China / Hong Kong Company Update

China International Capital Corp

Bloomberg: 3908 HK Equity | Reuters: 3908.HK

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DBS Group Research . Equity

1 Nov 2023

BUY

Last Traded Price (31 Oct 2023): HK$12.46 (HSI : 17,112)
Price Target 12-mth: HK$18.50 (48% upside) (Prev HK$21.50)

Analysts

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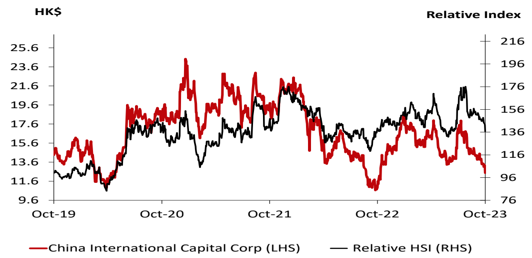
What's New

- 3Q23 profit to shareholders -52% y-o-y; earnings miss due to weak IPO and equity trading income amid lacklustre sentiment
- Senior management succession issue may drag strategic changes in near term, but impact should be manageable
- Revise down FY23F/24F earnings by 47%/45%, respectively, to reflect the slower-than-expected IPO recovery and fierce competition in equity derivatives
- Negatives largely in price, suggest buying on pullback to position for potential market rebound. Maintain BUY with lower TP of HK$18.5

Price Relative



Forecasts and Valuation

FY Dec (RMBm)	2022A	2023F	2024F	2025F
Total Revenue	37,398	36,233	39,794	44,832
Total Expense	(28,339)	(29,057)	(30,596)	(33,990)
Pre-tax Profit	9,056	7,207	9,249	10,893
Net Profit	7,045	5,370	7,076	8,449
EPS (RMB)	1.46	1.11	1.47	1.75
EPS (HK$)	1.56	1.19	1.57	1.87
EPS Gth (%)	(32.4)	(23.8)	31.8	19.4
DPS (HK$)	0.19	0.15	0.20	0.24
BV Per Share (HK$)	18.34	19.52	21.02	22.80
PE (X)	8.0	10.5	7.9	6.7
Net Div Yield (%)	1.5	1.2	1.6	2.0
P/Book Value (X)	0.7	0.6	0.6	0.5
ROAE(%)	8.9	6.3	7.7	8.5
Earnings Rev (%):		(47)	(45)	New
Consensus EPS (RMB)		1.59	1.91	2.28
Other Broker Recs:		B:18	S:1	H:1

Source of all data on this page: Company, DBS Bank (Hong Kong) Limited ("DBS HK"), Thomson Reuters

Beta play to catch market turning point

Investment Thesis

Strong sponsorship to stand out. CICC has been one of the top sponsors of the majority of the largest Chinese companies' IPOs, which is also synergistic to its institutional and private wealth businesses. While the weak market sentiment and the temporary tightening of its A-share IPO have weighed on its near-term earnings, the long-term prospects are intact, for which we remain positive. CICC should benefit from the market consolidation and expected IPO volume growth driven by the registration reforms.

Key beneficiary of market normalisation. We have revised down its FY23F/24F earnings by 47%/45% to reflect the slower-than-expected IPO recovery and lower return from equity trading. Yet, we think underperformance is in the price and is more a business mix issue, while it has indeed retained its edge in key businesses. We expect a strong FY24F/25F earnings rebound, at 32%/19% y-o-y, respectively, driven by the monetisation of the pent-up IPO pipeline and higher equity trading income, as the market is expected to normalise from the distressed level.

High-beta play to catch the market turning point. Along with the gradually improving economic data points, the recent step up in the efforts of policymakers to source new funds for the equity market from the "national team" and insurers could be the effective "fuel" needed to trigger a meaningful market rebound. We think CICC would benefit from it the most, from both a fundamental and fund-flow perspective.

