農銀國際
ABC INTERNATIONAL
ABCI SECURITIES COMPANY LIMITED

2H21 ECONOMIC OUTLOOK & INVESTMENT STRATEGY

Commodity Supercycle

ABCI China/ HK Equity Research

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Global Economic Outlook

2H21 Global Economic Outlook

Andy Yao, Economist

- Global economy improved steadily in 1H21 with the support of macroeconomic policies and vaccination program that makes reopening of the economy possible
- 1Q21 GDP growth in major countries, except Japan, rebounded from 4Q20 on effective pandemic measures, active fiscal stimulus, and accommodative monetary policy
- Global inflation has significantly risen since the start of 2021 because of rising prices of oil and commodities, disruptions of supply chain in certain sectors, and surging shipping costs
- Global economic growth is expected to strengthen in 2H21 with the increasing vaccination rate throughout the world. However, recovery is likely to be uneven as the pace of vaccination will differ substantially across countries. Emergence of virus variants and rising debt burden present major challenges in 2H21
- We expect economies in the US, China, Eurozone, Japan, and the UK to grow by 7.0%, 8.5%, 4.0%, 3.0%, and 7.0% in 2021E, respectively, up from -3.5%, 2.3%, -6.6%, -4.7%, and -9.8% in 2020

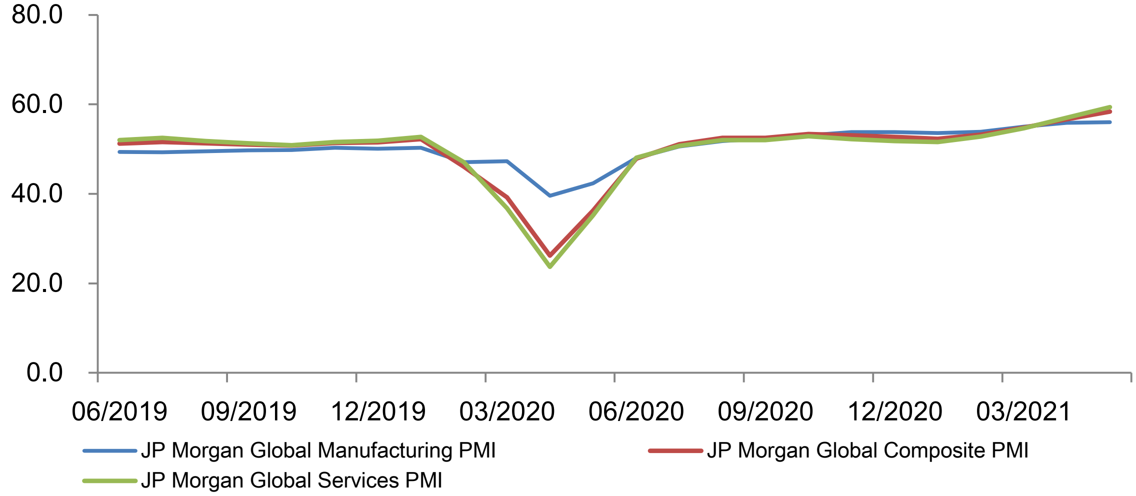
Global growth prospect improved in 1H21

Global economy improved steadily in 1H21 with the support of macroeconomic policies and vaccination program that makes reopening of economy possible. As shown in Exhibit 1, both the JP Morgan global manufacturing PMI and service PMI rebounded in 5M21, indicating economic improvement. Global trade activity revealed a strong recovery − the Goods Trade Barometer released by the WTO rebounded to 109.7 in May and the sub-indicator export order index climbed to 114.8, well above the baseline value of 100. However, global economic recovery has been uneven as vaccination rate differs across countries; in general, the developed countries have a higher rate than the developing ones.

1Q21 GDP growth in major countries, except Japan, rebounded from 4Q20, helped by the effective pandemic measures, active fiscal stimulus, and accommodative monetary policy. Economies in the US, China, Eurozone, Japan, and the UK grew by 0.4%[1], 18.3%, -1.8%. -1.9%, and -6.1%, respectively, in 1Q21, compared to -2.4%, 6.5%, -4.9%, -1.1%, and -7.3% in 4Q20 (Exhibit 2). With the economy reopening, unemployment rate in major countries has steadily declined since the start of 2021. However, employment in services sector is still below the pre-pandemic level in 2019 due to continued containment measures, resulting in an uneven recovery in the job market.

[1] All growth rates are year-on-year except specified otherwise

Exhibit 1: JP Morgan Global PMIs (%)



Source(s): Bloomberg, ABCI Securities

Exhibit 2: GDP growth of global major economies (%)

Real GDP Growth (YoY)	2020	4Q20	1Q21
US	(3.5)	(2.4)	0.4
China	2.3	6.5	18.3
Eurozone	(6.6)	(4.9)	(1.8)
Japan.	(4.7)	(1.1)	(1.9)
UK	(9.8)	(7.3)	(6.1)

Source(s): Bloomberg, ABCI Securities

Global inflation has significantly risen since the start of 2021 on the price recovery of oil and other commodities, supply chain disruptions in specific sectors, and surging shipping costs. Compared with the global consumer price inflation, the inflation in global producer price has been particularly significant. In a few emerging economies, disruptions to food supply chains are pushing up food prices. In the US, headline CPI and PPI inflation rebounded to 5.0% and 6.2% in May and inflation expectation for 2021 are now at 2.8%. Although CPI in China was mild at 1.3% in May, PPI rebounded significantly to 9.0%, the highest since Sep 2008.

Major central banks have maintained an accommodative monetary policy to support households, companies, and financial markets. The central banks in the developed countries have continued their bond purchasing programs while leaving the policy interest rates unchanged. PBOC has maintained a loose monetary policy to support economic growth since the start of 2021. However, global financial conditions have tightened slightly as higher inflation has driven up long-term yields on government bonds. Some emerging and developing countries have kick-started the process of interest rate hike due to currency depreciation and above-target inflation.

Global economy will continue to recover in 2H21

Looking ahead, global economic growth is expected to strengthen in 2H21, mainly driven by the widespread vaccination throughout the world. However, the recovery is likely to be uneven as the pace of vaccination will differ substantially across countries. In the current trade forecast on Mar 31, 2021, WTO estimated the volume growth of global trade in goods in 2021 will rebound to 8% following a 5.3% decline in 2020. According to the latest Global Economic Prospects released by the World Bank in June 2021, global economic growth is projected to be 5.6% in 2021, the highest in 80 years, compared to the 3.5% contraction in 2020 (Exhibit 3). Potential emergence of more COVID-19 variants and rising debt burden will present challenges in 2H21, however.

We expect the US economy to grow by 7.0% in 2021E, up from the 3.5% contraction in 2020. Unprecedented fiscal relief and quick vaccination coverage will boost economic recovery. Rising wages and additional large-scale fiscal relief will support consumption. Unemployment rate is likely to fall with more workers returning to the labor market. Inflation, while expected to be high, should be manageable. On the monetary front, with the rising inflation expected, we believe the Fed will begin to taper off asset purchase starting from the 4Q21. However, federal funds rate would remain at the near-zero level in 2H21 to encourage investment and consumption by easing debt burdens and supporting asset prices.

With the high GDP growth in 1Q21 due to low base effect, we believe China's economy will expand by 8.5% for 2021E, up from 2.3% in 2020. Strong external demand and gradual recovery of consumption will be the main engines. On the monetary front, PBOC is expected to maintain a neutral monetary policy as the recovery takes on a more solid footing. The rates for one-year LPR and five-year LPR would be steady in 2H21, while RRR for financial institutions would likely be unchanged. We expect fiscal policy to normalize as the recovery strengthens further.

We project Eurozone's GDP growth to rebound sharply to 4.0% in 2021E from the 6.6% contraction in 2020 on the expected acceleration of vaccination and relaxation of pandemic restrictions. Moreover, the implementation of EU Recovery Fund will help reinvigorate the economy. External demand, especially those from the US, will rebound on the global recovery. Private consumption is likely to benefit from the lifting of containment measures and a gradual drop in household saving. According to ECB's monetary meeting in June, we expect interest rate to remain unchanged for the rest of 2021E. ECB will conduct net asset purchases under the pandemic emergency purchase program with a total envelope of €1,850bn until at least the end of Mar 2022. Net purchases under the asset purchase program will continue at a monthly pace of at least €20bn. Meanwhile, we expect the UK economy to expand by 7.0% in 2021E, down from the 9.8% contraction in 2020 due to a high vaccination rate and easing restrictions to economic activities.

We forecast Japan's economic growth to rebound from -4.7% in 2020 to 3.0% in 2021E as sustained government spending would bolster domestic demand; meanwhile, recovery of external demand would drive up exports in 2021. However, uncertainties surrounding the 2021 Tokyo Olympic Games remain, thus limiting its economic benefits. With inflation outlook remaining low and below the 2% target set by BOJ, the country's ultra-loose monetary stance would be held firmly in place throughout 2021. Short-term policy rate would remain at -0.10% till the end of 2021E.

Exhibit 3: GDP growth forecasts for global major economies (%)

Real GDP Growth (YoY)	2019	2020	2021E
US	2.2	(3.5)	7.0
China	6.0	2.3	8.5
Eurozone	1.3	(6.6)	4.0
Japan	0.0	(4.7)	3.0
UK	1.4	(9.8)	7.0
World	2.5*	(3.5)*	5.6*

*Denotes World Bank estimates and forecasts
Source(s): World Bank, Bloomberg, ABCI Securities estimates

China Economic Outlook

2H21 China Economic Outlook

Andy Yao, Economist

- China's economy grew by 18.3% in 1Q21 due to the low base in 1Q20 and effective pandemic control measures. As the low base effect fades, data shows the economy has started to normalize in 2Q21
- Despite the high GDP growth in 1Q21, we believe China’s economic growth will slow significantly in 2H21 as the low base effect withers. Strong external demand and steady consumer spending will be the main growth drivers. On the contrary, high debt burden and COVID-19 variation would present major challenges in 2H21
- Overall, we expect China’s economy to expand by 8.5% for 2021E, higher than the previous estimate of 8.0% due to high growth in 1Q21
- Despite the sharp rebound of PPI in recent months, we believe PPI inflation would ease gradually in 2H21 as commodity supplies recover with the rising prices. PPI/CPI are expected to be 4.5%/1.2% for 2021E. We believe the macro policy will not be constrained by inflation in 2H21
- On the monetary front, PBOC would maintain a neutral monetary policy to support economic growth. We believe benchmark interest rates and RRR would be steady in 2H21
- Fiscal policy in 2H21 will continue to normalize. The normal fiscal policy that includes tax and fee reductions, specific consumption-stimulating measures, and programs to boost infrastructure investment for decarbonisation and renewable energy will be maintained to support economic growth

China’s economic growth returned to normality in 2Q21

China's economy grew by 18.3%[1] in 1Q21 due to the ultra-low base in 1Q20 and effective pandemic measures. As the low base effect fades, economic data indicates the economy has begun to normalize in 2Q21, with YoY growth in investment, retail sales, trade, and industrial production in Apr and May all slowing substantially from 1Q21.

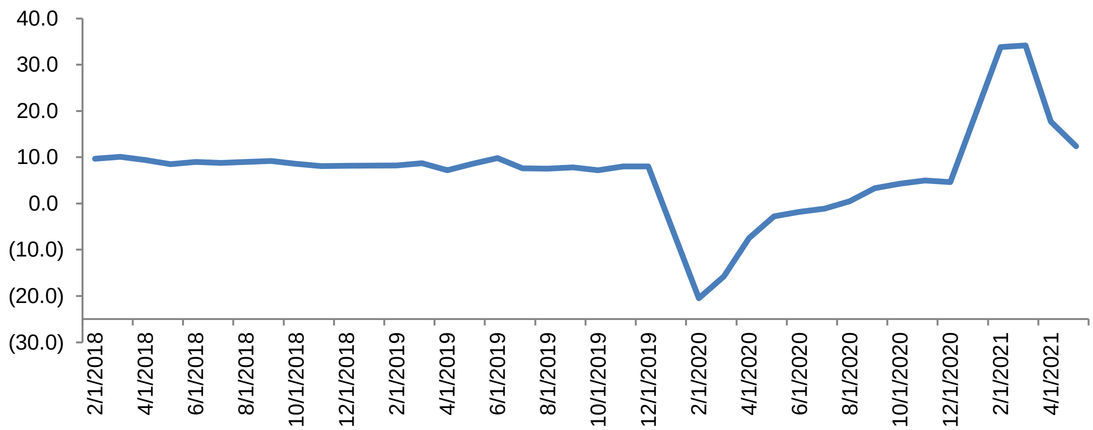
With the resumed production and strong export growth, industrial production rose 17.8% in 5M21, with an average growth of 7.0% in two years. As a synchronous indicator of the macro economy, electricity output expanded by 14.9% in Jan-May. PMI for manufacturing, which covers 31 industries, exceeded the 50 threshold level in all of the first five months in 2021. Meanwhile, profit growth of industrial enterprises accelerated to 83.4% in Jan-May, with an average growth of 21.7% in two years.

[1] All growth rates are year-on-year except specified otherwise

In terms of domestic demand, both consumer spending and FAI have recorded robust growth since the start of 2021 due to low base in 1H20. Retail sales increased 25.7% in Jan-May, with an average growth of 4.3% in two years (Exhibit 1). FAI growth in urban areas also surged to 15.4% in 5M21, with an average growth of 4.2% in two years (Exhibit 2).

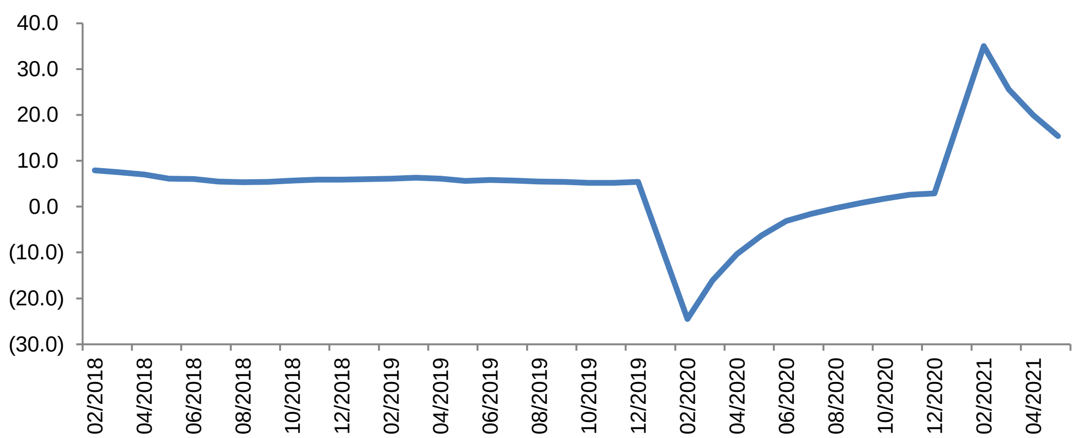
On the external front, exports grew 40.2% in Jan-May in USD terms, thanks to the increase in external demand supported by the gradual recovery of the world's major economies (Exhibit 3). Imports expanded 35.6% in Jan-May, mainly attributable to the accelerating growth in domestic demand and the sharp rebound in international commodity prices. Trade surplus surged to US$ 203.5bn in 5M21, significantly higher than the US$ 121.4bn in 5M20.

Exhibit 1: China's retail sales growth (%)



Source(s): NBS, ABCI Securities

Exhibit 2: China's FAI YTD growth (%)

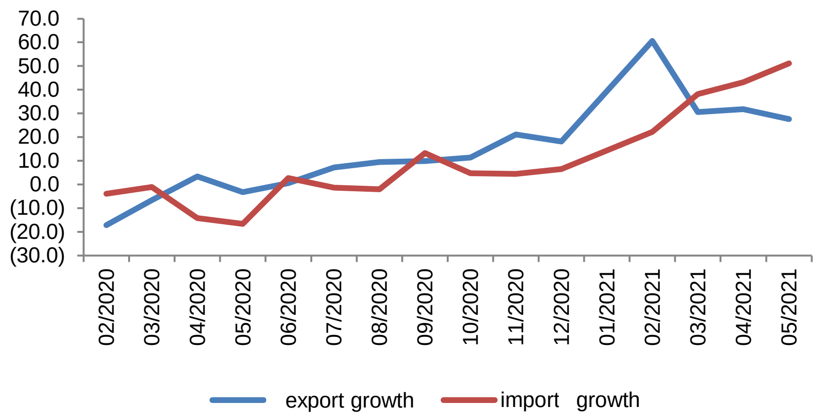


Source(s): NBS, ABCI Securities

CPI and PPI diverged significantly in 5M21. CPI eased to 0.4% in 5M21 from 4.1% in 5M20 as food inflation moderated, especially for pork price. PPI rebounded to 4.4% in 5M21, compared with the 1.7% decline in 5M20. The sharp rebound of PPI in Apr was mainly due to the low base effect and the rising commodity prices, including those of oil, non-ferrous metals, and ferrous metals.

On the monetary front, PBOC has begun to normalize the monetary policy since the start of 2021. The benchmark interest rates and RRR stayed unchanged. Growth in broad money supply (M2) decelerated to 8.3% in May 2021 from 11.1% in May 2020, while total social financing, a comprehensive measure of all types of financing for the real economy, dropped to about RMB 14.0tr in 5M21 from RMB 17.4tr in 5M20. The government bond yields, as well as the seven-day repurchase rate that measures the short-term funding costs, were held stable.

Exhibit 3: China's export and import growth (%)



Source(s): General Administration of Customs, ABCI Securities

Economic growth to slow in 2H21

Despite the high GDP growth in 1Q21, we believe China's economic growth will slow substantially in 2H21 as the low base effect withers. Strong external demand and steady consumer spending will be the main growth drivers. On the contrary, high debt burden and emergence of COVID-19 variants would present major challenges in 2H21.

Domestically, investment growth is expected to ease because tightening policies in the property market would weigh on growth in property investment; also, growth in infrastructure investment would ease due to slower fiscal revenue growth. On the contrary, manufacturing investment and private investment would expand steadily amid improving profit and strong external demand. Increasing income and low employment rate would support consumer spending. Externally, despite strong global demand, export growth would moderate on high base effect. For these reasons, we expect China's economic growth to be 8.5% for 2021E, higher than the previous estimate of 8.0% due to substantial rebound in 1Q21 (Exhibit 4). However, significant financial risks remain, particularly those from the elevated corporate sector debt exceeding 160% of GDP in 2020. The pandemic risks still linger in China since COVID-19 is still rampant on a global level.

Despite the sharp rise of PPI in recent months, we believe the index's inflation is likely to ease in 2H21 as the commodity supply recovers on rising prices. CPI inflation is expected to remain mute in 2H21 due to the lower food prices, especially the pork price as supply improves. PPI is expected to be 4.5% in 2021E, while CPI is expected to be 1.2%. We believe the macro policy would not be constrained by inflation in 2H21.

On the monetary front, PBOC is expected to maintain a neutral monetary policy to support growth. The authority is likely to keep liquidity abundant to support loan growth for private firms and SMEs. We predict new RMB-denominated loans and new aggregate financing to be ~RMB 20.5tr and ~RMB 33.0tr in 2021E. Meanwhile, benchmark interest rates would remain steady in 2H21. The rates for one-year LPR and five-year LPR are expected to be 3.85% and 4.65% by end-2021E; meanwhile, RRR would be stable at 11.0% for large financial institutions and 9.0% for medium and small financial institutions. Broad money supply (M2) is set to grow by about 8.5% in 2021E. Regarding the exchange rate, we expect spot USD/CNY rate to approach 6.4500 by end-2021E with the widening US-China real interest rate gap, as compared to 6.5273 at end-2020.

Normalization of the fiscal policy will continue in 2H21. Fiscal policy that includes tax and fee reductions, specific consumption-stimulating measures, and programs to boost infrastructure investment for decarbonisation and renewable energy will be maintained to support economic growth. We forecast fiscal deficit ratio to approximate 3.5% of GDP in 2021; issuance of special treasury bonds will likely be halted, and various fiscal policy support will be withdrawn.

