

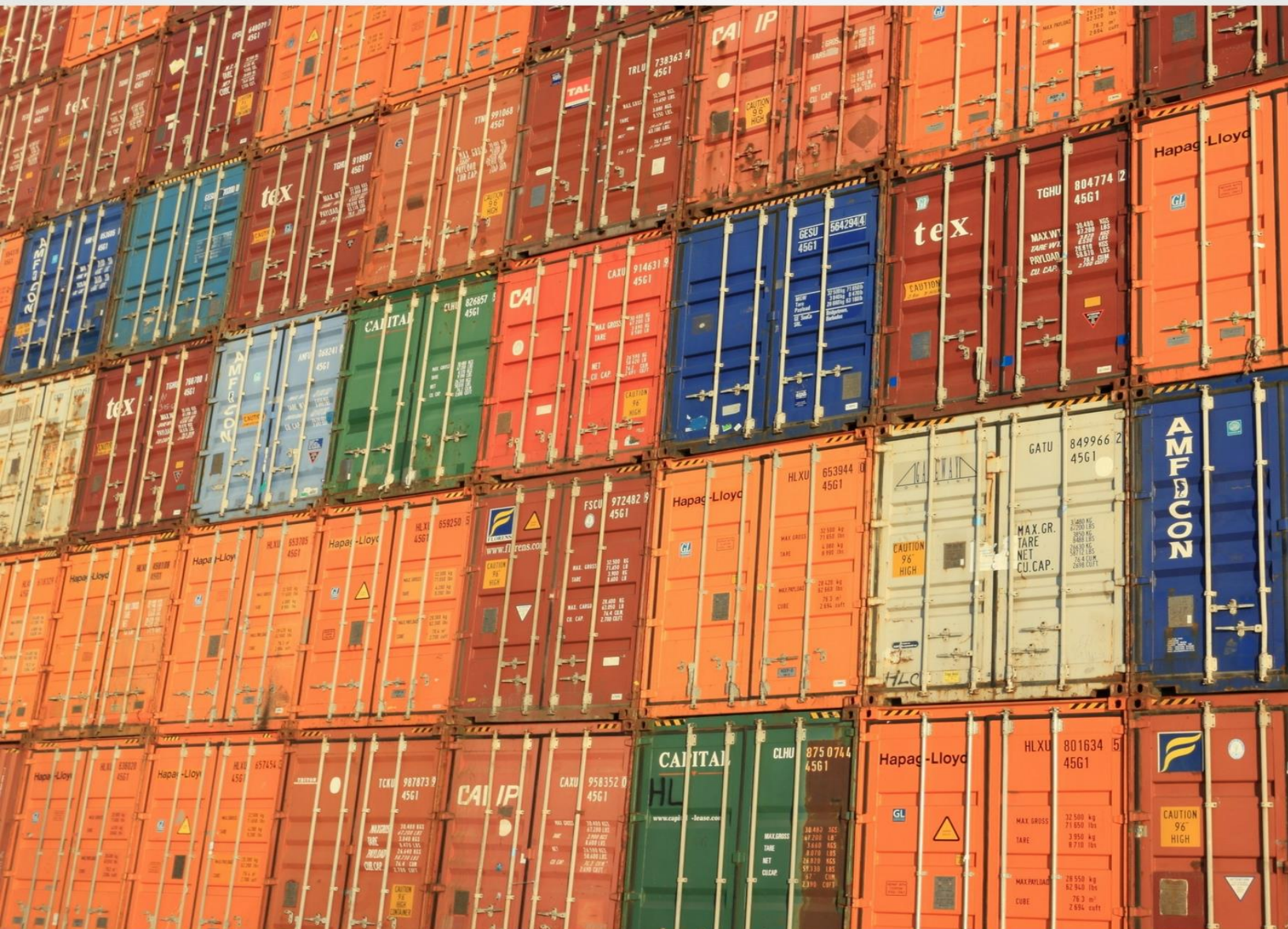


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ABC INTERNATIONAL

ABCI SECURITIES COMPANY LIMITED

Potential Development of the Sino-US Trade War and Its Impact on Industries



ABCI Securities Research

Apr 20, 2018



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Potential Development of the Sino-US Trade War and Its Impact on Industries

Macroeconomic View of the Sino-US Trade War

1. Overview of the Sino-US trade war

Since 2018, Sino-US trade friction has increased and two rounds of trade sanctions were enforced or proposed. The first round began with the imposition of tariffs on imports of steel and aluminum products by the US under the Section 232 plan; in retaliation, China announced 15% and 25% tariff increases on US\$ 3bn of US exports. Following that, the US announced a 25% tariff on US\$ 50bn of imports from China based on results of the Section 301 investigation; in return, China announced a 25% tariff on US\$ 500mn of imports from the US. The punitive tariffs announced in the first sanction have already come into effect, while tariffs on goods announced and detailed in the second sanction have yet to be imposed. On Apr 5, the US President Donald Trump issued a statement claiming that he had instructed the US Trade Representative's office to consider the appropriateness of imposing tariffs on an additional US\$100bn of imports from China based on the Section 301 investigation.

2. Multi-scenario analysis of the Sino-US trade war on China's macro economy

In 2017, China's exports to the US were RMB 2.91tr, while its total exports to the world were RMB 15.33tr. China's nominal GDP was RMB 82.71tr. In other words, its exports to the US accounted for 18.9% of total exports and 3.5% of nominal GDP. China's exports to the US mainly included electrical and mechanical products, furniture toys, textiles and raw materials, and base metals and products, which accounted for 75.5% of China's total exports to the US in 2017.

US exports to China in 2017 amounted to US\$ 130.4bn, while US's exports to the world were US\$ 1,546.8bn. US's nominal GDP was US\$ 19.39tr in 2017. Its exports to China accounted for 8.4% of exports and 0.67% of nominal GDP. US's exports to China were dominated by transportation equipment, mechanical and electrical products, plant products and chemicals, which jointly accounted for 61.9% of US's exports to China in 2017.

We have considered three possible trajectories of the Sino-China trade war in 2018. In the first scenario, the two countries will maintain the 15% and 25% tariff already in place on the US\$ 3bn of goods; in the second scenario, a 25% tariff will be imposed on the US\$ 50bn of goods announced but yet to be taxed; in the third scenario, a 25% tariff will be imposed on US\$ 150bn of goods. Assuming that the commodity price elasticity of Chinese exports to the US is neutral with a price elasticity coefficient of 1, China would reduce its merchandise exports to the US by ~US\$ 650mn, US\$ 12.5bn, and US\$ 37.5bn, respectively, in the three scenarios. The first scenario indicates minor impacts on China's overall exports and GDP growth in 2018. In the second and third scenarios, export growth rate would reduce by 5.5ppt and 16.5ppt, dragging down the GDP growth rate by 0.1ppt and 0.3ppt. Bear in mind that other than the US, China can also explore other export destinations. We believe the actual impact of the sanctions would be smaller than expected. China's macroeconomic situation would remain manageable even in the worst case scenario (third scenario).

