農銀國際
ABC INTERNATIONAL
ABCI SECURITIES COMPANY LIMITED

2H20 ECONOMIC OUTLOOK & INVESTMENT STRATEGY

ROAD TO RECOVERY

ABCI China/ HK Equity Research

農銀國際
ABC INTERNATIONAL
ABCI SECURITIES COMPANY LIMITED

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Global Economic Outlook

Andy Yao, Economist

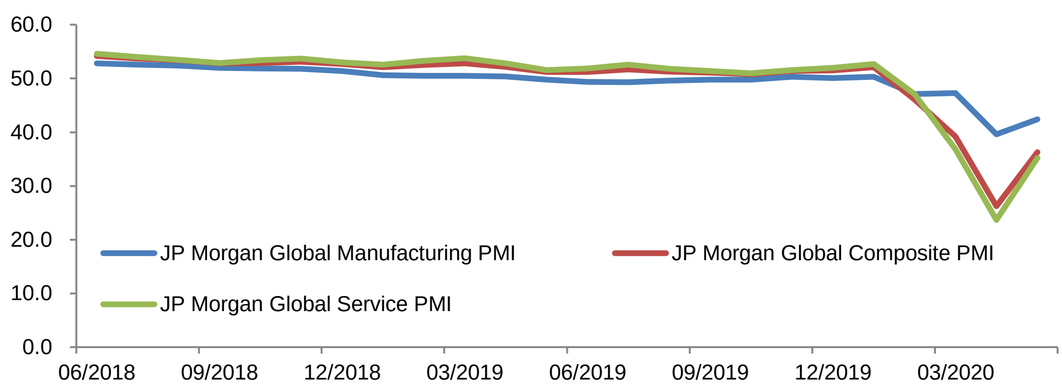
2020 Global Economic Outlook

- Global economic growth has taken a severe hit since the start of 2020 on COVID-19-induced downturn across the world. 1Q20 GDP growth in major countries eased significantly as a result of city lockdowns, extended school closures, and border restrictions
- Global inflation has been mild since the start of 2020 on weak demand and the fall in oil prices. Core inflation, excluding food and energy prices, stayed muted on sluggish wage growth
- Looking ahead, global economy is expected to remain in recession in 2H20, mainly driven by the pandemic's broad-based disruptions. Global outlook is clouded by the unpredictable evolvement of the pandemic and the lack of ideal exit strategies from the lockdown
- We expect economies in the US, China, Eurozone, Japan, and the UK to grow by -5.8%, 2.0%, -8.2%, -4.7%, and -7.6% in 2020E, respectively, compared with 2.3%, 6.1%, 1.2%, 0.7%, and 1.4% in 2019

Global growth took a severe hit in 1H20

The COVID-19 pandemic has wreaked havoc around the world since the start of 2020 as economic activities came to a screeching halt. As shown in Exhibit 1, both the JP Morgan global manufacturing PMI and service PMI plunged in 5M20, pointing to an economic recession. Global trade activity revealed a steep decline with the COVID-19 outbreak − the World Trade Outlook Indicator released by WTO descended to a contraction level of 87.6 in May and the sub-indicator export order index remained dismal at 83.3, well below the baseline value of 100. As of late-June 2020, more than 9mn of COVID-19 cases have been confirmed, meaning that at least one-thousandth of the global population has been diagnosed. The spread and sustainability of the epidemic have repeatedly exceeded expectations.

Exhibit 1: JP Morgan Global PMIs (%)



Source(s): Bloomberg, ABCI Securities

Note: All growth rates in the" 2H20 Global Economic Outlook" and "2H20 China Economic Outlook" sections are year-on-year except specified otherwise

1Q20 GDP growth in major countries eased significantly, reflecting the severe consequences of the pandemic such as city lockdowns, extended school closures, and border restrictions. Economic growth in the US, China, Eurozone, Japan, and the UK slowed sharply to 0.2%, -6.8%, -3.1%. -1.7% and -1.6%, respectively, in 1Q20, compared to 2.3%, 6.0%, 1.0%, -0.7% and 1.1% in 4Q19 (Exhibit 2). Business shutdowns caused by the pandemic have increased unemployment in major economies. Except for China, 2Q20 data unequivocally point to a decelerating momentum in major economies.

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

Real GDP Growth (YoY)	2019	4Q19	1Q20
US	2.3	2.3	0.2
China	6.1	6.0	(6.8)
Eurozone	1.3	1.0	(3.1)
Japan	0.7	(0.7)	(1.7)
UK	1.4	1.1	(1.6)

Source(s): Bloomberg, ABCI Securities

Global inflation has been mild since the start of 2020 on weak demand and the fall in oil prices. Core inflation, excluding food and energy prices, stayed muted on sluggish wage growth. In most advanced economies, core inflation failed to meet the central banks' targets due to the pandemic-induced downturn. Among the emerging economies, core inflation remains below 2% on depressed employment levels. However, significant currency weakness following substantial capital outflows has boosted inflation, partially offsetting the downward pressure resulted from low energy prices. In a few emerging economies, disruptions to food supply chains or labor shortages are pushing food prices up.

Major central banks have provided an unprecedented degree of monetary support to households, companies, and financial markets. The Fed has cut its target range for the federal funds rate to 0.00%-0.25%; based on its announcement, the Fed will purchase an unlimited amount of treasuries and mortgage-backed securities to support the financial market. ECB further lowered the rates on targeted longer-term refinancing operations, and the pandemic emergency purchase program has been increased to EUR 1,350bn. BOJ and BOE boosted their bond purchasing programs while leaving the interest rates unchanged; PBOC has adopted a loose monetary policy to support economic growth since the start of 2020.

Global growth to remain in recession for most in 2H20

Looking ahead, global economic growth is expected to remain in recession in 2H20, mainly driven by the pandemic's broad-based disruption. Economic outlook is clouded by the unpredictable evolvement of the pandemic and the lack of ideal exit strategies from the lockdown. In the Apr trade forecast, WTO estimated the growth of global trade in goods in 2020 will fall by between 13% and 32%. According to the latest Global Economic Prospects released by the World Bank in June 2020, global economy is projected to contract by 5.2% in 2020, the worst rate in post-war history, compared to the 2.4% growth in 2019 (Exhibit 3).

We expect the US economy to contract by 5.8% in 2020E, down from the 2.3% growth in 2019. Weak household confidence and high unemployment rate will contain consumer spending, while investment and trade are likely to fall. Massive fiscal and monetary stimulus, however, should provide some relief to households and businesses. The possibility of a second outbreak, ongoing conflicts with China, and recent social protest triggered by the death of George Floyd nonetheless pose risks to the economy. On the monetary front, with a weakening economic outlook, we expect the Fed to maintain the federal funds rate at near-zero level in 2H20. The Fed is likely to sustain its purchases of treasury securities, and agency residential and commercial mortgage-back securities at its current pace. However, we believe the Fed will unlikely adopt a negative rate policy as it will adversely affect lending and profits of commercial banks.

Despite the anemic GDP growth in 1Q20, we believe China's economy will regain strength and expand by 2.0% for 2020E, down from 6.1% in 2019 − a decent growth considering the pandemic crisis. On the monetary front, PBOC is expected to continue with the counter-cyclical policy measures to stabilize economic growth. The rates for one-year LPR and five-year LPR are expected to fall to 3.25% and 4.35% for end-2020E. With a moderate inflationary pressure and increasing downward pressure on the economy, we expect PBOC to lower its RRR twice in 2H20E.

We project Eurozone's GDP growth to fall sharply to -8.2% in 2020E from 1.2% growth in 2019 on unemployment, weak investment and reduced household spending. Moreover, the impact of COVID-19 on the tourism sector has been devastating due to the resultant border restrictions. External demand will be weak. According to ECB's monetary meeting in June, we expect interest rate to remain unchanged for the rest of 2020E. ECB will continue to expand its asset purchase program. Meanwhile, we expect the UK economy to contract by 7.6% in 2020E, down from the 1.4% growth in 2019 due to reduced private consumption, investment, and exports.

We forecast Japan's economic growth to slow sharply from 0.7% in 2019 to -4.7% in 2020E as the pandemic disrupts business activity and weighs on consumption and investment growth. Overseas demand for Japanese exports will also fall. With a tame inflation outlook remaining low and dampening economic momentum, we expect BOJ to leave its monetary policy unchanged and increase purchases of various assets.

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

Real GDP Growth (YoY)	2018	2019	2020E
US	2.9	2.3	(5.8)
China	6.6	6.1	2.0
Eurozone	1.9	1.2	(8.2)
Japan	0.3	0.7	(4.7)
UK	1.3	1.4	(7.6)
World	3.0*	2.4*	(5.2)*

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

China Economic Outlook

Andy Yao, Economist

2H20 China Economic Outlook

- China's economy contracted by 6.8% in 1Q20 due to the impact of COVID-19. As the epidemic ebbs and production resumes, economic data shows that the Chinese economy has begun to rebound since 2Q20

- China's GDP fell sharply in 1Q20. With the resumption in infrastructure and property investment as well as consumption recovery, however, we forecast the figure to expand by 2.0% for 2020E, down from 6.1% in 2019

- Globally, the pandemic is still rampant, with the rising likelihood of a second wave. External demand is likely to continue to weaken. After the first phase of the Sino-US trade agreement, US's containment policy towards China is hampering the latter's supply chain. Challenges in the Chinese economy should not be underestimated

- In terms of policy, we expect PBOC to continue with the counter-cyclical policy measures, including RRR and interest rate cuts. The rates for one-year LPR and five-year LPR are expected to fall to 3.25% and 4.35% for end-2020E. The central government will adopt a more proactive fiscal policy to support economic growth. Such policy measures include lifting the fiscal deficit rate, increasing the issuance of local government bonds, issuing special government bonds, raising public expenditure in epidemic prevention and livelihood security, and further reduction in taxes and fees

China's economy started to rebound in 2Q20

China's economy contracted by 6.8%[1] in 1Q20 due to the impact of COVID-19. As the epidemic ebbs in China and production resumes, economic data shows that the economy has begun to rebound in 2Q20. Economic activity in Apr and May grew faster than that in 1Q20 on the back of production resumption, with investment, retail sales, trade surplus, and industrial production all rebounding significantly.

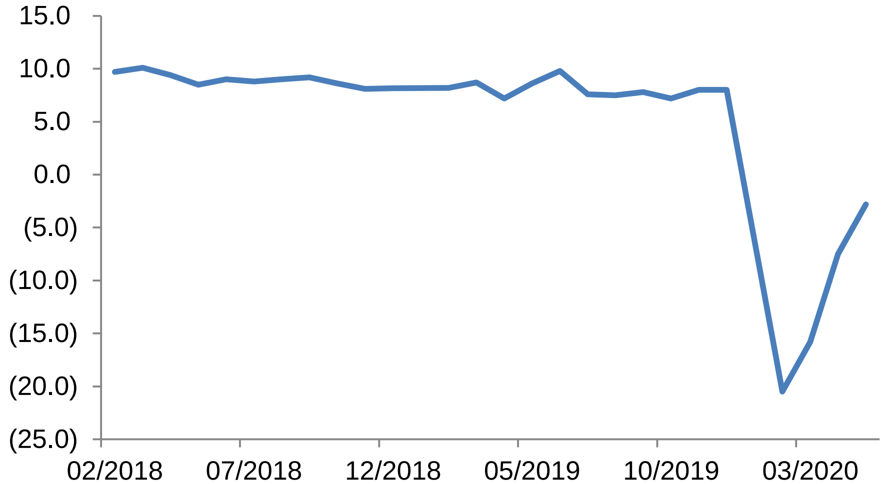
With the resumption in production as well as increases in infrastructure and property investment, industrial production rose 3.9% in Apr and 4.4% in May after declining by 8.4% in 1Q20. As a synchronous indicator of the macro economy, electricity output expanded by 0.3% in Apr and 4.3% in May, compared with the 6.8% decline in 1Q20. PMI for manufacturing, which covers 31 industries, jumped to 52.0 in Mar after recording a historical low of 35.7 in Feb. Manufacturing PMI also exceeded the 50 threshold level in Apr and May. Meanwhile, profit growth of industrial enterprises only fell 4.3% in Apr after declining by 36.7% in 1Q20.

In terms of domestic demand, both consumer spending and FAI rebounded significantly. Retail sales fell by 7.5% and 2.8% in Apr and May, compared to the 19.0% drop in 1Q20 (Exhibit 1). FAI growth in urban areas also advanced to 0.8% in Apr and 3.9% in May from -16.1% in 1Q20, which we believe can be attributed to property and infrastructure investment gaining back strength (Exhibit 2).

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

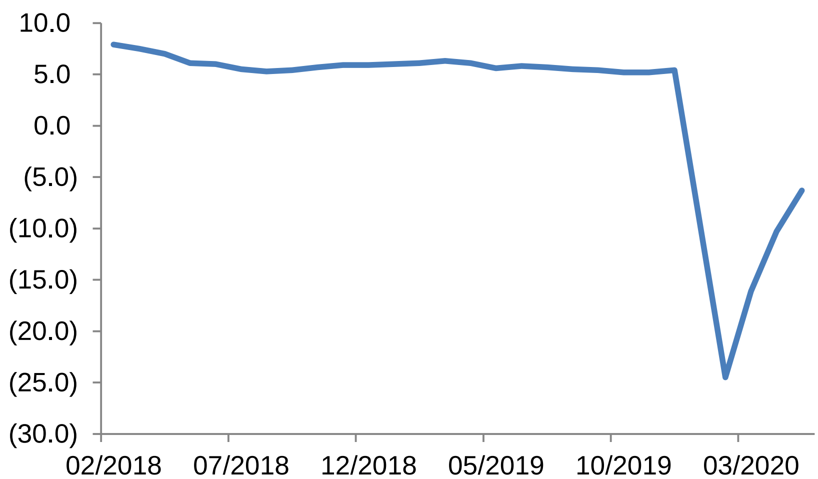
On the external front, export growth in Apr and May rebounded sharply from 1Q20 due to significant export growth of epidemic prevention-related products and remote office products (Exhibit 3). Export growth was 3.5% in Apr and -3.3% in May in USD terms, higher than -13.3% in 1Q20. Import growth fell 14.2% in Apr and 16.7% in May due to the persisting pandemic overseas, compared with the 2.9% drop in 1Q20. Trade surplus increased sharply to US$ 45.3bn in Apr and US$ 62.9bn in May due to significant decline in import, which was significantly higher than the US$ 13.2bn in 1Q20.

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



Source(s): NBS, ABCI Securities

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

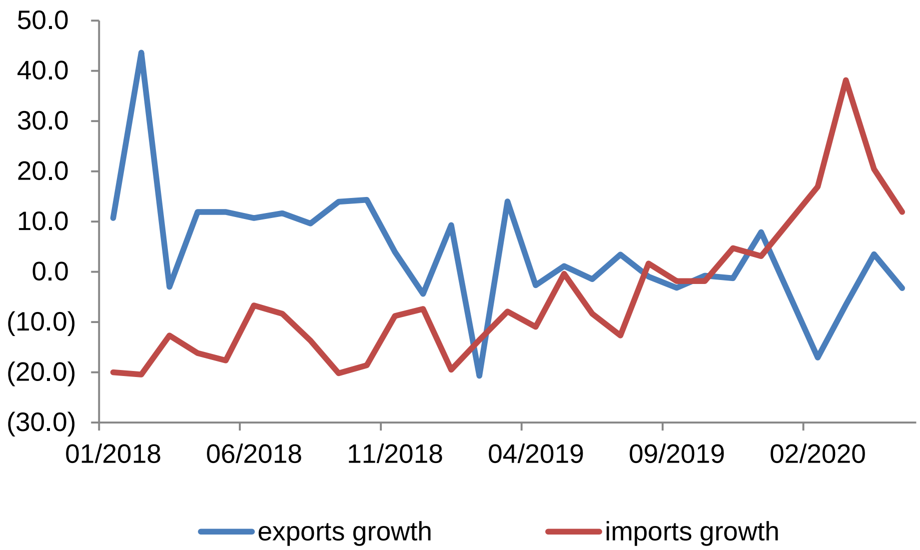


Source(s): NBS, ABCI Securities

Inflation slowed in Apr and May. CPI eased to 3.3% and 2.4% in Apr and May from 4.9% in 1Q20 as food inflation moderated; meanwhile, PPI fell by 3.1% in Apr and 3.7% in May, compared with the 0.6% decrease in 1Q20 due to the sharp drop in oil price and the weakened domestic demand.

On the monetary front, PBOC has adopted a loose monetary policy to support economic growth since the start of 2020. It slashed RRR thrice to lower financing costs for the real economy, especially for small/medium enterprises and private companies. Although the benchmark deposit interest rates set by PBOC have stayed unchanged, the LPR was lowered twice. Growth in broad money supply (M2) accelerated to 11.1% in May from 8.7% in Dec 2019, while total social financing − a comprehensive measure of all types of financing for the real economy, increased to RMB 17.4tr in 5M20 from RMB 12.0tr during the same period last year.

Exhibit 3: China's exports and imports growth (% YoY)



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

Economic growth to rebound significantly in 2H20

Despite the anemic GDP growth in 1Q20, we believe China's economy will rebound significantly in 2H20. However, the risks faced by China will not be low as the pandemic is still rampant on a global level.

China will increase special local government bonds by RMB 1.6tr from 2019 to RMB 3.75tr for 2020; the proportion used as project capital will be raised. In 5M20, RMB 2.2tr of special local government bonds have been issued, of which ~80% have been invested in the infrastructure sector, thereby driving the growth in infrastructure investment back up to 2.3% and 8.3% in Apr and May. The 2020 Government Work Report proposes to strengthen the construction of new infrastructure (such as 5G applications), enhance the construction of major projects (such as transportation and water conservancy), and increase the national railway construction capital by RMB

100bn. We therefore estimate infrastructure investment growth to rebound from 3.8% in 2019 to ~5% in 2020E.

The promotion of new urbanization construction and the newly started reconstruction of 39,000 old urban communities will support the steady growth of property sales and investment. The continued decline in LPR and loose liquidity support financing for property companies, hence the land purchase area and newly started area have recovered significantly. The single-month property investment in May rebounded from 6.7% in Apr to 8.4%. Measured by floor space and value, new home sales jumped 9.6% and 14.2% in May, compared with -2.3% and -5.0% in Apr. We expect property investment growth to be~6.5% in 2020E.

As the epidemic ebbs in China and production resumes, the job market gradually revives, releasing pent-up consumption. From a liquidity perspective, the net deposits in the residential sector decreased in Apr and May and consumption willingness increases. Driven by the central and local policies to promote automobile consumption, automobile retail sales, which accounted for 10% of overall retail sales, increased 3.5% in May, compared with the 22.6% decrease in 4M20. The completion of property construction in May recorded a positive growth; also, the volume of old urban community renovation doubled that of 2019. Property-related consumption, including household appliances, building materials, and furniture, is expected to jump significantly. Meanwhile, catering consumption is expected to recuperate in 2H20. We expect the retail sales growth to be ~2% in 2020E.

However, the COVID-19 pandemic is still rampant on a global level; together with the rising likelihood of a second outbreak, external demand is likely to remain sluggish. After the first phase of the Sino-US trade agreement, US's containment policy towards China has hampered the latter's supply chain. The US plans to dismantle China's supply chain by desinicizing the US industrial chain while moving the US suppliers out of China's industrial chain. The US continues to target against the Chinese enterprise Huawei in the high-end supply chain through the entity list; meanwhile, as a result of the tariff measures enacted by the US, China's low-end supply chain is transferred to Southeast Asia, which harms employment in China. The challenges faced by China should not be underestimated.

Overall, we believe that China's economic growth is likely to turn positive in 2H20. We expect China's GDP to expand by 2.0% for 2020E, down from 6.1% in 2019 − a decent growth under the impact of the pandemic (Exhibit 4).

On the monetary front, PBOC is expected to continue with the counter-cyclical policy measures to stabilize economic growth. On June 17, 2020, the State Council Regular Meeting has proposed banks to sacrifice RMB 1.5tr in profits in 2020 to support enterprises. The rates for one-year LPR and five-year LPR are expected to fall to 3.25% and 4.35% for end-2020E. With a moderate inflationary pressure and increasing downward pressure on the economy, we expect PBOC to lower its RRR twice in 2H20E. According to the Work Report, China will increase fiscal expenditure by RMB 3.6tr in 2020 from last year, accounting for about 3.63% of total GDP in 2019 – a signal that the central government will adopt a more proactive fiscal policy to support growth. Such policies include raising the fiscal deficit rate, increasing the amount of local government bonds, issuing special government bonds, raising public expenditure in COVID-19 prevention and enhancing livelihood security, and further reduction in taxes and fees.