Exhibit 4: Economic forecasts

Economic indicators	2019	2020	2021E
Real GDP growth, %	6.1	2.3	8.5
FAI growth, %	5.4	2.9	6.0
Retail Sales growth, %	8.0	(3.9)	18.0
Export growth in USD terms, %	0.5	3.6	25.0
Import growth in USD terms, %	(2.8)	(0.8)	30.0
Industrial Production growth, %	5.7	2.8	10.0
CPI, %	2.9	2.5	1.2
PPI, %	(0.3)	(1.8)	4.5
M2 growth, %	8.7	10.1	8.5
Aggregate Financing, RMB bn	25,674	34,900	33,000
New Yuan Loans, RMB bn	16,816	19,600	20,500
Spot CNY per USD, End-year	6.9632	6.5273	6.4500
One-year LPR, %	4.31	3.85	3.85
Five-year LPR, %	--	4.65	4.65

Source(s): NBS, PBOC, ABCI Securities estimates

Investment Strategy

2H21 Investment Strategy

The Commodity Supercycle

Philip Chan, Head of Research

The global commodity supercycle is elevating global inflationary pressure. In 1H21, inflationary pressure is emerging in the producer prices, which will later on transmit to consumer prices in 2H21. The current supercycle is similar to the one in 2007-09.

Exhibit 1: Features of the supercycle in 2007-09 and 2020-22

	2007-09 supercycle	**2020-22 supercycle so far**
From inflation cycle to deflation cycle	OECD developed economies: 3Q07 CPI at 2.11% rose to 4.38% in 3Q08 before plummeting to -0.41% in 3Q09 US urban CPI rose from 2.0%YoY in Aug 2007 to 5.6% in Jul 2008, then down to -2.1% in July2009 China urban CPI rose from 2.0%YoY in Jan 2007 to 8.5% in Feb 2008 before dropping to -1.9% in Feb 2009	OECD developed economies: 2Q20 CPI at 0.66% climbed to 1.84% in 1Q21 OECD predicts 2021 CPI to be 2.58% US urban CPI surged from 0.1%YoY in May 2020 to 5.0%YoY in May 2021 China urban CPI rose from -0.4%YoY in Nov 2020 to 1.4% in May 2021
Stagflation	Economic growth slowed significantly after the high inflation rate. US GDP tumbled to -3.9% YoY in 2Q 09 from 1.1% in 1Q 08. China's GDP slowed from 11.5% YoY in 1Q08 to 6.4% YoY in 1Q09	
Catalysts	* Global financial crisis leads to monetary expansion, resulting in sharp decline in risk-free rates and expansion of credit supply * Global commodity supply was interrupted during the crisis * Surplus liquidity flows into the commodity market on the anticipation of demand recovery * Uneven vaccination rate among countries in 2021 results in uneven recovery in supply side and demand side. High income countries (demand side) recover at a faster pace than low/middle-income countries (supply side).	
Inflation transmission channel	Crude, coal prices: Common energy input resources of secondary and tertiary industries; supply interruption during crisis but swift recovery in demand post-crisis Food prices: Common energy input resources of human and animal activities; industrial demand was suppressed during the crisis but rebound rapidly afterwards Base metal: Copper	

Source (s): OECD, ABCI Securities

Investment theme

During the last commodity supercycle when commodities were trading at high prices throughout 2007 and 1H08, a deflation cycle soon took place in mid-2008. Lowering of the Fed Funds rate in 2007-08 had fueled the commodity supercycle, which eventually ended in mid-2008. The collapse of the supercycle, however, was not caused by unfavorable interest rate cycle; instead, the escalating commodity prices encouraged supply, which then outstripped demand in 2009, driving up deflation risk. When deflation risk mounted in 2009, the central banks, without much option in their disposal, adjusted down the interest rates further. If the 2007-09 supercycle repeats in 2021-22, inflation risk will escalate in 2021 and deflation risk will rise sharply in 2022.

Currently, capital market investors are concerned that inflationary pressure may result in an earlier-than-expected rise in interest rates by the Fed. This expectation, however, can be erroneous if deflation risk rises sharply in 2022, just like it was in 2009. In that case, the Fed may slash the interest rate to the negative territory from the current near-zero level. The essential factor that will reverse the inflation cycle at present is the substantial increase in COVID-19 vaccination among commodity-exporting countries. The rising commodity prices in 1H21 will encourage governments and enterprises of commodity-exporting countries to increase inoculation in 2H21 and raise commodity output in 1H22.

Our estimate on the timing of the cycle, however, entails uncertainties. Unlike the general consensus, we believe there is the possibility that a deflation cycle may occur after the current inflation cycle; therefore , the Fed may choose to lower interest rate further to reduce deflation risk. Our view for 2022-23 is at odds with the current market expectations.

Capital market in 2H21

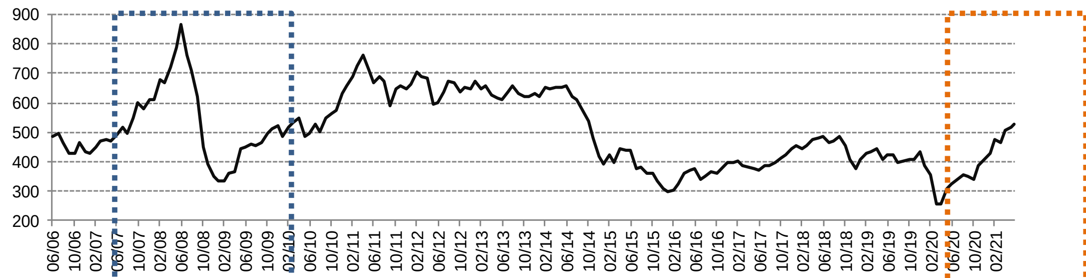
For 2H21, we expect the capital market will be subjected to inflationary risk with the expectation of the interest rate hike in 2023.

- Commodity stocks: The expected profit jump of upstream energy resources and base material producers will boost stock prices in 2H21.
- Phama stocks: Among pharma stocks, profits of vaccine makers will show stellar growth in 2021. Government bulk procurement for major drugs and fast consumable medical equipment will suppress valuation of drug and consumable medical equipment producers. Biotech companies developing innovative drugs will provide shelters for investors in the pharma market.
- New energy stocks: Wind and solar energy producers are expected to post solid profit growth in 2021 due to capacity expansion in 2020. To boost clean energy output, installed capacity of clean energy generation should increase accordingly. New energy equipment makers will benefit earlier than the energy producers.
- Transportation stocks: The gradual recovery of air travel in 2Q21 will set to benefit airport operators and airline ticketing companies in 2H21. NEV makers will continue to prosper as the Chinese government aims to increase proportion of NEV sales to 20% of total auto sales in 2025. In 5M21, NEV sales accounted for ~9% of total auto sales.

- Digital economy stocks: Semiconductors lie at the core of the digital economy. The shortage of chips in 1H21 will extend to 2H21. We expect China, the US, Korea, Japan, and China Taiwan to step up FAI in the semiconductor industry. Upstream chip equipment makers and material producers will be much in demand in 2021. Downstream packaging and testing service providers will see explosive demand growth in 2022-23 after midstream chip foundries expand their production lines.
- Fintech banks: The tightening regulatory control makes it hard for technology companies to penetrate into the financial services industry. Instead, large-sized commercial banks are increasing their capital and human resources on Fintech. In general, continuous investment in technology is crucial to raising the competitive edges of players in the financial industry over the long run, with ABCDI (AI, blockchain, cloud computing, big data, and Internet of things) forming the core of technological future. In 2020, ICBC (1398 HK) invested RMB 23.819bn (+45.47%) in Fintech and employed 35,400 related staff (+1.72% or 8.1% of total workforce); CCB (939 HK) invested RMB 22.109 bn (+25.38%) in Fintech and employed 13,100 staff (+28.75%, or 3.51% of total workforce). In 2020, ABC (1288 HK), BOC (3988 HK), and CMB (3968 HK) invested RMB18.3bn (+43.08%), RMB 16.707bn (+43.36%) and RMB 11.912bn (+27.25%) in technology to strengthen their Fintech capabilities, respectively.

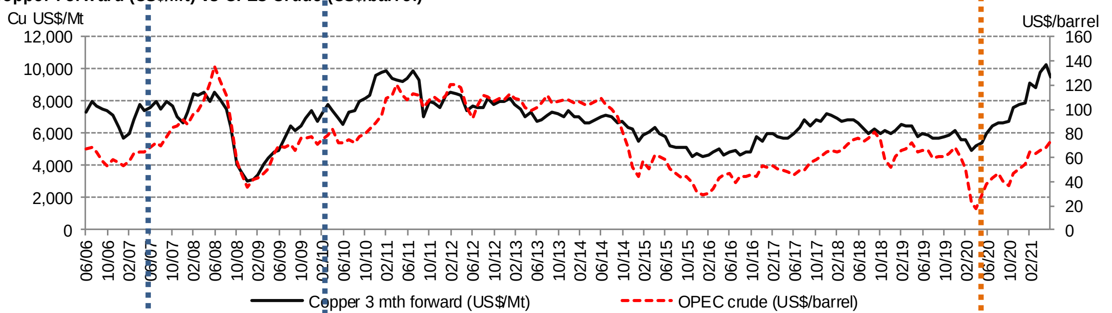
Exhibit 2: Commodity supercycle driven by prices of crude, food and metal

S&P GSCI Commodity Index



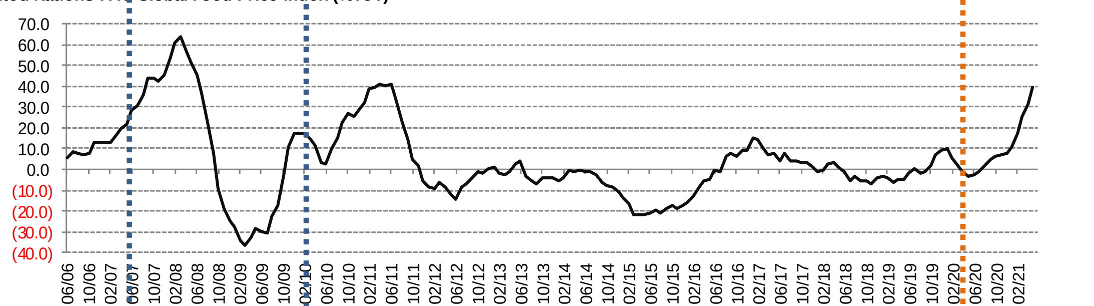
Source(s): S&P GSCI, Bloomberg

Copper Forward (US$/Mt) vs OPEC Crude (US$/barrel)



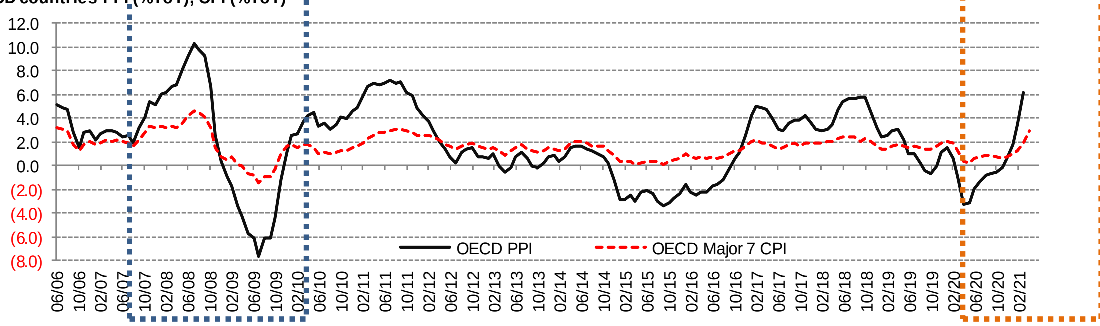
Source(s): London Metal Exchange, OPEC, Bloomberg

United Nations FAO Global Food Price Index (%YoY)



Sources: United Nations FAO

OECD countries PPI (%YoY), CPI (%YoY)



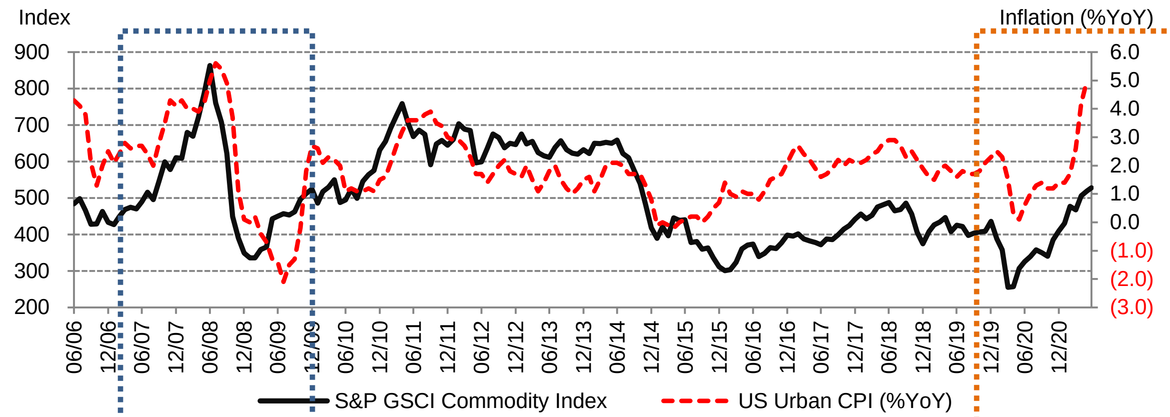
Sources: OECD, Bloomberg

All sources include ABCI Securities

What history told us…

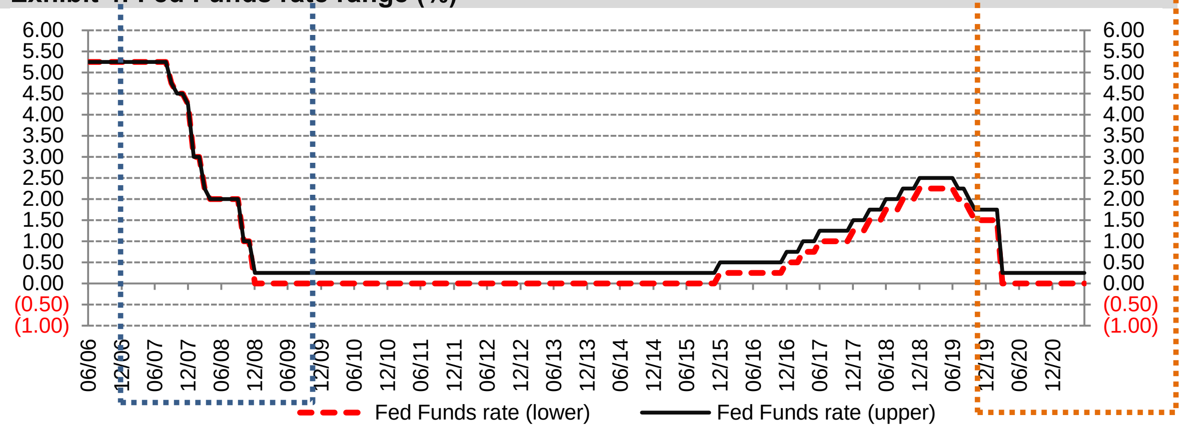
The Fed lowered interest rate and drove up inflationary pressure in 1H07-1H08. Interest rate was slashed further to cope with deflationary pressure in 2H08-1H09. The Fed maintained a zero interest rate environment to support reflation in 2H09-2H10. Deflation cycle in 2H08-1H09 was not caused by interest rate hike – it was a result of the change in demand-supply dynamics of commodities.

Exhibit 3: Commodity Price Index (LHS) vs. US Inflation (RHS)



Source(s): S&P GSCI, Bureau of Labor Statistics, Bloomberg, ABCI Securities

Exhibit 4: Fed Funds rate range (%)



Source(s): Federal Reserve, ABCI Securities

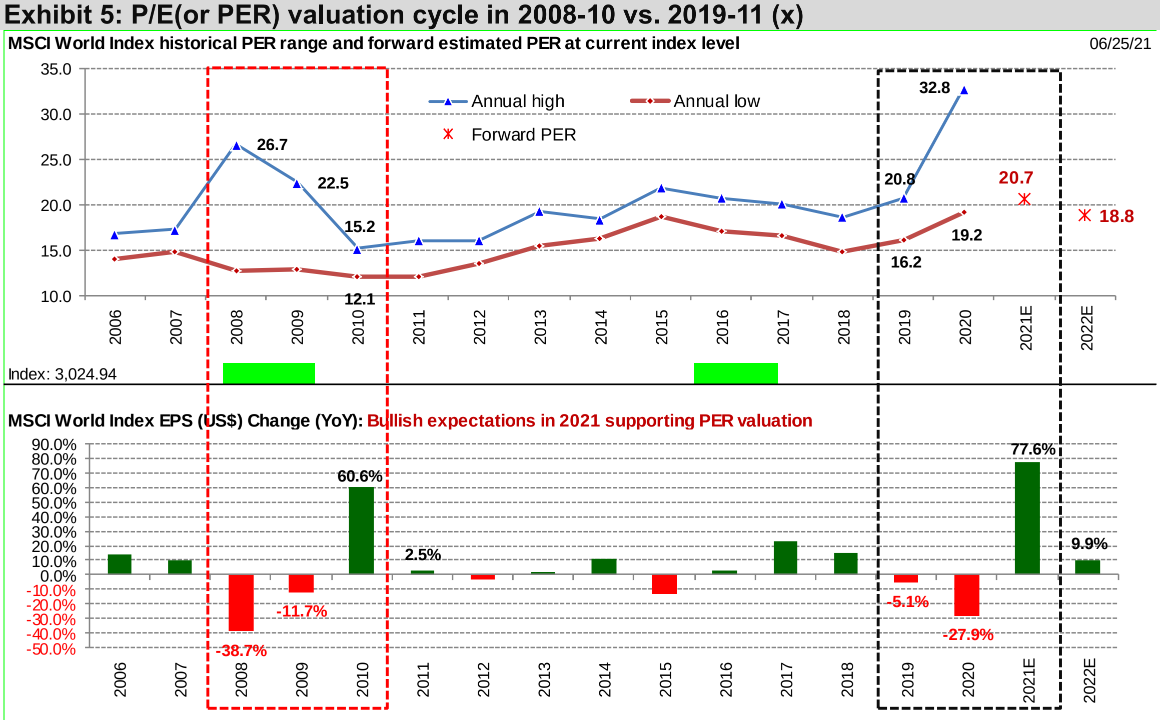
Hong Kong Stock Market

2H21 Hang Seng Index trading range: 26,600-29,900
2022E Hang Seng Index trading range: 28,800-33,600

Expensive valuation in the stock market, which has factored in strong earnings growth expectation for 2021, leads to an unattractive risk-return profile for short-term investment. The low earnings base in 2020 has greatly distorted the earnings growth in 2021 and 2022. Corporates will report impressive profit growth 2021 due to the low base in 2020, but low profit growth can be expected for 2022 due to the high base in 2021. Investors' focus will shift from 2021 earnings to the one expected for 2022 in 4Q21, and stock valuation will fall based on the lower growth momentum projected.

According to Bloomberg consensus, the market expects EPS of MSCI World Index to surge 77% YoY for 2021E and 10%/9% for 2022E/23E. The index (3,025 on June 25, 2021) represents 20.7x/18.8x.2021E/22E P/E. During 2015-19 (pre-COVID), the P/E range of the index was 14.9-21.9x.

Exhibit 5: P/E(or PER) valuation cycle in 2008-10 vs. 2019-11 (x)



Source(s): Bloomberg , ABCI Securities

The Hang Seng Index (28,817 on June 23, 2021) was trading at 13.5x 2021E P/E and 12.0X 2022E P/E. During 2015-19 (pre-COVID), the P/E range of the index was 9.1-13.6x with the mean at 11.7x. The market expects the index EPS to grow by 9.0% YoY in 2021 and 12.7%YoY in 2022.

