

Haitong Securities [6837.HK; 600837.CH]

Weak Q2 results hit by a sharp decline in investment gains

Haitong Securities (HTS) reported a net profit of RMB1.3bn for Q2 2017, down 27% YoY, affected mainly by a 76% decline in investment income (fair value adjustment included), as a result of the volatile equity and bond markets in mainland China during the quarter. We cut our 2018E/2019E EPS by 17%/15% to reflect more conservative assumptions for investment income, given the lacklustre performance of the A-share market. We set our Gordon growth model-based target price at HK\$8.70 (previous: HK\$13) (0.71x 2018E PBR, beta 1.25, cost of equity 9.18%, medium-term ROE 8.55%). Our **BUY** call is mainly a valuation call, as the stock is trading at 0.57x 2018E PBR, which is already lower than the historical average by more than two standard deviations. However, the share price performance may remain lacklustre in the near term before we see significant improvement in sentiment in the A-share market. We also lower our target price for HTS-A (600837.CH) from RMB14.25 to RMB10.28, based on a 36% premium (3-year average) over our H-share target price.

Investment Highlights

Uninspiring Q2 performance due to weak investment gains. HTS's profit decline in Q2 was affected by the China factor and the Hong Kong factor. The 76% decline in investment gains to RMB605m was caused mainly by market weakness in the stock market and bond market in mainland China. In particular, the volatile bond market in Q2 was a key factor, as fixed income products accounted for a higher portion of the Company's investment assets. In addition, Haitong International (0665.HK) reported a net profit decline of 17% in 1H18 due to an investment loss of HK\$196m, caused mainly by its investment in structured bond funds as seed money.

Investment banking business recovered in Q2. After reporting a revenue decline of 30.8% in Q1, we note the investment banking business reported revenue growth of 18.9% in Q2, driven mainly by good performance in its bond underwriting business. It underwrote RMB97.8bn in bonds in 1H18, up 23% YoY based on WIND data.

Deleveraging of margin financing and stock pledged lending to reduce risk. According to WIND data, HTS is one of the top two players in the stock pledged lending business, which is one of the key reasons for the share price weakness. The Company has already scaled down this business to reduce its risk exposure. The balance of its stock pledged lending dropped from RMB112bn at end-2017 to RMB10.6bn at end-1H18. Its margin financing balance also fell from RMB48bn at end-2017 to RMB44bn at end-1H18. According to management, the maintenance margin ratio of its margin financing and stock pledged lending business stood at 237% and 216%, respectively, at end-1H17.

PBR trading below two standard deviations. HTS is trading at 0.57x 2018E PBR, which is already lower than the historical average by more than two standard deviations. We understand that investors may still have concerns about the stock pledged lending business if the A-share market remains weak. Therefore, we expect the share price performance to remain unexciting until we see a significant improvement in market sentiment, which should help alleviate concern about its stock pledged lending business.

Y/E Dec 31	2015	2015	2017	2018E	2019E
Turnover (RMB m)	51,192	35,000	35,677	34,136	38,266
Recurring net profit (RMB m)	15,819	8,043	8,618	7,088	8,108
Adjust net margin (%)	50	43	44	41	42
Recurring EPS (RMB)	1.38	0.70	0.75	0.62	0.70
% Change	71	(49)	7	(18)	14
PER (x)	4.2	8.7	7.9	9.9	8.7
PBR (x)	0.62	0.64	0.58	0.57	0.55
ROAA (%)	3.4	1.4	1.6	1.3	1.4
ROAE (%)	18.0	7.4	7.6	5.9	6.5

Sources: Company, CGIS Research

China Securities Sector

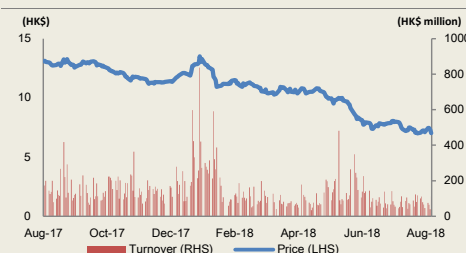
BUY

Close: HK\$7.02 (Aug 30, 2018)

Target Price (H): HK\$8.70 (+24.1%)

Target Price (A): RMB10.28 (+19.9%)

Price Performance



Market Cap	US\$13,213m
Shares Outstanding	11,501m
Auditor	Deloitte
Free Float	86.0%
52W range	HK\$6.96-13.58
3M average daily T/O	US\$14.2m
Major Shareholder	China Securities Finance Corp. (4.90%)

