.9	5.7%
4	Huatai	66.1	5.6%
5	Citic Securities	65.9	5.6%
6	Guotai Junan	65.2	5.6%
7	CMS	62.8	5.4%
8	Haitong	60.7	5.2%
9	Guosen	45.9	3.9%
10	Everbright Securities	38.8	3.3%
	Total	1,174.1	100%

Source: Wind. Note: There could be a discrepancy between company data and WIND data in this set of data due to different criteria in calculation).

Table 48: CMS ranked #8 in trading volume (equity+funds) (2015)

Rank	Broker	Volume (Rmb bn)	Market share
1	Huatai	45,158	8.4%
2	Galaxy	27,494	5.1%
3	Guangfa	25,828	4.8%
4	Guotai Junan	25,485	4.7%
5	Shenyin Wanguo	25,323	4.7%
6	Haitong	26,928	5.0%
7	Citic Securities	22,872	4.2%
8	CMS	22,186	4.1%
9	Guosen	21,007	3.9%
10	China Securities	17,149	3.2%
	Market total	539,787	100.0%

Source: Wind. Note: There could be a discrepancy between company data and WIND data in this set of data due to different criteria in calculation).

Full-service platform with improving underwriting capacity

Improving ranking in underwriting business

Investment banking is one key focus for CMS to develop the institutional business by providing financing, investment and M&A throughout the entire life cycles of corporate clients on the back of its competitive cross-border business platform and effective internal coordination mechanism and systems. Revenue from investment banking has been growing in recent years driven by equity/debt underwriting along with robust growth at OTC investment banking.

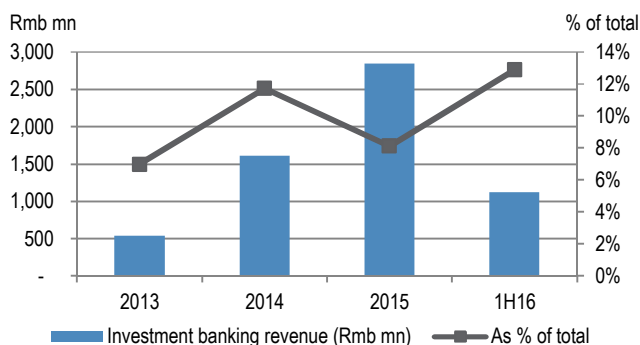
Table 49: Rising market share in investment banking business for CMS

		2013	2014	2015
Equity underwriting volume	Rmb bn	8.7	15.7	47.5
	Ranking	10	9	5
	Market share	3.2%	3.0%	5.0%
Bond underwriting volume	Rmb bn	31.5	73.5	265.7
	Ranking	10	8	3
	Market share	2.8%	3.7%	7.4%
ABS underwriting volume	Rmb bn	N/A	22.4	82.4
	Ranking	NA	4	1
	Market share	N/A	7.4%	14.5%
SME Board Underwriting volume	Rmb bn	N/A	2.6	1.1
	Ranking	NA	2	4
	Market share	N/A	13.3%	6.1%

Source: WIND, company data (Note: There could be discrepancy between company data and WIND data due to different criteria in calculation).

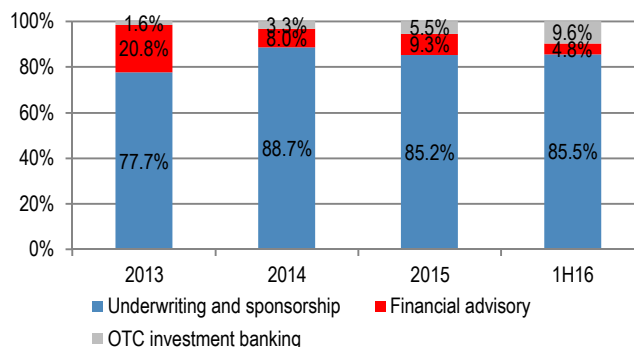
- **Equities underwriting, with strength in SME and CHINEXT board:** In 2015, CMS as a lead underwriter ranked fifth in terms of equity underwriting, improving from #9 in 2014 and #10 in 2013. In addition, OTC investment banking has been benefiting from structural growth at NEEQ listing and its stronger franchise in Shenzhen and prime brokerage should facilitate its development in this segment. Its ranking in underwriting for stocks listed in ChiNext is 9 and SME board of 4.
- **Debt underwriting:** In 2015, CMS as a lead underwriter ranked fifth and third in terms of equity and debt underwriting respectively, with superior ranking in non-financial enterprises (second) and ABS (first) in particular.
- **Financial advisory** contributed to 20.8%, 8.0%, 9.3% & 4.8% of investment banking revenue in 2013-2015 and 1H16, respectively. We believe the decline in advisory fee is partly due to regulatory tightening on M&A and back-door listing in China.
- **OTC investment banking** contributed to 1.6%, 3.3%, 5.5% and 9.6%, respectively, in 2013-1H16. Despite a volatile market, revenue contribution and industry ranking have increased steadily. Ranking on NEEQ improved from 20 in 2013 to 7 in 2015.

Figure 52: Investment banking segment has an increasing contribution to CMS's revenue and other income



Source: Company data.

Figure 53: Underwriting and sponsorship contributed over 80% of investment banking revenue in recent years, and OTC investment banking has an increasing contribution.



Source: Company data.

Table 50: Equity underwriting market share (2015)

Rank	Company	Underwriting volume (Rmb bn)	Market share
1	Citic Securities	94.3	9.9%
2	Guotai Junan	73.3	7.7%
3	Guangfa Securities	51.4	5.4%
4	China Securities	50.1	5.3%
5	CMS	47.5	5.0%
6	Huatai Securities	40.4	4.3%
7	Guosen Securities	37.2	3.9%
8	Southwest Securities	35.6	3.7%
9	Haitong Securities	33.5	3.5%
10	ZhongDe Securities	29.1	3.1%
	Total	949.7	100.0%

Source: Wind. Note: There could be a discrepancy between company data and WIND data in this set of data due to different criteria in calculation).

Table 51: Bond underwriting market share (2015)

Rank	Company	Underwriting volume (Rmb bn)	Market share
1	Citic Securities	415.6	11.5%
2	China Securities	370.3	10.3%
3	CMS	265.7	7.4%
4	Guotai Junan	251.1	7.0%
5	Haitong	147.0	4.1%
6	Guangfa	143.7	4.0%
7	CICC	137.3	3.8%
8	Galaxy	127.8	3.5%
9	CDB Securities	106.3	2.9%
10	Guosen	96.7	2.7%
	Total	3,610.5	100.0%

Source: Wind Note: There could be a discrepancy between company data and WIND data in this set of data due to different criteria in calculation).

Table 52: ABS underwriting – market share (2015)

Rank	Company	Underwriting volume (Rmb bn)	Market share
1	CMS	82.4	14.5%
2	Citic Securities	69.5	12.3%
3	CDB Securities	60.3	10.6%
4	Galaxy Securities	49.5	8.7%
5	China Securities	38.9	6.9%
6	Guotai Junan	38.7	6.8%
7	Hengtai Securities	24.6	4.3%
8	Guangfa	22.1	3.9%
9	CICC	19.3	3.4%
10	Orient Securities	14.2	2.5%
	Total	566.8	100.0%

Source: Wind. Note: There could be a discrepancy between company data and WIND data in this set of data due to different criteria in calculation).

Table 53: M&A transaction value – market share (2015)

Rank	Company	Transaction value (Rmb bn)	Market share
1	Huatai Securities	264.9	12.2%
2	Citic Securities	234.7	10.8%
3	Southwest Securities	153.3	7.0%
4	Guotai Junan	148.8	6.8%
5	Haitong Securities	147.5	6.8%
6	CICC	125.7	5.8%
7	Guangfa Securities	115.7	5.3%
8	Great Wall Securities	91.6	4.2%
9	Morgan Stanley Huaxin	65.9	3.0%
10	China Securities	64.9	3.0%
11	CMS	64.4	2.9%

Source: Wind. Note: There could be a discrepancy between company data and WIND data in this set of data due to different criteria in calculation).

Table 54: SME board – market share in underwriting (2015)

Rank	Company	Underwriting volume (Rmb bn)	Market share
1	Pingan Securities	2.26	12.3%
2	BOCI Securities	1.90	10.4%
3	Guosen Securities	1.32	7.2%
4	CMS	1.13	6.1%
5	Guangfa	1.04	5.7%
6	Essence Securities	0.95	5.2%
7	Minsheng Securities	0.93	5.0%
8	Zhongde Securities	0.84	4.6%
9	China Investment Securities	0.70	3.8%
10	Haitong	0.63	3.4%
	Total	18.38	100%

Source: Wind. Note: There could be a discrepancy between company data and WIND data in this set of data due to different criteria in calculation).

Table 55: CHINEXT market share in underwriting (2015)

Rank	Company	Underwriting volume (Rmb bn)	Market share
1	Guosen	4.03	13.1%
2	CICC	2.88	9.4%
3	Everbright	2.14	7.0%
4	Guojin	2.01	6.5%
5	Shenwan Hongyuan	1.97	6.4%
6	Guangfa	1.79	5.8%
7	Pingan	1.55	5.0%
8	Cinda	1.47	4.8%
9	CMS	1.20	3.9%
10	Zhongtai	1.06	3.5%
	Total	30.76	100%

Source: Wind. Note: There could be a discrepancy between company data and WIND data in this set of data due to different criteria in calculation).

Table 56: Examples of ABS transactions of which CMS acted as an underwriter

Year	Issuer	Offering size (Rmb mn)	Role	Highlights
2016	CMB	233.0	Lead underwriter	First non-performing credit card receivables ABS
2016	CMB	470.0	Joint lead underwriter and book runner	First non-performing microloan receivables backed securities in the PRC
2016	Ping An Bank	981.0	Joint lead underwriter	First mortgage-backed personal consumption loan receivables backed securities
2015	Volkswagen Finance (China)	1,890.5	Joint underwriter	Innovative structures such as overcollateralization and partially proportionate repayment
2015	BOC	3,928.8	Joint lead underwriter	Our first ABS of large state-owned bank
2015	CMB	3,149.9	Joint lead underwriter	Residential mortgage backed securities issued through market based offering mechanism
2014	CMB	8,109.1	Joint lead underwriter	First credit card ABS
2014	Industrial Bank	3,494.2	Joint underwriter	First ABS for enterprises in the environmental protection industry

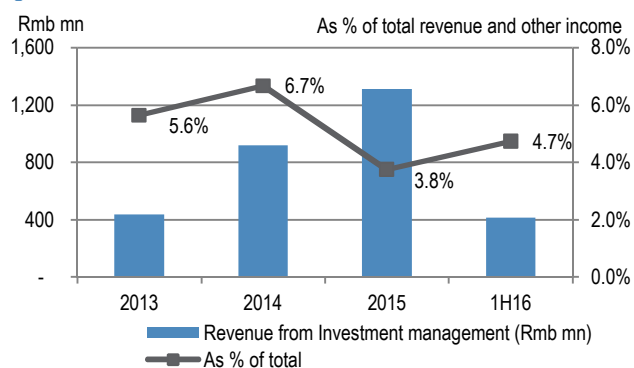
Source: Company data.

Top asset manager for retail funds

CMS Asset Management, the major entity of the asset management business at CMS, was ranked eighth and ninth in terms of revenue and AUM in 2015 and 1H16, respectively, but is ranked fifth on collective asset management schemes as of August 2016, which are more retail-oriented with higher fee charges, compared to targeted and specialized asset management schemes.

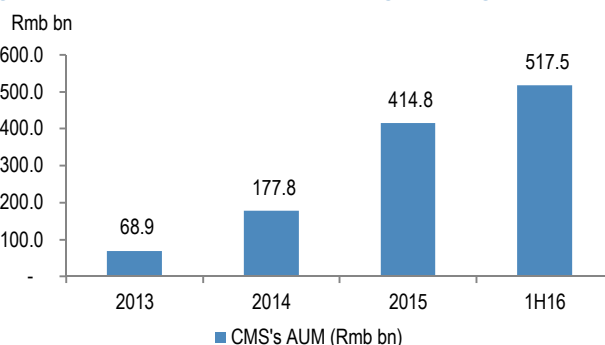
Meanwhile, CMS also conducts fund management businesses via its 49%-owned and 45%-owned Bosera Fund and China Merchant Fund that have AUM of Rmb460bn and Rmb329bn respectively, among which mutual fund related AUM amounted to Rmb490bn in aggregate, which makes it the third-largest mutual fund manager in the PRC. Both Bosera Fund and China Merchant Fund have qualifications for pension, management of Social Security Fund and corporate annuity, and thus are well-positioned to benefit from enlarging pension/annuity flows in the future.

Figure 54: Revenue contribution from investment management segment



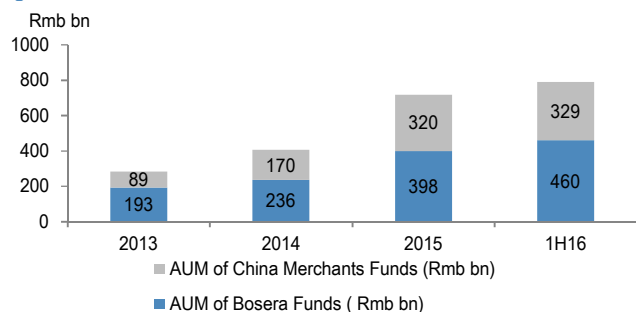
Source: Company data.

Figure 55: AUM of CMS's investment management segment



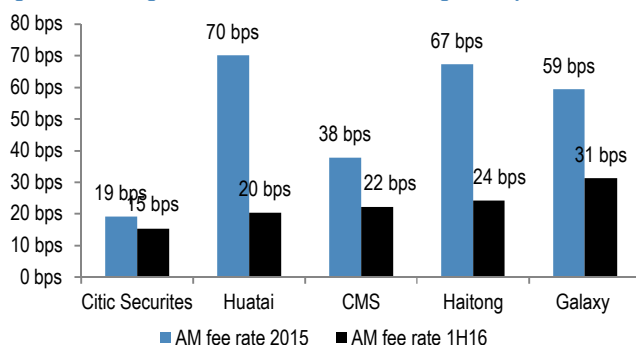
Source: Company data.

Figure 56: AUM of China Merchants Funds and Bosera Funds



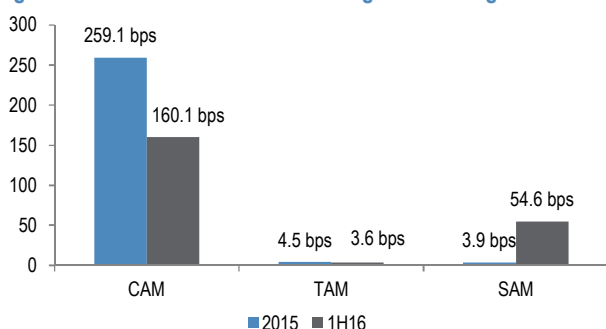
Source: Company data.

Figure 57: Management fee rates of asset management plans



Source: Company data. (Note: fee rate of AMP= management fee/ average balance of AMP).

Figure 58: CAM schemes have much higher fee charges



Source: Company data. (Note: fee rate of AMP= management fee/ average balance of AMP).

Table 57: Ranking of brokers AUM as of 1H16

Rank	Broker	AUM (Rmb bn)
1	Citic Securities	1,571
2	Huatai	815
3	China Securities	727
4	Guangfa	678
5	Guotai Junan	650
6	Shenwan Hongyuan	634
7	Haitong	593
8	BOCI	561
9	CMS	527
10	Huafu	466

Source: AMAC.

Table 58: Collective asset management ranking by brokers as of Aug. 2016

Rank	Broker	AUM (Rmb bn)	Market share
1	Guangfa	291.8	19.3%
2	Huatai	101.0	6.7%
3	Citic securities	95.1	6.3%
4	Guotai Junan	86.7	5.7%
5	CMS	56.4	3.7%
6	Qilu	54.7	3.6%
7	Haitong	50.1	3.3%
8	Everbright	43.0	2.8%
9	Huarong	42.6	2.8%
10	Caitong securities	42.3	2.8%
	Total	863.7	

Source: Wind.

Table 59: Ranking of mutual funds as of 1H16

Rank	Funds	AUM (Rmb bn)
1	Tianhong Asset Management	850.5
2	China Asset Management	515.7
3	ICBC Credit Suisse	482.4
4	Efund Management	405.7
5	China Southern Asset Management	342.7
6	Harvest Fund	313.3
7	China Universal	286.2
8	Bosera Fund	249.8
9	CCB Principal Asset Management	245.4
10	BOC Investment Management	244.5
11	China Merchant Fund	240.9

Source: Asset Management Association of China.

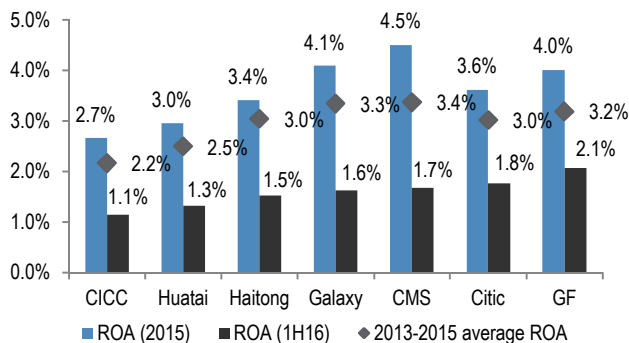
Maintaining relatively high ROA amid a challenging environment

Through-the-cycle ROA has been ahead of peers

CMS's ROA in 2015 was highest compared to H-share brokers. And its average ROA from 2013 to 2015 is also the highest; this demonstrates its ability to achieve relatively high returns throughout the cycle. Note average daily turnover of the A share stock market in 2013, 2014 and 2015 was Rmb197bn, Rmb304bn and Rmb1,048bn, respectively. We believe this is mainly due to the following:

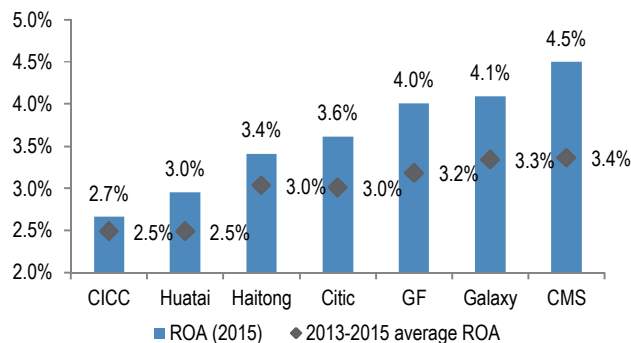
- Relatively higher brokerage commission rates due to client selection and focus on institutional business
- Strength in underwriting on CHINEXT and SME boards (ranks 9 and 4 respectively, vs overall equity underwriting ranking of 5 in 2015). Underwriting fee on CHINEXT and SME boards are higher than main board
- Effective cost control: we noted its CIR is relatively lower than peers, despite focus on wealth management and institutional business

Figure 59: ROA of H-share brokers



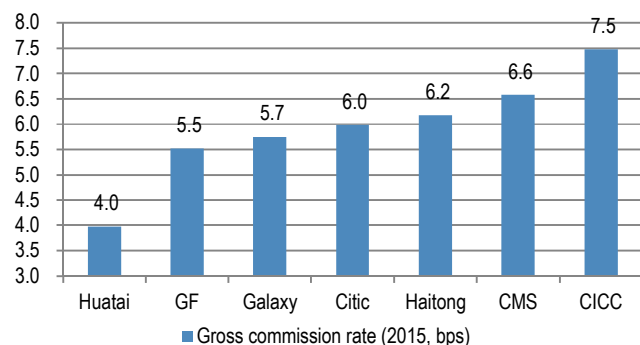
Source: Company data.

