

# Shenwan Hongyuan Group (6806 HK)

## Top player in China securities industry

- A leading investment holding group focusing on securities business in China with a long track record, reputable brand and deep market insight,
- Leading positions across businesses with strong geographical presence in China
- Above-peer ROAE proves solid value creation capability
- Eight consecutive years of CSRC "AA" rating demonstrates sound risk management and corporate governance practices
- Initiate **BUY** with TP of HK\$ 3.65

**Strong position in China securities sector.** With over 30 years of operating history, the Shenwan Hongyuan Group Co., Ltd (SWHY) has navigated through various market cycles and regulatory reforms to become a leading investment holding group focusing on securities business in China.

**Leading positions across businesses.** SWHY was ranked fourth in terms of the no. of branches and operated the most branches in Shanghai at end-2017. As of Dec 2018, total market value of clients' securities under custody was ranked top three, according to Wind data. In addition, the AUM of its securities firm asset management business was ranked fifth in the industry as of Dec 2018.

**Solid value creation capability.** SWHY's ROAE was 10.6%/ 8.6% in 2016/17, ranking second and sixth among the top ten securities firms by net asset in China. In 2018, its ROAE (6.2%) was ranked second among major listed peers. This demonstrated SWHY's ability to translate its core strength into operating performance, in our view.

**"AA" rating from CSRC reflects strong corporate governance practices.** SWHY was awarded the "AA" rating from CSRC for eight consecutive years from 2011-18 – a recognition for its high standard of corporate governance, in our view.

**Initiate BUY with a TP of HK\$3.65.** In view of SWHY's superior standing in the industry, high ROAE, and solid corporate governance, we initiate **BUY** with a TP of HK\$ 3.65.

**Risk factors:** 1) Further decline in brokerage commission rates; 2) Sharp decline in A-share market turnover; 3) Severe downturn in China's economy; 4) Penalties related to violation of regulatory requirements.

### Financial summary

FY ended Dec 31	FY17A	FY18A	FY19E	FY20E
Revenue (RMB mn)	20,925	24,110	29,640	34,273
Chg (% YoY)	(3.7)	15.2	22.9	15.6
Profit attributable to shareholders	4,600	4,160	6,560	7,942
Chg (% YoY)	(15.0)	(9.6)	57.7	21.1
EPS (RMB)	0.23	0.19	0.26	0.32
Chg (% YoY)	(14.9)	(18.5)	40.2	21.1
BVPS (RMB)	2.8	3.1	3.3	3.6
Chg (% YoY)	5.5	13.3	5.9	7.6
P/E (x)	11.9	14.5	10.4	8.6
P/B (x)	1.0	0.9	0.8	0.8
ROAE (%)	8.6	6.2	8.1	9.3
DPS(RMB)	0.05	0.05	0.07	0.08
Dividend Yield (%)	1.8	1.9	2.4	2.9

Source(s): Company, ABCI Securities estimates

## Company report

June 4, 2019

Initiation

Rating: **BUY**

TP: **HK\$ 3.65**

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Share price (HK\$)	3.06
Est. share price return	19.3%
Est. dividend yield	2.4%
Est. total return	21.7%
Previous Rating & TP	NA
Previous Report Date	NA

Source(s): Bloomberg, ABCI Securities

### Key Data

52Wk H/L(HK\$)	3.64/3.04
Issued shares (mn)	25,040
Issued H shares (mn)	2,504
H-share market cap (HK\$ mn)	7,662
Avg daily turnover (HK\$ mn)	47.8
Major shareholder(s)	
JIC	26.3%
Central Huijin	20.1%
Shanghai Jiushi	4.8%

Source(s): Company, ABCI Securities

### Share Performance (%)

	Absolute	Relative*
1-mth	(5.8)	4.8
3-mth	NA	NA
6-mth	NA	NA

\*Relative to HSI

Source(s): Bloomberg, ABCI Securities

### Share Performance in 2019 (HK\$)



Source(s): Bloomberg, ABCI Securities



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June 4, 2019

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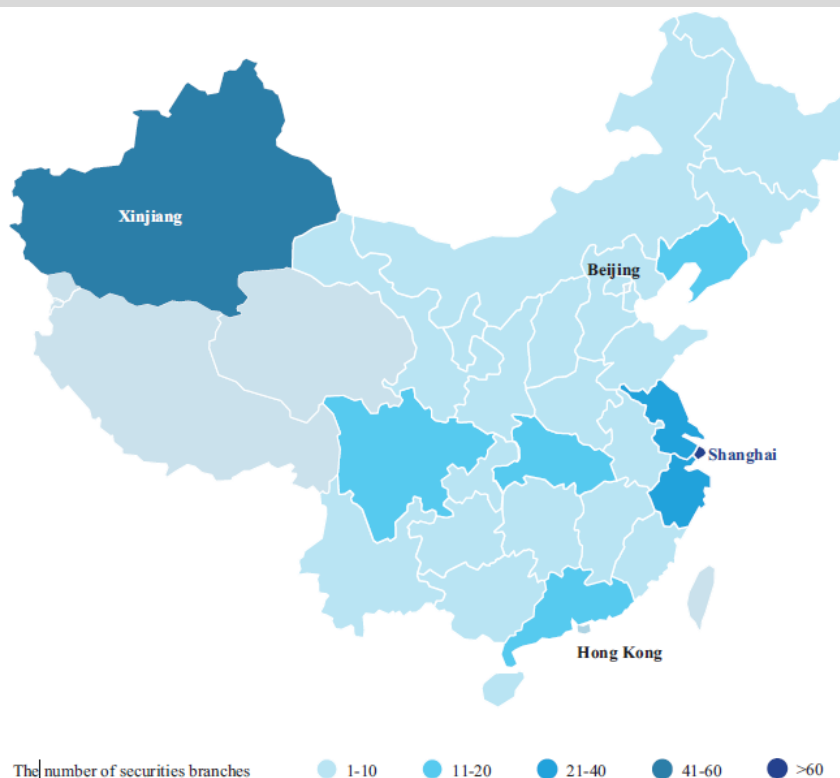
## Esteemed position in China securities sector

### A snapshot of Shenwan Hongyuan (SWHY)

Shenyin Securities (SYS) and Wanguo Securities (WGS) were established in Shanghai on July 1, 1988 and July 15 1988. On Sep 16, 1996, a merger was completed between SYS and WGS to become Shenyin & Wanguo Securities (SYWG); meanwhile, Hong Yuan Securities (HYS) (formerly known as Hongyuan Trust) was founded on May 25, 1993, in Xinjiang and was listed on Shenzhen Stock Exchange on Feb 2, 1994.

In Jan 2015, with the approval of CSRC, the Group successfully integrated SYS, WGS and HYS together. In particular, the merger between Shenyin & Wanguo Securities (SYWG) and Hong Yuan Securities back in Jan 2015 was the largest merger in the China securities industry at the time, according to Dealogic. With over 30 years of operating history, the Group has been through numerous market cycles and major regulatory reforms to become a leading investment holding group focusing on securities businesses in China. The Group is committed to providing diverse financial products and services to clients.

**Exhibit 1: SWHY's branch network**



Source(s): Company, ABCI Securities

As of Dec 31, 2018, with its investment parent company and securities firm headquartered in Beijing and Shanghai, SWHY had 48 branch offices, 310 securities branches, and 40 futures branches in 29 provinces of China. SWHY was ranked fourth in terms of the no. of branches in 2017. The Group operates the largest number of securities branches in Shanghai and Xinjiang among all securities firms in China.