Sources: Company, Bloomberg

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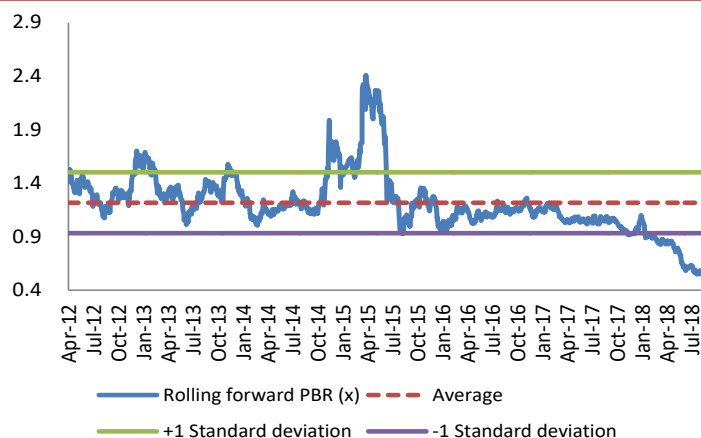
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Figure 1: HTS results highlights

Y/E Dec (Rmb '000)	Q3 2016	Q3 2017	YoY change	Q4 2016	Q4 2017	YoY change	Q1 2017	Q1 2018	YoY change	Q2 2017	Q2 2018	YoY change
Brokerage	1,165,209	995,808	-14.5%	1,238,737	1,018,482	-17.8%	924,389	899,001	-2.7%	1,002,597	758,037	-24.4%
IBD	815,587	897,875	10.1%	1,103,075	801,619	-27.3%	832,577	576,017	-30.8%	797,822	948,925	18.9%
Asset Management	109,842	467,501	325.6%	239,507	717,905	199.7%	447,011	447,382	0.1%	465,471	420,859	-9.6%
Others	284,460	45,267	-84.1%	864,692	27,247	-96.8%	42,060	26,369	-37.3%	72,568	106,265	46.4%
Commission and fee income	2,375,099	2,406,451	1.3%	3,446,010	2,565,253	-25.6%	2,246,037	1,948,769	-13.2%	2,338,458	2,234,086	-4.5%
Net interest income	1,138,096	778,297	-31.6%	680,831	1,145,004	68.2%	1,028,864	1,219,109	18.5%	713,760	1,200,652	68.2%
Net investment gains	797,461	1,967,143	146.7%	3,113,369	4,076,917	30.9%	2,272,156	1,281,326	-43.6%	2,340,816	1,099,209	-53.0%
Fair value adjustment	954,956	(105,762)	n.a.	(1,406,587)	(964,095)	-31.5%	(444,939)	(18,260)	-95.9%	185,385	(493,601)	n.a.
FX change	(39,128)	(679)	-98.3%	245,799	18,884	-92.3%	(90,697)	(65,342)	-28.0%	(152,980)	64,416	n.a.
Others	2,427,113	1,141,433	-53.0%	2,130,846	1,937,215	-9.1%	1,251,223	1,279,788	2.3%	865,818	1,228,417	41.9%
Total revenue	7,653,598	6,186,883	-19.2%	8,210,267	8,779,179	6.9%	6,262,644	5,645,390	-9.9%	6,291,257	5,333,179	-15.2%
Other income and gains	69,266	28,525	-58.8%	78,898	137,376	74.1%	403,012	297,866	-26.1%	33,400	138,577	314.9%
Total revenue and other income	7,722,864	6,215,408	-19.5%	8,289,165	8,916,555	7.6%	6,665,656	5,943,256	-10.8%	6,324,657	5,471,756	-13.5%
Operating expenses	(4,796,337)	(3,292,879)	-31.3%	(5,617,064)	(5,201,741)	-7.4%	(3,570,198)	(3,400,745)	-4.7%	(3,869,764)	(3,476,574)	-10.2%
Business tax	(37,704)	(46,466)	23.2%	(38,814)	(33,136)	-14.6%	(38,124)	(43,187)	13.3%	(48,247)	(42,605)	-11.7%
Business and admin expenses	(2,409,427)	(2,027,581)	-15.8%	(2,754,996)	(2,754,796)	0.0%	(2,268,524)	(2,135,816)	-5.8%	(2,704,216)	(1,934,802)	-28.5%
Asset impairment	(85,174)	(304,572)	257.6%	(952,100)	(675,393)	-29.1%	(248,106)	(180,771)	-27.1%	(458,587)	(517,057)	12.8%
Other operating expenses	(2,264,033)	(914,260)	-59.6%	(1,871,153)	(1,738,416)	-7.1%	(1,015,444)	(1,040,970)	2.5%	(658,714)	(982,111)	49.1%
Operating profit	2,926,526	2,922,529	-0.1%	2,672,102	3,714,813	39.0%	3,095,458	2,542,512	-17.9%	2,454,893	1,995,181	-18.7%
Share of profits of associates	57,972	254,606	-0.1%	10,312	193,825	39.0%	180,192	59,291	-67.1%	79,863	(95,597)	n.a.
Profit before tax	2,984,498	3,177,135	339.2%	2,682,414	3,908,639	1779.6%	3,275,650	2,601,802	-20.6%	2,534,756	1,899,585	-25.1%
Taxation	(662,873)	(753,999)	339.2%	(739,229)	(966,326)	45.7%	(684,963)	(609,908)	-11.0%	(608,506)	(432,108)	-29.0%
Minority interest	(221,519)	(301,349)	6.5%	(264,256)	(462,375)	45.7%	(350,522)	(259,790)	-25.9%	(142,934)	(168,652)	18.0%
Net Profit	2,100,106	2,121,786	13.7%	1,678,929	2,479,938	30.7%	2,240,164	1,732,105	-22.7%	1,783,317	1,298,824	-27.2%