Exhibit 4: Economic forecasts

Economic indicators	2018	2019	2020E
Real GDP growth, %	6.6	6.1	2.0
FAI growth, %	5.9	5.4	1.5
Retail Sales growth, %	9.0	8.0	2.0
Export growth in USD terms, %	9.9	0.5	(2.0)
Import growth in USD terms, %	15.8	(2.8)	(4.0)
Industrial Production growth, %	6.2	5.7	2.2
CPI, %	2.1	2.9	3.0
PPI, %	3.5	(0.3)	(1.0)
M2 growth, %	8.1	8.7	10.5
New Aggregate Financing, RMB bn	22,492	25,580	30,000
New Yuan Loans, RMB bn	16,170	16,810	20,000
Spot CNY per USD, End-year	6.8785	6.9632	6.9000
One-year LPR	4.31	4.15	3.25
Five-year LPR	NA	4.80	4.35

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

Investment Strategy

Philip Chan, Head of Research

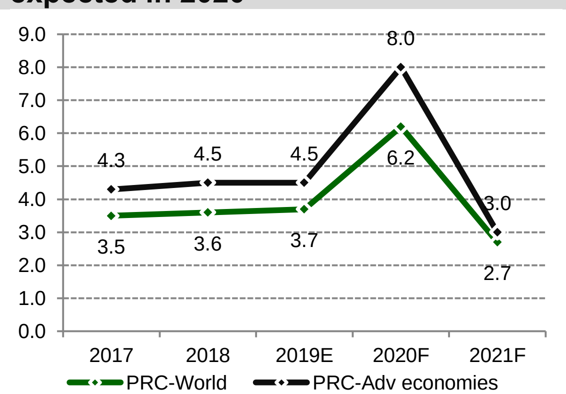
2H20 Investment Outlook

Our views on the global affairs

- Global economic cycle turns favorable to China in 2020-21 in relative terms
- Decoupling of the US and China means lower investment beta between the two; we believe fund managers will be incentivized to increase investment allocation to the Chinese assets
- Finding the Chinese unicorn in semi-conductor industry – the core of China's new infrastructure development
- Substantial influx of hot money into China in 2020-21 is expected as the global economy undergoes monetary and fiscal expansion

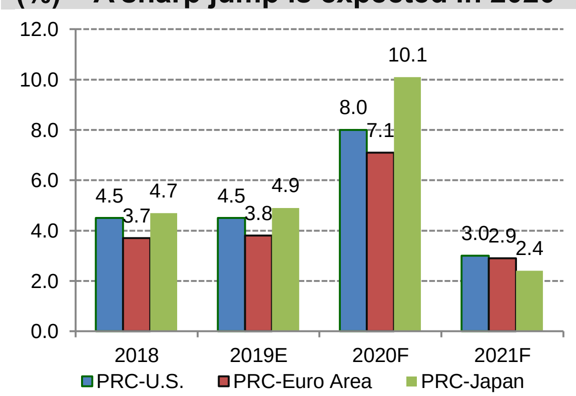
Relative economic growth matters. China and the world have been suffering from the coronavirus pandemic since early 2020 – and concerns over the economic outlook mounts, with pessimism dominating the sentiment. For 2020, we believe China may outperform the advanced economies in terms of relative economic growth. According to the World Bank, China's relative real GDP growth (i.e. China's GDP growth minus GDP of other economies) will increase to 8.0% in 2020E from 4.5% in 2019E against the advanced economies; the relative growth will increase to 6.2% in 2020E from 3.7% in 2019E against the world. For global investors, relative economic growth rate is one of critical factors in determining investment allocation. Based on the World Bank's projections, economic growth in China will be 8.0ppt, 7.1ppt , and 10.1ppt higher than that in the US, Eurozone, and Japan, respectively, in 2020E.

Exhibit 1: China's GDP growth relative to other regions (%) – A sharp jump is expected in 2020



Relative real GDP growth= China GDP minus GDP of other region
Source(s): Global Economic Prospects issued by the World Bank in June 2020, ABCI Securities

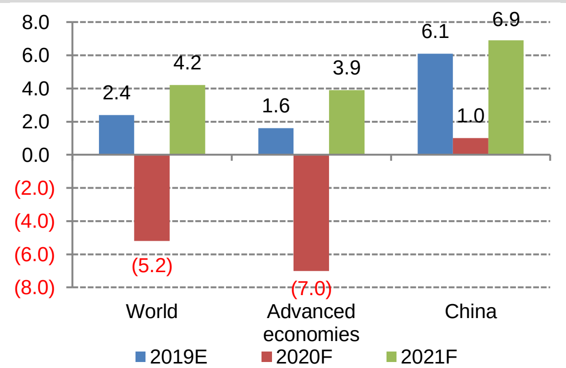
Exhibit 2 : GDP growth in China relative to those in the US, Eurozone & Japan (%) – A sharp jump is expected in 2020



Relative real GDP growth= China GDP minus GDP of other region
Source(s): Global Economic Prospects issued by the World Bank in June 2020, ABCI Securities

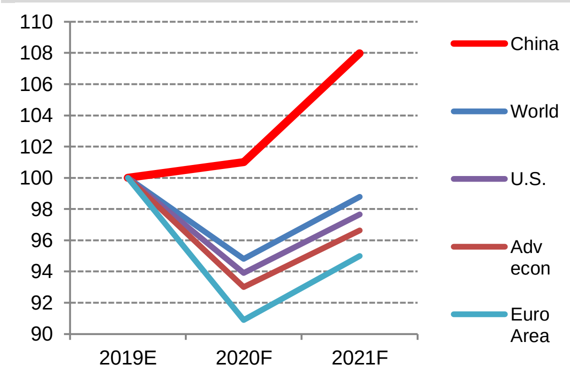
Duration of economic cycle matters. The global economy may only recover to the 2019 level after 2021. Although the global economy is expected to rebound sharply in 2021 due to the low base in 2020, the global output by then may not recover to the level in 2019. The World Bank predicts that China's economic output will recover back to the 2019 level in 2021, but economic outputs in the US, Eurozone, and Japan will return to their 2019 levels only after 2021. Combined with the relative economic growth and recovery timing of the global economic cycle, China presents an attractive choice for global investors to increase their investments in the region in 2020-21.

Exhibit 3 : Global real GDP growth (%YoY)
In general, the global economy is expected to rebound sharply in 2021



Source(s): Global Economic Prospects issued by the World Bank in June 2020, ABCI Securities

Exhibit 4 : Global economic output (2019 base=100)
Except for China, economic output of the advanced economies will not recover back to 2019 level before 2022



Source(s): Global Economic Prospects issued by the World Bank in June 2020, ABCI Securities

Decoupling of China and the US means multi-polarization of global economy, widening investment opportunities for fund managers. Decoupling of China and US economies will imply lowering correlation between the two. Incentive to invest in China's assets will increase – a notion that may sound counterintuitive for some. Our reasoning is that if prices of two assets are highly correlated, investors will be indifferent to either of them, and the incentive to invest in the two assets will diminish. On the contrary, when the correlation lowers, diversification of investments on the two assets will become meaningful. Decoupling of two superpowers will lead to uncertainty initially, but new investment opportunities may arise later on. Obviously, investors will be concerned about the economic impact of the US's banning of high-tech exports to China. The consequence is that the Chinese government will act to reduce reliance on the US tech industry; hence, investment opportunities will emerge in China's semi-conductor industry and the tech sector as a whole. Hence, decoupling of the two superpowers is widening the scope of investment opportunities if the impasse between the two countries persists.

Marginal investment return matters. From the economic perspective, when the supply of goods is abundant, its marginal return of increment supply will be minimal. We believe deficiencies in the China tech sector will provide a high marginal investment return to investors. As the decoupling occurs, the Chinese tech companies will need to fulfill domestic demand that is originally taken up by the US. The return is determined not as much by the technological level of these products as the extent of unmet demand in the domestic market and the ability to manage cost efficiency.

Chips are the common core components of integrated circuits (ICs). ICs are the core components that determine the efficiency and effectiveness of China's new infrastructure investments in coming years. While the strength of Huawei demonstrates the global competitive strength of IC design sector in China, but deficiency of other segments in China's semi-conductor industry may offer a relatively high marginal investment return.

Currently, there are no commercialized 14nm Fab foundry production lines in China. SMIC (981 HK) will enjoy the first-mover advantage in China, although the 14nm production line is two generations behind the 5nm production line. China's IC designers rely on the US's EDA software. Providers of domestic IC analysis services, IC design services and EDA software services (such as Empyrean Software (华大九天软件), Cellixsoft Corp (芯愿景软件技术), etc) will compete with foreign competitors. Domestic chip equipment makers will also benefit from increasing localization rate of Fab foundries in the long term.

Overall, the decoupling of China and the US increase the localization rate of the value chain in China's semi-conductor industry, providing attractive return to private equity investors who succeed in identifying the unicorn companies.

Exhibit 5: The comparison of mass production time of key technology nodes among major Fab foundries – SMIC, the top player in China, is five years or two generations behind the market leader, TSMC

Year of launch	2011	2012	2013	2014	2015	2016	2017	2018	2019
TSMC	**28nm**			**20nm**	**16nm**	**10nm**		**7nm**	
Global Foundries	**32nm**	**28nm**			**14nm**			**12nm**	
UMC			**28nm**				**14nm**		
SMIC	**40nm**				**28nm**				**14nm**
Powerchip		**90nm**		**55nm**		**25nm**			
Huahong						**65nm**	**55nm**	**28nm**	
Tower Semi				**65nm, 45nm**					

Source(s)：Prospectus (issued on June 1, 2020) of SMIC

Exhibit 6: Low localization rate of China's fab foundries may offer a high marginal investment return in coming years

Item	Equipment name	Localization rate	Major domestic manufacturers
1	Degumming equipment	Over 90%	SEMICON China
2	Cleaning equipment	Around 20%	ACM Research (ACMR US), NAURA (002371 CH)
3	Etching equipment	Around 20%	AMEC(688012), NAURA, SEMICON China
4	Heat treatment equipment	Around 20%	NAURA, SEMICON China
5	PVD equipment	Around 10%	NAURA
6	CMP equipment	Around 10%	HWATSING
7	Glue developing equipment	Zero breakthrough	Kingsemi (688037 CH)
8	Lithography equipment	Zero breakthrough	SMEE

Source(s): Prospectus (issued on June 1, 2020) of ACM Research (Shanghai), Inc, ABCI Securities

Exhibit 7: China's new infrastructure development

New infrastructure development	Beneficiaries
5G	Huawei, ZTE (763HK, 000063CH)
Big data centers	China Communication Services (552 HK)
AI	Baidu, AI chip producers (e.g. Cambricon Technologies Corp)
Industrial internet	NB-IoT chip producers
Intercity high-speed railway and urban rail transit	China Railway signal & Communication (3969 HK, 688009 CH)
New energy vehicle charging pile	BYD (1211 HK)
UHV	Clean energy producers

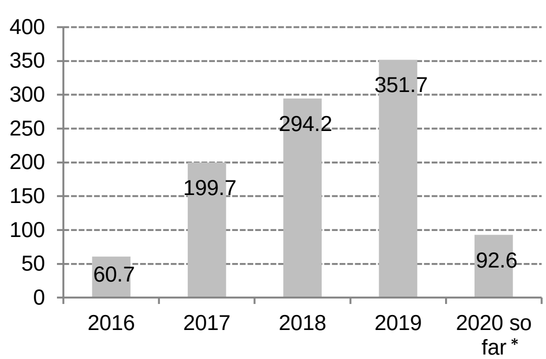
Source(s): ABCI Securities

Bullish on the continued influx of liquidity into China. Unlike most of the global crisis in past two decades, major developed countries are applying aggressive monetary and fiscal expansion measures to reverse the downturn induced by the coronavirus pandemic. Subsequently, one can expect a booming global capital market in 2020-22 due to the sharp increase in supply of global liquidity; the downside is that sovereign debt risk, driven by the substantial increase in fiscal deficits, will escalate in some countries. Nonetheless, international financial hubs, including Hong Kong, will benefit from the global monetary and fiscal expansion in 2020-22.

In our view, liquidity is not the major issue in the global capital market but rather the lack of sizable investment opportunities with satisfactory returns. This is the time for China to further open up its economy to absorb surplus liquidity in the global capital market. Coupling the interests of global investors with those of China is a good strategy to increase defensiveness of the Chinese economy against external shocks.

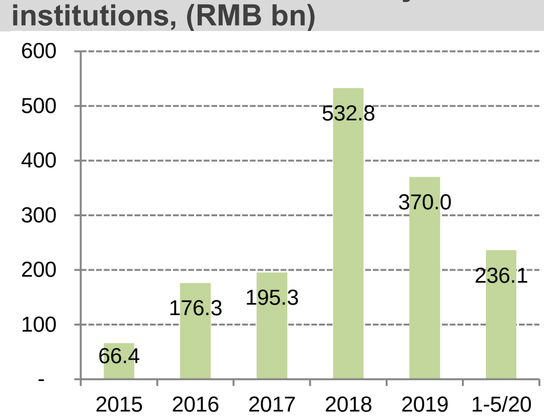
Liquidity offered by offshore financial and industry investors keeps flowing into China even though the domestic economy was softening in 1H20. So far this year (up to June 17), offshore investors have net bought RMB 92.6bn of A-shares. China's onshore bonds held by offshore institutions increased by RMB 236.1bn to RMB 2.11tr in 5M20. Actual non-financial FDI in China was RMB 355.2bn in 5M20.

Exhibit 8: Annual net buy of A shares via the Connect , (RMB bn)



* 2020 data up to June 17
Source(s): HKEx, Bloomberg, ABCI Securities

Exhibit 9: Net increase of China's onshore bonds held by offshore institutions, (RMB bn)



Source(s): China SAFE, ABCI Securities

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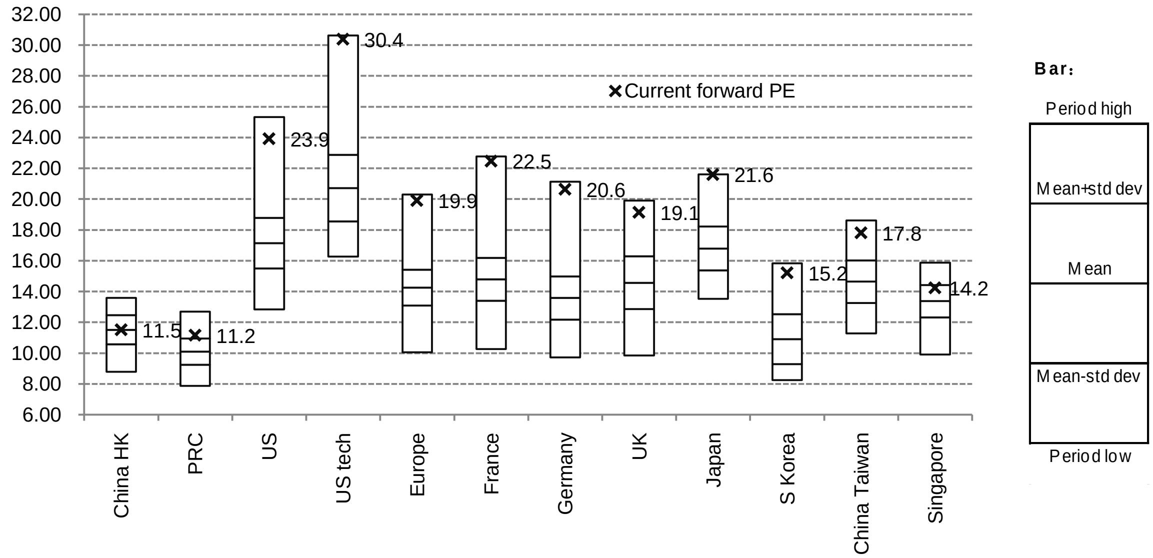
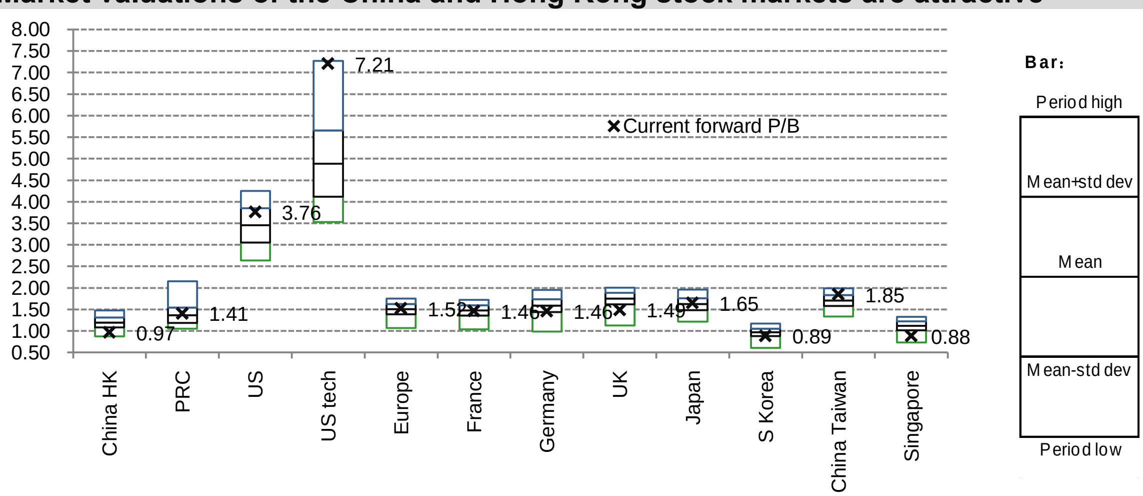
Global stock market: Valuation at a glance

Exhibit 10: Global stock market valuation (forward P/E) at a glance
Market valuations of the China and Hong Kong stock markets are attractive



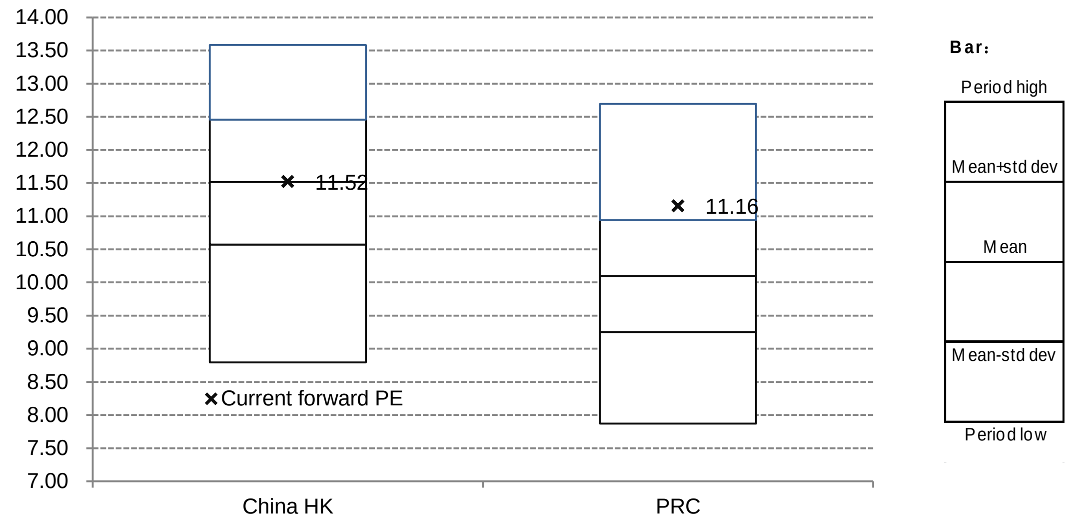
Period: Since 2015 forward P/E range (High, Mean+std dev, Mean, Mean-std dev, Low)
Reference indices in corresponding markets (left to right):HSI,SSE50 Index, INDU Index, NDX Index,SX5E Index, CAC Index, DAX Index, UKX Index, NKY Index, KOSPI Index, TWSE Index & STI Index
Data as of June 19, 2020
Source(s): Bloomberg, ABCI Securities

Exhibit 11: Global stock market valuation (forward P/B) at a glance
Market valuations of the China and Hong Kong stock markets are attractive