Exhibit 6: Hang Seng Index P/E valuation projection

P/E range	High (x)	Low (x)	Close (x)	EPS growth
2016	13.56	10.17	12.24	(12.5%)
2017	12.51	9.07	12.39	34.3%
2018	13.11	9.61	10.12	5.8%
2019	12.15	9.99	11.31	(2.4%)
Average 2016-19	12.83	9.71	11.52	
2016-19 range	13.56	9.07		
2020 (COVID)	14.91	10.80	13.91	(21.5%)
2021E	14.00	12.50	13.50	9.0%
2022E	14.00	12.00	13.00	12.7%

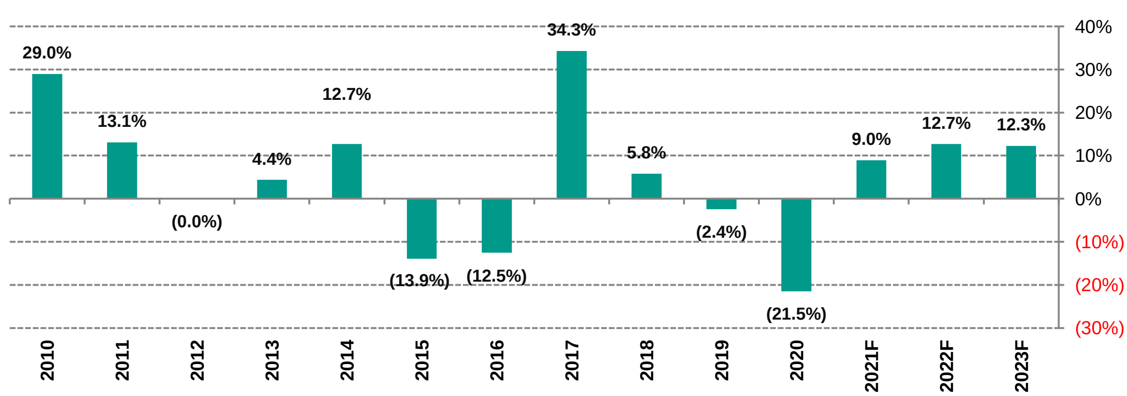
Year P/E high = Yea- high of index/ annual EPS
Year P/E low = Year-low of index/ annual EPS
Source(s): Bloomberg, ABCI Securities estimates

Exhibit 7: Hang Seng Index trading range projection

	Our projection in Dec 2020 for 2021E	Actual range in 1H21	Our projection in June 2021 for 2H21E	Revision
Hang Seng Index				
High	30,297	31,183	29,853	(1.5%)
Low	24,033	27,079	26,655	2.0%
Year close	27,967		28,787	2.9%
	In 2022		**In 2022**	
High	31,773		33,644	5.9%
Low	26,918		28,837	7.1%
Year close	29,126		31,240	7.3%

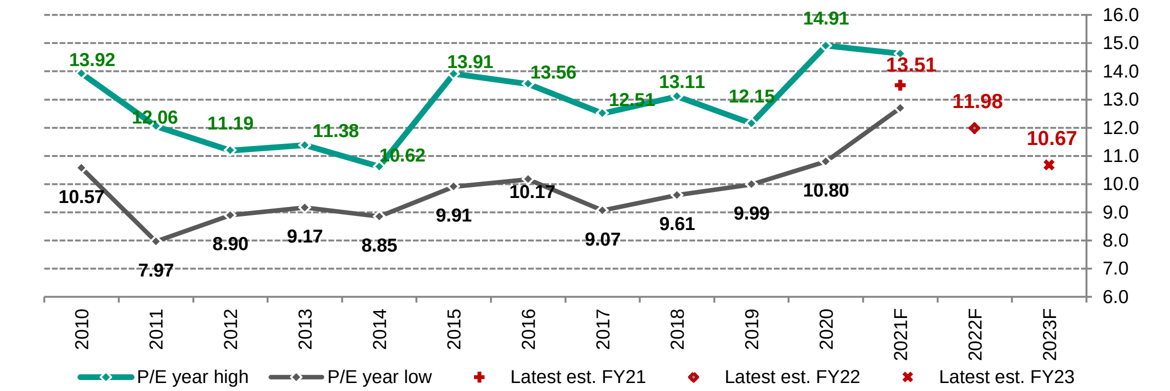
Source(s): ABCI Securities estimates

Exhibit 8: Hang Seng Index EPS Growth (%YoY)



Index: 28,817
Source(s): Bloomberg, ABCI Securities estimates

Exhibit 9: Hang Seng Index P/E band (x)



Index: 28,817
Source(s): Bloomberg, ABCI Securities estimates

Hong Kong IPO Market

Steve Chow, Analyst

Internet and new-economy stocks to drive growth

- **In 1H21, Hong Kong IPO market has raised US$ 26.4bn vs. US$ 51.6bn in 2020**
- **Kuaishou (1024 HK) accounted for 23.6% of the total IPO volume in 1H21**
- **We expect internet/new-economy stocks to stay as a major driver in the near future**

In 1H21 (up to June 24, 2021), the Hong Kong IPO market has raised US$ 26.4bn vs. US$ 51.6bn in 2020. In 1H21, a total of 42 IPOs were issued, with an average issue size of US$ 630mn each.

Overall, the IPO market has seen higher concentration in industry and company mix compared to 2020. In terms of industry mix, communication is the major driver accounting for 55% of the IPO volume in 1H21, followed by industrials (15%), healthcare (14%), technology (9%), and others (7%). Internet stock Kuaishou (1024 HK, classified as under the category of "Communications" based on Bloomberg) has become the largest IPO in 1H21 (HK$ 48.3bn), solely accounting for 23.6% of the total IPO volume during the period. As a result of Kuaishou's contribution, average issuance size has increased from US$ 356mn in 2020 to US$ 630mn in 1H21.

Looking forward, China Tourism Group Duty Free Corp (601888 CH), China's largest duty-free shop operator, is planning to be dually listed in Hong Kong. Its IPO size could potentially exceed Kuaishou's. In addition, we expect the internet/new-economy stocks to be a major driver for the IPO market in the near future.

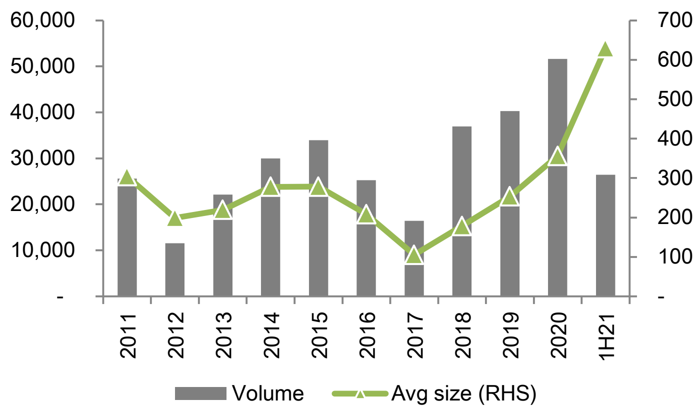
In our view, the increased supply of internet stocks may prompt institutional investors to rebalance their industry portfolio.

Exhibit 1: 1H21 HK IPO Overview *

Industry	Volume (US$ mn)	Avg deal size (US$ mn)
Communications[1]	14,529	2,076
Industrials	3,936	492
Health Care	3,670	334
Technology	2,449	408
Consumer staple	1,057	352
Real estate	754	151
Others	52	26

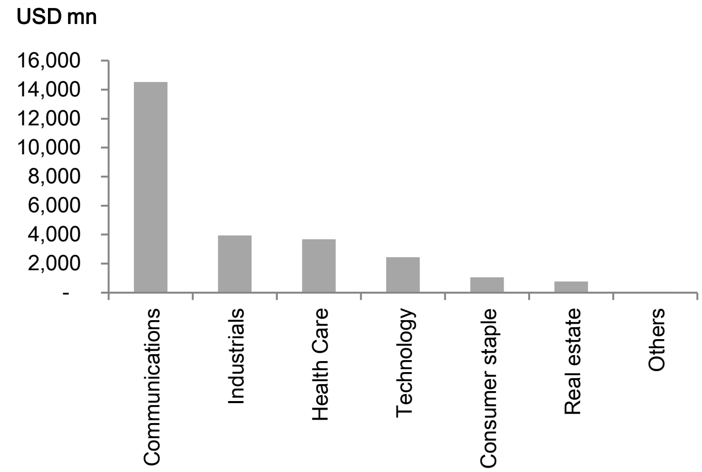
[1] Include internet /media stocks
Note: Data as of June 22, 2021
Source(s): Bloomberg, ABCI Securities

Exhibit 2: HK IPO volume and average deal size* (1H21*, USD mn)



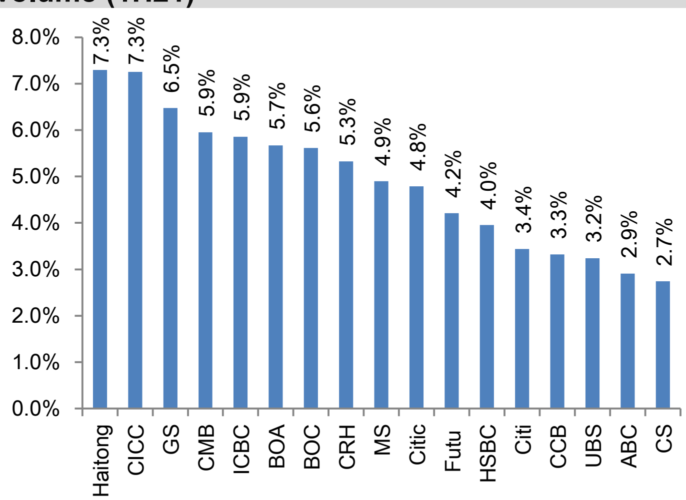
*1H21 - Up to June 24, 2021
Source(s): Bloomberg, ABCI Securities

Exhibit 3: HK IPO volume by industry (1H21)*



Source(s): Bloomberg, ABCI Securities

Exhibit 4 : Market share of HK IPO underwriters by volume (1H21)*



*1H21 - Up to June 24, 2021
Source(s): Bloomberg, ABCI Securities

Sector Outlook

OVERWEIGHT
China Banks Sector – Surprise on fundamentals required for re-rating

Johannes Au

Key Data		Sector Performance	Absolute (%)	Relative (%)
H-shr		**H-shr (relative to MXCN)**		
Avg. 21E P/E (x)	5.10	1-mth	(3.61)	(4.99)
Avg. 21E P/B(x)	0.57	3-mth	(6.35)	(1.95)
Avg. 21E div yield (%)	7.27	6-mth	14.66	12.85
A-shr		**A-shr (relative to CSI300)**		
Avg. 21E P/E (x)	6.26	1-mth	(1.45)	(0.19)
Avg. 21E P/B(x)	0.70	3-mth	(4.07)	(4.70)
Avg. 21E div yield (%)	5.80	6-mth	5.35	2.75
Source(s):Bloomberg, ABCI Securities estimates		Source(s):Bloomberg, ABCI Securities		

- Stable fundamentals for banks given policy priority in financial stability
- Mild system NIM pressure to persist; asset quality will be steady
- Big banks remain stable; differentiation among bank categories is growing
- High policy risk would shadow over the internet finance sector - adaptability as key to survive
- **OVERWEIGHT** rating for both A/H banks sectors. Prefer big banks for defensiveness and promising dividend yield. **CCB(939 HK/601939 CH)** is our sector top pick

Policy-driven fundamentals. With the prolonged impacts of COVID-19 and Sino-US dispute, fundamentals of the financial sectors have become closely tied with policy direction. We have listed out the major trends in China's bank sector: 1) In order to support recovery of China's economy, momentum in the system loan growth in FY21E-22E would continue. Our economist forecasts FY21E target new loans to be ~RMB 20.5tr. Robust growth was seen in 5M21, with total new loans accounting for 51.9% of our full-year target. In view of the policy direction, a larger proportion of new loans would be allocated to technology, green, and agricultural-related MSEs; 2) Lower social financing cost has been the key to macro recovery, but we believe the re-pricing impact of LPR reform has come to a close in 2Q21, which means that the average lending rate of banks would be stabilized at ~5%. Nevertheless, changes in loan mix with increased allocation to policy support areas may allow some banks to outperform in terms of asset yield; 3) Asset yield would be stable, while retail deposit cost would rise on keen competition in retail business. We project a mild system NIM pressure in FY21E-22E, with the contraction pace of NIM to be slower than that in FY20; 4) Avoiding financial systematic risk would continue to be one of the top policy priorities. We expect banks to remain proactive in NPL handling in FY21E-22E and large provisions would be made to strengthen risk buffers, which in turn would limit net profit growth. We project the system NPL to be in the range of 1.7%-1.9% in FY21E-22E (Mar 2021:1.8%); 5) To capture opportunities in the wealth management market in China, retail and fintech would become the key battlefield among banks in coming years.

Higher differentiation among bank categories. We believe differentiation among bank categories would increase in the future. Large commercial banks would be stable in terms of profitability, asset quality, and dividend payout; nonetheless, these big players would carry a higher policy risk than the smaller counterparts because of the higher level of social responsibility. In terms of Fintech development, these big banks, given their sufficient resources, would have an edge. Specifically, we estimate their fintech expenses to approximate 3%-5% of their topline revenue in FY21E-22E. Among JSBs, CMB (3968 HK/600036 CH) has the strongest fundamentals and therefore, the highest valuation in the sector. For other JSBs, such as MSB (1988 HK/600016 CH), provision need may go up in FY21E-22E. For district banks, in view of their smaller operation size, we expect a higher volatility in both share price and fundamentals in FY21E-22E. To investors, low trading liquidity and declining dividend payout ratio of the district banks should be the major concerns.

Internet finance sector - high policy risk. The new-economy sector, which umbrellas a wide range of sectors including the internet finance, has garnered more attention since FY20 as a result of the fast growth during the pandemic. Internet finance is in the initial stage of fast growth, but under the policy priority in financial system stability, policy risk has been surging in recent months. Since the sector is a young one, high policy risk can be expected in the medium-to-long term. In the process of sector standardization, the business models and fundamentals of the players would be altered, and high adaptability to policy changes would be crucial to survival. Fintech players, compared to the Techfin ones, are more competitive because of their experience in cooperating and collaborating with the regulators. On the other hand, traditional FIs, such as the banks, have increased their fintech investment; competition in the internet finance industry, therefore, will stiffen. High policy risk and increasing competition would offset the rapid growth in this new-economy sector. We suggest investors to adopt a wait-and-see approach in the short term, and accumulate the top players for long-term investment.

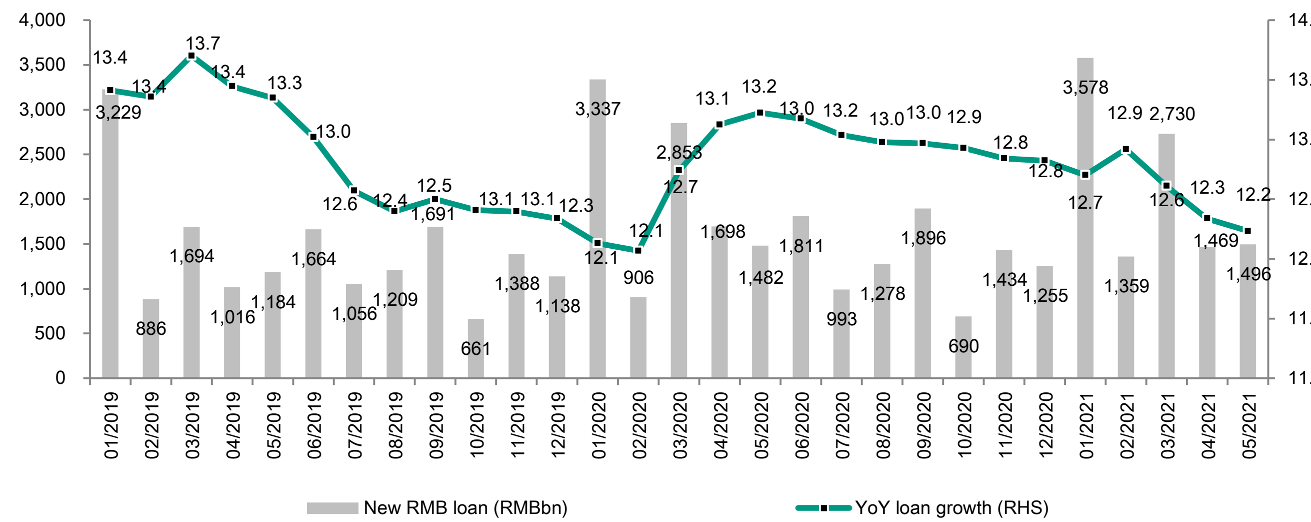
Long-term Outlook
Policy risk is the largest overhang in the China financial sector, though we believe a highly regulated and disciplined business environment are prerequisites to sound fundamentals in the long run. COVID-19 and Sino-US disputes will continue to affect the industry.

Short-term Outlook
Macro environment is recovering from impacts of the pandemic. We expect investors to remain cautious over the banking industry in the near term. Re-rating of the sector may occur in 3Q21-4Q21 on better-than-expected financials and macro data.

Stock Recommendations
We reiterate our **OVERWEIGHT** rating for the China banks sector in both A/H share markets given the stable fundamentals and low valuation. Surprise on the fundamental aspects, however, will be necessary to drive sector re-rating, in our view. We have observed that investors' attitude toward policy risk has been neutralizing, which implies limited downside from the current valuation. We prefer the big banks for their promising dividend yield, defensiveness against policy risks, and high adaptability to macro changes. **CCB (939 HK/601939 CH)** is our top pick for its prudent practices.

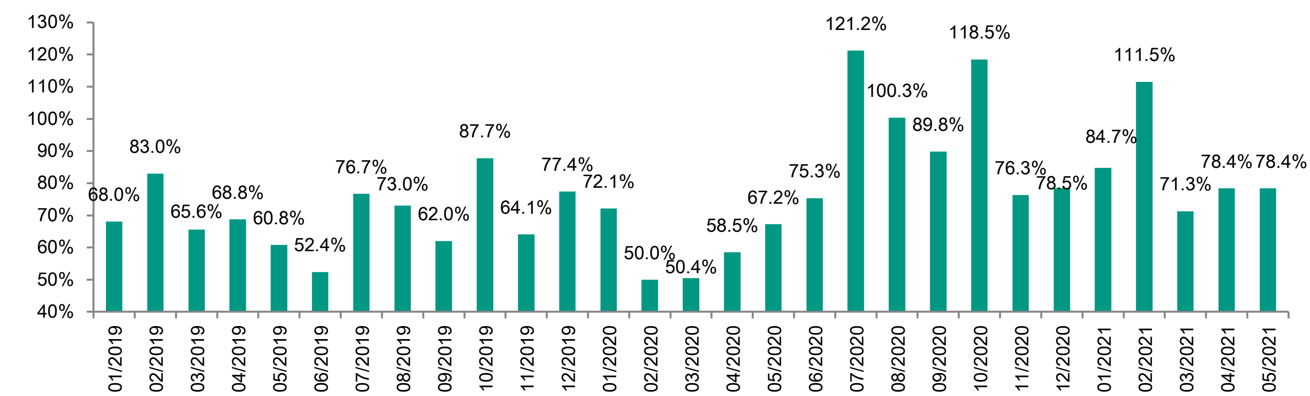
Risk Factors
1) Radical changes in business environment induced by increased supervision and heavy-handed policies; 2) Increasing competition from cross sector financial institutions and foreign players; 3) Sharp deterioration in asset quality; 4) Increasing policy risk in new and fast-growing businesses; 5) Prolonged impacts from COVID-19 pandemic and Sino-US disputes.