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3. The underlying motives of the Sino-US trade war

Many believe that the US's enormous trade deficit with China has prompted the Trump administration to initiate the trade war. By imposing tariffs to limit imports from China, trade deficit would narrow. We, however, believe that there are two main reasons behind such provocation by the Trump administration. First, the trade war is launched to support the midterm elections this Nov in the US by appealing to the Republican voters. By ensuring the Republicans would hold a majority of seats in the House and the Senate, the current president would have a higher chance of being reelected. Second, the trade war is waged to hinder China's high-tech development and protect the intellectual property rights of the US companies. Of the 1,333 products released by US government in the Section 301 investigation, as much as 70% of the products are aimed at the "Made in China 2025" strategy. The US government has gone so far to include aircraft products that China has not started producing or exporting on a large scale in the tariff catalog. Lately, the US government has stepped up efforts to limit business activities of Chinese technology players **ZTE (763 HK)** and Huawei in the US.

4. Possible development of the Sino-US trade war

Recognizing the underlying motives of the trade war can help us forecast the potential development of the dispute. We believe winning the midterm elections is the priority of the Trump administration. Without reelection, President Trump will not be able to dent rising competitiveness. Trump's success in tax reform last year has won him a lot of support; to gain further backing, he would need to accentuate the "US priority" strategy on trade issues. In fact, the US has proposed tariffs on imports from many other countries including its allies. In our view, the possibility of a full-fledged and prolonged trade war is slim, although short-term tension between China and the US seems inevitable.

President Trump is likely to lose support from more voters should the trade war escalate further since it will be damaging to both China and the US. We see limited incentive for Trump to launch a major trade war, and China is certainly reluctant to engage in one. We believe the possible outcome is that the dispute will be resolved through negotiations and China will increase imports from the US. President Trump has announced that he is considering rejoining the Trans-Pacific Partnership Agreement (TPP), which the US withdrew shortly after he was elected president. Separately, earlier at the Boao Forum, President Xi Jinping has emphasized the significance of liberalizing market access, creating a more attractive investment environment, strengthening intellectual property rights protection, and proactively expanding imports. Special mentions were made to the considerable reduction of tariffs on motor vehicles and further opening-up of China's financial sector.

5. Timeline of the near future

The Sino-US trade tension will fluctuate in the near future. Below are the important dates that will be indicative of the development of the trade war: the 8th round of negotiations of the North American Free Trade Agreement (NAFTA) commenced on Apr 6, 2018; deadline for written submissions on May 11, 2018; public hearings on May 15, 2018; rebuttals to hearings on May 22, 2018; US midterm elections on Nov 6, 2018. We expect an agreement will be struck between the US and China as early as May or latest in Nov. To remark, US's tariffs on the proposed list of Chinese imports will only be enforced after relevant consultation procedures (i.e. public hearings and rebuttals to hearings) are completed.

Policy Snapshot

Analysis of risk premium in the stock market

The Sino-US trade war is one of the many risk factors affecting the stock market. While not isolated from other risks, the trade war will be mostly analyzed as one of the independent market risk factors in this report. From an investment perspective, it is important to compare the market risk premium at present with the historical level.

PRC stock market

Risk premium in the PRC stock market has fallen from 10.8% in March to 8.6% in mid-Apr. Risks have been already partially released by the downward correction in the market, in contrast to the high-risk sentiment perceived by investors at the moment. Since 2010, PRC's risk premium was averaged at 10.4% with an SD of 1.47%. Current risk premium is almost 2 SD below the historical average, illustrating that most risks have been reflected in the A-share market, including those pertain to the trade war. As such, we believe this is not a selling time; instead, investors should buy on dips.

US stock market

Despite the volatility observed in the US stock market, risk premium has been relatively stable. Risk premium in mid-Apr was averaged at 7.3%, compared to 7.2% in Feb and Mar. Since 2010, the historical risk premium was averaged at 7.73% with a SD of 0.72%. Current risk premium was slightly below the historical average, reflecting that investors are cautiously optimistic over the stock market outlook.

Hong Kong stock market

Risk in the Hong Kong stock market has been falling since the correction commenced in Feb 2018. Market risk premium in mid-Apr was averaged at 12.6%, lower than 14.8% and 15.9% in Feb. Since 2010, the historical risk premium was averaged at 11.6% with an SD of 1.72%. Current risk premium is still higher than the historical average, reflecting investors' optimism as well as the fact that market risk has not been fully released.

Below is our analysis of the Sino-US trade war.

1. Objectively speaking, the US and China are the largest and second-largest economic entities globally. Both are each other's major trader partner - a relation that will not be easily changed in the foreseeable future in our view.

Sino-US trade data (2017)

	% of total export		% of total import
China's export to the US	18.99%	China's import from the US	8.36%
Ranking	US as No. 1	Ranking	US as No. 4
US's export to China	8.43%	US's import from China	21.58%
Ranking	China as No. 3	Ranking	US as No. 1

Source(s): China Customs, US Department of Commerce, and ABCI Securities

Policy Snapshot

2. We believe the escalation of trade tension between the two superpowers is inevitable in the long run. Occurrence of Sino-US trade dispute is within expectation, given China's long-standing current account surplus (2009-16 average: 2.64% of GDP) and capital account surplus, and persisting deficits in US's current account (2009-16 average: 2.65% of GDP) and capital account. Moreover, US has the largest trade deficit in goods with China (2017 deficit: US\$ 375.2 bn).
3. From a continuity perspective, USD has long been the global reserve and settlement currency and US treasury bonds are referenced as the standard risk-free asset. Accumulating US-denominated assets have been the implied financial goal in most countries (except the US) or enterprises. This is the factor sustaining the imbalance between the two countries. The Sino-US trade conflict will persist for a long time although intermittent easing would occur from time to time. Therefore, investors in the capital market should strengthen long-term risk management.
4. Based on the statements made and signing of tariff measures, we believe the US president is striving for more bargaining chips in subsequent trade negotiations.
5. Unless an import ban is enforced, the import tariff is means to increase government's revenue and manipulate import price. For imports that cannot be sourced locally or easily substituted, the burden of the tariff will eventually be shifted to consumers in the form of an implied sales tax. If the US places a high tariff on imports and maintains a weak USD, pressure of import inflation will rise - a result not desired by the Fed. Nonetheless, the different levels of import tariff enforced by the US against countries will have significant impacts on global liquidity and resource allocation. The capital market should be prepared for that.
6. China has clearly stated its intention to promote superpower diplomacy with Chinese characteristics, foster new international relations and establish a community of shared future. As such, we believe China would maintain an empathetic attitude and avoid initiating a trade war. However, to maintain its control over the issue, China would need to come up with its own solutions, which we believe will include the increased opening of domestic market to foreign investors and expand imports of high-quality goods and services.
7. From a strategic point of view, due to the changes in China's economic structure and the improving living standard, competitiveness of certain export items and industries has inevitably deteriorated. The country would need to lower the concentration of export destination and increase the overall competitiveness of export goods. At the same time, it is important to expand the export market, explore new export demands, and accumulate client resources from regions covered in the Belt and Road Initiative. Moreover, outdated capacity has to be eliminated by technological upgrade to enhance product quality. Instead of adopting the low-price strategy, China should develop quality products that are not easily replaced by those from other countries.
8. Despite the escalating tension between China and the US, structural reform in China's economy will not be halted. In fact, the incident has only reinforced the government's resolution to implement its long-term strategic plans, such as "Made in China 2025" (China to transform from a big industrial country to a manufacturing superpower), supply-side structural reforms (better use of resources to increase efficient supply under the government's supervision), opening of the economy to increase competitiveness of domestic enterprises through upgrades and innovations.