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### **Solid customer base**

The Group had over 6.5mn of personal finance clients, with over 19,000 of high-net-worth (HNW) clients and more than 253,100 of affluent clients as of Dec 31, 2018; meanwhile, it focuses its business on mainstream institutional investors, accumulating over 1,000 institutional clients as of Dec 31, 2018.

### **Business segments**

The Group has four core business segments, which are enterprise finance, personal finance, institutional services and trading, and investment management.

Enterprise finance (EF) - Provides investment banking and principal investment to corporate clients, such as equity underwriting and sponsorship, debt underwriting and financial advisory services.

Personal finance (PF) – Fulfills financial needs of individuals and non-professional institutional clients with services such as securities and futures brokerage, margin financing and securities lending (MFSL), stock-backed lending, sales of financial projects and investment advisory through SWHY’s online and offline platforms.

Institutional services and trading (IS&T) – Mainly provides prime brokerage and research services for SWHY’s professional institutional clients, while also engages in trading of FICC, equities, and equity-linked securities.

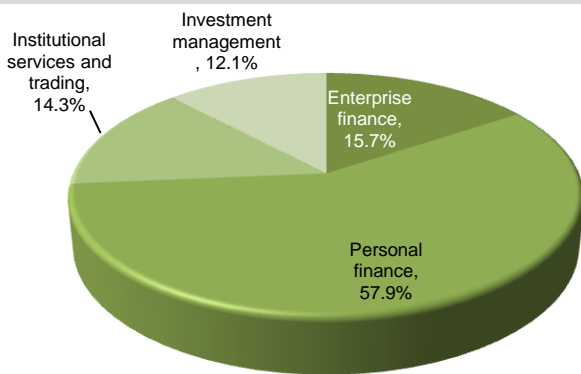
Investment management (IM) – Consists of asset management, mutual fund management, and private equity fund management services.

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**Exhibit 2: SWHY's business lines**

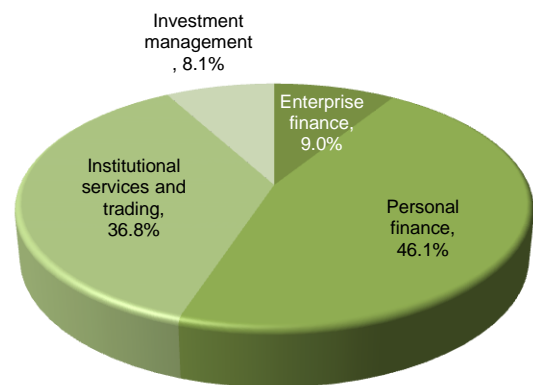
Enterprise Finance		Personal finance	Institutional services and trading	Investment management
Investment banking	Principal investment			
Equity financing	Equity investment	Securities and futures brokerage	Prime brokerage	Asset management
Debt financing	Debt investment	Margin financing and securities lending	Research	Mutual fund management
Financial advisory	Other investment	Stock-backed lending	FICC sales and trading	Private equity fund management
		Sales of financial products	Equity sales and trading	

Source(s): Company, ABCI Securities

PF provides the major source of income for SWHY. In 2018, the segment accounted for 46.1% of the Group's total revenue, followed by 9.0% and 36.8% by EF and IS&T.

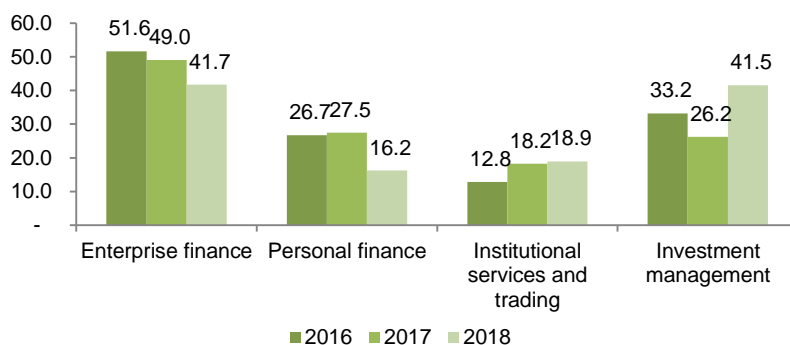
**Exhibit 3: SWHY's revenue mix (2016)**


Source(s): Company, ABCI Securities

**Exhibit 4: SWHY's revenue mix (2018)**


Source(s): Company, ABCI Securities

While revenue contribution of PF fell from 58% in 2016 to 46% in 2018, the segment remains to be the core revenue contributor; meanwhile, IS&T's revenue mix increased to 36.8% in 2018 from 14.3% in 2016.

**Exhibit 5: SWHY's segment margin (%)**


Remarks: Segment margin = segment profit before income tax/segment revenue and other income

Source(s): Company, ABCI Securities

Due to keen competition in the China securities industry, SWHY's segment margin of EF fell from 51.6% in 2016 to 41.7% in 2018. Given high correlation to market turnover, segment margins of PF and IS&T were relatively volatile at 16.2%-27.5% and 12.8%-18.9% over 2016-18. Segment margin in IM rose from 26.2% in 2017 to 41.5% in 2018.

#### **“Dual layer” corporate structure**

The Group developed a “dual layer” corporate structure consisting of an investment parent company and a securities firm. This structure allows the Group to provide corporate clients with one-stop services and capital support throughout their life cycle.

In particular, the Group provides enterprise clients at early stage with NEEQ recommendation service, private equity investment, and private placement of bonds. Later at the growth stage, the Group enterprise assists clients with IPO sponsorship and underwriting services; at the listing stage, the Group underwrites bonds and follow-on offerings and assists enterprise clients in their M&A to facilitate business expansion.

In relation to NEEQ business, SWHY has recommended 796 companies for quotation, acted as financial advisor for 702 follow-on placements, and provided continuous supervisions to 613 companies on the NEEQ as of Dec 31, 2018. Since inception, the Group had completed a total of 350 equity financing transactions as a lead underwriter or sponsor, of which 183 were IPOs while the remaining 167 were follow-on offerings up to Dec 31, 2018, according to Wind data. It completed 501 debt offerings as the lead underwriter, raising an aggregate amount of RMB 581.3bn. The Group participated in 21 M&As involving listed company with a total transaction value over RMB 56.2bn.

## Leading positions across businesses

With over 30 years of operating history, the Group accumulated in-depth market knowledge and insights to become a leading player in the industry. In terms of revenue and net profit, SWHY was ranked sixth among all China securities firms in terms of net profit in 9M18 and seventh among all China securities firms in terms of net asset on Sep 30, 2018. The Group's ROAE was the highest among the top 10 securities in terms of net asset in 9M18.

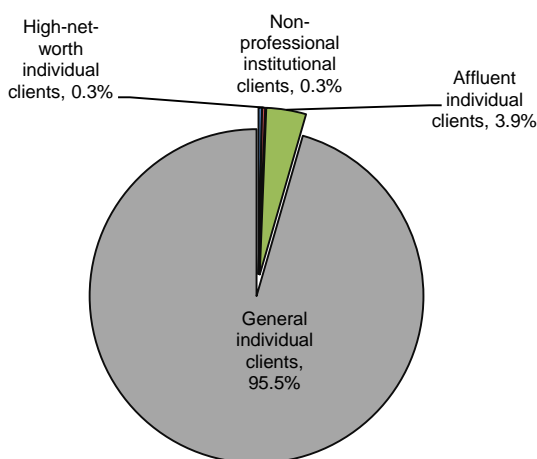
### Strong presence in Shanghai and Xinjiang

With extensive branch network and strong presence in Shanghai and Xinjiang, SWHY is set to be one of the key beneficiaries in the "Belt and Road" initiative. In our view, extensive network also translates into SWHY's key strength in PF segment. As of Dec 31, 2018, total market value of clients' securities under custody amounted to RMB 2.4tr, or a market share of 7.1%, and was ranked top 3, according to Wind data.