Exhibit 1: Monthly RMB loans (RMB bn) and total RMB loan balance YoY (%)



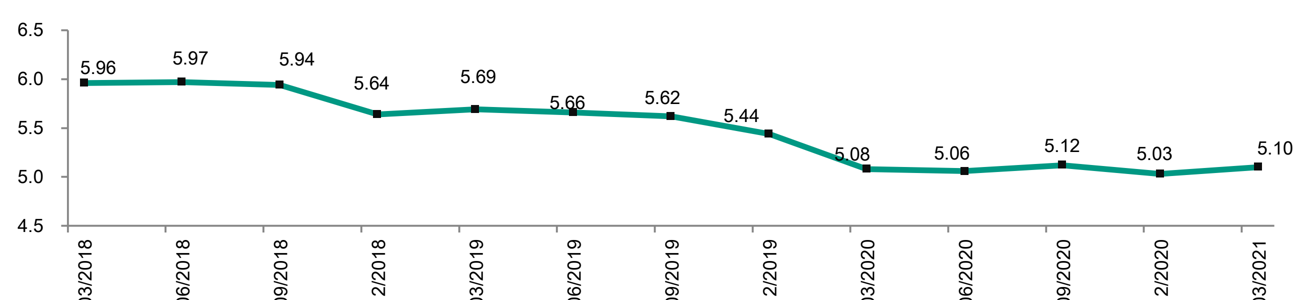
Source(s): PBOC, ABCI Securities

Exhibit 2: Medium-to-long-term loans to monthly total RMB loans (%)



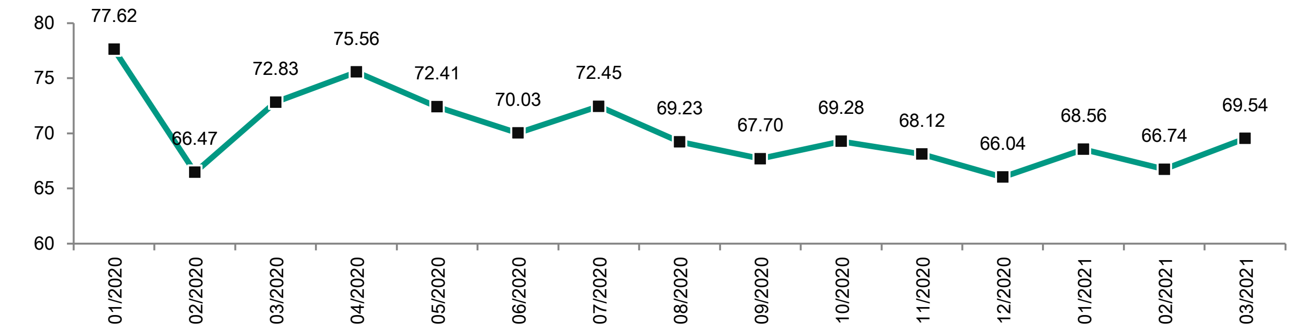
Source(s): PBOC, ABCI Securities

Exhibit 3: System monthly average lending rate (%)



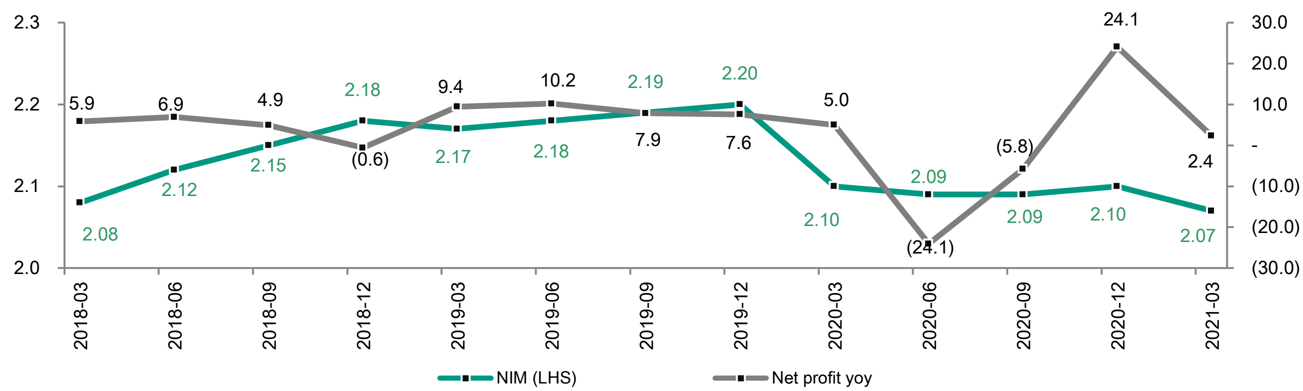
Source(s): PBOC, ABCI Securities

Exhibit 4: Proportion of loans priced above LPR (%)



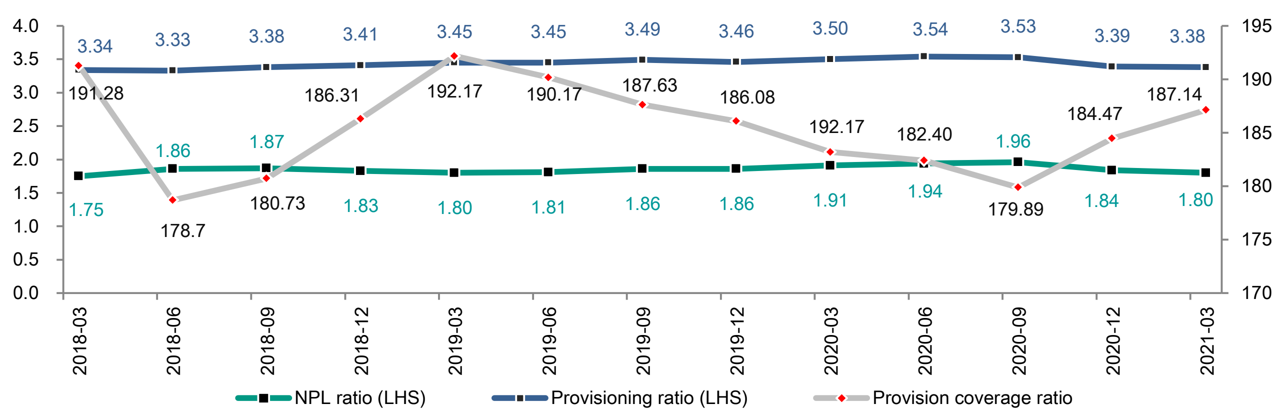
Source(s): PBOC, ABCI Securities

Exhibit 5: System NIM vs. system quarterly net profit YoY (%)



Source(s): CBIRC, ABCI Securities

Exhibit 6: System asset quality indicators (%)



Source(s): CBIRC, ABCI Securities

Valuation of sector top picks for H-shr market (Data as of June 25, 2021)

Company	Ticker	Rating	TP (HK$)	Upside (%)	FY21E P/E(x)	FY22E P/E (x)	FY21E P/B (x)	FY22E P/B (x)	FY21E Yield (%)	FY22E Yield (%)
CCB	939 HK	BUY	8.72	40.65	4.73	4.58	0.53	0.49	6.75	6.97

Source(s): Bloomberg, ABCI Securities estimates

Valuation of sector top picks for A-shr market (Data as of June 25, 2021)

Company	Ticker	Rating	TP (HK$)	Upside (%)	FY21E P/E(x)	FY22E P/E (x)	FY21E P/B (x)	FY22E P/B (x)	FY21E Yield (%)	FY22E Yield (%)
CCB	601939CH	BUY	9.66	43.32	6.12	5.93	0.69	0.63	5.22	5.39

Source(s): Bloomberg, ABCI Securities estimates

NEUTRAL

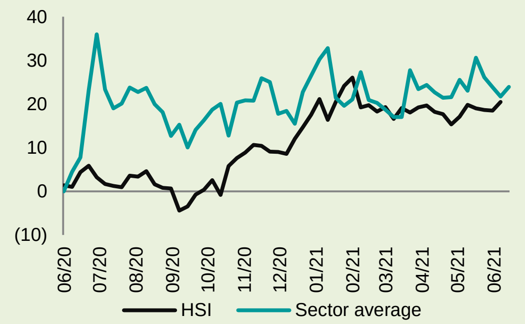
China Securities & Brokerage Sector – Lack of positive catalyst

Steve Chow

Key Data		Sector Performance (relative to HSI)	Absolute (%)	Relative (%)
Avg. 21E P/E (x)	7.1	1-mth	(4.4)	(5.0)
Avg. 21E P/B(x)	0.6	3-mth	5.4	2.1
Avg. 21E div yield (%)	5.2	6-mth	5.5	(5.8)
Source(s):Bloomberg, ABCI Securities, estimates		Source(s):Bloomberg, ABCI Securities		

- YoY growth in A-share ADT in 2H21 will be affected by high base in 2H20
- Structural decline in industry ROAE due to lower leverage and intensified competition
- Lack of positive catalysts in the near term

1-year sector performance



Source(s):Bloomberg, ABCI Securities

High base for 2H21. In 5M21, A-share monthly average ADT was RMB 899bn vs. RMB 758bn in 5M20, supporting commission income. Margin financing and securities lending (MFSL) balance increased from ~RMB 1.61tr at end-2020 to ~RMB 1.72tr at end-May 2021. On the other hand, the SHSZ300 Index gained 2.3% in 5M21. Looking forward, 2H21 YoY growth will be affected by the high base since A-share monthly average ADT increased to RMB 924bn in 2H20 vs. RMB 753bn in 1H20. In particular, A-share monthly average ADT jumped to RMB 1312bn /RMB 1061bn in July/ Aug 2020, making a high comparison base for 3Q21.

ADT and index movement are the main revenue determinants. For the sector, brokerage is the largest revenue contributor in 2020 (37%), followed by trading (33%), investment banking (15%), asset management (7%), and others (9%), according to SAC. Overall, brokerage and trading collectively accounted for 70% of industry revenue; therefore, ADT and index movements are the main proxies of the revenue trend.

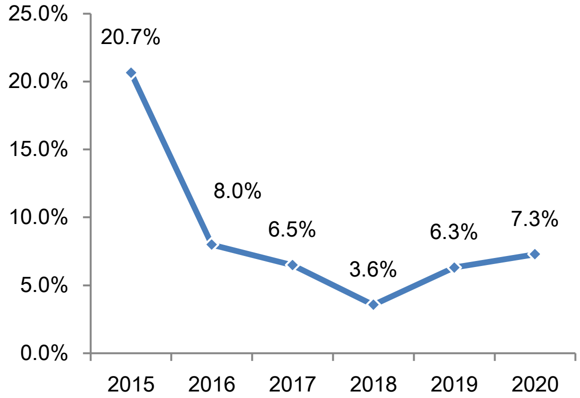
Structural decline in industry ROAE. Overall, ROAE in the brokerage industry has been falling over the past few years. Industry ROAE fell from the peak of 20.7% in 2015 to the single-digit levels in recent years. In our view, such structural decline is due to 1) Lower leverage. Industry asset/equity ratio fell from 4.4x in 2015 to 3.9x in 2020. Although this indicates better risk management for the industry, it hinders ROAE as brokers have turned more conservative in financial leverage; 2) Ongoing price pressure resulted from intensified competition of the brokerage business, which accounted for 37% of industry revenue in 2020.

Lack of re-rating catalysts. Major H-listed securities companies have been undergoing a de-rating trend over the past few years with its forward P/B falling from ~1x in 2016 to ~0.6x at present. In our view, this is in-line with its declining ROAE trend.

Risk Factors

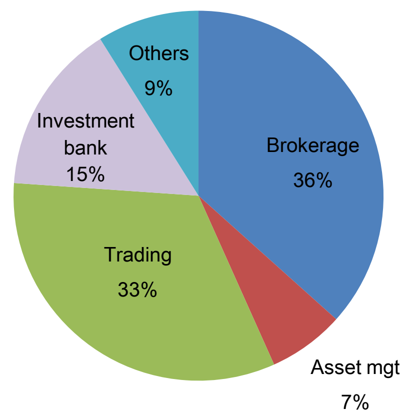
1) Market risk of financial assets; (2) Credit risk associated with bond investments and lending business; (3) Volatility in market turnover; (4) Penalties on misconduct or staff malpractice in securities firms; (5) Regulatory changes in direct financing; (6) Spill-over impact of deleveraging in the financial sector; (6) Intensifying competition after the relaxation of foreign ownership in the industry; (7) Intensifying competition between banks and securities companies in direct financing business.

Exhibit 1: Industry ROAE



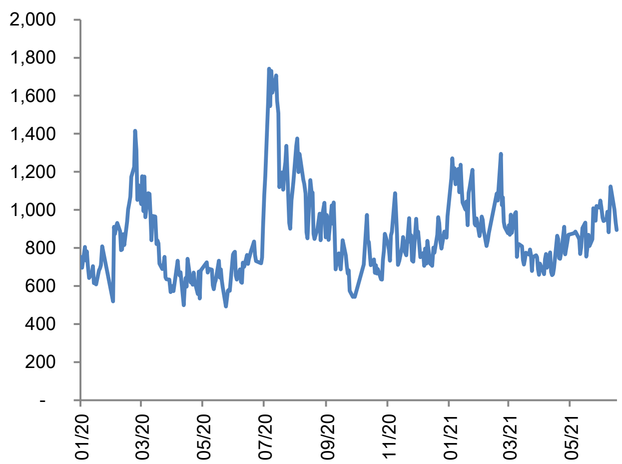
Source(s): SAC, ABCI Securities

Exhibit 2: Industry revenue structure (2020)



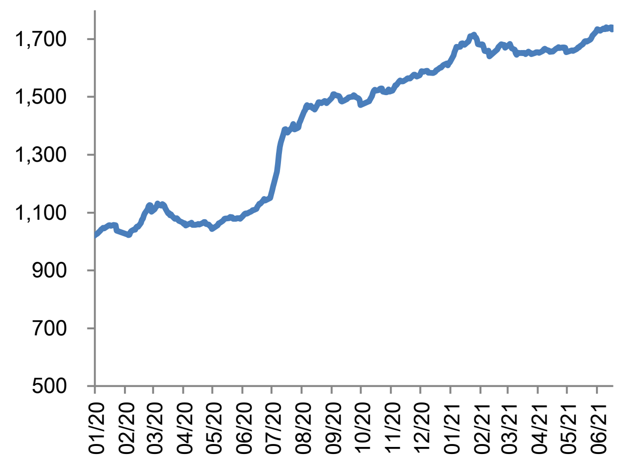
Source(s): SAC, ABCI Securities

Exhibit 3: A-share ADT (RMB bn)



Source(s): Bloomberg, ABCI Securities

Exhibit 4: MFSL Balance (RMB bn)



Source(s): Bloomberg, ABCI Securities

OVERWEIGHT

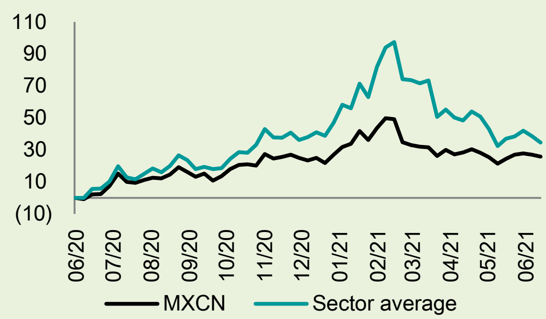
Internet Media and Consumer Commerce – Major step-up in new venture investment

Steve Chow

Key Data		Sector Performance (relative to MXCN)	Absolute (%)	Relative (%)
Avg. 21E P/E (x)	31.7	1-mth	5.1	3.8
Avg. 21E P/B(x)	11.9	3-mth	(3.2)	2.1
Avg. 21E div yield (%)	0.3	6-mth	10.9	7.1
Source(s):Bloomberg, ABCI Securities estimates		Source(s):Bloomberg, ABCI Securities		

- Major internet platforms are stepping up investments in key strategic areas， such as community group purchase
- Consumer demand on online shopping is resilient
- We favor **Alibaba (9988 HK)** and **Tencent (700 HK)** for their leading positions in ecommerce and online gaming

1-year sector performance



Source(s):Bloomberg, ABCI Securities

Stepping up investments. Major internet platforms have been stepping up investments recently, using all or part of incremental profits to invest in new businesses and key strategic areas. Overall, investors are expecting these investments to dampen near-term earnings; the ultimate and extent of such impacts on the P/L, however, would depend on the nature of investment since businesses vary in operating expenses, fixed assets, acquisitions, etc.

Ecommerce platforms enhance effort in merchant retention. Under the new regulatory environment, merchants have lower switching costs among multiple ecommerce platforms as the latter can no longer demand to be their clients' exclusive distribution channel. As a result, ecommerce platforms would need to strengthen its support to merchants by providing more value-added technological services to increase loyalty.

The community crowd-purchasing race. Major ecommerce platforms, including Alibaba (9988 HK/BABA US), Meituan (3690 HK), and Pinduoduo (PDD US), have been actively developing the community group-purchasing business in recent months. In our view, the rapid development of the community group-purchasing market can be attributed to the increased willingness to purchase food and daily groceries online as a result of the pandemic. Demand for affordable food and grocery ecommerce platforms is rising. Among major players, Meituan and Pinduoduo have been the most eager in developing this segment. Given the low profitability of the nascent business, aggressive promotional or pricing strategies can reduce earnings in the near term.

Ongoing consumption shift from offline to online. On the demand side, consumer demand on online shopping has been resilient. Online sales of physical goods in China increased by 19.9% YoY in 5M21, accounting for 22.6% of total retail sales during the same period. Overall, 19.9% YoY growth in 5M21 is lower than the 23.1% growth in 4M21 mainly due to the normalizing base impact following the improved pandemic situation in 2Q20.

In addition, the express delivery industry (the downstream industry of the ecommerce industry) is also witnessing a normalizing trend. According to the State Post Bureau, volume growth in the express delivery industry was 24.9% YoY in May vs. 30.8% YoY in April.

Penetration rate of online shopping was 22.6% in 5M21versus 22.2% in 4M21 and 20.7% in 2M21, indicating an ongoing consumption shift from offline to online.

Positive momentum in online entertainment. In 5M21, online retail sales in China increased by 24.7% YoY, higher than the 19.9% YoY growth of online sales of physical goods during the same period. In our view, this implies that online sales of non-physical goods, including online games and online video, among others, enjoyed a higher growth than that of the physical goods. This would bode well for online entertainment platforms such as Tencent.

Stock Recommendations

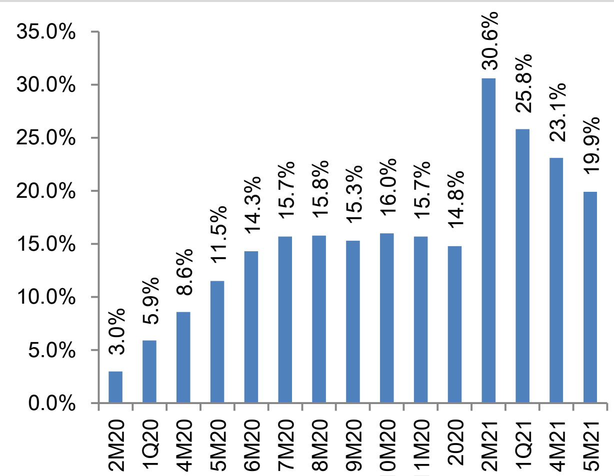
Alibaba (9988 HK) enjoys a dominant position in ecommerce. Overall, its annual GMV per active buyer is significantly higher than peers, indicating customer stickiness and loyalty. In addition, we believe the market has priced in its short-term impact of its aggressive investment plans allocating all of its incremental profits in FY3/22 to support merchants and finance new businesses.

In addition, we continue to like **Tencent (700 HK)** given its leading position in online gaming and online entertainment despite the potential near-term impact of higher investment in key strategic areas.

Risk Factors

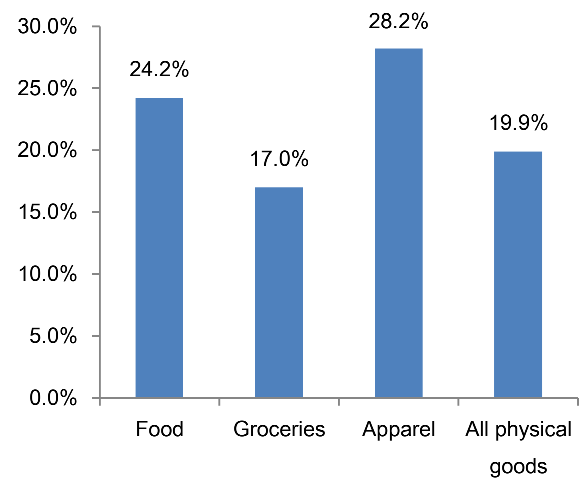
1) Regulatory risk such as anti-trust investigations; 2) Slowdown in ecommerce and internet finance; 3) Non-GAAP financials.