Maintain BUY and lower TP to HK$18.5 (vs. HK$21.5 previously). Our TP is based on 0.8x FY24F P/B, slightly below its past five-year average of 0.9x, to reflect the lower ROE expectations in the near term due to the prolonged weak sentiment. We see good risk-reward from the current valuation of 0.5x FY24F PB, or near 2SD below its past five-year mean.

Key Risks

A substantial slowdown in China's economy, meaningful contraction in market liquidity, noticeable share price drop in the A/H-share market, and implementation of restrictive market policies.

At A Glance

Issued Capital (m shrs)	4,827
Mkt Cap (HKm/US$m)	60,144 / 7,687
Major Shareholders (%)	
Tencent Holdings Ltd	11.4
Alibaba Group Holding Ltd.	10.7
Free Float (%)	78.0
3m Avg. Daily Val. (US$m)	24.2
GICS Industry: Financials / Diversified Financials	

ed- BM / sa- CS /JY

WHAT'S NEW

3Q23 earnings miss

3Q23 profit to shareholders was down 52% y-o-y to Rmb1,047m, below market expectations. We think the miss was mostly due to the weak market sentiment despite the policy support since late Jul 2023. It affected CICC in the following ways:

(1) Net investment banking fees fell 68% y-o-y to Rmb631m due to weak IPO volume – while a decline was expected, the magnitude exceeded the A-share market's 35% y-o-y decline, as CICC's large deals were put on hold by regulators to avoid a market overhang.

(2) 9M23 net investment income still fell behind the expected run rate, despite a q-o-q improvement in 3Q23, as equity derivatives trading income was dragged by (i) weaker client demand, (ii) narrower spread amid fierce competition, and (iii) substantially lower market volatility y-o-y as investors stayed on the sidelines (9M23 SSE volatility at 11.9%, -6.5ppt y-o-y).

(3) Leverage ratio further contracted q-o-q, from 5.47x in Jun 2023 to 5.30x in Sep 2023, as the company further trimmed its offshore capital allocation to its more profitable offshore businesses amid heightened geopolitical risks for prudency.

We think the underperformance was largely a result of a business mix issue, as CICC earns a high revenue contribution from IB and equity trading, which are more sensitive to market sentiment. Yet, it has retained its edge in IPO sponsorship and cross-border derivatives. For instance, it led the HK IPO sponsorship with a 23% market share in 9M23. It is also the co-sponsor of the two mega A-share IPO pipeline deals with a total proposed amount of Rmb95bn, which was only put on hold due to sentiment. It also managed to grow its volume of cross-border derivatives by a double-digit rate YTD, despite the broadly weak investment appetite towards China.

Senior management succession issue manageable

CICC's CFO resigned in Sep due to personal reasons, and its CEO also retired early in Oct. Wu Bo, the prior president of CICC Wealth Management and head of equities, first took over the CFO role, and subsequently became the interim CEO as well. He has been with CICC for almost 20 years and held multiple roles in the brokerage firm, including investment banking divisions. He became part of the management committee in Apr 2018.

Considering Wu's wealth of experience in CICC, we see a minimal impact to daily operations. Notably, he has successfully integrated CICC WM post-acquisition and grown the retail/PWM client base, which has effectively diversified CICC's income streams. While this situation could drag strategic decision-making, if any, until the permanent choice of CEO is confirmed, we think the impact should be manageable, as we don't see any structurally inefficient businesses in CICC now.

Chen Liang, who recently resigned from China Galaxy's (6881 HK, NR) chairman role, is set to take over as the company's chairman from Shen Rujun, who would remain as the president of Central Huijin. We view this more as a rotation of job duties among Central Huijin Investment, the country's sovereign wealth funds that controls both brokerage firms, and therefore expect limited impact.