Out of the 6.5mn PF clients, over 19,000 and over 253,100 are high-net-worth (HNW) and affluent clients. With the highest no. of branches in Shanghai and Xinjiang, SWHY has ~5,300 client managers and securities brokerage agents and 1,850 professional investment advisors, ranking seventh in the industry, according to SAC. Dedicated division has been built for HNWs with research in market strategies, industry products, and individual stocks.

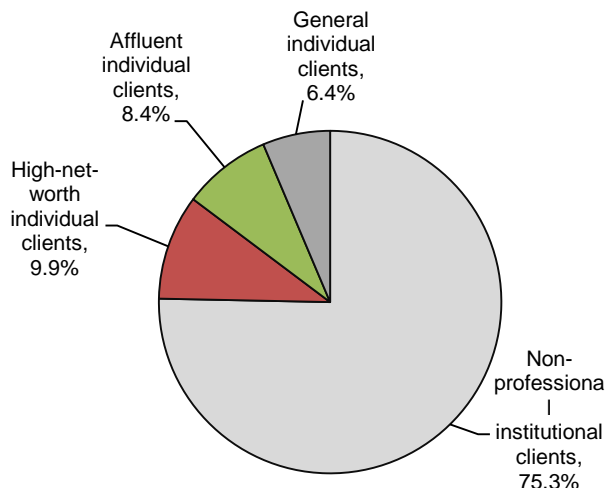
In addition, non-professional institutional clients accounted for 0.3% of total clients but contributed to 75.3% of client account balance by Dec 31, 2018.

**Exhibit 6: The no. of personal finance clients by client type (Dec 31, 2018)**



Source(s): Company, ABCI Securities

**Exhibit 7: Account balance of personal finance clients by client type (Dec 31, 2018)**



Source(s): Company, ABCI Securities

SWHY has developed a leading online platform for personal finance customers. Its mobile apps had 2.8mn of average monthly active users (MAU) in 2018, according to Analysys.



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## Brokerage

The top 10 securities firms in China accounted for 49.6% of the total trading volume in A-share secondary market in 2018. In 2018, SWHY was ranked fifth with a market share of 4.8% in term of total trading volume of bilateral basis of stocks, funds, and bonds. Similarly, the top 10 securities firms took up 53.8% of market share in MFSL business in 2017. In 2017, SWHY was ranked 7<sup>th</sup> in this business line with a market share of 5.3%.

Stock-backed lending business was launched in the Shanghai Stock Exchange and Shenzhen Stock Exchange in 2013, with rapid growth being seen in recent years. Aggregated balance of stock-backed lending in 2017 was RMB 819.4bn; the top 10 securities firms took up a market share of 57.3% in 2017. SWHY was ranked seventh in stock-backed lending business in 2017 with a market share of 3.9%.

## Above average commission rate

SWHY has been able to maintain an above-peer commission rate, which we perceive to be a critical factor of succeeding as a securities broker in China. According to Wind data, SWHY commanded a stocks and funds commission rate of a 3.6bps in 2018, which was above the market average. The rate calculation also includes distribution of financial products developed by SWHY and from third parties. Financial products with a total value of RMB 143bn were sold in 2018 by SWHY, while total balance of MFSL reached RMB 42.7bn as of Dec 31, 2018.

## Position to focus on mainstream institutional investors

The Group positions to serve mainstream institutional investors. As of Dec 31, 2018, SWHY had over 1,000 institutional clients, including more than 100 mutual fund managers, 600 private investment fund managers, 50 insurance companies, 130 commercial banks, and 270 overseas institutional clients such as QFIIs, RQFIIs, and B-share institutional investors.

According to the SAC, SWHY's trading revenue from units leasing service was ranked fourth in the industry with a market share of 4.7% in 2017. Moreover, 20.1% of QFII clients in the market were covered by SWHY as of Dec 31, 2018. Revenue from institutional clients accounted for 36.8% of total revenue and other income in 2018.

FICC business was another bright spot. Returns from SWHY's own capital used for fixed income trading in 2016, 2017 and 2018 were 10.5%, 6.0% and 16.4%, respectively, which were 8.7ppt, 4.1ppt and 9.7ppt higher than the average return rate achieved by open-end bond funds in China for the same periods.

SWHY's bond distribution capability was outstanding - 12.6%, 12.8% and 9.1% of debt financing instruments for non-financial enterprises in the market were distributed by the Group in 2016, 2017 and 2018.





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### **Investment banking**

For the primary market, the top 10 securities firms took up 72.8% of market share in terms of amount underwritten in 2018. Since the establishment of the PRC securities market till Dec 2018, SWHY was ranked fifth and eighth in terms of the total number of IPO underwritten and total number of equity offerings underwritten. Regarding NEEQ business, SWHY was ranked first in terms of the no. of recommendations for quotation since the establishment of the NEEQ till Dec 31, 2018. For municipal bond issued, SWHY was ranked fifth with a market share of 8.4% in 9M18.

### **Investment management**

Overall, asset management business grew rapidly in past years. As of Sept 2018, total AUM of asset managed by securities firms, fund managers, and private investment fund managers amounted to RMB 14.2tr, RMB 11.7tr, and RMB 12.8tr, respectively.

The Group's aggregated AUM was RMB 731.6bn for investment management business as of Dec 31, 2018; in particular, AUM under asset management business was RMB 674bn, ranking fifth among China securities firms according to Wind data.

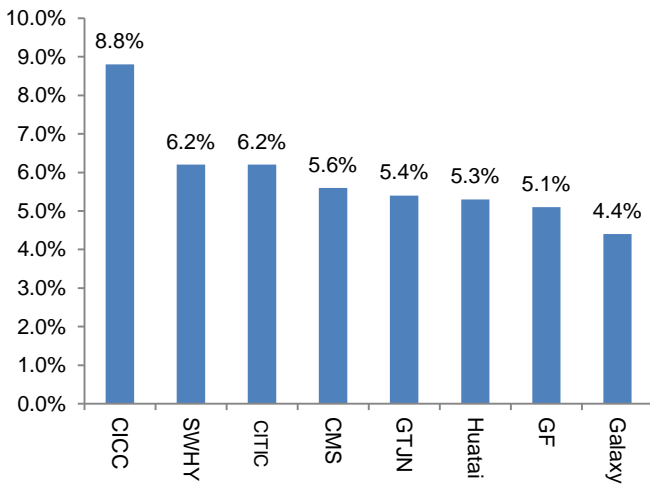


### Above-peer returns show value creation capability

Committed to enhancing shareholder value and profitability, SWHY's ROAE, based on PRC GAAP, was 10.6%, 8.6% in 2016 and 2017, ranking second and sixth among the top 10 securities firms by net asset in China. In 2018, its ROAE (6.2%) was ranked second among major listed peers.

Overall, its average ROAE between 2015 and 2018 was the second highest among the major listed peers.

Exhibit 8: ROAE comparison (2015-18)



Notes: CICC (3908 HK); SWHY (6806 HK); CITIC (6030 HK); CMS (6099 HK); GTJN (2611 HK); Huatai (6886 HK); GF (1776 HK); Galaxy (6881 HK)

Source(s): Companies, ABCI Securities



## CSRC’s AA rating as recognition of solid corporate governance

The Group has been dedicating to create value through cautious risk management. SWHY received the “AA” regulatory rating from CSRC in 2018 - the highest rating attained by a China securities firm to date.