Figure 60: ROA (excluding client money)



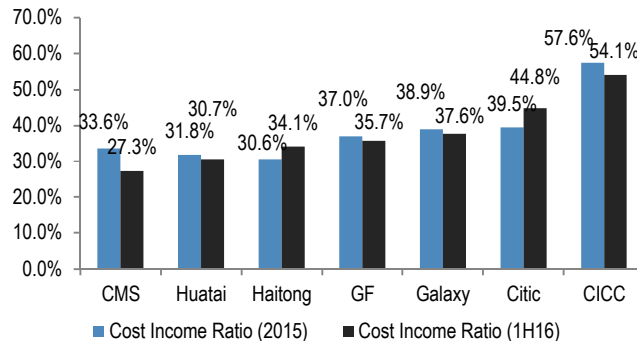
Source: Company data.

Figure 61: Gross commission rate of H-Share brokers



Source: Company data.

Figure 62: Cost Income Ratio



Source: Company data. (Note: we excluded interest expense and commission expense in our calculation)

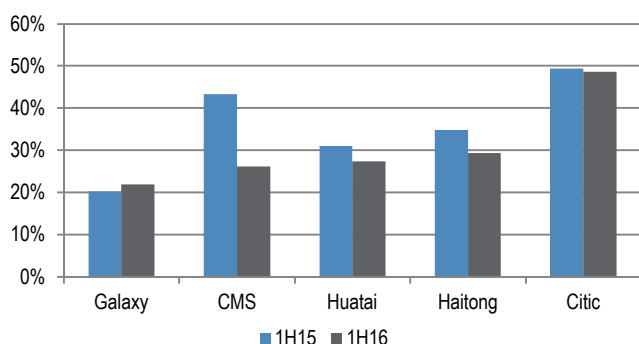
1H16 ROA contraction likely temporary

1H16 ROA was 1.7%, lower than major H-share listed peers. This is mainly due to investment income and rising financing costs. We could see some improvement in 2H16 due to:

- CMS was renowned for its market-neutral trading strategy. Brokers are not able to hedge their positions in the current regulatory environment and thus are unable to execute market-neutral trades. We saw equities investment as a percentage of total investment increased by 2% HoH. We believe this has impacted its investment income. Nonetheless, we believe regulators will gradually normalize the regulatory environment when confidence levels in the market stabilize. The announcement of the SZ-HK Connect affirms our assumption.

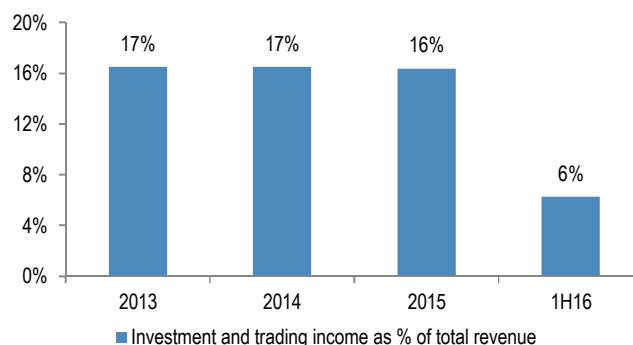
- We note average long-term liabilities increased to 32% of interest-bearing liabilities (IBL) in 1H16 from 15% at in 1H15. This reflects more prudent/conservative asset-liability duration management, as evident by its smallest gap between interest earning assets and interest bearing liabilities and more long term funding than needed, but partly leads to rising finance expenses as a result. However, we note that long-term IBL declined at end 1H16 vs end 2015, due to contraction in margin financing balances. Thus, we believe interest expenses will decline in 2H16.

Figure 63: Equity as % of total investment of CMS declined significantly from 43% in 1H15 to 26% in 1H16



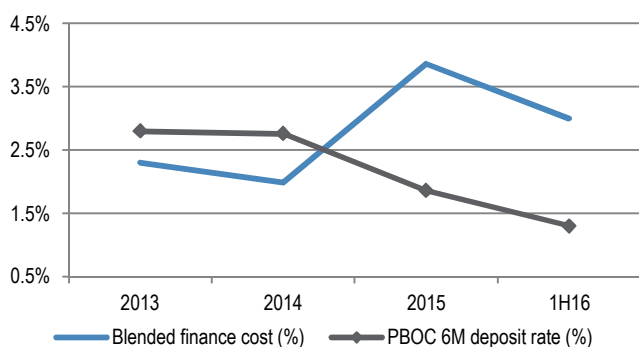
Source: Company data

Figure 64: Contribution from investment and trading income as % of total revenue declined from 16% in 2015 to 6% in 1H16



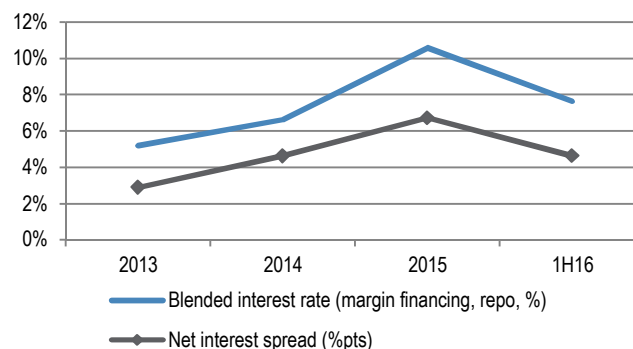
Source: Company data. (Note: 1H16 data not available for Haitong and Galaxy)

Figure 65: CMS – Financing costs vs. 6M PBOC Deposit rate



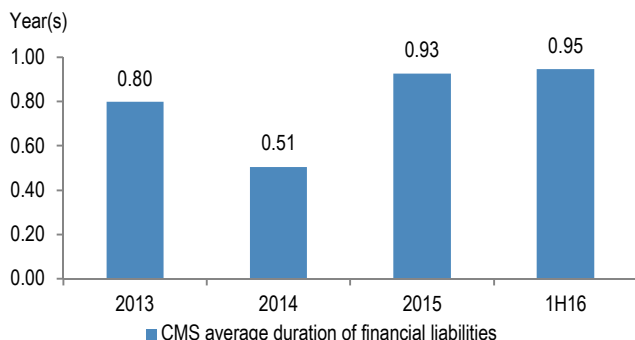
Source: Company data, CEIC. Note: 2013 based on end of period balance.

Figure 66: CMS – Average interest rate and Net interest spread



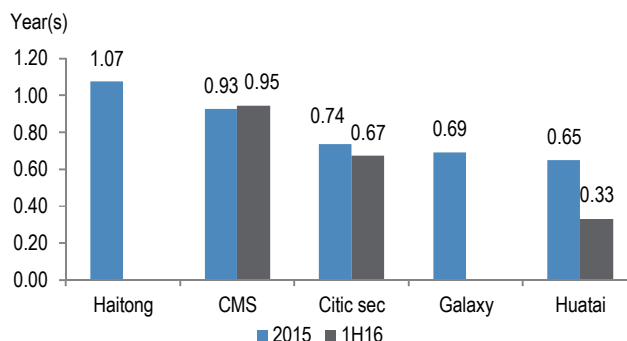
Source: Company data. Note: Average interest rate on margin financing and repo. Net interest spread = Avg interest rate-blended financing cost. 2013 based on end of period balance.

Figure 67: CMS – duration of financial liabilities



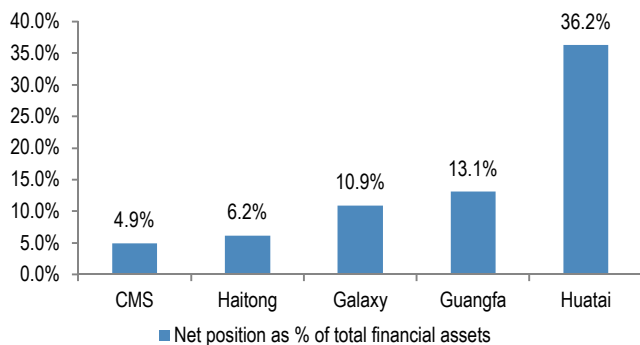
Source: Company data

Figure 68: Duration of financial liabilities for Chinese brokers in 2015 and 1H16



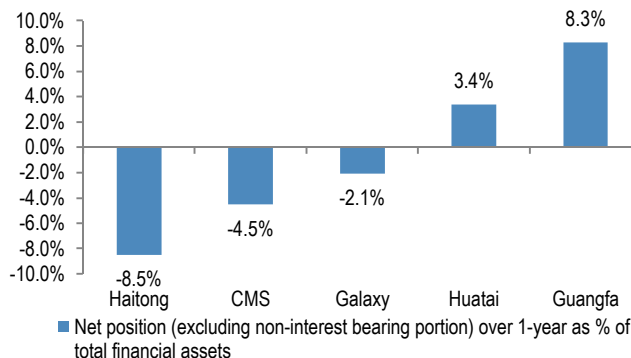
Source: Company data. (Note: 1H16 data not available for Haitong and Galaxy)

Figure 69: Net position as % of total financial assets as of 1H16



Source: Company data (Note: For Galaxy, Haitong and Guangfa, we used 2015 data; Data for CiticS and CICC is unavailable) Note: Net position = interest earning assets – interest-bearing liabilities during the period

Figure 70: Net position with duration > 1 year as % of total financial assets as of 1H16



Source: Company data. (Note: For Galaxy, Haitong and Guangfa, we used 2015 data; Data for CiticS and CICC is unavailable) Note: Net position = interest earning assets – interest-bearing liabilities during the period

Growth opportunity by leveraging CM Group affiliation

As one of the key members of China Merchants Group, which has over a 140-year operating history and is ranked No. 3 among state-owned enterprises in terms of asset size, CMS would be able to leverage on the group resources of its investment banking and wealth management businesses.

Investment banking: There are multiple corporate financing and restructuring opportunities in China Merchants Group and its subsidiaries. For example, CMS was the sponsor and lead underwriter in 2012 and 2015 for the equity private placement of China Merchants Energy Shipping and the M&A financial advisor to China Merchants Holdings (International) in 2013 and to China Merchants Shekou Industrial Zone Holdings in 2015. CMS also assisted China Merchants Bank in issuing the first credit card ABS in China. We think CMS will benefit more from such intra-group collaboration under the trend of SOE reform and proliferation of domestic bond markets.

Table 60: Examples of corporate financing and restructuring opportunities in China Merchants Group and its subsidiaries

Time	Deal size	Cooperation entity	Detail
2012 and 2015	Raised RMB2.9 billion and RMB2.0 billion, respectively	China Merchants Energy Shipping Co.	Acted as the sponsor and lead underwriter for the equity private placement of China Merchants Energy Shipping Co., Ltd.
2013	RMB1,787.3 million acquisition	China Merchants Holdings (International) Co.	Acted as the financial advisor to China Merchants Holdings (International) Co., Ltd. on its RMB1,787.3 million acquisition of the 25% equity interests of Shenzhen Chiwan Wharf Holdings Limited
2015	NA	China Merchants Shekou Industrial Zone Holdings Co.; China Merchants Property Development Co.	Financial advisor for China Merchants Shekou Industrial Zone Holdings Co., Ltd. on its merger-by-absorption of China Merchants Property Development Co., Ltd. through the issuance of new A shares, and as joint lead underwriter for the concurrent private placement of A shares for financing.

Source: Company data.

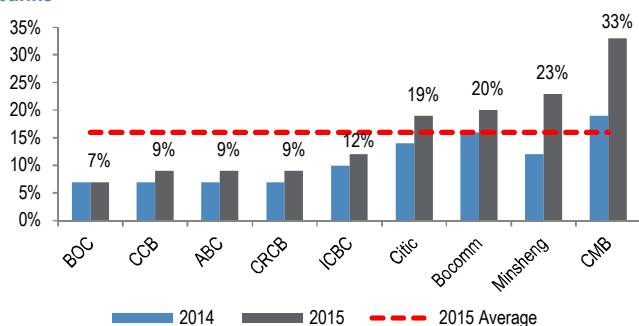
Wealth management: As the largest custodian bank for customers’ deposits to CMS, China Merchants Bank has referred a substantial number of its customers to CMS brokerage businesses while we think the strong franchise and leading position in wealth management/private banking businesses at China Merchants Bank could facilitate CMS to further enhance the contribution to brokerage and wealth management businesses from high-net-worth and affluent customers.

Table 61: Example of collaborations between China Merchants Bank and CMS

Details of collaboration
CMB was CMS’s largest custodian bank for customers’ deposit as of June 30, 2016
CMB has referred customers to open brokerage accounts with CMS, and CMS is the largest partner securities firm with CMB in terms of customer deposits as of 1H16
CMS assisted CMB in issuing the first credit card ABS in China and had underwritten an aggregate of Rmb 44.3 billion as of 1H16.
CMS acted as the joint lead underwriter and book runner for the first non performing micro loan receivable backed securities for CMB in 2016

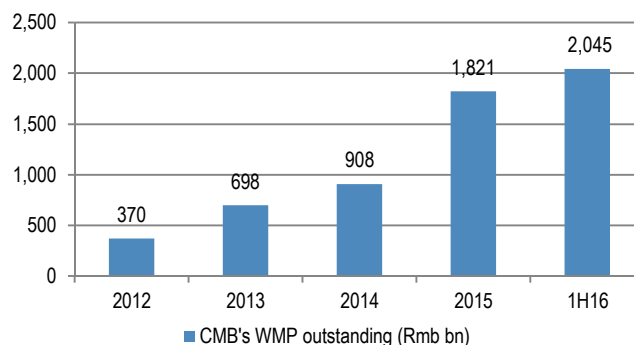
Source: Company data.

Figure 71: WMPs ~33% of assets for CMB, highest amongst China banks



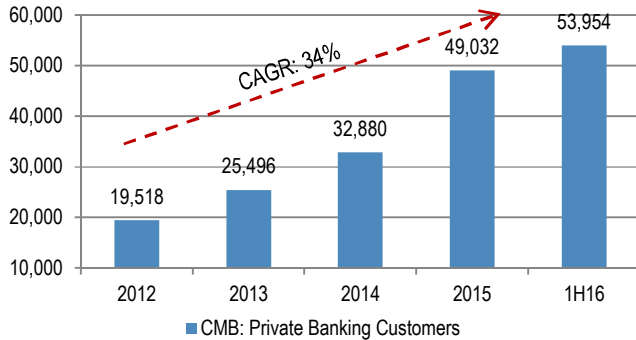
Source: Company data.

Figure 72: CMB’s WMP outstanding grew at CAGR of 63% since 2012



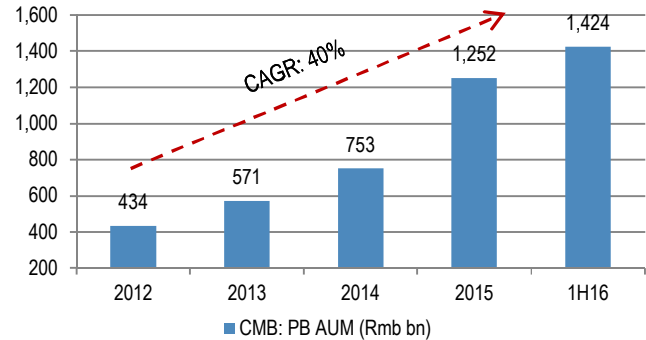
Source: Company data.

Figure 73: CMB: Private Banking Customers



Source: Company data.

Figure 74: CMB: Private Banking AUM



Source: Company data.

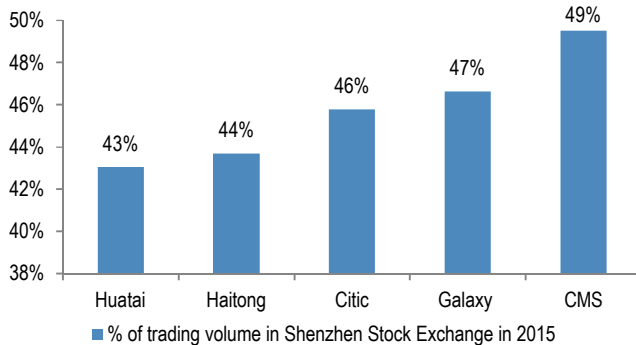
More benefits from SZ-HK Stock Connect

The State Council has approved the SZ-HK Stock Connect on 16 August, which could be officially launched before year end. Being headquartered in Shenzhen, we expect CMS to benefit more than peers from this new initiative in terms of both brokerage and underwriting businesses.

First, trading volume from SZCOMP accounted for 49% of total trading volume at CMS in 2015 compared to 45% at other leading players and thus any incremental positive impact on market turnover as a result of the SZ-HK Connect could lead to more revenue/earnings upside to the brokerage businesses at CMS.

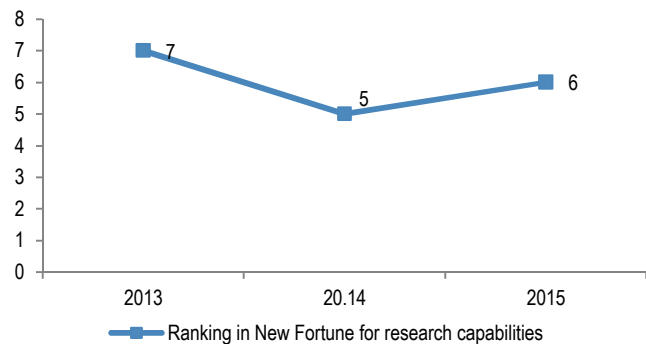
Second, the inclusion of constituent stocks in SZSE Small/Mid Cap Innovation Index (with market cap of Rmb6bn or above) into the SZ-HK Connect should boost the equity underwriting demand in the mid to long term while the improving underwriting position on NEEQ listing (ranked #7 in terms of newly listed companies in 2015) and recognized research capability at CMS indicate its competitive advantages and upside for business flows in the future.

Figure 75: % of trading volume in Shenzhen Stock Exchange in 2015



Source: WIND.