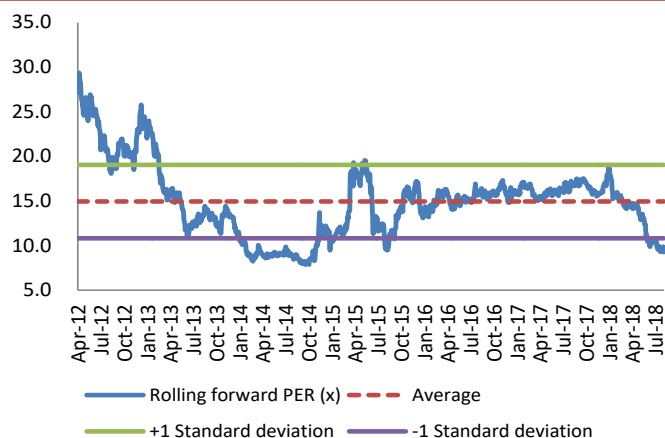
Sources: Company, CGIS Research

Figure 2: Rolling Forward PBR Range



Sources: Bloomberg, CGIS Research

Figure 3: Rolling Forward PER Range



Sources: Bloomberg, CGIS Research

Key financials

Haitong Securities (6837.HK)
Income Statement
 (RMB'000, except for per share amount)