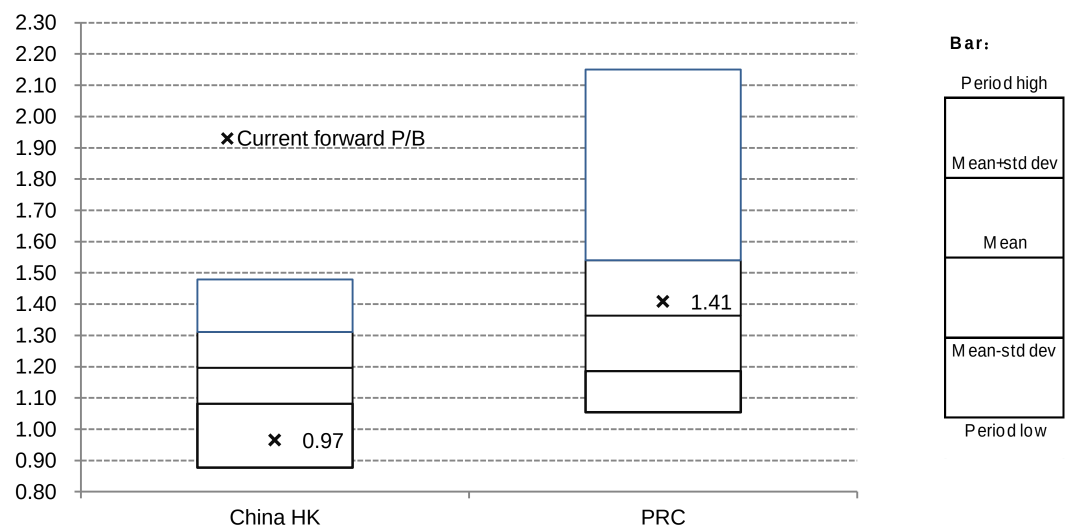
Period: Since 2015 forward P/B range (High, Mean+std dev, Mean, Mean-std dev, Low)
Reference indices in corresponding markets (left to right):HSI Index,SSE50 Index, INDU Index, NDX Index,SX5E Index, CAC Index, DAX Index, UKX Index, NKY Index, KOSPI Index, TWSE Index & STI Index
Data as of June19, 2020
Source(s): Bloomberg, ABCI Securities

Exhibit 12: Stock market valuations (forward P/E) of Mainland China and Hong Kong - Hong Kong stock market is fairly valued in terms of P/E range



Period: Since 2015 forward P/E range (High, Mean+std dev, Mean, Mean-std dev, Low)
Reference indices: HSI Index (left) and SSE50 Index (right)
Data as of June 19, 2020
Source(s): Bloomberg, ABCI Securities

Exhibit 13: Stock market valuations (forward P/B) of Mainland China and Hong Kong - Hong Kong stock market is at the lower end of the valuation range by P/B



Period: Since 2015 forward P/B range (High, Mean+std dev, Mean, Mean-std dev, Low)
Reference indices: HSI Index (left) and SSE50 Index (right)
Data as of June 17, 2020
Source(s): Bloomberg, ABCI Securities

Hang Seng Index (HSI)

Forecast trading range in 2H20: 22,700-26,700
Forecast trading range in 2021: 26,700-32,900

So far this year (till June 17, 2020), the market has revised down EPS of HSI by 18.6% YoY for 2020E and 11.3% YoY for 2021E, in view of the various negative factors and the reported results of companies in 1Q20. After the downgrade in earnings outlook for 2020E-21E, the market expects EPS of the index to decline by 14.4%YoY for 2020E before rising by 18.0% YoY in 2021E, according to Bloomberg consensus. Despite of the expected earnings rebound in 2021, the estimated EPS for the year would only be 1.0% higher than that in 2019. The market remains cautious on recovery in 2021.

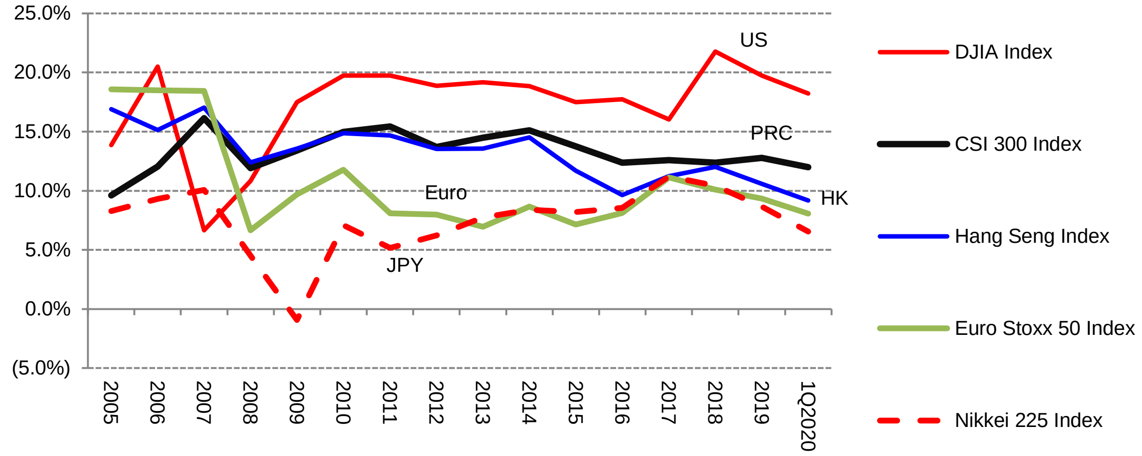
The trading range of HSI in 2H20 is expected to be ~22,700-26,700, equivalent to 10.6x-12.4x 2020E P/E or 0.89-1.04x 2020E P/B. The decline of ROAE from 10.58% in 2018 to 9.19% in 2019 and 8.8% in 2020E justify the current valuation of the index at the lower P/B range. Moreover, the expected decline of earnings growth in 2020 will cap the ceiling of the P/E valuation.

For 2021E, we expect the index trading range will expand to 26,700-32,900, equivalent to 10.5x-13.0x 2021E P/E or 0.98x-1.21x 2021E P/B. ROAE of the index will improve to 9.6% in 2021E from 8.8% in 2020E. However, we expect the possible inclusion of some large-cap, new-economy stocks in the index will increase volatility.

External shocks usually occur and dissipate with few, if any, warnings in advance. This is not an issue specific to the capital market in Hong Kong ; instead, these are risks inherent in the global capital market. Judging from the continued influx of liquidity into China's A-share markets and onshore bond market, we believe global investors are still increasing their asset allocations to China. One of the future challenges for Hong Kong is whether its capital market can provide a wide scope of risk assets for global investors. Dual listing of China's new-economy companies with weighted voting rights and listing of pre-revenue and pre-products biotech companies permitted in Hong Kong are some of the strategic moves to widen the scope of risk assets to lure global investors.

The current structure of HSI has hindered the development of ETF products. HSI and Hang Seng China Enterprises Index (HSCEI) are two popular indices tracking performance of the Hong Kong stock market. However, the large overlap of member stocks in the two indices has inevitably resulted in a high correlation. Besides, the indices are dominated by China's old-economy companies in financials, real estate, telecom services, and energy resources − the profitability and growth momentum of these companies are not high enough to deliver investment returns lucrative enough to long-term investors.

Exhibit 14: ROAE of benchmark blue chip index in major stock markets

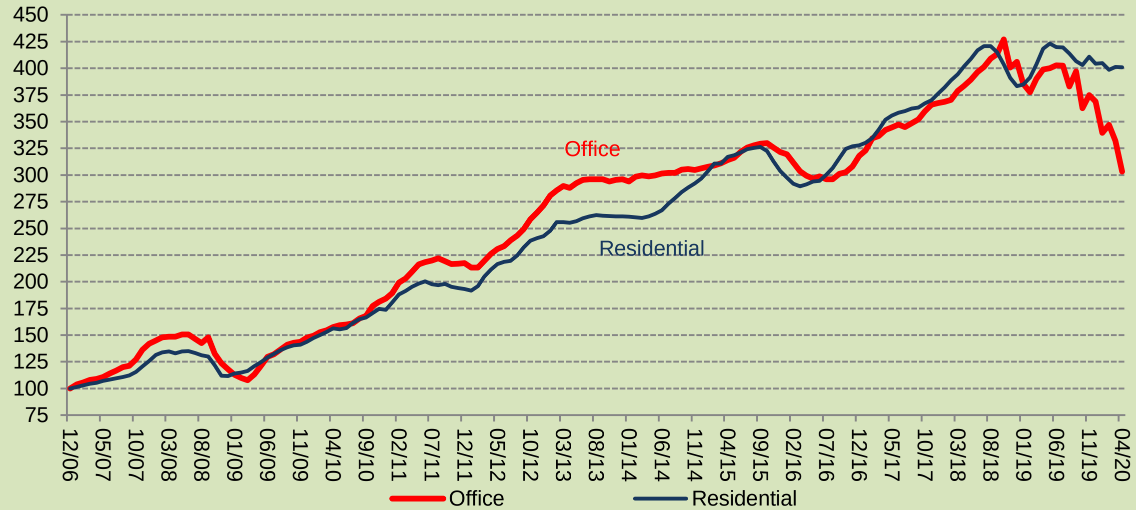


Source(s): Bloomberg, ABCI Securities

Special Topic
Hong Kong property market is at high risk: A lesson to other Chinese cities

The importance of maintaining an upbeat economic expectation in the Hong Kong property market

Exhibit 15: Hong Kong property price index (Rebased at 12/2006=100) : Home price is edging on the cliff



36 months correlation between two indices at end-2019 was 0.87.
Source(s): Rating &Valuation Dept, Bloomberg, ABCI Securities

Office prices are tumbling; no stabilization signs in sight. Based on our estimates, office property prices have tumbled by ~29% on average from Oct 2018 and are now at a level similar to mid-2016. The escalated Sino-US trade war since 2018, the social unrest in HK since 2H19, and the outbreak of COVID-19 in 1H20 have hampered the city's economic outlook and subsequently weakened the demand for office properties. The latest office property price index indicates that downward price adjustment was accelerating in the first few months of 2020. No signs of stabilization have been observed so far.

Local and foreign enterprises scale down operations in Hong Kong. Correction of office property prices is an early indicator of reduced capital and operating expenditures by local and foreign enterprises in Hong Kong. Their actions are based on their judgments on the cost and return of maintaining their physical presence and scale of presence in the region.

Office prices and home prices are highly correlated. The strong correlation between office property prices and residential property prices in previous years indicates the downside risk of residential property prices is mounting. Thanks to the Fed's monetary expansion and the decline of market interest rates in the first few months of 2020, we believe the downward adjustment of residential property prices has been postponed. In this way, homebuyers may have underestimated the mounting price risk in the residential property market.

Home price is likely to fall on rising unemployment rate. Unemployment rate in Hong Kong increased from 2.8% in June 2019 to 3.3% in Dec 2019 and 5.9% in May 2020. The continued increase in unemployment rate suggests the debt repayment capability and purchasing power of residents have been weakening. We believe residential property prices may tumble in 3Q/4Q20, if the aforementioned risk factors persist or escalate. We estimate the potential downside risk of residential prices to be 28%, meaning that prices will fall to a level similar to the trough in 2016.

Government needs to take preemptive measures to contain systematic risk caused by the sharp correction of property market. We believe the local banking industry has already been affected by the fallen prices of office properties since 2018. Systematic risk in the Hong Kong banking industry will increase if the downward correction in residential property prices is as rapid as the one observed in the office property market. According to the Hong Kong Monetary Authority, the outstanding balance of residential mortgage loans increased to HK$ 1.464tr at end-Apr 2020(or ~51% of Hong Kong nominal GDP value in 2019) from HK$ 1.437tr at end-2019, HK$ 1.311tr at end-2018, and HK$ 1.119tr at end-2016. If residential property prices adjust down to the level in 2016, we estimate HK$ 0.35tr (or 12% of HK nominal GDP value in 2019) of mortgage loans will be at risk.

Implications on the Hong Kong stock market

- Hong Kong-listed property investment companies, especially office property owners in the city, will likely record revaluation loss on their financial statements in 2020; contraction in profits and equity values will be seen. Their financial leverage will increase because of the reduction in values of assets and equity. As a result, banks may reduce the amount of credit facilities extending to these companies.
- Deterioration of the financial health in Hong Kong property investment companies may weaken their debt repayment and dividend payment capabilities in the next 12 months.
- As the historical net book values may not be the best reference to current market situation, investors will demand a high risk premium in investing in shares (i.e. larger discount of share price to historical book value).
- Prudent financial management of property companies, as characterized by low financial leverage and diversified revenue sources, is crucial to surviving the down cycle. Various macroeconomic risk factors will expose the weakness of companies imprudently managed.

Counter-cyclical business expansion – a chance to bargain-hunting

Sharp correction of office property prices since 2018 has pushed down the office price to levels similar to mid-2016, which implies the current replacement cost of office premises has substantially reduced. It is time for corporates to consider counter-cyclical business expansion in Hong Kong. Asset management companies with long-term funding sources are looking for opportunities to conduct bargain hunting on prime office properties.

Hong Kong IPO Market

Analyst: Steve Chow

The return of the overseas-listed Chinese companies will drive growth in 2H20

- **Hong Kong's IPO market has been impacted by the COVID-19 pandemic. In 1H20, Hong Kong IPO market has raised US$ 11.3bn**
- **Nonetheless, IPO market started to recover since 2Q20, driven by dual-listing of oversea listed internet platforms**
- **Consumer discretionary and technology stocks have collectively taken up 69% of IPO volume in 1H20. We expect this trend to carry into 2H20.**

The coronavirus pandemic has affected Hong Kong's IPO market. In 1H20 (up to June 22, 2020), the Hong Kong IPO market has raised US$ 11.3bn vs. US$ 40.3bn in 2019. In 1H20, a total of 59 IPOs were issued, with an average issue size of US$ 191mn each.

On a positive note, the IPO market has been recovering since 2Q20 with the dual-listing of two major internet platforms in China. As a result, consumer discretionary and technology stocks have become the major contributors of the IPO market, jointly contributing 69% of IPO volume in 1H20.

After consumer discretionary and technology, healthcare stocks are the third largest contributor accounting for 18% of IPO volume in 2019. Financial stocks accounted for only 8% of IPO volume in 1H20, lower than 17% in 2019.

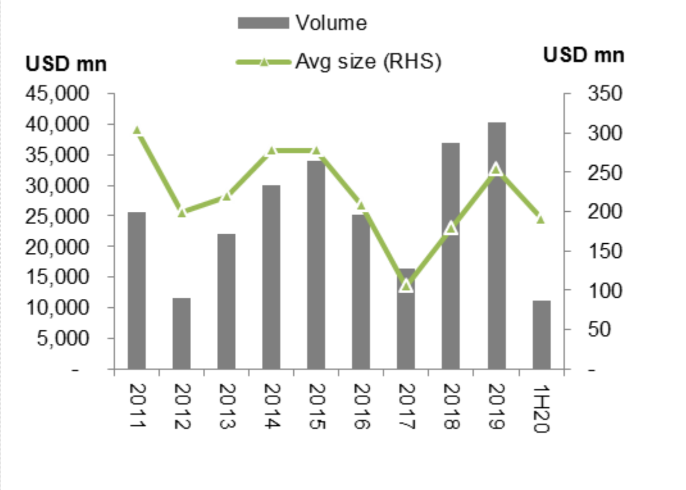
We expect to see more dual-listing of overseas-listed Chinese companies in coming months, and most of them will be internet platforms. In our view, this could lead to increase the supply of internet stocks in the near term, which may result in rebalancing of the portfolio of internet stocks by major institutional investors.

Exhibit 1: 1H20 HK IPO Overview *

Industry	Volume (US$ mn)	Avg deal size (US$ mn)
Consumer Discretionary	4,493	300
Technology	3,280	656
Health Care	1,992	332
Financials	857	107
Industrials	283	24
Telecom	219	44
Others	139	17

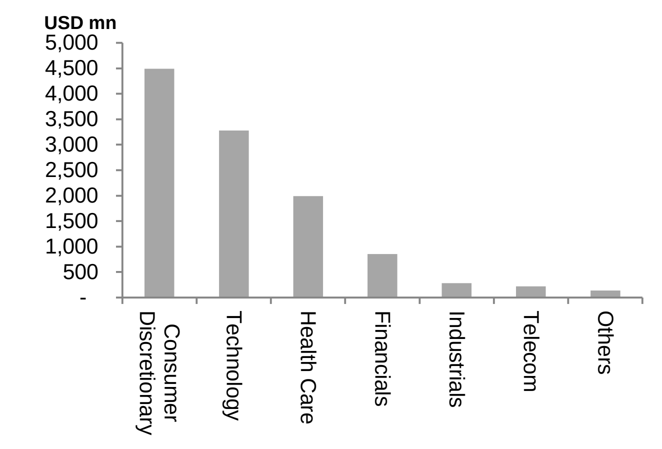
*Up to June 22, 2020
Source(s): Bloomberg, ABCI Securities

Exhibit 2: HK IPO volume and average deal size*



*1H20 - Up to June 22, 2020
Source(s): Bloomberg, ABCI Securities

Exhibit 3: HK IPO volume by industry (1H20)*



Source(s): Bloomberg, ABCI Securities

Exhibit 4 : Market share of HK IPO underwriters by volume (1H20)*

*1H20 - Up to June 22, 2020
Source(s): Bloomberg, ABCI Securities

Sector Outlook

ABCI Analysts

OVERWEIGHT

China Banks Sector – Policy direction supports manageable industry fundamentals

Johannes Au

Key Data		Sector Performance	Absolute (%)	Relative (%)
H-shr		**H-shr (relative to MXCN)**		
Avg. 20E P/E (x)	4.16	1-mth	1.18	(8.12)
Avg. 20E P/B(x)	0.48	3-mth	(0.23)	(12.94)
Avg. 20E div yield (%)	5.90	6-mth	(12.23)	(14.70)
A-shr		**A-shr (relative to CSI300)**		
Avg. 20E P/E (x)	5.54	1-mth	(0.21)	(7.29)
Avg. 20E P/B(x)	0.60	3-mth	(0.51)	(12.50)
Avg. 20E div yield (%)	5.84	6-mth	(10.35)	(13.16)
Source(s):Bloomberg, ABCI Securities estimates		Source(s):Bloomberg, ABCI Securities		

- Regulatory measures support a stabilized asset quality outlook
- Large provision will cap earnings growth momentum in banks
- NIM pressure induced by rate cut cycle and policy direction will persist until 2021, but robust balance sheet growth would help offset some of the impacts
- Expect more capital-raising activities by district banks to support balance sheet growth
- Reiterate **OVERWEIGHT** rating for both A/H markets. Prefer big banks for defensiveness and promising dividend yield. **ABC(1288 HK/601288 CH)** and **CCB(939 HK/601939 CH)** are our sector top picks

Policy to stabilize asset quality. Shadowed by the dual economic impacts of COVID-19 and Sino-US dispute, concerns over asset quality risk in the Chinese banks heighten, hampering the sector's valuation. According to the CBIRC statistics, system NPL inched up by 5bps QoQ to 1.91% as of Mar 2020. By category, average NPL ratios of big banks and joint stock banks (JSBs) were up by 1bps QoQ to 1.39% and stayed flat at 1.64% in 1Q20, while the average NPL ratio of city commercial banks and rural commercial banks rose by 13bps and 19bps QoQ to 2.45% and 4.09%. Bigger banks are more defensive against asset quality risk through NPL handling capacity and business diversification, while risk-buffering ability of district banks are weaker given their small operation size and higher business exposure to micro and small enterprises (MSEs). The 2020 Government Work Report has prioritized on preventing major financial risk and supporting inclusive finance MSEs, with PBOC releasing more detailed measures on June 1, 2020 as a follow-up. More specifically, the policy encourages banks to delay the principal and interest payment of medium, small, and micro enterprises till end-Mar 2021 without classifying the loans as NPLs prior to that; an extra 1% incentive will be given to district banks for any first-time delay in repayment of loan. As such, we expect a stable asset quality outlook till early 2021, with the system NPL fluctuating by single-digit bps QoQ in coming quarters. Nevertheless, to strengthen risk buffers, we forecast large provisions to be made in coming quarters, hence curbing earnings growth momentum. Yet, banks with a high provisioning ratio may maintain a faster earnings growth.