Policy Snapshot

Based on our analysis, the Sino-US tension is only one of the many external factors affecting the equity market. The US may impose a higher tariff on imports from China amounting to US\$ 153.0bn, equivalent to 1.15% of China's 2017 nominal GDP or 7% of China's total export value in 2017. While remaining cautious, one should refrain from exaggerating the associated risk and losing sight of investment focus that aligns with China's economic development strategy.

“Made in China 2025” Strategy: the long-term strategic development of enhancing China’s competitiveness

China’s “Made in China 2025” strategy has laid out the 10 major sectors prioritized for development in the next 1-2 decades. China will invest enormous efforts and resources to promote these sectors in order to increase competitiveness in the global market. Angel funds, VC, PE and industrial funds will be searching the prospective unicorns in these industrial areas. Most companies in the 10 key sectors are still in their nascent stages of development, meaning that investment risk is relatively high. Nonetheless, the long-term return of these industries will be lucrative should they take off.

Made in China 2025: 10 key sectors prioritized for development

10 major industrial development areas	Corresponding areas of products/services, technologies or applications
1.New generation IT technology industry	<ul style="list-style-type: none"> • Upgrade application adaptability of domestic chips • High density packaging technology and 3D micro assembly technology • Fifth-generation mobile communications (5G) technology, core routing switching technology, ultra-high-speed high-capacity intelligent optical transmission technology, "future network" core technology and architecture • Quantum computations, neural networks • High-end servers, large-capacity storage, new-type routing switches, new intelligent terminals, next-generation base stations, and network security equipment

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2. High-end CNC machine tools and robots	<ul style="list-style-type: none"> Automobiles, machinery, electronics, manufacture of dangerous goods, defense industry, chemical industry, light industry and other industrial robots, special robots Medical service, family service, educational entertainment and other service robots Robot body, reducer, server motor, controller, sensor and driver, and other key components and system integration design and manufacturing
3. Aerospace equipment	<ul style="list-style-type: none"> Large-scale aircraft development, timely launch of wide-body passenger aircraft development, encourage international cooperation in the development of heavy-duty helicopters Industrialization of trunk feeders, helicopters, drones and general aircraft High thrust-to-weight ratio, advanced turboprop (shaft) engine and high bypass ratio turbofan engine technology A new generation of launch vehicles and heavy-duty vehicles enhances the ability to enter space New satellites and other space platforms and loads, and a broadband Internet system for air and space, forming long-term sustainable and stable spatial information service capabilities such as satellite remote sensing, communications and navigation
4. Marine engineering equipment and high-tech ships	<ul style="list-style-type: none"> Deep-sea exploration, resource development and utilization, offshore operation support equipment and its key systems and special equipment Development and engineering of deep-sea space stations, large-scale floating structures Luxury cruise ship design and construction technology Enhancing the international competitiveness of high-tech ships such as LNG carriers
5. Advanced rail transportation equipment	<ul style="list-style-type: none"> Application of new materials, new technologies and new processes Systematic security assurance, energy saving and environmental protection, digital intelligent network technology Lightweight, modular, genealogical products A new generation of green intelligent, high-speed heavy-haul rail transportation equipment system
6. Energy saving & new energy vehicles	<ul style="list-style-type: none"> Development of electric vehicles and fuel cell vehicles, mastering low-carbon, information, and intelligent core technologies for automobiles Power battery, drive motor, high efficiency internal combustion engine, advanced transmission, lightweight materials, intelligent control Independent brand energy-saving and new energy vehicles in line with international advanced level

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7. Power equipment	<ul style="list-style-type: none"> • Industrialization of large-scale, high-efficiency, ultra-clean emission coal-fired power unit • High-capacity hydropower generating units, nuclear power units, heavy-duty gas turbine manufacturing • New energy and renewable energy equipment, advanced energy storage devices, power transmission and distribution equipment for smart grids, and client equipment • Manufacturing and application of key components and materials such as high-power electronics components and high-temperature superconducting materials
8. Agricultural machinery and equipment	<ul style="list-style-type: none"> • Large-scale tractors and their multi-function work tools, large-scale high-efficient combine harvesters and other high-end agricultural equipment and key core components • Informatization overall solution for agricultural production
9. New materials	<ul style="list-style-type: none"> • Special metal functional materials, high-performance structural materials, functional polymer materials, special inorganic non-metallic materials and advanced composite materials • Superconducting materials, nanomaterials, graphene, bio-based materials
10. Biomedicine and high performance medical devices	<ul style="list-style-type: none"> • New mechanisms and new target-chemical drugs, antibody drugs, antibody-coupled drugs, brand-new structural protein and peptide drugs, novel vaccines, innovative Chinese medicines with outstanding clinical advantages, and personalized therapeutic drugs • High-performance medical equipment such as imaging equipment and medical robots, high-value medical consumables such as degradable blood vessel stents, and mobile medical products such as wearable and remote diagnosis and treatment • Biological 3D Printing, induced pluripotent stem cells

Source(s): State Council

Policy Snapshot

Impact on Industries



China Banking Sector

Industry impact

- Although internationalization of the Chinese banking industry has accelerated in recent years with policy aid from the central government, onshore business has remained as the core component of the Chinese banks. Topline revenue from offshore operations of the big four banks, excluding that of Bank of China (BOC), only accounted for 3.9%-8.8% of total operating income in 2017. Benefiting from the well-established offshore business franchise through BOCHK, BOC's offshore business revenue accounted for 24.2% of total operating income in 2017. Therefore, we believe potential impact from trade war on the Chinese banking industry is minimal.
- Areas directly affected by the trade war mainly include the loan balance in trade finance and a proportion of fee income from settlement, clearing, and foreign exchange. However, such contributions are relatively low in the total loan balance and total net fee income.
- We believe the trade war may pose indirect impacts on the banking industry. If the trade war lasts longer than expected, enterprises in export businesses will be pressured financially, which in turn may trigger a lag effect on banks' asset quality. Yet, considering the solid fundamental and robust risk buffer of the HK-listed Chinese banks, we are confident that most banks will be able to maintain their asset quality at a reasonable level.
- In the worst case scenario, if China and the U.S. deadlocked in the trade war, the US may further retaliate by restricting overseas operations of the Chinese banks in the US. To be cautious, the Chinese banks would need to consider relevant risks and contingency plans. Still, given the small scale of Chinese banks' operations in the US, the impacts will be limited.