Figure 76: CMS ranked 7th, 5th and 6th by New Fortune for its overall research capabilities in 2013, 2014 and 2015 respectively



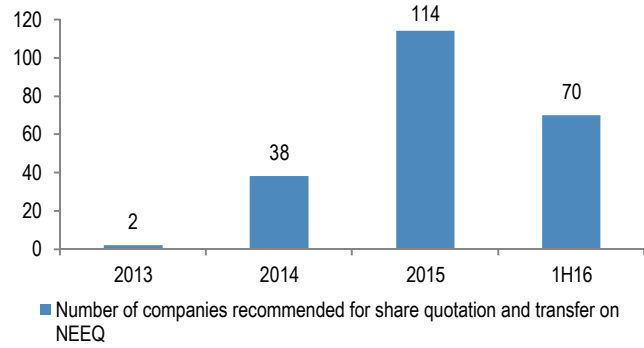
Source: Company data.

Table 62: SME board – underwriting -market share (2015)

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8	Zhongde Securities	0.84	4.6%
9	China Investment Securities	0.70	3.8%
10	Haitong	0.63	3.4%
	Total	18.38	100%

Source: Wind. Note: There could be a discrepancy between company data and WIND data in this set of data due to different criteria in calculation.)

Figure 77: NEEQ – Number of companies recommended by each broker (2015)



Source: NEEQ.

Investment Risks

Market volatility-induced intervention to constrain trading flexibility

CMS contributed Rmb9.3bn in aggregate to conduct return swaps with CSFCL under the market stabilization measures in July and September 2015. Without publically available information of the investment details and discretion of divestment, CMS might incur losses due to further disposal or impairment and equity position could fluctuate upon revaluation.

In addition, CMS has undertaken not to reduce the A-share proprietary trading positions below the balance as of July 3, 2015 as long as SHCOMP is below 4,500, a commitment that constrains its flexibility on trading should the market experience material corrections. Based on our calculations, total equity positions, booked as held for trading, fair value through P&L, and available-for-sale, amounted to Rmb11bn as of 1H16 and represented 8% of total assets and 42% of total equities, lower than CITICS and similar to other major peers under our coverage; we estimate every 10% volatility at the equity investment portfolio could affect 25.5% earnings and 1.9% BVPS based on 1H16 reported profits.

Although A-share market performance has been much more stable in recent months, there are always risks that brokers will be included in the market stabilization measures amid meaningful market turmoil.

Table 63: Equities investment as a percentage of book

1H16 (Rmb m)	Citic	Haitong	Galaxy	Huatai	CMS
Equity investments					
--AFS	24,829	11,482	6,488	23,658	3,340
--through P&L	7,467	13,086	716	4,329	0
--held for trading	47,790	0	1,919	0	7,620
- Investment in CSFC	21,100	19,457	10,500	14,440	9,300
Equity investment as % of assets*	18%	8%	8%	7%	11%
Equity investment as % of equity *	74%	42%	36%	36%	54%

Source: Company data, J.P. Morgan estimates (Note*: we include investment in CSFC as part of equity investment in the calculation).

Tightening supervision on fast-growing asset management businesses

CSRC is more strictly supervising the asset management business as a result of its fast growth in recent years. For example, total AUM of asset management schemes at CMS reached Rmb518bn as of 1H16, up more than 650% compared to end of 2013. Under the new capital rules that came into effect in October, risk weights for AA-rated brokers on AUM under targeted asset management schemes, which accounted for nearly 90% of total AUM at CMS, has increased to 35bps compared to 20bps before and would be even higher (63bps) if the underlying investments are non-standardized assets; assuming all else equal, the ratio of net capital/total risk capital reserves at CMS would drop 106% from 782% as of 1H16 based on our estimates. Further tightening of capital requirements could be adverse to the development of the asset management businesses.

In addition, CMS also invests its own capital into collective asset management schemes, of which the AUM is equivalent to 9% of total, in order to attract customers; capital contribution was Rmb617m as of 1H16, among which Rmb218m is in the subordinated tranche for credit enhancements should investment returns of senior tranches fall below the anticipated yields. Along with the growing AUM, invested capital could also increase and is subject to market/credit risks as well.

Table 64: Risk weights for different AMP under existing capital rules and new capital rules

	Grade A for 3 consecutive years	Grade A	Grade B	Grade C	Grade D
Risk weights of AMPs under existing capital rules- as % of AUM					
SAM	0.40%	0.60%	0.80%	2.00%	4.00%
CAM	0.40%	0.60%	0.80%	2.00%	4.00%
TAM	0.20%	0.30%	0.40%	1.00%	2.00%
Risk weights of AMPs under new capital rules- as % of AUM					
Structured CAM	0.70%	0.80%	0.90%	1.00%	2.00%
TAM investing in non-standardized assets	0.63%	0.72%	0.81%	0.90%	1.80%
Private equity funds	0.49%	0.56%	0.63%	0.70%	1.40%
Other TAM	0.35%	0.40%	0.45%	0.50%	1.00%

Source: CSRC.

Potential de-regulation of brokerage fee structure

Local media in April reported that CSRC is drafting Measures on Brokerage Securities Business. The consultation paper requires brokers to specify the fee charges in detail based on various services and brokers are allowed to negotiate the fee charge scheme with specific clients based on the AUM and transaction volume/frequency; this has induced concerns that de-regulation on fee structure might further intensify competition on commission rates.

In our view, the de-regulation might not necessarily lead to further pricing pressure in that CSRC does highlight that commission fee charge overall cannot be significantly lower than related service costs while we estimate breakeven commission rates for the Top 17 brokers were 2bps and 4bps on average in 2015 and 2014, respectively, and 2.6-5.4bps for the names currently under our coverage, which are not really far below the prevailing commission rates currently. However, the impacts are still subject to the final details given the definition of service costs remains unclear.

Table 65: Details of drafted measures for the Management of Securities brokerage business

No.	Details
1	Clear definition of securities brokerage businesses
2	Reinforcing the due diligence of real-name account requirement
3	Strengthening the daily management of client transaction activities
4	Deregulating the brokerage commission fee charges
5	Requiring brokers to manage branches by classification
6	Governing the scope of broker outsourcing businesses and related management
7	Implementing the accountability mechanism of brokers for business related irregularity and misconducts

Source: Shanghai Securities Journal.

Table 66: Calculation of breakeven commission rate of brokers (for FY15)

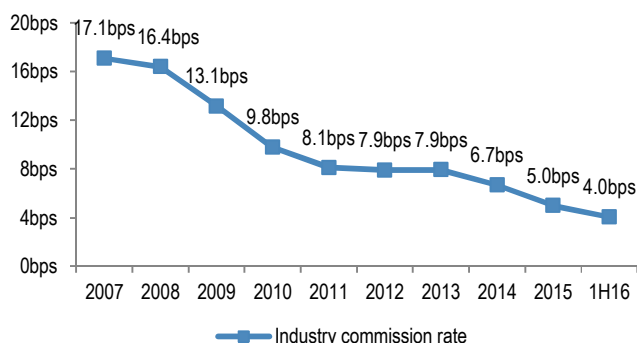
Rmb mn		Galaxy	CiticS	Haitong	Huatai	CMS
Revenue from brokerage business	A	26,448	26,816	27,876	28,666	24,404
Opex from brokerage business	B	15,997	13,125	16,556	16,491	13,702
Brokerage commission expense	C	409	4,621	2,650	5,421	2,511
Turnover (RMB bn)	D	26,359	21,470	24,429	37,362	21,449
Breakeven commission rate	(B-C-5%xA)/D	0.054%	0.033%	0.051%	0.026%	0.046%
Company net commission rate		0.056%	0.052%	0.047%	0.028%	0.054%

Source: J.P. Morgan estimates, company reports (Note:1) We estimate business tax is about 5% of revenue; 2) For CiticS, commissions expense not broken out into brokerage commission).

Long-term pressure on brokerage commission rates

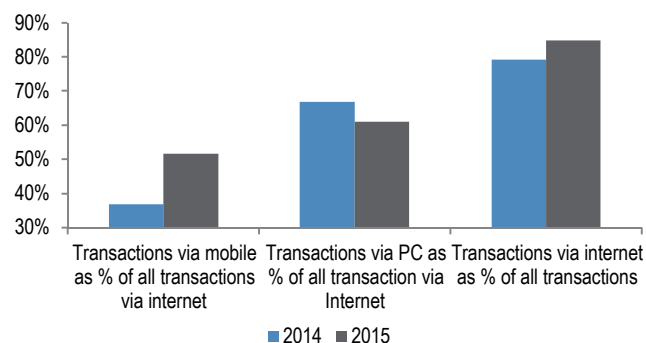
The industry has suffered from falling commission rates over the past few years. Unlike in many developed countries, the majority of transactions in China's equity market still come from individual investors, rather than institutional investors. Retail investors accounted for 85% of trading turnover (Shanghai Stock Exchange, latest data as of 2014). As a result, fierce competition in retail brokerage triggered industry-wide commission rate compression.

Figure 78: Industry commission rate declined from 18.8 bps in 2007 to 4.0 bps in 1H16



Source: WIND.

Figure 79: Brokerage transactions via internet represented 85% of all transactions in 2015, rising from 79% in 2014



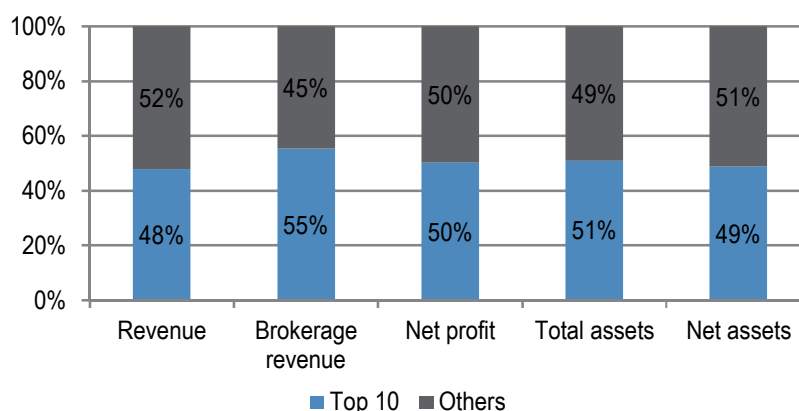
Source: Securities Association of China.

Average commission rate for stocks and funds brokerage at CMS has slid from 8.1bps in 2013 to 6.6bps in 2015 and further edged down to 5.7bps in 1H16; such level is better than the industry average which, in our view, reflects CMS's efforts to penetrate into institutional and high-net-worth individual clients with higher commission rates. However, we think the downward trend is likely to persist in the foreseeable future for the following reasons:

- In the near term, individual investors have been allowed to open up to 20 accounts for trading in A-shares and close-end funds at Shanghai/Shenzhen Stock Exchanges effective 13-Apr-2015; this offers investors who are pricing sensitive greater bargaining powers over brokers while tighter regulatory supervision this year means brokers might be forced to focus more on traditional businesses. However, the revision of account opening regulations in Oct 16 which limit the maximum number of accounts held by an investor from 20 to 3 should ease operating pressure of brokers, in our view.

- In the medium term, continued development of online and mobile platforms should allow brokers to lower operating costs, thus leaving more room for brokers to lower the commission rates. According to SAC, online trading accounted for 84% of total trading accounts in 2015, up from 79% in 2014, while trading through mobile devices represented 52% of total, up from 37% during the same period as 83 brokers have introduced their own APPs.
- Structurally, the fragmented industry landscape puts pressure on brokerage commission rates. While the Chinese equity market has become the second-largest in the world, along with its growing economy and capital account deregulation, the China brokerage industry is still fairly fragmented. There are 126 domestic brokers as of 1H16. In 2015, the Top 10 brokers accounted for about 50% net profits share in the sector and had a 55% market share in securities brokerage commission, much lower than the 74% for banks, 86% for P&C insurers. Competition in the brokerage business is particularly fierce, given its simple business model/structure.

Figure 80: Key market shares for brokers (2015) – A fragmented market



Source:

WIND.

We believe local protection is a major hurdle to industry consolidation, especially given that many local governments have historically been major shareholders of many small local securities brokers. Although we believe the industry will consolidate in the longer term, as seen in many other countries, this may take a very long time. M&A is more likely to take place in a bear market, when local governments see little value in the small brokerage firms. Low industry consolidation may provide fertile soil for an irrational price war in brokerage. Fierce competition in the domestic market, especially in the brokerage business, has led to a decline in brokerage commission rates in the past couple of years.

Still a highly cyclical business

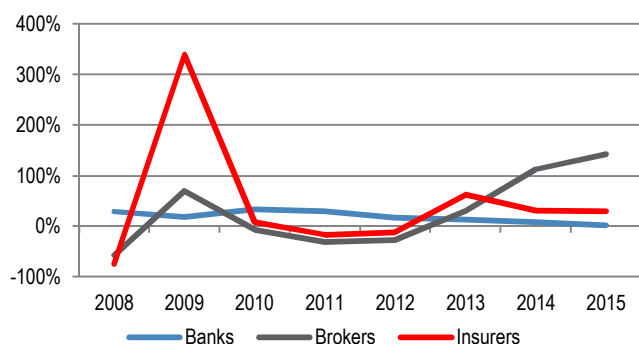
Chinese brokers have a relatively simple business model, given their short history of around 25 years. A common feature of virtually all Chinese securities firms is that volume-driven brokerage business is a major component of revenue. In some smaller firms, proprietary trading also plays a very significant role in revenue contribution. The revenue breakdown of the listed Chinese brokerage firms is very different from that of U.S. securities firms and still has a heavy focus on securities brokerage. Over the past few years, while the share of brokerage business in total revenues has declined somewhat, it is still the biggest segment among all Chinese securities firms.

While institutional investors have surpassed individual investors as the largest holders of floatable shares over the past few years, the majority of transaction value still came from individual investors. While institutional investors (including corporate investors) held about 76% of the market cap in 2014, 85% of transaction value (turnover) came from individual investors. As a result, retail brokerage remains a critical component of Chinese brokers' business.

The over-reliance on brokerage and proprietary trading, along with very high retail investor trading activity in the market and a high level of speculation, make the securities business even more cyclical than other financial sectors that are also largely subject to macroeconomic cyclicality. As the below figure suggests, the earnings growth of listed Chinese brokers is more volatile than that of listed banks or insurance companies in China.

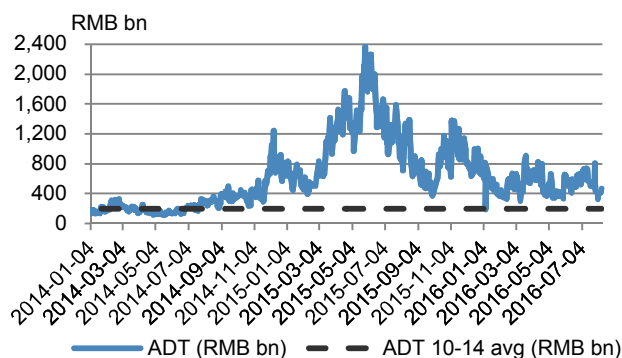
Like most securities firms in China, CMS has high revenue exposure to brokerage and proprietary trading businesses, both of which are highly leveraged to economic cycle and market conditions. Brokerage and proprietary trading accounted for at least 80% of total revenue from 2013-2015.

Figure 81: Earnings growth comparison of listed securities, banks and insurance companies listed in A shares market



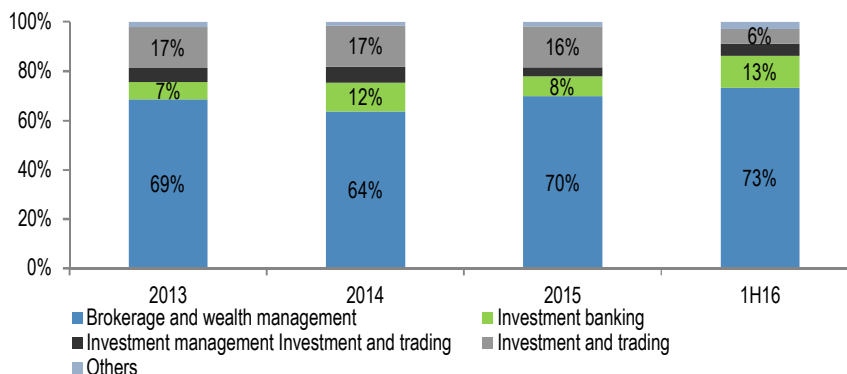
Source: WIND

Figure 82: A-share market ADT fluctuated in 1H16



Source: WIND

Figure 83: CMS's revenue and other income contribution from 2013-1H16



Source: Company data

Potential competition if China banks are allowed to enter the securities business

CSRC spokesperson Zhang Xiaojun commented during a press conference on 6-Mar-15 that China may issue brokerage licences to banks. In addition, during its analyst briefing, Citic Securities management also commented that banks may obtain brokerage licences within two years.

Under the current regulations, banks are not allowed to directly own brokerage businesses onshore and thus major Chinese banks have established their offshore brokerage businesses in recent years, mainly in HK, to circumvent regulatory restrictions but these bank-controlled securities subsidiaries already conduct businesses in the domestic market. The typical example is BOCI China, which is indirectly owned by BOC via BOCI Holdings, with leading market shares in investment banking and institutional brokerage in China. BoCom was also approved to acquire a 33.3% stake in Hua Ying Securities via BoCom International last July.

In other words, brokers may face more intense competition not only at brokerage but also equity underwriting businesses if current regulation is relaxed since banks, with strong balance sheets and unparalleled customer franchises, would have competitive advantages in terms of distribution network and capital. For example, ICBC had 17,498 branches at end-2015, while CMS had only 200 securities branches at end 1H16.