SWHY has been awarded this rating for eight consecutive years from 2011-18, thanks to the comprehensive risk management system developed by SWHY that covers market risk, credit risk, liquidity risk, operational risk, and compliance risk.

Various major securities firms such as CITIC Sec (6030 HK), Galaxy Sec (6881 HK), GF Sec (1776 HK), and Huatai Sec (6886 HK) have lost their “AA” ratings in 2016. The Company, however, has been able to retain its “AA” rating throughout the years, demonstrating its outstanding risk management capability amid market changes.

Exhibit 9: CSRC’s rating among major PRC securities firms

	2013	2014	2015	2016	2017	2018
<b>SWHY</b>						
<b>(6806 HK)</b>	AA	AA	AA	AA	AA	AA
GTJN						
(2611 HK)	AA	AA	AA	AA	AA	AA
CMS						
(6099 HK)	AA	AA	AA	AA	AA	AA
CITIC						
(6030 HK)	AA	AA	AA	BBB	AA	AA
Huatai						
(6886 HK)	AA	AA	AA	BBB	AA	AA
Galaxy						
(6881 HK)	AA	AA	AA	A	AA	AA
Everbright						
(6178 HK)	AA	C	A	AA	A	A
DFZQ						
(3958 HK)	A	AA	AA	AA	A	AA
GF						
(1776 HK)	AA	AA	AA	BBB	AA	AA
Guosen						
(002736 CH)	AA	AA	AA	BBB	A	A

Source(s): CSRC, ABCI Securities

Aside from being a recognition of its stringent corporate governance standard, CSRC’s high rating may bring numerous benefits.

**Business development** – In our view, securities firms with a higher CSRC rating may facilitate regulatory approval process for business development such as branch expansion and fundraising. In addition, we believe large financial institutions, including insurance companies, would select and allocate businesses among counterparties based on CSRC’s rating.

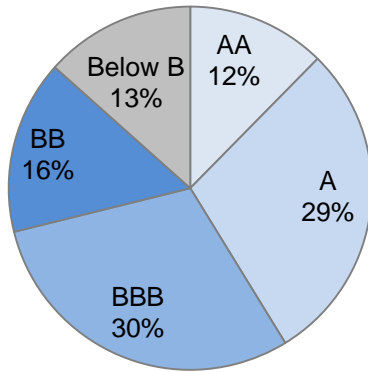
**Securities Investors Protection Fund (SIPF)** – Lower contribution to SIPF for securities firms with higher ratings in general.

**Funding channel and cost** — More funding channels and lower funding cost for securities firms with a higher rating in general.



**Capital requirement** — General lower capital requirement for securities firms with a higher rating.

Exhibit 10: CSRC's rating distribution (2018)



Source(s): CSRC, ABCI Securities

### Prudent risk management and internal control

Over the years, SWHY has established an effective risk management and internal control to monitor, evaluate, and manage various risks in businesses. It complies with all of CSRC's capital adequacy and risk control index requirements.



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## Key growth drivers

Leveraging on its “dual layer” model, we believe SWHY would be able to maintain its leading position in the China securities sector. Future growth would be driven by the four core business lines.

**Enterprise finance business.** The business will continue to focus on targeted clients and create greater synergies between principal investment and investment banking. It will help large enterprises to strengthen their market position through industry consolidation and capital raising, and attracting new economy enterprises and leveraging SWHY’s strong capability in NEEQ market. Also, it will capitalize on quality investment opportunities through enhancing synergies between principal investment and investment banking businesses. Also, in new era of international trade, the Group will seek to grow cross-border business opportunities in M&A advisory.

**Personal finance services.** The business will continue to upgrade its personal finance platform, both online and offline, to enhance client experiences and loyalty. It will focus on HNWs and expanding the variety of financial products. We expect SWHY’s branch network and investment advisory team to grow, with the Group transforming itself from a traditional brokerage services provider to one offering full-service wealth management. We perceive investment in FinTech to be another major step to expand client base by providing a higher degree of automated and tailored services.

**Institutional services and trading.** The business will expand its institutional client base through enhancement in sales and trading capability. In particular, we expect SWHY to increase focus on commercial banks, private funds, and foreign institutional investors. At the same time, leveraging on its leading position onshore, it will develop cross-border research, product distribution, and trading services to offshore clients.

**Investment management.** The business will focus on asset allocation, FinTech, and cross-border asset allocation. We expect SWHY to extend its investment capacity globally and optimize its portfolio management and risk management through artificial intelligence and FinTech.

## Industry overview

### Parallel growth with macro economy

The Chinese economy has enjoyed explosive growth for over four decades and financial system has evolved with higher sophistication. A multi-layered capital market system is demanded by market participants, and a comprehensive capital market has been gradually forming in China. According to the National Bureau of Statistics (NBS), the securitization ratio (total market capitalization of PRC stock market divided by the nominal GDP) of Shanghai Stock Exchange and Shenzhen Stock Exchange increased from 40.2% in 2013 to 48.3% in 2018.

#### Exhibit 11: China's capital market

	2014	2015	2016	2017	2018	CAGR 2014-18 (%)
No. of listed company	2,613	2,827	3,052	3,485	3,584	8.2
Market capitalization (RMB bn)	37,254.7	53,130.4	50,768.6	56,708.6	43,492.4	3.9
Total amount of new equity issuance (RMB bn)	819.2	1,540.2	1,867.5	1,540.0	1,005.9	5.3
Total trading volume (RMB bn)	7,491.3	255,594.2	127,768.0	112,809.8	90,295.9	5.0

Source(s): Shanghai Stock Exchange, Shenzhen Stock Exchange, ABCI Securities

The no. of listed companies in China grew at 8.2% CAGR over 2014-18 while market capitalization expanded at 3.9% CAGR over the same period. Trading volume grew at 5.0% CAGR over 2014-18. With further development of direct financing in China, we could expect further enhancement of securitization ratio in China, which would bring huge opportunities to the China securities sector.

China's bond market has played an increasingly important role globally. According to BIS, PRC bond market has become the third largest in the world as of June 30, 2018, in terms of outstanding balance.

#### Exhibit 12: PRC funds market (RMB bn)

	2014	2015	2016	2017	2018	CAGR 2014-18 (%)
Mutual fund	4,535.4	8,397.2	9,159.3	11,599.7	13,034.7	30.2
Private securities investment fund	464.0	1,729.0	2,611.7	1,723.4	2,239.1	48.2
Private equity investment fund	803.8	1,727.0	3,526.4	5,958.6	7,711.4	76.0

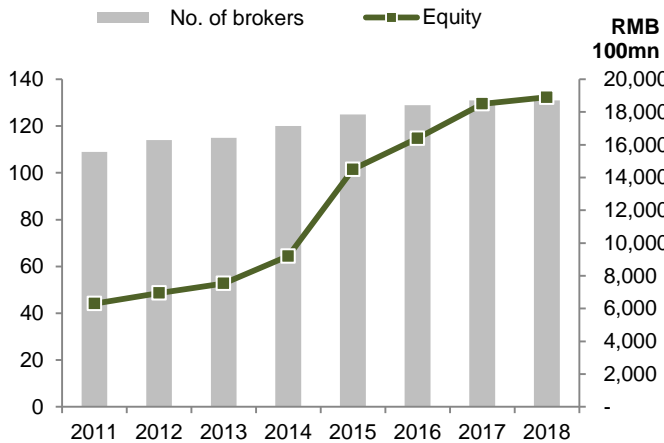
Source(s): Asset Management Association of China, ABCI Securities

The PRC funds market has undergone significant growth in recent years, supported by evolving regulatory environment and accumulation of personal wealth. According to the Asset Management Association of China statistics, there were 74,642 private fund products and 24,448 private fund managers registered as of Dec 2018. AUM of mutual funds and private securities investment funds surged at 30.2% and 48.2% CAGRs over 2014-18.