Stock impact

- While the overall impact of the Sino-US trade war on China's banking industry would be minor, the big banks, with a higher degree of businesses internationalization, would be more impacted than the smaller counterparts. In particular, **BOC (3988 HK)** would suffer the most with its higher contribution from overseas businesses.
- Conversely, JSBs and district banks would be subjected to greater indirect impacts, mainly because their core customers include the medium, small and micro enterprises, which in general are less financially resilient. According to data from the China Customs, approximately 40% of total exports in 2017 were from private enterprises. Among the JSBs, **China Minsheng Bank (1988 HK)**, with a strong focus on medium, small and micro enterprises, would be subjected to greater risks. Asset quality of district banks would be pressured given their core business focus also in smaller enterprises.



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- Assuming the trade war will recede in a few quarters, we believe impacts on the banks' fundamentals would be minimal. Share price correction triggered by the rising risk aversion has been largely factored in the current situation. Unless the Sino-US tension escalates further, with the trade war dragging on for longer than expected and market risk premium escalating sharply, we will maintain our **OVERWEIGHT** rating given the current sector valuation is low.

Policy Snapshot



China Brokerage Sector

Industry Impact

- Overall, impacts of the Sino-US trade war in the securities industry are mostly indirect.
- According to SAC, revenue breakdown of the securities industry in 2017 is as follows: securities investment income (28%), securities brokerage (26%), investment banking (17%), asset management (10%), and others (19%). Therefore, the major risks of the industry are downturn in the stock and bond markets and reduced trading volume in the secondary market.
- China's President Xi Jinping has recently announced at the Boao Forum that China will raise the foreign equity caps in banking, securities and insurance industries, as well as easing restrictions over the establishment of foreign financial institutions in China and expanding the business scope for these foreign entities. While industry competition would intensify in the long term, we believe foreign investors may opt to enter the Chinese market through acquiring existing players, thus boosting the industry valuation in the short term.

Stock Impact

- We believe players with a higher proportion of trading income, such as **DFZQ (3958 HK)**, will be more negatively affected.
- Securities companies relying more on investment banking business, such as **CSC (6066 HK)**, would be less affected. The government is encouraging large-scale overseas listed Chinese internet/high-tech companies to return to the A-share market and unicorns (i.e. technology startups with a valuation of more than US\$ 1bn) to list locally. Supportive policies in place to support these initiatives will be beneficial to the investment banking business.

Policy Snapshot



China Property Sector

Sector impact

- We believe trade war will have limited impacts on China's property sector since housing demand is largely domestically driven and construction materials are locally produced. Moreover, market share of overseas property investors or developers have been shrinking due to Home Purchases Restrictions (HPR) and market consolidation.
- However, fluctuating interest rates and exchange rates induced by the trade war could pose threats as developers are highly sensitive to these factors. In our coverage universe, the average net gearing of developers was 85% as at Dec 2017; also, about 32% of the total debts of developers were denominated in USD or HKD.
- Trade war could result in significant price increase of imported goods and drive up the CPI in both China and the US. This could lead to an earlier interest rate hike in order to mitigate inflation. Developers will be burdened by the rising finance costs of USD bonds and domestic bank loans as interest rate increases. However, we believe such negative impacts will not be reflected on P&L immediately given developers normally capitalize the majority of finance cost to the balance sheet.
- Trade war could also lead to more volatile movements in exchange rates. There are speculations that China may consider depreciating RMB gradually and market confidence has been somewhat weakened as a result. If RMB depreciates against USD, developers will register a mark-to-market loss on P&L when their USD debts are revaluated.

Stock impact

- The market generally uses DCF to estimate the net assets value (NAV) of developers' projects. The fair values are subsequently derived by applying a discount to the NAV estimates. Therefore, if interest rate increases, the market may adjust down their NAV forecasts by applying a higher WACC.
- We believe developers with a low gearing or USD debt exposure would be more defensive against the risks posed by the trade war. **Times China (1233 HK)** and **Aoyuan (3883 HK)** has a net gearing of 58% and 59% in 2017, while USD/HKD debt only represents 27% and 30% of total debts. These players have high exposures in the Big Bay Area - presales from the region accounted for 87% and 53% of total in 2017. They also have a large number of redevelopment projects in the region, laying a strong foundation for future presales and earnings growth. To reiterate, these two companies are our sector's top picks.
- Given the steady cash flow and low debt level, property management sector offers an alternative for investors desiring to gain exposure in the property sector. The sector derives revenues and incurs costs domestically, and their asset-light business models enable low gearing levels and interest expenses. Among the HK-listed property management companies, we favor **A-living (3319 HK)** and **Colour Life (1778 HK)**. **Agile (3383 HK)** and **Greenland (600606 CH)**, A-living's two major shareholders, provide a steady pipeline of new projects. The company's VAS revenue was also boosted by the injection of property agency business from its parent group. Separately, Colour Life should register a big jump in 2018 net profit after the injection of Wanxiangmei (formerly known as Wanda Property Management). Reiterate **OVERWEIGHT** rating for the sector.

Policy Snapshot



China Environmental Protection/Alternative Energy Sectors

Industry impact

- **Waste incineration:** Equipment of the Chinese waste incineration plants is manufactured domestically. Most of the waste incineration operators are controlled by SOEs or private enterprises in China. Therefore, the domestic waste incineration operation or equipment manufacturing markets are largely immune to the Sino-US trade war. On the export side, solid waste is generally disposed by landfills in the US. Only a small proportion of China's waste incineration equipment is exported to the US.
- **Wastewater treatment:** Equipment of China's sewage treatment plants is manufactured domestically. The operators are mostly SOEs or private enterprises in China. On the export side, the US has been developing its wastewater treatment facilities early on and does not rely on equipment and parts imported from China.
- **Nuclear power:** China's nuclear power facilities have been developing rapidly in recent years, with the localization rate of parts and components exceeding 90%. Except for some nuclear reactors built earlier that require components imported from Europe, the new domestic reactors are assembled using China-made parts. Uranium, the raw material of nuclear power, is mainly imported from Canada and Australia. China's reliance on the US for components or raw materials is low. On the export side, China's nuclear power equipment manufacturers are intending to go global; so far, they have been mostly targeting the fast-developing markets in Southeast Asia. The US, whose nuclear market is highly developed, is not a target of these Chinese equipment manufacturers.
- **Wind power:** Localization rate of wind power components and machineries have almost reached 100% in China, with quality of these equipment reaching the international standard. Dependence on imported parts and components from the US is low. On the export side, as China's equipment manufacturers are mostly focusing on the domestic market. China's wind power equipment manufacturers exported ~158 MW of completed wind turbines to the US in 2017, accounting for 25% of total exports but only 0.8% of total production.