FY23F/24F earnings revised down

Considering (1) that the IPO volumes in both the A and H-markets have not recovered as expected and the reversal is likely be more gradual in view of the weak investor sentiment and the higher-for-longer offshore interest rate; (2) there is a drag on the return from equity derivatives due to fierce competition; and (3) the y-o-y ADT decline, which is faced by every broker, we have lowered FY23F/24F earnings by 47%/45% to Rmb5.4bn/7.1bn, respectively. We expect to see a meaningful earnings rebound amid normalising market activity, with FY25F earnings to reach Rmb8.4bn.

Maintain BUY with lower TP of HK$18.5

Our TP is based on 0.8x FY24F P/B, slightly lower than the previous multiple of 0.9x (also past five-year average), to reflect the lower near-term ROE expectations in view of the prolonged weak sentiment.

We think the 3Q23 underperformance is largely in the price, as the counter has corrected by c.30% from the peak in August, including the 6% daily drop after the 3Q23 results announcement. After all, the company has retained its leading position in key businesses. Despite the earnings swing from its more cyclical business portfolios, it still has one of the most sophisticated and prudent risk management systems, which could keep its capital relatively safe from downside risks in case of black swan events.

As such, we remain positive on the company's long-term prospects, and believe the benefits from having a leading IB franchise will be further unleashed as the market normalises. While the potential structural growth brought about by the policymakers may take more time to materialise, we think the current valuation (0.5x FY24F P/B, near 2SD below the five-year average) would also offer attractive risk-reward to bet on a market rebound. CICC would likely benefit from it the most among names in the sector, per observations of previous market rallies, as its business is more sensitive to sentiment and it has been the top-of-mind Chinese broker among foreign investors.

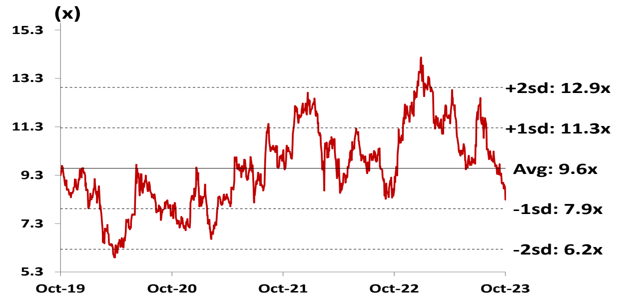
We also think the market rebound could happen anytime soon, as China's economic data has been turning more positive, and we see policymakers also taking the opportunity lately to bring new funds to the market, including Central Huijin's decision to buy a broad-based market ETFs and insurers' adjusted KPI system that incentivises high equity allocation.

Company Background

CICC was established in 1995 and was first listed on the HKEx in 2015. CICC is the first joint venture investment bank in China and has established a full-service business model offering investment banking, equities, FICC, wealth management, and investment management. As of FY22, its total assets and equity reached RMB649bn and RMB99bn, respectively.

Historical PE and PB band

Forward PE band (x)



PB band (x)

Source: Thomson Reuters, DBS HK

Key Assumptions

FY Dec	2021A	2022A	2023F	2024F	2025F
Annual trading volume (Rmb bn)	18,166.7	15,638.6	15,562.5	17,636.4	19,969.5
Brokerage commission rate (bps)	4.5	4.3	4.2	4.2	4.1
Annual underwriting amount (Rmb bn)	1,973.9	1,959.5	1,622.7	1,835.9	2,125.1
Annual asset management AUM (Rmb bn)	1,541.4	1,176.8	1,240.0	1,393.9	1,572.1
Margin trade outstanding (Rmb bn)	37,804.6	30,284.8	33,389.0	35,058.4	36,811.3
Cost to income ratio (%)	68.7	75.8	80.2	76.9	75.8
No. of staff	13,557.0	15,168.0	15,168.0	15,168.0	15,926.4
Cost per staff (RMB)	1,159,563.5	829,066.9	746,160.2	752,037.6	819,731.3

Source: Company, DBS HK

Income Statement (RMB m)