Exhibit 1: Online sales of physical goods (YoY%)



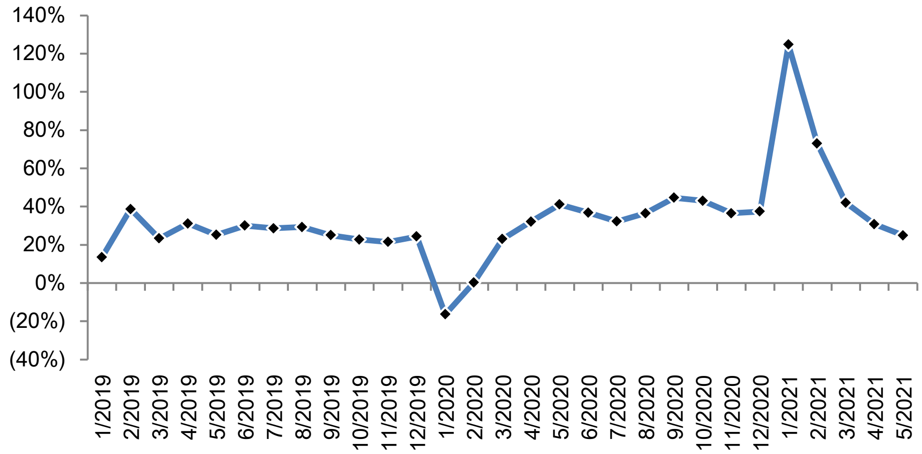
Source(s): NBS, , ABCI Securities

Exhibit 2: Online sales of physical goods by category (5M21, YoY%)



Source(s): NBS, , ABCI Securities

Exhibit 3: Express delivery volume growth (YoY%)



Source(s): State Post Bureau, ABCI Securities

Valuation of sector top picks (Data as of June 25, 2021)

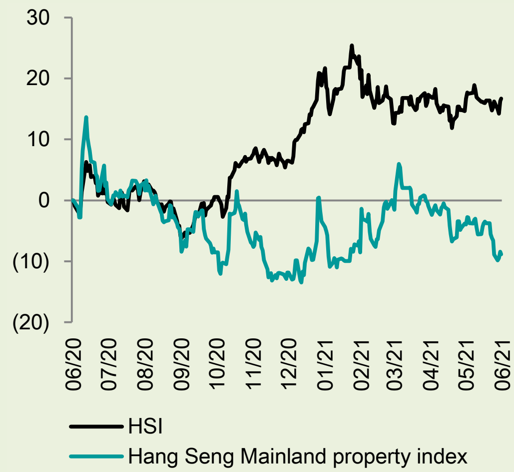
Company	Ticker	Rating	TP (HK$)	Upside (%)	FY21E P/E(x)	FY22E P/E (x)	FY21E P/B (x)	FY22E P/B (x)	FY21E Yield (%)	FY22E Yield (%)
Alibaba	9988 HK	BUY	270	25.6%	21.1	17.5	3.4	2.8	NA	NA
Tencent	700 HK	BUY	800	33.6%	29.1	24.1	5.7	4.8	0.4	0.5

Source(s): Bloomberg, ABCI Securities estimates

OVERWEIGHT
China Property Sector – Strong balance sheet as key; short-term turbulence on property management players on placement risks
Kenneth Tung

Key Data		Sector Performance (relative to HSI)	Absolute (%)	Relative (%)
Avg. 21E P/E (x)	4.68	1-mth	(5.23)	(7.00)
Avg. 21E P/B(x)	0.76	3-mth	(7.41)	(11.05)
Avg. 21E div yield (%)	8.03	6-mth	4.66	(5.09)
Source(s):Bloomberg, ABCI Securities estimates		Source(s):Bloomberg, ABCI Securities		

1-year sector performance (%)



Source(s):Bloomberg, ABCI Securities

- We expect debt levels to improve among developers by Dec 2021; turning “green” can help lower finance cost
- Slower sales growth in 2H21 as low base effect fades; gross margin is unlikely to improve substantially on still-fierce land competition
- Active fundraising activities may create short-term turbulence in the property mgt (PM) sector
- **COLI (688 HK)** is our top pick among the PRC developers given its solid balance sheet and possible FX gains due to high exposure to HKD/USD borrowings. We favor **Evergrande PS (6666 HK)** in the property management (PM) sector for its impressive growth in GFA under mgt and CVAS business

Sector Outlook

Developers:

Developers’ borrowings slowed. With the implementation of the “three red lines” policy and concentration mgt system for banks’ property-related borrowings, loan growth slowed in 1Q21. According to PBOC, property-related borrowings increased 10.9% YoY to RMB 50.03tr in 1Q21, slower that other borrowing growth by 1.7ppt. In 4M21, growth rate of property-related borrowings trended down further to 10.5%. Property-related borrowings only represented 21.7% of 1Q21 new borrowings, 3.7ppt lower than that of FY20. Besides, according to Rong 360, average first-home mortgage rate was 5.31% in May 2021, 9bps higher than that in Jan 2021. Rising mortgage rate may reflect stricter approval process and reduced loan quota in banks’ mortgage business.

A healthier balance sheet by end-2021. Going forward, given the effectiveness of restrictive policies on property borrowings implemented on the national level, more tightening measures targeting at the city level may roll out to clamp down speculative property demand seen in specific cities. Capping the debt level in the property sector may result in slower landbank expansion for developers, whose balance sheet position and gearing may improve. As of Dec 2020, among the 22 listed developers with a core profit size larger than RMB 3bn in 2020, 45%/45%/0%/9% are classified as the green/yellow/orange/red tier, compared to 18%/59%/9%/14% in June 2020. We expect more developers to turn “green” in Dec 2021 with various tightening measures in place to limit borrowings. In fact, lower financing costs in the bond market shows growing confidence in the green-tier developers. For instance, coupon rate of Powerlong (1238 HK), whose status has switched from yellow to green since Dec 2020, was just 4.9% for its US$ 200mn five-year maturity bond issued in May 2021, 1.35ppt lower than its batch issued in Aug 2020. In our view, refinancing risks for the property sector is limited after rounds of tightening; instead, we expect funding costs to lower based with the healthier balance sheet positions.

Slower sales momentum in 2H21. According to NBS, new home sales grew 57% YoY to RMB 6.5trn in 5M21; GFA sold grew 39%YoY to 597mn sqm and ASP rose 15%YoY to RMB 10,842/sqm. Contracted sales of the 20 large-scale, listed developers also increased 44% YoY in 5M21, driven by the 34% YoY GFA growth and 8% YoY ASP hike. In May 2021, however, contracted sales growth of these major listed developers slowed from 121%YoY in Feb to 48%YoY in Mar, 29%YoY in Apr and 17%YoY in May. As we expect the low base effect resulted from COVID-19 to ease as the year progresses, developers' monthly sales growth would slow to 5-10%YoY on average in 2H21. From a longer-term perspective, the 'three red lines" policy has already limited developers' annual borrowing growth to 0-15% depending on one's tier under the "three red lines" policy; as such, we believe the competitive landscape is more leveled because developers cannot increase its market share solely through aggressive leverage and land acquisitions.

Margins unlikely to improve substantially in the longer term. Margin-wise, there were hopes that the concentrated land sales program might reduce land cost in the longer term by increasing the land supply within a specific short period of time each year; the effectiveness of the strategy, however, is called into question as competition remains stiff in the recent concentrated land sales. At the FY20 results presentation of the Hangzhou-based developer Binjiang Group (002244 CH), the company's mgt said they are expecting a 1-2% net margin for the five pieces of land acquired from the centralized land sales program. Despite the 8% YoY ASP hike registered in 5M21 among the major developers, we expect gross margin to remain stable in the next two years due to surging land costs. Even if land prices are below the market price, we believe the contracted prices would be limited by the local governments to ensure the benefit of the saved cost would be directed to the citizens instead of translating into better margins for developers.

- **Property mgt companies (PMCs):**

Active fundraising activities may create short-term turbulence. After the inclusion in the Hang Seng Index, Country Garden Services (CGS, 6098 HK) raised HK$ 10.5bn through the 139.4mn new share placement (4.35% of enlarged capital) at HK$ 75.25/share (a 6% discount to last close) on May 25, 2021. Following that, A-Living (3319 HK) also placed 86.7mn of new shares (6.10% of enlarged capital) at HK$ 37.60/share (6.6% discount to last close) to raise HK$ 3.2bn in on May 28, 2021. While these placements have driven up short-term volatility in share prices, share placement and inclusion into major indices would increase the weighting of PM sector in fund managers' portfolio. Besides, the offshore proceeds from share placement may facilitate acquisitions of HK-listed peers in the future. We believe active M&A among the larger PMCs may trigger the re-rating of smaller PMCs such as Aoyuan Healthy (3662 HK), Kaisa Prosperity (2168 HK), and Redsun Services (1971 HK) on the possibility of being acquired by the bigger players. These potential candidates are currently trading at 8-9x 2021 P/E.

Two mega-sized IPOs will be under the spotlight. In 2020, 16 PMCs completed their HK-listing, raising a total of HK$ 64.95bn. As of June 9, 2021, 18 PMCs have initiated A1 filing with HKEx. While no concrete timetables have been released, Onewo (previously known as Vanke Services), a PM subsidiary of China Vanke (2202 HK), and Wanda Light Asset Commercial Mgt will be the two largest IPOs in the PM sector. According to Reuters, Wanda Light Asset Commercial Mgt is targeting a valuation of RMB 200bn. According to China Vanke's annual report, Onewo has 566 mn sqm of GFA under mgt and revenue of RMB18.2bn (+27% YoY) in 2020, higher than CGS's 377mn sqm of GFA under mgt and revenue at RMB 15.6bn. Therefore, we believe Onewo could easily become the next HSI candidate after listing in our view. The significance of PM sector, we believe, will grow in the capital market.

Stock Recommendations

- **Developers:**

COLI (688 HK) is our top pick given its solid balance sheet position; Powerlong (1238 HK) is our small/mid-cap pick with faster-than-peer sales growth. We believe the market will place increasing emphasis on balance sheet health instead of sales growth with the borrowing policy in place. COLI's high USD/HKD borrowing exposure (45.7% of total debt as at Dec 2020) would result in favorable FX gains as RMB appreciates. Trading at 3.6x 2021 P/E (vs. large cap peer average at 5.6P/E), COLI is valued at a depressed level in our view. We also favor YRD developers over the GBA ones with the resurgence of COVID-19 in Guangdong. **Powerlong**

(1238 HK) is our top small/mid-cap pick given its solid 5M21 contracted sales growth (+100% YoY vs. 44%YoY for peers),and its status as a green-tier developer since Dec 2020.

■ **PMCs:**

Evergrande PS (6666 HK) is our top residential PMC pick

Evergrande PS (6666 HK)'s share price was pressured due to the lock-up expiration of pre-IPO investors and refinancing rumors of Evergrande (3333 HK); nonetheless, we remain positive on its long-term fundamentals. Evergrande PS, whose GFA under mgt was 300mn sqm as at end-2020, is on track to meet its 2021 GFA under mgt target of 600mn sqm (+100%YoY) after adding 110mn sqm in 2M21. After the acquisition of Evergrande Insurance Agency from parent, Evergrande PS will introduce property, vehicle, and medical insurance products within its residential community under mgt to boost CVAS revenue.

Risk Factors

■ **Developers:**

1) Uncertain development of COVID-19; 2) Further policy tightening on borrowing; 3) Margin erosion on intensive competition for land.

PMCs:

1) Substantial related-party transactions between PMC subsidiaries and parent developers; 2) Heavy reliance on parents for new projects; 3) Potential margin erosion caused by M&A; 4) Increasing number of PMC stocks may suppress sector valuation; 4) Placement risks to finance for future M&As.

Exhibit 1: 5M21 contracted sales of major listed developers

			5M21						2021	
		Stock code	Amount RMBbn	YoY %	GFA '000 sqm	YoY %	ASP RMB/sqm	YoY %	Target RMBbn	% Achieved
1	Greentown	3900 HK	129.3	114%	5,460	92%	23,681	12%	310	41.7%
2	Powerlong	1238 HK	42.5	100%	2,715	97%	15,653	2%	105	40.5%
3	R&F	2777 HK	72.9	99%	5,504	78%	13,240	12%	150	48.6%
4	CIFI	884 HK	110.1	98%	6,495	94%	16,946	2%	265	41.5%
5	Sunac	1918 HK	241.8	72%	16,640	63%	14,532	6%	640	37.8%
6	Logan	3380 HK	63.6	71%	3,291	36%	19,322	25%	145	43.9%
7	Jinmao	817 HK	110.2	69%	6,609	74%	16,667	-3%	250	44.1%
8	KWG	1813 HK	45.9	60%	2,379	39%	19,282	15%	126	36.4%
9	CR Land	1109 HK	126.1	60%	7,216	59%	17,474	0%	315	40.0%
10	Aoyuan	3883 HK	52.6	58%	4,592	41%	11,450	12%	150	35.1%
11	Beijing Capital	2868 HK	30.6	56%	1,422	128%	21,512	-32%	NA	NA
12	Shimao	813 HK	121.8	52%	6,870	50%	17,729	1%	330	36.9%
13	Times	1233 HK	37.3	52%	1,925	9%	19,368	39%	110	33.9%
14	Agile	3383 HK	60.9	51%	3,929	43%	15,503	6%	150	40.6%
15	Poly-A	600048 CH	234.9	51%	14,384	37%	16,331	10%	NA	NA
16	Longfor	960 HK	111.8	36%	6,538	35%	17,105	1%	310	36.1%
17	COLI	688 HK	155.4	36%	7,676	22%	20,248	11%	NA	NA
18	Yuzhou	1628 HK	41.7	36%	2,314	21%	18,019	12%	110	37.9%
19	Sino-Ocean	3377 HK	40.8	29%	2,244	35%	18,193	-5%	150	27.2%
20	Country garden	2007 HK	249.8	21%	28,210	15%	8,854	6%	628	39.8%
21	Vanke	2202 HK	286.8	16%	17,956	14%	15,972	2%	NA	NA
22	Evergrande	3333 HK	285.2	5%	33,832	12%	8,428	-7%	750	38.0%

Source(s): Companies, HKEx, ABCI Securities

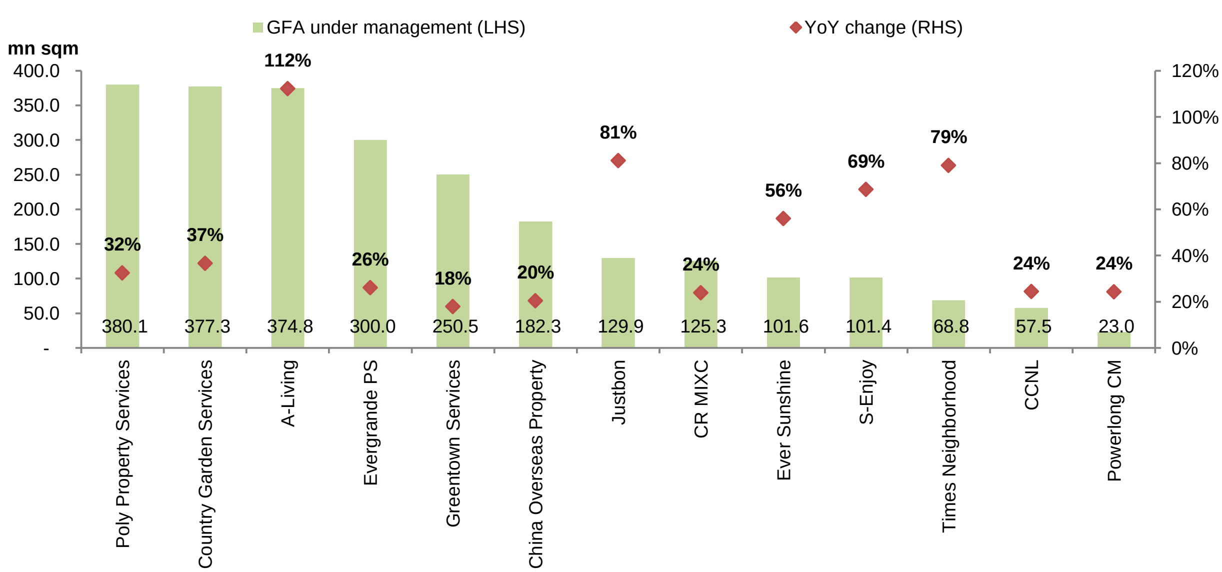
Exhibit 2: Classification of major developers under the "three red lines"

	Developer	Stock code	"Three red lines" classification	
			Dec-20	Jun-20
1	Vanke	2202 HK		
2	COLI	688 HK		
3	Country Garden	2007 HK		
4	Sunac	1918 HK		
5	Poly-A	600048 CH		
6	CR Land	1109 HK		
7	Longfor	960 HK		
8	Shimao	813 HK		
9	Logan	3380 HK		
10	Future land	1030 HK		
11	Agile	3383 HK		
12	CIFI	884 HK		
13	Evergrande	3333 HK		
14	KWG	1813 HK		
15	R&F	2777 HK		
16	Times	1233 HK		
17	Aoyuan	3883 HK		
18	Kaisa	1638 HK		
19	Greentown	3900 HK		
20	Powerlong	1238 HK		
21	Jinmao	817 HK		

Note: Each developer is assigned an annual growth limit of total borrowing, which is 0% for red, 5% for orange, 10% for yellow, and 15% for green

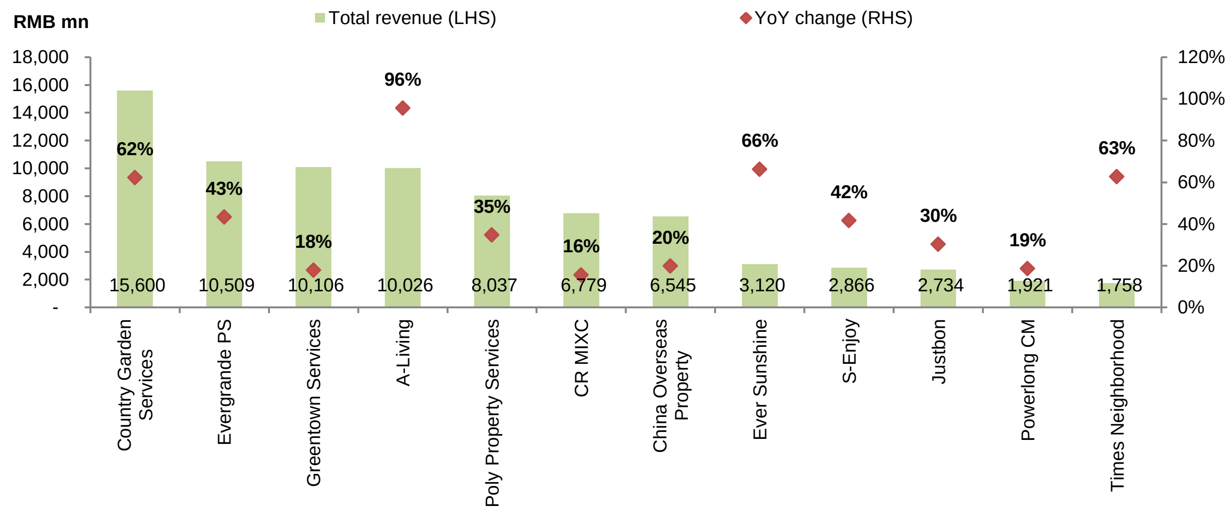
Source(s): Companies, ABCI Securities

Exhibit 3: GFA under mgt of major listed PMCs (2020)



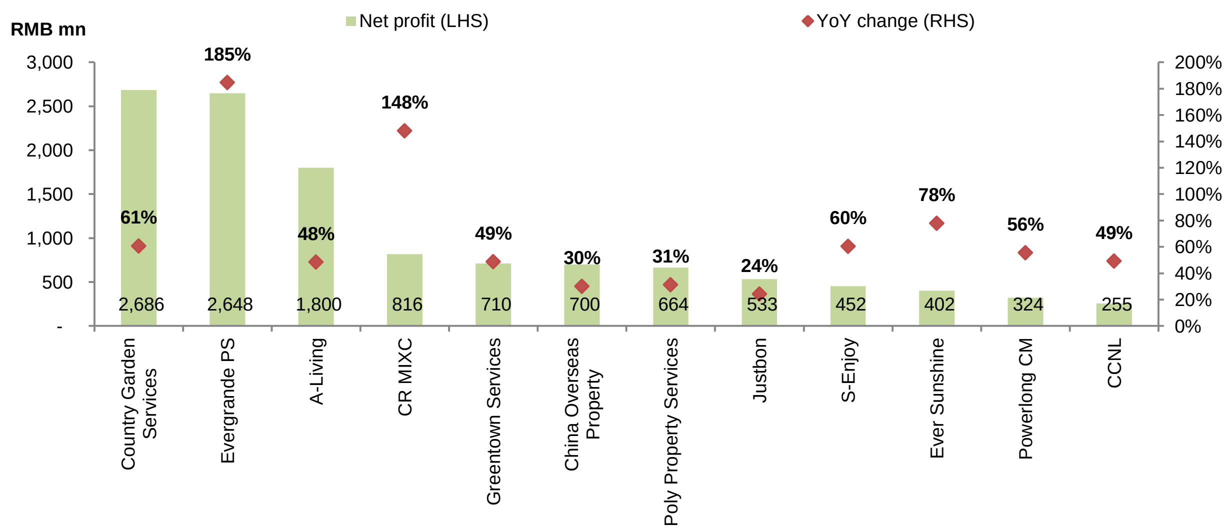
Source(s): Companies, ABCI Securities

Exhibit 4: Total revenue of major listed PMCs (2020)