NIM pressure to persist in 2021. Once again, the Government Work Report has highlighted the reduction in lending interest rate, lowering of banks' profitability, substantial decrease in comprehensive financing cost, and increasing lending availability to enterprises. Together with the LPR reform started in Aug 2019, average lending interest rate fell gradually from 5.62% in Sep 2019 to 5.08% in Mar 2020, down 61bps YoY or 36bps QoQ, according to PBOC data. In addition to the declining trend of LPR, loan pricing was also on a downtrend. The proportion of loans priced at above the LPR fell from 83.04% in Sep 2019 to 72.83% in Mar 2020. System NIM, as a result, narrowed by 10bps QoQ to 2.1% in 1Q20. Specifically, rural commercial banks showed the largest average NIM squeeze of 37bps QoQ in 1Q20, average NIM in other bank categories was down by 3bps- 9bps QoQ. Going forward, we believe robust balance sheet growth, driven mainly by rapid growth in inclusive finance MSEs lending, would remain as the core defensive factor against NIM pressure. The explicit inclusive finance MSE loan growth target of 40% YoY set for the Big 5 Banks was higher than the 2019 MSE loan growth target of 30% YoY. Meanwhile, a credit loan refinancing plan for district banks was introduced by PBOC on June 1, 2010 ; qualified district banks could apply to PBOC for the one-year duration refinancing fund that amounts to 40% of inclusive finance MSEs credit loans with a duration of over 6 months granted between Mar 1, 2020 and Dec 31, 2020. NIM pressure is inevitable under the rate cut cycle, while the process of loan repricing would extend the downtrend in NIM to 2021. In our view, big banks and JSBs would be able to defend margins through solid balance sheet growth and management of balance sheet components.

More capital-raising activities for district banks. Continuous growth in balance sheet will drive up capital needs. According to CBIRC, growth in total assets and total liabilities in commercial banks accelerated to 10.7% and 10.4% YoY in Mar 2020, compared to 8.69% and 8.35% YoY in Mar 2019. System CT1 and CAR were reported at 10.88% and 14.53% as of Mar 2020. The 2020 Government Work Report aims to strengthen capital position of small/medium-sized banks, while the goal for 2019 was to enhance capital channels for the large banks. The change in policy direction indicates the government is aware of the fact that both RRR cut and sufficient capital position are essential to higher loan growth. While capital positions of big banks and JSBs have been strengthened in past years, the same cannot be said for district banks, especially since fundraising from the equity market has turned more challenging in recent years due to the increased number of listed banks in both A/H markets. We expect more alternative funding tools, such as preference shares and perpetual bonds, will be utilized in coming quarters by district banks to improve capital position.

Long-term Outlook

Policy risk remains to be the largest overhang in the China banks sector, though we believe a highly regulated and disciplined business environment are prerequisites to robust industry fundamentals. COVID-19 and Sino-US dispute may cast long-term impacts.

Short-term Outlook

Economic impacts of COVID-19 will be reflected in coming quarters, although radical deterioration in banks' asset quality is unlikely given the regulatory support and disciplined operation of banks. With persisting NIM pressure, investors would stay cautious to the fundamental outlook of the Chinese banks in the near term. Possible rerating of the sector may occur in 4Q20-1Q21 the earliest when asset quality and NIM outlook show stability.

Stock Recommendations

We reiterate our **OVERWEIGHT** rating for the China banks sector in both A/H share markets given the sustainable growth outlook and manageable fundamentals. Big banks, with a promising dividend yield and a high degree of business diversification, have repeatedly proven their defensiveness against policy risks and high adaptability to macro changes. Our A/H sector top picks are **ABC (1288 HK/601288 CH)** for its robust risk buffer and competitive edge in inclusive finance; we also like **CCB (939 HK/601939 CH)** for its prudent practices and diversified businesses.

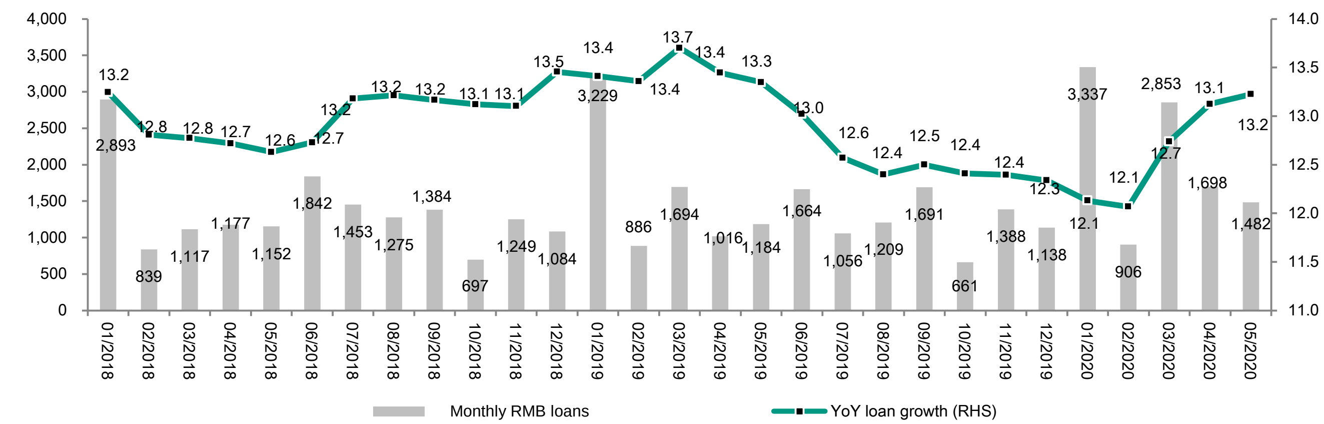
District banks, with a smaller balance sheet, have higher operational flexibility; nonetheless, they are sensitive to changes in macro and policy environments compared to other banks. Driven by China's policy focus on inclusive finance, we expect growth in balance sheet and earnings of district banks to stay at relatively high levels; this would elevate capital needs and potentially dilute EPS and equity value if equity financing was used. To investors, low trading liquidity of the district banks' shares is a concern.

农银国际
ABC INTERNATIONAL
ABCI SECURITIES COMPANY LIMITED

Risk Factors

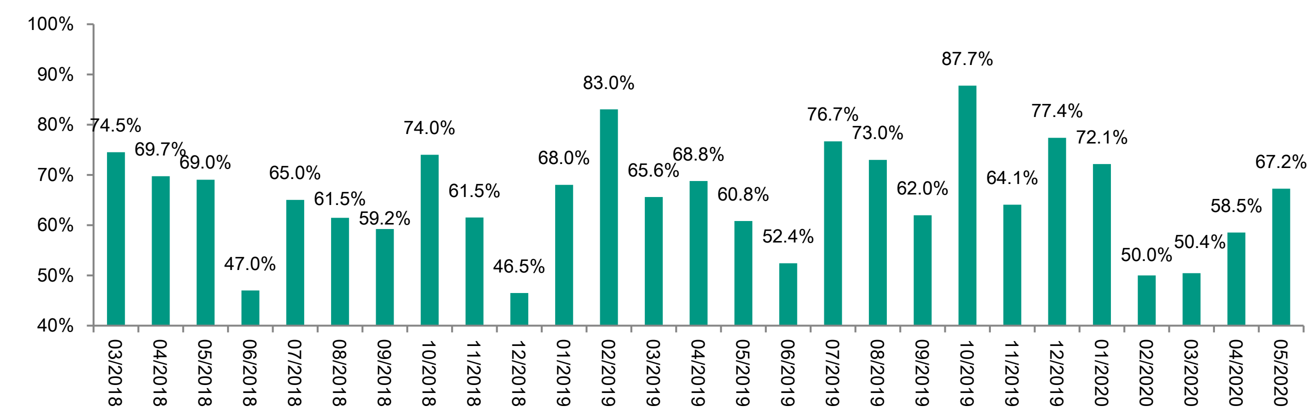
1) Radical changes in business environment induced by increased supervision and heavy-handed policies; 2) Increasing competition from non-bank financial institutions and foreign players; 3) Sharp deterioration in asset quality; 4) Increasing policy risk in new and fast-growing businesses; 5) Prolonged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

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



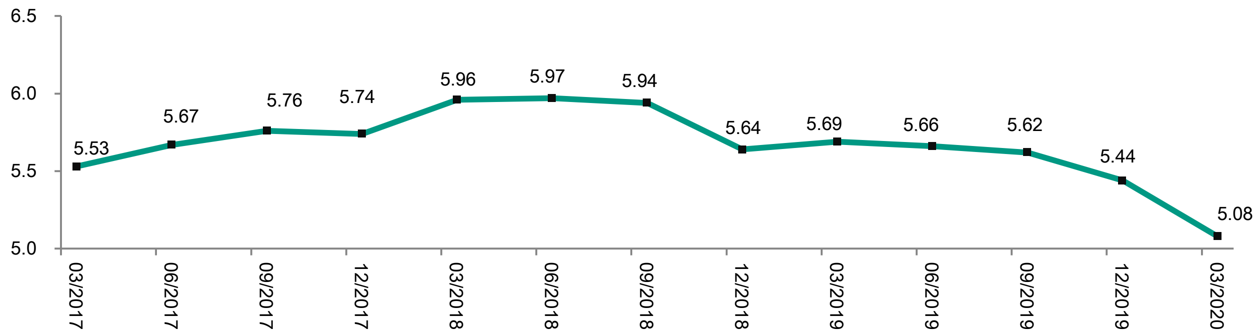
Source(s): PBOC, ABCI Securities

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



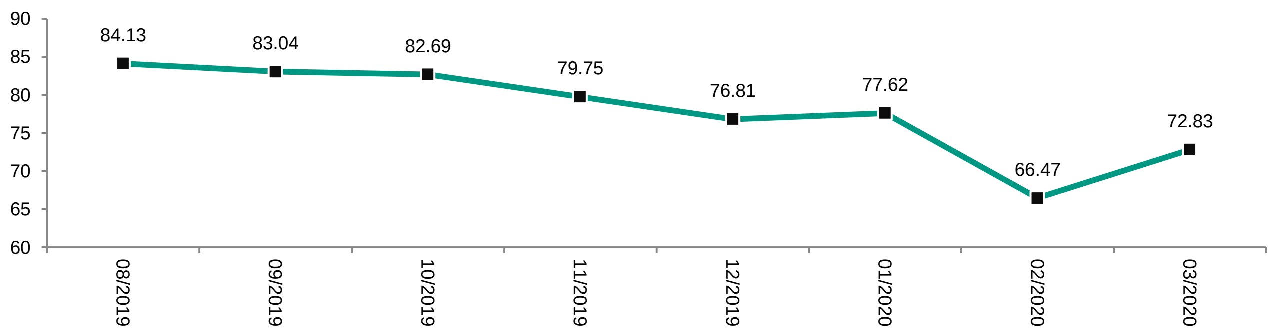
Source(s): PBOC, ABCI Securities

Exhibit 3: System monthly average lending rate (%)



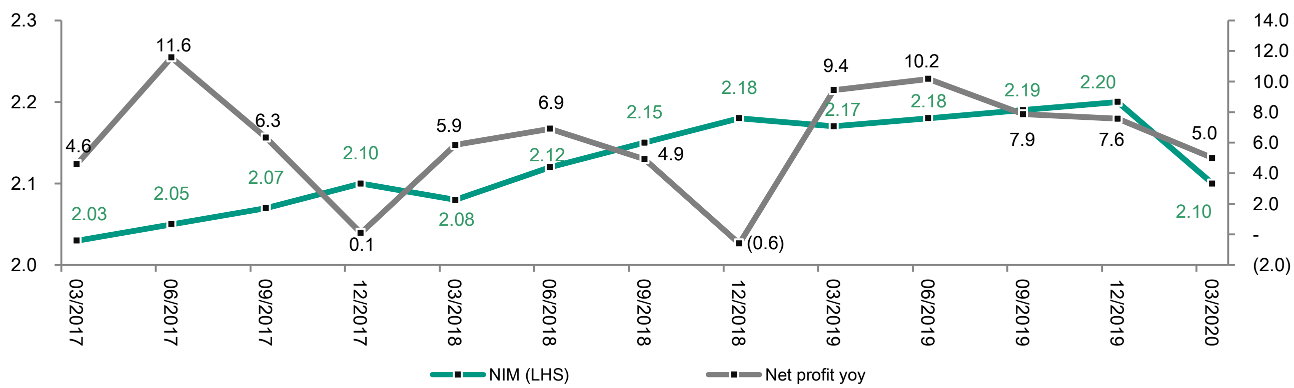
Source(s): PBOC, ABCI Securities

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



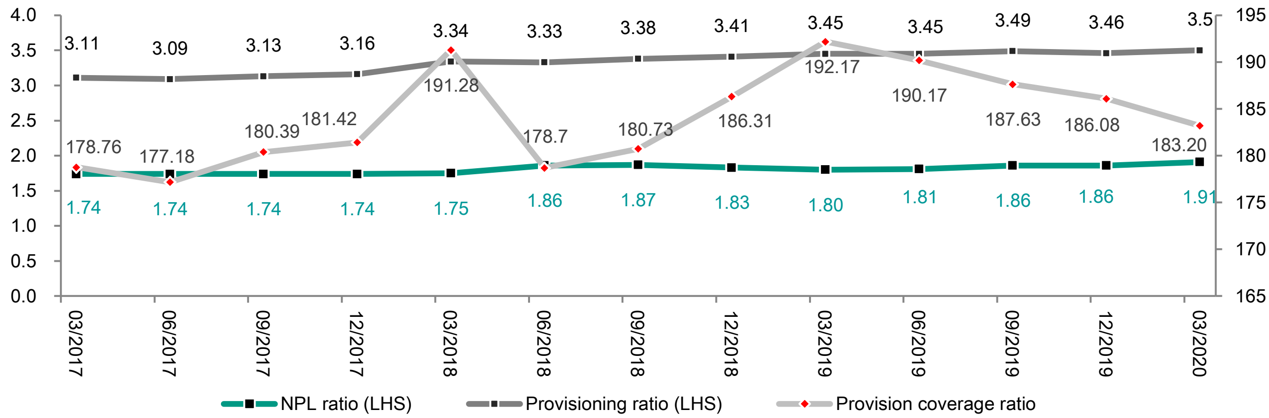
Source(s): PBOC, ABCI Securities

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

Exhibit 7: Valuation of sector top picks for H-shr market (Data as of June 23, 2020)

Company	Ticker	Rating	TP (HK$)	Upside (%)	FY20E P/E(x)	FY21E P/E (x)	FY20E P/B (x)	FY21E P/B (x)	FY20E Yield (%)	FY21E Yield (%)
ABC	1288 HK	BUY	4.88	54.92	4.73	4.49	0.53	0.49	6.63	6.97
CCB	939 HK	BUY	8.94	42.81	5.16	4.96	0.62	0.57	5.90	6.13

Source(s): Bloomberg, ABCI Securities estimates

Exhibit 8: Valuation of sector top picks for A-shr market (Data as of June 23, 2020)

Company	Ticker	Rating	TP (HK$)	Upside (%)	FY20E P/E(x)	FY21E P/E (x)	FY20E P/B (x)	FY21E P/B (x)	FY20E Yield (%)	FY21E Yield (%)
ABC	601288CH	BUY	5.08	51.64	5.50	5.22	0.62	0.57	5.70	6.00
CCB	601939CH	BUY	9.21	46.89	5.64	5.43	0.68	0.63	5.39	5.60

Source(s): Bloomberg, ABCI Securities estimates

NEUTRAL
China Securities & Brokerage Sector – Undemanding valuation, but cautious on volatile index movement
Steve Chow

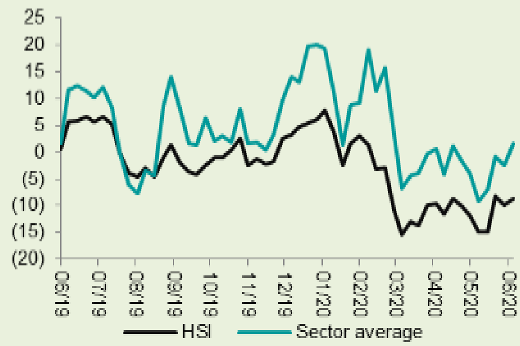
Key Data	
Avg. 20E P/E (x)	9.1
Avg. 20E P/B(x)	0.7
Avg. 20E div yield (%)	3.8

Source(s):Bloomberg, ABCI Securities estimates

Sector Performance (relative to HSI)	Absolute (%)	Relative (%)
1-mth	13.7	3.1
3-mth	18.3	(6.7)
6-mth	(5.2)	(8.0)

Source(s):Bloomberg, ABCI Securities

1-year sector performance



Source(s):Bloomberg, ABCI Securities

- Mixed industry trend in the near term
- Supportive policy environment to remain in the long term
- We like **SWHY-H (6806 HK)** for its high ROAE in recent years and undemanding valuation

Mixed industry trends. According to SAC, industry revenue and net profit were down 4% and 12% YoY in 1Q20 mainly dragged by the 9.8% drop in SHCOMP index in 1Q20 amid COVID-19. Annualized industry ROAE dropped to 7.6% in 1Q20 from 9.2% in 1Q19 but higher than 6.3% in 2019. On a YTD basis, A-share monthly average ADT improved from RMB 634bn in 5M19 to RMB 758bn in 5M20, supporting commission income. On the other hand, the SHCOMP index dropped 5.1% in 5M20, affecting investment income. Margin financing and securities lending (MFSL) balance increased slightly from ~RMB 1.02tr at end-2019 to ~RMB 1.08tr at end-May 2020. Overall, this represents a mixed trend among different sub-segments in the industry.

ADT and index movement are the main determinants. For the sector, brokerage is the largest revenue contributor in 1Q20 (44%), followed by trading (30%), investment banking (11%), asset management (7%), and others (8%), according to SAC. Overall, brokerage and trading collectively accounted for 74% of industry revenue; therefore, ADT and index movements are the main proxies of the revenue trend.

Supportive policy environment. In the 2020 Government Work Report, growth in aggregate social financing this year is expected to be significantly higher than 2019. This is consistent with the government's long-term strategy of increasing the proportion of direct financing and promoting the healthy development of the multi-level capital market. In addition, the work report covers the reform of the GEM and registration-based IPO system, which, in our view, can be referenced to the Sci-Tech innovation board (STAR) in Shanghai in 2019. Such reforms are beneficial to the investment banking business, including equity financing and bond financing, in securities firms. The fact that these goals have been mentioned in previous work reports shows that the government's long-term strategy for the capital market has remained unchanged.

Undemanding valuation. Major H-listed securities companies are currently trading at 0.8x 2019E P/B, still significantly below the peak level at >2x during the bull run in 2015 and the historical average at 1.2x. In our view, the sector valuation is undemanding.

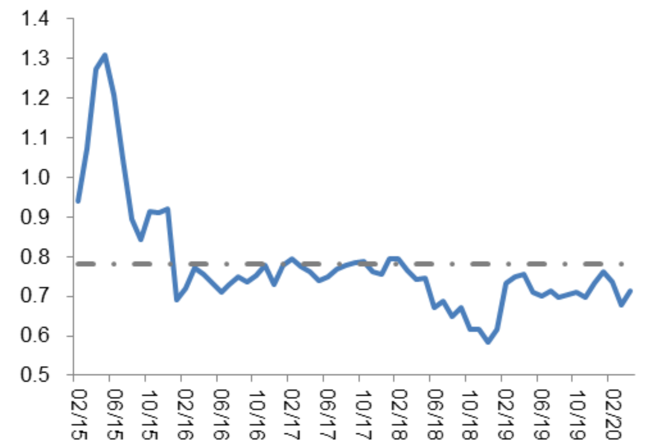
Stock Recommendations

Among our covered brokerage stocks, we like **SWHY-H (6806 HK)** for its high ROAE across the market cycle and reasonable valuations.