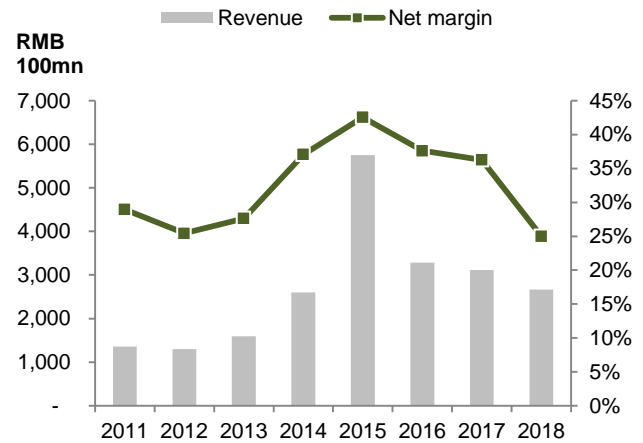
### Size and profitability are rising

According to SAC, there were 131 securities firms in China at end-2018. Overall, the industry's total net asset rose from RMB 0.63tr in 2011 to RMB 1.89tr in 2018, indicating an ongoing industry growth. In addition, industry total assets increased

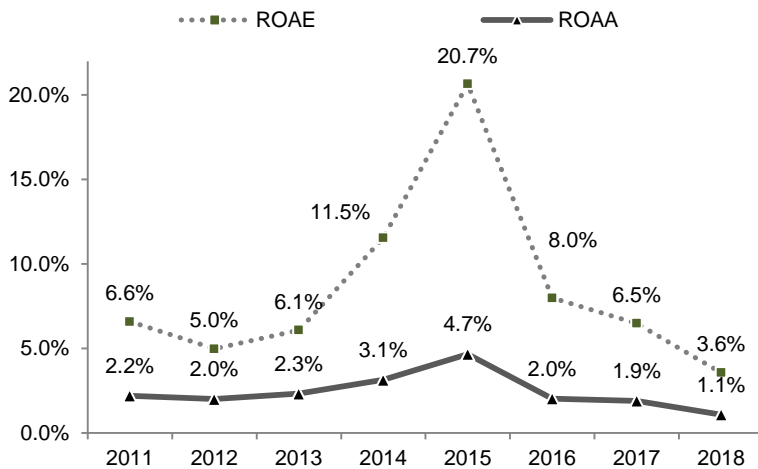
from RMB 15.7tr in 2011 to RMB 62.6tr in 2018. Industry revenue increased from RMB 0.14tr in 2011 to RMB 0.26tr in 2018.

**Exhibit 13: No. of securities firms (LHS) and net asset (RHS)**


Source(s): SAC, ABCI Securities

**Exhibit 14: Revenue (LHS) and margin (RHS)**


Source(s): SAC, ABCI Securities

**Exhibit 15: ROAE and ROAA trends**


Source(s): SAC, ABCI Securities

### Investment banking business – the rise of direct financing

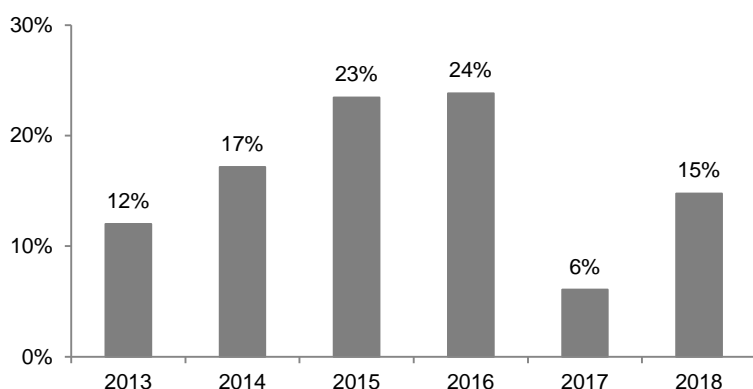
In our view, the investment banking segment is set to benefit from the government's commitment on industry reform via developing direct financing in the capital markets. Such goals have been outlined in the 13<sup>th</sup> FYP (2016-20).

Overall, the government will increase the contribution of direct financing in the economy through the development of a diverse, multi-layered capital market. It also aims to promote product innovations such as high-yield bonds, hybrid financing, and more. In our view, such developments will be supportive to the investment banking business.

Overall, direct financing (including net corporate bond financing and domestic equity financing from non-financial institutions) accounted for 24% of aggregate financing in the economy in 2016, up from 17% in 2014. In 2017, direct financing only accounted for 6% of aggregate financing due to tightened regulations in the bond market. The situation has since then improved in 2018, with direct financing/aggregate financing ratio rebounding to 15% accordingly. Still, compared to the US's ratio at 50%, direct financing still has room for growth in China.

Looking forward, we believe the share of direct financing in total aggregate financing will continue to rise. This should bode well for equity and bond underwriting business.

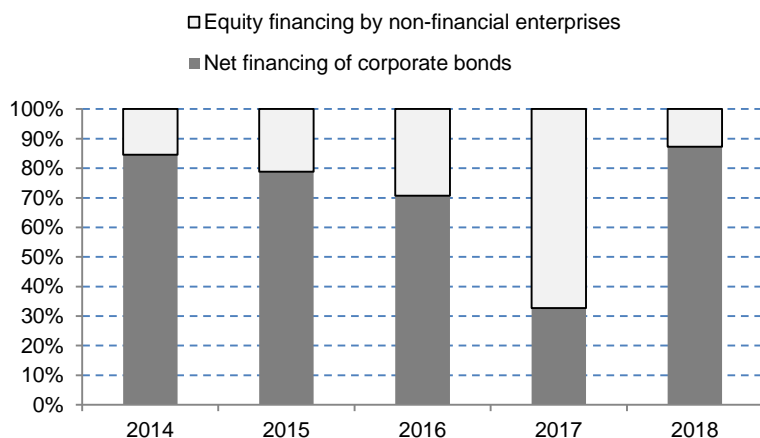
**Exhibit 16: Direct financing as a percentage of aggregate financing in the economy**



Source(s): PBOC, ABCI Securities

Within direct financing, debt financing generally accounted over 70% of the total amount while equity financing only contributed to a small proportion. The only exception was in 2017 when the corporate bond issuance market experienced a downturn.

**Exhibit 17: Direct financing – bonds vs. equity**



Source(s): PBOC, ABCI Securities



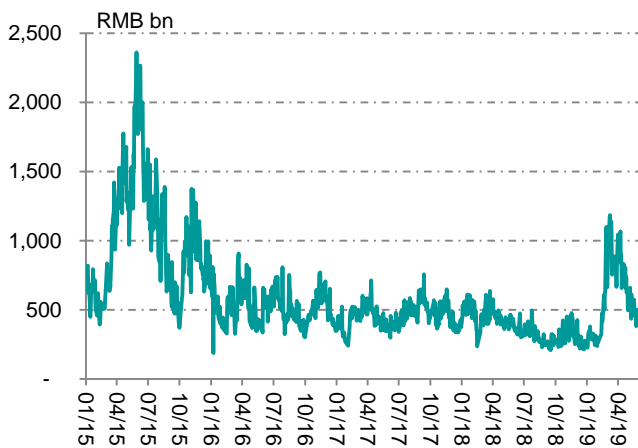


### Trading volume in the A-share market moderates

A-share monthly ADT has improved significantly from RMB 266bn in Dec 2018 to RMB 898bn in Apr 2019. Margin financing and securities lending (MFSL) balance increased from ~RMB 0.76tr at end-2018 to ~RMB 0.97tr at end-Apr. The momentum, however, has waned since May 2019 as the Sino-US trade dispute escalates. As a result, monthly ADT fell to RMB 496bn and MFSL balance dropped to RMB 0.94tr at end-May.