FY Dec	2021A	2022A	2023F	2024F	2025F
Fee and commission	19,481	18,063	15,884	18,599	21,211
Interest income	7,277	8,153	7,961	8,163	8,619
Investment income	14,703	10,608	10,205	12,849	14,819
Other income	(497)	574	2,182	183	183
Total Revenue	40,964	37,398	36,233	39,794	44,832
Total Expense	(28,134)	(28,339)	(29,057)	(30,596)	(33,990)
Expected credit losses	408	21	(31)	(31)	(29)
Operating Profit	12,830	9,059	7,176	9,198	10,843
Associates & JV Inc	148	(3)	30	51	51
Pre-tax Profit	12,978	9,056	7,207	9,249	10,893
Tax	(2,168)	(1,461)	(1,189)	(1,526)	(1,797)
Minority Interest	(32)	3	2	3	3
Net Profit	10,423	7,045	5,370	7,076	8,449
Growth					
Revenue Gth (%)	26.4	(8.7)	(3.1)	9.8	12.7
Opg Profit Gth (%)	46.7	(29.4)	(20.8)	28.2	17.9
Net Profit Gth (%)	46.7	(32.4)	(23.8)	31.8	19.4
Du Pont analysis (%)					
Net Profit/Total Revenue	25.4	18.8	14.8	17.8	18.8
Total Revenue/Total Asset	7.0	5.8	5.6	5.9	6.1
Total Asset/Total equity	766.9	652.2	620.0	627.1	645.3
ROAE (%)	14.6	8.9	6.3	7.7	8.5
Per share analysis					
EPS (RMB)	2.16	1.46	1.11	1.47	1.75
BPS (RMB)	15.73	17.15	18.25	19.66	21.32
DPS (RMB)	0.30	0.18	0.14	0.19	0.23

Source: Company, DBS HK

Balance Sheet (RMB m)

FY Dec	2021A	2022A	2023F	2024F	2025F
Cash and Cash Equivalent	66,143	85,789	72,921	72,921	80,213
Cash Held on Behalf of Customers	91,037	83,017	70,564	70,564	77,621
Reverse Repurchase	25,858	27,136	24,422	26,864	29,551
Financial Assets	358,748	353,878	380,863	422,615	469,862
Margin Account	39,479	31,626	34,868	36,611	38,442
Other Assets	68,529	67,318	66,017	69,994	75,621
Total Assets	649,795	648,764	649,655	699,570	771,309
Customer Brokerage Deposit	91,037	83,017	70,564	70,564	77,621
Repo and Short-term	74,119	126,420	134,898	144,017	153,829
Long-term Debt and Loan	125,755	87,273	91,637	96,219	101,030
Other Liabilities	274,153	252,580	247,778	277,213	319,302
Total Liabilities	565,065	549,289	544,878	588,013	651,781
Shareholder's Equity	84,422	99,188	104,508	111,311	119,308
Minority Interests	309	287	269	247	220
Total Cap. & Liab.	649,795	648,764	649,655	699,570	771,309

Source: Company, DBS HK

Target Price & Ratings 12-mth History

S.No.	Date	Closing Price	Target Price	Rating
1	13-Dec-22	HK$15.32	HK$20.00	BUY
2	17-Apr-23	HK$16.90	HK$21.50	BUY

Source: DBS HK

Analyst: Ken Shih

Edmond Fok

DBS HK recommendations are based on an Absolute Total Return* Rating system, defined as follows:
STRONG BUY (>20% total return over the next 3 months, with identifiable share price catalysts within this time frame)
BUY (>15% total return over the next 12 months for small caps, >10% for large caps)
HOLD (-10% to +15% total return over the next 12 months for small caps, -10% to +10% for large caps)
FULLY VALUED (negative total return, i.e., > -10% over the next 12 months)
SELL (negative total return of > -20% over the next 3 months, with identifiable share price catalysts within this time frame)

**Share price appreciation + dividends*

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