Source(s): Companies, ABCI Securities

Exhibit 5: Net profit of major listed PMCs (2020)



Source(s): Companies, ABCI Securities

Valuation of sector top picks (Data as of June 25, 2021)

Company	Ticker (HK)	Rating	TP (HK$)	Upside (%)	FY21E P/E(x)	FY22E P/E (x)	FY21E P/B (x)	FY22E P/B (x)	FY21E Yield (%)	FY22E Yield (%)
COLI	688	BUY	33.30	81.6%	3.6	2.9	0.48	0.43	7.1	8.7
Powerlong	1238	BUY	9.50	18.3%	4.9	3.7	0.60	0.55	9.4	11.9
Evergrande PS	6666	BUY	21.50	134.2%	20.0	13.3	6.34	4.67	1.2	1.9

Source(s): Bloomberg, ABCI Securities estimates

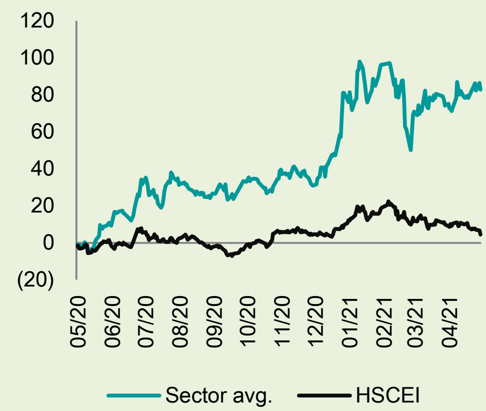
OVERWEIGHT
China Alternative Energy Sector – New carbon targets to boost growth
Kelvin Ng

Key Data		Sector Performance (relative to HSCEI)	Absolute (%)	Relative (%)
Avg. 21E P/E (x)	11.88	1-mth	13.9	13.6
Avg. 21E P/B(x)	1.47	3-mth	20.5	21.3
Avg. 21E div yield (%)	3.22	6-mth	50.6	46.3

Source(s):Bloomberg, ABCI Securities estimates

Source(s):Bloomberg, ABCI Securities

1-year sector performance (%)



Source(s):Bloomberg, ABCI Securities

- China is raising the installed capacity target for renewable energy to 50% of national total by end of the 14th Five-Year Plan (FYP)
- Wind power operators would be the key beneficiary of carbon neutrality policy; hydropower operators are cash-cow companies
- **China Yangtze Power (600900 CH)** is our top pick for the hydropower sector for its world's largest operating scale and strong cash flow

The vision of achieving carbon neutrality by 2060 will accelerate alternative energy development in China. During the United Nations General Assembly in Sep 2020, President Xi announced the targets of achieving 1) carbon emission peak by 2030 and 2) carbon neutrality by 2060. These goals were reiterated in the National People's Congress in Mar 2021. The vision of carbon neutrality will boost development of alternative energy; specifically, wind and solar power will be preferred due to their shorter construction period.

National Energy Administration (NEA): Installed capacity of renewable energy to account for 50% of the national total by 2025. NEA announced at end-Mar 2021 that the government would target to boost installed capacity of renewable energy (include wind, solar, hydro, and biomass) to 50% of the national total by end-2025. This target indicates a 74% jump from the current renewable energy capacity, implying an 11.7% CAGR in 2020-25E. We believe the strong push in clean energy would present great opportunities for wind and solar power industries.

Hydropower: Not a key substitute for coal-fired power due to geographic limitations. Power output and capacity growth of hydropower is limited by the geographic landscape and water resources (e.g. rainfall); capacity expansion is constrained since large dams have already been built in China's major rivers. Hydropower is therefore unlikely to be the key substitute for coal-fired power in China.

But, hydropower operators are cash cows. Hydropower operators have a high GPM due to the low unit production cost. In addition, as the hydropower tariff at RMB 0.24/kWh (ex. VAT) is far lower than that of the coal-fired one (RMB 0.35/kWh ex. VAT), no subsidies are needed, avoiding the issue of a high account receivables (wind power and solar power operators have high receivables due to tariff subsidies deferred by the local governments). Without major capacity expansion plans, hydropower operators usually enjoy a strong cash flow, rendering them a good investment target especially in times of liquidity shortage.

Hydropower: 4%/2%YoY growth in output in 2021E/22E. We believe capacity growth of China's hydropower is limited due to the geographic requirements (e.g. hilly landscape with rivers). Since hydropower facilities have already been developed in large rivers (e.g. Yangtze River, Yellow River, etc.), headroom for capacity growth is limited. As such, we estimate hydropower output to inch up by 4%/2%YoY in 2021E/22E.

Nuclear power: Policy change will decelerate capacity growth. China's ambitious carbon neutrality policy would boost capacity growth in wind power, solar power, and nuclear power. To achieve an emission peak by 2030, speed is crucial. Nuclear power falls short in this aspect given its long construction cycle and high safety standard required.

Nuclear power: 7%/6%YoY growth in China's nuclear power output in 2021E/22E. National installed capacity of nuclear power expanded swiftly at a 20% CAGR 2011-18; since then, growth has slowed. In 2020, the capacity expansion was reported at 2.4%YoY. For the next few years, capacity growth of China's nuclear power will not be as rapid as that of wind and solar power due to its long construction period. For 2021E, new nuclear power plants in Tianwan unit 6 (Zhejiang province), Fuqing unit 6 (Fujian province), and Hongyanhe unit 5 (Liaoning province) will commence operation, adding 3.4GW of new installed capacity. For 2022E, Hongyanhe unit 6 and Fangchenggang unit 3 and unit 4 are expected to commence operation, adding 3.5GW of new installed capacity. All in all, we expect China's nuclear power output to expand by 7%/6%YoY on the back of the 7%/7%YoY capacity growth in 2021E/22E.

Wind power: Carbon emission peak by 2030 and carbon neutrality by 2060 would accelerate wind energy development. Construction of nuclear power plants spans from five to eight years; for hydropower plants, it usually takes no less than five years. Wind/solar power, whose plants usually entail a six-month construction period, are therefore preferred given the time constraint to achieve the carbon targets. We expect China's wind power capacity growth to escalate.

Wind power: China's wind power output to expand rapidly by 27%/26%YoY in 2021E/22E enabled by the strong capacity growth. We believe the carbon emission targets would spur China's wind power capacity growth in the next few years despite the gradual withdrawal of subsidies. Our previous estimates indicated a 11% YoY growth in wind power capacity for 2021E, assuming that the subsidy-free policy would lower the incentive for operators to invest in capacity expansion; yet, with the carbon targets now in place, demand for wind power will increase. We revise up our growth forecasts for wind power capacity to 28%/25% YoY in 2021E/22E, which results in wind power output growth of 27%/26%YoY.

Long-term Outlook

Nuclear power: To achieve an emission peak by 2030, speed is crucial. Nuclear power is likely to maintain a moderate growth in the next few years given its long construction cycle and high safety standard required.

Hydropower: Hydropower is the energy source with the lowest cost in China and therefore is preferred by the government. However, the development of hydropower is highly dependent on geographic factors; hence, significant output expansion is unlikely.

Wind power: China's carbon targets would benefit wind power whose capacity and output growth would be in the double-digit level.

Short-term Outlook

Nuclear power operators: Lack of new commencement of nuclear power plant would restrain output growth.

Hydropower operators: Geographic limitation would hinder the development of hydropower and therefore output growth would be moderate.

Wind power operators: Both capacity and power output would jump.

Stock Recommendations

■ **Hydropower operators:**

China Yangtze Power (600900 CH, CYP) is our top pick. We believe CYP, the world's largest hydropower operator, will remain as the leader in the industry. China's target in achieving carbon neutrality by 2060 would be a long-term positive for CYP as hydropower is a clean energy with a low generation cost.

Risk Factors

■ **Nuclear power operators:**

1) Operation safety risk; 2) Construction risk; 3) Fuel cost risk; 4) Tariff risk; 5) Currency and interest rate risks; 6) Fundraising activities for M&A.

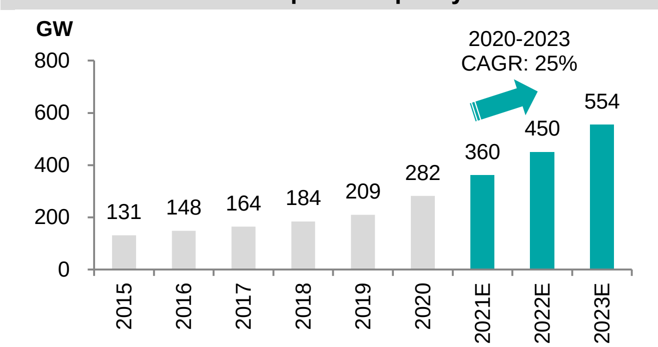
■ **Hydro power operators:**

1) Widespread drought would affect power output; 2) Construction risk; 3) High net gearing ratio prompts concern on fundraising activities; 4) Safety risk; 5) Policy risk.

■ **Wind power operators:**

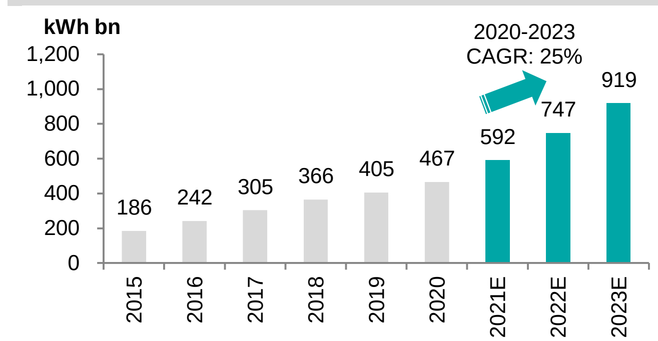
1) Power curtailment risk; 2) Wind resources risk; 3) Tariff risk; 4) Construction risks; 5) Fundraising risk 6) Government policy to deleverage may constrain growth.

Exhibit 1: China's wind power capacity outlook



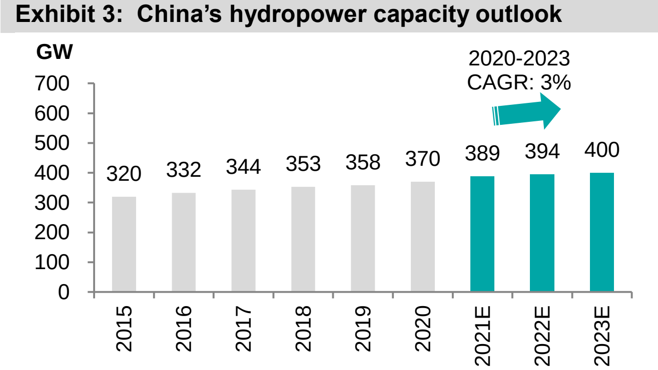
Source(s): NEA, CEC, ABCI Securities estimates

Exhibit 2: China's wind power output outlook



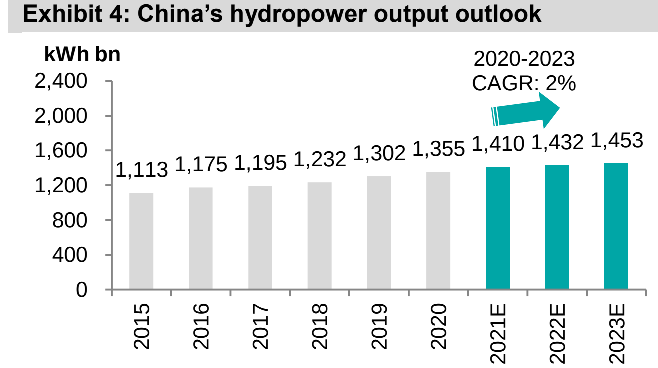
Source(s): NEA, CEC, ABCI Securities estimates

Exhibit 3: China's hydropower capacity outlook



Source(s): NEA, CEC, ABCI Securities estimates

Exhibit 4: China's hydropower output outlook



Source(s): NEA, CEC, ABCI Securities estimates

Valuation of sector top picks (Data as of June 25, 2021)

Company	Ticker	Rating	TP	Upside (%)	FY21E P/E(x)	FY22E P/E (x)	FY21E P/B (x)	FY22E P/B (x)	FY21E Yield (%)	FY22E Yield (%)
China Yangtze Power	600900	BUY	RMB 23.00	11.4	17.4	12.7	2.6	2.4	3.8	5.1

Source(s): Bloomberg, ABCI Securities estimates

NEUTRAL

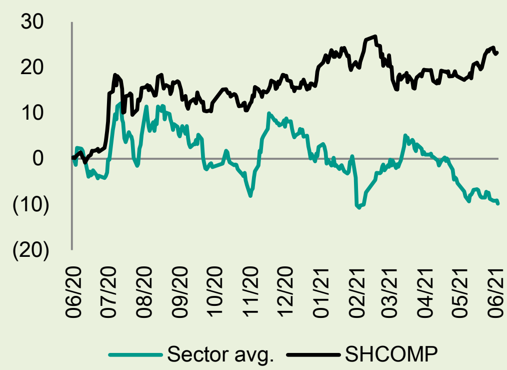
China Airport Sector – Domestic passenger as near-term support

Kelvin Ng

Key Data		Sector Performance (relative to SHCOMP)	Absolute (%)	Relative (%)
Avg. 21E P/E (x)	333.74	1-mth	(1.9)	(6.2)
Avg. 21E P/B(x)	1.64	3-mth	(11.5)	(14.0)
Avg. 21E div yield (%)	0.46	6-mth	(11.5)	(15.8)
Source(s):Bloomberg, ABCI Securities estimates		Source(s):Bloomberg, ABCI Securities		

- Global vaccination rate is still low, denting China's international passenger carried
- Domestic passenger is the key revenue driver to airports in near term
- Air passengers are expected to grow 12%/19%YoY in 2021E /22E
- National cargo carried to increase by 23%/6%YoY in 2021E/22E
- **Shenzhen Airport (000089 CH)** is our preferred pick in the China airport sector for strong population growth in the Shenzhen district and high exposure to domestic passengers

1-year sector performance (%)



Source(s):Bloomberg, ABCI Securities

Global vaccination rate is still low, denting China's international passenger carried. According to BBC and Our World in Data, as of June 28, 2021, vaccination rate (total vaccinations per 100 ppl) in the UK, US, France, and Germany were 114.9, 96.3, 75.5, and 85.3, respectively. In Asia, vaccination rate in China, Japan, Korea and India were 80.8, 29.4, 36.7, and 22.8, respectively. Compared to the West, vaccination rate in Asian countries are still low. Substantial recovery in the international passenger flights is unlikely at least in the near term, especially since governments worldwide are vigilantly guarding against virus variants. We believe China's international passenger carried will remain subdued. In this way, domestic passengers will be the key support.

Air passengers are expected to grow 12%/19%YoY in 2021E /22E. Affected by COVID-19, air passengers from China dipped 37% YoY in 2020 to 418mn, the lowest since 2014.The situation has started to recover partially since Apr 2020, and we expect China's air passenger total increased by 12% YoY 2021E on the back of the 14% YoY growth in domestic passengers. Foreign passengers would decline by 80% YoY in 2021E. For 2022E, we expect domestic passengers to report a 18% YoY growth, reaching 94% of the 2019-level; foreign passenger would jump 300% YoY as vaccination rate rises, propping up total passenger carried by 19% YoY. In short, we believe China's passenger carried in the next three years would rely mainly on domestic passengers. Hence, investors should focus more on airport operators with a high exposure to domestic flights.

National cargo carried to increase by 23%/6%YoY in 2021E/22E. National cargo carried reported a 10% YoY decline in 2020, yet the rebound has been swift and strong. According to the data of Civil Aviation Administration of China (CAAC), in Mar 2021, cargo carried was 0.65mt, up 35% YoY, reaching 104% of the level in Mar 2019, indicating a full recovery from the pandemic shock. For 2021E, as traveling is still restricted in most regions, demand for goods would be strong, spurring the need for air delivery service. We estimate cargo carried would rise by 23%YoY; for 2022E, with the fading pandemic impact, demand for air delivery would soften and therefore, we expect a 6% YoY growth. Unlike passenger carried, we believe foreign cargo carried would contribute to more than 30% of total cargo carried in the next three years.

Population growth in China by region. According to Housing and Urban-Rural Development (MOHURD), the Shenzhen district has the fastest population growth among the coastal regions in China.

Shanghai district: Total population in Shanghai district (including seven cities: Shanghai, Wuxi, Suzhou, Changzhou, Changshu, Nantong, and Jiaxing) reached 44.3mn in 2019, up 3.3% YoY over 2018; 2015-19 population CAGR was 1.8%;

Shenzhen district: Total population in the Shenzhen district (including four cities: Shenzhen, Jiangmen, Dongguan, and Zhongshan) amounted to 28.5mn in 2019, up 20.4% YoY; 2015-19 population CAGR was 6.8%;

Guangzhou district: Total population in the Guangzhou district (including six cities: Guangzhou, Foshan, Zhaoqing, Sihui, Qingyuan, and Yingde) totaled 30.7mn in 2019, an 8.4% YoY increase over 2018; 2015-19 population CAGR was 2.7%;

Capital district: Total population in the Capital district (including four cities: Beijing, Baoding, Zhuozhou, and Langfang) was 26.4mn in 2019, down 0.3% YoY; 2015-19 population CAGR was zero;

Xiamen district: total population in Xiamen district (including four cities: Xiamen, Zhangzhou, Longhai, and Longyan) was 8.4mn in 2019, a 4.0% YoY increase over 2018; 2015-19 population CAGR was 2.9%.

Shenzhen district had the highest population growth in 2019 due to the rising transient population in Dongguan and Zhongshan. Permanent population growth in Dongguan was robust (+9.9%YoY); for Shenzhen city, the figure was 3.2%. We believe strong population growth in Shenzhen and Dongguan would drive up the number of air passengers.

China's low average flight per capita per year indicates great potential for aviation industry. We believe China's low average flight per capita per year, a proxy for the number of times each China resident travels per year, would drive demand for air travel as disposal income rises. According to the World Bank, in 2019, the average flight per capita per year (number of air passengers divided by total population) of China was 0.47, far below US's 2.82, UK's 2.13, Korea's 1.79, and Germany's 1.32. For developing countries in Asia such as Thailand and Vietnam, the figures were 1.12 and 0.55. We believe as disposal income increases, residents would increase the number of flight trips.

Rising urbanization would benefit airports in major cities the most. The Chinese government has been promoting urbanization to help reduce the unit cost of public facilities such as hospitals, parks, and schools. Job opportunities and higher living standard have attracted population to major cities, bringing more opportunities to airports, especially those in tier-1 cities such as Beijing, Shanghai, Guangzhou, and Shenzhen. According to the National Bureau of Statistics (NBS), population in urban areas increased from 541mn in 2004 to 848mn by end-2019, a 57% jump or 3% CAGR in 15 years' time.

Long-term Outlook

We believe increasing disposal income per capita in China would spur travelling demand and benefit airports. In addition, rising urbanization rate in China's major cities, which drives up population, would bring more travelers to airports.

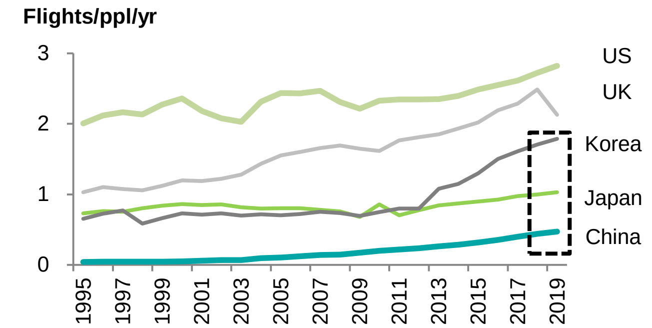
Short-term Outlook

The low global vaccination rate at present is dragging recovery; airports with high exposure to international flights have been the hardest hit. Domestic passengers are likely to be the key revenue driver for airports in the near term.