Stock impact

- Sewage treatment operator **Beijing Enterprises Water (371 HK)** and waste incineration operator **China Everbright Int'l (257 HK)** mainly operate in domestic cities and use domestically-made equipment. They are relatively unaffected by the trade war.

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- Nuclear power operator **CGN Power (1816 HK)** and wind power operator **China Longyuan Power (916 HK)** provide electricity in domestic provinces and cities. Their equipment is domestically produced and therefore, these companies are defensive against the impacts of trade war. Nonetheless, a prolonged trade war may reduce national fiscal revenue and delay payment of national power subsidies. Such subsidies usually account for 15%-20% of revenues among the wind power operators.
- Since the utilities companies focus almost exclusively on the domestic market and their equipment are manufactured in China, we believe the sectors are relatively defensive against the trade war in the short term. However, a prolonged conflict may affect China's fiscal and national income, subsidy payments to the power operators could be affected. Since environmental protection and alternative energy industries are prioritized sectors in China's strategic development, we remain optimistic over their prospects. Despite the recent rally inspired by the increased risk aversion, the industry is only trading in the range of 8x-11x 2018 P/E – a valuation we deem attractive. As such, we reiterate our **OVERWEIGHT** rating for both sectors.

Policy Snapshot



China Consumer Goods Sector

Industry Impact

- China has recently announced a 25% import tariff on pork and related products from the US, which we believe will affect companies in the hog-raising or pork-processing domain. While the existing price gap between the US and China pork (US as cheaper) would provide some buffer for the added tariffs imposed on the US pork export, the ample supply of hog in China will still be the major factor determining the hog price in the country.
- China's newly announced import tariff on soybean would impact the consumer goods industry because the crop is used across a wide spectrum of products, and the US has been one of China's soybean suppliers. We believe the new tariff would drive up the cost of imported soybean but the volume imported from the US will remain largely stable.
- In our coverage universe, most companies in the consumer goods sector would only be impacted indirectly. Those exposed to the pork-selling business or rely heavily on pork for raw material will be affected directly.

Stock Impact

- For **WH Group (288 HK)**, pork exported to China in 2017 only contributed to a small portion (~1%) of its total fresh meat sales. If the new tariff leads to significant reduction in US's pork export to China, its business will not be much affected.
- The tariff on soybean would lead to the increase in feed cost, driving up the cost of raw milk and hog production, thus elevating the production cost for **WH Group (288 HK)**, **Shuanghui (000895 CH)**, **Mengniu (2319 HK)**, and **Yili (600887 CH)**. Currently, the prices of raw milk and hog in China are pressured by the ample supply in the industry. We believe increase in production cost would eliminate smaller farms and reduce excess capacity.

Policy Snapshot



China Automotive Parts Sector

Industry impact

- China has recently announced the 25% import tariff on automobile imported from the US while planning to reduce tariff on automobile (vehicle) imported from other countries. This would mean imported automobiles from the US would be less price-competitive in China. Chinese automotive parts manufacturers with a geographically diverse client base would be more defensive against impacts of the trade dispute.
- In the proposed tariff list under the Section 301 Action, a variety of automotive parts are covered, with some of them used in new-energy vehicles. Automotive parts manufacturers exporting to the US would be directly affected.

Stock impact

- North America contributed to 25.9% of **Xin Point's (1571 HK)** total revenue in 2017. Currently, the proposed tariff list under the Section 301 Action does not cover the products manufactured by the Group although the items may expand should the trade dispute escalate. In addition, prolonged trade dispute may lead to slowdown in China/ US economic growth and consumer demand for automobiles, denting Xin Point's growth prospect.

Policy Snapshot



China Technology/E-commerce Sector

Industry impact

- The list of Chinese imports set to be targeted by US tariffs mainly covers aerospace, information and communications technology, robotics, and machinery. These industries are sectors targeted in the "Made in China 2025" strategy. The tension between China and the US, in our view, is not arising solely from the need to reduce trade deficit. China would need to defend its strategic positions in various emerging industries within the "Made in China 2025" strategy.
- Overall, "Made in China 2025" is part of China's strategic plan covering three decades to revamp its manufacturing sector. By 2025, China will transform from a big manufacturing country to a manufacturing superpower; by 2035, its manufacturing competence will be comparable to that of the developed nations; by 2045, China will become one of the leaders among the developed manufacturing powers.
- Given the strategic importance of "Made in China 2025", the Chinese government is unlikely to slow down its pace in implementing the "Made in China 2025" strategy just because of the rising Sino-US tension. On the contrary, we believe that the Chinese government may introduce more supportive policies for the emerging industries to offset the export losses caused by the trade war.

Stock impact

- Tech stocks with higher contribution from export sales will be more affected. About 30% of **Lenovo's (992 HK)** sales are exported to the Americas; about 25% of **ZTE's (763 HK)** sales are accounted by Europe, the Americas and Oceania; about 60% of **AAC's (2018 HK)** sales are exported to the Americas. . In particular, US's latest move to ban US companies from supplying to ZTE would have significant impact on the company, in our view.
- Major online e-commerce platform may be affected by reduced international business. International e-commerce business accounts for ~ 8% of **Alibaba's (BABA US)** sales.
- **Tencent (700 HK)**, whose main revenue is domestically driven, will not be impacted directly. However, if domestic economy slows down on a prolonged trade war, profitability may reduce.
-
- Smartphone component companies such as **Sunny Optical (2832 HK)**, **Tongda (698 HK)** and **Q Tech (1478 HK)** mainly supply to domestic smartphone brands, direct impact will therefore be limited. However, if China adopts countermeasures against the US semiconductor chips, the Chinese smartphone brands may demand these domestic component suppliers to slash prices to offset the increase chip costs.