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: A-share market cap/China M1

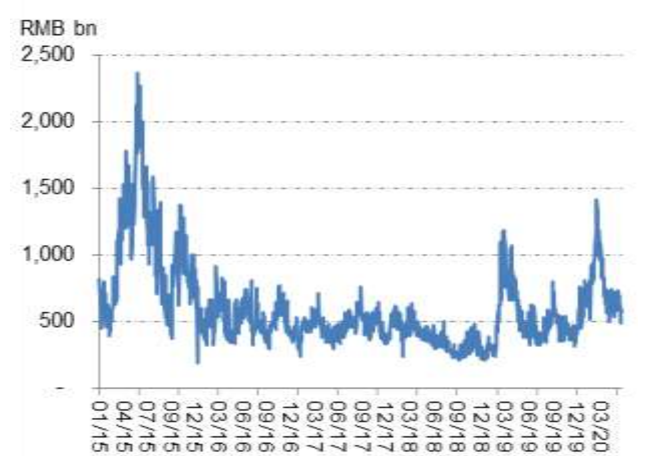


Source(s): Bloomberg, ABCI Securities

Exhibit 2: MFSL balance/A-share market cap

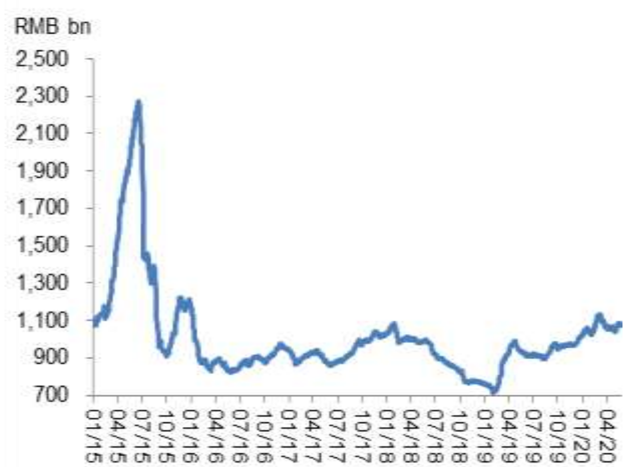
Source(s): Bloomberg, ABCI Securities

Exhibit 3: A-share ADT



Source(s): Bloomberg, ABCI Securities

Exhibit 4: MFSL Balance



Source(s): Bloomberg, ABCI Securities

Exhibit 5: Valuation of sector top picks (Data as of June 23, 2020)

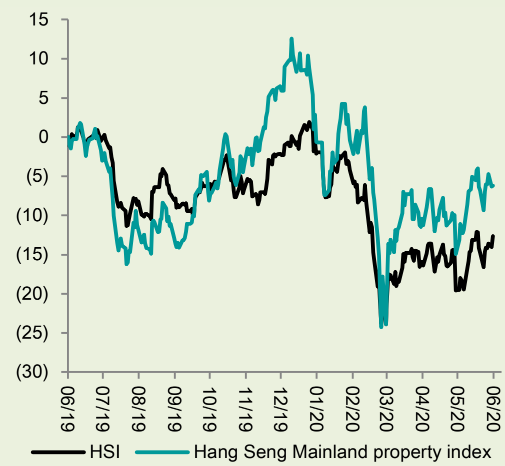
Company	Ticker	Rating	TP (HK$)	Upside (%)	FY20E P/E(x)	FY21E P/E (x)	FY20E P/B (x)	FY21E P/B (x)	FY20E Yield (%)	FY21E Yield (%)
SWHY-H	6806 HK	BUY	3.0	37.6	7.6	6.2	0.6	0.6	3.8	4.3

Source(s): Bloomberg, ABCI Securities estimates

OVERWEIGHT
China Property Sector – No policy easing for developers; emerging M&A opportunities for PMCs
Kenneth Tung

Key Data		Sector Performance (relative to HSI)	Absolute (%)	Relative (%)
Avg. 20E P/E (x)	6.1	1-mth	10.1	3.2
Avg. 20E P/B(x)	1.1	3-mth	23.1	10.1
Avg. 20E div yield (%)	6.3	6-mth	(12.0)	0.1
Source(s):Bloomberg, ABCI Securities estimates		Source(s):Bloomberg, ABCI Securities		

1-year sector performance (%)



Source(s):Bloomberg, ABCI Securities

- Developers' contracted sales rose 13% YoY on average in May 2020. We expect growth to rebound to 8%/12%YoY for 2020E/21E
- The Government Working Report confirmed no major easing for property developers
- PM sector should enjoy meaningful labor cost reduction in 2020 on government's supportive measures
- **Aoyuan (3883 HK)** is our top pick among the PRC developers given its solid contracted sales track record (2014-19 CAGR: 57%) and urban redevelopment in GBA. We favor **A-Living (3319 HK)** in the property management (PM) sector for its largest GFA under management and impressive M&A record

Sector Outlook

■ Developers:

Contracted sales regained momentum. Contracted sales of 23 major listed developers rebounded in May 2020 (+13% YoY) as the spread of COVID-19 recedes in China − a substantial improvement over the 33%/9% YoY sales decline in Feb/Mar and a moderate growth of 3%YoY in Apr. In particular, 20 out of the 23 major listed developers resumed positive YoY growth in May, and seven of them (Yuzhou [1628 HK], Jinmao [817 HK], Evergrande [3333 HK], Shimao [813 HK], Greentown [3900 HK], Logan [3380 HK], and KWG [1813 HK]) achieved a positive YoY growth in 5M20. Contracted sales growth of the listed developers was in-line with the national sales of commodity properties, which increased by 10%YoY by GFA and 14%YoY by total amount in May. We believe contracted sales of the listed developers would increase by 8%/12%YoY for FY2020E/21E as the impact of COVID-19 gradually fades.

Impressive sales of the listed developers have been largely driven by price cutting, as ASP declined by 2% YoY while GFA sold grew 15% YoY in May. Falling ASP may reduce margins, considering that land cost has been trending up in the past few years. We forecast ASP to resume momentum in 2H20 as sales pick up, and full-year ASP would stay flat for 2020E.

The Government Working Report in May indicated no major easing. The report reiterated its anti-speculative stance in home purchase. Policy direction for the property sector will remain unchanged, in our view. Despite the COVID-19-induced downturn in the economy, no signs of relaxation in price control and home purchase restriction have been observed so far. Among the 70 large and medium-sized cities, 57 registered a MoM increase in new home price, compared with 50 in Apr and 38 in Mar. New home price for tier-1/2/3 cities rose at a faster rate of

0.7%/0.6%/0.7% MoM in May, compared to 0.2%/0.5%/0.6% MoM in Apr. Without any meaningful corrections in property prices, policies are unlikely to loosen.

- **PMCs:**

GFA growth should accelerate further on increases in developers' contracted sales and M&As. Based on our calculation, GFA sold by parents or related developers in 5M20 would boost the future GFA under management of listed property management companies (PMCs) by 7.7% on average (Exhibit 5), assuming the total GFA sold will be fully converted to GFA under management. Aside from organic growth by parents, the listed PMCs have also revved up their paces in M&A. In May, three acquisitions amounting to RMB 156mn with a total GFA of 10mn were announced; in particular, S-Enjoy (1755 HK) increased its GFA under management by 5.22mn sqm by acquiring a 61.5% stake in Chengdu Chengyue Times Property Services for RMB 104.55mn, while GFA under management in Aoyuan Healthy (3662 HK) and Times Neighborhood (9928 HK) increased by 2.41mn sqm and 2.43mn sqm post-M&A at the costs of RMB 37mn and RMB 14.87mn. In fact, Ever Sunshine (1995 HK) indicated that the number of potential M&A targets has increased due to the COVID-19 crisis; its latest new share placement of HK$1.6bn would allow the group to acquire small/mid PMCs.

Supportive measures to lower costs. To lower costs in the labor-intensive PM industry, tax and fee reduction measures, including the suspension of social insurance contributions for SMEs, will be extended till the end of 2020 instead of June, according to the Government Working Report. Smaller subsidiaries of the listed PMCs at the regional or city levels may benefit. Listed PMCs may turn more eager to acquire the smaller competitors since the latter will enjoy significant labor cost reduction on social insurance suspension. Besides, the Ministry of Finance also confirmed in May that the preferential corporate income tax at a reduced rate of 15% (for encouraged industries located in western China, including PM) will be extended for another decade from Jan 1, 2021. This should ease concerns over the continuation of preferential policies for PMCs in western China, including Justbon (2606 HK).

Stock Recommendations

- **Developers:**

GBA players to benefit from rising property demand. Due to the uncertain post-pandemic sales outlook and possible margin erosion, we prefer developers with high exposure in the Greater Bay Area (GBA) and Yangtze River Delta (YRD) region, where economic growth and property demand are among the highest in China. **Aoyuan (3883 HK)** is our top pick given its solid track record in contracted sales growth (2014-19 CAGR: 57%) and expertise in urban redevelopment projects.

- **PMCs:**

A-Living (3319 HK) is our top pick for its solid track record in M&As. A-Living acquired 66.8mn sqm of GFA under management in 2019, and the CMIG acquisition would boost A-Living's GFA under management by another ~290mn sqm in 2020E, making it the largest listed PMC by GFA under management. Also, the increased availability of potential M&A candidates after the pandemic would present numerous opportunities for the group.

Risk Factors

- **Developers:**

1) Slowing contracted sales due to moderating economic growth; 2) Rise in FX risks on worsened Sino-US relations; 3) New share issuance to lower gearing and reduce refinancing pressure.

PMCs:

1) Substantial related-party transactions between PMC subsidiaries and parent developers; 2) Non-independent PMCs may rely heavily on shareholders for new projects; 3) Potential margin erosion caused by M&A; 4) Increasing number of PMC stocks may suppress sector valuation; 4) Placement risks given significant share price rally YTD.

Exhibit 1: 5M20 contracted sales of major listed developers

	Developer	BGG	May 2020						5M20						2020	
			Amount	YoY chg	GFA	YoY chg	ASP	YoY chg	Amount	YoY chg	GFA	YoY chg	ASP	YoY chg	target	Achievement ratio
		Code	RMBbn	%	000 sqm	%	RMB/sqm	%	RMBbn	%	000 sqm	%	RMB/sqm	%	RMBbn	
1	Yuzhou	1628 HK	10.8	107%	639	83%	16,836	13%	30.7	44%	1,905	35%	16,136	6%	100	30.7%
2	Jinmao	817 HK	20.1	51%	1,203	117%	16,729	(31%)	65.2	20%	3,790	47%	17,213	(19%)	200	32.6%
3	Evergrande	3333 HK	60.2	12%	6,367	28%	9,458	(12%)	272.8	18%	30,078	40%	9,069	(16%)	650	42.0%
4	Shimao	813 HK	22.0	37%	1,260	41%	17,472	(3%)	80.3	12%	4,582	14%	17,518	(2%)	300	26.8%
5	Greentown	3900 HK	19.0	12%	950	(7%)	20,000	20%	60.4	9%	2,850	(2%)	21,193	12%	250	24.2%
6	Logan	3380 HK	11.6	14%	704	(8%)	16,420	24%	37.3	8%	2,417	(5%)	15,412	14%	110	33.9%
7	KWG	1813 HK	9.2	45%	509	46%	17,978	(1%)	28.7	1%	1,713	6%	16,756	(5%)	103	27.8%
8	Times	1233 HK	7.5	26%	518	30%	14,517	(3%)	24.6	(2%)	1,771	6%	13,894	(8%)	82	29.9%
9	Longfor	960 HK	22.1	10%	1,290	6%	17,140	4%	82.3	(2%)	4,850	(8%)	16,973	6%	260	31.7%
10	Powerlong	1238 HK	7.4	14%	484	35%	15,185	(16%)	21.2	(6%)	1,377	(1%)	15,397	(5%)	75	28.3%
11	Country garden	2007 HK	56.1	3%	6,650	14%	8,438	(10%)	206.0	(7%)	24,560	0%	8,387	(7%)	na	na
12	COLI	688 HK	26.8	-9%	1,480	(10%)	18,103	1%	114.5	(7%)	6,270	(7%)	18,253	(1%)	360	31.8%
13	Vanke	2202 HK	61.3	6%	3,868	6%	15,843	0%	247.1	(8%)	15,754	(5%)	15,686	(3%)	na	na
14	Yuexiu	123 HK	11.2	47%	424	22%	26,536	21%	25.8	(10%)	1,005	(19%)	25,708	11%	80	32.2%
15	Agile	3383 HK	13.8	24%	996	21%	13,896	3%	40.2	(12%)	2,743	(11%)	14,659	0%	120	33.5%
16	CR Land	1109 HK	21.2	0%	1,272	11%	16,683	(10%)	79.0	(13%)	4,541	(7%)	17,404	(6%)	262	30.2%
17	Aoyuan	3883 HK	10.3	2%	1,015	(6%)	10,099	9%	33.3	(13%)	3,253	(14%)	10,230	1%	132	25.2%
18	Sunac	1918 HK	45.2	2%	3,198	5%	14,128	(3%)	140.7	(14%)	10,221	(9%)	13,766	(5%)	600	23.5%
19	CIFI	884 HK	20.2	26%	1,135	12%	17,791	13%	55.6	(16%)	3,340	(15%)	16,645	(1%)	230	24.2%
20	R&F	2777 HK	10.6	1%	882	(5%)	12,048	6%	36.5	(17%)	3,100	(18%)	11,787	1%	152	24.0%
21	Poly-A	600048 CH	47.1	12%	3,175	17%	14,826	(4%)	155.7	(18%)	10,518	(14%)	14,802	(4%)	na	na
22	Beijing Capital	2868 HK	8.8	46%	271	24%	32,435	18%	19.7	(21%)	625	(38%)	31,456	27%	80	24.6%
23	Sino-Ocean	3377 HK	8.2	-19%	454	(12%)	18,076	(8%)	31.8	(27%)	1,663	(18%)	19,104	(11%)	130	24.4%
	Total		**530.6**	**13%**	**38,743**	**15%**	**13,695**	**(2%)**	**1,889**	**(4%)**	**142,927**	**2%**	**13,219**	**(6%)**	**4,277**	**29.9%**
	National figures															
	- All types of commodity properties		1,441	14%	147,300	10%	9,783	4%	4,627	(11%)	487,030	(12%)	9,500	2%		
	- Residential only		1,296	16%	130,250	9%	9,949	6%	4,125	(8%)	429,410	(12%)	9,606	4%		

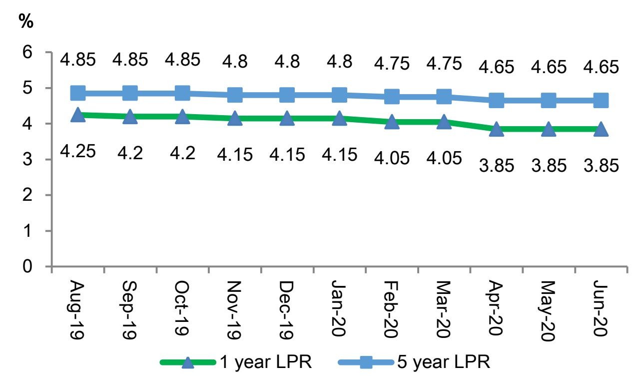
Source(s): Companies, HKEx, ABCI Securities

Exhibit 2: Contracted sales of recently listed developers

Developers	listing date	stock code	2018	2019	YoY change	5M20	YoY change
			RMBmn	RMBmn	%	RMBmn	%
Sinic	11-Nov-19	2103 HK	71,081	91,423	29%	32,730	NA
Tianbao	11-Nov-19	1427 HK	NA	NA	NA	NA	NA
JY Grandmark	5-Dec-19	2231 HK	2,298	3,116	38%	NA	NA

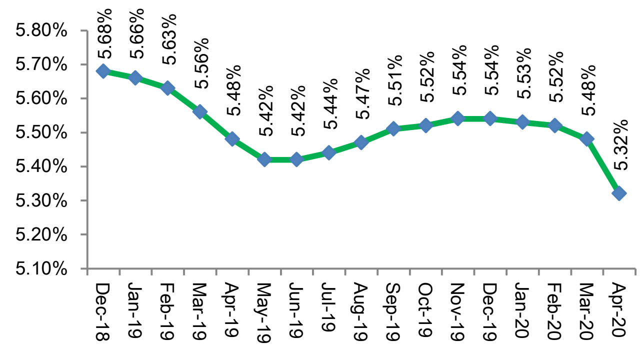
Source(s): Companies, ABCI Securities

Exhibit 3: LPR trend



Source(s): Bloomberg, ABCI Securities

Exhibit 4: Average first-home mortgage rate based on Rong360



Source(s): Rong 360, ABCI Securities

Exhibit 5: PMCs: GFA under management vs. Parent/ related developer's GFA sold

			GFA under management (mn sqm)			GFA sold (mn sqm)							5M20 GFA sold, as % of PMC's GFA under management as at Dec 2019
	PMC	Stock code	2018	2019	YoY	Parent/related developers	stock code	2018	2019	YoY	5M20	YoY	
				<A>							<B>		<B/A>
1	PPD	6049 HK	191	287	51%	Poly-A	600048 CH	27.7	31.2	13%	10.5	-14%	3.7%
2	A-Living	3319 HK	138	234	69%	Agile+ Greenland	3383 HK/ 600606 CH	43.7	41.4	-5%	10.2	-23%	4.4%
3	COP	2669 HK	141	151	7%	COLI	688 HK	15.9	17.9	13%	6.3	-7%	4.1%
4	S-Enjoy	1755 HK	43	60	40%	Seazen	1030 HK	18.1	24.3	34%	6.5	-18%	10.9%
5	Ever Sunshine	1995 HK	40	65	62%	CIFI	884 HK	9.6	12.0	26%	3.3	-15%	5.1%
6	AHL	3662 HK	10	15	45%	Aoyuan	3883 HK	8.9	11.7	32%	3.3	-14%	21.6%
7	Justbon	2606 HK	61	72	18%	Languang	600466 CH	8.0	11.0	37%	2.1	-42%	2.9%
8	Powerlong CM	9909 HK	17	18	12%	Powerlong	1238 HK	2.8	3.8	34%	1.4	-1%	7.4%
												Average	7.7%

Source(s): Companies, CRIC, ABCI Securities

Exhibit 6: Valuation of sector top picks (Data as of June 23, 2020)

Company	Ticker	Rating	TP (HK$)	Upside (%)	FY20E P/E(x)	FY21E P/E (x)	FY20E P/B (x)	FY21E P/B (x)	FY20E Yield (%)	FY21E Yield (%)
A-Living	3319	BUY	51.4	17.4	30.9	22.4	7.6	6.5	1.6	2.2
Aoyuan	3883	BUY	11.1	11.7	4.0	2.9	1.3	1.0	7.4	10.4

Source(s): Bloomberg, ABCI Securities estimates

NEUTRAL
China Alternative Energy Sector – Focus on nuclear power
Kelvin Ng

Key Data	
Avg. 20E P/E (x)	11.2
Avg. 20E P/B(x)	1.2
Avg. 20E div yield (%)	3.0

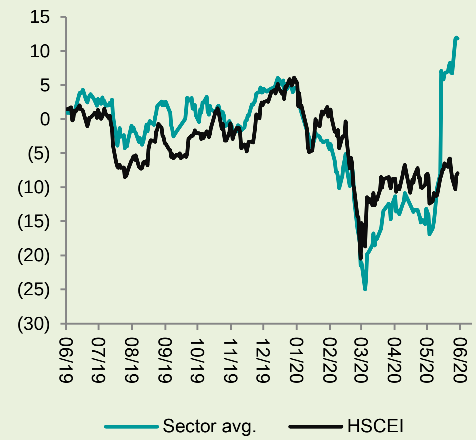
Source(s):Bloomberg, ABCI Securities estimates

Sector Performance (relative to HSCEI)	Absolute (%)	Relative (%)
1-mth	31.3	30.0
3-mth	43.1	33.7
6-mth	8.0	17.6

Source(s):Bloomberg, ABCI Securities

- Nuclear power is an ideal substitute to coal-fired power. Contribution of nuclear power to China's total power output remains low; therefore, we expect nuclear power output to expand at 12% CAGR in 2019-22E.
- No feed-in tariffs for hydropower and nuclear power means no financial burden on local governments.
- We are positive on **CGN Power (1816 HK, 003816 CH)** based on its leading market position in China's nuclear power market and its high exposure in Guangdong.

1-year sector performance (%)



Source(s):Bloomberg, ABCI Securities

Nuclear power: An ideal alternative to coal-fired power in China. Nuclear power is an ideal alternative to coal-fired power due to its 1) high utilization hour; 2) low production cost, 3) clean nature with no greenhouse gas being emitted in power generation. In developed countries, nuclear power accounted for average 31% of total power output in 2018; in France, the figure neared 75%. In China, the unit production cost for nuclear power is ~RMB 0.307/kWh, lower than coal-fired power's RMB 0.32/kWh. Unlike other alternative energy sources, the low cost of nuclear power means the industry does not require subsidies.

Nuclear power: Output growth stayed solid in 5M20. According to National Bureau of Statistics (NBS), nuclear power output reached 31.1bn kWh in May 2020, up 14.3% YoY. For 5M20, the figure was 139.8bn kWh, up 5.9%YoY. Both monthly and YTD growth of nuclear output is much higher than that of the national power production (May: +4.3% YoY; 5M20: -3.1% YoY). Nuclear power output ascended at 17.4% CAGR in 2009-19, and we expect the momentum to strengthen based on China's continuous shift to cleaner energy sources

Nuclear power: Capacity and output will expand at 12%/12% CAGRs in 2019-22E. Although the COVID-19-induced economic downturn may restraint the output growth of China's nuclear power output in the near future, we believe the country's continuous push for nuclear power and its low contribution to total energy output would drive the industry forward. According to China's "Strategic Action Plan of Energy Development (2014-20)" (The Plan) announced in June 2014, China targeted a nuclear power capacity of 58GW for 2020, representing a 19% growth from 48.7GW in 2019. Going forward, we expect nuclear power capacity to expand at 12% CAGR during 2019-22E, partially due to its low base (accounted for 2.4%/4.8% of national energy capacity/output in 2019). Together with priority dispatch to the power grid and the high utilization hours(usually around 7,000hr − much higher than 5,000hr for coal-fired, 2,000hr for wind, and 1,500hr for solar), nuclear power output would expand at 12% CAGR in 2019-22E based on our estimates.