Company History, Milestones & Franchise Overview

Table 67: Corporate history and timeline of business milestones

Year	Event
1991	- Predecessor- the Securities Department of China Merchants Bank, was established
1993	- Renamed as China Merchant Securities Co., Ltd.
1996	- Acquired six securities branches in Shenzhen and had 16 branches in total
2002	- One of the first securities firms to be granted the qualification for entrusted asset management business and open-ended funds distribution rights - Entrusted by China Merchants Group to manage CMSHK (formerly U.B. Securities Limited or CM-CCS Securities Limited)
2006	- Selected as primary dealers of SSE 108 Index Exchange Traded Fund. - Entrusted with 16 securities branches of Jutian Securities Co., Ltd., which we subsequently acquired in June 2007 - Acquired the brokerage business assets of Beijing Securities Co., Ltd.
2007	- Obtained the QDII qualification
2008	- Received "(Class A) AA" regulatory rating from the CSRC. CMS maintained such rating in every subsequent year
2009	- Listed on the Shanghai Stock Exchange with net proceeds of Rmb 10.88 billion -Received no objection letter from CSRC on the pilot operation for direct investment business
2010	- Being selected as one of the constituent stocks of the CSI 300 Index -Obtain approval to carry out pilot operation for margin financing and securities lending business. -Became the first securities firm to commence "regular period with regular amount investment" asset management services
2012	- Became the first securities firm to commence "regular period with regular amount investment" asset management services. - Awarded the "Best Sponsor" by the Shenzhen Stock Exchange for the second consecutive year - Received no objection letter from CSRC on stock repurchase trading - Obtained the qualification for underwriting private placement bonds of small and medium enterprises - The first securities firm to receive no objection letter from CSRC on comprehensive custodian services for private investment funds - Obtained the qualification for underwriting debt financing instruments of non-financial enterprises by National Association of Financial Market Institutional Investors - Obtained qualification for financial products sale
2013	- Being selected as one of the constituent stocks of the SSE 50 Index
2014	-Among the first batch of securities firms to obtain the qualification for securities investment fund custodian business -Commenced our international precious metals physical trading on behalf of clients -Won the diamond award in "The Best Global Commodity Investment Bank in China of 2013" by Institutional Investor - Assisted Shanghai Chongyang Investment Management Co., Ltd., an Independent Third Party, to establish the first contractual private investment fund under the new PRC regulatory regime and registration system -Obtained the NEEQ market-making qualification - China Merchants Securities Investment Management (HK) Co., Limited, our wholly-owned subsidiary, became a founding member of the international board of Shanghai Gold Exchange and was the first securities firm to obtain such membership. - Authorized by the Shanghai Stock Exchange to trade under Shanghai-Hong Kong Stock Connect
2015	- Qualified as a clearing member of London Metal Exchange and ICE Futures Europe - One of the first batch of participants approved by the Shanghai Stock Exchange to conduct proprietary trading of stock options and one of the market makers for SSE 50 ETF options trading - Obtained the no objection letter from the CSRC on our spot gold proprietary trading business - Awarded "The Best Global Commodity Investment Team in Greater China of 2014" by Institutional Investor

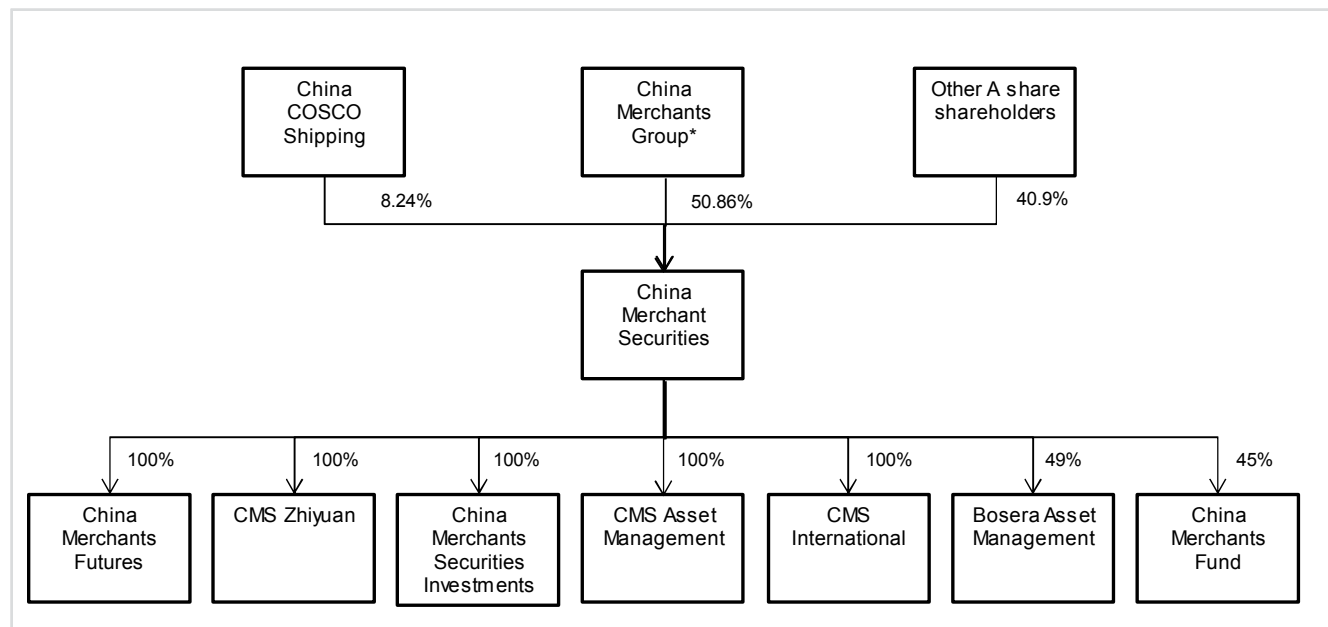
Source: Company data.

Table 68: CMS's shareholding structure (latest disclosed – before H share global offering)

Shareholder	Number of shares (mn)	Shareholding %
China Merchants Finance Investment Holdings Co., Ltd	1,435	24.71%
Shenzhen Jisheng Investment Development Co., Ltd	1,341	23.09%
China COSCO Shipping Corporation Limited	479	8.24%
Other A share shareholders	2,553	43.96%
Total	5,808	100.00%

Source: Company data.

Table 69: CMS's corporate structure (latest disclosed – before H-share global offering)



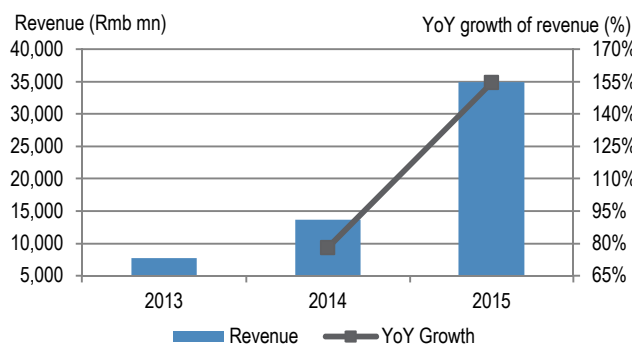
Source: Company data (Note: China Merchants Group holds CMS through three of its wholly owned subsidiaries- of which China Merchants Finance Investment Holdings holds 24.71% of CMS, Shenzhen Jisheng Investment Development Co., Ltd holds 23.09% of CMS, and China Merchants Steam Navigation Co., Ltd holds 3.05%, respectively).

Business scope and market positioning

CMS's business lines cover securities and futures brokerage, investment banking, investment management and wealth management, proprietary trading and overseas business (mainly in Hong Kong).

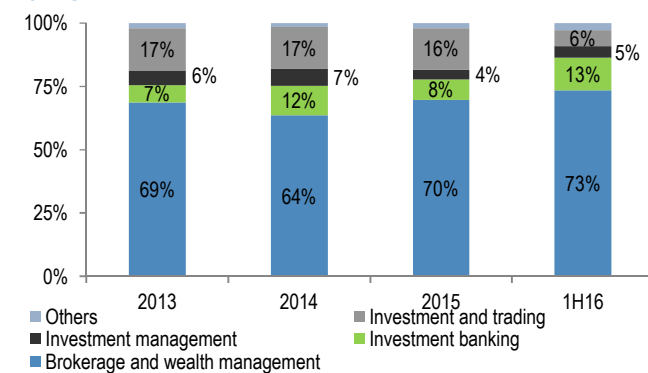
As it is for most brokers in China, securities brokerage is the key business for CMS, contributing 70% of revenue in 2015. The percentage is high in the industry as well, as brokerage revenue accounted for only 47% of total revenue in 2015 based on WIND broker industry data. CMS's revenue increased 155% in 2015, outpacing industry revenue growth of 121%.

Figure 84: CMS's total revenue increased 155% in 2015



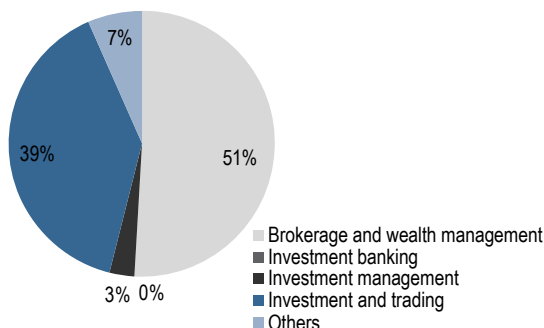
Source: Company data.

Figure 85: CMS's revenue and other income mix – Brokerage is the key segment



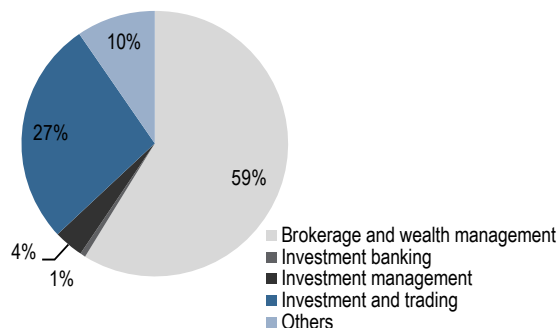
Source: Company data.

Figure 86: CMS's asset mix (1H16)



Source: Company data.

Figure 87: CMS's liability mix (1H16)



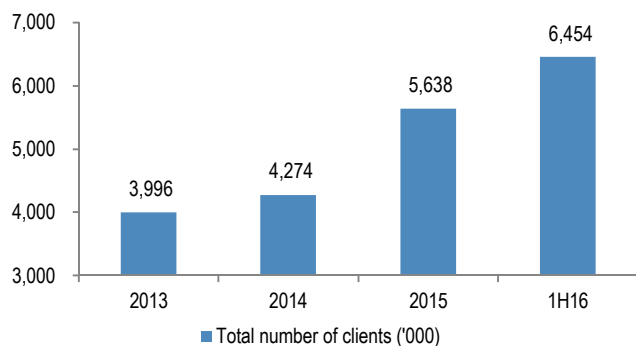
Source: Company data.

Client base and branch network

As of 1H16, CMS has approximately 6.5m brokerage and wealth management customers: including 6.25m retail customers, 0.2m affluent customers and 9,900 high net worth customers. Among these clients, approximately 2.0m customers are active customers who have had accounts with CMS for over three years. Apart from retail clients, CMS also has over 15,000 institutional clients as of 1H16, including 984 private investment funds and 101 mutual funds.

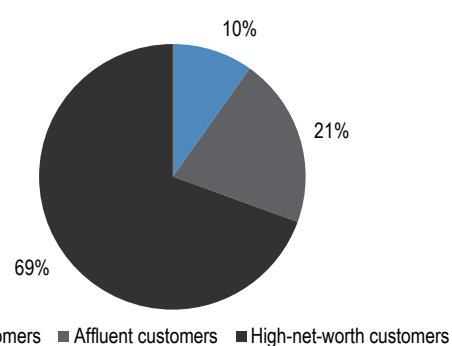
CMS has expanded the geographical reach of its branch network with the number of branches increasing from 100 as of end-2013 to 200 as of 1H16, among which 96 are "light branches" with less space, fewer employees and no trading counters and facilities so as to optimize the network in a cost-effective manner. CMS's branches are located in 28 provinces as of 1H16, with approximately 63.0% of total securities branches situated in economically well-developed regions such as the Pearl River Delta, the Yangtze River Delta and the Bohai Rim.

Figure 88: CMS's number of clients



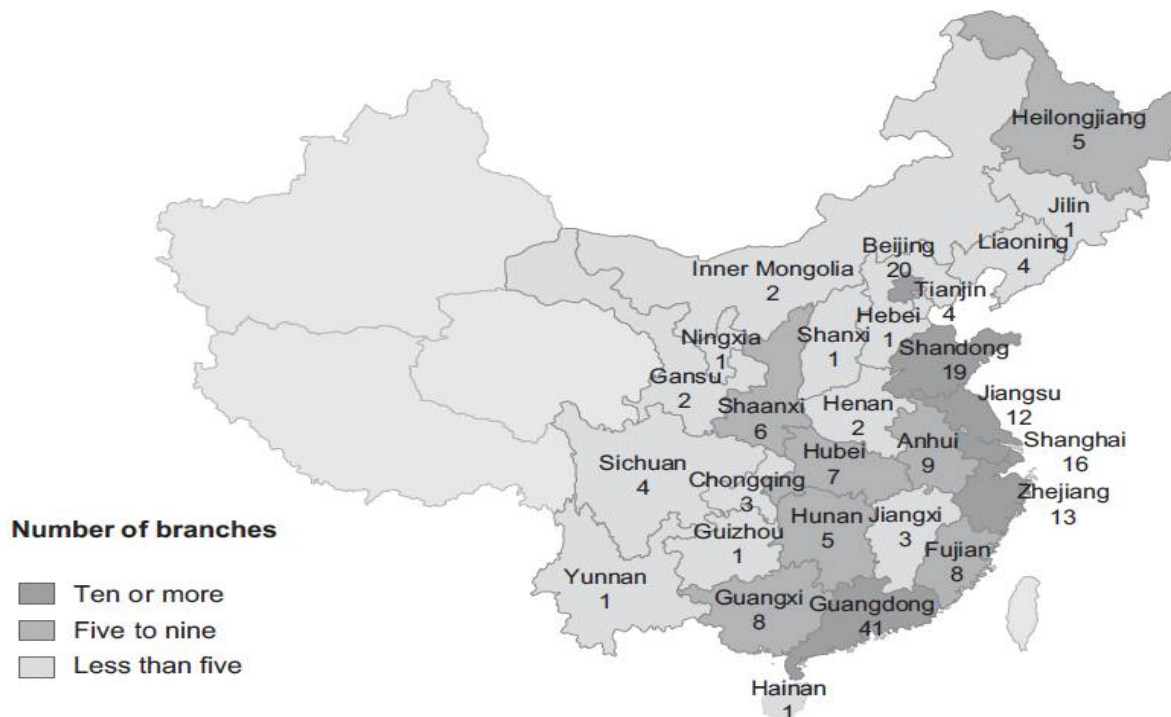
Source: Company data.

Figure 89: Breakdown of CMS's clients by asset (1H16)



Source: Company data.

Figure 90: Geographic distribution of CMS's branches



Source: Company data.

Brokerage business

1. Securities brokerage

According to WIND data, CMS's operating revenue ranked No. 9 among brokers in China in 2015, with a market share of 4.4%, while its securities brokerage ranked No. 8 in terms of both market share and revenue among A-share listed brokers in 2015. CMS ranked No. 8 in terms of trading turnover in stocks and funds in 2015, with a market share of 4.1%.

Table 70: Top 10 brokers by brokerage revenue as of 2015

Ranking	Broker	Brokerage income (Rmb bn)	Market share
1	Guotai Junan	24.24	7.80%
2	Citic Securities	21.71	6.99%
3	Galaxy	20.83	6.71%
4	Huatai	17.99	5.79%
5	Guangfa	17.60	5.67%
6	Guosen	17.54	5.64%
7	Haitong	16.25	5.23%
8	CMS	16.03	5.16%
9	China Securities	10.31	3.32%
10	Founder Securities	9.37	3.02%
	Market total	310.6	

Source: WIND. (Note: There could be discrepancy between company data and WIND data due to different criteria in calculation.)

Table 71: Among A-share listed brokers, CMS ranked #9 by operating revenue in 2015

Ranking	Securities firm	Operating revenue (Rmb bn)
1	Citic Securities	56.0
2	Haitong Securities	38.1
3	Guotai Junan	37.6
4	Guangfa Securities	33.4
5	Shenwan Hongyuan	30.3
6	Guosen Securities	29.1
7	Huatai Securities	26.3
8	Galaxy Securities	26.3
9	CMS	25.3
10	China Securities	19.0

Source: WIND. (Note: There could be discrepancy between company data and WIND data due to different criteria in calculation.)

Table 72: Top 10 brokers by stock and fund trading turnover in 2015

Ranking	Broker	Trading turnover (Rmb bn)	Market share
1	Huatai	45,158	8.4%
2	Galaxy	27,494	5.1%
3	Guangfa	25,828	4.8%
4	Guotai Junan	25,485	4.7%
5	Shenyin Wanguo	25,323	4.7%
6	Haitong	26,928	5.0%
7	Citic Securities	22,872	4.2%
8	CMS	22,186	4.1%
9	Guosen	21,007	3.9%
10	China Securities	17,149	3.2%
Mkt total		539,787	

Source: WIND. (Note: There could be discrepancy between company data and WIND data due to different criteria in calculation.)

Table 73: Top 10 brokers by stock, fund, bond trading turnover 2015

Ranking	Broker	Trading turnover (Rmb bn)	Market share
1	Huatai	55,417	7.0%
2	Galaxy	37,183	4.7%
3	Guangfa	39,890	5.0%
4	Guotai Junan	47,748	6.0%
5	Shenyin Wanguo	41,401	5.2%
6	Haitong	39,009	4.9%
7	Citic Securities	43,605	5.5%
8	CMS	32,752	4.1%
9	Guosen	31,799	4.0%
10	China Securities	30,829	3.9%
Mkt total		794,179	100.0%

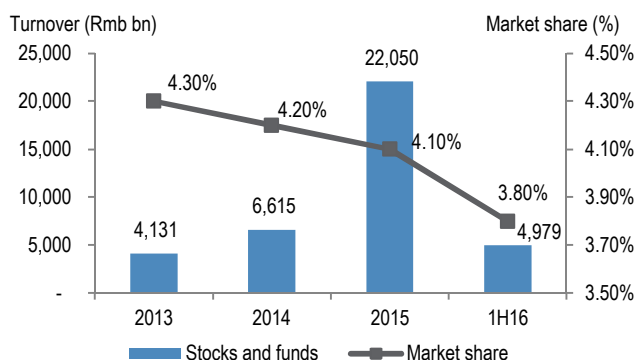
Source: WIND. (Note: There could be discrepancy between company data and WIND data due to different criteria in calculation.)

CMS acquired the brokerage business assets of Beijing Securities and the securities branches of Jutian Securities in 2006 and 2007, respectively, and expanded its customer base and business scale.

CMS was authorized by the SSE to trade under Shanghai-Hong Kong Stock Connect. The brokerage trading volume of CMS accounted for ~7.9% of the total trading volume under the Stock Connect programme, ranking second among all PRC securities firm.

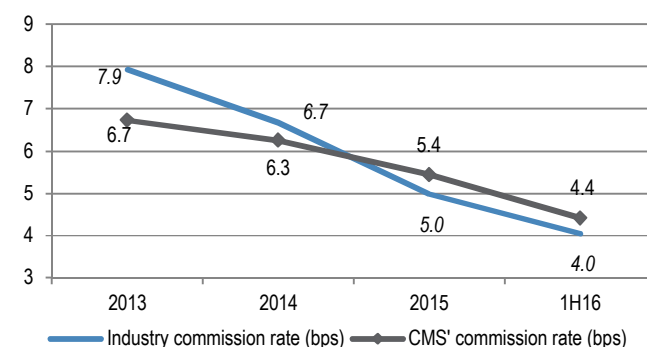
CMS's brokerage commission rate was higher than the industry average in 2014 and 2015. Its brokerage commission rate dropped by 0.4 bps HoH in 1H16, vs the industry decline of 1.0 bps. CMS has adopted various measures to upgrade its brokerage business model amid an industry-wide decline in brokerage commission rates. For example, the company has provided diversified and customized services to affluent and high net-worth customers through its "Zhiyuan Wealth Management Plans", which allows CMS to charge approximately two times the overall average brokerage commission rate.