Policy Snapshot

Stock Picks

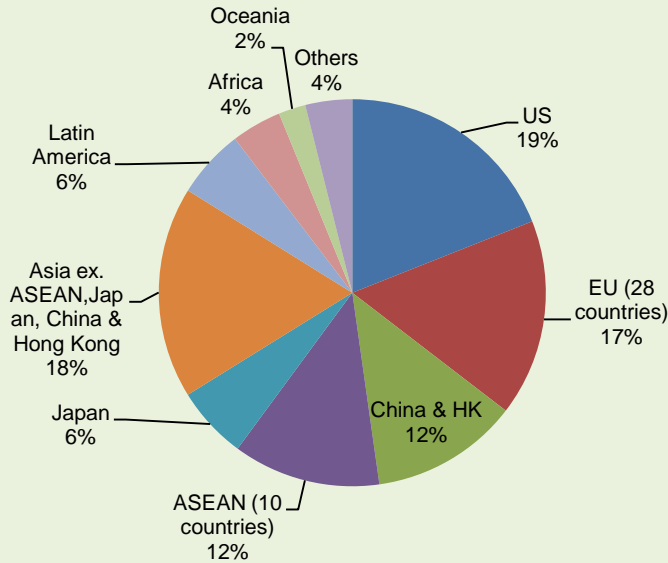
	Share price (As of Apr 19, 2018)	Mkt Cap. (HKD 100mn)	18E P/E	19E P/E	18E P/B	19E P/B	18E Yield	19E Yield
China Banking								
ABC (1288 HK)	4.39	15,243	5.71	5.13	0.76	0.69	5.37	5.65
ICBC (1398 HK)	6.89	25,931	6.39	5.73	0.86	0.78	4.68	5.04
CCB (939 HK)	8.18	20,555	6.17	5.64	0.86	0.78	4.85	5.31
China Brokerage								
CSC (6066 HK)	6.40	8,070	9.00	7.60	0.87	0.79	1.70	2.00
China Property								
Times China (1233 HK)	11.38	214	5.38	4.30	0.95	0.82	5.58	6.98
Aoyuan (3883 HK)	6.38	173	5.01	3.41	1.18	0.95	6.00	8.80
A-Living (3319 HK)	10.96	150	16.24	10.98	2.24	1.94	1.54	2.28
Colour Life (1778 HK)	6.90	91	12.42	10.47	2.19	1.99	2.95	3.50
China Environmental Protection/ Renewable Energy								
Everbright Int'l (257 HK)	10.88	488	11.81	10.15	2.18	1.91	2.54	2.96
BJ Enterprise Water (371 HK)	4.39	384	8.36	7.15	1.55	1.34	3.59	4.20
CGN Power (1816 HK)	2.14	973	8.72	7.87	1.16	1.07	3.47	3.84
Longyuan (916 HK)	6.81	547	11.04	8.98	0.97	0.88	1.81	2.23
China Consumer Goods								
WH Group (288 HK)	8.46	1,242	12.40	11.03	2.03	1.92	3.22	3.63
Mengniu (2319 HK)	27.95	1,098	36.29	24.64	3.62	3.30	0.71	1.14
Anta (2020 HK)	44.45	1,193	26.44	20.59	6.54	5.99	2.67	3.44
Yili (6008878 CH)	RMB 28.95	RMB 1,760	20.56	18.95	4.71	4.25	3.10	3.37
Shuanghui (000895 CH)	RMB 25.86	RMB 853	17.31	15.94	5.65	5.45	5.20	5.65
China Automotive Parts								
Xin Point (1571 HK)	5.75	58	9.67	8.02	2.09	1.90	3.62	4.36
China Technology/ E-commerce								
Tencent (700 HK)	405.80	3,854,694	34.30	26.50	9.20	7.00	0.26	0.33
Alibaba (BABA US)	US\$ 181.39	3,642,213	31.00	NA	6.50	NA	0.00	0.00

Source(s): Bloomberg, ABCI Securities

Policy Snapshot

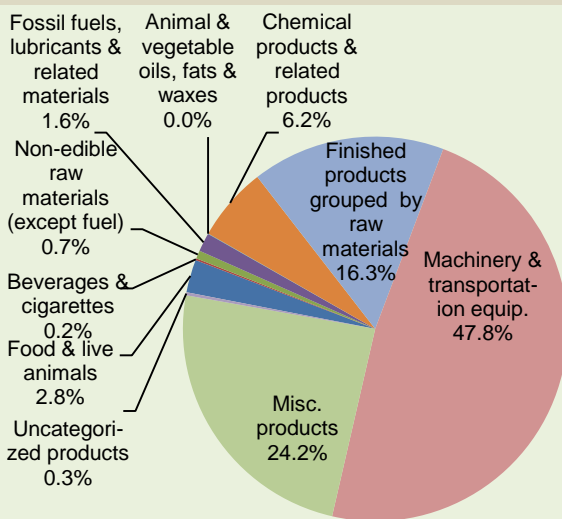
Appendix: Analysis of Sino-US trade relation

Exhibit 1: China's exports to destinations in 2017 (by USD value)



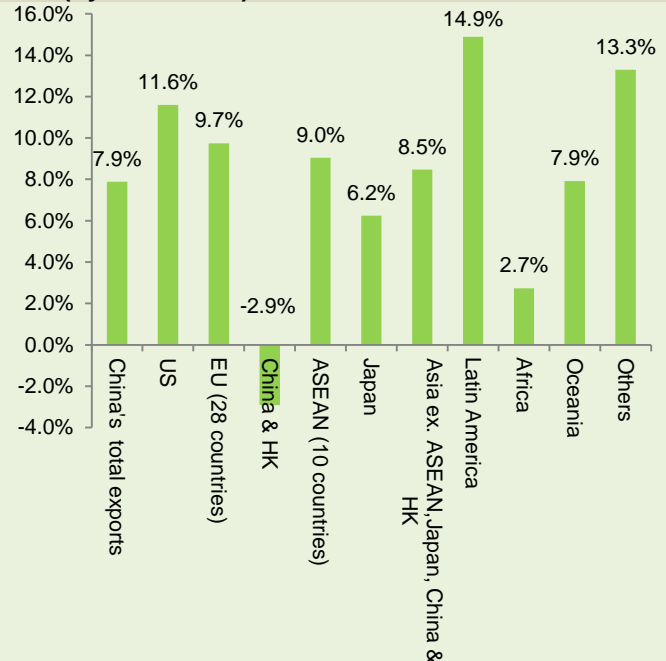
Source(s): China Customs & ABCI Securities

Exhibit 3: China's exports*in 2017 by value



*Product categories are based on SITC classification
Source(s): China Customs & ABCI Securities

Exhibit 2: YoY chg in China's export to destinations in 2017 (by USD value)



Source(s): China Customs & ABCI Securities

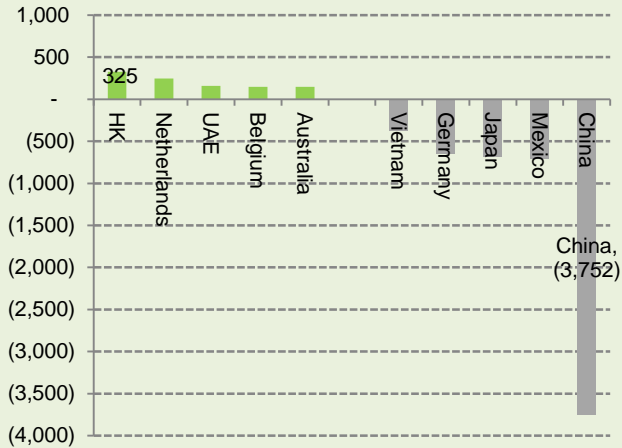
Exhibit 4: Are China's exports sensitive to RMB changes?