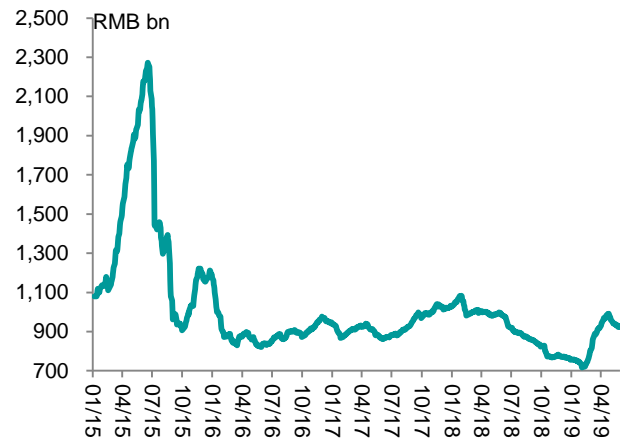
Since uncertainties surrounding trade war remains, it is our belief that market sentiment would continue to moderate in the near term.

Exhibit 18: A-share ADT



Source(s): Bloomberg, ABCI Securities

Exhibit 19: MFSL balance



Source(s): Bloomberg, ABCI Securities

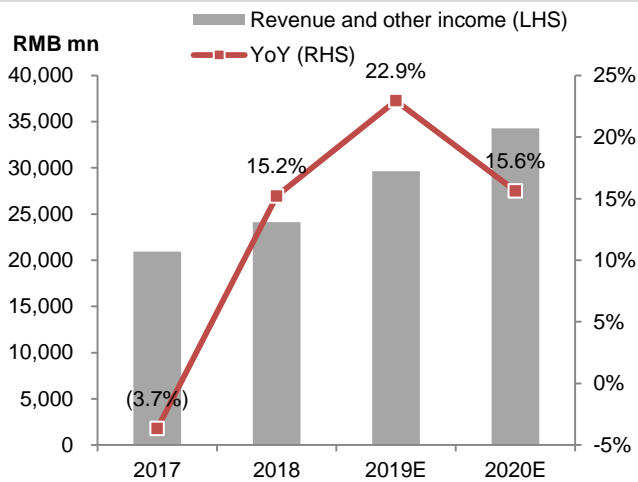
## Financial outlook

For 2019E-20E, we expect total revenue and other income to grow by 23% YoY and 16%, riven by improving operating environment.

In terms of key assumptions, we expect the Group's ADT to increase by 50% YoY and 25% YoY in 2019E and 2020E. We also expect the Group's MFSL balance to increase by 20% YoY and 18% YoY in 2019E and 2020E.

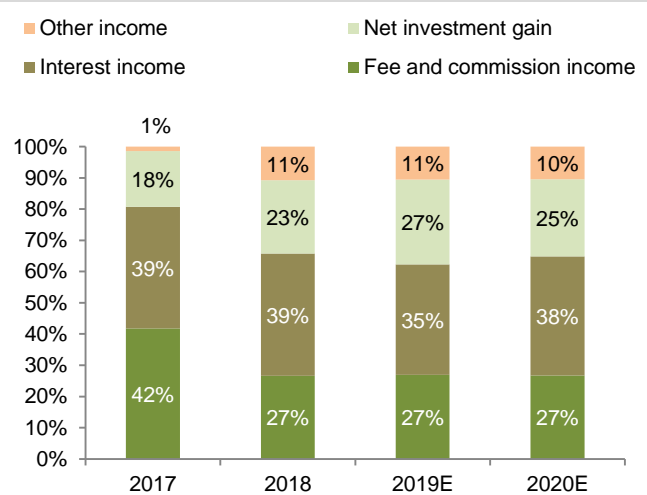
In 2018, interest income accounted for 39% of total revenue and other income, followed by fee and commission income (27%), net investment gain (23%), and other income (11%). We expect the revenue mix to remain largely stable in 2019E and 2020E.

**Exhibit 20: Revenue outlook**



Source(s): Company, ABCI Securities estimates

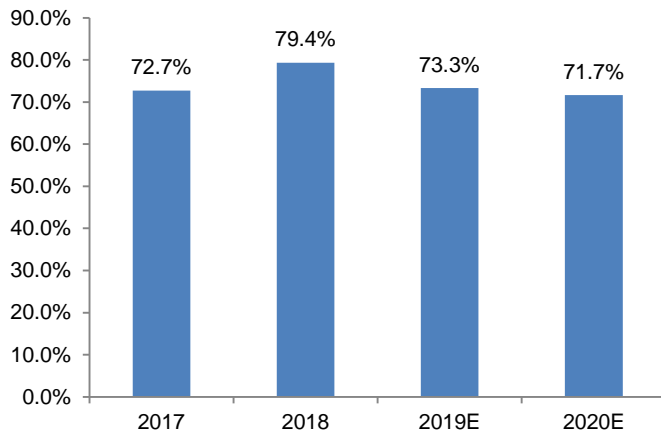
**Exhibit 21: Revenue mix trend**



Source(s): Company, ABCI Securities estimates

On the cost front, we expect operating cost-to-income ratio to improve in 2019E-20E on better economies of scale, potential optimization of capital structure (driven by recent regulatory approval to issue up to RMB19.1bn of short-term commercial paper), and potential write-back of provisions given the recent rebound in A-share stock market.

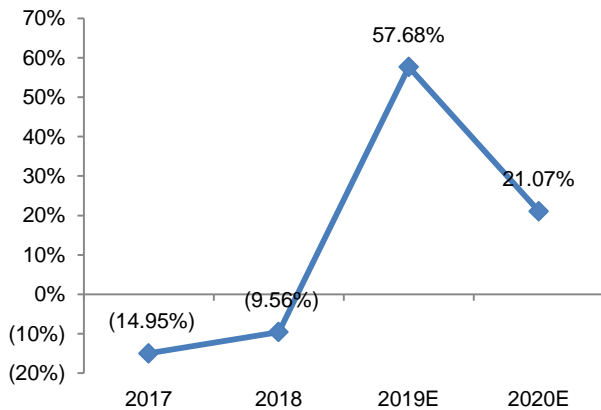
**Exhibit 22: Operating cost/revenue**



Source(s): Company, ABCI Securities estimates

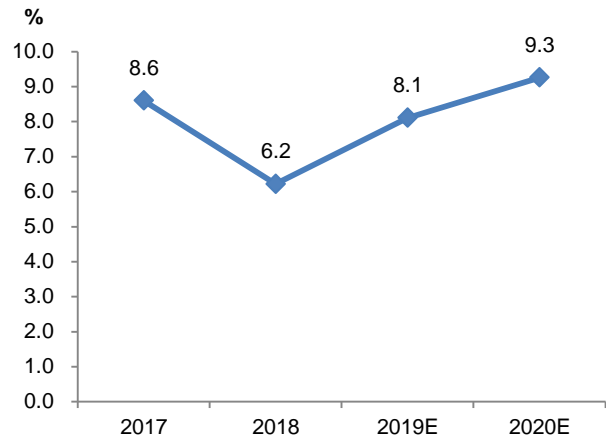
Overall, we expect net profits to ordinary shareholders to rise by 58% and 21% in 2019E and 2020E, representing an ROAE of 8.1% and 9.3%.