Year ended 31 Dec	2014	2015	2016	2017	2018E	2019E
Equities	5,939,819	15,852,454	6,406,529	4,958,296	4,328,660	4,244,924
Investment banking	1,309,095	1,644,980	2,619,300	2,467,057	2,313,187	2,670,315
Asset management	1,202,203	2,465,127	1,641,855	2,098,349	2,086,325	2,088,646
Futures/derivatives	404,187	479,974	551,135	511,907	557,106	594,549
Others	660,866	1,370,081	1,492,474	1,189,474	1,282,542	1,357,399
Commission and fee income	9,516,170	21,812,616	12,711,293	11,225,083	10,567,820	10,955,832
Interest income	7,699,971	18,322,037	16,180,548	15,124,317	17,948,017	20,171,662
Net investment gains	5,708,662	11,057,133	6,107,923	9,327,622	5,619,704	7,138,296
Total revenue	22,924,803	51,191,786	34,999,764	35,677,022	34,135,541	38,265,791
Other income and gains	742,063	4,093,767	7,492,492	5,647,480	6,000,000	6,000,000
Total revenue and other income	23,666,866	55,285,553	42,492,256	41,324,502	40,135,541	44,265,791
Staff costs	(4,131,308)	(7,829,712)	(6,168,040)	(6,400,066)	(5,380,021)	(5,654,512)
Commission and fee expenses	(1,295,519)	(3,842,160)	(1,746,284)	(1,668,884)	(1,679,159)	(1,729,887)
Interest expenses	(4,340,189)	(13,566,443)	(12,340,937)	(11,458,392)	(12,878,825)	(14,812,083)
Others	(3,646,790)	(9,409,814)	(11,275,703)	(9,616,250)	(9,944,249)	(10,320,846)
Operating expenses	(13,413,806)	(34,648,129)	(31,530,964)	(29,143,592)	(29,882,254)	(32,517,327)
Operating profit	10,253,060	20,637,424	10,961,292	12,180,910	10,253,287	11,748,464
Share of profits of associates	167,334	481,445	200,435	708,487	207,198	217,558
Non-recurrent items	-	-	-	-	-	-
Income before tax	10,420,394	21,118,869	11,161,727	12,889,397	10,460,485	11,966,022
Income tax expense	(2,301,371)	(4,277,553)	(2,231,209)	(3,013,794)	(2,405,912)	(2,752,185)
Minority interests	(408,400)	(1,022,465)	(887,184)	(1,257,180)	(966,549)	(1,105,660)
Net income	7,710,623	15,818,851	8,043,334	8,618,423	7,088,025	8,108,177
Recurring net income	7,710,623	15,818,851	8,043,334	8,618,423	7,088,025	8,108,177
EPS (RMB)	0.804	1.375	0.699	0.749	0.616	0.705
Recurring EPS (RMB)	0.804	1.375	0.699	0.749	0.616	0.705
DPS (RMB)	0.250	0.450	0.220	0.230	0.185	0.211
A-share average daily turnover	303,014,286	1,045,302,582	519,090,730	460,911,721	420,000,000	430,000,000
Brokerage market share of Haitong (%)	4.8	5.0	4.7	4.6	4.6	4.6
Net commission rate of Haitong (%)	0.061	0.044	0.035	0.029	0.026	0.023
Margin financing balance	57,169,592	60,659,240	44,707,720	48,009,027	43,060,930	49,288,606
Staff cost-to-income (%)	22.9	20.7	21.7	22.7	21.0	20.4
Cost-to-income (%)	43.1	45.5	61.4	56.8	59.9	57.6
Cost-to-income (ex-impairment)	43.1	45.5	61.4	56.8	59.9	57.6
Growth Rates:						
Commission and fee income	41%	129%	-42%	-12%	-6%	4%
Interest income	110%	138%	-12%	-7%	19%	12%
Net investment gains	166%	94%	-45%	53%	-40%	27%
Total revenue and other income	85%	134%	-23%	-3%	-3%	10%
Operating profit	92%	101%	-47%	11%	-16%	15%
Recurring net income	91%	105%	-49%	7%	-18%	14%
Recurring EPS	91%	71%	-49%	7%	-18%	14%
Margins and Ratios:						
Adjusted operating margin	55.0%	49.0%	16.6%	29.0%	21.7%	26.5%
Adjusted net margin	47.0%	49.9%	42.7%	43.8%	41.1%	42.4%
Effective tax rate	22%	20%	20%	23%	23%	23%

Key financials

Haitong Securities (6837.HK)
Balance Sheet
 (RMB'000, except for per share amount)