Hydropower: No feed-in tariffs means no financial burden on local governments. Hydropower is the most-preferred energy source on the back of its ultra-low generation cost and clean nature. Hydropower has the lowest tariff among all energy sources in China: RMB0.24/kWh excl. VAT vs. RMB0.34/kWh for coal-fired, RMB0.36/kWh for nuclear, RMB0.48/kWh for wind, and RMB0.7/kWh for solar. Hydropower has no fuel costs – its generation relies on heavy raining and flooding. Low generation cost is crucial for local governments to minimize financial burden.

Hydropower: High priority dispatch on power grid during the flood season. Timing is crucial for utilizing hydropower – the energy will be wasted if left unused within a short period after generation. In the summer when heavy raining is frequent, dams would have to undergo flood discharge. If hydropower cannot be dispatched on grid and consumed, the energy produced will be wasted. Like nuclear power (whose non-stoppable nuclear fission reaction may trigger explosion if forced to shut down), hydropower is preferentially dispatched on state grid. The curtailment rate is negligible, as compared to 5% for wind power − an aspect that is significant especially when national power demand is low.

Hydropower: A sustainable energy source unaffected by geopolitical situation. Hydropower generation is dependent on the frequent river flooding and heavy raining in China during summer. The energy source (water) does not need to be transported (unlike coal and oil), meaning that it is strategically secure. Supply of oil, natural gas, and coal could be affected by geopolitical situations that may affect land or sea traffic.

Hydropower: Capacity and power output would expand at 3%/3% CAGR in 2019-22E. Unlike other alternative energy, the development of hydropower is related to geographically resources such as rivers, hilly landscape, and altitude differences. As most of China's hydropower resources are located in the southwest regions (such as Yunnan, Guizhou, and Guangxi provinces), we believe its pace of development would be slower than that of nuclear and wind power. Hydropower capacity in China expanded rapidly in 2003-13 (11.4% CAGR) before slowing down in 2013-19 (4.1% CAGR). Based on this, we forecast China's hydropower installed capacity and output would expand at 3% CAGR during 2019-22E.

Uptrend in wind power output persisted in 5M20. According to NBS, China's wind power output was 39.6 bn kWh in May 2020, up 5.2%YoY. Wind power output was 178.6 bn kWh in 5M20, up 5.0%YoY. Wind power output rose at 30.8% CAGR in 2009-19. The uptrend is likely to extend.

Wind power: Subsidy-free policy would favor low-cost SOEs. As expected, China will terminate the feed-in tariffs for wind and solar power operators. National Development and Reform Commission (NDRC) announced in May 2019 that the government will no longer subsidize onshore wind and solar power facilities approved before end-2018 but remain unfinished by end-2020; no subsidies will be provided to onshore wind power facilities approved between Jan 1, 2019 and end-2020 but remain incomplete by end-2021. Starting from Jan 1, 2021, no subsidies will be given to newly approved onshore wind power facilities. As the subsidy-free era approaches, it becomes crucial for wind power operators to shore up competitiveness.

Wind power: Outbreak of COVID-19 would lower national utilization hour. Wind power output would suffer from the pandemic disruption and global slowdown in 2020. Assuming that China's power demand growth would moderate, we estimate utilization of wind power plants to drop from 1,931hr in 2019 to 1,814hr in 2020E. Going forward, as curtailment rate declines further, utilization would stabilize at 1,900hr, which is positive to the industry.

Wind power: Capacity and power output would grow at 11%/10% CAGRs in 2019-22E. We expect nationwide wind power installed capacity growth will accelerate in 2020 after NDRC announced the withdrawal of tariff subsidy for wind power facilities completed and connected to state grid after 2020. We estimate wind power installed capacity would expand by 15% YoY in 2020E since operators would rush to complete projects by end-2020; meanwhile, capacity would increase at 11% CAGR in 2019-22E. Assuming that utilization would stay at above 1,900hr, wind power output would grow at 10% CAGR in 2019-22E.

Long-term Outlook

Nuclear power: This energy is an ideal substitute to coal-fired energy for its low production cost, zero pollution emission, and high efficiency. We believe the development of nuclear power (both by capacity and output) would remain strong in the next decade.

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

Wind power: Subsidy-free policy would reduce the number of wind power operators since the less competitive ones would be ousted. We believe the rapid growth phase is largely over; the sector is now in a steady phase marked by lower growth and reduced production cost. Low-cost SOEs would gradually dominate the market.

Short-term Outlook

Nuclear power operators: Public concerns on safety issue would be the key risk. Nuclear and radiation incidents would result in public panic and defer development pace. Outbreak of COVID-19 will reduce power output growth in 2020.

Hydropower operators: Outbreak of COVID-19 would negatively impact power demand and thus hydropower output in 2020.

Wind power operators: High account receivables would be the key risk.

Stock Recommendations

- **Nuclear power operators:**

CGN Power (1816 HK) is our top pick. COVID-19 pandemic would reduce China's overall power demand in 2020, but the government's direction to shift from coal-fired power to alternative energy remains unchanged. As the best substitute for coal-fired power in terms of cost, nuclear power would develop rapidly in the next decade. As the industry leader in China, we believe CGN would benefit immensely from the rise of nuclear power in China. Also, it is the only listed nuclear power operator in the H-share market.

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.

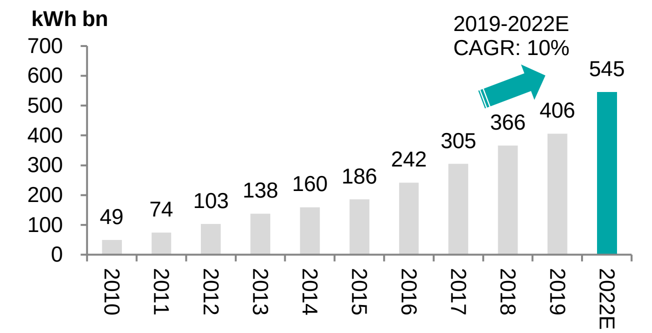
- **Hydro power operators:**

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:**

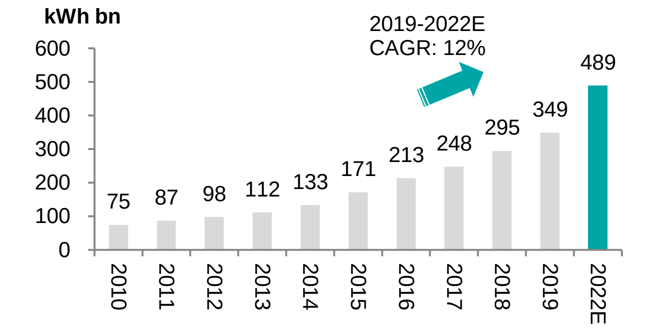
1) Power curtailment risk; 2) Wind resources risk; 3) Tariff risk; 4) Construction risks; 5) Fundraising risk 6) Government policy to deleverage may constrain growth.

Exhibit 1: China's wind power output outlook



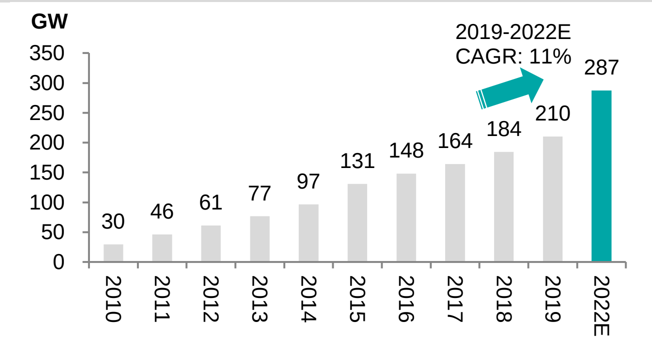
Source(s): NEA, CEC, ABCI Securities estimates

Exhibit 2: China's nuclear power output outlook



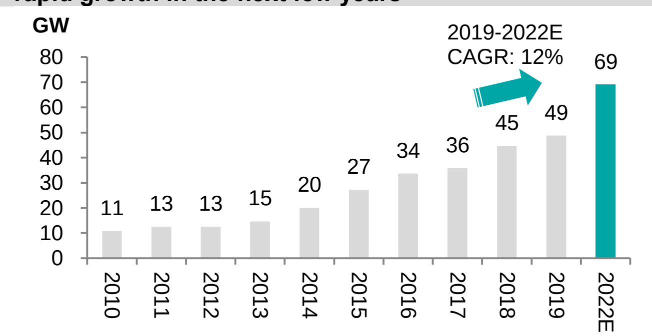
Source(s): NEA, CEC, ABCI Securities estimates

Exhibit 3: China's wind power capacity outlook



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

Exhibit 4: China's nuclear power capacity outlook: rapid growth in the next few years



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

Exhibit 5: Valuation of sector top picks (Data as of June 23, 2020)

Company	Ticker	Rating	TP	Upside (%)	FY20E P/E(x)	FY21E P/E (x)	FY20E P/B (x)	FY21E P/B (x)	FY20E Yield (%)	FY21E Yield (%)
CGN Power-H	1816	BUY	HK$ 2.2	31.0	7.6	7.5	0.8	0.7	4.6	4.7
CGN Power-A	003816	HOLD	RMB 3.3	11.1	14.8	14.5	1.5	1.4	2.4	2.4

Source(s): Bloomberg, ABCI Securities estimates

OVERWEIGHT

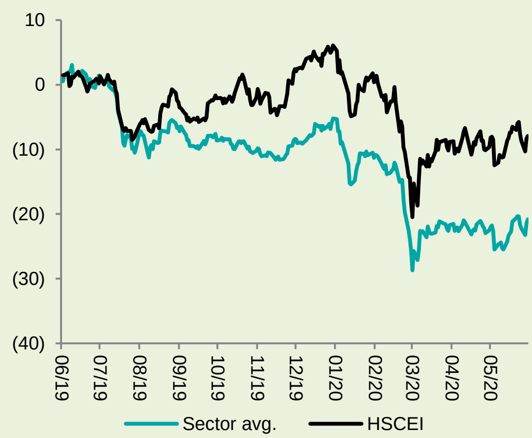
China Environmental Protection Sector – Incineration as the growth spot

Kelvin Ng

Key Data		Sector Performance (relative to HSCEI)	Absolute (%)	Relative (%)
Avg. 20E P/E (x)	4.5	1-mth	3.5	2.2
Avg. 20E P/B(x)	0.7	3-mth	7.8	(1.6)
Avg. 20E div yield (%)	6.6	6-mth	(12.0)	(2.4)
Source(s):Bloomberg, ABCI Securities estimates		Source(s):Bloomberg, ABCI Securities		

- Solid waste produced per capita maintains an uptrend on increasing O2O activities; volume CAGR of 0.7% in 2018-21E is expected
- Average penetration rate in urban area remains low for incineration; volume of waste incinerated is likely to grow at 15% CAGR in 2018-21E
- Nationwide wastewater treatment volume would increase at 4% CAGR in 2018-21E since current penetration has already reached 95%
- Future development of wastewater operators would expand via acquisition
- **China Everbright Int'l (257 HK)** is our preferred pick in incineration sector for its leading position in a growing industry.

1-year sector performance (%)



Source(s):Bloomberg, ABCI Securities

Incineration: Solid waste produced per capita maintains an uptrend on increasing O2O (online-to-offline) activities; expect volume CAGR of 0.7% in 2018-21E. According to Ministry of Housing and Urban-Rural Development (MOHURD), China's solid waste produced per capita was trending down in 2003-13 from 1.44kg/day to 1.11kg/day, representing -2.6% CAGR during the period. The figure rebounded to 1.21kg/day by end-2018, equivalent to 1.7% CAGR during the period. We believe such increase was driven by growing O2O activities in China. According to National Bureau of Statistics (NBS) data, O2O sales in China rose from RMB 2.8tr in 2014 to RMB 9.0tr in 2018, indicating a 34% CAGR in 2014-18. We believe O2O shopping would drive up solid waste produced in urban area due to the disposal of packaging materials, and expect solid waste produced per capita to expand at 0.7% CAGR in 2018-21E.

Average penetration of incineration at 39% by end-2018, up 20% YoY. According to MOHURD, by end-2018, 39% of solid waste in urban areas was treated by incineration (landfill: 58%; others: 3%). Volume treated via incineration in 2018 was up 20% YoY (landfill: -2.5% YoY; others: +15% YoY). Waste volume treated by incineration increased at 21% CAGR in 2008-18, surpassing landfill's 6% CAGR during the same period.

2018-21E outlook: Urban waste incinerated would increase at 15% CAGR. We believe increasing urbanization and rising solid waste produced per capita would drive up the amount of solid waste incinerated in the next few years. Urban population expanded at 2.8% CAGR during 2009-19 − the trend will sustain as the government continues to promote urbanization to lower unit cost of healthcare and education. We expect urbanization rate to reach 63% by end-2021E, suggesting an additional of 59mn people would take up residence in urban areas during 2018-2021. Solid waste produced per capita would increase at 0.7% CAGR in 2018-21E due to robust O2O activities in China. Based on our estimates, urban waste incinerated would jump from 112mn tons in 2018 to 168mn tons in 2021E, suggesting a 50% leap or a 3-year CAGR of 15%.

Wastewater: China's urban wastewater treatment rate to reach 96% by end-2020E. According to MOHURD, as of end-2018, urban wastewater treatment rate reached 94.8%, close to China's end-2020 target of 95%. Given the run rate in urban areas, the target is likely to be reached. As standard of public hygiene keeps rising, we expect treatment rate to reach 95.7% by end-2020.

Urban wastewater produced per capita would grow at 0.9% CAGR in 2018-21E. China's urban wastewater produced per capita increased from $85m^3$/pp/yr in 2008 to $93m^3$/pp/yr in 2018, up 9% (or 0.8% CAGR) during the period. We believe the uptrend will persist with the rise in hygiene awareness. Wastewater produced per capita would expand at 0.9% CAGR in 2018-21E.

Urban wastewater treatment volume to grow at 4% CAGR in 2018-21E. We believe 1) rising urbanization means more citizens would reside in urban areas, hence raising demand for wastewater treatment service; 2) rising living standard would boost wastewater produced per capita. Current penetration rate of urban wastewater treatment facilities is over 90%, suggesting future growth would be driven by newcomers to the cities (3% CAGR in 2018-21E) and increase in urban wastewater produced per capita (0.9% CAGR in 2018-21E). We estimate urban wastewater treatment volume to increase at 4% CAGR in 2018-21E.

Large and profitable players are preferred. New growth drivers would be coming from rural, inland areas. Nonetheless, population in coastal and urban areas would continue to expand on migration and improved living standard. Demand for wastewater treatment would increase, hence supporting the rise in consumer-borne treatment tariff. Large players, especially those with wastewater facilities in affluent regions (e.g. tier-1 cities), would have a higher profitability partially because it is easier to raise fees in areas with higher income.

Future growth rate will be low due to high penetration rate; existing operators to expand by acquisition. In 2018, urban wastewater treatment rate reached 94.8%, close to the government's target of 95% by end-2020. We believe the high penetration rate of urban wastewater treatment would urge operators to acquire smaller peers or expand into rural area for further growth.

Long-term Outlook

Incineration: China's low penetration rate in incineration (2018: 39%, compared to landfill's 58%) would leave the industry with ample room to grow since the government is targeting to have 50% of urban solid waste incinerated in the long run.

Wastewater treatment: Penetration rate of urban wastewater treatment facilities is high (2018: 94.8%). Since greenfield projects are rare, operators would opt to expand their operation scale through acquisition. We believe large and profitable players would dominate the market with their prime assets and higher acquisition capability.

Short-term Outlook

Benefiting from the low penetration rate, incineration operators would report a solid double-digit earnings growth in the 2020/21 despite the coronavirus pandemic. However, high CAPEX would be the major overhang as operators' net gearing may spike. For the large wastewater treatment operators, we believe they will acquire smaller competitors; river restoration projects would be another earnings driver.

Risk Factors

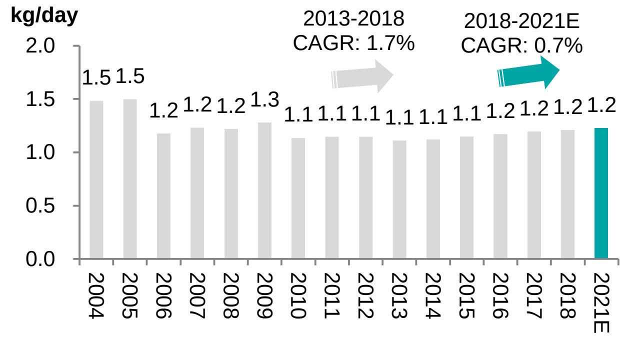
- **Incineration operators:**

1).Slower-than-expected capacity growth; 2).Default risk; 3).Policy risks; 4).Surge in maintenance costs; 5).Public resistance to incinerator construction.

- **Wastewater treatment operators:**

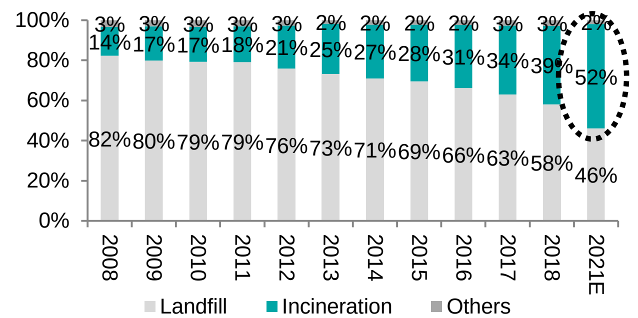
1).Slower-than-expected capacity growth; 2).Default risk; 3).Policy risk; 4).High net gearing ratio; 5).Negative cash flow.