Figure 91: CMS's stock and fund trading turnover and blended market share



Source: Company data.

Figure 92: CMS's net commission rate vs industry average (bps)

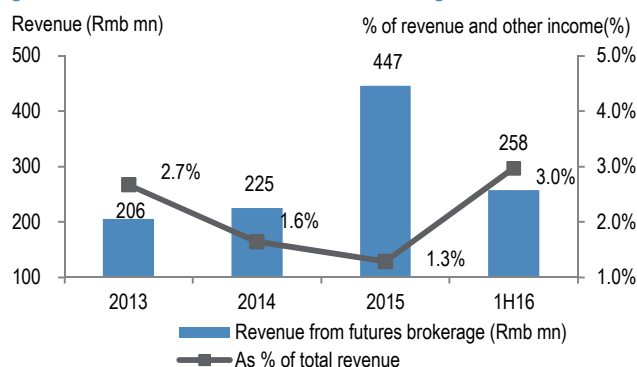


Source: Company data, WIND.

2. Futures brokerage

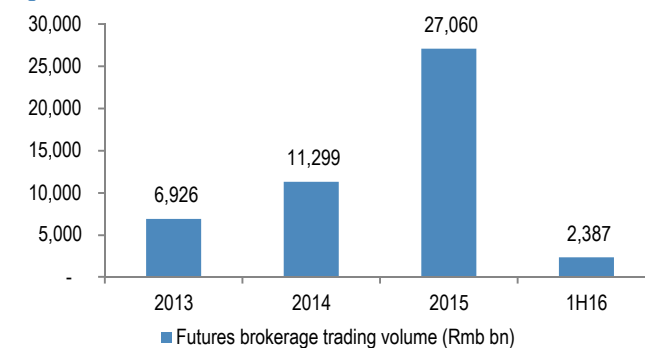
CMS conducts future brokerage business through its wholly-owned subsidiary, China Merchants Futures, which is a qualified trading agent for all types of futures in the futures market of China. As of end-1H16, China Merchants Futures had four futures branches with over 50,000 customers. 122 of CMS's securities branches were authorized to introduce customers to participate in futures trading as well. CMS's total futures turnover increased from Rmb6.9 tr in 2013 to Rmb27.1trn in 2015. CMS's revenue from futures brokerage accounted for 2.7%, 1.6%, 1.3% and 3.0% of total revenue in 2013, 2014, 2015 and 1H16, respectively.

Figure 93: CMS's revenue from futures brokerage



Source: Company data.

Figure 94: CMS's futures turnover



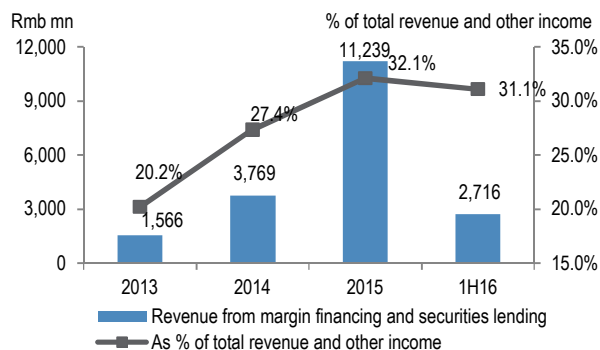
Source: Company data.

3. Margin financing and securities lending

CMS launched its margin financing and securities lending business in 2010. Since then, this business has experienced rapid growth, contributing to an increasing share of total revenue. CMS's revenue from margin financing and securities lending accounted for 27.4% of total revenue in 2014 and 32.1% in 2015, up from 20.2% in 2013. The current margin loan interest rate and margin rate are 8.35%, which is 4% above the PBOC benchmark of six-month loans for financial institutions.

As of end-1H16, CMS had 188,951 margin financing and securities lending accounts. It provides margin financing and securities lending services at 185 out of 200 securities branches in China. Its margin financing and securities lending balance ranked No. 5 as of 1H16.

Figure 95: CMS's margin financing and securities lending has a significant weight in revenue mix



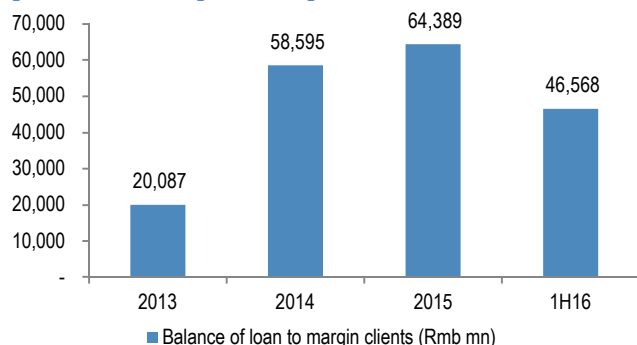
Source: Company data.

Table 74: Top 10 brokers by margin financing and securities lending balance (1H16)

Ranking	Broker	Margin financing and securities lending balance (Rmb bn)	Market share
1	Citic Securities	50.3	5.9%
2	Huatai Securities	50.1	5.9%
3	Galaxy Securities	49.6	5.8%
4	Guangfa Securities	48.2	5.6%
5	Shenwen Hongyun	47.5	5.6%
6	Guotai Junan	46.8	5.5%
7	CMS	45.7	5.4%
8	Haitong Securities	44.9	5.3%
9	Guosen Securities	34.5	4.0%
10	China Securities	26.8	3.1%
Mkt total		853.5	

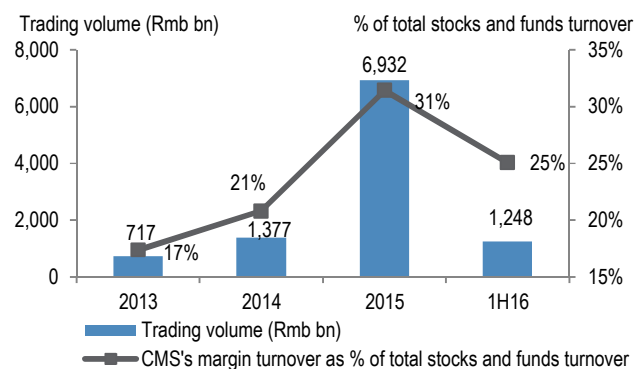
Source: WIND, based on parent company data. (Note: There could be discrepancy between company data and WIND data due to different criteria in calculation.)

Figure 96: CMS's margin financing and securities balance



Source: Company data.

Figure 97: CMS's margin trade turnover represents a substantial portion of total stocks and fund turnover



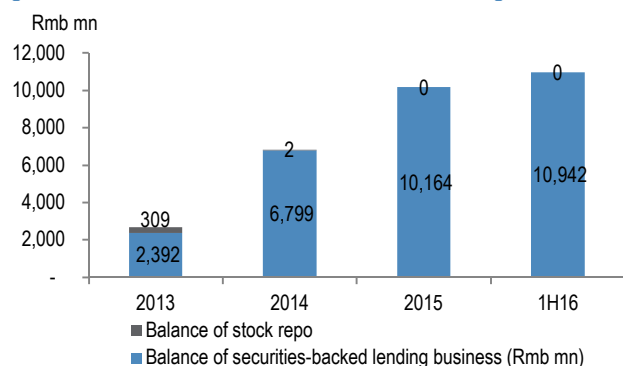
Source: Company data.

4. Securities-backed lending and stock repurchases

With respect to securities-backed lending, CMS provides loans to clients who pledge their securities to CMS. As of end-1H16, CMS's balance for securities-backed lending was Rmb10.9bn, and the collateral coverage ratio was 319%. CMS's revenue from securities based lending and stock repurchases accounted for 1.0%, 1.7%, 1.9% and 4.9% of total revenue and other income as of 2013, 2014, 2015 and 1H16, respectively.

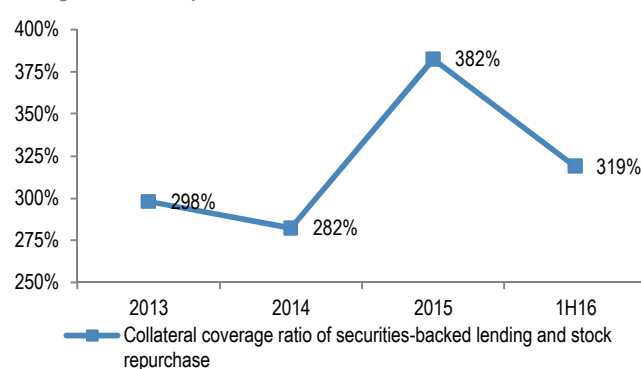
With respect to stock repurchases, CMS purchases securities from clients under a repurchase agreement under which the clients will buy back the securities at predetermined prices and within a specified period of time. As of end-1H16, the balance of CMS's stock repurchase business was nil, as all of the securities CMS held under the stock repurchase agreements had been purchased back by its customers by end of 2015.

Figure 98: Balance of CMS's securities-backed lending business



Source: Company data.

Figure 99: CMS's collateral coverage ratio of securities-backed lending and stock repurchase business



Source: Company data.

Investment banking

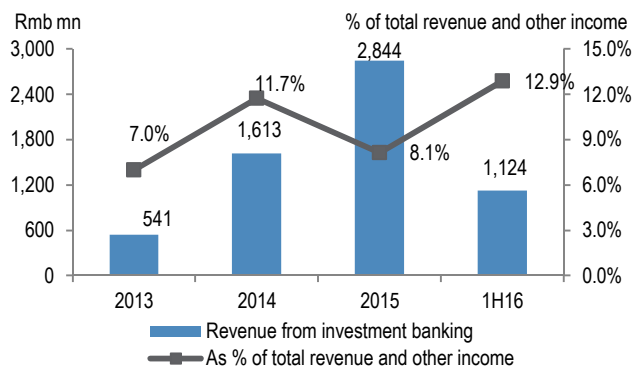
CMS's investment banking business provides equity and debt financing and financial advisory services. Its revenue from investment banking accounted for 11.7% of total revenue and other income in 2014, 8.1% in 2015 and 12.9% in 1H16. Its 1H16 investment banking segment is made up 85.5% from underwriting and sponsorship, 4.8% from financial advisory and 9.6% from OTC investment banking.

CMS's financial advisory business is centered on advising M&A transactions and restructuring of corporate clients. For OTC investment banking, CMS recommends qualified companies to be listed on the NEEQ (National Equities Exchange and Quotations) for share quotation and transfer as chief agency broker. CMS recommended 2, 38, 114 and 70 companies in this universe during 2013, 2014, 2015 and 1H16, respectively.

According to WIND, CMS ranked 5 in terms of equity underwriting amount, with a market share of 5.0%, in 2015. CMS's blended equity commission rate as a lead underwriter dropped from 3.24% in 2014 to 1.62% in 2015 and 1.05% in 1H16. This is mainly because follow-on offerings with much lower commission rates accounted for a higher percentage of business volumes in 2015 and 1H16.

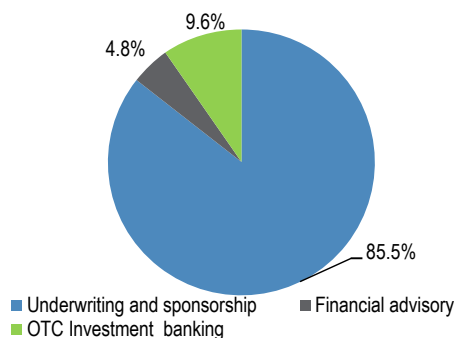
According to WIND, CMS ranked 3 among brokers in China in terms of debt underwriting amount in 2015, with a market share of 7.4%. CMS's blended debt underwriting commission rate was 0.31%, 0.60%, 0.53% and 0.42% in 2013, 2014, 2015 and 1H16, respectively. The drop in debt underwriting commission rate was due mostly to a declining commission rate for corporate bonds, which accounted for ~60% of debt underwriting as of 1H16.

Figure 100: CMS's IB revenue has an increasing weight in revenue mix as of 1H16



Source: Company data.

Figure 101: CMS's investment banking revenue breakdown in 1H16



Source: Company data.

Table 75: Top 10 brokers by number of M&A transactions in 2015

Ranking	Broker	Number of M&A transactions
1	Huatai Securities	41
2	Morgan Stanley Huaxin	42
3	Southwest Securities	39
4	Guangfa Securities	38
5	Guotai Junan	34
6	Citic Securities	29
7	Sinolink Securities	26
8	Haitong Securities	25
9	Guosen Securities	25
10	Shenwen Hongyuan	18
11	CMS	16

Source: WIND. (Note: There could be discrepancy between company data and WIND data due to different criteria in calculation).

Table 76: Top 10 brokers by M&A transaction amount in 2015

Ranking	Broker	M&A transaction amount (Rmb bn)	Market share
1	Huatai Securities	264.9	12.2%
2	Citic Securities	234.7	10.8%
3	Southwest Securities	153.3	7.0%
4	Guotai Junan	148.8	6.8%
5	Haitong Securities	147.5	6.8%
6	CICC	125.7	5.8%
7	Guangfa Securities	115.7	5.3%
8	Great Wall Securities	91.6	4.2%
9	Morgan Stanley Huaxin	65.9	3.0%
10	China Securities	64.9	3.0%
11	CMS	64.4	2.9%
	Total	2,179	

Source: WIND. Note: There could be a discrepancy between company data and WIND data due to different criteria in calculation.

Table 77: CMS's equity underwriting amount and commission rate

Rmb mn	2013	2014	2015	1H16
Equity underwriting				
IPO	-	8,224	4,968	2,184
Follow-on offering	5,634	11,018	42,821	13,955
Fee				
IPO	-	456	377	107
Follow-on offering	117	167	397	62

Source: Company data.

Table 78: CMS's debt underwriting amount and commission rate

	2013	2014	2015	1H16
Debt underwriting (Rmb in billions)				
Enterprise bond	7.0	3.3	8.8	-
Corporate bond	14.4	0.8	55.2	93.2
Debt of non-financial enterprises	0.2	24.8	82.6	17.7
ABS	3.7	21.5	77.9	39.1
Financial bonds	2.5	8.3	1.2	7.9
Others	0.4	0.3	0.2	-
Fee (Rmb in millions)				
Enterprise bond	25.5	16.4	27.8	-
Corporate bond	36.4	4.9	426.3	365.0
Debt of non-financial enterprises	1.9	277.6	624.6	260.2
ABS	11.1	45.5	111.4	28.5
Financial bonds	6.8	7.6	5.0	8.9
Others	5.6	2.5	4.5	2.0

Source: Company data.

Table 79: Top 10 equity lead underwriters by amount underwritten in 2015

Ranking	Broker	Equity underwritten (Rmb bn)	Market share
1	Citic Securities	94.3	9.9%
2	Guotai Junan	73.3	7.7%
3	Guangfa Securities	51.4	5.4%
4	China Securities	50.1	5.3%
5	CMS	47.5	5.0%
6	Huatai Securities	40.4	4.3%
7	Guosen Securities	37.2	3.9%
8	Southwest Securities	35.6	3.7%
9	Haitong Securities	33.5	3.5%
10	ZhongDe Securities	29.1	3.1%
	Total	949.7	

Source: WIND. Note: Equity underwriting includes IPOs, follow-ons, rights issues and convertible bonds. There could be a discrepancy between company data and WIND data in terms of equity underwritten due to different criteria in calculation.

Table 80: Top 10 debt lead underwriters by amount underwritten in 2015 (underwritten by brokers only)

Ranking	Broker	Debt underwritten (Rmb bn)	Market share
1	Citic Securities	415.6	11.5%
2	China Securities	370.3	10.3%
3	CMS	265.7	7.4%
4	Guotai Junan	251.1	7.0%
5	Haitong	147.0	4.1%
6	Guangfa	143.7	4.0%
7	CICC	137.3	3.8%
8	Galaxy	127.8	3.5%
9	CDB Securities	106.3	2.9%
10	Guosen	96.7	2.7%
	Total	3,610.5	100.0%

Source: WIND. Note: Debt underwriting includes enterprise bonds, corporate bonds, financial bonds, short-term financing bills, MTN, convertible bonds, local government debt, ABS, etc. There could be a discrepancy between company data and WIND data in terms of debt underwritten due to different criteria in calculation.

Asset management

CMS conducts asset management business through its wholly-owned subsidiary, CMS Asset Management. CMS provides asset management services primarily through collective asset management schemes, targeted asset management schemes and specialized asset management schemes. According to WIND data, the revenue from asset management business ranked 10th among peers.

CMS's collective asset management (CAM) schemes had AUM of Rmb48.7bn as of end 1H16, with 76 CAM schemes outstanding. CMS charges a management fee of 0-2.0% of its collective plans according to the size of AUM.

CMS's targeted asset management schemes have a minimum subscription amount of Rmb1m. At end 1H16, CMS's targeted asset management schemes' AUM amounted to Rmb455.5bn, accounting for 88% of total AUM. CMS charges a management fee based on a certain percentage of AUM (0-80bps). At end 1H16, CMS has 279 targeted asset management schemes outstanding.

Table 81: CMS's AUM and revenue from asset management breakdown

	2013	2014	2015	1H16	CAGR
AUM (in Rmb bn)					
CAM	12.0	23.1	54.3	48.7	75%
TAM	53.8	152.2	350.7	455.5	135%
SAM	3.1	2.6	9.8	13.3	80%
Total	68.9	177.8	414.8	517.5	124%
Fee (In Rmb mn)					
CAM	179.4	335.8	1,002.6	412.3	39%
TAM	11.2	39.1	112.9	72.6	111%
SAM	1.7	1.2	2.4	31.6	222%
Total	192.3	376.1	1,117.9	516.5	48%

Source: Company data.