**Exhibit 23: Net profits growth outlook**



Source(s): Company, ABCI Securities estimates

**Exhibit 24: ROAE outlook**



Source(s): Company, ABCI Securities estimates

## Valuation

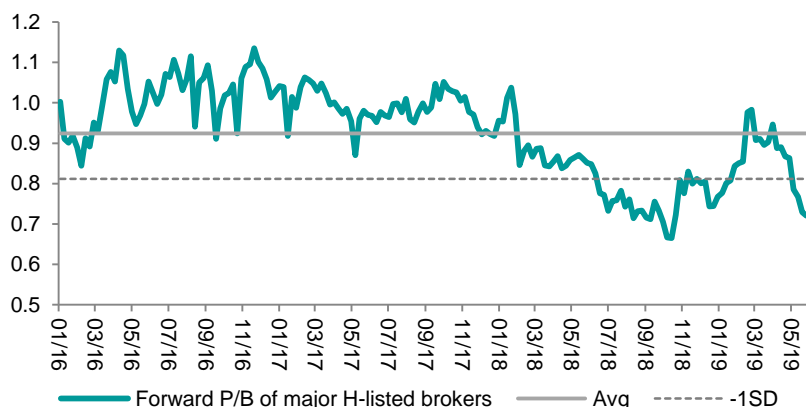
Hong Kong-listed PRC national securities companies are currently trading at an average of 0.75x 2019E P/B and 9.9x 2019E P/E; A-share peers are trading at an average of 1.41x 2019E P/B and 21.3x 2019E P/E.

In our view, the higher valuation in the A-share market may reflect differences in investor structure between the A-share and H-share markets, with the former being dominated by retail investors and the latter by institutional investors.

Overall, sector valuation has been volatile in the past given the cyclical nature of the industry. E.g., major H-listed securities firms once traded at about 1.1x fwd P/B in 2016 but fell to 0.7x fwd P/B in late 2018 during the market correction.

In our view, sector valuation could potentially improve in the future if overall market sentiment improves.

**Exhibit 25: Historical valuation of major H-listed securities firms**



\*Average of CITIC (6030 HK), Galaxy (6881 HK), GTJN (2611 HK), Huatai (6886 HK), GF (1776 HK), CMS (6099 HK), Everbright (6178 HK), DFZQ (3958 HK), CICC (3908 HK), and CSC (6066 HK)

Source(s): Bloomberg, ABCI Securities

## Valuation

Based on the Gordon Growth Model (GGM), a widely adopted valuation method for securities companies, we value the counter at HK\$2.87-HK\$4.41, equivalent to 0.71x-1.09x 2020E P/B. We set our TP to HK\$3.65, approximately at the mid-point of the valuation range.

**Gordon Growth Model assumptions**

Our assumptions are as follows:

- Long-term ROAE of 12.3% (average of the company's historical ROAE and our ROAE forecast)
- A cost of equity of 12.3%
- A risk-free rate of 3.3% (10-year Chinese government bond)
- An equity beta of 1.0 (with reference to listed securities companies and SWHY's A-share)
- An equity risk premium of 8.5%-11.5% (reference to listed securities companies and SWHY's A-share)
- A long-term growth of 6.25%

**Exhibit 26: Peer comparison table**

Ticker	Name	Share price (local)	2019 PER (x)	2019 P/B (x)	2020 PER (x)	2020 P/B (x)
<b>HK-listed China securities companies</b>						
6030 HK Equity	CITIC SEC-H	14.28	10.80	0.92	9.94	0.87
2611 HK Equity	GUOTAI JUNAN S-H	13.38	11.02	0.84	9.99	0.78
6806 HK Equity	SHENWAN HONGYU-H	3.06	10.36	0.82	8.42	0.75
6886 HK Equity	HUATAI SECURIT-H	12.42	10.71	0.81	9.61	0.76
1776 HK Equity	GF SECURITIES-H	8.94	8.67	0.65	7.74	0.60
6881 HK Equity	CGS-H	4.21	8.66	0.53	8.37	0.51
6099 HK Equity	CHINA MERCHANT-H	9.09	9.60	0.73	8.88	0.69
6178 HK Equity	EVERBRIGHT SEC-H	6.28	10.28	0.52	9.06	0.49
3958 HK Equity	DFZQ-H	4.98	9.83	0.54	9.33	0.52
3908 HK Equity	CHINA INTERNAT-H	14.24	11.55	1.16	9.74	1.06
6066 HK Equity	CSC FINANCIAL-H	5.56	8.05	0.79	7.60	0.73
<b>Average</b>			<b>9.90</b>	<b>0.75</b>	<b>8.94</b>	<b>0.70</b>
<b>China-listed China securities companies</b>						
600030 CH Equity	CITIC SECURITI-A	20.13	17.52	1.48	15.70	1.38
601211 CH Equity	GUOTAI JUNAN S-A	16.07	14.20	1.10	12.80	1.03
000166 CH Equity	SHENWAN HONGYU-A	4.72	18.15	1.43	16.28	1.31
601881 CH Equity	CHINA GALAXY-A	10.13	25.14	1.46	23.95	1.38
600999 CH Equity	CHINA MERCHANT-A	15.46	17.81	1.40	16.14	1.32
600958 CH Equity	ORIENT SECURIT-A	10.25	26.08	1.31	23.62	1.25
601688 CH Equity	HUATAI SECURIT-A	18.63	18.72	1.38	17.14	1.30
000776 CH Equity	GF SECURITIES-A	12.97	14.38	1.07	12.58	1.01
601901 CH Equity	FOUNDER SECURIT-A	7.17	35.85	1.53	35.85	1.46
601066 CH Equity	CSC FINANCIAL -A	23.00	45.28	3.60	39.66	3.31
601788 CH Equity	EVERBRIG SEC -A	11.15	19.80	1.04	17.70	0.99
601377 CH Equity	INDUSTRIAL-A	6.18	18.45	1.13	15.85	1.04
000783 CH Equity	CHANGJIANG SEC-A	7.15	20.78	1.40	18.72	1.33
600369 CH Equity	SOUTHWEST SEC-U-A	4.66	46.60	1.37	23.30	1.33
000728 CH Equity	GUOYUAN SECURIT-A	9.20	1.21	1.23	23.00	1.18
000686 CH Equity	NORTHEAST SEC-U-A	8.57	12.79	1.09	11.43	0.98
<b>Average</b>			<b>21.30</b>	<b>1.41</b>	<b>19.33</b>	<b>1.32</b>

Notes: Closing price as at May 31, 2019

Source(s): Bloomberg, ABCI Securities



## Risk factors

### Market and economic risk

As a comprehensive financial service provider, SWHY's businesses are highly sensitive to changes in China's financial markets. As a substantial portion of SWHY's revenue was derived from the China securities market, risks associated to securities markets such as volatility, fluctuation, trading volume, investor confidence, as well as general economic and political conditions could result in fluctuations in SWHY's profitability.

### Policy risk

Financial performance of SWHY could be largely affected by the changes of policy environment. Generally speaking, financial service is a highly regulated business subjected to numerous laws and regulation. In addition, potential business development overseas may expose SWHY to global policy risk.