Exhibit 1: Increasing O2O activities would boost solid waste produced per capita



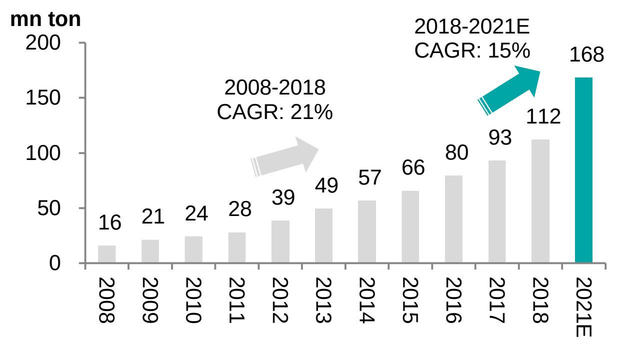
Source(s): MOHURD, ABCI Securities estimates

Exhibit 2: China would increase the proportion of waste incinerated in 2021E



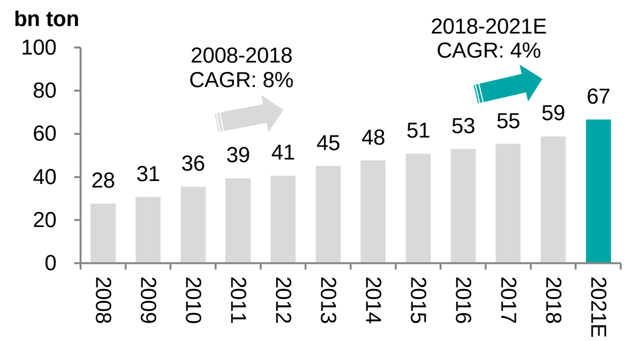
Source(s): NDRC, ABCI Securities estimates

Exhibit 3: Waste incinerated in urban areas would rise in 2018-21E



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

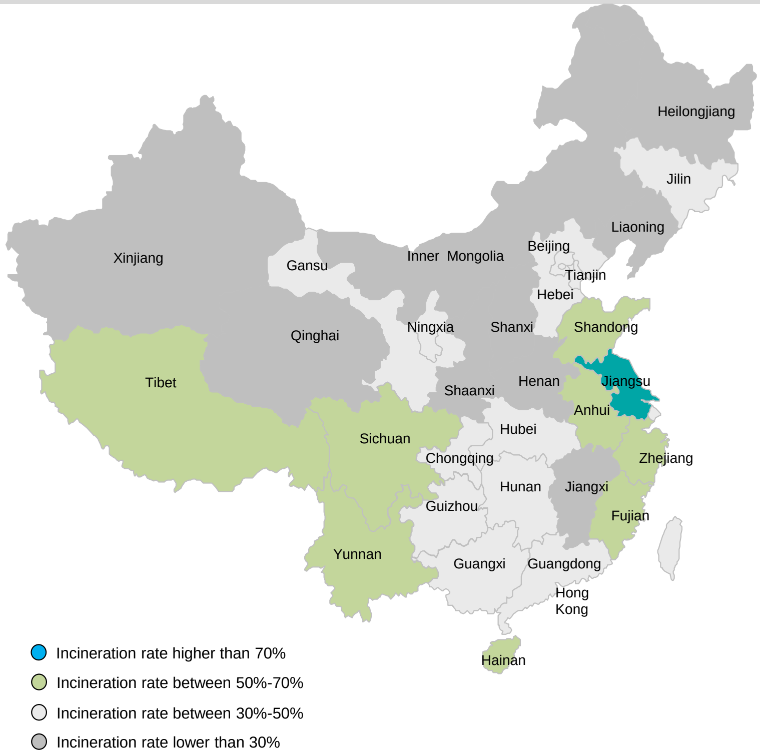
Exhibit 4: China's wastewater treatment volume would expand at 4% CAGR in 2018-21E



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

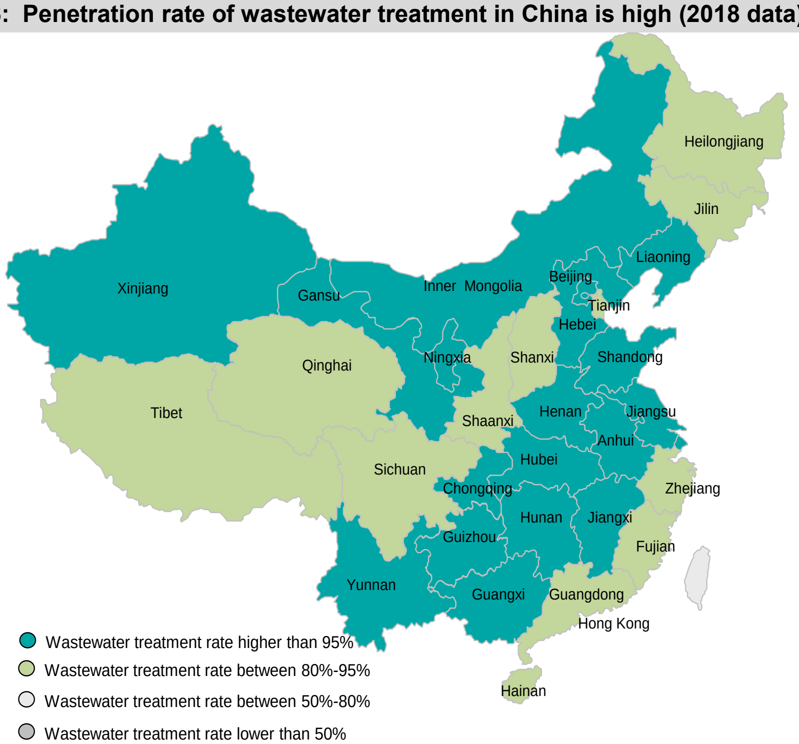
农银国际
ABC INTERNATIONAL
ABCI SECURITIES COMPANY LIMITED

Exhibit 5: Penetration rate of incineration in China remains low (2018 data)



Source(s): MOHURD, ABCI Securities

Exhibit 6: Penetration rate of wastewater treatment in China is high (2018 data)



Source(s): MOHURD, ABCI Securities

Exhibit 7: Valuation of sector top picks (Data as of June 23, 2020)

Company	Ticker	Rating	TP (HK$)	Upside (%)	FY20E P/E(x)	FY21E P/E (x)	FY20E P/B (x)	FY21E P/B (x)	FY20E Yield (%)	FY21E Yield (%)
CEI	257	BUY	7.50	81.6	4.3	3.8	0.6	0.5	7.0	8.0

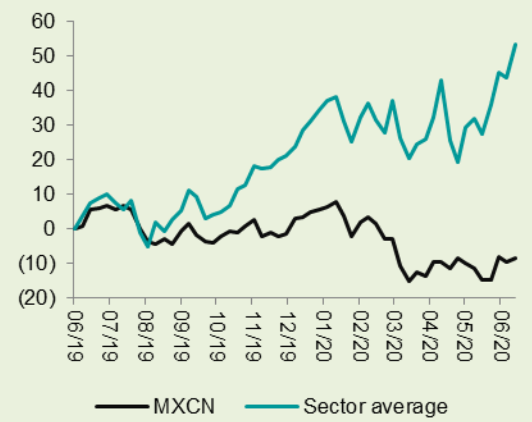
Source(s): Bloomberg, ABCI Securities estimates

ABC INTERNATIONAL
ABCI SECURITIES COMPANY LIMITED

OVERWEIGHT
Internet Media and Consumer Commerce – Positive momentum in 2H20
Steve Chow

Key Data		Sector Performance (relative to MXCN)	Absolute (%)	Relative (%)
Avg. 20E P/E (x)	30.2	1-mth	21.8	0.8
Avg. 20E P/B(x)	5.8	3-mth	52.5	24.8
Avg. 20E div yield (%)	0.7	6-mth	34.3	31.7
Source(s):Bloomberg, ABCI Securities estimates		Source(s):Bloomberg, ABCI Securities		

1-year sector performance



Source(s):Bloomberg, ABCI Securities

- Growth in online gaming revenue may normalize in the near term after the sharp increase during the COVID-19 outbreak.
- Online shopping has benefited from the structural shift in consumer behavior and cyclical recovery in the near term
- **Alibaba (9988 HK)** is our top pick for the sector

Online gaming: Normalizing growth. The extended CNY break amid COVID-19 in 1Q20 has led to increased traffics and time spent on online entertainment, including online games. Tencent's smartphone gaming revenue in 1Q20 rose 37% YoY. We expect, however, such impact to gradually normalize in 2Q20 onwards as the pandemic retreats in China. On the regulatory front, the number of new mobile game approvals has remained stable, averaging at 100-110 per month in 2019 and 4M20.

Online advertising will be adversely affected. The pandemic-induced slowdown in the economy will prompt businesses to tighten advertising budgets. China's retail sales dropped by 13.5% YoY in 5M20, according to National Bureau of Statistics (NBS), with jewelry, automobiles, furniture, apparel, construction materials, and consumer electronics as the hardest hits. These industries are more likely to reduce its overall advertising expenses in coming months. In addition, competition from ByteDance (parent company of Douyin) intensifies. According to R3, ByteDance's online advertising market increased markedly from 5% in 2017 to 23% in 1H19, and has become the second largest player in China's online advertising market in 1H19 with a 113% YoY revenue growth during the period.

Online shopping: Positive momentum. In our view, the pandemic has shifted consumers' shopping behavior from offline to online, and we believe such change will persist. China's online sales of physical goods grew 8.6% YoY in 4M20 vs. 5.9% YoY in 1Q20, implying a sequential improvement in Apr 2020. In addition, the express delivery industry, a proxy to e-commerce industry, recovered in Apr/May 2020. According to the State Post Bureau, volume growth of express delivery improved to over 27% YoY in Apr 2020 and 39.6% YoY in May 2020 vs. 3.2% YoY in 1Q20. In our view, the strong momentum has carried into June 2020, partially encouraged by sales campaigns from major e-commerce platforms, including Alibaba's "618 Shopping Festival" with a discount period between June 1 and June 18. Overall, we are optimistic on the recovery in e-commerce industry.

Stock Recommendations

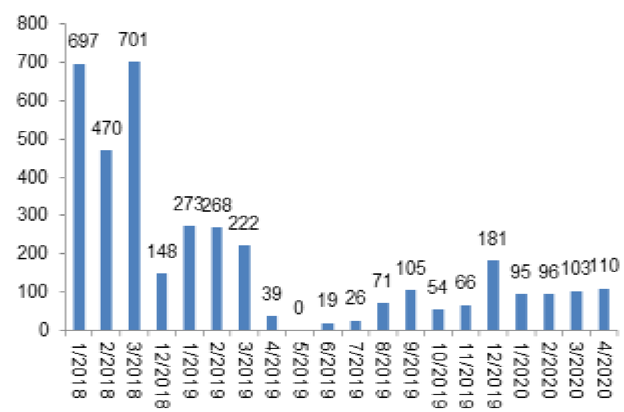
Alibaba (9988 HK) is our top picks given their dominant positions in online shopping industries.

Alibaba: We reiterate our long-term positive view on Alibaba for its leading market position in the e-commerce industry. Overall, its annual GMV per active buyer is significantly higher than peers, indicating customer stickiness and loyalty. The group has been transforming its business from an online distribution platform to a technology enabler for online merchants via AI and big data. Thanks to improving business mix, Alibaba has experienced accelerating revenue growth in recent years.

Risk Factors

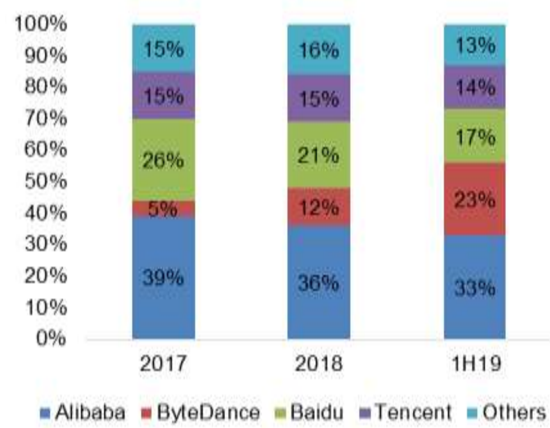
1) Tightening regulation on internet finance/mobile game/online payment; 2) Entry of foreign competitors such as Facebook and Google; 3) Slowdown in ecommerce and internet finance; 4) Life cycle of mobile games; 5) Non-GAAP financials.

Exhibit 5: No. of approved new mobile games



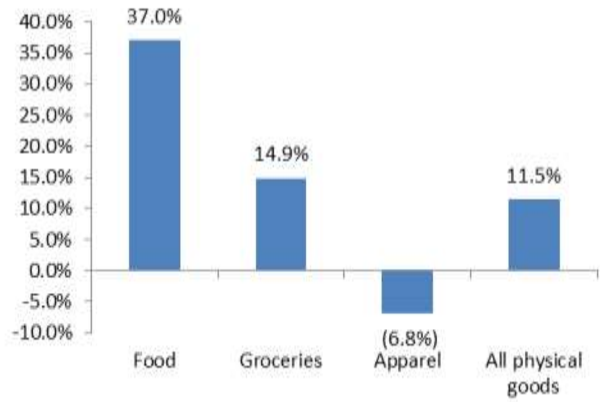
Source(s): SAPPRFT, ABCI Securities

Exhibit 6: Online advertising market share



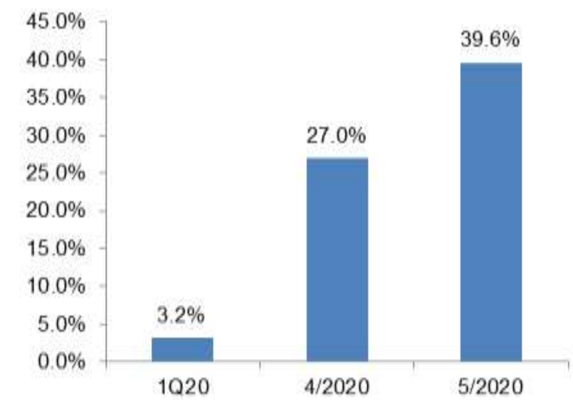
Source(s): R3, ABCI Securities

Exhibit 7: Online sales growth (5M20)



Source(s): NBS, ABCI Securities

Exhibit 8: Express delivery volume growth



Source(s): State Post Bureau, ABCI Securities

Exhibit 9: Valuation of sector top picks (Data as of June 23, 2020)

Company	Ticker	Rating	TP (HK$)	Upside (%)	FY20E P/E(x)	FY21E P/E (x)	FY20E P/B (x)	FY21E P/B (x)	FY20E Yield (%)	FY21E Yield (%)
Alibaba	9988 HK	BUY	263.0	19.5	25.7	20.3	4.6	3.8	NA	NA

Source(s): Bloomberg, ABCI Securities estimates

NEUTRAL
China Consumer Goods Sector – Prefer consumer staples for higher defensiveness
Pau Pan

Key Data	
Avg. 20E P/E (x)	32.0
Avg. 20E P/B(x)	4.1
Avg. 20E div yield (%)	3.1

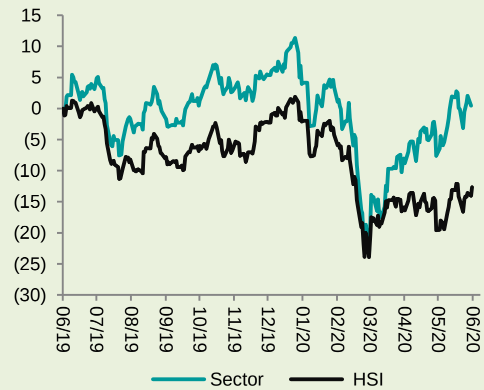
Source(s):Bloomberg, ABCI Securities estimates

Sector Performance (relative to HSI)	Absolute (%)	Relative (%)
1-mth	10.0	1.4
3-mth	32.6	17.8
6-mth	(3.7)	7.1

Source(s):Bloomberg, ABCI Securities

- Retail sales declined by 2.8% YoY in May vs. 20.5% YoY in Jan-Feb 2020, showing resilience against COVID-19
- Resurgence of outbreak across the nation means the pandemic would have lingering impact on the consumer market
- Inflationary pressure may resume later this year
- We favor leaders in the consumer goods sector with high defensiveness, including **WH Group (288 HK)**

1-year sector performance (%)



Source(s):Bloomberg, ABCI Securities

A resilient consumer market. The consumer market has recovered as the COVID-19 pandemic ebbs in China. Retail sales declined by 2.8% YoY in May vs. 20.5% YoY in Jan-Feb 2020. A number of consumer products saw major rebounds in growth. We believe normalizing retail sales shows that pent-up demand is being released and the consumer market is regaining strength. To be cautious, however, we believe the recovery can be disrupted by the resurgence of COVID-19 in China and the continued spread globally.

Lower inflationary pressure driven by lower pork price. CPI trended down from 5.4% YoY in Jan 2020 to 2.4% YoY in May 2020, thanks to the lower pork price. According to MOA, the average wholesale pork price declined from RMB 53.8/kg in Jan 2020 to RMB 47.63/kg May 2020. However, the supply of pork is still marred by potential disruption of overseas imports and the unresolved African Swine Fever problem domestically. Uptick in the slaughter house output price has been seen in the past few weeks − early signs that the pork price may resurge and drive up the national CPI in coming months.

Long-term Outlook
The growth potential in China's consumer market remains attractive. However, the declining birth rate and newborns in recent years will pose new challenges. In addition, we believe consumers are growing more receptive to online shopping after the pandemic. Players in the consumer goods sector with online sales channels would benefit from such changes.

Short-term Outlook
Pandemic risk remains a major uncertainty. We believe the current resurgence of COVID-19 in China would hinder consumption recovery. We continue to favor consumer staples for their higher defensiveness against the pandemic-related volatility.

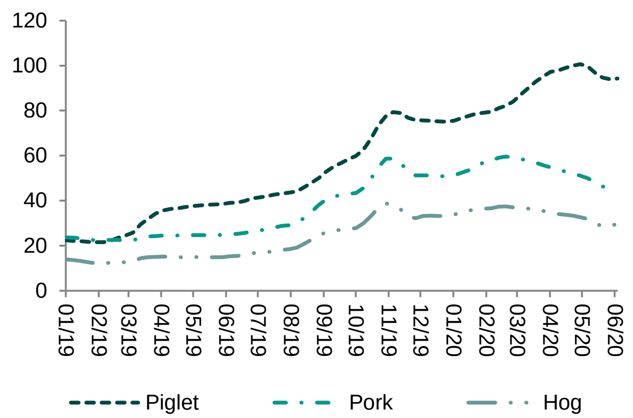
Stock Recommendations

COVID-19 would weigh on the industry's performance in 1H20. We believe **WH Group (288 HK)** in the consumer staples sector would outperform.

Risk Factors

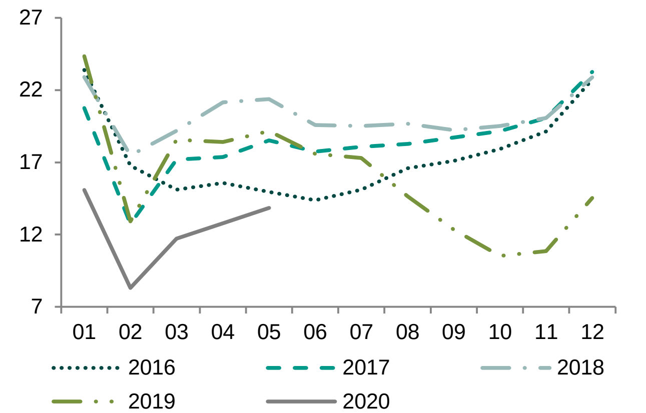
1) Macroeconomic risk; 2) Policy risk; 3) Product quality risk; 4) Commodity price risk; 5) Demographic risk; 6) Pandemic risk.

Exhibit 1: Hog, piglet, and pork average weekly wholesale price in China (RMB/kg)



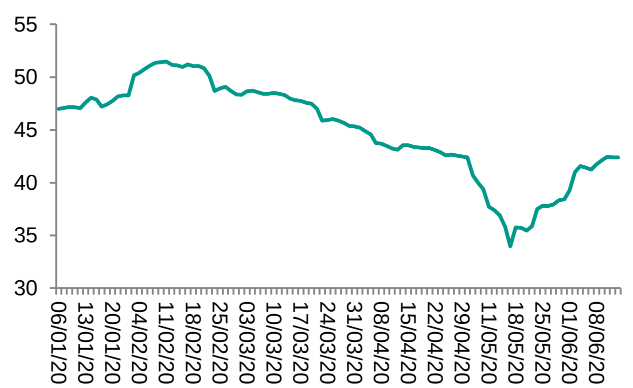
Source(s): MOA, ABCI Securities

Exhibit 2: Slaughter house output in China (YoY %)



Source(s): MOA, ABCI Securities

Exhibit 3: 16-province average factory-gate price of eviscerated hog in 2020 (RMB/kg)

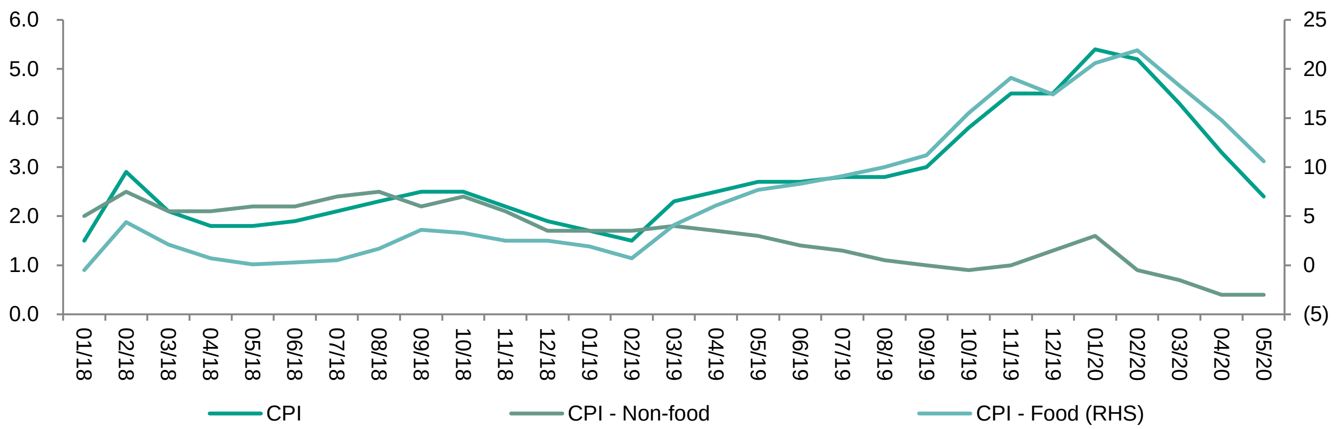


Source(s): MOA, ABCI Securities

Exhibit 4: Slaughter house output price in 2020 (RMB/kg)