Figure 102: CMS's market share in terms of AUM

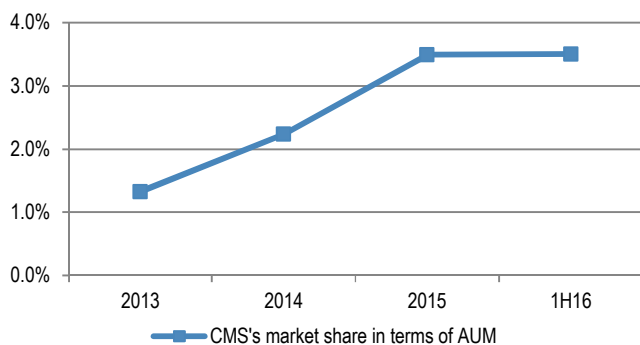
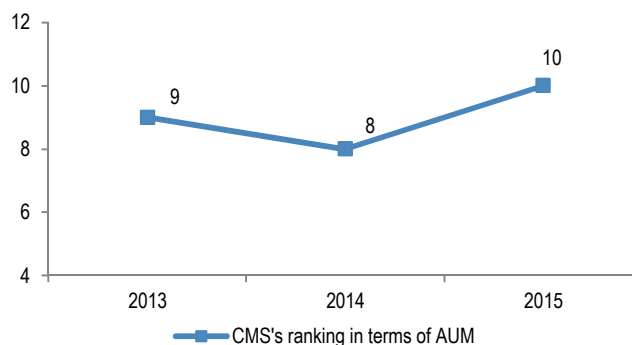


Figure 103: CMS's ranking in terms of AUM



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

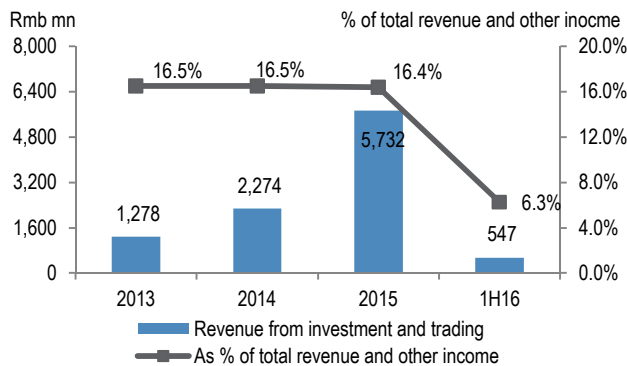
Source: Company data, WIND, J.P. Morgan.

CMS has two associates in the asset management industry in China. CMS is the largest shareholder of Bosera Funds, with a 49% stake. As of end 1H16, Bosera Funds has Rmb459.9bn in AUM, including 117 mutual funds with AUM of Rmb249.8 bn. CMS also holds a 45% equity stake in China Merchants Fund. As of end 1H16, China Merchants Fund managed total assets of Rmb328.8 bn.

Investment and trading

CMS engages in the proprietary trading of equity, funds, fixed income and other financial products. Its investment balance grew 114% and 151% in 2014 and 2015, respectively. Its segment revenue accounted for 16.5%, 16.5%, 16.4% and 6.3% of total revenue and other income in 2013, 2014, 2015 and 1H16, respectively.

Figure 104: CMS's investment and trading revenue



Source: Company data.

Table 82: Breakdown of CMS's investment position and average return from investment and trading

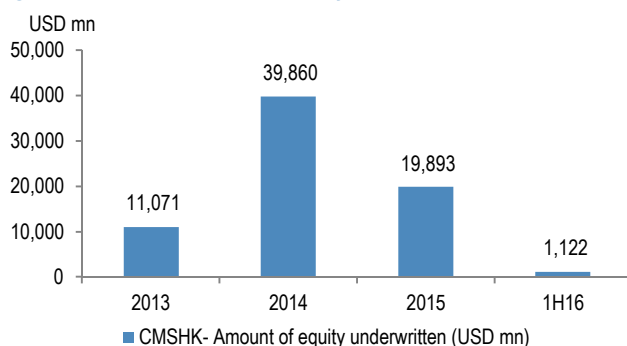
Rmb in millions	2013	2014	2015	1H16
Balance by assets class				
Stocks	4,345	14,819	13,654	8,853
Funds	3,110	4,012	25,076	14,354
Debt securities	7,065	13,747	33,075	24,144
Derivative financial instruments	(45)	(838)	(850)	(161)
Others	450	236	9,459	9,788
Total	14,925	31,975	80,414	56,979
As % of total				
Stocks	29%	46%	17%	16%
Funds	21%	13%	31%	25%
Debt securities	47%	43%	41%	42%
Derivative financial instruments	0%	-3%	-1%	0%
Others	3%	1%	12%	17%
Average rate of return from investment and trading	5.60%	9.50%	10.30%	0.80%

Source: Company data. Note: (1) Others primarily include asset management schemes, trust schemes and wealth management products offered by financial institutions in China.

Overseas businesses

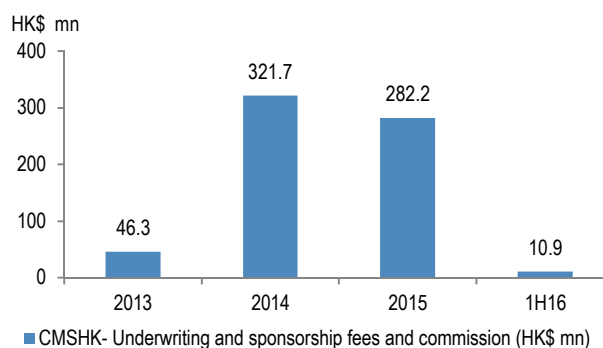
CMS conducts its overseas business through CMS International to offer a full-service platform in Hong Kong. CMSHK, the subsidiary of CMS International, has made good progress on equity underwriting businesses in recent years, ranked fourth in 2015 and second among PRC-based securities firms in HK.

Figure 105: CMSHK- Amount of equity underwritten



Source: Company data.

Figure 106: Underwriting and sponsorship fees and commissions by CMSHK



Source: Company data.

Financial Analysis

P&L

We estimate net profits to grow 39% and 23% in FY17 and FY18 after a 46% decline in FY16, mainly driven by:

- Gradual improvement in turnover in the A share markets
- Continued growth in the M&A, equity/debt underwriting, and asset management businesses
- Return-to-normal of operating performance at investment & trading and investment management after the market disruptions in 2H15 and 1Q16

Table 83: Key P&L items and estimates

(In Rmb mn)	2013	2014	2015	2016E	2017E	2018E
Revenue	7,702	13,713	34,905	19,621	24,380	28,738
Total commission & fees income	4,447	7,290	19,317	11,967	14,594	17,408
Total interest income	1,985	3,885	9,906	6,947	6,679	7,384
Net investment gain	1,270	2,538	5,681	707	3,108	3,946
Operating expense	(5,359)	(9,133)	(21,906)	(13,003)	(14,968)	(17,060)
Profit before tax	2,650	4,972	13,634	7,371	10,250	12,611
Attributable profits	2,232	3,851	10,909	5,889	8,197	10,089
Growth YoY						
Revenue		78%	155%	-44%	24%	18%
Total commission & fees income		64%	165%	-38%	22%	19%
Total interest income		96%	155%	-30%	-4%	11%
Net investment gain		100%	124%	-88%	340%	27%
Operating expense		70%	140%	-41%	15%	14%
Profit before tax		88%	174%	-46%	39%	23%
Attributable profits		73%	183%	-46%	39%	23%

Source: Company data, J.P. Morgan estimates (Note: Please refer to the Disclaimer (pages 2 & 3) for disclosures on estimates, forecasts and projections).

Revenue – commission income

We forecast commission income to grow 22% and 19% in FY17 and FY18 after a 38% decline in FY16 mainly because of the historical high base of equity brokerage fees in FY15 while fees related to futures, debt underwriting, asset management, and fund custody businesses continue to grow with decent momentum.

Table 84: Key components and estimates of commission income

(In Rmb mn)	2013	2014	2015	2016E	2017E	2018E
Total commission and fees income	4,447	7,290	19,317	11,967	14,594	17,408
Securities brokerage fee income	3,348	4,956	14,506	6,365	6,416	6,282
Futures brokerage fee income	206	225	447	162	190	209
Underwriting and sponsors fee income	420	1,432	2,423	2,888	4,398	5,927
Financial advisory fee income	193	192	427	554	832	1,248
Asset mgt fees income	255	449	1,215	1,397	1,676	2,011
Growth YoY						
Total commission and fees income		64%	165%	-38%	22%	19%
Securities brokerage fee income		48%	193%	-56%	1%	-2%
Futures brokerage fee income		10%	98%	-64%	18%	10%
Underwriting and sponsors fee income		241%	69%	19%	52%	35%
Financial advisory fee income		0%	122%	30%	50%	50%
Asset mgt fees income		76%	171%	15%	20%	20%

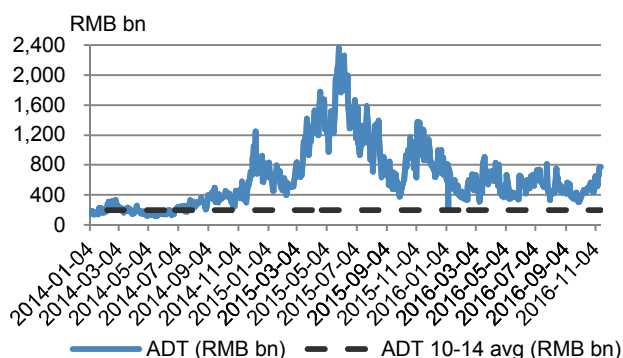
Source: Company data, J.P. Morgan estimates (Note: Please refer to the Disclaimer (pages 2 & 3) for disclosures on estimates, forecasts and projections).

Brokerage fee income

We estimate securities brokerage commission fees to drop 56% YoY in FY16 and grow by 1% and -2% in FY17 and FY18 for the following reasons:

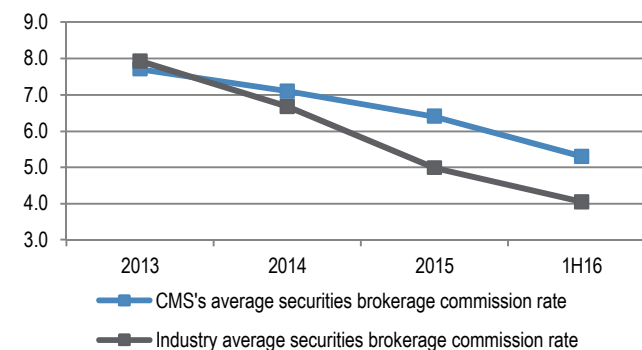
- 1H16 ADT was Rmb531bn, down 54% and 49% YoY compared to 1H15 and FY15 but still at very decent levels compared to the average of Rmb205bn during 2010-2014. We forecast ADT for FY16, FY17, and FY18 to be Rmb576bn, Rmb645bn, and Rmb710bn, respectively.
- Along with the industry trend, average brokerage commission rates at CMS have been declining, from 8.1bps in 2013 to 6.6bps in 2015 and 5.7bps in 1H16. We expect that the trend would continue but CMS should be able to maintain superior commission rates vs industry average due to its increasing focuses on institutional clients and HNW individuals; we forecast commission rates for FY16, FY17, and FY18 to be 5.3bps, 4.8bps, and 4.3bps, respectively.
- CMS market shares at securities brokerage have been relatively stable at 4.1-4.3% during 2013-2015 but down slightly to 3.8% in 1H16 due to its higher contribution from margin financing and securities lending customers, of whom the trading activities have slowed down more significantly earlier this year.

Figure 107: A-share market ADT fluctuated in 1H16 and picked up since 3Q16



Source: WIND.

Figure 108: CMS's commission rate vs industry commission rate (bps)



Source: Company data, WIND.

Underwriting income

We estimate underwriting income will increase 19%, 52%, and 35% in FY16, FY17, and FY18, respectively.

- We estimate equity underwriting in 2016 will decline slightly compared to the level in 2015, dragged by lukewarm IPO activities (down 47% YoY at CMS) as a result of volatile market conditions earlier this year and delay of the registration system while follow-up offerings remain quite stable
- We expect debt issuance to continue to be robust along with the development/deregulation of overall markets, in particular corporate bonds and ABS.
- CMS is ranked No. 5 with 4.9% market share in equity underwriting and ranked No. 3 with 7.4% market share in debt underwriting, especially its leading position in ABS with 14.9% market share.
- CMS is headquartered in Shenzhen, which is at the forefront of market reform and innovation in China and one of the originations of SMEs in particular in the tech segments and thus offers significant advantages and opportunities for its NEEQ businesses.

Table 85: CMS's equity underwriting amount and fee income

Rmb mn	2013	2014	2015	1H15	1H16
Equity underwriting					
IPO	-	8,224	4,968	4,151	2,184
Follow-on offering	5,634	11,018	42,821	14,054	13,955
Fee					
IPO	-	456	377	299	107
Follow-on offering	117	167	397	176	62

Source: Company data.

Table 86: CMS's debt underwriting amount and fee income

Rmb mn	2013	2014	2015	1H15	1H16
Debt underwriting (Rmb bn)					
Enterprise bond	7.0	3.3	8.8	1.2	-
Corporate bond	14.4	0.8	55.2	3.5	93.2
Debt of non financial enterprises	0.2	24.8	82.6	16.5	17.7
ABS	3.7	21.5	77.9	15.6	39.1
Financial bonds	2.5	8.3	1.2	0.6	7.9
Others	0.4	0.3	0.2	0.2	-
Fee (In Rmb mn)					
Enterprise bond	25.5	16.4	27.8	-	-
Corporate bond	36.4	4.9	426.3	26.0	365.0
Debt of non financial enterprises	1.9	277.6	624.6	124.6	260.2
ABS	11.1	45.5	111.4	17.8	28.5
Financial bonds	6.8	7.6	5.0	2.0	8.9
Others	5.6	2.5	4.5	2.0	2.0

Source: Company data.

Table 87: Top 10 equity lead underwriters by amount underwritten in 2015

Ranking	Broker	Equity underwritten (Rmb bn)	Market share
1	Citic Securities	94.3	9.9%
2	Guotai Junan	73.3	7.7%
3	Guangfa Securities	51.4	5.4%
4	China Securities	50.1	5.3%
5	CMS	47.5	5.0%
6	Huatai Securities	40.4	4.3%
7	Guosen Securities	37.2	3.9%
8	Southwest Securities	35.6	3.7%
9	Haitong Securities	33.5	3.5%
10	ZhongDe Securities	29.1	3.1%
Total		949.7	

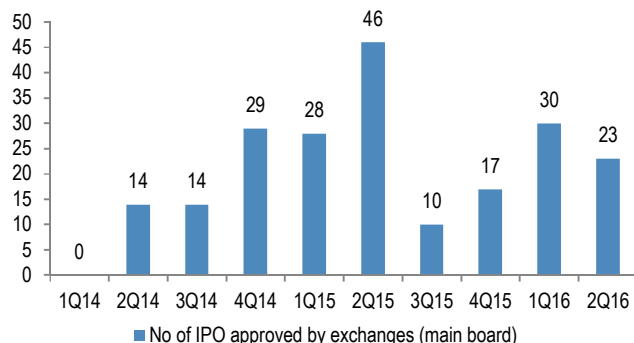
Source: WIND. Note: Equity underwriting includes IPOs, follow-ons, rights issues and convertible bonds. There could be a discrepancy between company data and WIND data in terms of equity underwritten due to different criteria in calculation.

Table 88: Top 10 debt lead underwriters by amount underwritten in 2015 (underwritten by brokers only)

Ranking	Broker	Debt underwritten (Rmb bn)	Market share
1	Citic Securities	415.6	11.5%
2	China Securities	370.3	10.3%
3	CMS	265.7	7.4%
4	Guotai Junan	251.1	7.0%
5	Haitong	147.0	4.1%
6	Guangfa	143.7	4.0%
7	CICC	137.3	3.8%
8	Galaxy	127.8	3.5%
9	CDB Securities	106.3	2.9%
10	Guosen	96.7	2.7%
Total		3,610.5	100.0%

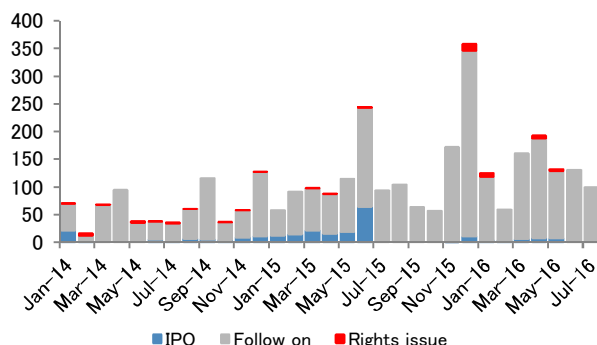
Source: WIND. Note: Debt underwriting includes enterprise bonds, corporate bonds, financial bonds, short-term financing bills, MTN, convertible bonds, local government debt, ABS, etc. There could be a discrepancy between company data and WIND data in terms of debt underwritten due to different criteria in calculation.

Figure 109: Number of IPO approved by exchanges on main board



Source: WIND.

Figure 110: The amount of IPO issuance remained muted in 1H16



Source: WIND.

Revenue – interest income

We forecast total interest income to decline 30% and 4% in FY16 and FY17 but recover 11% in FY18 due to lower balances at both bank deposits and margin finance.

Table 89: Breakdown of interest income and average interest-earning assets

(In Rmb mn)	2013	2014	2015	2016E	2017E	2018E
Total interest income	1,985	3,885	9,906	6,947	6,679	7,384
Interest income from financial institutions	698	871	2,416	1,685	1,557	1,704
Interest income from margin financing and securities lending	1,092	2,567	6,704		4,178	3,900
Interest income from securities backed lending and stock repurchases	89	317	692	960	1,056	1,162
Interest income from other financial assets held under resale agreements	27	10	51	76	115	172
Other interest income	79	120	43	47	52	57
Growth						
Total interest income		96%	155%	-30%	-4%	11%
From financial institutions		25%	178%	-30%	-8%	9%
From margin financing and securities lending		135%	161%	-38%	-7%	10%
From securities-backed lending and stock repurchases		257%	118%	39%	10%	10%
From other financial assets held under resale agreements		-62%	402%	50%	50%	50%
Other interest income		52%	-64%	10%	10%	10%
Average balance (simple average)						
Bank deposits	25,283	40,075	68,242	72,761	67,208	73,579
Margin financing and securities lending	20,087	39,341	61,492	57,950	54,087	59,496
Reverse repo assets	2,675	4,260	8,357	11,414	12,556	13,811
Growth						
Average balance (simple average)						
Bank deposits		59%	70%	7%	-8%	9%
Margin financing and securities lending		96%	56%	-6%	-7%	10%
Reverse repo assets		59%	96%	37%	10%	10%

Source: Company data, J.P. Morgan estimates (Note: Please refer to the Disclaimer (pages 2 & 3) for disclosures on estimates, forecasts and projections).

Interest income from financial institutions

CMS deposits its own funds and clients' money in banks, and the deposit rates are benchmarked to PBOC's six-month deposit rate. About 88% of the bank balances are clients' funds as of 1H16, which has dropped 11% HoH as a result of lower market turnover and we forecast relatively stable balances in 2H16 vs 1H16.

In addition, the rate cuts in 2015 suggests average yields from these bank deposits will be lower this year; in sum, we forecast interest income from financial institutions to decline 30% YoY in FY16.

Interest income from margin financing

Margin balance has declined 27% for the industry and at CMS in 1H16 but we expect some pickup in 2H16.

Yields on margin financing would also come down following the PBOC rate cuts and pricing competition among peers although we think the pricing pressure should be much lower than that of brokerage commission rates.