	2013	2014	2015	2016	2017	1-2/2018
China's exports (in USD) YoY chg	7.9%	6.1%	-2.9%	-7.7%	7.9%	24.4%
China's exports (in RMB) YoY chg	N/A	4.9%	-1.9%	-2.0%	10.8%	18.0%
Average USD/RMB	6.1483	6.1618	6.2850	6.6478	6.7541	6.3816
YoY chg	-2.5%	0.2%	2.0%	5.8%	1.6%	-5.5%
RMB vs. USD	RMB APP.	RMB DEP slightly	RMB DEP further	RMB DEP further	RMB DEP less	RMB APP further

Remarks: APP stands for "appreciates"; DEP stands for "deprecates"
Source(s): China Customs & ABCI Securities

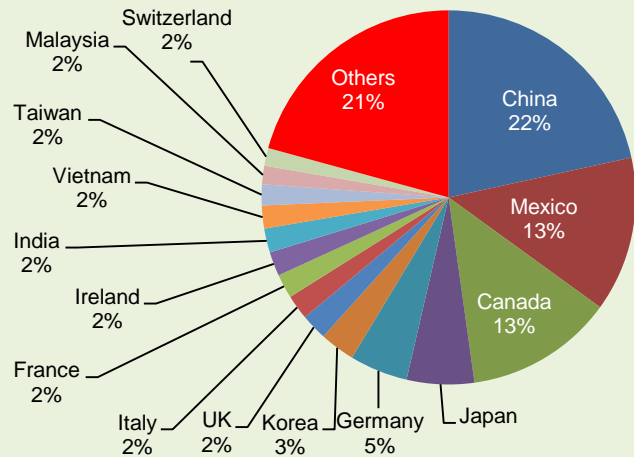
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Exhibit 5: US's top 5 trade surplus regions vs. top 5 trade deficit regions (in 100mn USD)



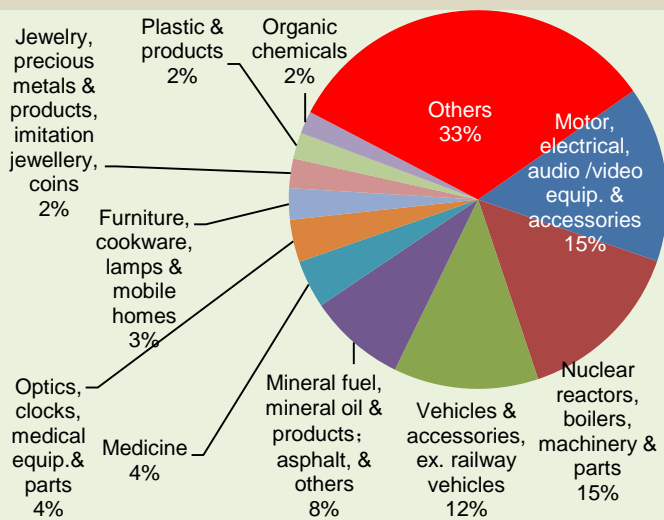
Source(s); MOC, US Dept. of Commerce, ABCI Securities

Exhibit 6: Top 15 regions exporting to the US by value (2017)



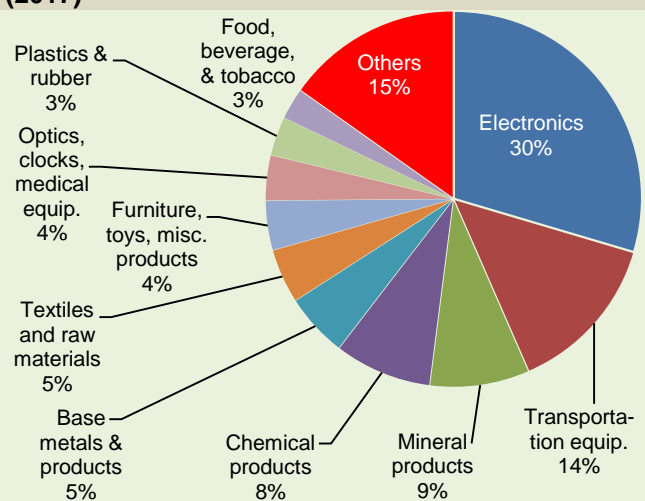
Source(s); MOC, US Dept. of Commerce, ABCI Securities

Exhibit 7: Top 10 imports* in the US by value (2017)



* Product categories are based on HS classification
Source(s); MOC, US Dept. of Commerce, ABCI Securities

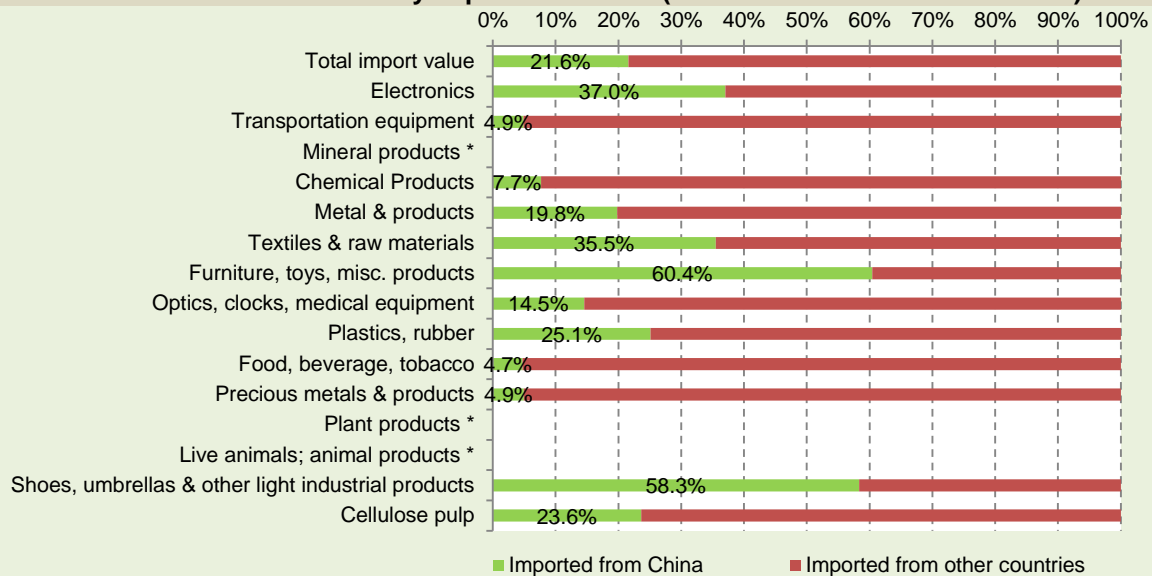
Exhibit 8: 10 major imports* in the US by value (2017)