Risk Factors

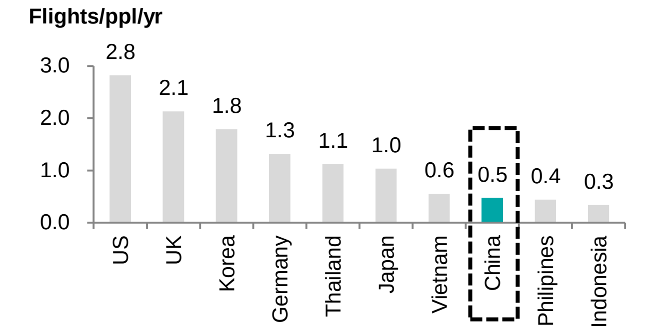
1) Disease outbreak would reduce travelling demand; 2) Slowdown in economy would reduce disposal income and traveling demand; 3) Technological advancement in high-speed railway would lower demand for short-haul flights; 4) Fear of terrorist attacks may reduce air travel; 5) Earthquake and other natural disasters will reduce tourist flow and travelling demand.

Exhibit 1: Average flight per capita per year



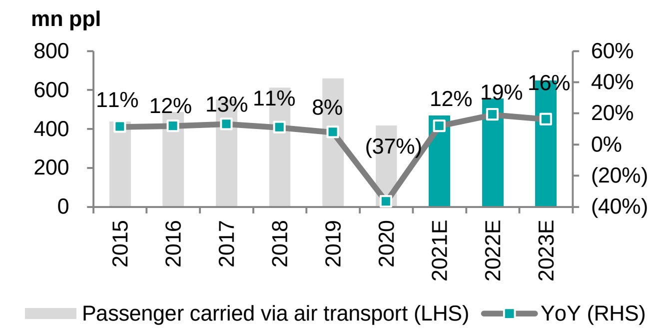
Source(s): World Bank, ABCI Securities

Exhibit 2: Average flight per capita per year (2019)



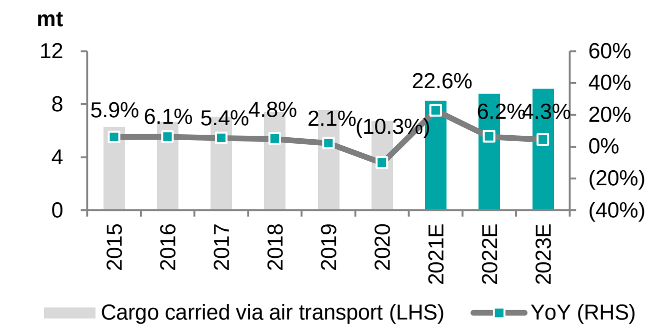
Source(s): World Bank, ABCI Securities

Exhibit 3: The number of air passengers in China has grown strongly



Source(s): MOHURD, CAAC, ABCI Securities estimates

Exhibit 4: China's cargo carried via air



Source(s): MOHURD, CAAC, ABCI Securities estimates

Valuation of sector top picks (Data as of June 25, 2021)

Company	Ticker	Rating	TP (RMB)	Upside (%)	FY21E P/E(x)	FY22E P/E (x)	FY21E P/B (x)	FY22E P/B (x)	FY21E Yield (%)	FY22E Yield (%)
Shenzhen Airport	000089	BUY	9.50	19.8	30.3	19.8	1.3	1.3	0.8	1.3

Source(s): Bloomberg, ABCI Securities estimates

OVERWEIGHT

China Consumer Sector – Challenging path to recovery

Pau Pan

Key Data	
Avg. 21E P/E (x)	29.0
Avg. 21E P/B(x)	4.1
Avg. 21E div yield (%)	2.4

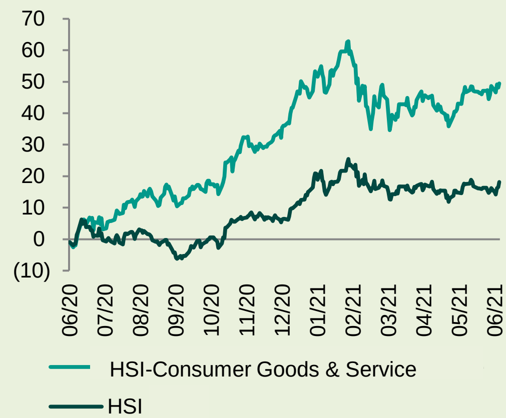
Source(s):Bloomberg, ABCI Securities, estimates

Sector Performance (relative to HSCEI)	**Absolute (%)**	**Relative (%)**
1-mth	2.49	1.19
3-mth	9.64	4.66
6-mth	9.88	(1.12)

Source(s):Bloomberg, ABCI Securities

- Retail sales growth has fluctuated in the past few months, showing challenges in boosting the consumer market
- Food price inflation has been mild mainly due to the declining pork price
- Recent resurgence of COVID-19 in Guangdong adds to uncertainty
- Declining number of newborns is a long-term concern
- We prefer leading players for their defensiveness; our sector top picks are **Nongfu Spring (9633 HK)** and **Yili (600887 CH)**

1-year sector performance (%)



Source(s):Bloomberg, ABCI Securities

Recovery in consumer market remains challenging. In May 2021, the national retail sales grew 12.4% YoY vs. 17.7% YoY in Apr 2021. The reduced growth was more substantial in product categories such as "Garments, Footwear, Hats, Knitwear" and "Gold, Silver and Jewelry", while "Grain, Oil, Foodstuff" and "Cultural and Office Appliances" saw increased growth. We believe recovery in the consumer market will remain challenging due to uncertainties over economic recovery and possible resurgence of COVID-19.

Food price inflationary pressure subsides. The recent bout of increase in commodity prices is a major cause of CPI increase. CPI reached 1.3% YoY in May 2021, while the non-food CPI rose to 1.6% YoY and food CPI was at 0.3% YoY. The low food inflation was mainly due to the declining pork price – average wholesale price of pork dropped to RMB 24.6/kg in the fourth week of June 2021 vs. the RMB 59.64/kg recorded in Feb 2020. The decline is mainly supported by the increase in hog output, with some leading hog producers more than doubling their sales volume in 2021. So far, the CPI has been well within the target of 3% YoY set for 2021 in the Government Work Report issued in the beginning of 2021. We believe a mild inflation would be conducive to consumer spending.

Disruption from COVID-19 adds to uncertainty. Resurgence of COVID-19 in Guangdong has reignited concerns of another outbreak in the country.. Since the pandemic's onset, consumer conservatism has been limiting the growth of per capita average spending, which only surpassed income growth in 1Q21. Apprehension of a new outbreak may add volatility to consumption recovery.

Decline in newborns continues. The number of newborns declined by 18.1% YoY to 12mn in 2020, marking the fourth year of decline. To reverse the downtrend, the government has recently announced the three-child policy permitting each couple to have three children. If childbearing willingness remains low, the consumer market may suffer from the consequences of long-term decline in consumer base and the population's shift in age distribution.

Long-term Outlook

The decline in the number of newborns may result in a substantial demographic shift in the long term if the fertility downtrend continues. On the one hand, the consumer base may shrink due to the smaller number of newborns; on the other hand, the change in age distribution would lead to change in consumption behavior.

Short-term Outlook

Potential resurgence of COVID-19 pandemic in China may disrupt the recovery of the consumer market. In addition, the consumer market is still curbed by consumer conservatism and uncertainty in the economy. On a brighter note, the mild inflation may boost consumer spending.

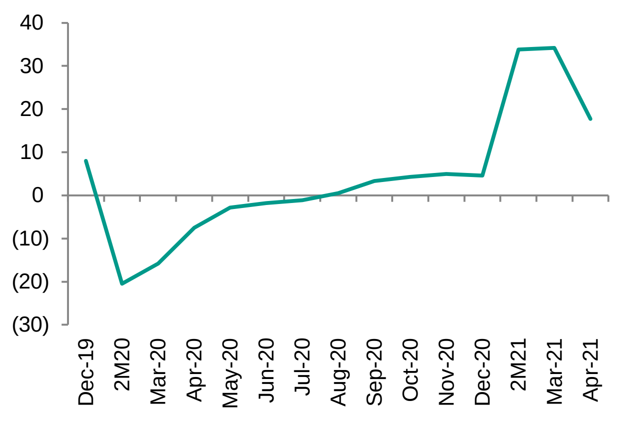
Stock Recommendations

We continue to favor leaders for their proven defensiveness amid uncertainty. Our top picks include **Nongfu Spring (9633 HK)** and **Yili (600887 CH).**

Risk Factors

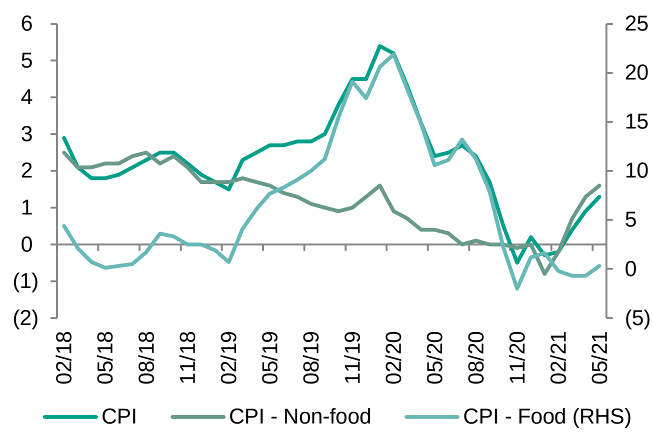
1) Macroeconomic risk; 2) Policy risk; 3) Product quality risk; 4) Commodity price risk; 5) Demographic risk; 6) Pandemic risk.

Exhibit 1: Retail sales growth (YoY %)



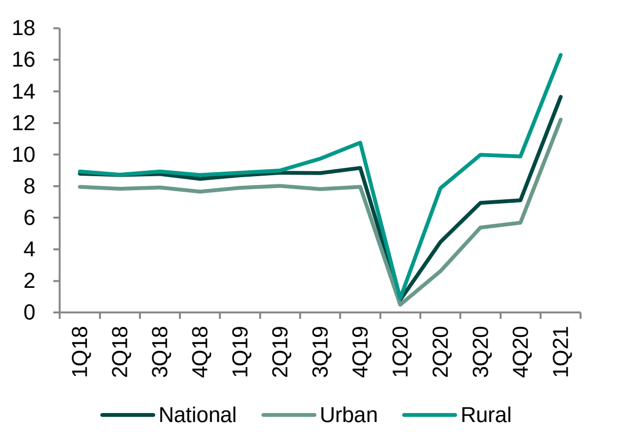
Source(s): NBS, ABCI Securities

Exhibit 2: CPI (YoY %)



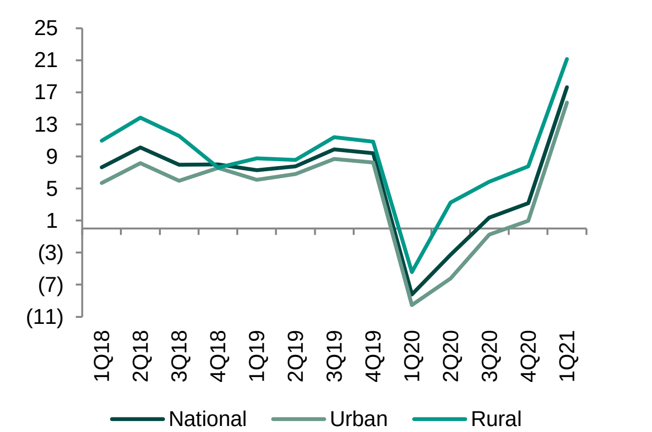
Source(s): NBS, ABCI Securities

Exhibit 3: Per capita average income in China (YoY %)



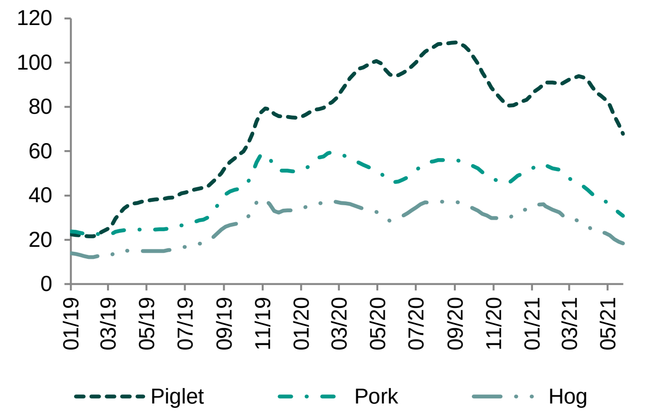
Source(s): NBS, ABCI Securities

Exhibit 4: Per capita average spending in China (YoY %)



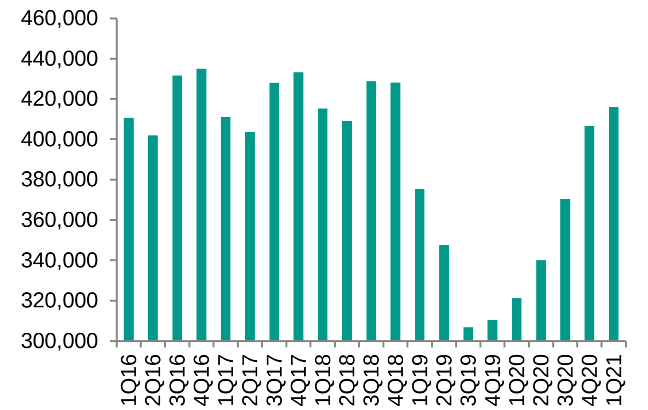
Source(s): NBS, ABCI Securities

Exhibit 5: Hog and pork average weekly wholesale price in China (RMB/kg)



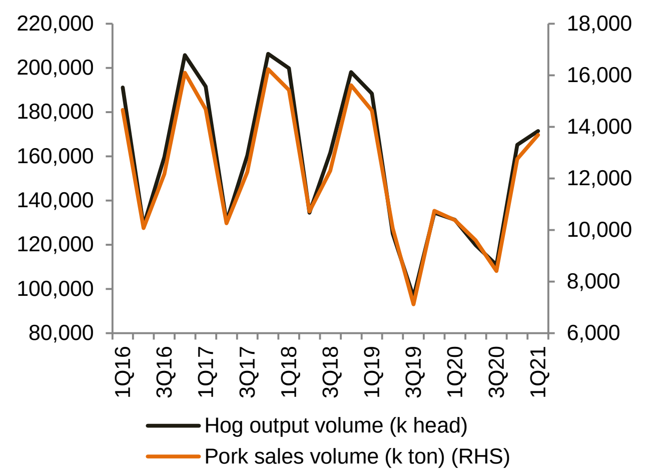
Source(s): MOA, ABCI Securities

Exhibit 6: National hog inventory (k head)



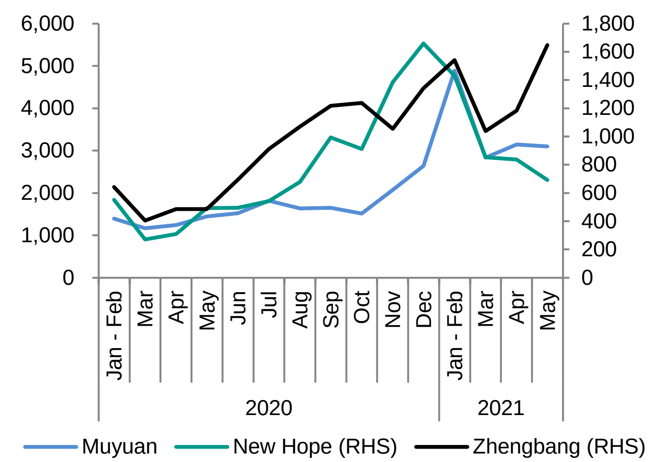
Source(s): NBS, ABCI Securities

Exhibit 7: National hog and pork sales volume



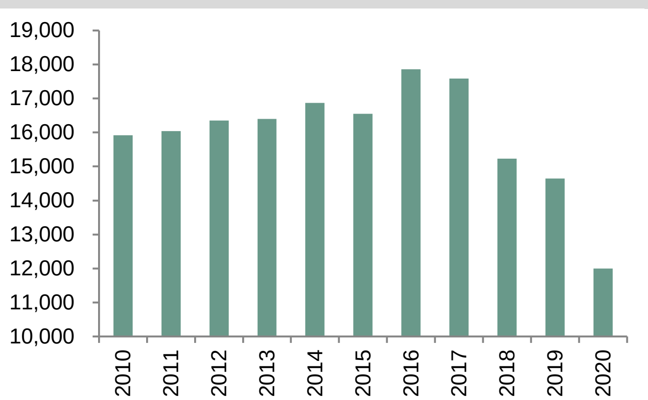
Source(s): NBS, ABCI Securities

Exhibit 8: Hog sales volume of leading players (k head)



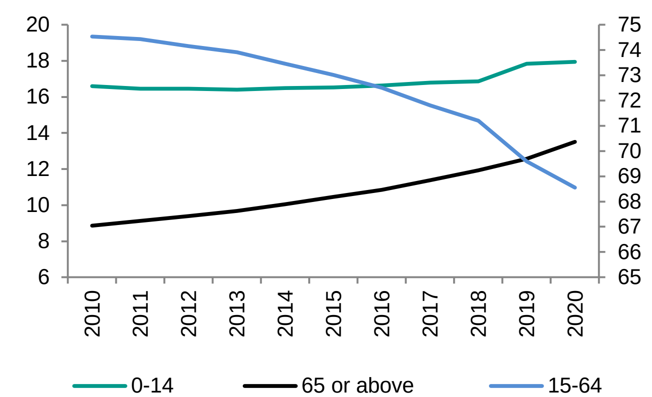
Source(s): Companies, ABCI Securities

Exhibit 9: Number of newborns in China



Source(s): NBS, ABCI Securities

Exhibit 10: Age distribution of China's population (%)



Source(s): NBS, ABCI Securities

Valuation of sector top picks (Data as of June 25, 2021)

Company	Ticker	Rating	TP	Upside (%)	FY21E P/E(x)	FY22E P/E (x)	FY21E P/B (x)	FY22E P/B (x)	FY21E Yield (%)	FY22E Yield (%)
Nongfu Spring	9633 HK	BUY	HK$ 45.8	12.1	65.37	53.96	20.35	16.11	0.47	0.56
Yili	600887 CH	BUY	RMB 45.6	21.9	24.61	20.22	6.86	6.22	2.86	3.48

Note: FY ends at Dec 31
Source(s): Bloomberg, ABCI Securities estimates

NEUTRAL

China Education Sector – Policy favors higher education players

Paul Pan

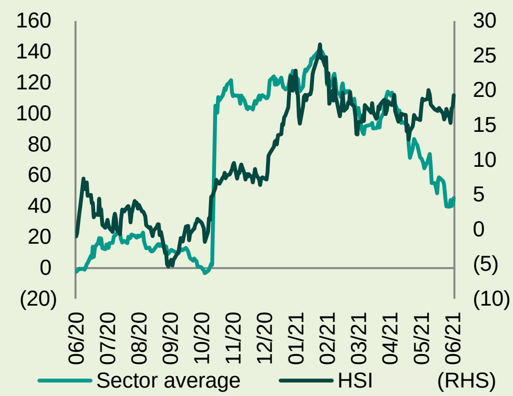
Key Data	
Avg. 21E P/E (x)	12.8
Avg. 21E P/B(x)	2.2
Avg. 21E div yield (%)	3.1

Source(s):Bloomberg, ABCI Securities estimates

Sector Performance (relative to HSI)	Absolute (%)	Relative (%)
1-mth	(14.98)	(16.29)
3-mth	(27.91)	(32.88)
6-mth	68.56	57.56

Source(s):Bloomberg, ABCI Securities

1-year sector performance (%)



Source(s):Bloomberg, ABCI Securities

- Changing policy and regulatory environment is more favorable to higher education players than the after-school education players
- 2020 national enrollment continued to grow, but primary school and junior high saw decline in new student intake
- Declining number of newborns would be a challenge in the long term
- Prefer higher education players; our top picks are **CEG (839 HK)** and **Edvantage (382 HK)**

Changing policy environment. Numerous education policies have been announced recently. For the formal education industry, the MOE has released the "The Revised Implementation Measures of the Law on the Promotion of Private Education" (Revised Measures; 《中华人民共和国民办教育促进法实施条例》) , which will be effective from Sep 1, 2021. The Revised Measures provides a regulatory foundation for the future development of the private education industry in China. For the private education segment, K-9 education (kindergarten to Grade 9) will be subjected to more regulatory supervision and limitation than the G10-12/vocational/higher education segments. In addition, various new policies have been introduced to reduce burdens on K-12 students, which include "Notice on Sleep Management of Primary School, Junior High, and High School Students" (《教育部办公厅关于进一步加强中小学生睡眠管理工作的通知》), "Opinion on Transition from Preschool Education to Primary School" (《教育部关于大力推进幼儿园与小学科学衔接的指导意见》), "Notice on Homework Management for Compulsory Education" (《教育部办公厅关于加强义务教育学校作业管理的通知》), and "Regulation on Minor Protection at School" (《未成年人学校保护规定》). These policies, though not directly targeting at the after-school education segment, have entailed specific measures for the participants. We believe the Revised Measures would be more favorable to the higher education industry. Though no specific measures have been announced for the after-school education segment, we expect regulatory oversight to increase.