Revenue – investment gains

Investment gains include disposal, MTM, and dividends/interest income from trading and AFS securities. Dividends and interest income are relatively stable and correlated with the investment balances while disposal and MTM gains/losses are the factors of volatility.

We estimate investment gains to dwindle 88% YoY in FY16 but rebound 340% and 27% in FY17 and FY18.

Table 90: Breakdown of net investment gains

Rmb in millions	2013	2014	2015	2016E	2017E	2018E
Net investment gain	1,270	2,538	5,681	707	3,108	3,946
Disposal gain/(loss)	(161)	(279)	1,915	(1,060)	557	584
Dividend and interest income from AFS financial assets	239	410	709	848	891	935
Dividend and interest income from FA designated at FV through P&L	1,290	1,287	3,207	2,419	2,661	2,927
Unrealized fair value change	(98)	1,120	(150)	(1,500)	(1,000)	(500)
Growth		100%	124%	-88%	340%	27%
Disposal gain/(loss)		73%	-787%	-155%	-153%	5%
Dividend and interest income from AFS financial assets		72%	73%	20%	5%	5%
Dividend and interest income from FA designated at FV through P&L		0%	149%	-25%	10%	10%
Unrealized fair value change		-1247%	-113%	899%	-33%	-50%

Source: Company data, J.P. Morgan estimates (Note: Please refer to the Disclaimer (pages 2 & 3) for disclosures on estimates, forecasts and projections)

Operating expenses

We forecast operating expenses to decline 41% in FY16 but increase 14-15% in FY17 and FY18 for the following reasons:

- Commission expenses should decrease this year along with lower commission income; we estimate a 46% decline in FY16 but 13-15% growth in FY17 and FY18.
- Interest expenses should also decrease this year, given lower balance of client deposits as well as lower interest rates for all interest-bearing liabilities; we estimate a 48% decline in FY16 but 3-8% growth in FY17 and FY18.

- We estimate staff costs to decline 44% YoY in FY16 on the back of much lower bonus levels following the revenue trend but increase 24% and 18% for FY17 and FY18; however, the number of staff should continue to grow for business expansion.
- We expect total cost-income ratio (excluding interest and commission expense) will deteriorate to 39.1% in FY16 but gradually improve to 38.1% in FY17 and 37.7% in FY18.

Table 91: Key operating expense lines

	2013	2014	2015	2016E	2017E	2018E
Operating expenses	5,359	9,133	21,906	13,003	14,968	17,060
Fee and commission expenses	767	1,109	2,869	1,544	1,771	2,002
Interest expenses	1,147	1,974	7,285	3,779	3,903	4,222
Staff cost	2,004	3,622	8,180	4,598	5,714	6,735
Depreciation and amortization	134	141	151	159	167	175
Business tax and surcharges	354	588	1,664	937	1,165	1,373
Other operating expenses	949	1,029	1,528	1,758	2,021	2,324
Reversal of/(provision for) impairment losses	4	670	228	228	228	228
Growth						
Operating expenses		70%	140%	-41%	15%	14%
Fee and commission expenses		45%	159%	-46%	15%	13%
Interest expenses		72%	269%	-48%	3%	8%
Staff cost		81%	126%	-44%	24%	18%
Depreciation and amortization		5%	7%	5%	5%	5%
Business tax and surcharges		66%	183%	-44%	24%	18%
Other operating expenses		8%	49%	15%	15%	15%
Reversal of/(provision for) impairment losses		16065%	-66%	0%	0%	0%
Cost-income ratio (excl. interest & commission expenses)	44.7%	44.1%	33.7%	39.1%	38.1%	37.7%

Source: Company data, J.P. Morgan estimates (Note: Please refer to the Disclaimer (pages 2 & 3) for disclosures on estimates, forecasts and projections).

Balance sheet analysis

We estimate that total assets will decrease 9% in FY16 but grow 9% and 8% in FY17 and FY18 while total liabilities will decrease 17% in FY16 and increase 9% and 7% in FY17 and FY18, respectively; such changes are driven by the volatility of flow-based businesses, including margin finance and equity brokerage businesses, and related financing channels.

Margin financing lending

We expect the balance of margin financing could further expand after a temporary drop from relatively high levels in 2015 by a few factors: 1) increasing financing channels, 2) increasing penetration among affluent and high-net-worth customers, and 3) improving capital levels.

Financial assets at fair value through profits or loss

These account for around 20% of assets as of 1H16 and are largely investments in equities, funds, and debt securities that are traded on Shanghai and Shenzhen Stock Exchanges and Interbank Bond Market.

Available-for-sales financial assets

These account for around 15% of assets as of 1H16, 24% of which are related to investments in collective asset management schemes, trust products, and other WMPs. The Rmb9.3bn capital contributed by CMS to CSFCL for market stabilization is also included.

Bank balances and settlement accounts for clients' money

We estimate the balance will decline 26% in FY16 but grow 9-11% in FY17 and FY18, respectively, reflecting the migration of equity brokerage transaction amounts.

Table 92: Growth of key balance sheet items

Rmb in millions	2013	2014	2015	2016E	2017E	2018E
Margin accounts receivable	20,087	58,595	64,389	51,511	56,663	62,329
Investment	22,831	51,102	99,585	105,587	114,830	122,314
Financial assets held under resale agreements	2,866	7,545	14,335	15,768	17,345	19,080
Clearing settlement funds	5,047	12,192	19,166	15,053	16,601	18,039
Cash held on behalf of brokerage clients	22,683	47,487	72,416	53,782	59,884	65,486
Cash and bank balances (HTSC)	2,600	7,380	9,202	10,122	10,628	11,159
Others	7,745	9,107	12,562	13,277	13,894	14,543
Total assets	83,860	193,408	291,656	265,100	289,846	312,950
Accounts payable to brokerage clients	26,718	57,694	88,749	60,286	67,126	73,406
Borrowings & placements from financial institutions	2,576	7,739	7,544	6,521	7,127	7,806
Financial assets sold under repurchase agreements	4,358	49,139	42,953	46,162	53,221	58,000
Debts issued	17,780	24,346	80,839	64,439	66,530	68,133
Other payables and accruals	2,034	7,329	9,895	10,885	11,973	13,171
Others	3,208	5,565	13,243	14,076	14,988	15,989
Total liabilities	56,675	151,812	243,224	202,369	220,967	236,504
Growth						
Margin accounts receivable		192%	10%	-20%	10%	10%
Investment		124%	95%	6%	9%	7%
Financial assets held under resale agreements		163%	90%	10%	10%	10%
Clearing settlement funds		142%	57%	-21%	10%	9%
Cash held on behalf of brokerage clients		109%	52%	-26%	11%	9%
Cash and bank balances		184%	25%	10%	5%	5%
Others		18%	38%	6%	5%	5%
Total assets		131%	51%	-9%	9%	8%
Accounts payable to brokerage clients		116%	54%	-32%	11%	9%
Borrowings & placements from financial institutions		200%	-3%	-14%	9%	10%
Financial assets sold under repurchase agreements		1027%	-13%	7%	15%	9%
Debts issued		37%	232%	-20%	3%	2%
Other payables and accruals		260%	35%	10%	10%	10%
Others		73%	138%	6%	6%	7%
Total liabilities		168%	60%	-17%	9%	7%

Source: Company data, J.P. Morgan estimates (Note: Please refer to the Disclaimer (pages 2 & 3) for disclosures on estimates, forecasts and projections).

Accounts payable to brokerage clients

This is closely correlated to “bank balances and settlement accounts for clients’ money.” Please see the detailed discussion above.

Financial assets sold under repurchase agreements

These account for near 30% of current liabilities as of 1H16 and serves as an important short-term funding vehicle for CMS’s investments and margin finance businesses.

Debt issued

CMS has ST debt issued as structured notes with fixed rates or variable rates linked to certain stock indices but the amount of Rmb7.7bn is relatively small. CMS also issued long-term debt, including four tranches of non-convertible bonds with Rmb15bn in aggregate and five tranches of subordinated bonds with Rmb35bn in aggregate.

Review of 1H16 financials

Table 93: Summary of 1H16 financials

Rmb in millions	1H15	2H15	1H16	HoH	YoY
P&L items					
Net commission and fees income	10,488	8,830	5,003	-43%	-52%
Securities brokerage fee	8,632	5,874	2,859	-51%	-67%
Futures brokerage fee	234	212	258	21%	10%
Underwriting and sponsors fee	889	1,534	962	-37%	8%
Financial advisory fee	102	324	163	-50%	59%
Asset management fee	530	685	558	-19%	5%
Net interest income	5,234	4,672	3,298	-29%	-37%
Investment gains	4,737	944	387	-59%	-92%
Other income	37	47	41	-14%	11%
Total revenue and other income	20,496	14,492	8,729	-40%	-57%
Total expenses	(11,474)	(10,432)	(6,224)	-40%	-46%
Profit before tax	9,331	4,303	2,845	-34%	-70%
Income Tax	(1,996)	(710)	(609)	-14%	-69%
Net profits	7,335	3,593	2,236	-38%	-70%
Minority interest	(20)	1	6	553%	-131%
Attributable profits	7,315	3,594	2,242	-38%	-69%
Key balance sheet items					
Client deposits and clearing funds	122,128	89,291	74,070	-17%	-45%
Margin loan	114,825	64,389	46,568	-28%	-59%
Total assets	364,795	291,656	245,265	-16%	-33%
Total liabilities	316,936	243,224	197,378	-19%	-38%
Equity attributable to shareholders	47,771	48,351	47,813	-1%	0%
Key ratios					
ROAA	5.24%	2.19%	1.67%	-52 bps	-357 bps
ROAE	32.76%	14.96%	9.33%	-563 bps	-2344 bps
Avg. assets/avg. equity (x)	6.3 x	6.8 x	5.6 x	-1.2 x	-0.7 x
Avg. assets (excl. client\$)/avg. equity	4.1 x	4.5 x	3.9 x	-0.6 x	-0.2 x

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

CMS recently released 1H16 financial results; net profits were down 69% YoY and 38% HoH; total revenue declined 57% YoY and 40% HoH, while total operating expenses came down 46% YoY and 40% HoH. Annualized ROA and ROE contracted to 1.7% and 9.3% from 5.3% and 32.8% one year ago.

Within the details, total commissions and fee income dropped 52% YoY mainly dragged by a 67% decline in equity brokerage commissions, which was bigger than the 60% reduction in trading volume due to further contraction in commission rates. On the other hand, other business lines such as underwriting, financial advisory, asset management, and fund custody all registered decent growth.

A 37% YoY decline in interest income was more moderate since the drop in margin financing (down 49% YoY) was partially offset by relatively stable interest income from deposits and securities-backed lending and stock repurchases.

Investment gains experienced the biggest headwinds, down 92% YoY and 59% HoH as a result of unfavorable market conditions and limited flexibility on portfolio adjustments; dividend income has been quite stable, up 15% YoY, but CMS suffered both realized and unrealized losses of Rmb1.4bn compared to net gains of Rmb3.2bn in the same period last year.

The 46% YoY decline in operating expenses was mainly a result of savings on commission expenses and staff costs although it is inevitable that the cost-income ratio still deteriorated, up to 71% from 56% in 1H15.

Appendix I: Key Management Biographies

Name	Position	Biography
Gong Shaolin	Executive Director and Chairman	Mr Gong Shaolin, aged 60, has served as Chairman of the Board and executive Director since November 2001. Mr Gong has experience in the securities and financial industry via serving as chairman of the board of directors of CMS International from January 2006 to September 2015, vice president of China Merchants Bank from July 1997 to July 2001; secretary of the general office of the PBOC, division head of the fund planning department of the PBOC, vice president of the Shenzhen branch of the PBOC and deputy administrator of the Shenzhen branch of the SAFE from December 1986 to June 1997. Mr Gong obtained a Ph.D. degree in economics from Southwestern University of Finance and Economics in June 1999. Mr Gong was granted the title of Senior Economist by the PBOC in July 1993.
Wang Yan	Executive Director, President, Chief Executive Officer	Mr Wang Yan, aged 50, has served as the executive Director of CMS since December 2011, and President and Chief Executive Officer since January 2012. Mr Wang has experience in management of securities companies and banks via serving in management or administrative positions of various securities companies and banks. Mr Wang has been director of CMS International and CMSHK since October 2011 successively, and he is currently serving as chairman of the board of directors of CMS International and CMSHK. Mr Wang was director of China Merchants Securities Investment Management (HK) Co., Limited, CMS Capital (HK) Co., Limited and China Merchants Nominees (HK) Co., Limited from October 2011 to May 2014. Mr Wang served as president and chief operating officer ("COO"), acting chief executive officer ("CEO"), executive president and CEO of BOC International Holdings Limited from March 2005 to September 2011; deputy general manager of the Hong Kong branch of Industrial and Commercial Bank of China Limited ("ICBC") from April 2000 to January 2005, and during that period from July 2001 to December 2004 also as deputy general manager of Industrial and Commercial Bank of China (Asia) Limited; representative and chief representative of the New York branch of ICBC from February 1997 to April 2000; and deputy division head of the general planning division of the international business department of ICBC from August 1991 to February 1997. Mr Wang obtained a bachelor's degree and a master's degree in law majoring in international law, and a doctoral degree in economics majoring in national economics, all from Peking University, in July 1986, July 1989 and January 2005, respectively. Mr Wang was granted the title of Senior Economist by ICBC in August 1999.
Xiong Jiantao	Vice President	Mr Xiong Jiantao, aged 47, has served as Vice President since December 2005. Mr Xiong has served as chairman of the board of directors of China Merchants Futures since March 2008; director of Bosera Funds since November 2014; chairman of the board of directors of CMS Asset Management since March 2015; and director of CMS International since September 2015. Mr Xiong served various positions in CMS from June 1995 to December 2005, including manager of computer department, general manager of computer center, general manager of the IT technology center and general technology director. Mr Xiong had been seconded by the CSRC to be a member of the administrative take-over group of China Southern Securities. Mr Xiong served as deputy manager of the information center of China Merchants Bank from April 1993 to June 1995. Mr Xiong obtained a bachelor's degree in engineering majoring in telecommunications engineering from Nanjing University of Posts and Telecommunications (formerly Nanjing Institute of Posts and Telecommunications), a master's degree in engineering majoring in automatic instrumentation and installation from Huazhong University of Science and Technology and an executive master's degree in business management from Fudan University in July 1989, June 1992 and June 2014, respectively.
Deng Xiaoli	Vice President	Ms. Deng Xiaoli, aged 48, has served as Vice President since November 2005 and Chief Risk Officer since August 2014, and secretary to the Board from August 2014 to December 2014. Joining CMS in November 2001, Ms. Deng served as deputy general manager and general manager of the risk management department of CMS from March 2002 to March 2006. Ms. Deng served as director of CMS International since January 2006, director of China Merchants Fund since November 2006 and vice chairman of the board of directors of China Merchants Fund since November 2013. Ms. Deng had been seconded by the CSRC to be a member of the administrative take-over group of China Southern Securities. Before joining CMS, Ms. Deng was senior analyst in the risk management department of Citigroup Inc. from August 1998 to October 2001 and senior risk analyst of Provident Financial Corporation from June 1997 to August 1998. Ms. Deng obtained a bachelor's degree in science majoring in management science from Shandong University, a master's degree in arts from the State University of New York and a doctoral degree in philosophy from the State University of New York in July 1989, December 1993 and December 1996, respectively. Ms. Deng was granted the title of Senior Economist (Finance) by the Shenzhen Human Resources and Social Security Bureau in December 2013.
Sun Yizheng	Vice President	Mr Sun Yizheng, aged 48, has served as Vice President since November 2009. Mr Sun served as director of Guangdong Equity Exchange Co., Ltd since September 2013. He was managing director and assistant to the president of the investment banking department of CMS from October 2007 to December 2009. Mr Sun worked in the Listed Companies Department and the Listed Companies Supervision Department of the CSRC from February 1998 to April 2001. Mr Sun obtained a master's degree in engineering majoring in management engineering from Xi'an Jiaotong University and a doctoral degree in management majoring in technical economics and management from Tsinghua University in June 1992 and January 2002, respectively.

Name	Position	Biography
Ding Edward An Hua	Vice President	<p>Mr Ding Edward An Hua, aged 52, has served as Vice President since October 2011. Mr Ding has been the chief economist since May 2009 and director of CMS International since December 2009. Mr Ding acted as consultant of the management committee of the research center of CMS from May 2009 to December 2009 and was the Director from August 2007 to April 2011. Mr Ding also acted as director of China Merchants Bank from June 2007 to June 2010 and director of China Merchants Energy Shipping Co., Ltd. from December 2004 to April 2010. Mr Ding held various positions at China Merchants Group from March 2001 to April 2009 and from October 1992 to December 1994, including the following: deputy general manager of the business development department; deputy general manager of the corporate planning department; general manager of the strategic research department; and chief researcher of the research department.</p> <p>Mr Ding obtained a bachelor's degree in engineering majoring in automobile application engineering from Changsha University of Science & Technology (formerly Changsha College of Transportation) and a master's degree in engineering majoring in industrial management engineering from South China University of Technology in October 1984 and December 1989, respectively.</p>
Li Zongjun	Vice President	<p>Mr Li Zongjun, aged 50, has served as Vice President since July 2015. He has served as chairman of the board of directors of CMS Zhiyuan since January 2015 and director of Ganzhou China Merchants Zhiyuan No. 1 Equity Investment Management Co., Ltd. since June 2013. Mr Li served as assistant to the President from December 2014 to July 2015; deputy general manager of China Merchants Capital from April 2013 to January 2014; deputy general manager of the corporate planning department of China Merchants Group from February 2006 to April 2013; and assistant to the general manager of China Merchants Holdings (International) Co., Ltd. from March 2003 to February 2006. Mr Li served as deputy manager of the overseas listing department of COSCO's asset management center from September 1997 to April 1999; and assistant to the general manager of COSCO Finance Co., Ltd. (formerly COSCO Group Finance Co., Ltd.) and general manager of its Beijing securities department from March 1994 to October 1997.</p> <p>Mr Li obtained a bachelor's degree in economics and a master's degree in economics, both from Nankai University, in June 1987 and April 1990, respectively. Mr Li was granted the qualification of senior economist by the Ministry of Transport in October 1998.</p>
Zhao Bin	Chief Compliance Officer	<p>Mr Zhao Bin, aged 46, has served as Chief Compliance Officer since January 2016. Mr Zhao has been director of China Merchants Futures and CMS Asset Management from July 2008 and from July 2015, respectively. He had served as general manager of the department of retail brokerage from April 2008 to January 2016, and during such period, he served as general manager of the channel management department from April 2013 to January 2014. Mr Zhao had also held the following positions in CMS: employee representative Supervisor from July 2007 to May 2011; general manager of private customer service department from January 2006 to April 2009; manager of the Shenzhen Nanshan Nanyou Road securities branch from August 2001 to January 2006; deputy manager (person-in-charge) of the Shenzhen Longgang securities branch from August 1999 to August 2001; and assistant to the general manager of brokerage business department from January 1999 to August 1999. Mr Zhao had held the following positions in the securities department of China Merchants Bank: assistant to the manager and manager of Haikou branch from March 1996 to December 1998; head of Futian branch from May 1995 to March 1996; and staff of the securities department from July 1992 to May 1995.</p> <p>Mr Zhao obtained a bachelor's degree in economics majoring in international finance from Shenzhen University and a master's degree in science majoring in project management from the University of Greenwich in June 1992 and February 2011 respectively.</p>
Wu Huifeng	Secretary to the board	<p>Mr Wu Huifeng, aged 41, has served as Secretary to the Board since December 2014. Mr Wu had held the following positions in CMS: assistant to the President from May 2014 to March 2015; co-general manager of the Board office from June 2014 to June 2015; Supervisor from July 2007 to May 2014; and Director from May 2004 to July 2007. Mr Wu had held the following positions in China Merchants Finance Holdings Company Limited: deputy manager from September 2013 to May 2014; assistant to the general manager from July 2008 to September 2013; general manager of human resources department from June 2008 to May 2010; general manager of the finance and audit department from June 1999 to June 2008. Mr Wu served as deputy manager of the finance department of Shanghai Nanshan Real Estate Development Co., Ltd. (formerly Shanghai Chengnan Real Estate Development Company) from August 1998 to June 1999; and clerk and head of the settlement center of China Nanshan Development (Group) Co., Ltd. from June 1996 to August 1998.</p> <p>Mr Wu obtained a bachelor's degree in economics majoring in accounting from the Shanghai University of Finance and Economics and a master's degree in economics majoring in finance from Peking University in June 1996 and January 2012, respectively. Mr Wu was granted the qualification of accountant in May 1998 by the Ministry of Finance of the PRC</p>

Source: Company data.