As at 31 Dec	2014	2015	2016	2017	2018E	2019E
Financial assets	111,149,516	162,916,629	155,947,857	174,328,168	190,923,811	207,923,811
Advances to customers	64,883,359	76,324,967	63,212,920	61,560,953	43,060,930	49,288,606
Others	41,889,579	71,333,111	102,922,381	87,927,706	93,638,749	102,804,444
Cash held on behalf of customers	62,592,458	112,066,661	87,496,620	70,213,569	65,279,760	67,568,480
Bank balances and cash	23,111,153	51,124,559	31,721,171	29,144,760	48,701,487	46,813,451
Total current assets	303,626,065	473,765,927	441,300,949	423,175,156	441,604,737	474,398,791
PPE, net	1,210,145	1,317,178	1,615,839	2,862,370	3,037,105	3,155,932
Financial assets	9,024,602	33,522,971	45,353,442	31,725,358	31,875,000	33,750,000
Others	38,761,337	67,842,816	72,595,616	76,943,449	85,584,171	95,924,185
Total non-current assets	48,996,084	102,682,965	119,564,897	111,531,177	120,496,276	132,830,117
Total assets	352,622,149	576,448,892	560,865,846	534,706,333	562,101,013	607,228,909
Accounts payable to brokerage clients	80,766,843	129,026,336	104,059,287	83,774,388	77,807,736	80,325,328
Financial assets sold under repo	59,807,864	90,951,854	43,638,525	32,645,727	36,155,292	38,405,292
Due to banks and other financial institutions	34,077,574	32,799,527	49,884,220	51,255,180	53,000,000	63,500,000
Others	46,471,975	83,244,832	98,123,355	91,735,122	103,413,696	114,542,570
Total current liabilities	221,124,256	336,022,549	295,705,387	259,410,417	270,376,724	296,773,190
Bank and other borrowings	4,537,684	9,330,007	14,489,442	15,810,543	16,500,000	18,000,000
Others	54,696,006	114,168,665	128,712,616	129,791,069	140,120,803	150,264,803
Total non-current liabilities	59,233,690	123,498,672	143,202,058	145,601,612	156,620,803	168,264,803
Total liabilities	280,357,946	459,521,221	438,907,445	405,012,029	426,997,527	465,037,993
Shareholders' equity	68,364,431	107,694,545	110,130,127	117,755,479	122,198,113	128,179,882
Minority interests	3,899,772	9,233,126	11,828,274	11,938,825	12,905,374	14,011,034
Book value per share (HK\$)	9.06	11.33	11.01	12.08	12.22	12.82
Dupont analysis (as % of average total assets)						
Equities	2.3%	3.4%	1.1%	0.9%	0.8%	0.7%
Investment banking	0.5%	0.4%	0.5%	0.5%	0.4%	0.5%
Asset management	0.5%	0.5%	0.3%	0.4%	0.4%	0.4%
Futures/derivatives	0.2%	0.1%	0.1%	0.1%	0.1%	0.1%
Others	0.3%	0.3%	0.3%	0.2%	0.2%	0.2%
Commission and fee income	3.6%	4.7%	2.2%	2.0%	1.9%	1.9%
Interest income	3.0%	3.9%	2.8%	2.8%	3.3%	3.5%
Net investment gains	2.2%	2.4%	1.1%	1.7%	1.0%	1.2%
Other income and gains	0.3%	0.9%	1.3%	1.0%	1.1%	1.0%
Total revenue and other income	9.1%	11.9%	7.5%	7.5%	7.3%	7.6%
Operating expenses	-5.1%	-7.5%	-5.5%	-5.3%	-5.4%	-5.6%
Operating profit	3.9%	4.4%	1.9%	2.2%	1.9%	2.0%
Income tax expense	-0.9%	-0.9%	-0.4%	-0.6%	-0.4%	-0.5%
Recurring net income (ROAA)	3.1%	3.6%	1.6%	1.8%	1.5%	1.6%
Leverage (x)	4.0	5.3	5.2	4.8	4.6	4.7
Non-client asset/net asset (x)	3.8	3.8	3.7	3.5	3.6	3.7
ROAE	11.9%	18.0%	7.4%	7.6%	5.9%	6.5%

Sources: Company data, CGIS Research estimates

Finance Ratios

	2014	2015	2016	2017	2018E	2019E
PER(x)	6.9	4.2	8.7	7.9	9.9	8.7
EPS growth (%)	91	71	-	49	7	18
Yield (%)	4.5	7.8	3.6	3.9	3.0	3.5
Payout ratio (%)	31	33	31	31	30	30
PBR(x)	0.77	0.62	0.64	0.58	0.57	0.55
Total asset/equity (x)	5.2	5.4	5.1	4.5	4.6	4.7
Non-client asset/net asset (x)	3.8	3.8	3.7	3.5	3.6	3.7
ROAA (%)	2.96	3.41	1.41	1.57	1.29	1.39
ROAE (%)	11.9	18.0	7.4	7.6	5.9	6.5
Revenue breakdown (%)						
Equities	25.9	31.0	18.3	13.9	12.7	11.1
Investment banking	5.7	3.2	7.5	6.9	6.8	7.0
Asset management	5.2	4.8	4.7	5.9	6.1	5.5
Futures/derivatives	1.8	0.9	1.6	1.4	1.6	1.6
Others	2.9	2.7	4.3	3.3	3.8	3.5
Commission and fee income	41.5	42.6	36.3	31.5	31.0	28.6
Interest income	33.6	35.8	46.2	42.4	52.6	52.7
Net investment gains	24.9	21.6	17.5	26.1	16.5	18.7

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Explanation on Equity Ratings

BUY : share price will increase by >20% within 12 months in absolute terms

SELL : share price will decrease by >20% within 12 months in absolute terms

HOLD : no clear catalyst, and downgraded from BUY pending clearer signal to reinstate BUY or further downgrade to outright SELL

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