### Investment risk

The Group's exposure to credit risk mainly comes from debt investments under its principal investment business, with financial instruments such as asset management schemes and trust schemes. As of Dec 2018, total outstanding balance of its debt investment was RMB 11,158.9mn, which accounted for 82.5% of its total outstanding amount of principal investment.

### Interest rate risk

With substantial business exposure in debt investments and interest rate sensitive business lines, such as MFSL, stock-backed lending, stock repurchases, financial assets held under resale agreements, and leveraged financing. Volatility in interest rates could affect the Group's operations and financial results.

### Competition risk

In light of intensifying competition in the China securities market, SWHY has lowered its brokerage commission rate and interest fee rate for MFSL business in past years to gain market share. With the rise of online brokerage services, further decline in brokerage commission could be expected, which may adversely affect SWHY's profitability.

### Asset quality risk

Several business lines such as MFSL and stock-backed lending business expose SWHY to customer default risk. Even with sufficient collaterals, failure to liquidate client position in a timely manner could lead to profitability and liquidity risks.

### Redemption risk

In view of SWHY's growth asset management business, market factor or poor investment performance could trigger redemption risk and a significant decline in AUM. This could affect SWHY's fee-based income source in relation to AUM.

### Currency risk

With the ambition to expand its footprint globally, SWHY would expose to higher foreign currency risk when contribution of overseas operations increases.



## Financial forecasts

### Consolidated income statement (FY16A-FY20E)

FY Ended Dec 31 (RMB mn)	FY16A	FY17A	FY18A	FY19E	FY20E
Fee and commission income	11,554	8,748	6,419	7,992	9,146
Interest income	7,255	8,139	9,451	10,469	13,089
Investment income	2,672	3,750	5,645	8,066	8,457
<b>Total revenue</b>	<b>21,481</b>	<b>20,637</b>	<b>21,515</b>	<b>26,527</b>	<b>30,692</b>
Other income	238	287	2,595	3,114	3,581
<b>Total revenue and other income</b>	<b>21,719</b>	<b>20,925</b>	<b>24,110</b>	<b>29,640</b>	<b>34,273</b>
<b>Total expenses</b>	<b>15,545</b>	<b>15,220</b>	<b>19,134</b>	<b>21,726</b>	<b>24,563</b>
<b>Operating Profits</b>	<b>6,174</b>	<b>5,704</b>	<b>4,976</b>	<b>7,914</b>	<b>9,709</b>
Share of profit of associates and JVs	212	223	212	254	305
<b>Profit before tax</b>	<b>6,385</b>	<b>5,928</b>	<b>5,187</b>	<b>8,168</b>	<b>10,014</b>
Tax	857	1,202	940	1,470	1,903
<b>Profit after tax</b>	<b>5,528</b>	<b>4,726</b>	<b>4,248</b>	<b>6,698</b>	<b>8,111</b>
Minority interests	119	126	88	138	169
<b>Profits attributable to shareholders</b>	<b>5,409</b>	<b>4,600</b>	<b>4,160</b>	<b>6,560</b>	<b>7,942</b>
<b>Growth</b>					
Total revenue and other income		-4%	15%	23%	16%
Total expenses		-2%	26%	14%	13%
Operating Profits		-8%	-13%	59%	23%
Net profit		-15%	-10%	58%	21%
<b>Operating performance</b>					
Operating margin (%)	28.4	27.3	20.6	26.7	28.3
Net margin (%)	25.4	22.6	19.3	24.7	25.9
ROAE (%)	10.6	8.6	6.2	8.1	9.3
ROAA (%)	3.9	1.6	1.3	1.8	2.0

Notes: Individual items may not sum to total due to rounding differences

Individual items may vary from reported figures due to rounding differences/ definition differences

Source(s): Company, ABCI Securities estimates



Consolidated balance sheet (FY16A-FY20E)

As of Dec 31 (RMB mn)	FY16A	FY17A	FY18A	FY19E	FY20E
Fixed assets	1,505	1,481	1,441	1,513	1,543
Other intangible assets	117	142	149	156	159
Investment in associates	974	1,871	2,399	2,519	2,569
Financial assets	19,059	17,865	18,246	20,071	22,078
Financial assets held under resale agreements	3,375	10,483	20,993	24,142	26,556
Other non-current assets	8,028	7,853	7,808	8,199	8,363
<b>Total non-current assets</b>	<b>33,057</b>	<b>39,695</b>	<b>51,036</b>	<b>56,599</b>	<b>61,268</b>
Cash & equivalents	23,260	22,375	25,286	21,533	18,299
Clearing settlement funds	1,706	2,590	3,091	3,246	3,408
Cash on behalf of brokerage clients	86,597	62,007	57,522	60,398	63,418
Financial assets	56,472	78,485	116,336	123,475	131,103
Derivatives	6	7	454	477	500
Account receivables	1,467	1,525	1,238	1,299	1,325
Other receivables and prepayments	2,698	3,950	4,569	4,797	4,893
Margin accounts receivables	55,869	55,739	43,107	51,728	61,039
Financial assets held under resale agreements	14,357	33,571	45,087	51,850	57,035
<b>Total current assets</b>	<b>242,432</b>	<b>260,248</b>	<b>296,689</b>	<b>318,803</b>	<b>341,021</b>
<b>Total assets</b>	<b>275,488</b>	<b>299,943</b>	<b>347,725</b>	<b>375,402</b>	<b>402,289</b>
Accounts payable	89,704	63,629	60,271	63,284	66,448
Loans and bonds	9,421	33,874	36,269	38,082	41,853
Placements from banks and other financial institutions	3,000	7,900	11,619	12,200	13,420
Other current liabilities	56,207	76,497	96,058	100,857	105,895
<b>Total current liabilities</b>	<b>158,333</b>	<b>181,900</b>	<b>204,216</b>	<b>214,423</b>	<b>227,616</b>
Loans and bonds	56,676	49,796	66,219	69,530	76,483
Other non-current liabilities	6,407	11,241	6,095	6,333	6,583
<b>Total non-current liabilities</b>	<b>63,083</b>	<b>61,037</b>	<b>72,314</b>	<b>75,863</b>	<b>83,066</b>
<b>Total liabilities</b>	<b>221,415</b>	<b>242,937</b>	<b>276,531</b>	<b>290,286</b>	<b>310,682</b>
<b>Net current assets</b>	<b>84,099</b>	<b>78,348</b>	<b>92,472</b>	<b>104,380</b>	<b>113,405</b>
Equity attributable to shareholders	52,305	55,197	69,399	82,637	88,939
Non-controlling interests	1,768	1,809	1,797	2,479	2,668
<b>Total equity</b>	<b>54,073</b>	<b>57,006</b>	<b>71,196</b>	<b>85,116</b>	<b>91,607</b>

Notes: Individual items may not sum to total due to rounding differences

Individual items may vary from reported figures due to rounding differences/definition differences

Source(s): Company, ABCI Securities estimates





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### Definition of equity rating

Rating	Definition
Buy	Stock return rate $\geq$ Market return rate (10%)
Hold	- Market return rate (-10%) $\leq$ Stock return rate < Market return rate (+10%)
Sell	Stock return < - Market return (-10%)

Notes: Stock return rate: expected percentage change of share price plus gross dividend yield over the next 12 months

Market return rate: average market return rate since 2005 (HSI total return index 2005-17 CAGR at 10%)

Time horizon of share price target: 12-month

Stock rating, however, may vary from the stated framework due to factors including but not limited to: corporate governance, market capitalization, historical price volatility relative to corresponding benchmark index, average daily turnover of the stock relative to market capitalization of the stock, competitive advantages in corresponding industry, etc.

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