Appendix II: Comparison of Key Operating Metrics

RMB mn	2013	2014	2015	2014	2015	2013	2014	2015	2014	2015	
Total assets						Total liabilities					
				YoY %					YoY %		
Galaxy	78,284	180,026	300,656	130%	67%	Galaxy	52,863	150,690	243,406	185%	62%
Citic	271,354	479,626	616,108	77%	28%	Citic	181,952	378,495	474,371	108%	25%
Haitong	169,124	352,622	576,449	108%	63%	Haitong	105,018	280,358	459,521	167%	64%
HTSC	116,214	272,226	452,615	134%	66%	HTSC	79,413	230,282	371,086	190%	61%
CMS	83,860	193,408	291,656	131%	51%	CMS	56,675	151,812	243,224	168%	60%
Margin loans						Bonds payable					
Galaxy	18,393	61,443	70,138	234%	14%	Galaxy	4,000	26,900	50,401	573%	87%
Citic	34,302	74,135	75,523	116%	2%	Citic	26,177	43,167	67,836	65%	57%
Haitong	25,760	63,563	76,459	147%	20%	Haitong	17,940	35,776	89,806	99%	151%
HTSC	19,852	64,637	67,432	226%	4%	HTSC	9,980	21,345	69,374	114%	225%
CMS	20,087	58,595	64,389	192%	10%	CMS	9,980	9,982	52,961	0%	431%
Investment assets						Other interest-bearing liabilities (excl. bonds payable)					
Galaxy	15,760	18,906	71,049	20%	276%	Galaxy	9,491	34,552	55,643	264%	61%
Citic	105,603	175,021	228,927	66%	31%	Citic	89,623	184,916	218,659	106%	18%
Haitong	61,813	78,636	180,531	27%	130%	Haitong	42,870	152,296	210,608	255%	38%
HTSC	33,032	65,281	169,362	98%	159%	HTSC	18,954	76,094	40,603	301%	-47%
CMS	21,985	51,012	99,585	132%	95%	CMS	14,735	71,241	78,376	383%	10%
Client deposits and clearing funds						Accounts payable to brokerage clients					
Galaxy	33,827	74,367	115,485	120%	55%	Galaxy	36,451	78,408	117,992	115%	50%
Citic	40,125	96,841	143,554	141%	48%	Citic	45,196	101,846	150,457	125%	48%
Haitong	37,965	76,130	126,279	101%	66%	Haitong	40,430	80,767	129,026	100%	60%
HTSC	29,769	72,081	134,496	142%	87%	HTSC	30,843	70,228	128,367	128%	83%
CMS	27,248	58,520	89,291	115%	53%	CMS	26,718	57,694	88,749	116%	54%
Reverse repo assets						Total equities					
Galaxy	1,284	7,405	21,791	477%	194%	Galaxy	25,175	29,024	56,914	15%	96%
Citic	22,092	42,863	36,771	94%	-14%	Citic	87,688	99,099	139,138	13%	40%
Haitong	9,037	63,166	77,469	599%	23%	Haitong	61,507	68,364	107,695	11%	58%
HTSC	6,088	20,710	25,635	240%	24%	HTSC	36,174	41,299	80,785	14%	96%
CMS	2,866	7,545	14,335	163%	90%	CMS	27,159	41,537	48,351	53%	16%

RMB mn	2013	2014	2015	2014	2015	2013	2014	2015	2014	2015	
Total revenue				YoY %		Total expenses			YoY %		
Galaxy	8,426	13,017	33,759	54%	159%	Galaxy	(5,533)	(8,014)	(20,625)	45%	157%
Citic	20,279	39,525	72,924	95%	84%	Citic	(13,644)	(24,733)	(46,282)	81%	87%
Haitong	12,803	23,667	55,286	85%	134%	Haitong	(7,465)	(13,414)	(34,648)	80%	158%
HTSC	9,000	15,978	39,416	78%	147%	HTSC	(6,272)	(10,349)	(25,572)	65%	147%
CMS	7,740	13,766	34,989	78%	154%	CMS	(5,359)	(9,133)	(21,906)	70%	140%
Commission and fee income						Commission expenses					
Galaxy	5,039	7,135	17,279	42%	142%	Galaxy	(171)	(201)	(447)	17%	122%
Citic	10,699	18,915	34,253	77%	81%	Citic	(1,061)	(1,799)	(4,621)	70%	157%
Haitong	6,751	9,516	21,813	41%	129%	Haitong	(1,156)	(1,580)	(4,142)	37%	162%
HTSC	5,627	8,127	20,200	44%	149%	HTSC	(981)	(1,650)	(5,660)	68%	243%
CMS	4,447	7,290	19,317	64%	165%	CMS	(767)	(1,109)	(2,869)	45%	159%
Interest income						Interest expenses					
Galaxy	2,666	4,182	11,725	57%	180%	Galaxy	(685)	(1,377)	(7,030)	101%	410%
Citic	4,090	7,851	15,622	92%	99%	Citic	(3,260)	(6,901)	(12,831)	112%	86%
Haitong	3,671	7,700	18,322	110%	138%	Haitong	(1,484)	(4,340)	(13,566)	192%	213%
HTSC	2,516	4,851	11,894	93%	145%	HTSC	(1,013)	(2,466)	(7,373)	143%	199%
CMS	1,985	3,885	9,906	96%	155%	CMS	(1,147)	(1,974)	(7,285)	72%	269%
Investment income						PBT					
Galaxy	697	1,653	4,454	137%	169%	Galaxy	2,893	5,003	13,134	73%	163%
Citic	5,259	10,204	19,510	94%	91%	Citic	6,846	15,422	27,287	125%	77%
Haitong	2,150	5,709	11,057	166%	94%	Haitong	5,455	10,420	21,119	91%	103%
HTSC	781	2,679	6,757	243%	152%	HTSC	2,948	5,915	14,263	101%	141%
CMS	1,270	2,538	5,681	100%	124%	CMS	2,650	4,972	13,634	88%	174%
Net profits						Cost income ratio					
Galaxy	2,135	3,771	9,836	77%	161%	Galaxy	65.7%	61.6%	61.1%	-410bps	-47bps
Citic	5,244	11,337	19,800	116%	75%	Citic	67.3%	62.6%	63.5%	-471bps	89bps
Haitong	4,035	7,711	15,839	91%	105%	Haitong	58.3%	56.7%	62.7%	-163bps	599bps
HTSC	2,220	4,486	10,697	102%	138%	HTSC	69.7%	64.8%	64.9%	-492bps	11bps
CMS	2,232	3,851	10,909	73%	183%	CMS	69.2%	66.3%	62.6%	-289bps	-374bps
ROAE						Cost income ratio (excl. interest and commission expense)					
Galaxy	10.0%	13.9%	22.9%	39%	65%	Galaxy	55.5%	49.4%	38.9%	-607bps	-1049bps
Citic	6.0%	12.1%	16.6%	102%	37%	Citic	46.0%	40.6%	39.5%	-541bps	-103bps
Haitong	6.7%	11.9%	18.0%	77%	52%	Haitong	37.7%	31.7%	30.6%	-602bps	-102bps
HTSC	6.3%	11.6%	17.5%	85%	51%	HTSC	47.5%	39.0%	31.8%	-852bps	-719bps
CMS	8.4%	11.2%	24.3%	33%	117%	CMS	44.5%	43.9%	33.6%	-56bps	-1036bps
ROAA						ROAA (exclude client \$)					
Galaxy	3.0%	2.9%	4.1%	-3%	40%	Galaxy	6.0%	5.0%	6.8%	-95bps	174bps
Citic	2.4%	3.0%	3.6%	27%	20%	Citic	2.9%	3.7%	4.6%	83bps	94bps
Haitong	2.7%	3.0%	3.4%	8%	15%	Haitong	3.6%	3.8%	4.4%	18bps	58bps
HTSC	2.2%	2.3%	3.0%	5%	28%	HTSC	3.2%	3.1%	4.1%	-7bps	100bps
CMS	2.8%	2.8%	4.5%	-1%	62%	CMS	4.4%	4.0%	6.4%	-37bps	240bps

Source: Company data.

Investment Thesis, Valuation and Risks

China Merchants Securities Company Ltd - H *(Overweight; Price Target: HK\$15.50)*

Investment Thesis

China Merchant Securities (CMS) is one of the top-ten full-platform brokers in China, with a noted emphasis on risk management, and prioritizing profit margins over pure volume growth. CMS is differentiated from peers by its market position in the institutional business: ranking number one in both trading volume among mutual funds and PE fund custodians in China. We believe this business emphasis positions CMS for a relatively superior growth outlook and stronger/more stable margins compared to peers in the face of industry compression trends.

Valuation

Our PT (Dec-17, DDM-derived) of HK\$15.5 implies a forward P/BV of 1.4x and P/E of 11x (FY17E). Key assumptions include risk free rate of 3.5%, equity premium of 8%, beta of 1.25x, and long term growth of 6%.

Risks to Rating and Price Target

Downside risks to our rating and price target include: risks related to contributions to the government stabilisation fund (the CSFC) and ban on hedging; tighter regulatory supervision on the rapidly-emerging domestic asset management businesses; long-term pressure on brokerage commission rates due to development of online/mobile industry platforms and fragmented market conditions, combined with uncertainties from potential deregulation of brokerage fee structure.

China Merchants Securities Company Ltd - H Summary of Financials

Income statement	FY14	FY15	FY16E	FY17E	FY18E	Growth rate (%)	FY14	FY15	FY16E	FY17E	FY18E
Commission and fee income	7,290	19,317	11,967	14,594	17,408	Commission and fee income	63.9%	165.0%	(38.1%)	22.0%	19.3%
Total interest income	3,885	9,906	6,947	6,679	7,384	Total interest income	95.7%	155.0%	(29.9%)	(3.9%)	10.6%
Net investment gain	2,538	5,681	707	3,108	3,946	Net investment gain	99.9%	123.8%	(87.6%)	339.7%	27.0%
Other income	53	84	92	111	133	Other income	38.4%	58.9%	10.0%	20.0%	20.0%
Total revenue	13,766	34,989	19,713	24,491	28,871	Total revenue	-	-	-	-	-
Total expenses	(9,133)	(21,906)	(13,003)	(14,968)	(17,060)	Total expenses	70.4%	139.8%	(40.6%)	15.1%	14.0%
Profit before tax	4,972	13,634	7,371	10,250	12,611	Profit before tax	87.6%	174.2%	(45.9%)	39.1%	23.0%
Income tax	(1,087)	(2,706)	(1,463)	(2,034)	(2,503)	Income tax	163.3%	148.8%	(45.9%)	39.1%	23.0%
Minority interest	(34)	(20)	(20)	(20)	(20)	Minority interest	531.0%	(42.4%)	0.0%	0.0%	0.0%
Attributable profit	3,851	10,909	5,889	8,197	10,089	Attributable profit	72.5%	183.3%	(46.0%)	39.2%	23.1%

Balance sheet	FY14	FY15	FY16E	FY17E	FY18E	Balance sheet structure	FY14	FY15	FY16E	FY17E	FY18E
Own deposits and clearing funds	7,380	9,202	10,122	10,628	11,159	Own deposits and clearing funds	3.8%	3.2%	3.8%	3.7%	3.6%
Client deposits and clearing funds	58,520	89,291	66,314	73,839	80,746	Client deposits and clearing funds	30.3%	30.6%	25.0%	25.5%	25.8%
Investments	51,000	98,569	104,520	113,710	121,137	Investments	26.4%	33.8%	39.4%	39.2%	38.7%
Loan to margin clients	58,686	64,389	51,511	56,663	62,329	Loan to margin clients	30.3%	22.1%	19.4%	19.5%	19.9%
Reverse repo assets	7,545	14,335	15,768	17,345	19,080	Other assets	16.8%	16.7%	19.9%	19.4%	19.1%
Other assets	10,278	15,869	16,864	17,661	18,498	Brokerage payables	38.0%	36.5%	29.8%	30.4%	31.0%
Total assets	193,408	291,656	265,100	289,846	312,950	Repo and other short-term borrowing	42.0%	26.3%	25.7%	27.9%	28.7%
Brokerage payables	57,694	88,749	60,286	67,126	73,406	Other liabilities	20.0%	37.2%	44.5%	41.7%	40.2%
Repo and other short-term borrowing	63,802	63,966	52,036	61,606	67,928						
Other liabilities	30,316	90,508	90,047	92,234	95,170	Capital ratio	FY14	FY15	FY16E	FY17E	FY18E
Total liabilities	151,812	243,224	202,369	220,967	236,504	Net capital / net assets	62.7%	80.3%	80.3%	80.3%	80.3%
Non-controlling interest	59	81	81	81	81	Net capital / total risk capital reserves	803.7%	728.2%	877.7%	885.6%	915.8%
Equity attributable to shareholders	41,537	48,351	62,651	68,798	76,365	Net capital / total liabilities	29.0%	25.6%	32.9%	33.3%	35.0%

Capital	FY14	FY15	FY16E	FY17E	FY18E	Growth in per share data	FY14	FY15	FY16E	FY17E	FY18E
Net assets (reported, Rmb mm)	40,556	46,275	54,791	60,070	66,774	EPS (reported, Rmb)	50.9%	160.0%	(50.2%)	29.1%	23.1%
Net capital (reported, Rmb mm)	25,449	37,154	43,991	48,230	53,613	DPS (reported, Rmb)	7.7%	402.6%	(71.8%)	39.2%	23.1%
Total risk capital reserves (rpt, Rmb mm)	3,166	5,102	5,012	5,446	5,855	BVPS (reported, Rmb)	22.7%	16.4%	10.9%	9.8%	11.0%

Per share data	FY14	FY15	FY16E	FY17E	FY18E	Du pont analysis	FY14	FY15	FY16E	FY17E	FY18E
No. of shares (period end, in mm)	5,808	5,808	6,789	6,789	6,789	Gross fee income / avg assets	5.3%	8.0%	4.3%	5.3%	5.8%
EPS (reported, Rmb)	0.72	1.88	0.93	1.21	1.49	Interest income / avg assets	2.8%	4.1%	2.5%	2.4%	2.4%
DPS (reported, Rmb)	0.15	0.77	0.22	0.30	0.37	Investment gain / avg assets	1.8%	2.3%	0.3%	1.1%	1.3%
BVPS (reported, Rmb)	7.15	8.32	9.23	10.13	11.25	Cost / avg assets	(6.6%)	(9.0%)	(4.7%)	(5.4%)	(5.7%)
						Operating ROAA	3.3%	5.4%	2.4%	3.4%	3.9%

Brokerage assumption	FY14	FY15	FY16E	FY17E	FY18E	ROAA	FY14	FY15	FY16E	FY17E	FY18E
Equities trading turnover (Rmb bn)	6,615	22,050	12,057	13,425	14,681	ROAA (excl. client assets)	4.0%	6.5%	2.9%	4.0%	4.5%
IB underwriting amount (Rmb bn)	-	-	-	-	-	ROAE	11.2%	24.3%	10.6%	12.5%	13.9%
Securities commission rate	0.075%	0.066%	0.053%	0.048%	0.043%	Avg assets/ avg equity (x)	4.0	5.4	5.0	4.2	4.2
Average AUM in asset mgmt (Rmb bn)	-	-	-	-	-	Avg assets (excl. client\$)/avg equity	2.8	3.8	3.6	3.2	3.1

Source: Company reports and J.P. Morgan estimates.

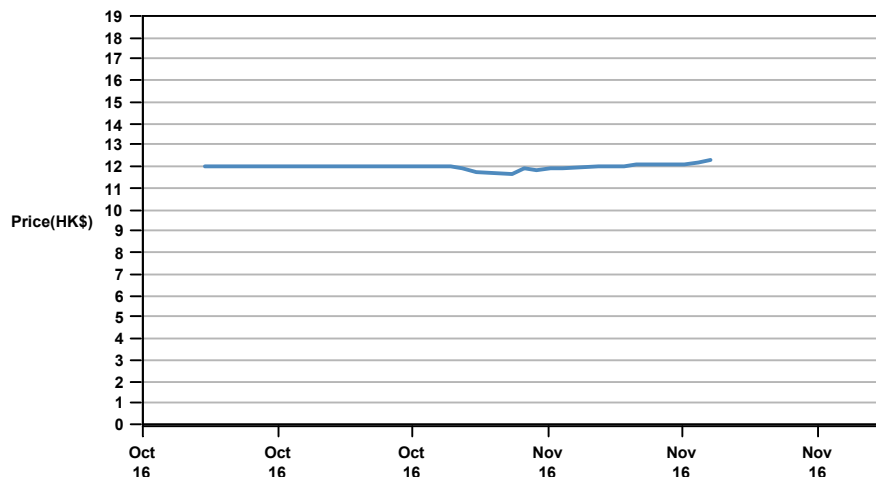
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China Merchants Securities Company Ltd - H (6099.HK, 6099 HK) Price Chart



Source: Bloomberg and J.P. Morgan; price data adjusted for stock splits and dividends.

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