Continuous growth in enrollment. According to MOE, in 2020, enrollment in preschools, primary schools, junior highs, high schools, and higher education institutions grew 2.2% YoY, 1.6% YoY, 1.8% YoY, 3.3% YoY, and 4.5% YoY, respectively. However, the number of new students in primary school and junior high decreased by 0.6mn and 0.1mn in 2020. The number is not significant compared to the overall student enrollment, but it can be interpreted as an early impact of declining newborns in recent years.

Long-term challenge posed by demographic change. According to the NBS, the number of newborns decreased to 12mn in 2020, 18.1% lower than that in 2019, marking the fourth consecutive year of decline. If the downtrend cannot be reversed, the education industry will be facing a shrinking pool of eligible students in the long run. The impact would be first felt by the fundamental education segment before trickling down to the higher education segment.

Long-term Outlook

If childbearing willingness remains low in the country, total student enrollment would decline in the future. In addition, policy stance on the K-9 education segment will remain stringent

Short-term Outlook

The after-school education segment would be affected by the increasing regulatory oversight as the government targets to lower the burden of students and parents as well as encouraging childbearing. Meanwhile, the higher education segment would outperform due to the supportive policies.

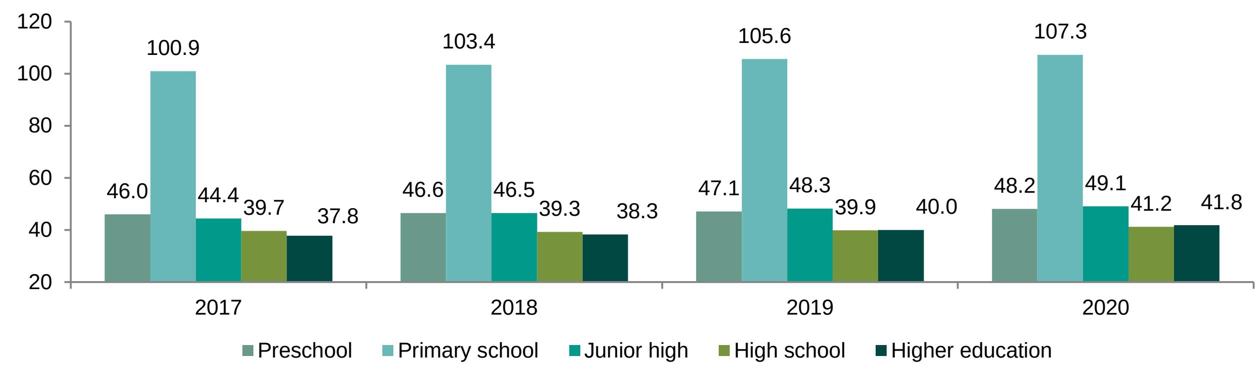
Stock Recommendations

We favor the higher education segment and prefer players with leading market positions or high exposure in affluent regions. Our top picks include **CEG (839 HK)** and **Edvantage (382 HK)**.

Risk Factors

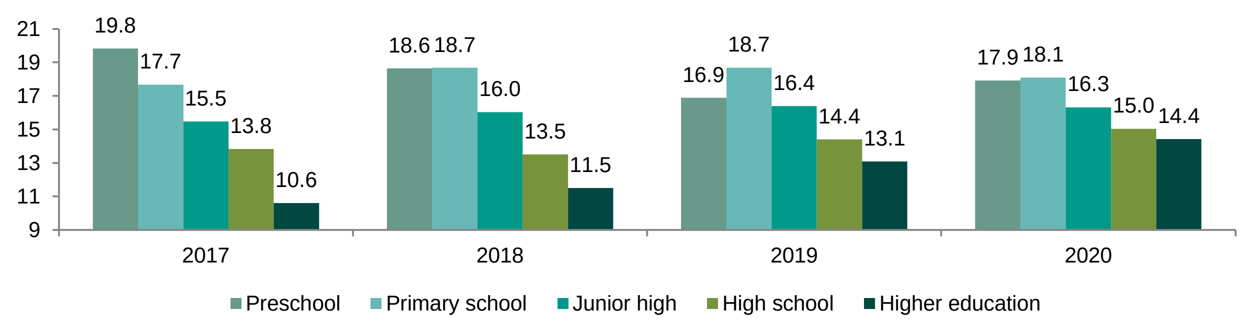
1) Demographic changes; 2) Policy risk; 3) Education quality and dropout risk; 4) Operation and reputation risks; 5) Expansion bottleneck; 6) Pandemic risk.

Exhibit 1: National enrollment (mn ppl)



Source(s): MOE, ABCI Securities

Exhibit 2: National new student intake (mn ppl)



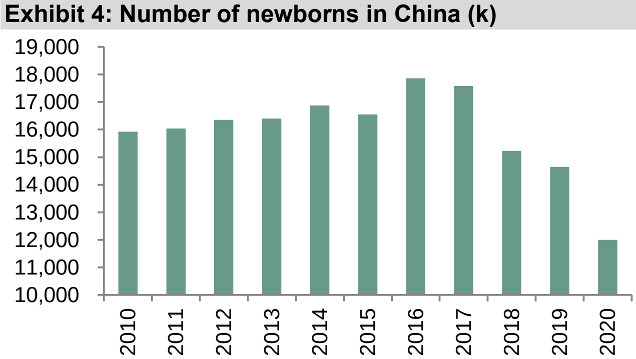
Source(s): MOE, ABCI Securities

Exhibit 3: Policy/Regulation highlights

Policy/Regulation	Highlights
"Revised Implementation Measures of the Law on the Promotion of Private Education" 《中华人民共和国民办教育促进法实施条例》	➢ Foreign-invested enterprises in China or social organizations whose ultimate controller is not domestic cannot participate in the compulsory education institutions (primary school + junior high). ➢ Prohibits the control of private compulsory education institutions or not-for-profit private preschool education institutions through the means of merger, acquisition, or contractual control. ➢ Prohibits connected-party transactions for compulsory education institutions, but allows such transactions for G10-12/vocational/higher education schools in a transparent and fair manner and based on a periodically audited disclosure system. ➢ Private formal education institutions enjoy the same rights in student recruitment as the public counterparts. ➢ Provides preferential tax policies for private schools in line with national policies and not-for-profit schools would enjoy the same tax treatment as the public counterparts.
"Regulation on Minor Protection at School" 《未成年人学校保护规定》	➢ Schools and after-school education institutions are not allowed to cooperate to provide courses to stude nts.
"Notice on Homework Management for Compulsory Education" 《教育部办公厅关于加强义务教育学校作业管理的通知》	➢ After-school education institutions are prohibited from leaving homework. To prevent excessive burden caused by homework from after-school courses, relevant authorities should prioritize homework-leaving prevention among regulatory oversight and enforcement measures for afterschool tutorial courses for primary and middle school students.
"Opinion on Transition from Preschool Education to Primary School" 《教育部关于大力推进幼儿园与小学科学衔接的指导意见》	➢ Relevant authorities should continue to ramp up regulatory oversight and enforcement measures on after-school education institutions, primary schools, and kindergartens. ➢ After-school education institutions are prohibited from providing training or tutorial courses to preschool students. ➢ Primary schools should implement admission by locality rather than examination, and are prohibited from using any form of results from exams, contest/competition, or training/tutorial courses as basis of admission. Primary schools should strictly follow the teaching guideline provided by the MOE without skipping entry-level or transitional courses for G1 students. Primary schools should not provide prep-school education. ➢ Kindergartens should not teach courses designated for primary schools, and leave homework that involves calculation, writing, or reading. Kindergartens should not provide prep school education. Kindergartens should investigate and report to relevant authorities about dropout of senior students. ➢ After-school education institutions that are in violation of providing preschool students training or tutorial courses would be put on a blacklist, which would be posted on a national credit information sharing platform. ➢ Violations would be punished accordingly.
"Notice on Sleep Management of Primary School, Junior High, and High School Students" 《教育部办公厅关于进一步加强中小学生睡眠管理工作的通知》	➢ Relevant authorities should supervise the online tutorial platforms and all nighttime online training/tutorial activities must end by 9pm.

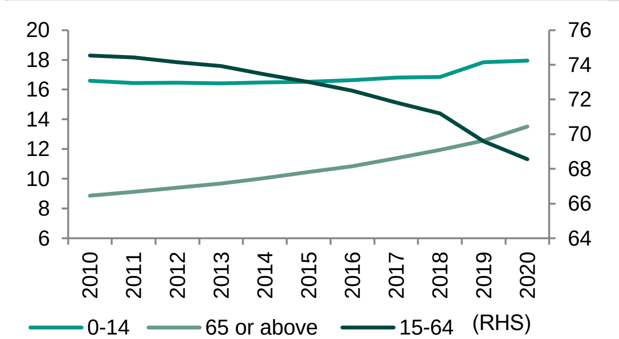
Source(s): MOE, ABCI Securities

Exhibit 4: Number of newborns in China (k)



Source(s): NBS, ABCI Securities

Exhibit 5: Age distribution in China (%)



Source(s): NBS, ABCI Securities

Valuation of sector top picks (Data as of June 25, 2021)

Company	Ticker	Rating	TP (HK$)	Upside (%)	FY21E P/E(x)	FY22E P/E (x)	FY21E P/B (x)	FY22E P/B (x)	FY21E Yield (%)	FY22E Yield (%)
CEG	839 HK	BUY	20.0	13.0	28.98	21.65	2.96	2.72	1.23	1.65
Edvantage	382 HK	BUY	13.1	73.7	14.72	10.00	2.86	2.23	2.43	3.57

Note: FY ends at Aug 31
Source(s): Bloomberg, ABCI Securities estimates

OVERWEIGHT

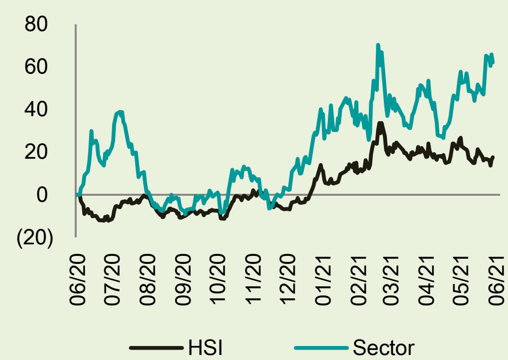
China Telecom Sector– Rebounding mobile ARPU expected for 2021

Ricky Lai

Key Data		Sector Performance (relative to HSI)	Absolute (%)	Relative (%)
Avg. 21E P/E (x)	14.1	1-mth	0.5%	(0.1%)
Avg. 21E P/B(x)	2.0	3-mth	(4.7%)	(1.2%)
Avg. 21E div yield (%)	1.9	6-mth	19.1%	7.7%
Source(s):Bloomberg, ABCI Securities estimates		Source(s):Bloomberg , ABCI Securities		

- Telecom operators' mobile ARPU is improving on higher 5G user penetration rate
- Forecast 5G use penetration rate to reach 31.0% in 2021E
- **China Mobile (941 HK)** is our top pick for its high dividend yield, healthy balance sheet, and dominant position in China's telecom market

1-year sector performance (%)



Source(s):Bloomberg

China's 5G users to exceed 500mn in 2021E. As of May 2021, the mobile user market share of China Mobile/China Unicom (762 HK)/China Telecom (728 HK) were 58.6%/19.2%/22.2%. China Mobile has maintained the highest share thanks to its superior network coverage and quality services. Telecom operators are fostering 5G user growth through competitive service package and launching the latest 5G smartphone models. 5G users have surpassed 300mn in May 2021, and we estimate the total to exceed 500mn in 2021E on lower service tariff and new 5G smartphone models, and 5G user penetration rate would reach 31.0% in 2021E. The 5G base stations exceeded 950,000 as of May 2021, and we expect the figure to total 1.3mn in 2021E due the need for more standalone 5G network. Hence, we forecast telecom operators' CAPEX to go up by 2.3% YoY in 2021E.

Wireline business supported by new applications. The demand for wireline broadband network was strong due to the increasing demand for cloud computing, big data, home office, and home entertainment. We expect China's wireline broadband market in 2021E to grow steadily with better network speed and IPTV utilization rate. Thanks to its aggressive pricing strategy and efficient marketing plans, China Mobile had the highest market share in wireline broadband user at 46.8% as of May 2021, higher than China Unicom's 18.8% and China Telecom's 34.4%. We expect the wireline broadband to be supported by a number of new applications for smart home, AR/VR, 4K TV entertainment, among others.

Global smartphone shipments to grow 8.0% YoY in 2021E. According to IDC, global smartphones shipments were 345.5mn in 1Q21, up 25.5% YoY because of the low base in 1Q20 and increasing 5G smartphone contributions. Most of the major smartphone makers recorded a higher market share in 1Q21 by taking up Huawei's share. However, the global smartphone shipment growth in 2H21 could be slower than that in 1Q21 due to chip shortage and the higher base in 2H20. We expect the global smartphone shipments in 2021E to grow by 8.0% YoY. To strive for a higher market share, many smartphones makers have introduced high-res camera and new features in smartphones, benefiting the upstream electronic component supply chain with the increased high-end product demand. Thanks to the rising 5G smartphone contribution, we believe the electronic component makers would see better margins and product shipments in 2021E.

Long-term Outlook

In the long term, telecom operators will benefit from higher 5G user base and penetration rate, in addition to the higher average mobile data usage per user and mobile ARPU. There will be more 5G-related new applications supporting the internet of things, autonomous driving, smart home, AR/VR, etc. Telecom operators can generate more value-added service revenue by expanding the range of innovative services. Users can access video contents and online games with the much faster transmission network. Telecom operators will expedite the 5G network development in China and increase CAPEX for it since 5G requires a much denser base stations distribution and wider fiber network coverage.

Short-term Outlook

In the short term, we expect growth in ARPU and mobile service revenue to increase on higher mobile data usage and 5G user base. We expect CAPEX of telecom operators to increase, benefiting the upstream telecom equipment supply chains. Wireline service growth would maintain a strong growth in 2021E, thanks to rising demand for big data, cloud computing, and home entertainment. The electronic component suppliers are expected to benefit from higher ASP and shipment growth induced by rising adoption of 5G smartphones.

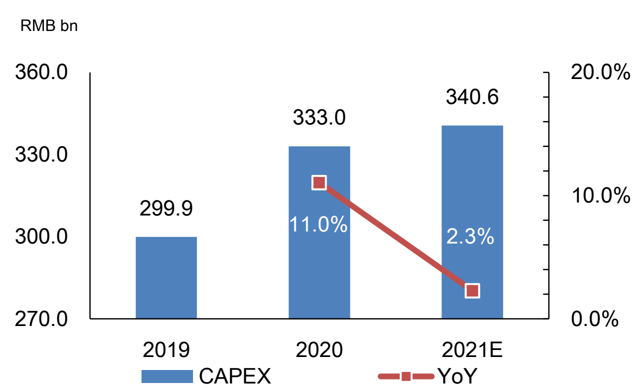
Stock Recommendations

China Mobile (941 HK) is our sector top pick. We expect China Mobile's mobile ARPU to rebound in 2021E on higher 5G user base. It is likely to maintain the highest market share with its network advantage. Our TP is HK$ 82.0, which implies 4.7x FY21E EV/EBITDA.

Risk Factors

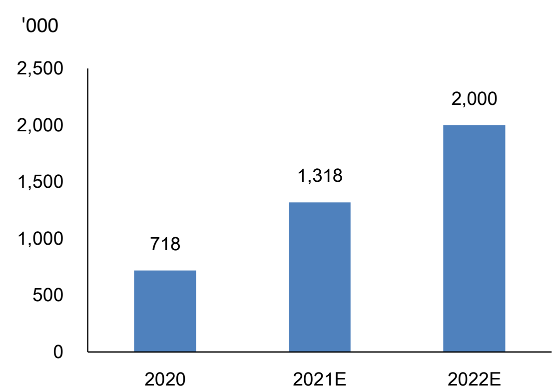
1) Further reduction in service tariff as requested by authorities; 2) User saturation; 3) Intensifying market competition; 4) Slower growth in smartphone shipments; 5) Slowdown in 5G network development.

Exhibit 1: Telecom operators' CAPEX



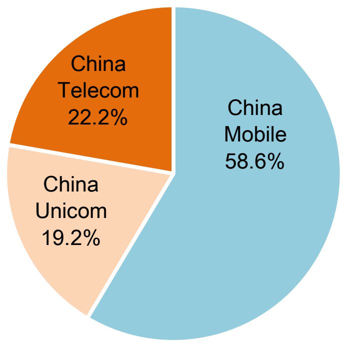
Source(s):MIIT, ABCI Securities estimates

Exhibit 2: Number of 5G base stations



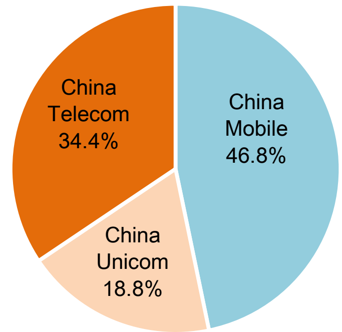
Source(s):MIIT, ABCI Securities estimates

Exhibit 3: Mobile user market share



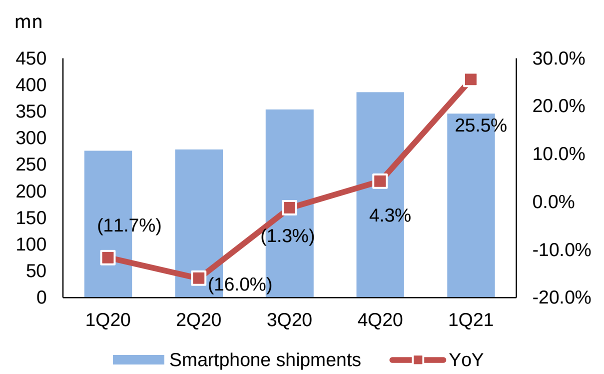
Source(s): Companies, ABCI Securities

Exhibit 4: Wireline broadband user market share



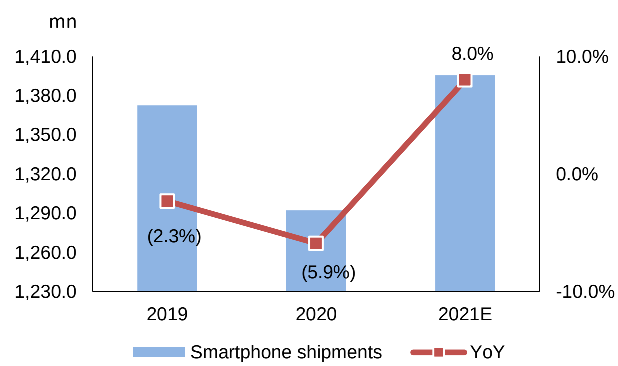
Source(s): Companies, ABCI Securities

Exhibit 5: Quarter smartphone shipments (LHS) and growth



Source(s): IDC, ABCI Securities

Exhibit 6: Yearly smartphone shipments (LHS) and growth



Source(s): IDC, ABCI Securities estimates

Valuation of sector top picks (Data as of June 25, 2021)

Company	Ticker	Rating	TP (HK$)	Upside (%)	FY21E P/E(x)	FY22E P/E (x)	FY21E P/B (x)	FY22E P/B (x)	FY21E Yield (%)	FY22E Yield (%)
China Mobile	941	BUY	82.00	65.6%	8.4	8.2	0.7	0.6	6.4	6.6

Source(s): Bloomberg, ABCI Securities estimates

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Disclosures

Analyst Certification

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

Definition of equity rating

Rating	Definition
Buy	Stock return rate≥ Market return rate (~10%)
Hold	- Market return rate (~-10%) ≤ 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 2008 (For reference: HSI total return index 2008-20 CAGR at 9.2%)

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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