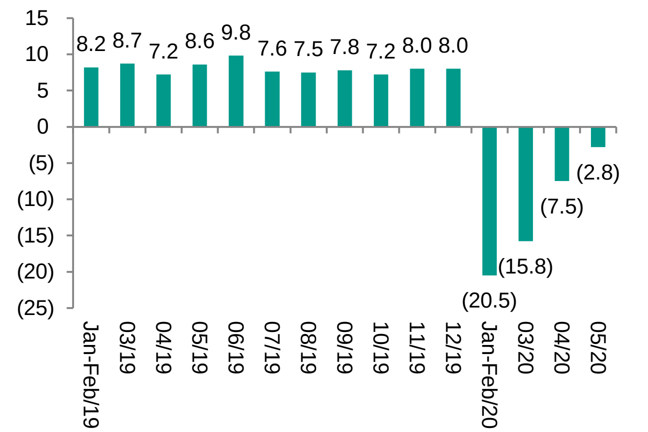
Source(s): MOA, ABCI Securities

Exhibit 5: China's CPI (YoY %)



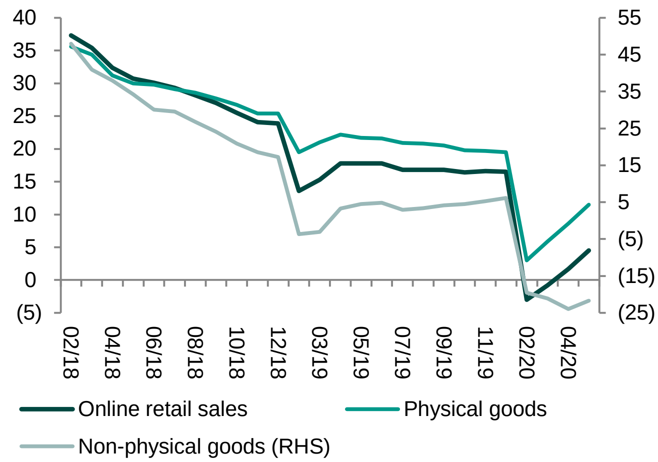
Source(s): NBS, ABCI Securities

Exhibit 6: National retail sales growth in China (YoY %)



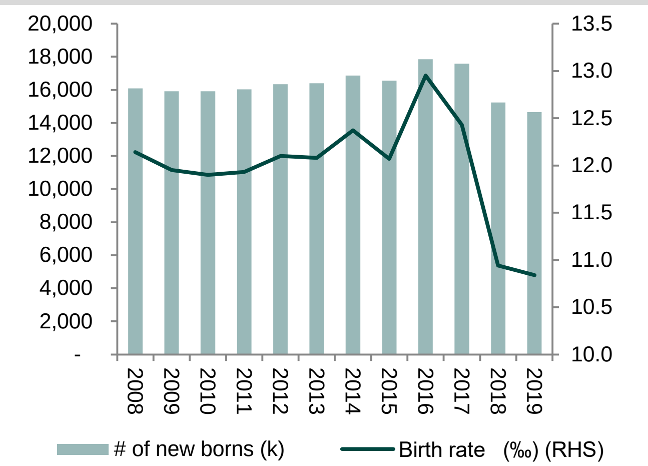
Source(s): NBS, ABCI Securities

Exhibit 7: Online retail sales in China (YTD YoY %)



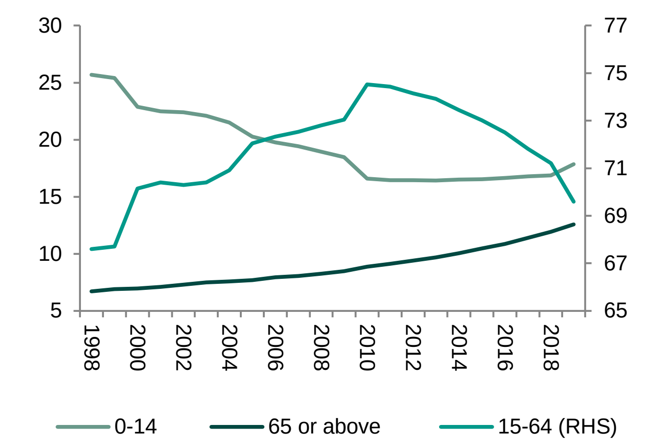
Source(s): NBS, ABCI Securities

Exhibit 8: Birth rate and newborn growth in China



Source(s): NBS, ABCI Securities

Exhibit 9: Age distribution of China's population (%)



Source(s): NBS, ABCI Securities

Exhibit 10: Valuation of sector top picks (Data as of June 23, 2020)

Company	Ticker	Rating	TP	Upside (%)	FY20E P/E(x)	FY21E P/E (x)	FY20E P/B (x)	FY21E P/B (x)	FY20E Yield (%)	FY21E Yield (%)
WH Group	288 HK	BUY	9.6	42.4	8.5	7.2	1.3	1.2	4.7	5.5

Source(s): Bloomberg, ABCI Securities estimates

OVERWEIGHT

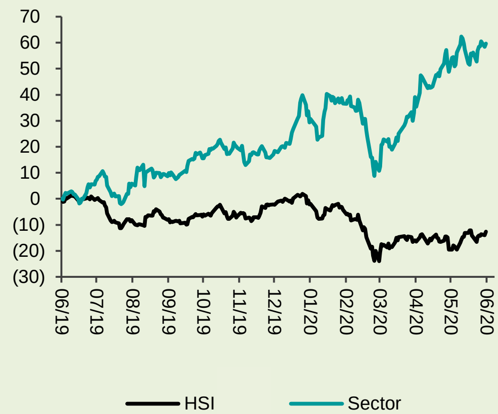
China Education Sector – Continue to favor higher education players

Paul Pan

Key Data		Sector Performance (relative to HSI)	Absolute (%)	Relative (%)
Avg. 20E P/E (x)	17.7	1-mth	8.6	7.3
Avg. 20E P/B(x)	3.7	3-mth	14.8	44.1
Avg. 20E div yield (%)	2.3	6-mth	(10.7)	36.4
Source(s):Bloomberg, ABCI Securities estimates		Source(s):Bloomberg, ABCI Securities		

- Formal education players are more defensive amid the pandemic crisis since the tuition fees would not be affected as much due to the supplementary online education
- Postponement in the finalization of Private Education Law Investment sentiment continue to cast uncertainty on the sector
- Student enrollment in private education institutions took up ~19.8% of the total student enrollment in 2019
- The private education subsector above the preschool level still has much room for growth in our view
- High education players remain attractive; recommend **BUY** on **CEG (839 HK)** and **Edvantage (382 HK)**

1-year sector performance (%)



Source(s):Bloomberg, ABCI Securities

Formal education industry is less impacted by COVID-19. COVID-19 outbreak has led to temporary closing of schools. For formal education players, the major impact would be the potential refund of boarding fees, while the tuition fees would not be affected as much due to the supplementary online education. For informal education service providers, the reopening of offline education centers will follow the full reopening of formal education schools as mandated by the local education bureau. Therefore, we believe that formal education players are more defensive amid the pandemic crisis.

Passage of education law postponed. The Regulations on the Implementation of the Law on Promoting Private Education in PRC (Private Education Law) is still in its draft form; no reviews were given during the 2020 NPC session. We believe such postponement will continue to add uncertainty to the sector, especially the private fundamental education subsector where more limitations are imposed upon based on the current draft.

Market expansion provides growth opportunity. According to MOE, in 2019, the number of student enrollment in all levels of education increased by 19.1% YoY to 281mn, and student enrollment in private education institutions reached 55.7mn, equivalent to ~19.8% of the total student enrollment. Among all subsectors, pre-school has the highest private enrollment mix of 56.2%, followed by 17.7% in higher education. The private education subsector above the preschool level still has much room for growth in our view.

Long-term Outlook

We believe the sector would continue to enjoy high demand from students seeking quality education. Higher levels of competition and consolidation can be expected. However, the declining birth rate and newborns would pose long-term risks.

Short-term Outlook

The sector will be temporarily affected by the COVID-19 resurgence across China, adding uncertainty to school reopening. In addition, the delay in finalization of the Private Education Law continues to weigh on subsectors, such as the fundamental education sector.

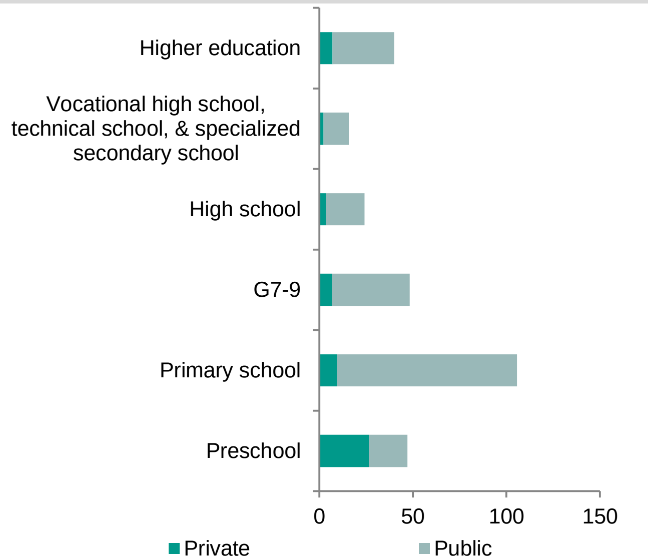
Stock Recommendations

We are optimistic on higher education based on the supportive policies - players in the subsector are usually more able to scale up quickly. In addition, they not as affected by the pandemic as peers in other education subsectors. Our top picks are **CEG (839 HK)** and **Edvantage (382 HK)**.

Risk Factors

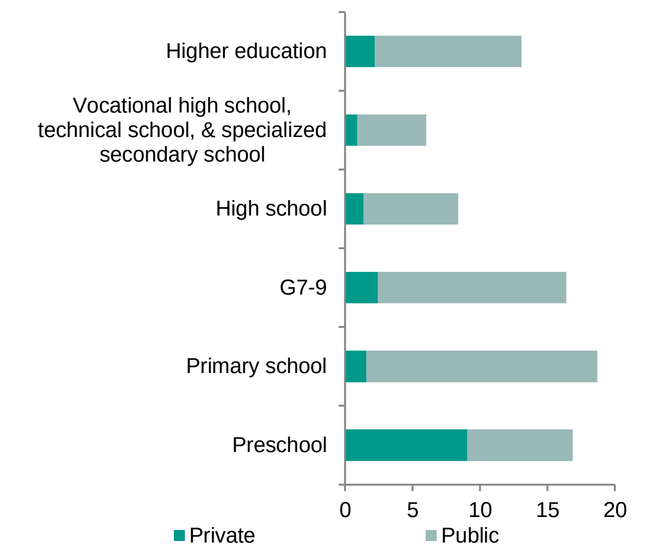
1) Demographic changes; 2) Policy risk; 3) Education quality and dropout risk; 4) Operation and reputation risks; 5) Expansion bottleneck; 6) Pandemic risk.

Exhibit 1: National enrollment in 2019 (mn ppl)



Source(s): MOE, ABCI Securities

Exhibit 2: National new student intake in 2019 (mn ppl)



Source(s): MOE, ABCI Securities

Exhibit 3: Number of schools (k)

	2015	2016	2017	2018	2019
Overall					
Kindergarten	223.7	239.8	255.0	266.7	281.2
Primary school	190.5	177.6	167.0	161.8	160.1
G7-9	52.4	52.1	51.9	52.0	52.4
High school	24.9	24.7	24.6	24.3	24.4
Higher education	2.9	2.9	2.6	2.7	2.7
Private education					
Kindergarten	146.4	154.2	160.4	165.8	173.2
Primary school	5.9	6.0	6.1	6.2	6.2
G7-9	4.9	5.1	5.3	5.5	5.8
High school	4.8	4.9	5.1	5.2	5.4
Higher education	0.7	0.7	0.7	0.8	0.8

Source(s): MOE, ABCI Securities

Valuation of sector top picks (Data as of June 23, 2020)

Company	Ticker	Rating	TP (HK$)	Upside (%)	FY20E P/E(x)	FY21E P/E (x)	FY20E P/B (x)	FY21E P/B (x)	FY20E Yield (%)	FY21E Yield (%)
CEG	839 HK	BUY	15.2	15.2	27.9	20.9	3.2	2.9	1.7	1.6
Edvantage	382 HK	BUY	7.0	11.4	17.3	13.9	3.0	2.5	1.9	2.4

Source(s): Bloomberg, ABCI Securities estimates

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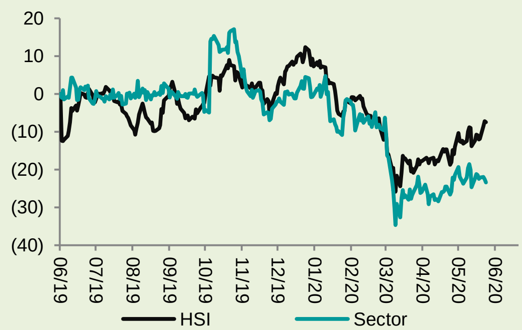
OVERWEIGHT
China Telecom Sector– Increased CAPEX for 5G network
Ricky Lai

Key Data		Sector Performance (relative to HSI)	Absolute (%)	Relative (%)
Avg. 20E P/E (x)	15.5	1-mth	(7.7)	(8.1)
Avg. 20E P/B(x)	0.8	3-mth	(19.2)	(17.5)
Avg. 20E div yield (%)	3.0	6-mth	(16.0)	(4.3)
Source(s):Bloomberg, ABCI Securities estimates		Source(s):Bloomberg, ABCI Securities		

- Telecom operators raised 2020 CAPEX to improve 5G network coverage.
- **China Mobile (941 HK)** has the highest market share of 59.4% in terms of mobile user. It is our top pick for its high dividend yield, healthy balance sheet, and dominant position in China's mobile business.

1-year sector performance (%)



Source(s):Bloomberg, ABCI Securities

Telecom operators increase 2020 CAPEX for 5G network development. Chinese telecom operators have budgeted RMB 334.8 bn (+ 11.7% YoY) for 2020 CAPEX, including RMB180.3 bn for 5G network development, which will benefit the telecom equipment providers. Telecom operators will develop the 5G standalone network to improve network speed and transmission quality. The State Council of China and MIIT have called for expedited development the 5G network development. Currently, there are over 250 thousand 5G base stations and 600 thousand base stations will be constructed by end-2020. The 5G network will support the growth of a number of applications, including cloud computing, AR/VR, autonomous driving, AI technology, etc. Chinese telecom operators are launching more incentive plans for 5G upgrade. We forecast overall 5G users will reach over 200mn by end-2020.

More cooperation among telecom operators for 5G network development. China Telecom (728 HK) has teamed up with China Unicom (762 HK) to co-build and co-share the 5G telecom network. Meanwhile, China Mobile cooperates with China Broadcast Network Corporation for 5G network development. As the 5G telecom network requires a much higher capital than 4G, cooperation can help lower costs and improve network efficiency.

Speed Upgrade and Tariff Reduction policy to continue. China's mobile users reached 1.59bn and average mobile data per user exceeded 10.05 GB in May (up 28.8% YoY). The mobile user market share of China Mobile/ China Unicom/ China Telecom were 59.4%/ 19.4%/ 21.2%, respectively. Telecom operators will continue to follow the Speed Upgrade and Tariff Reduction policy in 2020. Penetration rate of the mobile internet users reached over 82.1%, driven by lower mobile data tariff and better network coverage.

Global smartphone shipment dropped 11.7% YoY in 1Q20. According to IDC, global smartphones shipment was 275.8mn in 1Q20, down 11.7% YoY, affected by COVID-19 and the resultant regional lockdowns. The unstable economic environment has hampered consumption sentiment. IDC expects the global smartphone shipment to drop by 11.9% YoY in 2020 and business of electronic components suppliers could be adversely affected.

Long-term Outlook

The 5G telecom network is expected to benefit the telecom sector with more applications and usage. Increased CAPEX of telecom operators will boost the equipment supply chain with more base stations demand. Telecom operators may introduce more incentives and subsidies to encourage 5G upgrade. The 5G network, which has a higher transmission rate with lower latency than 4G, will support new applications such as cloud computing and autonomous driving. Reduced tariff of mobile data service has affected revenue growth, but telecom operators have launched various value-added services, IPTV, and video contents to expand revenue channels.

Short-term Outlook

In the short term, the Speed upgrade and Tariff Reduction policy will affect telecom operators, who are confronted by user saturation and stiffening competition. Telecom operators will encourage upgrades to the 5G platform. Demand for big data and cloud computing is growing as enterprises are more receptive to video conference and remote access due to the need for social distancing.

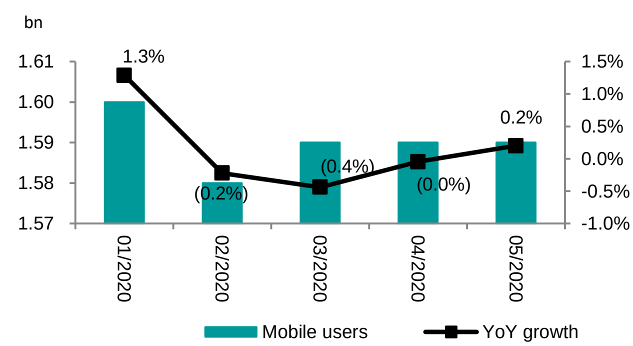
Stock Recommendations

China Mobile (941 HK) is our sector top pick. Thanks to its network advantage with better coverage and resources, China Mobile maintains its largest market share of mobile users in the Chinese market. We expect the Group to benefit from increased mobile data consumption amid tariff cut in data service. Our TP is HK$ 82.0, which implies 4.9x/ 4.7x FY20-21E EV/EBITDA.

Risk Factors

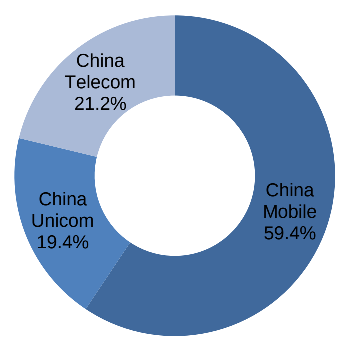
1) Further reduction in service tariff as requested by authorities; 2) User saturation; 3) Intensifying market competition; 4) Slower growth in smartphone shipments.

Exhibit 1: China's mobile user and YoY growth



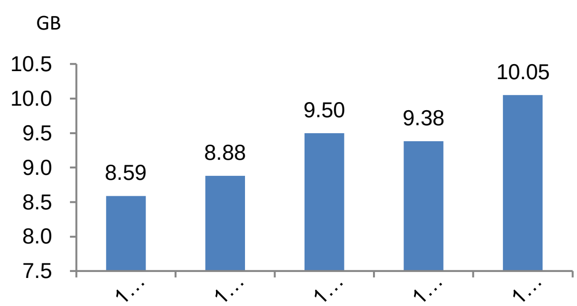
Source(s): MIIT, ABCI Securities

Exhibit 2: China's mobile users market share (June 2020)



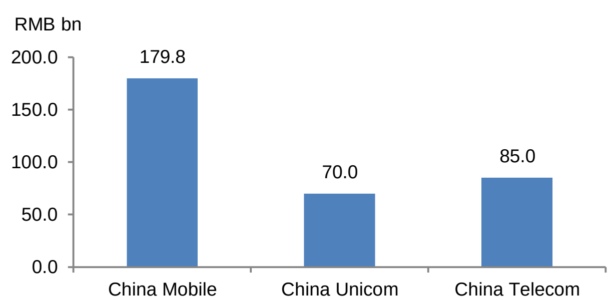
Source(s): MIIT, ABCI Securities

Exhibit 3: China's average monthly data usage



Source(s): MIIT, ABCI Securities

Exhibit 4: CAPEX by telecom operators in 2020



Source(s): MIIT, ABCI Securities

Exhibit 5: Valuation of sector top picks (Data as of June 23, 2020)

Company	Ticker	Rating	TP (HK$)	Upside (%)	FY20E P/E(x)	FY21E P/E (x)	FY20E P/B (x)	FY21E P/B (x)	FY20E Yield (%)	FY21E Yield (%)
China Mobile	941	BUY	82.00	49.6	9.8	9.2	0.9	0.8	5.7	5.5

Source(s): Bloomberg, ABCI Securities estimates

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Disclosures

Analyst Certification

The analysts, CHAN Sung Yan, AU Yu Hang, Johannes, CHOW Sau Shing, LAI Pak Kin, NG King Chuen, PAN Hongxing, TUNG Yiu Kei, Kenneth, YAO Shaohua, being the persons primarily responsible for the content of this research report, in whole or in part, hereby certify that all of the views expressed in this report accurately reflect my personal view about the subject company or companies and its or their securities. We also certify that no part of our compensation was, is, or will be, directly or indirectly, related to the specific recommendations or views expressed in this report. We and/or our associates have no financial interests (except "Disclosures of Interests" below) in relation to the listed company(ies) covered in this report, and we and/or our associates do not serve as officer(s) of the listed company (ies) covered in this report.

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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 (HSI total return index 2008-19 CAGR at 10%)

Time horizon of share price target: 12-month

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

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