* Product categories are based on customs classification
Source(s); MOC, US Dept. of Commerce, ABCI Securities

Policy Snapshot

Exhibit 9: China's contribution to key imports in the US (based on custom classification)



*Not included in the 15 major imports from China
Source(s); MOC, US Dept. of Commerce, ABCI Securities

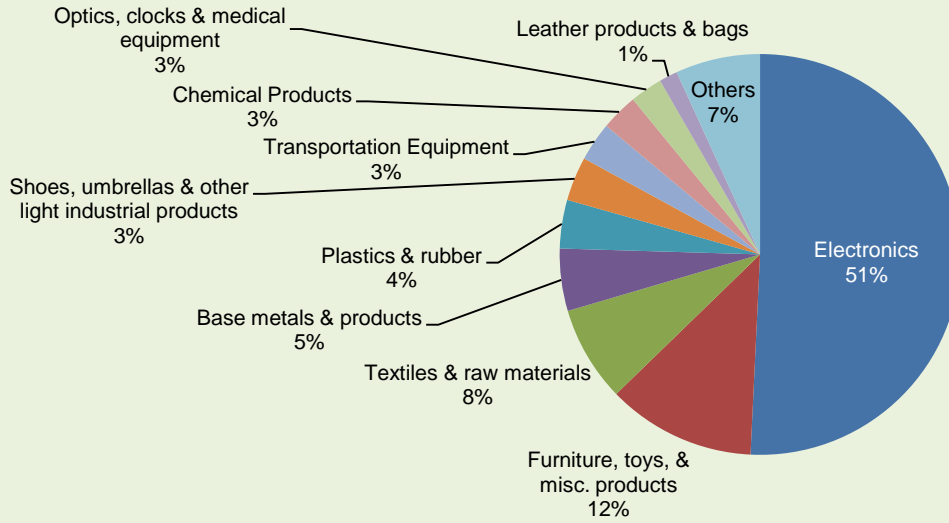
Exhibit 10: Countries/regions of US's top 5 imports

	Machinery & Electronic Products	Transportation Equipment	Mineral Products	Chemical Products	Base metals & products
Import countries/regions	%	%	%	%	%
China	37.0			7.7	19.8
Mexico	16.7	26.3	5.7		8.9
Japan	6.9	16.9			
Germany	4.7	9.4		9.9	4.5
Canada	4.2	19.0	37.2	8.6	19.1
Korea		6.5			
Saudi Arabia			8.8		
Venezuela			5.8		
Iraq			5.4		
Ireland				17.5	
Switzerland				8.3	
Taiwan Province					4.4
Top 5 import countries /regions (% of total)	69.5	78.1	62.9	52.0	56.7
Other countries and regions (%)	30.5	21.9	37.1	48.0	43.3
Is China within the top five import regions?	Yes	No	No	Yes	Yes
Highly dependent on China?	Yes	No	No	No	Yes

Source(s); MOC, US Dept. of Commerce, ABCI Securities

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Exhibit 11: Major imports from China to the US in 2017 (by value)



*Import categories are based on customs classification
 Source(s); MOC, US Dept. of Commerce, ABCI Securities



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Exhibit 12: Geographical breakdown of 10 major imports from China in the US

Contribution (%)	Machinery & Electronic products	Furniture, toys, misc. products	Base metals & products	Textiles & raw materials	Plastic & Rubber	Shoes, umbrellas, & products	Transportation Equipment	Chemical products	Optics, clocks, medical equipment	Leather products & luggage
China	37.0	60.4	19.8	35.5	25.1	58.3	4.9	7.7	14.6	53.3
Mexico	16.7	12.6	8.9		9.5	1.8	26.3		15.5	
Japan	6.9				5.4		16.9		8.3	
Germany	4.7		4.5		5.3		9.4	9.9	10.7	
Canada	4.2	5.8	19.1		17.2		19.0	8.6		
Vietnam		5.4		10.8		18.7				8.3
India				7.1		1.5		4.8		3.6
Italy		1.5				4.6				10.0
Malaysia	4.1				5.2					
Korea			4.2				6.5			
Ireland								17.5	7.1	
Switzerland								8.3	6.9	
Taiwan		2.3	4.4							
Indonesia				4.4		5.9				
Bangladesh				4.7						
Philippines										2.6
France										5.2
Top 2 contribution (%)	53.7	73.0	38.9	46.3	42.3	77.0	45.3	27.4	30.1	63.3
Top 5 contribution (%)	73.6	88.0	60.9	62.5	67.7	90.8	83.0	56.8	63.1	83.0
China contribution(%)	37.0	60.4	19.8	35.5	25.1	58.3	4.9	7.7	14.6	53.3
Top 5 contribution ex. China (%)	36.6	27.6	41.1	27.0	42.6	32.5	78.1	49.1	48.5	29.7
China's ranking	1	1	1	1	1	1	5	4	2	1

Source(s); MOC, US Dept. of Commerce, ABCI Securities

Policy Snapshot

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Philip Chan holds H-shares of Agricultural Bank of China Ltd (1288 HK).

Steve Chow holds H-shares of Tencent (700 HK).

Definition of equity rating

Rating	Definition
Buy	Stock return \geq Market return rate
Hold	Market return - 6% \leq Stock return < Market return rate
Sell	Stock return < Market return - 6%

Stock return is defined as the expected % change of share price plus gross dividend yield over the next 12 months

Market return: 5-year average market return rate

Time horizon of share price target: 12-month

Definition of share price risk

Rating	Definition
Very high	$2.6 \leq 180$ day volatility/180 day benchmark index volatility
High	$1.5 \leq 180$ day volatility/180 day benchmark index volatility < 2.6
Medium	$1.0 \leq 180$ day volatility/180 day benchmark index volatility < 1.5
Low	180 day volatility/180 day benchmark index volatility < 1.0

We measure share price risk by its volatility relative to volatility of benchmark index. Benchmark index: Hang Seng Index.

Volatility is calculated from the standard deviation of day to day logarithmic historic price change. The 180-day price volatility equals the annualized standard deviation of the relative price change for the 180 most recent trading days closing price

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